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## **Globalization and Varieties of Capitalism: Lessons for Latin America**

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# Globalisation and Varieties of Capitalism: Lessons for Latin America

Sebastián Royo ♦

## Abstract:

In the opinion of some scholars, globalisation is imposing exigencies of increasing competitiveness on national economies that have compelled countries to deregulate their labour markets, welfare systems, and industrial relations. According to this view, these impetuses for change are pressuring countries to move towards an Anglo-Saxon model of capitalism. This paper will challenge the interpretation according to which the responses of countries to these pressures are uniform. Countries have choices and there is not a single model of capitalism that allows countries to be successful in a global economy. This paper will draw from the Varieties of Capitalism literature to outline lessons for Latin American countries.

## The Myth of Globalisation

This paper seeks to contribute to the ongoing debate about the impact of globalisation on national economies and on the policy autonomy of governments. Globalisation, defined as “the growing economic interdependence of countries worldwide through the increasing volume and variety of cross-border transactions in world and services and of international capital flows, and also through the more rapid and widespread diffusion of technologies,”<sup>1</sup> is considered the great economic event of our era because it involves the expansion of capitalism on a global scale and it is transforming the twentieth-century managerial capitalism into a new global financial one. Some scholars have noted that “much of the institutional scenery of two decades ago—distinct national business elites, stable managerial control over companies and long-term relationships with financial institutions—is disappearing into economic history.”<sup>2</sup> As a result, large part of the world behaves like a single economy, which means “an increase in the geographic range of locally consequential social interactions.”<sup>3</sup>

While globalisation is widely considered as the defining process of our time, this phenomenon is still highly contested and misunderstood. It has been the result of three processes: Technology development, and in particular enhanced communications and lower technology costs; second organisational innovations from Transnational Corporations (TNCs), which have been powerful engines of global economic integration; and finally, economic and trade liberalisation. In the last few decades it has been promoted actively by TNCs, states, international organisations (such as the World Bank-WB or the International Monetary Fund-IMF), and civil society.

It accelerated after World War II: The ratios of exports to output have risen from 12 to 17 percent since 1970; and there has been a deepening on the integration of financial markets: \$2

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<sup>1</sup> As defined by the International Monetary Fund, 1999. See Kesselman (2007).

<sup>2</sup> See Martin Wolf, “The New Capitalism: How Unfettered Finance Is Reshaping the Global Economy,” in *Financial Times*, June 19, 2007, p. 11.

<sup>3</sup> Charles Tilly, “Globalisation Threatens Labour’s Rights.” *International Labour and Working-Class History*. No. 47 (Spring 1995), pp. 1–2.

trillion per day; as well as a dramatic surge of technology transfers all facilitated by governments bound by multilateral agreements. However, it is not a new phenomenon, nor it is only a Western one.<sup>4</sup>

On the contrary, it could be argued that there has been an even higher degree of integration in previous decades. For instance, between 1870 and 1914, the United Kingdom's capital outflow in 1914 was nine percent of GDP, twice as big a share of GDP as outflows from Germany and Japan in the 1990s; gold was the world currency; there was even greater labour mobility at that time than nowadays; and the percentage of immigrants relative to the world population peaked in 1910 and has not returned to that level. The key difference now is the explosion and impact of free trade and capital mobility. The financial sector is now unbound.

Indeed, as noted by Wolf,<sup>5</sup> finance has exploded: the ratio of global financial assets to annual world output has increased from 109 percent in 1989 to 316 percent in 2005, and in that year the core of the global stock of core financial assets reached \$140,000 billion. Furthermore, finance "has become far more transnational oriented" because financial markets are increasingly performing the intermediation role that banks traditionally did, and new players (such as the hedge funds and equity funds) and products ("derivatives") are transforming the opportunities for managing risk and providing additional sources of funding. In addition, this new form of financial capitalism is more global than ever: for instance, international financial assets and liabilities from residents of high-income countries have increased from 50 percent of GDP in 1970 to 100 percent in the mid-1980s, and 330 percent in 2004; and the value of mergers and acquisitions jumped from \$850 billion (in 9,251 deals) in 1995, to \$3,861 (in 33,141 deals) in 2005. Finally, the share of developing country products in the manufactured imports of high-income countries has doubled since the early 1990s.<sup>6</sup>

Hence, some authors claim that globalisation is "not a choice [but] a reality," which has to be accepted because it is here to stay and even question whether it means the end to geography (Friedman: 2000). It has brought about the "flattening of the world" (Friedman: 2006). Others, however dispute the flattening of the world and point out that more than 90% of investments are still domestic, only 2% of the telephone calls are international, 95% of the university students study in their home country, and there is little evidence of salary convergence across countries that could be expected if the world was really flat and the frontiers would be irrelevant.<sup>7</sup> Yet, according to most observers it is the cause of outcomes in many spheres from production processes to public policies; as well as changes in areas such as culture, the environment, transnational cooperation, or migration patterns.

However, globalisation is becoming highly controversial, as unease about the effects of globalisation has been building during the past decade, and more and more people view it as an overwhelming negative force. Recent polls provide evidence that the citizens of rich countries feel that globalisation is more a curse than a blessing.<sup>8</sup> The opponents of globalisation claim that it is responsible for industrial desertification, higher unemployment, reduced social protection, increasing poverty, and inequality; it has a negative impact on small farmers, and lower wages that result from higher imports from developing countries. Furthermore, they contend that outsourcing also puts downward pressure on wages, that technological changes and global supply

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<sup>4</sup> Amartya Sen, "How to Judge Globalism." *The American Prospect* No. 13, Vo. 1 (2002).

<sup>5</sup> Wolf, "The New Capitalism," p. 11.

<sup>6</sup> Martin Wolf, "Employment Policies Can Ensure a Fair Share of the Feast," in *Financial Times*, March 11, 2007, p. 11.

<sup>7</sup> Pankaj, Ghemawat, *Redefining Global Strategy: Crossing Borders in a World Where Differences Still Matter* (Cambridge, MA 2007).

<sup>8</sup> According to an FT/Harris poll the number of Britons, French, and Spaniards who believe that globalisation is having a negative effect outweighs those with a more positive outlook by three to one. This feeling is rooted in the perception that the gap between rich and poor in their countries is widening. See "Poll Reveals Backlash in Wealthy Countries against Globalisation," "Globalisation Generates Dark Thoughts," and "A Difficult Sales Job," in *Financial Times*, July 23, 2007.

chains displace jobs, and that they foster labour fragmentation and weaken unions, while leading investment toward developed countries. This is so because employers are using the exit threat to move their operations offshore to take advantage of cheaper labour, as a bargaining chip in their negotiations with unions, thus resulting in a shift in power and income from labour to capital. In short, globalisation weakens the bargaining position of unions. As a result, salaries have been shrinking as a proportion on national income in OECD member states. Furthermore the integration of countries such as China and India in the global economy with their cheap and abundant labour, and the outgrowth of outsourcing of manufacturing and services are also putting downward pressure on wages. Consequently in the U.S. real hourly wages have been virtually flat (while productivity has increased by 70 percent).

At the same time, it is argued that globalisation fosters job insecurity for workers because it makes companies more vulnerable to external shocks, such as exchange rate fluctuations (OECD 2007). Finally, some scholars contend that globalisation causes extensive harm to the environment and people (i.e., patents), and that TNCs violate labour laws, pay low wages, damage the environment, and abuse workers.<sup>9</sup>

The supporters of globalisation, however, challenge these arguments and claim that, on the contrary, it promotes economic growth, thus reducing poverty and fostering equality; that developed countries benefit extensively because as a result of globalisation new jobs are created in other sectors and there are more exports to developing countries. They further argue that it promotes investment, productivity, and development; generates economic efficiencies that result from specialization, economies of scale, and lower costs of production, thus allowing countries to improve their competitive position, and brings benefits for consumers.<sup>10</sup> (Wolf: 2004; Friedman: 2000, 2006; Bhagwati: 2004).

These scholars contend that the transformation of capitalism is a good thing because active financial investors swiftly identify and attack pockets of inefficiency, thus improving the efficiency of capital everywhere; they impose the disciplines of the market on incumbent management; they finance new activities and put old activities into the hands of those who can exploit them better; they create a better global ability to cope with risk; they put their capital where it will work best anywhere in the world; and in the process, they give quite ordinary people the ability to manage their finances more successfully.<sup>11</sup>

To support their claims the advocates of globalisation dispute the notion that investment is flooding toward developing countries, among other reasons because most trade (94.5 percent) takes still place among industrialized countries; imports from developing to industrialized countries are only between three and eight percent of the latter's production, while imports from developing countries increased only from 1.1 percent of all imports in 1967–68 to 5.4 percent in 1987–89 (only 1.2 percent of OCDE countries' GDP). They recognize the impact of offshoring—moving production abroad, but they point out that offshored inputs have been moving more

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<sup>9</sup> Branko, Milanovic, "The Two Faces of Globalization: Against Globalization as We Know It." *World Development Journal* Vol. 31 No. 4 (2003), pp. 667–683; Vandana Shiva, *Stolen Harvest: The Hijacking of the Global Food Supply* (Cambridge 2000); David Dollar and Aart Kray, "Spreading the Wealth." *Foreign Affairs* Vol. 81, No. 1, (January/February 2002, pp. 120-133; Robert Hunter Wade, "The Disturbing Rise of Poverty and Inequality: Is It a 'Big Lie?'" In David Held and Mathias Koenig-Archibugi, eds., *Taming Globalization: Frontiers of Governance* (Cambridge 2003); Bernard D'Mello, "Reebok and the Global Footwear Sweatshop." In Jim Yong Kim., ed., *Dying for Growth: Global Inequality and the Health of the Poor*. Monroe (ME 2000); Joyce V. Millen and Timothy Holtz, "Dying for Growth, Part I: Transnational Corporations and the Health of the Poor." In Jim Yong Kim et al., eds., *Dying for Growth: Global Inequality and the Health of the Poor*. (Monroe, ME: Common Courage Press, 2000); Joseph Stiglitz, *Globalization and Its Discontents* (New York 2002); and Joseph Stiglitz, "Globalism's Discontents." *The American Prospect* 13 (1) (January 2002a), pp.16-21.

<sup>10</sup> Martin Wolf, *Why Globalization Works* (New Haven 2004); Thomas Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (New York 2000); Thomas Friedman *The World is Flat: A Brief History of the Twenty-First Century* (New York 2006); Jagdish Bhagwati, "The Demands to Reduce Domestic Diversity among Trading Nations," in Jagdish Bhagwati and Robert Hudec. *Fair Trade and Harmonization*. (Cambridge 1996), pp 9–40.

<sup>11</sup> Wolf, "The New Capitalism," p. 11.

slowly than total trade, and its rise has been driven by skilled (not unskilled) inputs.<sup>12</sup> They also highlight that unemployment and lower wages affect both qualified and non-qualified workers as well as manufacturing, service, and construction workers (which are largely shielded from external competition and should not suffer as much the effect of outsourcing) and that the percentage of TNCs production outside of their countries of origin is only six percent of their total production and 0.2 percent in services.

Indeed, the latest OECD report shows that trade appears to make only a modest contribution to increases in inequality and suggest that such increases may have more to do with technological changes (see OECD 2007). Finally, they claim that there are other factors that help account for wages' stagnation such as technological changes, or the fact that most new jobs are being created in the service sector with lower productivity (e.g., in the United States there was a reduction in the number of workers in the manufacturing sector from 28 percent to 16 percent between 1964 and 2000).

They also dispute the claim that globalisation has resulted in lower investment in developed countries, highlighting the fact that capital stock invested in developing countries is only 3.1 percent of all fixed capital; that most investment still takes place in developed countries; and that investment to developed countries decreased from 30.6 percent in 1967 to 23.4 percent in 1991, while the external debt resulted in higher flows to developed countries. Indeed, while North America accounted for 40 percent of global private equity in 2005 (down from 68 percent in 2000), Europe increased its share of investment from 17 percent to 38 percent.<sup>13</sup>

A recent report by the *American Chamber of Commerce in the EU* shows that globalisation has benefited the EU countries and could boost household income by 5,000 Euros within a few years. According to this study European countries have benefited from the "ring of prosperity" that is emerging around them, as Russia and countries in the Middle east and North Africa, which are benefiting from high commodity prices, have become important customers and thus boosted European exports. At the same time, this proximity to an expanding market has also attracted investment from US companies. As a result of this development exports from the EU15 to the developing world quadrupled to \$1,000bn between 1990 and 2006, and as a proportion of total exports they grew from 52 to 64%. Yet the report also acknowledges that some countries that compete with India and China in low-skilled industries have lost jobs: i.e. Portugal has lost a quarter of its jobs in industries like footwear. However, other countries like Ireland, which lost a similar proportion of jobs, have been successful attracting investment from companies' off-shoring into Ireland and replacing the jobs lost. Germany, although it has outsourced a significant number of jobs to neighbouring eastern European countries, it is still the world's largest exporter and has gained new jobs as it skilled labour has attracted research and development.<sup>14</sup>

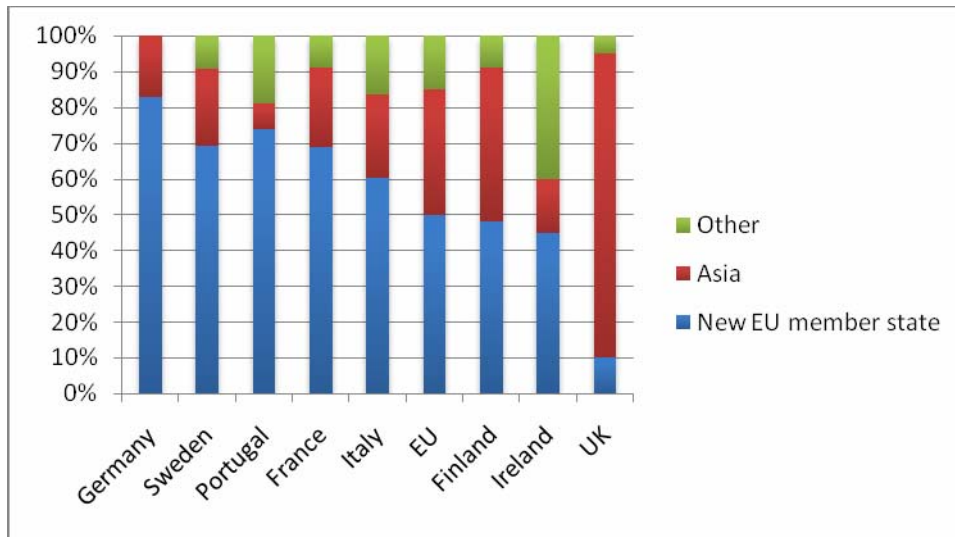
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<sup>12</sup> Martin Wolf, "Employment Policies Can Ensure a Fair Share of the Feast," in *Financial Times*, March 11, 2007, p. 11. He also points out that "imports of intermediate manufactured and service inputs accounted for only about 5% of gross output and 10% of total intermediate inputs in the high-income countries in 2003."

<sup>13</sup> Wolf, "The New Capitalism," p. 11.

<sup>14</sup> Study from the American Chamber of Commerce from Daniel Hamilton and Joseph Quinlan. From "Globalisation enriches EU, study says," in *Financial Times*, Friday February 29, 2008, p.2. The report also highlights that Europe needs to attract more skilled workers from abroad: only 5% go to the EU compared with 55% to the US. A failure to address this challenge could prove costly: for Germany it is estimated that the skills shortage could cost the \$27bn or 1% of GDP.

**Figure 1: Destination of Off-Shored Activities (% of jobs moved, 2003-06)**



Source: Amcham EU

Indeed, the empirical evidence shows that the impact of globalisation is uneven. Globalisation has resulted in cheaper imports and this has benefited the entire economy. While it is true that most of U.S. TNCs' sales (70 percent), fixed capital (78 percent), employment (73 percent), and value added is still based in their home country, that 90% of investments are domestic, and also that other factors such as infrastructure, productivity, and skills play a critical role in economic outcomes; it is also true that globalisation has shifted the balance of power between workers and employers in favour of the latter. Furthermore, while citizens throughout the world express legitimate concerns about the impact of globalisation over the falling share of wages in national income and increasing wage inequality, the evidence has shown that such concerns are often overestimated. Indeed the argument that globalisation is the culprit for the stagnation in real hourly wages in the last 25 years, despite a huge increase in output, has been contested. Globalisation, technological change, and labour market policies all have had an impact in labour income share. For instance, a new study has examined the wage-productivity gap and has shown that the 70 percent increase in productivity of the last 25 years is largely accounted for by rising nonwage benefits such as health insurance (60 percent), by using the correct deflator to adjust wages, by the shift of the workforce toward higher-skilled employment, which increases output and average wages (but not for those who are unskilled and work hourly), and by labour's smaller share of national income. According to this analysis real hourly wages have not been as flat since the early 1980s, as they have risen by roughly 1.5 percent a year. Furthermore, it shows that without globalisation economies would have grown more slowly, and hence most wages would have increased at a slower pace as well.<sup>15</sup>

Moreover, according to the OECD, wages in the OECD countries have been increasing in real terms in spite of offshoring, but the gap between the richest and poorest workers has widened in 18 of the 20 OECD countries (see Table 1). In 16 of the member states the earnings of the best-paid ten percent grew faster than those of the lowest paid ten percent between 1994 and 2005. Of the OECD countries only in Spain, Ireland and Japan the wages of the highest-paid have not outpaced those of the lowest-paid. For instance, in 1995 in Spain the top ten percent income

<sup>15</sup> Robert Lawrence, "Slow Real Wage Growth and the US Income Inequality: Is Trade to Blame?" in <http://ksghome.harvard.edu/~rlawrence/lawrence%20for%20brandeis.pdf>. From Clive Crook, "Why Middle America Needs Free Trade," in *Financial Times*, June 28, 2007, p. 9.

earners made 4.2 percent more than the bottom ten percent; in 2005, this proportion had decreased to 3.5 percent.<sup>16</sup>

**Table 1: Employment and Salaries in OECD Countries**

In Euros*	Average Annual Salary 2005	Average Annual Salary 2005 with Price Parity	Employment Rate 2006 (percent)	Unemployment Rate 2006 (percent)	Per capita GDP 2006 (UE-27=100)
Austria	28.909	26.396	70.2	4.8	129
Belgium	31.972	28.547	60.4	8.4	123
Denmark	39.672	26.751	76.9	4.0	127
Finland	28.199	21.581	68.9	7.8	117
France	28.305	24.197	62.3	9.8	113
Germany	27,880	25,172	67.2	10.4	113
Greece	18.404	19.719	61.0	8.9	89
Holland	32.308	28.846	72.4	44.4	131
Ireland	38.819	29.428	68.1	4.4	144
Italy	22.781	20.340	58.4	6.9	104
Portugal	13.538	14.701	67.9	8.1	75
Spain	19.754	20.093	65.7	8.6	102
United Kingdom	32.996	29.728	72.5	5.4	118
United States	33.428	33.428	72	4.7	-

- Original data in USD. Exchange Rate applied, 1.363 USD per Euro

Sources: European Commission, OECD and *Eurostat*. From: *El País*, Sunday July 8<sup>th</sup> 2007, p. 73.

Yet, for instance in Spain, despite the large numbers of jobs created (with a record employed population of 20 million workers), income from labour has reduced its weight in the total national income from 62 percent in 1992 to 54.4 percent in 2005 (in the EU this decline was more moderate: from 61.6 percent to 57.6 percent). This is owed to the poor quality of new jobs (typically not very productive, with little remuneration), which have pulled down the average salary around fourpercent between 1995 and 2005 (it is now about 20,000 Euros).<sup>17</sup> Unemployment in the OECD countries was still set to fall (from 33.6 million in 2006 to 32 million in 2007) (see Figure 1).<sup>18</sup>

In the end, the key is to understand the impact of globalisation on labour markets, institutions, and domestic structures. This is precisely one of the objectives of this paper.

<sup>16</sup> OECD 2007 *Annual Employment Outlook* (OECD 2007).

<sup>17</sup> “Los salarios pierden frente al capital,” in *El País*, Sunday, July 8, 2007, p. 73.

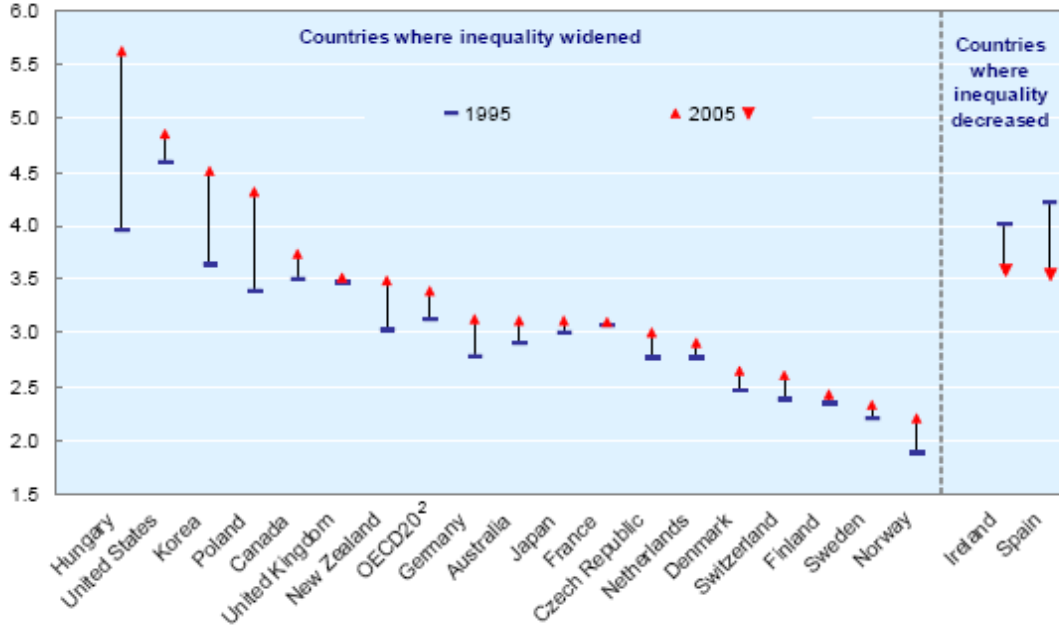
<sup>18</sup> “OECD Counters Globalisation Fear,” in *Financial Times*, June 20, 2007, p. 2.



**Figure 2: Earning Inequality**

Earnings inequality has tended to widen

Ratio of the 90<sup>th</sup> to 10<sup>th</sup> percentile earnings<sup>1</sup>



Note: The figure shows that in all countries except Ireland and Spain, the earnings of the 10% best-paid workers increased more than the earnings of the 10% least-paid workers, over the 1995-2005 period (i.e. earnings inequality widened).

1. Full-year, full-time workers. The data shown are consistent over time, but not entirely comparable across countries owing to differences in pay reporting periods and coverage of workers.
2. Unweighted average of countries shown in the figure.

Source: OECD database on Earnings Distribution.

From: OECD 2007 Annual Employment Outlook.<sup>19</sup>

At the same time this paper seeks to challenge the arguments from some of the proponents of globalisation who contend that countries are now converging in one model of capitalism—the Anglo-Saxon one.<sup>20</sup> This argument is partially rooted in the belief that globalisation reduces governments’ autonomy to develop their own domestic policies. According to this view, globalisation has resulted in the dismantling of borders and has transferred power to business, individuals, and transnational communities.

Yet this view oversimplifies the consequences of globalisation and minimizes the power of governments. Authors such as Garrett<sup>21</sup> have strongly contested this argument and have shown that domestic partisan politics, institutions, and other forms of social organisation still have an important impact on economic policy and performance. Indeed, governments are not “prisoners” of markets. The role of governments was questioned long before the globalisation process intensified in the 1980s. It was the crisis of the 1970s that led politicians to question previous policies and led to deregulation, liberalisation, and economic integration, which in turn

<sup>19</sup> From: <http://www.oecd.org/dataoecd/26/35/38795690.pdf>.

<sup>20</sup> See Colin Crouch and Wolfgang Streeck, (eds.), *Political Economy of Modern Capitalism. Mapping Convergence and Diversity*. (Newbury Park, CA: Sage Publications, 1997).

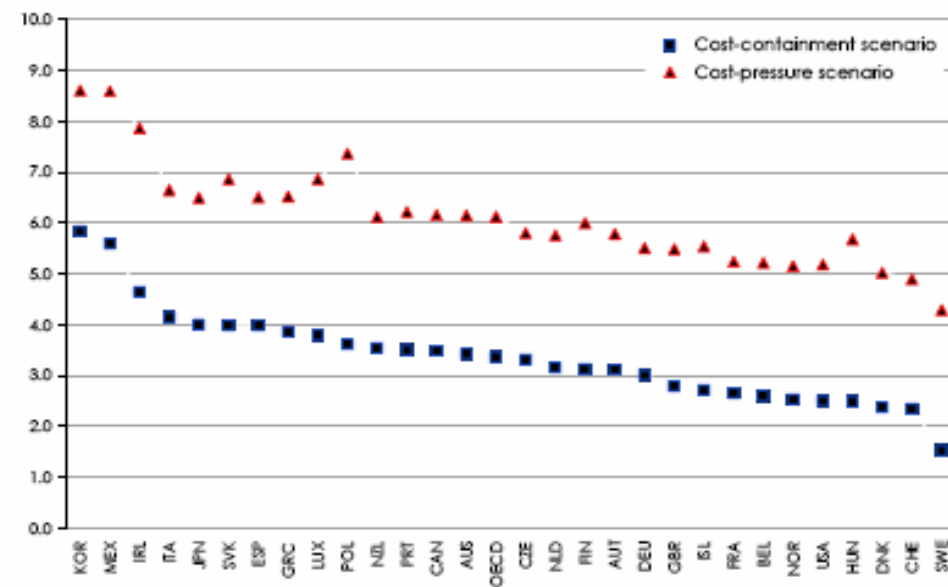
<sup>21</sup> Geoffrey Garret, *Partisan Politics in the Global Economy* (New York 1998).

accelerated the globalisation process. However, these decisions were implemented by democratically elected governments and supported by voters. It was this process of deregulation, liberalisation, technological diffusion, and economic integration that really weakened governments' powers.<sup>22</sup>

Indeed, the decisions to eliminate barriers between commercial and investment banking (such as the Glass-Steagall Act in the United States, or the famous "Regulation Q," which forbade the payment of interest on demand deposit) or dismantle foreign exchange controls were all domestic decisions taken by national governments (even when they were supported or recommended by international organisations like the IMF), and they contributed to the dramatic growth of financial intermediation that led to changes in the global economy and influenced the balance of power among economic actors. This process was hastened by the development of new technologies in computing and communications, and the revolution in financial economics, which contributed to the emergence of new financial instruments.<sup>23</sup>

Yet, the empirical evidence shows that governments are not "prisoners" of markets. Indeed, governments' intervention in the economy has not decreased: for instance, public spending as proportion of GDP—which determines the level of intervention of governments in the economy—has increased systematically (30 percent in 1960 and 45 percent in 2005) (see figure 3). If governments are prisoners of markets, how is this possible?

**Figure 3:**  
**Total increase in health and long-term care spending by country, 2005-2050**  
 In percentage points of GDP



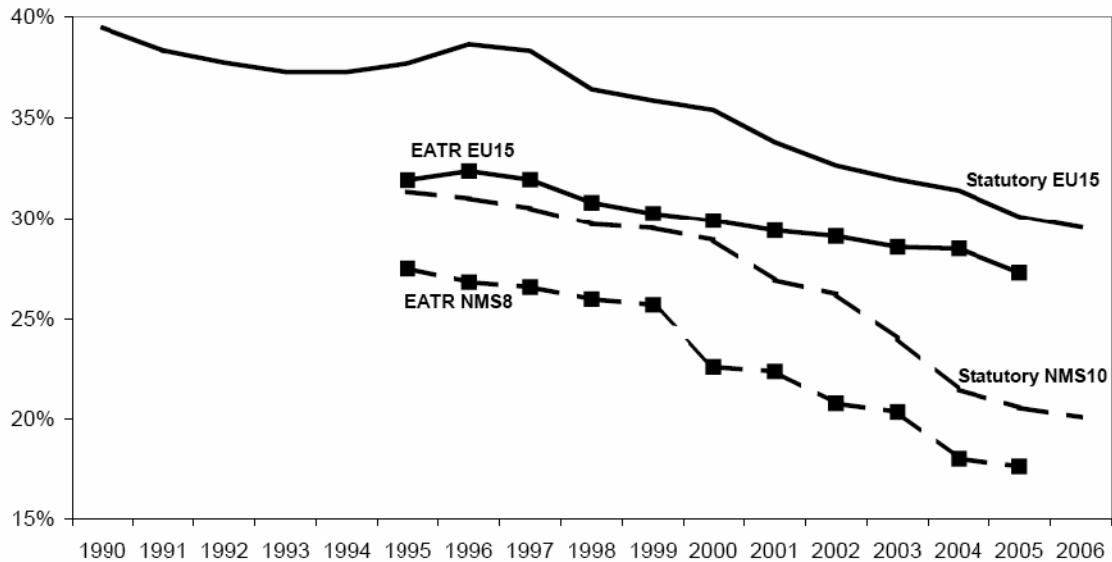
Source: OECD calculations.

While it is true that corporate taxes have declined, how is it possible to explain that governments have been able to maintain income taxes (see figure 4)?

<sup>22</sup> See "Prisoners of Markets," in *The Economist*, Dec. 6, 1997.

<sup>23</sup> Wolf, "The New Capitalism," 2007, p. 11.

**Figure  
4:**  
Corporate Tax Rates in EU25 1990-2006



Sources: Devereux, Griffith and Klemm (2005), Eurostat, KPMG for statutory rates; Overesch (2005) for EATR (Effective average tax rates).

Indeed, governments are still able to determine social policies. While they have a cost, they are also beneficial because they help cushion the negative impact of globalisation and technological change. In fact the evidence shows that governments can implement policies that promote employment and increase the incomes of the low-paid.<sup>24</sup> Finally, while it is true that there are limits in monetary politics and levels of public debt, high levels of debt have been possible with stable monetary policies (i.e., in Italy or Belgium with levels of debt higher than 100 percent of their GDP).

On the contrary, in this paper I make the case that success in the global economy demands national government actions, and that it does not need to be based necessarily in convergence, but on diversification and differences. In fact, I argue that in the global economy we survive by becoming more diverse and focusing on what we do best, not by copying other countries or economic models. The question should be not so much about the costs and benefits of globalisation (there are both), but how to distribute the benefits. In fact globalisation can help generate the resources to develop social policies. It is the inequity in the balance of institutional arrangements that results in unequal benefits. Some scholars are advocating for a “New Deal for Globalisation” based on a reform of the tax system to share the benefits more widely, in order to make globalisation more tolerable for citizens who have experienced little real income growth.<sup>25</sup>

<sup>24</sup> OECD 2007.

<sup>25</sup> Kenneth F. Scheve and Matthew J. Slaughter. “New Deal for Globalization.” *Foreign Affairs* Vo. 86, No. 4, (July/Aug., 2007), pp. 34-47.

I argue that we should not build a wall against the world beyond. Success will be based on the elimination of tariff and nontariff barriers by rich countries, the establishment of appropriate policies and institutions, the development of adequate adjustment assistance and efficient financial systems, regulated migration, and strong governance. According to a recent OECD report, globalisation is “compatible with employment rates, provided the right policies are in place” (OECD: 2007).<sup>26</sup> Governments should respond to citizens’ concerns about the negative effects of globalisation (it creates losers) and address the growing gap between the successful and the unsuccessful. The solutions are well known: better education, flexible economies, improved infrastructure, and safety nets. They may ignore these solutions at their own peril.

Government leaders should remember that public institutions and political decisions also mediate capital markets. Politics are not only desirable but also inevitable in dealing with the political and economic effects of globalisation. Citizens, who feel threatened by a phenomenon that is perceived as a profit-making and inhuman machine, want governments to shield them from the insecurities of the age, and powerful coalitions are forming to curb the increasing power of global capitalist interests and elites. Yet, it is important to remember that many of the current challenges are transnational (i.e., climate change, energy security, terrorism, migration, demographic changes, global pandemic, increasing competition, or proliferation of weapons of mass destruction) and they cannot be addressed effectively alone by national governments.

In sum, governments are not “prisoners” of markets. They nearly have as much (or as little) control over their economies as they had in the past. This has been a convenient argument to deflect political pressures and justify unpopular policies. Governments should be responsible of their own choices and policies. They should act to configure markets. As some scholars have pointed out,

Globalisation’s soft underbelly is the imbalance between the national scope of governments and the global nature of markets. A healthy economic system necessitates a delicate compromise between these two. Go too much in one direction and you have protectionism and autarky. Go too much in the other and you have an unstable world economy with little social and political support from those it is supposed to help.<sup>27</sup>

In the end, markets and democracy are both necessary to fulfill the ideals of liberty, solidarity, and equality that are intrinsic to Western values. The main challenge is one of global governance because economic globalisation is moving faster than political and institutional one.<sup>28</sup>

### **Against Convergence**

The proponents of globalisation contend that countries are now converging in one model of capitalism—the Anglo-Saxon one. In the opinion of some scholars, the combined impetuses of globalisation and the process of economic integration have imposed exigencies of increasing competitiveness on national economies and firms, which have compelled countries to deregulate their labour markets, welfare systems, and industrial relations.<sup>29</sup> According to this view, these pressures for change have undermined coordinating capacity, hence pressuring governments to implement uniform policies based on deregulation and further liberalisation. This type of explanation perpetuates the extended myth that there is only one economic model to operate in a global economy based on a set of institutions that promotes market efficiencies and entrepreneurship. While states’ steering capacities are being constrained by developments beyond their national boundaries, this does not mean a loss of state control or convergence in a neoliberal direction.<sup>30</sup>

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<sup>26</sup> [http://www.oecd.org/document/12/0,3343,en\\_2649\\_201185\\_38792716\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/12/0,3343,en_2649_201185_38792716_1_1_1_1,00.html)

<sup>27</sup> Dani Rodrik, “The Cheerleaders’ Threat to Global Trade,” in *Financial Times*, March 27, 2007.

<sup>28</sup> Joseph Stiglitz, *Making Globalization Work* (New York 2007).

<sup>29</sup> Crouch and Streeck, *Political Economy of Modern Capitalism*, p. 92.

<sup>30</sup> Sebastián Royo, *From Social Democracy to Neoliberalism* (New York 2000).

This paper seeks to challenge the argument according to which the Anglo-Saxon countries (and in particular the United States, and to a lesser extent the United Kingdom) have institutions and policies that other countries must follow to achieve economic success in a global world (See Table 2).

**Table 2: Basic Socio-economic Data of a Number of Western Countries:**  
Employment rates (15 to 64 years), standardized unemployment, income inequality,  
and poverty rates (defined as income lower than 50 percent of median)

	Employment Rate		Standardized unemployment rate		Gini Coefficient	Percentile Ratio 90/10	Poverty Rate
	1990	2005	1990	2006			
Australia	68.40	71.60	6.70	4.80	0.32	4.25	13.01
Austria	..	68.60	..	4.70	0.26	3.15	7.74
Belgium	54.40	61.00	6.60	8.20	0.28	3.28	7.88
Canada	70.30	72.50	8.10	6.30	0.32	4.19	12.37
Denmark	75.40	75.50	7.20	3.90	0.23	2.75	5.39
Finland	74.10	68.00	3.20	7.70	0.25	2.90	5.38
France	59.90	62.30	8.50	9.50	0.28	3.45	7.31
Germany	64.10	65.50	4.80	8.30	0.28	3.37	8.36
Ireland	52.10	67.10	13.40	4.40	0.31	4.48	16.15
Italy	52.60	57.50	8.90	6.80	0.33	4.47	12.76
Netherlands	61.80	71.10	5.90	3.90	0.23	2.78	4.91
Norway	73.00	75.20	5.80	3.50	0.25	2.80	6.40
Spain	51.80	64.30	13.00	8.50	0.34	4.69	14.16
Sweden	83.10	73.90	1.70	7.00	0.25	2.96	6.53
Switzerland	..	77.20	..	4.00	0.27	3.38	7.56
U.K.	72.50	72.60	6.90	5.30	0.34	4.57	12.46
U.S.	72.20	71.50	5.60	4.60	0.37	5.46	17.05

Sources: OECD: <http://stats.oecd.org/WBOS/Default.aspx?QueryName=251&QueryType=View>

OECD Factbook 2007: <http://masetto.sourceoecd.org/v1=4023467/cl=27/nw=1/rpsv/factbook/>

Luxembourg Income Study (LIS) Key Figures as of 13 Aug. 2007:

<http://www.lisproject.org/keyfigures.htm>

In recent years there have been constant references to the economic decline of Europe, and scholars have pointed out to the fact that in the last 20 years the continent has lost ground vis-à-vis the United States. They highlight economic data suggesting that the European economies have stalled. For instance, in the first 30 years after the war Europe reduced its per capita GDP distance from the United States by half (from 42 percent to 80 percent), yet since then it has gone down to 70 percent of the U.S. level.<sup>31</sup> Other data seem to confirm this trend. While productivity growth in the United States increased from an annual rate of 1.5 percent between 1973 and 1975, 2.5 percent between 1995 and 2000, and 3.5 percent between 2001 and 2005, in Europe productivity growth has been slow: only 0.9 percent after 1998 (although the latest data seems to indicate that Europe is catching up: in 2006 productivity grew in the EU 1.5%, whereas in the United States it increased only by 0.9%)<sup>32</sup>. Furthermore, the number of patents granted per

<sup>31</sup> Alberto Alesina and Giavazzi. *The Future of Europe: Reform or Decline* (Cambridge 2006), pp. 4-5.

<sup>32</sup> Yet this productivity growth was uneven among the EU countries: while Germany and Greece experienced increases of 2.7%, the United Kingdom of 2%, and France of 1.2%; productivity only increased 0.7% in Spain and

working person between 1990 and 2003 has been 3.6 in the United States, but less than one in the United Kingdom, France, and Germany; continental output per hour is still about 90 percent of U.S. levels, and only 75 percent of those in working age in France and Italy were in employment, against 87 percent in the United States. This has led observers to call for further liberalisation and market-led change in Europe that will put in place the right incentives to take risks, and work.<sup>33</sup>

The Nobel laureate Edmund Phelps, highlighted in his Nobel lecture, the failure of European economies to deliver neither dynamism nor high employment, and attributed the recent economic underperformance of these economies to “the continent’s corporatist economic system (or systems), a system constructed of big unions, big employer confederations and big banks, all mediated by a big public sector- a system that has been built up starting in the 1920s on the belief that it would be better than capitalism.” While he supports a system that combines high dynamism with social inclusion, he advocates market-led change.<sup>34</sup>

Yet, this paper defends that in the global economy we survive by becoming more diverse and by focusing on what we do best, not by copying the United States. While it is true that Anglo-Saxon countries have experienced strong economic performance in the last decade, there are many other indicators that point to significant weaknesses in their economic performance and social well-being. According to UN reports on child welfare and child poverty, the United States and the United Kingdom are the two worst industrial countries in which to grow up: child poverty doubled in the United Kingdom between 1979 and 1998, and in the United States a baby from a family in the bottom five percent of U.S. income distribution will have a life span 25 percent shorter than a baby from the top five percent. On the contrary other countries, such as Sweden, Norway, and the Netherlands, countries traditionally associated with Social Democratic governments and corporatist models of capitalism; score higher than the United States in almost every indicator of well-being: inequality, poverty, and economic insecurity are all lower.<sup>35</sup>

Along the same lines, Pontusson provides a comparative overview of the two systems (what he calls the “liberal capitalism” of the United States and Britain, and the “social market” capitalism of northern Europe) and examines the presumed trade-off between equality and economic growth. He makes the case that it is not clear that liberal economies generate more wealth. While he acknowledges that Americans do make more per capita than anyone else (\$36,000 a year in 2002) some of the European countries closely follow it (Norway is right behind at \$35,000), plus the difference with the other continental European nations (ranging from \$26,000 to \$29,000) is not large enough to claim unambiguously the superiority of the U.S. system. He points out that inequality is higher in liberal capitalist countries: their poverty rate of 15 percent (11.5 percent in the United States) is more than three times higher than in the social market countries. Finally, he notes that while unemployment is higher in Europe the divergences are not so large either: the social market economies have a 5.2 percent unemployment rate between 2000 and 2003, while the liberal capitalist economies had a 5.6 percent.<sup>36</sup> The key difference among these countries is the importance that they attach to social cohesion. Pontusson shows that social market economies can produce growth and employment without the inequities of the liberal capitalist countries. According to him, Europeans seek to share the benefits of economic growth and mitigate the adjustment costs; hence their policies are geared toward

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0.2% in Italy. See, “Europa eleva la productividad y se acerca a la de Estados Unidos,” in *El País*. Thursday Nov. 22, 2007.

<sup>33</sup> Alesina and Giavazzi, *The Future of Europe*, pp. 168–172; Martin Wolf, “European Corporatism Needs to Embrace Market Led Change,” in *Financial Times*, January 24, 2007.

<sup>34</sup> Edmund Phelps, “Macroeconomics for a Modern Economy,” Oslo: Dec. 8, 2006. Published by the *American Economic Review*. Vol. 97. No.3, June 2007, pp.543-61.

<sup>35</sup> Mica Panic, “Child Poverty Exposes the Anglo-American Model,” in *Financial Times*, April 2, 2007; and “Does Europe Need Neoliberal Reforms?” in *The Cambridge Journal of Economics*, January 2007.

<sup>36</sup> Jonas Pontusson, *Inequality and Prosperity*. (Ithaca: Cornell University Press, 2005); See Christopher Shea, “Vive la Welfare State!” in *Boston Sunday Globe*, January 29, 2006, p. E5.

improving both social and individual welfare. The institutional setting of these countries makes these policies and these choices possible.

### **Models of Capitalism**

Indeed, there are several viable models to succeed in the global economy. In the last few years there has been a growing body of literature outlining different models of capitalism. The Varieties of Capitalism (VoC) literature explains differences and similarities in economic policies and economic performance.<sup>37</sup> It focuses on the institutional frameworks of market economies and identifies complementarities between institutional arrangements. The VoC approach looks at the role that institutions play and how they condition policy, and it seeks to address questions such as what features distinguish one type of policy from another? How are the main VoC constructed? It takes as a starting point the neoclassical view, which uses as a reference the economic success of the Anglo-Saxon countries during the past decade and contends that competitive market relations are the best way to assure strong economic performance. Yet it disputes this conclusion and argues that there is more than one route to economic success. This literature has examined whether a liberal direction can be identified or whether countries are more or less locked into already developed paths because of the complementary character of their institutional framework. It has also analyzed the forces and mechanisms that make institutional change possible.<sup>38</sup>

The VoC approach argues that the institutional frameworks within which firms operate conditions what they can do. It makes the following two core contentions: First, firms are the central actors of the economy (moving away from the neocorporatist's focus on labour unions) because they are the agents of adjustment; and second, it has a relational view of firms: Their success depends on a core of set competences that they develop, which in turn depend on the quality of the relationship with other actors. Therefore, according to this approach, success is contingent on coordination, and hence coordination is the central challenge.

Hall and Soskice propose two types of coordination: *Market Coordination* characterized by arm's-length relations and formal contracts, intense competition and clear market signals, which encourage investment in general assets that can be used for different purposes; and *Strategic Coordination*, based on the collaboration among economic actors with substantial knowledge of each other, which encourages investment on specific assets. Each one of these models of coordination requires specific institutions. *Market Coordination* demands institutional support for the effective enforcement of contracts and regulation to encourage competitions, transparency, and factor mobility whereas *Strategic Coordination* requires institutional support to provide regulatory regimes that places limit on competition and contract laws that allow for incomplete contracts.

This approach provides a comprehensive summary of the institutional, economic, and organisational differences between countries categorized as Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs). It argues that both models have institutional advantages for growth. LMEs are organized around market-based linkages. These countries are competitive on the basis of their flexibility. CMEs, on the contrary, base their competitiveness on high levels of coordination, which fosters compromise among economic actors. Therefore, according to this literature there are two types of ideal institutional models: the LMEs and the CMEs. The LMEs, like the United States and the United Kingdom, are organized around a decentralized model based on general skills and market-based linkages, deregulated labour markets, strong competition policy, education and training systems focused on general skills, and

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<sup>37</sup> Peter Hall and David Soskice, (eds.). *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford 2001); and Peter Hall, "The Evolution of Varieties of Capitalism in Europe." In B. Hancké, M. Rhodes, and M. Thatcher, eds., *Beyond Varieties of Capitalism: Contradictions, Complementarities, and Change* (Oxford 2007).

<sup>38</sup> Colin Crouch, *Capitalist Diversity and Change* (New York 2005).

a financial setting with relatively fluid capital markets and public information. On the contrary, the CMEs of Northern and Central Europe are characterized by a large number of nonmarket-based cooperative institutional mechanisms, such as long-term finance ties through which firms secure capital in ways that does not depend solely on their short-term performance (such as networks of cross share holdings in other companies and financial institutions), and regulated labour markets in which wages are set through coordinated collective bargaining. According to them, differences across countries in the quality and configuration of these institutional frameworks contribute toward explaining disparities in firms' behavior and performance. It is, therefore, essential to construct a theory of "comparative *institutional* advantage."<sup>39</sup>

In addition Amable identifies five different models: the market-based Anglo-Saxon model; Asian capitalism; the Continental European model; the social democratic economies; and the Mediterranean model, and examines the institutional transformation that have taken place in Continental Europe to argue that Continental European economies will not converge with the Anglo-Saxon model.<sup>40</sup>

Baumol, Litan, and Schram also advance four different archetypes of capitalism: state-guided, oligarchic, big-firm, and entrepreneurial.<sup>41</sup> They show that developing countries tend to be state-guided or oligarchic, whereas developed economies tend to be characterized by big-firm capitalism (Continental Europe, Korea, and Japan) or a mix of big-firm and entrepreneurial capitalism (the United States). From this typology they make the argument that for countries to reach (and maintain) the living standards of the rich countries they will need to adopt some combination of big-firm and entrepreneurial capitalism, and they outline the four ingredients necessary for building and maintaining the mixed form of capitalism: easy to start a business, rewards for productive entrepreneurial activity, disincentives for unproductive activity, and keeping the winners on their toes. In other words, they make the case that countries have to move toward the U.S. model of entrepreneurial capitalism.

Other scholars have developed other typologies. According to Andre Sapir, there are at least four political economy models in Europe: The "Nordic model" (Denmark, Finland, Sweden, and the Netherlands) characterized by highest public spending on welfare and social protection, relatively unregulated labour markets, and active labour market policies; the "Anglo-Saxon model," which provides generous social assistance; weak union and unregulated labour markets (Ireland and the United Kingdom); the "Rhineland model," (Austria, Belgium, France, Germany, and Luxemburg), which relies on stronger protection than in the Scandinavian countries, relatively powerful unions, as well as social protection for the unemployed; and finally the "Mediterranean Model," characterized by support for early retirement, regulated labour markets that protect employment, as well as provision of pensions (Greece, Italy, Portugal, and Spain). Sapir examines the impact of these models on the levels of employment and poverty and concludes that the Nordic and Anglo-Saxon models have better employment performance, while the Rhineland and Nordic models have a better record in eliminating relative poverty. According to his analysis the Mediterranean model (which includes Spain) performs poorly on both objectives. Hence the conclusion is that countries such as Spain should become either more Nordic or more Anglo-Saxon.<sup>42</sup> The problem is that it is not easy to move in the Nordic direction

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<sup>39</sup> David Soskice, "Divergent Production Regimes. Coordinated and Uncoordinated Market Economies in the 1980s and 1990s." In H. Kitschelt, Peter Lange, Gary Marks, and John D. Stephens, eds., *Continuity and Change in Contemporary Capitalism* (New York 1999), pp. 101–134.

<sup>40</sup> Bruno Amable. *The Diversity of Modern Capitalism* (Oxford 2003).

<sup>41</sup> William J. Baumol, Robert E. Litan, and, Carl J. Schramm. *Good Capitalism, Bad Capitalism and the Economics of Growth and Prosperity* (New Haven 2007), pp. 60–92 and 95–121.

<sup>42</sup> Andre Sapir, "Globalisation and the Reform of European Social Models," Sep. 2005, [www.bruegel.org](http://www.bruegel.org). Other scholars, such as Richard Layard, have argued that painting a stark contrast between models misses the point, because the real distinction is "between countries that have had effective active labour policies and those that have not." According to Layard the picture of the United Kingdom producing high levels of inequality is no longer accurate: since the mid-1990s this trend has been halted, and the United Kingdom currently has some of the fastest growth in health



because these countries have specific institutional features (e.g., highly educated population, solidaristic culture, high levels of taxation and public spending, as well as some of the most developed welfare states in the world) that are not easy to replicate. Therefore, he seems to suggest that the most likely option for these countries would be to move toward the Anglo-Saxon model.

Yet, this paper shows that a movement toward an Anglo-Saxon model is not preordained. It supports the conclusion by other authors who have claimed that there may be more than one combination of institutions capable of producing the same level of efficiency.<sup>43</sup> Competition will generate growing pressures for European countries to “deliver their preferred mix of public and private good more efficiently,” but there are European countries, such as the Scandinavian ones, who have been very successful at finding the right equilibrium to maintain their social protections while enhancing the efficiencies of their production system. Moreover, as we have seen, Europeans have different preferences; therefore, their institutions should also differ.

### **Lessons for Latin America**

Economic and social policies in advanced industrial democracies constitute successful models to promote growth and equity. Therefore they may offer lessons and guidelines that may be applicable to Latin American countries as they try to adapt their institutions and policies to the challenges posed by globalisation. These countries are still trying to address the challenge of growth with equity and it is critical to underscore that there is not a single path to success. And this is a continent that is expected by 2025 to have 25% of the world’s population and represent approximately 7% of the world’s economy.

In Latin America the lack of an efficient bureaucracy with autonomy from particularistic interests, which has the capacity to pursue goals and implement policies in a consistent manner has been a very important impediment for the successful pursuit of effective developmental policies. These countries have also lacked the distribution of power among interest groups that has facilitated the emergence of solidaristic policies in Europe. Also, the state is much weaker and generally does not have the control over the resources that are typical of the European ones, while the private sector is stronger and more autonomous in its pursuit of its own interests (oftentimes at the expense of the common good).<sup>44</sup> Lastly the alliance between reformist parties and the labour movement (central to the European Social Democratic and Christian Democratic models) is much weaker in Latin America. The region has also been hindered by the hegemonic role played by the US, which has pushed for the implementation of neoliberal policies and the retrenchment of the state in these countries. Does this mean that the region will converge towards the Anglo-Saxon model?

In the 1990s economic policies throughout Latin America showed a trend toward growing deregulation, privatization, decentralization and liberalisation, which were often accompanied by deepening labour market inequalities. Indeed in most cases reforms have reproduced and exacerbated existing problems. Yet more recently this general trend has been countered by the emergence, in countries such as Chile or Brazil, of an alternative model that combines liberal economic policies with a focus on redistribution and social policies.

Yet, models of capitalism in Latin America have suffered from great instability and with few exceptions, like Chile or Costa Rica, have had lacked staying power. Indeed, economic and social policies in the regions have been characterized by radical and constant changes. Interventionist

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spending in the world. See “EU Set for Clash on ‘Anglo-Saxon’ versus ‘Social’ Welfare Models,” in *Financial Times*, Oct. 25, 2005, p. 2.

<sup>43</sup>Barry Eichengreen, *The European Economy since 1947* (New Jersey 2007).

<sup>44</sup> Ben Ross Schneider and Sylvia Maxfield. “Business, the State and Economic Performance in Developing Countries,” in Silvia Maxfield and Ben Ross Schneider, eds. *Business and the State in Developing Countries* (Ithaca, NY 1997).

models have failed because their protectionist tendencies have precluded the promotion of industrial and technological diversification. Populist ones have been characterized by disastrous macroeconomic policies based on large deficits and expansive monetary policies that have led to vicious boom and bust cycles. Finally, liberal models have failed because of weak democratic institutions, and inadequate underlying structural conditions (i.e. high inequality and concentration of wealth, bureaucratic weakness of the state, low educational levels, too much centralization, weak employment, high population growth, high dependency ratios, and reliance on exports and external capital) that have hampered the working of the market. In countries in which trust among economic and social actors is largely lacking, the absence of strong and impartial institutions that can enforce the contractual arrangements that are typical of liberal market economies is self-defeating.<sup>45</sup>

Fortunately, the fortunes of Latin American countries have been transformed since the 2001-02 financial crisis. For most of the countries in the region the last decade has been a very positive one. They have been able to leave behind the infamous “lost decade” of the late 1990s marked by hyperinflation, and the effects of the international financial crisis, which brought a recession to these countries between 1998 and 2002. Indeed, according to many observers that period has been one of the most beneficial ones for the region in the last three decades. Inequalities persist, but unemployment and poverty have been declining. Economic growth has been accompanied by an increase in purchasing capacity, and between 2003 and 2007 per capita GDP in the region has increased 18.5% (3.5% annually). Moreover, in 2000 only 18 million Latin Americans had access to the internet, and by 2008 125 million do (one every four).<sup>46</sup> In 2007 LA economies grew by an average 5.3% and are expected to expand by 4% in 2008.<sup>47</sup>

**Table 3: Perspectives for Latin America**

	GDP Growth (annual average, %)			Inflation (end of year) (annual average, %)			Budget Balance (% of GDP)			Current Account Balance (% of GDP)		
	2006	2007*	2008*	2006	2007*	2008*	2006	2007*	2008*	2006	2007*	2008*
<b>Argentina</b>	8.5	8.5	6.5	9.8	8.5	10	1.4	1.0	0.5	3.8	2.5	1.5
<b>Bolivia</b>	4.6	4.0	2.8	5.0	11.7	10.0	5.0	1.5	-3.0	11.8	12.0	6.0
<b>Brazil</b>	3.8	5.5	5.0	3.1	4.5	4.5	-3.0	-2.2	-2.5	1.4	0.3	0.0
<b>Chile</b>	4.0	5.2	4.9	2.6	7.8	4.3	7.9	8.7	5.0	3.6	4.0	2.0
<b>Colombia</b>	6.8	7.0	5.5	5.0	5.7	4.5	-1.0	-0.7	-1.6	-2.1	-4.0	-4.5
<b>Mexico</b>	4.8	3.2	3.0	4.1	3.8	3.8	0.1	0.0	-0.1	-0.2	-1.0	-1.3
<b>Peru</b>	7.6	8.3	6.5	1.1	3.9	2.8	2.1	3.0	2.0	2.8	2.5	2.5
<b>Venezuela</b>	10.3	8.5	6.5	17.0	22.8	26.0	-2.0	-3.3	-5.0	14.0	11.0	10.0
<b>America Latina</b>	5.4	5.6	4.8	5.0	6.2	6.3	-0.7	-0.4	-1.0	2.0	1.0	0.4

\*Estimated

Source: Solchaga and Recio Asociados. From: *El País*, March 30<sup>th</sup>, 2008, p.16-Negocios.

According to the *Comisión Económica para América Latina* (CEPAL) the middle class has taken off in countries like Brazil, Mexico and Peru; and the percentage of the population who lives in a situation of extreme poverty in the region has decreased from 48% in 1990 to 35% in 2008. In addition, the continent is in track to fulfill the UN Millennium Objectives to have

<sup>45</sup> John Sheahan, “Alternative Models of Capitalism in Latin America,” in *Models of Capitalism: Lessons for Latin America* (University Park 2002).

<sup>46</sup> From “América Latina cierra un lustro de oro,” in *El País*, March 30<sup>th</sup>, 2008, p.16-Negocios.

<sup>47</sup> “Latin American optimism dented,” in *Financial Times*, Wednesday April 9, 2008, p. 5.

poverty halved in half by 2015.<sup>48</sup> There have been cases of dramatic success. For instance, Chile grew an average of 5% during the last decade, more than doubled its per capita income from \$3,638 to \$8,900, improved dramatically its fiscal position (it registered a surplus of more than 8% of GDP in 2007) experienced inflation rates below 10%, balanced its balance of payments (in 2007 it had a surplus of \$3bn) tripled and diversified its exports (Asia represents 25% of its exports, the EU and the USA half, and the 25% left goes mostly to other LA countries), negotiated trade agreements with 56 countries,<sup>49</sup> invested in new sovereign wealth funds,<sup>50</sup> and received \$70bn of FDI between 2000 and 2006 (and to put this figure in perspective GDP in Chile in 2005 was \$115bn).<sup>51</sup>

Brazil, another star performing country, has experienced similar successes. The country has been able to break from the malaise of the previous decade when the economy only grew 2.3% between 1980 and 2003, while population grew 1.8%, 50 million Brazilians lived below the poverty line (20 million of the under extreme poverty), and per capita income stagnated. The commitment from the last two presidents, Fernando Henrique Cardoso and Luiz Ignacio Lula da Silva, to political stability, combined with economic policies that would balance economic growth with social responsibility (i.e. growth first and spending later) has paid off. Inflation decreased from 150% in 1986, to 7% in 2000 and 3.6% in 2007; foreign debt has been reduced (it reached \$100bn in 2001, or the equivalent of 4-5% of the exports), the trade balance has improved (the surplus has averaged between \$30-45bn); FDI has exploded (between 2004-2008 Brazil will receive \$115bn), poverty has been dramatically reduced (the social programs like *Bolsa Escola* of Zero Hunger, have rescued 16 million Brazilians from poverty: the equivalent of the entire Chilean population of 40% of Argentina's); and in the last seven years it has created almost nine million new jobs and the minimum wage has increased from 139 to 415 *reales*.<sup>52</sup>

Increasing confidence on the economic fundamentals of the countries of the region has helped them to regain the trust from investors. Indeed, the continent has become, one again, a magnet for Foreign Direct Investment (FDI) driven by the increase in commodity prices, and the expanding consumer demand in the countries of the region. According to the latest data from the CEPAL, in 2007 FDI increased 84.3% in Brazil (\$34bn), 22.7% in Mexico (\$23bn), 35% in Colombia (\$8.7bn), 13.6% in Argentina (\$5.7bn), and 94% in Chile (\$15bn).<sup>53</sup> Latin America has also benefitted greatly from the incursion of the Asian giants in these countries. For instance, China's commercial exchanges with LA countries have reached \$105bn.<sup>54</sup>

Indeed, these positive developments have been the result of the implementation of orthodox macroeconomic policies in most Latin American countries, which have contributed to reduce inflation and budget deficits. The region has also benefited from the boom in developed countries (according to the IDB, of the average 6% annual growth of these economies, 2% are the

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<sup>48</sup> "Despega la clase media," in *El País*, March 30<sup>th</sup>, 2008, p.16-Negocios.

<sup>49</sup> The EU is a key partner: it is the largest investor, the first source of cooperation and trade partner (it ratified a trade treaty in 2004). Commercial exchanges between the EU25 and Chile increased from \$7.4bn in 2002, the year prior to the trade agreement, to \$22.3bn in 2007, with a surplus on Chile's favour of \$16.3. Spain is the second largest investor in Chile, after the US, and commercial exchanges between the two countries have increased 175% between 2002 and 2007 (from \$816 million to \$2.2bn). From "El cobre es oro para Chile," in *El País*, May 11, 2008.

<sup>50</sup> Following the Norwegian model, in May 2008 the Chilean government announced that it will invest up to \$5.9bn in international equities and corporate bonds to diversify assets, as part of the counter-cyclical approach to fiscal policy that the country has followed since the 1990s (running surpluses when the economy is growing and increasing spending during economic downturns). This follows the launching of two funds in 2006 that injected the equivalent of 0.5% of GDP into a pension guarantee fund and the decision to invest any surplus above one percent of GDP into a social and economic stabilization fund. As a result the build-up in the two funds has been very rapid and has reached \$16.8bn in 2007. See "Chile to invest \$5.9bn in new sovereign fund," in *Financial Times*, Wednesday April 9, 2008, p. 5.

<sup>51</sup> From "El cobre es oro para Chile," in *El País*, May 11, 2008.

<sup>52</sup> See José Juan Ruiz, "No es la revolución, pero da resultados," in *El País*, May 11, 2008.

<sup>53</sup> "Vuelve la inversión extranjera," in *El País*, March 30<sup>th</sup>, 2008, p.17-Negocios.

<sup>54</sup> See "El 'todo a cien' de China e India" in *El País* Sunday, May 4, 2008, pp.36-37-Negocios.

consequence of the improvement in the international context), and the increase in the price of energy, minerals and food, which they export.

Yet, despite these notable economic improvements income distribution and poverty remain major problems throughout the region. For instance, according to a recent report from the *Instituto de Investigación Económica Aplicada* (Ipea) in Brazil 10% of the population controls 75.4% of the wealth of the country. And this wealth is also very unevenly distributed from a geographic standpoint: in São Paulo 10% of the population controls 73.4 of the GDP; in Salvador de Bahia 10% controls 67%, and in Río de Janeiro 10% control 62.9%. More astonishing is the fact these figures are almost identical to the one registered at the end of the XVIII century: in Rio de Janeiro, for instance, the distribution of income was almost identical: 10% of the population controlled 68% of the wealth.<sup>55</sup> A recent report from Argentina shows that, although there has been a decline in the poverty rate (it reached a peak of 57.7% in October of 2002 at the height of the economic crisis), urban poverty still stands at 20.6% in 2008 (2.8 percentage points lower than the previous year). There are still 4.9 million Argentines who live in urban areas that cannot fulfil their basic needs for food, health, housing, education, transportation, and other basic services; and 5.9% of the urban population (1.4 million people) is indigent (with income lower than \$311 or 982.38 pesos for a family of four members) and cannot eat adequately.<sup>56</sup>

Furthermore, although very rapid rates of economic growth in countries like Peru, Colombia, Chile or Panama, which have grown as fast as the East Asian Tigers, and have contributed to the overall GDP growth of the region (both in absolute and per capita terms), the rates of growth are still lower than that of the Eastern European countries. This suggests, according to observers that the continent still needs to deepen structural reforms, invest in education, lower the costs to make business and invests more in R&D and innovation (China invests 3% and LA 1%).<sup>57</sup>

Most analysts forecast that despite the 2008 worldwide financial crisis, the continent is well prepared to avert a crisis: positive trade balances, fiscal consolidation, and the strengthening of the financial sector have prepared the LA countries to confront economic difficulties. Yet the United States' slowdown has dented optimism in the region. The IADB has alerted that the 2008 crisis will expose a host of vulnerabilities in growth, productivity, and investment performance. While fiscal management has improved in most countries (in particular in Chile with the establishment of stabilization funds), most of them have adopted pro-cyclical spending and have not invested enough.<sup>58</sup> Indeed, the challenge of growth with equity is still a daunting one for most LA countries.

But, the analysis of the European experience illustrates that it is possible to combine equity with growth. The European social model shows that proper regulation, along with public investment in human capital are crucial for sustained economic growth with social integration. In Europe cooperation among the economic actors at the national or sectoral level has promoted growth with high levels of unemployment and productivity, while maintaining a generous safety net. While this model is not easily transferable (models of capitalism are the result of particular socioeconomic, historical and institutional contexts; and are shaped by different distribution of power, policy choices and historical legacies), the failure of alternative models of development in the region has weakened entrenched institutional practices and actors, which may facilitate the process of institutional reform. This will require not only an institutional transformation, but also a behavioural one.<sup>59</sup> Yet the failure of the neoliberal agenda and the crisis can provide ideal contexts for radical departures from long-established policy patterns.

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<sup>55</sup> "La renta en Brasil, como hace siglos," in *El País*, May 19, 2008.

<sup>56</sup> "El gobierno argentino anuncia un descenso de la tasa de pobreza," in *El País*, May 22, 2008.

<sup>57</sup> "América Latina cierra un lustro de oro," in *El País*, March 30<sup>th</sup>, 2008, p.16-Negocios.

<sup>58</sup> "Latin American optimism dented," in *Financial Times*, Wednesday April 9, 2008, p. 5.

<sup>59</sup> Evelyne Huber. "Introduction: Posing the Question," and "Conclusions: Actors, Institutions and Policies," in *Models of Capitalism: Lessons for Latin America* (University Park 2002).

As we have seen in the preceding section, many paths are open for pursuing economic and social goals, and a combination of models is also possible.<sup>60</sup> If we want to look at the transferability of models and policies it is imperative to look at institutions and actors, and the distribution of power among these actors.<sup>61</sup> What are the lessons for the European experience?

First, institutional and policy convergence toward an Anglo-Saxon model characterized by state retrenchment in the social and economic policy realm is not inevitable. On the contrary, as we have seen, there are alternative models and countries with different institutional structures have been very successful in the global economy. Countries can respond in different ways to the pressures from international markets and financial institutions. These pressures are filtered through domestic institutions and power distributions.<sup>62</sup>

Second, cultural deterministic arguments that focus of the role of the Catholic Church and corporatist traditions of Latin America countries as impediments to entrepreneurship and the acceptance of hierarchy and authority<sup>63</sup> need to be discounted in light of the differences in performance of countries with similar cultural traditions throughout the continent. One just has to examine the recent transformation of Spain, or the recent performance of the Chilean economy, to challenge such over-deterministic arguments.

Third, institutional change is possible.<sup>64</sup> There should be no institutional determinism either. Although institutions are path-dependent, they still offer constraints and opportunities for change and they can be modified through policy changes. In European countries institutional evolution has been the result of the actions from actors with particular interests that have been influenced by “changes in the broader social environment and the character of [the] actors themselves”<sup>65</sup> and by coalition shifts. Indeed, institutions are largely shaped by political choices and power distributions. Institutional change is not only a consequence of exogenous shocks;<sup>66</sup> it is a dynamic process that can develop as part of an incremental but cumulative transformative process.<sup>67</sup> Uncertainty and competitive challenges can provide pressures on the social actors to experiment within existing institutions. They add new elements that can alter the institutions overall trajectory and shift them towards new goals and functions. In other words, institutional adaptation is possible and institutions that were created for a set of purposes can be reconfigured to serve different goals.<sup>68</sup>

Fourth, exogenous factors can induce the social partners to review their positions and strategies vis-à-vis existing arrangements. In this regard, it is necessary to complement neoinstitutional explanations with a new set of hypotheses concerning actors' behaviour.<sup>69</sup> The institutional structure of the country combined with the competitive challenges faced by its firms

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<sup>60</sup> Sebastián Royo, *Varieties of Capitalism in Spain* (New York 2008).

<sup>61</sup> Evelyne Huber. “Conclusions: Actors, Institutions and Policies,” p. 468; and Carlos Filgueira and Fernando Filgueira, “Models of Welfare and Models of Capitalism: the Limits of Transferability,” in *Models of Capitalism*.

<sup>62</sup> Huber. “Introduction: Posing the Question,” p. 2.

<sup>63</sup> Claudio Veliz, *The New World of the Gothic Fox: Culture and Economy in English and Spanish America* (Berkeley 1994).

<sup>64</sup> Paul Pierson. *Politics in Time: History, Institutions, and Social Analysis* (Princeton 2004); Kathleen Thelen, *How Institutions Evolve: The Political Economy Skills in Germany, Britain, the United States and Japan* (New York 2004); Avner Greif and David D. Laitin, “A Theory of Endogenous Institutional Change.” *American Political Science Review* Vol. 98, No. 4. (Nov. 2004), pp. 633–652.

<sup>65</sup> Pierson. *Politics in Time*, p.108.

<sup>66</sup> Mancur Olson, *The Rise and Decline of Nations* (New Haven 1982).

<sup>67</sup> Wolfgang Streek and Kathleen Thelen, (eds.). *Beyond Continuity: Institutional Change in Advanced Political Economies*. (New York: Oxford University Press, 2005).

<sup>68</sup> Thelen, *How Institutions Evolve*, pp. 292-94.

<sup>69</sup> Marino Regini, “Between Deregulation and Social Pacts. The Responses of European Economies to Globalization.” *Politics & Society* Vo. 28, No.1 (March 1999), pp. 5–33.

can more advantageous for countries to support different institutional models that seek to balance market flexibility with the adequate supply of collective goods.<sup>70</sup>

Fifth, developments within the international economic environment and within the domestic structure can change the balance of power among the social actors. These changes can facilitate the emergence of new strategies among the social actors and influence their predisposition to negotiate and settle their differences through social bargaining. Pre-existing institutions do not necessarily condition as much the choices made by the social actors. On the contrary, new emerging constraints and incentives to change can determine their interaction and strategies.<sup>71</sup>

Sixth, in the context of structural constraints that influence the range of option available to economic actors with their own interests, they design institutions. Countries are not stuck in a particular pattern of labour relations and practices. Indeed, institutions are the object of political contestation. Existing institutions influence the interests and strategic options available to the social actors, but coalition shifts influence the institutional designs.

In a region in which economic and social policy implementation has been often hampered by lack of coordination among economic actors, and the insufficient provision of collective goods, the CME model of continental European countries may offer an alternative path to the historical challenge of growth with equality. The European experience shows that these goals are not incompatible in the context of open and export-dependent economies. It shows that the fulfillment of economic objectives does not have to be at the expense of social ones. On the contrary, in continental Europe they go hand in hand: high wages, high skills, employment quality and stability, vocational training and education, and social protection are the keys that have made Germany the largest exporter in the world. In Latin America the focus on low wages, minimal social protection and job instability have resulted in lower productivity; and the decentralization of bargaining has weakened the social actors and hindered the promotion of solidaristic approaches.<sup>72</sup> Indeed, the European experience shows that it is possible to maintain a competitive position in world markets in countries that maintain an extensive system of social protection to cushion adjustment problems, invest in human capital, increase labour participation (particularly among women), and promote cooperation among the economic actors.<sup>73</sup>

Debates about economic and social models have been largely absent in Latin American countries, and for decades reforms have been mostly driven by economic and social crises (often under the influence of international financial institutions like the IMF and the WB). It is imperative to break from that pattern and to focus on the development and adoption of long-term goals and strategies that will achieve the combined goals of growth and equality.

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<sup>70</sup> Ibid., p. 19.

<sup>71</sup> Royo, *Varieties of Capitalism*, pp. 2-7.

<sup>72</sup> Victor E. Tokman, "Jobs and Solidarity: Challenges for Labor Market Policy in Latin America," in *Models of Capitalism*.

<sup>73</sup> John D. Stephens. "European Welfare State Regimes: Configurations, Outcomes, Transformations," in *Models of Capitalism*.