Can orthodox stabilization and adjustment work? Lessons from New Zealand, 1984–90
Herman Schwartz

Can orthodox economic stabilization and adjustment programs work? Two factors made most debates about this during the 1970s and 1980s a dialogue of the deaf. First, because defenders and critics of orthodoxy held contrary initial assumptions, they interpreted the same data in contrary ways. Second, and more important, because peripheral or less developed countries (LDCs) had rarely been successful in their attempts to implement fully and sustain an orthodox program, most of the evidence, even in aggregate quantitative studies, was weak and contradictory.¹ Nevertheless, two things now allow

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for partial resolution of this debate. The first is that practical policy advice proffered by critics and defenders has converged during the past two decades, allowing us to construct an image of a "typical" orthodox program for stabilization and adjustment. The second is that such a program was not only fully implemented but has also been sustained in New Zealand since 1984. Just as the failure of heterodox stabilization in Peru shows the limits to the heterodox model in general, the results to date in New Zealand point to significant outer limits to what is possible with the orthodox approach to stabilization.

In general, orthodox stabilization programs try to solve short-term imbalances between aggregate demand and supply by combining demand-reducing and supply-enhancing measures. Demand is reduced by lowering the fiscal deficit, decreasing the rate of growth of the money supply, devaluing the currency, and desubsidizing economic activities. Supply is enhanced by decontrolling and reforming prices to allow for more efficient market allocation of investment and other resources. Adjustment, which is the long-term process of accommodation to the poststabilization level of aggregate supply and demand, relies more on supply-side measures. Defenders of orthodox programs argue that successful demand reduction primarily requires administrative capabilities and state strength, while supply expansion is a market-driven phenomenon.

Several factors make New Zealand a suitable case for testing the orthodox model of stabilization. Despite its image as a developed industrialized nation, New Zealand has an economic structure similar to that of the middle-income developing countries, a structure that combines an internationally competitive primary sector with a largely uncompetitive and sheltered manufacturing sector. Beginning in 1965, New Zealand faced declining terms of trade for its primary product exports. Between 1975 and 1984, its payments and fiscal deficits grew unsustainably in a fashion typical of the developing countries. And like many of these countries, New Zealand tried to overcome the structural tendency toward imbalance through foreign debt-financed import substitution industrialization (ISI). But, as in Latin America, ISI in New Zealand created uncompetitive industries whose inefficiencies and tax-funded subsidies hurt the export (agricultural) industry, leading to a large fiscal deficit, relatively high levels of inflation, and growing foreign indebtedness. As Table 1 indicates, New Zealand's external debt by the mid-1980s was close to that of the highly indebted LDCs.

There are, however, important differences between the economic problems faced by New Zealand and those faced by the LDCs. The typical supplicant to multilateral lending agencies such as the International Monetary Fund (IMF) has massive unemployment and concentrated patterns of land ownership. According to critics of orthodox stabilization programs, this prevents market signals from calling forth investment and an expansion of supply. Since the supply-side response to orthodox programs is severely constrained, they argue, the programs fail. In contrast to the LDCs, New
TABLE 1. A comparison of New Zealand’s external debt with that of selected developing and developed countries, 1985a

<table>
<thead>
<tr>
<th>Country or group</th>
<th>Net debt as a percentage of GDP</th>
<th>Net debt as a percentage of exports</th>
<th>Debt service as a percentage of GDP</th>
<th>Debt service as a percentage of exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand</td>
<td>51</td>
<td>164</td>
<td>4.6</td>
<td>14.7</td>
</tr>
<tr>
<td>Highly indebted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LDCs b</td>
<td>46</td>
<td>271</td>
<td>4.9</td>
<td>27.9</td>
</tr>
<tr>
<td>Portugal</td>
<td>43</td>
<td>111</td>
<td>5.6</td>
<td>14.5</td>
</tr>
<tr>
<td>Spain</td>
<td>8</td>
<td>36</td>
<td>1.1</td>
<td>4.9</td>
</tr>
<tr>
<td>Turkey</td>
<td>48</td>
<td>189</td>
<td>2.5</td>
<td>9.8</td>
</tr>
<tr>
<td>Australia</td>
<td>25</td>
<td>157</td>
<td>2.8</td>
<td>17.7</td>
</tr>
<tr>
<td>Denmark</td>
<td>40</td>
<td>108</td>
<td>4.2</td>
<td>11.5</td>
</tr>
<tr>
<td>Finland</td>
<td>14</td>
<td>46</td>
<td>1.9</td>
<td>6.3</td>
</tr>
<tr>
<td>Sweden</td>
<td>22</td>
<td>62</td>
<td>2.5</td>
<td>7.0</td>
</tr>
</tbody>
</table>

aData are for the calendar year 1985. Fiscal year data for New Zealand are shown in Table 4.

bFigures indicate the averages of the following highly indebted less developed countries (LDCs): Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Ivory Coast, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.


New Zealand does not have these types of impediments to productivity-enhancing investments. Nor did New Zealand appeal to the IMF for help to solve its problems. Instead, the Labour government of New Zealand developed and implemented a stabilization program designed to reduce aggregate demand while allowing for market-led expansion of supply.

In the next two sections of this article, the economic and political debates over orthodox stabilization programs are delineated, with emphasis placed on the defenders’ arguments. Although IMF-designed programs have been the focus of this debate in the literature, New Zealand’s government-designed program is also considered typical of the orthodox approach in the arguments presented here. In subsequent sections, New Zealand’s program is outlined and used as a test case for orthodox stabilization programs in general. The New Zealand case is close to being a “crucial case” for some

2. In a crucial case, all of the independent and intervening variables that a theory posits are both present and acting in the manner that the theory presumes. Dependent variables thus should behave as the theory posits; if they do not, the theory or its assumptions are questionable. See Harry Eckstein, “Case Study and Theory in Political Science,” in F. I. Greenstein and N. W. Polsby, eds., Handbook of Political Science, vol. 7 (Reading, Mass.: Addison-Wesley, 1975), pp. 79–137.
critics' and many defenders' arguments about the probable outcomes of the orthodox approach. Because the supply-side constraints in New Zealand were weak and the Labour government had not only the desire but also the capacity to reduce demand through tight monetary and fiscal policies, conditions were highly conducive to attaining economic stabilization. Yet New Zealand achieved only a precarious stabilization after six years of reasonably sustained policy. In addition, sustained policy implementation revealed a previously unsuspected contradiction between orthodox prescriptions for disinflation and increased financial liberalization, both of which are at the core of orthodox policies. The article concludes that if New Zealand's efforts were only mildly successful, then we can only expect worse outcomes elsewhere, where supply-side constraints loom larger and administrative capacity is weaker.

Beneath the debates: contrary premises

Because critics and defenders of orthodoxy start from different basic premises, they disagree profoundly about the fundamental nature of capitalism in the peripheral countries.3 Their differing initial assumptions in turn lead them to contrary conclusions about the probable consequences of orthodox stabilization programs. Most discussions about the arguments advanced by the two sides see the differences as a function of the defenders' focus on monetary control and other demand-side issues and the critics' focus on supply-side issues. But over the years, the "monetarists" have added more and more supply-side elements to their programs, while the "structuralists" have acknowledged more and more the need for reducing demand to sustainable levels. This demand-side versus supply-side contrast obscures a more fundamental division. Orthodox defenders believe that all capitalist economies behave similarly and that orthodox policies in developing economies should therefore have the same results as in developed economies. Consequently, if inflation and an imbalance of payments persist in developing countries, this reflects failures of political will. In contrast, structuralist critics see peripheral economies as fundamentally different from core economies. Supply bottlenecks and social impediments to investment lead to inflation and unbalanced payments in peripheral economies, and the usual orthodox package aggravates rather than ameliorates these existing problems, thereby making growth impossible.

Are there "intermediate" positions in this debate? The steady incorporation of supply-side arguments and policies into neo-orthodoxy and demand-

3. Obviously, not all critics and defenders hold all of the assumptions that characterize the contrary models drawn here. Contrary to the usual view, however, here I do not argue that a range of opinion tends to run along a continuum stretching between the critics and defenders.
side arguments and policies into neostructuralism seems to suggest a convergence along some continuum stretching between the orthodox demand-siders at one extreme and the heterodox supply-siders at the other. In this view, the "real economy" approach of Tony Killick and his colleagues, an approach that attempts to reconcile stabilization and growth objectives, would constitute some golden mean balancing supply and demand concerns. But while a balanced intermediate position can be found at the policy level, it cannot be found at the level of underlying premises. The basic premises of "critical defenders" and "defensive critics" do not differ greatly from those held by the extremes in this debate. It is the basic premises which have produced the seeming opposition of demand- and supply-side concerns. Let us look at the defenders' and critics' premises to see why.

Defenders of orthodox stabilization programs

The defenders of orthodoxy believe that only one "economics" exists. They do not believe that developing economies have any structural features predisposing them to macroeconomic disequilibrium. In developing and developed economies alike, any persistent and unsustainable imbalance of payments reflects a macroeconomic disequilibrium between aggregate demand and domestic supply. Excess aggregate demand results from exorbitant central bank credit and money creation, including government borrowing overseas to cover current account deficits. Simultaneously, domestic supply shortfalls result from government price subsidies, maintenance of artificial exchange rates, and the general inefficiencies associated with public, as opposed to private, enterprise. The combination of uncontrolled aggregate demand and inefficient resource allocation causes an increase in inflation, which in turn leads to an increase in debt as the trade imbalance grows.

According to the defenders, the solution to these compounding problems is to constrict aggregate demand, thereby bringing supply and demand back into balance. In many cases, the IMF's institutional role has been to grant

4. See Killick et al., Quest for Economic Stabilization.
6. An imbalance of payments is chosen as the indicator because this is the generic institutional concern of the IMF, which is involved in most efforts to implement an orthodox program.
loans on the condition that demand-side measures be implemented. These loans have traditionally been short-term and designed to resolve immediate payments problems and, more important, to attract foreign private lending to LDCs adhering to the conditions. This does not mean that the IMF or orthodoxy’s defenders abjure supply-side measures in favor of purely monetarist policy. The IMF indeed recognizes that a new equilibrium could emerge from increased supply, too. But because, as two staff members stated, “many types of supply-side measures improve output only after a significant delay” and because the IMF is institutionally concerned with alleviating short-run imbalances of payments, the IMF is to an extent disinterested in supply-side measures. Nevertheless, as both the IMF and the defenders of orthodoxy are careful to point out, all programs in recent years have had a significant “supply-side” component. However, since both groups believe a priori in the relative inefficiency of government economic intervention to increase supply, both prefer to encourage supply-side expansion by eliminating demand-side distortions such as price controls, rather than by active intervention in markets.

Typically, both the IMF and the defenders of orthodoxy recommend decelerating or constricting monetary growth to slow inflation or produce deflation; devaluing to encourage redeployment of economic resources into tradable goods so as to balance international payments; and freeing the market from government and political interference to promote long-run growth through efficient allocation of resources. A crucial component of demand control is the reduction of the fiscal deficit. Although responses to this typical program might vary in degree, there should be no qualitative differences in response among the various economies in the world. According to the defenders, developing economies contain sufficient resources and production capacity to service debt and provide a modicum of growth over

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7. See The Lending Policies of the International Monetary Fund, in which Williamson offers a disinterested view arguing for eclecticism in IMF programs.


10. IMF staffers habitually state that their policies are good medicine for developed as well as developing countries. See Khan and Knight, Fund-Supported Adjustment Programs and Economic Growth. As Cohen indicates, the seeming uniformity of stabilization programs is a function of the IMF’s origins in the Bretton Woods system, which adopted the notion of sovereign equality. Logically, at least from a juridical point of view, the IMF ought not apply different standards to “developed” and “developing” nations. Nevertheless, as Killick points out, 108 of 114 new standby agreements negotiated by the IMF from fiscal year 1976–77 through 1981–82 were with developing countries. See Benjamin Cohen, “Balance of Payments Financing: Evolution of a Regime,” in Stephen Krasner, ed., International Regimes (Ithaca, N.Y.: Cornell University Press, 1983), pp. 315–36; and Killick, Quest for Economic Stabilization, p. 3.
the long term once inflation, resource misallocation, and inherently inefficient public enterprises are removed.\textsuperscript{11}

The fact that defenders of orthodoxy believe that their arguments hold true for all economies means that New Zealand cannot be rejected as a test case on the basis of its economic structure.

\textit{Critics of orthodox stabilization programs}

Unlike the defenders of orthodoxy, who argue that only one "economics" exists and that responses to programs vary only in degree (quantitatively), the critics of orthodoxy argue that there are structural differences between peripheral and core economies and that responses to programs therefore vary in type (qualitatively).\textsuperscript{12} The structural critique has two distinct lines of argument. The stronger version, which stands in stark opposition to the orthodox view, makes a supply-side argument, while the weaker version, which is akin to the modified orthodoxy that has motivated programs such as the IMF’s Compensatory Fund, Extended Fund, and Structural Adjustment Facilities (discussed below), makes a demand-side argument.

According to the stronger and more elaborate structural argument, the nature of social relations in the periphery creates severe supply-side constraints, and these in turn make the "peripheral capitalist mode of production" qualitatively different from that of core capitalism.\textsuperscript{13} In the periphery, a vast oversupply of labor not only keeps wages low but also inhibits investment in the labor-saving technology essential to capitalist development.

\textsuperscript{11} For recent expositions, see Khan and Knight, \textit{Fund-Supported Adjustment Programs and Economic Growth}; and Research Department of the IMF, \textit{Theoretical Aspects of the Design of Fund-Supported Adjustment Programs}. For criticism, see Carlos Diaz-Alejandro, "Southern Cone Stabilization Plans," in Cline and Weintraub, \textit{Economic Stabilization in Developing Countries}; Killick et al., \textit{The IMF and Stabilization}; and Killick et al., \textit{Quest for Economic Stabilization}. Note that on p. 39 of \textit{Quest}, the authors conclude that wage inflation was not a major cause of inflation in most LDCs.


\textsuperscript{13} See Raoul Prebisch, \textit{The Economic Development of Latin America and Its Principal Problems} (New York: United Nations, 1950); and Samir Amin, \textit{Accumulation on a World Scale} (New York: Monthly Review Press, 1974), particularly chap. 3. Although Amin does not directly criticize the IMF, his analysis of "peripheral capitalism" underpins weaker and more incoherent versions of the structural critique. Amin, like many defenders, can be accused of adhering to a "monoeconomics" view of LDCs. While peripheral capitalism is distinct from center (or core) capitalism and while the real social formations associated with peripheral capitalism have heterogeneous origins and consequently heterogeneous characteristics, all of them suffer from an absolute oversupply of labor induced by contact with full-blown capitalist social forma-
and increased productivity. In the core, where there is no oversupply of labor, wage regulation by workers is possible through unionization. While rising wages lead to higher prices for core goods through "mark-up pricing," wage pressures and competition also lead naturally to innovation, investment in technology, and increased productivity. The result, as Samir Amin and Raul Prebisch argue, is that the terms of trade both for agriculture and for industry in peripheral economies ineluctably deteriorate as core productivity outstrips peripheral productivity. Moreover, this tendency toward declining terms of trade is worsened by the juxtaposition of subsistence agriculture and commercial or export-oriented mono-agriculture, which creates supply rigidities. Juxtaposition immobilizes agricultural resources and thus reinforces barriers to investment. This creates inflationary pressures whenever domestic or foreign demand rises, since land cannot be shifted from one use to another without significant social disruption. Structuralists advancing this argument thus foresee steadily worsening imbalances of payments for peripheral economies. They attribute the failure of orthodox programs in the periphery to supply-side constraints that emerge from social conditions, whereas defenders of orthodox programs argue that supply-side constraints emerge from political intervention in markets.

The above supply-side structural argument is not relevant to the case of New Zealand, since the labor and land use conditions that limit supply are not present in New Zealand. However, the two arguments that comprise the demand-side structural critique are relevant. The first argument rests on the nature of total global demand and its effects on core and peripheral economies, while the second rests on the nature of domestic demand in individual peripheral economies.

The "global demand" critique, which derives from traditional arguments about prisoners' dilemma, is best seen as a denatured version of the Prebisch thesis regarding wage-induced terms-of-trade problems. According to this critique, peripheral countries at best have competitive agricultural sectors and uncompetitive industrial sectors, and their terms-of-trade problems are

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14. See Prebisch, The Economic Development of Latin America and Its Principal Problems; and Amin, Accumulation on a World Scale.

15. If a peripheral country's agricultural and manufacturing sectors were both internationally uncompetitive, the country would be forced out of world trade, and the nature of the problem would change from one with which the IMF was concerned into one with which various charitable agencies were concerned, at least in principle.
aggravated by the differing demand elasticities for agricultural and manufactured goods. Weaker demand for "Engels' goods" means that agricultural exporters in the periphery face declining terms of trade. This, in turn, either creates a payments deficit as agricultural exports fail to cover "socially necessary" manufactured imports or leads to a decline in growth and living standards as imports contract. The argument is based on the notion that the total global demand is insufficient to induce greater exports by peripheral economies. Any expansion of their agricultural exports in the face of stagnant demand would lead to a decline in prices as markets become glutted.

The "domestic demand" critique, which derives from a long tradition of writings concerning late development and stretches from Friedrich List through Alexander Gerschenkron to Dieter Senghaas, is best seen in Albert Hirschman's work on ISI and the structure of peripheral income distribution and demand. According to Hirschman, the demand for industrial goods from peripheral economies is weak in comparison to that from the larger core economies. The weak demand makes forward and backward linkages from agriculture to industry difficult. On the one hand, if policymakers in peripheral economies do nothing to overcome these difficulties, the results are stagnation and suboptimal use of resources. On the other hand, if they pursue strategies to overcome bottlenecks in manufacturing and create the linkages necessary for development, this naturally leads to inflation and short-term international imbalances in payments. In Hirschman's view, this second course is worth pursuing, since credit-driven inflation and payments disequilibria are a reasonable price to pay for future development. Killick is among those agreeing with Hirschman's prescriptions.

Different premises, different answers

Supply- and demand-side constraints and policy recommendations

The discussion above shows why the debate between defenders and critics, at least at the theoretical level, is not simply a debate about the appropriate proportion of supply- and demand-side mechanisms in adjustment policy.


17. In Quest for Economic Stabilization, pp. 50–53 and 274–75, Killick agrees that the mild inflation which occurs when output is pushed to its limits has benefits that exceed the costs imposed by that inflation. This is why he cautions against overkill. This view also has some neoclassical adherents; see, for example, W. Arthur Lewis, "Economic Development with Unlimited Supplies of Labour," Manchester School Journal 22 (May 1954), pp. 134–91.
Instead, it is about different types of supply- and demand-side policies. The different premises of the critics and defenders lead them to locate the specific supply- and demand-side problems in different places. As an example, we can turn to inflation, which most econometric studies of developing economies show comes from domestic sources.\textsuperscript{18}

Structuralist critics (with differing emphases) claim that inflation in peripheral economies originates from the bifurcation of agriculture into a subsistence segment and a commercial and export-oriented segment or springs from the reliance of industry on imported capital and intermediate goods. Let us consider the argument about agriculture as it pertains both to an expansion of and a reduction in external demand. On the one hand, structuralists argue that any expansion of external demand for commercial agricultural goods creates extra wages in that segment. This in turn creates extra demand for food products from the traditional segment, subsistence agriculture. The combination of low productivity in subsistence agriculture and the difficulty in shifting land from commercial and export use to subsistence use (especially when export demand is rising) causes food prices to rise and thus results in inflation.\textsuperscript{19} Since export agriculture is monocultural and sometimes inedible (as in the case of rubber or coffee), it cannot provide any increment to food supplies. If demand for food results in extra imports, this will of course ameliorate inflation but will reduce any balance-of-payments gain from extra exports. On the other hand, a reduction in external demand for commercial agricultural exports also results in inflation, according to the structuralist view. As production declines, workers expelled from commercial agriculture are forced to compete for the limited supply of subsistence land, and this causes rents to rise. Since the demand for primary products is highly volatile, it is not particularly surprising to structuralists that inflation is a permanent feature of peripheral economies.

Given their assumptions about the nature of peripheral economies, the structuralists naturally predict perverse effects from implementing orthodox programs, such as the standard IMF package, in the periphery. This is because supply-side responses will be impeded by social factors including labor surplus, land use problems, and overreliance on agricultural exports, none of which can be ameliorated by solely demand-based or indeed solely economic remedies. Devaluation, for example, causes an increase in exports

\textsuperscript{18} See Killick et al., \textit{Quest for Economic Stabilization}, p. 41. Note, however, that Killick does not think that domestic wage rigidities account for inflation in developing economies. This view is consistent with the structuralist arguments about labor oversupply. Regarding this point, see Killick et al., \textit{The IMF and Stabilization}, p. 7.

\textsuperscript{19} In the limited number of cases in which a country’s edible agricultural goods are dietary staples (as with beef in Argentina, for example), increased external demand leads directly to increased domestic prices. This is because the export sector has completely eliminated "traditional" or subsistence agriculture as a source of the alternative edible goods. The land constraint in these cases is absolute, not political. For an extended analysis, see Frenkel and O’Donnell, “The ‘Stabilization Programs’ of the IMF and Their Internal Impacts.”
and a decrease in imports and thus helps balance payments but only if
production capacity can be increased in the tradable sector. If there is no
incentive for productivity-enhancing investment (as in the case of most pri-
mary products, where overseas markets are easily saturated), exports re-
spond only sluggishly to the higher relative prices that devaluation brings.
At the domestic level, devaluation multiplies the difficulties the industrialists
face. First, by raising the cost of imported capital goods, it makes labor-
replacing investment even more irrational. Second, making postdevaluation
exchange rates credible through tight monetary policy increases credit costs
and forces enterprises out of business, thereby shrinking rather than en-
hancing absolute domestic capacity.20 Slashing the state’s budget is also
partly self-defeating, since it is unlikely that private sources will invest to
create backward linkages. Today’s tight money only creates future bottle-
necks and more cost-push inflation.
In contrast to the above view, the defenders of orthodoxy argue that
inflation has political rather than economic roots. It is caused by monetization
of the fiscal deficit or by excessive credit creation for the private sector (the
fiscal deficit’s flip side). They can argue this because they assume, in sharp
contrast to the structuralist critics, that surplus capacity exists in the non-
tradable sector, which includes what defenders call “domestic use agricultu-
re” and what structuralists call subsistence agriculture. If surplus capacity
did not exist in this sector, then devaluation could not be a viable anti-
inflationary and export-promoting strategy. Such a strategy is premised on
the ability to shift domestic demand from tradable goods to a nontradable
sector in which capacity utilization is low because of inflation-driven
overvaluation of the exchange rate.21 In this situation, an expansion of ex-
ternal demand for tradable goods subsequent to a devaluation would lead
to increased investment in the tradable sector and thus to growth. Mean-
while, increased domestic demand for nontradable goods would be absorbed
in a noninflationary way by existing surplus capacity in the nontradable
sector.
Unsurprisingly, given their belief in a capitalist monocoeconomics, the de-
fenders see policy as the independent variable and view economic outcomes
as the dependent variable: proper policy produces the proper outcome in
core and peripheral economies alike. In explaining why a given state is less
than successful in its efforts at stabilization, then, the defenders argue that

20. Some neostructuralists carry this point farther, arguing that by driving up the costs of
working capital, sharp rises in interest costs raise prices and aggravate inflation. See Foxley,
An interesting article by ex–World Bank staffers Riccardo Faini and Jaime de Melo, “Adjust-
ment, Investment and the Real Exchange Rate in Developing Countries,” Economic Policy 11
(October 1990), pp. 491–519, generates statistical data supporting some of these structuralist
propositions.
21. See Cline, “Economic Stabilization in Developing Countries.”
the problem lies not in the economic policies themselves but in the state’s failure to implement the policies properly.

**Policy retreats**

The critics’ and defenders’ different perspectives on demand- and supply-side constraints on policy have thus led the two sides to offer different policy recommendations. Nevertheless, both sides have made significant policy retreats when faced with the complexity of the real world and the outcomes of policy experiments. The greatest weakness to the critics’ position is their inability to come up with practicable alternatives to the typical deflationary package. Making some bows in the direction of being “patient monetarists,” virtually all structuralists agree that real wages cannot be sustained at the unrealistic levels that often precede an internal or external crisis leading to imposition of austerity regimes. In other words, they concede that the excesses of Carlos Diaz-Alejandro’s “populist euphoria” will inevitably give way to “economic retrenchment.”  

Most structuralists admit that there is such a thing as too much inflation, even if they simultaneously argue that the IMF’s orthodox programs involve “overkill” in their efforts to extirpate it. Finally, they concede to defenders the point that maintaining a given level of investment will not produce the growth that structuralists desire if the investment goes into unremunerative or unproductive areas.

The policy retreats of the defenders are reflected in the IMF programs. Despite the IMF’s steadfast adherence to orthodox monetarist premises, the institution has steadily created new programs addressing the demand-based critique. In this movement, it actually anticipated some of Killick’s criticisms and suggestions. In 1962, the IMF created the Compensatory Fund Facility, which helps offset large shifts in the terms of trade of primary products; however, it understands these shifts as a short-run volatility inhering to the prices of primary products. The Extended Fund Facility (EFF)

22. See Diaz-Alejandro, “Southern Cone Stabilization Plans.”


24. The usual exception for investments with a social rate of return in excess of a privately approprable rate of return applies here, of course.

and the Oil Fund Facility (OFF) extended this principle to cope with the 1970s oil shocks. The EFF, which lends on a medium-term (three-year) basis, represented a concession to the argument that production bottlenecks can slow economic adjustment and that orthodox policies could therefore in the short run have negative consequences for output and employment if pursued too vigorously. In light of this, stabilization programs had to be sustained to be effective. The EFF also represented a loosening of the institution’s conditions so as to give developing economies more time for lasting structural adjustment. The Structural Adjustment Facility (SAF) and the Extended Structural Adjustment Facility (ESAF) provided concessional variations on the EFF in 1986 and 1987, respectively. But beneath these programmatic concessions, the IMF retained its fundamental belief that a quantitative difference in response time between LDCs and developed countries does not correspond with any qualitative difference that might require a different strategy. The EFF, SAF, and ESAF simply provide more time to bring economies back into line using the same old policy tools of demand compression, economic liberalization, and deflation. IMF programs have thus remained firmly orthodox, despite their inclusion of more supply-side components.

**Political preconditions for successful stabilization**

Differences in the premises of the two sides have not only given rise to different policy recommendations but also to different interpretations of data about the outcomes of IMF-instituted or IMF-style programs. If stabilization is not achieved by a developing country, the structuralist critics point to the failure of the program to address the problems affecting peripheral economies. In contrast, the defenders of orthodoxy point to the failure of the country’s government to implement the program properly. Successful stabilization, they argue, depends on proper implementation, which in turn depends on administrative capacity and political will.

In outlining the political preconditions for successful stabilization, defenders argue that a particular form of government (for example, democratic or authoritarian) is not essential. Recent research by self-conscious critics


28. See Killick et al., *Quest for Economic Stabilization*, pp. 48–53 and 290. Because my article uses New Zealand as a test of the arguments advanced by the defenders, the relevant question to be addressed about the politics of stabilization is not whether stabilization produces a particular political outcome (namely, authoritarianism, as some critics have argued) but,
of the IMF, such as the analysis of the political determinants of success for the EFF undertaken by Stephan Haggard and the study of stabilization in Latin America performed by Karen Remmer, appears to support the defenders’ view.\(^{29}\) For example, Haggard found that “authoritarian or one-man rule does not necessarily facilitate adjustment, particularly where resource constraints are severe.”\(^{30}\) Instead, he concluded, the following factors were critical for success: an ideological orientation of political and bureaucratic elites in favor of stabilization, the availability of nonconditional resources to buy off political opposition and mobilize support for the program, and the administrative strength to carry out reform. The various case studies reported in two works edited by Joan Nelson, Fragile Coalitions and Economic Crisis and Policy Choice, suggest that the management of political demands during either heterodox or orthodox stabilization also requires the insulation of government policymakers from social forces.\(^{31}\)

To evaluate outcomes in keeping with the defenders’ arguments, then, the relevant questions to ask are whether there was sufficient administrative capacity to implement a program in technically correct ways, whether the “stabilizing coalition” had the capacity to sustain its program long enough to bring the economy around, and whether the policymakers were insulated


\(^{30}\) Haggard, “Politics of Economic Adjustment,” p. 171. Remmer agrees that in Latin America, at least, authoritarian rulers have proven less adept at stabilization. She suggests that “the type of political coalition emerging after regime breakdown and the related willingness and capacity of new authorities to implement orthodox stabilization policies are conditioned by the perceived successes and failures of their predecessors.” See Remmer, “The Politics of Economic Stabilization,” p. 19.

enough from popular pressures to sustain what in terms of the stabilization effort could be termed rational policy.

New Zealand as a crucial test case

The economic stabilization and adjustment program implemented by New Zealand’s government in July 1984 should provide a crucial case for testing orthodox stabilization programs of the type that have generally been tried in LDCs. Like the LDCs, New Zealand had a small, sheltered, and inefficient manufacturing sector as well as a large foreign debt and high levels of inflation. However, New Zealand was not confronted with the supply-side constraints typically faced by LDCs, nor did its government lack the capacity or political will to institute economic reform. Since its economic and political conditions were conducive to a stabilization program aimed at reducing demand, neither the critics nor the defenders of orthodox programs would be surprised if the stabilization efforts were successful.

Economic conditions before orthodox stabilization

New Zealand resembles many middle-income developing countries. Its economy, which is roughly the same size as that of Israel, has largely revolved around the highly efficient transformation of grass into wool, meat, and dairy goods. In the early 1980s, New Zealand’s agricultural activities comprised from 9 to 10 percent of its gross domestic product (GDP), an amount two to three times larger than that in most developed economies. Its manufacturing products most competitive in world markets were all closely linked to the agricultural sector and included dairy production and processing equipment, sawmill and wood processing equipment, animal control systems, and carpets. While food processing accounted for 27 percent of its manufacturing activity, an amount above the average for members of the Organization for Economic Cooperation and Development (OECD), machinery and equipment production accounted for 25 percent and was below the OECD average. The relatively small size of New Zealand’s economy prevented the emergence of industries in which economies of scale are critical. Although an industry involving the assembly of cars from knock-down kits emerged, its survival was possible only because of tariffs and quantitative import restrictions.

The weakness of the manufacturing sector has resulted in slow growth and a low standard of living in nominal terms. Up to 1975, the GDP per capita in New Zealand grew at a rate well below that of European Community (EC) and OECD countries; and between 1975 and 1984, the per capita real
growth rate curve for New Zealand was flat.\textsuperscript{32} New Zealand’s geography (a pleasant climate and plenty of space), its social organization of production around small factories and family farms, and its welfare state, which ensures that income disparities stay at developed country levels and that health services and education are evenly distributed, all contribute to a subjectively high standard of living in New Zealand. But, objectively, New Zealand’s GDP per capita of about US $7,850 in 1987 was surpassed by Singapore’s that year. To explain this, we must look to export figures.

In New Zealand, as in many developing countries, the agricultural sector is both efficient and competitive in world markets, but the manufacturing sector is largely inefficient and uncompetitive. In 1981, New Zealand’s three largest exports—meat, dairy products, and wool products, each at a three-digit standard international trade classification (SITC) level—accounted for almost 40 percent of its total exports, a percentage higher than that for any other developed country.\textsuperscript{33} These goods, together with wood products and other animal products in various forms, have usually accounted for two-thirds to three-fourths of the country’s exports. This reliance on primary product exports has created the kind of economic stagnation and tendency toward unbalanced payments described in the weak version of the Prebisch thesis. Between 1965 and 1982, the terms of trade for New Zealand’s three largest exports fell 30 percent (albeit after large fluctuations in both directions).\textsuperscript{34} During this period, New Zealand’s customers had begun to pursue economically irrational agricultural promotion programs, thereby limiting New Zealand’s market access. But even without this turn of events, agricultural specialization meant that New Zealand’s exports grew more slowly than the world gross national product (GNP). According to a study published in 1983, a 1 percent increase in world GNP only called forth a 0.6 percent rise in New Zealand’s exports, while at the same time a 1 percent increase in New Zealand’s GDP created a 1.2 percent increase in the country’s imports.\textsuperscript{35} Finally, low demand elasticity for agricultural exports meant that expanded export volumes, particularly in the commodities in which New Zealand’s share of world exports was large, only caused price declines in the long run. For example, a 10 percent increase in the production of mutton triggered a 4.4 percent decline in world market prices for this commodity.\textsuperscript{36}

34. See *Reserve Bank Bulletin* 49 (September 1986), p. 446; and *Reserve Bank Bulletin* 52 (June 1989), p. 155.
36. Ibid., pp. 18–20. In 1984, New Zealand supplied 53.4 percent of world mutton exports (SITC 0112), 14.7 percent of boneless beef exports (SITC 01112), and 17 percent and 43 percent
Like the LDCs, New Zealand has a structural tendency toward an imbalance of payments. And in New Zealand, as in much of Latin America, the state tried to compensate by promoting ISI but found that the benefits were greatly outweighed by the untoward effects on the fiscal and current account deficits. From 1965 to 1984, both the National party government, which was most frequently in control, and the Labour party government pursued the strategies of subsidizing rural investment and manufactured exports while sheltering the domestic market by means of quantitative import controls. Manufactured exports did rise from 6 percent to 22 percent of exports, but this still left New Zealand in 1985 at the same level that Australia, another weak exporter of manufactured goods, had already reached in 1970.37

During the period in which ISI was pursued in New Zealand, import controls gave the manufacturing sector effective rates of protection of about 60 to 70 percent, but subsidies provided over 18 percent of the value of the manufactured exports and thus strained the state’s budget.38 Since the small domestic markets continued to inhibit investment, the National party administration embarked on a program called “Think Big” and borrowed roughly NZ $5 billion to invest in heavy industry. The interest costs of “Think Big” also strained the budget. The effect of these budget burdens, along with the burden of compensating export agriculture for the costs imposed by protection, swelled the fiscal deficit. Partial monetization of this deficit in turn fueled inflation, which averaged 15 percent per year from 1976 to 1982.39 Government stimulation of the economy also caused an increase in domestic incomes and a disproportionate rise in the level of imports. As a result of this general increase in imports and the increase specifically arising from the

of greasy and degreased wool exports, respectively (SITC 2681 and 2682). In dairy products trade, New Zealand’s share of total exports is much smaller; however, because so much of this trade is price-regulated trade within the EC, New Zealand’s effective weight on the open international market is much greater than its share would suggest. New Zealand supplied 6.3 percent of milk and cream exports (SITC 022), where intra-EC trade accounted for 76.3 percent of all trade in this commodity; 13.1 percent of butter exports (SITC 023), where intra-EC trade accounted for 78 percent of exports; and 3.6 percent of cheese exports (SITC 024), where intra-EC trade accounted for 77.8 percent of exports. New Zealand’s share of residual (extra-EC) world trade in these dairy commodities thus was approximately 27, 60, and 16 percent, respectively. See United Nations, International Trade Statistics Yearbook, 1983, vol. 2 (New York: United Nations, 1985).


38. “Effective protection” is the share of value added contributed by either subsidy or protection.

capital goods imported in connection with the "Think Big" effort, the current account deficit also swelled.

In an effort to control the rising fiscal and current account deficits, the National party imposed wage, price, and interest rate controls and substituted a crawling peg devaluation of the New Zealand dollar for a fixed exchange rate. Unable to balance payments with increased exports, burdened by the cost of subsidizing agricultural and manufactured exports, and unwilling to attack consumption levels, the National party administration also borrowed extensively overseas to make ends meet. By fiscal year 1983–84, New Zealand was in economic crisis. Its fiscal deficit had reached 9.0 percent of its GDP; its current account deficit had risen to nearly 6 percent; its public overseas debt had increased to 35.4 percent; and its total overseas debt had soared to 46.7 percent. In comparison, in their crisis year of 1982, Mexico and Brazil had total foreign debts of 34 percent and 58 percent of their GDPs, respectively.

By mid-1984, then, like the typical Latin American supplicant to the IMF, New Zealand had a protected, overcontrolled, inflationary economy with large "twin" fiscal and trade deficits and was on the verge of falling into a self-sustaining overseas debt trap. Standard and Poor downgraded New Zealand's credit rating from AAA to the lower ranges of AA in early 1984. Simultaneously, a highly critical internal IMF report arguing that "further borrowing should be limited to economically viable investment, rather than to sustain[ing] the level of consumption" was leaked during the run-up to New Zealand's July 1984 election. International capital markets pushed over the house of cards after the Labour party won. Speculators, assuming correctly that the incoming Labour government would substantially devalue the New Zealand dollar, exhausted the Reserve (Central) Bank's supply of foreign exchange by swapping New Zealand dollars for hard currency at the pre-election fixed rate. International credit markets rebuffed the Reserve Bank when it turned there for emergency loans. New Zealand thus experienced the typical crisis cycle of the Third World, albeit in a milder form: political responses to worsening terms of trade create a combined fiscal and trade deficit, growing foreign debt, and inflation; these problems accelerate; and foreign creditors pull the plug.

42. Significantly, though, the interest rate spread on New Zealand securities did not fully reflect this credit downgrading. The spread on New Zealand's Aa3-rated (Moody's) bonds was barely larger than that on Sweden's Aaa-rated bonds. Reserve Bank Bulletin 52 (June 1989), p. 120.
Economic conditions during orthodox stabilization

Stabilization efforts and results from mid-1984 to mid-1989. The refusal of international banks to extend credit during the July 1984 crisis solidified the desires of the state financial bureaucracy and the incoming Labour cabinet to reorganize the entire economy around an orthodox deflationary stabilization program. While the IMF did not have a direct hand in developing New Zealand’s stabilization program, the policy content of the government-initiated program overlaps considerably with that of typical IMF-instituted programs, as shown in Table 2, and thus justifies the use of New Zealand’s program as a test of the orthodox model.44

Consonant with the IMF’s market-oriented approach, the Labour administration introduced market regulation to virtually all areas of economic life. The wage, price, and interest controls imposed earlier by the National party administration were removed during the Labour party’s first year. Domestic and international financial transactions were deregulated, and subsidies for agriculture and manufacturing were phased out.45 Government-supplied services and goods began to be sold at market prices. The only area in which the Labour administration failed to introduce a full market regime was in the labor market. Despite some moves toward decentralization and enterprise bargaining, the old system of juridical collective bargaining at the industry level, with wages and conditions officially set by the Arbitration Court, remained pretty much intact. Rapidly increasing unemployment moderated union wage demands, however, and consistent with orthodox policy, the wage share of New Zealand’s GDP fell steadily over the next four years.

As Table 3 shows, New Zealand substantially reduced its fiscal deficit, a goal that defenders of orthodoxy have come to regard as most important.46 The Labor administration achieved this primarily by implementing a three-step program to increase taxation faster than either interest payments or

44. Data from published sources and from my interviews with officials in New Zealand in July 1988 suggest that the IMF had only minimal influence on New Zealand’s austerity program. While the bureaucrats in New Zealand’s Treasury and Reserve Bank who worked with the Labour party in developing the program were familiar with the policies of both the IMF and the World Bank, neither of these organizations had a direct hand in the specifics of New Zealand’s stabilization program, nor has New Zealand been under any formal conditionality. See Economic Monitoring Group, Foreign Exchange Constraints, Export Growth and Overseas Debt, p. 32; Bruce Jesson, Behind the Mirror Glass (Auckland: Penguin, 1987), pp. 116–34; Jonathan Boston and Martin Holland, eds., The Fourth Labour Government: Radical Politics in New Zealand (Auckland: Oxford University Press, 1987); and Roger Douglas and Louise Callen, Towards Prosperity (Auckland: David Bateman, 1987), pp. 48–50 and 205–9.


46. It should be noted, however, that some other OECD countries made equally large reductions in their fiscal deficits in this period as well. Denmark and Sweden each made reductions roughly twice the magnitude of New Zealand’s reduction. See OECD, Economic Survey: Denmark, 1986–87 (Paris: OECD, 1987).
**TABLE 2. A comparison of the typical orthodox or IMF policy recommendations and the policy of New Zealand after 1984**

<table>
<thead>
<tr>
<th>Policy area</th>
<th>Orthodox policy recommendation</th>
<th>New Zealand policy course</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Monetary policy</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit ceilings</td>
<td>Restrict credit.</td>
<td>Tight monetary policy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>since 1985.</td>
</tr>
<tr>
<td>Interest rates</td>
<td>Raise rates to control inflation.</td>
<td>Rates peaked in 1987; Reserve Bank required in 1989 to keep inflation under 2 percent.</td>
</tr>
<tr>
<td>Reserve ratios</td>
<td>Increase reserve requirements.</td>
<td>Prudential regulation only.</td>
</tr>
<tr>
<td><strong>Tax reform policy</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax structure</td>
<td>Introduce more indirect taxes and revenue neutrality for income types.</td>
<td>Value-added tax introduced in 1986; marginal rates lowered.</td>
</tr>
<tr>
<td>Tax levels</td>
<td>Raise taxes to lower fiscal deficit.</td>
<td>Taxes as percentage of GDP up 11 percent.</td>
</tr>
<tr>
<td>Administration</td>
<td>Increase effectiveness.</td>
<td>Already effective.</td>
</tr>
<tr>
<td><strong>External debt policy</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control over foreign loan commitments</td>
<td>Centralize public and decentralize private control.</td>
<td>Public sector control centralized into Treasury; private sector capital flows deregulated.</td>
</tr>
<tr>
<td>Loan maturities</td>
<td>Lengthen maturities.</td>
<td>Maturity management, but maturities shortening.</td>
</tr>
<tr>
<td>Currency risk</td>
<td>Spread risk.</td>
<td>Spreading risk.</td>
</tr>
<tr>
<td>Reduction of arrears</td>
<td>Repay arrears.</td>
<td>No arrears.</td>
</tr>
<tr>
<td><strong>Exchange and trade policy</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange rates</td>
<td>(Recommendation varies by country.)</td>
<td>Clean float since March 1985.</td>
</tr>
<tr>
<td>Exchange system</td>
<td>Market or auction system.</td>
<td>Market allocation of foreign exchange.</td>
</tr>
<tr>
<td>Trade regulation</td>
<td>Deregulate trade.</td>
<td>Deregulating trade.</td>
</tr>
<tr>
<td>Import substitution efforts</td>
<td>Leave to the market.</td>
<td>Left to the market.</td>
</tr>
<tr>
<td>Policy area</td>
<td>Orthodox policy recommendation</td>
<td>New Zealand policy course</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>--------------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>Import protection</td>
<td>Reduce protection.</td>
<td>Tariffs and import licensing phased out by 1991.</td>
</tr>
<tr>
<td>Export promotion or liberalization</td>
<td>Liberalize and promote exports.</td>
<td>Already liberalized; subsidies removed.</td>
</tr>
<tr>
<td>Wage and price policy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage guidelines</td>
<td>Freeze wages.</td>
<td>Juridically set wages; falling real wages.</td>
</tr>
<tr>
<td>Producer prices</td>
<td>Allow for free market pricing.</td>
<td>Deregulated.</td>
</tr>
<tr>
<td>Retail prices</td>
<td>Allow for free market pricing.</td>
<td>Deregulated.</td>
</tr>
<tr>
<td>Public sector policy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonfinancial public enterprises</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td>Decrease expenditures.</td>
<td>Left to the market.</td>
</tr>
<tr>
<td>User fees</td>
<td>Introduce more and higher fees.</td>
<td>Full cost recovery by 1988.</td>
</tr>
<tr>
<td>Administered prices</td>
<td>Replace with market pricing.</td>
<td>Replaced with market pricing.</td>
</tr>
<tr>
<td>Employment</td>
<td>Decrease overmanning.</td>
<td>Major reductions in labor force.</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>Freeze wages and salaries.</td>
<td>Juridically set wages; falling real wages.</td>
</tr>
<tr>
<td>Ownership</td>
<td>Privatize if possible.</td>
<td>Massive privatization of public enterprises.</td>
</tr>
<tr>
<td>Bank borrowing</td>
<td>Decrease borrowing.</td>
<td>Forced to borrow at market cost.</td>
</tr>
<tr>
<td>Transfers and subsidies</td>
<td>Decrease subsidies.</td>
<td>Subsidies removed, but social transfers up.</td>
</tr>
<tr>
<td>Other public sector (nontrading departments)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td>Decrease expenditures.</td>
<td>Spending as a percentage of GDP up 3.8 percent.</td>
</tr>
<tr>
<td>Policy area</td>
<td>Orthodox policy recommendation</td>
<td>New Zealand policy course</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-------------------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>Investments</td>
<td>Decrease investments.</td>
<td>Based on market criteria.</td>
</tr>
<tr>
<td>Subsidies</td>
<td>Decrease subsidies.</td>
<td>Subsidies phased out for trading enterprises.</td>
</tr>
<tr>
<td>Transfers</td>
<td>Decrease transfers.</td>
<td>Social transfers up, mostly as unemployment insurance.</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>Freeze or decrease wages and salaries.</td>
<td>Shift to individual or merit-based pay system; falling real wages.</td>
</tr>
<tr>
<td>Control over foreign loan commitments</td>
<td>Centralize control.</td>
<td>Control centralized into Treasury.</td>
</tr>
<tr>
<td>Fiscal deficit</td>
<td>Decrease as percentage of GDP.</td>
<td>Reduced from 9 to roughly 2 percent of GDP.</td>
</tr>
</tbody>
</table>

**Private sector policy**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Wages and salaries</td>
<td>Freeze wages and salaries.</td>
<td>Juridically set wages; falling real wages.</td>
</tr>
<tr>
<td>Control over foreign loan commitments</td>
<td>Decentralize control.</td>
<td>Capital flows deregulated.</td>
</tr>
</tbody>
</table>


Social spending. First, it instituted an essentially unavoidable 10 percent goods and services tax (value-added tax) in October 1986 and raised it to 12.5 percent in July 1989. Second, it lowered the marginal rates on personal income tax, thereby making the goods and services tax more palatable. In New Zealand, as in the United States, the elimination of most loopholes partially offset the drop in marginal rates. Third, it combined this overt "revenue enhancement" with covert "tax" collection by transforming public firms into profit-making corporations, as explained in further detail below. Together, the three efforts expanded New Zealand’s revenues from 35.3 percent of its GDP in fiscal year 1984–85 to 45.0 percent in 1987–88. On the expenditures side, the Treasury recommended and the Labour administration executed a steady removal of production subsidies. Savings here, though,
were offset by the expansion of welfare spending, particularly for unemployment benefits. Overall, the fiscal deficit came down from 9.0 percent of GDP in fiscal year 1983–84 to 1.9 percent in 1987–88, which represents a sustainable level.

The effects of the market-led deregulatory policies are best illustrated in the public sector. In 1984, state-owned enterprises (SOEs) received over 20 percent of investment in New Zealand and employed over 60,000 people, but they generated only 12 percent of New Zealand’s GDP and consistently lost money, despite their monopolistic status, access to low-cost loans, and favorable tax situation. The Treasury and Labour cabinet reconstructed the SOEs and government departments along corporate lines, using private-sector management techniques. The goals were to allocate resources (tax and trading revenues) via the market, to make the SOEs and departments attempt to recover the full costs of their services from consumers and other government agencies, to make subsidies visible and justified in terms of explicit social policies, and to encourage the SOE and department managers to set performance goals for lower levels of management using private-sector notions of profit. If the SOEs and departments could not compete with privately provided goods and services, they would be disbanded. If they could compete effectively, the revenues and taxes that they generated would be returned to the state for debt service and reallocated on a rate of return basis among the SOEs.

During the reform, the government in New Zealand privatized a larger proportion of its public sector than the Thatcher government privatized in Britain. Most recently, with the sale of New Zealand Telecom, the domestic telephone service came into private hands. As a result of the market-based reforms in SOEs and departments, the public sector’s situation was reversed. Output rose from December 1984 to December 1988, despite 18,000 layoffs. SOE dividend, tax, and interest payments to the state equaled 2 percent of New Zealand’s GDP in fiscal year 1987–88 and provided nearly 6 percent of the total state revenue. Revenue from privatization of SOEs enabled the state to retire NZ $767 million and $656 million of overseas public debt in fiscal years 1987–88 and 1988–89, respectively.

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</tr>
</thead>
<tbody>
<tr>
<td>1 Revenue</td>
<td>33.8</td>
<td>32.5</td>
<td>35.3</td>
<td>37.9</td>
<td>39.3</td>
<td>45.0</td>
<td>41.7</td>
</tr>
<tr>
<td>2 Expenditure</td>
<td>34.5</td>
<td>35.0</td>
<td>35.1</td>
<td>33.5</td>
<td>35.1</td>
<td>38.6</td>
<td>36.4</td>
</tr>
<tr>
<td>3 Primary surplus ((1 - 2)^b)</td>
<td>-0.7</td>
<td>-2.5</td>
<td>0.2</td>
<td>4.4</td>
<td>4.2</td>
<td>6.4</td>
<td>5.3</td>
</tr>
<tr>
<td>4 Interest payments</td>
<td>5.0</td>
<td>6.5</td>
<td>6.5</td>
<td>7.4</td>
<td>7.7</td>
<td>8.3</td>
<td>7.4</td>
</tr>
<tr>
<td>5 Financial balance ((3 - 4)^c)</td>
<td>-5.7</td>
<td>-9.0</td>
<td>-6.3</td>
<td>-3.0</td>
<td>-3.5</td>
<td>-1.9</td>
<td>-2.1</td>
</tr>
</tbody>
</table>

aData are for the fiscal year beginning 1 April and ending 31 March.

bPrimary surplus is the budget balance net of interest payments; negative numbers indicate a primary deficit.

cFinancial balance is calculated on a government financial statistics (GFS) basis and is equal to the fiscal balance plus net lending.

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</tr>
</thead>
<tbody>
<tr>
<td>1 Public foreign debt</td>
<td>36.6</td>
<td>35.4</td>
<td>47.9</td>
<td>47.3</td>
<td>55.0</td>
<td>43.0</td>
<td>—</td>
</tr>
<tr>
<td>2 Private foreign debt</td>
<td>9.9</td>
<td>11.3</td>
<td>14.1</td>
<td>11.7</td>
<td>13.4</td>
<td>13.4</td>
<td>—</td>
</tr>
<tr>
<td>3 Gross foreign debt (1 + 2)</td>
<td>46.5</td>
<td>46.7</td>
<td>62.0</td>
<td>58.9</td>
<td>68.4</td>
<td>56.4</td>
<td>—</td>
</tr>
<tr>
<td>4 Official reserves</td>
<td>3.5</td>
<td>3.2</td>
<td>4.9</td>
<td>6.0</td>
<td>14.2</td>
<td>9.0</td>
<td>—</td>
</tr>
<tr>
<td>5 Net foreign debt (3 − 4)</td>
<td>43.0</td>
<td>43.5</td>
<td>57.1</td>
<td>52.9</td>
<td>54.2</td>
<td>47.4</td>
<td>—</td>
</tr>
</tbody>
</table>

aData are for the fiscal year beginning 1 April and ending 31 March. Any discrepancies in sums are due to rounding.

bData for 1988–89 are not available.

### TABLE 5. New Zealand balance of payments in NZ$ billions\(^a\)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>1 Merchandise exports(^b)</td>
<td>7.9</td>
<td>9.6</td>
<td>11.3</td>
<td>11.2</td>
<td>12.3</td>
<td>13.4</td>
<td>14.8</td>
</tr>
<tr>
<td>2 Merchandise imports(^b)</td>
<td>7.4</td>
<td>10.3</td>
<td>11.4</td>
<td>11.0</td>
<td>11.4</td>
<td>10.3</td>
<td>13.4</td>
</tr>
<tr>
<td>3 Trade balance (1 – 2)</td>
<td>0.5</td>
<td>-0.7</td>
<td>-0.1</td>
<td>0.2</td>
<td>0.9</td>
<td>3.2</td>
<td>1.4</td>
</tr>
<tr>
<td>4 Net interest invisibles</td>
<td>-1.4</td>
<td>-1.9</td>
<td>-2.6</td>
<td>-2.8</td>
<td>-2.9</td>
<td>-3.0</td>
<td>-3.4</td>
</tr>
<tr>
<td>5 Total net invisibles</td>
<td>-2.2</td>
<td>-2.7</td>
<td>-3.6</td>
<td>-3.9</td>
<td>-4.0</td>
<td>-4.5</td>
<td>-5.3</td>
</tr>
<tr>
<td>6 Current account balance (3 + 5)</td>
<td>-1.6</td>
<td>-3.5</td>
<td>-3.7</td>
<td>-3.7</td>
<td>-3.1</td>
<td>-1.3</td>
<td>-3.9</td>
</tr>
</tbody>
</table>

\(^a\)Data are for the calendar year. Any discrepancies in sums are due to rounding.

\(^b\)Exports and imports are on a free on board (FOB) basis.

Monetary policy also imitated the usual orthodox program in substance and intent. Like the defenders of orthodoxy, the Treasury Department argued that devaluation and a clean float, coupled with steady elimination of trade protection, would shift productive activity into tradable goods. Concerned with New Zealand’s substantial overseas debt (see Table 4), the Treasury also recommended an extremely tight monetary policy to be achieved largely by eliminating overseas public borrowing. The Labour administration floated the New Zealand dollar in March 1985 and raised the domestic share of newly issued public debt from 37.6 percent in fiscal year 1984–85 to 100 percent in fiscal year 1986–87. This dramatic increase in the government’s demand for domestic funds drove domestic interest rates to a peak in mid-1987, when the Reserve Bank’s discount rate reached 27 percent. Tight money and increased taxation slowed inflation from 16 percent in fiscal year 1985–86 to an annualized rate of 4.4 percent in the middle business quarters of 1989 by constricting domestic purchasing power. Inflation subsequently revived and in 1990 was running at an annual rate of about 6 percent.53

The Labour administration also tried to close the balance-of-payments gap. Its goal, as with all developing debtors, was to maximize the merchandise surplus (the noninterest current account) and thereby generate currency for debt service. By fiscal year 1988–89, the current account deficit had receded to roughly 2 percent of GDP from its 6 percent peak in 1984–85. As shown in Table 5, the balance of payments in calendar year 1988 reflected a current invisibles deficit of NZ $4.5 billion—mostly debt service—offsetting a large merchandise surplus of about NZ $3.2 billion. But this success was less the reflection of an increase in exports caused by devaluation, deregulation, and similar policies than it was the reflection of the coincidence of a significant recession-induced reduction in import demand with a temporary recovery in the terms of trade. While exports increased slightly in real terms under the Labour administration (reflecting a current dollar rise from NZ $9.6 billion in calendar year 1984 to $13.4 billion in 1988), imports fell in real terms (reflecting a small current dollar rise from just under NZ $10.3 billion to just over $10.3 billion in the same period).

During the period from 1984 to 1988, the increasing strength of the New Zealand dollar made imports relatively cheap. As a result, some domestic manufactured goods, particularly cars assembled in New Zealand, were replaced by imports. But the absence of import growth signaled strongly that the positive trade balance was a function of depressed incomes and not an export success. Although manufactured exports grew to some degree, especially during fiscal year 1987–88, most of the increase in the revenues from exports was a function of the commodities boom in wool and meat, which caused export volumes and, more important, prices to rise for these goods.

Stabilization reversals in mid-1989. Following a 10 percent rise from 1988 to 1989 alone, New Zealand’s terms of trade were at their highest level since 1975 (although they were still below the average levels of the 1950s and 1960s).\footnote{See Reserve Bank Bulletin 49 (September 1986), p. 446; and Reserve Bank Bulletin 52 (June 1989), p. 155. When 1955 terms of trade are indexed as 100, then 1989 terms of trade are 88.} In other words, growth in export value was largely due to external circumstances—namely, the high level of demand for raw materials that typically exists toward the end of the economic cycle in industrialized countries. When domestic demand recovered and world demand softened at the end of 1989, imports quickly caught up with exports, thereby erasing the large merchandise surplus of 1988. Indeed, New Zealand actually ran a merchandise trade deficit through the last two quarters of 1989. Over those quarters, on a seasonally adjusted basis, imports nearly doubled from an average of NZ $1.1 billion per month to $1.9 billion in the month of December 1989. Overall, imports in the last half of 1989 were 21 percent higher than in the first half, while exports, hurt by falling world market prices for New Zealand’s major products, stagnated.\footnote{OECD, Monthly Statistics of Foreign Trade, July 1990 (Paris: OECD, 1990), pp. 56–57.}

What happened to reverse the apparent stabilization achieved from 1985 to early 1989? Obviously, the answer to this question has two parts, one explaining the relative failure on the supply side to expand exports and the other explaining the sudden surge in demand. Let us start with supply.

Beyond stabilization, the Labour administration’s policy did aim at structural adjustment to facilitate an expansion of supply. As defenders of orthodoxy would expect, deregulation and tight money caused a shift of resources, primarily labor, out of inefficient enterprises and led to an increase in productivity per manufacturing employee. The combination of tight money, the removal of protection, and the end to subsidies also cleared out inefficient enterprises, particularly in textiles and garments. Roughly 12 percent of manufacturing jobs disappeared between February 1986 and February 1988. During and after this period, the increases in productivity per employee were substantial. For example, in 1988 alone, productivity was up 9.3 percent. Nevertheless, there was an 8.4 percent decrease in absolute volume of production from 1985 to the end of 1988. Similarly, manufacturing fixed investment in current terms was actually slightly lower in fiscal year 1987–88 than in 1984–85, as were imports of capital goods. While both recovered somewhat in 1988–89, they remained well below real 1984–85 levels.\footnote{See Wellington Dominion, 2 July 1988; Reserve Bank Bulletin 51 (September 1988), Tables J1 and J2; Reserve Bank Bulletin 52 (June 1989), pp. 112–17; and Economist Intelligence Unit (EIU), Country Profile: New Zealand, 1988–89 (London: EIU, 1989), pp. 10 and 17.}

A similar process occurred in agriculture. Desubsidization, rising interest rates, and the subsequent appreciation of the New Zealand dollar led to plummeting real income and land values. Although some agricultural pro-
ducers "exited," negative net worth and the prospect of being left in debt and without income encouraged most to hang on. To make ends meet, producers cut employment by 15 percent from fiscal year 1983–84 to 1987–88. They also cut back investment, particularly in fertilizer application, to half its historic level. Because New Zealand's exports largely depend on the transformation of grass into saleable commodities, the reduction in fertilizer signaled a potentially serious decline in future output and thus export capacity.

In both the agricultural and manufacturing sectors, demand-side measures were successful in clearing out inefficient or highly indebted operations and reestablishing a market-based profitability; however, in neither sector did this profitability motivate new investment and increased output. Supply-side policy measures were successful in increasing employee productivity; however, in neither sector did this increased productivity translate into an increase in absolute production. New Zealand's "welfare system" had traditionally operated by providing jobs for everyone through overmanning, and clearly one of the effects of the measures instituted during stabilization was the elimination of feather-bedding. Firms, farms, SOEs, and government departments all shed unneeded labor—a total of 93,000 jobs from December 1984 to mid-1989. Under the Labour government, unemployment doubled, stabilizing by mid-1989 at 7.5 percent, an extremely high level by New Zealand standards. The average period of unemployment tripled, and most new jobs were part-time work.

The imbalance of payments in 1989 came primarily from the demand side, despite the demand- and import-constraining aspects of the stabilization program. Why? Disinflation combined with financial and trade deregulation to produce a wealth effect–driven consumption boom. Disinflation increased the real income stream from various assets, thereby increasing the capitalized value of these assets. Owners withdrew part of this increased capital value from the liberalized financial sector as credit and then spent it on imported goods. Successful implementation thus had unexpected side effects that ran contrary to policy intentions.

To sum up, New Zealand's Labour government managed over a period of five years to reduce its twin deficits with a program virtually identical to classic orthodox programs. The fiscal deficit came back to the more normal levels of the 1960s and, more important, came in line with the general expansion of the economy. The current account deficit by 1989 reflected a substantial merchandise surplus offset by a net outflow of interest payments.

and, like the fiscal deficit, was back to levels typical of the 1960s. Inflation also came back in line with the average OECD rate. Nevertheless, the wealth effect–driven consumption in 1989–90 completely undid the trade "success" of the first five years. As a result, renewed efforts at import suppression are now required. Since the October 1990 elections returned the National party to power, it seems unlikely that severe measures will be taken to compress demand. Major parts of the National party opposed the bulk of Labour’s market-oriented policies.

The politics of orthodox stabilization

According to the logic of the defenders of orthodoxy, the proper implementation of stabilization and adjustment programs requires political will, ability to mobilize support, and administrative capacity. In determining whether these political preconditions were met, it is helpful to begin by examining the emergence of poststabilization cadres and their efforts to concentrate power.

In New Zealand, as in Latin America, the sources of economic "distortion" in recent decades have been as much political as economic. However economically irrational New Zealand’s National party policies were, Brian Easton has argued, they were politically popular because "many of the market overruling measures . . . had the effect of underwriting the return on capital while allowing . . . firm[s] to pay the centrally set wage rate." 61 When the National party rejected the Treasury’s analyses in the early 1980s and approved the "Think Big" ISI projects for obviously political reasons, bureaucrats in the Treasury and Reserve Bank rebelled against state economic intervention.

Inside the Labour party at this time, one faction was arguing that economic policymaking should be depoliticized, while another faction took the view that there should be more consensus and public participation in economic decisions. The latter faction lost the debate, foreclosing an Australian-style social pact linking jobs to wage restraint. Prior to the 1984 elections, a close-knit group of six Labor party members favoring an orthodox stabilization program emerged and was centered around Roger Douglas, who became Finance Minister after the election. 62 In the lead-up to the elections, bureaucrats from the Treasury and Reserve Bank assisted this group and their party beyond accepted norms. When the party was victorious and the six members became ministers, the bureaucrats provided both a blueprint for stabilization and a coherent administrative cadre to enact it. 63 With the

63. See Jesson, Behind the Mirror Glass, pp. 120 ff.; and Douglas and Callen, Towards Prosperity, chap. 7.
continued intellectual backing of the Treasury and Reserve Bank, the six continued to dominate the cabinet during the latter part of the 1980s, despite struggles within the Labour party.

The six members of the inner Labour cabinet systematically concentrated power in the hands of the state’s economic policy apparatus and insulated this apparatus from outside pressures. They appointed a new committee, the Cabinet Policy Committee, which was officially charged with ensuring the clarity and coherence of all policy but was in effect given control, as one analyst gently put it, over the “overall resource limits for the major areas of the government programme.”64 Since the Finance Minister and his two deputies have seats on the committee and one of them sits on every subordinate policy committee, the Treasury has a large say in all economic policymaking, including the direction of SOEs. The state’s economic policy apparatus was given even more power in 1989, when legislation obliged the Reserve Bank to secure inflation rates below 2 percent and thus turned the institution into a miniature “Bundesbank.”

Power was also concentrated in the hands of the Labour party, as distinct from the government. Before 1984, the Labour party had been responsive to bottom-up “remit” sent to its annual policy conferences by party members. Labour needed the voluntary work of these members to flood the eight or ten key swing electoral districts with campaign workers. After 1984, the party ignored these remits from party members, since the remits were almost uniformly against the cabinet’s orthodox policies. These policies alienated the party’s traditional membership base, and party membership consequently fell from 77,000 in 1984 to roughly 10,000 in 1988.65 The inner cabinet members could afford to ignore this fall because they received NZ $3.7 million in campaign funds directly from the newly concentrated financial sector, and this allowed them to launch an American-style, capital-intensive, media-oriented electoral campaign. Strict spending limits on campaigns for individual parliamentary candidates made them dependent on the inner cabinet’s “generic” advertising.

While funds from the financial sector helped the Labour party stay in power, overseas resources also bought time for the party and helped it create a new social base. Beginning in fiscal year 1984–85 and continuing through 1986–87, high interest rates attracted short-term capital to New Zealand. During this three-year period, a total of NZ $5.9 billion—equivalent to around 3 percent of the GDP per year—was received.66 The effect of this capital inflow was threefold. First, it lowered the real cost of debt service as the New Zealand dollar appreciated. Second, it touched off a construction and

stock market boom that obviated the immediate pain of the state’s tax increase and thus contributed to the Labour party’s electoral victory in 1987. And, third, it facilitated a centralization of economic power that in turn created a new social base for the Labour party. The party’s financial market deregulation enabled takeover artists, using Euromarket funds, to gobble up firms stricken by the tight monetary policy. The newly emergent financial empires then provided the Labour party with both election cash and a series of chief executive officers who were willing to run New Zealand’s newly corporatized SOEs.

In summary, the Labour party had the political will and administrative capacity necessary for implementation of the stabilization program and was successful in implementing it. Thus, the key political determinants of success outlined by Haggard and others were all present in the case of New Zealand. Political elites favoring stabilization were joined by bureaucratic elites from the Treasury and Reserve Bank, who helped construct a base for free market policy within the Labour party prior to the 1984 election and provided the necessary administrative expertise to enact reforms after the Labour party’s electoral victory. The inner Labour cabinet was able to insulate the state’s economic policy apparatus from social forces and obtain resources from the financial sector to stay in power. Tight monetary policy also attracted significant amounts of international speculative capital, and this money helped the Labour party construct a new base of support to offset losses caused by alienation of its traditional supporters.

If we take the defenders of orthodoxy at their word and assume that no better policy alternative existed for achieving stabilization, the primary lesson to be learned from New Zealand’s experience is that there are severe limits to what can be achieved by an orthodox stabilization program even under the best possible circumstances.

Conclusions

New Zealand’s experience with stabilization suggests that the defenders of orthodox programs are correct in their belief that political will and a largely demand-based policy can bring about a degree of economic stabilization. While stabilization does have some perverse effects, the critics in the demand-side group clearly suggest wrong reasons for why this is so. But New Zealand’s experience also suggests three fundamental limits to orthodox policies and, by extension, IMF policies. First, there is a significant contradiction between deflationary policy and financial liberalization, a contradic-

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67. This, as local New Zealand observers noted, strongly paralleled events in Chile and lent an ironic twist to repeated government warnings that New Zealand would turn into a “banana republic” in the absence of drastic measures.
tion heretofore unobserved in LDCs because inflation never really has been lowered to trivial levels in these countries and because so much LDC wealth is held overseas.\textsuperscript{68} Second, in regard to long-term structural adjustment or growth, there are serious limits to what can be achieved by pursuing demand compression as a matter of deliberate policy but leaving supply expansion to occur via market stimuli; while productivity per employee may increase as distortions are eliminated, this does not guarantee any expansion in production output. Third, simply achieving stabilization requires a significant amount of time and resources in any case and certainly a longer time horizon and more resources than the IMF currently permits. After each of these problems, starting with the simplest, is discussed in further detail, New Zealand’s experience will be compared with experiences in developing countries.

IMF staff members argue that “a viable balance of payments . . . implies that the balance of payments problems will not merely be suppressed but eradicated” and that “the improvement in the country’s external position will be durable.”\textsuperscript{69} Despite the fact that New Zealand’s administrative, financial, and economic circumstances are more favorable than those of any of the LDCs, its balance-of-payments situation is barely “durable” by this definition. In New Zealand’s case, a balance of payments clearly rested on an unstable suppression of import demand through an expansion of unemployment and a diminution of the wage share of GDP. Once the modest 1989 economic recovery stabilized unemployment and wealth effect–driven consumption created demand for more imports, the trade balance deteriorated. Clearly, a durable balance of trade will require another round of import suppression. The IMF’s standby programs run for one year, and its EFF allots three years for structural adjustment (and even friendly critic Killick calls for five years). After five years, New Zealand managed to get both the fiscal and payments imbalances back to sustainable, albeit unstable, levels, which were then disrupted by wealth effects. Barring an internally contradictory resort to direct credit controls or some other form of financial regulation, the combination of deregulation and disinflation means that programs will have to be sustained over six to ten years. As Latin American experiences in the 1980s show, this is an extremely difficult task.

Stabilization in New Zealand not only took longer but also required more external finances than allowed for by the IMF. Despite the Labour party’s efforts to minimize overseas debt, foreign debt levels rose significantly in absolute and relative terms (see Table 4). The IMF’s resources, even following the expansion of members’ quotas in 1990, cannot support require-

\textsuperscript{68} The possible exceptions might be Argentina and Uruguay at the end of the 1970s, when a similar neo-orthodox stabilization program caused wealth effects which in combination with overvalued exchange rates led to a destabilization of import levels.

\textsuperscript{69} Khan and Knight, \textit{Fund-Supported Adjustment Programs and Economic Growth}, p. 2.
ments of this size. If the IMF were to attempt to support restructuring on the New Zealand scale for even a portion of the LDCs, it would soon exhaust its resources, particularly since most LDC debtors lack New Zealand’s creditworthiness.70

Another problem is that of supply expansion. Once New Zealand’s temporary improvement in terms of trade gave out, the absence of any supply-side surge in export volumes became obvious. Rather than diversifying and expanding exports, New Zealand continued exporting traditional commodities albeit at somewhat better prices than usual from 1986 to 1988. Because of investment cutbacks in traditional exports from 1985 to 1988, an expansion of volume in these exports is unlikely in the medium run. No significant nontraditional exports have emerged. The only significant gain from Labour’s policies is that such export production as now occurs, whether traditional or not, is profitable without government subsidies. This will help the state restore fiscal balance.

The case of New Zealand also suggests that long-term structural adjustment and growth are severely limited by strategies based solely on internal changes. Real income in New Zealand, particularly for workers, was slightly higher in March 1981 than in December 1987; income declines in 1988 were not offset by the mild recovery of late 1989. Furthermore, while real investment has recovered and returned to the pre-Labour level, it is sufficient only to ensure modest levels of growth that are well below the OECD average.71 The only bright spot—which demand-side critics should note—is that unlike the disastrous pre-Labour “Think Big” ISI investment, the current investment will generate a real return. New Zealand’s economy has been stabilized at a somewhat higher level of productivity per employee, but this has not translated into a gross increase in the volume of production. The future economic expansion of New Zealand, like that of most of the developing debtor countries, seems mortgaged to uncertain growth in the “core” of the world economy. The doubling of unemployment that followed the stabilization program’s demand compression is unlikely to reverse itself.

The fact that New Zealand encountered limitations to what could be achieved with orthodox stabilization suggests that LDCs will fare even worse. While New Zealand’s stabilization economic problems were in many ways similar to those of the LDCs, New Zealand was not faced with mass unemployment and concentrated patterns of land ownership, which critics argue are impediments to supply-side response. Nor did New Zealand lack administrative strength and capacity. In the case of New Zealand, most of the people were “on the books” as wage and salary earners, tax withholding

70. For calculations regarding this problem, see Williamson, The Lending Policies of the International Monetary Fund, p. 60.
was long established, and a bureaucracy existed to run the sizable value-added tax imposed in 1986. In most LDCs, the situation is precisely the opposite: revenue extraction is not institutionalized, much economic activity goes unrecorded, and the wealthy either evade taxes or delay payment until inflation has rendered their payment meaningless. In addition, LDCs are hit harder by the effects of orthodox stabilization on customs duties, which fall as imports are compressed. In the case of low-income and middle-income developing countries, customs provide roughly 30 percent and 20 percent of taxes, respectively, while they provide an average of only 4.1 percent in developed countries.72 Given these factors, it is not surprising that stabilization in LDCs seems difficult even in the rare cases where it is politically sustainable.

A brief discussion of one recent, relatively successful attempt at stabilization by an LDC demonstrates the difficulties. The Collor de Mello administration in Brazil has tried to implement an orthodox austerity program since early 1990. It placed a total freeze on liquid assets—a much more extreme measure than any taken in New Zealand—and managed to bring inflation down from 84 percent to “only” 14 percent per month. Even so, a substantial part of the frozen assets have “melted” and leaked back into circulation, threatening a revival of inflation. Similarly, efforts to shrink the public sector have run into resistance. As of May 1990, New Zealand’s public railroads had dismissed more public employees than the entire Collor de Mello administration had managed to dismiss.73 And although Brazil has a more varied export mix than New Zealand does, it has experienced even more volatile terms of trade, as was evident in the 45 percent decline from 1977 to 1985.74 Nevertheless, Brazil’s Collor de Mello has so far done much better than, for example, Argentina’s Menem.

In New Zealand, where all of the political and most of the economic preconditions for successful stabilization were present, where virtually everything that the defenders of orthodoxy could have asked for in terms of demand- and supply-side policy was undertaken, and where voluntary lending by international credit markets continued to be available, the outcome has been a highly unstable equilibrium. This equilibrium, which took over five years to achieve, depended on increased external debt to finance the persistent albeit shrinking current account deficits. While these deficits might have been sustainable in the presence of a stable external environment, the continued occurrence of commodity shocks and the nature of the business

cycle suggest that external debt will again become unsustainable. Finally, "successful" disinflation turned out to have unforeseen and detrimental consequences that make disinflationary measures a dangerous tool for stabilizing current account deficits.

Given the higher inflation rates and inflationary expectations of LDCs, their potential for wealth effect–driven consumption and import sprees is even greater than that in New Zealand. Their structural impediments to investment and increased productivity, combined with their less favorable political conditions, mean that LDCs will find it hard to attain an outcome as "good" as that in New Zealand. This suggests what has been obvious for a long time about the efficacy of traditional stabilization and adjustment programs. Not only in the case of the indebted LDCs but also in the case of some of their highly indebted but developed cousins, such as New Zealand, Australia, and Ireland, a long-term payments equilibrium depends just as much on economic restructuring, trade liberalization, and debt write-downs among the creditor countries as it does on the restructuring, tax hikes, and political reforms of the particular debtor country. 75 This is especially obvious with regard to agricultural trade. The OECD estimates that agricultural protection and the consequent overproduction of agricultural commodities cost New Zealand, Australia, the United States, the EC, and Japan roughly US $75 billion per year. Somewhat symmetrically, the Australian Centre for International Economics estimates that the LDCs, New Zealand, Australia, and the United States—all of which have substantial current account deficits—stand to gain $76 billion per year from liberalization of agricultural trade. Of this, LDCs would accrue $26 billion, which is roughly equal to one-fifth of their current interest payments. With this amount, they could make greater strides toward achieving a sustainable balance of payments than they could with virtually anything that the IMF could do itself or induce through conditionality. 76 Once this kind of "structural adjustment" was made, the IMF could return to the limited and perhaps more easily achieved mission envisioned by Harry White, the mission of temporary balance-of-payments financing.