New Priorities in Financing Latin American Development

Balancing Worker Rights, Democracy, and Financial Reform

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ISBN: 0-922826-44-X

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Acknowledgments
The ideas expressed in this work are solely my responsibility. However, I am deeply indebted to Thea Lee of the Economic Policy Institute for her careful critique and dedication in shepherding this project through the necessary administrative steps. In the same vein, I want to express my appreciation to Miranda Martin for bringing the manuscript to an acceptable preproduction level.

I also want to express my appreciation to John Cavanagh, Doug Hellinger, Peter Hakim, and Prof. Robert Blecker for their reading of the manuscript in an early stage and for their constructive comments. Karin Lissakers provided a particularly helpful critique in connection with an important part of the manuscript.

This project would not have been possible without the financial support of the Jaffe Foundation. The Twentieth Century Fund also provided early financial support. And I am especially grateful to Larry Mishel and Jeff Faux for their encouragement and willingness to have EPI publish the work.

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1730 Rhode Island Ave., NW, Suite 200
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Library of Congress Catalog Card Number: 94-72203
ISBN: 0-944826-44-X

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Executive Summary

The World Bank, the International Monetary Fund, and the Inter-American Development Bank have played a critical role, particularly in the past decade, in financing Latin American development. And, in the absence of a significant U.S bilateral-aid program for the region, successive American administrations have come to rely increasingly on these institutions to achieve foreign and economic policy goals.

This report analyzes how these three financial institutions have performed this function. The debt crisis, which followed Mexico's default on its commercial bank debt obligations in August 1982, provided the impetus for an enhanced role for these institutions. That initiative, which the Reagan administration strongly supported, coincided with the emergence in Latin America of a group of like-minded leaders, political and economic. The result was a sea change in Latin American development priorities:

The aggressive promotion of a neoliberal economic agenda by the multilateral financial institutions reflects a highly constricted view of development that could thwart the consolidation of democratic political institutions in the hemisphere.

- The role of the state in the direct production of goods and services declined.
- Latin American countries privatized many state-owned enterprises.
- They liberalized trade and increased their emphasis on market forces for allocating resources, domestic and foreign.
- These countries increasingly relied on private enterprise, both domestic and foreign, as the engine of development.

With the possible exception of Brazil, this embrace of a neoliberal economic agenda has constituted a near revolution. However, the aggressive promotion of this agenda by the multilateral financial institutions reflects a highly constricted view of development that could thwart the consolidation of democratic political institutions in the hemisphere and hinder the more equitable distribution of income without which longer-term social and political stability is unlikely.

Specifically, the multilateral financial institutions reward a country that executes the neoliberal economic agenda, even if it has a highly authoritarian political structure, abuses human rights, and represses independent trade unions. This has been the case with Mexico. On the other hand, a country that lags in implementing the multilateral agenda but successfully consolidates a transition from military rule to genuinely democratic institutions gets no credit for its accomplishments. This is the case with Brazil.

The result is a distorted concept of development that elevates economic criteria above political values and depreciates social justice in the pursuit of economic efficiency. And because the neoliberal economic model accentuates existing regressive income distribution in the hemisphere, in the near term, it is likely to increase social tensions. The temptation will be great for governments to resort to authoritarian means to repress such tensions, a temptation made more plausible by the belief, reinforced by experience, that adherence to neoliberal economics ensures continued access to international financial resources.

Because the neoliberal economic model accentuates existing regressive income distribution in the hemisphere, in the near term, it is likely to increase social tensions.

This paper urges a reconsideration of existing concepts of development priorities. It makes three specific proposals to redefine country performance criteria:

- Elevate worker rights to the same priority as financial and investment reform, redressing the imbalance in lending criteria that now strongly favor the interests of multinational corporations and banks.
- Explicitly take into account the consolidation of democratic political institutions and the absence of abuse of the human person.
- Address the social question in Latin America in part through a more aggressive use of program lending by the Inter-American Development Bank.

There is an institutional basis for such a reconfiguration of development lending concepts: the International Labor Organization, founded in 1919, was the first independent agency accepted as part of the United Nations system. This body, as well as the Inter-American Commission on Human Rights and the United Nations Human Rights Commission, could gain significant influence if their findings had real financial consequences. Relating financing decisions to the findings of these international organizations would restore the multilateral financial institutions to their original conception as part of an international system with social and political dimensions.

Introduction

Following on the patterns of its predecessors, the Clinton Administration is relying on the multilateral financial institutions (MFIs) as a principal instrument of U.S. policy toward Latin America. Through these major international lenders for economic development, Undersecretary of the Treasury for International Affairs Lawrence H. Summers has declared, the United States takes on "a vital but shared role in advancing economic opportunities overseas, in promoting sustainable development, and in furthering the broader U.S. vision of the world. We rely heavily on the banks to address critical U.S. interests around the world" (Summers 1994, 3).

Nevertheless, the MFIs have proven to be an uncertain instrument for achieving U.S. interests in Latin America in large part because these institutions have perceived those interests far too much in narrow economic terms. In fact, U.S. interests encompass the evolution of stable societies in the region, with representative democratic political institutions and social equity and mobility for those at the bottom rungs of society. Only if the MFIs revise their lending criteria to reflect that broader conception of development can they play a positive role in Latin America.

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There are three MFIs: the two so-called Bretton Woods Institutions—the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank)—and the regional development bank for Latin America, the Inter-American Development Bank (IDB). The World Bank and the IDB have been remarkably successful at raising money in private capital markets for long-term development, while the IMF does not rely on such funding. In 1990, 1991, and 1992, the World Bank and the IDB loaned approximately $32 billion for Latin American development. The lending by the World Bank and the IDB is conditioned on a borrowing country having an agreement with the IMF relating to its overall economic policies. Such agreements, until recently, have also been a precondition for renegotiation of a country's debts with the commercial banks. (Only in the case of Brazil, in April 1994, after a prolonged negotiation, have commercial banks agreed to such a renegotiation in the absence of an agreement with the IMF.)

Moreover, the significance of the MFIs to a borrowing country is greater than the amount of direct loans it receives. A seal of good economic house-keeping by these institutions is a virtual precondition for a country to borrow directly in international capital markets. In effect, then, governments, capital markets, and creditors and debtors have invested the MFIs with enormous power to determine who has access to international capital for development.

This responsibility is relatively recent, dating from Mexico's 1982 default on its financial obligations to private commercial banks from which it had borrowed heavily during the 1970s. But the lens through which the MFIs view development is a highly constricted one that distorts the development process itself. It is excessively weighted toward the interests of capital, both domestic and foreign. It is indifferent, at best, to abuses of worker rights in the borrowing countries, and, more generally, abuses of the human person. And it has become the rationale for supporting with substantial financial resources politically oppressive regimes.

The lens through which the MFIs view development is a highly constricted one. It is indifferent, at best, to abuses of worker rights in the borrowing countries, and, more generally, abuses of the human person.

This expanded mission for the MFIs relegates to a decidedly secondary plane of priorities the social question. That question, as Hannah Arendt, the noted political scientist, has observed in her classic work, *On Revolution*, is "what we may better and more simply call the existence of poverty. Poverty is more than deprivation, it is a state of constant want and acute misery whose ignominy consists in its dehumanizing force" (Arendt 1963, 54).

In the past decade, the social question has become more, not less, acute. Enrique Iglesias, president of the IDB, in his 1992 speech to the annual meeting of the IDB in Santo Domingo, observed that 50 million more people were living in poverty in Latin America at the end of the 1980s than at the beginning (Iglesias 1992, 7). The World Bank's annual report for 1993 states:

> In most countries of the region, the poor suffered inordinately during the years of crisis [1982 through 1992]. As growth slowed, poverty and unemployment rose, and income distribution became increasingly skewed. Latin America has historically been a region with a high degree of income inequality relative to other regions in the world....Overall, the bottom 20 percent of the population on the income distribution scale received only 4 percent of total income in 1989. At the same time, 32 percent of the region's population was living in poverty, up from 22 percent in 1989. (World Bank 1993a, 135-36)

The social question in Latin America is now pushing to the fore, as it did in the late 1950s, with an urgency that will make it impossible to ignore. In 1989, riots in Caracas, Venezuela, forced the newly elected Bush administration to acknowledge what its predecessor would not: debt reduction is an essential element in debt renegotiations with the commercial banks. Presidential elections in Venezuela in 1993 resulted in an electoral repudiation of the neoliberal economic model espoused by the Perez government, although general disgust in Venezuela with perceived corruption by the political class also strongly influenced the electoral outcome. The armed uprising of peasants in Chiapas, a remote rural state of Mexico, stunned the international financial community, which had acclaimed that country as the star economic performer. The sophisticated message of the revolt was that political liberalization is a necessary precondition of achieving economic and social equity.

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The Chiapas uprising exploded the notion that political liberalization in Mexico could wait for economic modernization. It further repudiated the government's strategy of buying social peace in the rural areas by a program of small community investments rather than addressing the questions of land ownership, concentration of economic assets, and political representation of those at the bottom of the social scale. And in Brazil, the most populous country in Latin America, one of the most important political parties and a leading presidential candidate both explicitly repudiate the neoliberal philosophy and its concept of the limited role of the state in addressing deep social inequities, which is the foundation stone of the policy prescriptions of the MFIs.

This is not to say that the MFIs are solely responsible for the social ills that are so prevalent in Latin America, or for the priorities that have accorded them less importance than economic efficiency. Those priorities have been shared by a Latin America leadership that assumed power in the decade of the 1980s. But it is also true that the MFIs have not been passive actors in the Latin American drama. The development philosophy they expound, and the financial resources they control, directly and indirectly have given them a key role in defining both the past and future in Latin America.

The constricted view of development the MFIs have espoused to date must be expanded to:

- allow more tolerance for social and political instability in Latin American countries and therefore a margin for less-than-perfect economic policies;

- explicitly elevate worker rights to the same order of priorities as incentives for investment;
- explicitly recognize that political liberalization and respect for human rights are essential to development.

The next section puts the evolution of the two development banks—the World Bank and the IDB—in perspective by tracing their origins and early history. The paper then examines the role of the World Bank and the other MFIs in the debt crisis of the 1980s, when these institutions emerged as arbiters of finance for development for their borrowing member countries. The following section analyzes the priorities of the MFIs' direct lending from 1990 to 1992. This period marked the conclusion of a particularly contentious negotiation over replenishing the IDB's resources, redefining its role, and mandating it to act in conjunction with the World Bank in a new form of program lending. That lending defined priorities in Latin America for the borrowing member countries of both institutions. At the same time, the MFIs emerged as direct financiers of the collateral commercial banks required as the price of their accepting debt reduction when renegotiating outstanding loans with debtor countries. Finally, the study discusses the application of the country-performance criteria in the context of Mexico and Brazil, the star and the black sheep, respectively, of the international financial system. The report concludes with recommendations and a rationale for a broader definition of a country's development performance as a basis for allocating MFI resources.

If the MFIs do not clearly delineate new rules of the game, local elites and their allies abroad may be tempted to revert to authoritarian regimes in the interest of stability and a favorable investment climate.

The issue is likely to be acute in the remainder of the decade. An increasingly open trading and investment climate will put great pressure on labor and environment standards, potentially driving them down to the lowest common denominator. And the social question may accentuate conflict in the near term, as it already has in Mexico. If the MFIs do not clearly delineate new rules of the game, local elites and their allies abroad may be tempted once again, as in the 1960s, to revert to authoritarian regimes in the interest of stability and a favorable investment climate. On the basis of the past record, they may well believe that they will pay no price in their continued access to the MFIs and international financial markets. It would be well to disabuse them in advance of this conviction.

A Brief History of the Multilateral Financial Institutions

The Bretton Woods Institutions

Planning for a post-World War II economic framework began even during the war. The central problem for the architects of the postwar system was how to construct a multilateral trade and investment regime that would avoid the "beggar thy neighbor" policies of the prewar years and instead promote and sustain high levels of income and employment.

Such a system had to accommodate the political realities of the postwar era: the breakdown of colonial regimes in Asia, Africa, and the Middle East, as well as the emergence of a more assertive Latin America. The industrialized nations could no longer politically dominate with an imperial reach spanning the continents, but they did control the capital necessary for economic development.

The philosophy of the IMF and the World Bank mirrored the prevailing U.S. view because the United States contributed the most resources to them.

As the war wound down, the United States under President Franklin D. Roosevelt and his successor, Harry S. Truman, appeared committed to resolving political and economic differences within an international context. The proposed scope of that international effort was extremely ambitious. In addition to the United Nations, the United States pressed for what became the International Monetary Fund to stabilize exchange rates and the International Bank for Reconstruction and Development (World Bank), to underwrite the rebuilding of the war-ravaged economies of Europe and Japan and finance economic growth in less-developed countries. In addition, the United States sought an International Trade Organization to ensure that destructive barriers did not inhibit the free flow of goods and services across international boundaries. Although this body never materialized, the General Agreement on Tariffs and Trade (GATT) came to serve as a substitute.

The hoped-for coordination among these agencies foundered amid the fundamental divisions between the United States and the Soviet Union over the shape of the postwar political and economic order. Although the Soviet Union signed the Articles of Agreement of the IMF, it never ratified them. Because the IMF and the World Bank, the financial keystones of the postwar international economic order, remained securely in the control of the Western industrialized nations, led by the United States, the Bretton Woods institutions avoided the paralysis of the other parts of the new United Nations system.

The philosophy of each institution mirrored the prevailing U.S. view because the United States contributed the most resources to them. In the case of the IMF, the proposal by the British delegation, headed by John Maynard Keynes, for a world central bank to finance an expanding level of international trade and investment, was rejected. Instead, a more limited arrangement, sponsored by the United States, was adopted: countries could only change the par value of their currencies after securing IMF approval. The negotiators recognized that countries might face strong pressures to adopt restrictive measures such as tariffs, import quotas, or currency devaluations if they confronted a drastic payments imbalance. To remove the temptation to impose such unilateral policies, the plan provided that countries could have recourse to the IMF for short-term financing to ease the economic adjustment needed to bring their external accounts into reasonable balance. Such financing would be conditional on the IMF's judgment that the proposed reforms were likely to remedy the imbalance.

The IMF was not originally conceived as a semipermanent monitor of a country's overall economic performance.

As Louis Rasmiskey, the former governor of the Bank of Canada, put it, with the Bretton Woods Agreement, the "world community took control of the international monetary system" (Solomon 1982, 11). Nevertheless, the IMF was not originally conceived as a semipermanent monitor of a country's overall economic performance.

In postwar Western Europe and Japan, the primary task was reconstructing the railways, factories, ports, and electric-power facilities devastated by the war. The less-developed countries needed to establish that same infrastructure to augment their production and delivery of goods and services. Financing these additions to productive capacity was beyond the mandate of the IMF. The commercial banking system, still scarred by the memory of debt defaults in the decade prior to the war, particularly in Latin America, was not yet prepared to extend long-term credits for this purpose. The Bretton Woods Agreement established the World Bank to fill the financing gap. By informal agreement among the major shareholders, the president of the World Bank would be a U.S. national and the managing director of the fund a European.

In February 1947, the Truman administration persuaded John J. McCloy, former high commissioner for Germany in the Occupation authority of that country, to assume the presidency of the World Bank. McCloy was closely associated with Chase Manhattan Bank, and, as part of his terms for accepting the presidency of the World Bank, he brought his own team with him. Eugene Black, vice president of Chase Manhattan, became the U.S. executive director and took charge of bond operations. McCloy chose Robert Garner, "a gruff, no nonsense business man and banker," to be the vice president (Bird 1992, 285-6). When McCloy introduced Black and Garner to the executive directors of the World Bank, Sir James Grigg, the British director, muttered, "Here goes a meeting of the Chase Manhattan" (Bird 1992, 289).

McCloy had definite ideas on how to run the Bank, and they did not include an aggressive role in financing development. "[H]e planned to run the Bank as if its clients were Wall Street investors and not the forty countries that had joined in the hope of receiving development aid," Kai Bird (1992, 288) has written. This approach led the British to conclude that the Bank and the IMF would be "utterly ineffective as a substantial contributor towards world recovery...and can merely be reckoned as instruments of dollar diplomacy" (Bird 1992, 288). The British may have overreacted, but they correctly foresaw the Bank's extreme sensitivity to the interests of the international banking community and the political desires of the United States.

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In a 1948 speech to Latin American leaders in Bogota, Columbia, McCloy defined the Bank's mission as intended to "blaze the trail for private international investments" with respect to Latin America (Bird 1992, 279). The World Bank limited its Latin American lending to project loans, in contrast to the early reconstruction loans to European countries for commodity imports. And it conditioned its loans on an agreement with the borrowing country on an acceptable overall economic policy framework, affording the Bank an opportunity for a dialogue with the country authorities on the content of their economic reforms. Thus, the principle linking Bank lending to economic targets and performance indicators was established early.

Summarizing its experience in dealing with the less-developed countries, the Bank's 10th anniversary report observed:

> [The Bank] could not expect that the projects it helped to finance, however well planned and carried out, could function efficiently in isolation from the economy of the borrowing country as a whole. The Bank carried on a dialogue with the borrowing country authorities on a whole range of questions: it has consistently urged attempts to settle defaulted external debt, to put economic and fiscal policies on a sound footing and to direct public investment in such a way as to promote, rather than to obstruct or displace, the flow of private capital. (World Bank 1955, 34)

This classic statement of the conservative case for development, with its emphasis on the need for social and political stability to attract investment capital, underlies the Bank's development philosophy. It follows from this emphasis that anything that imperils stability is not to be encouraged. Social reforms that were inherently disruptive—such as land tenure reform in Latin America—have never figured as priorities for the World Bank.

Robert McNamara assumed the presidency of the Bank in 1968, interrupting the ascendancy of the Wall Street bankers. McNamara briefly tried to change the Bank's direction and introduce social reform as a priority. At the 1973 annual meeting of the World Bank's Board of Governors in Nairobi, McNamara called for an attack on "absolute poverty," which he described as a "condition of life so degraded by disease, illiteracy, malnutrition, and squalor as to deny its victims basic human necessities" (Shapley 1993, 510). McNamara assigned the Bank a central role in alleviating the "extremes of privilege and deprivation."

The leverage of the World Bank for inducing any kind of reforms in the debtor countries was minimal.

Within weeks, however, the Yom Kippur war between Israel and Egypt again changed the calculus. The sixfold rise in the oil price and the resulting surplus of petrodollars gave some borrowers in developing countries, many of which were in Latin America, direct access to international capital markets.

The leverage of the World Bank for inducing any kind of reforms in the debtor countries was minimal. McNamara's ambitious concept of an international war on poverty, led by the World Bank, foundered. But even if there had not been great access to international capital markets, McNamara's zeal for attacking poverty would not have resonated in Latin America. Conservative military governments, their allies in the business community, large agricultural landholders, and a newly emergent middle class had little interest in social reforms. Economic growth was their objective, and let the distribution of the benefits take care of itself.

The World Bank, the IMF, and the IDB were marginal influences on their borrowing member countries during the 1970s. That situation changed in the aftermath of the debt crisis that erupted in August 1982 with Mexico's default on its commercial bank obligations. At that point, the Bretton Woods institutions emerged as key players in shepherding the international financial system through crisis. And that crisis would also redefine the role of the IDB.

The Inter-American Development Bank

The formation of the Inter-American Development Bank was a reaction to the triumph of Fidel Castro and the Cuban revolution. Latin American finance ministers and political leaders expressed the need for a financial mechanism separate from the Bretton Woods institutions at a meeting of the Inter-American Economic and Social Council, held in Quitandinha, Brazil, November 22 through December 2, 1954. These leaders were dissatisfied with the World Bank's emphasis on private investment, particularly foreign investment, as the basis for development (Levinson and De Onis 1970).

Momentum for a new lending institution built slowly during the 1950s. In 1957, in a contentious meeting between President Juscelino Kubitschek of Brazil and U.S Secretary of State John Foster Dulles over the proper response to Communist subversion in the hemisphere, Kubitschek proposed an ambitious program of hemispheric development and reiterated the need for an alternative source of financing for Latin American industrial development. Operation Pan-American, as it was dubbed by the Brazilians, along with the earlier call to action at Quitandinha, set the stage for the IDB and the Alliance for Progress program, sponsored by President John F. Kennedy, at the beginning of the sixties.

Borrowing member countries could not defy the United States on any important issue, if they wished for future increases in the resources of the IDB.

To maximize the Latin American character of the IDB, the Eisenhower administration agreed that Latin American member countries would own a majority of the shares (53.5%). Although the United States accepted a minority status (34.5%) it was still the single largest shareholder. Later, during the 1970s, most of the countries of Western Europe, plus Japan, Israel, and Yugoslavia, became members of the IDB. Among them, they owned 8% of the total capital of the Bank. Canada held the remainder of the shares (4%).

Under the IDB charter, the IDB board would ratify decisions, including approval of loans by a simple majority of the shares, unless otherwise specified. By voting as a bloc, the Latin American shareholders could approve individual loan operations even over the opposition of the United States. But this power has proved more theoretical than real. The IDB, like the World Bank, can borrow in the capital markets only against its reserves, paid-in capital, and the callable capital subscribed by the non-borrowing countries. In the 1960s, this meant, in effect, the capital subscribed by the United States. Consequently, the borrowing member countries could not defy the United States on any important issue, if they wished for future increases in the resources of the IDB. Moreover, the presence of the U.S. director was necessary to constitute a quorum of the IDB board. In an extreme case, the U.S. director could bring Bank business to a halt.

However, by negotiating as a group, Latin Americans had far more bargaining power in the IDB than in the Bretton Woods institutions, even though, to bargain effectively, they had to resolve differences among themselves and maintain a united front on such issues as the conditions attached to loans. The larger and richer Latin countries had to accommodate the interests of the smaller and poorer countries. The IDB was virtually the only international forum in which the normally fractious and divided Latin American countries effectively negotiated as a bloc with the industrialized countries.

From its inception the IDB maintained a certain distance from the Bretton Woods institutions and the U.S. Treasury. It declined to formulate overall lending conditions relating to the management of a country's economy.

The IDB established a Fund for Special Operations (FSO), initially financed primarily by the United States, to finance projects with a social-equity dimension. The loan-repayment conditions were highly favorable to the borrowers: a 40-year repayment term with a 10-year grace period and very low interest rates. However, approval of projects financed with FSO resources required an affirmative vote of two-thirds of the share capital. Because the United States held 34.5% of the voting shares, it could veto FSO projects.

Unlike the World Bank, the IDB financed industrial projects in which the state had an ownership interest, including steel, petrochemical, and pulp and paper developments. Similarly, it financed agricultural projects, usually for farmers with small holdings whose production was destined for the local market, while the World Bank emphasized large agricultural enterprises that could earn foreign exchange. And the IDB financed potable water and sewage projects, not only for the great metropolitan centers, but also for lesser cities where the people were poorer and more neglected. At least in its initial years, the IDB also financed unconventional programs involving rural public-health facilities and adult-literacy and primary-school programs. Like the World Bank, it also financed more traditional infrastructure projects: roads, power, and communications.

From its inception the IDB maintained a certain distance from the Bretton Woods institutions and the U.S. Treasury. It declined to formulate overall lending conditions relating to the management of the economy: fiscal, monetary, and exchange rate policy or incentives for private domestic and foreign investment. Those decisions, with their implications for social and political stability, could not be made from Washington but had to be made on the ground in Latin America.

The U.S. government and the Bretton Woods institutions increasingly perceived this approach to development financing as a rationalization for an unwillingness to make hard judgments about individual country economic performance. This would make the IDB an imperfect instrument for achieving U.S. objectives in the Alliance for Progress.

The Agency for International Development

The Kennedy administration adopted the Latin American thesis that economic development required a commitment to public-capital transfers analogous to those of the Marshall Plan. As a result, the United States reorganized its bilateral foreign aid (not only for Latin America) to emphasize capital transfers rather than technical assistance. Washington put a new entity, the Agency for International Development (AID), in charge of the program.

The U.S. government and the Bretton Woods institutions increasingly perceived the IDB's approach to development financing as a rationalization for an unwillingness to make hard judgments about individual country economic performance.

AID controlled extensive resources. Between 1961 and 1969, AID provided $4.4 billion in resources to Latin America; the IDB provided $2.4 billion and the World Bank (including affiliated organizations), $2.7 billion (Levinson and De Onis 1970, 138). The agency also had great flexibility in the use of its funds. It was not limited to project lending. Moreover, in contrast with the IDB and World Bank, it was not constrained to base loan decisions solely on economic criteria. AID's non-project loans, called program loans, were unrelated to the construction of any particular facilities, such as roads, schools, or dams. Program loan resources could be used for almost any type of import, save for a list of ineligible goods and services. The funds were disbursed in stages ("tranche") tied to economic measures that the borrowing country agreed to implement. These measures almost invariably concerned the overall management of the economy: the size of the fiscal deficit or surplus, monetary policy, and foreign-currency-reserve requirements.

The advantage of the program loan from the point of view of the borrower was that the country received funds immediately upon agreement on the conditions of the loan. And the amounts of the individual loans could be substantial; it was not unusual for AID to lend $150 million to $350 million in this way. Program loans also provided AID with more negotiating leverage with the ministers responsible for economic management than did a project loan for a specific facility. The agency could adjust program loans up or down, depending upon any number of considerations: a balance-of-payments analysis showing a "gap" to be financed, how much AID judged was necessary to obtain desired policy commitments, or the need for the United States to show support for a particular government during a critical election.

In most cases, AID made a serious effort to coordinate with the Bretton Woods institutions regarding the economic policy conditions it attached to program loans. But when AID considered it important to support a government for political reasons, it could subordinate coordination and conventional economic performance criteria to the Cold War calculus. The United States considered the multilateral financial institutions in the 1960s as complementary, not primary, instruments for accomplishing foreign-policy goals.

Increasingly, the United States used its bilateral aid program to prop up governments in Central America and the Caribbean thought to be vulnerable to Cuban-inspired subversion.

By the late sixties, the early social-reformist thrust of the Alliance for Progress had dissipated. Reform proved socially and politically disruptive, even destabilizing. Powerful conservative forces allied with the military to topple elected governments in Brazil, Uruguay, Argentina, and the Dominican Republic. The social-democratic political parties, the mainstay of the reforms the Alliance for Progress was designed to support, turned out to be far weaker in their own societies than had been anticipated. And the United States perceived governments of the left, reformist in intent, as economically incompetent and politically unreliable.

A Republican administration in 1969 disassembled the pale remnant of the Alliance for Progress, burying the reform ambitions of the program unceremoniously. The large AID program loans, representing public-capital transfers not only for Latin America but also for India and developing countries on other continents, became a thing of the past. The United States admonished borrowing countries, as in the 1950s, to create an environment that would attract private foreign direct investment and to rely more upon the Bretton Woods institutions and the regional development banks. (Following the IDB, the Asian and African development banks were established.) Increasingly, the United States used the bilateral aid program to prop up governments in Central America and the Caribbean thought to be vulnerable to Cuban-inspired subversion. In the larger Latin American countries, bilateral assistance dwindled to irrelevance.

The Multilateral Financial Institutions Take Center Stage

Stage 1: 1982-85

Two events in 1979 and 1980 returned the international financial system to crisis: the Iranian revolution, which toppled the Shah from power, and the advent of Paul Volcker as chairman of the Federal Reserve Board, the arbiter of U.S. monetary policy. The new Iranian government's declared policy of reducing oil production led to a second oil price revolution. Consumer states, just recovering from the 1973-74 oil-price shock, now had to cope with a new one. Instead of borrowing to maintain investment levels, developing countries now had to borrow just to pay for current oil consumption. Their problem was compounded by the Fed's decision to brake domestic U.S. inflation with severe deflationary policies, which led to soaring interest rates, both in the United States and internationally.

Instead of borrowing to maintain investment levels, developing countries now had to borrow just to pay for current oil consumption.

Borrowing countries faced an insoluble dilemma: while the bottom fell out of the principal market for their exports, interest rates on their international debt rose sharply. Responding to the uncertain international economy, private commercial banks, which had promoted loans among the borrowing countries, increasingly withdrew from new lending (World Bank 1992d, 44-45).

Mexico could not meet its financial obligations to the commercial banks. Jesus Silva Herzog, then-Mexican finance minister, described the scene:

> What became known as the beginning of the debt crisis took place Friday the twentieth of August of 1982, when we called a meeting of the most prominent representatives of international banking in the building of the Federal Reserve Bank of New York. Neither the high officials of the governments of the industrial countries nor the most prominent bankers nor the less sophisticated bankers, and least of all the financial academics, foresaw the debt crisis. We erred—the debtors as much as the creditors—in interpreting the essence of the debt problem. At that moment, August 20, 1982, we in the debtor nations and equally the creditor nations and the international organizations thought it was a liquidity problem....[W]e believed that it was a short-term problem that would be resolved through restructuring the existing debt, obtaining new resources and adopting internal austerity measures in each of the debtor countries. (Herzog 1987, 71)[1]

An emergency loan from the United States and advance purchases of Mexican oil for the U.S. Strategic Petroleum Reserve temporarily resolved the Mexican crisis. In keeping with the view that the problem was one of short-term liquidity, U.S. Treasury officials, who led the negotiations on the U.S. side, also required Mexico to agree with the IMF on an economic-adjustment program that would bring its external accounts into better balance.

Before concluding such an agreement, however, the managing director of the Fund, Jacques de Larosiere, insisted that Mexico's private bank creditors agree to continued financing. A $4.2 billion "involuntary" private commercial-bank financing package was assembled, establishing a pattern for dealing with other major debtor countries: an immediate U.S. rescue operation, including a short-term credit; a commitment to seek an agreement with the Fund; and involuntary continued lending by private bank creditors, linked to an agreement between the debtor country and the IMF.

The debt crisis gave new urgency and a specific mission to the IMF: shepherd the debtor countries through their financial difficulties to retain the integrity of the private international commercial banking system. The IMF had been in search of a mission for itself ever since par values of currencies had been abandoned by the major industrialized countries at the beginning of the 1970s in favor of floating exchange rates. The forum for coordinating the economic policies of the major industrial countries became the annual summit meetings among heads of state.

The economic adjustments the Fund advocated differed in detail for each country, but the emphasis was the same: shift resources from the domestic sector into activities that increased foreign-exchange earnings. In practice this formula meant stepped-up production for export, reduced government expenditures and economic activity, and a currency devaluation to spur exports. The reduction in public spending effectively translated into a decline in investment. Debtor governments, generally fearing political unrest, attempted in the first instance to save jobs. The ax therefore fell instead on public investment. Finance ministers, concerned to meet IMF goals as a condition for further infusions of capital, slashed expenditures for health, education, energy, and public construction. Demand for imports declined; import substitution by local industry was encouraged and exports were spurred, often by subsidies.

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As economist Patricio Meller summarized the record of the Chilean adjustment program with the IMF:

> The first priority of these standbys was to ensure full external debt service: total consumption in Chile in 1982-83 fell by more than 24%; total gross fixed investment declined by more than 50%. Average annual financing for Chile from the World Bank, IDB and IMF for the period 1983-87 amounted to $750 million, a sum equal to 40% of the net external financial payments to the commercial banks. (Meller 1990, 70)

IMF and World Bank incentives for an export-led growth strategy in combination with the strong dollar and the tendency of multinational corporate investment to gravitate abroad to low-wage jurisdictions had a devastating impact on U.S. workers. The Morgan Guaranty *World Financial Markets* newsletter observed: "U.S. manufacturers are keenly aware of the cost savings attainable through contracting for production in low wage areas abroad. [A]verage real wage gains have been negligible in this recovery, maintaining their stagnation of the last ten years or more" (Morgan Guaranty Trust Company 1985, 9).

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The impact in Latin America was equally devastating. Although the developing countries substantially reduced their combined current-account deficit, from approximately $100 billion in 1982 to $44 billion in 1984, the cost was high. Between 1981 and 1984, the net transfer of debt-service payments from Latin America to private commercial banks was an estimated $100 billion. "In the last five years, Latin America has regressed a decade," stated the foreign ministers of eight of the largest countries in South America (Group of Eight 1985).

Mounting political resistance in the United States to a flood of imports from debtor countries and slow growth at home combined with debt fatigue in Latin America to force a change in direction. What gave the issue urgency was the July 1985 announcement by the newly elected president of Peru, Alan Garcia, that he intended to limit payments to foreign creditors to 10% of Peru's export earnings. The IMF passed the baton to the World Bank to take the lead in managing debtor countries through the debt crisis.

Stage 2: The World Bank Steps Up

The Baker Plan (1985-89)

At the October 1985 annual meeting of the World Bank and the IMF in Seoul, South Korea, U.S. Secretary of the Treasury James A. Baker III acknowledged that the payments problems of the heavily indebted countries were not merely an issue of short-term liquidity; the debtors were unlikely to resume economic growth simply by following the austerity path pressed upon them by the U.S. Treasury and the IMF. Baker proposed that additional resources be made available to those debtor countries that undertook major economic policy reforms. The reforms would emphasize reducing the role of the public sector in the direct production of goods and services; market-opening measures to encourage foreign direct investment, capital inflows, and imports; reliance on market-oriented exchange rates, wages, and prices; and adherence to sound monetary and fiscal practices. Private commercial bank creditors would lend $20 billion of net additional resources (that is, beyond what was needed to cover anticipated principal and interest payments) over three years to debtor countries undertaking such reforms. The World Bank and the regional development banks would increase their disbursements by 50% (Baker 1985).

There was not a single word in Baker's speech to the World Bank/IMF meeting about poverty, inequality, or social justice.

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Baker's call for new net lending from commercial banks conflicted with their strategy of reducing their loan exposure in debtor countries and therefore went unheeded (International Monetary Fund 1989, 51). Since private commercial banks provided no new money, the composition of the debt shifted. By the end of 1989 official creditors held about 48% of total developing-country long-term debt, in contrast with 38% in 1982 at the start of the debt crisis (World Bank 1990a, 33).

With no substantial program loans available from AID, the World Bank filled the financing gap left by the commercial banks. The Bank modified its cautious, project-lending strategy and designed its own version of the 1960s AID program loans: structural adjustment loans (SALs) and, later, sectoral adjustment loans (SECALs). (The World Bank SALs and SECALs and IDB sector loans are hereafter referred to collectively as program loans as opposed to project loans.)

World Bank program lending more than doubled after 1985, rising from an average 12% of total lending in the period 1981-85 to 26% between 1986 and 1990 (World Bank 1992b, 32). Like the AID loans of the 1960s, the Bank tied disbursement to the execution of policy reforms, but recipients could use the loan resources to finance imports of any kind (with the exception of certain prohibited items). The program loans enabled the debtor countries to maintain the fiction that they could continue to meet their debt-service obligations—at least the interest component—without reducing the nominal amount of debt owed to the commercial banks.

In line with Baker's initiative, these program loans were overwhelmingly oriented toward improving the debt-servicing capacity of the debtor economies. In recent years, the program loans have cushioned the shock of adjustment programs for the weaker sectors of society with emergency public-works projects that created jobs, but their focus has remained on the medium-term adjustment problem (World Bank 1992a, 32).

Throughout the debt crisis, neither the IMF nor the World Bank seriously deviated from the U.S. Treasury/Fed line opposing debt forgiveness.

Throughout the debt crisis, neither the IMF nor the World Bank seriously deviated from the U.S. Treasury/Fed line opposing debt forgiveness. The debtor countries would have to export their way out of the debt crisis. Without a commitment to honor the full amount of their debt to commercial banks, the debtor countries could not regain voluntary access to the private capital markets. Reestablishing that access as the primary means of financing development remained the preeminent objective of the Baker/MFI policy.

In February 1989, the policy received a severe jolt.

The Brady Plan (1989-92)

Venezuela's newly elected social-democratic (Acción Democrática) government of Carlos Andrés Pérez devised and implemented a tough economic austerity program endorsed by the IMF and the World Bank. The program represented a radical departure for the Adecos, as the party is known in Venezuela. Previous Adeco governments (including one headed by Pérez himself) had aggressively used the state to promote economic development. This time the Pérez government relied on a group of young economists, many of them U.S.-educated, to devise its policies. These economists echoed the diagnosis of the Bretton Woods institutions that Latin American countries had relied too much on the state as the engine of development and too little on market forces to allocate resources. They were rewarded by an IMF agreement and the promise of substantial lending from the World Bank and the IDB.

The Pérez government implemented an austerity program by immediately reducing subsidies for gasoline and other daily necessities; bus fares and bread prices dramatically escalated. Down from the hills surrounding Caracas, from the poor communities known as *rivaderos*, came thousands of people, desperate and angry. Riots ensued. Troops and armored cars appeared on the streets; more than 250 people were killed. The new Bush administration feared this could be a precursor of worse to come in other large cities in Latin America. Just as the Baker Plan had been devised in 1985 to counter "debt fatigue" and the risks posed by Alan García's limit on debt service payments, the Bush administration responded to the Caracas riots with a new initiative.

Secretary of the Treasury Nicholas F. Brady, in a speech to the Bretton Woods Association on March 10, announced that debt reduction would be an acceptable element of restructuring agreements between debtor countries and creditor banks.[2] Additionally, Brady broke the link between disbursements by the Bretton Woods institutions and an agreement between the debtor countries and the commercial banks (Brady 1989). Financing from these institutions had previously been held hostage to such an agreement, putting commercial banks in a powerful negotiating position.

In the event of another debt crisis, the countries that have entered into debt-reduction deals and the Bretton Woods institutions may both be worse off than if they had not entered into such arrangements.

The debt-reduction deal under the Brady plan involved Mexico, the country in the roughest straits. In 1988, Carlos Salinas de Gortari claimed the presidency of Mexico in a hotly contested election. Because many Mexican and foreign observers concluded that Salinas had won through electoral fraud, the Salinas government took office with its credibility already diminished (Castañeda 1993; Golden 1994b). It badly needed a deal with the commercial banks. Without such a deal, it would have been virtually impossible to induce the repatriation of Mexican flight capital, attract foreign direct investment, or construct a believable economic plan.

The Salinas government initially demanded that commercial banks cut the nominal amount of the commercial debt in half, but it settled for no more than a 35% reduction. The amount of the reduction was less important to the government than the fact that a deal was consummated. The agreement with the banks introduced a measure of certainty into Mexico's international financial commitments and led to a substantial repatriation of capital, primarily from the United States.[3]

As the price for agreeing to debt forgiveness, the banks insisted that the debtor countries guarantee repayment; the collateral of the renegotiated and reduced indebtedness was placed on deposit with the New York Federal Reserve Bank. The collateral, or "enhancements" as they were called, would consist of zero-coupon U.S. Treasury bonds (or equivalent-quality securities), with the purchase financed by the Bretton Woods institutions.[4]

In the event of another debt crisis, the countries that have entered into debt-reduction deals and the Bretton Woods institutions may both be worse off than if they had not entered into such arrangements. The securities financed by the Bretton Woods institutions and the IDB are the property of the debtor country; they are counted as assets of the debtor country but are "pledged" as security for repayment of the commercial debt. If a debtor country fails to make timely principal and interest payments, the creditor commercial banks may demand the securities in satisfaction of the debt owed. The debtor country could lose the assets it had deposited with the New York Fed, but it would still owe the Bretton Woods institutions and the IDB the amounts it had borrowed from them to finance the purchase of the securities. There would then be political pressure in the debtor country to discontinue payments on the debt to the IMF and World Bank. This is the dilemma in which Venezuela now finds itself.[5]

When the Salinas government acceded to the demands of the commercial banks, the other debtor countries lost whatever negotiating leverage they might have had.

Should such a crisis occur, commercial banks are in a far stronger negotiating position than they were in 1982. Previously, they had to negotiate with the debtor country, the Bretton Woods institutions, and the U.S. Treasury to have any hope of getting a substantial part of the interest (and principal) repaid. The MFIs and the Treasury staff may have aligned themselves with the commercial banks in such negotiations, but the commercial banks did at least have to negotiate with them. With the enhancements in place, they need not negotiate at all; they can simply demand that the New York Fed pay the security over to them.

Whether the enhancements were really necessary to close the deals with the commercial banks cannot be definitively known. Most of the commercial banks had already set aside reserves against losses on the debts owed to them by the borrowing countries. They were in a position to concede a larger discount on the outstanding debt than the 35% agreed upon with Mexico. And they needed a deal with Mexico and the other debtor countries to clear away uncertainties surrounding their overall financial conditions (Lipin 1992).

When the Salinas government acceded to the demands of the commercial banks for enhancements financed by the Bretton Woods institutions, the other debtor countries lost whatever negotiating leverage they might have had. The 35% discount became the rule for Latin America. Neither the U.S. Treasury nor the Bretton Woods institutions would support a higher discount for any other debtor country. To have done so would have required reopening the Mexican debt negotiation. Politically, Mexico would have had to demand "most favored nation" treatment from the commercial banks. Thus, the parameters for debt reduction in Latin America were not set in terms of what the debtor countries needed to restore economic growth and remedy the underinvestment in human capital resulting from a decade of stagnation. Those parameters were established by the political weakness of the Salinas government in Mexico.

In essence, each debtor country confronted a cartel of creditors. These cartels picked off the weakest debtor country (Mexico) and imposed on the rest of them the terms negotiated with the most distressed.

A great deal of the responsibility for this state of affairs rests with the debtor countries themselves for their inability to agree among themselves on a common negotiating front. Both the banks and the developed-country governments had formed creditor committees to negotiate with individual debtor countries. Both the U.S. Treasury and the Bretton Woods institutions supported this strategy, which worked to the disadvantage of individual debtor countries. In essence, each debtor country confronted a cartel of creditors. These cartels picked off the weakest debtor country (Mexico) and imposed on the rest of them the terms negotiated with the most distressed.

Why did the major Latin American debtor countries accept this patently inequitable negotiating paradigm? The conventional explanation is that the debt profile and level of development among the debtor countries varied so much that an across-the-board solution was not feasible. This explanation is not convincing. The debt portfolio among the major creditor banks and governments also varied greatly, but the creditors realized that it was in their interests to submerge their differences and present a common negotiating front.

The debtor countries' failure to follow suit was political and personal. When the government of Raúl Alfonsín assumed office in Argentina in 1983 it considered the more radical strategy of trying to change the terms of the debt renegotiation. But other large Latin debtors—Brazil, Mexico, and Venezuela—did not endorse Argentina's 1984 Grinspun initiative at Montevideo calling for conversion of debt into long-term bonds guaranteed by the multilateral financial institutions, which anticipated the Brady plan.

In 1983, Brazil's military regime was on its last legs. Soon after, in 1984, the country went through the trauma of the death of its newly elected president, Tancredo Neves, the veteran politician who had engineered the withdrawal of the military-backed government. The vice president, Jose

Sarney, assumed power afterward without a popular base of support. He did not want any unnecessary confrontations, and he inherited a conservative finance minister, who was determined to reach an agreement with the external creditors.

Mexico was the model debtor. It followed the rules: it had negotiated an agreement with the IMF, and it was current in its interest payments to the commercial banks. The Mexican authorities were confident that they were on the road to regaining voluntary access to the private credit markets and did not want Argentina to prejudice this strategy. The Mexican minister of finance, in conjunction with U.S. Treasury staff, assembled a bridge loan for Argentina to enable it to meet its interest payments to commercial banks. The loan was to bridge the time it would take for Argentina to reach an agreement with the IMF on an economic-adjustment program. Brazil and Venezuela contributed funding for this bridge loan, apparently willing to pay to keep Argentina in line with the rules of the game as defined by the U.S. Treasury and the IMF.

The debtor countries shared the financial institutions' critique that Latin American governments relied on the state too much to allocate resources. They internalized this critique, absorbing excessive blame when there was plenty to go around.

This early experience left a bitter taste among the Argentines and prejudiced the chances for a common front in 1987 when Brazil declared a unilateral moratorium on debt-service payments. Argentine debt negotiators appeared in Brasilia in November of that year, creating the impression of forging a joint strategy with Brazil just as Argentina was beginning debt renegotiations with its commercial bank creditors. The Brazilians thought they had an agreement with the Argentine economic team for a joint payment moratorium (Margolis 1988). But the Argentines merely used the prospect of such an alliance to obtain marginally better terms from their creditors.

The South Americans did not trust the Mexicans enough for joint negotiations with the United States and the commercial banks. Each debtor country believed it had a special advantage in negotiations with the commercial banks: Mexico because of its proximity and interest to the United States; Brazil because of its continental size and economic potential; Venezuela because of its vast oil resources; and Argentina because of its recent transition to democracy.

The negotiators for the debtor countries—the economic ministers and officials of the central banks—had gained experience in international financial-market transactions during the 1980s. With a few exceptions, they shared the financial institutions' critique that Latin American governments relied on the state too much to allocate resources. They internalized this critique, absorbing excessive blame when there was plenty to go around.

It is true that the easy borrowing that followed the 1973 oil-price revolution masked underlying structural problems, which were present well before the debt crisis. These included the inability to establish a secure revenue base by effective taxation, resulting in a permanent disequilibrium in public finances; a near-feudal agrarian landowning structure in many countries, prompting a steady stream of migrants from impoverished rural areas to the great metropolitan centers; and the concentration of economic assets among a few powerful groups, which led to unrealistic popular demands for public-sector intervention to compensate for the inequity.

Successive administrations in Washington after 1973 insisted upon a strategy that relied excessively on private commercial banks that had their own agendas.

It is also true that the creditor countries, particularly the United States, contributed to the debt crisis. Successive administrations in Washington after 1973 insisted upon a strategy that relied excessively on private commercial banks that had their own agendas. The result for Latin America was jumbo loans, paving the way for the corruption and diversion of funds now generically referred to as "the excesses of the seventies." Incredibly, the Fed, under Paul Volcker, and the Treasury acquired the role of "honest brokers" between debtor countries and the commercial banks, when in fact both agencies were primarily concerned to prevent a failure of the international banking system. Paradoxically, those concerns might have constituted negotiating leverage for the debtors in the early eighties, had these countries gotten their act together. The failure to do so carried a high social cost.

The Outsider: Reform of the IDB

The Bretton Woods institutions, from the inception of the debt crisis, had played critical roles. This was not true of the Inter-American Development Bank, which the Treasury deeply mistrusted. The IDB was born out of a concern for social questions in Latin America and a tolerance for import-substitution industrialization and state-owned enterprises. Its Latin American leadership was skeptical that a single economic formula could be applied indiscriminately to all countries in the region. Its strength was in its project lending capability at a time when potential investment resources were diverted to paying the foreign debt. It represented everything that had fallen from grace in the aftermath of the debt crisis.

For these same reasons, the IDB came in for special censure from Secretary Baker in his 1985 Seoul speech. Secretary Baker warned that the IDB would play no role in his plan if it did not implement major internal reforms. He implicitly threatened that the United States would not support a replenishment of the IDB's resources. As a practical matter, no replenishment could occur without U.S. support: none of the IDB's lending members would defy the U.S. Treasury secretary.

With its funding on a four-year cycle, the IDB's seventh replenishment should have been negotiated among the member countries to take effect in 1986. Past replenishment negotiations had largely focused on the size of the lending program and the conditions that would attach to it. In the negotiations this time, the U.S. Treasury offered the Latin American members a Faustian bargain: in return for a capital increase, which would support a lending program of $22.5 billion (approximately $5.5 billion per year), they would have to agree to new voting rules. This change would give the United States and Canada an effective veto. It was directly contrary to the basic compact of the IDB, which based decisions on a simple majority vote.

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What made the prospect of a replenishment particularly enticing to Latin American finance ministers was the prospect of receiving 25% of the new resources in the form of fast-disbursing program loans. The Treasury also agreed to lift quantitative restrictions on borrowing by the largest countries—Argentina, Brazil, Mexico, and Venezuela. The Carter administration had established these restrictions in 1978 to provide more assistance for smaller and less-developed countries.

The replenishment negotiations deadlocked. At the IDB's annual meeting in Miami in March 1987, Secretary Baker proposed a compromise, but one that still provided for an effective North American veto over the Bank's loan and technical-assistance operations. The governors of the four largest Latin countries—Argentina, Brazil, Mexico, and Venezuela—caucused to consider the Baker compromise. (Within the Latin group, their views are usually decisive in a replenishment negotiation.) The Argentine governor declared that he could not defend the Baker compromise before his parliament. He then asked the others whether they would defend the Baker proposal in front of their legislatures. Each responded that he would not.

The four Latin governors did not want to tell Baker no directly. They told him they needed time to consult with their political authorities and would respond at a meeting of the Bretton Woods institutions in Washington in April.

There, in a very brief conversation in Baker's office, the four finance ministers informed the Treasury secretary that they could not accept his compromise. After making sure that they understood the consequences—no U.S. support for the seventh replenishment of the IDB's resources—Baker changed the subject of the conversation. The negotiations were put on indefinite hold.

The impasse in the IDB negotiations reflected fundamentally different ideas about the proper role of a development bank. For the Treasury staff, what was important were policy changes that Latin American leaders, left to themselves, would not undertake. The debt crisis was an opportunity to move the debtor countries in Latin America off excessive reliance on the state as an engine of economic development. In this view, the IDB's resources without the kind of conditionality demanded by the Bretton Woods institutions would be sheer folly. The IDB would become an escape hatch from the discipline imposed by the Bretton Woods institutions. For the United States, the object of the replenishment negotiations was to incorporate the IDB into the prevailing Washington policy consensus or, failing that, to allow the institution to become irrelevant.

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For the IDB, the seemingly endless conflicts between the Bretton Woods institutions and the borrowing countries were evidence of the lack of consensus on how to apportion the costs of economic adjustment. In the last military government in Brazil, which ended in 1984, Minister of Finance Delfim Neto entered into no less than seven letters of intent with the IMF without ever meeting the program targets. The IDB could not possibly compensate for that deficiency. A Latin American political leadership would have to emerge that could forge a consensus. This would take time, and many countries were just emerging from military dictatorship.

In December 1987, Michael Curtin, executive vice president of the IDB, resigned. By informal agreement among the members, a U.S. national always holds this office. The charter of the Bank requires that he or she be nominated by the president of the Bank and approved by the board of executive directors. In fact, the U.S. Treasury selects the person. In this instance, the Treasury indicated to President Antonio Ortiz Mena that it wished to replace Curtin with James Conrow, its lead negotiator in the deadlocked seventh replenishment negotiations. Rather than nominate Conrow, Ortiz Mena resigned.

Don Antonio Ortiz Mena had presided over the IDB for 17 years. He was a distinguished former finance minister of Mexico. He had been one of the Latin American experts at Quitandinha, Brazil, in 1954, when the original proposal for a Latin American financing institution was broached. He was one of the drafters of the Charter of Punta del Este in Uruguay, in 1961, when the Alliance for Progress was launched. In outlook, he was a fiscally conservative social democrat. He was, in short, a senior Mexican political figure and a respected Latin American elder statesman. The seventh replenishment of the IDB's resources was to crown his stewardship of the Bank. Nominating Conrow without a replenishment was unacceptable to him.

The IDB elected a new president in 1988, Enrique Iglesias, the former foreign minister of Uruguay. Iglesias, in his late 50s, was nearly 20 years younger than Ortiz Mena. Originally closely associated with the import-substitution industrialization strategy, he had come to share the critique of that strategy in the 1980s. In style, he was direct and to the point and easier for the Treasury officials to understand than the often cautious and indirect Don Antonio.

The adjustment and stabilization programs implemented in Latin America in the past decade have improved the region's financial indicators, but they have not improved conditions of life for vast numbers of people.

In March 1989, at the IDB's annual meeting in Amsterdam, with the Caracas riots of a month earlier fresh in mind, Iglesias brokered with the Latin governors a complex formula on decision-making acceptable to the Treasury. Iglesias recognized that, without additional resources, the IDB could not be a credible development institution in Latin America. Along with the $22.5 billion lending program, the members agreed that for the first two years they would only undertake program loans in conjunction with the World Bank. As a further guarantee that the IDB would not depart from the prevailing Washington orthodoxy, responsibility for administering the program loans was located in the IDB's Department of Plans and Programs, and a former official of the U.S. Treasury was placed in charge. Ordinarily, responsibility for the lending program lay with the Operations Department, traditionally headed by a Brazilian national. The IDB was securely locked into the conditionality of the Bretton Woods institutions.

Country Performance and Lending Priorities

The Lost Decade

The adjustment and stabilization programs implemented in Latin America in the past decade have improved the region's financial indicators, but they have not improved conditions of life for vast numbers of people. The IDB notes that external resources totalled more than $60 billion, "a figure 77% larger than the one for 1991, and three and a half times larger than that of 1990" (IDB 1993a, 3). At the same time, "there is evidence that the standard of living of the population has deteriorated and that every day growing numbers of people are finding it harder and harder to satisfy their basic needs" (IDB 1993a). As the opening paragraph of a recent study prepared for the IDB candidly admitted, "income distribution and poverty have always been the dark side of development in Latin America....[T]he harsh structural adjustments of the 1980s have significantly worsened the poverty problem. Casual evidence from virtually every country confirms the deterioration of living standards and the widening inequality of the last decade" (Morley 1992).

As the opening paragraph of a recent study prepared for the IDB candidly admitted, 'income distribution and poverty have always been the dark side of development in Latin America....[T]he harsh structural adjustments of the 1980s have significantly worsened the poverty problem....'

In 1991, for the first time in this century, cholera appeared in Latin America on a significant scale. Cholera is preventable by taking such basic steps as installing adequate sewage systems, running water, and sanitary landfills. "In South America less than 5% of sewage is treated at all, most in antiquated systems, according to a Peruvian sanitation adviser to the Pan American Health Organization" (Farah 1993).

Of the 12 million people in the Buenos Aires metropolitan area, 62% are without sewage infrastructure; in the poorer, outlying areas of the city, only 3.5% of the population is linked to a sewage network, according to a report to the United Nations Development Program (Gall 1992). And Venezuela's infrastructure, "built with the finest materials that petro-dollars could buy during the 1970s oil boom [is] crumbling. The nation's water system, for example, is in such disrepair that some poorer neighborhoods of the capital have gone without water and sewage service for nearly a year. Even affluent neighborhoods experience regular water outages that can last for days" (Robberson 1992).

In February 1993, at a Forum on Social Reform and Poverty in Latin America, sponsored by the IDB, the heads of the three MFIs all emphasized the urgency of confronting poverty and inequality in Latin America. IMF head Michel Camdessus explicitly stated that "economic growth alone is not enough to create social progress. [A]n excessively unequal distribution of income and wealth is unlikely to provide the kind of economic and political environment congenial to long term growth" (Camdessus 1993). A 1991 operational directive of the World Bank declared, "The volume of lending should be linked to country efforts to reduce poverty. Stronger government commitment to poverty reduction—as measured by the adequacy of the policy framework for growth plus human development and/or willingness to reform—warrants greater support; conversely, weaker commitment to poverty reduction warrants less support" (World Bank 1991c, 6).

The World Bank has singled out investment in education as the best means of addressing poverty and income inequalities. In analyzing the efficacy of investment, the Bank notes that "returns to investment have generally been higher in education than in physical assets. Economic rates of return to primary education in developing countries have averaged 26%, compared with estimated returns on physical capital of 13%" (World Bank 1987, 63). Commenting on the experience of countries that have achieved fast economic growth—Hong Kong, China, Israel, Japan, Korea, and Singapore—the Bank observed, "[a]ll adopted a balanced investment strategy that included education, along with increased physical capital and technology transfer. All had achieved universal or almost universal enrollment at the primary school level by 1965. The most successful also achieved high percentages enrolled in secondary schools and near universal literacy of their labor force" (World Bank 1987, 63).

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There is no lack of rhetorical recognition of the problem of poverty and increasingly regressive income distribution. The program reality, however, does not match the rhetoric.

The Program Reality

The stipulation in the seventh replenishment negotiation that the IDB coordinate its program lending with the World Bank presented an opportunity for the two institutions to together offer substantial assistance to redress the underinvestment in the social infrastructure and human capital of Latin America. The program-loan discussions establish the priorities of medium-term adjustment programs with the borrower and determine the size of the individual loan programs.

Precisely because of its flexibility, the program loan is a potential means of financing investments in education and health care. Finance ministers, worried about their overall economic commitments to the World Bank and IMF, are generally not enthusiastic about borrowing for expenditures like health and education programs. They fear that their countries could not meet funding requirements for such investments and remain consistent with their commitments to the Bretton Woods institutions on overall economic policy goals. But the program loan might resolve such dilemmas. It provided additional foreign exchange resources for central banks, enabling governments to make the desired investments while staying within their overall fiscal plans. The loans could finance a "time slice," that is, a portion of the budget of a particular ministry for a specified time rather than for individual budget items.

Except for relatively small IDB loans to Costa Rica and Guyana for health programs, none of the program loans went toward enhancing the human capital of the region.

If the IDB had eased repayment terms, it might have been possible to neutralize the traditional opposition of finance ministers to ambitious program loans for investing in social infrastructure and human capital. But this opportunity was not seized.

Over the three years from 1990 to 1992, the IDB loaned its member countries $15.2 billion. Of this, $4.8 billion was in the form of fast-disbursing program loans. Over the same three years, the World Bank loaned $16.8 billion to countries in Latin America, including $5.6 billion of program loans (Annual Reports, World Bank and IDB, 1990-92). The largest commitment of program loan funds ($2.975 billion) went to three of the largest debtor countries (Argentina, Mexico, and Venezuela) to permit them to guarantee the repayment of reduced bank debt to their private commercial bank creditors, as detailed earlier.

Ostensibly, the program loans were for four purposes:

- Public enterprise reform—that is, privatization of state-owned enterprises (IDB, $1.34 billion; World Bank, $1.47 billion);
- Financial sector reforms designed to make it easier to attract private capital, both domestic and foreign (IDB, $2 billion; World Bank, $440 million);
- Trade liberalization (IDB, $675 million; World Bank, $740 million); and
- Reforms of the agricultural sector, primarily the removal of subsidies and other measures aimed at increasing efficiency (IDB, $440 million; World Bank, $675 million) (Annual Reports, World Bank and IDB, 1990-93).

With few exceptions, the borrower countries rarely expended the loan resources for any of these purposes. Central banks used the funds received from the World Bank and IDB for general imports or as an indirect means of helping the debtors meet their debt-service obligations to commercial banks. Except for relatively small IDB loans to Costa Rica and Guyana for health programs, none of the program loans went toward enhancing the human capital of the region.

The IDB and the World Bank have financed important individual loans for education, health, and low-cost housing, but it is the program loans that define their development theology. The appropriate role of government, notes the World Bank, is to ensure adequate investments in people, provide a competitive climate for private enterprise, keep the economy open to international trade, and maintain a stable macroeconomic policy. Beyond these roles, the report argues, "governments are likely to do more harm than good unless interventions are market friendly" (World Bank 1993c, 10). The IMF echoes the World Bank:

> The impressive economic performance of the most successful developing countries illustrates both the longer term benefits of sustained stabilization and reform efforts and the scope for growth to recover when the necessary reforms and a stable macroeconomic environment are in place. In all cases, market forces have increasingly been allowed to allocate resources efficiently, through price liberalization, financial market reforms, outward trade policies, exchange market unification, and convertibility. (IMF 1993, 7)

With respect to labor, the World Bank seems to have a positive aversion to independent trade unions that can bargain aggressively for their members.

The Bretton Woods institutions have thus come full circle, returning to the orthodoxy of the 1950s, with an important exception: an added emphasis on education, particularly at the primary and secondary level, as a means of ameliorating poverty. These institutions frown upon more direct government measures to redress poverty and income inequalities, such as land-tenure reform or increases in minimum wages.

Indeed, with respect to labor, the World Bank seems to have a positive aversion to independent trade unions that can bargain aggressively for their members. The Bank observes, "Only when labor in the protected formal sector wields significant power, distortions and inequities remain....Employment regulations, such as job-security laws, can undermine the link between pay and performance and lead employers to hire fewer employees" (World Bank 1991d, 80). The Bank attributes the success of East Asian economies in part to the absence of independent unions (World Bank 1993c, 164-67). In World

Bank lexicon, unions impede the free market. That appears to justify government intervention—for example, in Mexico—to keep labor in line.

Where World Bank literature discusses labor relations, the perils are all on the side of having unions that are too powerful. There is no mention of abuse of worker rights—child labor or the intimidation of workers and union leaders. According to the Bank's 1987 *World Development Report:*

> As new entrants, the NICs [newly industrializing countries] were able to absorb the existing technology and combine it with labor that was much cheaper and highly productive. Labor in the NICs not only was willing to operate at lower wages than in the industrial countries, and with fewer safeguards for health and safety at work, but also was exempt from over-manning, job demarcation, and restrictive working practices which were common in industrial countries. (World Bank 1987, 10)

The Bank depicts workers in the industrialized countries, who must compete with counterparts who have no effective means of protecting their own interests, as seeking to protect their narrow interests.

It is disingenuous to credit how "willing" workers are to accept conditions that are imposed on them by authoritarian governments. Moreover, the Bank depicts workers in the industrialized countries, who must compete with counterparts who have no effective means of protecting their own interests, as seeking to protect their narrow interests, delaying the "shift of resources from dying industries to more productive uses" (World Bank 1987, 10). There is no recognition that comparative advantage ought to exclude abusive labor practices that give countries an edge in attracting corporate investments. It is symptomatic of a distorted concept of development, as Mexico and Brazil illustrate.

Mexico—Star Performer?

Mexico is the textbook example of a country that has embraced the development path promoted by the international financial community. It has reduced its fiscal deficit from nearly 16% of gross domestic product (GDP) in 1987 to near zero in 1992. The government has sold state-owned companies, including the telephone company and the banks, to private buyers. It has altered the *ejido* system of communal land tenure to permit the sale of individual parcels, a measure designed to increase economic efficiency through the accumulation of larger agricultural holdings. On the international front, Mexico joined the GATT, sharply reduced its protection against imports, relaxed regulations for direct foreign investment, and concluded negotiations with the United States over the North American Free Trade Agreement (NAFTA). In February 1990, Mexico finalized a $48 billion debt-restructuring pact with the commercial banks (Weintraub 1993).

Mexico has been suitably rewarded for its performance. In the three years 1990-92, the World Bank and the IDB loaned Mexico a total of $8.1 billion. Approximately $5.3 billion was in the form of program loans (Annual Reports, World Bank and IDB 1990-92).

However, Mexico's performance has a darker side. Because Mexico drastically liberalized its import regime, it has run a current-account deficit "unusually high for a nation of Mexico's size," estimated to be over $20 billion for 1993 (Fraser 1994). Mexico has financed this deficit with an influx of capital, primarily portfolio investment from the United States. Some substantial part represents the repatriation of Mexican capital that had fled the country earlier, but this returning money is a mixed blessing: it is sensitive to fluctuations in domestic interest rates (currently higher than in the United States) and the performance of the Mexican stock market. Perceptions of political instability or changes in international interest rates can cause repatriated capital to exit in a hurry. Thus, Mexico feels great pressure to attract less volatile forms of capital, mainly direct investment in plant and equipment.

To attract investment in plant and equipment, Mexico has sought to create a low-wage labor climate, and it has tolerated environmental degradation on the U.S. border.

To attract that capital, Mexico has sought to create a low-wage labor climate, and it has tolerated environmental degradation on the U.S. border. As Louis Uchitelle (1993) notes in the *New York Times*, "[T]o maintain the low wages that draw American companies to Mexico, President Carlos Salinas de Gortari has gotten commitments from business and union leaders to limit raises. It could be years before the gap with American wages narrows significantly." Average real wages (adjusted for inflation) declined between 40% and 50% between 1980 and 1988. Although real earnings, particularly for skilled labor, picked up after 1987, workers are nowhere near recovering from the decline of their purchasing power in the 1980s (Weintraub 1993).

There is growing evidence that productivity in Mexico has increased significantly without a commensurate growth in wages. Majority leader of the U.S. House of Representatives Richard Gephardt observes with respect to a Sanyo plant in Tijuana, "The plant manufactured circuit boards for TV sets to be assembled at Sanyo's facility in Forrest City, Ark. The manager of the plant said his employees achieved better quality and productivity than Sanyo's Japanese or U.S. facilities—for a wage of a little over $1 an hour" (Gephardt 1993). What is true of television sets is also true in other industries. Professor Harley Shaiken of the University of California, Berkeley, has shown that Ford's Hermosillo plant is among the company's most productive in the world (Shaiken 1993).

Mexico has been able to hold the line on wages in large part because its labor union leadership is beholden more to the governing Institutional Revolutionary Party (PRI) than to the workers it nominally represents. A report prepared by the U.S. Embassy in Mexico City observed, "For the moment, the PRI apparatus is holding the unions in check and that permits the continuation of a price and wage restraint pact with them and the employers—which is the basic pillar of [President Salinas'] economic strategy" (U.S. Embassy in Mexico City 1991). The most powerful union confederation is the Confederation of Mexican Workers (known by its Spanish acronym, CTM) created in 1935 and until recently a stalwart of the PRI. Top CTM leaders regularly hold seats in the federal legislature and, at lower levels, salaried positions in local and state government, on regional committees, and as labor representatives to government agencies and arbitration boards (Goldin 1990, 207). CTM leaders thus depend on the PRI for their paychecks.

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Unions must register with the Ministry of Labor to be recognized as an authorized bargaining representative, but the ministry discourages independent trade union organizing. As the U.S. Embassy has observed, Minister of Labor Arsenio Farrell Cubillas "has maintained his reputation as a formidable labor opponent. He has maintained pressure on the labor sector in an effort to hold the line on wage demands. Farrell has not hesitated in declaring a number of strike actions illegal, thus undercutting their possibility for success" (U.S. Department of Labor 1989-90, 9).

It can be argued that Mexico's strategy parallels that of South Korea in the 1970s and early 1980s under military dictatorship: low wages as a temporary expedient to attract investment. Over time, the argument runs, the available low-wage labor will be absorbed into the booming industries. Wages will rise, just as they did in Korea. And the jobs that are created, even under oppressive labor conditions, are better than no jobs at all. More equitable income distribution and political democracy will come in time through some magical process impossible to describe. In the meantime—however long that may be—an authoritarian political regime is necessary to keep the lid on potential labor unrest. Political reform and wage liberalization must be subordinated to stability—social and political—to attract investment capital to finance economic modernization. However, Korean wages, particularly industrial wages, did not rise as part of a natural evolutionary process; they only rose significantly when the military dictatorship ended and unions could function relatively freely.

The Bretton Woods institutions and the IDB are bankrolling the Mexican strategy despite its flaws. They require Mexico to have a satisfactory economic policy framework as a precondition of lending. They demand commitments with respect to such matters as privatizing of state-owned industries, liberalizing imports, removing barriers to investment, and reducing subsidies. All of these measures are designed to reduce the role of the state in administering the economy. Wages are the only area in which administered prices are acceptable. By endorsing economic-efficiency reforms while failing to address the repressive labor relations, particularly the obstacles to independent unions, the Bretton Woods institutions and the IDB, in effect, embrace those practices.

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That same need to attract investment has led to environmental degradation on the U.S. border. Taking advantage of lax enforcement of Mexican environmental laws, companies have dumped toxic wastes that have contaminated water supplies of communities on both sides of the border. These plants (*maquiladoras*), primarily owned by U.S. companies, assemble components from the United States and then ship the final product back to the United States under favorable tariff conditions. Judge Charles R. Ritchey notes, "[T]hese problems are so severe that the area has been called a virtual cesspool and breeding ground for infectious diseases" (Public Citizen et al. 1993, 16). Not until NAFTA appeared headed for defeat in the U.S. Congress did Mexico and the World Bank commit substantial funding to address these conditions.

As a result of privatization, a further concentration of economic assets is compounding Mexico's already highly skewed income distribution. A report by the U.S. International Trade Commission observed that "the greater part of the para-statal entities were purchased by large consortia that produced the same goods as the sold enterprise. These buyers, monopolies or oligopolies, sought to consolidate their market through the purchase of the para-statal company" (U.S. ITC 1990, 3-10).

Mexico had nationalized its banks at the beginning of the 1980s in part to end the incestuous relationship between major industrial groups and the leading banks they controlled. However, when the Salinas government privatized those banks, the bidders, according to the *Wall Street Journal*, included "some of the big bankers ousted by nationalizations here a decade ago" (Solis 1991). The sale, wrote Andrea Dabrowski in the *Washington Post*, was intended to strengthen a "few groups of rich Mexicans before allowing foreign competition in the financial services sector....[E]ven Salinas's most admiring supporters say the methods of bidding used tend to concentrate capital and replace government monopolies with private ones, rather than promote competition" (Dabrowski 1991).

The continuing viability of Mexico's economic program, the Bank states, may depend on 'how the government responds to chronic poverty....'

The reform of the Mexican constitution to permit individuals to sell land owned in common is similarly intended to encourage the creation of larger, more economic units in anticipation of intense competition once NAFTA's agricultural sections are phased in. The government hoped to make these measures politically palatable by expanding community-development financing, the "Solidarity" program as it is known. The *Financial Times* describes the program: "Day after day on Mexican television and radio smiling peasants give thanks to Solidarity for the arrival of roads and electricity; food coupons for the poor, medical clinics in villages, loans to small farmers, student scholarships all bear the Solidarity imprint" (Fraser 1991).

But, as the *Economist* observed:

> Mr. Salinas's economic policies have widened already huge disparities of wealth. Mexico now has seven dollar billionaires, according to *Forbes* magazine—as many as Britain. Some have grown rich from a privatization program which brought large capital sums to the state but which also converted public monopolies into private ones. At the other extreme, despite sharply increased social spending by the government, 16% of Mexico's population—13.5 million people—is officially classified as living in "extreme poverty" and another 23.6 million as "poor." (*Economist* 1994, 19)

In a confidential paper on Mexico, the World Bank noted warning signs on the horizon. First, Mexico's current-account deficit is very large, $22.9

billion in 1992, or 7.1% of GDP. Moreover, investment has hardly expanded, and private savings have been in decline since the late 1980s, implying increased dependency on foreign financing. Third, capital inflows are speculative in nature, driven primarily by the large differential between Mexican and international interest rates. Fourth, Mexican banks and corporations have borrowed so much from abroad that their exchange-rate exposure is a matter of concern (World Bank 1993b).

Nor has the Mexican economy responded as the Bank expected to economic reform: GDP growth in 1992 was only 2.6%, down from 3.7% in 1989-91. In the last two quarters of 1993, the Mexican economy entered into recession. The Bank has no explanation: "Perhaps the most puzzling question is *why* GDP and productivity have not grown more. Their present growth rates are low by historical standards as well as in comparison with other countries with successful adjustment programs" (World Bank 1993b, 4). The continuing viability of the economic program, the Bank states, may depend on "how the government responds to chronic poverty—and to the possibly more visible and politically charged problem of a policy-induced deterioration in the distribution of income" (World Bank 1993b, 9).

Mexican society widely supported the demands for political reform and land for the peasants. But these issues also create a substantial doubt as to the ability of Mexican authorities to assure the continuity of the current economic and political model.

On January 1, 1994, the date NAFTA formally went into effect, armed Mexican rebels of Indian descent seized control of a number of towns in the remote Mexican state of Chiapas. This action by the Zapatista National Liberation Army struck at the central assumption of the Salinas government strategy: that the Solidarity program and the promise of future benefits with NAFTA could buy off the dispossessed. On the contrary, the Zapatistas linked their rebellion to grievances over land ownership; they demanded compliance with the Mexican revolution's commitment to distribute land to the peasants, a demand directly contrary to the government's strategy of encouraging consolidation of landholding into ever larger units. And they demanded political reform, with clean elections at all levels of government, thus linking economic equity to political reform.

Mexican society widely supported the demands for political reform and land for the peasants (Golden 1994a). But these issues also create a substantial doubt as to the ability of Mexican authorities to assure the continuity of the current economic and political model, which depends upon assuring social and political stability to attract investment capital. These doubts were compounded by the assassination in March of the PRI presidential candidate, Luis Donaldo Colosio. Even if the PRI candidate, Ernesto Zedillo Ponce de Leon, selected by President Salinas to succeed Colosio, prevails in the August 1994 presidential elections, the social question will demand a higher priority than it has received in the Salinas years. A Zedillo aide remarks, "This country has revealed itself to us as something different from what we thought it was" (Golden 1994b).

What seems clear is that it is premature to acclaim the Mexican reforms and the country's development performance as a model for others. The truth in this matter, as in the case of Brazil, is much more complicated.

Unlike Mexico, Brazil has not embraced the neoliberal agenda of the MFIs and is therefore considered a laggard in implementing structural economic reforms.

Brazil—Black Sheep?

Unlike Mexico, Brazil has not embraced the neoliberal agenda of the MFIs and is therefore considered a laggard in implementing structural economic reforms. Brazil, however, has made major strides in consolidating genuinely democratic institutions—an independent judiciary, legislature, trade unions and press—for which it receives no credit from the international financial community.

Brazil is almost the exact opposite of Mexico. It has no equivalent of Mexico's PRI, a party capable of enforcing economic discipline. It has independent trade unions that demand a seat at the table in formulating an economic policy. It has an opposition political party with a realistic chance of winning the presidency on a platform diametrically opposed to the policies of the Bretton Woods institutions. Above all, Brazil is attempting to consolidate democratic political institutions after throwing off a 20-year military regime.

Brazil has a long and troubled history of conflict with the Bretton Woods institutions, particularly with the IMF. Three decades ago, Tad Szulc observed that the "United States had made it a condition of financial assistance to countries with balance-of-payments problems that the assistance programs be tied to the International Monetary Fund's policies of currency stabilization." The drawback of this policy, he continued, was that it was "too inflexible in its execution, failing to take into consideration the political realities in each country" (Szulc 1963, 178). In Brazil, that reality included the fear of a social convulsion, which took place in 1964.

The basic dilemma that Brazil faced (and continues to face) is that a near-feudal agrarian structure in northeast Brazil has created a continuous stream of landless peasants migrating to the great metropolitan centers: "Certainly, the 18 million northeasterners who left the region in the 1900s and the 24 million who followed them in the 1970s largely explain the chaotic growth of São Paulo, Rio de Janeiro, Brasilia and other cities to the south" (Riding 1988). Reform of this land-tenure system was not feasible without virtual civil war. Landowners were organized and armed. Isolated in the vast rural expanses of northeast Brazil they easily controlled the landless peasants. But in the great metropolitan centers, rural migrants provided the labor power for the burgeoning industrialization and huge public-works projects vigorously promoted by Kubitschek during his presidency during the late 1950s.

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In the *favelas*, the shanty-towns surrounding the city centers, these transplanted migrants—and particularly the children growing to maturity there—increasingly constituted a powerful political force, vociferous in their demands for basic services—education, health care, housing, and jobs. These demands created tremendous pressure on the fiscal resources of the state. More traditional groups maintained their claim on those same resources, while endemic tax evasion limited the funds available to the state. The result was chronic inflation.

Brazilian political leaders sought to reconcile these claims on limited resources by embracing a "religion" of economic growth: "Brazil is home to 'developmental' economics, a school of thought which holds that all traditional economic goals should be subordinated to one—economic growth" (*Economist* 1987, 6).

Getulio Vargas, the populist dictator who ruled Brazil intermittently in the 1930s and 1940s, had sought to harness this urban industrial labor force. He formed the Brazilian Labor Party (PTB) to represent their interests, and he allowed the formation of controlled unions much like those that prevail in Mexico today. Often corrupt, the system nevertheless prevented the Communists and more radical leftist elements from dominating this labor force. The PTB became the political spokesperson for the *favela* population. Its leader, João Goulart, elected vice president in 1960, ascended to the presidency in 1962.

Goulart was no more successful than Kubitschek in reconciling the need for fiscal probity with the incessant demands for investment, credit, and services. Goulart initially supported moderate economic reforms designed to bring inflation under control. Although devised by the respected Brazilian economist, Celso Furtado, and the equally respected finance minister, Santiago Dantas, the program was defeated, primarily because the Paulista business leadership was unwilling to tolerate a prolonged economic slowdown.

The result was spiraling inflation, a reeling economy, and social conflict. The IMF and the World Bank stopped lending to the Goulart government. Only the IDB, then true to its offbeat ideology of continuing to lend to governments even during their most dire straits, made loans directly to the national government. The United States redirected its bilateral aid toward state governments.

Only the IDB, then true to its offbeat ideology of continuing to lend to governments even during their most dire straits, made loans directly to the Brazilian national government.

In the aftermath of the 1963 collapse of the Furtado/Dantas program, Goulart opted for a radical solution to the Brazilian impasse. At a massive rally on March 13, 1964, at the Central Railroad station in Rio de Janeiro, where Vargas had often addressed his followers, and with thousands of workers bussed in from the outlying suburbs, Goulart, in effect, proposed to invert the Brazilian social pyramid. He issued a radical agrarian reform decree, expropriating underutilized private properties for redistribution to landless peasants, a measure that threatened to change the balance of power in rural Brazil. He nationalized by decree privately owned oil refineries and imposed rent control, measures that seemed to attack the foundations of private property and the income of the middle class, which often owned small rental properties. And he extended the vote to illiterates and to enlisted men in the armed forces, amplifying the electorate in one fell swoop to include the dispossessed of Brazilian society, the ones most likely to vote for radical solutions to Brazil's problems.

In short, Brazil seemed to embody Hannah Arendt's compelling imagery of the French Revolution: "where the breakdown of traditional authority set the poor of the earth on the march, where they left the obscurity of their misfortunes and streamed upon the marketplace, their force seemed as irresistible as the motion of the stars, a torrent rushing forward with elemental force and engulfing a whole world" (Arendt 1963, 89-90).

In Brazil, that impression of irresistible force was an illusion. Landless peasants were no match for well organized and armed ranchers and plantation owners. Nor were urban workers a revolutionary proletariat, eager to take up arms against the existing order. Nevertheless that spectre was sufficiently plausible to frighten the middle class into embracing the military coup that overthrew the Goulart government on March 31, 1964 (Pedreira 1965).

In the aftermath of the coup, the new government entrusted economic policy to conservative economists Roberto Campos and Octavio Bulhoes, who quickly reached an agreement with the IMF. The Agency for International Development in Brazil mounted a major lending program to demonstrate U.S. support for the post-coup government. The World Bank reentered Brazil with a commitment to significant lending. When the emphasis on containing inflation engendered the same opposition that had defeated pre-coup attempts at economic stabilization, Campos resigned in 1967. His replacements, Antonio Delfim Neto and an economic team from São Paulo, immediately accelerated economic activity, beginning the Brazilian economic miracle. The economy grew by 9-11% per year in the late 1960s and early 1970s.

The 1978 oil price revolution, declining economic growth rates, and increasing debt sapped the legitimacy of the Brazilian military regime, while Mexico's default deprived Brazil of easy access to the international financial markets.

The 1978 oil price revolution, declining economic growth rates, and increasing debt sapped the legitimacy of the military regime, while Mexico's default deprived Brazil of easy access to the international financial markets. As with Mexico, the United States insisted upon an IMF agreement with Brazil as a precondition for international financing. But the military government, facing a resurgent Congress and increasing popular resistance, was in no condition to meet the IMF demands for a stringent austerity program (Margolis 1983). In 1984, civilian rule returned to Brazil.

The military regime left a mixed legacy. The economic expansion policies of the 1970s bequeathed Brazil an industrial plant capable of impressive export performance and an agriculture increasingly oriented to exports. In 1993, exports amounted to $48 billion, of which approximately two-thirds were industrial products, earning a trade surplus of $13 billion. At over $30 billion, foreign currency reserves were at record levels (Banco Central do Brasil 1994).

It also left rural land ownership even more concentrated than in 1964. The social conditions in the great cities reflected the same deterioration: "Over 90% of our primary schools are in disrepair and 200,000 people are not in school," stated the Mayor of São Paulo (Riding 1989). And income distribution appears to have worsened:

> Today, fully 32 million Brazilians—more than a fifth of the population—earn less than twice the minimum monthly wage (about $150), or just enough to purchase basic foods, but nothing else. These Brazilians face a Hobson's choice: spend everything on food and forgo clothes, bus-fare, medicine, and school books, or

> else go hungry. Worse still, 15 million Brazilians receive half that starving wage, while as many as 5.2 million work not for money at all, but food or shelter, or handouts.
>
> Meanwhile, the country's richest 20% earns 63% of the personal income nationally, 27 times more than the poorest fifth. That is one of the largest income gaps in the world, worse than Botswana's, Colombia's, the Ivory Coast's, even Bangladesh's. (Margolis 1994, 2)

There is limited enthusiasm in Brazil for a diminished state role in the economy.

The wealthy—and middle classes—are relatively insulated from the ravages of a 2,500% annualized rate of inflation (Brooke 1994). Rents, interest income, and organized labor wages are indexed to maintain at least a semblance of their real value. It is the poor, retired people, and those who do not have income-earning assets that can be indexed who bear the burden of inflation. But the price of bringing down that rate of inflation to "acceptable" levels is an economic slowdown that, historically, has been anathema to the Paulista entrepreneurs and a political leadership that, like Kubitschek in the late 1950s, is terrified at the prospect of a social convulsion.

The government of Fernando Collor de Mello, particularly in its last year (1992), initiated important import-liberalization measures. There now appears to be a grudging acceptance that foreign investment and privatization of state-owned enterprises can play a constructive role (Brooke 1994, D2). And a corruption scandal that beset the Congress in 1994 may have cleared the way for a policy that significantly reduces the fiscal deficit.

Still, there is limited enthusiasm in Brazil for a diminished state role in the economy, and there is important political support for an alternative view of how to attack Brazil's problems. After the military regime dissolved the system of government-controlled unions, labor groups sought their legitimacy on the factory floor. This "new unionism" rejected state tutelage in favor of direct negotiations between labor and management (Markoff and Baretta 1990, 428).

A labor-based political party, the Workers Party (PT), has emerged. In the 1989 presidential election, the first direct election for president after 20 years of military rule, its candidate, Luiz Inacio Lula da Silva, lost to the conservative Collor by a relatively narrow margin. Lula, as he is known in Brazil, and the PT will be strong contenders in the 1994 presidential elections. And, as the *New York Times* notes, "A da Silva government would be frontally set against the neo-liberal model" (Brooke 1993).

A Lula victory would set the stage for a replay of the conflict that beset Kubitschek and Goulart, one in which Brazil goes against the prevailing economic orthodoxy. What is new this time around is an element of political pragmatism on the Left. "Workers Party leaders have started meeting with middle- and upper-level officers....[R]ather than focus on rancor remaining from Brazil's military Government of 1964 to 1985, talks focus on the future" (Brooke 1993). Similarly, a report of the major labor confederation of Brazil soberly assesses the difficulties in implementing an agrarian reform. It sets out the case for the neoliberal economic model in nonpolemical terms, at the same time contesting its validity in the context of Brazil.

Brazil's post-military democracy survived a severe test during the scandal that led Collor to resign in December 1992. Collor had been suspended from office since September 1992, when Congress voted to authorize his impeachment over corruption charges (Lamb 1992). Later, the Congress itself was rocked by charges of corruption within its own ranks, and responded in exemplary fashion by expelling several members (Brooke 1993). In both instances, an often raucous but free press kept up the pressure for action. Yet the policies of the MFIs reflect none of these democratic accomplishments, nor the implications of the 1964 coup, which overhangs Brazilian society.

The prevailing criteria the MFIs use to allocate their resources have perverse effects. The international financial community acclaims Mexico for its outstanding performance, while Brazil gets no credit for implementing genuinely democratic institutions.

Rethinking Country Performance

The prevailing criteria the MFIs use to allocate their resources have perverse effects. Mexico has fully implemented the neoliberal agenda, but there is cause to believe that the Mexican president who implemented the program only won election through fraud. Moreover, Mexico discourages independent trade unions and physically intimidates labor leaders and workers who depart from government policy (Levinson 1993). Abuse of human rights is endemic (Americas Watch 1993). The press, the judiciary, and the legislative branches of government are, with few exceptions, subordinate to the executive branch.

For its part, Brazil lags in implementing that same neoliberal agenda but has a fully independent legislature. It has elected a president in a fiercely contested popular election. And it impeached the president for alleged corruption, guided by an independent judiciary and in accord with constitutional procedures. The Congress has conducted an internal purge relating also to alleged corruption. Independent trade unions and an independent press function without apparent government interference.

Yet the international financial community acclaims Mexico for its outstanding performance and bestows upon it a cornucopia of financing, while Brazil gets no credit for implementing genuinely democratic institutions. In the same three years in which Mexico received $8 billion from the IDB and World Bank, Brazil, with one and one half times the population, received barely half the amount. The message is clear.

Because the Bretton Woods institutions and the IDB envisage development in purely economic performance terms, they encourage anti-democratic forces to believe they will be eligible for continued financing so long as they adhere to neoliberal economic theology.

Because the Bretton Woods institutions and the IDB envisage development in purely economic performance terms, they encourage anti-democratic forces to believe they will be eligible for continued financing so long as they adhere to neoliberal economic theology. Rhetorical flourishes on the part of the U.S. government (and other non-borrowing nations) espousing commitments to democratic institutions lose all credibility. They are contradicted by the flow of resources, which continued without interruption despite public criticism in the case of the Pinochet government in Chile during the 1970s and 1980s, as well as those of the military dictatorships in Brazil, Argentina, and Uruguay. More recently, it has occurred with the Fujimori government in Peru after his "auto-coup" in 1992.

Worse, the MFIs' economic model actually exacerbates income inequalities and increases social tensions. In Mexico, those tensions erupted in armed rebellion, but Mexico is not an isolated case. Social tensions are on the rise throughout the hemisphere. Venezuela had two coup attempts in 1990. In Brazil off-duty policemen, hired by merchants who want the human debris eliminated from their storefronts, routinely murder street children. In Brazil and much of Central America, rural violence and the murder of progressive priests and union leaders is pervasive. And in Argentina, the sacking of a municipality by dissatisfied employees may signal a more generalized resort to violence by the dispossessed.

The election of social-democratic political leaders in Costa Rica and Honduras, the 1992 election of a socialist mayor of Caracas, the strong showing of a left coalition in Buenos Aires in recent elections for an assembly to redraft the Argentina constitution, Lula's popularity in Brazil, and the political uncertainties in Mexico—all suggest that the social question in much of Latin America is reemerging as a principal issue in the second half of the decade of the 1990s.

Agenda for the Future

Is 50 years enough? Have the Bretton Woods institutions and, more recently, the IDB accumulated too much power? And have they abused that power? The answer to all three questions is yes.

Invested with responsibility to manage the debt crisis, the MFIs uncritically followed the lead of the U.S. Treasury and the Fed. It took the shock of Peru's limiting debt-service payments in 1985, along with growing U.S. concern about declining export markets in Latin America, to change the strategy. But the Baker initiative, again a U.S. initiative, failed to acknowledge the need for debt forgiveness. Not until the Caracas riots of 1989 did these institutions, again following the U.S. lead, change course. Throughout the 1980s, the Bretton Woods institutions did not serve well the interests of their borrowing member countries. The cost in Latin America, particularly for those at the bottom rung of society, has been high.

The MFIs' embrace of neoliberal theology has also exacerbated already highly regressive income-distribution patterns.

The MFIs' embrace of neoliberal theology has also exacerbated already highly regressive income-distribution patterns. The 1993 World Bank Country Strategy paper on Mexico is commendably candid when it acknowledges that the future viability of the government's economic program depends upon how it handles the question of poverty, and particularly the "politically explosive" growing income inequality, which it acknowledges is policy-driven. But the World Bank is not an innocent bystander. It has enthusiastically bankrolled the Mexican government strategy that has resulted in this growing concentration of economic power and income.

Beginning with the tenure of John J. McCloy as president of the World Bank, the Bretton Woods institutions have unduly benefited the multinational banks and corporations. The conditions attached to their lending operations are primarily designed to remove barriers to investment, paving the way, as McCloy said in 1948, for the international corporations. And that investment is often for the purpose of taking advantage of low-wage labor to export goods back to the United States. This tendency culminated in the 1980s with the Bretton Woods institutions—and later, the IDB—financing the collateral that guarantees the repayment of commercial bank debt.

Undoubtedly, the MFIs would argue that they do not intend primarily to benefit the multinational banks and corporations but rather to remove obstacles to the development of borrowing countries. However, their policy recommendations—coupled, at best, with indifference to worker rights—have favored corporate interests against the interests of working people in both the borrowing and lending countries.

Perhaps the most pernicious aspect of the MFIs' operations is their definition of country performance, which provides a cover for financing political repression and abuses of worker and human rights. In the decade ahead that definition may constitute an incentive for governments to reverse their democratic courses in pursuit of the political stability necessary to attract investment.

It is surely irrational when the member countries condemn human-rights violations and then approve loans to the very same governments that commit those violations. It is such incoherence that should end now.

A powerful case can be made for curtailing the influence of these institutions or even declining to fund them any longer. However, this would be unrealistic. In an international economy, some form of financial collaboration is inevitable.

With decades of experience, the World Bank and the IDB are uniquely situated to mediate between financial markets and the needs of member countries. It is not possible to replace the MFIs' credibility in those markets, and if rhetoric is the precursor to action, the foundation may exist for a departure from the distorted priorities of the past. Thus, the better course would be to engage on the issues and return these institutions to the conception that originally inspired them.

The Bretton Woods institutions originated as part of the United Nations family of organizations, while the IDB emerged out of a political and social crisis in Latin America. Partly as a consequence of the Cold War, however, the Bretton Woods institutions and the IDB spun off into their own orbits. They could do so because they were largely self-financing, particularly in later years when they were less dependent upon direct congressional (and parliamentary) appropriations. They became increasingly insular, defining their role in narrow economic terms, largely divorced from the world of politics and social conflict.

The result is an anomaly, for example, when the member countries sponsor an international code of labor conduct through the International Labor Organization and simultaneously finance regimes that violate the basic tenets of that code. Similarly, it is surely irrational when the member countries condemn human-rights violations and then approve loans to the very same governments that commit those violations. It is such incoherence that should end now.

Worker Rights

In the economic environment of the nineties, Latin American countries are unlikely to have unlimited access to international capital markets as they did during the seventies. They have therefore embraced a development model that places a premium on attracting foreign direct investment, but they are not alone in competing for such capital. The former Communist states of Eastern Europe and the Soviet Union now also seek investors. In Asia, China and India are now full players in the scramble for investment capital. As summarized by the IDB, "[T]he global savings-investment balance is likely to remain tight throughout the decade. Traditional sources of external finance for developing countries will be scarce" (IDB 1993c, 11).

The vital question is whether the contest for investment capital will be subject to international rules that require countries to recognize and enforce minimum standards of worker rights. Without a corollary agreement on such rights, it is certain that countries will engage in cutthroat competition to attract foreign direct investment, ratcheting down wages and labor standards in the developing countries and in the United States and Western Europe as well. Companies will accelerate the shift of production to low-wage jurisdictions that create attractive investment incentives for them through any means, including repression of workers' rights.

Without a corollary agreement on worker rights, it is certain that countries will engage in cutthroat competition to attract foreign direct investment, ratcheting down wages and labor standards in the developing countries and in the United States and Western Europe as well.

Moreover, unless workers can bargain for a fair share of productivity gains, regressive income distribution is unlikely to be reversed. Workers will not be able to increase substantially their purchase of consumer goods, inhibiting the expansion of a vibrant middle class. As Karin Lissakers has put it with respect to Mexico, "Unless Mexican workers get a bigger share of the economic benefits from incoming investment and free trade through higher wages, shorter work days and weeks...the promised payoff for Americans will not come. Mexican workers will not be able to increase greatly the purchases of American consumer goods" (Lissakers 1992).

Conventions 87 and 98 of the International Labor Organization's code are the cornerstone that supports a standard of internationally recognized worker rights. Convention 87 states, "Workers and employers, without distinction whatsoever, shall have the right to establish and, subject only to the rules of the organization concerned, to join organizations of their own choosing without previous authorization." The convention further declares that workers and employers "shall have the right to draw up their constitutions and rules, to elect their representatives in full freedom." Convention 98 proclaims, "Workers shall enjoy adequate protection against acts of anti-union discrimination in respect of their employment." The United States has yet to ratify these conventions, citing disagreements about specific wording. However, President Clinton has said:

> While we continue to tear down anti-competitive practices and other barriers to trade, we simply have to ensure that our economic policies also protect the environment and the well-being of workers. And as we bring into the orbit of global trade people who can benefit from the investment and trading opportunities we offer, we must ensure that their policies benefit the interests of their workers. (Clinton 1994)

The uncritical votes of the U.S. executive directors of the World Bank and IDB in favor of $8 billion in loans to Mexico over the three fiscal years 1990-92 cannot be reconciled with Mexico's labor-relations practices.

The uncritical votes of the U.S. executive directors of the World Bank and IDB in favor of $8 billion in loans to Mexico over the three fiscal years 1990-92 cannot be reconciled with Mexico's labor-relations practices or U.S. congressional mandates on worker rights expressed in trade legislation and, most recently, foreign-assistance legislation. The most recent legislation was occasioned by the 1992 revelation that U.S. AID representatives in Central America appeared to be encouraging American companies to relocate production abroad to take advantage of cheap labor and the absence of effective unions. The legislation prohibited "assistance for any project or activity that contributes to the violation of internationally recognized workers rights" (U.S. Congress 1993). The legislation is arguably applicable to the multilateral financial institutions, but it is not clear what effect, if any, it will have on the U.S. Treasury, which instructs the U.S. executive directors on voting in the Bretton Woods institutions and the IDB.

Of course, the IDB and the World Bank do attach conditions to their industrial loans. They require the borrowing countries to charge their industrial clients interest rates that reflect financial market conditions. Other conditions also commonly attach to industrial loans as well, such as removing barriers to investment, lowering tariffs, and so forth. Yet the contracts made up by the two banks do not require the industrial establishments that receive the credits to adhere to fair labor practices, either in accord with local law or with international conventions to which the borrowing country has adhered. The lending institutions make no effort to monitor the labor practices of the industries being financed. Even if abusive practices are discovered, the lenders have no remedies without provisions in the loan contracts.

The United States should condition its participation in future replenishment of the resources of the Bretton Woods institutions and the IDB on a commitment by these institutions that (a) they will initiate a review of borrowing country compliance with the principles expressed in Conventions 87 and 98, and (b) compliance with those principles will be integral to assessments of a country's economic performance. The MFIs should draw upon the expertise and findings of the International Labor Organization, enforcing its credibility.

Worker rights should be integrated into the culture of the MFIs as one more criterion in judging country development performance, as valid as fiscal, monetary, and exchange-rate policies.

It would be a mistake, however, for these institutions to establish separate worker-rights units. The IDB and World Bank have done so in connection with the environment, but the units have tended to be isolated. (See Appendix.) Rather, worker rights should be integrated into the culture of the MFIs as one more criterion in judging country development performance, as valid as fiscal, monetary, and exchange-rate policies.

In Latin America, the problem is rarely that the laws or constitution of the country are too weak. To the contrary, worker-rights laws are often stronger than those in the United States. The issue is enforcement. Until resource flows are linked to the enforcement of workers rights such laws are likely to be more honored in the breach than the observance.

The same principle ought to be acceptable to the European Community members of the MFIs. Eleven out of 12 members of the EC (the exception being Great Britain) have been negotiating a social charter among themselves to avoid "social dumping"—that is, the deliberate maintenance of inferior working conditions for the purpose of attracting foreign capital. But the EC can no more insulate itself from "social dumping" in Mexico and Malaysia than can the United States.

What is being proposed here undoubtedly extends the concept of conditionality beyond the conventional reach. Many will perceive it as an unacceptable intervention in the domestic politics and affairs of the borrowing countries. But labor relations are as central to the overall economic framework of a country as the rules governing investment. Since the beginning of the 1980s, borrowing countries, particularly in Latin America, have accepted conditions from the multilateral financial institutions relating to privatization, trade liberalization, reduction of subsidies, and lifting of restrictions on foreign investment. Each of these conditions has political implications in the borrowing country, affecting the balance between small and large industry, foreign and domestic investment, agricultural producers and urban consumers. There are winners and losers, just as there are in labor disputes.

Why then does sovereignty become inviolable when worker rights are introduced? Conditions related to worker rights are no more political or intrusive than those relating to financial reform and all the other conditionalities demanded by the multilateral banks. If a country considers compliance an unacceptable invasion of its internal affairs, it can forego development-bank financing. No country has an "entitlement" to such assistance.

A repressive labor-relations system requires an authoritarian regime. Consequently, a concern for worker rights will invariably lead to concern for the overall political character of a regime.

Worker rights are only one aspect of human rights. Why single them out for special treatment? One answer is that they relate most directly to the climate for investment. It is also true that a repressive labor-relations system requires an authoritarian regime. Consequently, a concern for worker rights will invariably lead to concern for the overall political character of a regime. Development policy, considered as a whole, is a seamless web comprising economics, environment, politics, social relations, and human rights.

The Political Question

The Articles of Agreement of the World Bank explicitly prohibit the bank from taking into account "the political character of the member or members concerned." The articles also enjoin the Bank to ensure that the proceeds of any loan are used "for purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations." The IDB charter has analogous provisions.

These caveats enable both the World Bank and the IDB to operate on a highly selective basis. If a government's economic policies conform to the prevailing orthodoxy, the charter provisions shield the multilateral lenders, enabling them to reward economic performance without reference to political context. The MFIs can ignore with impunity, for example, the conditions described by the Chilean Presidential Commission for Truth and Justice, which concluded that, during the Pinochet dictatorship, 2,279 victims died under torture, were executed, or were made to disappear.

In principle there is no reason why a development bank must eschew any connection between lending policies and a recipient's human rights and democratic practices. Political considerations are fundamental to the charter of the European Bank for Reconstruction and Development. Its preamble commits the EBRD to the "fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics."

In fact, the general counsel of the World Bank has expounded a concept of "governance" that would enable the Bank to expand the dialogue with member countries to encompass corruption because it impinges upon effectiveness in carrying out programs. According to the General Counsel, "the Bank may assist in improving efficiency or competence of judicial systems to reduce the costs of economic transactions." (World Bank 1991b, 39).

The World Bank and the IDB have deliberately sought to keep their distance from the United Nations Human Rights Commission and the Inter-American Human Rights Commission. That longstanding practice should now end.

It is difficult to understand why persistent abuses of human rights or the absence of representative political institutions is any less of a threat to the execution of World Bank programs than is pervasive government corruption. Violation of human rights can create a climate of fear and uncertainty that can inhibit investment as much as pervasive corruption can. Unpredictability arising from the excesses of authoritarian governance ought to be as relevant as any other type of official misconduct.

There are problems of judgment and criteria, particularly in determining the degree to which a country's political institutions are truly representative. Countries are often at different stages of political and social evolution. The key question may well be whether the country is moving in a democratic direction. This eminently political judgment can be made only at the political level of the MFIs—by the board of executive directors or the governors of the institution.

The World Bank, a component of the United Nations system, and the IDB, conceived as part of the family of inter-American organizations, have deliberately sought to keep their distance from the United Nations Human Rights Commission and the Inter-American Human Rights Commission. That longstanding practice should now end. The lending decisions of these institutions ought to reflect the deliberations and conclusions of both the UNHRC and the Inter-American Human Rights Commission. This would enhance the commissions by backing their decisions with real financial consequences.

The charters of the multilateral lending institutions ought to be interpreted to permit them to take into account the level of respect for human rights as well as political pluralism. Neither institution has ever officially interpreted the prohibitions on considering "political character." They might reasonably bar distinctions in allocating resources on the basis of whether a government is socialist, social democrat, conservative, liberal, or labor. Unfortunately, the MFIs instead use these charter provisions to justify bankrolling regimes—such as the Pinochet government and the Argentine military dictatorship—that have committed some of the very abuses against which the war with Nazi Germany was fought and that provided the background for forming the Bretton Woods institutions.

Similarly, the IDB emerged in the context of a struggle against authoritarian governments of the left and right. It is no more credible in this case than in that of the Bretton Woods institutions that the drafters of the IDB charter intended to countenance abuses of the human person or unrepresentative political institutions.

The Alliance for Progress set out to prove that Castro's accomplishments in Cuba could be achieved in Latin America without totalitarianism. Over the past 30 years, the MFIs, the governments they have supported, and the United States have flunked the challenge.

In Latin America, such an official interpretation of the MFIs' charter would clearly establish the rules of the game: a military coup means diminished access to the resources of the Bretton Woods institutions and the IDB. The World Bank, in its 1993 country strategy report on Mexico, observes that backsliding on economic reforms could lead to a substantial reduction in lending to that country (World Bank, 1993b). The same principle should apply to backsliding on worker rights or human rights and political pluralism.

The IDB Eighth Replenishment

The Alliance for Progress set out to prove that Castro's accomplishments in Cuba in education and health care and raising the standard of living for those at the bottom of society's social scale could be achieved in Latin America without totalitarianism. Over the past 30 years, the MFIs, the governments they have supported, and the United States have flunked the challenge. More people are poorer than they were 10 years ago, and health and education services have deteriorated markedly. Already exaggerated extremes in the distribution of income have grown yet worse.

The eighth replenishment negotiations were successfully concluded at the IDB's annual meeting in April 1994 in Guadalajara, Mexico. The replenishment provides for a capital increase of $40 billion, which should permit a sustained annual level of lending of approximately $7 billion without the need for further replenishment of the Bank's resources. The negotiations increased the proportion of shares held by Japan and major European countries; the United States and Latin American members diminished their ownership interests.

The shareholders directed the IDB to devote half of the loan resources of the replenishment toward alleviating poverty and enhancing the human capital of the region. The target is commendable. But it is also true that historically the Bank has defined projects that address poverty elastically. It is difficult to see how to direct significantly more loan resources toward these purposes without aggressive program lending. Yet the IDB proposes to use program lending less than in the seventh replenishment. It further intends to continue to apply program lending to the same purposes as previously: to promote privatization, macroeconomic policy reform, etc. The temptation will be great to divert resources for these other purposes should it be as difficult as it has been in the past to develop projects and programs that address the human-resource needs of the region.

Adult literacy and primary and secondary education have received short shrift from the IDB. Concern for higher education is legitimate, but it should not be so disproportionate to the attention given other levels of education.

The Clinton administration (and the U.S. Congress) could indicate a significant departure in development policy by supporting IDB program lending. The amount should equal or exceed what was authorized in the seventh replenishment but for use only to support multi-year investments in human capital. Priority could go to reducing poverty and income inequality by extending access to primary and secondary education as well as by providing health care for the most deprived part of the population.

Such a proposal would steer the IDB away from its traditional concentration on higher education. This concentration reflected the close ties that have existed between the Latin American staff at the IDB and the universities where many of them were educated. Moreover, every Latin American head of the Bank and all its senior staff have determined that Latin America not be consigned to second-class technological status. It is inconceivable to them that the regional development bank should not play a role in equipping centers of higher learning with modern facilities and equipment, as well as providing scholarships to study at the best universities in richer countries. In South America in particular, adult literacy and primary and secondary education have received short shrift from the IDB. Concern for higher education is legitimate, but it should not be so disproportionate to the attention given other levels of education.

The IDB further proposes to direct 5% of the Bank's portfolio for direct lending to the private sector, without government guarantees. Unlike the World Bank, the IDB charter does not require it to lend only with government guarantees of repayment. In practice, however, it has required such guarantees since the late 1960s. The proposed departure from the norm is to assist recently or soon-to-be privatized enterprises that provide infrastructure services: electric power, water and sewage, and telephone.

However, the purchasers of these enterprises are usually powerful domestic or foreign groups. Typically, they buy the companies with a minimum of cash and an exchange of foreign debt paper purchased at large discounts on the secondary financial markets. It is difficult to see the rationale for allowing these groups access to the IDB's limited resources. They can use their creditworthiness to obtain resources in the private financial markets, especially if the shareholders of the privatized enterprises are themselves international banks.

A new IDB policy cannot substitute for the political willingness in individual countries to confront poverty, disease, and the lack of housing and schooling.

This proposal to confine sector lending in the IDB's eighth replenishment to investment in education and health is not a panacea, and it entails risks. Given the neoliberal outlook of the IDB and World Bank, their involvement in education, with such large resources, may undermine the prospects for improving public education in Latin America. But this is part of the larger question of addressing the social question in Latin America. A new IDB policy cannot substitute for the political willingness in individual countries to confront poverty, disease, and the lack of housing and schooling. After all, no program can stand in isolation from the overall social and political context of a society. Children of landless laborers, whose parents face constant economic insecurity, are unlikely to attend school regularly. If the adults have no work, children may be forced to become vagrants and thieves in the great cities to survive. Under such conditions, social spending cannot reach those who most need help.

Investment in the human capital of a society is not a technical question. At bottom, it is a profoundly political matter. The issue for the rest of the 1990s remains what it has been from the inception of the Alliance for Progress in the 1960s. Is there a political commitment in the Latin American countries themselves, in the MFIs, and in the industrialized countries that contribute resources to them to address income inequality and the social question in Latin America?

Appendix

It is difficult to see how advocates of a steady-state economic paradigm can be reconciled with the advocates of economic growth both within the Bretton Woods institutions and the borrower countries. The basic thesis of steady-state economics is that the planet cannot sustain existing levels of resource consumption, much less increased ones. Consequently, it is a mistake to promote economic growth as the primary objective of policy reform:

> The regenerative and assimilative capacities of the biosphere cannot support even the current levels of resource consumption, much less the manyfold increase required to generalize the higher standards [of living] worldwide. Still less can the eco-system afford an ever growing population that is striving to consume more per capita. (Daly 1993, 27)[6]

Yet the objective of policy reform promoted by the MFIs is precisely to increase per capita income and consumption. For the policymaker, it is politically perilous to raise the income of the lower segment of the population at the expense of the better off. The solution is thus increased economic growth, which translates into increased consumption per capita (Pilling 1993; Economic Commission for Latin America and the Caribbean 1993).

In much of Latin America, the urgency of addressing social issues will swing the balance in favor of increased economic growth and consumption at least for the rest if the decade. The more salient issue is likely to be the division within the individual societies of the fruit of that growth and consumption.

Endnotes

1. Herzog is only partially correct in stating that the crisis was unforeseen. The subcommittee on multinational corporations of the Senate Foreign Relations Committee called attention to the prospect of a systemic crisis resulting from a major debtor-country default as early as September 1975 (Multinational Corps. and United States Foreign Policy: Hearings Before the Subcommittee on Multinational Corps. of the Senate Committee on Foreign Relations [Part 15], 94th Congress, 1st Session [1975], p. 17). Its successor subcommittee on international economic policy in October 1977 specifically singled out Mexico and Brazil as prime candidates for default (The Witteveen Facility and the OPEC Financial Surpluses: Hearings Before the Subcommittee on Foreign Economic Policy of the Senate Committee on Foreign Relations, 95th Congress, 1st Session [1977], pp. 23, 25, 30).

2. On September 7, 1987, Luiz Carlos Bresser Pereira, Brazil's minister of finance, explained to Secretary Baker his proposed scheme to require conversion of half of Brazil's $60 billion commercial bank debt to long-term, low-interest loans. If seriously pursued, said the *Financial Times,* "the plan would have completely changed the course of the five-year-old debt crisis. It would have forced quick and sustained write-offs by banks of loans to Brazil and many other countries." (Nicoll 1987). However, Baker dismissed the Bresser Pereira plan as a "non-starter." Senator Bill Bradley had proposed a case-by-case debt-forgiveness program strictly tied to debtor-country commitments to economic reform and modernization (Bradley 1986). Two years after Bresser Pereira's trial balloon was shot down, the minister of finance of Japan made a similar proposal, only to have it spurned by American officials. Congressional proposals for debt forgiveness received equally short shrift from the Treasury.

3. For contrasting views of the adequacy of the debt deal from Mexico's viewpoint, see Castañeda 1989 and Cline 1989.

4. In fiscal year 1990, the World Bank loaned Mexico $1.24 billion to finance the enhancements and set aside $750 million from loans previously authorized for other purposes to further finance the commercial bank enhancements. The IMF loaned Mexico $1.8 billion for similar purposes. Additionally, Mexico mobilized funds from its own resources so that the total enhancements for the Mexican debt deal amounted to $7 billion. The total Mexican debt eligible for restructuring under the scheme totaled $48 billion (World Bank 1993c, 88).

5. As part of the debt-reduction deal with the banks, Mexico accepted provisions that enabled it to receive additional payments if its oil exports fetched prices above a certain base amount. In effect,

the banks would share in any windfall resulting from an extraordinary rise in oil prices. However, there was no corresponding provision that required the banks to accept lower debt-service payments in the event that oil prices fell below an agreed baseline. Venezuela accepted similar provisions for its Brady debt-reduction agreement with the commercial banks.

In December 1993, Rafael Caldera was elected president of Venezuela, succeeding the discredited government of Carlos Andrés Pérez. Caldera ran as an independent, against the austerity program of the Pérez government and the market-liberalization promises of the major opposition-party candidate. And he promised to seek further debt relief from the creditors. However, Caldera found his negotiating room constrained by the agreement with the creditor banks. The international price of oil, which yields 90% of Venezuela's budgetary revenues, fluctuated in the $14-15 per barrel range at the time Caldera was elected. Ninety percent of Venezuela's renegotiated debt was now in the form of bonds held by the banks guaranteed by collateral on deposit with the New York Fed. And this collateral had been financed by Venezuela's borrowing from the IMF and the World Bank, as well as its own resources. Having accepted the parameters of the Mexican debt deal, despite the precipitate fall in the price of its oil exports, Venezuela was now locked into fixed debt-service obligations to the private commercial banks.

6. Daly has expounded on this thesis in greater detail in Daly and Cobb 1989.

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