THE DEBT CRISIS AND ECONOMIC ADJUSTMENT IN LATIN AMERICA

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THE POLITICAL ECONOMY OF INTERNATIONAL MONEY: IN SEARCH OF A NEW ORDER. Edited by LOUKAS TSOUKALIS. (London and Beverly Hills: Sage Publications, 1985. Pp. 313. $45.00.)

As the decade of the 1980s draws to a close, Latin American countries are struggling to get back on their feet. After an apparently auspicious beginning, the decade has become an economic nightmare for Latin America, which in the last few years has suffered its worst recession since the 1930s. When Mexico disclosed its financial difficulties in August 1982, what seemed to be an isolated case of temporary illiquidity soon spread to most of the developing world, seriously jeopardizing the stability of the international financial system. The adjustment process that followed from 1982 to 1987, which can best be described as emergency stabilization, has been extremely costly: real income per capita has experienced steep declines in most countries.[1]

A direct outgrowth of the crisis has been the mushrooming of books, pamphlets, and articles dealing with different aspects of the problem. Some of this literature is of remarkably high quality, some will be quickly forgotten, and a nontrivial proportion is plainly awful. This essay will review only a few of the volumes that deal in one way or another with the crisis. Many are collections of articles, which makes the reviewer's task more difficult because the contributions not only vary in quality but often lack unity. For this reason, I will deal with these collections selectively, dwelling on some of the essays and almost ignoring others, although I will try to assess each volume as a whole.

The first section will discuss the role of the international monetary system in unleashing the crisis. The second section will focus on the specific role of the International Monetary Fund (IMF) and its policies. In the third section, I will review individual country experiences, emphasizing recent attempts to implement unorthodox stabilization programs, like the Austral and Cruzado plans and the APRA experience in Peru.

The International Monetary System, Latin American Development Strategies, and the Debt Crisis

Stephany Griffith-Jones's and Osvaldo Sunkel's *Debt and Development Crises in Latin America: The End of an Illusion* represents an ambitious attempt to place the debt crisis in the context of the evolution of the international monetary system. According to the authors, the debt crisis represents a broad and deep crisis in the international monetary system and in the development strategies followed by the developing world in recent decades. As a consequence, Griffith-Jones and Sunkel argue, solving the debt crisis presupposes reforming the international monetary system and drastically changing the focus of development strategies. With respect to the international monetary system, they point out three areas of failure. First, the system has been unable to provide less developed countries (LDCs) with the amount of funds "required" to achieve their development targets. Second, capital flows to the developing countries have been procyclical, making it difficult for these countries to use foreign funds to face world recessions. Third, unlike the events of the 1950s, 1960s, and 1970s, the 1980s have not

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witnessed the emergence of a new financial sector that could lead the world out of the crisis. *Debt and Development Crises in Latin America* contains abundant statistical information as well as the authors' fairly detailed plan for reforming the international system.

Griffith-Jones and Sunkel have written a nostalgic book whose tone evokes the earliest structuralists' ideas of the 1950s and 1960s. Neither the criticisms of structuralism of the last two decades nor the developments introduced by neostructuralists in the last few years can be found in this work. Moreover, it contains a number of claims that are either inaccurate or unsupported by empirical evidence. For instance, the authors sustain that in response to the crisis, Latin American nations implemented "restrictive policies . . . to stabilize the balance of payments and keep the economies open" (p. 11). Yet it is well known by close observers of the Latin American economic scene that nearly all countries in the region responded to the crisis by imposing extremely restrictive trade, capital, and exchange controls—that is, they closed their economies. Only very recently and slowly have some countries begun to venture into trade liberalization reforms.[2] Another example is the authors' claim that banks made large monopolistic rents in the rescheduling process (pp. 61–62), a hypothesis that is not rigorously verified by the brief paragraph in Chapter 8 (pp. 113–14). In fact, Sule Ozler's recent extensive study of a large number of banks and their loans to LDCs found that although banks made above-normal profits for the reschedulings of the 1970s, they made below-normal profits during the reschedulings that followed the 1982 crisis (Ozler 1988).

Given Griffith-Jones's and Sunkel's backgrounds and previous writings, it is puzzling that *Debt and Development Crises in Latin America* makes so little reference to historical events. Latin American economic history is replete with debt crises. Although few episodes have exhibited the depth and seriousness of the current crisis, many lessons can be drawn from these experiences. A fascinating literature on this subject has emerged in the last few years, but I will mention only two studies here. Eichengreen (1989) discusses the reasons that determined why the debtor countries in the 1930s failed to form a unified front for negotiating with their creditors and how the case-by-case approach was adopted, as has occurred in the 1980s. Lindert and Morton (1988) have shown that following the debt crisis of the 1930s, the international financial community failed to differentiate between debtors who behaved "well" and "badly." Even those countries that kept current in their payments were subjected to "penalties" and did not regain access to voluntary lending. This kind of information is extremely valuable when evaluating the costs involved in not paying all or part of the debt.

Loukas Tsoukalis and Michael Posner have both assembled collections of essays dealing with the international monetary system. Although the scope of the two volumes goes beyond the developing countries and the debt crisis, each contains some interesting articles on the poorer nations. The Tsoukalis volume, *The Political Economy of International Money*, contains three articles that are particularly relevant. In a highly informative paper, Susan Strange analyzes the evolution of the monetary system from the mid-1970s to the mid-1980s, thus providing a much-needed survey on the evolving views of different schools of thought. According to Strange, monetary mismanagement in the industrialized world lies at the core of many of the current international problems. She persuasively argues that the current wave of protectionism in much of the industrialized world is one of the most serious consequences of these countries' lax monetary policies. In the same volume, Graham Bird and Tony Killick summarize their research on the role of the International Monetary Fund in the macroeconomic adjustment of developing countries.

Finally, David Lewellyn discusses the role of private banks. Understanding the behavior of private banks is essential to any serious evaluation of the role played by the international monetary system in unleashing the debt crisis, and Lewellyn takes some helpful steps toward fulfilling this task. He starts by pointing out that two major developments occurring in the 1970s were the shift from bond to bank financing and the switch from official to private sources of funding. He argues that after some years of smooth functioning, the system developed a confidence problem in the early 1980s as concern mounted over the poorer countries' ability to service their debts. Lewellyn goes on to question the adequacy of the case-by-case approach in solving the crisis that followed in 1983–84. He argues in favor of a long-term solution involving some reforms of the international monetary system, including provisions to avoid a similar crisis in the future.

Overall, Tsoukalis has put together a useful volume. Among the chapters not reviewed above, I particularly recommend John Williamson's piece. By focusing on the role and activities of international economists, he masterfully discusses important aspects of the sociology of the economics profession.

Posner's collection, *Problems of International Money, 1972–1985*, is a natural complement to the Tsoukalis volume. In fact, many authors appear in both collections, producing an unavoidable sense of déjà vu. What makes Posner's volume interesting in its own right is that it brings together articles by a number of senior IMF officials with essays by some of the most persistent critics of the IMF. In fact, the book was jointly produced by the IMF and the Overseas Development Institute, a London research institution directed by Tony Killick, a well-known critic of the IMF. One essay not directly related to the LDC debt, that by G. G. Johnson on IMF surveillance, offers a particularly enlightening explanation of the evolution of the Fund's role after the Bretton Woods system was abandoned. One gets the clear impression that abandoning the system of fixed exchange rates in 1973 provoked serious soul-searching at the IMF because suddenly the role of the institution had become unclear. It is perhaps ironic that the debt crisis and the concomitant need for massive macroeconomic adjustment in the LDCs have given the IMF a new and major role. Michael Dooley provides a worthwhile study of the role of international reserves in the international monetary system. His analysis of the currency composition of holdings of reserves by many LDCs is enlightening in its use of data not generally available to academic researchers. But Dooley says very little about the nature of the optimizing problem that gives rise to a demand for international liquidity by the developing countries. What he says is actually tautological: "Countries tend to adjust their reserves holding until the benefits derived from such holding are equal, at the margin, to the net cost of holding them" (p. 108). One can only hope that any junior majoring in economics, under the pressure of an exam, would be able to say that much.

Killick and Tsoukalis argue in their respective contributions that one of the most serious flaws of the international monetary system is the lack of symmetry in international adjustment. In their view, surplus countries should share the burden of adjustment with deficit countries, resulting in a more symmetric adjustment that would benefit the world economy as a whole. But the authors do not discuss how this type of adjustment could be enforced. If surplus countries have not yet willingly participated in a major program along these lines, what would make them participate? How can free-rider problems be avoided? Neither of these questions is addressed in *Problems of International Money*. Ignoring the international political economy dimensions of this problem constitutes the major shortcoming of an otherwise interesting volume.

One of the most important questions regarding the debt problem is, why did the unfavorable external terms of trade and interest rate shocks, with a recent historical precedent in the 1975 world recession, result in the unleashing of a major crisis that has halted regional growth for a number of years? Why were the Latin American countries unable to recover quickly, as they did after the even more severe world recession in 1975? In a characteristically stimulating article in the Thorp and Whitehead volume, Díaz-Alejandro argues that the shocks of the 1980s were greatly compounded by the "breakdown" of the international financial system that occurred in 1982. Unlike the situation in 1975, when the Latin American nations "borrowed" themselves out of the recession, in 1982 the financial community cut the flow of loans to Latin America rather than increasing it. Díaz-Alejandro asserts that "what could have been a serious but manageable recession during the early

1980s in Latin America has turned into a major developing crisis mainly because of the breakdown of international financial markets and an abrupt change in conditions and rules for international lending" (Thorp and Whitehead, p. 12). This view characterizes the majority opinion of the contributors to the volumes reviewed in this section.

Although these authors are correct in pointing out that the international financial system exhibited some serious deficiencies in the period surrounding the crisis, it is not clear whether a complete "breakdown" occurred. The reason why Latin America could "borrow" itself out of the recession in 1975 but could not do so in 1982 is that by the late 1970s and early 1980s, Latin America had already borrowed so much that when the 1982 recession erupted, most of these countries had already used all their borrowing capacity. Perhaps the system's main inefficiency was that international banks failed to exercise the prudence traditionally associated with bankers. They lent massively to Latin American countries in the middle and late 1970s, disregarding issues as central as how the funds were being used (to finance investment or to fuel capital flight) and whether the recipient countries were following "sound" policies. Indeed, in the process of competing to recycle abundant petrodollars, the banks literally "pushed" loans on Latin American countries, the result being a highly procyclical lending pattern. A second area of inefficiency was that when the crisis actually erupted, the banks failed to distinguish among different Latin American nations. Instead, the banks exhibited a remarkable herd instinct by simultaneously pulling out of the region as a whole. Even Colombia, a country without major economic problems, has found it increasingly difficult to get its loans rolled over.

Now that the collapse of the international monetary system has been aborted, the most important outstanding issue is that of working out debt-relief packages (including debt forgiveness) that would alleviate the burden of making huge transfers and solve the debt overhang problem. Whether banks will participate willingly in such a scheme is not clear. Sadly, recent evidence suggests that shortsightedness is one of the banks' more prominent characteristics.

The Role of the International Monetary Fund

The International Monetary Fund (IMF) is a mysterious and often feared institution. Among the many myths surrounding it, perhaps the best known and least accurate is the rumor that IMF staff members fly all around the world (first-class, of course) imposing unnecessarily harsh adjustment policies on poor countries. This image is far from the truth. Strictly speaking, the IMF has no real power to impose any policy. It is, however, a combination of financial examiner and international lender of last resort. Member countries facing financial difficulties approach the IMF for short- and medium-term financial help. Before providing such assistance, however, the IMF requires the country to sign an agreement that it will "put its house in order." This promise usually means undoing the policies that led to financial trouble in the first place, or in cases where the difficulties are external in origin, adjusting to new international circumstances. Most times these programs call for devaluation, credit restraints, regaining fiscal discipline, and raising prices for public enterprises. Only after an agreement has been reached does the IMF disburse part of the money. Further disbursements are made after the IMF is satisfied that the country is indeed following the agreed-upon policies. The concept of tying financial assistance to a certain policy package is known as "IMF conditionality," an issue that is dealt with in three of the books and several of the essays reviewed here.

Critics of the IMF have traditionally argued that its policies focus narrowly on short-term financial and external targets and pay little, if any, attention to growth. But Manuel Pastor's new book, *The International Monetary Fund and Latin America: Economic Stabilization and Class Conflicts*, criticizes both the IMF and its traditional critics. Taking a neo-Marxist perspective, he argues that the critics' excessive focus on growth (or lack of it) is misplaced and that the most serious limitation of IMF programs is their disregard for income distribution and poverty. Pastor's book is a refreshing contribution in many ways. First, he has attempted to make his neo-Marxist perspective accessible to those uninitiated into the political jargon of the Marxist left. Second, unlike so many Latin American Marxists, Pastor has made a serious effort to document his theoretical and analytical claims with empirical evidence. Nevertheless, the author's enormous enthusiasm, which makes the book refreshing, is also its main limitation. The style and failure to follow arguments all the way through suggest that this book has grown directly (and with little revision) from the author's doctoral dissertation. The fact that a work is based on a dissertation need not be a drawback, as demonstrated by the evidence that many modern classics in the social sciences originated in doctoral research. Pastor, however, has not polished his material sufficiently.

The most interesting part of *The International Monetary Fund and Latin America* is found in Chapter 4, where Pastor presents empirical findings on the effects of IMF programs (both Standby and Extended Fund Facility) in eighteen Latin American countries. Using a battery of statistical tests, he finds that IMF programs have improved the balance of payments, have not improved the current accounts, and have reduced labor shares in real incomes. With regard to real growth, he finds no clear-cut evidence. Pastor's most significant finding, which is discussed at length, is that IMF programs have a negative effect on income distribution. This analysis is highly useful, but it has some methodological limitations. First, it concentrates on the very short term, looking only at what happens one year after the programs are implemented. Some IMF policies, especially those geared toward aggregate supply, undoubtedly require a longer period of time to bear fruit. Second, the analysis is based on a before-and-after methodology that compares the values of the key indicators before and after the programs. No effort is made to separate the effect of IMF programs from those coming from other kinds of disturbances. Third, the author does not provide a coherent "counterfactual" adjustment policy.[3]

The International Monetary Fund's official historian was Margaret de Vries, until her recent retirement. Her book, *Balance of Payments Adjustments, 1955 to 1986: The IMF Experience*, traces the evolution of IMF involvement in adjustment programs from 1945 to 1986. Using a historical approach, de Vries makes great effort to document a number of small details regarding Fund operations. This attention to minutiae may make the book somewhat boring to those interested in the big picture rather than the day-to-day workings of the IMF. What is interesting about this book is the chronicle of the IMF's evolution from its original role, as envisaged by the articles of agreement, to its recent participation in the debt crisis. The picture that emerges is a rather dynamic institution that has been able to adapt to new times and to even invent new tasks for itself (like surveillance) when its own raison d'être was being questioned after the breakdown of the Bretton Woods system. *Balance of Payments Adjustments* fails, however, to address any of the criticisms that have been made of IMF operations over the years.[4]

SELA's *El FMI, el Banco Mundial y la crisis latinoamericana* contains articles on IMF and World Bank relations with Latin American countries, most of them written by prominent Latin American economists. The collection takes a generally critical tone and offers a number of reform proposals. The book contains three general articles by Edmar Bacha, Bacha and Miguel Rodríguez Mendoza, and Bacha and Richard Feinberg, as well as articles dealing with these institutions' relations with specific countries—Argentina, Brazil, Colombia, Jamaica, Mexico, Peru, and the Dominican Republic. Although the criticisms of the IMF presented here are not new, I found Bacha's article on reforming IMF operations particularly intriguing. He advocates three major changes: implementing two-tier conditionality—one tier for variables expressed in foreign exchange and one for variables in domestic currency; adopting "inverted conditionality," in which the local authorities offer their program and the IMF monitors its achievement; and adopting an analytical framework to formulate programs that incorporate the findings of the 1960s and 1970s on disequilibrium macroeconomics. Bacha is a

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formidable critic of the IMF because he understands its operation and has thought carefully about alternatives. His proposals are nevertheless impractical and, I would say, even somewhat naive. Why would the IMF—or to put it more directly, its larger members— agree to adopt the most radical of his reform propositions?[5] The answer to this question lies in the realm of the international political economy, an area totally unaddressed in this volume. Moreover, several of Bacha's propositions are dubious from a purely economic point of view. For example, the economics profession has largely abandoned disequilibrium models. After a promising beginning, these models have proved to be difficult to manipulate and short on useful insights. Also, it is unclear whether dichotomizing the functioning of an economy between "variables expressed in foreign exchange" and "variables in domestic currency" is useful. General equilibrium interrelations in modern economies are extremely complex, and the evolution of "domestic currency" variables such as inflation will undoubtedly affect foreign-sector variables.

El FMI, el Banco Mundial y la crisis latino americana is nevertheless a valuable contribution, despite its disregard for international political economy aspects and the absence of considerations of the modern theory of policymaking in an uncertain environment. The country chapters provide much detailed information about IMF operations in Latin America, including the contents of many letters of intent, that cannot be found elsewhere.

Country Experiences with Adjustment

Thorp and Whitehead's *Latin American Debt and the Adjustment Crisis* is the third volume of a series dealing with different aspects of adjustment in Latin America. Like its two predecessors, this book contains a number of country-specific chapters as well as two essays dealing with the region as a whole. The countries covered are Argentina, Brazil, Chile, Colombia, Peru, and Mexico, with an additional chapter on the Central American countries. The unifying theme is the limitations of "orthodox" adjustment policies, described here as policies centering around the need to impose fiscal discipline and restrain the creation of domestic credit. What makes this volume particularly interesting is that these essays were written before the different "heterodox" programs were implemented in full force (the Cruzado and Austral plans and the APRA program). Recurring throughout the volume is the belief that inflation is an "inertial" phenomenon. The authors of these essays expressed great confidence that such heterodox plans should succeed and would greatly facilitate adjustment in the region. Unfortunately, history has shown since these essays were written that such confidence mainly reflected wishful thinking. At the current time, the broad consensus is that these plans were a big flop. Their failure, however, does not necessarily reflect an incorrect diagnosis, rather very poor implementation (few doubt that inertia is a crucial force in Brazil). I will return to this point below in reviewing the special issue of *El Trimestre Económico* devoted to the heterodox programs.

On the whole, Thorp and Whitehead have produced a valuable volume that provides a wealth of information about recent macroeconomic developments in the region as well as a glimpse of the thinking of some prominent Latin American economists (some of whom may hold public office in the years to come) on several key issues. It should be noted nonetheless that the selection of the contributors and their essays reflect the views of the editors: the volume contains a fair amount of IMF bashing and skepticism about the efficiency of markets.

Carneiro's chapter on Brazil provides a worthwhile account of Brazilian negotiations with the IMF. He clearly demonstrates how this process can be draining for local authorities and concurs with the authors of the SELA collective work on the difficulties usually encountered in achieving domestic targets. Perhaps the most important point made by Carneiro is that because most of the Brazilian debt is government debt, its payment will require a transfer from the private to the public sector. This link is one of the most serious and least understood aspects of the crisis: the debt crisis is as much a domestic fiscal problem as an external problem. Carneiro's chapter is full of references to the inertial aspects of inflation and the need to tackle the indexation mechanism in order to achieve a semipermanent solution to the inflation problem. Jaime Ros's informative chapter on Mexico focuses on the role of capital flight in the Mexican crisis. This key issue highlights the fact that those who benefited from acquiring the debt are not the ones who are now shouldering most of the costs of paying it. Surprisingly, the other essays in *Latin American Debt and the Adjustment Crisis* devote little space to discussing this issue.

Whitehead's chapter on economic policy in Chile under Pinochet analyzes the underlying causes of the collapse of the Chilean economy in 1982. After discussing the roles of exchange-rate and monetary policies, he analyzes the relationship between Chilean economic policy and the political nature of the Pinochet regime. He argues that given the dictatorial and right-wing nature of the government, analysts should not be surprised by the inflexibility and dogmatism exhibited by the Chilean economic team—the so-called "Chicago boys."[6] Whitehead also argues that because Pinochet's initial goal was to destroy the Allende legacy and institute a free-market system, the "Chicago boys" pushed the free-market reforms at maximum speed without regard for any short- and medium-term consequences. He even goes so far as to say that "high unemployment might actually have some attractions for the

Chilean regime as a policy objective" (p. 146). I find this view as far-fetched as the hypothesis entertained by the Chilean extreme right regarding the economic policies of the Allende government. According to this notion, Allende's economic minister Pedro Vuskovic designed a policy package deliberately aimed at destroying the Chilean capitalist economy so that a new socialist economy could be built upon its ashes. This is all nonsense, of course.

In interpreting economic policymaking under Pinochet, Whitehead misses one crucial point altogether: although Pinochet and the Chilean Armed Forces were strongly anticommunist, or more accurately anti-Marxist, they did not favor a free-market system initially. It is a well-known fact that the Chilean military traditionally held highly nationalistic views in economic matters, favoring some type of indicative planning and major government involvement in the economy (see Edwards and Edwards 1987, chap. 4). A key question is why did the military end up embracing the policies of the "Chicago boys" rather than drawing on the Chistian Democrats' program? After all, the Christian Democratic party initially supported the coup, and many of its members participated in the government economic team. The "Chicago boys" were able to retain the military's confidence only to the extent that their policies "worked" in the sense of reducing inflation and, especially after 1975, in generating growth. The policy mistakes that contributed to the collapse of 1982 resulted not from a conspiracy to starve the working classes but rather from technical miscalculations fueled by arrogance. As I have argued elsewhere, the dictatorial nature of the regime encouraged the maintenance of these incorrect policies for a long time (Edwards and Edwards 1987).

Whitehead's article ends with a pessimistic assessment of the medium-term prospects for the Chilean economy. Yet in the last few years, to the surprise of most observers, the Chilean economy has recovered with great vigor. At this juncture, Chile's problem is not strictly the economy but more fundamentally, the political future of the country. By the time this review essay appears, we will know whether the Chilean people have succeeded in defeating the odds and are managing to head back toward democracy.

Although I cannot review other chapters in *Latin American Debt and the Adjustment Crisis* in detail due to space considerations, I strongly recommend José Antonio Ocampo's chapter on Colombia. In his characteristically lucid style, Ocampo analyzes how and why Colombia was spared during the general collapse of the Latin American economies. Unfortunately, recent developments, particularly the puzzling attitude of the private banks, may prove that Ocampo's cautious optimism about Colombia's future was premature.

One of the most important lessons emerging from Latin America's macroeconomic experiences during the 1980s concerns the dynamics of high inflation. As the IMF staff dealing with Brazil learned the hard way, in highly indexed economies, inflation takes on a life of its own: inertial forces become dominant and monetary authorities have little alternative but to validate these inertial pushes. Luiz Bresser-Pereira's and Yoshiaki Nakano's book deals with the theory of inertial inflation, while the articles in the special issue of *El Trimestre Económico* edited by José Antonio Ocampo deal with recent anti-inflationary programs in Latin America, particularly the heterodox programs in Argentina, Brazil, and Peru. Both volumes are highly recommended for their presentation of an important new view on inflation.

In *The Theory of Inertial Inflation: The Foundation of Economic Reform in Brazil and Argentina*, Bresser-Pereira and Nakano rightly observe that in order to understand chronic inflationary processes fully, it is necessary to go beyond the narrow realm of economics and tackle political and distributive issues. Indexation is nothing more than the institutionalization of a defense mechanism. But indexation can become so entrenched that it alters the dynamics of inflation. In these cases (like Brazil), inflation can be reduced only if the economy is de-indexed. Few analysts doubt that the Cruzado and Austral plans were based on the correct diagnosis regarding the role of indexation. But the implementation of both plans erred badly in not enforcing the necessary policies for managing demand along with income policies and heterodox shocks. Bresser-Pereira and Nakano have a point in arguing that the orthodox approach that relates fiscal deficits to money creation and money creation to inflation is very simplistic and almost tautological. But precisely because this approach is tautological, it cannot be ignored when implementing a stabilization program. No matter how many heterodox shocks are applied, if the fiscal finances are not put in order, inflation will not decline, and to ignore this principle is not only bad economics but irresponsible politics. Most Latin American democracies are too fragile to place at risk by implementing irresponsible economic policies.

The more interesting—and troubling—contributions to the special issue of *El Trimestre Económico* are those on Peru by Richard Webb, Jürgen Schuldt, and Rosemary Thorp. In August 1985, the newly elected government of President Alan García instituted a new and "heterodox" anti-inflationary plan. The Alianza Popular Revolucionaria Americana (APRA) had inherited a crippled economy suffering from an annual rate of inflation exceeding 200 percent. The Peruvian experience, however, has differed significantly from the other two heterodox cases in Argentina and Brazil. First, wage and price indexation in Peru was not generalized and did not constitute a serious problem. Second, the economy had become highly "dollarized" during the last two years of the Belaúnde government. Third, Peru early on reduced its foreign debt burden by limiting interest payments to approximately 10 percent of exports. Fourth and most important, the Peruvian program went well beyond seeking to reduce inflation to become a development plan ultimately aimed at redirecting the Peruvian economy. Rosemary Thorp's contribution is particularly worthwhile. The work of a longtime student of the Peruvian economy, her essay provides a clear description of the rationale behind the APRA program. It is nevertheless difficult to understand why, in light of the program's poor results, she insists on calling it a "success" (p. 366).

The Peruvian program consisted of a price freeze, increases in wage rates, tax cuts, exchange-rate pegging, reduced payments on foreign debt interest, and an increase in government expenditure. The program was put together in a hurry. As Webb explains, it was presented to García on 31 July 1985, and its main measures were implemented during the first week of August 1985.

As Rudiger Dornbusch (n.d.) has recently pointed out, the Peruvian program completely disregarded every basic principle of economics. For instance, its architects argued that the fiscal deficit has no effect on inflation. In an act of faith, they asserted that the Peruvian fiscal deficit was not a cause but rather a consequence of inflation. What evidence backed this assertion? Certainly not the existence of indexation because, as Thorp points out, this factor was not significant in Peru. An important element of the Peruvian program was the belief that the economy had large "unutilized capacity" and that, consequently, higher aggregate demand—stimulated via hikes in domestic credit—need not be inflationary. The basic argument was that all that was needed was to freeze prices and increase wages for the right groups. Yet history has shown time and time again that such a policy has a very short-run positive effect on output. As soon as inventories are exhausted and foreign exchange is used up, a serious process of repressed inflation takes over. The external sector enters a crisis, the real exchange rate becomes seriously overvalued, severe exchange and trade controls are imposed, and the productive side becomes highly distorted. The formal sector shrinks, and the underground economy thrives; as activities shift into the informal sector, sources of taxation disappear. The fiscal deficit broadens and inflationary pressures become more significant. Sadly, a vicious circle develops, and breaking out of it becomes increasingly difficult. This scenario is exactly what has been happening in Peru, and the result is that the country is rapidly approaching economic and political suicide.

Why did the architects of the program or their academic advisors fail to anticipate these developments?[7] The problem, I think, is that they failed to learn the lessons of recent Latin American history. As it turns out, the Peruvian program has a recent predecessor in the Unidad

Popular program in Chile. Many of the same elements were present in Allende's program: the diagnosis of unutilized capacity, skepticism regarding the fiscal sources of inflation, the price freezes, overvaluation of the exchange rate, and the populist hike in wages, to mention only some of the factors. As any careful student of recent Latin American history knows, the Unidad Popular program quickly resulted in unsustainable economic pressures, repressed inflation, and a major crisis that helped trigger the coup leading to fifteen years of rule by Pinochet.[8] One can only hope that President García will have the vision to change course before it is too late. Democracy is too precious to risk by implementing economic policies that have already proved to be a disaster.

NOTES

1. On the debt crisis, see for example the collection of articles forthcoming in Edwards and Larraín (1989) and Sachs (1988).
2. See, for instance, the discussion in my article in the Sachs debt volume (1988).
3. The emphasis here is on "coherent." Pastor pushes the Marxist view that only structural (revolutionary) changes will solve these problems in the end. History is stubborn, however, and has shown that even socialist countries cannot escape the need to adjust when facing imbalances.
4. Notice, however, that through the years the IMF has been receptive to criticisms and has made efforts to establish an intellectual dialogue with its critics. The Posner volume reviewed above is a good example of this approach.
5. The emphasis here is on "radical." In fact, the IMF has already adopted some of the less radical proposals, such as contingent conditionality.
6. In this section, Whitehead is partially reacting to my own view of the dogmatism of the "Chicago boys." See pp. 140–45 of Whitehead's article as well as my 1984 article.
7. In a recent book, *El Perú heterodoxo: un modelo económico*, the architects of the plan expose the technical underpinnings of the program. The volume is full of equations and statistical jargon, and a number of econometric models of 1960s vintage are presented and discussed. These technicalities, however, fail to disguise the plan's lack of economic coherence and judgment.
8. For a comparison of the Allende and García economic programs, see Dornbusch and Edwards (1989).

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