THE MISSING SOCIAL CONTRACT: GOVERNABILITY AND REFORM IN LATIN AMERICA

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Chapter 2 of Ducatenzeiler, Graciela and Philip Oxhorn, eds. (1998) *What Kind of Democracy? What Kind of Market? Latin America in the Age of Neoliberalism.* Filadélfia: Penn State University Press: 21-41.

Abstract. According to conventional wisdom economic problems in developing countries are originated in politicians' populist behavior. This is just part of the truth. Incompetent policymaking is another major explanation. Developing countries, particularly the Latin American ones, have been living abnormal times since 1980. It is in such moments that it becomes evident the absence of a true social contract derived from huge income inequalities. Targeted social policies are often presented as a strategy to overcome the political support gap. An alternative is to have a national project of development coupled with competent economic and political reforms aiming to build state capacity and promote the permanent reduction in income inequalities.

According to present conventional wisdom, "economic problems have a political origin". Another form of approaching the same problem is to say that macroeconomic adjustment and structural reforms fail or are not completed for lack of political support. Finally, a safety net or targeted social policies are often presented as a strategy to overcome the political support gap. This view on one hand corresponds to the real world; on the other, it is imprecise and contradictory, it is plagued by ideological motives and often serves as excuse for incompetent economic policy-making.

In this paper we will try to clarify the different meanings and implications the three related propositions presented in the former paragraph. We will discuss the political origin hypothesis of economic problems, the political support gap for adjustment and economic reforms, and the compensatory social policies as means of overcoming political obstacles. As an alternative to the "political origin" and "political obstacles hypotheses", that are dominant in the age of neoliberalism, we will suggest what could be called the "missing social contract hypothesis": the legitimacy of governments, that assures governability and allows for effective economic reforms, depends on the existence of a basic social contract; as long as this contract is well instituted in the advanced democratic societies, but weak, poorly accorded, in the developing countries, a development oriented political pact is required as a surrogate.

In Latin America societies, given their heterogeneity and deep income inequality, civil society is poorly structured and there is not a broad political agreement on the prevailing economic regime, particularly on the income distribution pattern. The long term solution for this would be economic reforms that have as permanent outcome the reduction of inequalities. An alternative for the local elites, that tend to oppose or procrastinate distribution, is to celebrate development oriented political pacts with the middle class and the workers. This compromise was often used in Latin America to secure governability, but it depends on the resumption of the development process. For this market oriented reforms - particularly macroeconomic adjustment, price stabilization and trade liberalization - are necessary conditions. Yet, if their outcome is not a stronger state, able to implement social policies and promote economic growth, governability will not be achieved.

Our assumption is that given the crisis of the state that more than any other thing characterized Latin America in the 1980s, market-oriented reforms, that have indiscriminately been identified with neoliberal reforms, are necessary. Only through them it will be possible to overcome the crisis of the state in Latin America, to rebuild it, and regain governability.[1] Yet, today it is quite clear that these reforms are not enough to resume growth: additionally they demand effective measures to rebuild the state and define its new roles in promoting economic growth and income distribution. On the other hand, it is mistaken to assume that economists or policymakers know well which reforms should be undertaken - it is very usual to see dogmatism and ideological orthodoxy to determine the content of economic reforms. Finally, its is inappropriate to explain economic problems and the obstacles to economic reform imputing them to politics. The recent increase in the interest for political economy should be welcomed, but this should not be a excuse to give an exogenous rationale for economic policy failures, as it is implicit in the political origin and the political obstacles hypotheses. And it should make us cautious with simple solutions as targeted social policies. Economy and politics are intrinsically linked. Economic problems and economic reforms have always a political content. In some cases targeted social policies may represent a short term answer, but they should not imply disregarding more long term economic an political reforms leading to a real social contract.

[1] - The Latin American crisis of 1980s was essentially a crisis of the state, requiring a "crisis of the state interpretation" to understand it, and the adoption of social-democratic or social-liberal reforms to confront it. On the subject see Bresser-Pereira, Maravall and Przeworski (1993) and Bresser-Pereira (1996).

In the opening chapter of this book Oxhorn and Ducatenzeiler say that the "more recent analysis of success of economic reform ignore the reasons *why* organized interests are so weak. The literature tends to abandon civil society as an explanatory variable..." In this paper, while criticizing the naive political origin and political obstacles hypotheses, we will try to partially fill this gap showing how, in the Latin American faulty democracies, broad political coalitions play a strategic role in connecting civil society and the state and, so, in providing governability and making feasible the required economic and political reforms.

1. The Political Origin Hypothesis

The political origin hypothesis for economic problems is today often associated with the same intellectual realm where extremely abstract neoclassical economic models are developed. The reason for that is clear: since these models assume that markets are able to optimally allocate resources and maintain balanced the economy, economic problem must have an exogenous - nom-market - cause. This exogenous cause is power. In the past the type power that used to be emphasized was big business' monopoly power. Presently, political power - the power that comes from the state - receives all attentions. If were not for the expansionist policies populist administrations undertake and the rent-seeking activities that politicians are usually engaged, economic problems would not exist, or would be milder.

Yet, this approach loses most of its explanatory power when the assumption that markets are able to optimally coordinate the economy is dropped. In this case, economic crises cease to be just the outcome of wrong economic policies or of the pressure of interest groups, to be the inevitable result of the inner dynamics of the endogenous economic cycle. Additionally, if one adds to economic models - as it is being increasingly done recently - externalities and increasing returns of scale, multiple equilibria will be found, some of which are perverse, consistent, for instance, with economic stagnation or high inflation.[2]

Yet, the belief that economic problems have a political origin was an essential part of the views of classical and Marxian economists. Originally they named their science "political economy". "Economics" was a word that was only adopted in late XIXth century by the rising neoclassical economists that wanted to rid the economic science from political influences and considerations. Today "political economy" usually means an intermediate area between pure economics and political science, where the political aspects of economic problems are taken into consideration. For the classical economists it meant the economic science proper - a science that was not just logical-deductive model whose microfoundations economists are supposed to discover and analyze, but also an inductive and historical science, where market and power elements are intrinsically mixed.

After the crisis represented by the Keynesian revolution, neoclassical economics gained forces and in the last twenty years recovered hegemony. Yet - and paradoxally - the *de facto* political origin of economic problems gained weight in this century. The basic reason for that was the decisive - although complementary - role the state assumed in

[2]- See Romer (1989), Grossman (1990), Krugman (1992), Grossman and Helpman (1993).

capitalist economies, either allocating resources or interfering in the distribution of income. Probably as a reaction to that, mainstream economics and conventional wisdom turned their attention to politics that suddenly became the origin of all economic evils. The more clear manifestation of this fact was the emergence of the public choice or rational choice school - a neo-liberal branch of neoclassical economics that aptly adopted as research program to view government action as an endogenous variable. The rational choice school, that has in James Buchanan, Gordon Tullock, William Niskanen and Mancur Olson its leading representatives, borrows from neoclassical economics methodological individualism. As economic agents rationally maximize their interests in the market, politicians do the same in the political arena that is also seen as a kind of market. Since they are intrinsically selfish, since there is no difference between the ethics of business, where the exclusive pursuit of the self -interest is legitimated, and the ethics of politics, since the ideas of solidarity and collective action are assumed to be unlivable for large groups, politicians or the government do not have as objective the public interest, but their own interests. These radical assumptions justify their utopian option for a minimum state.[3]

Thus, in curious way, political economists, rational choice adepts and neoclassical traditional economists converge to the same and obvious view - politics matters -, but their understanding of the problem remains different. For the political economists politics is an essential part of the economic system. For the adepts of rational choice government action is seen as endogenous. Yet, there is a substantial difference between the two schools: while political economists view the endogeneity of governments as a consequence of class and ideological struggles, rational choice adepts view it as the outcome of individual preferences and strategies. Finally, for the more traditional neoclassical economists politics is an exogenous (to the market) obstacle to market clearing and to economic reform. The former may also see politics as an obstacle to macroeconomic adjustment and structural economic reform, but an endogenous obstacle - an obstacle that comes from the dynamic interplay of economic and political factors in the real world.

The answer to the question about the political or economical origins of economic problems depends on the concept we adopt of the economic and the political system. If we define the economic system just as a self-regulating market system, where rational individuals take production and exchange decisions, while the political system would be the domain of government power, economic problems would have primarily a political - or exogenous to the economic realm - origin. Contrarily, if we define the economic system as a system of production and distribution of income and wealth through institutions, among which the market, money and the state are the main ones, the conclusion will be opposite. In this case markets are themselves institutions that depend on other institutions as the property system, the legal contract system and the money system. They are institutions that exist and function as long as they are informally regulated by society and formally by the state. According to this view, that we share, individuals conserve an essential role as economic

[3] - For a survey of the public choice school, made by one of its adapts, see Mueller (1976). This paper was published in a book of readings (Buchanan and Tollison, 1984), that, together with Buchanan and Tullock (1962) and with Olson (1965), offer a general view of the school, that became later highly influential among American political scientists.

agents in the market, but social classes are also crucial, as they express their specific interests through social and state regulation.

This does not mean that economics and political science are mixed. The economists remain basically concerned with production and distribution through the market, the political scientist, with power relations. But it means that the state is not exogenous to the economic system. On the contrary, it is an essential part of it. If the state is in crisis, the property and the contract systems will poorly work; money - a manifestation of state sovereignty and credit - will be permanently endangered; entrepreneurs will ration investments; the economy will be also probably in crisis.

The inverse is also true. Cyclical economic crises - particularly long waves - bring with them political crises. In the expansive phase, strong political coalitions are formed, that break-down in the downturn.[4] In this case, we have an economic origin of political crises. The economic crisis itself had its origin endogenously: short term economic downturns are usually the consequence of a large and uncontrolled expansion; long-term downturns, the result of the exhaustion of a cluster of Schumpeterian innovations.

Yet, in some historical moments, the cause behind a long term economic crisis may not be purely economical, but jointly economical and political, as it is present case in Latin America and Eastern Europe. If we look for a basic cause of this crisis, the best answer will probably be that it is a crisis of the state: (a) a fiscal crisis of the state, (b) a crisis of the mode of intervention (or the development strategy) of the state, and (c) a legitimation crisis, in which the role of the state in the economy is contested.[5] The fiscal crisis of the state is defined by the loss of public credit; the crisis of the mode of state intervention, by the exhaustion of the import substitution strategy in Latin America, and of the statist strategy in Eastern Europe; the legitimation crisis, by the waning down of state authority and prestige caused by the fiscal crisis and the exhaustion o the mode of intervention and accentuated by the neo-conservative wave that started in the 1970s.[6]

The assumption behind this diagnostic is that the state has important economic roles that it is unable to well perform, when it is paralyzed by the fiscal crisis, by the lack of a clear intervention strategy and by lack of legitimacy of the government, its politicians and public officials. Given the crisis, state capacity is reduced, government is paralyzed or hampered, political coalitions are shaky and unstable. Yet, the fact that the economic crisis derives from the crisis of the state does mean that it has just a political origin. It has an economic-political origin, since the state is a also a part of the economic system.

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[4] - Peter Gourevitch, studying the 1873-96, the 1929-49 and the present crisis, observes: "In the prosperous years preceding the crisis, a policy approach and support coalition developed. The came the crisis, challenging both policy and coalition" (1986: 21-22).

[5] . See Bresser-Pereira (1988, 1990, 1993). Through these texts, the author is trying to develop an explanation for the current crisis, its cyclical character, and its basic origin in a crisis of the state.

[6] - This neo-conservative or new-liberal wave emerged in the 1970s as a response to the excessive and distorted growth of the state in the previous fifty years. Yet, in the last three years there are clear signals that this trend is wavering down.

And the corollary is that the solution for the problem is not the minimum state, as neo-liberals assume, but to reform and rebuild the state. When, today, people speak of "economic reforms", they are actually referring to reforms of the state. Fiscal adjustment, privatization, trade liberalization, deregulations should be seen in this vein as strategies to rebuild a smaller but stronger state.

2. The Political Support Hypothesis

There is a second way of approaching the same theme. Instead of focusing the origin of the crisis, one can focus the reason why it is not solved. In this case the standard assertion is: "required economic reforms are often not undertaken for lack of political support". Behind this affirmation there is the belief that for all or for most economic problems there is a set of economic policies that will solve them, provided that there is political support. Political obstacles would explain the failure of economic reforms.

The concern with the political aspects of inflation may be viewed as an antecedent to the political obstacles literature. Marxist economists always viewed inflation as consequence of political conflict and monopoly power. In the 1930s, Gardiner Means, Michael Kalecki and Joan Robinson were analyzing the political cycle and cost-push inflation. In the 1950s Aujac wrote about the influence of social groups in inflation (1950). The Latin American structuralist theory, initiated by Noyola (1956) and Sunkel (1957), and complemented by Rangel (1963) and Pinto (1973), where Keynesian and Marxian influences are present, incorporates a sociological and institutional approach to inflation. Hirschman (1981) wrote extensively on the subject. On the other hand, there is an extensive literature on the political aspects of inflation and its relation to populism, beginning with Canitrot (1975) and O'Donnell (1977) and Hirschman (1978). It is, however, in the 1970s that sociologists and political scientists start focusing their attention in inflation. An extensive literature is opened with three collections of essays: Hirsch and Goldthorpe (1978), Thorp and Whitehead (1979), and Lindberg and Mayer (1985).

Up to this moment, attentions were concentrated in the political and social causes of inflation. In the 1980s, with the break-down of the debt crisis - that soon turned into a fiscal crisis - inflation rates accelerated in the highly indebted countries. The need for short term fiscal adjustment and long term structural reforms became evident. The pressure on this direction coming from the developed world mounted. It is in this moment that political scientists become particularly interested in the political dimension of policy-making. The political support gap hypothesis will then be analyzed in several books: Nelson, ed. (1989, 1990), Ethier, ed. (1990), Haggard and Kaufman, eds. (1992), Przeworski (1992), and Bresser-Pereira, Maravall and Przeworski (1993), Bates and Krueger, eds. (1993), Smith, Acuña and Gamarra, eds. (1994), Williamson, ed. (1994), and Haggard and Kaufman (1995).

Economists, on the other hand, came increasingly interested in the political aspects of adjustment and economic reform. Economic populism was revisited in two collections of essays: Bresser-Pereira, ed. (1991), Dornbusch and Edwards, eds. (1991). The political aspects of economic policy reform were focused in Williamson, ed. (1994). Concern with political cycle in macroeconomic policy and with the political resistance to stabilization, that was present since the 1970s, gained new strength specially with the utilization of game theory: Alesina (1987), Alesina and Sachs (1988), Alesina and Tabellini (1988), Sachs (1989), Edwards and Tabellini (1990), Alesina and Drazen (1992). The literature on economic development was also enriched by the "new political macroeconomics": Cukierman, Hercowitz and Leiderman, eds.(1992). Papers by Persson and Tabellini (1992) and Alesina and Rodrik (1992) show the positive relations between distribution of income and growth.

All this literature is relevant. It responds to a real problem - the political obstacles to highly needed fiscal adjustment policies and economic reforms. Yet, most of it suffers from two limitations: from a technocratic bias - the idea that all economic problems have a policy solution -; and from a naive assumption - the assumption that economists or policy-makers are competent in adjusting, stabilizing and reforming the economy, and only do not succeed for faltering political support.[7] A more realistic approach was adopted by Williamson and Haggard (1994). After surveying several successful economic reforms they concluded that prior political consensus on the desirability of reforms is not required, at least to initiate them. In contrast, they found that a coherent economic team enjoying strong executive support is a prerequisite for successful reform.

Discussing the conditions for economic reform, Grindle and Thomas (1991: 4) took issue on "much of the literature in political science and political economy" that "narrowly focused on the analysis of obstacles to change", or assume a "narrowly defined self interest as the basis of political action". Given these premises, they ask, how could reforms have taken place in Latin America since the breakdown of the debt crisis - as the have? Grindle and Thomas' response is to credit a considerable autonomy to the policy elite (political leaders and bureaucratic officials). Instead, our answer it double: in the short run we suggest that this will occur when the net transition cost of adjustment become negative, or, in other words, when the costs of procrastinating adjustment and reform turn higher than the expected costs of reforming.[8] In fact, in acute crisis situations, it is usual the adoption of economic reforms that still do not have behind them a political consensus.[9] Only in the long run reforms require a substantial public support - a political support that will legitimize government and assure governability. For that we will discuss in this paper the strategic role of development oriented political pacts replacing a missing social contract.

In the literature on the political obstacles to sound economic policies the political business cycle theory always received special attention. Assuming a four year political incumbency, politicians would adjust the economy in the first two years, opening room for, in the last two years engage in an expansionary policy and get reelected. This theory is

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[7] - Bates and Krueger (1993) are explicit on this assumption. After reviewing the experience in eight developing countries, they concluded that in no case program design flaws were crucial to the outcomes.

[8] - This usually happens when the economic crisis is so acute, when the state's treasury is empty and the economic crisis is reaching unbearable costs, so that the net transition costs - that is, the costs of adjustment and reform minus the costs of procrastinating them - become negative. We will not discuss the theme in this paper. See on the subject Bresser-Pereira and Abud (1994).

[9] - This point was strongly made by Sachs (1994).

simple and the prediction involved was repeatedly confirmed in the real world.[10] Yet, it does not apply for economic reforms that often require a larger span of time either to cause pain or to induce favorable outcomes. It also does not apply in abnormal times, when the fiscal crisis turns acute and is in the origin of high inflation. In such moments, economic expansion does not bring votes, and we have a reversion of the political cycle: the recommended political strategy to facilitate reelection is to adjust and control inflation. As a matter of fact, in these contingency an expansionary fiscal and monetary policy tends to be ineffective in promoting growth given faltering government credibility. Economic agents expectations will be that the expansionary policies will be short lived; thus they will not invest or consume as in normal times they would given the same policy incentives.

3. A False Assumption

Successful economic reforms depend both of a consistent economic program and on long term political support. Yet, the political economy of economic reforms tends to emphasize the second prerequisite, when the essential one is the first. An economic program based on false premises, that adopts mistaken economic policies, is doomed to fail. When Washington policy-makers write or speak about economic reforms that would be fit to Latin America they usually start from the assumption that the economic programs they are offering are consistent and efficient. Accepting this premise, political scientists in the First World ask themselves why reforms are procrastinated or take place in an incomplete way. They often fail to consider that these policies may be just wrong or inadequate.

An example of this fact is the recent experience of Latin America and particularly of Brazil in fighting high inflation. Economic policy as a pervasive economic and political phenomenon is a historical new fact that dates from this century, specifically from the Keynesian revolution. Before that, economic theory denied the need for economic policy and did not dispose of a relevant set o policy tools, while political science ignored the problem. After Keynes, while governments in developed and developing countries made extensive use of economic policy to achieve full employment and growth, neoclassical economists denied real effects for them, asking, instead, for permanent and credible policy rules. Yet - in a technocratic and optimistic way - this did not prevent mainstream economics of assuming the full effectiveness of conventional stabilization policies, when often this was not the case.

In a first phase, the assumption behind the macro-economic models was that governments were exogenous and all-powerful entities. More recently, given its obvious lack of realism, this assumption was dropped, giving rise among economists and political scientists to the political obstacles literature. Yet, the technocratic bias remained. If conventional economic policies designed to avoid economic unbalances are consistently followed, if permanent rules endowed of credibility are adopted and enforced, stabilization and growth would follow. Thus, if an economy gets out of balance, this would just be a question of political will, as it will be a question of political will to adopt the required corrective economic policies. As the possibility that unbalances originate in the economic

[10] - See, among others, Nordhaus (1975), Soh (1986) and Alesina and Sachs (1988).

realm itself is overlooked, the chance that the failure to stabilize and grow is due to wrong economic diagnosis and poor policy-making is neglected.

Stagflation in the 1970s and inertial inflation in the 1980s challenged this view. Particularly in Latin America, where the neo-structuralist theory of inertial inflation was initially developed, economists challenged the conventional stabilization policies.[11] In a second moment, the new-Keynesian school followed the same line of thought.[12] On the other hand, as inertial inflation changed into straight hyperinflation in many Latin America and Eastern Europe countries, it became evident that they faced abnormal or exceptional times - times in which just conventional monetary and fiscal policies are unable to control inflation.[13]

Yet, when political scientists turned interested in the politics of economic reform, although often recognizing the unique character of inertial inflation and/or the exceptional character of hyperinflation and the fiscal crisis of the state, they ignored the neo-structuralist and new-Keynesian critiques of conventional policy-making and assumed that orthodox or conventional economist knew well how to stabilize. They adopted this standpoint either because they shared the orthodox and technocratic views, or because they prefer not to intrude in alien domain. In doing so, they unwillingly offered an alibi for incompetent and weak policy-makers that adopted a kind of contented political determinism: it is useless to design and implement bold economic reforms, since there is no political support for them.[14]

As a matter of fact, in abnormal times, when a fiscal crisis of the state critically undermines public credit and hyperinflation or a hyperinflationary process prevails, only bold shock policies, usually including monetary reforms, are able to succeed in stabilizing the economy. If these policies are skillfully designed and courageously implemented, they may readily produce positive economic results and, thus, engage wide political support. This was what happened when inertial inflations were brought under control in Israel (1985), Mexico (1987), and Brazil (1994), or when and hyperinflations were defeated in Bolivia (1985), Poland (1990), Peru (1990), Argentina (1991). The shocks that controlled inflation neutralizing inertia were "heterodox", the ones that ended with hyperinflation, "orthodox shocks".[15] For sure, in the design and implementation of the shock policies policy-makers

[11] - On the Latin American theory of inertial inflation see Pazos (1972), Bresser-Pereira and Nakano (1983), Arida and Resende (1984), Lopes (1984).

[12] - See Bruno, Fischer, Helpman and Liviatan, eds. (1991) and Mankiew and Romer (1991).

[13] - For a critique of conventional stabilization policies in Brazil see Bresser-Pereira and Nakano (1984, 1990) and Bresser-Pereira (1996: ch.14).

[14] - This happened, for instance, in Brazil in 1991-92, when the IMF approved a gradualist and conventional stabilization program instead of demanding that the 25 percent a month inflation was controlled abruptly through the combination of orthodox and heterodox policies (see Bresser-Pereira, 1996: ch.15).

[15] - In Israel and Mexico inertial inflation was brought under control through a price freeze combined with conversion tables that neutralized inertia; in Brazil, a original mechanism was adopted to neutralize inertia. They are called "heterodox" due to neutralization of inertial involved. In Bolivia, Poland, Peru and Argentina inflation had already turned into hyperinflation, that was defeated by a

took into account and tried do circumvent political obstacles. But the essential factor in the positive outcome was the efficiency and consistency of the economic reforms.

In some cases stabilization policies fail just because they are wrong, unable to achieve the announced goals. In most cases, however, they hypothetically may achieve the goals, but are inefficient, involving unnecessary transition costs, that eventually turn the stabilization program not viable in political terms.

4. The Social Compensation Strategy

Summing up the previous discussion, economic crises may have a political origin, but it is basically flawed to adopt the implicit assumption that markets efficiently coordinate the economy and to attribute all or most economic problems to politics. Market failures and the consequent endogenous character of the economic cycles probably remain the basic cause behind them. On the other hand, the existence of political obstacles to adjustment and structural reforms, although a fact, has a more limited scope than present conventional wisdom claims, since the implicit assumption that the economic policies that are being proposed and face political resistance are always consistent and efficient is at least disputable.

In the extent, however, that a political support gap exists, the adoption of compensatory targeted social policies became a favorite strategy in recent times, particularly in the realm of the Washington consensus.[16] Through them, the specific social groups most hardly affected by fiscal adjustment or by structural reform would be partially compensated. Besides the humanitarian value in itself of this strategy, it would also be short term or pragmatic a means of overcoming or circumventing the political obstacles, or of winning political support to the administration.

The World Bank (1990: 3) asserts that the basic strategies to fight poverty are (1) to promote the productive use of the poor's most abundant asset, labor, and (2) to provide basic social services: education, health care, nutrition and family planning. But it adds that when an adverse macroeconomic shock takes place, "a comprehensive approach to poverty reduction calls for a program of well targeted transfers and safety nets as an essential complement to the basic strategy". This view is essentially correct. The compensatory social policies are a temporary complement to job creation and the supply of basic social services. Or, in other words, to long term distributive policies. Yet, there is the permanent risk of its adoption as a substitute for the more long term policies. Populist and authoritarian

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exchange rate anchor. Since this policy is for long part of mainstream economic policy it may be called “orthodox”. In all cases conventional fiscal adjustment and tight monetary policies were required to consolidate stabilization.

[16] - One of the authors of this paper was one of the first to criticize the Washington consensus for its neoliberal bias (Bresser-Pereira, 1990, 1993). Yet it should be noted that the critique is not directed to the recommendations involved in the consensus - basically the demand for the observation of the macroeconomic fundamentals and for the adoption of market-oriented reforms - but to the failure to devise a positive role for the state in promoting economic growth and income distribution.

governments alike often tend to see targeted assistance as a cheap way of gaining or conserving short term political support, in the moment economic reforms are being implemented.

Oxhorn and Ducatenzeiler (1994) observed that the market oriented reforms that were adopted recently in Latin America were often the outcome of authoritarian or technocratic political coalitions. In order to compensate the losers, targeted assistance programs focused on helping *individuals* to escape poverty, thus encouraging state paternalism, which undermines the long term prospects for the full incorporation of the popular sectors.

Yet, it is possible to devise cases that would require targeted compensatory social expenditures. When some groups are particularly hit, there is an obvious case for them. Particularly if the losses are transitory and targeted social expenditure have a corresponding limited duration. When reforms are introduced at a very slow pace or take too much time to produce positive outcomes, compensatory social expenditures may also be recommended. It is important, however, to check if this is not just a case of inefficient economic reform. Or, in other words, if there are not alternative economic policies that would bring positive outcomes more rapidly. A third and correlated case is the one in which there is a permanent reform process, one economic reform following the other. In this case, the social costs involved in each reform may be quite transitory, but the total losses may be large, given the succession of reforms. In this case the reform process is long, not because reforms are incomplete or partially unsuccessful, but because the required reforms are many. If reforms were not producing the expected results, we would have a case of inefficiency, requiring a change in the design of reforms, not a case for targeted social expenditures.

It is not realistic, however, to believe either that compensatory social policies will really compensate the losses involved, or that they will not be used as a substitute for more long term income distribution. The World Bank pro-poor policies, that in the 1970s intended to be permanent and imply an effective distribution of income, were never really implemented in large scale, given the resistance of the privileged groups in each country. With the debt crisis and the fiscal crisis, they were for some time abandoned, to reappear in the end of the 1980s in the form of targeted social expenditures, that were supposed to involve limited resources and play a political role: to support reforms. In these circumstances, it is clear that they were intended to replace more long term distributive policies.

Joan Nelson, that surveyed the compensatory social programs, observed that they are often criticized as "band-aids" applied to relieve some of the damage of depression and adjustment. And added: "A longer term and more enduring approach to protecting and promoting the poorer groups in the course of adjustment is reorienting the structure of public social sector programs. Such reorientation is a major theme in present adjustment dialogue because it addresses both poverty problems and the acute fiscal crisis likely to continue in many countries into the 1990s" (1989: 105). Yet, in mid 1990s, this reorientation had not take place. Instead, targeted social expenditures, as Chile's, Bolivia's and Costa Rica's programs in the 1980s, and, presently, the Programa Nacional de Solidariedad (Pronasol), in Mexico, continue to be popular in Washington.[17]

This fact may be explained in several ways. First, because they are often the only alternative left, given the political weakness of the poor in Latin America since the crisis broke up in the early 1980s and magnified the excess supply of unskilled labor. Actually, long term distributive policies are unlikely when they depend on solidarity of the rich, rather than on the demand from the poor. A second reason for the popularity of target assistance programs, in this case not in Washington but among politicians in Latin America, is the fact that, if well administered, they may originate support, if not directly to economic adjustment, to the government (Graham: 1992).[18] Yet, the basic rationale behind their attractiveness is their relatively low cost and immediate results, if the programs do not become themselves victims of partisan interests.

Their popularity in Washington does not mean that they are neo-liberal or conservative programs. As Draibe (1992) observes, the fact that social programs assume a targeted or limited scope and that they adopt decentralization as a strategy does not necessarily means that they are conservative or neo-liberal. In Brazil, for example, when, in 1983, an IMF approved adjustment program was nationally implemented, the progressive Montoro administration in São Paulo state successfully adopted targeted social policies.

The criterion to distinguish progressive from conservative social policies is not if they are targeted, but if the selective programs are seen as a substitute for long term income distribution policies. Conservatives usually see poverty and inequality as a consequence of individual differences, rather than of the existing economic structures and the institutional framework. Another way of approach the same problem, is to ask if the political obstacles that these policies are supposed to overcome are specific problems that require defined solutions - in this case, targeted policies are recommended - or if they are structural ones, as long as they are related to the land property system, the structure of overall state expenditures, the distribution of income and the quality of the political institutions, requiring a more broad approach.

5. The Missing Social Contract Hypothesis

The last phrase brings us back to the central problem of this paper: the political origin of economic problems. There is no doubt about the close relation between the economic and the political system, between economic policy and politics. The critique of neoclassical economics by Marxist, Keynesian, structuralist and institutionalist economists is based on its

[17] - The Brazilian program “Comunidade Solidária”, started in 1995, although targeted, has not a compensatory character. And its target is broad taking in the poorest municipalities in the country.

[18] - Carol Graham studied Bolivia's Emergency Social Fund adopted by the Paz Estensoro administration between 1985 and 1990. Her evaluation is highly positive. She attributes the good results to the fact that "the ESF managed to remain remarkably free of political constraints and influences, and to deserve reputation for conducting the vast majority of its operations in an efficient and transparent manner" (1992: 1246).

ignorance or underestimation of power relations prevailing in the market. As we saw before, in the last ten years mainstream economics got increasingly interested in politics, but the emphasis was given to the short-termed analysis of the political obstacles to the well functioning of markets.

The alternative is to assume that the economic and the political spheres are intrinsically and dynamically interrelated (Sola, 1994). Not only because markets are themselves political institutions, that depend on the state to be regulated. This type of analysis escapes the scope of this paper. But also because governability - the support governments have in civil society as they count with political institutions that adequately intermediate interests - is a central political variable that intrinsically depends of the economic regime.[19]

From this assumption we may develop a "social contract hypothesis" to explain the governability problems Latin American countries face and to clarify why development oriented political pacts or class coalitions are so crucial in these countries.

Since Hobbes it became clear that, to be governed, capitalist societies require a state and its respective government legitimated by a social contract. Hobbes came to this conclusion and established the basis for the contractualist or jusnaturalist theory of the state. The power of the prince ceased to be a divine right or a historical fact, to be the outcome of a contract. He adopted a logical-deductive method to come to this theory, but, in fact, he was reflecting the emergence of capitalism and of the separation between civil society and the state, between the private and the public domain.[20] If this observation was true in Hobbes times, when what prevailed was a mercantilist economy, it is more so in the complex and democratic advanced capitalist societies of today. In these societies, there is a basic agreement on the prevailing economic regime, that is, on the property system and on the distribution of income between individuals and social classes.[21] Przeworski and Wallerstein (1985: 182) gave to the classical social contract a specific and more rigorous economic and class content when they say that:

> Given the uncertainty whether and how capitalist would invest profits, any class compromise must consist of the following elements: workers consent to profit as an institution, that is, they behave in such a manner as to make positive rates of profit possible; and capitalists commit themselves to some rate of transformation of profits into wage increases and some rate of investment out of profits.

Thus, the class compromise or the basic social contract, that is behind all capitalist societies, is based not only on an agreement between government and citizens, on a trade-off

[19] - Governability - the effective power to govern - does not assure governance - the quality and effectiveness of government action. In this paper we are not dealing with governance, not withstanding the relevance of the problem..

[20] - On the subject see remaking essay by Bobbio (1979).

[21] - An interesting question would be to know if the concentration of income that took place in the developed countries, particularly in the United States, in the last 25 years, is not endangering this basic social contract.

between order and personal freedom, as Hobbes proposed, but also in an agreement between capitalists and workers, on a trade-off between profit legitimation on one side and investment and wage increases on the other. Actually this basic agreement involves a third party, the state that, in its intermediation role, presides on second-best choices made by capitalists and workers. In the words of Paul Buchanan (1995:16)

> The strategic interaction between the state, labor, and capital under democratic capitalism is fueled by a triple logic of collective action... What labor wants from the state in terms of public goods it cannot get from capital; what the state wants from capital in terms of investment it cannot get from labor; and so on. The overall need for systemic reproduction leads to overlapping and complementary strategies of accommodation based on a belief in compromise and mutually beneficial exchanges resulting in second-best choices for all sides".

It is this agreement, it is this basic social contract, besides a complex institutional system, that legitimates governments, assures governability and guarantees the effectiveness of economic policies. This does not mean that the distributive conflict was eliminated. It just means that it is under control, not only because differences in wealth and income are not so great, but also because civil society is well structured and effectively connected to the sate, so that there is a complex and well structured institutional system of interest representation and intermediation (Putnam, 1993).

When civil society is weak and this basic agreement is faltering or incomplete, as it is the case of most developing countries, the political obstacles to economic policy-making become evident. In these countries the opposition to the capitalist system ceased to be relevant since the communist regimes collapsed, but the disagreement on the income distribution pattern remains extremely high, particularly in Latin America, where concentration of income remains a major problem. The political response to this difficulty has been either to resort to authoritarianism or, in the realm of democracy, to compensate the weakness of the basic social contract with the celebration of broad but excluding development oriented political pacts, that give a positive perspective to the working class.

The literature on political pacts in Latin America is extensive. Usually political pacts are understood as specific agreements between workers and businessmen, intermediate by unions and political parties.[22] It is not in this sense that we are using the expression. Development oriented political pacts are here defined as broad and informal class coalitions that tend to be formed to legitimize a set of interpretations and strategies adopted by the political elite, that may be united in and represented by a political party, a group of associated political parties, or even a group of competing political parties that share common

[22] - This is, for instance, what Paul Buchanan (1995) eventually does. He starts his book with a broad concept of class coalitions, as the one above quoted, but in the rest of the book, he identifies class compromisses with the several attempts in which Latin American governments were involved to reach a formal agreement betwen labor and capital. In this words (1995: 27-28): "Democratic class compromise is a product of institutionalized strategic interaction between the sate, labor, and capital". Only in a few cases formal agreements come to be relevant, while the informal, development oriented, political pacts we are reffering are of overwelming importance.

beliefs. Our hypothesis is that in Latin America political pacts are a surrogate of the social contract that characterizes developed capitalist societies.

These political pacts or class coalitions are excluding because do not involve the whole society. Since the 1930s these pacts assumed, in Latin America, the form of the "national-developmentalist and populist pacts" that Vargas, Peron, and many others led in the 1940s and 1950s. Urban workers were included, rural workers and urban informal workers, excluded from this class coalition. The economic distortions brought by populism led, in the 1960s and 1970s, to the "authoritarian capitalist-bureaucratic regimes", that were even more excluding. The authoritarian pacts were not populist but, in spite of its alleged modern character, deepened protectionist and statist policies that characterized national-developmentalism.

In Brazil this authoritarian pact started to break down in the mid 1970s when the business class began to reconsider its alliance with the civil and military bureaucracy, giving rise to a "democratic political pact" that led to redemocratization in 1985. Yet, the populist aspects of this pact led the failure of the Cruzado Plan, and the collapse of the democratic pact itself in 1987. Between then and 1994 Brazil experiences a political vacuum - a serious governability crisis, since no political pact gets in place. Only in 1994, after the Real Plan stabilized inflation in 1994, the election of Fernando Henrique Cardoso involved the formation of "pragmatic and social-democratic political pact". As it happens in all hegemonic political pacts, it occupied the ideological center. If it is consolidate as a class compromise, it may well represent for the country the beginning of a new stage of economic development.[23]

In the absence of development oriented political pacts, the democratic regimes in Latin America face, in different degrees, a permanent governability crisis, that is aggravated by the fact that we live times of structural adjustment and state reform. This governability crisis will only be overcome when stabilization is achieved and growth resumed. In most countries in the early 1990s stabilization was achieved due to severe fiscal adjustment combined with heterodox shocks that neutralized inertia, or combined with orthodox shocks when a straightforward hyperinflation was taking place. Growth, however, remains timid, uncertain, as fiscal adjustment, trade liberalization and privatizations were not enough to rebuild state capacity nor were followed by development oriented political pact that define a new and positive role for the state in the social and economic realm.

Acuña and Smith (1994: 53), exploring the future paths that may spring from politico-economic tendencies, concluded that "full-blown neoliberal restructuring with the consolidation of democratic rule is not a likely future for most Latin American societies". We would say for all, since the neoliberal demand for a minimum state is not realist. According to these two authors:

[23] - This analysis of political pacts in Brazil and Latin America just presented is a "heroic" summary of two books (Bresser-Pereira, 1985 and 1996). In the second book the relationship between the lack of a basic social contract and the need for development oriented political pacts is extensively discussed (ch. 11 and 17).

> The most probable scenario seems to be dualist democracies. In this scenario state elites establish an alliance with a strategic minority of the opposition for purpose of excluding the majority of the remaining social actors by disarticulating and neutralizing their capacity for collective action.

This is a pessimistic view, probably modeled on Argentina recent experience. If it is a realistic perspective or not is difficult to say. Yet it has the merit of requiring a political pact to legitimize the governing elite. The question is to know if this pact will have to be so excluding as Acuña and Smith predict. A realistic development oriented political pact, that rejects the minimum state ideology, strength the state, and define a clear role for it in the coming 21st century's will not necessarily be so excluding. It will always imply a certain degree of exclusion capitalist - this is the where political pacts are distinguished from a basic social contract - but not such a radical exclusion as the one implicit in Acuña and Smith "dualist democracies". We would rather suggest that they will be social-democratic or social-liberal pacts that are able to engage an increase share of the Latin American population. This, however, is not the place for future-telling.

Conclusion

In conclusion, the conventional wisdom that economic problems have a political origin must be qualified in many ways. Many economic problems have a strict economic origin, deriving from the dynamics of the economic cycle and the imperfection of the market. On the other hand, the belief that stabilization programs and structural economic reforms are not implemented or fail for lack of political support is only partially true. In many cases, the inefficiency of the reforms, the sheer incompetence of policy-makers, has also a part in the explanation of the negative outcomes.

A more fruitful approach to this question is to consider that governability, the effective power to implement required economic reforms, depend not only on institutional and personal considerations, but essentially on a basic social agreement on the prevailing economic and political regime. When civil society is poorly structured, when this agreement is weak, when the property system and particularly the income distribution pattern is being strongly contested, governments lack legitimacy and find increasing problems in implementing economic reforms.

In this case, the strategy of securing political support for economic reforms through a transitory social safety net may be effective, provided that the targeted social programs are well and transparently managed, but the limits of such strategy are clear. A better alternative is to promote economic and political reforms that have as outcomes not only giving back state solvency, assuring a more efficient allocation of resources, and building an adequate institutional framework, but also guaranteeing a permanent reduction in income inequalities. Yet, this is an "expensive" alternative, in the sense that it means the transference of income from the rich and the middle class to the poor, facing permanent opposition from the former. A third alternative is the celebration of development oriented political pacts that legitimize the political elite in government. This alternative, however, involves a chicken and egg problem. It is only viable when economic development is resumed - an economic development that depends on the implementation of the reforms that require political legitimation.

Thus, in certain moments we have to count on the conjunction of several economic and political factors to have stabilization achieved, growth resumed, and a political pact celebrated assuring governability. Among these factors we may have the exhaustion of populist policies provoked by the crisis, the adoption of bold and innovative economic policies to control inflation, the ability to build political institutions that intermediate group interests, and the capability to rebuild the state finance and recover state governance.

This approach is quite different from the one assumed in the "political origin" and "political obstacles" hypotheses, that assumes that stabilization and growth are automatically guaranteed by the market-oriented reforms, the only reason why they are not adopted being the opposition of politicians. This is a neo-liberal approach that ignores the relations between the economic and the political sphere and adopts a linear cause-and-effect approach. Instead we stress that these economic reforms will only make sense if they are able to overcome the fiscal crisis of the state and are able to rebuild the state. And we propose that this kind of reform will be adopted when the economic and the political spheres get together, when economic reforms and a development oriented political pact assure governability.

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