

POLI 332. Politics and Governments of Latin America

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Session 6. Washington Consensus and Neoliberal Reforms

Plan of the lecture

1. Recap: ISI
2. Debt Crisis and the “Lost Decade” (1980s)
3. Dual Transitions
4. Washington Consensus and the Rise of Neoliberalism
 - Problems
 - Solutions
 - Successes
 - New problems created

Recap: ISI (1930s-1980s)

	Import Substitution Industrialization
PROBLEMS TO SOLVE	<ul style="list-style-type: none">• Adverse terms of trade• Lack of industrialization• Weak domestic markets – High inequality
SOLUTIONS (Policies)	<ul style="list-style-type: none">• Protectionism, Tariffs and Regulation• State-led industrialization• Social spending
SUCSESSES:	<ul style="list-style-type: none">• Human Development• Stronger states (less reliant on elite support)• Incorporation of popular classes into politics• Industrialization and urban growth
FAILURES (New problems:	<ul style="list-style-type: none">• Public debt & overgrown states• Rent-seeking & corruption• Unproductive industries• Inflation

Debt Crisis & the “Lost Decade” (1980s)

- Latin American countries borrow from foreign private banks and international financial institutions in 1960s-1970s.
- They start borrowing more than they can pay back: foreign debt quadrupled between 1972 and 1985, reaching 50% of GDP of the region.
- Oil crisis of 1973 generates an increase in oil prices.
 - Oil-exporting countries borrow heavily at floating interest rates forecasting long-term high prices.
 - Developing countries need to borrow money at high interest rates to import capital goods that are becoming more expensive.
 - Developed countries are facing inflation due to the rise of oil prices.
- Creditor countries increase interest rates to control inflation.
 - This leads to an international recession by the end of the 1970s.
 - The recession entails a reduction in the international markets for commodities exported by developing countries.
 - Foreign debt of developing countries skyrockets with the increase of interest rates, plus the liquidity crunch that comes from the commercial deficit.
- Mexico first (1981) and then several countries declare moratoriums on their debt payments.
 - Capital flight
 - Banking crisis

Dual Transitions:

Democratization + Economic Liberalization

- ISI begins to face important challenges: oil crisis in 1973 and, especially, debt crisis of 1980s.
 - **Credit**
 - **Less money to distribute to members of governing coalitions (corporatist unions, for example)**
 - **Disenchanted middle-classes**
- By the 1970s, the nationalist-populist model (in its authoritarian and democratic versions) of state building begins to exhaust itself.
 - **Complaints about overgrown, paternalistic, intrusive states.**
 - **Demands for the expansion of political and social rights (post-materialist politics).**
- **This leads to two parallel processes that in most places occurred hand-in-hand: political democratization and economic liberalization.**

Exceptions to the Dual Transitions (**neoliberalism without democracy**): Mexico, Argentina, Uruguay, Chile

- In the more advanced Latin American countries, economic liberalization was driven before the rest of the continent by a intensification of authoritarianism (**Uruguay, Chile, Argentina**).
- In **Mexico**, the PRI party-state that built the nationalist-populist model between 1930s and 1970s, liberalized the economy in the 1980s without democratizing until the late 1990s.

Washington Consensus: Problems to solve

- Debt crisis:
 - Balance of payments problems
 - Nationalization of private debt
- Uncompetitive industries
 - Debt had been used to purchase commodities rather than to invest in productivity.
- Inflation and macroeconomic stability
- Inequality
 - Seen as the result of corruption and rent-seeking produced by market distortions of ISI

Neoliberal Reforms (Policies): *Stabilize, Privatize, Liberalize*

1. Fiscal policy discipline
2. Redirection of public spending from subsidies to pro-growth and pro-poor expenditures
3. Tax reform
4. Interest rates that are market determined
5. Competitive exchange rates
6. Trade liberalization
7. Liberalization of inward Foreign Direct Investment (FDI)
8. Privatization of state enterprises
9. Deregulation
10. Legal security for property rights

Source: Williamson, John. 1990. "What Washington Means by Policy Reform":
<http://www.iie.com/publications/papers/paper.cfm?researchid=486>

Successes of neoliberalism in Latin America

- Controlling and renegotiating debt
- Macro-economic stability (controlling inflation) and fiscal discipline
- Streamlining the state
- Institutional reform that reduces the amount of rents that governments can distribute in the form of patronage to gain support (a democratic externality): autonomous central banks, weakening of some de facto veto powers (SOE's, corporatist unions, etc.)

Failures of neoliberalism in Latin America

- Growth:
 - 1980s become the Lost Decade (no growth or negative growth!)
 - 1990s most countries experienced little to no net growth (Chile is the exception)
- Poverty:
 - Entire economic sectors were badly hit by the reforms (agriculture)
 - FDI liberalization + De-regulation: take advantage of conditions for labour-intensive industries (maquiladoras)
- Inequality:
 - Reductions in social spending + little economic growth + reduction in wages and unemployment
- Corruption:
 - Privatization processes favour political insiders