REVIEW ESSAY

RE-FORMING THE STATE: GOVERNANCE INSTITUTIONS AND THE CREDIBILITY OF ECONOMIC POLICY

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Presidents, Parliaments, and Policy. Stephan Haggard and Mathew D. McCubbins, eds.; Cambridge, UK, Cambridge University Press, 2001, xvi+360 pages, references, index ($70 hardcover, ISBN 0-52177-304-0; $25 paperback, ISBN 0-52177-485-3)

Economic Policy Reform: The Second Stage. Anne O. Krueger, ed.; Chicago and London, The University of Chicago Press, 2000, xiv+614 pages, author and subject indexes ($65 hardcover, ISBN 022645-447-9)

Reinventing Leviathan: The Politics of Administrative Reform in Developing Countries. Ben Ross Schneider and Blanca Heredia, eds.; Miami, North-South Center Press at the University of Miami, 2003, 264 pages ($55 hardcover, ISBN 1-57454-101-3; $22.50 paperback, ISBN 1-57454-102-1)

Reinventing the State: Economic Strategy and Institutional Change in Peru. By Carol Wise; Ann Arbor, University of Michigan Press, 2003, 272 pages ($54.50 hardcover, ISBN 047211316X)

Sustainable Public Sector Finance in Latin America. Federal Reserve Bank of Atlanta, Georgia, ed.; Atlanta, Research Department, Federal Reserve Bank of Atlanta, 2000, ix+175 pages (paperback, ISBN 0-9624159-2-8).

Has reform failed emerging market economies? What went wrong? Since the mid-1980s, a number of developing countries and transition economies have been engaged in unprecedented efforts to alter their economic policy regime. They have abandoned the ineffectual strategies based on state control and import-substitution industrialization and embraced the market logic to economic management, which entailed reforming the state and the public sector. However, after almost two decades of reform, results are mixed and largely disappointing (Stallings and Peres 2000; Lora 2001; Lora and Panizza 2002). The reform impetus inspired by the Washington consensus has stalled and given way to doubt.

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In Latin America, there is a growing backlash against Washington-inspired neoliberal economic reform and structural adjustment, rooted in an increasing fatigue with reform. The dramatic collapse of Argentina's economy in the winter of 2001-02 represents a turning point. This critical juncture has prompted policy-makers and scholars alike to revisit the initial assumptions of the neoliberal paradigm of development economics encapsulated in the Washington consensus and its institutional variant of the post-Washington consensus (Naím 2000). Should the neoliberal precepts of the Washington consensus be amended or reaffirmed? Are there failed reforms to be rolled back? At its annual meeting in Fortaleza, Brazil, in 2002, the Inter-American Development Bank (IADB) openly confronted these questions, recognizing the need for reforming the reforms. Quite significantly, in his opening address, former Brazilian President Fernando Henrique Cardoso questioned the foundations of the prevalent paradigm and in particular the way in which international financial institutions have imposed their standard recipes.

Since the mid-1990s, policymakers have argued that a second stage of reform is required to complete the reforms initiated and reap their full benefits. While first generation market reforms focus on macroeconomic policy reform and structural adjustment, second generation economic reforms emphasize the importance of governance institutions and political incentives (Burki and Perry 1998). There has been renewed attention to the role of the state and the politics of economic reform. The state's weak capacity to implement policy has been identified as the main hindrance to effective economic development. The new development agenda underscores that sustainable growth and development not only require the existence of formal institutions of governance, but more fundamentally improving their effectiveness.

The reform of the state and the strengthening of governance in emerging market economies has thus acquired renewed urgency, rooted in the recognition of the role of the state in economic management, political democratization and the rule of law (Bresser Pereira and Spink 1999; Grindle 1996, 2000; Haggard 1997; Kaufman 1997, 1999; Santiso 2001a, 2003a, 2003b; Schedler, Diamond, and Plattner 1999; Starr 2002; Tanzi 2000). The new fiscal crisis of the state and the resurgence of the debt problem are prompting policymakers to rethink, recast, rebuild, and reform the state (Schamis 2002). Indeed, the reform paradigm rests on the assumption that the market-oriented reforms are built on coherent, functioning states. Reformers have often assumed the existence of state institutions capable of carrying out the reforms enacted by insulated technocratic teams. In terms of strategy, reformers have largely assumed that economic restructuring and state reform would be mutually reinforcing endeavors, two sides of the same coin. However, economic reforms have often been implemented in the context of largely dysfunctional states marred by weak capacity and fragile institutionalization.

These assumptions no longer hold. Effective economic policymaking requires efficacious state institutions. The process of economic reform does include redesign of state institutions, in particular those pivotal for the conduct of economic policy such as finance ministries or tax authorities. In democratic systems of government, strengthening governance entails restoring the mechanisms of horizontal accountability anchored in core state institutions (Diamond 1999, 2002), complementing and completing the mechanisms of vertical accountability provided for by regular, free, and fair elections. Indeed, as processes of democratization unfold and often fail to consolidate, it becomes urgent to critically examine the politics of institutional reform. A particular feature of recent research findings concerns the elusive search for the rule of law and the rediscovery of political accountability (Behn 1998; Moncriffe 1998; Przeworski 1999; Santiso 2003a, 2003b).

Effective reform requires building the capacity to pursue it. As noted by Stephan Haggard and Robert Kaufman, successful economic reform entails a fundamental paradox: "For governments to reduce their role in the economy and expand the play of the market forces, the state itself must be strengthened" (1995, 25). In other words, the paradox of the adjusting state concerns the ambivalent role of governments during the transition process—while the state is postulated to withdraw from policy interventions and become leaner, the transition usually requires nimble and robust political institutions that are capable of implementing and enforcing policy reform and an accountable bureaucracy responsive to shifts in policies. Thus the central question should not be the size of government, but the activities of government as well as its methods of governing. Consolidating democratic governance entails not only reforming the institutional architecture of the state, as proposed by proponents of the post-Washington consensus, but more fundamentally reforming the state and revising the modes of government.

Untying the Gordian knot of the political economy of state reform has become a defining endeavor of comparative politics. In recent years, there has been renewed interest in the political economy of economic reform (i.e., the study of the political constraints that condition the contents, timing, speed, and sequencing of economic reforms). The books reviewed here address critical dimensions of the politics of economic reform. They are all concerned with the credibility of economic policy and the capacity of the state to pursue it. As such, they enrich the growing literature on the political economy of institutional reform and revisit the debates on state autonomy and capacity.

ECONOMIC REFORM AND GOVERNANCE INSTITUTIONS

The credibility of policymaking is a key dimension of effective democratic governance. Yet, the credibility of government commitment to policy reform has been essentially neglected as a pivotal condition for effective economic reform. In *Presidents, Parliaments and Policy*, editors Stephan Haggard and Mathew McCubbins fill this gap in the comparative analysis of economic policymaking in presidential systems. Undeniably, *Presidents, Parliaments, and Policy* constitutes a major contribution to the rich field of comparative political economy and the impact of institutional design and constitutional engineering on democratic governance.

Presidents, Parliaments, and Policy articulates a sophisticated framework to assess the credibility of economic policymaking in presidential systems and the quality of governance in consolidating democracies. Assembling renowned scholars of comparative politics, it goes beyond the broad and restrictive dichotomous typologies of political systems (democracy versus authoritarianism) to explain how political institutions and the nature of executive-legislative relations shape public policy. It offers an elegantly written, consistently structured, and insightful study that significantly enriches the perennial debate on the comparative advantages of parliamentary versus presidential systems of government initiated over a decade ago, a debate that remains largely inconclusive (Linz 1990a, 1990b, 1994; Shugart and Carey 1992; Mainwaring and Shugart 1997).

The growing literature on new institutional economics clearly demonstrates that political institutions do influence policy outcomes as they shape the incentives politicians face. Individuals operate in institutional contexts that constrain the range of feasible options available to them (Crisp and Escobar-Lemmon 2001). However, as Haggard and McCubbins point out, "less is known about *how* and *when* institutions affect policy outcomes" (1). Drawing on detailed case studies of fiscal policy, budget management, and regulatory reform in emerging market economies in Asia, Latin America, and Central Europe, contributors reveal the great diversity of presidential systems and the varying effects of different institutional arrangements to capture their influence on policymaking. Downplaying the differences between formal regime types (presidential versus parliamentary systems), they argue that "different institutional arrangements also have systematic effects on policymaking" (3). As Mathew Soberg Shugart and Haggard underline, the main policy challenge of contemporary democracies is "to understand how institutions affect the ability of democratic systems to meet two fundamental policy challenges: initiating policy reforms and guaranteeing the stability and credibility of these reforms once enacted" (65).

GOVERNANCE REFORM AND ECONOMIC POLICYMAKING

A major contribution of *Presidents, Parliaments, and Policy* resides in the analytical framework it offers to assess the trustworthiness of economic policymaking in presidential systems. Haggard and McCubbins accurately note that finding an adequate balance between strong leadership and effective checks on executive discretion is the defining challenge of the governability of democratic systems. This balance, in turn, decisively influences the government's incentives either to be more responsive to the society's general interest or instead to cater to narrow interests. They investigate "why some governments implement reforms quickly and decisively, while other governments are marked by delay and indecision" (10). Why do political leaders continue to place their own personal interests in front of the common interest? More fundamentally, they seek to uncover what explains the credibility of economic policy, which is measured by its stability and irreversibility once it is enacted. Critical independent variables affecting it include the powers of the president, legislative structures, federalism, and in particular, electoral rules and the party system.

Gary Cox and McCubbins convincingly argue that the credibility of economic policy critically hinges upon the interplay between the separation of powers and the separation of purpose, which in turn affects the degree of decisiveness and resoluteness of a political system. They point to the two central tradeoffs of economic policymaking in presidential democracies: the first between the decisiveness and resoluteness of policymaking, and the second between the search for the general interest and the compulsion to respond to narrower constituencies. However, decisive policy and resolute policy appear to demand somewhat contradictory institutional capabilities.

Separation of powers between the executive and the legislative branches of government (and to a lesser degree the judiciary) is characteristic of constitutional rule and a defining feature of presidential systems. It enables different branches of government to influence public policymaking, in particular through the exercise of their respective veto power. Separation of purpose occurs when different branches of government are responsive to different constituencies and are moved by different motivations. It critically hinges upon the choice of electoral rules and the nature of the party system. For Shugart and Haggard, separation of purpose arises "when separate elections result in different partisan groups controlling the two different branches of government, a phenomenon often referred to as divided government" (64), so that, as Haggard and McCubbins note, "the different parts of the government are motivated to seek different goals" (3). The French system of cohabitation, during most of the 1990s, constitutes an example of divided government.

Shugart and Haggard demonstrate that "systems in which politicians' incentives are to cater to narrow constituencies will be less capable of carrying out reforms than those in which politicians compete for the allegiance of the median voter by advocating broad, programmatic policy platforms" (66). A central theme of their chapter is that "the separation of powers inherent in presidentialism has consequences for policymaking even when it does not produce divergent partisan control of the assembly and executives" (66). The paradox of presidentialism is that "while the president should be interested in providing public goods at the national level as a result of his nationwide constituency, legislators' separation from the executive typically makes them less interested in providing national policy than in parliamentary systems. Thus, a separation of purpose remains a real possibility even when the assembly and the president are controlled by the same party" (63).

POLICY DECISIVENESS VERSUS POLICY RESOLUTENESS

The trade-off between the decisiveness—defined as "the ability of a state to enact and implement policy change," and the resoluteness—defined as "the ability of a state to commit to maintaining a given policy" (26-27) of political systems is critical. The more decisive a political system is, the less likely it is to be resolute, as policy can be reversed as easily as it has been adopted. Conversely, the more resolute it is, the less decisive it is likely to be. Haggard and McCubbins note that "the more powers are divided, the more likely is state resoluteness, and the less likely is state decisiveness" (33). The critical variable is the effective number of veto players in political decision making: the more veto players, the more resolute policymaking is, and the less decisive it becomes. The reverse is also true. Examples of veto players or veto gates include, for example, the judiciary and judicial review, especially of government decrees. According to this reasoning, "in a polity in which the effective number of vetoes is large, changing policy will be difficult, but committing to policy will be easier" (6). The main finding is that the "choice of democratic institutions entails significant trade-offs" (63), and "politics that combine institutional divisions of decision-making authority with political division of purpose will tend to be either indecisive or prone to morselizing public policy, or both" (61-62).

There exists a myriad of tradeoffs between decisiveness and resoluteness. A political system that is more prone to decisive action and swift decision making, while possessing a greater ability to change policy (in the short run at least), is also more able to reverse policy and thus likely to be less resolute. As a consequence, its commitment to policy reform tends to be less credible. The main consequence of feeble resoluteness is the lack of credible commitment. By contrast, a more resolute political system is less able to reform or change its policies, and is thus is less decisive. However, once adopted, policies are more likely to endure and less likely to be reversed. As a consequence, policy commitment under such arrangements should be more credible.

The contrast between Argentina and Brazil is illustrative of these trade-offs. Analyzing economic policymaking in Argentina and Brazil from the theoretical perspective offered by *Presidents, Parliaments, and Policy* sheds new light on the dynamics of economic policy reform. In particular, it challenges the conventional wisdom on the most adequate pace and sequence of reform (gradualism versus shock therapy). While the Argentinean political system has allowed for greater decisiveness, the Brazilian system paradoxically made policymaking more resolute, which tends to explain the surprising resilience of the Brazilian reform process. In the early 1990s, President Carlos Menem initiated sweeping market reforms in Argentina and acted decisively using, and often abusing and misusing, executive decree authority. By contrast, constrained in the straightjacket of an inadequately detailed constitution and an inchoate party system, Brazil has muddled through gridlock during the two consecutive terms of President Cardoso (1995-2002). However, the dramatic collapse of the Argentinean economy in the winter of 2001-02 was partly caused by the lack of credibility of economic policymaking and, more fundamentally, the discredit of the entire political system.

It could be argued that, notwithstanding intrinsic design flaws, Argentina's reforms lacked credibility precisely because of the way in which they were adopted and implemented. Reforms could be reversed as easily as they had been adopted. In Brazil, however, reforms are harder to achieve, but once adopted they are more difficult to reverse. Hence, they are more likely to endure and thus tend to have greater credibility. It is true that in such a system, reforms are more likely to be delayed and diluted. Nevertheless, and although they may be less ambitious, they reflect more realistic goals reflecting hard political realities. Indeed, by 2002, Argentina and Brazil reached similar levels of structural reform (Lora 2001; Lora and Panizza 2002; Morley, Machado, and Pettinato 1999).

Investigating the interaction between presidents and parliaments, Shugart and Haggard make another distinction between the president's reactive (veto) and proactive (decree authority) powers and analyze how these prerogatives affect the separation of power and purpose. Through the use of executive powers (such as decrees, vetoes, and agenda-setting privileges), presidents are able to dominate the legislative agenda, especially in strong presidential systems such as Argentina and Russia. Nevertheless, the sources of executive predominance are varied: in Argentina, it originated from the authority delegated by Congress, while in Taiwan presidential power came from control over the majority party.

Building on earlier work on executive decree authority and congressional delegation (Carey and Shugart 1998), Shugart and Haggard argue that the more reactive powers a president possesses, the more resolute (i.e., less decisive) will be the policymaking process; while the more proactive powers a president has, the more decisive (i.e., less resolute) will be the process. They distinguish those decrees that the executive can use at its discretion, especially in cases of economic crisis, from those powers that are explicitly delegated to the executive by the legislature. Few constitutions allow presidents to promulgate new legislation by decree without prior delegation of authority and the explicit consent of parliament. Only Argentina, Brazil, Colombia and Russia allow for such executive decree authority, giving tremendous discretionary powers to the president. However, in Brazil, the validity of these types of decrees is only temporary unless they are converted into regular legislation. In 2001, the recourse to these *Medidas Provisorias* (MP) was further constrained.

In general, executive decrees are issued under powers explicitly delegated by the legislature. In 1989, President Menem obtained authority from the outgoing Congress to issue new laws in a wide range of policy areas, including the legislation framing economic reforms. However, prior to the constitutional reforms of 1994, Argentina's constitution allowed the president to issue executive decrees in the absence of prior congressional delegation (the *Decretos de Necesidad y Urgencia,* DNU). These powers were abundantly used and often abused. They progressively became the preferred mode of governance, neutralizing congressional oversight and judicial checks on executive power.

EXECUTIVE-LEGISLATIVE RELATIONS IN PRESIDENTIAL SYSTEMS

The logics of executive-legislative relations are even more complex when one party dominates legislative institutions and parliamentary structures. In that respect the nature of electoral rules is a key factor, as it decisively shapes the party system. Features of the electoral system expand the degree to which legislators' incentives differ from presidents' incentives to make political gridlock more likely. For example, open-list proportional representation in federal Brazil creates a particularly fragmented and inchoate party system that hampers democratic governance. In Argentina, the close-list electoral system is party-centred and gives an overwhelming power to party structures and hierarchies. Provincial governors thus exert decisive influence on national policymaking and, as a result, "Argentine presidents, even under unified government, face party rank and file determined to increase transfers of revenues to provincial party leaders" (88). In both cases, state or provincial politics dominates national politics.

The timing of presidential and legislative elections also influences the degree of separation of purpose. In 1994, Brazil shifted from a nonconcurrent to a concurrent system. This change enhanced governability and granted President Cardoso relatively more control over interparty politics. According to Shugart and Haggard, the institutional combination more conducive to unity of purpose is "concurrent presidential and legislative elections, a party-centered electoral formula, a unicameral Congress elected congruently with the president's constituency, and full renewal of all legislative seats at each election" (94). These authors are primarily concerned "with the ability of governments to act decisively (particularly in enacting economic reform), the credibility and sustainability of the policy choices made, and the particularism of policy (i.e., how prone it is to exceptionalism, rent-seeking, and the distribution of pork)" (96). Governments characterized by unity of purpose are more likely to exhibit decisiveness, while governments marked by separation of purpose tend to be less decisive. Nevertheless, there exist, as mentioned above, trade-offs between the decisiveness of policy and its sustainability or credibility. However, this problem may be somewhat less severe in presidential systems than in parliamentary systems, as "unity of purpose is never complete in any presidential system" (97).

However, there is no one-size-fits-all presidential system. The efficiency of the arrangement adopted will greatly depend on the interaction between a wide range of institutional variables. Philip Keefer and Mary Shirley underline some of the drawbacks of separation of powers and purpose. Looking at the privatization process in transition economies, they demonstrate that unity of purpose under Czechoslovakia's parliamentary system allowed for more efficient privatization reforms, while Poland's variant of a presidential system was mired in indecisiveness. Poland's premier-presidential system is marked with greater separation of power and purpose and tends to lead to gridlock, forcing policymakers to muddle through reform. Conversely, Lisa Baldez and John Carey illustrate some of the benefits of the separation of powers and purpose. They aptly show that one should expect relatively small budget deficits in Chile because of the difficulty of forging cross-institutional coalitions to create new spending programs, thus generating fiscal restraint.

Examining the budget process in Argentina, Mark Jones revisits the classical delegative democracy argument (O'Donnell 1994). He notes that it is "a mistake to infer from the relatively smooth passage of the president's budget in Congress that the budget process is extremely executive-dominated" (164). Traditionally, and although having the power to do so, the Argentine Congress has introduced few modifications of the budget proposed by the executive. This fact has often been interpreted as a sign of legislative acquiescence and executive dominance of the budget process and, more broadly, the policymaking process. However, Jones convincingly demonstrates that Congress's relative inaction reflects a strategic choice, not powerlessness. He contends that "if a legislator or legislative group wants to influence the content of the budget, it is easier to do so at the draft stage of the budget (via lobbying of the executive branch and decentralized organization) than when the budget bill is under examination in Congress" (163). Jones indeed contributes to the current reexamination of the delegative nature of Argentine democracy (Panizza 2000; Peruzzotti 2001; Eaton 2001; Santiso 2001b).

Hence, Haggard, McCubbins, and Shugart underline in their concluding chapter that after a decade of reforms, "what is required is more nuanced analysis that looks at variations within large categories and to interactions among different institutions" (319). As the volume demonstrates, "the initiation of reform requires decisiveness, and in turn, a certain concentration of decision-making authority; but resolute policy requires that the status quo not be easily overturned, which requires less concentrated decision-making" (320). Indeed, William Heller and McCubbins, in their chapter on electricity regulation in Argentina and Chile, show that decree power may have had negative effects on investor perceptions precisely because it implies the ability of the president to overturn existing policy, thereby increasing uncertainty.

THE SECOND STAGE OF REFORM

These debates on economic policymaking in presidential democracies insert themselves into the broader reconsideration of the politics of economic reform and institutional development, and the realization that trade-offs do exist between these intertwined processes. *Economic Policy Reform: The Second Stage* is an important contribution to the now vast, yet increasingly balkanized literature on the political economy of policy reform and second-generation reforms. It is also an important book because of its influential editor, Anne O. Krueger, a renowned economist who is now the first deputy managing director of the International Monetary Fund (IMF) and who was the World Bank's vice president for economics and research between 1982 and 1986.

The volume aptly captures the tensions and contradictions between the first and second stage of reform in a wide variety of policy areas such as fiscal and tax reform, trade policy, budget management, exchange rate policy, labor markets, privatization, telecommunication policy, water management, infrastructure development, education reform, and poverty alleviation. Krueger underscores that reform in each policy is marked by two successive waves, the first centering on the reform of policies and the second anchoring them by altering the incentive structure and institutions of governance shaping policymaking. Most contributors agree that the main challenge of second-stage reforms resides in the institutional context: "First-state reforms are in general politically and administratively easier to implement for a variety of reasons. Their very success, however, generates the need for second-stage reforms, without which the full benefits of first-stage reforms cannot be realized. . . . Second-stage reforms tend to encounter more political resistance . . . and, in addition, more technical bureaucratic and administrative work must be done, first, to obtain parliamentary approval for reforms and, second, to implement them once enabling legislation is passed" (4).

Economic Policy Reform questions core assumptions of the technocratic consensus that continues to impregnate the economist profession's approach to policy reform, couched in rational choice theory. It reflects the growing recognition of the centrality of the politics of policy reform as well as the political economy of policy implementation, a critical dimension overlooked by first generation reforms. It was originally assumed that once reforms had been adopted, implementation would necessarily follow. However, recent experience clearly demonstrates that this is not necessarily the case, and administrative capacity and institutional development are critical to ensure successful reform. Moreover, first generation market reforms and structural adjustment advocated by the international financial institutions (IFIs) have dramatically undermined the capacity of the state bureaucracy to implement policy. Indeed, the central paradox of state reform in the neoliberal age, as Gerald Caiden points out (1994, 111), is that "countries most in need of state reform are least able to implement it." Hence, as Kurt Weyland remarks in *Sustainable Public Sector Finance in Latin America*, the orthodox paradox noted by Miles Khaler (1990) is not a transitional one but a permanent one: "paradoxically, the main actor of market reform and state retrenchment must be the state" (48).

As Stephan Haggard aptly points out in *Economic Policy Reform*, "a number of so-called second-stage reforms imply fundamental changes in organizational routines or the creation of altogether new institutions," such as regulatory agencies, autonomous implementing agencies, independent central banks and supreme audit institutions, insulated tax collection agencies, "or fundamental changes in existing bureaucratic organizations" (34), as the result of new methods of public management. Hence, "even if initiated quickly, (institutional reforms) are likely to require some time to reach fruition" (34). The sequence of reform is nevertheless more complex than analytical frameworks suggest. In the case of the telecommunication sector, Roger Noll notes that although the second stage of policy reform has already arrived, the first was never really undertaken. Looking at education reform, Michael Kremer underscores that improving access to education, especially at the primary and secondary levels, must not distract from the simultaneous need to improve the quality of education.

In his chapter on "Interests, Institutions and Policy Reform," Haggard provides an insightful overview of the major trends of the literature on the political economy of policy reform. He distinguishes two main strands, one couched primarily in terms of social preferences and interest group theory (winners versus losers, as well as the concentration of costs and the dispersion of benefits), and another focusing on institutional arrangements and incentives structures.

The first approach locates the challenge of policy reform in terms of coalition-building, building support for and neutralizing opposition to reform, and consequently focuses on strategic and tactical questions concerning the timing, speed, and sequencing of reforms, as well as compensatory mechanisms. As Haggard underscores, "approaches that emphasize the role of interests see policy reform as a coalition-building process. Successful reform results from the formation of a minimum winning coalition and the defeat, or at least acquiescence, of those groups opposed to reform. . . . [Consequently,] the great debates center on how the design of the reforms themselves affects political support for the program and thus successful implementation and stability" (22). There is, however, a "lingering authoritarian undertone to some of the reform literature that springs directly out of the interest group approach" (37), as it tends to suggest that a strong government is often required to overcome the collective action dilemmas policymakers face. However, as Haggard recognizes, "the process of delegation is a central one in democratic systems: modern democracy would be impossible without it. Thus the issue is not whether or not to delegate, but how delegation can be structured to maximize both efficiency and accountability" (43).

In the second strand of the literature, institutions matter because they shape the incentives that motivate policymakers to act in certain ways. Institutions constrain the range of feasible options and thus decisively influence policymaking. According to Haggard, this strand focuses "on constitutional design, the decision-making process, and the incentives facing politicians. An advantage of this work is to see the politics of reform not simply in terms of discrete policy changes but as requiring institutional and administrative reforms that will ensure that policy-making is decisive, efficient, and credible over the long run. The great debate in this area centers on the advantages of concentrated authority and the 'insulation' or 'autonomy' of government as opposed to decision-making processes that provide for multiple veto gates ('checks and balances') and consultation of various sorts" (22). The new institutionalism of comparative politics aims to explain why, when and how reform occurs: "The emerging theory on public policy centers on how the design of these institutions affects the incentives facing politicians, their capabilities, and as a result various features of policy itself" (40). As Haggard underscores, the often overlooked "question of capabilities is particularly important for understanding policy reform: can policymakers take decisive action when required, and can they implement decision once taken? These issues were generally assumed away in the extensive literature on strategy and tactics, in which executives had agenda-setting or even decree-powers" (40).

Two institutional dimensions of policymaking are particularly important: the constitution of executive authority and the nature of the relations between the executive and legislative branches of government, and the nature of the party system (fragmentation, polarization, and internal discipline) and the choice of electoral rules. Furthermore, the quality of governance institutions partly explains the permanence of policy reform once enacted, as "winning coalitions can lock in their policy preferences by creating institutions that raise the costs of policy reversal and thus enhance both the coherence and credibility of policy" (42). This has been the case, for example, in the areas of monetary policy and exchange rate management with the creation of independent central banks, or public management with the establishment of autonomous executive agencies. However, new institutionalism tends to pay less attention to the contents of policies, often taking the nature of reform as given.

FEASIBLE REFORMS AND SECOND-BEST OPTIONS

As Vittorio Corbo aptly underscores in *Economic Policy Reform*, "a major challenge is to carry out this second-generation of reform while preserving the newly gained macroeconomic prudence that is necessary to increase the payoffs of the first and second-generation of reforms" (90). Reviewing the mixed and varied record of Latin America with economic policy reform, Corbo notes that the "problem with the second generation of policy reforms is that no blueprint for these reforms is available, as there was for the first generation of reforms" (85), and "the order and sequence of reforms is much less clear-cut than was the case with the first generation of reforms" (86). Indeed, in his comments to the article by Corbo, Miguel Savastano warns against overselling the "need for and the gains from economic policy reform" (96) when there is still great uncertainty regarding the contents and most adequate strategy of these reforms among economists.

Joseph Stiglitz, the controversial Nobel prize winner and former chief economist of the World Bank, is particularly critical of the reform agenda that the Washington-based IFIs have advocated since the late 1980s: "There is little doubt about the *insufficiency* of the Washington consensus dictums of reform. The *necessity* of those dictums has also been questioned" (555). According to Stiglitz, the frequent failure of the Washington consensus has been to not draw attention to some of the trade-offs that policy choices entailed, between, for instance, inflation control and growth promotion, or capital account liberalization and the need for a sound financial system, especially in the context of dramatic financial crises such as in East Asia in 1997 or Russia in 1998. More recently, he has argued that Argentina's collapse was partly rooted in its unwillingness to bring flexibility in the currency board system of exchange rate management introduced in 1991, especially since the late 1990s when Argentina entered a prolonged recession.

Advocates of market reforms tend to claim that the countries simply failed to stay the course and that weak performance is due not so much to the reforms, but to their implementation (or lack thereof). However, as Stiglitz convincingly argues, "a reform agenda is a view of change in a country's rules of the game (institutions and policies) that one might reasonably expect to be implemented, taking into account the capacity of government and its political process. Implementation and political sustainability are not sideshows but the main event in a reform agenda" (556). Hence, "it is not too *large* a government that is the problems of these inadequacies, but a government that fails to undertake those functions that are uniquely its responsibility" (554), such as tax collection, monetary stability, or law enforcement.

Stiglitz further underscores that the reform movement based on the narrow conception of the Washington consensus has often overlooked critical issues related to the goals of reform, the strategies for attaining those goals, and the political process by which reforms are attained. In particular, Stiglitz emphasizes that while it may be appropriate to have ambitious goals, it is necessary to set reasonable intermediate objectives. Indeed, overzealous reformers have neglected the theory of the second best when setting reform objectives—that is, realistic and feasible reform objectives. For Stiglitz, policymakers must pay careful attention to the sequencing and pacing of reform as well as the political economy of reform, which not only determine the costs of reform and their distribution, but more fundamentally their feasibility. Nevertheless, the theory of the second best is not an excuse for inaction, but for cautious pragmatism and realistic expectations.

Assessing the politics of economic policy reform, Stiglitz claims that "the way the reform process was conducted in many ways not only undermined the sustainability of the reforms but also undermined democratic processes" (572). Indeed, although the reforms were essentially political, "reformers tried to push such political reforms as mere technocratic changes designed to enhance the performance of the economy" (572) and in many cases, such as in Indonesia, "reformers went well beyond what was required to address the crisis, into longer term structural issues" (573). Inappropriate responses to crises, misguided reforms, and inconsistencies between advice and action are often to blame for reform failure.

The issue of state capacity and feasible reforms is also central to the chapter by Vito Tanzi on fiscal policy and budget management. Conceptualizing fiscal policy as "the manipulation of fiscal tools to achieve desirable economic objectives" (435), Tanzi argues that while the standard principles and assumptions underpinning sound fiscal policies may be realistic for developed countries, their applicability to developing countries is more questionable. Theories of rational budget and optimal fiscal policy are highly unrealistic for developing countries. In such circumstances, the "rationalization of the government budget and the pursuit of sound fiscal policy can become very difficult" (436).

Looking at the quality of the budget process, Tanzi aptly notes that "at each step, the process may fail and in fact it often fails so that the *effective* execution of the budget is different from the *legislated* one" (444). Rational fiscal theory tends to assume that "the same fundamental goals that would be pursued by an ideal government are also pursued by the actual government . . . [and that] the instructions given by the ministers to the heads of the institutions and departments, which will be responsible for implementing the policies, are clear, are not challenged, and are carried out faithfully and competently by those who received them" (444). However, budget processes in transition economies rarely follow such a rational pattern. Instead, they are marked by a wide array of principal-agent problems undermining the effective implementation of policies (Santiso 2001b; Bresser Pereira and Spink 1999).

The theory of the second best discussed by Stiglitz is designed to address problems of implementation and unrealistic expectations. In developed countries, "discussion of public policies can focus on the policies themselves and not worry about how these policies will be carried out or implemented" (445). This is clearly not the case in transition economies where implementation failure is a determining factor of reform performance. Feasible policies are precisely those that adequately integrate considerations about state capacity in the design of reforms. Fiscal policy reform and tax modernization must thus be couched in realistic expectations and an objective assessment of the capacity of the state bureaucracy to implement them. As Tanzi argues, "between their creation and their final implementation, fiscal decisions go through many stages at which mistakes, indifference, passive resistance, implicit opposition, and various forms of principal-agent problems may distort the final outcome. The theory of fiscal policy simply ignores these potential problems" (445).

Implementation issues are so critical that, for instance, "tax administration *is* tax policy because of the discretion [of the agents]. In other words, the administration of the law can, *de facto*, change the original content of the law, and the director of taxation has much power in deciding how a law will be applied" (448). In such contexts, "economic policy is full of examples of countries where major policy changes generate no visible changes in the economy. One reason is that economic policies can be emasculated in the process of transmission or implementation. This emasculation may be intentional . . . or it may be consequence of total inefficiency in the implementation state of the policies" (449).

REFORMING THE STATE AND STRENGTHENING GOVERNANCE

Rebuilding administrative capacity has risen to the top of the reform agenda in transitional countries and IFIs. An important emerging strand of the literature on public administration reform endeavors to revisit the original assumptions and prescriptions concerning the reform of the state, which focused on government failure and the subsequent need to downsize the state and withdraw it from the management of the economy. The New Public Management school of public administration reform is nevertheless showing its limits in transitional countries (Schick 1998).

Instead, many transitional countries suffer from a lack of state presence. In extreme cases of state capture and state failure, the state itself has ceased to exist. Lawmaking and policy formulation are captured by special interests so that rules and regulations are adopted or modified to fit their preferences. Peru under President Alberto Fujimori, particularly during his second term, is a dramatic illustration of these perverse trends. State capture, which occurs when political power is used for private gain as a result of inappropriate patterns of public spending and resource allocation, is more damaging than state corruption and particularly difficult to confront. Bribery is only the tip of the iceberg. Evidence from transition countries in East and Central Europe reveals the devastating effects on governance of systemic corruption and state capture (Hellman, Jones, and Kaufmann 2000).

In more subdued cases of state weakness, the state lacks the capacity to assert an authoritative presence of law and order. Systemic ungovernability manifests itself in a dramatic decline in the state's capacity to implement policy and the persistence of pervasive corruption, both in its grand and petty variants. While cases of grand corruption reflect instances of capture of the state, petty corruption is often the result of weak bureaucracies gone astray. Indeed, the forced shrinkage of the state in the wake of neoliberal reforms has undermined the state's capacity for implementing reform, sustaining policy, and enforcing the law. The paradox is that while first generation economic reforms have advocated a drastic reduction in the prerogatives of the state, second generation institutional reforms require a stronger state. A capable state is required to guarantee public security and the rule of law, necessary conditions for both sustainable economic development and democratic consolidation. It is now widely recognized that markets require a legal and regulatory framework that only governments can provide.

Nevertheless, and despite reiterated attempts, adequately and successfully reforming public bureaucracies has proved particularly challenging. Indeed, Peter Spink has aptly exposed the disappointing results of seventy years of administrative reform, situating their cause in the technocratic approach adopted and the insufficient attention paid to the politics of reform (Spink 1998; and Spink in Bresser Pereira and Spink 1999).

While economic policy reforms, especially in their first stage, have tended to emphasize the importance of state autonomy, state capacity is critical to sustain market reforms. Rebuilding state capacity is the central theme of *Reinventing Leviathan: The Politics of Administrative Reform in Developing Countries*. Editors Ben Ross Schneider and Blanca Heredia carefully assess the politics of second generation administrative reform, where the focus is on (re)building administrative capacities of core state functions, such as tax collection, maintaining monetary stability, and law enforcement. Bringing together empirical work based on case studies and comparative analyses, the stated goal of *Reinventing Leviathan* is "to provide political explanations for why some governments are able to enact significant administrative reforms while others cannot" (1). The fundamental question, however, is to understand why governments voluntarily relinquish part of their power by agreeing to reform their main source of patronage, the bureaucracy.

Schneider and Heredia place themselves in the direct lineage of the growing literature on comparative political economy. They identify the main obstacles of administrative reform in the intractable dilemmas of collective action and multileveled principal-agent relations (coalition building, mobilizing winners versus neutralizing losers, the concentrated costs of administrative reform versus the uncertain, dispersed and delayed benefits). In their introductory, conceptual chapter, Schneider and Heredia offer a useful and insightful typology of the three major models of administrative reform in central government agencies, which include civil service reform, accountability reforms, and managerial reforms. While these three types of reform often overlap in practice, their ultimate objective is quite distinct.

Civil service or Weberian reforms aim to enhance the management of human resources in state bureaucracies through the introduction of rigorous rules of career management. Managerial reforms are designed to increase the efficiency of the public sector by introducing market-based management techniques such as contracting out, decentralization, and results-based management. An important contribution of managerial reforms is emphasizing that budgeting should not be an act of fiction, but must instead be oriented towards achieving results and targets. The objective of accountability reforms is to enhance transparency, oversight, and control in order to increase the responsiveness of state bureaucracies. In that model, “the problem is excessive power in the executive administration, and the cure is greater democratic control, transparency, and accountability” (8). As Jeffrey Rinne aptly remarks in his chapter on Argentinean reforms, “instead of accountability through procedures, the new public management prizes accountability based on results. The Weberian model is hierarchical, guided by rules, not missions, Meanwhile the new public management promotes decentralized, arms-length arrangements through contracts” (37).

In reality, reform programs combine elements of the three models or attempt to address all bureaucratic maladies simultaneously. However, “this multifront attack on the bureaucracy downplays trade-offs among the models of reform, and minimizes the negative by-products of each model. . . . [Indeed,] the emphasis in much of the technical literature on public administration on ‘best practice’ and ‘optimal’ administration neglects the fact that reformed state structures are not the product of ‘optimizing’ strategies on the part of state reformers, but rather the result of protracted and intense political struggles. Each model of reform shifts powers in significant ways. All of them shift power away from the presidents and their inner circles” (9). Indeed, as Schneider emphasizes in *Sustainable Public Sector Finance in Latin America,* what is often missing in the technical literature on administrative reform is “an appreciation and assessment of the politics of administrative reform” (54).

THE POLITICAL ECONOMY OF STATE REFORM

Reviewing the experiences of Chile, Mexico, Brazil, Hungary, Argentina, and Thailand, examined in detail in the individual country chapters, *Reinventing Leviathan* underlines the great variety in the state’s pre-reform characteristics, the diverging traditions of stateness as well as the path dependency of the reforms engaged in the 1990s. Schneider and Heredia point out that reform programs usually originated in a small group in the executive insulated from political pressures, change teams whose theoretical approach was often shaped by international influences embedded in transnational networks. Luiz Carlos Bresser Pereira and Jeffrey Rinne show the channels though which the New Public Management school has influenced the reform trajectories in Argentina and Brazil, directly through advisers and consultants to the reform teams or indirectly through the financial institutions.[2] The cases under review confirm the insulated policymaker hypothesis of comparative economy approaches to the study of state reform (Haggard 1995, 1997; Kaufman 1997, 1999). As Bresser Pereira argues, “the approval of major reforms depends on four factors: need, policy design, democratic persuasion, and alliances” (89).

Reform success, in particular during the initial stages, nevertheless requires coherence within the executive, which is found to be a determining factor for explaining reform success or failure (as in Hungary). Hence, politics within the executive are of critical importance: “Core issues with the executive are the degree of fusion among political and bureaucratic elites, the programmatic commitments of the political elite, and the extent of cohesion (or lack of fragmentation or division) among the major groups represented in the executive" (19-20). Fiscal crises accelerated reform initiatives (Bresser Pereira 1996; Bresser Pereira and Spink 1999; Haggard 1997), and the associated fiscal adjustment drew governments into closer contact with multilateral lending institutions and their lending programs. In that respect, international funding, rather than political conditionalities in emergency bailouts, helped overcome resistance and implement reforms.

Schneider and Heredia aptly note that the challenges of administrative reform do not reside only in the initiation stage, but also in the implementation or institutionalization phase. As second generation administrative reforms are not self-sustaining, "the often huge monitoring and enforcement costs of bureaucratic reform help explain why these processes tend to be so difficult to sustain over time" (6). As Schneider comments in *Sustainable Public Sector Finance in Latin America*:

> In an ideal model of successful reform, the political process in democratic systems can be divided into three stages. In the first stage, parties, leaders in civil society, and politicians overcome obstacles to collective action to elect pro-reform candidates. Second, the newly elected pro-reform legislators cooperate with the reformist president to enact reform policies. Third, once enacted, the president (the principal) then delegates implementation to his or her subordinates (agents) in the executive bureaucracy. Compared with many other kinds of economic and political reforms, administrative reform encounters especially severe problems at all three stages of this stylized model: election, enactment, and implementation (54-55).

Indeed, making ambitious proposals for administrative reform has become routine in transitional economies—"less common are cases where bureaucratic reform receives high policy priority and where reformers manage to effectively implement it" (14). What Schneider and Heredia describe as the fusion between bureaucrats and politicians is a critical hindering factor inhibiting effective reform. "In contexts marked by close fusion between bureaucrats and politicians, policy elites will tend to have few incentives to award administrative reform a high priority . . . [as] the principals are the agents and vice versa" (15). This partly explains the scant progress of Mexico and Thailand. As Daniel Unger notes in the case of Thai politics, the principals of administrative reform are also its agents. In the case of Mexico, Juan Pablo Guerrero and David Arellano note that, since the 1960s, presidents have emerged from within the bureaucracy. In contrast, "elected officials with weak organic links to bureaucrats or political 'outsiders' are more likely to be open to reform proposals" (15), although they are also more likely to encounter opposition and are usually not trusted by the bureaucracy. This scenario corresponds to the Chilean case in 1990 and in post-communist Hungary. "The extent of fusion mostly influences the likelihood that bureaucratic elites will be receptive to reform proposals" (15). Thus the paradox of administrative reform is that it requires the commitment of the bureaucracy, and it is precisely the bureaucracy's resistance that hinders it. Reformers must strike a balance between insulation and consultation to keep the reform process unfolding and instigating commitment to reform within the bureaucracy.

The hypothesis that governments backed by disciplined parties with a majority in the legislature will be better able to enact significant reforms is not confirmed by the study. The fact that Brazil has been able to enact administrative reform and has begun to implement it, while Argentina has largely failed to articulate a comprehensive program, contradicts prevailing assumptions about the styles of government more apt to engage reforms. While party politics have an uneven explanatory power, Schneider and Heredia underscore that coherence and cohesion within the executive itself are more powerful explanatory factors. Indeed, reforms in Mexico, Thailand, Hungary, and to a lesser extent in Brazil, were stalled by infighting within the executive branch.

Furthermore, *Reinventing Leviathan* delves into the politics of coalition building, moving beyond the classical distinction between reform opponents, the strategies developed to neutralize them and their supporters, and strategies to galvanize them. The political economy of administrative reform is indeed shaped by a wide variety of group dynamics and the interaction between what Schneider describes as central reformers, passive partners, and peripheral allies in *Sustainable Public Sector Finance in Latin America* (62). Schneider argues that administrative reforms are largely the result of change teams within the executive, with strong backing from the president, that are able to design administrative reform in isolation. Administrative reform is thus quite an insulated process, where the kinds of coalitions that support reform "generally do not comprise pro-reform groups but, rather, passive, captive, or peripheral allies" (63), in particular among the middle class.

While there are few principals, there exists a myriad of agents with different and sometimes diverging interests. Administrative reform requires the commitment, or at least the sustained cooperation, of the agents themselves. As such, the politics of coalition building within and between the government and the bureaucracy (in particular, its unions) are key determining factors. In such contexts, administrative reform is exposed to capture by vested interest and patronage networks. The middle class, which pays income tax and thus expects efficient state services in return, is often the only pro-reform group, but it is usually too diffuse and amorphous to exert decisive influence. Often, peripheral allies, such as the governors in Brazil, play a critical role, as both Bresser Pereira and Marcus André Melo show in their respective chapters on Brazil's reform trajectory. As a result, and "given the high costs of second wave reform and daunting political obstacles, the strategies and leadership of reformers [in particular, reform packaging] sometimes loom large in explaining reform outcomes" (18).

Economic factors, especially fiscal crises, are triggers that help explain timing. Nevertheless, "reform proposals may get enacted under the duress of fiscal crises, however their medium-term implementation depends more heavily on political factors, both institutional in the sense of the structure of the party system, as well as coalitional, in terms of which groups support reform and how strongly" (19). Major determinants are the degree of fusion among political and bureaucratic elites (and hence the initial costs of reform), the degree of programmatic commitment of the political elite in the executive (or the willingness to bear the costs over the longer term), and the extent of cohesion (or lack of fragmentation or division) among major groups represented in the executive.

SUSTAINING ADMINISTRATIVE REFORM AND STATE MODERNIZATION

Schneider and Heredia convincingly argue that “contrary to some policy recommendations, our cases do not suggest any benefits from sequencing reforms or completing first wave reforms before embarking on second wave reforms” (20). Indeed, in his theoretical contribution, Robert Kaufman underscores that the prevalent distinction between first and second generation reforms in the contemporary debate on reforms do not apply to the reform of the state.

According to Schneider and Heredia, “two additional factors appear to be particularly important in conditioning the sustainability of reform efforts: the durability of the conditions under which reforms are initiated and the particular model of administrative reform enacted” (20). In general, managerialist and accountability reforms are easier to institutionalize, since they tend to create concentrated groups of winners and thus supporters of reform (the managers and the legislators). By contrast, civil service reform is the most difficult to implement and institutionalize because of the sheer weight of the vested interests at stake and the irresistible force of the established structure of incentives. As Schneider underscores in *Sustainable Public Sector Finance in Latin America*, once proposals are enacted, “administrative reform encounters new problems because, unlike economic reforms, it takes so long to implement. . . . Administrative reform does not automatically create strong winners who can make sure the reforms are not overturned” (66). The core paradox of administrative reform is that it requires the sustained cooperation of the agents themselves, when there are so many agents and so few principals.

Furthermore, “the three types of reform—Weberian, accountability and managerial—have different consolidation dynamics. Weberian reforms confront the most difficult principal-agent dilemmas because they require the active cooperation of the agents who are the objects of reform. . . . Weberian reforms may of course involve a lot of rulemaking, but compliance is a more difficult matter. Accountability reforms do not rely to such a great extent on the bureaucrats themselves” (67). However, the primary sources for consolidating accountability reforms come from those state institutions doing the accounting, and in particular the parliament, the judiciary, the supreme audit institution, and the ombudsperson’s office. By introducing more competition in the delivery of public services, managerial reforms, too, depend in part on external agents for their consolidation.

However, in his theoretical chapter, Robert Kaufman underplays the pertinence of the distinction between first and second generation reforms in the area of administrative reform, as well as the analytical distinction between types of administrative reform (Weberian, accountability, and managerial reforms). In his contribution to *Sustainable Public Sector Finance in Latin America*, Andrés Fontana, former undersecretary of state of Argentina, largely concurs with this insight, arguing that “first and second are not a sequence but together are a unitary and continuous process” (73). Furthermore, assessing the explanatory power of theories of comparative political economy, Kaufman argues that international political economy, institutional rational choice, and institutional sociology each provide insights into the politics of administrative reform.

Nevertheless, none of the three approaches alone captures the entire complexity of administrative reform; they are more complementary than mutually exclusive.

Together, these theoretical approaches provide powerful tools to identify the parameters within which reformers operate. Ultimately, as Kaufman underscores, "while these theoretical approaches may not serve as ex ante predictors of reform outcomes, they may provide some insights into the openings and obstacles that potential reformers may face" (296-297). Individuals operate in institutional contexts and their decisions both shape and are shaped by interests and incentives. Melo skillfully reveals the interaction between the four Is of political economy (individuals, institutions, incentives, and interests) when examining the divergent fate of administrative, social security, and tax reforms in Brazil in *Reinventing Leviathan*.

A critical issue affected by the overall quality of the state bureaucracy concerns the credibility of economic policy, a central theme of *Presidents, Parliaments, and Policy.* As Fontana argues, "unlike in the past, the primary role of administrative reform is not efficiency but credibility. The challenge for countries like Argentina or Brazil is not only to become more efficient and competitive or to have a more rational and transparent public administration. As 'emerging markets,' we depend on a continuous flow of international capital to finance our growth. Thus, credibility becomes a crucial factor. . . . Therefore, administrative reform today constitutes a substantial aspect of any strategy aimed at increasing credibility" (74).

STATE REFORM AND PUBLIC FINANCE MANAGEMENT

Policy credibility is also a core dimension of sustainable public finance management. Why, despite so many efforts over the past two decades, have governments not been able to implement effective and sustained fiscal adjustment? *Sustainable Public Sector Finance in Latin America* contributes to the untying of the intricate interplay between economics and politics in the process of state reform. It underscores the intrinsic linkage between sustainable public sector finance and the credibility of economic policy, in particular fiscal policy. As Robert Eisenbeis notes, "the feasibility of a particular fiscal package depends not only on a sound economic approach but also on the establishment of a new political and judicial approach to the decision-making process that would avoid the type of institutional conflicts that have occurred in some countries" (vi), most recently in Argentina. Indeed, the rule of law, judicial security, and judicial governance are critical elements of the credibility of economic reform (Santiso 2003a).

Assessing recent trends in deficit financing and debt management, *Sustainable Public Sector Finance in Latin America* reveals the need for greater understanding of the role of institutions in fiscal policy reform. As Teresa Ter-Minassian and Gerd Schwartz (1997, 10) underline, the foremost common characteristic of governments having failed to harness fiscal policy "is perhaps the fact that they all failed to signal convincingly a fundamental change of the economic policy regime and therefore lacked credibility." The authors attribute this lack of credibility to inconsistent policy mixes, excessive reliance on exogenous factors, failure to implement fundamental fiscal reforms, and the lack of needed complementary structural reforms (10-11). The notion of sustainable public finance connotes more than the nature of fiscal policy or the level of public debt. It refers to the capacity of the state to credibly conduct economic policy, given its resources and spending constraints.

In a general context of sluggish economic growth and economic austerity, financing persistent budget deficits becomes a challenging and perilous endeavor. The margin of maneuver of fiscal policy has considerably narrowed in recent years. Indeed, the debt problem has resurged in Latin America in recent years, placing a heavy burden on populations exhausted by over a decade of adjustment. Persistent poverty and inequality is scarring Latin American emerging economies and restored democracies. Popular disillusion with the functioning of democracy and the elusive fruits of neoliberal economic policies puts economic policymaking under heavy stress (Easterly 2001).

In such sensitive contexts, raising taxes and reducing public spending becomes politically unfeasible. The low level of tax revenues, representing a mere 12 percent of GDP in countries such as Peru, as a result of weak tax administration, fiscal evasion, an inefficient bureaucracy, and a narrow tax base, often requires governments to resort to external financing of the fiscal deficit, via the bond market where feasible and most often via international lending from IFIs. The perverse consequence of this method of deficit financing is the steady increase in the level of indebtedness.

As Luiz Carlos Bresser Pererira (1996) underscores, the fiscal crisis of the state is the root cause and instigator of the reform of the public sector. As a result, the reform of the state and the modernization of the public sector have gained renewed urgency in recent years in Latin America. The issue is not so much the level of public spending but rather the efficiency of public spending and the containment of structural corruption, both grand and petty. Sustainable public finance requires improving the efficiency and effectiveness of public spending, in particular social spending. Thus, in recent years, public finance management and accountability have become core components of the agenda on state reform. Undoubtedly, the governance of the budget, the oversight functions of parliaments in the budget process, and the institutions of public finance accountability such as supreme audit institutions undoubtedly deserve closer scrutiny.

Indeed, there is a newfound appreciation of the role that institutions play in producing policy outcomes. Recent research on the relationship between governance institutions and fiscal deficits suggest that fiscal policy outcomes result, in part, from institutional design. Stein, Tavi, and Grisanti (1998) have divided budgetary institutions into three categories based upon numerical constraints, procedural rules and transparency. Balanced-budget laws, fiscal targets, and debt ceilings constitute numerical constraints. Procedural rules refer to whether or not budgets are set in hierarchical or procedural arrangements and the relative powers of the executive and legislative branches of government in the budget process. Hierarchical rules tend to give greater power to the executive branch, while collegial rules provide a greater balance between the government and the legislature. The transparency of the budget process and the strength of the mechanisms of accountability are critical determinants of the credibility of the budget and the accuracy of the projections of revenue, expenditure, and debt. Stein, Tavi, and Grisanti (1998) demonstrate that more transparent and hierarchical budget institutions tend to have lower deficit and debt levels. Hence, as Elisabeth McQuerry, Michael Chriszt, and Stephen Kay stress in *Sustainable Public Sector Finance in Latin America*, “governments pursuing fiscal policy reform must carefully appraise the role of institutions and consider the extent to which institutional reform might complement fiscal policy reform" (16).

RESTORING GOVERNANCE AND STRENGTHENING ACCOUNTABILITY

Finding the adequate role of the state in the economy is the central theme of *Reinventing the State: Economic Strategy and Institutional Change in Peru.* As Carol Wise argues, while successive Peruvian governments have been able to insulate economic policy and thus increase state autonomy, economic development has been hampered by the failure to simultaneously strengthen state capacity. Consequently, the lack of state continuity and the absence of a genuine development strategy have led to repeated swings in political regimes and erratic styles of policymaking grounded in the insufficient institutionalization of the state. While the title of the book suggests that the challenge is to reinvent the state, its analysis nevertheless suggests that Peru has yet to invent it. Thus, the challenge of state reform resides in strengthening the capacities of the state to intervene more effectively in the economy and discharge its core public functions.

Economic policy credibility is, again, a major concern of this important contribution to the growing body of knowledge on state reform and economic performance. Specifically, *Reinventing the State* focuses on the internal renewal of the state and, more specifically, the capacity of the state to implement economic policy and development strategies. It demonstrates how difficult it is to implement bureaucratic and administrative reform, as, unlike first generation macroeconomic policy reforms, these reforms inflict "more concentrated pain (loss of power and access to patronage), while the benefits (greater public accountability, increased efficiency in the delivery of key public services) are far less tangible" (38). While it has been relatively easy and quite effective to create new economic policy agencies, "the lasting change of internal rules within existing institutions has turned out to be . . . one of the most challenging second-phase tasks of all" (38).

Reinventing the State assesses the institutional causes and consequences of repeated swings of political regimes and economic strategy throughout the second half of the twentieth century. As Wise notes, "up until the late 1950s, each interventionist spur had been followed by the successful reconstruction of a liberal economic policy regime" (59). The statist program of the Leguía administration, which ruled from 1919 to 1930, was the first attempt at constructing the institutional foundations of a modern state. Yet, repeated attempts at modernizing the state, while they succeeded in insulating economic policymaking, ultimately failed because they did not simultaneously strengthen the capacity of the state to adequately implement policy and revamp the bureaucracy. Peru's economic development strategy is thus characterized by state intervention without state capacity. As Wise aptly underscores in reference to state-led management approaches, the Peruvian paradox resides in the fact that "the prevailing attitude toward the state as overly intrusive, yet at the same time weak and ineffectual, served to reinforce the very characteristics of the state" (151). Often, reform efforts have tended to circumvent the state and thus undermine "those bureaucratic, institutional, and administrative structures that would have been crucial for the successful implementation of any development program" (151).

Wise adopts a political economy approach to state formation and reform. She identifies four key institutional variables as contributing most to effective state intervention: "political structures that insulate technocrats and economic decision makers from outside pressures and clientelist exchanges" (80), and consequently "the creation of autonomous agencies within the state bureaucracy" (6); "the consolidation of few powerful economic and planning institutions that closely link decisional and operational authority in strategic policy areas, with institutional continuity and efficacy resting on a technically skilled civil service governed by merit procedures; stable leadership with the support of a manageable coalition of dominant groups that can legitimate the policy change they initiate; and the organization of societal interests such that policy is mediated through peak organizations that are sanctioned by the state" (80). Wise is particularly concerned with those core state institutions critical to economic policymaking, in particular the ministries of finance and planning, and the central bank. She treats institutions both "in the classic sense, as those formal and informal rules that shape the behavior of individuals and organizations in civil society" (22), and in more concrete terms that "take into account the coherence of the bureaucracy, the delegation of decisional and operational authority, and the kinds of instruments that policy makers have at their disposal" (6).

Reinventing the State evaluates the changes in the role and functions of the state in the three main phases of state intervention: the developmentalist phase spanning from the 1950s until the 1982 debt crisis; the retrenchment phase with the retreat from statist strategies prompted by financial insolvency and the collapse of public finances between 1982 and 1990; and the renewal phase with the revival of the state's economic presence since 1990, although through indirect means. Successive Peruvian governments have been relatively successful in enhancing the autonomy of the bureaucracy by creating autonomous state agencies and strengthening the independence of those institutions critical for economic governance, in particular the central bank and the finance ministry. As in most other Latin American countries in the late 1980s and early 1990s, Peru's highly presidentialist political system allowed the executive to rely heavily on legislative decrees and the advice of insulated technocratic teams in the implementation of first generation economic reforms.

Under the government of Fernando Belaúnde (1963-1968), the state embarked on its first developmentalist experiment, but "the outright inability of the state sector to rise to the tasks that were chaotically set for it" (62) and, more fundamentally, the absence of a broad-based societal coalition supporting import-substitution industrialization, led to failure. As Wise notes, the "pattern of letting the state sector passively evolve, as opposed to the purposive institutional building characteristic of Brazil under Vargas or Kubitschek, for example, signalled a deeper problem for the Belaúnde administration: Peru marched into its first major modernization effort without any one planning or financial entity capable of taking the lead in generating and realizing the state's policy goals" (63).

Similarly, the state capitalist experiment of the military regime under General Juan Velasco Alvarado (1968-75) and General Francisco Morales Bermúdez (1975-1980) marked another lost opportunity to build a modern state bureaucracy in the Weberian sense, as the rapid expansion of the state sector was not accompanied by "an equivalent extension of the administrative capacities to support the state's various new functions" (84). The expansion of the state's role in the economy relied on excessive external borrowing, reckless increase of state-owned enterprises, heightened conflict between the state and domestic entrepreneurs, and the worsening of poverty and income distribution. This period, particularly the first phase under Velasco, “also signified Peru’s first full-fledged attempt at constructing an insulated and autonomous policy-making apparatus within the state” (86).

The fiscal crisis of the state in the late 1970s and 1980s is largely attributable to the excessive and unrestrained recourse to external financing. The second administration of Belaúnde (1980-85)—who, ironically, carried out a populist development strategy in the 1960s—rejected an explicit state-led management approach and engaged in “orthodox stabilization with populist overtones” (119). Peru then embraced the social-market model, which was not “as much a development strategy as it was an attitude towards the state” (151). The insulation of political decision making within the bureaucracy was central for carrying out the reform program. However, “the near obsession with the expansion of executive authority took precedence over the need to foster pockets of expertise within the bureaucracy to carry out the executive will. . . . As policymaking came to rely almost solely on executive decree, its implementation was of peripheral importance” (127-128). However, “the embracement of a market strategy became an excuse for not drawing on those planning and managerial resources that that state did have to offer. The lesson of this period . . . is that market policies are also ‘interventions’ that demand a basic level of capacity, coordination, and willpower to be carried out” (151). Hence, the failure of Belaunde’s experiment was rooted both in its design and in its implementation (or lack thereof).

In 1985, under President Alan García, Peru attempted a heterodox stabilization following the eruption of the debt crisis across Latin America. As Wise demonstrates, “as a catch-up strategy for economic restructuring, the heterodox program placed rigorous demands on the political capacity of the state to effectively intervene” (153). Given the structural weakness of the state bureaucracy, the program faltered rather quickly. As with the economic strategy pursued by Belaúnde, García’s approach failed to address the intrinsic weakness of the bureaucracy: state intervention took place without state capacity. The central bank and finance ministry continued to be the focus of fierce conflicts over the content and implementation of economic policy. At the level of the state, “the most glaring limit to García’s program was the continued failure of any development institution to take the lead in formulating and carrying out public policy” (167). These problems were compounded by García’s propensity toward an autocratic and exclusionary leadership style. Indeed, “political insulation during this period correlated less with state capacity and autonomy, and instead with unaccountable and loosely linked administrative structures controlled by special interests” (169). The García administration ended in hyperinflation, economic collapse, corruption, and the disintegration of the state.

Paradoxically, the renewal of the state originated from the neoliberal strategy pursued by President Alberto Fujimori (1990-2000) and inspired by the prevailing Washington consensus. The sheer magnitude of the economic crisis forced Fujimori to jettison his earlier promises of gradual reform and embark on a radical program of macroeconomic stabilization and structural adjustment similar to those initiated by Carlos Andrés Perez in Venezuela and Carlos Menem in Argentina. As Wise shows, and despite the many flaws of Fujimori’s quasi-authoritarian rule dramatically illustrated in the 1992 civilian auto-coup, there has been a "quiet process of state reconstruction and institutional reform that occurred over the course of the 1990s . . . as the president had little choice but to overhaul those state institutions which were critical for economic recovery" (180). These included, in particular, the ministry of economy and finance, the central bank, and the national tax agency.

A key feature of these reforms was the modernization and rationalization of strategic economic institutions, which, in turn, increased their relative autonomy. "The internal reform and modernization of those state agencies that are essential to the success of a market strategy constituted a necessary condition for sustaining economic reforms and for stabilizing politics" (212). However, as Wise argues, "over time, it was precisely the autonomy of these state agencies that would put them at odds with the office of the executive. . . . The institutional underpinnings of Peru's economic recovery were as much inadvertent as they were a purposive part of the designated economic strategy under Fujimori" (180). By making economic governance institutions more autonomous, Fujimori also made them prone to capture. Thus, "although Fujimori delegated authority to these autonomous agencies as a means of guaranteeing the success of his own policy goals, he did it in such as way as to render them relatively easy to create and easy to disable" (205), but also easy to neutralize or capture. As a result, Fujimori's second term in office was characterized by pervasive corruption and the use of economic institutions, such as the tax administration—lauded by the international financial institutions as a model in the early 1990s—as effective tools for political coercion and private gain.

Sustaining reform required broader coalitional support and the strengthening of institutional ties between the state and society, through more coherent and structured intermediation mechanisms. The second stage of market reform, initiated in the wake of the Mexican tequila crisis of 1994-95, would have required a more inclusive and accountable style of politics, something that Fujimori was increasingly unwilling to allow. His autocratic style of government significantly undermined the vertical and horizontal mechanisms of intermediation, between the state and society as well as along the parties-legislature-executive axis. Instead, Fujimori increasingly relied on a neoliberal populist strategy, which entailed the use of inclusive political gestures and targeted social programs to smooth over the exclusive and regressive impact of neoliberal reforms. Furthermore, "the more purposeful effort at streamlining in the early 1990s would require the rationalization of the public sector but also the revival of the state's ability to provide an acceptable level of public goods" (198). In 1996, the government did propose a new program to modernize the public administration. The attempt ultimately failed, but its objectives are as every bit as relevant today as when they were proposed.

As the economy tapered off in the late 1990s, altering the autocratic modes of government became essential to sustain market reforms. However, in his reckless quest for a third consecutive reelection, Fujimori was unwilling to allow an opening of the political regime and manipulated the constitution, the judiciary, and state institutions to extend his rule. The electoral crisis of April and May 2000 and the unexpected resignation of Fujimori in November 2000 opened a new phase in Peru's development. The election in June 2001 of President Alejandro Toledo, following the transitional government of Valentín Paniagua, has generated pent-up expectations for economic renewal and political reform. However, the Toledo administration is finding the job of adequately combining more consensual methods of government with the efficacious management of the economy much harder than expected. State and administrative reform is, once again, topping the charged political agenda, with the passing of a new state modernization law by the Peruvian Congress in January 2002, backed up by a US$150 million loan from the Inter-American Development Bank.

As Wise accurately underscores, “Peru’s economic revival has depended disproportionately on autocratic decision-making practices and insulated state agencies” (8). Nevertheless, and “despite the inroads that have clearly been made, without a more cohesive institutionalization of politics itself, the country risks sinking back into the same underachiever niche that it has heretofore occupied” (17). However, Peru’s recent history reflects “a strong continuity in the area of exercising executive authority and the neglect of the state bureaucracy” (154). The challenge of development remains to encourage “the state apparatus to do what it should do while impeding it from doing what it should not” (Przeworski 1999, 15).

Retracing the political and institutional history of contemporary Peru, Wise convincingly underscores that initiating reforms using insulation tactics based on the concentration of executive authority are bound to fail in the implementation stage, as poor state capacity undermines the ability of the state to intervene effectively. Hence, state autonomy is ineffective unless backed by adequate state capacity.

Current debates on the political economy of policy reform tend to overemphasize the importance of the autonomy of economic policy and insulation of policymakers for initiating meaningful reform decisively, a strategy which often leads to isolation, conflict, and fragility. Less attention has been paid to the simultaneous need to strengthen the capacity of the state to fulfill its obligations. State capacity is indeed a critical determinant of the credibility and resoluteness of economic policy. The erratic and volatile nature of policymaking remains a structural weakness of governance in Peru.

The question is not so much about the principle or degree of state intervention as such; rather, it is about its effectiveness. As *Reinventing the State* convincingly demonstrates, it is simply not enough to launch a development strategy from the office of the executive without properly grounding that strategy within the state apparatus. The daunting challenge for Peru is to renovate, reinvent, and reinvigorate the state to enable it to adequately and effectively intervene in the economy.

CONCLUSION: THE CENTRAL DILEMMA OF DEMOCRATIC GOVERNANCE

Adequately reforming the modes of government and the styles of policymaking is a critical task for emerging democracies struggling to consolidate. Indeed, one may argue that the analysis of the trade-off between policy decisiveness and resoluteness should be expanded to integrate considerations about the effectiveness of the mechanisms of political accountability. Decisive economic policymaking advanced by insulated technocratic teams under the president’s authority requires reducing or neutralizing veto points, such as judicial review by independent judiciary. As such, increasing decisiveness necessarily entails undermining accountability. By contrast, resoluteness reflects greater political accountability, and strengthening it necessarily requires expanding political accountability.

The experience of emerging markets and consolidating democracies clearly shows the limits of expeditious decision making often used to implement sweeping market reforms in the 1990s, and the consequent need to strengthen the mechanisms of horizontal accountability (O'Donnell 1998; Schedler, Diamond, and Plattner 1999). Clearly, government by executive decree, while an asset in the initial phase of economic reform, progressively becomes a liability in the second phase of reform. As the books reviewed herein aptly demonstrate, the central dilemma of democratic governance is how to retain the advantages of strong executive authority required to manage the economy, especially in times of turbulence, while at the same time providing the institutional checks and balances that guarantee effective accountability (Santiso 2001a, 2001b). The weakness of the rule of law is a major factor undermining economic policy credibility (Santiso 2003a, 2003b). Dramatically reforming the modes of government and the styles of policymaking is a critical task in that regard.

NOTES

1. The views and opinions expressed herein are those of its author and do not necessarily reflect DFID policy.

2. David Osborne and Ruth Richardson, New Zealand's former minister of economy and labor, advised the Argentinean government, while a group of British consultants headed by Kate Jenkins was instrumental in assisting in the design of the Brazilian reform project.

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