

Economic Paradigms and Latin American Development Theory: The Search for Nirvana

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I.

INTRODUCTION

The pursuit of the optimal, economic development paradigm in Latin America has proved to be as elusive as the search for nirvana. This paper will describe and put into context the major theories of economic development that have served as the basis for Latin American trade policy, both in the United States and Latin America.¹ I will do so by first analyzing the modern theory of economic and political development articulated by Walt Rostow and others.² I will then examine the theory of import substitution principally put forth by Raúl Prebisch and the United Nations Economic Commission for Latin America.³ Thirdly, I will consider the neo-liberal economic development theory first articulated by the University of Chicago-trained economists who served in the Chilean government led by General Augusto Pinochet.⁴ I will then conclude with a number of observations regarding the analysis and applicability of these paradigms to the Latin American context.

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1. This article is based on a panel presentation, considering the topic of trade, development, and economic theory in Latin America, made at LatCrit X, Critical Approaches to Economic Injustice (Oct. 8, 2005). Other speakers explored specific issues on this topic, including "Cuba and the IMF: Conflicting Visions of Globalized Capital Flow and the Obligations of Debtor States;" "Argentina: Crisis and Law, A Critical Analysis of Law and Economics;" and "Trade Negotiations of Trade Capitulations – The European Union and the African, Caribbean and Pacific Grouping: A South African Experience."

2. See, e.g., WALT ROSTOW, *STAGES OF ECONOMIC GROWTH* (1961); Amy L. Chua, *Markets, Democracy and Ethnicity: Toward a New Paradigm for Law and Development*, 108 *YALE L.J.* 1 (1998-1999); Brian Z. Tamanaha, *The Lessons of Law-And-Development Studies*, 89 *AM. J. INT'L L.* 470 (1995) (book review); David M. Trubek & Marc Galanter, *Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States*, 1974 *WIS. L. REV.* 1062 (1974).

3. See, e.g., Raúl Prebisch, *Cinco Etapas de mi Pensamiento sobre el Desarrollo*, L. EL TRIMESTRE ECONOMICO 1077, 1084 (Mexico, Fondo de Cultura Económica, Abril-Junio 1983); U.N. ECON. COMM'N FOR LATIN AMERICA [ECLA], *The Economic Development of Latin America and its Principal Problems* (1950) [hereinafter ECLA Report].

4. See JUAN GABRIEL VALDÉS, *PINOCHET'S ECONOMISTS: THE CHICAGO SCHOOL IN CHILE* (1995).

II. THEORIES OF ECONOMIC DEVELOPMENT

A. *Economic Development and Modernization: The Unstoppable Train.*

The concept that economic and political development was an inevitable and evolutionary process that would eventually result in advanced economic, political and social institutions was first articulated by a series of American economists, political scientists and sociologists in the years after World War II.⁵ The economic articulation of this paradigm is best exemplified by Walt Rostow, who starts with the premise that the economic history of a nation or region can be broken down into a series of stages of growth, which are the product of political, social and economic forces.⁶ These five stages include the traditional society, the preconditions for take-off, the take-off, the drive to maturity, and the age of mass consumption.⁷

The traditional society is one whose structure is developed within limited production functions, based on pre-Newtonian science and technology and on pre-Newtonian attitudes toward the physical world.⁸ This society had limited productivity and devoted a very high proportion of its resources to agriculture. Flowing from this agricultural system was a hierarchical social structure with limited scope for vertical mobility. Notwithstanding the existence of central political organizations, political power generally lay in the regions, in the hands of those who owned or controlled the land. These landowners maintained fluctuating but usually profound impact over any central political power that may have existed and essentially held economic and political control over their regions. Examples of traditional societies include imperial China, the civilization of the Middle East and Mediterranean, and the world of medieval Europe.⁹

The second stage of growth, the preconditions for take-off, is a transitional stage from the traditional society. At this stage, scientific discoveries begin to be translated into new technologies that allow for the growth and increased efficiency of industry and agriculture. Economic progress begins to be perceived as a possible and desirable societal goal. Education, necessary for the understanding and application of modern technologies, becomes valued and serves as a mechanism for social mobility. Individuals or governments become willing to mobilize their savings and to take risks in the pursuit of profit from new economic activity. The scope and activities of commerce increase. Investment in transportation, communications and other "modern infrastructure" are made. Banks and other institutions that mobilize and direct the investment of capital appear.¹⁰ In short, a

5. Tamanaha, *supra* note 2, at 471.

6. See ROSTOW, *supra* note 2, at 2.

7. *Id.* at 4.

8. Rostow uses Newton "as a symbol for that watershed in history when men came widely to believe that the external world was subject to a few knowable laws, and was systematically capable of productive manipulation." *Id.*

9. *Id.* at 5.

10. *Id.* at 6-7. These more advanced societies also "exported" these technologies and societal notions to traditional societies, setting in motion a process whereby these traditional societies were exposed to "modern" economic, social, and political notions.

modern sector, which for a time will coexist with the traditional economic and political groups, begins to make its appearance. The emergence of a new urban-based elite, which competes with the traditional land-based rural elite and which must eventually supersede its social and political power, is also a critical element of this stage.¹¹

The take-off is the stage where “the forces making for economic progress,” which had made their entrance during the prior stage, achieve domination and control of society.¹² Economic growth becomes the norm and industrial expansion yields profits that are reinvested in new industry. Their requirements for factory workers, support services and other manufactured goods stimulate a further expansion in urban areas. New techniques in agriculture spur the commercialization of agriculture, and increasing numbers of farmers are willing to accept the new methods of production and concomitant changes in their way of life.¹³ The beginning of the take-off is usually caused by some sharp stimulus, such as political revolution, technological innovation, or the international environment.¹⁴

The drive to maturity is characterized by two economic changes. The first economic change is the increase of real income per person to the point where large numbers of persons have resources which can be used in consumption of goods beyond life’s necessities; the second is the change in the structure of the working class to one where its members are predominantly urban dwellers who work in offices or in skilled factory jobs.¹⁵ Economic resources tend to be increasingly allocated to the production of consumer goods and to the rendering of services on a mass basis.¹⁶

In the last stage, the age of mass consumption, the balance of attention of society, which takes an advanced industrial society as a given, shifts from the creation of wealth to the consideration of the purposes for which that wealth ought to be used. Three major objectives now compete for resources: the national pursuit of external power and influence, the use of the power of the state to redistribute income to achieve human and social objectives, and the additional expansion of consumption levels towards luxury goods and services.¹⁷

Three factors are striking about this paradigm. The first factor is the inevitability of the process. Although different countries will start this process of “economic modernization” at different times, and spend different times in different phases,¹⁸ all countries will undergo this transformation.¹⁹ The second factor is the direct interrelationship between the creation and growth of stable, powerful, and “modern” political and societal institutions and economic growth. Without the former, the latter will not occur. The last factor is the assertion that, for many, if not most countries, the preconditions for takeoff have arisen out of the “exportation” of

11. *Id.* at 26.

12. *Id.* at 7.

13. *Id.* at 7-8.

14. *Id.* at 36-37.

15. *Id.* at 10.

16. *Id.* at 11.

17. *Id.* at 73-74.

18. *See, e.g., id.* at 36-50, 50-67, 75-89.

19. *See, e.g., id.*, Table at p. 1.

modern technology, norms, and institutions from more “modern and advanced”²⁰ countries. Most importantly, the existence of free trade at an international level seems to be a critical precondition to this process.

Modernization theory represents the political side of this development paradigm. Essentially, development itself is an inevitable evolutionary process where increasing societal differentiation would ultimately produce “Western style” economic, political, and social institutions. The end result of this process includes a free market system, liberal democratic political institutions, and the rule of law.²¹ Four elements are deemed to be essential to political development: rationalization, nation building, democratization and mobilization. Rationalization involves the process by which a society begins to value achievement, objectivity, and neutrality. Nation building emphasizes the development of national institutions, which in turn fosters national integration, particularly critical in multi-ethnic, developing countries. Democratization emphasizes pluralism, competitiveness, and accountability. Lastly, mobilization, or individual participation in political life, is to be achieved by popular education aiming for the expansion of political participation.²²

Law is both a necessary element for the achievement of development and a useful instrument to achieve it.²³ It is essential to economic development because it provides the elements necessary to the functioning of a market system.

These elements include universal rules uniformly applied, which generate predictability and allows planning; a regime of contract law that secures future expectations; and property law to protect the fruits of labor. In theory, law assists political development by serving as the backbone for the liberal-democratic state. Law is the means through which the government achieves its purposes, and it serves to restrain arbitrary or oppressive government action.²⁴

How, then, can the nations of the “developed world,” those nations who have achieved economic and political maturity, assist developing countries in achieving these goals? This assistance required the provision of financial and technical expertise and resources that could be used to build modern institutions and to provide capital financing for the creation and improvement of economic facilities and resources. This assistance was rendered by international institutions, such as the World Bank,²⁵ the International Monetary Fund,²⁶ and the United Nations,²⁷ and by

20. See, e.g., *supra* note 11 and accompanying text.

21. Tamanaha, *supra* note 2, at 471.

22. *Id.* at 417-72.

23. Trubek & Galanter, *supra* note 2, at 1073.

24. Tamanaha, *supra* note 2, at 473; see also David M. Trubek, *Toward a Social Theory of Law: An Essay on the Study of Law and Development*, 82 YALE L.J. 1, 6-9 (1972-1973); Trubek & Galanter, *supra* note 2, at 1073-1074.

25. See World Bank, Int'l Bank for Reconstruction and Dev. [IBRD], *Articles of Agreement*, Art. 1 (amended Feb. 16, 1989) available at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20049563~pagePK:43912~menuPK:58863~piPK:36602,00.html#11>.

26. See International Monetary Fund, *Articles of Agreement of the International Monetary Fund*, Art. I, available at <http://www.imf.org/external/pubs/ft/aa/aa01.htm>.

27. See, e.g., Tamanaha, *supra* note 2, at 474 (suggesting that the United Nations and its various instrumentalities have been especially involved in the creation of international and harmonized

countries like the United States.²⁸

Unfortunately, this approach did not work. All the technical assistance and monetary assistance provided to “developing” nations did not create and strengthen modern institutions or promote economic growth. Instead, they entrenched local elites, destabilized traditional societies, wasted resources, and enmeshed many countries in insurmountable debt.²⁹

B. ECLA and Import Substitution

The import substitution and integration theories and initiatives of the United Nations’ Economic Commission for Latin America, hereinafter ECLA, and its long-time executive secretary, Argentine economist Raúl Prebisch, during the 1950s and 1960s represent the antithesis to the development paradigm of modernization. Unlike Rostow’s theory, Prebisch did not view economic and political development as neither an inevitable nor a linear process; rather, his theory of development divided the world economy in two: the center and the periphery.

The center consisted of countries that had reached a high degree of industrialization. Such countries consumed primary goods, that is raw materials, and produced a large number of finished goods, which were then exported to the rest of the world.³⁰ Developments in technology and increases in productivity lowered the production costs of the center’s finished goods, which in turn increased the demand for them.

All countries not in the center were in the periphery of the world economy. Countries in the periphery exported primary goods to the center and imported the finished goods, using their scarce capital and foreign exchange to pay for them.³¹ The countries of the periphery found themselves in a difficult position: technological innovations did not affect the production of primary goods as it did that of industrial goods. Demand and prices of primary products were far more volatile than those of finished products; further, technical advances could effectively eliminate the market for their primary products completely.³² Competition from the big multinational enterprises destroyed those few industries that have been formed in the periphery, and shortages of capital prevented the development of new industries.³³ This resulted in the countries of the center becoming richer and richer while the countries of the periphery remained poor.

Prebisch challenged the unequal distribution of gains from trade between the center and the periphery and the inadequacy of market mechanisms in stimulating development.³⁴ To solve these problems, Prebisch proposed that the countries of the periphery engage in a policy of substitution of the finished goods

legal norms).

28. See, e.g., VALDÉS, *supra* note 4, at 81-87 (describing post-war United States’ foreign aid and technical assistance programs).

29. See, e.g., Tamanaha, *supra* note 2, at 473; Sammy Adelman and Abdul Paliwala, *Law and Development in Crisis*, in *LAW AND CRISIS IN THE THIRD WORLD I* (Sammy Adelman & Abdul Paliwala eds., 1993); Chua, *supra* note 2..

30. ECLA Report, *supra* note 3, at 8.

31. *Id.* at 16-18.

32. *Id.* at 13-14.

33. *Id.* at 37.

34. VALDÉS, *supra* note 4, at 94.

that were being imported from the countries of the center.³⁵ The state, the only actor in these countries who was powerful, technically competent, and “objective” enough to implement such a policy, was to manage this industrial development.

The import substitution policy had a number of characteristics, which included, first of all, a limitation on the growth or even a reduction in imports of finished goods from the countries of the center.³⁶ Furthermore, the policy encouraged the creation of new industries, financed by savings achieved from the limitation of imports, government expenditures, and funds from international organizations,³⁷ to produce previously imported goods for which there was a local demand. In order to produce a competitive product, these industries needed access to the latest technology and incentives to make the product attractive and affordable. Moreover, these infant industries required protection protected from foreign competition and foreign takeover through the use of tariffs, limitations on foreign investment, subsidies, and other similar devices of governmental regulations.³⁸ As such, the import substitution model was premised on state management of the process of economic development. Because of its attributes of rationality, efficiency, and honesty, the government was presumed to be able to mobilize and unite all of the various economic and political interests in society and convince them to work together. At the national level, many countries in Latin America embraced the ECLA recommendations and adopted statutes limiting foreign investment³⁹ and mandating the transfer of imported technology.⁴⁰

However, once the new industries were created and functioning successfully, a new problem would arise, Prebisch predicted. Given the small size of most of the countries in Latin America, their markets would not be able to absorb all of their production. In order to thrive, the new industries would need to export their production abroad, which would require competition with more advanced industries of the countries of the center. The solution to this problem as anticipated by Prebisch would also require economic integration on a regional scale. This would be necessary in order to attract capital and technology to a larger market, which would enable the producers of these newly manufactured products to increase their efficiency. This process of economic integration had to be a gradual one, one that could culminate in a common market.⁴¹

Indeed, Prebisch and ECLA were highly instrumental in the creation of a Latin American common market, spearheading its process. In fact, their studies on

35. ECLA Report, *supra* note 3, at 6, 15-16.

36. *Id.* at 46-47.

37. *Id.* at 6, 56-57.

38. *Id.* at 53.

39. See Julio C. Treviño, *New Rules Affecting Foreign Investment in Mexico-The 1973 Law on Foreign Investments*, in New York University, International Institute on Tax and Business Planning, 1974: DOING BUSINESS IN MEXICO 23-36 (Newberger, ed., 1974) (describing the prototypical example of this genre, the Mexican 1973 Law on Foreign Investments) [hereinafter DOING BUSINESS IN MEXICO].

40. See Mariano Soni, *Principles Governing the Transfer of Technology-Basic Requirements of the New Law-Practical Problems and Experiences under the New Law*, in DOING BUSINESS IN MEXICO, *supra* note 39, at 37-64.

41. ECLA Report, *supra* note 3, at 6-7; JUAN MARIO VACCHINO, INTEGRACION LATINOAMERICANA: DE LA ALALC A LA ALADI 34-36 (1983); Prebisch, *supra* note 3, at 1077, 1084; Robert J. Radway, *The Next Decade in Latin America: Anticipating the Future from the Past*, 13 CASE W. RES. J. INT'L L. 3, 13 (1981); MICHAEL S. WIONCZEK, LATIN AMERICAN ECONOMIC INTEGRATION 74 (1966).

interregional trade and regional integration during the 1950's set the stage for discussions regarding the possibility of the establishment of a Latin American common market or another form of regional economic cooperation.⁴²

The ECLA created a Trade Committee in 1956 to analyze and recommend solutions to problems arising out of interregional trade. At its economic conference in Buenos Aires in 1959, the Trade Commission discussed the possibility of a common market or free trade zone, and its participants agreed on the desirability of a common market. ECLA then established a Working Group on the Latin American Common Market, which first met in Santiago, Chile in 1958. At an ECLA conference in Panama City, Panama in 1959, this Working Group presented a draft proposal, which was extensively discussed and then followed by intensive negotiations among the governments in the region.⁴³ These discussions and negotiations resulted in the execution of the Treaty of Montevideo in 1960,⁴⁴ which created the Latin American Free Trade Association ("LAFTA").⁴⁵ LAFTA was the first effort to implement ECLA's integration recommendations and create a generalized regional Latin American economic organization. For a number of reasons, it failed miserably and finally disbanded in 1980.⁴⁶

Unfortunately, the ECLA/Prebisch model of economic development did not work either. The countries of Latin America that embraced this model found themselves no better off than under policies adopted under the modernization and development theory. There are a number of reasons why this model failed. First, the linchpin of the process, government, was generally not powerful, rational, technically competent, effective, efficient, honest and objective, as was presumed. Indeed, its institutions were often weak, incompetent and corrupt.⁴⁷ Furthermore, the infant industries that had been created under this model, protected from foreign competition and possessing a captive market, had no incentive to become competitive. Accordingly, they remained unprofitable and failed. The failure of regional integration schemes like LAFTA limited potential export markets for those industries that had been able to manufacture competitive products. Moreover, many of these industries were owned by a bloated public sector, which did not have enough resources to provide adequate financing for them or to construct or maintain the infrastructure they required. Technology transfer laws generated an unintended consequence: holders of intellectual property rights on new technology, for fear of losing these rights, avoided importing them into countries with transfer of technology regimes. Lastly, the imposition of high tariffs on foreign industrial imports generated retaliatory tariffs from industrialized countries, limiting exports and growth.

Indeed, nirvana was not to be found either at the end of an inevitable

42. WIONCZEK, *supra* note 39, at 74.

43. *Id.* at 75.

44. Mercosul, Montevideo Treaty, Feb. 18, 2006 [hereinafter Montevideo Treaty], available at http://www2.uol.com.br/actasoft/actamercosul/espanhol/tratado_de_montevideu_de_1960.htm.

45. *Id.* at Art. 3.

46. See RAFAEL PORRATA-DORIA, MERCOSUR, THE COMMON MARKET OF THE SOUTHERN CONE 10-14 (2005) (describing LAFTA and the reasons for its failures).

47. See William Easterly, *Governments can Kill Growth, and Corruption and Growth in THE ELUSIVE QUEST FOR GROWTH: ECONOMISTS' ADVENTURES AND MISADVENTURES IN THE TROPICS* 217-40, 241-53 (2001).

process or through a process of assisted internal development. How then, could growth be spurred?

C. The Chicago School and Neo-Liberal Economic Theory.

The ECLA/Prebisch theory of development caused great distress and a strong reaction in the traditional economic circles in developed countries. Indeed, as a result of this reaction, a number of conservative economists, including a number of the faculty members at the University of Chicago's School of Economics, collectively known as the "Chicago School,"⁴⁸ entered the development theory debate.⁴⁹

The Chicago School believed that only classical economic theory was relevant to deal with development issues.⁵⁰ Its approach, based on the ideas and tools of neo-classical economic theory, appears to feature three major topics: the centrality of the free market, a reduced role for government, and the importance of the quantity theory of money.⁵¹

The market is viewed as the framework of free and informed individual exchange. Furthermore, it is the paradigm of a free and non-coercive social organization and the focus and the objective of economic scientific accumulation.⁵² Since the market is rational and efficient, it works. Because the market works, freedom becomes possible and is represented by three features: the private ownership of capital or productive assets, the private management of economic enterprise, and the existence of competitive enterprise.⁵³

Government, on the other hand, is a form of monopoly that interferes with the market and inhibits freedom by denying individuals economic choices. Government should, therefore, play a different role and not behave as a monopolistic force. This means that government should provide a process and system for modifying rules, mediate differences among participants regarding the meaning of the rules, and enforce compliance with the rules. It clearly should not be involved in the creation or maintenance of public economic monopolies.⁵⁴ In short, the critical role of government is that of "keeper and enforcer" of the rules voluntarily created by its citizens.

Lastly, the quantity theory of money becomes an extremely important factor in the equation. Its principal tenet is that inflation is, at all times and everywhere, a monetary phenomenon. Only a steady increase in the money supply, consistent with the real growth of the economy, can ensure price stability.⁵⁵ This conclusion is based on the premise that the general equilibrium of the economic system, its "natural state," insures price stability. This price stability and equilibrium can only be

48. See VALDÉS, *supra* note 4, at 52-59 (describing the growth and development of the "Chicago School").

49. *Id.* at 94.

50. *Id.* at 65-72.

51. *Id.*

52. *Id.* at 67.

53. *Id.* at 68-69.

54. *Id.* at 70 (citing MILTON FRIEDMAN, CAPITALISM AND FREEDOM 28 (1982)).

55. *Id.* at 71 (citing GEORGE MACESICH, MONETARISM, THEORY, AND POLICY 3 (1983)).

disrupted by inappropriate government intervention.⁵⁶

In the Chicago School's contributions to the development discussion, three principal areas of policy development policy gain primacy: free trade (and lack of protectionism) in the international arena, the cultivation of market institutions in developing countries, and the provision of foreign aid to stimulate growth.⁵⁷ From 1974, Chile became a laboratory for the Chicago School's theories.

1. The Chicago School and the Chile Experiment.

In 1970, Salvador Allende, a Marxist, who promptly sought to develop what he called the "Chilean Road to Socialism," was elected President of Chile. His policies included the nationalization of the Chilean copper mines, banks, and other foreign-owned assets and a massive redistribution of land. In 1973, the Chilean military launched a coup that overthrew President Allende and installed a conservative government led by Augusto Pinochet.⁵⁸ Appointed to senior government economic positions by the Pinochet government starting in 1974 were a group of economists, known as the "Chicago Boys."⁵⁹ Trained at the University of Chicago as a result of a joint program, funded as a foreign aid program by the United States government, between the Universidad Católica de Santiago, a conservative institution, and the University of Chicago,⁶⁰ these individuals had been in contact with the Chilean military prior to the coup.⁶¹

The "Chicago Boys" economic program was put in place from 1974 through 1980. Its principal purposes were to reduce the magnitude of the public sector, minimize the government's role in direct production and the promotion of development, and to minimize the government regulatory influence in the economy.⁶² The measures used to implement this program included the elimination of virtually all government controls on retail prices, the liberalization of the internal capital market, the establishment of private financing companies and the imposition of restrictions and regulations in the labor market.⁶³ The Chilean market was made more accessible to foreign trade by the reduction of import duties and tariffs. Chile left the Andean Pact and substantially liberalized its foreign investment regulations, giving "national treatment" to foreign capital operating in any economic sector.⁶⁴ Foreign investors were authorized to bring capital into Chile on an unrestricted basis and were given guaranteed access to foreign exchange. Moreover, banks were authorized to borrow directly from foreign sources and loan regulations were relaxed.⁶⁵

Other measures further limited government involvement in the economy.

56. *Id.* at 72.

57. *Id.* at 95.

58. Steve Kangas, *The Chicago Boys and 'The Chilean' Economic Miracle*, 1-2, available at <http://www.rojasdatabank.org/econom-1.htm> (last visited 2/25/07).

59. VALDÉS, *supra* note 4, at 18-21.

60. *See id.* at 127-165 (describing the development and implementation of this joint program).

61. Michael Rosch, *The Meaning of Technocratic Elites in Chile*, 2, available at <http://tiss.zdv.uni-tuebingen.de/webroot/sp/barrios/themeC1f.html>.

62. VALDÉS, *supra* note 4, at 23.

63. *Id.* at 21.

64. *Id.* at 21-22.

65. *Id.* at 22-23.

Government spending was dramatically reduced, and government employment fell by almost 20 percent in four years. An extensive program of privatizations covering every sector of the economy was undertaken and CORFO, the Chilean corporation for the promotion of industrialization, reduced its activities in promoting economic activity. Moreover, industrialization was de-emphasized, and mining, agriculture, forestry and fisheries were given primary importance. Lastly, as part of its support for a "monetary approach to the balance of payments," the government adopted the concept of dollar parity, retaining a nominal fixed exchange rate to the dollar from 1979 through 1982.⁶⁶

The results of these measures were inconsistent. For instance, the privatization process resulted in the sale of the state's share in 197 companies from 1974 through 1978. These sales took place during a recessionary period in the private sector and provided highly advantageous terms to the purchasers. Prices were low, and purchasers were only required to pay a small percentage of the purchase price, as low as 10-20 percent, in cash and could finance the remainder could be financed with long-term loans at interest rates of 8-12 percent. Such loans were even secured by the shares in the companies being purchased. These privatization sales resulted in major losses for the state and in the creation of a series of highly concentrated private financial groups chiefly financed through massive indebtedness.⁶⁷

Further, the Chilean government's elimination of price controls, deficit reduction measures, opening of the Chilean markets to international trade and financial liberalization were meant to defeat inflation. Unfortunately, inflation was not so easily defeated and, in 1980, after seven years of reform, the inflation rate still stood at 35.1 percent. Only in 1981 did it decrease to 10 percent.⁶⁸ Further, economic growth was highly unstable. Although extensive foreign capital inflows permitted growth rates of 8 percent in 1977 and 1979, great decreases in economic growth were also recorded in other years.⁶⁹ As a consequence, average GDP growth from 1974 through 1981 was approximately 2.6 percent.⁷⁰ The resulting massive cuts in state spending in areas such as health, education, family benefits and salaries substantially affected Chile's working classes.⁷¹ Since the government did not believe in the regulation of private enterprise or government intervention in the private sector, the government did not interfere with or limit the accumulation of private external indebtedness. As a result, private debt in Chile increased massively, from under \$2 billion in 1978 to over \$14 billion by 1982.⁷²

In 1982, as a result of an international economic recession, the Chilean economy collapsed. Chilean exports were severely curtailed and GDP fell 15 percent. Moreover, industry and construction contracted by over 20 percent, effective unemployment reached 30 percent and bankruptcies tripled.⁷³ The private

66. *Id.* at 23-24.

67. *Id.* at 26.

68. *Id.* at 25.

69. *Id.* at 26. ("In 1975, the Chilean economy experienced a 17 percent drop in economic growth.").

70. *Id.*

71. *Id.*

72. *Id.* at 27.

73. *Id.* at 28.

financial groups suffered losses of twice their capital⁷⁴ and had to pay extremely high interest rates on their massive foreign loans. The situation became so critical, and the collapse of the biggest financial groups so imminent, that they had to be financially rescued by the state.⁷⁵

These events led to a period of very unstable economic decision-making. The government first devalued the peso by 18 percent and instituted a system of daily exchange adjustments, which led to a run on the peso and a sharp fall in the Central Bank's reserves. The Central Bank then implemented a program of purchasing risky portfolios from debtors and set a preferential exchange rate for debts in dollars, which could be adjusted for inflation.⁷⁶ Chile sought to negotiate agreements with international financial organizations and creditor banks to obtain funds. The International Monetary Fund, the World Bank, and others supplied the Chilean government with an annual average of \$760 million per year from 1983 to 1987. The commercial banks allowed the rescheduling of foreign debt repayment and offered new funds to cover interest payments. These funds allowed the Chilean government to subsidize the repayment of a number of these loans by the banks and financial sectors.⁷⁷ In response to business sector and consumer complaints, measures were also taken to deal with the problems of other debtors, who had often been forced into bankruptcy. Policies to stimulate exports were also undertaken and the government introduced greater regulation of economic activity. The economy finally began to recover and GNP began to grow by an average of 7.7 percent a year.

From 1987 on, the money supply grew moderately, fiscal accounts moved into surplus, and a trade surplus helped offset the external debt service payments.⁷⁸ The Chicago experiment had essentially been abandoned. A number of other countries tried variations of the Chicago experiment, with massive privatization, deregulation and tariff reductions. Their results were no better.⁷⁹

2. A Revival of the Chicago School: The Heritage Foundation Index of Economic Freedom

Approximately a decade ago, the Heritage Foundation ("Foundation"), a conservative American research and educational institute, revived the theories of the Chicago School.⁸⁰ The Foundation, in conjunction with the *Wall Street Journal*, created the "Index to Economic Freedom, an annual publication meant to describe economic freedom around the world and create benchmarks to judge a country's chances of economic success."⁸¹

74. *Id.*

75. Kangas, *supra* note 58, at 4.

76. VALDÉS, *supra* note 4, at 263.

77. *Id.*

78. *Id.* at 264-65.

79. See THOMAS L. FRIEDMAN, *THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY* 315-17 (2000).

80. See Heritage Foundation, Mission Statement, available at <http://www.heritage.org/about> (stating the mission of the Heritage Foundation is "to formulate and promote conservative public policies based on the principles of free enterprise, limited government, individual freedom, traditional American values, and a strong national defense").

81. Heritage Foundation, 2007 Index of Economic Freedom, at xi, available at <http://www.heritage.org/research/features/index/index.cfm> [hereinafter Index].

The 2007 Index starts by noting that the concept of economic freedom is based on the ability of individuals to achieve their goals and satisfy their needs.⁸² It is defined as “that part of freedom that is concerned with the material autonomy of the individual in relation to the state and other organized groups.”⁸³ The Index is an average of ten individual freedoms, which are important to the development of personal and national prosperity.⁸⁴ These include business freedom, trade freedom, monetary freedom, freedom from government, fiscal freedom, property rights, investment freedom, financial freedom, freedom from corruption, and labor freedom.⁸⁵ These ten factors are weighted equally, and each one is graded using a scale from 0 to 100, where 100 signifies maximum freedom.⁸⁶ All countries in the world are examined and ranked according to this criterion.

Not surprisingly, the authors of the Index find that economies in the Americas are stagnating.⁸⁷ The only Latin American country found to have a high degree of economic freedom and prosperity was Chile, which was ranked 11th in the world in terms of economic freedom.⁸⁸ Most of the countries in the Americas received a score between 50 and 80 percent for economic freedom.⁸⁹ Two countries were denominated “repressed economies, “which is an economic freedom score of 49.9 percent or lower.”⁹⁰

The similarities between the concepts propounded by the Index and those articulated by the Chicago School are not accidental.⁹¹ The international arena shows deep involvement in the global economy, which reflects the benefits of globalization.⁹² The free market has proven superior over all other fields since it yields the best results for society and workers. Similarly, the labor market is essential to economic prosperity. Freedom in the labor market is just as fundamental to the concept of economic freedom as any other market. The components of the basic market principle of free, voluntary exchange consists of free choice, free pricing, and free competition resulting in improvements in innovation, price reduction, and consumer prosperity.⁹³ Limitations on the labor market, such as government interventions through labor regulations, actually produce adverse consequences in efficiency and employment.⁹⁴ Lack of limitations on the labor market should translate into creation of new jobs and more employment.⁹⁵ Indeed, the Index is essentially a repackaging and reintroduction of the Chicago School paradigm in a quasi-empirical format. Accordingly, it has the same difficulties as its predecessor.⁹⁶

82. *Id.*

83. *Id.* at 37.

84. *Id.*

85. *Id.* at 38-39.

86. *Id.* at 39.

87. *Id.* at 64.

88. *Id.* at 65-66.

89. *Id.* at 66.

90. *Id.* at 65-66. These two countries are Cuba and Venezuela.

91. *See supra* notes 48-57 and accompanying text.

92. Index, *supra* note 81, at 28.

93. *Id.* at 28.

94. *Id.* at 29.

95. *Id.* at 30.

96. *See* JEFFREY D. SACHS, THE END OF POVERTY: ECONOMIC POSSIBILITIES FOR OUR TIME

III.

CONCLUSION: THE SEARCH FOR NIRVANA COUNTRIES

The above discussion supports a number of conclusions regarding the assumptions and assertions of the various paradigms.

First, Rostow's modernization development theory has a number of problems. Of principal concern is the fact that modern experience makes it clear that economic progress and "development," however defined, is not an inevitable and linear process. Moreover, external pouring of money and technical expertise into "modern institution building" in less developed countries does not necessarily result in effective, competent, efficient or honest institutions. Similarly, external pouring of money and technical expertise into the development and establishment of new industries and industrial facilities in less developed countries does not necessarily result in the establishment of successful industrial facilities.⁹⁷

The ECLA/Prebisch import substitution development paradigm has similar faults. The substitution of market mechanisms for state management as the principal catalyst of economic development does not work. Nationalization of private industry and the creation of new public industries creates a bloated public sector which constitutes a massive monetary drain on often limited public income. This situation results in inadequate funding for either economic development or government services. The state as a manager is not generally technically competent, objective, effective, or efficient to be able to manage an extensive economic infrastructure. Moreover, private and public "infant industries," nurtured by protective import substitution mechanisms, never seem to mature and become either regionally or globally competitive. High tariffs, imposed as part of an import substitution regime, merely invite retaliation from industrialized countries, which results in damage to export markets. Technology transfer regimes imposed by developing countries did not result in the acquisition of new technology. To the contrary, they will cut off access to new technologies because the owners of the new technology will not want to lose their rights to it. Lastly, limitations on foreign investment do not stimulate domestic capital investment. To the contrary, they prevent much needed foreign capital from coming in.

On the other hand, the Chicago School's paradigm is also imperfect. As was seen in the case of Chile, the elimination of state regulation, intervention, or involvement in the economic system does not necessarily result in increased economic growth and stability. It can result in instability, increased debt, and chaos. Privatization of government-owned industries as an ideological imperative often results in "fire sales," causing great economic losses to the state and the creation of monopolistic or quasi-monopolistic concentration of industrial power in small groups. Excessive dependence on foreign capital inflows, both debt and equity, can create massive instability. Excessive private foreign debt can devastate an economy, the Chilean situation in 1982 demonstrates. Excessive reliance on foreign equity investment is also problematic, since the foreign investors attracted by favorable conditions may leave if they find more favorable conditions elsewhere. Lastly,

(2005) (critiquing the Index).

97. A good example of this is the experience of Ghana with the construction and operation of an aluminum smelter. See EASTERLY, *supra* note 47, at 25-28.

excessive and exclusive reliance on monetarist macroeconomic policies to resolve structural economic problems may exacerbate these problems.⁹⁸

If none of these paradigms is appropriate to resolve the problem of economic growth and "development" in Latin America, what are we to do? The problem is that these paradigms view the "process" of development in a very simplistic way. The modernization theory views development as a natural and inevitable process that is primarily internally driven and merely requires some "tweaking" by external actors in order to be successful.⁹⁹ To the import substitution theorists, development is a centrally planned and executed internal process where government management takes the place of market forces. Its antithesis, the Chicago School, views development as a global process that should be exclusively market driven and where government should have a minimal role, if any.

Instead, economic growth is a complicated process with many variables.¹⁰⁰ These variables are interconnected with each other and include economic, political, geographical, historical, technological, environmental, educational, population, cultural, and other factors.¹⁰¹ The management of these variables requires comprehensive solutions which embrace their interconnections and which involve economic, political, social, cultural and environmental policies working together. As the ECLA experience teaches us, functioning and relatively free markets and private initiative cannot be ignored and are an essential component of economic growth. Appropriate governmental regulations and policies, however, as seen in the Chilean experiment, are also essential to this process.¹⁰² Indeed, the optimal development paradigm is one that is adjusted to the individual situation of a particular country and which includes elements of all of the paradigms that we have discussed, together with those political, social, cultural and environmental policies that are appropriate for that country's conditions.

98. See FRIEDMAN, *supra* note 79, at 317.

99. This "tweaking" can take the form of capital investment, sharing of ideas, introduction of new technologies, financial assistance, technical assistance in "institution building," and the like.

100. See, e.g., SACHS, *supra* note 96.

101. *Id.* at 50-73 (describing these factors and their interconnections).

102. See FRIEDMAN, *supra* note 79, at 321 ("Good regulation does not mean zero regulation. The optimal level of regulation is not none, but may be less than what is currently found in most countries, and especially in poor ones.") (citation omitted).