# INTERNAL MARKET LED GROWTH MODEL IN LATIN AMERICA AFTER A CRISIS: AN INSPIRING UTOPIA?

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## 1 INTRODUCTION

After decades of strong growth, the crisis of the eighties left Latin America deeply bruised. It took 14 years to restore its 1980 level of GDP, while rising poverty rates during the eighties decade were such that only 25 years later has Latin America recovered the level of wealth it had in 1980 (Jimenez, 2010). A continent marked (with few exceptions) by high inequalities, regressive taxation, small social transfers as compared to those effective in Europe, and modest trade openness (except for Mexico and a few countries of Central America), was interrupted in a phase of relatively high growth since 2003-2004 by the international crisis of 2008.

Unlike the crisis of the eighties, the 2008 crisis is less the product of internal difficulties than the contagion of a crisis that originated in developed countries. In this respect, it resembles the Great Depression of the thirties. Also unlike the crises of the eighties and thirties, the crisis of 2008, although severe, appears to be of short duration – since recovery was relatively strong at the end of 2009. However, one should be careful not to confuse a cyclic period with a trend, particularly in referring to a structural crisis. In the current state of international crisis, the sustainability of recovery remains in doubt so as long as the international architecture has not been redefined. It is certainly a fragile recovery, but as with the crisis of the eighties and especially that of the thirties, the " experience " of the crisis is characterised by a mutation of production structures, which, though difficult to read at present, is likely to change existing modes of governance.

The purpose of this paper is to question whether, after years of increasing openness, a new growth plan, focused on a more equitable distribution of income and subsequent expansion of the domestic market, has a serious chance of contributing to a sustained recovery of growth. This investment in the domestic market, following the bet made on the external market with the Washington Consensus in the nineties, seems utopian given the depth of inequalities and powerful conflicts of interest opposing fiscal reform and a redistributive policy that would

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be costly to the high social strata. But it is clear that in some countries, like Brazil and to a lesser extent Argentina, this "utopia" has had some early implementation. The counter-cyclical policies decided in the aftermath of the global crisis are different from those of previous years, which were inspired by the Washington Consensus and characterised by a reduction in social spending at the outset of a currency crisis, thus precipitating a recession. The new policies, inspired by a "pragmatic Keynesianism", seek to promote support for demand and lead to a decrease in primary surpluses. These measures have mitigated the social cost of this crisis rather than increased it, at least until the early 2010s.

In at least one respect, these counter-cyclical policies are, to some extent, part of a continuity that can be observed in some countries since the early 2000s: small decline in inequalities, more sustained social policy, and growth recovery. Can we consider then that the international crisis, in an underground way, is accelerating a process that had already begun? Or, more pessimistically, should we think that this process is shaky and that a somewhat reshaped version of the previous excluding model will be back in full force, once the illusion of recovery is confirmed? A return of the domestic market, a mobilising utopia, or a return to the previous model, more open, less vulnerable "primarily the increase in international reserves" and after more fragile, but more fragile "primarily due to increased opening rate and content of exports"? (Salama, 2009a, 2009b) The first part of this paper will review the effects of the thirties crisis on the industrial structure of the major Latin American economies. The second part will try to assess the likelihood of success of the "domestic market bet" by focusing on two factors: the degree of openness in that market, and the importance of income inequalities.

## 2 FROM ONE CRISIS TO ANOTHER

### 2.1 Unexpected consequences of the 1930 crisis: an original mode of industrialisation in Argentina, Brazil and Mexico

Because it was assigned to an international division of labour pertaining to the exploitation of primary products by dominant powers, industrialisation was a threat to jobs in the firms of dominant countries. Not only did it complicate the social formation of these countries, it also opened the door to challenges of their domination. This explains the hostility to the industrialisation of the exploited countries and the subsequent small scale of their domestic markets. This relationship of domination was deeply altered, however, first by the 1914-1918 war, and then by the Great Depression of the thirties. Finally, there was a change of hegemony: The United States, in seeking to take the place of a weakened and declining Great Britain, created a more favourable environment for the industrialisation of developing countries.

The crisis of 1930 was a major one, and its impact on developing economies was significant almost everywhere. With the deterioration of trade agreements and the sharp drop in exports of primary commodities, the import capacity of these countries was strongly affected. The duration of the crisis, unforeseen by policymakers, had different consequences in different countries. Some did not experience profound mutations and continued, in a "traditional" way, to take part in the international division of labour while others, after a more or less prolonged crisis period, experienced a phase of "unplanned industrialisation", an expression aptly used by the United Nation's ECLA (Economic Commission for Latin America). This unplanned industrialisation was the result of a series of conditions: *i)* the existence of a minimal industrial structure produced by the exporting activity itself (e.g. workshops for repairing steam engines used in the transportation of raw materials, agglomeration economies arising from the construction of ports and cities); *ii)* a more or less important demand, depending on the nature of exports, arising from the spread of market, and even monetary, relations; *iii)* finally, the support of exporter incomes through the purchase, in local currency, of a part of their production. Once these conditions were met, the unanticipated extension of external restrictions led to an original mode of industrialisation: a virtuous circle of import substitution of light consumer goods (of low capital intensity) allowing the resumption of strong growth within a context of international crisis, and, in the process, creating a coherent domestic market.

The size of the domestic market increased as the process of import substitution took hold. Investment played a large part in creating jobs, since the capital intensity of goods produced was low. Workers came in part from international migration but also, in an increasing proportion, from an internal migration from the countryside to the cities. Their employment led to a process of monetisation, since as peasants their labour had had little monetary value. This process was at the source of an increasing demand for what became known as "worker goods". The increasing monetisation took over the demand of exporters and augmented it, valuing production for the growing domestic market. In this sense the circle was virtuous. The dynamic for growth came from increased demand, but unlike the classical Keynesian process, this increase was more a product of the growing monetisation of a workforce that had hitherto been little monetised, than of an increase in wages. This essential aspect of the process of light import substitution in the years 1930-1940 is often ignored by economists.

The structural crisis of the thirties gave birth to a new growth regime that was "pulled from within", in the words of the ECLA. In this sense, the crisis opened up a process of restructuring and surpassing, in which "the old, not wanting to die (the export economy) gave way to the new, trying to be born (industrialisation by import substitution)."

In provoking this unplanned industrialisation in certain countries of the Periphery, the Great Depression led to the emergence of specific political regimes. The growth of industry changed the social formation, and gradually, new conflicts of interest appeared between the social classes and within them. These were exacerbated when the light import substitution slowed down. On one hand, import capacity did not increase much, if at all; and the international crisis persisted. But on the other hand, the structure of imports became increasingly rigid. To produce equipment goods and intermediate products that could not be imported in sufficient quantities became increasingly difficult for two reasons. On one hand, production of goods is more capital-intensive and requires substantial investments; on the other hand, there is no stock exchange to accumulate the capital that small individual entrepreneurs cannot raise alone. That leaves the State as an agent capable of investing in these sectors. But it is not because the State should (objectively) intervene that it will necessarily do so. Everything depends on the configuration of social conflicts, and how these are overcome and given meaning. In Argentina, Brazil and Mexico, the emergence of Caesarist political regimes (Péron, Vargas, Cardenas), initiated a passage from growth driven by light import substitution to growth propelled by heavy import substitution, resulting from the State's direct intervention as an investor in these sectors. In a certain way, the State took the place of the private contractor, who found himself in deficit because of insufficient size and absence of financial market (Mathias and Salama, 1983).

Heavy industry, along with the energy and infrastructure sectors, could continue to grow insofar as the necessary political conditions were in place, which made it possible, for some time, to overcome the quasi-insurmountable obstacles produced by the previous growth model. Thus, the impact of the thirties crisis on Argentina, Brazil and Mexico was very important from both the economic and political perspectives. Is the crisis of 2008 likely to cause effects of similar magnitude?

### 2.2 The 2008 Crisis

The crisis that began in 2008 is different in its causes from the crisis of the thirties. Financialisation, this time, appears to takes precedence over other causes. The consequences of financialisation on sluggish labour incomes and household debt in some developed countries are now known. However, we cannot classify the 2008 crisis as a realisation crisis on the grounds that wages do not rise much in developed countries over a long period, because the taking on of debt kept up demand, which would otherwise have been sluggish. Nor can we classify it as a crisis of over-accumulation, because the rate of investment remains generally poor in all developed countries and idle production capacity is low.

The effects of the globalisation of trade and finance on wages and productive investment were instrumental in precipitating the 2008 crisis. The globalisation of trade and external constraints from low-wage countries in Asia led to a dissociation between productivity growth and wage increase, causing the latter to stall, not only in developed countries but also in the emerging economies of Latin America. Financial globalisation led to a new organisation of business firms to raise their immediate profitability. If we ignore the soaring incomes of managers, the share between profit and salary has tended to be at the expense of the latter, and, within profits, the share of financial profits (or costs) has increased. This means a two-fold effect on earnings: an external constraint, the financial constraint in the distribution of value added, and the temporary positive impact of the "construction" of securitised financial products (shares) that have become very attractive.

If the present crisis is structural, as we believe, a cyclical upswing will not overcome the causes that produced it. Only a thorough reform of the international financial architecture and the imposition of new rules governing international trade – that take into account the ethical and environmental conditions of production – can overcome the crisis of 2008. In light of what happened during the Great Depression of the thirties, with the emergence of a new model of industrialisation and the resumption of growth in major Latin American countries, we can consider that the crisis of 2008 may allow for new growth opportunities in the emerging countries of Latin America. We must be cautious, however, as to the duration and meaning of the recovery in these Latin American economies. Is this a cyclical upswing in a downward trend? Or is it the beginning of a sustainable decoupling: the continuation of a structural crisis in industrialised countries and the beginning of sustainable growth, the premise of a new pattern of growth in emerging Latin American economies. It is difficult to answer these questions because the answer depends, as in the thirties, on the political responses given to conflicts of interest, especially to distributive conflicts, that arise.

The more or less pronounced openness of Latin American economies to trade and financial flows has created "transmission channels", promoting the effects of contagion between developed countries, and between them and developing countries (WTO/OECD, 2009; OECD, 2009; IMF, 2009).[1] The 2008 crisis was severe, causing growth rates to drop between five and ten points in emerging Latin American economies (Salama, 2009 and 2010). This was followed by a fairly rapid recovery, dependent mainly on a boom in the domestic market

1. Let us recall that in emerging economies in general, banks had few high-risk assets. The beginning of the crisis, triggering a credit crunch in developed countries, led in turn to a drying-up of liquid assets in emerging economies. This occurred mainly because capital « fled » these countries in order to supply liquid assets to parent companies, multinational banks and international investors, causing a drop in their respective currencies against the dollar. The return of capital, attracted by high returns in emerging stock exchanges, has not however led to a significant increase in loans, because state banks are now compelled to take over from failing private banks.

of these countries and their continuous supply of exports to Asian economies (China and, to a lesser extent, India). However, should a crisis occur again in developed countries, such as the one now threatening the sovereign debt of some European nations, the recovery of Latin American economies could be problematic. The effects of such a crisis would be more or less devastating for emerging economies, depending on their degree of trade openness, the type of goods exported, the intensity of financial globalisation, the stock-flow structure of foreign capital (bonds, equities, direct investments),[2] and the magnitude of their actual net reserves.[3] This is not only because there would be a drop in external demand, a depletion of liquid assets and a scarcity of international credits for export, but also because the possible consolidation of market dynamics in some emerging economies depends on the length of time between crises. The longer this interval, the stronger the opportunities to resist an external crisis.

The scope of this article does not allow us to concern ourselves with this eventuality, which seems unlikely to occur in the near future. Our hypothesis is that developed countries will continue to experience low growth so long as structural reforms have not been undertaken. Within this context of weak recovery in industrial countries and potential financial turmoil, we analyse the possible emergence, in the major Latin American economies, of new growth plans focused on boosting their domestic market.

### 2.3 Can history repeat itself?

In the twenties, the share of exports of major Latin American economies in world exports was greater than it is at present, despite years of continued openness. It is common, moreover, to characterise the twenties as a period of liberalisation of markets and to conclude that economies were more globalised than they are today. This, however, fails to take into account the fact that the world at that time differed from today's world on a key point: *the degree of monetisation*. In developed economies, self-produced consumption was still important in the countryside, where most of the population resided. In Latin American economies such consumption was even more significant. Therefore, the ratio of exports to GDP had only minor significance, as it related entirely to monetised values at a time when a very important part of domestic production was passing through non-monetised channels, and hence not being counted in the GDP. Nowadays,

2. The impact of a crisis on developing economies depends on the extent of the globalisation process in different countries. Synthetic indicators can help to assess this. International institutions (IMF, 2009) have been trying to do this with varying degrees of success, since according to the OECD indicator (2009, 42), Mexico should suffer less than other countries from the effects of the crisis, which is far from being the case.

3. This is an important point, but little analysed. The reserves are made up of trade balance surpluses and/or capital balance surpluses. Only the former correspond to actual reserves, while the latter are highly sensitive to economic conditions and may be truncated by a partial return of capital, as was the case in late 2008. On this point, see Bradesco (2009).

monetisation is almost complete and this ratio is more relevant than it was in the twenties. The domestic market already exists; the only way to improve it now is to increase wages and social transfers, which, in today's context of globalisation of trade, can only be done if a country's relative competitiveness is maintained. In the absence of sustained competitiveness, imports replace domestic production. Unlike the thirties, growth today that is centred on the development of a domestic market will have to respect the constraints of competitiveness – unless we assume a significant return to protectionism. Protectionist measures could in fact be "legitimised" by considerations of respect for ethical and environmental production conditions, even with incentives to buy " national " products as can already be observed. It is from this dual context of globalisation and of near-complete monetisation, which was quasi-inexistent in the thirties, that today's "bet on the domestic market" must be analysed in terms of two variables: the contribution of foreign trade to growth and the extent of inequalities.

### 2.4 A stronger (but still relatively weak) contribution of foreign trade to growth

The contribution of foreign trade to growth can be analysed from two perspectives: one a strictly accounting perspective, the other emphasising economic mechanisms and snowball effects.

In the accounting perspective, the assessment of the contribution of trade to GDP is concerned with the growth of exports and imports, i.e. exports net of imports. The former are positively involved in the growth rate, the latter, negatively. External trade may not contribute positively to a country's growth when its trade balance is negative, even if it is open to the global economy. Conversely, a positive trade balance of exports over imports will have a positive effect on growth. The case of Asian countries, and especially of China, is interesting because it is often given as an example to highlight the beneficial effects of export development on growth. If we consider the period between 2000-2008, the average contribution of net exports to the growth rate in China was 10,2%. This means that for a 10,2% average GDP growth rate, this contribution is only 1.1 points, while the contribution of investment is 5 points and total consumption represents 4.1 points. Nonetheless, with China's increasing trade surpluses during this period, the proportion has grown: The contribution of net exports rose by about 5% between 2001 and 2004 to more than 20% between 2005 and 2007, according to Goldstein and Xie (2009).[4]

Contribution in the accounting perspective is not entirely the same as economic contribution, which can sometimes be significant even in situations

4. For example, South Korea's net contribution throughout this period is higher (28.6%) and Singapore's also (27.3%); Germany's was 64% (strong trade balance surplus) while in the U.S. it was -4.3% (trade deficit).

where, from an accounting perspective, the contribution of net exports to growth is weak or negative. In this way, exports can play a coherent role in growth or, conversely, have little or no effect on it, even if the rate of trade openness is high. Let us consider two examples of highly open economies: Mexico and Korea. In the first case, growth is not pulled from the outside, in the second, it is.

In Mexico, unlike Brazil and Argentina in recent years, the trade balance remains in deficit. The structure of Mexican exports consists by 10-15% in the export of oil, the price of which is volatile, with the remainder divided roughly equally between products primarily for the Mexican domestic market and products intended wholly for external markets (almost exclusively the United States). The sharp increase in Mexico's rate of trade openness over the last thirty years is explained by the growth of exports of manufactured assembled goods, produced in " *maquiladoras* ", where the value added is low, and there is very little cluster effect (Palma, 2005). Here, we see that the economic contribution of exports to growth is reduced: GDP growth remains sluggish despite the vitality of exports. Thus, the multiplier effect is weak (Ibarra, 2008).

In Korea, growth is driven by booming exports, but the relationship is more complex than is generally believed. Following the work of D. Rodrik (1995) and, contrary to the liberal *doxa*, it was not the development of exports and the marked opening of the economy that allowed the acceleration of growth in the sixties. Imports of capital goods grew faster than exports, consisting mainly of intermediate products and sophisticated capital-intensive equipment.

The sharp increase in these imports mirrored the increase in investments. The latter, therefore, were the real drivers of growth. An important portion of these investments was in fact intended for the production of goods to be exported, which would in turn bring in foreign currencies. The sequence is thus: increased investment rate leading to import growth leading to export growth; and it was only later that the balance of trade became positive. From an economic perspective, it is clear that the positive contribution of exports to growth is explained here by the government's industrial policy of encouraging local production of the inputs needed for the manufacture of exported products. It is this policy, designed to increase the value added locally, which explains both the increase in investment and in imports of capital goods. Indeed, efficient investment practices, as reflected here by the imports of sophisticated capital equipment, were equally instrumental in bringing about the desired growth. We are in a scenario, therefore, that is radically different from the Mexican case. The contribution to export growth comes from an intensification of related industry, through a direct increase of investments in the sector producing goods for export, and an indirect increase in sectors producing inputs for these products. From a Keynesian viewpoint, the multiplier effect of increased investment outweighs the negative effect of imports and enhances the positive contribution of exports. This analysis of the Korean case can be applied to many other Asian economies. Boosting the domestic market through a redistribution of income does not mean neglecting the role played by the foreign market. It is not "a zero sum game".

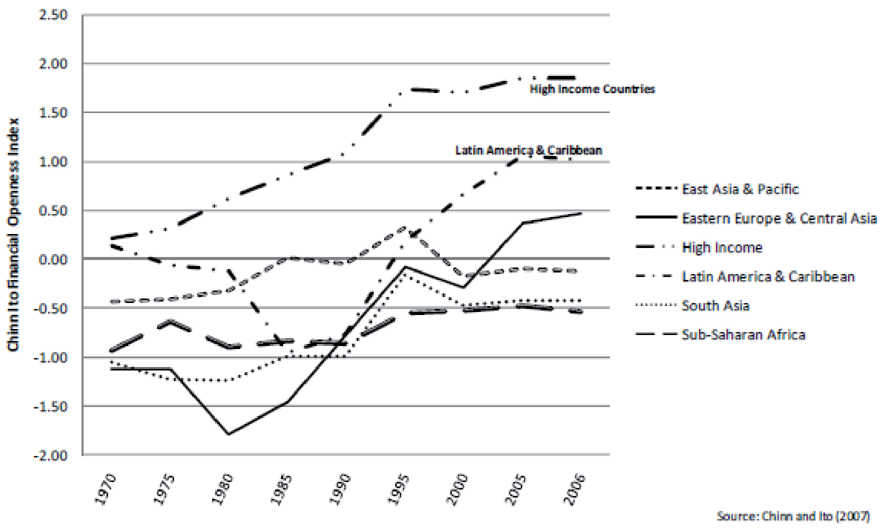
The relationship between external market and internal (domestic) market is therefore more complex than appears at first glance. To speak as philosophers, we are dealing with two data that are "separate but interdependent". It is a point often overlooked by economists.

This being said, trade openness has been moderate and the contribution of exports to growth in Latin America has been weak over the past twenty years. Contrary to what one might imagine, the emerging economies of Latin America have not experienced an exceptional process of trade liberalisation. Though Mexico and some small countries in Central America are exceptions, Brazil, Argentina and many other countries have maintained their overall participation in world exports.[5] As these have grown on average twice as fast as world GDP during this period, globalisation has increased, of course, but at a rate more or less equivalent to the global average. Thus, despite a substantial increase in Brazil's degree of openness between 1990 (11.7%) and 2004 (26.9%), its weight in international trade remains at a marginal level and relatively stable, hovering around 1.1% between 1975 and 2005 (Kliass and Salama, 2008), although it has since gone up slightly due to the significant rise in the cost of raw materials. By contrast, the growth of exports from China is much faster than the global average. Its share in international trade, which was roughly equivalent to that of Brazil in 1975 (0.9%), has risen sharply: 1.9% in 1990, 3.9% in 2000 to reach 7.4% in 2005 and now soaring at 8.9% (Instituto economico do desenvolvimento industrial and WTO-OECD). The globalisation of trade is therefore faster and more important in China than in Brazil. Although Brazil and Argentina have opened up to the world economy, they are not yet what could be called open economies. However, unlike what can be observed in Asian countries, the globalisation of finance in Latin America has been substantial, much higher in fact than in Asian countries, as is shown in the chart below.[6]

5. As noted by N. Birsall Birdstall and Hamoudi [2002] in their criticisms of the work of Dollar and Kraay (2000), this is far from being a perfect indicator for economies whose exports are largely, and even exclusively, made up of primary products, as is the case in the least developed countries (LDCs). Indeed, commodity markets are highly volatile. The numerator of this ratio, and hence the indicator itself, are strongly affected by the fluctuating cost of raw materials. To define certain economies as « Globalizers » or not, depending on the evolution of this ratio, and seek to establish a relationship with the growth rate of GDP, is therefore inappropriate from a scientific perspective.

6. See Galindo, A., Izquierdo, A. and Rojas-Suarez, L. (2010, p.12). Today, there is abundant literature on this topic; we cite for its especial interest the article by Titelman, D., Perez-Caldentey E. and Pineda, R. (2009).

CHART 1
**Financial openness**

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However, financial openness did not bring about a significant development of high-risk financial stock share products in banks. For this reason, the latter suffered from scarce liquidity due to the repatriation of capital at the beginning of the crisis, more than from the need to "clean up" their balance sheets. Although their balance sheets have only been slightly affected by high-risk financial products, the behaviour of private banks in these countries has adapted to that observed in developed countries: credits to the economy have declined, and the financing of investments and exports has become more difficult. Credits to the economy have not entirely collapsed, however, because governments have sought to facilitate access to credit and to charge low interest rates (multiple subsidised rates for the purchase of cars and homes, for export, etc.), through their public banks. This policy has been facilitated in some places by the existence of large state banks such as BNDES in Brazil, and made more difficult elsewhere by their absence, or smaller size.

### 2.5 Strong inequalities as barriers to recovery of growth by the domestic market

Income inequalities are particularly high in the vast majority of Latin American countries (Salama, 2006), though with three exceptions, they have declined slightly in many countries between 2002 and 2008 (ECLA, 2009; Lopez-Calva and Lustig, 2009; Hopenhayn, 2009; Salvatori Dedecca, 2010).

This development is important, and its causes numerous: change in how the labour market operates, greater social transfers, less regressive fiscal policies, population decline and increase in the employment rate of women – though the contribution of these last two factors to the decline in inequality is relatively modest according to Lopez-Calva and Lustig (2009: p. 40 et seq.). Indeed, the number of adults per household accounts for 6.6% of the decline in inequality between 2000 and 2006 in Brazil, 8% in Argentina and 10.3% in Mexico. The reduction of inequalities mostly comes, in fact, from improved working conditions (employment, salary) and only in a relatively small proportion from increases in revenue not generated by labour[7] (26% in Argentina, 15.1% Mexico). The exception is Brazil (45.2%). More precisely, we observe in Brazil that the improvement in labour incomes is stronger for low incomes than for high incomes. The earning ratio of the richest 5% to the most modest 50% of the population went from 14.3 in 1993 to 13.5 in 2008, while the ratio of the richest 5% to the poorest 25% went from 23.6 to 18.6 (Salvatori Dedecca, 2010: p.16). These data may be surprising.[8] They are partly due to the strong increase in the minimum wage, and thereby the amount of pensions paid by the public sector,[9] and partly also to employment growth and the changing structure of jobs (Salama, 2007 and 2008). But the bottom line is that social transfers, contrary to common belief, play only a small role in the transformation of inequalities. We shall examine this last point more closely.

The works of the OECD (2008) and of Goni, Humberto-Lopez and Serven (2008), from which the chart below is borrowed (p.7), clearly show the very weak influence of social transfers on the concentration level of incomes, as measured by the Gini coefficient. In considering the difference between gross income (including social transfers) and market income in Latin America and Europe, we observe that the impact of these transfers on the concentration of incomes is high in Europe but very low in Latin America. If we consider the available income (including transfers and direct taxes) and gross income (including transfers), we observe that the impact of taxes on the reduction of inequality is much higher in Europe than in Latin America.[10] The only effect of remittances in Latin America

7. This is a very heterogeneous category, consisting in social transfers as well as rent and income on capital.

8. Two comments :*i)* Income of 0.01%, 0.1% of even 1% of the richest population grew much faster than the rest of the population, as indeed in all Western countries *ii)* Income on capital (interest, dividends) is very poorly recorded.

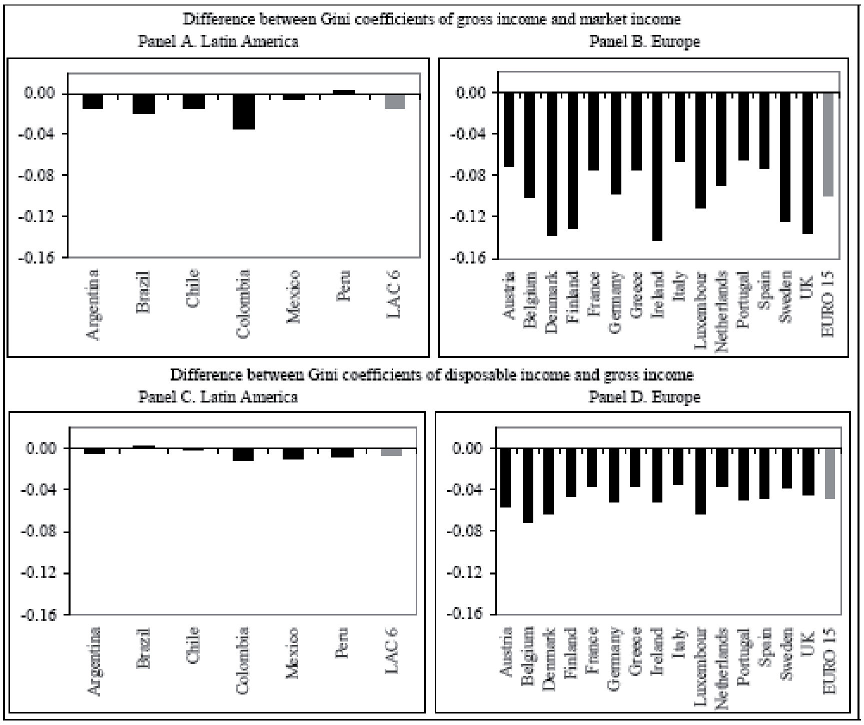
9. In many countries, there appears to be a link between the minimum wage and amounts paid into pensions. A relative increase in the minimum wage tends to raise total pensions. On a more general note, social policies, as defined in Latin America (education and social transfers as well as social protection, which mainly consists in pensions and health care) are still relatively weak, although increasingly strong in some countries like Brazil. According to research by Afonso and Dain (2009), there are only 3 countries (Argentina, Chile, Costa Rica) in which social spending exceeded 13% of GDP between 1985-1990. There were 9 such countries in 2006-2007, including Brazil (24.4% of GDP), but no longer Chile. In Mexico, social expenditures were less than 9% of GDP during the first period but increased during the second period to11.2% of GDP.

10. The difference would probably be greater still had this research taken indirect taxation into account – this being higher in Latin America than in Europe (ECLA, 2009; Gómez Sabaini *et al*., 2008). Indeed, indirect taxes are usually more regressive than direct taxes, because all individuals pay the former at a constant rate, contrary to direct taxation.

is low compared to European countries. The Gini down slightly by 2 points on a scale of 1-100, while it decreased much more sharply in Europe on average (see the first two tables). The effect of direct taxes is extremely low in Latin America on average (less than 1 point on the Gini), while it is also much higher on average in Europe (see the last two tables). Therefore these differences are much more important once transfers, net of taxes, are included (on the order of 20-25 points). On average, the Gini in Latin America goes from 51.6 to 49.6 while in Europe it goes from 47.6 to 28.2.

From these data, we can readily understand why many economists, following the work of Celso Furtado, have seen the trend of economic stagnation as being caused by these levels of inequality and low social spending (Salama, 2006: chapter 1) and, conversely, why the slight reduction in inequalities and increase in social expenditures may have boosted growth in the years 2000 and revitalised the domestic market.

CHART 2
**The role of taxes and transfers in Latin America and Europe**

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## 3 CONCLUSION

It is difficult to discuss the possible futures of Latin American countries without distinguishing the different paths they have followed during the last ten to fifteen years. Brazil, Argentina, and Mexico have certain features in common: high income inequality, higher in Brazil than in Argentina; slight reductions in these inequalities; a modest openness to international trade (with the exception of Mexico); primary exports once again making up an important proportion of total exports in Argentina and Brazil; a difficulty in exporting sophisticated industrial products, less pronounced in Brazil than in Mexico or Argentina; and finally, a trend towards appreciation of the real exchange rate, with the exception of Argentina in the 2000s. These countries also have different backgrounds. In Brazil and Mexico, the average growth rate of GDP has been modest in the 2000s. While Brazil's growth rate increased somewhat in 2004, Argentina's appeared to take off in Asian style. In 2009, the drop of the GDP was very sharp in Argentina, but still less pronounced than in Mexico and much less so than in Brazil. Inequality has fallen more significantly in Brazil in the 2000s than in Mexico or Argentina, and, while social expenditures have increased in proportion to GDP in Brazil and Argentina, they have stagnated in Mexico (Alonso and Dain *op.cit.*).

These developments, as well as accelerating growth from 2003-2004 onwards, raise questions as to whether the beginnings of a new growth regime in Brazil (and more tentatively in Argentina), started even before the crisis erupted in 2008, carried by a boom in domestic demand. This boom may have been hidden by the simultaneous growth in primary product exports caused by the rise in their prices.

These countries are at a crossroads. Economic recovery and countercyclical policies,[11] decided in the aftermath of the breakout of the international crisis, could serve as a springboard for defining a new growth regime. In so doing, these countries, building on what appeared timidly in the 2000s, would " benefit " from the international crisis to further reduce their income inequalities and promote the contribution of their internal market to economic recovery,– somewhat like what happened in 1933-34 after the Great Depression of the thirties.

The massive return of capital into the so-called "emerging" markets of Latin America, the resumption of GDP growth, the difficulties in sustaining demand insofar as it could increase labour costs – all these factors strengthen the political

11. These were characterised primarily by policies to support domestic demand, both at a tax level (reduction of certain taxes), a monetary level (artificially low interest rates for the purchase or sale of certain products), and even a budgetary level (due to the increases in the minimum wage, pensions and social transfers). Countercyclical policies were relatively little characterised by policies of major public work on infrastructures, such as occurred in China (Khatiwada, 2009; Jimenez, 2009).

weight of those who would like to "close the parenthesis of the crisis" and return to the previous excluding growth pattern of the early 2000s. This temptation is even greater now that the return of capital translates into a new trend of appreciation in national currencies, after their sharp decline in 2008-2009. This trend is favourable to foreign investors but bad for exporters of industrial products, because the decrease in competitiveness caused by rising labour costs, expressed in dollars, is not always compensated for by the decline in value of their imports of intermediate and capital goods.

One might think that Mexico will probably be most tempted by this route, as its foreign trade is almost exclusively directed towards the United States and Canada, and foreign ownership in its banking system is very powerful. Conversely, a resumption of the international crisis would promote the continuation of an anti-cyclical policy favouring demand, stimulate the search for alternative trading partners and enable a further depreciation of the peso, thereby offsetting increases in labour costs.

A continued policy supporting domestic demand is more likely to occur in Brazil and in Argentina. But it suffers from many handicaps. As we have seen, the reduction of inequalities is weak and these inequalities remain at an extremely high level. The absolute size of Brazil's population (which is greater than Argentina's) and the existence of Mercosur allow it to have a sufficiently large domestic market, in terms of capital development, for a wide range of products. This in itself seems insufficient, however, to inspire sustainable market-driven growth as long as the weight of finance and its effects on income distribution have not been contained. Increasing the wages of the least paid social strata, however desirable it may be given the extent of poverty, is not sufficient. The obstacle of regressive taxation must be lifted, which cannot be done without deepening serious conflicts of interest that have been at work for some years already.

In the thirties, the market was created through a "forced march" of monetisation, produced by industrialisation and giving it impetus. Today, the domestic market can contribute to sustainable growth only if a true Welfare State is established. This alone will make it possible for the domestic market to offset the sluggish external demand for industrial products. Not to choose this path is to accept a return to international specialisation in primary commodities on the pretext that the international demand is strong. This is choosing the easy way out today, but also a fragile economy for tomorrow. It is opting for a return to the years preceding the thirties – a strange reversal of History.

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