LIBERALIZATION AND DEMOCRATIZATION IN THE CONTEXT OF A WEAK STATE AND A WEAKER CIVIL SOCIETY

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Abstract. A weak state, financially bankrupted and politically deprived of support from civil society, as it is common in Latin America and Eastern Europe, is unable to regulate markets and is ill-suited to guarantee market-oriented reforms, just as much as a weak civil society is inconsistent with representative democracy. Liberalization of the economy and the consolidation of democracy are only possible where the state and the civil society are strong. The strength of the state depends on its political legitimacy, on its fiscal soundness, and on the support that both the state and the government derive from civil society.

The Forlí Conference on liberalization and democratization was a stimulating exchange of ideas. For three days, twenty people from Europe, United States, Latin America and Eastern Europe debated nine excellent papers on the concept of democracy, markets and the state, the processes of democratization and the introduction of market-oriented reforms, most of them rather theoretical but nonetheless well informed about in present realities.

All of us learned a lot in this conference, and my first inclination was to underline what was consensual: what <u>we</u> learned rather than what <u>I</u> learned. A near consensus was achieved, for instance, on a very crucial point: the liberalization of the economy and the consolidation of democracy are only possible where the state and the civil society are strong. The strength of the state depends on its legitimacy (on its government being representative), on the its fiscal soundness, and on the support that both the state and the government derive from civil society. The strength of civil society depends on the existence of a well-structured market system and on the balance of powers and the cohesiveness of the multiple groups and associations forming it.

I could go on developing these ideas, but since I am as much attracted as I am doubtful about consensus, I would rather say what I learned over and above the broad accord we reached: that a weak state, financially bankrupted and politically deprived of support from civil society, as it is common both in Latin America and Eastern Europe, is unable to create or regulate markets and is ill-suited to guarantee market-oriented reforms, just as much as a weak civil society is inconsistent with representative democracy.

An inner contradiction befuddles the recent processes of transition to democracy in those two regions and the present hope for the consolidation of new democracies. The transitions to democracy took place in the middle of a deep and double crisis - a fiscal crisis of the state related to the debt burden and a crisis of the developmentalist and protectionist pattern of state intervention. This double crisis helped produced the transition to democracy, but subsequently undermined the new democratic governments, as they proved themselves unable to effectively recover the solvency of the state. Thus, the crisis of the state was both causes of the democratization process and a reason behind the failure of the new democracies to consolidate. Furthermore, a strong but lean state, i.e., an effective although reduced state apparatus, is necessary to the consolidation of democracy: to guarantee property rights and contracts, to stabilize the economy, to promote income distribution and welfare, to liberalize and privatize, and even to assure the existence of a strong civil society. The question, then, is to know how is it possible to perform all these tasks within an ideological context where market-oriented reforms are identified with the withdrawal of the state from any economic role, where economic liberalization is assumed to aim at a minimum state, and within a practical context where privatizations are frequently so wild, stabilizations so costly and reforms so inefficient. Since privatization has been wild in Argentina, the social cost of adjustment very high in Venezuela and Chile, and stabilization very incompetent in Brazil, since reforms often proved inefficient and destructive of the existing productive system in Eastern Europe, one can ask: are these attempts at reforms consistent both with the their effective implementation and with the consolidation of democracy?

For many years, economists have debated how to stabilize, to achieve fiscal discipline and the solvency of the state, to promote market-oriented reforms, economic growth and income distribution. In Washington, something like a consensus was achieved in late 1980s - the "Washington consensus". It corresponds do a conservative, neo-liberal paradigm. Although it was John Williamson who coined this expression, the actual neo-liberal consensus should be distinguished from Williamson's (1992) careful own definition of the consensus he is identified with (he adopts a neo-classical rather than a neo-liberal approach). Besides, it becomes clear that this "consensus" is far from being consensual in Washington or anywhere. In the Forlí conference it surely was not. Today it is generally agreed that the state has grown too much, that fiscal discipline, trade liberalization and privatization are necessary. But the consensus ends here. Paul Streeten, is his paper, showed that "for the proper work of markets, strong and in many cases expanded, state intervention (of the right kind, in the right areas) is necessary. It is possible to favour a strong state with a limited agenda" (1992: 1). Besides, Williamson underlined the need of de-ideologizing the role of the state in modern economies. And properly observed: "the fundamental political divide (on economic issues) is not between capitalism and socialism, or between free markets and state intervention, but between those concerned to promote an equitable income distribution (`the left') and those concerned to defend established privileges (`the right')" (1992: 5).

Peter Gourevitch's paper (1992) defined four possible theories relating markets and democracy (1: markets require democracy; 2: markets require authoritarianism; 3: democracy requires markets; 4: democracy requires centralized planning and public ownership). Yet, even if the last theory is broadly discarded for obvious lack of support in reality, the consistence of the other theories with the recent experience of nations is also far from obvious. For instance, how consistent with democracy is the "big bang" approach being urged upon and used in Eastern Europe? Moreover, as reforms according to the "big bang" approach cancel the state's economic coordinating role where there is no market to replace it, is it realistic to suppose that markets will be spontaneously created and the democracy consolidated, while the state is destroyed rather than reformed?

The historical phase in which the creation of markets and the consolidation of capitalism required an authoritarian state is over for most countries in the world. This was the phase of primitive accumulation, where the basic stock of capital of a nation was formed, where saving roughly increased from 5 to 15 per cent of GDP. In the history of capitalism this was the mercantilist phase, that in most of Europe took place in the eighteenth century and in Latin America and Asia happened a century later. The recent experiences of technobureaucratic authoritarianism in Eastern Europe (communism) and Latin America (bureaucratic developmentalism) represented an artificial lengthening of the process of primitive capital accumulation, a strategy to boost heavy industrialization that, only for some time, was able to successfully promote heavy industrialization.

In the industrialized countries, a similar but milder process of increasing state intervention took place from the beginning of the century and particularly since the 1930s. This process was quite successful up to the end of the 1960s. Yet, in the early 1970, the crisis of this mode of state intervention broke up. This crisis was flagged by the ending of the gold convertibility of the dollar and by the first oil shock. It was defined by a general slow-down of the world economy. But its inner cause was the fiscal crisis of the state, originated from a distorted cyclical growth.[1]

In the industrialized countries the immediate response to the fiscal crisis was fiscal adjustment. As a consequence, the crisis - except in the U.S. and in Italy - was overcome or circumvented. The growth rates declined to half of what they were during the post-war 25 years but remained positive. Latin American and the Eastern European countries did not follow the example. For about 10 years they were able to postpone adjustment, supported by abundant foreign finance. The result was an enormous foreign debt, a much worse fiscal crisis, the rise of inflation changed into hyperinflation in several cases, and the urgent need for deep market-oriented reforms.

Yet, if the inner nature of the crisis is just one and if the experience of the industrialized countries is to be taken into account, - rather than to adopt the neoliberal rhetoric, it is necessary to underline that in these countries the state was not destroyed or weakened, but strengthened. Thus, the same should be done in Latin America and Eastern Europe. In East and South-East Asia the crises itself was avoided because the state remained strong whereas the economy turned highly competitive, market-oriented.

The political scientists, who, in the last years, concentrated their interest in stabilization programs and economic reforms, initially assumed that the economists knew how to design them. Thus, they did not take into account that economic reforms could be costly, inefficient and even ineffective, if they ignored the current <u>economic</u> conditions existing in Latin America or Eastern European countries[2].

Economists, policy-makers, businessmen and political scientists in the First World are convinced that the only reason why stabilization programs and market-oriented economic reforms do not work is political. Populist politicians, radical union leaders, corporatist bureaucrats and shortsighted or covetous businessmen in developing countries would impede the success of reforms. In believing so they ignore that after World War II those countries experienced high rates of growth counting on the same human assets; that in developed countries politicians, workers, middle class bureaucrats and businessmen may have a stronger sense of citizenship but are not essentially different; that in Latin America the direct cause of the present 12-year old crisis was not populism but the unconsidered developmentalism of the military

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1 - See Bresser-Pereira (1988). In this paper I suggest that the present process of liberalization, privatization and deregulation, i.e., the reduction of the state, as well as the conservative, neo-liberal wave that comes with it, are part of a cyclical reduction of the state apparatus, after an enormous growth since the 1930s.

2 - I underlined this fact in Bresser-Pereira (1992).

regimes that Washington authorities supported politically and First World banks financed.

This view that blames politics for all evils is now changing among political scientists as they see that many reforms with strong initial political support fail. And also as they perceive this approach is very dangerous to the consolidation of democracy, even having obviously some foundation. If it is the resistance of politicians that block reforms, the "logical" solution is to close Congress, is to restore authoritarian regimes, as Fujimori, an elected president now turned dictator, has just done in Peru. Furthermore, if it is acknowledged that there are political resistances, but also poorly designed economic reforms, it will be wiser to give equal weight to the tasks of surmounting political obstacles and defining efficient reforms that stabilize and ensure the resumption of growth at acceptable or justifiable costs.

Populism has re-emerged in Latin America and nationalism is resurging in Eastern Europe as a direct consequence of the democratization process. As the economic crisis was not resolved but deepened, the first democratic governments after the transition were subject to increasing loss of support. Meanwhile, the debt crisis, transformed into a fiscal crisis as the foreign debt was transferred to the state, was not satisfactorily managed. The burden of fiscal adjustment fell almost exclusively on the debtor countries. Some countries, like Mexico, were able to impose the sacrifices on their people while competently stabilizing the economy and introducing reforms. Other like Chile, less competently stabilized (the costs were extremely high), but were effective in the design and implementation of structural reforms. Most countries initially failed to stabilize and reform. As the crisis deepened, hyperinflation exploded. This was particularly the case of Bolivia, Peru, Argentina and Brazil in Latin America - countries whose experience Kaufman and Haggard (1992) analyze. Some years after the democratic transition, when new presidents are elected in the middle of severe hyperinflation, they adopt shock market-oriented reforms, liberalizing, sometimes wildly, their economies.

Kaufman and Haggard ask "how is that democratic governments could launch such comprehensive and orthodox program?" (1991: 26). International pressures (the Washington consensus) may be a cause, but the real reason for these liberal shocks - that contrast with the gradualist character of reforms in Chile and Mexico -, is the depth of the state crisis. When the state is fiscally collapsed, when it is immobilized by economic chaos, when " de facto privatization" is the radical and disorderly reduction of the fiscal capacity of the state rather than the result of a rational policy (as it happened in Peru)[3], when "the state is dying" (as declared Bolivia's president Paz

[3] - Richard Webb, in the "Prologue" to Sachs and Paredes' book on Peru writes: "The most striking result of Peru's fifteen-year economic crisis has been de facto privatization. The public sector has undergone massive compression. The state is withering away, and

Estensoro in 1985), when the net costs of adjustment are smaller than muddling-through the crisis,[4] when the economy is on the verge of or has already fallen into economic chaos, there is no alternative for a new government but to adopt radical - and often irrational - liberal measures.

Yet, the exercise of extensive executive powers in the midst of economic crisis, that Haggard and Kaufman aptly analyze, can have a longer-term explanation. In a new paper O'Donnell (1992) deepens the concept of "delegative democracy" he has been developing in the last two years[5]. He reminds us that representative democracy is based on a strong state that should not be equated only with the bureaucratic apparatus: "the state is also (besides a bureaucratic apparatus), and no less primarily, that aspect of social relations that establishes a certain order" (1992: 2). It is "the effect of a legality". In representative democracy "the equality guarantied to all members of the nation in terms of citizenship is crucial not only to the exercise of the political rights entailed by the workings of political democracy, but also to the "effectiveness of the individual and associational guarantees" (1992: 4), i.e., to the existence of a strong civil society. And O'Donnell adds: "One of the contemporary tragedies is that, in most newly democratized countries, privatizations and other forms of de-statization are undertaking jointly - and unnecessarily - with a sharp weakening of the state. Nothing illustrates better the dominance of neo-conservative ideas than the almost indiscriminate evilness presently attributed to the state. The carriers of these ideas, in interplay with a deep socio-economic crisis, are not only reducing the size of the state: they are destroying the state" (1992: 6).

Laurence Whitehead contrasts the belief existing in consolidated democracies that both representative governments and price stability are ends-in-themselves, to Latin American general view that "will attach a higher priority to the reduction of gross inequalities or the breaking of supposed `bottle-necks' to development, than to absolute price stability or the more polished refinements of `formal' democracy" (1992: 19). And he adds: "both democratic consolidation and economic liberalization rest on a common foundation: the manufacture of stabilizing expectations. Fiscal crisis may abruptly lower expectations, and thus create a moment of opportunity for this to be done" (1992: 25). In fact, expectations are much lower today in Latin America and Eastern Europe. This is certainly helping the introduction of economic reforms, but if they are not economically efficient, politically realistic, and do not have expressly in

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surprisingly the process has been independent of any political program... The shrinking preceded conservatism... The state is shrinking despite the politicians, the bureaucrats, and the broad preferences of the Peruvian polity." (1992: 1)

4 - For the concept of net transitional costs, see Bresser-Pereira (1992). Net transitional costs are transitional costs, the costs of adjusting and reforming, less the costs of muddling through the crisis. As the crisis deepens, net transitional costs tend to lower.

5 - See also O'Donnell (1991).

mind to preserve rather than to destroy the state, these two regions are headed for many economic and political troubles.

There is no doubt that stabilization and market-oriented reforms are a priority in Latin America as well as in Eastern Europe. The question, however, is whether these objectives are to be achieved in inefficient, unnecessarily expensive ways: destroying, rather than strengthening, the state; fragmenting rather than assuring cohesiveness to civil society; excluding from the agenda the resumption of growth; and leaving free monopolistic "market" forces which only increase economic inequalities. As Whitehead warns, the possible positive effect of lowered expectations "will fade over time unless the resulting patterns of economic and political behavior can be underpinned and reinforced by a new framework of more effective and credible liberal institutions" (1992: 25).

As Hawthorn's paper stressed "there may, as Constant suggested, be an affinity between free commerce and a representative democracy. But as Hume and Smith had insisted, remembering Hobbes, this can only be realized if there is a sovereign authority to guarantee secure and civil liberty... Indeed, Zaire, India and Venezuela show how liberalization can actually undermine the preconditions for democratization that liberal theory suggests as its natural corollary. The demand now is that economies open themselves to investment from outside, and that they retain control over their currencies and their non-economic policies only in so far as both are compatible with the free flow of money and goods. It is, in effect, the demand that governments surrender their economic sovereignty" (1992: 38-39). And he concludes, based on the quoted authors and on the American Federalists, that nothing can be achieved without a strong state, a sovereign state.

If this is so, the neo-liberal strategy - because it weakens the state and ignores that the strength of civil society is not opposed to a stronger state - may eventually be harmful both to market-oriented reforms and democracy. The facto that democracy is not consolidated in Latin America and Eastern Europe was dramatically confirmed one day later by Fujimori's coup in Peru. Liberalization will help the consolidation of democracy only if it is not achieved by destroying the state instead of reforming it.

The neo-liberal views prevailing in Washington propose to fight high, inertial inflation in gradual and orthodox terms, using just conventional fiscal and monetary policy, and to privatize and liberalize abruptly, according to the "big-bang" strategy. Such course makes very little sense. The inverse - to frontally attack high inflation while imposing fiscal discipline, and to privatize and liberalize gradually while the market institutions are created by civil society and regulated by the state - is a more sensible alternative. Macroeconomic problems, such as stabilization and balance of payments adjustment, are to be dealt with in a different manner from microeconomic ones, as the property system and the efficient allocation of resources. The state and the market are strengthened when fiscal discipline and price stabilization are achieved in the short-run; they are weakened when wild privatization and shock liberalization are attempted where market institutions are poorly defined or non-existent.

International competitiveness and the elimination of protectionism is an essentially desirable reform and must be firmly secured, but trade liberalization should not be so radical and abrupt as to mean the destruction of local industry. Neither should it be implemented if the local exchange rate is overvalued, given an immoderate flow of international resources. This danger, that seemed remote in the 1980s is now present, not because the debt crisis has been solved but because it has not. While in the developed countries the interest rate is now very low, in the highly indebted countries, including Mexico, interest rates remain extremely high, demonstrating that the crisis is still present, and, at the same time, perversely attracting international capitals and mistakenly signaling prosperity. Today hot money finance in the developing countries has many similarities to junk bond finance in the developed nations.

The day after the Forlí Conference, the Italian newspaper *La Repubblica* published an editorial from which I believe opportune to translate a paragraph: "What remains from the state in Sicily, in Calabria, in many quarters of Napoli, in the Vesuvian region, in South Puglia? A conglomerate of ruins: infiltrated municipal and regional councils, impotent and abandoned public prosecutors, intimidated Justice Courts, disorganized police, fraudulent public contracts, terrorized and divided businessmen and a river of drugs that flows by millions of millions, dismantling, corrupting and annihilating all resistance". This is said of a state in an industrialized, European Community country. If the "evaporation of the public dimension of the nation-state", to use O'Donnell's expression, can take place in a country like Italy, just imagine what can happen or is already happening in Latin America and Eastern Europe where stagnation and high rates of inflation are indiscriminately fought with inefficient or incompetent policies.

There is an implicit assumption in the neo-liberal consensus that the alternative to it is populism and/or nationalism. In fact, there is a more pragmatic or social-democratic alternative, that has similar immediate objectives - the solvency of the state and the introduction of market-oriented reforms - but that preserves the role of the state, asserts its social and economic roles, and underlies its function as a principle of legality and sovereignty. The critique of the neo-liberal approach and the draft of this alternative was the central concern of a study that Maravall, Przeworski and I recently completed on economic reforms in new democracies (1992). In the Forlí Conference the same theme was the object of privileged reflection and conceptualization: democratization and liberalization are precarious in the context of a weak state and a weaker civil society.

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