A Never ending Recession?
On the Vicissitudes of Economics and Economic Policies and How Latin American Economies Pander to It[1]

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1 Introduction

The crisis facing the world economy since the end of 2007 has shaken to the core the economic paradigms that were the basis of models for economic policies and governmental roles for the past 30 years. The protracted recovery of the economies of the European Union and the United States is causing alarm, as the latest economic forecasts published by multilateral organizations suggest[2], and policy makers and their advisers suggest that the world is facing an economic *secular stagnation*, a period of low interests rates, low inflation, low growth and high unemployment (Summers, 2013), with dramatic negative impacts on incomes and equality.

Due to the global financial crisis, the ability of the market to unleash politically, socially and environmentally sustainable growth has been called into question, given that to be sustainable, growth must be inclusive, be able to reduce inequality and poverty, extend universal citizenship rights, and promote the rational use of the factors of production. The crisis challenged the unconditional acceptance of the democratizing effects of the free market and the foundations of the macroeconomy, based on the assumptions of classical and neoclassical economic theory and subjected to the fundamentals of microeconomics. This led to questioning the nature of the policies supported by these principles. The alleged credentials of economic theory – as an exact science, politically neutral, and with predictive capacities – have been essentially called into question. One of the few, if not the only, positive effects of the crisis has been the return of economics to the social sciences. This return is especially important for macro economics, in which economic theory cannot be separated from politics.

There is concern about the future of capitalism, that the progress in economic liberalization will be reversed, and populism – beaten down when observed in

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[2]See: IMF (2014), OECD (2014) and ICMBS (2014).

developing countries and tolerated when applied in developed countries – will return. The crisis was confronted with some monetary quantitative easing to save banks, plus austerity measures, deep cuts in public spending, which constitute one more step towards dismantling the welfare state that was initiated with structural reforms 20 years back. These cuts eliminated inalienable civil rights won by workers in long and hard struggles, and replaced them with the right to obtain credit to meet basic needs or acquire public goods.

The economic crisis of 2007-8, which affected the global order, was not predicted. The surprise was best expressed by Queen Elizabeth's question, during a visit to the London School of Economics in November 2007: "It's awful! Why did nobody see it coming?" (RDMP, 2009). UK's monarch sparked an intense exchange of communications among leading economists, competing to give the sovereign a satisfactory answer.[3] It highlighted the crisis in economic theory as a social science and opened a still ongoing debate. The political establishment and the media mirrored this race for explanations and justifications.

What remains of all this eagerness to ask questions and seek answers? It seemed that at least the financial arrangements would be reordered. Neither Europe nor the United States have emerged from the crisis (IMF, 2014; ICBM, 2014), nor has the power of the large financial institutions weakened. Or so it seems.

Governments fall and citizens are impoverished, but the liberal orthodoxy responsible remains in place. However, it would be inaccurate, or perhaps fallacious, to claim that "nobody saw the crisis coming". Many predicted it and raised the alarm (Galbraith, 2009). These voices were ignored by the carriers of 'politically correct' economic thought, in an exercise of intolerance towards positions critical of the orthodoxy of the "neoclassical repression" (Rogoff, 2002),[4] by which papers challenging the orthodoxy were not accepted in leading economic journals.

The limitation of macroeconomic theory of modelling only that which can be sustained by the microeconomic foundations of the representative agent in a general equilibrium

[3] The *Financial Times* established a panel to debate the future of capitalism and the measures to save it, and maintains the blog 'The Future of Capitalism': http://blogs.ft.com/capitalismblog. President Sarkozy convened heads of states and social scientists for a discussion on 'New World, New Capitalism', and *The Economist* devoted several issues to the crisis of macro-economic theory and financial economics, including comments by Nobel Prize winner R.F. Lucas. The OECD created the forum 'Measuring the Progress of Societies' to find ways to measure the progress of nations.

[4] "There are more than a few of us in my generation of international economists who still bear the scars of not being able to publish sticky-price papers during the years of new neoclassical repression" – Rogoff, K. (2002, page 9).

framework led to the predominance of econometrics over economic theory and to deviations in its teaching, which aroused concern years before the current crisis. In 1988, the American Economic Association formed a commission[5] to assess graduate economic theory programmes in American universities. In its report, the commission (American Economic Association Commission, 1991) lamented the fact that economic theory had become a branch of applied mathematics, detached from real world events and institutions. According to the commission, U.S. graduate programmes "produce generations of economists, *idiot savants,* well versed in techniques but innocent of real economic facts" (American Economic Association Commission, 1991). The major flaws described were a lack of teaching in history, philosophy, geography, institutions, and of course, economic theory, as well as not reading the classics.

This trajectory continued, programmes were not modified, and deficiencies identified by the commission even intensified – to the extent that in September 2000, students of economics at the École Normale Supérieure in France protested against the excessive mathematical formalization in the teaching of economic theory, not due to a rejection or fear of mathematics but to the "schizophrenia" created by choosing modelling, in place of reality, as the route to developing theory. They called for the end of the hegemony of neoclassical theory and the return to pluralism and a willingness to consider "concrete reality" (Post Autistic Economics, 2000). Similar movements were launched in Argentine universities, and also called for supporting social movements that rejected the FMI mandated "adjustment". The inequality resulting from policies backed by the neoclassical theory model, exacerbated in its turn by the crisis, is the principal policy advice multilateral organizations and the subject of intense theoretical reflection[6].

It does not appear that a great amount of progress has been made down the route of return to pluralism and considering "concrete reality", at least not in the USA or the UK. Simon Wren-Lewis (2010), of the London School of Economics, describes the depression he feels when listening to brilliant economics students saying they would love to explore some real-life problems, but refrain from doing so because the microeconomic assumptions are unclear.

[5]Journal of Economic Literature, September 1991.

[6]In the recent book *Beyond Outrage: What Has Gone Wrong With Our Economy and Our Democracy, and How to Fix It* (2012), Robert B. Reich, professor at Berkeley, documents that "modern capitalism", consolidated over the past three decades by concentrating wealth, erodes its sources of growth and undermines democracy. The richest 1% of the US population accumulated 45, 65 and 93 per cent of the income growth during the Clinton, Bush and Obama administrations. The OECD (2011) laments the concentration of income and warns of the damage to social cohesion and the system that it implies.

This essay first discusses recent changes in economic theory and the paradigms that were the basis for economic development. The economic crisis, past and present, destroyed economic theory paradigms. Secondly, some not-so-flattering observations are presented, regarding the trajectory followed by Latin American economies following the implementation of structural and liberalization reforms, closely related to the neoliberal paradigms installed as dominant ideas which in Latin America were first instrumented in Chile and Argentina in the seventies.

2 Economic crises and the crisis of economic theory

In the attempt of explaining the current crisis, two processes can be identified that feed on one another: firstly, the transformation of economic theory since the end of World War II; secondly, the transition from pluralist concepts to analytical reductionism with the enthronement of the neoclassical school as the dominant theory. As the economy moved from the post-war *golden age of capitalism*, to the post debt crisis *great moderation* era, and from there to the *great recession* of today, economic theory and macroeconomics adopted metaphors from physics and applied them to society, under the principles of perfect competition and rationality based on complete information.

Economic crises, like any type of crisis, demand reflection on the course of events. Crises have led to profound changes in the political and economic standards of societies and the institutions that regulate them, since a crisis weakens the forces and arguments that support the status quo (Alesina *et al.*, 2006). However, other interpretations suggest that prevailing paradigms remain and survive longer than they should, and society invests resources and wastes time trying to adjust the irreparable (Stigler, 1982).

3 From the classics to the neoclassics: what is economic science for?

Economic theory, since Smith and Ricardo, is based on physics metaphors (Jomo, 2005) in the idealization of markets and in the reduction of individual behaviour to fully predictable selfish rationalism. In these metaphors, society, like the universe, is governed by the invisible hand[7], which in the universe keeps the cosmos in order and,

[7] Since Smith and Ricardo, metaphors are present in the language of economics: the invisible hand, time is money, bubbles, reheating, and the labour market. Econometric models are the mathematical formulation of these. The problem is not the use of metaphors, but rather which, why, and to what end they are used and, more seriously, that they obscure rather than help research. Krugman (1997) and Steven Landsburg (2010) suggest that the economic rhetoric comes from parables, and like those of Aesop, in order to have a clear moral it is not necessary for them to be true, or even realistic. They just need to be well told. "On the role of metaphors in the process of knowledge and learning and the development of economic

after disasters, restores balance. The rising of the sun, the phasing of the moon or eclipses take place and no human action can avoid them although they may be predicted with relative accuracy. In the economy, and in society, the invisible hand conserves and restores balance at a lower cost than that incurred if visible hands were to intervene.

According to Davidson (2012), Paul Samuelson is responsible for the proposal that in order to ascend from *the realm of history to that of science,* economic theory must adopt the methods of the natural sciences and build ergodic axioms which demonstrate that the economic future is predetermined by an ergodic stochastic process. Therefore, he states, the function of economists should be reduced to calculating the probability distributions of future prices and productivity. For Samuelson, Davidson goes on to say, economic events are repeated inexorably on a predictable path, so that based on past events, without considering the initial conditions, it is possible to predict events and respond to them without trying to alter their course. Therefore, once economic actors, motivated by individual interest, have reliable information about the future, they will correctly invest in what gives higher returns and therefore ensure global prosperity (Davidson, 2012: 3). Economists such as Lucas and Sergent, Cochrane, Mankiw, M. Friedman, and Scholes based their theoretical contributions on these axioms, and consecrated this method as the only approach to scientific research in economic theory, and as the rational basis of public policy (*Ibid*). This was the intellectual response to meet the demand for security and certainty of the *animal spirits*, without which capitalism cannot be sustained. Of course, there are departures of neoclassical theory emphasizing market imperfections. Stiglitz, for example, being a neoclassical, highlighted the problems of information asymmetry and other market imperfections that turn the market pathologically imperfect[8].

Ergodic models elevated economics to the rank of the natural sciences and dressed some economists in the 'emperor's new clothes' of political neutrality; and the models' proposals became irrefutable axioms, beyond all social, political, and historical context.

Stigler, in his Nobel Prize acceptance speech in 1982, explored the sociology of economists as powerful actors, and declared them responsible for the stagnation that economic theory had suffered since the scientific method of testing theories against reality had been abandoned. Thus, for Stigler, today good economists are no longer

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thought": Deirdre N. McCloskey *The Rhetoric of Economics* or Philip Mirowski (1994), as well as Arjo Klamer, Donald N. McCloskey, Robert M. Solow, 1989 or Arjo Klamer, 2007.

[8]Stiglitz, J. (1991), *The Invisible Hand and Modern Welfare Economics,* NBER Working Paper No. w3641.

those who are correct, but those that affect the profession as a whole. Which means that since it is harder to sell new ideas than new products, they apply the persuasion techniques of a street vendor: repetition, exaggerated claims, and disproportionate emphasis, and they eventually become preachers instead of scholars and theorists, (Stigler, 1955).

This metamorphosis of economic theory – as noted by Galbraith (1974) in his first conference as President of the American Economic Association – responds to the need to supposedly manage and reduce risk, as well as to the aspiration of subordinating the state and society to the dictums of the market and to “reject all heresies, in any organized form, that is to say, anything that seems to threaten the sanctity of property, profits, appropriate tariff policy, or the balanced budget, or implied sympathy for unions, public property, public regulation, or the poor” (Galbraith, 1974: 239).

He adds that by excluding power from the analysis and “...converting economic theory into a non-political discipline – neoclassical theory destroyed, by the same process, its relation to the real world" (Galbratih, 1974: 240). By distancing itself from the serious problems of the real world, Galbraith goes on to say, classical and neo-Keynesian economic theories limited themselves to proposing models that explain nothing and suggest incorrect solutions (*Ibid*.). Such proposals include, for example, the two most consolidated proposals in relation to global warming. On the one hand, that which prioritizes adaptation – that is, there is no need to intervene because it is the normal course of the planet and humanity can adjust to its changes – and on the other hand, that which while accepting the need to reverse or least contain warming, focuses the solutions on market mechanisms and pricing systems.

This state of affairs in economic theory can be traced to the 1970s, when economic science plunged into the great project of assimilating macroeconomics to microeconomics, which implies that from the study of the behaviour of individuals, it is scientific and feasible to analyse and solve problems related to growth, inflation, business cycles, external shocks, unemployment and income concentration (Jomo and von Arnim, 2009). In this effort, economists, armed with physics metaphors and the arsenal of long term time-series for wide universes, with dozens of countries, multiple variables, powerful machines and sophisticated software, tried, like physicists, to find a law, the universal law that explained everything. "If there were to be such an economic theory, there is really only one candidate, based on extreme rationality and market efficiency. Any other theory would have to account for the evolution of individual beliefs and the advance of human knowledge, and no one imagines that there could be a single theory of all human behaviour" (Kay, 2009). To account for scale economies, increasing marginal returns, involuntary unemployment and waste of resources would lay to rest the axiom of perfectly competitive markets.

Macroeconomic theory abandoned the complexity of the real world and distanced itself from the issues explored by the pioneers of development economics, such as Prebisch and Furtado, and by the structuralist school (notions such as increasing economies of scale, or the role of history and institutions as historical creations), variables that were difficult to model at the time (Krugman, 1999). Orthodox economics, evolved under the premises of perfect competition and diminishing returns, took the simplification that could be modelled as if it was reality and consigned to oblivion the progress from the 30s and 40s (Krugman, 2009a).

In due course, the scientific method of testing hypotheses against reality was sacrificed for the sake of elegance, and gradually, economists have become more worried about "making an impact" than about research quality.

4 The forgotten lessons

Three transcendental events marked the end of three models of economic theory, revealing that the theoretical economic paradigms are neither eternal nor immutable. In fact, at all times, a number of theories have coexisted and it is feasible to apply multiple perspectives to explain the same event. However, for diverse reasons, not all of them economic, only one over-rules the rest. The epistemological fatigue produced by alternative approaches gained strength during the crises and forced advocates of the prevailing paradigm to face its limitations.

The first event was the crisis of the 30s, the great depression, which marked the end of an era of rapid growth in productivity, global trade and technological advances; the second, the stagflation of the mid-70s, which led to the debt crisis which ended the golden age of capitalism, or of the rebuilding of the economies devastated by World War II; and the third, the great stock market crash of 2008, which led to the great recession and gave the final blow to the period of the Great Moderation, the long period from the early 1980s to mid 2007, during which inflation was controlled and recessions in developed countries were relatively mild but intense and frequent in the developing world (Ocampo *et al*., 2010b). Several crises affected developing countries: the debt crisis at the dawn of the 80s, the Tequila from 1994-1995, and East Asian of mid 1997, which after disturbing Russia and Latin America spread to almost all developing countries. Brazil and Argentina also suffered economic shocks. All of these occurrences, like the Great Recession, were caused by "excessive risk-taking and the exuberance of the financial markets" (Stiglitz, 2010 cited in Ocampo *et al*., 2010b).

4.1 On the Great Depression

The Great Depression ended the faith in the market's ability to regulate the economy and make the necessary adjustments to overcome cycles. The collapse of the stock market in 1929, economic stagnation, and the fall in demand made obvious the need to intervene. Interventions were needed not only in relation to the euphemistically named ‘externalities’ or market imperfections, but also to maintain a minimum of economic activity and effective demand given the evident invalidity of Say's Law, according to which everything that is offered for sale is sold. Keynes understood that. The crisis, Keynes argued, was more than an isolated episode and the capitalist system, to function in a satisfactory way, needs an agency viz. the state, to protect the system, print money and invest to maintain employment and sustain demand when crises demand it. He was especially critical of the financial sector, due to its propensity for short-term speculation.

One of Keynes’s most important contributions was the rejection of the ergodic method of classical economic theory, arguing that the axioms of this school are applicable only to specific cases and not to contemporary economic conditions, from which it logically follows that adverse outcomes can result from wrong conclusions (Davidson, 2012: 3)[9]. Indeed, the insistence on the validity of the ergodic axioms led to the qualification of the experiences of China, India and some countries of Latin America as temporary deviations from the normal path of capitalism which, sooner or later, were bound to adjust themselves.

Some theoretical and empirical shortcomings also contributed to the advance of neoclassical economic principles and the most dismal of the Keynesian paradigms. “On the theoretical front, Keynes failed to explain why unemployed workers would not offer to work for a lower wage, and why profit maximizing firms would fail to hire them. On the empirical front, Keynesian economics failed to explain stagflation (Farmer, 2012).

[9] Keynes also rejected the supposed neutrality of money and the substitutability of money and capital goods.

Therefore, economics returned to "the business cycle theory of the 1920s", Farmer added.

Then, as now, there was no shortage of economists who saw the crisis as a great opportunity for capitalism and, applying the parable of the broken glass, emphasized the benefits of destruction, its constructive effects, and minimized or abstracted its economic and social costs in order to emphasize that all countercyclical actions cause more damage than the crisis itself. The resemblance to current austerity proposals with emphasis on fiscal discipline and monetary control of inflation for Europe, the United States and Colombia, and generally in Latin America, is no coincidence (Sarmiento, 2002; 2005). One lesson, now preferred to be forgotten, is that by prematurely withdrawing the New Deal stimuli, the US economy again began to decline, and only recovered with World War II military spending (Krugman, 2009b).

4.2 From the golden age of capitalism

Keynesian assumptions dominated economic theory and political action, at least from the end of the war until the early 70s, during the phase known as the *golden age of capitalism* (Scott, 1991). During this time, all countries, developed and developing, grew at unprecedented rates[10]. The rapid growth created pressure on natural resources and accelerated inflation. The costs of depletion of natural resources appeared in the intellectual and political landscape, with the Club of Rome, OPEC, the petro-dollars, the preamble to the debt crisis, and the structural reforms.

The 'stagflation' of the early 70s ended the *golden age of capitalism* and opened the way for proposals that rejected Keynesian economic theory, in particular his recognition of lack of demand as a cause of crises, and refuted the idea of implementing active employment policies through public spending to maintain economic activity and domestic demand.

Starting in the 70s, many elements of classical economic theory gained traction again, this time with less analytical complexity and more sophisticated instruments, focused on price and product stability instead of growth, and also legitimized microeconomic fundamentals for macroeconomic analysis.

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[10]Latin America recorded the highest growth rates and reduced the gap between its GDP per capita and that of the United States. In this period (1945-1980), several Latin American countries, especially Argentina, Brazil, México, Peru, Venezuela, registered the highest rates of growth since the beginning of the Twentieth Century up to 2013.

The oil shocks and inflation of the late 60s prompted the general equilibrium models. The assumptions of individual rationality and market efficiency were fully incorporated into the econometric models: the representative individual became the lead actor. Due to the assumptions of perfect rationality and complete information, economic policy was labeled as ineffective in reducing unemployment. Since individuals know how the market works, they anticipate that any increase in public spending causes inflation and, in consequence, adjust wages and prices accordingly, which prevents (even in the short term) increased unemployment (Kaletsky, 2009). Unemployment became a voluntary decision of rational and informed individuals (Friedman, 1968). Therefore, the mass unemployment of the 30s, or the striking total unemployment in Spain (24.5%), and the dramatic unemployment amongst young people (53% of the economically active population) would be a *great collective vacation* (Krugman, 2009b).

The crisis of the 70s questioned the validity of the Phillips curve and the existence of the indirect relationship between unemployment and inflation. The inflation of the 70s and the debt crisis were followed by the economic and social costs of the lost decade, caused by the severity of the adjustments. The bias of the structural reforms *were not structural enough* (M. Lipton, 1991) since they only removed market restrictions resulting from the state's actions and kept intact the suppression of transactions or exchanges, emerging from the concentration of capital, production, knowledge and trade. As we shall see, in Latin America the theoretical basis of the reforms and the macroeconomic policies adopted were consistently applied: in Chile and Argentina during the 70s, and in other countries following the debt crisis of the early 80s, and under the adjustment and structural reform programmes of the International Monetary Fund, and the double conditionality established between the IMF and the World Bank.

4.3 The great moderation, or the dangers of stability

The liberalization of the economy in response to the debt crisis and inflation – that is to say, the removal of the state from economic management – set the course that would be followed by economic theory, economic policy and the foundations of social organization. On the one hand, the neoclassical ergodic axioms mentioned above were fully enthroned in theory and macro-economic policy, and on the other, the market and individualism were held up as the fundaments of all social action. Economic and political practice focused on the ultra-liberal ideology summarized in the phrase of M.

Thatcher (1987): "...there is no such thing as society. There are individual men and women, and there are families".

Far from being a purely technical project, which exclusively affects the economy and seeks only efficiency of public spending, the change of development model disrupted the structure of political power and the distribution of economic surplus, and transformed the relations between state and society, between and within capital and labour, and between social groups. By redefining the boundaries of the state, profitability was established as the guiding principle of the economy. Efficiency, profitability and competitiveness were recognized over equity as the guiding principles of public policy, and economists, it was said, needed not worry themselves about value judgments (Stigilitz, 1991). It deepened the separation between positive economic theory and normative economic theory, and abandoned the principle that efficiency and equity form a unit. This principle and the fact that market imperfections permeate the whole economic system and do not guarantee the optimal use of resources should be a topic of discussion between economists and politicians, as Stiglitz put it: "... these issues – and not the issues of whether the market economy attains the ideal of Pareto efficiency – are or ought to be the focus of discussion in democratic societies and not, as today, that the debate centres on whether with democracy the market ensures Pareto efficiency or not" (*Ibid*: 41). Equity was relegated to residual measures, separated from economic policies, in order to offset some of the damage caused by the exclusive preference for efficiency and capital profitability. There is a greater tolerance for levels of poverty or degrees of inequality, exclusion, unemployment and precarious employment, which were previously considered morally unacceptable.

The liberal model ushered in the era of The Great Moderation, if some cases are ignored, such as the crisis in the United States (mid-80s), the crises in Mexico (1986, 1994, 2009), and the later crises in Southeast Asia, Colombia and Argentina. The liberal model plunged the region into the lost decade, as a result of the severity of the adjustment and structural reforms, as discussed below.

The ‘Great Moderation’, a term coined by James Stock (2003) and legitimized by Ben Bernanke (2004), refers to the reduction in price and product volatility, and was brandished as empirical confirmation of the success of liberalism and market power to establish the optimal distribution of factors of production. Bernanke (2004) considers monetary restriction and central bank independence as key among the various causes of stability. Bernanke disregards as insignificant the political and structural causes: easy money, deregulated markets, currency revaluations, cheap imports and less severe external shocks, among others. The Great Moderation led Robert E. Lucas (2003: 1) to declare as solved, for many decades to come, the great problem of macroeconomic theory: the management or prevention of economic cycles. He limited the role of macroeconomic theory to the definition of appropriate incentives to induce individuals to work and save: low taxes and moderate public spending. For Lucas, the long-term welfare benefits deriving from better fiscal policies far exceeded the short-term potential benefits of management of demand, however optimal it may be (Lucas, 2003). In short, having tamed inflation and with available data and complex models, risks have been eliminated. Thanks to complete information, the markets are efficient and give the correct prices.

Efficient markets and correct prices were theoretical paradigms that endorsed the deregulation of financial and commodity markets, and guided the privatization and mergers of all types of businesses. All was well, or so it appeared, until the real estate bubble burst, in 2007-2008, ending the Great Moderation.

Several economists drew attention to the dangers that these axioms embodied, many using simple but revealing statistics, such as those shown convincingly by Galbraith (2009). One of the clearest perhaps was by Minsky (2008), who argued that long periods of stability induce the taking of greater risks with higher rates of return, which fatally lead to Ponzi schemes like Madoff, Stanford, and the Colombian Creole version La Pirámide de La Hormiga (The Ant´s Pyramid).[11] For Minsky, instability is intrinsic to the capitalist financial system, so it requires better and more refined control, rather than less regulation. Thus Minsky dared contradict the opinion of Greenspan (1998), who assured us that “information technologies have expanded markets to such an extent that governments, even the unbelievers, have no alternative but to deregulate ... The global financial markets are today, undoubtedly, more efficient than ever” (Greenspan, 1998: 1).

The crisis was foreseen and was avoidable, and only indifference and irresponsibility impeded it, as concluded by the extensive report of the United States Congress’ Financial Crisis Inquiry Commission (FCIC, 2010).

Clearly, the crisis that began at the end of 2007 has been long and deep by the standards of post World War II, and full recovery is still not in sight (IMF, 2014). It is also not yet

[11] A Ponzi scheme instrumented by David Murcia Guzmán. The name comes from the Putumayo city in which the scheme was located (2014)

clear which axioms have been permanently discredited, since, although several paradigms have been challenged, resistance to change is strong, giving life to the words of W. Faulkner: "The past is not dead. Indeed, it is not even past." In Latin America, the crisis hit countries with different intensities, and, as we shall see, the recovery has been slow if not fragile.

In his appearance before the US Congress to explain the financial crisis, Greenspan (2007) stated that the intellectual foundations on which the macroeconomic policies of the Great Moderation had been built (the hypotheses of efficient markets and correct prices) had collapsed because the models did not sufficiently assess risk. However, 18 months later, in his submission to the Financial Crisis Inquiry Commission (FCIC), while he did identify the “global proliferation of toxic credit securities” as the immediate causes of the crisis, he exonerated the policy of cheap money and mass deregulation by identifying the collapse of communism as one of the root causes of the crisis. According to Greenspan, by establishing the rule of capitalism and market economics throughout the world, the United States had become exposed to competition from countries with lower costs, that save too much and spend too little, especially China and other Asian nations (Greenspan, 2010). In the same forum, Stiglitz (2009) provided a more objective assessment of the causes and actors responsible for the crisis: banks, financial funds, controlling agencies, and governments failing to fulfil their duty to protect citizens.

5 Are the physics metaphors dead?

At the end of 2014, nearly seven years after the onset of the crisis, we can ask if a new economic model, or at least a new international financial architecture, is emerging as many expected (Ocampo *et al.*, 2010a), or if, as John Quiggin (2010) stated: "Some ideas … are difficult to remove, even when they has been shown to be erroneous and dangerous. They are neither living nor dead – they are undead, or zombie ideas.” The Great Moderation principles that lead to the actual crisis are still in force among academics, politicians and public administrators, although their lack of explanatory power, erroneous economic predictions and their toxic prescriptions have been consistently demonstrated, as shown by the financial crisis of the Euro, most recently in Cyprus.

Only time will tell which ideas will prevail: those that conform to scientific rigour, or those that ensure the elegance and parsimony of the models and satisfy vested interests.

Some propose to bury the *natural unemployment rate* (NUR) and the *non-accelerating inflation rate of unemployment* (NAIRU) which have been used to design monetary and fiscal policies although their difficult or impossible demonstration makes both the NUR and the NAIRU a dubious guide to economic policy. Both these assumptions have legitimized the high rates of unemployment, or high informal and precarious employment of the strategies focused on GDP growth with low inflation, and have undervalued active policies to counter the high and prolonged unemployment that the crisis has generated. Today, more than ever, the automatic return of the labour market to full employment is questioned, and the acceptance as normal of high long term rates of unemployment, the so called *jobless recovery* and *jobless growth* is staggering (Farmer, 2009). Accepting the validity of both the NUR and the NAIRU would require the admission, on the one hand, that it has risen sharply in recent decades, far above the 5% level considered normal, and on the other, of the futility of any attempt to revive the labour market. Nothing has to interrupt the *great vacation*, however, in Kalecky´s words unemployment is nothing more than an irrational waste of productive resource.

A more comprehensive approach points to the efficient market hypothesis (EMH)[12] as another axiom to lay to rest. The EMH credo supposes the rationality of investors and households, and assumes that, given the necessary information about the future, they make correct decisions about consumption or investment (Kaletsky, 2009; Greenspan, 1998: 1). Markets give reliable signals for resource allocation according to Pareto optimality (Kay, 2009). The EMH, applied to financial markets, implied the deregulation of hedge funds and derivatives (Puyana, 2011; Thaler, 2009) and, for others, is the source of energy – and natural resource intensive GDP growth, deforestation, pollution, and climate change (Woodward and Sims, 2006).

A clear conception of the EMH is that the future is predetermined and revealed by the information provided by the models, and, as described by Davidson (2012: 3), [13] it eliminates the constant reflexive interaction that takes place between the actors involved in the markets, especially the financial market, and ignores the effects of these

[12]Hypothesis proposed by Fama (1970) and criticized by Fox (2009), Thaler (2009), Bernstein (1996), Roubini (2006), and Shiller (2007), among others. Another criticism comes from a conservative author, who suggests that the current crisis proves that markets are not self-regulating and assigns the responsibility not to the government but to a market failure that market forces were unable to solve. Thus the deregulation of the financial market is responsible (Posner, 2009).

[13]Davidson criticises Samuelson for his endorsement of the ergodic models, because they eliminate the capacity for reflection and its effects.

interactions because "...what people think about today's market can affect and alter the future path the market takes. The future is not predetermined" (Davidson, 2012: 3).

Other critics (Shiller, 2005; Akerlof and Shiller, 2009) have described the EMH as one of the most remarkable errors in the history of economic thought, since economic agents are not perfectly rational, and often have moments of optimism that lead to *irrational exuberance*, followed by pessimism and withdrawal from the market. The agents tend to act as a herd, because in the markets both optimism and panic are contagious. While it is difficult to predict prices, it does not necessarily follow that the prices dictated by the market are correct. Greenspan, in his testimony before Congress in 2008, identified the EMH, the great exuberance and the to-act-as-herd instinct as direct causes of the crisis.

The negligence of economists like Greenspan and Bernanke, managers of public policies that affect us all, was in rejecting even the possibility that there was a housing bubble, or if it existed, that it could explode, since the market would promptly take care of its gradual deflation (Greenspan, 2004, and Bernanke, 2005, cited in Krugman, 2011).

The crisis also challenged the assumption of *complete information* about products, prices and risk. The mortgage crisis and speculative bubbles would not have been possible if all investors were fully rational and had known the exact value of all investment options (Ackerman, 2008). However, only beings with superpowers would be able to access the hundreds of thousands of disperse data related to prices and profits that would be required to make truly optimal decisions (Foyle, 2004).

Finally, another neoclassical paradigm under discussion as a result of the Great Recession is the concept of *Pareto optimality*. The most serious criticism relates to public policies that allocate public goods based on a narrow definition of social objectives which are distant from reality.

That the market is not always efficient in allocating resources and frequently fails to ensure a stable balance, is now a conclusion more generally accepted. There are goods that cannot be put in the market, such as human life, and others in which trade would be morally unacceptable (slavery, human trafficking). Justice, education and other public goods should be available for all and the access to them cannot be price rationed. Moreover, public policies always benefit some groups to the detriment of others, depending on the interests pursued by the dominant groups (Ackerman, 2008). Hence the optimum is rarely achieved (Stiglitz, 1991).

That not everyone benefited and many lost from the reforms leading to the prevailing liberalized market is evident from the increase in concentration of wealth that has occurred in the globe during the last three decades, disproving the macroeconomic neoclassical ‘trickle-down’ promises: the spill that would guarantee greater welfare for all if GDP grew. Something did not work as expected and clogged pipes meant that 1% of Americans took ownership of 93% of the additional revenue generated in 2010, as compared to 2009. In addition, the average income of a full-time worker is less than it was more than four decades ago - "meanwhile, those at the top have never had it so good" (Stiglitz, 2012: 1). The elite 1% of the richest Americans concentrates the power to influence and direct the definition and enactment of laws, regulations and policies that favour them, according to Stiglitz. For example, the bailout of banks with public funds, the labour flexibility laws, corporate incentives and tax policy, and the rejection of writing-off of mortgage debt or its renegotiation (Despain, 2012). To resolve the crisis, monetary easing should be accompanied by debt forgiveness to households, not banks. Ocampo *et al.* (2010a) and Ocampo and Stiglitz (2008) give clear ideas and arguments as how to analyse the intrinsic problems of the functioning of the global economy since the eighties, and proposes ways to reform and improve them. The ideal solution to the financial system is to transform the Special Draw Rights (SDR) into the major global reserve asset, creating a global fiduciary currency as the centre of the system (Ocampo *et al*., 2010a: 24). The solution is not easy for political resistance of the USA and other developed countries.

6 Social policies versus economic policies

The debate about the relationship between economic and social policies has been strengthened by the facts shown in previous sections and the publication of Capital in the Twenty-First Century[14] and the myriad of notes on the author's theoretical limits, arguments and statistical methods[15]. In synthetic form, the definition of growth as the ultimate goal of any economic policy subsumes all others. The definition of development and social policy typically accepted since the 70s is clearly based on this subordination, and enshrines GDP growth as the primary objective of economic theory and the central concern of economic policy (Lynn, 2003: 129). Growth has become, as revealed by the in-vogue definition of social development, the basis for political advancement since the 80s: "We conceive of social development as the natural complement to economic development, both for its intrinsic and instrumental value" (World Bank, 2005:2). Thus, social policy is reduced to no more than a complement to economic policy, which cannot affect either its essence or nature. For example, poverty programmes must limit themselves to relieving the more aggressive and harmful effects of the growth model (increased inequality, resilient poverty and precarious employment), since these can lead to 'disappointment' with democracy, or globalization, or both; to social conflicts of varying intensity; or to unexpected election results and undesirable populist governments (some from South America) with, for orthodox economists, unacceptable redistributive programmes. The desire to isolate and make social policy independent from economic policy has its origins in the separation of positive and normative economic theory, and leads to the false question of whether there are social and economic objectives that are independent and contradictory to each other – a meaningless distinction in economic reality. There are no economic objectives without social effects and vice versa – they form an indivisible unity. Exchange policy, for example, has clear distributional effects (revaluation is a subsidy to imports, and affects the production structure of importable and exportable goods and the labour market). It is also a subsidy to those with debts and expenses in dollars, and a tax on remittances. It changes the relative prices of importable, exportable and non-tradable goods. Curbing inflation has effects on employment, labour income, investment in education and health; on the labour force, its dynamic and productivity; and on economic growth.

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[14]Piketty, T.(2014) *Capital in the Twenty-First Century, Harvard UP*l

[15]For an exhaustive account, see **Real-world economics review special issue** (no. 69) on **Piketty's** Capital at: http://www.paecon.net/PAEReview/issue69/whole69.pdf

Finally, the alleged scientific superiority of economic theory (Edward, 2000; Becker, 1996) has ignited a debate about the relationship between economics and other social sciences. The assumed scientific superiority has led to the emergence and acceptance of the 'imperialism of economics in the social sciences'[16], and other social science disciplines are uncritically adopting the economic axioms currently under question among economists from different strands. Perfect markets and rational expectations invaded the study of voters' rationality, institutions, economic history, political uprisings and the drug trade. The study and interpretation of the institutions also adopted them to propose the third wave of structural reforms. It is also evident in social programmes, where the universal social rights of the welfare state are being replaced by targeted and conditioned cash transfer programmes. In these, it is assumed that the poor are rational beings and, as such, will respond correctly to bureaucratically established economic stimuli and sanctions. Once equipped with basic health and education, children from households in extreme poverty will be individuals with the skills and knowledge necessary to compete and triumph in supposedly perfect markets, in imaginary meritocratic societies. At this point society has done its duty, the responsibility now rests with the individual.

7 The lessons from Latin America

Several reasons validate concluding this essay on the crisis of economic theory and economic policies, with insights into the Latin American economic development, since the 1982 debt crisis, exemplified by the Mexican experience.

The first reason is that the process of reforms and structural adjustment that took place in Latin America in the 70s, 80s and 90s, and which intensified after Mexico signed NAFTA, have been repeatedly presented as examples of the successful implementation of economic liberalization, macroeconomic adjustment and fiscal discipline. The entire world, especially the countries now called 'peripheral Europe', has been advised to follow Latin American reforms as an exemplary safe route to sustained growth. C. Lagarde spoke in this vein in 2008, in declarations before her visit to Mexico, Peru and Brazil.[17] The International Monetary Fund chief prudently failed to mention that Latin

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16 For a detailed analysis of the imperialism of the economy, the abundant literature of Fine Ben, such as: Fine (2008) and Fine and Milonakis (2009a; 2009b).

17 Ms Lagarde in an interview to *iMFDirect*, stated: "...the new Latin America can provide some lessons to the developed countries about saving for a rainy day and controlling the financial system". Lagarde, C. (2011) 'Latin America-Taking the Helm' *iMFDirect* Retrieved on Sept. 10/ 2014 from http://blog-

America is the region with most inequality in the world, and that large numbers of the population have been and are being permanently excluded from progress and civil rights, and have never enjoyed a welfare state. Under the prevalent Latin American political conditions, it may be easier to establish cuts to basic social spending than in more plural, less discriminatory and more democratic societies. The International Monetary Fund chief, in her statements, neglected to mention that structural reforms in Latin America were initiated in the 70s in Chile and Argentina, during the military dictatorship of Pinochet and Videla, and subsequently in Mexico during the full power of the PRI regime – the 'perfect dictatorship' according to Vargas Llosa. In these countries the liberal reforms were earlier and more intensive and comprehensive than in other, less dictatorial or more democratic, Latin American countries (LAC).

Second, liberalization of foreign trade and the North American Free-Trade Agreement (NAFTA) were presented to the world, especially to developing countries, as the optimal integration into the global economy, by linking Mexico and the United States in a process of total and accelerated trade liberalization. Mexico and United States are highly contrasting countries in terms of their resource endowments, productivity, technological development, political might and military power. According to classical economic theory, this North-South trade agreement, of the most classical Ricardian cut, would maximize Mexican trade benefits and ensure higher economic growth rates than those Mexico had before NAFTA came into force. After two decades under the rules agreed in NAFTA, not one of these effects has emerged at the expected speed and intensity and the Mexican economy has not recovered the rates of GDP, productivity and employment growth registered during the import substitution period. Nevertheless, several Latin American countries, including Colombia and Chile, ten years later signed NAFTA type agreements, possibly to avoid being left out of the '*friends of the United States'* club. They followed the path initiated by NAFTA, without paying attention to the effects that were already being observed in Mexico. It could be said that leaders in Mexico, Colombia or Chile not only failed to read Linder (1961) Amsden (1986; 1989), Krugman or Rodrik, but also overlooked the real world lessons coming from Mexico and other countries.

imfdirect.imf.org/2011/11/25/latin-america-taking-the-helm/. Argentina confronted the 2001 crisis devaluating the peso and defaulting on payments, measures that Greece, Spain and Italy cannot adopt if they wish to stay in the monetary union.

Third, and linked with third, Latin America seems to be specializing in primary commodities, rebuffing to deepen industrialization, and ignoring the consequences of relying on the exports of natural resources and subjecting their economies to the *Dutch Disease symptoms* and the *natural course syndrome*. This "reprimarization" of Latin American Economies is a logical and expected effect of the liberalization of the regions' economies and foreign trade policies (Frenkel and Rapetti, 2011). All Latin American countries become engaged in a Ricardian exports pattern: on one side, Mexico and other Central American and Caribbean countries as exporters of manufactures inserted in global value chains, with low national value added and low labour intensity at individual product level and; on the other – Argentina, Brazil, Chile and Colombia amongst them – specializing in commodities and resource based manufactures.

Fourth, the growth spells Latin America experienced (2004-2008 and 2008-2013) are attributed to adjustment policies and liberalization. But most important, as proof that the actual main concern of Latin American policy makers and academics is how "to manage prosperity with equity"[18] and not how to restore growth and control inflation, the main tasks during the lasts decades (1980-2000). These assertions recall Lucas's (2003) dictum on the death of economic cycles mentioned above. The growth spells Latin America experienced before the 2008 crisis coincided with low inflation, rising commodity prices and a relaxation of the external constraints which were the constant restriction affecting Latin American growth.

Fifth, the region succeeded in reducing poverty and inchoately lowering income concentration, when in other countries, especially in the EU and the USA, the path was the opposite. For considering the above points, we will discuss the path of trade liberalization and its effects, since it was the centre element of the reforms. Further, we present in more detail the effects of economic liberalization, the reprimarization of exports and the reduction in inequality.

The liberalization path after the debt crisis: The liberalization of Latin American countries has been intensive and indisputable. For example, the external coefficient of Argentinean GDP grew from 10.3 % in 1970 to 34% in 2011 and descended in the two years after. The change observable in Chile and Mexico was from 14.5% to 65.8% and from 17.4% to 64.2%, respectively (WB, 2014). Table No. 1 presents the trajectory of

[18]Augusto de la Torre´s (World Bank, Chief Economist for Latin American and the Caribbean), comments at the OAS Forum on 'Prosperidad con Equidad: el Desafío de la Cooperación en las Américas', Washington, October, 2014. The same opinion was defended by Bustillo, Director of ECLAC office in Washington.

the liberalization of LAC economies. Some patterns emerge: (a) Chile and Mexico, the upmost liberal economies with an external coefficient that, in 2013, almost doubles the LAC average; (b) Argentina, Brazil and Colombia, with the lowest external coefficient in 2013 and (c), Colombia and Chile had between 1960-1970, the highest external coefficient of all countries represented in Table No. 1, and the liberalization of Colombia after 1990 was rather slow. In general, larger economies tend to have a smaller external coefficient since their larger domestic market and resource abundance would permit it. But Mexico does not fit this argument. All countries liberalized their economies and there is no clear ideological difference between the left-leaning regimes (Left of the Centre, LOC) countries and the centre-right and right as in the classification in Cornia (2012).

TABLE No. 1

External Coefficient of the economies of selected Latin American Economies 1960-2013

		EXTERNAL COEFFICIENT (EXPORTS+IMPORTS/DGP)100					G. Domestic Product	
	GDP Trillons US$ 2005)	Values in % GDP[1]			Annual growth rates[2]		Annual growth rates[2]	
		1960	1980	2013	1960-1980	1981-2013	1960-1980	1981-2013
Brasil	1.17	14.2	20.4	27.6	4.8	1.6	7.3	2.6
México	1.04	20.1	23.7	64.2	1.0	3.8	6.8	2.5
Argentina	0.33	15.2	11.5	29.3	-0.2	4.5	3.5	2.6
Colombia	0.21	30.4	31.8	37.4	0.6	0.7	5.4	3.6
Venezuela[4]	0.19	43.3	50.6	50.4	1.1	-2.0	3.9	2.3
Chile	0.17	29.2	49.8	65.5	3.6	1.0	3.6	4.8
Perú	0.12	41.6	41.8	48.4	0.5	2.6	4.5	3.3
Ecuador	0.06	36.3	35.0	63.6	1.2	2.3	5.5	3.2
Panamá[7]	0.03	ND	186.9	137.7	ND	-0.6	6.0	4.8
Costa Rica	0.03	47.6	63.3	73.9	1.7	1.0	5.9	4.1
Uruguay[4]	0.03	32.4	35.7	55.8	2.4	-1.0	2.2	2.5
El Salvador[5]	0.02	55.2	67.4	72.2	1.6	0.7	3.1	2.1
Bolivia[3]	0.01	48.9	46.8	85.1	0.0	-0.8	3.4	2.9
Paraguay[6]	0.01	ND	ND	92.7		0.7	7.0	3.6
Honduras	0.01	44.4	81.3	117.5	3.3	1.7	5.1	3.3
Nicaragua	0.01	49.8	67.5	92.9	1.8	5.0	3.9	2.0
	PROMEDIO	36.3	54.2	69.6	1.7	1.3	4.8	3.1

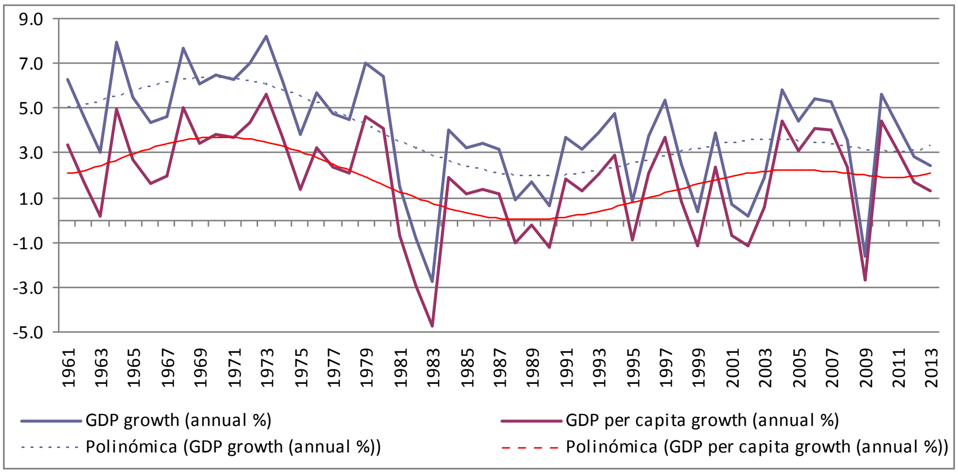
Source: Own elaboration based on WB, WDI, 2014

As to the speed of liberalization, Table No.1 suggests that in the period 1960-1980, several countries in Latin America (Brazil, Chile, Uruguay, Honduras...) did open the economy, reforming the Import Substitution model. In the second period, some countries, included the ones with the lower coefficient in 2013, opened their economies to external competition at high gear. Paradoxically, Chile, up to date the most liberal economy, opened its economy less rapidly than Brazil and Argentina. And Colombia, considered to be a radical orthodox economy, appears as moderate in exposing its economy to external competition.

And yet, the post liberalization growth path does not correspond with expectations, as Graph No. 1 illustrates. Structural reforms and liberalization, both within the framework of the WTO or in regional arrangements, were supposed to deliver a balanced macroeconomic environment conducive to higher growth rates and move the economy towards a new process of industrialization with higher levels of productivity, as well as stimulate private domestic and foreign investment so as to raise the rate of capital formation. All these effects were to improve employment and labour income. As we shall see, little of this has been achieved despite the undisputed liberalization, which took place at a different pace and intensity in each country.

Economic expansion after 1983, even the growth spells (2003/2008 and 2010/2013) have been lower than before the crisis (two last columns in Table No. 1, and Table No. 2). A similar course followed capital formation and labour productivity (Puyana, 2014). The rates of Latin American GDP growth, presented in Table No. 2, show the lower pace since 1980.

Graph No. 1
Latin American and Caribbean gross domestic product rates of growth.
In percentages. 1960-2013.



Source: Own elaboration based on WB, WDI, 2014

From both Graph No. 1 and Table No. 2, it is clear than not even during the years of faster growth, were the record levels of the decades before the crisis surpassed. It is clear as well that instability, measured by the standard deviation of the growth rates seems to be higher than before. So optimism has to be restrained.

Table No. 2
Latin American GDP Growth Rates. 1960-2013

	Annual GDP Growth		Standard Desves.	
	Total	per head	Total	per head
1961-1980	5.83	3.20	2.13	2.02
1981-2000	2.41	0.65	2.01	1.99
2001-2008	3.41	0.27	1.65	1.60
2009- 2013	2.71	1.56	2.71	2.68

Source: Own elaboration based on WB, WDI, 2014

The impacts of liberalization of capital and trade accounts, plus the brunt of the protracted appreciation of national currencies as a price anchor, were not made explicit. Under these conditions, productive investments do not flow due to a lack of profitability, and the registered growth of the economy has proved to be insufficient to boost job creation and prevent salary deterioration.

The liberalization of foreign trade increased the trade imbalance as a proportion of GDP, an indicator of the limits of foreign trade as growth driver. Among the variables that explain the growth of the region, and of each of the large and medium countries, trade liberalization has very little explanatory power – almost none – although the relation is positive in some countries (Colombia, Chile and Peru) and negative in others (Mexico, Argentina, Brazil) (Puyana, 2014). The changes in the tariff structure reduce the protection to domestic value added, which, combined with currency appreciation, has generated another type of substitution: that of national with imported labour. All in all, and despite significant trade liberalization, the region has not recovered the proportion of world trade that was recorded in 1960 or 1970.

The reprimarization of Latin American Economies: Economic liberalization opened the door to the reallocation of productive factors in accordance with competitive advantage and abundance of natural resources, and the resurgence of specialization based on it in accordance to the Heckscher-Ohlin model. Brazilian and Argentinean exports of commodities and food products constitute 63-65% of total exports. This proportion is similar to that registered in Costa Rica and Honduras, which export low technology final consumption manufactures inserted in global value chains. Again, as with the external coefficient, nothing clear-cut emerges between countries divided by political differences. Production and export structures of countries with larger economies and territories tend be more diversified and in commodities and food than small countries.

So, the Latin American neo-extractivism emerged along with an interesting theoretical debate on how to interpret it. There are two ways of looking at neo-extractivism: first, the increasing participation of commodities in total exports; and second, the resulting deindustrialization of open economies. Both processes are present in the trajectory of the region´s economies structures. Table No. 3 presents the structure several Latin American Countries and reveals the specialization in commodities and their manufacture. Mexico, Costa Rica, El Salvador and Panama figure as exporters of hi-tech manufacturing, a misleading data since even in Mexico the national value added of its exports is minimal and responds mainly to ensemble activities.

Table No. 3
Export structure of Latin American Countries. In percentage of total exports.

	Exports structure	**Specialization of exports**
Argentina	Materias primas (65%)	Alimentos (54%)
Bolivia[3]	Materias primas (95%)	Combustibles (55%)
Brasil	Materias primas (63%)	
Chile	Materias primas (86%)	Oro y metales (61%)
Colombia	Materias primas (82%)	Combustibles (70%)
Ecuador	Materias primas (91%)	Combustibles (58%)
El Salvador[5]	Manufacturas (71%)	Manuf de alta tecnología 4.7%
Costa Rica	Manufacturas (61%)	Manuf de alta tecnología 39.6%
Honduras	Materias primas (66%)	Alimentos (56%)
México	Manufacturas (74%)	Manuf de alta tecnología 16.3%
Nicaragua	Materias primas (95%)	Alimentos (90%)
Paraguay[6]	Materias primas (91%)	Alimentos (60%)
Panamá[7]	Manufacturas (93%)*	Manuf de alta tecnología 35.4%
Perú	Materias primas (85%)	Oro y metales (50%)
Venezuela[4]	Materias primas (97%)*	Combustibles (97%)

Source: Own elaboration based on WB, WDI, 2014

The debate intends to respond to two main questions: is neo-extractivism a new development model, and are the governments pursuing it neo-developmental ones? Gudynas (2012) describes neo-extractivism as a development path based on the "commoditization of nature" with an enclave type of production mainly for exports. The model depends on foreign investments and technology. Coinciding with Acosta A. (2012) he suggests that neo-developmental states use commodity rents to pay for social expenditure, reduce poverty and alleviate inequality, without taxing large capital earnings or changing the export lead model, therefore, for Gudynas neo-extractivism is a new economic model, which he names post neo-liberal. On the other side, Hans-Jürgen Burchardt and Kristina Dietzb suggest that the political ecology of neo-structuralism has not been sufficiently analysed. For them, despite the improvements in poverty and inequality, and in some cases in the labour market, neo-extractivism is not a new model and the neo-extractivist states maintain several elements of rentist states. The distribution of the rents could be one way to consolidate political support for a model that has several negative effects on distribution, democracy, employment and the environment. So, a conservative political consensus emerged based on "sharing the spoils, not on solidarity" (Burchardt and Dietzb, 2014: 476).

The reduction in poverty and inequality registered in Latin America is one of the arguments in favour of economic liberalization and structural reforms, although the reasons for the decline are not without debate. Abundant literature on the reduction of poverty and inequality in the region seems to confirm the gains even during and immediately after the 2008 crisis, and they attribute it to the emergence of democratic left wing regimes, especially in South America (Bolivia, Brazil, Chile, Ecuador, Uruguay and Venezuela).

Table No. 4 shows the long term trajectory of the GINI index of income concentration in several Latin American Countries, grouped by political orientation as suggested by Cornia (2012). Andrea Cornia (2012; 2014) provides a classification of countries according to their political orientation. He puts countries in four groups (Radical Left, Social Democrat Left, Centre, Centre Right and Right). For him, the biggest reductions are registered in countries at the *Left of the Centre* (LOC) and explained it in terms of the change of regime in 15 countries. Without commenting the problems related to such fine tuned classification, we would like to show that the progress in reducing Latin

American inequality depends on the period considered. In a long term perspective, to reckon the trajectory after the reforms, a long term perspective is needed and a different picture emerges. In several countries inequality was more intensive in 2010 than in 1960 or in 1980, and the reduction is minimal. During 1960-1980, almost all countries reduced inequality, and the process reversed after the reforms in the 80s decade. In the 2000-2010 period, the Radical Left and Social Democrat Left countries did manage to reduce inequality quite substantially indeed, but it took place after 2005. Some of the causes of this improvement cannot, however, be attributed to public policies, neither to an economic model that promotes a growth path with better employment, higher productivity and higher incomes, and progressive fiscal and labour policies.

Table No. 4
Latin America. Gini Coefficient evolution from 1960 to2010

Political regime	País	Índice de Gini						GINI growth by periods					Gini Growth. Average country groups					
		1960	1980	1990	2000	2005	2010	1960-80	1960-10	1980-00	1960-10	2000-10	1960-80	1960-00	1960-1(	1980-00	1980-10	2000-10
Radical Left	Bolivia			42.04[1]	64.3	58.47	50.8[2]		20.9	52.9	20.9	-21.0						
	Nicaragua	68.1	57.9	56.7	57.9[3]	53.2	47.8[2]	-15.0	-29.8	0.0	-29.8	-17.4						
	Venezuela	46.2	44.7	44	46.8	49	39.4	-3.2	-14.7	4.7	-14.7	-15.8	-9.1	39.3	-9.1	19.2	1.1	-18.1
Social-demcratic-left	Argentina	41.4	47.2	47.7	51.06	49.27	44.5	14.0	7.5	8.2	7.5	-12.8						
	Brasil	57	57.1	57.3	64[4]	61.3	57.6[2]	0.2	1.1	12.1	1.1	-10.0						
	Chile	48.2	53.1	54.7	55.22	51.79[5]	52[2]	10.2	8.3	4.0	8.3	-5.8						
	Ecuador	61	54.2	56	55.9	53.1	49.5	-11.1	-18.9	3.1	-18.9	-11.4						
	El Salvador	42.4	48.4	50.5	53.1	47.88	45.4	14.2	7.1	9.7	7.1	-14.5						
	Paraguay		45.1	57	55.8[4]	52.8	53.3		18.2	23.7	18.2	-4.5						
	Uruguay	37	43.6	40.6	44.39	45.87	42.2	17.8	14.1	1.8	14.1	-4.9	7.5	2.3	-1.3	8.9	-0.2	-9.1
Centrists	Costa Rica	50	48.5	46	47.4	47	49.2	-3.0	-1.6	-2.3	-1.6	3.8						
	Honduras	66	54.9	57	56.4[4]	59.51	56.7	-16.8	-14.1	2.7	-14.1	0.5						
	Perú	61	43	46.4	50.93	49.28	45.8	-29.5	-24.9	18.4	-24.9	-10.1	-16.4	-12.1	-13.5	6.3	4.4	-1.9
Centre-right and right	Colombia	54	59.13	56.7	58.68	55.1	55.7	9.5	3.1	-0.8	3.1	-5.1						
	México	60.6	50.9	53.1	54.2	52.8	48.1	-16.0	-20.6	6.5	-20.6	-11.3						
	Panamá	50	47.5	56.3	57.66	52.9	51.9	-5.0	3.8	21.4	3.8	-10.0	-3.8	4.5	4.5	9.0	0.3	-8.8

1 Gini 1991 y 2009. 2 Gini 2009. 3 Gini 2001. 4 Gini 1999.
Source: Own elaboration based on Cornia (2012), WDI (2014), CEPAL (2014) for index in green and Prados de la Escosura (2005) in red index.

Cornia lists external and internal causes for reductions in poverty and inequality among the first. He mentions the terms of trade improvements, rising remittances from workers abroad and larger access to international credit. The domestic causes of poverty and inequality reduction are: first, decline of the rate of dependence and the increase in activity rates; second, improvements in education levels and the reduction in higher education responding not to increase of wages of low skilled labour resulting from increase in the demand of that labour, but from the declining of real medium salaries of better educated workers; last but not the least, the effects of monetary conditioned cash transfers, fast economic growth and changes in fiscal expenditure.

Some lessons from Mexico.

The advancement of Mexican exports is the most notable amongst all Latin American countries, a real miracle as some called it in early 90s. In fixed year 2000 dollars, they grew from $24 billion in 1980 to $330 billion in 2013. Imports grew faster. Manufactured goods account for 85 % of external sales, and a similar proportion of these are products originating in *maquila*[19] and other temporary import programmes. Mexican exports of manufactured items incorporate low national value added, have low technological intensity, are intensive in imported inputs and despite its relative labour intensity, generate few jobs. In effect, while manufacturing exports advanced from 10 to 85% of the total Mexican foreign sales, its proportion of GDP and total employment stagnated (around 18% the first) or declined (to 10% the second). Hence, sectoral productivity gains have been achieved, but mostly by reducing employment rather than by increasing total production volume. These facts demonstrate the effects generated by the combination of full trade liberalization, dilution of labour regulation and exchange rate appreciation. In fact, the index of manufacturing openness is around 93 % of the sectoral GDP, due to the high imported content of manufactured exports.

In contrast to what was proposed, in Mexico neither capital endowment per worker nor gross formation of fixed capital have grown in relation to GDP, despite the increase in external financial flows. The increase in investments in the late 80s and early 90s is primarily explained by privatizations and acquisitions of existing companies, none of which raised capital stock. In 2013, the capital endowment per Mexican worker in 2000 dollars was about 3% lower than in 1980. Investments are made by a limited number of companies linked to either the export sector or activities that emerged during the import substitution industrialization, such as the manufacture of automobiles, chemicals, plastics, electronics, etc. When these activities and businesses are embedded in global production chains, they are located in the fragments of the production process with the lowest technological content, and the investments are not complex.

In corollary with the negative investment trajectory, the informal economy and informal employment are rising, with the former representing about 27% of GDP, and the latter around 63% of the total employed population (Puyana and Romero, 2012). The advance of the informal sector suggests, firstly, that the surplus of labour in agriculture has shifted to the cities and taken refuge in the informal sector, and secondly, that the movement of factors has not driven the growth of total productivity, neither labour nor a total of factors, as suggested in Puyana and Romero (2009) and several authors cited in that work.

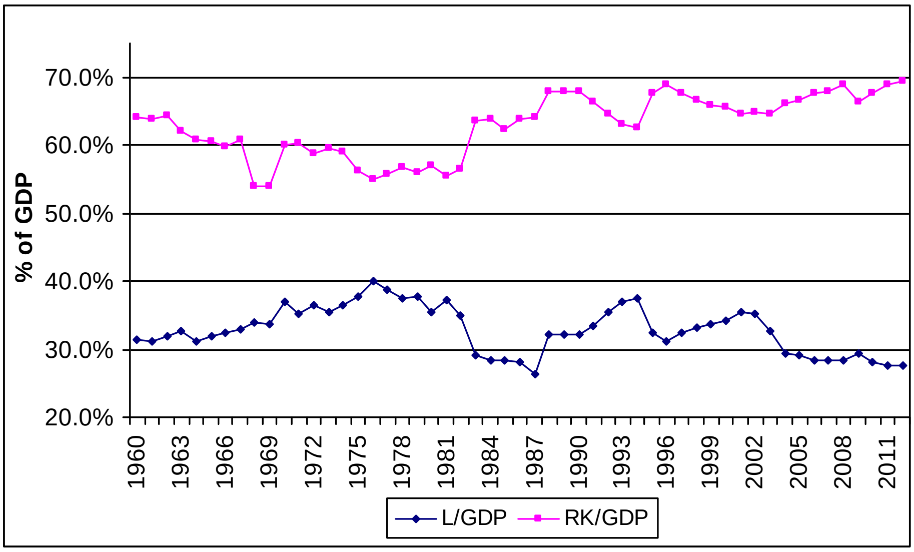
[19] A manufacturing operation in a free-trade zone, which imports material and equipment on a duty-free and tariff-free basis for assembly, processing or manufacturing, and then exports the finished products.

Both the reforms and the multilateral liberalizations (or NAFTA) seem to have failed to bring about change in the structure of GDP and employment towards the tradeable sectors with higher productivity in international terms. These have receded considerably and given way to services and construction, sectors which combined have lower productivity than manufacturing, although slightly more than agriculture. This composition of GDP and employment is a symptom of the premature receding of tradeable sectors, in a process that has intensified since 1981 and which also affects almost all Latin American countries, Colombia, Argentina or Brazil.

This context displays the most important failures of the reforms: their inability to guarantee sustained growth rates higher than those from the period of import substitution in Latin America and those registered in developed countries, which, in the case of Mexico, explicitly meant bridging the gap that separates it from the United States. It was said repeatedly that the push that NAFTA would give to exports and investments would be of such magnitude that Mexico would export goods and not people as the two economies converged. This has not happened, given that the Mexican average annual growth per capita in GDP during 1980-2011 was the lowest since 1900, and far less than that recorded in 1945-1980, when recorded growth rates of GDP per capita were higher than in the United States and the gap between the countries narrowed. Since NAFTA, migration has multiplied, reaching over half a million nett migrants per year and, *pari passu*, this has made remittances expand to over 24 billion pesos in 2008, with a strong effect on the earnings of at least four million poor households. Only the crisis in the United States and the militarization of the border has reduced migration and reversed the diaspora..

Besides the "export success", low unemployment – around 4.4% of the active labour force since 1982 – with inflation below 6% in the last year are presented as an example of the strength of the Mexican economy. Hence, the traditional low unemployment rate does not imply that the Mexican economy is in good health or approaching full employment, given the accumulation of informal employment, low productivity and low incomes. During the crises, the Mexican labour market adjusted itself in terms of income, wages, and changes in the relationship between formal and informal employment. The long lasting effect of the worsening of labour conditions is the fall of labour´s share in national income and the increase of earnings accruing to capital. Labour share decreased from nearly 40% of income in 1975 to just above 29% in 2012 (Figure No. 2).

Figure No. 2
Share of labour and capital in national income. 1960-2012



Source: From Puyana, A. 2014

The production of manufactured items presents a similar path: larger rates of growth of income (g) and lower in wages (r). In effect, for the period 1990-1013, the value of r-g was -13.48, signaling a major expansion of g. In comparison, for the period 1995-2013 we found gains in annual productivity which contrasts with declining in real annual wages per worker (Figure 3).

Figure 3
Mexico: Annual productivity per worker and real annual average wages per worker. 1995-2013. In thousand pesos 2010.

Source: Puyana, A. 2014

According to Lewis (1953), under conditions of abundant labour, real incomes rise when an economy moves from the earliest stage of classic development with abundance of labour, to the second stage, that of neo-classical development, with scarce labour and increases in the total labour income. Before reaching this stage, the benefits of growth accrue due to the absorption of surplus labour and not to the growth of incomes (Puyana and Romero, 2012)[20]. Our assumption is that the Mexican economy is still in the classical development stage of abundance of labour at a pre-Lewisian turning point, as a result of the pattern and dynamic of economic growth since the reforms. The surplus labour in agriculture has moved to the urban informal sector, let it be, domestic labour, trade, street traders and so on, and not to modern sector higher productivity activities such as manufactured goods and sophisticated services. So, agriculture and rural emigration in Mexico have taken place at an intensive pace without corresponding increases in labour productivity, and only with decreases in its share in total GDP and labour. Mexico and other Latin American countries did not promote the *agricultural revolution*, that is, accelerated increments in labour productivity and per hectare yields which Kaldor (1967) presented as necessary requisite for industrialization, which in turn is an indispensable development factor. Other authors such as Meier, G (1995 and 2000), Krugman (1997) and Rodrik (2013) arrived at the same conclusion years later. Industrialization is even more important for open economies intensively integrated in global markets. What a country exports matters for economic growth and income distribution. As Haque suggested, it does matter whether a country exports potato-chips or micro-chips (Haque Irfan *et al*., 1995). The failure to industrialize and to elevate agricultural productivity has put Latin American countries in a track of low growth-low income-low demand. This is an effect of the deindustrialization process resulting from depressed aggregate demand, spurred by the interaction with international economy (Patnaik, 2003) in not full employment conditions. In developing countries, even in the most dynamic emerging countries, full employment was and is not the norm.

Mexico, and practically all of Latin America, fully liberalized their economies so the movement of goods and capital is totally free, but labour is not and economic international migration is very costly. This partial factor liberalization accelerated the mobility of capital and increased the ratio capital/labour mobility. Therefore, capital is relatively more scarce, labour more abundant and the relative profitability of capital higher. From 1980 to 2012, Mexican real minimum collapsed and medium wages stagnated. Table No. 5 presents the index of real minimum and medium wages during 1980-2013. The index of minimum wages in 2012 was 68.3% lower than in 1980.

Table No. 5
Index of minimum and medium real wages. 1980-2013
Year 2000 = 0

[20]In Puyana and Romero, 2012, the Lewis model is analysed in detail, and its econometric formulation is developed and applied to the study of Mexican growth between 1940 and 2008.

	Minimum Real wage	Medium Real wages
1980	312	114
1990	145	89
2000	100	100
2010	97	113
2013	99	114

Source: Puyana, A. 2014

The problem is that in Mexico, as in other Latin American countries, there is evidence of an asymmetric reduction of the income elasticity of employment, which means that if the response of employment to falls in output is now less intense, the recuperation of employment when the economy expands is even more subdued. In other words, if one accepts the notion of a natural rate of unemployment, it appears to be rising. The liberalization of the economy and the expansion of exports have not encouraged greater labour absorption or its transfer to the tradable sectors with higher productivity.

Another factor to consider is the declining labour intensity of GDP, observed between 1960 and 2011. In Mexico it fell 40%, while in Colombia, Argentina, Chile and Uruguay it fell by more than 50%. This trend is the consequence of increasing productivity by substituting jobs for capital and maintaining lean output growth. This situation is paradoxical since with liberalization, the effective demand for the domestic product is global and, for small countries such as Colombia, Chile, and even Mexico, demand is assumed to be infinite and, except for a few products (such as Brazilian or Colombian coffee), their production and exports do not affect world prices. The reduction of production cost by importing better inputs at lower than domestic prices, or by the liberalization of labour and capital markets and tax cuts, have not been translated into more investments and higher output and employment growth, but rather into juicier profits and an elevation of the share of capital in income and decline in of that of wages, very clearly so in Mexico, as illustrated in figures No. 1 and 2 and commented in Puyana, A. (2014). That trend has translated into the fall of the index of real minimum and average wages. While average wages recovered the loss between 1980 and 1990, the real minimum wage index fell sharply, to represent by 2013 only 31% of the index in 1980. During this period, the proportion of people paid less than three times the minimum wages did not change, whereas to have the same purchasing power of a minimum wage in 1980, at the end of year 2013 a household required 3.2 times the minimum wages. So the balance of the Mexican liberalization is alarming: lower rates of economic growth, rather feeble expansion of productivity and the fall in real incomes and, with it, faint domestic demand.

Conclusions

There are grave doubts about the possibility of an economic paradigm shift being the outcome of the protracted global economic crisis. For a radical change to be feasible, a political change is needed, deeper perhaps than that which occurred in France in the last election or in those of other countries around the globe. I have in mind Argentina, Bolivia and Ecuador, for instance. The power of large financial interests is great and in the United States they have a legal license to promote the election of presidents, Congressmen and women, and the discretion to relentlessly lobby them. Latin America seems divided into two well-defined camps, with two distinct ways of making policy and directing the economy. Which of these will be predominant in the long term remains unclear. The changes in political power and economic policies in some countries such as Argentina, Bolivia, Brazil, Ecuador or Venezuela are interesting and important, but so far it is not clear whether they will last, or how far they intend to change the liberal export lead model in a meaningful degree. There are also doubts about the economic path the newly elected Indian Prime Minister will take and where the country will go.

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