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Latin America: Economic Development Theories and Their Policies

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In considering economic development in Latin America over the past forty years, we find three theories distinctive to the region when compared with other developing areas. They are "structuralism," "dependency" and "neoliberalism." Corresponding economic policies derived from these three are: import-substituting industrialization; socialistic economic construction; and no intervention, respectively. None of them, however, have been successfully carried out. Facing the last decade of the 20th century, we would like to summarize and evaluate these theories.

I. Development Theories Born in Latin America

In Latin America, two original development theories have evolved, reflecting regional characteristics which differ from those based on economic growth in advanced countries. One is "structuralism," or the structuralist school theory; the other is known as the "dependency" theory. In addition, a new liberal trend called "neoliberalism" has emerged, intensifying conventional liberalism.

1. Structuralism

This theory started from controversy over Chilean inflation during the 1950s. It was put into general use by scholars from the Economic Commission for Latin America (ECLA, later ECLAC), evolving in to a development theory for the region. These scholars maintain the view that the Latin American economy has structural conditions which are "heterogeneous" with those of advanced countries and that unless obstacles hindering the region's economic growth are removed, development will not occur.

With respect to inflation in Chile, the IMF dispatched a survey mission in 1950 and the U.S. Klein and Sacks Advisory Mission visited Chile in 1955 to advise on economic stabilization policies. The policies recommended by these monetarists to counter inflation centered on control of the money supply, and severe aggregate demand controls were adopted. However, the deflationary effects were so severe that although price increases were restrained, economic growth came to a halt. The structuralist school theory emerged as a criticism to those policies.

The structuralist theory maintains that there are two factors in inflation: a "propagation" factor, such as credit expansion, price-wage spiraling and fiscal deficits; and a "structural" factor which causes imperfections in the money and commodity markets. The structural factors for inflation can be summarized as follows:

(i) Supply bottlenecks in the agricultural sector (a bottleneck in the supply of foodstuff production partly due to large-scale land ownership and partly due to rapid urbanization)
(ii) Limitations of supplies in the industrial sector (monopolistic or oligopolistic suppliers caused by small domestic markets)
(iii) Monoculture-type foreign trade pattern (the structure of foreign trade with a heavy dependence on primary product exports while the import of industrialized products causes a reduction in production due to poor purchasing power of exports)
(iv) Tendency for fiscal deficits (expenditures increasing due to "populism" or large state enterprises, while revenues decline due to an ineffective tax system)
(v) Unequal distribution of income (low savings ratio limiting investment and reducing production, resulting in small domestic markets)

In short, the structural factors mainly cover the limitations of the supply side. In contrast, the monetarists put emphasis on improvements on the part of the demand side called "aggregate demand control."

These structural factors can be obstacles, not only in relation to inflation, but from the viewpoint of economic development. Therefore, scholars of the structuralist school, mainly belonging to ECLA, generalized upon them in a development theory for Latin America. In particular, Raul Prebisch (1961, 1963) played an important role as the key man of the structuralist school. According to him, the world economy can be divided into two: the center which specializes in industry and the periphery which specializes in primary products. Economic growth in the periphery meets with obstacles due to external and internal limitations, resulting in a widening differential with growth rates in the center. With respect to the external limitations, the main problem arises from their export structure which specializes in primary products. Since income elasticity of demand for primary products is generally low, the long-run demand becomes stagnant and the terms of trade turn unfavorable for the periphery (see Table 1). Foreign currency con-

Table 1. Latin America: Evolution of Merchandise Terms of Trade, 1928 – 1987

Year	Export Price Index	Import Price Index	Merchandise Terms of Trade	Export Quantum	Purchasing Power of Exports	Import Quantum
1928	100.0	100.0	100.0	100.0	100.0	100.0
1929	90.6	96.2	94.2	103.1	97.1	106.4
1930	62.3	93.3	66.8	87.9	58.7	75.8
1931	41.8	79.2	52.8	93.0	49.1	51.9
1932	36.2	65.1	55.6	77.8	43.3	37.9
1933	29.3	56.6	51.8	81.2	42.1	46.3
1934	28.4	48.1	59.0	91.3	53.9	51.9
1935	31.8	48.1	66.1	105.6	69.8	56.1
1936	33.9	48.1	70.5	109.3	77.1	60.3
1937	38.1	52.3	72.8	120.4	87.7	75.7
1938	34.9	50.9	68.6	96.3	66.1	70.1
1939	33.8	49.5	68.3	101.8	69.5	68.7
1940	35.9	53.3	67.4	90.7	61.1	58.9
1941	40.1	57.6	69.6	94.4	69.2	60.3
1942	44.8	67.7	66.2	88.2	58.4	46.3
1943	49.7	73.5	67.6	96.0	64.9	47.7
1944	53.6	73.5	73.0	101.9	74.4	58.9
1945	54.6	79.2	68.9	111.3	76.7	65.9
1946	71.2	92.2	77.2	119.1	91.9	86.9
1947	89.7	115.3	77.8	121.1	89.7	119.1
1948	99.4	123.9	80.2	121.1	94.2	116.3
1949	93.6	123.9	75.5	111.3	84.0	103.7
1950	110.5	118.1	93.6	115.2	107.8	105.1
1951	130.4	141.2	92.4	115.2	106.4	130.3
1952	93.9	144.1	65.2	111.3	72.6	124.7
1953	93.9	134.0	70.1	123.0	86.2	114.9
1954	97.7	136.9	71.4	123.0	87.8	128.9
1955	87.3	139.8	62.4	130.8	81.6	128.9
1956	85.9	139.8	61.4	142.5	87.5	134.5
1957	88.1	141.2	62.4	146.4	91.4	155.5
1958	80.9	139.8	60.0	148.4	89.0	142.9
1959	73.0	135.4	53.9	162.1	87.4	138.7
1960	74.4	138.3	53.8	166.0	89.3	142.9
1961	74.4	141.2	52.7	171.9	90.6	145.7
1962	71.5	144.1	49.6	187.5	93.0	144.3
1963	72.2	144.1	50.1	195.3	97.8	140.1
1964	76.5	149.9	51.1	197.3	100.8	148.5
1965	75.1	152.7	49.2	211.0	103.8	149.9
1966	76.5	152.7	50.1	218.8	109.6	166.9
1967	75.8	154.1	49.2	220.8	108.6	174.0
1968	76.2	152.7	49.9	230.6	115.1	191.0
1969	78.4	155.6	50.4	246.2	124.1	206.6
1970	84.1	159.9	52.6	254.0	133.6	229.2
1971	79.8	164.9	48.3	275.8	133.2	146.7
1972	110.8	178.1	62.1	251.7	158.2	260.2
1973	129.9	204.2	63.6	304.0	193.3	301.4

Table 1. (Continued)

Year	Export Price Index	Import Price Index	Merchandise Terms of Trade	Export Quantum	Purchasing Power of Exports	Import Quantum
1974	216.5	293.8	73.6	264.0	194.3	359.0
1975	218.6	325.3	67.2	240.5	161.6	345.2
1976	234.7	331.5	70.8	260.9	184.7	351.8
1977	269.9	358.0	75.4	271.0	204.3	374.9
1978	278.9	392.9	70.9	281.9	199.9	388.5
1979	340.8	458.7	74.2	310.1	230.1	418.2
1980	424.4	553.4	76.7	329.4	252.6	501.2
1981	418.9	581.6	72.0	358.9	258.4	515.6
1982	379.0	544.4	65.9	362.0	238.6	418.3
1983	341.7	522.3	65.3	401.8	262.4	328.9
1984	354.3	501.8	70.6	432.3	305.2	356.0
1985	337.4	493.5	68.3	427.0	291.6	363.4
1986	291.5	469.8	62.1	417.8	259.5	389.0
1987	311.6	487.6	63.6	438.4	278.8	410.8

Source: For 1928 – 1970, CEPAL and for 1971 – 1987, ECLAC (CEPAL) data bank.

straints bring about a limited import of intermediate and capital goods, resulting in production limitations. Furthermore, there exists a technological gap between the center and the periphery. Productivity increases in the center thanks to ever-progressing technological innovation result in increased wages. On the contrary, the industrial sector in the periphery fails to sufficiently absorb the surplus labor in the agricultural sector, and thus low wages and prices persist.

The internal obstacles for development include the coexistence of the modern and traditional sectors of agriculture, low savings/investment ratios, a lack of social mobility, and the existence of income disparities. Particularly, when we think of industrialization, the size of domestic markets is crucial. Not only low per capita income, but also a wide differential in earnings will impede the formation of domestic markets. The majority of people suffer from poverty (especially in the rural areas), and they fail to create a sizable demand for domestically-produced industrial goods. The small market can not fully take advantage of economies of scale, which are inherent to modern technology.

Therefore, the structuralist school recommends an end to the specialization in primary products and the start-up of domestic industrialization; i.e. "import-substituting industrialization." It further insists upon the removal of internal obstacles which limit development, such as reforms on land, taxes and education. This inevitably means an increased role for the state, which will have to act agressively, not only on the institutional aspects, but in the formation of capital (infrastructure investments and direct participation in production activities by public enterprises) and for financial intermediaries (financing activities by governmental banking facilities).

At the same time, the granting of incentives to import-substituting industries in the form of tax breaks, financial support, and subsidies, signifies intervention by the state in the market mechanism. It is not the "invisible hand" that leads the economy but the government's "visible hand" that tries to overcome market imperfections.

The historical background of this era also affected these policy changes. The Cuban Revolution in 1959 inspired radical groups in Latin American countries. The U.S., which was afraid of these developments, recommended several social policies such as agrarian and tax reform under the program of "the Alliance for Progress" in order to improve income disparity and realize sustainable growth, as well as providing economic assistance to the region. The role of the state became more and more important because the use of "economic planning" in particular was the prerequisite for such assistance (Bianchi, 1990). The policies for import-substituting industrialization advocated by ECLA were adopted by almost all Latin American countries and became the guiding principle for industrialization during the past forty years.

2. Dependency Theory

It is no exaggeration to say that the dependency theory supported chiefly by A.G. Frank (1967, 1969, 1972)[2] was stimulated by the Cuban Revolution. According to him, the world capitalistic system contains an element which produces and accelerates "underdevelopment." Underdevelopment is not caused by the remains of feudalism or a lack of capital funds, but rather is produced by the same historical process which brings about the development.

The world economy is composed of many metropolis-satellite relationships. The metropolis, which represents the European capitalistic countries, has developed because of the deprivation of the satellite, which stands for developing countries. The satellite economies are always incorporated into the world economy led by the metropolis and are suffering from underdevelopment due to the exploitation by the latter. This exploitation is unilateral, as surpluses generated in the satellite are drawn off towards the metropolis, accelerating more and more the underdevelopment of the satellite ("development of underdevelopment"). This construction of the metropolis-satellite linkage exists in the developing countries as well. The domestic metropolis makes the domestic satellite its subordinate, and exploits it. Therefore, if you have a look from the above, the world may appear as a numberless constellation composed of the metropolis and the satellite chain. This relationship has been observed since the initial stage of colonialism, and therefore the "latifundio" in the rural area is not the issue because it is feudalistic and oligarchic; but because it deprives farmers and constitutes capitalistic exploitation by collaborating with the capitalists in the cities. The metropolis, while developing through exploitation of the satellite's natural resources and labor at low cost and low wages, leaves the satellite in a state of underdevelopment. Exploitation comes from the principle of "unequal exchange."

The uniqueness of this theory is that the state of underdevelopment in Latin America is not in its "dual structure" or the feudalistic remains, but in the incorporation into the world's capitalistic production/trade structure. In order to solve these situations it is recommended to abandon capitalism, or move towards socialism, for instance.

The Brazilian F.H. Cardoso (1979) and T. Dos Santos (1970, 1978) gave more flexibility to this "mechanico-formal" theory or dualism (dominating-dominated, exploiting-exploited, capitalism-socialism) and deepened the dependency theory. International affairs will of course affect domestic conditions, however, the formation and development of internal elements such as domestic classes and social forces are also important. In Mexico or Brazil, where there is government-led development, there can be capitalistic development/expansion in the satellite to a certain degree ("dependent-development"). Dos Santos focused on the adverse influence of multinational corporations and characterized them by an exploitation of the labor force, a monopoly in technology of a capital-intensive nature, and a remittance of profits, hampering the formation of domestic capital. He further points out that the multinational corporations of recent years are more and more integrated into the international division of labor, and that a new international division ("new dependence") is being established.

The dependency theory has political/social significance rather than as an economic model. However, in the sense of emerging from dependent capitalism, the dependency theory aims at the socialism model (or the possibility of fascism as its polarity). The theory and its policies have been tried, in a sense, by the Allende government of Chile (1970–73), the Sandinista government of Nicaragua (1979–89), and, to a certain degree, in the Velasco government of Peru (1969–75).

3. Neoliberalism

What this theory asserts that is different from the earlier two theories is the revival of the classical school (laissez-faire), and what Fishlow (1986) called "international monetarism." Nothing but free competition will create the Pareto-optimum in resource allocations, and the government's intervention in the market mechanism will hamper it. Protectionism and state intervention by means of subsidies, tax incentives and other forms of privileges given to priority industries distort prices and hinder industrial and trade development. Thus, these intervention measures should be eliminated. Accordingly, the following have been explained as policy direction: abolition of controlled prices, wages and interest rates; abolition of subsidies; gradual lifting of import duties and subsequent liberalization of trade; and privatization of state enterprises. Here, industrialization and trade are carried out according to the law of comparative advantage. The government's preferential policies for industry should be removed. This theory was originally advocated by the University of Chicago, represented by Prof. Friedman. Those who studied at the Chicago campus and later became economic policy makers were called the "Chicago boys" or the "Chicago school."

The neoliberalists introduced the "monetary approach to the balance of payments" particularly as a measure against inflation. This is the modern interpretation of the "specie flow mechanism of price" supported by the classical school, and it gives the following three assumptions:

(i) The law of one price (same production cost in each country for the same product); (ii) The quantity theory of money (demand for money has a stable relationship with the nominal income); (iii) The accounting identity of money (the volume of money supply is equal to the total of international reserves plus domestic credits).

Here, commodity prices, wages and interest rates are all flexible in a world under the gold standard. Therefore, a domestic demand increase (i.e. separation from the balanced conditions, or pressure for price rise) will bring about increased imports, a deterioration of the balance of payments, decreased international reserves, and a decreased money supply. As a result, adjustments for demand and thus prices are achieved.

Policies of neoliberalism were adopted by the military regimes of Latin America's southern cone countries, such as Chile (1973 – 82), Argentina (1976 – 83), and Uruguay (1973 – 84). It is quite interesting that the Chicago boys played important roles under authoritarian rule. At that time, the military succeeded the leftist government (Chile) or the government strongly characterized by populism (Argentina, Uruguay). It can be said that the "small government" proposed by the neoliberalists matches the army generals' thought as an antithesis against the full state intervention as shown in nationalization and the expansive fiscal expenditures by the previous governments.

II. Appraisals of Each Policy

1. Import-Substituting Policy

When all the countries in Latin America faced an external debt crisis in the 1980s, the crucial point was that there had not been sufficient foreign currency earned from exports to pay off the debts. This contrasts to the situations faced by Asian countries such as the Republic of Korea and Malaysia, which have avoided the same problem. In short, the strategy for industrialization has been successful in Asian countries by promoting the export of manufactured products, but not in Latin America where an import-substituting policy has been pursued since the Great Depression. It came to be recognized that the import-substituting policy has the following shortcomings (Hirschman 1968, Fishlow 1986):

(i) It has not improved the foreign currency constraint. (The first-stage import substitution, i.e. domestic production of consumer goods successfully ended, but the second-stage import substitution, i.e. consumer durables and intermediate goods required more import materials and capital goods. Import substitution itself was import promoting. In addition, overvalued exchange rates adversely affected exports.)

(ii) Consciousness for efficiency and quality has been neglected. (Efforts in cost reduction and quality consideration tended to be forgotten because of incentives granted to import-substituting industries. Moreover, oligopolies divided the small domestic market and higher prices remained. This resulted in low competitiveness when they began to export their products overseas. In addition, resources were wasted to protect their incentives and vested interests as shown in lobbying or directly unproductive activities.)[3]

(iii) The "big government" created an underlying cause for inflation and external debt. (Finance for chronic fiscal deficits caused by expansive spending relied heavily on internal and external debts as well as an inflation tax or seigniorage.)

(iv) The effect of employment creation by the import-substituting industries was less than expected. (The import substitution policies, which in a sense can be realized by the sacrifice of agricultural production, failed to stop the flow of population into the cities and to create sizable employment opportunities to absorb the excess labor sufficiently. This also had a lot to do with the labor-saving technology of the multinational enterprises.)

(v) There was no improvement in the distribution of income. (It is said that income concentration has intensified and the distributional gap has grown wider. The higher-income strata tended to consume modern and luxurious goods because of international demonstration effects and, as a consequence, skewed imports, while the lower-income strata failed to form effective demand in the domestic markets.)

As explained above, import-substituting industrialization did not have favorable results, but some steps have been taken to adjust for these defects. One of them was to set up a common market to compensate for the small size of individual markets. Second, more state intervention (state capitalism) was made along the basic line of import substitution. Third, through radical and socialistic means, market forces were completely suppressed.

As regards the common market, integration of the areas was performed, following the ECLA's suggestions, in order to enjoy benefits of specialization and economies of scale. Basically, two instruments were adopted: tariff reduction and the industrial supplementary agreement. Examples are the Latin American Free Trade Association (LAFTA) of 1961 and the Central American Common Market (CACM) of 1961. In 1968 the Caribbean Free Trade Association (which became, in 1973, the Caribbean Common Market — CARICOM) was formed. However, economic integration left differences in the distribution of benefits among relatively developed and under-developed countries in the integrated region. In case of LAFTA, for instance, the "comparatively" under-developed countries in the market formed in 1969 the Andean Common Market (ANCOM). Furthermore, LAFTA itself was dissolved into a new association in 1980, the Latin American Integration Association (LAIA), in which eleven Latin American countries were more loosely united. In short, the idea of a common market failed to become an instigator of economic growth in each country.

From the latter half of the 1960s to the beginning of the 1970s, high economic growth occurred in the military-led governments of Argentina and Brazil. Under state leadership, priority was put on development rather than distribution ("developmentalism"), and comparatively orthodox tight fiscal/monetary policies were adopted. Foreign investment grew rapidly, particularly by multinational corporations in durable consumer goods and heavy and chemical industries. Moreover, domestic demand expanded due to the development of consumer finance.

In Argentina, the military regime led by Ongania started in 1966 and up to 1973 the economy recorded an average annual growth rate of 5%. Under the Brazilian military regime, the economy showed a tremendous performance between 1968 and 1974 at 11% per annum under the minister of finance, Delfin Netto. During these periods, the state corporations took aggressive steps to acquire private enterprises, making them subsidiary and affiliate companies and expanding production activities. In this way, the mixed state of public and private enterprises evolved. However, high growth came to an end as terrorism by the city guerrillas led to an unstable political situation and increased social anxiety in Argentina. In Brazil, the first oil crisis, put an end to the "Brazilian Miracle."

2. Experiments of Leftist Regimes

In Chile, from the end of 1970 to September of 1973, socialistic economic policies were taken by Allende. Here, private ownership was limited; national intervention and control became the basic rule. For example, (i) nationalization of big copper mines, (ii) land reform (laws reforming land were set up by the Alessandri government in 1962 and strengthened by the Frei government in 1967) to be fully performed, and (iii) state controls of banks and major enterprises.

Consideration as to the distribution of income was strong enough to raise wages and decrease unemployment, but it brought about a decline in production, an expanded fiscal deficit (in 1973, 25% to GDP), high inflation (508 % in 1973), and an international balance of payments crisis. The decline in copper prices and halting capital flows due to a deterioration of relations with the U.S. were secondary causes, but the principal reason was the supply bottleneck caused by the hastiness in implementing the long-run structural reform.

The Sandinista government in Nicaragua (1979 – 89) carried out socialistic policies as well. There, the 1987 constitution stipulated political pluralism and a mixed economy as basic principles, and did not set out to nationalize all the assets of the people. The land reform permitted both national and private ownership as well as ownership by coopretative unions. In the economy, there were national and private sectors as well as the mixed type in which both sectors collaborated jointly. (However, the mixed economy here is different from Brazil, which puts state capitalism with private ownership as its premise.) In principle, strongly socialistic policies were carried out. The Nicaraguan Revolution reached its lowest point because of the ten-year civil war against the Contras and the U.S. embargo. The poor condition was reflected in the economy (a drop by 33% of per capita GDP during 1981 – 89, an inflation rate in 1989 of over 3,000%, a continuation of hyperinflation since 1985), and in the election in February 1990 the liberal V. Chamorro as President.

In contrast to Cuba, the governments in Chile and Nicaragua had only short lives, so it is not possible for us to make an overall appraisal of this system. Although they were effective in correcting the distortion in income distribution (and increasing the rate of literacy in the case of Nicaragua), they failed to solve the imbalances in the macroeconomy such as inflation and deficits in the current balance of payments.

3. Neoliberal Policies

Neoliberal policies, in which state intervention is minimized in favor of the market mechanism, are specifically as follows: (i) Liberalization of the financial market (freeing interest rates, liberalization of capital movement, etc.), (ii) Balanced fiscal budgets (revision of government-fixed prices, reforms of the tax system, reduction of expenditures, privatization of state enterprises, etc.), (iii) Releasing controls on commodity prices and wages (abolition of controlled prices and indexation of commodity prices/wages, etc.), (iv) Free trade (releasing import controls, the reduction of tariffs, pre-announced devaluation program, fixed exchange rate, etc.).

These policies were carried out in a complete manner in Chile (1973 – 82), Argentina (1976 – 83), and Uruguay (1973 – 84). In Chile, the military government that overthrew Allende in 1973 returned nationalized land and enterprises to the private sector in order to establish private ownership and promote liberalization of finance, capital and trade (Kagami 1990). The government put most of its efforts toward the achievement of a well-balanced budget and succeeded with a surplus during the period of 1979 – 81. This greatly contributed to reducing the inflation rate to only 9.5% in 1981. However, because overly radical liberalization occurred in the context of immature financial markets real interest rates went up, conglomeration of financial/industrial organizations worsened, external debt increased rapidly due to the mass inflow of capital, and a wide-ranging trade deficit was seen due to the freeing of imports (a 16-fold increase of consumer-good imports during the period of 1974 – 81). The economy with the bubble phenomena went into a great recession because of bankruptcies, recording a per capita GDP decline of 14.5% in 1982, the largest drop in all Latin American countries. Paradoxically, this again invited massive government intervention, through nationalizations of private institutions (Diaz-Alejandro 1985).

As with Chile, the liberalization of finance, capital and trade in Argentina have been the aim of the military government since 1976. However, this failed to reduce the fiscal deficit (particularly in the latter half of the period, 1981 – 83), and the inflation rate did not fall as much as expected (between 1976 and 1983, the lowest rate was 88% in 1980, and in 1983 it was 434%). The balance of current accounts turned to the red due to the sudden increase of imports and the external debt accumulated (45.1 billion dollars as of the end of 1983). Per capita GDP in 1982 fell 7% and a gain of only 1% was observed in 1983 (Bianchi, Lahera and Muñoz 1989).

As with the above, economic management based on the neoliberal framework was made under the military government of Uruguay (1973 – 84), but stagflation was the result due to a recession (per capita GDP fell 10.6% in 1982, 6.6% in 1983 and 1.9% in 1984) and inflation (52% in 1983 and 66% in 1984). As in Argentina, Uruguay's balance of current accounts also turned to the red and the external debt accumulated (4.7 billion dollars at the end of 1984) (Ramos 1984).

The following four elements can be pointed out to explain the failure of these neoliberal policies:

(i) The monetary approach to the balance of payments is the partial equilibrium analysis of adjustments to the balance of payments. Just as the elasticity or absorption approaches, the monetary approach only focuses on the relations between external reserves and the supply of money and ignores other relations in the general equilibrium system. For example, other variables such as domestic credits also change, so the overall influences must be taken into consideration.
(ii) There is a confusion of the short-run and the long-run. The adjustments of prices, interest rates, wages and exchange rates will not reach a balanced condition in an instant, but are ordinarily accompanied by a time-lag. With immature or segmented financial markets, it takes a longer time to reach a market equilibrium point, and distortion in prices and interest rates usually result. (For instance, despite the substantial flow of capital, real interest rates settled at a very high level in Chile and Argentina.)
(iii) With respect to wages, rigidities exist in the downward phase because of the indexation system and the pressure of labor unions. Because of these factors, no adjustment in relative prices but rather a reduction in production and employment were seen. (This was observed in Chile in 1982.)
(iv) When the system of financial intermediaries is immature, freeing the market suddenly creates confusion because of the appearance of those who want to take advantage by concentrating economic power in the form of "economic groups" and conglomerates, and the appearance of speculative enterprises preferring high risk. Regulations and adequate supervision by the central bank on entry permissions and asset purchases become essential.

III. Development Theory and Policy Measures in the 1990s

The external debt crisis in the 1980s was one of the turning points for the economic development in Latin America. The region, which experienced a decline in per capita GDP throughout the 1980s, will have to have a drastic changeover of its policies toward self-sustained growth. Payment of external debt has amounted to so much that it put pressure on government expenditures, and huge deficits will be the cause of hyperinflation in debt-stricken countries. The balance of payments position will not improve and stagnant investment levels will restrain economic growth. To cut off the vicious circle (Bresser 1990), a solution of the external debt problem must be found. Since 1989, thanks to the Brady Plan, reduction of external debts on the part of commercial banks is being done in some countries (Mexico, Venezuela, Costa Rica and Uruguay). In the future, there is a possibility for some reduction of official debts as well.[4]

1. Heterodox Shock

As regards the economic policies on the macroeconomic imbalances, especially on inflation, measures that are different from conventional ones have been taken in Brazil and Argentina. These were called heterodox policies or "shock treatments," as compared with orthodox policies. The new measures center around an income policy which freezes or fixes prices, wages and exchange rates to reduce inflation and particularly to cut inflationary expectations caused by the indexation mechanism. The aggregate demand control policy which monetarists prefer takes considerable time to adjust, and as it requires such social costs as depression, unemployment and social turmoil, the heterodox policies intend to make the adjustments instantly to minimize such costs. Therefore, these are often called "neo-structuralist" policies. This conforms to the "Austral Plan" in Argentina in 1985 and the "Cruzado Plan" in Brazil in 1986.

However, these policies are only effective as long as prices, wages and exchange rates are fixed on the basis of an adequate distribution of resources (i.e. fixed at the equilibrium level of demand and supply). If there is some distortion in relative prices, a shortage of goods and black markets will emerge and it will be difficult to maintain the freeze. As a result, when the freeze is lifted, the commodity and other prices will jump suddenly. Moreover, it will be difficult to hold down inflation if effective aggregate demand controls, particularly curtailment of fiscal deficits, are taken together with the income policy.

In Argentina, the "Austral II" and "Austral III" plans came out in February and October 1987, along with the "Primavera Plan" in 1988. Brazil had the "Bresser Plan" in 1987 and the "Summer Plan" in 1989. All these plans applied the heterodox-type measures, however, inflation flared up and accelerated. This phenomenon indicated a loss of credibility for the policies taken by government and, for the government itself.

2. Great Changes in Political Trend and Return to Orthodoxy

From the end of the 1980s to the beginning of the 1990s, the U.S.S.R. and East European countries had historic changeovers. In Latin America, too, there have been changes of administrations in many countries, showing significant new political trends. New administrations were born, one after another, which were more democratic and liberal, flexible internally and economically, and more open externally, aiming at collaboration with the international financial organizations as well as industrialized countries. They include: Salinas in Mexico (February 1988), Perez in Venezuela (February 1989), Menem in Argentina (February 1989), Chamorro in Nicaragua (March 1990), Collor in Brazil (March 1990), Fujimori in Peru (July 1990), Gaviria in Colombia (August 1990).

With respect to the economic policies in these countries, the overall trend is to attach importance to orthodox market mechanisms, although a shock treatment including a deposit freeze, was adopted in the Brazilian "Collor Plan" (March 1990). A shock treatment including wide-ranging increases for government-set prices and a drastic devaluation of the exchange rate was seen in the stabilization policy taken by Fujimori in Peru (August 1990). What is prominent in each country is: (i) reduction of the fiscal deficit; and (ii) liberalization of trade.

In regard to the fiscal deficit, which is the prime reason for inflation, such policies as tax reforms, the raising of government-set prices, curtailment of subsidies, and the reduction of budget expenditures are introduced as counter-measures. In addition to these, privatization of state enterprises becomes a main goal. This can be described as the movement to look for efficiency and cost-consciousness by making use of the private sector and market mechanisms.

Concerning the liberalization of trade, by abolishing import controls and gradually lowering custom duties, the aim is to alleviate protectionism, which distorted prices of import goods, and to promote more competitive exports. These policies have been taken in Chile since the middle of the 1970s and in Mexico since the middle of the 1980s (Zabludovsky 1990) and have subsequently trickled down to other Latin American countries.

Changes can be seen from import-substituting to export-oriented industrialization, from rent-based, extraordinary comparative advantage of natural resources (Ground and Bianchi 1988) to non-traditional exports,[5] and from intervention to the market mechanism. This idea is not based on conventional thinking such as structuralism, dependency, neoliberalism, or populism, but can be termed as a return to the orthodoxy in order to try and revitalize the economy.

The structuralist school once had intensive discussions with the monetarists over inflation, but the movements as above are approaching the stabilization policy recommended by the IMF and the structural adjustment policy of the World Bank. For the time being, dependence on these two institutions is unavoidable for suitable development policies.[6] Of course, there is no doubt that the World Bank and IMF have learned a considerable amount from their 40 years of experience in economic development and they have made exceptional progress in the field of theory and application.

3. New Development Theories toward a Rebirth

No development theories can be applicable in all Latin American countries because the size of domestic markets, natural resource endowments, and the labor force vary significantly from country to country. They have no alternative but to look for the theories that are most suitable to their countries. Kubo (1990) pointed out that industrialization growth relies on the following four elements:

(i) domestic demand expansion
(ii) export expansion
(iii) import substitution
(iv) choice of technology (changes in the intermediate input structure)

Therefore, industrialization policies will differ according to which element is emphasized. It can be said that the policy mix of the four elements will decide the economic growth of each country. Based on the Asian experience, it is widely known that export expansion, particularly the promotion of manufactured goods exports, helped to stimulate the Asian economies. The success of the Asian economies can be explained as follows (Yanagihara 1990):

(i) As demand comes from abroad, they can enjoy economies of scale regardless of the size of domestic markets.
(ii) By choosing the export industries which have large backward linkage effects, they can stimulate the industries of raw materials, parts and components, and help enlarge upper-stream industries.
(iii) As they have to face competition from abroad, incessant improvement of efficiency is required, including prices, quality, delivery dates, and management know-how. In other words, an efficiency consciousness will be inevitable.
(iv) The above three cover not only static considerations but the overall economic efficiency to be checked constantly, even at different points through feedback from each industry, i.e. to increase the "dynamic efficiency."

In this respect, the fact that Latin American countries are now promoting free trade is highly welcomed. So far, the efficiency issue on the production side has not been discussed much. It is considered that the efficiency of production factors and improvements in the quality in labor, capital and technology will be more and more important. Specifically, education and vocational training of workers; rationalization and modernization of labor unions; the pay-system and working conditions; catch-up of new technology; improvement of management know-how including process controls; increased after-care and servicing, all these must be well organized and taken care of.

Based on the failure experiences of neoliberal policies, we can say that an overly radical opening-up of the economy will result in confusion in developing countries where the market is still immature. In this respect, it will be necessary to think of the validity of the "industrial policy" taken for example in Japan and Korea (under the adequate supervision and guidance of the government, fostering the industry without hampering competition).

The structural problems of Latin America which were pointed out by the structualist school have not yet been solved. As pointed out by ECLAC (1990), it is important to transform the production structure, particularly to increase inter-industry linkages, while giving consideration to social welfare. For this purpose, Latin America needs to make a drastic step to reform the existing system.

To sum up, the key words for development in the 1990s in Latin America are, "liberalization," "efficiency," and "competitiveness."

NOTES

1. The scholars that are said to be of the structuralist school and who are members of the United Nation's Economic Commission for Latin America (ECLA or ECLAC later, CEPAL in Spanish) include Raúl Prebisch (Argentina), Anibal Pinto (Chile), Osvaldo Sunkel (Chile), Victor Urquidi (Mexico), Celso Furtado (Brazil) and Maria Conceiçao Tavares (Brazil).
2. A.G. Frank, born in Germany, taught at various universities in Latin American countries from 1962 to 1973, and particularly from 1968 he taught at CESO (Centro de Estudios Sociales) of the University of Chile. Together with the Brazilian Dos Santos who was exiled from the country by the military regime, he made a study of dependency theory. Because of the coup d'etat by the Chilean military in 1973, Frank fled to West Germany, and Dos Santos went to Mexico.
3. Bhagwati (1982) called these activities DUP (directly unproductive profit-seeking activities).
4. President Bush made a speech on June 27, 1990, proposing the following three initiatives: (i) Trade Initiative; (ii) Investment Initiative; and (iii) Debt Initiative. (i) includes the "Free Trade Association for the Americas" initiative which covers both North and South America; (ii) proposes the promotion of investments, particularly strengthening of the functions of the Inter-American Development Bank (IDB); and (iii) suggests the partial reduction of official debts.
5. It does not mean that each country has not made any efforts to promote exports of industrialized products thus far. Since the latter half of the 1960s, many countries have tried to promote exports through tax privileges, export finance and insurance systems, foreign exchange policies, free trade zones, etc. Some of the well-known examples include: Brazil's BEFIEX system (1972), Colombia's Decree-law No. 444 (1967) on promotion of non-traditional exports, and Mexico's maquiladora system (1965). However, when we look at all of Latin America, exports of industrialized products are still considered to be very low, with room for improvement.
6. ECLAC made the paper known to the public as the development strategy of the 1990s (ECLAC 1990) at the 23rd general meeting held in Caracas in March 1990. Here, while taking note of the social welfare, it proposes several policies to transform the industrial structure in Latin America. However, it covers general measures and no clear-cut development strategies are considered to have been raised.

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