Lecture 1
Latin America and Economic Ideologies

Domingo F. Cavallo[1]
Harvard University, Cambridge, Massachusetts, U.S.A.
2004

In understanding the recent history of Latin America the expression "Washington Consensus" is only useful if interpreted as a short for "Washington support for the Latin American Consensus".

I will argue along this course that by the mid 80's a Consensus emerged among economists and democratic political leaders all across Latin America on the need to introduce "new rules of the game" for the national economies in order to defeat hyperinflation and renew growth. But these reforms could not be successfully implemented unless Washington would provide help to free Latin American nations from the Debt Trap.

Washington support came with the Bush 41 and Clinton Administrations. But seems to have "gone with the wind" of the Bush 43 Administration. On the Latin American side the consensus started to disappear with Chavez in Venezuela and Duhalde in Argentina.

The purpose of the course is to examine if the lack of Washington support for the disappearing Latin American Consensus will make room for better reforms or will simply consolidate the very discouraging current landscape in Latin America. Or, even worst, will recreate the situation of the 70's and 80's.

In this first class I will describe how the ideological discussions and the course of events interacted to generate the Latin American Consensus. My story today will try also to draw the picture of the Latin American region we saw in the mid 80's.

Why the mid 80's? Because it is the date, which is usually considered the start of the implementation of the economic reforms by democratic governments. The first episode took place in Bolivia in 1985. It is easy for me to recall what I thought back then because coincidentally it is a turning point in my professional life: after publishing my book "Volver a Crecer" (Back to Economic Growth), I switched from the academia to politics.

Let's start with the ideological discussions on economic matters that took place from the mid 40's to the mid 80's.

In the aftermath of the WWII, ideological discussions in the world focused on the dichotomy Socialism versus Capitalism. Naturally this dichotomy embodied the economic aspect of the East-West confrontation that characterized the Cold War.

---

[1] Lecture delivered at the Department of Economics, Harvard University, Spring Term 2004, in the capacity of Robert Kennedy Visiting Professor in Latin American Studies.

Latin American countries tried not to get involved in this confrontation adopting what Juan Domingo Perón, who was the Argentine President at the time, called “The Third Position” (in Spanish: “La Tercera Posición”). These ideas would be the seed of the Not-Aligned Countries Movement, which in turn several developing countries joined.

At the same time, in Latin America economic academic thinking moved towards the so called “Structuralism” as opposed to the “Orthodoxy” that had prevailed in previous decades. “Structuralism” looked like the “Keynesianism” of the Developing World. A good account of the Structuralist School is offered by Rhys Jenkins in Chapters 5 and 6 of the book entitled Industrialization and Development edited by Hewitt, Johnson and Wield.

“Structuralism” gave intellectual support to the Import Substitution Industrialization (ISI) growth strategy and the Populist Macroeconomic Policies that most Latin American governments implemented since the mid forties until the eighties with varied intensity.

The economic organization and the economic policies suggested by “Structuralism” were functional to the political regimes that prevailed in most Latin American countries in those years: either civilian governments in corporate state democracies or military dictatorships. For them “Statism” was a way to accumulate and preserve political power.

The only case of a military dictatorship that implemented economic reforms departing from the Structuralist Policies was Chile under Pinochet. But the very fact that the Economic Liberal Reforms had been decided and implemented by a repressive regime had added more passion to an already heated debate. Even though very informative from the economic point of view, the Chilean Experience could not be easily digested by the political leaders of the emerging democratic regimes of Latin America during the 80’s.

In Mexico and Brazil, strong criticism to the Import Substitution Industrialization growth strategy began to be heard only after the eruption of the Debt Crisis in 1982. Indeed, economic discussions had started to take place prior to 1982 analyzing whether the development strategy based on the ISI model was exhausted. These discussions overlapped with a few, but not really frequent, episodes of Populist Macroeconomic Policies based on the Structuralist mindset. But, all in all, the ISI growth strategy had delivered rapid growth in both countries during the period 1945-1982. The good results had been undisputable until the first oil crisis in 1973, and the difficulties created by the commodity crisis of the 70’s had been overcome by readily available foreign financing.

By the mid 80’s the criticism regarding the Import Substitution Industrialization growth strategy that had emerged at the time of the Debt Crisis became strong and convincing because the difference in economic performance between East Asia and Latin America during the period 1965-80 spoke by itself. (See Table 1-2 in Sebastian Edwards’s book, chapter 1, page 4)

In Argentina the evidence against the policies recommended by Structuralism were even more eloquent and came from a different comparison. Until the WWII, Argentina had achieved a standard of living quite close to that enjoyed by the most advanced countries in the world. This was the outcome obtained from the combination of its vigorous international trade, its infrastructure and its education system. In turn, the implementation of the Import Substitution Industrialization strategy along with Populist Macroeconomic Policies produced a disappointing outcome instead. The disappointing consequence of implementing the last set of policies was a stagnant economy suffering high levels of inflation since the mid 1970s.

In the Institute I ran at the time, we analyzed the Argentine case compared to countries with similar endowment of human and natural resources such as Canada and Australia. There was an obvious divergence among the economic performances of those countries from the WWII on. We, then, aimed at finding the reasons of Argentina's backwardness. We came to the conclusion that the disappointing performance of Argentina after the WWII was due to a certain institutional misplace, which had been a consequence of the trade and macroeconomic policies implemented thereafter.

In a well-organized mixed economy, resources are efficiently allocated by means of the signals sent by relative prices. Relative prices, in turn, are determined in competitive markets. On the other hand, redistributive policies are explicitly included in the government's Budget.

In Argentina, on the contrary, those instruments of economic policy had switched roles. Instead of being instrumental in the efficient allocation of resources, relative prices were controlled by the government aiming at redistributing income. On the other hand, instead of playing a role in the redistribution of income, the government's Budget aimed at allocating investment and employment.

You can find a synthesis of our findings in the article entitled "The Argentina that Could Have Been," authored by Yair Mundlak, Roberto Domenech and myself. (See in particular Figures 1 and 7)

This work along with the work of other authors laid the foundation of our position on the matter. We explained that Argentina's problem was not that it had too much Capitalism as Structuralists argued, nor was it that it had too much Socialism as the Orthodox Economists said. The real problem was that it has a poor combination of both Capitalism and Socialism. Our economy was a mixed of "Capitalism without a Market and Socialism without a Plan."

Our diagnosis led us to propose a different approach in order to attain sustained economic growth. We proposed a strategy based on a complete reorganization of the economy. Hence, in our political discussions we used to talk about "New Rules of the Game." This is, by the way, the expression that Daniel Yerguin came across when doing his research on economic reform in Latin America. Notably, the chapter of his book "The Commanding Heights" in which he referred to Latin America is entitled "Playing by the Rules."

I published "Volver a Crecer" (Back to Economic Growth), as a way to spread our interpretation of Argentina's maladies and their possible solutions. The book's subtitle is "Proposing New Economic Rules of the Game for Argentina." It has not been translated into the English language; however, a very short synthesis of our thesis can be found in the chapter "Three Views on Restoring Growth," from the book Inflation

Stabilization. The Experiences of Israel, Argentina, Brazil, Bolivia and Mexico, edited by Bruno, Di Tella, Dornbusch and Fisher.

In that comment, I argued that in order to be effective, the change in the rules of the game in Latin America should be backed by the United States of America via similar mechanisms as those applied to help with the reconstruction of Japan and Europe in the aftermath of the WWII. I also argued that, exactly as happened in the post-war period, the benefits would spread over not only the countries being helped but also the global economy. I considered that to attain higher global growth without unleashing inflationary pressures new stimuli were needed. But they should come not from rapid expansion of consumption in the US, where the saving rates were already very low, but from increased investment in Latin America.

This account of our interpretation of our economic reality back in the mid 80's seeks to prove to you that at that time Latin- American leaders were not asking for recipes to solve the problems. On the contrary, we were asking for concrete help in order to fund increased investment levels that in turn would help to increase the productivity rates of our economies. Our countries needed that help in order to being able to obtain sustainable economic growth.

Actually, we thought we had come up with our own recipes as to how to open-up investment opportunities, how to mobilize domestic savings, and how to cure inflation. We had reached our own conclusions based on our research on the country's reality. We did not base our proposal on theoretical universal recipes. Our mindset did draw on conventional Microeconomic Theory and the then recently developed Open Economy Macroeconomics, but these were simply tools for the analysis. Our proposal was based on the research on our reality we had conducted. Even though economic reality was not always similar across Latin America, there was a common element: the Debt Trap. To get out from the Debt Trap we needed help. Hence, most Latin American leaders asked for such help to Washington.