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JOSÉ ANTONIO OCAMPO

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The Oxford Handbook *of* LATIN AMERICAN ECONOMICS

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JOSÉ ANTONIO OCAMPO

and

JAIME ROS

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Preface

Latin America has been central to the main debates in development economics. Given the region's traditionally high levels of inequality in the distribution of income in comparison to other developing regions and the developed nations, this includes, first of all, the relationships between income inequality and economic growth. The debates on the importance of geography vs. institutions in development have often concentrated on Latin America's colonial legacy. The region's experiences with import substitution industrialization in the post war period and more recently with market reforms have been the focus of attention in the debates on the effects of trade, trade openness and protection on growth and income distribution.

Similarly, the abundance of natural resources in the region and the resulting specialization of many countries in primary exports have, for many, illustrated the importance of the "Dutch disease" and the "resource curse" in development as well as the effects of the pattern of trade specialization on economic growth. The experience with State-led industrialization and the market reforms of the "Washington consensus" era have also been an important input in the debates on the appropriate balance of State and markets in different stages of economic development.

Despite the interest in the region, which has increased over time, there is no handbook on Latin American economics and there are only a few general textbooks on Latin American economics available in the English language, notably Eliana Cardoso and Ann Helwedge, *Latin America's Economies: Diversity, Trends, and Conflicts*, which is more than a decade old, and Patrice Franko's *The Puzzle of Latin American Economic Development*.

As a result of all this, the most readily available general books on the economics of the region are the institutional reports published by multilateral organizations—the United Nations Economic Commission for Latin America and the Caribbean, the Inter-American Development Bank, and the World Bank—which tend to have a short life span and do not have broad academic use.

Furthermore, most of the literature on Latin American economics is generally published in Spanish and Portuguese, not English, and the literature available in English is biased towards certain conceptual frameworks, and therefore tends to leave aside analyses by the school that is broadly known as Latin American structuralism (and neo-structuralism).

Interestingly, and in contrast to this lacuna, there are two handbooks on Latin American economic history: *An Economic History of Twentieth Century Latin America*, a three-volume collection edited by Enrique Cárdenas, José Antonio Ocampo and Rosemary Thorp, and the two-volume *Cambridge Economic History of Latin America*, edited by Victor Bulmer-Thomas, John Coatsworth and Roberto Cortés Conde.

This Handbook aims at filling that significant gap. It has three additional features that make it particularly attractive. First, it covers a fairly complete set of relevant issues. Second, it includes contributions from economists who belong to different schools of economic thought. So, the reader will find a range of perspectives from orthodox to heterodox. Third, we have also taken care of guaranteeing that the contributors come from throughout Latin America, recognizing the diversity of the region.

The Handbook is organized into five parts. The first looks at long-term and cross-cutting issues, including shifting ideas on development and the economic performance of the region under different development strategies, the institutional roots of Latin America's underdevelopment, the political economy of economic policy making, the rise, decline and reemergence of alternative paradigms from the Washington consensus to new developmentalism, and the environmental sustainability of the development pattern.

The second part considers macroeconomic topics, including the management of capital account booms and busts, the evolution and performance of exchange rate regimes, the advances and challenges of monetary policies and financial development, and the major fiscal policy issues confronting the region, including a comparison of Latin American fiscal policies with those of the OECD.

The third part analyzes the different facets of insertion of the region's economies into the global economic system. First, it addresses the role of Latin America in the world trade system, the attempts at regional and hemispheric integration, and the effects of trade liberalization on growth, employment and wages. Second, it looks at the effects of dependence on natural resources, characteristic of many countries of the region, on growth and human development. Finally, it reviews the trends of foreign direct investment, the opportunities and challenges raised by the emergence of China as buyer of the region's commodities and competitor in the world market, and the transformation of Latin America from a region of immigration to one of massive emigration.

The fourth part deals with matters of productive development. At the aggregate level it analyzes issues of technological catching up and divergence as well as different perspectives on the poor productivity and growth performance of the region during recent decades. At the sectoral level, it looks at agricultural policies and performance, the problems and prospects of the energy sector, and the effects on growth of lagging infrastructure development.

The last part looks at the social dimensions of development. First, it analyzes the evolution of income inequality, poverty and economic insecurity in the region, particularly the rise and fall of inequality and poverty over the past decades. Second, it looks at the evolution of labor markets including the expansion of the informal sector and issues of labor market regulation. Finally, it examines the performance of and policies towards the educational sector, as well as the evolution of social assistance programs and social security reforms in the region.

We want to thank Oxford University Press for having asked us to lead this effort, and to the authors, who had to bear our repeated requests for revision of their chapters. We also want to thank Juliana Vallejo, who provided invaluable help in this editorial effort, as well as James Giganti and Farah Siddique, who helped us in the processing of the manuscript, and Anthony Tillet, who translated three of the chapters.

We have the firm conviction that this Handbook is a significant contribution to the academic and policy community, those interested in Latin America and those interested in how the region fits into exercises in comparative development.

José Antonio Ocampo and Jaime Ros

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PART I

DEVELOPMENT PARADIGMS AND LONG-TERM GROWTH PERFORMANCE

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CHAPTER 1

SHIFTING PARADIGMS IN LATIN AMERICA'S ECONOMIC DEVELOPMENT

JOSÉ ANTONIO OCAMPO AND JAIME ROS

1.1 Introduction

Latin America has experienced in recent decades a major shift in the paradigms that oriented its development patterns. In the first decades after World War II ("postwar period", for short), the region had embraced a paradigm that placed the developmental state at the center of the strategy, with industrialization as the major objective, which was regarded at the time as critical to increase living standards. We will characterize this paradigm as state-led industrialization, a concept that—following Cárdenas, Ocampo, and Thorp (2000)—expands upon the more traditional concept of Import Substitution Industrialization (ISI), because import substitution was only one of its features and not the central feature in all countries during all time periods. This strategy had taken root in the postwar years, but it had precedents in the long protectionist past of many Latin American countries (Coatsworth and Williamson 2003) and in the responses to the external shocks experienced during World War I and, particularly, the Great Depression of the 1930s, which will be the point of departure for our analysis. This paradigm was replaced during the 1970s in a few countries and the mid-1980s in the rest of the region by another which placed markets and integration into the world economy at the center.

This chapter analyzes the central features of both paradigms and presents an overall evaluation of its development outcomes. The economic literature is full of caricatures of both paradigms—of state-led industrialization in the more orthodox literature, and of market-led development in the more critical literature in recent years. Caricatures have the advantage that they are easy to demolish, and the obvious disadvantage that they do not reflect what was actually thought or done in economic policy. We provide here a more balanced view of both paradigms. Following terminology that was common in Latin American structuralism in the past but has actually become quite fashionable in other schools of thought in recent years, we will refer to the industrial countries as the "center" and developing countries as the "periphery" of the world economy.

1.2 State-led industrialization

The collapse of Latin America's terms of trade and export revenues in the 1930s, together with increased protectionism in the center of the world economy, suggested to many that excessive reliance on foreign trade and primary exports as engines of growth could be detrimental to economic development, and thus had a major role in the paradigm shift that took place in those years. While the break with the previous phase of economic development—the classic period of primary export-led growth—may have been less clear-cut than implied by much writing on the subject, both because industrialization was not new in the region and because the primary export sectors continued to have an important role in the development process, the collapse of the primary export-led growth process led to the emergence of a new development strategy that combined industrialization and enhanced state intervention.

The collapse of the primary export-led growth process was not, however, the only "big fact" that contributed to a paradigm shift. The collapse of the world financial system was another, as the financing boom that many Latin American countries experienced in the 1920s was followed by a bust and default in the early 1930s. Furthermore, this collapse had long-term implications, since an alternative world financial system would not emerge until the 1960s. Also, as noted by Lindauer and Pritchett (2002), the Great Depression of the 1930s had shown that an activist government was needed to bring stability to the economy, whereas the world war effort and the rapid industrialization of the Soviet Union had suggested that governments could plan and direct successfully rapid expansions of economic activity and radical transformations of the economic structure. The successful reconstruction of Europe under the Marshall Plan showed, finally, that large inflows of aid could greatly contribute to development.

What were the main components of the new development strategy that emerged in Latin America? Following Fishlow (1985), we can say that there were three elements which manifested themselves very clearly in the new conceptions: macroeconomic policies centered on the management of the balance of payments, industrialization as the engine of growth, and a strong state intervention in various areas of the economy.

1.2.1 Macroeconomic policies in the periphery

The previous phase of export-led growth had been characterized by recurrent balance of payments crises, as cyclical collapses in commodity prices were generally accompanied by sharp reversals of capital flows. In response to these crises, an important group of

Latin American countries had shown a tendency to abandon the gold or silver standard for more or less prolonged periods of time. However, this proclivity was always accompanied by the aspiration to restore those standards, implying that there was never an attempt to permanently abandon macroeconomic orthodoxy. All this changed radically with the crisis of the 1930s, as the foundations of orthodoxy were undermined by the collapse of the gold standard in the central countries themselves. The abandonment of the gold standard by its architect, Great Britain, in September 1931 was a landmark which was followed (and in some cases anticipated) by pragmatic attempts in various industrialized countries to face the crisis through public spending and expansionary monetary policies.

Economic theory itself experienced a radical change with the publication of John Maynard Keynes' *The General Theory of Employment, Interest and Money*, which led to an unprecedented macroeconomic activism aimed at stabilizing the business cycle. Counter-cyclical macroeconomic policies also emerged in Latin America as a result of the crisis of the 1930s, but their major features were different from those in industrialized countries, reflecting the different nature of the determinants of the business cycle in the periphery of the world economy. Indeed, while Keynesian thinking focused on the stabilization of aggregate demand through active fiscal and monetary policies, the predominance of external shocks—on raw material prices as well as volatile capital flows—explains why the focus of macroeconomic management in Latin America leant towards the management of balance of payments shocks, both negative and positive.

With time, government intervention in this area became more complex, and included (with a variety of national experiences) exchange controls, tariffs and direct import controls, taxes on traditional exports, and multiple exchange rates—which were often used as instruments of trade policy rather than exchange rate policy and, later in the process, incentives for new exports. Many of these instruments had parallels in industrialized countries, particularly Western Europe, where multiple exchange rates were common in several countries and exchange controls were only fully dismantled as late as 1990. The management of these instruments responded to aggregate supply shocks of external origin and, by trying to shift demand towards domestic goods, had a more important counter-cyclical role than aggregate demand management as such.

1.2.2 The industrialization strategy

Balance of payments interventions were intimately linked, in turn, to the second component of the development strategy, industrialization, whose focus was nonetheless on long-term growth. The industrialization strategy did not emerge suddenly, in practice or in theory, but arose rather gradually as the mistrust in the possibility of a return to primary export-led growth took hold. Fundamental landmarks in this process were the collapse of raw material prices after World War I and again in the 1930s. Moreover, as noted by Diaz-Alejandro (2000), the emergence of protectionist policies in the industrialized countries multiplied these direct negative impacts. The passage of the Smoot–Hawley tariff in the US in 1930, the British Commonwealth preferences of 1932, the reinforced protectionism by France, Germany, and Japan—and discriminatory trade arrangements for areas under their political hegemony—contributed to the feeling in Latin America that the era of export-led growth had come to an end. As a result, even if prosperity returned in the industrialized economies, the outlook for Latin America's exports that competed with production in industrial countries or their colonies and commonwealths was pessimistic.

The idea of industrialization also gained strength in world economic thinking, and in the 1940s became the basis of the new economic development theories. Industrialization and development became synonymous for several decades. Nonetheless, just as in the case of macroeconomic management centered on the balance of payments, it was facts that forced the shift to industrialization policies and, at least in the initial stages, more as a result of experimentation than an articulated theory. As brilliantly expressed by Love (1994): "Industrialization in Latin America was fact before it was policy, and policy before it was theory" (p. 395).

The idea of industrialization emerged from the facts to the point that it was adopted in Latin America at a time when—with a few exceptions such as Mexico—the interests of commodity exporters continued to be dominant. Moreover, those interests continued to play an important role during the whole industrial development phase, among other reasons because industrialization continued to depend on the foreign exchange generated by commodity exports. Indeed, in Hirschman's (1971) interpretation, a distinctive characteristic of Latin America's industrialization, in contrast to the experience of "late industrialization" in Europe examined by Gerschenkron (1962), was precisely the weakness of industrial interests in relation to those of primary product exporters.

The theory, which in the Latin American case was provided by the United Nations Economic Commission for Latin America (CEPAL being its Spanish acronym),[1] arrived in an advanced stage to rationalize a process that was proceeding at full strength almost everywhere. It is worth noting that in this vision, embodied above all in CEPAL's 1949 report, which Hirschman baptized as the "Latin American Manifesto," the solution to Latin America's development problems was not to isolate itself from the international economy but to redefine its insertion into the international division of labor. This was essential, in CEPAL's view, for the Latin American countries to benefit from technological change which was viewed as intimately linked to industrialization. Moreover, industrialization policies varied through time in order to correct their own excesses, to respond to new opportunities that the world economy started to offer in the 1960s, and to adapt to the opportunities open to countries of different sizes. As emphasized in various histories of CEPAL's thinking (Bielschowsky 1998; ECLAC 1998; Rosenthal 2004), from the 1960s CEPAL became persistently critical of the excesses of import substitution, and advocated a "mixed model" that combined import substitution with export diversification and regional integration. This strategy helped rationalize import substi-

[1] United Nations Economic Commission for Latin America and the Caribbean, after the Caribbean joined.

tution and exploit the opportunities that were increasingly available to developing countries in world markets. It also helped adapt the strategy to the possibilities for small countries. Such mixed model became the dominant pattern in the region during the mid-1960s, and was reflected in the generalization of export promotion policies, the partial rationalization of the complex structure of tariff and non-tariff protection, the elimination and simplification of multiple exchange rate regimes, and the adoption of gradual devaluation policies in countries with an inflationary tradition (Ffrench-Davis, Muñoz, and Palma 1998; Ocampo 2004a).

In particular, the small economies returned early in the postwar period to reliance on primary exports, which they mixed with the promotion of light manufacturing and, in the case of Central America, with the launch of its common market in 1960. Even in some larger economies, like Peru and Venezuela, primary exports continued to be central to the development strategy. In those larger economies where industrialization was the core of the development strategy (i.e. Argentina, Brazil, Chile, Colombia, and Mexico), export promotion policies, geared to the development of new export sectors, became common in the mid-1960s. These policies included export subsidies (tax rebates and subsidized export credit), import duty drawbacks for exporting firms, and export processing zones.[2] As already mentioned, gradual devaluation ("crawling pegs"), to compensate for the inflation differential between the domestic economy and its main trading partners, also became an important export promotion instrument in several major South American countries, notably Argentina, Brazil, Chile, and Colombia, from the mid-1960s onwards.

1.2.3 State intervention

The first two components of the development strategy produced an unprecedented degree of state intervention in the economy. But state intervention also involved a wider array of policy instruments in addition to interventions in the management of the balance of payments and the use of protection as a development policy instrument. The state intervened actively in providing fiscal incentives to new industries and in financing productive activities through state development banks such as BNDES in Brazil, CORFO in Chile, IFI in Colombia, and NAFINSA in Mexico, and the establishment of directed credit to strategic sectors. It also developed a complex intervention apparatus in the agricultural sector (technological development centers, price regulations, distribution of agricultural products, irrigation, and in some cases agrarian reform). The process was also accompanied by an expansion of public expenditures, with priority

[2] The first and major example is the maquiladora plants in Mexico's northern border, which in 1965 began processing textiles and later assembling electronic components for export to the US. Similar free trade zones were later introduced in many other countries, notably in Central American and Caribbean countries (Dominican Republic and Haiti being the first) to exploit locational advantages (low transport costs due to proximity to the US market) and labor cost advantages.

given to economic development spending on infrastructure and social services, financed by the development of a new tax base that relied much more on incomes and indirect taxes on domestic economic activities than on import tariffs. The development of infrastructure services (water and sewage, electricity and telecommunications) as well as, in several countries, financial services, also relied heavily on state-owned banks.

The development strategy also led to greater activism in social policy. Some developments were common to the region in the postwar period, in particular the establishment of public education and health systems. The more developed schemes followed a tendency to create social security systems based on wage employment and to actively regulate the labor market. In the more developed countries of the region, these systems had started to be developed in the last phases of the primary export-led phase. To the extent that access to wage employment in the modern sectors was limited—particularly in the less developed countries—the results were "segmented welfare states," in which wage earners in the formal sector had a wide array of benefits to which the urban informal sector and most of the rural population did not have access. The poorer sectors of the population remained subject to the laws of economies which worked with an "unlimited labor supply" *à la* W. Arthur Lewis. On the other hand, under the initial leadership of Mexico and in a wider set of countries from the 1960s, different agrarian reform models were applied. In general their results were limited, except in the case of Cuba, and thus only partially changed the extremely high concentration of rural property inherited from the past. In most cases, therefore, the weight of dominant agrarian interests continued to prevail.

State intervention and industrialization thus became distinctive features of a whole era. It is worth noting, however, that among the different models of state intervention that were typical in the immediate postwar period, Latin America opted for a *lesser* rather than a greater degree of state intervention—that is, for a model of economic organization in which private enterprise continued to have a major role. Indeed, in the early postwar years, and with very few exceptions (the US being the most important one), the real choice was not between state vs. free market economies but rather among different variants of state intervention and economic planning. In this spectrum, Latin America opted for a mixed economy model, which resembled more that of Western Europe than the different variants of socialist systems that proliferated at the time, including in Asia and Africa. In Latin America, only Cuba adopted a socialist model at a later stage (in the 1960s); there were also failed attempts in that direction by Chile and Nicaragua in the 1970s and 1980s respectively. It is also worth noting that foreign investment was welcome to the extent that it contributed to the industrialization process. While in many countries its access was certainly restricted in some sectors—natural resources, infrastructure, and financial services, in particular—it is also true that overall, these restrictions were less stringent than in the "Japanese model" followed at the time in Japan and some East Asian tigers (notably in South Korea).

The preference for a mixed economy, with a large presence of domestic and foreign private-sector firms, is likely to have its historical roots in the fact that Latin America had experienced, unlike other regions, a relatively fast process of economic growth in the period preceding state-led industrialization. Indeed, from 1913 to 1950 Latin America

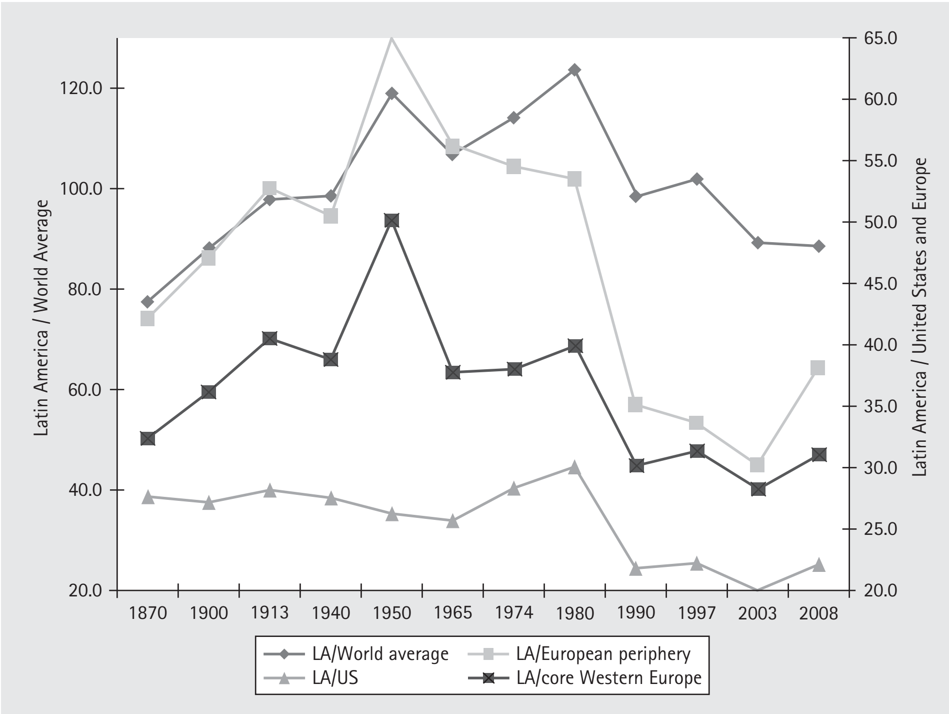

FIGURE 1.1 Latin America's relative per capita GDP

Source: Maddison (2006) and online updates of his series. Core Western Europe refers to Maddison's Europe 12, and European periphery to Maddison's 14 small Western European countries.

had been, together with the United States, the region of fastest growth in the world (Figure 1.1). Relative success thus contributed to curtailing the "statist excesses" in the subsequent phase of development.

1.2.4 The development performance of the region under state-led industrialization

Latin America's development performance during the period of state-led industrialization has been a controversial issue. For some, the postwar period should be seen as a golden age of unprecedented prosperity and increase in living standards. For others, the postwar period witnessed a dismal performance in which Latin America squandered opportunities for rapid growth and catching up.

A first reason for the disagreement has to do with the perspective adopted. The 1950–80 period was one of unprecedented prosperity for the world economy as a whole. In this context, Latin America's average comparative performance was not particularly impressive. Its 2.7% annual growth rate of GDP per capita was somewhat above the world average and that of the US but lower than that of the core Western European countries. In the latter case, however, the war collapse and later reconstruction are the basic explanation, as the relative position of Latin America in 1980 was slightly better than in 1940 (see again Figure 1.1). The region's average performance did fall short of the best performances in Southern Europe, Japan and the East Asia tigers. But, again, if we compare this with the European periphery, Latin America's relative position in 1980 was again slightly better than in 1940. Furthermore, if we leave out the early post-war period and focus on 1965-1980, Latin America grew faster than the average for the world and for the leading industrial countries.

Therefore, a positive view of economic performance is a more appropriate perspective. This was indeed a period of acceleration of growth with respect to a successful past and, particularly, a period of major economic and social transformations which compare favorably with what happened in Latin America before 1950 and after 1980. Hirschman (1987) calls the 1950–80 period "les trente glorieuses" precisely because of the substantial increase in living standards. Performance is particularly remarkable given the rapid acceleration in population growth and urbanization that took place during these years. Indeed, total GDP growth in Latin America (rather than GDP per capita) exceeded that of the industrial countries and the world (see Table 1.1). Progress started to permeate a broader segment of society. Based on Bértola, Hernández, and Siniscalchi (2010), Table 1.2 indicates that advance in human development accelerated in the 1940s and was rapid until 1980 (see also the analysis in Astorga, Bergés, and FitzGerald 2003). Prados de la Escosura (2007) also estimates that the bulk of the reduction in poverty achieved during the 20th century took place between 1950 and 1980. Nonetheless, income inequality remained very high by world standards, and increased in several countries over different time periods.

An additional reason for the disagreement concerning the growth record during the period of state-led industrialization is the high heterogeneity of performances across the region. Take, for example, the richest economies in 1950, Venezuela and, particularly, the Southern Cone countries (Chile, Argentina, and Uruguay). These countries had an income per capita well above that of southern Europe or Japan in 1950. Compared to the performance of these countries after 1950, the growth performance of the Latin American richer economies looks dismal indeed (Table 1.3). By 1980, Greece, Portugal, and Spain had caught up with Argentina and surpassed Uruguay and Chile, while Italy and Japan had incomes per capita that were more than twice those of Chile and Uruguay and well above those of Argentina.

Yet now look at Brazil and Mexico and other fast-growing countries in Latin America (which also include Costa Rica, Ecuador and Panama with growth rates of over 3% per capita; Colombia, the Dominican Republic, Guatemala, and Paraguay can be added to that list since the mid-1960s). Although not as good as the best performers in East Asia, these economies' rates of growth of GDP implied a process of catching up with several developed economies, certainly including the United States (see Table 1.1). Brazil was the star performer with GDP per capita growth of 4.1% per year from 1950 to 1980, while Mexico also had a rather high growth rate of 3.4%—in both cases despite rapid

Table 1.1 Weighted average growth rates (%)

	GDP		GDP per worker		GDP per capita	
	1950–80	1990–2008	1950–80	1990–2008	1950–80	1990–2008
Argentina	3.3	4.2	2.0	1.8	1.6	3.0
Bolivia	3.2	3.8	2.4	0.4	0.9	1.5
Brazil	7.0	3.0	3.4	0.6	4.1	1.5
Chile	3.5	5.4	1.9	3.7	1.4	4.0
Colombia	5.1	3.5	2.3	0.5	2.3	1.9
Costa Rica	6.3	5.1	2.9	1.5	3.2	2.8
Dominican Republic	5.8	5.7	2.6	3.0	2.7	3.9
Ecuador	6.1	3.2	4.1	–0.3	3.2	1.5
El Salvador	4.1	3.8	1.4	1.5	1.2	1.8
Guatemala	5.0	4.0	2.7	1.5	2.2	1.5
Honduras	4.3	4.1	1.9	–0.4	1.3	1.8
Mexico	6.6	3.0	3.4	0.5	3.4	1.6
Nicaragua	4.1	3.3	0.7	0.1	1.0	1.5
Panama	6.1	5.6	3.6	2.5	3.2	3.6
Paraguay	5.5	2.6	3.0	–1.1	2.8	0.5
Peru	4.9	4.9	2.4	1.8	2.1	3.4
Uruguay	2.2	3.2	1.2	1.6	1.3	2.8
Venezuela	6.0	3.2	2.4	–0.7	2.2	1.2
Latin America	5.5	3.4	2.7	0.7	2.7	1.8
United States	3.6	2.8			2.2	1.7
Core Western Europe	4.1	1.9			3.5	1.6
European periphery	4.3	2.2			3.4	1.3
World	4.5	3.7			2.6	2.4

Source: Latin America according to ECLAC database. Non-Latin America according to Maddison (2003) and online updates of his series.

Table 1.2 Indicators of human development

	Education Index[a]		Life Expectancy Index[b]		Human Development[c]	
	LA20	LA7[d]	LA20[e]	LA7	LA20	LA7
A. Latin American index						
1900		0.101		0.141		0.074
1910		0.113		0.185		0.092
1920		0.129		0.233		0.106
1930		0.150		0.265		0.123
1940		0.175		0.321		0.142
1950		0.206	0.420	0.435		0.183
1960	0.227	0.236	0.555	0.576	0.214	0.227
1970	0.275	0.286	0.618	0.633	0.257	0.271
1980	0.327	0.334	0.689	0.702	0.311	0.326
1990	0.401	0.414	0.743	0.751	0.334	0.354
2000	0.446	0.461	0.770	0.780	0.367	0.390
B. Relative to industrial economies						
1900		0.255		0.343		0.305
1910		0.264		0.382		0.335
1920		0.283		0.425		0.356
1930		0.310		0.437		0.364
1940		0.343		0.505		0.388
1950		0.380		0.591		0.439
1960	0.393	0.410	0.717	0.744	0.452	0.479
1970	0.424	0.441	0.783	0.802	0.466	0.492
1980	0.462	0.472	0.828	0.844	0.499	0.524
1990	0.532	0.549	0.866	0.876	0.485	0.513
2000	0.570	0.589	0.869	0.880	0.486	0.516

[a] The Education Index refers to years of schooling, with a ceiling of 16 years.
[b] The Life Expectancy Index has a minimum standard of 20 years and a maximum of 85 years.
[c] The Human Development Index is a geometric average of the first two and per capita GDP.
[d] LA7 includes Argentina, Brazil, Chile, Colombia, Mexico, Uruguay, and Venezuela.
[e] LA20 includes also Bolivia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, and Peru.

Source: Bértola, Hernández, and Siniscalchi (2010).

population growth, which implied that GDP growth was very fast (7.0 and 6.6% respectively).

What factors explain these differences in growth performance? The first one has to do with the size of the economy. It cannot be a coincidence that Brazil and Mexico, the two

Table 1.3 GDP per capita in richest Latin American countries vs. southern Europe and Japan

	1950	1980
Venezuela	7,462	10,139
Argentina	4,987	8,206
Uruguay	4,659	6,577
Chile	3,670	5,680
Italy	3,502	13,149
Spain	2,189	9,203
Portugal	2,086	8,044
Japan	1,921	13,428
Greece	1,915	8,971

Source: Maddison (2006).

most populous countries, were those able to sustain the highest rates of growth during the second, more difficult phase of industrialization, in which manufacturing expanded into heavy intermediates (steel and petrochemicals), consumer durables, and some capital goods. The size of their domestic markets is probably a major factor here, since it allowed industrial sectors with high fixed costs (associated with their capital intensity), and, as a result, strong economies of scale, to be established while it attracted the foreign investment required to set up these capital and technologically intensive industries. For these reasons, it also facilitated the transition to the "mixed model" in which non-traditional exports played an increasing role in the expansion of manufacturing industries. In other countries, the opportunities for industrialization were concentrated in light consumer goods and intermediate goods with low capital and technology intensity, and attempts to enter the "difficult phase" could have resulted in highly inefficient manufacturing sectors.

A second factor has to do with the structural features of the domestic economy—a fact that differentiates the Southern Cone countries from the rest of Latin America. Díaz-Alejandro (1988: ch. 12) highlights this factor in his comparison of the economic histories of Argentina and Brazil. Brazil had a Lewis-type economy with a surplus of labor that generated an elastic supply of labor to the modern sector of the economy. The expansion of the industrial sector meant that the process of industrialization caused labor to move from low- to high-productivity sectors (from the "subsistence" to the industrial sector). These productivity gains were behind the rapid increases in GDP per capita. Argentina, by contrast, was a mature economy in which more sectors were modern, and there was not a large subsistence sector. This meant that the economy would benefit less from the reallocation of labor from low- to high-productivity sectors. Rather, the expansion of the industrial sector caused labor to be taken away from the modern export sector. Because industrialization crowded out labor in the export sector, the anti-export bias was higher in Argentina. It was implied that formal labor markets were more developed and unionization was more important (see below).

A third factor relates to the role of export promotion policies and exchange rate policy, and the degree of success of the transition to the "mixed model" of import substitution-cum-export promotion. It is worth noting that most of the fast-growing economies are among those that started experimenting with export promotion policies some time in the 1960s or early 1970s; two of them (Brazil and Colombia) also adopted crawling pegs. By contrast, the slow-growing economies, with few exceptions such as Argentina and Chile, were not early adopters of export-promotion policies. In the case of the countries with large domestic markets (Brazil, Mexico, and to a lesser extent Colombia), the success of export promotion policies was facilitated by the smaller anti-export bias generated by more moderate protection of intermediate and capital goods. All this suggests some role in growth outcomes for the type of industrialization policy adopted.

In relation to economic performance, it must be pointed out, finally, that despite Latin America's reputation for high inflation, this was not a general feature of the region before the 1970s. Indeed, as noted by Sheahan (1987), in the 1950s and 1960s only four countries (Argentina, Brazil, Chile, and Uruguay) could be characterized as having had high rates of inflation relative to the rest of the world. In the 1960s the other 14 countries had rates of inflation lower than the average inflation rate in Asia (which has a reputation for low inflation), and ten countries (in Central America and the Caribbean plus Mexico, Paraguay, and Venezuela) had lower inflation than the average for the world economy (4.0%). One factor behind the inflationary trends of the Southern Cone countries was the strength of the labor unions. With indexation systems (of the exchange rate, in particular), Brazil and Colombia were able, from the mid-1960s, to avoid the overvaluation and unstable real exchange rates affecting their export competitiveness, and the uncertainty and stimulus to speculative activity with its discouraging effects on long-term investments. This can also be said of Chile after its 1970s traumas (high inflation under the Allende years, followed by massive macroeconomic imbalances during the first phase of the Pinochet regime).

1.3 The era of market reforms

State-led industrialization started to be criticized in the 1960s both by the political left and by economic orthodoxy.[3] From the left, the criticism focused on the inability to overcome external dependency and, above all, to transform the dependent and unequal social structures inherited from the past. In particular, as already pointed out, the industrialization experience had done little to eliminate the very unequal income distribution and, in some cases, was thought to have led to growing social marginalization. Moreover,

[3] See e.g. the reviews of the debate at different points in time by Hirschman (1971), Fishlow (1985), and Love (1994).

the initial dependence on primary exports had been compounded with new forms of dependence on foreign capital and technology. Without necessarily sharing the point of view of the political left, Hirschman (1971) expressed brilliantly the underlying idea: "Industrialization was expected to change the social order and all it did was to supply manufactures" (p. 123).

The criticism from economic orthodoxy, located at the time in some US universities and the International Monetary Fund—though not yet at the World Bank[4]—centered on high inflation and associated lack of macroeconomic discipline—which, as discussed above, was relevant only for a few countries—and on the allocative inefficiencies that were generated in particular by trade protection and resulting anti-export bias (negative effective rates of protection for exporting sectors), as well as by anti-agricultural (net taxing of the agricultural sectors, largely through price regulation) and anti-employment biases (on the assumption that Latin America's comparative advantages were in labor-intensive sectors). Major texts in this line of criticism included Little, Scitovsky, and Scott (1970), based on a comparative study of seven developing countries in Asia and Latin America, and the major NBER research project led by Krueger (1978), which emphasized the superior growth and productivity performance of "outward oriented" industrialization vis-à-vis import substitution strategies.

Eventually, the viewpoint of economic orthodoxy, extended to encompass the criticism of a wider range of state interventions, became the dominant paradigm. According to Lindauer and Pritchett (2002), a number of "big facts" contributed to this new paradigm shift in Latin America and elsewhere in the developing world. The rapid growth of East Asia, based on manufacturing exports and outward orientation, led to a reassessment of the role of trade as well as of the role of government, given the mainstream (incorrect) interpretation of the East Asian development experience in the 1970s and 1980s as supposedly less state-led. The shortcomings of central planning were by the early 1980s also becoming clear, both in its strong form (the Soviet Union and Eastern Europe in general, as well as China, which would adopt a major shift in the late 1970s) and in its soft form (India with its disappointing growth performance). In the late 1980s, the fall of the Soviet Union and the end of communism in Central and Eastern Europe did much to further undermine the support for state-led development.

For Latin America, however, the debt crisis of the 1980s was by far the most important "big fact" determining the shift in the paradigm. The critics of state-led industrialization saw this event as the crisis of the whole development model followed until then. Independently of the problems that that model was facing in several countries, this is an incorrect interpretation. More than structural problems, the debt crisis was the result of the risky macroeconomic policies of the 1970s and, particularly, the second half of that decade: high external indebtedness, in the context of low real interest rates at the international level, and high commodity prices, combined with a huge external shock

[4] The Bank was, at least until the 1970s, part of the industrialist consensus, and contributed with its projects to the industrialization process and to building modern apparatus of state intervention, notably in the areas of infrastructure.

generated by the strong and unexpected increase of interest rates in the US in 1979–80 and the collapse, also largely unexpected, of commodity prices (Díaz-Alejandro 1988: ch. 15; Ocampo 2004a). The predominance of these macroeconomic factors over structural factors is reflected in the fact that the crisis hit large debtors, such as Brazil and Mexico, that continued to pursue state-led industrialization, but also affected with equal or even greater severity those countries that had engaged in the 1970s in market liberalization experiments (Argentina, Chile, and Uruguay). In contrast, the country that better managed the boom of the second half of the 1970s (Colombia) was hit by the contagion generated by the debt crisis, but did relatively well.

In any case, this event led to a reversal of the previous consensus on the development strategy and to a new conventional wisdom which viewed government as an obstacle to development, the private sector as the leading actor, trade as the engine of growth, and foreign direct investment as a priority.

1.3.1 The new paradigm

An essential difference between the rise of the new and the old paradigms lies in the relationship between ideas and practice. As we have seen, the old paradigm, articulated by CEPAL, arrived at an advanced stage in order to rationalize a process that was already in place. In the new paradigm shift, ideas came first as an intellectual and even openly ideological attack that acquired full force in the 1970s. The most paradigmatic case was, of course, the Chicago school offensive in Chile, which started in the 1950s and whose main results arrived with the Pinochet regime, giving a distinctive feature to a regime that initially lacked an economic model (Valdés 1995). Some texts, especially Balassa et al. (1986), had an important role in this process.

The World Bank and the IMF also had an important role in the diffusion of the reform agenda, through their policy conditionality. This gave the shift an appearance of an external imposition. This is in contrast with the previous paradigm, which, although conditioned by external influences, clearly emerged from within. Thus, while the document that best synthesized the vision of the previous period was CEPAL's "Latin American Manifesto," the one that more clearly articulates the new paradigm is the ten policy recommendations of the "Washington Consensus" formulated by Williamson (1990) to summarize what he perceived to be the reform agenda being pushed by the Washington institutions. The center of gravity had clearly shifted towards the economic thought generated in industrial economies and especially in the United States. To use CEPAL's terminology, the "center–periphery" model now dominated the realm of economic ideas prevailing in Latin America. Although these external influences were important, the view of the reform agenda as a mere external imposition is incorrect, as we will see below.

If industrialization and state intervention had been at the core of the previous development phase, the liberalization of market forces took that role under the new paradigm. In the area of macroeconomics, the idea that became popular in the 1970s, and especially in the 1980s, was that of "getting the prices right"—an expression that made reference to achieving an equilibrium exchange rate and letting interest rates be determined by market forces. The expression was also used to highlight the need for eliminating the discrimination against agricultural goods that resulted from price regulation by the state, as well as the need to set the price of public utilities in such a way as to cover costs. Later, the emphasis shifted in the macroeconomic area to low inflation rates guaranteed by autonomous central banks. In more than a few cases, however, inflation targets were achieved through the overvaluation of the exchange rate, thus contradicting the objective of "getting the prices right."

Low inflation in turn entailed the need to maintain healthy public-sector finances—an objective that proved harder to achieve. In the 1980s, the task was synonymous with reducing public spending, and thus rearranging government priorities, as well as changing the tax structure by increasing value added tax and reducing direct tax rates. Towards the end of the 1990s, public finance restructuring involved in addition the formulation of explicit fiscal targets of different kinds (primary surplus or budget balance, but also restrictions on the growth of government spending), as part of a broader set of fiscal responsibility rules which also affected the regional or local fiscal authorities in federal or decentralized systems.

With respect to changes in the economic structure, the early and prominent components of the reform agenda were trade liberalization and deeper integration into the world economy based on comparative advantages, as well as a broad opening up to foreign direct investment. Although only a few countries imitated the Chilean model, adopted in the 1970s, of establishing a uniform tariff, tariffs were sharply reduced and the tariff structure radically simplified as non-tariff barriers were largely eliminated. The objective of setting low tariffs was thus achieved to a much greater extent than in the classical period of primary export-led growth. Moreover, under the leadership of Mexico and Chile, a wave of free trade agreements was launched.

Trade liberalization was accompanied also by the dismantling of state intervention in productive development that characterized the previous period, not only in the manufacturing sector but also in agricultural development. This vision was succinctly summarized by a lemma that was repeated in several contexts: "the best industrial policy is *not* to have an industrial policy." In the application of this precept, technology policy, on which little progress had been made in the previous development phase (except, perhaps, in some agricultural research institutions), was also set aside, despite the fact that this is an element of intervention around which there is greater consensus. Trade liberalization and the dismantling of productive development policies was based on a number of arguments: the negative effects of protection on static efficiency (by moving the economy away from specialization according to comparative advantage and closing it off from external competition) as well as the encouragement of rent-seeking behavior as firms devoted resources to gaining advantages rather than increasing their efficiency.

Trade liberalization was accompanied, in addition, by the elimination of exchange controls and domestic financial liberalization. The latter included the liberalization of interest rates, the elimination of most forms of directed credit, and the reduction and simplification of reserve requirements on bank deposits. In this case, advocates of reform argued that the previous system of "financial repression" discouraged savings, as deposits frequently received negative real interest rates on their funds. This led, in their view, to limited access to credit, especially for small and medium-size enterprises, and in several instances to lending based on political connections rather than the profitability of the projects.

Another element in this agenda of structural reforms was the privatization of a large set of public enterprises together with the opening up to private investment of public services and utilities sectors. In this case, however, the process was more gradual, and a number of countries kept public-sector banks and a number of other firms, notably in oil and infrastructure services (water and sewage more than electricity and telecommunications). The more general deregulation of private economic activities was also part of the agenda, although it was recognized from the beginning that there should be some regulation of monopolistic practices and unfair competition, including those that could present themselves in privatized utilities. It was also accepted that financial liberalization required regulation to avoid the accumulation of excessive risks in the financial system, though the full acceptance of the need for regulation only came after a fair number of domestic financial crises.

Social development was not prominent in the initial market reform agenda. In Williamson's original decalogue, for example, spending on education and health was only mentioned as a priority in the task of reducing and restructuring public sector expenditures. However, in the reform proposals that the World Bank promoted, there were three ideas amply disseminated: decentralization, targeting of public social spending towards the poor, and the introduction of private-sector participation in the provision of social services. There was, in any case, recognition of the essential role of the state in this area. A topic where there was an overlap between this agenda and fiscal retrenchment was the pensions regime. The introduction of a new individual savings scheme, adopted by Chile in the 1980s to replace the old pay-as-you-go system, was disseminated as a panacea in the region and beyond, especially in post-communist Central Europe, even though not all reformers followed this trend. There was, finally, an agenda of at least partial liberalization of labor markets, but here political factors largely blocked the reform proposals (Chapter 31 in this volume, by Murillo, Ronconi, and Schrank).

1.3.2 Policy diversity

As the implementation of the new paradigm made major strides, alternative policy proposals were advanced from other quarters. CEPAL's *Changing Production Patterns with Social Equity* (ECLAC 1990) was an important contribution in this regard, to which other contributions from this institution were added in subsequent years. Outside CEPAL, the alternative paradigm took the form of "neo-structuralism"

(Sunkel 1993; Bielschowsky 2009). These alternative proposals focused on four predominant themes:

(i) the adoption of more active and counter-cyclical macroeconomic policies in order to avoid, in particular, the disequilibria generated by boom-bust cycles in external financing;
(ii) the combination of trade liberalization with open regionalism;
(iii) the promotion of innovation through active technology and productive development policies adjusted to the new open economies; and
(iv) the adoption of equity at the center of development policy (see esp. Ocampo 2004b; Ffrench-Davis 2005).

Over time, this last objective would eventually obtain an important place in the agenda of those institutions that promoted reforms, in particular the World Bank, and the first would be brought into the agenda during the 2008–9 global financial crisis.

Reflecting these and other alternative views, the map of structural reforms shows a diversity of national responses, even during the years of greater activism (see e.g. Stallings and Peres 2000). This diversity indicates, furthermore, that the transformation cannot be simply understood as an external imposition: it was really the outcome of national decisions adopted since the mid-1980s by democratic political regimes, in sharp contrast with the initial neo-liberal experiments in the 1970s in the Southern Cone. Diversity was evident both in the models of macroeconomic management and in the speed and scope of some structural reforms—trade opening, financial liberalization, and the privatization process. There were, in addition, relatively common elements that were not part of the initial reform agenda and that responded more to domestic political pressures. Chief among them is the generalized increase in social spending that took off in the 1990s (ECLAC 2009). Greater social activism, together with the very limited scope for labor market deregulation, are probably the most important contributions to the revision of the reform agenda that came with the democratic wave that simultaneously swept the region. Another element that emerged from the political realm was support for regional economic integration, which was in opposition to the more orthodox visions that promoted unilateral trade liberalization.

Diversity became broader over time as a reflection of the poor results of reforms in several countries, as well as of the open political rejection of market reforms in some countries. The "lost half-decade" that followed the Asian crisis of 1997 and the Russian crisis of 1998 was a turning point in this regard. From then on, a greater pragmatism was accompanied by the incorporation of new issues into the agenda, especially those relating to equity and institutional development. The excessively positive assessments of the reforms, which curiously were drafted as the new crisis hit the region (IDB 1997; World Bank 1997), were followed by much more subtle views that emphasized the need to make progress in overcoming the severe problems of poverty and inequality in the region, as well as on institutional development (see esp. Kuczynski and Williamson 2003; World Bank 2006).

1.3.3 Economic and social performance

The economic and social performance of Latin America since the 1980s has been weaker than that of the previous development phase. This is true even if we leave aside the "lost decade" of the 1980s. For the period 1990–2008, the average of Latin America's per capita GDP growth rate has been 1.8% per year, well below the growth rate of the period 1950–80 (2.7%) and less than the average growth rate of the world economy (see again Table 1.1). The growth performance of GDP per worker, a gross measure of productivity, is even worse: 0.7% per year for 1990–2008 vs. 2.7% in 1950–80. This means that most of the increase in GDP per capita since 1990 has been the result of the demographic bonus resulting from the slowdown of population growth (from 2.7% to 1.5%) in the face of a still relatively fast growth of the labor force (2.6% per year, a rate similar to the 2.8% of 1950–80) (see Ros 2009).

Table 1.1 indicates that only two countries have experienced a dynamic growth of productivity since 1990 (Chile and the Dominican Republic); two countries show fairly similar though relatively low productivity growth in both periods (El Salvador and Uruguay); the rest show a much poorer performance in 1990–2008 than in 1950–80. This poor overall productivity performance is not due to the absence of new dynamic and highly productive activities; rather, it reflects the rising share of low-productivity informal activities, as the dynamic highly productive sectors were unable to absorb a larger share of the labor force.

Despite the significant demographic bonus, the mixed growth performance during the reform period is illustrated in Table 1.4. There are seven countries that have grown since 1990 at a per capita rate above the world average, six of which have improved in this respect relative to their own past performance, while eleven countries have experienced performance below the world average, and seven of them also with respect to their past record. Across countries there is no apparent relationship between the degree and timing of market liberalization and growth performance. The countries in the upper left corner of the table include Chile, an early reformer, the Dominican Republic, a late reformer, turbulent Argentina, with a heterodox exchange rate policy since 2002, and relatively more orthodox Peru. Interestingly, all the fast-growing economies under state-led industrialization, most of which have thoroughly liberalized their economies, have now underperformed in relation to past and world trends, with the major exceptions of the Dominican Republic and Panama. In contrast, the poor performers under state-led industrialization have done better under the new paradigm.

This economic performance was affected not only by the poor results of the market reforms but also by worldwide macroeconomic turbulence. The collapse of growth during the lost decade of the 1980s was followed by a recovery in 1990–97, although at a slower pace than during the years of state-led industrialization, and then by the "lost half decade" of 1998–2003. As a result, the relative position of Latin America in the world economy went back in 2003 to the levels of 1900 (Figure 1.1)! The combination of a new surge in external financing and the increase in commodity prices, which had been absent since the 1970s, generated a new boom in 2004–7, at a pace that was then more similar to

Table 1.4 Relative growth performance, 1990–2008

		Relative to 1950–80	
		Above	**Below**
	Above	Chile (4.0%)	Costa Rica (2.8%)
		Dominican Rep. (3.9%)	
		Panama (3.6%)	
		Peru (3.4%)	
		Argentina (3.0%)	
		Uruguay (2.8%)	
Relative to world average	**Below**	El Salvador (1.8%)	Colombia (1.9%)
		Honduras (1.8%)	Mexico (1.6%)
		Bolivia (1.5%)	Brazil (1.5%)
		Nicaragua (1.5%)	Ecuador (1.5%)
			Guatemala (1.5%)
			Venezuela (1.2%)
			Paraguay (0.5%)

Source: See Table 1.1 (average per capita GDP growth in 1990–2008 in parentheses).

that of the 1970s. But if the slow pace of economic growth since 1990 cannot solely be attributed to market reforms, neither can reformers claim for themselves the success of the recent period, which had also been remarkable in countries now embracing more heterodox views. In any case, the global crisis in 2008–9 suddenly interrupted the recovery after 2003, bringing about a deep recession in 2009 which was second only, among emerging and developing countries, to that of Central and Eastern Europe.

In the social development area there was really no "lost decade," as revealed by the continuous progress made in education and health in the 1980s (see Table 1.2), though with a slowdown in the 1990s that, together with the fall in relative per capita income, led to a lag in human development vis-à-vis the industrial countries. The lost decade led to a significant increase in income poverty, but this was followed by progress in this area during the two periods of economic expansion in the 1990s and the new century, with a partial reversal during the "lost half-decade." However, it was only in 2005 that poverty rates returned to their 1980 levels, so that in this area Latin America lost a quarter of a century rather than a decade (Figure 1.2)! Reduction in poverty rates was significantly helped—and in countries with young populations in 1980 greatly so—by the near-completion of the demographic transition since, as already mentioned, most of the increase in average per capita incomes for the region was the result of the demographic bonus—i.e. the increase in the labor force rather than the increase in GDP per worker (Ros 2009).

The significant reduction in poverty levels during the first decade of the 21st century also reflects the effects of an improvement in income distribution in several countries,

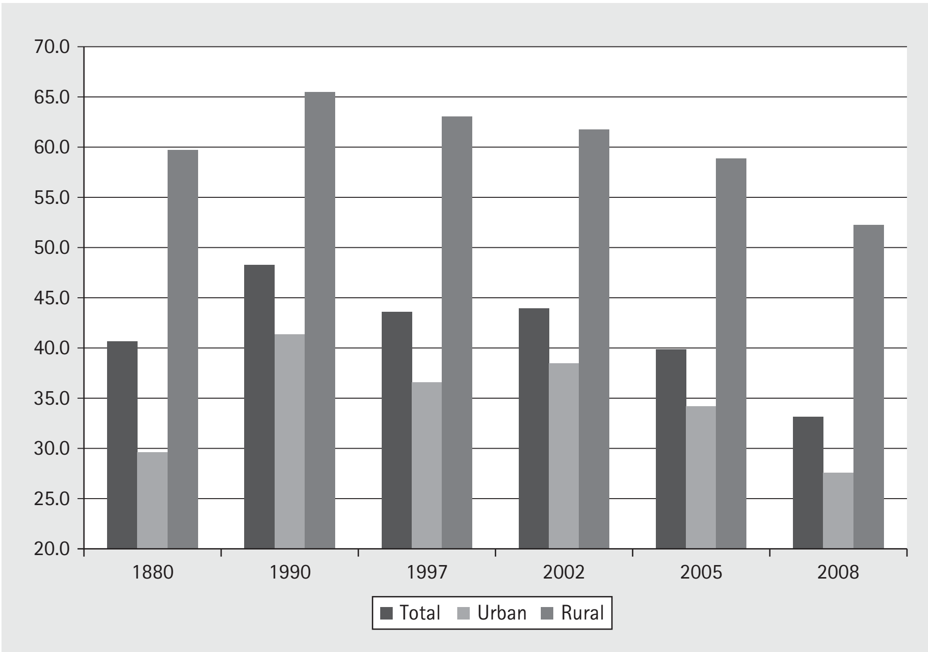

FIGURE 1.2 Latin America's poverty

Source: ECLAC (2009).

which reversed the moderate deterioration that had taken place on average from the early 1990s to the early 2000s (and in some cases, in the 1970s or 1980s). The factors behind the recent improvement in income distribution are still subject to debate. Rising social spending has played an important role, both transfers to poor households and, even more so, improved educational opportunities, which is a major factor behind the reduction in the skill premia, in sharp contrast to the opposite trend that was experienced in most Latin American countries during the 1990s. Improved distribution was facilitated by more conjunctural factors, such as the reduction in the rural–urban gap, thanks to booming agricultural prices, and increased formal employment during the 2003–8 boom, in the context of a significant reduction in the growth of the labor force. In any case, these improvements have only made a small dent in the large inequalities that still characterize the region (Gasparini et al. 2009; Cornia 2010).

1.4 Looking forward

The mixed outcomes of market reforms led to a heated debate and the reopening of many issues in the development agenda (Birdsall, de la Torre, and Valencia Caicedo, Chapter 4 below). If we look back at the neo-structuralist views set out by CEPAL since the 1990s, counter-cyclical macroeconomic policies and more active social policies are now clearly on the regional agenda. As we have seen, economic integration was introduced by politics rather than economics, though its success has been mixed. There is also broader agreement on the need for active technology policies, accompanied now by growing interest in production sector policies, under the leadership of Brazil, but action is still marginal in both areas in most countries. As in the past, regional differences in responses are already evident, in some cases backed by strong ideologies.

Major external shocks have always led to significant changes in Latin America. The 2008–9 world financial crisis was a shock of this type, and one which has already led to broader state activism throughout the world. An equally significant event is the collapse of international trade that took place during the recent crisis, and its still insufficient recovery as this chapter is written. Whatever happens in this area will be crucial, given the emphasis of market reforms on integration into the world economy. The crisis will also speed up the shift away from Western hegemony in economic affairs. These processes may lead to new changes, which could be major or even epochal ones. The immediate future will thus be full of news about global development patterns.

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CHAPTER 2

INSTITUTIONS AND THE HISTORICAL ROOTS OF LATIN AMERICAN DIVERGENCE

LUIS BÉRTOLA

2.1 Introduction[1]

There is no doubt that Latin America has fallen behind the more developed countries as regards per capita income, but there is still much debate about when and why this happened.

In this chapter, I analyze the relation between long-term growth and institutional development in Latin America. My motivation is a certain dissatisfaction with the state of the art concerning general theories on Latin American development, as expressed both by today's very widespread neo-institutional approach, which considers that institutions created during colonial times were responsible for backwardness, and by most of the reactions against that approach. I propose some guidelines to interpreting long-run Latin American development that try to capture the contributions of recent research, but also find some inspiration in previous structuralist and Marxist writings on Latin America.

In the first part of this chapter I will present a few stylized facts about Latin American relative performance, to which the institutional discussion is related. The second section starts with a conceptual discussion of institutions and relations of production and discusses different applications to the Latin American context. I finish by summarizing my conclusions.

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2.2 When did Latin America fall behind?

2.2.1 Latin America, the West, and the Rest

Since 1500, Latin America's per capita GDP has fluctuated within a range of +/− 20% of average world per capita income (Table 2.1). However, differences of per capita GDP between countries and regions has been steadily increasing. Thus, while the gap between Latin America and the West has continuously widened, so has the gap between Latin America and Africa until now, and likewise the gap between Latin America and Asia until the 1950s.

International relative growth rates have been increasingly discussed in terms of the "little divergence" and the "great divergence". The Western countries moved from a relatively slow growth path dominated by population expansion in 1500–1820, to a fast and intensive growth path since the 1820s, in which per capita GDP growth clearly dominated over population growth (Figure 2.1). During the first period, the rest of the world only grew extensively, and at slower rates than the West, giving rise to the so-called "little divergence." During the second period, GDP growth rates accelerated, but population growth remained high and accounted for half of total growth. World productivity, as measured by per capita GDP, grew at only 60% of the growth rate of the West, giving rise to the so-called "great divergence."

After independence, Latin America (LA) followed a path similar to the Rest of the world: it showed slightly higher growth rates but with the same structure, which is that population growth explained 60% of total growth. Latin America's per capita GDP growth was only 70% of that of the West. Relative growth, however, may blur the size of the gap. Between 1820 and 2008 the absolute size of the gap increased by a factor of 40, and in relative terms it became 2.9 times higher than average LA per capita income. As regards colonial times, it is very difficult to estimate GDP and population. Based on very fragile assumptions such as those of Maddison, we might guess that there really was a non-negligible gap between Latin America and the West, but it did not widen significantly during this period.

To sum up, while the West was growing extensively and somewhat slowly, the gap between the West and the Rest (Latin America included) was not negligible, but increased moderately. When the West shifted to an intensive growth pattern LA lagged further and further behind and the gap became huge, in spite of LA having continued and even accelerating growth. Therefore, while the original gap and colonial heritage deserve considerable attention, new growth patterns emerged and the scene changed dramatically after the Industrial Revolution.

We can identify different periods in the life of the independent Latin American countries.

The "cost of independence" seems to have been huge in terms of relative development. This is a traditional view, represented for example by Halperin Donghi (1985). This point is also implied in Bates, Coatsworth, and Williamson's (2007) descriptive name "Lost

Table 2.1 Per capita GDP, population, and GDP 1500–2003 by region (1990 international dollars) and relative to world average

	1500	1820	1870	1913	1950	1973	2001
Per capita GDP ($)							
West	702	1,109	1,882	3,672	5,649	13,082	22,509
Rest	538	578	606	860	1,091	2,072	3,372
LA	416	648	813	1,481	2,506	4,504	5,811
Rest without LA	545	576	597	821	960	1,809	3,105
World	566	667	875	1,525	2,111	4,091	6,049
West-LA gap	286	461	1,069	2,191	3,143	8,578	16,698
West-LA gap/LA	0.69	0.71	1.31	1.48	1.25	1.90	2.87
Per capita GDP (world average = 1)							
West	1.24	1.66	2.15	2.41	2.68	3.20	3.72
Rest	0.95	0.87	0.69	0.56	0.52	0.51	0.56
LA	0.73	0.97	0.93	0.97	1.19	1.10	0.96
Rest without LA	0.96	0.86	0.68	0.54	0.45	0.44	0.51
World	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Table 2.1 (contd.)

	1500	1820	1870	1913	1950	1973	2001
Population (millions)							
West	75	175	268	424	565	718	859
Rest	363	867	1004	1367	1959	3198	5290
LA	18	22	40	81	166	308	531
Rest without LA	345	845	964	1286	1793	2890	4759
World	438	1,042	1,272	1,791	2,524	3,916	6,149
GDP (thousand millions)							
West	53	194.4	504.5	1,556.9	3,193	9,398	19,331
Rest	195.3	501	608.2	1,175.2	2,137	6,626	17,862
LA	7.3	14	33	119.9	416	1,398	3,087
Rest without LA	188	487	575.68	1,055.3	1,721	5,228	14,775
World	248.3	695.4	1112.7	2,732.1	5,330	16,024	37,193

Source: Maddison (2007: tables 1a–c); for Latin America 1820 and 1870, Prados de la Escosura (2009: table 6).

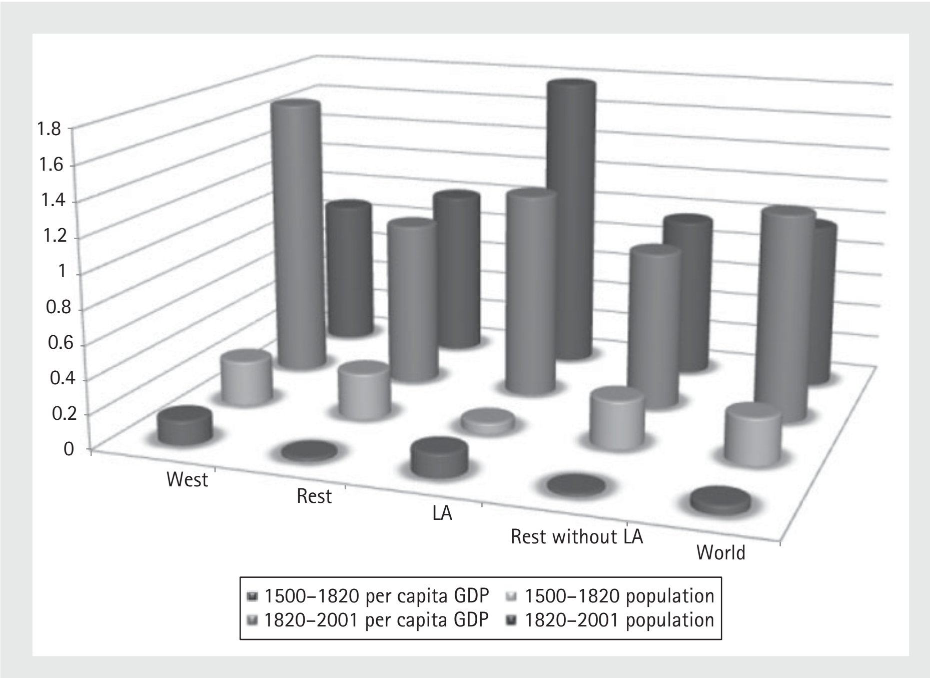

FIGURE 2.1 Growth rates of population and per capita GDP, 1500–1820 and 1820–2001, by region

Source: Table 2.1.

Decades." However, more recently Prados de la Escosura (2009: 306) concluded that between 1820 and 1870 Latin America grew "at a similar rate to the global average, matching that of the European periphery and proving far higher than that occurring in Asia and Africa. 'Lost decades' seems to be an inadequate description of aggregate performance in post-independence Latin America."

We find it difficult to agree with this author. First, while world average annual growth was 0.6%, 12 Western European countries (Europe 12) were growing at 1% and the US at 1.3%, the Latin American rate was only 0.4%. Secondly, the gap between Latin America and Europe 12 increased from 0.9 to 1.6 of Latin America's per capita GDP; the gap between the US and Latin America increased from 0.9 to 2.0 of Latin America's per capita GDP. Some countries were growing fast, and many former colonies were taking advantage of that. Even if Latin America was not a stagnant or sclerotic society, the decades following independence were lost in terms of relative performance and potential growth. Gelman (forthcoming) states that during this period disparities increased significantly in Latin America, as the commodity lottery allowed some regions to grow fast while others remained stagnant, thus making it difficult to generalize. Even if true, this statement does not change the general view: diverse performance is not a special feature of this period in Latin America.

Within two quite different environments Latin American performance in 1870-1950 seems, at first glance, to have been reasonably good. While the gap between the West and the Rest increased from 2.3 in 1870 to 4.5 in 1913 and to 5.6 in 1950, Latin America went up from 0.9 of the world average to 1 in 1913 and 1.4 in 1950. The gap between LA and both Africa and Asia increased considerably. However, there is no reason to be complacent about this performance: the absolute gap between per capita income in the West and that of Latin America increased by 81% in 1870–1913 and by a further 52% in 1913–50 (it widened by 176% in 1870–1950). It increased from 131% to 148% of LA's GDP between 1870 and 1913, but narrowed to 125% in 1950.

The trend has changed since the 1950s. During the Golden Age (when the West grew as never before) and after (when Asia started to grow faster and the communist world was still doing well), Latin America lagged behind, although the gap between it and Africa continued to widen. Latin America's performance after the 1970s was relatively poorer, in spite of a slower growth rate in the West.

2.2.2 Latin American diversity

Latin America is diverse, and its development and growth have been uneven. As can be seen in Table 2.2, in 1820 the combined per capita GDP of Argentina and Uruguay may have been double that of the rest of the continent combined. The trend until the 1950s was of increasing disparities between countries, probably since the early years of independence (Gelman forthcoming), with Chile and Cuba already in the-high income group in the 1870s, and Venezuela joining in the 1950s.

However, starting in the 1910s, the Latin American economies began to converge. This was due to sluggish growth in the relatively high-income countries and fast growth in Brazil, Mexico, and Colombia, for example. Today no Latin American country rates as a developed country, but this does not mean that some of them, at certain points in time and under special circumstances (often related to the so called "commodity lottery"), have not had high income levels and high growth rates. However, Latin American countries have not been able to sustain high growth rates over time. Instead of steadily approaching the levels of the world's leading economies, they have tended to experience "truncated convergence" (Ocampo and Parra 2007) and have shifted between "convergence and divergence regimes" (Bértola and Porcile 2006).

Relative backwardness, however, is not stagnation or total inertia. Since the time of the conquest, per capita income in the region has grown by a factor of 17, and since independence it has grown tenfold. If we add population growth to these figures, since Independence total GDP has grown by a factor of 283 while GDP in the West increased by a factor of 117 in the same period. This kind of growth must mean that far-reaching structural and institutional changes have taken place. No doubt the kinds of growth mechanism have changed over time, and so the institutional determinants of growth and the impact of growth on institutions probably changed as well. In both cases, these changes affected both the domestic and the international arena.

Table 2.2 Per capita GDP of some Latin American countries, 1820–2003 (1990 international dollars)

	1820	1870	1913	1950	1973	1990	2003
Argentina	1,249	1,837	3,797	4,987	7,962	6,436	7,666
Brazil	652	680	811	1,672	3,882	4,924	5,563
Chile	607	1,295	2,988	3,670	5,034	6,402	10,951
Colombia	423	539	1,236	2,153	3,499	4,840	5,228
Mexico	693	720	1,732	2,365	4,853	6,085	7,137
Uruguay	1,004	1,880	3,310	4,659	4,974	6,474	6,805
Venezuela	347	529	1,104	7,462	10,625	8,313	6,988
Average	648	813	1,618	2,696	4,875	5,465	6,278

Source: Maddison (2007); Latin America 1820 and 1870, de la Escosura (2009: table 6).

2.3 Institutions in the Latin American context

In the last decade, the Latin American experience has been re-examined with neo-institutional approaches including work by Engerman and Sokoloff (1997), Landes (1999), North, Weingast, and Summerhill (2000), Acemoglu, Johnson, and Robinson (2005), Lange, Mahoney, and Vom Hau (2006), Robinson (2006), and Sokoloff and Zolt (2007). With some nuances, even Coatsworth (2008) can be included in this group. These studies involve the basic idea that the fundamental causes of Latin America's long-run backwardness are to be found in the institutions that were set up shortly after the Spanish conquest, which promoted a high concentration of wealth and political power. Regardless of their disagreement about the factors that ultimately determined the nature of these institutions, or even the timing, these authors all seem to trace Latin American backwardness to its colonial roots. This is a traditional subject in Latin American historiography, and an issue that the new literature generally ignores (see Stein and Stein 1970; Furtado 1974; Cardoso and Pérez Brignoli 1979; Sunkel and Paz 1982; and many others).

Nevertheless, this is a very important development: when this new line of research re-emerged in the 1990s, the dominant approach to Latin American backwardness centered on the idea that these countries developed in a negative way in the middle decades of the 20th century largely because the scene was dominated by state-led growth and import-substitution strategies. Neo-institutional approaches also had important policy implications: as institutions are path-dependent and very prone to inertia, no policy recommendation imposed from the outside can easily change long-run trends unless considerable domestic changes also take place. The development prospects implied by this view are not particularly optimistic.

2.3.1 Institutions: new institutional economics and Marxism

Institutional analysis is not new, and it is worth recapitulating what is new in neo-institutional approaches so as to grasp their contributions and eventual shortcomings. Many of the previous theories about Latin American economic history have some kind of Marxist inspiration. In order to compare the new contributions with previous ones, it would be interesting to compare New Institutional Economics with Marxism.

New Institutional Economics is the result of three decades of refining definitions and formal approaches. This movement combines two complementary sets of ideas (Dye 2006: 170): North's contributions (1990; 1994), which define institutions as rules of the game, and Acemoglu and Robinson's approach (2006), which conceptualizes institutions as producers of sustained or equilibrium behavior.

According to North (1994), "Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (e.g. rules, laws, constitutions), informal constraints (e.g. norms of behavior, conventions, self-imposed codes of conduct), and their enforcement mechanisms. Together they define the incentive structure of societies and specifically economies" (p. 360).

Informal institutions are awarded an important role in the theory. Formal institutions may be imposed on different societies or different formal settings and may be adopted in enthusiastic response to what has been applied in other societies. Unless these institutions are also embedded in informal institutions, ways of behavior, and beliefs, however, the probable outcome could be quite different than what was expected (Dye 2006).

The New Institutional Economics approach to institutions mainly boils down to two distinct sets of institutions, which are almost sufficient to explain modern economic growth. One set has to do with property rights, and there are two dimensions to this: the economic and the political. The economic dimension is the defense of property rights. The political dimension involves attaining and defending civil rights, i.e. the right to a political voice to defend the interests of the people of the country, and in particular the right to defend property and income from abuses by wealthy and politically powerful elites and dictators. What matters here is capital accumulation. The second set of institutions has to do with inequality. When power and wealth are highly concentrated, this makes for a context in which it is easier for elites to expropriate wealth and income and abuse power, but this kind of situation hampers the accumulation of human capital. A skewed distribution of income and wealth will probably impose limits on the accumulation of education and knowledge by the great mass of the population and thus impede growth.

Most New Institutional Economists have in mind the Solow-type growth model extended with human capital. The institutions considered by New Institutional Economists are concentrated at the macro-level. However, there is no clear consideration of the institutions that regulate the micro-level or all the different institutions that regulate the innovation process. Innovation seems to be seen as an outcome of human and physical capital accumulation. Based on the concepts of scarcity and competition, good institutions are those that foster fair competition. As in the Solow-type model, productivity growth is obviously important, but no clear explanation of it is proposed.

It seems paradoxical that New Institutional Economics should focus so much on domestic relations and avoid too many references to international relations, because in neo-classical economics the main focus in development economics has been to promote free trade, globalization, and integration into international factor and commodity markets. It seems that New Institutional Economists share with neo-classical approaches the idea that international integration naturally has a positive impact on development. However, the main idea is that, no matter how powerful global forces might be, their contribution to development largely depends on the domestic institutions each country has, since it is institutions that can cause slow-growth equilibrium even when international conditions are supposedly favorable.

The Marxian view is that economies develop as the result of the interaction between the productive forces (people, techniques, knowledge, physical capital, land, particular geographical and climatic conditions) and the social relations of production, i.e. relations between different social groups involving power and ownership of natural resources, physical capital, knowledge, and labor. Marx differentiates between the structure and the super-structure. The structure is composed of relations of production and productive forces (endowments). The relations of production are themselves institutional arrangements, i.e. relations between individuals and groups of individuals who have different positions with respect to the ownership of land, capital, and labor. Formal institutions (the super-structure) are based on informal, pre-existing relations of forces, social relations, and they constitute the legal apparatus and its enforcement mechanisms, the state or other organizations that play this role, and also ideology, religion, and culture.

What is the connection between the relations of production and institutions? Is it possible to produce a conceptual interface? These concepts have many similarities. What North calls "institutions" are what Marx calls "social relations of production." The relations of production exist at both the informal and the formal level. In the latter case, they become part of the super-structure of society.

What is probably more important is to see how these different levels of analysis interact with each other, and what their hierarchies are. The comparison between the two groups of theories is made difficult by the variety of approaches within each school of thought. In order to make the discussion easier, we will focus on how these different views appear in the Latin American context.

2.3.2 The colonial heritage

2.3.2.1 Neo-institutionalism and the colonial heritage

Most New Institutionalists seem to agree that colonial institutions are the fundamental cause of Latin America's backwardness. However, they do not agree on the origin of these institutions.

Landes (1999) and North et al. (2000) state that Latin American institutions are mainly the result of some kind of cultural and political transfer from the colonizing power. On a list of alternative features, Latin America (unlike North America) is always on the wrong side: federalism vs. centralism, democracy vs. monarchy, transparency and accountability vs. privileges and arbitrary decisions, free trade vs. monopolistic policies, religious freedom vs. official doctrine, cultural pluralism vs. monoculturalism and racism. This point was recently reformulated by Lange, Mahoney, and vom Hau (2006), who maintain that the differences arise from two different economic doctrines, the liberal view and the mercantilist stance. In a joint article, Sokoloff and Robinson (de Ferranti et al. 2004: ch. 4) agree in their opposition to this view:

> Following Engerman and Sokoloff (1997, 2000, 2002) and Acemoglu, Johnson, and Robinson (2001, 2002), the authors of this chapter argue that the contemporary situation cannot be understood without recognizing that extreme inequality emerged soon after the Europeans began to colonize the Americas half a millennium ago, and has been reflected in the institutions they put in place. Both this initial inequality and institutions were shaped largely by the factor endowments that the Europeans found in Central and South America, rather than the nature of the colonial powers themselves. Although these colonies ultimately gained independence and the development of technology and the world economy brought about important changes, extreme inequality persisted into the nineteenth and twentieth centuries because the evolution of political and economic institutions tended to reproduce and reinforce highly unequal distributions of wealth, human capital, and political influence. (World Bank 2003: ch. 4)

But these two authors later disagree. The Engerman and Sokoloff argument may be labeled as endowment deterministic:

> . . . various features of the factor endowments of the three categories of New World Economies, including soils, climates, and the size or density of the native population, may have predisposed those colonies toward paths of development associated with different degrees of inequality in wealth, human capital, and political power, as well as with different potentials for economic growth. Even if, later on, institutions may ultimately affect the evolution of factor endowments, the initial conditions with respect to factor endowment had long, lingering effects. (Engerman and Sokoloff 1997: 275–6)[2]

In subsequent papers, Sokoloff with other co-authors make further studies of institutional architecture, but now with reference to education, political participation and suffrage, fiscal policy, local government, etc. However, the basic idea remains: poor institutions rely on the features of domestic resource endowments.

[2] The three categories here are (1) tropical crops like sugar that yield increasing returns to scale and promote the concentration of property. This was reinforced by the introduction of slave labor; (2) corn production, which never had increasing returns to scale and which led to a farmer society; (3) the Andean and Mesoamerican societies, with their high concentration of land, natural resources, and domestic labor, i.e. a similar structure of incentives to those prevailing in the tropical regions (Engerman and Sokoloff 1997).

Acemoglu and Robinson's approach differs from this. Rather than emphasizing natural resources in the different regions or dwelling on the supposedly different technical features of the different kinds of production with respect to increasing returns to scale, they mainly focus on one kind of endowment, labor. Their arguments boil down to quite a simple idea: in places where the native population is numerous or immigration is hampered by a fear of diseases, there are incentives for the colonial elite to develop coercive labor relations. This leads them to set up "bad" institutions that further foster the concentration of wealth and political power. The opposite scenario pertains when colonists form the majority of the population: they create "good" institutions for themselves, thus promoting the accumulation of physical, human and "political" capital. The origin of the colonists does not really matter, and nor do the geographical determinants of technical aspects of society, but the environment in which colonists settle is significant. To support the notion that institutions rather than geography or natural endowments play a decisive role, Acemoglu and Robinson use the "reversal of fortune" argument. This is the idea that regions with high development levels in 1500 had lower per capita income at the end of the 20th century, and what was probably explained by geography in 1500 institutions reversed as time went by.

According to Acemoglu and Robinson (2006), the distribution of wealth and the political regime at a certain point of departure is the *de jure* and tacit political framework which determines the prevailing formal and informal economic and political institutions.

In short, two assertions feature Neo-institutionalist thinking on Latin America: that early colonial institutions are the main explanation of Latin American backwardness; and that these institutions were inert to a large extent and tended to reproduce themselves over time. However, there are still considerable disagreements about the origin of institutions, between a resource determinism that can be said to be exogenous, a cultural or political determinism that is also exogenous and is dependent on the kind of colonial power, and an endogenous sociopolitical determinism.

2.3.2.2 Marxist and structuralist approaches to the colonial heritage

Marx considers the distributional outcomes of previous processes to be the starting point for prevailing social relations. The Marxist emphasis is probably on the fact that, logically, the real tacit relations of production emanating from power relations are the ultimate determinants of the shape that formal institutions take. In the Marxian approach, social relations are embedded in power relations and wealth distribution, which according to Acemoglu and Robinson constitute the given equilibrium variables at time zero.

Differences between Marx and North may be more important. When North's institutions ultimately rely on culture, North turns Marx upside down. If North's institutions are more related to daily experience and particular local conditions, then the gap gets smaller.

However, even within Marxism different approaches may be found. One widespread view is to see development as the unrestricted unfolding of productive forces, which use social relations as a vehicle for progress. Once the social relations that previously powered growth start hampering it, progressive social forces introduce revolutionary changes to power relations and new social relations of production appear, and this frees productive forces so that they can develop and clear the way for further progress (Lange 1980). While for North, performance is the result of institutions (institutions are the ultimate causes of growth; the accumulation of physical capital, labor, and human capital are the proximate causes of growth), according to this deterministic Marxist view we might conclude that the development of productive forces is the ultimate cause of growth.

Marx's own studies of capitalism can be read as meaning that capitalist social relations are the real forces that, through their economic reproduction, have the power to produce the unprecedented development of productive forces. This is what happened during the Industrial Revolution, a specific product of capitalism. It might be said that in Marx the relations of production determine the rate and direction of the development of productive forces. Other Marxist approaches, such as those of Robert Brenner (1990), emphasize the role played by social and political power relations to explain the different paths of capitalist development and economic performance in Europe. Acemoglu and Robinson can be placed close to this point of view.

Let us take a look at one example of the Marxist approach to Latin American growth and "institutions." Ciro Flamarión Santana Cardoso and Héctor Pérez Brignoli's *Historia Económica de América Latina* (1979, henceforth referred to as C&PB) is a book that has been almost completely ignored by New Institutional Economics, as it was neither translated into English nor presented in New Institutional language. The reason to choose this work as an example, among many others, is that it is a very good synthesis of varied earlier contributions from many.

In short, C&PB's argument is as follows. Latin American colonial societies are based on three components: the European economy, African pre-colonial societies, and obviously the pre-Columbian civilizations. These components combined in different ways in different parts of the region in response to local environmental and social conditions. Societies developed as a part or extension of the European economy, but they also developed structures and dynamics of their own. For example, the fact that there was no second agrarian revolution in Latin America can hardly be explained by the dominance of Spain or Portugal alone, as no colony of any other colonial power had such a revolution either (p. 150). The different regions are identified by four different criteria:

(a) the colonial power (weak explanatory power, as compared to North);
(b) the degree of linkage with world markets (export centers, subsidiary economies, and marginal regions often overlap in the same space);
(c) the kind of product, highly dependent on geography (mining centers, tropical products, the production of foodstuffs and consumer goods for domestic markets), with big impacts on techniques and social organization; and
(d) labor relations and the character of the colonization process.

In this last type, authors distinguish, first, Euro-Indian regions, which were the core areas of the pre-Columbian civilizations and where colonization meant a redistribution of productive factors and the imposition of forced labor on reorganized peasant communities in many different and heterogeneous forms. Second, there were Euro-African societies, i.e. more homogeneous slave societies in regions suitable for tropical crops. Third, there were Euro-American societies in temperate regions with low native population densities and increasing European immigration. The various combinations of all these factors gave rise to a wide variety of regional cases.

The land was owned by the crown and was bestowed on individuals to promote conquest and colonization. Occupied land could be bought from the crown, and the Indian communities had to have enough land to live on, reproduce, and pay taxes. In the wake of the demographic catastrophe and the decline in silver production, the hacienda system came into being. This was based on large tracts of land owned by the church or other landlords, mine owners, merchants, and bureaucrats. The *mestizos* were not allowed to own land.

A hacienda might be more or less market-oriented, but the hacienda system seems not to have been particularly prosperous. Most fortunes were made in mining and trade. Colonial Latin America was technologically backward. In spite of technology transfers from Europe, production was quite primitive, and the technological path was more oriented to the extensive use of land based on exploiting unskilled forced labor than to the intensive use of land as such. Colonizers adapted to the prevailing local conditions instead of making use of up-to-date European technology. Thus the Indian–European mix led to technological stagnation or even involution.

The more market-oriented plantations combined two agrarian sectors: production by slaves for their own consumption, and the production of goods for the market. Even though the division of labor was more advanced, the technological pattern was equally backward, as it was based on the extensive use of labor and land. Technical change was not impossible, but slave economies were not a particularly susceptible environment in this respect. Plantations were firmly inserted into trade flows and closely linked to European markets. Profits depended on the cost of labor (partly thanks to the existence of high levels of self-sufficiency) and international commodity prices. Plantations were also highly dependent on the supply of labor through the slave trade, and on the severe application of enforcement mechanisms. As regards land, the Spanish, Portuguese, and French colonies preserved the patrimonial character of land ownership, unlike the system in the British and Dutch colonies, where land markets came into being quite early.

In short, C&PB gather into a single view many of the nuances that would later appear in the varied range of new institutionalist approaches. However, while in neo-institutional approaches most of the story is already written, this is not the case with C&PB. As we will see, other writers, such as John Coatsworth, also share this view.

2.3.3 Latin America, the Industrial Revolution, and the national state

C&PB consider that the period 1750–1870 was when the relation between Latin America and the world economy was reformulated, a process that can also be viewed as a transition to peripheral capitalism, i.e. a kind of capitalism lacking the structural and technological dynamics that feature in the central economies. These authors concentrate their analysis on the late colonial period and on the second half of the 19th century, when a process with three components took place: the abolition of slavery, the liberal reforms (which involved the expropriation of church land, the control and privatization of public land, and the control of the labor and land of indigenous peasant communities), and expansion into new areas. The C&PB study is particularly weak when it deals with the role of independence. It seems as though one volume of the book is missing. The "great delay," as it was called by Halperin Donghi (1985), is a vacuum. According to most studies this was a period of disorder and of sluggish and discontinuous economic growth. This period was also neglected by the main body of neo-institutional writing because the most important part of the story had already been written.

According to C&PB, in the context of the independence of the British colonies, the Industrial Revolution, and the Napoleonic Wars, Latin America enjoyed relatively fast economic growth and institutional reorganization which, following Lynch (1991), has been called "the second conquest." The Bourbon and Pombalian reforms were aimed at extracting as much profit as possible from the colonial system, and in this process the previous inward-looking trend was reversed and the Latin American economy became more closely linked to the international economy. Thus, the colonial heritage is not mainly a matter of what happened during the early years of colonization. These international links, formal and informal, were not an original sin at time zero but an ongoing determinant of economic, social, and political developments. While in New Institutional writing the colonial powers and the colonizers play the role of initiators, and afterwards domestic institutions keep on reproducing themselves, in C&PB's approach the colonial powers remain an important and dynamic factor. It is worth noticing that C&PB's approach constituted a frontal attack on the extreme versions of dependency approaches, which saw external links as the main source of underdevelopment and the exploitation of the periphery as the main explanation of capitalism's development at the core. Domestic relations are seen to play a key role in the explanation of European development and also in that of Latin America. However, external relations do not disappear.

This is an important point. New Institutional Economics mainly developed in the US, and it seems to export to Latin American studies some features of the North American experience and to reproduce that pattern of analysis. Most of the successful development experience of the US is that of a large, independent nation (see introduction to Haber 1997). Most studies of US development assign the decisive and outstanding role to domestic forces. It seems that when studying Latin America, New Institutional Economics is prone to some kind of path dependence. The shift towards the study of domestic forces is not exclusive to neo-institutionalists. The so-called dependency school (Hettne 1990) started by focusing almost completely on external forces, but slowly moved to consideration of domestic barriers to growth. ECLAC's pioneering works from the 1950s mainly focused on the so-called centre–periphery system, and had some kind of naive view about the underlying potential of Latin American society and the capacities of the state; but in the 1960s domestic structural barriers to growth and development (agrarian structures, trade mechanisms, patterns of consumption, etc.)

came to the forefront of the analysis, although the center–periphery approach was not neglected (Rodríguez 2007). New Institutional approaches are another example of this movement. However, New Institutional Economics seems to have focused too much on domestic circumstances and to have forgotten the role played by the changing dynamics of international relations. The recent book by North, Wallis, and Weingast (2009) is almost completely about the creation of "open-access economies" but in a closed-economy framework.

John Coatsworth is an experienced Latin America specialist. His view (2008) differs from others and is full of insights. He shares with C&PB the idea that 1750–1870 was an important period of missed opportunities. He seems to take the side of the branch of New Institutional tradition that believes Latin American backwardness is closely linked to Iberian institutions. Coatsworth's view is similar to that of North et al. (2009), insofar as the Industrial Revolution is seen as the result of previous institutional changes in Holland and England.

> ...the Portuguese and Spanish empires had failed to adapt to the revolution in property rights that produced a Commercial Revolution and sustained economic advance in Britain and the Netherlands at least a century earlier. The Iberian failure to modernize property rights and other institutions affected elites as well as commoners. As generations of Spanish and Portuguese policymakers understood, the survival of their empires depended crucially on the maintenance of a fragile equilibrium in which the authority of weak and distant monarchs depended as much on keeping settler elites insecure in their rights and properties as it did on keeping the lid on discontent from below. By clinging to absolutist principles and colonial hierarchies of race and caste, the Iberian World had already lost the opportunity to make an Industrial Revolution on its own. (Coatsworth 2008: 558)

According to Coatsworth, Latin American elites were not as powerful as North American ones because the peasant communities were able to keep control of their land, which contrasts with the drastic land expropriations implemented in North America and in Australia and New Zealand, for example. This weakness in Latin America made local elites dependent on the protection of the colonial power, and this in turn meant that colonial power in Latin America was longer-lived than in North America. The elite were taxed by the colonial power in many different ways, which differs from what happened in North America. The colonial powers were partly responsible for the weakness of the local elites, as the Iberian colonial powers were careful not to give local elites sufficient autonomy or property rights over land or even over labor.

Coatsworth goes even further with a highly controversial statement: economic growth did not require institutions that encouraged the poor to invent and invest, but rather institutions that made it possible for people of means to do so. Latin America was not unequal enough to promote accumulation by the local elites.

This point is interesting for two different reasons. First, it tacitly confronts the idea that the institutions that are good for growth are always the same. I firmly share this view. Capitalist development is not always a story about increasing equality. Industrialization led to an increase in inequality, the so-called first phase of the Kuznets curve. However, there is a second aspect with which I disagree: the fact that peasants kept part of the land does not necessarily mean that elites lacked a degree of control. Quite the contrary: the presence of large numbers of peasants is what makes it possible to extract labor from them and to maintain an unequal social structure. Peasants were assured a piece of land because they worked it for their own subsistence, and the existence of this peasant community made it possible to generate a workforce that paid taxes to the haciendas, the church, and the crown. We are not talking about free peasants who were able to accumulate, get richer, buy new land, and so on, but about people who lived close to subsistence levels and produced surplus labor for the elite, both domestic and colonial, and were dominated by an oppressive class, race, and caste system. We are still not in a position to say how severe inequality was by modern standards. However, a great deal of work would have to be done before the idea of a not-too-unequal colonial society could be acceptable. What really matters is not merely inequality measures such as the Gini-coefficient, but the kind of inequality that prevailed and the underlying social relations and their dynamic implications. And in this discussion of inequality, international relations have to be included since it was not only the domestic elite that were involved.

Coatsworth also emphasizes that the efforts of the Iberian empires were mainly devoted to defending their territories, repressing internal rebellions, and extracting tax revenues to do both; they did not have enough energy to invest in public services, physical infrastructure or human capital. The weak national states in Latin America that had to cope with these tasks were faced with a much harder situation because the Industrial Revolution had already changed the international arena, and what was expected from peripheral regions was that they would produce raw materials. In every field of industrial production there was now tougher competition from the industrialized world and easier access to world markets thanks to the transport revolution.

> To resist such pressures, Latin America would have needed strong and effective governments committed to promoting modern industry, that is, not less inequality and exploitation, but perhaps much more of both, including subsidies to business and efforts to keep wages down. Until late in the nineteenth century or later, any country or colony that had not already made its own industrial revolution faced insuperable difficulties trying to import one from elsewhere. (Coatsworth 2008: 560)

Instead of strong national states, Latin American societies had highly volatile formal institutions. What really matters are the underlying informal institutions and not the successive formal constitutions that were introduced from time to time and later on changed. A self-reinforcing institutional process repeatedly restored political power to the conservative elite, as governments were not expected to last for long and as informal institutions interacted with the formal ones—and in fact changed the original aims of the latter (Dye 2006).

A similar point was made by C&PB (pp. 92–3) with reference to liberal reforms. Constitutions were designed to extend rights to the broad mass of the population, but ultimately they were limited and constrained by underlying forces, and in the end they gave political rights only to the white elites. On a more abstract level, this is a good example of the particular way in which existing, real, and informal social relations have an impact on the form taken by formal institutions.

According to Coatsworth, "The pace of nineteenth century institutional modernization, with its socio-economic correlates, performs better as a predictor of long term economic performance than colonial extraction and exploitation, as is proposed by Acemoglu, et al." (2008: 565). Coatsworth further states that the pace was quickest in the temperate zone colonies populated mainly by European settlers and their descendants (i.e. the expansion of the frontier), and that the areas that were slowest to modernize their institutions included Brazil and the centers of pre-Columbian civilizations: "The duration and depth of the post-independence civil conflicts depended on the nature of colonial social conditions: conflicts tended to deepen and last longer in places where the power and status of settler elites was most challenged from below. International competition often exacerbated the persistent internal conflicts."

Two comments are in order here, following what was said above. First, what Coatsworth is saying about the 19th century is not very different from the C&PB argument about the way in which economic reforms advanced in different areas in Latin America. Secondly, however, it is striking that Coatsworth makes an attempt to disconnect 19th-century processes from colonial institutions, given the fact that his own reasoning makes it clear that the socio-institutional context he mentions is described precisely according to the features these institutions adopted during the colonial period. Once again, what we see is an artificial attempt to isolate forces and causes in limited time and conceptual frameworks, while what we have in front of us is a process in which new domestic and external forces transform and maintain features of the past. It is impossible to disconnect the pace at which reforms advanced in the 19th century from the ways in which the different socioeconomic structures and institutions evolved during the colonial period.

2.3.4 Institutions and the first globalization boom

Some general features of economic performance in different Latin American regions have been described elsewhere (Furtado 1974; Cardoso and Faletto 1979; Sunkel and Paz 1982; Bulmer-Thomas 1994; Bértola and Williamson 2006). Latin American growth performance improved, but growth was unequally distributed. The regions that expanded their frontiers in temperate zones with high shares of immigrant labor had higher growth rates and higher levels of foreign investment, literacy, exports per capita, etc. Plantation economies, especially those on the Atlantic coast, were further behind in all these respects, and the core colonial regions come at the bottom of the performance list, but not too far behind the tropical regions.

This ranking clearly reflects what was mentioned above concerning the pace at which institutional modernization took place in the different regions. However, as we have noted, the causal chains are not simple. Institutional modernization had to do with previous economic and institutional developments in a process with deep historical roots, closely linked to colonial structures that were based on extracting a surplus from the native population, where this population was large enough, and from slave plantations in areas where native labor was not available and where free immigration was not attracted.

There is general agreement about the broad institutional features of the period of export-led growth. This period ended the *larga espera* (long wait), and authoritarian, exclusive, elitist regimes succeeded in imposing order and stimulating progress. In spite of the high institutional volatility described by Dye, this period was different from the 50 years following independence in that the central power of the states was really strengthened and the property rights of the elite were more efficiently preserved.

The provocative arguments put forward by Coatsworth (2008) are again a good starting point for our discussion:

> The nineteenth century ended . . . by committing the sins that much of the new political economy erroneously attributed to the colonial era: relatively high economic inequality, dominance of government by narrow economic elites, exclusion of competing interests and groups from political influence, and "bad" institutions that fail to protect the property and human rights of majorities. Unfortunately for our theorists, and for the region, the nature and timing of Latin America's sinning clearly indicates that it was good for economic growth, not bad. The conditions that Engerman-Sokoloff and Acemoglu, Johnson, and Robinson saw as blocking economic growth were in fact the conditions that made it possible.

Let us consider some of these interesting assertions one by one.

These "bad" institutions were good for growth. Latin America grew somewhat faster than world averages, and improved its position relative to Asia and Africa. However, as mentioned previously, the gap between the per capita income of the West and that of Latin America increased by 81% in 1870–1913 and from 131% to 148% of LA's per capita GDP in the same period. This gap may be used as a proxy for the technological gap, and reflects the ability to compete in world markets with skill-intensive products. It follows that in the wake of the first globalization boom Latin America's prospects of catching up were worse. As Coatsworth correctly stresses, the Industrial Revolution led to a new institutional order based on exchanging raw materials for manufactured goods. As the Latin American structuralist tradition repeatedly stressed, export-led growth itself was never a guarantee that the golden road to growth and development would be found.

What was supposed to happen in terms of inequality in the 18th century really happened in the late 19th century. At the present time there is an interesting debate about this subject. Most people agree that Latin America had relatively fast growth in the second half of the 18th century. This process was not particularly egalitarian: the majority of the population was not given property or political rights. It is undeniable that the late 19th century had its own characteristics. A transport revolution made new regions economically competitive and prosperous, labor systems were transformed, investment in infrastructure produced many changes in relative productivity, and there was a redistribution of land in favor of the elites and at the expense of peasant communities, the church, and the state. However, there is a big gap between these phenomena and the assertion that colonial society was not unequal and that inequality was a late 19th-century process. Both Williamson (2009) and Coatsworth (2008) think that inequality in Latin America was not particularly high when compared to Europe at the same time. Williamson bases his arguments on the Milanovic, Lindert, and Williamson (2007) idea that inequality cannot be so great if per capita GDP is low, because there will not be a sufficiently large surplus for the elite to appropriate. However, there seems to be agreement that inequality was high in Latin America at the end of the colonial period (not only and not principally in terms of income), and some new estimates show that inequality was already high on the eve of the first globalization boom. The evolution of inequality during the first globalization is also a matter of debate (Bértola et al. 2010).

Inequality was good for growth. All classical authors assumed that capital accumulation meant the concentration of income and wealth in the hands of "Schumpeterian" capitalists (not rent-earners *à la* Ricardo). The Lewis model also meant there was a first phase of increasing inequality linked to growth, and this paralleled the idea of the Kuznets curve. This is a good point against the universal neo-institutionalist growth model. And this is also compatible with world history, as it presents industrialization as going hand in hand with increasing domestic *and* international inequality, adopting the form of uneven development and even imperialism, plunder, invasions, expropriation. and so forth. While the first globalization boom increased growth rates in Latin America, the kind of growth that took place conditioned future patterns. Modern economic growth is characterized by the systematic use of knowledge to transform nature and society. The first globalization boom was made possible not by a sudden reduction in transport costs, but by a steady, continuous, cumulative increase in technical capabilities, which strongly affected international competitiveness. Latin American growth was based on the exploitation of natural resources. Technical change was often quite limited. Contrary to what pro-global theorists have believed, the first globalization boom was not strong enough to break with the informal and formal institutions that had evolved so slowly and were so deeply rooted in the Latin American social network. Quite the contrary, in fact: as the structuralist tradition and C&PB have correctly stressed, the first globalization boom often ended up interacting with or even strengthening the power of landed, commercial, and political elites. And in the process, the kind of development and the kind of inequality produced was a long way from the inequality trends that tended to empower a technologically dynamic industrial sector. The colonial heritage, based on the exploitation of natural resources using large numbers of dependent and slave labor, was almost ubiquitous; economic development during the first globalization boom was path-dependent to a high extent. The elitist societies and the patterns of development imposed by colonial rule constrained the transformation of these societies, leading to what C&BP correctly characterize as peripheral capitalism, where land was highly concentrated and labor relations did not evolve into free labor relations but towards a continuum of very varied forms of dependent labor, in a context characterized by sluggish technological change.

These kinds of societies are able to grow, but in most cases not to converge. And if convergence happened to be possible, as in the countries of the Rio de la Plata, it seems that it did not happen on a sustained basis but only as long as some positive impacts of globalization lasted.

The Latin American settler economies, such as those of Argentina and Uruguay, were the most successful. There, many positive situations combined: the production of goods competing with European producers on the basis of free labor and with a good location close to the coast, and the relative weakness of colonial institutions due partly to low population density. However, even in these cases the pattern of land appropriation differed significantly from other apparently similar settler societies such as Australia and New Zealand. The way in which land was appropriated is due to the combination of new forces and patterns of behavior and institutional features that clearly show the colonial heritage, more in informal relations than in formal ones. The result made for big differences in the innovative capacities of the two groups of economies, and in the way the factorial distribution of income took place between landowners, capitalists, and workers, favoring land rents in the Rio de la Plata (Alvarez, Bértola, and Porcile 2007). Besides, it is difficult to neglect the role played by close links to a dynamic central economy, as was the case with the former British colonies.

2.4 Concluding remarks

Relative backwardness has been a constant feature of the history of Latin America. In spite of the important technological transfers consequent upon the conquest and of not-negligible growth during the colonial times, in the wake of independence the gap between Latin America and the industrializing world was already wide. The gap widened during the first decades after independence, due to the diffusion of the Industrial Revolution from Britain to the European continent, increasing growth rates in the West, and institutional volatility in the new Latin American Republics. While Latin America resumed growth after the 1870s, the gap was not reduced. In the last decades of the 20th century, the Latin American economies diverged even more from those of the West. Throughout this process there were far-reaching domestic and international changes. New actors appeared, technological revolutions took place, and social relations as well as formal institutions were transformed.

I have argued in favor of the Neo-institutionalist approach to Latin American economic history in the sense that the colonial institutional setting had a long-lasting impact on Latin American development. I stressed, however, that most of the varying and even contradictory assertions made by different Neo-institutionalist writers had already been advanced, in Marxist language, in works such as that of C. F. S. Cardoso and H. Pérez Brignoli.

We have criticized Neo-institutionalist writings for being excessively focused on original colonial institutions and their lasting effects, and for neglecting to some extent how these institutions changed in relation to a profound transformation in international relations and technological environments. The Industrial Revolution symbolizes these far-reaching transformations, which radically affected the way in which the Latin American countries were integrated into the world economy. The Bourbon and Pombalian reforms, Independence, the Liberal Reforms, the abolition of slavery, and the expansion to new areas were followed by radical changes in social relations, political institutions, and international relations. The pace at which these changes came about depended on several particular circumstances and to a large extent on the previous development path in colonial times in what came to be different independent Latin America states, and this had a huge impact on the increased disparity in economic performance among these new republics.

We have also argued that many reactions against New Institutional approaches seem to be exaggerated. The idea that some contemporary features of Latin America such as high income inequality are products of the late 19th century, and not of colonial times, makes a similar mistake to the idea attributed to neo-institutionalist writings: instead of omitting important historical changes that were continuous in the historical process, an artificial break in this process is introduced, negating the almost obvious institutional inertia that was present in many aspects of Latin American economic life. In this respect I have argued that Latin American inequality was at a high level by the end of the colonial period, and that this kind of inequality can hardly be estimated merely in terms of a Gini-coefficient. What really matters is the kind of social and power relations underlying economic life and the distributional and technological dynamics they involved. I have further argued that the kind of inequality produced during the First Globalization boom could hardly be considered good for growth. While the idea that growth prospects were not always linked to diminishing inequality constitutes a good and frontal criticism of some Neo-institutional writings, the kind of inequality produced in Latin America was not necessarily good for growth. By then the world economy had gone through not one but two industrial revolutions. International trade was increasingly moving towards skill-intensive products, inequality gave rise to serious shortcomings in terms of human capital accumulation, and the pattern of specialization reinforced a path of slow rates of technical change and social relations not particularly conducive to technical change.

Globalization studies—which almost completely focus on resource allocation, factor movements and price convergence—usually underestimate the institutional context in which globalization forces expand, and underestimate the negative impact of globalization on the domestic economy in terms of institutional development, patterns of specialization, and technical change.

State-led growth led to many mistakes, but most current analyses of this period ignore the problems the Latin American economies were facing at the end of the first globalization boom, and the deep historical roots of these problems. The search for structural change, associated with radical institutional and social changes and the enhanced capacity of the national state, first appeared as a spontaneous reaction to negative external demand shocks. When this was developed as a more explicit theory, its reach was clearly conditioned by several economic, social, political, and institutional constraints, which widened the gap between theory and practice. Thus, excessive protectionism, biased structural change towards light industry, a lack of policies aimed at deepening technological spillovers from foreign investment, and autarkic nationalism were all features that hampered technological and structural change. However, a good assessment of the achievements and limits of state-led growth can only be accurately made in the light of the historical roots of Latin American divergence.

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CHAPTER 3

POLITICAL INSTITUTIONS, POLICYMAKING, AND ECONOMIC POLICY IN LATIN AMERICA

MARTÍN ARDANAZ, CARLOS SCARTASCINI, AND MARIANO TOMMASI

3.1 Introduction[1]

Economists have been traditionally interested in understanding which policies work best for increasing welfare and providing adequate policy recommendations. In their quest, they have generally studied policymaking using models in which economic policies are chosen by a benevolent social planner. The point of departure of this chapter is that policies are not chosen by benevolent planners (or similar constructs), but are instead the outcome of strategic interactions among a number of key participants (voters, economic interest groups, politicians, technocrats), each with its own motivations and incentives. Moreover, it is also necessary to consider that policy decisions have an intertemporal component (i.e. policies usually have an impact beyond the period in which they are discussed, and political actors usually interact over time). Thus to understand policies—and the features of those policies relevant for their impact on behavior and welfare—it is necessary to study strategic political interactions over time. By doing so it is possible to understand better what aspects of the functioning of the institutions of democracy are relevant for explaining the features of policies, and hence for explaining patterns of development.

[1] We received valuable comments and suggestions from José Antonio Ocampo and Jaime Ros. We are grateful to Melisa Iorianni for her assistance during the production of this chapter.

This chapter presents a brief and selective overview of some themes in the *political economy* of policymaking Latin America. The first section selectively reviews some of the key contributions to the study of political economy of Latin America during its major phases of economic and institutional development. It briefly covers stop-go cycles, bureaucratic authoritarianism, dependency theory, the political economy of import-substituting industrialization, and the political economy of market-oriented reforms. It roughly follows a timeline of actual events and of academic understanding and methodological vintages in attempting to explain those events. It focuses on major economic policies (such as macro, trade regime, state or private ownership) and macro political outcomes (such as the switches between dictatorship and democracy).[2]

The rest of the chapter focuses more narrowly on a strand of recent research that concentrates on actual decision and implementation processes, and on the political institutions and state and social actors involved in those processes. The motivation for such an emphasis is twofold, relating to a timeline of events and academic vintages. On the one hand, in relation to the usual concerns of development economists, it is important to emphasize the importance of home-grown development strategies adapted (among other things) to each country's institutional capabilities. On the other, after two decades of democratic practice, it is plausible to rely on deeper knowledge about the inner workings of democratic institutions to understand the actual functioning of the policymaking process in each country. This way, this chapter complements and "piggybacks" on a wealth of new research in political science.

3.2 Big themes in the political economy of Latin America

During much of the 20th century two facts shaped the research agenda of political economy scholars in Latin America. The political fact was that democracies were unstable regime types, with military rule as the often substitute. The economic fact was the prevalence among policymakers of a growth strategy, known as Import Substitution Industrialization (ISI), characterized by a variety of macro and micro policies consisting of high levels of trade restrictions coupled with active state involvement in the productive process (Hirschman 1968).

These facts gave rise to research questions or puzzles among political economy scholars such as (1) why are democracies in Latin America unstable? and (2) what

[2] An earlier version of this chapter (Ardanaz, Scartascini, and Tommasi 2009) provides a slightly longer review of that earlier literature on the political economy of Latin America. In choosing to follow a virtual timeline of events and research, we have left out some important recent work in political economy, such as the economic theories of dictatorship and democracy of Acemoglu and Robinson, and Engerman and Sokoloff's work on path dependence, inequality and development across the Americas (see e.g. Engerman and Sokoloff 2002; Acemoglu and Robinson 2006).

types of coalitions and economic interests support different regime types and economic policies? The theoretical frameworks of the time (modernization theory, structuralism, or the dependency school) provided clues for solving those puzzles. While each of these frameworks differ along important dimensions, the three have in common a focus on deep *structural socioeconomic* factors (such as level of development, class or sectoral structure, the international division of labor) that are outside the immediate control of individuals but that affect group behavior and thus political and economic outcomes.

For example, in trying to explain the instability of democracy among Southern Cone countries, Guillermo O'Donnell looked at the impact of economic cycles ("stop–go") and distributive conflicts between interest groups (urban vs. rural sectors, "popular" sectors vs. the "elite") on the political system. Basically, in each cycle, different coalitions are formed and the interests of those coalitions determine policies. During the "go" phase, the internal market alliance—made up of the working class and organized middle-class workers along with the "local" national urban bourgeoisie, encompassing the smaller, less efficient domestic firms—pursued their preferred economic policies. Thus, export restrictions and trade taxes made possible the transfer of resources from the rural to the "popular" ISI sector through real wage increases and industrial subsidies. However, balance of payments crises marked the end of the expansive phase of the cycle and thus created the opportunity for a different type of coalition to shift the course of economic policy: a coalition made up of rural interests, and internationally oriented businesses, that benefited from exchange rate devaluations. In terms of political regime dynamics, this coalition provided the social base of support for the inauguration of military governments which O'Donnell (1973) dubbed "bureaucratic authoritarian."

At the same time as political scientists were trying to explain political regime instability in Latin America, economists and other social scientists were debating the roots of Latin America's economic underdevelopment. Many intellectual strands came together (economists working at ECLAC, sociologists, economic historians, etc.) in the 1960s with the elaboration of a more general and comprehensive theoretical framework that came to be known as the "dependency school." While there is some heterogeneity in the depth and logic of the arguments stressed by different scholars within this perspective, a common assumption made by *dependentistas* is that the underdevelopment of Latin America can only be understood in connection with the region's historical insertion into the international division of labor. Contrary to comparative advantage assumptions common in neoclassical economics, dependentistas claimed that the distribution of the gains from trade between developed (the "center") and developing (the "periphery") nations consistently disadvantaged developing economies, such as those in Latin America (Cardoso and Falleto 1969). In particular, the region's insertion into the international economy as producer and exporter of raw materials and foodstuffs for the industrial center and importer of manufactured goods made it vulnerable to declines in foreign trade and terms of trade deterioration, and undermined local capital accumulation, thus contributing to its underdevelopment.

The severity of the external constraint on the economies of the region reached a peak during the 1930s, provoking a switch in development strategy that led to the inauguration of ISI. During this period, governments such as those in Argentina, Brazil, Chile, and Peru engaged in fiscal and monetary expansion and exchange rate appreciation intended to shift income to "popular" groups in the service and ISI sectors. All of them discounted the risks of inflation posed by expansive fiscal and monetary policies, and relied instead on extensive price controls and foreign exchange rationing to subsidize ISI industries. Most important, as foreign exchange reserves were depleted and fiscal pressures mounted, the policies in each of these cases ended in inflationary disasters and economic collapse.

In order to understand this "macroeconomic populism" (Dornbusch and Edwards 1991) or "*facilismo macroeconómico*" (Ocampo 2004), the crucial point from a political economy perspective is to understand the political support base and incentives of populist leaders, whose origin can be traced in part to class and sectoral divisions in the economy. For example, Sachs (1989) argues that high income inequality in Latin America contributes to intense political pressures for populist macroeconomic policies that raise the incomes of lower-income groups. However, because there is little or no intraregional correlation between populist policy cycles and income distribution, a focus on sectoral divisions that emerged within the context of ISI and the primary export sector seemed to provide a better explanation for the persistence of populist cycles across Latin America (Kaufman and Stallings 1991).[3]

While Latin America grew at an annual average rate of almost 6% between 1950 and 1980, certain features of ISI steadily undermined the long-term sustainability of this growth strategy. By the 1980s, most Latin American economies were in disarray, weighed down by accumulated external debt, delayed adjustment to negative external shocks, and a desperate need for reserves. As a result of the debt crisis, economic policy views in the region began to converge on a different set of fundamentals based on market forces, international competition, and a more limited role for the government in economic affairs. These views were connected to a climate of ideas which had a focal point in the so-called "Washington Consensus," a list of policy prescriptions considered capable of restoring growth in Latin America. The combination of economic reform with democratization shaped the research agenda of subsequent political economy scholarship.[4]

For example, during the 1980s and 1990s, economists and other social scientists working on the political economy of Latin America were involved in creating a literature

[3] Similarly, Frieden (1991) presents an analytical framework based on class (capital vs. labor) and sectoral cleavages within the business community (asset-specific vs. liquid asset holders) to explain variation in economic policy reactions to fluctuations in the supply of foreign credit in five major LAC countries (Argentina, Brazil, Chile, Mexico, and Venezuela).

[4] See Geddes (2002) for a more general overview on the impact of such changes to the study of politics in developing countries.

known as the "political economy of reform," an attempt to understand the strategies and conditions leading to different reform sequences and outcomes in the various countries.[5] A large portion of the reform literature, at least on the side of economics, worked on the premise that the reforms that countries needed to undertake were technically obvious; reform was therefore a matter of figuring out the way to implement those reforms in the context of a collective action problem due to the fact that losers from reform are concentrated, whereas beneficiaries are diffused. Following this logic, several Latin American scholars focused on the role of key socioeconomic interest groups (e.g. business, labor unions) and "distributional" coalitions in shaping the reform process and its outcomes.[6]

However, the transformations in the political economy of Latin America during the 1980s and 1990s were not only economic. In the political realm, as transitions to democracy encompassed nearly the whole region, political science scholars began to debate the promise and peril of alternative institutional designs for consolidating democratic regimes. In particular, one of the main issues on the agenda was whether Latin America should switch to parliamentary forms of government or stick with presidential constitutions. The facts informing the debate were by then clear: presidential democracies were unstable in comparison to parliamentary ones. Latin America, a region historically characterized by the preponderance of presidential constitutions, offered the highest level of regime instability, understood as shifts between democracy and dictatorship (Cheibub 2007). The question then was whether presidentialism was to blame for that record.

Starting with the seminal contribution of Juan Linz (1990), a lively debate in both academic and political circles emerged around the relative merits and perils of presidentialism in Latin America. Linz argued that presidentialism is inherently prone to regime breakdown, given that this form of government does not provide incentives for cooperation between president and legislatures. While some authors offered responses to Linz in defense of presidentialism,[7] the Linzian view remained popular among academics: they recommended the adoption of parliamentary systems in particular countries of the region, and soon some of these proposals even reached the policy agenda.[8] Both the literature on the market reform period by economists and the analysis of alternative institutional arrangements by political scientists provides a nice background for the line of research to be presented in the next section.

[5] See Rodrik (1996) and Tommasi and Velasco (1996).

[6] See Schneider (2004a) for a review of this literature.

[7] Shugart and Carey (1992) and Mainwaring and Shugart (1997).

[8] In Argentina, a presidentially appointed commission in the 1980s studied the issue of regime type and recommended a move toward parliamentarism, but the proposal did not make headway among politicians. Similar proposals were debated, but not adopted, in Chile. In Brazil, politicians put the question before voters in a 1993 referendum that offered not only parliamentarism, but also the option for returning to a monarchy, as alternatives to presidentialism (Carey 2005).

3.3 Political institutions, policymaking, policies, and outcomes in Latin American democracies

Economists have tended to focus on uncovering which are the best policies that countries should adopt in order to develop. The last "universal recipe" recommended and adopted throughout Latin America were the market-oriented reforms of the 1990s. The varied and less-than-stellar outcomes of that effort have redirected intellectual attention. This chapter reports on one particular line of inquiry which emphasizes that economic and social outcomes are the results not so much of the specific contents of policies and titles of institutions (whether utility companies are public or private) as of several characteristics of these policies. As will be shown later, countries able to generate policies with such attributes will reap the benefits of specific economic reforms more than others. If the policies adopted do not have such attributes—no matter how good they look on paper—they are unlikely to achieve good development outcomes.

Rodrik (1995), for instance, analyzed six countries that implemented a set of policies that shared the same generic title—"export subsidization"—but had widely different degrees of success. He relates their success to such features as the consistency with which the policy was implemented, which office was in charge, how the policy was bundled (or not) with other policy objectives, and how predictable the future of the policy was. Rodrik's insights resonate well in the context of Latin America, a region that during the last couple of decades embarked on a process of market-oriented reforms which, despite a similar orientation and content of policy packages, have had very diverse results in practice (Forteza and Tommasi 2006).

This example illustrates that public policies are more than their titles. More important for performance and outcomes are fundamental state capabilities, such as the ability to commit to not expropriating, or the ability to enforce compliance. However, such capabilities do not fall from the sky, nor are they provided by benevolent social planners. They are instead derived from the process by which policies are discussed, decided, implemented, evaluated, and modified. In a nutshell, policies are endogenous to the *policymaking process* (PMP), which by definition is a political process that involves a multiplicity of actors (such as professional politicians, economic interest groups, and common citizens) who interact in a variety of formal and informal arenas (such as Congress or the street), which can in turn be more or less transparent.

As noted above, development outcomes depend on the features of public policies more than on their titles. But what are these features specifically? This study focuses on several dimensions that seem to capture the necessary conditions for policies to have a positive impact on welfare. Those conditions include the *stability* or credibility of policy, *adaptability* of policies to changing economic conditions, *coordination and* *coherence* of policies across areas and levels of government, *quality of implementation and enforcement*, *public-regardedness* (see below), and *efficiency*.[9] What explains variation in such policy features? It has been argued in previous work that the extent to which some desirable policy characteristics are attained depends on the behavior of political and socioeconomic actors in the policymaking process in general, and in particular on their capacity to *cooperate*, i.e. to reach and enforce intertemporal agreements.[10] The PMP is viewed as a series of bargains and exchanges among political actors whose behavior depends on their interests, incentives, and constraints, and on their expectations about the behavior of other actors. These interactive patterns of behavior constitute equilibria of the policymaking game, which are conditioned by the rules of the policymaking process and by some characteristics of the players. In democratic polities, these rules of the game relate to the workings of *political institutions* such as the legislature, executive–legislative relations, the political party system, the judiciary, and the civil service. Thus, political institutions play a key explanatory role in understanding the determinants of political cooperation and, therefore, its effects on policy features and socioeconomic outcomes.

Political institutions have occupied center stage in explaining both economic policy[11] and development outcomes[12] across the political economy research field. In the context of Latin America, the study of democratic political institutions lagged behind much of the developed world for an obvious reason: for much of the 20th century, democracies in the region were the exception rather than the rule. For example, as late as the 1970s only around a third of Latin American countries could be considered democracies, following standard definitions in political science.[13]

The late 1970s and 1980s were the time of democratization in Latin America. With the 1989 democratic elections in Brazil and Chile, all Latin American countries, with the exception of Cuba, had elected constitutional governments, marking a significant transformation in the region away from long periods dominated by military authoritarianism. As countries in the region started to experience more or less stable democratic rule, the study of political institutions expanded dramatically. Thus, a new breed of researchers has been deploying some of the tools originally developed to study American politics (and later European politics) to study the details of the workings of political institutions in Latin America.[14] In this chapter we draw on this scholarly work to show how political institutions work in shaping the incentives of politicians and other players in the PMP,

[9] The next section provides definitions and empirical counterparts to each of these dimensions.

[10] See e.g. Spiller, Stein, and Tommasi (2003); Spiller and Tommasi (2007); and Scartascini, Stein, and Tommasi (2009).

[11] See Persson and Tabellini (2000; 2003) for surveys.

[12] Rodrik, Subramanian, and Trebbi (2004).

[13] Such as the criteria of Przeworski et al. (2000).

[14] Some excellent books focusing on institutional features of Latin American polities are Mainwaring and Scully (1995) on party systems, Mainwaring and Shugart (1997) on constitutional and partisan powers of the president, Carey and Shugart (1998) on the executive decree authority, Morgenstern and Nacif (2002) on legislative politics, and Gibson (2004) on federalism. A recent report by UNDP (2005) brings together parts of this rich literature to explore the functioning of democracy in Latin America.

thereby affecting economic policy in the region. Below we sketch the main insights of a framework developed to explore the institutional determinants of policy outcomes.[15]

3.3.1 Modeling the policymaking process as an intertemporal game

The policymaking process in modern-day democracies can be understood as a process of bargains and exchanges among various political and socioeconomic actors. Some of these exchanges are consummated instantly (spot transactions), while in many other cases current actions or resources are exchanged for promises of future actions or resources (intertemporal transactions). Issues of credibility and the capacity to enforce political and policy agreements are crucial for political actors to be able to engage in intertemporal transactions.[16]

A number of features, amenable to analysis from a transaction cost perspective, characterize the political transactions surrounding public policies:

(1) Politics and policymaking take place over time.
(2) The relative political power of various actors changes over time.
(3) There are elements of both conflict and commonality of interests in almost any relevant policy issue.
(4) The socioeconomic reality in which policies operate changes over time.
(5) Most policies could be characterized by two decision frequencies: moments of major institutional definition and regular policymaking under those rules.
(6) Many of the changing realities in (4) are such that it would be impossible for political or policy agreements to cover every feasible future circumstance.

Models capturing those features have been developed, using the logic of repeated games to analyze policymaking (Spiller and Tommasi 2007: ch. 2). As a result of such analysis it is possible to explain the characteristics of policies and ultimately certain patterns of development. The ability of a polity to cooperate determines whether certain characteristics of policies are attainable. For example, in less-cooperative policymaking environments, policies might be too volatile and/or too rigid, poorly coordinated, and in general of low quality due to insufficient investment.[17] These properties of policies are among the dependent variables explored below.

[15] See Spiller et al. (2003) and Spiller and Tommasi (2007) for a more detailed account and formalization of this framework.

[16] In addition to the key *time* dimension, there is a *spatial* element to these bargains, as these can take place in arenas with varying levels of "institutionalization": while on one extreme, formal institutions such as Congress and parties are the central locus of demands by socioeconomic actors, at the other end of the spectrum, the "street" can provide the space for interest groups to deploy alternative political technologies (e.g. road blockades) to influence economic policy (Scartascini and Tommasi 2009).

[17] See Spiller and Tommasi (2007) for proper formalization.

3.3.2 The characteristics of policies

As previously mentioned, several characteristics of policies condition whether they deliver the expected welfare impacts. Among them are the six discussed immediately below.

- *Policy stability*. Having stable policies does not mean that policies cannot change at all, but rather that changes tend to respond to changing economic conditions or to failure of previous policies, rather than to slight shifts in political winds. Some countries seem capable of sustaining most policies over time (such as Chile). In other countries, policies are frequently reversed, often at each minor change of political winds, leading to a highly volatile policy environment.
- *Policy adaptability*. It is desirable for countries to be able to adapt policies to changing economic conditions and to change policies when they are clearly failing. Policy adaptability can be hindered either by a policymaking process prone to gridlock or by rigidities introduced explicitly to avoid opportunistic manipulation of policy. That is, in order to limit opportunism by the government of the day, some countries may choose to resort to fixed policy rules that are difficult to change (as in the case of Argentina's Convertibility Rule). This, of course, would limit policy volatility, but at the cost of reducing adaptability. As shown in the experience of Argentina, it may prove to be a costly trade-off.
- *Policy coordination and coherence*. Public policies are the outcome of actions taken by multiple actors in the policymaking process. Ideally, different agents acting in the same policy domain should coordinate their actions to produce coherent policies. In some cases coordination across policy areas is crucial (fiscal and monetary policy, health and education, and so on.) If agencies do not coordinate, even the best individual policies might not deliver to their full potential. The ability to coordinate is strongly related to the ability of actors to cooperate and to invest in their capabilities.
- *Policy implementation and enforcement*. A policy could be well thought out and pass through the appropriate legislative debate yet be completely ineffective if it is not well implemented and enforced. In many countries, the quality of policy implementation and enforcement is quite poor. This is associated in part with the lack of capable and independent bureaucracies, as well as the lack of strong judiciaries. To an important degree, the quality of policy implementation and enforcement in a given country will depend on the extent to which policymakers in that country have incentives and resources to invest in such policy capabilities.
- *Policy efficiency*. Whatever policy direction a government decides to follow (redistribute to the poor, clean the environment, promote non-traditional exports), it can do so with varying degrees of efficiency—i.e. by making better or worse use of its human and economic resources. Efficient policies imply, for example, that public spending is not wasteful. Efficient policies, however, might not necessarily be

public-regarded (the government could be very efficient in targeting a very small subset of the population).

- *Public-regardedness of policies.* "Public-regardedness" refers to the extent to which policies produced by a given system promote the general welfare and resemble public goods (i.e. are "public-regarding") or tend instead to funnel private benefits to certain individuals, factions, or regions (Cox and McCubbins 2001).[18]

We have created various empirical measures of these policy characteristics for most countries in Latin America, originally using opinion survey data encompassing more than 150 experts in 18 Latin American countries, and later expanding the analysis to a larger cross-section by drawing from available international data sources.[19] As expected, these policy features have a positive association with some measures of economic development (Table 3.1).

Table 3.2 summarizes how each country of Latin America fares in each one of the indices and in a composite index we call "Policy Index."[20] Countries have been ordered according to this composite index.

Figure 3.1 puts these values in international context. Latin American countries as a group do not rank very highly in indices of policy quality, but there is substantial intraregional variation. Chile ranks high in the international comparison; a few countries (Uruguay, Costa Rica, Mexico, El Salvador, and Brazil) appear around the median of the world, a set of countries including Colombia is in the second quintile from the bottom, and then there is a group of countries at the low end of the distribution.

3.3.3 Political institutions, cooperation, and policy outcomes

We have argued that the ability of political and socioeconomic actors to cooperate is an important determinant of the characteristics of policies. The next question, then, is: what conditions make policy cooperation more likely? Drawing insights from the theory of repeated games, some of the factors that affect the degree of cooperation in equilibrium outcomes are the following:

[18] With the partial exception of the sixth policy characteristic (public-regardedness), the reader might be puzzled by the absence of equity or distributional aspects of public policy in this list. This omission does not mean that we are not aware of or concerned by the obvious fact that inequality is a major issue in Latin America, one of the most unequal regions in the world. We have tried to focus on characteristics of policies independently of their distributional content (and of other "contents") to highlight the importance of these policy qualities in attaining the desired societal objectives, including equity concerns. For instance, in Machado, Scartascini, and Tommasi (forthcoming), it is shown that countries with stronger policymaking capabilities, such as those highlighted here, are better able to achieve coverage objectives in policy areas such as education and health.

[19] Such as the World Economic Forum's Global Competitiveness Report, Columbia University State Capacity Survey, the Profils Institutionnels database, the Bertelsmann Transformation Index (BTI), and the Economic Freedom of the World Project (Fraser Institute).

[20] The specific components of each index can be found in Berkman et al. (2009).

Table 3.1 Features of public policies and economic development

	Stability	Adaptability	Coordination and coherence	Implementation and enforcement	Public regardedness	Efficiency	Obs.
Latin American countries							
GDP per capita growth	0.443*	0.46**	0.465*	0.536*	0.695***	0.537**	18
1990–2007	0.257	0.307	0.345	0.400	0.555**	0.404*	18
Human Development Index	0.581***	0.684***	0.71***	0.607***	0.594***	0.748***	18
(change) 1990–2005	0.532**	0.5912***	0.678***	0.546**	0.544**	0.708***	18
Developing countries							
GDP per capita growth	0.392***	0.304***	0.328***	0.173*	0.197**	0.238***	113
1990–2007	0.296***	0.333***	0.341***	0.199**	0.243***	0.248***	107
Human Development Index	0.379***	0.401***	0.458***	0.312***	0.418***	0.446***	97
(change) 1990–2005	0.192*	0.291***	0.301***	0.11	0.217**	0.253***	97

Note: Simple correlations between policy qualities and political variables are shown in the first row of each subgroup.
Partial-out correlations (controlling for GDP per capita of 1990) are shown in the second row of each subgroup.
* Significant at 10%; ** Significant at 5%; *** Significant at 1%.

Source: Authors' calculations using data from World Development Indicators and Berkman et al. (2009).

Table 3.2 Features of public policies in Latin American countries

Country	Stability	Adaptability	Implementation and enforcement	Coordination and Coherence	Public-regardedness	Efficiency	Policy Index
Chile	3.3	3.2	3.1	2.1	2.8	3.0	3.0
Uruguay	3.1	2.8	2.2	n.a	2.3	1.7	2.3
Brazil	3.0	2.6	2.3	2.0	1.5	1.5	2.2
Mexico	2.8	1.9	1.9	1.5	1.7	1.8	1.9
Costa Rica	2.8	2.0	2.2	1.3	1.9	1.0	1.9
Colombia	2.7	2.4	2.1	1.5	1.2	1.5	1.9
El Salvador	2.6	1.5	2.1	0.7	2.0	1.7	1.9
Peru	2.6	1.9	1.5	0.8	1.8	1.1	1.6
Panama	2.2	1.7	1.7	1.8	1.3	1.4	1.6
Argentina	2.7	1.8	1.3	1.4	1.1	1.4	1.5
Honduras	2.4	1.3	1.6	0.0	0.9	0.8	1.3
Bolivia	1.7	1.5	1.6	1.0	0.9	1.0	1.2
Nicaragua	2.1	1.3	1.4	1.3	0.7	1.1	1.2
Dominican Republic	1.9	1.4	1.5	1.3	1.3	0.6	1.2
Venezuela	2.0	1.1	1.4	1.0	1.2	0.5	1.1
Ecuador	1.7	1.6	1.3	1.3	1.2	0.6	1.1
Guatemala	1.9	1.0	0.8	0.9	1.0	1.0	1.0
Paraguay	1.8	1.3	1.0	0.4	0.3	0.6	0.8

Source: Author's calculation using data from Berkman et al. (2009).

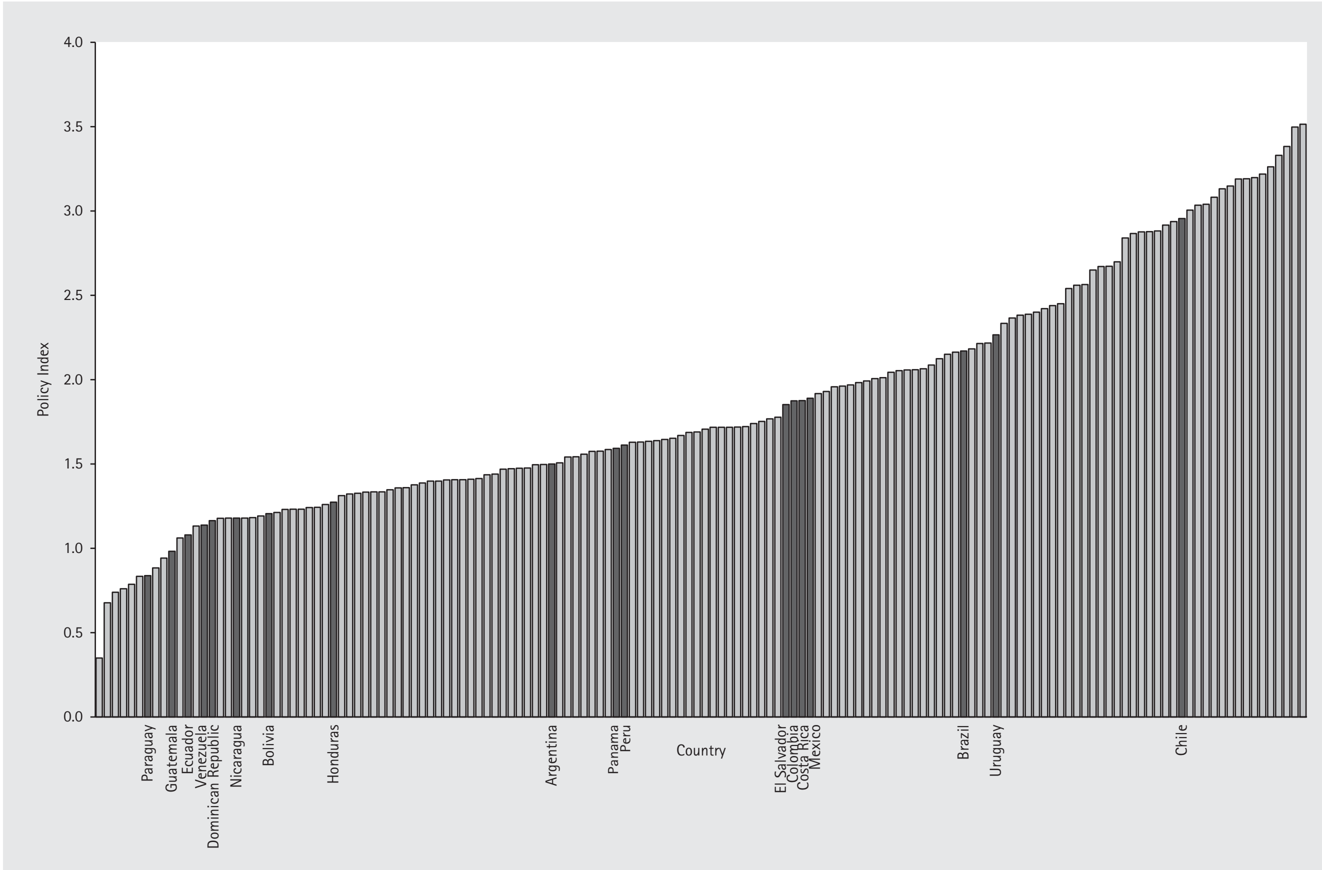

FIGURE 3.1 Policy Index across countries

Source: Author's calculation using data from Berkman et al. (2009).

- *Number of political players*. The larger the number of players, the smaller the set of other parameters for which cooperation is obtained. In a complex modern polity, the empirical counterpart of this abstract concept might relate to the capacity for aggregation of institutions such as the political party system, or of other structures of political participation of socioeconomic interests.
- *Intertemporal linkages among key actors*. The intertemporal pattern of interactions among specific individuals in formal political positions (such as legislators, governors, bureaucrats, and business or union leaders) matters for developing cooperative outcomes. It is not the same to have a legislature in which the same individuals interact over extended periods of time as to have a legislature where individuals change frequently. Cooperation is less likely in the latter.
- *Delegation*. Other than self-enforcement through repeated interaction, certain forms of cooperation could be achieved by alternative institutional means. Delegating policy to an independent bureaucracy is one such alternative. Similarly, societal actors such as business interests are more likely to enter the policymaking process in a non-particularistic and long-term way if they have invested in building more permanent structures of interaction with policymakers such as business associations and think tanks.
- *Availability of enforcement technologies*. As in transaction cost economics, intertemporal cooperation is easier to achieve if there is good third-party enforcement. The presence and characteristics of a potentially impartial umpire and enforcer of political agreements, such as an independent judiciary, will vary from country to country, providing variance in the degree of enforcement of intertemporal political cooperation.
- *Characteristics of the arenas where key political actors undertake their exchange*. The complex intertemporal exchanges required for the implementation of effective public policies could be facilitated by the existence of exchange arenas that are organized in ways that make cooperation easier to enforce. For example, it might be easier if transactions were part of legislative debate than if they were the outcome of closed backroom negotiations. Seminal work on the US Congress debates the role that different institutional arrangements have in facilitating legislative bargaining. While these studies suggest that most of the policy "action" takes place in institutionalized arenas such as Congress, the legislature certainly does not exhaust the possible locus of exchange among socioeconomic and political actors, especially in developing countries such as those of Latin America. Whether the legislature is the arena where these transactions take place is adequately institutionalized depends on several factors, including legislators' incentives and capabilities.

To sum up, political cooperation leading to effective public policies is more likely if: (1) the level of aggregation at which political actors enter the policy process is high; (2) those actors have long horizons and/or strong intertemporal linkages; (3) good delegation technologies are available; (4) good enforcement technologies (such as a strong court to arbitrate) are available; and (5) the key political exchanges take place in arenas where properties (1)–(4) tend to be satisfied.

What are the actual characteristics of political institutions and of the organization of actors that make political cooperation (and hence good public policies) more or less likely? The theoretical elements of the game listed above could be mapped to observable features of policymaking environments. For example, judicial independence seems to be a natural proxy—though not necessarily the only one—for the existence of enforcement technologies. Similarly, the quality of the civil service seems to approximate the existence of delegation mechanisms.[21]

We have shown elsewhere (Stein and Tommasi 2007 for Latin America; Scartascini, Stein, and Tommasi 2009 for a broad cross-section of countries) that proxies for these characteristics of institutions are highly significant for explaining the features of policies emphasized before. Below we describe some of these characteristics of institutions in the Latin American context.

3.3.3.1 *Congressional policymaking capabilities*

Congress is the democratic arena *par excellence* for the negotiation and enforcement of intertemporal policy agreements. Legislatures are critical to the functioning of democracy and act as an important arena for discussing and negotiating policy. A legislature made of up professional legislators (with technical capabilities for discussing and overseeing policies) and adequate organizational structures can facilitate the development of relatively consensual and consistent policies over time.

During the last decades, important contributions in political science have advanced the understanding of legislatures in Latin America.[22] Against the backdrop of earlier stylized views of the functioning of presidential systems in the region,[23] and by drawing on seminal studies of the US Congress, this new scholarship suggests that, while legislatures in Latin America in general may not be heavily involved in formulating and advocating policy change, they are nonetheless relevant to policy outcomes. Although it is true that in executive–legislative interactions legislatures are usually

[21] Interestingly, some of these concepts also embody qualities that are the result of the intertemporal equilibrium in which the polity happens to be at a given point in time. That is, having a highly skilled and professionalized civil service is by no means the result of a random drawing by nature or the result of a de jure institution imported from abroad. On the contrary, it is the result of years of investments in the capabilities of the civil service and self-restraint by a government that does not use the bureaucracy as a political instrument for patronage and clientelism. These behaviors are only possible in polities interested in long-run welfare, and they would seldom occur in polities where taking short-term advantage of political power is a higher priority.

[22] See Morgenstern and Nacif (2002) and references therein for details, especially the chapters by Morgenstern and Cox.

[23] That stylized view of political systems in the region, associated with the notion of *hyperpresidentialism*, emphasizes personalization of power, disdain for institutions, and confrontational political style. In that view, Latin America legislatures are no checks to presidential powers, and "delegative democracies" (O'Donnell 1994) are the norm. According to some views, when the president enjoys a governing majority, then the legislature is simply a rubber stamp to executive decisions and plays a subservient role; in contrast, in situations of divided or minority governments, the legislature solely plays an obstructionist role, which leads to impasse or deadlock. In our view, that is a mode of interaction that obtains *in equilibrium* in some countries, but not in others.

relegated to play a "reactive" role and presidents a more "proactive" one, the image of a recalcitrant assembly vis-à-vis an imperial president is by no means the only pattern of legislative politics in Latin America. Legislatures in some countries are in fact *active* in policymaking not only by performing the role of veto players blocking legislation proposed by the executive, but also by negotiating policy issues behind the scenes with the executive or in amending or reformulating executive legislative initiatives.

What factors affect whether legislatures play an active role in policymaking? Among other institutional features, *electoral rules* are key determinants of legislators' career prospects, and hence can contribute to or undermine investment in the development of legislature's policymaking capacities (Morgenstern and Nacif 2002). In other words, if legislators do not intend to remain in the legislature, they are unlikely to take an interest in institutionalizing the body so that it can develop a collective interest in policy and oversight responsibilities. In contrast to the US Congress, in which the "electoral connection" works in the direction of long legislative careers and a strong committee system, the rates of immediate re-election to the Congress in Latin America are low on average, although there is some important variation within the region (Saiegh 2010). In some countries, low re-election rates have conspired against the development of policymaking capacities of legislatures. In these countries, legislators typically have an incentive to work toward advancing a career outside the legislature (such as in national, state, or local government) and are also less experienced. Their career objectives are often furthered by satisfying (in some cases, provincial) party leaders rather than centering their attention on satisfying constituents' interests and demands (Coppedge 1997; Jones et al. 2002). As a result, the technical expertise and strength of committee systems in these legislatures tends to be lower than in countries with higher re-election rates (e.g. Chile or Uruguay).

Following these insights, IDB (2005) developed an index that attempts to capture the policymaking capabilities of Latin American legislatures with reference to some aspects of Congress as an organization, as well as to some characteristics of legislators. The index includes both objective and subjective variables, such as the strength and specialization of congressional committees, the confidence that the public has in Congress as an institution, the level of education and legislative experience of legislators, their technical expertise, and the extent to which Congress is a desirable career place for politicians (see Table 3.3).

Saiegh (2010) examines the robustness of such characterization when only the quantitative indicators are included, using multidimensional scaling (MDS) techniques. Comparing 18 Latin American legislatures to identify the main differences in their organizational structures, institutional features, and membership characteristics, Saiegh confirms that those legislatures with greater capabilities are the ones that play more constructive roles in the PMP, enabling intertemporal agreements and-long time horizon policies.[24]

[24] Some of these measures on legislative capabilities, capturing opinion about the effectiveness of lawmaking bodies and confidence in Parliament are available for a large sample of countries. Berkman et al. (2009) and Scartascini et al. (2009) show that these measures seem to be a good predictor of the policy features introduced in the previous section.

Table 3.3 Summary of some measures of legislature capabilities

Country	Confidence in Congress, average 1996–2004[a]	Effectiveness of lawmaking bodies[b]	Average experience of legislators (years)	% of legislators with university education[c]	Average no. of committee memberships per legislator	Strength of committees	Place to build career	Technical expertise	Congress Capability Index
Argentina	20.5	1.6	2.9	69.6	4.50	Medium	Low	Low	Low
Bolivia	19.9	1.8	3.3	78.4	1.66	Medium	Medium	Medium	Medium
Brazil	24.9	3.1	5.5	54.0	0.92	Medium	High	High	High
Chile	36.0	3.7	8.0	79.4	1.95	High	High	High	High
Colombia	20.3	2.7	4.0	91.6	0.86	High	High	Medium	High
Costa Rica	29.9	2.2	2.6	80.4	2.09	High	Medium	Low	Medium
Dominican Republic[d]	n.a.	2.0	3.1	49.6	3.54	Low	High	Low	Low
Ecuador	13.3	1.7	3.5	83.1	1.26	High	Medium	Low	Medium
El Salvador	27.7	2.1	3.9	64.0	2.44	Medium	High	Low	Medium
Guatemala	19.9	1.8	3.2	68.4	3.24	Low	Medium	Low	Low
Honduras	30.8	2.6	3.0	73.1	2.34	Low	Low	Low	Low
Mexico	27.4	2.0	1.9	89.5	2.43	High	Medium	Medium	Medium
Nicaragua	23.1	1.6	3.5	85.6	1.96	Low	Medium	Medium	Medium
Panama	22.5	1.8	5.8	81.3	1.86	Medium	High	Low	Medium
Paraguay	25.0	2.2	5.5	75.4	3.15	Low	High	Low	Medium
Peru	22.1	1.7	5.2	92.9	2.44	Low	Low	Low	Low
Uruguay	38.2	2.7	8.8	68.4	0.98	High	High	Low	High
Venezuela	27.8	1.4	4.9	74.6	0.97	Medium	Medium	Low	Medium

Note: [a] Latinobarometer; [b] World Economic Forum (2005). [c] PELA (2002);
[d] the Dominican Republic was included only in the 2004 survey; no average is shown.

Source: IDB (2005) (based on PELA, various years, and Saiegh 2010).

3.3.3.2 *Judicial independence*

The Judiciary, especially the Supreme Court or Constitutional Tribunal is a natural candidate for the enforcement of those political or policy agreements reflected in constitutions and laws. In its role as an independent referee, the judiciary can provide a "durability mechanism" that can increase the probability of reaching intertemporal agreements. A judiciary that effectively plays its role may contribute to better public policy outcomes, such as enhanced policy stability, and policy implementation and enforcement.

Magaldi de Sousa (2010) provides a typological framework for categorizing and comparatively assessing the scope of *judicial activism*, that is, the extent of courts' involvement in the PMP across Latin America. The extent to which the judiciary can veto new legislation, shape legislative content, enforce the implementation of existing rules as an impartial referee, and act as an alternative representative of society in the PMP defines the four main characteristics and roles discussed by the author. However, the extent of judicial activism is a function, among other things, of the level of judicial independence. Although judicial independence has various interrelated dimensions, a de facto independent judiciary is one that issues rulings that are respected and enforced by the legislative and executive branch; that receives an adequate appropriation of resources; and that is not compromised by political attempts to undermine its impartiality. Without institutions that guarantee budgetary autonomy, a uniform, transparent, and merit-based appointment system, stable tenure for judges, and promotion procedures based on evaluation of performance, Latin American courts simply would not be able to veto policies, shape their content, or act as a referee and a societal representative. To put it differently, judicial independence is a necessary (although not sufficient) condition for judicial activism.

Table 3.4 shows the relative rankings of judicial independence for selected Latin American countries in 1975 and 2005. Chile, Brazil, and Uruguay achieved considerable higher levels of judicial independence, while Venezuela and Argentina seem to have moved in the opposite direction.

The evidence presented by Magaldi de Souza supports the argument that courts are increasing their impact on the PMP in Latin America. Furthermore, while countries with broad judicial activism seem to present rather stable and adaptable public policies, the democracies with narrower levels of judicial activism show more volatility and rigidity in their policies. In line with this argument, Scartascini, Stein, and Tommasi (2009) show that a proxy of judicial independence, which captures whether the judiciary is subject to interference by the government or other political actors, correlates well with policy features such as stability, adaptability, coherence and coordination, implementation and enforcement in a large sample of countries.

3.3.3.3 *Civil service capacity*

A strong, independent, and professional bureaucracy seems the most natural vehicle for the flexible enforcement of political agreements via delegation. An effective and capable bureaucracy is likely to improve the quality of implementation of public policies, as well as their coordination across ministries. The competence and independence of the

Table 3.4 Relative judicial independence, selected Latin American and Caribbean countries, 1975 and 2005

Ranking	**1975**	**2005**[a]
1 More judicial independence	Costa Rica	Uruguay (15)
2	Venezuela	Costa Rica (1)
3	Colombia	Chile (16)
4	Argentina	Brazil (12)
5	Mexico	Dominican Republic (7)
6	El Salvador	Mexico (5)
7	Dominican Republic	El Salvador (6)
8	Peru	Colombia (3)
9	Panama	Guatemala (11)
10	Ecuador	Bolivia (14)
11	Guatemala	Honduras (13)
12	Brazil	Peru (8)
13	Honduras	Argentina (4)
14	Bolivia	Panama (9)
15	Uruguay	Paraguay (18)
16	Chile	Ecuador (10)
17	Nicaragua	Venezuela (2)
18 Less judicial independence	Paraguay	Nicaragua (17)

[a] 1975 rankings are in parentheses.

Source: Magaldi de Sousa (2010) (based on Verner 1984 and World Economic Forum 2005).

bureaucracy may decrease the susceptibility of likelihood that policy will be prone to politicization and political opportunism, and could increase policy adaptability to changing circumstances by relying on technical expertise.

Zuvanic and Iacoviello (2010) discuss some characteristics of Latin American bureaucracies, their role in the PMP, and their capacity to put into practice long-lasting agreements. Their characterization is based on a model where two dimensions—autonomy of political power and technical capacity—are considered. They group bureaucracies into four types: patronage, administrative, meritocratic, and parallel. On the basis of this typology, they present evidence that characterizes Chile, Brazil, and Costa Rica as cases that stand out in the region because of the higher level of development of their civil services. At the other extreme, the most critical situation occurs in Bolivia, Peru, Paraguay, Ecuador, and various Central American countries. Considering both dimensions simultaneously, Figure 3.2 groups Latin American countries according to their levels of bureaucratic development.[25]

[25] Scartascini et al. (2009) use cross country regressions to show that a similar proxy for the degree of professionalism of the bureaucracy has a significant positive effect on the overall quality of public policies.

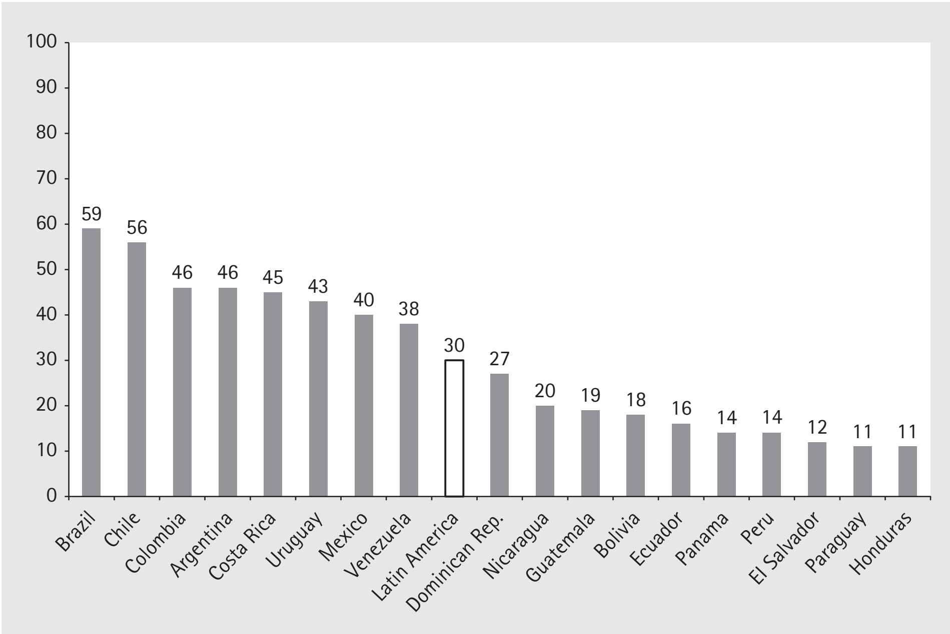

FIGURE 3.2 Civil Service Development Index

Source: Zuvanic and Iacoviello (2010).

3.3.3.4 *Party system characteristics*

Mainwaring and Scully (1995) introduced a central concept into the study of Latin American party systems: *party system institutionalization* (PSI).[26] An institutionalized party system is a natural aggregator that reduces the effective number of players at the bargaining table and increases the horizons of individual political actors. The structure and organization of political parties and party systems can have an important influence on the policymaking process, both by playing a direct role and through interactions with other institutions. Political parties can influence policy debates, affect executive–legislative relations, enhance or constrict the possibilities for coordination in Congress, or manage the incentives of politicians at both the national and local level. In sum, institutionalized party systems serve as facilitators of intertemporal policy compromise.

Several indicators have been developed to measure the different dimensions of PSI in Latin America. For example, the stability of inter-party competition is usually measured using the level of vote or seat volatility in different elections. Latin America presents a

[26] Party systems can be considered institutionalized when four conditions are present: the patterns of interparty competition are relatively stable; parties have fairly stable and deep bases of societal support; parties and elections are viewed as legitimate and as the sole instruments for determining who governs; and party organizations are characterized by stable rules and structures (Mainwaring and Scully 1995).