Up for Debate: Dependencia and Protectionism in Hindsight
Osvaldo Sunkel

The Persistence of Dependency

OSVALDO SUNKEL: During this process, as local industrial production was protected through tariffs, international firms, the global corporations, which started to expand in the '60s or '70s, couldn't get a hold into these markets. So what they started to do was to establish subsidiaries in the local markets, importing the materials and machines and so on, and then producing the goods locally.

We would have imported a car, and then we started to import the parts that made the car but [completed] the final assembly of the car locally. This is what eventually led to the idea that here we were trying to develop national industry, but in fact [we were] helping to generate the conditions for subsidiaries of global corporations to take over industrial process in the countries.

Dependency was a condition that we'd had since colonial times. We were dependent on Spain, dependent on Portugal, and then we were dependent on Britain. But more specific dependency meant that there were new conditions. We had been trying to create a national economy, a strong national industrial economy, but this had been expropriated by the big foreign firms. It's also called the "new dependencia" because of that, because this was the essential concept.

Then it became the economic concept. It also became expanded into a sociological or sociopolitical approach, arguing that the national industrial groups, which had been formed during the previous period, became also associated to transnational corporations, and that your national bourgeoisie was in fact becoming a transnational bourgeoisie associated to multinational corporations, therefore eroding the process of national development.

INTERVIEWER: This sort of neo-dependency outlook is paradoxical when shared by people from the left like Fidel Castro, nationalists like Peron, and people to the right as well.

OSVALDO SUNKEL: It was shared mainly by people from the center to the left, and it had various shades. There was a very strong Marxist argument, which we would not share in CEPAL, which argued that the development of developed countries produced the underdevelopment of underdeveloped countries -- in other words, a cause-and-effect relationship.

Our argument was different. Our argument was that both developed and underdeveloped countries grew out of this relationship, but some grew more than others did.

And then there is a right-wing argument, but this is more of a nationalist argument, which is not so much on dependencia, [but] which is based on a phobia [of the] foreign. ... But that would be some of the right-wing groups.

The Lure of Foreign Capital

INTERVIEWER: Can you explain to us what the Latin American debt crisis was?

OSVALDO SUNKEL: The debt crisis is something that comes much later. Debt crisis is a phenomenon that occurred in the early '80s. I think I have to give a little background to the debt crisis of the early '80s. The process of Latin American industrialization and development started to get into difficulties by the late '60s and early '70s for many reasons. The industry that had been created was not very competitive; [there was] high tariff protection, the foreign companies had come in and taken over, and so on.

There were also inflationary pressures building up, and there was a very strong political influence. In the early '70s we had the Allende regime in Chile, and then the military coup. [There were] also revolutionary movements in Argentina and Uruguay and Bolivia. The political factor [was also] very much influenced by the Cuban presence and Che Guevara exporting revolution to Latin America.

So the policies of the '50s and '60s were declining [and] were becoming less effective in the '70s. The way to keep development going was to invite foreign capital to come in and to get into credit. During the '70s was exactly the period when the oil crisis in '73 produced a huge increase in the price of oil and generated what was known as the petrodollar accumulation in the Arab countries and in the global banking system. So the banks became very anxious to lend, and our countries became very anxious to borrow. During the '70s there was a buildup of foreign debt, and then there were two or three big blows at the end of the '70s and early '80s which unleashed the debt crisis.

One [of these blows] was a second huge rise in the price of oil in '79, which induced the developed countries to apply deflationary policies, restrictive policies. This produced a huge increase in interest rates, and countries that had become heavily indebted could not pay at those interest rates. The first country that collapsed was Mexico in I think August '82, and this [started a] chain reaction of other countries that followed. That was the origin of that crisis.

INTERVIEWER: And the point of all the borrowing was presumably to try to finance industrial development?

OSVALDO SUNKEL: And continuing to try to finance industrial development, under conditions where this wasn't really very viable anymore.

INTERVIEWER: Some people might say that the Latin American debt meant two kinds of bankruptcy: financial bankruptcy and intellectual bankruptcy, that the new dependency theory really didn't hold water anymore.

OSVALDO SUNKEL: No problem about the financial crisis; that was obviously the leading factor. The intellectual -- I don't know if one can call it intellectual bankruptcy. Let me clarify something: Dependencia is not a policy. Industrialization was a policy, and import substitution was a policy. These countries were following policies of industrialization. Dependencia was a critique of those policies. As well it was a critique from the left to the left. So it isn't really that dependencia had become obsolete; the policies that had been pursued ran out of steam and became obsolete given the new conditions.

What came was a new wave of thinking which overran the type of thinking that had been going on. Dependencia was swept aside because what came in was a critique from the right that swept dependencia away as a critique from the left. And the new critique was: We have to change from state-promoted development to market-promoted development. And that is the big shift that was very easy to bring about because these countries were in the middle of the debt, having to apply restrictive policies. It was very easy for international financial organizations and for the economists -- a profession which is basically very right wing, very market-oriented -- to link the provision of support for getting out of the crisis with structural reforms, which would put the state out of the picture and open the door for the markets to take over the essence of the functioning of the economy.

Up for Debate: Dependencia and Protectionism in Hindsight
Moises Naim

The False Promise of Independence

INTERVIEWER: Explain for us the dependency theory.

MOISES NAIM: Dependencia is a vision of the world in which the world is like a pyramid, that you have some at the top and some at the bottom. Those at the top exert power to their advantage at the expense of those at the bottom. And those at the bottom are both inside countries and within the international system. So you have countries at the top that benefit at the expense of the countries at the bottom. And the wealth, prosperity of the countries at the top is only understood as a result of the poverty of countries at the bottom. It was a very limited way of perceiving the economies.

INTERVIEWER: Why did it become so widespread in Latin America?

MOISES NAIM: Some Latin American thinkers started looking at the way in which Latin America patterns of imports and exports worked, and they saw that Latin American exports were essentially raw materials and minerals. In exchange for that they imported tractors and cars and television sets and refrigerators. They saw the prices of the things that [they] were importing were increasing each year much more than the prices of the raw materials they exported, and they said, "Unless we start developing our own industries, we will always be condemned [to] exporting [goods] very cheap on process, without a lot of value-added things in exchange [for] getting to the sophisticated manufactured goods. So we need to move to an economy that instead of being based on agriculture and minerals is based on industry. The only way for us to compete with those imports is by limiting the imports and therefore forcing our consumers to buy manufactured goods made in this country." Therefore they enacted very high obstacles to the importation of foreign goods, and that spurred the creation of a whole slew of local industries that manufactured the goods and created an industrial base in Latin America that unfortunately was not very efficient, not very competitive, and was very dependent on foreign capital either borrowing or investing. And that then led, eventually, to the debt crisis.

INTERVIEWER: Why was that economic idea popular politically? What chord did it strike in Latin American economy?

MOISES NAIM: Latin America does not have a monopoly on nationalism. You can also see that whenever debates about international trade happen in almost any country they touch the very raw nerve of nationalism. Things that are made in this country are better than things that are made elsewhere because they generate employment of our neighbors and families and friends. So there is a very strong nationalistic appeal to the notion of "Let's consume things that are made by us." Well, the reality is that very often that generates [goods that are] more expensive and probably of a lower quality and ends up impoverishing a lot of your neighbors, families, and friends. It may create jobs here and there, but in the long term it may create even more poverty.

INTERVIEWER: The political appeal of the idea you mention began with Marxist undertones. Then you had someone like Juan Peron adopting [it] as well. Talk about Argentina and the reason that he embraced that idea.

MOISES NAIM: It [was] not simultaneous. Argentina was one of the wealthiest countries in the world. It was a very significant exporter of the world -- grains, meat. It was a very, very significant economic player in the world economy. But then a series of global trends, including the Depression, including the wars, including all sorts of things going on in the world, undermined Argentina's position, and Argentina began to decline economically. The response was a very political response in terms of continuing as if nothing had happened. [There was] no adjustment, no reforms, no need to [adjust] the policies that Argentina was following to the new realities of the world. So Peron started [what] then became very well known as populism, which essentially was the distribution of wealth that was not being created. That then became very common in many countries in which governments started expanding much more than that were they collecting in terms of revenues and taxes and creating very significant government deficits that then fueled inflation.

INTERVIEWER: So as countries adopted this theory, this policy, you said that a lot of the enterprises became inefficient. How did the process play itself out? When did the inefficiency start becoming apparent, what impact did they have on the economies, and what was the final response the outcome?

MOISES NAIM: The model that we called import-substitution industrialization essentially meant that you would produce domestically what you used to import. Sounds like a good idea, except that when you do it behind high barriers that inhibit the efficiencies of the companies because they are not threatened by competition, you create very lazy, noncompetitive companies that produce not very good goods at higher prices. But if you have consumers that are condemned to use those products, you end up having economies that have a very high propensity for high inflation. At the same time, governments were spending more than they were collecting, [which] also fueled inflation. So you all of a sudden needed to have infusions of foreign capital to cover those gaps. That foreign money then was a chance. In the mid-70s there was an oil crisis, and all of the oil-exporting countries were very cash-rich, and they deposited their cash in banks in the United States, in London, Japan. These banks needed to place that money somewhere, and they lent it to these countries under the assumption that these countries would never default. And that created the debt crisis, because guess what? One day these countries could no longer afford to repay the interest and the capital on their debts. It was a whole category of countries that went to the banks and said, "We cannot continue to serve the debts, to pay interest on capital." That debilitated the banks, and it was very threatening to the whole global economy. As the debt crisis played itself out in the '80s something else happened at the end of the [decade]: the end of the Cold War. So as the Soviet Union collapsed that was a coincidence, almost a perfect storm in which you have very different factors converging and creating a breaking point that then yielded the reforms of the '90s.

INTERVIEWER: Let's talk about when the system started to crack in Latin America.

MOISES NAIM: The crack in the capacity to sustain this import-substitution model [started] when the financing for it started to dry up. Essentially this model was highly reliant on foreign flows of capital. The moment that these foreign flows of capital were no longer as available as they used to be, the model cracked. It was ... very hard to keep it up.

INTERVIEWER: So this theory that said "We have to be independent from foreign control" actually was built upon or relied upon a lot of foreign money coming in?

MOISES NAIM: Right, and it was very ironic that it ended up creating even more dependency than what these countries had before. Before they had a dependency that was based on their exports of raw materials and agriculture. Now, on top of that dependency, they also had a financial dependency because they needed money from the international financial system in order to make the model viable.

INTERVIEWER: But what's the lesson of that in terms of the extent in which countries can remain independent?

MOISES NAIM: There is an illusion that you can cut yourself off from the international economy, and some countries have attempted to do it and will continue to attempt to do it. In the future we will continue to see countries that try to drop out from the system and try to build the fence and all sorts of barriers. The lesson of history is that those are short-lived. If you have a lot of oil you can sustain it for a longer period, but we now know that it's very, very hard to create a set of policies that will isolate your country from the vagaries of the world economy. Look at the Chinese Wall and think about what that did for China. Look at all of the walls, either ideological or physical, that have [been] created throughout history to isolate countries, and you'll see that sooner or later they will collapse.

Up for Debate: Dependencia and Protectionism in Hindsight
Arnold "Al" Harberger

Latin America Goes the Way of Import Substitution

INTERVIEWER: What was the general thrust of Juan Peron's foreign economic policy in Argentina?

AL HARBERGER: Well, it was very much an inward-looking policy, and that was a policy of so-called import substitution that became the flagship story of Latin America for the whole postwar period, heading into the '60s and '70s. Now, the origins of that were probably the Depression, and even more so [World War II]. The Depression spoiled the purchasing power of the Latin American countries, which were mainly primary exporters, and the war interrupted supplies from [abroad], so the plausibility of "Let's do it on our own" seemed so wonderful, you know, and Raul Prebisch was a distinguished Argentine economist, and he became the captain of the ship, so to speak, intellectually, and Argentina, Chile, Uruguay, Mexico, Brazil all went down that import-substitution line. There were times when import tariffs were 200 and 300, even 400 percent. The amount of hothouse industries that were being protected behind these barriers was unimaginable. Most of the protected items would cost there, measured in dollars, one and a half, two, two and a half times what they did in American markets.

INTERVIEWER: Is this the kind of policy that [was implemented] because he was an ultra-nationalist, [designed to make] the country strong?

AL HARBERGER: Exactly. He came to power during the war, if I remember correctly, and so he was there right at the birth, so to speak, of this feeling of this need, you see, and [he was] preaching self-sufficiency at a time when you hardly had any alternative. It made a certain amount of sense and led to a lot of popularity, not only of [Peron] but of other politicians around Latin America, but it was very bad economics.

INTERVIEWER: Why was it such bad economics?

AL HARBERGER: Well, let's say at the time a market economy would have worked the same way. It would have worked to have an exchange rate, a price of the dollar which was sufficiently high to automatically and efficiently protect a lot of domestic industry, but what happened was that the chick was barely out of the egg when the war ended, you see, so this whole enormous hen that came out in the end grew in a period when it was absolutely counterproductive from the standpoint of those economies.

Up for Debate: Dependencia and Protectionism in Hindsight
Ricardo Lagos

Importing Cars and Exporting Wine

INTERVIEWER: How do you view dependency theory from today's perspective?

RICARDO LAGOS: The dependency theory was to some extent an explanation of the world as it was during those days where you were "dependent" because you were providing primarily raw materials and you imported manufacturing goods, and then your terms of trade were very uneven vis-a-vis those countries that were purchasing the raw materials. The dependency theory plays a role, because to some extent, the economic policy that you can get from these ideas was that you had to build economic barriers very high, you had to protect yourself, not have a chain with the rest of the world.

In other words, the dependency theory was present at a particular stage of the world [development] after the second world war, when most of the trade concentrated between the Atlantic Ocean, the U.S., and continental Europe, and therefore most of the growth economy took place in another part of the hemisphere. Therefore we were "dependent" on what was going on in some other parts of the world, and we couldn't profit from the benefits of the technological changes, because technological change was taking place there. And here we were dependent also in another area: We were unable to produce our own capital goods. Because we had a closed economy, we were [supposedly] in a situation to produce almost everything, which is nonsense. I mean, today I say, well, this is nonsense. When is Chile going to produce a car of its own? Never. You can produce cars if you're going to export, but not for the 15 million Chileans.

INTERVIEWER: Why did dependency theory go bankrupt?

RICARDO LAGOS: I think that primarily because the world changed in the sense that the we discovered that it was possible to have our own areas of export if we do the things in the right way to the rest of the world; that it's not going to be necessary to produce here in Chile products in every area, but we can export some and we can import the others. And if we were to import, if we were going to have really free trade, we were going to improve our standard of living, and therefore it's cheaper for Chile to import a car from abroad, provided that we are able to produce and to export wine. The question is to discover what are the major areas where you have a more comparative advantage, and it seems to me this is what really makes a difference today.

Up for Debate: Dependencia and Protectionism in Hindsight
Jorge Quiroga

The Government Doesn't Always Know Best

JORGE QUIROGA: Dependencia was a theory that the government always knew best, and then you put yourself in the hands of the government, and there were people [somewhere in] the government who would decide who were the winners, who were the losers, [and] whom to help. Import-substitution models [postulated] that you would determine what types of industries you would champion and then protect, and then [under the banner] of trying to help a few domestic industries, you would close off the imports of those competitive goods to help some types of local champions, all that in detriment to the consumer who would not have access to choice or variety of products, and I think that was for a long time funded by multilateral organizations or bilateral help. U.S. [and] European countries that financed the construction of pipelines, turbines, telecom switches, factories, mining smelters -- they financed that.

It was viewed as a way to address poverty. It was definitely very wrong, because you do not do anti-poverty programs through factories. You do them through investment and help and education and water and sanitation -- the things that nobody else will do -- and through having clear rules, and opening up the manufacturing and services sectors for private investment, local or foreign. And it's a type of thing that Bolivia has now, whereby you get private investment that used to be done by the government before with lots of cronyism and political mishandling. That is done now by private enterprise, foreign investment, and the government is dedicated to a very decentralized execution of social programs -- health, education, things that multinationals won't come to do. But that is the primary responsibility of the government, and that was neglected for a very long time.

Up for Debate: Dependencia and Protectionism in Hindsight
Stanley Fischer

When Economic Theory Falls Short

INTERVIEWER: Why have we seen a shift toward markets around the world in the last 20 years?

STANLEY FISCHER: The shift toward markets took place quite late in the postwar period. Right through the '60s and '70s, the heavy reliance on government intervention seemed to be working, and many of the countries, like Brazil, which had very extensive intervention, were growing quite fast. It was a period of the '70s after the energy crisis, the early '80s the debt crisis, when it became clearer and clearer that this model of trying to shut off the world economy, rely on protectionism, control everything was not working. And gradually -- and it was very gradual -- countries moved into a new model. It was not ideologically driven. It was driven by the failures of the old model.

INTERVIEWER: Does this general shift make sense?

STANLEY FISCHER: I don't doubt that the shift towards freeing up trade has been enormously beneficial to the countries that have done it. And you learn things in strange ways. I began to think about this more than anything looking at cars in Argentina and India. They protected their car industries, and when you went to Argentina in the 1980s you saw tens of thousands, hundreds of thousands of 1962 Fords. And if you went to India in the 1980s you saw hundreds of thousands of 1958 British cars. And you realize, if you protect, you don't have technical progress, your consumers are hurt, and firms get lazy, and you need that competition from abroad. You need new technology to come in for industries to do better and for citizens to get the benefit of what is available out there in the world.

I knew all the theories, and I'd studied them. And I knew that free trade had many benefits. It also had certain disadvantages. It's one thing to see it in the textbook; it's another to look at it and say, well, I guess that's what the textbooks mean. I was a student of the London School of Economics in the 1960s and then moved to the United States. One of the hardest things to understand is that relying on markets can work. And the notion of protectionism, of giving your producers a chance of producing employment in your country, is intuitively plausible. Any protectionism is the obvious way for people who haven't been trained to think [economically]. So as I started, I found all that very persuasive. It was also true that during that period there was more success. The Soviet Union looked like it was working. Then gradually over the course of time, watching what happened, thinking about the economics of it, and the economic points I believe in the direction of markets. Your views begin to change. I was not fully convinced of the virtues of more market approach when I was in the World Bank in the late '80s. The more I saw of what countries were doing to themselves, and to their citizens, the more I moved in the direction of markets.

When you're a professor or a student you tend to get very tied up in special cases and all the nice theoretical possibilities that are out there. And there is no question that there are many ways in principle of improving on markets, by being clever, by regulating this, that, and the other. When you actually work with governments and watch the consequences of these attempts at very detailed intervention trying to help out there and deal with an imperfection here and an externality there, you begin to get much more skeptical about the ability of social scientists to predict what's going to happen, and then their inability to understand some of the political economy of what happens, and I think it is those factors, watching governments try to make what sounds like good policies work and realize that you can get into huge messes. That tends to move you, and to understand the theories as good guides to what is analytically possible, but that you have to look at what has actually happened when different governments have tried to implement these measures, to understand what you should recommend as opposed to what is analytically a possibility.

More than anything else I changed my views based on watching Latin America and watching countries which I thought had got interventions well organized, particularly Brazil. I watched what happened to them as they kept pushing further and further in the interventionist route and saw their macro-economies first destabilized, and then the micro-economies didn't work, and realizing, watching them, that they had to rely more and more on markets. It's as much a theory about how difficult it is for the state to do these things as about what is analytically possible.