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Dependencia Rules

The traditional [state-control] approach to markets in Latin America [before the late-1990s] was greatly influenced by what was known as dependencia, or dependency theory. It rationalized state dominance—high import barriers, a closed economy, and a general demotion of the market. And from the end of the 1940s right up to the 1980s, dependencia ruled.

Its origins were in the late 1920s and 1930s and the Great Depression, when the collapse of commodity prices devastated the export-oriented economies of Latin America. Meanwhile, in line with the tenor of those times, "national security" became a justification for governments to take over "strategic sectors" of the economy to meet the needs of the nation, not those of international investors. This led, notably, to the founding of state oil companies in a number of countries. After World War II, the shift toward a much greater reliance on the state was propelled by the emergence in the West of both the welfare state and Keynesian interventionism and by the prestige of Marxism and the Soviet Union. One other thing motivated both Latin American economists and their governments: anti-Americanism—fear of the colossus to the north and antipathy to what were seen as exploitative American corporations operating in the Latin arena.

The dependencia theorists rejected the benefits of world trade. By the end of the 1940s, the essential elements of their thinking were already articulated and promoted by the United Nations Economic Commission on Latin America (ECLA) and most notably by an Argentinean economist named Raul Prebisch, who headed the commission from 1948 until 1962. He began his career, in his words, as "a firm believer in neoclassical theories." But "the first great crisis of capitalism—the Great Depression—prompted in me serious doubts regarding those beliefs." He had experienced the challenge firsthand as director of Argentina's central bank in the early 1930s, when contagion swept the Latin American banking system and Argentina teetered on financial ruin.

Prebisch and those who joined him at ECLA propounded an international version of the inevitability of class warfare. They argued that the world economy was divided into the industrial "center"—the United States and Western Europe—and the commodity-producing "periphery." The terms of trade would always work against the periphery, meaning that the center would consistently exploit the periphery. The rich would get richer and the poor would get poorer. International trade, in this formulation, was not a method to raise standards of living but rather a form of exploitation and robbery, committed by the industrial nations and their multinational corporations. The victims were the peoples of the developing world. This belief became the received wisdom in universities across Latin America.

So instead, the periphery would go its own way. Rather than exporting commodities and importing finished goods, these countries would move as rapidly as possible toward what was called "import-substituting" industrialization (ISI). This would be achieved by breaking the links to world trade through high tariffs and other forms of protectionism. The infant-industry logic became the all-industry logic. Currencies were overvalued, which cheapened equipment imports needed for industrialization; all other imports were tightly rationed through permits and licenses. Overvalued currencies also discouraged agricultural and other commodity exports by raising their prices and thus making them uncompetitive. Domestic prices were controlled and manipulated, and subsidies were widespread. Many industries and activities were nationalized. A jungle of controls and regulations grew throughout the economy. The way to make money was by making one's way through the administrative and bureaucratic maze rather than by developing and serving markets. Overall, what guided the economy were bureaucratic and political decisions, not signals and feedback from the market.

Until the 1970s, the approach seemed to work. Real per capita income nearly doubled between 1950 and 1970. Over the same period, the role of the state continued to expand, as did state-owned enterprise. Tariffs and other trade barriers were raised. The biggest criticism at the time was that governments were not doing enough and that they should move closer to the centrally planned model of the Soviet Union and Eastern Europe. The deep weaknesses of this system were mostly hidden—until the beginning of the 1980s.

The Lost Decade

The debt crisis hit Latin America very hard. The buildup in borrowing had been enormous. Between 1975 and 1982, Latin America's long-term debt almost quadrupled, from $45.2 billion to $176.4 billion. Adding in short-term loans and IMF credits, the total debt burden in 1982 was $333 billion. Yet no one was paying much attention to that ominous increase until August 1982, when Mexico teetered on default. What ensued was a double bankruptcy—financial and intellectual. The ideas and concepts that had shaped Latin American economic systems had failed; they could no longer be funded. Dependencia had caused them to go broke. The years that followed, in which Latin America struggled to reshape its economies, became known as the "lost decade." And with good reason. For at its end, in 1990, per capita income was lower than it had been at the beginning of the decade.

Over those years, the full costs of the old system came to be reckoned. The industrial enterprises—both private and state-owned—that it had fostered were inefficient, owing to protectionism, lack of competition, and isolation from technological innovation. For the most part, they put little emphasis on quality and scale of service. Agriculture was seriously damaged. Budget deficits swelled. With inflation pervasive and deeply entrenched, family savings were devastated. As a result, people could not retire. Inflation rose to astounding levels, driven by the deficits and loose monetary policy. The domestic economies were denied the benefits of international trade, and there was no improvement in fundamental social inequality.