

# Political economy of development in Latin America

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# Development is not only economic growth

- Amartya Sen (1998) “The enhancement of living conditions must clearly be an essential –if not the essential- object of the entire economic exercise and that enhancement is an integral part of the concept of development.”
- Joseph Stiglitz (1998) “It used to be that development was seen as simply increasing GDP. Today we have a broader set of objectives, including democratic development, egalitarian development, sustainable development, and higher living standards”.

# ISI development strategy

## ➤ **Industrial policy**

Form state-owned firms

Form mixed economic enterprises

Require government purchases from national firms

Foreign firms needed to establish joint ventures

Requirements to foreign firms to increase local content.

# ISI development strategy

## ➤ Foreign trade instruments.

- Tariffs on final goods
- Quotas on imports
- Exchange rate overvaluation
- Exchange rationing
- Import licenses

# ISI development strategy

- Fiscal and monetary policy
  - Subsidies for cheap inputs such as electricity.
  - Subsidies for public transportation.
  - Tax breaks in production.
  - Preferential interest rates (development banks).
  - Accommodating monetary policy.

# ISI development strategy

- State was considered a key player:
  - Promotion of national technological capabilities.
  - Financial, fiscal, trade policies were key policies.

Labor became a politically powerful actor protected under the law.

Populism – political use of state owned firms

Inefficient business class.

# ISI results

- The average annual growth rate between 1950-1980 was 5.5 percent.
- Between 1950 and 1970 Latin American gross domestic product (GDP) tripled.
- Emergence of a national business class and a parallel labor union movement.
- Change in the agrarian balance of power.
- Emergence of successful industries (automobiles in Mexico, Brazil and Argentina) but....

# Political and economic consequences (exhaustion of ISI)

- Labor became a politically powerful actor protected under the law.
- Populism – political use of state owned firms.
- Inefficient business sector.
- Corruption with government contracts, import licenses, investment permits, etc will have an impact on the neoliberal view of the role of the state in a country's development strategy.

# Political and economic consequences (exhaustion of ISI) cont.

- Debt crisis.
- Change of the international environment  
(combat against inflation in US – rise of  
international interest rates)

Capital flight – eventually devaluation.

IMF conditionality

World Bank: request for structural  
adjustment.

# Lessons from exhaustion of ISI

- Debt crisis showed the importance of responsible fiscal policy.
- Highly integrated capital markets punished irresponsible government macroeconomic policy making.
- The economic crisis was accompanied by political liberalization and spread of democracy in the region.

Rather than an authoritarian regression, the challenge is disappointment with democracy.

- Low quality democracies?

# A new development strategy

- Contrast of development strategy in Latin America and East Asia.
- ISI versus exported oriented model.
- Arguments for replacement of development strategy.
- Reluctance of IMF and World Bank to accept the role of state intervention in the East Asian miracle.
- Need for stabilization of economy.
- Growth first, distribution later.

## ➤ Original Washington Consensus

1. Fiscal discipline
2. Reorientation of public expenditures
3. Tax reform
4. Financial liberalization
5. Unified and competitive exchange rates
6. Trade liberalization
7. Openness to DFI
8. Privatization
9. Deregulation
10. Secure Property Rights

## ➤ Augmented Washington Consensus (second generation reforms)

11. Corporate governance
12. Anti-corruption
13. Flexible labor markets
14. WTO agreements
15. Financial codes and standards
16. Independent central banks/inflation targeting
17. Social safety nets
18. Targeted poverty reduction

# Limitations of the neoliberal reforms

- Corruption in privatization processes.
- Distributional consequences of neoliberal reforms.
- Erosion of legitimacy of market reforms given a privileged access to certain group to the policy process.
- Technocrats replacing traditional politicians.
- Political use of neoliberal reforms (*neopopulist solutions to neoliberal problems?*)
- Market-oriented institutions but also practices and institutions that hindered economic competition.
- Compensatory measures financed by resources from privatization.

## Limitations neoliberal reforms cont.

- Challenge of economic growth with equity has intensified.
- Are redistribution policies possible in Latin America?
- Inequality not only affects prospect for growth, but also shapes political life (distortion of democratic representation).
- Exceptionally high inequality – state susceptible to influence trafficking.

## Median Gini Coefficients by Region and Decade

REGION	1960s	1970s	1980s	1990s
Eastern Europe	25.1	24.6	25.0	28.9
South Asia	36.2	33.9	35.0	31.9
OECD and high income countries	35.0	34.8	33.2	33.7
Middle East and North Africa	41.4	41.9	40.5	38.0
East Asia and Pacific	37.4	39.9	38.7	38.1
Sub-Saharan Africa	49.9	48.2	43.5	46.9
<b>Latin America</b>	<b>53.2</b>	<b>49.1</b>	<b>49.7</b>	<b>49.3</b>

Source: Klaus Deininger and Lyn Squire "A new data set measuring income inequality" World Bank Economic Review, vol.10, No.3, Washington, D.C., World Bank (1996).

## Challenges for the immediate future in a competitive global environment

- State needs to play a smaller but smarter role.
- Enhance competition into all markets.
- Independence of state regulatory services.
- Regulation and supervision must come before liberalization and privatization.
- Partial reforms beneficiaries oppose to further reforms.
- Huge informal market.
- Potential negative combination in a status quo with flawed states and flawed markets.

# Challenges for the immediate future in a competitive global environment cont.

- Internal imbalances/inequalities: global integrated regions and insulated states in the same country (e.g. Mexican northern state such as Nuevo Leon and the southern states of Oaxaca and Chiapas).
- Perform more value added activities and not only manufacturing.
- Challenge for human capital competitive in the world.
- Elite bias of education policy in the region.

ONCE AGAIN: Challenge to break the negative existent equilibrium.