

Why has productivity growth stagnated in most Latin American countries since the neo-liberal reforms?

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The business of historians
[and of economists...]
is to remember what others forget.

Eric Hobsbawm

Today the appeal to newness,
of no matter what kind,
provided only that it is archaic enough,
has become universal.

Theodor Adorno

[Our recent past] demonstrates that the
victory of the ideals of justice and equality
is always ephemeral, but also that [...]
we can always start all over again [and again].

Leo Valiani

[Latin America] has a narcissistic tendency
to use reality as a mirror for self-contemplation.
[... Yet] human history is the product of discontent.

José Ortega y Gasset

1.—Introduction

Latin America's economic performance since the neo-liberal reforms began has been poor; this contrasts with its performance pre-1980, and also with what was happening simultaneously in Asia. I shall argue that the weakness of the region's new paradigm is rooted as much in its intrinsic flaws as in the particular way it has been implemented. Discussing Say's Law, Keynes said that Ricardo conquered England as completely as the Holy Inquisition conquered Spain; the same could be said for neo-liberalism in Latin America: it has conquered the region, including many in its left-wing intelligentsia, as completely (and fiercely) as the Inquisition conquered Spain. This process has been so successful that it has actually 'closed the imagination' to conceptualising alternatives.

The genesis of the new political economy paradigm can be located in a series of negative external and domestic shocks c.1980, when the region was particularly vulnerable. As had happened in the 1930s, these laid the foundations for a radical ideological transformation that led to the new paradigm along the lines of Anglo-Saxon neo-liberalism and US neo-conservatism, and quite distinct from what was happening in Asia, where economic reform was implemented in a much more pragmatic, imaginative and diverse way, as most actors in favour of the reforms (including local capitalist elites and many 'new-left' intellectuals) were probably just too cynical and with too much sense of national identity to be

seduced by the 'discreet charm' of a narcissistic ideology—especially if most of the so-called 'new' ideas were just recycled ones from the past.

In Latin America (LA), what characterised the economic reforms most was that they were undertaken as a result of the region's perceived economic *weaknesses*—i.e., it was an attitude of 'throwing in the towel' vis-à-vis their previous state-led industrialisation strategy (ISI), as most politicians and economists interpreted the 1982 debt crisis as conclusive evidence that ISI had led the region into a cul-de-sac. As Hirschman argued (1982), part of the problem was that people got stuck with some bad choices for too long, leading to such frustration and disappointment with existing institutions (and ISI) that there was a remarkable 'rebound effect' (see also Palma, 2009c). From this perspective, what characterises LA is not just the strength with which new ideologies are adopted, but also the form in which they are subsequently given up—Hirschman called this LA's 'fracasomania' (Ibid.).² Consequently, the discourse of the reforms ended up resembling a compass whose 'magnetic north' was simply the reversal of as many aspects of the previous development strategy as possible—as Gustavo Franco (President of Brazil's Central Bank) explained, the main task of Cardoso's first government was "...to undo forty years of stupidity [besteira]..." (Veja, 15/11/1996).³ With that 'reverse-gear' attitude, perhaps it should not be surprising that this experiment ended up mostly as an exercise in 'not-very-creative-destruction'. The mere idea that alternatives could exist met with a mixture of amusement and contempt. Franco again: "[The alternative now] is to be neo-liberal or neo-idiotic [neo-burros]." This helps to explain the peculiar set of priorities and the rigidity with which the reforms were implemented in LA, as well as their poor outcome, as distinct from many Asian countries—where reforms were intended mainly as mechanisms to help lift pressing economic and financial constraints in order to continue and *strengthen* their existing ambitious industrialisation strategies.

LA is also a region whose critical social imagination has stalled. The emergence post-1950 of an intellectual tradition in the social sciences somehow runs against what one could call the 'Iberian tradition', which has been far more creative in painting, music, literature and film than in contributions to the social sciences. Basically, in the Iberian Peninsula social sciences have suffered due to

² Perhaps, one reason why 'ideology' is so important in LA is because there is little else in the form of social cohesion.

³ For Franco, the fact that Brazil's ISI-industrialisation had delivered for most of those 40 years one of the fastest growth rates in the world was probably a mere detail of history.

a lack of 'enlightenment' beyond the arts and letters, and specifically the lack of sophistication in the state's exercise of power. Foucault's ideas can help understand this issue: knowledge and power are interrelated, one presupposing the other (Foucault, 2004). Foucault intended to show how the development of social sciences was interrelated with the deployment of 'modern' forms of power (Frangie, 2008). But in the Iberian world, since states have often governed through 'un-modern' means, and at times via crudely mediated forms, they have not required much social knowledge, or sophistication in the forms of control; so, social sciences have been relegated to a relatively marginalised academic enterprise.

In essence, what has become manifest in the implementation of economic reforms in LA is how its brand of neo-liberalism—with its Anglo-Saxon fundamentalism and its Iberian 'minimalism'—has fitted perfectly with its underlying power structure (and in particular with its perennial rent-seeking bias), and its lack of political need for social imagination. Perhaps that also helps understand why this ideology was soon wrapped in an aura of superiority, 'specialness' and contempt, not just for possible alternatives but also for everything that happened before (the past, even the recent past, acquired a growing sense of unreality).⁴ And (not unrelatedly) what became 'modern' in terms of economic thinking reminds us of Adorno's proposition: "[t]oday the appeal to newness, of no matter what kind, provided only that it is archaic enough, has become universal." (2006; see epigraph to this paper).

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

⁴ As quoted in the epigraph, for Hobsbawm the business of historians is to remember what others forget; today in LA this also applies to economists.

2.—Latin America's poor growth performance post-1980: two main stylised facts

2.1.—The collapse of Latin America's growth rate post-1980 is unique in the Third World

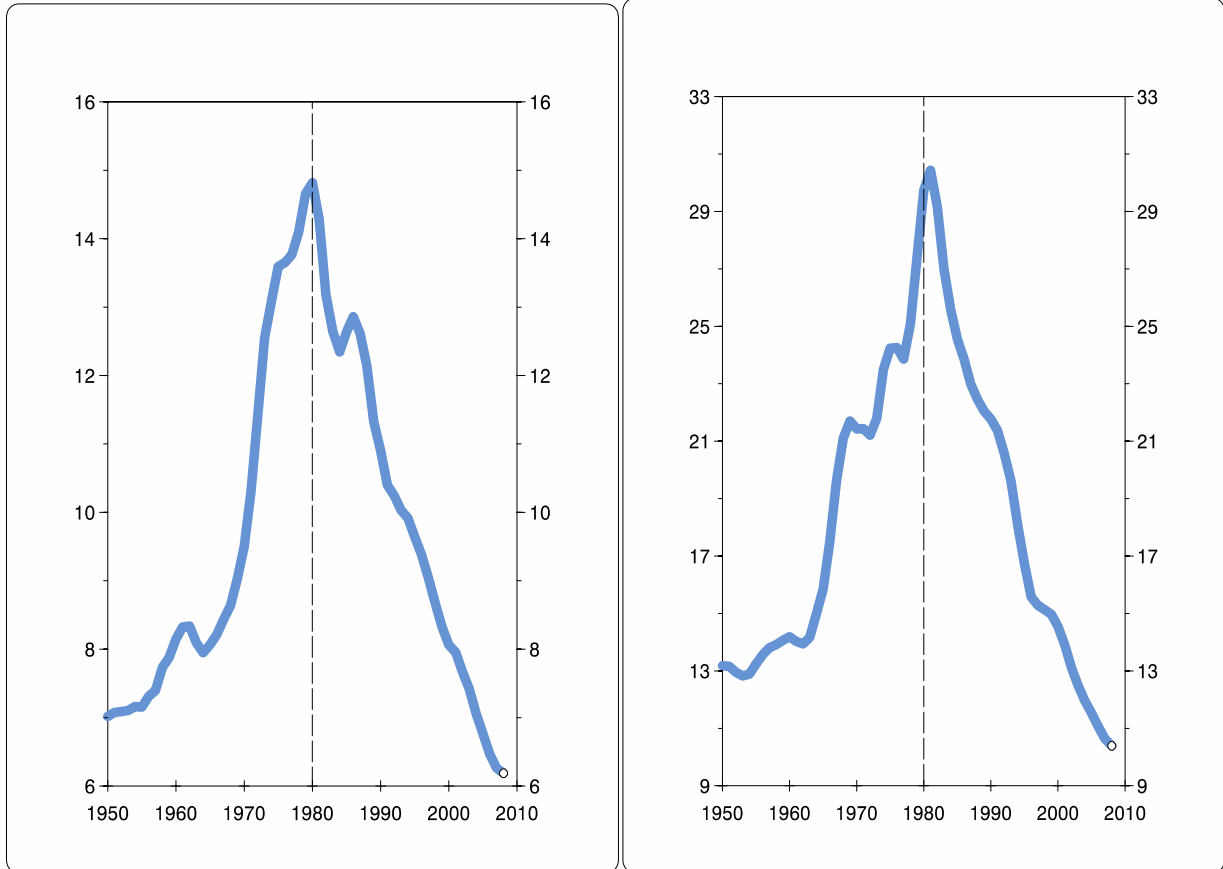
As is well-known, the beginning of neo-liberal reforms was followed by a significant slowdown of the world economy. This was also associated with the complex transition from the 'mass-production-for-mass-consumption' techno-economic paradigm to the age of information and telecommunications, with its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

The exception to the slowdown was the 'third-tier' NICs (China, India, and Vietnam). Elsewhere in the developing world, 'second-tier' NICs (Malaysia, Thailand, Indonesia) managed on average to keep their growth-rate stable despite 1997, while in 'first-tier' NICs (Korea, Hong-Kong, Singapore, Taiwan), and in North Africa and Sub-Saharan Africa they declined, but by a relatively small margin. LA, meanwhile, saw its growth rate halved to 2.7%. For example, if one ranks all countries by GDP growth-rate, Brazil's growth-ranking collapses from 10 (1950-1980) to 70 (1980-2008); in turn, Mexico falls from 13 to 62. What a contrast with China (43 to 1), India (72 to 7), and Vietnam (84 to 2)! Their divergent fortunes become evident in Figure 1.

FIGURE 1

Brazil's GDPpc as a multiple of India's GDPpc, 1950-2008

Mexico's GDPpc as a multiple of Vietnam's GDPpc, 1950-2008



•**GDPpc**=GDP per capita. 3-year moving averages.

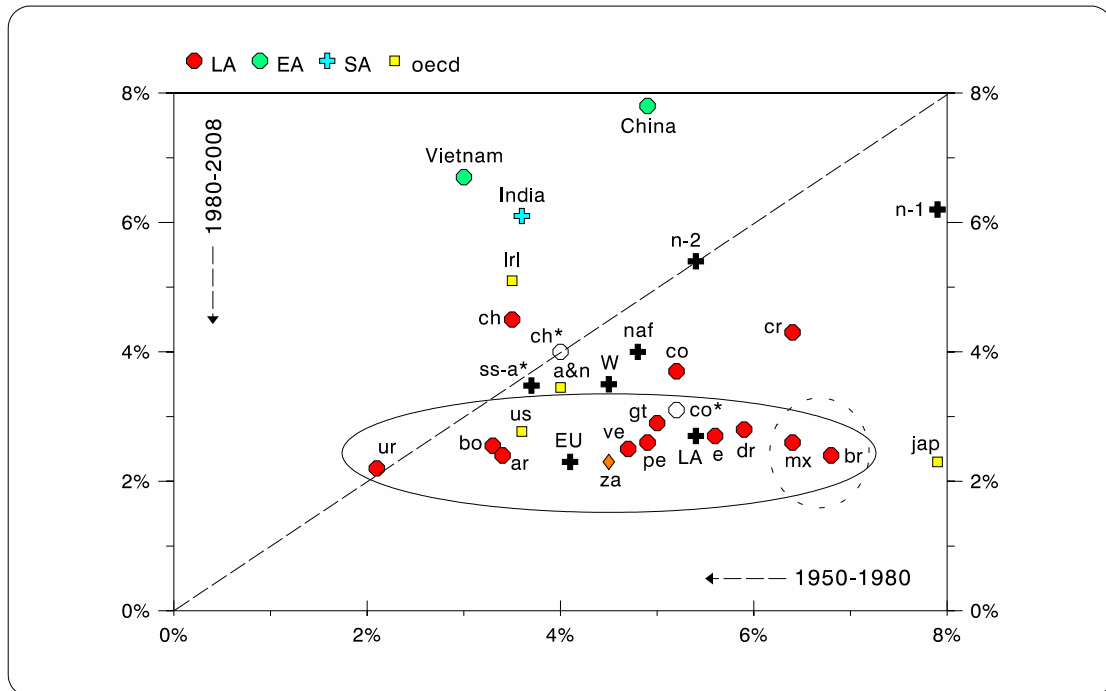
•**Source:** WDI (2010, data in constant 2000-US\$). The series were brought back to 1950 using GGDC (2009).

Although from a Gerschenkronian perspective one would have expected some catching-up by lower-income Asian countries, the extent is truly remarkable—and China's catching-up is of course faster still. Figure 1 also confirms that (as opposed to what is usually argued) LA's relative growth weakness is *not* confined to the 1980s.

Moreover, LA's disappointing post-1980 performance is fairly homogenous—see Figure 2.

FIGURE 2

Latin America and other regions: GDP growth 1950-1980 and 1980-2008



• **Horizontal axis**=rate of growth of GDP 1950-1980; **vertical axis**=1980-2008.
 • **Regions:** **LA**=Latin America; **EA**=East and South East Asia; **EU**=European Union (excluding Germany because of unification); **n-1**=first-tier NICs; **n-2**=second-tier NICs; **naf**=North Africa; **SA**=South Asia; **ss-a***=Sub-Saharan Africa (excluding South Africa); and **W**=weighted average for the 97 countries of the source. • **Countries:** **a&n**=Australia and New Zealand; **ar**=Argentina; **bo**=Bolivia; **br**=Brazil; **ch**=Chile (**ch***=Chile 1950-72 and 1972-2008; 1972 is chosen as a cutting year to avoid the distorting effect of 1973, the year of the military coup); **co**=Colombia (**co***=Colombia, second period 1980-2004); **cr**=Costa Rica; **dr**=Dominican Republic **e**=Ecuador; **gt**=Guatemala; **mx**=Mexico; **pe**=Peru; **us**=United States; **ur**=Uruguay; **ve**=Venezuela; and **za**=South Africa. Unless otherwise stated, these acronyms will be used throughout the paper.

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

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

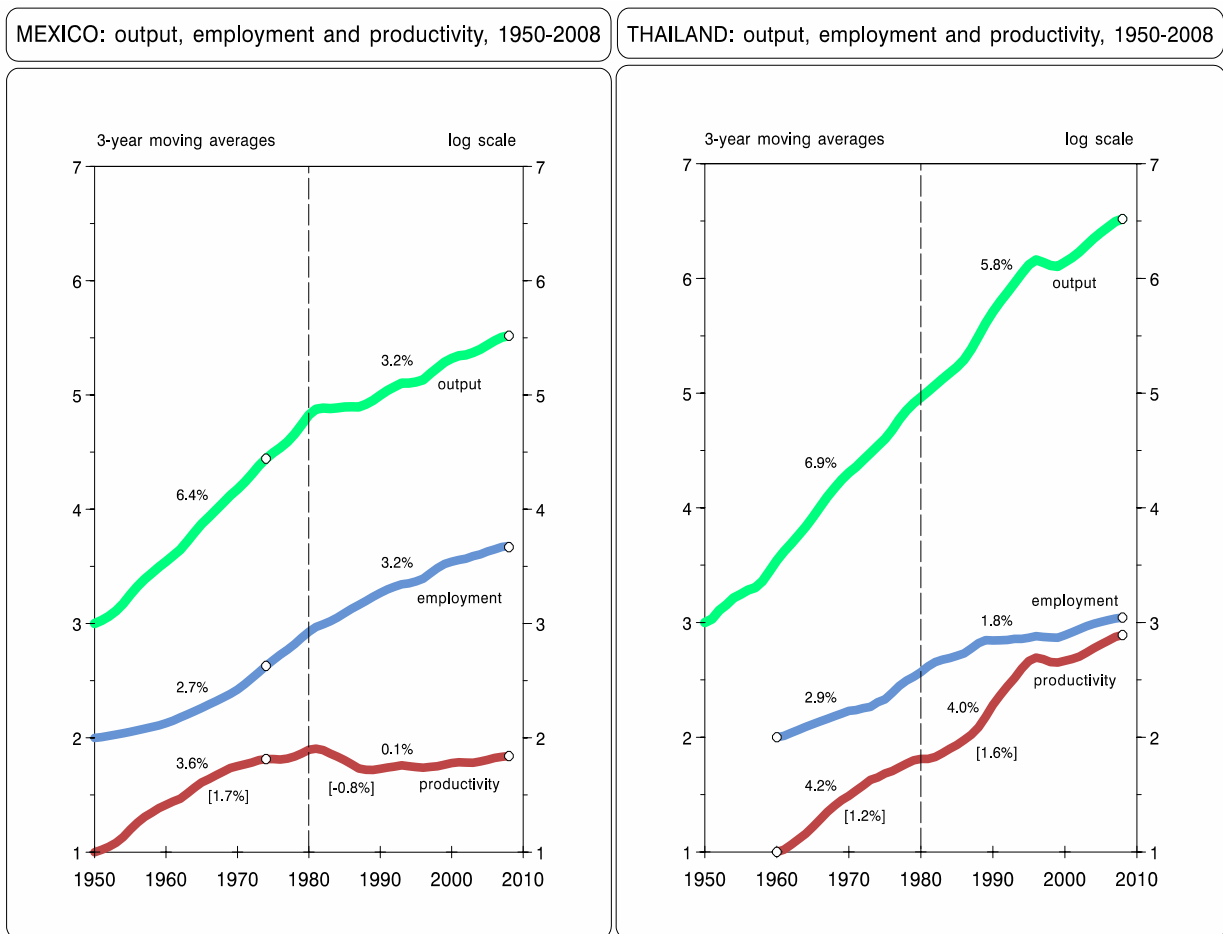
Moreover, only Chile (and marginally Uruguay) managed to grow faster in the second period; however, as reforms in Chile began in 1973, a comparison between pre-1973-ISI and post-1973-economic-reform periods shows that the

growth rate actually remained the same in both (4%; see 'ch*'). This Figure also confirms the remarkable collapse of Brazil and Mexico—only Japan does worse.

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

A comparison between Mexico and Thailand helps explain the second contrast between LA and Asia—now in terms of how a decline in GDP growth is absorbed differently by employment and labour productivity (Figure 3).

FIGURE 3



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

● **Source:** for TFP growth, see Figure 5 below.

If one divides these six decades into two long periods, during the first there is little difference between the two countries in terms of their growth-rate of GDP, employment and productivity. This is not the case afterwards: although both

GDPs slowed, in Mexico this is *totally* absorbed by a decline in labour productivity, and in Thailand by employment. So while Mexico's productivity growth collapses, employment creation continues unaffected—in fact, it actually accelerates.⁵ In contrast, Thailand's productivity growth continues at the same pace and employment absorbs the fall in GDP growth. Both countries have cycles and sectoral diversities, but in aggregate term the contrasting picture in terms of 'GDP-shock-absorbers' is clear. And as Thailand has had little industrial policy, this asymmetry reflects market outcomes. In fact, in Mexico, as the whole of GDP growth ends up being explained by additional employment, TFP growth becomes negative (and remains so after reforms; see Table 2 below). Table 1 shows that this contrast in terms of 'GDP-shock-absorbers' also applies to other countries in each region.

TABLE 1
GDP, Employment, Labour Productivity and Gross Employment
Elasticities, 1950-2008

	GDP		Employment		L Productivity		Emp "Elast"	
	1950	1980	1950	1980	1950	1980	1950	1980
	1980	2008	1980	2008	1980	2008	1980	2008
China*	4.9	8.5	2.4	1.7	2.0	6.7	0.5	0.2
Viet Nam*	3.0	6.7	1.8	2.4	0.6	4.2	0.6	0.4
N-1*	8.1	6.2	3.7	2.0	5.0	4.2	0.5	0.3
India*	3.6	6.1	2.0	2.3	1.4	3.8	0.6	0.4
N-2*	5.4	5.4	2.4	2.3	3.5	3.0	0.5	0.4
Ireland	3.5	5.1	-0.2	2.2	3.7	2.9	-0.1	0.4
"World"	4.4	3.7	2.0	1.6	2.4	2.1	0.4	0.4
USA	3.6	2.9	1.7	1.3	1.9	1.6	0.5	0.4
EU	4.1	2.3	0.5	0.8	3.6	1.5	0.1	0.4
Australia & NZ*	4.0	3.3	2.1	1.8	1.9	1.5	0.5	0.6
South Africa*	4.5	2.3	2.8	1.2	1.7	1.1	0.6	0.5
Latin America	5.4	2.7	2.8	2.5	2.5	0.2	0.5	0.9
Colombia	5.2	3.7	3.1	2.2	2.0	1.4	0.6	0.6
Chile	3.5	4.5	1.4	3.1	2.1	1.4	0.4	0.7
Costa Rica	6.5	4.3	3.6	3.4	2.8	0.9	0.6	0.8
Argentina	3.4	2.4	1.2	2.0	2.1	0.4	0.4	0.8
Brazil	6.8	2.4	3.1	2.3	3.6	0.1	0.5	1.0
Dom. Rep.*	5.9	2.8	3.8	2.8	2.1	-0.1	0.6	1.0
Venezuela	4.7	2.5	3.7	2.5	1.0	-0.1	0.8	1.0
Uruguay*	2.1	2.2	0.6	2.2	1.6	-0.1	0.3	1.0
Mexico	6.4	2.6	3.2	2.7	3.1	-0.1	0.5	1.1
Peru	4.9	2.6	2.3	2.8	2.6	-0.2	0.5	1.1
Guatemala	5.0	2.9	2.7	3.1	2.2	-0.2	0.5	1.1
Bolivia	3.3	2.5	0.8	3.0	2.5	-0.5	0.2	1.2
Ecuador	5.7	2.7	2.7	3.5	2.9	-0.8	0.5	1.3

⁵ There are well-known problems with employment data, especially in services (information on formal jobs is normally available, but those in the informal sector are often estimates). However, there is no reason to believe LA's employment statistics are any different than Asia's.

•Countries and regions are ranked according to their 1980-2008 labour productivity growth rates. For those with '*', for employment and productivity the first period rates are restricted to 1960-1980. **L Productivity**=labour productivity; **Emp "Elast"**=gross employment elasticities (understood simply as the ratio between employment growth and GDP growth); and **NZ**=New Zealand. 'World' excludes African countries as the source does not provide information on employment (and ILO, 2010 only provides information on African employment for a small number of years; furthermore, as for many African countries no real data exist, ILO estimates are based on econometric models). For South Africa, Quantec (2009).

Among the many issues arising from Table 1, four stand out vis-à-vis the first period (1950-80). First, pre-1980 only the 'first-tier' NICs (N-1) were doing better than LA in terms of GDP and employment. Second, LA's pre-1980 productivity growth was also relatively energetic (2.5%); i.e., productivity doubling every 28 years, with Brazil and Mexico needing less than 20. Third, pre-1980 there was nothing special about LA's employment elasticities. And fourth, there was diversity within LA.

However, post-1980 things changed sharply: while LA's GDP growth rate fell by half (becoming among the worst), its employment creation (by remaining stable) jumps to the top of the league. Consequently, its employment elasticity nearly doubles (from 0.49 to 0.92, a level about twice most other countries'), and its labour productivity sinks to the bottom.

A further comparison (Brazil vs. Korea), helps illustrate the above phenomenon. In terms of productivity, Brazil was just about keeping up with Korea between 1965 and 1980. In fact, by 1980 Brazil's overall productivity level was still slightly higher (US\$[1990]12,500 and 11,500, respectively). However, by 2008 Korea's productivity was over 3 times higher than Brazil's (US\$41,000 and 12,900). So, while Korea was closing the productivity gap with the US very rapidly—up from 28% (1980) to 63% (2008)—Brazil was falling behind equally fast, (down from 30% to 20% of US's productivity levels).

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

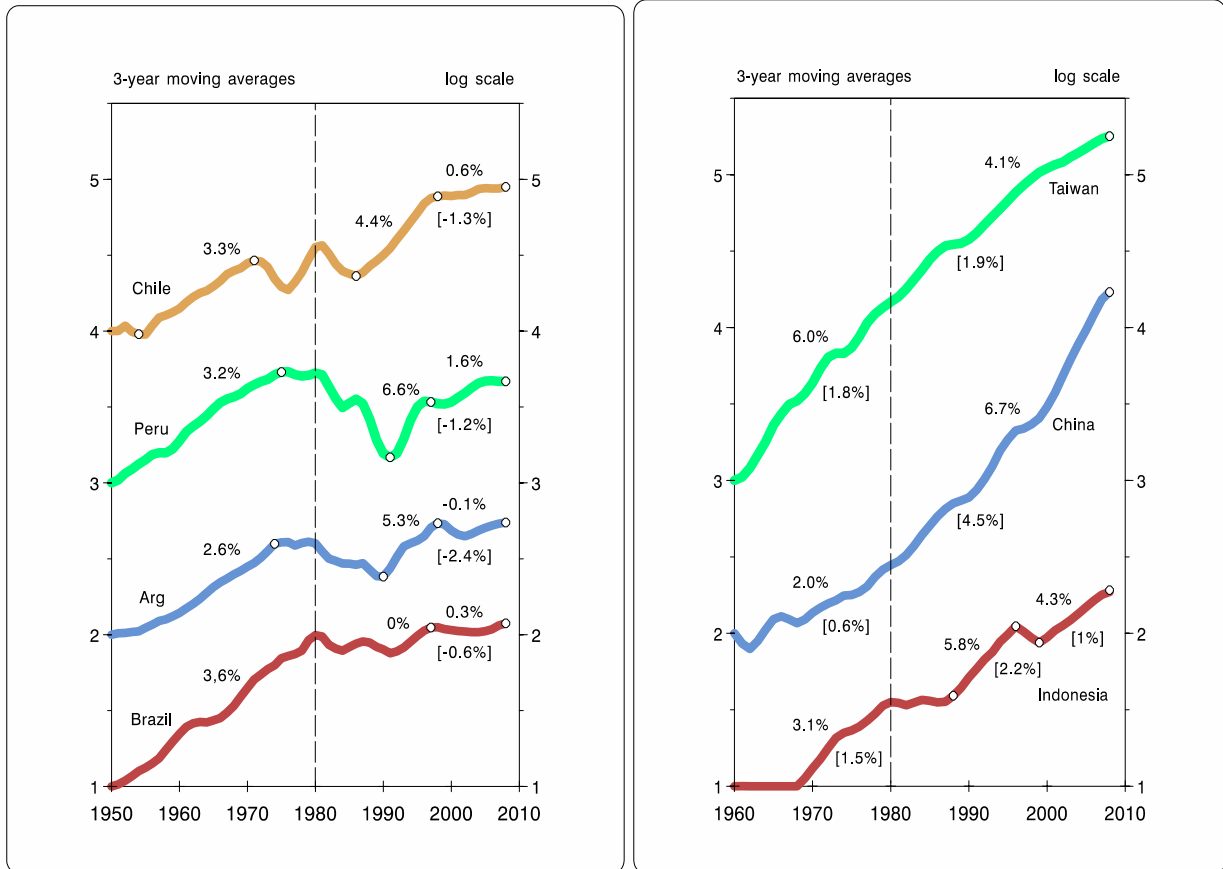
3.1.- Productivity growth in Latin American countries: an international perspective

Perhaps the most significant stylised fact emerging from the above is that while LA is perfectly capable of generating periods of dynamic productivity growth, it seems unable to *sustain* it long-term; meanwhile, many in Asia mastered this technique quite nicely (Figure 4).

FIGURE 4

Brazil, Arg, Peru & Chile: productivity growth, 1950-2008

Taiwan, China & Indonesia: productivity growth, 1960-2008



● Percentages above the lines are average annual real rates of growth during respective productivity cycles; those in brackets below the lines indicate TFP growth rates.

Brazil (like most of LA) followed the same contrasting productivity pattern as Mexico: a dynamic rate of productivity growth pre-1980, followed by productivity-stagnation. The other three countries of Figure 4 (with Uruguay) are the only ones that experienced at least some years of rapid productivity growth in post-1980 LA; however, productivity growth in them all stopped abruptly after a relatively short period—and TFP growth became negative (see Figure 5; the same happened to Uruguay). So, as far as productivity growth is concerned, if pre-1980 many LA countries were at least good middle-distance runners, post-1980 they were at best good sprinters... Meanwhile many Asian tigers became top marathon-runners (i.e., able to hold their nerves more effectively in cycles).

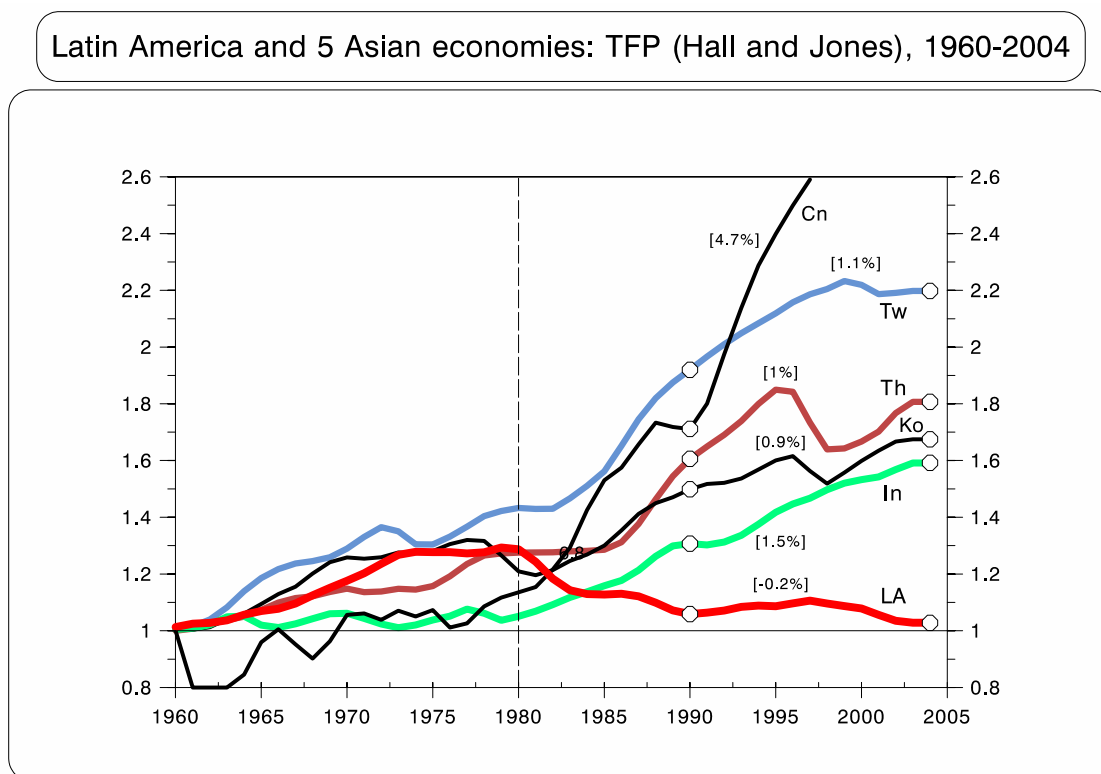
The Chilean case is probably the most notable, in that its high productivity-growth period stopped abruptly in 1998 without a mayor financial crisis (as in Argentina) or political crisis (Peru). Chile needed only a relatively minor aftershock (or contagion) from Asia and Russia, and (this being 'macho-monetarist' LA) an over-reaction by its Central Bank. Subsequently productivity

growth practically vanished (0.6% between then and 2008), becoming actually negative in 'per-hour-worked' terms (-0.4%)—and even more so in TFP terms (-1.3%).⁶ How different from the Asian countries of Figure 4 (representing each of the three NIC groups).

The Indonesian experience is particularly relevant; not only was the hardest hit in 1997, but its whole post-independence history has been turbulent, plagued by natural disasters, separatism, poverty, genocide and corruption (the latter two especially during Suharto's three-decade-long presidency). Also, since the end of its oil-boom, Indonesia largely abandoned its (somewhat megalomaniac) industrial policy, and soon acquired a Latin-American-style proclivity for premature financialisation and monetarist-macro. Yet, no Latin American country has managed Indonesia's productivity-rate since 1990.

For those who consider TFP growth a more telling indicator of economic success, Figure 5 shows that the contrasting picture between the two periods is even more striking.

FIGURE 5



⁶ Referring to these two contrasting periods, Michael Porter once said that Chile was like a two-act play; by then Chile was well into the second act, but most Chileans were still giving the first a standing ovation... Perhaps Ortega y Gasset would not have been surprised...

●**Cn**=China; **In**=India; **Ko**=Korea; **Th**=Thailand; and **Tw**=Taiwan. Percentages shown in the graph are TFP growth rates between 1990 and 2004 (the period of full-blown neo-liberal economic reform throughout Latin America). 3-year moving averages.

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

Much has been said regarding the 'Krugman-TFP-critique' of East Asia (EA), as if the capacity to learn how to achieve rapid rates of factor accumulation (especially physical and human capital) could be dismissed as 'not the real thing'. However, Figure 5 and Table 2 show that even these more moderate Asian rates are well above LA's average post-1980 performance. That was not the case with LA's pre-1980 TFP-rates.

TABLE 2

TFP growth: Latin America, Asia, South Africa and OECD, 1960-2004

	1960-80	1980s	1990-2004		1960-80	1980s	1990-2004
China	0.6	4.2	4.7	Chile	0.5	0.7	1.4
Ireland	1.9	2.0	2.6	D Republic	1.0	-1.8	1.0
India	0.2	2.5	1.5	Costa Rica	0.4	-1.6	0.8
Nordic*	1.0	0.8	1.1	Argentina	0.1	-2.9	0.8
Taiwan	1.8	2.9	1.1	Peru	1.1	-3.7	0.3
Thailand	1.2	2.4	1.0	El Salvador	-0.7	-2.4	0.3
Australia	1.2	0.2	1.0	Brazil	2.2	-2.5	0.0
Korea	0.8	2.4	0.9	Guatemala	2.1	-1.6	0.0
Singapore	1.2	1.4	0.9	Uruguay	1.4	-1.5	-0.1
US	0.8	0.8	0.8	Nicaragua	-1.7	-4.6	-0.4
Malaysia	1.1	0.0	0.7	Ecuador	2.8	-1.3	-0.5
World (84)	1.2	0.7	0.7	Mexico	1.6	-2.4	-0.6
New Zealand	0.2	0.9	0.6	Colombia	1.9	-1.1	-0.6
EU*	2.0	0.9	0.3	Honduras	0.6	-1.2	-1.1
South Africa*	1.7	-2.1	0.1	Paraguay	1.9	-1.8	-1.3
Latin America	1.4	-2.3	-0.2	Venezuela	-0.5	-1.6	-2.4

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

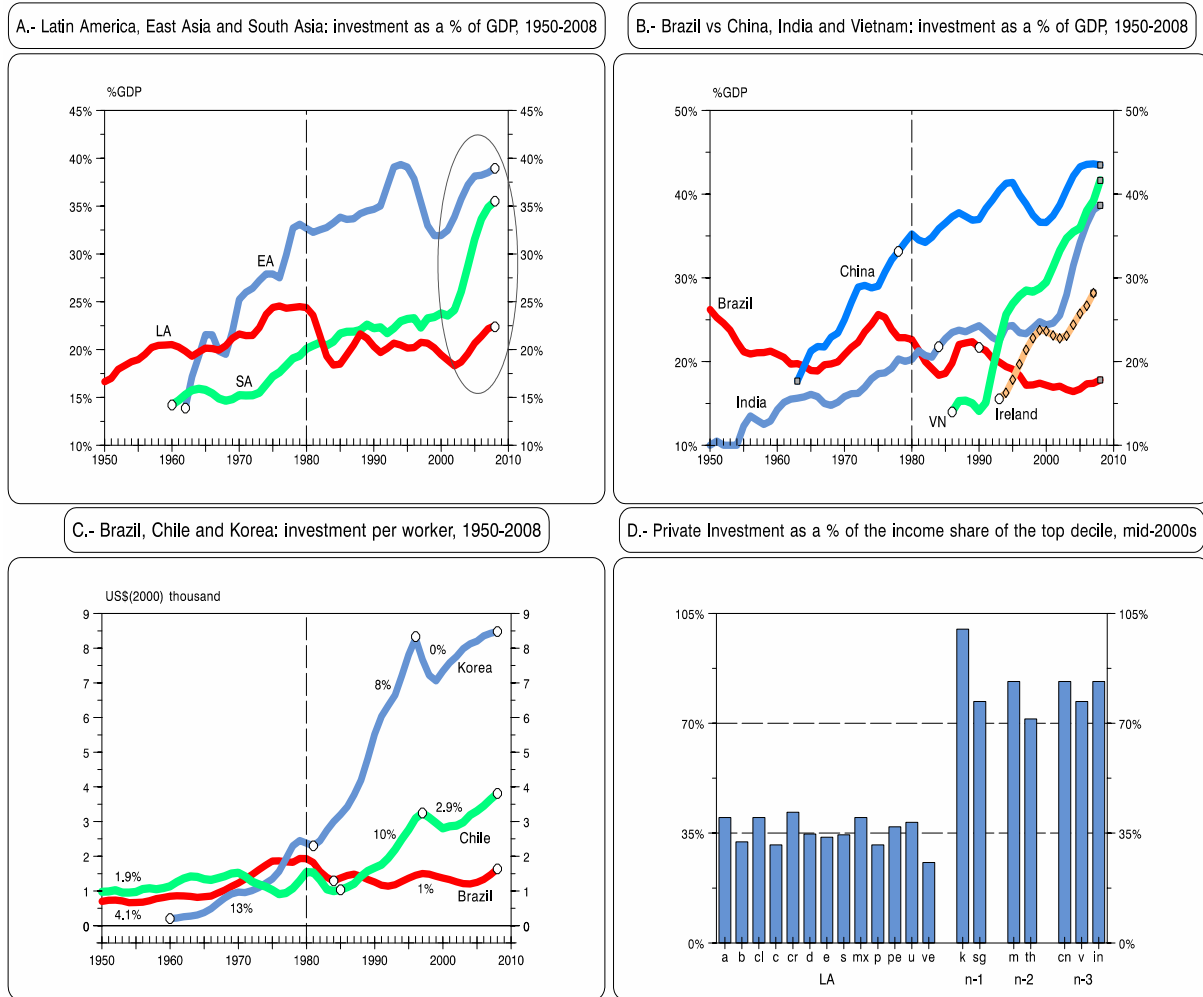
LA's pre-1980 TFP-performance was also among the fastest in the world.

However, with the exception of Chile, all LA posted a highly negative rate during the 1980s, and in half of them TFP growth remains negative after 1990 (and in two others is zero, and in another two practically stagnant). As a result, both during the 1980s and the post-1990 period LA's average is well below everybody else's. So, for those who follow the Washington Consensus, the most challenging question must be how was it that in most of LA TFP growth became negative (or at best stagnant) well *after* full-blown economic reform? And the well-rehearsed answer that what is needed is yet more of the same sounds increasingly hollow.

3.2.—Latin America’s remarkably poor investment effort and its political economy

There is little doubt that the core of LA’s inability to sustain productivity growth after 1980 is its low rate of accumulation—poor even from the perspective of its relatively inadequate historical record (Figure 6).

FIGURE 6
Investment patterns in Latin America and Asia, 1950-2008



●As Figure 2. In Panel **B**, **VN**=Vietnam; in Panel **D**, **n-3**=third-tier NICs (China, India and Vietnam), and **a**=Argentina; **b**=Brazil; **cl**=Chile; **c**=Colombia; **cr**=Costa Rica; **d**=Dominican Republic; **e**=Ecuador; **s**=El Salvador; **mx**=Mexico; **p**=Paraguay; **pe**=Peru; **u**=Uruguay; **ve**=Venezuela; **k**=Korea; **sg**=Singapore; **m**=Malaysia; **th**=Thailand; **cn**=China; **v**=Vietnam; **in**=India. In Panel **B**, white circles indicate the beginning of economic reform; for China, Deng Xiaoping’s 1978 speech to the Third Plenary Session of the Party’s Eleventh Central Committee; for India, 1980, for Vietnam, 1986 (Doi moi); for Brazil, 1990 (Collor’s ‘New Brazil’ Plan); and for Ireland, 1993. For presentational purposes, Ireland is shown also only from the beginning of economic reform. In Panel **C**, percentages shown in the graph are growth rates in the respective periods (for Brazil, 1950-1980 and 1984-2008; for Chile, 1950-80, 1985-98 and 1998-2008; and for Korea, 1960-80, 1981-97 and 1997-2008. 3-year moving averages.

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

In Panel A, while investment-rates in EA and South Asia (SA) are stationary around a positive trend, LA's rate is stationary around a (low) intercept.⁷ It is fairly obvious that the region's capitalist élite has a preference for mobile assets (financial ones and capital flight).⁸ And neo-liberal reforms—despite all their efforts towards defining and enforcing property rights, and other 'market-friendly' policies—have had little impact on that. Even the small increase in investment during the surprisingly positive environment after 9/11 (particularly in terms of trade and access to finance) is unremarkable vis-à-vis those of Asia. That is, while in LA (2002-2007) despite massive 'financial-deepening'—with the ratio of the stock of financial assets to GDP increasing from 106% to 182%—the investment rate only improved from 19% to 22% (IMF, 2009).

Basically, no theory of investment seems to be able to explain LA's stationarity-around-a-low-intercept behaviour, especially taking place during such a *long* period, such *diverse* domestic and international scenarios, and through such *divergent* development strategies. In turn, Panel B shows that in Brazil (like the rest of LA) economic reform seems to have unleashed more powerfully the predatory and rentier instincts of the region's capitalist élites (the former especially during the privatisation period) rather than their Schumpeterian ones. Many Asian countries, meanwhile, saw reforms as mechanisms to help lift increasingly binding economic and financial constraints in order to continue and *strengthen* their existing ambitious industrialisation strategies. Thus, in these Asian countries the rate of accumulation increased significantly *after* economic reform;⁹ in LA, meanwhile, the opposite was true. The contrast between Brazil and India in panel B is particularly telling.

Furthermore, in the very few cases in LA where investment actually increased after reforms (eg. Chile), it is not obvious why it took so long for it to happen (over ten years), let alone why it ran out of steam so easily after a while. Panel C indicates a similar difference in terms of investment per worker. While in Chile, at least for a time, this statistic show dynamic growth, in Brazil by 2008 investment per worker was still more than 20% *below* that of 1980

⁷ Due to space constraints, these and some other statistics below are not reported here; see Palma (2010a).

⁸ At least access to mobile assets help oligarchies become more democratic... (Boix, 2003).

⁹ The same is true, among others, for Korea, Malaysia and Thailand.

(US\$[2000]1,634 and 2,106, respectively). On average, LA as a whole follows a pattern similar to Brazil's, with its 2008 level still below that of 1980. An extreme example is post-1980 Mexico (not in the graph): despite the highest level of FDI per worker in the world, by 2008 its investment per worker still hadn't recovered its 1980/1981 level. By then, and despite 1997, Korea had a level 3.6 times higher, and Malaysia and Thailand 2.2 times higher. In turn, China's 2008 level was 12 times higher, India's 4.5 times higher, and Vietnam had more than trebled this statistic.

Perhaps from this perspective the contrasting productivity growth performance of LA and many in Asia—and the inability of LA to sustain productivity growth—are not that difficult to explain after all... However, what is still unclear is why (despite the huge share of national income appropriated by the top earners, well-defined and enforced property-rights, and 'pro-market' reforms) every time private investment in LA manages to rise much above 15% of GDP its capitalist élite starts experiencing feelings of vertigo.

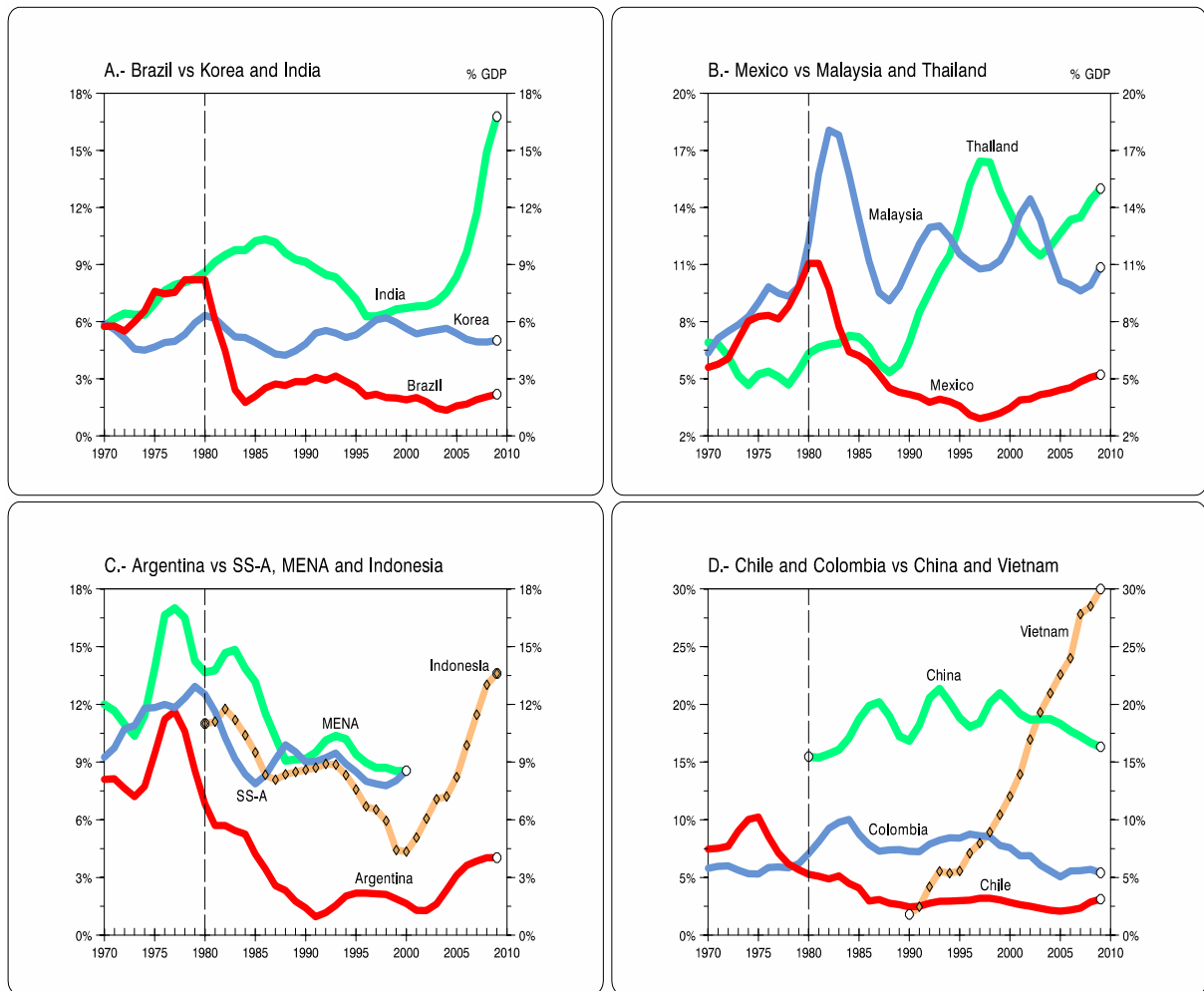
From this perspective, the most striking difference between LA and Asia is found in their contrasting relationships between investment and income distribution. It is often acknowledged that the historical legitimacy of capitalism—i.e., the legitimacy of a small élite to appropriate such a large proportion of the social product—rests on the capacity of its élite to develop society's productive forces. And they can do so mainly by reinvesting most of that huge share. So, no other statistic seems to reflect so neatly the difference in the nature of capitalism in LA and most of Asia than that of Panel D in Figure 6—as that of LA's 'high-appropriation-cum-little-accumulation' élites.¹⁰ In fact, as discussed in statistical detail elsewhere (Palma, 2010b), except for South Africa and 'diamond-rich' Southern Africa (Botswana and Namibia), LA's distributional world is so unique that one must conclude that in LA the rich are not just much (relatively) richer, but that there is a group of rich people in LA simply not found elsewhere!

Figure 7 shows another key component of the poor investment effort in LA after neo-liberal reforms—the collapse of public investment.

¹⁰ In South Africa (in this respect, LA's honorary middle-income country in Africa), and in The Philippines (the honorary one in Asia) similar low shares indicate that their capitalist élites have the same Latin preference for having their cake and eating it...

FIGURE 7

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



●Panel C, MENA=Middle East and North Africa. 3-year moving averages; current prices.

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

One of the stated aims of neo-liberal reform in LA (but not in Asia) is tying the hands of governments in terms of their capacity to create artificial rents. In LA, however, neo-liberal reforms only succeeded in tying government hands in terms of public investment—leaving its squeeze as the only mechanism to square public finances—while artificial rents and corruption continued unabated.

Unsurprisingly, crumbling infrastructure and shortages of complementary capital became one of the major constraints for growth. Figure 7 indicates that the collapse in public investment took place as much in economies with high tax intake (Brazil, 30% of GDP), as those with low ones (Mexico, 12% for non-oil taxes). In fact, Colombia, with the lowest tax collection among the major

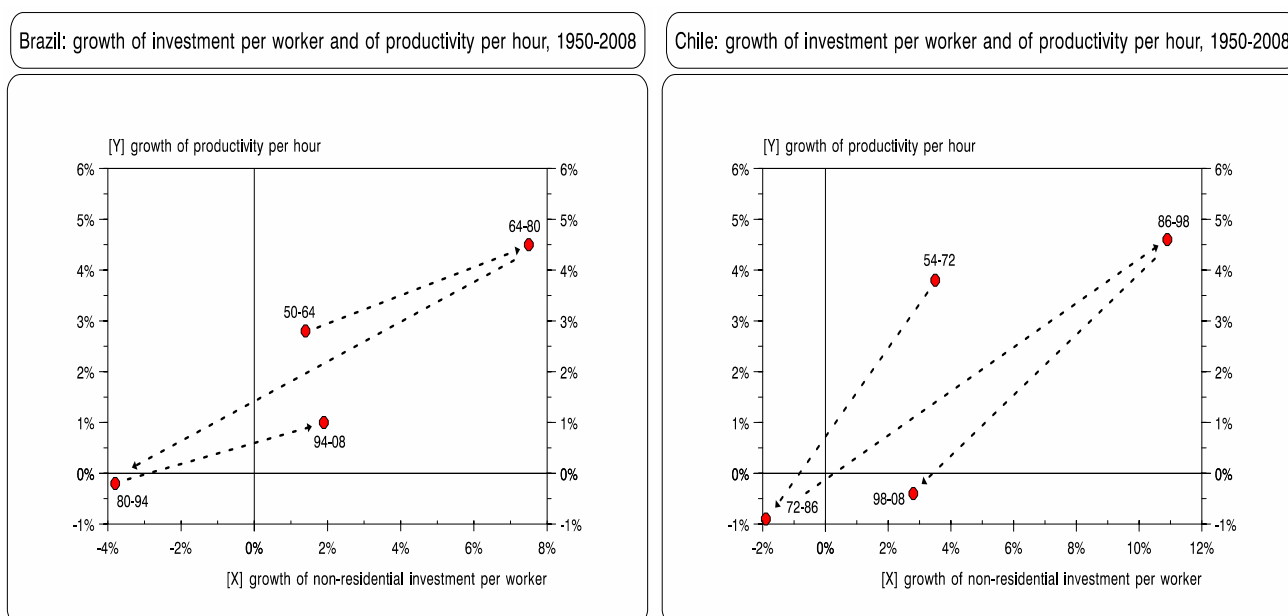
economies, had a slightly higher rate of public investment. Chile at least invested in infrastructure via private 'concessions'.¹¹

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

The most robust statistical relationship in this concern is found between the growth of *non-residential* investment per worker and that of productivity *per hour worked*. Not only is there a strong correlation between the two (stationary) series, but also (via an autoregressive distributed lag model that allows for more complex dynamics in the data) investment is found to have a large—and highly significant—impact multiplier (Palma, 2010a).¹²

Figure 8 summarises the related growth cycle in two economies with at least one period of (Asian-pace) dynamic growth: Brazil (1964-1980), and Chile (1986-1998).¹³

FIGURE 8
Investment and productivity paths in Brazil and Chile, 1950-2008



•[Y]=vertical axis; and [X]=horizontal axis. Each observation indicates the average rate of growth for both variables during the respective period.

¹¹ However, this experiment may well indicate that a negative externality of large *private* investment in infrastructure is the 'crowding-out' of other private investment.

¹² In Brazil (1960-2008), for example, the $R^2=68\%$, the impact multiplier 0.37, and its 't' statistics=9.

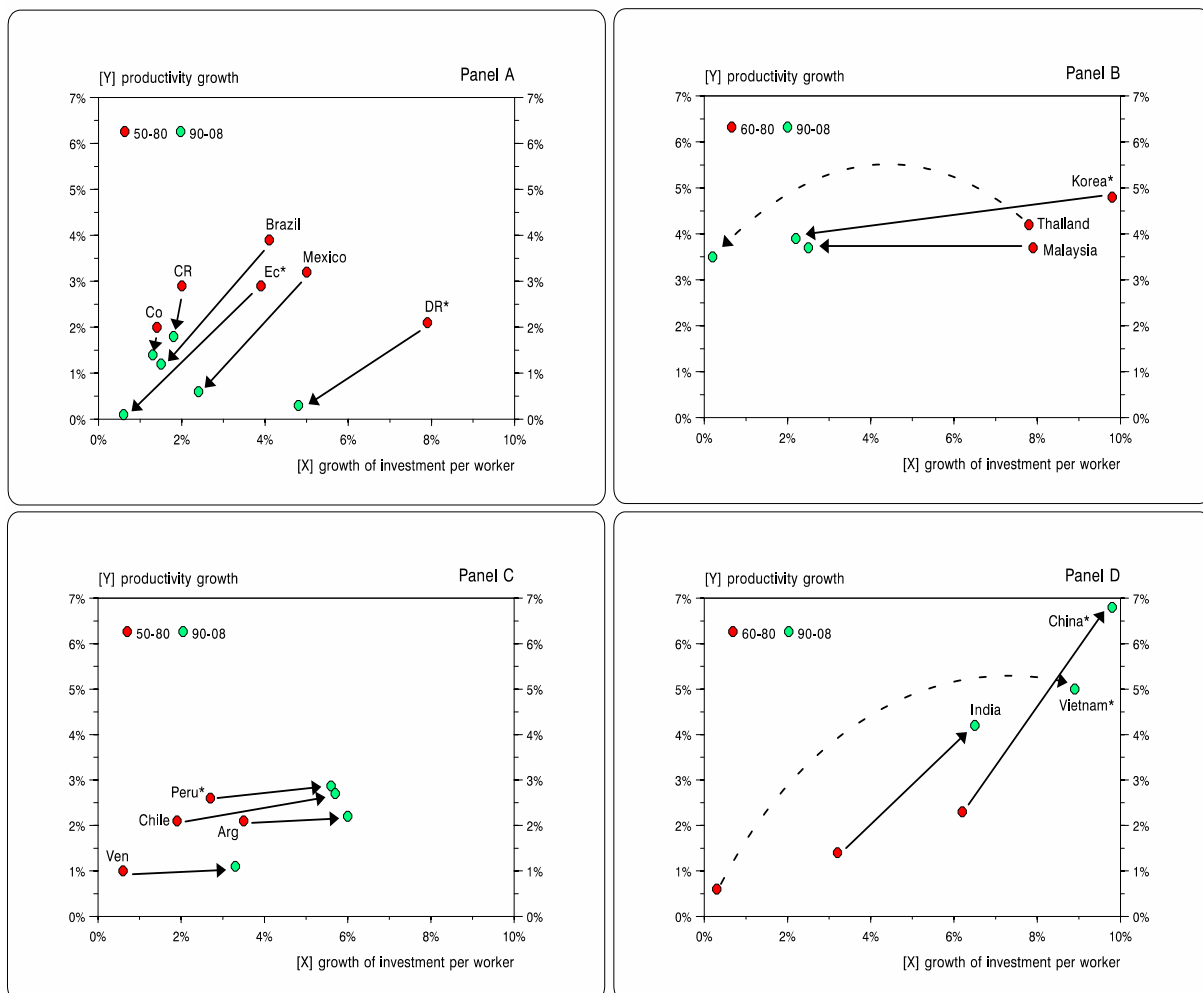
¹³ 1986 is the starting growth-date in Chile because its post-1982-crisis economy only recovered the pre-1982 GDP in 1987.

•**Sources:** for productivity and employment, GGDC (2009); for investment, WDI (2010). To obtain the non-residential component of investment, I have multiplied the WDI data by the share of non-residential investment (from Hofman, 2000, and updates by author).

Of the many intriguing issues arising from Figure 8, three are revealing: first, unsurprisingly, the periods of rapid productivity growth are associated with high investment growth.¹⁴ Second, when (for different reasons) investment declined subsequently productivity growth *collapsed*. Finally, although in both countries investment growth in the last period resembles that in the first, productivity growth is significantly lower. Figure 9 shows that in this respect the striking difference between LA and Asia is even more intriguing.

FIGURE 9

Latin America and Asia: growth rate of labour productivity and of investment per worker, 1950-80 and 1990-2008.



•[Y]=vertical axis; and [X]=horizontal axis. •Note that the second period is restricted to 1990-2008 in order to study the post-1990 economic reform period with the pre-1980 ISI

¹⁴ For Kaleckian growth-dynamics, see Taylor (2010); and Ocampo, Rada and Taylor (2009).

one. ●**Ec***, **DR*** and **Peru***=first observation 1960-80; **Korea***=investment growth rate 1960-80, 13%). **China***= investment growth rate 1990-2008, 12.2%; **Vietnam***=due to lack of data, first observation is a rough estimate using Trần Văn Thọ, et al. (2000).

●**Sources**: as Figure 8 (although, due to lack of data for the residential component of Asia' investment, the horizontal axes represent the growth of overall investment per worker). Investment for Colombia, CEPAL (2010).

In Figure 9, LA is divided between those countries in which the investment per worker growth-rate was lower in 1990-2008 than in 1950-1980 (six countries, Panel A), and those where it was higher (four, Panel C). Starting with Panel A, the contrast between LA and three of the Asian countries affected by the 1997 crisis (Panel B) cannot be starker: while in LA a declining investment rate is associated with a collapse of productivity growth, in Asia an extraordinary post-1997 fall in the investment rate leaves productivity growth practically unaffected. Aside from Asia's preference for absorbing shocks via employment rather than productivity, this comparison suggests a more solid productivity growth foundation in Asia (due to higher levels *and* different sectoral distribution of investment), helping to keep generating productivity growth when investment per worker stagnates.

The contrast between the countries shown in Panels C and D is even more remarkable, indicating the alternate vertical and horizontal trajectories; while in the four Latin countries of Panel C an increased investment rate (though, in some cases, from a low starting point in 1990) is associated with *similar* productivity growth rates, in Panel D these are associated in Asia with hugely improved productivity growth.¹⁵

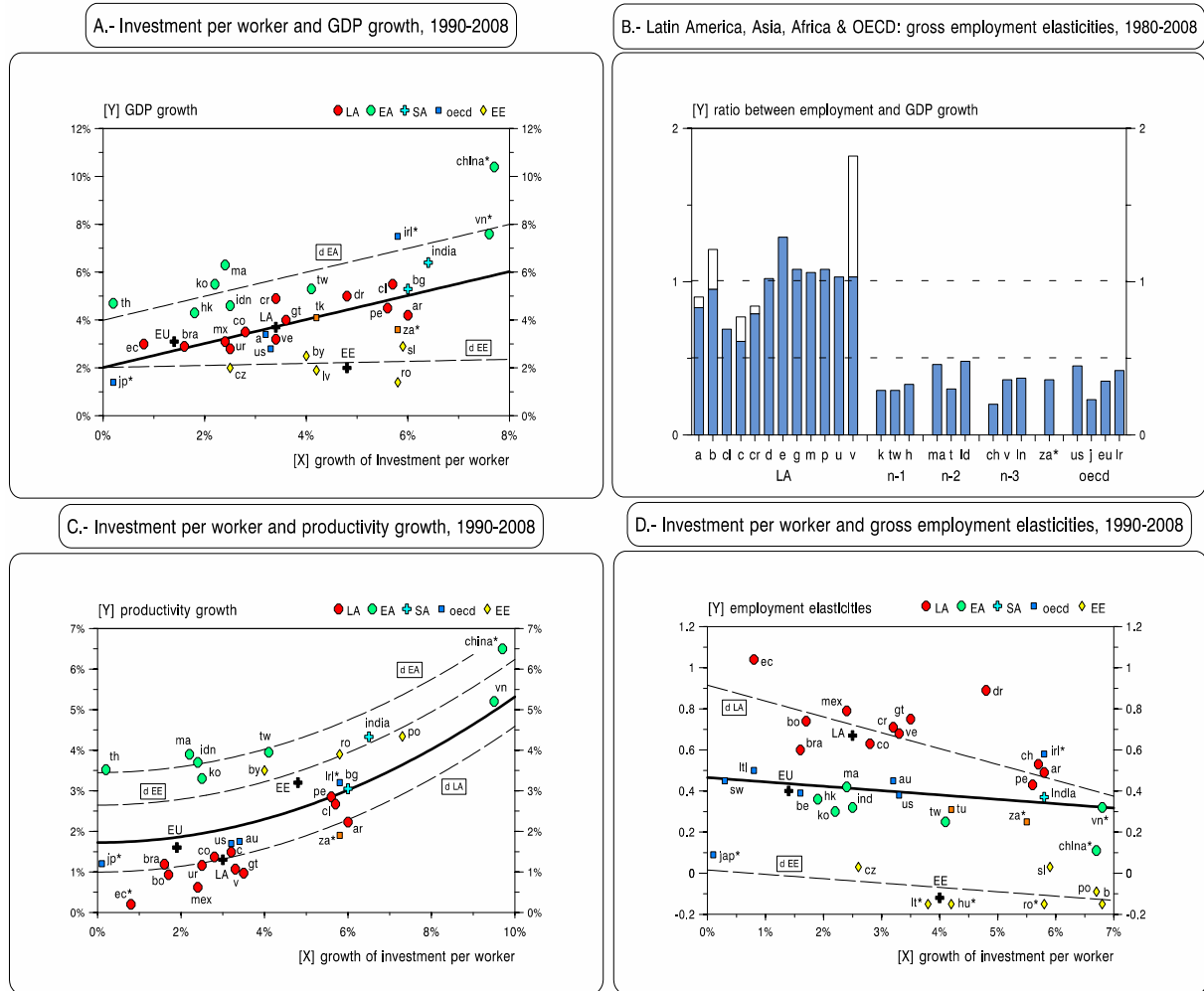
4.- Latin America's uniquely high post-1980 employment elasticities and productivity growth

As far as employment elasticities are concerned, post-1980 LA seems to live in a world of its own—see Figure 10, Panel B.

¹⁵ In LA, Bolivia and Guatemala don't even travel horizontally: an increased investment rate was associated with *lower* productivity growth.

FIGURE 10

Latin America: the contrasting fortunes of employment and labour productivity in the post-reform period



●[Y]=vertical axis; and [X]=horizontal axis. ●In Panels **A**, **C** and **D**, acronyms as in Figure 2, and **au**=Australia; **bg**=Bangladesh; **by**=Belarus; **cz**=Czech Republic; **EE**=Eastern Europe; **hk**=Hong Kong; **idn**=Indonesia; **irl***=Ireland (1993-2007, to reflect the high growth, post-economic reform period); **lv**=Latvia; **ro**=Romania; **si**=Slovenia; **tk**=Turkey; **tw**=Taiwan; **v**=Venezuela; and **za***=South Africa (1994-2008). **china***=investment growth, 12.2%; **ec***=productivity growth, -0.1; for **jp***=-0.6%. **'d LA'**=dummies for LA (intercept in Panel C, and intercept and slop in Panel D); **'d EA'**=dummy intercept for EA (Panels A and C); **'d EE'**=dummy slop for EE (Panel A), and intercepts for Panels C and D). ●In Panel **B**, employment elasticities as in Table 1 (African countries are excluded because the GGDC, 2009 dataset does not provide data on employment, and the ILO database only provides econometric estimate; for South Africa, Quantec, 2009). White bars on top of blue ones are additional elasticity when ratio is calculated using GDP in domestic currencies. The employment elasticities for most EE are actually negative (see Figure 11). Acronyms as in Figure 6, and **eu**=European Union; **ir**=Ireland; **h**=Hong Kong; **j**=Japan; and **t**=Thailand. ●For regression statistics, Palma (2010a); R^2 in Panel A=77%; in Panel B=86%; and in Panel D=82%; all variables are significant at the 1% level. In these and following regressions, 't' statistics are calculated using White's heteroscedasticity adjusted standard errors.

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

A sectoral analysis of LA's high employment elasticities indicates that this is entirely due to services; for example, in Brazil between 1980 and 2008 net-job creation reached 32 million, of which 30 were in services—11 in trade/hotels/restaurants; 2 in transport/storage/communication; 2.5 in finance/insurance/real estate; and 14 in community/social/personal/government services. Furthermore, whatever the 'populist' literature may suggest, there is no evidence that in the latter category these are mainly government jobs—in Brazil, for example, the employment elasticities of services reached 2.2, while excluding the latter sub-sector this increases to 3.5.

At the same time, and going against the expectations of those in the Washington Consensus, other than in the 'maquila' industry there is little evidence that increased employment creation relates (in a Heckscher–Ohlin–Samuelson fashion) to trade liberalisation, especially commodities. Not only did employment in the primary sector decline in most countries (Brazil lost 2 million jobs), but those jobs created in services are only very partially associated with the commodity boom.

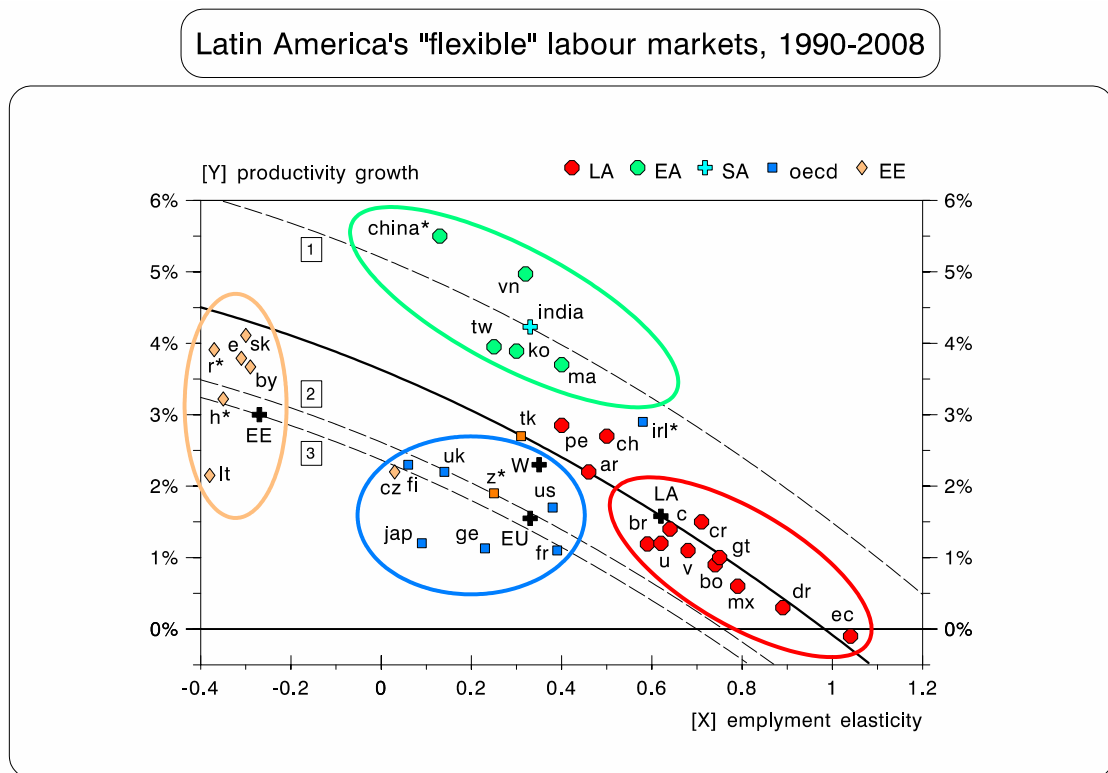
There are, of course, many political economy issues that emerge from LA's high employment elasticities that cannot be analysed here. However, I would like to mention at least one: the historical legacy of the 'new left'. Whatever one's views on the 'new left', it certainly helped reduce the capitalist élites' 'workers-paranoia' (Palma, 2009a). Here a comparison between Brazil and South Africa is telling. Both countries started reforms simultaneously, and had similar growth rates post-1994 (i.e., the beginning of the ANC period, and the first election of Cardoso and the 'Real Plan'). However, in the following decade South Africa's GDP growth is almost entirely explained by productivity growth, Brazil's by employment. There are, of course, many differences between the two countries, but the fact that in Brazil the PT became the capitalist élite's best friend while in South Africa COSATU (one of the ANC dominant forces) remained a militant organisation had a lot to do with this. From this perspective, South Africa's main problem is that it has East Asian levels of employment elasticities, but Latin American levels of GDP growth, resulting in a quarter of its labour force unemployed.

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

Panels C and D of Figure 10 indicate that during the post-1990 reform period in LA, there is a contrasting geometry between investment and productivity growth, on the one hand, and between investment and employment growth, on the other. While in panel C, LA is best represented by a highly significant negative (productivity) dummy, in Panel D it generates a highly significant positive (employment) one. However, both dummies cancel each other out, and LA's relationship between investment and GDP growth (Panel A) ends up best represented by the base regression.¹⁶

The fundamental point here is whether LA's ability to generate high employment elasticities affects investment and GDP growth negatively. More specifically, from the perspective of LA's high employment elasticities and low productivity growth, the two crucial questions are: what is the nature of the relationship? And (crucially), if there is a fundamental relationship between the two, which is the direction of causality? See Figure 11.

FIGURE 11



¹⁶ For a discussion of the important econometric issues raised by cross-section regressions like these, see Pesaran, et. al. (2000). In particular, one has to understand that these regressions are simply a cross-sectional **description** of cross-country differences, categorised by the explanatory variable. That is, they should *not* be interpreted in a 'predicting' way, because there are a number of difficulties with a curve estimated from a single cross-section—especially regarding the homogeneity restrictions that are required to hold.

•[Y]=vertical axis; and [X]=horizontal axis. •Countries and regions as Figure 2 and 10, and **c**=Colombia; **fi**=Finland; **sk**=Slovak Republic; **uk**=United Kingdom; **u**=Uruguay; and **v**=Venezuela. Employment elasticity for **h***=Hungary, -1.2; and for **r***=Romania, -2. **china***=productivity growth, 8%. **[1]**=dummy intercept for EA; **[2]**=dummy intercept for OECD countries; and **[3]**=dummy intercept for EE. • $R^2=85\%$; all variables are significant at the 1% level (Palma (2010a)).

As expected, most Latin American countries are uniquely positioned within the geography of this relationship; this is due to their remarkable labour market 'flexibility'—flexibility in the sense that they are able to generate single-digit unemployment rates despite such poor GDP growth. Figure 11 also indicates that in the rest of the world there are also specific regional patterns.

As far as LA is concerned, there are at least two ways of understanding this intriguing relationship between employment, productivity, investment and growth. One is the structuralist view, emphasizing low GDP growth as the starting point, leading to modest labour absorption in the (slow-growing) 'modern' sector, and (the necessity of) high labour absorption in (low-productivity) services—mostly via the informal sector. The inevitable end result is low *overall* productivity growth (see Ocampo, 2004; and Ocampo, Rada and Taylor, 2009). So, slow aggregate productivity growth is understood as low-GDP-growth leading to increased (low-productivity) informality rather than as a Kaleckian-low-investment phenomenon. The other (suggested here) is that even though this mechanism is also at play, my view of the causality question emphasises a converse logic: there are analytical and statistical reasons for arguing that the starting-point is not low GDP growth (somehow determined somewhere else in the economy), but the political economy of the labour market (reinforced by that of public finance). Here the dynamics run mostly from high employment elasticities to low productivity growth via the 'Cambridge-connection'—especially Kalecki and Joan Robinson. In essence, I shall argue that what could be called 'excessive-labour-market-flexibility' is a key foundation for LA's poor productivity *and* GDP growth performances—mostly via its negative impact on investment. The (non-linear) relationship of Figure 11 is also more significant when employment elasticity is the explanatory variable.

Two different dynamics (leading to structural heterogeneity) are at work. On the one hand, in many commodities and in a few industrial and services activities openness and international competition have launched more interesting investment-productivity growth dynamics. However, in the (more protected) bulk of the economy there is a very different reality. In LA, unemployment rates may be relatively low, but this does not mean that labour markets are tight; the labour force still grows fast by new entrants, in most countries the primary sector and

often also manufacturing keep shedding labour, and there is a large 'reserve army' in the informal sector. Consequently, some tradable and most non-tradable activities (i.e., more than two-thirds of the economy) can operate with a remarkably elastic supply of labour and no pressures on wages (or income distribution). That is, can operate with few *compulsions* thanks to 'flexible' labour markets and high degree of oligopolistic concentration. Why would there be much incentive to invest, particularly in terms of investment *per worker*? As Joan Robinson analysed long ago in her criticism of the supposed 'exogeneity' of the variables making up the Harrod–Domar model, the incentives for investment and productivity growth would only really kick in when the labour market gets tight.

Furthermore, as labour-intensive techniques in manufacturing have been mastered in low-income Asia—where wages are even lower and labour is in abundance—LA cannot compete in low-wage labour-intensive manufacturing anymore (except when its geographical location and trade treaties favour 'maquila' activities). So in LA services are the employment-answer; at the same time (and very importantly) in relatively high middle-income countries there is also an insatiable (and often highly income-elastic) demand for low-cost-low-productivity services—both formal *and* informal.¹⁷ In low-income Asia, meanwhile, more growth-enhancing labour-intensive manufacturing provides the higher employment-GDP-growth-outlet; Bangladesh is a good example of this, with its labour market more flexible than India's. So, Bangladesh follows a typical Lewis-model, but LA (in the bulk of the economy) an atypical one: there is high labour-absorption with little pressure on wages *and* on investment per worker, but labour is being transferred to little or no productivity-growth-potential services (and often informality)—sometimes even from manufacturing.

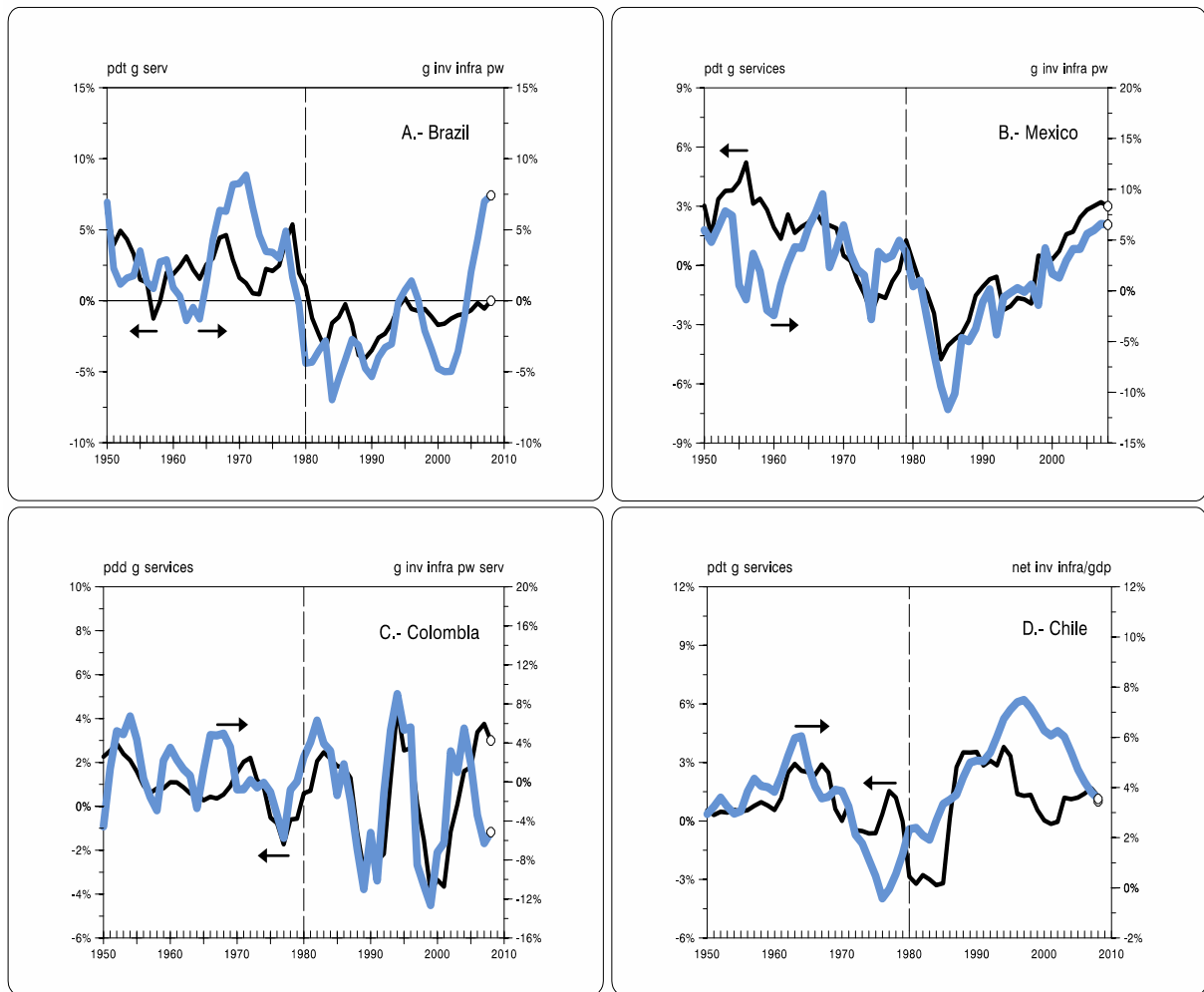
LA's abysmal rates of productivity growth in services between 1980 and 2008—either zero (Chile and Colombia) or negative (rest of the region)—are clearly not shared by the Asian countries discussed so far, where (among other factors) manufacturing helps by pulling services à-la-Hirschman (India 4%, Taiwan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

¹⁷ Although sometimes 'low-productivity' is due only to the peculiar way in which output in services is measured in national accounts.

From this perspective, one piece of the puzzle that the structuralist analysis underestimates is that LA's low-productivity-growth in services is not just informality-related, but also low-investment-related; see Figure 12.

FIGURE 12

Latin America: investment in infrastructure and business construction per worker and productivity growth in services, 1950-2008



• **pdt g serv**=productivity growth in services; **g inv infra pw**= growth of investment in infrastructure and business construction per worker employed in services; **net inv infra**=net investment in infrastructure and business construction as a share of GDP. Note that Chile's investment data are shown differently to indicate an alternative way of looking at the relationship between investment and productivity in services. Moving averages.

• **Sources:** investment, Hofman (2000); productivity, GGDC (2009).

We know (via an autoregressive distributed lag model) that in LA there is a relatively strong correlation between the growth of investment and of productivity *in services*—the former in terms of investment in infrastructure and business construction per worker employed in services (both series are stationary). There is also a large and highly significant investment impact-multiplier. For example, in Brazil (1960-2008), the R^2 of the regression is 50%, the impact multiplier is

0.33, and its 't' statistics 6; and in Mexico the respective statistics are 52%, 0.15 and 6.5.¹⁸

From this perspective the squeeze of public investment is, of course, a crucial component of LA's post-1980 abysmal rates of productivity growth in services. The investment boom in infrastructure and business construction in Chile between 1986 and 1998 confirms that in LA, too, services can not only absorb labour (3.8% per annum), but also generate a high rate of productivity growth (3.3%; see also Figure 13).

In sum, low productivity growth in services—and, given the size of this sector, in the overall economy—is not just a low-GDP-growth phenomenon limiting the capacity of the 'modern' sector to absorb additional labour (with 'high-employment-absorption-informality' coming to the rescue—the structuralist model). It is also the result of both (a mostly public-investment-squeeze-related) low investment in infrastructure and business construction, and the political economy of LA's labour markets (in part) endogenising sluggish output growth.¹⁹ The resulting GDP and (particularly) productivity growth rates may be poor, but there is a relatively stable low-intensity dynamic that the 'invisible hand' finds it difficult to break.²⁰ This, together with peculiar politics (particularly when the 'new left' is involved), has led to political settlements characterised by 'low-intensity' Nash equilibria (Palma, 2009c). And where something different has been attempted, as in Venezuela, the results have been rather disastrous.²¹

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

¹⁸ For the statistics of the regressions for other countries, see Palma (2010a).

¹⁹ In net-terms, in most of LA investment in infrastructure and business construction was remarkably poor not just during the 1980s, but also after reforms; see Hofman (2000).

²⁰ Nelson was already trying to address this issue of 'low level equilibrium traps' in the 1950s (Nelson, 1956).

²¹ As discussed elsewhere (Palma, 2009c), with globalisation it is LA who is now exporting the political economy of its labour markets to the US (rather than the other way round). In other words, and as opposed to Marx's prediction, now it is the less developed countries who are showing the industrialised ones the 'image of their own future'... For example, in the US private investment as a percentage of the income share of the top decile fell from about half (before 1980s' Reagan) to a more relaxed 'Latin' level of about a third.

countries to break with this dynamic, but perhaps it is unsurprising that after a relatively short period they have returned to the fold; and the burst of productivity growth has fizzled out.

Within the context of the above-mentioned structural heterogeneity, LA has developed two types of successful 'modern-sector' regional oligopolies: those involved in large-scale capital-intensive commodity production for exports, and those that have mastered the technique of organising low-value-added labour-intensive production chains—sometimes for exports (mostly agricultural products), and sometimes in services (eg. retail).²² Ultimately, in LA commodities have provided the foreign exchange, services (both informal *and* formal) the highly-precarious, low-productivity and low-wage employment creation, and financial markets the fun.²³

So, what is really wrong in post-reform LA is that neither the really 'modern' sector (usually associated with large-scale commodity production), nor the formal economy (mostly oriented towards the domestic market, although lately more regionally oriented), or (unsurprisingly) the informal sector are able to generate much of what really matters for the complexities of economic growth—i.e., dynamic economies of scale, increasing returns, externalities and spill-over effects, processes of cumulative causation, etc.²⁴ That is, those issues which are central to the 'how-one-thing-leads-to-another' Hirschmanian growth-philosophy when dealing with such intricate market structure as those that characterise developing countries (often with the added problem of size)—complexities that often get even more intricate as developing countries move to middle income levels.

Although neo-liberals were just about the only political group who really understood Kalecki's idea that capitalism cannot endure the political consequences of sustained periods of full employment, Latin American neo-

²² Their success has made the entry by foreign firms into the latter markets difficult; it is only when these regional oligopolies need new technologies that they get a foreign partner (rather than making the creative effort themselves)—see Robinson (2008).

²³ Between 2002 and 2007, the capitalisation of LA's stock exchanges increased *annually* by 45% in real terms, its bank assets by 21%, and its private and public bonds by 22% and 25%; IMF (2009).

²⁴ These are the kind of (difficult-to-model) issues that were usually ignored by traditional (constant-returns-cum-perfect-competition) mainstream economics, and are now tackled (but so far not very successfully) by the 'new' traditions in mainstream thought. In the latter, growth is modelled as a function of market imperfections that somehow create increasing returns in the process of technical change—but this process is still *explicitly* modelled as not-sector-specific (see Palma, 2005b).

liberals have overshot in the opposite direction: capitalism with clearly insufficient labour market compulsions seems not to work very effectively either. That is, as capitalists practically need not compete with each other in the labour market, there are few market pressures coming from this direction either forcing productivity growth, or the investment levels necessary to back this up.

To perpetuate this, in most countries there is no collective bargaining, strike-breakers are legal, sub-contracting labour (as a mechanism to bypass even timid labour legislation) is widespread, minimum wages are ignored, etc. And at the first sign of labour markets getting tight, governments are quick to react—e.g., in Chile, when the (income elastic) market for domestic servants became slightly tight, and meagre wages threatened to increase, the socialist government immediately opened up immigration from Peru.

What the new paradigm seems not to grasp is that it's one thing to implement reforms to create market *opportunities*, quite another to ensure that there are sufficient market *compulsions* to ensure that not only workers but also capitalists continuously have to struggle to improve their performance just to survive.²⁵ What LA urgently needs today are new institutions (especially those capable of 'disciplining' the capitalist elite à-la-EA), and a new structure of property rights (including well-defined and enforced rights *on skills* à-la-Japan or Germany) that would introduce radically new compulsions for productivity growth.²⁶ And, of course, the ideology to back this up would help—as Gramsci said, more often than not battles are won or lost on the terrain of ideology.

5.- Sectoral diversities and the "one-thing-at-a-time" processes of catching-up

Figure 13 measures the relative productivity gaps of four Latin American countries vis-à-vis the US. In Panel A, Brazil's productivity gaps throughout the 1950-2007 period show LA's 'one-thing-at-a-time' style of catching-up. While ISI succeeded in significantly closing the manufacturing productivity gap, this happened at the expense of commodities; the opposite was the case afterwards. One big difference, however, is that (as in EA) the pre-1980 manufacturing catching-up managed to pull services à-la-Hirschman. This goes a long way to explain the differences in the aggregate productivity growth rates between the periods. Another one, of course, is the superior growth-enhancing characteristic

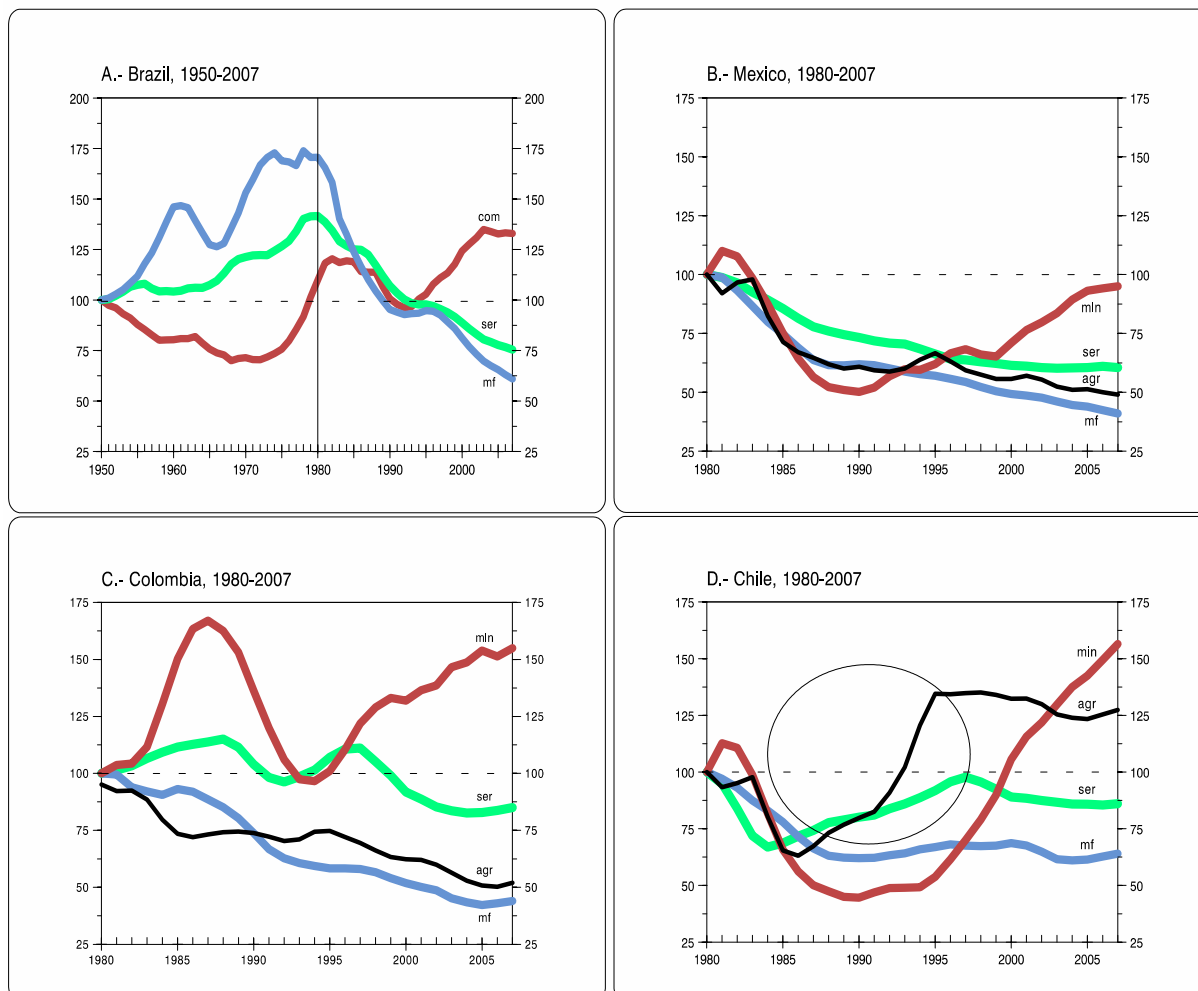
²⁵ Wood (2002) and Khan (2005).

²⁶ On the latter issue, see especially Pagano (1991).

of manufacturing due to its dynamic economies of scale. And yet another is the fact that the post-1980 commodities' catching-up (except in Chile) was really only a narrow mining phenomenon.²⁷

FIGURE 13

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



•**com**=commodities (primary sector); **agr**=agriculture, forestry and fishing; **min**=mining and quarrying; **mf**=manufacturing; and **serv**=services. •Each line is an index number (1950=100 for Brazil, 1980=100 for the rest) of the ratio of labour productivities between the respective country and the US (each in real terms and domestic currencies). An increase implies 'catching up' with the respective labour productivity in the US, and a decline a falling behind. 3-year moving averages; due to sharp fluctuations, in mining Colombia's is a 5-year one.

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

Panel D synthesises Chile's better 1986-1998 GDP performance. What took place was mostly an investment-led burst of productivity growth in agriculture, forestry and fishing (10% p.a.), and increased productivity in services (3.3%), backed up

²⁷ Even in Argentina, the overall agriculture productivity gap with the US widened vis-à-vis 1980.

by infrastructural investment and business construction.²⁸ The growth of productivity in mining only started in the mid-1990s (when other sectors began to falter), reaching 11% p.a. in 1994-2003. Also, after falling behind in the 1980s, the productivity gap in manufacturing stabilised.

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

Regarding the remarkable neglect of manufacturing, as argued elsewhere (Palma, 2005b, and 2008), the closer one gets to the productivity frontier, the need for industrial policy increases exponentially.²⁹ From this perspective, the sad irony is that LA abandoned industrial policy at the very moment it needed it most! So, for example, Brazil's 1980-2007 manufacturing productivity has fallen behind the US's by more than a factor of three (Panel A). As all three groups of NICs were instead catching up with the US in manufacturing, LA fell behind them by an even larger *relative* margin.

6.- Exports as a faltering engine of growth

As far as exports are concerned, LA moved from a situation in which pre-1980 exports and GDP were growing at roughly the same pace, to one where (on average) they grew 2.5 times faster—3.5 times faster in Mexico. As in the ISI period income elasticities for imports were certainly higher than one, there was an inevitable accumulation of foreign debt. Therefore, a pro-exports policy re-engineering was surely inevitable; however, the one chosen has not been the most effective: while the rate of growth of exports has increased by about half, that of GDP *fell* by half.³⁰ So, unsurprisingly, when comparing LA with the rest of the world the region generates a significant negative export-GDP-dummy (Figure 14).

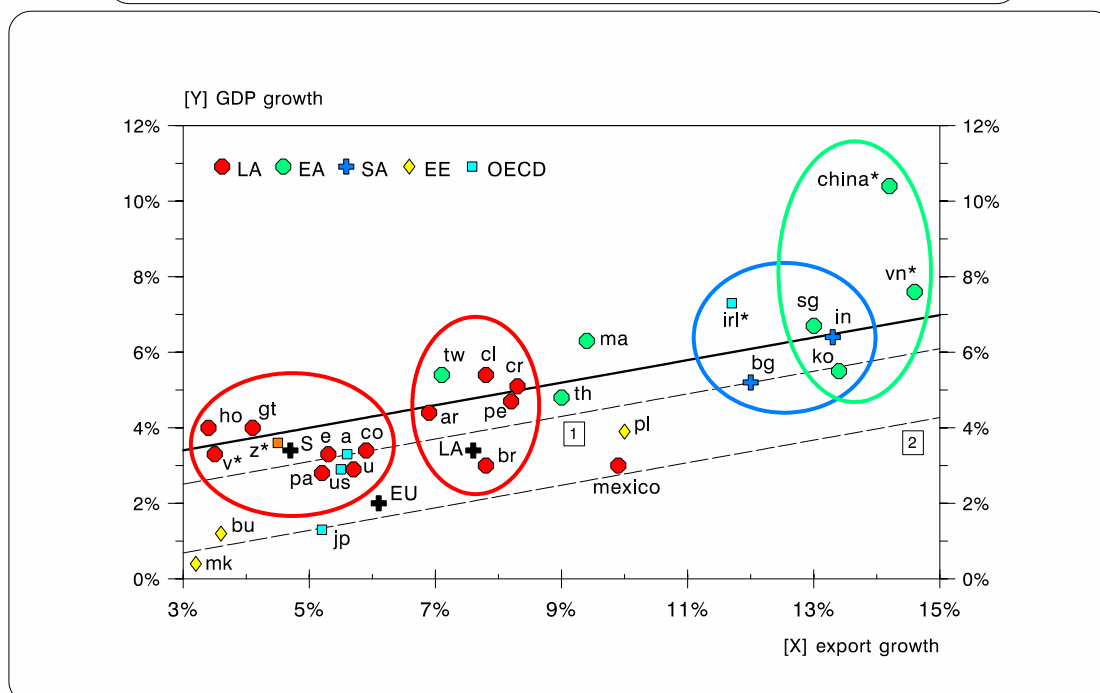
²⁸ On average, post-1973-Chile has seen no productivity growth in services either before or after the 1986-1998 period.

²⁹ See also, Khan and Blankenburg (2009).

³⁰ The East Asian strategy of simultaneously insulating domestic markets and outwardly orienting manufacturing production was not even considered as an option.

FIGURE 14

Export and GDP growth in four developing regions, 1990-2008



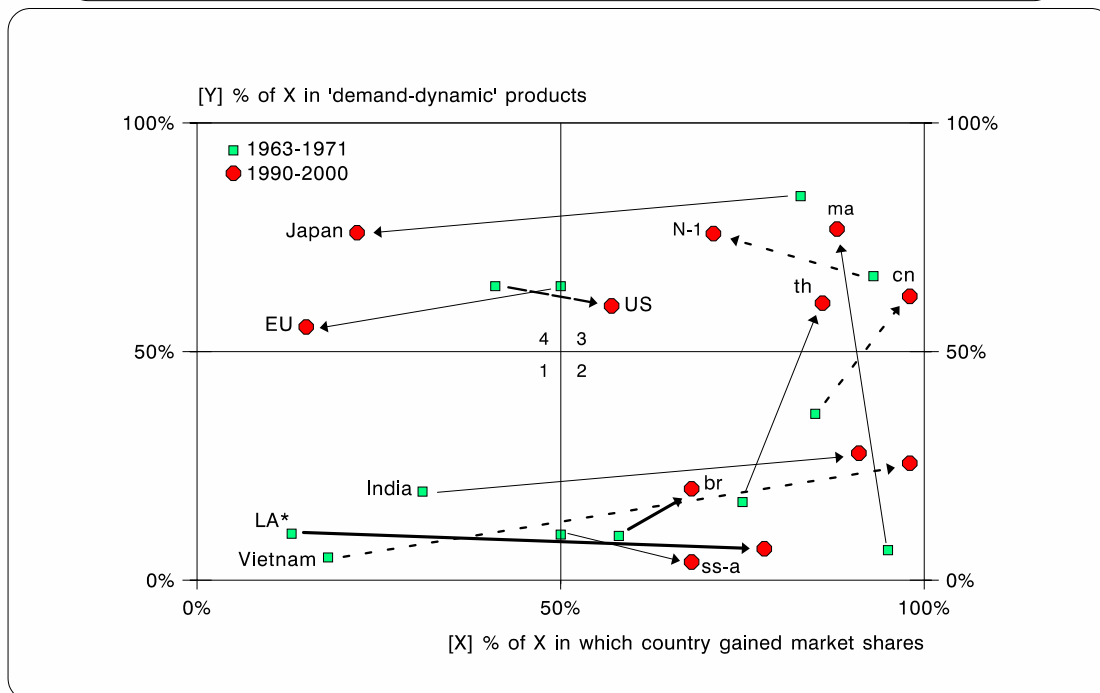
•[Y]=vertical axis; and [X]=horizontal axis. •As Figure 2 and 10, and a=Australia; bu=Bulgaria; china*=export growth, 17.1%; e=Ecuador; it=Lithuania; mk=Macedonia; pl=Poland; S=Sub-Saharan Africa excluding South Africa; u=Uruguay; v*=Venezuela (exports growth=0.2%); vn*=Vietnam (exports growth, 19.8%); and z*=South Africa (1994-2008). [1]=intercept dummy for LA; and [2]=intercept dummy for EE.; there is also an intercept dummy for the OECD (not included in Figure). LA excludes Venezuela (including Venezuela, export growth=6.9%). R²=79%, and all variables are significant at the 1% level (Palma, 2010a).

•Source: WDI (2010); for Taiwan (2010).

There is little doubt that one of the foundations of LA's negative export-GDP-dummy is the fact that in an export-led model what matters is not only how much but *what* one exports (together, of course, with having a non-monetarist growth-enhancing macro-policy). Figure 15 looks at this 'quality' of exports issue.

FIGURE 15

'Anti-clockwise' export-trajectories between the 1960s and the 1990s



•[Y]=vertical axis; and [X]=horizontal axis. •excludes oil. X=exports; LA*=Argentina, Bolivia, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay (i.e., Latin America excluding Brazil, oil-exporting Venezuela, and Mexico and Central America due to maquila exports); N-1 excludes Hong Kong. Data for Taiwan correspond to those reported in the second edition of the Trade-CAN software. Regarding Vietnam, the first observation corresponds to the period 1973-1984 (i.e., from the date when US combat troops left Vietnam until the beginning of economic reform; Trần Văn Thọ, et al. 2000). •**First observation**: export profile of a country or region between 1963 and 1971. •**Second observation**: that between 1990 and 2000. •**Vertical axis**: percentage of exports in products that were 'demand-dynamic' in OECD imports (i.e., products that increased their share in OECD imports during respective periods due, for example, to their higher income elasticity). •**Horizontal axis**: percentage of exports in which the respective country or region gained market shares in OECD imports during the relevant period. That is, the vertical axis refers to product 'quality' and the horizontal one to countries/regions' competitiveness. Therefore, if an observation is in **Quadrant 1** this indicates an 'uncompetitive' country (i.e., less than half its exports have gained market shares) exporting 'non-demand-dynamic' products (i.e., less than half its exports are 'demand-dynamic' products); if it is in **quadrant 2**, it shows a 'competitive' country exporting 'non-demand-dynamic' products; if in **quadrant 3**, a 'competitive' country exporting 'demand-dynamic' products; and in **quadrant 4**, an 'uncompetitive' country exporting 'demand-dynamic' products (Appendix 3 in Palma, 2009) for a more formal definition of the four quadrants).

•**Source**: Trade-CAN (2009).

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

positive-externalities-and-spill-over-effects' products (Palma, 2009b); Figure 15 indicates that it did not include demand-dynamic products in general.³¹ Meanwhile in EA the swift movement of 'second-tier' NICs (N-2) and China from quadrants 2 to 3 is so fast that it even eats away some degree of export-competitiveness of the N-1. This process is much more acute vis-à-vis Japan (and the EU). With the exception of the US (mostly due to the Clinton years), the overall pattern that emerges is an anti-clockwise trajectory.

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

So far, there is little evidence of *endogenous* upward forces from '2-to-3'. Countries in quadrant 2 seem to need an East Asian-style exogenous push. For these policies to be effective, however, what is also needed is the underlying power structures and institutional arrangements that allowed them to be so effective there. These include a professional bureaucracy capable of devising intelligent trade and industrial policies that generate rents as incentives for the transfer of resources towards more growth-enhancing exports, but also a state strong enough to be capable of imposing performance-related conditionalities to 'discipline' the capitalist élite to use them effectively—i.e., a state capable of threatening non-performing companies *credibly* with withdrawal of subsidies.

If these policies—and the institutional arrangements necessary for their success—are not implemented in LA, the potential GDP-growth-enhancing effect of further increases in export-competitiveness would continue to be restricted by the generally low productivity growth long-term potential of its current export pattern, its modest positive externalities and spill-over effects, and its low capacity to induce productivity growth elsewhere in the economy (including services). Furthermore, lack of an upward movement from '2-to-3' could

³¹ In Palma (2009b) I show that the statistic used in Figure 14 to measure demand-dynamics could also be considered a proxy for a product's technological content.

seriously affect the welfare gains from trade specialization in terms of the purchasing power of exports.

Existing evidence for LA indicates that the (not-so-)invisible hand of globalised markets are only creating incentives leading towards further penetration into quadrant 2, because current Ricardian international comparative advantages (as Cimoli, Dosi and Stiglitz, 2010, states) “are a luxury that only technological and market leaders can afford (indeed a major asset that they can exploit)”. One example is Chile, whose Ricardian comparative advantages led to a horizontal export trajectory (in fact, slightly downward) from quadrant 1 to 2. Its copper industry is a good example; while rapidly gaining market share, Chile has actually been *reducing* the share of manufacturing value-added in its copper exports (Palma, 2009b)—not much evidence of a Hamilton-List-Akamatsu-style logic here. There is ample evidence that the sharp slowdown in Chile’s growth since the late 1990s is partly due to this under-investment in upward productive diversification (Moguillansky, 1999). Finally, the nature of regional trade agreements with the US is likely to make the ‘2-to-3’ transition even more intricate—as opposed to Asia’s Japanese and Chinese ‘upward pulling’ powers.³²

In sum, export-led growth when based on relatively unprocessed primary commodities or ‘thin’ maquila exports has proved to be a poor engine of growth. The main lesson from post-reform LA is that if the region wants to insist on this export orientation, it should think about this model only as an export-‘enabling’ growth-strategy, not as an export-‘led’ one. That is, one in which dynamic (but not much growth-enhancing) exports can only be expected to provide the necessary foreign exchange to enable a fast rate of growth that is not balance-of-payments constrained. However, for this growth actually to take place there is still the need for a proper ‘engine’ to be found elsewhere in the economy. That is, other sectors or activities that would play the role of ‘production frontier shifters’, able to set in motion processes of cumulative causation—characterized by their positive feedback loops into the system, and capable of generating a momentum of change which is self-perpetuating (e.g., in the Veblen/Myrdal or Young/Kaldor manner). There is not much evidence from LA since 1980 that unprocessed primary commodities or ‘maquila’ exports can play that role—nor that the countries of this region have made much effort toward export-upgrading or looking elsewhere for an effective engine of growth (such as manufacturing,

³² In the case of the N-2 countries, for example, the (‘non-maquila’) production of manufacturing components for export to China has had a significant effect in this direction (Palma, 2009b).

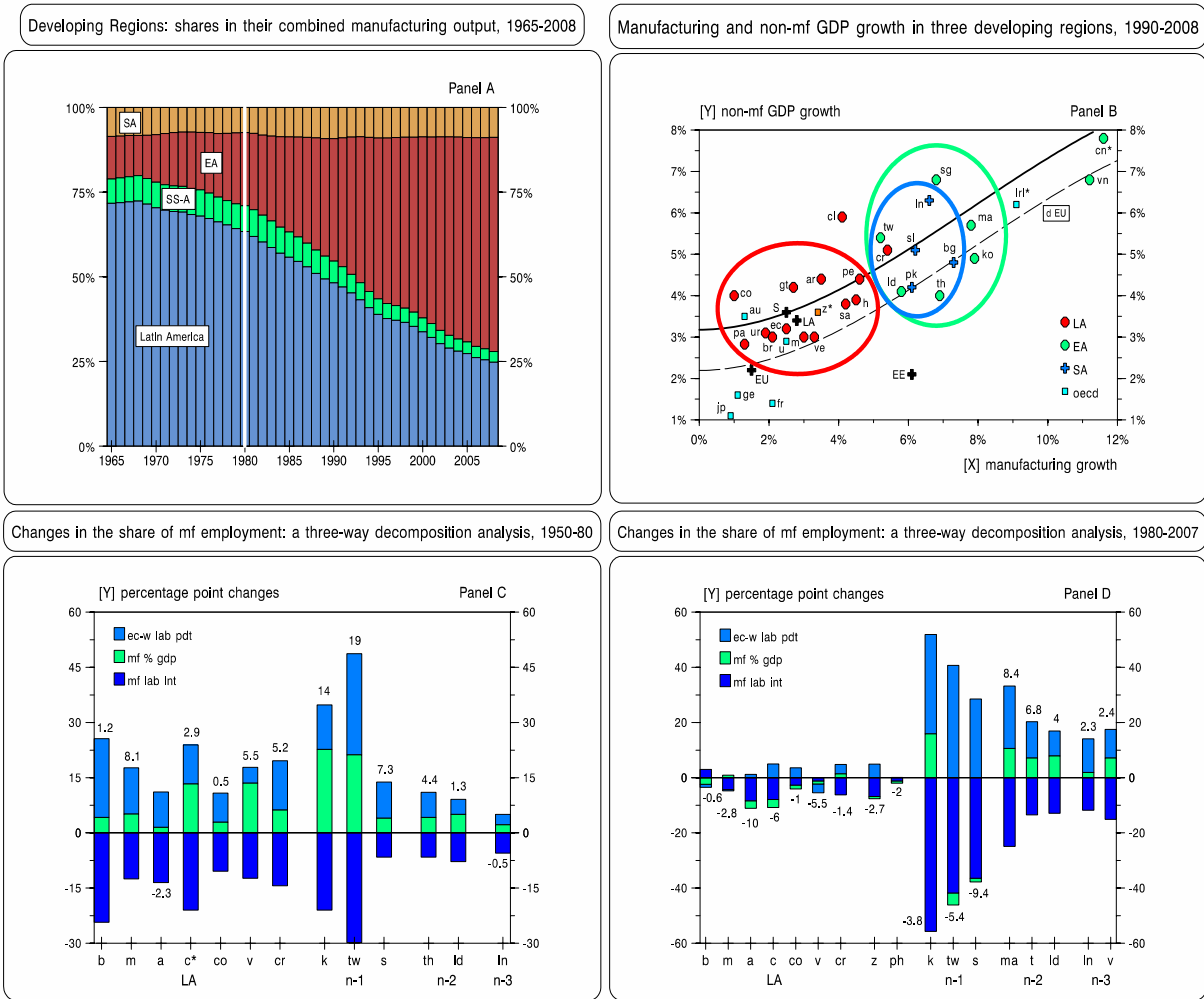
including, of course, the up and downstream manufacturing activities associated with commodity production and processing; see section 7).

As Stiglitz has often said, even from the perspective of mainstream economics, in a world full of distortions—including, of course, some Asian competitors with effective trade and industrial policies, as well as pro-growth 'populist' macros—the lifting of one distortion (e.g., trade barriers) does not necessarily lead to a superior (let alone optimal) equilibrium.

7.- Manufacturing as a faltering engine of growth due to Latin America's premature de-industrialisation

It's hard to believe today that during the 1960s LA was the undisputed manufacturing powerhouse of the South, responsible for nearly three of every four dollars of manufacturing value-added generated there (Panel A, Figure 16). Although its share began to fall in the 1970s due to some inevitable catching-up from late-starters, this process accelerated after 1980 in such a way that by 2008 LA's share represented just one-fourth of the total—and adding Taiwan to EA (not included in the WDI database), just one-fifth. As SA has kept its share almost intact, and as Sub-Saharan Africa represents a small (although declining) proportion of the total, what is really going on is a switching of position between LA and EA. That is, when the inevitable catching-up from late-starters began to take place properly, LA, instead of putting up a fight, threw in the towel...

FIGURE 16



•**[Y]**=vertical axis; and **[X]**=horizontal axis. **ec-w lab pdt**=economy-wide labour productivity; **mf % gdp**=the share of manufacturing in GDP; **mf lab int**=labour intensity in manufacturing (the inverse of labour productivity). In panels **C** and **D**, percentages shown above each bar are the overall percentage change in the share of manufacturing in total employment (the net effect of the three processes at work); when the figure is negative, the percentage is shown below the bar (and vice-versa). •Regions: in Panel **A** according to WDI definitions; EA excludes Taiwan. In Panel **B**, **S**=Sub-Saharan Africa (excluding South Africa); and **EE**=median country for EE (Hungary). •Countries: in Panels **B**, acronyms for as Figure 2, and 10; and **cn***=China (manufacturing growth=12.3%); **h**=Honduras; **fr**=France; **ge**=Germany; **m**=Mexico; **u**=US; **id**=Indonesia; and **pk**=Pakistan. **[d EU]**=intercept dummy for the EU; there is also a negative intercept and slope dummy for EE, and a negative intercept dummy for SS-A not shown in the graph. In Panels **C** and **D**, acronyms for as Figure 2, 6 and 10, and **c***=Chile (1950-73); Malaysia and Vietnam are excluded from Panel **C** due to lack of data on manufacturing employment. •**R²** in Panel B=71%; all variables are significant at the 1% level (Palma, 2010a).

•**Sources:** for manufacturing output, WDI (2010; data are only available from 1965 for all regions; some Eastern European countries have data available only from 1995). For Ireland, UN (2010), and Taiwan, Taiwan (2010). For manufacturing employment, GGDC (2007) and ILO (2010). Tregenna (2009) was used for the methodology in the 'decomposition' analysis.

LA's decline is particularly acute in the case of Brazil. By 1980 Brazil's manufacturing output (US\$[2000]86 billion) still slightly exceeded the combined output of Korea, Singapore, Malaysia, Thailand, Indonesia, Turkey and India

(US\$83 billion; WDI, 2010). By 2007, its manufacturing output (US\$119 billion) was equivalent to just one fifth of their combined output. If one adds China, the collapse of Brazil is even more extreme, falling from two-thirds of the combined output of the other 8 countries to well under 10%.

In turn, Panel B in Figure 16 shows that in manufacturing (unlike in exports) there are no significant dummies for LA—poor performance in manufacturing is linked to similarly poor performance in GDP. Also, the most robust specification for this relationship tends to confirm ‘Kaldorian’ dynamic increasing returns in manufacturing; that was not the case for the (linear) export regression.

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

Finally, Panels C and D build on my previous work on de-industrialisation (Palma, 2005b, and 2008), this time using an imaginative de-composition methodology (Tregenna, 2009), which disaggregates the changes in the share of manufacturing employment into its three main components. The main findings are: first, between 1950 and 1980 (Panel C) changes in the share of employment in manufacturing were all positive, and were the outcome of large changes in its three components. Second, that LA’s post-1980 decline in the shares of manufacturing employment (Panel D) are similar to those of much more advanced, much higher income-per-capita, N-1 economies (rather than those at more similar level of development—the N-2). Third, that the post-1980 decline in the share of employment in manufacturing, although similar in size to those in the N-1 countries, was the result of forces of *very* different magnitude. This suggests that after trade liberalisation and neo-liberal reforms LA adopted a type of ‘standing still’ defensive strategy in this respect. And fourth, as the evidence of Panel D particularly suggests, that rather than referring just to the 1980s as the ‘lost decade’, as far as manufacturing is concerned, in LA the three post-1980 decades might well deserve that label.

ISI’s legacy, of course, was not helped either by the distortions created by its rigid protection in highly-income-unequal domestic markets, as incentives led to horizontal diversification because there were more rewards for developing new products than for productivity ‘deepening’. In this sense, despite its discourse, ISI did not really have an ‘infant industry’ agenda because its logic was not one of temporary protection to help (and push) firms to get to the frontier and become

internationally competitive. Rather, it was usually 'infant' corporations (eg. General Motors, ITT, General Electric, Bayer or Nestlé) who were being protected with effective rates that sometimes reached four-digits. In fact, there was actually a 'double play': with big exceptions (eg. EMBRAER), the manufacturing industry that emerged from ISI may have been too fragile to adjust to the new open paradigm (especially at the speed taken by trade liberalisation, and the unnecessary difficulties created by 'tough' monetarist-macro); but what developed around ISI (including some institutions, suppliers and skills) was considerable.³³

In sum, in post-reform LA there is not much evidence in manufacturing of the characteristics that Thomas Friedman associates with a 'high-imagination-enabling-country'. Rather, evidence in Panel D points towards countries whose manufacturing sectors are 'hibernating'.

8.- Conclusions

In the economic literature there are three different analytics of growth, but only one (the structuralist/Post Keynesian/heterodox) analyses growth as a 'sector-specific' phenomenon (Palma, 2005b, and 2008). From this perspective, the appalling performance of LA's TFP *after* economic reform should make those who agree with the Washington Consensus think again. That is, LA's TFP record *after* the 'getting the prices right' and the 'institutions right'—i.e., after open capital accounts, free trade, public accounts (fairly) 'right', property rights on physical capital (but not necessarily on human capital) well defined and enforced, independent central banks, etc.—can only be describe as appalling.³⁴ And the well-rehearsed argument that what is needed is yet more of the same sounds increasingly hollow. Maybe the Washington Consensus is just one of the many heaps of ideological recipes still waiting for a proper theory (or a fire...); how can it explain that so many in Asia do things 'wrong' (sometimes *very* 'wrong') but develop fast, while LA does almost everything 'right' but can only achieve a low-intensity growth dynamic that the 'invisible hand' does not know how to break? When Keynes said that people usually prefer to fail through conventional means

³³ Unfortunately, ISI was not allowed to change the region's political configuration as a normal process of industrialisation would have done—military regimes put a stop to that.

³⁴ No much evidence though of 'getting the social capital right', but this was never part of the blueprint.

rather than to succeed through unconventional ones, he could not have guessed just how accurately his remarks would define LA today.

So, most of Asia gets unsavoury capitalism, but at least one capable of developing the productive forces of society, while LA gets a brand of capitalism with both a tendency towards a chronic deficiency of effective demand, and one full of market 'opportunities' and 'credibility', but with the wrong structure of property rights and institutions to generate compulsions for productivity growth (other than mostly in some commodities, although not much even in their up- or down-stream associated activities). That is, on the demand side, the chronic deficiency of effective demand in Latin American-style capitalism results mostly from 'the deadly triad' of undervalued labour, overruled exchange rates, and 'sterilised' governments—the outcome of 'flexible' labour markets, open capital accounts, and government with their hands tied for counter-cyclical action and pro-active public investment. And on the supply side, Latin American-style capitalism seems only able to offer world class commodities, stylish retail, lucrative finance, abundance of precarious jobs, and the 'purity of belief'.

By now it should be obvious that 'flexible' labour markets do not transform an oligarchy into a proper capitalist class; even from a neo-liberal perspective surely one can have too much of a good thing. The same happens with the opening of capital accounts excessively reinforcing the domestic élite's 'high-appropriation-cum-little-accumulation' distributive strategies, and its long-standing biases for mobile assets. As discussed in detail elsewhere (Palma, 2009a and 2009c), neo-liberalism may have become the most effective technology of power ever in terms of its capacity to transform a particularly asymmetric set of distributive strategic choices, and the corresponding payoffs, into a Nash equilibrium by convincing the majority that there is no point trying to change asymmetric distributive strategies like those found in LA while the all-too-powerful top income players keep theirs unchanged. *And* by achieving this not by 'chicken' (or 'hawk-dove') games, but by 'by conviction'—i.e., via a 'spontaneous consensus' type of hegemony (in the Gramscian sense) within a democracy—something that surely deserves an entry in the *Guinness Book of Records*. However, from an economic perspective, this remarkable set of ('by conviction') Nash equilibria in terms of political settlements and distributive outcomes seems only able to deliver productivity-less growth, where (as mentioned above) commodities provide the foreign exchange, the service sector the (highly-precarious, low-productivity and low-wage) employment creation, and financial markets all the fun. The UNDP may well call this model 'pro-poor'—the

alternative could be South African unemployment levels—but there is no emerging ‘tiger’ in sight.

Some economists, like Rodrik, have argued that in LA the contrast between the two periods is based on the fact that during ISI there were incentives to invest (industrial policies), but little market discipline due to lack of competition; in turn, during the reform period there was little incentive to invest, but a lot of market discipline. However, on the latter issue, I think the region is still waiting for the real thing.³⁵ And one should never forget that in many countries in EA the ‘market’ discipline has had a crucial ‘state discipline’ component; i.e., the ability of the state to threaten non-performing companies *credibly* with withdrawal of subsidies.

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

Perhaps it is time to acknowledge that Latin American economies, some of them well above the ten thousand dollar mark now in per-capita PPP terms, should be perfectly capable of relying on their own resources and capabilities. Perhaps the biggest challenge facing LA’s capitalist élites today is how to change their long-standing addiction to ‘low-intensity’ economic life (currently so well

³⁵ As the head of Chile’s largest holding company and former President of the Confederation of Chilean Industry explains, “[t]his is a market economy in name only. Competition has disappeared; mergers and acquisitions have led to a huge degree of oligopolistic concentration”. (<http://www.atinachile.cl/node/4629>).

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

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