OCCASIONAL PAPERS
Number 7

PN-ABD-626
634

SOME PROBLEMS IN IMPLEMENTING ECONOMIC POLICY

Jesus Silva-Herzog

INTERNATIONAL CENTER FOR ECONOMIC GROWTH

[redacted]ernational Center for Economic Growth is a non-profit research institute founded in 1985 to stimulate international discussions on economic policy, economic growth, and human welfare. The Center sponsors research, publications, and conferences in cooperation with an international network of correspondent institutes, which distribute publications of both the Center and other network members to policy audiences around the world. The Center's research and publications program is organized around five series: Sector Studies; Country Studies; Studies in Human Development and Social Welfare; Occasional Papers; and a Reprint Series.

The Center is affiliated with the Institute for Contemporary Studies, and has headquarters in Panama and a home office in San Francisco, California.

Publication signifies that the Center believes a work to be a competent treatment worthy of public consideration. The findings, interpretations, and conclusions of a work are entirely those of the author and should not be attributed to ICEG, its affiliated organizations, its board of overseers, or organizations that support ICEG.

For further information, please contact the International Center for Economic Growth, 243 Kearny Street, San Francisco, California, 94108, USA. Phone (415) 981-5353.

ICEG Board of Overseers

1

Some Problems in Implementing Economic Policy

By Jesus Silva-Herzog

International Center
for Economic Growth

Affiliated with the
Institute for Contemporary Studies

2

Inquiries, book orders, and catalogue requests should be addressed to ICS Press, 243 Kearny Street, San Francisco, California 94108 (415) 981-5353.

ISBN 1-55815-019-6

3

PREFACE

This paper, by Jesus Silva-Herzog, is the seventh in the series of Occasional Papers. We are particularly pleased to publish this essay by Jesus Silva-Herzog who has had a distinguished career of more than thirty years of public service in Mexico. As Minister of Finance and Public Credit (1982-86), he was one of the key architects of Mexican economic adjustment policies—dealing firsthand with the problems inherent in applying such policies—and made significant contributions to a more advanced understanding of this crucial process. Moreover, as a professor at two of Mexico's most prestigious universities, he has taught these lessons to Mexico's next generation of policymakers. Mr. Silva-Herzog has been recognized for his work in countries throughout Latin America and Europe.

In this essay, Mr. Silva-Herzog draws on his policymaking experiences in Mexico to make recommendations vital to successful policy implementation. The lessons, which are universal, emphasize the necessity of cooperation between economic theorists and policymakers, among departments within the government, and between government and the constituencies of the nation. We are confident that both scholars and policymakers will find his analysis valuable for understanding the policy process and implementing economic policy.

Nicolás Ardito-Barletta
General Director
International Center
for Economic Growth

Panama City, Panama
September 1988

.4'

ABOUT THE AUTHOR

In his long career of public service, Jesus Silva-Herzog has made many contributions to Mexico's economic development. Mr. Silva-Herzog has served as the Minister of Finance and Public Credit in Mexico (1982-86), Director General of the National Housing Fund Institute for Wage-Earners—INFONAVIT (1972-77), General Manager of the Banco de Mexico (1977-78), and Deputy Minister of Finance (1979-81). Mr. Silva-Herzog is also a professor at both the National School of Economics and Colegio de Mexico. He is a member of the High Level Review Committee of the InterAmerican Development Bank, the InterAmerican Dialogue, and the Policy Board of the Inter-Action Council. He studied at the National School of Economics of the University of Mexico, and holds a graduate degree from Yale University. Currently, Mr. Silva-Herzog lectures at various universities throughout the U.S. and Mexico and serves as a consultant to major corporations, governments, and international organizations.

5

JESUS SILVA-HERZOG

Some Problems in Implementing Economic Policy

Although recent advances in economic knowledge have made important contributions to the formulation of economic policy, too little attention continues to be paid to policy implementation. While economic policy planning can today be executed with great sophistication and elegance, the same attention that produced that sophistication in formalizing policy has not, for the most part, been extended to understanding problems involved in carrying out policies.

Unfortunately, a perfectly planned economic policy, with a solid theoretical foundation, can be hampered and even defeated by problems of implementation. In fact, in the great majority of cases, problems of implementation rather than of policy are responsible for the failures experienced by programs designed to effect economic alignment or reform. There is little point in knowing what must be done if we do not know how to do it.

The absence of literature on economic policy implementation is surprising. Although economic policymakers have for the most part focused on implementation, they do not write about it. Academic

The preliminary concepts discussed in this study were presented at the Seminar on Implementation of Economic Reforms: Institutional and Administrative Factors, sponsored by the World Bank and held on January 28, 1987, in Annapolis, MD.

economic theorists, on the other hand, have not focused on it at all. Although orthodox economists take part in diagnosing a problem and provide—or contribute to—a plan of action, they normally abandon the policy process in the implementation phase, because of problems or limitations of an administrative or political nature. Such considerations are not their specialty or concern. Yet they are vitally important, and the success or failure of a policy ultimately depends on knowing how to solve them. [1]

Recent Mexican economic experience, from the oil boom to the foreign debt crisis, provides a showcase of problems associated with policy implementation. These problems offer instructive lessons. In June 1985, the program of economic realignment initiated in December 1982 had gone considerably off course. As Secretary of the Treasury, I spoke out about the serious "implementation problems"[2] besetting the program. The phrase caught on with friends and foes alike and was used both to bestow praise and to heap criticism. Those problems shed much light on implementation faced by many developing countries. We can understand the lessons to be learned by recounting recent Mexican development history.

Recent Mexican Economic Development, 1982-88

Following a long period of stable economic growth (6 percent annual growth of GDP with 3-4 percent inflation), the Mexican economy experienced a collapse in August 1976. After twenty-two years of stable exchange rates, in that month the peso was devalued. The most plausible explanation for the collapse involved high subsidies, slow growth of government revenues, and an expansionist policy accompanied by a high level of public spending during the previous five years, all of which strained prices and the balance of payments. Efforts to improve the social aspects of development and income distribution collapsed with inflation, the flight of capital, and uncertainty.

In 1977, the administration of Lopez Portillo launched an orthodox program for economic stability with International Monetary Fund (IMF) support. In the first year, the principal goals of the program were met in their entirety. The government deficit was reduced, the external sector improved, and inflation decreased. But the situation changed in 1978, when new oil fields were discovered in the Gulf of Campeche, at the same time that access to foreign capital and concomitant indebtedness was beginning.

Revenues from oil exports climbed from less than $10 billion in 1976 to $16 billion in 1982. On the other hand, external public debt increased from $20 to $80 billion in the same period. The temptation to take advantage of these two factors—oil revenues and access to credit—was too much to withstand. The economic climate of austerity that had characterized the beginning months of the new administration gave way to an air of general optimism that distorted all perspective and any sense of limitations. The country had discovered the magic formula by which its oil resources could be utilized efficiently. Once we became a capital exporting country, we had to learn how to lend money abroad and "manage our wealth." This led to purchases of banks in London and in the United States. During the oil boom, spending pressures from all sectors of the economy proved almost irresistible.

The country grew in a dynamic fashion. Between 1978 and 1981, the economy grew 8.4 percent in real terms. Production capacity expanded, but without a strict sense of priorities. For the first time we could do whatever we wanted, without regard to fiscal constraints. It was a new and fascinating situation. The scattered voices of caution went unheard.

In mid-1981, the price of oil declined, following fundamental changes in the conditions of supply and demand on the oil market. The consumer countries had a remarkable success in their reduction of energy consumption, while the oil producers maintained their illusion of ever-growing oil production and exports. But the decline was interpreted as a passing event; no need was seen for compensating measures. The exchange rate remained unchanged, despite clear indications that it was overvalued. The price index in Mexico rose far beyond that experienced in the United States. "The cheapest thing that you can buy in Mexico is the dollar" was a favorite expression. Society acknowledged this fact by sending an enormous amount of capital—close to US $9 billion—abroad during the months of July and August 1981. This outflow was compensated by an active process of short-term foreign indebtedness which created problems in liquidity during the first months of 1982.

By February 1982, confronted with continuing capital flight and uncertainty, Mexico could not delay the decision to devalue the peso.

A wage increase a short time later sparked only confusion. The months that followed were characterized by uncertainty, unsuccessful efforts at containing the crisis, and intensive capital flight. The course originally charted appeared lost. On August 5, another devaluation was announced; one week later, the creation of a two-tier foreign exchange system. On August 20, foreign debt repayments were suspended, and on September 1, the banking system was nationalized and a comprehensive system of exchange rate controls was implemented.

On December 1, 1982, a new administration assumed office and immediately instituted an ambitious economic adjustment program addressing both short-run problems and setting in motion longer term structural changes. (These were implemented later.) The program was launched with a sense of realism and even, perhaps, brusqueness. It was comprehensive, utilizing all economic policy instruments in pursuit of common goals.

But the situation was difficult. Shortly thereafter, one would hear: "Enough of this realism, let's get back to the promises!" The economy was at a standstill: inflation was running at 100 percent; the public deficit was equivalent to 17 percent of the GNP; the deficit in the current balance of payments exceeded US $6 billion; there were extremely low foreign currency reserves; and, above all, the public was left with a pervasive feeling of crisis and loss of confidence.

Nevertheless, the initial efforts were largely successful. The government's deficit was cut almost in half; the balance of payments showed a definite improvement; currency reserves increased; and inflation declined. On the other hand, the economy itself declined by more than 5 percent in 1983, as did real wages.

Gradual improvements continued during the first months of 1984, but by the third quarter the signs of new problems began to appear. Public sector expenditures, already underestimated in the original versions of the appropriations budget, began to exceed anticipated levels. Private investment entered a period of expansion that surpassed all expectations, but in which opportunities were not fully appreciated. The expansion was especially pronounced toward the end of the year, in part because of fiscal incentives and loosening of credit restrictions. Inflation, too, exceeded predicted levels, as international interest rates began a new upward trend.

In 1985, economic troubles were apparent from the outset. The drafting of the budget—the cornerstone of all economic policymaking—suffered from the usual problems: underestimation on the expenditures side and too many compromises in matters of inflation. In the second half of January, the first curbs on public-sector spending were announced. The goal of a 35 percent annual inflation rate was crushed when the consumer price index rose more than 7 percent during January. Some months later, oil markets became soft, and international prices dipped slightly in May. In July, significant modifications to the economic program were announced: a further devaluation of approximately 20 percent, greater restrictions on monetary and credit practices, across-the-board cuts in public spending, including the announced layoffs of government workers, and—above all—decisive measures aimed at liberalizing business policies.

Many of the measures announced were only partially executed, owing to mistakes in implementation. For all practical purposes, economic realignment policies were dropped that year, not because of any political decision, but because of difficulties in implementing them. That is what the main economic indicators demonstrated, and that is also the way Mexican society saw it. As a result, capital flight from the country intensified. The outside world also reacted, beginning a campaign of negative press aimed at the country and its governing authorities, a campaign mixed with complex political undertones. The devastating earthquake in September 1985, with its enormous psychological and economic impact, added to the already existing difficulties.

In 1986, the government maintained its basic course. An effort was made to complete the remaining, unfulfilled 1985 goals regarding economic realignment and restructuring. But the original goals for the 1986 annual program were set back, again, by the same problem of overreaching optimism. The crushing drop in oil prices, far lower than anyone had expected, altered the situation and the basic prospects for the country. Falling oil prices resulted in more than US \$8 billion in lost foreign currency revenues—33 percent of tax-base derived revenues, and about 6 percent of the GNP. It was an extraordinarily severe blow. There is no doubt that the fall in oil prices complicated the Mexican economic realignment program. But it must also be acknowledged that other serious problems existed before the decline in oil prices, problems that the oil crisis obscured. These problems were overlooked as the drop in the price of oil was used as justification for the deviations in economic policy.

In the Economic Cabinet, an internal debate ensued over the proper course to be taken. The argument was between those who advocated more of the same and those who wanted a new domestic and foreign policy. Eventually, the Cabinet embraced an aggressive domestic financial program covering monetary, credit, interest rate, and exchange policies. This helped ride out the storm. Other factors mitigating the situation were the fall in international interest rates, the rise in oil prices at the end of the year, and a sizable increase in non-oil-related exports. Despite the lack of new measures, the policy direction was maintained. As the year progressed, it brought better results than anyone had anticipated. Nevertheless, economic activity still declined by more than 3.5 percent, and inflation rose by more than 100 percent for the first time in decades.

Hopes for 1987 included an upturn in economic growth and a decline in inflation—conflicting objectives, at least in the short run. The driving force behind these goals was intended to be the financial package agreement reached with the international banking community in October 1986, a return of the capital that had "flown" the country, and a recovery in private-sector investment. In 1987 the economy was marked by moderate growth, with, however, increased inflation (160 percent), which further complicated the administration's final year in office.

By mid-1987, several favorable events had brought a climate of euphoria. But the optimism was premature.

During the first months of 1987, the stock exchange experienced explosive growth. The recently nationalized banking system had reduced many of the limits on existing investments and created new investment opportunities, many of which were undervalued and hence, sought after. This phenomenon created "collective greed," as small and large investors alike poured their money into the market, and substantial amounts of capital returned to the country to capitalize on the speculative opportunity. But these wildly optimistic expectations soon evaporated.

The devaluation of the peso—one example of the aggressive exchange rate policies—stimulated exports of manufactured goods and discouraged imports. Moreover, external aid was abundant—perhaps excessive—and international reserves attained an unprecedented level. By September 1987, as I have already said, triumph, euphoria, and optimism prevailed. Although still high, inflation was considered "under control." Government officials congratulated themselves on avoiding hyperinflation. But the reality of the situation was quite different. Economic activity remained weak, and annual growth for 1987 was only 1.5 percent. The national deficit, lacking effective measures to control spending, reached the excessively high level of 17 percent of GDP. Finally, prices, far from being under control, increased by 160 percent—an unprecedented figure for Mexico.

These underlying factors caused upheaval in the month of October. The stock exchange crashed—before the New York Stock Exchange, and the mass selling which caused a devaluation of the peso by more than 20 percent. Despite government warnings to the contrary, prices immediately rose—thus creating vigorous demand for salary increases and causing the threat of a general strike. The government reacted with determination, and together with workers, peasants and private sector leaders, developed a vigorous stabilization program. This was unusual, given the public's tendency to reject such drastic measures. But this was an unconventional plan to fight inflation. Whereas the previous realignment program depended on substantial price and tariff increases, devaluation of the peso, salary increases, and rising interest rates, the new program implemented vigorous measures of fiscal control. Prices and salaries were frozen, and interest rates fell abruptly, aided by a controlled exchange rate, which anchored this realignment effort.

The results of the anti-inflation program during the first seven months of 1988 were encouraging. Monthly inflation declined from 15 percent per month in December 1987 to 2 percent per month in July 1988. Although it was easier to achieve this reduction than to sustain it, the deflation was an impressive achievement nonetheless. Inertial inflation was seriously affected, although it could have been replaced by repressionary inflation.

The next stage—maintaining the low inflation rate—is the difficult one. It is the "landing" stage, in which basic prices are allowed some flexibility, and a more dynamic output in production is sought. The country, however, is in an excellent position to tackle this second stage. It has a high level of international reserves, which affords it substantial flexibility in setting exchange rate policies. It has restructured the economy, achieving remarkable progress in opening it up to international trade, and in redefining the public sector. Most important, it has made great improvements in the efficiency of public sector expenditures, which is vital to stabilization.

But even with these achievements, the challenge of economic growth for the coming years is difficult and complex. For the period 1982-86 there will be a negative cumulative economic growth. The average real salary for workers has declined by almost 40 percent, and the population has increased by 10-12 million. Inflation, despite the stabilization program, will reach 60-80 percent by the end of 1988. However, the margin of error in the design and implementation of economic policies has been greatly reduced.

The crisis that has affected the Mexican economy during the past six years is a complex phenomenon whose development—with considerable fluctuations—is dependent on both domestic and foreign factors. I do not intend to analyze exhaustively either the evolution of the crisis or the effectiveness of the instruments marshaled to contain it. I will try instead to identify the most salient problems associated with the implementation of economic policy, many of which are common to other developing countries.

Some Problems in the Implementation of Economic Policy

Following is an outline of the most important factors to consider in successful implementation of economic policy:

1. *Scope and Formulation of Economic Adjustment Programs*. The most important issues relate to the problem of defining the terms and scope of the program in relation to anticipated problems of implementing it. While each program will present its own problems to solve, the following issues must also be considered in relation to all adjustment programs:

a) Appreciation of political and social constraints relating to the program, including the ideological predisposition of the head of the government.

b) Delegation of responsibility to a single agency to formulate the policy, and follow-through in consultation with other governmental agencies and sectors of society. The formulation and implementation of policy cannot be done by consensus; there must be only one person in charge. If there is more than one, serious problems will result.

c) Acceptance of the fact that in Latin America and in other underdeveloped parts of the world, opposition will arise to any economic program imposed or recommended by foreign sources. Prospects for success will thus improve if the respective society is aware of the program's native origins.

d) Avoidance of the perception that all program variables are under government control, which is, obviously, not the case.

e) Establishment of clear priorities, even where the program pursues multiple goals. Frequently, the notion appears within the political culture of many Latin American countries that everything is a priority. When everything takes priority over everything else, coherence is lost, and little is accomplished.

2. *Credibility.* An economic reform program must be credible to the government at large and to the people as a whole. Maintaining this credibility is crucial to the program's success. As Thomas Schelling recently wrote: "The efficacy of many policies depends on how credible they are." Credibility is a complex and dynamic concept and must be based not only on general policy considerations but also on "fundamental issues"—definitely not on "castles in the air." One must always bear in mind that economic administration depends on the art of persuasion. In the Mexican experience, after four decades of sustained growth amid a generally positive economic climate, it was difficult to adjust social perceptions on a short-term basis to a different climate, in which crisis was the dominant characteristic.

All economic realignment programs benefit certain groups of the population and hurt others. This fact is reflected in the indices of economic change and jeopardizes a cohesive social fabric. It intensifies friction between groups and sectors of the population and thus presents an impediment to all serious efforts at economic reform. Therefore, for example, a policy aimed at curbing demand, with its recessive effects, will impact the weakest groups in society. An aggressive foreign exchange policy will benefit export-oriented activities and hurt importers. It is never easy to determine "truth" in economics.

3. *Coordination of Policies.* The various instruments of economic policy must be used in a coordinated and concerted manner in pursuit

of a common goal. While no one will argue with this statement, it is nevertheless easier said than done. First, there is the problem of conflict between competing goals, which is eternally present in decisions affecting economic policy.

Two simple examples will make the point. First, it is difficult to encourage domestic savings deposits when interest rates are low. If the rate is raised to attract savers, however, credit becomes more costly and this, in turn, can have a dampening effect on economic growth. Second, a dynamic foreign exchange policy, safeguarding the balance of payments, will inevitably drive prices up.

The conflict between these goals will affect responsible policy-makers in the government. Political dissension will be the norm. How a crisis is perceived, how the state of urgency and overruling precedence of program goals are assessed, will vary among the different officials involved. In general, the Secretary of the Treasury will take one side and, practically speaking, the balance of his Cabinet, another. This is neither crucial nor determinative, as long as the Secretary of the Treasury finds himself on the right side — which is to say, on the side of the head of the government.

In any case, the success of an economic realignment program will hinge, in large measure, on the ability of various departmental agencies to move in the same direction, driven by a shared purpose and plan of action. Where the approved policy is reduction of the national deficit, to be accomplished by decreased government spending, all agencies and all department Secretaries—for Agriculture, Defense, Education, etc.—must act together in pursuing the same philosophy and objectives. Unfortunately, the intrinsic responsibilities and goals of each department make it difficult to accomplish such consensus of purpose. In fact, divergent departmental goals constitute one of the most serious impediments to serious economic reorganization. As a high-ranking official of a Caribbean country noted in explaining the causes for the failure of an economic stabilization plan: "...Important foreign exchange reforms did take place, but the changes that needed to be made to the policies involving taxation, tariffs, and protection of local industry were not."

The allocation of basic, overall responsibility to one individual constitutes a fundamental decision. In my opinion, it is dangerous to delegate responsibilities in these matters. Following are two illustrations of the problems that can occur with delegation.

In Mexico, the Department of the Treasury's lack of legal authority over government expenditures is responsible for creating an ongoing, internal conflict between the Treasury and the budget office. Their positions on fundamental issues are divergent. The Treasury, pressed to correct fiscal imbalances, always pushes for reductions in spending, arguing that not enough has been done. The Budget Office, in contrast, insists that everything has been done to trim back expenditures—"we're down to the bone"—and calls for increased efficiency in revenue collection.

A second conflict is always present between the Treasury Department and the operational agencies that spend money. During the fiscal year, when faced with a request for a budgetary increase by an agency, the Treasury always insists on adhering to budgetary spending limits—that is, on the millions of pesos appropriated. The Treasury proposes dealing with prospective imbalances by reducing physical production goals (tonnage, hectares, liters, kilometers, etc.). The agency charged with meeting these goals insists on meeting them and demands instead an increase in its budget allocation. These examples of almost inherent conflict between government agencies illustrate how economic policies are subjected almost daily to tests of their adequacy.

4. *Realistic Goals.* In general, all economic realignment or reform programs tend to establish overly optimistic goals. Statements to the contrary notwithstanding, this prevalent practice constitutes a very serious mistake. It would be far better, especially in the initial phases of the program, to promulgate modest goals, which can be met and even exceeded. In so doing, the program would gain credibility and confidence. For example, the short-run goal of zero inflation announced by Argentine officials at the outset of the Plan Austral was unfortunate for their daring efforts to eliminate inflation. Thomas Schelling's observation is again instructive: "The most a government can commit to is to provide its input, not to the final product–to a program, not to a result."

In the Mexican experience, inflation-related goals have been a recurring source of lost credibility. This was especially true in 1985, when, from the very beginning of the year, a marked deviation from stated goals directly affected overall program planning. Occasionally, of course, an ambitious goal can contribute to improving expectations, as long as basic tendencies remain unchanged; but more often the expectations are not met and credibility is lost.

Mexico: Inflationary Trends, December 1983–December 1987

	Projected	Actual
1983	55	81
1984	40	59
1985	35	64
1986	50	106
1987	70/80	159

In 1987, as I have already pointed out, projections included an economic recovery of 2-3 percent in real terms, as well as a decline in the inflation rate. Very few people thought these conflicting goals could be met concurrently, and it was no surprise when they were not. In recent years, these all too sanguine goals with regard to inflation turned out to be traps that authorities set for themselves.

Public-sector budget reductions provide another example of overly optimistic goals. Reduction in public-sector spending is a common component of all economic realignment programs. Frequently, officials succumb to the temptation of announcing across-the-board cuts in spending: an 8 percent cutback meted out to all budgetary programs. In addition to the practical difficulties involved in carrying out such plans, this kind of measure normally suffers a lack of credibility. Implementing agencies resort to all kinds of defensive ploys. For example, by focusing reduction plans on essentials, such as servicing of the debt, final phase of a project, etc., the cutbacks become untenable. Guided by a sense of priorities, reductions in public spending must therefore be executed by means of vertical cuts to the budget. That is the only way to achieve goals and gain credibility.

Finally, the permanent scrutiny accorded the quantitative enforcement of austerity measures diverts authorities' attention from the fundamental aspects of economic planning.

5. *The Difference Between Decisions and Implementation.* From both an economic and political point of view, there is nothing worse

than announcing an intention to act and then failing to follow through. On several occasions, the highest echelons of government will adopt a decision and issue equivalent instructions, but the bureaucratic system at the intermediate levels responds by doing everything it can to avoid implementing those directives that affect their interests or spheres of administrative power. In such cases, the policy directives become gridlocked; they do not penetrate to the lower levels and remain unimplemented. Moreover, the work of the committees, task forces, and commissions that are established in the name of program coordination frequently constitute additional obstacles which thwart the adoption of viable decisions. Two examples will illustrate the point.

First, the Mexican government makes a decision to promote charter flights in order to increase foreign tourist travel. Until this decision was made, the government granted charter flight licenses only sparingly to protect Mexico's domestic airlines. These few licenses were granted only after innumerable bureaucratic procedures had been completed. But despite the decision to promote charter flights, protectionism at the intermediate level continues. The functionaries entrusted with implementing the commitment continue to look for ways to slow implementation, or even to deny licenses outright. The outcome: six months after the presidential decision, the number of charter flights has declined.[3]

Second, the Mexican government decides to sell off state-run enterprises. A committee is formed; no one cares to assume leadership responsibilities, and the process stalls. Credibility suffers.

6. *Consistency*. A program of economic reform or realignment is a mid- to long-term process. Normally, the results cannot be appreciated over the short haul. Many factors, both domestic and foreign, influence the process. Although these factors should be accounted for, they should not cause significant changes in the objectives because such changes often result in changes to overhaul planning. As Herbert Stein, past chairman of the Council of Economic Advisors, has pointed out: "The consistency of, and perseverance in, a policy that has been adopted can be as important as the very choice of that policy."

The battle against inflation requires particular consistency and perseverance. Measures designed to reduce inflationary pressure on the demand side—reducing the government deficit, tightening credit, etc.—are subjected to political and social pressures that can become so great that they will compel abandonment of the program. Although policymakers often claim the measures were ineffective, the real problem was a failure to apply them consistently.

While economic programs must be adapted to changing circumstances, consistency also must be maintained in pursuing basic program objectives.

7. *Adaptation.* While maintaining consistency, an economic program must also be able to adapt itself to new circumstances. New events and changes in both the domestic and foreign environment must be taken into consideration as soon as possible, because in times of crisis the society at large will monitor and scrutinize every aspect of a government's economic program.

Developing countries suffer a heightened vulnerability to shocks originating abroad, and this vulnerability underscores the importance of the ability to modify or adapt economic plans. A good example of this occurred for Mexico when oil prices collapsed during the first few months of 1986.

Nevertheless, the risks entailed in abandoning or downscaling original program objectives are immense. Such programs are, in their nature, essentially political; local or short-term interests may often prevail over long-term and national interests. For example, pressures to tone down the battle against inflation frequently prevail because the costs of reducing inflation generally manifest themselves long before the benefits.

On the other hand, it is also necessary to consider the deep regional differences that exist in the majority of developing countries. A realignment program tends primarily to affect the nation's capital city, producing isolated repercussions in the rest of the country, where circumstances are often completely different.

8. *Social Dialogue.* Ten years ago society's interest in economic issues, domestic or foreign, was limited. This has radically changed. Today, rudimentary understanding of economics notwithstanding, ordinary citizens are showing a growing interest in subjects such as interest rates, exchange rates, balance of payments, and indebtedness. This is only natural, since the development and behavior of these variables affects the day-to-day life of every country. This growing

awareness poses a difficult problem for those who make economic policy or implement programs of reform or realignment, for they must deal with increasing numbers of people who, although they have limited economic understanding, are nevertheless vitally interested in economic issues, issues that directly affect their well-being and that of their families.

On the other hand, the world has also become "smaller" and more interdependent. Any effort at economic reform will be carefully and closely monitored by the outside world. The reactions of the world's press will resound, almost instantaneously, throughout the country and thus affect the results derived from various policy measures.

Now, more than at any time in the past, the challenge of implementation requires a continuing process of dialogue and communication with both a nation's inhabitants, in the context of their social and regional differences, and with the various international and media audiences, which exercise unprecedented influence on all aspects of the economic policy dialogue. For without adequate understanding of the program to be implemented, it will be hard to avoid compromising its objectives and results.

Notes

1. "Despite the advances in the economic sciences during the past two decades, the ability of academically oriented economists to contribute to the formulating of economic policy is quite limited. When they do provide their input, they do so, normally, in the abstract, failing to appreciate the legal and institutional settings in which decisions are effected." Roger J. Vaugham, "Economists, Economics and the State Economic Policy," *American Economic Review* (May 1983).

2. "It must be acknowledged that in 1984 the internal realignments undertaken were inadequate to the task; we experienced failures in implementation and difficulty in detecting nascent phenomena. The progress made in the task of structural transformation and encompassed by the plan was also less than anticipated. The fundamental goals, the course that had been charted, remained unchanged." Jesus Silva-Herzog, speech given at the Second National Banking Convention, Guadalajara, Mexico, July 22, 1985.

3. This situation has radically changed in recent months.

ICEG Academic Advisory Board

. 21