State Economic and Social Policy in Global Capitalism

by

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Across the capitalist world in countries of varying levels of development, the 1980s and 1990s witnessed a retreat of the state from intervention in the economy reversing a trend that dates back to the Great Depression. In the advanced capitalist countries, countries led by parties of varying political colors privatized state enterprises, reduced state regulations, liberalized capital markets, and, to varying degrees, cut welfare state entitlements. In the Latin American and Caribbean economies, as in much of the rest of the less developed world, countries turned from import substitution industrialization (ISI) with high tariffs, capital market regulation, and high levels of state intervention to neo-liberal open, export oriented models.

The dominant interpretation among political and journalistic observers has been that trends toward greater reliance on the market were both products and manifestations of "globalization," the increasing economic openness of the national economies and integration of the world economy. The academic version of this view, the "hyperglobalization thesis", argues that the emergence of a single global market and global competition has eliminated the political latitude for action of national states and imposes neo-liberal policies on all governments. Proponents contend that as markets for goods, capital and, more recently labor have become more open, all countries have been exposed to more competition and the liabilities of state economic intervention and deviation from market oriented "best practices" have become more apparent because these raise the cost of production. As capital markets have become more open and capital controls increasingly unworkable, capital in these countries moves elsewhere in search of lower production costs. Thus, governments must respond and reduce state intervention to stem the outflow of capital. The hyperglobalization thesis has Marxist (e.g. Amin 1997) and neo-liberal (e.g. Ohmae 1995) proponents. For the neo-liberals, traditional social democratic policies are the targets of globalization; for the Marxists, they are the victims.

In the literature on advanced industrial societies, proponents of the hyperglobalization thesis are rare outside open economy macro-economics and business schools, as Hay (2002) points out. While it is commonplace to note that economies have become more open in the past three decades (see below), the effects of this increased openness are highly disputed. Garrett (1998) stakes out the diametrically opposed position that globalization is positively related to welfare state generosity, resurrecting the thesis that economic openness generates demands for "domestic compensation" and for productivity enhancing public goods characteristic of an earlier generation of writings on comparative political economy, particularly the work on corporatism (e.g. see Cameron 1978, Katzenstein 1985). In his comprehensive review of the experiences of twelve advanced industrial societies, Scharpf (2001) takes the middle ground arguing that countries' ability to shape macro-economic policy and intervene in the economy has been reduced in large part due to international economic integration, but that this has had a much more modest impact on countries' ability to pursue full employment, social security, and social equality. With regard to the welfare state, Esping-Andersen (1999), Pierson (2001), and Pierson and Myles (2001) contest the thesis linking globalization to retrenchment, particularly the neo-liberal version of it, citing other more important causes of stagnation and retrenchment such as changing demographic patterns, changing gender roles, the changes in the rates of return on capital relative to wage growth, and changing

sectoral and occupational compositions of the economy (also Stephens, Huber and Ray 1999, Huber and Stephens 1998, 2001).

In Latin America, the economic transformation has been much more dramatic than in advanced industrial countries. In addition, it took place in the midst of an economic crisis, which caused tremendous economic and social dislocations. At the level of political and journalistic debate, the hyperglobalization thesis is popular also. It certainly provides a convenient way to legitimize painful measures taken by governments in the process of economic opening. Academic explanations of the trend towards greater openness and reliance on markets, though, center around a combination of three factors, with different emphasis put by various authors on one or the other of these factors. First are the problems with ISI, particularly the chronic balance of payments problems, which began in the 1950s and were glossed over because of easy access to massive amounts of recycled petrodollars in the 1970s in the form of loans at floating interest rates. Second, when international interest rates began to rise in the early 1980s, at the same time as commodity prices fell, and the large international banks reacted to solvency problems of major debtor countries with a full stop of new lending, Latin American and Caribbean countries found themselves in a profound debt crisis. This debt crisis then gave heavy leverage to the international financial institutions (IFIs) that demanded stabilization and liberalization of the economies. Third, as the reforms progressed, they created their own beneficiaries and thus strong political supporters for further liberalization and privatization, mainly among the largest entrepreneurs and in the financial sector. The reactions to these pressures for reform, though, were not uniform but rather heavily shaped by domestic power distributions and political institutions.

The debate about the effects of economic opening, deregulation, and privatization is still in its beginning, given the relatively short period of time that has passed since their implementation. The record shows that Latin American and Caribbean countries experienced renewed economic growth in the 1990s, but with high volatility because of vulnerability to external shocks. Most countries made some progress in reducing poverty, but not inequality. Moreover, progress in poverty reduction in the 1990s did not even fully repair the damage done in the 1980s. Given this modest record, the main argument of the proponents of reform is that Latin America still is confronting deep structural problems of long standing, and things would be much worse without the reforms. Critics point to the high social costs of the reforms in terms of increased inequality, low human capital formation, and lack of employment in high productivity sectors. Unlike in advanced industrial countries, there is also much concern about the impact of the structural reforms on the quality of the emerging democracies.

In this chapter, we examine the evidence on the extent of economic internationalization, the interaction between domestic and international causes of policy change, and the nature of changes in state economic and social policy in advanced industrial countries and Latin America and the Caribbean. We begin by documenting, quantitatively where possible, the extent of the increase in economic internationalization in the past four decades and then proceed to an analysis of the experience of advanced industrial countries and then Latin America and the Caribbean.

Dimensions of Economic Internationalization

In this chapter, we limit ourselves to examining the economic aspects of globalization. Economic internationalization can be broken down into four dimensions: increasing integration of markets for goods and for capital, growing internationalization of production, and growing strength of supranational bodies. Both trade and capital market openness can indexed by the flows of capital or goods and services and by the barriers to flows (Table 1). For capital markets, we have data on both controls and flows. The data on tariff and non-tariff barriers are spotty for the earlier period so we have not included them. This is unfortunate because variations in trade volume across countries are not very good indicators of trade barriers, as size of the domestic market is such an important determinant of volume of trade. Due to economies of scale, small countries cannot produce a full range of goods for domestic producers and consumers and must import goods to satisfy these needs. Thus, small countries may have very high trade barriers and nonetheless have high trade flows. For instance, in the 1970s Jamaica had very high tariffs, non-tariffs barriers, and quantitative restrictions on trade, yet exports and imports were still over 70% of GDP, far higher than most European countries in the 1990s when trade barriers there were quite low (Stephens and Stephens 1986). Fortunately, we do have data on trade barriers for the EEC and six South American countries (Bulmer-Thomas 1994: 280) which, though not completely comparable to the available World Bank Data for the 1990s (http://www1.worldbank.org/wbiep/trade/TR_Data.html), do allow us to sketch variations through time and across regions.

Table 1a presents the trade and capital market data for advanced industrial countries. The index of capital controls (columns 1 and 2) varies from 0 to 4 in increments of .5, with 4 denoting complete absence of capital controls and 0 denoting the presence of all controls coded by the creators of the index (Quinn and Inclan 1997). As one can see, many countries maintained significant capital controls in the Golden Age of post war capitalism but by the 1990s only a few countries retained any controls. The change in actual flows of capital is even more dramatic with both flow measures increasing more than eight fold from the 1960s to the 1990s. By contrast, the trade flows increased modestly, by 30%. The change in tariff protection was also less dramatic than in the case of capital controls, with EEC/EU external tariffs varying from 1 to 19% depending on the sector circa 1960, to 1 to 5% in 1999. Across all sectors, the advanced industrial countries imposed average tariffs of 4% in 1999. Our spotty evidence indicates that the corresponding figure would have been around 10% in 1960.

Table 1b present similar data for Latin America and the Caribbean. With regard to trade, most countries register significant increases in trade flows, though there are some notable exceptions. Tariff barriers were very high especially in the six countries which fully adopted an inward oriented ISI model (Argentina, Brazil, Chile, Colombia, Mexico, and Uruguay). In those countries, average tariffs were typically over 100%. The remaining countries, while continuing to depend on exports from a few primary products, did eventually turn to ISI to develop a domestic consumer goods industry and thus also imposed tariffs which were very high by industrial country standards, though not as high as in the six inward oriented countries (Bulmer-Thomas

1994: 297). The abandoning of ISI by both groups resulted in impressive reductions in tariffs: The average tariffs level in the region in 1998 was only 10%. [Discussion of capital controls and capital flows in LA.]

The third dimension of economic internationalization is internationalization of production: the growth of transnational corporations (TNC) and development and growth of "global commodity chains" in which the manufacture and distribution of a product occurs in different countries organized by a single enterprise and produced by either that enterprise or sub-contractors (Gereffi and Korzeniewicz 1994). While there are no hard figures on the growth of the proportion of total world production accounted for by TNCs and global commodity chains, case studies suggest that it is substantial. Since a large proportion of the expansion of these global production networks must occur through direct foreign investment, the figures for the increases in DFI in Table 1 are probably a good indicator of the increase in the internationalization of production.

The fourth dimension of economic internationalization is the growth of the role of supranational governing bodies: the international financial institutions (IFIs), such as the International Monetary Fund (IMF) and World Bank, and international organizations, such as the European Union (EU) and the World Trade Organization (WTO). The growth in the influence of IFI's in developing countries in the wake of the debt crisis is extraordinary. In the case of the advanced industrial countries, the expansion and deepening of the EU is without historical precedent, shifting vast areas of decision making from the national state to the EU (Schmitter 1996: 125). We document the extent of the influence of these organizations below.

Developments in the Advanced Industrial Countries

Economic and Social Policies up to 1980

In order to situate the retreat of the state and increase in market regulation in advanced capitalist societies, it is necessary to characterize the political economies of these countries about a decade after the close of the Golden Age of post war capitalism a point at which the degree of state regulation was at its pinnacle. Beginning with the relationship between welfare state and production regimes, we take Soskice’s (1999) distinction between coordinated market economies and liberal market economies as point of departure for our conceptualization. Soskice emphasizes employer organization and relationships between companies and financial institutions as defining characteristics of production regimes. Employer organization takes three distinctive forms: coordination at the industry or sub-industry level in most continental and Nordic economies (industry-coordinated market economies - CMEs); coordination among groups of companies across industries in Japan and Korea (group coordinated market economies); or absence of coordination in the deregulated systems of the Anglo-American countries (uncoordinated or liberal market economies - LMEs). In coordinated economies, employers are able to organize collectively in training their labor force, sharing technology, providing export marketing services and advice for R&D and for product innovation, setting product standards, and bargaining with employees. The capacity for collective action on the part

of employers shapes stable patterns of economic governance encompassing a country's financial system, its vocational training, and its system of industrial relations.

A central characteristic of the coordinated economies is the generalized acceptance by all major actors of the imperative of successful competition in open world markets for tradable goods. Successful competition in turn requires a high skill level of the labor force and the ability of unions to deliver wage restraint to the extent needed to preserve an internationally competitive position. In the industry-coordinated market economies of Central and Northern Europe, initial labor skills are effectively organized in companies or with strong company and union involvement in public schools. Unions are organized mainly along industrial lines and play an important cooperative role in organizing working conditions within companies and in setting wage levels for the economy as a whole. Banks and industries are closely linked, providing industries with preferential sources of long term credit, or the state plays a major role in bank ownership and performs a similar role in preferential credit provision for industry. In uncoordinated market economies, in contrast to both types of coordinated economy, training for lower level workers is not undertaken by private business and is generally ineffective. Private sector trade unions are viewed as impediments in employer decision making, have little role in coordinating their activities, and are weak. Bank - industry ties are weak and industries must rely on competitive markets to raise capital.

Following Esping-Andersen (1990), within the industry coordinated market economies, we can distinguish two subtypes on the basis of their welfare state: The Nordic social democratic welfare states and the continental European Christian democratic welfare states. While both have very generous transfers systems, the social democratic type is more redistributive (Bradley et al. 2001). The greater degree of centralization of bargaining in the Nordic countries which results in lower levels of wage dispersion reinforces this highly egalitarian pattern (Wallerstein 1999). The continental countries' intermediate degrees of bargaining centralization still result in more wage equality than in the liberal welfare states which are characterized by enterprise level bargaining and weak unions. The main difference in the welfare state configuration is the very high level of public health, education, and welfare services delivered in the Nordic welfare states and the low level in the continental welfare states. The difference in public social service employment results in very high levels of female labor force participation in the social democratic welfare states and low levels in the Christian democratic welfare states.

The liberal market economies can be divided into two groups based not on their welfare states which in both cases are residual, but on the basis of wage regulation systems and tariff regimes. Following Castles (1985, 1988), we distinguish, the "wage earner welfare states," Australia and New Zealand, from the liberal welfare states, the remaining Anglo-American countries. Similar to the Latin American countries discussed below the Antipodes followed an import substitution policy of high tariff barriers on manufacturing goods, with primary product exports financing the cost of importation of consumer goods and inputs for the manufacturing sector. The high tariffs were part of an explicit compromise in which workers received high wages delivered by the compulsory arbitration systems.

Outside of Australia and New Zealand, none of the advanced industrial countries maintained high tariffs on goods. As previously mentioned, the CMEs, particularly the smaller countries, were dependent on exports and defended open trade in international fora (Katzenstein 1985). Otherwise, the state was highly interventive, the area of intervention varying by the particular political economy configuration of the country, though all had generous welfare states.[1] Some countries had large state sectors (Austria, Finland, France, Italy, and Norway) and the state often subsidized investment and employment in the enterprises. Most countries maintained capital controls (Table 1) and heavily regulated internal capital market. This allowed them to set interest rates below international interest rates and offer lower interest rates domestically to business investors. Some countries (Finland, Italy, and Sweden, as well as Australia, Britain, and New Zealand among the LMEs) resorted to politically determined devaluations in order to restore competitiveness. Almost all countries pursued Keynesian counter cyclical demand policies and a number of countries incurred large fiscal deficits in the fight against economic stagnation in the 1970s. Some countries (Austria, France, Germany, and Norway) used state owned banks to subsidize investment in both private and public industries while in others the state budget was used for the same purpose. In all of the CMEs and most of the LMEs, public interest services such as telecommunications, mass transportation, energy supply, and public utilities were provided primarily by state monopolies insulated from both domestic and international competition (Héritier and Schmidt 2000). And finally, many countries used non-tariff barriers, such as product regulations, to protect domestic producers.

Changes in Economic Policies and Globalization

As Scharpf (2000) points out, the policies just outlined had been greatly reduced or abandoned by the turn of the century. Many state owned enterprises had been privatized, even by social democratic governments. Those which were not privatized were directed to operate by market, profit seeking principles; operating without subsidies and no longer supporting employment. Capital controls were eliminated and domestic capital deregulated. Devaluation was abandoned as a policy tool and twelve European countries adopted a common currency, completely eliminating even the possibility of using currency adjustment as a policy instrument. The combination of the elimination of capital controls and the fixing of currencies meant that international markets set national interest rates, effectively eliminating monetary policy as a counter-cyclical tool and cheap interest rates as a measure to stimulate investment. External financial decontrol also limits a government's ability to employ fiscal stimulation as a tool, as fiscal deficits are considered risky by financial markets and either require a risk premium on interest rates or put downward pressure on foreign exchange reserves. For European Union countries, the deepening of European integration after 1990 further limited monetary and fiscal policy latitude and prohibited non-tariff trade barriers and subsidies to support investment and employment. Finally, with the possible exception of Switzerland, almost all

[1] See Huber and Stephens (2001) and Scharpf (2000) and the contributions to Scharpf and Schmidt (2000) for a more detailed country by country description.

countries reluctantly retrenched welfare state entitlements, though the cutbacks were modest in all but a few cases.[2]

The fact that there are parallel trends toward globalization and reduction of state intervention in the market does not, of course, establish that they are causally linked. Let us first take increased exposure to trade where, outside of Australia and New Zealand, the effects of increased economic internationalization have been most limited because, other than in those two countries, the advanced industrial economies were very trade open at the beginning of the globalization era and increases in trade openness have been modest (Table 1). The one area where one does detect a significant impact of increased trade openness is the trend toward privatization and "marketization" of state enterprises. Even here the process is complex and the lowering of tariff barriers does not figure strongly in the picture. Perhaps the most dramatic change is the public service monopolies, particularly telecommunications. Here rapid technological change made what were once natural monopolies into enterprises exposed to international competition. With the advent of satellites and cell phones, governments could only prevent private alternative providers from offering their services with increasingly draconian measures. The cost of using state enterprises to support employment, a common response to the crisis of the 1970s, forced government after government to abandon the practice in the course of the 1980s and attempt to put state enterprises on a profit making basis. Once this was accomplished, the logic of even having the enterprises in the state sector disappeared and privatization was often the next step. The large budget deficits faced by many governments made this a yet more attractive option. Another pressure towards privatization was growth of the scale of enterprises, as the optimal size for competitiveness in sectors such as manufacturing outgrew the scale of the national enterprises and the search for partners through merger or absorption resulted in the dilution of the state owned portion of the resulting enterprise or outright privatization. Finally, the spread of neo-liberal ideology primarily in parties of the secular right but also of other political tendencies, most notably New Zealand Labor, further spurred on privatization. Neo-liberal ideological commitments led governments to push privatization and marketization even to sectors which remained natural monopolies or which were widely perceived by the public to be public services which should not be governed by market principles, such as education and health care. In such cases, the results of privatization/marketization were often less satisfactory as in the privatization of British rails (Héritier and Schmidt 2000) and the marketization of health care in New Zealand (Kelsey 1995).

With regard to increased capital mobility, there is compelling evidence that the opening of capital markets and the very large increases in capital flows shown in Table 1 have had a large constraining influence on macro-economic policy. As Simmons (1999: 41-43) points out, while the early popular accounts stress technological innovation, the revolution in electronic transfer, as the impetus for removing capital controls, later more nuanced academic analyses add market competitive, political, and ideological factors. The technological innovations and the growth of the off shore dollar

[2] There have been cutbacks in the 1990s in Switzerland but these were overshadowed by the expansion over the whole of the last two decades (Bonoli and Mach 2000).

market in the 1960s and the collapse of the Bretton Woods systems of fixed but flexible exchange rates in 1971-73 set the scene for a round of competitive deregulation led by the United States in 1974, then Canada and the Netherlands in the same year and then by Germany and Switzerland later in the decade (Simmons 1999:41). Note that all of these countries were characterized by relatively liberal foreign capital regulations in the 1960s already (Table 1). Leftist governments tended to resist this movement but by the mid-eighties, the ability of multinational businesses and financial institutions to circumvent national controls and to exploit them for arbitrage influenced most governments to abandon controls. The final vestiges of controls were eliminated in European Union countries under the provisions of the Single European Act of 1987 by the beginning of 1993.

As a result of the elimination of controls on capital flows between countries, governments cannot control both the interest rate and exchange rate. If a government decides to pursue a stable exchange rate, it must accept the interest rate which is determined by international financial markets. The absence of capital controls makes the option of setting low interest rates while accepting a depreciating currency unattractive as it results in inflation which greatly complicates wage bargaining (see below). As a result of the decontrol of financial markets, competition from non-OECD countries for investment funds (Rowthorn 1995) and the world wide debt build up in the wake of the two oil shocks, real interest rates increased from 1.4% in the sixties to 5.6% in the early nineties (OECD 1995: 108). As a result of decontrol of domestic financial markets (which was in many cases stimulated by international financial deregulation), government's ability to privilege business investors over other borrowers also became more limited. Countries which relied on financial control to target business investment were particularly hard hit as businesses moved from a situation in which real interest rates offered to them via government subsidies, tax concessions, and regulations were actually negative to a situation in which they had to pay the rates set by international markets. In addition, in the pivotal German economy, the increase in capital mobility weakened the bank-industry link, with capital becoming less patient, less willing to wait for the long term payoff (Seils and Manow 2000, Streeck 1997). External financial decontrol also limits a government's ability to employ fiscal stimulation as a tool, as fiscal deficits are considered risky by financial markets and either require a risk premium on interest rates or put downward pressure on foreign exchange reserves. Finally, because of the interest rate penalty that international currency markets made countries with a history of devaluation pay, countries effectively dropped competitive devaluation as a policy tool and the 12 European Monetary Union countries went so far as to completely eliminate the possibility of currency adjustment.

These developments put great pressure on wage bargaining systems in countries where unions were at least moderately strong, at the same time as they pushed huge responsibilities for maintaining macro-economic balance and external competitiveness onto these systems. With EMU membership or fixed exchange rates, the wage gains above the European norm are translated immediately into loss of export markets and thus into higher unemployment. In this environment, inflation is the number one enemy of the bargaining system because nominal not real increases in wages

undermine export competitiveness. Without the fiscal and monetary tools once available to combat unemployment, the responsibility increasingly falls on the wage bargainers.

With containing inflation as the central policy goal and interest rates set by international markets, it is not surprising that countries with central banks dependent on government authority moved to increase the independence of their central banks since such a move could increase the credibility of government policy in the eyes of international money markets and thus reduce interest rate premiums. The monetary policy and institutional arrangements favored by the German Bundesbank and conservative economists became the norm.

The remaining question in the area of macro-economic management is the extent to which these outcomes were products of inescapable processes of economic internationalization or were partly or even largely products of voluntary choices to deepen European integration, as Hay (2002) contends, or of political decisions guided by neo-liberal ideology. There is little doubt that fixed exchange rates/common currency, independent central banks, macro-economic policy targeting inflation, no capital controls, etc. are all policy commitments of the European Union and that meeting the criteria for entry into the EMU, particularly the deficit, debt, and inflation targets, imposed economic austerity on many of the prospective entrants. However, it is clear that the process of decontrol of capital markets, which was so critical in constricting the latitude for macro-economic management, substantially predated the decision to deepen European economic integration. The average index of capital market openness shown in columns 1 and 2 of Table 1 was 2.5 in 1973 and had been stable for a decade. It moved to 3.1 by 1985, the year of the announcement of the Single European Act, and then to 3.7 by 1993, the year than the Act came into force. In Sweden in 1985, five years before the Social Democrats reversed their stand to favor entry into the European Community, the Swedish social democratic government made the decision to decontrol domestic capital markets because the development of "gray", i.e. not quite illegal, credit markets had made the existing controls unviable (Feldt 1991: 260, 281-82). The economic thinking which underlay the U-turn of the French Socialists after their first eighteen months in office in the early 1980s and the Swedish Social Democrats' "Third Way" between Keynesian expansion and monetarist austerity introduced on their return to office in 1982 is consistent with the constrained macro-economic choices outlined above. Thus, while it is possible that the neo-liberal commitments of social democratic policy makers, such as Swedish finance minister Kjell-Olof Feldt, led social democrats to abandon policies which were still viable - the counter cyclical investment funds come to mind here (see Pontusson 1991: 75-79) – it is probably the case that changes in the broad parameters of macro-economic policy were the inevitable result of the de-control of capital markets by the early liberalizers which then forced such moves on others. Whether the early liberalizers' hand was forced by the development of off shore dollar markets and technological innovations is a matter of dispute (cites). [Find out about WTO constraints of subsidies to investment and interest rates and insert a sentence here.]

Welfare State Retrenchment and Globalization

There is very little evidence from recent scholarly studies, including our own (Huber and Stephens 2001) supporting neo-liberal thesis which strongly and directly links welfare state retrenchment to globalization. The recent quantitative work on social spending shows a very modest positive relationship between variables measuring various aspects of economic internationalization and welfare spending (e.g. see Garrett 1998, Swank 2002). However, social spending data are particularly unsuited for the study of retrenchment as spending can increase substantially due to the increase in recipients; the unemployed, disability pensioners, early pensioners, and the retired.[3] The few analyses of data which directly measure welfare state entitlements (e.g. replacement rates in various programs) come to rather different conclusions about the determinants of retrenchment (Allan and Scruggs 2002, Hicks and Zorn 2002, Korpi and Palme 2001), perhaps because they differ in both the statistical methodology and dependent variables. Only Hicks and Zorn (2002) find any evidence that measures of economic openness are related to retrenchment and their results, that moderate degrees of openness are associated with welfare expansion while high degrees are related to retrenchment, are hardly ringing endorsements of the neo-liberal thesis. Both Hicks and Zorn (2002) and Korpi and Palme (2001), which, unlike Allan and Scruggs (2002), are true studies of retrenchment,[4] find that fiscal deficits and/or unemployment are related to retrenchment, which squares with the results of comparative case studies.

Based on our analysis of nine advanced industrial countries (Huber and Stephens 2002), the twelve case studies in Schmidt and Scharpf (2000), and Myles' (1996, 2002) studies of North America – that is, sixteen of the eighteen advanced industrial countries in Table 1 – we find that rollbacks in welfare state programs have been a universal phenomenon in the past two decades. Our case studies indicate two different dynamics: ideologically driven cuts, which occurred in only a few cases, and unemployment driven cuts, which were pervasive. It is the timing and severity of the latter type of rollbacks that argues that they were largely unemployment driven. The countries where unemployment rose early (Denmark and the Netherlands) initiated cuts in the mid-1970s, the countries where unemployment rose late (Sweden, Norway, Finland) continued to expand welfare state entitlements until the late 1980s. The countries where unemployment levels remained very high for a long time (e.g. the Netherlands) made deeper cuts than the countries where they remained more moderate (e.g. Norway). This is not to say that all the policy changes were somehow dictated by economic constraints; perceptions and beliefs about the effectiveness of different policies in achieving certain goals did play a role. Thus, the rising hegemony of neoliberal doctrines certainly contributed to the rollbacks.

These rollbacks in most cases did no more than reduce the increase in welfare state expenditures. In fact, if one looks at the aggregate data for the different welfare state types, the average annual increase in most indicators of welfare state expenditures in the seventies was higher than it had been in the Golden Age, and it

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[3] See Huber and Stephens (2001) and Allan and Scruggs (2002).

[4] The dependent variable in Allan and Scruggs (2002) is annual change in various replacement rates in the period 1975 to 1999. While the study is clearly a study of the retrenchment era, part of the results are certainly products of *increases* in replacement rates which occurred in many countries, especially early in the period.

continued to increase in the 1980s, though at a slower pace than in the previous two periods. Essentially, in the 1970s governments countered the deteriorating economic situation with traditional Keynesian counter cyclical policies, but by the 1980s they had all realized that the rules of the economic game had changed and demanded new approaches. Still, the increase in claimants of benefits kept pushing up expenditures.

Retrenchments generally began with lags in adjustments of benefits to inflation and increased co-payments for welfare state services, particularly health care. The data on public share of total health care expenditures reflect these economizing measures; the average annual increase in the public share was already lower in the 1970s than in the earlier period, and in the 1980s the public share declined. Increases in waiting days for benefits, decreases in the length of time for which the most generous benefits could be claimed, and decreases in replacement rates followed. Eligibility criteria for a variety of programs were stiffened, particularly for unemployment and disability benefits. In the case of pensions, cuts in benefits promised for the future but not yet enjoyed by retirees were implemented in some countries. Only rarely were entire programs abandoned or radically changed, such as the maternity and death grants and the child benefit in Britain or the universal health care system in New Zealand. Nevertheless, the cumulation of all these changes meant in some cases a significant reduction of entitlements, though not a system shift. [This paragraph could be deleted.]

Our data and case studies show a sharp decline in partisan effects on welfare state expansion/retrenchment.[5] Curtailment of entitlements, or at best defense of existing entitlements, was on the agenda everywhere. As Pierson argues (1996, 2001 also see Huber and Stephens 1993, 1998), the politics of retrenchment are different from the politics of welfare state expansion. The right was constrained in its ability to cut by the popularity of most of the large welfare state programs, and the left was constrained in its ability to raise taxes to keep the programs on a sound financial basis by the economic slowdown. This is not to say that there have not been significant differences in the rhetoric of political parties with regards to desirable welfare state reforms, but simply that electoral constraints worked against radical departures from established welfare state models.

There were only a few cases of large-scale ideologically driven cuts. The most dramatic were Thatcher in Britain, the National (conservative) government in New Zealand, and the Reagan administration in the United States. In the case of the Reagan administration the cuts were focused on cash and in kind benefits to the poor, a small but highly vulnerable minority, while Social Security was preserved by a large increase in the contributions. In any case, the United States cannot have been said to have made a "system shift" if only because it already had the least generous welfare state of any

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[5] Our data analysis is based on social spending, which is fraught with difficulties as noted above, and thus we consider the case studies which do show a narrowing of partisan differences to be more reliable evidence. The three quantitative studies of entitlements mentioned above come to differing conclusions on partisan effects: Allan and Scruggs (2002) find that right government is negatively associated with replacement rate changes, and Korpi and Palme (2001) find that left government is negatively related to retrenchment, while Hicks and Zorn (2002) find that Christian democratic government is most negatively associated with retrenchment.

advanced industrial democracy. Only in Great Britain and New Zealand could one speak of an actual system shift from welfare state regimes that used to provide basic income security to welfare state regimes that are essentially residualist, relying heavily on means-testing. We argue that the exceptional nature of these two cases can be traced to their political systems which concentrate power (unicameral or very weakly bicameral parliamentary governments in unitary political systems) and make it possible to rule without a majority of popular support (single member districts and plurality elections which allow parties with a minority of votes to enjoy large parliamentary majorities). Thus, in both cases, the conservative governments were able to pass legislation which was deeply unpopular.

Given the crucial role that the rise in unemployment has had in stimulating welfare state retrenchment, we have to seek to understand the reasons for the dramatic increases in unemployment in the eighties and early nineties. Here we can only summarize the arguments we make elsewhere at length (Huber and Stephens 1998, Huber and Stephens 2001a: Chapters 6 and 7). Let us begin by dispensing with the standard neo-liberal argument on trade openness, that is, with increased trade openness, the countries with generous welfare states and high wages were increasingly exposed to trade competition and their generous social provisions made them uncompetitive in ever more open world markets. First, increased trade openness is not a good candidate for explaining dramatic change as it has increased only modestly (see Table 1).

Second, as we pointed out above, the generous welfare states of Northern Europe were developed in very trade open economies in which the performance of the export sector was pivotal for the economic welfare of the country. Moreover, retrenchment was unrelated to export performance. For instance, the export sectors of countries such as Sweden and Germany were performing incredibly well in the mid-nineties at precisely the same time when the governments of those countries were cutting social benefits (Huber and Stephens 1998; Pierson, 2002; Seils and Manow, 2000). As Scharpf (2001: 76-78) points out, there is no relationship between total tax burden and employment in the exposed sector in advanced industrial societies, strong evidence that generous social policy does not make countries uncompetitive in world markets.

The question then becomes what caused the increases in unemployment?[6] Let us begin by observing that it was not the low level of job creation, since employment growth after 1973 was as rapid as before (Glyn 1995). Rather, rising labor force participation due to the entry of women into the labor force is one proximate cause of the increase in unemployment. The inability of the Christian democratic welfare states to absorb this increase either through an expansion of low wage private service employment as in the liberal welfare states or through the expansion of public services as in the social democratic welfare states is one reason why the unemployment problem in these countries has been particularly severe. The other proximate cause is the lower levels of growth in the post 1973 period. This in turn can be linked in part to lower levels of investment which in turn can be linked in part to lower levels of savings, to lower levels

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[6] The following few paragraphs summarize our arguments in Huber and Stephens (2001a: Chapter 7, 2001b). See those writings for more detailed discussion and statistical documentation.

of profit, and to higher interest rates. High interest rates is where globalization comes in since, as outlined previously, they can be linked in part to deregulation of capital markets. Moreover, because decontrol of capital markets made counter cyclical economic management more difficult, it certainly raised unemployment in that regard also.

While we do think the evidence supports the view that financial deregulation has contributed to the rise in unemployment, it is important to recognize the importance of political decisions and conjunctural developments in explaining the current high levels of unemployment in Europe. Though it almost certainly was not a conscious decision, or at least not seen in these terms, the Christian democratic welfare states, faced with a growing supply of (female) labor rejected the alternatives of creating a low wage market in private services along American lines or expanding public services (and thus raising taxes) along Nordic lines. As we pointed out above, the combination of the debt build up in the 1970s and the policies required for accession to the EMU imposed austerity on European countries in the nineties. The mismanagement of the process of financial deregulation led to a consumer boom and then real estate bust, which was the primary cause of the unemployment crisis in Finland, Sweden, and, to a lesser extent Norway.

Nor do we want to overstate the importance of the increases of unemployment (whatever their causes) for welfare state retrenchment. Pierson (2001) succinctly summarize other pressures on the welfare state. The shift from manufacturing to services has slowed productivity growth and contributed to the slowed economic growth noted previously. The growth of spending on programs legislated in the past, most notably pensions and health care, stresses national budgets. Population ageing pushes up spending, particularly on these two programs. The decline in fertility, which has been dramatic in Christian Democratic welfare states, threatens to greatly aggravate this problem in the future (Esping-Andersen 1999). The change in family structure, the decline in male breadwinner families and increase in single mother and dual earner families, creates new demands for day care, maternity leave, and related programs. The decline in wage growth and increase in returns on capital along with demographic change undermine the PAYGO pension systems and make funded systems more attractive, yet present the public with a double payment problem in financing a transition to a funded system (Myles and Pierson 2001). In sum, the rise in unemployment has been only one contributor to welfare state stress, and globalization in all of its manifestations has been only one contributor to unemployment. Thus, the contribution of economic internationalization to welfare state retrenchment is modest.

For Australia and New Zealand, it would appear that a case can be made for the globalization thesis in that changes in the international economy did compel both countries to deregulate markets and fundamentally change their systems of social protection. In these "wage earner welfare states", social protection was delivered primarily by the compulsory arbitration system which assured the family of an adequate living standard by providing a male breadwinner family wage and a number of social benefits from the employer to the wage earner. The formal welfare state, that is, transfers and services delivered by the state, was rather underdeveloped by European standards. This distinctive Australasian political economy became unviable as a result of long term

secular changes in commodity prices and the entry of the United Kingdom into the European Community, with a consequent loss of preferential markets for Commonwealth exports. In both countries, the wage regulation system, which was the core of the system of social protection, was changed substantially - in New Zealand altered completely - and this, along with the rise in unemployment, exposed workers to much higher levels of risk of poverty than had earlier been the case. Add to this other marketizing reforms (see Castles et al. 1996; Schwartz 1994a, 1994b, 1998), and it becomes apparent that the political economy of the Antipodes has converged on the liberal type. Thus, in these two countries, it is accurate to say that changes in the international economy forced them to abandon policies which had protected an uncompetitive manufacturing sector.

Latin America and the Caribbean

Economic and Social Policies up to the 1980s

The first argument to make when discussing Latin America and the Caribbean is that the countries in the region are extremely diverse, much more so than OECD countries. There are very small, extremely poor, still largely agricultural countries like Haiti, Nicaragua, and Honduras, along with upper-middle income countries with partly advanced industrial sectors like Argentina, Chile, Brazil, and Mexico. So, any generalizations are extremely hazardous. Nevertheless, it is possible to point to some important economic characteristics that are shared by most of these countries. Starting with colonization, they were all shaped into raw material export economies. The effects of the Great Depression then generated incentives for ISI, and the more advanced countries, Brazil, Chile, Mexico, Argentina, Colombia, and Uruguay began to implement pro-ISI policies; other countries, such as Peru, Venezuela, and Jamaica, followed much later on this path. Pro-ISI policies entailed high protective tariffs and non-tariff barriers to imports, preferential interest and exchange rates for industrial investment and thus regulated capital markets, state investment in strategic sectors of the economy, regulation of DFI and a host of other regulatory activities.

As industrialization progressed, these countries faced the problem of integrating labor as an economic and political actor. The political integration took different forms, in some cases under leadership of the state and in others through party-union alliances, but in all cases the state played an active role. State corporatism was prevalent, in more inclusionary and more exclusionary versions, and even where state/ capital/ labor relations were more pluralistic, there was a high degree of labor market regulation. With industrialization and as part of the process of labor incorporation came the expansion of social insurance schemes to the urban working class. Social insurance schemes had been introduced earlier for the most important pressure groups, such as the military, civil servants, and the judiciary, and then slowly expanded to middle class groups and strategic sectors of the working class. As a result of this process of gradual expansion, the systems of social insurance were highly fragmented and generally quite inegalitarian. What is crucial, though, is that the entire edifice of social protection, from pensions to family allowances and health care, was built around employment and the male breadwinner model, not citizenship rights. Women and children were covered as dependents. This meant that coverage remained restricted to those employed in the

formal sector. Even where the self-employed were included on a compulsory basis, their evasion rate in paying contributions was very high, as contribution rates for them were set high. Employer contributions to social security reached in many cases comparatively high levels, but given the high tariff wall, employers were able to pass the costs on to consumers.

Only six Latin American countries had built up a system of social protection that might be called a welfare state, covering more than 60% of the economically active population with some form of social security as of 1980. These countries are Argentina, Brazil, Chile, Costa Rica, Cuba, and Uruguay; at least three Caribbean countries, Bahamas, Barbados, and Jamaica, also belong to that category.[7] Another group of six countries had expanded coverage to between 30% and 60% of the economically active population by 1980; Colombia, Guatemala, Mexico, Panama, Peru, and Venezuela. Coverage in the remaining countries had remained below 30% of the economically active population, with the lowest being the Dominican Republic, El Salvador, and Paraguay, with 12%, 12%, and 14%, respectively.

As noted above, ISI strategies began to run into a variety of problems, which in turn manifested themselves in recurring balance of payments crises from the 1950s on. Still, with a variety of coping strategies the model was kept alive and then received a new, albeit short-lived, lease on life due to the easy availability of loans from international banks in the 1970s. The debt crisis of 1982, then, forced a reorientation. Since then, every single country in Latin America and the Caribbean has been exposed to pressures for reform. Yet, there are significant differences in the extent to which countries have complied with these pressures.

The austerity measures used to deal with the recurrent balance of payments crises also put pressure on the social security systems. In addition, the pension components of social security in the more advanced countries were experiencing severe financial pressures of their own. The pension systems had matured and thus the ratio of working to retired people was deteriorating. The reserves that should have been built up in the maturation phase typically had been used for other state expenditures, often for the health care component of social security. During periods of high inflation, there was often decapitalization of the pension systems. Benefits in the privileged systems in some countries were very high, as were administrative expenditures of the systems. Employers attempted to evade payment of contributions, or delayed payment for long periods, particularly during high inflation. Thus, there was a consensus on the need for reform, but again the types of reforms chosen have varied significantly.

Reforms in Economic and Social Policy

[7] These figures are drawn from Mesa-Lago (1994: 22); he does not provide figures for Trinidad and Tobago nor for any of the small Caribbean countries. Coverage figures vary widely among different sources, depending on whether legal entitlements or actual contributions are taken as the criterion. Mesa-Lago is the most prolific researcher and writer on social security in Latin America, and his figures can be accepted for the purposes of classification here.

The main points of the reform agenda, what Williamson has aptly called the Washington consensus, are reduction of fiscal deficits, to be achieved mainly through cuts in expenditures, particularly in subsidies of all sorts; tax reforms that cut marginal rates and broaden the tax base; market determination of interest rates; market determination of exchange rates, with possible intervention to keep them competitive; import liberalization; liberalization of foreign direct investment; privatization of state owned enterprises; deregulation of all kinds of economic activity; and protection of property rights (Williamson 1990: 7-20). To this one should add the agenda for second generation reforms, that is, reforms in labor market policy, social policy and political institutions, which was developed by the IFIs in the 1990s. The main points of this agenda are liberalization of labor markets; privatization of social security systems, primarily pensions but also provision of health care; targeting of social expenditures on the neediest groups; decentralization of responsibility for the provision of social services; and reforms of the judicial system.

On average, the countries in the region moved far in trade liberalization and financial liberalization; they advanced less in privatization, tax reform, reforms of social security systems, and decentralization of social services; and least in deregulation of labor markets and judicial reform. The average tariff rate was lowered from 49% in the mid-1980s to 11% in 1999, and non-tariff restrictions were reduced from a coverage of 38% of imports in the pre-reform period to 6% of imports in the mid-1990s (Lora 2001). Now, as we discussed above, in comparative perspective these tariff levels remain higher than in advanced industrial countries. Nevertheless, the lowering had a dramatic impact on many Latin American economies, particularly where it was done in a very short period of time. Many enterprises went bankrupt, which meant that many formal sector jobs were lost.

The decrease in the gap between the black market and the regulated market exchange rate is one indicator of relaxation of foreign exchange regulations. Deregulation in this area, along with fiscal and monetary stabilization policies and the renewed flow of capital to Latin America, led to a drastic reduction in this gap between 1988 and 1997, from over 100% in some cases to around 5%. In the area of financial regulation, controls on interest rates were abolished in all countries by 1995 and reserve requirements were reduced, but most countries retained some forms of intervention in lending agreements (ibid.).

In tax reform, a replacement had to be found for revenues previously coming from taxes on foreign trade, which fell from 18% of total tax revenue in 1980 to 14% in the mid-1990s. Most countries adopted or substantially increased value added taxes, but collection rates have remained lower than the statutory rates (ibid.). Marginal tax rates on personal income and taxes on corporate profits were reduced in virtually all cases. However, average tax revenue has remained low; taxes made up only 72% of total government revenue in Latin America in 1990-94, compared to 90% in the OECD countries. Non-tax revenue included items such as natural resource rents and income from state owned enterprises. Income taxes and social security contributions accounted for 44% of government revenue compared to 67% in the OECD countries. Total

government expenditure was on average slightly below 25% of GDP, roughly half of the level of OECD countries (IADB 1997: 104-106).

The extent of privatization has varied considerably among countries; the cumulative value of privatizations between 1988 and 1999 reached 5% or more of GDP in ten countries, whereas other countries hardly privatized anything. Most of the privatizations affected infrastructure, particularly energy and telecommunications, and in some countries the banking system (Lora 2001).

Reforms of the social security system are generally categorized into structural and non-structural reforms, the former involving elements of privatization and the latter changing rules on financing and entitlements. Nine Latin American countries have implemented and a tenth has legislated full or partial privatization of the pension system. In five cases, privatization was total, with the public system being closed down; in five cases it was partial, with the private system being supplementary or a parallel option (Muller 2002). In the cases where the public system survived, it typically underwent reforms as well to strengthen its financial basis. Reform of the health insurance and delivery systems has been very heterogeneous, which makes a summary assessment very difficult. In many cases, private insurance and delivery have expanded their share, sometimes by design and sometimes by default. Generally, public resources have been targeted at the neediest sectors of the population, but even these sectors are expected to pay user fees.

Decentralization has been high on the reform agenda and most countries did transfer some responsibilities and revenues to lower levels of government, particularly in the area of social services, but again the actual reforms that have been implemented are very heterogeneous (Willis et al. 1999). On average, the share of state and local governments in total government spending increased from 16% in 1985 to almost 20% in the mid-1990s (IADB 1997: 99). However, the variation is large, ranging from 49 and 46% in the federal systems of Argentina and Brazil to less than 5% in small unitary countries, such as the Dominican Republic, Panama, and Costa Rica (IADB 1997: 157). Even among the more decentralized countries, there is considerable variation in the amounts of actual autonomy enjoyed by subnational governments in decisions on expenditure and revenue generation (Garman et al. 2001).

In the areas of labor law reforms, the IFIs have been pressing for reduction of costs associated with laying off workers, relaxation of restrictions on the hiring of temporary workers, and a lowering of social security contributions. They have been arguing that these policies restrict employment creation in the formal sector. Yet, only six countries implemented significant reforms in these areas between the mid-1980s and 1999 (Lora 2002). This is understandable in light of the fact that unemployment insurance is virtually non-existent in Latin America, and that virtually all social transfers and services are tied to formal sector employment. Thus, loss of a formal sector job is a catastrophic event and labor has most strenuously opposed such reforms.

Reform of the judicial system is important to the IFIs because of protection of property rights and predictability of decisions in case of a dispute between

investors, particularly foreign investors, and the government or private actors. [look for more info]

Depending on the criteria and time points used, analysts come up with somewhat different classifications of countries' reform efforts. For instance, the Inter-American Development Bank, looking at their structural policy index in 1985/86 and 1995, lists Argentina, Chile, and Jamaica as early reformers (above the average in both 1985 and 1995); Bolivia, El Salvador, Nicaragua, Paraguay, and Peru as intense reformers (below in 1985, above in 1995); Colombia and Uruguay as gradual reformers (above in 1985, below in 1995); and Brazil, Costa Rica, Ecuador, Guatemala, Honduras, Mexico, and Venezuela as slow reformers (below at both time points) (IADB 1997: 50). In contrast, Stallings and Peres, in a study sponsored by the United Nations Economic Commission on Latin America and the Caribbean (ECLAC), only look at the nine countries with the longest history of implementing economic reforms in the region and divide them into aggressive and cautious reformers, the former including Argentina, Bolivia, Chile and Peru, the latter Brazil, Colombia, Costa Rica, Jamaica, and Mexico (2000: 14; 48). In general, Chile is regarded as the prototype of the early and radical reformer and Argentina of the late and radical reformer, the former being highly successful and the latter experiencing economic chaos in 2001-2002. There is also consensus that Peru, Jamaica, and Bolivia have introduced far reaching reforms and that these reforms were implemented rather rapidly in Peru and Bolivia. In contrast, Brazil, Costa Rica, Uruguay, and Venezuela are clearly regarded as slow and cautious reformers.

Explanations of Reform Trajectories

Three main types of explanations have been advanced to account for the differences among countries in the depth and speed of reforms: insulation of technocratic political leaders and/or centralization of political power in the hands of the executive, depth of the economic crisis and consequent leverage of IFIs and readiness of leaders and the public to accept radical reforms, and coalitions of political leaders with winners from initial reforms for further reforms, or changes in the balance of power between proponents and opponents of reforms. These explanations are certainly not mutually exclusive; rather, they can be combined to some extent, and to some extent they explain different phases of the reform process. Haggard and Kaufman (1995) argue that in the early phases of stabilization and adjustment, centralized executive authority is crucial, because winners are not defined yet but losers perceive the threat or reality of losses more clearly. Thus, the reforms have to be imposed against opposition and with little support from internal allies. For consolidation of reforms, then, and progress in second generation reforms, executive behavior needs to become more predictable, and new support coalitions have to be formed. The formation of support coalitions is particularly crucial in the case of social sector reform, where there are many stakeholders.

Many authors have argued that depth of preceding crisis is a good predictor of support for reforms, but Weyland (1998; forthcoming) has offered the most theoretically coherent version of this explanation. He uses prospect theory, which holds that when people are in the domain of losses they are more ready to accept the risks of reform, whereas being in the domain of gains makes people, both leaders and the mass

public, risk averse and thus opposed to far reaching reforms. Indeed, this explanation fares well in explaining both cross-national differences and the timing of reforms. Depth of crisis has another crucial effect which then tends to propel reforms forward. The deeper the crisis, the greater is the leverage of the IFIs and thus the probability that they will be successful in pushing their reform designs.

Chile is a special case, as it was the first country to adopt radical neoliberal reforms, beginning in the mid-1970s. Certainly, executive power was extremely centralized in Pinochet's hands and opposition to the reforms was simply not tolerated. In the Chilean case, the economic reforms went way beyond what the IFIs prescribed, as the reforms followed a political agenda as well, to remove the state from the center of decisions about distribution and thus as a target for collective action, and to atomize civil society (Garretón 19xx). Chile moved very rapidly in trade and financial liberalization and in privatization. The speculative boom created by these reforms ended in a spectacular financial crash in the early 1980s, even before the general debt crisis in Latin America. In response, the government expanded its role in the economy again temporarily, but at the same time it proceeded with a full privatization of the pension system and a very significant expansion of the private sector in health care. The sustained high economic growth rates experienced by Chile from the mid-1980s to the mid-1990s, and the comparatively low degree of volatility turned the country into a poster child for advocates of neoliberalism. The fact that the democratic governments did not attempt to change the basic parameters of the model in the 1990s further enhanced its legitimacy.

Argentina is an interesting case of radical reform carried out by an unlikely candidate, the leader of the historically labor-based Peronist party, Carlos Menem, who became president in 1989 after running a vaguely populist campaign. Clearly, in this case the disastrous experience with heterodox stabilization programs introduced by his predecessor, Alfonsín, who resigned early in the midst of hyperinflation and a deep fiscal crisis, strengthened Menem's resolve and his capacity to obtain support for his reforms from his own party. Since the Peronists for the most part controlled both houses of congress, he faced little effective legislative opposition. He used various strategies to neutralize opposition from the unions, and with varying success, from giving some of them participation in ownership of privatized enterprises, compensating workers who lost their jobs, and allowing unions to run private pension funds, to weakening others with simple dismissal of their members, thus exacerbating divisions in the union movement that had deep historical roots (Murillo 2001). The price stabilization brought about in part by the convertibility plan, which tied the peso to the dollar, along with renewed capital inflows and economic growth enabled Menem to win a second term in 1994. However, exchange rate parity and financial deregulation over the longer run led to a rising foreign debt and severe balance of payments problems. Internally, these problems were aggravated by fiscal indiscipline, particularly among provincial governments. Inaction on the part of Menem and his successor, de la Rua, ultimately led to a profound financial crisis and a default on Argentina's foreign debt.

Fujimori in Peru is another leader who campaigned on a vague but clearly anti-IFI platform, only to make a 180 degree turn right after his election to embark on a

radical reform course. Like Menem, he followed a predecessor who had pursued populist, nationalist, expansionist policies and presided over a spectacular economic disaster. Unlike Menem, he did not have a strong party base and faced strong legislative opposition. His solution was to close congress in a self-coup and thereafter continue to rule in a semi-authoritarian fashion, which was facilitated by the fact that his supporters gained a majority of seats in the new constituent assembly and then the new legislature.

All three of these cases of rapid and profound reform share the characteristics of a profound crisis preceding the accession to power of an executive enjoying high power concentration, albeit through different means. In Argentina and Peru, leaders who had come to power on an alternative platform were confronted with disastrous economic conditions which really left them few alternatives to adopting IFI prescriptions. In Argentina, Menem was able to implement the reform program through legal means combined with heavy political maneuvering due to high party discipline and virtual control by his party over the legislature, whereas Fujimori in Peru dealt with political opposition through unconstitutional means. In Chile, the military regime ruthlessly repressed any opposition and embarked on a process of economic and social engineering to destroy the chances for any possible reemergence of a mass movement of the left, their equivalent of a profound crisis.

Among the slow and cautious reform cases, the combination of profound crisis and high power concentration was not present, with the result that either no far-reaching reform package was presented by the executive, or the package was blocked in the legislature or by popular referenda. In Brazil, the fragmentation of the party system and the lack of party discipline stymied reform efforts of presidents, and in Uruguay popular referenda played that role in the case of pension reform.

Globalization and Reforms

Certainly, globalization was the key driving force behind the economic and social policy reforms in Latin America and the Caribbean, much more so than in the OECD countries. However, neoliberal economic analyses that attribute the reforms to the inexorable logic of the growing integration of world markets miss the essential mediating mechanisms that translate world market dynamics into concrete policy changes, and they cannot explain differential responses to these dynamics. The essential mediating mechanisms were the debt crisis of the 1980s, the growing power of the IFIs, and the spread of specific educational and career patterns. The causes of differential responses to world market dynamics are domestic political institutions and power distributions between opponents and proponents of reform.

At the root of the reforms is clearly the debt crisis, and the debt crisis in turn is a result of the growth of international financial markets. The growth and integration of international financial markets facilitated overborrowing in the 1970s, put pressure on debtor countries through rising interest rates in the early 1980s, and served as catalyst for a general crisis when the large private banks all decided to stop new lending to Latin America. It then propelled the IFIs into a very powerful role, because agreements with the IMF were generally a precondition for any debt rescheduling

agreements with private lenders and any bilateral or multilateral rescue packages. However, it is important to emphasize here that international financial markets were backed up by the power and interests of economically powerful nations. The governments of these nations decided that the burden of solving the debt crisis was to fall exclusively on the shoulders of the debtor countries. Defaults were to be prevented and debt relief was initially not even considered.

A further mediating mechanism between globalization and economic policy reform in Latin America is the growth of educational and career circuits that bring technocrats with neoliberal world views into powerful political positions. These circuits bring promising Latin American graduate students in economics to Ph.D. programs in the United States, where they absorb neoliberal economics. After graduation these economists often circulate between positions in the IFIs and in leading administrative positions in their home countries. Thus, the IFIs find domestic supporters for their reform programs who share a common world view and help to convince politicians of the necessity of neoliberal reforms.

Globalization then had an indirect effect on the systems of social protection via the austerity and structural adjustment policies implemented in the wake of the debt crisis, and a direct effect via the influence of the IFIs. Social expenditures were reduced as a percentage of GDP and in absolute terms in the 1980s, and they recovered slowly in the early 1990s. Bankruptcies and privatizations led to layoffs in the formal sector and thus to loss of social security coverage of a large number of employees and their families. Though the IFIs had developed a clear concern with the political sustainability of the economic reforms by the late 1980s, their reform plans did little to alleviate the plight of these employees. The approach of the IFIs was to privatize pensions and large parts of health care, and to concentrate resources in targeted programs on the poorest sectors in the form of preventive health and nutrition programs, and social emergency funds. These funds were to provide loans to the poorest communities for economic and social infrastructure, social services, and sometimes production ventures. In the 1990s, the IFIs added a concern with human capital and began to promote investment in primary education.

Effects of the Reforms

The most cited achievements of the reform efforts are a reduction of inflation through macroeconomic stabilization measures and a strengthening of fiscal discipline, visible in smaller budget deficits. Also, after the lost decade of the 1980s, growth resumed in the 1990s as did capital flows to Latin America, increasingly in the form of direct investment. Renewal of capital flows is attributed to economic liberalization in so far as these reforms strengthened investor confidence. However, Latin American economies have suffered from great volatility and vulnerability to external shocks, and various financial crises, such as the Mexican Peso crisis, the East Asian financial crisis, and the Argentine crisis of 2001-02, had ripple effects throughout the area. The boom and bust pattern can clearly be linked to the reforms. Strong inflows of capital in the context of liberalized capital markets and trade led to an appreciation of the real exchange rate, increasing trade deficits, excessive expansion of the financial

system, and increases in private and public spending. When investor confidence and capital inflows declined precipitously due to some external shock, the booms were followed by busts and governments were forced into new rounds of austerity measures. Average growth performance was far from sufficient to generate enough jobs to absorb the growth in the labor force, and growth rates fell from an average of 4.1% in the first half of the decade to 2.5% in the second half (ECLAC 2001: 23).

Defenders of the reforms argue that Latin America's main problems, insufficient export performance, high concentration of wealth and income, high un- and under-employment, high poverty, and low tax revenue, are of a long-standing structural nature. However, not only did the reforms not fulfill the promise of alleviating these problems, but at least in the case of concentration of wealth and income they aggravated the problem. The largest firms, with access to foreign financing and markets, were in the best position to take advantage of the liberalized markets and of privatization of public enterprises, and thus to expand their holdings, while many smaller enterprises went bankrupt. Among the many unfulfilled promises of the reforms is the sluggish response of export production; indeed, export increases have been lagging behind import increases (Baumann 2002; Stallings and Peres 2000: 20-21). Unemployment increased from 4.6% of the labor force in 1990 to 8.6% in 1999. Also, most of the jobs that have been created since the early 1990s are in low productivity and thus low wage sectors, principally in the informal sector (Tokman 2002).

Most countries increased their social spending in the 1990s in both absolute terms and as a percentage of GDP; on average, social expenditure rose from 10.4% in 1990 to 13.1% in 1999. This increase, however, even combined with economic growth, was far from sufficient to lower poverty effectively and undo the damage done in the 1980s. Poverty did decrease from 48.3% of the population in 1990 to 43.8% in 1999, but this figure remained above the 40.5% of the population who had been poor in 1980. In absolute terms, the number of poor people increased by 11 million in the 1990s (ECLAC 2001: 14-15). Nor was there any progress in reducing inequality; Latin America remains the region with the most unequal income distribution. Indeed, in some countries inequality continued to increase. What is crucial to point out here is that the two countries that performed clearly best in protecting the lowest levels of inequality were Uruguay and Costa Rica (ECLAC 2001: 18), where structural reforms had been carried out slowly and cautiously and the structural reform index in 1999 was below the regional average (Lora and Panizza 2002).

Given these experiences with two decades of reform in economic and social policies, critiques of the Washington consensus are assuming a higher profile in policy making circles in some Latin American governments, and even in some IFIs. Most simply urge greater attention to human capital formation and to state capacity for implementing reforms properly, but others are beginning to ask whether the reforms have not restricted the state's role excessively. In particular, the recurrent financial crises and their ripple effects are putting the question of deregulated capital markets squarely on the table.

Conclusion

Advanced Industrial and Latin American and Caribbean Societies Compared

The extent of liberalization and privatization has clearly been greater in Latin America and the Caribbean than in advanced industrial societies, in both economic and social policy realms. Just to take a couple of dramatic examples, no advanced industrial society completely privatized its pension system, whereas five Latin American countries did so; or, no advanced industrial country slashed its government expenditure in half, as did Argentina between 1983 and 1989. Three main factors account for these differences. First, state intervention in the economy, particularly protection of domestic production, had been more extensive, so there was more to liberalize. Tariff levels in the early 1980s were still at an average of 45%, and average maximum tariff levels at 84% (Baumann 2002). Second, Latin America's dependence on foreign capital had been an incentive for overborrowing in the 1970s, which in the context of the debt crisis of the 1980s gave great leverage to the IFIs to push the agenda of austerity and liberalization. The rising debt burden greatly aggravated government deficits, which climbed above 5% in the early 1980s in many countries and reached into the double digits in some. The IMF response was a slashing of public expenditures. Indeed, total government expenditures as a percentage of GDP declined between 1983 and 1989 from 20 to 10% in Argentina, 35 to 26% in Chile, 26 to 23% in Mexico, and 19 to 13 % in Peru; the decline in Uruguay and Costa Rica was smaller, from 20 to 18% and from 20 to 19%, respectively (IDB 1991: 284-85).

Third, domestic opponents of liberalization, particularly labor unions and leftist political parties, have been weaker than in advanced industrial societies, and the democratic political institutions through which they might have resisted have been weaker also. Labor had been greatly weakened through repression under the military regimes, and the economic crisis added to its weakness. There are no reliable data on union density in Latin America, but even if we take the higher end of McGuire's (1996) estimates, there is no doubt that density is much lower than in advanced industrial countries, with the exception of the United States and France. Political divisions with long historical roots further diluted the collective action potential of the union movement. With some important exceptions, parties as institutions are rather weak in Latin America (Mainwaring and Scully 1995), and parties of the democratic left are among the weakest. Only in Costa Rica and Chile can one speak clearly of effective participation of democratic left parties in national governmental power in the 1980s and 1990s.[8] Relatedly, legislatures as institutions have often been too weak in the newly established democracies to oppose overbearing executives in the implementation of radical austerity and liberalization policies.

Reflections on the Nature of Globalization

In the visions of neo-liberal academics and popular journalism, the root cause of globalization is the inexorable operation of impersonal market forces assisted by advances in communications and transportation technology. By contrast, our account has

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[8] In Chile the reforms had been implemented under the military dictatorship; the civilian governments of the 1990s left the new structures unchanged but significantly increased social expenditures.

emphasized how political the process has been, with the decisions of governments, international organizations, and powerful economic interests figuring centrally in the onward march of globalization. While it is disputed whether the hands of the early capital market liberalizers were forced, as we mentioned above, it is indisputable that these governments, all large actors in the international economy, made these decisions to secure their own economic advantage. By sociological accident not yet fully understood, the size of the domestic market is inversely related to union density and by extension to the strength of the left (Stephens 1979, 1991; Wallerstein 1989, 1991, Western 1997). Thus, countries where the left was strong and had employed capital controls as a tool to pursue its economic ends were not in a position to resist decontrol once the large countries had liberalized their internal and external capital markets. As a consequence, even Nordic social democracy favored entry into the EU under the conditions of the Single European Act by the end of the 1980s. However, with the exception of New Zealand and Britain, pro-welfare state forces were able to resist radical retrenchment, so the edifice of the post war welfare state stood intact as of 2002, and poverty and inequality did not rise significantly except in New Zealand, Britain, and the U.S. with its traditionally minimalist welfare state. The Latin American countries, as we have seen, were not so fortunate due to both more unfavorable internal balances of power, greater influence of the IFIs, and the differing posture of the relevant international organizations (IMF and World Bank vs. EU) on the appropriateness of neo-liberal solutions in the area of social policy. Moreover, the reality of political power and interests continues to support globalization: Though the economic costs of currency speculations have been repeatedly demonstrated, the political will to reintroduce modest controls, such as the Tobin tax, is lacking, particularly in the United States, one of the chief beneficiaries of the free flow of capital.