PN ABS-334

A PRECARIOUS BALANCE

AN Overview OF DEMOCRACY AND ECONOMIC REFORMS IN Eastern Europe and Latin America

Edited by Joan M. Nelson

INTERNATIONAL CENTER FOR ECONOMIC GROWTH
AND
OVERSEAS DEVELOPMENT COUNCIL

Since 1985 the International Center for Economic Growth, a nonprofit international policy institute, has contributed to economic growth and human development in developing and post-socialist countries by strengthening the capacity of indigenous research institutes to provide leadership in policy debates. To accomplish this the Center sponsors a wide range of programs—including research, publications, conferences, seminars, and special projects advising governments—through a network of over 300 correspondent institutes worldwide.

The Center is affiliated with the Institute for Contemporary Studies and is headquartered in Panama with the administrative office in San Francisco, California.

For further information, please contact the International Center for Economic Growth, 720 Market Street, Fifth Floor, San Francisco, California 94102, USA. Phone (415) 981-5353; fax (415) 433-6841.

ICEG Board of Overseers

Y. Seyyid Abdulai
OPEC Fund for International Development, Austria

Abdalatif Al-Hamad
Arab Fund for Economic and Social Development, Kuwait

Nicolás Ardito-Barletta
Chairman, ICEG, Panama

Roy Ash
Ash Capital Partnership, USA

Bruce Babbitt (on leave)
USA

Raymond Barre
France

William Brock
The Brock Group, USA

Roberto Campos
National Senator, Brazil

Carlos Manuel Castillo
Costa Rica

A. Lawrence Chickering
ICEG, USA

B. T. G. Chidzero
Ministry of Finance, Zimbabwe

Gustavo Cisneros
Organización Cisneros, Venezuela

Roberto Civita
Editora Abril, Brazil

A. W. Clausen
BankAmerica Corp., USA

Pierre Claver Damiba
African Capacity Building Foundation, Burkina Faso

Antonio Garrigues Walker
J & A Garrigues, Spain

Toyoo Gyohten
The Bank of Tokyo, Ltd., Japan

Mahbub ul-Haq
United Nations Development Programme, Pakistan

Robert B. Hawkins, Jr.
Institute for Contemporary Studies, USA

Ivan Head
University of British Columbia, Canada

Robert W. Kasten
Kasten & Company, USA

Woo-Choong Kim
Daewoo Corp., Korea

Adalbert Krieger Vasena
Argentina

Pedro Pablo Kuczynski
Peru

Agustín Legorreta
Inverlat S.A., Mexico

Sol Linowitz
Coudert Brothers, USA

J. W. Marriott, Jr.
Marriot Corporation, USA

Tomás Pastoriza
Banco de Desarrollo Dominicano, S.A., Dominican Republic

John Petty
American Czech & Slovak Enterprise Fund, USA

William Ryrie
International Finance Corporation, USA

Mohammad Sadli
Indonesian Chamber of Commerce and Industry, Indonesia

Terry Sanford
Duke University, USA

Stephan Schmidheiny
Anova A. G., Switzerland

Hari Shankar Singhania
J. K. Organization, India

Ellen Johnson Sirleaf
United Nations Development Programme, Liberia

Anthony M. Solomon
Institute for East-West Security Studies, USA

Ernest Stern
World Bank, USA

J. J. Vallarino
Consejo Interamericano de Comercio y Producción, Panama

Amnuay Viravan
Government of Thailand, Thailand

Paul A. Volcker
James D. Wolfensohn, Inc., USA

A Precarious Balance

An Overview of Democracy and Economic Reforms in Eastern Europe and Latin America

Edited by Joan M. Nelson

A Copublication of the

International Center for Economic Growth

and the Overseas Development Council

ICS PRESS

Institute for Contemporary Studies

San Francisco, California

©1994 Institute for Contemporary Studies

Printed in the United States of America. All rights reserved. No part of this book may be used or reproduced in any manner without written permission except in the case of brief quotations in critical articles and reviews.

Publication signifies that the International Center for Economic Growth 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 authors and should not be attributed to ICEG, its affiliated organizations, its Board of Overseers, or organizations that support ICEG.

The Overseas Development Council fosters an understanding of how development relates to a much changed U.S. domestic and international policy agenda and helps shape the new course of global development and cooperation. ODC's programs focus on three main issues: the challenge of political and economic transitions and the reform of development assistance programs; the development dimensions of international responses to global problems; and the implications of development for U.S. economic security. ODC is a private nonprofit organization funded by foundations, corporations, governments, and private individuals. The views expressed in this book are those of the authors and do no necessarily represent those of the Overseas Development Council as an organization or of its individual officers or Board, Council, and staff members. Overseas Development Council, 1875 Connecticut Avenue, N.W., Washington, D.C. 20009.

Publication of the publication was made possible by support from the United States Agency for International Development (AID) and the Bank of America.

Inquiries, book orders, and catalog requests should be addressed to ICS Press, Institute for Contemporary Studies, 720 Market Street, San Francisco, California 94102 USA. Telephone: (415) 981-5353; fax: (415) 986-4878; book orders within the continental United States: **(800) 326-0263**.

Editor: Heidi Fritschel

Cover designer: Irene Imfeld

Library of Congress Cataloging-in-Publication Data

A Precarious balance: an overview of democracy and economic reforms in Eastern Europe and Latin America/edited by Joan M. Nelson.
p. cm.
"An International Center for Economic Growth publication."
Includes bibliographical references (p.).
ISBN 1-55815-356-X
1. Europe, Eastern—Economic policy—1989– —Congresses.
2. Europe, Eastern—Economic conditions—1989– —Congresses.
3. Latin America—Economic policy—Congresses. 4. Latin America—Economic conditions—1982– —Congresses. I. Nelson, Joan M.
HC244.P72 1994
338.947—dc20 94-13473
CIP

Contents

Preface v

Acknowledgments vii

Chapter 1 Introduction 1
Joan M. Nelson

Chapter 2 The Transition in Bulgaria, Hungary, and Poland: An Overview 9
Jacek Kochanowicz, Kalman Mizsei, and Joan M. Nelson

Chapter 3 Economic and Political Transitions in Latin America: The Interplay between Democratization and Market Reforms 33
Marcelo Cavarozzi with Joan M. Nelson and Miguel Urrutia

Notes and References 53

About the Contributors 57

Conference Participants 59

Preface

In the past decade the countries of Eastern Europe and Latin America have taken dramatic steps toward democratic rule and market-oriented reforms in hopes of achieving political freedom and economic prosperity. The ultimate success of these changes, however, is not yet assured. Painful economic reform and the sometimes messy push and pull of democratization can stimulate nostalgia and even pressure for the security of authoritarian or totalitarian political systems and command economies.

The International Center for Economic Growth is publishing a two-volume study, entitled *A Precarious Balance*, in which twelve social scientists look at the interaction of political and economic reforms in six countries to see how such reforms sometimes support and sometimes impede one another. This book offers an overview of the conclusions reached in those two regional studies. In Eastern Europe, Bulgaria and Poland are attempting simultaneous reform, while Hungary is farther along the road to a market economy. In Latin America, Argentina, Bolivia, and Brazil have slightly more experience with democracy but are still working on liberalizing their economies.

While there are countries that have adopted market reforms under authoritarian systems, the objective of this study is to examine the links between political and economic changes in countries that are pursuing both at once. These links are often elusive, but they will certainly affect the outcome of the present reform efforts in Eastern Europe and Latin America. The authors of this set of studies address vital questions: To what extent do democracy and the market go hand-in-hand and to what extent do they conflict? How do reforms affect parties and interest groups and vice versa? How can a broad share of the population be given a stake in the success of the reforms? The answers to these and other such questions will determine the future of the political and economic transitions in Eastern Europe and Latin America.

In this crucial moment of history, a greater understanding of the processes of democratic and market-oriented change is vital, for failure in any one country will have consequences far beyond its borders. The International Center for Economic Growth is pleased to publish this important study, which

deserves the attention of policy makers, scholars, and students of development the world over. A companion study to these issues, *Intricate Links: Democratization and Market Reforms in Latin America and Eastern Europe*, focuses on issues common to both regions and will be published by the Overseas Development Council in fall 1994.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
June 1994

Acknowledgments

This overview and the two volumes of case studies it introduces are products of a collegial research project of the Overseas Development Council. The project as a whole was financed primarily by the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundations. The International Center for Economic Growth provided funds for regional workshops in Budapest and Rio de Janeiro to review initial country drafts. We would like to thank the Institute of World Economics of the Hungarian Academy of Sciences and the Department of Economics of the Pontifical Catholic University of Rio de Janeiro for hosting the regional workshops reviewing the first drafts of the case studies. We are also indebted to the participants in those and the later cross-regional workshop for their many insights and suggestions: they are listed at the end of this volume. Finally, we would like to gratefully acknowledge the ongoing support, resourcefulness, and patience of the staff of the Overseas Development Council and particularly of Stephanie Eglinton.

CHAPTER 1

Introduction

Joan M. Nelson

Two roughly simultaneous trends have emerged in much of the world since the mid-1980s. In almost all of Latin America, in most of what was recently the communist world, and increasingly in sub-Saharan Africa, authoritarian governments have disintegrated or been pushed aside by demands for more free and open political systems. And in much of the world, inward-oriented growth strategies entailing extensive state intervention are being replaced by more open and market-oriented policies and institutions.

This volume is part of a larger project exploring how political and economic liberalization interact. There is a massive literature on different aspects of market-oriented economic reform. Transitions from authoritarian to democratic political systems have also been extensively analyzed. But the two trends are usually examined separately. Where they are brought together—for instance, in the growing literature on the politics of market-oriented economic reform—the focus often is on narrow, short-run issues: political obstacles to economic reform and tactics to overcome those obstacles.

These essays and the country case studies on which they are based (*A Precarious Balance: Democracy and Economic Reforms in Eastern Europe* and *Democracy and Economic Reforms in Latin America*) try to move beyond the politics of economic stabilization and market-oriented reforms, to consider how democratic openings and efforts to consolidate democracy interact with deliberate and rapid economic liberalization. We also move beyond the fairly short-run focus of much previous work to consider not only democratic transitions but also the long and delicate process of consolidating democracy, not only initial economic stabilization and liberalization measures but also the slower and more complex structural and institutional reforms.

We do not assume that these two trends automatically or necessarily go together. Indeed, since World War II and outside of Western Europe, strong

market-oriented growth strategies or vigorous economic liberalization have more often been pursued by authoritarian than democratic governments: Taiwan, Korea, and Chile are obvious examples. Postcolonial and later democratic transitions seldom triggered a shrinking state economic role; more often, heightened democracy was associated with increased state intervention. For a brief moment, after the collapse of communism at the end of the 1980s, it seemed to many that democratic governments and market-oriented economies must go hand-in-hand. But both longer history and more recent experience underscore instead the complex and ambiguous relations between the two processes: each complements and supports the other in some crucial respects, but the two also often conflict, not only in the short run but also in more fundamental, often unanticipated, ways.

Nor do we assume that democratization and marketization follow some single trajectory, some roughly similar route in different countries. Quite obviously the starting points—the nature of the economic and political systems before significant reforms—varied greatly. Desired end points also vary: a wide range of specific arrangements are possible within the broad categories of market economies and democratic polities. The specific version that emerges in any country will reflect not only differing priorities but also the unintended consequences of major choices. It follows that the links between economic and political liberalization are not only complex and problematic, but also highly variable. The six country cases explored in this project document how unique historic legacies, institutions, and circumstances lead to contrasts in the sequences, pace, and design of political and economic reforms, and in the prospects for sustaining and deepening those reforms. Much more tentatively, they begin to suggest how interactions between market-oriented policies and democratic political processes may shape the particular kinds of market-oriented economies and democratic polities that emerge.

Despite the crucial unique features of each case, however, certain common themes emerge within each region and—to a surprising degree—across both regions. The essays in this volume summarize regional themes. Issues common to both Latin America and Eastern Europe are explored in a later volume *Intricate Links: Democratization and Market Reforms in Latin America and Eastern Europe* to be published fall 1994 by the Overseas Development Council.

The country and regional studies are the product of a collegial effort by twelve social scientists, all but one from Latin America or Eastern Europe. The group included economists, economic historians, and political scientists, several with considerable direct policy experience. Authors for Eastern Europe were Jacek Kochanowicz, András Körössényi, Kalman Mizsei, and Ekaterina Nikova. Latin American authors were Edmar Lisboa Bacha, Adolfo Canitrot, Marcelo Cavarozzi, Eduardo A. Gamarra, Bolívar Lamounier, Silvia Sigal, and Miguel Urrutia.

In Latin America, we analyzed the experience of Argentina, Bolivia, and Brazil; in Eastern Europe we examined Bulgaria, Hungary, and Poland. The choice of cases in Latin America was largely guided by our interest in interactions between roughly simultaneous economic and political liberalization. That focus ruled out the two Latin American countries most advanced in market-oriented reforms: Chile and Mexico. We also decided not to examine several long-established competitive democracies attempting far-reaching economic reforms: most notably Costa Rica and Venezuela. Argentina and Bolivia were obvious candidates: after definitive shifts from military to civilian rule in the early 1980s, both (with lags) pursued dramatic economic stabilization and structural reforms. Brazil was chosen because of its size and importance and because its post-1985 experience underscores the risks of half-hearted reforms that deepen the crisis unleashed by the exhaustion of statist growth strategies. In most of Eastern Europe political and economic openings coincided (although Hungary's history of economic liberalization began much earlier). Our selection reflected our desire to include at least one country from the Balkans rather than focus solely on Central Europe. Further, we wished to avoid the complications introduced by severe regional and ethnic divisions (as in Czechoslovakia, which had not yet split when the project began).

In each of these cases, the authors sought to capture key characteristics of political and economic transformations and to consider how transformation each affects the other. That inquiry was handicapped by the brevity of the period that has elapsed since political transitions occurred, especially in Eastern Europe. Examining short time periods inevitably spotlights the importance of voluntaristic action: the decisions and behavior of key individuals and small groups, rather than the effects of changes in broader social, economic, or political structures or trends. Moreover, the studies deal with unfinished stories: even while the studies were being written, major and quite unexpected events changed the pictures in Bulgaria, Poland, and Brazil.

One important dimension of these transformations is the extent to which they represent sharp breaks from the past. Certainly in Eastern Europe, most observers perceived the changes of 1989 and 1990 as abrupt and unexpected discontinuities. Political and economic shifts were less dramatic, but still major, in our Latin American cases. Yet in both regions, the importance of a wide variety of legacies from the recent and the more distant past has become increasingly evident. The case studies illustrate how different starting points, as well as the ongoing effects of institutions, attitudes, and relationships from the past, shape both market-oriented economic reforms and efforts to consolidate democratic openings.

Above all, the studies attempted to trace the links between the shift to more liberal political institutions and later efforts to consolidate these, on the one hand, and economic measures, including stabilization, liberalization, and structural reforms, on the other. The links are often indirect and elusive. One

fairly clear link turns out to be the extent to which political elites and the broader public perceive the need for both economic and political reforms as intertwined, or instead (as in our Latin American cases) initially assume that political transformation will correct economic difficulties without painful economic reforms. A second link also operates through public perceptions: economic and political measures and trends each affect the credibility of the other. Other interactions are mediated through changes in civil society rather than through public opinion. Both political and economic transformations alter the structure, agendas, alliances, and strategies of major interest groups like farmers, labor unions, and business associations. These changes in turn affect both democratic consolidation and further economic reform. Still another linkage flows not through organized interest associations but through shifts in socioeconomic structure: the effects of market-oriented reforms in creating or enlarging groups with strong stakes in the system and, conversely, groups that are excluded. Some of these and other linkages emerge quickly; others are at best beginning to be visible, and how they will evolve remains unclear.

Our studies focus on trends and structures internal to each country. External forces obviously powerfully influence and sometimes largely determine domestic choices and events. The cases we examined are not independent of each other: especially within each region, events and experience in one country (and especially the countries that started reforms earlier) obviously shape debates and choices in other countries. With respect to economic stabilization, experience in Latin America spilled beyond regional boundaries to influence thinking in Eastern Europe.

Still more obvious is the importance for internal trends of international political and economic events, such as the former Soviet Union's loosened control over Eastern Europe and its own internal disintegration, or the Gulf War. In all of our cases, specific international institutions, particularly the International Monetary Fund (IMF) and the World Bank, creditors' organizations (the Paris and London clubs), and, in Eastern Europe, the European Community, played direct and influential roles with regard to economic policy. Yet outside pressures bear differently on different countries, in part reflecting divergent earlier policies and events and in part as a result of varied responses by governments and societies. The purpose of the project, however, is not primarily to trace and understand the course of economic reforms or democratic consolidation but to explore the linkages between the two processes. Those linkages are intrinsically internal to each country.

By examining both the Eastern European and Latin American experiences, this project brought into relief some perhaps instructive contrasts and parallels between the regions. Several of the contrasts are obvious. First, the discontinuities between old and new economic and political systems are much more marked in Eastern Europe than in Latin America. In Latin America,

private capital—large and small, domestic and foreign—played a major role in the economies. Private markets existed; they needed to be liberalized, reoriented, and invigorated, but not created from scratch. And in the political realm, most military-dominated governments in Latin America did not eliminate semiautonomous political parties or eradicate somewhat independent unions and other associations. Rather, they tried to constrain nongovernmental groups by varied combinations of co-optation and repression. In many countries, including the three on which we focused, post-transition politics continued to be dominated by the same parties and labor and business associations that had survived under, and sometimes collaborated with, military governments. And in contrast to the post-transition socialist parties and ex-official unions of our East European cases, the main political groups carried over from the authoritarian period in Latin America did not undergo any major reorientation. In Eastern Europe, however, a whole panoply of new parties and interest groups has emerged, creating new political markets analogous to the emerging economic markets.

A second important contrast was that when political transitions occurred in Latin America, most politicians, many technocrats, and virtually all of the public assumed that far-reaching economic restructuring would not be necessary to address economic problems, perhaps because Latin American economic systems did not contrast so obviously with those of the advanced industrial democracies. Most people blamed serious and persistent economic difficulties on mismanagement by the former military governments and hoped or assumed that new democratic governments would be able to correct the problems without major sacrifices. Labor groups, indeed, assumed that they would now fare far better. When the first elected governments tried to address serious economic problems (in Bolivia in 1983–1984, in Argentina in 1986–1989, and in Brazil in 1986–1989), they lacked adequate support to counterbalance boisterous opposition. In contrast, in Poland in 1990 and Bulgaria in 1991, much of the public and major elements of organized labor acquiesced (not without fears and doubts) to draconian stabilization and liberalization measures, since it was widely agreed that the old economic system must be replaced by something radically different. In Bolivia and Argentina, hyperinflation had a similar effect, enabling the second-round elected governments to carry out quite radical reforms.

A third major contrast between the two regions concerns the distribution of income, education, opportunity, and social security. In Eastern Europe, forty years of communism left a comparatively egalitarian tradition. In Latin America, both economic and political strategies had produced grossly unequal societies.

Despite these and other major contrasts, there are important parallels in the two regions regarding some of the legacies of state-led or state-controlled economies and in the political dynamics and distributive impact of market-

oriented economic reforms. Among the shared legacies, perhaps the most important and problematic is the collapse of the overextended state. In both regions, though obviously to a far greater extent in Eastern Europe under communism, the state had become directly responsible for a tremendous range of functions, including not only the guidance and stimulation (in Latin America) or direct management and operation (in Eastern Europe) of economic activity, but also the provision of most or all social services and the brokering and resolution of most social conflicts. As countries embarked on democratic changes, the new states faced pressure from all sides for effective and efficient action while their capacity to take such action was increasingly diminished. Revenues were falling, and political changes sent state bureaucracies into turmoil. Yet domestic groups who felt discriminated against by previous regimes demanded immediate compensation, and international institutions called for the rapid and efficient dismantling of the old state-centered economic and political systems. In neither Eastern Europe nor Latin America have state agencies been able to respond successfully to these pressures.

The politics of economic reform show parallels in the two regions and have important implications both for sustaining the reforms and for consolidating democratic openings. Even when the need for sweeping reforms was widely accepted, governments enjoyed at best a brief respite from bitter criticism and strong opposition in legislatures and from organized interest groups. This fact, coupled with some of the technical requirements of initial stabilization and liberalization measures, has meant that reform packages in both regions have been introduced more or less by executive fiat, with little consultation. Where legislative approval was essential, measures were pushed through quickly, sometimes using the need for rapid agreements with the IMF and other external agencies as a stick to prod the reluctant. It may well be that urgent and high-handed executive action was unavoidable in initial stages. But that style of decision making, if long continued, clearly dilutes the democratic character of the political system.

In both regions, later-stage reforms have tended to move more slowly. This change partly reflects the more complex and extended nature of institutional and structural changes compared with initial stabilization and deregulation. The slowed pace has also resulted partly from more assertive legislatures and interest groups. In short, the tension between rapid, technocratic, top-down market reforms and the strengthening of democratic procedures and institutions has increased over time. If governments are to continue and deepen economic reforms as well as protect democratic values from long-term damage, they must modify their tactics and develop more effective consultative channels.

Despite sharply contrasting social structures in the two regions, stabilization and market-oriented reforms have had roughly parallel distributive

effects. The distributive effects in turn affect the prospects for deepening and consolidating democratic political systems. In Eastern Europe, market-oriented reforms are generating a growing category of people who are poorer and less secure than they used to be and who feel excluded from the opportunities of the new system: they are tinder for antireform and extremist nationalist or ethnic appeals.

In both regions market-oriented reforms have also sharply reduced the living standards of organized labor and major elements of the urban middle classes, including government and public service workers and professionals. Austerity measures virtually always force down incomes of both groups. Structural and institutional reforms pose more permanent threats: privatization and governmental reorganization directly threaten jobs; labor market liberalization and the opening of economies reduce the power of organized labor to maintain high wages (and often directly reduce the organizational power of unions as well); targeting social welfare programs to the most needy generally reduces subsidies to organized workers and middle-class groups. Yet these same groups are also those best positioned to organize and mobilize protests under more permissive democratic political rules.

At the same time, in both regions market-oriented reforms are generating a class of conspicuous gainers at the top of the economic pyramid. It is widely assumed that many of the biggest winners owe their fortunes to shady or blatantly illegal practices. The dismantling of economic controls hampering private entrepreneurs has not been matched with the installation of new regulatory arrangements to prevent fraud and corruption. As a result, disillusion and cynicism regarding "the magic of the marketplace" are spreading rapidly. Moreover, especially in Latin America but increasingly in Eastern Europe as well, there are growing concerns regarding the long-run effects of the increasing concentration of wealth on democratic politics.

The unfinished business of constitutional reform continues to absorb a great deal of energy and attention in both Eastern Europe and Latin America. These struggles have deflected and delayed economic reforms (such was the case in Bulgaria for the first eighteen months after the end of the communist monopoly on power and is still the case in Brazil). At the same time, the need for economic reforms has powerfully influenced actual or potential constitutional reforms: Argentina, Poland, and Russia offer examples. The long-drawn-out debates and maneuvers are likely to frustrate and alienate less-educated and poorer citizens, who are more concerned with effective action on economic and social reforms.

In short, in both Eastern Europe and Latin America, efforts to simultaneously sustain and deepen economic reforms and consolidate democratic openings are proving extraordinarily difficult. Well-established democratic institutions and free markets, once in place, tend to support each other. But the process of moving from heavily state-controlled to freer markets and the

process of attempting to consolidate democratic political procedures and institutions conflict with each other in many ways. Yet in the long run, and in the context of the 1990s and beyond, the success of each is crucial for the success of the other.

Greater recognition of the tensions and conflicts has already prompted discussion and some action to ease them. Some governments are aware of the need to shift the style of economic reforms from strong executive initiatives to more consultative approaches. A good example was the effort of the Suchoka government in Poland to devise a Pact on Enterprises to provide a channel for responsible trade union participation in the design and implementation of privatization. Concern in international development circles for the distributive effects of economic reforms is also much more evident in 1994 than ten or even five years earlier. The World Bank's 1990 *World Development Report* and subsequent operational guidelines are intended to inject into the design of broad macroeconomic and sectoral policies greater awareness of effects on the poor. The Inter-American Development Bank's more recent emphasis on social sector reforms is intended to help Latin American governments reorient and strengthen social programs. Within both Latin American and Eastern European countries, these themes are also gaining much more attention from governments. Still unaddressed, however, are the risks for democratic consolidation posed by squeezing the middle class to concentrate attention and resources on the poor.

Also little recognized thus far are issues of excessive concentration of wealth (with possible adverse effects on democratic politics, only partly addressed by tough campaign finance laws) and the immensely complex and difficult issues of simultaneously reviving and reorienting the state. Indeed, prescriptions for reviving the state remain largely confined to proposals to shed functions to the private sector or decentralize to lower levels of government, plus growing emphasis on the crucial need for more effective tax administration. Those prescriptions are not wrong, but they are painfully partial.

While the effort to pursue economic reforms and democratic consolidation simultaneously raises partly parallel challenges in Eastern Europe and Latin America, the historic legacies and current contexts specific to each region powerfully shape the changes under way. The overviews that follow trace, for each region, the ways in which the old state-centered economic and political systems came to disintegrate, their continuing legacies, and some of the emerging links between economic and democratic reform. Succeeding in the difficult and tumultuous process of broad societal change will require understanding the complex blend of economic and political forces at play in Eastern Europe and Latin America. This project is an attempt to increase that understanding.

CHAPTER 2

The Transition in Bulgaria, Hungary, and Poland: An Overview

Jacek Kochanowicz, Kalman Mizsei, and Joan M. Nelson

In 1989, communism collapsed in Eastern Europe.[1] The Polish "Round Table" of August 1989 and Hungary's decision to permit free passage to East German refugees triggered chain reactions. One by one Eastern European communist governments, their legitimacy shattered, let opposition movements surface and ceded their monopoly on power. Emerging elites set as their goal the establishment of market economies and democratic political systems. The collapse was wholly unexpected, and the course of transformation totally uncharted.

This study analyzes the relationship between market reforms and democratization in three Eastern European countries: Poland, Hungary, and Bulgaria.[2] A considerable body of theory and evidence suggests that, once established, market economies and pluralist politics are mutually supportive. But historically the rise of democratic institutions has been a long and complex process. Few nations have attempted to move simultaneously from command to market economies and from highly authoritarian single-party to democratic multiparty political systems. Therefore there has been very little analysis of how the processes of economic and political liberalization interact when they are undertaken jointly.

On the face of it, such simultaneous transformations look improbable. In the now highly developed countries of Western Europe, markets and capitalism emerged before mass democracy. Much more recently, in the successful newly industrialized countries of Southeast Asia, early phases of industrial

development and social modernization took place under authoritarian rule. In contrast, in several Latin American nations early mass political mobilization (often including militant union action) spurred inflation, disrupted emerging markets and industrial development, and ultimately aborted emerging democratic processes.

Eastern European experience between the two world wars reinforces doubts about regional prospects for simultaneous transformation. Parliamentary democratic systems launched after World War I could not contain the inflation of the 1920s nor cope with the depression of the 1930s. Most of the countries of the region slid toward authoritarianism while at the same time developing highly statist economies. The beginning of the 1990s shows disconcerting similarities to the earlier era: inflation, recession, and unemployment again test fragile democratic traditions, while reforms must combat the additional obstacles created by forty years of communist authoritarianism and command economy.

Not only historical experience but also the logic of the situation argues that simultaneous market-oriented reforms and consolidation of democratic openings are in sharp tension with each other. Democratic politics are likely to block economic reforms that inflict severe costs on much of the population; struggles over fundamental constitutional issues and the restructuring of party systems and interest groups are likely to divert attention and prevent action on urgent economic measures. And if those reforms are actually carried through, then the resulting economic hardship may well push democracy off course.

Yet, surprisingly, democracy holds and the economic transformation pushes forward in most of the countries of the region. Elections are free, and governments are responsible to legislatures. The media are not censored; civil rights are not abused.[3] Four years after the collapse of communist governments, most prices and much trade are freed of controls. The private sector already accounts for over 40 percent of output in Hungary and at least 45 percent in Poland. Stabilization has been reasonably effective: inflation is falling or has reached manageable levels. Exports have expanded. These gains have come at a heavy price, and the future is far from assured. But the striking fact to date is that democracy has held while market reforms have progressed.

What factors have permitted this outcome, confounding apparent tensions and historical experience? Are those factors likely to persist, or are the later stages of the attempt at simultaneous transition likely to take a different course in some or all of the countries of the region?

This study seeks to shed some light on these questions, though it can hardly provide definitive answers: too little time has passed since the collapse of the communist monopoly on power, and three country cases offer only partial evidence. Our comparative approach is further limited by considerable

interdependence among the three cases and by the fact that we are examining the initial stages of what will certainly be a long historical process.[4]

Why these three countries? Poland and Hungary are of course among the "Western tier" reformers; Bulgaria represents the Balkan countries, which began their transformation slightly later and have cultural and historical legacies and geographical links different from those of the Western tier. We have selected three fairly homogenous countries in order to screen out the additional complications introduced by ethnic or regional tensions. Bulgaria's relative homogeneity, of course, is not typical of other Balkan nations. Since Yugoslavia was not part of the Soviet Bloc, we have not tried to take into account its experience nor that of its successor units.

The collapse of communism and the transition to a new order is a global process, in which evolution in any given country is related to much wider international economic and political trends and forces. In this essay, however, we focus primarily on internal developments, touching only briefly on the external context.

The events of 1989–1990 in Eastern Europe were startlingly abrupt. Yet the collapse of communism grew out of a long process of the disintegration of the institutions and effectiveness of the command economy and the communist political system. Disintegration started at different times and moved at different rates in our three cases, as well as elsewhere in the region. Post-1989 economic and political reforms obviously do not build on clean slates, but on the partial ruins of the former systems. In each country, the nature of the transition itself and later transformation has been powerfully affected by the degree to which old institutions and legitimacy had already decayed.

Where disintegration of the old arrangements started early and was well advanced by 1989, it was followed by the emergence of new economic, political, and social institutions and actors, providing a basis for the far more rapid post-transition emergence of markets and democratic politics. Where disintegration started late and occurred slowly, emergence of new institutions and actors was delayed. Since 1989, a third process has come into play: the redefinition of both communist and anticommunist institutions and actors' roles and strategies. All three processes—disintegration, emergence, and redefinition—continue to unfold in present-day Eastern Europe.

The three processes provide a conceptual framework for summarizing and comparing transitions and transformations in our three case studies. This overview examines each process in turn. The final section suggests some reasons for the compatibility thus far—contrary to both historical experience and logical expectations—of democratic openings and economic reforms and identifies some of the challenges that lie ahead.

First, however, we sketch a few key features of the historical heritage of each of the three countries under review. In each, unique historic, cultural, and

social legacies shaped responses to and effects of the communist era. These differences in turn affected the way in which communist economic and political systems eventually disintegrated, the groups and institutions that have emerged to replace communism, and receptivity to Western models of democracy and market economy.

Heritages

The three nations have sharply contrasting historic associations with "West" and "East." Poland and Hungary received Christianity from Rome, while Bulgaria, developing within the shadow of the Byzantine Empire, participated in Eastern Christianity. Bulgaria's isolation from the West was reinforced by a long period of Turkish rule. These contrasting religious and cultural traditions in Poland, Hungary, and Bulgaria shaped social and political evolution and continue to do so today. Poland and Hungary are both dominantly Catholic. Hungary, however, includes a sizable Protestant population. Although the Catholic Church played a lesser role in political affairs in Hungary than in Poland, in both countries the substantially autonomous (and sometimes antagonistic) spheres of church and state created an inherent pluralism, a climate in which the notion of civic associations independent of the state could later emerge. Bulgaria, in contrast, is largely Eastern Orthodox, save for a Muslim minority of roughly 10 percent. The traditional Orthodox fusion of head of state with head of church worked to discourage the idea of pluralism. Poland and Hungary represent, therefore, the Western-oriented part of Eastern Europe (in which Slovakia and the Czech Republic can be included), while Bulgaria exemplifies the Balkan countries.

These different traditions affected the countries' pre–World War II patterns of modernization and their reaction to communism after the war and to its collapse some forty years later. Bulgarians were sympathetic toward Russia both because they had religious and linguistic ties to that country and because Russia helped Bulgaria shed the Turkish yoke at the end of the nineteenth century. Hungary, in contrast, looked west: it was part of the Hapsburg Empire and was long strongly influenced by German culture. Poland was more complex on this score: rural and urban segments of society were deeply divided socially and culturally. An important stratum of intelligentsia and a powerful, elitist "high culture" tradition survived both war and Stalinism. While most Poles tended to be both anti-German and anti-Russian (reflecting their unhappy national history), intellectual elites were pro-Western not only throughout the nineteenth and early twentieth centuries, but even under communism.

Despite some broad parallels, the three nations' political histories, including their experience with independence and democracy, also varied in ways

that affected more recent events. All were independent states for periods during the Middle Ages and in the early modern period, but each came under the domination of larger empires or states—Russian, Prussian (later, the German Reich), Hapsburg, and Turkish—before they had begun to evolve into modern nations. Therefore all started to develop the institutions and traditions of independent modern states relatively late: Hungary (within the dual monarchy), after 1867; Bulgaria, with the end of the Turkish occupation early in this century; and Poland, after World War I. Current efforts to revamp the structures of the state, the economy, and the political system can draw on only limited prior experience with independent government.

With respect to economic and social patterns, compared with Western Europe all three countries were peasant societies until World War II. Much of the population was at best only partly engaged in the market economy. In each, the state played an important role in early steps toward modernization and economic development. The metaphor of "returning to Europe," so fashionable now in Poland, misses the point: Eastern Europe, save perhaps the Czech lands, lagged considerably behind Western Europe, and this lag had deep historical roots (see Chirot 1989). Among the three, Bulgaria was the most rural and egalitarian, while Hungary had the strongest "petite bourgeoisie" tradition.

All three countries went through the harsh experience of World War II (Poland on the side of the Allies, the other countries on the Axis side), and communism was established after the Red Army overran their territories in 1944. Poland was most devastated, and its social structures were shattered by the war. The Holocaust, the shift of territory to the West, and the postwar expulsion of Germans from the acquired territories also left Poland much more ethnically homogeneous than it had been before the war.

The initial period of communism was probably harsher in Hungary than in Poland or Bulgaria: terror and repression were freely used both in the early years and after the attempted uprising of 1956. Paradoxically, Hungary after 1956 went furthest in "domesticating" the communist system, developing its own unique modifications that would later ease the market and democratic transitions. In Poland, in contrast, strong social tensions emerged in later years. In Bulgaria, communism was more readily assimilated, owing to traditional social egalitarianism, pro-Russian feelings, and perhaps also the paternalistic Orthodox cultural legacy with its lack of emphasis on individual freedom. In all three countries, the communist era brought profound changes—most dramatic in Bulgaria and least dramatic in Hungary—converting largely peasant societies into substantially urban and industrial ones. In Bulgaria in particular, many of these changes were widely seen as positive.

In short, varying cultural and historical legacies produced important variations in the impact of and responses to the imposition of communist systems. The lowest degree of political acceptance was in Poland, the highest in

Bulgaria. These contrasts strongly influenced differences in the timing, nature, and sequencing of the disintegration of communism in the three countries, and the emergence of new political and economic institutions and groups.

Disintegration

Communism's final collapse in 1989 was preceded by a long process of decomposition of all aspects of the system—economic, social, and political. In Hungary and Poland in the later years, disintegration was accelerated in some respects by deliberate reforms. After 1989, of course, the dismantling of communist economic and political institutions intensified. But the process is still far from complete.

Analyzed with a perspective of several decades, communism had its own life cycle of growth and decay. Initially, totalitarian regimes generated high rates of economic growth by using political mobilization techniques; drawing on easily obtainable manpower, energy, and raw materials; and disregarding ecological consequences. These advantages initially offset the inherent inefficiency of command economies (low output-input ratios) and their inability to innovate. Societies atomized by war and revolution were responsive to political mobilization; rapid upward mobility for some segments of society also generated political support.

By the late 1950s, however, difficulties were emerging: new social structures began to become more rigid and resources less readily available. Despite attempts at autarky and the rapid reduction of trade outside of the communist bloc, communist economies became dependent on technology transfers from the West. Nor could initial efforts at cultural isolation be maintained: partial openings to the West after the mid-1950s spurred rising consumer demands.

In Poland and especially in Hungary, partial reforms eased the first round of difficulties. When similar problems reemerged in the 1970s, they were temporarily offset by foreign borrowing. But by the late 1970s and the 1980s, the communist system throughout the region was less and less able to face the challenge of international economic and military competition, especially accelerating technological change. Nor could it meet the consumer and political aspirations of its own societies. Welfare achievements—cheap housing and food, free health and education—deteriorated. By the beginning of the 1980s, at least the more enlightened segments of ruling elites realized that the system was in fundamental crisis. Within the constraints of the system, however, they were not able to put forward credible policies of adaptation.

Economic disintegration was paralleled by a decay of totalitarian political structures. Powerful lobbies arose within various regions and industries, eroding central economic control. The dedicated, even fanatical, party cadres of the 1950s gave way to the petty realists of the 1960s, and they in turn to the

corrupt and cynical bureaucrats of the 1970s. Only lip service was paid to Marxist-Leninist ideology, particularly in more liberal Hungary and Poland. An implicit bargain replaced earlier political mobilization: political quiescence in exchange for economic security and progress. Growing inability to deliver progress thus struck directly at the basis of fragile legitimacy. Perestroika in the Soviet Union delivered the final blow.

Variation among Countries in Patterns of Disintegration

Within these broadly similar trends, the specifics differed in each of the three countries. De-Stalinization (the dismantling of the techniques of political mobilization of the entire society) in the 1950s was handled quite differently in Hungary and in Poland; in Bulgaria it never really occurred. The revolutionary sixteen months of Solidarity's emergence in Poland in 1980–1981 has no counterpart in Hungary or Bulgaria: that period essentially destroyed the morale of the ruling elite and fatally wounded the Leninist "transmission belt" role of labor unions in Poland.

Paradoxically, the harsh terror imposed in Hungary after 1956 paved the way for a later process of pragmatic change imposed from above in response to economic problems, coupled with a policy of co-opting the intellectuals. After 1956, Premier János Kádár repressed both left- and right-wing opposition and initiated a long series of gradual, relatively successful market-oriented reforms. A sizable circle of economists became familiar with Western theories and analysis. The reforms produced reasonably efficient systems of resource allocation and product distribution, avoiding both severe shortages and repressed inflation. Foreign trade was more diversified than elsewhere in the region. Agriculture was organized in collectives, but part of the land was rented out to the collective farmers, who lived in successful symbiosis with the profit-oriented cooperative units. In Hungary one could almost discern a silent but deliberate dismantling of the command economy, to a degree unique in the region. Nonetheless, Hungary could not wholly escape the gradual disintegration common to the region, since the reforms fell far short of a fundamental change in system.

Poland, in contrast, went through repeated cycles of attempted reforms and reaction. Władysław Gomułka neither wished nor was able to follow the Kádárist centrist path after the disturbances of 1956 in Hungary. Instead, partial and ineffective reforms were introduced during the late 1950s, the 1970s, and the 1980s. These failed to avert increasingly severe economic crises, leading by 1988 to acute shortages and in 1989 to near hyperinflation. That situation called for the harsh "shock therapy" instituted by Leszek Balcerowicz. The failure of earlier partial reforms also left more severe structural problems than those in Hungary. Poland depended more heavily on trade within the Council for

Mutual Economic Assistance (CMEA) area, and many state-owned enterprises were extremely hard hit by its collapse. Agriculture was almost wholly private, but most farms were small and technically backward. And because of policies pursued during the 1970s, both the size and structure of external debt were extremely burdensome.

As we noted earlier, Bulgaria was far more receptive to both communism and Russian influence, though repression of intellectuals and other critics of the regime was also harsher. Clear signs of disintegration, including acute shortages and inflation, did not emerge until relatively late in the 1980s. The command system was left virtually intact until the very end; growing difficulties prompted frequent reorganizations of the management hierarchies that fell short of meaningful reforms. Bulgarian industry was highly concentrated in large state enterprises; likewise, agriculture was dominated by immense collectives. Bulgarian trade depended overwhelmingly on the CMEA; the Soviet Union accounted for as much as two-thirds of Bulgaria's foreign trade. Therefore the collapse of the socialist international trade system left Bulgaria one of the most isolated countries in the region. The Yugoslav conflict next door further aggravated the country's physical isolation from the developed parts of Europe.

Post-1989 Dismantling

After 1989, of course, deliberate dismantling greatly speeded the disintegration of the old system throughout the region. Stabilization policies, introduced by the postcommunist governments with the backing of the International Monetary Fund (IMF), and the collapse of CMEA trade spurred the processes of disintegration. Of the countries in the region, only Hungary and Czechoslovakia had relatively stable macroeconomic situations that made shock therapy unnecessary. But Hungary shared with the other countries a sharp drop in output, as state enterprises proved much less adaptable to market rules than the mushrooming (but still mainly small) private firms.

The accelerated dismantling of the old system dramatically altered the situation of many major social groups. Workers in state enterprises faced sharp declines in real income and the possibility of unemployment. The intelligentsia had been employed under communism as managers of state enterprises and staffs of public sector cultural, educational, and political institutions. The protracted and severe fiscal crisis compressed their incomes and undercut their security. Despite the contrasts among the three countries in the property structure and organization of agriculture, farmers in all three felt the consequences of the collapse of guaranteed prices, import competition from the European Community, and the reduction of state subsidies for agricultural inputs.

Whereas before 1989 recessions had usually been transformed into inflation and shortages, in the new economic order the fall in output and revenues

and macroeconomic imbalances produced severe fiscal crisis in each of the three countries.[5] Fiscal strain in turn accelerated the disintegration of the inefficient but pervasive welfare systems (health, education, housing, and pensions). The consequences were particularly painful in the context of falling real wages and rising unemployment. Not only social services, but the entire range of state functions and services continued to deteriorate, in part as a result of fiscal pressures and in part because of the disruption, confusion, and demoralization of abrupt changes. Bureaucrats' behavior could hardly be expected to change overnight. Moreover, most are poorly paid and easily corrupted by the new temptations of the emerging market economy.

The process of disintegration will continue for some years, since the role of large state enterprises in the economy is still much too great and social values still reflect four decades of communism in the region. Moreover, the capacity of most public institutions continues to decline. Eastern European societies will have to struggle with the legacy of communism for a long while.

Emergence

Parallel to the unraveling of the old systems and in direct proportion to their disintegration, market institutions and elements of civil society started to emerge. This emergence was clearest in Poland and Hungary. Of course, the events of 1989 mattered. But in these two countries there was also considerable continuity; the political collapse of communism was perhaps most important as a symbol. It also helped to bring in foreign political backing and, with it, capital and foreign expertise. In Bulgaria, in contrast, elements of civil society and market institutions began to emerge only in the late 1980s, and the collapse of communist control was essential before serious economic reform could begin.

Emerging Elements of Future Market Systems

Economic reforms in Hungary and Poland before 1989 have already been discussed as responses to disintegration. Some of these reforms also contributed to the emergence of markets, gradually introducing market mechanisms within the command economy by shifting allocative decisions from central authorities to state enterprises. This shift allowed directors of those enterprises, especially in Hungary, to learn Western-style management, financial, and marketing techniques.

Not only the contrasting nature and degree of communist economic reforms, but also differences in the influence of workers in Poland and Hungary contributed to different degrees of "market learning" in the two countries. In Hungary, workers' opposition to the communist regime was less

powerful than in Poland, in part because of memories of the brutal crushing of the Hungarian uprising of 1956. Therefore consumer prices could be kept comparatively high, and consumer markets remained in equilibrium. Shortages were less acute and frequent, and all economic actors received more social training in market behavior. In Poland, in contrast, workers' pressures held down consumer prices, directly causing recurrent severe shortages and indirectly interfering with learning about market principles.

Alongside limited market-oriented changes in the organization and operations of the official sectors in Poland and Hungary, the shadow or second economy was emerging well before 1989. Flourishing particularly in services, technically illegal but tolerated shadow-economy activities helped to fill the gaps in the official distribution network, increased family incomes, and provided experience in entrepreneurship.

Both countries also permitted a limited amount of officially sanctioned private economic activity. As already noted, Poland's agriculture remained almost entirely in private hands, while in Hungary private plots were permitted within the larger structure of agricultural collectives. In both countries there were also a fair number of legal family-sized enterprises in retail trade and crafts. In Poland by the second half of the 1980s, as antiprivate property ideology diminished, restrictions on the size of enterprises were lifted and foreign capital was permitted to enter. The result was the growth of somewhat larger private businesses. The private sector expanded continuously from the late 1970s on, while the output of the state sector shrank considerably. Private sector growth was still inhibited, however, by lack of capital, skills and expertise, infrastructure, and confidence that the new policy changes would be sustained. In Hungary the pattern and timing of emerging private sector activity was similar to that in Poland in spite of marked differences in the patterns of dismantling the communist system. In the final years of the communist era, informal privatization of state enterprises also gained ground in Hungary.

Hungary and Poland's loosening of the command economy was unique within the Soviet Bloc. Bulgaria, in contrast to these two but in common with the rest of the bloc, had very little private sector (legal or shadow) and virtually no experience with marketlike incentives and constraints within the all-encompassing state sector. The most rural of the three countries, Bulgaria had an agricultural sector dominated by immense Soviet-style state and kolkhoz farms.

The political transitions of 1989 sharply accelerated the emergence of small and medium-size private sector firms. By March 1993, private sector activity was estimated to account for at least 45 percent of gross domestic product (GDP) in Poland (and the private sector employed almost three-fifths of the labor force); 40–42 percent of 1992 GDP in Hungary; and roughly 20 percent of GDP in Bulgaria.

The way in which different postcommunist countries stabilized their macroeconomic situations influenced private sector formation. In Poland the

Balcerowicz plan squeezed the large state trading organizations; accompanied by a conscious policy promoting small privatization, this tactic caused a rapid takeover of virtually the whole retail market by small private entrepreneurs. Bulgaria's lag reflects not only the absence of private or marketlike experience before 1989, but also macroeconomic policies somewhat less vigorous than Poland's. As a result, its state-owned trading companies have been less energetically pushed out of operation. In Hungary the small-scale private sector grew rapidly, but this increase was a continuation of pre-1989 trends. András Köröseényi's discussion of Hungary in the companion volume emphasizes the strong continuity of economic reforms in Hungary in the late 1980s (Nelson 1994).

In all three countries, however, it has proved more difficult and slower to revise old and create new legal and financial institutions appropriate for market economies than to encourage small private firms. Again, both in Poland and in Hungary there had been some modest steps to develop such institutions in the last years of the communist period. Legal regulations had been amended and financial markets (such as banks and stock exchanges) introduced and reorganized. Still, despite the efforts of postcommunist governments and parliaments, these reforms are lagging behind the needs of the burgeoning business sector. For example, financial intermediaries able to channel private savings into investment remain extremely weak.

Transformation of the large state-owned enterprises has proved much more difficult than small-scale privatization. In most of the region, with the exception of Hungary, most large enterprises have not changed status. However, piecemeal and inevitably experimental privatization policies, coupled with "spontaneous" behavior by managers and others, are under way in most countries and have gone particularly far in Hungary, which has also pressed official privatization programs more rapidly than other countries. The process is producing layered, complex, and often obscure networks of property rights. For instance, managers of state-owned firms may spin off assets to new satellites that are legally limited liability firms; the old firm remains the dominant owner, while suppliers and banks (still state-owned) are also major shareholders. It may be difficult to develop and apply appropriate regulation for these unanticipated and poorly understood ownership networks. More broadly, the emerging patterns defy conventional distinctions between public and private sectors. The effects on productivity, investment, taxation, and other crucial aspects of economic performance remain to be seen.

Unhealthy side effects of the emerging market are also quickly appearing: tax evasion, corruption of officials, and mafia-type illegal economic activities. These effects are exacerbated by the general weakness and disintegration of the state already mentioned. Side effects are partly a result of lags in legal and financial reforms. The temptation is also huge: no accepted moral code guides businesses and state officials, and privatization and easy access to the money of state banks generate large-scale corruption. Such phenomena, which appear

almost universally in the early stages of capitalism, are probably unavoidable. They are nevertheless dangerous, posing both a direct threat to private and public sectors and a more indirect risk that criminal structures, once brought to life, will petrify.

New Social Stratification

New social groups are emerging parallel to the development of markets. In Hungary and Poland an embryonic entrepreneurial class, present throughout the entire communist period, expanded considerably during the 1980s. Still small compared with that in Western societies, this middle class is growing rapidly. A tiny group of very wealthy people is also appearing. Income differences (which, contrary to the official propaganda, never disappeared under "real socialism") have become much more conspicuous. In Bulgaria, restitution of urban property to precommunist owners has created a small but politically influential class of property owners. The short-run effects of the measure in stimulating entrepreneurship remain uncertain.

At the other end of the social scale, one of the unfortunate outcomes of reduced real wages and growing unemployment is the emergence of an "underclass" of people, who, for various reasons (such as age, social and ethnic characteristics, and lack of education or skills), are unable to compete in the new system. In Poland, the emerging underclass includes many low-income, poorly educated rural people, as well as unskilled manual workers in urban areas. It is also beginning to include even some skilled employees of state enterprises, who, for lack of housing elsewhere, cannot move out of regions particularly hard hit by unemployment and recession. Undereducated young people from working-class urban backgrounds pose particularly urgent social problems. Gypsies in many countries of the region confront special problems of combined ethnic and social prejudice. Among the cases studied here Hungary is the most affected by the problems of Gypsies. The social situation of Turks and of Gypsies is difficult in Bulgaria as well, while Poland is the most ethnically homogeneous country in the region.

The Emergence of Civil Society and Political Opposition

Critical groups—embryonic political opposition—had also started to emerge in Poland and Hungary long before communism collapsed. While economic reforms proceeded furthest before 1989 in Hungary, political opposition was most developed in Poland. Bulgaria, in the political as in the economic sphere, had the least experience with opposition before 1989. It needed the external impulse of perestroika in the late 1980s to give birth to a modest environmental movement and to the autonomous trade union federation Podkrepa.

In Poland, the emergence of critical groups independent of the state owed much to the Roman Catholic church. Historically, the church had maintained its autonomy; under communism it played the role of a "public sphere" both in its own right and as the vehicle for covert but ardent nationalist sentiments. Since at least 1976, there had also been a tolerated open opposition, reinforced by the sixteen months of mass participation through Solidarity in 1980–1981. Workers' councils were also comparatively numerous and influential in their own enterprises. Economic structure—specifically, the relative importance of heavy industries where workers' organizations tend to be strong—contributed to the political importance of unions and workers' councils in Poland. In Hungary, in contrast, the church played very little political role. Nor, after 1956, was there significant mass-based opposition; criticism was more intellectual in character. In both countries, since the harness of ideology and censorship was relatively loose, the authorities tolerated considerable independent activity within academia and the arts. Through teaching, movies, cabarets, essays, books and translations, cartoons, and rock music, independent ideas were diffused to a wider public. "Homo sovieticus" was disappearing, and elements of civil society clearly emerged in Hungary and Poland before the major political shakeup.

Even within the very core of communism—the party itself—independent tendencies were not unknown in Hungary and Poland, although in neither country did internal criticism reach the level of that in 1968 in Czechoslovakia, when the communist party was briefly the main proponent of radical reform. In Poland in 1980–1981 there were unprecedented attempts to institutionalize such tendencies, but the more general tendency was to exclude dissenters. In contrast, in Hungary after 1956, the Kádár regime followed a strategy of trying to co-opt dissenters. As a result, the political transition in Poland was fundamentally confrontational and entailed mass mobilization, while the Hungarian transition was negotiated among political elites and involved rather little mass participation. In Bulgaria, doubts and divisions within the party surfaced only just before the moment of transition and were generated largely by events in the Soviet Union. The transition began as a "palace coup" by reformers seeking to introduce perestroika. Moreover, the Communist party maintained broad popular support, as its victory in the first competitive election demonstrated. These contrasting dynamics of political transition in turn shaped the patterns of post-transition politics.

Another important aspect of the emergence of civil society consisted of constitutional and statutory changes under communism that expanded the role of the judiciary and the rule of law. For example, administrative and labor courts were established in Poland in the 1970s and constitutional and state tribunals and the office of the ombudsman in the 1980s.

After the collapse of communism, all three countries rapidly started to build new constitutional and political orders—a process that is still just

beginning. Civil society, so important in the final abolition of communism, turned out to be only partially prepared for this new task. Social structures are in flux, as they reorient themselves to new economic and political rules of the game. New social groups are not yet well organized; indeed, it is hard even to define and articulate interests in the context of rapid change. Nevertheless, certain groups have managed to develop or retain some capacity to influence government policies. The clearest illustrations are probably the former Communist and Solidarity labor federations in Poland and the dramatically growing Podkrepa federation in Bulgaria. Business associations in all three countries have also emerged rapidly. In Poland some agricultural interests have maintained strong associations to pursue their goals, and all three countries have organized (or revived pre-Communist) agrarian political parties. More generally, however, the opposition elites that emerged in the last years of the communist era and gained experience in civil disobedience and passive resistance had no practical knowledge of open, competitive democratic electoral politics. Especially in Poland and Bulgaria, parties were often little more than personalist factions, emerging almost accidentally and with little social basis, often uniting under symbols from the past or from abroad. Only more recently have they started to search for constituencies.

In Poland, opposition to communism was powerfully united under the umbrella of Solidarity. But Solidarity started to crumble within a few months after the Communist government was displaced. The negotiated transition entailed a lengthy period of coalition government that included the discredited Communists; in the first free elections electoral arrangements produced a badly fragmented legislature. This result contributed to ongoing tension between the president, the government, and the legislature. New electoral laws adopted in 1992 produced a much less fragmented outcome in the elections of September 1993. It remains to be seen whether the decisive leftward swing of those elections will produce a more coherent legislature.

In Hungary and Czechoslovakia, more workable party structures emerged in the campaigns for the first democratic elections in 1990. In Hungary the six-party system, fostered by electoral laws discouraging fragmentation, has turned out to be surprisingly stable, adding to the overall stability and gradual progress of the country. But even in Hungary, and more clearly in Poland and Bulgaria, there is a danger that the parties emerging from the transition period may fail to build broad social bases; much of the public may then become alienated, perceiving politicians and legislators as a new political class playing their own game, divorced from citizens' concerns.

In Bulgaria, the emergence of a new competitive party system took a different path. In Poland and Hungary, the disintegration of the Communist party led to splits and fairly low—though not trivial—popular support in the first competitive elections. In Bulgaria, however, more of the population

supported at least aspects of the communist system, and organized opposition emerged only shortly before the transition. As already noted, the former Communist party won the first election, which discouraged both splintering and reform from within the party. The continued strength of the ex-Communists fostered the growing dominance of the most ardent right-wing groups within the variegated democratic opposition. As Ekaterina Nikova describes vividly, politics and parties were temporarily frozen in intense polarization (Nelson 1994).

By the end of 1992, however, the Bulgarian parties showed signs of the pattern traced earlier in Central Europe: the anti-Communist coalition splintered, while the former Communists somewhat reoriented their stance. Moderate democratic groups became alienated or were pushed out of the anti-Communist coalition. The right-wing elements, still bearing the name of the original broad coalition, won a razor-thin majority in the second round of elections in October 1991 and formed a coalition government with the party representing Bulgaria's Muslim population. Within one year, however, the uncompromising rightist government had managed to alienate almost all groups within society, including its coalition partner, and was brought down by a vote of no confidence. The new government formed in the last days of 1992 is a centrist coalition of moderates from the Socialist (ex-Communist) party and the Muslims, with support from some of the original anti-Communist groups. The coalition has not proved very effective, and new elections are likely in 1994. Bulgaria's electoral laws will discourage fragmentation similar to Poland's, but it remains an open question how the party system will evolve.

Redefinition

The collapse of communism was not only an event of great historical importance, but it was also amazingly nonviolent in most of the bloc. Nor did the transition involve any major physical dislocations: towns and factories were not destroyed; people were not forced to move from their homes. With the broad physical framework and much of the social system intact, the political transition did not entail destruction but rather redefinition of social roles.

The process of redefinition is most visible in the case of the former *nomenklatura*, those party apparatchiks who played the most important political roles in the old order. In Hungary, as Körösényi suggests, the nomenklatura had already partly redefined their role by the 1970s, emphasizing technical and managerial skills rather than ideological roles (Nelson 1994). The nonrevolutionary and negotiated character of the transition spared members of the nomenklatura both physical danger and, at least initially, legal threats. In Poland and Hungary shortly before 1989, many of them had tried to

prepare fallback positions. Many turned their political capital into economic capital, converting skills and connections acquired under the old system into marketable assets under the new one. Former party apparatchiks, high officials, and state enterprise managers started early to establish private companies, often privatizing state enterprises or finding jobs as representatives of Western corporations. In short, state officials redefined themselves as capitalists. This transformation happened much more easily in Poland and especially in Hungary than in Bulgaria.

A similar process took place in politics. Communist parties reorganized and changed names, usually calling themselves "social democrats" and claiming adherence to democratic principles. In Hungary the party split in 1989; the reformist wing successfully capitalized on its liberal credentials and is now a well-established part of the Hungarian competitive party system. From 8.5 percent of the seats in the 1990 Parliament, its popularity has risen to the point that it may well run first or second in the elections of spring 1994. In Poland the former Communists won over 10 percent of the popular vote in the 1991 parliamentary elections; within the fragmented Polish Sejm they formed the largest parliamentary caucus. In September 1993 the Democratic Left Alliance, a coalition dominated by the direct successor to the Communist party, finished first with more than 20 percent of the vote, and the left-leaning Polish Peasant Party won an additional 15.3 percent. Together the two will control two-thirds of the seats in the Sejm. In Bulgaria, however, reorientation of the former ruling party was slowed precisely by its initial victory (with 47 percent of the vote) in the free elections of 1990; only more recently have some reformist elements split from the party to form separate groups. More generally, in the Central European or Western tier countries of the region, the renamed and to varying degrees reoriented Communists have not been able to capture more than 15 percent in elections, while their counterparts have done considerably better in Bulgaria or Romania.

Trade unions have also had to reorient their structure, agendas, and alliances. In Poland, Solidarity had been a union more in name than in fact, being in reality a political opposition movement. Since 1989 it has had to become a more typical labor union federation. The former Communist unions have also had to reorient their role and have proved surprisingly effective in so doing. Under communism they were corporatist institutions, uniting managers and workers within industries and trying to transmit party policies to the shop floor. Now they organize industrial actions much as Solidarity does. A similar remodeling of the unions is under way in the whole region. Many of the officials of the old unions, perhaps especially the younger among them, are more skillful and disciplined in the day-to-day realities of politics than are most leaders of the newer unions and parties. In Poland and Bulgaria, the reorienting of the former Communist unions has been accelerated by competition with strong new autonomous trade union federations. But more recently that

rivalry itself has been redefined: in Poland, at least at the level of some firms, and in Bulgaria, at higher levels, there has been clear collaboration between ex-Communist and anti-Communist unions. Nikova's suggestion regarding Bulgaria applies to Poland as well: union influence is enhanced by the relative weakness of parties. In Hungary, unions in general have long been less influential, and the new anti-Communist unions have thus far been weak. The ex-Communist unions have very cautiously, step-by-step, gained some legitimacy among the employees by actions designed to demonstrate their services, but they have not yet challenged government decisions over the economy. They are, however, open and strong allies of the Socialist party in the 1994 elections.

Within the not yet fully emerged competitive party systems discussed in the previous section, anti-Communist politicians and groups have also had to redefine their roles, since many of them are now part of the new political elite. At the same time, state institutions have been redefined politically, shedding the Marxist ideological legitimization and often donning more nationalistic garb, sometimes—as in Poland—with religious overtones.

Economic and Political Transformation: How Closely Linked?

Even our small sample of cases displays sharp contrasts in pre-Communist heritage and wide variation in the timing and speed of the disintegration of communism and the emergence of new, more market-oriented or democratic actors and institutions. Yet despite considerable differences in the course of economic and political reforms since 1989, the three countries show a number of broad similarities with respect to the nature of the economic measures adopted, the impact of those measures, the slower and more difficult progress of institutional and legal reforms, resistance to large-scale privatization, and the dissolution and restructuring of both former Communist and anti-Communist political coalitions. Since our main interest is the linkages between economic reform and consolidation of political openings, one similarity is particularly interesting: broadly, painful economic reforms have not been blocked by democratic politics (despite considerable protest, particularly in Poland and Bulgaria), nor have unexpectedly severe economic declines thus far derailed democratic consolidation. What factors explain that pattern? Can it be expected to continue?

One set of factors is of course the shared external context. The collapse of the Soviet Union and the CMEA and the Gulf War combined with long-festering domestic economic troubles to create an absolutely overwhelming economic crisis. At the same time, events in the Soviet Union destroyed any remaining credibility of statist economic strategies, while both intellectual currents and

real-world events elsewhere around the globe seemed to point to the inevitable triumph of market-oriented economic strategies and democratic political systems. For many in the Soviet Bloc, that triumph not only seemed inevitable but also was ardently desired: both the consumer goods and the political and cultural freedom of the West were magnets. Most clearly in Central Europe, but also in the Balkans, the desire to "belong to Europe" influenced both political behavior and economic policies.

The very severity of the economic crisis also forced rapid imposition of drastic economic measures; the nature of the crisis left little room for maneuver. The international financial community, mainly but not exclusively the IMF, urged tough stabilization measures except in Czechoslovakia (before its division) and in Hungary, where severe imbalances had been avoided.

The depth and drama of the recession also captured public opinion. Initially the public in our three countries (and more broadly in Eastern Europe) was prepared for temporary sacrifice, if not because the old system was despised (as it was in some but not all cases) then because of the glittering lure of Western standards of living. Yet most people probably were not prepared for some of the more drastic aspects of the adjustment, including soaring unemployment rates. An intense debate has emerged among specialists regarding the real impact of the transitions on living standards, taking into account not only nominal wage and price trends but also less easily quantifiable positive and negative trends such as reduced scarcities, the burgeoning and undercounted small-scale private sector, and eroding standards of public services. Popular reactions probably depend less on the balance of objective gains and losses than on hopes, fears, and perceived alternatives. It is worth noting that in Bulgaria—the country in our sample least disaffected from communism—the United Democratic Front won the elections of September 1991 after seven months of supporting acute austerity measures, while the architect of the measures, Ivan Kostov, was returned to the legislature with a strong majority. Still more clear-cut is the popularity among Czechs of Prime Minister Vaclav Klaus, the architect (as former minister of finance) of rapid and sweeping economic reforms.

A fourth common factor that helps to explain the initial compatibility between economic reform and democratic consolidation was the weakness of the potential opposition groups. For the most part, former Communist parties and unions were discredited and in disarray, while newer groups that would later advocate alternative economic approaches or less-than-democratic political philosophies were not yet organized.

Moreover, the democratic consolidation agenda was substantially independent of the economic reform agenda. Intense debates over issues as fundamental as new constitutional frameworks, or as apparently frivolous and superficial as the design of the flag or other symbols, absorbed a great deal of time and attention. So did political maneuvering and planning, as both

Communist parties and anti-Communist coalitions crumbled and new parties emerged. Unclear relationships between heads of state, heads of government, and legislatures caused considerable tension; so did issues such as control of the media and the military, and, in Poland, relations between church and state.

All of these factors contributed to the somewhat surprising compatibility of initial economic reforms and democratic openings. But links and strains between the two processes may well increase in the near future. To the degree that the macroeconomic crisis has been eased and inflation contained, the sense of potential catastrophe has been reduced. Public tolerance for further sacrifice is dwindling, while the immense task of restructuring the large state enterprises and banks remains to be addressed. The size and dynamism of the private sector, hence its capacity to absorb workers from the state-owned firms, may prove crucial in determining the pace of politically sustainable reform. Opposition groups of the left and right are emerging and are likely to pose more of a threat than in the early post-transition period. Finally, as some of the big issues of initial democratic consolidation are at least temporarily resolved, both the public and policy makers will be freer to turn their attention more fully to economic questions.

As the shared circumstances that dominated the early post-transition stages fade, the contrasts in different countries' heritages from precommunist and communist eras may well exercise more influence on the pace and pattern of economic reform and on political trends. Clearly those countries where disintegration had gone least far and market-relevant experience and institutions had not emerged are at a disadvantage as they now try to encourage market behavior. Creation of new institutions and opportunities may not be able to outpace the destructive effects of dismantling the old arrangements. On the political side, the advantages of an early start may be less clear: it depends what "lessons" were learned regarding effective political behavior. The lessons learned in Hungary, both by elites and by the public, stress elite negotiations and downplay popular participation. In Poland much of the population learned lessons regarding mass political opposition but little about compromise. The turbulent politics of the first years after 1989, however, seem to have produced at least a tacit agreement not to pursue differences to the point of paralysis or breakdown and a somewhat increased capacity for compromise.

Thus far we have discussed the relationship between economic reform and democratic consolidation in terms of short-run effects on the sustainability of economic policies and open politics. But the two processes also interact in more specific and disaggregated ways, some of which are likely to have long-run effects on the pace and pattern of economic and political evolution. For instance, Körösényi points to the replacement of old forms of Communist patronage and clientelism by new patterns of allocation of privatized assets to build political support, while Nikova notes that the second Bulgarian land reform law was motivated far more by the desire to weaken ex-Communist

control in rural areas than by the desire to establish more efficient agricultural production. Changing class structure will also of course have powerful effects and indeed may pose one of the long-run challenges to the viability of both aspects of the double transformation. It is to these challenges that we now turn.

Challenges

The processes of disintegration and dismantling, emergence and redefinition are far from over, and the picture is still unclear. Throughout the region, a long road remains to fully fledged market economies and stable democracies.

Challenges to both goals stem in part from the international economic and political setting: international competition is strong; the global economy is in flux; and the regional and world political order is undergoing recomposition after the collapse of the Soviet Empire. Prospects for Eastern European recovery and growth depend on the ability of those countries to compete in world markets. Unfortunately, protectionist impulses have revived in many Western nations with the end of the Cold War threat and as a result of current domestic economic problems. Although the European Community and other Western nations have partially opened their markets to Eastern European goods, the broader goal of integration—more likely for the Central European nations than for the Balkans—will clearly be slowed by fears regarding inflows of cheap imports and anxiety regarding massive labor migration. External debts are a further burden: repayment cuts into funds for domestic investment, while attempts to renegotiate or delay payment reduce credibility with foreign investors. For Bulgaria (among our cases) and several other Balkan countries, the civil war in parts of former Yugoslavia has increased geographic isolation while the international embargo on trade with Serbia has imposed heavy costs. The largest unknown is the future of the successor states of the Soviet Union, which are likely—whatever the course of events—to draw attention and resources away from Eastern Europe.

In addition to the uncertainties and problems of the external context, Eastern European nations face an array of challenges stemming from internal trends. The first of these is the possible rise of antimarket forces. Major social groups are threatened by changes already accomplished or planned, and many people are unprepared to face life in a competitive market system. Voices for more intervention, for more state protection, for a return to the cozy welfarism of bureaucratic paternalism easily gain popularity among state enterprise workers who fear layoffs, among the growing marginalized underclass, and among the many pensioners. Doubts about the desirability of a largely market economy may extend to other groups as well, particularly in Bulgaria (among our cases) and elsewhere in the Balkans.

This challenge, plus less fundamental but still formidable technical and economic obstacles, thus far has prevented more than modest progress in privatizing or restructuring the massive, inefficient, largely technically obsolete state industries that still make up a large (although in Poland rapidly decreasing) share of the economy and employ a high proportion of the labor force. Hungary's economic and political situation has permitted somewhat better though still partial progress. Any rapid resolution of this issue seems unlikely; considerable state intervention might well occur, reflecting growing demands for some sort of industrial policy to keep potentially viable industries alive.

Aside from the restructuring of state enterprises, the biggest structural challenge the Eastern European countries face is budget reform. In each of these countries, welfare and social spending considerably exceeds that of market economies with comparable per capita income. Yet budget restructuring is a highly complex and politically sensitive operation. Failure to reform in this field would mean that high marginal tax rates will prevail, forcing businesses to conceal many of their activities. That outcome would generate much higher inequalities than if radical budget reform could be carried through.

The evolution of political systems also poses challenges. In all three countries—most clearly, thus far, in Hungary and Poland—there are signals of possible right-wing movements of a nationalist or religious character. Such groups feel their national identity is threatened by the changes brought about by the market and democratization and by the cultural homogenization resulting from globalization of markets and political openness. These groups are marginal in both countries. Yet prolonged and widespread hardship could increase their social support. Such tendencies raise questions about the future character of Eastern European societies and states: will they be open and based on liberal ideas and rule of law, or will they instead be defined in ethnic and religious terms?

Clashes over these fundamental political values, as well as over economic goals and means, will affect how still-fluid party systems evolve and how unresolved constitutional questions are managed. In our three countries, only Hungary appears to have evolved a workable party structure; the Polish party system remains fragmented (though less so after the elections of autumn 1993), and the polarized Bulgarian parties seem to be starting a process of crumbling and regrouping. The challenge is not only to create party systems capable of producing stable and effective governments, but also to develop ties between the political class and social constituencies that can counter the growing trend toward cynicism and apathy among the public.

Basic constitutional issues, including the division of power between presidents, governments, and legislatures also must be defined or fine-tuned. Until these issues are resolved, already overburdened governments will be further hampered by uncertainty and controversy.

Consolidating democratic transitions poses a further challenge of incorporating emerging interest groups (themselves still very much in flux) into the decision-making process. Labor unions present a particularly acute challenge. Both their institutional interests and the welfare of many of their members are perceived to be directly threatened by aspects of market-oriented reform, including measures (still largely in the future) to increase the flexibility of labor markets and to reduce the role of unions as channels of social benefits. Unions are likely to resist such reforms, yet they cannot be left out of democratic decision-making processes. Moreover, enlisting some degree of their cooperation may prove crucial for successfully implementing key economic reforms.

Both economic and political challenges converge on a third set of issues: redefining the role of the state itself. Here all postcommunist states are in a dilemma, because they need much less of the state and yet more of the state at the same time. Two overlapping sets of issues demand attention. First, while a market-friendly environment demands less state intervention in the economy, the state must act in many ways as the architect of the transition. The state sector is still considerable, and the government must both introduce privatization and manage those enterprises that, for the time being, will remain in public control. A different but equally crucial state role during the transition period is to provide a safety net adequate to protect both basic welfare and the political sustainability of the reforms. The second set of issues concerns the long term, not the transitional period. Even in a largely market economy the state must serve key functions, including tax administration and enforcement, a fair and efficient judicial system, and the kinds of appropriate market regulations that characterize established market systems. Permanent state functions also include substantial roles in education, health, and social security—but current structures are both inefficient and financially unsustainable. Consolidating market reforms and democratic politics will require reversing the ongoing disintegration of basic state functions, while resolving the extraordinarily contentious questions of the boundaries and goals of those functions.

Despite challenges and anxieties, however, considerable progress has been made on the road to market societies and democratic systems. Whatever the shortcomings of institutional arrangements, the ideas of democracy and markets prevail throughout the region. In contrast with the interwar period, people—by and large—do not seek answers to their problems in strong leaders and authoritarian solutions, and self-appointed "strongmen" have not emerged. It is too early to give any definitive answers why this is so, but certain factors are likely to matter.

First, there is a "snowball effect." The trend toward democracy is global. There is a zeitgeist of which democracy and human rights are part—as totalitarianism and authoritarianism were part of a zeitgeist in the 1930s.

Moreover, societies are affected by developments elsewhere much more than in the past. The media—television in particular—play an enormous, unprecedented role, and it is difficult to isolate people from what is going on in other countries. The feeling is overwhelming in the world that statist economies and authoritarian political systems are outmoded and ineffective systems.

Second, there is the enormous appeal of the global mass consumer society. When one looks at young people in a Warsaw disco, in a McDonald's, or in a music shop, it is hard to imagine them in the red ties of the Communist youth movement. Blue jeans, cars, washing machines, and videocassette recorders are parts of an open, market society.

Third, in Eastern Europe specifically, the proximity of the European Community has enormous influence. Elites in Eastern Europe know that the values of Western Europe cannot be easily dismissed if a given country does not want to be reduced to the role of a pariah.

Democracy and market reforms thus far have held. These factors improve the chances that they will—against the historical odds—be consolidated.

CHAPTER 3

Economic and Political Transitions in Latin America: The Interplay between Democratization and Market Reforms

Marcelo Cavarozzi with Joan M. Nelson and Miguel Urrutia

During the 1980s most of Latin America's military dictatorships were replaced by democratic governments. In the set of countries analyzed in this chapter—Bolivia, Argentina, and Brazil—transitions to civilian rule occurred in the first half of the 1980s.[1] This trend largely overlapped with the collapse of the dirigiste economic models that had prevailed since the 1930s. Thus, the new governments faced two simultaneous tasks: consolidation of fragile democratic political institutions and economic stabilization and reform. In contrast, in Mexico and Chile, and outside of the hemisphere in Korea, Taiwan, and Turkey, economic reform preceded democratizing trends. Alternatively, in Costa Rica, Venezuela, and post-1982 Spain, democracy was well-established when deep economic crisis demanded basic structural change.

Argentina and Brazil are among Latin America's early industrializing countries; Bolivia is one of the region's least industrialized and least modernized countries. These contrasts permit us to examine interactions between stabilization of democratic institutions and implementation of market-oriented reforms in a range of contexts. Despite the dramatic differences among these countries, simultaneous economic and political changes initially prompted partly parallel responses. In all three, the departure of the military was supported by the overwhelming majority of the population. Especially in

Argentina and Brazil, a surge of optimism prevailed. There was a generalized expectation that the civilian governments would be capable of extricating the economies from the recessions they were experiencing and, at the same time, of reversing the real or perceived regressive effects of the military's economic policies.

The record of the first civilian administrations shows that that optimism was unfounded.[2] Partly as a result of the legacy of massive foreign indebtedness and mounting fiscal deficits left by the military governments, and partly because the civilian administrations erred in their diagnoses and made critical policy mistakes, the recessions turned into economic crises comparable only to the depression of the 1930s.

If an analyst had extrapolated the trends of the previous thirty years, he would have concluded that the chances of consolidating democratic institutions in the mid-1980s in Bolivia, Argentina, and Brazil were slim. From the 1950s to the 1970s economic crises less severe than those of the early 1980s had invariably led to military destabilization of the incumbent civilian administrations. But notwithstanding the failure of the first-round democratic governments, and despite the deepening of economic and social crisis, democracy survived, and the likelihood of authoritarian regressions appears to be extremely low.

Especially in Bolivia and Argentina, the second-round democratic governments adopted much more drastic market-oriented reforms. Moreover, both Victor Paz Estenssoro and Carlos Menem implemented these reforms more consistently. The zealousness of the second-round presidents produced more successful results. Fiscal deficits were reduced and kept low, inflation was abated, and the level of economic activity rebounded from the recessionary depths associated with the hyperinflationary episodes of 1984–1985 (Bolivia) and 1989 (Argentina).

Brazil's second-round president, Fernando Collor de Mello, also launched a promarket program. The measures he initially applied, however, were much more heterodox in nature. Later he moved more decisively in the direction of economic adjustment and privatization. But at that point, his honeymoon with the Brazilian people ended, and the political class turned overwhelmingly against his imperial style of political management. Economic indicators again began to deteriorate sharply, and Collor was impeached for corruption and finally expelled from office in 1992.

The considerable successes of Paz Estenssoro (and his successor Jaime Paz Zamora) and Menem in adjusting the economies of their countries have helped to popularize the idea that trends toward political democratization and a greater role for markets in the economy are congruent. Brazil's experience seems to support the same idea: shakier democratic regimes have been associated with trepidation in introducing market reforms. Democracy, associated with "less state" in politics, appears to consolidate more firmly where

there is also "less state" in the economy, that is, when the policies of deregulation, opening of the economy, and privatization of state enterprises and services have been more fully implemented.

The analyses in this volume suggest much more complex and problematic links between democratic consolidation and market-oriented reforms. In Bolivia, Argentina, and Brazil, the political and economic transformations of the past decade have not related in linear ways and the changes have not necessarily been mutually reinforcing.

The authors of the country studies on which this chapter is based discuss how democracy has to some extent furthered market reforms, but often in a rather tortuous way. The transitions to democracy accelerated the crisis of the state-centered model that had prevailed in Argentina and Brazil since the 1930s and in Bolivia since the 1952 revolution. That crisis created the preconditions for, and also forced, democratic governments to adopt promarket strategies.

Conversely, the implementation of market reforms contributed in several ways to the stabilization of democratic governments and institutions. But market reforms were also related to the deterioration of the state and the erosion of its capacity to enforce the rule of law and maintain a monopoly on violence throughout national territories. This erosion could in turn undermine the basic foundations of the emerging democratic political systems.

Pre–World War II Evolution

The three Latin American cases in this study offer significant contrasts. During the last half of the nineteenth century and the first quarter of the twentieth, Argentina and Brazil (in Brazil, especially its central and southern regions) were among the world's most successful cases of export-led economic growth. Furthermore, the two countries were Latin America's early industrializers. In both, state-led responses to the Great Depression—import substitution, the closing of the economy, and the extensive regulation of capital and labor markets—were initially effective responses to the changes in the international economic system. Argentina was among the few debtor countries that did not default on their foreign loans in the 1930s, and Brazil became one of the world's most rapidly expanding economies after World War II.

However, partly despite its success and partly because of it, Brazil transformed itself into a "dual" society. The central and southern regions expanded and modernized, while the Northeast remained (some analysts would say became) backward and was populated by an overexploited and extremely impoverished landless peasantry. During the twentieth century, and especially after the antioligarchic 1930 revolution, the Northeast provided the social basis for the emergence and consolidation of a clientelist political class. After the semidemocratizing process associated with the downfall of Getulio Vargas's

dictatorship in 1945–1946, this political class became the core of the conservative wing in each of the most important political parties and was able to secure a disproportionate share of national political power under both military and civilian governments.

This circumstance offered a striking contrast with Argentina. The expansion of capitalist agriculture in Argentina all but eliminated the remaining pockets of subsistence agriculture. Peasants might have composed the socio-electoral basis of conservative parties in the earlier stages of democratization, but their numbers rapidly dwindled. Conservative parties like the once hegemonic National Autonomous Party (PAN) ceased being a relevant factor in electoral politics during the 1920s and 1930s. The intrinsic weakness of Argentina's conservative parties contributed to the emergence of Peronism in 1945 and to the unparalleled electoral strength it enjoyed thereafter. This movement dominated Argentine politics during the next half-century, blending support from organized labor in the country's metropolitan core with that from the traditionalist elites and impoverished masses of the northern provinces.

Bolivia's historical itinerary was almost exactly the reverse of those of Brazil and Argentina. During colonial times the region (then known as Alto Peru) thrived on the export of silver and the exploitation of Indian serfs. After independence, with the collapse of silver prices and continuous internal strife, the country's economy lagged; tin later became its sole significant, albeit modest, export. This period of feeble export growth provided only a fragile foundation for post–World War II inward-oriented development. Bolivia never developed a significant manufacturing sector, as Brazil and Argentina did. Neither the industrial bourgeoisie nor the urban working class emerged as significant social actors. In fact, the mine workers, led by militant left-wing groups (mainly of Trotskyite leanings), were the political core of the country's proletariat. Modern agriculture was limited, and Indian subsistence peasants remained the large majority of the predominantly rural population.

As Eduardo Gamarra recounts, traditional oligarchic rule predominated in Bolivia until the mid–twentieth century (Nelson 1994). In 1952 a nationalistic and reformist revolution nationalized the tin mines, decreed an extensive agrarian reform, and all but disbanded the national army. The new regime headed by the Movimiento Nacionalista Revolucionario (MNR) lacked, however, the expansive and transforming capabilities of Brazil and Argentina's populist governments oriented toward state-driven development in the 1945–1965 period. The MNR soon splintered, and by the early 1960s the Bolivian political system lost its capability to incorporate the popular sectors. Economic growth was not dynamic, and Bolivia's version of state developmentalism was almost exclusively dependent on expanding public employment (based on deficit financing), generalized political corruption, and redistributive policies. These practices undermined the state's financial capabilities without significantly

contributing (through the expansion of demand) to economic growth and productive investment.

The State-centered Model

As we have indicated, Bolivia, Argentina, and Brazil were extraordinarily different in terms of historic trajectories, social structures, and economic dynamism. However, the three countries shared the features of what we define as a state-centered model. This model developed earlier and in more potent variants in Brazil and Argentina than in Bolivia. In the latter the state-centered model was the product of the late "agrarianist" and nationalistic 1952 revolution. Within this model, several aspects of state economic intervention were significant: (1) direct productive undertakings, (2) the running of basic services and utilities, (3) the regulation of relations between capital and labor, (4) the protection of domestic manufacturing and other import-substituting economic sectors, and (5) the taxing of export-oriented activities.

But the state-centered model was not limited to the economic dimension; it also had a political element. The state's economic roles depended on, and in turn reinforced, a mode of political organization in which interactions among social groups were mediated through state channels. The state's political interventions within this model were seldom institutionalized. They shaped, and were shaped by, patterns of behavior of the major private actors who shunned explicit or institutionalized forms of bargaining. In the state-centered political model, both individual and collective actors tended to favor the state's adoption of discretionary patterns of decision making. At the same time, however, the implicit consensus enjoyed by the state was tenuous: it was based largely on its capacity to distribute rewards. Neither authoritarian rulings from above nor conflict settlement attained through representative institutions managed to turn into effective mechanisms for securing reliable compliance from private actors.

The prevailing pattern of statist politicization undermined the strength and stability of representative institutions. Nevertheless, the operation of electoral democracy was never completely abolished in any of the three countries. The weak democratic mechanisms were intermittently, albeit systematically, used to exert pressure upon public decision making.

The state-centered model was quite successful in promoting dynamic economic growth in several countries, especially Brazil. But the sectors promoted by the model were nevertheless dependent on key resources from abroad, and they showed only limited flexibility in adapting to the changes in the international economy. They were especially vulnerable to the dislocations of the late 1970s and 1980s.

As Bolívar Lamounier and Edmar Lisboa Bacha argue for the case of Brazil,

one of the characteristics of the inward-looking economic approach of the state-centered model was the permanent lack of macroeconomic equilibrium (Nelson 1994). Inflation systematically exceeded international rates and almost continuously tended to higher levels. In fact, Carlos Díaz-Alejandro's assessment of the post–World War II Argentine economy could well be extended to the other two cases:

> Even when prices reflected, on average, social opportunity costs, their erratic movements induced by policy changes and by inflationary conditions increased uncertainty and deprived such signals of a great deal of their usefulness. A situation developed where neither coherent planning nor the price mechanism was used to allocate resources rationally (Díaz-Alejandro 1970:115).

The lack of equilibrium generated, and in turn was nurtured by, a pendular pattern of economic policy making: orthodox stabilization policies to stop inflation and reequilibrate the balance of payments and fiscal accounts alternated with reactivation policies intended to increase production and reduce unemployment.[3] Within this seesaw approach, however, the prevailing logic was always to pursue the established strategy of import substitution under the various umbrellas of state promotion and tutelage. The specific ways in which sectoral interests were woven together within the state-centered model precluded the possibility of retrenchment or basic changes of course. Lamounier and Bacha's assessment of General Ernesto Geisel's economic strategy in Brazil could apply to almost every government in the region using the state-centered model: the high-growth strategy "precluded timely adjustment even through a temporary retrenchment, favoring instead the *fuite en avant* strategy."

In fact, the statist-inflationary pattern of conflict settlement and intermittent military rule were essential aspects of the logic of state-centered development in Brazil, Argentina, and Bolivia. We will examine these issues more carefully.

The State-centered Model, Inflation, and the Military

Inflation was an intrinsic aspect of the operation of the state-centered model. Inflationary mechanisms "lubricated" the transition into the postoligarchic era. The democratizing trends of the first half of the twentieth century had rendered virtually obsolete the traditional political patterns used by oligarchic regimes for containing and submerging conflict. The modernizing but still deeply divided societies of Latin America had enormous potential for conflict.[4]

Thus, inflation provided an "invisible" mechanism for resolving divisive distributive conflicts.[5] It also enabled state agencies to cope with conflicting interests while avoiding severe repression, especially of labor demands. Inflation allowed the state to partially mask the zero-sum nature of the distributive game. For example, the export sector, the urban landlords, and the future beneficiaries of the social security system often became the losers in the price race as a result of price freezes, exchange rate manipulation, or similar mechanisms. Owners of manufacturing firms, their workers, and the undertaxed middle class gained accordingly.

As Adolfo Canitrot (1979) has argued, wage bargaining was a typical example of the implicit covenants negotiated under the mantle of inflation. Urban workers in the heavily protected manufacturing sector were the beneficiaries. Managers yielded to union demands rather than face the risk of stoppages and other forms of work disruption. Then they transferred the costs to consumers, who had no choice but to buy the more expensive and often lower-quality domestic commodities. One of the distinctive features of this pattern of accommodation was that, except for largely ritualistic bargaining procedures, management and the unions did not engage in direct negotiations. Instead, there were two pairs of one-to-one negotiations; in each of them, state agencies and officials bargained separately with both sides.

The lubricating effect of inflation was possible, however, only if prices rose at a "moderate" pace of less than 40–50 percent a year. So long as inflation remained moderate, markets were distorted but could still be regulated; relative losses were significant but not so great as to force losers out of business. Nor were the taxing capabilities of the public sector irreparably damaged.

In a more general sense, moderate inflation reflected widespread, albeit shaky, confidence in the political authorities to manage economic variables and especially to enforce the value of domestic currencies. This confidence waned during the 1970s and collapsed in the early 1980s.

The loss of control over inflation signaled the crisis of the state-led growth model. The shift from moderate to high inflation was spurred by the devices and tactics used by firms and individuals to shield themselves from the effects of inflation, including dollarization, indexation, and ever-shorter contracts. In different ways, each of these mechanisms severely reduced the effectiveness of the traditional tools of economic policy making.

Fiscal pressures also fed inflation. The state-led model required high investment in state enterprises and loans and subsidies to private industries, as well as the usual government expenditures for education, health, social security, the military, and the system of justice. Increased popular political participation led to demands for higher social expenditures. The government could not raise sufficient taxes to finance both increased social expenditures and the requirements of state-led industrialization. In addition, populist

policies caused price adjustments for state enterprises to lag behind inflation.[6] Growing financial deficits in those enterprises began to require massive transfers from the government. The proximate cause of accelerated inflation was the increase of runaway government expenditures that were being financed by the central banks. Moreover, by the 1980s, those government expenditures no longer included large investments in industry and infrastructure.

Although inflation had long been high in Brazil, Argentina, and Bolivia compared with international standards, it topped the 50 percent level only with the onset of the deep fiscal and political crisis that made the continuation of the state-led model impossible. It is worth emphasizing, however, that the patterns of acceleration revealed by annual consumer price indexes varied sharply among the three countries. In Brazil, from the early 1970s average annual inflation steadily and significantly increased from each presidential term to the next. In fact, inflation and the degree of political opening were positively correlated after the 1974 transfer of government from the hard-liner General Emilio Garrastazú Médici to the *aperturista* General Geisel. Under the first two civilian administrations of José Sarney and Fernando Collor de Mello, acceleration became particularly rapid.

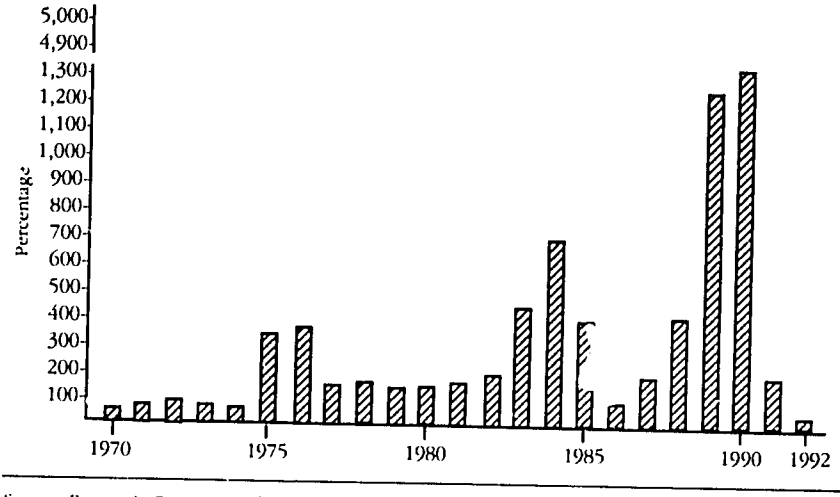
Trends in Bolivia, and especially in Argentina, contrasted significantly with Brazil. Both countries experienced ever more extreme cycles of accelerating inflation followed by abrupt but ephemeral price stabilizations. After the hyperinflations of 1984–1985 (Bolivia) and 1989 (Argentina), however, inflationary rates seem to have been more stably reduced to yearly averages below 25 percent (see Table 3.1 and Figures 3.1, 3.2, and 3.3).

TABLE 3.1
Inflation in Argentina, Bolivia, and Brazil, 1970–1992 (percentage)

Year	Argentina	Bolivia	Brazil	Year	Argentina	Bolivia	Brazil
1970	21.6	3.8	17.7	1982	209.7	296.5	100.3
1971	39.1	2.3	18.1	1983	433.7	328.5	178.0
1972	64.2	23.6	14.0	1984	688.0	2,176.8	209.1
1973	43.9	34.8	13.7	1985	385.4	8,170.5	239.1
1974	40.1	39.0	33.8	1986	81.9	65.9	58.6
1975	334.8	6.0	31.2	1987	174.8	10.6	396.0
1976	347.1	5.5	44.8	1988	387.7	21.5	994.3
1977	150.4	10.5	43.1	1989	4,923.8	16.6	1,779.1
1978	169.8	13.5	38.1	1990	1,343.9	17.1	1,794.8
1979	139.7	45.5	76.0	1991	171.7	21.4	440.8
1980	87.6	23.9	95.3	1992	24.9	21.0	1,146.6
1981	131.3	24.6	93.5				

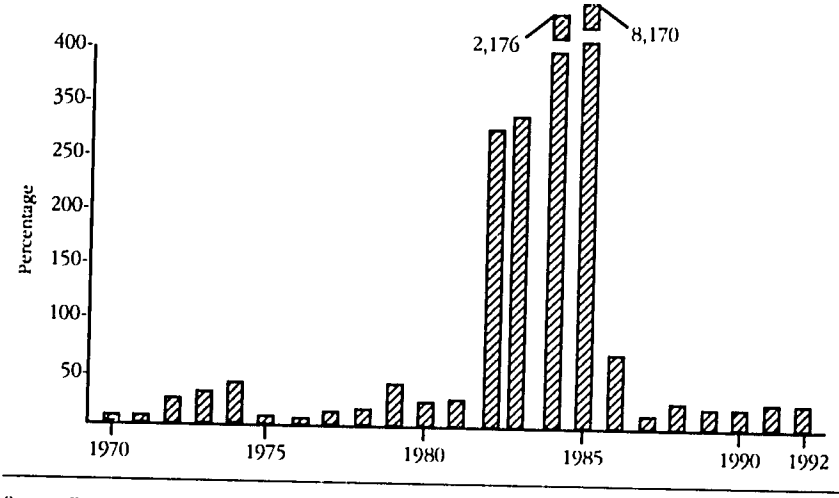
Source: Economic Commission for Latin America and World Bank.

FIGURE 3.1
Consumer Price Index in Argentina, 1970–1992 (annua' average)



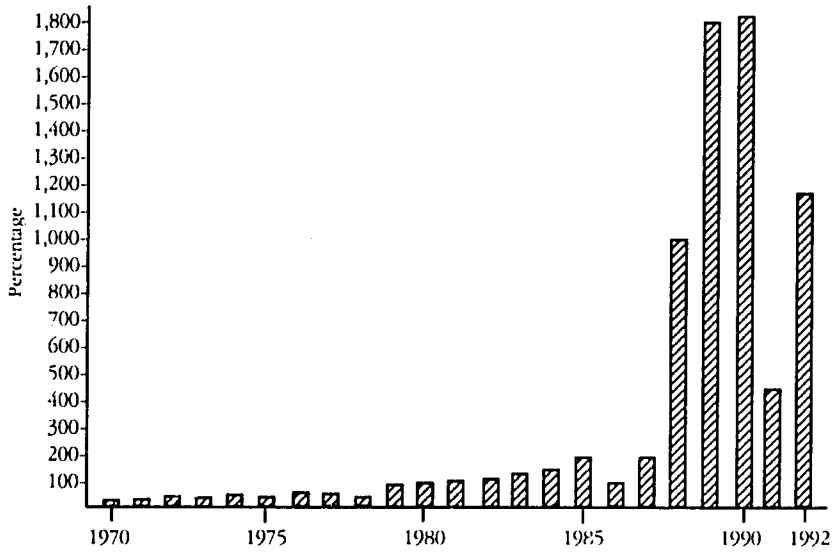
Source: Economic Commission for Latin America, World Bank, and International Monetary Fund.

FIGURE 3.2
Consumer Price Index in Bolivia, 1970–1992 (annual average)



Source: Economic Commission for Latin America, World Bank, and International Monetary Fund.

FIGURE 3.3
Consumer Price Index in Brazil, 1970–1992 (annual average)



Source: Economic Commission for Latin America, World Bank, and International Monetary Fund.

The dissimilar inflationary patterns of Brazil, on the one hand, and Bolivia and Argentina, on the other, suggest important variations among the specific political models of the three countries. Cyclical eruptions of inflation in Bolivia and Argentina were manifestations of chronic political instability. Since the late 1950s in Argentina and the late 1960s in Bolivia, both military and civilian governments have tended to collapse after brief initial periods of relatively high popular support. The eclipses of these governments coincided with the erosion of public confidence in the stability of the national currency. Confidence was temporarily and partially restored by each successor government, somewhat lowering inflation and starting another cycle of initially successful, but later aborted, stabilization.[7]

In contrast, the more gradual and less cyclical evolution of post-1950 Brazilian inflation partly reflected the more uniform presence of the military in this country's politics. Constant military tutelage became a major feature of postwar Brazilian politics. Beneath the surface of institutional instability prevailing in the 1950s and early 1960s—evidenced by the episodes of largely successful military pressure of 1954, 1955, and 1960–1961—civilian rule tended to blend, not without some obvious roughness, with an evolving pattern of military guardianship (to use Alfred Stepan's words). These types of arrangements

were not completely abolished when the military took power in 1964. When the army high command inaugurated two decades of authoritarian rule, it did not entirely do away with elections, and those elections were largely free of fraud. Moreover, civilian politicians were not entirely displaced. This pattern of rule was associated with relatively high effectiveness in setting and implementing economic policy goals. Under the military regime, the Brazilian economy not only avoided the calamities the Bolivian and Argentine juntas brought upon their subjects, but also grew rapidly from the mid-1960s to the early 1980s and considerably modernized its agricultural sector as well as deepening industrial development.

Nevertheless, as we have already suggested, during the twenty-year military period, the capacity of the armed forces to rule effectively was gradually but steadily eroded. Unlike Bolivia and Argentina, however, Brazil never became completely ungovernable. The avoidance of extreme economic destabilization and recession may be a mixed blessing for contemporary Brazilian society. The population in general, and the major economic actors in particular, developed adaptive behavioral patterns partly shielding them from the most negative effects of economic instability. But the resilience of these defenses against inflation reinforced the spiral of instability affecting Brazil since the return of civilian rule.

Argentine and Bolivian military regimes proved much less successful than their Brazilian counterpart in managing their countries' economies before the democratic transitions of the 1980s. In both countries the military tended to be deeply fragmented, at least from the 1950s onward. As a result, the armed forces were as effective in destabilizing their own governments as they were in removing civilian administrations. Each round of political instability resulted in growing ungovernability and in increased risk of economic chaos. Both countries finally fell into hyperinflation after the transitions of the 1980s. But it would be unfair to blame the newly elected leaders more than their predecessors. Hyperinflation and the destruction of political authority associated with it were largely the result of cumulative processes of erosion of public confidence and repeated implosions of the policy-making mechanisms since the 1960s.[8]

The political incompetence of the Bolivian and Argentine military has certainly minimized the possibility of their return to power in the foreseeable future. But their dismal performance as rulers (or as builders of political alternatives to their rule) has had a more profound, and probably longer-term, effect. It has also helped to highlight the bankruptcy of the more encompassing political formula of which they were part.[9]

Contrasts between Bolivia and Argentina, on the one hand, and Brazil, on the other, suggest a striking paradox. The state that was the most effective in promoting economic growth under the state-centered model, Brazil, is proving to be the most incompetent in reforming the already exhausted system. Brazil

has already gone through two rounds of democratic governments without being able to break away from the syndrome of ever-increasing inflation and greater destruction of political authority. In contrast, the second-round presidents of Bolivia and Argentina laid down the foundations of thus far more successful market reforms.

Post-Transition Patterns

The First Round: Democratization and Aborted Stabilization Attempts

The collapsing state-centered model left a triple legacy: the delegitimation of authoritarian government and the military; unstable economies; and a general crisis of the state (and thus of any form of government). In all three countries considered here, the first democratic presidents could neither avoid nor overcome the traps associated with that legacy. Especially in Argentina and Bolivia, the first civilian presidents embodied the moral rejection of the military governments and of their policies. They failed to perceive that the mere reversal of the policies adopted by the authoritarian regimes would not be enough to overcome the crisis. Ultimately, as Adolfo Canitrot and Silvia Sigal concluded about Alfonsín, the new democratic regimes denied the crisis (Nelson 1994).

Whether they were intrinsically weak, like Hernán Siles Zuazo, or they enjoyed for a time greater levels of social support and legitimacy, like Alfonsín and to a lesser extent Sarney, the three first presidents barely managed to complete their constitutional terms.[10] In all three cases, the intensification of the economic crisis—including hyperinflation in Bolivia and Argentina—was the main cause of their failure.

In varying degrees the first-round presidents were psychological and political captives of the state-centered model. They failed to clearly perceive that the new context rendered state-centered policies and populist reflexes counterproductive. They were also subject to unrealistic popular expectations. Much of the population—especially organized labor and the middle classes—believed that democracy would painlessly correct the economic difficulties and compensate them for the losses they had suffered during the authoritarian period.

In both Argentina and Brazil, the new governments soon realized that they had to reduce inflation drastically. The stabilization programs they launched, however, rested on the heterodox assumption that anti-inflationary policies and the required fiscal adjustment could be implemented without a recession (or with only a minor one) and without a drastic shrinking of the state. Argentina's 1985 Austral Plan and Brazil's 1986 Cruzado Plan had some initial

success in bringing down inflation and in generating mild economic recoveries. But neither Alfonsín nor Sarney really believed that a structural reform of the state was required. Thus, the window of opportunity opened in 1985–1986 was closed. The heterodox plans rapidly lost effectiveness, and the economic indicators soon deteriorated again.

The collapse of the Austral and Cruzado plans also radically undermined the political reforms envisioned by Alfonsín's and Sarney's party associates.[11] Their goal had been to found viable party systems, reversing their countries' tradition of feeble parties and institutional instability. More specifically, they intended to establish the Unión Cívica Radical (UCR) and the Partido Movimiento Democrático Brasileiro (PMDB) as the dominant players in the new game. The abortion of the economic reforms, however, thwarted that possibility; the UCR and the PMDB both were thoroughly defeated in the following presidential elections.

The dismal failure of the first post-transition party governments seriously eroded the attempt to reorganize national political life around the predominance of political parties. Every party was negatively affected by the failure of the *radicales* and the *pemedebistas*; the credibility of party governance itself was seriously undermined in the late 1980s.

Bolivia's first democratic government also ended in economic disaster, including devastating hyperinflation. The circumstances, however, were quite different, and so was the political impact of the economic debacle. Siles never had a chance. Despite repeated initiatives, Siles's government could not launch a credible economic program. As Gamarra notes, Siles was opposed by every organized sector of Bolivian society: the military, the labor confederation (the COB), and the private sector led by the Confederación de Empresarios Privados de Bolivia (CEPB) (Nelson 1994). The party alliance supporting Siles (itself badly splintered since 1983) had only a minority of seats in Congress, which remained firmly under the control of a de facto alliance between Paz Estenssoro's MNR and Hugo Banzer's Acción Democrática Nacionalista (ADN).

In 1984–1985, when political conflict and the economic crisis reached its peak, most Bolivians blamed labor and the left—especially the Communists and Siles's own party, the Movimiento Nacionalista Revolucionario de Izquierda (MNRI). In contrast to Brazil and Argentina, where the entire political class was discredited as a result of economic calamities, in Bolivia the blame was more targeted. As a consequence, the radical policy change in the Andean country did not require a major shift in the preferences of voters, while it did in Argentina and Brazil. Especially in Brazil, the shift signaled by the 1989 elections amounted to an electoral earthquake.

In all three cases, however, the elections leading to the installation of the second-round democratic governments involved more than a mere changing of the guard. In fact, the replacement of one party, or party coalition, by

another coincided with a more fundamental shift in the way the majority of the people approached politics. The successive failures of military and civilian governments—including their destructive impact on the routines of everyday life—fueled widespread disillusion with solutions coming from, or proposed by, political authorities. There was, in short, a generalized collective retreat from politics.[12]

The retreat from politics proved to have ambiguous effects. On the one hand, it expanded the acceptance (or at least the acquiescence) of the public toward policies aimed at radically shrinking the spheres of action of, and regulation by, the state. On the other hand, it contributed to the weakening of the informal rules, and even the moral consensus, upon which both government and society are ultimately based.

The depoliticization of the mid- and late 1980s thus implied the reversal of the trends of statist politicization that had prevailed for several decades. It opened space for the implementation of radical reforms in the direction of less state and more market. But it also generated a novel challenge: that of devising means or channels of political support for the long-term consolidation of market reforms. How this space was used by the new leaders of the three countries and how the challenge is being met help to explain the different trajectories followed by the three countries during the most recent years.

The Second Round: Different Political and Economic Routes

As we have discussed, the first post-transition governments in Argentina, Bolivia, and Brazil each ended in economic and political debacle. Although Bolivia and Argentina were more extreme cases of hyperinflation and political void, the Brazilian collapse of the late 1980s was in a way more dramatic: it put an end to almost half a century of state-centered growth, as well as to the national optimism that had prevailed among both elites and the middle classes.

Democratic regimes confronted with deep economic crises were not new to Latin America. This time, however, the outcome was novel. The loss of prestige of presidents and their parties, the weakening of the entire party system in both Argentina and Brazil, and the ensuing ungovernability did not result in political breakdown. Neither the elites nor the public seriously entertained the possibility of military coups; instead, they turned to the polls to reject the incumbents.

In Bolivia in 1985 and Argentina in 1989, the newly elected, second-round democratic governments introduced a second novelty: vigorous and creative stabilization measures combined with strong and sustained structural reforms. At one level of analysis, sheer political survival demanded halting the evaporation of the national currency and restoring minimal capacity to manage the economy. More fundamentally, as the Argentina study in particular notes, many economists and some politicians had learned from past experiences. Miguel

Kiguel and Nissan Leviatan's study of hyperinflation in Latin America captures the changed perspective:

> The persistence of inflation [in the cases studied] is linked to the inability of the authorities to convince the public that the [stabilization] programs could sustain low inflation on a long term basis. . . .
>
> Policy makers needed to continuously demonstrate their commitment to the stabilization program, and in most cases this task required the adoption of a comprehensive set of policies which went beyond restoring fiscal balance on a short or medium basis. Programs could not be credible unless they frontally attacked the structural features that gave rise to an inflationary economy: namely addressing the deficits of the public enterprises, reducing the size of the public sector, and introducing institutional reforms to restore control over the money supply process (Kiguel and Leviatan 1992).

Ordinary people in Bolivia and Argentina had also gradually grown disillusioned with the old state-centered model system, as the economy sputtered and the state's capacity to deliver even the most basic governmental services and functions dwindled. The crucial factor creating popular acceptance of the new strategy, however, was hyperinflation. In Bolivia in 1985 and Argentina in 1989, the extreme uncertainty and the collapse of normal life patterns caused by hyperinflation opened a window of political opportunity. Much of the public now not only accepted but demanded strong government action, including market-oriented reforms.

Indeed, the searing experience of hyperinflation created surprisingly long-lasting public tolerance for deep reforms. In Argentina, Menem's first economic program succeeded only temporarily in halting hyperinflation; later economic teams adopted more draconian measures that were widely supported despite recession and increased unemployment. And in Bolivia, the reforms introduced under the Paz Estenssoro administration were sufficiently well accepted that all three major candidates for president in the subsequent election in 1989 campaigned on platforms of continuing the approach.

In both Bolivia and Argentina, the course of basic reform was eased not only by elite and popular acceptance, but also by strong political bases. Both leaders had had long careers within the quintessential state-centered, model parties in their respective countries. Paz Estenssoro was the founder of the MNR and the architect of the 1952 revolution; Menem had been a leading Peronist politician since the early 1970s, when he first became governor of the province of La Rioja. Furthermore, although they designed their economic policies with virtually no effective involvement of Congress and political parties and implemented them in a strict technocratic fashion, both Menem and Paz Estenssoro enjoyed solid parliamentary majorities.

Skillful political manipulation of party loyalties permitted each to maintain support in party and legislative circles, even as they pursued measures

antagonistic to their respective parties' traditions and ideologies. Although Paz Estenssoro did not even win a plurality in the elections of 1985, he engineered an alliance between his own and Banzer's party guaranteeing legislative backing for his draconian economic measures and for swift repression of the rebellious unions. In Argentina, Menem promised a wage boost during the presidential campaign. But he then successfully cajoled and seduced Peronist party and union leaders to follow him when he explicitly abandoned the nationalist and statist tenets traditionally held under Peronism and embraced a promarket program including sharp curtailment of state services and subsidies and extensive privatization. The Peronists held majorities in both houses with the support of minor provincial parties, and Congress rubber-stamped the presidential directives.

In Brazil, events took a different course, but the Brazilian story reinforces several of the points that grow out of the Bolivian and Argentine experience. Brazil's history of extraordinary economic growth led Brazilians to be particularly reluctant to interpret recent economic problems as evidence that the old formula no longer worked. Furthermore, Brazil had developed sophisticated indexation mechanisms that diminished the costs of inflation for individuals and firms. Kiguel and Leviatan suggest that "the fact that the hyperinflation in Brazil did not bring about a collapse of the economy can explain why the required reforms of the economy are still postponed. Thus the economy became a captive of its own inflation-mitigation technology." In contrast to Paz Estenssoro's and Menem's situations, and despite a growing consensus in technical circles by the late 1980s, Collor's economic reform initiatives were hampered by the absence of a broad popular conviction that fundamental economic changes were imperative.

In addition, Collor faced a second crippling handicap: the absence of a strong party base. He was a newcomer to national politics, and his own party controlled less than 5 percent of the parliamentary seats. He had little bargaining power in relation to the major parties—the PMDB and the Partido Frente Liberal (PFL). More broadly, the entire political arena was in flux. As Lamounier and Bacha note, while the two largest parties had won 70 percent of the seats in Congress in the 1986 legislative elections, the combined vote for their presidential candidates totaled less than 10 percent in 1989. In fact, none of the three top vote getters in that year's elections—Collor, the union leader Lula, and Leonel Brizzola—enjoyed a solid party base.

Despite the traditional image of Brazil as having a strong state, by the early 1980s its coherence and power had dwindled under what Bacha and Lamounier describe as "the multiple pressures of an emerging mass democracy, of a huge electorate, of a new generation of independent and aggressive labor leaders, of states and local governments demanding a larger share of the budget, and all of this at a time when the public sector could not invest and the labor markets could hardly accommodate pressures via upward mobility" (Nelson 1994). In

short, both Collor's specific political weaknesses and the far broader crisis of the state in Brazil undercut efforts at economic reform.

Collor's own corruption, of course, brought down his administration at the end of 1992. Yet especially in the context of constitutional debate and state crisis, the manner in which Brazil dealt with this "awkward, imperial, and corrupt" president (as Lamounier and Bacha describe him) was encouraging for the prospects for democracy. In sharp contrast with the executive domination typical of both military and civilian governments under the state-centered model, in 1992 the Brazilian Congress and the judiciary fully exercised their constitutional prerogatives in judging and dismissing the president. Moreover, throughout the whole impeachment process various segments of Brazilian civil society were actively and peacefully involved, and they fully supported the procedures.

While Collor's impeachment was a victory for democratic procedures, Brazil continues to face a complex and profound crisis of governability. As noted earlier, the partial consensus on economic strategy that emerged in Argentina and Bolivia has not yet clearly gelled in Brazil. Moreover, owing partly to its far greater size and complexity, Brazil is simultaneously struggling with fundamental questions regarding the form of government, including the electoral system, the relationship of legislature and executive, and major aspects of the design of the federal system. If secessionist pressures are to be taken seriously, there are even challenges to the integrity of the state itself.[13]

Future Challenges

In varying degrees Argentina, Bolivia, and Brazil continue to face the double challenge of completing still partial and insecure economic restructuring while strengthening fragile democratic institutions. Crucial to both goals is a third: restoring the fundamental capacities of the state while altering its economic and political roles.

In Argentina and Bolivia, fiscal deficits that drive inflation have been largely contained, but this has been accomplished in part with one-time revenues from privatization and with unsustainable cuts in basic government expenditures. Still largely unaddressed is the reform (probably including down-sizing) of the government itself—a challenge complicated not only by powerful public sector unions, but also by the still-extensive use of patronage to help incumbent governments co-opt opponents and assemble power to undertake other reforms.

Aspects of the economic reforms themselves have created new problems. As Canitrot and Sigal note, stabilization through a fixed nominal exchange rate in Argentina raises questions of credibility and may interfere with domestic price mechanisms (Nelson 1994). Privatization also raises questions. In Argentina

rapid and extensive privatization has produced a "ring of monopolistic public services around the state." In Bolivia there is concern that privatization (thus far fairly limited) will further concentrate wealth and political influence.

Meanwhile private investment is still sluggish (in Bolivia) or skittish (in Argentina), reflecting lingering doubts regarding the continuity of policy and political stability, plus lack of confidence regarding ability to compete in an open economy.

At one level continued rapid economic reforms may be crucial, not only to supplement and begin to derive gains from measures already taken, but also to protect democratic politics. The state-led model became unpopular when the fiscal crisis created not only economic instability but also scarcity in state-provided goods and services, owing to the lack of investment in state enterprises and also to their inefficiencies and management problems. The danger for the new democracies in Latin America is that the now-unpopular state-led model may become identified with democracy if the democratic regimes do not distance themselves from that model and its failings rapidly enough.

At a different level, however, there are tensions between economic reforms and democratic consolidation. Economic reforms in all three countries have required concentrated executive authority. Yet in all three, constructing and maintaining political authority has become an increasingly intractable task. In Bolivia and Argentina, Paz Estenssoro and Menem successfully parlayed considerable personal power into impressive state authority to conduct economic reforms. But as Gamarra, Canitrot, and Sigal note, it is not clear whether these arrangements will remain ad hoc and dependent on specific personalities and conjunctures or can be transformed into more durable institutional changes (Nelson 1994).

Moreover, in all three countries (though only briefly in Brazil), central authority has been generated by reducing the power or influence of other institutions and players crucial to democratic politics: legislatures, parties, the judiciary, and unions. Arguably, only some segments of business have maintained or increased their influence in shaping policy. Autocratic tactics have contributed to a paradoxical trend in public opinion: while support for democracy is higher among ordinary people and major interest groups than at any time in the past, only small minorities indicate respect or approval for parties and legislatures.

As elections approach and the acquiescent mood generated by economic crisis fades, governments may have to consult and negotiate more intensively with legislatures and key interest groups in order to maintain and deepen reforms. A less autocratic approach will require not only changed government tactics, but also changes within civil society—unions, business associations, and political parties—as these adjust to the dismantling of the state-centered model and the emergence of new economic and political rules. Thus far, despite considerable reform pressures within major political parties and some unions, changes in internal structure and agendas have been limited.

Both economic and political challenges raise a third set of issues, to some extent separate but also entwined with the first two. The functions of the state itself need to be redefined and revitalized. Liberalizing the economy and privatizing state enterprises entails dismantling old regulations and activities, but also calls for redefining appropriate regulatory roles, most urgently with respect to monopolistic public services. A market-friendly environment also requires well-functioning basic public services and institutions, ranging from roads to courts. Both sustainable growth and sustainable democracy require the immediate reform and revival of long-deteriorating health and education sectors. Fiscal reform will require building much more capable collection capabilities and altering age-old elite attitudes regarding tax responsibilities. It will also demand rethinking the role of the state with respect to social security and welfare. Especially in Argentina, rethinking social welfare and liberalizing labor markets mean a basic change in the relations between the state and labor unions. In all three countries, the division of responsibilities and powers between central and lower levels of government is also in flux. Neither economic recovery nor democratic consolidation can be achieved without redefining and revitalizing the state.

Notes and References

Chapter 2, "The Transition in Bulgaria, Hungary, and Poland: An Overview"

Notes

1. We use the term "communism" in a descriptive sense, referring to political regimes operating in Eastern Europe from the late 1940s to 1989, which were dominated by the Communist party. Eastern Europe refers, for brevity, to postcommunist Europe outside of the former Soviet Union.

2. This chapter is based on the three country studies that appear in *A Precarious Balance: Democracy and Economic Reform in Eastern Europe*. Authors of the country studies are Jacek Kochanowicz (Poland), András Köröseny i (Hungary), and Ekaterina Nikova (Bulgaria).

3. We cannot enter into a debate on the definition of "democracy" and in particular whether an unstable democracy can be treated as a "real" one. There are strong reasons, however, to accept a narrow definition (see Huntington 1991: 6).

4. See Skocpol 1979: 33–40 and Rueschemeyer et al. 1992: 12–26 on comparative historical analysis.

5. In fact, among the transforming postcommunist economies, so far only Czechoslovakia has avoided acute fiscal problems. After the split from Slovakia, the Czech Republic may be the only fiscally sound economy in the whole region.

References

Chirot, Daniel. 1989. *The Origins of Backwardness in Eastern Europe*. Berkeley: University of California Press.

Huntington, Samuel J. 1991. *The Third Wave: Democratization in the Late Twentieth Century*. Norman: University of Oklahoma Press.

Nelson, Joan M., ed. 1994. *A Precarious Balance: Democracy and Economic Reform in Eastern Europe*. San Francisco: ICS Press for the International Center for Economic Growth.

Rueschemeyer, Dietrich, et al. 1992. *State and Market in Development*. Boulder: Lynne Rienner Publishers.

Skocpol, Theda. 1979. *States and Social Revolution*. Cambridge: Cambridge University Press.

Chapter 3, "Economic and Political Transitions in Latin America: The Interplay between Democratization and Market Reforms"

Notes

1. This chapter is based on the three country studies that appear in *A Precarious Balance: Democracy and Economic Reform in Latin America*. Authors of the country studies are Adolfo Canitrot and Silvia Sigal (Argentina), Eduardo Gamarra (Bolivia), and Bolívar Lamounier and Edmar Lisboa Bacha (Brazil).

In the case of Brazil, the military successfully resisted the demands for *diretas já*, that is, the social protests in favor of direct presidential elections. Thus, the first civilian president was elected by Congress, where the Social Democratic party (PDS), the promilitary party, enjoyed a solid majority. Nevertheless, a split within the PDS paved the way for the victory of the opposition candidate, Tancredo Neves. Neves died before assuming office, and the vice president–elect, José Sarney, became the first civilian president in more than two decades.

2. In the companion volume we refer to the administrations of Hernán Siles Zuazo (Bolivia, 1982–1985), Raúl Alfonsín (Argentina, 1983–1989), and José Sarney (Brazil, 1985–1990) as the first-round democratic governments.

3. Until the mid-1970s, orthodox stabilization was associated with currency devaluations and subsequent wage and salary freezes.

4. It could be argued that in Brazil and Argentina the post-1930 strategies of the elites were largely designed to preempt conflict through the controlled incorporation of the masses into the polity.

5. Inflation became a functional mechanism within what Roberto da Matta (1981: 141) has insightfully described as conflict-averse societies. This does not mean that conflicts did not materialize within those societies. On the contrary, conflicts were both abundant and multidimensional in the increasingly complex state-centered societies. Precisely because those conflicts were so threatening, there emerged patterns of indirect and arbitrary settlement through state intermediation. The system depended on a degree of self-restraint among the various actors: state intervention could remain effective precisely because the major actors usually refrained from violence or other extreme forms of economic or political behavior.

6. Albert Fishlow has noted that in contexts of high inflation it becomes almost impossible not to let the losses of public enterprises mount. As a consequence, these losses tend to weigh more heavily in fiscal deficits.

7. In Argentina, however, as Figure 3.1 indicates, starting in the early 1970s inflation was lowered in the stabilization phase of each cycle but without returning to the previous lows. In this sense, the behavior of Argentine inflation is typical of a process of hysteresis. Hysteresis is a pattern of increasing disorganization defined by the irreversibility of certain trends once the initial cause of dislocation disappears.

8. The nature of this phenomenon is grasped by Gamarra in his analysis of the Bolivian experience: "The economic crisis gripping Bolivia in 1982 was the result of the collective failures of several past governments" (Nelson 1994).

9. Within this formula civilian politicians and union leaders often became the

main casualties of the game of repression and political instability. But the politicos and the *sindicalistas* were not just innocent victims; they also became adept contributors to the constant infringement of the democratic rules they helped to build. Several examples of the inherent ambiguity of the political role of labor leaders could be cited: in November 1964 Juan Lechín and other labor leaders joined with the military and factions of the MNR to overthrow Paz Estenssoro. Lechín was the president of Bolivia's labor confederation (the COB), a member of the MNR, and a former vice president of the country. In July 1966, the most powerful leaders of the Argentine labor confederation (the CGT) supported the successful military coup against civilian president Arturo Illía.

10. Both Siles Zuazo and Alfonsín were forced by the economic crises to accelerate the transfer of power to their constitutionally elected successors, Paz Estenssoro and Menem. Sarney was able to complete his five-year term but had to abandon his intention of getting the Constituent Assembly to approve a six-year mandate.

11. As we have indicated, Sarney came from the ranks of the Partido Frente Liberal (PFL), which had split from the official party under the military. It was the PMDB, however, that provided him with parliamentary support during the initial stages of his presidency.

12. Both in Argentina and in Brazil, since the mid-1980s public opinion polls have suggested that most voters are increasingly disillusioned with both civilian and military authorities.

13. Although it is not clear if they should be taken seriously, proposals for the creation of a secessionist República de las Pampas have emerged in the three southernmost, and richest, states of Paraná, Santa Catarina, and Rio Grande do Sul.

References

Canitrot, Adolfo. 1979. *La disciplina como objetivo de la política económica*. Buenos Aires: CEDES.

Da Matta, Roberto. 1981. *Carnavais, Melandros e Herois*. Rio de Janeiro: Zahar.

Díaz-Alejandro, Carlos. 1970. *Essays on the Economic History of the Argentine Republic*. New Haven: Yale University Press.

Kiguel, Miguel, and Nissan Leviatan. 1992. "Stopping Three Big Inflations: Argentina, Brazil, and Peru." National Bureau of Economic Research.

Nelson, Joan M., ed. 1994. *A Precarious Balance: Democracy and Economic Reform in Latin America*. San Francicso: ICS Press for the International Center for Economic Growth.

About the Contributors

Marcelo Cavarozzi is a professor of political science at the Facultad Latinoamericana de Ciencias Sociales (FLACSO) in Mexico City. He has been a visiting professor at Georgetown University, the Massachusetts Institute of Technology (MIT), the University of North Carolina, and the Universita degli Studi de Firenze in Florence, Italy. He received his Ph.D. in political science from the University of California, Berkeley. Cavarozzi has written extensively on political change in Latin America.

Jacek Kochanowicz received his Ph.D. in 1976 and his habilitation in 1991 at Warsaw University, where he is an associate professor of economic history. He specializes in the comparative economic and social history of Eastern Europe in the nineteenth and twentieth centuries. In 1990–1991 he was a member of the Institute of Advanced Studies of Princeton University's School of Social Sciences. He has also been a visiting professor at the University of Washington, Seattle, and the University of Chicago. Kochanowicz chairs the supervisory board of the Bank of Social and Economic Initiatives, founded to help small businesses in Poland.

Kalman Mizsei is the Pew economist-in-residence and director of the economics program at the Institute for EastWest Studies, New York. Mizsei has been a participant in the international project of the World Institute for Development Economic Research on Eastern and Central European transformations. In 1990–1991 he was deputy director of the Institute for World Economics of the Hungarian Academy of Sciences, where he served as a fellow from 1979 to 1989. From 1990 to 1992 he served as an adviser to the president of the National Bank of Hungary. He was also an expert on the International Blue Ribbon Commission for advising Hungary on economic reform in 1990.

Joan M. Nelson is a senior associate of the Overseas Development Council. She received her Ph.D. from Harvard University in 1960. She has worked with the Policy Planning Division of the U.S. Agency for International Development (AID), taught at the Massachusetts Institute of Technology, and codirected a research program at the Harvard Center for International Affairs. From 1974 to 1982 she established and directed the program in Comparative Politics and Modernization at the Johns Hopkins School for Advanced and

International Studies. Her publications include *Aid, Influence, and Foreign Policy* (1968); *No Easy Choice: Political Participation in Developing Countries* (with Sam Huntington, 1976); *Access to Power: Politics and the Urban Poor* (1979); *Fragile Coalitions: The Politics of Economic Adjustment* (1989); *Economic Crisis and Policy Choice* (1990); and *Encouraging Democracy: What Role for Conditioned Aid?* (1992).

Miguel Urrutia is governor of the Colombian central bank. He has held positions in the Colombian government, including minister of energy and director of the National Planning Department, and was manager of the Economic and Social Development Department of the Inter-American Development Bank. He has also taught at Los Andes University and the National University of Colombia, and was a fellow of St. Anthony's College, Oxford, and vice rector of the United Nations University.

Conference Participants

Rio de Janeiro Conference

Persio Arida
Amaury de Souza
João Paulo Dos Reis Velloso
Antonio Barros de Castro
Ricardo Carciofi
Catalina Smulovitz
Juan Antonio Morales

Budapest Conference

Tamás Bauer
András Inotai
Deyan Kiuranov
Henryk Szlajfer
Edmund Wnuk-Lipinski

ICEG Academic Advisory Board

Abel G. Aganbegyan
Academy of National Economy, Russia

Michael J. Boskin
Stanford University, USA

Hakchung Choo
Korea Development Institute, Korea

Rudiger Dornbusch
Massachusetts Institute of Technology, USA

Albert Fishlow
University of California, Berkeley, USA

Ernesto Fontaine
Pontificia Universidad Católica de Chile, Chile

Herbert Giersch
Kiel Institute of World Economics, Germany

Francisco Gil Díaz
Ministry of Finance, Mexico

Malcolm Gillis
Rice University, USA

Arnold C. Harberger
University of California, Los Angeles, USA

Helen Hughes
Australian National University, Australia

Shinichi Ichimura
Osaka International University, Japan

Glenn Jenkins
Harvard Institute for International Development, USA

D. Gale Johnson
University of Chicago, USA

Roberto Junguito
Banco Sudameris, Colombia

Yutaka Kosai
Japan Center for Economic Research, Japan

Anne O. Krueger
Duke University, USA

Deepak Lal
University of California, Los Angeles, USA

Yuan-zheng Luo
China

Ronald I. McKinnon
Stanford University, USA

Charles E. McLure, Jr.
Hoover Institution, USA

Gerald M. Meier
Stanford University, USA

Seiji Naya
University of Hawaii, USA

Juan Carlos de Pablo
Argentina

Affonso Pastore
Universidade de São Paulo, Brazil

Gustav Ranis
Yale University, USA

Michael Roemer
Harvard Institute for International Development, USA

Leopoldo Solís
Instituto de Investigación Económica y Social Lucas Alamán, Mexico

Frederick van der Ploeg
University of Amsterdam, The Netherlands

David Wall
University of Sussex, United Kingdom

Richard Webb
Pontificia Universidad Católica del Perú, Perú

James Worley
Vanderbilt University, USA

As Eastern Europe and Latin America pursue dramatic political and economic reforms, it is becoming clear that such reforms both support and hinder one another. Based on case studies of six countries—Argentina, Bolivia, Brazil, Bulgaria, Hungary, and Poland—this volume examines how democratic and market reforms interact.

Although each of these countries faces a unique political and social context, as a group they are attempting to answer similar questions: How fast and in what order should political and economic reforms be initiated? What are the political implications of emerging issues of equity and income distribution? How can democratic institutions be created and sustained during difficult economic periods? How each country answers these questions will have long-term consequences even outside its borders.

Understanding the links between political and economic reforms is essential if the liberalizing countries are to succeed at their daunting tasks. With its broad analysis of how such links work in the two regions, this study begins to close the gap in our knowledge.

Joan M. Nelson is a senior associate of the Overseas Development Council. Her publications include ***Encouraging Democracy: What Role for Conditioned Aid?; Economic Crisis and Policy Choice;*** and ***Fragile Coalitions: The Politics of Economic Adjustment.***

Ordering information available from ICS Press or from ICEG at the California address below.

International Center for Economic Growth

P.O. Box 7737
Panama, Zone 9
Panama

720 Market Street
San Francisco, California
94102 USA

ISBN 1-55815-356-x

9 781558 153561 9)000>

ICS Press
Institute for Contemporary Studies
San Francisco, California
1-415-981-5353 Fax 1-415-986-4878