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Institutions and development: what a difference geography and time make!

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Abstract: Ha-Joon Chang, in his article 'Institutions and Economic Development: Theory, Policy, and History', provides a description and critique of the mainstream view of institutions and development. It applies well to Latin America in the 1980s and 1990s. However, the effort to introduce these Anglo-American institutional structures (Global Standard Institutions; GSIs) in the 1980s and 1990s resulted in uneven and unstable economic performance, not development. As a result, the relationship among institutions, development and economic policy in Latin America today has generally moved far beyond this 'mainstream'. The institutions to insure macro stability have generally been preserved, and some countries do follow GSI prescriptions. However in most countries, especially in South America, the effort to find the right mix of institutions for development has moved far beyond this mainstream. The result has been innovative initiatives to address more fundamental development issues such as inequality, property rights and international economic institutions. This process is likely to continue, facilitated by the currently robust democratic political systems that grew out of the earlier turmoil.

1. Introduction

Ha-Joon Chang (2011) provides a cogent critique of the 'currently dominant discourse on institutions and development' (ibid.: 1), using a large number of sources. His main reference is to the World Bank, particularly their 'Governance Matters' approach to institutions, as well as his own academic writings.

His description and critique apply quite well to Latin America, particularly to the Latin America of the 1980s and 1990s. The relation of institutions, development, and economic policy in Latin America in 2011 is quite different from this 'mainstream'.[1] The effort to introduce the Anglo-American institutional structures in the 1980s and 1990s resulted in uneven, unstable and

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1 To be sure, mainstream advice is still offered. For example, Timothy Wise (2010) describes a World Bank expert extolling the virtue of commercial agriculture after NAFTA and blithely stating that small famers could simply move to other employment. This is in Mexico with 57% of the workforce in the

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questionable development. To be sure, some mainstream institutions were locked in 'by design', e.g. in free-trade agreements, and more careful macro policy has become the norm. Nonetheless, the effort to find the right mix of institutions for development has moved far beyond what Chang characterizes as mainstream, especially in South America. More importantly, this process seems likely to continue apace, facilitated by the robust democratic political systems that grew out of the earlier turmoil.

2. Institutions and Latin American development under the Washington Consensus

The earlier mainstream institution-building period began with the dictatorial imposition of a market-based economy in Chile after 1973. Despite some increased social expenditures and attempts to confront Chile's extreme inequality, this market-based, export-oriented, open economy was not fundamentally changed when the left-leaning Concertación came to power in 1990. This institutional continuity resulted in a 5 percent annual gross domestic product (GDP) growth rate from 1990 to 2009, compared with the overall Latin American rate of 3 percent.

In most of the rest of Latin America in the 1980s, the difficulty of adjusting to the transfer of their income to oil-producing countries led to shifting approaches to development policy as well as to political instability. The mix was poisonous, and the 1980s was truly a lost decade economically.

This led Latin American countries to adopt Chang's mainstream policy package, formulated as the 'Washington Consensus' (Williamson, 1990). This step was encouraged, or often imposed on countries, by the World Bank, the International Monetary Fund (IMF) and the US government. Most of the seven elements of the 'Global Standard Institutions (GSIs)' (Chang, 2011: 2) were put into place in most of Latin America. Argentina became the poster-child for the package and the darling of the international institutions, especially when it adopted 'convertibility', a modified currency board that severely restricted discretionary monetary policy.[2]

The programs had various descriptions, e.g. Durán Ballén's 'modernization' program in Ecuador (1992–1996) or the Franco/Cardoso 'Plano Real' in Brazil (1994–1995). Their implementation was facilitated by the rise of US-educated technocrats to important executive positions, e.g. Mexico's President Carlos Salinas de Gortari (1988–1994) was a Ph.D. graduate from Harvard who was succeeded by the Yale Economics Ph.D. graduate Ernesto Zedillo (1994–2000). At a macro-economic level the technocratic institutional reforms were successful,

informal sector. However, in most of Latin America, the audience is no longer receptive to such simplistic formulae.

2 Convertibility was one factor in reducing Argentine inflation from 4923 percent in 1989 to 3.8 percent by 1994.

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relative to the chaos of the 1980s. Inflation stabilized and growth became positive. In part this reflected the parallel performance of the US economy, which experienced its longest expansion along with a moderation of inflation. However, the process of institutional change was not without setbacks, most notably when liberalizing the financial system. This led to banking crises in many countries – Brazil, Mexico and Venezuela in 1994, Paraguay in 1995, and Ecuador in 1996.

Nonetheless, there was profound macro institutional change that nowhere in Latin America has been completely reversed; it occurred not through 'development', but from the failures of the 1980s. In some countries, these GSI changes were locked in through international agreements, specifically free-trade agreements with the USA. The North American Free Trade Agreement (NAFTA, signed by the USA, Canada and Mexico) and the bilateral agreement between the USA and Chile were the first (January 1994). The most recent is the bilateral agreement with Peru in February 2009. Free trade is not an apt description of these treaties. They are more investment agreements that subject the countries' economic policy to international regulations, providing exceptional recourse to private investors and restricting government support for domestic economic actors. They were successfully designed to limit countries' institutional freedom (Chang, 2011: 18).

So, in the 1990s, development policy in Latin America did exemplify the mainstream version of institutional change. Argentina carried that banner and illustrates that well. Opening its banking system to foreign capital led to modernization and to an implicit role of the foreign banks as the lender of last resort, replacing the convertibility constrained Central Bank. State enterprises were closed or sold to private investors, the union control of the labor market was broken, foreign investors were quite attracted to the country, and Argentina's stock market index, the MERVAL, increased dramatically until it hit a high of 866 in 1997 (1986 = 0.01). But the model failed. The economy went into recession in 1998 and the mainstream institutions were too rigid to adjust. Stability increasingly depended on international capital flows, particularly from the IMF. Financial turmoil in 2001, along with political uncertainty, led to economic and political chaos by the end of that year and a fundamental reorientation of the economic model from 2002 on.

The failure of the institutional structure that Argentina had adopted, based on the mainstream discourse, resonated throughout the hemisphere, particularly in South America. It caused a fundamental re-examination of economic and political institutions and a reassessment of the meaning of development. Without doubt, the homogeneity of the discourse on institutions and development that Chang (2011) assumes is not descriptive of Latin America in the first decade of the 21st century. This is a period of experimentation and innovation in an attempt to find institutions appropriate to Latin America's development needs. Perhaps the most tangible indicator of Latin America's insulation from the mainstream model is that none of the major countries have any 'outstanding purchases or

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loans' from the IMF that had previously provided the IMF with leverage to enforce its mainstream policy package.

3. Institutions and contemporary Latin American development policy

The failures of the 1980s prioritized macro stability and put in place institutions designed to accomplish this goal. As a result most of Latin America has weathered the current crisis relatively well in terms of growth, inflation and international balance. Some have gone further and follow most of the GSI prescriptions. This is usually because of a close economic relation with the USA, as in Mexico, Colombia, Peru, as well as Chile. However, throughout Latin America, and even in these 'mainstream' countries, identifying the GSI institutions as 'development' is the exception rather than the rule.[3] The limitations and contribution of the mainstream discourse to the disarray in previous decades has broadened both the definition of development and the range of possible policies far beyond that mainstream.

The result has been a vibrant upwelling of institutional innovation and experimentation in the interest of 'development'. This exemplifies the complexity of the relation of institutions and development noted by Chang (2011: 21–22) and relies on 'human agency' to confront the difficulties of institutional change. Let us note some of the most important cases.

Chang (2011: 3) notes that 'GSIs are institutions that inherently favour the rich over the poor'. However, since the 1990s there have been a series of institutional changes in the mechanisms of social protection in Latin America that together represent a creative effort to address this shortcoming of the GSIs. They are more consistent with the positions in 'Washington Contentious' (Birdsall and de la Torre, 1998) than with the Washington Consensus. Traditional social security programs were initially complemented by make-work programs to deal with extreme poverty. They evolved into social investment funds in a number of countries, e.g. Ecuador, Peru, Bolivia and Jamaica, that allowed decentralized local decisions on infrastructure projects and that provided employment and community development (Ferreira and Robalino, 2010: 7). Simple transfer programs targeted to the poor were also adopted as non-contributory social or health insurance programs in many countries. Finally, conditional cash transfer programs have expanded, providing a direct transfer to a poor family, contingent on a behavioral response such as ensuring that the children attend school or obtain required health services (Ferreira and Robalino, 2010: 11–12). These institutional changes are profound:

3 For example, in Peru the orthodox Alan Garcia and his predecessor, Alejandro Toledo, are both highly unpopular, even though the macro performance of Peru has been quite good, with the third highest growth rate of GDP between 2000 and 2009.

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> ... the transformation of Latin America's social assistance system over the last two decades or so goes beyond the increase in the monetary value of its expenditures. From a situation twenty-five years ago, when social insurance was only available to a minority of workers in urban areas, and social assistance was limited to a few untargeted food and fuel subsidies, many countries in the region have now created systems that distribute resources to large numbers of poor people, including in rural areas. In that sense, the system's effectiveness has increased more markedly that [sic] its costs (Ferreira and Robalino, 2010: 13).

In large measure these programs emanate from the strengthening of democratic institutions following the earlier military dictatorships. This is another major institutional change that seems robust, despite the challenge represented by the coup against President Manuel Zelaya in Honduras in 2009.[4] Another important outcome of democratization has been to give voice to groups whose identity and worldview stand in direct opposition to the GSIs. Most notable are the indigenous in Ecuador and in Bolivia who have succeeded in redefining the countries as 'plurinational states' through consititutional reforms. This allows the indigenous to oppose private property claims, based on communal rights and traditional relationships with the land. This has become a basis for resisting private investments in mining, water and oil projects that would affect their pacchamama, their mother earth (Jameson, 2011). The reassessment of private property has also encouraged those governments to renegotiate natural resource concessions that had been granted to international corporations under the Washington Consensus. In the case of Ecuador's ITT-Yasuní oil field, the government has solicited international funds to pay to keep the oil in the ground. This wedding of carbon-offset economics with indigenous rights and aspirations is an exceptional example of institutional innovation beyond the mainstream.

One of the most notable efforts at creating new democratic institutions has been the 'participatory budgeting' effort begun in Porto Alegre, Brazil, in 1989, and now used in some 150 Brazilian municipalities. Much of the city's construction and service budget is allocated based on a highly decentralized process, driven by grassroots participants. Deepti Bhatnagar *et al.* (2010) found that this innovation has resulted in notable improvements in physical infrastructure and in access to services.

There have also been innovative trans-national efforts to develop institutional structures that operate directly in opposition to the mainstream. Venezuela's oil revenues were put to the service of a number of these efforts. The most avowedly anti-mainstream was the Bolivarian Alliance for the Peoples of Our America (ALBA), which was established on 14 December 2004 and now has nine

4 There was also a coup in Venezuela in 2002, though Hugo Chávez was returned to power, a planned coup in Bolivia in 2008, and a police insurrection in Ecuador in 2010. Only Honduras saw the removal of the head of state.

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members plus a number of observers. It is to be 'a regional alliance committed to social, political, and economic cooperation and equality' (DeFeo, 2010). ALBA is far from a viable counterweight to the existing institutions of inter-American coordination, and the need to shift resources to domestic issues in Venezuela will further weaken it. In any case, it represents an effort to fundamentally alter existing institutions. Its first transaction in its clearing currency, the 'sucre', occurred in July 2010 when Ecuador sold rice to Venezuela and was paid in sucres (at 1.25 sucres per dollar) (Mather, 2010).

More significant is the 12-member Union of South American Nations (UNASUR), which came into being in May 2008 'as a vehicle for economic, political, social, and cultural integration' (NotiSur, 2009: 1). It will be a case study of how humans can act to change institutions, avoiding the corner solution of fatalism or voluntarism (Chang, 2011: 17). The Union created two sub-organizations. The South American Defense Council is 'an entity to strengthen mutual trust and consolidate the region as a peace zone' (NotiSur, 2009: 1). The Council may have played a role in encouraging Ecuador's military to support President Correa when he was attacked by elements of the national police on 30 September 2010. UNASUR's representatives met in special session in Buenos Aires and affirmed their support for Correa and democratic government. They then proceeded to Quito when calm had returned (Planas, 2010: 1). The second sub-organization is designed to change the institutional constraints of the international financial system. Its vehicle is the Banco del Sur (Bank of the South) that was initially capitalized at $7 billion by Latin American government contributions. Its goal is to provide autonomy and development financing for Latin American projects. At this point it remains in formation, but again is a clear effort at institutional innovation, designed to alter the constraints placed on Latin America by the mainstream institutions.

4. The potential revenge of the mainstream

While Latin America provides a hopeful counter to the dominance of the GSIs, the end result of the institutional innovation that has taken place is far from clear. In this, Chang's warnings about the complexity of institutional change are well placed. The old saw that 'Brazil has a wonderful future – and always will' may be appropriate for this context. Inequality continues in the extreme in Latin America and only if the new social programs fuel true incorporation of the marginalized, and mobilization of their potential, will the underlying structure be changed. Much of the current macro-economic success of Latin America has depended on commodity booms and discovery of new deposits of minerals and oil. This is the traditional Latin American pattern that has never generated the long-term economic success that other areas such as East Asia have attained. In addition, even though Cuba has recently expanded its private sector access, there are ample divisions among the Latin American countries in their economic

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policies. So their ability to withstand a USA that is intent on supporting the GSI policies could be severely limited over time. So Chang's critiques and cautions may in the long run dominate the story.

Nonetheless, in comparison with the days of the Washington Consensus version of the mainstream discourse, the vibrancy of institutional innovation and change that has characterized the last two decades in Latin America must be given its due. It certainly deviates fundamentally from any univocal mainstream discourse.

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