

**Sessions 6: Development and Underdevelopment in Latin America**

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Stages of development (Duncan Green)

Colonial (**What are land tenure patterns during this period?**)

- Specie, indigo, sugar
- Spain and Portugal are main markets
- England is indirectly the main partner
  
- 1810-1870: Chaos
  - bauxite, metals (e.g., copper), fertilizers (nitrates)
  - England main market
  
- 1870-1929: Primary product-led growth
  - coffee, copper, bananas, tin, beef, leather
  - railroads
  - England still main market
  - In 1920s, U.S. becoming main market
  - Foreign investment increasing
  - Trade increasing
  
- 1930-82: ISI
  - Depression, autarkic development, forced ISI initially
  - Steel in more developed countries (Mexico, Brazil, Argentina)
  - multinationals: steel, autos, chemicals, oil, petrochemicals, etc.
  - U.S. main market for exports
  - In post-war era, ISI is deliberate policy
  - Debt crisis at the end
  
- 1982-present: Neoliberal Era
  - Debt, austerity and adjustment
  - "Lost decade"
  - Not much development going on, most countries just now catching up

Crop-growing patterns

- Latifundium
- Haciendas, plantations, and small farms
- Factory farms

Focus of economic activity in cash crops, minerals until second half of 20<sup>th</sup> century

Why might economic reliance on primary commodities be bad?

- Substitution
  - Aluminum for tin
  - Synthetic dyes for indigo
  - Manufactured for extracted hormones
- Terms of trade shift against you
  - Explain argument from ISI school
- Exhaustion of resource base
  - Sugar cane land

- Minerals
- Changing demand
  - Brazilian coffee replaced by higher end varieties
- Development of cheaper production methods
- Price fluctuations

**Are these potential problems unique to primary products?**

Counter-evidence

- Substitution and cheaper production methods: all goods face this problem
  - And can form cartels
- Terms of trade don't always shift
  - Oil
- Exhaustion of resource base only applies to non-renewable commodities
  - And if they are exhausted, price may increase
- Changing demand could help
  - E.g., all-natural products
  - Can move into high end
- Price fluctuations
  - Can develop policies to manage this (hedging, commodities futures, government purchasing programs, etc.)

## Theories of Development

Why is Latin America underdeveloped?

- Racist theories
  - These are goofy; won't spend much time on them. **Why do you suppose we mention it here?**
  - First, it was the dominant explanation until mid-20<sup>th</sup> century
    - And you still hear it in some quarters
    - Indians and blacks deemed inferior
  - Second, this sort of thinking informed public policy
    - 19<sup>th</sup> century attempts to "bleach" populations in Southern Cone (especially Argentina and Brazil)
  - Discredited after WWII
- Cultural theories (dominant in 1950s, still seen a lot)
  - Question is different: why development at all?
  - Only this part of the world that touched the Rhine river that got its act together.
    - Religious origins (explain Weber's argument)
    - Geography (colder climates, culture of thrift and invention)
    - Historical accident (trade routes, settlement patterns)
  - Latin America inherited bad culture from Spain and Portugal:
    - throes of the counter-Reformation (contrast to U.S.; Tocqueville)
    - Catholic, authoritarian, anti-scientific
    - Indigenous societies were hopelessly backward
  - **Any problems with this type of argument?**
    - Difficult to measure (survey research); mass vs. elite
    - Difficult to assign causality
  - Discredited for a while, now making a resurgence (Putnam, *Making Democracy Work*; Sowell: *Migrations and Cultures*). Examples:
    - Mennonite communities in Paraguay, Central America, Southern Mexico, etc.
    - Evangelical Protestants in Central America
    - Sowell
    - Ansel in Sri Lanka
    - Trust: **How would economic transactions be different in the context of low trust?**
  - Empirical counter-evidence
    - Central America overall
- Modernization theory (important in 1950s and 1960s)
  - Everyone else started late
    - Why? Who knows?
  - The point is that now, we're all on the same path
    - This path looks more-or-less the same everywhere
    - Lerner: *Passing of the Traditional Society*
    - Urbanization, spread of mass communication, literacy, education
    - Tradition authority to rational-bureaucratic authority; superstition to secularism; parochialism to cosmopolitanism
    - Leave farms and move to cities; jobs in industry would be waiting for them
  - Prediction: Latin America would soon become like the West
  - economic progress, social equality, democracy
    - Kuznet's curve: perhaps temporary increase in inequality

- Latin America is now on that path; “takeoff phase”
  - Some evidence to support
    - growth rates in Brazil and Mexico
    - Political argument holds: democracy associated with economic development
    - But received lots of criticisms
  - But many take exception
    - Huntington: not all good things go together; changes can be wrenching
    - New mindsets might be destructive (e.g., ethnic identity formation instead of nationalism or cosmopolitanism; class-mobilization)
    - Divisive and polarizing politics
    - Political institutions might not develop fast enough to contain or channel new pressures; political disorder, anarchy, violence
  - Economically, there may be big caveats
    - What if capital equipment were imported and didn’t generate employment?
    - no jobs; lots of unemployed; low wages; increasing disparities; ugly politics
  - Coups in South America in 1960s and 1970s; modernization discredited
- Dependency Theory (dominant in 1970s)
  - Basic argument: countries conditioned by “more of insertion” into the international system
  - Core, periphery, and later an ambiguous category of semi-periphery
  - Drew on Marxist theory, but different from classical Marxism
  - Classical Marxism: Technology → Class Structure → Politics
  - Dependency: International System → Class Structure → Politics
  - Latin America had warped class structure, dictatorial politics, and limited growth prospects
  - In colonial era, Dependency worked through mercantile laws, which prevented industrial development and forced colonies to accept poor terms of trade
  - After independence, Dependency was enforced by UK and US through imperialism and gunboats
  - Then, Dependency on technology and multinational corporations
  - Finally, financial Dependency
  - Fit some cases pretty well (e.g., Central America)
  - First theory that came from Latin America, rather than from West; totally new ascription of blame
  - New question: not why development, but why underdevelopment. Underdevelopment in one area goes hand in hand with development elsewhere
  - Informed a lot of writing, especially in political science
  - Very harshly criticized: origins of economic system; too much ascription of blame, too much zero-sum; too much determinacy (both political and economic)
  - Long on prescription, short on cure
  - Finally, totally blown to pieces by Asian success stories
  - Total failure of Communist countries; collapse of Communism; Dependency theory discredited

- Pieces and milder version survive under somewhat different names: supply chains, economic accounts that stress economies of scale and barriers to entry
- Neoliberalism/neoinstitutionalism (dominant in 1980s and 1990s)
  - State is the problem!

The current development debate is over neoliberal economic reform

- All these grand theories of development out there, and you will encounter them in the readings and in conversations

### **The Latin American Development Debate**

#### **Key terms**

- Liberalism (in European sense)
- Factor endowments
- Comparative advantage
- Coase theorem
- Structuralism
- Declining terms of trade
- Raul Prebisch
- Value-added chain
- Market failure
- Economies of scale
- Economies of learning
- Infant industries
- Tariffs
- Import-Substituting Industrialization (ISI)
- Subsidies
- Producer cartels
- Nationalization
- Urban bias
- Rent-seeking
- Neoliberalism
- Austerity measures
- Paquetazos
- IMF (International Monetary Fund)
- Structural adjustment
- economic reform/economic liberalization
- market-friendly reform, market-oriented reform
- TINA
- Neoliberalism
- Human capital
- Second stage reforms

We've talked about paradigms of economic development. The policy debate was a little different.

1880-1930: Liberals

- Liberal in the European sense, of smaller government; not U.S. sense, of favoring redistribution
- Liberals emphasized that free trade was beneficial to countries
- Country had different natural resources ("factor endowments")

- Argentina had a temperate climate and huge prairies, great for growing wheat and raising cattle
  - Chile has copper, but not a lot of technology
  - England has no copper and a lousy climate, but it's really good at making textiles
- So each country has a “comparative advantage” in something different
  - Makes sense that Argentina should export wheat and buy textiles from England
  - This is beneficial to both countries
- No need here for the government to get too involved, which might discourage countries from pursuing their natural comparative advantage
  - This point of view is articulated by an economist named Ronald Coase, who proved that if property rights are well defined and transactions of costless, the market will produce an efficient outcome
    - Wins Nobel in 1991
  - As long as governments protected property rights, and enforced contracts, and didn't levy huge taxes, countries would develop economically
- Indeed, L.A. is developing economically exporting primary products (agricultural products, minerals, etc.) and importing manufactured goods
  - Argentina, for instance, is one of the most Liberal countries and also one of the richest countries in the world in 1900
  - getting rich
  - At least, if you're a cattle rancher in Argentina or a mine owner in Bolivia

Liberals are criticized by the structuralists in the 1950s

- Actually, it's not so good to be in the primary product business
- As we talked about last week, CEPAL economists claim that terms of trade shift against you
  - Especially important if the primary product you're exporting is non-replenishable (e.g., minerals)
  - Eventually, it will run out; then you're screwed
  - Want to be in the business of adding value, manufacturing
  - Instead of exporting raw copper and importing finished copper bars and wire, turn the copper into bars and wire yourself
  - Move up the "value-added chain"
  - **Examine value-added chain for cocaine**
  - Even if it's agriculture; go from raw leather to shoes and belts
- But there's a problem here: a market failure
- Markets don't operate the way Liberals say, where transactions are costless and one can become a copper manufacturer overnight
  - Takes technology and know-how
  - You are not the first one to try this: Economies of scale and learning
  - We talked about this a bit in recitation
  - **So what happens if you're Chile?**
- So you're not competitive right away. You need to achieve some scale first, and you need to get some practice before you can compete.
  - **What's the solution?**
  - Known as import-substituting industrialization (ISI)
  - In theory, you would gradually phase out tariffs over time as you get competitive
- By the way, there are also other answers to the problem of being a primary product producer
  - **What might you do?**
  - Story of OPEC
  - Story of Banana Cartel (undone by bribe from banana companies to Honduran official)
- In general, L.A. adopts ISI
  - Brazil, Mexico very aggressively
  - Argentina less so
  - Smaller countries not so much, but still have tariffs
  - Prebisch argument has big influence; pro-industry bias in policies
  - high tariffs, subsidies to industry,
  - nationalization of industries (especially foreign industries)
  - big role for state in regulating economy
  - Supported by both workers and businessmen; politically attractive
- Works for a while
  - Foreigners invest to avoid tariff; open factories
  - Some local industry develops, often in conjunction with foreign capital and the state
  - Substantial development
  - Mexico, Brazil develop big industries (steel, chemicals, etc.)....

...but there are some potential problems with ISI. **What might those be?**

- inefficiency, industries never get competitive
- corruption to keep subsidies and tariffs ("rent-seeking")
- monopolies and oligopolies domestically
- Urban bias to policies; migration to higher wage jobs

- Neglect of agriculture (Argentina)

#### ISI worsens in 1970s

- Clear it's past its usefulness
- But governments don't want to correct it
- Running big budget deficits
- big trade deficits as well, since exports are not competitive
- Countries borrow to finance their deficits; by early 1980 up to their eyeballs in debt
- Where is the money they borrow coming from?
  - Producers' cartel, called OPEC, raises price of oil
  - Recycled petrodollars are lent to Latin America through Western banks
- Bursts in early 1980s, with recession in West
  - Demand for commodities drops
  - money to oil suppliers goes down
  - interest rates go up
  - Latin America must pay higher interest rates, but can't export
  - August 1982, Mexican default triggers debt crisis
  - Everyone but Colombia in S. America has big problem
  - ISI blamed

#### Question is now what to do

- Immediate answer: belt-tightening
  - Cut spending, austerity measures
  - Often imposed by IMF as condition for new loans
  - "*paquetazos*"
  - Cutbacks in spending, huge interest rates
  - recession, poverty
  - 1980s become "lost decade"
- Deeper answer: dismantle the old ISI system, make economies more productive
  - Help them to pay off loans, but also help them avoid the same problem
  - "Structural adjustment", "economic reform", "orthodoxy", "neoliberalism", "market-friendly reform", "market-oriented reform"
  - general goal is to reduce the role of the state and increase the role of the market
  - thought to be much more efficient
- Response to structuralists emerges
  - Liberals told you the market was most efficient
  - Structuralists pointed out that market is best in theory, but in practice, there are market failures; this means that the market is only second-best
  - Neoliberals now reply: it's true that the market may be imperfect, but it's also true that the government is imperfect
  - Better a second-best market than a second-best state
- Elements of new economic orthodoxy
  - Trade liberalization
  - Investment liberalization
  - Eliminate subsidies; get prices right
  - Tight fiscal policy
  - Privatization
  - Labor market reform
- Country that undertakes these measures most (Chile) does best
  - But it does so under a dictatorship

For years, this was it

- Total dominance of this policy prescription
- "TINA" (There Is No Alternative)

Lately, neostructuralists have been coming up with a kind of reply

- Acknowledge the need to balance the budget
- Understand the need to get the government out of a lot of things in the name of efficiency
- But insist that the government is needed for some things
  - Enforce the law
  - Invest in human capital (education, health)
  - Regulate businesses (private monopolies, financial sector)
- Doing these things requires revenue
- Instead of just cutting government spending, emphasize the need to build a working tax system

Current debate over development focuses on "second stage" reforms

- Financial sector reform (stock markets, regulation of banking system)
- building tax system (replaces inflation tax)
- human capital (education, health care); can reduce inequality and grow at the same time
- cutting military spending (already very low in Latin America)
- pension privatization
- state capacity: civil service reform, etc.
- decentralization

Consequences of neoliberal reform so far

- Inequality, adjustment costs, "Valley of Tears"
- Opposition from many groups
  - Public sector workers, who would be laid off
  - Unions in ISI industries, who would have to take wage cuts and might get fired
  - Business groups in ISI industries, who would lose subsidies and protection
- Support from some groups
  - Those hurt by inflation
  - consumers
  - exporters
- Impact on growth is really unclear
  - Chile and Bolivia (rapid reformers) vs. Costa Rica and Venezuela (slow)
- Political results really differed
  - Difference between austerity and SA
  - Most politicians who adopted SA increased their share of vote (Fujimori, Cardoso, Salinas, Zedillo, Menem, Paz, etc.)
  - Some measures much more popular (inflation vs. trade vs. privatization)
  - Depended on how it was sold to public, what happened to economy, and perceptions of corruption
  - In Mexico, mixed (Salinas then and now; Zedillo): high approval ratings, PRI reelected, Chiapas rebellion
  - In Venezuela, results were disastrous: riots, coup attempts, etc.
- In general, support for democracy has tended to be higher where these reforms were undertaken much more gradually (Costa Rica and Uruguay)