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Why Has Productivity Growth Stagnated in Most Latin American Countries Since the Neo-Liberal Reforms?

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Abstract and Keywords

Except for commodities and a small number of other activities, Latin America's economic performance since the beginning of the neo-liberal reforms has been poor. This not only contrasts with its performance pre-1980, but also with what has happened in Asia since 1980. This chapter argues that the weakness of the region's new paradigm is rooted as much in its intrinsic flaws as in the particular way it has been implemented. It argues that neo-liberalism conquered Latin America, including many in its left-wing intelligentsia, as completely as the Inquisition conquered Spain. This process has been so successful that it has actually 'closed the imagination' to conceptualizing alternatives.

Keywords: economic performance, Latin America, Inquisition, neo-liberalism, economic weakness

23.1 Introduction

Except for commodities and a small number of other activities, Latin America's economic performance since the beginning of neo-liberal reforms has been poor. This not only contrasts with its own performance pre-1980, but also with what has happened in Asia since 1980. I shall argue that the weakness of the region's new paradigm is rooted as much in its intrinsic flaws as in the particular way it has been implemented. Keynes once said (discussing Say's Law) that Ricardo conquered England as completely as the Holy Inquisition conquered Spain; the same could be said for neo-liberalism in Latin America: it has conquered the region, including many in its left-wing intelligentsia, as completely (and fiercely) as the Inquisieptualizing alternatives.

(p. 569) The genesis of the new development strategy can be located in a series of negative external and domestic shocks c. 1980, when the region was particularly vulnerable. As had happened in the 1930s, these laid the foundations for a radical

ideological transformation that led to the new paradigm along the lines of Anglo-Saxon neo-liberalism and US neo-conservatism. This was quite distinct from what was happening in Asia, where reforms were implemented in a much more pragmatic way. Perhaps the main difference is that in Asia most actors in favor of the reforms (including local capitalist élites, the administrative classes, and most intellectuals—even many in the 'new' left) have a strong sense of reality, national identity and historical awareness. Nobody had to convince them that in the real world there are so many distortions, market failures, coordination failures (especially with investment) and financial fragilities that when it came to policymaking the Washington Consensus's set of 'first-best' policies belongs to a fantasy world. Perhaps they also were cynical enough to realize that the neo-liberal ideology is based mostly on recycled 19th-century ideas wrapped in a narcissistic 'end of history' aura. So, in Asia one often finds the parallel existence of a neo-liberal discourse (to appease the gods of the markets), with a more pragmatic, targeted and sometimes imaginative implementation of reforms. And a pro-growth macro is never far away. In LA, instead, policy makers (including those in the 'new' left) do not just aim at 'talking the talk' of the neo-liberal orthodoxy; for them—and often with the enthusiasm of the new convert—what really matters seems to be the 'walking the walk' of that orthodoxy!

In fact, I sometimes wonder whether the brand of neo-liberalism bought by so many Latin Americans is just shorthand for 'nothing left to decide'—and, of course, 'nothing left to think about *critically*' (Palma, 2009a). Indeed, in most of the region the attitude today towards neo-liberal economics and (in particular) policymaking resembles Lord Kelvin's attitude towards physics at the end of the 19th century (Kelvin, 1900), when he famously declared that in physics "there is nothing new to be discovered now. All that remains is more and more precise measurement."

What characterizes LA's economic reforms most is that they were undertaken primarily as a result of perceived economic weaknesses—i.e., there was an attitude of 'throwing in the towel' vis-à-vis the previous state-led import substituting industrialization strategy (ISI). Basically, most politicians and economists interpreted the 1982 crisis as conclusive evidence that ISI had led the region into a cul-de-sac. As Hirschman has argued (1982), policymaking has a strong component of 'path-dependency'. As a result, people often stick with policies well after they have achieved their aims, and those policies have become counterproductive. This leads to such frustration and disappointment with existing policies and institutions that is not uncommon to experience a 'rebound effect'. An extreme example of this 'backlash' (or 'reverse shift') phenomenon is post-1982 LA, where economic reforms were mostly about the reversal of the previous development strategy—which, in many aspects, had overstayed its welcome.

From this perspective, what most differentiated LA from Asia was not just the strength with which the new neo-liberal ideology was adopted, but also the form in which the previous one (ISI) was given up. Hirschman called this LA's tendency to 'fracasomania' (1982). So, perhaps it should not be surprising that the discourse of the reforms ended up resembling a compass whose 'magnetic north' was simply the reversal

of the previous (p. 570) development strategy-as Gustavo Franco (when President of Brazil's Central Bank) explained, the main task of Cardoso's reforms was "… to undo forty years of stupidity [besteira] …" (Veja, 15/11/1996). With that 'reverse-gear' attitude, this experiment inevitably ended up as an exercise in 'not-very-creative-destruction'. This phenomenon was reinforced by the usual dynamic of idealization: when there is an unremitting need to sustain the idealization of something (in this case, the neo-liberal economic-reforms), what is needed is simultaneously to demonize something else (in this case, anything to do with 'the past', especially the previous development strategy of state-led industrialization). In fact, the more evident the flaws of what was idealized, the stronger the demonization of the past has to be. The mere idea that alternatives could exist met with contempt. Franco again: "[The alternative now] is to be neo-liberal or neo-idiotic [neo-burros]." Perhaps one reason why 'pure' ideology is so important in LA is because there is little else in the form of social cohesion. This helps to explain the peculiar set of priorities and the rigidity with which the reforms were implemented in LA, as well as their poor outcome, as distinct from many Asian countries-where reforms were implemented not as a messianic endeavor but (rightly or wrongly) as a more targeted and pragmatic mechanism to lift specific pressing economic and financial constraints in order to continue and strengthen their existing ambitious industrialization strategies.

LA is also a region whose critical social imagination has stalled. The emergence post-1950 of an intellectual tradition in the social sciences somehow runs against what one could call the 'Iberian tradition', which has been far more creative in painting, music, literature and film than in contributions to the social sciences. Basically, in the Iberian Peninsula social sciences have suffered due to a lack of 'enlightenment' beyond the arts and letters, and specifically the lack of sophistication in the state's exercise of power. Foucault's ideas can help understand this issue: knowledge and power are interrelated, one presupposing the other (Foucault, 2004). Foucault intended to show how the development of social sciences was interrelated with the deployment of more 'modern' forms of power (Frangie, 2008). But in the Iberian world, since states have often governed through 'un-modern' means, and at times via crudely mediated forms, they have not required much social knowledge, or sophistication in the forms of control. So, social sciences have been relegated to a relatively marginalized academic enterprise. In essence, what has became manifest in the implementation of economic reforms in LA is how its brand of neo-liberalism—with its Anglo-Saxon fundamentalism and its Iberian 'minimalism'—has fitted perfectly with its underlying power structure (and in particular with its perennial rent-seeking bias), and its lack of political need for more sophisticated forms of social imagination. Perhaps that also helps understand why this ideology was soon wrapped in an aura of superiority, 'specialness' and contempt, not just for possible alternatives but also for everything that happened before (the past, even the recent past, acquired a growing sense of unreality).[1] And (not unrelatedly) what became 'modern' ina (p. 571) terms of economic thinking reminds us of Adorno's proposition: "[t]oday the appeal to newness, of no matter what kind, provided only that it is archaic enough, has become universal" (2006).

Ortega y Gasset once referred to LA's "… narcissistic tendency to use reality as a mirror for self-contemplation, rather than as a subject for critical analysis and progress." He also observed that in LA he found too many "self-satisfied individuals," reminding them that "… human history is the product of discontent" (1918). There's probably no better way to summarize what is wrong with LA's current ('Anglo-Iberian') neo-liberal paradigm and its political economy than Ortega's observations, as (for reasons beyond the scope of this chapter—see Palma, 2009a) these regional features have returned with a vengeance.

23.2 Latin America's poor growth performance post-1980: two main stylised facts

23.2.1 The Collapse of Latin America's growth rate post-1980 is unique in the Third World

As is well-known, the beginning of neo-liberal reforms instituted by Reagan and Thatcher was followed by a slowdown of the world economy. This was also associated with the complex transition from the 'mass-production-for-mass-consumption' techno-economic paradigm to the age of information and telecommunications, with its more knowledge-intensive and flexible production techniques (Pérez, 2002). The average annual growth rate of the world economy fell from 4.5% (1950–1980) to 3.5% (1980–2008). The median rate fell even further—from 4.7% to 3.1% (GGDC, 2009). However, LA's collapse was extreme, even in this context (5.4% to 2.7%).

The exception to the general slowdown was the 'third-tier' NICs (China, India, and Vietnam). Elsewhere, the 'second-tier' NICs (Malaysia, Thailand, Indonesia) managed to keep their growth-rate despite 1997, while in the 'first-tier' NICs (Korea, Hong-Kong, Singapore, Taiwan), and in North Africa and Sub-Saharan Africa growth-rates declined, but by a relatively small margin. LA, meanwhile, saw its growth rate *halved* to 2.7%. For example, if one ranks all countries of the database (excluding oil-exporting Middle Eastern countries) by GDP growth-rate (97 countries), Brazil's growth-ranking collapses from 10 (1950–80) to 70 (1980–2008); in turn, Mexico's falls from 13 to 62. What a contrast with China (43 to 1), India (72 to 7), and Vietnam (84 to 2)—see Figure 23.1.

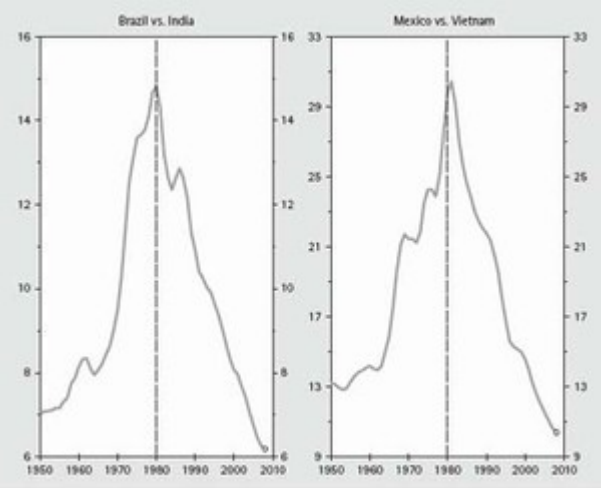

figure 23.1 Brazil's GDP per capita as a multiple of India's GDP per capita, and Mexico's as a multiple of Vietnam's, 1950–2008

Source: WDI (2010, data in constant 2000-US$). The series were brought back to 1950 using GGDC (2009).

Notes: 3-year moving averages.

Although from a Gerschenkronian (or Kuznetsian) perspective one expects some catching-up, the extent of Asia's post-1980 gains is remarkable—and China's catchingup (p. 572) is faster still. Figure 23.1 also confirms that LA's relative growth weakness is *not* confined to the 1980s. Moreover, LA's disappointing post-1980 performance is fairly homogenous—see Figure 23.2.

While between 1950 and 1980 the range of growth in LA was rather wide (from 2.1% (Uruguay) to 6.8% (Brazil)), in the latter period (1980–2008) 10 of the 13 countries of the database appear within a very narrow range—between 2.2% (Uruguay) and 2.9% (Guatemala). Furthermore, Colombia only emerged from this narrow range after 2004 (see ‘co⋆’), leaving only Costa Rica and Chile properly outside (growth-rates of 4.3% and 4.5%, respectively).

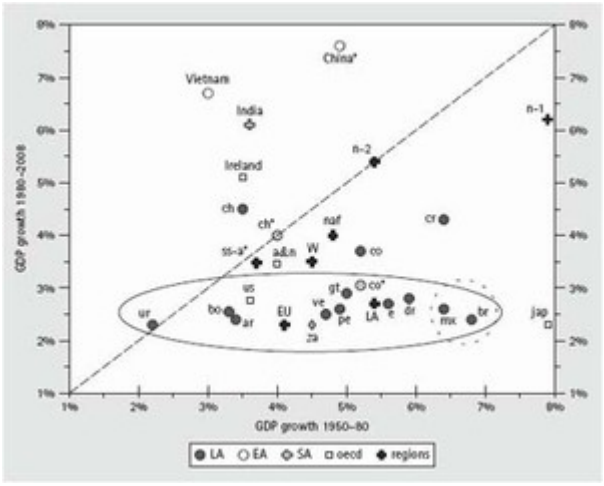

figure 23.2 Latin America and other regions: GDP growth, 1950–80 and 1980–2008

Source: GGDC (2009, data in constant 1990-US$, converted at Geary Khamis PPPs). The GGDC dataset only provides information for 13 Latin American countries (all included in the graph). Unless otherwise stated, this will be the source of all data on GDP, employment and labor productivity in this chapter.

Regions: LA=Latin America; EA=East and South East Asia; EU=European Union (excluding Germany because of unification); n-1=first-tier NICs; n-2=second-tier NICs; naf=North Africa; SA=South Asia; ss-a*=Sub-Saharan Africa (excluding South Africa); and W=world (weighted average for the 97 countries of the source).

Countries: a&n=Australia and New Zealand; ar=Argentina; bo=Bolivia; br=Brazil; ch=Chile (ch*=Chile 1950–72 and 1972–2008; 1972 is chosen as a cutting year to avoid the distorting effect of 1973, the year of the military coup); China*, rate of growth 1980–2008=8.5; co=Colombia (co*=Colombia, second period 1980–2004); cr=Costa Rica; dr=Dominican Republic e=Ecuador; gt=Guatemala; mx=Mexico; pe=Peru; us=United States; ur=Uruguay; ve=Venezuela; and za=South Africa (the rate of growth of the second period improves to 3.6 if restricted to 1994–2008). Unless otherwise stated, these acronyms will be used throughout the chapter.

Moreover, only Chile (and marginally Uruguay) managed to grow faster in the second period. In Chile, however, reforms began in 1973, so a more meaningful comparison would be between pre-1973-ISI and post-1973-reform periods. In this case, the growth rate is actually the same (4%; see ‘ch⋆’ in Figure 23.2). This Figure also confirms the remarkable growth-collapse of Brazil and Mexico—only Japan does worse. **(p. 573)**

23.2.2 In Latin America the decline in GDP growth after 1980 was entirely absorbed by productivity, leaving the employment growth practically unaffected

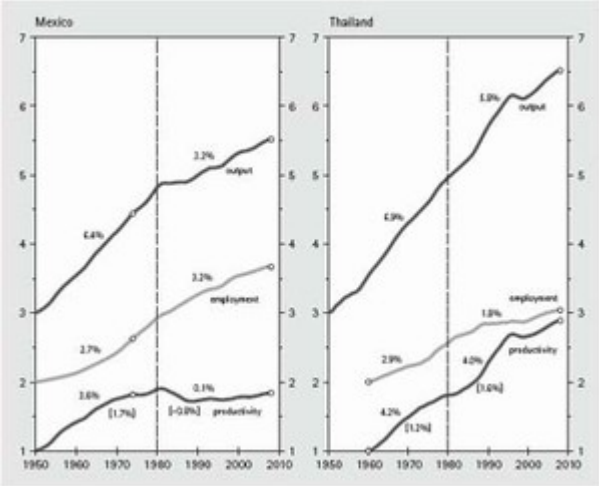

figure 23.3 Mexico and Thailand: output, employment, and productivity, 1950–2008

Source: as Figure 23.1. For TFP growth, see Figure 23.5 below.

Notes: Log scales and 3-year moving averages. Percentages above the lines are average annual real rates of growth for respective periods (Mexico, 1950–74 and 1974–2008 due to its different productivity cycle); those in brackets below the productivity lines indicate factor productivity (TFP) growth rates (due to lack of data, throughout this chapter TFP rates are restricted to 1960–2004). For Th ailand (and other Asian countries below), the first period in employment and productivity also starts in 1960 because the GGDC database only provides employment data from that date.

A comparison between Mexico and Thailand helps explain the second contrast between LA and Asia—how a decline in GDP growth is absorbed differently by employment and labor productivity (Figure 23.3). (p. 574)

If one divides these six decades into two periods, during the first there is little difference between the two countries. This is clearly not the case afterwards: although both GDPs slowed, in Mexico this is *totally* absorbed by a decline in labor productivity (from 3.6% to 0.1%), and in Thailand by employment. So while Mexico's productivity growth collapses, employment creation actually accelerates. In contrast, Thailand's productivity growth continues at the same pace and employment absorbs the fall in GDP growth. Both countries have cycles and sectoral diversities, but the contrasting picture in terms of GDP-'shock-absorbers' is clear. And as Thailand has had little industrial policy, this asymmetry mostly reflects market outcomes. In fact, in Mexico, as the whole of GDP growth ends up being explained by additional employment, TFP growth becomes negative (and remains so after reforms; see Table 23.3). This contrast in terms of GDP-'shock-absorbers' also applies to the other countries of each region.

(p. 575) Pre-1980 only the 'first-tier' NICs (N-1) were doing better than LA in terms of GDP and employment. LA's pre-1980 productivity growth was also relatively energetic (2.5%); i.e., productivity doubling every 28 years, with Brazil and Mexico needing less than 20. However, post-1980 things changed sharply: while LA's GDP growth rate fell by half (becoming among the worst), its employment creation remained basically stable.

Consequently, its employment elasticity nearly doubles (from 0.49 to 0.92, a level about twice most other countries'), and its labor productivity sinks to the bottom of the league.

A further comparison (Brazil vs. Korea), helps illustrate the above phenomenon. In terms of productivity, Brazil was just about keeping up with Korea between 1960 and 1980 (3.6% and 4.8%, respectively). In fact, by 1980 Brazil's overall productivity level was still slightly higher (US$12,500 and 11,500, respectively). However, by 2008 Korea's productivity was over *3 times* higher (US$41,000 and 12,900; data in constant 1990-US$). So, while Korea wasclosing the productivity gap with the US—up from 28% (1980) to 63% (2008)—Brazil was falling behind, (down from 30% to 20% of US productivity levels, respectively).

23.3 Why is it so difficult for Latin America to sustain productivity growth (and TFP growth) for any significant length of time?

23.3.1 Productivity growth in Latin American Countries: an international perspective

Perhaps the most significant stylized fact emerging from the above is that while LA is perfectly capable of generating periods of dynamic productivity growth, it seems unable to *sustain* it long-term. Meanwhile, many in Asia mastered this technique quite nicely (Figure 23.4).

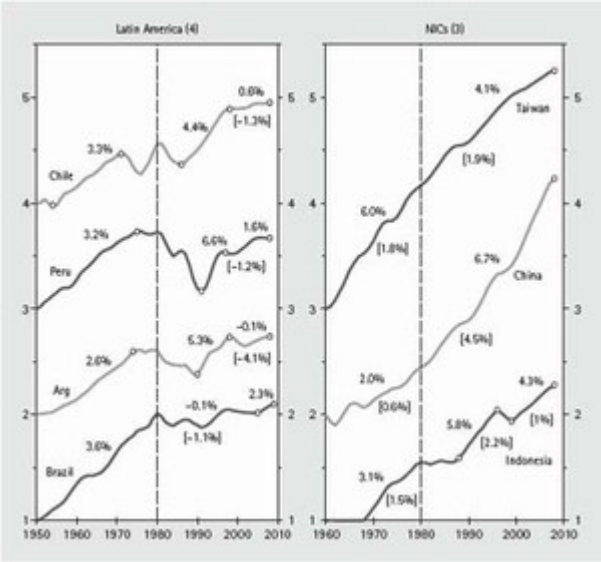

figure 23.4 Productivity growth: Argentina, Brazil, Chile, and Peru vs. China, Indonesia, and Taiwan, 1950–2008

Notes: Log scales and 3-year moving averages. Percentages above the lines are average annual real rates of productivitygrowth during respective cycles; those in brackets below the lines indicate TFP growth rates between the end of the respective growth period and 2004 (last year for which TFP-data are available). Employment data for Asian countries are only available since 1960. For Brazil data were extended to 2009 using an update of the GGDC database (so, the last rate of growth corresponds to 2005–9). Arg=Argentina.

As mentioned above, Brazil (like most of LA) followed the same contrasting productivity pattern as Mexico: a dynamic annual rate of productivity growth pre-1980 (3.6%), followed by a long period of productivity-stagnation (-0.1% in 1980–2005). As has been widely reported, the Brazilian economy then entered a new growth-cycle in 2004 (led mostly by commodities, finance and real estate), which was quickly resumed in 2010 after the 2009 slowdown. As a result, productivity growth has accelerated to 2.3% (2005–2009). The other three Latin American countries of Figure 23.4 are included because (with Uruguay and some recent recoveries) they are the only ones in the region that also experienced at least some years of rapid productivity growth after 1980. However, productivity growth in them all stopped abruptly after a relatively short period—and TFP growth became negative after that point (see also Figure 23.5; the same happened to Uruguay). So, if pre-1980 many LA countries were at least good (p. 576) middle-distance (productivity-)runners, post-1980 they became at best good sprinters … Meanwhile many Asian tigers became top marathon-runners (a skill that crucially includes the ability to hold one's nerve more effectively in both stages of the economic cycle).

The Chilean case is notable, in that its high productivity-growth period stopped abruptly in 1998 without a financial crisis (as in Argentina) or political crisis (Peru). Chile needed only a relatively minor contagion from Asia and Russia, and an over-reaction by its Central Bank. Subsequently productivity growth practically vanished (0.6% 1998–2008), becoming actually negative in 'per-hour-worked' terms (-0.4%)—and even more so in TFP terms (-1.3%).[2] How different from the three Asian countries of (p. 577) Figure 23.4 (each representing one of the three NIC groups), or from other Asian countries that also managed rapid productivity growth during the three decades post-1980, such as Korea (4.7%), Vietnam (4.2%), Thailand (4%), India (3.8%), Hong-Kong (3.4%), Malaysia (3.3%),

Singapore (3.1%), Sri Lanka (3.1%), Bangladesh (2.4%), or Pakistan (2.9%), among others. LA's average for this period (0.2%) seems to belong to a different world. Even if the 1980s are excluded and the period is restricted to the post-reform 1990–2008 one, LA's average (1.3%) is just a fraction of that of most Asian countries (China 8%, Vietnam 5%, India 4.2%, Taiwan 4%, Korea 3.9%, Malaysia 3.7%, Thailand 3.5%, and so on).

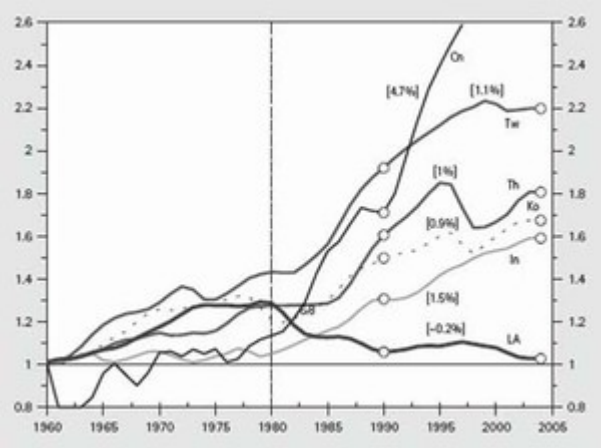

figure 23.5 Latin America and five Asian economies: TFP, 1960–2004

Source: Calculations made by Anish Acharya and author, using the Hall and Jones 1999 methodology for decomposing output per worker; data were available only until 2004 (2003 for some countries). Acharya 2009, and Palma 2010.

Notes: 1960=1. Cn=China (2003=3.12); In=India; Ko=Korea; Th =Th ailand; and Tw=Taiwan. Percentages shown in the graph are TFP growth rates between 1990 and 2004 (i.e., the period of full-blown neo-liberal economic reform throughout Latin America). Th ree-year moving averages.

Indonesia is included in Figure 23.4 (even though it is the least dynamic of the N-2) because its experience is relevant for a comparison with LA. Not only was it the hardest hit by the 1997 crisis, but its whole post-independence history has been turbulent, plagued by natural disasters, separatism, poverty, genocide and corruption (the latter two especially during Suharto's three-decade-long presidency). Also, since the end of its oil-boom, Indonesia largely abandoned its (somewhat megalomaniac) industrial policy, and soon acquired a Latin-American-style proclivity for premature financialization and monetarist-macro. (‘Financialization’ is the rise in size and dominance of the financial (p. 578) sector, as well as the diversification towards financial activities in non-financial corporations.) Yet, no country in LA has managed Indonesia's productivity growth-rate since 1990.

For those who consider TFP growth a more telling indicator of economic success (despite the problems associated with its concept and its measurement), Figure 23.5 shows that in LA the contrasting picture between the two periods is even more striking.

Much has been said regarding Krugman's ‘TFP-critique’ of East Asia (EA), as if factor accumulation could be dismissed as ‘not the real thing’. However, Figure 23.5 and Table 23.1 show that even these more moderate Asian TFP-rates are well above LA's post-1980 performance. That was not the case pre-1980.

With the exception of Chile, all LA posted a negative TFP-rate during the 1980s, and in half of them TFP growth remained negative after 1990 (and in two others is zero, and in

another two practically stagnant). As a result, both during the 1980s and the post-1990 reform-period LA's average is negative and well below everybody else's. That was clearly not the case between 1960 and 1980. So, for those who follow the Washington Consensus, the most challenging question must be how was it that in most of LA TFP growth became negative (or at best stagnant) well *after* full-blown economic reform? And the well-rehearsed answer that what is needed is yet more of the same neo-liberal reforms sounds increasingly hollow.

23.3.2 Latin America's remarkably poor investment effort and its political economy

There is little doubt that the core of LA's inability to sustain productivity growth after 1980 is its low rate of accumulation—poor even from the perspective of its relatively inadequate historical record (Figure 23.6).

In Panel A, while investment-rates in EA and South Asia (SA) are stationary around a positive trend, LA's rate is stationary around a (low) intercept.[3] It is fairly obvious that LA's capitalist élite has a preference for luxury consumption and for accumulating via mobile assets (financial ones and capital flight) rather than via ‘fixed’ capital formation.[4] And neo-liberal reforms—despite all their efforts towards defining and enforcing property rights, and many other ‘market-friendly’ policies—have had little impact on investment. Even the small increase during the surprisingly positive environment after 9/11 (particularly in terms of finance and terms of trade) is unremarkable vis-à-vis those of Asia (see Panel A). Basically, in LA (2002–7) while the ratio of the stock of financial assets to GDP jumped from 106% to 182%, the investment rate only improved from 19% to 22% (see IMF, 2009). Not much evidence here of the supposed revitalizing effects of ‘financial-deepening’ promised by McKinnon and Shaw.

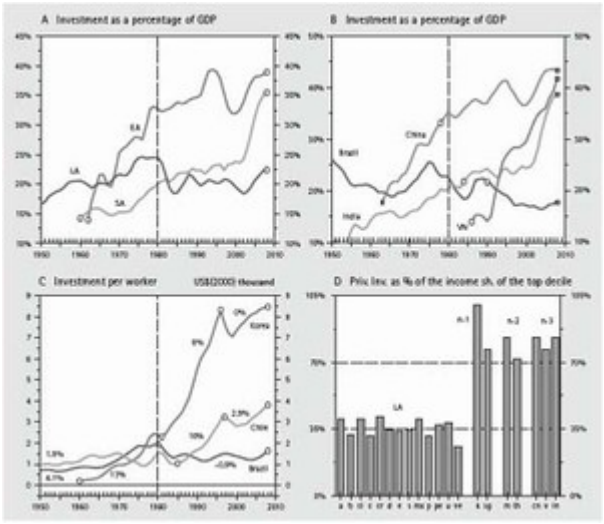

figure 23.6 Investment patterns in Latin America and Asia, 1950–2008

Source: for investment, and for income distribution, WDI (2010); for investment before 1960 in LA, CEPAL (2010); in India (http://mospi.gov.in/). For employment, GGDC (2009); for private investment, IMF (2010).

Notes: In Panel**B, VN**=Vietnam; white circles indicate the beginning of economic reform (for China, Deng Xiaoping's 1978 speech to the Third Plenary Session of the Party's Eleventh Central Committee; for India, 1980; for Vietnam,1986—Doi moi; and for Brazil, 1990—Collor's 'New Brazil' Plan. In Panel **C**, percentages shown in the graph are growth rates in the respective periods (for Brazil, 1950–80 and 1980–2008; for Chile, 1950–80, 1985–98 and 1998–2008; and for Korea, 1960–80, 1981–97 and 1997–2008. Panel **D, n-3**=third-tier NICs (China, India, and Vietnam), and **a**=Argentina; **b**=Brazil; **cl**=Chile; **c**=Colombia; **cr**=Costa Rica; **d**=Dominican Republic; **e**=Ecuador; **s**=El Salvador; **mx**=Mexico; **p**=Paraguay; **pe**=Peru; **u**=Uruguay; **ve**=Venezuela; **k**=Korea; **sg**=Singapore; **m**=Malaysia; **th**=Thailand; **cn**=China; **v**=Vietnam; **in**=India. Three-year moving averages.

Basically, no theory of investment seems to be able to explain LA's stationarity-around-a-low-intercept behavior, especially taking place during such a long period, such diverse domestic and international scenarios, and through such divergent development (p. 579) (p. 580) strategies. In turn, Panel B shows that in Brazil (like the rest of LA) economic reform seems to have unleashed more powerfully the predatory and rentier instincts of the region's capitalist élites (the former especially during the privatization period) rather than their Schumpeterian ones. In many Asian countries, meanwhile, reforms, especially (partial) financial liberalization, may have brought complex challenges to the macro and the inevitable financial fragilities (as well as 'flexible' labor markets, increased inequalities, and so on), but at least in these Asian countries the rate of accumulation increased (p. 581) after their implementation. In LA, meanwhile, the cloud did not even have that silver lining. The contrast between Brazil and India in panel B is particularly telling.

Table 23.1 TFP growth: Latin America, Asia, South Africa, and OECD, 1960–2004

	1960–80	1980s	1990–2004		1960–80	1980s	1990–2004
China	0.6	4.2	4.7	**Chile**	0.5	0.7	1.4
Ireland	1.9	2.0	2.6	**D Republic**	1.0	?1.8	1.0
India	0.2	2.5	1.5	**Costa Rica**	0.4	?1.6	0.8
Nordic	1.0	0.8	1.1	**Argentina**	0.1	?2.9	0.8
Taiwan	1.8	2.9	1.1	**Peru**	1.1	?3.7	0.3
Thailand	1.2	2.4	1.0	**El Salvador**	?0.7	?2.4	0.3
Australia	1.2	0.2	1.0	**Brazil**	2.2	2.5	0.0
Korea	0.8	2.4	0.9	**Guatemala**	2.1	?1.6	0.0
Singapore	1.2	1.4	0.9	**Uruguay**	1.4	?1.5	?0.1
US	0.8	0.8	0.8	**Nicaragua**	?1.7	?4.6	?0.4
Malaysia	1.1	0.0	0.7	**Ecuador**	2.8	?1.3	?0.5
World (84)	1.2	0.7	0.7	**Mexico**	1.6	?2.4	?0.6

New Zealand	0.2	0.9	0.6	**Colombia**	1.9	?1.1	?0.6
EU	2.0	0.9	0.3	**Honduras**	0.6	?1.2	?1.1
South Africa*	1.7	?2.1	0.1	**Paraguay**	1.9	?1.8	?1.3
Latin America	1.4	?2.3	?0.2	**Venezuela**	?0.5	?1.6	?2.4

Source: as Figure 23.5.

Notes: Countries/regions are ranked according to their TFP growth rates between 1990 and 2004. Nordic=median Nordic country (Sweden); EU=median EU country excluding Nordic countries (Belgium); and South Africa*=later period 1994–2004 (to reflect the period since the beginning of democracy and end to sanctions).

Furthermore, in the very few cases in LA where investment actually increased after reforms, as in Chile, it is not obvious why it took so long for it to happen (over ten years after the beginning of reforms), let alone why it ran out of steam so easily afterwards (post-1998). Panel C indicates a similar difference in terms of investment per worker. While in Chile, at least for a time, this statistic show dynamic growth, in Brazil (despite the post-2003 recovery) by 2008 investment per worker was still 22% below that of 1980 (US$1,634 and 2,106 respectively—data in constant 2000-US$). On average, LA as a whole follows a pattern similar to Brazil's, with its 2008 level still *below* that of 1980. An extreme example is post-1980 Mexico: despite the highest level of FDI per worker in the world, by 2008 its investment per worker still had not recovered its 1980/1 level. By then, and despite 1997, Korea had a level 3.6 times higher, and Malaysia and Thailand 2.2 times higher. In turn, China's 2008 level was 12 times higher, India's 4.5 times higher, and Vietnam had more than trebled this statistic since 1994 (first year data are available).

Perhaps from this perspective the contrasting productivity growth performance of LA and many in Asia—and the inability of LA *to sustain* productivity growth—are not that difficult to explain after all. In Brazil, for example, when between 1965 and 1980 investment per worker grew at an annual rate of 6.8%, productivity grew at East Asian levels (4.3%). And when investment per worker subsequently collapsed, productivity stagnated. Finally, when investment per worker began to increase again (6.9%between 2004 and 2009), productivity growth improved to 2.3. However, what is still unclear is why (despite the huge share of national income appropriated by the top earners, well-defined and enforced property-rights, and ‘pro-market’ reforms) every time private investment in LA manages to rise much above 15% of GDP its capitalist élite starts experiencing feelings of vertigo.

From this perspective, the most striking difference between LA and Asia is found in their contrasting relationships between investment and income distribution (see Figure 23.6, Panel D). It is often acknowledged that the historical legitimacy of capitalism—i.e., the legitimacy of a small élite to appropriate such a large proportion of the social product—rests on the capacity of its élite to develop society's productive forces. And they can do so mainly by reinvesting most of that huge share. So, no other statistic seems to reflect so neatly the difference in the nature of capitalism in LA and most of Asia than that of Panel D in Figure 23.6.[5]

(p. 582) Figure 23.7 shows another key component of the poor investment effort in LA after neo-liberal reforms—the collapse of public investment.

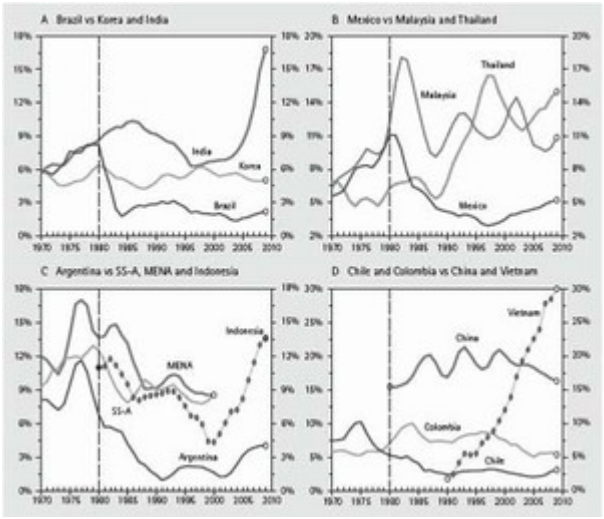

figure 23.7 Latin America and other developing regions: public investment as a share of GDP, 1970–2008

Source: for countries, IMF (2010; data for China and Indonesia only available from 1980, and for Vietnamfrom 1990). For regions, WB (2002; data available only until 2000).

Notes: Panel C, MENA=Middle East and North Africa; SS-A=Sub-Saharan Africa. Three-year moving averages; current prices.

One of the stated aims of neo-liberal reform in LA (but not in Asia) is tying the hands of governments in terms of their capacity to create so-called 'artificial' rents. In LA, however, neo-liberal reforms has only succeeded in tying government hands in terms of public investment—as it left its squeeze as the only mechanism to square public finances—while all sorts of 'growth-hindering' rents (e.g., from lack of proper competition policy) and corruption continued unabated. Basically, a low tax intake (on average, less than half the OECD level) and an emphasis on balanced budgets left little room for public investment (DiJohn, 2007). In some countries, especially Brazil, there was the added problem of servicing a huge public debt—a debt acquired mostly as a result of the mismanagement of financial reforms (Palma, 2006). Unsurprisingly, crumbling infrastructure and shortages of complementary capital became major constraints for growth. (p. 583) So, as Figure 23.7 indicates, the collapse in public investment took place as much in economies with high tax intake (Brazil) as in those where this was low (in Mexico just 12 of GDP for non-oil taxes). In fact, Colombia, with the lowest tax collection among the major economies, had a slightly higher rate of public investment. Chile at least invested in infrastructure via private 'concessions'.

23.3.3 The crucial relationship between investment and productivity growth: the economy's engine-room

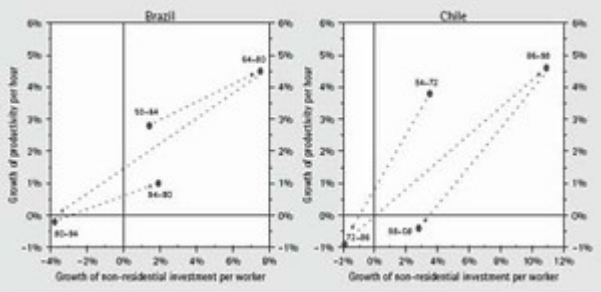

figure 23.8 Brazil and Chile: growth of non-residential investment per worker and of productivity per hour, 1950–2008

Source: for productivity and employment, GGDC (2009); for investment, WDI (2010). To obtain the non-residential component of investment, I have multiplied the WDI data by the share of non-residential investment in total investment (from Hofman, 2000; this author provided the necessary updates).

Notes: Each observation indicates the average rate of growth for both variables during the respective period.

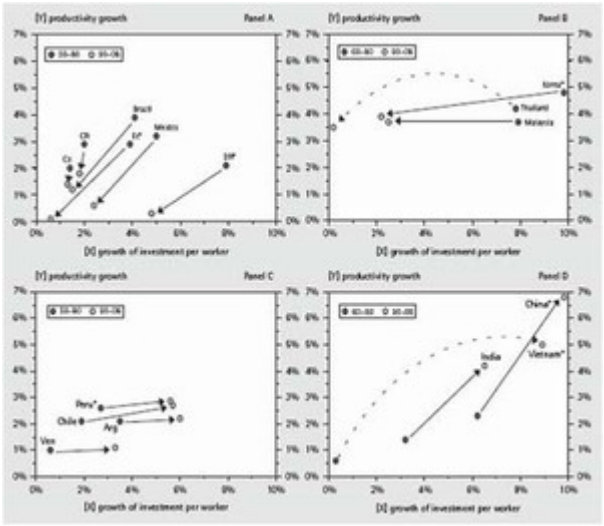

figure 23.9 Latin America and Asia: growth rate of investment per worker and of labor productivity, 1950–80 and 1990–2008

Source: as Figure 23.8 (due to lack of data for the residential component of Asia' investment, the horizontal axes represent the growth of overall investment per worker). Investment for Colombia, CEPAL (2010).

Notes: [Y]=vertical axis; and [X]=horizontal axis. In Panel A and C, due to lack of data for Ec*, DR* and Peru* first observation is restricted to 1960–80; Korea*, investment growth rate for 1960–80=13%. China*, investment growth rate for 1990–2008=12.2%; Vietnam*, first observation is only a rough estimate (using information from Trần Văn Thọ, et al., 2000);. Note that in all panels the second period is restricted to 1990–2008 in order to compare LA's post-1990 economic reform period with its pre-1980 ISI one.

The most robust statistical relationship between the growth of investment and productivity is found between non-residential investment per worker and productivity *per hour worked*. Not only is there a strong correlation between the two (stationary) series, but also (via an autoregressive distributed lag model that allows for more complex dynamics in the data) investment is found to have a large—and highly significant—impact multiplier (Palma, 2010).[6] Figure 23.8 summarizes the cycle in two economies with at least one period of (Asian-pace) growth: Brazil (1964–80) and Chile (1986–98).[7] **(p. 584)**

Of the many intriguing issues arising from Figure 23.8, three are revealing: first, unsurprisingly, the periods of rapid productivity growth are associated with high investment growth.[8] Second, when investment declined, productivity growth did not just decline, it actually *collapsed*. Finally, although investment growth in the last period resembles that in the first, productivity growth is significantly lower. Figure 23.9 shows that in this respect the striking difference between LA and Asia is even more intriguing.

In Figure 23.9, LA is divided between those countries in which the investment per worker growth-rate was lower in 1990–2008 than in 1950–80 (six countries, Panel A), and **(p. 585)** those where it was higher (four, Panel C); Asia is divided along the same lines in Panels B and D. Starting with the top panels, the contrast between LA (Panel A) and three of the Asian countries affected by the 1997 crisis (Panel B) could not be starker: while in LA a declining investment rate is associated with a collapse of productivity growth, in Asia an extraordinary post-1997 fall in the investment rate leaves productivity growth practically unaffected. Aside from Asia's preference for absorbing shocks via employment rather than productivity, this comparison suggests a more solid productivity growth foundation

in Asia due to higher levels *and* different sectoral distribution of investment. This helps hedge productivity growth against temporary drops in investment.

The contrast between the countries shown in Panels C and D is even more remarkable, indicating the opposite vertical and horizontal trajectories from those found in Panels A and B. In the four Latin countries of Panel C, an increased investment rate is associated with *constant* rates of productivity growth (in fact, Bolivia and Guatemala, not included in the graph, do not even travel horizontally: an increased investment rate was associated with *lower* productivity growth). In Asia (Panel D), enhanced investment rates are instead associated with hugely improved rates of productivity growth.

23.4 Latin America's unique post-reform combination of high employment elasticities and low productivity growth

As far as employment elasticities are concerned, post-1980 LA seems to live in a world of its own—see Figure 23.10, Panel B

As mentioned above, LA's post-1980 employment elasticities are about twice as high as anybody else's. A sectoral analysis of LA's high employment elasticities indicates that these levels are entirely due to services. For example, in Brazil (1980–2008) net-job creation reached 32 million, of which 30 were in (slow-growing) services—11 in trade/ hotels/ restaurants; 2 in transport/storage/communication; 2.5 in finance/insurance/real estate; and 14 in community/social/personal/government services. That is, while output in services was growing at just 1.9%, employment did so at 4.1%. Furthermore, there is no evidence that these are mainly government jobs—the overall employment elasticities of services was 2.2, while excluding the latter subsector this increases to 3.5.

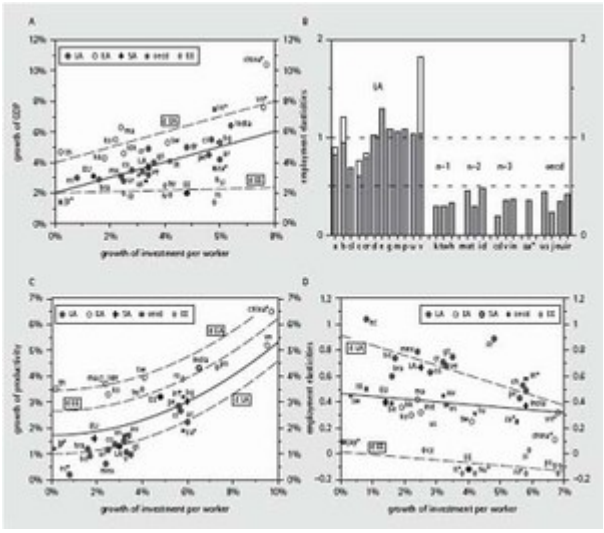

figure 23.10 Latin America: the contrasting fortunes of employment and labor productivity in the post-reform period, 1990–2008 Full titles: Panel **A**, Growth of investment per worker and of GDP, 1990–2008. Panel **B**, Latin America and Asia: employment elasticities, 1980–2008. Panel **C**, Growth of Investment per worker and of labour productivity, 1990–2008. And Panel **D**, Growth of investment per worker and employment elasticities, 1990–2008.

Sources: for GDP and investment, WDI (2010, constant 2000-US$); for Taiwan 2010. For GDP in domestic currencies, GGDC (2007), and UN 2010; for employment GGDC (2009).

At the same time, and going against the expectations of those in the Washington Consensus, other than in the ‘maquila’ industry (an industry that exists due to artificially-created preferential access to the US markets) there is little evidence that increased employment creation relates (in a Heckscher—Ohlin-Samuelson fashion) to trade liberalization. This is especially true in commodities. In fact, not only did employment in the primary sector decline in most countries (Brazil lost 2 million jobs), but there is no evidence that the jobs created in services are significantly associated with the commodity boom.

(p. 586)

(p. 587) There are, of course, many political economy issues that emerge from LA's high employment elasticities that cannot be analyzed here. However, I would like to mention at least one: the historical legacy of the ‘new’ left. Whatever one's views on the ‘new’ left, its emergence certainly helped reduce the capitalist élites' ‘workers-paranoia’ (Palma, 2009a). Basically, when the ‘new’ left became convinced that it could not get political power to implement its own political and economic agenda, it decided to gain power to implement someone else's agenda. In fact, Mrs. Thatcher was right when she proudly proclaimed that ‘New’ Labour was her greatest political achievement. Likewise, perhaps the greatest political achievement of Pinochet (and other similar dictators) is the Latin American ‘new’ left. So, as far as employment was concerned, there was not much point for the capitalist élites continuing with their anti-labor bias. Here a comparison between Brazil and South Africa is telling. Both countries started reforms simultaneously, and had similar growth rates post-1994 (i.e., the beginning of the ANC period, and the first election of Cardoso and the ‘Real Plan’). However, in the following decade South Africa's GDP growth is almost entirely explained by productivity growth, Brazil's by employment. There are, of course, many differences between the two countries, but the fact that in Brazil the PT became the capitalist élite's best friend while in South Africa COSATU (one

of the ANC dominant forces) remained a militant organization had a lot to do with this. From this perspective, South Africa's main problem is that it has East Asian levels of employment elasticities, but Latin levels of GDP growth, resulting in a quarter of its labor force being unemployed.

The main lesson from the contrast between these two countries indicates that even in this globalised world there are still significant degrees of freedom regarding the labor-intensity of output. And if LA has chosen a labor-intensive growth-path and South Africa the opposite, this has been for *endogenous* political economy reasons.

Panels C and D of Figure 23.10 indicate that in post-1990 LA there is a contrasting geometry between investment and productivity growth, on the one hand, and between investment and employment growth, on the other. While in panel C, LA is best represented by a highly significant *negative* (productivity) dummy, in Panel D it generates a highly significant *positive* (employment) one. However, both dummies cancel each other out, and LA's relationship between investment and GDP growth (Panel A) ends up best represented by the base regression.[9]

The fundamental point here is whether LA's ability to generate high employment elasticities affects investment and GDP growth *negatively*. More specifically, the two crucial questions are: what is the nature of the relationship between LA's high employment elasticities and low productivity growth? And (crucially), if there is a fundamental relationship between the two, which is the direction of causality? See Figure 23.11.

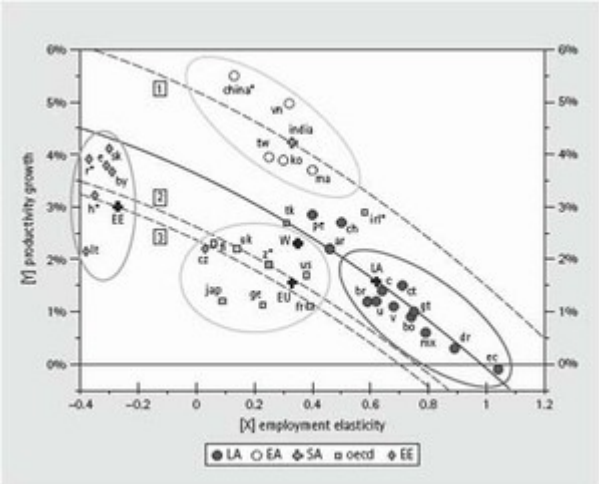

figure 23.11 Latin America's "flexible" labor markets, 1990–2008

Notes: [Y]=vertical axis; and [X]=horizontal axis. Countries and regions as Figure 23.2 and 23.10, and c=Colombia; fi=Finland; sk=Slovak Republic; uk=United Kingdom; u=Uruguay; and v=Venezuela. Employment elasticity for h*, Hungary=-1.2; and for r*, Romania=-2. china*, productivity growth=8%. [1]=dummy intercept for EA; [2]=dummy intercept for OECD countries; and [3]=dummy intercept for EE. R^2 =85%; all variables are significant at the 1% level (for regression statistics, see Palma, 2010).

(p. 588) Even though this is a difficult relationship to interpret as both variables have crucial elements in common, Figure 23.11 complements what we already know from Figures 23.3 and 23.10 above—this time for the shorter post-reform period 1990–2008. That is, most Latin American countries are uniquely positioned within the geography of this relationship during the post-reform period due to their remarkable labor market 'flexibility'–flexibility in the sense that they are able to generate single-digit unemployment rates despite such poor GDP growth.

As far as LA is concerned, there are at least two ways of understanding this intriguing relationship between employment, productivity, investment and growth. One is the (neo)structuralist view, postulating that in the absence of a binding foreign exchange constraint, output growth is largely driven by the demand. The emphasis here is in deficient demand leading to low GDP growth as the starting point for understanding overall low productivity growth. Sluggish output growth leads to modest labor absorption in the 'modern' (higher-productivity) sector, and to high absorption in the informal sector, resulting in low overall productivity growth (see Ocampo, 2004; and Ocampo, Rada, and Taylor, 2009). So, slow aggregate (p. 589) productivity growth is understood mostly as a low-effective-demand/low-GDP-growth problem leading to increased informality, rather than as a Kaleckian-low-investment phenomenon. On such 'Pasinetti grounds', a high employment elasticity is a *derived* measure.

There is an alternative perspective on the 'causality question', which is the one suggested here. Even though some of the above mechanisms may well also be at play, my view emphasizes a converse logic: there are analytical and statistical reasons for arguing that the start-ingpoint is not low GDP growth (somehow determined somewhere else in the economy), but *the political economy of the labor market* (reinforced by that of public finance). High employment elasticities are not the end result but *the starting point* of the analysis. Here the dynamics run mostly from high employment elasticities to low productivity growth via an alternative 'Cambridge-connection'—especially those of

Marshall, Kalecki, Joan Robinson, and Salter. In essence, I shall argue that what could be called ‘excessive-labor-market-flexi-bility’ is a key foundation for LA's poor productivity performance—mostly via its negative impact on both investment per worker, and efficiency wages.

From this perspective, two different dynamics (leading to structural heterogeneity) are at work. On the one hand, in many commodities and in a few industrial and service activities international competition has launched more interesting investment-productivity growth dynamics. However, in the (more protected) bulk of the economy there is a very different reality. In LA, unemployment rates may be relatively low, but this does not mean that labor markets are tight: the labor force still grows fast by new entrants; in most countries the primary sector and often also manufacturing keep shedding labor; and there is a large ‘reserve army’ in the informal sector. Consequently, this dominant part of the economy (typically more than two-thirds) can operate with a remarkably elastic supply of labor and little pressure on wages, investment per worker and productivity growth. In other words, this bulk of the economy can operate with few *compulsions* for productivity growth thanks to ‘flexible’ labor markets, natural protection, and a (typically) high degree of oligopolistic concentration. And if in the bulk of the economy output can grow mostly by additional employment, what would be the incentive (let alone the compulsion) to invest, particularly in terms of investment *per worker*; or what would generate upward pressure on wages to give a Marshallian efficiency-wage dynamics a chance? As Joan Robinson analyzed long ago in her criticism of the supposed ‘exogeneity’ of the variables making up the Harrod—Domar model, the incentives for investment and productivity growth would only really kick in when the labor market gets tight.

Furthermore, as labor-intensive techniques in manufacturing have been mastered in low-income Asia—where wages are even lower and labor is in abundance—LA cannot compete in low-wage labor-intensive manufacturing anymore (except when its geographical location and trade treaties favor ‘maquila’ activities). So in LA services are the employment-answer. At the same time (and very importantly), in relatively high middle-income countries there is also an insatiable (and often highly income-elastic) demand for low-cost low-productivity services—both formal *and* informal (although sometimes ‘low-productivity’ is due to the peculiar way in which output in services is measured in national accounts). In low-income Asia, meanwhile, more growth-enhancing labor-intensive manufacturing provides the higher employment-GDP-growth-outlet. Bangladesh is a good example of this, with its labor **(p. 590)** market more flexible than India's (and its minimum wages of less than US$2 a day). So, Bangladesh follows a typical Lewis-model (e.g., 2 million workers have been absorbed by the export-garment industry), but LA (in the bulk of the economy) follows an atypical one: there is high labor-absorption, but labor is being transferred to little or no productivity-growth-potential services (and often to ‘informality’)—sometimes even *from* manufacturing (due to de-industrialization; see Palma, 2005b and Section 23.7 below).

LA's abysmal rates of productivity growth in services between 1980 and 2008—either zero (Chile and Colombia) or negative (rest of the region)—are clearly not shared by the Asian countries discussed so far (India 4%, Taiwan 3.7%, Singapore 3.6%, Malaysia 3.5%, Indonesia 2.4%, Hong Kong 2.3%, Korea and Thailand 1%), where (among other factors) rapid growth in manufacturing helps by pulling services *à-la*-Hirschman (as was often the case in LA before 1980). This single factor goes a long way to explaining the differences in the *overall* productivity growth rates between both regions.

From this perspective, one piece of the puzzle that the structuralist analysis underestimates is that LA's low-productivity-growth in services is not just low effective demand/ informality-related, but also low-investment-related. An autoregressive distributed lag model indicates that in LA there is also a strong correlation in services between the growth of investment and of productivity—the former in terms of investment in infrastructure and business construction per worker employed in services (both series are stationary; see Palma, 2010). There is also a large and highly significant investment impact-multiplier. For example, in Brazil (1960–2008) the R^2=50%, the impact multiplier is 0.33, and its 't'=6.

From this perspective the squeeze of public investment (particularly in infrastructure) is, of course, a crucial component of LA's post-1980 abysmal rates of productivity growth in services. The investment boom in infrastructure and business construction in Chile between 1986 and 1998 is the exception that confirms that in LA, too, services can not only absorb labor (3.8% per annum), but also generate productivity growth (3.3%; see also Figure 23.12).[10]

In sum, low productivity growth in services is not just a low-effective-demand/low-GDP-growth phenomenon limiting the capacity of the 'modern' sector to absorb additional labor (with 'high-employment-absorption-informality' coming to the rescue, like the cavalry in every good old Western—the structuralist model). It is also the result of both the political economy of LA's labor markets, and low investment in business construction and (a mostly public-investment-squeeze-related one) in infrastructure endogenising sluggish output growth.[11] The resulting productivity growth rates may be poor, but there is a relatively stable low-intensity dynamic that the 'invisible hand' finds it difficult to break. This, together with peculiar politics (particularly when the 'new' left is involved), has led to political settlements characterized by 'low-intensity' Nash equilibria (Palma, 2009c). And where something different has been attempted, as in Venezuela, the results have been rather disastrous.

(p. 591) So, in most of the region today investment per worker is below, or at best similar to 30 years ago, and the unintended consequence of tight monetary policy (making sure that labor markets never even begin to get tight) is to preserve this 'market failure.' Unless governments get serious with (East Asian-style) trade and industrial policies, increased public investment, more growth-enhancing macros, more effective market compulsions and other forms of 'disciplining' the capitalist élite, it is difficult to envisage a breakthrough. Unique specific circumstances may have helped some countries to break

temporarily with this dynamic, but perhaps it is unsurprising that after a relatively short period they have returned to the fold, their burst of productivity growth having fizzled out. And despite a growing euphoria (and what Ortega y Gasset would have probably called an abundance of “self-satisfied individuals”), there is so far little evidence that Brazil's current growth-acceleration could prove to be the exception to this rule.

Within the context of the above-mentioned structural heterogeneity, LA has developed two types of successful ‘modern-sector’ regional oligopolies: those involved in large-scale capital-intensive commodity production for exports, and those that have mastered the technique of organizing low-value-added labor-intensive production chains—sometimes for exports (mostly agricultural products), and sometimes in services (eg. retail).[12] Ultimately, in LA, the commodity boom has lifted foreign exchange constraints; services have generated the precarious, low-productivity and low-wage employment (both formal and informal), while financial markets have provided all the fun.[13]

So, what is really wrong in post-reform LA is that neither the really ‘modern’ sector (usually associated with large-scale commodity production), nor the rest of the formal economy (mostly oriented towards the domestic market, although lately more regionally oriented), or (unsurprisingly) the informal sector are able to generate much of what really matters for the complexities of economic growth—i.e., the externalities and the spill-over effects, and the processes of cumulative causation that take advantage of dynamic economies of scale, increasing returns, etc. That is, those issues which are central to the ‘how-one-thing-leads-to-another’ Hirschmanian growth-philosophy when dealing with such complex market structures as those that characterize developing countries (often with the added problem of size)—complexities that get even more intricate as developing countries move to middle and high/middle income levels.

Although neo-liberals were just about the only political group who really understood Kalecki's idea that capitalism cannot endure the political consequences of sustained periods of full employment, Latin American neo-liberals have overshot in the opposite direction: capitalism with clearly insufficient labor market compulsions seems not to work very effectively either. That is, as capitalists practically need not compete with each other in the labor market, there are few market pressures coming from this direction either forcing productivity growth, or the investment levels necessary to back this up.

(p. 592) To perpetuate this, in most countries there is no collective bargaining, strike-breakers are legal, subcontracting labor (as a mechanism to bypass even timid labor legislation) is widespread (even in the public sector), minimum wages are not just remarkably low but often ignored, (even in the formal sector many workers do not have a contract), and there are still activities in which workers do not even have a legal minimum wage or some other basic right—domestic servants in Chile, for example, an occupation that accounts for 12% of female employment, still do not have a minimum wage, and their legal working hours are 12 per day, and so on.[14] And at the first sign of labor markets getting tight, not just ‘independent’ Central Banks, but also governments are quick to react. For example, in Chile, when the market for domestic servants became

slightly tight, and meager wages threatened to increase, the socialist government immediately opened up immigration from Peru—many things are possible in LA, but middle classes unable to afford domestic servants is not one of them.

23.5 Sectoral diversities and the “one-thing-at-a-time” processes of catching-up

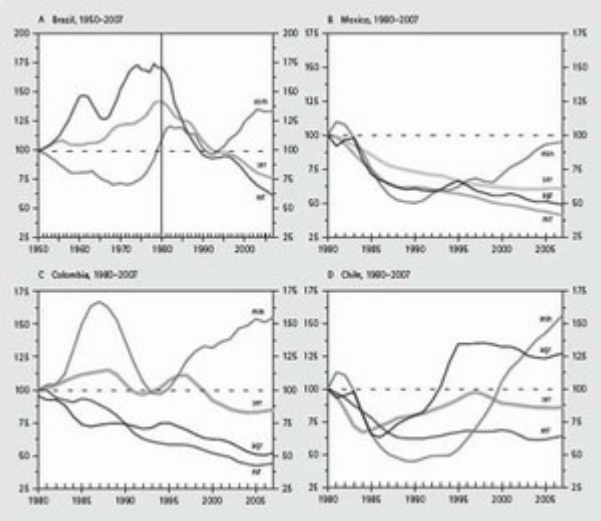

figure 23.12 Brazil, Mexico, Colombia, and Chile: relative productivity gaps with the US

Source: GGDC (2007); ILO (2010); and UN 2010.

Notes: com=commodities (primary sector); agr=agriculture, forestry and fishing; min=mining and quarrying; mf=manufacturing; and serv=services. Each line is an index number (1950=100 for Brazil, 1980=100 for the rest) of the ratio of labor productivities between the respective country and the US (each in real terms and domestic currencies). An increase implies ‘catching up’ with the respective labor productivity in the US, and a decline a falling behind. Three-year moving averages; due to sharp fluctuations, Colombia's mining is a 5-year one.

Figure 23.12 measures the relative productivity gaps of four Latin American countries vis-à-vis the US. In Panel A, Brazil's productivity gaps throughout the whole 1950–2007 period show very clearly LA's ‘one-thing-at-a-time’ style of catching-up. While pre-1980 ISI succeeded in significantly closing the manufacturing productivity gap, this happened at the expense of commodities; the opposite was the case afterwards. One big difference, however, is that (as in EA) the pre-1980 manufacturing catching-up also managed to pull services *à-la*-Hirschman. This goes a long way to explain the differences in the aggregate productivity growth rates between the two periods (3.7% per annum in 1950–1980 and 0.4% in 1980–2008). Another one, of course, is the superior growth-enhancing characteristic of manufacturing due to its dynamic economies of scale, spill-over effects, and so on. And yet another is the fact that the post-1980 commodities' catching-up (except in Chile) was really only a mining phenomenon.[15] This does not mean that agriculture had not also gone through a major transformation as well. In fact, a technological revolution has been unfolding, which has altered the organization of production and the social relations in the rural sector of several Latin American countries. In many cases, the traditional farmer has been replaced by ‘sowing pools’ and ‘cero tillage’ production arrangements. And this technological and organizational change

has not come about only because of the influence of multinationals; (p. 593) it has also been the result of domestic technological efforts involving R&D carried out both by public institutes (such as Fiocruz or Embrapa in Brazil, INTA and Instituto Malbran in Argentina, INIA in Chile), and local companies. Furthermore, the primary commodities revitalization has had the added advantage of benefiting from the post 9/11 surge in commodity prices. Yet, as this phenomenon has been fuelled by massive speculation, it may well prove to be no more than a short term bubble; although it is possible that it could last for longer, while China and India continue to surge ahead. However, the key question here, as well as with the mining, timber and fisheries' revolution is why they have had such little capacity to pull the rest of the economy with them. Basically, what is happening is that while a few activities in the primary sector have succeed in forging ahead in their efforts to 'catch-up' with their counterparts in rich nations, the bulk of the economy (including, as Figure 23.12 shows, most of manufacturing) is being left behind. "Convergence", therefore, seems to be a more complex phenomenon (p. 594) than it is implicit in neoclassical models. This is a remarkable fact that (with few exceptions; see Katz, 2004) finds little emphais in the literature.

Panel D synthesizes Chile's better 1986–98 GDP performance. What took place was mostly an investment-led burst of productivity growth in agriculture, forestry and fishing (10% p.a.), and increased productivity in services (3.3%), backed up by infrastructural investment and business construction. The growth of productivity in mining only started in the mid-1990s (when other sectors began to falter), reaching 11% p.a. in 1994–2003. Also, after falling behind in the 1980s, the productivity gap in manufacturing stabilized.

One phenomenon apparent from Panel B is Mexico's particularly poor performance. For reasons of space, I cannot analyze this here in detail (see Palma, 2005a) but, basically, an economy with FDI levels and access to the US markets that policymakers in other developing countries can only (day)dream of, has performed particularly disappointingly in terms of productivity growth—falling behind the US in *all* sectors.

Regarding the remarkable neglect of manufacturing, as argued elsewhere (Palma, 2005b and 2008), there is plenty of evidence to suggest that the closer one gets to the productivity frontier, the need for industrial policy increases exponentially.[16] From this perspective, the sad irony is that LA abandoned industrial policy at the very moment it needed it most! So, for example, Brazil's 1980–2007 manufacturing productivity has fallen behind the US's by more than a factor of three (Panel A). As all three groups of NICs were instead catching up with the US in manufacturing, LA fell behind them by an even larger *relative* margin—for example, the collapse of Brazil's productivity in manufacturing relative to Korea's is truly remarkable: since 1980, manufacturing productivity in Korea has forged ahead of Brazil's by a factor of 7.5! (Palma, 2010).

23.6 Exports as a Faltering engine of growth: the middle-income ‘export-trap’

As far as exports are concerned, LA moved from a situation in which pre-1980 exports and GDP were growing at roughly the same pace, to one where (on average) they grew about three times faster–3.5 in Mexico. As in the ISI period income elasticities for imports were certainly higher than one, there was an inevitable accumulation of foreign debt. Therefore, a pro-exports policy re-engineering was surely inevitable. However, the one chosen has not been the most effective: while the rate of growth of exports has increased on average by about half, that of GDP *fell* by half (excluding Venezuela, for the post-1990 economic reform period these rates are 8.1 percent and 2.6 percent, respectively). In this pro-exports policy re-engineering, the East Asian strategy of simultaneously insulating domestic markets and outwardly orienting manufacturing production was never even considered as an (p. 595) option. So, unsurprisingly, when comparing LA with the rest of the world the region generates a significant negative export-GDP dummy (Figure 23.13). The comparison between Mexico and Malaysia (or Thailand) in the middle of the figure is the most telling.

There is little doubt that one of the foundations of LA's negative export-GDP dummy is the fact that in an export-led model what matters is not only how much, but *what* one exports (and, of course, how one makes those exports—i.e., the ‘maquila’ issue). In addition, having a non-monetarist growth-enhancing macro-policy (able to deliver both a competitive exchange rate and a reasonable interest rate, as in most of fast-growing Asia) also helps. Figure 23.14 looks at this ‘quality’ of exports issue.

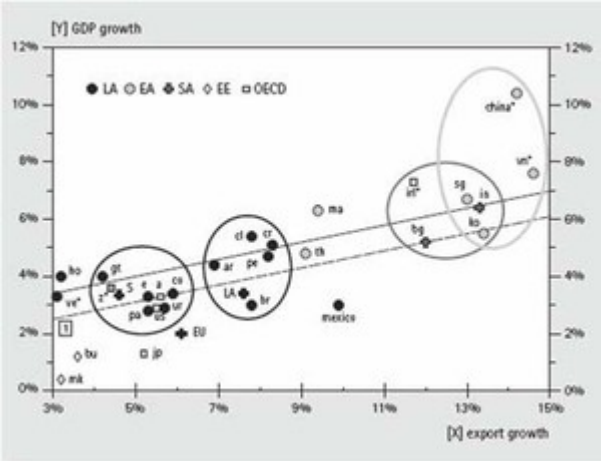

figure 23.13 Exports and GDP growth in four developing regions, 1990–2008

Source: WDI (2010).

Notes: [Y]=vertical axis; and [X]=horizontal axis. As Figures 23.2 and 23.10, and a=Australia; bu=Bulgaria; china*, export growth=17.1%; e=Ecuador; mk=Macedonia; S=Sub-Saharan Africa excluding South Africa; v*=Venezuela (exports growth=0.2%); vn*=Vietnam (exports growth, 19.8%); and z*=South Africa (1994–2008). [1]=intercept dummy for LA; there are also negative intercept dummies for the EE and the OECD (not included in Figure). LA=Latin America excluding Venezuela (including Venezuela, average export growth=6.9%). R^2 =79%, and all variables (including dummies) are significant at the 1 level (for regression statistics, see Palma, 2010).

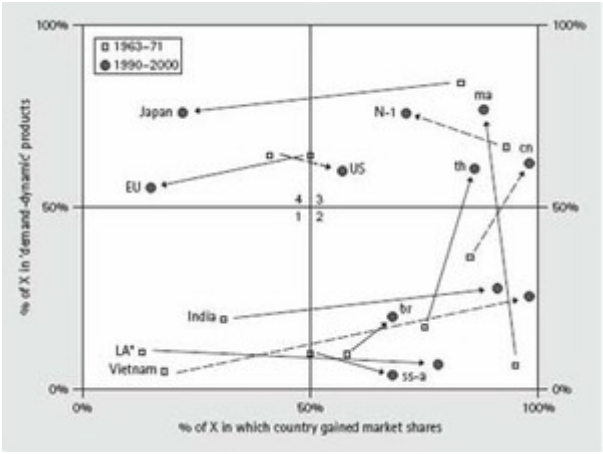

figure 23.14 "Anti-clockwise" export trajectories between the 1960s and 1990s Full title of axes: horizontal axis, Percentage of exports in which country/region gained market shares in OECD imports; vertical axis, Percentage of exports to OECD markets consisting of "demand dynamic" products.

Source: Trade-CAN (2009).

This figure shows that LA's remarkable increase in market shares (export-comp-etitiveness)—i.e., the successful movement from quadrants 1 to 2—was not accompanied by an improvement in the 'quality' of its exports—an upward movement from '2' to '3'. It is well-known that LA's improved export-competitiveness did not include many 'high-tech' products, with their high-positive-externalities and

spill-over-effects (Palma, 2009b). (p. 596)

Figure 23.14 indicates that it did not include demand-dynamic products in general.[17] Meanwhile in EA the swift movement of the N-2 and China from quadrants 2 to 3 is so fast that it even eats away some degree of export-competitiveness of the N-1. This process is much more acute vis-à-vis Japan (and the EU). With the exception of the US (mostly due to the Clinton years), the overall pattern that emerges is an anti-clockwise trajectory.

(p. 597) For LA and other countries moving into quadrant 2, the crucial trade and industrial policy issue is whether there are *endogenous* market forces that would lead them afterwards in an upward '2-to-3' trajectory. Or whether there are crucial (Ricardian) market failures that would trap them into being increasingly competitive in products that tend to be marginalized (in value terms) from world markets—except for temporary cycles such as those benefiting many commodities after 9/11, and after the 2008 global financial crisis. Furthermore, especially in commodity-markets, excessive competitive struggle for market shares often leads to a self-defeating fallacy of composition problems.

So far, there is little evidence of endogenous upward forces from '2-to-3.' Countries in quadrant 2 seem to need an East Asian-style 'exogenous push'. For these policies to be effective, however, what is also needed is an underlying power structure and institutional arrangements that would allow them to be successful (as was the case in most of Asia). These include a professional bureaucracy capable of devising a competent educational and training system that encourages the acquisition of productive capability, as well as being able to implement intelligent trade and industrial policies that generate rents as incentives for the transfer of resources towards more growth-enhancing activities (such as those with more long-term productivity growth potential), and, a state strong enough to be capable of imposing performance-related conditionalities to 'discipline' the capitalist élite to use them effectively—i.e., a state capable of threatening non-performing companies credibly with withdrawal of subsidies.

If these policies—and the institutional arrangements necessary for their success—are not implemented in LA, the potential GDP-growth-enhancing effect of further increases in export-competitiveness would continue to be restricted by the generally low productivity growth *long-term* potential of its current export pattern, its modest positive externalities and spill-over effects, and its low capacity to induce productivity growth elsewhere in the economy (including services). In other words, as has become evident so far, without these policies LA's current export pattern has little capacity to generate growth-enhancing processes of cumulative causation.

Existing evidence for LA indicates that the (not-so-)invisible hand of globalised markets are only creating incentives leading towards further penetration into quadrant 2. This quadrant-2 'stickiness' is what I like to call the middle-income 'exporter trap.' This 'trap' seems to be equally relevant to those who export commodities (in terms of the difficulties to increase the share of manufacturing value added in their exports via the up and downstream manufacturing activities associated with commodity extraction and

processing, as in the Nordic model), as to those who export 'maquila'-manufacturing (in terms of the difficulties to increasing the share of value added in the gross value of output). In fact, current Ricardian international comparative advantages, as Cimoli, Dosi, and Stiglitz (2009) state, "are a luxury that only technological and market leaders can afford (indeed a major asset that they can exploit)." One case in point is Chile, whose Ricardian comparative advantages led to a horizontal export trajectory (in fact, slightly downward) from quadrant 1 to 2. Its copper industry is a good example; while rapidly gaining market share, Chile has actually been *reducing* the share of manufacturing value-added in its copper exports, with the proportion of refined copper in total exports being drastically reduced in favor of the far more (p. 598) primitive copper 'concentrates' (Palma, 2009b). Not much evidence of a Hamilton-List-Akamatsu-style logic here. There is ample evidence, however, that the sharp slowdown in Chile's growth since the late 1990s is partly due to this underinvestment in upward productive diversification (Moguillansky, 1999). Finally, the nature of regional trade agreements with the U.S. is likely to make the '2-to-3' transition even more intricate—as opposed to Asia's Japanese and Chinese 'upward pulling' powers.

In sum, export-led growth when based on relatively unprocessed primary commodities or 'thin' maquila exports has proved to be a poor engine of growth. The main lesson from post-reform LA is that if the region wants to insist on this export orientation, it should think about this model only as an export-'enabling' growth-strategy, not as an export-'led' one. That is, one in which dynamic (but not much growth-enhancing) exports can only be expected to provide the necessary foreign exchange to enable a fast rate of growth that is not balance-of-payments constrained. However, for this growth actually to take place there is still the need for a proper 'engine' to be found elsewhere in the economy. That is, other sectors or activities that would play the role of 'production frontier shifters', able to set in motion processes of cumulative causation—characterized by their positive feedback loops into the system, and capable of generating a momentum of change which is self-perpetuating (e.g., in the Veblen/Myrdal or Smith/Young/Kaldor manner). There is not much evidence from LA that unprocessed primary commodities or 'maquila' exports can play that role—nor that the countries of this region have made much effort toward export-upgrading or looking elsewhere for an effective engine of growth.

As Stiglitz has often said, even from the perspective of mainstream economics, in a world full of distortions the lifting of one (e.g., a trade barrier) does not necessarily lead to a superior (let alone optimal) equilibrium. Or, as Lipsey and Lancaster demonstrated half a century ago, "if one of the Paretian optimum conditions cannot be fulfilled, a second best optimum situation is achieved only by departing from *all* other optimum conditions" (1956, p. 12; emphasis added). For example, if policy makers in LA ignore distortions simply because they are out of bounds (such as Asian competitors with 'distorting', pro-growth macros, and 'distorting' trade and industrial policies) and design what they—from their mainstream perspective—consider to be 'first-best' policies (and apply, for example, flexible exchange rates, a low and flat import tariff, or abandon trade and industrial policies), then the likely outcome will not even be 'second-best'. Additionally, if policy makers in LA keep assuming they live in a world in which the

‘efficient capital market theory’ rules, and continue to implement sweeping financial deregulation and full opening of capital accounts (as if all that mattered in financial markets were market discipline and self-regulation), the likely outcome is even more financialisation, financial fragilities, overvalued exchange rates, and so on.

Surely it is time to realize that free trade, Ricardian comparative advantages, fully open capital accounts, ‘flexible’ exchange rates, ‘independent’ monetary policy, regressive taxation, liberalized finance, economies on automatic pilot with policy ‘neutrality’, and so on may be internally coherent in mainstream economic models, but do not lead to sustainable growth. Although there is little doubt that pro-growth macros, progressive taxation, strategic trade and industrial policies, coordination of investment, capital controls, a competent educational system, and so forth are challenges as big as they (p. 599) come, why should it be that only Asian countries are able to master this course of action effectively? Perhaps LA's ‘purity of belief’ is just an excuse for not even trying …

To summarize, perhaps the main problem with LA's neo-liberal economists (of all political denominations) is how a rigid ideology seems to constrain their core policy making from moving beyond a virtual world of ‘first bests’. As a famous Chicago-trained economist said recently in Chile, the main problem with Latin American market fundamentalists is “… that [their] ideology … is blind to the common sense.” (www.stanford.edu/dept/SUSE/ICE/pdfs/Chilepaper.pdf).

23.7 Manufacturing as a faltering engine of growth due to Latin America's premature de-industrialization

It's hard to believe today that during the 1960s LA was the undisputed manufacturing powerhouse of the South, responsible for nearly three of every four dollars of manufacturing value-added generated there (Panel A, Figure 23.15). Although its share began to fall in the 1970s due to some inevitable catching-up from late-starters, this process accelerated after 1980 in such a way that by 2008 LA's share represented just one-fourth of the total—and adding Taiwan, just one-fifth. As South Asia has kept its share almost intact, and as Sub-Saharan Africa represents a small proportion of the total, what was really going on was a switching of position between LA and EA. That is, when the inevitable catching-up from East Asian late-starters began to take place properly, LA, instead of putting up a fight, threw in the towel.

LA's relative decline is particularly acute in the case of Brazil. By the mid-1970s Brazil's manufacturing output was almost identical to the *combined* output of China, India, Korea, Malaysia and Thailand. By 2008 its manufacturing output was equivalent to less than 10 percent the combined output of these 5 Asian countries (WDI, 2010). This turnaround took place because while between 1965 and 1980 Brazil's manufacturing output was able to grow at roughly the same pace as the combined output of these Asian countries (9.2% and 9.5%, respectively), between 1980 and 2008 it did so at a rate which was just one-

fifth the Asian one (1.9% and 9.8%, respectively–2.1% vs. 10.1% for the post-1990 economic reform period).

In turn, Panel B in Figure 23.15 shows that in manufacturing (unlike in exports) LA is best represented by the base regression: poor performance in manufacturing is linked to similarly poor performance in GDP. Also, the most robust specification for this relationship tends to confirm ‘Kaldorian’ dynamic increasing returns in manufacturing; that was not the case for the (linear) export regression.

Together with low rates of accumulation and lack of upward export capacity diversification, there is little doubt that the remarkable neglect of manufacturing lies at the heart of LA's productivity problem, especially its long-term sustainability.

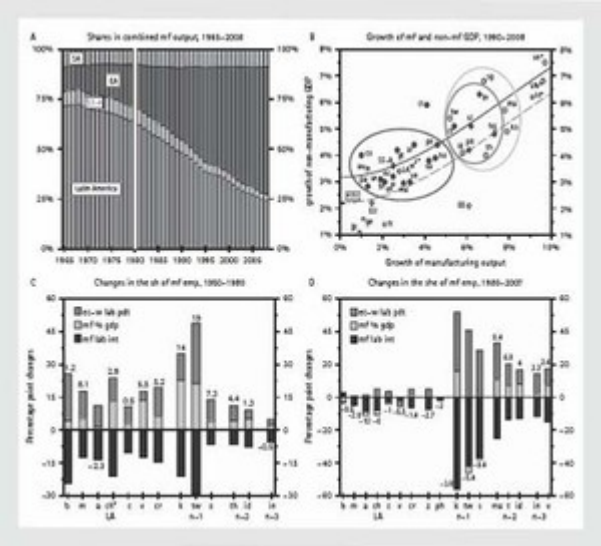

figure 23.15 Latin America: the neglect of manufacturing and the post-1980 process of de-industrialization Full titles: Panel A, Developing regions: shares in combined manufacturing output, 1965–2008; Panel B, Growth of manufacturing output and of non-manufacturing GDP, 1990–2008; Panel C, Changes in the share of manufacturing employment: a three-way decomposition analysis, 1950–80; and Panel D, 1980–2007

Source: for manufacturing output, WDI (2010; in Panel B, for some Eastern European countries data are only available from 1995). For manufacturing output in Ireland, UN 2010, and in Taiwan, Taiwan 2010. For manufacturing employment, GGDC (2007) and ILO (2010). In Panels C and D, Tregenna 2009 was used for the methodology in the 'three-way decomposition' analysis.

Notes: in panels C and D, 'ec-w lab pdt'=economy-wide labor productivity; 'mf gdp'=the share of manufacturing in GDP; 'mf lab int'=labor intensity in manufacturing (the inverse of labor productivity). Percentages shown above each bar are the overall percentage change in the share of manufacturing in total employment (the net effect of the three processes at work); when the figure is negative, the percentage is shown below the bar. Regions: in Panel A according to WDI definitions; EA excludes Taiwan. In Panel B, SS-A=Sub-Saharan Africa (excluding South Africa); and EE=median country for EE (Hungary). Countries: in Panels B, acronyms as Figures 23.2 and 23.10; and cn*=China (manufacturing growth=12.3%); h=Honduras; fr=France; ge=Germany; m=Mexico; u=US; id=Indonesia; and pk=Pakistan. [d EU]=intercept dummy for the EU; there is also a negative intercept and slope dummy for EE, and a negative intercept dummy for SS-A not shown in the graph. In Panels C and D, acronyms for as Figures 23.2, 23.6 and 23.10, and ch*=Chile (1950–73); Malaysia and Vietnam are excluded from Panel C due to lack of data on manufacturing employment. R^2 in Panel B=71%; all variables are significant at the 1% level (for regression statistics, see Palma, 2010).

Finally, Panels C and D build on my previous work on de-industrialization (Palma, 2005b, and 2008), this time using an imaginative decomposition methodology (Tregenna, 2009), which disaggregates the changes in the share of manufacturing employment into its three (p. 600) (p. 601) main components—the economy-wide labour productivity, the share of manufacturing in GDP, and the labour intensity in manufacturing (i.e., the inverse of labour productivity). The main findings are: first, with the exception of Argentina, between 1950 and 1980 (Panel C) changes in the share of employment in manufacturing were all positive, and were the outcome of large changes in its three components. Second, that LA's post-1980 decline in the share of manufacturing employment (Panel D) are similar to those of much more advanced, N-1 economies (rather than those at more similar level of development' the N-2). Third, that the post-1980 decline in the share of employment in manufacturing, although similar in size to those in the N-1 countries, was the result of forces of a *very* different nature. This suggests that after trade liberalization and neo-liberal reforms LA adopted a type of 'standing still' defensive strategy in this respect. And fourth, as the evidence of Panel D suggests, that rather than referring just to the 1980s as the 'lost decade,' as far as manufacturing is concerned, in LA the three post-1980 decades might well deserve that label.

ISI's legacy, of course, was not helped either by the distortions created by its rigid protection in highly-income-unequal domestic markets, as incentives inevitably led to horizontal diversification because there were more rewards for developing new products than for productivity 'deepening'. In this sense, despite its discourse, ISI did not really have an 'infant industry' agenda because its logic was not one of temporary protection to help—and push—firms to get to the frontier and become internationally competitive (Pérez, 2008; Díaz-Alejandro, 1989; and Fajnzylber, 1990). Rather, it was usually supposedly 'infant' corporations (eg. General Motors, ITT, General Electric, Bayer, or Nestlé) who were being protected with effective rates that sometimes reached four-digits. In fact, there was actually a 'double play': with big exceptions (eg. EMBRAER), the manufacturing industry that emerged from ISI may have been too fragile to adjust to the

new open paradigm (especially at the speed taken by trade liberalization, and the unnecessary difficulties and distortions created by monetarist-macros). But what developed around ISI (including institutions, suppliers and skills) was considerable.[18]

On the supply side, after trade liberalization LA's manufacturing had to struggle against an Asian “double-squeeze”. On the one hand (and as mentioned above), as low-income Asia had mastered labor-intensive techniques in manufacturing—where wages are even lower, labor is in abundance, and exchange rates and interest rates are kept at levels which are both stable and competitive—LA found it particularly difficult to compete in low-wage, labor-intensive, tiny-profit-margins manufacturing (except when its proximity to the US favored ‘maquila’ activities). On the other, LA's manufacturing also found it difficult to compete with technologically-advanced, rapid-product-evolving manufacturing production from high-middle income Asian countries, with their huge investment rates, effective trade and industrial polices, ‘pro-growth’ macros, and outstanding technological-absorpting capabilities. From this perspective, what is particularly difficult to understand is what little effort was made by Latin American countries to develop the obvious manufacturing niche available to them: the up and downstream manufacturing activities (p. 602) associated with commodity extraction and processing. Moreover, on the demand side, Latin American-style neo-liberal capitalism has been characterized by a chronic deficiency of effective demand for its non-commodities tradable sector, especially manufacturing. This has been the direct outcome of the ‘deadly triad’ of undervalued labor, overvalued exchange rates (backed up by high interest rates), and ‘sterilized’ governments. These are, respectively, the direct outcome of ‘flexible’ labor markets, open capital accounts with ‘tough’ macros, and governments with their hands (institutionally) tied in terms of implementing effective countercyclical action and proactive public investment.

To summarize, in post-reform LA there is not much evidence in manufacturing of the characteristics that have been associated with a ‘high-imagination-enabling-country.’ Rather, evidence in Panel D points towards countries whose manufacturing sectors are (defensively) ‘in hibernation’.

23.8 Conclusions

In the economic literature there are three different analytics of growth, but only in one is growth analyzed as a ‘sector-specific’ phenomenon (the structuralist/Post Keynesian/ heterodox tradition; see Palma, 2005b, 2008). From this perspective, LA's abysmal TFP-record well after economic reform should make those who believe otherwise think again. For example, how can those in the Washington Consensus—with their emphasis on ‘getting the prices right’ and ‘getting the institutions right’—explain that well after putting into practice open capital accounts, free trade, balanced public accounts, well defined and enforced property rights on physical capital, independent central banks and so on (i.e., well after having set the Latin American economies on automatic pilot and policy neutrality), LA's TFP record can still only be described as appalling?[19] And the

well-rehearsed argument that what is needed is yet more of the same sounds increasingly hollow. Perhaps the main lesson from LA's experiment with neo-liberal reforms is that the Washington Consensus is just one of the many heaps of ideological recipes still waiting for a theory relevant to the real world (or a bonfire …). How can it explain how so many in Asia do things 'wrong' (sometimes *very* 'wrong') but develop fast, while LA does almost everything 'right' (and with so much 'credibility', and scoring so high in the usual indices, such as those of 'economic freedom', 'competitiveness', and so on), but can only achieve a low-intensity growth dynamic—with all its difficulties in creating, let alone sustaining productivity growth—that the 'invisible hand' does not know how to break? When Keynes said that people usually prefer to fail through conventional means rather than to succeed through unconventional ones, he could not have guessed just how accurately his remarks would define LA today.

(p. 603) So, most of Asia gets a capitalism that is pretty unsavory (with all its contradictions, unfairness and excuses), but at least capable of developing many of the productive forces of society.[20] LA, meanwhile, gets a neo-liberal brand of capitalism which is not even able to offer much productivity growth—i.e., LA gets the cloud without the silver lining. This is mostly due to an elite that does not want to know what capitalism is really about, and a bunch of highly-trained economists who still believe that when it comes to policy making the first commandment is that one has to stick to the 'first-best'. From the latter perspective, perhaps the key difference between LA and Asia is that policymakers in the former still believe that the Washington Consensus is a set of ingenious tricks devised by Dumbledore, while the latter instinctively know that they actually are the work of Voldemort … Apparently, in LA market capitalism is a system in which only workers and small firms continuously have to struggle to improve their performance just to survive; for big capital the rules of the game are more agreeable. What the new neo-liberal paradigm seems not to grasp is that it is one thing to implement reforms to create market *opportunities*, but quite another to ensure that there are sufficient market *compulsions* to guarantee that these opportunities are taken up (Wood, 2002; and Khan, 2005). As a result, LA's brand of capitalism is characterized as much by its capacity to generate market opportunities as by its ability to waste them. What LA urgently needs today is new institutions to help create both the required capabilities and the necessary compulsions for productivity growth, especially those that would help to 'discipline' the capitalist elite *à-la* EA. It also needs a new structure of property rights—including well-defined and enforced rights on skills à la Japan or Germany (Pagano, 1991). And, of course, the ideology to back this up would also help—as Gramsci said, more often than not battles are won or lost on the terrain of ideology.

Added to this is the already mentioned phenomenon that Latin American-style capitalism has also been characterized by a chronic deficiency of effective demand from the 'deadly triad' of undervalued labor (due to 'flexible' labor markets), overvalued exchange rates with high interest rates (due to open capital accounts and monetarist macros), and 'sterilized' governments.

In summary, the region's growth performance since economic reform may be rather disappointing, but Latin American-style neo-liberal capitalism is unrivaled when offering world-class commodities, an abundance of (precarious, low-productivity and low-wage) jobs, stylish retail, lucrative finance, and the ‘purity of belief’.

By now it should be obvious that ‘flexible’ labor markets do not transform an oligarchy into a proper capitalist class; even from a neo-liberal perspective surely one can have too much of a good thing. The same happens with the opening of capital accounts excessively reinforcing (p. 604) the domestic élite's ‘high-appropriation-cum-little-accumulation’ distributive strategies, and its long-standing biases for mobile assets. As discussed in detail elsewhere (Palma, 2009a and 2009c), neo-liberalism may well have become the most effective technology of power ever in terms of its capacity to get away with such remarkable inequalities and political settlements *within democracies*. That is, for its capacity to transform a particularly asymmetric set of distributive strategic choices, and the corresponding payoffs, into a Nash equilibrium by convincing the majority that there is no point trying to challenge these strategies while the all-too-powerful top income players keep theirs unchanged. What is particularly remarkable about neo-liberalism is its capacity to achieve this not by traditional forms of social conflict resolution, such as ‘chicken’ or ‘hawk-dove’ games, but mostly by ideological conviction. In other words, there is no longer any need for neo-liberals to threaten the majority with the idea that they have too much to lose and little chance of winning by challenging the top player's strategy. Now, by convincing the majority that this is the only workable game in town, they can get away with such a remarkably asymmetric distributional outcome through a spontaneous consensus type of hegemony (in the Gramscian sense). As a result, in most of LA military regimes—as a hedge against a distributional challenge by the majority—have become obsolete. The key point here is that there is a big difference between the great majority entering into such an unfavorable Nash equilibrium out of having ‘thrown in the towel’ when faced with overwhelming odds against the likelihood of succeeding in challenging the ‘pure’ distributional strategy of the capitalist élite, or entering into this Nash equilibrium simply out of ideological conviction. If the latter dominates, the game would then cease to be one of ‘chicken’. The astounding aspect of this most unlikely of Nash equilibria (in which the great majority is now ideologically prepared to put up with such an unequal distributive outcome as if it was just their lot in life) is that it takes place despite the obvious ‘collective action’ conundrum by which the majority could clearly improve their payoffs if only they could somehow agree on a strategy different from the current one. This most unlikely of Nash equilibrium surely deserves an entry in the ‘Guinness Book of Political Records.’ However, with very few exceptions, from an economic perspective, this remarkable set of (‘by ideological conviction’) Nash equilibria in terms of political settlements and distributive outcomes seems only able to deliver nearly productivity-less growth and a huge process of financialisation. For example, in the five-year period before the global financial crisis the capitalization of LA's stock exchanges increased 10 times faster than GDP (IMF, 2009). So (as mentioned above), in Latin American style neo-liberal capitalism, commodities provide the foreign exchange, services the jobs, and financial markets the fun. So this is a rather good example of a

Nash equilibrium that (although rather pleasant for the élite) is clearly not Pareto optimal. Perhaps, the very fact that this equilibrium has been unchallenged from within is a significant ingredient in the dynamic that leads to productivity-less growth. When Adam Smith said that 'without competition there is no progress', he was surely also referring to ideology. And as Ortega y Gasset explained, "human history is the product of discontent." The UNDP may well call this model 'pro-poor' because the alternative could be South African unemployment levels—but (despite all the current euphoria in Brazil) there is no emerging 'tiger' in sight.

Some economists, like Rodrik, have argued that in LA the contrast between the two periods is based on the fact that during ISI there were incentives to invest (industrial (p. 605) policies), but little market discipline due to lack of competition. In turn, during the reform period there was little incentive to invest, but a lot of market discipline. However, on the latter issue, I think the region is still waiting for the real thing—as the head of Chile's largest holding company and former President of the Confederation of Chilean Industry explains, "[t]his is a market economy in name only. Competition has disappeared; mergers and acquisitions have led to a huge degree of oligopolistic concentration." (http://www.atinachile.cl/node/4629). Moreover, one should never forget that in many countries in EA the 'market discipline' has had an added 'state discipline' component; i.e., the ability of the state to threaten non-performing companies credibly with withdrawal of subsidies.

Those in heterodox circles who like to look at the Anglophone periphery as models (i.e., Ireland and New Zealand rather than Korea or Malaysia), and argue that what LA needs to be able to replicate their pattern is an industrial policy that attracts FDI to fill the more challenging productivity gaps, create 'clusters', and so on, have something to explain: how will middle-income LA ever become a dynamic capitalist endeavor without a proper domestic capitalist class (like those found in some Asian countries)? In this respect, the weakness of post-reform FDI-intensive Mexico is particularly telling. And oddly enough, many pre-1980 structuralist thinkers made the same mistake, expecting (in vain) that FDI would be the force that would transform ISI into a more export-oriented endeavor. Despite its many contributions, FDI was actually part of ISI's main problem: its anti-learning bias (Pérez, 2008). In addition, even when it was the Latin American domestic firms that had contracts with foreign companies, they normally had to import the technology and use it rigidly as it came; whenever possible, they also had to import the machinery and parts. In the early 1970s Brazil may have produced more cars than the whole of developing Asia put together, but there was no *Hyundai* in sight …

Surely it is time to acknowledge that Latin American economies, some of them already well above the ten thousand dollar mark in per-capita PPP terms, should be perfectly capable of both relying on their own resources and capabilities, and dealing with their two main current challenges. The first is the one facing LA's neo-liberal economists of all political persuasions: when it comes to policy making, how to abandon their fantasy world of the 'first-best'. The second is the one facing LA's capitalist élites: how to change their long-standing addiction to 'low-intensity' economic life (currently so well nourished by

the ‘discreet charm’ of a narcissistic ideology) for the Schumpeterian ambitions of some of their Asian counterparts—with their Canon-style motto: ‘if anybody can, we can’.

Perhaps the key difference between the Latin American and many Asian oligarchies simply boils down to the fact that while the former have ‘tenure’, the latter have continuously to deliver if they want to go on enjoying their power and privileges (Palma, 2011).

Alexis de Tocqueville once said that he “[could not] help fearing that men may reach a point where they look on every new theory as a danger, every innovation as a toil-some trouble, every social advance as a first step toward revolution, and that they may absolutely refuse to move at all” (quoted in Judt, 2010). Neo-liberalism (despite all the flashy virtual realities and fickle-minded euphorias) may well be leading LA into that cul-de-sac …

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Notes:

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(1) For Hobsbawm the business of historians is to remember what others forget. Today in LA this applies also especially to economists.

(2) Referring to these two contrasting periods, Michael Porter once said that Chile was like a two-act play; by then Chile was well into the second act, but most Chileans were still giving the first a standing ovation …

(3) Due to space constraints, for relevant statistics, see Palma 2010.

(4) At least easy access to mobile assets help oligarchies become more democratic (Boix, 2003).

(5) In South Africa (in this respect, LA's honorary middle-income country in Africa), and in The Philippines (the honorary one in Asia) similar low ratios for private investment as a proportion of the income share of the top decile indicate that their capitalist élites have the same Latin preference for having their cake and eating it … Also, as discussed in

detail in Palma (2009c), with globalization there seems to be now more Latin-'contagion', as LA is now exporting its political economy to the US. In the latter country, private investment as a percentage of the income share of the top decile has fallen from about half (before 1980s' Reagan) to a more relaxed 'Latin' level of about a third. In other words, and as opposed to Marx's prediction, now it is the less developed countries that seem to be showing the more industrialized ones the image of their own future.

(6) In Brazil (1960–2008), for example, the R^2=68%, and the impact multiplier is 0.37 (with a 't' statistics=9).

(7) In Chile I have chosen 1986 as the starting date of the high growth period because after the 1982 crisis the economy only recovered its pre-1982 level of GDP in 1987.

(8) For Kaleckian growth-dynamics, see Ocampo, Rada, and Taylor (2009); and Taylor 2010.

(9) For a discussion of the important econometric issues raised by cross-section regressions like these, see Pesaran et al. (2000). In particular, one has to understand that these regressions are simply a cross-sectional *description* of cross-country differences, categorized by the explanatory variable. That is, they should *not* be interpreted in a 'predicting' way, because there are a number of difficulties with a curve estimated from a single cross-section—especially regarding the homogeneity restrictions that are required to hold.

(10) On average, post-1973-Chile has seen no productivity growth in services either before or after the 1986–98 period of high investment in infrastructure and business construction.

(11) In most of LA net-investment in infrastructure and business construction was remarkably poor; see Hofman 2000.

(12) Their success has made the entry by foreign firms into the latter markets difficult; it is only when these regional oligopolies need new technologies that they get a foreign partner—see Robinson 2008.

(13) In LA (2002–7) the capitalization of the stock exchanges increased *annually* by 45% in real terms, bank assets by 21%, and private and public bonds by 22% and 25% (see IMF, 2009).

(14) In Mexico, for example, in real terms, (i.e., when deflated by the consumer price index) in 2010 the minimum wage was worth just one-third of its 1976 value. (see http://www.inegi.org.mx). Latin American neo-liberals have not paid much attention to Churchill's views that low wages only subsidize inefficient producers, because "… the good employer is undercut by the bad, and the bad employer is undercut by the worst."

(15) Even in Argentina, and despite the boom in soya, the overall agriculture productivity gap with the US widened vis-à-vis 1980.

(16) See also, Khan and Blankenburg (2009).

(17) In Palma (2009b) I show that the statistic used in Figure 23.14 to measure ‘demand-dynamics’ could also be considered a proxy for a product's technological content.

(18) Unfortunately, ISI was not allowed to transform the region's political configuration either (as a normal process of industrialization would have done)—military regimes put a stop to that.

(19) Not much evidence, though, of ‘getting the social capital right’, but this was never part of the neo-liberal blueprint. As Mrs. Thatcher famously made it clear, from a neo-liberal perspective “there is no such a thing as society, just individuals.”

(20) India, for example, is an extreme example of this. It has had 30 years of remarkably rapid GDP-growth, leading to a near six-fold increase in GDP, and threefold boost in productivity. However, according to the Multidimensional Poverty Index (an index that measures the ‘deprivations’ in households—from education and health to assets and services), just eight Indian states currently account for more poor people than in the 26 poorest African countries combined (421 million). And the ‘intensity’ of the poverty in parts of India is often worse than that in Sub-Saharan Africa (see http://www.ophi.org.uk/policy/multidimensional-poverty-index/).

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