

# Economic paradigms and the role of the State in Latin America

*Enrique V. Iglesias*

**T**his paper looks at the two successive development paradigms that prevailed in Latin America during the second half of the twentieth century, examining in particular the role assigned to the State in each. It will discuss how, in the ECLAC paradigm, a far-reaching role for the State as guide, sponsor and direct participant in productive development became less viable as the State was captured by private interests that no institution was solid enough to contain. Later, after the advent of the Washington consensus, the State became too severely weakened to carry out proper regulation of privatized activities or to sustain its long-term vision or its concern about income concentration. The paper touches upon the social demand for a new type of State and examines the requirements and objectives that will have to be met if the State is to facilitate the effective operation of markets and act to reduce social inequalities, among other things.

Enrique V. Iglesias  
Ibero-American Secretary-General  
Ibero-American Secretariat (SEGIB)  
Former President of the Inter-  
American Development Bank (IDB)  
Former Executive Secretary of  
ECLAC  
✉ [eiglesias@segib.org](mailto:eiglesias@segib.org)

# I

## Introduction

At the kind invitation of my great friend and colleague José Luis Machinea, I took part not long ago in a very special meeting at the Economic Commission for Latin America and the Caribbean (ECLAC). The meeting was convened to honour the memory of Raúl Prebisch, an iconic Latin American economist and illustrious contemporary of many of those present. His memory evokes the golden age of development economics in the latter half of the twentieth century, a discipline he led with such wisdom in Latin America and brought to greater prominence in international academic circles and prestigious specialist institutions such as ECLAC, the Latin American and Caribbean Institute for Economic and Social Planning (ILPES) and the United Nations Conference on Trade and Development (UNCTAD). His life was rich in thought and action and in due course was instrumental in moulding new generations of professionals committed to the economic and social progress of Latin Americans, while his ideas are held in deservedly high regard by many prominent economists in the academic world today. For me his memory is genuinely moving, since he was both the

teacher who opened my eyes to the workings of the real economy in Latin America and the world and a generous friend whose example, advice and support were a crucial influence on my career and my own dedication to the economic and social development of Latin America and the Caribbean. At the event, these feelings mingled with nostalgia for the years spent at ECLAC, which was and, I feel, still is my home —the cradle of aspirations and experiences shared over so many years. I feel very grateful for the opportunity I was given to revisit the memories it holds for me and to find myself once again in the company of such good friends and travelling companions.

On that occasion, I shared a number of reflections on the role of the State over more than half a century of efforts to develop economic paradigms in the Latin America region. In this paper I will do the same. I do not intend to write a theoretical treatise, but rather to illustrate the vision of an exceptional practitioner in the work of academic disquisition and in the practicalities of the development policies followed by the great majority of the region's countries.

# II

## Economic paradigms

The search for economic paradigms has been a constant in the region since the middle of the twentieth century. Few regions have known such fierce debate or such varied experimentation as Latin America. The region has been a veritable laboratory of ideas and policy proposals, each driven by the ideologies of the moment and often following teachings that originated elsewhere in the world.

A number of lessons can be drawn from this search. One thing I have learned in nearly half a century of experience is that economic underdevelopment is a much more complex matter than we believed it to be fifty years ago, for all the thought devoted to the subject at the time. In part, ECLAC was a seedbed of ideas brilliantly propounded by Raúl Prebisch. But it was also a centre for research and learning about the economic reality in each country, often in close cooperation with governments. The experience this provided gave us a better understanding of each country's economic complexity and of its international environment.

Thus, one thing we were taught by the experience of so many years was to avoid the reductionism or oversimplification of reality that often accompanies the

---

□ This paper is based on the lecture given by the author at the Economic Commission for Latin America and the Caribbean (Santiago, Chile, 28 August 2006) on the occasion of the Sixth Raúl Prebisch Memorial Lecture.

search for paradigms. Simplification of this kind has been a feature of almost all theoretical formulations and the policy proposals following on from them. In my personal experience, oversimplification is found in two areas: in economic matters, and in relation to social and political frameworks.

How can we avoid the simplifications of theory? Advances in macroeconomic analysis have made an enormous contribution to policymaking. Macroeconomic models have made extraordinary progress in their capacity for policy analysis and prescription. Three areas in which particularly substantial and useful progress has been made are monetary and financial affairs, price formation (including inflation) and external trade.

Often, though, I feel that reality has been sacrificed to the formal and mathematical elegance of the models. Not that we should underestimate the contribution of macroeconomic models to knowledge and policy implementation, but there is sometimes a tendency to put formal elegance before the complexity of the economic, social and political reality.

Perhaps we can illustrate this by drawing a parallel with the building of a house. The input of a good engineer is needed to make sure the house has proper foundations and infrastructure. It will simply not be safe without them. But there is also the need for an architect who can supply a design that matches the aspirations and needs of its occupants. I think the search for economic paradigms is rather akin to this. Good economic engineers are needed to ensure the consistency of economic models and work out the optimum conditions for them. But economic architects are needed as well to see that the rationality of the economic engineering matches the requirements of the social and political reality. In my view, economic engineering has moved far ahead of the architecture of economic paradigms. The experience of years past has often revealed flaws in the design of houses whose structure, by contrast, has been a model of formal elegance.

What has the experience been as regards socio-political paradigms? Different ideas and categories of sociological and political analysis have been deployed in the effort to ascertain and grasp the true state of affairs, and this has brought us closer to a comprehensive understanding of reality. Inevitably, though, this appreciation of conditioning social and political factors has often fallen prey to non-empirical ideologies or constructs which, while useful in shedding light on social phenomena, risk putting ideology before reality. And this leads to socio-political simplification that is just as dangerous as the economic kind.

One of the most valuable lessons of recent years, then, is the need to avoid both types of simplification. In one case we risk ending up with economies but no society, and in the other with societies but no economy. All paradigms entail one risk or the other, so we must guard against oversimplification if we hope to develop an all-round appreciation of the reality in which we mean to implement relevant and viable economic and social policies.

None of this is to say that we should dismiss the role of ideas and ideologies. These have proven their value throughout history. What I have found in my personal experience, though, is that the search for economic and social paradigms needs to take account of national and international realities and identify the obstacles and conditionalities these create for the application of different policy proposals.

Institutions play a crucial role in shaping economic, political and social realities, as is increasingly being recognized. And one of the most important institutions is the State. In Latin America, the role of the State has been a key element in all major development paradigms.

This issue is not new, but I propose to address it here because it may be interesting to examine it in the light of my personal experience, drawing in particular on the findings of our work over the last few years at the Inter-American Development Bank (IDB), where we set up a special unit to analyse political problems in Latin American development, particularly the role of the State. In doing this, we were simply adding our efforts to the institutionalist thinking of recent years, with its stress on the fundamental role of institutions when it comes to explaining and combating development problems.

I should like to discuss the role of the State in each of the two main economic policy paradigms of the last 50 years in Latin America: the ECLAC paradigm and the Washington consensus. Consideration of this and the lessons it yields shows the need to rethink the role of the State in the light of the new realities in Latin America and the economic strategies being applied in the region.

### 1. The ECLAC paradigm

For our generation, the first great encounter between State and paradigm in Latin America resulted from the ECLAC approach. As we know, the framework of that paradigm contained a set of key ideas that included: (i) the setting of the paradigm in the framework of the

centre-periphery relationship; (ii) inward development; (iii) the role of technology; (iv) import-substitution industrialization; and (v) an active role for the State. Implementation of this development strategy required a series of specific tariff, tax, currency and credit instruments and policies, along with fiscal incentives for industrial development and measures to deal with the explosion of social demands generated by migration from rural areas to cities.

In these circumstances, the State had a leading role to play and accordingly created line ministries, planning offices and development banks to mobilize financial resources and technology. Enlarging and strengthening the State apparatus was the central tool of economy policy. The development process driven by this strategy profoundly altered the economic and social profile of Latin America. One of the main aspects of the social transformation was intensive urbanization. As regards the economy, the manufacturing sector came to account for a larger proportion of total production and employment while agricultural output held steady or declined, the growth of public-sector services (and employment) accelerated, and government bureaucracies expanded in tandem with the share of total resources absorbed by the State. Urban incomes grew and outstripped rural incomes quite markedly, although this upward tendency weakened sharply from the 1960s to the 1970s.

What accounts for this progressive exhaustion of Latin American development? Were not the underlying development policy principles the same as those applied so successfully by the “Asian tigers”? So why did Latin America prove unable to operate a progressive industrial economy in a viable way, instead losing significant ground to countries that began their industrialization from a weaker base? The causes were many, but there were some factors that had a particularly harmful impact.

In Asia, the State had greater autonomy than in Latin America and could build on a tradition of bureaucratic efficiency and independence from the influence of private interests. The Latin American experience was very different, not so much in the nature of the policies as in the way these were implemented. The fiscal base was inadequate, mainly because there was no genuinely redistributive social and political covenant. The State was easily dominated by private interests, including those of political groupings or parties, business groups, military leaders, caudillos or dictators, who used the State to build up their own political and economic power. This also accounts for

the clientelism of employment and public expenditure management by authoritarian or semi-democratic regimes.

In short, the kind of State that existed at the time of the ECLAC paradigm was omnipresent, centralist and captive. Moreover, few Latin American countries succeeded in making much progress with the construction of a solid democratic State, an essential condition for securing independence from private interests and confidence in the rule of law. Those flaws led ultimately to political instability and the democratic deficit.

The studies done at the IDB analysed this democratic deficit from the perspective of two different relationships: State-market and State-society. Gaps or flaws in those relationships made sustainable, equitable development a less viable proposition.

Thus usurped by private interests, the State intervened in ways that blocked the efficient operation of the market and encouraged rent-seeking, speculation and corruption. Again, public policies that had been captured by private interests could not respond to the demands of most citizens, and this played a part in excluding large sections of the population from the benefits of development and eroding the legitimacy of the State.

The exhaustion of the heterodox ECLAC model precipitated the crisis of the State. This is not the occasion to examine the reasons for this model's exhaustion. Suffice to say that the crisis experienced by Latin America in the 1980s—which reached its nadir with the debt crisis—accelerated inflationary processes, accentuated the loss of economic competitiveness and widened social gulfs. On the institutional side, central banks, ministries of planning and financial and development institutions were destroyed. Just as serious, however, if not more so, was that the long-term approach to development policymaking was lost. In most Latin American countries, policymakers' attention was monopolized by the problems of economic survival and short-term crises. This situation, and especially the problems arising from the debt crisis, prompted ECLAC to warn at the beginning of the 1980s that a “lost decade” was imminent for the continent. Unfortunately, this proved to be exactly the case, with deeply damaging consequences for the economies and societies of Latin America.

The severity of the crisis led to the abandonment of the heterodox model and to the return of the orthodox model and the adoption of the Washington consensus.

## 2. The Washington consensus

The return of orthodoxy meant the adoption of market rules, use of the price system as the main mechanism for resource allocation, the implementation of stringent stabilization programmes, the liberalization of international trade, inflows of financial resources and private investment from abroad, and a far-reaching policy of privatization. Economic reforms were promoted largely by financial agencies in Washington, and particularly those that emerged from the Bretton Woods Conference, which were to be among the driving forces behind reform.

The conception of the liberal State enshrined in the Washington consensus was pervaded by an anti-statist attitude whose rationale derived from the crisis of the heterodox State, with its inefficiency, its unwieldy bureaucracy and, especially, its corruption.

Another definite influence was the generally expanding role of the market in a growing number of emerging economies, both in developing countries and in the socialist sphere.

The new conception was of a minimalist, hands-off State. All sorts of reasons were found to disqualify the State from acting as a mechanism of resource allocation, the main ones being its inefficiency, corruption, clientelism and bureaucratic excesses. Hence the advocacy of a minimized State, entailing the closure of institutions, the abolition of policy instruments and the pruning back of excessive interventionism. Industrial and agricultural policies, for example, were dispensed with. Most importantly, long-term vision was lost.

A serious mistake was thus made in implementing the reforms, that of turning away from the State. Because State involvement was rejected, the generality of reforms lacked credibility. According to *Latinobarómetro* surveys, only a third of Latin America's people have faith in the reforms. The result has been that large majorities of the population have increasingly come to view reforms and the market as illegitimate. This crisis of credibility has compounded a widespread feeling of frustration and fatigue at the slow pace of progress and the severity of the sacrifices made to implement reforms.

So, how does the State relate to the market and citizens in this new paradigm?

Where the State-market relationship is concerned, economic policy has undergone major changes, including: (i) privatizations and the opening up of whole sectors of the economy to market forces; (ii) the

weakening or absence of the regulatory frameworks needed to spur competition and protect consumers' interests; (iii) the sustained opposition of corporate interests to reform processes; (iv) the lack of proper mechanisms for negotiation between the winners and losers from reform; (v) the abandonment of measures to promote specific production sectors; (vi) lack of progress on genuine fiscal reform; and (vii) low and decreasing public investment in infrastructure.

Concerning the State's relations with citizens, a number of points need to be raised. The conditions for genuine justice and the rule of law are still absent in many countries. For one thing, judicial systems are unreliable, and this heightens the lack of legal security. Meanwhile, the State lacks the capacity to promote redistributive social covenants.

Moving on to the approach taken by the new development strategies to the role of the State, a general feature of the latter years of the twentieth century and the early years of the twenty-first has been a strongly renewed concern with social development. In one way or another, too, the whole world has felt the effects of the tragic events of 11 September 2001, especially the emphasis on State-led security measures.

The State's relationship with the market and citizens in this new paradigm has left the public administration poorly equipped to develop and implement policies, largely as a result of fiscal crises. Reforms to the public administration have yielded more in the way of fiscal reforms than of specific exercises in reorganization. They have tended to be technocratic in nature, neglecting to pursue real change in the structure of the State.

Hence, in recent years there has been a new interest in redefining the role of the State in the context of the new development strategies including, as noted earlier, a marked concern with social development and, since 2001, with national security measures. This has coincided with a propitious international economic environment, substantial growth in world output and trade, an upturn in commodity prices and an expansion in financial flows and foreign private investment. The benefits this international economic upsurge has brought to Latin America have been further enhanced by the sound macroeconomic management that is now the rule in most of the region's countries, where both external debt management and export performance have benefited from favourable external conditions.

The new economic strategies are being applied in a general framework dominated, on the external side, by better balance-of-payments positions than in the past and

by the presence of new international actors such as China and India, which represent both great opportunities and major challenges for the region; and domestically, by the consolidation of sound macroeconomic management, a new focus on macroeconomic problems and a renewed acceptability both for specific public policies to correct market failures and for State action generally. All of these are issues that ECLAC has been working on since its foundation.

Might this be a new paradigm we are seeing? In all honesty, I think not; I prefer to construe it instead as an

incremental paradigm. Latin America possesses a great deal of pragmatism, learned from its own and others' experience, together with an increased awareness of the constraints imposed by international relations in the modern world. As State and market have drawn together, the general rule has been the one expressed by President Ricardo Lagos here in Santiago: more market and better State. Of course, it is up to each country to decide the best relationship between the two.

### III

## A new conception of the State: its objectives and the means to achieve them

The matter we need to consider, therefore, is the new conception of the State, drawing on the good and bad lessons learned from its role in the two preceding paradigms. I propose now to use those experiences to identify a number of objectives that I think are important in the effort to define this new State.

#### 1. Objectives

A first objective is to have a State capable of making market efficiency a viable proposition. The State is important, if not indispensable, in achieving an efficient market, which requires a reliable and credible legal and judicial system to enforce property and personal rights. Another necessity is a regulatory framework that strikes the right balance between public and private interests. Competition also has to be fostered and protected in the interests of market efficiency. Experience has shown how bad the results of privatizing State enterprises can be when these conditions are absent, with a public monopoly simply being replaced by a private one. In short, an efficient market capable of providing growth and opportunities for the whole population requires a State that can act effectively where needed, refraining from intervention when this can do no good.

Second, the State needs to be able to stimulate production capacity. This is not to argue for a producer State as a matter of principle, although the option should not be ruled out. What is important in this conception of the State's role is the implementation

of public policies to build up production capacity in the sectors most critical to development, such as those associated with technological and productive innovation. We propose that the State should intervene intelligently, but without going against the market, and that the dogmatic exclusion of the State that was a feature of earlier years should be avoided.

Third, we need a State that can take responsibility for reducing social inequalities. The State plays a essential role in actively defending social cohesion and combating poverty. The efficiency of political and civil rights hinges on the existence of a State apparatus that can guarantee respect for legality and decent material living standards for the population by recognizing and protecting economic and social rights. This entails the State performing two basic functions: an enabling role and a compensatory one. The State enables citizens by providing access to greater equality of opportunity through education, while its compensatory role derives from its obligation to protect the welfare of the most vulnerable in society. This is not to say, however, that the State should have a leading role in economic growth as a way of solving the problems of poverty, since this would mean supplanting the private sector in its economic responsibilities.

Fourth, a prominent part of the modern experience is a new relationship between the State and private enterprise that has yielded substantial economic and social dividends. New forms of cooperation can be identified in this field, such as the joint financing of

infrastructure by the State and private enterprise, which will certainly represent one of the greatest challenges for the regional economy in the coming years.

Fifth, where the State's role vis-à-vis civil society is concerned, it is clearly understood today that strengthening civil society goes hand in hand with State reform. At the IDB we have repeatedly stressed that there can be no effective State without a strong civil society, and vice-versa. That is, there cannot be a strong civil society without the support of a robust and efficient State. Strength must not be confused with size, however, or muscle with fat, as Prebisch often used to say. Development requires more State, more market and more civil society, but in a coherent fashion that allows all three to co-exist and bring out the best in each other. The relationship needs to be fostered creatively by building up mechanisms for civil society engagement in State functions. This is undoubtedly a great challenge, and the first step in addressing it is to do away with the mutual suspicions so often found in this relationship.

Sixth, the State has a key role to play in orienting and setting the policies that will determine the country's international positioning. It is the State's job, in consultation and collaboration with the private sector, to take the major decisions that go into shaping the country's relationship with the outside world. This is crucially important at a time when international relations are becoming more and more complex, both regionally and globally. The role of the State is especially significant in the regional integration process. The kind of de facto solidarity on which economic and political integration is built depends on a progressive convergence of interests, values and cultures, whose backbone is the institutional capacity of the countries and, in particular, the role of the State. Integration is a complex, dynamic process that is advanced by resolving the conflicts that arise in adapting the economic, political and social structures of the different countries. It is difficult to see how this could be achieved without the leadership of State institutions. Jean Monet used to say that nothing was possible without people but nothing was lasting without institutions. Regional integration, which is itself a process of State reform, can hardly progress unless there are States capable of dealing effectively with the adaptation problems it entails.

Seventh, the State plays an absolutely crucial role in technological innovation. At the early stages of nation-building, the State played a fundamental role in educating citizens. Today, the new frontier that is

opening up for the primary responsibility of the State is support for the development of technology and technological innovation. What education was yesterday, the expansion and quality of education are now. Today's responsibilities also include the promotion of scientific research and technological innovation. This is not to deny the essential role of private-sector activity in this field, but the gap that separates us from the developed world may widen unless we make a massive effort of technological development, and this will inevitably require effective action on the part of the State.

Eighth, in our increasingly complex world we need to strengthen our capacity to analyse key trends in the economy, society and politics at the international level. We live in a world that is advancing at an unprecedented rate in every field, dominated by the forces of globalization and the astonishing development of information and communication technologies. Accordingly, one of our very highest priorities must be to maintain the maximum possible level of observation and monitoring capabilities. In this, the modern State needs to encourage ongoing discussion and analysis by the public and private sectors so that we can cope with the challenges and benefit from the opportunities created by different aspects of globalization.

Ninth, planning offices are a proven institutional tool for developing the capacity to analyse major national and international economic, social and political trends. It is time to make amends for our past failure to analyse and reflect on the future. Long-term thinking must again become an important objective for the contemporary State. We are not arguing for central planning, but for the ability to project long-term trends as a basis for development strategies.

Tenth, another vital function of the modern State is to build up broad national consensus. We know that consensus-building at different levels between the State, private enterprise, trade unions and civil society has been a valuable experience for many developed countries. Without wishing to dilute the responsibilities of each sector of society, it is worth trying to create mechanisms to contribute to the broad national consensus that appear to be so useful and necessary in the conditions prevailing in the region today. Creating and supporting economic and social councils would seem to be a task that merits particular attention from the State.

To supplement this veritable catalogue of objectives for the new State, we should try to identify or determine the requirements and instruments that are appropriate and necessary to achieve them.

## 2. Requirements

In my view, the first requirement is a robust democratic system. This is certainly the most important precondition, although this assertion may be rather unexpected given that it is perhaps unusual to treat the capacities of the State as conditional upon the maintenance and advancement of democracy. It is, however, relatively common to associate the poor functioning of democracy with the development of its liberal component, relating this to the weakness of the mechanisms that protect civil and political rights and liberties by effectively limiting and apportioning power. Less attention has been paid, however, to the weakness resulting from deficiencies in what has been called the republican component of democracy, by virtue of which the exercise of public power should be a public-spirited activity involving strict obedience to the law and the public interest, often at the expense of private interests.

A second condition is the creation of a professional civil service with a solid institutional position and sense of duty, set within a suitable legal framework. In advanced democracies, the institutional independence of a civil service in which access and career progression are governed by strict criteria of equality, merit and ability acts as a counterweight to political and governmental freedom of action and as a check on arbitrary behaviour, safeguarding the values of legality without which the rights and liberties of citizens would be difficult to protect effectively. Democracy cannot be consolidated without State reform to institutionalize a professional civil service. The progress of political, economic and social democracy in developed countries cannot be understood without acknowledging the strength of their administrative institutions. It should come as no surprise, either, that the Latin American countries with the best indicators of social cohesion are those whose public institutions have the strongest traditions, including a career civil service. Consequently, there is a need to depoliticize the public administration and prevent its capture by private interests, leading to clientelism and cronyism. This is a vital step along the road to the kind of State that Latin American democracy needs today.

There is also a need to expand and improve public expenditure management capabilities. Sustainable and equitable growth depends on the quality and efficiency of public policies and management. It is therefore

essential to increase the fiscal capacity of governments, together with their responsibility. A particular priority must be to adapt resource allocation systems to the needs of the poorest and to tailor systems of provision to their specific circumstances, providing them with opportunities for direct participation and engagement. To achieve all this, it is essential to depoliticize the public administration and prevent its capture by private interests, as already noted. It is the role of public administration to provide the basic institutional platform for the design and implementation of public policies that reflect the general interests of society.

Lastly, any approach to State reform will need to deal both with the ideological baggage associated with this and with the logic that reduces it to a mere set of technical problems. State reform can only be arrived at through incremental adjustments conceived on the basis of a political economy that is grounded in the achievable. Reality shows that ideas, not ideologies, are what gradually drive progress towards solving problems. This holds true for the design of the State: there are few viable options associated with flags of a particular colour, but there are opportunities for gradual and usually cross-cutting changes requiring broad consensus and support from society as a whole.

By the same token, to treat State reform as an exclusively technical problem distinct from politics is to ignore a reality that reappears over time in unsuspected forms. It has become increasingly clear that the countries which have been able to make sustainable progress are not those which have subordinated political logic to purely technical criteria. Only when there is some kind of entente between technical and political rationality, when reforms have been presented and discussed openly and without fear of the political cost, when there has been cross-cutting investment in local knowledge and collective appropriation of plans and projects, do we see advances which, albeit slower, prove more sustainable and equitable. It is important to emphasize that, apart from some basic common ground in relation to macro balances, the most successful countries display a very diverse range of institutional and political reform models. But another common trait is that they have devised innovative ways of solving their problems, each striking a particular balance between political and technical rationality. This is perhaps the most important lesson from reform in such countries as Chile and Brazil.

*(Original: Spanish)*