



## Latin America's 100 Years of Lagging Performance

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I first paid attention to South Korea's economy some 50 years ago when, as a junior State Department officer, I served on the desk responsible for Japanese and Korean affairs. The consensus of informed observers then was that South Korea's economic prospects were dismal after years of Japanese occupation and the destruction from the Korean War. The country's GDP per capita, as best determined, was the equivalent of \$60.<sup>1</sup> I had served in the U.S. embassy in Mexico City just before I was assigned to Northeast Asian affairs. Mexico's GDP per capita in 1955 was \$241.<sup>2</sup> Mexico devalued its currency in 1954 and what followed was about 25 years of steady growth, with low inflation; and this was depicted as the Mexican miracle. This stellar performance was followed by the "lost decade" of the 1980s, when there was practically no economic growth.

At the close of 2004, South Korea's GDP per capita was \$14,162 and Mexico's was \$6,346. The disparity between the good performance of East Asian countries and the desultory economic advances in Latin America and the Caribbean (LAC) covers entire regions, and not just South Korea and Mexico. East Asia has prospered and the LAC countries have stagnated. East Asian merchandise exports last year were 9.7 percent of world exports and are growing; those of LAC were 5.1 percent and declining.<sup>3</sup> Excluding Mexico, the LAC share was 3.1 percent. Foreign investors look much more to East Asia than to LAC when they make long-term investments, especially those unrelated to the existence of natural resources for which investor choices are limited to what is in the ground or under the sea. I will return to this theme on foreign investment.

Why has LAC done so poorly? The management of governments in Latin America is in the hands of educated persons of western backgrounds. Despite the popular perception that Latin America is *mañanaland*, Latinos work hard, something that is evident when they migrate to the

United States. The educational structures in East Asia generally are superior to those of LAC, but that observation begs the question: why is this so? The colonial history of LAC countries may have impeded an entrepreneurial drive, but East Asia also has a history of foreign dominance. Income distribution is highly unequal in LAC countries, which generally is not the case in East Asia. LAC countries have large groups outside the main economy, such as the indigenous populations of Peru, Ecuador, Guatemala, even Mexico; however, the Argentine economy did not flourish during the twentieth century despite its largely European-origin population.

It is more straightforward to compare policies on key economic issues in the two regions than to analyze in a brief essay why LAC countries chose the policies that they did. Perhaps the most important of these policies relates to the role of trade in fostering economic development. Import substituting industrialization (ISI) was the hallmark of LAC development policy, and the essential feature was to keep out foreign goods to the extent feasible in order to foster domestic production. This started with finished products and later was applied to intermediate goods used in the production process. Many of the laws and regulations prescribed a growing percentage of domestic content in the value of final products, and this often forced producers to use inferior and more expensive domestic inputs in their production. It was hard to compete in foreign markets under these conditions, and a philosophy of export pessimism took hold. The argument often used was that if an LAC producer succeeded in capturing a significant share of a foreign market, particularly in the United States, protectionism against that product would be employed. This did happen often enough to be a superficially credible contention.

The dominant policy in East Asia was to encourage exports. This was accompanied to some degree by import substitution, but not by so much as to destroy competitiveness in foreign markets. South Korea, Taiwan, Singapore, Thailand, and Malaysia all followed this practice, as had Japan earlier and as China is doing today.

<sup>1</sup> Bank of Korea.

<sup>2</sup> Banco de México.

<sup>3</sup> The East Asian countries included in calculating this figure are Taiwan, Hong Kong, Rep. of Korea, Malaysia, Singapore, and Thailand. LAC includes all the countries in the region.

Import substitution was natural during the Great Depression of the 1930s because the market for LAC primary products dried up and funds to import needed goods were lacking. This reality gradually led to conscious ISI justification, led by the Economic Commission for Latin America, then directed by Raúl Prebisch. I knew Prebisch and admired and respected him, even though I thought his reasoning was economically flawed. He was a dynamic man, a person dedicated to improving the lot of the population of the LAC region. I asked him more than once why he stuck with the ISI philosophy even as he witnessed greater growth in East Asia than in LAC. His response was largely that the two regions differed in their cultural formations and human talent and, hence, that the Asian export-promotion model did not fit the LAC circumstances. Why export pessimism in LAC, I asked him, when it was evident that Asian countries were doing well in penetrating many U.S. and European markets? The answer to this was never clear, although many instances of protectionism were accurately cited.

One other criticism of the ISI model was that the domestic markets in LAC countries were generally too small to stimulate economic advances without simultaneously penetrating foreign markets. This was recognized by intellectuals in LAC and was the basis for encouraging economic integration of the entire region. The Latin American Free Trade Association (LAFTA) was an attempt to expand the total market, but LAFTA had so many defects that it did not endure long. It was, in essence, ISI on a regional scale, but without a compulsory schedule for reaching LAC-wide free trade. LAFTA was less about free trade than it was about protectionism in the guise of economic integration. The key beneficiaries of LAFTA were the bigger and more economically developed countries, Brazil and Mexico, which had large enough markets to successfully carry out ISI for a time. Mexico's policy of import substitution ended in 1982 when the country faced a debt crisis that in due course involved most LAC countries during the 1980s.

The LAC countries have long had problems in effectively cooperating with each other: Peru and Ecuador recently fought a border war; Argentina and Chile came close to war over territory in Patagonia before the Vatican assisted in working out a solution; Peru and Chile are now engaged in a dispute over the extent of their respective maritime limits; Bolivia refused to ship natural gas via a pipeline to the Pacific because the port suggested by the consultants who did the technical work was in Chile; Argentina recently broke a contract to ship natural gas to Chile because of domestic shortages; the four countries of the Common Market of the South (Mercosur) have not taken the necessary action to make this an economic success in some 15 years of existence; and at the recent Summit of the Americas in Mar del Plata, Argentina, 29 countries

indicated they were prepared to proceed in examining a Free Trade Area of the Americas, but 5 countries including Brazil, the largest LAC country, were not. Hugo Chávez, the president of Venezuela, has been using his oil revenue to generate LAC solidarity, and this is couched in anti-U.S. and pro-Castro rhetoric. I suspect that he will succeed in fostering bilateral cooperation with some (but by no means all) LAC countries as long as his money holds out.

Latin American intellectuals have been highly imaginative in finding rationalizations for their relative lack of development. These include: dependency theory, to explain why the developed countries prospered at the expense of the less-developed countries of LAC in the 1950s through the 1970s; why the center prospers, but the periphery does not; the evils of neoliberalism, which by advocating less protection against imports, exposes LAC countries to "unfair" competition from more-developed countries; and the damage wrought by the "neoliberal" and mainstream macroeconomic tenets of the Washington Consensus.

There are counter-voices to these rationalizations. Jesús Reyes Heróles, a senior Mexican personality who writes regularly for the Mexico City daily newspaper *El Universal*, referred in his December 2 column to a conference held at the University of Guadalajara whose theme was the lack of LAC insertion into the global economy. Reyes Heróles cited a book by Andres Oppenheimer, an Argentine-born journalist with the *Miami Herald*, in which there is a discussion of the LAC proclivity to blame others for their own shortcomings. A key theme of the discussion was that drastic shifts in economic policy as new governments assume power removes the necessary predictability to capture long-term investment, especially in a time of growing globalization.

I have spent many years living in, working with, and visiting LAC countries and have come to love the region. I would much prefer to write about long-term economic success, but this is not possible when comparing the LAC region with East Asia. Many observers will likely disagree with some of my specific comments, but I don't think it is possible to contradict the main theme—that LAC has been economically deficient compared with East Asia, the region most appropriate for direct comparison.

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