# Liberalization in the Developing World

## Institutional and economic changes in Latin America, Africa and Asia

*Edited by*
Alex E. Fernández Jilberto
and André Mommen

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# LIBERALIZATION IN THE DEVELOPING WORLD

*Liberalization in the Developing World* compares the success of liberalization strategies in Asia, Africa and Latin America over the past decade. Three models emerge, corresponding to the three continents covered, which reflect the degree of state intervention in the economy and the success of liberalization policies adopted.

In East Asia, where liberalization policies have been most successful, it is shown that a period of relative autonomy from the world economy preceded export-led industrialization and, contrary to free market paradigms, economic growth involved a high degree of state intervention in conjunction with national conglomerates. Like the East Asian 'tigers', Latin American countries also underwent a period of import-substitution in the 1970s but in the 1980s political democratization and market liberalization were not accompanied by miraculous economic growth. Finally, case studies of countries in Africa illustrate how neoliberal policies have been most ambiguous where the state has been 'persuaded', through conditionality from the Bretton Woods institutions, to take a back seat and let international market forces decide.

The conclusions drawn demonstrate that economic and political liberalization do not have to go hand in hand. On the contrary, the case studies presented in this volume show that the role of the state can be crucial in mobilizing both the human and capital investment needed to be able to compete in international economy.

**Alex E.Fernández Jilberto's** career has taken him from his native Chile to the Netherlands via Spain, writing extensively on the political economy of Latin American countries. **André Mommen** has published many articles on the Belgian economy and more recently on developing and ex-socialist economies.

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# PREFACE

> They believed their words. Everybody shows a respectful deference to certain sounds that he and his fellows can make. But about feelings people really know nothing. We talk with indignation or enthusiasm; we talk about oppression, cruelty, crime, devotion, self-sacrifice, virtue, and we know nothing real beyond the words. Nobody knows what suffering or sacrifice mean—except, perhaps, the victims of the mysterious purpose of these illusions.
>
> Joseph Conrad, (1974) *Tales of Unrest,* New York: Gordon Press

In recent years the conceptualization of internationalization and liberalization has provoked a heated debate on major shifts in the fortune of nations and the development strategies adopted by the developing countries. After having for several decades opted for import-substituting industrialization policy, practically all developing countries adhered to neoliberal reforms and opened up their economies to foreign competition in order to enhance competitiveness and acquire comparative advantages. Not all of them succeeded in gaining economic strength, but, as the several cases of the emerging economies in Asia and Latin America show, neoliberal reforms in combination with export-led industrialization drives led the way for self-sustained growth.

The theory presented in this book attempts to capture the full complexity of the ongoing economic transformation of the Third World economies. The cases presented in this book seek to integrate the many elements that influence how governments and political regimes try to increase their wealth by gaining competitive advantages. In turn this allows them to increase their share in world trade and permits them to finance their development out of their rising import earnings.

Our theory draws on and spans several fields. At its core is the theory of competitive advantage and technological innovation. But given the extremely diverse countries studied in this book, it would be hazardous to develop a comprehensive theory of competitive advantage of nations. Not all nations compete with each other and many of them remain in a dependent position *vis-à-vis* the stronger economies or the international financial institutions. The different authors who contributed to this book do not share the same theoretical or practical points of view because they come from different continents and scientific disciplines. But they all tried to analyse recent economic and political transformation in the countries they know best in the light of a process towards full liberalization, regionalization and deregulation of all national economies. Globalization goes hand in hand with free trade, foreign direct investment and relocation of industries. Countries who failed to take part in this ongoing process were condemned to economic decline and political instability.

This book comprises fourteen original essays by specialists with country-specific expertise from around Asia, Latin America and Africa. In an introductory chapter we discuss the basic arguments underpinning our analysis of the recent trend towards globalization and the accompanying political transformations. The chapters on individual countries contain empirical findings illustrating how governments succeeded or failed in coping with economic stagnation and political instability. First of all we focus on the Asian countries who are experiencing after the negative oil shock of 1985 a remarkable economic upswing. Then we concentrate our attention on some Latin American countries who broke with their previous policies of import-substituting industrialization and adopted neoliberal reforms in combination with democratic reforms. Finally we examine four African countries that all failed to cope with their economic and political problems. The reasons for the deterioration of their competititive position and their inability to unite the nation behind a project of thoroughgoing economic and political reforms are manifold. The weakness of their regimes seems to be a determinant factor for the explanation of the African drama.

The East Asian emerging economies moved away from a dependence upon import-substituting industrialization to development strategies featuring the promotion of labour-intensive manufactured exports. Because the East Asian economies realized faster economic growth than most other developing countries by keeping governmental deficits within the limits of prudent financing and by adopting export-led growth as the way out of economic stagnation and underdevelopment, they can be used as 'models' for all other developing countries. But much of the success of these Asian emerging economies was due to inflows of foreign capital engendering a process of sustained industrialization and economic growth. However, their strategies for promoting key industries varied considerably (see Chapter 3). Their strong state was a necessary precondition for obtaining economic stability. Their state was sufficiently competent to intervene in markets and guide companies in a coherent fashion. In Indonesia economic growth occurred within a context of a new division of labour and an ongoing process of internationalization of the world economy (see B.Simatupang in Chapter 3). Inward-oriented Asian economies became export-oriented economies when they abandoned their strategy of import-substitution industrialization. Notwithstanding erratic reforms, the Vietnamese communist regime opted for a mixed economy. After 1989 the country integrated into the regional Southeast Asian economy when foreign direct investment increased and the state capitalist sector revigorated (see D.Truong and C. Gates in Chapter 4).

In Latin America many of these transformations were the result of neoliberal reforms carried out by military regimes. The economic stabilization programmes worked out by the democratically elected Presidents of Argentina, Brazil and Bolivia, all trusted on market principles and neoliberal fiscal and monetarist reforms. M.Teubal (see Chapter 10) identifies the neoliberal reforms imposed by President Carlos Menem as a 'monetarist *coup d'état*'. In Brazil economic and financial stabilization (see A.M. Fernandes in Chapter 5) only occurred after the presidential elections of 1994. Neoliberal adjustment policies required the abandonment of populist radicalism and in some cases 'centrist governments' trusting in popular support. In Bolivia 'political centrism' and democratic stabilization (see C. Toranzo Roca in Chapter 8) was the precondition of macroeconomic stability. In Central America (see O.Catalán Aravena in Chapter 6 and K. Blokland in Chapter 9) economic and political stabilization only could be the outcome of a long-lasting process of pacification in a region disturbed by civil wars and foreign military interventions. The most striking case of free-market reformism is provided by Mexico's adherence to NAFTA (see A.Fernández Jilberto and B.Hogenboom in Chapter 7). Mexico's increased openness to the Northern American market inaugurated an era of great expectations. The newly emerging markets of Latin America can be presented as a model for other developing countries. Unfortunately, these emerging economies are still at the mercy of short-term capital inflows. Their overvalued exchange rates may cause balance-of-payment problems.

The prolonged world recession in the 1980s and the general decline in commodity prices have thrust fundamental questions about the direction of economic policies in all Third World countries. There has been widespread recognition that the countries whose economies have performed best have been those that were able to maximize their share of global exports. Bringing about structural adjustments in order to promote competitiveness became a major concern of all governments. But, in spite of the common resolve of a wide range of structural reform measures, there has been a striking divergence in their ability to bring about policy changes successfully. In short, the governments of some Latin American countries have gone much further than others in pursuing what are essentially similar policy reform agendas.

In contrary to most Latin American and Asian economies, most African countries failed to reform their economies. Ghana and Zaïre (see K.Nimako and A.Mommen in Chapters 13 and 14) experienced a gradual collapse of their economy and even a prosperous and stable country like Cameroon (see P.Konings in Chapter 12) is facing a severe economic and political crisis. These countries were forced to accept structural adjustment programmes drafted by the International Monetary Fund. But democratization of their regimes proved to be a general failure. Algeria is the most blatant example of political and economic decay. After 1988 'Algerian socialism' collapsed as a result of an unbalanced industrialization combined with growing foreign indebtedness. Algeria's ruling class was unable to transform its authoritarian regime in a period when popular demands were being articulated by an emerging 'political Islam' (see M.Beker in Chapter 11).

All books have their own history. This book is being completed during a period of exciting and unusually dramatic changes within individual countries and continents. The collapse of the communist bloc and the end of the Cold War can be considered as a major event. Authoritarian regimes became democratized and hitherto closed economies opened up their markets to competition. Free trade became a hot issue in all debates. Global capitalism inspired many to rethink economic policies and development strategies. In Africa many countries abolished the one-party state. In Latin America the military withdrew from power. In Asia many countries announced democratic reforms. All these events contributed to the decision to compile this book.

Of course, this book could not have been published without the trust shown by all the contributing authors in the project the editors had designed. Immediately, the authors reacted with great enthusiasm when invited to contribute to this project. Moreover they respected our deadlines and made our suggestions theirs when we proposed revisions to their texts. Although some of the authors are working and teaching at the University of Amsterdam, they do not form a school or a think-tank inspired by a common ideology or interest.

Alex E.Fernández Jilberto and André Mommen

# 1

# SETTING THE NEOLIBERAL DEVELOPMENT AGENDA

## Structural adjustment and export-led industrialization

*Alex E.Fernández Jilberto and André Mommen*

Protectionism is considered by neoliberals as a threat to economic progress and trade barriers may reduce real incomes of consumers when increasing the prices of both imported goods and the domestically manufactured products with which they compete. Protectionism reduces incentives for local firms to operate more efficiently, to hold down costs, and to develop new technologies or products and to conquer new markets. Protectionism leads to retaliation by trading partners, which provokes a downward spiral and a weakening of the international banking system.

But the transition to free trade has its costs. Liberalization means that countries that do not enjoy a comparative advantage have to move resources to more productive sectors or activities, which is usually a painful process. The benefits of liberalized trade are equally distributed among all consumers, but categories of producers suffering from cheap imports may oblige the state to intervene. So many governments are tempted during recessions to slow the adoption of open trading policies in order to secure national independence. Where production is essential for national defence, it may be supported directly through procurement practices rather than indirectly by protection. In other sectors of the economy, tariffs and contigents are still powerful instruments of the state when the national interest requires the survival of inefficiently operating firms or sectors.

However, advocates of pure free trade are rather limited in number and influence. These neoliberals believe that the government does not have to take special measures to protect domestic producers against foreign competition, because they are sceptical that government intervention can effectively cure market failures. That the neoliberals succeeded in acquiring a large audience and significant influence in governmental circles has much to do with their ability to present their policies as practical solutions to the difficulties governments have in balancing their budgets or fostering economic growth. So market-oriented reforms managed to gain the favours of politicians and technocrats looking for a way out of the economic crisis and financial problems.

The neoliberals blame governments who finance their activities by creating deficits and unbalanced economic growth. Moreover, balance-of-trade problems may result from a succession of state budget deficits that drain private savings and generate rising volumes of imports to meet domestic demands for consumption and investment. High borrowing from foreign lenders helps to finance the trade deficit and combined with increases in debt finally leads to impoverishment, because increased exports of goods decrease the living standard of the local population.

In order to combat these distortions, the neoliberals have put forward rigorous measures against the protectionist threat. The neoliberals believe that all nations will benefit from multilateral liberalization as well as from trading patterns consistent with the laws of comparative advantage. They believe that free-trade areas or common markets offer new perspectives and that free-trade arrangements enable participating countries to accept common regulations of behind-the-border practices. But the danger of freetrade areas or common markets is that they may fragment the world trading system into regional blocs. The net result of such efforts might be freer trade within the areas but also greater divisions between the competing trade blocs. Behind-the-border barriers (different technical standards, different safety and environmental regulations, different antitrust policies, different tax systems, different restrictive national procurement practices) exist within the trade blocs and common markets and continue to thwart foreign supplies. Therefore the neoliberals are pleading for the creation of a global trade regime that may foster export-led economic growth in the developing economies. Export-led economic growth supposes qualitative and quantitative transformations with rising savings rates and falling marginal capital/output ratios in combination with a slowing down of inflation and unproductive imports. Tax and government expenditure reforms, interest rate reforms, exchange rate reforms, and a general emphasis on export promotion and reliance on international prices complete the menu of neoliberal incentives. In this case the export bias allows efficient industries to establish themselves without being limited in size by the domestic market; also the export bias leads to an increasingly open economy, generating a growing share of the foreign exchange that lessens the economy's dependence on foreign capital inputs.

In this chapter we want to examine how neoliberal policies conquered the world and changed the development agenda. Liberalization stimulated regime-transforming processes in Eastern Europe and obliged developing economies to reinvigorate their economies by adopting free-market principles. The hypothesis is that trade is an engine of growth and that there is an automatic relationship between economic development in the lessdeveloped countries along their economic growth track. Since the demandfor exports from developing countries is far weaker now than in the first half of this century, and since the looking-inward solution failed to foster fast growth, the conclusion that external demand may be useful to boost economic expansion and allocate resources came to the fore. The neoliberals declare that the removal of trade protection will generate welfare gains, if welfare-reducing monopolies are eliminated, rent-seeking behaviour is prevented, and costs reductions are imposed in combination with an improvement of quality of domestically produced goods and services.

## NEOLIBERALISM AND THE STATE

Despite the tremendous growth of economic interdependence, states remain the central actors shaping the international economic order because of their control over the linkages between the international and domestic economies. Moreover, states do not respond uniformly to external pressures. In East Asia developmentalist states forged powerful alliances with business groups around an aggressive strategy of exports. In Latin America and Africa basic changes occurred in development strategies when the large economies adopted market-oriented reforms for solving the problem of backwardness. Furthermore, during the last decade many countries underwent democratic transitions and adhered to neoliberal policies in order to respond to a steep world recession and two oil price shocks that contributed to enormous debt and balance-of-payment problems. Initially, many developing countries responded to these external shocks by forestalling economic policy changes. However, foreign exchange shortages forced them to adjust (in many cases with the help of the Bretton Woods institutions) and, ultimately, many economies shifted to market- and export-oriented economic policies. The Latin American economies induced structural transformations under neoliberal military regimes and later on democratized after having completed their economic restructuring. Just like the Latin American economies, the New Industrializing Countries (NICs) of Asia shifted from import-substitution industrialization (ISI) to export-led industrialization (ELI) and recently they were also to fall prey to the demands of rising democratic coalitions.

In the eyes of the neoliberals the triumph of democracy and markets over authoritarianism and statist economies was combined with efforts to promote open economies and open polities stressing the necessity of thoroughgoing economic reforms supporting ELI policies. But those countries that failed to reform their economies were compelled by the Bretton Woods institutions to conform to Structural Adjustment Policies (SAPs).

For development economists, the rise of the East Asian economies vindicating the liberal prescriptions of market-oriented policies and participation in the world economy made obsolete policies drawn from stateinterventionist theories and protectionism. New growth trajectories stressingthe importance of export-led development became widely accepted as an integral part of neoliberal ideas inspiring economic and political changes in the world. Moreover, the downfall of communism in Eastern Europe and the collapse of the apartheid regime in South Africa can be depicted as the supreme examples of ill-fated attempts to sustained economic growth within a closed economy. However, virtually all successful, export-led industrializers began to export manufactures within the confines of a state-led ISI strategy and the first stage of their ISI strategy aimed at high growth when focusing on local production for the domestic market. High growth contributed to the transformation of their agrarian sector, but, already in a very early phase, their ISI policies failed in their attempts to build up a competitive intermediate and capital goods sector; instead of industrial growth, this gave way to economic stagnation, inflationary pressures, recurrent balance-of-payments imbalances, and/or widespread urban unemployment.

In Korea and Taiwan, ISI was a response to constraints similar to those in Latin America, but in neither case did ISI last longer than ten years. The major Latin American economies (Mexico, Brazil and Argentina) adopted ISI policies during the Depression and the Second World War and beyond. In Africa, ISI projects collapsed after 1974 and were abandoned by the ruling bureaucratic bourgeoisie. In Latin America, ISI policies were frustrated by the old authoritarian coalitions of *latifundistas* and/or mineral exporters and the liberal elites involved in commodity-exporting activities (storage, shipping, transportation). In Asia all countries (not only India, but also the Philippines, Indonesia and communist China) embarked upon ISI policies. Finally, these policies proved to be less innovative than the authoritarian East Asian regimes who fashioned export-based growth coalitions.

East Asian regimes were not hindered by the existence of distributional coalitions and established strong regimes built on a coalition of bureaucrats and business interests. Export manufacturing instead of ISI became a priority and its implementation under authoritarian auspices achieved macroeconomic stability, trade liberalization and competitive exchange rates. Regime liberalization occurred when East Asian ELI policies had been successful and macroeconomic stabilization had been consolidated. Some ELI regimes were able to democratize their political structures. They were able to maintain competitive exchange rates and implement trade liberalization without altering their export-pushing policies. None the less, some ELI regimes had to face, when transforming their ISI economies into ELI economies, hyperinflation, distorted wages, and inefficient parastatal enterprises requiring formidable costs of adjustment. State-owned enterprises had to reduce their workforce or even to close factories. Devaluations imposed losses on those sectors depending on imports and provoked rising prices and high unemployment rates in the urban areas (Krueger 1978:277–300).

In Latin America, ELI reforms were carried out by military regimes. Later on, when democratic transitions opened the way for reviving populardemands, maintaining macroeconomic stability remained a major objective of all post-dictatorial regimes in the Southern Cone of Latin America (Chile, Argentina, Uruguay and Brazil).

In Africa a tradition of clientelism prevented the bureaucratic elites from breaking with authoritarian rule until the fall of communism occurred in Eastern Europe. Clientelism around directly unproductive activities and corruption were carried over into the democratic transition and some of the recently established 'democratic' governments even refused to cope with protectionist rents and overvalued national currencies. Liberalization meant a frontal attack on the rents of clients benefiting from protectionist ISI policies. That the state protected jobs and instituted monopolies was a widely accepted practice which the ELI countries of East Asia could even underwrite (Japan and South Korea are still protecting local rice-growers although the traditional food-exporting countries in the area were pleading for a lowering of import duties).

## STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs)

The easy-money decade after the first oil shock (1973) led many developing countries to overborrow. In the early 1980s they were caught in the squeeze in a period when interest rates soared and debts came due. These countries had to adjust their expenditures in order to service their foreign debt when incomes were far below their outlay requirements. The International Monetary Fund (IMF) and the World Bank forced them to adjust their economies. The adjustment strategy of IMF-supported programmes underwent a major shift in the late 1970s in response to the change in economic environment arising from the sharp rise in oil prices and the associated imbalances in members' payment positions. Structural adjustment programmes (SAPs) placed greater emphasis on structural measures to promote domestic resource mobilization, alleviate price distortions, ensure increased access to imports, and reorder investment priorities in countries looking for IMF assistance. Because the Bretton Woods institutions held the 'seal of approval' giving access to credit from all other sources, they could force the developing countries to comply with adjustment programmes.

Low growth, poor export performances, high debt burdens, and financial imbalances forced many developing countries on to the road of economic reforms (Thomas and Chibber 1989:28–31). A standard requirement was that the debtor state had to export at any cost and without regard to the social stability of its own economy. The ultimate goal of this strategy is to restore an excess on the balance of payments and enable the debtor state to service its foreign debt. Earning more cash through exports was an option all developing countries had to adopt no matter how poor they were.

It was by means of these programmes that the introduction of a 'freemarket economy' was facilitated and that market-determined prices were able to influence production levels and consumption patterns, favour exports, and reinforce the orientation of Third World economies towards external markets. Meanwhile the creditor countries were invited to reduce the outstanding debt of the poorest developing countries if the latter were willing to implement SAPs. This was necessary because reduced interest payments would relieve the miserable impoverished living conditions of countries of the south. But, in turn, debt-servicing was necessary in order to encourage these countries to export at any social cost when investing their meagre resources in the export sector.

In the free-market integrationist worldview propagated by the Bretton Woods institutions, merchandise, labour and money must be free to circulate and cross borders. Countries must trade and exchange goods and develop their sector of 'tradeables'. This mechanism for forcing potentially reluctant participants to engage in the world market is the set of economic policies called structural adjustments and its vital component is the insistent implementation of the doctrine of export-led growth. SAPs aim to increase the role of exports in the economy and stimulate the private sector through the combination of wage and price stabilization policies and austerity programmes. SAP packages include a mix of the following measures:

1 privatization of state and parastatal enterprises in order to reduce inefficiencies and government protection (monopolies);
2 high interest rates and credit squeeze in order to reduce inflationary tendencies;
3 trade liberalization in order to open up the internal market and expose local industry to world market competition and boost foreign trade exchange;
4 domestic demand management leading to a lowering of state budgets and decreasing expenditures in the social sector;
5 currency adjustments in order to improve the balance of payments by raising import prices and making exports more competitive;
6 free-market prices in order to remove distortions resulting from subsidized food and fertilizers and from import taxes on luxury items.

Institutional reforms were introduced in combination with labour market reforms, and changes in the social security system were completed with new schemes tending to privatize social services, etc. These adjustments necessitated constitutional reforms and led to changes in juridical procedures and institutions. SAPs were based on an orthodox approach. They gave greater weight to growth objectives than to income distribution objectives and their strategy was reminiscent of the neoclassical growth strategies of the 1950s and 1960s. SAPs aimed at realigning overall domestic expenditure and production patterns in order to bring the economies back to a path ofsteady and balanced growth. Stabilization and structural adjustment loans were intended to overcome short-term imbalances through expenditureswitching measures designed to reduce the level of aggregate demand, which often meant a reduction of budgetary deficits, bringing prices to market levels, a liberalization of trade and devaluations, a tight control of money supply and credit (Ramos 1986:176).

Reforms launched by the SAPs aimed at changing radically the existing preconditions of the economic structure of Third World countries. The neoliberal SAPs were designed neither to sustain the former policies of import substitution, nor to intensify a process of industrialization by selectively opening the economy to foreign competition. In this respect a shock therapy replacing the populist policy of import substitution was proposed and economic interventionism and protectionism were considered as being responsible for evils such as high inflation rates, unemployment and balance of payment and trade deficits, inefficiently operating productive systems, etc. Subsequently state interventionism had to be confined to the organization of public services (the Ministries of Defence and Justice), to the instalment of a regime of law and order, and to the support of activities the private sector was unwilling to provide.

Since the late 1970s and early 1980s about thirty African countries have adopted SAPs with the approval and support of the IMF and the World Bank. Initial SAPs were often interrupted and then renegotiated (Zaïre, Senegal, Ghana, Kenya, Nigeria), but by 1986 most African countries had embarked on structural or financial recovery programmes, with or without the help of the Bretton Woods institutions. Notwithstanding this export-led growth strategy, the countries of sub-Saharan Africa were unable to transform their economies. Their foreign debt more than doubled between 1982 and 1990, reaching US$164 billion.

In Latin America structural adjustments were introduced during the 1970s by dictatorial military regimes (Augusto Pinochet Ugarte in Chile and Jorge Rafael Videla in Argentina) combining neoliberal reforms with a doctrine of national security inspired by the ideology of the Cold War. The eradication of the communist danger was now associated with an abandonment of the former strategy of independent economic development and identified as a policy aiming at a revalorization of the export of primary products. Even in a country like Mexico, where the ruling party—Partido Revolucionario Institucional (PRI)—used to crush any form of open revolt, President Miguel de la Madrid and his successor Carlos Salinas de Gortari adopted structural reforms. In other Latin American countries Keynesian populism, which had dominated during the 1950s, was substituted by neoliberal populism when authoritarian regimes democratized (Carlos Saúl Menem in Argentina, Patricio Aylwin Azocar in Chile, Violeta de Barrios Chamorro in Nicaragua). A radical reduction of inflation rates and export-led growth became the ingredients of a development strategythat radically coped with the former strategy of import substitution and subsidies to the sheltered sectors of the economy.

This strategic option helped to weaken the social and political power of the working classes and decrease the impact of radical ideas on the middle classes. Reduced state intervention provoked mass unemployment under intellectuals and a subsequent 'privatization' of the middle classes because social demands were removed from the sphere of the state to the realm of the market forces. The atomization of the social tissue obliged too many individuals to rely on the market forces instead of regulating their problems via collective arrangements implemented by social organizations. A state discharged of its social burden had to favour the generation of social mobility which led by necessity to a growing social fragmentation.

## NEOLIBERAL REFORMS IN AFRICA

Economic deterioration in Africa was predominantly a consequence of the failure of domestic policy and the institutions the state had helped to develop and sustain. Exogenous factors have also been harmful, but mismanagement wasted any chance to cope with underdevelopment. Poorly conceived and implemented investment strategies bringing about acute imbalances in the external and external accounts were the outcomes of inappropriately large investment pushes after the nationalization of industries and the establishment of inefficient public enterprises and the allocation of distortionary subsidies.

After independence African regimes failed to modernize their economies and, almost without exception, relied for their foreign exchange on just one or two export commodities, whose prices were highly unfavourable due to the abundance of supply and because the same commodities were often easily available in Latin America and Asia, which again had a lowering effect on the world price. Given the structure of the African economies inherited after independence, exogenous factors could not be absorbed, but hampered economic transformation. The new African economies were vulnerable not only to the shock of falling world prices for primary products, but also to rising prices for imported oil and consumer goods. The post-independence African states tried to develop import-substituting manufacturing, but their state-run institutions charged with achieving these objectives served mainly to sustain the state rather than to achieve the development goals. The inherited and transformed institutional structures facilitated the abuse of power and contributed to the devastating impact of rent-seeking activities developed by the ruling class under the flag of African socialism or nationalism (Apter and Rosberg 1994:1–57). State controls with little management capabilities led to unmitigated failure. The pervasive interference of government pricing and allocation of foreign exchange resulted in overvalued exchange rates stifling exports and makingISI strategies directed by the state unrealistic and unsustainable. Capacity utilization plummeted and lack of foreign exchange to pay for intermediate inputs, coupled with the suppression of markets to which output could be sold, had devastating effects on African economies. The stagnating agricultural sector was the outcome of the combined effects of heavy taxation of export agriculture and poor management, even in those economies where the smallholder sector was not suffering from governmental interference in production and marketing. Stagnation occurred in those rural economies where the formal sector declined and poor management provoked bankruptcies in the manufacturing sector (Sahn 1994:1–22).

*Table 1.1* Agricultural characteristics (1978–80)

| | (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|---|
| Africa | 69.8 | 1.5 | 1.7 | 1.4 | 8.2 | 850 |
| Far East | 62.8 | 1.0 | 24.8 | 2.0 | 35.1 | 1,700 |
| Near East | 54.0 | 2.5 | 21.4 | 6.6 | 33.0 | – |
| Latin America | 34.7 | 4.5 | 8.6 | 5.4 | 42.2 | 1,600 |

(1) Percentages of economically active population in agriculture.
(2) Cultivated area (ha) per person economically active in agriculture.
(3) Percentages of cultivated area irrigated.
(4) Tractors per 1,000 ha of cultivated area.
(5) Fertilizer consumption (kg) per ha of cultivated area.
(6) Cereal yield (kg/ha), 1975–77.
Source: *Jamal and Weeks 1993:9*

During the 1980s living standards in Africa fell after three decades of modest improvement. Unfortunately, reliable statistics are hard to find and they only give a slanted view of reality, because in most African countries the informal sector and subsistence farming are growing in importance. Most African countries are poor agrarian economies, and more than in Latin America and Asia, the African states depend on agriculture for their survival (see Table 1.1). Although official data prove to be worthless for determining trends in African trade and national income figures are unreliable, the forty-nine nation states in sub-Saharan Africa belong to the category of Underdeveloped Economies (UEs) and twenty-nine of them belong to the category of Least Developed Countries (LDCs), because of their poverty and low contribution of manufacturing to their Gross National Product (GNP). World Bank and United Nations Conference on Trade and Development (UNCTAD) figures show that per capita income among LDCs ranged in 1988 from US$1,654 a year in Botswana to US$121 a year in Ethiopia and that the average per capita income in LDCs was US$340 a year. For all sub-Saharan African developing countries the average was US$430 in 1988. The average annual aggregate real GNP per capita in developing countries increased 2.5 per cent between 1962 and 1990, but in East Asia/Pacific it grew 4.04 per cent a year, while in Africa it increasedonly 0.8 per cent a year. The combined Gross Domestic Product (GDP) of sub-Saharan Africa, including South Africa, is far below that of the Netherlands (15 million inhabitants) (see Table 1.2).

*Table 1.2* Annual average growth rates

| | *1962– 90* | | *1962–75* | | *1975–90* | |
|---|---|---|---|---|---|---|
| | *(1)* | *(2)* | *(1)* | *(2)* | *(1)* | *(2)* |
| World | 1.80 | 1.63 | 3.15 | 1.59 | 0.58 | 1.67 |
| Developed | 2.58 | 0.55 | 3.92 | 0.77 | 1.95 | 0.36 |
| Africa | 0.80 | 2.19 | 2.27 | 1.95 | 0.57 | 2.35 |
| Asia | 1.89 | 2.46 | 1.20 | 2.43 | 1.95 | 2.50 |
| East Asia/Pacific | 4.04 | 1.70 | 4.63 | 1.83 | 3.43 | 1.59 |
| Middle East | 2.14 | 2.61 | 4.91 | 2.33 | 0.75 | 3.08 |
| Western Hemisphere | 1.13 | 1.49 | 2.59 | 1.53 | 0.29 | 1.50 |

Key:
(1) GNP in percentages.
(2) Population.
Source: *Passé-Smith 1993:18*

The most appalling aspect of Africa's decline is the decay of Africa's institutional capacities. Corruption, criminality, nepotism and oppression are common features of all African countries. Some regimes and their bureaucratic rulers have been extremely brutal and have regarded their dominance as an occasion for pillage. Routinely used torture and murder became their instruments when they tried to stay in power and their successor regimes have often had just as little repect for human rights and liberties. Most of these regimes have failed in their attempt to construct a nation state or to cope with the legacy of their colonial past. Military regimes have been the outcome of economic failure and most African regimes rely on ethnic support and bureaucracies in order to control the population. Growing violence and instability have accompanied and induced a process of state disintegration in many an African country (Hughes 1992:4–20).

The SAPs' negative outcomes provoked outrage among African leaders and they retaliated with two United Nations Economic Commission for Africa (UNECA) reports, namely *Statistics and Policies: ECA Preliminary Observations on the World Bank Report, Africa's Adjustment and Growth in the 1980s and African Alternative to Structural Adjustment Programmes (AA-SAP): A Framework for Transformation and Recovery,* which revealed that currency devaluations increased prices for imported food and equipment and boosted commodity exports unless other African countries did the same. The urban consumers and local industry were the main victims of devaluations, while local farm production was not boosted by higher food prices because of declining income. In addition, the impact of freeing prices was nullified by falling world prices, while demand management reduced public funds destined to local development projects and infrastructure improvement. High interest rates resulted in bankruptcies of small businesses and pushed up domestic costs for local industry. Moreover, import liberalization increased dependence on foreign suppliers and made local business prone to foreign takeovers. Privatizations of parastatals led to bankruptcies or takeovers of strategical enterprises by foreign capital without boosting investment.

None the less, the World Bank demonstrated that salvation only could come from growth through the promotion of export of traditional primary products. African countries had to find their own resources for their development through foreign trade and had to grow by earning foreign exchange. Therefore they had to increase their share of world markets by exporting increased volumes of traditional commodities. Although prospects for most traditional commodities were dim and Africa's export markets were shrinking, the SAPs were all concerned with increasing the role of exports in the economy. In addition, labour-intensive manufactures (low-quality textiles) and labour-intensive commodity production (and its processing) requires inputs the African countries are not able to finance out of their export earnings or savings. ELI requires import restrictions, import substitution, strict control over access to foreign exchange, and import of modern production techniques. Capital accumulation only can be the outcome of export-led growth promoted by a strong government that deliberately contrives investment and that only opens outright its economy to foreign competition after a period of tight regulation of imports and prices. But none of that occurred in Africa (Tarp 1993:7–28).

It might be argued that African economies have neither the skill nor the opportunity to process their own raw materials. Furthermore, most African states are too small to develop their home market or to mobilize savings for large-scale production. In addition, export-led growth requires infrastructures (harbour facilities, roads, electricity power-plants, telecommunications). Many African states have no direct access to a major international harbour.

In the case of Africa, foreign trade is needed for development; however, without access to better technology, development will be a chimera. The African commodity producers even had to diminish their export volumes because of falling investment rates in their traditional mining and agricultural sectors. Their financial crisis was so deep and their debt burden so heavy, that they could not alter the economic framework in which production took place. Hence, the large share of primary commodity production in national incomes of African states has made these economies extremely vulnerable to falling commodity prices for these products. This has a bearing on the appropriateness of export-led growth strategies prescribed by the Bretton Woods institutions, because export-led growth implies import-intensive growth and an intensification of land use or mining activities. In addition, when cash crops supplant farming for food,

food imports will increase (imports of food to Africa have increased since the late 1960s). The growth in the output of export crops has mostly come from an increased input of fertilizers and irrigation works. Decreasing food prices discouraged African peasants from growing food for the domestic market and, finally, African farmers were no longer able to compete with subsidized food imports from Europe and preferred cash-cropping under control of foreign multinational companies. In some countries, subsistence farming based on the village economy had been broken up by the spread of wage labour and emigration. Food production for the market grew steadily throughout Africa, but, because all African countries also compete to increase sales of cash crops in order to generate export earnings, they were cutting their own throats and destroying their whole life-support system. According to the Bretton Woods institutions, they protect inefficient industries and interfere in the market by setting prices and high exchange rates for their local currencies at levels that make exports uncompetitive. Moreover, African regimes are levying rents through direct taxes and marketing boards, who are diverting rents to non-productive uses and hindering economic growth.

The World Bank identifies five types of rent the African regimes use to fund their public expenditures: tariff revenues, protection of domestic manufacturing, monopolistic marketing boards, allocation of foreign exchange, and the misuse of investment funds for non-market-related activities. Moreover, protectionism favours inefficient local production and subsidies divert resources from productive uses to expensive and non-competitive industries. According to the World Bank, the attempt by the state to control prices and allocate resources proved to be an unmitigated failure and provoked unsustainable account imbalances. In addition, African countries cannot rely on direct foreign investment and the impact of technological transfer has been limited. Local employment opportunities for highly skilled workers are few and so it costs more in foreign exchange to produce goods locally than to import them.

However, new forms of investment can be of importance for Africa providing management agreements, technology licensing agreements, and forms of subcontracting are implemented in an economically and politically stable situation. Production-sharing contracts can favour inflows of foreign capital. The industrial success story is Mauritius, where the government established an Export Processing Zone in order to cope with its single export commodity (sugar). A package of incentives (free trade, tax exemption, free repatriation of capital and profits, local financial and infrastructure support) attracted between 1970 and 1985 some 400 foreign firms and a strong Hong Kong connection invested in the textile and garment industry. This Hong Kong connection was running up against the quota ceilings of the Multi-Fibre Arrangement (MFA) for its imports into industrialized countries. Since 1989, Mauritius's success has eroded because pressure for higher wages made its Export Zone less attractive; this illustrates that export-led growth can work only as long as wages are very low.

But the establishment of successful export zones requires a stable social and political environment and favourable foreign exchange rates. An Export Processing Zone in Senegal was less successful, although the government established total exemption from duty on imports and from direct or indirect taxation for twenty-five years, because until 1994 Senegal suffered from the high Communauté Financière Africaine (CFA) franc/French franc exchange rate. Export zones were also established in Mombasa (Kenya) and Togo, but without success (Brown and Tiffen 1992:136–7) because foreign investors are bypassing Africa completely. SAPs are not always promising inflows of foreign capital. Ghana has pursued one of the most vigorous SAPs in the whole of Africa, but with little success. Zambia and Zimbabwe were slow to adopt structural adjustments, but could attract foreign investment, because in many African countries export-led growth depends on access to external markets.

Europe is Africa's principal market and investment partner and because Europe has itself labour-intensive industries, it is less interested in developing Africa than the USA and Japan are in their respective regional markets. Moreover, the opening up of Eastern Europe for Western European capital marginalized Africa as never before and the emerging American free trade bloc and the Japanese Pacific Rim reinforced a trend tending to exclude Africa from the regionally integrated, independently sustainable networks of overseas investment. So the marginalization of the African LDCs is likely to continue at a time when investment flows to developing countries are going to the newly industrializing countries of Asia and Latin America.

## THE EAST ASIAN MODEL

Over the past years an expanding amount of research has been done on the causes and origins of the East Asian economic success. Many studies stress the fact that the East Asian economies were more succesful than others in terms of long-run growth because they followed the prescriptions set forward by the neoliberal theory and neoclassical economics. In the view of the neoliberals, growth is a natural property of capitalism and governments have an important role in providing enterprises with those public goods and macroeconomic stability that firms need in order to be successful. But beyond that point, governments should not involve themselves, except in the case of market failures (Page 1994:2–5; Deyo 1987:11–22).

In the case of the industrializing East Asian economies, the governments have gone beyond these neoliberal limits. Moreover, the importance of the East Asian countries is often exaggerated and, compared with Japan, the importance of their economies is rather small. This having been said, the East Asian economies have made some progress. South Korea and Taiwan have jumped from the capitalist 'periphery' to the 'semiperiphery'. Especially South Korea can be considered as a new industrial giant, because by 1988 its per capita income was far above the figures for Mexico and Brazil and about equal to that of Portugal. Already in 1986 South Korea was the fifth biggest exporter of manufactures to the United States. The rise of skill-intensive, high-value-added industries that are competitive at the world market standards of costs and product specifications made South Korea and Taiwan important competitors in the world arena. The Korean semiconductor industry succeeded in producing most of the semiconductor memory chips and is well ahead of all European firms. Today, South Korea is exporting large quantities of computers, automobiles, ships, steel and construction, all having a sizeable impact on the world economy (World Bank 1993:27–104).

If we take several criteria together, South Korea and the other Asian industrializing countries have been more successful than other poor countries and this refutes what those critics on the left said during the 1970s about the progression of underdevelopment. The Asian NICs use very different combinations of economic policies, from hands-off to highly interventionalist development policies. Because of this diversity of policies there is no single Asian model of development. But in general all countries share one common feature, i.e. macroeconomic stability and investment in human capital (Lorot and Schwob 1986).

The high-performing Asian countries are identified by several common characteristics, such as very rapid export growth and industrializing faster than all other regions in the world. They have grown more than twice as fast as the rest of East Asia; three times as fast as Latin America and South Asia; five times faster than sub-Saharan Africa; and have even outperformed the oil-rich countries of the Middle East. The most striking characteristics are the high rates of growth of manufactured exports and physical capital supported by high rates of domestic savings and a rapid output and productivity growth in agriculture. The Asian NICs grew more rapidly than any other group of economies in the world. With an average of 5.5 per cent annual per capita real income growth, they outperformed the Latin American countries and sub-Saharan Africa (except diamond-rich Botswana).

Moreover, the Asian NICs had lower levels of income inequality and improvements in income distribution generally coincided with periods of rapid growth and a steady decline of agriculture's share of the economy. Relative decline of agriculture was due not to lacking agricultural dynamism, but to fast industrialization. East Asian governments kept on supporting investment in irrigation and other rural infrastructures and invested in high-yielding crops and manufactured inputs (electricity, fertilizers and equipment). Rising productivity in agriculture eased export-led industrial growth and prevented governments from heavily taxing agricultural outputs or overvaluing currencies and protecting domestic industries that manufacture agricultural inputs and the goods purchased by rural households. Low taxation and positive protection of agriculture suggest that the East Asian NICs avoided transferring any resources from agriculture to industry. Transfers were rather voluntary (financial savings) and did not strangulate agricultural growth (Leipziger and Thomas 1994:6–9).

As a group, the East Asian NICs increased their share in world exports from 8 per cent in 1965 to 13 per cent in 1980 and 18 per cent in 1990. These growth rates were obtained by exporting manufactures. For instance, between 1965 and 1990 Japan emerged as the world's biggest exporter of manufactured products, increasing its share of the world market from nearly 8 per cent to almost 12 per cent (Lincoln 1993:56–159). The Four Dragons' share of manufactured exports grew between 1970 and 1990 four times faster than Japan's. Around 1980, the three Southeast Asian NICs (Indonesia, Malaysia and Thailand), after being dependent on commodity exports, recorded a similar (but smaller) surge in manufactured exports (Alamgir 1994:67–80; Rock 1994:18–37).

Physical investment and savings rates increased markedly in the eight Asian countries (South Korea, Taiwan, Indonesia, Thailand, Singapore, Hong Kong, Malaysia, and Japan), outstripping the performance of other developing countries and even the developed countries in the West. Economists view investment as one of the driving forces of economic growth. In the eight Asian NICs private investment was high, but public investment remained important and was counter-cyclical to the reduction in private investment in periods of economic contraction. In other economies the fiscal contraction of macroeconomic adjustment was reflected in lower public investment rates. Furthermore, the Asian NICs invested in education and were well ahead of other developing countries (Haggard 1990:191–271). Primary enrolment rates grew above 70 per cent in Indonesia during the 1965s and in Korea and Taiwan superior education systems at the secondary level had gained some importance. Only Thailand remained rather backward.

Even communist China recorded average annual GNP growth of 9.4 per cent from 1979 to 1989, with a surge to 11.4 per cent from 1982 to 1988. After a brief retrenchment trimming growth to 4.4 per cent in 1989 and 4.1 per cent in 1990, the economy recovered, reaching a breakneck 12 per cent in 1992 and 1993. China resembles the economies of the Asian NICs. Rapid growth relied on a government-fostered export push and reforms giving farmers more possibilities to increase their productivity to market their crops. China's export-push policy included tax reforms, currency devaluations and duty-free imports. Productivity gains are highest in the export-oriented regions in the southern provinces that could attract heavy investment flows from neighbouring Hong Kong and Taiwan.

## LATIN AMERICA'S *APERTURA*

The Latin American region has been enjoying fast economic growth since 1990. Average GDP increased by over 3 per cent between 1990 and 1994. Countries like Peru, Argentina and Mexico are recovering from their doldrums. Argentina's economy has grown by over 30 per cent between 1990 and 1994, placing it third behind China and Thailand. But the real engine of economic growth has to be Brazil if inflation can be brought down and budgets balanced. However, many Latin American countries are still suffering from high inflation rates. Countries like Mexico and Argentina succeeded in bringing inflation rates down by rationalizing and increasing taxes and slashing government expenditures, especially subsidies, as well as by selling state assets. Mexico created since 1991 a budget surplus and Argentina followed this example. Latin American state-run pension systems went bankrupt. Nowadays, some Latin American countries are studying Chile's early privatization of pensions by using a forced-savings regime that stimulated private savings (which grew from 2.8 per cent of GDP in 1980 to 14.3 per cent in 1991).

But the big pillar of Latin American reformism is the *apertura,* the liberalization of markets and the abolishment of high tariffs against imports and production for the domestic market. Tariffs, licences and other restrictions have been abolished and between 1991 and 1993 alone the average tariff for the region was almost halved (from 26 per cent to 12 per cent). Financial sectors have been opened up, interest rate controls lifted, and direction of credit ended. Mexico was forced to take a drastic turn in its economic policy and since the mid-1980s, trade liberalization has been one of the key elements of the new orientation. With 70 per cent of the country's exports in oil, the oil price slump had put Mexico in a difficult situation. Faced with high international interest rates, massive capital flight, a debt of US$82 billion, almost no foreign exchange reserves, and an inward-looking economy, Mexico had to gain greater access to the US market. Mexico removed all restrictions on capital flows when letting in foreign banks, securities firms and insurance companies. Other Latin American countries saw direct investment and portfolio capital coming in and local companies were able to raise money abroad (Schatan 1993:79–98).

The third pillar of reform has been privatization. State firms were sold in order to gain revenues for the budget, to reinforce macroeconomic stabilization, and to improve efficiency. Mexico sold its state-owned oil company Petroleos Mexicanos (PEMEX); Peru launched a privatization programme; but Chile's copper mining firm Corporación del Cobre (CODELCO) is still owned by the state. Brazil has already sold many state firms and the new government led by President Fernando Cardoso wants to privatize more state-owned firms or accept private shareholders in telecoms, electricity and mining activities. The Argentinian government wants to withdraw from all large concerns still in state hands (nuclear plants, the post office, harbours, the mint and petrochemicals).

Latin America's better access to financial markets was the result of rescheduling old debts under the aegis of international arrangements (especially the Brady Plan). Commercial banks started lending again and even Peru, the last Latin American country that had resisted its foreign creditors, has complied in negotiating the Brady Plan. Meanwhile, Latin America is contracting new loans and foreign direct investment has increased substantially. Between 1990 and 1993 more than US$170 billion poured in, of which a third was direct investment going into private assets. These inflows financed an import boom of both consumer and capital goods, provoking in some countries an appreciation of local currencies or inflation. Notwithstanding all these neoliberal reforms, Latin America's economic performance (productivity and quality) has not yet improved and the continent's reliance on foreign capital is still worrying. Savings are low in comparison with East Asia (20 per cent of GDP against 34 per cent in East Asia) and investment rates are too modest (22 per cent of GDP). Income inequalities are too pronounced and high inflation hits the lowest paid very hard, while private industry is not yet creating additional jobs. Despite economic growth, employment is still decreasing while, in contrast to the Asian NICs, education remains inadequate.

## DEMOCRATIZATION

Foreign exchange shortages forced many developing countries to adjust their economies and more often than not this was partially or entirely financed by the IMF and the World Bank. Loans conditional upon the adoption of market- and export-oriented policies were combined with democratic transitions occurring in tandem with market- and export-oriented shifts in economic policies. None the less, we have to keep in mind that democracy is a matter of power. Democracy presumes that there are also democratic conditions and political equality. This idea is the ground upon which democracy has to be founded, because power relations determine whether democracy can emerge, stabilize, and then maintain itself even in the face of adverse conditions (Schumpeter 1954:269–83). There is the balance of power among different social classes and class coalitions. But there is also the nature and the independence of the state apparatus *vis-à-vis* popular demands. In the meantime the political strength of the entrepreneurial class who developed over the previous years those countries with fast-growing, export-oriented economies, has to be taken into consideration, because the transition to democracy and the consolidation of democracy interact with and affect the shift to an export-led industrial development strategy.

In Latin America democratic transitions have opened the way for well-organized popular sector groups to re-enter politics. Elections were held to legitimize the post-dictatorial democratic regimes. In Africa the non-existence of an independent class of capitalist entrepreneurs and the prevalence of the 'statist bourgeoisie', refusing to abdicate, means that the state sector remains predominant in the economy of all African countries. In the so-called 'socialist' African states or in the hypercapitalist countries like Nigeria, public expenditure rose to high levels. This explains why the structural adjustment plans try to reduce the pre-eminence of the public sector. The members of the oligarchy and the bureaucracy within the state are also by no means the least active participants in the private sector. These structural adjustment plans often worked as safety-valves in a period when the 'development strategy' was completed with neoclassical, market-oriented approaches (Kabou 1991:17–45; Cornia *et al.* 1982:1–7).

In Africa former one-party rulers managed to arrange their victory at multi-party elections or to survive the neoliberal drive. In Angola Eduardo dos Santos won the election, but then the civil war started again. In Mozambique President Joaquim Chissano easily managed in November 1994 to beat his opponent Afonso Dhlakama. In Nigeria General Ibrahim Babangida annulled in 1993 the results of the elections and, again, the military took over power (Ihonvbere 1994:191–216). Meanwhile dictators like Joseph Mobutu (Zaïre) and General Omar Bashir (Sudan) rarely bother themselves even with references to elections and just like 'revolutionaries' they neglect all pressures coming from the IMF or the World Bank. Former French colonies also democratized, but many of them had to do so under pressure from Paris. In Africa France has maintained a pervasive influence in its former colonies and in the former Belgian colonies (Zaïre, Rwanda and Burundi). The government in Paris never showed compunction in supporting autocrats or devoting substantial resources to maintain economic influence by sponsoring a franc zone encompassing former colonies (Chabal 1994:200–47; Cornia *et al.* 1982).

In Asia the authoritarian regimes had to meet demand for more democracy and subsequently many of them reformed in a period when they had almost completed their shift from ISI to ELI. The downfall of Marcos's authoritarian regime in the Philippines initiated a process of democratization and a restoration of parliamentarism, but also revealed the high costs of elite disunity, the exclusion of powerful business groups and landlords, and the repression of mass aspirations. Marcos's downfall occurred in a period when his regime had gone bankrupt because of a failing ISI policy. The Chinese and Burmese governments succeeded in crushing popular aspirations and in clinging to state power. Taiwan liberalized constraints on political organization and committed itself to slow democratization. In other Asian countries an analogous ELI process occurred.

In South Korea the main elements in transitional politics from an authoritarian regime to a would-be democratizing government during the Roh Tae Woo presidency involved liberalization of the regime, activation of the civil society, and the relative weakening of the state. A variety of social forces has played a role in political change in South Korea. Militant industrial workers, reform-minded white-collar workers and students represented a major threat to the coercive regime. Disciplined low-cost labour was a basic element of the export-oriented industrialization under President Park Chung Hee. Labour repression intensified in the early 1980s under Chun Doo Hwan, when the latter suspended all collective bargaining and banned social protest and independent labour unions. The Sixth Republic installed by President Roh Tae Woo after his narrow election in December 1987 gave more autonomy and self-regulation of various social sectors, but loss of efficient and effective state capacities was the price Roh had to pay for democratization. Pressures originating from the world system were 'significant external factors and class dynamics were a potentially crucial factor in determining political configurations' (Lee 1993:365).

Politics in Malaysia could be classified as semi-democratic because the government constrained societal organizing and the ruling United Malays National Organization (UMNO)—and its successor, the New UMNO—has dominated shifting coalitions of ethnic parties. But in 1988 the ruling UMNO split into two parties. None the less, the New UMNO led by Prime Minister Mahathir Mohamad remained in power. Mounting factionalism within the government gave way to more open and wider-ranging competition leading up to the general election in 1990. The New UMNO stayed in power, contending that in a multi-racial country full democracy weakens the viability of the state, especially when elites driven by electoral calculations make strong ethnic appeals (Case 1993:107).

## ONE WORLD, ONE MARKET

The rise to globalism was sustained by the spread of multinational capital all over the world and the opening of markets for foreign competition. Free-trade areas became extremely popular because all nations wanted to compete, attract foreign investment and conquer new export markets. Protectionism appeared to be old-fashioned and an inadequate method of fostering industrialization (Cline 1983:1–54). This liberal breakthrough only came after the Mexican debt default of August 1982, which was the worst in the modern history of Latin America.

Far from provoking the violent social upheavals, the 1980s saw a flowering of democratic transformations and a gradual opening up to the outside world and a revival of competitive capitalism in Latin America. Although the collapse of communism in Eastern Europe overshadowed in the public mind the transformation of Latin America, both had many features in common. Just as happened with the implosion of communism, the rejection of populist-authoritarian politics went hand in hand with the collapse of the nationalist-statist economic model. The depression of the mid-1980s turned out to be the deathblow for the militarist, populist and communist regimes. In retrospect, the debt crisis seemed to have been an inadvertent catalyst for the abandonment of protectionist and statist economic ideologies across Latin America, Eastern Europe, Africa and Asia (Tussie and Glover 1993:1–10).

Economic growth and monetary stability permitted Latin America to regain political stability and reactivate the process of regional economic integration (Battle Ibañez 1991:35). But not one major debtor country proved capable of servicing its full obligations or restoring its creditworthiness before the Brady Plan officially sanctioned debt forgiveness in 1989. Even the showcase economies like Chile and Colombia eventually won substantial debt relief through debt-equity swaps and other Brady Plan arrangements. Even in the most successful countries, such as Mexico and Chile, the economic achievements are still tenuous and the financial pressures remain intense. In Brazil economic stabilization and structural reforms have only just begun and the external debt burden has not yet been lifted, while the poorest countries (Peru, Bolivia and the countries of Central America) remain vulnerable to economic and political shocks (Bottome *et al.* 1992:1–12).

Neoliberal policies met with varying degrees of success when introducing radical political and economic reforms. In the case of the North American Free Trade Agreement (NAFTA), the introduction of neoliberal policy was seen as a first step on the road towards the expansion of the pact south from Mexico, creating a free-trade hemisphere (Rugman 1994:18; Pastor 1993:37–52). NAFTA is locking Mexico firmly into the US economy and is currently forming a market of some 360 million consumers with a GNP estimated at US$6,000 billion. In NAFTA's waiting room are many other Latin American countries (Chile, Colombia, Venezuela). So, in the near future NAFTA can facilitate a restructuring of the hegemonic position of the US economy with respect to the Latin American continent and eliminate definitively the formally independent associations, such as the Latin American Free Trade Association (LAFTA) which since 1970 has integrated the economies of Mexico, Argentina, Chile, Brazil, Paraguay and Uruguay, and which had been reformed in the 1980s under the label of the Latin American Integrated Association (LAIA) (Grinspun and Cameron 1993:10). The Common Market of the South—or Mercado Común del Sur (MERCOSUR), founded on March 26, 1991—is another regional free-trade association created as a common market for the economies of Argentina, Brazil, Uruguay and Paraguay (Hirst 1990:85). The MERCOSUR was inspired by a neoliberal substrate underpinning the idea that a liberalized regional market can boost the activities of regional firms (i.e. that the suppression of all fiscal constraints imposed by national governments will stimulate overall economic growth) (Battle Ibañez 1991:25).

Overshadowed by the debate over the accord between the USA, Canada and Mexico, the economies of Latin America have experienced a free-trade transformation of their own (Weintraub 1990:12; Camp 1989:84). In January 1994 Colombia, Mexico and Venezuela signed an agreement that will phase out tariffs over a decade, creating a duty-free market of 150 million people. The average tariff charged by Latin American nations to outsiders has dropped from 56 per cent in 1985 to 15 per cent in 1993, and this opening has made Latin America the world's fastest-growing market for goods manufactured in the United States. Half of Latin America's trade is now with the USA. Of all the Latin American applicants to the NAFTA, Chile has the best prospects. Chile emerged from Pinochet's military dictatorship as Latin America's most robust economy with expansion at an average rate of 8 per cent a year since 1990. Since 1990 Chile has signed free-trade pacts with Argentina, Bolivia, Colombia, Venezuela and Mexico and started in 1993 preliminary talks with the Clinton administration in order to join NAFTA. In July 1994 the countries of the Caribbean, Colombia, Venezuela, Mexico and the Central American states signed an agreement establishing the Association of Caribbean States (ACS). All these free-trade arrangements improved Latin America's image because overall exports grew (see Table 1.3). None the less, Latin American countries are

*Table 1.3* Trade push for ten South American countries, plus Mexico (but minus Guyana, Suriname and French Guyana)

| | *Exports* | | *Imports* | |
|---|---|---|---|---|
| | *1989* | *1993* | *1989* | *1993* |
| Total (in US$billion) of which | 101.9 | 123.2 | 71.9 | 136.6 |
| intra-regional, % | 11.0 | 19.2 | 15.5 | 16.9 |
| intra-Andean, % | 4.1 | 9.7 | 5.3 | 9.2 |
| intra-MERCOSUR, % | 8.2 | 18.5 | 15.1 | 19.7 |

Source: The Economist *1994(47):52*

*Table 1.4* Basic indicators of the world economy

| | *(1)* | *(2)* | *(3)* | *(4)* |
|---|---|---|---|---|
| Sub-Saharan Africa | 543.0 | 530 | 277.9 | 282.0 |
| East Asia & Pacific | 1,688.8 | 760 | 84.5 | 85.8 |
| South Asia | 1,177.9 | 310 | 191.0 | 209.2 |
| Europe & Central Asia | 494.5 | 2,080 | 124.5 | 133.0 |
| Middle East & N. Africa | 252.6 | 1,950 | 198.0 | 145.5 |
| Latin America & Caribbean | 453.2 | 2,690 | 267.1 | 250.4 |
| High-income economies | 828.1 | 22,160 | – | – |

Key:
(1) Population in millions mid-92.
(2) GNP per capita in US$ 1992.
(3) Net present value of total external debt as percentage of exports in 1989.
(4) Idem in 1992.
Source: World Development Report 1994:*163, 207*

still lagging behind the East Asian countries. So they will have to push their exports in order to improve their foreign debt/export ratio (see Table 1.4).

Obviously, customs unions have been a dream since the end of Spanish and Portuguese colonial rule in the early 1800s and they have integrated major geographic areas (Central America, the Caribbean, the Andean nations and the Southern Cone). Optimists think that by the end of the 1990s most trade within Latin America will be tariff-free. According to President Carlos Saúl Menem of Argentina, isolated countries have no destiny, no future. Of all the South American countries, Brazil has shown the least interest in joining NAFTA, and in September 1993, at a regional heads of state meeting, President Itamar Franco blocked approval of a nonbinding motion of support for NAFTA. Instead, he presented a plan for the Northern Common Market, a free-trade pact encompassing Brazil and its Amazon neighbours (Guyana, Suriname, Venezuela, Colombia, Ecuador, Peru and Bolivia). Brazil fears that under NAFTA the USA will eventually import duty-free from Mexico goods that are taxed when imported from Brazil: orange juice, shoes, steel and automobile parts. None the less, these fears demonstrate that the free-trade wind is blowing and even the Fondaciao Getulio Vargas had to concede that NAFTA is giving powerful support for consolidating free-trade policies in Brazil (*International Herald Tribune,* 30 December 1993).

In the Asia-Pacific region, free trade is coming closer after the eighteen members of the Asia-Pacific Economic Co-operation (APEC) forum committed themselves on 15 November 1994 in Bogor (Indonesia) to creating a free-trade area stretching from the USA to Thailand and from Chile to China. But this ambitious goal—set out in what will now be known as the Bogor Declaration—is expected to be reached only by 2020 and stipulates that developed nations should achieve 'free and open trade' by 2010 and developing nations by 2020. But the difference between developed and developing nations is not defined. Moreover, the Malaysian government had managed to attach an addendum to the Declaration stipulating that the date of 2020 is not binding and the Japanese and Korean governments are muttering about excluding agriculture from APEC's discussion. Paul Keating, the Australian Prime Minister, and Bill Clinton argued that tariff cuts made under APEC could go further and faster than those already agreed under the General Agreement on Tariffs and Trade (GATT), but other countries (Japan and Thailand) emphasized that they wanted the World Trade Organization (WTO) to set the pace. Especially Japan stressed that liberalization must not hurt APEC's poorer states, whereas other developed states supported the idea that falling trade barriers in Asia may create extra jobs back home (*The Economist,* 19 November 1994).

The institutionalization of an annual APEC is the most noticeable sign of the prospect of a negotiated downward movement in tariffs and trade liberalization, and annual APEC consultations reflect American economic ties with Asia. (America now exports more to Taiwan than to France, and imports as much from China as from Germany.) APEC may help to boost the development of trade across the Pacific and reinforce a process that is already well under way. For instance, China wants to be a founder of the WTO and to include a fifth of the world's population in a new liberal trade regime. Although China has promised to do much to bring down tariffs, as well as to phase out most quota restrictions by 1999, it remains highly illiberal over imports; foreign firms must still deal through a state trading cartel and many trading regulations go unpublished.

In the case of Africa, economic decline and political instability hampered any form of regional economic cooperation. Several subregional organizations still exist in Africa. But they are of no importance for their development or self-reliance. The Economic Community of West African States (ECO-WACS), the Communauté Economique de l'Afrique Occidentale (CEAO), the Union Douanière et Economique de l'Afrique Centrale (UDEAC), Preferential Trade Area (PTA), and the Southern African Development Coordination Conference (SADCC) did not establish common external tariffs and none is coordinating its members' investment programmes (Polhemus 1994:263–8). Most of the participating African countries do not possess convertible currencies to settle their accounts and most of these countries concentrated on protecting their own interests instead of promoting free trade among African states. Meanwhile the Organization of African Unity (OAU) has abandoned the goal of establishing an African Economic Community as originally envisaged by the Lagos Plan of Action (1980) (Sandbrook 1993:142–4). Meanwhile, the prospects are not good for maintaining the flows of aid to Africa. The needs of Eastern Europe are far more pressing and, despite official denials, a large proportion of the Third World's traditional allocations of aid and credit is likely to be diverted to the ex-communist countries.

As we can see, the regionalization process started in the 1960s in the form of a gradual elimination of all economic barriers, without eliminating the fragmentation of the region into national markets. Most of these regional agreements remained within the concept of free-trade areas and most of them were based on a multilateralization of bilateral agreements or unions. The mushrooming of initiatives gave birth to many treaties and institutions of economic integration which still exist, but were never a success. Nowadays regionalization and free-trade areas have become popular in Latin America at a time when protectionism has lost its popularity. ELI and free trade have gained the support of Latin American regimes looking for a rapid modernization process fostered by free inflows of capital and technology and export to the wealthy North American market. Beyond that, all developing countries will have to exert pressure to make the Western world live up to its rhetoric about free trade and free capital movement, because if the export-oriented development model now being adopted across many countries turns out to be succesful, the US and the European Union (EU) will have to open up its markets.

External pressure was clearly important in provoking the initial movement to liberalization in most countries. Between 1986 and 1991, thirty developing countries undertook unilateral liberalizations and today a number of developing countries have more open trade policies (as measured by the level and dispersion of tariffs and the prevalence of quantitative restrictions) than the US and the EU. Developing countries became active participants in the GATT, and individually and as members of coalitions they were committed to the Uruguay Round. Moreover, trade negotiations have begun to affect sovereignty as well as the historical framework of societies in a period when international commodity agreements designed to stabilize or increase prices for primary commodities have attracted less interest.

## CONCLUSION

The experience of industrializing countries suggests that coping with underdevelopment necessitates extensive governmental action, because mobilizing the necessary human and capital resources requires extensive central coordination. This includes as well a mobilization of domestic and foreign savings and an identification of lucrative niches within the global capitalist world system. Strong interventionist states of East Asia created industrial growth and achieved development goals based on high savings and investment rates. Bureaucratic elitism did not prevent them from being highly competitive on the world market. But in Africa, Latin America and Asia, too many countries failed to transform their economies into 'economic tigers'.

The triumph of neoliberal reform politics—both political and economic—illustrates the failure of the politics of import substitution in Latin America and the bureaucratic transformism in Africa. In many aspects the consolidation of the export-model of growth prompts two fundamental changes in the social structure. The first is the appearance and growth of new middle strata involved in international trade and services profiting from the export-import economy. A second major change is an increased integration of Latin America and some parts of Africa and even parts of China and Vietnam into the global capitalist system.

Protective tariffs for industry undoubtedly saddle urban consumers with higher-priced, lower-quality goods, and protection can impair the profits of export-import interests. Economic and political liberalism still cross-cut in another way. Anti-liberal ideas in economics, such as protective tariffs and controls on foreign investment, are associated with anti-liberal political ideas and thus the connection is easily established: anti-liberal ideas in economics must mean authoritarian government.

Programmes aiming at compressing the state's economic role usually start with extensive retrenchments in the public sector and elimination of 'ghost workers' from the salary rolls. Privatization of public corporations can help in shrinking the state's size and enhancing economic efficiency. But in many cases these public enterprises or parastatals had been created because of the weakness of the local entrepreneurial class or the prominence of foreign capital. Parastatals expanded to provide social services, run public utilities, and manage or oversee commercial, financial and productive activities. In many cases these parastatals were undermined by Third World diseases (such as clientelism), because populist politicians created overstaffed administrations and hampered technical rationality and efficiency. Remedies offered by the IMF and the World Bank consist of rather limited options. African and Latin American countries must either privatize public enterprises or commercialize their activities by subjecting them to competition and reducing subsidies. But privatization also provides excessive benefits to foreign purchasers and creates foreign-owned monopolies without necessarily rejuvenating the private sector. All depends on the willingness of the foreign investor to invest in public utilities and on the opportunities offered by the developing countries to repatriate profits.

At the administrative level, the failure of the established government bureaucracies to find any way out of the economic crisis of the mid-1980s led to a generational shift in the locus of power. The pendulum swung away from the old military-nationalist elites whose policies were built on the economic foundations of the protected industrial monopolies and semi-feudal agricultural fiefdoms (in Latin America and the Philippines) or marketing boards and state-owned mining firms (especially in Africa).

The present world system operates on a scale never attained before. Multinationalization of production and the creation of a unique world market goes hand in hand with a growing disparity in the costs of labour power. In this world system the United States, Japan and the former colonial powers of Western Europe are playing a major role. Economic and financial bonds have shaped a complex unity creating inequalities and new disparaties, but also solidarities. The transformation of national productive structures in Latin America and Africa has to be understood as responses to fundamental changes occurring in the economic world system. The failure of all Third World political regimes generated by movements of national liberation wanting to cope with dependency created a vacuum that easily was filled up with neoliberal strategies aiming at adjusting their economies to the needs of the world market. Former Keynesians in the West and also in the South accepted the idea that neoclassical economic ideas could be useful to obtain balanced growth or combat inflation. Overvalued currencies had to be devalued and national economies exposed to foreign competition in order to achieve more efficiency and competitiveness or smooth capital inflows. It is not the expansion of internal markets, but that of foreign markets which fosters economic growth and investment opportunities for private capital.

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# 2

# THE ASIAN MIRACLE

## A critical reassessment

*André Mommen*

The neoliberal approach, with its emphasis on the mutuality of interests between rich and poor countries, promotes the idea that the policy lessons derived from the experiences of the Asian NICs are the clear-cut causes of the NICs' success. Neoliberal theory highlights the role of private enterprises as the main vehicle of the Asian NICs' economic development. Although the incisive role played by the visible hand of the state is not denied as a source explaining the 'exceptional' success of the Asian NICs, the neoliberals stress the state's contribution when removing the obstacles to economic growth. Moreover, the neoliberals present government intervention as outward-looking, market-oriented policies in combination with rapid improvement in human resources and institutional development. One can be critical about the neoliberal explanation of the Asian NICs' development trajectory and consider their success as an achievement that owes much to a coercive political system resting on long working weeks, low wages and an underdeveloped welfare state. Therefore we shall give in this article a rather critical account of the achievements of the Asian NICs.

The Newly Industrializing Countries (NICs) of Asia achieved something which the rest of the world recognized as rapid economic growth through an astonishing mobilization of resources. Much of the Asian NICs' economic success was due to superior accumulation of physical capital, technological know-how, human capital and geographical and historical factors. The Asian NICs were able to allocate their resources to highly productive investments. They did this in combination with policies combining market-oriented interventions with export-boosting industrialization and a surge of the employed share of the population. Miraculously, these NICs were shaking off their Third World status and successfully exporting manufactured goods to the advanced industrial countries.

In many reports and other publications this success is described with admiration and even called a 'miracle', because never before had economies grown as fast as those of the 'Four Tigers' (Hong Kong, the Republic of Korea, Singapore and Taiwan) which formed a nucleus of states dominating the Pacific-Asian Area. Moreover, most writers on the global economy have taken it for granted that this success demonstrates that the Western nations are losing their traditional advantage and that the Asian NICs have succeeded in preparing the ground for a shift of the world's economic centre of gravity to the Western Pacific by their successful Export-Led Industrialization (ELI) policies.

The older industrialized countries are presumed to be threatened by the rise of the Asian NICs and therefore the other developing countries are urged to adhere to ELI policies. The neoliberal approach even emphasizes that economic stagnation, falling profit rates, and soaring unemployment in the Western economies have much to do with protectionism and ill-fated state interventions and pretends that free trade and economic liberalization can restore economic growth and productivity in the same way as the Asian NICs did during the last decades.

## COMMON CHARACTERISTICS

The Asian NICs are sharing many common characteristics that set them apart from other developing countries. A recent World Bank study (*The East Asian Miracle* 1993) characterizes the Asian NICs as countries with, in general, higher than average rates of productivity growth. These higher growth rates of physical capital are supported by high rates of domestic savings and higher rates of manufactured exports, while productivity gains in agriculture are combined with a slowdown of fertility rates and population growth and higher growth rates of human capital (Thomas and Chibber 1989:28–31; *The East Asian Miracle* 1993:8–23).

These economic fundamentals do not explain the whole problem of succesful ELI policies. Almost all of the East Asian economies engaged, at one time or another, in some form of state interventionist Import Substitution Industrialization (ISI). But when they decided to shift to ELI policies, they all adopted selective interventions in order to preserve the interests of their economies. Selective interventions took many forms (repression of interest rates, directed credit, selective industrial aid, export promotion, etc.) of pushing manufactured export in combination with interventionist policies aiming at accumulating physical and human capital, acquiring technology and productivity gains, and allocating capital to highly productive investments. After the oil shock of 1973, when global economic growth slowed down dramatically, the Asian NICs were able not only to sustain their growth, but also to do it in an outward oriented fashion. Asian NICs like Hong Kong, South Korea, Singapore and Taiwan emulated Japan. After having penetrated foreign markets for basic commodities(e.g. steel, heavy chemicals) and for textiles, countries like South Korea and Taiwan shifted in an ever outward direction, while the entrepôt economies Singapore and Hong Kong were already among the world's most open economies. South Korea and Taiwan remained more protectionist, but later on they implemented policies to reduce their average tariffs (Barrett and Chin 1987:23–43).

The Asian economies are extremely diverse in terms of size and natural resource endowment. Japan and Singapore have specialized in technologyintensive products, while Malaysia, Thailand and Indonesia are still exporting large quantities of natural resource products. The Asian NICs found growing export opportunities in North America at a time when Japan met increasing difficulties in sustaining its export-led growth. Investors from the US, Japan, Hong Kong, South Korea and Taiwan established transplants in lower-wage countries (Thailand, Malaysia, Indonesia, China, Vietnam, the Philippines, Mauritius). The latter countries received Foreign Direct Investment (FDI) inflows, which in turn led to the creation of an emerging regionally integrated economic area (Haggard 1990:212–22). Singapore, South Korea and Taiwan shifted from unskilled labour towards technology and human-capital intensive products while lessening their reliance on natural resource-based production.

The emergence of communist China, with its special zones in the coastal areas, induced an explosive export-pushed growth. Imitating the Asian lowerwages NICs, communist China exports basic commodities (coal, oil) and labour-intensive industrial products (Gong 1994:29–43). A major difference between China and some of the high-performing economies in East Asia is that China has been far more dependent on foreign capital to generate exports, particularly of manufactured goods. Expanding economic ties became a mechanism for furthering FDI. China has opened itself to FDI to a greater extent than many other Asian economies. In 1992 and 1993, for example, foreign-invested firms, which account for only a few percentage points of China's output, were the source of about two-thirds of the expansion of exports (Lardy 1994:23) About 70 per cent of FDI in China in 1992 came from Hong Kong and about 10 per cent from Taiwan. Chinese business networks are being grafted on to American corporate networks, the Japanese *keiretsu,* and the Korean *chaebols* (Funabashi *et al.* 1994:23–4).

Today, China is upgrading its exports to medium-tech products and a complementarity has occurred with Hong Kong. Hong Kong is currently re-exporting almost 30 per cent of all China's exports. Taiwan's and Hong Kong's economic successes drove China's growth. Although direct trade between the People's Republic and Taiwan is illegal, the total volume of their trade has jumped from US$1.5 billion in 1987 to US$14.3 billion in 1993. Over 5,000 Taiwanese firms have set up transplants in mainland China. More than 50 per cent of the labour force of Hong Kong companies is working in Chinese subsidiaries and Hong Kong is China's number one supplier with 28 per cent of total imports in 1993 (*Hong Kong* 1994:88; Goodman and Chongyi 1994:177–201).

Resource-intensive countries like Malaysia and Indonesia experienced in the 1970s and 1980s oil and commodity booms which led to strong, overvalued currencies which reduced the competitiveness of the manufacturing sector. Falling export earnings and debt repayment pressures obliged both countries to implement changes in domestic policies (including devaluations and trade and investment liberalizations) in a period when Japan and the other NICs had to face major changes in international competitiveness. So, by welcoming FDI and redirecting their economies towards manufactured exports, they could achieve high growth rates and stabilize their internal and external balances.

Much of East Asia's success is also due to geographical and historical factors. For many centuries key Asian ports were integrated into the emerging capitalist world system as the result of European expansion in the area and cheap ocean transport (Dixon 1991:217–26). Moreover, US assistance in rebuilding Japan after the Second World War and US economic assistance and military spending in the region during and after the Korean War and the Vietnam War boosted investment in export industries. Japanese industry provisioned US troops in Korea, but when Korea started building its industrial conglomerates, US troops in Vietnam required goods and services to sustain the war effort. The geographical proximity facilitated capital flows as Japanese manufacturers started moving their labour-intensive factories to take advantage of lower wages in the region. Investment flowed from Japan and later from Korea, Taiwan and Singapore to Indonesia, Malaysia and Thailand. Quantitative import restrictions on Japanese products in the USA and Europe created opportunities for other Asian economies to enter foreign markets and develop their fast-growing industries in a wide variety of sectors (garments, shoes, electronics, automobiles, pharmaceuticals, shipbuilding, steel, chemicals) (Cumings 1984:1–40).

Governmental policies were extremely important. Korea encouraged heavy chemical and steel industries by offering financial incentives. Japan promoted the development of several industrial branches and organized cartels facilitating the exit of weaker firms. Taiwan used public investment. Capital markets were not free in these three economies and interest rates were repressed and credit directed to strategic sectors. Governments fostered markets and economic growth by setting prices and distorting incentives in order to accelerate growth. Government activism did not aim at guiding resource allocations by anything other than market mechanisms, but public agencies and industry associations collaborated when gathering and disseminating information on technology and quality standards for exports. Preferential access to credit and foreign exchange have been attractive rewards, while rules were centred on economic performance and understood as an imperative to export.

The entrepôt economies of Singapore and Hong Kong have been outward-looking from the very beginning and several factors have contributed to their initial success. Neither of these city-states had been confronted with landed elites or the modernization problem of agriculture, but both cities are ruled by strong executives. Singapore's economic policy has been highly interventionist, while Hong Kong has remained extremely liberal. Singapore has relied on foreign investment, while Hong Kong's economy was boosted by Chinese Nationalist manufacturers who had left Shanghai. In the case of Singapore, ISI was not a viable strategy and, as in South Korea and Taiwan, Singapore launched institutional reforms preceding a policy of export-led growth. The central policy institution was the Economic Development Board. But external shocks, the withdrawal of the British, and trade conflicts with Malaysia drove the government into the direction of stateguided industrialization and authoritarianism. On the other hand Hong Kong inherited a relatively developed manufacturing sector from China and a developed commercial and banking sector. Because of its special colonial status, the government could maintain its independence (So and May 1993:61–80) from local pressure groups (Haggard 1990:100–25, 151–7). Hong Kong enjoys a worldwide reputation as a producer and exporter of manufactured consumer goods (textiles, clothing, watches and clocks, electronic products, plastic products). It has developed shipbuilding, ship repair and aircraft engineering industries and about 80 per cent of its manufactured products are exported. Manufacturing lost its predominant position in employment in the 1980s, because manufacturers took advantage of China's open-door policy to shift labour-intensive jobs into China (*Hong Kong* 1994:88–91). Hong Kong's Industry Department encourages manufacturers to upgrade their operations and monitors the availability of land and trained manpower, while the Hong Kong Industrial Technology Centre Corporation facilitates the promotion of technological innovation. Given the open nature of its economy, Hong Kong has always been a staunch supporter of free trade and never has been adept at export-pushing activities.

## SOUTH KOREA'S ELI SUCCESS

Unlike other East Asian economies evolving from protectionism and inward-looking trade regimes towards relatively open economies, South Korea had no opportunity other than export-led development. Today, its performance may be described as a success built on forced economic growth and the result of a systematic policy of importing raw materials and intermediate goods for processing and exporting finished and semifinished products with added value.

South Korea's export-led growth was pushed by governmental measures and prepared by direct investment in infrastructures. Although Korea was not a very low-developed economy before the Second World War, after the Korean War (1950–3), with the whole country destroyed and the partitioning of the country (that had severed economic links between the industrialized north and the agricultural south), South Korea had to rely on American aid to overcome its underdevelopment (Kim and Roemer 1979:21–39).

South Korea's economic development passed through three stages. In the 1950s the south restored its transportation and communication networks and completed a land reform programme. The economy was at that moment dependent on large inflows of American aid, which financed about three-quarters of total imports between 1953 and 1960. Multiple exchange rates kept the Korean currency substantially overvalued and discouraged exports. High tariffs and quantitative import restrictions encouraged a Latin American style ISI, but growth in per capita output remained rather low, because the Syngman Rhee regime failed to mobilize domestic savings for industrial investment (Schwartz 1989:240). Declining US aid and US pressure for economic reforms acted in conjunction with institutional and political reforms, which were initiated after 1961 when a military regime under Park Chung-Hee was established and technocrats in the newly restructured policy-making apparatus acquired more scope than before. Growing imbalances necessitated a reform of the exchange rate and implied a reform of the export-promotion policies when the US suspended in 1962 all aid in an effort to bring the spending deficit and income imbalances down and to alleviate inflationary pressures (Haggard 1990:51–75). For instance, over the period 1955–60, South Korea experienced an average yearly inflation rate of 16 per cent that would be considered high by all but Latin American standards (Kim and Roemer 1979:71).

Under President Park Chung-Hee, export promotion was combined with import protection and the government maintained a firm control over trade, exchange, industrial policy and finances. Export-oriented firms were supported with multiple exchange rates, direct cash payments, permission to retain foreign exchange earnings to import commodities, and permission to borrow in foreign currencies. Exporters were exempted from import controls and tariff exemptions were given to direct and indirect exporters. The state-controlled banking system earmarked loans for specific activities or industrial branches, and government directives designated export performance as the criterion of creditworthiness. The level of protection was high in industries without strong export prospects and low in internationally competitive industries. The interest rate reform of 1965 can be singled out as one of the most important reforms, because it stimulated private saving and tended to reallocate investment towards more efficient use. Successive devaluations, adjustments in tariffs and subsidies, and domestic price rises maintained a constant incentive to export. The exchange regime favoured production for export over production for the home market. So it is hard to resist 'the conclusion that this was a key factor in Korea's successful growth' (Kim and Roemer 1979:75).

In addition to effective exchange-rate distortions and tax concessions for exporters, the government extended special temporary tax privileges to key industries (Bahl *et al.* 1986:216–22). The degree of foreign capital infusion into the economy was important. The fact that the US and Japan accounted for 57.9 per cent of the US$8.9 billion that flowed in between 1959 and 1975 is immediately striking. The US provided 38.5 per cent of all commercial loans in this period and Japan was responsible for 65.5 per cent of all direct investment (McCormack 1978:94).

When the take-off stage (1961–73) was terminated, the government shifted away from neutral incentives to a commitment to use all its resources when altering the industrial structure. Six strategic industries (steel, petrochemicals, nonferrous metals, shipbuilding, electronics and machinery) received the attention of the government. The government adopted the first three sectors in order to create self-import capital equipment instead of acquiring technology sufficiency in raw-materials-processing technology. The latter three were adopted to develop technology-intensive export sectors. The government gave conditional incentives to encourage private investors to participate in officially backed projects. Unlike other developing countries who tried to build up a large heavy-industrial sector, South Korea was rather successful, because from the outset the government stressed that these industries had to become internationally competitive and that they needed imported technology and foreign-trained engineers. A major concern was to prepare for a reduced military presence and to upgrade the industrial structure and to maintain export successfully in the face of increased competition in light manufactures (OECD 1994:18–19; Winters 1994:419–52).

Despite a decade of unprecedented economic growth, bottlenecks emerged. After the second oil shock (1979), South Korea's development had come to a standstill. Increased protection for heavy industries, particularly machinery, had reversed the earlier trend towards reducing import licensing and rising aggregate rates of effective protection that had introduced a significant anti-export bias. Inflation soared and exports faltered. The government had to curtail support for strategic industries; credit allocations were curbed; the currency was devalued; and the government recognized that a greater role for the market was needed (Chang 1992–3:41–53). Indicative planning was translated into a wider range of financial and import-liberalizing measures leading to more competition, a restructuring of distressed industries, and support for new technologies. Only limited reforms were introduced to liberalize the financial markets and, finally, after 1989 South Korea reformed its financial sector and tried to promote a more balanced and less forced export-led growth. The commercial banks were privatized and the impact of the regulated interest rates reduced (Bedeski 1994:85–89). Selective industrial promotion laws were abolished and replaced by an industrial development law pressing for rationalization of ailing industrial branches (like shipbuilding and overseas contracting). All these economic reforms went hand in hand with political and social liberalization measures, while trade barriers were reduced (Hwang 1993:77–83).

The second five-year tariff reduction phase, announced in 1989, promised to reduce tariff rates on manufactured imports to Organization for Economic Cooperation and Development (OECD) levels, while non-tariff barriers would be lowered. Controls on current-account transactions were removed in 1988 when South Korea accepted the IMF obligations, but restrictions on FDI remained important (OECD 1994:45–57).

After the inauguration of President Kim Young Sam in February 1993, a new five-year economic plan was adopted for the period 1993 to 1997, acknowledging that a further reduction of state interference in economic affairs had become necessary. Financial market reforms were announced intending to promote the autonomy of the financial institutions and the opening up of South Korea's financial market. South Korea prepared for OECD membership and promised to give more emphasis to environmental protection, social welfare and housing programmes.

Two competing interpretations concerning the impact of South Korea's economic policies have come to the fore. On the one hand, the neoclassical approach stresses the importance of liberal incentives and it attributes South Korea's success to its high investment and savings rates, its wise fiscal policy, its investment in human capital, its upgrading of its industrial output, and its relatively high degree of openness to world-market influences. But on the other hand, the 'revisionist theory' argues that governmental interventions have accelerated economic growth and improved competitiveness by deliberately distorting prices and giving incentives which resulted in acquiring comparative advantages. For instance, the government promoted heavy and chemical industries and altered the very structure of the South Korean economy by successfully promoting infant industries. Later on, new industries (such as electronics) were developed under less tight governmental control when heavy industry had lost a good deal of its international competitiveness (Haggard and Moon 1983:131–89; Mardon 1990:111–28).

Rapid economic growth also owed much to imported technology and low labour costs. As the gap between the technology of Korean firms and their competitors abroad narrowed, their expenditure on Research and Development (R&D) increased, while government expenditure in this field was maintained constant. A favourable tax environment aided firms after 1989 to write off their R&D expenditures more rapidly than physical assets. Because firms preferred buying imported machinery instead of acquiring foreign technology, liberalization of technology import also led to a rapid increase in royalty payments from about US$100 million a year before 1989 to over US$1 billion by 1990. Major sources of growth were the rapid increase of factor inputs, i.e. capital and labour. Between 1963 and 1990 total factor productivity increased at an annual average rate of 2.4 per cent and labour input at 3.2 per cent, while annual GDP growth rate attained

8.76 per cent per annum. Massive migration from agricultural areas to the cities caused a rapid decline of the share of agriculture in the labour force to one-third by 1980 (OECD 1994:72–86).

Export success explains rapid economic development. By 1960 exports were insignificant and foreign aid provided foreign exchange, but between 1961 and 1973 the export volume increased at an annual rate of 35 per cent and grew from less than 1 per cent to 24 per cent of GDP. Although export growth moderated after 1973, South Korea's share in world trade continued to rise. Until 1980 frequent devaluations preserved international competitiveness and after 1980 the exchange rate was permitted to float. Initially, exports mainly comprised raw materials and agrarian and fishery products, but the share of manufactures in total exports increased from 12 per cent to 95 per cent during the last thirty years. The composition of manufactures shifted from labour-intensive products to more advanced products (electronic goods, automobiles, machinery). The US remained the most important export market, while Japan remained until recently the major supplier of imports. But in 1992, Asian countries (excluding Japan) had become the first export and import market, reflecting the growing importance of China and other Asian countries in the region.

## TAIWAN, MALAYSIA, INDONESIA AND THAILAND

Just like South Korea's development scheme, Taiwan's development policy consisted of five stages. When in 1949 the Nationalist government was installed in Taipei, one of the first measures was an ambitious land reform fostering increased agricultural production and raw materials for exports in order to earn foreign exchange to pay off imports of machinery and intermediary products, which enabled the authorities to shift from an economy based on agriculture (yet in 1955 exports were 90 per cent agricultural, mainly sugar and rice) to export-led industrialization. During the second stage (1952–7) the government attempted to develop industry as the base for economic self-sufficiency, while US aid enabled heavy investment in infrastructures and power networks built by the Japanese (Hwang 1991:11–44).

The domestic market was protected by high tariff rates and quantitative restrictions, while the government subsidized investment in light industries and consumer goods industries (textiles, bicycles, leather, apparel and wood products). Industrial output doubled, but the costs of import-substituting industrialization were high and created a growing trade deficit which the US had to finance. The small domestic market (Lorot and Schwob 1986:37) became rapidly saturated, causing a slowdown of overall economic growth in a period the US wanted to terminate their aid. In 1958 the government started a programme of measures aimed at promoting export-led growth and foreign investment. So tariffs and import restrictions were gradually reduced in order to lower costs of the export-oriented industries. The Bank of Taiwan offered low-interest loans to exporters and the government started export-promotion activities. Low labour costs and direct foreign investment played a catalytic role and replaced US foreign aid as the main source of development in manufacturing. The government promoted investment in petrochemicals, plastics, home appliances, synthetic fibres, consumer electronics, watches and clocks, which facilitated output diversification and skill transfers from one sector to another. By 1980 Taiwan was the fourth largest producer of synthetic fibres in the world. Many upstream industrial projects were carried out by the state, especially in the petrochemical sector, basic metals (steel, aluminium), shipbuilding and nuclear power. Even the privately owned automobile industry was initially under close government supervision. The government was very successful in enlisting the help of American and Japanese multinationals (Haggard 1990:76–99).

The transition from ISI to Export-Led Industrialization (ELI) had a dramatic impact on economic growth. Exports, which had grown less than 12 per cent annually in the period 1953–62, grew 28 per cent a year in the period 1963–72, rising from US$123 million to US$3 billion. In 1953 Taiwan had a per capita income below the Mediterranean countries, well below any Latin American country, but by 1982 this had reached US$500, substantially higher than Brazil and Mexico and on a par with Portugal, Argentina and Chile (Wade 1988:30).

Taiwan's economy was transformed from a relatively closed and protected one to an open economic system exposed to foreign competition. However, internal and external challenges threatened the successful continuation of export-led growth because other low-wage countries attracted capital and promised higher profits, and, when the mainland Chinese market was opened up, foreign capital lost confidence in Taiwan. The oil shock of 1973 had a dramatic repercussion for the Taiwanese economy and provoked high inflation rates (47 per cent in 1974), while exports crumbled down by about 7 per cent. The government shifted its development policy from light industries to heavy industries and launched a public-sector investment project costing US$8 billion (Hwang 1991:69–85). Highways, railroads, airports and nuclear powerplants were necessary to remove structural bottlenecks, while investment in petrochemical and heavy industries was promoted in order to facilitate production of intermediates and raw materials for export industries. Even during the era of ELI growth, the government promoted more skill- and capital-intensive industries. ELI and a second-stage ISI went hand in hand, because rapid success in new sectors was eased by the very existence of a basic productive sector.

After 1981 Taiwan entered into the era of high-technology industries (information, biotechnology, electronics, precision instruments). This shift to a high-technology economy was fostered by tax incentives and venture capital at a time when other Asian countries were trying to undercut Taiwan, whose wages had risen. Taiwan started recruiting technical manpower from abroad by offering higher wages and assisted its industry with tax advantages when diversifying and improving production techniques. After 1985 the government launched an investment project aimed at modernizing telecommunications and transportation networks. Soon economic liberalization measures, including the lifting of foreign exchange control, were adopted in order to attract foreign capital in the sector of sophisticated and higher value-added manufacturing, where small-scale firms are still predominant. The aim was to change the country's comparative advantage in anticipation of changing market conditions (Chung-in Moon 1994:142–66; Hwang 1991:87–111).

According to the generally accepted view, Taiwan's economic miracle is due to a thoroughgoing application of the theorems of neoclassical economics: labour-intensive manufactured exports grew rapidly because labour costs were kept low. Meanwhile labour-intensive export growth generated a home market and rapid gains in employment. As demand pulled up labour costs and as labour-intensive exports encountered protectionist barriers, so the economy's comparative advantage waned away and obliged the entrepreneurs to shift towards more capital- and technology-intensive activities (Haggard 1990:143–4). But the Taiwan case also shows that the state has played a major role in the domestic economy and that the government has sought to change the composition of exports, to shift upwards into 'hightech' products as well as to create a solid base of heavy and chemical industries. The government removed the anti-export bias and promoted certain industries and specific export products. The government identified certain key sectors as being of strategic importance for the country's economic growth. The government reduced Taiwan's vulnerability to foreign (Japanese) suppliers and generated a higher value-added, more incomeelastic and more closely interlinked set of productive activities. Prices and profits were not left to the vagaries of the market; nor were long-term investment plans abandoned in the face of short-term fluctuations in the market.

The state promoted investment in key industries in order to capture economies of scale and favour productivity gains and high-performance products. Non-strategic sectors were more or less ignored and the pricesetting of domestic producers was disciplined by quantitative import restrictions. One may summarize that the neoclassical view is not completely wrong but 'misleadingly incomplete, as though cutting paper were to be explained in terms only of one blade of the scissors' (Wade 1988:59). Indeed, the major changes in the economy have been instigated by the government: the agrarian reform, the shift from ISI towards ELI, state guidance of investment and export promotion, financial liberalization, the choice of leading industries (Wade 1988:45). Unlike in South Korea, however, there was no 'big push', but the very reason for this resides in differences in political structure and culture. In Taiwan a sharper division of labour existed between the political and economic bureaucracy than was the case in South Korea (Haggard 1990:140–3; Hwang 1991:45–67; Amsden 1985:78–106; Amsden 1989).

The development trajectory of Malaysia, Thailand and Indonesia was quite different from that of South Korea and Taiwan, because of the existence of an important commodity-exporting sector dating back from the colonial period.

After independence, Malaysia continued economic policies of the former British colonial government, although the government protected its importcompeting industries. During the 1950s Malaysia's exports of tin and natural rubber accounted for a third of GDP. As in other developing countries, the government promoted import substitution in order to reduce imports of consumer goods. Processing of natural resources had to create industrial employment. None the less, the Malaysian government did not promote individual sectors and average rates of protection were rather low compared with its neighbours. But ethnic conflicts between Malayans, Indians and Chinese obliged the Malayan ruling class to launch the New Economic Policy (NEP). Exports shifted from rubber, timber, palm oil, petroleum and tin to light manufactures (textiles, footwear and garments) by promoting tax reductions for export-related industrial investment and export-credit policies. Free-trade zones and duty-free imports of raw materials destined for the export-manufacturing sector boosted foreign investment, particularly from Japan and the Four Tigers. Finally, the crisis of 1986 obliged the government to move away from state-led industrialization and to opt for more selectivity and export promotion (Zainuddin 1993:79–90; Bowie 1994:167–94).

After independence in 1949 the Indonesian government relied on nationalism in order to unite the nation. A complex system of import and investment licences and anti-Chinese sentiments were the ingredients of Indonesia's economic policy aiming at direct economic control of production and trade. Dutch enterprises were nationalized and the state took over all economic activities, including the import monopolies. The economic crisis and macroeconomic imbalances caused social violence and set the stage for political change. In 1965 the military led by Suharto took over power and adopted a more favourable stance to foreign capital (see Chapter 3 on Indonesia). The outward-oriented new regime under General Suharto returned nationalized enterprises to previous owners and large devaluations restored competitivity.

An export-led drive in manufacturing was the result of these policy changes and, in addition, during the 1970s the oil boom gave the government the opportunity to intensify its export-led growth policy and modernize its infrastructures. Economic growth averaged 8 per cent through the 1970s and early 1980s and conservative borrowing abroad kept debt-service payments low. Because the government invested in capital-intensive sectors such as oil-refining, chemicals, pulp, cement and steel, the state-dominated sector grew and a gradual appreciation of the exchange rate eroded the competitiveness of the non-oil exporting sector.

The end of the oil boom in the mid-1980s obliged the Suharto regime to implement a broadly based adjustment programme designed to maintain macroeconomic and fiscal and monetary stability. The current-account deficit and inflation were brought down, causing a slower growth as a result of weak domestic demand. By 1985 the government instituted import controls and favoured import substitution. By 1986 the government was obliged to shift to export-oriented deregulations and the major exporters were given duty-free access to imports and permitted the private sector to invest in telecommunications, electric power stations and harbour facilities. Economic growth accelerated again (after 1986 GDP grew on average 9.3 per cent annually) and although textiles and plywood remained important export items, other manufactures (electronics, shoes) acquired more importance.

Thailand was known as an exporter of primary and agricultural products and its initial economic policy consisted of state control, export-taxing and a multiple exchange rate. Thailand established import protection, but overall levels of effective protection to industry were rather modest. In the 1970s Thailand embarked on a policy of ISI with heavy taxation on imported consumer goods and low duty on entering capital and intermediary goods. This favoured investment in textiles, pharmaceuticals and automobile manufacturing. But after 1981 economic policy shifted in the direction of export-led growth while reducing export taxes. The exchange rate was devalued, although effective protection remained higher than in the East Asian countries.

Thailand's experience with foreign investment shows how openness towards foreign investment and export orientation can contribute to a dynamic export-push strategy. The Thai government adopted in the 1960s a favourable stance to direct foreign investment and its Board of Investment made the country attractive to foreign capital. But in the meantime the Thai government protected the domestic market in order to promote importsubstituting industrialization. Dependence on imported machinery and inputs put a heavy constraint on the balance of payments, which obliged the Board of Investment to shift its policy to an export strategy and invite foreign investors to sustain its export-pushing strategy. By 1983 the Board of Investment facilitated export-oriented investment, permitted majority foreign ownership of export-oriented firms, and solicited foreign firms for export-oriented investment. Export-oriented firms received full tax exemptions on imported machinery, equipment and raw materials; they also received refunds on all taxes paid in the process of export production. So, between 1980 and 1988, direct foreign investment more than tripled. More than half of Thailand's exports are manufactures (electrical appliances, machinery, transportation parts, chemicals) produced by foreign-owned companies or joint ventures (Rock 1994:18–37; Alamgir 1994:67–80).

The military was the most powerful political force during the 1950s and 1960s, but with the adoption of a modern bureaucratic system and a modern business class, new forces began to be more visible in the 1970s and 1980s. A zero-sum struggle between the military and democratic forces continued in the 1970s and 1980s under General Prem Tinsulanonda. With the unprecedented economic growth in the 1980s and the emergence of a business class, the military had to democratize the regime in 1988, but in February 1991 the generals overthrew the parliamentary regime. Popular protest forced the King to intervene and the September 1992 elections brought the Democratic Party with Chuan Leekpai as Prime Minister in power (Maisrikrod 1992:26–49; Case 1993:183–205; Nicro 1993:167–82).

## EXPLAINING THE ASIAN MIRACLE

In all Asian countries the ELI trajectory began with a primary productexport phase that gave way to an ISI phase, followed by an ELI phase. Each phase had economic policies associated with the economic structure. In contrast to the Latin American countries, the Asian NICs started exporting consumer goods and meanwhile they deepened their industrial capacities by shifting to ELI policies, while the growing external pressure acted in conjunction with institutional and political changes at the domestic level (Chowdhuri and Islam 1993:42–56). Using greater state autonomy, the Asian regimes could concentrate on ELI policies, but their Latin American counterparts failed to do so. Although since the first United Nations Conference on Trade and Development (UNCTAD) in 1964 and the Generalized System of Preferences (GSP), the developing countries have stressed trade rather than aid as a mean of increasing their collective share of the world's wealth, the tariff barriers which they faced in the industrialized world resembled a pyramid: from zero or very low tariffs on traditional commodities, moderate tariffs on semiprocessed goods (oil, timber), and high tariffs on nontraditional, labour-intensive manufactures.

In order to increase their share of value added, the developing countries proposed that the developed countries would grant preferential treatment to manufactured exports originating from the developing economies. Since the developed countries could not work out an agreement encompassing all markets and all manufactured products, each individual industrialized country constructed preferential tariff schemes. The US based eligibility for its preferential system on political as well as economic criteria. Accordingly, Indonesia, as a member of the Organization of Petroleum Exporting Countries (OPEC), was ineligible, but on the other hand the Philippines were allowed to export in 1977 duty-free goods worth US$77 million to the American market (Pringle 1980:141).

Although the Asian NICs faced significant trade barriers throughout their development, they succeeded in circumventing them by using a flexible bargaining strategy to maximize their room for manoeuvre and to increase their export revenues (Glover 1993:171–200). But in the case of South Korea this manoeuvring room was rather limited, because by 1970 about 46 per cent of its exports were going to the US and 20 per cent to Japan, while dependence on Japanese imports was extremely large. Moreover, all small exporting economies experience shocks during times of turbulence more dramatically than large developed economies (Chowdhury and Islam 1993:193–214).

While participating in the New International Economic Order (NIEO) agenda and the Tokyo and Uruguay Rounds, the NICs found themselves in an ambiguous position. Their high levels of trade gave them an interest both in tariff reductions and in strengthening those provisions that would protect them against arbitrariness. So they used to play the role of the 'principled liberals' although they benefited from preferential treatment. The growing importance of exceptionalist arrangements (the Multifibre Agreement (MFA) and the Lomé Treaties) has meant that bilateral bargaining strategies assume equal if not greater importance than multilateral arrangements.

When South Korea and Taiwan began their rapid rise, several favourable circumstances also enhanced their efforts. The comparative advantage of these lower-income countries without natural resource endowments created opportunities to export manufactures to the rich North American and Western European markets in a period when Japanese exports were discriminated against by the European Community and the American government. Because South Korea and Taiwan benefited from this situation and because they had no natural resources to cause a 'Dutch disease' effect on the exchange rate and wages, they had to rely on ELI policies.

Two key elements can help to explain how the Asian NIC could realize their 'miracle'. First, they all could rely on a 'strong state'. Second, governmental policies were able to develop export-pushed industrialization and attract FDI as long as comparative advantages prevailed (Haggard and Cheng 1987:84–135; Lorot and Schwob 1986:103–18; Haggard and Cheng 1987:210–37; Chowdhury and Islam 1993:107–25).

The very model of the Asian NICs is Japan. From the beginning Japan has sought to protect its infant industries and, in order to meet these goals, the Japanese Ministry of International Trade and Industry (MITI) focused on four major areas: creating infrastructures for all industries, restructuring individual industries, allocating resources among the industrial sectors, and helping small and medium-sized firms. Special attention was paid to coal and steel, because the economy was suffering from productive capacity shortages. During the 1950s Japan fostered strategic sectors like shipbuilding, electric power, synthetic fibres, fertilizers, petrochemicals, electronics and machine tools. MITI organized mergers and coordinated specialization of small firms and launched a comprehensive energy programme. In the early 1970s Japan was already integrated into the international economic system and started liberalizing import quota, tariffs and capital controls. MITI stressed objectives other than quantitative economic growth and shifted to more functional incentives, while the government sharpened environmental legislation. But Japan's successful export strategy also stirred protests from the USA and Europe, and conflicts with its major trade partners inspired the government to control and limit exports (Matthews and Ravenhill 1994:42–58).

The interpretation is that the Asian NICs enjoyed a powerful and centralized state, enabling them to implement a succesful programme of industrialization. For instance, South Korea as well as Taiwan experienced a state-led, export-oriented industrialization in the 1960s and 1970s. In the case of South Korea, the strong state operated as a major initiator of new investment, a discipliner of labour (Deyo 1989:51–151), and a distorter of prices. None the less, industrialization was also fostered by a convergence of economic interests among elites in Japan, Korea, Taiwan and the United States which necessitated an ongoing interpenetration and mutual transformation between the domestic structures and international capital (Deyo 1989:42–50; Lee 1993:351–67; Hawes and Liu 1993:629–60).

Although the role of the strong state as a key factor shaping the political economy and explaining its outcomes is widely recognized by many scholars and was considered as a decisive momentum in a successful process of industrialization, foreign influences were of equal importance for the shaping of a successful industrialization strategy. During Japanese occupation of Korea the strong colonial state had created an industrial infrastructure with a new proletariat. During 1930–45 Korea's mining and manufacturing sectors had expanded significantly, especially the heavy and chemical industries owned and operated by Japanese. Commercial and industrial activities were regulated under the Decree of 1910 and required anyone establishing a business firm or foreign subsidiary to obtain a licence from the Japanese authorities. The colonial government introduced a modern system of landownership and taxation, absorbed all land with an unclear title of ownership, and won the cooperation of the noble class by providing legal guarantees for the traditional tenant system (Kim and Roemer 1979:2–20). In fact, the Japanese had destroyed the Korean feudal landlords in an attempt to transform the Korean people into Japanese. After the Second World War and the Korean War, a Korean national bourgeoisie had to be created by the Korean military with the help of American policies (Cumings 1984:1–40).

The situation of Taiwan was perhaps different, but as a frontline state of the Cold War the Chiang Kai-shek regime had no choice other than to industrialize the island-in order to survive politically (Lorot and Schwob 1986:94). US assistance was available and anticommunism facilitated the controlling tasks of the strong state when disciplining all classes and factions. The ruling Chinese Nationalists avoided any form of populism. In South Korea agrarian reforms created an electoral bulwark of rural voters supporting the ruling party. South Korea followed the Japanese industrialization model favouring in a first phase light industries (textiles) before switching to heavy industries (steel, chemicals, automobiles) and then, in a third phase, penetrating into high-tech sectors, before attaining the phase of self-sustained economic development.

Already in the mid-1960s in Taiwan and South Korea free export zones had been established. Furthermore a 'pilot organization' bolstered macroeconomic planning. During this period US pressure on both countries was considerable and US guidelines stressed the necessity of self-sustained growth combined with privatization and reduction of foreign aid. In the case of Taiwan, the military and the bureaucrats opposed a reduction of defence spending and an industrialization programme was carried out via cartelization of key sectors (textiles, paper, iron and steel, rubber, cement) and FDI in the export zones. South Korea and Taiwan were integrated into a triangular relationship with the US, Japan and the peripheral states of Asia (Crone 1993:501–25). In the case of South Korea, the anti-Japanese and unpopular regime of President Syngman Rhee had to be replaced by a more pro-Japanese junta led by General Park Chung-Hee. The expansion of the US war effort in Indo-China constituted an important economic incentive for the economies of the region, while US aid to Taiwan and South Korea remained huge and Japan started to relocate its polluting heavy industries (steel, oil refining, shipbuilding, petrochemicals), to Taiwan and South Korea (Gills 1993:203–22).

All Asian NICs engaged in industrial activities that were in line with comparative advantage settings concentrated their efforts on labour-intensive export production while importing more capital-intensive goods from countries where labour was scarcer and capital more abundant. But in the case of South Korea it is also true that capital-intensive industries producing intermediates experienced higher growth rates than the manufacturing average (Wade 1992:297). Most of these industries benefited from substantial levels of protection and they could rely on a skilled labour force. A hypothesis to put forward is that South Korea's ELI (including the dualtrack promotion of some capital-intensive intermediate branches alongside labour-intensive manufactures and intermediates for export markets) did not depart from a comparative advantage strategy to any significant strategy (Wade 1992:298). Furthermore, South Korea excelled by learning by producing at low costs, although it had to face difficulties in many heavy and chemical industries in the late 1970s and early 1980s.

The export push in these sectors caused inflationary pressures and budgetary deficits combined with balance-of-payments difficulties, which necessitated a stabilization package, which caused deflation and lower returns.

But South Korea's economy soon would recover from the slump, which may have been due to economic liberalization measures and a maturation of its heavy and chemical industries. Much of the capital used for South Korean development came from foreign loans and once South Korea was able to demonstrate progress, and foreign investors gained confidence, foreign capital poured in. All loans went directly or indirectly to the Korean government, which channelled capital at heavily subsidized interest rates to selected industries. A rapidly rising savings rate, second behind Taiwan, led to rapid domestic capital formation. Many of the industries in which South Korea enjoyed national competitive advantage drew on substantial local demand (shipping, construction, steel, cement). As many Japanese companies moved upmarket while the yen appreciated and trade barriers were erected against Japanese products, these segments of international markets were opened to Taiwanese and Korean firms.

In semiconductors nearly all Asian NICs have made progress because standard memory chips demand by local producers of consumer electronics increased. But in contrast to Taiwan and Hong Kong, South Korea was more willing to invest in international marketing and in technology, which was vital to upgrade and sustain competitive advantage for large companies (chaebol) such as Hyundai, Daewoo, Samsung, and Lucky-Goldstar (Porter 1990:453–79).

*Table 2.1* GNP level of some Asian economies (1992)

| | *GNP per capita in US$* | *GNP growth* | | *Distribution of GDP in %* | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | *1970–80* | *1980–92* | *1970* | *1992* | *1970* | *1992* | *1970* | *1992* | *1970* | *1992* |
| | | | | *Agriculture* | | *Industry* | | *Manufacturing* | | *Services* | |
| Japan | 28,190 | 4.3 | 4.1 | 6 | 2 | 47 | 42 | 36 | 26 | 47 | 56 |
| Singapore | 15,730 | 8.3 | 6.7 | 2 | 0 | 30 | 38 | 20 | 28 | 68 | 62 |
| Hong Kong | 15,300 | 9.2 | 6.7 | 2 | 0 | 36 | 23 | 29 | 16 | 62 | 77 |
| South Korea | 6,790 | 9.6 | 9.4 | 26 | 8 | 29 | 45 | 21 | 26 | 45 | 45 |
| Malaysia | 2,790 | 7.9 | 5.9 | 29 | – | 25 | – | 12 | – | 46 | – |
| Thailand | 1,840 | 7.1 | 8.2 | 26 | 12 | 25 | 39 | 16 | 28 | 49 | 49 |
| Philippines | 770 | 6.0 | 1.2 | 30 | 22 | 32 | 33 | 25 | 24 | 39 | 45 |
| Indonesia | 670 | 7.2 | 5.7 | 45 | 19 | 19 | 40 | 10 | 21 | 36 | 40 |
| China | 470 | – | 9.1 | – | 27 | – | 34 | – | – | – | 38 |
| Pakistan | 420 | 4.9 | 6.1 | 37 | 27 | 22 | 27 | 16 | 18 | 41 | 46 |
| India | 310 | 3.4 | 5.2 | 45 | 32 | 22 | 20 | 14 | 12 | 37 | 37 |
| Bangladesh | 220 | 2.3 | 4.2 | 55 | 34 | 9 | 17 | 6 | 9 | 37 | 49 |

Source: World Development Report 1994

Although the Asian NICs and Japan have expanded through high rates of efficiency growth, the era of unlimited growth seems to have come to an end now that Japan's economy is experiencing a painful restructuring. Moreover, Japan's GDP growth slowed down between 1980 and 1992 to 4 per cent per annum (see Table 2.1). The economic problems Japan was facing in 1992–4 were relatively serious, and the recession was the first time the economy had actually contracted for two consecutive quarters since 1974. The collapse of the stock and real estate markets—a large accumulation of bad debts was held by the major banks—implied a period of financial restructuring after a period of 'bubble economies' in the late 1980s and was accompanied by financial scandals shaking the corrupt ruling Liberal Democratic Party.

The Asian NICs have taken over the lead from Japan. Because their economic success was primarily input-driven, the capital piling up demonstrates that they soon may experience diminishing returns on additional investment. They have already become, just like Japan (Lincoln 1993:160–200), significant exporters of capital to the lower-waged economies of Asia because of their increasing wage standards. Today, they still pay wages well below advanced-country levels, but in the meantime they are losing much of their comparative advantage when extending their welfare programmes and their internal markets.

Within the context of the new international division of labour, the export-oriented economies of East Asia managed to attract foreign capital to invest in industries, while the strong state kept wages low. With the ongoing internationalization of the economy (Kwan 1994:140–8), liberalization and investment in high-tech industries became a necessity, while mounting pressures for at least formal democratization challenged during the second half of the 1980s the authoritarian state. Both South Korea and Taiwan democratized their regimes when deciding to become more 'open economies' and major exporters of capital in the region, especially to mainland China and the export-pushing economies of Indonesia, Thailand and Malaysia.

## CONCLUSIONS

The succesful East Asian economies have experienced much more rapid growth and success than most other developing countries and have achieved macroeconomic stability by keeping fiscal deficits within the limits of prudent financing and by rapidly correcting their macroeconomic imbalances that emerged when the international economic situation changed. Rapid export growth was achieved by developing highly competitive export industries and adopting macroeconomic stability as a major goal when intervening in their economies. Assistance to exporting industries varied over time and included preferential tariffs, public financing, export promotion, tax incentives, subsidized infrastructures, and foreign investment incentives. Some governments favoured traditional exports, but others promoted export-industrialization because their economies had to import their raw materials. All countries shifted from ISI to an export push and facilitated access for exporters to imports at world prices and to long- and short-term financing. Governments facilitated export-led growth by assisting firms in penetrating foreign markets and imposing flexibility.

Although the Asian NICs have achieved rapid economic growth, popular enthusiasm about Asia's booming economy deserves to be criticized, because this achievement was reached in large part through an astonishing mobilization of resources and nowadays their growth may run into diminishing returns (Krugman 1994:62–93). The effectiveness of the Asian NICs depends on sophisticated industrial policies and selective protectionism, but, because of the extremely diverse institutions and policies of the Asian NICs, a common 'Asian system' cannot be denominated. None the less, many people believe that there exists some kind of 'Asian system' that engendered the 'Asian Miracle' and that some kind of common denominator underlies the Asian success story.

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# 3

# ECONOMIC TRANSFORMATION AND LIBERALIZATION IN INDONESIA

*Batara Simatupang*

Indonesia's economic success is largely due to the oil boom (1973–81) that helped sustain the high economic growth of the 1970s and the promotion of import-substituting industries. The economy and state revenues were highly dependent on oil and the economy was increasingly subjected to a multitude of controls and restrictions. Starting from 1982, the international oil prices dropped and economic growth slowed down during the period 1982–8. Fiscal deficit and deficit in current account rose sharply, whilst the rupiah exchange rate was overvalued. With the decline in oil-related export earnings, the government realized the danger of an inward-looking development strategy and the need for a fundamental change in the incentive and regulatory framework to open the economy and to sustain economic growth. From 1985 the government implemented a series of reforms in trade and in foreign investment licensing by reducing substantially the level of import tariffs and the non-tariff barriers and by liberalizing foreign trade investment. Since 1988 economic growth has been restored and a reduction in the number of people below the poverty line has been realized.

## RAPID ECONOMIC GROWTH

Indonesia is the world's fourth most populous (179.2 million in 1990) country, after China, India and the United States of America. It is endowed with rich and varied natural resources and a favourable tropical climate as well. According to the World Bank study, Indonesia belongs to the group of eight high-performing Asian economies.

After the devastations due to the Japanese wartime occupation and the Indonesian struggle for independence, output expanded since the early 1950s. It has been estimated that Gross Domestic Product (GDP) increased between 1951 and 1959 by 4.1 per cent per annum. Sukarno's Guided Economy, actually an economic *dirigisme* which aimed to develop import-substitution industrialization, and which was accompanied by external military campaigns, led to an economic mess with high inflation, widespread shortages, disinvestment and low utilization of productive capacity. This resulted in a low and unsteady growth of GDP of only 2.0 per cent per annum in 1960–6, i.e. less than the annual rate of population growth. The standard of living fell, and it has been estimated that per capita real income in 1966 was 3.6 per cent below the 1958 level (Glassburner 1971:427).

During the New Order's rule between 1967 and 1993, Indonesia's GDP growth was nearly 6.5 per cent per annum with income per capita growing at a rate of about 4.3 per cent per annum. In 1968, Indonesia was one of the poorest countries in the world with income per capita, according to a number of guesses, probably not higher than US$200. By 1992 per capita income had reached US$650, which according to World Bank's criteria still belonged to the low-income group. Assuming that in the future high growth is sustained, Indonesia will quite soon join the ranks of middle-income economies.

Throughout the period of President Kemura A.Suharto's rule, economic performance and the factors underlying growth for each subperiod varied significantly. This section will describe briefly economic performance and the characteristics of growth at various subperiods: the subperiod of economic stabilization and rehabilitation (1967–72); the oil boom period (1973–81); the post oil boom adjustments (1982–8); and the non-oil export-led growth since 1988.

President Suharto's programme of economic stabilization and rehabilitation (1967–72), supported by a rising growth of investment, foreign trade liberalization (Pitt 1991:114–33) and the fight against fiscal deficits and hyperinflation contributed to rapid economic recovery. Gross domestic investment as percentage of GDP increased fast from 8 per cent in 1967 to 19 per cent in 1972, of which nearly one-half was financed by foreign savings (foreign aid, foreign direct investment) (Gillis 1984:252; see Table 3.1). Indonesia obtained a long-term moratorium on its debt. Most probably part of the capital parked abroad during the uncertain period of Sukarno's Guided Democracy was repatriated afterwards to Indonesia, thus boosting imports and private domestic savings.

The incremental capital output ratio (ICOR) during the rehabilitation period was low, reflecting high productivity of investment (see Table 3.2). Investment outlays for the rehabilitation of physical infrastructure which had fallen into utter neglect during Sukarno's Guided Democracy produced high and quick returns. Capital repairs, greater supply and availability of industrial raw materials, fuel and spare parts, which were made possible by larger flow of foreign exchange and imports, enabled higher utilization of existing plants. Supported by measures of economic liberalization and the rising growth of investment, and combined with a low ICOR, GDP increased by 7.2 per cent per annum in 1967–72 (see Table 3.1).

*Table 3.1* Indonesia: savings, investment rates and GDP growth (1960–92)

| *Period* | *National savings rate (% of GDP)* | *Domestic investment rate (% of GDP)* | *Real GDP growth (%)* |
|---|---|---|---|
| 1960–66 | 4.7 | 7.9 | 2.0 |
| 1967–72 | 6.6 | 12.8 | 7.2 |
| 1973–81 | 22.8 | 22.3 | 7.7 |
| 1982–88 | 20.8 | 25.1 | 3.6 |
| 1989–93 | 23.9 | 26.3 | 6.9 |

Source: *Wing Thye Woo* et al. *(1994): 120; Central Bureau of Statistics and World Bank Staff*

*Table 3.2* Indonesia: aggregate efficiency indicators (1973–88)

| | *1967–73* | *1973–81* | *1982–85* | *1985–87* | *1988–91* |
|---|---|---|---|---|---|
| A. Rate of return on investment (% p.a.)[1] | 53.4 | 31.4 | 13.1 | 26.0 | 17.0 |
| B. Incremental Capital Output Ratio (ICOR) | 1.8 | 2.8 | 7.8 | 5.3 | 3.7 |
| C. Total factor productivity (TFP) Change | 7.8 | 8.0 | 4.0 | 5.9 | 7.5 |
| Growth rate of: | | | | | |
| Value added[2] | | | | | |
| Factor inputs: | | | | | |
| – Labour | 2.8 | 3.0 | 2.8 | 7.3 | 2.1 |
| – Capital[3] | 7.6 | 10.7 | 6.8 | 6.8 | 8.4 |
| *Total Factor Productivity*[4] | 2.1 | 0.8 | −2.5 | −1.1 | 2.2 |

Key:
1 Rate of growth of non-oil GDP as a percentage of average investment rate during the period.
2 Using non-oil GDP.
3 Capital change is derived by using the 'perpetual inventory method'.
4 TFP change is calculated as the difference between rate of growth of value-added and factor inputs (labour and capital; the inputs are weighted by their income shares).
Source: *World Bank staff estimates, reproduced in Bhattacharya and Pangestu (1993)*

The oil boom (1973–81) helped to sustain the high growth in the 1970s. The Arab countries' oil embargo of October 1973 led to quadrupled world oil prices and Indonesia, as a net oil-exporting country, benefited considerably from the rapid increase of world oil prices. Unlike the brief commodity boom prices (1950–1) during the Korean War, the oil boom lasted for a relatively long time. The size of the oil windfalls was estimated at 15.9 per cent of non-mining GDP in 1974–8 and 22.7 per cent in 1979–81, which was comparable to those other oil-exporting developing countries. But on per capita basis, oil exports in 1979 were only US$62 in Indonesia, as compared to an unweighted average of US$438 in four oil-exporting developing countries (Algeria, Equador, Nigeria and Venezuela). Most of the oil windfalls accrued to the government. As a result the share of total revenue estimates as percentage of the non-mining GDP rose from 15.6

per cent in 1970–2 to 30.9 per cent in 1979–81 (Gelb 1988: tables 4–1, 5–2, 5–3 and 5–4).

With the oil windfalls, the economic options of the Indonesian government widened considerably and the traditional growth constraints such as foreign exchange, domestic savings and investment were relaxed substantially. The impacts of the oil windfalls on economic growth depended on their uses. A large part of the oil windfalls was used to expand expenditure on public development and state administration. Part of the windfall was used to bail out the state oil company Pertamina, with its large external debt, when it failed to roll over its short-term financial obligations in 1975. The rapid increase in government expenditure was used to sustain and to reinforce the investment priorities adopted during the stabilization and rehabilitation period. The agriculture sector (food security, subsidies for fertilizers and pesticides, intensification of high-yielding and pest-resistant rice varieties), rural infrastructure (rehabilitation and expansion of roads and irrigations), and the development of agriculture-related industries (fertilizers, cement industries, etc.) continued to receive investment priorities during the oil boom period. Rapid rural development, where the overwhelming majority of the population lived, helped to enhance political stability and to avoid excessive urbanization. Agriculture, particularly food crops (rice) production, increased rapidly.

Despite growing overvaluation of the rupiah exchange rate up until 1978, Indonesia succeeded in avoiding the so-called 'Dutch disease' by developing rapidly non-oil sectors of production and expanding non-oil exports (Glassburner 1988). Aside from agriculture, import-substitution industries, funded by the oil windfalls, expanded strongly. Gross domestic investment as a percentage of GDP rose from an average of 13 per cent between 1967 and 1972 to 22 per cent between 1973 and 1981. The national savings rate rose rapidly (see Table 3.1). The high growth in employment and investment formed the main sources of economic growth. It has been estimated that about 40 per cent and 50 per cent of the total growth of GDP between 1973 and 1981 was attributable to growth in employment and investment (at base period technology) respectively. Only marginally was economic growth in 1973–81 attributable to an increase in labour productivity due to technical progress (Sundrum 1986:40–69). The oil boom resulted in a growth of GDP by 7.7 per cent per annum in 1973–81, which was half a percentage point higher than the growth during the rehabilitation period (1967–72).

Average growth of GDP slowed down substantially to 3.6 per cent per annum during the post oil-boom adjustment period (1982–8) compared with 7.7 per cent per annum in 1973–81. An explanation for the fall in growth rate in terms of the fall in world oil prices which reduced government revenue and expenditures (investment and consumption) is only part of the story. The government made large external borrowing and also drew on foreign exchange reserves to supplement the drastic fall in oil revenue in order to maintain a high level of imports and investment in 1982–3. GDP declined by 0.3 per cent in 1982, the lowest growth ever achieved during the period of 1967–92, partly owing to OPEC's (Organization of Petroleum Exporting Countries) decisions concerning oil quota restriction and also owing to the fall in agricultural output growth due to bad weather (Booth 1992a:20).

Average gross domestic investment as a share of GDP in 1982–8 was over 25 per cent i.e. about 3 percentage points higher than during the oil boom period (1973–81). On the other hand the incremental capital output ratio (ICOR) jumped sharply in 1982–7, reflecting a decline in investment efficiency (Sundrum 1988:47, see also Table 3.2). Greater allocation of investment funds to manufacturing sectors having higher capital intensity, and sheltering behind high tariff and non-tariff protection, contributed to the decline in investment efficiency, which was most probably one of the causes of a fall in the growth rate (Booth 1992a:22–3). The sharp fall in the external terms of trade led to a drastic decline in government revenues and expenditures (sharp decline in capital expenditures and consumption), which caused a sharp decline in domestic aggregate demand and a further fall in growth. Moreover, the post oil-boom adjustments led to unemployment growth in the urban sector, underutilization of production capacity, and a three year freeze of nominal salaries of public employees, which contributed to a further fall in effective demand and growth.

*Table 3.3* Structural change in Indonesia, 1965–90

| | *1965* | *1970* | *1980* | *1990* |
|---|---|---|---|---|
| *As % of GDP* | | | | |
| Openness | | | | |
| Total Trade | 14.0 | 22.2 | 46.8 | 54.7 |
| Non-oil Exports | 4.0 | 7.0 | 11.5 | 15.7 |
| Imports | 7.5 | 10.6 | 15.5 | 26.3 |
| Gross Domestic Investment | 8.0 | 10.8 | 18.7 | 24.6 |
| Gross National Savings | 7.9 | 9.5 | 32.8 | 24.6 |
| Sectoral Shares | | | | |
| Agriculture | 55.0 | 47.5 | 24.3 | 19.4 |
| Manufacturing | 8.5 | 10.9 | 13.4 | 19.4 |
| Other Industry | 6.5 | 8.9 | 29.7 | 22.1 |
| Services, etc. | 30.0 | 32.7 | 32.1 | 39.1 |
| External Debt | 50.0 | 32.5 | 30.0 | 66.6 |
| *As % of Exports* | | | | |
| Oil LNG Exports | 40.0 | 40.5 | 78.5 | 44.8 |
| Debt Service | 11.0 | 6.0 | 13.9 | 27.3 |
| *Memo*: Private Investment as % of total | – | – | 51.0 | 64.7 |

Source: *Central Bureau of Statistics (BPS) and World Bank Staff Estimates, reproduced in Bhattacharya and Pangestu, 1993*

A non-oil, export-led expansion since 1988 restored high economic growth to almost 7 per cent per annum in 1989–93. The investment rate was stepped up, accompanied by a significant improvement in the efficiency of investment (see Table 3.2). Broad-based, non-oil (mainly manufacturing) and export-oriented growth, supported by trade deregulation (reduction of tariffs, dismantlement of non-tariff barriers and system of government permits), in combination with devaluations (1983 and 1986) and financial and fiscal reforms, have offered strong incentives for rapid expansion of ouput and non-oil exports. Non-oil exports increased from US$12.1 billion in 1988–9 to US$28.9 billion in 1993–4, of which manufacturing exports increased from US$3.7 to US$17.6 billion. Increased internal and external competition contributed to more efficient allocation of resources, leading to increased productivity of capital and labour.

Along with the long-run rapid growth of GDP, its sectoral composition changed considerably. The share of agriculture in GDP declined sharply, falling from 55.0 per cent in 1965 to 47.5 per cent in 1970 and declining further to 19.4 per cent in 1990. The share of manufacturing in GDP increased steadily from 8.5 per cent in 1965 to 10.9 per cent in 1970 and 19.4 per cent in 1990. The economy-wide structural changes were visible in many other sectors. The economy has become more open and is being integrated into the world economy, with total trade flows as a percentage of GDP rising sharply from 14 per cent in 1965 to 22.2 per cent in 1970 and 54.7 per cent in 1990.

Extremely important was the rapidly growing capacity of the economy to mobilize national savings, which was reflected in the rise of national savings as a percentage of GDP from 7.9 per cent in 1965 to 26.3 per cent in 1990. The excessively high dependency of exports and government revenue on oil was considerably reduced; the exports and revenue base has become broader and more diversified. The trend of the gross investment as a percentage of GDP was rising. The role of the private sector was growing, following the deregulation of the economy, whilst the state sector was contracting. Private investment as a percentage of total investment in the 1980s was growing significantly (see Table 3.2); whilst the share of state enterprises' manufacturing in total manufacturing value-added has been estimated by the World Bank to have fallen from 20 per cent in 1985 to 15 per cent in 1990.

## MACROECONOMIC MANAGEMENT

Suppression of the regional rebellion (1957–8), followed by the West Irian campaign (1958–62) and the 'crushing Malaysia' campaign (1963–6), led to rapidly rising military expenditures, which contributed substantially to growing budget deficits. They were aggravated by the sharply dwindling volume of foreign trade (exports fell due to overvaluation of the rupiah and the fall of production), which was the main tax base for government revenue. As a result, total central government taxes as share of GDP dropped sharply from 13.2 per cent in 1961 to between 3.9 and 5.4 per cent in 1962–6 (Gillis 1984:237). Because of the absence of money and capital markets, budget deficits were financed by money printing and central bank credits. Under such a situation one could observe a close correlation between the growth of the money supply and price rises. Whilst in 1953–9 average annual inflation was only 25 per cent, it accelerated to between 128 and 160 per cent per annum in 1962–4; soared to 596 per cent in 1965; and to 636 per cent in 1966 (Wing Thye Woo and Nasution 1989:33–8.). The rupiah was heavily overvalued, causing export and foreign exchange reserves to drop sharply. Smuggling became highly profitable and was practised widely.

The new government under General Suharto, advised by a small group of young Indonesian economists trained in the United States and the International Monetary Fund (IMF), designed and announced a stabilization and rehabilitation programme in October 1966. The immediate and top priorities were to reduce the budget deficits, to curb inflation and to decontrol foreign trade. On the expenditure side, outlays for showcase projects were stopped and subsidies to state-owned enterprises were reduced. The trade liberalization since 1966 helped to raise the trade volume, tax receipts and government revenues considerably (Pitt 1991:118–19). The government resorted to foreign assistance and loans to bolster revenues. It has been estimated that in 1966–9, foreign aid comprised 28 per cent of government spending. Due to intensive tax collection, by 1969 the share of government revenue in GPD had nearly doubled.

Since 1967 the government pledged to adhere to the 'balanced budget' principle; meaning that government expenditure was to be limited by domestic revenue and external loans/grants. This was a commitment to put an end to money printing and domestic loans (credits) to finance deficits. The elimination of budget deficits financed by money creation led to a drastic deceleration of growth in the money supply, leading to a fall of inflation from 636 per cent in 1966 to not higher than 10 per cent per annum in 1969–71. Furthermore the monetary authorities set nominal interest rates on time deposits at a high level, so that real interest rates became positive, varying between 10.4 and 35.7 per cent in 1969–72 (Cole and Slade 1992:85). As a result, time deposits and savings increased, which helped to suppress inflationary pressures. Starting from 1967, the inherited complex system of multiple exchange rates was simplified, accompanied by a series of devaluations. In April 1970, the exchange rate was unified and the rupiah was pegged to the US dollar. Since 1970 foreign exchange transactions, including capital account, have been free of restrictions, although the foreign exchange position was still uncertain at that time. (Contrary to the conventional wisdom, Indonesia has adhered to the principle of free capital movement since 1970. It has been argued that because of the vicinity of Indonesia and Singapore as a major financial and trade centre and with the wide formal and informal international networks of Indonesian businessmen of Chinese origin, the government could not exert effective control on capital movement anyway.) Maintenance of free capital account movement means that the foreign exchange rate and domestic interest rates need to be adjusted regularly to a realistic and internationally competitive levels to avoid capital flight and to stimulate exports.

Two basic macroeconomic rules, a 'balanced budget' and steady foreign exchange adjustments (devaluations) have been accepted by Suharto's government; and they serve as instrument of macroeconomic discipline. Although the Indonesian government did not fully adhere to these basic macroeconomic rules, especially during the oil boom period, they have been, however, reasonably observed for the rest of the period of President Suharto's rule. Studies based on experiences of developing countries have indicated that countries that have maintained long-run macroeconomic stability and market-friendly approaches are more likely to achieve high growth rates (*World Development Report* 1991; *The East Asian Miracle* 1993). A coordination of and a choice of the right mix of macroeconomic policies (fiscal, monetary and financial, management of the exchange rate and external debt), with the aim of maintaining macroeconomic stability and growth, are the main objectives of macroeconomic management.

## Fiscal policy

During the 1970s the oil windfalls filled the government revenues generously, making for a high revenue dependency on oil. Oil revenue as a share of central government revenue increased from 26 per cent in 1969–70 to peak at 71 per cent in 1981–2. With the drastic fall in oil prices since 1982 and the danger associated with the narrow tax base, fiscal policy had to change. Due to the sharp fall in oil revenue, the fiscal deficit (according to the IMF definition) reached nearly 5 per cent of GDP in 1982–3 compared to 1.3 per cent in 1981–2 and the fiscal surplus in 1979–81. The new fiscal policy had to reduce the fiscal deficit, through cutting expenditures (demand) and mobilize domestic resources through widening the tax base. Many large, capital-intensive projects were postponed or fully abandoned in 1983. Moreover the government introduced large cuts in real capital spending from 1983 and imposed restraint on investment spending at state-owned enterprises. The deficit as percentage of GDP was nearly halved in the years 1983–5.

Far-reaching tax reform was implemented in 1984–6 in order to boost non-oil tax revenues and to improve the tax system. As a result of these measures, total non-oil taxes as a percentage of non-oil GDP rose from 8.3

per cent in 1983 to 11.5 per cent in 1988–9. With the second oil shock, the fiscal deficit increased again to about 5 per cent of the GDP in 1986–7, requiring further cuts in current and capital spending. The required fiscal austerity by this time was more stringent compared to previous ones, due to heavy constraints imposed by the higher level and burden of servicing external debt. As a result of the expenditure cuts, the share of public expenditure (investment and consumption) fell from 22.4 per cent of GDP in 1981 to 18 per cent in 1988. Thanks to prudent fiscal policies, the government succeeded in maintaining low and manageable fiscal deficits in 1989–93.

### Monetary and financial policies

As was noted earlier, the acceptance of the 'balanced budget' rule has excluded the use of money creation and domestic credits to finance the budget deficit. Money supply was affected by changes in the foreign asset position of the central bank. During the oil boom, government revenues and foreign exchange reserves increased rapidly. With the rapid increase of government spending and money supply, inflationary pressures built up rapidly. Inflation increased from 5.4 per cent per annum in 1971–2 to 27.6 per cent per annum in 1973–6. To control the increase in money supply originating from the monetization of oil revenue denominated in US dollars, the central bank set up credit ceilings (by means of administrative methods) for individual banks, accompanied by an extensive selective credit system (a sort of credit rationing) in accordance with priorities determined by the government and with loans being charged at subsidized, low-interest rates. Moreover the central bank channelled directly a substantial amount of low-interest credits (liquidity credits) to priority sectors (Wing Thye Woo and Nasution 1989:83–91).

With the fall in oil prices in 1982–3, the financial reforms initiated in June 1983 allowed state banks to set interest rates freely on deposits and loans. This reduced substantially the volume of subsidized central bank's credits (the so-called liquidity credits) and abolished the administratively determined credit ceilings. Furthermore the monetary authorities developed open-market instruments to regulate the money supply. The immediate effects of the financial reform were a rapid increase of interest rates on bank deposits, and a sharp growth of time and savings deposits. During the highly regulated financial system in the oil boom period, real interest rates were negative. Over the long term, to avoid capital flight, domestic interest rates should be linked to international interest rates plus a premium depending on expectations of rupiah devaluation.

Further financial reforms in 1988–9 promoted competition by allowing easy entry into the banking sector and an improvement in the working of money and capital markets. The number of new banks exploded rapidly, breaking the monopoly position of the state banks. Deregulations in the capital market led to rapid growth in the number of companies listed and the capitalization value of assets traded. Monetary and financial policies in the 1980s, in combination with fiscal austerity, competitive exchange rates and prudent debt management helped to contain inflationary pressures and to prevent capital flight, mobilize financial resources, and improve the efficiency of financial resources. Due to mismanagement and widespread corruption of the managerial staffs, the volume of bad loans at the state banks was growing rapidly. With a loosening of monetary policies and rapidly growing investment demand in 1989 and early 1990, the economy became overheated in 1990–2. This indicates the small margins available for a vigorous anti-cyclical policy in an open economy like Indonesia. The government responded promptly by tightening monetary policy (a cut in credits and a rise in interest rates) to help restore macroeconomic balance (Ahmed 1993).

## Exchange rate management

A number of researchers dealing with the Indonesian economy have recognized that foreign exchange management is not only an instrument for the management of external balances (current balances, debt management), but also ‘an extremely potent policy instrument that can effect large scale, economy wide resource allocation and income distribution’. They considered that the experience of foreign exchange management under President Suharto’s government, in combination with prudent fiscal and monetary policies, has been successful in stimulating exports, restraining imports and to keeping debt at manageable levels (Wing Thye Woo and Nasution 1989:21; Warr 1992; Gillis and Dapice 1988; Wing Thye Woo *et al.* 1994). A series of devaluations were undertaken during the last three years of the 1960s in order to preserve Indonesian export competitiveness under conditions of high domestic inflation. In 1971, the government decided to devalue the rupiah by 10 per cent in response to the deterioration of the current account deficit.

From August 1971 to October 1978, the exchange rate remained fixed at 415 rupiah/dollar for a record of seven years. The oil boom made both the balance of payment and the exchange reserves strong, despite the surge in imports and the Pertamina crisis. The exchange rate was kept fixed despite high inflation between 1973 and 1976. The overvaluation of the rupiah led to a profit squeeze in the tradeable sectors. Despite strong balance of payments and international reserves, the government decided to devalue the rupiah by 34 per cent in November 1978. The 1978 devaluation was interpreted as the use of the exchange rate to protect the tradeable sector, i.e. to promote non-oil exports. The 1978 devaluation was widely considered as successful, despite the rise in inflation in 1979–

80. Non-oil exports were more competitive and rose sharply in 1979, and manufacturing output increased rapidly whereas import growth was restrained.

The international price of oil began to fall in 1982 and coincided with a sharp fall in the prices of other export commodities. The balance of payments deteriorated sharply, reaching a record in current account deficit of 7.7 per cent of the Gross National Product (GNP) in 1982–3. The balance of payments worsened further in the first quarter of 1983. Imports continued to grow without an export recovery, while capital flight was accelerating. In March 1983 the rupiah was devalued by 28 per cent, combined with deep cuts in budget spending. The combined measures succeeded in reducing non-oil imports substantially, boosting manufacturing output, and to a less extent raising non-oil exports. Prudent fiscal and monetary policies kept domestic inflation under control, so that the real effective exchange rate remained stable over the following two years. Current account deficits fell to a manageable level of an average of 2.4 per cent of the GNP in 1983–5.

As a result of the second oil price shock, oil earnings fell sharply and the deficit on the current account rose to a new height of 6 per cent of the GNP in 1986. In September 1986 the rupiah was devalued by 31 per cent. This occurred in combination with prudent fiscal and monetary policy, thereby keeping inflation under control, so that Indonesia could improve and maintain its export competitiveness. In combination with a package of trade deregulation in 1986–8, non-oil exports grew rapidly and imports were restrained; hence the deficits on current account were reduced to manageable levels. Whereas the 1983 devaluation was mainly intended to reduce the deficits on current account, the 1986 devaluation primarily aimed to improve competitiveness of non-oil economy (Bhattacharya and Pangestu 1993:15). Since 1978, Indonesia has maintained a managed float (pegged to a basket of currencies) regime, but it was only actively applied from 1986. This gradual depreciation of the rupiah has contributed to the rapid growth of non-oil exports.

## External debt management

As noted above, the inflow of foreign resources to finance government expenditures during the early period of President Suharto's government was large. In the 1970s, thanks to the oil windfalls, the ratio of foreign borrowing to government expenditure fell steadily from 27 per cent in 1969–70 to 17 per cent in 1979–80; whilst the ratio of foreign borrowing to GDP rose slightly from 2.9 per cent in 1970–74 to 4.5 per cent in 1975–9. Due to an improvement in Indonesia's creditworthiness and an oversupply of loanable capital, it increasingly borrowed money from the international capital market in the 1970s. Despite the sixfold increase in debt between 1970 and 1980, the debt/export ratio fell from 206 per cent to 67 per cent, and the debt/

GNP ratio fell from 27 per cent to 22 per cent (Wing Thye Woo and Nasution 1989:117–19). The Pertamina debt crisis in 1975 resulted in a strict government control on state-owned enterprises' foreign borrowing; state agencies' external borrowing would be administered and coordinated by the Ministry of Finance and the Central Bank; moreover the government should eschew short-term loans. By 1980 the debt service ratio was low, only 14 per cent.

The total stock of debt increased more than threefold from US$20.9 billion in 1980 to US$67.0 in 1990 and rose further to US$84.4 billion in 1992. It is estimated that by 1993, total debt exceeded US$90 billion, of which about 45 per cent is private and over 20 per cent short-term loans. Nearly US$25 billion of rollovers are needed each year. The increase was caused by a rise in borrowing to finance public and private capital spending and a depreciation of the US dollar against the yen and other currencies. (According to the World Bank's estimate, the depreciation of the US dollar against the yen and other currencies added US$12.6 billion (31 per cent) to Indonesia's public debt between 1985 and 1988.) From the 1980s, the debt burden grew sharply. With the drastic fall in oil prices, Indonesia's capacity to service the growing debt fell. The debt service ratio rose from 14 per cent in 1980 to 29 per cent in 1985, and it rose further to 40.2 per cent in 1988. Thanks to the rapid growth in non-oil exports, the debt service ratio was pushed downwards to 31 per cent and 33 per cent between 1990 and 1992 (*World Debt Tables* 1993–4, vol. 2:210; *Indonesia: Stability, Growth and Equity* 1994). In 1989–90 private borrowing rose and as economic growth picked up a number of potentially large, capital-intensive projects have reemerged. The government established in 1991 the Commercial Offshore Loan Team (COLT) to scrutinize borrowing by public and private enterprises, set up borrowing ceilings, priorities, etc. Other debt indicators showed a certain worsening. For instance, the share of short-term debt to total debt was growing, whilst the share of concessional loans to total debt was falling. Despite high growth and progress in economic diversification, Indonesia remains vulnerable to external shocks.

## TRADE AND REGULATORY POLICIES

The major liberalization move in 1966–71 was followed by increasing industrial protection. After the devaluation in 1971 the list of prohibited imports began to expand, covering the import of a wide range of durable consumer goods and varieties of textiles. Manufacturing protection increased between 1971 and 1978 (Pitt 1991:156–8), consisting of high tariffs and a wide range of non-tariff barriers (NTBs).

During the early 1980s, Indonesia's trade regime became increasingly oriented towards protection of domestic production and against imports. Supported by the oil boom, the government industrial policy was geared more towards encouraging 'upstream' industries such as cement, fertilizer, synthetic fibres and iron/steel. Some of these industries required protection higher than that provided by the high tariffs, particularly when recession (low industrial utilization) hit the economy. Under pressure from the producers, the government issued in late 1982 and early 1983 a series of decrees which dramatically increased the number of products requiring an 'approved importer' licence. (The 'approved importer' system restricted the right to import such goods to designated producers or traders. The actual degree of restriction depended on the type of licence category under which the good was classified, and whether a formal quota or import ban was in effect.) It is estimated that by mid-1986 over 1,700 items (about a third of total items imported) were covered by some form of restrictive licence. These items accounted for about 40 per cent of the total value of imports and of production.

The private sector in the 1970s and the 1980s was increasingly subjected to a multitude of controls: a restrictive investment and production capacity licensing system, limiting entry; an extensive control of foreign investment; a multitude of provincial and local regulations; and cumbersome land and labour laws. The growing importance of non-tariff barriers (NTBs), coupled with the prevailing high-import tariff providing high protection to domestic production, in combination with a multitude of domestic controls and regulations, fostered the development of high-cost and inefficient industries (Wardhana 1989:207–17).

The complex relationship between macro and micro rules in Indonesia could be described generally as being inconsistent until 1987. On one hand, the macro rules that define the broad parameters (exchange rate, interest rate, prices of basic products like rice, energy) under which economic activities take place had been more or less liberalized. On the other hand the micro sphere was saddled with micro *dirigisme* and .bureaucratic overregulation which stifled initiative, competition and efficiency; furthermore it encouraged monopoly, corruption and rent-seeking behaviour. The discrepancy between the macro and micro spheres was particularly disturbing during the ambivalent period of 1982–5, when on one hand macro policies began to be liberalized and on the other hand trade and industrial policies became more protectionist (Pangestu 1989:222–3). With the decline in oil-related export earnings, beginning from the early 1980s (according to the IMF and the World Bank estimates, Indonesia's loss of income due to sharply deteriorating terms of trade, mainly because of the drastic fall in oil prices, amounted to some 8–9 per cent of the GNP yearly during 1983–8), the government realized the danger of an inward-looking development strategy and the need for a fundamental change in the incentive and regulatory framework to open up the economy to world markets and to sustain economic growth (*Indonesia. Strategy for Growth* 1989:4; Bhattacharya and Pangestu 1993:9).

The government responded by implementing far-reaching reforms in the trade regime and industrial policy. In March 1985 the tariff system was rationalized; the tariff ceiling was lowered from 225 per cent to 60 per cent, and most tariffs ranged from 5 to 35 per cent. The number of tariff levels was also reduced from 25 to 11. In April 1985 the government placed the politically sensitive job of certifying imports in the hands of a private Swiss surveying company, Société Générale de Surveillance (SGS), and reorganized port and shipping operations. As a result, the average time spent on customs procedures was cut by several weeks and the cost of freight forwarding for exports and imports fell substantially.

In 1986–7 the government decreed further important reforms in trade policy and investment licensing. In May 1986, the government announced a package of measures that allowed producer exporters the option of importing their inputs, bypassing the approved importers and free from import duty. Moreover a duty drawback facility was created to enable exporters to reclaim import duties. Providing internationally priced inputs to exporters' production was one way to cut costs in the high-cost Indonesian economy. In October 1986, January 1987 and December 1987, the government announced further trade reform packages, focusing on the removal of import-licensing restrictions and reducing the anti-export bias. The basic idea was to move away from a trade regime that was dependent on NTBs to one based on tariffs.

Since 1985, a series of steps has been taken by the government to streamline the investment approval process and to relax licensing. The number of licence requirements was reduced and the role of the Investment Coordinating Board (BKPM) as a 'one-stop' service for foreign investors was strengthened. Further steps to simplify the investment licensing system were taken in 1987: expansion of the list of sectors open to foreign and private investors that were previously closed; allowance to expand investments and operations up to 30 per cent of their licensed capacity without any investment approval; and firms' freedom to change product lines within the broad band product categories. An important improvement in investment licensing occurred in 1989, when the government moved to a short list of sectors of industries closed to foreign and domestic investment (in 1993 thirty-three sectors were included in the negative investment list) from the previous policy of a short list of industries open to investment. The new principle encourages entry and competition.

The government has instituted, since the 1970s, a number of local content programmes for a range of products, mostly in the metal and engineering subsectors. In 1986–7 the government relaxed the deletion programmes: it lengthened the timetables for achieving the local content target for several products like diesel and gasoline engines, commercial vehicles and tractors; and introduced flexible interpretation and implementation of local content and timetables, allowing producers to import components from any source.

Beside the general measures relaxing investment licensing, additional measures were also taken to ease foreign investment regulations. Before 1986, foreign investment or companies had to be established with a minimum of 20 per cent domestic equity, and by the end of the tenth year of commercial operation, domestic ownership had to be raised to 51 per cent. Moreover foreign companies were not allowed to engage in domestic trading (this could be undertaken only through authorized dealers); foreign companies were prohibited from borrowing from the state banks. With the May 1986 'package,' for foreign investment in priority sectors (i.e. companies which export 85 per cent of their output), the initial domestic equity requirement was reduced to 5 per cent; the validity of investment licences was extended to thirty years; foreign companies were allowed access to the export credit scheme on the same basis as domestic investors; and foreign companies were allowed to act as a marketing channel for export producers.

Additional measures were taken in December 1987 to ease foreign investment regulations by further relaxing ownership requirements (the conversion period was lengthened from ten to fifteen years, with the possibility of further extension). Subsequently various measures were taken to reduce the impediment for foreign investment and the differential treatment between domestic and foreign investment has been greatly reduced; all areas that are open to domestic investment are open to foreign investment. Whereas foreign investment regulations of 1992 permitted initial 100 per cent foreign ownership for investment in Java and Sumatra with a minimum paid-in capital of US$50 million, in the October 1993 'package' the minimum capital requirement for foreign companies was reduced to US$2 million, provided they produced intermediate goods or components that could be used by other firms. The period to achieve divestiture was lengthened. The June 1994 'package' relaxed further foreign investment restrictions (no obligation to have a domestic partner; elimination of the minimum size of foreign investment requirement; opening up of nine economic sectors previously closed to foreign investment such as sea ports, production, transmission and distribution of electricity, telecommunications, shipping, etc.). Indonesia has improved its competitiveness and it hopes to attract more foreign investment with the reform package of September 1994, which lowered corporate tax rates to 10–30 per cent from 15–35 per cent. Approved foreign investment for the first 10 months of 1994 reached a record high of $23.1 billion, compared to $10.3 billion and US$8.1 billion in 1992 and 1993 respectively (*The Jakarta Post,* 4 November 1994).

Trade and regulatory reform is an ongoing process; the government has issued nearly every year a new deregulation 'package' containing a new reduction or relaxation of tariffs and NTBs. The average level of tariffs and their dispersion has fallen considerably. The (unweighted) average tariff rate fell from 37 per cent before 1985 to 20 per cent in 1991 with a dispersion of 17 percentage points. Despite big progress being made in the rationalization of tariffs, the tariff system remains complex; there is plenty of room for further improvement (i.e. reduction of maximum tariff surcharges). Since the mid-1980s, most of the major changes in trade policy implemented went through an annual 'package' which involved in the reduction of the coverage of non-tariff barriers (NTBs) on imports (import licensing). The 'packages' have reduced the share of production protected by NTBs from 41 per cent in 1986 to 22 per cent in 1992. The opening has been greatest in manufacturing, where the share of protected production has fallen from 68 per cent in 1986 to 31 per cent in 1992. The reduction of NTBs in agriculture has been less. Despite great progress in reducing the coverage of NTBs, a significant share of production is still protected by NTBs. At the sectoral level, agriculture and agro-industry, paper products and engineering, including steel and automobiles, are highly protected by NTBs. Hence the level of effective rates of protection is still considered high compared to neighbouring countries that have completed comprehensive trade liberalization (Bhattacharya and Pangestu 1993:21–2).

Manufacturing output and non-oil exports grew rapidly since 1988. For instance the export-output ratio for manufacturing has increased from 8 per cent in 1985 to 16 per cent in 1990. The prudent and sound macroeconomic policies in combination with a far-reaching deregulation in trade policies and in the regulatory framework have succeeded in bringing about a transition from a domestically oriented economy (high tariff and non-tariff protection) with a high oil dependency of government revenues and exports towards a non-oil, export-led growth economy with much less dependence on oil. Competition, market entries and efficiency seem to have improved significantly since 1988.

The evidence, however, suggests that industrial concentration and oligopoly power in Indonesia are strong. Many sectors of the economy are controlled by large business groups or conglomerates. According to one source *(Indonesia. Sustaining Development 1993),* there are 200 conglomerates (with an overwhelming domination by the top ten) having an annual average turnover of US$250 million in 1990, and a total turnover of US$50.6 billion. This constitutes about 35 per cent of the GDP. A large majority of the conglomerates is controlled by Indonesian businessmen of Chinese origin. This is a highly sensitive political issue. Indonesia's Chinese minority accounts for only 3 per cent of the total population, but holds a disproportionate share of economic power. According to a recent estimate, it controlled 70 per cent of all corporate assets (Wing Thye Woo *et al.* 1994:7). It appears that the growth of conglomerates was faster in the 1980s than in the 1960s and 1970s, and that sectors with high tariff protection are more concentrated, supported by debt financing (with a very high debt equity ratio) by the banking system. But it would, however, be incorrect to assume that economic liberalization led to a demise of small industries. H.Hill, based on the industrial census, concludes that small firms have prospered during the New Order period (Hill 1992:247–9). This general finding is also confirmed by the recent study about the effect of the financial liberalization since 1983, which concludes 'that small establishments enjoyed the greatest increase in domestic credit', accompanied by an improvement in overall economic performance (Harris *et al.* 1994:23–43).

The economic deregulation of the 1980s seems to be irreversible and the process is still going on. With the agreement over the Uruguay Round trade pact of the GATT and the recently made agreement by the six South East Asian Nations (ASEAN) to establish a common market in the year 2003, the impulse to reduce the tariff rates and NTBs, and further liberalize investment in the near future is expected to become stronger.

## ECONOMIC GROWTH, POVERTY AND EQUITY

In the 1960s the incidence of poverty in Indonesia was severe. Especially rural Java, and in particular rural Central Java, was desperately poor. Rapid rural development (rapid growth of agricultural output, improvement in the infrastructure, health service and education, etc.) in the 1970s, funded partly by oil windfalls, helped to alleviate poverty in rural areas. During the adjustment period in the 1980s, the government did try to protect the poor from the fiscal austerity cuts by maintaining the amount of transfers to the provinces and labour-intensive rural infrastructure projects and by raising the share of social services and agriculture in total government development expenditures (Ravallion *et al.* 1991:58–9).

According to World Bank estimates, based on Indonesia's National Socioeconomic Surveys (SUSENAS) data, both the absolute number and the percentage of the population living below the poverty line (Booth 1992b: 342–5) in both rural and urban areas have been falling steadily since 1971. The number of persons below the poverty line went down from 67.7 million (57.2 per cent of the total population) in 1971 to 57.8 million (39.2 per cent) in 1980 and fell further to 34.6 million (19.3 per cent) in 1990. The decline in the number of poor people in the rural areas, particularly in Java, was fast. In rural Java the number below the poverty line fell from 41.8 million (67 per cent of the rural population) in 1971 to 36.1 million (53 per cent) in 1980 and fell further to 16.3 million (24 per cent) in 1990. The decline in the number of the poor in the 1980s in both urban and rural areas outside Java was less rapid (*Indonesia. Stability Growth and Equity* 1994:112–14). The reduction in the incidence of poverty in the Outer Islands, particularly in the eastern parts of Outer Islands, was much less.

The distribution of expenditures seems to have become less unequal: the poorest 20 per cent accounted for 6.9 per cent of total expenditure in 1970, for 7.7 per cent in 1980, and 9.2 per cent in 1987. The respective values of the Gini coefficient were 0.35, 0.34 and 0.32 (Wing Thye Woo *et al.* 1994:129–30). The urban-rural disparities in consumption expenditures did, however, widen considerably in the 1970s.

Social indicators have improved considerably. Total gross enrolment in primary school as a percentage of school age population went up from 86 per cent in 1970–5 to 116 per cent in 1987–92; for females the corresponding figure went up from 78 per cent to 114 per cent. Infant mortality per thousand live births fell from 114.0 in 1970–5 to 66.0 in 1987–92, whereas life expectancy went up from 49 years to 60 during the same period. Social indicators in Indonesia are still worse than those in East Asian countries (*Social Indicators of Development* 1994:158).

The robust economic growth and the broad-based, labour-intensive economic growth pattern helped to reduce sharply the incidence of poverty. During the rehabilitation period and in the 1970s, the government placed high priority on the development of the rural sector, including agricultural sector. This led to a rapid growth of agriculture during 1971–83. Since the mid-1980s, emphasis has shifted to the development of labour-intensive manufacturing in Java, oriented towards exports. The growth in agriculture and labour-intensive manufacturing led to a rise in employment and incomes, which directly and indirectly led to a growth in the services sector. According to World Bank estimates, using the data from the population census and labour force surveys, total employment growth was fast, increasing nearly 4 per cent per annum in the 1970s and 3 per cent per annum in the 1980s. Employment growth was much faster than growth of the potential labour force, resulting in rising participation rates, from 49 per cent in 1971 to 54 per cent in 1990. Employment growth was accompanied by a rise in real wages. Agricultural wages increased on average by 2.3 per cent per annum between 1983 and 1990, and industrial wages rose by 3.4 per cent per annum (Wing Thye Woo *et al.* 1994:142). Both rapid growth of employment and the rise in real wages contributed to the reduction of poverty.

## CONCLUSION AND OUTLOOK

The stabilization and rehabilitation programme (1967–72) succeeded in stopping the inflation of over 600 per cent per annum in 1965–6 and cutting it to an average of less than 10 per cent in 1970–2. It also brought the economy on a high growth track. The oil boom sustained the high growth in the 1970s and Indonesia succeeded in avoiding the so-called Dutch Disease, by developing the tradeables sector. A drastic fall in oil prices since 1982 and a subsequent large loss of incomes led to high fiscal and current account deficits in 1982–3 and in 1986–7. The Indonesian government responded in time by implementing macroeconomic adjustments (deep cuts in government. expenditures, mobilization of domestic financial resources through reforms in the tax and financial systems, devaluations and prudent debt management) and reforms in the trade regime (cuts in tariffs and a reduction of the coverage of NTBs) and investment regulations.

The combination of a prudent macroeconomic management and reforms in trade regime and investment regulations contributed to a considerable reduction in revenue and export dependency on oil, and helped to transform the inward-oriented economy towards a non-oil, export-oriented economy. The rapid economic growth was accompanied by structural economic changes. The robust and broad-based nature of the economic growth contributed to the large reduction in the incidence of poverty in Indonesia.

The sixth five-year development plan *(Repelita VI)* covering the period 1994/5–1998/9, programmes a continuation of rapid growth with macroeconomic stability and a reduction of poverty. The plan targets GDP annual average growth of 6.2 per cent, non-oil GDP growth of 6.9 per cent and industrial GDP growth of 9.4 per cent; whereas non-oil export growth (in current US$) is planned to grow on average per year by 16.8 per cent. The GDP and non-oil export growth targets of the plan are somewhat lower than average growth over the last five years (1989–93). Assuming that the government continues the prudent macroeconomic management and keeps up the momentum of deregulation, and provided that there are no large external shocks and no major dissent among the Indonesian political elite over the president's succession in 1997–8 that lead to critical uncertainties and political turmoil, the objectives of the sixth five-year plan are realistic and feasible.

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# 4

# VIETNAM'S GRADUALIST ECONOMIC REFORMS

*David H.D.Truong and Carolyn L.Gates*

Vietnam's economic renovation programme—*Doi Moi*—may properly be viewed within the dramatic historical movement occurring in the Soviet Union and Eastern Europe in the late 1980s and early 1990s. As they shared similar political and economic institutions, interlocked trade and financial networks, and major technical and information exchange programmes, momentous events in one part of the socialist bloc necessarily affected other parts. Furthermore, the systemic and institutional legacy Vietnam inherited from its experience with socialist transformation includes a rather large number of features shared in varying degrees with other socialist or centrally planned economies (CPEs). Both were typified by inefficient resource allocation, low mobility of factors, factor price rigidity, low productivity and income levels, obsolete technology, sluggish technical progress, and slow organizational adjustment (Svejnar 1991:123–38; Gelb and Gray 1991; Schmieding 1993:216–25), all of which emanated from the economicpolitical-social logic of Soviet-style socialist development. None the less, Vietnam's transformation path has been conceptually and empirically distinct from European CPEs, due primarily to disparate initial conditions and long-term political goals. We will address these in turn.

When Vietnam began its transition to a market-oriented system, its domestic markets—which ranged from tolerated, but illegal parallel markets in both rural and urban areas, to legal or quasi-legal 'production at the margin' for the market by production teams, cooperatives and state-owned enterprises (SOEs)—had played a far larger role in the economy than was the case of a stylized CPE. The importance of Vietnamese markets was a result of economic decentralization, particularly during the Vietnam-US war; the critical need to supplement its shortage economy; the problems of integrating North and South Vietnam after 1975; and the shorter period of time in which Vietnam experienced socialist transformation. A second variation in initial conditions is the structure of Vietnam's economy. In contrast to typical European CPEs, but similar to China, Vietnam started its transformation process with a rural economy on which 80 per cent of the population was dependent. Concomitantly, high unemployment/

underemployment existed in Vietnam, which could only be absorbed through a massive transfer of labour in the traditional agricultural sector to a more productive industrial sector. Hence, while Vietnam's socialist development strategy had emphasized high-speed industrialization, in reality its industrial sector remained small by European CPE standards. Moreover, directive planning had never been pervasive, and the state sector remained comparatively small in Vietnam. Hence, Vietnam's economy, characterized by difficulties of a dual transformation involving both central planning/ management and developmental components (Andreff 1993:515–31), can be contrasted with that of the model European CPE.

A second factor that has clearly differentiated Vietnam's reform process from that of the Europeans has been Vietnam's long-term strategic objective of maintaining its political system under the dominance of the Communist Party. Although economic reform has certainly influenced Vietnam's political life, the liberalization of politics—perhaps the highest priority in many former European socialist countries—continues to be vehemently opposed by Vietnam's leadership. Similar to China's reform priorities, Vietnam's emphasis on political stability and continuation of one-party rule during its economic renovation drive has brought about its own pattern of defining, sequencing and pacing of reforms.

## GRADUALISM AND REFORMISM

A growing consensus among economists maintains that sequencing and pacing reforms are key determinants of successful transition to market systems. Within sequencing, institutional change is viewed as an ideal first phase of reform and external financial liberalization as among the last areas of adjustment. As for the speed of reform, there is greater controversy. 'Shock therapy' or the 'big bang' finds more support within the orthodox economics community than does 'gradualism'; but a growing number of economists—especially analysts of the Chinese transition—are concluding that the gradualist approach has facilitated high growth rates and reduced adjustment costs, as compared to the 'big bang'. On both counts, Vietnam has opposed orthodoxy by, for example, instituting a gradual pace of reform and liberalizing inward capital flows before establishing a domestic, market-oriented, institutional framework of property rights, commercial and company law, and legislation regulating (or deregulating) factors markets (e.g., labour, capital and land). However, in the domain of macroeconomic stabilization, Vietnam has taken a more orthodox path. Strong stabilization measures aimed at reducing inflation in 1989 followed 'shock therapy' prescriptions. They succeeded far beyond expectations: inflation fell from almost 500 per cent in late 1986 to 18 per cent in mid-1989; and by 1993, it had been stabilized at 5–6 per cent per annum, although it has been rising since. Within this structure of reform, Vietnam has made great progress in establishing institutions and policies that have reoriented its external economic environment, that have stabilized the economy, and have supported a market-based system of relative prices, which has been strengthened as the weight of the private sector and competition in the consumers' goods markets have grown.

*Table 4.1* Typical 'big bang' sequencing of reforms of European economies in transition to market systems

| *Stages* | *Reform* |
|---|---|
| 1 | Institutional Reform |
| 2 | Fiscal/Monetary Stabilization |
| 3 | Privatization |
| 4 | Trade Reform |
| 4 | Domestic Price Liberalization |
| 5 | Domestic Financial System |
| 3/4/5 | Capital Flow Liberalization |

Source: *R.Dornbush (1991) 'Strategies and Priority for Reform', in P.Marer* et al. *(eds)* The Transition to a Market Economy, *Paris, OECD: 169–83*

*Table 4.2* Vietnam's gradualist sequencing of reforms

| *Stages* | *Reform* |
|---|---|
| 1 | (Partial) Capital Flow Liberalization |
| 2/4 | Domestic Financial System |
| 2/3 | Fiscal/Monetary Stabilization |
| 4 | Domestic Price Liberalization |
| 2/4 | Trade Reform |
| 5/6 | Domestic Institutional Reform |
| 5/6 | Privatization (equitization) |

Sources: *C.L.Gates (1995) 'Foreign Direct Investment, Institutional Change and Vietnam's gradualist approach to reform',* Southeast Asian Affairs 1995, *Singapore: Institute of Southeast Asian Studies: 385; C.L.Gates* et al *(1992)* Reform of a Centrally- Managed Developing Economy: the Vietnamese Perspective, *Copenhagen: NIAS.*

Pressed by both internal and external challenges, Vietnam's leadership initiated a formal process of economic reform in early 1987. *Doi Moi,* however, was not Vietnam's first experience with reform: informal economic reform, comprising a gradual and often spontaneous, bottom-up process, can be traced back to the 1970s. During this protracted period, the objectives, institutions and mechanisms of reform, nevertheless, have substantially changed, although one pragmatic objective—making the system work—has remained a constant. In the early 1980s, reform aimed at creating a modified socialist development strategy that achieved high growth, rapid industrialization, efficiency and equity ideals. Since 1989, Vietnam's leadership has abandoned most goals, structures and mechanisms of a socialist development strategy, opting instead to utilize the market mechanism to speed up industrialization and economic growth. The altered framework of Vietnam's socio-economic goals and reform policies reflect the impact of the interplay of internal economic and political forces (e.g., recognition of the inviability of Vietnam's traditional socialist model, economic stagnation, and the problems of political consensus on and sustainability of reform (Fischer and Gelb 1991:91–105) and the ongoing changes in the international political economy (e.g., the collapse of the old socialist bloc, rapidly rising East Asian-Vietnamese trade and capital flows, normalization of relations with the US, Vietnam's membership in Association of Southeast Asian Nations, ASEAN). While Vietnam's reform process has been gradual and erratic, it has nevertheless been firmly implanted, so that a return to the old model is now impossible. What is less defined is its path of socioeconomic restructuring for the remainder of this decade. Currently, it does not appear that Vietnam's leadership has forged a strategy to establish, sequence and pace key institutional reforms to fill gaping holes in its new economic environment, something that is essential if Vietnam is to meet its basic socio-economic objectives for the year 2000.

In the following analysis, we will address this and other challenges to Vietnam's economic transformation process in the medium run by examining Vietnamese economic reform over the past fifteen years. While unexpected—discontinuous—changes in Vietnam's socio-economy have occurred during that period, we would argue that given its long-run objectives and apparent political stability, the past can provide important evidence about probable continuous economic and institutional change in Vietnam.

## Vietnam's spontaneous reform, 1981–8

Reform in Vietnam was initiated in 1981 to revitalize its traditional socialist model based on the strategic goals of rapid socialist transformation and high-speed growth centred around heavy industrialization and autarkic economic development. The first five years of this period witnessed spontaneous grassroots change and *ad hoc* official reforms which sought to restore economic growth through various incentive and decentralization measures, to strengthen the state sector by increasing its efficiency, and to utilize resources outside the state sector more effectively. While the reforms enhanced short-term static efficiency in the agricultural and cooperative sectors and spurred output in the economy, they were unable to achieve the major goal of creating a viable model for rapid socialist transformation.

By late 1986, Vietnam's Communist Party and state leadership abandoned their formal political support for the old socialist model. This position emerged concretely at the Sixth Party Congress in December 1986 when policy-makers formally-assessed the 1981–5 reforms as failures in meeting the challenges of Vietnam's fundamental economic problems. Moreover, they viewed these reforms as major contributing factors to hyperinflation—which was running at almost 500 per cent in 1986—and to the deterioration of the state's fiscal and financial positions.

The Sixth Party Congress mobilized and intensified political support for deeper reforms during the next two years. Thus, the 1987–8 period marks the beginning of the transition from patchwork measures aiming at reforming Vietnam's centrally planned economy to bolder economic reform (Andreff 1991:198–209; Bauer 1987:5–34): moving from 'tinkering' with the system to fundamental reform. But due to the leadership's preoccupation with the fight against inflation and to its uncertainty over how best to respond to growing macroeconomic imbalances, serious reform did not emerge until 1989.

## Bolder reforms since 1989

Despite the failures of reform in 1981–5 and policy indecisiveness in the 1987–8 period, Vietnam's communist and state leadership committed themselves to the implementation of bolder reforms from 1989 when three basic areas drew focus:

1 macroeconomic stabilization, decentralization and liberalization;
2 a deepening of the economy's reorientation from the goal of socialist transformation to that of creating a 'developed multisector commodity-producing economy';
3 Integration of Vietnam into the regional and international economies.

Since 1991, Vietnam's leadership has sought to create a supportive institutional framework for a market-oriented economy; and specifically, it has taken measures to bolster these three areas of stabilization and adjustment. Such efforts were encapsulated by the Seventh Party Congress of 1991, which laid out the leadership's basic political and economic orientation up to 1996 with the promulgation of the new Constitution in 1992—setting the framework for a modern and strong government—and with subsequent legislation on key socio-economic sectors. Until 1994, Vietnam's complex process of institutional change has emphasized the establishment of a basic regulatory framework for the state and the elimination of major socio-economic bottlenecks and distortions in Vietnam's economy. More recently, this process has begun to tackle comprehensive administrative reform which, notwithstanding the bureaucracies' glaring constraints in coping with Vietnam's fast-moving socio-economic developments, promises to be more sophisticated, albeit protracted.

By early 1995, Vietnam enjoyed a much improved macroeconomic environment, but financial and fiscal challenges threatening continued progress became more pressing. Other problems slowed Vietnam's reorientation to a 'multisector' economy: a protracted process of restructuring state industrial enterprises; difficulties caused by a complex interaction between the creation of new, more market-oriented institutional structures and the rationalization of old hierarchical structures; and an unwieldy and ineffective bureaucracy made worse by the slow pace of administrative reform. Furthermore, new challenges and opportunities are beginning to face Vietnam in the second half of this decade. Since the lifting of the US embargo in early 1994, Vietnam's integration into the world economy has accelerated. And that has only increased in 1995, as international lending for large infrastructure projects began to take effect; foreign interest in Vietnam expanded after the normalization of Vietnamese-US relations; and Vietnam entered into ASEAN, East Asia's fastest-growing region.

## MACROECONOMIC STABILIZATION, DECENTRALIZATION AND LIBERALIZATION

Throughout the 1980s, Vietnam's policy-makers attempted to stabilize an economy which was incurring growing fiscal, financial and trade imbalances, which along with other features of its shortage economy, resulted in repressed and open inflation. In 1989 when inflation was running in the triple digits, a radical reform programme was initiated to slash inflation. A series of policies was implemented simultaneously or in rapid sequence to attack imbalances in the macroeconomy through stabilization, decentralization and liberalization measures. These policies focused primarily on establishing discipline and transparency in Vietnam's financial and fiscal regimes and on reforming its foreign trade system to promote exports and to relieve Vietnam's current account and long-term debt positions. By 1994, stabilization and decentralization policies had visibly improved the economic environment. However, the establishment of effective financial and foreign trade policies remains problematical, particularly with the slow restructuring of the public sector.

## MONETARY REFORM AND THE EXCHANGE REGIME

Vietnam's leadership initiated two key policies in 1989 to reform the monetary system and to fight inflation: interest-rate restructuring and exchange devaluation. Interest rates were restructured in March 1989 first by unifying the official and parallel market rates; and second, official interest rates on savings were raised to positive levels for individuals and households in real terms—estimated at 100 per cent per annum in mid-1989 (Wood 1989:571). The government maintained positive interest rates in real terms until the second quarter of 1990, after which they were sharply reduced. The large rise in interest rates in 1989 attracted domestic savings, resulting in an increase of household bank deposits by 630 per cent from March 1989 to January 1990. These measures were very effective in the short term in absorbing excess liquidity, restraining aggregate demand, and thereby reducing inflation. However, they also had a strong impact on aggregate supply, stimulating the 1989 economic contraction whereby gross industrial output declined by about 3 per cent from 1988 to 1989.

The implementation of interest-rate reform was coupled with a series of currency devaluations, bringing the cross dong-dollar rate from VN dong 900/US$1 in early 1988 to VN dong 4,500/US$1 in mid-1989, narrowing the margin between the open market and official rates to an average of 12.2 per cent in 1989 and 9.4 per cent in 1990 (Fforde and de Vylder 1991: B-III– 82). Since April 1989, the official exchange rate has been tied to developments in the parallel market and to inflation indexing. Although the government has been forced to maintain a non-unified foreign exchange system to fulfil its large obligations in foreign exchange transactions, it has managed to simplify and cautiously liberalize its exchange regime. Its exchange rate management has since 1992 gradually improved, resulting in a very moderate fluctuation of the VN dong *vis-à-vis* the US dollar. The government's 1 October 1994 decision to remove the dollar from official circulation represents an important turning point in the country's monetary policy: first, towards the obvious de-dollarization of its domestic economy, and second, towards achieving greater control over imports and foreign debt payments. However, this decision could deflect the need to undertake more important tasks—primarily, to reduce the budget and trade deficits and control the growth of the money supply—which, in the long run, will determine the effectiveness of monetary and fiscal management.

The success of the government in bringing down inflation by the middle of 1989 to about 18 per cent per annum from a rate of almost 500 per cent in 1986 had a very positive effect on the leadership's commitment to and implementation of more comprehensive reform. Vietnam's success with the simultaneous implementation of interest rate, currency and price reforms and the positive results of this reform package contrasts starkly with the experiences of many other CPEs in Eastern Europe and China, whose economies have suffered severe dislocations caused by price reform and anti-inflation measures. However, Vietnam's success in controlling inflation at the low levels of late 1989 was not sustained over the next three years because of, first, the lack of political will to maintain high interest rates that slowed (or reversed) economic growth and, second, mistakes made in this reform.

But perhaps the biggest obstacle to maintaining a stable price level has been the continued bureaucratic domination of Vietnam's banking system (Le Van Tu 1992:257). In particular, large state bank loans to SOEs continue to impede financial and fiscal stability in Vietnam. While there are rational financial aspects to the banks' lending preference for SOEs—i.e., *informal* state guarantees of the loans and greater information about SOE management and financial conditions—moral hazard problems and state bureaucratic networks threaten the central government's stabilization efforts (based on interviews by the authors with top managers of banks and state and private enterprises in Hanoi and Ho Chi Minh City in 1993–4) (Le Dang Doanh 1990:10). The significant role of the SOE burden to financial stabilization is suggested by the following correlation: the abolition of the SOEs' right to acquire imported inputs at below market prices in 1991 and the cancellation of direct bank subsidies to SOEs in 1992 were direct contributing factors to reducing inflation to its lowest point, 4 per cent in 1993.

## PRICE REFORM

Price controls on most goods and services in Vietnam were abolished in March 1989. However, there remained administrative regulation of the prices of electricity, water, transport fuels, and postage and telecommunication tariffs. The elimination of the 'two-price' system was a major breakthrough in Vietnam's transition. Moreover, three months after the implementation of market prices in Vietnam, the CPI (Consumer Price Index) declined by about 3 per cent (Le Dang Doanh 1990:10). The establishment of a rationalized and realistic system of relative prices has also brought about the improvement in the overall supply/demand structure of the economy. Thus, the market price system improved relative prices for producers, goods and the terms of trade for agricultural commodities (*Vietnam. Recent Economic Developments* 1990:10–11; Fforde 1990:13) (for different reasons, the latter have deteriorated over the past few years, but are now recovering), which have in turn contributed to an increase in output and exports.

Furthermore, the introduction of market-clearing prices has hit at the heart of Vietnam's old bureaucratically managed economy by reducing the role of the state in resource allocation and virtually eliminating CPE quantitative planning. Consequently, many characteristics of Vietnam's shortage economy, which were pervasive only a few years ago, have disappeared (Kornai 1980). The price system and market adjustment mechanisms, however, are still underdeveloped in Vietnam. They display numerous distortions and non-competitive conditions, due primarily to supply bottlenecks, monopolistic structures and pricing, and an inefficient capital structure (de Vylder 1991:17–18). The reduction of distortions and the further development of the market system are essential to the decentralization of economic decision-making, which is clearly a goal of Vietnam's reform process.

## REFORM OF THE FINANCIAL SYSTEM

Since 1988, the Vietnamese government has placed a higher priority on restructuring the financial system which had changed very little since its inception in the 1950s. With international assistance, the government is seeking to restructure the entire system by reorganizing the state central bank and creating more effective commercial banks, specialized credit institutions and complementary capital markets. Since 1993, considerable efforts by the government and country donors have focused on the modernization of the banking system. The expansion of financial intermediation is now viewed as vital for the development of Vietnam's multisector, commodity-producing economy.

The thrust of financial reform has been the liberalization and decentralization of the banking system, although Vietnam's leadership also views it as a force for macroeconomic stabilization in the medium term. Vietnam's first banking reform was initiated in early 1988, laying a new commercial basis for Vietnam's banking system to be formed by a central bank, specialized commercial banks, and investment and development banks (Le Van Tu 1992:243–52). In mid-1988, four new specialized banks—the Bank for Foreign Trade, the Bank for Agricultural Development, the Bank for Industry and Commerce, and the Bank for Investment and Development—were established and assumed the various commercial banking responsibilities formerly held by the State Bank of Vietnam. Additional legislation was promulgated in May 1990 to tighten regulation of the financial system; to allow the specialized banks to operate in all sectors of the economy; and to encourage them to commercialize and diversify their operations. Subsequent regulations aimed at the development of other domestic financial institutions. By mid-1994, forty-five shareholding financial institutions (mixed state-private ownership) and less than a dozen foreign banks were operating. Vietnam also took further steps in 1993–4 towards the creation of a modern financial market structure by inaugurating markets for interbank borrowing and lending in VN dong and in foreign exchange.

Despite the attention that financial reform has received, many problems remain. A major lacuna in the system is the lack of an effective legal framework and accompanying regulatory and enforcement mechanisms. Hence, without working mechanisms to enforce reserve requirements, to collateralize loans, and to collect debt (particularly from the SOEs), these institutions cannot effectively function as banks based on commercial criteria.

Until 1989, Vietnam followed a shallow financial strategy characterized by non-price rationing of credit and sharply negative real interest rates, both of which were viewed as essential policies to provide adequate investment to the favoured sectors of economic development. Thus, SOEs were granted credit with little consideration of risk and opportunity costs. But at the same time, other sectors of the economy were 'crowded out' from investment funds. Moreover, this strategy had little success in mobilizing household and private savings to channel into either private or public investment.

After 1989, the Vietnamese adopted a deeper financial strategy by raising real interest rates and mobilizing a larger volume of savings from the domestic economy, particularly through the household and private capitalist sectors. Nevertheless, the private sector has continued to face investment shortages—at least from the formal market—due to the favoured position of the SOEs. (There is virtually no reliable data on the informal financial markets. From our field research in Vietnam, however, it appears that the private sector has easy access to this market, but lending conditions are very burdensome: nominal interest rates start at 2 per cent per month, lending is short term, and loans often must be 100 per cent collateralized loans.) Financial reform and the end of 'heavy industry first' policies have, however, made more state investment available to the non-state agri-, consumer and export goods producers. In 1990, some 60 per cent of state investment flowed into agriculture and consumer and export industries; in 1982, only 35 per cent of state investment flowed into agriculture and light industry (Le Dang Doanh 1990:5; *So Lieu Thong Ke* 1991). As a consequence of reform, domestic private investment—reaching about 30 per cent of total investment in 1990—has grown rapidly in the past few years: in 1992, it expanded by 30 per cent; and by 70.4 per cent in 1993 ('Vietnam's five-year 1996–2000 strategy' 1994).

Vietnam's rate of savings that is channelled into national investment has expanded in the past few years. In 1994, Vietnam's domestic savings ratio reached 16.2 per cent of GDP, an increase from 8 per cent in 1990; it is expected to exceed 20 per cent in 1995. Tran Duc Nguyen of the party's Central Economic Committee has estimated that Vietnam must generate a minimum domestic savings ratio of 15 per cent by the year 2000 in order to modernize (Tran Duc Nguyen 1991:39). At such a ratio, it could increase the volume and efficiency of gross investment to a level that would support a targeted minimum 5–7 per cent growth rate per annum. However, officials have recently stated that the government has revised upwards its growth objectives to 8.5–9.7 per cent per annum for the 1996–2000 period, implying that the country can mobilize growing domestic and foreign savings.

## FISCAL REFORM

The primary cause of inflation in Vietnam is its budget deficit (Le Dang Doanh 1990:12; Tran Ngoc Vinh 1990:94; Fry 1991:27–33). Vietnam's total current government expenditure in 1989 comprised 20.1 per cent of GDP (*Vietnam. Recent Economic Developments* 1990:29–31), which is not especially high when compared to other low-income countries. However, its overall deficit—which has been rising since 1986—is large, reaching about 11.5 per cent of GDP in 1989 (ibid.: 28). Due to tighter fiscal measures dealing with capital and current expenditures, Vietnam's budget deficit has since been reduced to 4.4 per cent of GDP in 1991. Since then, the deficit has grown due to looser fiscal policies, and in 1994, it was estimated to be about 7 per cent of GDP.

Since 1987, Vietnam's policy-makers have paid more attention to fiscal policy in their efforts to achieve macroeconomic stabilization, even though monetary reforms quickly slowed inflation in 1989. The issue of fiscal reform has become more urgent since 1989 due to the growing decline in transfers from the SOEs to the state and due to the fact that tax collection within the non-state sector is not keeping apace with its economic growth. Both of these factors have contributed to a growing budget deficit. Thus, fiscal instruments are being created to reduce that deficit by decreasing spending and increasing revenues. However, there are three major constraints on implementing fiscal reform: the weakness of Vietnam's state apparatus; the resistance of the bureaucracy which controls fiscal matters; and the very low social consciousness about tax responsibility (Vo Dinh Hao 1992:263–5; Phan T.T.Hang 1990:75–82).

Vietnamese fiscal reform has focused on establishing discipline in the budget and restructuring the tax structure to generate revenues. The most important instruments used to implement fiscal reform have been:

1 the establishment of restraints on government consumption through the reduction of state employment and subsidies to state enterprises and employees;
2 the introduction of a flexible tax system in 1990 (e.g., the establishment of a taxation department along with legislation governing the system);
3 since mid-1994, the adoption of tighter controls on expenditures of governmental institutions.

It is still too early to assess the effectiveness of fiscal reform. However, it can be said that even though the government has had some success in reducing state employment, state subsidies, and state finance of social welfare services, it continues to be burdened by its large financial and labour subsidies to the state sector. Direct and indirect subsidies to state employees in 1991 amounted to some US$100–120 million per year (Fforde and de Vylder 1991: B-I-64)—more than 15 per cent of the 1991 budget. Furthermore, although Vietnam's fiscal authorities have improved their revenue collection since 1992 with the establishment of a new taxation system, tax losses from the state sector remain substantial. At the same time, revenue collection from the private sector is very limited due to the lack of trained personnel, to the financial secrecy of household and private units, and other constraints. Given these and other factors, a long time-lag can be expected before fiscal reform translates into a balanced budget.

## REFORM OF THE FOREIGN TRADE SYSTEM

Before 1989, Vietnam had no formal foreign trade strategy. In fact, Vietnam followed an inwardly oriented, centrally managed development strategy whereby trade was utilized as a mechanism to expedite the industrialization process in the long run and to stabilize the domestic economy in the short run. Thus, Vietnam's centrally administered bureaucratic mechanisms and the Council for Mutual Economic Assistance (CMEA) trading system heavily regulated Vietnam's commerce, which was based on bilateral exchange between Vietnam and individual CMEA countries. Furthermore, Vietnam's production and trade plans and exchange rate regime encouraged a surplus of imports over exports, made possible by Soviet foreign economic policies and the CMEA system.

Since 1989, when major changes erupted within the CMEA trading bloc, the Vietnamese government has promulgated trade legislation which has aimed at protection against selected imports and at increased rationalization, liberalization and decentralization of the tariff and trade regimes. In addition, it has greatly liberalized its foreign exchange system, already discussed above. Two of these objectives—decentralization and liberalization—have been viewed as key mechanisms to expand exports, and hence, to generate foreign exchange and to balance its current account position.

The 1989 legislation established a new tariff schedule that began to rationalize duties and liberalize trade by reducing quotas on imports and exports—although many non-tariff barriers remained in place. A two-stage reform was established in April 1989 and December 1989, which lowered most export taxes and reduced the number of export and import commodities subject to duty. Import duties remained high on imported goods that can be domestically produced (for example, 50 per cent on bicycles); and luxury goods are subject to tax rates of 40–100 per cent (*Vietnam. Stabilization and Structural Reforms* 1990: annex C 20–1). However, due to the impact of the collapse of the CMEA trading system and the subsequent shortage of foreign exchange reserves, the government in the second half of 1990 increased restrictions on (or banned a number of) consumer and luxury products. Since that time, the authorities have made periodic adjustments of import and export restrictions in order to regulate foreign trade according to economic objectives.

In addition to tariff liberalization and rationalization in 1989, Vietnam's foreign trade system was decentralized by allowing provincial/local authorities to establish competing foreign trade companies and eliminating the pre-1989 requirement that local/provincial SOEs trade through the intermediary of the state's centralized foreign trading corporations. The new measures brought about a dramatic expansion of local state enterprises and state companies engaging in trade: from 80 in 1987, to 400 in late 1989, to 600 by mid-1990. In 1991, Vietnam moved closer to a highly decentralized and moderately liberalized international trade structure, as growing numbers of enterprises were granted the legal right of direct trading access to foreign markets. In the past few years, the government has tried to build a firmer regulatory framework to combat rampant smuggling and to reduce chaotic trade competition, but so far it has not tackled comprehensive trade reform.

## DEVELOPING A MULTISECTOR COMMODITY-PRODUCING ECONOMY

The Vietnamese leadership abandoned the ideal of socialist transformation by 1986, reorienting state policy towards developing a 'multisector, commodity-producing economy' (i.e., a mixed economy). This shift is in fact, the most radical aspect of *Doi Moi,* entailing enormous changes in economic management and organization from an archetypically command to a market-oriented economy; and to the recognition and legitimation of new property-ownership categories (i.e., private property rights). While analysts differ on the number and categorization of legal property in Vietnam, it is evident that conceptually five economic sectors are now recognized as the major constituents (and legally co-equals) of Vietnam's economy:

1. the state sector
2. the collective sector (agricultural cooperatives and small-scale industry)
3. the household and individual sector
4. the private capitalist sector
5. the state capitalist sector (joint ventures between domestic state and private enterprises and between Vietnamese SOEs and foreign capital).

### State sector: restructuring and revitalization

Since the early 1980s, the Vietnamese government has sought to reform state enterprises in order to reduce the state's financial burden in the economy and to make the state sector a viable engine of growth and transformation. Indeed, one of the earliest economic reforms in 1981 was the introduction of the 'Three Plan' system, which aimed at improving static efficiency in industrial SOEs by granting worker incentives and decentralizing the production process. However, the government's objectives of promoting competition and allocative efficiency in state industry have not been successful: the SOEs have not been very responsive to reform, as measured by increased economic efficiency and technical progress (Do Duc Dinh 1990; Dan Son *et al.* 1990). But these earlier reforms must be placed in the context of Vietnam's strategic goal of socialist transformation, which aimed at the rapid expansion of the state or socialist sector.

After 1988, more dynamic and evolving perspectives on the role of the state in the economy emerged. One important change is that a majority of the leadership acknowledges that the role and weight of the state sector must be changed. However, there is no precise view about how it should be changed. The predominant official position centred around the notion of retaining a fundamental role for the state, as theorized by the concepts of 'market socialism' or some variant of a 'Third Way'. Two senior analysts in the Central Economic Committee of Vietnam's Communist Party have stated that the SOEs—and hence the state sector—will continue to play an important role in Vietnam's economy through the market and guidance-planning mechanisms, thereby supplanting their function as primary instruments of accumulation and transformation in a centrally planned economy (Nguyen Thang Bang and Tran Duc Nguyen 1991:194). This position has been echoed by other economists and technocrats, some of whom have argued that Vietnam will remain essentially 'socialist' through the establishment of expanded, but modified state economic levers and controls over the economy (Thanh Son 1990:67–74). Moreover, the creation of legislation in 1994 and 1995 to permit the establishment of large, state-enterprise, industrial-financial-trade combines, 'General Corporations', supports this idea. Others have argued that the state sector should be 'mean and lean' and comprise no more than 300 (or even 100) state enterprises in strategic economic or security areas after restructuring is completed. However, the latter position could underpin a strong role for the SOEs in either an essentially capitalist economy or a market socialist variant.

Inconsistent and muddled policies and unexpected consequences have characterized state enterprise reform. Two important trends of the state economic role—which are negatively correlated—will persist in the medium term. First, SOEs will continue to play an important role in Vietnam's economy despite the reduction and/or consolidation (merger) of about half of the 12,054 existing SOEs since 1990. On an aggregate level, the state sector's share in gross industrial output has remained at a trend of 60 per cent for the past decade. In agriculture, state farms—which only account for 2 per cent of output and 13 per cent of arable land—have been major beneficiaries of price reform, resulting in expanded output and income (*Vietnam. Recent Economic Developments* 1990:10). Moreover, state enterprises continue to be able to secure inputs and credit under relatively favourable terms, even though old-style planning and input-output quotas have been abolished.

Second, Vietnam's leadership has accepted the notion of 'sinkability' of state enterprises, even though bureaucratic interests continue to support the state sector (Le Dang Doanh 1990:9). Thus, ideological considerations are battling objective reality. While the promulgation of the 1993 law on bankruptcy is intended to facilitate the dissolution and restructuring of SOEs, the state banks continue to reserve the majority of credit—67 per cent in 1993, down from 86 per cent in 1991–2—for state enterprises (Hiebert 1992:52; De Vylder 1991:177) (the majority of which is allocated to current operations, rather than fixed investment). Credit and labour subsidies have also been provided to the SOEs. Nevertheless, the economic and financial positions of an undefined number of SOEs continue to deteriorate because they no longer enjoy a *sufficiently* soft budget constraint (and some are operating under hard budget constraints). The management and employees of some of the ailing SOEs have responded to the state's fiscal austerity by initiating in the past four years various forms of internal privatization, formal equitization and, to a lesser extent, a shutdown of operations.

Surveys of the SOEs indicate that the trend of economic decline of the state sector is likely to continue. In 1990, analysts estimated that about 40 per cent of the 12,054 existing SOEs needed to be re-organized and modernized in order to continue operations on a competitive basis; 30 per cent were deemed to be technically sound and economically competitive in the market; and 30 per cent of the SOEs were seen as candidates for bankruptcy or privatization (Le Dang Doanh 1990:9; Nguyen Xuan Mai 1992:391–411). After four years of complex restructuring and consolidation, 6,544 SOEs remained in operation, with the largest 300 SOEs forming the core of the state sector; the latter contributed 76 per cent of the SOEs' transfer revenue to the national budget and held 75 per cent of total SOE capital (Le Dang Doanh 1994:26). The government also instituted an experimental divestiture (equitization) programme involving initially seven SOEs. It was later expanded to include a total of twenty-one SOEs, but so far, only three SOEs have successfully completed the equitization process.

### Household rapidly supplanting collective economic organization

The Vietnamese leadership and bureaucracy have what can only be described as a 'Janus-faced' perspective about the role of the collective sector. While the Communist Party maintains its ideological commitment to the cooperative as the primary form of rural economic organization in Vietnam (Fforde 1990:34), much of the economy's labour and organization have been transferred from collective to private household units (Chu Van Vu 1992:149–58). Moreover, the leadership has clearly recognized the fact of a secular trend of the declining weight and role of the collective sector (*Socio-Economic Issues* 1991). Thus, small-scale cooperative industry has declined dramatically since 1985: its contribution to gross industrial output has decreased from 26 per cent in 1985 to 13.7 per cent in 1990; and its employment share has decreased from 46.9 per cent in 1985 to 31.3 per cent in 1989. Furthermore, it is estimated that only 30 per cent of small industrial and handicraft cooperatives can survive profitably due to their uncompetitive fundamentals (Le Dang Doanh 1990:9). Recent reports appear to indicate that at best 20 per cent of the more than 30,000 industrial and handicraft cooperatives of the pre-1988 period have managed to survive the ongoing transition to the market. Their future remains bleak without increased governmental support (interview with Hoang Minh Tang, Chairman of the Vietnam Union of Cooperatives, in *Vietnam Investment Review,* 26 December 1994:9).

Political differences over the collective sector are not new, nor are they easily resolved. They are most acute in the agricultural sector. One reason for the differences is essentially ideological: some of the leadership continue to view the collectivization of agriculture as a tribute to Vietnam's path towards socialist transformation. Another reason is the role of the cooperative, previously the most important economic unit of agricultural production—contributing about 50 per cent of total output (*Vietnam. Recent Economic Developments* 1990:9) and occupying some 70–80 per cent of all cultivated land in Vietnam (*Report on the Economy of Vietnam* 1990:86). These data probably overestimate the influence of the cooperative structure because the post-1975 collectivization of agriculture failed in South Vietnam, where agricultural production remained primarily in the hands of the small private producers. In 1987, Radio Hanoi reported that in South Vietnam, only about 30 per cent of the cooperatives functioned 'according to set procedures' (Fforde and de Vylder 1988:91). The important Mekong Delta region in the south contributes about 40 per cent to total agricultural production in Vietnam (*Vietnam. Recent Economic Developments* 1990:9).

Compounding this factor is the weight of agriculture in Vietnam's economy: it generates 40 per cent of total national income and 70 per cent of total employment (ibid.: 9). Thus, the shift of agricultural production from collective organization to family-based management is making an enormous impact on the overall functioning of Vietnam's political economy.

Since the late 1980s, the influence of the collective in agricultural production has been increasingly eroded by the expansion of the household economy. Family-based farming has grown rapidly as a result of a number of reforms, the most important of which is Decree 10 of April 1988. Under Decree 10, agricultural taxes were substituted for the obligation of producers to sell their output to the state at low prices; land tenure is assured for at least fifteen years; contractual obligations to the cooperatives are clearly defined; and individual farmers are to retain at least 40 per cent of output; the planning obligations of the farmers and cooperatives have been abolished; the cooperative budget no longer covers expenses of the local party branches (ibid.: 10; Nguyen Van Bich *et al.* 1990:129–32). While the formal structure of the cooperative has not changed very much, its primary economic function has shifted from being a mechanism of surplus extraction to an organization providing services, supplying inputs, and collecting taxes (*Report on the Economy of Vietnam* 1990:87–8; *Vietnam. Recent Economic Developments* 1990:10; Le Dang Doanh 1990:9). However, state trading companies, various intermediaries, and cooperative cadres continue to extract from individual farmers high economic rents that result from market inefficiencies (Fforde 1990:12–14). Moreover, the state bureaucracy has slowly responded to the implementation of Decree 10, although the positions of an estimated 50 per cent of cooperative cadres have been eliminated (*Report on the Economy of Vietnam* 1990:88).

As a consequence of Decree 10, other reforms and domestic economic forces, the household and individual sector—which accounted for 48 per cent of total agricultural output and 18 per cent of gross industrial output before 1988—has become even more important. With the decline of the control of the cooperatives over the rural economy, the household economy now plays the largest role in agricultural production (ibid.: 88). Furthermore, it employs a growing number of industrial workers (37 per cent of the total industrial workforce in 1989; 45.7 per cent in 1990; 55 per cent in 1992), while employment in the state sector has stabilized at about 32 per cent of the total industrial workforce in 1989–92 (Truong and Gates 1992:38).

In general, official policy towards the household and individual economy has been and continues to be very favourable because of its intermediate ownership and organizational positions and its ability to increase output and employment in agriculture and industry in the short term (Nguyen Thanh Bang and Tran Duc Nguyen 1991:195). Particularly significant to policy-makers is the fact that the household contract system is estimated to have accounted for at least 15–30 per cent of the rice surplus in 1989–90 (Le Dang Doanh 1990:7). In addition, there exists a large pool of private savings in the household economy that can be tapped for investment in small enterprises. However, at this time, small-scale investment is concentrated in commerce and services because they produce higher and quicker profits than 'productive' (agricultural and industrial) enterprises (Le Dang Doanh 1990:8) and because small producers are being bankrupted by the growing volume of cheap smuggled foreign goods (Hiebert 1992:8).

## Recognition of the private capitalist sector

To encourage microeconomic efficiency by unleashing the competitive forces of private production and to improve macroeconomic factors by tapping into underutilized private resources, the Vietnamese government officially recognized the private sector in 1988 (Kirkpatrick 1989:94). Pre-1985 state policies had reduced the role of the legally abolished private sector to that of 'filling in the gaps' of a shortage and crisis-prone economy. Since 1988, the attitude of the Vietnamese leadership towards the private sector has become increasingly favourable, but no political consensus yet exists about the acceptable level of state interference (e.g., through macroeconomic management and state participation in joint stock companies) in private economic activities (Nguyen Thanh Bang and Tran Duc Nguyer 1991:196).

The government instituted its landmark policy revision towards the private sector through several pieces of legislation in 1988. First, the Council of Ministers' promulgated Resolution 27/HDBT of 9 March 1988, which set out 'policies towards the private economy, manufactures, industrial services, construction, transport, in the private sector'. For the first time in the history of the Socialist Republic of Vietnam, an official document established the legal rights, functions and activities of private enterprises and micro-enterprises. A second piece of legislation, a 'twin' Resolution 28/ HDBT, was promulgated on the same day, which placed the private sector on an equal footing with the cooperative sector. Third, the Politburo announced its Decision 16/NQTU of 15 July 1988, politically confirming the above resolutions and affirming the process of 'embourgeoisement' in Vietnam. (János Kornai defines the 'process of embourgeoisement' as the officially encouraged organic process of private accumulation of capital in reforming socialist economies, *see* Kornai 1990:52, 188.)

Even though the legitimate position of the private sector has been established, Vietnamese policy-makers and economists still do not have a clear notion of how to proceed with privatizing—equitizing—SOEs. One problem, of course, is the matter of financial resources and intermediation. As one senior Vietnamese economist told the authors: 'Precisely, how do we find private buyers for inefficient, outmoded and highly risky enterprises?' And even if it found private domestic buyers (foreign buyers are only considered within the issue of the establishment of a stock market), there is a financial problem: yet to emerge in Vietnam's economy is a structure expanding financial intermediation, essential to sell the SOEs. This financial constraint is linked to a second underlying problem: resistance of most state enterprise management to equitization. SOE managers, who enjoy great privileges under the status quo, wish to maintain Vietnam's fuzzy financial environment which increases their freedom of action. A third obstacle to privatization is a more fundamental politico-ideological issue. The Vietnamese are still uncertain about how to define the proper role, weight, concepts and links of private and social ownership in society (Nguyen Van Huy and Dinh Duc Sinh 1990:15–19, 26–7). Finally, there is the constraint of inadequate implementation of laws on the private sector at the lower levels of the bureaucracy (according to Minister of Justice Nguyen Dinh Loc's Addresses to the National Assembly, Vietnam, Television Network, Hanoi, 15 December 1991, *World Broadcast Summary,* FE/ 1256 B/4 [14]). Additional legislation to encourage private industrial development has recently been promulgated (e.g., the 1994 Law to Promote Domestic Investment), but as long as intrusive state interference within the private sector and unequal state and private playing fields continue, it is unlikely that Vietnam will see rapid growth of private manufacturing enterprises in the near future.

### Emerging state capitalist sector

An emerging state capitalist sector (defined as joint participation of foreign-domestic state capital or domestic state-private capital) is a recent phenomenon in Vietnam's transition to the market. We will not discuss the role and effects of joint Vietnamese and foreign ventures in Vietnam, as many of these are only now coming on stream (Nestor 1994), nor legally sanctioned, domestic, state-private enterprises. More important for our analysis is a byproduct of the transition process, comprising non-sanctioned, domestic, state-private enterprises, many of which have emerged from spontaneous and extra-legal privatization. In essence, this sector is developing from (a) a hollowing out of state enterprises whereby the more profitable activities of an SOE are transferred to an effectively private entity; and (b) the operation of party or state organizations as private enterprises.

In the first category, one important means of internal privatization is to divert capital, labour, supplies, and know-how to private enterprises, which may be held in the names of relatives of state management and may compete directly with the SOE. Second, managers may establish private companies to supply or service their state companies. Third, SOE management may offer interest-free loans to relatives to establish private enterprises; and while these enterprises may not compete with their state companies, the newly established private enterprises (PEs) are typically in areas where the SOE managers have strong bureaucratic ties and networks. These methods of partial internal privatization imply a unidirectional diversion of state assets by state managers to private activities (regardless of legal ownership), but their essential feature is a combination of state and private interests. This feature is magnified in the more common multidirectional cooperative relationships, joining state managers with private entrepreneurs for mutual economic gain. In a simple form that does not require long-term cooperation, domestic private entrepreneurs or foreign firms may purchase assets or various state enterprise rights or privileges (e.g., user rights of lands and buildings, trading and financial privileges) from management. In a more complex relationship, private entrepreneurs *informally* contract with state managers to provide state resources and rights for specified private activities. In this way private entrepreneurs acquire cheaply the use of state capital and the 'state seal' to 'oil the wheels of business' and allow the PE to operate under the umbrella of the state. These trust-based relationships reduce production and transaction costs and raise profits. In return for the state manager's cooperation, he receives an agreed share of the profits and other benefits.

In the second category of informal joint state-private ventures, party/state organizations use the cover of the private sector for their activities. These ventures are typically registered in the name of a 'private' individual(s), and they have become especially prevalent in the tourism-hotel, services, textiles-garments and electronics sectors. While they legally operate as private units, they are also able to utilize their bureaucratic networks to acquire resources relatively cheaply and to avoid taxes, duties and laws that increase transaction costs of ordinary private enterprises. Thus, one major *raison d'être* of such 'profit centres' is to generate higher revenues and profits by maximizing the various advantages of the private and state sectors.

The net effect of the establishment of joint state-private activities—particularly through internal privatization—is to provide additional resources and capabilities to expand both the real private and state capitalist sectors; and it creates new autonomous centres of capital, thereby deepening the marketization process. It also blurs the conceptual and real differences between public and private capital. The future of a state capitalist sector, however, raises many questions. For example, can these enterprises be transformed into *dynamic,* competitive organizations? Or can Vietnam's state/party bureaucratic managers be turned into entrepreneurs?

## INTEGRATION INTO THE REGIONAL AND WORLD ECONOMIES

As early as December 1986 at the Sixth Party Congress, Vietnam's leadership indicated that it wished to 'take part in the international division of labour and promote economic relations with foreign countries on the basis of equality and mutual benefit' (Le Dang Doanh 1990:3–4). Since that time, Vietnam has increased its commercial ties with the Asia-Pacific region, which now accounts for the majority of Vietnam's trade. In fact, between 1988 and 1994, Vietnam's exports to convertible currency countries in Asia more than tripled. In this expansion of regional trade, Vietnam has increased its exports of several important commodities—rice, oil, coal—and a number of agri- and aqua-products and handicraft goods. At the same time, Vietnam has substantially expanded its imports of raw materials, capital equipment and consumer products from the region. Furthermore, both private and state enterprises are establishing direct trading relationships with East Asian firms.

The same trend of growing regionalization is occurring in Vietnam's non-trade flows. According to the State Committee for Cooperation and Investment (December 1994), by the end of 1994, Asian companies invested more than 65 per cent of the US$10.3 billion of recorded Foreign Direct Investment (FDI) in Vietnam. The largest share of FDI originates from the newly industrializing economies (Taiwan, South Korea, Hong Kong, Singapore), Malaysia, Thailand, Japan and Australia. Most of the Asian companies investing in Vietnam are seeking to relocate their labour-intensive manufacturing facilities to Vietnam where labour is abundant, cheaper and relatively well trained. This is a development which is likely to accelerate intratrade manufactures within the East Asian region. Reflecting this changing pattern of foreign investment is the fact that in 1994, Vietnam's manufacturing sector was the recipient of over 40 per cent of cumulative contracted FDI, as compared to 13 per cent in 1988–90.

Vietnam's Ten-Year Plan, *Socio-Economic Strategy up to Year 2000,* declares that the establishment of 'economic and market ties in Northeast and Southeast Asia' is a long-term objective. Moreover, the Vietnamese have clearly stated that the policy of expanding foreign trade and attracting foreign capital investment must constitute an organic part of its development strategy up to the year 2000. Prime Minister Vo Van Kiet sought to make this objective tangible and manifest early in November 1991 when he visited key ASEAN countries and signed bilateral economic cooperation agreements with the governments of Malaysia, Singapore and Thailand. In January 1992, his Deputy Premier asserted that a high policy objective of Vietnam was membership and integration into ASEAN. These statements and activities paralleled the signing of an unprecedented number of energy agreements in 1992–3 between Vietnam, on the one hand, and Thailand, Malaysia, South Korea, Taiwan and Japan, on the other hand. The lifting of the US embargo in early 1994 paved the way for further Vietnamese integration into the region and internationally. Following a number of high-level exchange visits between Vietnamese and ASEAN leaders, Vietnam applied in October 1994 for membership in ASEAN, and it became ASEAN's seventh member in July 1995.

It is too early to make a substantive evaluation of Vietnam's integration into the regional and international economies. However, it is clear that a political consensus exists among Vietnam's leadership to continue and accelerate this shift in foreign economic relations. Barring a major foreign crisis, this will remain one of the two top priorities (the other being rapid domestic socio-economic development) of Vietnam's leadership for the remainder of this decade (*Political Report of the Intermediate Party Congress* 1994; Vo Dai Luoc 1990:1–9).

## CONCLUSION

Vietnam's *Doi Moi* has set into motion a process that cannot be reversed and will largely determine Vietnam's future socio-economic growth and transformation. The impact of economic reform over the past six to seven years has been enormous, and if that presages the future, the pace of change will only increase. Nevertheless, Vietnam's reform programme does not mean that Vietnam is moving towards an archetypically capitalist economic system. This often stated conclusion is logical from a simplistic juxtaposition of market vs. bureaucratic hierarchy. However, Vietnam's real transformation process is far more complex: it is *seeking* to establish its own path, which can be conveniently identified as a 'third way' of economic development—a Vietnamized variant of market socialism. While Vietnam's leadership has repeatedly acknowledged this objective, since they embraced the market mechanism in 1986, many observers have chosen to ignore their equally strong espousal of socialism. Others argue that the market is synonymous with capitalism, and regardless of the leadership's goals and ideology, capitalism is an inevitability.

What market socialism really means to the Vietnamese, however, is not at all clear. Nor does China's longer experience with market socialism provide answers. One indication of Vietnam's 'third way' has been its path of state enterprise reform. Reform of the state sector in 1988–94, which incorporated market mechanisms to discipline enterprises, but at the same time gave them far greater autonomy, progressed slowly as compared to other areas of reform, partly because it strikes at the heart of a modern economic system. Since 1995, the central government has shifted its focus by moving to reassert control over strategic state industrial enterprises and reinforce the state economic role through these enterprises. Party/government directives and legislation in 1994 and 1995 set out the structures of this policy: 'General Corporations' (GCs), which on paper are vertically and horizontally integrated organizations, combining industrial, financial and commercial strengths of powerful SOEs and a few private enterprises (PEs). While the future GCs are touted as Vietnam's answer to South Korean *chaebols,* they retain many characteristics of Vietnam's old Enterprise Unions, a hallmark of its socialist transformation days. The blurring or blending of socialism and 'East Asian capitalism' characterizes Vietnam's search for its own economic path.

Nevertheless, Vietnam's economic transformation is unlikely to be determined solely by strategic objectives, ideology and the formal policy process. Nor can fundamental political issues be put off unendingly. Increasingly important will be the interplay between formal political and economic objectives and institutions, on the one hand, and the informal socio-economic movements at the micro- and meso-levels, on the other. Their interaction will fashion the long-run success or failure of Vietnam's gradualist reform, and ultimately, the viability of Vietnam's economic and political systems.

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# NEOLIBERALISM AND ECONOMIC UNCERTAINTY IN BRAZIL

*Ana Maria Fernandes*

What has been the nature of Brazil's enduring crisis? Is Brazil destined to be the perpetual economic recidivist? Why in the face of near hyperinflation has Brazil not collapsed into economic and social anarchy and how has it even managed in 1993 and 1994 to register growth rates of 5 per cent or more? Why does a fertile country with a powerful agro-economy need a national programme against hunger? Why do more than 30 million Brazilians live in misery? Is the growing violence and penetration of the drug trade in the slums of the major cities controllable?

The debt problems, the high levels of inflation and enduring economic stagnation which were experienced in Latin America during the 1980s and which until recently persisted in Brazil, have been treated as failures of economic management. An analysis of why in 1994 Brazil remains one of the few countries of the world, other than those devastated by civil war and famine, to have experienced an annual inflation rate of nearly 1000 per cent (in the first half of 1994 accumulated inflation approached 800 per cent and following the July 1994 implementation of the *Plano Real,* in the six months to December 1994 accumulated inflation fell to less than 20 per cent); why it is the only Latin American country which has yet to fully implement an orthodox economic adjustment programme; and why it is the second ranking country in terms of social inequality—such an analysis cannot be restricted solely to the economic aspects. The present account adopts the wider concept of political irresolution to trace the progress of Brazil to its present state of economic and social instability.

Such an approach is directly relevant to the attempts to liberalize what has been one of the world's most closed economies. Since the first measures were taken in 1990, the succeeding administrations have continued the process of opening the economy, albeit with variable degrees of commitment. Privatization of state companies, principally in the steel and petrochemical sectors, and relaxation of import controls marked the first phase of the liberalization process. The second and more difficult phase, which involves the ending or 'flexibilization' of the state monopoly of oil and gas, electricity generation and distribution, and telecommunications, has been embarked upon by the Fernando Henrique Cardoso government. Major problems still to be resolved include the future of the insolvent state banks, the precarious financial position of the state pension and social security scheme, fiscal reform and control of public expenditure. Attempts to modify the status quo in all of these areas confront strong and wellorganized opposition, determined to resist loss of privileges and advantages accumulated over more than four decades.

## POLITICAL IRRESOLUTION

According to Lamounier (1990), the decline of the macrosocial capacity of decision-taking commenced in the 1980s when the public sector was effectively nullified as a propulsion agent of economic development. This broke with the past in that since the 1930s the state had assumed the role, of inductor of economic development. The state surrendered this role in the view of Lamounier, as a result of the fiscal crisis, the pressures of the external and internal debts, and the increasing demands for redistribution of the nation's wealth. Schmidt, Nascimento and Pécaut (1993:3–14) consider the indecision as both political and economic, focusing their analysis on the issue of political representation and the management ability of the state.

Lamounier (1990) focused his analysis on the political and ideological aspects of indecision as manifested during the crises of the 1980s. He defines crisis as a combination of circumstances exceptionally adverse which coincide with a macrosocial incapacity to make adequate choices about the actions necessary to surmount these circumstances. In other words, a tendency to decision paralysis just at the time when fundamental choices became imperative because of the critical circumstances. He attributes the decline of the macrosocial capacity of decision-taking to three principal factors: a more equal dispersion of power among conflicting sectors; institutional impasses; and the competitive co-existence of alternative views.

The progressive dispersion of power in Brazil occurred during the transition of power from the military to civilian rule. This was, in fact, a very gradual process of political and cultural liberalization with elections as milestones. These were strictly regulated with just the minimum necessary conceded to give them some legitimacy. The culmination of this process was the selection in 1985 by an electoral college of the respected veteran politician Tancredo Neves as the civilian President of the New Republic. This transition suffered a fatal blow with the untimely death of Tancredo Neves on the eve of his assumption on 21 April 1985. His substitute, José Sarney, owed his position as prospective Vice President to his conservative background and links with the military regime. As a figure-head Vice-

President without power, he had little significance, but as President he was without political legitimacy. The New Republic turned into a period of virtual ungovernability with the Sarney administration unable to reinstitute a system with effective decision-taking capabilities.

While various factors were instrumental in the dispersion of power, in some cases being the intentional consequences of decisions taken to further democratization (for example, the complete deregulation of the formation of parties in May 1985), more significant was the decision in February 1986 to establish a Constitutional Assembly to frame a new Constitution. This was a very unstructured process with the Assembly having authority to examine all the institutional order, including even the term of the President then in office. The involvement in the Constitutional Assembly of highly organized lobbies from all sections of civil society led to constant jockeying for position and intense pressures both in favour and opposed to key issues. The new Constitution soon came to be recognized as a severe impediment to the urgent need for structural reform and modernization of the state and economy.

Another factor contributing to economic and institutional irresolution was the debate during the 1980s of a new national agenda which focused on the role and size of the public sector, having as alternatives the economic Utopias of nationalization and extreme neoliberalism. Lamounier (1990) considers that the division between the public and private sectors became in itself unstable, even unsustainable, as it generated a major transfer of resources from the most to the least efficient sectors, via the public deficit. In the political-institutional area, three Utopias struggled for ascendancy: participatory, presidentialist-plebiscitary and parliamentary. As a choice was not made in either sphere, these Utopias are still present in the Brazilian debate and Lamounier's supposition is that a system becomes temporarily ungoverned when it loses the capacity to choose a direction for its future evolution. The consequent impasse led to interminable and unresolved conflicts with no progress made in the definition of a national agenda.

Schmidt *et al.* (1993:3–14) identify three sources of irresolution: the first arises from the difficulty of integrating short-term measures with long-term objectives. The second came from the belief in economic and political models that in the past had assured the feeling of a continuous progress towards modernization and prosperity. Finally, indecision is related to the fragility of political parties, the reduction of state efficacy and, generally, to the fact that a majority of the population does not give credit to political promises, officially announced. Indecision here is associated with political credibility. The authors consider as a major illustration of national irresolution the deferment by the 1987–8 Constitutional Assembly of the plebiscite on the form of political regime to 1993 and the proposal for a global revision of the text of the newly agreed Constitution in the same year.

## ANTECEDENTS OF IRRESOLUTION

The military took power in 1964 and from 1968 adopted a strategy of growth-cum-debt with the aim of propelling Brazil into a leading economic power. This strategy had already produced results by 1974, and even though there were adjustments, this was not a period of irresolution. Subsequently, however, two new factors emerged with the external conditions having changed for the worse and the declaration of the beginning of the transition to a civilian government. Correspondingly emasculation of the existing strategy and irresolution in the definition of a replacement can be observed. Short-term measures were taken to surmount the problems caused by external factors without being related to medium- or long-term objectives. Moura, in analysing the economic policies from the Ernesto Geisel to the Fernando Collor de Mello governments (1974–92), argued that concerns with 'economic growth, structural changes and social justice were submerged by the violent conjunctural fluctuations that berated the Brazilian economy over this period' (Moura 1990:37).

The succession of incoherent measures taken by the Geisel administration were typical 'stop—go' policies. The succeeding administration of Joao Figueiredo also alternated between recessionist and growth policies and produced the worst decline in economic activity of the last sixty years. The recession of 1981–3 in terms of decline in Gross Domestic Product (GDP) per capita was even more severe than the worst years of the Depression of the 1930s. Without underestimating either the severity of the external crisis or the internal difficulties, there were failures of timing, consistency and adaptability. As Moura records:

> It is now recognized that Brazil reacted with enormous delay and persistent inconsistency to the first oil shock (1973) and to its consequences namely, recession in the industrialized countries and strong fluctuations in international commodity and raw material prices. More than simply slow and late, it can be argued that the policies implemented by the Brazilian government amplified in good measure the economic crisis and compounded its notorious vulnerability to external events.
>
> (Moura 1990:38)

Much the same applies to the second global crisis at the beginning of the 1980s when 'The reaction of the Brazilian policy-makers to this new external shock was once more ambiguous' (Moura 1990:48). There was no interference from a compliant Congress or other pressure groups in the economic plans during this time, and international financial institutions imposed no major constraints (as will be discussed later). The new factors which emerged when civilian government was restored in 1985 were the spread of political power and the ongoing debate about the long-term political and economic structure.

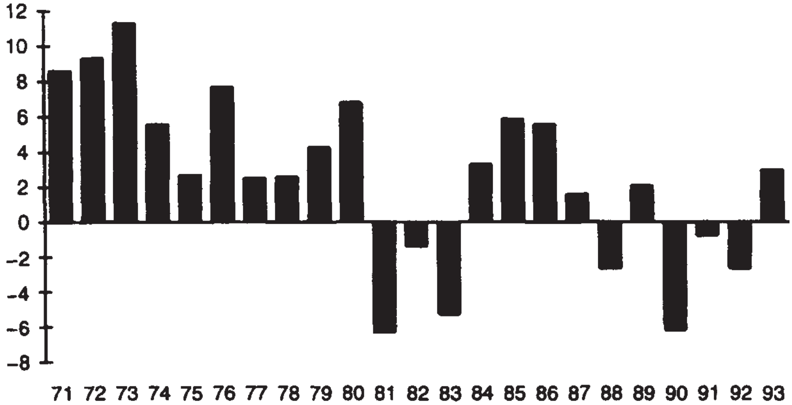


*Figure 5.1* Brazil: annual change in GDP per capita
*Source:* IPEA 1994, 689

The conclusion to be drawn is that irresolution antecedes the transition of power. When external conditions changed the military ruling group, its technocrats did not adjust their economic policies in a coherent way. Irresolution, especially during the mandates of the final two military presidents, had two new and critical aspects: international economic crises and political transition towards a civilian government. However, irresolution reached its zenith during the Sarney administration (1985–90). A succinct description of the economic measures is that of: 'an inexorable succession of failures' and 'a series of attempts to achieve simultaneously, incompatible economic targets and an incapacity to order objectives and respect fundamental economic restrictions' (Moura 1990:50).

In 1990, Collor de Mello took office with the legitimacy of the first President directly elected after the military regime, but he was without critical support in Congress. His economic policies were inclined towards the neoliberal economic model and included medium-term proposals for the privatization of state enterprises and the gradual opening up of the economy through tariff reductions and removal of import barriers. The economic plan he introduced immediately after he assumed office gained congressional support, largely because of the hyperinflationary conditions he inherited, and despite doubts about the legality of some of the measures, particularly the removal of up to 90 per cent of monetary liquidity by freezing access to bank deposits. According to Moura, the measures had an immediate impact because of their boldness but very shortly exposed the inexperience of his economic team in the first phase of the programme's management.

The impact of the reforms initiated by the Collor administration has been highly significant, not so much for what was achieved during its curtailed two-year term, the last six months of which were almost totally devoted to his attempts to counter the ever-mounting pressures for his impeachment, but as the beginning of an irreversible and accelerating process of economic modernization. There is already clear evidence that privatizations and the opening of the economy to foreign competition, particularly in the MERCOSUR free-trade area comprising Brazil, Argentina, Paraguay and Uruguay, have increased the productivity and competitiveness of Brazilian industry.

Following Collor's impeachment in 1992 as a consequence of the corruption scandal which overwhelmed his administration, the Vice-President, Itamar Franco, assumed the presidency with no support in Congress, other than the temporary euphoria created by the popular decision to remove Collor from office. Irresolution, both by the new administration and the political groupings in Congress, soon prevailed and this, together with the further dispersion of political power, led to the effective filibustering of the long-awaited constitutional revision. Again there was a failure to articulate appropriate economic policies up to 1994 and various changes of economic ministers and plans occurred.

According to Santos (1992), the excessive promises and efforts made to convince the population that resolution of all the problems depends crucially on the outcome of the elections, is detrimental to the development of the idea of citizenship and the fundamentals of a civic culture. The fragility of the parties and especially their lack of ideologies are main factors in the national indecision. All measures of alliances are made in order to gain votes, both at the federal and the state level. The electorate grew from 1 million in 1930 to 29 million in 1970 and to 90 million in 1990. In the main, voters are poor, often illiterate or only with a few years of schooling, urban but from recent rural origin, exposed to mass communications, and vote for candidates rather than parties (Góes 1993). They are economically excluded and politically included, and according to Góes, their response through the vote is not ideological but emotional which values the demagogue and not the statesman. Thus elections turn into radical plebiscites between diametrically opposed agendas and are not very propitious for the debate of a national agenda.

The asymmetry between social-economic and political inclusion is the structural rout of populism, reflecting the population's predisposition and the political elite's behaviour. As the population wants rapid and magic solutions, a vision which the political elite adapts to rather than attempts to change, the consequence is that economic populism frequently becomes irresistible. As defined by Dornbusch and Edwards, 'For us, economic populism is an approach that emphasizes growth and income distribution and deemphasizes the risks of inflation and deficit finance, external constraints, and the reaction of economic agents to aggressive nonmarket policies' (Góes 1993:117).

In the October 1994 presidential election, the winning candidate, Fernando Henrique Cardoso, had been until a few months earlier the finance minister who launched the stabilization plan to reduce inflation. This was based in the short term on the introduction of a new currency tied to the dollar, although not involving formal parity, and supported by the US$40 billion foreign reserves of the Central Bank. Subsequent stages of the plan previsaged the end of the complex indexation system, fiscal reform and control of public expenditure, although all have yet to be achieved. The presidential election was polarized between two candidates: Cardoso, the candidate of an alliance between the social democratic party Partido Social-Democrata Brasileiro (Brazilian Social-Democratic Party, PSDB) and the main conservative party Partido da Frente Liberal (Liberal Front Party, PFL), and Luiz Inacio *Lula* da Silva, the Partido dos Trabalhadores (Workers Party, PT) candidate. That Cardoso won handsomely at the first round was undoubtedly due to the early success of the stabilization plan which had brought little of the consumption booms and supply shortages that had characterized earlier plans. The plan was also perceived by the electorate as being more soundly based than the simple wage and price freezes of previous attempts to control inflation. The PT's criticisms of the plan during the long electoral campaign combined with the absence of detailed proposals of its own, were highly damaging to their prospects.

The outlook for Brazil in 1995 is more optimistic. There exists an agenda for economic and political reforms and there are better prospects of breaking out from the past fifteen years of crisis and entering a new cycle of development. While Brazilian democracy has shown itself to be 'a more resilient and vibrant democracy than many believed' (Castañeda 1993:4), the political institutions have not been seen to contribute to the solution of the economic problems, and the economy's difficulties can erode the state and its functions, threatening the consolidation of democracy and social stability (Salama and Valier 1990). Indecision, the lack of an agenda, and the enduring economic crisis have deferred the process of adjustment, avoiding the reform of the state towards liberalization: and within this scenario Brazil's relations with the international financial system have always been a significant element.

## ADJUSTMENT AND THE ROLE OF LIBERALIZATION

The external sector has had an important role in Brazil's growth, providing markets for Brazilian exports and capital for investment. The swings between periods when terms and conditions were advantageous to Brazil and those that were less favourable were accommodated by reductions in commercial dependency. So much so that the predictions of catastrophe following the first oil crisis in 1973 (when there was a combination of a deterioration in exchange terms and an increase in imports of capital goods for the infrastructural, industrial and agricultural development then in full swing) was replaced at the beginning of the 1980s by a debate on the consequences of the trade surplus resulting directly and indirectly from that earlier investment. But gradual adjustments could not cope with the magnitude and range of the global repercussions of the second oil crisis, principally the increase in interest rates (the *libor* peaked at 16.5 per cent in 1981 compared to an average rate of 8 per cent in the previous decade), the deterioration of exchange terms (between 1981 and 1985 the exchange rate was 30 per cent inferior to the average of the previous decade), and the reduction in international growth rates. These factors generated a compounding and interdependent set of difficulties with the service of the debt, the smaller international purchasing power of exports, limitations on access to the international financial markets, an increase in remittances abroad, and the overall de-stimulus to investment. Consequently Brazil had no option but to accede to the adjustment demands of international institutions such as the International Monetary Fund (IMF) and the World Bank (Baumann 1989a).

While the first World Bank loan to Brazil was in 1949, 70 per cent of the total amount loaned up to 1989 was released in the 1980s. The principal objective of the Bank in the 1960s was the promotion of economic growth in developing countries with loans directed to infrastructure and, in particular, to sectors such as energy and transport. In the 1970s loans were more sectorally diversified including social programmes, while in the 1980s the Bank launched its policy-based loans to attend to the needs of developing countries' balance of payments. The Bank began also to monitor the allocation and the use of loans with particular reference to measures for reducing government deficits and effecting structural adjustments.

The IMF and World Bank had by this time converged in their diagnoses of inappropriate and inefficient internal policies as the origins of the economic

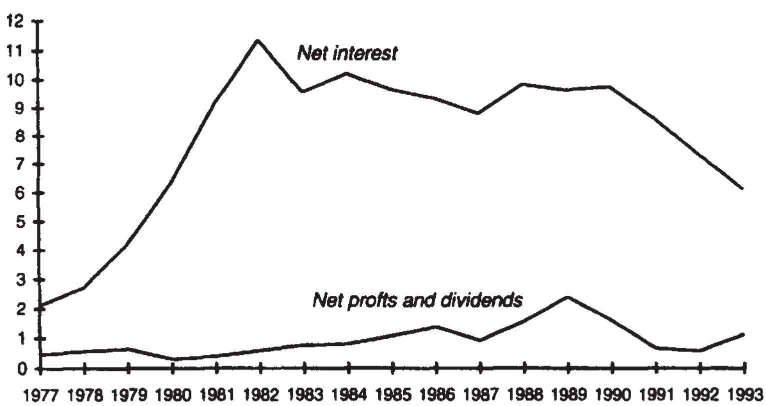


*Figure 5.2* Brazil: net remittances (US$ billion)
*Source: Conjuntura Económica,* May 1994

instability of developing countries. Their policies were also complementary, with the IMF focusing on stabilization programmes and provision of shortterm loans with the central objective of equilibrating the balance of payments, whereas the World Bank concentrated on adjustment programmes via long-term credits aimed at increasing the production of export goods (Gonzalez *et al.* 1990:81). In 1988 the IMF lifted some of its conditions, such as audits by visiting missions and the complementary release of loans from commercial banks, but this easing was counteracted by new conditions imposed by the World Bank, which began to audit macroeconomic policies in addition to sectoral projects. Furthermore, an increase in the Bank's capital was subject to approval by the American Congress and issues such as indigenous communities and environmental conservation became critical factors in the approval of credits. From the viewpoint of borrowing countries, the Bank's involvement was frequently regarded as unwarranted interference in their internal affairs (Araújo 1989:124).

Gonzalez *et al.* (1990), in an evaluation of the macroeconomic impacts of financial flows from the World Bank and the Inter-American Development Bank, concluded that the total loans in the 1980s only marginally alleviated the resources shortfall. Total loans from the World Bank and the Inter-American Development Bank represented on average only 0.5 per cent of GDP, or 2.6 per cent of total investment in Brazil during the 1980s. However, this represented 6.6 per cent of gross public sector capital formation and was relevant in some strategic sectors of industrial development such as energy in Brazil. Furthermore, while relations with the World Bank were not significant in terms of the total volume of capital, these were of importance in the context of negotiations with the international finance community.

Brazil's relations with the World Bank have been a mixture of identity of interests, especially with the long-term targets of many of Brazil's development plans and with the priority sectors funded by the Bank, and of dissonance over the state of the economy and how it should be managed. The latter occurred in 1955 when negotiations broke down only to be restored again in 1964 with the military in power and also in 1984 and 1989, which were periods of particular political and economic instability prior to changes of administration when the Bank blocked new loans.

IMF loans have always been subject to strict conditions and the Fund has been frequently criticized, not only in Brazil, for its 'lack of flexibility in the policy instruments used for the correction of instability' (Almeida 1989:37). Brazil joined the IMF in 1949 and, with the exceptions of 1952 and 1956, obtained loans using lines of credit which did not impose conditions on the borrower. In 1959 the government of Juscelino Kubitsheck did not accept the economic measures which the IMF wished to impose as a condition of further loans, and negotiations were broken off. The rupture continued until 1961 when Brazil adjusted to the discipline of the IMF, the

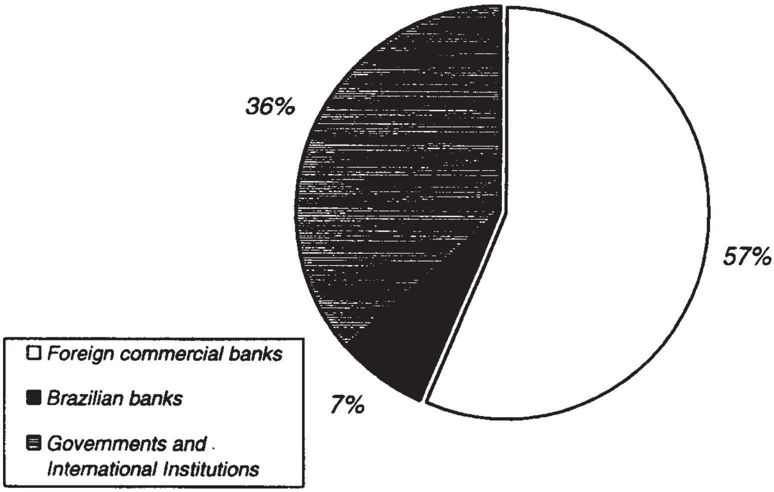


*Figure 5.3* Brazilian external debt by creditor (1991 US$124 billion)
*Source: Central Bank Bulletin,* April 1994

same occurring in 1964 and 1965. However, most of Brazil's foreign debt was contracted in the eurocurrency market with floating rates of interests.

Over the period 1950–86, 96 per cent of the value of IMF loans to Brazil occurred during the period 1982–6 (Almeida 1989:41). In 1982 the current account deficit had increased to US$16 billion and the financial markets were effectively off-limits as the international bankers had embargoed further lending pending an IMF-approved plan of austerity. Then commenced the convoluted process of letters of intent and visits by IMF missions to evaluate the administration's economic policies and audit their execution, not to speak of the procession of Brazilian ministers and their technocrats to Washington. At the beginning of 1985, the lack of monetary control led the IMF to suspend negotiations until the assumption of the next President, but it offered to continue monitoring without a formal accord. Early in 1987, in negotiations with the Club of Paris representing the major government creditors, Brazil proposed a revised *modus operandi* with the IMF, involving regular economic reports while ending direct monitoring. As this was rejected Brazil suspended interest payments and froze the commercial deposits of Brazilian banks overseas. An emergency package was arranged at the end of 1987 and in February 1988 a stand-by agreement with the IMF was signed, ending the moratorium. This was followed in September of the same year by a pluriannual agreement with commercial banks. The debt due for repayment in the period 1987 to 1989 (approximately US$64 billion) was rescheduled over twenty years with an eight-year period of grace; moreover repayment of short-term lines of credit

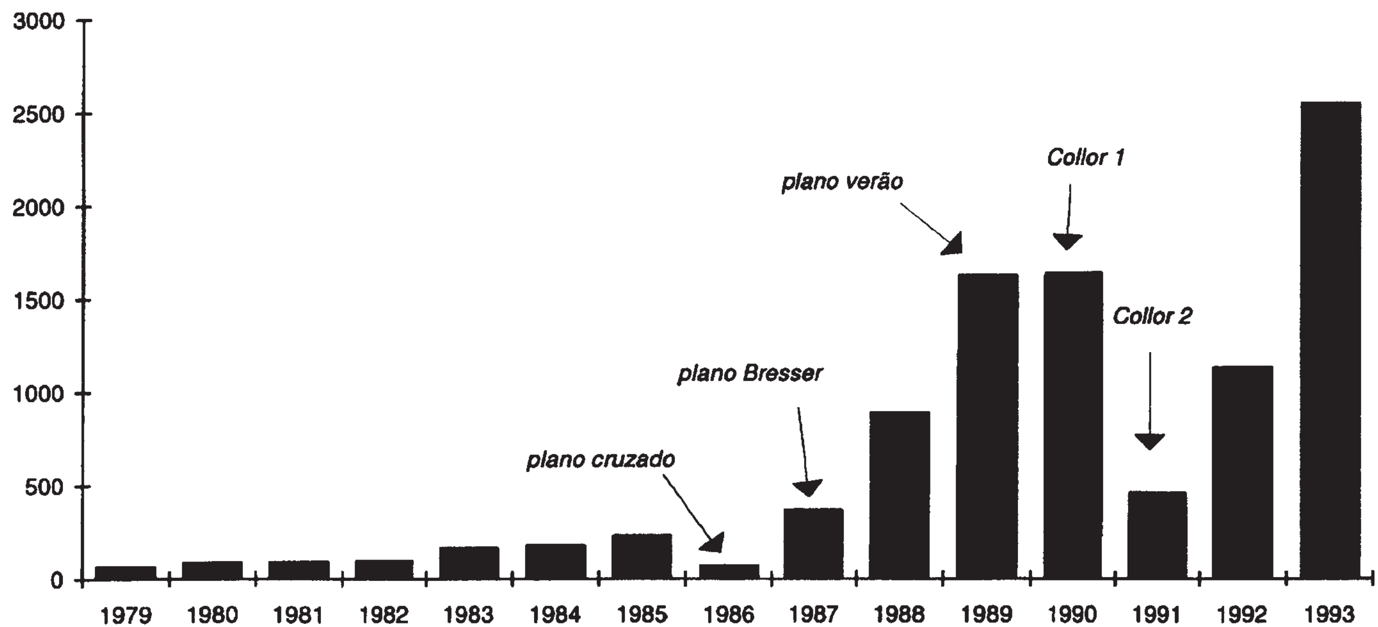


*Figure 5.4* Brazil: annual Percentage variation in prices
*source:* IPEA 1994,724

(US$15 billion) was postponed for two and a half years. The facilities gained were the improvement of financial terms and the option of converting debt into investments. However, the need to generate large trade surpluses and conversion of the debt led in 1988 to monetary expansion and a consequent acceleration in inflation over the short and medium term.

The shortness of the periods of relative harmony and the intervening periods of tetchy and even turbulent relations between Brazil and the IMF (1982–8) can be analysed from different perspectives. The Brazilian authorities have been criticized for their optimistic forecasts and for their preference for short-term agreements which forfeited opportunities for minimizing distortions caused by the adjustments. Brazil invariably went to the IMF at the last moment in a position of weakness, with the necessity of negotiating an agreement in any circumstances: 'the national interest was sacrificed in favour of a conciliation strategy whose results were unfruitful' (Araújo 1989:114). There was no internal cohesion or legitimacy for the measures taken. On the other hand, the international financial system failed to acknowledge the scarcity of foreign investment for developing countries, especially in Latin America. This inertia of the multilateral organizations meant that adjustments were imposed with inadequate levels of liquidity:

> adjustments required large surpluses of the commercial balance achieved painfully through abrupt reductions in imports, falls in production and investment, and devaluations which aggravated inflation and increased the imbalances of the internal accounts.
>
> (Araújo 1989:110)

While progress was made in restoring the health of the balance of payments, the effects were adverse in respect of increasing both inflationary pressures and the internal deficit as a percentage of GDP (Almeida 1989:37). In one respect, however, the international financial system has been efficient in safeguarding its interests, since by dealing with the demands of debtor countries individually rather than *en bloc,* it has left them divided and weakened.

Brazil has been one of the developing countries which in the last three decades have attracted most foreign investment. Between 1971 and 1989 Brazil paid debt interest totalling US$123 billion on a debt which had reached US$112 billion by 1989. In the 1980s the cost of foreign capital increased because of the more intensive use of risk capital and in the middle of the decade an increase of profit and dividend remittances generated negative net investment flows. While this produced demands for extramarket solutions to the debt problem (Baumann 1989b:19), the low level of international interest rates in recent years has diminished the burden of servicing the external debt to a manageable level. The exceptionally high real interests prevailing in Brazil have attracted large inflows of foreign capital but these have consisted largely of hot money which are as readily

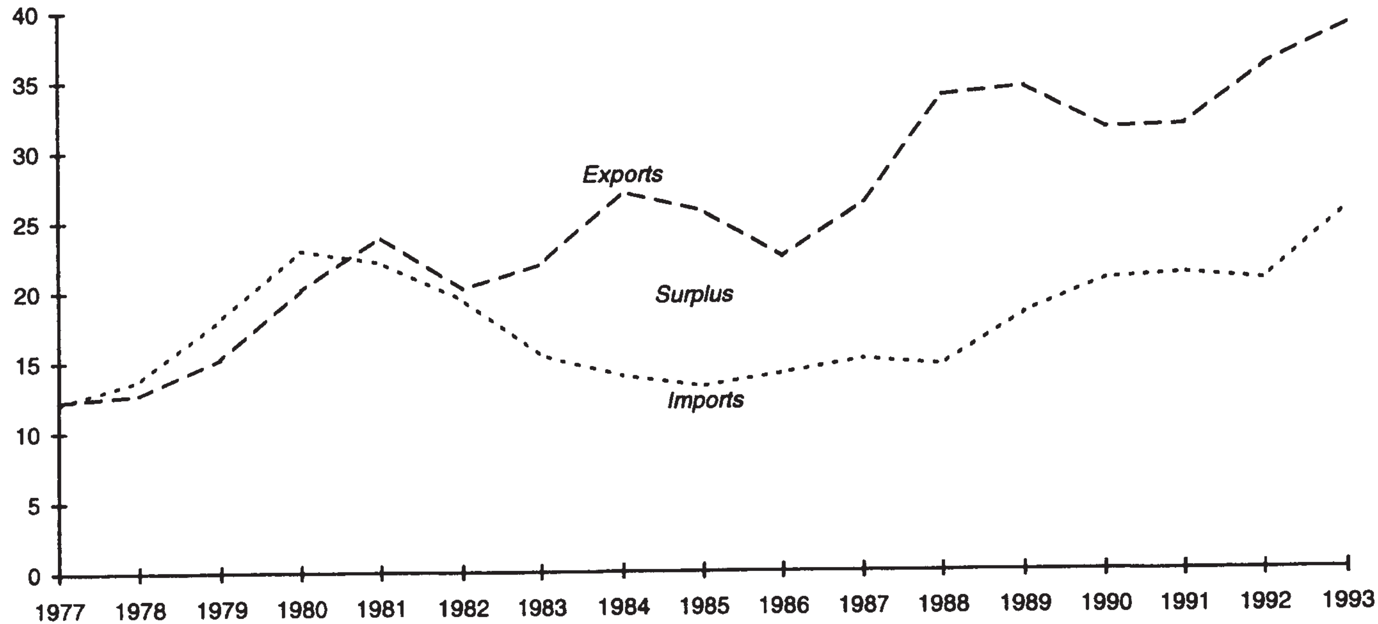


*Figure 5.5* Brazil: exports and imports (US$ billion)
Source: *Conjuntura Económica*, May 1994

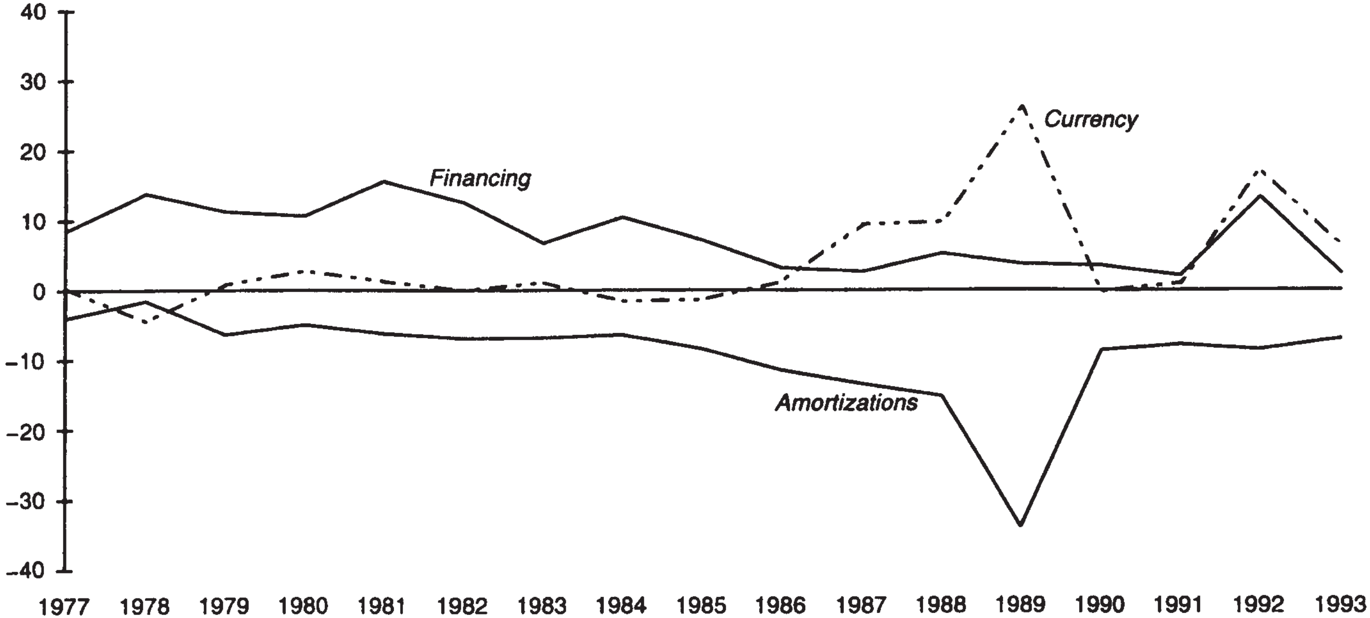


*Figure 5.6* Brazil: Capital flows (US$ billion)
*Source: Conjuntura Econômica,* May 1994

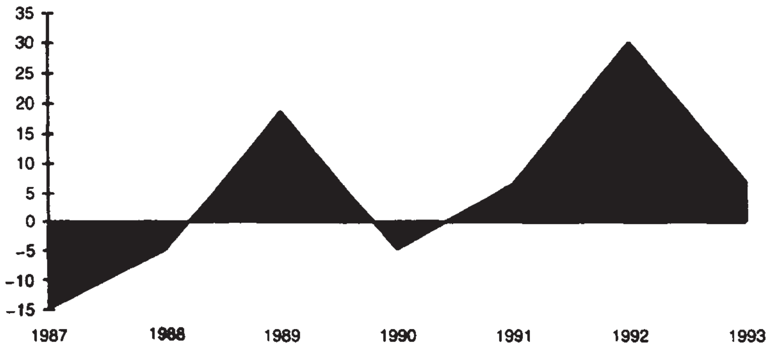


*Figure 5.7* Brazil: real domestic interest rates accumulated in the year (over)
*Source: Central Bank Bulletin,* April 1994

transferred from Brazil when relative interest rates converge. These inflows are essentially opportunistic, seeking short-term gains from the failure of the authorities to control public expenditure. Moreover, while these inflows make no contribution to the shortfall in investment capital, they add to inflationary pressures.

A development of perhaps more long-term significance occurred in March 1994, when Brazil finally reached an agreement with its commercial bank creditors which involved the conversion of debt totalling US$49 billion into new securities guaranteed by Brazil. The immediate effect was a reduction of US$4 billion in the debt total and a corresponding long-term reduction in the costs of debt servicing. Less tangible is the stimulus to inflows of investment capital which could result from the restoration of Brazil's financial credibility.

## FOREIGN DIRECT INVESTMENT

Over a period of sixty years from the Vargas dictatorship, a wide range of controls both legal and fiscal have been instituted to protect the Brazilian market from foreign competition. Modernizing the archaic and bureaucratic system developed during this time is a formidable task which daunts even reform-minded politicians and civil servants; this continues to inhibit much potential foreign direct investment in production capacity in Brazil. Examples of this nationalist policy include the reservation of specific sectors regarded as strategic for state enterprises, in particular petroleum exploration and refining and telecommunications. In some sectors there have been constitutional restrictions on foreign ownership (as in the mining industry where the majority stakeholder must be a Brazilian partner), while in other sectors, tariff and other barriers have been imposed to limit imports.

Nevertheless, multinational companies have established themselves in Brazil and hold strong market positions in a number of industries, complementing the oligopolic structure of much of Brazilian private sector industry. In a somewhat different mould is the dominance of the vehicle industry by multinational manufacturers, who during the 1950s and 1960s were encouraged to establish production facilities in the country and who subsequently have benefited from tariff and legal protection from imports to the undoubted detriment of the Brazilian consumer. While General Motors and Ford have assembled vehicles in Brazil since the 1920s, the breakthrough in creating a national vehicle industry was the late 1950s start-up of the Volkswagen plant in São Paulo state, which was followed in the 1960s and 1970s with investment from other foreign manufacturers. Fiat was a relative latecomer with the opening of its production facilities near Belo Horizonte in the early 1980s, since when it has flourished and is now challenging the market leadership of Volkswagen. In addition, Scania, Mercedes Benz and Volvo dominate the Brazilian market for trucks and buses. Notable by their absence to date have been the Japanese vehicle manufacturers with the exception of a single Toyota plant producing a limited range of small utility vehicles.

Other sectors in which foreign-owned companies hold a significant position relative to major national enterprises are fuel distribution, food, and pharmaceuticals and chemicals. However, only 4 per cent of the total net assets employed by the 500 largest enterprises are classified to foreign-owned companies and these are concentrated in relatively few sectors. It should be noted however that other multinationals established in Brazil are registered as Brazilian companies and the role of foreign capital is unquestionably greater than the figures presented would indicate.

*Table 5.1* Net assets of foreign companies included in the 500 largest enterprises in Brazil

| *Sector* | *Percentage of total net assets of foreign-owned companies* | *Foreign-owned companies as % of sector totals* |
|---|---|---|
| Cement | 4.9 | 10.9 |
| Chemicals | 22.9 | 27.3 |
| Food and Drugs | 10.6 | 38.9 |
| Fuel Distribution | 10.7 | 50.5 |
| Manufacturing | 9.0 | 20.2 |
| Metallurgy | 16.9 | 9.9 |
| Vehicles | 18.9 | 64.7 |
| Other | 6.0 | 0.3 |

Source: Conjuntura Econômica, *August 1994*

Following its growth in the 1970s, foreign direct investment slumped dramatically throughout the 1980s, reflecting the enduring economic and political crises which beset Brazil during this period. In fact, during this period the main currency of direct investment was debt conversion. The liberalization policies of the Collor government, which were continued by the Franco government, have stimulated increases in inward flows since 1990. However, these remain small relative to other external capital inflows and in particular to what have been essentially speculative investment in portfolios. In 1993 and 1994 surges in portfolio investments were a significant destabilizing element, at first contributing to inflationary pressures when the Central Bank actively intervened in the foreign exchange market and exchanged Brazilian currency for dollars and lately, since the 1994 economic measures when the Central Bank adopted a more non-interventionist role, contributing to an overvaluation of the Brazilian *real.* The consequence was an appreciation of the *real* by 15 per cent by the end of 1994, when over the same period domestic price inflation has been of the order of 20 per cent.

Paradoxically, continued direct investment flow growth may be threatened by the acceleration of the modernization and liberalization measures promised by the incoming Cardoso government if these continue to attract large external inflows of speculative capital. Vehicle manufacturers have been at the forefront of the criticisms of the sudden reduction in import tariffs by the government in its battle to maintain the *Plano Real* on course and, in particular, to alleviate inflationary pressures. Planned increases in investment in augmenting production facilities are now being questioned in favour of direct imports from overseas. A major challenge of the incoming administration will be to reconcile these conflicting pressures and encourage foreign direct investment, which is believed to cause less real currency appreciation than other capital inflows.

## PRIVATIZATION PROGRAMME

The privatization programme begun by the Collor administration was continued by the Franco government, although progress has been modest in terms of both proceeds and scale. Steel and petrochemicals accounted for virtually all the privatizations to the end of 1993 and only US$150 million of the US$6.1 billion realized from the sales in this period were paid in cash, the major currencies utilized being public debt certificates. On the other hand, some of the companies, particularly in the steel sector, have produced major turnarounds in performance in their short period in private hands and are generating profits after years of loss-making and dependence on government subsidies. In 1994, disposals of stakes in steel, petrochemical and fertilizer companies have again predominated. Cash proceeds totalled nearly US$500 million to August with a target for the year of over US$900 million.

Dynamization of the privatization programme is the stated policy of President Fernando Henrique Cardoso, who has committed his government to accelerate and extend the range of state enterprises to be passed into private sector ownership. While the programme remained stalled for the first six months of his mandate, it was subsequently restarted and the first electricity distribution utility passed into private hands. Planned sales in 1995 include petrochemical companies, further electricity distribution utilities and banks. The planned sale of the state's majority stake in mining giant Companhia Vale do Rio Doce (CVRD) has been announced, although timing and approach have yet to be decided. Electricity generation has also been included in the government's privatization plans, although the restructuring required will defer disposals to 1997 or later. For the state telecommunications and oil and gas industries, there are no immediate disposal plans; rather the approach is introducing competition in these sectors by ending or modifying the monopoly power of the state. While the technical arguments for privatization are based on efficiency and the state's inability to finance huge investments required in the state industries, in the short term the government is faced with the urgent necessity to generate significant additional revenue in order to avoid budget deficits in 1995 and 1996 which would seriously undermine its economic programme and it is planned to raise around US$5 billion in 1995 from further disposals.

## BRAZIL'S SOCIAL INEQUALITY

There was a continuous increase in wealth concentration from 1960 to 1990. In the 1960s the group which suffered a decrease in its share of income was the middle class while in the 1980s it was the poorest. It has been argued both that there is a positive association between economic growth and equality (as inequality was lower in the 1970s) and that inequality is intensified under high rates of inflation (as occurred in the 1980s, when GDP per capita was largely constant and years with higher inflation tended to be the ones when inequality increased). Recession has also had an impact on per capita income. The failures of the economic policies of the 1980s and 1990s have produced nearly fifteen years of stagnation and high inflation resulting in unemployment, falls in the purchasing power of wages, and consequent increases in poverty and misery.

The minimum wage was established in Brazil in 1940 and is the basic reference for millions of Brazilian workers and pensioners. It was estimated that in 1989, 12 per cent of the economically active population received one minimum wage or less. In rural areas it is frequently the actual wage of the main breadwinner of the family, and municipal employees in small towns, including teachers and health workers, commonly receive less than the prevailing national minimum wage and just as commonly spend months without being paid. In 1990 the income of families constituting nearly 32 million Brazilians was no more than two minimum wages and over 61 million comprised families where the income did not exceed four minimum

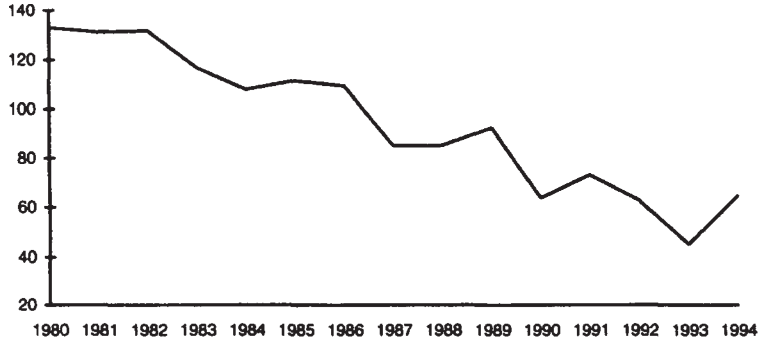


*Figure 5.8* Brazil: minimum wage (1991 US$)
*Source:* IPEA 1993

wages. The real value of the minimum wage has been falling virtually since it was established, but has experienced a dramatic decline since 1982 and the present value (in constant US dollars) is half what it was in 1980.

The roots of social inequality are to be found in the slavery of Brazil's colonial past, which emancipation did little to correct. Regional inequalities have been generated in the way the economy has been shaped, with exportation of primary goods and industry concentrated in the southern half of the country. Agrarian reform has not been pursued and the extension of labour rights to the rural areas expelled thousands of workers to the urban concentrations. In 1991 nearly 43 million people inhabited the nine metropolitan regions in Brazil compared to a rural population of 36 million. It is in the Brazilian cities that poverty has grown the most, as opposed to the countryside. The incidence of poverty is much greater in the urban areas of the north-east region, where 30 per cent of the population has a family income of less than two minimum wages compared to 11 per cent and 9.5 per cent in the south and south-east regions respectively.

Brazil has the highest level of inequality among the forty countries in which the World Bank collects data on the respective proportions of income appropriated by the most wealthy upper 10 per cent and the poorest 40 per cent. In the Western democracies the average income of an individual in the upper 10 per cent of incomes is between 4 and 8 times the income of an individual in the lower 40 per cent. In Latin American countries the corresponding figure is between 8 and 12 and in Brazil it is about 25 (Barros and Mendonça 1993:477).

The labour market both generates inequality as well as reflecting its underlying level. In Brazil education explains between 30 and 50 per cent of income inequality and its influence is greatest in the north-east where income inequality is also highest. The explanatory power of education derives both from the difference in educational level of the labour force and from its influence on average salary. The inequality in education is four times higher in Brazil than in the United States and salaries increase, on average, 15 per cent per studied year: a much higher rate than in other countries.

Another source of inequality is the segmentation of the labour market when equally productive workers receive different rewards. In Brazil two contributing factors are often quoted: institutional aspects (such as the effects of the trade unions and labour legislation) and the heterogeneity of enterprises. Studies have shown that there is a wage differentiation in favour of workers who are legally registered compared to informal workers, and in favour of employees of state enterprises compared to employees of private enterprises. There is also a significant variation in wage levels between the metropolitan regions in Brazil.

Barros and Mendonça (1993) argue that the inequality of income in Brazil is generated by an educational system marked by inequality of opportunities, resulting principally from regional disparities in provision. The minority who benefit from a university education receive salaries six times higher than a worker with only 1–4 years of education; and the income of an illiterate is 70 per cent of the average of workers with primary education. The educational profile of the workforce has changed little over the last ten years and inequality of income has been maintained even with the economy in a state of stagnation. Public investment in education prioritized to the primary and secondary levels (rather than free tertiary education at the federal and state universities which primarily benefits the middle classes) would, in the long term, make a key contribution to a more equal society.

Regional disparities are illustrated in Figure 5.9, which shows life expectancy, literacy rates and GDP per capita. The north-east is the poorest region and the south-east and the south are the more developed. However, while the south-east has the highest GDP per capita, the south has less extreme inequality. The regional disparities are even more marked when the infant mortality rates by state are examined: the states of the north-east region (Pernambuco, Paraíba, Ceará, Maranhão and Bahia) and of the North (Pará) have the highest infant mortality rates (see Figure 5.10). Brazil has also experienced the metropolitanization of poverty: the number of poor in rural areas grew from 18.6 to 20.1 million between 1980 and 1990, while in urban areas the increase was from 10.8 to 19 million in the same period. In 1991 over 38 per cent of the urban population lived in the nine metropolitan regions and in large Brazilian cities poverty, disease, crime and drug usage coexist with the high living standards of the upper and the middle classes (Rocha and Tolosa 1993).

Inflation and recession have eroded the state's resources which, aggravated by inefficiency and corruption, have worsened economic and social inequality. The fall in GDP per capita and the rise of unemployment have produced a further concentration of income.

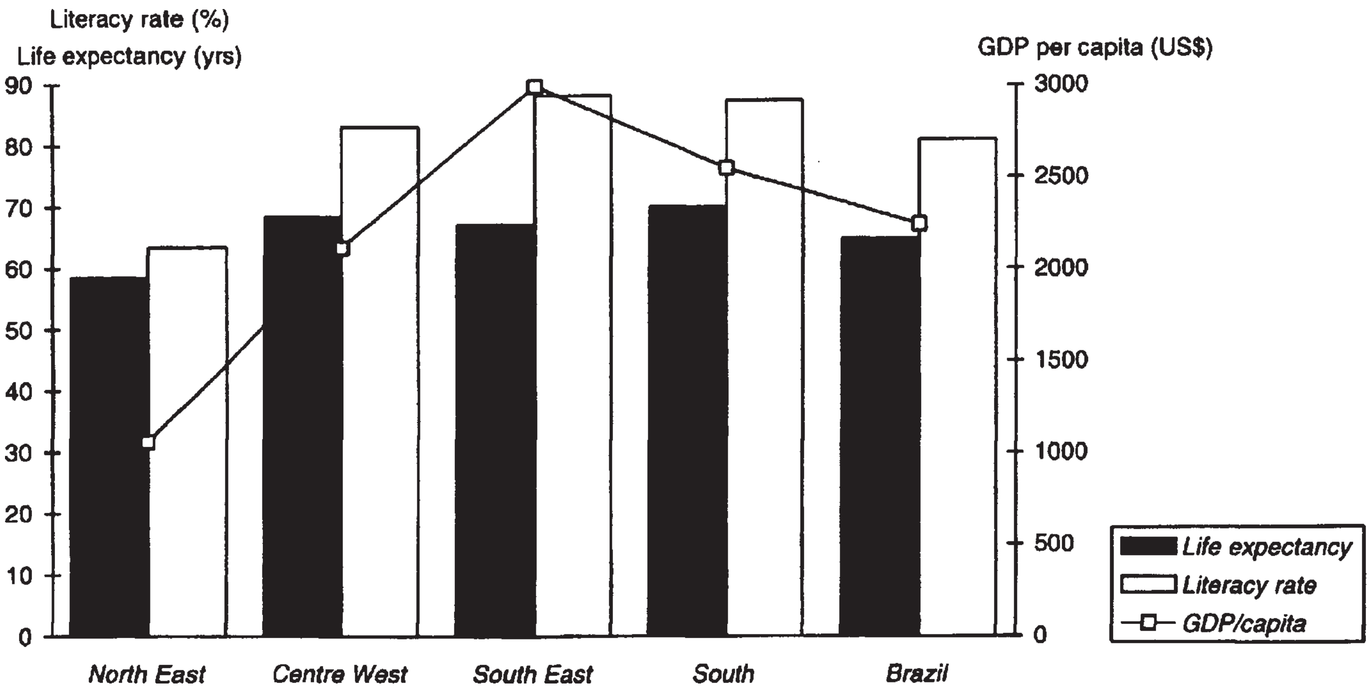


*Figure 5.9* Brazil: socio-economic indicators by region, 1998
*Source:* IPEA 1993, 22

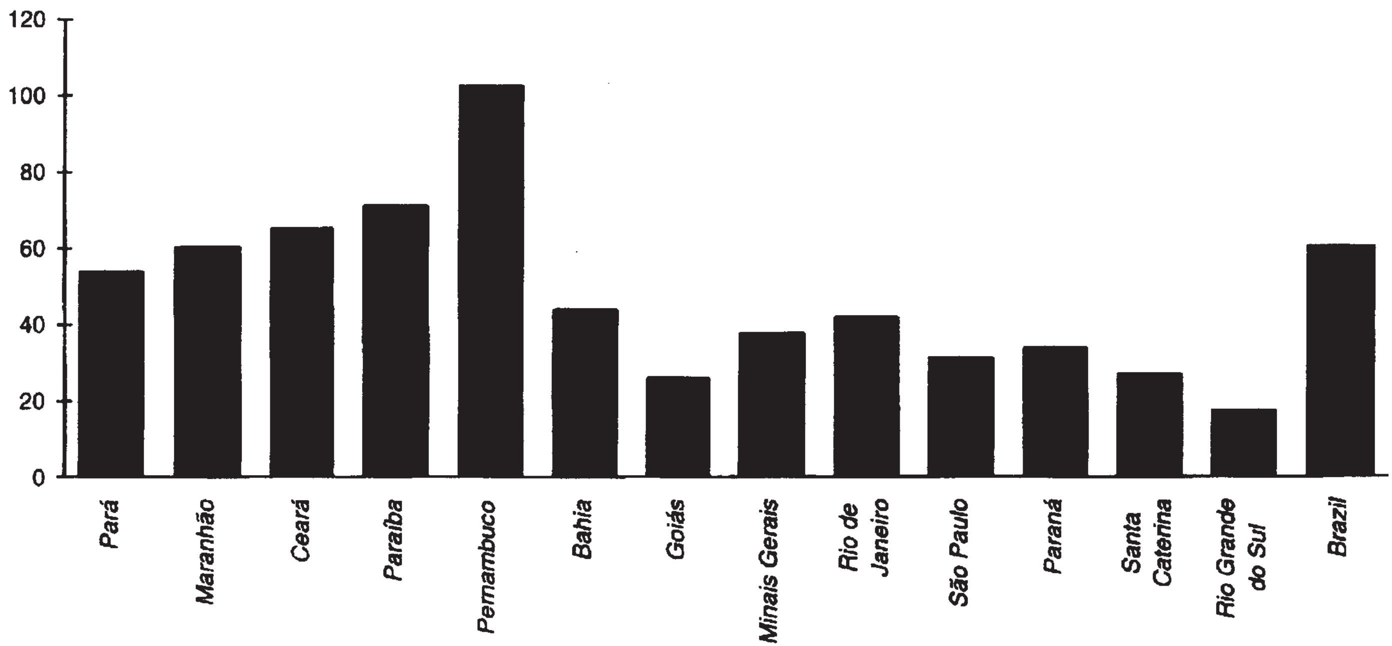


*Figure 5.10* Brazil: infant mortality per 1,000 population
*Source:* Editora Abril

Unemployment has impacted more on unqualified workers, and inflation has eroded the income of workers with lower wages, who have been unable to protect themselves while the better-off were able to utilize the sophisticated financial instruments to their benefit (referred to by Brazilians as *'ciranda financeira'* or financial dance). The reduced ability of the state to fund social services, especially health and education, again affects the poor disproportionately. Health services in public hospitals have deteriorated dramatically with shortages of material, equipment and doctors. There has also been an inadequate distribution of resources available, with 80 per cent of funds directed to hospitals and only 20 per cent to preventive health. Consequently there has been a significant increase in infant mortality, which has forced the government to launch an emergency social programme.

Social scientists in Brazil have been investigating the roots of socioeconomic inequality in the cultural and the political-juridical spheres. Brazil was a slave society and remnants of this social organization remain in the relations between rich and poor. There is no notion of common citizenship, no public space of equality; individuals are deprived of rights and relegated to the status of non-citizens with the law preserving privilege rather than enforcing progress, towards equality and guaranteeing basic rights (Nascimento 1994). Education in Brazil has not played the same role as it has in many other countries where building citizenship is an important if implicit aspect of the learning process; in Brazil education is regarded as a privilege, reinforcing inequality.

## CONCLUSION

Brazil's malaise has been essentially political under the influence of corporatist and clientelistic interests. Efforts to modernize the state, its institutions and the economy have been undermined by political factions both conservative and on the left who, fearing the decline of their privileges, have successfully manipulated the weakness and divisions of the reformers. Few would deny that the dominant problem has been that of inflation, which has been the main cause of the very low level of investment and which has led to one of the most extreme polarizations of income distribution in the world. The sophisticated system of inflation-proofing the major sectors of the economy, which has astonished the international financial community by its apparent efficacy in maintaining economic order, also advantaged powerful politico-economic sectors. These include banks (which have made large and easy profits from the high real interest rates and the captive deposits of their clients), large construction groups (who have thrived on super-factored cost plus government contracts), and the sugar-cane industry (which has obtained scandalous concessions in deferment of its debts with state banks).

Interests on the left of the political spectrum have also opposed orthodox measures to combat inflation, as this would mean reductions in public expenditure and a withdrawal by the state from sectors which it currently monopolizes. The arguments against privatization are reminiscent of those prevalent in the Western industrial democracies during the early 1980s, with the added highly emotional ingredient of nationalism as the defenders of the state enterprises see predatory foreign interests waiting in the wings. In this the left is allied with the management of the state enterprises, who rightly fear that privatization would mean the introduction of efficient management and lead to cuts in their overstaffed and highly paid bureaucratic administrations.

Indexation of public service wages and salaries, albeit not fully compensating for losses in purchasing power, has created an illusion of security and the powerful federal civil service trade unions also resist measures that would lead to an overhaul of the ineffective civil service. Indexation has also provided little incentive for the government to practise sound fiscal management, which could always be deferred to an ever future occasion.

The resilience of industry in adapting to the uncertainties of a highinflation economy has been impressive but has been helped by protectionist policies and subsidies. The gradual opening up of the economy and the phased reduction of some subsidies is increasing the competitive pressures in both the agricultural and manufacturing sectors. These pressures have been aggravated by the years of low investment and the consequent failure to increase productivity in step with trends in the major industrial countries.

Structural reforms in the political and economic spheres are fundamental to the continued success of the stabilization programme and these would bring about a retraction of the federal state from many sectors of the economy. However, the government needs to have its reform proposals sanctioned by the Congress, and where amendments to the Constitution are at stake it must obtain at least 60 per cent support. This is the root of the government's problem since its supporters in Congress form an uneasy alliance of social democrats, economic liberals and traditional populist politicians. In the interest of ensuring a sufficient majority for its proposals, the government has had both to mitigate its reforming zeal and to trade political appointments in order to keep the main thrust of its policies on track. Recourse to the judiciary has also been a favoured tactic of its opponents to delay measures, particularly where these affect workers' rights to automatic correction of salaries and stability of employment in the public sector.

While the government attempts to push its reforms through Congress, it has experienced difficulties in maintaining its stabilization plan on course. In order to avoid the overheating of the economy, short-term interest rates have been maintained at high levels and strict controls on bank lending have been enforced through compulsory deposits at the Central Bank.

This has caused problems with government supporters in the Congress and generated protests from the powerful industrial and agricultural lobbies, who have raised the prospect of recession. Another difficulty has been the rapid reversal in the terms of trade, with Brazil running a trade deficit in the first half year of 1995 as a result of the overvalued *real* and reductions in import duties. The government's abrupt raising of import duties on vehicle imports led to concerns that it was vacillating in its open-market policy and provoked a crisis with Argentina, Brazil's main partner in MERCOSUR.

Despite these setbacks, circumstances are generally propitious. There is increasing popular recognition that the state has failed to invest in the provision of adequate basic health services, education and housing, while in other sectors, through a combination of mismanagement, incompetence and corruption, huge sums have been squandered. While changes in the intricate political system can only occur gradually, the success of the economic measures taken since 1990 and the widening perception that economic and social distortions demand radical policies that will reverse the decline in the living conditions of many Brazilians, give grounds for believing that resolution may at last predominate over vacillation. However, in the affairs of nations, serendipity is at best a transitory phenomenon and the economic and social crisis in Mexico during the very transition of governments in Brazil demonstrated the urgency of implementing the government's reform programme.

The immediate future following the 1994 presidential, congressional and governmental elections and the assumption of office of the new administration will be a highly critical period for Brazil. Circumstances are generally propitious and the new administration is committed to bring about structural reforms in the political and economic spheres and to undertake the reconstruction of the state.

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# 6

# CONTROLLING HYPERINFLATION AND STRUCTURAL ADJUSTMENT IN NICARAGUA

*Oscar Catalán Aravena*

An unfavourable international context, long years of war and economic blockade, and a policy of transformations which affected the efficiency in the allocation of resources generated macroeconomic imbalances in the period 1979–87 which brought the mixed Sandinista economy to the brink of collapse. Structural adjustment, which had been postponed by the war and the international political conjuncture, could not be put off any longer by the beginning of 1988.

In 1988 the Sandinista government put an end to the expansionist policy and initiated an adjustment programme orientated towards the reestablishment of macroeconomic equilibrium by means of corrections in relative prices and a reduction of demand. This policy, which could count on a solid base of social support at first, but which lacked the support of the multilateral financial organizations, failed through the lack of external funding. The results were hyperinflation, increased recession and social frustration.

With the arrival of the new government, starting in April 1990, the war was rapidly brought to an end and Nicaragua was readmitted to the international financial community. From then on, the Violeta Chamorro administration has implemented a strategy of accelerated transition towards a free-market economy. Within the framework of the new strategy, the stabilizing efforts initiated by the Sandinistas were continued.

The Mayorga Plan implemented in 1990 was unsuccessful in its attempt to bring a rapid halt to inflation. During the first year of the Chamorro administration, an inconsistent restrictive policy was applied, due to the open resistance of wide social sectors and to the failure to materialize of the foreign aid which had been promised. During this period, characterized by the test of strength and open confrontation between the new government and the Sandinista opposition, the country was on the verge of civil war.

At the end of 1990 the government signed economic and social agreements with trade unions and peasant organizations. These agreements later functioned as a political basis for the implementation of the Lacayo Plan, which came into force in March 1991 and which put a sudden stop to hyperinflation in April. From the second quarter of 1991 the government considered that the stage of economic reactivation had begun. In order to guarantee a flow of concessionary resources to finance the deficit during the period of economic restructuring, the government signed a stand-by agreement with the International Monetary Fund (IMF) in October 1991. This agreement enabled it to count on sizeable external resources in 1991 and 1992.

Despite the foreign aid received and the favourable renegotiation of the foreign debt with the member states of the Club of Paris, the policy applied was not able to reactivate the economy, and the process of impoverishment and marginalization of broad social sectors continued. The attempts at economic reactivation were limited by the restrictive policies that were applied and the accelerated liberalization of foreign trade.

In 1993 the total flow of external resources contracted, particularly the flow of liquid resources, as a result of which a substantial part of the effective expenditure was tied to specific projects and to servicing the external debt. The scarcity of external resources made it necessary to step up the restrictive character of the fiscal and monetary policy. The year 1993 closed with a reduction in economic activity, the reduction of the international reserves to a critical level, and with a slight upswing in inflation.

The aim of this chapter is to present: an analysis of the macroeconomic stabilization and structural adjustment policies implemented in the 1988–93 period; a critical evaluation of their effects; and an elaboration of suggestions for a policy of reactivation capable of halting the prolonged recession and initiating a sustainable economic growth.

## THE STABILIZATION AND ADJUSTMENT POLICY OF THE SANDINISTAS

Right from the monetary reform of February 1988 to the end of 1989, the main objective of the economic policy of the Sandinista government was to correct the macroeconomic imbalances which had arisen during the war years and to apply the Sandinista mixed economy strategy. The Sandinista stabilization and adjustment programme did not count on the support of the multilateral financial organizations.

In 1988 efforts were concentrated on the realignment of the system of relative prices. To this end, the multiple exchange rates were unified, the córdoba was heavily devalued, and the main domestic prices were freed. Furthermore, measures were taken to contain inflation by reducing the fiscal deficit and controlling credit. The policy of correcting relative prices, by means of devaluation of the exchange rate, generated increased inflation, which in turn necessitated further devaluation. The result was a remarkable devaluation/inflation spiral: the average annual devaluation of the exchange rate in 1988 was 281,757 per cent (Neira and Acevedo 1992:38), and the cumulative inflation for that year stood at 33,657 per cent.

Despite the reduction in economic and social investment, the attempts to reduce the fiscal deficit failed in 1988 as a result of the inflexibility of defence expenditure and the exceptional social costs of hurricane Juana. The main adjustment variable was the real wage, which contracted by more than 40 per cent. The contraction of demand in turn brought about a reduction in economic activity of 13.5 per cent.

The main aim of economic policy in 1989 was to contain the hyperinflation unleashed by the series of devaluations. To this end, drastic cuts in public spending were applied, which brought down the fiscal deficit from 26.6 per cent of the Gross National Product (GNP) in 1988 to a mere 6.7 per cent in 1989, while the real liquidity of the economy fell by more than 50 per cent in relation to the 1988 level (Acevedo 1993:109). These measures enabled a significant de-acceleration of inflation, which was reduced to 1,689 per cent in 1989, and deepened the economic recession: the GNP fell by 1.8 per cent and underemployment and unemployment increased to almost 40 per cent of the active population.

To sum up, as a result of the lack of support of international reserves and of the failure of any foreign financial injection to materialize, the Sandinista government's attempts to correct the macroeconomic imbalances which had accumulated in the course of ten years of revolution released a hyperinflationary process and a profound recession, with the concomitant enormous costs in economic, social and political terms.

The GNP fell by 15.3 per cent during the period 1988–9, and the per capita fall in the GNP was almost 20 per cent. The outbreak of the recession affected all productive activities, especially those connected with the domestic market: production in the manufacturing sector dropped by 25 per cent in 1988 and 2.7 per cent in 1989 (Dijkstra 1994:19). As a result of the recession, almost half of the small industrial companies had to close down. The social costs were primarily expressed in the explosive growth of underemployment and unemployment and in the accelerated deterioration of basic social services.

The defeat of the Frente Sandinista de Liberación Nacional (Sandinista Front of National Liberation, FSLN) in the elections held in February 1990 and the triumph of the Unión Nicaraguense Opositora (National Opposition Union, UNO) coalition reflected the social discontent arising from the consequences of the adjustment and the weariness at the sacrifices imposed by the war. During the transitional period from February to April 1990, which followed the UNO's electoral victory, the new government considerably loosened up the rigorous fiscal regime applied during 1989, mainly by means of significant adjustments to salaries in the public sector, leading to a new acceleration of the fiscal deficit and inflation (Dijkstra 1992:183). The government of President Chamorro put an end to the

Sandinista policy of mixed economy and initiated the transition towards a free-market economy in Nicaragua.

## CONTROLLING HYPERINFLATION

After the change of government, the war came to an end, the United States lifted the trade blockade which had been affecting Nicaragua since 1985, and the country was readmitted to the international financial community. The Chamorro administration continued the attempts at stabilization by the previous government and simultaneously launched an accelerated programme to liberalize the economy. The strategy of stabilization and structural reform that was formulated is in line with the conceptual framework promoted by the IMF and the World Bank (Medal 1993:93).

With the so-called Mayorga Plan, from April 1990 attempts were made to contain inflation through a restrictive monetary policy and the reduction of public spending. Thanks to the successful resistance of the labour movement to measures that implied a reduction in employment or salaries, current expenditure increased as a percentage of the GNP and the restrictive policy was reflected in a drastic reduction in fiscal investments, which fell to 1.3 per cent of the GNP. The liberalization of foreign trade was also initiated by reducing import tariffs and selective consumer tax. Moreover, a change of policy was implemented aimed at unifying the official rate of exchange with that of the free market by means of weekly devaluations.

A new unit of currency, the 'córdoba oro', was introduced in July 1990. According to Mayorga's plans, the córdoba oro, which was indexed to the dollar, was intended to replace the 'córdoba nuevo' as a unit of exchange and subsequently to facilitate the stabilization of prices, provided there were sufficient international reserves available to maintain the parity of the córdoba oro with the dollar within the regime of free convertibility (Catalán 1993).

After the outbreak of a hyperinflationary process, the monetary and fiscal measures applied were not sufficient to stabilize prices. Independently of its origin, inflation was now spreading not only because of the increase of the money supply or the pressures of demand, but also because of the increase in the velocity of circulation of money due to the inflationary expectations aroused among the economic agents by the constant and massive devaluations. In an economy with prices expressed in dollars, a spiral of devaluation/inflation emerged, and the restrictive measures provoked an increased contraction of demand and a crisis of liquidity, without managing to check the inflationary spiral.

In 1990, far from disappearing, inflation continued to accelerate, reaching 13,490 per cent. The economic recession continued with a new drop in the GNP of 0.1 per cent, and underemployment reached the record of 44.6

per cent of the active population. The fiscal deficit, which had been reduced to manageable levels in 1989, increased explosively, reaching 17 per cent of the GNP. Exports, which had made a considerable recovery in 1989, continued to grow, but at a slower rate. Imports, which had fallen by 22 per cent during the last year of the previous government, picked up again, so that the trade balance demonstrated a rather insignificant improvement.

The failure of the Mayorga Plan is due not only to the resistance of popular sectors, but also to the low level of support from the employers' sector, the US government's delay in the disbursement of the aid it had promised, and the impact of the liberalization of trade. In view of the failure of the promised resources to materialize, it was impossible to support the stabilization of the exchange rate which was to serve as an anchor for prices. Devaluations increased inflation, thereby making fresh devaluations necessary, and the fiscal and monetary restrictions deepened the recession. In spite of the restrictions on the demand side, the balance of trade was not corrected because a real devaluation failed to take place and the commercial liberalization favoured an increase in imports.

From August 1990, a heavy reduction in import duties and selective consumer taxes which mainly affected imports were begun. The rate of nominal protection fell from 43.2 per cent in 1990 to 15.2 per cent in 1991 (Medal 1993:144–5). This alleviation of duties reinforced the existing pro-importer bias due to the overvaluation of the córdoba.

After this first period of a trial of strength with the Sandinista opposition, the government decided to try to make economic and social agreements with the organizations of producers and workers. What was at stake was an attempt to resolve the extreme political polarization pragmatically in order to secure political viability for the project of structural adjustment. In October 1990 the trade union federations, the Unión Nacional de Agricultores y Ganaderos (National Union of Agricultural Producers, UNAG) and the government signed important agreements. As a result of these agreements, the government committed itself to applying a more gradual economic policy and selective reactivation and reorganization of agricultural loans. Furthermore, it recognized the assignment of property by the Sandinista government (prior to 25 February 1990) and promised to compensate landowners who had been unjustly expropriated. For their part, the unions agreed not to organize strikes, while the government accepted the privatization of some of the state enterprises in favour of the workers. The union of large industrialists Consejo Superior de la Empresa Privada (Supreme Council for Private Enterprises, COSEP) refused to sign these agreements.

The economic agreements at the end of 1990 created the political conditions for the implementation of the Lacayo Plan, which put an end to hyperinflation. In March 1991 the córdoba nuevo was devalued by 400 per cent, which resulted in an increase in prices of 300 per cent. From now on the córdoba oro came into use, replacing the córdoba nuevo as a unit of currency. Prices rose by 20 per cent in April, and inflation came to an abrupt halt after then.

The anti-inflationary policy consisted of indexing domestic prices to the dollar and then freezing the exchange rate. Once prices had become indexed to the dollar, the exchange rate was stabilized through the introduction of the córdoba oro (indexed to the dollar) as the unit of currency. In order to discourage inflationary inertia and to back up the stabilization of prices which had been achieved, the government decreed the reduction of certain prices and tariffs for public services and exercised administrative supervision of the key prices, including freezing wages and the exchange rate. The donations by the United States Agency for International Development (USAID) ensured a plentiful supply of food during the first three months, thereby reinforcing the package of heterodox measures which had been applied.

A stable exchange rate, in a regime of free convertibility in which the Banco Central de Nicaragua (National Bank of Nicaragua) does not emit currency which is not backed by international reserves, was possible thanks to the resources received from abroad in 1991, especially from the United States. The total in foreign aid in 1991 amounted to US$884.5 million in donations (equivalent to 51.2 per cent of the GNP) and US$604.6 million in loans (*Banco Central* 1992:194–7). The Economic Stabilization Programme was supported with US$717 million, of which US$306 million were liquidities in the form of bills of exchange which were used to finance imports, to increase the international reserves, and to finance the fiscal deficit ('Nitlaplán' 1993:4–10).

After prices had been stabilized in the second quarter of 1991, the government considered the stabilization stage to have come to an end. It announced the start of the stage of economic reactivation. With price stability and the guarantees that had been offered, it was initially hoped that private investment would play a spontaneous reactivating role. However, the role of the private sector turned out to be a different one.

The lack of interest on the part of the sectors with investment capacity and the repatriation of capital can be explained by economic factors, such as the poor state of the infrastructure, the overvaluation of the córdoba, the fact that energy prices were above regional levels, the lack of liquidity, the fragility of the stabilization, and by political factors connected with the problem of the properties confiscated during the previous administration.

The medium and small producers did not reactivate their investments for mainly economic reasons. The maxi-devaluation of the dollar in March 1991, combined with credit restrictions, had destroyed their work capital and broken the small and medium producers, who could not pass on their increased costs in prices because of the price stabilization. Moreover, once prices had been stabilized, the fiscal and financial policies maintained their restrictive character, which accentuated the recessive tendencies.

*Table 6.1* Nicaragua: main economic indicators (1988–93)

| | *1988* | *1989* | *1990* | *1991* | *1992* | *1993* |
|---|---|---|---|---|---|---|
| Gross National Product (%) | – 13.5 | – 1.8 | – 0.1 | – 0.2 | 0.4 | – 0.9 |
| GNP per capita (%) | – 15.6 | – 4.3 | – 3.0 | – 3.6 | – 3.3 | – 4.6 |
| Central govt. deficit/GNP (%) | – 26.6 | – 6.7 | – 17.1 | – 7.5 | – 7.6 | – 6.3 |
| Consumer prices (%) | 33.6 | 1.7 | 13.5 | 8.7 | 3.5 | 19.5 |
| Underemployment (%) | 26.5 | 39.9 | 44.6 | 53.5 | 49.1 | 51.3 |
| Variation in real wages (%) | – 42.7 | 66.0 | 61.5 | 3.2 | 19.2 | – 3.4 |
| Trade balance ($m) | – 583.0 | – 326.0 | – 290.0 | – 486.0 | – 584.0 | – 449.0 |
| Exports, goods and services ($m) | 273.0 | 341.0 | 392.0 | 338.0 | 309.0 | 367.0 |
| Imports, goods and services ($m) | 856.0 | 667.0 | 682.0 | 824.0 | 893.0 | 816.0 |
| Terms of trade (%) | 6.3 | – 5.3 | 2.1 | – 5.3 | – 7.3 | – 2.5 |
| Index real exchange rate (1980=100) | 100.0 | – | – | 89.6 | 78.0 | 82.1 |
| Net variation international reserves ($m) | 44 | 64 | – 39 | 86 | 8 | – 100 |
| Public foreign debt ($m) | 7.220 | 9.741 | 10.616 | 10.312 | 10.806 | 10.987 |

Source: *CEPAL, based on official statistics*

The success gained over inflation in 1991 was overshadowed by the economic recession and the social consequences of the policies implemented: although inflation reached minimal levels from April 1991, the GNP fell by 0.2 per cent, representing a drop of 3.6 per cent per capita (see Table 6.1). The trade deficit rose by 68 per cent, unemployment and underemployment affected more than 53 per cent of the active population. Unemployment, low wages, and the deterioration in education and health services exacerbated extreme poverty and social tensions, bringing about a dangerous process of social disintegration.

## THE IMF CONDITIONS AND THE ATTEMPTS AT REACTIVATION

In September 1991, six months after prices had been stabilized, the government signed a stand-by agreement with the IMF, which was initially to last for eighteen months. This agreement consisted of a loan of 41 million IMF Special Drawing Rights (SDRs), equivalent to 60 per cent of the Nicaraguan quota (Acevedo 1993:21), dependent on the application of a Financial Programme. From then on, the economic policy of the country has been subject to the conditionality agreed upon with the IMF.

These terms consist of the laying down of quantitative quarterly limits to central government spending, loans to the non-financial public sector, the public external debt, and the internal assets of the Banco Central de Nicaragua and its international reserves. In the event of an exogenous shock, current expenses must be automatically adjusted to compensate. Current expenses are only to be paid with current income, and capital expenses are to be financed with internal savings and external funds. Together with the financial programme, it was decided to continue the programme of accelerated commercial liberalization with the application of a programme of financial liberalization allowing the functioning of private banks, the liberalization of the rates of interest and the privatization of state enterprises.

In 1992 the government recognized the need to promote economic reactivation with an autonomous increase in spending. As it could count on the external funds promised by the multilateral banks (World Bank and Interamerican Development Bank), an ambitious Public Investment Programme (PIP) was drawn up to generate 80,000 new jobs and to serve as the driving force behind reactivation. Due to the successful checking of inflation, the signing of the stand-by agreement, and the favourable renegotiation of the debt with the members of the Club of Paris, the government's expectations for 1992 were very optimistic: the implementation of the Financial Programme was considered compatible with an annual economic growth of 4.7 per cent, an increase of the international reserves by US$15 million, and a reduction of inflation to an annual rate of 15 per cent (*Banco Central* 1992:11).

Although there was a significant drop by comparison with 1991, external aid was still considerable in 1992. US$378.6 million (equivalent to 20.6 per cent of the GNP) were received in donations, of which US$ 142 corresponded to liquidities. The total loans received amounted to US$380.5 million, of which US$335 million consisted of liquidities (*Banco Central* 1992:11).

Although the government could count on sufficient resources to fund an investment programme intended to launch economic reactivation (central government external financing almost doubled the deficit), the PIP had a low level of implementation and a low impact on the job market. The main problem was the lack of national resources to meet current expenses as a counterpart of the external resources which had been approved. In accordance with the agreements, this problem had to be solved by a reduction of the investment programme or a reduction of current expenditure to generate savings. The government opted for a policy of not cutting operating expenses even further than they had already been reduced.

The fiscal restrictions of 1992 are due to the compensatory adjustment in public spending. This mechanism was activated as a response to the deterioration of the external situation at the end of 1991 and the beginning of 1992 because of the drop in prices of export products (the terms of trade deteriorated by 5.3 per cent in 1991 and 7.3 per cent in 1992) and to the difficulties in the disbursement of multilateral loans.

Although the disbursement of liquid credits and donations was speeded up in the second quarter of 1992 to accelerate the execution of the programme, it was not possible to initiate the majority of the planned construction programme. Construction is a state activity in Nicaragua. It takes place during the dry season (November–April). This explains why public investment in construction dropped by 0.8 per cent, while investment in machinery and equipment increased by 110.4 per cent. Part of the external resources obtained in 1992 had to remain frozen in the Banco Central de Nicaragua without contributing to the mobilization of productive resources which were lying idle because of the recession. These resources could have doubled the investment programme (Acevedo 1993:48–9).

A second factor which explains the low level of execution of the PIP is the dismantling of the capacity for preinvestment studies and the execution of projects as a result of the reduction of civil servants. Although the repair of the infrastructure does not require large-scale studies, part of the disbursement of the external resources was hindered by delays or the lack of back-up studies for the investment plans (Acevedo 1993:51). A third factor which explains the low level of execution of the investment programme was the crisis brought about by the suspension of part of the US financial aid (*Banco Central* 1992:11). The importance of the US$100 million of USAID lies in the fact that these were liquid resources and that their retention generated speculation on the exchange market.

Internal prices were kept at a stable level during 1992, with inflation running at a mere 3.5 per cent, an achievement which was well above the programmed target. However, as for the growth target, far from being reactivated, the economy practically stagnated; the growth in the GNP was only 0.4 per cent, implying a per capita reduction in the GNP of 3.3 per cent. This modest result is due not only to the low level of execution of the PIP but also to its reduced multiplier effect. As a result of the commercial liberalization, the increased demand created by the investment programme was translated into a strong growth in imports, revealing that internal production is not in a position to compete with imported goods as a result of its low level of efficiency and considerable technological backwardness.

The growth in imports at the expense of national production, and the drop in exports, were reinforced by the overvaluation of the exchange rate and the deterioration in the terms of trade: it is estimated that the córdoba oro was overvalued by 22 per cent in 1992, while the deterioration in the terms of trade was 7.3 per cent.

The relations between the government and the IMF were affected by the problems connected with the implementation of the PIP. In addition, other sources of tension emerged: the agreements signed by the government to cut down the army and to demobilize the resistance implied expenditure which had not been planned. The government financed this 'investment for peace' with excess external funds because of the low execution of the PIP, thus departing from the IMF agreement. By drawing on resources which had not been used in the PIP, the government disbursed US$42.2

million in debt payment—more than twice as much as planned. The stand-by agreement was frozen prematurely in December 1992. From then on until the end of the first half of 1994, when the negotiations on resources and the terms of the new Enhanced Structural Adjustment Facility (ESAF) ended, the government operated de facto in terms of an unsigned shadow agreement.

The year 1993 was characterized by the sudden reduction in foreign aid. The effective disbursements of loans and donations were reduced to US$383 million, of which only US$127 million were realized in liquidities. The rest of the aid consisted of resources tied to specific projects and to the payment for the service of the foreign debt ('Nicaragua: Evolución económica durante 1993':1).

*Table 6.2* Nicaragua: fiscal indicators (1990–3)

| | *Central Goverment (% of GNP)* | | | |
|---|---|---|---|---|
| | *1990* | *1991* | *1992* | *1993* |
| 1. Current income | 14.9 | 19.3 | 20.4 | 18.9 |
| Income from taxes | 13.5 | 17.7 | 19.3 | 18.0 |
| Direct | 3.6 | 3.4 | 3.4 | 2.5 |
| Indirect | 7.0 | 10.7 | 11.9 | 11.6 |
| Foreign trade | 2.9 | 3.6 | 4.0 | 3.9 |
| 2. Income from capital | 0.0 | 0.2 | 0.1 | 0.5 |
| 3. Total income (1+2) | 14.9 | 19.5 | 20.5 | 19.4 |
| 4. Current expenses | 30.7 | 23.5 | 22.1 | 20.0 |
| 5. Capital expenses | 1.3 | 3.5 | 6.0 | 5.7 |
| 6. Total expenses (4+5) | 32.0 | 27.0 | 28.1 | 25.7 |
| 7. Deficit (3–6) | – 17.1 | – 7.5 | – 7.6 | – 6.3 |
| *Financing:* | | | | |
| Internal | – 5.2 | – 4.6 | – 6.1 | – 0.6 |
| External | 22.3 | 12.1 | 13.7 | 6.9 |

Sources: *CEPAL, based on the statistics of the Ministry of Finance and the Banco Central de Nicaragua.*

*Table 6.3* Nicaragua: monetary indicators (1990–3)

| | *Balance at end of year (Millions of córdobas oro of 1990)*[1] | | | |
|---|---|---|---|---|
| | *1990* | *1991* | *1992* | *1993* |
| Money (M1) | 76 | 75 | 84 | 67 |
| Internal Credit | 653 | 401 | 2177 | 2108 |
| To public sector | 558 | 228 | 1973 | 1853 |
| Central government | 179 | 105 | 1887 | 1775 |
| Institutions[2] | 378 | 123 | 86 | 78 |
| To private sector | 95 | 173 | 204 | 255 |

1 Current córdobas adjusted by the consumer price index at the end of each year (865.6 per cent in 1991, 3.5 per cent in 1992, and 19.46 per cent in 1993).
2 Including the public property sector.
Sources: *Own calculations based on CEPAL statistics*

The reduction in external resources is explained by the termination of the stand-by agreement with the Fund in March 1993, by the temporary suspension of US aid and, once again, because the limited capacity of execution of projects slowed down the rate of disbursement of the loans that had been promised. The reduction in external resources made it necessary to step up fiscal and financial austerity measures. The fiscal deficit was reduced from 7.6 per cent to 6.3 per cent of the GNP: current expenditure was cut back by 10 per cent and capital expenditure by 5 per cent (see Tables 6.2 and 6.3). The credit of the Banco Central de Nicaragua to the financial system was drastically reduced from 607 million current córdobas accumulated in 1992 to only 214 million current córdobas accumulated in 1993 (*Nicaragua:* Evolución económica: 14).

In an attempt to correct the anti-export bias, the nominal unit of exchange was devalued by 20 per cent in January 1993 and an annual 5 per cent crawling peg was introduced. Due to the existing indexing in the economy, inflation picked up, despite the restrictive policies and the freezing of salaries in the public sector. As inflation reached 19.5 per cent, the real devaluation of the exchange rate was minimal.

During 1993 the hopes of economic reactivation were dashed once again: production fell by 0.9 per cent, implying a new per capita drop in the GNP of 4.4 per cent. In the grip of the recession, the agricultural sector displayed a slight upswing of 1 per cent and a heterogeneous behaviour due to the process of restructuring which the sector was undergoing. The recession continued in the traditional export items: coffee production fell because of the drop in international prices and the insecurity in the main zones of production; cotton exports practically disappeared because of the drop in the international price; sugar exports fell despite the slight improvement in the international price. The emerging exports of non-traditional agricultural products increased by 67 per cent, attaining a value virtually equivalent to that of coffee (statistics for agricultural and industrial production in 1993 are taken from CEPAL 1993).

Agricultural production for internal consumption increased in rice, sorghum and soya, but dropped in maize and beans. Livestock production increased by 10 per cent, especially poultry. The export of meat increased by almost 50 per cent, becoming the main export article (US$60 million). Fishery production increased by 66 per cent.

The reduction in economic activity in 1993 is due to the drop in the manufacturing industry and in services. In the manufacturing industry the most striking decreases are in textiles and ready-made clothing, metallic products, machinery and transport material. There was a growth in items connected with export, such as abattoirs, leather and footwear and marine product processing.

The decrease in domestic demand and the deterioration in export activities such as coffee and cotton resulted in an increase in unemployment, which came to account for more than 50 per cent of the active population. However, the positive aspect of the results obtained in 1993 is the growth, although still very feeble, of the export sector. The trade deficit fell by 25 per cent as a result of the increase in exports by 19.7 per cent and the reduction in imports of 12.3 per cent.

The increase in livestock, fishery and non-traditional agricultural exports is an indication of the growth of activities forming the spearhead of the reactivation. Some slight indications of reactivation were also perceptible in the manufacturing industry in activities connected with the export of livestock and fish. The reduced deterioration in the terms of trade in 1993 was due to the variation in the structure of exports in favour of these items.

Thanks to the severe fiscal and financial restrictions, price stability was kept within reasonable limits, although the reduction in international reserves of US$100 million demonstrates the fragility of the stabilization that has been achieved and its dependence on the flow of aid from abroad. The increased social conflicts revealed once again the weakness of the base of social support for the reform project that has been implemented. The political viability of the transition to a free-market economy appears seriously threatened by the mediocre economic results of the structural adjustment and its high social cost.

## SUGGESTIONS FOR A REACTIVATION POLICY

The stability of prices achieved in 1991 is extremely fragile, and the restrictive policies applied to sustain it generate economic recession, which in turn encourages social and political conflicts. In an economy with a rate of unemployment running at more than 50 per cent of the active population, with an idle productive capacity because of the reduction in expenditure, the claim that the problem is one of excessive demand is hardly convincing. Additional restrictions on demand are equivalent to a continuation of the generation of recession, a destruction of productive capacity, and a lack of governability.

In spite of the large amount of foreign aid received, the economy has not been reactivated, nor have the conditions been created to replace temporary foreign aid by investments. As a result of the policy applied, exports—which should have been the driving force behind reactivation—have fallen and imports have risen. Consequently, the increased trade deficit has swallowed up an important part of the abundant concessionary resources which the country had at its disposal.

The slight positive effects of the restructuring of the economy are counteracted by the recessive effects, the conflicts, and the social disintegration produced by the structural adjustment. A policy geared towards increased use of the productive potential would enable economic recovery and reduce unemployment. The solution to the crisis is not to be sought in trying to cut back demand, but in the availability of resources and, in particular, in their efficient utilization. The Nicaraguan problem is how to restore sustained economic growth.

The adjustment policies envisage measures to cut down expenditure in order to reduce the difference between aggregate demand and supply, as well as modifications in relative prices in favour of tradeable goods. Expenditure cuts, which produce recession in the short term, are necessary to the extent that it is not possible to finance a substantial part of expenditure permanently from external resources. The recessive effects of the cuts in spending should be compensated by the reactivation of exports and the drop in imports encouraged by the real devaluation of the exchange rate and other measures in favour of tradeable goods.

In the case of Nicaragua, drastic measures have been implemented over a period of six consecutive years to reduce demand. However, the measures tending to modify relative prices in order to encourage the production of tradeables have not achieved the desired result, both because of a lack of flexibility which prevent supply from reacting to the signals emitted by the market, and because of the feebleness and contradictory nature of these signals. The result is a profound recession and an increase in the trade deficit, which has been covered by foreign aid.

In Nicaragua, in which the value of imports is almost three times as high as that of exports, the elimination of the trade deficit by reducing aggregate demand to the level of the supply would generate such an enormous recession in the short term that it is not viable in political or social terms. The magnitude of the problem calls for a gradual approach. The gradual reduction of demand should be accompanied by measures which help to overcome the existing inflexibility on the supply side. As the majority of improvements on the supply side are only possible in the medium or long term, breaking the vicious circle of economic recession, restrictive policies, and social conflicts requires the maintenance of the flow of aid from abroad to finance the changes in the supply side and to support a climate of social and political stability.

The policies applied have been inconsistent in implementing an accelerated reduction in tariffs with an overvalued exchange rate. Furthermore, the financial liberalization has led to very high real interest rates and high differentials between active and passive rates.

Nicaragua is an extremely polarized society which is undergoing an accelerated process of social disintegration as a result of the marginal existence and extreme poverty of the majority of its population. The forced application of a policy which generates more recession, in the hope that the market will resolve the problems, implies huge risks, not only for the viability of the transition to a market economy, but also for the very viability of the whole country. The gravity of the situation necessitates a revision of the policies applied during the last four years. A reorientation of economic policies is required to break the vicious circle of economic recession/restrictive policies/social and political instability.

The proposed reorientation consists of a change of emphasis from the policy of limiting general demand to a differentiated policy of promoting and restructuring supply. To this end, the structural adjustment programme should be made more flexible with the introduction of heterodox elements, and more attention should be paid to the relation between macroeconomic and social balances, since the application of limited programmes to compensate for the social effects of the adjustment is not sufficient to guarantee its political viability.

Irrespective of the fact that priority was assigned to stabilizing prices in Nicaragua and that the anchoring of the exchange rate was the instrument chosen to achieve this end, it would appear that the real devaluation of the exchange rate is not feasible in the short term. Although a restrictive fiscal and monetary policy remains in force, a nominal devaluation implies the resurgence of inflation due to the existing indexing in the economy (increase in the velocity of circulation of money and economic recession). On the other hand, a real devaluation implies a drop in real wages in the short term, which in Nicaragua tends to be reflected in a drop in productivity; moreover, it is uncertain whether it is politically sustainable. In these circumstances, a real devaluation of the exchange rate depends on increases in productivity and improvements on the supply side, which are only possible in the medium term.

As long as the exchange rate remains overvalued, it is necessary to counter the anti-export bias by means of selective intervention to channel resources towards production, especially tradeable goods, and to divert them from consumption, so that the external imbalance can gradually be reduced. The proposed heterodox elements—policy of selective credits, preferential rates of interest, freezing of the commercial relief, and preferential fiscal policy—should form a package of measures aimed at reactivating the economy and actively promoting exports.

In an open economy like the Nicaraguan one, an increase in the monetary supply would generate an increased liquidity, which would manifest itself as an increase in demand, which would be satisfied to a large extent by additional imports. In the first instance the international reserves would decrease; later prices would rise. Therefore, rather than increasing credits outside the increase in the international reserves, it is a question of channelling credit towards production and investment and fixing limits to consumer credit. Similarly, it is necessary to adopt preferential interest rates which, without failing to encourage saving (with positive real rates), promote investment in production, especially in the export sector.

The commercial policy should in the first instance freeze the current process of lowering tariffs, as long as the decided reactivation of the export sector is not realized and as long as a real devaluation of the exchange rate to put an end to the anti-export bias is not possible. In addition, an efficient use of the external resources signifies that they should finance the reactivation instead of being limited to financing consumption. This calls for temporary alterations to the policy of indiscriminate commercial freedom which is in force at the moment. The temporary commercial policy should facilitate the import of intermediate goods and vital consumer goods, as well as temporarily reducing the import of luxury consumer goods or goods that compete with national production.

Fiscal policy should develop direct activities of reactivation and promotion of production to make it possible to exceed the minimal investment levels of the past few years and to contribute to overcoming the enormous technological backwardness and to increasing productivity. To this end, it is necessary to finance a coherent package of infrastructural and productive reconversion projects. The available external resources should be used preferably to improve the infrastructure in support of the export activities and restructuring projects in that sector.

Furthermore, mechanisms of social protection should be reinforced to compensate for the social impact of the adjustment, in a search for solutions to enable the sectors affected to come up with responses on the supply side by developing productive alternatives. The financing of the deficit should be tackled not only by cutting expenditure but also by increasing revenue: the reduction of the regressive tendency of the policy on duties is possible by increasing taxes on luxury goods and by increasing direct taxes.

From 1992 onwards, the debt service has swallowed up external resources and has seriously affected the fiscal budget. Nicaragua is not in a position to maintain the debt payment schedule which has been drawn up. The available external resources should be used primarily to finance the reactivation of the economy: without economic reactivation, it will be impossible to pay the debt.

The application of the proposed economic policy is a technical issue, but it is also a political one, since it entails a redefinition of the agreements made with the international organizations and creditor countries. This requires a forceful government, capable of demonstrating to the international community that the continuation of the present policy will place the country in a cul-de-sac.

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# 7

# MEXICO'S INTEGRATION IN NAFTA

## Neoliberal restructuring and changing political alliances

*Alex E.Fernández Jilberto and Barbara Hogenboom*

The peso crisis that started in late 1994 has clearly demonstrated the fragility of Mexico's neoliberal restructuring. Contrary to the rhetoric of President Carlos Salinas de Gortari (1988–94), his policy of economic liberalization proved far from soundly based. Insufficient reserves rendered Mexico's economy very sensitive to shocks. The coming into force of the North American Free Trade Agreement (NAFTA) had further increased the import of consumption goods, thereby deepening Mexico's trade and balance-of-payments deficit which was paid for by short-term bonds. Instead of governing a newly designated First World country, President Ernesto Zedillo Ponce de León (since 1994) immediately had to face untenable financial problems that were created and neglected by his predecessor.

Salinas's failure was equally bitter for the foreign supporters of his liberalization policy. In order to prevent Mexico from bankruptcy and limit the global repercussion of the peso crisis as far as possible, they had to overcome several obstacles. In the course of their efforts to provide Mexico with resources to contain the situation, the International Monetary Fund (IMF) had to violate its own regulations, President Clinton had to circumvent Congress and witness the dollar fall, whereas a serious disagreement arose among the G7, the group of the seven largest industrialized countries. The image of Mexico as a classic example of economic liberalization swiftly faded.

A previous crisis, namely the debt crisis of 1982, had formed a major incentive for the dramatic reform of the economic policy of modern Mexico. This crisis led to a unilateral suspension of debt service payments, inflation, a dramatic devaluation of the peso, and the nationalization of the banks in September of that same year. Under President Miguel de la Madrid Hurtado

(1982–8) a policy of stabilization and structural adjustment was applied to overcome the crisis, and neoliberal reforms were introduced. The new policy implied a fundamental change in the economic functions of the state and a radical transformation of the old economic policy that had been based on Keynesianism in an authoritarian populist style. Headed by President Salinas, the neoliberal restructuring was further deepened. The earlier reforms were strengthened and the economic model of Import Substitution Industrialization (ISI) was finally replaced through the privatization of state enterprises and the limitless opening and regionalization of the Mexican economy by signing the NAFTA. In addition, the state-led process of economic liberalization implied a separation between the economic role and the political role of the party-state system.

Between the 1940s and the beginning of the 1980s Mexico had demonstrated a striking, repressive, political stability. The Partido Revolucionario Institucional (Institutional Revolutionary Party, PRI) has governed the country without interruption since 1929 through electoral fraud, corruption and repression. Under the banner of 'revolutionary nationalism', and unlike other Latin American countries with repressive governments, Mexico has always been tolerated by the international community. The most recent proof of this is the fact that during the negotiations for the North American Free Trade Agreement (NAFTA) the question of human and political rights in Mexico was never on the agenda.

Since 2 October 1968 (when approximately 300 students who tried to use the international attention for the Olympic Games in their call for democratization were killed on the Plaza de las Tres Culturas), the Mexican system has systematically cultivated an image of political stability that contrasted with that of its southern neighbours (Guatemala, El Salvador and Nicaragua). This strategy has been supported by a progressive foreign policy and support for national liberation movements in developing countries, including a discourse with a prudent dose of anti-imperialism. This period came to a close with the rebellion of the Ejército Zapatista de Liberación Nacional (Zapatista Army for National Liberation, EZLN) on 1 January 1994 in the state of Chiapas and the assassination of the presidential candidate of the PRI, Luis Donaldo Colosio, less than three months later.

Colosio's substitute, Zedillo, won the politically crucial elections of 1994 and the PRI will therefore remain in power until the end of this century. In contrast to the equally long-governing Communist Party of the former Soviet Union, the party-state system of Mexico—despite its prolonged political monopoly—has never succeeded in totally destroying civil society. In spite of Zedillo's victory, the rebirth of Mexico's civil society has pushed the PRI on the defensive. The dramatic political and social impact of more than one decade of reforms in Mexico can partly be attributed to the disruption of global economic and political structures. An additional explanation lies in the corporate relations between state and civil society in a system in which the state is identified with a party, the PRI. The replacement of an authoritarian populist state by a neoliberal state has been undertaken by the political bureaucracy of the state and the party in an attempt to maintain its power and to regionalize the internationalization of the Mexican economy. The latter seemed preferable considering Mexico's economic dependence on the United States (US) as regional bloc formation intensified globally.

The transition of a Keynesian state to a neoliberal state, however, has brought some problems for the corporate authoritarian tradition of Mexico. In times of economic recession and after privatization of state enterprises, it is hard to sustain the clientelism that supported this tradition. The fact that the reforms were initiated from 'above' by the state and party bureaucracy itself permitted this bureaucracy to present itself as a democratizing force. This has been enforced by the theoretical tradition of political liberalism that takes economic modernization to be the inevitable cause of replacement of corporate authoritarian systems. According to this analysis, such systems cannot at the same time control the political process and liberalize the economy. The end of the former central economic role and control of an authoritarian system would automatically entail the loss of its political power and legitimacy, thereby giving way to democracy.

The integration of Mexico in NAFTA, and through this Mexico's regionalization and internationalization, has been a factor of consolidation for its neoliberal restructuring. Mexico's integration with the US and Canada does, none the less, represent a rupture with the Latin American tradition of economic integration that started in the 1970s. This tradition aspired to a model of self-sustained industrialization in a nationalist and to some degree anti-North American way. With a market of 360 million consumers, NAFTA is the economic bloc in which the other Latin American economies now place their hope. It transforms other integration initiatives, such as the Mercado del Sur (MERCOSUR, with Brazil, Argentina, Uruguay and Paraguay), into a waiting-room for a later entry to NAFTA.

The central aim of this chapter is to analyse the background of and reasons for the above-mentioned economic and political developments in Mexico and the Americas. The first part presents a retrospective study of Latin American initiatives for economic integration and how they have been substituted after the crisis of international Keynesianism. In the second part we present a description of the regionalization of Mexico's economy that preceded its integration in NAFTA. The third part touches upon the relation between the Mexican economic reforms and the changing structures of the party-state system. Part four deals with the political effects of these neoliberal reforms. Finally, we will present some concluding remarks on possible future developments in part five.

## HISTORIC FORMS OF LATIN AMERICAN INTEGRATION

Experiences of Latin American integration have existed for nearly half a century. At the beginning of the 1960s a not very successful attempt at regional economic integration was made with the Asociación Latinoamericana de Libre Comercio (Latin American Free Trade Association, ACLAC). Later on, in 1980, a similarly weak initiative was undertaken with the creation of the Asociación Latinoamericana de Integración (Latin American Integration Association, ALADI). These organizations were meant to deal with three problems. First, the formation of the European Economic Community (EEC) in 1957 was considered to pose the threat of closing the European market to Latin American agricultural products. Second, it was necessary to renew and extend the agreements on preferential goods between Latin American countries to take advantage of the most-favoured-nation clause that was confirmed by the General Agreement on Tariffs and Trade (GATT). Supported by Article XXIV of GATT, the creation of a free-trade area was strived for. Third, at the beginning of the 1960s the stagnation and crisis of the ISI model became apparent. The widening of the internal market was perceived as one of the solutions to the crisis. Furthermore it enabled a deepened industrialization. This widening of the market through regional integration would lead to regional industrialization in which each country would specialize in certain branches, cutting down the costs of capital goods. This process would increase the profitability of capital and stimulate the process of accumulation, while strengthening the profitability of state capitalism (state enterprises) too.

The failure of the early initiatives of Latin American integration was not only due to the crisis of models of Keynesian industrialization and the following collapse of international Keynesianism. Another factor was the early introduction of neoliberal restructuring in an authoritarian way during the 1970s, by the dictatorships of Chile, Argentina, Bolivia and Uruguay, that stressed the principle of free trade. As a result, regional Keynesian policies, which became identified with protectionism, were under discussion. Only in the middle of the 1980s, with the restoration of democracy in Brazil and Argentina, were the debates on regional integration reopened, giving way to the formation of MERCOSUR.

The first antecedent of MERCOSUR was the Programa de Integración y Cooperación Económica (Integration and Economic Cooperation Programme) between Argentina and Brazil in 1986. This programme was partly the result of the democratization process that took place in these countries. It was launched at a time when both countries were involved in similar anti-inflation actions: the Austral Plan and the Cruzado Plan. In the beginning, the Integration Programme represented an attempt to restore the Keynesian models of integration, at least from the side of Argentina. In 1990 Brazil and Argentina decided to formalize the creation of a common market at the end of 1994.

In 1991 Paraguay and Uruguay joined the regionalization initiative which gave rise to the Tratado de Integración (Integration Agreement) which officially created MERCOSUR. The agreement that establishes a common market has several implications. First, goods, services and productive elements will circulate freely between the countries through the elimination of customs rights and non-tariff barriers. Second, a common external tariff will be established and a common trade policy will be adopted in relation to third states or groups of states. Third, coordination of macroeconomic and sectoral policies will take place between the participating nations. Finally, legislation of the participating countries will be harmonized in order to strengthen the integration process. In August of 1994, an agreement was signed to form a customs union on January 1st of 1995, exactly one year after NAFTA had come into being. The first economic results of MERCOSUR seem promising, as trade among the four participating countries nearly doubled between 1991 and 1993.

The formation of MERCOSUR was a response to the international strategy of bloc formation. The participating countries sought a major negotiation capacity towards their principal commercial partners: the US and the EEC. Only under the regimes of Fernando Collor de Mello (Brazil) and Carlos Menem (Argentina) did MERCOSUR acquire a neoliberal character. From the perspective of Argentina, MERCOSUR is then also considered as a mechanism to consolidate its neoliberal reforms and as anteroom for later entry to NAFTA, thereby binding itself finally to Bush's Enterprise for the Americas Initiative. MERCOSUR recognizes that the Enterprise for the Americas Initiative differs from earlier US initiatives towards Latin America, such as the Alliance for Progress. The Alliance was inspired by the Cold War and had a geopolitical vision of the region, rebuffing the Cuban revolution. The Initiative, however, is a post-Cold War product of political pacification. It is not an economic assistance programme but has the aim of 'cooperating for development', adapting to the new relation between Latin America and the US in the era of bloc formation.

The relations of MERCOSUR with the US have been formalized by agreements that are known as 'Four Plus One' and were signed in 1991 by the four countries of MERCOSUR and the US. These agreements led to the creation of the Consejo Consultivo sobre Comercio e Inversión (Consultative Council on Commerce and Investment) of MERCOSUR. The negotiations with the US will no longer take place by each individual country but through MERCOSUR. This will also be the principal mechanism of future dialogues concerning entry to NAFTA.

The consensus on the neoliberal character of bloc formation in Latin America was previously legitimized by what have been called 'the new neoliberal democracies'. Even the Economic Commission for Latin America and the Caribbean (ECLAC) has formulated a regional policy in the already classic text *Development with Equity* (CEPAL 1990). This analysis is based on the concept of the 'lost decade', referring to the sharp decline in development during the 1980s. The real per capita product of 1989 equalled that of 1976. Latin America faced the beginning of the 1990s with the effects of its external debt and the unsuitability of the composition of its exports with the structure of external demand. Added to this are its obsolete capital scheme and physical infrastructure, the incapacity to assimilate international technological changes, the deterioration of financial capacities and policy of the countries, the growing social inequalities, a giant increase of unemployment and underemployment, and the inefficient and inaccurate exploitation of natural resources in addition to environmental decay. At the level of political systems, several countries that experienced dictatorships implementing neoliberal reforms in an authoritarian way have seen the reestablishment of democracy. Among them are Chile, Argentina, Bolivia, Uruguay, Brazil and Paraguay. In the 1990s, the consolidation of neoliberal policy has, however, been accompanied by what the ECLAC calls the deideologization of the political economy debate.

## REGIONALIZATION OF MEXICO'S ECONOMY

As in other Latin American countries, industrialization initiated in post-revolutionary Mexico was a response to the consequences of the Great Depression of 1929. In the middle of the 1970s, the process of ISI had consolidated the protagonist role of the state in the economy and strengthened a social contract between the business elite and the sectors of PRI-supporters. This contract was directed at an expanding state capitalism that would keep the accepted status quo of the domination of the Pax Americana in its place. In the years of expansion of the ISI model (1940–70), Mexico was presented as an example of development to other Latin American and developing countries. In the years of the 'Mexican miracle', an annual growth of 6 per cent was achieved and this was considered the era of stable growth (1954–70). It needs to be noticed, however, that Mexico's industrialization was facilitated by forced savings of agriculture and a nearly unlimited labour supply because of large-scale migration from rural to urban areas (Wionczek 1985:19).

From a theoretical point of view, ISI was destined to reduce the imports of manufactured goods of industrialized countries and to widen the capacity of the internal market for the consumption of the new national industrial products through the medium of the state. It is this strategy that was exhausted in the 1970s and this was shown by the significant growth of imports of capital goods that had to satisfy the demands stemming from the expanding petrol industry and the service and financial sectors.

The economic reforms of President Luis Echeverría (1970–6) aimed at replacing his predecessor's economic model of stabilizing development for shared development. The state had to strengthen its function of intervention in order to regulate the economic and social inequalities deriving from development. Echeverría's reforms required a vertical integration of ISI (shifting support from light to heavy industry) to stimulate the production of capital goods and to solve the chronic deficit of the balance of payments that was an inherent characteristic of the ISI. For that purpose, the Bank of Mexico was set up in 1971 to support export industry (Alarcón and McKinley 1992). From the same period onwards, some economic liberalizing measures for specific areas and sectors were also taken. Examples of this were the Car Pact (General Motors, Ford and Chrysler) and the programme of Border Industrialization, which transformed the Mexican border states into a zone of free trade for the export of the *maquiladora*[1] industry (Philip 1988; Bennett and Sharpe 1985).

These liberalization tendencies were strengthened by the central role of the state in the definition of the national programme of 'shared development'. The economic opening of the border states for trade and external investments meant a rupture with earlier policy and the beginning of the end of Mexico's adhesion to the nationalist principles of the ISI model. The new liberalization signified the extension of the *maquiladora* programme that has promoted the development of export manufacturing since the early 1970s.

There are three factors that explain the development of the *maquiladora* industry. First, there were changes in the US customs regulation in 1962 which facilitated Mexico's free import of components and parts of products destined for later assemblage. This customs reform stimulated industries to place a part of their production outside of the US. The second factor was the end, in 1964, of the US programme for Mexican labourers, which provoked a considerable rise of unemployment in the border regions with the US and an increase in illegal migration. The third factor that stimulated the *maquiladora* industry was the globalization of production and investments. In the beginning of the 1950s, the labour-intensive industries started to be transferred from developed countries to industrializing areas (Altvater *et al.* 1991:260). In the context of the New International Labour Division, Mexico had been at the 'historically right time of production' (Fatemi 1990) and the maquiladorization of the economy was functional in this process. The financial elite and the industrial conglomerates formed the central elements of the maquiladorization, together with the monetarist policy of the Mexican government. The concentration of the economic power of the conglomerates and the gradual decrease of the national participation have been inherent characteristics of this process.

Like other Third World countries, Mexico made notable progress in its capacity of production of intermediary and capital goods that require a high level of technology and sufficient access to the global market. Similar to other Latin American cases, the transnationalized sector of the economy was the most dynamic. When in the middle of the 1970s the decrease of economic growth and the loss of effectiveness of the development programmes became evident, there was an attempt to compensate for this tendency by giving priority to the export sector. This was done by state support for irrigation programmes in the northern regions, tax reductions, an increase in credits and technical assistance.

The structural deficiencies of both the industrial and the agricultural sectors became linked to the financial crisis and to the deterioration of the balance of payments. The fiscal deficit increased significantly, the peso was overvalued, inflation grew constantly, flight of capital became systematic, and imports increased. All these processes formed the beginning of a prolonged crisis. The solutions that were applied were based on shortterm financial measures, starting with the use of resources from the international financial market that were not set aside to solve the structural economic problems. The discovery of petrol in the Bay of Campeche fed false hopes on the effectiveness of these measures. The period of 1978–81 granted a new temporary solution to the Mexican system, based on the spectacular rise of the petrol price on the world market.

With the following fall of the petrol price and the rise of interest rates, a deep recession of the world market took off, because of which the US economy had to endure the 'Reaganomania'. The years of the Mexican miracle had definitively come to an end. In the last months of his mandate, President José López Portillo (1976–82) intended to control the effects of the crisis by means of the nationalization of the banks and the devaluation of the peso. The necessity to pay the external debt services and the collapse of the petrol industry offered the business sector the unique possibility to try to eliminate the state model of development.

Finally, in 1983, the external debt was financed by a newly created credit fund Fideicomiso para la Cobertura contra el Riesgo Cambiario (Trust Fund for the Coverage of Exchange Rate Risks, FICORCA) directed at covering the risks of external trade and serving as an intermediary between enterprises and banks. This new institution was a compromise between the business elite and the international, predominantly US, banking. The whole of these measures was politically presented with an enormous populist rhetoric. Its purpose, however, was to satisfy the demands of the business elite, especially of Monterrey, which had accumulated around 40 per cent of the external debt (Rojas 1991). In spite of this purpose and the reprivatization of the banks by the new government of De la Madrid, there came no end to the crisis of the 'alliance for gain' between the party-state system on the one hand and the national and foreign business elite on the other hand.

The solution for the external debt problem from within the PRI consisted of the use of inflation to cover the public debt in the short term, and to economize by freezing the salaries of the workers of state and semi-state enterprises. Given the high inflation rates, new monetary emissions were impossible and by virtue of this, the tactical measure of freezing wages at extremely low levels was applied, together with a decrease of subsidies for basic foodstuffs and social services. In order to attract 'fresh capital', the government displaced loans to the capital market, giving the financial sector official documents at a much lower interest rate than at the international financial market. This policy clearly revealed the initial existence of a new strategy based on a tripartite alliance between the state, the national business elite and foreign companies.

When the financial collapse had occurred in 1981, Mexico had turned to the World Bank, the IMF, and Washington. The emergency assistance had been of short duration. The cartel-wise organized international financial community required a neoliberal restructuring of Mexico's economy. The major restructuring element within the PRI consisted of a new group of US-educated technocrats *(técnicos)* who proposed the introduction of drastic neoliberal reforms and the application of a 'shock therapy' (Weintraub 1990). The implementation of these reforms and the adaptation of the Mexican external debt according to the requirements of the Baker Plan and the Brady Plan placed Mexico in a more favourable position for the negotiations for its membership of GATT in 1986 and its entry to NAFTA in 1994.

In sum, in the decade of the 1980s, Mexico adopted an economic strategy that was more tightly linked to the requirements of its integration in the world market and in particular of its entry in the neoliberal bloc of NAFTA. These requirements were based on two classic ideas: economic stabilization and growth by means of comparative advantages. The economic stabilization was directed at solving the financial problems as the result of the fiscal deficit, the inflationary pressure and the imbalance of the balance of payments stemming from the external debt and capital flight. This approach was matched by the application of monetarist economic theories that emphasize the idea that both the economic crisis and the decline in the process of capital accumulation arise from the lack of balance between the expansion of public spending and the capacity of state revenues. According to these theories, the stabilization of the economy should come about by means of austerity measures, privatization, the decrease of public spending, and the liberalization of trade and investments.

The economic crisis also gave rise to the elimination of restrictive norms for foreign investments. In 1985 Mexico was required to implement further liberalization for these investments in the context of negotiations on its external debt. In the end these measurements resulted in a change of the law on foreign investments and an extended right of return of capital in 1989. The incentive stemming from these measures for foreign investments was directed at 'strategic economic areas' that included, among others, the subsoil, the infrastructure of construction and public services, and the oil and chemical industries.

At the international level, Washington pushed for the triumph of the *técnicos* and the neoliberal reforms. As US exports to Mexico increased significantly in the second half of the 1980s, Mexico started to be perceived as an important potential market for US capital and consumer goods industries. In fact, the integration of Mexico in the economic globalization process accelerated significantly in the last years of the Cold War by the effects of capital flight, the stagnation of international petrol prices, and the drastic devaluations of the peso.

The new economic growth has resulted from private investments in the export sectors with sufficient comparative advantages to compete profitably in international markets. The low labour costs and the geographic proximity to the US are Mexico's two most relevant advantages, and of special importance in the exploitation of its cheap natural resources. These characteristics are compatible with the globalization of the world economy and with international neoliberalism. Yet in its dependence on cheap labour and natural resources for growth, Mexico is still—despite its aspirations and its entry into NAFTA and the Organization of Economic Cooperation and Development (OECD)—more a Third World than a First World nation.

## THE PARTY-STATE SYSTEM AND NEOLIBERAL REFORMS

The economic crises of 1973 and 1976 brought an end to the Mexican miracle and to the idea of a self-sustained industrial and politically consensual modernization (Pastor and Castañeda 1988). It also gave way to the state's abandonment of the nationalist and populist rhetoric and of traditional mechanisms of ideological legitimization towards civil society. The rhetoric of President Echeverría signified the last time that popular pressure on the bureaucratic politics of the state and the PRI proved effective. Echeverría attempted to revitalize the populist state, negotiating a 'social contract' between the business elite and popular movements. This went together with a political reform to replace repressive political exclusion by negotiation. These initiatives meant a political opening directed at widening the participation of parties and social groups that had traditionally been excluded from the political system (Tamayo 1993:258).

The ultimate result of Echeverría's political reforms was a crisis between the party-state system and the private sector which culminated in the period of 1981–3. Only in moments of such a crisis has the Mexican state succeeded in having considerable autonomy with respect to business groups and international economic interests. The first time was under President Lázaro Cárdenas (1934–40). Three later moments of state autonomy were the support of the Mexican state for revolutionary groups in Central America and the repudiation of US policy in the period of 1974–84; the refusal to become a member of the GATT in 1980; and the nationalization of the banks in 1982.

Since the beginning of the 1980s Mexico has undergone the introduction of the free market model and the implementation of neoliberal reforms that are dominant in the global system. The last two governments—of De la Madrid and Salinas—have eliminated the barriers to trade and external investments. They have reduced the participation of the state in the economy and have implemented a strategy of export promotion that is considered as the most adequate solution for the problems of the Mexican economy. As a necessary consolidation of the economic neoliberal restructuring, Mexico decided to agree to the association of free trade with the US and Canada.

Mexico's recent entry in NAFTA represents the institutionalization of its 'silent' integration in an area of US influence. This means the end of the revolutionary rhetoric used by the political and intellectual elite when necessary to guarantee political stability. The 'Mexican revolutionary family' that originated from the revolution (1910–20) culminated in a political elite that designed a hierarchical corporatist state with a dynamic national populist party, the PRI. This elite relied on a model of capitalist reproduction of a mixed economy and on the application of repressive tolerance in the political system. The function of the PRI was—and still is—to give stability to a centrist political bloc and to contain the contradictory nature of class conflicts (Teichman 1992:88).

The PRI incorporated not only organizations of the public sector but also peasant and urban labour organizations. The incorporation of the military apparatus in the state and the party was legitimized by the use of the concept of national security. The state also used control mechanisms towards the private sector through affiliations with business organizations.

The symbiotic relation between the state and the party was articulated by the existence of a 'national project'. The hegemony of both the state and the party over the private sector was guaranteed by the monopoly over subsidies, public contracts, licences, and direct control over labour unions. The so-called 'alliance for gain' of the party-state system together with the national economic elite and transnational investors formed the basis of this national project (Reynolds and Tello 1983). In the period 1958–68 this project was consolidated and deepened.

The *modus vivendi* of the 'alliance for gain' survived the national economic problems of the 1980s and the changes in the global economy. The stability and autonomy of the state was guaranteed by the strategic alliance of the PRI with the heterogeneous capitalist class and by its link with the US hegemony and the Western hemisphere. The national project was a functional part of the Pax Americana, whose most important ingredient was the ISI model. This model gave the specific shape to Mexico's integration in the global system (Fröbel *et al.* 1991:75).

Under De la Madrid and Salinas, the relative autonomy of the working class with respect to the Mexican state has become politically limited in three ways. First, the difference in priorities and strategies of the vertical and horizontal organizations of the state and the PRI gave way to a friction between *políticos,* with whom labour traditionally had strong links, and *técnicos* in favour of the técnicos. In the discourses of the state the neoliberal alternative of the industrial elite of the north and the export-oriented bourgeoisie of Monterrey started to predominate as a result of this development. Second, the influence and pressure of the US hegemony weakened the Mexican working class. Third, because of economic modernization labour unions lost a considerable part of their influence. At the same time, critical social organizations that were not based on an occupational division (so-called new social movements) arose. They operated independently from the official syndicalism of the party-state and attracted many people that were no longer satisfied with the way the clientelist official unions represented their interests.

The highly centralizing capacity of the state that is expressed by the concentration of public power, has given sufficient capacity to both the state bureaucracy and the PRI, together with the business elite, to define the national economic policy. This has happened without counterweight and in the absence of a pluralist political arena. Through its political monopoly, the PRI has been able to solve the shortcomings generated by the alliance, in the form of cooptation, its domination over the media, electoral fraud and if necessary repression. The role of the PRI has none the less varied historically. Sometimes the PRI forms the synthesis of contradictory interests negotiated within the party that, at such moments, takes the shape of a restricted political arena. At other times, the PRI transfers the crucial role of the formulation of the national project to the state and the political class of the state.

The realization of a political bloc constructed by the 'alliance for gain' has prompted an increasing deterioration of the national populist politics and the old political aristocracy. This process has been accompanied by a progressive decline of social mobility, especially of the gradually impoverished middle class that used to have strong links with the party-state bureaucracy, and a strengthening of ethnic discrimination. This gave rise to a loss of the state's capacity to maintain political cohesion and the stability of the party-state system.

The economic result of the neoliberal reforms introduced by De la Madrid and deepened by Salinas has been the so-called 'new Mexican miracle', taking place after the debt crisis and financial crash of the state. This miracle is based on the general privatization of public enterprises, a drastic concentration of income and the regionalization of the Mexican economy. The 'alliance for gain' and the domination of the neoliberal fraction of the PRI form the essential components of the stability of the system. During the *Porfiriato* (the period of 1876–1910 when Porfirio Díaz ruled Mexico), the political class of the state was dominated by the so-called 'scientifics' who in their economic policies were inspired by French positivism. Interestingly, their similarity with the neoliberal technobureaucracy of De la Madrid and Salinas is considerable in the sense of the aspiration to restore the market forces without questioning these forces, the private sector or international capitalism.

The economic opening up of Mexico has, none the less, produced a split between two national industrial sectors (Bizberg 1993:182). The industrial export sector is the winner; its growth has been impressive and is used to give Mexico an image of a modern and First World nation. As industrial exports increased and state-owned petrol became simultaneously less dominant in Mexico's exports, the export sector could enforce less state intervention in the economy. The loser of Mexico's new economic policy is the industrial sector which mainly produces for the internal market; the former ISI-industry. This sector has lost its economic importance with the shift to the new economic model, and small and middle-sized firms have lost their political representation in the party-state system. In the preparation of NAFTA, for instance, the interest group representing small and middlesized industry, Cámara Nacional de Industria de Transformación (National Chamber of Transformation Industry, CANACINTRA), had less access to the government than organizations that represent large export-oriented industry which strongly supported Mexico's integration in North America. Other industries find themselves somewhere between the above two sectors, growing and exporting only moderately. The latter have not made a constructive contribution to the 'new Mexican miracle'.

The 'alliance for gain' has successfully pushed economic and trade liberalization in the past two *sexenios* (presidential periods of six years). Their interests converged in Mexico's entry to NAFTA. As protectionist tendencies in the US were increasing, it became very important to secure access to the US market, which is the major export market for both transnational corporations (TNCs) and the Mexican export sector (Alba Vega 1993:227–9). External trade organizations, that had sometimes been each other's opponents in the past, decided to create a coordinating interest organization, the Coordinadora de Organizaciones Empresariales de Comercio Exterior (Coordination of Business Organizations of External Trade, COECE). Through their different channels of political influence, the heterogeneous alliance had a strong pro-NAFTA lobby in the US system too.

In 1987 the Pacto de Solidaridad Económico (Pact of Economic Solidarity, PSE) was established as an agreement between the economic elite, the official labour unions and the government to reduce inflation by means of wage reductions and price control. The political purpose of the PSE was the re-establishment of class harmony and a moderated reformulation of the tripartite social pact with a corporatist nature. In 1988, Salinas announced a new pact: the Pacto para la Estabilidad y el Crecimiento Económico (Pact for Economic Stability and Growth, PECE). An important aspect of the PECE was the abolition of constitutional social guarantees. As a result of the PSE and the PECE, in the period of 1988–91 the minimum salary was cut down by 80 per cent, whereas the prices of basic consumer goods increased by 250 per cent during the same period.

The process of neoliberal restructuring did not harm the position of labour equally in all economic sectors. The *maquiladora* industry, the forerunner of the neoliberal model, experienced a deregulation of labour representation. Contrary to a traditional role for official trade unions in this sector in the 1960s and 1970s, the influence of unions in *maquiladoras* has virtually disappeared. In other sectors, such as the car industry, this deregulation has been somewhat less extreme. Still, the effect of geographic relocation and annulment of collective contracts has been a considerable weakening of unions in these sectors too. Many other companies went through a process of internal flexibilization, which implies an adjustment of arrangements that leaves companies with more freedom of action *vis-à-vis* unions (Bizberg 1993:177–80). Next to the changing situation within companies, there were many workers who lost their jobs in the process of neoliberal restructuring. Unemployment and underemployment consequently increased, resulting in a great number of people dependent on the informal sector to obtain a minimum income.

Also on the land, great changes are taking place due to the economic and political reforms. Whereas still some 24 per cent of Mexico's labour force works in the agricultural sector, De la Madrid and Salinas have rapidly dismantled governmental support for basic foodstuff farmers. The abolition of price guarantees and the lowering of subsidies for small farmers have already displaced large numbers of people, providing the industry with an endless stream of cheap labour. Moreover, in anticipation of NAFTA, Salinas adjusted the Mexican Constitution in order to make land a free tradeable good. The system of *ejidos,* agricultural cooperations that were created for small farmers after the revolution and under President Lázaro Cárdenas, has been consequently commercialized. The land that peasants work on individually is no longer the property of the *ejido,* but is to be divided among them. With their new property rights, peasants are now able to sell this land. Only the communal pieces of land remain the property of the *ejido*.

An end has come to the traditional link of the PRI with small, often indigenous, peasants. Through its revolutionary rhetoric, cooptation and a minimum of assistance, the PRI always received wide electoral support from this group. The neoliberal restructuring, however, implied a further economic and political marginalization of small farmers. Despite strong protests of farmers' organizations, the constitutional reform has been implemented and will undoubtedly lead to increasing migration as poor farmers are forced from their land, due to the structural lack of credit and governmental support while having to compete with (subsidized) US and Canadian agricultural business. Next to dramatic social consequences, the new agricultural policy will have a negative environmental impact, too. On the one hand, it leads to both a desertion of less fertile land and an increase of mega-firms on more fertile lands, the first resulting in erosion and a loss of farming land and the latter giving way to more monocultures and increased use of fertilizers and pesticides. On the other hand, as the peasant families move to big cities, the environmental and health situation in urban areas will further deteriorate.

## THE POLITICAL IMPACT OF NEOLIBERAL RESTRUCTURING

The new policy of neoliberal restructuring has had considerable effects on the political system. The most sensitive parts for the 'silent' transformation of the political system are linked to the corporate character of the state's functioning and the influence of the dominant sectors of the PRI. This springs from the necessary reorganization of the political alliances that are destined to favour the link of the business elite with the influential position of transnational companies and Washington.

The economic and political transformations that stem from the introduction of the neoliberal model risk giving rise to political instability. As most Mexicans suffer from the economic liberalization, this policy has to generate sufficient economic growth and jobs to prevent social disorder. Yet, even in the case of economic growth, it proves that with Mexico's social structure, economic liberalization deepens existing inequalities instead of diminishing them (Smith 1993:381–2).

In the period 1985–8, the PRI was rapidly losing its legitimacy because of widespread popular dissatisfaction. The nationalistic rhetoric that formed an indispensable part of the Mexican official discourse (Ros 1966; Sigmund 1970) disappeared together with the idea of a 'national' development project. Instead, concepts such as economic integration, productivity, low costs, labour discipline, diversification of exports, privatization and free trade started to predominate. Moreover, the economic crisis forced the PRI to curtail its clientelistic relations with labour unions, etc. and to terminate many structural social support programmes, whereas the crisis and neoliberal restructuring entailed mass unemployment and migration. Grassroots initiatives increased and social movements grew stronger as people lost faith in the PRI and as official organizations could no longer satisfy popular demands.

In the context of widespread popular discontent, Cuauthémoc Cárdenas (son of the charismatic former President Lázaro Cárdenas) was able to organize a powerful left-wing opposition. This former *PRI-ista* founded the Partido de Revolución Democrática (Democratic Revolution Party, PRD) that was supported by many popular organizations and small political parties. On the right, the conservative Partido de Acción Nacional (National Action Party, PAN) also became stronger. With its neoliberal economic ideas and its criticism of the undemocratic and centralist (Mexico City-dominated) PRI monopoly, it found support principally among the middle class and economic elite in the northern states. In the end, Cárdenas's populist call for social and economic justice and democratization rendered him more popular than Salinas, who was only able to win the elections of 1988 by fraud.

As in other neoliberal experiences in Latin America, those who do not benefit from the reforms and especially those who are unemployed as a result of privatizations are temporarily compensated. After the disastrous presidential elections of 1988, Salinas introduced the presidential Programa Nacional de Solidaridad (National Solidarity Programme, PRONASOL). This social programme has been financed by the selling of state and semistate enterprises such as Teléfonos de México (Mexican Telephone Company, TELMEX) and many others. By stressing this point, Salinas tried to receive more popular support for his neoliberal policy. In addition, PRONASOL has clearly aimed at relegitimizing the PRI, as the programme started in and concentrated on areas where the opposition was popular.

In an attempt to deal with the expressions of popular discontent, Salinas came up with his social liberalism so that the neoliberal fraction of the PRI could maintain some populist tendencies. PRONASOL replaces many structural social programmes that were abolished in the process of neoliberal restructuring. What remains is a much cheaper populist skeleton that only spends money where and when it is politically necessary. PRONASOL is presented as a new form of fight against poverty, but its creation was in the first place an answer to manifestations of popular discontent with the PRI. The programme attempts to compensate for the increasingly exclusive character of the PRI by recreating a clientelist linkage with those groups that are no longer represented through traditional corporatist structures, such as peasants, workers and the unemployed poor. As it coopts numerous popular initiatives and organizations (the state as a 'partner in development') while competing with more independent groups, PRONASOL diffuses the political struggle of the popular movements. Simultaneously, former corporatist traditions and actors are replaced and presidential control is intensified (Dresser 1991).

Before the introduction of neoliberal policy, the transformation of the political elite into an authoritarian, bureaucratic regime did not solve the conflict of interests between the party-state bureaucracy in charge of formalizing the economic policy (the so-called *técnicos*), on the one hand, and the *políticos* of elective representation that were integrated as a corporatist fraction of the PRI, on the other hand. The economic crisis, however, gave way to a situation in which *técnicos* have the upper hand. Consequently, the powerful *camarillas* (heterogeneous alliances between persons in the party-state system) suffered an important division. Among the internal political consequences of Mexico's incorporation in the global economy is the deepening of the political discrepancies between the *técnicos* and *políticos* within the PRI (Camp 1990).

The opposition of neoliberal politics and the dismantling of the populist state has been headed by Cuauthémoc Cárdenas. His demands are democratization and an end to state corporatism and the political monopoly of the PRI over every political mass activity. The *neocardenismo* is a reformulation of populism, destined for resisting the dismantling of the state's social functions and neoliberal politics in general. This movement is based on the necessity to introduce a model of pluralist democracy (Tamayo 1993). It relies, in its favour, on the large nationalist tradition of modernization and on the idea of a 'Mexicanity' that rejects in the long term all anti-democratic limitations of the political system.

The political turmoil of the 1980s was expressed by what, in progressive circles, is called the 'debate for the nation' that reinvented social justice, nationalism and populist values of the Mexican revolution that are denied by the project of neoliberal reforms (Reynolds and Tello 1983). This debate reproduces and reiterates the old contradiction, that exists since the 1930s, between the progressive ideals of Lázaro Cárdenas and the conservatism of Miguel Alemán.

The way in which NAFTA was dealt with in Mexico illustrates the fact that the neoliberal restructuring has given rise to political discontent which is threatening the party-state system.

> The Mexican government has given NAFTA negotiations the equivalent of a national security affair, keeping information almost a state secret, preventing any meaningful public debate, maintaining a close vigilance on its opponents, and transmitting only general propaganda messages to the public.
>
> (Aguilar Zinser 1993:207)

This situation hampered the mobilization of critical non-governmental organizations, as they had few resources to inform people on 'the other side of NAFTA' and had restricted information themselves. In addition, the Chamber of Deputies was not allowed to discuss the agreement: only the PRI-dominated Senate could. In total, Salinas successfully prevented a national debate on NAFTA that would have touched sensitive issues such as Mexico's loss of sovereignty, its dependence on the US, the range of negative effects of liberalization, the increasing power of TNCs and big national companies, and the question whether NAFTA is in violation of the Mexican Constitution.

The major criticism of Mexico's economic modernization and its participation in the regional bloc of NAFTA comes from the left. It centres on the enormous asymmetry and imbalance between the Mexican, the US and

Canadian economies, and the authoritarian character of Mexico's political structures (Grinspun and Cameron 1993). The programmes of political modernization that are implemented by Salinas are criticized by both the left and the liberal right. They point to the political fraud, the monopoly of the PRI as well as the state in financial resources, and the ideological propaganda that manipulates any intention of democratization. The central aim of the government seems to be to come to a new form of political control that facilitates the existence of limited democracy.

The need for political changes partly stems from the substitution of the Keynesian model of industrialization for the neoliberal model of export promotion. This substitution gives way to dramatic changes in the social structures, whereas these changes are also linked to the shifts in the political configuration of the global system, the globalization of the world economy, and the international patterns of production, communication and investment.

Economic restructuring and liberalization policies have deepened the geographic inequalities of income distribution between the Mexican states, especially to the detriment of the south, which is characterized by structural poverty. In Oaxaca, Chiapas, Guerrero and Hidalgo, two-thirds of the population live in extreme poverty. The neoliberal strategy intensifies many of the social problems that have existed traditionally in Mexican society. In 1987, the richest 10 per cent of Mexicans controlled 37 per cent of the national income, whereas 80 per cent of Mexico's population divided only 46 per cent. Of the 90 million Mexicans, 43 million are affected by malnutrition (Alarcón and McKinley 1992:82). These inequalities do not only arise from the structure of social classes, but also have an ethnic, gender-based and geographical background.

There is a threat of the conditions of the Porfiriate epoch (1876–1910) returning today. The irritating distribution of privileges favours external (especially US) investors, bankers, industrialists and agricultural exporters. The social distance is also reproduced by the relation between the political elite and the popular sectors. After the Mexican revolution, socialist, populist and nationalist tendencies emerged against the traditional political alliance of merchants, regional industrial barons, agrarian aristocracy and international financiers (Meyer and Sherman 1991). With the exception of the regionalization of the Mexican economy, Mexico's situation of the early twentieth century is very similar both to the political alliances that are now nationally dominant, and to the levels of poverty in which the popular sectors are living.

## NAFTA, MEXICO AND LATIN AMERICA: FUTURE PERSPECTIVES

The plan for further integration of the Mexican economy with the US through NAFTA gave way to a heated political debate in Washington. In particular, large US multinational companies were to profit from the agreement. Mexico's liberalization of financial services and the agricultural sector has offered many new opportunities for US business. US banks and insurance companies can benefit from a market that until recently was closed, whereas under NAFTA their access will be practically unlimited by the year 2000. The Mexican petrochemical and energy sector will be liberalized in a period of at most ten years, although the state monopoly on the exploitation of energy resources will remain. It is expected that many small and medium-size Mexican companies will not be able to compete with large US business now that the latter's activities on the Mexican market will become less and less restricted. One of the effects of this development will be an increase in the rate of capital concentration in Mexico (Russell 1992:28).

Proponents of NAFTA, who held that regional economic liberalization would give way to higher productivity and economic growth in the three countries, faced strong opponents. The US opposition to NAFTA consisted of a heterogeneous group of unions, environmental groups, farmers and consumers' organizations that received considerable support in Congress. These organizations joined forces and claimed to represent around 40 million US citizens opposing the trade agreement as formulated under Bush. The central arguments of these organizations were that low labour costs and lax environmental protection in Mexico would displace US production and jobs to Mexico. Additionally, environmental organizations feared that US business would use Mexico's bad record of implementing its environmental legislation to lobby for less stringent environmental protection in the US. Finally, there were a number of organizations that protested against free trade with a country with an authoritarian political system which systematically violates human rights, permits ecological destruction, and does little to diminish the enormous economic inequality in the country.

The idea that US workers would be the first victims of the agreement was especially stressed by unions and small domestic businesses. They pointed out that the average wage per hour in Mexican manufacturing is about one-seventh of that in the US, which partly explains why before the entry of NAFTA (January 1994) already some 200 US multinational enterprises, such as Honeywell, Sears, General Motors and Ford, had built installations in Mexico. All these enterprises are similar in that they have gone through a radical process of reorganization and job losses. The displacement of productive sectors and jobs to Mexico is a real phenomenon and responds more to the productive adjustments stemming from the globalization of the world economy than to NAFTA. Some of the US groups opposing NAFTA assumed that with the help of tariff barriers it would be possible to prevent displacement of labour without considering the earlier decision of US enterprises to benefit from Mexico's economic growth and its potential market of 90 million consumers.

For the US, future entries to NAFTA are troubled. As President Clinton could not be confident of sufficient support, he had to make considerable financial concessions for the congressional approval of NAFTA. At the international level, the US were accused of protectionism by Asian countries. Later on, the peso crisis brought about further domestic criticism on the Clinton administration. Altogether, the political cost of NAFTA has been high when compared to the economic gain of the agreement, as 75 per cent of US exports go to markets other than Canada and Mexico. With the recent Republican majority in US Congress, the President's political margins have become even more limited. Consequently, the US government has an ambivalent attitude towards future candidates for NAFTA. There is still US interest for the entry of a number of large and successful economies, as the negotiations with Chile demonstrate. Central America and the Caribbean, however, find themselves totally marginalized. With the end of the Cold War, the first is no longer a priority for US external relations. The latter have lost their attraction for investment now that Mexico's tax regime has become superior to what was traditionally offered in the Caribbean region.

In Mexico, the debate on neoliberalism versus a nationalist economic policy at first seemed exhausted with the electoral victory of Zedillo. The attempts to re-establish the former interventionist model that was identified with Cuauthémoc Cárdenas's neopopulism and the PRD had failed. Salinas had been able to deepen the neoliberal restructuring process by ending the supremacy of *póliticos* over *técnicos,* neutralizing the political and social demands through neopopulism, and opening future possibilities for *rapprochement* between the PRI and the political right that is represented by the PAN.

The peso crisis, however, has shown that economic liberalization alone cannot solve Mexico's problems. Through increased deficits and the enlarged dependency on shock-sensitive foreign portfolio investments, liberalization has contributed to this crisis. Simultaneously, Mexico's new position in the world economy has undoubtedly helped it in finding assistance to stabilize the situation. The real costs of the crisis are nevertheless to be paid for by the majority of Mexicans, who have already experienced a period of impoverishment under both De la Madrid and Salinas.

In spite of Mexico's recent economic and political instability and despite the fact that their markets were also harmed by the peso crisis, the other Latin American countries continue to look upon NAFTA as the neoliberal materialization of Bolivar's ideal of panamericanism. Only this time panamericanism takes the form of free trade from Alaska to Tierra del Fuego. Latin American ideologues of neoliberalism consider the extension of NAFTA to new members (Chile, Argentina, Venezuela, Colombia and Costa Rica) as the right compensation for economic liberalization and drastic privatization. Anxiety over the possibility that US investments will go to other regions, over the threat of US protectionism, and over the entry of other members from outside the region (like New Zealand) together form the backdrop of the new 'Bolivarian' ideal.

Outside the Americas, the NAFTA initiative has been looked at with Argus' eyes. In November 1993 President Clinton argued that a repudiation of NAFTA would create difficulties for US negotiations with Asian countries. The US are demanding the elimination of customs barriers from Japan, China and other countries of the South Pacific. As long as they do not agree to this, the US resists every measure to expand the entry of products from this region into the US market. The Asian countries, on the other hand, consider NAFTA as a protectionist regionalization initiative that principally harms their car, electronic and textile industries.

The increasing interest of non-American business for Mexico as a station in the North American Free Trade Area reflects the ongoing struggle between the economic tendencies of regionalization and globalization that are both linked to neoliberal restructuring. Anticipating the closing of the North American market, Asian countries started to penetrate the Mexican economy in the late 1980s. In 1989, Japan had become the third investor in Mexico, after the US and Germany. In 1991 Mexico's industrial exports were valued at US$1,700 million, bringing in for the first time more foreign currency than the tourist industry. In 1992 this number went up to US$ 2,400 million, mainly as the result of investments by companies from Japan, Taiwan, South Korea, Singapore and Hong Kong. Access to the US market, low energy and transport prices, and the availability of good and cheap labour are important reasons for Asian investments in Mexico. Finally, the fact that labour costs in the Mexican border region with the US are lower than in South Korea, Singapore and Taiwan, has also been a strong stimulus for these countries to invest in Mexico's *maquiladoras*.

## NOTE

1 The term 'maquiladora' comes from *maquila*—a portion of grain collected by millers as payment for grinding a farmer's grain in the old days. *Maquiladoras* were originally set up as in-bond manufacturing plants to transform imported and domestic inputs into manufactured exports using Mexican labour.

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# 8

# BOLIVIA

## Crisis, structural adjustment and democracy

*Carlos F.Toranzo Roca*

In 1985 Bolivia was living an event of transcendental importance when the removal of state control over the economy was decided. Indeed, the National Revolution of 1952 had imposed the advent of a period of economic development influenced by political populism and the emergence of the state as an important economic actor.

As in many other Latin American countries and in other parts of the world, Bolivia adopted after 1985 a new model of economic development, which this time was based on economic liberalization, and adopted market-oriented regulations because the government believed that the entrepreneurial state had to create more room for the role of private actors and enterprises in the economy. The state had to confine its role to that of exercising specific regulatory and fiscal functions. Therefore we shall study in this chapter the post-1985 period, which was characterized by the initiation of economic liberalization and deregulation policies.

### THE NATIONAL REVOLUTION

As is well known, a considerable part of Bolivian history, if not all of it, can be associated with mining production; in fact, the colonial past was marked by silver, while the twentieth century can be assigned to tin. However, the current century deserves an essential historical cut. The first part, up to the National Revolution of 1952, was dominated by private mining, in which property became concentrated in the hands of three men: Patiño, Aramayo and Hochschild, better known as the tin barons. They built the so-called Super Mining State, an accurate expression of the economical and political domination of the country (on the history of the tin mines, see Céspedes 1979).

The second half of the century, not only in mining matters but also in new political and societal construction, begins with the National Revolution of April 1952, which introduced the ideology of revolutionary nationalism and accustomed the country to the logic of populism. The National Revolution of 1952 sees the construction of the modern Bolivia of this second half of the century. It marks the country with the stamp of state management in the economy and of corporatism in politics. This combination gave rise to the *State of 1952,* in which the state mediations—*vis-à-vis* labour unions (working class and/or rural) as well as the Army Forces—are crucial to an understanding of the political system (Lazarte 1992; Zavaleta 1982). Like other revolutions, that of April 1952 led to the recovery of fundamental acquisitions such as: the general vote, agrarian reforms, nationalization of the mines, educational reforms and other structural transformations of great importance.

The National Revolution was led by the Movimiento Nacionalista Revolucionario (Revolutionary Nationalist Movement, MNR), with Víctor Paz Estenssoro as leader. Within this party, the syndicates in coalition with the Central Obrera Boliviana (COB) and the Federación Sindical de Trabajadores Mineros de Bolivia (FSTMB) as nuclei, apart from the armed forces, are keys to understanding the political phenomena which occurred between 1952 and 1985. The year of 1985 stands as a watershed for the declivity of the state of 1952, the surpassment and dismantlement of economic statism, the alienation of populism and revolutionary nationalism, as well as the fall of the socialist Utopias in Bolivia and the diminution of the ideological impact of the labour movements.

We will review events since 1985, from the perspective of the interrelationship of two issues that are fundamental to the contemporary history of Bolivia: structural adjustment and economic liberalism on one side, with reconquest and intensification of democracy on the other. In this chapter we look at the particular Bolivian history within the framework of the aforementioned interrelationship. This interrelationship is a global phenomenon, experienced by most Latin American countries during the 1980s.

## ECONOMIC CRISIS AND POLITICAL CRISIS

Already at the end of the 1970s it was clear that the Bolivian mining industry had entered a productional and technological crisis of profound dimension, especially for the companies of nationalized mining, i.e. in the Corporación Minera de Bolivia (COMIBOL) (about the mining crisis of that period, see Toranzo Roca 1988). In fact, ever since the nationalization of mines in 1952, state mining developed neither processes of productive reinversion, nor processes of reconversion and technological innovation. Simultaneously the world entered into another technological era: substituted minerals for clays, recycled used minerals and, in general, diminished radically the amount of minerals per manufactured unity.

On the other hand, in the period 1952–85 the Bolivian economy did not diversify; it failed to create an industrial plant, neither did it solve the problem of weak agricultural productivity. For that reason, the mining crisis, so vital to the economy, had a more than important impact on the decrease of economic growth. If to that sphere of productive crisis the denominated crisis of external debt that afflicted the country in the first half of the 1980s is added, a general overview of economic crisis in that first half of the 1980s can be made (for the theme of the external debt, see Ugarteche 1986).

In the political sphere it is important to stress that from 1971 to 1978, Bolivia was a military dictatorship, led by Colonel Hugo Bánzer; from 1978 to 1980 various presidential episodes passed by, that argued the high political instability of the country. From 1980 to 1982, military governments again ruled, the first of them, dictatorial and linked to the traffic in narcotics, led by Colonel Luis García Meza (1980–1). Only since 1982 has democracy re-emerged by means of the government of the Unidad Democrática y Popular (UDP) led by President Hernán Siles Zuazo (see Mayorga 1991; Laserna 1992).

That stands as the nodal point for the reconstruction of the political system, and the revaluation of democracy. In fact, it is during the period of the government of the Unidad Democrática y Popular (1982–5) that representative democracy is revalued. It is the fundamental period from which the society and the population start to admit democracy as a value in itself, and no longer as something instrumental, a transitory situation, 'veranillo democrático' (popular way of understanding democracy by radicalized syndicates and left-wing parties) before revolution, but rather as something more transcendent. Even radical sectors such as the working class and farmers, apart from some intermediate classes like teachers and university students, affiliate themselves to the movements that accept representative democracy as something crucial for the political development of the country.

However, this radical shift in ideology is not altogether surprising: for this to happen the population had to incorporate two traumatic facts into its memory and conscience: (a) The military dictatorship of Colonel Hugo Bánzer (1971–8) and (b) the military dictatorship of Colonel Luis García Meza (1980–1). Both brought with them the fresh memory of the violation of human rights and the lack of civil guarantees. This led to the fact that society and population had to choose between democracy and dictatorship. The choice was clear: take the way to democracy and envisage it as a positive value.

Nevertheless, a population, a society or syndicates and left-wing and right-wing parties that had not lived in a democracy for years and years—or even more than that, that had not practised representative democracy in their lives—had no reason to demonstrate very rational conduct when they began to live the reinstated democracy. Everyone—labourers, farmers, middle classes, parties, syndicates, even the government—rushed in to enjoy that which had been absent for so long. In an easy way they exploited the demands, wishes and claims held up during many years of dictatorial obscurity.

The syndicates did not only want to be part of government, they wanted to govern, to take control of the power to establish their socialism. The left-wing parties that were not in the front lines of government conspired in order to assault the state in a revolutionary way. In conformity with their progressive positions, the government parties Movimiento de Izquierda Revolucionaria (MIR) and Partido Comunista de Bolivia (PCB), wanted to establish an economic model of redistribution, putting all manner of subsidies and subventions on the shoulders of a state and public companies which were already undermined by the severity of their crises and their disproportional deficit (about the syndical themes of that period, see *Crisis* 1987; Lazarte 1988).

It is important to say that between 1982 and 1985 a lot of political and social actors acted against the grain of history. When the swell of the global market and liberalization came up, in Bolivia the discussion was still centred on how to amplify economic statism. When democracy gained ascendancy in an almost universal way, the working class was still prompting a socialist project. When world technology already had outstripped Taylorism, in Bolivia they still did not dream of the assembly line. When every nation struggled to stabilize its economy, in Bolivia inflation was still not proscribed; the consensus was that it could bear the acceleration of the growth. When the UDP government disciplined its labour forces, it was practically surrounded and cornered by the syndicates.

In short, the course of Bolivia's politics and economy seemed to be the opposite of what had happened in the rest of the world, but, as is well known, this could only happen in a conjunctural way, it could not last; neither in an internal nor in an external way did the country possess conditions to stabilize itself. In our analysis this becomes clear when we point out that the mining industry in general collapsed. In fact, the real Gross National Product (GNP) of 1982–5 in each of those years was negative, an accurate reflection of the severe recession the country suffered (for economic figures see *Estadísticas Económicas* 1990–1). However, more serious still than the recession and the diminution of the size of the economy, which illustrated the gravity of the crisis, was the situation of high inflation and hyperinflation into which the country drifted. In 1982 inflation was 296 per cent, in 1984 it was 2,175 per cent, and in 1985 it reached 8,168 per cent (*Estadísticas Económicas* 1991:3).

It is clear that in the phenomenon of hyperinflation all the problems of the economy and politics were concentrated in a negative way (Morales 1987). In fact, that merciless inflation, the growing lack of basic goods, the long and endless queues to obtain the first necessities of life, the excess of (civil) strikes, road blockades—in short, the anomie into which the state and the society had drifted; all these were an expression of the exhaustion of the 'State of 1952', as well as the wastage of economic statism.

With the crisis of 1982–5 not only were the government of the UDP and President Hernán Siles Zuazo dislegitimated, but more than that, the syndical maximalism that wanted to build a new state was undermined, left-wing radicalism collapsed; even more far-reaching, the left in all its shades was held responsible for the whole political and economical disaster (Miranda 1993).

The accumulated crisis during that period marks the limits of revolutionary nationalism, of populism and, of course, expresses the collapse (in this case not because of internal reasons) of the socialist ideas, hopes and Utopias. This means that politics in the future should be built with basic ideas other than those unfolded in the past. Nevertheless, there are lessons to be learnt from the mistakes of the past. First, there is no doubt that this period and the government of the UDP were very democratic, and that they respected human rights. More than that, as a progressive regime, the UDP tried as much as possible not to repress excesses by syndicates, industrial circles, citizens or parties. The period between 1982 and 1985 can be considered the period of democratic recovery which created the foundations for the democracy in which we live today.

Second, in spite of the profound economic and political crisis, the society as well as the population, political class, parties and even the military, admitted that the solution to the problem should be a democratic one, and not a historically traditional Bolivian one, i.e. through people's revolts or military coups. The solution was offered by President Siles Zuazo himself, who offered to resign a year before completing his mandate (Lazarte 1992; Mayorga 1987).

Third, the period itself demonstrated that the political system had already exhausted the old statal mediations around which the political decision-making was built. In fact, the syndicates and the armed forces were no longer enough to settle such a complicated situation; the road was open to the political parties to define solutions within the democratic framework (Toranzo Roca n.d.).

Fourth, the Siles Zuazo government found itself with serious problems of governability, because when it came into power and during the entire governing period, it always had a parliamentary minority, which obviously turned into an almost complete blockade of the executive by the legislature. Without knowing it, the UDP and President Siles Zuazo founded the phenomenon which we can define as 'governability trauma', which was introduced in the conscience of the political class and the political parties (concerning the themes of governability in Bolivia, see Mayorga 1992).

## TOWARDS ECONOMIC AND POLITICAL STABILITY

The impact of hyperinflation in a society that does not have a long inflationary tradition is disastrous, because it disrupts the political and social pattern and, what is even worse, creates a situation of strong insecurity about the future. It could even be said that the hyperinflation trauma tends to convert people, institutions and political organizations into a conservative way of thinking (on this theme consult Arrieta and Toranzo Roca 1989). In the specific case of Bolivian hyperinflation, there is no doubt that the 'agony' of inflation led to a transition towards a conservative ideology. That not only happened to the denominated right-wing and conservative social sectors, but also the phenomenon extended towards popular sectors and some left-wing political parties.

The gravity of the fear of hyperinflation among the people became what René Zavaleta calls a *'state of disposability'* (Zavaleta 1986; Zavaleta 1992) towards change; i.e., it created a situation of disposability or acceptance for the social and political actors to agree upon anything directed towards alleviating or eliminating the phenomenon that was harassing them, even though the 'medicine' might strike their customs and traditions. That means, using Zavaleta again, that at certain moments in a society's history, an ideological erosion is produced (Zavaleta 1992), something that should be repaired with a new ideological or conceptional interpellation, which of course should be completely different from the old one.

In fact, society had already left behind economic statism; for that reason it was in a state of disposability to accept another type of economic politics, even if that should mean an 'economic shock' with a 'neoliberal' character. Strictly speaking, the population was disposed to accept any type of measure which could stop inflation, alleviate the growing lack of goods, and eliminate the queues; i.e. that society was ready to admit a structural adjustment whatever the severity of it might be, in spite of the fact that it would entail very severe social costs.

The new economic model and the consequential economic shock could count on the active legitimation given by the business class, high-income middle classes, the military and small businessmen. But it also counted on a passive legitimation from popular sectors, the working class, farmers and small merchants, who admitted in silence, without applauding openly, any new kind of economic politics that would get rid of inflation.

However, putting into action *New Economic Politics* in Bolivia did not only mean the implementation of an instrumental package of measures to stabilize the economy. The New Economic Politics approved of in August 1985 was also the beginning of a new strict programme of structural adjustment, and it also turned into the first phase of the structural reforms which changed the orientation of the economy. Much more than all that, and surpassing the categorial scaffolding used by the international financing organizations, one could assert that with these new economic politics the societal organization of the country was being redesigned and, simultaneously, that its politics, the state, the political system and its articulation with the political actors would be redefined.

The New Economic Politics strictly speaking did not only entail economic elements; more than this, it caused political and ideological transformation as well, because it had the capacity to change the old political concepts into economic categories covering liberal political content. Concepts like socialism, revolutionary nationalism, economic statism, popular revolt, self-organization of the masses, etc., were changed for categories that were apparently innocent but charged with another world vision, like: elimination of fiscal deficit, budget equilibrium, equilibrium of the macroeconomic variables, free functioning of the market, deregulation of the markets, privatization of public companies and services, reduction of the state, liberalization of the markets, interest taxes and rates of exchange.

It is a reality that all these economic categories turned into ideological concepts that defined a new political situation of liberal stance; the old categories of the syndicalist and left-wing radicalism were exorcised from the people's minds. More than that, the ideological squall of the modern 'new right wing' (Lazarte 1988; Calla 1989) had the capacity to identify syndicalism, socialism, statism, revolutionary nationalism, working-class radicalism and populism, as being identical to hyperinflation, queues, disorder, strikes, state anomie, the end of provisions, etc. The fact that this redefinition of the old concepts became incorporated in the public consciousness marked an ideological victory of the social and political sectors that implemented the stabilizing shock, over those adhering to ideas linked with a radical ideology.

The process of stabilization and the beginning of the programme of structural adjustment were incorporated into people's minds without the characteristic violence of Bolivian political processes, it accustomed the people to democratic conditions, which was something very unusual for the country's history. Between 1952 and 1985, to a greater or less extent it was revolutionary nationalism, working-class syndicalism and the socializing left-wing of all shades that emitted the ideology that previously influenced society. Ever since 1985 none of them had the capacity to impose itself on the ideological battlefield, and lost to the different political and social actors who defended a liberal way of thinking; a defeat from which they did not recover until today.

It is important to stress that the structural adjustment is imposed in an ideological way and implemented in a practical way under democratic conditions. Until these democratic conditions presented themselves, all efforts to stabilize the economy came with substantial measures of force and violence. This is a very important fact in contemporary politics. In the 1989 elections the party that applied the adjustment asserted itself: the MNR led by its candidate Gonzalo Sánchez de Lozada, executor of the structural adjustment in the 1985–9 period.

It is curious how an adjustment that had a high social cost could be introduced as an ideology and at the polls (see Morales 1987), because in fact the Paz Estenssoro regime (1985–9) reduced the number of employees in the state mining industry to 70 per cent, fired thousands of public bureaucrats, created high unemployment amongst labourers in private industry due to liberalization of external trade, but in spite of all that, stabilization and those who implemented it did not lose electoral support.

The paradox could probably be explained by the way New Economic Politics managed to slow down inflation. Inflation rates dropped from 8,168 per cent in 1985 to only 10.6 per cent in 1987 and 15 per cent in 1989. Also, during that same period the structural adjustment managed to break the recessive tendency of the economy, that after seven consecutive years of decrease recovered, reaching growth rates of about 2.7 per cent of the real GNP since 1987. Apart from the economic reason or explanation of adhesion to the structural adjustment, there were also some political reasons that were related to the political stability of the period and to the kind of efficient government administration displayed during those years.

## THE INTENSIFICATION OF DEMOCRACY

There is no doubt that for Bolivia a parallelism existed, and still exists, between the application of structural adjustment and democracy (or even better: intensification of democracy). The country's political past was marked by the logic of war, because of the 'to the bitter end' kind of confrontation that had been common. Whether it was between syndicates and the military, or amongst political parties, the logic of dialogue and the habit of compromise did not exist. Even more, such practices were looked upon in a derogatory way, with the accusation that concessions to the political enemy or the class adversary had been made (Lazarte 1988). Between 1982 and 1985 that political practice was still prevailing; indeed, the fate of the government of the UDP depended on the amount of initiative manifested by the legislature, the severe 'trauma of governability', emerging from an old opposition and obstruction from the parliament, dominated by the opposition (MNR; Acción Democrática Nacionalista, ADN; and other smaller parties).

The presidential elections of 1985 gave General Hugo Bánzer Suárez of the ADN the first relative majority. The second place was taken by Víctor Paz Estenssoro, of the MNR; the third place was occupied by Jaime Paz Zamora, of the Movimiento de la Izquierda Revolucionaria (MIR). Given the fact that no one obtained an absolute majority, which was necessary to assume the presidency, according to the constitutional norm it was the parliament that had to choose the President amongst the three candidates that had received the most votes. As such, Víctor Paz Estenssoro of the MNR was elected thanks to votes from the MIR and other small parties. The most important fact to stress was that the parliament did not obstruct nor frustrate the process of the election of the President, as had occurred in the past.

But more important than smoothing the way for the election of the President is what happened immediately afterwards, in the same year 1985. We refer to the signing of the Pacto por la Democracia between the party of elected President Víctor Paz Estenssoro, the MNR, and ADN of General Hugo Bánzer Suárez, because by the signing of that pact and through the creation of the MNR-ADN coalition, a solution was sought to the 'trauma of governability' that had paralyzed the UDP during its governing period of 1982–5.

It was not easy to foresee a pact between parties like ADN and MNR, which continued to have ideological differences, to no extent unbridgeable ones, but distances none the less. Notwithstanding, the parties' leaders and the Bolivian political class began to understand that the functioning of the democracy depended on generating and preserving governability. With that reasoning as a starting-point, and tabling the governability crisis of 1982–5, Bolivia started to experiment and live a key change in the functioning of the political system marked by the beginning of the logic of pacted democracy and by the habit of forming coalitions to govern. Together with that phenomenon, the opposition started to discuss the necessity of executing a constructive or an inspecting opposition; this concept comes from the MIR in the period between 1985 and 1989.

In the next elections of 1989, when the government of Dr Víctor Paz Estenssoro had come to an end, the situation was as follows: the first relative majority was won by government party MNR, led by Gonzalo Sánchez de Lozada. The second place was occupied by General Hugo Bánzer Suárez of ADN; while Jaime Paz Zamora, of the MIR, ended up third. The situation had changed and since nobody obtained the absolute majority, the election of the President had to be arranged in the parliament, and that is the way it occurred; the parliament chose the President among the three candidates that obtained most votes.

To the astonishment and consternation of the population, the MIR of Jaime Paz Zamora and ADN of General Hugo Bánzer Suárez, formed the winning coalition, called the Acuerdo Patriótico (AP), and chose Paz Zamora as a President. Where as in 1985 the MNR-ADN pact generated perplexity, in 1989 there was dismay because of the coalition between General Hugo Bánzer Suárez of ADN (dictator between 1971 and 1978 and persecutor of the MIR in those days) and Jaime Paz of the MIR. But in spite of the fact that it might have been a surprising agreement between 'persecutor and persecuted', that pact, the AP, consolidated the logic of coalitions, outlawing the logic of war that had ruled Bolivian politics.

The election as President of the candidate who had occupied third place in the elections—Jaime Paz Zamora, who only had obtained 19 per cent of the votes—ratifies the road and/or the consolidation of pacted democracy and shows that pacts and coalitions are possible. Even more, it is a great stimulus for the guarantee for governability so that democracy can be consolidated. However, the fact that a candidate who had ended up third in the elections was elected President, respecting the constitutional norm, created the conflict and discussion about the opposition between legality and legitimacy. Jaime Paz Zamora was accorded full legality in his election, but then a doubt arose about its legitimacy.

It was that *impasse* that cultivated the idea of a constitutional reform in order to modify the way a President was elected. Simultaneously, given the fact that Paz Zamora's triumph in parliament was not entirely unequivocal, the idea arose of making more open the functioning of the institutions of democracy, especially of those people entrusted with the electoral theme. The lack of openness existed owing to the manoeuvring in 1989 of the Corte Nacional Electoral in favour of Paz Zamora's party, the MIR, and his ally ADN, cutting off the entry of Gonzalo Sánchez de Lozada, winner of the elections, into the Palace.

The story of the 1993 elections shows a repeat of the practice of pacted democracy. The elections were won by the MNR of Sánchez de Lozada (33.8 per cent), which in turn tied itself before the elections to the Movimiento Revolucionario Tupaj Katari de Liberación (MRTKL), of Víctor Hugo Cárdenas. The second place was obtained by the Acuerdo Patriótico (Front of the MIR and ADN), with its candidate General Hugo Bánzer Suárez (20 per cent); the third place was occupied by Conciencia de Patria (CONDEPA), with its candidate Carlos Palenque (13 per cent) (for details and dates on the relevant elections, see *Informe Confidencial* 1993). As was obvious, the MNR had ample opportunity to form a government coalition. It decided to found the Pacto de Gobernabilidad with Unión Cívica Solidaridad (UCS) de Max Fernández (13 per cent of the votes in that election) and with the Movimiento Bolivia Libre (MBL) of Antonio Araníbar (5.1 per cent of the votes).

That is the way in which in 1993 the logic of pacted democracy was confirmed; the confirmation of coalitions and the protection of governability. As distinct from the past, today *any* combination of parties that can form a coalition no longer surprises anybody, because an additional and fundamental change in Bolivian politics consists in the fact that politics has shifted to the centre or, in other words, the so-called political centrism has established itself. In fact, the parties' programmes are getting more similar every time. A distinction between left and right can no longer be made, that terminology ceased to be valid; or at least, had lost the power to describe or explain in the way it had in the past. As such, because of the amplified political centre, the formation of coalitions and the generation of political pacts are more likely to happen.

It is also important to stress that the logic of pacts has extended its domain; its validity is reaching further than the election of the President. Pacts between the parties have begun to function in thematical spheres of democracy where there exist problems and questions that require consensus in order to intensify democracy. That is why in 1991, 1992 and 1994 pacts between the government parties and those belonging to the opposition were signed, in order to solve crucial problems of democracy such as the electoral, juridical and constitutional reforms; decentralization; and other issues concerning the institutional modernization of democracy and the democratization of the state. Furthermore, for major issues, that consensus between government and opposition would henceforth invoke the 'two-thirds' rule, meaning that in order to define crucial agendas or in order to nominate functionaries of the electoral or juridical powers, an agreement and a division of two-thirds in parliament would be required.

## NEW POLITICAL AND SOCIAL ACTORS

The democratic process adopted by Bolivia since 1982 and the structural adjustment implemented since 1985, have been accompanied by new discussions and new problems of analytical options. As could have been expected, democracy has generated hope, but the simultaneous presence of the structural adjustment creates doubts about the capacity of a new model like the New Economic Politics, to create equity.

In the same way that socialism fell, those on the left who became democrats, understood that neither the state nor the proletarians and their way of thinking would prevail. Exactly like them, Bolivia had to revalue representative democracy and she had to understand it as a value in itself. Also in the margin of economy, little by little the importance of the market was understood; there was a move towards the teaching of economical liberalization; and it was understood that productivity, efficiency and human capital were and still are paramount to the world economy. Thus, from a political and economic point of view, the country was impelled to inject itself with globalism. It had to read the signs of time.

However, the most developed places of the world cannot survive solely on the appraisal of globalism and in accordance with cosmopolitanism; nor should the most backward areas look at themselves from a global perspective. Attention to the particular is necessary: surveying the specific character is a key to enriching the concept of democracy. The perspective must be from the local and regional dimension, in such a way that the nuance is not lost, but even detached to find the specific personality of every national democracy (see *Diversidad étnica y cultural* 1992).

From that viewpoint, the realignment to world modernity cannot take place successfully if it does not take on board the identity or identities that characterize every country, because identity is the simultaneous interconnection of tradition and modernity. That is one of the most vital discussions that could lead to an effort to interconnect universalism and particularism in a successful way.

It has been said that representative democracy is unstoppable; moreover that it has a progressive character. However, bearing the specific Bolivian character in mind, we have to consider the following facts: the democracy we mentioned has an exclusive urban validation (58 per cent of the population), whereas it is alien to the rural society (42 per cent of the population). The most recent form of democracy (in spite of the fact that the *conquista* took place 500 years ago) lives and reproduces itself in accordance with codes of a communal democracy, to a logic of solidarity and to proper mechanisms of organization and nomination of their authorities (see also *Lo pluri-multi* 1994). Thus, the challenge consists in thinking of and constructing a political system that does not lead to the 'absorption' of communal democracy by representative democracy. That has not happened in five centuries, so perhaps the most feasible option is to interconnect representative democracy and communal democracy; the result of that special joint venture should be a more fluid and more representative political system than we have today. It is true that we are not at zero, the Ley de Participación Popular (see *Reflexiones* 1994), approved of in 1994, gives a signal through recognizing natives and community organizations. Nevertheless, it maintains the view of 'incorporating' communal democracy in representative democracy, which is-not always correct.

Besides the interconnection of those two types of democracy, in the urban as well as the rural field, the problems of simultaneously interconnecting two phenomena appear to be: (a) one that is already visible and corresponds to the civil cutting-up corresponding to the advance of representative democracy; and (b) the immediate and pressing necessity to preserve the logic of solidarity, in which besides the individual self, room could be left for the existence of the collective self. It is possible that the last one could benefit through the re-creation of public spheres where collective logic would be guaranteed, so that it accompanies and gives validity to the civil logic that up to now has isolated the subjects and left them unprotected in all sorts of circumstances (on women, see Ruiz 1993).

A phenomenon that has received much publicity centres on the presence of new social and political actors on the Bolivian scene (see *Nuevos actores Políticos* 1993). The emphasis is on the acceptance of diversity in a country possessing multifarious cultural, racial, regional, religious, linguistic and other elements. Contemporary Bolivia, to the annoyance of its oligarchies and conservative sectors, is accepting itself little by little as the real bulwark of diversity.

The mestizo *'cholaje'* society of recent immigrants, small merchants and domestic servants has constructed its own identity as a social actor and even has proper political actors (parties) that represent a considerable proportion of them. This is the case with the party of Carlos Palenque, CONDEPA (for an elaboration of this theme, consult Archondo 1991; also Sandóval and Saravia 1991). Another example is the UCS of Max Fernández which, without wanting to be an organic expression of the *'chola bourgeoisie',* symbolizes the tendency of the financially strong, dark-skin sectors (i.e. of those fractions of *'mestizaje'* that, accumulated in a self-made-man style, came to be *bourgeois,* but are not recognized as such by the oligarchic sectors, or by the same Bolivian sociology (Mayorga n.d.)).

Not only is the mestizo world in all its elements enriching the social and political diversity of the country, but also the rural, peasant and aboriginal worlds add to the country's diversity. All the political actors are starting to mitigate their political positions and are beginning to accept representative democracy, without compromising their indigenous identity or losing respect for their community organization. The phenomenon is so far-reaching that in the 1993–7 period the Vice President Víctor Hugo Cárdenas (who accompanies President Sánchez de Lozada) is in fact an indigenous intellectual, who belongs to the MRTKL: that is one of the many fractions in which the *campesino* and *indígena* movements of the country have been organized (on the *kataristas,* see Albó 1994). In fact, the same diversity is amplified by the rebelliousness of the natives, because now it is no longer restricted to the *quechua* and *aymara,* but extends as far as all ethnics.

It is a fact that political, cultural, racial, linguistic and regional diversity has conquered the social scene. But besides this, the incorporation of new social and political actors within the political system has allowed it to grow, thereby giving it an undisputed representativeness and, of course, preventing or at least postponing the violence of the kind shown by the Peruvian *Sendero Luminoso,*[1] which arose because of the dogged exclusivity of the political system and its failure to incorporate new social actors.

Together with the explosion of diversity and the presence of new social and political actors, new problems appear that amplify and complicate diversity; the politics and different views do not cease with the traditional trilogy: labourers, bourgeoisie and the military. The first have lost the ideological high ground and their ideological interpretation is no longer as powerful as some decades ago.

The second group, the businessmen, met an economical model that leaves them as central leading men, being responsible for growth. However, until now they have not fulfilled the roles assigned to them by the liberal paradigm, which leads to the rethinking of the model and the mitigation of the dogmas of the Communist Party or the new dogmas of the market, which replaced the dogma of state intervention in the economy.

The third group, the military, by dint of the intensification of democracy, lost the basic role they played in power, a role that so many times, through a military coup, left them in the presidential seat. The role that the military plays in society today should change. Maybe they should cooperate in supporting the works of development and abandon the hypothesis of war with other countries. Moreover they should also abandon the internal fight against 'communism', where that no longer is a threat. None the less, among the new themes is the traffic in narcotics. In this matter, in accordance with the demands of the United States, the Armed Forces and not only politics, should play a more active role in the approach of that plague.

The new themes that have been incorporated in the discussion are those that refer to ecology and environment, sustainable development, regions, local power, decentralization, modernization of the state, etc. A lot of them arise from foreign fashions, others derive from conditions necessary for international credit facilities; few emerge from an authentic discussion among the social actors. Since the national dialogue has these dimensions, it is necessary to take the aforementioned factors into account.

Something that was particular to the image and the construction of democracy in Bolivia is related to the profuse discussion about, and advances in, the legal, electoral, juridical, constitutional and institutional fields of democracy (see also *Adores sociales* 1993; *Partidos políticos* 1989). It is clear that those spheres were ignored and unknown in the country; today we are beginning a dialogue about them (see *Reflexiones* 1994; *Debate sobre* 1990).

And maybe, corresponding to those dimensions, a new discussion arises that is related to the search for better standards, institutions and state organization, that can guarantee an openness in the wielding of power and that can improve representativeness in the political system. The cushy jobs and extreme clientelism in the actions of the state have recalled the dialogue about ethics and politics, about the relation that most likely exists between those two dimensions, because without linking them it is probable that the legitimacy of democracy itself will be unsettled.

Nevertheless, some very important themes exist that are a prelude to violence in the country and that require a more thorough examination without the prejudices that considered them as taboo problems. One of them is related to the traffic in narcotics and to Bolivia's relation with the United States and the treatment of that specific issue (see Verdesoto and Ardaya 1993; *100 Documentos* 1993; *Condiciones* 1990). However, another issue in which possibility of violence is created and, consequently the possibility of destabilization of democracy itself, is that of the persistence of poverty.

In fact, a paradoxical phenomenon appears in the people's conscience: democracy and its recuperation have been accompanied by a structural adjustment of which the social costs, during the nine years of its execution (1985–94), are too high. The danger exists that the population in its desperation may feel that democracy and the persistence of poverty are identical. This may destabilize the political system and democracy itself, because it is well known that an excess of poverty and poor living conditions can evoke an ungovernable violence that can undermine the bases of democracy (Chávez and Toranzo Roca 1993). What is even worse, we already know that violence does not lead to the 'promised land', but only worsens the population's situation with respect to their living conditions.

The enrichment of democracy has allowed the citizens to gain and recover political and civil rights, but still democracy does not afford the poorest stratum of society economic rights; i.e. the right to an acceptable standard of living. Thus, taking into account the distance between politics and economics, the shadow of violence and destabilization of democracy is growing. It is necessary to discover the way in which the structural adjustment and its economic models can not only stabilize the economy but also make possible a streamlined growth and, above all, that they do so generating equity. This utopia is tiny compared to those of the past, but it is the challenge of the present (*Políticas* 1991; *Necesidades* 1990).

## CONCLUSION

About ten years have passed since Bolivia started its policy of economic liberalization with the approval in August 1985 of the New Economic Politics. These reforms aimed at a destruction of economic etatism when designing a national modality for structural adjustment. After a decade of economic reforms it is perhaps useful to draw some, although not entirely definitive conclusions from these experiences.

First of all, Bolivia was confronted with a rampant inflation which reached between August 1984 and August 1985 about 22,000 per cent. But during the end of the period (1993–4) inflation was under control at 10 per cent a year. The spending deficit was also under control; devaluations were of limited importance; in addition, interest rates were positive again. We may sum up by saying that all macroeconomic indicators showed a stabile situation.

Notwithstanding that the economic, monetary and fiscal situation had stabilized, economic growth was too low to meet the demands of an underdeveloped country. Indeed, during the last years of the decade average growth rates oscillated around an average of 4 per cent per annum. Low economic growth rates were also accompanied by a growing concentration of income and wealth, which demonstrated that the neoliberal reforms did not enhance equity. If something was characteristic of the economic situation of the last ten years, then it was the fact that monetary stability was accompanied by growing impoverishment. Now that the state-owned enterprises were dismantled and their productive activities disrupted, the privately owned national and foreign companies could not demonstrate their vitality by generating productive dynamics through increased productivity and competitiveness. A dangerous aspect of the actual neoliberal model is its dependency on international finance. Foreign loans and aid programmes finance 60 per cent of the public debt, which is monitoring at the same time a growing balance-of-trade deficit. So the paradoxical result of a model promising to boost exports and competitiveness was that imports increased while exports decreased.

## NOTE

1 *Sendero Luminoso* is a Maoist, Peruvian political party, founded in 1970. The party started guerrilla actions in the province of Ayacucho. From 1988 until 1992 the party operated guerrilla actions in Lima.

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# 9

# NEOLIBERALISM AND THE CENTRAL AMERICAN PEASANTRY

*Kees Blokland*

## INTRODUCTION

In Central America, the decade of the 1980s was marked by different attempts to achieve a transition towards socialism. The intent which presented the best perspectives for success was in Nicaragua, where the Sandinista movement was able to assume actual control of the state. However, to an equal degree the experiences of the liberated zones of El Salvador and the insurrectional struggle of indigenous peoples in Guatemala nourished hopes of a change in the model. With time, many peasants who formed part of the revolutionary movements, and particularly those in Nicaragua, formulated serious criticisms regarding the political and economic centralization of the official revolutionary project. They eventually arrived at a fresh perspective on the revolutionary model in the process of development. This explains their unexpected position regarding neoliberalism at the beginning of the decade of the 1990s.

Costa Rica, the only country of the Isthmus exempted of armed struggle within its borders, started the implementation of neoliberal adjustment at the beginning of the 1980s. Nicaragua, on the other hand, due to the socialist orientation of its government, tried to withstand economic adjustment and liberalization as long as possible. However, due to enormous external and internal disadjustments Nicaragua too finally had to proceed in 1986 with the liberalization of the domestic market of basic grains. Still more drastic adjustments were carried out in 1988, as inflation in 1987 reached an accumulated 1,347 per cent and was expected to skyrocket to 13,000 per cent in 1988. At that point, the official exchange rate of seventy córdobas for a dollar was lacking way behind the black market rate where dollars were exchanged at 40,000 córdobas. Production was collapsing in virtually all sectors. The adjustment programme tried to follow the accustomed three-staged path of recovery of the relative prices, reduction of inflation and economic recovery. The opening up of external markets and breaking up of the state monopoly on foreign exports and banking, though, lasted until the coming to power of the new elected government in 1990, which also started a privatization programme of state properties.

At the start of the current decade, the Central American peasantry found itself at very particular crossroads, characterized by the end of the armed conflicts, both revolutionary and counterrevolutionary, in the region. Hope and optimism reigned, particularly in Nicaragua, El Salvador and Guatemala, and above all in the countryside which had been the scene of the conflicts, with the peasants supplying the dead and wounded from both sides. Given these circumstances, the structural adjustment measures of a neoliberal nature did not receive the expected opposition on the part of the peasantry because they coincided with new hopes for peace, reconciliation, prosperity and economic development. Optimism forged the hope of being able to reverse the unfavourable character of neoliberalism for the poor majority through negotiation, and to take advantage of the policies of privatization and open competition to bring into being their own particular interpretation of the future model, an economic project for the peasantry. This project had been nurtured, in theory as well as in practice, amid the wars of the 1980s.

That which has often been called a lost decade for the Latin American countries, was not lost from the point of view of the Central American peasantry. Rather, in the words of the Costa Rican peasant leader Jorge Hernández, it was, 'the decade during which the most dynamic processes were developed, in terms of their political presence, insertion [in society] and integration [of the movement]' (*Central American Peasant Organizations* 1993:7). Hopes for the future were fuelled by the idea that the correlation of forces had suffered a profound change in the countries referred to, despite the fact that the transition to socialism did not lead to the definite conquest of power or the continuance in power. In Nicaragua, the Sandinista Front of National Liberation party (Frente Sandinista de Liberación, FSLN) lost the 1990 elections to a coalition of fourteen opposition parties known as the National Opposition Union (Unión Nacional Opositora, UNO). In El Salvador, the revolutionary movement was unable to achieve power either by force of arms or via the 1994 elections. In Guatemala, the brutal repression prevented the consolidation of the liberated zones and led to an important contingent of refugees in Mexico. There the shared life in the refugee camps of Quintana Roo and Chiapas gave root to new forms of organization which in themselves came to enrich the movement for change in Guatemala now that the refugees have been repatriated.

What then is the peasant project? What are its premises and what are its perspectives for realization, even in times of neoliberalism? We will review these questions on the basis of the experience of the Unión Nacional de Agricultores y Ganaderos (National Union of Farmers and Ranchers, UNAG) of Nicaragua and their criticism of the official Sandinista project. With these criticisms as a point of departure, they have taken a series of initiatives that have culminated in their own particular doctrine of economic democracy and a peasant project for development. This has captured the imagination of the organized peasantry of the Central American region which, building on the experiences of the UNAG, is carrying out its own process of regional integration. We will be looking at the theory and practice of the peasant mode of appropriation, a process involving the harnessing of resources necessary for the realization of the peasant project. We will further analyse the criticisms of centralized planning within the context of a mixed economy and demonstrate how peasant participation can alter the content of the mixed economy, reducing the role of the state until this gives way to a panorama of negotiated competition between social sectors and the government. In the same way, we will be examining some of the problems that affect the peasant project and which—despite undeniable advances in the construction of their appropriation mode—have produced tensions between the leaders and the grassroots within the peasant movement. We will argue that these problems are due to the fact that development aid capital has not adapted itself to the neoliberal logic, but continues to be channelled from government to government.

## THE PEASANT PROJECT

### Economic democracy

The peasant project is aimed at economic democracy, in diametrical opposition to the exclusive forms of development which have been the general rule in Central America and which have been fortified still more by neoliberalism. The agrarian reform occupies an important place in this type of democratization, emphasizing the necessity for complementing land redistribution with integral support policies which guarantee credit, agricultural inputs, technical assistance and training to the peasantry. Still more important are adequate price policies so as to assure profitability to those who have been benefited with land. The importance of a coherent price policy lies in the necessity of assuring that the effects of the reform are not undone in the medium run, giving way to a new process of marginalization in which the lands are abandoned, mortgaged or usurped. The concept of economic democracy must involve a betterment in the earnings of the agricultural sector and an improvement in the terms of interchange between city and country in favour of the countryside, especially food producers. Food security plays a central role, ending dependency on imports and donations and inhibiting their use as a means of depressing internal prices and thus undermining the incentive for local production.

A strategy for improving the earnings of the rural sector must be linked to a project for agro-industrial transformation, broadening the process of cooperative organization to embrace the spheres of purchasing, processing, internal distribution and export. Recently, the Central American peasantry links its strategy towards economic democracy more explicitly to a project for technical development and technological outreach from peasant to peasant. This broadens the technology at the disposition of the producer, including both mechanization and the use of agro-chemicals as well as other types generally referred to as adapted technology. It also includes the concept of sustainable development, which implies a more critical criterion when looking at those technologies which involve a high component of imports. Finally, the concept of democratization is linked to the peasantry's possibilities of gaining access to the flow of national and international capital, by having this be channelled to producers through their own institutions (Núñez Rodríguez 1990; *Estrategia económica y social de la UNAG* 1991).

## The peasant mode of appropriation

The crux of the peasant project lies in capturing the largest possible quantity of resources for its realization. We summarize this aspect with the concept of the 'peasant mode of appropriation'. It refers to the measures necessary to achieve control over the aggregate value produced within the agricultural sector, to increase the possibilities for retaining it within the sector, and to reduce the factors which impede such retention. In order to accomplish this, methods are needed to combat the extraction of resources from the peasant sector and from the productive units and to capture resources from other sectors of the economy or from outside. The organized peasantry of the region carries on this struggle on different levels; in addition, they maintain the intention of socializing its use. That is, they wish to make investments subject to a collective criterion so that they, too, be marked within the strategy for economic democratization.

The first form in which this peasant mode of appropriation is expressed is through the formation of cooperatives; the promotion of cooperatives is fundamental. This process must begin with the organization of interest groups, incipient organizations which are structured in order to gain control over certain resources which will serve the group's interests. The interest to be satisfied might be land, for example, giving way to organized land takeovers or to a collective demand issued to the corresponding officials so that lands be ceded to the group. Or it might be production services, giving way to the establishment of grassroots organizations which will take upon themselves the job of purchasing inputs and selling the production, or the foundation of pools of machinery, processing plants or rotating funds, all of a cooperative nature. At the level of each cooperative, the appropriation mode is found in its 'multisectoral' character—the effort of the cooperative to broaden its activities into other sectors of the economy:

the group which comprises the cooperative makes decisions about new investments in order to perform more economic functions for its members and to replace intermediaries with cooperative structures (*Nuevo enfoque* 1982).

The second form involves the establishment of a special financial structure for the peasantry, also of a cooperative character. This should be capable of attracting the savings of all sectors of society and of obtaining access to national and international lines of credit in order to channel these towards the projects that have been prioritized in the policies formulated by the bank. Given that the shareholders in this type of bank are generally farmers and directors of agribusiness, it is possible to guarantee that the bank policies respond to the farmers' interests. The savings funds that the bank attracts are channelled towards projects formulated by the peasants at the grassroots, using selection criteria which go beyond mere profitability. Within the acceptable profit margins, the bank may select those projects that correspond to the development strategy formulated by the organized peasantry, of which those producers who serve on the bank's board of directors should be faithful representatives. The notion of appropriation for the sector is implicit in the cooperative structure of such a bank in itself. Although only farmers and cooperatives can be members, the services can be made available to both members and non-members. Money earned through services to non-members, nevertheless, enters the bank as its proper capital. It is worthy of mention that the cooperative bank is considered the motor force of the cooperative movement (Diepenbeek 1990).

The third form is the participation that the grassroots peasant organizations and their superior representations are able to obtain in public investment and in the use of development aid and loans. The level of this participation depends on their having the capability for negotiation, but also on their technical capacity for presenting projects. By the end of the decade of the 1980s, the peasant organizations were well able to comprehend that the key of the moment lay in the investment effort. At the root of the agrarian problem at the time was the peasants' need for autonomy to determine their own development project and for a voice in the decisions made regarding the assignment of those investment resources available within the economy. They demanded that the independent and state technical advisors joined in on the investment effort by offering the cooperatives help in elaborating their own profiles and designing investment plans in accordance with the potential that these revealed (*Plataforma de lucha del movimiento cooperativo* 1989:12).

The fourth form, speaking by now of a superior level, involves an effective form of integrating the cooperatives, their related economic entities (i.e. the enterprises belonging to peasant organizations) and the union itself in such a way as to constitute a unity or economic bloc. It must be emphasized that this does not mean that the cooperatives and the farmers' union become one, or that all must be part of the same corporate body. Rather, this unity is aimed at unifying criteria by means of dialogue among the different parts regarding the direction in which to develop. At the same time, the activities of each component member are decentralized, allowing them to dispose of their products in accordance with their own particular criteria. As such, this unity is compatible with the existence of private property. In order to understand such a unity better, we might visualize a process in which the needs of the producers who wish to initiate their own projects for processing and marketing their products are linked up by way of their representative organization (farmers' union) with the technical assistance and national and international capital available. At the same time, the national discussion regarding economic strategy which is promoted by the same union, along with its proposals for policies and positions on the issues of food security and rural agro-industrialization, serves to give feedback and to define the framework for investment decisions at a local level, even more so because they form the banner under which the union is capable of attracting external capital. Through the vertical integration of the parts that compose the unified peasant movement, the peasants scattered nationwide can arrive at unified positions regarding cooperative strategy; the integration between the union and the cooperatives creates mechanisms for implementing this strategy, by having leaders on the different levels who serve in both structures, for example. In short, the basis for all forms of peasant appropriation and of the peasant mode appropiation is the unity among the peasantry.

## PLANNING AND THE MIXED ECONOMY

### Criticisms of centralized planning

The concept of a peasant mode of appropriation rose from the criticism of centralized planning with its related concentration of investments or accumulation within the state. We will elaborate on this theme in order to better comprehend the peasantry's optimistic expectation that they would be able to take advantage of the neoliberal policies to realize their own economic project. We will analyse the fundamental criticism of centralized planning by referring to Charles Bettelheim's work (1975). In the classic discussions about planning, the focus was above all on the productive part of the economy. Bettelheim imagines a situation in which all of the productive activity is concentrated in one single subject: the state. In such a situation, the flow of merchandise (raw material and intermediate products) would be reduced to zero; that is, the goods lose their mercantile character. The circulation of goods in this situation is merely an internal flow within the state, an interchange of products between dependencies of the same subject. Bettelheim goes on to argue that complete state control and centralized planning of production is not usually possible in the countries in transition, given the level of development of the productive forces. This implies that different economic subjects will always exist, including in production.

It should be mentioned that, at any rate, there always exists another quantity of economic subjects: the consumers. Having left this reality aside, postulating that the state would know the consumers' necessities and that the level of consumption did not hold any implications for economic growth, is one of the negative elements of the classic form of socialist planning, with lasting effects on the socialist economies which existed in Europe. This type of abstraction originates from the ideas of the economist Mikhail Tugan-Baranovski who affirmed that industry would be able to proportion the effective demand for its own production; that is, that the accumulation process could take place without taking into consideration the level of social consumption (Sweezy 1970:166; 'Debate sobre el campesinado y la transición' 1989:40).

Bettelheim argued that there will exist the need for markets and money to make possible the flow of merchandise between the different subjects involved in production (Bettelheim 1975: ch. 2). This has consequences for the plan; in the final analysis, economic planning in such a situation, which represents the normal state of affairs, is reduced to merely reconciling the strategies of each individual enterprise with the overall state economic strategy. This reconciliation becomes the first aspect of the essence of planning.

Nevertheless, such a reconciliation is achieved not only through a process of persuasion, but also through the development of explicit mechanisms that direct the productive and investment activities of the enterprises to make them compatible with a global development strategy. Social control over the direction of development is believed to be assured in this concept of planning because the state has been invested with the power of imposing its priorities on the plan. Although it does not have control over all of the means of production, the state can determine the direction in which the economy will develop, concentrating the investment funds in its own enterprises through the utilization of price policies. The appropriation mode within the context of centralized planning, then, refers to the possibilities of implementing the plan, even in a situation where there is a lack of consensus regarding the global strategy. It refers to ways in which the organ responsible for carrying out the plan can mobilize the necessary means, as well as its technical statistical ability, to make the price policy effective, and, through skilled management of this policy, centre accumulation in the state enterprises. In this way, the plan can be realized in accordance with the global strategy formulated by the state (Dijkstra

1988:48). We arrive, then, at the second essence of the planning process, the appropriation mode. FitzGerald states with regard to this:

> Any planned economy will logically have a 'socialist mode of surplus appropriation' because the immediate economic interests of enterprises cannot be expected to coincide with those of the economy as a whole…. I am arguing here that central planning is about reconciling heterogeneous enterprise strategies with overall economic strategy.
>
> (FitzGerald 1988:51)

## Coexistence of productive forms

Given the economic perspectives of the revolutionary movement, the model in the process of formation has been defined as a mixed economy. In Nicaragua, where, effectively, the aforementioned concept of centralized planning was applied, the mixed economy was reduced to nothing more than the coexistence of different productive forms. None the less, the character of an economic order is not determined by the variation of productive forms in existence but by the issue of decision-making power over production, consumption and distribution, which in turn depends on the ability to control the means of production and the product (Dijkstra 1988:3–8).

The crux of the problem in Nicaragua lay precisely there, because although different social forms of production coexisted, including state enterprises, cooperatives and private enterprise, with time the state consolidated a type of organization of production and interchange in the territories which gave it 'greater control over the nerve centers of the accumulation processes' (MIDINRA 1987:67). This 'greater control on the part of the state over the relations of interchange' was established with the explicit goal of 'capturing the surplus value' (*Recomendaciones* 1985:23). The different forms of production were coordinated 'under the hegemony of the more advanced forms', which, according to the official view, were the state enterprises and the production cooperatives, especially that sector of them known as 'associated enterprises' (*Movimiento cooperativo* 1989:173–82). The purpose of this arrangement was to capture the surplus value for accumulation in the state, lessening the possibilities of other economic units, including peasant production, of making autonomous decisions about the means of production and the product. That is to say, the fundamental problem with the aforementioned concept of planning is related to the lack of real active participation on the part of the majority. If the model of a mixed economy is to go beyond the mere coexistence of different social forms of production and advance towards the influence of majority groupings on economic development, this protagonistic participation should be established at all levels, especially by allowing peasant incidence in the macroeconomic and investment policies.

## Peasant participation

The participation of the peasantry, even in Central America where peasants represent almost half of the population, obviously presents some insuperable problems for governments, even the revolutionary ones. The problem is well illustrated in the works of Orlando Núñez Soto (Director of the Centro de Investigaciones y Estudios de la Reforma Agraria, Centre for Investigation and Study of the Agrarian Reform (CIERA), and close advisor to Commandant Jaime Wheelock, Minister of Agriculture from 1979–90 and also a member of the National Direction of the FSLN during this same period). He understands that the support of the peasantry is vital for the social revolution (Núñez Soto 1987a:149). The legitimacy of political power can be measured by how well it represents the popular interests in general (Núñez Soto 1987b:61). But, in contrast to the working class and its 'proletarian project' or 'proletarianization' (Núñez Soto 1987a:112, 173, 226), the peasantry forms part of a 'residual bloc' (Núñez Soto 1987b:63). It is true that they cannot be ignored (ibid.: 63–64) because they are or could be a majority sector. It may be necessary to maintain the alliance for tactical reasons. At moments of defending power, it may even be necessary at times 'to satisfy the immediate needs and demands of the masses at the cost of economic investment' by 'holding back the advance of the project' (ibid.: 66).

Another analyst sums up this dilemma in the following way: if the peasantry is not included in any way, there is a risk of 'losing the willing support of the masses, losing the role of vanguard and the role of leader' (Marchetti 1987:107). In contrast, if the peasants are fully integrated, there is a risk of 'sealing the process with a very capitalist ink and with the letters of rural backwardness', since their demands or immediate interests may very well go contrary to the proletarian project (ibid.: 107). Therefore, since the 'mass movement' in Nicaragua, a country of peasants with some urban middle-class sectors, is not predominantly composed of workers, O.Núñez Soto holds that the guarantee of the project's remaining on a socialist course depends, among other factors, on the predominance of the state in the accumulation process (Núñez Soto 1987a:77–8).

## Concertation

In the face of this predominance of the state and of an accumulation concentrated in the state at the expense of the peasantry, the latter group unleashed in Nicaragua a participatory policy-generating process which culminated in the definition of their own particular development strategy. Their economic project, which can be summed up in the objective of economic democracy, has captured the imagination of the region's peasantry. In order for it to achieve concrete form and in order to construct a peasant appropriation mode, a political and organizational strategy has been defined that is characterized by the processes of 'reconciliation' and 'concertation': *reconciliation* between peasants who fought on opposing sides with the goal of building class solidarity; and *concertation,* a term used to indicate the attainment of a negotiated consensus for action, between the peasantry and the wealthy strata of farm producers, with the goal of building unity among all rural producers. Concertation must also be achieved among social sectors and between these and the government with an eye to policy definitions, in order to give shape to a mixed economy with popular participation.

Wilson Campos, coordinator of the Asociación de Organizaciones de Productores Agropecuarios Centroamericanos para la Cooperación y Desarollo (Association of Central American Peasant Organizations for Cooperation and Development, ASOCODE) observes:

> We will come to an agreement and we will generate a peaceful way of living together where the direction of society is not in the hands of the state, but of economic groups which exert pressure upon each other and arrive at concertation. [I would underline at the same time that] social concertation is not necessarily a process effected only between the social sectors and the state. It may well take place among productive sectors and we have advanced in the employment of this alternative. Some of the labour unions have called us Social Democrats and traitors, but one of the lessons that we learned from the war in Central America is that no one sector should dominate the social process.
>
> (Campos 1992:4–7)

## Premises

The mixed economy which effectively delegates decision-making power to the different social sectors, can be viewed as a process of negotiated competition between sectors in similar conditions (Tirado 1988). Peasant participation, then, reduces the role of the state in the economy, which is precisely the point where the premises of the peasant project converge with those of neoliberalism. The state is relegated to the task of guaranteeing macroeconomic stability. FitzGerald sums up these perspectives in the following way:

> In a longer term perspective, the new scheme of a mixed economy implies another accumulation model and a different form of planning. …It requires a more active role on the part of the state bank and the trade and popular organizations, which are then converted into the kingpins of the planning process, from 'above' and from 'below' respectively.
>
> (FitzGerald 1989:42)

In the case of planning from above, it would be perhaps more accurate to speak of monetary and economic authorities, utilizing among other things the lever of credit. We would add that within the financial system a separate producers' bank can play an additional role for the agricultural sector similar to that anticipated by FitzGerald for the economy as a whole in the case of the state bank. The technical and statistical knowledge is decentralized and based on the quantitative evaluation practices of the economic subjects (*Propuesta* 1988). Price controls continue to be important so that the decisions arrived at through concertation are not undone and in order to guarantee, through skilled management, economic stability for the producers. Within this type of mixed economy, though, there exists no set blueprint for the future; there is no guarantee that in the end the producers can make concrete those projects that they have defined as strategic. Still, the unions, as we will see below, are preparing to play their role.

None the less, from the point of view of the peasants, the state is also called upon to assume certain facets of economic life and to back up their initiatives for maintaining themselves as a force on the economic scene at moments when they are weak. That is, according to this conception, the state has the responsibility for preventing the marginalization of the producers.

## THE APPROPRIATION MODE

### Peasant unity

Following the signing of the Peace Accords by the region's Presidents in Esquipulas, Guatemala in 1987, the chiefs of state initiated a series of summit meetings aimed at resolving the armed conflicts and promoting the economic and political coordination. With the electoral defeat of the Sandinista Front in Nicaragua, the different heads of government began to move more definitely in the direction of economic and political integration. The reorientation of economic policies was profoundly influenced by neoliberalism: liberation of prices, reductions of import taxes, allowing international competition in the internal consumption markets, elimination of subsidies, promotion of agro-exportation, restrictions on credit and public investment, privatization of state enterprises and an end to agrarian reform.

Obviously, these measures signified a particularly brusque change in the case of Nicaragua. The position of the UNAG in the face of these changes, nevertheless, was unexpectedly positive. This influential union, founded in 1981 as a branch of the Sandinista Front in the countryside, had developed by the mid-1980s a strong criticism of the state monopoly in banking and export trade, as well as its criticism of the price controls on domestic trade and the lack of real peasant participation in policy definitions. Using the rhetoric of neoliberalism and taking advantage of the new government's need to prove its legitimacy, they gave their support in the concertation sessions to the official proposals for the shrinking of the state apparatus, the liberation of foreign trade, the reform of the financial sector, and the joint elaboration of a development strategy. In exchange for this, they demanded the democratization of the economy and guarantees for the agrarian reform. Together with the labour unions, they also achieved an agreement whereby only 30 per cent of the state enterprises in the agricultural sector would be returned to those who had owned them before the Sandinista expropriations, while 21 per cent were to be turned over to peasants who had been commanders and soldiers of the counter-revolutionary army, 17 per cent to ex-officers of the Sandinista army, and 32 per cent to the workers on these same state enterprises. In this way, a quantity of land equal to one-quarter of the total area affected by the agrarian reform since 1979 were redistributed in only two years (Blokland 1992:90–1; 'El rompecabezas de la propiedad' 1992:19).

Privatization, according to UNAG, represents an option which allows the sector to conquer the processing and marketing means necessary for their appropriation mode. This demands the transfer of such installations outside of any official bidding processes, that is, by negotiation. Their first achievement in this respect was the acquisition of the slaughterhouse Carnes Nicaraguenses (CARNIC), the largest in Nicaragua, with an annual capacity for 100,000 head of cattle. CARNIC was transformed into a cooperative owned and managed jointly with the installation's workers. In this same period, UNAG invested in the coffee processing plant in Matagalpa which was a central pivot in their plan to establish themselves as the largest single coffee-exporting firm in Nicaragua; in fact, they were able to purchase and export 12 per cent of the coffee harvest of 1991–2. The cooperative enterprise Empresa Cooperativa de Productores Agropecuarios (ECODEPA), founded in 1986 as an importer and distributor of farm supply merchandise, was reorganized in 1990 as a multisectoral cooperative, expanding their field of action to include industrialization, services and the channelling of the savings of members of cooperatives. In subsequent years the progress of this strategy can be observed in the new installations which have been established, the founding of the rural savings and loan cooperatives, and more recently the opening of the Banco del Campo (Rural Bank).

We have considered it necessary to offer a particularly extensive treatment of the Nicaraguan case because it set the tone for the organized peasantry in the rest of the countries, in terms of their position in regard to neoliberalism. Operating from similar premises of unity among peasants, concertation with other rural sectors, and the concertation of the whole sector with the government, the other peasant organizations of the region also became convinced that they would be able to take advantage of the policies of integration and economic liberalization for developing their own peasant project.

Although the organization of the peasantry in associations and cooperatives is a very recent phenomenon in Nicaragua, dating from the FSLN triumph of 1979, its influence in the region has been great. This is in part due to the fact that in 1984 UNAG established an active alliance with donor groups from the northern countries of Europe, particularly the Swedish Cooperative Centre. This has helped to reinforce with concrete actions the active role that UNAG wished to play internationally. The Swedish aid also gave a new impulse to the Confederación de Cooperativas del Caribe y Centro América (Caribbean and Central American Confederation of Cooperatives, CCC-CA) and in this way to the affiliation of cooperative organizations of the region with the International Cooperative Alliance (ICA). Daniel Núñez Rodríguez, President of the UNAG since 1984, occupied the presidency of the CCC-CA in 1989, and in 1992 was elected President of the regional ICA. From 1990 onwards and following in the path of the integration efforts between countries, the peasant movement has reinforced its own integration process. In coordinating meetings held during 1990, the leaders of the Isthmus elaborated a document titled *Development Demands Concertation* emphasizing the need for political and economic concertation, the push for agrarian transformation, respect for the distinctive cultures, and the effective participation of the small and medium producers (*Central American Peasant Organizations* 1993:7).

In 1991 the first regional peasant conference was held to discuss the future structure of peasant coordination. A productive proposal was approved for the tenth presidential summit, which was accepted and integrated into number 35 of the summit's final declaration. In December of 1991, ASOCODE was founded with its seat in Managua, Nicaragua, as a definitive coordination structure subordinated to the national organizational processes. The principal task of ASOCODE is to facilitate and support the national efforts for peasant coordination and concertation in all of the countries of the Isthmus. An initial count of all the affiliated organizations indicates that ASOCODE represents 1.4 million producers of the Central American region, including Panama and Belize.

In the first year since the founding of ASOCODE, national coordinating bodies were created in Belize, Panama and Guatemala, product of the promotion and emphasis on concertation within the agricultural sector. In Costa Rica and El Salvador this process had taken place previously, while in Nicaragua the UNAG was already functioning as a confederation of different organizational modalities, with the Federación Nacional de Cooperativas Agropecuarias y Agroindustriales (National Federation of Agro-Cooperatives, FENACOOP) included under its wing. At this time the establishment of the Coordinadora Nacional Campesina (National Peasant Coordinating Commission, CNC) was also achieved in Nicaragua, product of a spectacular process of reconciliation initiated by Daniel Núñez, President of UNAG, with those peasants who formed part of the counter-revolutionary army (Nicaraguan Resistance). This CNC served more as an expression of the level of reconciliation that had been achieved in Nicaragua than as a functioning organism in the sense that its name might indicate. The Presidents responded to the consolidation of the Association by recognizing in the final declaration of their Thirteenth Summit in 1992 the right of peasant and other organizations to assume a participatory role in the design and execution of agricultural and food production policies (*Central American Peasant Organizations* 1993:7–13).

Recently the integration of the popular movement has made yet another advance with the establishment of the Iniciativa Civil de Integración y Cooperación (Civil Initiative for Central American Integration, ICIC), which includes the aforementioned organizations ASOCODE and CCC-CA, but also the Confederación Centroamericana de Trabajadores (Central American Confederation of Workers, COCENTRA), the Central American Concertation (Non-Governmental Organizations, NGOs), the Frente Continental de Organizaciones Comunales (Continental Front of Communal Organizations), the Confederación Centroamericana de la Pequena Empresa (Central American Confederation of Small and Medium Industry, CONCAPE) and others.

## The cooperative movement

The peasant movement's tendency towards unification in the region is undeniable. This is of great importance in laying the foundation for the peasant mode of appropriation. We can also see progress in other aspects, notably in the cooperative movement. According to data from the Organization of American States (OAS), in 1963 there were no more than 387 cooperative enterprises of any kind with 53,532 members in all of the five Central American countries and Panama. In 1986, the number of cooperatives had increased to 7,589 with a total of 1,033,900 members.

The growth was spectacular in Nicaragua, where in 1963 there were only 43 cooperatives, against 3,570 in 1986. As in Honduras and El Salvador, the increase in Nicaragua was a result of the impulse towards cooperative organization given by the agrarian reform. As a result, 65 per cent of the region's cooperatives are agricultural, although at the same time these cooperatives have relatively fewer members, representing only 26 per cent of the total number of cooperative members, taking into consideration all the different forms of cooperatives.

The agrarian reform in Honduras was begun in 1962 but promoted with greater emphasis in the decade of the 1970s. A total of 383,850 hectares, representing 14 per cent of the total area of farm production, was reassigned, forming in this way 2,650 units with 63,000 participants; 29 per cent of these production units are registered as cooperatives (Ruben and Fúñez 1993).

In Nicaragua, the Sandinista government intervened in 1,592,000 hectares, equivalent to 28 per cent of the land area dedicated to farm production. With these lands they consolidated a state area that in 1989 comprised 664,000 hectares; at the same time, 77,430 people were benefited with the remaining 928,000 hectares. The beneficiaries organized themselves in production cooperatives of a collective nature. In addition to this, the cooperative movement in Nicaragua received a push from the broad expansion of credit. The banks extended their credit coverage to the point where the number of loan recipients increased nearly three times between 1978 and 1981. This level was maintained until 1988 when the Sandinista government began to apply a series of structural adjustment measures (Blokland 1992:90–1, 117).

In El Salvador, the agrarian reform was launched via decrees through which the peasantry eventually recuperated 282,225 hectares, equivalent to 19 per cent of the land; in this way 81,000 families were benefited by 1989 (Goitia 1991:172). The popular movement was able to overcome its initial opposition towards a reform project of a counterinsurgent nature. The cooperative members themselves were able to reconstitute their representative federation and in 1988 the Confederación de Federaciones de la Reforma Agraria Salvadorena (Confederation of Salvadorean Agrarian Reform Federations, CONFRAS) was founded with an initial membership of 89,000 people representing 161 cooperatives from four federations. Following this, another four federations were affiliated, so that today CONFRAS includes 346 cooperatives, including some cooperatives from the traditional sector as well as the agrarian reform cooperatives.

In Costa Rica, the number of production cooperatives is more limited: 155 with 48,200 members since the agrarian reform was applied on a lesser scale here, involving some 6 per cent of the land. In Guatemala, where the most important attempt to carry out an agrarian reform was frustrated in 1954, there are 462 cooperatives in existence with 50,000 members (Goitia 1991:173).

Despite the advances, there was a notable tendency towards decollectivization at the end of the 1980s. It was initially expressed in Nicaragua by opposition to the formation of the state area and in peasant pressure that the state farms be turned over to peasant groups. This aspect of the decollectivization process culminated with the electoral defeat of the Sandinistas, after which first the outgoing Sandinista government itself and later the UNO government reassigned the state farms. The reassignment of land on the part of the Sandinista government was carried out in a hasty manner, in the period just before they handed over the reins of government. Those benefited were generally the high army officers and government officials. This period is referred to as *'la piñata'* in reference to a popular children's game in which a papier mâché doll is broken open, producing a rain of sweets. Sinforiano Cáceres, UNAG leader, has referred to those benefited—in particular the colonels of the Sandinista army—as 'the untouchables' ('El rompecabeza de la propiedad' 1992:17).

We have already made reference to the fact that in this reordering the peasantry achieved a new deepening of the land distribution process, although the emphasis placed by subsequent governments to redistribute lands while maintaining the integrity of big landholdings favours the emergence of a new landholding class of former army commanders, trade union and cooperative directors. Anyhow, this phase of the decollectivization process did not weaken so much the advances previously reported. Nevertheless, in Nicaragua and other countries with an important reformed sector, the tendency towards decollectivization was expressed on a later occasion by the growing individualization of production in the agricultural cooperatives, the increasing peasant pressure to divide up the farm lands, and even the sale of lands received during the agrarian reform. This phenomenon has been observed with great concern, and at different times prominent peasant leaders have opposed it. In the opinion of CONFRAS of El Salvador the agrarian policy of the government was marked within the framework of neoliberalism and pointed exclusively towards the parcelling out of the cooperatives' lands. With this policy, they aimed to effect an organic dismantling of the cooperatives, converting them into more manageable associations of individuals and forcing them to turn back the clock towards family subsistence production (*Projecto* 1993).

In a similar vein, the Honduran School of Economists took a negative view of the Law for the Modernization and Development of the Agricultural Sector because it facilitated 'the sale of their lands and other goods by the cooperatives, putting the stability of the movement in danger' (Ruben and Fúñez 1993). A quantitative analysis of the phenomenon however, although not a complete tally, shows that it may involve some 3–5 per cent of the reformed land in Honduras (ibid.). Generally the tendency is related to the lack of a complementary policy that would permit the transformation of the reassigned farms into viable enterprises. 'The property problem is a problem of people without economic potential and without investment potential', expresses Sinforiano Cáceres, leader of FENACOOP ('El rompecabeza de la propiedad' 1993:17). Cases of former owners who threaten the poor in order to take a small parcel away from them are rare, and the cooperatives that are under menace 'are few in number' according to Cáceres (ibid.: 17).

It is worth asking, then, if in the long run the opposition to the process of parcelling out the cooperative land and to its ultimate consequence, the sale of land, has not been exaggerated; forgetting in the process that decollectivization is related to the fact that the members of the cooperatives in the region oppose the above-mentioned emergence of a new landholding class. It should also be noted that this cooperative movement is passing over into another stage that is characterized by an attempt at economic recovery and to generate economic potential for the rural poor. In the former stage, the collective character imposed on the agricultural cooperatives fulfilled important functions: (a) it incited those demanding land to organize their demand; (b) it assured the defence of the conquered land by the new ownership group against any attempts of counter-reform (particularly important in the case of the countries at war); and (c) it guaranteed that the land would remain in the hands of the social strata to be benefited, since it permitted members to enter and leave the cooperative without affecting the quantity of reformed land, which continued to belong to the agrarian reform sector. However, in a later stage, the members opt to transform the farm into the source of their family progress. Towards this end they seek to parcel out the collective lands and have each member's parcel inscribed in their own name, since this permits family investment and the incorporation of the part-time labour of women and children into the work routine. In this stage, the concern of the peasants no longer centres on the acquisition of land, but revolves around the objective conditions for making it produce and for being able to obtain some profit from it. This coincides with a greater emphasis in organizing production services. In this phase, the peasantry works to organize cooperatives which can serve them in matters of credit, inputs, processing and marketing of their product. The censuses of cooperatives show that, effectively, the 8,044 cooperatives that existed in the region in 1989 had diminished to 5,366 in 1992–3, due to a 45 per cent decline in the agricultural production cooperatives. On the other hand, during the same period the number of credit and service cooperatives increased (*Realidad* 1994:50–8).

> This reality demonstrates that we are in the presence of a restructuring of the cooperative movement in the region, moving from being a sector with a strong productive inclination to one characterized by credit and service activities.
>
> (*Realidad* 1994:57)

Given this evolution, references such as that of CONFRAS to 'dismantling the cooperatives' and conversion to 'manageable associations of individuals' may say something about the intentions of the Salvadorean government, but do not reflect the reality of the situation, which is that the peasantry is constructing other complements to their appropriation mode. Perhaps this reality can be better described as CONFRAS itself did in another section, i.e. as a challenge for the cooperative movement to be able to convert their protagonism as a popular movement during the war into an economic and productive protagonism in this period of peace (*Proyecto* 1993).

## Final observations and conclusion

In summary, important advances were made during the period referred to, in terms of the recuperation of the land and to the benefit of 12 per cent of the peasant families. This in itself served as a basis for strengthening the peasant movement in a political and organizational sense. As a result, the peasant organizations are now recognized as representative forces by their governments and in the majority of the countries mechanisms for dialogue and concertation with regard to policy implementation have been established. In the area of economics, we can observe in the last few decades the expansion of the cooperative movement in the agricultural sector and in others, partly as a result of the actions of the organized peasantry. One indication of this is that 21 per cent of the peasants belong to cooperatives (Baumeister 1991:226). The cooperative sector represented in the CCC-CA, which includes agricultural and service cooperatives as well as those of urban origin, represents between 30 and 35 per cent of the regional Gross National Product (GNP) ('La integración desde abajo': 45). Cooperative enterprises in Nicaragua and El Salvador manage around 15 per cent of the coffee exports, one of the most important branches of foreign trade (Hansen and Romero 1993:9). The Banco del Campo as the financial expression of the organized peasantry, together with the important experiences in local savings and loan associations promoted by the NGO's in Nicaragua, form the germ of a popular system of financial intermediation. In this way, the progress of the peasantry towards the construction of their own appropriation mode is undeniable.

## PEASANT DISILLUSIONMENT

### New demands on the cooperative movement

In closing, two problems should be pointed out which lie in the way of further progress and the consolidation of the appropriation mode. Due to the complexity of national and international economic relations, a cooperative organization as a local phenomenon no longer has the possibility of maintaining itself without representation and backing from a superior level from the beginning. The predominance of international interactions, open economies and international competition produces a situation where the local cooperatives alone do not have sufficient force to counteract their submission to the market (Diepenbeek 1988:46–7), or to be able to defend themselves from the manipulations of the wealthy in search of ways to consolidate their power (Griffith and James 1981:66). Cooperatives established in the Central American countries must begin operations on a larger scale than did those in Europe during a comparable stage of development. It is no coincidence that organisms such as ECODEPA and the Banco del Campo in Nicaragua have established themselves first as national enterprises which must disseminate and broaden their operations and social base, instead of being constituted from local organizations which over time have consolidated themselves into superior structures. These cases occur because it is the only way that they can stand up to the external forces. The result is not necessarily different from an organization born at the grassroots level; the important thing is the capacity of the peasantry to control its own destiny (Székely 1977:1484).

By necessity, these large structures should involve producers of different strata, including the wealthy, since their initial establishment requires a large investment which can only be obtained with the inclusion of those who have capital. This is, in effect, the economic base of the concertation process. Moreover, in order for ECODEPA to be created, for example, the existence of UNAG was necessary. In an economic context adverse to this type of private initiative, as was the prevalent climate in Nicaragua in the mid-1980s, the farmers' union provided the decisive support necessary for bringing the idea into being (Kjeller 1986). It is for this reason that the concept of peasant unity which forms the basis for the appropriation mode postulates the integration of both the cooperatives (economic branch) and the union (the political branch of the peasant movement).

## External capital and neoliberal logic

The second problem arises in the process of carrying out the explicit objective of socializing the use of the resources captured or retained through the functioning of the appropriation mode. Under the circumstances described in the previous paragraph, how can the domination of the cooperatives by the wealthy producers be avoided? That is to say, economic democracy requires the establishment of some large cooperatives with considerable initial capital, but it also requires measures that guarantee the participation of the small and medium producers.

The slaughterhouse CARNIC, which UNAG acquired as a result of the privatization process, could perfectly well continue to operate on the basis of the programming of the large producers, with some sporadic additions from other production cooperatives. In order to broaden the small producers' access to this facility, supply networks should be structured between the communities and the country's capital, and there should be an organized attempt to purchase the small producers' cattle. This signifies a great effort and also an enormous investment. However, this need for investment funds comes up against the logic of the flow of international capital, which is directed at the government. Despite all the neoliberal rhetoric about the necessary shrinking of the state apparatus and the role of private industry, this flow of capital continues to be directed from government to government only, or from intergovernmental organisms to governments. The governments of the region pass on neither these funds, nor their own investment funds to the cooperative sector, save in a very minimum percentage: the cooperation from all sources received by the cooperatives of the region has been a mere US$27.9 million in 1992–3 (*Realidad* 1994).

On a world level, a mere 13 per cent of official aid is channelled directly through the NGOs of the wealthy countries to finance projects of the civil society in the developing countries. Our own calculations indicate that a maximum of 15 to 20 per cent of this flow goes to peasant organizations in all of their different expressions. That is to say, only some 2.6 per cent of all official external aid is directed to the peasant organizations.

With time, criticism of the neoliberal model has increased among peasant leaders, so that by the middle of the 1990s even the leaders of the big landholding export-oriented farmers' associations of Nicaragua, together with others from the more genuinely peasant sectors came out to head the protest marches against the International Monetary Fund (IMF) and the neoliberal policies. Obviously, the opposition to these policies was fiercer in Nicaragua, because over the period 1991–4 Nicaragua saw its per capita income drop by 12 per cent, whereas Costa Rica, for example, showed an increase over that same period of 10 per cent, like the three other Central American countries which showed increases ranging from 1.3 per cent in Honduras to 9.6 per cent in El Salvador. Despite the manifestations of the peasant leadership against neoliberalism, the hope of being able to utilize the neoliberal logic in order to mobilize support for the peasant project remains prevalent.

The opposite is true at the grassroots level of the peasantry where the disillusionment is general, given that their possibilities for realizing their personal projects of family well-being have proven to be null in the face of low prices for their products, credit restrictions, reduction in public services, tax increases and the resurgence of violence in the countryside, this time of an economic nature with emphasis on assaults, banditry and cattle rustling. To this, one must add that the peasant movement has not been able to structure branched networks linked to the large cooperatives in order to guarantee that the small and medium producers actually obtain some advantage from the movement's increased capacity for exportation, processing, financial intermediation and marketing. Above all this, the land problem persists and continues to affect hundreds of thousands of peasants.

In the middle of the decade of the 1990s then, there has been a great divorce between the peasant grassroots and their leaders. This is directly related to the lack of socialization of the achievements made in the construction of peasants' own economic project and the reluctance of those who finance development to reorient their capital flow towards peasant projects, in the way that the neoliberal logic itself would indicate.

## CONCLUSION

In summary, we can derive the following conclusions from this review of the peasant project in the era of neoliberalism. The neoliberal policies satisfy the needs of the peasant project in two major aspects: they bring back economic dynamism enabling economic recovery, as can be learned from the increases in per capita incomes after 1990 in most Central American countries; second, they give room for economic groups like the organized peasantry to take its share of the cake, especially because neoliberal policies respond to their demand that the state should draw back from economic affairs, retracting its influence over the 'nerve centres of the accumulation process', which it used to manipulate in order to channel off surplus value at the expense of the peasantry.

However, in a neoliberal system this contraction of the state is accomplished through privatizing enterprises and diminishing public services, often the rural ones. The correlative premise of the peasant project was that the changes would be accompanied by a reorientation of the state functions, in which the state would be required to adapt to the new economic logic by assuming a role in strengthening the position of those groupings which suffered the greatest difficulties in inserting or maintaining themselves within the newly reordered economy. That is, that the state would assume the job of avoiding new forms of marginalization. This has in no way taken place.

Moreover, half a century after Bretton Woods, international organizations and governments continue to channel development aid and loans to governments, instead of serving the private sector, largely composed of small and medium producers. Nor do these donors pressure the recipient governments to adapt to the logic of neoliberalism by giving priority to these sectors in their investment programmes. This presents a serious obstacle to the full realization of the peasant project, i.e. to the democratization of the rural economy, and has led instead to new contradictions between leaders of the peasant movement and the rank-and-file. Should the resulting disillusionment continue to increase—and this is most likely to occur in Nicaragua—it could well form the basis for peasant uprisings.

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# 10

# STRUCTURAL ADJUSTMENTS, DEMOCRACY AND THE STATE IN ARGENTINA

*Miguel Teubal*

Structural adjustment is not only an economic programme. It also implies adjusting institutions to the workings of the market. In most cases this leads to enormous transfers of income, wealth and power into the hands of the economic and political establishment. This concentration of power and wealth has as its counterpart a certain devaluation of everything that has to do with the social, and hence, marginality and exclusion for the majority of the population. As has been frequently considered, structural adjustment leads to a greater regressiveness of income distribution, unemployment in all its forms, and to a reduction in real wages both direct and indirect. It implies a new model of development or regime of accumulation which could be dubbed as socially and sectorally disarticulated (Amin 1974; de Janvry 1981; Astori 1984; Teubal 1994).

These trends bring to mind the issue as to the extent to which structural adjustments require institutions and political procedures which are not necessarily democratic. In essence, this begs the question: is this new regime of accumulation which is formed in the wake of Structural Adjustment Programmes (SAPs) compatible with a furthering of democratic procedures?

While it has been considered that for the first time since the Second World War the military in Latin America has lost credibility, and democracy appears as the only viable alternative political regime (Ducatenzeiler and Oxhorn 1994); while most political scientists point out that democracy requires the creation of institutions that are efficient and capable of articulating and representing the diverse interests of civil society, recent trends do not necessarily point in this direction. Among the reasons for this are the nature of the economic policies being implemented and the ensuing regime of accumulation that is instituted. Many studies considering the question of democracy do not always evaluate critically these aspects of SAPs established throughout Latin America. Structural adjustment programmes, particularity when they adopt a 'shock therapy' strategy, tend to be 'profoundly anti-democratic'. In the name of a 'superior understanding

…these prescriptions urge the few who rule to fool the many who are ruled' (Kohli 1993:682).

Structural adjustment goes along with marginality, exclusion and a lack of social justice, solidarity and access to justice—all of which are aspects which do not necessarily contribute to a furthering of democratic procedures. One wonders to what extent a greater regressiveness in income distribution, and the exclusion of vast social sectors from the welfare benefits of society, can only materialize if accompanied by the adoption of institutions tending to limit or reduce democratic procedures and mechanisms. Hence arises the question of the nature of the state and of democracy in the age of structural adjustment. Structural adjustment involves not only economic and social aspects, it also implies a political model and a state, which usually functions within a conservative perspective encompassing all matters including the cultural.

Hence the questions to be considered are: what socio-economic and political models are implied by SAPs? Is structural adjustment compatible with the extension of democratic procedures? We are not refering here to a participatory, social or economic democracy but simply to the more watered down versions of a formal political democracy: one in which prevail periodical free elections, freedom of speech, of political association, and the rule of the law; a system in which political parties, parliament and the fight for human, social and economic rights are legitimated.

Set in other terms, the relation between democracy and equality is also an important issue considered frequently by many authors (Honderich 1994). While it is easy to visualize that dictatorships may create greater inequalities than democracies, lasting inequalities also persist and even extend themselves under democratic regimes. The point is that if structural adjustment redistributes income and wealth regressively and therefore tends to concentrate political and economic power, as seems to be the case in most of the world, to what extent does this impinge upon the very nature of a democratic regime? To what extent is—*caeteris paribus*—a system in which wealth and power are being highly concentrated less democratic than one in which wealth and power are more equally distributed? Or is it that democracy has nothing to do with these economic or social matters?

Argentina presents us with an interesting case study in this respect. As we discuss in this chapter, in the past fifteen years—but in particular under the shock-therapy strategy of the present Carlos Menem administration—there has been a certain incompatibility between the extreme market reforms implemented in Argentina and normal democratic procedures. Needless to say these SAPs also tend to be incompatible with policies intent in redressing the issue of social justice and progressive income distribution.

Nowadays it is frequently forgotten that these extreme liberalization programmes were initiated under the military dictatorship of the 1976–83 period and the bureaucratic authoritarian state that was set in place at that time. Nevertheless the economic policies of the succeeding democratically elected regimes followed similar trends. They also tended to institute a similar economic or socio-economic model—or 'regime of accumulation'—in which the essential elements of the neoliberal market were maintained. While 'regime of accumulation' has been defined variously, it is related to a particular form of accumulation process, as governed by a particular set of social norms.

> The central idea is that crucial features of the trajectory of the capital accumulation process, over a long time period, are the product of the supporting role played by a set of social institutions. By the term 'institution' is meant a regular way of doing things, a norm for social interactions and relationships.
>
> (Kotz 1990:7)

Needless to say these democratically elected governments, sooner or later had to cope with a series of problems and conflicting issues related to the functioning of a democratic state.

## STAGES IN THE RECENT DEVELOPMENT OF ARGENTINA

Up to the early 1980s Argentine society had been plagued by political instability. The military coup of the 1930s was the first *coup d'état* overthrowing a democratically elected government. Thereafter, a succession of civilian—electorally based—and military regimes succeeded themselves. Needless to say, as we maintain elsewhere (Teubal 1992b, 1993), beginning the mid-1970s a new 'regime of accumulation' was set in place. This was begun and facilited initially by the military coup of 1976, which established one of the most ferocious bureaucratic authoritarian states of recent Argentine history and which began a process of economic reform tending to the development of a neoliberal economic programme.

The military coup of 1976 was an important starting point for the socioeconomic model which was to be soon set in place. Amidst the failure of the military dictatorship in the early 1980s, in part due to the Malvinas (Falklands) War, democracy was finally restored in late 1983. The democratically elected Raúl Alfonsín government could be visualized as the main social and political reaction to this military regime in the early 1980s. Alfonsín did not reverse course in most matters concerning economic policy. While his government was beset by a problem of governability, particularly after the Plan Austral failed in 1978, his administration ended in complete failure in the wake of the *golpe económico* (economic coup) of 1989.

The economic coup of 1989 began when large economic groups instrumented a wholesale capital flight beginning in February of that year which forced the government to devalue substantially, thus beginning a hyperinflationary spiral which was to culminate later that year. Needless to say this economic coup contributed substantially to the consolidation of the extreme neoliberal programme furthered by the Menem administration. The *golpe económico* of 1989 contributed to the ascent of Menem and *Menemismo* in that year and to the establishment of a new fully fledged liberalization programme thereafter. Hyperinflation was the result of this *golpe económico*. In the 1989–91 period several additional spurts of hyperinflation contributed to the development of a deep-seated hyperinflationary syndrome which was to prevail in Argentine society thereafter.

The so-called Convertibility Plan of the Minister of Economics Domingo Cavallo managed to attain a new-found stability which was to contribute substantially to the legitimation of the Menem administration's extreme liberalization programme, enhancing the development of a new regime of accumulation that, as mentioned above, has been in the making since the mid-1970s.

Thus the democratically elected governments of both Alfonsín and Menem applied economic policies which helped consolidate a new regime of accumulation. But this new socio-economic model was possible because of the two aforementioned coups, the military and the economic. Both these coups helped consolidate and legitimize a new economic and political establishment and formed the basis for the sociopolitical and economic programme established thereafter.

In this chapter we argue that the issue of democracy, heavily debated under the Alfonsín administration, continues being one of the main issues considered at present under Menem, despite the fact that the nature of the debate has changed substantially. While Alfonsín was purportedly intent on maintaining democratic procedures, but was confronted with the question of governability which led to a series of confrontations with the military and economic establishments, Menem has, apparently, been much more successful in this respect, probably because he emphasized much more the question of stability and structural adjustments even if these went counter to the maintenance of democratic procedures. The 'military question' was presumably done away with when Menem instituted the full-fledged *indulto* (pardon) to military officers convicted of human rights' violations under the military dictatorship of the *proceso* years (1976–83). He also showed a strong hand *vis-à-vis* the fundamentalist uprising at the beginning of his administration by firmly repressing it. Nevertheless, this does not mean that the issue of democracy and the long-run stability of the new economic and political model has been consolidated. While Menem has been much more prone to represent the main interests of the economic establishment—both national and transnational, industrial and financial—and to impinge upon normal democratic procedures if these went counter to the main interests of this dominating establishement, than was the case under the Alfonsín administration, there are limits to model being implemented.

Despite the apparent success of structural adjustment under Menem, many things have not been solved in Argentine society, and a future of conflict and contradictions is in the making.

## ARGENTINA'S SAP

Structural adjustment in Argentina has been on the agenda for quite some time now. While privatization, deregulation, and the opening of the economy to world markets are essential aspects of all structural adjustment programmes carried out under the stern eyes of the International Monetary Fund (IMF) and World Bank, the case of Argentina appears to be one of the most paradigmatic. Probably more than in other semi-industrialized countries, these measures have been implemented in a rigorous and extreme way. Both Mexico and Brazil have carried out adjustment programmes, but in the case of Mexico the state apparently has not lost much of the essential characteristics it used to have, including much of its power; in the case of Brazil the state also continues wielding an important *desarrollista* perspective.

The privatization of the public sector has been swift and exhaustive: in less than three years more then thirty state public enterprises—the bulk of the state enterprise system—have been privatized. Observers have been elated by the swiftness and thoroughness with which the Argentine government has proceeded to carry out its privatization programme, which encompassed not only the whole of the public enterprise system but a large share of the public sector as well. Needless to say, this has been carried out without the institutionalization of regulatory boards which in the First World are part and parcel of most privatization programmes. Deregulation has also followed similar procedures.

Government finances have also been controlled; taxes were increased, affecting mostly the middle classes, and expenditures were drastically reduced. A surplus of public finances was necessary to finance the external sector which includes foreign debt servicing. The international financial establishment is also elated by the fact that Argentina has entered the Brady Plan and is now paying regularly its foreign debt services.

The swiftness of the privatization programme was required by political considerations. The Menem administration was elected on a typically Peronista platform, which included a series of government interventionist measures. It also tended to be lenient with trade unions, and to develop nationalistic and pro-domestic market economic policies, based on the alliance of a national bourgeoisie with the working and middle classes. But Menem immediately switched course. While initially he had promised that his government would induce a *salariazo* (large wage increases) and a *revolución productiva* (productive revolution), from the start his government changed course and began the development of a neoliberal policy to be applied without parachutes or anaesthesia—that is, without consideration of any opposition that might emerge, or the social consequences of the application of this programme.

The Argentine government opted to apply a shock-therapy treatment in its economic policy. As Kohli mentions (and this was confirmed in the case of Argentina):

> implicit in this prescription is the realization that reforms necessarily engender political opposition. The solution, in turn, is to take the society by surprise; if reforms are implemented, all at once, no one in the society will know what hit them and, meanwhile, economic rationality will have triumphed. This logic, however distasteful to those who value democracy, is at least internally consistent. It recognizes that the liberalization package is not something society demands but 'needs'; it is the 'bitter medicine' prescribed by 'economic doctors' that local rules must administer for a society's own good.
>
> (Kohli 1993:682)

Up to 1991 the Menem experiment had almost failed. Several economic ministers had applied assorted policy measures but failed to control the ensuing hyperinflationary spurts. It was only after the Convertibility Plan was applied by the current Foreign Affairs Minister Domingo Cavallo that the economy acquired a degree of stability that was to permit the government to continue with its extreme structural reform programme.

The case of Argentina is presented in international forums as a showcase worth considering. Nevertheless, in recent years much social and political strife has emerged. Mention can be made of events of Santiago del Estero and other cities of the poverty-stricken northeast, northwest and southern tip of the country (Salta, Jujuy, Chaco, La Rioja, Tucumán, Tierra del Fuego); of events occurring in the Greater Buenos Aires; the continuing social strife and struggles against cuts in education, health, pension funds, as well as against the flexibilization of labour which most recently elicited the opposition of the workers of the automobile industry. The SAP which was applied, as it were, without parachutes or anaesthesia, seems to have also increased the public awareness that poverty and misery continue to be major problems affecting Argentine society today. Nevertheless, Argentina's Convertibility Plan instrumented in the past years is looked upon as one of the models to be considered internationally together with the Chilean and the Mexican.

The Minister of Economics is seen as a wizard in this respect, being well received in international circles. It is not difficult to see how this happened: first, inflation, has been brought down drastically,—consumer prices fell from about 5,000 per cent per annum in the midst of the 1989 hyperinflationary spurt to less then 6 per cent in 1993; second, the economy was reactivated somewhat—Gross National Product (GNP) increased in 1992 and 1993 though there is some question concerning the trustworthiness of government statistics; and the climate for foreign investments has presumably been considerably improved. In a country hard hit by the syndrome of hyperinflation, which has tended to influence all walks of life, the new-found economic stability is something which is highly valued.

There are several reasons for the presumed 'success' of the Cavallo programmes. First, mention must be made of 'stability' attained in the wake of the Convertibility Plan implemented in April 1991. In a country in which the hyperinflationary syndrome prevails, the fixing of the exchange rate to the dollar and the elimination of the indexation of contracts brought down inflation substantially. Stability was attained and consequently, according to the government statistics, the economy also grew substantially in the past three years. Nevertheless, as we point out in this chapter, this programme has its limitations.

This programme was carried out within the confines of a formally democratic regime—or at least without the military interventions which plagued Argentine society in the 1950s, 1960s and 1970s. Furthermore (and probably related to the above), for the first time in many years a neoliberal economic programme has not impeded President Menem from winning elections: something which a few years back would have seemed impossible.

Another fact that should be borne in mind is that an important part of the electorate belongs to Greater Buenos Aires, a circumscription pertaining to the Province of Buenos Aires. The Governor of that province applied a typically 'Peronist' local policy in his province with special funds oriented to social welfare needs, in particular for the population of Greater Buenos Aires.

What are the factors which have determined the relative success and limitations of the Menem administration (at least up to mid-1994)? If we consider what are some of the main issues to have cropped up in recent election campaigns, two have an important bearing. One is the issue of corruption, which in essence could be related to the enormous concentration of power in the hands of the economic establishment and their political allies, as well as the large-scale infringement and lack of openness in democratic procedures. The other is related to the issue of poverty, misery, and the (according to government sources) inevitable social costs of the adjustments: the violation of minimal social and economic rights for the population. When reference is made to the question of poverty, and therefore regressive income distribution in Argentina, consideration should be paid not only to the impact of wages and employment, but also the lack of access to food, health and other basic needs, which constitute part of the social wages previously perceived by Argentine society (Teubal 1992a, 1992b).

## PROBLEMS OF SAPs

While stability and a certain growth of the Argentine economy in the past few years have been highly valued, several factors blur the apparent success of the severe SAP being implemented at present, limiting its long-run viability and legitimization. Much social and political turbulence has cropped up in the past few years tending to limit somewhat the presumed success of the programme. Thus a more nuanced view concerning these matters should be made.

First, the adjustment programme has elicited important social costs (which the govenment characteristically considers as inevitable): income distribution has become more regressive; unemployment in its varied forms has increased; real wages and incomes of lower-income groups have fallen; and hunger and poverty continue being widespread or have even increased. The need to adjust public expenditures has placed the burden of the adjustment programme on wage-earners, the informal sectors and much of the middle classes including medium- and small-sized businesses. Health, educational and other services catering to essential basic needs of the population have suffered drastically by the cuts being implemented (Teubal 1992b, 1994).

Thus the question of poverty, hunger and marginality together with other important issues such as the ecological costs of structural adjustment have been put in the centre of the debate. Not only has unemployment in all its forms increased, reaching in 1994 record levels while wages and incomes of lower-income groups have fallen, but the quality and cost of health, education, housing and social security is playing havoc with the living conditions of the majority of the population. All these factors bring to mind the question of the degree to which a welfare network which, to some extent, had been minimally institutionalized previously under Import Substitution Industrialization (ISI), is to continue to remain in place in the future, bringing to mind the degree to which the SAP is to attain an adequate social legitimation in the long run.

Second, the extent to which it can be said that a long-run accumulation or growth strategy including a viable integration to the world economy is being implemented, has also been put in question. The 'integration' to the world economy need not be necessarily a positive factor *per se,* especially if this is followed by a worsening of living conditions for the majority of the population. Only to the extent that a viable long-run strategy is implemented could it be said that the present model is to have any continuity in the future. It has been pointed out that no export strategy has been instituted and this may be a necessary although not always sufficient condition for a long-run successful strategy.

As yet, no long-run accumulation strategy appears to be on the government agenda, other than the simple idea that this extreme adjustment programme is to attract foreign capital. Nevertheless, as is well known, attracting foreign capital *per se* does not solve the basic structural problems of the Argentine or of any other economy for that matter. In the past few years the bulk of capital inflows to Argentina have been of a speculative and financial nature, being attracted mainly by relatively high local interest rates compared with international rates. There have been hardly any real increases in productive investments or in the productive capacity of the economy, so that real investment rates continue to be extremely low. The government claims that import of capital goods has increased: amongst the capital goods the government claims have been imported are computers, radio transistors, electronics, and other consumer goods. On the other hand, the fact that in some sectors—for example in the food industry—new transnational have disembarked does not mean that this is to increase productive capacity. This may prove to be much more a substitution effect, rather than an addition to new productive capacity.

No industrial strategy or science and technology policy has been devised other than the presumption that the market is to solve everything. Furthermore, fixing the exchange rate to the dollar has tended to overvalue the Argentine peso, limiting the development of an export-oriented strategy. While fixing the peso to the dollar was initially the key to the stability attained, an overvalued peso is causing balance-of-trade and payment difficulties because domestic prices on the whole continue to increase more than international prices. Buenos Aires has become one of the most expensive cities of the world, a factor which reflects this highly overvalued peso. So far the government has accumulated foreign exchange reserves which were presumed to be sufficient to compensate for increasing balance-of-trade deficits, at least until the presidential elections of 1995. Furthermore, balance-of-trade deficits were compensated with capital inflows from abroad. The increase in international interest rates may reduce these funds from abroad, adding another element to the basic instability of the economic model being implemented.

The government is now pressing for new structural laws, such as the full flexibilization of the labour market, under the presumption that lower wages can compensate for high domestic costs and prices. The privatization of all public services has led to substantial increases in public rates—telephone, electricity, transportation, etc—so as to guarantee profit rates for the new private owners. Included in the privatization schemes are devaluation guarantees so that these rates would increase automatically if there were devaluations. Meanwhile the government has embarked upon the privatization of pension and retirement funds, giving new impetus (and substantial funds) once again to the financial sector of the economy.

Third, a new institutional setting and state has emerged which tends to be highly concentrated in power and wealth. To what extent this is compatible with a democratic state is a question worth considering. The extreme adjustment programme has been carried out, to a large extent, by overriding normal democratic procedures. Corruption, which has become widespread, can be looked upon as inherent to the enormous concentration of power developed in recent years, and the lack of an authentic *glasnost* and social control of government with regard to democratic procedures.

The question of democracy within the context of structural adjustment has become one of the main focuses of debate and struggle. The severe SAP has been implemented in an institutional setting which is highly biased and which has increased drastically the concentration of political as well as economic power in the hands of the economic establishment and its political allies—the structure of politicians which serve their interests.

As we mentioned above, this climate of political and economic stability has permitted the government to go ahead with an extreme and radical SAP. As already discussed, one of the issues which forms part of public debate in recent years is the extreme concentration of power in the hands of the President Menem and his government, and the newly consolidated economic establishment. Many are the mechanisms used to enhance this concentration of power, which in itself, has also gone along with the intention of disarticulating all opposition to the government's programme. Thus a series of institutional and structural changes have significantly changed the nature and character of the Argentine state. It is doubtful if this profound SAP would have been possible without these changes in the overall institutional framework. It is also doubtful if these institutional changes and the SAP in themselves would have been implemented if it were not for the stability attained due to the Convertibility Plan.

## STABILITY AND GROWTH

Stability was attained by pegging the foreign exchange rate to the dollar: a new peso was created and pegged to the dollar by means of a Congressional Law, while indexation was ruled out. Both these factors eliminated inflationary expectations, which in recent years had fed continously the inflationary process. (Inertial inflation, determined by previous inflation, was to a large extent based on the continous devaluation of the local currency in relation to the dollar.)

The most notorious effect of the pegging of the peso to the dollar was a reduction of the inflation rate; nevertheless up to 1994 at least, inflation while low in relation to recent historical trends continued to be higher than international inflation rates. One of the effects of this was that imports tended to increase more than exports, and balance-of-trade deficits became prominent, particularly in 1994. While in the past twenty years Argentina tended to have balance-of-trade surpluses, and imports—to a large extent due to overall stagnation—hardly increased more then exports, these trends apparently have been reversed. This factor not only strains policy measures, and has inhibited greater Mercado Común del Sur (MERCOSUR) integration measures *vis-à-vis* Brazil, but also has made very difficult the development of a viable exports strategy.

One of the problems the government will have to face in the future has to do precisely with this factor: if servicing foreign debt to the tune of US$3.5 billion per year is to proceed, a surplus in local finances will have to be acquired, but also an important balance-of-payments surplus will have to be obtained. If balance of trade becomes negative, as has occurred in the past few years, this will have to be compensated for by other factors: increased foreign debt or inflows of foreign capital. So far both these factors have had a balancing effect on Argentina's balance of payments, but increased international interest rates, and difficulties to increase exports due to an overvalued exchange rate, are additional factors which strain the overall economic model. Foreign factors thus remain in effect. Underlying these accumulation problems is the lack of a long-run strategy for the Argentine economy.

## LACK OF AN EXPORT STRATEGY

An overvalued exchange rate contributed to balance of trade and payments difficulties. According to government estimates, in 1994 the balance of trade deficit might reach US$4.3 billion (exports are to amount to US$14.9 billion while imports reached a high of US$19.4 billion) though private estimates consider the possibility of this reaching between US$5 and US$7 billion. Up to now this deficit has been balanced by the inflow of capital from abroad: a very tricky and unstable matter indeed. The government has therefore been worried by the increase in international interest rates, which might reduce the inflow of speculative capital to Argentina in the future.

But apart from this, an overvalued peso tends to reduce the competitiveness of Argentine industry in relation to the world market and has plagued Argentina with difficulties *vis-à-vis* Brasil limiting the advance towards a greater economic integration within the context of MERCOSUR. Needless to say, if structural adjustment is to be successful, an exports strategy would have to be in line, but this so far has not been the case.

## ADJUSTMENTS AND DEMOCRATIC PROCEDURES

It has been considered that these extreme adjustment programmes have been carried out within the confines of democracy. Of course this statement requires some qualification. To what extent is this true? Apparently, to the extent that the government has managed to bring forward the goods in the form of a continued relative stability, public opinion continues being receptive to government measures. In the meantime, concentration of power in the hands of the executive and in favour of a few economic establishment groups has become an essential aspect of the model. Here it is not only a question of corruption as a sort of accidental fact that somehow could be redressed, but it is the whole institutional and structural setting which forms part of the new model or regime of accumulation, in which the state has changed its functions substantially, and the diverse actors or corporate groups of civil society play a very different role in relation to that played under Import-Substituting Industrialization (ISI). Thus the changing role of the states is related to changes in civil society, and in particular the new role for some of the traditional social movements (for example, trade unions) within the model.

Progressive opinion in international journals has also been apparently quite receptive to the success of the Argentine model. Probably, the uprising in Santiago del Estero, and the continuing social strife which is characterizing Argentine developments, both social and political, may permit us a more nuanced viewpoint concerning the characterics of the Argentine model. Nevertheless, these structural adjustments would not have been carried out if it were not for the changed and thoroughly restructured institutional setting. Take as examples the administration of justice, the separation of powers, the respect for human and social rights, all trampled under the thrust of a superior *raison d'être* which presumably is that of the adjustments.

First, despite the denial of President Menem, the Supreme Court of Justice has responded to government appeals every time it has had to. It has for all practical purposes become an organ of the executive government, having completely lost its independence. Initially it was packed with members who served the government, and in the meantime lost totally the little prestige it may have had previously. At present it is difficult to sustain the independence of the Supreme Court and the judiciary system, *vis-à-vis* the other powers of the state, basically the executive power.

Second, President Menem and his administration dictated more Decretos de Necesidad y Urgencia (Decrees of Urgency and Need) bypassing the legislature than all the sum of decrees dictated by all previous governments. Since Menem came to power he has frequently used this mechanism to impose his will, even in defiance of the necessary consensus required of Congress, where nevertheless his party maintains a substantial majority, particularly in the Senate. This practice was initiated in 1989 when Alfonsín stepped down from the presidency five months prior to the conclusion of his term in office. Alfonsín reached an agreement with Menem to the effect that Congress would pass a series of emergency reforms of the state laws which would permit Menem to govern without the opposition of the Radical Party. Nevertheless, after these laws expired they were—illegally—extended. Given the fact that the judiciary does not function as a controlling force of the other powers of the state, there was no recourse to this mechanism as a limit to the powers of the executive.

Third, the extreme privatization ideology of the Menem administration also included in its non-interventionist stance the elimination of a series of institutions and regulatory boards which characterize the workings of modern capitalist democracies. Take the case of the Centro de Estudios y Asuntos Penales (Centre for the Study of Penal Cases of the Central Bank), which was dissolved because it brought action against people associated with government. The purpose of this institution was to represent the Central Bank in a series of criminal cases in which it acts as complainant; to investigate the connections that financial groups have among themselves and the control of actions which might signify violations of the law in financial matters. This research group had accumulated information which had permitted the Central Bank to act as prosecutor in some seventy cases, representing violations to the tune of more then US$3,000 (Verbitsky 1993:82). Other cases following similar trends encompassed: the Procuración del Tesoro de la Nación (Power of Attorney of the Treasury), the Inspección General de Justicia (General Inspection of Justice); the Tribunal de Cuentas de la Nación (Tribunal of Public Accounts), etc.

Fourth, the Menem administration initiated its term in office with the wholesale *indulto* (pardon) of military officers accused or condemned for human rights violations. Thereafter a series of human rights violations were carried out affecting young people confronted with police violence, shanty town dwellers, newspaper men investigating corruption charges, and conscripts serving the obligatory military service. The most notorious were some cases in which the dealings of politicians and mafia-type actions led to the intimidation and killing of newspaper reporters. The killing of a conscript in 1994 led to the elimination of obligatory military service as a consequence of the wholesale protests of civil society. The bombing of the Israeli Embassy in 1992 and the bombing of the building of the Jewish Community of Argentina in 1994 apparently have to do with Menem's foreign policy of 'carnal' relations (this was the expression the Minister of Foreign Affairs, Guido di Tella, used to describe the new alignment the Menem administration decided to have with the US, setting aside the more traditional 'non-alignment' of previous Peronista governments) with the US and the adoption of a series of measures, such as sending troops to the Gulf Area during the Gulf War, or withdrawing from the non-aligned conference, which made Argentina a vulnerable target for international terrorist fundamentalism. Local secret services were unable or unwilling to investigate these bombings fully because they were unprepared and apparently too oriented to the domestic 'dirty war' syndrome characteristic of the military dictatorship *proceso* years. The end result of this was that the government created a new Consejo Nacional de Seguridad (National Council of Security) which was presumably to coordinate the different intelligence groups existing hitherto, but which has as one of its main objectives controlling domestic uprisings such as that occurring in Santiago del Estero. In the wake of the recent bombing of the building of the Jewish Community, the government also is sending Congress a new antiterrorist law which has elicited the opposition of political parties, trade unions and human rights organizations due to its overtly repressive character against human rights, social movements and the press.

Fifth, much can be said concerning the violation of social and economic rights of the population. Because the retired and pensioners were not paid their dues, a series of suits waged against the government because of these violations were not heeded. The same refers to labour rights: many suits waged against businesses were disregarded or simply frozen.

## CONSOLIDATION OF MENEM'S REGIME

The new socio-economic and political system set in place in Argentina has had difficulties in consolidating itself.

> Such democratic institutions as parties and parliaments are fragile in most countries that have recently transited from authoritarianism. A typical outcome follows: irrespective of the levels of civil society activism during the anti-authoritarian phase, power in many a new democracy comes to rest in the hands of a few individuals, if not a single leader. A further recurring consequence is that whenever the ruling elite are threatened, further centralization of power is a readily available alternative. Because centralization of power in individuals nearly always further emasculates fragile institutions—strong institutions do constrain the power of individuals—there is a built-in incentive in new democracies for leaders to undertake periodic deinstitutionalization. Weak institutions and personalistic rule thus become vicious and mutually re-enforcing processes. As long as a democracy remains more an affair of a few elites and less an established framework that dwarfs the leaders, only exceptional leaders are likely to resist the tendency to maintain personal power at the expense of institutional development.
> (Kohli 1993:675)

Despite the fact that structural adjustment has been swift and extreme, and that measures were implemented without parachutes or anaesthesia (i.e. without consideration to their social and political costs), the political situation after the 10 April 1994 elections has suddenly changed. While the, up to then, main opposition force, the Unión Cívica Radical (UCR) or Radical Party, lost most of the little credibility that it had maintained—a fact which was reflected in the elections when the nationwide vote of this party fell from about 30 per cent to 20 per cent—the governmental Justicialista Party also lost an important part of its vote, in spite of the fact that it was still the main political force nationwide. But the true winner was the left-of-centre

Frente Grande, which obtained nationwide 13.6 per cent of the vote, winning by a wide margin in the federal capital Buenos Aires with 38 per cent of the vote and in the province of Neuquén as well. The Frente Grande thus emerged as an important oppositional force with the prospect of becoming the main opposition and an alternative to the Menemista regime.

Alfonsín, the leader of the UCR, instrumented his own hara-kiri when he embraced Menem, negotiating a pact whereby his party would accept changing the constitutional clause prohibiting the re-election of an incumbent President. Despite the fact that some things were negotiated, such as the ballotage—or second round—if no party obtained more than 45 per cent of the vote, Alfonsín and the UCR lost much of the little credibility that they still possessed as the leader of the main opposition force.

For the first time in many years a left-of-centre political movement encompassing a series of splinter groups belonging to heterogeneous ideologies and social movements, converge to form a new political force which is to try to consolidate itself as an alternative to the political and economic establishment. It is important for the health of democracy in Argentina that there be this opposition force, in particular now that the Radical Party has almost all but abandoned its opposition role. There remains the prospect that this left-of-centre political space may be filled by a new political force such as the (as yet embryonic) Frente Grande.

At the same time the government also seemed to have received the impact of the 10 April 1994 Congress elections, since the need for a change in some of the elements of the policies implemented so far have been mentioned. Mention has been made that by no means will economic policies be changed—in this respect new areas for the privatization of public spheres of influence crop up every day. Nevertheless, President Menem, in his opening speach to the Legislature on 1 May 1994, mentioned the need to place more emphasis on education, health and other social welfare needs, thus recognizing that there have been excesses in the social costs of the adjustment. Nevertheless, the new educational law presented to Congress follows quite strictly the dictates of the World Bank in educational matters, limiting even more so the funds available for these activities. This probably is to be no more than pure rhetoric; but it shows that President Menem at least recognizes the need to change course with regard to certain measures, focusing much more on social welfare needs.

The Congressional elections of 10 April 1994 were called to elect the members of the Convention which is to reform the Constitution. One of the main measures to be reformed was the clause which did not permit the re-election of the President. The incumbent Justicialista Party won the majority of the vote nationwide, but with a reduced percentage in relation to the vote it received in the previous elections of 3 October 1993. Overall the incumbent Justicialista party received 37 per cent of the nationwide vote, down from the 43 per cent obtained the previous October.

As mentioned above, in the city of Buenos Aires, the federal capital, the Frente Grande, won the majority with an extraordinary 38 per cent of the vote. The Frente Grande nationwide received 13 per cent of the vote, and also won in the province of Neuquén. It also made a very good showing in the important provinces of Santa Fe, Entre Rios and Buenos Aires, where it beat the Radicals with 16 per cent of the vote. The Frente Grande with more than 2 million votes nationwide appears to be an important opposition force, especially after Raúl Alfonsín, of the Radical Party, embraced Menem and signed a pact in which they agreed on several points to reform the Constitution, including the re-election of the President.

If we also consider the socialist vote (7 per cent of the city of Buenos Aires and an important part in the province of Santa Fe where it has its main stronghold), it can be said that almost one-sixth of the electorate voted left-of-centre in the elections of 1994. These facts have had an important impact on recent political developments, giving a new impetus to the opposition to the government's adjustment programmes.

It is true that consideration must be given to the fact that these were very special elections called for the purpose of reforming the Constitution in some of its points, and that during the campaign economic policy as such was not debated. All the contending parties during the campaign recognized the value of the stability obtained, and Chacho Alvárez, the leader of the Frente Grande, mentioned also that his movement as of yet did not have an alternative programme to replace it. Despite these facts it is undeniable that much of the opposition has converged towards the Frente Grande since much of the Radical vote has transferred to Chacho Alvárez, as well as much of the Peronista vote.

But probably what is also important, is that for the first time there is an important opposition, not only to the present government, but to the SAP in itself. And it is this opposition that has once again placed on the agenda of public debate the question of democracy, as well as the issue of economic policy. It is hoped that this new political stamina will not be rapidly spent by internal bickering and divisions.

The opposition to the government's SAP was manifested on 6 July 1994 during the so-called Marcha Federal (Federal March), a demonstration at the Plaza de Mayo in Buenos Aires organized by the dissident trade union movement which was attended by people of all walks of life from the whole country. This was one of the main manifestations of a new opposition to Cavallo's Convertibility Plan.

Faced with a capital flight of more than US$7 billion when the 'tequila crisis' broke out in the beginning of 1995, Menem was not sure to be reelected during the coming presidential elections of May 1995. Opinion polls said that it would be a close run between Menem and the dissident Peronista José Octavio Bordón who had acquired the favour of the leftist trade union leaders and different parties of the centre-left and the social movements. Finally, on 14 May 1995 the latter only took a third of the vote, while the once so mighty Radical Party was humiliated. Menem gained nearly 50 per cent of the vote—he needed only 45 per cent for a first-round victory—and was back in office.

Observers concluded that the cornerstone of his success was Cavallo's pegging of the peso to the American dollar. Menem had virtually eliminated inflation and a convertibility law had fixed the peso at parity with the dollar. Cavallo had also attracted investment and fostered economic growth. Menem's determination to stick to this fixed exchange rate even after Mexico's peso crisis in the first weeks of 1995 showed steel. Apparently, Menem easily defeated Bordón because the latter never appeared as a serious challenger with a programme vowed to continue the same neoliberal economic policy. He only could endanger Menem's re-election when campaigning against widespread corruption. Bordón promised to stay as a thorn in the President's flesh and to remain as an opposition leader of a President who is concentrating too much power in his hands. Moreover, after the election, in which half of the congressional seats too were at stake, Menem's party now controls both houses of Congress. Menem's brother is Chairman of the Senate.

Though Menem acquired a comfortable victory in the first round, all his problems were not solved. As a consequence of the 'tequila crisis' capital had flown out of the country. Menem's victory reassured foreign capital, but the return of foreign money remained cautious, because higher interest rates means slow growth and recession for a country used to an economy growing at over 7 per cent a year. Argentina's economy had made some progress, but by many standards it remains an uncompetitive one, particularly when set beside the emerging economies of Asia.

In a flight of post-electoral megalomania, Menem talked of eradicating unemployment in the same way that he had beaten inflation. He promised to halve Argentina's 12 per cent jobless rate in two years. Although before elections Menem had pushed labour-market reforms through Congress, when running for President he made promises to the working classes and the poor. Apparently he is now in a stronger position to push liberalization measures. Nobody seems to fear a second 'tequila crisis', because no country in Latin America returned to currency controls. During the peso crisis Mexico, Argentina and Brazil increased tariffs, but none has seriously thought of scrapping economic liberalism. Meanwhile foreign investment is not willing to return swiftly. Cavallo plans to reform the labour market and wants to stabilize mortgage loans in order to help home-buyers and thus the building industry. Menem's grand pre-election promises of investing US$80 billion to produce 1 million jobs can be interpreted as an example of pure demagoguery. The figures include, for example, job creation by the recently privatized firms.

## REFLECTIONS ON THE ARGENTINE CASE

Of all the countries of the Third World, Argentina is probably the one in which ISI had advanced most. This factor as well as the proto-welfare state developed in the 1940s, 1950s and 1960s contributed to the development of a relatively advanced large middle- and working-class society, and a certain dynamism of the Argentine civil society. This is the society that was largely attacked by the present structural reform programme. While many structural reforms have been introduced in Argentine society, it is as yet difficult to say if these changes are to have a lasting effect and to what extent are they to be legitimized in the long run. At present much opposition has cropped up and new paths of development are being strongly debated.

As we explain in this chapter, the Menemista Project has been sustained up to the present by the stability obtained in the wake of the Convertibility Plan of Cavallo. But this programme could only be carried out with the huge concentration of power into the hands of the establishment and their political allies. In the 1960s the economic establishment felt threatened by alternative socio-political projects that competed with it (Teubal 1993). At present it has been substantially consolidated, and its power has become highly concentrated. The Executive has also increased substantially its powers. Nevertheless there seems to be a limit to the powers concentrated in the hands of the Executive and the small number of large *grupos económicos* (economic groups). This concentration of power has been to a large extent consolidated only because democratic procedures were trampled upon. What has happened to civil society in the meantime? Up to now the Menemista Project maintained a substantial consensus due in large measure to the stability obtained by the Convertibility Plan. In a country largely affected by the hyperinflationary syndrome, the maintenance of stability apparently was the overriding factor which contributed to the Menemista Consensus. But apparently there too is a limit to this, which has begun to manifest itself strongly in the past two years.

After Menem's re-election in May 1995 the Menemista Project seems to have gained a new impetus. But at the same moment Menem discovered the limits of his power. Bordón, when campaigning against corruption, emerged as the leader of a centre-left coalition which replaced the Radical Party as the only challenger of Peronism. From now on the government will have to act with much more caution. Whether this coalition is to consolidate itself in the future is yet to be seen.

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# 11

# THE SEARCH FOR LEGITIMATION AND LIBERALIZATION IN ALGERIA

*Michiel Beker*

Algeria's recent history has shown the decline of an apparently strong state within the Arab and African regions. In 1962, the country successfully liberated itself from French domination under the leadership of the National Liberation Front (Front de Libération Nationale, FLN). In the 1970s, when Houari Boumediene's Algerian socialism was widely admired as a model, the country was in the forefront of the non-aligned movement. Less than two decades later, quite another revolutionary parallel was drawn, when the Islamic Salvation Front (Front Islamique du Salut, FIS) succeeded twice in achieving electoral victory in free elections. Seemingly, 'authoritarian rule by a Leninist-type party' (Entelis 1992:20) was on the verge of being replaced by a regime similar to that of Iran's (Zoubir 1993:105). Both comparisons are not very convincing. As to the Soviet parallel, the power of the FLN *as a state party* has always been limited due to the predominance of the military in Algerian politics since independence. Given this fact, the January 1992 *coup d'état,* which interrupted national elections that would have been won by the FIS, is more comparable to other cases where the army imposed itself as the main political actor. This applies to many historical examples in Africa, Latin America and the Middle East, but not to the former communist countries.

Whereas it is acknowledged that the political role of the army does not produce the same results in different cases, the emergence of political Islam (or Islamism) instead immediately activates the reflex of posing the second Iran-thesis. The fact of the Algerian Islamists' electoral victory in free elections (the conditions of which were nevertheless established by the incumbent regime) is, within this view, deemed irrelevant. Also, the Algerian FIS is not directed by the Islamic establishment, based on institutional strength and ideological coherence. In Iran, the clergy directed the assault on the state apparatus—to take it over eventually—by a mass revolt. In Algeria, however, the most important mass uprising against the regime, in October 1988, preceded the formation of the FIS. Furthermore, the proliferation of armed Islamist groups after the coup was not joined by mass demonstrations, while these also fell outside the orbit of the FIS imprisoned or exiled political leadership.

These references to the supposed Soviet-like *ancien regime* and its Iranian-type opposition only serve here to indicate some main features of Algerian political history. This history is characterized by both the politicization of Islam and the predominant role of the army in politics. In one way or the other, these and other present political forces still refer to a *revolutionary legitimacy* connected to the independence struggle. But while the Islamic current, in spite of its ideological strength, never succeeded in creating a durable organizational base, the army, being the strongest organizational power, has always been ambiguous with respect to the ideological question, which undermined its social base of support. After 1965, the Boumediene regime tried to permeate its linkage with society by transforming the revolutionary asset into an *institutional legitimacy*. This coincided with a civilianization of the military leadership. Massive industrialization, land reform and the creation of new institutions were instrumental in this respect. With this modernization effort, however, new tensions emerged between its technobureaucratic content and the need for a mechanism to control the social upheavals it caused. For a number of reasons, these contradictions were resolved by resorting to populist welfare policies combined with repression.

In the 1980s, external dependence came to hamper both the industrialization process and the possibility to compensate for this failure by massive imports. The crisis, cumulating in the 1988 uprising, resulted in an attempt by President Chadli Bendjedid to achieve *constitutional legitimacy* through free elections and the recovery of civil liberties.

This article will refer to these three modes of legitimization in order to explain the limits of political and economic liberalization. It must be stressed that liberalization policies resulted from the regime's reliance upon sources of legitimation which ultimately proved to be non-renewable: namely, the symbolic rent acquired by the fact of the liberation war, and material rent provided by hydrocarbon exports, which formed the main pillars of the 'populist compromise' (Carlier 1991:128). (The more specific definition of the concept 'rent', as it is used in this chapter, can be found on p. 230.) But instead of a transformation of the political system, liberalization has produced attempts to monopolize these resources by different power groups. The democratization from 1989 until 1992 has coincided with a revival of revolutionary populism in the guise of political Islam, while 'structural adjustment' has served to strike a new deal between the military regime and global finance, in order to sustain the redistributive capacity of the state.

## REVOLUTIONARY LEGITIMACY

Despite far-reaching socio-economic, political and cultural changes since independence, many features of present-day Algerian politics reflect the dilemmas of the past. In contrast to other Arab countries, the struggle for independence has significantly contributed to the consolidation of the idea of the Algerian nation. The definition of this concept, however, has always been heavily contested. The state's attempt to avoid a clashing of ideas by resorting to an eclectic approach of ideological-cultural issues, has paradoxically enhanced the development of mutually exclusive orientations.

### Sources of nationalism

The creation of the present Algerian nation-state is largely due to external influences. The state apparatus has been created by colonizing powers such as the Ottoman Empire and France, before the Algerian nation formally took it over with the war of liberation between 1954 and 1962. But also, the concept of this nation itself has not been uncontested. Algerian nationalism developed largely as a response to the French occupation starting in 1830. The European settlers occupied the best agricultural lands on the coastal plain, resulting in the development of the major cities in the north, as well as the integration within the metropolitan French economy. The intrusion of capitalism and subsequent urbanization led to the emergence of a variety of nationalist currents, all of which opposed the secondary status of Muslims within the framework of the French Republic. But at the same time, none of these succeeded in breaking with this framework.

Within the context of colonialism, Algerian workers and intellectuals were influenced by European ideologies. For instance, contacts with the French Communist Party were important in the political formation of Algerian nationalists like Messali Hadj. Although the socialist current became quite prominent within the FLN, within the nationalist mainstream, Western ideological concepts merged or coexisted with a definition of national identity in Islamic terms.

The importance of Islam resulted partly from the persistence of tribal culture in the mountainous hinterland, where most customs were defined with reference to religion. In fact, however, many of these practices, like the veneration of local saints, are contradictory to orthodox Islamic dogma implicit in the Qur'an. As in many other countries at the beginning of this century, an Islamic reformist movement came into being in Algeria that promoted a return towards scripturalist Islam: the Association of *ulama* (learned men of Islamic law). The tendency towards reform does not merely reflect a scholarly concern about the true meaning of religion, but must be seen as a direct reaction to colonialism. The Algerian *ulama* wanted to revitalize Islam in order to safeguard it in the face of European expansionism. Also, the movement had a distinct urban character. It provided the urban masses with social services like education, which was not limited to traditional Koran teaching (Cheriet 1992:9–14). The Association's credo—'Islam is our religion, Arabic our language, Algeria our country'—widely echoed the opinion of a large number of Algerians. In this way, the *ulama* laid the basis for the creation of a nationalist mass ideology with reference to traditional Islamic culture.

In a sense, the FIS is the heir of this 'ideological cement' (Leca 1990:18) of Algerian nationalism. Like its predecessor, the FIS derives its strength from its ability to play simultaneously upon the factors of traditional culture (and the fear of its decline through foreign domination) and overall socio-economic discontent (joined by total rejection of the incumbent regime). Also, its social base is largely composed of migrants with a rural background, who, having partly broken with traditional bounds, are excluded from full integration into dominant (urban) culture and society. While the colonial uprooting of traditional Algerian society led to the growth of the urban, scripturalist Islamic movement, the rise of the FIS can be attributed to comparable effects of state formation and dependent development after 1962 (which will be described below). Thus, far from being an archaic relic of ancient times, the predominance of political Islam is very much a product of social transformations linked to the integration of Algeria into the world market, both during colonialism and after. While Islamism as such could certainly not be reduced to the expression of social discontent alone, the mass character of movements like the FIS is hardly imaginable without taking into account the effects of the modernization process. The large urban masses without work, decent housing, and access to basic goods and facilities have every reason to be resentful towards the privileged elites associated with the state—an opposition which partly overlaps with a cultural divide.

## The Frontist logic of Algerian politics

The affirmation of identity on the basis of Islam was reinforced by the colonial authorities' differentiation between Muslims and non-Muslims within one nation; Algeria was not regarded as a colony, but as an integral part of France itself. All currents within the nationalist movement got stuck in the dilemma of how to improve the position of the Algerian population within a colonial framework that made them into second-class citizens. Neither the cultural resistance of the *ulama,* nor the creation of political parties and organizations—which were subject to electoral fraud or simply outlawed—could bring about radical change in this. The urgency of this dilemma was evidenced by the Setif massacre in May 1945, when French troops killed thousands of Algerians demanding independence. In order to break the deadlock, a small group of Algerian nationalists opted for the armed struggle. The FLN was born. Gradually, the liberation movement came to incorporate almost all pre-existing nationalist organizations. Representatives of the different political and ideological origins, such as the *ulama,* leftist workers and intellectuals, as well as a liberal current, were denied any autonomy. The 'Frontist' logic therefore implied the suppression of ideological dilemmas in favour of 'unity and action' (Leca 1990:18), which was clearly acceptable in conditions of the liberation struggle. The choice of a guerrilla war against the colonial apparatus had some other important consequences. The terrain best suited for guerrilla warfare was formed by the mountainous rural regions. Therefore, the FLN leadership had to come to terms with local interests in order to be effective militarily. According to Hugh Roberts, this interaction with its 'environment' more than anything else shaped the specific character of the FLN (Roberts 1993). The importance of the tribal hinterland, and its concomitant emphasis on regional divisions, further limited the impact of the urban-based nationalist currents, and the importance of ideological distinctions in general.

Among the insurgents who staged the first attacks on the colonial state during the night of 31 October/1 November 1954 were many future political personalities. Among the historical leadership of the FLN were two future state leaders: Ahmed Ben Bella, the first President of independent Algeria (1962–5) and Mohamed Boudiaf, who was called upon by the military after the January 1992 coup to serve as the head of a collective presidential college. Another *chef historique,* Hocine Ait Ahmed, founded the Socialist Forces Front (Front des Forces Socialistes, FFS), the third political force after the FIS and FLN in the 1991 elections. Furthermore, FIS leader Abassi Madani, although not part of the FLN leadership, was also one of the first guerrillas. Thus, because of their role in the wartime FLN, almost all political leaders of the parties that (re-)emerged from 1988 can lay claim to some sort of revolutionary legitimacy. Also, it seems more than a coincidence that the main political formations regard themselves as a 'Front' rather than a party. The latter term is associated with the impotence of nationalist forces in the colonial era, as well as by the emergence, from 1989, of scores of parties without any social base. In contrast, the reference to the original FLN reflects the achievement of independence and national unity through a strong organization with a clear definition of both purpose (national liberation) and means (the armed struggle). However, at the time the three fronts (FLN, FIS and FFS) attempted to act like political parties, these attributes had been captured by the military and the Islamist armed groups.

## The army: the primacy of organization

As the liberation war continued, another shift took place. While the rural fighters, together with an urban guerrilla movement, constantly put pressure on the French, they were clearly unable to defeat the colonial presence militarily. The war was to be won on the negotiating table as well as through active diplomacy by FLN officials. Apart from the internal guerrillas and the political leadership, the National Liberation Army (Armée de Libération Nationale, ALN) was gradually enlarging its external component. Across the frontiers of Morocco and Tunisia, the ALN developed into a well-organized regular fighting force, quite distinct from the rural guerrillas. The organizational capabilities of this force were partly due to the presence of significant numbers of officers who had served in the French colonial army (Leveau 1993:211).

With independence, this army of the frontiers, under the command of Colonel Houari Boumediene, became the principal supporter of Ben Bella's claim to the presidency. As the main organizational power, the army was the ultimate incarnation of the imperative of 'unity above all else' that had guided the wartime FLN. The persistence of regionalism, reinforced by the character of the war, provided the rationale for this, while there was also the risk that re-emergence of the ideological currents within the FLN could produce disruptions. (In fact, however, the army itself took part in the power struggle that erupted in the summer of 1962, involving complex coalitions which could not be reduced to regional or ideological divisions alone (De Villers 1987:28–30)—although these certainly played some role.) The victory of the Ben Bella-Boumediene alliance by no means implied an end to infighting within the FLN. After a tumultuous period, involving a border war with Morocco, internal uprisings and economic chaos, tensions between the President and the army commander increased. In June 1965, this resulted in a coup that brought Boumediene to power.

Significantly, Boumediene forestalled the evolution of the FLN into a strong party in command of the state apparatus. This was done not only out of concern for remaining Ben Bella supporters within the party bureaucracy, but also to prevent the establishment of power centres outside the armed forces. At the same time, Boumediene sought to avoid contestation of his rule from within the army itself. As was shown by the history of the wartime FLN—as well as by Ben Bella's role -infringements on the principle of collective rule (amounting to personality cults) could provoke risks in this respect. For these reasons, Algeria came to be ruled by a Revolutionary Council, which was in turn dominated by the Oujda group, meaning Boumediene and some close collaborators, that had come into being during the war in this Moroccan border town.

Some parallels can be drawn between the coups of 1965 and January 1992. In both cases, the FLN as a party came under attack by the military because it did not fulfil its self-proclaimed mission of achieving national unity. Either as a single party (in 1962) or within the context of multiparty politics (from 1989), the FLN did not manage to incorporate or defeat all regionalist or ideological currents, as it had done during wartime. For the same reason, the state leader, either civil (Ahmed Ben Bella) or 'civilianized military' (Chadli Bendjedid) was replaced in both instances. Thus, the military took over the role of the FLN as the main bearer of the 'organizational cement' (Leca 1990:18) that was assumed to hold the Algerian nation together. This, however, did not resolve the dilemma facing the army leaders of how to deal with the same nation's predominantly Islamic reformist ideological substance.

## Ideological pragmatism

The 1965 coup was meant to put an immediate end to the ongoing political crisis, but was also the beginning of an attempt to construct a new nationstate, in the process of which pre-existing divisions would gradually disappear. The state's orientation would be socialist, more or less in line with the Tripoli Programme adopted by the FLN in 1962. This programme propagated a state-led economy dominated by large, heavy industrial corporations (based on the expropriation of French interests), as well as agricultural reform. Many Algerians, however, had experienced the struggle against France as a *jihad,* an Islamic holy war. Also, the unifying aspect of Islam and the Arabic language could be useful to the nation-state-building effort by the new leadership. The orientations of Ben Bella and Boumediene reflected this duality of adherence to policies deemed socialist combined with an attachment to Arabo-Islamic cultural values.

Indeed, the state leaders took many specific policy measures with explicit reference to its proclaimed socialist attachment. Commitment to socialism as an ideology was, however, weak for most of the time, in the sense that the regime did not aim at 'a broadly based popular control of and participation in the economic and political affairs of society, according to a broadly egalitarian principle' (Ayubi 1992a:92). The instances where this principle applied, notably the *autogestion* of former colonial farms and industries shortly after independence, reflected initiatives by the workers themselves, only half-heartedly supported by the state. In these instances the farms were gradually deprived of their autonomy. In a similar way, references to Islam were numerous, while Arabic was promoted as the national language. But every attempt was made to empty this cultural orientation of the politico-ideological significance it possessed during the formation of Algerian nationalism. The *ulama* had already been incorporated by the FLN, while mosques came under state surveillance. In this way, the leadership sought to resolve possible contradictions; socialist developmental policies were considered culturally neutral, while Arabo-Islamic culture was supposed not to interfere with politics or the running of the economy.

The dual reference seemed to leave the state a maximized room for manoeuvring in order to legitimize its policies. Along with its collective leadership, this allowance for pragmatism has been one of the strengths of the Algerian regime since 1965. But it must be remembered that the ability of the state leaders to deprive both socialism and Islam of their potentially endangering aspects resulted largely from their control of the organizational field. This applied to the tight surveillance of society, but also to the curbing of state institutions that could challenge the supremacy of the military-based leadership. Thus, similar to the initial suppression of the state party's role to serve as an intermediary between state and society, the Islamic establishment was not required 'to solve the continuous contradiction between the Marxist strategy on the one side and the theological requirements of the Qur'an as a divine revelation on the other side' (Arkoun 1988:184). The crucial point here is that control over organizations does not imply ideological dominance over society. On the contrary, the state's ideological pillars were in fact uprooted from the social environment by conceiving socialism and Islam in a very abstract way. This abstraction later on facilitated the claim on these ideological resources by oppositional movements.

The Islamist movement benefited most from this state pragmatism. This current even succeeded in making inroads on the state's monopolization of organizational life. Canalization of social protest (about living conditions) inside the mosque grew into covert political criticism, followed by the establishment of 'independent' prayer halls (Rouadjia 1990). This development was enhanced by the state's Arabization policies, the move of the Bendjedid regime against the left, as well as the government's 'counter' policies of establishing Islamic institutes. The state's support for an abstract, scripturalist Islamic culture paradoxically bestowed legitimacy upon a movement relying on the renewed politicization of the nationalist heritage.

At the same time, other (cultural-) ideological expressions were severely repressed. This pertained to leftist currents within state trade unions and student organizations, feminist organizations, and the Berber cultural movement. In 1980, protests broke out in the predominantly Berber-speaking region of Kabylia, demanding the recognition of the Berber language and culture. As a reaction to the state's Arabo-Islamic stance, the movement embodied yet another definition of the Algerian nation, by insisting on its Berber identity—deemed only superficially 'Arabized'—as the main characteristic. The heavy-handed suppression of the Tizi Ouzou spring uprising of 1980 not only indicated the regime's refusal to allow the Berber-speaking population cultural autonomy, but more fundamentally it was an attempt to forestall the crystallization of political opposition. The state's refusal to allow the emergence of autonomous political and social organizations objectively enhanced the existence of the Islamist current as the almost exclusive channel of societal discontent.

## INSTITUTIONAL LEGITIMACY

From 1967, a new administrative and economic infrastructure came into being through extensive government plans. The twin processes of industrialization and political institutionalization aimed to forge a strong nationstate. Despite profound changes in society and the development of an extensive state apparatus, integration between the two did not come about. In important respects, this could be attributed to the effects of Algeria's specific integration into the world economy. During the 1970s, the country's position as a main exporter of oil and natural gas enabled the process of modernization, but also made possible forms of political control that could not be sustained after the fall of hydrocarbon revenues in the 1980s.

## Radicalization and continuity

During his reign, Houari Boumediene gradually sought to broaden his power base away from rule by a Revolutionary Council dominated by a narrow group formed during the liberation war. The creation of state institutions—not only administrative units but also 'representative' provincial and municipal councils—coincided with the industrialization drive, lacking however any dynamism. This reflected the attitude of 'state building from above' of the Oujda group. From the beginning of the 1970s, Boumediene distanced himself from his early collaborators, who gradually disappeared from the political scene. Significantly, he embarked on a more explicitly socialist course by the promulgation of the Agrarian Revolution and the Socialist Management of Enterprises. In a way, mobilization of leftist students and workers could be considered a means to outflank the FLN establishment, still dominated by regionalist and often conservative interests (Roberts 1984:30). In both cases, however, the mobilizational aspect rapidly faded away, or at least did not result in durable power shifts. This was due to the absence of a sufficiently strong social base for the leftist current, as well as the regime's unwillingness to allow the emergence of autonomous political forces competing with each other. In 1976, the adaptation of the National Charter and a new Constitution signalled a new phase of institutionalization. Formally, the party of the FLN regained a central position—which did not change much since Boumediene combined the functions of state President and head of the armed forces with that of party leader. Moreover, Boumediene openly defied the formal supreme decision-making body, the FLN National Congress, by having his presidency approved by referendum before its convocation.

It was at the moment of Boumediene's death in December 1978 that the FLN had begun to reassert itself. However, the issue of his succession again proved the ultimate power of the armed forces over all other institutions. Although the struggle for Boumediene's succession had no strong ideological colourings, the groups rallying behind the two main opponents represented different policy orientations. Mohamed Salah Yahyaoui, former head of the prestigious Cherchell military academy, had been appointed party coordinator charged with the organization of the

Fourth Congress of the FLN. He relied on those who wanted to continue the socialist policies set in motion by Boumediene. The other candidate, Foreign Affairs Minister Abdelaziz Bouteflika, was the only member of the Oujda group who had stayed in power. He advocated more openness towards the West, a wish shared by part of the technobureaucracy—obviously those who expected to gain more from an increase in exchanges with the world market. At first sight, the peaceful character of the transition process signalled a relative success of the institutionalization of the state. However, the logic of rule by the party was not followed to its end, while rule by the government still appeared to be subject to the power of the Revolutionary Council—or rather the highest echelons of the armed forces and the powerful military security apparatus. This resulted in the bringing to power of a relatively unknown officer, Colonel Chadli Bendjedid, the eldest of the regional commanders.

The positioning of Bendjedid seemed an adequate response to the disappearance of the embodiment of the regime since 1965, and also forestalled an imminent power struggle. On the other hand, this procedure formed a backlash for the establishment of legitimate state structures and decision-making procedures. Apart from excluding 'the people', the succession of Boumediene resulted from a mode of decision-making that was appropriate in times of war, but did not correspond with developments generated by the state-building process. Given the relative success of this process at the end of the 1970s, the establishment of new political mechanisms, by incorporating and balancing emerging forces, would then have been easier than it proved to be after 1988.

## Industrialization

The main driving force behind the transformation of society and the enlargement of the state apparatus was of course the process of massive and rapid industrialization initiated by the state. The colonial economy, based on agriculture, had provided only a limited impulse for accumulation that could serve as a basis for national industry. Only in 1958, the creation of heavy industry on Algerian soil was envisaged in the Constantine Plan, reflecting the interests of French industrial capital which was on the ascendancy after the coming to power of General De Gaulle. The industrialists' principal aim however was to maintain control over the Algerian oil reserves, discovered in 1956 (Ollivier 1992:5). This was the reason for the attempt by De Gaulle to exclude the Algerian Sahara from the peace agreement granting the country full independence, a prospect successfully forestalled by Ben Bella and Boumediene (De Villers 1987:30).

Shortly after independence, national companies had been established for the production of oil and derivatives (Société nationale pour la recherche, la production, le transport, la transformation et la commercialisation des hydrocarbures, SONATRACH) and steel (Société nationale de sidérurgie, SNS). The transformation of Algeria's raw material resources would provide the input for the production of industrial equipment, which, in turn, was necessary for the production of consumer goods and the mechanization of agriculture. The emphasis on a heavy industrial base, as well as the attachment to a considerable degree of self-sufficiency, resembled the pattern followed earlier by the Soviet Union. The Algerian model of 'industrializing industries' aimed at avoiding the disadvantages of both import-substitution and export-orientation strategies: these being excessive dependency on either expensive foreign technology and capital goods, or a world market in which many newly industrializing countries (NICs) were already active. The experience of the liberation war had made the only alternative—namely, resuming the colonial pattern of agricultural exports to Europe—a practical as well as a political impossibility. On the contrary, the 'second liberation' from foreign domination had to be the result of a large-scale process of industrialization.

The asset of oil (and natural gas) was of crucial importance for Algerian industrialization. The nationalization of French oil companies in 1971 made the state into the monopolist of these resources, the value of which grew considerably due to the oil boom during the 1970s. It is questionable whether the strategy of industrializing industries could have been pursued in its absence. Through oil revenues, Algeria was able to import capital goods needed to bring about the launch of its basic industries. This had the advantage of enabling rapid industrialization without the need to resort to the forced mobilization of internal surplus, or being totally dependent on foreign companies' willingness to invest in basic industries other than oil. The Algerian accumulation process, however, did not become self-sustaining. This was partly due to the gap between the highly ambitious industrial programme and actual state capabilities, as well as the relatively short duration of the oil boom—after a second large increase in 1979–80, prices began to fall gradually thereafter. Economic deficiencies—lack of qualified personnel and technology, stagnating agriculture and production of consumption goods, etc.—had to be compensated for by a massive resort to imports, thus increasing dependency and foreign debt. At the same time, the population boom as well as a shift towards urban consumption patterns led to a highly increased demand. Instead of expanding industrial production, oil rent more and more came to serve consumption-related activities. (Rent is 'an income not originating from the productive activity of the concerned unit, the flows of which are not directly linked to the beneficiary's activity (i.e., any income the amount of which is determined for the most part by decisions the concerned unit cannot control)' (Chatelus 1987:110).)

Reliance on hydrocarbon revenue caused the industrialization process to fluctuate with developments in the world oil market. This not only implied the overstressing of the state's planning capacities with the investment boom after 1974, but also brought about serious sectoral imbalances. The hydrocarbon sector itself, as well as other basic industries, were favoured to the detriment of the production of consumer goods and notably agriculture. The privileged position of capital- and technology-intensive industrial enclaves resulted from the state's model of development, but was also maintained by other factors. These industries' heavy reliance on foreign expertise enabled many high-ranking officials to acquire massive sums through 'hidden' commissions by foreign companies. According to former Prime Minister Abdelhamid Brahimi, these commissions amounted to US$26 billion—equivalent to the sum of Algeria's foreign debts at the end of the 1980s (Corm 1993:22). This source of enrichment enhanced the preference for large-scale, expensive industrial complexes, which led to the waste of income from non-recoverable resources and further undermined the possibility of self-reliance through the expansion of productive capabilities.

## Technobureaucracy

The move against French oil interests, coupled to Algeria's role within OPEC and its insistence on a New International Economic Order, all served to improve the state's margin of manoeuvre in the world market and the international system. In turn, this international leverage was in different respects used by the regime to strengthen itself domestically. Not only did the state's international prestige back up its revolutionary rhetoric, it also provided the resources potentially to transform this revolutionary legitimacy into one based on more durable assets. The 'national project' of industrial development would not only inaugurate a second stage of national liberation by breaking the bounds of dependency, but also sustain the regime's credentials in material terms.

Moreover, industrialization would result in the 'production of a constituency' by creating new social groups—thus diminishing the importance of regionalist and other 'traditional' bonds in favour of class affiliations. These new classes were not assumed to be antagonistic within the Algerian populist concept.

In this respect, the emerging technobureaucracy fulfilled a crucial role. At the level of the state, the developmental policies required a capable, coherent group that could successfully pursue the industrialization effort and run the administrative apparatus. In turn, the rapid extension of the state apparatus increased the role of the technobureaucracy as a social stratum. In principle, the technobureaucracy's main asset is the monopolization of specialized knowledge, which is not merely technical but equally ideological in nature—in that it enabled the 'rational societal project' of development (Konrád and Szelényi 1979). In the Algerian case, the mass mobilization of the population during the independence war had articulated the demand for social justice and prosperity which the colonial state had withheld from them. In this sense, the technobureaucracy can be viewed essential in producing a transformation from revolutionary to institutional legitimacy of the regime. Boumediene's ousting of the Oujda group coincided with the growing influence of the industrialists within the leadership (such as the Minister of Oil and Industry, Belaid Abdessalam). In this sense, the wartime elite had been replaced by a technobureaucratic successor. As opposed to the former, the latter possessed a growing social base within the expanding state sector. Also, since the military increasingly assumed administrative functions in other parts of the state apparatus, cohesion within the decision-making centres apparently grew.

To a certain extent, this development of a technocratic system composed of mobilizational, managerial and military elements (Entelis 1982:93) could also be perceived as the coming into being of a 'state class' (Elsenhans 1981:240), implying a transformation and broadening of the group ruling the state since 1965. It is questionable whether this notion applies to Algeria, since the basis of this class formation remained fragile. To begin with, the problems inhibiting the industrialization process weakened the position of the technobureaucracy, since these were able to affect the regime's developmentalist mode of legitimation. Also, internal divisions hampered coordinated actions to the defence of its interests—connected to regionalist and other neo-traditional loyalties underlying clientelist bounds with segments of society. Together with 'functional' competition within the state apparatus (De Villers 1984:227), these divisions in turn weakened the effective functioning of the public sector (Addi 1990). More fundamentally, these phenomena were connected with the state's excessive reliance on revenue income, leading to the coming into being of an 'allocation state'.

Within the state apparatus, control over distribution of state-channelled resources—or the immediate use of consumptional facilities on the basis of one's position—formed the main power factor, thereby devaluing the importance of specialized knowledge (Eftekhari 1984:53–4). Instead of constituting a source of the state's income, the underproductive industrial complexes became targets for allocation through which managerial cadres and workers could be tied to the regime. The state's autonomy from domestic productive forces through its reliance on the world market for hydrocarbons severely undermined the potential power base of these new social strata.

Gradually, these allocation policies evolved into a major political control mechanism regulating state-society relationships. The regime's reliance on revenue income allowed for centralized control despite massive changes in the social structure and a relative loss of control over the economic process. With the economy's failure to produce sufficient goods, employment and housing, the regime's power base increasingly shifted towards the mobilization of external support in order to sustain its welfarist credentials. In order to enlarge the clientele of the state, as well as to suppress the emergence of specific interest groups, the state had to compensate for the lack of political expression and influence by resorting to populist welfare policies. Therefore the orientation towards consumption was not only caused by economic factors, but also the result of the political process.

The extraversion of the economy also gave rise to cultural alienation (De Villers 1984:224–5) that undermined the integrative capabilities of the state-led economy, i.e. the creation of new social groups or classes in support of the state. In Algeria, this tendency was reinforced by the contrast between the Arabization of the educational system and the growing need for administrational or managerial cadres educated in French (and English) to deal with foreign technologies and experts. The successes of the educational system—receiving a large share of the state budget—stood in contrast to both the kind of knowledge and the (relatively limited) number of employees needed to run the industrial enclaves. Also, the logic of distributional power, extraversion and intersector rivalry favoured a limited number of state enterprises (in particular, the state oil enterprise SONATRACH, which received more than 50 per cent in actual allocations above planned investment (Lawless 1984:165)). The bonds between the middle and lower cadres, as well between the workers in the state sector, and the leadership, therefore remained weak. With the exacerbation of the state's legitimation crisis, there occurred especially among the *arabisants,* an increase in support for the Islamist movement.

## Restructuring of distribution

The inauguration in 1979 of Chadli Bendjedid as the Head of State at first appeared to imply important changes in Algeria's political economy. Quite logically, the new leadership was preoccupied with the need to tighten its grip on the state apparatus. Followers of Boumediene were thus gradually removed from most important decision-making organs. At the same time, the state industrial sector underwent a restructuring to the effect that, from 1980, most huge state corporations were split up into a number of smaller enterprises. These developments particularly undermined the position of the industrialist faction of the technobureaucracy. The restructuring of Algeria's economy by the Bendjedid regime derived partly from real economic imbalances, such as the overstretching of state planning capabilities and increasing foreign debt. The interpretation of these difficulties, however, served specific political interests. Moreover, the 'new policy' did not address many of the fundamental causes of particular failures, since this would undoubtedly spill over into the political field.

In line with the Egyptian example, the changes within Algeria's political economy from 1979 have often been referred to as *infitah,* or 'opening' (Vandewalle 1992:189–209). Originally, this term was used by the Egyptian President Anwar al-Sadat in 1973 to indicate the rupture with the Arab socialism of his predecessor Gamal Abdul Nasser. Main features were a shift in emphasis from the heavy industrial state complexes to light industry and a larger role for the private sector. In these respects, a parallel with the Algerian situation is justified. However, Sadat's 'opening' also explicitly aimed to attract foreign investors. In Algeria, this was only to be witnessed after 1990—apart from the fact that the role of foreign companies was at its height at the time of 'Algerian socialism'. In addition to the continuation of a strongly nationalist state discourse, the more limited approach also reflected the relatively prosperous state of Algeria's economy—despite all desequilibria—at the end of Boumediene's rule. This points at another outcome of the 'opening', which also applied to Egypt: instead of diminishing the state's role in the economy, it led to an increase of state power through simultaneous reliance on external capital and the weakening of internal economic actors—and the playing off of these two. Therefore, *infitah*-type policies do not result in a retreat of the state, but rather in a redefinition of its (economic) role (Richards and Waterbury 1990:261). Also, it is far from clear that the 'opening' will lead to the mobilization of (domestic) productive forces, given the predominance of (external) revenue income. Instead of an opening towards production, *infitah* more than often represents a restructuring of distribution. But in contrast to Egypt, this economic reorientation did not coincide with a political opening. At the beginning of the 1980s, the Algerian leadership felt strong enough to rely on allocation policies to prevent social discontent, while emerging protest movements were repressed.

The new policy partly reflected the logics of industrialization, in the sense that, after the completion of basic industrial complexes and infrastructure, a second stage aiming at the production of consumer goods had to be achieved. At this point, the state had to promote either *infitah*-like policies or a deepening of industrialization (Ayubi 1992b:44). This choice reflects the way in which the regime sought to maintain its power base. Given the weakness of an industrialist power group, as has been described above, the state's reliance on external resources logically led to the first option. This was also due to the evolving social structure. The state's dominant economic role had expanded the size of the new middle class, which was very much interested in getting access to luxury goods, preferably imported from the West. On the other hand, the large majority of the population had their minds set on acquiring even the most basic products, which the domestic economy was unable to deliver. With regard to both, programmes envisaging massive imports of basic goods were pursued. It is thus clear that the all-powerful state had to rely on the promotion of institutionalized consumerism in order to achieve stability. However, the increasing social differentiation accompanying this development, as well as the vulnerability caused by the state's reliance on the world market, ultimately made a major crisis inevitable.

## CONSTITUTIONAL LEGITIMACY

The widespread riots of October 1988 indicated the limit of the regime's ability to contain overall discontent. Revolutionary rhetoric had become worn-out with increasing social differences, widespread corruption and overall economic crisis, making any reference to social justice and a better life illusory. Already before the collapse of the oil market in 1986, it appeared that hydrocarbon income could not sustain industry as well as the import of consumer goods. Besides the relative failure of industrialization, the political aim of creating new social groups in support of the state was ineffective since the regime refused the institutionalization of their interests. Moreover, workers and the new middle class were by no means immune to the effects of the economic crisis. On top of this came profound divisions within the leadership about proposals for economic reform.

### Liberalization

Chadli Bendjedid tried to benefit from the dynamics generated by the 'October events' to accelerate economic reform by establishing political liberalization. After having assured his own position by his re-election in December 1988, the state leader promulgated the February 1989 Constitution. This document guaranteed many civil and political liberties, such as the right to form 'associations of a political character' (Article 40). Also, both the political role of the army and the reference to the socialist orientation of the state were scrapped. For three years, Algeria appeared as the forerunner of political liberalization in the Arab world.

The resort to constitutional rule was clearly linked to efforts to reform the economy. At a theoretical level, the granting of extensive autonomy to economic actors outside the state could contribute to a formalization of part of state-society relationships (Leca and Leveau 1993:4). Within the Algerian context, however, the emergence of autonomous actors is restrained by the attachment of productive forces to the state. This not only follows from the state's previous attempts to monopolize the economic field, but also is rooted in lasting dependency on external income: even in the case of denationalizations, tax income from the hydrocarbon sector will predominate over other sources of state revenue.

The opening of the political field was also directed against those sections of the state bureaucracy opposing reform. The FLN, although remaining a second-rate power, provided a platform for this opposition through its control over the Assemblée Populaire Nationale (National Assembly) which could block legislation. The admission of the FIS—although controversial on the basis of the Constitution (the Constitution stipulates that 'formations of a political character' cannot be based on religious or ethnic grounds)—inscribed to this presidential scheme of balancing forces (Leveau 1992:6).

In the longer term, political liberalization could serve to broaden support for painful economic reform and provide a channel for social discontent, thereby avoiding violent eruptions. Thus, a more democratic government should elicit a degree of trust and patience on part of the population. In practice, however, it proved very hard to maintain that economic reform would lead to general prosperity if the measures involved were seen to contribute to a worsening of the position of significant groups. Subsidy cuts were bound to disadvantage the poor still further, while restructuring of the state sector would affect the regime's 'natural' constituency. Not surprisingly, many within the state apparatus resisted heavily the liberalization drive, especially since it could also affect non-productive institutions like the FLN bureaucracy.

Between 1986 and 1988, a small group of economists worked out a number of reform measures, pertaining to price liberalization, convertibility of the dinar, and autonomy of state enterprises. Significantly, the reformers were directly responsible to the President and worked outside formal decision-making organs. In September 1989, the group formed the core of the government headed by Mouloud Hamrouche. Already before that date, the reformers contacted the World Bank and the IMF, which—in contrast to other international creditors—had begun to provide loans (Corm 1993:24). Algeria's many structural problems inhibited significant results in the short term. Debt servicing amounted to three-quarters of export revenues, while hydrocarbon markets (despite a short revival in 1990 at the beginning of the Gulf Crisis) remained depressed.

Encouragement of foreign investment, notably in the oil sector, did not produce significant results. Relaunching industrial activity seemed impossible in the absence of financial means that could only come about through massive foreign support. Apart from external constraints, reform efforts were hampered by increasing political tension, which further diminished the country's attractiveness for foreign capital. In part, domestic unrest was aggravated by regional events such as the Gulf Crisis (Roberts 1991:131–54), but it also evidenced the regime's failure to produce a coherent political strategy underlying the economic policy shift. The successive cabinets charged with economic reform were distrusted by important parts of the FLN, controlled by the army, and without public support (Yefsah 1993:87).

## Elections

In June 1990, the victory of the FIS in local elections with 55 per cent of the vote (against 28 per cent for the FLN) formed an indication of both the extent of political liberalization and the former state party's failure to deal with the new situation. Since these results did not directly affect central decision-making, and since the Islamists were proving themselves incapable of improving everyday living conditions in the provinces and municipalities, the regime apparently had time to react before the national elections announced for 1991 took place.

In the spring of 1991, a new electoral law favouring the FLN was approved by the National Assembly. Since the FIS had gained most votes in the urban areas, a new division of electoral districts was designed, favouring FLN strongholds in the countryside. But more important was the working of the district system as such. A party would win a seat in parliament by obtaining more than 50 per cent of the vote in a district; if none succeeded in doing this, the two parties emerging as the largest would compete for the seat in a second round. This seemingly technical matter had very substantive electoral significance, since it sharply enhances bipolarization, disproportionally advantages the largest party and eliminates all small and middle formations (Zeghouani 1992:6). Also, the proliferation of small political parties without any real social base was encouraged by the setting of minimal standards for approval and generous government subsidies. The aim was to enhance divisions among the secularist, leftist and Berberist parties, to the effect that these could not achieve any electoral results in the first voting round; in the second, their supporters would be forced to vote for the FLN in order to prevent the FIS from winning.

In the summer of 1991, FIS protests against the electoral law escalated in confrontations with the security forces and the arrest of its leaders. Nevertheless, the party decided to participate in the elections, the first round of which was held in December of that year. Against the expectations of many, the Islamists succeeded in achieving over 47 per cent of the vote—and, by the effects of the district system, were already assured of 188 of the 430 seats in parliament. This meant that the FIS would almost certainly win an absolute majority in the second round. The FLN, with 23 per cent, and the FFS (about 7.5 per cent) were the only other parties that gained seats. The election result sent a shockwave through the government and secularist opposition camp.

Several factors explain the continuing predominance of the FIS on the Algerian political scene. To begin with, the large number of voters who did not turn up at the polls made it possible to win the elections with less than a quarter of the potential electorate. Also, the FIS was seen by many as the only real opposition capable of putting an end to the *ancien régime*. But more importantly the FIS provided a linkage between this rejectionism and a continuity of the nationalist heritage with reference to the Arabo-Islamic cultural paradigm. External factors like the Gulf War and the hostility towards the Islamists in the Western media revived the nationalist impact and provided the FIS with opportunities to discredit the secularist parties as well as the regime. The victory of the Islamists in spite of internal divisions, the imprisonment of its leadership at the time of the elections, and the failure of FIS local government, above all indicate the persistence of the Frontist logic.

In many respects, Algeria's first free parliamentary elections did not represent a competition between parties. This also pertained to the position of the former state party. Despite the clear failure of the FLN in the 1990 elections, no attempt was made to turn it into a competitive party—or rather, to provide the regime with an electoral vehicle to sustain its influence or at least stabilize the political system. Other countries combining a multiparty system with a strong presidential role—which was strengthened by the 1989 Constitution—have seen a transformation of the state party. In Egypt, President Sadat even broke up the Arab Socialist Union while simultaneously allowing the emergence of other parties. In the Algerian case, a division in three of the FLN would not have been illogical, since the organization is an amalgam of socialist Boumedienists, Islamic conservatives, and liberal reformers. However, the choice for a liberal presidential party was probably assumed by the leadership to alienate the Front's social base which was more attached to the Arabo-Islamic cultural reference. These considerations did not take the slightest account of the FLN's identification with all ills of the old order in the eyes of the population.

The role of the FFS in the electoral process was significant, but could not prevent bipolarization and its devastating effects. The party's secularist orientations contrasted with its ethnically defined electoral basis, forestalling a nationwide breakthrough. Also, relations between the FFS and other secularist and/or Berberist formations were far from good. This not only reflected historical differences, but also encompassed matters of policy. The FFS, for instance, had opposed the electoral system, did not accept government financial support, and vehemently opposed the cancellation of the second voting round. The collective rejection of the 1992 coup by the three fronts could point at certain similarities. But it also indicated the creation of interests with the process of political liberalization, and thereby the tentative beginning of a possible transformation of fronts into parties.

## Explosion of violence

Despite the imbalance of the political field caused by the Islamists' victory, both the President and the FLN were ready to negotiate with the FIS after the first round. This was the sign for the military to intervene. The coup was supported by most secularist parties outside the FFS, as well as important parts of the administrative apparatus. The army leaders quickly took the initiative and installed a Higher State Council (HSC) headed by war veteran Mohamed Boudiaf, who had broken with the Algerian leadership in 1963 and since then lived in Morocco. Dismantlement of the FIS and continuing economic liberalization were supposed to shape the necessary conditions for a resumption of the electoral process to which the state leadership adhered.

In many respects, these policies ended in failure. The assassination of Boudiaf, and the dubious circumstances surrouding this event, did not enhance the regime's credibility. The banning of the FIS and the imprisonment of its cadres left the road open to armed Islamist groups, members of which had fought in Afghanistan and had never been attached to the FIS electoral strategy. Radicalized FIS cadres followed their example, resulting in thousands of armed attacks against the security forces. Repression by the army reached unprecedented heights, but was incapable of quelling the Islamist wave of assaults. The Islamist armed groups, which were not unified, were also unable to beat the army militarily. The deadly stalemate, as well as accompanying personal, political and criminal settling of accounts, increasingly made civilians the target, resulting in the killing of (secularist) intellectuals, foreigners, political personalities, and (alleged) Islamist sympathizers.

In the absence of any political renewal, the military resorted to a game of alternating conservatives (culturally more Arabo-Islamic, combined with a more statist economic orientation) and liberals within the cabinet and the HSC. At the beginning of 1994, army commander Liamine Zeroual abolished the HSC and became President. After three years of fighting, a military victory of the Islamist guerrilla seemed unlikely, given the ability of the army to maintain its coherence, despite desertions. For the time being, the state leadership dominated by the military has even exploited some consequences of continuing low-intensity warfare. Although the Islamist groups possess a large reservoir of recruitment among the impoverished urban youth, the atmosphere of widespread fear discourages social mass action against the regime's economic policies. Also, Western fears for the Islamist threat have ensured the delivery of military equipment and has been conducive to agreements with the IMF and other financial institutions to alleviate Algeria's debt burden. Rescheduling of repayments has provided the economy with more breathing space.

The real problem, however, concerns political arrangements. In 1994 and 1995, a number of political parties dominated by the three fronts concluded a treaty in order to put an end to violence and to shape the conditions for the resumption of the political process. This Treaty of Rome was vehemently rejected by the government, which tried to counter the proposal by the promise of presidential elections. At the same time, President Zeroual engaged in talks with the imprisoned FIS leadership. The fact that every sign of negotiation was followed by new waves of violence indicates the limits for a durable agreement. Most Islamist armed groups are opposed to negotiating with the military regime and are willing to prevent any FIS leader from doing so. Comparable to the situation within the wartime FLN, the political leaders therefore have reasons to fear the Islamist military. At the same time, contestation of the regime's monopoly of violence became the only way to regain access to the political arena after the military coup made any electoral strategy seem futile. However, violence does not merely indicate a division between 'radicals' and 'moderates', nor could it be regarded as an instrument serving a political strategy, but in addition has acquired its proper finality.

There is, however, hardly any alternative to some sort of power-sharing between the main political forces. The coup resulted in the continuation of all factors that endangered the process of political liberalization (economic crisis, politization of religion, distrust of government, etc.), in addition to that of generalized political violence. Circumstances in this respect are even more difficult than at the beginning of 1992.

## CONCLUSION

The overall crisis of the Algerian nation-state represents more than the failure of an experiment with political liberalization. The question is rather in which respect the regime's attempt to achieve legitimacy on the basis of more open political competition really constituted a break with the mode of political rule based on the nationalist-populist formula. Both the emergence of Islamism as the main political force and the persistence of military power are signs of a continuation of reference to the revolutionary paradigm. Contradictory attempts to redefine this symbolic rent have produced antagonisms between authoritarian tendencies. The exacerbation of this conflict is obviously linked to the equally exhaustive hydrocarbon revenue, which for a long time served to compensate for the symbolic exhaustion of the regime. But sustaining the state's redistributive capacity has exacted the price of failing institutionalization of political conflict, which was inevitable given the effects of social transformation.

In many models of democracy, the existence of organized class interests is considered a necessary condition for the emergence of political actors with certain interests in the existing order; attempts to increase relative class power does not lead to a questioning of the legitimacy of the state as such, since a democratic system is believed to provide sufficient opportunity to pursue these interests. Access to the decision-making process thereby results from the importance of a class within the economy and the organizational expressions on the basis of this realization. In Europe, the development of capitalism has made the working class into the principal factor in the creation of democracy, since its implication has broadened the extent of inclusiveness to a majority of the population (Rueschemeyer *et al.* 1992). In Algeria, the uprooting of traditional society by colonialism, the war of liberation and post-colonial industrialization, was not followed by the institutionalization of new interests. The emergence of economically powerful social groups was largely hampered by reliance on external sources of revenue, while the political functions of revenue also enabled the state to prevent social demands from having political consequences. This implied that the state leadership was by no means forced to allow some degree of influence to those groups least likely to reject the regime's legitimacy as such, since they had a stake in the existing system. Instead, the failure of the externally oriented state legitimized attempts to emulate the conquest of the colonial state apparatus by the nation through an inter class, ideological-cultural movement.

It is questionable whether economic liberalization, which is theoretically irreconcilable with the state's monopolization of resources and redistribution without production, could lay the foundation of a system in which antagonisms lead to democratic compromise instead of violent conflict. As with the political opening, the economy is not 'liberated' from the political manipulation of rent, the volume of which is sustained by the addition of new forms of strategic rent following the perceived emergence of new enemies of Western civilization. In turn, this phenomenon also provides a new lease of life to ideas of modernization from above. It is however very doubtful whether access to foreign credits (and possibly increasing exports of natural gas) could in itself bring about a relaunch of the economy under conditions of widespread contestation of the, state's authority. Repression of the mere symptoms and expressions of this contestation does not deal with its causes. Rather, continuing authoritarian elitism prevents Islamist utopianism, as the dominant expression of authoritarian populism, from being demystified as the vehicle of a counter elite equally incapable of solving Algeria's ills through imposing public morals. For the short term, the question is whether a temporary coalition government including all main political forces could be established to delegitimize the use of violence. In the longer term, the credibility of any regime will ultimately depend on its success in steering a way out of the socio-economic crisis and bringing about structural improvements in the living conditions of society at large. The Algerian state will probably remain dependent upon external resources, but distribution could be democratized.

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# 12

# THE POST-COLONIAL STATE AND ECONOMIC AND POLITICAL REFORMS IN CAMEROON

*Piet Konings*

Until recently Cameroon was lauded by many observers, including World Bank staff, as one of the most prosperous and most stable countries in sub-Saharan Africa. Today, this rosy assessment has been replaced by gloom. The country is facing an unprecedented economic and political crisis. After some initial hesitation, the Cameroonian government could not escape during the deteriorating economic situation from calling upon the International Monetary Fund (IMF) and World Bank for the implementation of a Structural Adjustment Programme (SAP). It was soon required to conform to the new standards of these financial institutions, linking structural adjustment to democratization. So, in addition to the economic conditionality that plagued African states during much of the 1980s, it was also obliged to accept 'political conditionality'.

The IMF and World Bank are, in fact, the spearheads of the neoliberal project that has become the hegemonic ideological project of our time following the collapse of the socialist-oriented states in Eastern Europe. The major tenets of 'neoliberalism' are: (a) the belief that rolling the state back and liberalizing the economy will induce economic development, and (b) the belief that there is an intrinsic connection between capitalism and democracy. Democracy is thought to enhance the prospects for economic development, while economic liberalization is thought to enhance the prospects for democracy (Beckman 1993:20–33; Jeffries 1993:20–35; Mkandawire 1994:155–73). Recent World Bank reports signal a major shift in the Western donors' perspectives, from a preference for technocratic-authoritarian regimes to an endorsement of democratic government. Democracy is said to be capable of legitimizing the imperatives of adjustment. It can also improve governance and state capacity to implement the austere adjustment measures. These reports, however, stress that sustainable democracy cannot be achieved without the empowerment of civil society.

Like elsewhere in the world, the SAP imposed upon Cameroon by the IMF and the World Bank has involved the application of a standard package of measures to stabilize the domestic economy, to minimalize state intervention in the economy, and to give the market a freer hand in the allocation of resources. These measures include reduction of public expenditure, removal of public subsidies, dismantlement of public sector, privatization and promotion of private enterprise (both national and foreign), trade liberalization, producer price reforms, devaluation, restructuring of state institutions, and legal reforms aimed at supplying an enabling environment. It is beyond dispute that the SAP has yielded some results in Cameroon: the labour and investment codes have been liberalized, several price controls have been abolished, many import and export duties have been reduced, the commercialization of export crops has been liberalized by withdrawing the buying monopoly of the cooperatives, restricting the activities of the National Produce Marketing Board to quality control, and allying local to world market prices, and, of late, the Communauté Financière Africaine (CFA) franc has been drastically devalued. What is most striking in the Cameroonian situation, however, is that most of these results in economic liberalization have been accomplished only after initial government opposition.

There is, in fact, ample evidence to demonstrate that the Cameroonian government has constantly attempted to undermine the economic and political reforms advocated by the Western donors and international financial institutions. As a result, the process of economic liberalization has been slow and inconsistent. The necessary institutional reform in the public and parastatal sectors, for example, has been largely thwarted by government delaying tactics and half-hearted implementation. This is particularly grave as the reform of these sectors marked by excessive costs and inefficiencies has been a cornerstone of the SAP. Political liberalization has hardly gone beyond the introduction of a multi-party system and a larger measure of press freedom. The government's weak commitment and limited implementation has led to protracted conflicts with the Western donors and international financial institutions, sometimes followed by suspension of financial aid.

It will be argued in this chapter that the government's persistent opposition to the neoliberal economic and political reforms can be explained by the class character of the Cameroonian post-colonial state. In his seminal book on Cameroonian politics, Bayart (1979) has claimed that the first President of Cameroon, Ahmadou Ahidjo, was instrumental in creating a highly centralized, authoritarian and patrimonial state and in shaping a hegemonic alliance out of the various élite groups in society which were given access to state resources and rent-seeking activities so as to cement their loyalty to him. This hegemonic alliance has a vested interest in the status quo and is inclined to resist any economic and political liberalization measures which threaten its control over state resources and rent-seeking activities. Apparently, its resistance has been successful: none of the reforms implemented so far seems to have struck at the roots of the authoritarian and patrimonial state as yet.

It will be shown in this chapter that one of the reasons for this success has been the regime's proficiency in the game of token implementation of economic and political reforms. Another is its proven ability to play donors off against one another so that conditionality has remained largely illusory. This was facilitated by the fact that the major Western donors and international financial institutions have continuously displayed a rather ambivalent and inconsistent attitude towards the regime. While they have sometimes blamed and 'punished' the regime for its lack of implementation of economic and political reforms, they have nevertheless continued to side with the regime against the opposition and to provide it with financial aid, for mainly economic and political reasons. The IMF and World Bank have never accepted the opposition parties in Cameroon as equal discussion parties, as they feared that any recognition of the opposition might have a negative impact on its established cooperation with the ruling regime needed for the implementation of the SAP. Moreover, the opposition's initial boycott of the economy, its fragmentation and its apparent incapacity to present a clear alternative to the ruling regime contributed to their decision to negotiate with the ruling regime exclusively. Given its enormous economic interests in its previous Trusteeship territory, it is not surprising that France has been even less inclined than other Western donor countries to insist on the strict implementation of the neoliberal project.

## THE NATURE OF THE POST-COLONIAL STATE IN CAMEROON

From the very start, the Federal State of Cameroon which came into being in 1961 following the achievement of independence and reunification of the previous French and British trusteeship territories, faced enormous problems (Le Vine 1964, 1971; Johnson 1970; Bayart 1979). There was the problem of underdevelopment and dependency. The economy was largely dependent on the export of a few agricultural products—in order of value: cocoa, coffee, bananas and palm oil. The tiny industrial sector, dominated by French capital, was mainly involved in the transformation of agricultural produce for export (Hugon 1968). France's predominant role in the national economy was clearly indicated by import-export statistics. In 1961 it accounted for 59 per cent of Cameroonian exports and 55 per cent of its imports. Membership in the CFA Franc Zone tied Cameroon monetarily to France; moreover, while it had the advantage of promoting economic stability and allowing an open trade regime, it established a tendency towards overvaluation of the currency and encouraged the development of imported consumer tastes (Vallée 1989).

Through the various agreements of cooperation signed by France and Cameroon before independence, France remained in a position to influence Cameroon's domestic and foreign policy strongly.

There was also the problem of ethnic fragmentation and regional divisions exacerbated by a colonial history that had split the country into English-speaking and French-speaking groups. And, last but not least, a civil war was going on at the time of independence and reunification, particularly in the Bassa and Bamilike areas. This bloody and destructive battle was the direct consequence of the determined effort of the Cameroonian government and the French to suppress the radical nationalist party, the Union des Populations du Cameroun (UPC) (Joseph 1977).

The challenge of solving these problems devolved on Ahmadou Ahidjo, the first President of the federal state. He was a Muslim and a Fulbe, the dominant ethnic group in Northern Cameroon (Azarya 1978). Initially, he was considered by many to be a mere puppet of the French and an intermediary figure at most. Indeed, he owned his ascendancy to power to a large extent to the French and he enjoyed hardly any support in the southern part of the country which had been more subject to colonial capitalism, education and Christianity than the north (Bayart 1979). Soon, however, Ahidjo displayed an unexpected political craftmanship which enabled him to strengthen his originally weak position and eventually to construct a system of personal rule. Centralization, coalition-building and repression were his major strategies to concentrate political and economic power in his office and person (DeLancey 1989).

The first strategy, centralization, had numerous aspects. There was the concentration of administrative decision-making in the capital, Yaoundé, and the use of the Constitution to funnel authority to the President. There was the formation of a single party, the Cameroon National Union (CNU), which was completed in 1966 after a two-step process of forging a single party in the francophone area and then merging this with the remaining parties of the anglophone area. As Bayart (1979:163) has shown, the party was firmly subordinated to the state, an arm of the government and particularly of the President: 'it is the party that emanates from the person of Mr Ahidjo, not the other way round'. There was also the dissolution of the federation in 1972 to form a unitary system of government. Centralization was enhanced by the elimination of autonomous forms of organization. Previously independent organizations became subordinated to the political party through the party's women's, youth and labour wings or through domination by or incorporation into government agencies (as had occurred with the anglophone cooperative movement). Related to this were policies to destroy any limited autonomy enjoyed either by local governments (more a reality in anglophone Cameroon) or by traditional governments.

The second strategy was coalition-building. In his study of the Cameroonian post-colonial state, Bayart (1979) highlights Ahidjo's pursuit of building a 'hegemonic alliance' out of different élite groups on the national and regional levels. This hegemonic alliance comprised not only of politicians, bureaucrats and businessmen but equally the traditional élite, the chiefs. From this heterogeneous coalition, a new dominant class was slowly emerging around the state. Ngayap (1983) asserted that the ruling class in Cameroon consisted of approximately 1,000 people. But if Bayart's contention that the traditional élite has also been co-opted into this alliance is valid, I would submit that this number is rather conservative. This hegemonic alliance was pulled together by several means, including the development of an extensive patron-client system. Clients were supposed to owe total allegiance to Ahidjo. Attempts by any of them to build a power base of their own was construed as betrayal that sanctioned removal from office. Ahidjo selected his clients on the basis of ethnic arithmetic or ethnic balancing. He was conscious that representation in the cabinet, national assembly, and so on, would reflect the various ethnic groups in society. As a matter of fact, the government's hand-picked élite or *barons* served as transmission belts between the President and the different ethnic groups. Thus every important ethnic group felt represented within the regime and thus able to exercise some influence on government policy (Jua 1991:162–70; van de Walle 1990).

Loyal followers in the ethno-client network were rewarded by appointments and nominations to state offices, access to state resources, and rentseeking opportunities. Beyond the numerous appointments Ahidjo could make to the cabinet and elsewhere in the system, he had a variety of other techniques to allow individuals to profit, even though they might not receive a lucrative appointment. For some associates of the President there were special loans from the banks, loans without interest or any expectation of repayment. Overall, the existence of smuggling and corruption provided a major avenue for the President to allow supporters to receive rewards. Special efforts were also made to appease and maintain support among the civil servants or bureaucrats. They received excellent pay compared to the average income of the Cameroonian citizens, as well as numerous perks such as free housing. Despite these advantages, they were allowed to convert their posts into monopoly rent-seeking opportunities. They considered the state to be a resource base, from where they could explore various pathways of capital accumulation (Geschiere and Konings 1993). The expansion of the state, particularly into the economic arena, was promoted to manipulate and sustain the alliance. It would be wrong to argue that rentseeking and patronage were the only reasons the state promoted state expansion after independence. Extensive public ownership conformed to prevailing development doctrines, was warmly supported by the donors, and responded to real development needs. Still, the scope that state ownership was to achieve (by 1988, the state had more than 150 parastatals in its portfolio) was helped by the fact that it afforded leaders like Ahidjo positions of prestige and power to distribute. In the context of the patrimonial state, these parastatals were converted into prebends for Directors-General or to serve other exclusive interests of the hegemonic class (Joseph 1978). Given this penchant of the parastatals to promote political rather than economic goals, it is not astonishing at all that, for the most part, they performed inefficiently. Their dependence upon the state for subsidies became a permanent rather than transient feature. This furthered ischaemia at the state treasury; by 1988, annual parastatal subsidies amounted to about FCFA 150 billion (van de Walle 1990; Konings 1993).

While Ahidjo constantly emphasized the need for ethnic balance and national unity, there is nevertheless sufficient evidence that two ethnic élite groups enjoyed a privileged position in opportunities for capital accumulation. These were, first of all, the Muslim Fulbe élite, especially those originating from Garoua, the home town of Ahidjo, the so-called 'Garoua barons'. And second, the Bamilike élite, renowned in Cameroon for their 'spirit of capitalism' (Warnier 1993). The Bamilike territory was until about 1970 one of the most important areas of UPC resistance against the regime. It is widely believed in Cameroon that Ahidjo was ready to grant the Bamilike élite ample room for capital accumulation, on condition that they would not meddle in politics. Ultimately, in spite of the variety of incentives for cooperation and agreement used by Ahidjo, the stability of the regime was based on the widespread use of repression and the suppression of human rights.

Ahidjo did not only succeed in gradually and imperceptively stabilizing his regime, he was even able to achieve a certain degree of autonomy from the French. Over the years, Ahidjo has developed relations with trading partners other than France. In 1985, France accounted for only 35 per cent of Cameroonian exports and 44 per cent of its imports. The regime's apparent political stability, its lack of ideological posturing and its liberal investment code appealed to the Western donors and business milieux. With an annual growth rate of some 8 per cent from 1970 to 1985, the Cameroonian economy was long considered one of the success stories in sub-Saharan Africa. While not without foundation, this view of the country's economy has proved to be excessively optimistic as it failed to take note of several disturbing trends by the end of Ahidjo's tenure. Much of the country's success was based on its rich resource base, yet the agricultural sector was stagnating: the growth registered was due mostly to increased acreage under cultivation brought about by expensive government and donor programmes, and it disguised the absence of sustained productivity growth. Moreover, infrastructural problems were daunting. The most disturbing trend, however, was the rapid growth of a costly and ineffectual public sector, though quite understandable from political efficiency considerations. Cameroon's seemingly impressive growth rate until 1986 was inflated by the discovery of oil in 1977. Strikingly, oil output and oil revenues have remained a state secret under Ahidjo's administration. Apparently, the bulk of oil revenues has been placed in foreign banks as extra-budgetary accounts. The official justification given by Ahidjo for this strategy was the elimination of the boom mentality that had crippled agricultural production in other African countries following the discovery of oil. Nevertheless, in conformity with the regime's patrimonial logic, the primary function of these extra-budgetary accounts soon became to cover parastatal deficits (van de Walle 1990; Jua 1991:162–70).

Ahidjo stunned the Cameroonian population on 4 November 1982 by announcing that he was resigning as President of the country and turning his office over to his constitutionally designated successor, the Prime Minister, Paul Biya; the transfer to take effect on 6 November 1982. Unlike Ahidjo, Biya was a Christian from the southern part of francophone Cameroon. He belonged to an ethnic group which is loosely classified as Beti. Although there were promising signs of change at the start of the Biya regime, it soon turned out that in all essential respects Ahidjo's system was continued under Biya's leadership. Soon after his assumption of power, Biya promised a New Deal. He spoke of a certain liberalization of the political system, an internal democratization of the single party, and the need of 'rigour, integrity and moralization', thus challenging the autocratic and patrimonial state (Takougang 1993:91–101). At first, many Cameroonians were sceptical. Biya was a product of his predecessor, Ahmadou Ahidjo, and owed his political fortunes to him. Moreover, although Ahidjo had resigned as the Head of State, he still retained the powerful office of chairman of the only party in the country, the CNU. Despite the initial scepticism, Biya's many speeches following his accession to power helped to convince many Cameroonians that he was serious about instituting change. This conviction was strengthened by a certain relaxation of police state controls in 1983.

Whether the concept of New Deal was simple a public relations ploy to extricate himself from Ahidjo's shadow, as some now argue, or whether it was a genuine attempt to forge a new direction for the country, the implementation of economic and political reforms would be extremely difficult within the existing political system. Ahidjo had spent more than two decades as Head of State and, during that tenure, had filled most of the top party and government positions with loyalists or people who believed in his political philosophy. Many in the government and the business community, especially the Muslim Fulbe, were not only unwilling to accept the fact that Ahidjo had handed over power to a southern Christian, but also perceived Biya's call for rigour, integrity and moralization as an effort to deprive them of the rights and privileges they had long enjoyed under Ahidjo's administration. Adding to the difficult situation Biya faced, was the fact that the former President continued to play a highly visible role in national politics until 1983–4, when he was accused of being involved in an assassination attempt on Biya (Bandolo 1985).

Therefore, in order to implement his New Deal programme, Biya had to replace these men with people who were loyal to him and committed to reform. However, it soon became apparent that he was either unwilling or simply lacked the resolute, tough and uncompromising leadership of his predecessor to do so. For one thing, any immediate wholesale replacement of experienced, albeit reactionary officials in the upper echelon of the government might have seriously impeded the smooth running of the administration. Moreover, many of the men in these positions were colleagues with whom Biya had served in government and who, like him, owed their political fortunes to Ahidjo. Consequently, even though some of them did not believe in his New Deal, he did not immediately replace them. Certain well-known 'barons' of Ahidjo were forced to resign, but within a few years they were back in prominent positions again, often as heads of parastatals. After an attempted *coup d'état* by the Republican Guard, which was still mainly composed of Ahidjo loyalists, on 6 April 1984, the police state was reimposed in full, with censorship, secretive government and a powerful secret police.

Given that his hold on power had become even more precarious after this failed *coup d'état,* Biya was compelled to raise the costs of maintaining the loose ruling alliance. He needed to please the state apparatus, notably those parts of the army which had supported him during the *coup d'état* attempt, and he wanted to meet the heightened expectations of his fellow Beti. A direct consequence was the acceleration of budgetary and state employment growth. The Beti élite saw the transfer of power from Ahidjo to Biya simply as an opportunity to, in Bayart's words (1989), promote ethnofascism. By implication, therefore, the fact that the President hailed from a specific ethnic group, should automatically give his ethnic fellowmen the right to monopolize power. Encountering great difficulties in consolidating his power, Biya started to give in to these ethnic pressures and to co-opt the Beti élite in the ruling alliance. The northern and Bamilike businessmen who had enjoyed a privileged position during Ahidjo's administration were increasingly replaced by Beti businessmen, the so-called Beti Mafia. Out of protest against their discrimination, Bamilike businessmen withdrew their savings from the banks and transferred them to informal saving circuits called *tontines* (Henry *et al.* 1991). This contributed to the growing liquidity problems of the banks. The Biya regime increased the number of civil servants from about 80,000 in 1982 to about 180,000 in 1988; the majority of the new employees being recruited among the Beti. The Beti also increasingly monopolized the pivotal positions in the government and security organs. Takougang (1993:95–6) reports that as of August 1991, thirty-seven of the forty-seven senior prefects (heads of administrative divisions), three-quarters of the directors and general managers of the parastatal corporations in the country, and twenty-two of the thirty-eight high-ranking bureaucrats who had been appointed in the newly created office of the Prime Minister, were from the President's ethnic group. The new regime's barons appeared to be much bolder in staking out claims on the state's resources than Ahidjo's supporters had been. Corruption and rent-seeking had always been fundamental characteristics of the regime (Joseph 1978; Médard 1977); after 1984 they increased to the point of becoming dysfunctional. When this political conjuncture was combined with a severe exogenous economic shock, the system started to crumble.

## THE POST-COLONIAL STATE AND STRUCTURAL ADJUSTMENT

From the mid-1980s the post-colonial state was confronted with a severe economic crisis (Körner 1988:77–94; van de Walle 1990). This crisis posed a severe threat to the economic base of the patrimonial state as well as to the system of prerogatives and privilege of the hegemonic alliance. A sharp downfall in commodity prices and the slide in the value of the American dollar against the CFA franc resulted in a 70 per cent deterioration in the country's terms of trade during the period 1986–93. The state's oil revenues, for example, decreased from US$350 million in 1985 to US$207 in 1988. The crisis was aggravated by massive capital flight estimated at FCFA150 billion a year which was almost a quarter of the annual national budget. The free flow of currency between the CFA Franc Zone and France encouraged the Cameroonian élite to transfer their capital to French banks which, moreover, supplied higher interest rates than the Cameroonian banks. As a result of the crisis, several government projects proposed or started in the boom days of the New Deal were either suspended or abandoned because of severe financial constraints. The deteriorating economic situation also forced many foreign companies that had invested in Cameroon to leave the country, further exacerbating the employment situation. The regime also experienced great difficulties in paying cash-crop farmers. Cocoa and coffee farmers responded by switching from cash-crop production to food-crop production.

The government's initial response to the trade shock of the mid-1980s was to rely on external financing in the hope of favourable commodity prices or exchange rate changes. As a result, external debt rose from US$2.7 billion in 1984 to US$4.7 billion in 1989. The IMF and the World Bank had been negotiating with the government on and off since mid-1986, without reaching agreement. At this time, Biya staked the national prestige on refusing the tough austerity programmes of those two institutions. Through 1986 and 1987, he insisted that Cameroon would undertake an adjustment of its own, and seek only non-conditional capital from bilateral donors and the private banks. He announced a cut of several hundred billion CFA in the 1987 fiscal year budget, a hiring freeze, new taxes on luxury goods and, in late 1987, the creation of a new anti-crisis ministry, the Ministry for the Stabilization of Public Funds.

Notwithstanding Biya's tough rhetoric, the crisis continued to worsen, with expenditure overruns of FCFA450 billion in 1986–7 (out of a total budget of FCFA800 billion) and of FCFA150 billion in the next fiscal year. Recourse to the international institutions became inevitable. Agreement was reached with the IMF on a stabilization plan in September 1988 and with the World Bank on a structural adjustment loan in May 1989. The World Bank and IMF adjustment strategies have contained the conventional prescriptions of important cuts in public expenditures, increased state revenues and the compression of consumption, coupled with the promotion of selective investments to foster long-term growth. They have called for the privatization, rehabilitation or elimination of almost all of the nation's parastatals, as well as thoroughgoing liberalization (van de Walle 1990).

Given the nature of the Cameroonian post-colonial state and the vested interests of the state élites in the status quo, it is not surprising that the Biya regime's implementation of the adjustment policies tended to be half-hearted and erratic. As van de Walle (1990:54) perceptively observes, 'it has attempted to cut off some fat, to excise some of its patrimonial tendencies while maintaining its core logic'. It had little choice but to cut public expenditures, since state coffers were empty, but personnel expenditures were initially left untouched. To take one example, only 5 per cent of the Ministry of Agriculture's total budget of FCFA39 billion was set aside in the 1988–9 budget for non-personnel related expenditures. The absurdity of this approach from a developmental point of view is well compensated by the political logic of placating the administration. Despite his constant exhortations against corruption, Biya continued to distribute rents so as to regulate and dominate the different factions of the hegemonic alliance. He also attempted to delay the reform of the costly and inefficient public and parastatal sector, which was a cornerstone of the World Bank's adjustment programme. In May 1987, he appeared to side with the World Bank when he appointed a National Commission to review the performance of the parastatal sector (Tedga 1990), but, subsequently, he took no action on the Commission's report. It was only under constant pressure from the World Bank that he started to restructure the parastatal sector. In the end, five parastatals were privatized, forty-four were liquidated, and the remaining 104 were required to sign 'performance contracts' with the government in 1989–90 which aimed at their self-sufficiency and eventual profitability. These performance contracts often gave rise to severe cuts in workers' wages and fringe benefits as well as mass lay-offs (Konings 1993).

Cameroon's IMF standby agreement programmes, signed in September 1988 and December 1991, expired without having fully disbursed authorized funds and without a follow-on programme in place, due to the Biya government's failure to comply with programme conditionality. In September 1992, IMF programming, World Bank project assistance, and Paris Club debt relief was suspended because of accumulating debt arrears. It was its continuing friendly ties with France that saved the regime from the disastrous consequences of falling into the status of non-accrual, which would have destroyed the country's financial credibility throughout the world: France was ready to pay Cameroon's accumulated debt arrears with the World Bank, amounting to FCFA60 billion. The important role of France in Cameroon's structural adjustment programme is manifest in its financial aid to Cameroon during the period 1990–2: this totalled FCFA181 billion, representing 36 per cent of all aid.

For a long time, the Biya regime strongly refused to give in to the World Bank's demand of laying off about 40,000 civil servants and state agents, the more so as most of them were Beti. It was, however, ready to reduce personnel costs. In 1991 it announced further cuts in the salaries and benefits of government employees. For instance, there was a 50 per cent cut in out-of-station and other allowances that civil servants could receive and a 7 per cent pay cut for most government workers. It also eliminated free housing, except to very high-ranking government officials such as ministers, directors and secretary-generals. The government, however, experienced increasing difficulties in paying its civil servants. Rather than laying off a certain proportion of the 'overdeveloped' civil service, it decided to implement two draconian salary reductions of respectively 30 per cent in January 1993 and 50 per cent in November 1993. Remarkably, in October 1993 France agreed to allocate a loan of FCFA15 billion to Cameroon to help the government in coming to terms with the salary arrears owed to civil servants.

France and Cameroon used to resist any pressures of the IMF and the World Bank to agree upon a devaluation of the currency in the CFA Franc Zone. In January 1994, however, they consented to a 50 per cent devaluation of the CFA franc. In return, the IMF ratified a standby credit of US$114 million to Cameroon on 15 May 1994 so as to support the government's economic policies for the next eighteen months. The disbursement of this loan was made conditional upon the government's termination of the contracts of 20,000 civil servants. The devaluation seems to have had a positive effect on the production and exports of cash crops, especially cocoa, coffee, and cotton (Pelzer 1994:205–15).

In 1990 van de Walle concluded as follows about the politics of structural adjustment in Cameroon:

> The inconsistent pace of reforms, its recurring breakdowns and betrayals suggest Biya is manoeuvering to placate the country's creditors while gingerly testing the political limits of the reform process. Ambiguity is an asset for Biya, as it keeps potential foyers of opposition off guard while cuts are made surreptitiously. Donor pressure and threats can be used to maintain pressure on recalcitrant allies. Still, Machiavellian machinations explain only a part of the reform's uneven

> progress. Some of the manoeuvering may be little more than delaying tactics: time may after all solve some of the problems while a rebound in world commodity prices could defer the crisis at least temporarily.
> (van de Walle 1990:70–1)

This conclusion seems still to be largely valid in 1994. In its political manoeuvring and delaying tactics the Biya regime has continued to be supported by France. One of the reasons for France's persistent support seems to be the concentration of organized opposition in Cameroon around a 'hard' anglophone core. Another reason seems to be the strong belief in French government circles that the shadow of Washington is behind the IMF, the World Bank and the Cameroonian opposition.

## THE POST-COLONIAL STATE AND DEMOCRATIZATION

By 1990 one could observe widespread popular discontent within the Cameroonian urban areas with the regime in power and growing dissent within the hegemonic alliance. Various internal and external factors are responsible for this situation. The majority of the population held the corrupt, authoritarian regime responsible for the serious economic crisis, resulting in its loss of legitimacy. Moreover, straight after his ascendancy to power, Biya had started to project himself as an advocate of greater political freedom and democratic reforms. He, however, believed that both should occur, at least in the short term, under the auspices of the single party which had been rebaptized Cameroon People's Democratic Movement (CPDM) in 1985. In other words, the party was supposed to define the extent to which freedom and democracy were going to be allowed in the country. Nevertheless, his limited political reforms encouraged the people, waking up after years of submission, to demand more political freedom and democracy than the Biya regime was willing to grant. The traditional propaganda, equating a single party with peace and harmony and a plural system with strife and discord, fell on increasingly deaf ears. In addition, with the end of the Cold War and the move towards democratization in Eastern Europe, Cameroonians, like Africans elsewhere on the continent, looked upon these changes as an added incentive to demand greater political reforms, including the introduction of multiparty democracy. Some of the élite, particularly those who had become dissatisfied with the regime because of its promotion of Beti domination, began to give expression to general discontent and even tried to organize the urban masses into political parties. They were joined by some members of the middle class who had become increasingly critical of the authoritarian and patrimonial state, such as members of the Cameroon Bar Association, intellectuals and journalists. Their critical attacks and organizational efforts, however, met first severe repression on the part of the state which wanted to keep the democratization process under control.

On 19 February 1990, ten prominent Cameroonians in Douala were arrested and charged with organizing secret meetings with the aim of undermining state authority and forming an alternative party. The leader of the group, Yondo Black, a renowned lawyer, received a three-year sentence from a military tribunal. Before and after his condemnation there were massive protest demonstrations. Following this event, the call for democracy and multipartyism became louder and louder. In reply, the government staged anti-democratization marches throughout the national territory in which participants shouted slogans like ‘No to Precipitate Democratization’. On 9 April 1990, Biya said calls for a multiparty system were manoeuvres for diversion, intoxication and destabilization. In Bamenda, the capital of the North West Province in anglophone Cameroon, a new party, the so-called Social Democratic Front (SDF), had been founded by then and, according to its leader John Fru Ndi, had given details of its formation to the authorities on 16 March 1990. When no reply was received, the SDF organized a huge rally at Bamenda on 26 May 1990, at which police opened fire, killing six people.

During the following weeks there was a remarkable change in President Biya’s attitude towards the growing demand for multipartyism. In a nationwide address in early June 1990, he claimed that Cameroonians had nothing to learn from abroad with regard to democracy. He himself had initiated perestroika and glasnost in his country long before Gorbachev did in the Soviet Union. However, during the CPDM Congress that took place at Yaoundé a few weeks later, he surrendered to the multiparty system demand. On that occasion, he declared that the party must be ready to face competition and added: ‘Consider also that other schools of thought exist which must be taken into account, fought against or integrated’ (Derrick 1992:172).

What happened in those weeks? Even though that was the very time that Cameroonians were absorbed in the good showing of their national soccer team during the World Cup competition in Italy, and seemed to think of nothing but football, in fact decisive pressure was brought to bear during these weeks. There was the pastoral letter from the Catholic bishops at Whitsun, which attributed the economic and political crisis mainly to the egoism, corruption and authoritarianism of the state élites, and called for an end to single-party rule. There was the resignation of John Ngu Foncha, the former Prime Minister of anglophone Cameroon who had led it into the federation in 1961, as an honorary Vice-Chairman of the CPDM. Foncha condemned the shooting and expressed the demand being made by anglophone Cameroonians for a return to a federal system. There was the pressure from the IMF and World Bank as well as from other international aid organizations. Financial assistance and loans were suspended, leaving the Cameroonian government with hardly any alternative but to open up grudgingly to the opposition. There was also pressure from France, which a regime so close to France for thirty years could not ignore. At the Sixteenth Summit of France and African States, held on 20–21 June 1990 at La Baule in France, the declaration agreed on by those attending, including Biya, spoke of 'the need to associate the relevant population more closely with the construction of their political, social and economic future'. François Mitterrand, speaking for himself, went further and said French aid would be 'less enthusiastic to regimes which behave in an authoritarian fashion and fail to accept the move towards democracy' (Derrick 1992:172).

After the surrender in principle, months passed before a new law was passed by the National Assembly on 5 December 1990, formally allowing creation of several parties on certain conditions. But, in the meantime, there was relaxation in many other ways. Many demonstrations and meetings were held in the Cameroonian cities. They expressed the new-found freedom and pent-up feelings about decades without freedom. Similarly, a free press blossomed, until after a few months, there were about sixty newspapers in circulation, including about fifteen dailies. The government did not take all this unrestrained freedom and met it with repression, but fitful repression that failed to check it. So as soon as new parties were formed, hundreds of thousands of people were waiting to rush to join them.

In the first months of 1991 new parties received their registration. The major new parties were:

- **The Social Democratic Front (SDF).** This was originally largely an anglophone party, but it was capable of gradually extending its membership to the francophone area, notably to the neighbouring francophone provinces. For example it enjoyed great support among the Bamilike in the West Province, an ethnic group that was closely related to the people in the Bamenda area, the craddle of the SDF. The party's Chairman was John Fru Ndi, a librarian by profession, who had failed to win a seat in the National Assembly on a CPDM ticket during the 1988 elections. He soon achieved an immense popularity among the urban masses because of his great courage and populist style of leadership.
- **The Union des Populations du Cameroun (UPC).** This radical pre-independence party which had been suppressed by the French and Ahidjo government, was refounded and was capable of rewinning strong support in its original areas of operation, Douala, the economic capital, and the Bamilike-Bassa regions. Its leadership consisted partly of ex-CPDM leaders and partly of old UPC leaders who had returned from exile. The party was soon marked by internal divisions based on personal, ideological and ethnic considerations.
- **The Union Nationale pour la Démocratie et le Progrès (UNDP).** This party enjoyed most support among the Fulbe of Northern Cameroon, Ahidjo's ethnic group. Its leadership had held prominent positions in

the party and the government during the Ahidjo period and early Biya period. It claimed the Ahidjo heritage.

These three parties were the main contenders with the CPDM by mid-1990. Many other parties were authorized, making a total of no less than forty-eight (with about twenty others operating but not legally registered) by early 1992. The legalization of many small parties was suspected in Cameroon to be intended to split the opposition to the government party. Strikingly, none of the parties had worked out a well-defined programme, except maybe the SDF Most of them did not go beyond generally calling for better social justice, cleaning up of public life, an end to secretive government, and measures to restore the economic situation. In this respect, it is worthwhile to mention that nearly all of them supported the implementation of the SAP in Cameroon. Apparently, their main concern was to devise strategies for the seizure of power from the ruling CPDM government. Like the ruling party, they usually tried to recruit their members through the creation of an ethno-client network (Schilder 1993:115–22). Of course, the charisma of the leadership, too, tended to be an important asset in the expansion of their membership.

The formation of the new parties was accompanied by a rise in popular protest in the cities. The growing number of unemployed, taxi-drivers, students and other social groups took to the streets to air their own specific grievances and their general discontent with the regime in power. Contrary to many other African countries, the trade unions refused to join and lead this popular protest as they were still state-controlled. There were several bloody clashes between the demonstrators and the forces of law and order which led to several people being killed in April 1991. By April 1991, party leaders and their followers were uniting around the claim for a national conference. This claim was inspired by the national conferences that had previously been organized in Benin and Congo during the transition to new multiparty regimes. Such conferences aimed at bringing together political, religious, business, trade union and other leaders in society, and assuming power to decide radical constitutional and other changes. In Benin the conference assumed sovereign power and ordered implementation of the changes decided, and this was what the opposition wanted in Cameroon. It wanted to force the authoritarian state to accept possibly radical constitutional changes and to expose misgovernment and corruption without fear. Such ideas, which were a challenge to the authoritarian, patrimonial state, enjoyed massive popular support.

Unsurprisingly, the Biya regime strongly opposed the organization of such a conference which was most likely to be transformed into a national tribunal. In a broadcast on 11 April 1991 Biya said that Cameroon did not need a national conference because ‘democracy is already a reality’. His refusal to consider a national conference gave rise to a long period of confrontation between the regime and the opposition. This confrontation was launched by a demonstration demanding a national conference at Bamenda on 11 May 1991, and the start of mass civil disobedience on 13 May 1991; there was also a general strike on 16–17 May 1991, widely followed in the western and northern provinces. From 24 June 1991 the most intense phase began, with the opposition's extension of civil disobedience to become a total shutdown in the cities, the so-called 'ghost town' campaign. This campaign involved the stoppage of all work, all trade, all traffic in the cities, except for Friday evenings and Saturdays, resulting in huge personal and public financial losses and an aggravation of the economic crisis. The government responded by not giving in.

For various reasons this ghost town campaign was not successful. It was not backed in the Beti region which remained loyal to Biya. This brought about a dangerous polarization on ethnic lines (the Beti versus the rest) which nearly led to a civil war. The state apparatus might have broken down if Biya had not had that solid regional backing. In the event it never broke down altogether. The government kept control over the forces of law and order and used them regularly to clamp down on the opposition.

The IMF and World Bank had regularly expressed their disapproval of the ghost town campaign. Greatly concerned about the adverse effect of this campaign on the national economy and SAP, they had regularly appealed to the government and opposition to arrive at a negotiated settlement. Both sides, however, ignored these appeals until October 1991 when it became evident that the ghost town campaign and, above all, the strength of the sympathetic population had exhausted themselves. Moreover, by that time there were tense conflicts among the opposition leaders about future strategy.

The offer of talks by Biya on 11 October 1991 was accepted by the opposition parties and the ghost town campaign petered out. A tripartite conference held at Yaoundé from 30 October to 17 November 1991, attended by government and opposition representatives and other prominent personalities who mediated and advised, led to agreements on 17 November 1991 which confirmed the government victory under a polite disguise. It was agreed that elections for a new National Assembly would soon be held and that, in the meantime, all protest campaigns would be called off. Some opposition parties even dropped the national conference idea. This, and the failure to arrive at a programme for change, were the main reasons why other opposition parties, like the SDF, declined to sign the agreements.

Among those satisfied with the agreements were the IMF and World Bank as well as the government of France. Biya attended a francophone state summit in Paris soon afterwards and was said to have had a good reception and approval from Mitterrand. Although some of Mitterrand's Africa policy-makers seemed to have favoured a national conference in

Cameroon, a delegation of Cameroonian opposition leaders had failed to win support in Paris in late August 1991.

Of the major opposition parties, the SDF decided to boycott the National Assembly elections which were held on 1 March 1992. Its Chairman, John Fru Ndi, said that the new election code, which was promulgated on 16 December 1991, was bad and that there was no guarantee of just and fair elections. Moreover, the election date was too early as most parties had not had sufficient time to organize and to prepare themselves for the coming elections. The government could afford to remain unmoved by such criticisms backed up by no more than the threat of a negative and self-defeating boycott. In the event, the elections distributed the 180 National Assembly seats among four parties only: the CPDM won 80, the UNDP 68, the UPC 18 and the Mouvement Démocratique de la République (MDR) 6.

The MDR was a party not considered important before the elections. It was headed by Dakole Daïssala, former Chairman of the city bus corporation Société des Transports Urbains en Commun du Cameroun (SOTUC), arrested as a northerner after the April 1984 *coup d'état* and held for six years without trial. He is one of the Kirdi, the ethnic minority groups in the north which were historically subordinate to the Fulbe and remained pagan or became Christian rather than Muslim (Motaze 1990). Most of the Kirdi declined to join the Fulbe-dominated UNDP and, during the elections, tended to cast their votes in favour of either the CPDM or the MDR.

For a party which had the full support of the government and its local officials, and which was the only party to field candidates in all forty-nine constituencies, the CPDM's showing was not too impressive. Eventually, it was three seats short of a majority in the Assembly, but after several weeks of discussion it agreed on a coalition with the MDR. This first coalition-government in Cameroon was headed by an Anglophone from the North West Province, Simon Achidu Achu. A former Minister of Justice under Ahidjo, he is the first anglophone Cameroonian to be Prime Minister of Cameroon. Biya indeed owes them many thanks, for their following the SDF call to boycott the polls ensured the CPDM's victory.

Soon afterwards, Biya announced that presidential elections were to be held on 11 October 1992 and that he would stand again as the government candidate during these elections. During the subsequent negotiations, the opposition parties failed to unite on the selection of one common candidate. A mixture of personal and ethnic animosities impeded any agreement. Eventually, approximately thirty opposition parties decided to support the SDF candidate, John Fru Ndi. After the elections which were marked by massive fraud, Biya was declared to be the victor. He was said to have won 39.9 per cent of the votes cast, 4 per cent more than John Fru Ndi. This was far short of the almost 100 per cent he had received in each of the two previous elections in 1984 and 1988 respectively, when he was the only candidate running for the post. He only won in the South, Centre and East Provinces (partly coinciding with the Beti area), but woefully lost in the other provinces.

After the elections, there were violent protests in Bamenda and the entire North West Province against 'Biya's theft of John Fru Ndi's victory'. Biya then imposed a state of emergency on this province for three months and John Fru Ndi was kept under military surveillance in his house at Bamenda. Many political activists, journalists and students, particular Anglophones and Bamilike, were arrested and tortured. The United States, Germany and the European Common Market had denounced the fraudulent elections and the state of emergency in the North West Province and threatened to abandon their aid programmes to Cameroon until 'there was a clear advancement in the democratic process'. Particularly the United States has often expressed its disapproval of Biya's authoritarian regime and has openly supported John Fru Ndi. The critical attitude of the United States towards the regime encouraged France to display its support for Biya, who appeared to be more likely to safeguard French interests in Cameroon than the Anglophone, John Fru Ndi.

Biya's victory was a pyrrhic one. Still desperately seeking for legitimacy, because of his rejection by over 60 per cent of the population, and with the economy in complete shambles and the civil service in a state of general apathy, the President was more isolated than ever. To broaden his base of support, Biya formed a government of national unity after the elections. Some individual members of the UNDP and the moderate faction of the UPC accepted ministerial posts. The SDF, on the contrary, refused to collaborate with a government of national unity.

It would appear as if the democratization process in Cameroon has stagnated. The power of the President is still relatively unlimited; the separation between the state and CPDM party is still insufficient; censorship of the press, violation of human rights and military excesses are still commonplace.

## CONCLUSION

This study has tried to demonstrate that the neoliberal project, which has been propagated by the Western donors and international financial institutions and largely supported by opposition parties, has not yet made much progress in Cameroon. This is not altogether surprising. Given the class character of the Cameroonian post-colonial state, the slow and inconsistent pace of economic liberalization was to be expected. The patrimonial logic on which the post-colonial state is built forms a clear obstacle to the institutional changes needed to carry through a transformation to market-oriented and private sector-led growth.

The rather limited political reforms introduced by the Biya regime in 1990, especially the legalization of multipartyism, seem not to have stimulated economic liberalization but rather to have further eroded the authoritarian and patrimonial state's capacity and willingness to undertake economic reforms. The Biya regime rightly feared that the implementation of economic reforms, such as the dismantlement and privatization of the costly and inefficient parastatal sector and the reduction of the public service, would fuel popular discontent and augment the membership of the opposition parties. Moreover, it was obliged to proceed with the supply of privileges, in the form of rent-seeking opportunities, so as to maintain the hegemonic alliance and to stave off opposition. In addition, the regime's loss of legitimacy and the increasing political instability encouraged capital flight and deterred foreign and national private investments.

The Biya regime appears to have been quite successful in resisting the internal and external pressures to speed up the process of economic and political liberalization. As a result, the post-colonial state remains very much as it always has been. Several reasons have been given in this chapter to explain the paradox of the evident lack of commitment to economic and political reform and the remarkable survival of the authoritarian, patrimonial state during the present economic and political crisis. First, the Biya regime has continued to control the (shrinking) state resources, which enables it to buy the loyalty of the state élites and to co-opt some of the opposition leaders into the hegemonic alliance. It also continues to control the forces of law and order, which enables it to intimidate and oppress the opposition. Moreover, it continues to monopolize some pivotal mass communication media like the television, which enables it to preclude the opposition parties from presenting their leaders and programmes to the public. Second, the Biya regime has continued to enjoy the firm support of the Beti élite who feared that their privileged access to state resources would come to an end with the opposition parties' seizure of power. Third, the opposition parties seem hardly to differ from the ruling party, using similar ethno-client networks for the expansion of their power base. And, above all, their leadership is divided by personal and ethnic animosities.

And finally, the Biya regime has exploited to the full the ambivalent and inconsistent role of the Western donors and international financial institutions in the execution of the neoliberal project. The IMF and World Bank depend upon the ruling regime's continuous cooperation for the successful implementation of the SAP to such an extent that they tend to confine themselves to quiet diplomacy, except in cases of extreme violations of human rights. Conversely, they decline to negotiate with the opposition. They have even expressed their strong disapproval of certain oppositional actions, such as the 'ghost town' campaign in 1991, which they perceived as a further onslaught on the already shattered national economy and an obstruction of the SAP. Undoubtedly, in its struggle for survival, the Biya regime owes a particular debt to France. France has tried to safeguard its economic interests in Cameroon by regularly assisting the Biya regime in overcoming any internal and external oppositional action. In January 1992, it did not even hesitate to supply, the Biya regime with arms for the maintenance of public order.

Of late, however, there are some indications that the Western donors and international financial institutions are losing patience with the slow and inconsistent pace of economic liberalization in Cameroon and becoming more determined to impose upon the Biya regime the tough choices it has so far avoided. In 1994, the World Bank forced the regime to lay off 20,000 civil servants and to announce the privatization of a first batch of fifteen important parastatal enterprises, notably in the transport and agro-industrial sectors.

It is most unlikely that the eventual achievement of greater political liberalization in Cameroon will enhance the prospects for any thorough economic liberalization. Political liberalization may even strengthen the patrimonial features of the Cameroonian post-colonial state. Although most opposition parties claim to champion economic liberalization, their capacity to implement the necessary economic reforms is very much open to question, since they appear to resemble closely the ruling regime in their frequent resort to patrimonial practices.

Much of the current thinking about political liberalization in Africa implies that institutional and economic change will be effected via the emergence of stronger civil societies. As a result, successful economic reforms require not only increased levels of state capacity but also higher levels of 'civil society capacity', that is, the effective and sustained organization of social interests over time. Civil society capacity, however, is still underdeveloped in Cameroon. Every organized group in Cameroonian civil society used to be co-opted or destroyed by the state, from trade unions to farmer cooperatives. Until these groups develop a certain degree of autonomy, they lack the power to call the regime to account for its policies (van de Walle 1990).

The experience in Cameroon, and elsewhere in Africa, suggests that there is no automatic linkage between political and economic liberalization. In African countries where autocratic and patrimonial regimes are still struggling for their political survival during the democratization process, economic reforms tend to be slowly and partially implemented and political reforms tend to create political instability which scares away national and international investors. Indeed, at least in the short term, there may be conflicts between the two objectives. There is thus an increasing tendency to emphasize the longer-term relationship between political and economic liberalization, as well as to view democracy as an end in itself, rather than a means to development.

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# 13

# POWER STRUGGLE AND ECONOMIC LIBERALIZATION IN GHANA

*Kwame Nimako*

In 1968, the British lawyer, Geoffrey Bing, who served as the Attorney General in the Nkrumah government between 1957 and 1966 made following observations:

> For NINE years, from its independence in 1957 to 1966, Ghana was illuminated by the glare of world publicity. Every figure who appeared on its stage was magnified and distorted, almost beyond recognition. Then suddenly in February 1966, as a result of military rebellion this little country was, so it seemed, cut down to size. Overnight it was converted into what in fact it had always been, a small state on the West Coast of Africa in no way historically, strategically or economically important to the world.
>
> (Bing 1968:11)

Bing was not only reflecting on his experiences in Ghana and how he was projected in sections of the British media, but also he was advocating a careful scrutiny of 'social reality'. This is all the more so because the above statement was made at the height of the Cold War. Political and economic developments were then subsumed under the socialism versus capitalism paradigm acquired from the nineteenth century. Alternative models and reasoning were considered Utopian or undesirable. The collapse of communist regimes in (the east of) Europe and the former Soviet Union, and their ramifications world-wide, have not only made these countries 'what they had previously been', namely, second-rate economies in the world economy, but also it has shattered some of our acquired wisdom and received ideas. Let us hope that the emerging pluralism versus ethnicity paradigm in the socalled democratization discourse on Africa will not become a new dogma that will foreshadow alternative models. For what difference does it make if Jonas Savimbi's Uniao Nacional para a Independencia Total de Angola (UNITA) movement fights the Movimento

Popular de Libertacao de Angola (MPLA) government in Angola under the banner of anti-socialism in the 1980s and anti-ethnic cleansing in the 1990s? In fact, if it is true that both capitalism and socialism have failed in Africa, as Basil Davidson (1992) has noted, then perhaps our theoretical task in understanding the developments in African economies and societies still lies before us (Frank 1984).

Bing's statement is of added significance because it touches on the fluctuations of the significance of Ghana in African (if not world) political developments. In fact, twenty years before Bing made the above observations the then British colonial Governor, Burns, had introduced constitutional reforms (in 1946) designed gradually to lead Ghana smoothly towards political independence. Ghana was then considered to be a model colony in Africa. However, two years after the introduction of what became known as Burns Constitution, Ghana was rocked by protests and violence, which obliged the colonial authorities to introduce a new Constitution to accommodate Ghanaian nationalists. Though the forces that shaped the protests and violence was beyond the control of even those who participated in them, they were blamed on the Ghanaian nationalists, and Ghanaian nationalists took advantage of the conditions.

Even after the failure of the colonial constitutional experiment, when Ghana gained political independence in 1957, she was viewed as a hope for African liberation, if not economic development. Twenty years after Bing's observations, around 1986, Ghana appeared again on the world stage as Africa's 'success story' in the area of the implementation of the Structural Adjustment Programme (SAP) coordinated by the International Monetary Fund (IMF) and the World Bank. The notion of the success story has been developed against the backdrop of two developments: (a) the decline of almost all African economies, fuelled by drought and civil wars, and (b) the arrest of nearly two decades of economic decline in Ghana. The Ghana success story therefore resembles a half-empty/half-full glass story. This is also partly because the neoliberal austerity shock therapy which is an ingredient of SAP was not accompanied by 'IMF riots' associated with IMF-sponsored austerity measures elsewhere in Africa. The May 1995 riots in (Ghana's capital city) Accra, which was in response to IMF and World Bank sponsored Value Added Tax (VAT), has however demonstrated that Ghanaians also behave like 'normal' human beings: they vote with their pocket-books.

In this chapter I will attempt to discuss the main structural features of Ghana's political economy, namely, a debt economy with a declining significance of its major foreign exchange earner (cocoa) for both the Ghanaian and world economies against the background of increasing potential for political violence. It will also be argued that the power struggle in Ghana not only is tied to the cyclical downturns in the Ghanaian economy but also is fuelled by a legitimacy crisis. This is compounded by the fact that political conflict in Ghana is structural and tied to the formation of the Ghanaian state. Viewed from this perspective, the idea(l)s and wishes of military men such as Jerry Rawlings are just personal opinions in the absence of the necessary military force and selective violence to back them. Equally structural is the capacity of Ghanaian coup leaders to use military force in post-colonial Ghana to achieve political and personal objectives: it appears that this capacity declines after three years through 'repression fatigue' and necessitates a transition to constitutional rule.

The second section of this chapter briefly examines the economic trends in twentieth-century Ghana. This is followed in the third section by an examination of the power struggle tied to these trends. The relations between economic trends and power struggle as expressed in economic policies are examined in section four. Finally we conclude that it is an illusion for the Rawlings government to assume that it can guide the democratic process on its own terms.

## DYNAMICS IN THE GHANAIAN ECONOMY

Since the incorporation of the Ghanaian economy into (what Immanuel Wallerstein calls) the modern world economy around the time of eighteenth century, the country's economic fortune has become tied to developments in the world economy. British occupation of Ghana at the turn of this century and the subsequent investment in gold mining, the encouragement of cocoa cultivation and export, and the infrastructural underpinning (especially railway construction) formed the basis of the first upswing in the Ghanaian economy in the twentieth century. The upswing lasted for about two decades and was followed by economic crisis and decline from the mid-nineteenth century till the end of the Second World War in 1945. In particular the decline was occasioned by three developments:

1 the end of systematic capital inflow and the completion of infrastructure tied to it,
2 the (in)famous Great Depression of the late 1920s and early 1930s in the industrialized world, and
3 the effects of the Second World War from 1939 to 1945.

This process constituted the first forty-year cycle in the Ghanaian economy in this century and was followed by a second upswing, which also lasted for about two decades from 1946 to around 1964.

Whereas the first expansion/upswing (1900–25) was occasioned by British investments in the mining sector, the second expansion/upswing (1946–64) was aided by favourable cocoa prices on the world market, which rose from £190 per ton in 1946 to £395 per ton in 1954. This upswing not only strengthened the development of productive forces and infrastructure, but also led to an improvement in the country's foreign reserves both under the colonial and nationalist administrations in the 1950s. In turn the strengthening of productive forces, infrastructure development and the availability of foreign reserves gave rise to economic growth. Thus when the country's foreign reserves stood at £200 million and 150 million in 1954 and 1960 respectively, the economy grew at an average of 5 per cent; when the country's foreign reserves dropped to £3.5 million in 1965, the economy grew by 0.2 per cent. However, the decline of the cocoa price on the world market from a peak of £395 per ton in 1954 to £138 per ton in 1965 arrested this development. The foreign exchange shortages that arose from these developments led to a longer economic decline, accompanied by deterioration of productive forces and infrastructure, especially railways, for nearly two decades from around 1965 to around 1984.

Between 1966 and 1981 governments were preoccupied with ad hoc economic measures necessary for their immediate political survival. Economic policies shifted resources towards local food production or towards imported food, or both. Then came the 1979–82 recession. The resulting foreign exchange shortages made it impossible for the government to import sufficient food to bolster the resulting shortages, which were aggravated by the 1981–3 drought. This symbolized a second forty-year cycle in the Ghanaian economy during this century.

Economic decline, which was aggravated by the drought, not only obliged the government to seek foreign aid to ease the food crisis and foreign loans to revive the economy but also they tied the interests of two major international companies, the British firm Lonhro and the US firm Valco, to the economic fortunes of Ghana. On the one hand, the search for foreign exchange necessitated the Provisional National Defence Council (PNDC) to renegotiate a new energy supply agreement with Valco. The drought lowered the water level of the Volta dam and brought production at Valco to a standstill. This in turn obliged the giant US company to renegotiate with the tiny PNDC government. On the other hand economic decline and political instability made technological renewal in the gold mining industry impossible. In other words the combination of drought, deterioration of productive forces and infrastructure, which also affected the mining sector, renewed the interests of 'international capital' in the Ghanaian economy and gave impetus to a new upswing (from 1985 onwards): the third of its kind this century.

Like the first upswing, the third upswing was also strongly influenced by developments in the gold mining sector. On 8 May, 1985, the International Finance Corporation (IFC) announced the provision of loans of US$55 million to Ashanti Goldfields Corporation (Ghana) Ltd. (AGC), a joint venture between the Ghanaian state and the British firm Lonhro. Not only did the loans form part of a project to co-finance a US$158 million, five-and-a-half year rehabilitation programme of the gold industry, but also it has been the single major investment project in the country since 1984.

These investments have had a multiplier effect and has expanded Lonhro's investments into hotels and farming in Ghana. The IMF/World Bank intervention in Ghana's economy and politics since 1983 was thus in response to the combination of the longer downturn in the country's economic fortunes and the renewed 1979–2 cyclical downturn in the world and Ghanaian economies. Just as British mining interests in Ghana's gold served as the driving force for British imperialism/colonialism in this part of the world in the 1890s, so the need to revive the gold industry partly influenced the 'enthusiasm' of the IMF/World Bank in Ghana in the 1980s.

The current (or third) upswing, is however qualitatively different from previous ones. Both major economic expansions or upswings in the previous two forty-year cycles were accompanied by one form of public debt or another. In both expansions or upswings (1900–25 and 1946–65) the development of productive forces and infrastructure was simultaneously accompanied by budget deficits and improvements in the standards of living of Ghanaians, especially in the latter phase. The current upswing has benefited from massive foreign aid but has simultaneously been accompanied by the accumulation of foreign debt. On the one hand, there has been an infusion of nearly $3.5 billion in external assistance between 1983 and 1989 into the Ghanaian economy. This made Ghana the world's third highest recipient of concessional World Bank assistance at the end of the 1980s, after India and China (Nimako 1991:203).

On the other hand, unlike previous expansions/upswings, the current investments have taken the form of loans and have increased the country's external debt burden. Ghana's foreign debt increased from US$120 million in 1966 to US$400 million in 1970, then to US$895 million in 1975, and reached US$1 billion in 1983. After the IMF intervention in 1983 the debt jumped to US$2.4 billion in 1986 and passed US$3.1 billion in 1987 (Nimako 1991:205). There are no signs that the country's foreign debt will decrease in the coming years. This is all the more evident because from 1990–1 alone the total external debt increased by nearly 9 per cent to reach US$3.8 billion; another 10 per cent increase in external debt was recorded from 1991–2, and rose by 12 per cent from 1992 to reach US$4.7 billion in 1993. It was therefore not accidental that the country's external public debt as a proportion of Gross Domestic Product (GDP) rose from around 61 per cent in 1992 to 79 per cent in 1993 (*The State of the Ghanaian economy in 1993* 1994:67).

Thus whereas the economic downturn has been arrested (at the expense of external debt accumulation), the erosion of the bureaucratic structures of the state continues and finds its expression in the retrenchment of the public sector. Some 70,000 people were made redundant between 1984 and 1989 as a result of retrenchment policies. Equally important to note is that unlike previous upswings, the current or third upswing is not accompanied by improved standards of living in the country. This is partly because cocoa prices have not risen alongside the investments in the gold sector and infrastructural rehabilitation. On the contrary, the average real commodity prices on the world market in the 1980s was the lowest since 1932. Cocoa price fell by 48 per cent between 1986 and 1989 (Callaghy and Ravenhill 1993:32). Whether the current upswing can match the previous ones which each lasted for about two decades remains an open question. The question that requires answer below, however, is how individuals and groups have understood and attempted to manage and control these trends.

## THE POWER STRUGGLE AND THE UNRESOLVED LEGITIMACY QUESTION

The power struggle in Ghana is not only tied to developments in the Ghanaian and world economies but also it is fuelled by a legitimacy crisis. Besides this the understanding of the power struggle in Ghana is incomplete without an understanding of the nature of the Ghanaian state and how it evolved. It can even be argued that the power struggle in post-colonial Ghana is primarily *state-government conflict,* and second party political. That is all the more so because the four dominant elements within the core state structures (namely, the civil service; the judiciary; the police service and the armed forces) have been active participants in Ghanaian political struggles. For this reason two patterns of political change have emerged. First, all previous civilian governments in post-colonial Ghana (i.e. Convention People's Party (CPP) 1957–66, People's Party (PP) 1969–72, and People's National Party (PNP) 1979–81) have been overthrown in military coups, hence there is a pattern of political instability. Second, all regimes that have transferred power 'peacefully' (i.e. the colonial regime, 1874–1957; the National Liberation Council (NLC) 1966–9, Armed Forces Revolutionary Council (AFRC) 1979, and PNDC 1981–93) have sought continuity rather than change, but without success.

Underneath the problem of political instability lies the legitimacy crisis. This in turn stems from the fact that colonial rule was considered illegitimate by both the colonizer and the colonized, hence the need to transfer power to a legitimate nationalist government. Like the colonial regime, Ghanaian military regimes have also been considered illegitimate. Thus whereas the power struggle under civilian regimes has been directed at a *change of government,* the power struggle under military regimes has been directed at a *transfer of power* from a military to (first and foremost) a civilian regime, and second, to a civilian government. Furthermore, political struggle in Ghana has become more complex since decolonization, partly because of the active involvement of dominant elements within the core state structures.

In the 1940s political struggle manifested itself primarily as a conflict between Ghanaian nationalism(s) and British colonialism and revolved around three major organized forces, namely, the colonial state, holistic nationalists, and sub-nationalists. This was partly because the process of

British occupation and/or colonization conditioned the pattern of nationalism(s). Four areas were colonized successively:

1 the Gold Coast colony proper (i.e. the southern part, 1874);
2 the Asante (i.e. the central part, 1901);
3 the North (in 1902);
4 the Volta region (i.e. the Eastern part, 1921).

In response to the process of colonization, however, five nationalisms (i.e. four sub-nationalisms, plus holistic nationalism) emerged:

1 Gold Coast nationalism (1897–1958);
2 Asante nationalism (1954–8);
3 Northern nationalism (1954–8);
4 Ewe—or Volta—nationalism (1951–8); and
5 holistic nationalism (1948 onwards).

On the one hand, holistic nationalism was the ideological expression of an organized movement in opposition to British occupation and rule of Ghanaian territory—even though the contour of the territory being claimed by Ghanaian nationalists from the British was demarcated by the British. On the other hand, sub-nationalism was the ideological expression by a regional grouping in opposition to the dominance of holistic nationalists. Due partly to this colonization/decolonization process, all major national elections (in post-Second World War Ghana, 1951, 1954, 1956, 1969, 1979, 1992) have been contested by five major political parties.

The existence of various nationalisms also gave rise to a relative diffusion of political power in society. Thus around 1950, the probability that any of the three organized political forces in question within the country could carry out its own will in isolation was relatively low. The capacity of any one of the political actors to dominate the political arena depended on the conscious and/or unconscious alliance of two of the forces in opposition to a third party. The power of the colonial authorities depended on their control of the colonial state machinery, namely, the civil service, the police service, the judiciary, and the armed forces. The power of the holistic nationalists was based on their ability to galvanize the masses into action, and flowing from that, to make the country ungovernable by the colonial authorities. The power of the holistic nationalists was not only constrained by the colonial state but also by sub-nationalism. The power of the subnationalists rested on an alliance between a large section of the intelligentsia and the native rulers, and their subsequent non-cooperation with holistic nationalists, which in turn undermined the legitimacy of the holistic nationalists' rule.

Just as sub-nationalism followed the pattern of British colonization, so holistic nationalism followed the construction and development of the colonial state. The colonial state, which was the outcome of complex trade and political relations as well as (British) military occupation of the country, became the thread which held the (geographical) regions together. In a similar vein, holistic nationalism became the thread which held Ghanaians together, by uniting them in their resistance and opposition to British rule irrespective of class and ethnic background.

Unlike holistic nationalists, whose focus of opposition was British colonial rule, the primary target of opposition of sub-nationalists was holistic nationalists. Just as the emergence of holistic nationalism presupposed the existence of British domination, so the existence of sub-nationalism presupposes both British domination and the spectre and/or the existence of holistic nationalism. As a result of this, political struggle, which manifested itself primarily as a conflict between Ghanaian nationalism(s) and British colonialism in the 1940s, was superseded by a conflict primarily between holistic nationalism and sub-nationalism in the 1950s.

Decolonization and the process of 'Ghanaianization' of the state enhanced the power of holistic nationalists and accelerated the decline of sub-nationalism. The withering away of sub-nationalist groupings and the subsequent decline of their numbers in the parliament brought the conflicting and contradictory relations between the nationalist government and the state bureaucracy to the fore; this found its expression in the latter's opposition to 'socialist development', the professed ideology of the leadership of the nationalist government. In other words by the 1960s, the struggle between holistic nationalists and sub-nationalists had given way to a struggle between state bureaucrats and holistic nationalists.

Underneath the structural contradictions between the state bureaucracy and the government, and the concomitant conflict, were the socio-economic development perspectives of the two forces. The dominant elements within the state bureaucracy perceived economic development in terms of a balanced budget and a positive balance of payments. The nationalist government measured development through progress in areas such as education, health care, industrial units and establishments as well as the growth in the skills of the labour force. Yet since state bureaucrats were supposed to be loyal to the government of the day and neutral to politics, their opposition to government policies did not find its expression in open discussion. Instead it led to a military revolt in 1966, with the tacit support and approval of other state organs which were the making of colonial rule.

If the state bureaucracy 'exploded' in the 1960s, it 'imploded' in the 1970s. By 1975, economic decline and pressures from society for a transfer of power to a civilian rule had led to a disengagement of the civilian wing of the core state structures from its military wing (i.e army and police); in response to that, the military base of the regime was broadened. This found its expression in the formation of the Supreme Military Council (SMC), which embraced all the commanders of the armed forces and the head of the police service. This was followed by a disengagement of the rest of the ruling council from its leader in a palace coup in 1978 (SMC-II), and finally a disengagement of the junior army officers from their commanders in a successful uprising in 1979 (under the leadership of Fl. Lt. Rawlings): the 'implosion of the state'.

The 'explosion-implosion' of the state bureaucracy formed part of two decades (1964–84) of economic decline, and the deterioration of productive forces. The exclusion of the dominant elements within the core state structures of producers of material goods in society from the management of national affairs had given rise to 'non-cooperation' of the latter from the former. The threat of total national disintegration obliged the state to turn to producers or civilians, through general elections in 1979. However, two decades of economic decline and the 1979–82 world recession undermined the new civilian government and made the country an 'anarchist's paradise': it was uncertain as to who actually governed the country. Following this, for the first time in Ghana's history, retired junior army officers were able to organize and stage a coup (in 1981) to its successful conclusion, something that had failed in the mid-1970s.

The public justification of the (second Rawlings') coup was however much more difficult than all previous coups in Ghanaian history. This was partly because the coup did not have an implicit/explicit approval and/or connivance of any relevant political grouping. The second Rawlings' coup however formed part of the 'learning effect' on coup-making. That is, besides their need for protection, all former Ghanaian coup-makers have considered their pre-coup knowledge of society and economy deficient and have regretted their involvement in a coup or regretted that they handed over power.

This does not only necessitate a kind of comeback but also it requires a justification of such comeback. In order to circumvent the problem of illegality and illegitimacy therefore, Rawlings and his associates chose to call their coup a 'revolution' and justified it through pre-emptive terror and repression for about three years, and selective violence afterwards. But this did not prevent the problem of legitimacy from surfacing. Resistance to repression from society and protests against military rule obliged the Rawlings regime to transform itself from military PNDC to civilian National Democratic Congress (NDC) at the turn of 1993.

The elections which precipitated the transformation of PNDC to NDC was initiated from two structurally opposing positions. On the one hand, from the position of the PNDC, it was a means to legitimize its rule so that its leaders could emerge from the 'bunkers' where they have ruled. Following this the PNDC attempted to be a player and referee of the electoral games at the same time by manipulating the electoral process. On the other hand, from the positions of the other four major political parties, the elections were the only peaceful means to overthrow the military regime. In other words, the opposing civilian groupings which formed political parties sought the transfer of power from military regime to a civilian regime; the PNDC, however, sought continuity and legitimacy. At the end of the day the elections were boycotted by the major political parties due to the manipulation of the electoral process which culminated in the rigging of the presidential elections. Thus the legitimacy crisis does not only remain unresolved but also the structural power struggle which underlies this crisis has made the country a 'land without heroes': not only have all governments been considered by a section of the population as illegitimate, but also almost all government leaders have been considered undemocratic.

## ECONOMIC POLICY AND POLITICAL CONFLICT

Like many economies in the world economy, the Ghanaian economy hardly moves in the direction 'where intentional political policy would direct it' (Frank 1984:3). In fact, in some cases economic policies aggravate economic problems and intensify political conflict instead of alleviating the former and minimizing the latter. On this score economic policies in (colonial and) post-colonial Ghana have not been the exception. On the one hand, not only did the need for the British mining interests to gain access and control of (Asante-controlled) gold mines contribute to wars between both groups at the turn of this century, but also the wars contributed to the exclusion of Asantes in the core state structures during the formation of the colonial state. On the other hand, the need for the (holistic) nationalist government to provide Ghanaians with 'the minimum basic services for a modern community', such as education and health care, contributed to active state intervention in the economy and also fuelled militant sub-nationalism (especially the Asante and Ewe variants) in the 1950s.

The nationalist government's economic strategy and/or policy was based on a 'development model' framed by the colonial authorities whose basis was the internal cocoa price stabilization policy. Formally the underlying assumption of the colonial development model was that, with the formation of the Cocoa Marketing Board in 1947, the domestic price of cocoa would be set lower than the world market price so that 'a reserve fund could be built up'. This in turn could provide savings which could be invested to develop the country's economy. The rationale was that it would drain off that excess purchasing power and thus the cocoa producer's income could be maintained in the case of collapse of world prices.

The real impact of this colonial regime of capital accumulation, however, was that it gave rise to the location of 'economic development' in the realm of welfare and made 'development' almost solely the task of the government. Besides this, the government-led capital accumulation concealed one economic fact: its potential for generating initial reserves gave a wrong impression about the actual health and state of the economy. Not only did the availability of foreign reserves become the object of political conflict (though it did not create it), but also availability of foreign reserves became the measurement of the health of the economy by many people and groups.

At the economic level, in response to dwindling foreign reserves, the government imposed taxes on major consumer imports in 1961 with the aim of discouraging excessive imports and encouraging local production and exports; this went hand in hand with tightened foreign exchange controls. Yet these fiscal policies did little to stem the drain on the country's foreign reserves. This was compounded by the inability of the local and foreign private entrepreneurs to make a major contribution to the countries industrial development. Thus by the middle of the 1960s, active government intervention in the economy had led to a trade-off: budget deficits on the one hand, and increased development of manufacturing industries and infrastructure on the other hand. In other words, Ghana was more economically developed in the 1960s than in the 1950s, but it was financially bankrupt in the 1960s.

At the political level, economic planning necessitated the control of society and introduction of the Seven Year Development Plan in 1963. The belief in the viability of the Seven Year Development Plan in turn forced the government to prepare itself to prolong its stay in power (at least until 1970) and contributed to the declaration of a one-party state a year later (1964). This process was complicated by the fact that the process of industrialization generates its own conflict, namely industrial conflict. There was a tendency for government-initiated and/or government-controlled industrialization to 'centralize' such industrial conflict, since management-labour relations became government-labour relations, and thus transformed itself into a political conflict. Not only did the Nkrumah regime declare a one-party state in reaction to economic planning, but also the one-party state was declared at a period when the most effective opponents of the government were not (sub-nationalist) political parties, but rather the dominant elements within the core state structures.

Equally important to note is that by the time the Nkrumah government was overthrown in 1966, the Ghanaianization of the state was almost complete. This was superseded by the Ghanaianization of the economy, and found its expression in the introduction of the Ghanaian Enterprises Decree of 1968 under the NLC military regime and was pursued further by the Kofi Abrefa Busia government (1969–71). Ironically the Ghanaianization of the economy went hand in hand with a fanatical appeal for foreign aid and investments by the Busia government. In turn, the fanatical appeal for foreign aid and investments (which was viewed then as an excessive pro-Western stance) revived Ghanaian nationalism and became one of the justifications of the overthrow of the Busia government in 1972 by NRC, led by Ignatius Kutu Acheampong.

Without sufficient foreign exchange and foreign investment, the next step was to go solo, namely 'self-reliance'. This new-found nationalism was accompanied by debt repudiation, which in turn had been a subject of debate within the top civil service and academic circles in the country since the overthrow of the Kwame Nkrumah regime. By the middle of 1975, however, the 'offensive phase' which characterizes many military regimes in the form of arrests, intimidation and torture, to destroy the power base of the regime just overthrown, was giving way to a 'defensive phase' of crisis management. In other words, the NRC regime was experiencing 'repression fatigue'. The dilemma of the state as the largest wage employer and the 'erosion' of its bureaucratic base, occasioned by the deterioration of the economy, found its expression both in mass emigration and protests/resistance simultaneously: the latter culminated in a palace coup in 1978.

Just as in the medium-term the food situation deteriorated under the Acheampong government (NRC/SMC-I), in spite of the government's expressed aim of attaining food self-sufficiency, so the Frederick Akuffo regime failed to combat inflation (which rose from 71 per cent in 1978 to 79 per cent in 1979), contrary to its objectives. The Hilla Limann government (1979–81) did not do better, despite the highly competent cabinet it assembled. Neither did the PNDC government succeed in its attempt to control the economy and society during the first three repressive years (or the offensive phase of Ghanaian military rules). Ironically though the PNDC proposed a state monopoly of the import/export trade in 1983; however, in less than two years the opposite was the reality, namely, trade liberalization. It took the return of the rains in 1984 to end the food shortages, and massive IMF/World Bank intervention in the Ghanaian economy to arrest the economic decline. For this reason let us take a closer look at the nature of IMF/World Bank intervention, and its relation to power struggle in the country.

## STRUCTURAL ADJUSTMENT PROGRAMME (SAP) AND DEMOCRACY

The active IMF/World Bank intervention in the Ghanaian economy since 1983 has given rise to two confusions. First, at the economic level, critics of IMF conditionality and austerity programmes have accused the Fund of prescribing the same economic medicine to all economic diseases (Onimode 1989). However, most countries (if not all) do turn to the IMF with a common economic disease, namely, inflation and balance-of-payments problems. On this score Ghana was no exception. The problem therefore is not the prescription *per se,* but rather its aftermath, namely, the response of the donor countries to the austerity measures taken. It was in this context that the World Bank made the passionate appeal during the critical phase of SAP that 'it would indeed be tragic if this experiment were allowed to fail for lack of adequate external support and Ghana's economy were permitted to slip back down the dreary slope of decline' (World Bank 1984:xii).

Equally important to note is that despite severe austerity measures, the country did not experience 'IMF riots' associated with IMF austerity and adjustment programmes elsewhere. This has given rise to another confusion, namely, the equation of effective government with political repression. In fact, the economic recovery, which was a consequence of the return of the rains in 1984, of investments in the mining sector, and of foreign aid, has eluded critics and admirers of the PNDC/NDC regime alike. According to one critic and opponent of the PNDC/NDC regime, the PNDC succeeded in implementing the SAP due to:

> the availability of two crucial inputs of finance and experts, the resolute implementation of all the necessary strategies however harsh or inhuman and the courage of the PNDC to contain all opposition to these strategies.... Surely only a military government could have implemented such bold and harsh measures and got away with it.
>
> (Boahen 1989:50)

Other observers confused the introduction of the austerity measures with repression by arguing that 'the government may respond by calling for greater discipline and sacrifice, but in the circumstances of modern Ghana, persuasion clearly has its limits'. They went on to argue therefore that:

> if at times this led to abuses of civil liberties and interference in the operation of the judicial system, it also increased the state's capacity to pursue harsh policies intended to rehabilitate the country's sagging economy.
>
> (Gyimah-Boadi and Rothchild 1986:274, 279)

Both views are misplaced because there is no evidence to support the view that bold and harsh (i.e. repressive) measures were necessary to implement the SAP. For not only did much of the PNDC terror occur in 1982, that is before Ghana took the IMF medicine in 1983, but also the repression occurred not in the name of SAP but rather in the name of an imaginary 'revolution'. On the contrary, the introduction of SAP had positive unanticipated consequences for the process of democratic struggle in two ways. First, the inflow of many international 'experts' to and from the country to supervise SAP made the country relatively more open to the outside world and made government atrocities difficult to conceal. Not only did the Standard Chartered Bank, 'which granted a pilot loan of £50 million in 1984 as an indication of its "confidence" in the economic policies of the PNDC, [insist] that the PNDC publicly renounce its partial nationalisation of foreign banks', but also the World Bank 'urged the PNDC to return properties seized under anti-corruption campaigns in 1979 to their owners' (Hutchful 1989:106).

Equally important to note is that whereas Rawlings could count on a small number of people on security matters, the technical nature of understanding and implementing SAP obliged the PNDC government to engage more Ghanaians in government affairs with little questioning about their political loyalty. In a similar vein, in a country like Ghana with a small elite and a history of political instability, the IMF/World Bank had to engage in a 'dialogue' with both members of the government and the opposition as an insurance against a sudden change of political events. Initially, however, this openness benefited formal and prominent 'politicians' than 'ordinary' Ghanaians. We shall return to this below, but for the moment suffice it to say that by inviting the IMF/World Bank, Rawlings and his associates acceded part of its power to the former.

Second, the need to promote privatization led the PNDC to lose more grip on the economy, and consequently on society. This is all the more so since, in the absence of proper democratic control and accountability, State Owned Enterprises(SOE) have been a key area and/or major source of past and present government(s) political patronage. The consequence of this process is that implicitly a new division of labour has developed between the Rawlings regime(s) and the IMF/World Bank in which economic power has been acceded to the latter and political power the former. The irony, however, is that the tight monetary policies associated with SAP, and its negative impact on certain private businesses, have been interpreted by some people in the business community as government control or an attempt by the government to destroy their businesses for political reasons. For this reason also some members in the business community have been acquiring NDC party-cards in the hope that it will aid them to gain government contract awards or improve their businesses. This does not only imply the importance of nepotism under Rawlings' rule but also it makes a mockery of Rawlings' past and present anti-corruption rhetoric. It also undermines market competition, the 'principles' on which neoliberal political-economic theory and policy (and why not practice?) is supposed to be based.

It should be noted, however, that the introduction of SAP is not the only factor that has enhanced the democratic process. It was aided by what I have referred to above as 'repression fatigue'. That is, an 'inbuilt' limitation of political repression, which in turn is a consequence of the process of elite formation in Ghana. For instance, before the mid-1960s all Ghanaian elites attended less than a dozen secondary schools. By the 1980s, the majority of Ghanaian elites had attended one of the three universities in the country. This did not only make the country's elite base thin but also it implied that many of the elites knew each other and related to each other through various social clubs. An attempt to build an exclusive club to control society thus became impossible.

These developments were in turn aided by 'grassroots' resistance which ranged from hooting at security forces to physical confrontations with the same. Whereas 'grassroots' resistance enhanced the demoralization of actual and potential supporters of the violence associated with the Rawlings regime, it also had the potential of accelerating violence which, without the intervention of the IMF/World Bank, could perhaps have led to civil war.

At the broader level of generalization, therefore, the reasons why the government was able to push the SAP through without the 'IMF riots' associated with IMF austerity and adjustment programmes elsewhere can be traced to three sources. First, economic hardships in the country at that point in time was subsumed under drought. Besides this, the implementation of the programme coincided with the return of the rains in 1984. Thus instead of leading to high food prices, the austerity programme coincided with (increased food production and) low local food prices. In other words, just as the drought aggravated the economic problems, so the return of the rains minimized the immediate impact of the series of devaluations at that point in time. Moreover, the consumption pattern of Ghanaians is not restricted to a single cereal or product as is common in other African countries; for instance maize in Zambia or bread in Sudan. This makes it difficult to ascertain the immediate reaction of a large section of the people to a price rise of a single commodity.

Second, there were shortages of imported goods before the austerity measures and devaluations. When afterwards, imported goods appeared in the shops, they appeared in the form of expensive goods rather than price hikes and/or increases on existing goods. This situation can be contrasted with the revolt and protest in May 1995 in Accra against the introduction of VAT in March of that year. Not only did the protest oblige the government to make a U-turn and abandon the project, but also it demonstrated that Ghanaians reacted like 'normal' human beings in the face of economic hardships and injustice. In turn the Rawlings government is reacting like a 'normal' African government: Ghana is now experiencing its share of the 'go-stop, go-stop' policies associated with the implementation of SAP policies in countries like Tanzania, Zambia, Zaïre and Cameroon.

Third, the ongoing emigration of young people from the country to Europe, North America and elsewhere means that a sizeable percentage of Ghanaians between the ages of 20 and 40 have left the country, continue to leave, or plan to leave instead of wasting their time on demonstrations at the government.

The negative impact of SAP on democracy lies somewhere else, namely in retrenchment policies associated with SAP. The policy of retrenchment fuels nepotism and disturbs ethnic relations because it is used to lay off and discriminate against certain people. This is compounded by the fact that like other military regimes, the PNDC-NDC government operates, consciously or unconsciously, through officials appointed by a handful of people. This implies that, for the sake of either security or legitimacy problems or both, only people who can either be trusted or controlled by the leadership tend to be appointed to influential positions. Flowing from this, not only has the PNDC-NDC government been accused of 'tribalism' but also hitherto all Ghanaian governments (i.e. NLC, PP, and PNDC) that have been accused of 'tribalism' have either swallowed the IMF medicine or pursued a strict supply-side economic policy.

Where government leadership has been Akan, Ewes have led the accusations; and where the leadership has been Ewe, Asantes have led the accusations. This is curious since there is no historical basis for the prejudice and animosities between Ewes and Asantes (save perhaps Akan linguistic dominance—which is not the making of Asantes—which may irritate some Ewe state officials, but not Ewe traders). Here also, some qualification is in order. Culturally, Akan linguistic and music influence in Ghana is visible; but this is a result of a complex interaction between internal urbanization processes and economic forces rather than a conscious policy by a particular government in post-colonial Ghana. On other cultural factors such as intermarriage, food and clothing, however, all ethnic groups influence each other.

Like the Nkrumah government (1957–66), the Acheampong government (1972–8) escaped accusations of 'tribalism'. However, like the Nkrumah regime, the Acheampong regime was accused of 'incompetence' and 'corruption'. Equally characteristic of both the Nkrumah and Acheampong regimes was deficit financing of public policy and the attendant inflation. These were compounded by economic regulation regimes based on price control mechanism which, in the face of dwindling foreign exchange, contributed to corruption. Subsequent governments, Akuffo (1978–9), Rawlings I (June 1979 until September 1979), and Limann (September 1979 until December 1981), were crisis governments; they also operated under collective leadership and were too short-lived to generate ethnic discourse.

Equally characteristic of governments accused of tribalism is their anticorruption rhetoric. In other words, all governments that have been accused of tribalism have also mounted massive public campaigns against corruption but have been equally corrupt. Consequently, what could be regarded as outright corruption under governments that pursue inflationary policies tends to be referred to as tribalism under governments that pursue deflationary policies. This is partly because, in the latter scenario, corruption and nepotism tend to be tied to retrenchment policies: the latter is fraught with discriminatory practices. The paradox of the current ethnic discourse is that accusations of 'tribalism' are being levelled at (Rawlings) one of the most cosmopolitan Ghanaian rulers in Ghana's post-colonial history. This is perhaps a further demonstration that economic policy hardly moves in the direction where intentional political policy would direct it.

Let us then conclude this section with the following observation. The reason why the SAP could be carried through had little to do with harsh measures since systematic political repression in Ghana could not be sustained for more than three years, due to the complex ethnic, class, gender and extended family relations which ties various groups and individuals together. This does not only give rise to repression fatigue but also it points at the limits of 'ideological fantasies' in the country.

## CONCLUSION

The current political struggle in Ghana has reached an exciting and dangerous phase. It is exciting because after a decade of personal rule, repression, naked nepotism, arbitrary arrests, murders, executions, torture and extortion, Ghanaians have at least been voicing their anger, not through violence, but through freedom of speech and press. It is also dangerous because not only did decades of economic decline undermine many state institutions such as the civil and police services, the armed forces and the judiciary, but also there are weapons in the hands of bandits to defend an imaginary revolution. This means that a forceful overthrow of the NDC government, amid accusations of tribalism, can plunge the country into civil war. This is compounded by the fact that the elections which were supposed to restore some freedom were inconclusive. In turn, the inconclusiveness of the elections, and their subsequent boycott by the major political parties, means that the heart of Ghanaian political instability, namely, the legitimacy crisis, remains unresolved. More importantly, political repression, selective violence, manipulation of electoral process and results by the PNDC government, and the subsequent boycott of the elections by the major political parties, has reduced the latter to 'social movements'. The absence of the major political parties in parliament in turn has reduced these parties to single-issue parties and made them watchdogs on human rights. On this score the Fourth Republic is dead.

At the same time the Fourth Republic is alive not only because of the transition from military to constitutional rule, but also because a disconnection between the state and the government is emerging: the core state structures, especially the judiciary and the police service, are emerging as autonomous entities. Gone are the days when the PNDC had absolute control of all major state organs or bypassed the state organs it could not control. Besides this the debt economy is absorbing much of the energy of the (P)NDC (after the departure of the military the PNDC became the NDC) leadership and a handful of public servants due to constant negotiations with international 'experts' and donor countries. This has led Ghanaians to fend for themselves within the natural economy (based on the dictates of weather) and the emigrant economy (based on the remittances from Ghanaians abroad). But whereas the government is losing grip on the economy partly because of the debt burden, the Ghanaian economy has become more and more dependent on external forces (i.e. weather conditions, remittance and foreign aid). This dependence could probably become total when another major drought strikes.

Viewed mechanically, economic development depends on savings, investments and access to markets. On this score the country's debt burden blocks savings and investments and hence further economic development. But economic development also depends on social organization. In turn social organization influences political conflict and the kind of marketing strategies that could be pursued. In the absence of massive foreign investments, what is left is institutional renewal to foster economic development.

This does not only require a lot of creativity but also it requires the (P)NDC government to abandon its erroneous belief that it can put the 'economy on a proper footing', which will permit the democratization of society at a later stage. Rawlings' tight control over the Central Bank and the armed forces à la Mobutu (of Zaïre), makes mockery of the current neoliberal economic policy which is propagated by the IMF/World Bank because it gives rise to non-liberal political environment. But this does not contradict the fact that within the division of labour (which we referred to above) economic power has been acceded to the IMF and the World Bank; it cannot be otherwise since the IMF and the World Bank are not politically accountable to Ghanaians. The political irony is that neoliberal economic policy propaganda under the (P)NDC rule gives entrepreneurs more political room to manoeuvre than it gives economic room. It is this political room (of which the protest against VAT and efforts to obtain NDC party-cards are part) that is being used to create economic space. But the fact that entrepreneurs obtain NDC party-cards for their business survival does not guarantee that in a secret ballot, those entrepreneurs in question will vote for the NDC.

Another political irony is that whereas a decade ago attempts to control society through the control of the state by Rawlings and associates was done in the name of an imaginary revolution and the 'masses', the need for political stability (which is an apology for the continuation of (P)NDC rule) is currently being propagated in the name of imaginary 'foreign investors', as if a country's investment codes alone are sufficient to attract capital inflow. What is also overlooked is that evolved political stability is much more durable than an imposed stability. In the 'material real world', however, the slowing of real GDP growth from 6 per cent in 1984 to between 2 and 3 per cent in 1990 shows that the dynamics of the Ghanaian economic is perhaps even beyond the comprehension of IMF/World Bank officials; the 5 per cent growth which was recorded in 1993 was also partly due to favourable weather conditions.

The Ghanaian economic environment has thus become as uncertain as its weather. Perhaps it is also a sign that the current upswing will be shortlived. Let us hope that if that becomes the fate of the economy, the Fourth Republic will survive; the latter in turn will partially depend on the end of personal rule. Personal rule can perhaps come to an end when we realize that democracy revolves and develops through the relative balance of social, political and economic forces in society rather than on the good intentions and/or wishes of individual 'politicians'. On this score the major political parties have more responsibility for ensuring the survival of the Fourth Republic than the very government which attempted to block it. For even if we do not know what 'democracy' is, we should know by now that personal rule, which Ghanaians have lived under for more than a decade now, is bad.

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# 14

# ZAÏRE'S ECONOMIC DECLINE AND ILL-FATED LIBERALIZATION POLICIES

*André Mommen*

The World Bank and the IMF are the major actors who had advocated market-oriented reforms and liberalization programmes in order to restore economic stability in Zaïre. Their policy conditionalities included monetary control, cuts in public spending, massive devaluations, wage controls and sweeping liberalization of the internal market and international trade. But in spite of all these reforms, Zaïre failed to cope with economic decline and impoverishment. Today Zaïre is facing a rampant crisis and an overall decline of its production capacity. What went wrong?

Although Zaïre was one of the first African countries to adhere to Structural Adjustment Programmes (SAPs) imposed by the Bretton Woods institutions, its economic transformation process was frustrated by its foreign indebtedness, falling export earnings and the inability of the ruling bureaucratic class to transform itself into an entrepreneurial class. In addition, Zaïre saw its dual economy, consisting of a formal but by and large sluggish economy and a thriving 'informal' sector, undermining the viability of the state. In spite of the SAPs, Zaïre's export dependence unleashed a complex series of forces preventing balanced growth and pushed the country towards ever greater external borrowing and imports.

In this chapter we shall discuss the causes of Zaïre's economic decline and argue that the country's inability to cope with its economic decline lay in its post-colonial economic deformations and class structure. All liberalization attempts failed because the ruling bureaucratic class represented by President Joseph Mobutu and other factions tried to survive by postponing the moment of full democratization and the removal of President Mobutu.

## ZAÏRE'S COLONIAL LEGACY

Like other modern African states, Zaïre is a colonial artifact (MacGaffey 1991:26–9). Minerals (copper, tin, zinc, cobalt, diamonds, manganese, iron, bauxite, etc.) and fertile agricultural land destined the former Belgian Congo to become the wealthiest country of sub-Saharan Africa. The potential for abundant production of cash crops existed in the fertile areas of highland Kivu and Bandundu and made the Belgian Congo an important exporter of agricultural products (tea, coffee, rubber, copal, cotton, palm oil) and timber (Lacroix 1967:91–150). The Belgian authorities developed an export-oriented economy specializing in the production of primary products, principally minerals (Gann and Duignan 1979:116–40; Maurel 1992:119–44). The task of the colonial state was to assist the mining companies in the recruitment of labour. The colonial authorities also granted concessions to plantation companies and live-stock farms. Compulsory cultivation of food crops was established and the imposed use of money drove people to wage labour and cash-crop growing. The establishment of a monopoly by the state over commercialization of the principal export crops and marginalization of the indigenous middle class held domestic food prices and wages very low. The long-term consequences of this economic policy were thoroughgoing. Investment was especially channelled to the mining areas of Katanga and Kasaï where a few big mining companies (Union Minière du Haut-Katanga (UMHK); Forminière; Minière du Bécéka) exercised a nearby monopoly and owned important territories (Lekime 1992:44–104; Depelchin 1992:42–63; Maurel 1992:119–64).

The export-oriented colonial economy required a developed transport and communication system which absorbed public investment (Peemans 1974:165–212). The privileged relationship between the mining companies and the colonial state shaped the nature of the post-colonial state. During the colonial period the colonial state depended on the taxation of a few export commodities (Bézy 1961:6). The market for consumer goods enlarged, but Import-Substituting Industrialization (ISI) had been halted by the colonial authorities, who preferred importing their manufactures, because international treaties (Berlin 1890 and Saint-Germain-en-Laye 1919) prohibited preferential tariffs and obliged Belgian imports to compete with foreign imports. Although during the 1920s an ISI process in textiles, breweries, soap-works, sugar mills, cement-works and food-processing industries (Lacroix 1967:18–32) occurred, light industries only developed in relation to the needs of the exporting mining industries. So in the 1950s the big mining companies had reached the stage of self-sustained growth by reinvestment of their profits and enhancing labour productivity (Gouverneur 1971:54–71; Bézy 1957:128–55). For instance, between 1920 and 1960 the UMHK had multiplied its labour productivity by 14 times and reduced wages to only a small part of its costs (Lacroix 1967:40–52) at a time when growing social tensions were threatening the stability of the colonial system.

The colonial authorities feared that higher taxation would reduce net outflows of capital to Belgium and provoke discontent among the Belgian stockholders united in powerful colonial holding companies. Therefore the colonial authorities preferred borrowing on the international capital market in order to meet their investment requirements, which meant that in the 1950s the colonial public debt multiplied. When in 1960 the Belgian Congo became the Congo Republic, the new regime inherited an important foreign debt it was unable to service.

As in other colonial countries, the economic transformation created a new class structure in the Belgian Congo (Callaghy 1987:95–117; Young 1965:204–31; Peemans 1974:101–26). Already in 1950, 59 per cent of the population was working in the market sector and by 1959 about 10 per cent of the wage-earners were employed in industry. A growing African bureaucratic petty bourgeoisie paid out of the state budget absorbed the largest part of the colonial budget. But vertical mobility inside the colonial administration was frustrated by European civil servants occupying the higher ranks of the administration and this created discontent within the newly formed class of African clerks and semi-intellectuals living in the urban centres (Weiss 1967:5–16). During the late-1950s social discontent spread among the urban and rural population and provided the African petty bourgeoisie of shop-owners and clerks *(évolués)* popular support for the demand of complete independence (Anstey 1966:18–60; Anstey 1970:194–225; Weiss 1967:17–63; Fierlafyn 1990:133–46). Finally, independence was accorded by the Belgian government on 30 June 1960 (Lemarchand 1964:167–250; Hoskyns 1965:42–84). Unfortunately for the Belgians and the colonial firms, the newly established political construction collapsed within a few days, making the Congo a centre of political and military instability *(congolization)* (Willame 1990:435–67).

During the chaotic period of the First Republic (1960–5) the Congolese government was in far too weak a position to control the principal mining company UMHK, which until the Katanga secession was ended in 1963 operated under the umbrella of the Moïse Tshombe regime in Katanga (Willame 1988:33–68). But in 1965 with the advent of General Joseph Mobutu as President of the Second Republic, the situation changed rapidly. In January 1967 Mobutu announced the establishment of a new state-owned mining company, the Générale Congolaise des Minerais (GECOMIN) (in 1971 altered to Générale des Carrières et des Mines—GECAMINES) and, finally, a compromise was reached with the UMHK directors in Brussels on a compensation package (Young and Turner 1985:292–3), which allowed Mobutu to align himself to both the Western interests and the rapidly emerging African nationalist regimes.

Mobutu stabilized his regime by increasing his fiscal take from the copper industry (Willame 1988:94–147) and concentrating political power in the hands of a political aristocracy occupying all levies of state power. However, although he established a ‘strong state’ his post-colonial regime could not cope with uneven development. Zaïre’s economic surplus still depended upon mineral exports, whereas the share of the agricultural surplus constantly lessened (from 40 per cent in 1958 to 22 per cent in 1972) whilst mining and metallurgy activities represented 41 per cent in 1972 to

33 per cent in 1958 (Peemans 1975:165). Although during the booming period 1966–72 Gross National Product (GNP) increased by 50 per cent, this performance was due to a continuation of the pre-colonial growth pattern. New inequalities appeared. The fastest-growing sectors were trading, state services, public works and manufacturing, while the agricultural production declined steadily. Export earnings and state incomes became increasingly dependent upon copper export and its price fluctuations. This incited the Mobutu regime to expand copper production by investing private and public capital in mining dependent activities (IngaShaba electric power line, the Inga II power plant, the Ilebo-Kinshasa railroad, a steel mill at Maluku near Kinshasa) (Willame 1986).

Three main poles of development were designed: the Kinshasa area, Bas-Zaïre, and Shaba (Katanga). Within a decade this industrialization drive would come to its end. The Maluku mill never operated at more than 10 per cent of its 250,000-ton capacity and by 1980 simply ceased to operate. The Inga II Dam with its 1,800-kilometre power transmission line from the power station to the Shaba copper refineries in Kolwezi was only completed in 1982, costing US$800 million and delivering extremely expensive electric power to GECAMINES. The Société de Développement Industriel et des Mines du Zaïre (SODEMIZA) founded in 1969 started copper production in 1972, but in 1983 the Japanese partners abandoned the site. Leon Tempelsman & Son established the Société Minière de Tenke-Fungurume (SMTF), but after April 1974 the prolonged slump obliged SMTF to suspend its operations after having expended more than US$200 million on site development (Katwala 1979:122–36).

By 1967 investment in light industries (tobacco, breweries, food industries, textiles) picked up and the bulk of the manufacturing investment went to ISI projects. Multinational companies (General Motors, Renault, Leyland, Goodyear, Continental Grains and Krupp) invested in transplants. The Cimenteries du Zaïre (CIZA) increased total output to 600,000 tons. But soon difficulties arose because of excess capacity and planning problems. Processing units bought in Europe proved to be unsuited for processing Zaïre's raw materials. The American oil company Gulf discovered offshore deposits, but the tax holiday guaranteed by the investment code denied to the state much of the initial benefit and the Italian-built oil refinery appeared to be unsuited for the type of crude being produced by Gulf (Young and Turner 1985:304–9). All capital goods had to be imported in ever larger quantities in order to sustain investment, but no organic increase of capital accumulation occurred. The high level of capital intensity in the mining industries created no diffusion of capital accumulation into the rest of the economy (Bézy 1957:161–210; Young and Turner 1985:276–325).

Meanwhile the new dominant bureaucratic class enriched itself by siphoning off the state's revenues for its personal benefits. The political aristocracy acquired more power when moving into the economy, especially by taking over the large companies or foreign-owned plantations and trading firms during the period of 'Zaïrianization' and 'Radicalization' in 1973–5. But their mismanagement immediately had disastrous effects on the economy and contributed to a further decline of the agricultural sector and commerce. Then the economy suddenly plunged into a crisis from which it never would recover and by 1976 the government issued the Decree of Retrocession, returning businesses to their former foreign owners with mandatory Zairian partners (Young and Turner 1985:326–62).

After independence the absorption of the labour surplus by the labour-intensive agricultural sector had been halted with the breakdown of the compulsory labour system. In the 1950s 55 per cent of wage-earners were employed in the capitalist agricultural sector. In 1968 they represented only 30 per cent and produced 5 per cent of total output. The output for the urban markets grew, but imports of processed foodstuffs increased as a result of the neglect of the peasantry by the regime and the deterioration of the transport system and a price policy which was unfavourable towards agriculture. The government reacted by imposing fixed delivery quotas and returned to the colonial coercive methods to increase supply for the market (Bézy 1957 1981:115–58), and, finally, in the early 1970s a number of parastatal organizations responsible for promoting production and marketing of various agricultural products (coffee, cotton, livestock, timber, sugar, rubber and fish) were created (Kazadi *et al.* 1983:7–11).

Rural proletarianization and migration to the cities were the final outcomes of the worsening of the internal terms of trade. Despite several measures (massive support for improving the transport system, cooperatives, credit facilities, production of fertilizers) the agricultural sector did not recover during the 1970s. The food crisis intensified from the mid-1970s on and was most acute in urban areas. In 1978 high prices relative to very low wages and scarcities caused by hoarding and speculation resulted in a famine in Lower Zaïre and uprisings in Kwilu and Kasai (Young and Turner 1985:309–25). Most of the parastatals were dismantled, although some survived (coffee and cotton) or were incorporated into the Ministry of Agriculture (Shapiro and Tollens 1992:42).

## A MITIGATED POPULIST REGIME

Much of Zaïre's inability to implement a policy of sustained economic growth was caused by the corrupt nature of the post-colonial regime established by Mobutu. Although after his seizure of power in 1965 Mobutu succeeded in improving his image of a true African nationalist, he failed to strengthen Zaïre's economic position. Mobutu proved to be a skilful politician. With the help of Moïse Tshombe, he arranged that Patrice Lumumba, who had been killed in January 1961, would be posthumously rehabilitated. He then crushed a rebellion of his white mercenaries (Kelly

1993:93–172), broke diplomatic relations with Portugal, and started the Africanization of topographical and personal names ('Authentification'). Mobutu could rely on the support of the emergent politico-administrative class only interested in stability (Willame 1972:129–58). After having executed some leaders of the eastern rebellions (Coquery-Vidrovitch *et al.* 1987), he broadened his political base by co-opting some former supporters of Lumumba whom he integrated in his regime.

The three most important institutional supports of the Mobutu regime were the military (Schatzberg 1988:52–70), the bureaucracy, and the official party Mouvement Populaire de la Révolution (MPR). The MPR soon became a simple administrative organization supporting the state. All heads of the administration and the villages were made ex-officio local party leaders and every Zaïrian citizen became a party member (Willame 1991:15–16). A growing number of mass organizations were founded with the help of the bureaucracy and specialized in mobilizing the crowds in the cities and the villages.

Ideology referred to nationalism, but combated communism, socialism and populism. Nationalist rhetorics were used when Mobutu embarked on a policy of nationalization of foreign-owned companies (Young and Turner 1985:185–220). He triggered Belgian economic interests, while American holdings were left relatively undisturbed. Mobutu also tried to become a recognized African nationalist and attempted to win regional leadership when proposing to set up a Communauté des États des Grands Lacs (Community of the States of the Great Lakes) and a Union of Central African States (Schatzberg 1991:31–6; Young and Turner 1985:288–92). Although Mobutu engaged Zaïre into the direction of economic nationalism, he preferred to publish in 1969 a liberal investment code in so far that he even denied the word 'nationalization' as a part of the Zaïrian lexicon.

It was Zaïre's booming economy and the absorbtion of all kinds of political and tribal opposition which enabled Mobutu to appear on the international scene as a successful African politician in the Organization of African Unity (OAU) and as a mediator in international conflicts. Mobutu recognized the German Democratic Republic and communist China and visited North Korea (this happened in the wake of Richard Nixon's normalization policy with Peking) and he even broke with Israel in order to attract the favours of the Arab states (who invited him as the only black African leader to their November 1973 summit). But he did not want to join the club of the non-aligned countries of the Third World and his close links with Holden Roberto's Frente Nacional de Libertaçao de Angola (National Front for the Total Liberation of Angola, FNLA) and Jonas Savimbi's Uniao Nacional para a Independência Total de Angola (Union for the Total Independence of Angola, UNITA) suggested that he never would embark on a policy of open confrontation with South Africa (Bustin 1987:63–75). In reality Mobutu remained a close ally of Washington.

The Angolan Civil War starting after 1975 led to the closure of the Benguela railroad, which was a vital lifeline for the copper province of Shaba. Widespread corruption created popular discontent in Shaba and other provinces. When in 1977 and 1978 a group of so-called Katangese gendarmes (former associates of Moïse Tshombe) made incursions in Shaba, American, French and Belgian military intervention was needed to keep Mobutu's regime in power. In the wake of the first invasion of Shaba, President Mobutu announced some political reforms, providing for the direct election from a multitude of candidates of members of the MPR's Political Bureau, the Legislative Council, and municipal councils, but the single-party domination of the MPR was not suppressed. During the parliamentary elections of October 1977 some non-party members representing the emergent Zaïrian commercial bourgeoisie stood for a seat in parliament (Young and Turner 1985:74–7), but they could not challenge the MPR bureaucrats occupying the levies of the state. Meanwhile Mobutu could rely on increased foreign military aid. (During the period 1981–5 he received arms transfers totalling US$150 million. Of this sum, US$40 million came from France, and the USA and Italy accounted for US$30 million each.)

## EARLY STRUCTURAL ADJUSTMENTS

Between 1965 and 1974 high growth rates (on average by more than 4 per cent a year) indicated that Mobutu's economic policy was rather successful. But in 1973, at the very moment when Mobutu started a policy of 'Zaïrianization' (nationalization) of the economy, the first oil shock had already worsened Zaïre's terms of trade. Sharply dropping copper prices (from US$3,370 in January 1974 to US$1,280 in December 1975) induced a steady economic decline, overall budget deficit, inflation, deteriorating terms of trade, and arrears on external debt (De Villers 1990:37–47).

The IMF entered into action with a stabilization programme, standby credits, and control of operations of the Bank of Zaïre. In March 1976 the IMF approved financial assistance for US$150 million. This was the first of four programmes negotiated with the IMF, which resulted between 1976 and 1981 in total drawings of SDR339 million. As it turned out, little progress was made during this period in bringing about internal and external stability and economic growth. GDP declined by about 1 per cent per year, largely as a consequence of the worsening of Zaïre's terms of trade. Although between 1979 and 1982 a slight economic recovery was observed, the Zaïrian economy was on the verge of default (Leslie 1987:65). As a consequence budget deficits soared; money supply increased at an average rate of 40 per cent a year between 1975 and 1983 and inflation at 60 per cent a year. By 1980 debt servicing attained 40 per cent of the budget because of the government's heavy borrowing abroad in the 1970s (Tshishimbi *et al.* 1994:109–10). Zaïre's growing foreign debt burden (US$5.6

billion or 78 per cent of GNP) became an object of discussion with its foreign supporters and the Bretton Woods institutions, who all pleaded for structural adjustments (Leslie 1987:63–4) to help combat the inflationary trends which were beginning to affect the Zaïrian economy.

Although Mobutu accepted IMF personnel in Zaïre's central bank, he refused to comply in matters of thoroughgoing economic and financial reforms. The IMF team tried to make hard currency inaccessible to Mobutu and his cronies, and, finally, the IMF's controller resigned. The secret IMF report described Mobutu's corrupt practices and mismanagement. The IMF conceded that repayment of Zaïre's foreign debt was a chimera (Leslie 1987:138; Willame 1992:74–8; Braeckman 1992:202). Mobutu would only repay old loans with new ones (Schatzberg 1991:67–9). In other words:

> The failure of the IMF-supported programmes to restore budgetary and external balance and reduce inflationary pressures, during the first real attempt at adjustment, to a large extent, reflected a lack of commitment on the part of the Zairian authorities to an effective implementation of the prescribed policies.
>
> (Tshishimbi *et al.* 1994:110)

Notwithstanding all these problems: Mobutu showed enough buoyancy to comply with the IMF. The so-called Mobutu Plan for Economic Recovery and Stabilization, as suggested by the IMF, was launched and implemented by December 1983. Finally, Zaïre embarked on a vigorous SAP, including a massive 77.5 per cent devaluation, reform of the foreign exchange system, trade liberalization, debt rescheduling, and cutbacks in public sector expenditures (Leslie 1987:65–6). The cornerstone of the 1983 SAP was the adjustment of the exchange rate and the trade system. Measures included a tight control of government spending through reductions in public sector employment and restraints on wage increases; large-scale reforms of public enterprises aimed at lowering the spending deficit; and a revision of the investment code aimed at attracting private and foreign investment.

During the SAP covering the period 1983–6 the average Gross Domestic Product (GDP) growth rate picked up to 2.3 per cent per annum. Zaïre was able to meet most of the performance criteria established by the IMF with regard to monetary and fiscal indicators, despite a deterioration in the terms of trade by almost 20 per cent. In 1982–5, 58 per cent of Zaïre's state expenditures were used for servicing its foreign debt. The number of civil servants decreased in this period from 444,000 to 289,000 and the number of its teachers from 285,000 to 126,000. Many of the latter category had to seek employment in private schools directly paid by the parents of the pupils (Braeckman 1992:236).

However, Zaïre's record remained far from satisfactory *vis-à-vis* structural adjustment and despite liberalization recovery did not come, because the shortage of foreign exchange associated with ever-increasing foreign debt servicing obligations and continued high demand for imported consumer goods led to a contraction of imports for investment purposes. For instance, in 1986, when a new slump was announced, GECAMINES' investment requirements absorbed already 45 per cent of Zaïre's foreign exchange earnings. For a while high copper export revenues could offset the sharp reduction in balance-of-payments assistance, but the overall result was a further deterioration of Zaïre's productive base in a period when Zaïre's exchange rate was overvalued. So economic growth remained fragile and negative in per capita terms (see Table 14.4) and inflation surpassed 100 per cent in 1986–8.

Mobutu protested against the IMF's policy and mobilized Third World public opinion against the inhuman aspects of SAPs. Then he cancelled the application of the IMF guidelines and when in 1986 Zaïre failed to meet its commitments (Leslie 1987:67), the IMF suspended in 1987 its financial interventions. Zaïre's main problem was the outflow of capital. During the period 1983–7 net outflows of capital totalled US$2 billion (in 1986 US$830 million) and by 1987 Zaïre had become an important international debtor. With a foreign debt of US$8.63 billion (about 164 per cent of GNP in 1987) a default would not imperil any foreign bank, because the vast majority (about 85 per cent) of Zaïre's outstanding debt was owed to official creditors. Maybe this explains why the Mobutu regime could easily obtain new foreign loans or reschedule its foreign debt, notwithstanding the fact that Mobutu used his power to accumulate an immense personal fortune (estimated at US$5 billion) (Braeckman 1992:193–212).

Finally, in November 1988 President Mobutu and his newly appointed Prime Minister Joseph Kengo wa Dondo promised to reduce the spending deficit, reform the state enterprises and liberalize the economy. Zaïre's major foreign creditor states (Belgium, Canada, France, the USA and Germany) cancelled a part of Zaïre's foreign debt (De Villers 1990:44–5). But these cancellations were conditional on strict adherence by Zaïre to the IMF programme. Apparently, they created room in the budget for productive investment and opened the road to more sustained economic growth in combination with a favourable investment climate.

Although liberalization had contributed to the elimination of major price-related distortions, higher inflation rates and falling investment rates threatened the economy. Furthermore, the government was unable to compress its expenditures. So the SAPs could not lay the base for long-term growth and a sustainable external financial position through improvements in macroeconomic management, reform of the agricultural sector and the transport sector. Unable to control public expenditure, the government resorted to money creation to finance the deficit and the standby arrangement with the IMF lapsed. The World Bank responded in a similar manner. Zaïre reacted by suspending its debt service and accumulated a substantial amount of arrears. In 1989 Zaïre initiated discussion with the IMF, but in 1990 the programme registered slippages once again. The structural programme supported by the World Bank collapsed and expenditures were allocated to unplanned objectives. As a result of all these failures the Bretton Woods institutions suspended disbursement and the adjusment effort ceased completely. Inflation soared to more than 1,000 per cent as money supply growth broke all records.

Since the inception of major policy reforms in 1983, long-term and external balances have not been restored and the prospects for improvement remain dim. The question is why the adjustment policies failed and economic performances have been so poor. The main reason for this failure was that the adjustment policies have been implemented inadequately or not at all. When measures were not implemented or programme targets were missed, they were all cancelled and new programmes were launched. Although Zaïre operated under IMF and World Bank tutelage, in practice the institutions' attempts to implement reforms and SAPs were often thwarted and inconsistently implemented and conceded loans were allocated without adequate monitoring. Zaïre's performance under the SAPs was extremely poor. None the less, during many years the Bretton Woods institutions presented Zaïre as their best pupil and for many years Mobutu could enjoy much sympathy and influence in Washington and Brussels. He could manipulate this support when soliciting loans from the IMF and World Bank. He could even benefit from debt relief arrangements conceded by the Paris and London clubs and contract new loans the country needed to finance its imports. In reality, many opportunities were missed and finally, as a result of all these failures the country's economic performance declined steadily. Zaïre's per capita income declined to US$260 in 1989 and poverty spread in the urban areas. Public sector salaries had declined in 1989 to just one-quarter of their 1975 level. In response the informal sector grew explosively and provided a strong incentive towards rent-seeking activities and corruption.

## THE CAUSES OF THE FINANCIAL CRISIS

As a consequence of the economic crisis, export earnings declined and caused a sudden breakdown of state finances. Five intrinsically linked causes were at the very origins of the financial crisis of the state. First, a shrinking taxable base caused by the crisis in the copper industry and falling export revenues; second, the foreign debt burden; third, the overall decline of industrial and agrarian production; fourth, high inflation rates making impossible a calculation of taxable incomes, and, fifth, the increasing importance of levying personal taxes by powerful people in and outside of the Zaïrian administration (Maton 1993; Maton 1993a; Maton 1994:91–129).

*Table 14.1* Zaïre: GECAMINES' total output (in metric tonnes)

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|
| Copper | 429,932 | 438,570 | 339,357 | 221,194 | 134,300 | 46,372 | 29,949 |
| Zinc | 54,042 | 61,085 | 38,203 | 28,183 | 18,800 | 4,158 | 623 |
| Cobalt | 8,649 | 10,032 | 10,030 | 8,700 | 6,600 | 2,174 | 3,528 |

Source: *Belgolaise,* Rapports, *1989–94*

*Table 14.2* Zaïre: government revenues over the period 1980–93 (in US$ millions)

| Year | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| 1980 | 339 | 166 | 372 | 222 | 65 | 1,164 | 2.8 |
| 1981 | 336 | 168 | 234 | 162 | 40 | 940 | 4.4 |
| 1982 | 317 | 244 | 250 | 66 | 71 | 948 | 5.8 |
| 1983 | 214 | 215 | 153 | 157 | 30 | 769 | 12.0 |
| 1984 | 170 | 178 | 139 | 137 | 22 | 646 | 36.5 |
| 1985 | 186 | 162 | 162 | 190 | 13 | 712 | 50.9 |
| 1986 | 196 | 129 | 191 | 152 | 47 | 716 | 58.7 |
| 1987 | 208 | 113 | 156 | 174 | 13 | 663 | 113.6 |
| 1988 | 177 | 98 | 165 | 367 | 19 | 826 | 187.0 |
| 1989 | 152 | 168 | 225 | 354 | 50 | 950 | 385.2 |
| 1990 | 131 | 127 | 197 | 173 | 9 | 637 | 979.8 |
| 1991 | 120 | 89 | 157 | 103 | 4 | 473 | 14,537.0 |
| 1992 | 66 | 89 | 102 | 0 | 4 | 203 | 639.3 |
| 1993 | 82 | 91 | 128 | 0 | 5 | 302 | 10,972.0 |

Key:
(1) Income taxes (excluding GECAMINES).
(2) Indirect taxes (excluding GECAMINES).
(3) Import and export duties (excluding GECAMINES).
(4) Taxes paid by GECAMINES.
(5) Other taxes and incomes.
(6) Total.
(7) Exchange rate (in 1992–3 in 000).
Source: *Maton and Aspeeler 1994:112*

## Falling export revenues

The Zaïrian state has always been depending for its revenues on taxes paid (on an average US$200 million a year) by the state-owned copper mining firm GECAMINES. Copper export earnings had allowed Mobutu in the period of economic upswing (1966–73) to finance his large-scale industrialization projects. But already during the crisis of the early 1980s debt servicing requirements were increasingly outcrowding all other expenditures. Zaïre's GDP decreased while a general shortfall of public investment caused a severe deterioration of the standard of living and the quality of public services.

Meanwhile the political elite kept on siphoning GECAMINES' export earnings (Kankwenda 1992:381–5). For instance, in 1988–9 the Zaïrian government siphoned an extremely high percentage of GECAMINES' earnings (see Table 14.2). In turn, this accelerated the deterioration of the mining company's financial position and its investment capacity. Subsequently, due to lacking maintenance and investment, GECAMINES' production fell dramatically (see Table 14.1) and by 1992 the firm had to stop all tax payments. The crumbling down of the Kamoto copper mine in 1990 symbolized the bankruptcy of Zaïre's copper mining economy.

Because the mining company's investment requirements remained very high and tax payments had stopped, the government tried to compensate these shortfalls by increased foreign borrowing and inviting foreign investors to float GECAMINES. As copper prices dropped and other copper-producing countries increased their output, foreign investors became very reluctant to invest in Zaïre's bankrupt mining activities. Especially the Belgian copper refineries belonging to the group of the Société Générale de Belgique (SGB) started purchasing copper bars in other copper-producing countries (Braeckman 1992:242). In 1994 the Union Minière decided to reduce its copper-refining capacity when modernizing its factories in Belgium and declared that in the near future copper from Peru and Asian countries would be purchased in order to prevent the Union Minière refineries from any shortage.

The bankruptcy of the Zaïrian state can be illustrated by the dramatic drop of its tax revenues. In 1980 tax revenues amounted to US$1,164 and in 1993 to US$302 million (see Table 14.2). By 1993 prospects for the future appeared extremely gloomy, because falling revenues were not compensated by decreasing expenditures. Over the period 1989–93 total expenditures rose from US$1,166 million in 1989 to US$1,268 million in 1992 because political and social demands had obliged the Mobutu regime to restore salaries at past levels, an effort which could not be sustained without inflationary money creation by the National Bank. As a consequence of expanding expenditures and declining tax revenues the overall spending deficit increased from US$64 million in 1989 to US$1,184 million in 1992. In 1992 expenditures were more than fivefold higher than revenues and the deficit had risen to almost 80 per cent of total outlays (see Table 14.3), which had to be financed by money printing.

## Zaïre's foreign indebtedness

In 1993 Zaïre's foreign debt amounted to US$10.7 billion. Since 1992 debt servicing had stopped and in 1993 arrears totalled some US$640 million (US$300 million to IMF, US$300 million to the African Development Bank (ADB), US$40 million to the World Bank). Zaïre never paid more than a fraction of its loans, except in years it received large amounts of exceptional foreign aid. Meanwhile Zaïre had contracted a high interest loan of some US$200 million brought together by a consortium of Arab bankers. This was not advantageously improving the country's image and solvability rate.

*Table 14.3* Zaïre: government expenditures and deficits over 1989–92 (in US$ millions)

| Years | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1989 | 479 | 199 | 70 | 868 | 62 | 930 | 242 | 1,166 | 982 | 242 | 64 | 5 |
| 1990 | 462 | 284 | 78 | 924 | 92 | 1,016 | 174 | 1,505 | 660 | 174 | 691 | 46 |
| 1991 | 468 | 333 | 58 | 925 | 171 | 1,099 | 87 | 1,402 | 473 | 87 | 842 | 60 |
| 1992 | 780 | 187 | 71 | 1,103 | 146 | 1,193 | 61 | 1,508 | 263 | 61 | 1,184 | 78 |
| 1993 | 604 | 149 | 68 | 924 | 118 | – | 30 | 1,268 | 302 | 30 | 936 | 74 |

Key:
(1) Goods and services.
(2) Wages.
(3) Subsidies.
(4) Total current expenditures.
(5) Investments on own budget.
(6) Current expenditures and local capital expenditures.
(7) Total aid.
(8) Total expenditures (including extra-budgetary expenditures).
(9) Taxes.
(10) Gifts.
(11) Government deficit.
(l2) Share of deficit in outlays.
Source: *Maton 1993:5; and Maton and Aspeeler 994:114*

Because interest payments to the IMF gradually had diminished from US$58 million in 1987 to US$11 million in 1992, foreign creditors grew angry and started cutting credit. So net disbursements or loans dropped from US$333 million in 1989 to US$50 million in 1992. In reality, foreign banks and investors had lost all confidence in Zaïre when foreign experts ascertained that it would be an illusion to think that Zaïre will pay back its past public debt. As long as Zaïre's copper exports decline and as long as the country is unable to create independent strongholds within the country providing guarantees for a debt servicing out of its own earnings of foreign exchange, inflows of foreign capital in behalf of loan financed projects will remain insignificant.

Declining copper export capacity forced Zaïre to increase its diamond export earnings. In 1985 about 11 per cent of its export earnings came from diamonds, but in 1993 diamonds represented 45.5 per cent of total export earnings. This was by no means a solution to Zaïre's structural payment difficulties, because, in contrast to copper mining industries, diamond production is difficult to tax and fraud is not easy to avoid in a period of shortage of foreign exchange earnings. In 1993 only US$87 million out of a total of US$813 million of Zaïre's export earnings went via its central bank (Maton 1994:1–116). In the meantime the mining province of

Kasai had forced a *de facto* status of relatively large autonomy under Jonas Mukamba, who was running the diamond mining company MIBA like his own privately owned firm.

## The agrarian and industrial crisis

Traditional cash crops (coffee, tea, rubber, palm oil and timber) generate additional foreign exchange earnings. Unfortunately, Zaïre's cash-crop agriculture has to face structural problems caused by a general breakdown of the transport system. Its network of roads and railways deteriorated because of a lack maintenance and transport costs soared because of insecurity problems and high fuel prices. Furthermore, only 2.5 per cent of Zaïre's agricultural sector belongs to the category of capitalist farming (plantations). Like other African countries, Zaïre became a small-peasant coffee-exporting country. Its cotton and palm oil production (M'bela Bolekolaka 1982:71–82) is insignificant and many other crops are smuggled to neighbouring countries where cash-crop prices are higher (Willame 1992:83–4).

Zaïre's manufacturing contributes only 0.6 per cent to total exports. Unfortunately, the manufacturing industry has to import 21 per cent of its intermediary goods and all its machinery. The manufacturing industry producing for the sheltered domestic market is not competitive, but highly concentrated (Willame 1991a:84–5). In the agribusiness and foodstuffs industries, large grain-mills, breweries and tobacco firms dominate the sector. Some are owned by foreign mutinational companies. The textile industry is in decline and, compared with 1970, its output had decreased by 1990 by around 40 per cent. The main reason for that decline is that cotton fibres have to be imported from the United States, while in the colonial period the north east was an important cotton-growing region. Imports of oil products increased because Zaïre's oil refineries had to reduce their output as a consequence of lacking maintenance.

After the implosion of the mining sector, agriculture has become GDP's major contributor (see Table 14.4). Practically 80 per cent of its produce goes directly to household-consumers or self-consumption. In order to feed Kinshasa's 4 million inhabitants the government has to import foodstuffs (in 1990 purchases amounted US$161 million worth). As long as the government fails to solve the increasing transport problems Zaïre's agricultural sector will be unable to meet the demands of the urban population (Kankwenda 1992:261–82).

## Inflation and corruption

In 1967, one zaïre was worth two US$2. In the early 1990s the zaïre was worthless. For many years the government had financed its huge spending deficit by printing more banknotes. No structural changes can be expected to occur without solving the problem of the control of the system of foreign exchange and the allocation of import credits. This will require normal rules with respect to foreign exchange, otherwise control will be nonexistent and most of the transactions will take place in the twilight zone of corruption and black market practices.

*Table 14.4* Composition of Zaïre's GDP (added value in million Zaires in constant prices of 1970)

| *Years* | *(1)* | *(2)* | *(3)* | *(4)* | *(5)* | *(6)* | *(7)* | *(8)* | *(9)* | *(10)* | *(11)* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1968 | 73.8 | 76.0 | 176.4 | 58.4 | 16.8 | 8.4 | 8.4 | 229.8 | 43.4 | 761.4 | 19.13 |
| 1969 | 73.3 | 76.0 | 195.1 | 64.3 | 21.0 | 10.5 | 8.7 | 333.8 | 48.4 | 831.1 | 19.87 |
| 1970 | 77.2 | 80.2 | 207.6 | 73.9 | 30.0 | 15.0 | 9.1 | 374.6 | 51.7 | 919.3 | 20.71 |
| 1971 | 81.9 | 84.8 | 215.9 | 78.4 | 34.2 | 17.1 | 9.3 | 403.1 | 51.2 | 975.9 | 21.25 |
| 1972 | 81.4 | 84.2 | 226.4 | 85.8 | 30.7 | 15.3 | 9.6 | 408.1 | 53.9 | 995.4 | 21.79 |
| 1973 | 83.8 | 88.1 | 243.4 | 93.4 | 34.6 | 17.3 | 10.4 | 453.6 | 51.8 | 1,076.4 | 22.34 |
| 1974 | 86.3 | 89.0 | 250.1 | 101.1 | 39.0 | 19.5 | 9.4 | 480.1 | 35.6 | 1,110.1 | 22.90 |
| 1975 | 88.9 | 83.8 | 242.0 | 92.1 | 38.7 | 19.4 | 10.2 | 446.9 | 32.8 | 1,054.8 | 23.50 |
| 1976 | 91.5 | 90.4 | 226.7 | 84.8 | 32.5 | 16.2 | 11.0 | 427.3 | 18.4 | 998.8 | 24.05 |
| 1977 | 94.2 | 81.7 | 239.8 | 83.0 | 27.1 | 13.5 | 11.2 | 440.0 | 15.9 | 1,006.4 | 24.61 |
| 1978 | 97.0 | 79.2 | 218.0 | 72.5 | 27.7 | 13.8 | 11.4 | 416.7 | 16.3 | 952.6 | 25.18 |
| 1979 | 99.9 | 81.7 | 206.3 | 68.3 | 25.0 | 12.0 | 11.0 | 435.8 | 15.1 | 955.1 | 25.77 |
| 1980 | 102.6 | 84.1 | 220.4 | 67.5 | 25.0 | 12.4 | 11.6 | 436.3 | 18.6 | 978.5 | 26.39 |
| 1981 | 105.4 | 86.3 | 236.2 | 68.0 | 25.1 | 12.5 | 11.3 | 442.1 | 19.1 | 1,006.0 | 27.05 |
| 1982 | 108.6 | 87.0 | 228.8 | 60.6 | 25.8 | 12.9 | 2.0 | 425.9 | 13.9 | 975.5 | 27.73 |
| 1983 | 111.9 | 87.6 | 237.5 | 60.3 | 29.2 | 14.6 | 12.0 | 426.6 | 8.6 | 988.3 | 28.42 |
| 1984 | 115.3 | 90.1 | 253.8 | 62.6 | 22.8 | 11.4 | 12.7 | 441.5 | 4.8 | 1,015.0 | 29.26 |
| 1985 | 119.7 | 93.5 | 260.9 | 65.4 | 23.7 | 11.9 | 13.2 | 444.9 | 7.2 | 1,040.4 | 30.12 |
| 1986 | 123.3 | 103.3 | 268.0 | 68.3 | 25.2 | 12.2 | 14.0 | 448.5 | 5.7 | 1,068.5 | 31.01 |
| 1987 | 127.0 | 100.4 | 262.6 | 72.4 | 29.4 | 14.7 | 15.3 | 469.0 | 5.0 | 1,095.8 | 31.93 |
| 1988 | 130.8 | 105.9 | 249.7 | 70.9 | 32.8 | 15.2 | 15.6 | 458.1 | 6.6 | 1,085.6 | 32.87 |
| 1989 | 134.3 | 106.3 | 234.3 | 67.9 | 30.1 | 15.0 | 16.3 | 458.6 | 6.3 | 1,069.1 | 33.84 |
| 1990 | 138.1 | 109.2 | 204.3 | 65.2 | 23.9 | 11.9 | 17.4 | 457.4 | 6.0 | 1,033.4 | 34.84 |
| 1991 | 142.3 | 110.4 | 185.5 | 58.0 | 20.8 | 10.3 | 17.9 | 362.4 | 6.0 | 913.6 | 35.82 |
| 1992 | 146.6 | 112.7 | 143.2 | 48.7 | 17.6 | 8.8 | 17.5 | 379.6 | 6.0 | 880.7 | 36.82 |

Key:
(1) Non-commercialized agricultural sector.
(2) Commercialized agricultural sector.
(3) Mining sector.
(4) Manufacturing sector.
(5) Modern constructing sector.
(6) Traditional constructing sector.
(7) Public utilities.
(8) Private and public services, commerce, transport.
(9) Export taxes.
(10) GDP.
(11) Population (in millions).
Source: *Maton and Aspeeler, 1994:34–5*

Although corruption has flourished at all levels of state and society, there was an important qualitative difference between the motives for corruption at the top of the hierarchy and for that practised at the bottom. Mobutu and his fellows siphoned a large part of Zaïre's export earnings to keep themselves in power. But for others down the social ladder this had become the only way to survive. Already in 1978 the American scholar Crawford Young had stated that a 'deepening social crisis provoked by the pauperization of the mass of the populace' (Young 1978:169) was threatening Zaïre's political and social stability. In 1993 another scholar described the origins of the systemic character of the Zaïrian sickness:

> Instead of accumulating and transforming profits into a greater production capacity, producing more goods and generating more profits, it wastes and distributes with desire, sometimes caricatured, to do the opposite of the colonizer. Where the colonizer saved, it redistributes; efforts at investment have been supplanted by spending for ostentation, costly trumpery, or clientelist support.
>
> (Verhaegen 1993:115)

## THE PITFALLS OF DEMOCRATIZATION

Although Mobutu's foreign protectors (the USA, France and Belgium) knew that with Mobutu in power Zaïre's crisis would continue, no real attempts were made to force him down (Willame 1992:121–53). But with the fall of communism in Eastern Europe Mobutu himself changed his mind. In his speech on 24 April 1990 he admitted that two opposition parties could be formed and free elections organized. A transitory government would be set up with the responsibility to prepare for the creation of more democratic institutions, the holding of a National Conference, and the revision of the Constitution (Longman 1991:172–7; Mobutu 1990:197–203). Apparently Mobutu's conversion to democracy had been inspired by the presidential clan fearing an uprising of the urban masses in Kinshasa and a complete breakdown of the regime.

After having promised to resign at last in December 1992, Mobutu conceded that Zaïre should become a multiparty democracy. The Union pour la Démocratie et le Progrès (UDPS) led by his former minister Etienne Tshisekedi appeared to be the most influential party and was supported by the American Embassy in Kinshasa. None the less, Mobutu refused to resign (Kelly 1993:243–58; Willame 1991a; Williame 1994:126–43). But when in May 1990 Mobutu's troops killed a number of students on the campus of the University of Lubumbashi in Shaba, Belgium followed by the other Western countries immediately stopped all technical assistance. The Zaïrian opposition leaders thought the moment of Mobutu's fall was approaching. Even the *mestizo* faction led by Joseph Kengo wa Dondo broke away from Mobutu's MPR and founded the Union des Démocrats Indépendants (UDI). But when Mobutu started soliciting the opposition politicians to enter into the different governments he successively appointed and dismissed, the 'united front' of Mobutu's opponents disintegrated.

The promised Conférence Nationale Souveraine (CNS) that started on 31 July 1991, elected Cardinal Laurent Monsengwo as President of the CNS. When discussing the foundation of the Third Republic the mobilized elites were far from agreeing on the founding principles of the new regime. In addition, the ensuing frenzy of political activities, with the creation of over one hundred political parties and strike after strike of civil servants and private sector workers, thoroughly destabilized the country (Willame 1994:128–33). Meanwhile public expenditures soared, because Mobutu and his cronies kept on plundering the central bank and smuggling diamonds and gold (MacGaffey 1991:95–9). His armed forces killed people in the streets and triggered the CNS that had elected in the summer of 1992 Etienne Tshisekedi as Prime Minister. But at that moment Tshisekedi's position was already hollowed out by internal rivalries and jealousies and on 1 December 1992 Mobutu dismissed Tshisekedi.

On 5 December 1992 Monseigneur Laurent Monsengwo was nominated Chairman of the newly established Haut Conseil de la République (HCT), supervising democratization of the political institutions and playing the role of a provisional parliament. But the old Assemblée Nationale with Mobutu supporters refused to sign its demise and finally Monsengwo had to accept a merger of his HCT with the pro-Mobutu Assemblée Nationale. In the Haut Conseil de la République-Parlement de Transition (HCT-PT) the Mobutu faction was dominant and the radicals around Tshisekedi were minoritized. That was the reason why Monsengwo's prestige faded away. Moreover, a majority composed out of Mobutu supporters and opportunists accepted that the moment of presidential elections should be postponed. Finally, the HCT-PT approved on 9 April 1994 the draft of the new Constitution (Acte Constitutionnel) at a moment when Mobutu's position was already consolidated.

On 14 June 1994 the HCT-PT elected Kengo wa Dondo as Prime Minister. This was a blow to the repudiated Etienne Tshisekedi, who still considered himself as the only legal Prime Minister (*Le Monde,* 16 June 1994). Obviously, when choosing Kengo wa Dondo, the HCT-PT preferred to elect a politician who was acceptable for Mobutu and the foreign powers. Kengo wa Dondo had twice been Prime Minister. Furthermore, Kengo had belonged to the technocratic *mestizo* faction of Mobutu's MPR and he was still in close touch with the unitarist commercial bourgeoisie and acquainted with the Bretton Woods technocrats. Kengo wa Dondo immediately invited businessmen and bankers to Kinshasa and he opened negotiations with France and Belgium in order to continue cooperation and assistance. But Kengo failed to attract investors or foreign aid to Zaïre. Moreover, Kengo was unable to restore his authority and to unite the political class. Because the administrative system had broken down, the government could not impose presidential and parliamentary elections (*Le Soir* 22 May 1995). A coalition of Mobutu politicians and radicals around Tshisekedi decided to depose Monsengwo as Chairman of the HCT-PT and to postpone all elections until 1997. The radical opposition had always rejected the archbishop and that may explain why 510 members of the 780-strong HCT-PT (the necessary majority) signed a motion calling for his dismissal. Then Prime Minister Kengo wa Dondo reformed his government but, again, he excluded the Tshisekedi faction from governmental power.

Thomas Kanza, who was once Patrice Lumumba's fellow traveller and later on an influential advocate of radical political change, had already critized in the early 1990s the ongoing process of democratization as a phoney attempt to create ideological differences between a multitude of political parties striving for power. Not ideological differences, but the greedy of Mobutu's opponents was the main factor during this period of political uncertainty (Willame 1994:133). In the meantime ethnic differences were stressed by all politicians holding a local power base. The decay of the central state was speeded up by the economic crisis and local authorities were obliged to take over the functions of the central state. In the larger cities tribal violence was progressing (Verhaegen 1993:124) and the informal economy and criminality were superseding all legal and normal economic activities. Meanwhile all attempts to reform the economy had failed. All financial resources were still drained into the pockets of Mobutu and his entourage. The survival of the Mobutu regime was costing US$15 million a month. Kengo wa Dondo tried to take over control of the National Bank. Finally he removed the President's man as governor of the central bank, but he failed to impose his authority by force. Local power brokers like Jonas Mukambo in Kasai frustrated the introduction of a new currency (Nouveau Zaïre). The diamond-rich province Kasai and the eastern province Kivu, where humanitarian relief assured the survival of refugees from Ruanda, had a dollarized economy. Kengo's stabilization programme could not prevent rampant inflation (in 1994 8,689 per cent) although state expenditures were cut (from US$1,200 million in 1993 to US$234 in 1995).

Kengo wa Dondo has no ethnic base and depends on the goodwill of the President and pressure from Western ambassadors to retain his post. Western governments hoped that Kengo and Monsengwo together would gradually twist power from Mobutu's grasp. But in Zaïre power derives from money, not from structures. Mobutu appeared to have put politics in quarantine under the care of two respected men, while he continued to milk his country as usual.

## CONCLUSION

Of course, Zaïre's failure to reform its economic and political structures has much to do with its class structure engendered by colonialism. In

Zaïre no entrepreneurial class exists. Because of its huge investment requirements and its corrupt bureaucratic ruling class any attempt to induce sustained economic growth and import-substituting industrialization failed.

Zaïre's export earnings were wasted during the early 1970s by investing in large-scale industrial projects ('white elephants') or by consumptive expenditures, which were at the origins of its indebtedness. Economic decline was speeded up by predatory practices and corruption. Until 1989 Zaïre's dictator was backed by the major Western governments. But after the withdrawal of the Cuban intervention army in Angola, the breakup of the Soviet empire, and the fall of the racist regime in South Africa, Zaïre's international position became of less importance for the super-powers. Meanwhile its mining products lost much of their strategic importance. Even Belgium's copper-refining industry had lost interest in Zaïre.

The SAPs could not halt the overal decline of the Zaïrian economy. The SAPs encountered a number of difficulties and some of these were external, but most stemmed from domestic developments. The government did not sufficiently restrain its expenditures and the budget deficit was financed through government's increased recourse to domestic bank financing, which, in turn, induced a sharp expansion of money supply and an acceleration of inflation. Meanwhile, the depreciation of the national currency and the spread between the official and the parallel market rates widened and contributed to the depletion of the country's foreign exchange reserves. In response to these developments, the government suspended all external debts payments except to a few countries and the Bretton Woods institutions. Distortions and structural weakness brought about by years of inappropriate economic policies remained entrenched in many segments of the economy.

At the end of 1991 Zaïre was at the verge of bankruptcy. The process of democratization had not united the political class and by 1995 the recently established Third Republic failed to consolidate a parliamentary system, based on accountability to the population. The new regime failed to introduce a programme of thoroughgoing economic and financial reforms. Although the single-party regime had been dismantled, Mobutu stayed in power and still manipulated the political class divided up in more than 100 political parties and factions.

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