ONE

The Question

The task which the loss of the stable state makes imperative, for the person, for our institutions, for society as a whole is to learn about learning.
(Schön 1973, quoted in Freeman 2006)

In much of the developing world, the 1980s and 1990s were decades of radical economic change. Whereas in the 1960s and 1970s, the prevailing model of development was based on state intervention and inward-looking policies, the 1980s and 1990s were characterized by the advocacy of market-oriented reforms. These reforms, packaged under the so-called Washington Consensus, aimed at opening up national economies and at reducing the role of the state in the economy.[1] The consensus became so broad that some described the new state of the debate on development as one of "universal convergence" (Williamson 1990, 1994; Biersteker 1995; Rodrik 1996: 9).[2]

The story of the "universal convergence" can be told along the following lines. The model of inward-oriented industrialization, epitomized by

[1] The Washington Consensus comprised ten policy prescriptions: Fiscal discipline, adjustment of public expenditure priorities, tax reform, financial liberalization, exchange rate adjustment, trade liberalization, promotion of foreign direct investment, privatization, deregulation, and support for property rights (Williamson 1990, 1994). For stylistic reasons, I refer to these measures as market reforms and neo-liberal programs.

[2] John Williamson acknowledges the existence of broad areas of disagreement in the Washington Consensus. See Williamson (1993) for a discussion. Also, note that this global trend toward market-oriented policies has not precluded differences in the timing of reforms, in their speed and intensity, and in their results. However, the aim of the present study is not to explain those differences but rather to explain why the thrust of economic policy, especially in the developing world, was so different in the 1980s than in the 1970s (Stallings 1992: 43).

the experience of many Latin American countries in the 1960s and 1970s, was a resounding failure. The bias against exports caused enormous balance-of-payment crises. Devaluations, inflation, and fiscal indiscipline became common. Governments borrowed massively from abroad to close the external and fiscal gaps. At the beginning of the 1980s, Mexico's debt moratorium alarmed foreign creditors, who cut off their lending. Without credit to finance chronic fiscal deficits, governments resorted to the printing press, which eventually resulted in hyperinflation and economic stagnation. Moreover, the proliferation of controls and the protection of industries and sectors were an invitation to evasion, rent seeking, and corruption (Iglesias 1992; Tommasi and Velasco 1995: 1–3; Krueger 1993, 1997).

In clear contrast, and simultaneously, Chile and the East Asian tigers (Korea, Singapore, Hong Kong, and Taiwan) achieved phenomenal rates of growth by relying on greater integration into the world economy. The hallmark of this strategy was an export-promotion policy, taken to be the quintessential illustration of the virtues of a small state. At the end of the 1980s, the collapse of Communist rule in Eastern Europe struck the final blow to the idea that state intervention was a requisite for development. By the early 1990s, even these countries had become engaged in market-oriented reforms.

These changes in the South and the East took place amid a neo-liberal revolution in the North. At the beginning of the 1980s, Conservatives in Britain and Republicans in the United States launched a campaign against the idea of "big government." The neo-liberal revolution put an end to the Keynesian consensus, which had dominated public affairs since World War II.

A widely accepted explanation of the wave of economic reform is that governments learned from contrasting experiences under alternative models of development. This learning would have entailed a change in the mapping from policies to economic outcomes, and a change in beliefs about the consequences of actions and the optimal strategies in a changing economic environment. Thus, the story goes, governments would have observed these contrasting experiences and changed their beliefs about the economic consequences of alternative economic models. Even short-sighted politicians could not have avoided the conclusion that

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the old policies had failed and the new orthodoxy had produced economic success (Kahler 1990, 1992; Haggard and Kaufman 1992; Hall 1993; Haggard and Webb 1994; Biersteker 1995; Tommasi and Velasco 1995; Krueger 1997). Yet, the learning hypothesis remains untested. Hence the question: *Did governments switch to market-oriented policies as a result of a learning process?*

In order to test this explanation rigorously, one needs an operational concept of learning.[3] I shall assume that governments are rational (Bayesian) learners. This means that governments efficiently update their initial beliefs about the expected results of alternative policies with reference to information about policy outcomes in the past and elsewhere. After updating their beliefs, governments choose the policies that are expected to yield the best result in terms of economic growth.[4] Hence, the model I test is one in which politicians first learn in the light of experience and then make rational choices on the basis of what they learn. Having been exposed to the same information, governments converged in their beliefs and, hence, in their policy choices.

This approach is used to test the role of learning in the decisions in the 1980s and 1990s to liberalize the trade regime, privatize, open up the capital account, and enter into agreements with the International Monetary Fund (IMF). The book shows that rational learning partly motivated policy switches in the cases of privatization and trade liberalization. Whereas learning also mattered in the decision to open the capital account, the magnitude of the effect was very small. Rather, rational learning appeared more consequential in explaining the decision to sustain an open capital account. Learning also mattered in the decision to sign agreements with

[3] Although the discussion about learning has been widespread, it has focused more on definitional questions (Heclo 1974; Odell 1982; March and Olsen 1989; Sabatier and Jenkins-Smith 1993; Rose 1991, 1993; Bennett and Howlett 1992; May 1992; Pierson 1993; Levy 1994; Haas and Haas 1995; Adler and Haas 1997; Stone 1999; Freeman 2006).

[4] Note that I am assuming that governments judge the success of market reforms in terms of their potential to promote economic growth. This view is generally agreed. As Stiglitz puts it (2000: 552), "privatization and trade liberalization are not ends in themselves, but means to ends – ends such as more rapid, more sustainable, and more equitable growth and improved living standards." Krueger (2000: 64) adds, "structural reforms were necessary to promote higher, sustainable growth by improving the environment for physical and human capital accumulation."

the IMF, but in a way that suggests that IMF contracts are not routine policy making. Thus, learning from the experience of others mattered in all policy illustrations but according to different patterns and with different impacts on policy decisions. Indeed, rational learning was never the most important determinant of policy choices. Emulating others, third-party coercion and particular domestic characteristics drove policy decisions to a considerable extent as well.

Overall, governments learned. But governments not only learned. From a normative point of view, it is good news that learning was at least part of the explanation for the adoption of market reforms. This means that countries, on average, adopted the policies that, again on average, performed comparatively better. Yet, it is less reassuring to find that, on occasion, governments mindlessly imitated the policies of others rather than understanding them (when privatizing and when liberalizing trade); or that governments adopted particular policies for which neither theory nor evidence was conclusive about their superiority. This book discusses the welfare consequences of adopting policies for reasons other than rational learning. It also speculates about the prospects of the reform movement in light of the results of this study.

The introductory chapter proceeds as follows: In the next section, I review some of the narrative evidence regarding the role that learning from others' experience played in the adoption of market reforms. The narrative suggests that governments did, indeed, look at the performance of other countries and draw lessons from their experience. Following this, I discuss the literature on learning and the different approaches to the study of this concept. I show that, whereas learning is a major topic in international relations and comparative public policy, the discussion has mostly remained at a conceptual level. I claim that rational updating is a powerful tool to overcome the operationalization conundrum. Next, I discuss alternative explanations for the observed convergence of market reforms. At the very least, convergence could have been motivated by an attempt to imitate, rather than to learn from the success of others. Also, supranational and international institutions could have forced or persuaded countries to adopt these policies in their role as disseminators of norms and policy ideas. Finally, convergence could have been the result of identical but independent responses of countries confronted with the same environment. The chapter concludes with an outline of the book.

1.1. Governments, Market Reforms, and Learning

Most of the many studies on the political economy of market reforms assume that at least some reforms are desirable, and focus on the social and political factors that preclude, delay, or promote the adoption of reforms and their sustainability through time.[5]

According to such studies, the conjunction of a deep economic crisis, a new government with a strong mandate, and a coherent and autonomous economic team supported by a "visionary" leader are good predictors of the *launch* of economic reforms. Compensation to the groups who suffered as a result of the adjustment and some external financial aid are usually cited as requisites for reform *sustainability*. The way in which these and other variables operate has been extensively documented, so I do not delve into them here. Instead, I focus on governments and their preference for market reforms.

It is not at all obvious why governments interested in remaining in office may find market reforms desirable. Reforms are highly uncertain. Indeed, the only certain thing is that reforms will make most of the population worse off, at least temporarily (Przeworski 1992: 45). Given the political risks they entail, the adoption of such policies is remarkable.

For some authors, politicians' preference for adjustment is a question of "vision," "political will," or even "heroism" (Harberger 1993; Williamson 1994). Politicians who embark on reforms are heroes because they are willing to "lift their sights beyond the next election" and run high electoral risks for the common good. Obviously, this reading makes sense only if reforms are viewed as intrinsically virtuous and uncontroversial. Yet, it is a poor explanation of governments' preferences.

For other authors, governments opt for reforms for ideological reasons. As reflected in the fact that reform pioneers were right-wing military governments (for example, Chile under Pinochet in 1973–90 and Korea

[5] Nelson 1990a; Grindle and Thomas 1991; Frieden 1991a; Przeworski 1991; Haggard and Kaufman 1992; Waterbury 1993; Bresser, Maravall, and Przeworski 1993; Bates and Krueger 1993; Krueger 1993; Harberger 1993; Taylor 1993; Harrington 1993; Keeler 1993; Haggard and Webb 1994; Smith, Acuña, and Gamarra 1994; Nelson 1994; Geddes 1994; Williamson 1994; Tommasi and Velasco 1995; Haggard and Kaufman 1995; Rodrik 1996; Maravall 1997; Weyland 1996, 2002; Sturzenegger and Tommasi 1998; Drazen 2000; Krueger 2000; for criticisms and nuanced arguments about the desirability of reforms, see, for example, Murrell 1991; Przeworski 1992; Bresser, Maravall, and Przeworski 1993; Rodrik 1996; Stiglitz 1998, 2000.

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under Park Chung Hee in 1963–79), the widespread contention is that market reforms are the natural preference of rightist governments. Some of the policy measures of the Washington Consensus were also vigorously defended by prominent rightist leaders in the North (such as Ronald Reagan in the United States in 1981–89 and Margaret Thatcher in the United Kingdom in 1979–90). Finally, domestic and foreign business groups, which are a traditional constituency of the right, frequently pressed for economic adjustment (Williamson and Haggard 1994: 570–71).

However, explanations based on ideological preferences cannot accommodate the fact that democratically elected leftist and populist governments also engaged in reforms, imposing the biggest sacrifices on their own constituencies – namely, labor and the poor. Socialists in Spain (under Felipe González, 1982–96), Labor governments in New Zealand (under David Lange, 1984–89) and Australia (under Bob Hawke, 1983–91), Peronists in Argentina (under Carlos Menem, 1989–99), and social democrats in Brazil (under Fernando H. Cardoso, 1995–2002) are just a few examples. Hence, ideological preferences seem to be a poor predictor of the decision to engage in these policies.[6]

I pursue another line of reasoning and argue that governments' preferences for market reforms were shaped by observing the experience of others, particularly by learning from policy failures and successes.

The hypothesis that crises facilitate the initiation of market reforms is very popular. However, it is also hotly debated. Dani Rodrik argues that, since there is no definition of crisis, the hypothesis that an economic crisis is a prerequisite for launching market reforms cannot be falsified. Indeed, it is a tautology: "[R]eform naturally becomes an issue only when policies are perceived not to be working. A crisis is just an extreme case of policy failure. That reform should follow crisis, then, is no more surprising than smoke following fire" (1996: 27; see also 1994). However, Drazen contends that there is something to be explained if,

[6] True, the literature on policy reform makes it clear that there is a social democratic approach to implementing these policies. As opposed to their rightist counterparts, leftist governments approach the reforms gradually, compensate the more vulnerable, and reach pacts with labor so that inflation is held in check while labor cooperation is rewarded with greater investment in welfare provision and education (Bresser, Maravall, and Przeworski 1993; Boix 1998).

to use Rodrik's metaphor, only big fires but not small or medium ones cause reforms (2000: 444–46). If this is the case, and only hyperinflation, burgeoning fiscal deficits, or exploding imbalances in external accounts cause reforms, the subsequent question is why do crises have to be deep in order to spur policy switches?

Periods of deep economic disarray and the accompanying sense of loss of control, great uncertainty, and looming catastrophe may weaken the power of vested interests that otherwise would block reforms. Also, the sense that something must be done creates space for "special politics," that is, for a temporary suspension of the regular channels by which interest groups, party politics, and legislatures influence the policy-making process (Balcerowicz, in Williamson 1994; Drazen 2000: 447).[7] In Keeler's words (1993), if politicians in power are backed up with a strong mandate, a deep economic crisis may open a macro window for reform.

Note that this mechanism, which links a deep crisis with an enhanced *capacity* for action, reveals nothing about the *content* of the response. But, if under particular circumstances, governments' autonomy increases, agents' preferences turn out to be crucial to understanding policy choices (Grindle and Thomas 1991).[8] Overall, crises create opportunities for change. State autonomy creates the capacity to implement choices. But the content of the response is, at least in part, determined by policy-relevant knowledge.

Deep crises generally prompt some diagnosis of what causes them. In this sense, the diagnostic conveys some policy content, at the very least, about what should be avoided. Kurt Weyland's account of the adoption of market-oriented reforms addresses politicians' motives for action and the content of their choices (1996, 1998, 2002). Weyland contends that market reforms can be explained in light of prospect theory (Kahneman and Tversky 1988). According to this psychological approach to decision making, individuals make risky policy choices only when

[7] Sometimes strong mandates and a divided opposition spontaneously give governments a lot of room for maneuver (as in Spain in 1982). At other times, this room is deliberately created by granting the executive special powers for swift action.

[8] Bates and Krueger's review of several episodes of reform concludes that "one of the most surprising findings of our case studies is the degree to which the intervention of interest groups fails to account for the initiation or lack of initiation of policy reform" (1993: 454).

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confronted with the prospect of big losses. A deep crisis puts decision makers in the domain of losses. As a result, governments are willing to launch draconian adjustment measures. For instance, the adoption of market reforms followed hyperinflations in Argentina, Bolivia, Brazil, Peru, and Poland. In Chile, Ghana, Senegal, Russia, and Tanzania, reforms were adopted amid uncontrolled fiscal or external deficits and mounting shortages of goods.

In addition, according to Weyland, new governments can overcome the strong status quo bias that characterizes decision making. Because changing the course of the political economy implies admitting that the previous course of action has failed, insiders are unlikely to endorse radical shifts in policy. However, new leaders are not affected by this bias. Indeed, new leaders often adopt radical policies to signal a break with past policies viewed as failures. Alberto Fujimori in Peru (1990) implemented a drastic reform program after the failed heterodox experiments of Alan García. The same applies to Fernando Collor de Mello (1990–92) and Carlos Menem (1989) in Brazil and Argentina respectively. Finally, Frederick Chiluba in Zambia (1991) launched a program of economic reforms after the heterodox adjustment program of Kenneth Kaunda (1964–73) collapsed. Hence, on this account, the adoption of market reforms appears as a reaction to previous failed policies (see also Nelson 1990a). Whether that reaction entailed an improved understanding of the relationship between policies and outcomes is not specified.[9]

The mechanism that relates deep crises to the content of the response is, precisely, learning. Tommasi and Velasco argue that crises contribute to Bayesian learning about the "right" model of the world. A period of intense economic disarray leads to a reassessment of the mapping from policies to outcomes – in particular, to a realization of how costly some previous policies were (1995:17–18). In the same vein, Harberger asserts that politicians have particular worldviews that may contain sensible explanations for bad economic outcomes. However, "every now and then,

[9] The same behavior applies to the electorate. The prospect of big losses makes people acquiesce to and even support the reforms. Weyland (2002) contends that reforms continue because, as soon as adjustment yields results, the electorate is placed in the domain of gains, where individuals are risk-averse. This interpretation overlooks that fact that, quite often, reforms restore growth only after long lags, if at all.

something happens that does not fit the previous image – something that shakes our Bayesian faith in what we used to think" (in Tommasi and Velasco 1995: 18). A period of deep economic disarray is a good candidate for provoking that breakdown of faith.

The contention that governments' preferences for market reforms were shaped, at least in part, by the experience of policy failures and policy successes is widely endorsed by scholars and policy makers alike. For instance, in 1993, Williamson asserted:

> [t]he hope that we can now develop far more consensus than would have been conceivable or appropriate in the 1950s is based ultimately on the fact that we now know much more about what types of economic policy work. At that time, it looked as though socialism was a viable alternative to a market economy; now we know that it is not. At that time, we had not discovered that pushing import substitution beyond the first ("easy") stage was vastly inferior to a policy of outward orientation that allowed nontraditional exports to develop: now we know better (p. 1331).

Maravall (1997: 168), discussing the adoption of market reforms in eastern and southern European countries in the mid- and late 1980s, holds that "some leaders sought to avoid experiments which might prove costly in political or economic terms. They were more likely to make this choice if they were particularly influenced by past experiments, whether in their own country or elsewhere." In fact, Hungarian reformer Peter Bod eloquently stated that "on the basis of my reading and limited personal experience of developments in industrialized and newly emerging industrial countries, it was quite clear to me that the process taking place in Hungary was not extraordinary in all respects. The painful restructuring, the decay of traditional industry, the market reorientation, the opening up and outward looking economic policies following autarkic periods – these were all concepts that could be amply studied in the economic histories of other countries" (in Blejer and Coricelli 1995: 99).

Nicolás Ardito-Barletta, president of Panama in 1984–85, asserted that "[T]here is a national learning process that permits society to discover, through trial-and-error, how to arrive at new social rules of the game and policies that are beneficial to the majority" (1994: 461). And he added: "the national learning process as a vehicle for economic policy change and stability is most useful when there is a national memory of past economic policy performance. Documented records of the failures or inadequacies of past policies are powerful teaching devices to support policy changes" (1991: 286). In his analysis of the adjustment process in Indonesia, Iwan Azis stated that "certainly, a 'learning process' has taken place during the course of Indonesia's development over the last 25 years" lessons that "policy makers . . . eventually grasped and digested" (1994: 410). Arriagada and Graham (1994: 282) contend that, in Chile, short-term populist strategies were discredited by "the chaos in neighboring countries, [which] made macroeconomic restraint much more politically palatable." Finally, Czech reformer Václav Klaus stated that "[o]f course we followed the experience of some other countries that reformed their economies in parallel with our own, especially those of Hungary and Poland, but I must say that what we learned from them was mainly on the negative side" (in Blejer and Coricelli 1995: 66).

As much as bad outcomes convey information about what not to do, good performance conveys information about alternative courses of action. If learning actually occurs, "the experience of many reforming countries (assuming a modicum of success) will . . . be imitated by others before having to experience themselves a crisis and the associated economic pain" (Tommasi and Velasco 1995: 19). Therefore, learning from successful reform experiences could explain the adoption of reforms in countries such as Colombia (1985) that adjusted despite not experiencing a deep crisis.

To continue with the narrative illustration, Moisés Naim (1993: 46), former Venezuelan minister of trade and industry, contended that Carlos A. Pérez's vision was influenced by the governing experiences of two of his closest personal and political friends. These experiences were:

> . . . the catastrophic failure of President Alan García in Peru and the successful reforms of Felipe González in Spain. Pérez was able to follow the policies and performance of these two governments very closely and his privileged vantage point allowed him to judge the consequences of the two radically different approaches.

The outstanding performance of Chile and the East Asian tigers appeared as the most important source of inspiration. Crucial to the appeal of the alternative cases was the interpretation of their success. While the crises