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In this issue:

***Forum on Economic Reform** (Part VII)*

In recent decades the alliance of neoclassical economics and neoliberalism has hijacked the term "economic reform". By presenting political choices as market necessities, they have subverted public debate about what economic policy changes are possible and are or are not desirable. This venue promotes discussion of economic reform that is not limited to the one ideological point of view.

The Future of Economic Policy Making by Left-of-Center Governments in Latin America: Old Wine in New Bottles?[1]

Juan Carlos Moreno-Brid[2], and Igor Paunovic[3] (United Nations, Mexico)

Introduction

To assess the medium-term economic prospects of Latin America, a fundamental element to be considered is the recent emergence of left-of-center governments in the region. What economic policies do they implement? How do these differ from the orthodox ones put in place by their predecessors? Will, as their advocates argue, governments of this "New Left" [4] adopt strategies – radically departing from so-called neo-liberal ones – that will help Latin America to enter a path of high and sustained economic growth? Or, on the contrary, are their fierce critics correct in stating that such alternative programs are revamped versions of populist experiments and, thus, sooner or later, will provoke acute inflation, bloated fiscal deficits, and push the region into financial crisis and recession? Other elements to take into account are the constraints imposed by the world economy and the international financial markets. In this paper we put forward a succinct assessment of these elements in order to examine the economic policymaking of the New-left governments in Latin America, and their results so far..

Antecedents

A key root behind the region's shift to the left is the disappointing result of the economic reforms – inspired by the Washington Consensus – implemented by previous governments. [5] Indeed, after nearly two decades of drastic macroeconomic reforms favoring trade and financial liberalization, deregulation, and downsizing of the public sector, Latin America is still unable to enter a path of high and sustained economic expansion. Inflation has come down, but economic activity has been sluggish. In addition, in the last ten years, the region has suffered acute economic crises; among the most conspicuous ones were the Mexican *tequila* crisis and the financial collapse in Argentina a few years ago.

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[1] The opinions expressed in this paper are the exclusive responsibility of the authors and may not necessarily coincide with those of the United Nations Organization. This is a revised and updated version of a paper that appeared in the *Harvard Review of Latin America*.
[2] Research Coordinator, Economic Commission for Latin America and the Caribbean, United Nations.
[3] Economic Affairs Officer, Economic Commission for Latin America and the Caribbean, United Nations.
[4] The term "New Left" is not used in the European sense of the last thirty years, but only to identify the left-of-center governments currently in power in Latin America.
[5] Ricardo Hausmann (2006) recently stated in the Council of the Americas that voters in Latin America tend to shift to political options based on heterodox economic programs, concerned with distribution, when the terms-of-trade of their primary commodities and mineral resources are high. And, analogously he claimed that they favor more orthodox stabilization policies in times of economic slowdown and high inflation.

During the 1980s the average real per capita GDP declined in Latin America due to the debt crisis. In the 1990s it expanded at 1.5 percent per year; four points below the average of developing countries in Asia. Moreover, between 1980 and 2000 the income gap between Latin America and the OECD widened, and there was scant progress in the reduction of poverty. By the beginning of the Millennium, close to 50 percent of its population lived in poverty, with 25 percent in conditions of extreme poverty. And, particularly worrisome, Latin America remained the most unequal region in the world.

Not surprisingly, Latin Americans became critical of the neo-liberal economic policies implemented. Latinobarómetro showed that by 2000 less than 30 percent of the population across the region believed that privatizations were beneficial, an approval rate 30 points lower than a few years before. The majority considered saw the market economy as the main road to development, but less than 25 percent claimed to be satisfied with its results. By then more than 50% were against the view that the state should not intervene in economic affairs. And physical insecurity and the lack of employment were regarded as the major concerns of Latin America.

On the other hand, the success of China – and other Asian economies – in luring vast inflows of foreign direct investment and maintaining a rapid economic expansion based on heterodox polices that allowed for an active role of the State in the economy, contributed to further undermine the credibility of the Washington Consensus. Thus, at the same time that the native population was becoming weary of the conventional economic strategies, the left-wing parties' campaigns in favor of a new development agenda were attracting respectability. An additional element in their favor was the fact that, after 9/11, Latin America appeared to drift away from the United States' screen of geopolitical priorities.

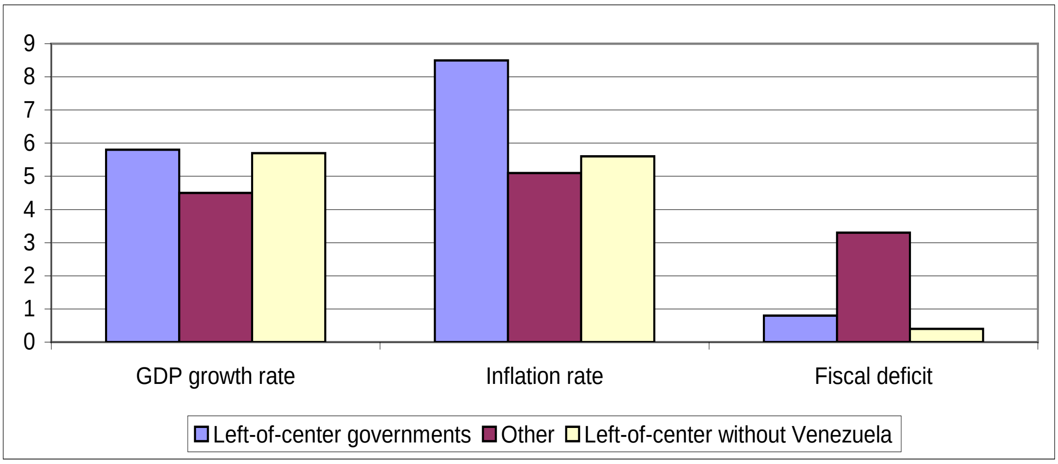
Rhetoric and Reality

The above mentioned factors shifted political preferences in Latin America, allowing for a number of left-wing parties to be ushered into power through democratic elections. The debate about the macroeconomic policies adopted by these New Left governments is ideologically charged, with rhetoric tending to prevail over reality. Their supporters defend them as alternatives to counteract the adverse effects of the neo-liberal agenda, while their critics brand them as populist programs doomed to end in a financial and economic crisis..

A preliminary inspection of the recent economic performance of the region suggests that the macroeconomic policies put forward by the New Left governments to date are not the irresponsible populist public spending experiments that their critics describe.

Figure 1 indicates that during 2003-05, the performance of medium and large Latin American economies under left-of-center governments (with the exception of Venezuela) does not substantially differ from that of other medium and large economies in the region under governments with a right-of-center political orientation. During this period the former governments have, on average, been somewhat more successful in sustaining a high rate of economic expansion, but less so in achieving low rates of inflation. Differences between both groups shrink if Venezuela is excluded. Note that in these three years the group of left-wing governments held tighter fiscal positions than other economies here considered. Indeed, whether Venezuela is included or not, the former group registered an average fiscal deficit lower than one percent of GDP, compared with an average of more than three percent for the other group. With the caveat that it is probably too early to draw firm conclusions, it seems that the New Left governments do observe fiscal prudence.

Figure 1
Latin America: Comparative performance of left-of-center and other governments, 2003-05



Note: left-of-center governments include Agentina, Brazil, Chile, Uruguay (2005) and Venezuela;
other governments incluce Bolivia, Colombia, Mexico, Peru and Uruguay (2003-04).
Source: Authors' elaboration based on data from ECLAC

The case of Venezuela deserves a special comment to the extent that its fiscal position relies on oil revenues (50%), though the same can be said of Mexico, where the oil sector contributes 40 percent of total public revenue. The fiscal situations of both countries are vulnerable and, unless additional sources of tax revenues are exploited, may become even more problematic if world oil prices decline significantly. In this event in particular, subsidies for food and health care for the poor in Venezuela may be subject to severe cuts.

To partially compensate for the adverse impact of high oil prices on consumers, many countries grant subsidies or set price controls on gasoline. In Argentina, to cut down inflation, the government has not updated utility rates, and has set up agreements to impose price caps on a range of basic goods, including beef, with wholesale stores and producers,. These measures will be ineffective if the Argentine economy continues growing, as it has, at real annual rates of 9 percent or above, unless additional investment comes forward to ease supply-side bottlenecks. In this regard it is important to point out that the government has put in place special incentives to stimulate the investment in sectors that produce key inputs or other goods intensive in innovation. In addition it recently banned the export of beef, in order to insure the supply for the domestic market.

A characteristic of the New Left's economic strategy is its marked effort to strengthen the margin of autonomy of macroeconomic policy by the reduction of public foreign debt. Argentina – against the advice of the IMF – negotiated with its foreign creditors and managed to restructure its external debt in the largest operation of its kind in history, obtaining a discount of 70 percent on close to US $100 billion. In addition, some New Left governments in mineral-rich countries have significantly increased their fiscal revenues by renegotiating with transnational companies the distribution of rents from the exploitation of natural resources. This has been done by increasing royalties and tax rates or, in Bolivia's radical move, by moving for the nationalization of such resources.

For fiscal policy to have the capacity to act in a counter-cyclical way, Latin America (on both sides of the political spectrum) needs comprehensive fiscal reforms to: 1) increase tax revenues as a proportion of GDP by at least 5 points above their current range of 10-20 percent, and 2) implement a more progressive tax system that will affect income distribution. Some advances have been made, but fiscal reform has a long way to go. It remains to be seen whether recently adopted measures to tax exports of certain commodities and financial transactions will be only temporary fixes, and soon abandoned to avoid their long-term distorting effect on production.

Fiscal prudence has been accompanied in most new-left governments – with perhaps the exception of Brazil - by a commitment to avoid a persistent and significant appreciation of the real exchange rate. Indeed, through open market operations, Central Banks have been reducing the supply of foreign exchange in the domestic arena and, simultaneously, increasing their external reserves. This orientation of monetary policy implies a recognition that the exchange rate has an important influence, not only on domestic inflation but also on international competitiveness.

Another essential element in considering the adequacy of the New Left's macroeconomic policies is the extent to which the government interferes in wage settlements. Argentina enacted income policy measures to strengthen the purchasing power of poor and middle income families. Uruguay, in addition, reinstated the old institutions of Wage Councils (Consejos de Salarios), which are once again the institutions where wages are negotiated at a national level. Most of the new governments in the region have decreed a significant but far from excessive hike in minimum wages, given the deterioration they had had in real terms in the past. Such restraint may reflect the fact that policy makers are concerned more with creating jobs than with improving employees' earnings in formal labor markets. It also reflects the recognition that, unless backed by increases in productivity, nominal raises in minimum wages may fuel inflation with scant effect on real wages. In any case by 2005, with the exception of Chile, the real average earnings of workers in countries under left-of-center governments were still below their level in 2000.

So far, radical measures to alter income and wealth distribution have not been included in the New Left agenda.[1] They have been ruled out due to political and electoral, as well as to economic considerations. In particular such measures, when unless they have a wide and strong political supports, tend to weaken the business climate and alienate part of the electorate. In addition, recall that New Left governments took power accompanied not by the noise of bullets but by ballots in free elections. Consequently, these governments are very much aware of the impact of their policies on the overall electorate. And some of these governments are backed by coalitions of diverse political trends and sectors, coalitions that may be not be solid enough to support radical redistribution policies or fiscal reforms.

International relations are one area where the economic policies of the New Left governments depart from previous models, as virtually all left-leaning countries are moving toward greater independence from international financial institutions. Temporary agreements with the International Monetary Fund (IMF) on macroeconomic policy tend, in general, not to be renewed. Moreover, in a move that gained international prominence, Brazil and Argentina prepaid their outstanding debt with the IMF. The recent evolution of some regional accords

[1] Bolivia's launched an Agrarian Reform to redistribute 22 million of unused productive hectares to poor families. It is too early to tell whether these reforms will actually be fully implemented, and what will be their socioeconomic impact.

has been complicated. Indeed, for example the Andean Community has suffered the withdrawal of Venezuela, though partially compensated by Chile. And the Free Trade Area of the Americas (FTAA) project seems to have stalled. In any case, regional integration is still seen as a more attractive option for increasing commerce than bilateral trade agreements with the United States. On the multilateral front, in contrast with the passivity in previous rounds, the New Left governments play an increasingly active role. It is clear now that the negotiations of the Doha Round face a grim future unless developed countries agree to open their agricultural sectors and to eliminate agricultural subsidies..

Exogenous Risks: The Global Imbalances

There are two scenarios that, in our view, should be first explored regarding the likely medium-term evolution of the world economy and its impact on Latin America. The first is characterized by a, say, “soft landing” of the United States’ economy coupled with a continuation of a rather strong growth of the European Union, the Chinese and other Asian economies so that world trade keeps expanding at a relatively solid rate. This scenario implies that the region will face no significant adverse shocks and, thus, its macroeconomic policies will not be particularly challenged. If the boom in commodity prices does not loose impetus, governments in the Southern Cone will continue to be pressed to avoid the appreciation of the real exchange rate. If the expansion of world trade does decline, the whole region will then continue to be pressed to meet the challenge presented by China in international markets, and may implement policies to boost production of tradable goods and value-added services, as well as of commodities and inputs that the Chinese market demands.

The alternative scenario assumes that the fiscal and current account imbalances in the US economy soon become un-manageable, and lead to a recession combined with substantial turmoil in the exchange rate matrix. In this case, the Latin American economies will be dramatically urged to accommodate a fast depreciation of the dollar, a slowdown in its GDP growth, and an increase in interest rates. This adverse scenario will pose a major challenge for macroeconomic policymaking in the region, with some countries most likely unsuccessfully fighting to avoid acute destabilization and recession.

Conclusions

With the exception of Chile’s Concertación, New Left governments in Latin America are recent arrivals on the real practical policymaking arena. Assessing and predicting the impact of their macroeconomic policies is thus an exercise in audacity and of a partial and preliminary nature. With this caveat, it is safe to conclude that so far Latin America’s New Left’s policies are not in a populist, free-spending mode that ignores budgetary constraints. On the contrary, New Left governments have shown strong fiscal prudence, an increasing state intervention in economic affairs and a commitment to avoid the persistent appreciation of the real exchange rate. This is particularly true of governments that, concerned with employment problems, try to stimulate job creation in export-oriented sectors.

Concerning the trade-off between inflation and economic growth, the New Left governments seem inclined to accept – within limits – higher inflation if it is accompanied by higher rates of economic growth. They emphasize the need for macroeconomic policies guided by development goals and not merely by price stabilization. In practice, their approach to achieving key social goals – poverty alleviation, income redistribution – has been gradual. They have not implemented high-impact social measures that run the risk of triggering large fiscal imbalances and debt spirals. Minimum wage increases have been rather reasonable, and trade liberalization measures have not been rolled back. The starkest innovations on policy matters concern relations with international financial institutions and some transnational corporations regarding the distribution of rents in activities that are intensive in the use of mineral resources. To achieve greater degrees of freedom in macroeconomic policymaking, governments have lowered the public debt ratio, rescheduled public debt maturity structures, issued bonds denominated in local currency, and, most notably, run high primary fiscal surpluses to improve debt sustainability.

The constraints that Latin American governments – left-wing and center/right-wing – face are formidable. Radical, drastic changes in macroeconomic policies are likely out of the question, given the weakness of public sector revenues and the commitment to trade liberalization and the free movement of capital flows. Nevertheless, certain changes in the composition of public expenditure, as well as in policies to promote innovation and to develop specific sectors, could lead to very different and positive outcomes in the medium term.

Perhaps the main risk today is having a big gap between what is expected from the New Left governments in terms of social and economic development and what they will actually achieve. A large credibility gap may undermine support for New Left governments, and lead society to push for more radical – left-wing or right-wing – governments. In our view, the Left today in Latin America is in the process of building a new paradigm of economic development policies. Whether it will succeed in doing so is unclear. In other words, and contrary to the opening statement in the title of this essay, the New Left macroeconomic policies seem to be more a case of “new wine in new bottles”. Whether this wine will age gracefully and have a rich and memorable taste or, on the contrary, sour and decay is too early to know.

Table 1
Latin America: Macroeconomic indicators of selected countries

	GDP real, average growth rate (%, estimates for 2006)					Inflation (annual growth rate, %)				Fiscal Balance (% of GDP)			
	2000	2003	2004	2005	2006	2000	2003	2004	2005	2000	2003	2004	2005
Argentina	-0.8	8.8	9.0	8.6	7.5	-0.7	3.7	6.1	12.0	-2.1	0.3	2.0	1.3
Bolivia	2.5	2.8	3.6	3.8	3.3	3.4	3.9	4.6	5.0	-3.9	-7.9	-5.7	-3.5
Brazil	4.4	0.5	4.9	2.5	3.4	6.0	9.3	7.6	6.2	-3.1	-2.5	-1.3	-1.7
Chile	4.5	3.7	6.1	6.0	5.5	4.5	1.1	2.4	3.6	-0.6	-0.4	2.2	3.4
Colombia	2.9	4.3	4.0	4.3	4.2	8.8	6.5	5.5	5.1	-5.4	-4.7	-4.3	-5.5
Mexico	6.6	1.4	4.2	3.0	4.0	9.0	4.0	5.2	2.9	-1.3	-1.1	-1.0	-1.2
Peru	2.9	4.0	4.8	6.0	5.6	3.7	2.5	3.5	1.1	-2.8	-1.8	-1.3	-1.2
Uruguay	-1.4	2.2	12.3	6.0	4.0	5.1	10.2	7.6	4.8	-3.5	-4.6	-2.5	-2.5
Venezuela	3.7	-7.7	17.9	9.0	7.0	13.4	27.1	19.2	15.3	-1.7	-4.4	-2.0	-1.5

Source: Authors’ own elaboration based on official data from ECLAC

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Forum on Economic Reform (Part VII)

Latin America: The End of an Era[1]

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The changes that have taken place in Latin America in recent years are part of an epoch-making transformation. To borrow from the Cold War framework that still prevails in U.S. foreign policy circles: we have witnessed the collapse of the Berlin Wall, and the formation of newly independent states. A region that has been dominated by the United States for more than a century has now, for the most part, broken away. Of course there are still strong commercial, political, cultural and even military ties; but as in the states of the former Soviet Union after 1990, these do not have the same economic or political implications that they had a decade or even a few years ago.

These changes seem to have been largely misunderstood – and vastly underestimated – across the political spectrum. They are certainly noticed. Hardly a day goes by without prominent warnings that the region – or at least a good part of it – is on the road to "populist" ruin, or worse. On the right – including the Bush administration – this process is viewed through a Cold War prism, a Castro-Chávez-Evo Morales axis that poses a strategic threat to the United States. Imagined or implied links to terrorism and the drug trade (little or no evidence is provided) are sometimes added for effect, as when the State Department cut off arms sales to Venezuela on May 15 for "lack of cooperation" in fighting terrorism.

The liberal/center views are less bellicose, but similarly pessimistic about what is happening in the region. *Foreign Affairs* has run three articles since the beginning of the year warning of the dangers of Latin America's left-populist drift, as well as sorry state of U.S.-Latin American relations. The news reports, editorials, and op-ed pages of America's major newspapers mostly carry the same themes.

But from the point of view of the vast majority of the hemisphere, including people in the United States, there is actually much to be optimistic about. As French President Jacques Chirac noted during a recent visit to South America, "there is a strong movement in favor of democracy in Latin America, a movement that is growing." He added that the newly elected leftist presidents cannot be cause for concern because they were elected in free democratic elections. Furthermore, there is every reason to believe that the changes of the last few years will not be reversed, and that the region will continue in the direction of further economic and political independence, diversification of trade and finance, some regional integration, and more successful macroeconomic policies. Not all of these economic policies and experiments will succeed, but most importantly it appears very possible that Latin America's long quarter-century of economic failure will be reversed in the foreseeable future, and that its hundreds of millions of poor people will be among the main beneficiaries.

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[1] To be published in the *International Journal of Health Services,* Vol. 36, No. 4 (2006)

Causes and Consequences: Latin America's Long-Term Economic Failure

The most important cause of Latin America's regional leftward shift has been vastly misunderstood: it is the long-term economic growth failure in the region. This is something that even most critics of "neoliberalism" – a one-word description of the last quarter-century's economic reforms that is more common in Latin America than it is here – have barely mentioned. Most often we read that these reforms have been successful in promoting growth, but that too many people have been left behind and that poverty and inequality have worsened, leading to political unrest.

This explanation misses the most important, indeed historic change, that has taken place in Latin America over the last 25 years: the collapse of economic growth. If we ignore income distribution and just look at income per person – the most basic measure of economic progress that economists use – the last quarter-century has been a disaster. From 1960 to 1980, per capita income in Latin America grew by 82 percent, after adjusting for inflation. From 1980 to 2000, it grew by only 9 percent; and for the first five years of this decade (2000-2005), growth has totaled about 4 percent. To find a growth performance in Latin America that is even close to failure of the last 25 years, one has to go back more than a century, and choose a 25-year period that includes both World War I and start of the Great Depression.

Of course, Latin America also has the worst income inequality in the world. The contrast between the luxury condos in the Barra da Tijuca neighborhood of Rio de Janeiro and the favelas in the hillsides where the police fear to tread, or between the poor barrios of Caracas and the wealthy estates of Alta Mira jumps out at you. But inequality in the region has not increased dramatically over the last 25 years. It is the growth failure that has deprived a generation and a half of any chance to improve its living standards.

And without growth, it is very difficult to do anything about inequality or poverty. If the economy is growing rapidly, it is at least possible to redistribute some of the increases in income and wealth towards those who need it most. When it is not growing, any gains for the poor must be taken from someone else – something that is difficult to do without violence.

Poverty and inequality are glaringly obvious in Latin America, and take the form of flesh and blood, street children and beggars – whereas economic growth is an abstract concept that most people do not follow. So it is understandable that the main cause of Latin America's political changes is overlooked. But economic growth – which is primarily defined by increases in productivity, or output per hour of labor – is vital, especially over such a long period of time. It is the main reason that we live better than our grandparents. Mexico would have average living standards at the level of Spain today if its economy had simply continued to grow at the rate that it grew prior to 1980. There would be far fewer Mexicans willing to take the risks of illegal immigration to the United States. Since these pre-1980 growth rates were good but not spectacular (e.g. as compared to South Korea or Taiwan), there is no obvious reason that they shouldn't be the relevant level of comparison.

In Washington, policy-makers engage in a special form of denial about Latin America's economic failure. After all, they have gotten most of what they wanted: restrictions on international trade and drastically reduced investment flows. Public enterprises have been privatized, even including social security systems in many countries. Governments are running tighter budgets and central banks are more independent and tougher on inflation. The state-led industrial policies and development planning of the past have been abandoned.

But the cumulative results have been an economic disaster, and so it is not surprising that presidential candidates who campaigned explicitly against “neoliberalism” have in recent years won elections in Argentina, Bolivia, Brazil, Ecuador, Uruguay, and Venezuela. The question of which policies contributed to the many and varied national economic failures is more complex, and the possible alternatives for restoring growth and development – only now beginning to be explored – vary greatly by country. But it should be clear that what we are now witnessing is a response to this epoch-making economic failure, and – following a series of revolts at the ballot box, and some in the streets – a number of governments looking for more practical and effective ways to make capitalism work.

The long era of “neoliberalism” in Latin America has not yet come to an end – that end is just beginning, for reasons discussed below. What really defines this as a new era is that the influence of the United States in a region that was until very recently its “backyard” has plummeted so rapidly, drastically, and probably irreversibly, that the current situation is truly unprecedented in the modern history of the hemisphere.

This is a dramatic change, especially if we consider that Washington in the 1980s spent billions of dollars, and supported the murder of tens of thousands of innocents, just to keep control over a few small, economically insignificant countries in Central America. President Clinton issued a rare public apology for the United States’ role in what the United Nations determined to be genocide in Guatemala, and Washington’s participation in the mass slaughter of El Salvador and the destruction of Nicaragua was even greater and more direct. Yet in the last few years these same people – literally in the case of such current and recent administration personnel as Elliot Abrams, Otto Reich, and John Negroponte – have watched almost helplessly as the bulk of the region, in population and economic terms, has slipped out of their grasp.

The Collapse of a Cartel

One reason the historic nature of these changes has not been appreciated is that Washington’s most powerful influence over the region – especially in the realm of economic policy – has never gotten much attention. And that particular influence has now quietly collapsed. Until recently the International Monetary Fund (IMF) headed a powerful creditors’ cartel that was arguably more important than Washington’s other levers of power – including military, para-military, diplomatic and other “soft power” projections such as foreign aid and “democracy promotion” programs. This cartel was not a conspiracy but rather an informal arrangement – not written into law or into the charters of the participating financial institutions – but nonetheless generally very effective.

The way it worked is that the IMF was the “gatekeeper” for most other sources of credit for developing country governments. If a government did not reach an agreement with the IMF, it would not be eligible for most lending from the World Bank, regional banks such as the important Inter-American Development Bank in this hemisphere, G-7 government loans and grants, and sometimes even the private sector. The 184-member IMF has always been dominated by the U.S. Treasury Department. Technically, the other rich countries, including European nations and Japan, could outvote the United States (voting is proportional to a quota system of contributions which gives the rich countries a huge majority) but this has virtually never happened over the last 62 years. During the last 25 years especially, this creditors' cartel was enormously influential in shaping the "Washington Consensus" policies that were adopted throughout Latin America and most other low and middle income countries. It extended far beyond just the raw power of using control over financial resources to influence policy.

As has been known for decades, the IMF acting as gatekeeper and enforcer of "sound economic policy" allowed the United States (and sometimes the other rich countries) to operate through an ostensibly multilateral, neutral, technocratic institution when pressuring developing country governments to privatize their natural resources or run huge primary surpluses to pay off debt. It is much more politically delicate for U.S. officials to publicly tell sovereign governments what to do. And as we witnessed in the recent Argentine debt restructuring, individual creditors – even big banks – do not have all that much power against a government that is willing to go to the brink. In a default situation, it is in their individual interest to settle for what they can get, cut their losses, and look to the future. It takes an external enforcer – outside of the market – to hold the threat of future punishment over the offending government, in the interest of the creditors as a class.

This arrangement began to break down in the wake of the Asian economic crisis of the late 1990s, after which the middle-income countries of that region piled up huge foreign exchange reserves. They had suffered through a terrible and humiliating experience with IMF-imposed conditions during the crisis, and although the post-crisis accumulation of reserves had other causes, it also ensured that they would never have to take the Fund's advice again.

But it was in Latin America that the IMF was reduced to a shadow of its former self. Argentina defaulted on $100 billion of debt at the end of 2001, the largest sovereign debt default in history. The currency and banking system collapsed, and the economy was continuing to shrink. Almost everyone assumed that the government would have to reach a new agreement with the IMF and receive an injection of foreign funds in order to get the economy growing again.

But a year went by without any agreement, and when it was finally reached there was no new money. In fact, the IMF took about $4 billion net – a huge sum amounting to four percent of GDP – out of the country during 2002. Yet in defiance of the experts, the Argentine economy contracted for only three months after the default before beginning to grow. Four years later it is still growing quite rapidly. In fact it has grown at the highest rate in the hemisphere, more than 9 percent annually for three years, despite a continued net drain of money out of the country to pay off the official creditors (the IMF, the World Bank, and the Inter-American Development Bank) that reached more than $14 billion between 2002 and 2005.

The Argentine government under Nestor Kirchner, who took office in May 2003, also enacted a series of unorthodox economic policies that were strongly opposed by the Fund, including a hard line in bargaining over defaulted debt, which invoked hostility from the international business press, along with predictions of prolonged economic punishment and stagnation. In one of a number of showdowns with the Fund, Argentina even temporarily defaulted to the IMF itself in September of 2003 – an unprecedented and uncharted move that had previously only been made by failed or pariah states such as Congo or Iraq. Default to the Fund had hitherto carried the threat of economic isolation, even the denial of export credits necessary for trade. But the world had already changed, and the IMF backed down. Argentina's long battle with the Fund – from the disastrous four year depression, brought on and exacerbated by IMF-backed macroeconomic policies, through the standoff of 2002, and the economy's subsequent rapid recovery on its own – was the final blow to not only the Fund's credibility as an economic advisor, but as an enforcer.

How much difference does the collapse of this creditors' cartel make? Consider Bolivia today, where the leftist, indigenous former leader of the coca growers' union, Evo Morales, was elected with the voters' largest mandate ever in December. He promised to nationalize the country's energy resources --it was really more of a return to constitutionality, since the current contracts with foreign energy companies were not approved by the congress, as required by the constitution – which account for the biggest chunk of its export earnings, and to use these resources to increase the living standards of the country's poor and indigenous majority. On May 1st, Morales announced that the government was indeed nationalizing the gas and oil industry, and that foreign companies would have six months to renegotiate existing contracts. Many details remain to be worked out, and the situation is complicated by the fact that Petrobras, the state-run Brazilian energy company is the largest gas producer, and that Bolivia can only export natural gas (which is the main energy export) by pipeline to Argentina and Brazil. But the Bolivian government has already increased its revenue from the gas producers, from 3.4 to 6.7 percent of GDP as a result of last year's hydrocarbons law. The increase amounts to a share of the economy comparable to most of the United States' federal budget deficit. The May 1st nationalization will increase these revenues even more, allowing the government to deliver on some of its promises to the poor.

The Bolivian government has since announced its intention to pursue an ambitious land reform program, which has also been met with hostility from the media. According to the ministry of rural development, over the next five years the government hopes to redistribute some 54,000 square miles of land, an area the size of Greece, to some 2.5 million people – about 28 percent of the population. The Bush administration had expressed its displeasure with the new government a couple of times, but until very recently has been relatively cautious about public statements ever since the U.S. Ambassador's denunciation of Morales sent the charismatic leader surging in the polls and almost carried him to victory in the 2002 Presidential election. But on May 22, in an ominous new turn, President Bush told the press that he was "concerned about the erosion of democracy" in Bolivia and Venezuela.

There will be further frictions in the near future, not least over drug policy. Washington has pursued its coca eradication agenda in Bolivia for years with little regard to its political, economic, or environmental impact on an increasingly angry local population. Anyone who has been to Bolivia and seen how ubiquitous coca is there, from the coca tea in restaurants to the leaves that people chew as a stimulant and to relieve altitude sickness, can only imagine what it would be like if people in United States were told that they must co-operate in a "coffee eradication" program at the behest of a foreign government so as to help prevent foreigners from abusing the product. Most of Morales' electoral base wants to kick the DEA (the U.S. Drug Enforcement Agency) out of the country tomorrow. Morales has taken a moderate position, pledging to co-operate in the fight against cocaine and drug trafficking, while supporting the legalization of the coca plant and the development of new markets for legal products. The Bush administration will most likely find this unacceptable.

But what can Washington do about its new "problem" government? Not all that much. This is all the more unprecedented because Bolivia is not Venezuela, the world's fifth largest oil exporter, nor Argentina, which until the late 1990s depression had practically the highest living standards south of our border. It is not a giant like Brazil, with a land area as big as the continental United States. It is the poorest country in South America, with nine million people and an economy not even one-thousandth the size of the United States', at current exchange rates. It is poor and indebted enough to have qualified for the IMF/World Bank HIPC (Heavily Indebted Poor Country) debt cancellation initiative, and in fact had its IMF and World Bank debt – about 35 percent of the country's total foreign public debt – cancelled this year after passing through the requisite gauntlet of conditions for several years.

But Bolivia is a free country now. On March 31, after twenty straight years of operating continuously (except for eight months) under IMF agreements – and a real per capita income amazingly less than it was 27 years ago – Bolivia let its last agreement with the IMF expire. The government decided not to seek a new agreement with the Fund. One of the first questions that arose was, what about money from other sources? Bolivia receives not only loans but grants from the governments of high-income countries, and until now even grants from the more liberal European countries were contingent on Bolivia meeting the IMF's approval. But it appears that this requirement has disappeared along with the IMF agreement. The Bush administration cut military aid – an insignificant $1.6 million – and may reduce other aid flows related to anti-drug efforts. The Spanish government expressed some concern over Bolivia's nationalization of the gas industry, since Repsol YPF, Spain's largest oil company, is the second biggest producer there. But so far none of the rich country governments have tried to use the threat of cutting off loans or grants as a mean of trying to change Bolivia's policies. Such a threat, or even an actual aid reduction, would almost certainly not alter the government's behavior; it would therefore be useless and counter-productive from their point of view.

The fact that we have arrived at such a situation illustrates how dramatically hemispheric relations have changed. A few years ago, a government like that of Evo Morales would have had a pretty short life expectancy. Washington would have had the ability to economically strangle the country, as it did to Haiti in order to topple the democratically elected government there just two years ago. The government of Haiti, which was overwhelmingly dependent on foreign aid flows, was cut off from virtually all international funding from 2001 on, thus assuring its ultimate downfall in the U.S.-backed coup of March 2004. For very poor countries and especially those that are without allies or media attention, the old rules may still apply – although even that is beginning to change. And in many low-income countries, for example in Africa, major economic policies are still subject to IMF approval.

But the Fund has lost its influence in middle-income countries, and that includes almost all of Latin America. Although it has received little attention in most of the media, the collapse of the IMF-led creditors' cartel is by itself probably the most important change in the international financial system since the end of the Bretton Woods system of fixed exchange rates in 1973. This is especially true for developing countries.

In Latin America this has coincided with a major and unanticipated change that, combined with the IMF's loss of influence, has helped usher in the new era of independence. A new international lender has emerged: Venezuela. When Argentina decided last December to say its final goodbye to the IMF by paying off its remaining debt of $9.8 billion (5.4 percent of GDP) at once, Venezuela committed $2.5 billion to the cause. "If additional help is needed to help Argentina finally free itself from the claws of the International Monetary Fund, Argentina can count on us," Chávez announced on December 15. Kirchner's statement announcing the decision was even harsher: "[the IMF has] acted towards our country as a promoter and a vehicle of policies that caused poverty and pain among the Argentine people," he said. Last year Venezuela also committed to buying $300 million of Ecuador's bonds; in December, it turned out that Ecuador had sufficient demand for its bonds that it only needed to sell $25 million to Venezuela, but the latter's commitment was there as a lender of last resort. Chávez has proposed to formalize this new relationship by establishing a "Bank of the South," to finance development in the region, and offered to start it off with a $5 billion contribution. In the meantime, Venezuela is also providing discounted oil financing for the Caribbean countries under its PetroCaribe program.

The result for Bolivia is that despite its poverty and underdevelopment, the new government will not have to worry too much about whether the United States approves of what it is doing with regard to foreign energy companies, trade negotiations (a bilateral trade deal, long sought by Washington, is now pretty much dead), macroeconomic policies, or drug policy. Any aid cuts from Washington, Europe, or international lending agencies will be more than replaced by Venezuela. When Bolivia was about to lose $170 million in soybean exports to Colombia as a result of the latter's decision in April to sign a bilateral trade agreement with the United States, Venezuela stepped in as a replacement buyer. Such is the paradox of the new hemispheric order: it is now even easier for a small, poor country to reject "the Washington Consensus" than it is for larger, middle income countries to do so – although the choices for all have been greatly expanded. Venezuela has more than $30 billion in foreign exchange reserves; whatever Bolivia might need will be pretty small relative to Venezuela's capacity for lending and aid. In just the last month (May), Venezuela has announced a $100 million loan to Bolivia and a similar amount to support the proposed land reform, as well as numerous other forms of aid. And Venezuela's lending and aid programs, unlike that of the international financial institutions or the G-7 governments, do not have economic policy conditions attached to them. This makes all the difference in the world.

Viewed through the Cold War lens of official Washington and the foreign policy establishment, these disbursements and initiatives are either as part of an attempt to build an "anti-American" axis, or, as Chávez simply buying friends in the region. Chávez himself, who has named his revolution after the 18th century liberator Simon Bolivar, sees it as freeing South America from the grip of the U.S. empire. But regardless of how it is seen in ideological terms, the impact of this alternative source of financing has already had an enormous impact on the ability of governments to ignore pressures from Washington. This trend is likely to continue unless there is a sudden and very severe collapse of oil prices.

There are two other important economic changes that will reinforce Latin America's drift away from the United States in the coming years. One is that the United States will no longer provide a rapidly growing market for the region's exports, as it has in the past. The reason is that the United States is running a record trade deficit, now more than 6 percent of GDP, that almost all economists recognize must adjust over the next decade. The United States does not have to balance its trade, but the deficit must fall to a level that allows the U.S. foreign debt to stabilize, rather than growing at an explosive rate. If the U.S. trade deficit were to remain at its current level, in 18 years the U.S. foreign debt would exceed the value of our entire stock market. This is not going to happen; instead, the dollar will fall and the deficit will be reduced. But one consequence of this adjustment is that the U.S. market for imports, measured in non-dollar currencies, will barely grow or possibly even decline. This means that Latin American countries hoping to expand their exports to the U.S. in the near future will mainly have to displace other exporters, which will be very difficult. So the United States does not have so much to offer in its proposed bilateral trade agreements. On the other hand, it is demanding concessions that are economically costly, as in the areas of patented medicines, where Washington insists on even stronger protectionism than is afforded by the World Trade Organization; and politically costly, as in agriculture, where the demands for opening up to subsidized exports from the U.S. have sparked considerable political opposition in most countries in the region.

At the same time, just as the growth of the U.S. import market will be slowing to a standstill, another market to which Latin American countries can export is expected to grow by about $1 trillion Euros over the next decade: China. This will reinforce the decline in the United States' relative economic importance to Latin America. Perhaps even more importantly, China has the potential to be an enormous alternative source of financing for investment in Latin America. So far the Chinese have proceeded relatively slowly; but they have discussed plans for $20 billion worth of investment in Argentina, for example, including major investments in railroads and infrastructure. The Chinese government now holds more than $800 billion in foreign exchange reserves. Most of this money is sitting in U.S. treasury bonds, where the government has lost tens of billions of dollars in the last few years – both from currency changes, as the dollar has fallen against other currencies, and capital losses, as U.S. long-term rates have risen. These trends are likely to continue. Until now, the Chinese have held these bonds as part of their overall economic strategy, which presumably has included keeping U.S. long-term rates low so as to support the economic recovery here (since 2001) and therefore increase demand for their exports. But this strategy will not persist indefinitely. As it stands now, the Chinese could invest hundreds of billions of dollars in Latin America, get a zero return on their investment, and still come out ahead as compared to their present strategy of holding U.S. treasuries. In reality they would most likely get a positive return. The Chinese are already interested and investing in energy and extractive industries to secure supplies of these materials for their booming economy. But as an emerging economic superpower, they may also come to see it as part of their strategic interest to have closer political and economic ties with Latin America. This would be especially true if current tensions between the United States and China get worse, but it is likely to happen in any case.

The energy and extractive industries in Latin America have also been deeply affected by the shift in regional power relations, with important economic and political implications. Although the run-up in energy prices has provided a strong incentive for governments throughout the region – including Venezuela, Bolivia, and Ecuador – to renegotiate their contracts and legal arrangements with foreign corporations, such moves would be more risky and probably less successful if the IMF consortium, and the United States government, had the power that it wielded just a few years ago. On May 16, the Venezuelan Congress voted to double the royalties on joint ventures with foreign oil companies, from 16.7 to 33.3 percent, thus increasing the government's total take to 50 percent. This was the second major hike for this heavy oil production, which a few years ago paid royalties of only 1 percent. The government is also demanding a controlling 60 percent stake in four joint ventures with foreign oil companies that account for about one-fifth of Venezuela's oil production. In Bolivia, even before the May 1 nationalization decree, last year's hydrocarbons law had already added hundreds of millions of dollars to the government's revenue by increasing taxes and royalties.

On May 16 the government of Ecuador announced that it would seize an oil field from Occidental Petroleum, the fourth largest U.S. oil company, as a result of a dispute in which Occidental is alleged to have illegally transferred part of an oil block that it operated to a

Canadian company. Washington retaliated almost immediately by announcing that it was suspending negotiations with Ecuador over a proposed bilateral trade agreement. It's not clear how much of a punishment this is – the negotiations had already become a big political liability for the government. In March, indigenous groups staged 11 days of protests – including highly disruptive roadblocks – demanding a halt to the negotiations, as well as a national referendum on whether to proceed, suspending the protests only after the government declared a state of emergency. On May 28, President Chávez announced that he would meet with Ecuador's President Palacio to expand Venezuela's energy ties to Ecuador and its state-owned oil industry, Petroecuador. One proposed accord would allow Ecuador to refine oil at Venezuelan-owned refineries, which according to press reports could save Ecuador some $300 million a year.

National control over energy and other natural resources – and demands that these resources be used to benefit the poor majority – played a major role in the revolutions at the ballot box in both Venezuela and Bolivia. In Venezuela it was the driving force: although Venezuela has had a state-owned oil company since 1976, by the 1990s it was turning over so little revenue to the government that the state was not fiscally viable. Something had to give, but it was not until the elected government of Hugo Chávez had gone through a U.S.-backed military coup (2002) and an economically devastating oil strike (December 2002-February 2003) that the government finally gained control over its own nationalized oil industry. In Bolivia, mass discontent over the privatization and looting of the country's natural resources helped bring down two presidents and contributed to the election of Evo Morales. In Peru, populist candidate Ollanta Humala took first place in the first round of voting, partly by promising to get a bigger share from foreign mining and energy companies and use it to benefit the poor. With some of the largest mining companies there exempt from royalties altogether (although they pay other taxes), there is plenty of room for negotiation.

These struggles by various governments to capture more of the rents from energy and natural resources are likely to continue. Latin America's newfound economic and political independence has increased its bargaining power, and there is increasingly less reason to concede any more to foreign producers than is necessary to make use of technology that these governments need. The shift in power relations has already provided billions of dollars of gains to the region, and there is likely more to come.

A Brighter Future

Despite the consternation in Washington, the collapse of U.S. influence in Latin America has already brought important and tangible positive results. In Argentina, almost 8 million people – 18 percent of the population – have been pulled over the poverty line as a result of the rapid economic recovery there – the demise of which has been predicted by most economists and the business press practically every month since it began four years ago. In order to achieve this extraordinary economic success, the government had to implement a number of unorthodox economic policies that were vehemently opposed by the IMF, most of which were presented as reckless and wrong in the international business press. This included not only hard bargaining to clear away about two-thirds of the country's foreign public debt, but also some macroeconomic policies that were essential to the recovery, including maintaining a stable and competitive exchange rate and lower interest rates. The government also refused to raise utility prices as demanded by the foreign owners and their governments (with the IMF as an advocate). More recently, the Kirchner administration instituted price controls to stem inflation rather than sacrifice employment and income by slowing the economy, as has become the norm in macroeconomic policy. The Argentine recovery is a remarkable achievement, one that both helped clear the path towards regional independence, and then continued to flourish in the new environment. It is easy to see how much weaker it might have been, or even collapsed altogether, had the government simply followed the orthodox advice that had been accepted in the past. At the same time, Kirchner has won high praise among human rights groups for revoking the impunity of military officers who committed atrocities during the brutal 1976-1983 dictatorship.

Venezuela has also had notable successes, most importantly in providing free health care for the first time to an estimated 54 percent of the population, mostly poor people, as well as subsidized food for more than 40 percent, and increased access to education. It is common to attribute these successes to high oil prices, but oil prices were even higher in the 1970s in real terms, and the country's GDP per capita actually fell during that decade. Chávez is best known – and reviled – in the international media for his confrontation with the Bush administration, but at home his unshakable popularity derives mainly from delivering on his government's promise to share the country's oil wealth with the majority of Venezuelans. And even aside from distribution, it must be recalled that the Venezuela suffered one of the worst economic declines in the region (and the world) – a 35 percent drop in per capita income from 1970-1998, prior to Chávez' election. The current government, which took office in 1999 and is almost certain to be re-elected in December, will probably be most remembered as the one that finally reversed Venezuela's long-term economic deterioration. The economy has recovered remarkably after stability finally returned to the country, following several opposition attempts to overthrow the government through a military coup and oil strikes. In just the past two years it has grown by more than 28 percent and it is still booming.

Bolivia, too, seems poised to reverse its long economic stagnation and begin to meet the needs of its poor, indigenous majority. It has created a new water ministry with the goal of providing clean drinking water to everyone, as well as water for agriculture. The increased revenue from control over its natural resources should make this, as well as the proposed agrarian reform and other anti-poverty programs, feasible.

Of course, all of these governments are still a long way from coming up with a sustainable, long-term development strategy. This is not necessarily because they don't want one, but mainly because – after decades of corrupt rule, as well as the deliberate shrinking of the state's capacity for economic regulation and decision-making – they simply don't have the administrative capacity to even make such plans, much less implement them. That is why even in Venezuela, where President Hugo Chávez talks about "21st century socialism," the private sector is a larger share of the economy today than it was before he took office. The Venezuelan government, contrary to popular perceptions, has embarked on a project of gradualist reform, experimenting with land reform, some production and credit co-operatives, and microcredit programs – but officials are very aware of the limitations of the corrupt and debilitated state that they inherited. In Argentina, which has a more developed economy, there is still little to nothing in the realm of development planning or industrial policy that could lead to the sustained growth and development of the Asian success stories, or perhaps even that of Latin America's pre-1980 past.

Nonetheless the renewal of economic growth, made possible by more sensible macroeconomic policies, is a vitally important beginning. It is a necessary but not sufficient condition for long-term economic and social progress in the region. And it is likely that more changes will follow as the various new experiments achieve success. The increased control over energy and natural resources, and a new commitment to poverty reduction, health care and education – as in Venezuela and Bolivia – are also important first steps, not only in their own right but also for the sake of democracy. Although both the Morales and Chávez governments are accused of authoritarianism by their detractors – which in Venezuela's case includes almost everyone who has access to large media outlets – from a more objective viewpoint, what we are witnessing is a revival of democracy. This is most obvious in the sense that people are actually getting what they voted for – in terms of social and some economic policy. It is for this reason that Venezuela came in first last year when one of Latin America's best polling firms, Latinobarómetro, asked people in each country how democratic their government was. On the question of how satisfied people were with their country's democracy, Venezuela came in second, after Uruguay.

Ironically, Latin American countries in the age of dictators had more national control over their economic policies than they have had since formal democratization, and therefore much more successful development and rising living standards under dictatorships. Hence the long term trends, now beginning to reverse, of citizens losing respect for democracy in Latin America – after 25 years of losing ground under democratic governments.

Fortunately, the mass discontent, organization, and revolt at the ballot box has not been aimed at a return to authoritarian government but rather its opposite, demands for an extension of democracy to include social and economic policy, as well as the increased participation of previously marginalized groups – the poor in Venezuela, the indigenous in Bolivia. The recent mass protests in Ecuador against the proposed trade negotiations with the United States should also be seen in that light. So too, the waves of mass organization that brought Evo Morales to power, and are actively encouraging the government to pursue pro-poor and pro-indigenous economic policies.

But it is not only in the countries that have already changed their economic and social policies that the impact of this huge shift in hemispheric relations is relevant. Consider Brazil, which continues to provide a classic example of the failure of "neoliberal" policies in Latin America. Brazil was once a fast-growing developing country: income per person grew by 123 percent from 1960-1980. But over the last 25 years, it has averaged about 0.5 percent annually. The country's president, Luiz Inácio Lula da Silva of the leftist Workers' Party, was elected in 2002 on a platform that promised to restore economic growth through lower interest rates, implement industrial and agricultural policies, and return to a national development strategy. The Workers' Party also promised redistributive policies to help the poor, in a country that has perhaps the most unequal distribution of income on the planet.

Since taking office, however, Lula's government has steadfastly maintained the economic policies of his predecessor, Fernando Henrique Cardoso, and achieved the same sluggish growth. Interest rates set by the Central Bank are currently at 15.75 percent (compare this to our own at 5 percent, after the Fed has raised interest rates 16 consecutive times). The country's currency is very much overvalued, which makes imports artificially cheap, and therefore makes it difficult for Brazilian industry to compete in either domestic or international markets. The federal government is paying off debt to the tune of more than 7 percent of GDP annually, leaving little in the way of funds for any anti-poverty initiatives.

But it is important to understand that these policies are the result of Brazil's internal politics, and the United States today has little to do with it. In almost every country there are conflicting interests over economic policy, especially monetary policy, between the financial sector and nearly everyone else. Bondholders, banks, and creditors generally do not have the same interest in economic growth that most people have. For the vast majority of people, more rapid growth means a better chance at employment and higher income. For the financial sector, economic growth is primarily seen as a threat of increased inflation, which lowers the value of bonds. This is a conflict of interest in the United States too, as the Fed sometimes raises interest rates and slows the economy when most people who have a stake in a growing economy would not do so. Brazil has an extreme form of this problem, in that this overwhelming political dominance of the financial sector – which prevails in all of the major political parties – has led to a prolonged period of stagnation and slow growth that the economy cannot seem to improve upon. For the financial sector, the 2.3 percent growth (about 1.2 percent per capita) of last year is considered to be just right, even if it does not create enough jobs to match the new entrants to the labor force.

Washington is very pleased with Lula's government, and has been supportive, including at key points in the corruption scandal that has engulfed the government and led to the resignation of Lula's chief of staff, finance minister, and top party officials. The international press is also very pleased, as have been the international financial markets – in fact the markets were quite nervous at the prospect of Lula's impeachment because his vice president, the conservative Jose Alencar, has committed himself to lower interest rates. So there is much international support for the current set of economic policies, but when there is a Brazilian government that decides to go in another direction, there will be little that anyone can do to prevent it. Last December, Brazil paid off its entire debt to the IMF, which was one the largest in the world owed to the Fund, at $15.6 billion dollars.

Furthermore, Lula's government has not been all that supportive of U.S. foreign commercial policy. Brazil was one of the leaders of the rebellion in Cancun in 2003, when developing countries decided that they were not going to negotiate any more concessions to the rich countries in the World Trade Organization if the latter were not willing to commit to cutting their agricultural subsidies. (The Brazilian delegation was more conciliatory at the latest WTO ministerial in Hong Kong.) Brazil has also, together with Argentina and Venezuela, soundly rejected the proposed Free Trade Area of the Americas after ten years of negotiation; the rejection by this bloc has pretty much doomed the agreement.

Latin America's independence has been spilling over into other multilateral institutions as well. Chile and Mexico, two governments that the Bush administration counts among its favorites, killed the United States' proposed UN Security Council resolution to confer legality on its invasion of Iraq. Last May, Washington failed for the first time in nearly six decades to get its candidate elected to head the Organization of American States. After Washington's two failed attempts, the body elected Jose Miguel Insulza, who was supported by Brazil, Argentina, and Venezuela. The OAS met in June that year and promptly rejected a U.S. proposal to amend the Inter-American Democratic Charter that would have empowered the organization to evaluate the functioning of democratic institutions in member countries – a move that was widely understood to be directed against Venezuela.

Washington Confronts Venezuela

In U.S. foreign policy circles, there have been a number of approaches to Latin America's new independence. The main cause of the electoral shift – Latin America's unprecedented long-term growth failure – is almost never mentioned, although it is well known among economists. Instead there are acknowledgements that the reforms have been “disappointing,” or failed to sufficiently reduce poverty. The rise of nationalism and especially “populism” is seen as a cyclical phenomenon, one that will run its course as these governments drive away foreign investment, spend their way into debt crises, and pursue failed economic policies generally. Argentina’s economic recovery has been buried so many times in the business press over the last four years that it seems a miracle it has survived.

Latin America’s drift away from the United States is seen as a result of the Bush administration’s preoccupation with the Middle East, especially the war in Iraq, which has caused Washington to ignore this hemisphere. The administration is criticized for the “lack of attention,” for cutting foreign aid, and for alienating many Latin Americans with the Iraq war, demanding exemption of Americans from the International Criminal Court as a condition for military aid, failure to make progress on immigration reform, and other mistakes. Venezuela is seen as competing for influence in the region on the basis of its oil revenues; according to this view, its influence and its economic growth, as well as social programs for the poor, will collapse when the price of oil drops.

The foreign policy establishment also divides the elected leaders of the left into “market-friendly” vs. “populist,” or a “Right Left versus Wrong Left,” in the words of Jorge Castañeda in the May/June 2006 issue of *Foreign Affairs*. The “Wrong Left” is Chávez, Morales, and Kirchner – coincidentally the ones who have delivered most on their electoral promises; the “Right Left” is Lula, Michelle Bachelet of Chile, and Tabaré Vásquez of Uruguay.

And it is Chávez that has become Washington’s main enemy, even eclipsing Cuba as the demon to be overcome. Although it is recognized that the Bush administration has mishandled Venezuela, the Chávez government is still portrayed across most of the political spectrum, and especially in the press, as “anti-democratic,” “authoritarian,” and a threat to the region. Part of this is a result of our peculiar electoral system, which gives 900,000 Cuban-Americans in the pivotal state of Florida disproportionate influence on our presidential race and hemispheric foreign policy. But much is simply based on ignorance and some of the worst U.S. foreign policy journalism in decades.

In fact anyone who has been to Venezuela in recent years can verify that it remains, despite the extreme political polarization and the turmoil that wracked the country until recently, one of the more open and democratic societies in the Americas. The vast majority of the media, including the largest television stations, are controlled by the opposition. It is the most anti-government media in the hemisphere, and carries on political campaigns that would not be allowed in most western democracies. Indeed, even the United States would surely bring back the Fairness Doctrine if any of our major media outlets were to become the partisan political actors that they are in Venezuela, not to mention the Venezuelan media’s active participation in a military coup and other attempts to overthrow the government. The Venezuelan state is anything but authoritarian – in fact it is more of an anarchistic state, a weak state that suffers from all the problems that plague the rest of Latin America, in terms of enforcing the rule of law. That is why the main victims of political repression in Venezuela are not opposition partisans, even those who have tried to overthrow the government, but rather the pro-government activists organizing for land reform in the countryside, who have been murdered by the landowners’ hired guns. The state cannot enforce the law even against murderers, even to protect its own supporters.

No reputable human rights organization would claim that Venezuela has deteriorated in terms of democracy, human rights, or civil liberties under the Chávez government; nor that it compares unfavorably with the rest of the region in these areas. But the Bush administration has created an image of undemocratic government in Venezuela and has managed to frame it that way for the media.

The administration has also tried to isolate Venezuela, but has so far succeeded only in further isolating itself in Latin America. Lately the war of words between Venezuela and the United States has become more heated; last March U.S. Secretary of Defense Rumsfeld compared Chávez to Hitler. Chávez responded by comparing President Bush to Hitler and fixing his rhetoric at that level of animosity. This will likely continue; for Chávez, the anti-Bush, anti-imperialist rhetoric plays well both at home and throughout most of the region. As Larry Birns of the Council on Hemispheric Affairs noted at a recent Congressional briefing, Chávez has become “the mayor of the Latin American street.” That Chávez could increase his popularity with this kind of confrontational posture speaks volumes about how U.S. foreign policy is perceived in the region. And for Chávez there is nothing to lose: the Bush administration has done everything it could do to undermine and topple his government, and will continue to do so, regardless of anything he says or does.

It is easy to understand this if one looks at the recent historical evidence. First, the Bush administration not only publicly supported the April 2002 military coup against Chávez, it was actually involved in trying to make the coup succeed. This can be seen from CIA documents of March and April 2002, which show first of all that the Bush administration had advance knowledge of the coup. When it occurred, both the White House and State Department spokespersons publicly denied that a coup had taken place, falsely claiming that President Chávez had resigned, and before resigning had conveniently dismissed his Vice President and cabinet – so that the head of the Venezuelan Chamber of Commerce could take power and proceed to dissolve the Congress, Supreme Court, and the constitution. That fact that administration officials had prior knowledge of the coup and yet publicly lied about what was happening, in order to help the coup succeed, is an important form of involvement that has mostly gone unnoticed here. More supporting evidence comes from the State Department Office of the Inspector General, which found that that “NED [National Endowment for Democracy], Department of Defense (DOD), and other U.S. assistance programs provided training, institution building, and other support to individuals and organizations understood to be actively involved in the brief ouster of the Chávez government.” And from Jorge Castañeda, who stated that “there was a proposition made by the United States and Spain, to issue a declaration with Mexico, Brazil, Argentina and France recognizing the government of [coup leader] Pedro Carmona.” But the documentary evidence combined with the administration’s own statements leave no doubt about its involvement.

All this has been almost completely ignored by the major media outlets; when mentioned it is in the form of an “accusation” by Chávez – and not a very credible one – that the United States was involved in the coup. Furthermore, Washington did not admit its mistake and change course after supporting the coup, but rather stepped up its funding to anti-Chávez groups, also tacitly supporting the devastating opposition oil strike of 2002-2003, which ironically for the first time disrupted oil supplies to the United States and raised the price of gasoline here. This demonstrated again how much Washington was committed to “regime change” in Venezuela, by any means necessary. This commitment continued with funding for the recall effort in 2004, which Chávez won overwhelmingly. At that point a number of Latin American and European governments that had been sitting on the sidelines told the State Department to give it up – that this was a legitimate, democratic government and they should learn to live with it. But they did not.

The Bush administration attacked further with a series of economic sanctions against Venezuela (e.g. at multilateral lending institutions) which, as oil prices continued to rise, had no impact on Venezuela other than to further inflame passions there. Last December, the Venezuelan opposition boycotted national elections, despite statements from the OAS and European Union observers that opposition demands had been met and they were expected to participate. Once again, Washington was tacitly supportive. This more than any other recent action – beyond the economic sanctions, the blocking of military aircraft and patrol boat sales from Brazil and Spain, and a host of other provocations -- shows how firmly the Bush administration, along with its allies in the Venezuelan opposition, is committed to a strategy of destabilizing and overthrowing the Venezuelan government. The opposition could have won an estimated 30 percent of the National Assembly but – with Washington's blessing – gave that up just to establish the pretense that Venezuela is a one-party state. And so they have constructed an Orwellian reality, with help from the media, which now reports that "the [Venezuelan] Congress is completely controlled by President Chávez." The reader is not informed that this is only because the opposition deliberately and without any legitimate reason – according to OAS and European Union observers –refused to participate in a democratic and transparent electoral process.

These details are important because they show how mired Washington remains in the strategy and tactics of the past, how divorced our leaders are from the changed reality in the hemisphere. Indeed if one looks at the report of the U.S. Senate's Church Committee from 1975, on the CIA's destabilization efforts leading to the overthrow of Chile's elected government in 1973, it reads remarkably like the events of 2001-2003 in Venezuela. You just have to change the name Allende to Chávez, Chile to Venezuela, and substitute the National Endowment for Democracy and USAID for the CIA; a truckers' strike (in Chile) instead of an oil strike. In both cases, there is opposition control of the media so as to blame the government for any and all economic problems, even those caused by the opposition; and manipulation of the international press to portray an elected social democratic government as despotic and Communistic.

But this is a new world; Chávez remains as head of state, and without the country having sacrificed civil liberties or democratic rights – despite all that it has been through. That, too, is part of the new reality. Democracy is here to stay. As OAS Secretary General Jose Miguel Insulza told the *Financial Times* on May 22, "Latin America is not a baby. When the left or right win in Europe, nobody pronounces about the destiny of the continent or anything like that. You have to let the political process take its course." But that is the one thing Washington is least likely to do. Its refusal to accept the results of democratic elections in Venezuela will continue for the foreseeable future, and few if any leaders in Latin America will want to be seen as taking the Bush administration's side in this ongoing fight.

Most recently the U.S. media has made disputes between Latin American countries a major theme, putting forth the idea that current rifts will predominate any moves toward regional economic integration or independence from the United States. And of course Chávez is described as exacerbating these divisions. There is no doubt that there are real disputes and conflicts of interest: Argentina and Brazil must settle with Bolivia over the terms and conditions of the natural gas that they receive from Bolivia; Argentina and Uruguay are in dispute over the potential environmental damage from two paper mills on the latter's side of the Uruguay River; the government of Vicente Fox in Mexico has been in a fight with Chávez since he responded to an attack from Fox in November by calling him a "lapdog of imperialism." Peru withdrew its ambassador from Caracas in protest of Chávez' endorsement of Ollanta Humala in the current election; the winner, former president Alan Garcia denounced Chavez throughout his campaign and in his victory speech. But none of these conflicts are likely to disrupt the overall trends toward increased nationalism, regional cooperation, and independence from the United States. After Bolivia nationalized its energy industry on May 1, the Brazilian media was spoiling for Lula to start a fight with Morales on behalf of Petrobras, the Brazilian state-run energy giant that is the largest producer of Bolivia's gas. The pressure on Lula became so intense that at one point he turned to the press and said, "I haven't had a fight with George W. Bush; why should I fight with Evo?" Indeed, a fight with Evo Morales might be very disconcerting to Lula's political base, which sees Morales as a hero, a champion of indigenous rights and the poor. On May 4, Lula met with Morales, Kirchner, and Chávez and they issued a statement affirming Bolivia's "sovereign right" to nationalize its energy resources. It probably didn't hurt that Venezuela is buying $3 billion dollars worth of oil tankers from Brazil, which will create an estimated 10,000 jobs in an election year there; or that Venezuela is lending $2.5 billion to Argentina.

Lula has repeatedly defended Chávez and his government in public statements. "A president that wins elections, passes a constitution and proposes a referendum on his own presidency; holds a referendum and wins the election again – nobody can accuse such a country of not having democracy," he said last September. "Indeed it could be said that it has an excess of democracy."

So has Kirchner: on May 21, while the stories about Latin American disunity were reaching their peak in the major English language media, Kirchner told the press: "I believe that Chávez is working with determination for the integration of Latin America; his dealings with Argentina have been admirable and with solidarity . . . Argentines should be very thankful to President Chávez, who has done very good things for this country." He also said that nothing would stop the process of regional integration.

Michelle Bachelet, who is classified as one of the "good leftists" in Washington's lexicon, stood up for both Chávez and Morales when the international press was raining scorn on them at the European Union-Latin American and Caribbean Summit of May 11-13: "I would not want us to return to the Cold War era where we demonize one country or another," she said. "What we have witnessed in these countries (Bolivia and Venezuela) is that they are looking for governments and leaders that will work to eradicate poverty and eliminate inequality."

The fact that all of these leaders would not only offer support, but in some cases unqualified praise for Hugo Chávez, who has called President Bush a terrorist, a murderer, a donkey, a drunkard, and a lot of other names including his favorite "Mr. Danger" – a reference to a nasty American in a famous 1929 Venezuelan novel by Romulo Gallegos – is another indication of how much the hemisphere has changed. And all this after more than four years of efforts by the Bush administration to isolate Chávez, combined with overwhelmingly negative and one-sided international media coverage of Venezuela.

On May 26, President Jacques Chirac of France threw his weight behind Bolivia's oil and gas nationalization, despite the fact that the French energy giant Total is the third largest producer affected by the decision. He praised Evo Morales as “a man who has restored honor to a people who had lost it for centuries and centuries.”

A collapse of oil prices would change the immediate political equation, but to reverse current trends it would have be a crash of a magnitude that almost no one currently foresees. Venezuela has been pretty conservative in its fiscal policy, budgeting for oil at about half the price that materialized last year, while vastly increasing tax collections. The country is enjoying a budget surplus, a nearly $9 billion trade surplus, and has more than $30 billion in foreign exchange reserves. Its ad hoc “Bank of the South” is not likely to go bankrupt anytime soon. And certainly not so long as the current tensions – with possibly worse to come – between Washington and Iran continue to add to the already war-inflamed risks of oil supply from the Persian Gulf.

There are a number of potential economic problems in the near future. As interest rates continue to rise in the United States, the possibility of the kind of destabilizing capital outflows that set off the Mexican peso crisis in 1995 – when the Fed raised interest rates from 3 to 6 percent beginning in 1994 – is still real, although the risk is smaller as compared to that of the fixed exchange rates of the 1990s. And Mexico especially, with more than 85 percent of its exports now going to the United States, is vulnerable to a likely downturn here when the U.S. housing bubble breaks. Also, as noted above, a sharp drop in the dollar would hurt those countries that are most dependent on exports to the United States. But it is unlikely that even hard times would cause Latin America to go back to its prior allegiance to U.S. policy-makers.

As economic integration proceeds, Washington’s influence will continue to wane. When the Colombian government kidnapped Rodrigo Granda, the FARC guerrilla’s “foreign minister,” from Venezuela last January, Chávez was furious and Washington was hoping for a serious fight. But Venezuela cut off commerce with Colombia, and as Venezuela is now Colombia’s second largest trading partner, the impact was immediately felt on the Colombian economy. Colombia’s President Uribe flew to Caracas and the two presidents settled their differences. They have had remarkably good relations ever since, as they have through most of Chávez’ presidency, despite being at opposite sides of the political spectrum. Uribe is Washington’s closest ally in the region, and highly dependent on U.S. aid.

The governments of Argentina, Brazil, and Venezuela are discussing a proposed 6,000 mile, $20 billion natural gas pipeline. Bolivia is also involved in the discussions, and other countries may be included. This type of energy integration, if it materializes, would also promote further economic and political integration in the region.

Successful examples of economic and social policy also have a way of spreading. Argentina’s phenomenal growth rate, more than twice that of the region, cannot remaine unnoticed indefinitely. Nor can the provision of health care and increased access to education in Venezuela, which are likely to follow in Bolivia. In Brazil, one of the largest and most organized social movements in the world, the Movement of Landless Workers (MST), is watching hopefully as Bolivia embarks on what promises to be the largest land reform program in decades.

From the north, there is little indication that Washington will make major policy changes in the foreseeable future to accommodate the new reality in Latin America. Even if the Democrats were to win the House of Representatives in November, the ranking Democrat and likely chair of the House International Relations Committee would be Tom Lantos, who is about as hawkish as the Bush administration on these issues. U.S. policy will therefore almost certainly continue to reinforce and contribute to current trends, including the loss of U.S. influence in the region.

There will undoubtedly be political conflicts, mistakes, backlashes, and unanticipated events as various countries move forward along more independent pathways. But a tipping point has been reached, and there will be no turning back of the clock. The most difficult task will be finding new, country-specific economic policies and development strategies, after more than a quarter-century of governments refusing to even think about these things, instead submitting to a narrow range of mostly unsuccessful choices. In this new era the economic choices have expanded rapidly, and the rules of the game are changing from month to month. However, a thick ideological fog, which denies that even the most modest alternatives are possible, still prevails among the international financial institutions, central banks, the media, and the institutions where most economists are trained. Governments that want to do anything different, like Kirchner's in Argentina, will need some vision, leadership, and courage to confront a lot of ideological opposition, in addition to varying political opposition. But so far they are doing pretty well.

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Will Computers Really Decentralize the Economy?

Ian Fletcher (USA)

It is a ubiquitous assumption of the technorati that future advances in computer technology will further decentralize advanced economies. But this assumption is probably autistic, and the reality a lot more complicated.

Basic Analytical Categories

It is an error to view computers as having the same effect on every industry or part of society. Instead, one should divide the world into four categories:

1. Areas where computers are a centralizing force.

2. Areas where computers are a decentralizing force.

3. Areas where computers cut both ways.

4. Areas where they have no effect.

The overall effect of computers on business and society is an *average* of these four effects.

These effects change with the state of computer technology. Prior to about 1975, the relatively primitive state of computers favored category #1, as computers were themselves centrally-controlled mainframes, and were so expensive that only large centralized organizations could afford them. Post-1975, computers themselves physically decentralized and became cheap, so this factor gradually dissipated.

Basic Cause-and-Effect Model

In 2006, corporate America's use of computers is dominated by the drive to exploit the economies of scale inherent in scalability. Although technological breakthroughs, which enable computers to perform tasks they could not previously perform at all, capture the public's imagination, most of these breakthroughs are economically (as opposed to technologically) viable for the same reason as most productive technologies since the dawn of time: a large quantity of work can be funneled through a finite technology infrastructure. If this were not so, then purely technological advances, like the ability of computers to recognize human speech, would remain like the moon landings: technological feats of trivial economic significance. But where will this scalability trend lead, as no trend lasts forever in economic history – something commentators often forget.

The basic assumption we should make is that as computers become ever cheaper, more capable, and more familiar, getting them to do whatever is called for by the economic task at hand will become ever more trivial. As a result, computer technology will cease to be felt as a constraint on what can or should be done; it will become a "free variable" that can be effortlessly organized around other needs. As a result, the key trend will be this:

> *As technology becomes more liquid, technological factors will cease to dominate organizations.*

It follows that:

> *As technology becomes more liquid, non-technological factors will increasingly dominate organizations.*

Superficially, this is paradoxical, but it makes perfect sense in terms of economic history. For most of human history, agriculture was primitive, so producing enough food to feed the population was a major challenge. A huge percentage of the population was engaged in farming, and major social institutions were organized around it. But as agriculture became sophisticated, food supply became something that could be taken for granted, and food production today occupies only a tiny percentage of society's attention.

This does not mean that computers will become unimportant, any more than food has. But it does mean that corporations, for example, will increasingly be organized around non-technological factors, like purely economic economies of scale, and decreasingly around their ability to afford and operate computers. (I am not saying the state of computer technology has been the only determinant of corporate organization; only that it has been one factor, which will decrease in importance.)

Take the giant American retailer Wal-Mart. Today, it enjoys a competitive advantage because of its superb computerized supply-chain management, which gives it sophisticated control of its supply chain at a low cost per item sold. But if any company could cheaply buy a similar system off the shelf, this would cease to be a competitive advantage, and thus remove a major factor that presently favors the existence of this highly-centralized company. It is only because Wal-Mart's logistical rocket science is expensive, that it takes a multi-billion-dollar company to spread that cost over enough items to make the cost-per-item viable. If it were cheap, a small company could afford logistics as good as Wal-Mart has.

But this does not mean Wal-Mart will go away if this technology becomes cheap, as this is not the only competitive advantage the present centralization of the company generates. It also produces a number of economies of scale, starting with the logistical advantages of being big that exist even *without* computerized management thereof. The fact that a small competitor could one day cheaply copy its computer systems will *not* give that competitor its fleet of trucks and distribution centers. Nor will it give its competitor Wal-Mart's buying power, or change the fact that investors would rather put their capital into a well-understood company like Wal-Mart, than into Jack's 99-Cent Emporium of Hoboken, NJ.

Economies of scale are not the only non-technological factors that will increasingly "show above the water" as cheap technology renders technological factors moot as a source of competitive advantage. For example, the *New York Times* used to have a uniquely privileged position as a distributor of news to educated and affluent Americans, simply because it had the physical means to dump millions of newspapers on doorsteps nationwide every morning. Small start-up publishers simply could not break into its market.

But with the Internet, and mere ownership of printing presses and delivery trucks no longer conferred privileged access to these readers. This story is familiar. But the reason the *Times* has not collapsed, of course, is the fact that these were not its only competitive assets. It also has, in addition to intangibles like brand image, a huge stable of capable writers and editors, who are able to turn out a culturally-sophisticated product that few can duplicate. This sophistication is most visible in the soft-news sections of the *Sunday Times*: anyone who has tried to run an Internet magazine, or who compares the *Times's* lifestyle and culture sections with what gets printed in regional newspapers, will be forced to admit this is true. In this lies the *Times's* true remaining competitive advantage.

It will be similar in other industries: cheap computers will tend to boil away technology as a source of competitive advantage, raising the relative significance of other factors. As a result, the future shape of any industry, (or branch of government or aspect of culture) with respect to centralization and decentralization, will increasingly depend on this: what do the non-technology factors favor?

Paradoxically, computers will thus over time kill their own significance.

The Long-Term Picture

The obvious implied question, in the case of the *Times* above, is whether "cultural sophistication" on its own is really a centralizing factor. This is a very tricky question: on the one hand, increasing diversity of cultural and lifestyle options argues for decentralization of the raw expertise that constitutes sophistication, and an explosion of sophisticated lifestyle publications confirms this fact. The idea of a few hundred Manhattanites being the arbiters of educated American culture was perhaps plausible as late as 1988, but not today. But on the other hand, raw expertise, as any penniless cultural critic or bankrupt magazine entrepreneur will know, is not an economic commodity. It has to be packaged into a form consumable by affluent consumers for it to be worth money.

It follows that this *packaging* would seem to be where the *Times's* true competitive advantage lies, so whether packaging is a centralizing or decentralizing force becomes the key question. A lot of this comes down to whether the management of the *Times* really knows something other companies don't: do they have a method for producing and packaging cultural sophistication *ad infinitum*? If they can, then they've got a unique (or rare) skill. And anything unique and valuable is centralizing by definition. So the key determinant of centralization here will be whether this kind of skill tends to crystalize in a small number of places, perhaps because it depends upon face-to-face interactions within small teams of people.

But what about more mundane kinds of management? Returning to the Wal-Mart case, let's look at how the company will hypothetically look, a few years after its computer systems have become available to anyone.

For a start, it will remain easier for Wal-Mart to attract capital, than for any given non-chain store selling the same goods – say, Jack's 99-Cent Emporium. This is, at bottom, because the cost of doing proper financial analysis on Wal-Mart, sufficient to know that the company is worth investing in, is no greater than doing the same analysis on a company half Wal-Mart's size, not much greater than doing it on a company 1/10 Wal-Mart's size, and not all that much greater than doing it on a company 1/100 Wal-Mart's size. So the economy of scale in attracting capital, is at bottom an economy of scale in financial analysis, and as long as financial analysis is both expensive and scalable, it will tend to favor centralization.

But if financial analysis ever becomes cheap, economies of scale in access to capital will cease to be a centralizing force (unless, of course, other factors turn out to affect economies of scale in access to capital.) Cheap financial analysis would probably require science-fiction levels of artificial intelligence, but is not impossible in the long run. Early stages of this are already visible: for debt capital, computerized innovations like credit scoring have already drastically reduced the cost of financial analysis, and there is strong evidence that small firms pay a lower premium on bank loans since its introduction.

A similar dynamic is likely with the internal corporate management of companies like Wal-Mart. Presently, there are some very expensive MBA's in Bentonville, Arkansas running the company. Because applying their decisions to 1,000 stores costs trivially more than applying them to 100, it is efficient to centralize stores under their management. But what if cheap robot MBA's became available? Then this would cease to operate a centralizing factor.

We may generalize thus:

> *Technological advances at the present level of technology, like decreases in price and increases in ubiquity and ease, increase the significance of non-technological factors. Technological advances to new levels of technology, changes these factors.*

Whether the latter advances will, in any particular case, be centralizing or decentralizing, will depend. If McDonald's can replace its MBA's with cheap robots, this will weaken the economy of its management, because any company will be able to afford management of similar capabilities, and therefore be a decentralizing force. But if McDonald's can replace its counter clerks and hamburger cooks with robots, so that thousands of restaurants can be remotely managed from a single control room at headquarters, it will be centralizing.

Even absent technological encroachment upon the frontier between technological and non-technological factors, non-technological factors themselves evolve. And increasingly liquid computer technology removes implementational "friction" from the economic environment, so that this evolution is more intensely reflected in economic structure.

For example, one of Wal-Mart's non-technological centralizing factors is buyer power (in the sense this term is used by MBA's, quintessentially in Michael Porter's book *Competitive Strategy*, summarized here: http://home.att.net/~nickols/five_forces.htm .) But basic economic theory tells us that buyer power only exists in markets that are not commodities: no buyer can get cheap crude oil.

As a result, over time, Wal-Mart may (or may not, if it evades commoditization of its goods by any of the known means) lose buyer power as a centralizing factor. If our imaginary Jack's 99-Cent Emporium can get scissors from Guangdong at the same price Wal-Mart can, decentralization will rear its head again.

Let's run a hypothetical scenario of the disaggregation of Wal-Mart, not because this will necessarily happen, but to identify the factors that make Wal-Mart be the way it is:

> Stage 1: Wal-Mart as it is today. Centralized distribution, same retail price everywhere for products like scissors, same "wholesale" internal transfer price to every store. (Whether the company actually *has* these same prices today is irrelevant to laying out this thought experiment, which can accommodate any empirical particulars.)
>
> Stage 2: Wal-Mart uses its computers to realize the market for scissors in Chicago and assigns a higher price than in Atlanta, so it raises the retail price, the transfer price, and/or the quantity supplied to the store.
>
> Stage 3: Wal-Mart realizes that stage 2 is a *bureaucratic* response to price signals, not a market one, and replaces this with a simulated "internal market," in which stores "bid" against each other for "wholesale" scissors from its supply chain. (Internal markets of various kinds have been tried in a number of companies, like the Koch natural gas company.)
>
> Stage 4: Wal-Mart jumps from a *simulated* free market to a real one, and breaks up the pieces of the company into independently-owned stores, distribution centers, etc, which freely contract for each other's goods and services, rather than having them assigned by commands from headquarters.

Although there are myriad issues at each stage here, this thought-experiment makes clear that, in a sense, decentralization is the natural condition of economic life under a basically free market. Therefore, if we see centralization instead, it is because some factor interfered with the transition between the stages above, which would otherwise run their course and decentralize everything. This is, of course, just basic Coase Theorem economics: firms exist at all, and big firms are bigger than small firms, because of transaction costs (broadly-defined) and the effectiveness of economies of scale in reducing these costs. (See Oliver Williamson's 1985 book *The Economic Institutions of Capitalism*, which applied the Coase theorem to the question of the boundaries of the firm.) So the answer to the question of computers' effect on centralization and decentralization is in the end obvious, almost trivial:

> *Computers centralize when they strengthen economies of scale. They decentralize when they weaken economies of scale.*
>
> This formulation covers the different possible outcomes we have seen or may see:
>
> 1. Computers did increase economies of scale in the past: from about 1950 to1975; only large companies could afford them, making centralization a source of competitive advantage.

2. Computers may increase economies of scale in the future: in 2020, the robotic McDonald's may enable McDonald's to run the entire chain from a single control room at headquarters.

3. Computers did reduce economies of scale in the past: post-1994, the Internet made nationally-distributed media, and sales channels for non-media products, vastly easier to create.

4. Computers may reduce economies of scale in the future, if artificial intelligence weakens economies of scale in management by mass-producing cheap management skills.

The above is a caricature: most effects of computers will be less dramatic. But it nicely reveals the fundamental tension present: between computer advances that act like a robotic cook, and advances that act either like a robotic MBA or like the Internet. The first will centralize, the latter two will decentralize.

So we have here one centralizing dynamic and two decentralizing dynamics. Computer advances that make it easier to aggregate vast numbers of things, like retail purchases at Wal-Mart, are a centralizing force, *when* this aggregation does something economically useful, like enable the exploitation of an existing economy of scale, like Wal-Mart's management or buyer power.

But computer advances that destroy some economy of scale will be decentralizing, and interestingly, this can happen in two *different* ways. With a robotic MBA, an expensive central resource suddenly becomes cheap, though the price of replicating its activity over the many objects of that activity remains the same. With the Internet, the cost of the central resource (content) remains about the same, but the price of replicating that content to many consumers of it drops dramatically.

The above analysis implies that the deck is probably stacked in favor of decentralization – but *only* long-run and big picture. In the short and medium term, and in particular industries, there exist profound reasons why things can cut the other way for long periods of time:

> *Until <u>every</u> existing economy of scale is liquidated (either by computers or something else) computers can often make it easier to exploit these economies of scale, and thus promote centralization.*

The above is only an analysis of economic factors. Although political bureaucracies will to some extent be affected similarly to industries in how they *implement* policies, the fundamental fact of politics is not bureaucratic implementation, it is coercive power – which operates according to very different rules, completely outside the scope of the above discussion and under no obligation to behave the same way. So as far as politics impinges on industry structure, the above analysis will be incomplete.

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Is New Labour's 'Third Way' new or just hot air in old bottles?

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Preamble. *This paper is presented and published in order to stimulate debate – and have feedback - on the various economic, political and social issues raised. Though the context is Britain, many of the issues raised are relevant for other countries. Readers are encouraged to circulate it among friends and colleagues who might have an interest and contribute to the debate.*

Abstract. *The paper discusses the main aims and characteristics of the three Ways in British economics and politics: the First Way refers to the period from after WWII to the mid 1970s; the second Way refers to the Conservative Government period starting from 1979; and the Third Way to the New Labour Government period since 1997. These three Ways are considered in relation to their main characteristics, the policies of the relevant governments and the problems they have encountered. The New Labour policies are analysed in more details by reference to the case of the National Health Service. The reasons why the New Labour Way is different from the second Way as well as the problems it is facing are highlighted. A discussion of why New Labour has taken the Third Way route follows.*

Introduction

The re-launch and revival of the British Labour Party as New Labour has gone hand-in-hand with the proposition that there is a 'Third Way' in economics and politics, that is a set of strategies and policies which differ substantially from the one followed in the post-WWII decades (the First Way) and from the one later followed by Margaret Thatcher (the Second Way)[2].

There are plenty of meaningless sound bites and of policy statements in the various manifestos of the Party but no clear statement of the essence of its philosophy or of the main aims of the so-called Third Way and of its differences from the two preceding 'Ways'[3]. The aim of this paper is to bring out the essential features of the three Ways in relation to their aims and strategies and then to analyse the New Labour government policies in more detail. Mention will also be made of the problems that the three Ways have encountered or are encountering. The aims of the three 'Ways' are inferred from the actual policies and strategies and not from the declared oral or written pronouncement of politicians and electoral programmes. Politicians themselves and their ideologues tend to make high-sounding, empty or even obfuscating statements rather than be explicit about their aims and strategies; so we must infer their aims from 'what they do, not what they say'.

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[2] See Grieve Smith (2001)
[3] An insider view is given by Giddens (1998) and (2000). A critical contribution is given by Callinicos (2001).

The 'First Way'

In the post-WWII there was a large consensus – which to some extent was cross parties – over the following *aims:*

- The economy was to be run under the capitalist mode.
- Industries which were both basic to the rest of the economy and unprofitable for the private sector would be nationalised and managed by the state sector. This would include also those services essential for the workforce to function effectively such as health and education[1].
- The level of capacity utilization and employment to be kept high in the interest of both capital and labour.
- The balance of class forces to be kept at a level which would avoid social upheavals and industrial strife. The State would take a role in securing this.

There was a large degree of consensus about these aims, though, of course, disagreement erupted often enough on the distribution of the cake between capital and labour and on the specific policies to achieve the aims. Various policies were designed through the decades by successive governments to achieve these broad aims and in particular:

- A series of tripartite arrangements – between business, trade unions and government - and the establishment of relevant institutions to achieve some balance of class forces and avoid strife. In some periods government intervention in this balance took the form of incomes policy.
- Demand management using both monetary and fiscal levers in order to stabilise the economy and achieve some sort of equilibrium between the objectives of high levels of employment, low inflation and the country's external accounts.

There were *problems* with this 'First Way' and whatever consensus there was in the first couple of decades it broke down completely in the 1970s. High levels of employment had gradually led to a shift in the balance of class forces away from capital. Inflation rates escalated as a result of the stronger and better organised labour force as well as of exogenous forces such as the increase in oil prices under the OPEC cartel. Meanwhile the structure of the economy was becoming old and unable to compete with younger economies whose capacity had been completely built or re-built after the WWII. Both inflation and unemployment began to rise; the latter took a cyclical as well as a structural form. Whole industries became unviable as the economy struggled – and often failed - to get into new sectors. As industries became uncompetitive, balance of payments crises became a feature of the British economy.

The 'Second Way'.

It is within this background that Margaret Thatcher took power in 1979. The *aims* of her government, partly openly announced and partly clearly implicit in her policies, can thus be stated.

- To shift the balance of class forces away from labour and thus reduce the bargaining power of trade unions on a long term basis if not permanently. Her policies were built

[1] The British tradition of elite private schools – the so-called 'public schools' - influential though it has been in public life, was never large enough to affect the training and education of the labour force at large.

on a fertile ground since the structural imbalances and changes in the economy were already operating against labour.

- To restore the profitability and competitiveness of capital.

The strategies followed to achieve these aims took a variety of forms. In particular the first aim was to be achieved via the following.

- High levels of unemployment and fears of losing one's job became a powerful disciplinary force for labour.
- Reshaping the context of Trade Unions power via legislation which included outlawing secondary strikes and restrictions on a variety of activities including picketing.
- The latter strategy went hand-in-hand with organisational fragmentation strategies for the labour force. By this I mean the strategies – followed by both private and public sector institutions - of outsourcing part of the production process; this caused the labour force previously all employed by the same company, to be divided into a myriad of sub-contractors. This fragmentation of labour led to greater difficulties for the organization of labour and its Trade Unions in the public and private sector in both of which the strategy was used and indeed encouraged by the Government.
- Allowing and indeed often encouraging the worsening of working conditions and the casualisation of labour with a view to increase productivity and decrease the bargaining power of labour.

These strategies supported not only the first aim but also the second one because they were supposed to lead to lower labour costs and higher productivity levels. Moreover support for the second aim was also to be achieved via large privatisation programmes and generally via drastic reductions in areas of direct public involvement in the economy. The basic idea being that a cut in the production of goods and services by the state sector would generate investment opportunities for the private sector. Moreover, a smaller state sector would require lower levels of taxation leaving higher disposable incomes to individuals and firms. This would – allegedly – encourage people to work harder and firms to invest more.

The overall underlying assumptions of the 'Second Way' can thus be summarised. If the balance of class forces is shifted away from labour, the overall business climate as well as the costs of production will be more favourable to capital and will lead to investment particularly in new industries. Moreover, investment opportunities for the private sector will be created by reducing the provision of services by the state.

The 'Second Way' was not without *problems* for capital and the government let alone labour. The economy was in a very poor state for many years: high unemployment; poverty; begging in the streets, hitherto an unknown feature in post-WWII British society; the decline in levels of education and in the health of the labour force were undermining productivity let alone leading to a cohesive society, one to be proud of. Indeed Margaret Thatcher contempt for society was summarised by her well known 1987 statement: "There is no such thing as society. There are individual men and women, and there are families"[1].

However, in a way the major problem was for capital itself. Though some investment opportunities were created and some foreign capital attracted in more deprived areas, the basic problem was that the shedding of activities by the state does not automatically create

[1] Interview in *Woman's Own*

profitable investment opportunities. Most of the activities which were in public ownership by the 1970s had originally become so because they were not profitable under private ownership. They did not necessarily or not always become profitable when the Thatcher government privatised them. With every privatisation the City went into euphoria because immediately after each selling by the government the value of the company shot up with huge gains for the buyers and for the institutions involved in the deals; this is not surprising given the fact that the public companies' assets were sold at grossly low prices. However, often the euphoria became short-lived as many companies faced difficulties and needed propping up with continuous handouts from the taxpayer; substantial amounts of these subsidies went to the shareholders and to increasingly demanding corporate managers.

The 'Third Way'.

Aims

New Labour swept in amidst an enthusiasm for political life which had not been seen in Britain for decades. The enthusiasm was mixed with high expectations about the changes which were to come for the economy and society after the previous bleak two decades.

The expectations were soon to be checked by the reality of a government that: put economic prudence and stability over fulfilment of pent up needs; put the financial expectations and interests of the higher echelons of society, the City, the big corporations – domestic and foreign – and the right wing press before those of the millions of people who voted it in; proved to be very aggressive in foreign policy and over enthusiastic for wars to achieve those aggressive aims; developed a very cavalier attitude towards democracy and accountability on the strength of a high parliamentary majority achieved, partly, through the specific British electoral system.

Many people on the Left have in the last few years tended to see the record of New Labour as no more than a continuation of Mrs Thatcher's policies of which Prime Minister Blair is known to be an admirer. However, even the most critical assessors of New Labour, will recognize that: (a) the economy has been run competently and with high levels of employment; (b) the last two years have seen a considerable increase in government expenditure in the public services particularly health; (c) the people at the bottom of society have been better provided than they had been for the previous two decades: street begging has become almost a thing of the past in the last few years.

These achievements are real and relevant; however, are they the crux of the differences between Thatcherism and Blair-Brown-ism? I think not and I will argue for this position in the rest of this paper which I now deliberately structure along the lines of the previous two, starting with the following *implicit aims of the New Labour Government.* They are aims springing from both the legitimization and accumulation function of the State.

1. To keep the balance of class forces strongly in favour of capital along the trajectory mapped by the Thatcher government.
2. To create opportunities for profitable investment by the private sector.
3. To secure long term advantages for British capital abroad and lower the economic and political risk of access to primary resources and to investment opportunities.

4. These aims to be achieved while securing: a stable economy with high levels of employment and low inflation; and a stable social environment in which the bottom of society had a safety net to fall in.

Aim three, coupled with the specific ambitions of the PM, led to the illegal and aggressive war in Iraq whose consequences will be felt world wide for decades. This aim has clearly not been achieved and is very unlikely to be achieved; indeed a higher level of instability and increased risk for people and for investment in the Region has been created. But this topic is beyond the scope of the present paper.

Aim one was to be achieved by: keeping the Thatcher legislation on industrial relations and Trade Unions; taking a declared stance of hand-off in industrial relations on the part of the government; greatly increasing the scope for the fragmentation of labour and hence for the difficulties in its trade unions organization. The latter objective was achieved by: organizational fragmentation brought about by the outsourcing strategies imposed on the providers of public services over and above those implemented during the Thatcher years: increasingly the labour force finds itself working for many private companies rather then one single public employer. Moreover, many providers are increasingly foreign firms[1] and this adds to the power of capital over labour because of the added difficulties of labour in dealing with a foreign employer.

To the fragmentation of labour created by the involvement of private providers within the public sector was added another type of fragmentation by New Labour: the encouragement – not always successful so far – for public sector institutions to 'go it alone' and operate individually and indeed in competition with other institutions not only in providing services but also in negotiating with their work force and setting contracts for their staff.

In the education sector, some university managers have indicated their desire to move in this direction. Moreover, the establishment of the so-called Academy Schools will create scope for local bargaining with education labour force at school level rather than centrally. In the health service the organisational fragmentation of the sector is leading in the same direction. Here are two examples on this trend. New Labour has established the formation of so-called Foundation Hospitals, that is hospitals with independent status free to conduct their own business including bargaining with their work force: once they are fully established, the health workers may be forced to enter into contractual arrangements with individual hospitals and not with a unified National Health service (NHS). A second example derives from legislation on Primary Care. From 2004 negotiations by General Practioneers (GPs) are to take place at the local level – with their local Primary Care Trust – rather than at the country's level with the Ministry of Health.

In essence the main aim of both Thatcher and Blair's governments was to support and strengthen capital via:

- Positioning the balance of class force away from the power of labour and trade unions as much as possible
- The penetration of capital into areas hitherto seen as the preserve of public provision
- Some handing over of subsidies to private companies

[1] The World Trade Organization (WTO) rules that once public services are run on a private basis – even partially – then foreign firms have the right to compete for provisions. The opening up of public services to foreign firms greatly helps the saturated US health industry; it also helps the British firms who use the developing expertise at home to branch out into new countries.

As regards the first element New Labour endorsed Thatcher's policies and went much further in the labour fragmentation strategy. As regards the second element Thatcher and Blair strategies differ.

Key differences between the 'Second and Third Ways'.

Thatcher had served capital very well in her strategy to lower the resistance of labour and its trade unions and therefore to shift the balance of class forces away from labour. This she succeeded in doing. New Labour, as mentioned above, has happily embraced the newly established balance, was keen to continue her policies and went further into the fragmentation strategy to secure further shifts in favour of capital.

The Thatcher government initiated the outsourcing of non-core activities within the public sector as a whole and New Labour endorsed this move and went further along the same root. However, the major differences between Thatcher and New Labour were with regard to the provision of core activities in the public services sector.

The Thatcher government's ideological stance on the role of private enterprise versus governments led it to believe that, provided the state provision of services were cut, the private sector would step in and organise the provision of the services along market lines. This is fine in theory, but in practice, private capital would only invest in such provisions if there was the prospect of profitability. But such a prospect eluded many traditional public services. The demand for private health services or education cannot be met with production at *profitable levels* when the majority of the population cannot afford it. At the same time, these services are essential to the supply of an effective work force to the economy: they are services that are not only beneficial to the individual consumer/user, they generate enormous positive externalities whose effects spread throughout the economy and society.

Similarly, the privatization of transport does not secure profits to the rail companies unless massive state subsidies and high fares are introduced. This was indeed done. Transport services also produce strong externalities. Unreliable, unsafe and costly transport leads to disruption in the workplace as well as to demand for higher wages to meet the costs of getting into work. The use of cars as alternative means of transport causes congestion and pollution which generates well known health problems and high economic and social costs.

It is interesting to recall that Mrs Thatcher herself was apparently against the privatization of the railways. This was implemented by the Conservative Major government that followed her demise. Once the euphoria of the privatization gains by the stock exchange – caused by the underselling of State assets to the private sector as in other cases – had subsided, the huge problems of this sector began to unravel: poor service; high fares, low safety standards; application for ever increasing State subsidies. These problems eventually led to re-nationalization of Rail Track, the company which owns and manages the basic track infrastructure.

Moreover, high levels of unemployment – as in the Thatcher era - are not exactly conducive to high demand for most type of products whether traditionally provided by private enterprises or arising from privatized public services.

The key insights of New Labour were therefore the following:

- A healthy economy running at high levels of employment can provide healthy demand and thus lead to profitable investment opportunities provided labour and its trade unions can be kept at bay.
- The provision of public services by the private sector can become profitable *only if the state guarantees demand and funding* thus lowering the risk for the private investor. Moreover, even under such conditions, profitability may require state subsidies to the companies providing the services as became evident from the case of the British rail network.

The latter point led to a new element in New Labour's strategy compared to Thatcher's. The State should not cut public expenditure on the provision of public services; on the contrary it should increase it compatibly with 'prudent' financing. However, while funding the services out of tax revenue, the state should shed its direct provision which would increasingly be contracted out to private companies: this means effectively a regime of private production/provision in the context of social/public funding. Therefore, while the *strategy of full commercialization* of public services (private funding and private provision) by the Conservative Government failed the private sector which it was supposed to help and encourage, the *strategy of private provision with public funding* by New Labour is helping capital. This is because the former strategy leaves the consumer to pay for the services while in the latter strategy the consumer receives the services free and the taxpayer foots the bill. Under the 'Third Way' capital is secured low risk, high demand, high prices provision and thus profitable investment. It is an irony that one of the traditional '*raison d'etre*' of - and justification for - profits is the assumption that the entrepreneur runs risks when investing. Here the state is using taxpayer money to reduce substantially the risk while securing profits for the private sector.

This pattern can be seen in many provisions of public services from transport to health to education to Home Office ones under New Labour: the outsourcing has increasingly been extended from non-core – security, catering, IT provision and maintenance, catering, laundering and cleaning - to core activities. The mantra we hear over and over again by the PM and his ministerial entourage is that the investment expenditure the government is providing must be subject to 'modernisation'. If one scratches the sound bite surface, one sees that 'modernisation' means allowing in private companies to provide these services paid by the taxpayer and free at the point of delivery.

The National Health Service (NHS): the main test case[1]

The opportunities for involvement by the private sector in the provision of core activities in services such as Education or Home Office or Defence services are rather limited: most non-core services have been privatised; however, extending the process to the key service is more problematic because the opportunities for *profitable* involvement by the private sector are more limited: nonetheless some attempts are being made as follows. First, the privatization of non-core services has proceeded along the Thatcher route; second, during New Labour government the private sector has become very involved in the provision of infrastructure via the Private Finance Initiative (PFI) on which more below; third some opportunities for to the private sector to get a share of core business is given here and there: from the outsourcing of prison management to the proposal for State supported pupils to study at private schools – in Britain called 'Public' Schools - to proposals for the outsourcing

[1] The main arguments in this sub-section are further developed in Ietto-Gillies (2006). An excellent source of the history of the NHS is Pollock (2004).

of Probation Services by the Home Office, to the outsourcing of some Defence activities to private contractors.

However, it is within the NHS that the major scope for full private sector involvement in non-core activities, as well as in infrastructure and core services delivery has been spotted and is currently being implemented. There is not much more to add about the outsourcing of non-core activities. Except that some non-core activities such as laundering, cleaning and catering have a strong impact on the health and safety of patients thus affecting the quality and cost of health care.[1]

Let us look at the involvement by the private sector in the provision and management of the building infrastructure: the process is similar in several of the public services institutions from health to schools to universities. The key development was the Private Finance Initiative (PFI) developed in 1992 by the Major government largely under pressure from an ailing construction industry. The scheme involves the public sector institution entering into a contract with a private sector consortium of construction and facilities management companies as well as banks, for the following services: raising funds and construction of buildings – hospitals, schools or universities. The buildings would then be leased to the public sector institutions by the consortium which would also provide some or all of the following: maintenance; security, cleaning etc. The contracts would last for an average of 30 years at the end of which, in most cases, the land and the building developed on it would belong to the private company/consortium. The public institution would pay: interest to the private banks for the funding; rent on the building; fees for the various services provided.

These payments are well above what would cost to produce the same infrastructure and services under public provision because: (a) borrowing on the private market is much more costly than if the government borrows; (b) to the cost of the various operations must be added the profits of the companies involved; (c) there are high administrative managerial and legal costs of dealing with the development and management of the contracts. The latter item of costs results in duplication across the NHS as a whole because the structure is now fragmented and each Trust is operating on its own and there is no central expertise to advise and help. Pollock (2004: 55-6) estimates that the costs of services PFI buildings are between two and three times higher than if the same building were built with funds borrowed by the government and the whole development were in-house rather than outsourced. The funds for these payments come from the annual allocation to the institution for the provision of its services: the higher costs means that cuts have to be made on the year to year provision of clinical services in the case of hospitals; in the case of universities it will result in lower staff/students ratios for years to come. The whole PFI system raises issues of intergenerational equity: we are forcing our children to go with poorer clinical services to pay for our current infrastructural expenses.

Nonetheless, it could be argued that having additional bed capacity is beneficial in a tight NHS and so is having better buildings for crumbling schools and universities. However, the capacity is often not additional but substitute and the extra cost often means that those NHS Trusts that want to own their new hospitals at the end of the period may have to knock down old decrepit structures and build new ones. However, because the latter is so expensive only smaller capacity can be afforded and the overall bed numbers is cut. Pollock (2004: 95) writes on the implementation of PFI by New Labour: “The result was an average reduction of 30 per cent in the number of beds and a 25 per cent reduction in budgets for clinical staff

[1] I owe this point to D.A. Gillies.

during the five-year period between the signing of the contract and the opening of the new PFI hospital…"

A similar move on the provision of physical infrastructure is going on in the Primary Care part of the service. Since 2001 a PFI type of system is being implemented regarding the provision of GPs premises; private firms are being involved in the funding, constructing, leasing and managing GPs premises.

What about the involvement of the private sector in the provision of core health services? When New Labour came to power they were keen to point out that they were not just borrowing a scheme developed by the Major government: the PFI. They renamed it PPP (Private Public Partnership); this was a cosmetic exercise as regards the provision of infrastructure; however, though little noticed at the time, it signalled the intent to apply outsourcing strategies to a wider range of core services: the private sector from now on would provide public core services under the title of 'strategic service delivery partnership' (Pollock, 2004: 58).

There are three areas of health services where outsourcing is currently being implemented though they are at different levels of development: (i) hospital clinical services both diagnostic and consultants' services; (ii) primary care services; and (iii) long term care for older people. As regards (i) the involvement of private surgery units for routine, low-risk operations has been widely publicized as has the use of foreign capacity with patients travelling to France or Germany to have their operations (paid for by the NHS).

As regards (ii), the traditional contract of GPs with the NHS is one of independent contractors not of salaried employees; this makes it very easy for other providers to come in and contract out of the NHS the care of thousands of patients – so much per patient and so much per specific service to the patient – and then run the Primary care Unit as a profitable venture: doctors and other health workers will then be employed at a salary that will leave a good surplus for the company. The entrance into the sector by private companies is proceeding at a fast pace, encouraged by the recent high settlements for payments to GPs. At the moment the Government through the PCTs is offering contracts to British and American companies; however, it is not difficult to see that in future some GPs may sell their practices to health care companies, particularly since they are now allowed to sell the practice 'goodwill'.

One point to note is the fact that it appears that the private providers of primary care are intending to run the practices with a much higher ratio of nurses to doctors than in current GPs practices: John Carvel in *The Guardian* of May 25th 2006 reports a total of three GPs and seven nurses to run a practice of 7000 patients in East London. This ratio is consistent with those in two other areas of full private involvement in primary care: NHS Direct and NHS walk-in centres (Pollock, 2004: 144-5).

As for (iii) the privatization of care for the elderly had proceeded very fast under Thatcher; New Labour was happy to keep it in private management and to dilute regulation in spite of some negative high-profile cases. Indeed New Labour has increased the scope for the involvement by private providers of nursing/care homes through the following. In order to free overstretched bed capacity (and, I think, also to generate further areas for profitable investment by the health care providers) the Department of Health has created an extra category of patients, those in need of 'intermediate care'. They are mainly the elderly people who occupy hospital beds though their acute clinical needs are over – or cannot be met; they still need nursing and care and this is to be provided by privately run nursing homes at the state's expenses.

Moreover, the taxpayer is made to contribute to the private sector also in a more direct way: through subsidies. The annual subsidies to the private Rail operators have so far been much higher than anything ever received by sector when it was publicly-owned. Not all hand out are easy to unravel and disclose. ITV plc Annual report indicates that the company had an increase in pre-tax profit of £143m for 2005 (p.39); where does this money come from? Courtesy and generosity of the Culture Minister who cut the licence fee from 207m to 75m (p. 24); what did the company do with this nice hand out? The dividends increased by 30% (p. 16).

It is often thought that the 'Second' and 'Third' 'Ways' are much the same in relation to public services because in both strategies the private sector is involved. However, there are substantial differences. The general thrust and the essence of Thatcher's support for the market system in relation to services previously provided by the state was to cut public expenditure and State involvement in them and encourage the full '*commercialisation*' of the services. This would lead to a US type of health care in which private provision is funded via private insurances. New Labour's strategy is to increase government expenditure in the services while outsourcing their provision to the private sector; in other words it is a form of *state sponsored private provision of services*, in which private provision is encouraged and supported by social funding via compulsory National Insurance contributions.

The Blair government repeats almost daily the mantra that the NHS is not being privatized because services will be 'free' for the patient. This is another case of deliberate obfuscation: they are using the possible confusion between funding versus provision: only the first one is public in the Third Way; the production/provision is becoming more and more privatized**.**

The 'Third Way': problems unravelling.

Blair's so called 'modernization' programme for the public sector and public services has generated much discontent in spite of large amount of funds made available by the Chancellor in the last couple of years. Why? Surely, we should welcome a government that provides public services free for the user and increases expenditure on them. Are we just whingeing or is something wrong? If so are the problems related to issue of competence in managing change or is there something more fundamentally wrong with the whole concept?

Undoubtedly there may be problems with managing changes and the more so when the changes are non-stop and do not carry with them the goodwill of the staff who are involved in these changes. However, I think that there is a fundamental problem in the 'modernizing' changes that have been imposed on the public services that make the current problems inevitable and indeed will lead to further problems in the future well after Blair and Brown are out of the political scene.

The problems can be seen in terms of the following: *costs; complexity and disintegration; quantity and quality of provisions; social cohesion.*

Costs

The PFI system is much more costly than if the funds were borrowed by the government and the capital expenditure for the buildings managed by the NHS or Universities or Education authorities for the following reasons: (a) Private sector borrowing carries higher interest rates than public sector one; (b) The private consortia charge profits for their shareholders on top of the actual cost; (c) These project involve a tremendous amount of expenditure on financial and management consultancy as well as on lawyers to draw contracts and handle inevitable litigations. The latter costs are further compounded by the fact that each Health/Education Authority or University has to have its own ‘experts’ because the centralized expertise that existed pre-Thatcher has been disbanded. The systems have been decentralized and institutions of the public sector have indeed been and are encouraged to compete with each other.

In relation to core services one opponent of the reforms, Frank Dobson - the former Health Secretary under Blair – writes in an article in *The Guardian* of 1st July 2006: “The private diagnostic and treatment centres are being paid on average 11% more per operation than NHS hospitals” and later “Commercialisation has already doubled the administrative costs of the NHS – only 4% under the old system”.

Simon Jenkins in *The Guardian* May 24th 2006 expresses the frustration of much media in stronger terms that I have seen elsewhere. He writes; “The Treasury handling of privatisation will, I believe, one day seem not far removed from what happened at Enron. Brown’s aids have encouraged public services, especially health education and transport to indulge in extravagant private borrowing from their associates in the City, enabling ministers to boost their ‘share prices’ and leaving future taxpayers to pay inflated bills. The new £1bn super-hospitals will each carry a cash burden of over £100m in profit and debt payments before caring for one patient. This is way above the cost of public loans. Little known firms such as Capita, Atkins, Serco and Carillon have grown rich on these contracts. Capita lent Blair £1m for his campaign last year after its turnover from public contracts increased in seven years from £112m to £1.4bn.”

It is often argued that any extra expenditure of private provision is more than counterbalanced by increased efficiency. There is, in fact, not much evidence that the private sector is better at running public services (Florio, 2004). Any productivity gains tend to be short term and are related to cut in staffing and or/use of poorly qualified staff which creates problems for quality and social cohesion. Moreover, we should take note of the inefficiency of the most privatised health care system on both the funding and provision sides: the US system.

We do not have official statistics on the provision side but we know that the US has the lowest percentage of public expenditure in relation to total health care expenditure among all OECD countries: in 2004 it was 44.7%. It also has the highest health expenditure as a percentage of GDP (15.3%) and the highest expenditure per capita ($6102). To this huge expenditure corresponds poor performance as evidenced by relatively low values of life expectancy (76.8 years) and high ratios of infant mortality (6.9 per 1000 live births). Most developed countries have life expectancy between 78 and 80 and infant mortality of between 3 and 4 (OECD, 2006).

Complexity and disintegration.

The last point on costs deals naturally to the issue of complexity: a myriad of companies, contracts, consultants, experts and lawyers are involved in the whole process: contracting and outsourcing require a whole new layer of bureaucracy in both the public and private sector. The transaction costs of all this is difficult to assess but it must be very large indeed. Apparently the contracts between London Transport and the private companies to which the services have been contracted out run into millions of pages. Moreover, the disintegration of the NHS into separate institution encouraged to compete rather than cooperate require that each keeps their own complement of 'experts' thus leading to duplication across the health system as a whole.

Moreover, the disentegration of services leads to safety issues in both transport and health services because each private company will try to shift the burden of safety measures on to others.

Quantity of services and capacity.

The government insists that once the public services institutions have been allocated the funds it is their responsibility to see that their budgets are balanced. Institutions do not have a choice as to how their services are run in terms of involvement by the private sector; they have to go along with the so-called 'modernization' programme or face lack of funding and eventually closure. However, the 'modernization' programmes are very costly as mentioned above. Where does the money come from? The institutions of the public sector – Universities or Hospitals or Schools – have to pay the PFI charges out of their annual funding and the extra costs imposed on them can only come at the expense of their core services such as clinical services in the NHS. This is most evident in the NHS where huge injections of funds are not leading to the expected improvements in services or to increase in the number of available beds. Sir Ian Carruthers, acting chief executive of the NHS is reported in *The Guardian* (14th June 2006: p. 4) as saying that cut in hospital services are very likely and possibly even closure of whole hospitals.

As regards capacity, the decrease in the number of hospital beds brought about by the high costs of building and managing new hospitals under PFI has already been mentioned. Moreover, in many cases private involvement in the provision of services cannot increase capacity because the staff working in the private sector comes from the NHS. In some cases staff come from foreign countries; however, it is difficult to be proud of poaching staff from countries whose health service can hardly afford to lose them and whose educational resources have paid for their training.

Quality of services and safety.

The private sector aim in production is and must be: profit. This aim often stands in the way of the quality of services provided or of safety. The UK railways have had a record of several serious accidents since privatization; hospitals' cleaning standard deteriorate with huge costs to the patients who may suffer the health consequences of problems such as MRSA with high costs for society and the NHS who have to pick up the consequences; meals provided in schools or hospitals becomes substandard: Pollock (2004: 38) reports that: '…10 per cent of seriously ill patients were found to have suffered malnutrition while they were in hospital." She thus concludes on the effects of the marketisation of NHS hospitals: "Some of the signs are all too clear, even if the root cause is usually officially denied – new PFI hospital buildings with too few beds and too few staff to cope with demand; outsourced meals too unappetising to eat; substandard cleaning or sterilisation of equipment by underpaid outsourced workers, contributing to the raise of dangerous infections; medical accidents due to faulty work by private pathology labs." (79-80).

Erosion of social cohesion.

The erosion comes about largely in the following ways. First because the outsourcing and generally the involvement of the private sector in the provision of public services fragments the labour force involved in the services. In the NHS workers employed by the Health Trusts – usually health workers – operate alongside private agency workers and private companies workers. The organizational fragmentation of the sector leads to a fragmentation of the work force with loss of morale and indeed with loss of bargaining power. Pollock (2004: 113) writes: "Outsourcing has changed relationships inside the hospital, creating a new kind of 'social apartheid'. Outsourced workers on lower pay and worse conditions of employment struggle to meet their supervisors' demands, while working alongside NHS staff with higher pay and status who do not always respect them".

Social cohesion is also being undermined in the health sector because well paid powerful GPs partners or hospital consultants work alongside under paid nurses who work hard to deliver the targets and points leading to the high remuneration of doctors.

In addition, the decentralization and competition drive between various Health Trusts or hospitals leads to a further fragmentation: institutions are encouraged to compete and eventually set their own salaries independently of other institutions. Erosion of social cohesion comes about also because the decentralization leads to inequality of provision by geography; moreover further inequalities are introduces because the long term care services – such as services for the elderly have now been almost completely outsourced and many old and disable people are left at the mercy of for-profit care providers.

Moreover, a third very pernicious element of erosion of social cohesion and indeed addition to social problems come via the 'modernizing' prescriptions for schools. The British school system always had elements of elitism and class divide; however, the Blair government is greatly adding to those elements - partly for ideological reasons - by; (a) encouraging Faith Schools which separate children along lines set by their parents' religion; and (b) moving towards a system that encourages selection which is likely to result into the educational ghetto-ization of children from the worse off families.

In spite of government's utterances, many parents are unimpressed with the existing Academy Schools and others are mounting legal opposition to the establishment of new ones as reported in a special Report on Academies in the *Education Guardian* of 13th June 2006.

These elements of erosion of social cohesion must be seen also in the context of ongoing changes in the distribution of income and wealth in favour of the rich and very rich. Pro business policies including cuts in income and corporation tax rates coupled with increases in indirect taxation have led to overall regressive taxation and to considerable shift in the distribution of income and wealth in favour of high income and high wealth groups in society. Tony Atkinson, at a lecture at La Sapienza University, Rome (2006) gave comparisons for the Gini coefficient of inequality between 23 developed or intermediate countries. It shows that around the year 2000 the within-country inequality in income distribution was highest in: Mexico (where the coefficient was almost 50%), Russia, USA, Estonia, Israel, UK and Italy). As regards the UK, the presentation gives further details that show that the Gini coefficient has increased from around 26% in 1977 to over 35% in 1990 with a slight decline to around 33% in the mid-1990s and a slight increase after that to reach the previous level of around 36% in 2000.

Atkinson (2003) traces the secular trend in the incomes of the top 1% UK earners during the XXth century. Fig 2:36 shows that the share of the top 1% declined steadily from after WWII to 1979 and then increased steadily during the Conservative and New Labour governments. The UK trend in the last 25 years is similar to that in the US – though the two shares in 2000 are respectively 13 and 17 percent - but not to that of France where the share has remained fairly constant throughout the period. He concludes that as regards the UK "..the shares of top incomes are now broadly back where they were at the end of the Second World War. The last quarter of a century saw an almost complete reversal of the decline in observed inequality at the top that had taken place in the preceding twenty-five years" (p. 22-3). Callinicos (2001) also reports that inequality has widened under New Labour. He writes:

> "… during Blair government's first two years in office…The richest 10 per cent of the population saw their income rise by 7.1 per cent, compared to only 1.9 per cent for that of the poorest 10 per cent." (p. 52).

He thinks that the responsibility for such trends under New Labour lies largely with the "…shifting the fiscal burden from direct to indirect taxation" (p. 53) started under the Thatcher government and continued under Blair-Brown. This strategy makes the overall system of taxation more regressive.

Summary and conclusions

The theme of the paper is set by the question in the title: is the Third Way just an ideological shell hiding essentially Thatcherite policies? Or is there something new and different to it? My answers to these questions are as follows.

Ideology does indeed play a strong role in Blair's strategy; an even bigger role is played by obfuscating words and sound bites: 'modernization', 'choice', 'equality of opportunities', are just a few.

Some commentators are baffled by the fact that Brown – the man who loves prudence – backs a strategy that clearly wastes taxpayer's money: is it possible that he is ill advised by consultants and civil servants too close to the private sector? Is he too much led by the ideology of Blair? Or is he fixated with keeping Public Sector Borrowing at low levels? In my view none of these are true. The sad truth is that the Blair-Brown project is about using State revenue and intervention to create profit opportunities for the private sector and further shifts in the balance of class forces away from labour. To this grand design everything else is subordinated.

Thatcher' government faced the crisis of capitalism of the 1970s head on and with brutal strategies in which the main aim was to increase the viability of capitalism via: (a) a shift in the balance of class forces between labour and capital; and (b) widening the scope and opportunities for profitable activities. These two aims are shared by the Blair government.

However, as regards the second strategy the Blair-Brown project realized that cutting public expenditure is not only difficult but may be counterproductive for capital. So, here comes the crux of the 'Third Way' which is the following: use of taxpayer's money to create profit generating opportunities by the State through the involvement of private companies as contractors to the public sector for the provision of services previously supplied by the State: essentially create a regime of social funding in the context of private production/provision. Moreover, 'modernization' strategies were also directed towards further inroads into (a), the disintegration of the institutional infrastructure with the – hidden – aim to fragment the labour force operating within the public services which traditionally had strong trade unions.

An added bonus of New Labour's strategy for capital is the fact that outsourcing, decentralization of provision, the institution of Foundation Hospitals and decentralised, competition-driven organizational structures for schools and universities, all contribute to the fragmentation of labour. There is organizational fragmentation because labour is employed by many different companies rather than a single institutions; geographical (by nation-state) fragmentation because the decentralization of responsibilities of single Health Trusts or University adds an element of difficulty for trade unions organization; inter-nationally because the outsourcing to foreign companies compounds the difficulties of organization by labour working in the same sector[1]. All this contributes to the shifting of the balance of class forces away from labour.

The implementation of the Blair-Brown project is currently under way and set to proceed much further. If things continue in their present course it is not difficult to see a time when most GPs practices are owned and run by large British and American private health companies and when much further inroads will be made into the privatization of hospital care.[2] As regards Primary Care the scene has been set by the recent high pay settlements for the services of GPs' practices. It is worth remembering that the settlement is about the prices that the NHS is prepared to charge Primary Care contractors (currently mainly GPs partners) for the provision of health services. The combination of prices and volume of services – largely set by the number of patients contracted as well as the range of services offered – will determine the budget for the GPs practices; once all expenses are paid including the largest ones for salaries of hired doctors, nurses, administrators and other health workers and for renting on the premises, the surplus will form the partners' remuneration.

Given the recent generous prices settlement by the NHS, the sector will attract private investors keen to turn into profits the existing surpluses: they will employ salaried health workers – including doctors – and administrators. It is not difficult to see the shape of things to come: the drive to cut costs will lead to the employment of cheaper labour and the adoption of labour saving technology. This will herald the era of nurses-led Primary Care assisted by computer-aided diagnostic technology[3] which uses AI (artificial intelligence) software; this system is already in use by NHS direct. These developments in Primary Care will see the end of the British NHS as established in 1948. They will eventually lead to the end of the current huge gap between pay of partners GPs and of nurses and other health workers:

[1] See Ietto-Gillies (2005), ch. 15.
[2] Pollock (2004: 123) reports that: "In 2001 the BMA [British Medical Association] published guidance for hospital doctors considering exchanging their salaried status for that of subcontractors and forming doctors' 'chambers', on the model of barrister' chambers, as a way to sell their services to the NHS and other hospital providers." Boots, the chemist is planning provision of GPs and consultants' services in its premises. Other large retailers have also expressed an interest.
[3] The use of AI programmes to assist diagnosis as well as the better utilization of health workers at all levels of skills may be a development to be considered positively but not in the context of profit-led provision.

the for-profit production by health corporation will gradually make everyone salaried within GPs' practices.

The problems of this Blair-Brown grand design for the public sector are beginning to unravel and they will increase as time goes by: problems for the user of public services; problems for the health workers and eventually problems for capital; problems for the State and the political class. Why the latter two problems? Because this grand design signals a profound structural crisis for capitalism. If the system needs propping up via continuous State intervention it cannot be very healthy. So what is going to happen when all that can be outsourced is outsourced and an even larger share of inland revenue goes to pay for private companies' profits?

Moreover, the state is in danger of despoiling itself of major functions and this may lead to a problem of legitimacy: if the State's function is limited to collecting taxes and handing them over to private – domestic and foreign – companies for the actual provision of services can the State justify itself? Will this create also problems for democracy? (Florio, 2004: 155).

A separate important question may be one that political scientists and future historian of politics may be able to tackle: how is it possible for a Labour-led Parliament to preside over the erosion leading to the demise of the NHS and to similar trends in other public services? A question almost as important as why the parliament and the Labour Party did not call government to account over the Iraq war. The huge amount of obfuscating that has been and is going on may explain why it was difficult for the wider public to understand the significance of the changes, but not why competent elected MPs accepted them.

Yes, the 'Third Way' is a new way; it is not just Thatcherism in new clothes, though a good amount of garments have indeed been enthusiastically borrowed.

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A Solution to the Alleged Inconsistency in the Neoclassical Theory of Markets: Reply to Guerrien's Reply

Deirdre McCloskey (University of Illinois at Chicago, USA)

In the *Post-Autistic Economics Review* of October 2002, which has just come to my attention, Bernhard Guerrien wrote an elaborate reply, including an appendix attacking in detail the old textbooks by me and by David Friedman, to those of us who believe that supply and demand curves are useful. He is very harsh in his complaint, and briskly confident that his complaint tells. Perhaps his confidence is misplaced.

Guerrien's complains bitterly about supply and demand curves that they assume a "given" price (correct); and that there is no conceivable source for the givenness except the patently absurd fiction of an Walrasian auctioneer (incorrect).

What's incorrect about this old criticism is that there *is* a source, an obvious one, though neglected by the Samuelsonian economics that Guerrien and I join in criticizing. Still, the obvious source is also ignored by Marxist economics, institutional economics (old and neo-), post-Keynesian economics, behavioral economics, whatever. The only economists who so much as mention it are the Austrians. That's one reason I count myself a fellow traveler of this much-disdained little group.

The missing source is conversation, rhetoric, language, sweet talk itself. The price gets its givenness from the literal conversations that go on in markets. I do not mean by "conversations" only the putting and taking of offers, surrounded otherwise, as has been assumed in economic theory since Ricardo, by stony silence. To be sure, mere money offers are, Adam Smith noted, a variety of persuasive talk: "The offering of a shilling, which to us appears to have so plain and simple a meaning, is in reality offering an argument to persuade one to do so and so as it is for his interest" (*Lectures on Jurisprudence, Report of 1762-3*, Glasgow edition, vi. 56, p. 352). But people do not merely silently offer shillings and silently hand over haircuts. People are not, as autistic economics and as Guerrien in his attack assume, vending machines. They talk, or as Arjo Klamer puts it, they converse. And in conversing they open each other to modifications of the price, it may be, and anyway they establish, as we say, the "going" price. Market participants "in this manner . . . acquire a certain dexterity and address in managing their affairs, or in other words in managing of men [and women, dear Adam, if you please]; and this is altogether the practice of every man in the most ordinary affairs." The ordinary affair of economics itself, for example. The going idea in Samuelsonian economics, we post-autism folk are saying, is that people do *not* converse. The Samuelsonians are mistaken.

Of course, in a large market or a large conversation a small voice is seldom heard. That is what we mean by givenness. There is little point in driving to an enormous California supermarket and initiating a conversation with the manager about the price of milk. You wait until you are talking to your friend the local shopkeeper, perhaps, who might actually respond, persuading you in the ensuing conversation that nothing is to be done, because after all he is in turn a small voice in the market for milk. Or you might, as an economist, wait until you are talking to the Milk Board, which sets the wholesale price of milk, though doubtless it does so after much talk with fellow Board members and with politicians and with Ministry of Agriculture functionaries. You *might* change their minds, and so their talk, and so the price, a bit. You certainly could change some weak minds if you were the President the United States, and wanted to redefine, say, the word "torture."

The situation in markets is identical to that of language. No prudent person will initiate conversations with strangers on the bus about the definition of "givenness" in economic theory. She will wait until she in talking to other economists, at any rate to economists imagining in their conservations a post-autistic economics that is not so dogmatically of the Left that it objects to *every* idea that the cursed bourgeois economists have articulated. We use the French word *amour* or the English word *love* without stopping to quarrel about their meanings, or insisting that *love* actually means "hate," or "light bulb," or "the train will arrive in six minutes." That is, the on-going conversation of language---I note that Walras' colleague Saussure made this point a century ago---gives to us mere ordinary speakers of it a set of distinctions serving to define what's on offer in French or English by way of *sheep/mutton* as against *mouton*.

Guerrien will perhaps reply that the going price/meaning is just an instance of his much-beloved bargaining. I think he and I agree, though, that if bargaining in a strictly game-theoretic way is what we are talking about, then we should abandon hope in economics entirely. The Folk Theorem showed some time ago that in a properly infinite game and an assumption of Prudence Only you can get any old equilibrium you want. Prudence-only game theory, without social agreements of solidarity and justice as to how a conversation can change minds, has no implications. None at all: change the assumptions, change the equilibrium. And in every empirical test on offer, this or that set of prudence-only assumptions has failed. Unlike supply and demand curves.

A price is not set usually by silent bid-offer, move-countermove game bargaining, with its intrinsic paradoxes, an elderly example of which Guerrien has repeated. (I note that in Guerrien's reliance on lecture-room paradoxes here, rather than on the lived experience of markets and languages, he perpetuates exactly the autistic, or if I may say Cartesian, method he has done so much to warn us of.) Price is not set by an auctioneer in most markets---though I wonder what Guerrien would make of the Alsmeer flower market in Holland, with its Dutch-auction clocks ticking the price down; or of the electronic exchanges replacing open-outcry pits at the Chicago Board of Trade. Most prices get their meaning and in particular the givenness of their meaning from the economic conversation. Just as *amour* has a more or less given meaning in French, modifiable at the edges by particularly persuasive talkers, so do dictionary-makers face a more or less given money price for their product. Larrouse cannot suddenly decide to charge 10,000 euros a copy for its big dictionary, or even much above the going price. And therefore it lives with supply and demand curves. There is nothing mysterious or self-contradictory about the situation.

I do not claim that we economists have already figured out how language and the economy intermesh. This scientific task still remains to be done, and will yield a fully humanistic economics, that is, an economics acknowledging humans as talking, singing, story-telling, ethical creatures. Until then the science will be incomplete and paradoxical in the ways that Guerrien has noted. Adam Smith, whose first job in Edinburgh was essentially that of a lycée teacher of English composition, started us off thinking about a *science humaine* of economics, but after 1790 we mislaid his instructions. Time to get back to them.

Meanwhile let's not let clever-sounding paradoxes of the lecture hall persuade us to toss away what tools we have. Givenness is how we little folk in a large society face any piece of our culture. We only need to recognize that the economy is part of the culture, and of its conversations, to recognize that supply and demand curves do after all work, rather well.

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Opinion

Keynes Without Debt

Ron Morrison (UK)

As the power of 'free market' Capitalism – or more precisely, the power of money, takes even deeper root in our 21st century, so also does the human vice of greed undermine our societies. Where once there were standards of behaviour and conduct whereby the democratic process would maintain some crude balance between self-interest and social responsibility, now our governments, ably abetted by a burgeoning 'middle class' seem intent upon dividing the world into 'haves' with even more and 'have-nots' with ever less. Such injustice is the fellow traveller of discontent, generating terrorism and disruption.

The challenge is to humanise the present style of capitalist system. We must recognise the social cost – not only in the obvious sense of the have-nots becoming poorer, but also the ever higher price being paid by the haves in terms of their own much vaunted lifestyles. If the wider infrastructure of society continues to deteriorate, there will be no green and pleasant environment to enjoy.

To this end there exists a practical and specific proposal to consider, which might be called Keynes without Debt. It embraces the economic principles of John Maynard Keynes. Currently unfashionable in the rarefied atmosphere of the neo-classical academicians who espouse the euphemistically styled free market, it was Keynesian principles which pulled the West out of the depression of the thirties and which helped Europe recover from the ravages of WW2.

As war developed into peace and the targets of full employment were achieved, so also began to grow once again the power of money. In the 1980's a new economic theory developed – that of deregulating the money business in the expectation that the market place would produce economic equilibrium. Much faith was invested in Adam Smith's 'invisible hand' - a much misquoted euphemism of the 'I'm alright Jack' fraternity. Hypnotised by this delightful simplicity, and encouraged by a body of bankers and financiers who were obviously extremely influential and financially successful, the politicians of the era – principally Thatcher and Reagan – committed the West to a world run by money as the prime mover of all other policy.

Not everyone was convinced of the long term effects of this, but the money lobby condemned spiralling taxation and the cost of government borrowing as becoming unsustainable and out of hand. The pro Keynes lobby were unable to marshal a counter argument - it was perfectly true that debt – both personal and National, was indeed beginning to spiral and Keynes' theories had never really got to grips with the role of the money system in the economic drama.

Keynes eschewed abstract mathematical theories based on apocryphal assumptions. He produced more practical theories than any of his fellow economists and he dealt with the real world and its problems. He firmly believed that government's job was to intervene where the free market broke down in social terms. However, he never really got down to the nitty-grittys of the money system - government remained obliged to borrow from the banking system in order to intervene effectively; and this implied increased taxation or an escalating National Debt.

Of course Keynes' General Theory was published in 1936 when currencies were still linked to the Gold Standard - indeed the US dollar was still linked to gold up until the early seventies. Keynes died in 1946, long before 100% fiat[1] currencies became the norm. At that time half the money supply in the UK was spent into existence debt free by the state and the other half was chequebook credit. It is not therefore altogether surprising that he felt constrained by traditional monetary theory and found it hard to look beyond bank borrowing to finance public expenditure. The concept of Keynes without Debt addresses our current domestic crisis of rescuing our obsolete Public Services without increasing taxation or cranking up the National Debt.

Now, fifty yeas on, bank credit supplies virtually all our everyday means of exchange, and this brings into sharp focus the simple fact that modern money is no longer constrained by outmoded intrinsic values. It is pure fiat and simply a glorified accounting system. Keynes did see money in this light when he conceived his International Payments Union (Bancor). Very briefly this was an international currency unit to be administered by the UN whereby all countries were encouraged to maintain a balance of payments and avoid excessive debt. Countries in surplus saw their balances reduced by the application of negative interest and those in debt had to pay interest or devalue.

Unfortunately for the developing world the Americans dominated the post war Bretton Woods Conference and were not prepared to permit the mighty dollar to play second fiddle to anyone or anything – no matter how good the logic. Even then they knew that whoever controlled the world's currencies also controlled the political power. However, the detail is not the point here, what is important is the principle – that money is now an accounting system which can be administered in such a manner as to optimise a declared objective.

Modern monetary reform is about displacing the current economic paradigm of 'what can be afforded' with 'what we have the capacity to undertake'. It is a unique situation that for governments the term 'affordability' in terms of money is a non word. *All* new money emanates from government either as cash or as credit authorised under the Banking Acts. The value of the money in our pockets and bank accounts is a function of good government acting responsibly to maintain its value. Nonetheless, the financial establishment (now over a quarter of the UK GDP)[2] reckons that it knows best how much our government can afford to spend on public services and infrastructure.

Governments have issued debt free finance for donkeys years and spent it into circulation interest free. It can be done again, given the political will. The evolution of credit this past fifty years has expelled this source and replaced our means of exchange with private, interest bearing debt. If government can issue Gilts and Bonds they can issue credit to finance the rebuilding of creaking national infrastructures. When government once again shares the money supply 50/50 with the banks we can reduce the tax burden and finance needed public services. Nowadays Wall Street and roads in London's City are not paved with gold but with paper and computer chips. The money supply is all to do with business and maximising shareholder value – nothing to do with benefiting the community. It is the road out

[1] Money declared as legal tender but without intrinsic value or backed by reserves.
[2] Financial Intermediaries – enterprises holding other people's money to make loans – were 27.6% of GDP in 1998. Abstract of National Statistics.

of a mixed economy into a frightening new world order where money buys power, both political and military. We need an alternative route. It's sign posted - Keynes Without Debt.

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Opinion

The Dream Of Creativeness As Outcome Of Political Economy

Margaret Legum

I have a dream, to coin a phrase. It is that human creativeness will become the agreed objective of political economy. Creativeness is more fulfilling and inclusive than happiness. Economics will be put in its place – not a science but as the servant of ethics, exercised through the democratic political process. (Bear with me for the dream: I come to the means later)

How is human creativeness fostered? By all research, it starts in the character of childhood experience, and is reinforced through good education with inspiring adults. Children are more creative who are appreciated rather than deprecated, who attract affection, humour and respect instead of scorn, dismissal and insult, whose bodies are treated with tenderness and not violence. Of course creativity can spring from appalling pain, but more often it is crushed.

What kind of political economy supports that kind of childhood experience? In essence it is one in which their dependency needs can be met – their weakness, their neediness, that trusting expectation of care which adults find so touching. The total dependence of babies and small children is what captures the hearts of even the hardest of adults, and gets us outraged when children are damaged, their small bodies traduced, their trust abused.

And what kind of situation gets dependency needs met? We all know that it is about carers with the resources, the time, the personal sense of security and the inclination to meet children's individual physical and emotional needs and enjoy doing so.

Contrast that with the experience of the great majority of children world-wide. Adults have the care of children in situations without any of the necessary conditions. Millions of mothers must tell their children there is no food, so there is no point in crying. Even middle class parents in the North have little financial security: jobs are casualised from the top of large corporations to the level of the checkout. Even if the worst does not happen, the *fear* of traumatic loss is deeply corrosive to relaxed, enjoyable family life.

Over a hundred leading childhood specialists of various disciplines wrote a letter to the *Daily Telegraph* last week. They describe widespread depression and other behavioral and developmental problems among British children, who are expected to cope with a variety of carers, in a fast-moving competitive culture, pushed by market forces and exposed to material unsuitable to their stage of growth. They say children need real food and real play, as opposed to junk food and sedentary second-hand entertainment: they need proper time-taking attention. The result of its lack is a rise in substance abuse, violence and self-harm – and a sharp reduction in academic achievement.

Publication in the *Telegraph* suggest the Tories will use this issue against the Labour government. Which is ironic, because it is the political economy they introduced in the 1970s that lead to children's needs being ditched in favour of the fast competitive commercial culture that eats up everyone today. All policy-makers now put competition at the top of the agenda –

not only in the private but also the public sector. Your job is on the line unless your output is high and rising. The security of your income and the ease of your family life is the last thing that counts.

Whereas in my children's early years my journalist husband could afford to keep us all in reasonable comfort, all my children's families must bring in two incomes while they raise children. So today's children are deprived of consistent, relaxed, responsive parental care to create minimal financial security. And every government bends every effort to push single parents into the workplace, rather than paying them to care for their own children. You would think we were desperate for labour – rather than desperately short of jobs. Making people work for money, as a condition of survival, is the weirdest, and cruelest, of the outcomes of the current political economy.

How would that have to change to make the dream come true?

Money must come back down from the top where it accumulates in the financial sector and diminishes national purchasing power. That sector pushes up property prices, and keeps labour costs low and unemployment high. The financial sector must stop hoarding our buying power to use it for speculation. That means limiting its right to send capital round the world in search of richer pickings.

Fortunately there are signs that the tide has turned. Economists like Joseph Stiglitz, and the king of global capital, George Soros, warn that without widespread redistribution – via capital controls in some form – the world is heading for financial disaster. The globalised capital market, says Soros, 'is more dangerous to capitalism than communism ever was'.

Popular opinion is changing too. Politicians in Sweden, now facing election, have attacked elements in the financial sector; a German politician likens some bond dealers to locusts. And in Britain, the *Observer's* city columnist, Anthony Hilton predicts that a change in No 10 Downing Street would be 'bad news for City's fat cats', because there is a popular revulsion against City incomes.

That would be the start of a political economy that would enable democratic governments to allocate resources to suit their own electorate rather than to attract footloose capital. It will not create the dream overnight, but it will remove the most savage barrier to its conception, and then its birth.

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