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3 Populism, Profligacy, and Redistribution

Eliana Cardoso and Ann Helwege

3.1 Introduction

Recent bouts of economic instability, originating in overexpansion and ending in hyperinflation, led economists to describe regimes in power during the past decade in Latin America as populist. Certainly Sarney, Alfonsín, García and the Sandinistas have overseen inflation caused by budget deficits and balance-of-payments crises. The macroeconomic imbalances of these governments show strong similarities with the economic record of Perón, Vargas, and Goulart, three leaders traditionally identified as populists. Yet one should think twice about generalizing the term. Although recent regimes have failed to rein in budget deficits, the economic strategies they pursued and their underlying motivations display considerable heterogeneity and are quite distinct from past populism. This paper discusses these differences.

Why debate terminology? There are lessons that recent leaders should have learned from traditional populists. The most basic is that failure to adjust to constraints imposed by the balance of payments and the internal productive capacity will lead to inflation and disaster (Harberger 1970). Yet, the early warning signs, evident in rhetoric and specific policies, have varied widely. If we broadly identify the disease and lump, ex post, all inflationary failures into the category of populism, we will not understand ex ante the development of crises and avert them. Moreover, because populism is associated with redistribution (although not toward the poorest), it is important to clarify when and why redistribution can lead to inflation.

We begin by describing classical populism, as it has been viewed by Latin

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Americanists over the past four decades (Archetti, Cammack, and Roberts 1987) and use the Argentine experience between 1945–52 to illustrate it. We then describe the new economic concept of populism, put forth by Sachs (1989), Dornbusch (1988), and Dornbusch and Edwards (1989). Their analyses stress the repeated willingness of Latin American regimes to push demand beyond economic bounds. We then examine specific cases of populism discussing the diversity of situations. We emphasize that there are at least three distinct roots of inflationary finance:

- excessive optimism about the potential for rapid growth through demand stimulation and inward-looking industrialization, as seen in the Peruvian experience under García;
- market-based socialism, which causes insecure property rights and triggers intervention from the United States and larger defense budgets, as observed in Nicaragua in the 1980s;
- the inability to impose the burden of contractionary adjustment on various groups, as in Brazil after the oil shock and debt crisis.

Far from providing a compelling indictment of redistribution efforts, the history of populism makes conspicuous the paucity of genuine redistribution programs in Latin America. Most regimes failed to target the poor. Urban workers in the informal sector did not benefit from populist increases in the minimum wage, nor did social programs concentrate resources on the indigent. The rural poor suffered both from a deterioration in agriculture's terms of trade and a failure to implement land reform with adequate credit and technical assistance.

3.2 Classical Populism

Social scientists (Baily 1967; Conniff 1982; Germani 1978; Hamilton 1980; Hennessy 1976; Malloy 1977; and Stein 1980) traditionally associate populism with policies pursued by Perón in Argentina between 1946 and 1949, by Vargas in Brazil after 1945, by Cárdenas in Mexico between 1934 and 1940, and by Velasco in Peru between 1968 and 1975.

We refer to these episodes as classical populism, an urban political tradition that opposed the primary-product-export-oriented status quo of the nineteenth century and endorsed accelerated industrial development. It constructed alliances linking the working class to the industrial bourgeoisie and minimized interclass antagonisms through the propagation of a broadly nationalist ideology.

Classical populism favored activist governments committed to a strong role in price determination, to protection of workers and wages, to policies of cheap food, to state ownership of key industries, to state allocation of credit at low interest rates, and to favors for private industry. It rejected any appeal to the need for overall restraints on spending. The consequences were an extensive growth of government relative to the private sector and the pervasiveness of corruption in varied forms, including tax evasion. Growing budget deficits resulted in rising dependence on foreign savings. Import substitution associated with trade restrictions resulted in dependence on foreign capital. The urban bias of economic policy and resource allocation resulted in dramatic rural poverty.

Economists and political scientists from right and left have emphasized the negative sides of populism. The right attacks populists as demagogues who fuel inflation, frighten capital, and provoke political instability. The left accuses them of betraying the masses. But it was not part of populist programs to carry out a social revolution, as in Allende's Chile or Ortega's Nicaragua. Populists hoped to reform the system, not to overthrow it. Their program was to deliver economic growth based on industrialization as the path to sustained employment. Overwhelmed by their mistakes, we now tend to forget the successful role played by import-substitution industrialization (ISI) in Latin American extravagant growth rates, which averaged more than 5 percent per year between 1950 and 1980 (table 3.1). It is worthwhile asking whether there were viable alternatives to the populist import-substitution industrialization of the 1940s and 1950s. Right-wing, coercive regimes in the 1970s did not provide political development, economic growth, and social justice. Neither did socialist governments.

ISI was the pragmatic answer to the problems following the Great Depression of the 1930s and the disruption of the Second World War. Later, structuralists, cepalists, reformists, and developmentalists conceived the economic models that justify the import-substitution strategy pointing to the inadequacy of market mechanisms alone to achieve industrialization (Prebisch 1976; Singer 1984). They built their arguments on two pillars:

- They called attention to the foreign exchange constraint as an important determinant of growth. In a world where the terms of trade moved against traditional primary export products, domestic production would have to substitute for nonessential imports, freeing foreign exchange for the needed inputs. Moreover, while technical progress in agriculture would leave labor unemployed, industry could absorb the growing population with increasing productivity and incomes. Expanding domestic production required protection against imports.
- In the microeconomic sphere, they stressed imperfections and discontinuities, both of which impeded effective operation of price signals. Whether in agriculture, where land concentration was notorious, or in industry, where new privileges provided shelter from market forces, the competitive model was flawed.

These conditions supported a strong state presence. Development was a consequence of policy, not the result of natural evolution (Cardoso and Fish-

Table 3.1 Per Capita Gross Domestic Output and Growth Rates of Latin American Countries[a]

	Share in Total Population, 1980 (%)	GDP per Capita (1975 Dollars)		Growth Rate of GDP per Capita (% per year)	
		1950	1980	1950–80	1981–89[b]
Brazil	35.6	637	2,152	4.2	.0
Mexico	20.2	1,055	2,547	3.0	−.9
Argentina	8.0	1,877	3,209	1.8	−2.4
Colombia	7.5	949	1,882	2.3	1.4
Venezuela	4.3	1,811	3,310	1.5	−2.5
Peru	5.1	953	1,746	2.1	−2.5
Chile	3.2	1,416	2,372	1.8	1.0
Uruguay	.8	2,184	3,269	1.4	−.7
Ecuador	2.3	638	1,556	3.1	−.1
Guatemala	2.0	842	1,422	1.8	−1.8
Dominican Republic	1.7	719	1,564	2.6	.2
Bolivia	1.6	762	1,114	1.3	−2.7
El Salvador	1.3	612	899	1.3	−1.7
Paraguay	.9	885	1,753	2.4	.0
Costa Rica	.6	819	2,170	3.3	−.6
Panama	.5	928	2,157	2.9	−1.7
Nicaragua	.7	683	1,324	2.3	−3.3
Honduras	1.0	680	1,031	1.4	−1.2
Haiti	1.6	363[c]	439	.7	−1.9
Latin America[d]				2.7	−0.8

Sources: Summers and Heston (1984); and ECLA, *Preliminary Overview of the Latin American Economy, 1988*.

[a]Countries are ordered by average share in regional GDP between 1950 and 1985.

[b]Figures for 1989 are preliminary.

[c]1960 amount.

[d]Latin America except Cuba.

low 1992). Such a model made sense but was far from perfect. It downplayed the market role and confronted three limitations:

- Protection led to overvalued exchange rates and hence to an eventual reduction in the export supply. Industrialization in turn required increased inputs of capital goods and intermediate imports. As trade deficits increased, foreign capital flows became vital, an ironic consequence of a strategy deriving its strong political appeal from its emphasis upon national productive capability.
- In sectoral terms, import substitution policies exaggerated industrial growth at the expense of agriculture. Moreover, relatively capital intensive manufactures absorbed only a fraction of the increment in the labor force, placing pressure on government to serve as an employer of last resort.

- Finally, as the resources taxed away from primary exports failed to increase, subsidies to industrial investment and growing government responsibilities put new pressures upon the budget. Monetization of the deficit led to persistent inflation.

The distributive agenda of populism called for an increase in urban incomes at the expense of rural producers, exporters, and foreign capital. Velasco and Cárdenas promoted agrarian reforms in Peru and Mexico, but their credit and price policies favored the urban sectors. Specific policies included higher minimum wages, price controls on food, and protectionist barriers. While the urban working class served as a primary constituency, domestic industrialists also supported Perón, Vargas, and Velasco.

The classical populist agenda of redistribution was not sustainable for the same reasons that ISI failed in the end. Protectionism did not raise real productivity to create a basis for large gains in urban wages. Nor did tax collections grow enough to finance government subsidization of the industrialization process. Inelasticity of supply in the agricultural and export sectors was overestimated: it did not take long for overvalued exchange rates and price controls to cause stagnation in these sectors. Alienation of foreign capital exacerbated problems. In the absence of a major boom in export prices, classical populism rapidly self-destructed.

The most representative populist was Perón. He came to power in 1946 by building a base of support among unions as Argentina's secretary of labor between 1943 and 1945. Perón promoted the vision of a rapidly industrializing Argentina, free of foreign influence.

Wages rose rapidly as Perón's government settled strikes in favor of workers: real wages rose 25 percent in 1947 and 24 percent in 1948 (Skidmore and Smith 1984). Labor's share of income rose from 40 percent in 1946 to 49 percent in 1949. Social security benefits expanded dramatically (Mesa-Lago 1978). What made this rapid redistribution possible without an immediate collapse of the economy was the boom in Argentina's export prices after the Second World War. Export revenues more than doubled between 1945 and 1948, although volume remained roughly the same (Rock 1975). Industry grew markedly faster than agricultural growth. Control of the state marketing board for agricultural output enabled the government to keep food prices down and reap a surplus from exports. Despite high world prices, agricultural income declined 27 percent between 1946 and 1949. Perón's strong nationalist streak led to nationalization of the railroads, the telephone system, and the ck facilities, with ample compensation of foreign firms.

Problems emerged in 1949. Argentina's terms of trade deteriorated sharply as adjustment in postwar Europe curtailed the region's ability to import food and U.S. agricultural protectionism excluded Argentine goods. The trade balance turned from surplus to deficit. Reserves disappeared. Complicating the situation was the adoption of inconvertible currencies by Argentina's trade partners. "Europe could not pay; the United States would not buy" (Fodor

1975, p. 150). Exchange rate policy and low prices paid by the agricultural marketing board exacerbated the consequences of unfavorable shifts in the world economy.

Internally, expansion had gone well beyond what could be financed by agricultural surpluses. The money supply was increasing rapidly in order to finance industrialization. Inflation doubled to 31 percent in 1949. Perón launched a stabilization program, tightened credit, cut government spending, and capped wage and price increases. He offered incentives to agriculture and made overtures to foreign capital. A severe drought in 1950/51 forced further adjustment.

The multiclass, nationalist alliance needed high growth to sustain political viability. After 1952, "the state's adjudicatory role in the economy ceased to be a matter of allocating relatively higher rates of return to one group or another in the midst of an expanding surplus. Economic recession meant that its role became more coercively redistributive" (Rock 1975, p. 191). The government became increasingly authoritarian to force adjustment on various groups. Growing levels of violence and social tension preceded a military takeover in 1955.

3.3 Economic Populism

Recent economic literature argues that populist policies like those of Perón were repeated in the 1980s, leading to similar crises. Two excellent articles spell out a new, economic definition of populism. Dornbusch and Edwards (1989) define populism as an "approach to economics that emphasizes growth and income redistribution and deemphasizes the risks of inflation and deficit finance, external constraints and the reaction of economic agents to aggressive non-market policies." The belief in excess capacity sets up the expectation that government deficits and higher real wages are feasible. Governments avoid devaluations because of their distributive consequences. As higher wages go into effect, the economy responds with more rapid growth, but it does so by running down inventories and foreign reserves. Bottlenecks become binding constraints and inflation takes off. The failure to reverse redistributive efforts leads into growing government deficits, balance of payments problems and pervasive shortages. The collapse of the economy makes workers worse off than they were at the beginning of the populist period.

In a similar vein, Sachs (1989) blames much of Latin America's inflation on attempts to implement redistributive policies. In an insightful analysis, he argues that Latin America's high level of income inequality creates political pressure to pursue bad macroeconomic policies. In an environment of high social conflict, populist regimes attempt to improve the lot of low income groups, mainly through demand stimulation. The result is a set of unsustainable macroeconomic policies including government deficits and overvalued exchange rates. What perpetuates the cycle of populism is that expansionary policies yield favorable results at first. Because leaders have insecure tenure in office they adopt short-sighted policies that bring immediate gains to their constituencies.

Both articles argue that the politics of each regime and the specific policies are not significant. What needs to be learned is a universally applicable lesson: policies must be consistent with the capacity of the economy to generate foreign exchange for imports and savings to finance investment. In the past two decades, several Latin American regimes have failed to manage their economy within these limits. Nowhere is the sense of déjà vu stronger than in the case of Peru's once charismatic president, Alán García.

García took power in 1985 promising growth at 6 percent per year and the weakening of the *Sendero Luminoso*. A demand-driven expansion was set in motion. Wages were sharply increased, interest rates cut, and taxes reduced. Old style structuralism provided the rationale: inadequate demand prevented the economy from reducing costs through economies of scale; low elasticities of supply in the export sector accounted for balance-of-payments problems; unemployment and unused industrial capacity implied that the economy could grow much faster.

Policies were nationalistic and inward looking. García increased tariff levels, imposed restrictions on capital flows and announced that Peru would not pay more than 10 percent of its export earnings in debt service. To control inflation, he froze prices and fixed the exchange rate. Like Perón, he intended not only to serve labor through higher wages but to raise profits for local industrialists through stimulation of demand and increased protectionism.

The initial results were fantastic. In 1986, inflation dropped to less than half its level in the preceding year and growth shot up to 9.5 percent. Strong growth continued in 1987 (at 6.7 percent), but inflation exploded and the economy moved quickly toward collapse. The public sector deficit had more than doubled, from 4.4 percent of gross domestic product (GDP) in 1985 to 9.9 percent in 1987 (Dornbusch 1988). As reserves evaporated, García continued to raise wages, announcing a generous wage package in April 1987. He executed his own coup de grace in late July by nationalizing the banks. Industrialists immediately withdrew their support and social conflict intensified. By early 1988, inflation was well over 1,000 percent and output was sliding rapidly. For all intents and purposes, García relinquished control to aides.

Like Perón, García did not aim at the very poor. Urban wage earners (especially unionized workers and public employees) and domestic capitalists were the first to gain. These gains were more distributive than redistributive: growth in the size of the pie can benefit all. Initially, the rural sector was hurt by García's exchange rate policies. As shortages of foreign exchange developed, he allowed peasant prices to rise and made credit more readily available, but he never implemented a program to overcome widespread rural poverty. Support for the *Sendero Luminoso* barely wavered.

If Perón served as the model for populism's demise, the shoe fit García fairly well. Neither was serious enough about redistribution to do it without trying to boost growth, and both were more interested in distributive issues affecting the politically powerful than the poor. As Sachs (1989) suggests, lack of consensus about income distribution does indeed cause political tension, and policymakers often try to diffuse this with inflationary spending. The poor, however, are neither part of the political conflict nor prominent in the populist solution. Populism lacks a significant role for redistribution.

Genuine efforts to mitigate poverty do not necessarily lead to hyperinflation: Costa Rica has done fairly well on this score. At the same time, hyperinflationary experiences are not always the result of failed populism. Few authors would be willing to argue that Martinez de Hoz was a populist, but his policies also led to a balance-of-payments crisis and the explosion of inflation in Argentina. The easy access to foreign capital enjoyed by the military in the late 1970s helped sustain bad policies and macro imbalances. Argentina's neoconservative experience indicates that even without populist rhetoric, governments are quite capable of pursing polices that fuel inflation and balance-of-payments crises (Ramos 1986). Procapital policies are not a panacea for instability, nor is redistribution necessarily to blame for economic mismanagement.

3.3.1 Allende and Ortega: Populists?

Two socialist experiences, Allende's regime in Chile (1970–73) and the Sandinista era in Nicaragua (1979–90) have been placed under the broad rubric of economic populism. Both regimes collapsed as hyperinflation created increasingly chaotic economies. Moreover, both governments promoted redistribution and ran deficits that were the proximate cause of inflation. In the case of Allende, there was also excessive optimism about the potential for economic growth through demand stimulation. Nonetheless, the socialist nature of these regimes sets them apart: their challenge to capitalism vitiated any possibility of building a multiclass alliance and set up strong internal and external forces determined to overthrow the regime. The instability caused by uncertain property rights and U.S. hostility figured strongly in the development of macroeconomic imbalances.

3.3.2 Allende

When Allende took power in 1970, Chile was already a highly urbanized, industrial economy. Chileans enjoyed the third highest per capita income in Latin America. An extensive social welfare system kept extreme poverty to low levels relative to the rest of Latin America. In contrast to Perón and Vargas, who introduced import-substituting industrialization strategies and social welfare legislation, Allende came to power after these had occurred in Chile. The economy depended upon imported parts and materials for its heavily protected industry, and agriculture had been neglected for decades. Whereas Perón tried to set up a successful and profitable industrial sector, Allende's program targeted redistribution. The multiclass base of Perón's regime was not evident under Allende. Instead, he took power despite strong opposition from capitalists.

Allende's first step in early 1971 was to increase real minimum wages by 37–41 percent for blue-collar workers and by 8–10 percent for white-collar workers. He expanded housing, food, and educational assistance: public-housing starts were up twelvefold and eligibility for free milk was extended from age 6 to age 15. The government deficit rose from 3 percent to 10 percent of GDP (World Bank 1981).

Initially, idle capacity, high copper prices, and large reserves of foreign exchange helped. Real GDP rose 7.7 percent, and unemployment in Santiago fell from 8 to 4 percent in 1971. Industrial output rose sharply as consumer demand expanded. The hard currency needed for this expansion came from foreign reserves, a drawing down of inventories and reduced capital imports. (Industrialists cut capital imports in part because of wariness about Allende's respect for private property rights.)

Allende attempted to repeat his early success with a new round of wage increases in 1972. Real blue-collar wages were increased by 27 percent and white-collar wages were fully indexed. But shortages of foreign exchange became serious, and it was impossible to increase Chileans' consumption without sustained copper earnings and commercial lending. Working-class consumption in Chile was very import-intensive, as both manufactured goods and food imports required foreign exchange. The country's backward agricultural sector was in no position to absorb growing demand for food. Eduardo Frei's gradual process of land reform was accelerated: takeovers increased eightfold in Allende's first year. Despite rising real food prices, both the area planted and output fell.

Compounding Allende's problems was a sharp decline in receipts of foreign exchange:

- Copper prices fell by a sharp 23 percent in 1971 and did not recover until mid-1973, a few months before the coup. At the time, copper accounted for two-thirds of the country's export earnings. Although volume did not change markedly, export earnings fell 24 percent, between 1970 and 1972.
- The U.S. government, opposing Allende from the start, contributed to his downfall by withdrawing aid, by placing an embargo on exports to Chile, and by financing his opponents. Allende's call to end compensation to foreign firms nationalized in the 1960s was a specific basis for opposition. Socialist ideals were the general cause of antagonism. Net official capital flows from the United States dropped from \$172 million in 1969 to −\$198 million in 1971. Refusal to repay debt restored capital flows to a negligible positive amount. Commercial lenders also eliminated their short-term credits. It is often noted that Allende received more aid from communist countries than he lost from Western creditors. In fact, almost all of this aid was granted for purchases of industrial plants and technical assistance, which

Chile did not need. It did not provide spare parts for existing equipment or necessary intermediate materials and food. By June 1973, the Chileans had taken up only 21 percent of the credits offered by the East Bloc.

Was Allende a populist? In terms of the new economic definition of populism, three criteria are met: he tried redistribution through wage increases, government deficits rose dramatically, and a balance-of-payments crisis figured prominently in the economy's collapse. By more traditional notions of populism, the case is not clear. The program never aimed at satisfying both capitalists and workers. From the start, it was expected that capitalists would gradually lose. The regime's socialist agenda brought property rights into question. Workers increasingly demanded that the state take over plants, and social tension over property rights turned to near anarchy by the end (Falcoff 1989). The Allende constituency was distinctly not a multiclass coalition, as political scientists so often describe populist regimes. Nor was Allende's long-term strategy to promote capitalist growth with the help of selective state intervention. The Popular Unity platform explicitly rejected the power of industrial monopolists who had gained power during Chile's import-substitution period (Sideri 1979).

The Popular Unity agenda violated basic rules of good macroeconomic management. Allende's problems, however, derived also from his willingness to step into the conflict between superpowers and his challenge to private property rights, two significant factors that cannot be dismissed. Of course, one can also debate just how socialist the Allende regime was. It never controlled the legislature enough to implement a dramatic change in the nature of production or the structure of social classes.

3.3.3 The Sandinistas

The Sandinistas' downfall resulted from weak economic performance, but they followed a different path from the one chosen by Allende. The Sandinistas put no stake on demand-driven growth. They counted the beans in their bag and knew that none were magic. Yet pursuit of a redistributive program (as distinct from distribution with growth) caused an unmanageable political backlash.

When the Sandinistas took power in 1979, the rural sector represented roughly half of the economy. The industrial sector employed a smaller proportion of the labor force than in other Latin American countries. Although some basic industries were in place (food processing, cement, fertilizer, and petroleum refining industries), there were virtually no sophisticated assembly operations. The Sandinista strategy did not have to cater to a highly protected industrial sector, nor did the program call for import-substituting industrialization.

The first years of the revolution brought an energetic attack on urban and rural poverty. During Somoza's last years, Nicaragua had the highest child death rate in Latin America, and 47 percent of the population was illiterate.

The Somoza regime itself estimated that 60 percent of rural Nicaraguans were undernourished. The Sandinistas embarked on a massive literacy campaign, construction of health clinics and schools, extension of water services, and agrarian reform.

Were there resources to finance these revolutionary programs? Initially, yes. Foreign aid was extraordinarily generous during the regime's first three years. Moreover, the government took over land owned by Somoza and his close associates (23 percent of the country's cultivated land) to initiate its land reform program. Taxes increased from an average of 13 percent of GDP in the period 1974–78 to 22 percent in 1980; they peaked at 35 percent in 1984. The government deficit, at 8.9 percent of GDP in 1978, stayed at that level through 1981 and then jumped when Contra activity began in 1982. However, extensive foreign aid mitigated repercussions from this deficit in the regime's first years (Helwege 1989).

The Sandinistas were very careful to avoid across-the-board wage increases. The right to strike was tightly controlled and wage increases were strongly discouraged as early as 1979 in an effort to contain inflation. The hope was that a tight lid on wages would help the private sector to slowly recover from the destruction caused by the war. Inflation was modest in the regime's first years. It was 37 percent in 1980 and dropped down to 12 percent in 1981, 17 percent in 1982, and 11 percent in 1983. It did not get over 100 percent until 1985.

What went wrong? Four factors contributed to the Sandinistas' problems. First, socialist rhetoric and threats to expropriate property created enormous uncertainty for private producers, who were expected to generate most output. Second, world prices of cotton and coffee, which account for about 60 percent of the country's export earnings, fell after 1980. Third, the currency was grossly overvalued as early as 1980. Finally, the war with the Contras, which started in 1982, must take most of the blame.

As a result of civil war, the government deficit soared to 30 percent of GDP in 1983 and stayed in the 15–25 percent range thereafter (Ocampo and Taylor 1989). Half of the government's budget was devoted to the military, squeezing out social spending. The war effort drew scarce resources from the rest of the economy. The draft exacerbated labor shortages and export earnings were diverted toward weapons, forcing industry and agriculture to get along without imported parts and fertilizers. Rebel attacks also destroyed the transportation infrastructure and prevented harvests in the most important agricultural areas of the country.

The war also made distributive issues more critical. Rural peasants could not be alienated for fear they would support the Contras. Both in pursuit of socialist goals and for defense reasons, the government continued to give peasants title to land and to build schools and health clinics in rural areas as budget deficits became unmanageable.

At the same time, it became increasingly important to maintain the presence of large private producers. They not only brought in most of the country's hard currency, but they legitimated the government's claim of respect for private property, blunting European support for a full-scale invasion by the United States. The government paid dearly for their support. Subsidies to this group included a multiple exchange rate system that enabled large producers to buy pesticides and fertilizers at low rates while selling export dollars back to the government at the parallel rate. Credit was also heavily subsidized.

Urban workers were the easiest to control. Although the government courted urban workers with rhetoric, their real wages fell every year after 1981 (and they had increased only minimally before that). Shortages of basic goods were pervasive in urban areas early on and became worse as the economy deteriorated.

Unable to impose the full burden of defense on any group, the government increasingly used the printing press. By 1986 private consumption had fallen to roughly one-third of its prerevolution level. For the next three years, Nicaraguans scrambled to outwit inflation by hoarding and speculating, making matters worse. By 1988 inflation had reached 11,500 percent and output had fallen back to levels of the late 1960s.

Populism was not the problem in Nicaragua, socialism was. It caused too much uncertainty about property rights, and it triggered a war that the country simply could not afford. Although the Sandinistas ran deficits, the reasons for these deficits differed from those one finds in classical populist experiences.

3.3.4 Brazil: Endless Populism?

1945 provides a good starting point for discussing politics in Brazil. Vargas's populist reputation is based on the last 10 years of his political career. Having relied on a ruling coalition of military elites, coffee exporters, and industrialists throughout the 1930s, Vargas began to bid for the support of workers in the mid-1940s. In 1942, he instituted a minimum wage and, in 1943, a labor code. In 1945, a group of radicals in the *Partido Trabalhista Brasileiro* (PTB) called for reform socialism and for special development banks that would provide massive injections of capital in order to broaden the internal market for domestic manufactures. This more radical program greatly influenced the PTB after Vargas's reelection in 1950. Vargas moved to the left within the framework of restrained militancy of organized labor and state control over union financing. With unions extensively supervised, Brazilian industrialists and exporters did not feel threatened and acquired a vested interest in the government subsidies and investment policies. During the decades to come, Brazil was to operate under the legacy of her most notorious populist leader. Continuing expansionist policies attenuated distributional conflicts and blended the interests of business and bureaucracy.

By 1950 the easy phase of populist import-substitution industrialization was over. Adjustment was avoided by violating budget constraints and engendering inflation. Such problems encumbered Vargas in 1954, Kubitschek in

1958, and Goulart in 1964. When Goulart, trapped in deep economic crisis, tried to undertake radical reforms, the military stepped in. National security doctrine provided the ideological justification for intervention by claiming that the survival of a free society depended on putting an end to the popular classes' resistance to authority.

The new military government announced a series of policies aimed at reducing the public-sector deficit, raising taxes, cutting import tariffs, establishing wage controls and allowing foreign investors easier access. The limits of the import substitution strategy were recognized and important modifications to commercial policy introduced in the late 1960s. A crawling peg exchange rate avoided the overvaluation so predominant earlier. Explicit concern for inducing nontraditional exports produced special export subsidy programs. In the context of a more buoyant international market, such reinforcements produced positive results, and export growth and diversification increased.

Still, the commitment to industrialization remained. And that meant an intrusive role for the public sector even under the "orthodox" policies pursued by military governments. Their administrations were a clear descendant of import substitution, not outward orientation. The large domestic market still dominated production decisions and economic austerity did not last long. By 1974 the populist tradition of accommodation staged a comeback.

Mounting indebtedness and deterioration of domestic policy in a more difficult external environment marked the post–oil shock experience. Brazil chose her adjustment strategy badly, relying upon import-substituting investment stimulated by the government rather than upon market-driven responses to changes in exchange rates or the relative price of petroleum. External debt played a central role: it financed investment and large current account deficits, postponing the negative real income effects of the shock. The strategy succeeded in sustaining high rates of growth, but the debt/export ratio almost doubled. At the same time, fiscal disequilibria increased as government pursued its ambitious investment plan. Even on the eve of the second oil shock, Brazil faced the need for a midterm modification of strategy. But the "recessionist" proposal of Finance Minister Mario Simonsen yielded to a more ambitious supply-side plan undertaken by Antonio Delfim Netto in 1979. Priority was given to credit expansion in order to finance investment in the agricultural and energy sectors. Macroeconomic policy was supposed to contain inflation by reducing interest rates (seen as a significant cost component) and by changing expectations through preannounced internal monetary correction and exchange rate devaluation.

Delfim's "populist" strategy did not work. The weakness of the economy only became fully apparent when a new oil price rise, an abrupt increase in real interest rates, and an OECD recession coincided in the early 1980s. The balance of payments registered a record current account deficit in 1980. The inflation rate reached the three-digit level, reflecting excess demand, supply shocks, and the consequences of a new wage law mandating a shorter adjustment lag. In October 1980, a more orthodox package of fiscal and monetary restraint was fashioned and Brazil entered into a period of adjustment through recession that was to last until 1983.

The translation to democracy in 1985 opened the way for popular resistance to austerity measures. Sarney brought in a new populist experiment, the Cruzado Plan. The goal was to stop inflation without imposing contraction. With prices frozen, the budget was allowed to deteriorate while monetary policy turned expansionist. Inflation disappeared temporarily but new stabilization programs were necessary in 1987 and in 1989. Once again, the government froze prices and cut zeros off the face value of the currency. Promises to eliminate the budget deficit were made but not kept. President José Sarney lacked the political will to implement measures of fiscal consolidation.

Was Sarney a populist? He certainly meets all the criteria of the new economic concept of populism. Yet, according to more traditional views, he fell short of the charisma of a populist leader. The heterodox Cruzado Plan reflected his inability to impose contraction on any constituency, for he lacked popular support and allies in the Congress.

The threat of hyperinflation at the end of 1989 coincided with the presidential election that brought Collor to power in March 1990. Collor seems to fit the classical description of the populist leader. During his campaign he spoke to masses of the poorer sectors of society against the existing institutions of the state. His speech had no precise or logically consistent ideology. It appealed to alienated or deprived members of a mass society and directed its energy against existing elites. He attacked traditional symbols of prestige in the name of popular equality. His populist rhetoric was a collection of strands of both left- and right-wing thought, with a heavy stress on his charismatic leadership, often with a highly illiberal and intolerant stand on traditional civic liberties.

His economic program, though, does not fit the new paradigm of economic populism. The plan mixes "free-marketeering" and authoritarian intervention:

- In 1989, the government had tried to reduce liquidity through high interest rates. As real interest rates rose, so did the cost of servicing the government's domestic debt and the debt itself. Because the government debt was almost equivalent to cash, high interest rates only helped to create more money. Collor's plan eliminated the money overhang. After five days during which all banks were closed by order, the government blocked a large portion of new cruzados in bank accounts—ranging from checking accounts and savings deposits to overnight money-market operations and corporate foreign exchange hedges—for a period of 18 months.[1] A monetary reform replaced the cruzado novo by the cruzeiro of equal value in order to distinguish money that remains in circulation from that which is held in the cen-

1. Frozen assets will yield monetary correction and 6 percent interest per year. Starting September 1991, the government will return funds in 12-month installments.

tral bank. The central bank estimates that M4 was reduced to one-third its previous level.

- The government counts on increased revenues to revert a deficit of 8 percent of GDP into a 2 percent surplus. Part of the revenue derives from increased taxation on financial investments. Elimination of unidentified investors, ceilings on bearer checks, and a special income tax declaration for blocked funds will cut down on tax evasion. Other taxes rose and new ones were levied. For the first time farmers pay taxes. Fiscal incentives are on hold. But increased taxation and a clampdown on evaders might be offset by the decline in economic activity. Some critics also say that the plan did little to curb the spendthrift state: closing a few useless federal establishments will get rid of only a very small fraction of public employees and the initial privatization program looks timid.[2]
- According to the new plan, Brazil has opened its borders. It abolished import quotas, import licenses, and the list of prohibited items. In their place remain tariff barriers. Export subsidies no longer exist. Port and merchant marine surcharges dropped by 50 percent and will disappear in 1991. The exchange rate for trade transactions will float.
- The government froze prices for 45 days but prices of the public sector, of fuel, electricity, postage, and telephone calls increased. Starting in April, wages are corrected according to the government-projected inflation. For April the correction is zero. Many industries have already negotiated with workers a 25 percent cut in wages and reduced work hours.

Collor's plan combines a liquidity and fiscal squeeze of such austerity that, if it sticks, will not only kill inflation but also create a major recession. Yet, the opinion polls show more than 60 percent support for the president. Congress grasped that message and approved the package. It is still too early to judge whether austerity will prevail or melt down before the October elections. The businessmen who last year hustled to fill Collor's campaign coffer now grieve, moan, and whine. The trade unions are protesting the prospect of mass unemployment. Is Collor a populist?

3.4 Populism, Poverty and Distribution

Redistributive efforts based on government deficits and overvaluation will melt in an inflationary pyre. Despite ample experience from the past, this is a lesson that bears repeating. There is, however, an important distinction to be made between policies of excessive spending and programs aimed at overcoming poverty.

Far from providing an indictment of redistribution efforts, the history of populism makes conspicuous the paucity of genuine redistribution programs in Latin American (see tables 3.2 and 3.3). Despite compelling criticism,

2. Banks and financial institutions will be forced to buy privatization certificates.

Table 3.2 Economic and Social Indicators in Latin America[a]

	GDP per Capita Index[b] 1980	Urban Population (% of total) 1987	Life Expectancy (Years) 1987	Infant Mortality (per thousand) 1987	Population per Physician (in thousands) 1984	Literacy Ratio 1978
$Y >$ $2,000 in 1980:						
1. Venezuela	100.0	83	70	36	.70	82
2. Uruguay	98.8	85	71	27	.51	94
3. Argentina	96.9	85	71	32	.37	93
4. Mexico	76.9	71	69	47	1.24	83[c]
5. Chile	71.7	85	72	20	1.23	89[d]
6. Costa Rica	65.6	45	74	18	.96	90[c]
7. Panama	65.2	54	72	23	.98	82
8. Brazil	65.0	75	65	63	1.08	76
$Y >$ $1,000 in 1980:						
9. Colombia	56.9	69	66	46	1.19	81[c]
10. Paraguay	53.0	46	67	42	1.46	84
11. Peru	52.7	69	61	82	1.04	80
12. Dominican Republic	47.3	58	66	65	1.76	67
13. Ecuador	47.0	55	65	63	.83	77
14. Guatemala	43.0	33	62	59	2.18	46[e]
15. Nicaragua	40.0	58	63	62	1.50	90
16. Bolivia	33.7	50	53	110	1.54	63[c]
17. Honduras	31.1	42	64	69	1.51	60
$Y <$ $1,000 in 1980:						
18. El Salvador	27.2	44	62	59	2.83	62
19. Haiti	13.3	29	55	117	7.18	23[c]

Sources: Summers and Heston (1984); World Bank, *World Tables*, IMF, *International Financial Statistics*, PREALC, and ECLAC.

[a]Latin America except Cuba; countries are ordered by size of GDP per capita in 1980.

[b]Indices of GDP per capita in 1980, Venezuela = 100. Venezuela GDP per capita = $3,310 in 1975 dollars.

[c]1980

[d]1970

[e]1975

Table 3.3 **Percentage of Population Living under the Poverty Line in Latin America, 1970–86**

	1970[a]	1981[b]	1986[b]
Argentina	8.0		
Brazil	49.0		
Chile	17.0		
Colombia	45.0		
Costa Rica	24.0	24.8	
Honduras	65.0	68.2	
Mexico	34.0		51
Panama	39.0	53.9	41
Peru	50.0		59
Venezuela	25.0		37
All 10 countries	39.0		

Sources: Altimir (1982); CEPAL (1989).

[a]The national averages of Altimir's poverty line vary between $162 for Honduras and $296 for Argentina (in 1970 dollars).

[b]ECLAC direct estimates follow Altimir's methodology.

changing relative prices was the most common strategy of classical populism. The costs of this policy included significant leakages as well as large government and efficiency costs. Organized, vocal, and visible groups of the modern sector used their political power to press for increases in the minimum wage as well as for food and transport subsidies. Governments, held directly responsible for the earnings of the workers in the modern sector, chose to impose losses on the rural and informal sectors because the administration would be less likely to be held accountable for such losses.

Classical populists distributed the gains from growth among the politically enfranchised. Latin American reformism in the 1960s was based in the alliance between the national bourgeoisie, the middle classes, and urban workers, all aiming at the development of an internal market. The favored groups were urban labor and the middle classes. Industrial workers gained union recognition, electoral power, and welfare benefits. The middle classes received more public jobs, better educational facilities, and decision-making authority in the bureaucracy. *Desarrollo hacia adentro* involved a pattern of growth based on higher levels of consumption by the urban population included in the *pacto social.* But strengthening the labor movement and increasing real wages soon would face its own limits. The *pacto social* supported policies that favored the urban middle class at the expense of the rural population. Thus its contradictory nature: the demand for increased food production by a growing urban population clashed with policies that channeled the bulk of public investment funds to industry.

Regardless of populists' promises to "serve all the people," some sectors were denied access, were ignored or excluded. Although populism favored the urban sector, it barely touched the urban poor. As the cornerstone of populist redistribution, minimum-wage increases promoted the welfare of relatively small groups at the expense of larger groups. When effectively enforced (and often they were not) such laws made wages higher for those fortunate enough to get jobs in the modern, formal sector. They did little to overcome poverty. The reasons are two. First, low income groups do not receive the official minimum wage. Second, the evidence does not support the hypothesis that there is a positive correlation between the official minimum wage and the level of wages below it (see Almeida dos Reis 1989).

In the urban areas, the poorest are self-employed (rather than wage earners), workers in construction (the most likely entry point for immigrants), and people working in public make-work programs such as those in Chile (World Bank 1986). Because the poor have larger families, the incidence of poverty among children is higher than among adults.[3] Programs that could have alleviated urban poverty would have included improved access to birth control and prenatal care, nutrition and sanitation programs, childcare programs for working mothers, and better primary school education. Classical populists expanded the welfare state, but the emphasis was not on poverty. Broad-based social security programs and state support for universities served the middle class and absorbed resources that could have targeted the poor.

The group most seriously neglected by populists—and nonpopulists—is the rural poor. The extent of poverty is markedly higher in rural than in urban areas in all Latin American countries (Altimir 1982). Whereas 26 percent of urban Latin Americans were poor in 1970, 60 percent of rural households were poor. Even in Argentina, Chile, and Uruguay, the most heavily urbanized countries in the region, the extent of rural poverty was not less than 20 percent of rural households. In Mexico, the poorest 30 percent of the population was almost entirely rural. In Brazil, 70 percent of the lowest four deciles in the mid-1970s were rural households. In 1986, the extent of poverty continued to be markedly higher in rural areas (table 3.4).

Both peasants and landless labor comprise the rural poor, although the mix varies among countries. In Brazil, for example, the poorest are mainly temporary laborers, while in Peru, subsistence farmers dominate. In Colombia, about half of poor rural households are small producers, the rest landless labor. Landowners who are poor typically own too little land to subsist on and earn a large share of their cash income as laborers on larger farms.

Where land ownership is concentrated in the hands of a few and large estates are farmed carelessly, agrarian reform can promote economic growth and greater equity. But of the regimes that might be considered populist by econ-

3. Selowsky (1982) and Altimir (1984) both estimate that the proportion of small children and school-age children in poverty is larger than the proportion of poor households; there are also more children in poverty among those belonging to households whose heads are female or have little education; Paes de Barros (1989) shows that in the metropolitan areas of Brazil children in households headed by women are overrepresented among the poor.

Table 3.4 **Percentage of Population Living in Poverty, 1986**

	% of Population below Poverty Line			% of Population below Destitution Line		
	Urban Area	Rural Area	Total	Urban Area	Rural Area	Total
Argentina[a]	11			3		
Colombia	39			16		
Guatemala	60	80	73	31	57	49
Mexico[b]	47	61	51	19	30	22
Panama	36	52	41	16	28	20
Peru[c]	51	71	59	23	53	34
Uruguay		21		5		
Venezuela	34	48	37	11	22	13

Source: CEPAL (1989).
[a]Metropolitan areas only.
[b]Figures from Mexico are from 1984.
[c]Preliminary figures.

omists, only a handful have implemented major agrarian reform: Velasco, Allende, and the Sandinistas. Democratic regimes fail to implement change for two reasons: large landowners still influence government and policymakers fear reform will improve rural diets at the expense of output for urban food and export markets. Plagued by foreign exchange crisis and afraid to alienate urban workers who are sensitive to food prices, populists dragged their heels on land reform. For the most part, it has been the military and revolutionaries who have reformed landownership.[4] The fact that military regimes have also reversed or prevented land reform, as in Chile and Guatemala, reflects the difficulty of achieving social consensus on rural property rights. Table 3.5 shows the impact of redistribution on rural households.

Land reform has yielded both orderly transitions and chaotic disruptions of output in Latin America. The diversity of experiences reflects considerable variation in the nature of redistribution within the region. New rights to land have taken the form of individual ownership, communally organized production, or the allocation of lands to family farms on a semipermanent basis. It also has involved distribution of unused public or private lands to new settlers. varying levels of compensation for expropriation and diverse degrees of protection for the nonreform sector.

In Mexico and Bolivia, land reform was relatively successful in pacifying the countryside and mitigating rural poverty. Peruvian land reform failed in

4. The Mexican revolution redistributed 43 percent of the country's agricultural land. the Bolivian revolution shared out 83 percent of the land. The Peruvian military government redistributed 40 percent of the country's farming area (see table 3.5). A more recent example of radical reform is found in Nicaragua. following the overthrow in 1979 of the Somoza dynasty. The Sandinista regime turned the Somoza family's holdings. covering more than a fifth of the country's arable land. into state farms and gave peasants access to idle land.

Table 3.5 Latin American Agrarian Reforms

Country	Year Initiated, Modified	Beneficiaries as % of Rural Households[a]		% of Affected Forest and Agricultural Surface[b]	Organization of Production[c]
Cuba	1959, 1963	70 (1963)			SF, IH, CO
Mexico	1917, 1971	69 (1971)	42.9 (1970)	43.4 (1970)	Ejidos
Peru	1963, 1969	37 (1975)	30.4 (1982)	39.3 (1982)	CO and some IH
Bolivia	1952, . . .	33 (1970)	74.5 (1977)	83.4 (1977)	IH
Nicaragua	1979, 1981	30 (1983)			SF, IH, CO
Chile	1962, 1970	20 (1973)	9.2 (1982)	10.2 (1982)	Asentamientos
Venezuela	1960, . . .	17 (1970)	30.6 (1979)	19.3 (1979)	IH, CO
El Salvador	1980, . . .	12 (1983)	22.7 (1985)	21.8 (1985)	IH, CO
Colombia	1961, 1973	10 (1975)			IH, CO
Costa Rica	1961, . . .	9 (1975)	5.4 (1980)	7.1 (1980)	IH, CO
Honduras	1962, 1975	8 (1978)			IH, CO
Ecuador	1964, 1973	7 (1972)	10.4 (1983)	9.0 (1983)	IH, CO
Dominican Republic	1962, . . .	3 (1970)	8.5 (1983)	14.0 (1983)	IH, CO
Panama	. . . . . .		13.3 (1977)	21.9 (1977)	IH

Sources: Deere (1985) and Thiesenhusen (1989).

[a]Total number of beneficiaries until the year in parentheses divided by number of rural households in that year.

[b]Affected area as measured until year in parentheses.

[c]SF = state farms; IH = individual holdings; CO = cooperatives.

both economic and political terms. It not only failed to stimulate production and eradicate rural poverty but it did nothing to improve political stability. In part its failure can be blamed on the weaknesses of the reform program but mostly it reflects Velasco's economic policies. The cooperative model also contributed to the poor results. The large-scale cooperatives were met with opposition from the peasantry; imposed from above the cooperatives were perceived as a burden by those they were supposed to benefit. The Peruvian experience indicates that land reform is not sufficient for rural development unless accompanied by proper price, marketing, credit, and investment policies.

Three lessons stand out from past experiences. First, land reform has been most successful from an efficiency perspective when it has involved the takeover of inefficient haciendas or colonization of undeveloped land. There is not much sacrificed on this situation and peasants eager for land are quick to put it into use. The takeover of commercial farms is most tricky: the transition period is damaging due to decapitalization and the existing managerial efficiency is difficult to duplicate.

Second, redistribution of land does not help the most destitute. Land tends to be distributed to those who know how to work with the authorities or those who have been permanent workers on large estates. Temporary workers often find it harder to find employment after land reform. As a welfare measure, land reform needs to be accompanied by programs that target the very poor.

Finally, land reform works best when it is accompanied by credit and technical assistance from the government. It is not a cost-free solution to rural poverty. Governments can proclaim a change in ownership at little fiscal cost. But credit and technical assistance to help land reform succeed is expensive. Past experience has demonstrated that capitalization and market stability are important if small farmers are to participate in the modernization of agriculture. Without credit, adequate irrigation, transportation networks, and reliable markets, access to a small piece of land may be only marginally better than the alternatives open to poor rural people.

In short, a serious land reform program requires broad social acceptance of its inevitable costs. The consequences fall not only on large landowners but also on urban consumers who will face higher food prices (at least in the short run) and taxpayers who must be willing to support credit and technical assistance. Populists have generally not been willing to commit resources to land reform.

Roughly 60 percent of Latin America's poorest people still live in rural areas. Land reform may be the most effective tool in helping these people to survive, because it distributes assets that outlive government jobs programs and minimum wage fiats. Even under the best circumstances, however, land reform will not absorb Latin America's rapidly growing rural population. A long-run solution to rural poverty must involve an expansion of job opportunities in the cities and targeted education programs that enable the poor to qualify for them.

The need for genuine redistribution and economic growth in Latin America is acute. In 1984, Couriel reported that poverty affected more than half of the population in Peru, El Salvador, Guatemala, Honduras, Nicaragua, Haiti, Ecuador, the Dominican Republic, and Bolivia. The Comision Economica para America Latina y el Caribe (CEPAL 1989) shows that, in 1986, more than 70 percent of the population of Guatemala lived below the poverty line (see table 3.4 above).

Attempts to accelerate growth through government deficits fail, as economic populism has amply demonstrated. Redistribution must carry the ball. Average income per capita in most Latin American countries exceeds that in African and Asian countries, but extreme poverty persists as a result of inequitable income distribution. Table 3.6 shows the distribution of income in several Latin American countries. A social consensus to tax, to reduce subsidies to the middle class, and to finance poverty programs and land reform are critical to changing this picture.

Economic stability contributes to the alleviation of poverty. Urrutia (1985) uses the case of Colombia to claim that progress can be achieved through prudent management: "A complete analysis of all existing statistical data shows that the income distribution did not worsen in the 1970s and that the real incomes of the poor improved significantly, especially in the later half of the decade." The Colombian eclectic system used controls but avoided the extreme protectionism of other Latin American countries; its crawling peg kept the exchange rate at reasonable levels, and government avoided inflationary finance. By stimulating housing construction and exports other than coffee, Colombia experienced sustained growth and avoided the spectacular crises found in other Latin American countries.

According to Urrutia, wages of agricultural workers increased faster than national income, while wages of lower-income urban workers grew faster than wages of higher-income urban workers and salaries of white-collar em-

Table 3.6 **Income Shares and Gini Indices for 14 Latin American Countries, circa 1970**

	Income Share of Top 20% as Multiple of Bottom 20%		Gini Index	
	(1)	(2)	(3)	(4)
Brazil	21	15	.574	
Mexico	15	16	.524	.567
Argentina	7	7	.437	.425
Venezuela	24	18	.622	.531
Colombia	17	15	.557	.520
Peru		26		.591
Chile	12	14	.506	.503
Ecuador	16	24	.526	.625
Dominican Republic	13		.493	
El Salvador	18	11	.539	.532
Costa Rica	11	9	.416	.466
Panama	20	24	.557	.558
Uruguay		13		.449
Honduras		21		.612

Sources: For cols. 1 and 3, Kakwani (1982). For cols. 2 and 4, Lecaillon et al. (1984).

ployees. Urrutia also argues that financial liberalization brought about better credit allocation, and that fiscal policy had a positive impact on income distribution. He suggests that the 1960s tax system was slightly progressive and that the reforms of 1974–75 were a factor in improvement. The income of the first decile was twice as high after taxes and government transfers, while the income share of the top decile was reduced. Education, health, and public services such as water, electricity, and government programs benefited the poor in more than a proportional way. Urrutia shows that between 1964 and 1972 the overall distribution improved because of the narrowing rural-urban differential. Londono (1989) calculates an 8 percentage points reduction in Colombia's Gini index between 1964 and 1988 (see table 3.7).

Despite progress, inequality and poverty in Colombia remain acute. But its stable macroeconomic policies certainly did more for the poor than the oscillations observed in Brazil and Chile. In both cases there is evidence that recessions caused dramatic increases in the Gini coefficient. In Brazil, the coefficient jumped from 0.5 in 1960 to 0.6 in 1970, an unusually large deterioration in only 10 years. Fishlow (1972) shows that the stabilization policies that followed Goulart's populism in 1964 were largely responsible for the widening of inequality. Chile also exhibits this extraordinary 10-point increase in the Gini coefficient in one decade (table 3.7). Two extreme recessions certainly played a role in this deterioration.

No doubt, secular growth is a significant factor in reducing poverty, but its effects are relatively small and thus easily washed over by greater earnings inequality and by cyclical conditions. Recessions have a disproportionate impact on the poor and widen the distribution of income. A recession causes more unemployment, a drop in the labor-force participation and slower growth of real earnings. The costs of continuing high inflation are not any smaller. Even where everything is indexed, including wages, prices, interest rates, taxes, and accounting systems, inflation has a profound impact on the lower classes whose subsistence is not protected. The inflation tax also falls more heavily on the poor classes who cannot benefit from indexed deposits accessible to those who can open accounts above a minimum floor. Stop-go policies hurt the poor. Stability might help them.

3.5 Conclusion

In Latin America, a variety of different political agendas have led to economic crisis:

- Classical populists put too much stake on the possibility of demand-driven growth, inward-looking industrialization, and unrealistic expectations. Perón, García, and Allende, to a large extent, failed to realize that Keynesian stimulus falters on foreign exchange constraints.
- Attempts at developing market-based socialism are also to blame for failed economic policy. Insecure property rights make it difficult to sustain private

Table 3.7 **Gini Indices for Brazil, Chile, and Colombia**

Year	Brazil	Chile	Colombia
1938			.442
1960	.500		
1961			.525
1964			.555
1970	.608		
1971			.527
1974		.45	
1975		.47	
1976		.54	
1977		.53	
1978		.52	.481
1979		.52	
1980		.53	
1980	.597	.52	
1981	.584	.54	
1982	.587	.54	.474
1983	.589	.55	
1984	.588		
1985	.592		
1988			.474

Sources: Hoffmann (1989), Larraín (1990), and Londono (1989).

production, and socialist rhetoric triggers costly intervention by the United States. The Sandinistas may have been overly ambitious in their initial plans to redistribute and their early budget deficits were high, but their downfall is more the result of Contra activity and uncertainty about property rights than of populism.

- Lack of social cohesion and strong political parties make it difficult to impose the burden of contractionary adjustment on various classes. Sarney and Alfonsín could never decide how to distribute the burden of adjustment to the debt shock. As fragile elected regimes without strong political support of any particular group, they were unable to impose contraction on anyone. The result was failure to live within the economy's contraints and hyperinflation.
- Although redistribution marks populism, the poorest have not benefited from it. Classical populism redistributed income from the agricultural and export sectors to capitalists and workers in the formal urban sector. Rural peasants and the urban poor remained marginalized both politically and economically. Modern populists did not serve them better.

Minimum wages, the redistributive centerpiece of populism, are ineffective in overcoming poverty in Latin America. The poor are in the countryside and in the informal sectors where minimum wages are not enforced. Broad-based social security programs have also failed to concentrate resources on the poor.

Solutions to poverty in Latin America lie in a concerted effort to tax and to redistribute revenue to support agrarian reform and programs that aim specifically at the poor. This is only possible if the rest of society accepts redistribution. Experiences with hyperinflation show that the politically enfranchised cannot agree on a distribution of income among themselves, much less on distribution toward an increase in the share of the poor.

Finally, whatever its root, budget deficit booms, however progressive they might sound, hurt the poor. The lesson is that fiscal responsibility, realistic exchange rates, and a stable environment are essential to sustain the basis on which to build a better income distribution.

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Comment William R. Cline

I find myself in broad agreement with the paper by Cardoso and Helwege, and my comments primarily will seek to highlight and extend rather than refute.

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The authors make an important point when they observe that populism is not the same thing as either socialism or equity-oriented redistribution without departure from private ownership of property. Populism purports to raise wages and benefit national capitalists without acknowledging trade-offs at the expense of other groups. Its redistribution is toward politically powerful groups, not those in need, for example, toward organized labor, not the rural poor. A corresponding point that is crucial for this discussion is the authors' correct observation that the failure of populism in Latin America should not be read as evidence that efforts to reduce income inequality are fatally in conflict with economic stability and growth.

I would also stress another point in the paper: inflation is regressive. The poor do not have financial instruments to defend themselves. The authors are correct in indicating that stable growth is the best climate for improving the conditions of the poor.

The experience reviewed in the paper does make one wonder whether there might not be a political inconsistency theorem for efficient redistributive policies: by the time the political situation has become radicalized enough that the new leaders are prepared to take action seriously favoring the poor, the group in power has an ideology antagonistic to efficient economic structures. For example, radical land reformers reject the family farm as petty capitalist and insist on state farms, even though all the evidence suggests the latter will be less efficient because of poor incentives.

Again on the political level, the shift in Brazil from Simonsen to Delfim II exemplified an irony of populist pressures in military regimes. The pursuit of rapid growth at all costs was a consequence of the need to seek legitimacy for a politically illegitimate government. The paradox is that there may be better chances for stability under democratic rule.

I agree with the critiques of import-substituting industrialization and would add the problem of monopoly in a closed economy resulting from the need for scale economies, as well as the loss of efficiency as the economy moves further from its comparative advantage. I generally concur with the criticism of Brazil's move to intensified protection and import substitution after the 1974 oil shock, although it should be kept in mind that Brazil's present export capacity in sectors such as steel is the consequence of investments made under that regime.

With respect to adjustment in Brazil and Argentina in 1990, I would note that both programs sought to exempt the poor by freezing assets above thresholds that caught primarily the middle and upper classes. In both cases, the verdict on whether the poor actually escaped will depend on whether there is severe recession that causes unemployment and job losses and on the long-term growth effects of damage to domestic financial institutions and trust in government obligations. I do think the Brazilian government may be more serious about fiscal adjustment than the paper implies; for example, the Collor administration is talking about dismissing over 300,000 government employees.

The paper is correct in its conclusion that raising the minimum wage is an inefficient means of reducing inequality. Workers in agriculture often do not receive the minimum wage, so that increases can generate intralabor inequality. In Brazil, the new constitution links pensions and social security to the minimum wage, so that increases have a devastating effect on the fiscal balance. Incidentally, the Cardoso-Helwege conclusion on the minimum wage contradicts the Fishlow analysis of Brazilian income distribution in the late 1960s and early 1970s; Fishlow emphasizes erosion of the real minimum wage as a source of growing inequality. Cardoso and Helwege cite recession later in the 1970s as the source of rising inequality. However, the data are so shaky that trends are questionable. Moreover, on the basis of theory one would not necessarily expect recession to concentrate relative income distribution, as profits are likely to be more procyclical than wages.

Let me turn to elaborations of some of the themes in the paper. An implicit issue in this conference is whether income redistribution can be pursed without causing macroeconomic destabilization. I would remind everyone of the rather extensive literature on income distribution and growth in the 1970s. At that time the structuralists argued that, without redistribution of income, Latin America was doomed to stagnation for lack of an adequate domestic market. Related arguments held that basic goods had higher labor intensity and lower import content, so that redistribution would favor growth on these grounds as well. In contrast, the orthodox view had been that premature redistribution would jeopardize growth by reducing saving. And empirical patterns in the "Kuznets curve" seemed to suggest an inevitable concentration of income in the early stages of growth before eventual redistribution.

Simulation analysis carried out by me and others found that the redistributional issue was essentially neutral with respect to growth. Marginal savings propensities did not differ sharply among income classes. There was no simple correlation between income elasticities of demand and labor or import intensity of basic versus luxury goods, and a large bloc of intermediate goods in the economy was necessary regardless of the composition of final demand. Such findings tended to leave the issue of income redistribution as a matter to be addressed on its own merits—neither a precondition for growth nor an obstacle to it.

Instead, attention turned by the late 1970s to a focus on absolute poverty and basic human needs. The principal objective of distributional policy was increasingly seen as a need to set a floor to living standards rather than to focus on relative income distribution. Researchers at the World Bank and elsewhere emphasized the importance of targeted government expenditure (e.g., on health, infant and maternal nutrition, rural potable water) as the efficient way to pursue equity-oriented policies. Unfortunately, the debt crisis of the 1980s meant that attention had to be concentrated on survival of the economy as a whole, and for a time the distributional issue became a luxury that had to be postponed.

What are the lessons of the populist record for policy formation in Latin America today? I think they are not only compelling, but that they have already been learned by key political actors. Consider Carlos Andrés Pérez in Venezuela. His past policies might have led to the expectation of another round of populism. Instead, his new government adopted strong adjustment measures. Or Carlos Menem in Argentina. A Peronist, his relatively orthodox austerity measures came as an even greater surprise to domestic and foreign observers. In Brazil, Fernando Collor also embarked on such nonpopulist measures as a wage freeze and cutback in government employment.

Mexico provides perhaps the best model of this transition. In contrast to the populism of Echeverría in the 1970s, the governments of de la Madrid and Salinas Gortari have carried out massive and painful fiscal adjustment. Salinas has the right diagnosis: it is necessary to slim the state sector so that it can become stronger and focus its activities on the fundamental responsibilities of the state, that is, the social infrastructure. As Salinas puts it, in his travels to Mexican towns he frequently hears pleas for new sanitation projects or irrigation; he never hears demands for additional Boeing 747s for the state airline to facilitate travel to Paris. The new government's budget reflects these priorities: even as it is privatizing airlines and the telephone system, the government is sharply increasing spending on education, health, school lunches, and other social areas after a long period of cutbacks for purposes of fiscal adjustment.

Privatization is in fact a major feature of the new trend in Latin America toward economic realism. As one high official in Brazil put it, the Brazilian state has some $200 billion in state firm assets and $180 billion in domestic and foreign public debt. Interest must be paid on the debt, but very little is earned in the way of dividends on the state firm assets. By reducing both sides of the balance sheet, the government can become much stronger fiscally. Even where state firms are not inefficient, privatization can help macro policy. Incomes policies often force the government to freeze the rates for utilities and other public services, causing them to lag behind inflation and provoke fiscal losses. Then, when the rates are increased, there is a new shock to inflationary expectations. Taking these services out of the state sector helps depoliticize pricing policy. I note that privatization is largely absent in the recommendations of the Cardoso-Helwege paper, but it would seem to be an essential part of successful adjustment and growth in many countries of Latin America.

One negative side of privatization and state-sector adjustment does need to be highlighted. In the past, many Latin American governments used state-sector employment as the means of generating jobs for a rapidly growing labor force. Somehow the private sector will increasingly have to provide these employment opportunities. The answer to this dilemma lies in part in the prospects for more rapid and sustained growth, as adjustment to the debt crisis and, more fundamentally, restructuring of economies under more open, modern strategies lifts Latin America out of a decade of recession and stagnation.

In sum, I would submit that the lesson from populist experiments in Latin America is not that governments must be hard-hearted, but that they should be hard-headed and soft-hearted instead of soft-headed and soft-hearted (if populists were ever soft-hearted). The elements of a successful strategy for growth with equity in the region must include:

- overall fiscal balance;
- the avoidance of unrealistic wage increases;
- concentration of antipoverty action on government spending on low-end social services, especially in rural areas;
- an open-trade model for efficiency and greater labor intensity;
- and firm anti-inflation programs, because inflation is the biggest enemy of the poor.