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# The Demise of Economic Development in Latin America and Its Implications for Other Developing Countries

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This paper reviews the demise of development in eight non-oil-exporting, reasonably large Latin American countries — Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru — and the contrast of their experience with the relative success of various East Asian countries including Korea. Several alternative explanations for the demise of development in Latin America are considered. Among them the failure to maintain balanced fiscal budgets and other political economy factors are identified as being relatively important. Even so, it is primarily the interrelationships among the various different factors that explain the demise of Latin American development and major difference in performance between the different Latin American countries and Korea. The analysis, which takes advantage of insights from the new institutional economics, yields several implications for policy and highlights the need for further research on several important issues.

## I. Introduction

The purpose of the present paper is to derive certain lessons for other less developed countries (LDCs) of the recent demise of development in Latin America. The paper is organized as follows: Section II highlights the divergent rates of growth experienced by Korea on the one hand and eight relatively large, non-oil-exporting Latin American countries (deemed to be most comparable to Korea) on the other hand. Section III examines the relevance of several general explanations for the comparative development failure of the Latin American countries. Section IV concentrates on the role of labor organization and political economy. Finally, Section V presents some implications for policy as well as future research.

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## II. Recent Latin American Economic Development and Its Relation to Korea

While various alternative starting dates might be proposed for tracing the rise and fall of Latin American economic development, in this study we begin with the mid-1950's. Only by the mid-1950's had the distorting effects of the two world wars and the great depression which had occurred in between them (and which had done much to deter the spread of modern economic growth to the less developed countries (LDCs)) been overcome. Thus only in the mid-1950's were conditions again ripe for the world economy to resume its apparently inexorable drive toward integration and for the economies of LDCs to once again resume the rapid growth that was observed in many of them during the several decades preceeding World War I.

In the mid-1950's few LDCs were in as favorable positions as those of Latin America. Latin American LDCs had not only escaped the ravages of war but had even profited from war by accumulating sizeable stocks of international reserves as a result of their wartime exports of raw materials and by receiving many relatively wealthly experienced and well-educated entrepreneurs and skilled professionals who were fleeing war and persecution in Europe. As shown by Diaz-Alejandro (1982), for the most part Latin American countries had also avoided the effects of the depression much more successfully than most other countries, developed countries (DCs) or LDCs alike. Among LDCs at least, Latin America was clearly playing a leading role.

Latin America's leadership among LDCs included leadership in economic doctrine and development strategy. Latin American economists, such as Raul Prebisch of Argentina and Celso Furtado of Brazil among others, called the world's attention to the problems associated with excessive dependence on primary exports and provided the rationale for successive new strategies of development, such as import-substituting industrialization (ISI) and regional economic integration. These new strategies were widely imitated by other LDCs as these countries gained their political independence in the course of the subsequent decade.

In order to afford a useful comparison with Korea, our examination of Latin America is fosuced on the following eight relatively large, non-oil-exporting countries: namely, Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. (Mexico became an important oil exporter only in the late 1970s.) As shown in Table 1, in 1955 the GNP per capita of Latin America and the Caribbean as a whole was approximately two

**Table 1**

GNP PER CAPITA IN CURRENT U.S. DOLLARS
1955-1988

| | 1955 | 1960 | 1965 | 1970 | 1975 | 1980 | 1983 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 649 | 596 | 963 | 910 | 1810 | 1960 | 1950 | 2120 | 2360 | 2360 | 2520 |
| Bolivia | 89 | 104 | 139 | 230 | 360 | 490 | 490 | 490 | 510 | 570 | 570 |
| Brazil | 289 | 283 | 285 | 450 | 1070 | 2080 | 1820 | 1670 | 1840 | 2020 | 2160 |
| Chile | 147 | 528 | 705 | 850 | 870 | 2110 | 1930 | 1450 | 1310 | 1310 | 1510 |
| Colombia | 200 | 274 | 336 | 340 | 560 | 1220 | 1440 | 1350 | 1280 | 1230 | 1180 |
| Costa Rica | 361 | 404 | 390 | 560 | 950 | 1950 | 1060 | 1400 | 1500 | 1550 | 1690 |
| Mexico | 245 | 301 | 392 | 710 | 1360 | 2320 | 2290 | 2200 | 1900 | 1820 | 1760 |
| Peru | 173 | 197 | 362 | 520 | 1000 | 990 | 1140 | 1010 | 1150 | 1430 | 1300 |
| Latin America and Caribbean | 255 | 330 | 440 | 570 | 1120 | 1930 | 1890 | 1750 | 1740 | 1780 | 1820 |
| Korea | 108 | 136 | 136 | 260 | 580 | 1620 | 2020 | 2160 | 2370 | 2690 | 3600 |

*Source:* International Monetary Fund, *International Financial Statistics Yearbooks,* various years; World Bank, *World Tables,* various years.

and one-half times that of Korea. Among the aforementioned eight non-oil-exporting countries of Latin America, only one, namely Bolivia, had a lower per capita income in 1955 than that of Korea. Argentina's GNP per capita was about six times that of Korea. The demise of Latin American development is highlighted by the fact that, by 1988, Korea's GNP per capita was virtually double that of Latin America and the Caribbean and none of the Latin American countries had a per capita income as high as three-quarters of that of the Republic of Korea. During the 1980s, moreover, most Latin American countries were enduring substantial reductions in per capita income evaluated in U.S. dollars.

Table 2 presents comparable data on growth rates of real GDP and real GDP per capita for the years 1965-1988. While Brazil, and to a lesser extent, Mexico and Costa Rica enjoyed rates of real GDP growth approaching the growth rate of Korea for the period 1965-1980, all other Latin American countries lagged far behind. The demise of Latin American development became especially striking for real GDP growth during the 1980-1988 period. Because of the more rapid population growth in most Latin American countries and the aforementioned sharp

**Table 2**

AVERAGE ANNUAL GROWTH RATES OF REAL GDP AND REAL GDP PER CAPITA, 1965-1980 AND 1980-1988

| Country | Rate of Growth of GDP Per Capita in Constant Prices | Rates of Growth of GDP in Constant Prices | |
|---|---|---|---|
| | 1965-1988 | 1965-1980 | 1980-1988 |
| Argentina | 0.0 | 3.5 | -0.2 |
| Bolivia | -0.6 | 4.5 | -1.6 |
| Brazil | 3.6 | 9.0 | 2.9 |
| Chile | 0.1 | 1.9 | 1.9 |
| Colombia | 2.4 | 5.6 | 3.4 |
| Costa Rica | 1.4 | 6.2 | 2.4 |
| Mexico | 2.3 | 6.5 | 0.5 |
| Peru | 0.1 | 3.9 | 1.1 |
| Korea | 6.8 | 9.5 | 9.9 |

*Source:* World Bank, *World Development Report*, 1989.

fall in Latin American growth in the 1980s, the overall differences in growth rates in per capita terms for the period 1965-1988 are even sharper than those for real GDP.

While Korea has not been alone in enjoying a dramatic rise in per capita income in recent decades, the demise of Latin American development has come as a shocking surprise. As a result, the failed development in Latin America deserves attention and explanation.

## III. Alternative Explanations for the Demise of Latin American Development

### A. *Capital Formation*

Since development theory typically identifies capital formation as the single most important direct determinant of economic growth, it would seem appropriate to begin our examination with a comparison of investment and savings rates of the same eight non-oil-exporting Latin American countries and Korea for selected years between 1950 and 1988. Such a comparison is presented in Table 3. As can easily be seen, even as

## Table 3

GROSS DOMESTIC INVESTMENT AND GROSS DOMESTIC SAVINGS AS PERCENTAGES OF GROSS DOMESTIC PRODUCT, 1950-1988

| Country | | 1950 | 1955 | 1960 | 1965 | 1970 | 1975 | 1980 | 1983 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | I/GDP | 28.0 | 19.0 | 36.0 | 21.1 | 21.6 | 25.9 | 22.2 | 17.3 | 8.5 | 8.8 | 9.9 | 14 |
| | S/GDP | | | | 21.5 | 21.6 | 25.5 | 20.0 | 22.1 | 15.2 | 11.1 | 10.1 | 18 |
| Bolivia | I/GDP | 16.0 | 21.0 | 15.0 | 17.6 | 23.8 | 36.9 | 14.1 | 3.5 | -.8 | 8.0 | 9.5 | 11 |
| | S/GDP | | | | 16.0 | 24.2 | 30.8 | 19.3 | 6.3 | .1 | 3.0 | 1.5 | 6 |
| Brazil | I/GDP | | 12.5 | 17.9 | 16.4 | 20.5 | 26.8 | 22.9 | 14.7 | 16.7 | 18.5 | 19.7 | 23 |
| | S/GDP | | | | 15.8 | 20.1 | 22.9 | 20.7 | 17.1 | 21.7 | 21.1 | 22.7 | 28 |
| Chile | I/GDP | | | 25.0 | 14.6 | 16.5 | 13.1 | 21.0 | 9.8 | 13.7 | 14.6 | 16.9 | 17 |
| | S/GDP | | | | 16.5 | 17.1 | 11.1 | 16.8 | 12.5 | 16.5 | 18.4 | 21.0 | 24 |
| Columbia | I/GDP | 16.8 | 18.0 | 20.5 | 17.5 | 20.2 | 17.0 | 19.1 | 19.9 | 19.0 | 18.0 | 19.0 | 21 |
| | S/GDP | | | | 17.5 | 18.4 | 18.8 | 19.7 | 17.1 | 20.3 | 24.7 | 25.8 | 22 |
| Costa Rica | I/GDP | 16.4 | 17.3 | 17.5 | 19.1 | 20.5 | 21.6 | 26.6 | 24.2 | 20.7 | 21.9 | 21.2 | 26 |
| | S/GDP | | | | 13.1 | 13.8 | 13.2 | 16.2 | 23.4 | 19.0 | 23.3 | 18.0 | 26 |
| Mexico | I/GDP | 10.9 | 14.3 | 16.7 | 19.9 | 21.3 | 22.3 | 27.2 | 20.8 | 21.9 | 18.5 | 15.5 | 20 |
| | S/GDP | | | | 17.9 | 18.7 | 19.0 | 24.9 | 30.3 | 26.7 | 23.2 | 17.5 | 23 |
| Peru | I/GDP | 23.1 | 22.6 | 22.1 | 28.1 | 15.5 | 24.7 | 27.5 | 23.7 | 22.4 | 24.2 | 24.6 | 28 |
| | S/GDP | | | | 24.8 | 17.4 | 13.6 | 27.5 | 22.7 | 27.2 | 22.1 | 22.9 | 24 |
| Latin America and | I/GDP | | | | 19.1 | 21.3 | 25.0 | 24.2 | 16.8 | 17.5 | 17.4 | 18.2 | 21 |
| Caribbean | S/GDP | | | | 18.5 | 20.6 | 22.5 | 22.8 | 20.8 | 22.1 | 19.7 | 19.8 | 22 |
| Korea | I/GDP | | 12.0 | 10.9 | 19.0 | 24.7 | 27.1 | 31.1 | 28.9 | 30.0 | 28.8 | 29.1 | 30 |
| | S/GDP | | | | 10.5 | 15.0 | 18.5 | 23.3 | 27.6 | 30.5 | 34.6 | 37.6 | 38 |

*Source:* International Monetary Fund, *International Financial Statistics Yearbook.*

late as 1960 the investment rates in all the Latin American countries listed in the table exceeded that of Korea; indeed, that of Argentina was over three times that of Korea. Since, Korea caught up to Latin America in savings and investment rates only by the early 1970's, clearly differences in savings and investment rates cannot explain why, prior to that, the economic growth rates were already higher in Korea than in Latin America. However, after that, the consistently lower savings and investment rates in the Latin American countries than in Korea no doubt contributed significantly to Latin America's lower growth rates. The subsequent fall in Latin American savings and investment rates, moreover, undoubtedly goes a long way toward explaining the deceleration of Latin American growth in the 1980s. However, even if savings and investment rate differentials completely accounted for the variations in growth rates within Latin America and between Latin American and other regions like East Asia, since the theory of savings and investment attributes variations in these rates to a variety of underlying factors, it would be difficult to identify these differentials as the critical *causal* factors.

*B. Manufacturing*

Given the allegedly deleterious effects of dependence on primary production, such as the greater instability of primary exports and the allged long run tendency for the terms of trade of primary products to decline via-à-vis manufactures advocated by the Latin American economists themselves, another possible source of differential growth rates could have been differences in the relative importance of manufactures. Note, however, from Table 4 that during the decade of the 1950s, manufacturing value added (MVA) accounted for well over 20 percent of GDP in Argentina (30.7%), Brazil (25.5%), Mexico (23.3%) and Chile (22.7%), compared to a mere 11.5% in Korea. Indeed, even Bolivia and Costa Rica, the Latin American countries (among those listed) with the lowest MVA shares in GDP, already had MVA shares that were considerably higher than Korea's. Moreover, as Diaz-Alejandro (1970, 1989) have pointed out, Latin America's industrialization had occurred relatively naturally as the result of transport costs, exchange rate movements, locally available raw materials and large domestic markets. As such, its industries were generally considered to be healthier than would have been the case had they been artificially promoted by deliberate sector-specific distortions, like tariffs and quotas, as in so many other LDCs during the 1950's and 1960's.

By the mid-1970's, however, although MVA shares continued to rise in virtually all Latin American countries, including some of the less in-

Table 4

SHARE OF MANUFACTURING IN GDP AT FACTOR COST

| | 1950-1960 | 1960-1970 | 1970-1977 | 1980 | 1985 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|
| Argentina | 30.7 | 31.1 | 36.3 | 22.5 | 27.3 | 27.3 | 31 |
| Bolivia | 14.7 | 14.8 | 13.1 | 15.0 | 13.8 | 13.0 | 17 |
| Brazil | 25.5 | 26.3 | 29.1 | 30.8 | 27.1 | n.a. | 29 |
| Chile | 22.7 | 25.9 | 20.8 | 21.4 | 20.6 | n.a. | n.a. |
| Colombia | 16.6 | 17.6 | 20.1 | 17.0 | 16.3 | 17.1 | 20 |
| Costa Rica | 14.2 | 16.5 | 19.5 | 19.9 | 20.0 | 20.1 | 20 |
| Mexico | 23.3 | 24.5 | 26.5 | 22.1 | 23.4 | n.a. | 26 |
| Peru | 16.4 | 17.2 | 19.8 | 20.3 | 25.0 | 22.5 | 24 |
| Korea | 11.5 | 16.9 | 23.2 | 29.6 | 29.9 | 30.3 | 32 |

*Note:* n.a. indicates data not available.

*Source:* World Bank, *World Tables* 1980, and *World Development Report* 1988, 1989 and 1990 editions.

dustrial ones like Costa Rica and Peru, the character of Latin American industrialization had started to change. Continuing balance of payments crises induced most Latin American countries to adopt more and more ad hoc protective policies. As a result, by 1970 the effective rates of protection on manufactured goods had become high and very unequal from one sector to another (Balassa and Associates, 1971, 1982). To further reduce the dependence on imported components by domestic assembly industries, several Latin American countries became leaders in designing and implementing regulations forcing the progressive substitution over time of domestically produced components for imported ones. Naturally, such distortions had the effect of decreasing the overall efficiency of investment allocation.

As a result of its much lower rates of industrial growth, by about 1970 Latin America had lost its lead over Korea with respect to MVA and since 1985 Korea's share of MVA in GDP has exceeded that of every Latin American country, generally by an increasing margin.

### *C. The Importance of the Public Sector*

A recently very popular explanation for the difference between the comparative failure of Latin America vis-à-vis Korea and other Asian NICs has been the allegedly larger share of the public sector and more interven-

tion by government in the former relative to the latter.

However, from the data presented in Table 5 it can be seen that, while there are some Latin American countries in which the public sector has been considerably larger than in Korea, such as Costa Rica and Uruguay (not shown), in quantative terms at least, the importance of the public sector in Korea has not been much smaller than that of Latin American countries.

**Table 5**

THE RELATIVE IMPORTANCE OF THE PUBLIC SECTOR

| | Share of General Government Consumption of GDP | | Share of Central Government Expenditure in GDP | |
|---|---|---|---|---|
| | 1965 | 1988 | 1965 | 1988 |
| Argentina | 8 | 11 | 19.6 | 21.6 |
| Bolivia | 9 | 20 | 9.6 | 15.8 |
| Brazil | 11 | 12 | 17.4 | 25.1 |
| Chile | 11 | 11 | 43.2 | 33.4 |
| Colombia | 8 | 11 | 13.1 | 14.7 |
| Costa Rica | 13 | 15 | 18.9 | 28.0 |
| Mexico | 6 | 10 | 11.4 | 27.9 |
| Peru | 10 | 8 | 16.1 | 14.6 |
| Korea | 9 | 10 | 18.0 | 15.7 |

*Source:* World Bank: *World Development Report*, 1990.

Although the data on the relative importance of public enterprise in manufacturing are much less comparable across countries, from data presented in Nabli and Nugent (1989) it is clear that once again the share of public enterprise in manufacturing in Latin American countries has not differed significantly from that of Korea and other East Asian countries.

The most frequently mentioned explanation for the demise of Latin American development in recent years has been the increasing severity of its debt burden. This burden has of course been compounded, not only by the high interest rates in world capital markets during the 1980's, but also by capital flight and by increasing inability to borrow. Table 6 presents data on the external debt of each of the same eight non-oil-exporting Latin American countries and of Korea. While the table dramatizes the size, pervasiveness and growth of external debt among

## Table 6

EXTERNAL PUBLIC DEBT AND DEBT SERVICE RATIOS

| Country | Debt Service as a Percentage of: GNP | | | Debt Service as a Percentage of: Exports of Goods and Services | | | Long Term Extended Public and Publically Guaranteed Debt in Millions of U.S. Dollars | |
|---|---|---|---|---|---|---|---|---|
| | 1970 | 1987 | 1988 | 1970 | 1987 | 1988 | 1970 | 1988 |
| Argentina | 2.1 | 5.1 | 4.9 | 21.6 | 45.3 | 36.0 | 1,880 | 49,544 |
| Bolivia | 2.3 | 3.3 | 5.6 | 11.3 | 22.1 | 32.9 | 480 | 4,651 |
| Brazil | 0.9 | 2.4 | 4.5 | 12.5 | 26.7 | 42.0 | 3,421 | 101,356 |
| Chile | 3.1 | 7.9 | 7.9 | 19.2 | 21.1 | 19.1 | 2,067 | 16,121 |
| Colombia | 1.7 | 7.0 | 8.0 | 11.7 | 33.4 | 42.3 | 1,297 | 15,392 |
| Costa Rica | 2.9 | 4.5 | 7.7 | 10.0 | 12.1 | 19.9 | 134 | 3,849 |
| Mexico | 1.9 | 6.4 | 8.2 | 23.6 | 30.1 | 43.5 | 3,196 | 88,665 |
| Peru | 2.0 | 1.0 | 1.3 | 11.6 | 12.5 | 8.7 | 856 | 13,898 |
| Korea | 3.0 | 10.4 | 4.8 | 19.5 | 21.9 | 11.5 | 1,816 | 27,376 |

*Source:* World Bank, *World Development Report* , 1989, 1990 Tables 21, 23.

Latin American countries since 1970, it also highlights the relative size and importance of Korean indebtedness, at least until the sharp reduction registered in 1988. Indeed, in terms of debt service in relation to GNP, Korea slightly exceeded all but one of the Latin American countries in 1970 and all of them by a considerable margin as recently as in 1987. As shown in Table 7, what has made the debt burden more tolerable in Korea than in Latin America are: (1) Korea's increasing share of exports in GNP, and (2) its considerably more rapid growth of exports. Note that the growth rate of exports in Korea vastly exceeded that of any Latin American country during both the 1965-80 and 1980-88 periods. As a result, as shown in Table 6, the debt-service-to-export ratio of Korea in 1988 was the second lowest of the listed countries and less than one-third those of Argentina, Brazil, Colombia and Mexico.

**Table 7**

EXPORT SHARE IN GDP AND AVERAGE ANNUAL GROWTH RATES OF MERCHANDISE EXPORTS

| | Exports Share in GDP | | Export Growth Rates | |
|---|---|---|---|---|
| Country | 1965 | 1988 | 1965-1988 | 1980-1987 |
| Argentina | 8 | 10 | 4.7 | 0.1 |
| Bolivia | 21 | 16 | 2.8 | –0.5 |
| Brazil | 8 | 10 | 9.4 | 6.0 |
| Chile | 14 | 37 | 7.9 | 4.5 |
| Colombia | 11 | 16 | 1.5 | 8.2 |
| Costa Rica | 23 | 36 | 7.1 | 2.9 |
| Mexico | 9 | 16 | 7.7 | 5.5 |
| Peru | 16 | 10 | 2.3 | –2.5 |
| Korea | 9 | 41 | 27.3 | 14.7 |

*Source:* World Bank, *World Development Reports,* 1988, 1989, 1990.

### *D. Openness*

Another prominent explanation in the literature of the demise of Latin American growth is the relatively low and falling rate of openness of the economy. Specifically, most Latin American countries are characterized as examples of inward-looking, import substituting strategies of economic development while Korea and other star performers are fre-

quently identified as examples of outward-looking development strategies.

Table 8 presents comparable estimates of the most common measure of openness, namely, exports plus imports divided by GNP, all measured in current prices, for each country and for selected years between 1950 and 1987. The fact that the openness indicator for Korea has risen more than ten-fold between 1950 and 1987, whereas those of several Latin American countries (Argentina, Brazil, Mexico and Peru) have fallen, calls attention

**Table 8**

DEGREE OF OPENNESS

INDICATOR: $\frac{\text{Export + Imports}}{\text{GNP}}$ x100

| | 1950 | 1955 | 1960 | 1965 | 1970 | 1973 | 1975 | 1980 | 1985 | 1987 |
|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | 25.9 | 11.8 | 20.8 | 14.0 | 18.4 | 17.8 | 15.9 | 16.2 | 26.8 | 21.6 |
| Bolivia | n.a. | n.a. | 32.6 | 39.7 | 37.9 | 43.2 | 47.0 | 33.8 | 28.8 | 40.0 |
| Brazil | n.a. | 22.0 | 12.1 | 12.6 | 13.5 | 17.1 | 18.3 | 16.7 | 20.6 | 15.1 |
| Chile | 19.5 | 17.0 | 30.9 | 27.8 | 30.2 | 30.1 | 55.1 | 51.5 | 54.9 | 68.6 |
| Colombia | 21.2 | 26.9 | 31.5 | 22.4 | 31.2 | 29.1 | 30.6 | 31.9 | 27.1 | 33.6 |
| Costa Rica | n.a. | n.a. | 47.9 | 58.3 | 64.1 | 70.3 | 70.9 | 66.8 | 70.1 | 74.9 |
| Mexico | 28.3 | 32.6 | 23.0 | 19.7 | 17.6 | 18.1 | 16.8 | 27.0 | 27.1 | 12.8 |
| Peru | 33.2 | 38.7 | 39.4 | 32.9 | 32.2 | 27.8 | 30.8 | 46.8 | 36.9 | 20.9 |
| Korea | 8.00 | 11.6 | 16.0 | 24.4 | 38.2 | 63.3 | 64.9 | 77.7 | 74.5 | 83.2 |

*Note:* n.a. indicates data not available.

*Source:* World Bank, *World Tables:* Volume I; 1984, 1988-89 edition.
OECD, *National Accounts of Less Developed Countries, 1950-1966,* Paris.

to the potential relevance and importance of openness in distinguishing between Latin America and Korea. On the other hand, since among Latin American countries openness increased most in Chile and, on average, was relatively high in Bolivia, which, as shown in Table 8, were the two countries in Latin America with the lowest growth rates in real GDP over the period under study, it is clear that openness in itself is not the major factor distinguishing between the Latin American and Korean growth experiences. Note also that several of the Latin American countries, such as Argentina, Bolivia, Chile and Costa Rica, had substantial increases in openness at the same time that growth rates were falling off dramatically from those of earlier decades. One can only conclude that openness, in

and of itself, and especially in the short run, cannot explain much of the dramatic difference in growth rates between Korea and Latin America.

*E. Inflation and Budgetary Deficits*

Another factor that is frequently used in order to help distniguish between Lain America and Korea is the differnce in the rate of inflation. Indeed, as shown in Table 9, for the 1980's it is certainly true that all Latin American countries experienced much higher per annum rates of inflation (rates ranging from a low of 20.8% in Chile to almost 500% Bolivia) than did Korea (5%). For the earlier period, i.e., 1965-80, however, Korea's average annual rate of inflation of 18.8% per annum was higher than that of Costa Rica (11.3%), Mexico (13.0%), Bolivia (15.7%) and Colombia (17.4%), although, even then, well below those of Argentina and Chile. Once again, it would appear that inflation, although generally associated with poor economic performance, is not a sufficient condition for economic failure. Neither is its absence a sufficient condition for success.

**Table 9**

AVERAGE ANNUAL RATES OF INFLATION (GDP DEFLATORS)
1965-1980 and 1980-1988

| Country | Rates of Inflation | |
|---|---|---|
| | 1965-1980 | 1980-1988 |
| Argentina | 78.2 | 290.5 |
| Bolivia | 15.7 | 482.8 |
| Brazil | 31.3 | 188.7 |
| Chile | 129.9 | 20.8 |
| Colombia | 17.4 | 24.1 |
| Costa Rica | 11.3 | 26.9 |
| Mexico | 13.0 | 73.8 |
| Peru | 20.5 | 119.1 |
| Korea | 18.8 | 5.0 |

*Source:* World Bank, *World Development Report,* 1990.

In particular, even if variations in inflation rates were perfectly correlated with variations in economic performance, inflation may be more a symptom than a cause of failure. Indeed inflation abroad (imported inflation), devaluations, supply shortfalls and uncontrolled monetary emis-

sions can consistute important sources of domestic inflation in the short run.

Especially since the role of the Central Bank has differed little among Latin American countries or between them and Korea, it is clear that neither monetary policy nor structural factors (including exchange rates, supply shortfalls, etc.) have been the main source of inflationary problems.

On the other hand, since like other LDCs all such countries have been typified by underdeveloped or non-existent capital markets, in general, government budget deficits have comprised the single most persistent and important source of domestic inflation. As a result, in such circumstances the inability to tax or otherwise balance a budget may quite appropriately be regarded as the more fundamental cause of both inflation and underdevelopment. In Table 10 we present some crude estimates of government budget imbalances for the same eight Latin American countries and for Korea for selected years between 1955 and 1988. Although such data are crude (in that they generally pertain only to central government budgets and therefore may not fully reflect the deficits of local governments and public enterprises), they are probably fairly reflective of both relative magnitudes and trends. Note the difference in trends of the deficits apparent in the table between that of Korea, which, aside from a minor blip in the early 1980s, has been downward, and the sharply increasing ones for Argentina, Bolivia, Brazil, Mexico and to lesser extent Peru (though not of Chile, Colombia or Costa Rica). Such differences in deficit reduction would appear to be important in explaining why inflation is accelerating in Latin America but decelerating in Korea after 1970.

## IV. Labor Unions, Political Economy and Interdependencies

In this section we turn to some (perhaps more deep-seated) social and political factors and to some important interdependencies between the various factors.

One such factor that has frequently been cited in explaining the comparative demise of Latin American countries vis-à-vis the success of Korea and other East Asian countries has been the difference in the character of their labor markets, being more competitive in East Asia than in Latin America (Fields and Wan (1989)). In particular, the problem with Latin American labor markets has been alleged to be excessive regulation and the excessive power of labor unions.

According to Greenfield and Maram (1988), labor unions and labor

## Table 10

GOVERNMENT BUDGET SURPLUS (+) OR DEFICIT (–)
AS PERCENTAGE OF GNP FOR SELECTED YEARS, 1955-1988

| | 1955 | 1960 | 1965 | 1970 | 1973 | 1975 | 1978 | 1980 | 1982 | 1985 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Argentina | | | | –1.18 | –5.57 | –12.20 | –4.00 | –3.57 | –7.85 | –8.03 | –4.1 |
| Bolivia | | | –2.7 | –1.95 | –3.36 | | –.02 | –5.50 | –19.60 | –28.24 | –0.1 |
| Brazil | –.08 | –2.85 | –1.36 | –.36 | + .60 | + .01 | –1.80 | –2.46 | –2.83 | –11.58 | –12.2 |
| Chile | | –2.50 | –3.89 | –2.95 | –7.88 | + 1.13 | –.11 | + 5.60 | –1.07 | –2.67 | –0.2 |
| Colombia | –1.06 | –.42 | –.65 | –.90 | –.99 | –.28 | + .69 | –1.86 | –1.67 | n.a. | –0.7 |
| Costa Rica | | | | –1.03 | –3.63 | –2.83 | –5.14 | –5.94 | –1.06 | –1.40 | –4.7 |
| Mexico | | | | | –3.10 | –4.12 | –2.74 | –3.23 | –16.62 | –9.16 | –10.0 |
| Peru | + .10 | + .99 | –3.43 | –1.38 | –3.95 | –5.54 | –.36 | –.66 | –1.20 | n.a. | –5.7 |
| Korea | –6.02 | –4.10 | –3.55 | –1.92 | –1.69 | –2.09 | –1.25 | –2.32 | –3.26 | –1.29 | 1.6 |

*Source:* World Bank, *World Tables, World Development Report,* various years.

policy in Latin America have gone through three distinct stages. In the first phase, beginning in the 1860's, rather skilled immigrant workers were organized along relatively narrow craft lines. During this phase most of the immigrants in Latin America were absorbed into agriculture. Beginning with the 1880's the rate of immigration accelerated making it increasingly difficult for the newer (generally unskilled) immigrants to be absorbed into the agricultural sector. Since this period coincided with the importation from Europe of new and more radical social and political views, labor organization during this phase became increasingly confrontational.

Over time, the size of organized labor groups increased and their large numbers of members made them an inviting target for political entrepreneurs. The political entrepreneurs would organize these groups in return for their support in overthrowing or ousting the heretofore dominant landed interests and their policies. During this third phase, labor, which was usually organized into hierarchical federations, became much less confrontational and more collaborative in relation to other groups. By the 1930's labor had come to exercise considerable influence, and used this influence to introduce various regulations over work hours and working conditions. Indeed, by 1950, Hanson (1951) noted that most Latin American countries, but especially Chile, Uruguay, Mexico, Nicaragua, Colombia, Brazil and Argentina, had ratified more labor-regulating conventions promulgated by the Swiss-based International Labour Office than had Canada, the United States, Australia, Japan and Switzerland itself. Only the United Kingdom, France and Belgium — all countries in which labor organizations had a long history and had grown to be very strong — had ratified more labor conventions than Chile. All Latin American countries, except Bolivia, Colombia, Venezuela and Central America (outside of Costa Rica), developed very substantial and generous programs of insurance, protecting employees against old age, invalidity, survivorship and health costs.

Since 1950 Latin American countries have continued to adopt labor legislation regulations perhaps even on an accelerated basis. While, quite naturally, as elsewhere the enforcement of these regulations has lagged behind their legislative or administrative decree, it is generally agreed that since 1960 Latin America's labor markets have been among the most highly regulated in the world. The charges for achieving the requirements of such labor legislation frequently constitutes 40% or more of total employee costs.

In most Latin American countries, labor organizations have been especially strong in sectors dominated by foreign enterprise, such as

foreign-owned mines in Chile, Bolivia and Peru and foreign-owned manufacturing industries in Brazil and especially Argentina. Popular resentment against foreign ownership no doubt has played a role in accounting for the rapid emergence of labor organizations and their remarkable success in achieving improved working conditions and regulations favorable to the interests of employed workers. In some cases labor unions have played a role in the revolutionary overthrow of incumbent governmental regimes.

The price that labor unionists in Latin America have had to pay for attaining their objectives through collaboration with government has been loss in independence, interference in labor union decision-making and indeed the periodic suppression of union leaders and union activities by government.

In the more recent postwar period, labor organization in Latin America has entered a fourth phase in which, as a result of inflation and price controls, collective bargaining and politically motivated strikes have been emphasized in order to protect job security and to avoid declines in real wage rates. The achievement of a labor settlement, moreover, has by no means come to serve as a guarantee of subsequent industrial peace (Cordova (1984)).

If labor contracts are set in nominal terms (as they normally are) for a period of two or three years, and if actual inflation rates exceed the expected rates of inflation, real wage rates can fall substantially. On the other hand, if actual rates of inflation fall short of expected rates of inflation, employers can find themselves paying much more than they expected. With rates of inflation as high or as volatile as those which have been experienced in most Latin American countries, especially since 1970, the magnitude of these unforeseen changes in real wage rates over the life of labor contracts can be quite sizeable indeed. Not surprisingly worker groups have attempted to reduce the risks of large unforeseen real wage reductions by having wage rates indexed to the cost of living. Indexation, of course, has further increased the need for regulation and typically also for data collection and reporting.

Indexation, in turn, has introduced many complex and difficult-to-resolve technical issues, e.g., deciding what to index, how to index, and the frequency of recomputing the index. Indexation, moreover, both makes considerably more difficult the task of controlling inflation and introduces the kinds of rigidities in relative prices which make it more difficult to achieve full employment and/or to avoid unwanted shortages or surpluses of particular goods and services via price adjustments. Also, the more complete and more frequent is the process of indexation, the more

vulnerable is the economy likely to be to external price shocks.

An alternative means of avoiding unwanted changes in real wage rates that avoids the aforementioned disadvantages of indexation is by more frequent recontracting. Although this alternative may involve transaction costs, to the extent that by their repetitive nature contractual negotiations can be routinized and/or mediation or arbitration procedures used, these costs need not be prohibitive (Aizenman (1984, 1985, 1988) and Aizenman and Frenkel (1986)).

Given the likelihood and importance of the effects of sharp changes in relative prices in inflationary situations on the respective interests of workers and employers with or without indexation (since in any case indexation is never perfect) and with or without frequent recontracting, labor unions frequently press for price controls just as do employers for wage controls. Not surprisingly, therefore, distortion-increasing price and wage controls have been frequently resorted to by Latin American countries in misguided attempts to control inflation. Such measures, of course, are very likely to (1) further exacerbate various disequilibria between supply and demand, (2) further reduce the flexibility of the economy, and (3) further increase the scope of political intervention in various important markets.

Another harmful consequence of collective bargaining in increasingly large unions has been the undermining of incentives for foremen and lower level managers. This is the result of the narrowing of wage differentials between skilled workers (including foremen and low-level managers) and unskilled workers which generally occur in mass-based labor unions in which decisions have to be adopted by majority vote. The narrowing differentials may well have discouraged entry into the ranks of foremen and lower-level management and tied the hands of those who remain, thereby thinning the ranks and lowering the quality of those best in position to raise labor productivity. Inefficiency has been further accentuated by the "personalismo" of the process (which implies both centralization and arbitariness) by which regulations have been introduced into labor and other markets (Fillol (1961)).

The high costs of regulation on regulated firms, of course, have to be paid. Naturally, governments and firms try to pass these costs on to consumers in the form of higher excise taxes and prices, thereby providing incentives for consumers and firms to go "underground" or "informal" so as to avoid the costs of satisfying the regulations. At the same time, however, the costs of excessive regulation spill over to the underground, informal or unregulated sector in the form of costs of avoiding being caught, or when caught, the costs of avoiding payment of the designated

penalities. In a fascinating study de Soto (1989) has quantified these costs and analyzed both their sources and effects for the case of Peru.

The regulatory approach that has been so characteristic of Latin America's approach to labor markets seems to have introduced still another source of inefficiency. Because job security, health, invalidity and old-age support benefits are obtained only indirectly through collective action-inspired legislation, a process is entirely separate from and independent from the more direct process of collective bargaining over wage rates with employers, the resulting combination of wages and benefits obtained by workers need not be Pareto-efficient. Indeed, frequently, it is shown that workers would in fact be willing to sacrifice some of these other benefits to obtain higher wages without changing the overall cost of labor to employers. Real wage rates have clearly increased much more slowly in Latin America than in Korea and other East Asian countries (as a result of less rapid growth and stagnant productivity). This is despite the fact that labor unions have generally been considerable stronger in Latin America.

It should be emphasized, however, that it would not be appropriate to blame the problems of Latin American development on the existence of strong labor organizations per se. As Fields and Wan (1989) have emphasized, what has been harmful are the distortionary rigidity-increasing and incentive-inhibiting effects of the regulations that have emerged from the interaction of labor organizations with government in Latin America. Latin America's regulatory, market intervention approach contrasts sharply with the experience in East Asia, in which government influence, although substantial, has largely been confined to non-distortionary mediation in reaching wage settlements and without the creation of large-scale welfare programs.

What has been especially harmful about the labor union experience in Latin America has been the macroeconomics and political-economy environment within which the labor unions have operated. It is the high and variable rates of inflation in Latin America that have made sharp changes in real income much more likely there than in East Asia, thereby greatly raising the stakes of different interest groups in bargaining outcomes. With both employer and labor groups well organized to defend their interests, it has been common to pass a substantive share of the rising costs of labor regulations on to governments. But, since governments have been unable to obtain agreement on who should pay the taxes to cover the expenses, this has led to a still further escalation of inflation rates as well as intermittent interventionist attempts to resolve the problem by imposing price and/or wage controls.

As a result, changes in policy regimes and relative prices have been frequent but unsustained, providing confusing, inconsistent and false signals to investors and other economic agents. A crude but useful indicator of the dynamic efficiency of investment allocation is the value of the incremental capital-output ratio (ICOR). When low levels of investment are required per unit of increased value added, i.e., when ICORs are low, the dynamic efficiency of investment is said to be high. The dynamic *inefficiency* of investment in Latin American countries relative to that of Korea is reflected in the high and rising values of ICOR shown in Table 11 for all Latin American countries. Indeed, for both the 1972-80 and 1980-87 periods, the ICORs of most Latin American countries are much larger than those of Korea, indeed, often several times larger.

**Table 11**

INCREMENTAL CAPITAL — OUTPUT RATIOS
(BASED ON DATA IN CONSTANT PRICES)

| | 1972-1980 | 1980-1987 |
|---|---|---|
| Argentina | 8.9 | 11.8* |
| Bolivia | 4.5 | 5.6* |
| Brazil | n.a. | n.a. |
| Chile | 10.2 | 27.5 |
| Colombia | 4.2 (for 1972-1979) | 11.6 |
| Costa Rica | 3.8 | 15.9 |
| Mexico | 4.3 | 24.2 |
| Peru | 5.2 | 19.0 |
| Korea | 2.9 | 3.7 |

*Notes:* Computed from data on gross domestic capital formation (I) and Gross Domestic Product (Y) with the following formula $(Y_{t+f}-Y_t)/\Sigma_{f=t}^{t+f-1} I_f$. Constant price data were used in the calculations.

n.a. indicates data not available.

* These are underestimates since the numerator, i.e., change in real GDP over the period, was actually negative.

*Source:* United Nations, *Yearbook of National Account Statistics,* various years.

### *Interdependencies Among the Factors*

What has been unique to Latin America is that most of the aforementioned factors have occurred together, more or less at the same time, each one compounding the difficulties of treating or overcoming the others.

For example, as we have seen, inflation has further stimulated interventionism in labor markets. But, labor market intervention and the indexation of wage rates have compounded the difficulty of reducing inflation. Likewise, inflation has induced the regulation of financial markets and led to financial repression, thereby compounding the degree of dualism and decreasing the flexibility of the economy. It has also led to deliberately, or inadvertantly, overvalued local currencies, which have discriminated against exports (hence decreasing openness) and raised the price of labor relative to capital (because imported capital goods typically enter the country at disequilibrium exchange rates free of the import duties imposed on finished goods), thereby damaging the prospects for reaching full employment and further accentuating the emphasis of labor organizations on job security (Shaw (1973)).

In the presence of repressed financial markets, inflation is directly attributable to government budget deficits. As noted above, budget deficits have been persistent and growing in most Latin American countries. These budget deficits, in turn, result, in part, from excessive and costly regulations which erode the tax base by forcing firms, workers and consumers into the informal, unregulated economy. While at low rates of inflation, slight increases in inflation rates can increase revenues by the inflation tax, at the rates that have been characteristic of Latin America, higher rates of inflation tend to raise expenditures more than revenues, thereby exacerbating the budget deficits and further raising inflation (Gersovitz (1987)). The repression of financial markets in Latin America and the failure of its governments to save and invest contribute to decreased rates of capital formation and hence lower rates of growth.

Several analysts such as Sachs (1985), Berg and Sachs (1989), Lin (1989) and Balassa (1984, 1989), have viewed the problems of Latin America more from a dynamic perspective of being less able and much slower than East Asia in responding to changing circumstances, such as higher levels of world interest rates, energy prices, international indebtedness and budget deficits. Indeed, the facts of the considerably slower response of Latin America to changing environmental circumstances are rather clear.

What is not clear, however, is the real reason for such differences. In part, they may arise from various differences in historical endowments, such as, (a) the relative importance of unpopular foreign owners and managers in many of Latin America's industries which has hindered the adoption of outward-oriented policies, (b) greater heterogeneity of the population by national origin, religion and culture, (c) the multiplicity of political parties which makes it difficult to forge coalition governments, or

(d) the personalities less institutionalized method of decision-making. Another plausible factor is the greater degree of inequality of income and wealth which, as shown in Table 12, is characteristic of most Latin American countries and which may provoke resentment by disfavored groups against the status quo, thereby greatly complicating the process of reaching agreement on suitable policies and of achieving stability in policy (Sachs (1985)).

**Table 12**

INCOME DISTRIBUTION: PERCENTAGE SHARES OF HOUSEHOLD INCOME, BY PERCENTILE GROUPS OF HOUSEHOLDS

| Country | Year | Lowest 20% | Second Quintile | Third Quintile | Fourth Quintile | Highest 20% | Highest 10% |
|---|---|---|---|---|---|---|---|
| Argentina | 1970 | 4.4 | 9.7 | 14.1 | 21.5 | 50.3 | 35.2 |
| Brazil | 1972 | 2.0 | 5.0 | 9.4 | 17.0 | 66.6 | 50.6 |
| | 1983 | 2.4 | 5.7 | 10.7 | 18.6 | 62.6 | 46.2 |
| Colombia | 1978 | 4.8 | 10.2 | 14.0 | n.a. | n.a. | 39.0 |
| | 1988 | 4.0 | 8.7 | 13.5 | 20.8 | 53.0 | 37.1 |
| Costa Rica | 1971 | 3.3 | 8.7 | 13.3 | 19.8 | 54.8 | 39.5 |
| Mexico | 1977 | 2.9 | 7.0 | 12.0 | 20.4 | 57.7 | 40.6 |
| Peru | 1972 | 1.9 | 5.1 | 11.0 | 21.0 | 61.0 | 42.9 |
| | 1985 | 4.4 | 8.5 | 13.7 | 21.5 | 51.9 | 35.8 |
| Korea | 1976 | 5.7 | 11.2 | 15.4 | 22.4 | 45.3 | 27.5 |

*Note:* n.a. indicates data not available.
*Source:* Colombia: Miguel Urrutia, 1989.
For other countries: World Bank, *World Development Reports*, 1988, 1990.

Another unfavorable historical endowment for Latin America is its record of past failures in sustaining reforms. Since the behavioral response to reformist pronouncements often depends on the credibility of government commitments to honor those pronouncements, the past record of failure in this respect seriously undermines the credibility of even very determined government officials. The same applies to the credibility of commitments to repay foreign loans and helps account for Latin America's current difficulties in obtaining new international credit.

Another important differnce in historical endowment is the earlier

origin of unions and import-substutiting industrialization (ISI) in Latin America than in Korea and East Asia. As Olson (1982) and Nabli (1990) have argued, the ability of groups to successfully undertake collective action in protection of their own interests is positively related to the duration of their existence. Hence, the earlier origin of labor unions and ISI in Latin America than in Korea and East Asia implies that labor unions and industrialists in Latin America are currently better able to protect their own (special) interests, often at the expense of the social welfare, than is the case in East Asia.

Finally, Ranis (1989) among others has suggested that Latin America's slower response rates to changes in environmental conditions may be attributable to its greater natural resource wealth which provides Latin American countries with a greater cushion with which to delay politically and socially costly adjustments until they prove themselves absolutely necessary. By contrast, other resource-poor countries like Korea, not having that margin or cushion, have therefore had little choice but to adjust promptly. So too, the transition from reliance on primary exports to that on industrial growth and exports is rendered more difficult in Latin America than elsewhere because of the inherently sharper conflict between the relevant social groups. This is because, more so than elsewhere, Latin America's, and especially Argentina's, exports have been of wage goods making it that much more difficult to resolve conflicts between primary exporters and urbanists over the pricing of food and exports.

## V. Conclusions and Implications for Policy and Future Research

One obvious implication of the Latin American experience is that simply having grown rapidly in the past and having achieved a critical minimum level of development, as Latin America had by the early or mid-1950's, is no guarantee for continued growth and development. By the same token, however, past stagnation does not doom a country to perpetual stagnation and poverty. This implication contrasts sharply with what was an important theme of the development economics of the 1950's in which viscious circles of poverty were seen as the fundamental explanation for underdevelopment and that a "critical minimum effort" or "big push" was seen as the only way of breaking out of the "low level equilibrium trap."

It should be clear from the above discussion that there are a variety of individual factors which seem to have contributed to the demise of Latin American development, especially since 1970, relative to the success of East Asian countries like Korea. Among these are Latin America's lesser

degree of openness, its higher and accelerating rates of inflation, its lower degree of dynamic efficiency resulting from greater degrees of instability in relative prices and policy regimes, its higher degree of financial repression, the relatively greater burden of its foreign debt, the greater degree of intervention in the labor market, its larger and more persistent fiscal deficits, and its greater difficulty in adjusting policies to changing circumstances. Nevertheless, it should also be clear from the above discussion that none of these factors, by itself, is sufficient to explain either the striking difference in performance between Korea (and other East Asian countries) and Latin America or those among different Latin American countries. Much of the explanation, therefore, hinges on important interdependencies between the different factors.

The demonstrated interdependencies among the factors impeding economic development in Latin America suggest that simple and direct interventions to overcome single aspects of these problems are likely to be unproductive and perhaps may even be counter-productive. For example, in the case of the public enterprise deficits, Fishlow (1990) has argued quite convincingly that privatization, by itself, is not likely to constitute a desirable solution. Likewise, in the case of labor unions, the adoption of union-busting and "hardline" disciplinary actions against labor are hardly likely to be successful in the long run. Indeed, hardline approaches and crackdowns can backfire by producing martyrs, thereby strengthening the resolve of group members to avenge their losses, and creating sympathy on the part of other groups. Labor organizations, moreover, can have a healthy role to play in protecting workers against monopsonistic and monopolistic practices and by helping to overcome informational problems which may result in market failure.

There is certainly nothing, however, which insures that labor organizations necessarily play that healthy role. If their role should turn out not to be healthy, LDC governments would do well to (e.g., perhaps by drawing upon collective action theory) suggest ways in which inappropriate collective action can be discouraged. For example, since union strength, violence and disruption are frequently closely related to the geographic and ethnic concentration of workers, it would make sense for businessmen in such situations to try to avoid excessive concentration of employment in a single location or among members of one or two ethnic groups in which group solidarity may be extremely high and easy to reinforce. Second, and closely related to the previous point, it could be useful to bias the size distribution of industrial plants in the direction of small size so as to minimize the sharpness of distinctions among owners, managers and workers, and thereby to foster communication between all such groups. In most Latin American countries, the shares of large firms in employment

and value added have risen sharply over time, whereas in Korea and other East Asian countries they have fallen, at least since 1976 (Nugent (1989)).

At the same time, however, it may be useful to allow for worker mobility between plants. This may be done by using either (a) open labor markets wherein workers unhappy about working conditions in their original firm can move (at low cost) to positions plants owned by other employers, or (b) the internal labor markets of large, hierarchical conglomerate firms wherein mobility within firms from one plant to another (or one job category to another) would be facilitated. Moreover, since conglomerate firms should be able to provide their employees with greater job security than single-plant, single-activity firms, there would presumably be less reason for workers in conglomerate firms to emphasize job security and other non-wage benefits in their negotiations with their employers.

Rather than confronting the unions on the level of fixed wage rates and fringe benefits, it would be prudent for management to provide appropriate incentives to workers to practice dilgent, conscientious, cooperative and efficiency-enhancing work habits, such as through the use of productivity-related bonuses, profit sharing and the like, although, if carried too far, this practice could have the effect of diluting the incentives of owners to make sure that workers and managers do not shirk in their duties to the enterprises which employ them.

Excessive and unwarranted regulation of labor markets should be avoided inasmuch as such distortion-increasing regulations can accumulate rapidly, leading to allocative inefficiency and dualism. Such regulation can also reduce the flexibility of the economy, decrease the competitiveness of labor markets and inhibit innovation, investment, dynamic efficiency and growth. From the Latin American experience with a vast array of politically-inspired and rent-seeking regulations, one can understand the basis of the popular Brazilian saying: "Brazil grows while the politicians sleep; Brazil sleeps while the politicians act." Instead of excessively regulating labor and other markets, governments can play a useful role in developing relevant information and disseminating that information to increase the competitiveness of these markets.

Another important implication of the Latin American experience is that the various components of reforms must be internally consistent and sequenced in a way that is politically feasible and dynamically efficient, and that maintains the momentum of the reform process. In view of the fact that the probability of success in (a) liberalizing the trade regime and (b) making the transition from ISI to industrial exports diminishes with the duration of protection, for other LDCs it suggests the importance of

minimizing the duration of protection of infant industries.

Perhaps above all else, the Latin American experience calls attention to the importance of a country giving priority to getting its fiscal balance in order. Most stabilization programs and reforms have foundered upon the inability to control fiscal deficits and hence inflation. All too frequently the fiscal deficits have triggered polices such as price and wage controls which treat the symptoms rather than the cause of inflation and in the process further distort incentives and fossilize the structure of the economy. To balance its budget, however, any government needs to maintain a strong and experienced group of professionals with enough power to resist the pressures of specific interest groups and to enforce and collect existing taxes. Otherwise, loopholes are easily identified and evasion is rampant, people may view requests to pay new taxes as unfair, giving rise to little in the way of additional tax proceeds (DiTella and Dornbush (1989)).

Inasmuch as high and/or rising income inequality can greatly exacerbate the difficulties of reaching consensus on economic policies and reforms, all segments of society should regard the containment of income inequality to tolerable levels to be a social objective of prime importance.

Postponing the actions needed to resolve problems is highly undesirable. Small and manageable problems can rapidly accumulate into large and unmanageable ones. Moreover, as they grow, they frequently lead to other problems. The more interrelated such problems become, the more complicated and difficult-to-achieve becomes their resolution. It becomes extremely difficult to identify consistent sets of policies, and to avoid the kinds of precipitous changes which are likely to generate popular rebellion, in some cases signalling the abandonment of reform efforts (Mallon and Sourrouille (1975)). In this context, strategies emphasizing export development are likely to be more feasible and more self-sustaining than those to liberalize imports.

The rules of the game with respect to labor management and other relations should be carefully and objectively defined. Moreover, they should be defined in such a way as to provide incentives to both workers and managers to work together toward the achievement of higher productivity and growth and to investors to provide the investments capable of bringing about these increases in productivity. Once defined, these rules should be consistently adhered to and changed only when necessary.

Admittedly, despite the rich experience of Latin American and other countries with numerous different approaches to solving common problems, reliable *quantitative* estimates of the prospects of success of the

various different strategies to their resolution and of the extent to which and how their effectiveness would be affected by different circumstances are not yet available. This suggests the need for giving proirity to this kind of analysis in future research.

Recent changes in many Latin American countries, such as increasing openness, increased emphasis on exports, and reduction of fiscal deficits and international debt, and privatization may suggest that at long last Latin America may be on the verge of returning to economic health and improved potential for future growth.

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