Evolution of the Latin American Development Models in the 20th Century: Lessons and Implications for Other Developing Countries

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Introduction

Based on the nature of development orientation, Latin American countries pursued three development models in the 20th century, i.e., ***the model of exporting primary exports, the model of import substitution industrialization*** (ISI) and ***the model of openness and deregulation***.[1] Evolution of these three models was apparently in line with the two abrupt shifts. The first shift took place during the 1930s and 1940s (mainly due to the Great Depression and the Second World War), and the second in the late 1980s in response to the debt crisis and the ensuing

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[1] The labels of these three models are mainly related to the development strategies incorporated in them. Models can also be named after different theories on which each model is established. For instance, the model of exporting primary commodities might be called "model of liberalism", which was mainly influenced by the classical liberalism. The ISI model could be said as the "model of structuralism" as its theoretical foundation was ECLAC's structuralism. And, the model of openness and deregulation can be termed "neo-liberal model", which means that the model is built on the theory of neo-liberalism.

economic crisis.[2]

In this paper I shall first present an overview of the evolution of the three development models. Then I shall endeavor to summarize several lessons and implications for other developing countries.

Evolution of the Latin American Development Models In the 20th Century: An Overview

The past one hundred years of economic development in Latin America witnessed the implementation and transformation of three different models.

The model of exporting primary commodities.

Ever since the Conquest, Latin America has produced primary commodities for the exports and used the income to import manufactured goods from the industrialized nations. In economic terms, the model worked successfully. Particularly after the birth of the Industrial Revolution in Europe, demand for foodstuffs and raw materials expanded and Latin American countries had seen their links with the world economy more integrated than before and Latin America benefited greatly from this type of integration, which was centered around the traditional model. As table 1 shows, in 1913 and 1929, Argentina and Chile were much better-off than Japan in terms of real per capita GDP.

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[2] It is important to note that in addition to the two major shifts, there were continuos modifications and adjustment. For instance, in the 1970s, the Southern Cone

Table 1 Selected Countries' Real Per Capita GDP

At Factor Cost, 1913-1985

(Dollars at 1965 factor cost)

Year	1913	1929
Argentina	790	908
Brazil	118	175
Chile	381	580
Colombia	188	236
Mexico	241	252
Peru	115	177
Japan	332	485
UK	1059	1105
US	1358	1767
India	173	174

Source: Inter-American Development Bank: *Economic and Social Progress in Latin America*, Johns Hopkins University Press, 1996, p. 6.

However, the model also made the region quite vulnerable to external shocks as it could not control the prices of and demand for the primary commodities in the world market. Particularly during the Great Depression, Latin America suffered gravely from negative shocks of price instability and demand fluctuations. By 1932, the dollar value of exports from the largest countries, namely, Argentina, Brazil, Chile, Colombia and Mexico, had fallen by 50 percent or more.[3] Furthermore, after the Great Depression, rising protectionism in the advanced countries shrank the market of Latin America's exports.

In the light of these large external shocks and given the dark prospects of world trade, Latin American countries were forced to replace the

countries undertook important policy changes.

[3] Harper, Richard K. And Alfred G. Cuzan (1997): "The Economies of Latin America", in Richard S. Hillman: *Understanding Contemporary Latin America*, Boulder: Lynne Rienner Publishers, p. 123.

model of exporting primary products with that of industrialization via import substitution.

The model of import substitution industrialization

Generally speaking, simple manufacturing activities in Latin America began to take hold in Mexico, Argentina, Brazil, Colombia and elsewhere during the last decades of the 19th century. However, only after the 1930s did the industrialization process pick up its pace in the region.

It seemed that Latin American decision-makers hoped to realize two objectives through the implementation of ISI model. One was to gain more economic independence. It was believed that, by constructing their own manufacturing facilities, Latin America would be less dependent upon the importation of industrial goods produced in Europe or the United States, and no less important was the likelihood that the region would be less vulnerable to external shocks like the Great Depression.

Another purpose, it was hoped, would generate more employment opportunities for the working class, which had grown both in size and importance since the early twentieth century (Skidmore and Smith, 1997:53). Political leaders of almost all the major countries in the region recognized that the workers could be a major political force in the emerging new political order, and industrialization would provide them with more secure jobs.

The whole process of ISI could be divided into two stages. In the late 1930s to the 1960s, at least in the major countries, the ISI model met with relative success, which was reflected in the fact that industrial activities had started to occupy an important position in the national

economies (see table 2).

Table 2 Share of Manufacturing in GDP

(in percent, 1970 prices)

Year	Argentina	Brazil	Chile	Uruguay	Mexico	Peru
1940	22.6	15.2	19.7	17.5	16.6	...
1945	24.7	17.3	22.1	18.2	18.8	...
1950	23.8	20.8	23.2	20.3	18.6	14.1
1960	26.7	26.5	25.5	23.9	19.5	16.9
1970	30.6	28.3	28.0	24.2	23.3	20.7

Year	Colombia	Paraguay	Ecuador	Venezuela	Bolivia
1940	9.1	16.0	16.9	7.8	...
1945	10.7	...	18.2	7.2	...
1950	13.1	15.9	17.1	6.3	12.3
1960	16.2	15.1	15.5	11.3	11.3
1970	17.5	17.3	17.6	13.7	12.8

Year	Nicaragua	El Salvador	Costa Rica	Guatemala	Honduras
1940	...	...	...	...	6.8
1945	11.4	11.3	11.3	...	7.4
1950	11.4	12.9	11.6	11.1	9.1
1960	13.0	13.9	12.5	11.9	15.3
1970	19.2	17.6	15.1	14.6	14.0

Source : Rosemary Thorp: *Progress, Poverty and Exclusion: An Economic History of Latin America in the 20th Century,* The John Hopkins University Press, 1998, p.162.

Staring from the 1960s, however, several pre-crisis signs of the ISI model appeared. The difficulties emerged from the nature of the model.

First of all, the region's balance of payments position had not turned for the better. On the one hand, the import substitution industries still relied heavily on importation of capital goods and sometimes raw materials. Latin American policy makers began to realize that ISI failed to reduce the region's dependence upon the industrialized countries. It merely altered the form of that dependency (Skidmore and Smith, 1997:55). On the other hand, due to poor terms of trade for its primary exports, Latin America could not earn more foreign currency.

Second, despite hopeful efforts to carry out regional integration, Latin America could not enlarge the internal market to absorb more industrial products made in the ISI process. Meantime, Latin America could not expand its overseas market. Therefore, in many countries, factories failed to enlarge production by taking advantage of economies of scale.

Third, ISI had not created enough jobs for the workers. This was due to the two factors. On the one hand, ISI in Latin America displayed clearly the nature of being capital intensive; on the other, the Latin American governments neglected the principle of comparative advantage and failed to make the correct choice of relying on labor or on technology. The result was that the expansion of high-cost, capital-intensive industries raised the capital requirements of additional output increments. In the 1960-1966 period, for instance, the incremental capital-output ratio in Latin America was almost 4 to 1. That is to say, a 1 peso increase in output needed an investment of almost 4 pesos (Balassa 1986:60).

By the 1970s, policy-makers of Latin America had realized the constraints of the ISI model. However, easy access to cheap external borrowing made them reluctant to correct these constraints. Instead, they started to depend more heavily on borrow foreign commercial bank loans to stimulate the ISI model. Between 1970 and 1980 Latin America

accumulated its foreign debt from $27 billion to $231 billion, with annual debt-service payments (interest plus amortization) of $18 billion (Skidmore and Smith, 1997:59).

While Latin America had to meet the obligation on debt service, commodity prices were declining and interest rates climbing. The inherent shortcomings of the ISI model, combined with the unfavorable external conditions, finally led to the debt crisis in the early 1980s, which in turn created a worst economic crisis in half a century.

The model of openness and deregulation.

In order to overcome the "twin crises" of the 1980s, i.e., the heavy external debt burden and stagnant economic growth, Latin American countries started to pursue the model of openness and deregulation by undertaking impressive reform programs starting from the late 1980s. It was not a simple or easy decision to walk on the path of reforms. Several factors might explain why the transformation of the Latin American model occurred then.

First, the policy-makers, who came to power in the "re-democratization wave" of the 1980s, were strong reformers. Mostly trained in western universities and often termed as "technocrats" or "a new generation of leaders" , they were apparently influenced by neo-liberalism and market theories. Mexico is a typical example. Practically all the ministers in the Salinas cabinet hold PhDs, mostly in economics from U.S. universities (Hojman, 1994:197).

Second, there was a strong desire, both from the "new leaders" and from the grassroots, to overcome the economic hardships. The adjustment measures, adopted after the "twin crisis" broke out, had

greatly reduced people's living standards. It was hoped that reforms would help get rid of the difficulties and walk upon a healthy track of rapid growth. It was also realized that everything should be tried and nothing except reforms would work. In this sense, transformation of the development models in the 1990swas both inevitable and irreversible.

Faced with economic crisis, the public also started to think about the causes and ways of change. It was reported that, in mid-1992, the Spanish translation of F. Fukuyama's book, *The End of History and the Last Man*, was for many consecutive weeks at the top or near the top of the bestseller lists. This book indicates that the free market has finally won the decades-long battle with the state. Not all the Chilean readers would agree to this point, but at least they were ready to consider it (Hojman, 1994:211).

Third, there were also the demonstration effects. Apparently, reforms in Chile, let alone the "miracles' made in East Asia, encouraged other Latin American countries to take up the path of reform. As a mater of fact, imitation of models that are perceived triumphant had had important effect on the policy-makers. Several Chilean economists were advising on reform around the region (Hojman, 1994:211). Therefore, as Dornbusch puts it in the case of Argentina, "It is not really Argentina that decided to change, rather it is the rest of the world that has made it totally impossible for the country to continue on the same path."[4]

The model of openness and deregulation has acquired the following notable features: 1) Trade regime was liberalized, and tariffs have been greatly cut. 2) State enterprises were privatized. 3) Foreign investment laws have been more liberal. 4) Financial repression has

[4] Cited from Hojman, David E. : "The Political Economy of Recent Conversions to Market Economics in Latin America", *Journal of Latin American Studies*, No. 1,

been reduced. 5) Tax system becomes neutral and simplified. 6) Pension system and labor code are increasingly market oriented.

The model of openness and deregulation has been successful. Because of profound reforms, the 1990s turned out to be very promising and optimistic for Latin America. As a matter of fact, economic performance in the last ten years of the twentieth century was even better than the 1970s. As table 3 shows, GDP growth rates for 1994 and 1997 were over 5% . Another notable achievement in the 1990s was that inflation had been tamed, and it was down to single digit in many years after decades of double digit or even three-digit rate.

Table 3 Latin America: Total GDP

(Percentages based on values at 1995 prices)

1991	1992	1993	1994	1995	1996
3. 8	3. 2	3. 9	5. 3	1.1	3. 7

1997	1998	1999	1981-1990	1991-1999
5. 4	2. 1	0.0	1.0	3.2

Note: The 1999 figure is a preliminary estimate. / 1991-1990 is calculated on the basis of figures at constant 1990 prices.

Source: ECLAC: *Preliminary Overview of the Economies of Latin America and the Caribbean,* 1999, p. 83.

However, the Latin American model of openness and deregulation has its own limitations. Due to fast liberalization of the economy, domestic enterprises have had a hard time to make adjustment. Inflow of foreign capital, particularly the "hot money" made the economy quite volatile.

1994, p. 193.

The peso crisis in Mexico and the financial turmoil in Brazil are two evident examples. Income distribution has not been improved and unemployment rate remains high. As a result, the poverty issue becomes more conspicuous. As a matter of fact, social problem remains the weakest point of the model of openness and deregulation.

Lessons from the Latin American Development

Models in the 20th Century and Implications for Other Developing Countries

We can draw the following lessons from the evolution and implementation of the three Latin American development models in the 20th century:

Lesson 1: Economic growth should be accompanied by equal income distribution so that economic benefits can be shared justly by everyone in the society.

Economic reforms of the early 1990s in Latin America did reduce the percentage in poverty, but population growth made the absolute number soared. The region's gap in the UNDP's *Human Development Index* has been reduced by more than 20percent between 1975 and 1997, reflecting a substantial improvement in social indicators. However, poverty remains stubbornly high, affecting 36 percent of the Latin American population, or some 185 million people. (Aninat, 2000:2).

Table 4 Income Distribution in Latin America and East Asia

(Gini coefficient)

	1960s	1970s	1980s
Latin America			
Brazil	0· 53	0· 60	0· 57
Chile	0· 46	0· 46	...
Mexico	0· 55	0· 50	...
Colombia	...	0· 57	...
Costa Rica	0· 50	0· 49	0· 42
Average	0· 51	0· 52	0· 50
East Asia			
Korea	0· 34	0· 39	0· 36
Singapore	...	0· 37	0· 42
Hongkong	0· 49	0· 43	0· 45
Thailand	0· 41	0· 45	0· 47
Malaysia	0· 42	0· 53	0· 48
Indonesia	0· 33	0· 32	0· 31
Average	0· 38	0· 40	0· 39

Source: Nancy Birdsall and Frederick Jaspersen (eds.): "*Pathways to Growth: Comparing East Asia and Latin America*", Inter-American Development Bank, 1997, p.87.

The poverty issue in Latin America has to do with many reasons, and

unequal income distribution must be one of them. Indeed, Latin America shows startling contrasts, between the rich and poor, between city and countryside, between the powerful lord of the hacienda and the deferential peasant, between wealthy entrepreneurs and desperate street urchins (Skidmore, 1997:3). As table 4 indicates, Latin America is among the world's several regions where income distribution is the worst.

Latin American policy-makers seemed to have been influenced by the following reasoning in dealing with the relationship between growth and income distribution: One was the belief that the benefits from economic growth would automatically "trickle down" to the poor people, and market forces would do the job of distributing income equally. Another assumption came from the belief that the government would be concerned with the fate of the poor and would make proper policies to improve their income. Finally, it was hoped that, in the early stage of development, the poor had to undergo a process of "belt tightening", and the rich tended to use their wealth to invest more in the economy, thus benefiting the poor as well.

Apparently, the above three justifications turned out to be totally wrong. The "trickle down" did not happen and the market force itself would not redistribute income for the benefits of the poor. From time to time the government, no matter democratic or authoritarian, made policies that worsened income distribution. And, the rich did not increase their investment out of their increasing wealth. They consumed more instead. It was found that small farmers saved at least as high a proportion of their income as big landlords (Steeten, 1979).

Unequal income distribution is not only an economic issue, but also a political one. It has caused much political and social unrest in Latin

America. The most notable example is the bloody fight between the landless and the big landlords over landownership in many countries, particularly in Brazil in recent years. One of the causes for the Chiapas uprising is poverty, which had been worsened by unequal income distribution.

It is increasingly recognized that, to improve income distribution, education is one of the best effective way. Education not only benefits personal career directly, in that a negative relationship often exists between education and unemployment, but also improves overall economic prospects for the nation. Progress made in education has been impressive in Latin America. Quite a few countries in the region now have universal primary education, and enrollment in both secondary and university education has rapidly increased (Urrutia, 1991:40) However, compared with some of the other developing countries, particularly those in East Asia, Latin American country's progress in education has been limited.

Lesson 2: The relationship between the state and market needs to be dealt with properly.

There has been much discussion about the role of the state and market in Latin American development. In the 1950s, ECLAC assigned the state a very important role in the pursuit of the ISI model such as designing and carrying out an industrial program, and protecting the domestic market against foreign competition. Indeed, as Enrique V. Iglesias, the IDB President and a native of Uruguay, once said, "Our generation was one that believed strongly in the role of the state."[5]

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[5] E. Iglesias, "From Policy Consensus to Renewed Economic Growth", in John

Although ECLAC suggested strongly that the state should play an important role in the economy, it also warned of the danger of excessive intervention. But ECLAC's call, particularly the new ideas of neo-structuralism or "updated structuralism" regarding the relationship between the state and markets, often fell on deaf ears.

Starting from the late 1980s neo-liberalism or Washington Consensus began to sweep across the whole continent of Latin America. According to this doctrine, governments should greatly reduce intervention in the economy by abolishing regulations that impede the entry of new firms or restrict competition, and ensuring that all regulations are justified by such criteria as safety, environmental protection, or prudential supervision of financial institutions.[6]

In pursuing the model of openness and deregulation, Latin American countries have privatized many SOEs. Indeed, privatization has marked a new chapter in Latin America's program of structural reforms, reversing decades of state intervention. According to the Inter-American Development Bank, Latin America has been a leader in the developing countries' efforts to privatize. The $59 billion that Latin America realized from its 694 divestitures over the 1990-1994 period is more than half the $104 billion realized by all developing countries. It far exceeds the $20 billion realized by East Asia and the $15 billion obtained by Europe and Central Asia (IDB, 1996:169).

Williamson (ed.): *Latin American Adjustment: How Much Has It Happened?* Institute of International Economics, Washington, DC, 1994, pp. 345-346.

[6] In addition to privatization and deregulation, the Washington Consensus also suggests the following: fiscal discipline, public expenditure priorities, tax reform, financial liberalization, competitive exchange rates, trade liberalization, and abolishing barriers impeding the entry of foreign capital. See John Williamson (ed.): *The Political Economy of Policy Reform*, Institute of International Economics, Washington, DC, 1994, pp. 26-28.

However, it seems that too much faith was placed in the capacity of privatization and market. Experience from implementing the ISI model and the model of openness and deregulation signifies that success at managing the economy will require not a zero government role but instead a modified one, although this role has to involve a decrease in government's public responsibilities. Particularly in those countries where much liberalization, whether in the financial sector or in other areas, government regulation and supervision is all the more important. The peso crisis of Mexico in 1994 was a proven example in this regard.

In the new century, with conditions of development changed significantly both internally and externally, the state in Latin America will be required to re-establish itself as an effective manager and supervisor for the liberalized economy. But this new role should be very different from that of the past. As Naim puts it, the more difficult task for the Latin American governments would be the reintroduction of the state, but not as the incompetent, corrupt owner-manager of airlines and steel mills, not as the myopic picker or subsidized "priority" industries that made inferior products at inflated prices, and not as the administrator of a constantly mounting pile of absurd economic regulations that boosted corruption and depressed growth. Rather, the "new" state should rebuild its capacity and ability to provide basic public goods and services, to collect taxes, to regulate effectively and honestly the activities of the private sector, to support local firms in international expansion, and to ensure that economic benefits can be spread to everyone in the society (Naim, 1993:27).

Indeed, in the words of Michel Camdessus, it is necessary to establish an arms-length relationship between governments and markets, neither

too close nor too distant.[7] For Latin America and other developing countries, the challenge is how to determine this "arms-length" under the new development model.

Lesson 3: International competitiveness matters.

It is interesting to note that Paul Krugman argues in the March-April 1994 issue of *Foreign Affairs* that competitiveness is a meaningless word when applied to national economies, and the obsession with competitiveness is both wrong and dangerous. He says, "The idea that a country's economic fortunes are largely determined by its success on world markets is a hypothesis, not a necessary truth; and as a practical, empirical matter, that hypothesis is flatly wrong. Thinking in terms of competitiveness leads, directly and indirectly, to bad economic policies on a wide range issues, domestic and foreign, whether it be in health care or trade." The well-known American economist goes on to write: "So when we say that a corporation is uncompetitive, we mean that its market position is unsustainable – that unless it improves its performance, it will cease to exit. Countries, on the other hand, do not go out of business. They may be happy or unhappy with their economic performance, but they have no well-defined bottom line. As a result, the concept of national competitiveness is elusive."(Krugman, 1994)

Krugman's argument might be misleading. It is not suitable for him to compare a nation's economy to the business performance of a company. As a matter of fact, in the age of globalization, competition tends to become more fierce than ever in the world market. So it is

[7] Michel Camdessus: "Governments and Economic Development in a Globalized World", Remarks at the 32nd International General Meeting of the Pacific Basin

highly necessary to strengthen competitiveness. For any country, particularly a developing one, if there is no competitiveness, there will be no chance to gain overseas market share.

Generally speaking, the extent and degree of competitiveness is closely related to exports. For Latin America, exports was the at the center of the model of exporting primary commodities. The ISI model neglected export promotion. In the 1950s, Latin America accounted for 12. 5% of world exports. In 1990, this percentage declined to less than 3.5%, the lowest point in a century (Naim, 1995:57).

The model of openness and deregulation has attached great importance to exports as the "engine of growth". This approach has worked rather successfully. Between 1987 and 1994, regional exports grew at around 10 percent annum in real dollar terms and 6 percent in volume (Burki, 1996:12). No less important has been the fact that the region seems to have diversified its export structures.

Globalization brings both opportunities and challenges. On the one hand, Latin America and any other country in the world will face a larger world market; on the other, every country will try to gain a bigger market share. Therefore, in order to expand exports on a solid base, Latin America should increase its competitiveness through productivity improvements.[8] To meet this end, first of all, the region needs to take advantage of the rapid development of the so-called "technological revolution" and "information revolution" to upgrade its industrial structures. [9] The objective of this task, *transformacion productiva* in

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Economic Council, Hongkong, May 17, 1999.

[8] However, as S]]]]] points out in a lecture presented at the Chinese Academy of Social Sciences recently, competitiveness should be gained at the expense of lowering wages for the worker.

[9] As an ECLAC document points out, however, it is worth noting that the most important impact of the current technological cycle on employment is the

ECLAC"s words, is to make economic activities move in the direction with a higher value added and a higher growth potential. In addition, reliance upon traditional exports of primary products needs to be reduced and non-traditional exports, especially manufactured exports, should be encouraged.

Lesson 4: Agricultural development should not be neglected in the process of industrialization.

In every Latin American country there are examples of agricultural progress. In some cases, agricultural organization, particularly in export agriculture, is even quite modern. For the most part, however, agricultural retardation has been evident in many parts of the region. In consequence, agricultural productivity has lagged behind industrial productivity in many Latin American countries.

Dring the 1960s and 1970s, while the economy grew at rates above the world average, the agricultual sector, constrained by the ISI model that prioritized the manufacturing sector, developed at rates somewhat below the world average (Reca, 1997).

Latin America's agricutural sector had been discriminated and neglected in the following aspects:

First, the government allocated more resources to the manufacturing sector at the expense of less agricultural investment. At the same time, the government also used exchange rate policies and protection to favour the manufactruing sector. Needless to say, when one sector was favoured, another would be in a disadvantagous position.

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obsolescence of certain skills and know-how. Consequently, some jobs are eliminated and others are created. (See ECLAC: *Latin America and the*

Second, although governments of Latin America have kept on talking about reforms of the agricultural sector, sometimes even including land redistribution, the reality was that, other than the Mexican and Bolivian reforms, results and effects have been quite disappointing (Glade, 1991:148). So the numbers of landless have been growing, and the problem of rural poverty is yet to be resolved.

Third, although price control was considered an instrument of social policy, it has in fact reflected the political power of the urban interests and has created huge losses for the rural residents. In addition to discouraging production and leading increased food imports, price control had pushed the farmers out of the fields to live in the urban areas, thus worsening the unemployment issue in many countries (Balassa, 1986:92).

Agricultural retardation in Latin America has had two negative results. On the one hand, since agricultural growth in many countries has failed to keep up with population growth, governments have to allocate scarce foreign exchanges to import food. On the other, rural income cannot be raised and the gap between the urban and the rural has grown all the time.

Lesson 5. In the age of globalization it is still important to strike at a correct balance between opening to the outside world and protecting domestic market.

For decades, due to the ISI model, the governments of Latin American countries built high walls of protection for the domestic market, resulting in a range of tariffs and procedures to control imports. Effective rates of protection of one thousand per cent or even more were not uncommon

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Caribbean: Policies to Improve Linkages with the Global Economy, 1999.)

(Hojman, 1994:205). The "lost decade" of 1980s worsened these practices.

The picture has changed completely since the late 1980s. If in the days of the ISI model, isolation was the rule in Latin America, now openness is the order of the day. Trade liberalization introduces foreign competition, forcing the domestic enterprises to raise efficiency. At the same time, however, many local firms were hard to face the sudden increase of challenges and went bankrupt, worsening the unemployment problem.

Despite the harsh reality, it is not wise to shut the door again and keep out foreign competition. But, opening the door does not mean that trade liberalization should be realized overnight and no protection could be applied. The Latin American experience seems to make the following two points more conspicuous:

First of all, speed of opening the domestic market is important. Whereas Brazil and Venezuela liberalized their tariff regime over a few years, Mexico, Argentina, Colombia and Peru conducted faster trade liberalization (Loayza, 1997:4). It seems that a gradual approach is more ideal in trade liberalization, simply because the local enterprises need time to adjust to the changes of market conditions.

Second, following the globalization trend does not mean that there should be no protection and safeguard for the domestic market. Introducing foreign competition can force domestic enterprises to be aware of the necessity of raising efficiency. But this should be carried out in a gradual way. Sudden opening without proper protection will result in an awkward situation for the local firms. In this regard, "dancing with the wolf" is certainly dangerous.

Lesson 6. Domestic savings rates should be raised to promote capital accumulation and reduce dependence upon foreign capital.

Both in theory and in reality, capital accumulation plays an important role in economic development. As a World Bank report notes, countries that grow faster devote a higher proportion of their GDP to investment and have developed a capital market that helps channel these funds towards high returns projects. A faster rate of capital accumulation requires an increase in domestic savings (Burki, 1996:14).

Latin America is well known for its low saving rates. In 1980 the region saved on average 19 percent of its GDP; by 1994 this ratio was basically unchanged. To maintain growth momentum, Latin America has been relying heavily on foreign capital, including foreign direct investment, portfolio investment and bank loans.

Foreign capital has made great contribution to Latin America's economic development. However, it has its side effects, risk and challenges. According to a World Bank research, at the macro level, large foreign capital inflow can affect an economy's competitiveness, saving, and investment performance, expose it to external shocks, and ultimately reduce its degree of policy independence from the rest of the world. At the micro level, sustained capital inflows can have profound effects on the policies of the financial, industrial, and other sectors, on the shape and regulation of domestic capital markets, and even on the extent and form of government activities in the economy. Furthermore, since not all external capital flows have the same nature and features, different types of such capital will have the different effects on the host economy (World Bank, 1996:1-2).

As a matter of fact, Latin America has bitter experience in this regard.

As mentioned earlier, the region was hit by a foreign debt crisis. Then came the Mexican peso crisis in 1994. With the quick outflow of foreign funds, mainly "hot money" of speculative nature, the tequila effect spread to other Latin American countries and to even some other parts of the world.

In a word, foreign capital is not a long-term reliable source of funds, or a substitute for domestic savings as a means for financing investment. The best possible way to reduce dependence upon foreign capital is to raise domestic savings rates.

For Latin America, how to raise savings rates is certainly not a difficult task. It seems that leaders of the region should pay attention to such policy actions as improving income distribution, establishing more efficient financial institutions to mobilize savings and changing the consumption habits of the rich, among others.

Lesson 7. Political stability should go hand in hand with economic development.

Implementation of each of the development models in Latin America was not purely an economic matter. In other words, effectiveness of any model is conditioned by some non-economic factors, and political development was one of the most important.

The relationship between economic development and political development has been long debated. While some say that political democracy is the prerequisite for rapid economic growth, others argue that economic development needs political authority that might limit democracy. It is true that some Latin American countries like Brazil and Chile made remarkable economic achievements during their military

rule, the so-called bureaucratic authoritarianism. However, some other Third World countries, where no progress of political democracy had been established, failed to develop the economy. Therefore, it seems that political democracy is not the sole condition for economic growth.

Another fact that needs to be taken into account seriously is the likelihood that, in a society where there is limited political democracy, political stability cannot be maintained for long. This has been proved not only in Latin America, but also in Korea and some other East Asian NIEs.

As a matter of fact, the essence of the relationship between economic and political development points to the necessity of maintaining political and social stability, a condition highly necessary for rapid economic development. Experience has shown that, to make radical economic reforms in Latin America, you need to have a high degree of political consensus. If a democracy is to manage what in the words of Aylwin, the former president of Chile, amounts to an "economic coup", the quality of politics must be very high.[10]

Conclusions

In the 20th century Latin America implemented three development models. Each model seemed to work well in the initial stage and each had its own inherent limitations, and would eventually encounter diminishing returns. That is why the policy-makers should be able to correct the shortcomings of a model or simply switch from this one to another at the best time. The inability of the Latin American economies to sustain growth of the ISI stage could be blamed at least partially on the

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[10] *New Perspective Quarterly*, Fall 1993, p. 18.

failure of the governments to recognize and/or act upon model switch-points (Dietz, 1995: 194).

The evolution and implementation of the Latin American development models in the 20th century exhibit important lessons and implications for other developing countries: 1) Economic growth should be accompanied by equal income distribution so that economic benefits can be shared justly by everyone in the society. 2) The relationship between the state and market needs to be dealt with properly. 3) International competitiveness matters. Lesson 4) Agricultural development should not be neglected in the process of industrialization. 5) In the age of globalization it is still important to strike at a correct balance between opening to the outside world and protecting domestic market. 6) Domestic savings rates should be raised to promote capital accumulation and reduce dependence upon foreign capital. 7) Political stability should go hand in hand with economic development.

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