Development in Latin America

Conceptualizing Economic Change in the Region

Latin America contains cities of splendor... (Courtesy of David Mangurian and the Inter-American Development Bank.)
Latin Americans live in a complex economic system, simultaneously inhabiting the frontiers of finance and technology while also appearing hopelessly mired in a vicious circle of poverty. Consider the following stories.

Uruguayan-born financier Juan Navarro has become the buyout king of Latin America. From his modern, elegant offices in Buenos Aires, Argentina, Navarro has built his equity buyout company, Exxel Group, into one of the country’s largest privately owned holdings. Since 1993, Exxel has invested more than $4.8 billion in seventy-three companies. Identifying undervalued firms in emerging markets, particularly the Mercosur countries of Brazil, Paraguay, Uruguay, and Argentina, Navarro convinced global investors such as GE, Travelers Insurance, Brown and Princeton Universities, Bankers Trust, and General Motors to invest in supermarkets, the privatization of postal services and duty free shops, a MasterCard franchise, and a music and electronics chain. With plans to expand these companies throughout the region, Navarro is taking on global giants such as the United States’s Wal-Mart and France’s Carrefour. Recent macro instability in Argentina, however, has rocked the company. Bankruptcy and loan defaults are plaguing Navarro.1 But for this aggressive Latin businessman, beating the odds, and transforming underperforming companies into success stories, has become part of his game.2

Brazilian soccer superstar Ronaldo has reached the apex of soccer fame, becoming one of the highest-paid players in soccer history. After battling knee injuries for two and a half years, his remarkable comeback led Brazil to win its fifth World Cup title. A striker for the Spanish team Real Madrid, he has signed deals with Nike and the

... and pockets of poverty. (Courtesy of David Mangurian and the Inter-American Development Bank.)
Italian milk company Parmalat, as well as Brazil’s number-one beer maker, Brahma. Born in a poor *favela* or slum, in Rio de Janeiro, Ronaldo had to quit soccer as a young boy because he didn’t have the bus fare. Sixteen of Ronaldo’s relatives live at the home where he grew up sleeping on the sofa with his older brother. The home is simply furnished—no telephone but a freezer and a television. Ronaldo is currently involved with a program in Brazil that takes poor kids out of the *favelas* and puts them in soccer camps to ensure that others have a chance for a future.3

Jessy Contreras, a cosmetology student, has long dreamed of logging onto the Internet to study the latest Parisian trends. But saving enough money for a computer and access in a poor country like Peru, where average income is less than $300 per month and few have private phone lines, seemed too far a stretch. Fortunately, Peruvians are signing on in droves through the Peruvian Scientific Fund, a network begun with $7,000 in seed money from the UN Development Fund and other cooperative arrangements with universities, hospitals, and nongovernmental organizations. Manuel Molla Madueno, a psychologist making somewhere in the range of $400–$500 a month, is able to access international journals and participate in bulletin boards. Local teachers are able to monitor Spanish culture from around the world. Unfortunately, expansion is limited by the slowness of Telefonica, the telephone company, in installing telephone circuits.4

Judith Yanira Viera, from El Salvador, is eighteen years old. For over a year she worked in the Taiwanese-owned Mandarin International *maquiladora* factory in the San Marcos Free Trade Zone where she made shirts for the Gap, Eddie Bauer, and...
JCPenney. From Monday to Thursday her shift went from seven in the morning until nine at night. On Fridays she would work straight through the night, starting at 7 A.M. and working until 4 A.M. She and her coworkers would sleep overnight on the factory floor. The following day, they would work from 7 A.M. until 5 P.M. Despite these very long hours, the most she ever earned was 750 colones, about $43 per month.5

Blasio and Claire Lehman struggle with the help of their two teenage sons to make approximately $900 a year as tobacco farmers in Brazil. With a simple home on a small piece of land, their dream when they married twenty-two years ago was a future in tobacco. But competition in the global tobacco market has soured their dream. Small farmers are forced, in a feudal-like arrangement, to take bank loans to buy kits comprised of seeds, pesticides, herbicides, fertilizers, a plastic sheet to cover the soil, and protective gear for applying chemicals. When purchasing the kits they must pledge to sell their harvest to the companies that sold them. Fifteen percent of the payment for the first harvest is withheld to ensure complete delivery. If growers try to hold back crops because they disagree with the companies’ valuation of the product, police assist the companies in seizing the crops. Illiteracy prevents farmers from mobilizing. Some farmers work in the tobacco processing plants to supplement crop income. The Lehmans’ son Ismail has offered to quit school to make his family’s ends meet—to save the $35 a month in bus fare. His future would brighten if the family could switch to another crop—but that would take money for start-up costs. Too bad that the fiscal incentives provided to the big tobacco companies—including Philip Morris—couldn’t find their way into more affordable transportation.6

Economically, Latin Americans range from the very wealthy Juan Navarro to the desperately poor Judith Yanira Viera. Resources available to create working lives may be the tobacco plant or the complex strands of the Internet. International markets—for clothing, fruit, or sports—may propel some to relative affluence, but there are always the masses left behind in Ronaldo’s favela. Economic life in Latin America is multilayered, from traditional rural life to dirty assembly factories to ultramodern skyscrapers in cosmopolitan cities. Latin American economic development is a puzzle. This text invites you to make some sense of this complex problem. Questions that we will explore in trying to unravel this puzzle include the following:

- How do so many fragments of different levels of economic life join to form a coherent whole?
- With a far wider income range than industrial countries, with available technologies running from a simple shovel to a sophisticated financial machine, what kind of macroeconomic policies can address the complex microeconomic structure of Latin America?
- How does this multilayered economy interface with the world market?
- How have the pressures of globalization and the international market transformed the varied lives of Latin Americans?

As an introduction to the puzzle of Latin American economic development, this book attempts to clarify the complexity of economic life in Latin America. We will
try to understand the potential that Juan Navarro has been able to tap, as well as the constraints keeping many farmers and factory workers in poverty.

**A Conceptual Map:**
What Is Economic Development?

To understand the multilayered economic home of Jessy Contreras and Juan Navarro, we first need to contextualize it within a theory of economic development. The objectives of this chapter are to explore briefly the meaning of development and to highlight selected characteristics of economic policy and performance in Latin America. In an ideal world, readers of this text would have taken courses in economic development, international trade, and international finance before embarking on a study of Latin American economics. However, many students come to understand the economic importance of Latin America late in their academic careers and simply don’t have the time (or may even lack the interest) to backtrack through this important theoretical framework. The economic component may be only a small part of your broader interest in the region. For you, this section raises some of the questions that would be grappled with over a longer period of time in a course on development theory. Students with a background in development theory are invited to draw on that broader conceptual framework and apply it to the case of Latin America to answer a fundamental question of this book: How can we understand the process of economic development in the Latin American region? How can we reconcile the different lives of Ronaldo and Juan Navarro within a single economic system?

**Characteristics of Development**

What characteristics do we normally associate with developed and less-developed countries? Try ranking the United States, Mexico, Brazil, Ecuador, Canada, and France on the following measures:

- Which countries have the highest rates of urbanization?
- Which countries have the highest per capita rates of **growth**?
- Which countries have the highest weight of international trade in the economy as measured by net exports and gross domestic product (GDP)?
- Which countries have the highest per capita carbon dioxide emissions?
Clean, potable water is a step forward for the community—but its collection is part of the double duty of work that women perform in the developing world.

(Courtesy of the Inter-American Development Bank.)
The answers might surprise you. In Brazil, 81 percent of the population live in urban areas; this is followed by 77 percent in both Canada and the United States, 75 percent in France, 74 percent in Mexico, and 64 percent in Ecuador. Average growth of per capita GDP from 1965 to 1999 ranged from 1.5 percent in Mexico and 1.9 percent in Canada and Ecuador to 2.0 percent in the United States, 2.1 percent in France, and 2.4 percent in Brazil. Trade plays the greatest role in Canada at 84 percent of GDP in 1999, followed by Ecuador and Mexico at 63 percent, France at 50 percent, the United States at 24 percent, and Brazil at 22 percent. The United States has the dubious honor of leading the list of per capita carbon dioxide emissions at 20.1 metric tons in 1997, followed by Canada at 16.6, France at 6.0, Mexico at 4.0, Ecuador at 1.8, and Brazil at 1.9.

This short exercise raises a few questions. What do we mean by a developed (versus an underdeveloped) country? Are countries neatly classifiable? What is the diversity of economic experience within Latin America itself? How can we begin to think about a development strategy with relatively divergent conditions? You might want to open the most recent World Development Report or log onto the World Bank homepage at www.worldbank.org to look at some of the other data within the Latin America region and comparisons between Latin America and the rest of the world. Tables 1.1 and 1.2 summarize some of these statistics. You may be surprised at the diversity you find.

### Table 1.1. Quality of Life Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Child Malnutrition (% of children under age five)</th>
<th>Under Age of Five Mortality Rate per 1,000</th>
<th>Female Life Expectancy at Birth</th>
<th>Access to Improved Sanitation (% of urban population 2000)</th>
<th>Household Consumption Spending (% growth 1990–1999)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>2</td>
<td>22</td>
<td>77</td>
<td>89</td>
<td>3.3</td>
</tr>
<tr>
<td>Bolivia</td>
<td>8</td>
<td>83</td>
<td>64</td>
<td>82</td>
<td>3.6</td>
</tr>
<tr>
<td>Brazil</td>
<td>6</td>
<td>40</td>
<td>71</td>
<td>85</td>
<td>1.6</td>
</tr>
<tr>
<td>Chile</td>
<td>1</td>
<td>12</td>
<td>79</td>
<td>98</td>
<td>7.3</td>
</tr>
<tr>
<td>Colombia</td>
<td>8</td>
<td>28</td>
<td>74</td>
<td>97</td>
<td>3.0</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>5</td>
<td>14</td>
<td>79</td>
<td>98</td>
<td>5.0</td>
</tr>
<tr>
<td>Ecuador</td>
<td>—</td>
<td>35</td>
<td>71</td>
<td>70</td>
<td>1.6</td>
</tr>
<tr>
<td>El Salvador</td>
<td>12</td>
<td>36</td>
<td>72</td>
<td>88</td>
<td>5.5</td>
</tr>
<tr>
<td>Guatemala</td>
<td>24</td>
<td>52</td>
<td>68</td>
<td>98</td>
<td>4.3</td>
</tr>
<tr>
<td>Honduras</td>
<td>25</td>
<td>46</td>
<td>72</td>
<td>94</td>
<td>3.1</td>
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<tr>
<td>Mexico</td>
<td>8</td>
<td>36</td>
<td>75</td>
<td>87</td>
<td>1.9</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>12</td>
<td>43</td>
<td>71</td>
<td>96</td>
<td>5.1</td>
</tr>
<tr>
<td>Panama</td>
<td>—</td>
<td>25</td>
<td>76</td>
<td>99</td>
<td>4.9</td>
</tr>
<tr>
<td>Paraguay</td>
<td>—</td>
<td>27</td>
<td>72</td>
<td>95</td>
<td>4.0</td>
</tr>
<tr>
<td>Peru</td>
<td>8</td>
<td>48</td>
<td>71</td>
<td>90</td>
<td>4.2</td>
</tr>
<tr>
<td>Venezuela</td>
<td>8</td>
<td>23</td>
<td>76</td>
<td>75</td>
<td>0.4</td>
</tr>
<tr>
<td>United States</td>
<td>1</td>
<td>8</td>
<td>80</td>
<td>100</td>
<td>3.2</td>
</tr>
</tbody>
</table>

Lack of access to adequate housing leaves millions in misery. (Courtesy of David Mangurian and the Inter-American Development Bank.)
In table 1.1, we can see that although some countries in Latin America exhibit poor performance on indicators of child malnutrition and child mortality, others perform extremely well. Honduras and Guatemala, for example, are the worst performers, with nearly one in four children malnourished, but in Chile only 1 percent of children suffer from hunger. Similarly, Bolivia, Guatemala, and Peru demonstrate tragic rates of infant mortality, whereas Chile, Costa Rica, and Argentina demonstrate strong records. In Ecuador and Venezuela, only 70 and 75 percent of the population have access to improved sanitation facilities. Guatemala, Nicaragua, Colombia, Panama, Paraguay, Costa Rica, and Chile all have rates higher than 95 percent. Throughout the region the growth of private consumption has been uneven, with slow rates in many countries reflecting small changes in the material well-being of the population. As we will see in this text, the long, hard road of economic adjustment to the debt shocks and the tough macroeconomic stabilization packages of the 1980s and the currency shocks of the 1990s have left many Latin Americans with little more in their homes than they had when they were children.

Table 1.2 gives a few measures of what you might expect to find in homes in the

### Table 1.2. Communications Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Television Sets (per 1,000 people)</th>
<th>Daily Newspapers (per 1,000 people)</th>
<th>Telephone Main Lines (per 1,000 people)</th>
<th>Mobile Phones (per 1,000 people)</th>
<th>Personal Computers (per 1,000 people)</th>
<th>Internet Hosts (per 1,000 people)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>293</td>
<td>123</td>
<td>201</td>
<td>121</td>
<td>49.2</td>
<td>47.34</td>
</tr>
<tr>
<td>Bolivia</td>
<td>118</td>
<td>55</td>
<td>62</td>
<td>52</td>
<td>12.3</td>
<td>1.73</td>
</tr>
<tr>
<td>Brazil</td>
<td>333</td>
<td>40</td>
<td>149</td>
<td>89</td>
<td>36.3</td>
<td>38.97</td>
</tr>
<tr>
<td>Chile</td>
<td>240</td>
<td>98</td>
<td>207</td>
<td>151</td>
<td>66.6</td>
<td>33.78</td>
</tr>
<tr>
<td>Colombia</td>
<td>199</td>
<td>46</td>
<td>160</td>
<td>75</td>
<td>33.7</td>
<td>10.15</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>229</td>
<td>94</td>
<td>204</td>
<td>35</td>
<td>101.7</td>
<td>24.33</td>
</tr>
<tr>
<td>Ecuador</td>
<td>205</td>
<td>70</td>
<td>91</td>
<td>31</td>
<td>20.1</td>
<td>1.67</td>
</tr>
<tr>
<td>El Salvador</td>
<td>191</td>
<td>48</td>
<td>76</td>
<td>62</td>
<td>16.2</td>
<td>1.62</td>
</tr>
<tr>
<td>Guatemala</td>
<td>61</td>
<td>33</td>
<td>55</td>
<td>30</td>
<td>9.9</td>
<td>2.54</td>
</tr>
<tr>
<td>Honduras</td>
<td>95</td>
<td>55</td>
<td>44</td>
<td>12</td>
<td>9.5</td>
<td>0.19</td>
</tr>
<tr>
<td>Mexico</td>
<td>267</td>
<td>97</td>
<td>112</td>
<td>79</td>
<td>44.2</td>
<td>50.60</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>69</td>
<td>30</td>
<td>30</td>
<td>9</td>
<td>8.1</td>
<td>2.18</td>
</tr>
<tr>
<td>Panama</td>
<td>192</td>
<td>62</td>
<td>164</td>
<td>86</td>
<td>32.0</td>
<td>10.21</td>
</tr>
<tr>
<td>Paraguay</td>
<td>205</td>
<td>43</td>
<td>55</td>
<td>196</td>
<td>11.2</td>
<td>2.66</td>
</tr>
<tr>
<td>Peru</td>
<td>147</td>
<td>0</td>
<td>67</td>
<td>40</td>
<td>35.7</td>
<td>3.88</td>
</tr>
<tr>
<td>Venezuela</td>
<td>185</td>
<td>206</td>
<td>109</td>
<td>143</td>
<td>42.2</td>
<td>6.48</td>
</tr>
<tr>
<td>Latin American</td>
<td>272</td>
<td>71</td>
<td>130</td>
<td>82</td>
<td>37.7</td>
<td>29.62</td>
</tr>
<tr>
<td>Average</td>
<td>252</td>
<td>82</td>
<td>92</td>
<td>42</td>
<td>17.0</td>
<td>3.98</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td></td>
<td>715</td>
<td>655</td>
<td>226</td>
<td>360.8</td>
<td>590.37</td>
</tr>
<tr>
<td>Canada</td>
<td>844</td>
<td>215</td>
<td>664</td>
<td>312</td>
<td>510.5</td>
<td>2,419.86</td>
</tr>
</tbody>
</table>

Americas. There are about thirteen times as many TVs in the United States (per 1,000 people) as there are in Guatemala and about twenty-five times as many mobile phones in Canada as in Nicaragua. Chileans have access to about twice as many computers per person as do Colombians, and Mexicans lead Latin America with the most Internet hosts per person. Of course we want to be careful with these data; cross-country data are always difficult to collect, especially when you are estimating houses with access to sanitation or computers. Furthermore, we don’t want to suggest that televisions or mobile phones are the bellwethers of what it means to be developed. We need to be aware of data difficulties even as we develop more sophisticated measures to evaluate progress and poverty in the region in later chapters.

What Do We Mean by Development?

When we think about the challenges of development and underdevelopment in Latin America, what do we really mean? Are mobiles and toilets the goal of development? How does “promoting development” translate into something concrete for the policy-maker to target? U.S. president Harry S. Truman, in his inauguration speech in January 1949, envisioned a bold new program, based on “the concepts of democratic fair-dealing,” to make the “benefits of our scientific and industrial progress available for the improvement and growth of underdeveloped areas.” Although the word “underdeveloped” had been introduced in 1942 by Wilfred Benson, a member of the secretariat of the International Labor Organization, development economists such as Paul Rosenstein-Rodan spoke of “economically backward areas,” and Arthur Lewis characterized the emerging challenge as the gap between rich and poor countries throughout the 1940s. Truman popularized the term “underdevelopment” but did not clearly define it. Since Truman, the goal of development has been to undo the hardships of underdevelopment—without a clear statement of the positive objective.

What does it mean to be developed? With the advent of the Cold War, the world was divided into industrial market economies, the communist or “second” world, and finally the rest of the globe or the “third” world. These nations were once again the residual—what was left over when the rest of the counting was done. Since the collapse of the Berlin Wall, the second world has euphemistically been referred to as “transitional economies.” What exactly are they transitioning toward? What is a usable definition of the goal of “development”?

In common language, development describes a process in which the potential of an organism is released to achieve its mature form. Dictionary definitions point to growth or expansion to bring about a more advanced state. When we think of the development of a tree or an animal, we have a clear idea of the appearance of the mature, advanced form. In economics we find ourselves in a bit of trouble. We can measure degrees of industrialization or access to a wider array of consumer products, but things become murky when we try to associate the terms “modern,” “mature,”
and “developed” with societies having well-articulated economic infrastructures. Given the long list of ills associated with modern society, we should be clear in our understanding that more sophisticated production techniques and a wider range of electronic toys do not necessarily imply a better or happier society. In addition, we don’t know which members of society have access to the gains of economic growth. More industrialization—particularly with the associated environmental costs—does not necessarily mean an increase in the well-being of citizens.

How then should we think about development? Is a developed country simply the opposite of a poor country? Is a developing country a rich country in the making? Box 1.1 presents the thoughts of development economists and practitioners on defining the term. Generally, they find it easier to agree on what constitutes the alleviation of poverty and meeting the basic needs of a population than on what represents the achievement of wealth or the satisfaction of material wants. This text looks at development as a process of meeting the basic human needs of the population and enhancing options for the allocation of economic resources both today and in the future to increase the choices citizens have in their daily lives. It pays particular attention to how much is produced and for whom, and it addresses the environmental sustainability of production for future generations.

**Growth versus Development**

From the definitions in box 1.1, we can see that most economists agree: development is far more than economic growth. It is useful, however, to clarify the difference between the two terms. Joseph Schumpeter distinguishes growth as a process of gradual change, with all quantities, such as wealth, savings, and population, increasing slowly and continuously; development is characterized as rapidly propelled by innovations. Robert Lucas defines growth as the increase of income proportional to the increase of population, and development as the process whereby income increases more rapidly than population. In other words, growth does not presuppose technical change; development does. For both Schumpeter and Lucas—economists of very different dispositions—development centrally engages the question of how **technological change** takes place in an economy. A key element in development is the management of technological change or how technology is used to transform the economic structure. This of course presupposes that technology is in scarce supply and its use has a price. In this sense, policy matters very much. Economic development is not simply driven by factor endowments or the quantity of resources but by how land, labor, and capital are combined in new ways to increase productivity and the choices available to a population.

New technologies require new ways of doing things. The leap from feudalism to early capitalism was propelled by technological changes—the introduction of the horse and plow as well as the three-field crop rotation system—that made an agri-
Box 1.1. Development, Underdevelopment, and Growth: An Evolution of Definitions

WEBSTER’S DICTIONARY
“The act, process, or result of developing; the state of being developed; a gradual unfolding by which something is developed, a gradual advance or growth through progressive changes.”

W. ARTHUR LEWIS (1954)
“The central fact of economic development is rapid capital accumulation, including knowledge and skills with capital.”

CELSO FURTADO (1964)
“Economic development, being fundamentally a process of incorporating and diffusing new techniques, implies changes of a structural nature in both the systems of production and distribution of income. The way in which these changes take place depends, to a large extent, on the degree of flexibility of the institutional framework within which the economy operates.”

P. BAUER AND B. YAMEY (1967)
“The widening of the range of alternatives open to people as consumers and producers.”

B. HIGGINS (1968)
“A discernible rise in total and in per capita income, widely diffused throughout occupational and income groups, continuing for at least two generations and becoming cumulative.”

THEOTONIO DOS SANTOS (1968)
“Development means advancement towards a certain well-defined general objective which corresponds to the specific condition of man and society or can be found in the most advanced societies of the modern world. The model is variously known as modern society, mass society and so on.”

DENIS GOULET (1971)
“Underdevelopment is shocking: the squalor, disease, unnecessary deaths, and hopelessness of it all! No man understands if underdevelopment remains for him a mere statistic reflecting low income, poor housing, premature mortality, or underdevelopment. The most empathetic observer can speak objectively about underdevelopment only after undergoing, personally or vicariously, the ‘shock of underdevelopment.”

CHARLES K. WILBER (1973)
“Development itself is simply a means to the human ascent.”

DUDLEY SEERS (1972)
“The questions to ask about a country’s development are therefore: what has been happening to poverty? What has been happening to unemployment? What has been hap-
pening to inequality? If all three of these have declined from high levels, then beyond
doubt this has been a period of development for the country concerned.”17

SIMON KUZNETS (1973)

“A country’s economic growth may be defined as a long-term rise in capacity to supply
increasingly diverse economic goods to its population, this growing capacity based on
advancing technology and the institutional and ideological adjustments that it demands.”18

JAMES J. LAMB (1973)

“If there is to be a possibility of choosing a human path so that all human beings may
become the active subjects of their own history, it must begin at the level of new analysis.
Development should be a struggle to create criteria, goals, and means for self-liberation
from misery, inequity, and dependency in all forms. Crucially, it should be the process a
people choose which heals them from historical trauma, and enables them to achieve a
newness on their own terms.”19

PAUL STREETEN (1979)

“A basic-needs approach to development starts with the objective of providing the oppor-
tunities for the full physical, mental, and social development of the human personality
and then derives ways of achieving this objective.”20

PETER J.A. HENRIOT (1981)

“‘Underdevelopment’ is seen as the flip side of the coin of ‘development.’ It refers to the
process whereby a country, characterized by subsistence agriculture and domestic pro-
duction, progressively becomes integrated as a dependency into the world market
through patterns of trade and/or investment.”21

ORTHODOX PARADIGM (1980s)

“The view of the historical process contained in the orthodox paradigm is clear from this
characterization: it is one in which developing societies move toward ever greater avail-
ability of goods and services for their citizens.”22

WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT (1987)

“Humanity has the ability to make development sustainable—to ensure that it meets the
needs of the present without compromising the ability of future generations to meet their
own needs. . . . sustainable development is not a fixed state of harmony, but rather a
process of change in which the exploitation of resources, the directions of investment, the
orientation of technological development, and institutional change are made consistent
with future as well as present needs.”23

GERALD M. MEIER (1995)

“Although requiring careful interpretation, perhaps the definition that would now gain
widest approval is one that defines economic development as the process whereby the
real per capita income of a country increases over a long period of time—subject to the
stipulations that the number of people below an ‘absolute poverty line’ does not increase,
and that the distribution of income does not become more unequal.”24

(continued)
cultural surplus possible. But like the transition into early capitalism, the contemporary process can be politically and socially tumultuous. Development policy can be viewed as the implementation of economic tools when political and social structures as well as economic institutions are rapidly changing. In contrast to the thrust of standard economic theory, where in principle we begin with the *ceteris paribus* condition, or "all else held constant," development policy is harder to carry out consistently due to simultaneous changes in a number of arenas. An economic policymaker in an industrialized country may be able to rely on a bit of automatic pilot under stable conditions; in the developing world, navigation is far more demanding with a variety of new challenges at each turn.

This text chronicles the development journey of Latin America. We begin by trying to understand the attempts of Latin American policymakers to promote growth and development in the region. Chapter 2 focuses on the engine of trade and Latin America’s export performance in the late colonial and early independence periods. Chapter 3 looks at a growth strategy widely adopted in the region from roughly the 1950s through the 1980s: import substitution industrialization (ISI). We can see, in both cases, that the strategy centered largely on the problem of growth and made less progress in the arena of social and environmental change. In chapters 4 and 5 we discuss two unintended results of the development strategies adopted: high rates of inflation and increased vulnerability to macroeconomic shocks. The policy response to economic disequilibrium was to step back and rely more on markets and less on state intervention in the economy. Chapter 6 takes up this changed role of the state under the neoliberal model; chapters 7 and 8 look at its implications for international capital flows and trade. How industry and agriculture have fared under a more open, internationalized economic model is taken up in chapters 9 and 10. Although policies that transformed the structure of Latin American economies from closed to open markets have been largely successful in macroeconomic terms, the rest of our book explores some of the deficits in human and social development hindering sustainable growth.

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**AMARTYA SEN (1998)**

“It is not hard to see why the concept of development is so essential in general. Economic problems do, of course, involve logistics issues, and a lot of it is undoubtedly ‘engineering’ of one kind or another. On the other hand, the success of all this has to be judged ultimately in terms of what it does to lives of human beings. The enhancement of living conditions must clearly be an essential—if not the essential—object of the entire economic exercise and that enhancement is an integral part of the concept of development.”

**JOSEPH E. STIGLITZ (1998)**

“It used to be that development was seen as simply increasing GDP. Today we have a broader set of objectives, including democratic development, egalitarian development, sustainable development, and higher living standards.”

(continued)
Basic Human Needs versus Growth as Measures of Development

In addition to thinking about how economies change, we must raise the question of welfare and growth: who benefits from new economic opportunities? Technological change—new combinations of capital and labor to produce a surplus—does not address the general well-being of society. Does the process of economic development help the rich or the poor? A modest goal of development might be for a developed nation to meet the basic human needs of its population. Paul Streeten defines enhancing basic human needs as improving income earning opportunities for the poor, reforming public services that reach the poor, augmenting the flow of goods and services to meet the needs of all members of the household, and increasing the participation of the poor in the policy-making arena. Streeten goes on to suggest why growth itself is not a good measure of economic development. Rather than generating the predicted theoretical results that growth would trickle down to the poor or that governments would extend benefits through progressive taxation or social services, Streeten argues that growth has been accompanied by increasing dualism. That is, when countries grow as measured by annual GDP growth rates, the rich often become richer and the poor more destitute in the process of change. We see the expansion of the modern, capitalist sector alongside a traditional, backward sector—two distinctly different worlds growing side by side. Dualism—the simultaneous existence of modern and traditional economies—complicates the policymaker’s task. More important, if an economy magnetized by growth neglects the plight of the poor, people without assets are marginalized by the growth process and made even worse off. Those without land, capital, or education, like the poor peasant in feudal times who lost access to the agricultural commons, can be pushed into the margins of society. Without access to resources, the poor can become poorer. Their attempts to scrape together a subsistence existence often pressure the environment as desperation drives people to use up land or forests or dump open sewage or waste today without thought of tomorrow—for tomorrow holds little promise when they struggle with hunger or sickness.

For development economists such as Todaro, growth must be accompanied by a change in the economic and social rules of the game. Todaro defines development, in addition to raising people’s living levels, as “creating conditions conducive to the growth of people’s self-esteem through the establishment of social, political, and economic systems and institutions that promote human dignity and respect and increasing people’s freedom by enlarging the range of their choice variables.” But this is a difficult task. As we will see in chapters 11–13, the social deficit in Latin America must be addressed to promote an equitable and sustainable development policy. As we investigate poverty in chapter 11, we will analyze ways of measuring human development including the **HDI** (human development index), which is a composite index comprising three indicators: life expectancy (representing a long and healthy life), educational attainment (representing knowledge), and real, inflation-adjusted GDP (representing a decent standard of living). Poverty and the associated social challenges of promoting education and health are discussed in chapters 12 and 13.
The United Nations, in its *Human Development Report*, suggests that a human development paradigm incorporates four elements—productivity, *equity*, sustainability, and **empowerment**. People must be enabled to increase their own productivity and participate as fully in the economy as their own talents allow. Gender barriers to achievement must be confronted. Economic growth is therefore a subset of human development models. To encourage fair outcomes, people must have access to equal opportunities. Economic and environmental sustainability is enhanced when all forms of capital—physical, human, and environmental—are replenished to promote access to opportunity, which must be for future generations as well as the present. Finally, development must be by people, not for them. People must participate fully in the decisions and processes that shape their lives for the benefits of genuine development.

**Is There a Development Theory?**

If the goal is to imitate industrial countries, is the road to a modern economy well marked by stages? Or are there different pathways to modernization? If countries are to progress economically and improve the quality of life for their inhabitants, what is the best way to do it? Is there a theory of economic development that is distinct from the economic theory we apply to our understanding of industrially advanced countries?

These are questions that economists have been grappling with for centuries. Adam Smith in *The Wealth of Nations* puzzled over how nations can best mobilize resources to produce the greatest wealth for their citizens. Box 1.2 highlights some of the conceptual guides that pioneers of development theory have offered in response to these questions. In contemporary times economists have struggled with the problem of understanding why some countries grow and others do not. This text does not assume that countries undergoing rapid economic change will necessarily follow the same pathway to achieve improvements in the quality of life. There may be different strategies to achieve the goal of raising the well-being of their citizens. The new global context for growth that Latin American economies face as we begin the twenty-first century requires a different set of policies from the ones used by the United States and Europe during the Industrial Revolution. A country’s place in the region, its size, and its natural endowments may also condition its development strategy. Development theory and practice are dynamic, evolving over time.

If development is more than growth, development theory must explain not only how nations grow but also how their economic structures adapt to meet new challenges over time. If the modest goal is to meet basic needs, is growth in the developing world different from growth in industrialized countries? Are poor countries intrinsically different from rich ones? How? What are some of the defining characteristics? Can the same combination of economic tools be used to address the problems confronted by policymakers in less-industrialized as compared to more-industrialized countries? Should it be? Before we answer these questions, it will be useful to compare statistics of a Central American nation, Mexico, with those of the United States and a European nation, Spain, as a way of thinking about economic contrasts.
Box 1.2. Pioneers in Economic Development

WALT W. ROSTOW (NEW YORK CITY 1916–)

Walt W. Rostow, an American economic historian, is known for his theory of the stages of economic growth. For Rostow, development was a linear process that began with traditional society, which then moved into the stage of “preconditions for take-off into self-sustaining growth.” The economy would then “take off,” follow “the road to maturity,” and finally hit “the age of high mass consumption.” Rostow believed that the “takeoff” would be caused by an increase in investment, leading manufacturing sectors, and the existence of an institutional framework consistent with expansion.

PAUL ROSENSTEIN-RODAN (AUSTRIA-HUNGARY 1902–1985)

Development economist Paul Rosenstein-Rodan advanced the concept of balanced growth. He believed that in order to achieve sustained growth, an economy must develop various industries simultaneously, requiring a coordination of investment or a “big push.” He was one of the first economists to emphasize market failure and the need for state intervention.

RAGNAR NURSKE (ESTONIA 1907–1959)

Ragnar Nurske, like Rosenstein-Rodan, advocated balanced growth and further elaborated upon his colleague’s work. For Nurske, small market economies were victims of a vicious cycle hindering growth. The small size of the market was responsible for the limited amount of production and income, and for the perpetual poverty and stagnation. To break the cycle, an economy needed a “big push” coordinated by a government properly allocating domestic and foreign resources.

ALBERT OTTO HIRSCHMAN (GERMANY 1915–)

Economist Albert O. Hirschman provided a contrary thesis: the idea of unbalanced growth as the principal strategy for development. Building on the concept of development as a state of disequilibrium, Hirschman identified and attacked bottlenecks to growth. Like Nurske and Rosenstein-Rodan, he called for government intervention to achieve sustained growth. Yet Hirschman believed that decision making and entrepreneurial skills were scarce in underdeveloped economies. Governments should therefore concentrate this scarce resource in a few sectors rather than on the entire economy. Planners and policymakers would need to use “forward and backward linkages” between industries to attack the bottlenecks within an economy.

W. ARTHUR LEWIS (WEST INDIES 1915–1991)

W. Arthur Lewis, a Nobel Prize winner in economics in 1979, formulated a model in the 1950s known as “economic development with unlimited supplies of labor.” Lewis’s structure of the economy has a dualistic nature, with divisions into the subsistence sector and the capitalist sector. According to Lewis, underdeveloped economies are characterized by a large subsistence sector with surplus labor and a small capitalist sector, which contributes directly to a low savings rate. Economic growth occurs when there is an increase in the savings rate, which is made possible only when the capitalist sector expands and absorbs the surplus labor from the agricultural sector.

(continued)
RAÚL PREBISCH (ARGENTINA 1901–1986)

Raúl Prebisch was an Argentine economist and former chairman of the UN Economic Commission for Latin America (ECLA). Prebisch is well known for the “Prebisch–Singer thesis,” which claims that the export of primary products prevalent in developing countries results in a decline of terms of trade—the price of exports compared to the price of imports. There are two important implications of the thesis: first, that a decline in terms of trade results in the transfer of income from the periphery (the developing countries) to the center (the developed countries), and second, the periphery then needs to export more and more to be able to import the same quantities as before. Prebisch’s pessimism on terms of trade was used to support import substitution industrialization policies in Latin America.

PAUL ALEXANDER BARAN (UKRAINE 1910–1964)

Paul Baran is known for his neo-Marxist view of development and for his contributions to the dependency school of thought. Although not completely agreeing with Marx, Baran used Marxist principles to locate the causes of underdevelopment. Countries suffer from low per capita income because the ruling classes fail to use productively the surplus extracted from peasants and wage laborers. Instead, they hold monopoly power over production and the political system. To break this monopoly power and achieve growth, a revolution must take place to replace the dominant class with one committed to social and economic development.

GUSTAV RANIS (GERMANY 1929– ) AND JOHN FEI (1923–1996)

Gustav Ranis’s early work focused on the economic development of Japan in the post-Meiji period and used it as a successful case of transition to modern growth. From there he began to focus on balanced growth and teamed up with another economist, John Fei, to further develop concepts used by Rostow and Lewis. For both Ranis and Fei, the process of “takeoff,” as introduced by Rostow, would occur when the industrial sector absorbed both redundant labor and the disguised unemployed, using Lewis’s process of absorption of surplus labor.

IRMA ADELMAN (ROMANIA 1930– )

Irma Adelman is well known for a forty-three-nation cross-country study done with Cynthia T. Morris. The results of the study show an increase in income inequality as poorer nations grow. Both women also provided a quantitative analysis of the effects of social and political factors on economic conditions. Prior to their work, social and political factors had been ignored. Adelman also worked with Sherman Robinson in the area of policy analysis and economic planning for developing countries and the application of computable general equilibrium models. Her current interests include land reform, trends in income distribution and poverty, agriculture-development-led industrialization, and the modeling of institutional change.

ANNE KRUEGER (NEW YORK 1934– )

Anne Krueger’s work on foreign trade controls creating windfall gains, known as rent-seeking behavior, and its relationship to corruption in developing countries influenced a new theory in development—the new political economy. Her early work concentrated on international trade and payments theory. She is currently researching policy reform in developing countries, the political economy of policy formation, and U.S. economic policy toward developing countries.
From table 1.3 we note certain differences between a large industrial nation, the United States; a smaller industrial economy, Spain; and a largely developing economy, Mexico. The size of the U.S. economy is more than ten times that of Mexico; you might be surprised to note, however, that Mexico’s economy is about 7 percent larger than that of Spain. Inflation, a sign of underlying instability, is higher in Mexico than in the two industrial countries. More of the Mexican economy is engaged in industrial activity (28.8 percent) than in the United States (24.7 percent), where the service sector is dominant. As smaller economies, Mexico and Spain are more open to international trade, with imports and exports together accounting for more than 50 percent of GDP. In financial terms, we can see Mexico’s greater vulnerability to international capital. Although U.S. financial markets provide 164.2 percent of domestic credit, in Mexico domestic intermediation is limited to just 28.8 percent. Mexico also lags considerably in indicators of scientific as well as basic infrastructure. The number of scientists and engineers per million inhabitants is 5.8 percent that of the United States; it has only 16.8 percent as many telephone lines to carry personal and commercial traffic. Health expenditures as a percentage of GDP are nearly one third lower than in the United States, a problem particularly for Mexico’s poor. The highly unequal distribution of income in Mexico is one of the largest impediments to a sustainable development policy.

Although there is considerable diversity in terms of the performance of Latin

Data Exercise

Consulting the sources for table 1.3, locate data for other Latin American countries. Select different country types (large and small) from different subregions. For example, consider the performance of Brazil, Ecuador, Guatemala, and Chile. How are they alike? Different?
### Table 1.3. Comparative Indicators of Economic Development

<table>
<thead>
<tr>
<th>Economic Indicator</th>
<th>United States</th>
<th>Spain</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macroeconomic Indicators</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (PPP value billions of U.S.$ at 2000 prices)</td>
<td>10,143.2</td>
<td>844.0</td>
<td>905.7</td>
</tr>
<tr>
<td>Inflation rate (consumer prices for 2000)</td>
<td>1.4</td>
<td>2.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Unemployment (as % in 2000)</td>
<td>4.0</td>
<td>14.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Gross domestic saving (as % of GDP for 1995)</td>
<td>15.0</td>
<td>22.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Tax as a % of GDP</td>
<td>28.9</td>
<td>35.1</td>
<td>16.0</td>
</tr>
<tr>
<td><strong>Sectoral Composition</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture (% GDP)</td>
<td>1.6</td>
<td>3.7</td>
<td>4.7</td>
</tr>
<tr>
<td>Industrial production growth rate (% GDP)</td>
<td>24.7</td>
<td>30.3</td>
<td>28.8</td>
</tr>
<tr>
<td>Services (% GDP)</td>
<td>73.7</td>
<td>66.0</td>
<td>66.5</td>
</tr>
<tr>
<td>Exports of goods and services (as % of GDP for 1999)</td>
<td>11.0</td>
<td>28.0</td>
<td>31.0</td>
</tr>
<tr>
<td>Imports of goods and services (as % of GDP for 1999)</td>
<td>13.0</td>
<td>28.0</td>
<td>32.0</td>
</tr>
<tr>
<td><strong>Financial Sector</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic credit provided by banking sector (as % of GDP for 1999)</td>
<td>164.2</td>
<td>108.9</td>
<td>28.8</td>
</tr>
<tr>
<td>Stock market (value traded as % of GDP for 1999)</td>
<td>202.9</td>
<td>124.9</td>
<td>7.5</td>
</tr>
<tr>
<td><strong>Technology</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scientists and engineers in R&amp;D (per million people for 1987–1997)</td>
<td>3,676.0</td>
<td>1,305.0</td>
<td>214.0</td>
</tr>
<tr>
<td>Patenting activity for 2000</td>
<td>12,682.0</td>
<td>86.0</td>
<td>8.0</td>
</tr>
<tr>
<td><strong>Communication, Transportation, and Pollution</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telephone main lines (per 1,000 people for 1999)</td>
<td>664.0</td>
<td>410.0</td>
<td>112.0</td>
</tr>
<tr>
<td>Television sets (per 1,000 people for 1999)</td>
<td>844.0</td>
<td>547.0</td>
<td>267.0</td>
</tr>
<tr>
<td>Vehicles (per 1,000 people for 1995)</td>
<td>748.0</td>
<td>454.0</td>
<td>131.0</td>
</tr>
<tr>
<td>Carbon dioxide emissions (per capita metric tons for 1997)</td>
<td>20.1</td>
<td>6.6</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Human Development Indicators</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lowest 20%</td>
<td>5.2</td>
<td>7.5</td>
<td>4.0</td>
</tr>
<tr>
<td>Second 20%</td>
<td>10.5</td>
<td>12.6</td>
<td>7.6</td>
</tr>
<tr>
<td>Third 20%</td>
<td>15.6</td>
<td>17.0</td>
<td>12.2</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>22.4</td>
<td>22.6</td>
<td>19.6</td>
</tr>
<tr>
<td>Highest 20%</td>
<td>48.3</td>
<td>40.3</td>
<td>56.7</td>
</tr>
<tr>
<td>Education expenditures, primary grade per student (for 1997)</td>
<td>6,043.0</td>
<td>3,267.0</td>
<td>863.0</td>
</tr>
<tr>
<td>Health (expenditures, private and public, as % of GDP for 1990–1998)</td>
<td>13.0</td>
<td>7.7</td>
<td>5.4</td>
</tr>
<tr>
<td>Total health expenditures per capita (for 1997)</td>
<td>4,373.0</td>
<td>1,749.0</td>
<td>452.0</td>
</tr>
</tbody>
</table>

American nations on each of these indicators, comparing Mexico with Spain and the United States provides insight into some of the characteristics of economies in Latin America. As we proceed, we will see questions of macroeconomic stability, depth of markets, distributional issues, and the role of the state generating considerable controversy.

**Challenges for Development Policy in Latin America**

Developing countries must contend with a set of economic issues that make economic policy more difficult—and for a student perhaps more interesting—than traditional theory. Throughout this text we will analyze how these issues have been addressed in Latin America from its earliest economic history through contemporary times. It is useful to raise some of these challenges here, to help you begin to think about the dilemmas of economic policy making in the region. It is important to remember, however, that each of these challenges plays out differently in each country in Latin America; the diversity of experience is probably as great as the set of common problems.

**Internal versus External Macroeconomic Balance**

Developing countries, in large part because by definition they are capital poor, find themselves reliant on international capital to fuel the growth process. Unlike the United States (which until recently focused little on domestic economic policy effects on the international sector because they were relatively small), Latin American countries have had to weigh carefully the effects of changes in domestic macropolicy—traditional money supply and fiscal tools—against their effects on the external sector. There is a constant tension between internal and external balance. Lessons from economic history in Latin America will show that a one-sided focus on either the internal or the external sector results in imbalances and the deterioration of the economic plan. Integrating a nation into international capital markets raises important complexities. This may be done in the form of debt (as in the 1890s and 1970s) or through foreign direct investment in the economy, raising questions of multinational presence (such as in the control of United Fruit Company in Guatemala in the 1950s) or contemporary questions of international labor standards. Countries that orient themselves toward the international export economy—as in Chile through copper or in Ecuador through oil—may have to sacrifice domestic goals to maintain an exchange rate that is compatible with international market conditions. One response to the trade conundrum has been to pursue alternate trade regimes in the form of integration efforts such as the Central American Common Market (CACM) or the South American Common Market (Mercosur). We will be grappling with the need to achieve internal and external balance throughout this text.
Internationalization creates a wide range of opportunities, but it also introduces constraints in domestic policy making. For new entrepreneurs like Juan Navarro, it creates profit, but it may limit the relative well-being of the Lehman family. For now, remember that developing economies are especially sensitive to the internal versus external balance.

Stability versus Change: The Question of Timing

The process of development involves rapid structural change, yet economic agents like certainty. In traditional economic models we assume perfect information held by all agents. We know that divergence from the assumption of perfect information leads to inefficiencies in the market. How to handle economic agents’ need for greater certainty and good information in an environment that is almost by definition (when it is working best) characterized by change is a challenge for policymakers in the developing world. Officials in Latin America must at once be agents of change, flexibly adapting to the dynamic needs of the economic transformation, while also acting as strict guardians of confidence and stability. The ability to walk this policy tightrope as both motivators and moderators of change often defines policy success. When governments fail to navigate and anchor the economy, they suffer a loss of confidence. Given rapid rates of change, past policy responses have often been volatile and unpredictable, creating uncertainty. Latin American governments have a smaller store of institutional credibility than, for example, the Bank of England or the U.S. Fed—where the big news might be a 0.25-percent increase in the interest rate and not the freezing of all bank accounts, the 30-percent devaluation of a currency, or the implementation of a currency peg. During Ismail Lehman’s young life, for example, the Brazilian currency changed names five times. Confidence building in economic policy making is a long and slow process—one not easily achieved when the economic waters are rough and choppy. Students of Latin American economic policy always need to ask how the policy proposed is going to affect the confidence and long-run credibility of economic agents.

Policy for Whom?

Economic policy affects various groups within an economy differently. One of the fundamental challenges facing policymakers in Latin America is the deep divisions that exist in its socioeconomic structure. Latin America is characterized by high degrees of income inequality. There is a huge gap between the lives of Juan Navarro and Judith Yanira Viera. The goal is to promote not only growth but some form of equitable growth—quite a tall order. Income inequality introduces complications in the measurement of growth. If equality is important, the change in a poor person’s income should carry roughly the same weight as that of a rich person. But given inequality, if a rich person earns twenty times more than a poor person, changes in the income of the wealthy receive twenty
times the weight of changes in income of the poor in the national growth calculation. If growth is supposed to measure economic performance, even the measures are far from the mark.

In many cases inequality is exacerbated by an ethnic and cultural mosaic of approaches to economic life. Traditional forms of social organization in indigenous communities may clash with the marketization of economic life. Gender also plays a key role in the assessment of policy outcomes. In a society often conditioned by traditional gender roles, policymakers sensitive to the gender divide must ask, for example, how accessible terms of credit or access to technology are to the widest range of citizens. Although these problems are not unimportant in policy making in more industrialized countries, the range of difference confronts the policymaker with hard choices. Women in Santiago, for example, may be well-educated, active economic contributors, whereas their sisters in the Altiplano live a far more traditional life. In assessing policy in Latin America, do not neglect to ask: Policy for whom? Whose needs should policy be designed to meet? Judith Yanira Viera’s? Or Juan Navarro’s?

**Present versus Future Value: The Environmental Dimension**

Promoting not only development but also **sustainable development**—or a strategy that leaves future generations as well-off as the present—may be unrealistic when more than half of a population lives on the verge of starvation or when inflation eats away at the meager earnings of the working poor. Policymakers in the developing world—like those anywhere—are constrained by political and financial capital. There are only so many things that can be done with limited energy and finances. Daily crises take precedence over long-term planning. This becomes quite evident in the environmental arena. The challenge becomes how not to forfeit future growth while confronting present dilemmas. Even in industrial market economies, characterized by less sensational economic twists and turns, it is hard enough to promote incentives for sustainable use of resources. Imagine the difficulties in a developing country. Enforcement of environmental laws in industrial economies, with stronger institutional and financial resources, is often lax or ineffective. Yet without an environmental sensitivity to the future, policy will not be sustainable over time. Bad choices today have costs tomorrow. Policy to promote rational environmental decision making in Latin America must be carefully crafted—and perhaps supplemented with external capital—for long-term investment in the future. Macro- and microeconomic policies must be assessed through environmental lenses to protect resources for future generations.

**The State and the Market: Promoting Partnership**

Who should be the primary development actor in the region? What should be the relative balance between the state and the market in promoting development in
Latin America? This question has framed much of the contemporary policy debate in the region. We will see that the pendulum has swung from a market-led to a state-dominated economy under ISI and back to the market under neoliberalism. Social protest in the first years of the twenty-first century by those marginalized by growth forced a reevaluation of the belief in the return to the market. Whether or not you support a stronger role for the state in economic decision making may be conditioned by your view of the relative sophistication of economic institutions in the region. Irma Adelman and Cynthia Taft Morris, two highly respected development economists, suggest that the crucial factor affecting development is the effectiveness of economic institutions and how economic institutions mediate the way in which gains from growth are distributed. Are the economic institutions—central banks, capital, land and labor markets, redistributive agents, and laws governing property rights—sufficiently strong to promote equitable and sustainable growth without much day-to-day state interference? If market institutions or the property code is weak, is policy intervention warranted? Defining where the state can and should supplement the activity of the market is an important element in crafting effective policy for development in Latin America.

Three broad schools of thought can be identified with respect to the role of the state in development policy. During the 1950s and 1960s, the success of the socialist model in jump-starting industrialization in the Soviet Union led to a planning model that accorded a strong role to the state in promoting development. The economists within Latin America who broadly believed that state intervention was critical to promoting development were called dependency theorists. Since markets were viewed as incomplete and unable to send strong and accurate price signals to economic agents, the state was viewed as an essential vehicle to orchestrate the growth process. Without an interventionist state, markets alone would not spontaneously generate growth. State-run activity was seen as necessary in providing infrastructure, such as roads and railways, and public services in education and health. In addition, state activity was encouraged in the direct production of goods and services in which private initiative had failed. The state was also supposed to help to counterbalance the power of domestic and international elites. We will consider the extension of this model to Latin America in chapter 3 on import substitution industrialization. Today, the potential gains from globalization and international trade, the benefits of entrepreneurship and the profit motive, and the difficulties introduced by problems of accountability and enforcement have created a shift away from the planning model.

The second broad approach falls within the institutionalist tradition. Institutionalists accord a strong role to nonmarket institutions. In particular, institutionalists suggest that rather than relying solely on price signals, other forms of organization—judges, chieftains, priests, or community councils—may intervene to settle disputes arising from the conflict over scarce economic resources. Economic problems must therefore be treated within the context of legal, social, and political systems. Economic outcomes were often determined as much by power as by price signals. As the wealthy would be better able to command resources, high degrees of inequality would bias development against the poor. For institutionalists, with a variety of factors influencing outcomes, development does not
tend toward equilibrium but may be a bumpy and discontinuous process. As we will see in chapter 3, the planning model and dependency theorists as well as institutionalist thought informed the position of some of the structuralist thinkers and policymakers in Latin America. Structuralists—economists who believed that the particular structure of developing economies warranted a different policy approach—dominated regional policy from the 1940s through the 1970s. Neostructuralists suggest that the modern demands of global markets require a balancing hand of the state.

A third school of thought in development economics is the neoclassical tradition. Linked in part to the Chicago School of orthodox economic policies, it places the market at the center of the development equation. The orthodox key to development policy is in ensuring that economic agents face accurate price incentives without interference to make the best of all possible economic decisions. State-led activity in infrastructure and public services is seen to have a poor performance record. Well-intended short-term market interventions are argued to perpetrate unintended long-run misallocations of resources. Strict neoclassical theorists therefore see a minimalist role for the state as a guarantor of rules and property rights and a provider of a limited array of public goods such as defense. The private sector, through the profit motive and Adam Smith’s invisible hand, will generate the greatest good for all. Foreign trade and international prices should become the engine for growth. Under the leadership of Milton Friedman, the Chicago School was the principal articulator of the Pinochet model in Chile, and it broadly informs the neoliberal policies that have dominated development strategies in Latin America in the 1990s.

All development approaches do not necessarily fall into one of these three policy boxes. However, the three tend to define answers to the critical question: Is the market the best of all possible mechanisms to organize economic activity and promote growth, or is state intervention a necessary ingredient to development policy in Latin America? The planner would argue for the hand of the state to guide development policy, the institutionalist would suggest that mechanisms beyond the market are critical in determining economic outcomes, and the subscriber to the Chicago School would staunchly support market-based policies. As we proceed through the puzzle of development in Latin America, you will need to resolve for yourself the most beneficial mix of market, state, and complementary institutions to promote development in the region. We will address this question in chapter 6 as we take an in-depth look at the contemporary role of the state in development.

These five issues—external balance, credibility, distribution, environmental sustainability, and the role of the state—pervade our examination of development policy in the region and our treatment of contemporary issues. In chapters 2 and 3 we will see how they played out in early development theories in the region. Chapters 4 and 5 address two of the dramatic legacies of imbalances of past mistakes—hyperinflation and debt. Chapter 6 introduces the new economic model in the region and chapter 7 chronicles the return of Latin America to international capital markets. In chapter 8 we consider contemporary trade performance, and then we go on to analyze sources of industrial competitiveness as well as the potential of the agricultural
sector in chapters 9 and 10, respectively. We will see the radical economic changes adopted by the region in the 1990s and evaluate their significant gains. But challenges remain. In chapter 11 we take up the problem of poverty, and in chapters 12 and 13 we assess educational and health systems in the region. Finally, although we pay attention to the environment throughout this text, in chapter 14 we look at environmental priorities in Latin America and suggest an agenda for action. We conclude in chapter 15 with an evaluation of the relative weight of the state and the market in addressing the challenges to a sustainable and equitable development strategy in Latin America.

**Key Concepts**

Chicago School  
empowerment  
planning model  
dependency  
equity  
sustainable  
development  
development dualism  
growth  
institutionalist tradition  
technological change

**Chapter Summary**

**Development: Definitions and Theory**

- Development is a word not easily defined in the context of economic advancement. Questions arise as to what kinds of characteristics “developed” countries have or should have.
- A distinction exists between development and economic growth. Development usually presupposes technological change, and economic growth considers political and social factors.
- The goals of development extend beyond economic growth. These goals may include meeting basic human needs, increasing economic opportunities for the poor, empowering marginalized groups, and ensuring economic benefits for future generations.
- Economists have not been able to agree on a single theory of development. The development processes for less-developed nations are likely to differ from those followed by industrialized nations. Approaches to development will depend upon the location, size, and natural endowments of each country.
- Three schools of thought for development policy provide policy guides to development strategy, the planning model, the institutionalist tradition, and the Chicago School; each of these defines a degree to which the state should intervene in the development process and the extent to which the process should be left in the hands of the market.
Challenges in Development Policy in Latin America

Policymakers face five major challenges when designing development policy in Latin America. First, they must establish a delicate balance between the external sector and domestic macro policy. Second, they must be attentive to the changing nature of the global economic environment as well as preserve confidence and stability within their own economies. Third, to attain equitable growth, they must fashion policies to target different economic, ethnic, and gender groups. Fourth, their policies must balance the allocation of resources between meeting the needs of present as well as future generations. Finally, policymakers are faced with the challenge of deciding the extent to which each state should supplement the activities of its own market to facilitate equitable, sustainable development.

Notes

2. “Exxel’s Shaky Empire.”


27. Paul Streeten, “From Growth to Basic Needs.”


29. If you would like to compare these three countries across a broader range of indicators, go to *The OECD Observer: OECD in Figures—Volume 2002 Supplement* 1 (E-book PDF Format).


