ANOTHER LOST DECADE? THE FUTURE OF REFORM IN LATIN AMERICA

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SUMMARY

The 1990s ended equivocally in Latin America. What has gone wrong? Is economic failure the cause or the consequence of the democratic decay and the erosion of governance throughout the region? The review essay revisits the debate on the intricate links between politics and economics in the second stage of reform. Moving beyond standard typologies of regime type, it explores the interactions between the quality of democratic governance and the performance of economic policy under democratic auspices, in particular its credibility. It is now amply recognized that reforms have been hindered by inefficient unreliable and unaccountable government institutions. Furthermore, the manner in which market reforms have been implemented has undermined governance and accountability. The importance of policy credibility has essentially been neglected as a pivotal condition for effective economic reform. Consequently, policymakers propose a new round of reforms, centring on strengthening the institutions of governance and modifying the incentives shaping public policy. The essay argues that restoring the credibility of policy requires a fundamental redefinition of the state and reforming the methods of government and the styles of policymaking. The defining challenge of Latin American countries is to strengthen capacity to adequately implement policy and credibly commit to policy reform. Copyright © 2003 John Wiley & Sons, Ltd.

INTRODUCTION: ANOTHER LOST DECADE?

The 1990s ended equivocally in Latin America, marked with a general sense of frustration. If the 1980s were a ‘lost decade’, the 1990s have largely been a ‘disappointing decade’ of recurrent turbulence and unmet expectations. These have given rise to growing dissatisfaction with the neo-liberal market model and the functioning of democracy (Ocampo \textit{et al.}, 2001.) These have revealed the intrinsic flaws of governance and uncovered the fault lines of democracy in the new and restored democracies in Latin America and the Caribbean. Public trust in political institutions has been significantly undermined by widespread corruption, the weakening of the state and the inefficacy of the mechanisms of ‘horizontal accountability’ (O’Donnell, 1998.) Furthermore, from the Mexican ‘tequila crisis’ of 1994–1995, the ‘Brazilian samba’ of 1999 and the dramatic ‘Argentine tango’ of 2001–2002, unstable international capital markets have shaken once promising emerging market economies.

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Until recently, Argentina was praised as the model of radical market reform and regarded as the poster child of international financial institutions (Pastor and Wise, 2001.) The consequences of the dramatic implosion of Argentina in the winter of 2001–2002 are still difficult to decipher and ascertain. Nevertheless, they question the initial assumptions and original predictions of the neo-liberal paradigm of development economics and its standard recipes for economic development. They have undermined the reigning faith in neo-liberalism that has prevailed throughout the 1990s and have generated frustration over how democracy actually functions. More fundamentally, the critical question lies in whether economic failure is the cause or the consequence of the democratic decay and the erosion of governance throughout the region.

What has gone wrong? Several explanations have been advanced. Many Latin Americans blame the neo-liberal prescriptions of the Washington consensus pursued during the last decade, a set of 10 policy reforms that Washington-based institutions (the US government and Congress and the international financial institutions, primarily the International Monetary Fund and the World Bank) were urging on Latin America in the late 1980s to stabilise and adjust their economies (Williamson, 1990, 1997, 1999, 2002; Kuczynski and Williamson, 2003).1

Why is democracy failing Latin America? While democracy as a political regime has spread across Latin America, its quality and durability are threatened by the gradual erosion of governance and the declining confidence in the rule of law. The transition from authoritarian rule has given rise to a broad spectrum of regime types. Many of them defy standard classifications, even with adjectives. This new breed of regimes, ‘of a type not yet theorised’ (O’Donnell, 1993) questions the foundations of the democratic transition paradigm (Carothers, 2002.) It was originally assumed that transitions away from authoritarianism would gradually yet inevitably lead towards democracy and its consolidation. The experience of the last decade suggests that it is not necessarily the case. Many emerging democracies have ended up in an ambiguous situation as hybrid regimes combining democratic forms with authoritarian features.

At the core of the recent controversies are the complex interactions between economics and politics. The recent crisis in Latin America has thus revived the debate on the tensions between the economic reform and political democratisation in the age of neo-liberalism. It is now amply recognised that market reform has been hindered by institutional factors resulting from inefficient, unreliable and unaccountable state institutions. Consequently, policymakers propose a new round of reforms, focusing on the strengthening of the institutions of governance and the incentive structure shaping public policy. Yet, despite general claims of the importance of institutions for economic development and political democratisation, little is known about how institutions emerge, function and change.

The volumes reviewed hereafter constitute important contributions to the political economy literature on the intricate links between the quality of democratic governance and the performance of economic policy, and in particular its credibility under democratic auspices (Haggard and McCubbins, 2001.) They raise the question whether regime type should be altogether abandoned as an intervening variable explaining economic outcomes. They also invite us to go beyond classical conceptual dichotomies of regime type (‘democracy’ vs ‘authoritarianism’) to develop more refined assessments of the quality of democratic regimes and the institutions of governance. While the literature on the relationship between regime type and economic development has been largely inconclusive (Przeworski and Limongi, 1993; Przeworski et al., 1996, 2000), recent empirical research on the relationship between regime quality and economic performance has yielded important insights. Divergences in economic performance are partly explained by variations in the quality of political institutions and, in particular, in the level of corruption, the strength of the rule of law and the efficiency of the state bureaucracy (Keefer and Knack, 1995, 1997).

**UNFULFILLED EXPECTATIONS**

*Growth, Employment and Equity* constitutes a systematic attempt at gauging the scope and reach of almost two decades of market-oriented economic reforms in the region. Undoubtedly, the neo-liberal model represents a major

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1 The neo-liberal reform package labelled the ‘Washington consensus’ focuses on macroeconomic stabilisation, microeconomic liberalisation, and trade and financial opening. It includes 10 policy reforms: fiscal discipline, reordering public expenditure priorities, tax reform, liberalising interest rates, a competitive exchange rate, trade liberalisation, liberalisation of inward foreign direct investment, privatisation, deregulation and property rights.
overhaul in the strategy for economic management and development. It has anchored a new economic model based on macroeconomic stability and fiscal rectitude and has created new confining conditions for the conduct of economic policy: ‘the package of structural reforms has altered the context in which the Latin American and Caribbean economies operate’ (35). Latin American countries have indeed been quite successful in lowering and controlling inflation, and attracting foreign direct investment. However, the experiences of the eight case studies examined by Stallings and Peres are ‘a mix of partial successes and pending challenges’ (205). The main finding is that, despite high expectations, the reforms have produced disappointing results and unintended consequences. The neo-liberal reforms, per se, had a surprisingly small effect on economic growth and social equity at the aggregate level: ‘the reform results were neither as positive as supporters predicted nor as negative as opponents feared’ (203). One of the original assumptions of reformers was that by enhancing the growth prospects, reforms would eventually generate other benefits indirectly, especially in terms of employment generation and income distribution. This assumption no longer holds, as the hoped-for ‘trickle down’ effects did not materialise.

Post-reform growth for the eight case studies was slightly below the 4% rate during the 1990s. It was lower than the region’s past performance of 5.2% between 1950–1980 and compared unfavourably with that in some other emerging regions. More fundamentally, it was lower than the rate necessary to deal with the region’s social problems of persistent inequality, increasing poverty and rising unemployment, despite encouraging trends in investment and labour productivity. Indeed, ‘the econometric evidence […] suggested that the reforms had a negative (if small) impact on both employment and equity’ (150).

One reason advanced by the authors for such disappointing results is that reforms worked slowly and were frequently inconsistent. Moreover, policymaking was often erratic and lacked resoluteness, undermining the credibility of economic policy (Haggard and MacCubbins, 2001). In the area of inflation control, a positive synergy emerged, with the adoption of an appropriate mix of reforms and macroeconomic policy. However, in other areas, such as the opening of the capital account, financial liberalisation and fiscal policy, important inconsistencies existed, which contributed to undermine the effectiveness and credibility of the package as a whole. Social policy and expenditure were particularly vulnerable to recurrent turbulence. Despite the positive impact of trade liberalisation and foreign direct investment, the reforms exposed once-promising emerging markets to new forms of vulnerability and uncertainty, especially violent swing of capital inflows during 1994–1995, 1997–1999 and more recently since 2000.

Another shortcoming of the reform process lies in the missing links between macroeconomic and microeconomic policy. At the core of dysfunctional governance is the fact that economic policy lacked credibility in the eyes of economic actors. As a result, ‘the uneven response of actors helped to explain both the less-than-hoped-for performance to date in most countries in the region, as well as the differentiated performance across countries’ (12). The authors underscore the role of information, expectations and incentives in influencing the credibility of economic policymaking. Reform initiatives are a ‘set of signals’ (7) in specific domestic and international contexts whose effectiveness depends on the ‘credibility of information and signals’ (8). However, the credibility gap, which arose from several inter-related factors, including the internal inconsistency of the package of reforms, weak popular support and an unfavourable environment, generated mixed responses from economic actors at the sector and firms levels.

The authors also revisit the longstanding debate between gradualism versus shock therapy on the most effective pace and sequencing of reforms. While the authors find important heterogeneity across countries, they underscore the increasing convergence over time between aggressive and cautious reformers. Faced with overwhelming problems including hyperinflation, poor economic performance, highly distorted economies and serious problems of governance, aggressive reformers, such as Argentina, Bolivia and Peru, chose to implement sweeping market reforms simultaneously. Cautious reformers with more auspicious initial conditions, such as Colombia, Costa Rica or Jamaica, opted for gradualism. Lastly, cautious but unstable reformers, such as Brazil and Mexico, were reluctant to embark on profound changes, even though they had to confront serious macroeconomic problems that eventually resulted in full-blown exchange rate crises in 1994 in Mexico and 1999 in Brazil.

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2The case studies are: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Jamaica, Mexico and Peru.
The comparison between Argentina and Brazil is particularly informative. Recent indexes of structural reform suggest that despite having followed radically different paths, Argentina and Brazil have reached similar levels of structural reform (Morley et al., 1999; Lora, 2001; Lora and Panizza, 2002). The collapse of Argentina in the winter of 2001–2002 and Brazil’s relative success warrant greater caution regarding the advisability of radical approach to market reform. Contradicting earlier fears of nervous capital markets, the new centre–left government of President Luiz Inácio Lula da Silva in Brazil constitutes a ray of hope in the continent. His centre–left government is pursuing prudent economic policies, while at the same time confronting poverty and indigence. It has engaged long overdue reforms in the tax and pension system and is endeavouring to give the central bank greater independence. The fate of Brazil is likely to depend on whether it will ultimately succeed. Nevertheless, the fact that the moderate left in Brazil has endorsed the principles of the Washington consensus (prudent macroeconomic and fiscal policy) reflects a shifting of paradigms.

Stallings and Peres underline that the reforms were ‘incomplete and need[ed] complementary policies to make them function properly’ (204) and to reap the full benefits of ‘first-generation’ market reforms. Indeed, they underscore the widespread ‘implementation failures’ (222) in the first stage of reform, reflecting a lessened capacity of states to implement policy. They argue that ‘with the partial exception of the macroeconomic area, the institutions responsible for implementing [economic policies] are weak with respect to both human and financial resources. Fragmented decision-making compounds the difficulties’ (222). This finding lends credit to the aforementioned third hypothesis.

The second stage of reform entails a major redefinition of the state and a dramatic increase in its capacity to adequately implement public policies. Reflecting a neo-Keynsian approach, Stallings and Peres recommend a more active role for government and argue that ‘macroeconomic policy should be strongly counter-cyclical’ (219) to cushion the social consequences of economic crises. The new reform horizon should include three critical areas: ‘the need to engage in competitiveness policies and investment promotion to increase growth, to undertake a major offensive in the social area, and to maintain and improve macroeconomic stability’ (211). However, the extent to which acting on these three fronts simultaneously is possible remains to be seen.

THE MISSING DEVELOPMENT STRATEGY

While the prevalent neo-liberal economic model has clearly shown its limitations, there is great uncertainty and confusion about its likely successor (Kuczynski and Williamson, 2003). It is increasingly being recognised that, while structural adjustment programmes provide a response to balance of payments problems, stabilisation in and of itself will not spur economic growth and development: fiscal righteousness, macroeconomic discipline and spending profligacy, per se, do not automatically translate into equity-enhancing economic growth and sustained poverty reduction.

However, while the institutional agenda enshrined in ‘second-generation reforms’ amends the dominant neo-liberal paradigm, it does not repudiate it. To the contrary, it reinforces it by palliating its insufficiencies. The Washington consensus remains the insuperable horizon of economic policymaking. Indeed, almost all statements about the policy priorities of the post-Washington consensus include a strong preface clarifying that sound macroeconomic fundamentals are indispensable. Sound macroeconomic policy has thus progressively become not only an objective, but also a precondition for sustainable development. Certainly, as the reform agenda is broadening, it is also becoming more complex.

Challenge of Change in Latin America and the Caribbean underscores some of the tensions and contradictions of the emerging development paradigm. ‘One significant advantage of the neo-liberal reforms’, says editor Jeffrey Stark, ‘was that they provided a “road map” for policymakers’ (4), focusing on a fairly narrow range of economic targets and macroeconomic indicators. Latin America now finds itself, once again, at a critical juncture, a defining ‘transitional moment’ (9). Articulating a post-neo-liberal development strategy requires rethinking the
development goals of economic policy reform and integrating greater considerations for poverty, equity and social welfare. Nevertheless, evaluations of the reform process reveal ‘divergent assessments of the performance and worth of Latin America’s neo-liberal reforms’ and offer ‘policy frameworks and prescriptions that imply quite different understandings of the future structure and role of the state in the region’ (9).

The absence of a coherent development strategy has also characterised the implementation of ‘first-generation’ market reforms themselves, as reflected by the divergent reform trajectories of Latin American countries. Market reforms were introduced in a general context of frustration and failure of the previous development strategy. ‘A sense of urgency drove the process’ (4) and, consequently, there was great scope for abuse on the part of executives, increasingly ruling by decree and often usurping the powers delegated to them by legislatures (Carey and Shugart, 1998.) The presidencies of Fernando Collor in Brazil, Carlos Menem in Argentina and Alberto Fujimori in Peru are characteristic of the autocratic tendencies of impatient presidents.

As Manuel Pastor and Carol Wise point out in their chapter on Argentina, a fundamental shortcoming of the Argentine restructuring under Menem was ‘the absence of an explicitly state development strategy’ as ‘market reform in and of itself is not a development strategy’ (44). The reforms became excessively rigid, constrained in the straightjacket of successful formulas. Indeed, Argentina became hemmed in by its own success. It did not progressively introduce flexibility when it was still time to do so. The strategy of the pegged exchange rate succeeded in quelling inflation, but failed to advance a pro-growth economic model beyond the immediate concerns of macroeconomic stability and monetary rectitude. At the same time, public finances and intergovernmental fiscal relations were allowed to deteriorate, dragging down the budget deficit. When recession came in 1998, few options were available for launching counter-cyclical policies. Mounting indebtedness became an irresistible temptation, which ultimately led to the collapse of the economy in 2001.

Pastor and Wise underscore the politics of economic reform and aptly uncover the dilemmas of economic policymaking. While in the early 1990s exclusive styles of policymaking helped enact sweeping market-oriented reforms, they undermined governance and allowed corrupt practices to develop. Under Menem (1989–1999), reforms were enacted in an exclusionary fashion relying on executive decrees and expeditious modes of governance: ‘The Menem administration’s autocratic and insulated style of decision-making did little to widen the “winners’ circle” from reform, usually a necessary undertaking to ensure the consolidation of long-term political support’ (21). However, this ‘style of closed, autocratic decision-making, much like the exchange rate targeting, outlived its usefulness’ (32). Building on earlier research (Pastor and Wise, 1999), Pastor and Wise demonstrate that, while an adequate strategy for initiating economic reforms, ‘hyper-presidentialism’ is largely inadequate to sustain them. Indeed, at the root of the dramatic implosion of Argentina lies its inability to reform the institutions of governance, especially ‘those state institutions most relevant to the policy-making process’ (43).

In Brazil, politics have also played a critical role in determining the contents and ultimate fate of reforms. The inchoate nature of Brazil’s political system forced President Fernando Henrique Cardoso (1994–2002) to adopt a gradual approach. As William Smith and Nizar Messari underscore, the slow pace of reforms is not explained by a strategic choice, but rather by necessity. Ambitious agenda for political, administrative, fiscal and social security reforms was almost brought to a halt, while measures to enhance the rule of law and reform the judiciary have stumbled in the Byzantine corridors of the legislative process. Cardoso recognised the need for a ‘Southern consensus’, ‘reacting beyond the Washington orthodoxy in order to tackle second-generation reforms that would focus on social issues, microeconomic reforms, and stronger state capacity’ (85). Yet Cardoso had to compromise ultimately, effectively muddling through reform. As Smith and Messari argue, ‘Cardoso attempted to advance his agenda in piecemeal fashion, offering patronage along the way in hopes of gradually strengthening governability’ (10). In the case of Brazil, ‘politico-institutional arrangements clearly constitute the primary obstacles to meaningful reform’ (94). Perverse incentives, inadequate governance structures and inefficacious institutions render the dilemmas of economic and political reform particularly daunting. Nevertheless, while it diluted the reform agenda and slowed its pace, incremental reform has allowed for processes of consensus-building and simultaneous adjustment in the institutions of economic policy, as the administrative reforms implemented between 1995 and 1998 suggest.
CONFLICT OR CONVERGENCE?

The aforementioned debates raise important questions concerning the compatibility between democratisation and market reforms. Based on the neo-modernisation paradigm, reformers originally assumed the existence of a positive synergy. In particular, state reform has been conceived in terms of both supporting democracy and promoting the market economy, presented as two mutually reinforcing processes.

In *Markets and Democracy in Latin America*, editors Philip Oxhorn and Pamela Starr question this central assumption of reformers. Building on earlier work on the political economy of economic reform (Przeworski, 1991; Oxhorn and Ducatenzelier, 1998), they revisit the compatibility hypothesis by examining ‘the logics of liberalizing’ (12). They reject the opposite hypothesis of inevitable trade-offs and ultimate incompatibility between democratisation and market reform.

The contributors to *Markets and Democracy* convincingly argue that there is not automatic causal or conditional relationship between the dual processes of political democratisation and market reform. These processes are ‘characterized by autonomous logics that in any given context can be complementary, contradictory, or even directly unrelated’ (4). For Oxhorn and Starr, ‘economic and political liberalizations are thus neither necessarily reinforcing nor inevitably incompatible’ (242). They posit that the two processes are ‘as likely to diverge as to reinforce one another’ (249), suggesting that ‘successful economic reform is largely independent of regime type’ (5) and that ‘no clear relationship exists between regime type and governments’ capacity to carry out neo-liberal economic reform’ (8). Although there may be areas of overlap and, indeed, convergence, economic and political liberalisation are parallel processes of change each with their own logic.

Oxhorn and Starr further stress that not only are the two processes distinct, they may also conflict. They hypothesise that ‘the institutional and political context in which economic reform policies are adopted is seen as mediating the relationship between economic and political liberalization’ (4). The nature of the interaction between the strategies of individual actors and the incentive provided by political institutions is a key determining factor. For example, explaining privatisation in Argentina, Brazil, India and Mexico, Leslie Elliott Armijo demonstrates that ‘political considerations motivate public policy choices as much as, and often more than, purely economic considerations’ (199). Similarly, Starr explains that the reasons for the diverging policy responses to the exchange rate crisis of 1994–1995 by Mexico and Argentina are to be found ‘in the structure of the electoral coalitions backing each government and the relative stability of the electoral environment in each country’ (204).

*Markets and Democracy* adopts a political-economy framework to explain the challenges of reform. Reforms are hampered by formidable collective action dilemmas. Philippe Faucher notes, ‘rational choice theory explains that stabilization measures are often politically difficult because costs tend to be immediate and concentrated, whereas benefits are more diffuse and are obtained only in the long run’ (118). Similarly, Carlos Waisman suggests that ‘the economic differentiation associated with the shift to a market-based development strategy contributes to an excessive fragmentation of civil society [. . .] that can undermine the consolidation of democracy. At the same time, political mobilization empowers those sectors with the most to lose from economic liberalization with the capacity to block needed reforms’ (245). Thus, the nature of the socio-political matrix within which liberalisation occurs is a determining factor conditioning the compatibility or incompatibility between democratisation and market reform. However, according to Manuel Antonio Garretón, the socio-political matrix that defines the relations among the state, the system of representation and social actors, is itself in a state of flux, transiting from one that was centred on the state to one that is increasingly centring on civil society.

Ultimately what matters most is not so much the nature of the regime *per se* but the quality of democratic institutions. Political and economic regimes are best understood as continuous rather than dichotomous variables, with only two values each (‘democracy’ vs ‘authoritarianism’; the ‘state’ vs the ‘market’). In between, there exist an array of sub-types of ‘hybrid regimes’ (Diamond, 2002) combining elements of both ideal types. As Oxhorn and Starr argue, ‘ultimately it may not be a question of an inevitable trade-off between the market and democracy, but instead a question of types of democracy and market that are compatible’ (246).
THE DOUBLE-EDGED SWORD OF EXECUTIVE DECREES

These considerations lead us to investigate the styles of policymaking best suited for undertaking each one of the two stages of reform. The first stage involved the dual processes of transition to democracy and macroeconomic stabilisation. The second stage entails initiating the institutional reforms required to consolidate democracy and anchor the market reforms.

Considering the recent experience of Latin America, one could argue that the manner in which first-generation market reforms were adopted and implemented, relying heavily on executive decrees, have actually undermined the institutional foundations upon which second-generation reforms can be forged. As Carlos Waisman accurately notes, ‘rule by decree, or decretismo, is a symptom of the weakness of state institutions in relation to civil society, rather than their strength. [...] Unfortunately, decretismo has further impeded the reconstruction of the state and the formulation of a democratic growth strategy’ (32).

Again, the comparison between Argentina and Brazil compels us to revisit conventional wisdom on the most adequate reform strategy. Despite the institutional flaws of Brazil’s political system described by Peter Kingston in Markets and Democracy, neo-liberal reform has gone a long way in Brazil precisely because of the incremental pace at which it was pursued. For Oxhorn and Starr, ‘only a gradualist approach could be successful in Brazil’s particular democratic context’ (250). Ultimately, as Faucher underscores, ‘the democratic road to economic stabilization lies with a leader’s ability to design a reform program that fits the nature and quantity of political support available’ (118). Although daunting challenges remain, Brazil has begun to progressively address the sources of ungovernability and restore economic policy credibility, something Argentina has failed to do. As Pastor and Wise suggest in Challenge of Change, Argentina’s demise is partly due to its failure to bring flexibility to its approach: ‘Opening the policy process up to more involvement may generate a reform agenda that is less ambitious, but a coalition that is capable of sustaining market reform in the longer term’ (46).

Enhancing governance and strengthening accountability remain the defining challenges of Latin American unstable democracies. Government ineffectiveness and ineptness are a major source of ungovernability. The states in Latin America lack the capacity to assert an authoritative presence of law and order. Indeed, as Waisman suggests, it is important to revisit the classical debate on the role of the state and find a more adequate balance between state autonomy and state capacity. Faucher lauds the ambitious administrative reforms launched by Carodoso during 1995–1998 specifically designed to restore state authority and autonomy. He nevertheless recognises that the ‘dramatic expansion of government legitimacy and of the resulting capacity to implement policy [...] has not been accompanied by an equally dramatic transformation of public policy’ (127, 128.)

THE ELUSIVE SEARCH FOR THE RULE OF LAW

The importance of government credibility and commitment to policy reform has been essentially neglected as a pivotal condition for effective economic reform. In Governing for Prosperity, editors Bruce Bueno de Mesquita and Hilton Root investigate the structural incentives shaping the conduct of public policymaking to elucidate ‘when bad economics is good politics’ (1). A puzzling paradox of the political economy of policy reform can be summarised as follows: ‘if the knowledge of what makes market work is widely known, then we must explain why so many governments resist changing their policies and their institutions until forced to do so in order to surmount a crisis’ (7).

Institutional reform, depending on its nature, can be either good or bad for economic development, as ‘democratic governance does not necessarily engender effective policy performance’ (9). Contrasting the experiences of countries such as India and Singapore, Governing for Prosperity argues that stability and predictability are more important than democracy to foster economic growth. In particular, ‘it is easy to erect institutions with the gloss of the rule of law. The key is to ensure that politicians are given institutional incentives to enforce the rules and govern in the spirit of the constitution. Stable institutions, by themselves, neither promote nor hinder growth’ (7). Bueno de Mesquita and Root nevertheless recognise that, as they are more responsive to the median voter, democratic governments tend to
pay greater attention to resolving co-ordination problems and enhancing the transparency of laws and regulations, while autocrats emphasise opaqueness and opacity that contribute to discretion. Indeed, ‘governments that create information asymmetries cannot be expected to intervene to make markets more efficient’ (85).

Douglass North and his colleagues argue that how successfully states resolve the credibility problem of economic policymaking is likely to determine their ability to promote economic development, as ‘the sources of political order involve state capacity concerning the creation of credible commitments’ (17). In turn, policy credibility is linked to the legitimacy of authority, the capacity of government to make authoritative decisions and the prevalence of the rule of law. However, the predominant literature tends to overstate the political requirements of long-term growth, as correlation is not necessarily causation. While many studies have revealed a negative correlation between economic growth and political instability, it is not clear which way causality runs. Latin American countries, despite being highly centralised, have been unable to secure these requisites of credibility. However, Stephen Haber and Armando Razo demonstrate in their chapter on Mexico that recurrent political instability has had only a minor impact on investor confidence and foreign investment, since continuity in economic policy appeared guaranteed.

The shrinkage of the state has undermined the state’s capacity for making policy and enforcing laws. In extreme cases of state failure, lawmaking and policy formulation are themselves captured by special interest so that rules and regulations are adopted or modified to fit their preferences. State capture, which occurs when political power itself is used for private gains as a result of inappropriate patterns of public spending and resource allocation, is more damaging than state corruption, as it is particularly difficult to confront. Robert Barro demonstrates that the strength of the rule of law is a key variable for explaining the quality of democracy and economic performance. Barro’s disturbing, yet persuasive, conclusion is that ‘for a country that starts with weak institutions—low levels of democracy and rule of law—an increase in democracy is less important than an expansion of the rule of law as a stimulus for economic growth and investment’. Consequently, ‘even if democracy is the principal objective in the long run, the best way to accomplish it may be to encourage the rule of law in the short run’ (230).

CONCLUSIONS: AFTER THE STORM

The different books reviewed herein underscore that the defining challenge of Latin American emergent economies is to reform the state and strengthen its capacity to adequately implement policy. The importance of the credibility of government commitment has been neglected as a pivotal condition for effective economic reform. How successfully states resolve the credibility problem of economic policymaking is likely to determine their ability to promote economic development, as the sources of political stability originate from the creation of credible commitments. In turn, policy credibility is intrinsically linked to the legitimacy of authority, the capacity of government to make authoritative decisions and the prevalence of the rule of law.

Two important conclusions can be drawn. First, strengthening governance requires a fundamental redefinition of the state. Faucher advances a particularly useful definition of the concept of governance, which ‘measures the capacity of the state to implement policy, to act within a set of predictable rules, and to maintain order’ (105). As such, governance refers to the state’s capacity to engage in governmental decision-making within an institutional environment of accountability, transparency, probity and the rule of law.

Second, dramatically reforming the methods of government and the styles of policymaking are critical dimensions of the reform of the state. The experience of Latin America clearly shows the limits of expeditious decision-making and the consequent need to strengthen the mechanisms of accountability. The credibility and reliability of the policymaking process are key dimensions of effective democratic governance (Santiso, 2004). As the books clearly demonstrate, government by executive decree, while an asset in the initial phase of economic reform, progressively becomes a liability in the second phase of reform. The central dilemma then is how to retain the advantages of strong executive authority while at the same time providing the institutional checks and balances that guarantee accountability and oversight.

The contrast between Argentina and Brazil has shown the limits, if not contradictions, of the consensus that prevailed in the early 1990s. Then, Argentina’s reform path was depicted as the model to follow, and Brazil’s
reform reluctance as hopelessly counter-model. A decade after, the roles have been reversed and Brazil appears now as the region’s best hope for equitable change. The fate of Brazil has wider significance for the region in search of a roadmap for reform beyond the Washington consensus. Will the new development paradigm emerge from Brasilia?

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