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When Political Instability Dictates International Trade Policy: Case Studies from Latin America

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Introduction

Politics and economics are deeply interconnected. The history of international economics can record several instances in which the course of the events was steered by the policies enacted by governments/nation-states. Liberalist measures are usually associated with better economic growth, which in turn is associated with less government change.

This thesis investigates the relationship between political instability, defined as the propensity of a government collapse because of conflicts or the incidence of political upheaval and violence in a society and international trade policies, as a proxy for economic growth. To this aim, the degree of protectionism implemented by a national government is assessed against the socio-political background of the country. The analysis is based on three case studies – i.e., Nicaragua, Colombia, and Argentina –, which have been selected according to the following criteria: first, they are all former colonies of the Spanish Empire and, as such, they went through the formation process of the nation state in the nineteenth century; second, they experienced long periods of political instability coupled with violence; third, they all experienced the influence of the Unites States' (US) imperialism – despite with different intensities; and, finally, they all implemented trade barriers to insulate their national economies.

The findings presented in the thesis proved my initial hypothesis: there is indeed a correlation between political stability and economic performance. However, it is hard to establish a causal link on which one of the two causes the other. Regardless, the literature proved that a country plagued by political instability, which often results in social violence, can hardly thrive economically, and very often it will resort to the implementation of trade barriers to insulate its economy.

The research has been conducted in a qualitative way. The extensive literature review conducted has led to gathering in-depth insights on the topic. The sources consulted were mainly secondary, except for few – but relevant – primary sources (i.e., Senate hearings) which gave a more punctual recollection of some moments in history.

The thesis is structured as follows. Chapter 1 presents the theoretical framework by discussing: what a global economy is and its underlying institutional framework – i.e., the multilateral trade system; the main strands of political economy; the relationship between political instability and trade; the impact of US imperialism on the subject countries; the theorization of import substituting industrialization; and the lost decade of Latin America.

Chapter 2 provides the account of the Nicaraguan case, starting with the independence from the Spanish Empire and ending more than a century later, in the late 1980s, with the final opening of the economy to international markets. The years from independence to the 1980s are recounted giving particular attention to the long periods of both overt and covert US intervention in the country and the consequences it entailed; the long periods of autarchic rule and, necessarily, the destabilization of the economy.

Chapter 3 explores the Colombian case and how it dealt with the paradox of a long, distinguished history of electoral fairness as one of Latin America's longest-standing democracies existing alongside a history of widespread political violence, carried out in various forms – insurgency, terrorism, narco-terrorism, paramilitarism, and human rights abuse. The economy, once characterized primarily by coffee and other agricultural export, had to go through a process of industrialization during these periods of social and political violence and resorted to policies of import-substitution industrialization (ISI) since the beginning of the twentieth century.

Chapter 4 provides insights into the most paradoxical country in Latin America: Argentina. Indeed, the country of Juan and Evita Perón went from being one of the richest countries in the world, competing head-to-head with industrialized countries, to one of the worst performing among developing countries. Since 1930, twenty-five governments rose to power, fourteen of them by coup d'état or by less overt forms of military persuasion. Political instability resulted in economic misfortunes.

Chapter 1 Theoretical framework and literature review

1.1 Global economy

There are a variety of definitions that seek to narrow down a vast concept such as ‘global economy’, and although the differences in nuances, they all have at their core the idea of economic interactions among nation-states. Indeed, the advent of globalisation – i.e., the process through which national and regional economies, societies, and cultures have become integrated via the global network of trade, communication, immigration, and transportation – led to the advent of the global economy. Four macro areas, each deeply linked with the other, characterize the world economy: the international trade system, the international monetary system, multinational firms, and economic development.

Both losers and winners emerge from the global economic exchange. While winners seek to deepen their link with the global economy to consolidate – or even extend – their gains, losers try to protect themselves and insulate their national economies by erecting trade barriers, such as tariffs, to minimize or reverse their losses.

Economics is the study of how societies use their resources, be them land, coal or people. Resources, however, are scarce, and therefore economics looks at how societies can use scarce resources to satisfy needs. These decisions have welfare and distributional consequences. Some societies face harsh decisions when dealing with the scarcity of their resources, therefore they might decide to trade with other societies to obtain what is needed for their survival.

In the last century the world got so accustomed to having a deeply interconnected, global economy that it is hard to imagine of a period in which this has not been the case. However, several important steps had to be taken to connect nations, one of them, if not the most important, being free trade. Far from being universally praised or inevitable, trade liberalization happened thanks to the conscious decisions of political and economic actors. The origins of its theorization can be traced back to Sir Adam Smith’s (1776) book *The Wealth of Nations*. However, the Scottish economist has not been the first to recognize the importance of free trade, as in 1581 the English scholar Sir Thomas Smith wrote:

“For although God is bountiful unto us and sends us many great commodities, yet we could not live without the commodities of others.” (Smith, 1776, p.8)

Smith’s *The Wealth of Nations* and the Ricardian economic theories originated in the eighteenth century as an opposition to seventeenth century’s mercantilism. It began when thinkers decided to turn their backs on medieval religion, and approach economic dilemmas from a rational, scientific perspective (Kishtainy, 2017). Looking at them from today’s perspective, their thoughts resembled more a hodgepodge of beliefs than a structured economic theory. Modern economists also criticize them for placing too much importance on gold, which embodies a nation’s wealth rather than goods. Nonetheless, such beliefs continue to influence economics. They argued that national power and wealth are connected tightly, national power in the international sphere depends on wealth, which is required to accumulate power; trade provided one way to accumulate power from abroad, but only if the country held a positive balance of trade. It follows that some economic activities are to be deemed more valuable than others thanks to their ability to generate wealth, and a positive balance of trade. Manufacturing activities are considered more important than agricultural activities. Therefore, given that economic actors and mere societal forces cannot be trusted to work in favour of the whole country’s balance of trade and power in the international arena, the state should play a large role on resource allocation. The mercantilist perspective was heavily influenced by the international economic environment, but also by the rise of nation-states as the primary political entities, which corroborated the deep interconnection between economic activities and politics, more specifically state power (Oatley, 2016).

Smith instead had a very different view of society and, therefore, economics. In his *The Wealth of Nations*, he posed that societies thrive when people act in their own self-interest, realising their capacities. Economic activity’s main purpose should be to enrich individuals instead of state power, countries do not enrich themselves by running trade surpluses and, finally, regardless of specific categories of production, societies are made wealthier when they produce goods that they can make at a relatively lower cost at home and importing goods that they would produce at a relatively higher cost. The last proposition is a rough explanation of the concept of comparative advantage. Thus, what does the government do? Liberalism argues that government's efforts to allocate resources reduce welfare, advancing a market-based system of resource allocation.

There is one last traditional school of thought to be considered: Marxism – eponymously derived from Marx's nineteenth century critique of capitalism. First, he (Marx, 1867) theorized that there is a natural tendency toward the concentration of capital in the hands of a small, wealthy elite. Second, capitalism is associated with a falling rate of profit. Finally, it is plagued by an imbalance between the ability of people to produce goods versus their ability to purchase goods. In contrast to liberalism's emphasis on the market-based system of resource allocation, Marx argued that capitalists make the decisions about how society's resources should be used, with the state only operating merely as an agent of the capitalist class. The three traditional schools of political economy offer three distinctive answers to how politics' shapes the allocation of resources.

Although the literature offers plenty of illustrious examples of upholders of the idea of free trade as well as opposers of it, there are at least three economic reasons for which countries need to trade: comparative advantage – and the Heckscher-Ohlin model (Ohlin, 1933); returns to scale; and imperfect competition. One key reason for international trade is differences between countries, and a theory of trade based on these differences is called a comparative advantage theory. The classic formulation of comparative advantage by British economist David Ricardo, first published in 1817, argues that countries should not produce every good or service, only those they are better at producing, i.e., goods they are able to produce at a lower opportunity cost, and import all others (McLaren, 2012). The Ricardian model is a comparative advantage theory that is based on differences in production technology across countries. The Heckscher-Ohlin model is an economic theory that proposes that countries export what they can most efficiently and plentifully produce. The model emphasizes the export of goods requiring factors of production that a country has in abundance. It also emphasizes the import of goods that a nation cannot produce as efficiently.

Comparative advantage though, does not explain every trade relation among countries, especially when the skills of the workers or the technological endowments are similar if not equal. According to Ricardian and Heckscher-Ohlin models, the United States and Japan or the United States and the European Union would have little reason to trade; however, we know this is not the case.

Another important motivation for international trade is the efficiency improvements that can arise because of the presence of economies of scale in production. Economies of scale means that production at a larger scale (more output) can be achieved at a lower cost. When production within an industry has this characteristic, specialization and trade can result in improvements in world productive efficiency and welfare benefits that accrue to all trading countries. Economies of scale are most likely to be found in in highly capital-intensive industries, such as automobiles or chemicals, given that running a production line requires a tremendous, fixed (i.e., it is present even if production drops to zero) cost (McLaren, 2012).

Imperfect competition arises when there is an imbalance of power among the actors. Monopolistic competition implies intra-industry trade and, in addition, benefits from trade that include lower price/marginal cost margins and greater product variety for consumers. If firms in a monopolistically competitive market differ in their productivity, and if exporting requires a fixed cost, opening to international trade can have the additional benefit of improving productivity. This is so because trade benefits large, efficient firms that export, leading them to increase at the expense of small, less efficient firms that produce only for the domestic market, and because the least efficient firms drop out of the market. This can be called the 'Melitz effect' (Melitz, 2003).

The history of international economics can record two waves of globalization: the first one, in the nineteenth century, and the second one, which might still be ongoing according to some scholars, that originated in the 1970s. They were both driven by technological change, although of a different nature. In the 1800s the invention of the steam engine and the normalization of the use of the telegraph dramatically driven down shipping costs. However, it is politics that made international trade a reality: bilateral trade agreements and an international monetary system. After a long dominance of the British Empire, the United States and Germany started to challenge such dominance. The first globalization process, and therefore interconnection, suddenly came to a halt due to the eruption of World War I. Economic globalization, however, is not inevitable, it is a product of the choices of the various economic and political actors involved. While World War II was still being fought, the Allied nations decided to put in place the Bretton-Woods system, which was characterized by an international monetary system key to allow international trade to happen, and in the 1970s a rise in trade flows and loosening of restriction to labour immigration, which brought about integrated world labour markets, resulted in a second wave of globalization. The technological changes that characterized this wave were the Internet, a phenomenon of 'containerization', and large movements of capital – in the form of foreign direct investment (FDI) –. As before, policy changes – such as the system based on the General Agreement of Tariffs and Trade (GATT) and, later, on the World Trade Organization (WTO) – were found to concur with technological innovation (Oatley, 2016). Trade agreements as the GATT are part of international trade policy.

1.2 The multilateral trade system and its implications

The central element of modern trade policy is the emergence of the multilateral trade system in the last half of the twentieth century. The multilateral trade system is an attempt by governments to make the economic environment stable and predictable. It is made of different countries and their political and economic ecosystems, which to various degrees, willingly participate to this alliance and agree to establish a free trade area among them.

From the early days of the Silk Road to the signature of the GATT and, later, the establishment of the WTO, trade has played an important role in supporting economic development and promoting relations among nations. Countries agreed to establish rules to govern international trade to reduce transactions costs and to curb the quasi-mercantilist expansion of trade driven by exporters and potential exporters seeking new markets. This trade expansion is encouraged by those politicians that regard exports as a means for creating jobs and improving trade balances. Alternative trade systems can also provide public goods, at least at the regional level, and can satisfy some of the mercantilist desires, but they are likely to be less efficient to the extent that they discriminate against excluded countries, reward regionally competitive exporters, and protect industries within the region from external competition. And, if rivalry breaks out among regional groups, the costs of trade can increase and the economic advantages diminish (Kerr and Gaisford, 2007). To sum up: the provision of rules, rules every player abides by, helps stabilize fluctuations in costs, which in turn increases national welfare.

The current multilateral trade system is based on the post-war construction of the GATT. The intent of the United States and the United Kingdom when leading its design was to set up a rules-based liberal trade system to prevent another collapse of the world economy. The five trading principles of the GATT/WTO are the following: to trade without discriminating (most-favoured nation), freer trade, predictability, promoting fair competition, encouraging development and economic reform (WTO)[1]. Every country participating to the WTO is held accountable by these principles and, in turn, holds other countries accountable.

However, the international trade system cannot function without the international monetary system: the International Monetary Fund (IMF) was established in 1944. The founding member countries sought to build a framework for international economic cooperation. Today, its membership embraces 190 countries. Its main roles are to provide loans to member countries that are experiencing difficulties in their balance of payments and to monitor global economic development (IMF)[2].

Among free trade agreements, there are also regional trade agreements (RTA), which, according to the definition provided by World Bank, are treaties between two or more governments that define the rules of trade for all signatories. They pose as an alternative to the multilateral trade system, often in cases of weaknesses of the latter. RTAs and multilateral trade agreements can coexist. Latin American countries show various examples of RTAs. The countries of our

[1] https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm
[2] https://www.imf.org/en/About/Factsheets/IMF-at-a-Glance

interest, indeed, participate to various agreements, among which the Andean Community (CAN), the Global System of Trade Preferences (GSTP), and the Latin American Integration Association (LAIA) (WTO).

According to Galli (1975) and Coleman (1998), most Latin America countries opted out of the global trade system following World War II. Profoundly convinced that the GATT was biased against their interest, developing countries worked through the United Nations to create international trading rules that they believed would have been more favourable towards industrialization. They pulled resources out of agriculture and into manufacturing. This belief had its theorization in the 1950s in the Singer-Prebisch theory (Prebisch, 1950; Singer, 1950), which in turn contributed to reinforce the initial belief. The Argentinian economists argued that participation to the GATT-based trade system would make developing countries worse off. They divided the world into two blocks: an advanced-industrialized core versus the developing-world periphery, and focused on the terms of trade between them (the ratio of the price of export and price of import). According to the theory, the developing-world periphery's terms of trad deteriorate over time because primary commodity's prices steadily fall compared to manufactured goods', due to income elasticity. As income rises in the core countries, demand for imported primary commodities falls; instead, as income rises in the periphery, a larger share of that income will be spent on imported manufactured goods. Economists since have then found important loopholes in the theory, but what matters is that back then, Central and Latin American governments believed it. Such belief led them to enforce protectionist policies to isolate their economies from the global trade system (Oatley, 2016). They also tried to change some of the rules governing global trade as they believed it amounted to economic imperialism. Since the GATT agreement contained no provisions for infant-industry protection, they united under the UNCTAD in 1977. It was a failure. The problems with the balance of payments and surging debt that happened in the 1980s forced them to turn to the IMF and the World Bank.

1.3 The relationship between political instability and trade

Whenever we consider how the political process affects economic decision making, we call it political economy. In most, if not all, economic models it is assumed that consumers make their decisions to maximise their utility, firms their profit, and governments national welfare. Globalization and the derived global economy, implied that international dynamics also play a role in determining national economic and trade policy. Therefore, when making decisions to maximise national welfare, governments also consider international policies and, in turn, such national decisions have an impact on the international ecosystem.

The standard definition of political instability is the propensity of a government collapse either because of conflicts or rampant competition between various political parties (Hussain, 2022; Alesina, A., Özler, S. et al., 1996). A different way to define political instability focuses instead on the incidence of political upheaval or violence in a society, such as assassinations, demonstrations, and coup d'état (Quy-Toan and Levchenko, 2005). Both definitions imply the weakness of institutions and state failure.

According to the Center for Systemic Peace,[3] the effects of political violence and warfare include fatalities and casualties, resource depletion, destruction of infrastructure, and population dislocations, among other things such as the psychological trauma to individuals and adverse changes to the social psychology and political culture of affected social identity groups. They derived that well-performing societal systems combine non-violent conflict, democratic governance, and highly productive and self-sustaining development. Poor-performing societal systems, instead, are characterized by high levels of violent conflict, weak autocratic governance, and low productivity and income. There is a strong correlation between political upheaval, weakness of institutions, and economic performance.

Toan-Quy and Levchenko (2005) analyzed the relationship between international trade and the quality of economic institutions and found that trade openness does seem to be associated with better institutions. However, country experiences are quite diverse. In some cases, opening to trade led to a diversified economy in which no firm had the power to subvert institutions, while in others trade led to the emergence of a small elite of producers, which captured all the

[3] https://www.systemicpeace.org/index.html

political influence and installed only the kinds of institutions that maximized their profits.

The three countries analysed in this thesis – Nicaragua, Colombia, and Argentina – have all experienced an agitated, at times violent, political history in the post-war period (Marshall, 2020). Concurrently, sudden shifts in economic strategy were more the rule than the exception. Casaburi (1998) found that protectionism in trade and industrial policy was one of the main reasons behind Argentine weak economic performance, and Argentina's experience with periods of autarchic, state-guided economic strategy ended in major crisis that shook the very foundations of the Argentine society repeatedly.

Alesina, Özler et al. (1996) investigated the question of correlation between economic growth and political stability by comparing two countries: Argentina and Japan. Indeed, at the beginning of the twentieth century, Argentina was one of the wealthiest countries in the word (Corden, Essays on the economic history of the Argentine Republic, 1972; Crassweller, Perón and the enigma of Argentina, 1987), since the 1960s, however, Argentina has often come close to econ collapse. In 1960, Japan had a per capita income below Iraq, Ireland, and Argentina was not even in the top twenty-five in the world (Alesina, A., Özler, S. et al., 1996). Since then, Japan has experienced on the fastest growth rates in the world. Argentina has had a history of political instability marked by several coups d'état and much political violence. In contrast, Japan has been a model of political stability. They found that political instability reduces growth, and this result is particularly strong for the case of unconstitutional executive changes such as coups, as well for changes that significantly change the ideological composition of the executive. To some extent, and with some caveats, they also find that low growth increases the likelihood of government turnover, particularly in the case of coups d'état.

Many have attempted to draw causal links between trade openness, political instability, and economic growth. The interconnected relationship existed between FDI inflow and trade volume, thus, the gain of these activities in achieving economic growth has been a significant area of concern for discussion. Most of the literature shows that openness to trade has a significant, positive impact on economic growth; on the other hand, political instability hinders economic growth (Afolabi and Abu Bakar, 2016). Indeed, political instability is regarded by economists as seriously harmful to economic performance as it is likely to shorten policymakers' horizons, which leads to sub-optimal macroeconomic policies. It may also lead to a more frequent switch of policies, creating volatility and thus, negatively affecting macroeconomic performance.

Rotunno (2016) argued that political power, even in the case of political stability and a strong leadership, is inherently volatile, therefore political stability and policy reforms, especially in the case of trade agreements, as instruments that lock-in future trade policies, are strongly correlated.

1.4 The US influence

US foreign policy objectives are an outgrowth of the capitalist economic system that is the basis of the American society as well as a reflection of the distribution of domestic power within the society. American national 'interests' have remained virtually unchanged for the past two centuries. Among others, they include: international freedom of access to raw materials, access to markets for manufactured goods and maintaining a favourable international 'balance of power'. These interests are the engine that drives American foreign policy which, at the broadest level finds expression in the practice of interventionism (Rubenberg, 1988).

American imperialism, and therefore intervention, consists of policies aimed at extending the political, economic, and cultural influence of the United States over areas beyond its boundaries. It may include military conquest, gunboat diplomacy, unequal treaties, subsidization of preferred factions, economic penetration through private companies, a regime change; or some combination thereof (Rubenberg, 1988). It usually occurs when conditions arise that are considered 'threatening' to American interests.

Over time the various policies employed to advance American interests have shown ideological continuity. One such policy is to issue unilateral proclamations – typically supported by sufficient military force to ensure that other countries acquiesce in their intention – as for example the Monroe Doctrine concerning American "rights" abroad (Rubenberg, 1988).

The policy of American imperialism over Caribbean and Latin America countries is usually considered to have begun in the late nineteenth century (Black, 1988). The question of whether the United States should intervene in the affairs of foreign countries has been debated in domestic politics for the whole history of the country. Imperialism, and the case of American imperialism is no different, is often caused by strategic geography, that dictates the turn of political and economic events. Therefore, many Central and Latin American countries have been influenced to various degrees by decision taken in the United States. What makes them different from other countries – especially those belonging to the "Third World" or experiencing socialist regime – the US chose to intervene in, is the degree to which their modern history was held hostage to the demands of American foreign policy (Black, 1988).

As early as 1823, the Monroe Doctrine, named after President James Monroe, who articulated it, had warned the European colonial powers to withdraw from the New World territories, especially Central and Latin America (Monroe, 1823). After 1848, the United States made a practice of intervening militarily in Latin American countries under the rhetoric of "Manifest Destiny" and "Dollar Diplomacy." Manifest Destiny was the belief that the US would and should expand its borders across the continent in order to spread the fruits of its so called "democratic" civilisation, according to a God-given right (Black, 1988).

Once the boundaries of the US reached the Pacific Ocean, the country began to expand towards its southern neighbours. However, instead of annexing territory, the US used military interventions and threats of force against various governments in the Western Hemisphere to allow friendly conditions for American companies to invest in a policy that become known as "Dollar Diplomacy" (Bermann, 1986).

The United States policed Latin America under the Roosevelt Corollary, and sometimes using the military to favour American commercial interests, such as intervention in the "Banana Republics" and the annexation of Hawaii (Boyce Davies and Jardine, 2003).

The countries analyzed make no exception, particularly Colombia and Nicaragua. Argentina adopted a more neutralist stance towards the United

States, but has nonetheless felt the pressure in some instances, such as the Falklands War, with relations between the two countries improving or deteriorating depending on who occupied the presidential seat in Buenos Aires. Both Colombia and Nicaragua have been part of the so-called “Banana Wars” (Musicant, 1990). The Spanish-American War of the late nineteenth century evicted Spain from the Americas and the Philippines, and fully established the United States as a major imperial player on the world’s stage.

Nicaragua appeared as the perfect commercial hub and plantation paradise. Moreover, it was the likeliest crossing point between the two oceans, and, for the Southern slave states, a new source of political power (Bermann, 1986).

Panama, even before its canal, was of vital strategic interest to the United States. Prior to 1903, it had been a department of Colombia and in mid-nineteenth century bilateral treaties the United States had accepted the right and obligation to maintain the free flow of commerce across this line of transit. By late century, it had already assumed a role of paramount importance to the US Navy. The United States only allowed Panama to gain control of the Panama Canal Zone, therefore asserting its independence, in 1979 (Black, 1988).

American imperialism over Central and Latin American countries has taken the form of economic, but also political and military imperialism (Musicant, The banana wars: a history of the United States military intervention in Latin America from the Spanish-American War to the invasion of Panama, 1990). The disparities of scale and power between the United States and its neighbors are manifest and pushed various US Administrations to consider them merely as their “backyard”.

1.5 Industrialization through import substitution

The first argument for protectionism was fully articulated by Alexander Hamilton in his 1790 *Report on Manufactures*. Hamilton professed that developing an industrial base in a country was impossible without protectionism because import duties are necessary to shelter the domestic ‘infant industries’ until they could achieve economies of scale (Bairoch, 1993). The nineteenth-century German economist Friedrich List (1789-1846) agreed with his contemporary, Hamilton, and argued that in the presence of more developed countries, backward countries cannot develop new industries without state intervention, especially tariff protection (Chang, 2003).

For some economists, industrial policy is an old concept and practice where policies are “designed to target specific sectors to increase their productivity and their relative importance within the manufacturing sector” (Pack, 2000, p. 48). For others, industrial policy encompasses government intervention in specific manufacturing sectors (picking winners) to utilise a country’s comparative advantage (Lin and Chang, 2009). Others, such as Lall (2004), argue that industrial policy should be more broad, functional rather than selective in promoting and targeting competitiveness across the entire economy. More recently, industrial policy has been described as a process which involves an ongoing dialogue between the government and the private sector to generate information that identifies and helps tackle the constraints that hinder the economy by employing various mechanisms and policies towards specific market failures and supporting structural change (Rodrik, 2008).

For Altenburg (2011), it is imperative to recognise the role of the government, in many aspects, as a critical element for successful industrial policy because governments can identify, design, and implements policies that correct market failures and drive both competition and innovation. Moreover, these policies can lead to long-term spillover effects and structural change that support and sustain stable economic growth (Rodrik, 2008). Empirical research has illustrated that the economic success of several East Asian countries (referred to as the ‘Asian Tigers’) was due to government intervention (Altenburg, 2011). Given the economic success experienced by the Asian Tigers, many developing countries have pursued industrialisation to develop their economies. However, for ‘industrially lagging countries’ (ILC) in the Global South to prosper, they must recognise the complex process of successfully designing and implementing industrial policy. Therefore, duplicating past successful industrial policy policies of the industrialised countries may not yield the intended result; instead, the content of industrial policy matters because the environment and situations confronting ILCs today are radically different from those experienced by the industrialised countries.

As forementioned, a considerable amount of empirical and theoretical literature has emphasized and pointed out the importance of industrial policy in addressing the distortions that constrain economic development, and why countries need industrial policy in fostering and structural transformation that supports and sustains economic growth. There are three distortions that have been highlighted in the literature: first, market failures, including information externalities; second, coordination failures; and third, the acquisition of knowledge and technologies.

The neoclassical economic theory argues that markets are efficient and will allocate resources accordingly to where they can be used efficiently. Therefore, state interventions must not affect the market's ability to allocate resources (Stiglitz et al., 2013).

For Hausmann and Rodrick (2002), information externalities discourage firms from discovering new markets, especially in developing countries with inadequate or no enforcement of property rights. Information externalities arise because the first firm that enters the new market reduces the 'cost-discovery' and uncertainty for followers as they learn from the outcome of the first firm.

The second reason for industrial policy is related to the presence of coordination failures that hinder industries and firms' ability to compete and expand accordingly (Pack and Saggi, 2006). The success (feasibility and profitability) of most economic activities requires and is dependent on the presence of "simultaneous [and complementary] investments" (Altenburg, 2011, p. 58). In other words, a firm is willing to invest in a specific sector or new market if there are available firms that will support its production process. Without such an environment or ecosystem, the production will be adversely affected (Rodrik, 2008; Pack and Saggi, 2006). Therefore, the state bears the responsibility for promoting and coordinating collective investments from investors and firms to develop the infrastructure to stimulate economic activities (Altenburg, 2011).

Finally, industrial policy can play an important role in addressing technological accumulation and learning deficits experienced by firms in developing countries. These firms boost their technical capabilities by relying heavily on existing technologies, but adopting such technologies is time-consuming and costly because most firms in developing countries lack access and the necessary information to acquire existing technologies (Altenburg, 2011). For Altenburg (2011), investing in developing countries can lead to knowledge spillovers (including technological accumulation) which, in the long run, will benefit investors. Therefore, the state must encourage and promote an environment for firms to conduct research and develop new technologies by instituting laws such as copyright and patent laws to protect property rights (Stiglitz et al., 2013). In fact, empirical evidence has tended to confirm that technological accumulation and learning, including industrial upgrading, were at the core of the industrialisation of East Asian economies (Lall, 2004; Rodrik, 2008).

Although the importance of industrial policy is well established, both theoretically and empirically, the conditions for its success are less consensual. Three theories aim to explain the success and failures of industrial policies: developmental state; business-state collaboration; and state-controlled rent mechanisms.

First, the developmental state theory, which is based on the East Asian countries' experience of industrialisation, illustrates that the success of industrial policy is due to the state's institutional characteristics. According to Evans (1995), the developmental state is a state that has a concrete vision and is highly committed to fostering a conducive environment for its economy by encouraging and promoting learning and investments in physical infrastructure, human capital, and providing credit and other incentives to the private sector through highly skilled bureaucrats. Second, the business-state collaboration theory emphasizes how the state must enable pro-active collaboration between the private sector and non-governmental institutions, although the state cannot allow the interests of the private sector to dominate its overall vision. The last theory illustrates how the success of post-war industrialisation was due to the state's ability to create and monitor rents and subsidies (Amsden, 2008). These state-controlled rent mechanisms exercised by the state were tied to learning and performance, which meant firms that received these subsidies had to reach a specific export target, investment, or output level, thus disciplining firms if rents had not been used productively. Lall (2004) has also argued that productive rent management, which matches incentives to performance, is critical for economic development and sustained technological transformation. Therefore, it is vital to understand the distribution of power within a country and how it affects and constraints state institutions in implementing industrial policy successfully.

The countries analysed in this dissertation have all implemented industrial policies, in particular import substitution industrialization in the form of infant industry protection. However, they were abruptly forced to abandon protectionism in favour of trade liberalization during the debt crisis of the 1980s.

1.6 The lost decade

In the 1980s, many Latin American countries experienced the worst economic crisis since the world-wide depression of the 1930s (Devlin and Ffrench-Davis, 1994); the countries considered in the following chapters make no exception. The 1970s oil shocks and their consequences laid the foundation for the 1980s debt crisis, a period referred to as 'the lost decade'.

Multilateral institutions played a key role in the growing indebtedness of Latin American countries, failing to acknowledge the cyclical, rather than in equilibrium, situation they were in.

According to Sachs (1988) and Devlin (1990), scholars looking for the roots of the debt crisis have typically focused on the deficiencies in the debtor countries' economic policies and on shocks from the world economy. However, they identified as a major, endogenous, source of instability in Latin America's debt the structural change that corporate banking underwent through in North America first and internationally later, which gave rise to more aggressive lending behaviour. At first, competition among banks for new borrowers was primarily concentrated in the industrialized countries; however, as of the early 1970s, the search for new customers became so intense that lending spilled over into the developing regions. Latin America was the most sought-after market, owing to its relatively greater development in the post-war period and its situation as a natural market for United States banks (Devlin, 1990). The sharp rise in crude oil prices that began in 1973 and continued for almost a decade accelerated this expansion in lending (Federal Deposit Insurance Corporation, 1997). In addition to generating inflationary pressures around the industrial world, these price movements caused serious balance of payments problems for developing nations by raising the cost of oil and imported goods. Developing countries needed to finance these deficits, and many began to borrow large sums from banks on the international capital market (Cohen, 1981).

During the late 1970s, the signs of impending crisis began to become clearer and were more widely recognized. Some observers believed that the ability of the Least Developed Countries (LDC) to continue servicing their debts was deteriorating quickly. The second major oil shock of the decade occurred in 1979, intensifying LDCs' debt-service problems. Nevertheless, Latin American nations continued their heavy borrowing (Federal Deposit Insurance Corporation, 1997). By 1982, international commercial banks began to understand the implications of the massive capital flight occurring in many Latin American countries, the rise in world interests, and the fall in export growth rates (Sachs, 1988). The cycle reversed abruptly; those countries went from a situation of immense financing to being completely cut off. Therefore, Latin American countries, unable to pay their debts, turned to the IMF, which provided money for loans and unpaid debts. In return, the IMF forced Latin America to make neo-liberal reforms that would have favoured free-market capitalism. The trade model in vogue in Latin America, based on inward-looking import substitution and state intervention, was dealt a death blow, with neo-liberal-style strategies emerging to take its place (Devlin and Ffrench-Davis, 1994).

Sachs (1987) reviewed the management of the debt crisis and considered several possible alternative approaches for international cooperation in the future. From the initial bailout to Mexico in 1982, the international management of the crisis had the following characteristics: the IMF made high-conditionality loans to the debtor government; commercial banks rescheduled existing claims by stretching out principal repayments, but without reducing the contractual present value of repayments; and, finally, the debtor countries agreed to maintain timely servicing of interest payments on all commercial bank loans. According to

Sachs (1987), the debt management strategy protected too much the commercial banks and failed in promoting economic growth in the debtor countries. He suggested partial debt relief in case of extreme difficulty, the stabilization of the inflow of new capital and, finally, shifting some of the risks from the debtor countries to the international markets. Devlin and Ffrench-Devis (1994) agree that countries will have to pragmatically manage capital flows and suggest that Latin America and other developing countries reinitiated the international discussion of reform of the international monetary system.

The policy prescriptions imposed by the IMF to the crisis-wrecked Latin American countries can be ascribed to 'The Washington Consensus' agenda. The term 'Washington Consensus' was coined in 1989 by economist John Williamson of the Peterson Institute for International Economics (PIIE) and it indicates a list of policies that have the backing of the main Washington-based economic institutions – the IMF, the World Bank and the US Treasury – and aim at helping countries recovering from debt crisis (Irwin and Ward, 2021). Such policies refer to a more general orientation towards a strongly market-based approach or neo-liberalism, that has to be achieved by maintaining fiscal discipline, reordering public spending priorities, reforming tax policy, allowing the market to determine interest rates, maintaining a competitive exchange rate, liberalizing trade, permitting inward foreign investment, privatizing state enterprises, deregulating barriers to entry and exit, and securing property rights (Williamson, 1990). Discussion over the agenda's success is contentious. Rodrick (2006) and Stiglitz (2003) have criticised it for its 'one size fits all approach', and a recent study by Goldfajn et al. (2021) on the implementation of the Washington Consensus in Latin American countries found that it achieved "mixed results" (p. 114). Indeed, although an improve in macroeconomic stability, economic growth has been heterogeneous and generally disappointing.

Chapter 2 Nicaragua

2.1 Independency from Spanish rule and US occupation

Nicaragua is characterized by an agriculture-based economy, a history of autocratic government, and strong imbalances in regional development. Since colonial times, Nicaragua has suffered from political instability, civil war, foreign intervention, and natural disasters (Merrill, 1994). Governments, often exhibiting forms of *caudillismo*[4], seem to have been unable to bring about political stability and durable economic growth.

The nineteenth century saw the establishment of an independent Nicaragua from Spanish rule. Independency, however, came in stages and was rife with violent conflicts. The first step, in 1821, consisted in gaining independency from Spain to become part of the Mexican Empire, another former Spanish colony. Then, a couple of decades later, in 1838, Nicaragua knew independency for the first time since the first wave of European colonization in the sixteenth century (Merrill, 1994). The early years of the independent Nicaragua were marked by domestic political instability and international rivalry between the United States and the British Empire to bring Nicaragua under their spheres of influence. The goal of both foreign powers was the control of a transisthmian transit route, either overland or via a new Caribbean-to-Pacific canal (Merrill, 1994; Black, 1988). Both the United States and the United Kingdom's interest in the country grew because of its strategic importance as a transit route; indeed, at the time there was no inter-oceanic route between the Atlantic and Pacific Oceans.

The possibility of economic riches in Nicaragua attracted foreign interests and consequent investment (Annis, 1994). Afraid of Britain's colonial intentions, Nicaragua held discussions with the United States in 1849, which led to a treaty, often referred to as the Hise-Selva convention (Rodriguez, 1964). The convention called for a virtual protectorate of Nicaragua by the United States, and gave the American government, or any company which it might endorse, a monopoly on the canal project. However, it clearly threatened British economic interests in the

[4] It refers to a system of political-social domination, based on the leadership of a strongman, that arose after the wars of independence from Spain in nineteenth-century Latin America.

region, and violence erupted in 1850 when the British tried to block the operations of the American company, the Accessory Transit Company, that enjoyed exclusive rights to build a transisthmian canal (Merrill, 1994). As a result, United States and British government officials held diplomatic talks and on April 19, 1850, without consulting the Nicaraguan government, signed the Clayton-Bulwer Treaty, in which both countries agreed that neither would claim exclusive power over a future canal in Central America, nor gain exclusive control over any part of the region (Rodriguez, 1964). Although the Nicaraguan government originally accepted the idea of a transit route because of the economic benefit it would have brought to Nicaragua, the operation remained under United States and British control (Merrill, 1994; Rodriguez, 1964).

Domestic unrest did not stop with the détente between the two foreign powers and was mainly aligned in two factions: the conservatives and the liberals. In the 1850s, the perpetual state of war between the two factions provided the opportunity for an American by the name of William Walker, to take over Nicaragua (Scroggs, 1916). He was supported by the Nicaraguan Liberal party and American Southern states interests. A puppet government, behind which Walker was the real power, was installed in 1855. Washington granted the new regime immediate recognition, and in 1856 Walker formally took over the presidency, instituted forced labor, legalized slavery – to gain support from the Confederate states –, and declared English the official language (Scroggs, 1916; Black, 1988).

However, the Walker regime did not last much. The following year he was overthrown by an alliance of Nicaraguans together with the owner of the Accessory Transit Canal company, Commodore Cornelius Vanderbilt, all four Central American armies – Costa Rica, Guatemala, El Salvador, and Honduras –, the United States Marines, and the British Navy, who controlled a protectorate on the Atlantic coast (Merrill, 1994). The struggle to expel Walker was long and costly, and represented the first example of what was to become common occurrence in the country: a propensity for Nicaraguan politicians to call on the United States to settle domestic disputes and an eagerness by the United States to respond by military intervention.

After Walker was ousted, the Conservative Party ruled in Nicaragua for three decades, from 1857 to 1893. The period of conservative rule was characterized by relative stability, coupled with some economic progress and prosperity (Merrill, 1994; Busey, 1958). A railroad system connecting the western part of Nicaragua with the port of Corinto on the Pacific coast was built, and roads and telegraph lines were extended. Exports of agricultural products also increased during this period, with coffee becoming the nation's principal export by 1890 (Annis, 1994). Toward the end of the nineteenth century, the Nicaraguan economy experienced dramatic economic growth because of the growing demand for coffee and bananas in the international market. The local economic elites were divided between the established cattle raisers and small growers and the new coffee-producers sector. Disputes about national economic policy arose, and the ruling conservatives passed laws favoring cheap labor that benefited mostly coffee planters (Merrill, 1994).

The peaceful political scene that had lasted almost thirty years was abruptly broken when in 1893, following a short period of Conservative-Liberal conflict, General Jose Santos Zelaya, a Liberal, installed himself in the presidential office, where he remained as a dictator for sixteen years (Busey, 1958).

A constitutional convention was hurriedly called, and a new constitution incorporating anticlerical provisions, limitations to foreigners’ rights to claim diplomatic protection, and abolition of the death penalty was adopted (Merrill, 1994). Perhaps promoter of the most progressive social and economic reforms up to that point, Zelaya opened the country to foreign investments, expanded coffee production, and boosted banana exports. His government promoted internal development and modernized Nicaragua's infrastructure endowment: new roads and seaport facilities were constructed, railroad lines were extended, and many government buildings and schools were built (Annis, 1994).

From the United States perspective, Zelaya’s main crime was nationalism. His attempt to diversify the country’s trading relations and modernize its economy, was met with strong opposition in Washington. Therefore, when domestic opposition from conservatives eventually erupted into a revolt, the support of the United States Marines helped drive Zelaya from power in 1909 (Black, 1988).

A new period of foreign intervention then opened in Nicaragua, which included the complete surrender of the national economy to Washington (Busey, 1958). The United States occupation of Nicaragua was part of a larger conflict that involved many other central American countries, known as the "Banana Wars" (Langley, 1983). United States Marines formally occupied the country from 1912 to 1933, with a brief interruption in 1925. Indeed, they officially withdrew from Nicaragua in 1925, but were sent back within the year after renewed political upheavals: the collapse of an unstable coalition government, a Conservative coup, and the declaration of a provisional Liberal government on the Atlantic coast (Black, 1988).

When the American President Calvin Coolidge in 1926 ordered the Marines to intervene once again, one Nicaraguan, rebel General Augusto César Sandino, rejected the United States occupation and began a sustained guerrilla war against both the Conservative regime and the United States Marines for over five years (Dospital, 1996). In 1927, Sandino published his political manifesto aimed directly at the Nicaraguan people, hoping to inform and educate them on his anti-interventionism ideology (Dospital, 1996).

As Sandino's guerrilla war proceeded over the year, political conditions both in the United States and Nicaragua changed. Franklin D. Roosevelt succeeded the conservative Herbert Hoover and promulgated the Good Neighbor Policy (Black, 1988). At his inauguration speech, Roosevelt spelled out the new, friendly, approach towards Central and Latin America: "In the field of world policy, I would dedicate this nation to the policy of the Good Neighbor, the neighbor who resolutely respects himself, and, because he does so, respects the rights of others; the neighbor who respects his obligations and respects the sanctity of agreements in and with a world of neighbors. […] we cannot merely take, but must also give" (Roosevelt, 1933, p. 6).

On the Nicaraguan bound, on the other hand, Liberal candidate Juan Batista Sacasa triumphed over Adolfo Díaz in the 1932 presidential election. Thus, the U.S. Department of State laid the groundwork for the withdrawal of the

Marines and the installation of the National Guard with Anastasio Somoza García as chief. On 23 January 1933, an agreement was reached that facilitated the departure of the Marines (Merrill, 1994).

When the Americans left in 1933, they set up the *Guardia Nacional* (National Guard), a combined military and police force trained and equipped by the Americans and designed to be loyal to American interests. After the Marines' withdrawal, Sandino and the newly elected President Juan Bautista Sacasa reached an agreement that Sandino would cease his guerrilla activities in return for amnesty, a land grant for an agricultural colony, and retention of an armed band of one hundred men for a year. However, National Guard director Anastasio Somoza García ordered his assassination the next year (Musicant, 1990).

2.2 Military dictatorships and the Revolution (Iran/Contra Affair)

Events like the assassination of General Sandino and the electoral fraud which installed Anastasio Somoza García in the presidential chair, have almost been the rule rather than the exception in the history of the country.

Nicaraguan politics have been characterized by violent conflicts and several military dictatorships, the longest being the hereditary dictatorship of the Somoza family, who ruled for forty two non-consecutive years, beginning in 1937 when Anastasio Somoza García slowly eliminated officers in the National Guard, ordered the assassination of Sandino, deposed President Sacasa, and became president himself on January 1, 1937, in a rigged election (Bulmer, 1990).

Somoza García controlled political power from 1936 until his assassination in 1956, when he was succeeded in office by his eldest son, Luis Somoza Debayle, who held the presidency from 1957 to 1963. The youngest Somoza son, Anastasio Somoza Debayle, instead, held two presidential terms: from 1967 to 1972, and from 1974 to 1979. Although the Somozas did not hold the presidency for the full forty-three years, they continued to rule through puppet presidents and their control of the National Guard (Bulmer, 1990; Busey, 1958). A cynical and opportunistic individual, Somoza García ruled Nicaragua with a strong arm, deriving his power from three main sources: the ownership or control of large portions of the Nicaraguan economy; the military support of the National Guard; and his acceptance and support from the United States (Merrill, 1994).

A weak opposition was tolerated but only to give a democratic facade to the regime. Strong opposition, instead, was met with torture and incarceration. In 1956, he declared "'ll give this country peace, if I have to shoot every other man in Nicaragua to get it" (Bendaña, 1978, p. 2).

Somoza García maintained power by changing roles to gain the support of one or another influential group in Nicaragua, while keeping the support of the United States. For example, he was sympathetic of fascist regimes in the late 1930s to win support from the business sector and the upper class. However, a few years later, during World War II, he was an ardent supporter of the Allies. His opportunistic support of the Allies benefited Nicaragua by injecting desperately needed United States funds into the economy and increasing military capabilities. Nicaragua received relatively large amounts of military aid and provided raw materials in support of the Allied's war effort. Exports of timber, gold, and cotton soared. However, because more than 90% of all exports went to the United States, the growth in trade also increased the country's economic and political dependence (Merrill, 1994).

Control over the country also meant almost complete control over its economy. While the Somoza family can be credited for advancements towards modernizing Nicaragua, such as building roads, railroads, and telecommunications to support the urban agricultural industries, and making it less dependent on banana income, at the same time though it accumulated wealth through corporate bribes, land grabbing, and foreign aid siphoning (Bulmer, 1990). In the 1940s and 1950s, the Nicaraguan economy experienced a boom as coffee prices soared, but most of the country's profit went into the pockets of Somoza Garcia and his cronies. They bought or expropriated farms, mining interests, and companies (Bulmer, 1990).

The turning point for many was the December 1972 earthquake that destroyed Managua. National Guard members joined in looting the city after the tremor, and it was later revealed that most of the international aid after the earthquake enriched the Somoza family instead of supporting the victims (Johnson-Lee, 2015). As a result, almost all political figures drifted over to the opposition (Merrill, 1994; Bulmer, 1990). The country's rapid economic decline after the earthquake lost Somoza the support of labor, the middle class, and Nicaragua's elite. The Roman Catholic Church and elements of the press, especially the influential La Prensa, joined the left and student groups that had long been vocal opponents of the regime (Johnson-Lee, 2015).

The group that eventually took the lead in opposing Anastasio Somoza Debayle was the Sandinista National Liberation Front (*Frente Sandinista de Liberacion Nacional* – FSLN), formed in 1962. Taking its name and much of its ideology from the former communist rebel General Sandino, the FSLN grew from a group of leftist university students to a small revolutionary organization that aimed at reproducing the Cuban revolution utilizing Che Guevara’s theory of guerrilla warfare (Bendaña, 2007). Fueled by growing disenchantment with the dictator, the FSLN gained enough support to be able to launch military initiatives challenging the National Guard throughout the country by the late 1970s (Lozano, 1985; Merrill, 1994). After the 1972 earthquake and the Somoza’s embezzlement of foreign aid, opposition quickly grew into a revolt and after two years of violent struggle, Anastasio Somoza Debayle finally fled Nicaragua. On July 20, 1979, the FSLN and other members of the revolutionary force entered Managua. A five-member *junta* assumed power, pledging political pluralism, a mixed economic system, and a nonaligned foreign policy (Merrill, 1994).

In 1979, power also changed hands in Iran when a radical Islamic movement overthrew the United States-backed government of the Shah Mohammad Reza Pahlavi (Douville, 2012). The Reagan administration believed that these changes in power occurred to these countries, although unrelated, equally threatened U.S. national interests. Therefore, when the Sandinistas seized power in 1979, the Administration, fearful of the potential spread of socialism throughout Latin America, eventually backed the contra revolutionary paramilitaries (hereinafter, the Contras) who sought to overthrow this revolutionary regime (Rubenberg, US Policy toward Nicaragua and Iran and the Iran-Contra Affair: Reflections on the Continuity of American Foreign Policy, 1988). The public disclosure on November 3, 1986, by Al-Shiraa, a Lebanese weekly (U.S. Senate, 1987), that various American diplomats were caught secretly and illegally selling weapons to Iran and using those funds to support anti-communist militias in Nicaragua, generated the so-called Iran-Contra affair. The Somozas and the Shah of Iran were both considered valuable surrogates in that they functioned on behalf of the United States as regional policemen and as supporters and advocates of the US dominated political-economic order within their geographical areas. Therefore, when they were overthrown, the Reagan administration decided to intervene.

The overarching United States interest vis-à-vis these countries has been the termination of their revolutions. The American intervention in the two countries stem from a continuity of historical American foreign policy interests, these interests being: international freedom of access to raw materials; access to markets for manufactured goods; securing the environment for the expansion of American corporate and banking concerns – which require international stability as a primary condition for capital venture; and maintaining a favorable international 'balance of power'. Indeed, particularly in Third World countries, the appearance of trade unions, peasant organizations, political parties, and, especially, nationalist movements all represent threats to a favorable investment environment. Business, therefore, typically seeks their suppression, and Washington responded to these concerns (Rubenberg, US Policy toward Nicaragua and Iran and the Iran-Contra Affair: Reflections on the Continuity of American Foreign Policy, 1988). Such ideologies translate into foreign policies that can be ascribed to interventionism and strong opposition to indigenous nationalism. Moreover, they are exemplary of a foreign policy strongly motivated by economic interests.

The Iran-Contra affair represents a point in history in which the US Administration used all the means necessary to achieve its foreign policy interests. The report of the Congressional Committees investigating the Iran-Contra affair states that: “The common ingredients of the Iran and Contra policies were secrecy, deception, and disdain for the law […] the United States simultaneously pursued two contradictory foreign policies – a public one and a secret one” (U.S. Senate, 1987, p. 11).

2.3 From a “Banana Republic” to ISI policies

Nicaragua, together with Cuba, Jamaica, Guatemala, Honduras (the quintessential Banana Republic), Costa Rica, and Colombia is considered as part of the “Banana Republics” (Henry, 1904). When domestic sale taxes on bananas were removed in 1913, there was an outpouring of festive verse in the American newspapers, and banana recipes abounded. The fruit was cheap, exotic, and nutritious, and the region it came from would henceforth be wrapped in cliché as the land of the “Banana Republics” (Black, 1988). Two large agricultural enterprises controlled the operations and trade in the region: the United Fruit Company and the Standard Fruit. The latter controlled the Nicaraguan banana trade. The arrival of the fruit companies often brought the host countries their real infrastructure, Nicaragua proved to be no exception. However, most commentators pointed out that a progress in infrastructure did not translate into an increase in entrepreneurial drive nor economic growth. The historian William Showalter wrote about Nicaragua “they have had revolutions since the memory of the inhabitants runneth not to the contrary. There seems to be little hope that they will ever be able to give themselves a good government” (Black, 1988, p. 32). Therefore, though the fruit companies spoke loudly of order and progress, their operations in the fields often resulted in chaos. Indeed, unlike in other Central American countries, domestic political squabbles over who would control the plantations and shipment of the crop prevented bananas from becoming the major export earner in Nicaragua.

By the end of the nineteenth century, the entire economy came to resemble what is often referred to as a "Banana Republic" economy, which means an economy largely controlled by a small domestic elite oriented toward the production of a single agricultural export and influenced by foreign interests. Profits from coffee production flowed abroad or to the country's small number of landowners. Taxes on coffee were virtually nonexistent. The economy was also hostage to variation in the price of coffee on the world markets, such that wide swings in coffee prices meant peaks and throughs, i.e., volatily, for the Nicaraguan economy (Annis, 1994).

The period after World War II was a time of economic diversification. The Somoza government brought in foreign technocrats to give advice on increasing production of new crops; hectarage in bananas and sugarcane increased, livestock herds grew, and cotton became a new export crop (Annis, 1994). The demand for cotton during the Korean War (1950-1953) caused a rapid increase in cotton production, and by the mid-1950s, cotton was the nation's second largest export-earner, after coffee.

The first World Bank mission to Nicaragua, from July 1951 to May 1952, reported that the principal weaknesses in the Nicaraguan economy were basically administrative ones: an archaic fiscal system, an inadequate transportation system, an ineffective credit system, and the absence of long-term planning. The mission's report called for programs to improve sanitation, education, and public health (Conroy, 1984). The mission concluded that the "progressive measures" undertaken by the Somoza government at that time, including reducing inflation by balancing the budget, beginning the formulation of a five-year plan, calling for fiscal reform and creating a National Economic Council composed of business leaders, represented "the achievement of a government alive to the needs of the country and with the will and desire to progress" (International Bank for Reconstruction and Development, 1953, p. 4).

Economic growth continued in the 1960s, largely because of industrialization. Under the stimulus of the newly formed Central American Common Market (CACM), Nicaragua achieved a certain degree of specialization in processed foods, chemicals, and metal manufacturing. By the end of the 1960s, however, import-substitution industrialization as a stimulus for economic growth had been exhausted (Annis, 1994; Evans, 1995). By 1970, the industrial sector was undergoing little additional import substitution, and the collapse of the CACM meant that Nicaragua's economic growth, which had come from the expanding manufacturing sector, halted. Furthermore, the manufacturing firms that had developed under the tariff protection of the CACM were generally high-cost and inefficient; consequently, they were at a disadvantage when exporting outside the region (Irvin, 1982).

The small industrial sector producing for domestic and regional markets experienced substantial growth during 1960s in response to tariff protection and intraregional trade expansion under the CACM, but declined precipitously thereafter. Industrial production as a share of Gross Domestic Product (GDP) peaked at 23% in 1978, dropping to 19% by 1989 (Fitzgerald, 1988).

During the 1950s and 1960s, Nicaragua had had high growth rates based on extensive agricultural production for export. But growth had not ‘trickled down’ to most of the population, as most people were excluded from the benefits of the growth (Irvin, 1982). The income distribution was very skewed: 50% of the population earned only 15% of the national income in 1977. Despite a rapid industrialization process in the 1960s and 1970s, the agricultural sector accounted for most exports and absorbed half the labor force in 1979. The industrial sector was to a significant extent dependent on imports of capital goods and raw materials (Annis, 1994).

2.4 The Sandinista era: a new model of economic development

When the Sandinistas seized power on July 1979, the economy versed in a disastrous state: decades of violent civil conflicts and guerrilla war resulted in damage to production and crops, loss of lives and massive capital flight. The Sandinista government inherited not only the consequences of the revolution, but a country – and, consequently, an economy – that had developed unevenly. The war effort translated into extraordinary expenses to support the constant fighting, and an incalculable burden upon the population, the environment, and the infrastructures. More than a decade and a half of widespread insurrection and war, coupled with a decade of incorrect economic policies, severely disrupted the Nicaraguan economy.

The Government of National Reconstruction, that took office in July 1979, included representatives of the full spectrum of political perspectives that supported the revolution. The *junta* included businessmen, ranchers, guerrilla commanders, and representatives of the working class. The economic model they adopted, whose main features can be found in the 1980 and 1981 plans, reflected an early commitment to broad participation and economic pluralism (Annis, 1994). On assuming power, the new government not only faced a daunting set of immediate economic and social problems, but was required to administer a new, expanded public sector with a bare minimum of personnel (Irvin, 1982).

The new government opted for a 'mixed economy': partial state ownership of the means of production that would coexist with private ownership, the latter subdued to state planning. The Sandinista government, although ideologically socialist, refused the option of complete state ownership of the means of production. Indeed, the economic isolation of Cuba pointed out to the dangers of delinking from world markets (Fitzgerald, 1988).

The first acts of the Sandinista government have been to confiscate the property of former dictator Somoza, which brought the economic potential of about a quarter of the GDP into state hands, and to take control of foreign trade and the banking system. In addition, the foreign-owned mining companies were expropriated. The effect of such interventions was to bring under direct government control about a quarter of agricultural production (mainly sugar and rice), about 20% of industry (including a good number of the largest and most modern firms), and virtually the whole of the modern commercial and banking sectors (Irvin, 1982; Merrill, 1994).

The rest of the economy, accounting for 60% of GDP, remained in private hands. The private sector consisted of small-scale handicraft producers, small traders and peasants, and large-scale producers in agriculture and industry. The market was still the dominant coordinating mechanism, but the government had decided influence on the economy through its control over the allocation of foreign exchange and finance. The government also set up large investment projects, mainly in agro-processing and in infrastructural prospects such as energy. At the same time, real wages were to be protected by subsidizing basic wage goods, and the profit margins of producers were to be maintained (Annis, 1994). This combination of macro-economic goals to achieve – social services, public investment, real wages, and private profits – was very ambitious for an already strained economic equilibrium, which inherited severe structural damages from the Somoza period. The government deficit was large and increasingly could not be financed from external sources. Money was printed, and inflation climbed to very high levels, especially after 1984 (Dijkstra, 1999).

On top of the disasters caused by political instability, Nicaragua suffered from several catastrophic natural disasters – an earthquake in 1972, a hurricane in 1988, and a drought in 1989 – and five years of a total trade embargo by the United States. Indeed, President Reagan in 1985 declared the United States embargo against Nicaragua, prohibiting all trade between the two countries, with the intention of undermining the Sandinista government and removing its ties with Cuba and the USSR (Reagan, 1985). The embargo, then found in violation of international law by the International Court of Justice,[5] was lifted in 1990 by President Bush. Along with the embargo, Nicaragua has been the target of other, far more damaging, economic sanctions, designed to make the economy scream. Indeed, before the trade embargo was announced in 1985, the United States had already terminated US bilateral assistance to Nicaragua, significantly reduced its imports of Nicaraguan products, and discouraged investment and loans from private US companies and banks (Conroy, 1984; Merrill, 1994). The Unites States were also effective in blocking loans and credit lines from powerful multilateral funding agencies, such as the Inter-American Development Bank (IDB), the World Bank, and the International Monetary Fund (IMF). Some assistance did trickle in, but Nicaragua was virtually cut off from these important funding sources (Merrill, 1994).

From 1984 onwards, it became clear that the destabilization of the Nicaraguan economy had become a major foreign policy goal of the US Administration (Conroy, 1984; Fitzgerald, 1988). Between 1984 and 1987, the average damage in terms of destroyed assets and output lost was equivalent to some 40% of potential annual exports, which exacerbated the already difficult balance of payments situation. It also sharply reduced available domestic resources so that consumption levels fell considerably (Fitzgerald, 1988).

[5] Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America). Merits, Judgment. I.C.J. Reports 1986.

2.5 The 1990s: a market-based, outward-oriented economy

The contradictions of the 'mixed economy', and the economic crisis which resulted from it, clearly contributed to the 1990 election defeat of the Sandinistas. As a matter of fact, the National Opposition Union (UNO) candidate Violeta Chamorro largely – by more than 14 points, defeated the FSLN incumbent President Daniel Ortega. The new Chamorro administration inherited a country with overwhelming economic, social, and political challenges.

After the change in power the type of aid changed, as well as its origins and conditions. Aid from the former socialist countries stopped, and aid from West European increased again. In addition, the United States and various multilateral organizations restored aid. The Unites States Agency for International Development (USAID) started to give loans to Nicaragua in June 1990, on condition that a stabilization plan was implemented. Further conditions were added in subsequent loans in 1990 and 1991 (Evans, 1995). In September 1991, the IMF, the World Bank, and the IDB began to lend again, after arrears with these institutions had been cleared with aid money from some West European countries. The loans from these institutions were conditional upon strict stabilization and structural adjustment measures (Dijkstra, 1999).

The Chamorro Administration (1990-1996) can be credited for having finally brought some resemblance of a long-needed economic stabilization in Nicaragua. According to many observers, the Chamorro government is a classic example of a technocratic administration, implementing stabilization and structural adjustment policies as recommended by the World Bank and the IMF among the international financial institutions (Borner et a.., 1994). However, Chamorro's policies also followed the self-interest and ideologies of the government, in addition to implementing the technical policies recommended by the international system (Dijkstra, 1999).

A World Trade Organization (WTO) report[6] on the trade policies of Nicaragua published in October 1999 shows that, since the early 1990s, Nicaragua has taken significant steps towards establishing a market-based, outward-oriented economy, reversing the import-substitution policies of earlier

[6] https://www.wto.org/english/tratop_e/tpr_e/tp118_e.htm

years, and addressing severe economic imbalances. The report of the WTO notes that the liberalization of the trade, foreign exchange, and investment regimes, accompanied by progress in deregulation and on-going public sector reforms, have resulted in a resumption of economic growth, the reduction of inflation, and a decline in unemployment. Annis (1994) and Dijkstra (1999), among others, have pointed out that by late 1993, Nicaragua had continued to face large trade and fiscal deficits, and it had yet to capture the confidence of either domestic or international investors.

Nicaragua's private sector and export competitiveness have been considered as the key elements for economic growth. However, Dijkstra (1999) argues that the drastic liberalizations of foreign trade and the financial sector led to a change in the structure of domestic production away from agricultural and industrial production, and towards trade and services. Production capacity was lost, and unemployment increased. Moreover, privatizations seemed to have benefitted only a restricted group of persons, without even producing benefits for the government.

Nicaragua, under the Chamorro government has undertaken autonomous reforms in trade and related policies, while pursuing greater integration in the world economy, both at the multilateral level through the completion and implementation of the results of the Uruguay Round, and at the sub-regional level through the CACM and various bilateral agreements. Following the World Bank and IMF's recommendations, Nicaragua has pursued trade policies objectives such as the reduction of the anti-export bias of past distortive policies, and the improvement of access and diversification of exports. Trade monopolies have also been eliminated.

The WTO report notes that Nicaragua has undertaken changes in its legislative and institutional framework, driven by constitutional reforms, agreements with multilateral financial institutions, and incorporation of regional and multilateral trade commitments. However, the internal political situation is far from being optimal and still exacerbated by the need for compromise with the Sandinistas (Merrill, 1994). The WTO report also points out that although Nicaragua has met several regular GATT/WTO notification requirements relating to its legislation, the transparency of its trade regime could be further enhanced. Nicaragua's trade expansion has largely been with respect to the United States, while trade with Latin-American and CACM countries expanded more slowly, and their share declined.

Although these developments are surely positive, the WTO (1999) expressed doubts over the sustainability of growth and the still increasing income inequality.

Chapter 3 Colombia

3.1 From independence to the Thomson-Urrutia Treaty

The history of the present-day Republic of Colombia, as many other Central and Latin American nations, begins two centuries ago, as the Spanish-American independence movements flared up the American continent (LaRosa and Mejía, 2017). Following Bonaparte's invasion of the Iberian Peninsula in 1808 and the consequent demise of the Spanish Empire, the Spanish territories both in Europe and Latin America underwent a political and structural transformation. They were divided into provinces (governed by *juntas*) and the American territories – today's Ecuador, Colombia, Venezuela, Panama, Cuba, Mexico, Peru, Chile, Puerto Rico, and Guatemala – were no longer considered as colonies, but part of the monarchy and, as such, they were asked to elect representatives. Although being numerically superior and comprising a larger territory than the provinces in Spain, it was clear from the beginning that they would not get fair representation (LaRosa and Mejía, 2017). Despite protests, Spanish America at first complied with the electoral process imposed by the Supreme Central Junta in Seville.

However, the situation changed in Colombia in 1810. On July 20, in Santa Fe, an altercation between creoles and a Spaniard sparked a rebellion and events quickly snowballed. Revolutionary leaders took part in an uprising deposing the Spanish viceroy, and the next day an act of autonomy was signed (Hudson, 2010).

Still a long way from being the liberal Republic of Colombia, they initially constituted an American governing *junta*, which lasted only a couple of days, another political project failed, and 1810 ended in disagreements and uncertainty over the future of the newly constituted territory. Indeed, the development of the nation did not follow a linear path. Historians point out the disunity that characterized the first years of independence struggle, both because of the patriots' misalignment in interests and the provincial fragmentation (Hudson, 2010; Ocampo López, 1998).

Following many other independence struggles against the Spanish Monarchy and within the provinces, an outward appearance of unity was finally achieved in 1821 (Hudson, 2010). The young republic, which was called Gran

Colombia, held a constituent assembly, known as the Congress of Cucuta, which duly reaffirmed the union and went on to adopt a highly centralized system of government, under which the entire country was divided into provinces and departments whose heads were named from Bogotá. While eschewing federalism, the constitution of 1821 in some other respects revealed the clear influence of the US model and was for the most part a conventionally republican document (Gibson, 1948).

From 1849 to 1886, Colombia oscillated between a liberal republic and a highly centralized, authoritarian government (Hudson, 2010; Gibson, 1948). Colombia had played a preeminent role in the movement for independence in Latin America at the beginning of the century. Once independence was achieved, however, the country lapsed into relative obscurity, with a weak connection to the world economy and, for many years, scant progress in the development of infrastructure or public education (Hudson, 2010). Indeed, the country's broken topography and primitive transportation made it difficult, if not impossible, to assert effective control in outlying areas. Improvements in infrastructure costed money that the Republic did not have.

Fiscal poverty reflected, in turn, the underdeveloped state of the economy, in which most of the population was employed in farming crops, raising livestock for domestic consumption only, or producing primitive handcrafts. The share of foreign trade per capita was the lowest among Latin America's larger countries, and this was a major reason for fiscal poverty because at the time customs duties were the leading source of revenue (Huck, 1972). New Granada began independent life with a single important export – gold – exactly as in the colonial era, and until the expansion of coffee cultivation at the turn of the century, stagnation was the rule.

The 1886 constitution gave the country its present name, reversed the federalist trend, and inaugurated 45 years of Conservative rule (Hudson, 2010). The constitution, which lasted more than a century, changed the ultra-federalism for an equally extreme centralism. Whatever party controlled the national presidency could thus control every departmental and municipal executive position in the country. Under the rule of President Rafael Nuñez, factionalism within political parties, political and economic instability characterized the period, inaptly named as the “Regeneration period” (Hudson, 2010).

The combination of economic malaise and dissension within the Conservative camp emboldened Liberals to launch another uprising, starting on October 17, 1899, and lasting three years, thus called The War of a Thousand Days (Dixon and Sarkees, 2016). The war brought about devastating social, political, and economic consequences for the country. Perhaps the most important one being the secession of Panama from Colombia, but there were other repercussions that cannot be overlooked. The combination of loss of lives, scarcity of primary resources such as food, hyperinflation – which meant an increase in the living and transportation costs as most means of transport had been destructed –, and lack of exports profits due to the trading halt caused by the war reduced Colombia to bankruptcy (Dixon and Sarkees, 2016).

The war also weakened and distracted the government from the Panama Canal negotiations, and in November 1903 Panamanian politicians, backed by the United States, declared independence from the Republic of Colombia. The United States made clear that it would not allow Colombia even to attempt to retake the isthmus (Hudson, 2010).

The Administration guided by Theodore Roosevelt blatantly interfered in the events that led to the Panamanian independence. This foreign intervention soured relations between the two nations and made others in Latin America suspicious about US activities.

On assuming office in 1913, the Democratic President Woodrow Wilson inherited the consequences of the by then strained relations between Colombia and the United States (Lael, 1978). Wilson tried to assuage the relations between the two countries, and the signing of the Thomson-Urrutia Treaty was a clear success of his efforts and a reversal of policy by the Republicans.

The Treaty, ratified in 1921 and met with stark opposition and legislative hostility in the US, especially from the former President Roosevelt, awarded the Republic of Colombia US$25 million for the US misconduct on the isthmus in 1903 (Lael, 1978).

3.2 Chronic political and economic instability: *La Violencia* and *El Golpe*

On the one hand, the Republic of Colombia has a distinguished tradition of political stability as one of Latin America's longest-standing democracies (Freedom House, 2021),[7] with a lasting record of usually fair and regular elections and respect for political and civil rights. It has historically been a two-party system with the two rival traditional parties, the Conservative Party and the Liberal Party, which have survived since their formation in the mid-nineteenth century.

On the other hand, Colombia has a very fractured and polarized society where the tradition of mostly fair electoral competition has existed alongside a history of widespread political violence, carried out in various forms – insurgency, terrorism, narco-terrorism, paramilitarism, and human rights abuse (Freedom House, 2021).

On the Colombian bound, the Thomson-Urrutia Treaty was negotiated by the Conservative President Marco Fidel Suárez. Ideologically, he was a stalwart Conservative and Roman Catholic traditionalist, yet he admired the more open society of the United States and believed that Colombia's progress heavily depended on close relations with the leading hemispheric power. He therefore worked for a normalization in relations with both the United States and Panama, and provided for Colombia to receive the US$25 million indemnity from Washington. As president, Suárez implemented the *Res Pice Polum* policy ("Follow the North Star" policy) which linked the foreign policy of Colombia with that of the North Star, the United States, through geography, trade, and democracy (Hudson, 2010).

The indemnity amount, although a paltry sum for the United States, was equal to 10 times the total of Colombian bank reserves. Moreover, it was not the only influx of money that entered the country in the 1920s, as Wall Street bankers were eagerly handing out loans during the boom years preceding the Great Depression (Stewart, 1930).

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[7] https://ourworldindata.org/grapher/free-and-fair-elections?tab=chart&time=1831..latest&country=~COL

The most obvious result from the inward flow of a large amount of money was a splurge of public works: new government buildings, roads, and, above all, railroads. The spending spree had a generally stimulative effect on the economy. Indeed, a report from the Central Bank of Colombia (*Banrep*; hereinafter, Central Bank) asserts that during the 1920s, the Colombian economy experienced the highest rate of growth in its history. They credit the economic reforms of 1923 (establishing a Central Bank, enacting banking legislation and fiscal reorganization), the coffee boom, the aforementioned influx of foreign capital, and import substitution industrialization as the driving forces behind this success (Meisel, Ramirez and Jaramillo, 2014).

However, the stimulus from loans and indemnity was not evenly spread. Outlying regions felt little impact, and neither was all the money wisely spent. The inequality caused further social and labor unrest, in part a renewal or continuation of the artisans' struggle during the previous century for job security and benefits (Hudson, 2010; Meisel, Ramirez and Jaramillo, 2014).

Politically, the Conservatives faced a deep internal division and unable to overcome it, they fielded two unsuccessful candidates in the presidential election of 1930. Capitalizing on the Conservative divisions, the Liberals returned to power for the first time in almost half a century (Hudson, 2010).

Under the Liberal rule (1930-1946), Colombia enjoyed a period of relative peace and economic stability. Colombia weathered the Great Depression rather successfully as more than half of the population was still rural and able to feed itself, while a sharp fall in coffee prices was partially offset by increased volume. The Olaya administration (1930 – 1934) followed an orthodox policy of cutting expenses while at the same time raising tariffs, measures that both saved foreign exchange that would have gone to imports and stimulated domestic manufacturing (Steiner, R. and Vallejo, H., 2010).

Olaya's successor, President Alfonso López Pumarejo was more receptive to the demands for change being put forward by labor activists, avant-garde intellectuals, and the recently founded Communist Party of Colombia. He sponsored the first agrarian reform law for rural workers, but above all, presided over a set of constitutional amendments that reintroduced universal male suffrage, declared that properly rights were limited by social rights and obligations, and eliminated the previous constitutional provision requiring public education to be always in accord with Roman Catholic doctrine (Hudson, 2010).

Many, even among his fellow Liberals, felt that he was moving too fast, therefore the Liberal candidate nominated to succeed him, Eduardo Santos Montejo, was a more moderate figure. The election of Montejo helped put partisan rancor aside, but it soon returned, and intensified once Lopez won re-election to a second term in 1942 (Bailey, 1967).

A passionate Francophile, the previous President Santos offered the United States Colombia's unconditional support in the war against Nazi-fascism. The United States, for its part, was anxious to assist reliable friends on its Southern Flank. Hence, the tightening of formal US-Colombian relations also had much to do with developments on the larger world scene (Hudson, 2010).

After World War II, Liberals were attacked on more than one front: on one side, the Conservatives, both frustrated for their loss of power and favorably impressed by the European Nazi-fascist movements; on the other, a dissident Liberal, Jorge Gaitán, presented himself as candidate for president in 1946, criticizing his own party for not being enough on the socialist end of the spectrum (Hudson, 2010).

At the 1946 presidential elections the Liberal party was therefore hopelessly split between its moderate and reformist wings, and presenting two mutually hostile candidates in the elections of that year allowed the Conservative candidate, Mariano Ospina Pérez, to win with a minority of the votes cast. The pattern of 1930 was repeated, in reverse, and the triumphant Conservatives in many parts of Colombia paid back their Liberal neighbors with accrued interest, despite Ospina Pérez' vigorous efforts to prevent bloodshed (Bailey, 1967).

Things started to fall apart in 1946 with outbreaks of violence throughout the country, but it was in 1948 that the violence reached its highest point. Following the assassination of the popular Liberal leader Jorge Gaitán on April 9, 1948, widespread riots in Bogotá, known as the *Bogotázo* riots, destroyed the city. The *Bogotázo* riots signalled an intensification of a period of countrywide violence known as *La Violencia* (The Violence). Except for the *Bogotázo*, *La*

Violencia was overwhelmingly rural. Atrocities were freely committed both by Conservative police or vigilantes as well as by Liberal guerrillas, who received no formal endorsement from party directorates but enjoyed widespread sympathy (Hudson, 2010).

Through different administrations, Liberal and Conservative, through constitutional government, civilian dictatorship, military dictatorship, and alternation, *La Violencia* has waxed and waned, but it has never entirely left Colombia (Bailey, 1967). Because of this continued social and political violent outbreaks, the term culture of violence is often applied to Colombia.

The military coup d'état of 1953 (*El Golpe*) stemmed from a necessity to overcome this period of violence and re-establish a functioning state. It was announced, consented, and favored on the part of the civil elite (Cruz Atehortúa, 2010). The rising of army men into politics enjoyed widespread support.

Once in power, Rojas declared a general amnesty for all guerrillas who surrendered to government forces with their arms. Thousands of guerrillas did so, and between 1953 and 1955 *La Violencia* gradually changed character, transforming itself largely from political to economic in motivation, and from guerrilla to bandit in character (Cruz Atehortúa, 2010; Bailey, 1967). Rojas can be credited for a period of relative reduction of violence.

Nevertheless, a string of Rojas' arbitrary actions, together with allegations of personal enrichment, eroded his support among both Liberals and Ospinista Conservatives and in May 1957, he was overthrown by another coup, organized by civilian leaders of both parties in conjunction with members of the business elite (Hudson, 2010).

After Rojas' deposition, the Colombian Conservative Party and Colombian Liberal Party agreed to create the National Front, a coalition that would jointly govern the country. Despite the progress in certain sectors, many social and political problems continued, and guerrilla groups were formally created, such as the *Fuerzas Armadas Revolucionarias de Colombia* (Revolutionary Armed Forces of Colombia – FARC).

In the early 1960s Colombian Army units loyal to the National Front began to attack peasant communities, which they considered as enclaves for bandits and Communists. The country entered in a new phase of *La Violencia* and suffered from an asymmetric low-intensity armed conflict among government forces, leftist guerrilla groups, and right-wing paramilitaries. The conflict is still ongoing to this day and insurgency has come to be considered endemic to the country (Marshall, 2020)[8].

3.3 The economy: from coffee to urbanization/industrialization

Colombia's contemporary economy, based on coffee and other agricultural exports, did not emerge until after independence in 1819, when local entrepreneurs were free to capitalize on world markets other than Spain. Although colonialism fostered minimal domestic economic growth, small entrepreneurial efforts began to take shape, so that by the nineteenth century well-defined economic enterprises existed (McGreevey, 1971).

However, it was only with the rise of the coffee industry in the late nineteenth and early twentieth centuries, that Colombia entered clearly on a path of economic modernization. Coffee exports represented Colombia’s insertion into international markets based on an efficient industry (Steiner, R. and Vallejo, H., 2010). As the tobacco and coffee export industries developed, they contributed to enlarging the merchant class and the growth of cities. The concentration of economic activity in agriculture and commerce, two sectors that focused on opening channels to world markets, continued slowly but steadily throughout the nineteenth century (Hudson, 2010). However, the country still versed in a severely underdeveloped state, especially infrastructurally wise.

It is after the War of the Thousand Days, at the turn of the century, that the coffee boom launched the country into the modern period, bringing an improvement in the means of transportation, particularly railroads – the so-called “coffee railroads”, communications infrastructure, and the first major attempts at manufacturing (Meisel, Ramirez and Jaramillo, 2014).

The Colombian industrialization process during the twentieth century can be divided into three main phases up to 1967. The first one, from 1900 to 1930, is regarded as the period in which the bases for modern manufacturing activities

[8] http://www.systemicpeace.org/warlist/warlist.htm

took place. Several forces converged and contributed to establish the necessary conditions for industrialization. The following ones had a central role: the booming coffee exports, railroad construction, modern exploitation in gold mining, the electrification of the main cities, the strengthening of the centralist state, and the development of human capital in the form of entrepreneurial activity (Pombo Vejerano, 2002).

The period from 1905 to 1920 has been described by many as the most significant growth phase in Colombian history. Characterized by a spectacular expansion of exports and government revenues, as well as an overall rise in GDP, it strengthen the country so that it was largely resistant to the Great Depression of 1929 (Steiner, R. and Vallejo, H., 2010; Pombo Vejerano, 2002; Ocampo, J. A., Cárdenas, E. and Thorp, R., 2000). Beyond its direct economic impact, the expansion of coffee production had also a profound social effect. In sharp contrast to mining and some agricultural products such as bananas, which were grown on large plantations, coffee production in Colombia historically developed on very small plots of land. As a result, it generated an important class of small landowners whose income depended on a major export commodity. Unprecedented amounts of foreign capital found their way into both private investment and public works during this period because of the strong performance of coffee and other exports (Steiner and Vallejo, 2010).

Nonetheless, social and economic improvements were uneven. A study (2010) conducted by España Eljaiek and Sánchez Torres for the Research Center for Economic Development of the Andes University (*Centro de Estudios sobre Desarrollo Economico*, CEDE) found that the most important factor that explained the disparity in the industrialization, and therefore of the consequent economic growth, was human capital. Industrial development needed workers, human capital, possessing a minimum level of skills that allowed them to receive basic instructions and perform simple calculations. This hypothesis on the effects of human capital accumulation on Colombian industrialization indicates that those regions that had lower proportions of free population during the late colonial period accumulated lower proportions of human capital in the long term, a situation that did not allow them to easily adapt to the flows of new and complex technologies that occurred in the process of late industrialization during the first half of the twentieth century.

During the three decades of Conservative rule, political stability brought on relative economic stability, which helped to boost private investment in manufacturing. The economic policy of this period was oriented to the reconstruction and expansion of public infrastructure, to consolidate the tax structure, and to organize a monetary system through a Central Bank (1923) able to regulate the financial market and the gold standard exchange rate regime. Although there was no formal industrial policy, there was some protectionism to promote new domestic manufacturing activities. The Reyes administration followed the Mexican model based on a system of concessions, monopoly grants, direct state subsidies to enterprises, and tariff protection. After 1910, preferential instruments were gradually suppressed, and the protection policy relied exclusively on tariffs. Tariff policy provided the necessary nominal protection for domestic manufactured goods to survive. In this sense, specific tariffs were raised mainly for processed foods (Pombo Vejerano, 2002). By 1930, the manufacturing industry also showed an interregional specialization: Medellín in textiles, Cali in sugar refineries, and Bogotá in brewery and cement industries.

Coffee was not the only commodity boosting the Colombian economic growth at the beginning of the century. Although overshadowed by coffee and centered in a coastal enclave around the port of Santa Marta, bananas were another rising export commodity. Indeed, the United Fruit Company began production of bananas on a large scale at the end of the century and apart from a drop in production during the War of a Thousand Days, exports of bananas grew at incredibly high rates. From 1903 to 1911, the average annual rate of growth of the number of stems exported from the Colombian Caribbean was 28.9% (Roca Meisel, 1998).

The exploitation of petroleum deposits in the central Magdalena valley was also underway, initially for the domestic market, but by 1930 petroleum was being exported on a modest scale. The new textile mills clustered around Medellín were importers of cotton rather than exporters of finished cloth, but their growing importance was an indication of Colombia's belated and still somewhat limited entry into the industrial age. They at least found an expanding home market, including among *campesino*[9] families who until the rise of coffee could seldom afford factory-made cloth. Like coffee growing, textile manufacturing was almost entirely in Colombian hands, whereas the American United Fruit Company controlled the banana trade, and US and British firms had a stake in exploiting Colombian oil (Steiner and Vallejo, 2010).

The second industrialization phase of the Colombia economy took place from 1930 to 1945. During this period manufacturing industries experienced one of the highest growth rates observed since 1925. Total manufacturing value added grew on average 8.1% per year, while total GDP grew at 3.3% per year. Industrial deepening kept going despite of the external shocks that the country had to face (Pombo Vejerano, 2002). The Liberal Administrations started a process of import substitution in manufactured raw materials, such as rubber, chemical products, and steel. There were several factors that contributed to that dynamism in manufacturing: natural protection, the relative industrial backwardness, the increase of domestic consumption of manufactures, and favorable economic policy. The natural protection argument relies on the physical constraint that import's closure represented to Colombia during those years. The two main external shocks that happened – the Great Depression and World War II – resulted in quantitative restrictions on imports (Pombo Vejerano, 2002).

These shocks had a substantial impact on manufacturing activity. First, there was a positive effect on import-competing industries. These sectors faced an increasing demand without constraints in their provision of raw materials. On the other hand, input availability was not binding these industries. The textile sector had already substituted the production of its main raw material – cotton yarn – by 1930 (Montenegro, 1984). Similarly, breweries started programs of input substitution by promoting barley crops, and sugar refineries managed their own sugar cane plantations. At the same time, there was a negative impact on manufacturing due to the constraint in machinery imports.

The growth of consumption of manufactured goods and the relative industrial backwardness also explains the industrial expansion during that period.

[9] A native of a Latin American rural area.

The country was experiencing fast urbanization process. According to population census statistics, the share of urban population was 12.4% in 1918, 17.5% in 1938, and 42.6% in 1951. The four largest cities passed from 0.3 to 1.5 million people from 1918 to 1951. Per capita income rose from $359 in 1930 to $440 dollars at 1990 prices. That is, real purchasing power grew at 1.4% per year. Both elements expanded the domestic market for consumer goods. The urbanization process in turn implied a change in the pattern of consumption toward manufactures and a demand increase for construction materials. Another factor that contributed to the increase in urbanization was *La Violencia.* Indeed, it forced *campesinos* to flight strife-torn rural areas to find shelter in the cities (Bailey, 1967).

Regarding the degree of industrialization, Colombia lagged with respect to other Latin American economies. The share of manufacturing industry to total GDP was 6.6% in 1930, compared to 22% in Argentina, 11.7% in Brazil, and 14.2% in Mexico (Ocampo, 1984). This meant that the supply of domestic manufactures was too small relative to economy's apparent consumption, and manufacturing was an infant rather that a mature industry. Thus, there was enough room to enhance import substitution industrialization.

The economic policy during this period was extremely favorable to import-substitution industrialization. Three policy measures helped the economic recovery of the 1930s and to sustain economic growth during World War II. First, the tariff reform of 1931 increased import duties of all import-competing goods, raising on average the levels of effective protection (Pombo Vejerano, 2002). Second, the shocks in the international capital markets forced the government to adopt exchange rate controls and to abandon the gold standard regime. These measures implied a devaluation of the real exchange rate by 68% from 1933 to 1935, which significantly increased the relative price of imports. Third, a counter cyclical macroeconomic policy was implemented. In general, the Central Bank reduced the discount rate, increased the discount credit-limits to commercial banks, and approved credits to the central government as advance payments for the rents of the salt concession just transferred to Banco de la República. In addition, new financial institutions were founded in the 1930s as a result of the policy of mortgage reduction and the diversion of new loans to the agricultural sector. Summing up, during the 1930-1945 period there was a strong expansion of the manufacturing industry in which external shocks had a central role.

3.4 ISI policies, 1945-1967

Likewise other Latin American countries, Colombia followed a policy of import-substitution industrialization (ISI) since the beginning of the twentieth century. This strategy was inward-oriented, and influenced by historical constraints in the international and domestic markets (Vejarano, 2002).

The third industrialization phase took place from 1945 to 1967. During those years, Colombia followed a well-defined program of import-substitution industrialization which focused on the establishment of late industries. The industrial policy switched toward the promotion of capital-intensive industries, such as petrochemicals, chemical products, plastics, paper, rubber, basic metals, machinery, and transportation equipment. The political economy of ISI was based on the dependency theory, which stated that the historical pattern of international division of labor had ended up in a center-periphery relationship between the industrialized economies and the developing world. The nature of such relation caused an increasing technological gap, explaining the poverty trap and the deterioration in the terms of trade observed in the periphery. To break and reverse these trends, it was necessary to promote an inward development able to consolidate an industrial base that could not be attained by relying on market forces. These ideas influenced Latin American political circles during the post-World War II years. They saw ISI as a path to economic development. Thus, trade and non-trade barriers, domestic credit, state promotion, and foreign investment, became central ISI policy instruments.

The official program of ISI in Colombia since the 1950s relied on the massive use of quantitative restrictions on imports by means of import licenses and prior import deposits. For instance, the proportion of imports under the prior licensing regime was 21% between 1950 and 1954, while it was 78% during the 1965-1969 period. The value of prior deposits as a percentage of total imports rose from 4.8% in the early 1950s to 25% by the end of the 1960s (Ocampo, The transition from primary exports to industrial development in Colombia, 1991).

The result of the third industrialization phase, focused on the development of capital and technology intensive industries, and which relied heavily on protection and state promotion, was an industrial deepening that increased manufacturing share to total GDP from 0.14 in 1945 to 0.22 in 1967, and a steady growth rate of 8% for the sector during the whole period.

Differing from most Latin American countries, Colombia did not experience 'the lost decade' as the others. Following a long tradition of heavy state intervention in and active management of the Colombian economy, the end of the 1980s and the beginning of the 1990s were years of wide-ranging, market-oriented reforms aimed at promoting private-sector participation, enhancing trade, improving the performance of the financial sector, and making labor and product markets more efficient. Because the fiscal position remained broadly under control, Colombia managed to service its foreign debt during the debt crisis of the 1980s. Average growth was not very high, but, unlike other regional economies, no sharp recession occurred either (Steiner and Vallejo, 2010).

The model of industrialization by import substitution in Latin America has general patterns that are shared by different countries, but it also has local characteristics. The twentieth century was a century of major social and economic structural transformations for Colombia. The country became an urban economy that could develop a domestic capital market, the manufacturing industry, and the service sector. In addition, the regulatory instruments regarding the coffee industry, the reconstruction of economic institutions (e.g., the Central Bank), and the labor market and social security were instituted. Colombia does not represent an extreme case of import-substitution industrialization, nevertheless there was anti-rural bias in the economic policies implemented.

Chapter 4 Argentina

4.1 Independency and civil wars

On the 13th of May 1810, news came from Spain that the mother country was now under the heel of France and had no longer any power to help or control the colonial territories. Argentina's formal assertion of autonomy on May 25, 1810, commonly referred to as the May Revolution, started the long process of political organization of the country as a sovereign state (Rudolph, 1985). The two decades that followed brought an extraordinary succession of violent events. The original Provisional *Junta* of 1810 was followed by two Triumvirates, five Supreme Directors, the collapse of the central authority, a first dissolution of the United Provinces, seven governors of Buenos Aires Province during a seven-month period in 1820, a president of a revived United Provinces, two failed constitutions that never went into effect, and a constituent congress that handed over power to an appointed governor before it dissolved the central government for the second time and adjourned sine die.

As the region gradually made its claim for self-rule, it paid a steep price due to the territorial segmentation and the collapse of transregional authority, which resulted in political instability and an economic breakdown. Between 1812 and 1816 widening fissures developed between Buenos Aires and its northern and western hinterland, from Santa Fe to Tucumán and Cuyo (Rudolph, 1985). Despite the internal political confusion, the commitment to emancipation was a strong as ever, and in 1916 the Congress effected one important achievement: it declared the independence of the United Provinces of the River Plate. A revolutionary general, Juan Martín de Pueyrredón, was appointed Supreme Director of the United Provinces of the Río de la Plata.

Nevertheless, the internal clashes did not stop, and revolutionaries split into two antagonist groups: the Unitarists and the Federalists, a move that would define Argentina's first decades of independence. The outcome of the frictions between the Unitarist, or Centralist, faction who advocated for a strong central government in Buenos Aires and the Federalist faction, who supported a loose confederation, on the other side, led to civil war and eventually the rise of *caudillismo*[10] in the region (Rock, 1987). The 1916 Declaration of Independence was followed by the internal turmoil and the attempts by the newly established government to defend its emancipation from the Spanish threat and the Portuguese invasion, which resulted in the loss of territories in the north-eastern area. Provincial leaders grew hostile of Pueyrredón's new methods of ruling. Indeed, he favored economic sanctions in lieu of direct political power, controlling the flow of goods along the river Paraná and thus threatening them with even greater economic disruption. It did not take much for a new crisis to erupt in 1819, and *caudillos* formally taking power, thus ending the short-lived attempt to centralised power (Rudolph, 1985).

The 1820 Battle of Cepeda, fought between the Centralists and the Federalists, resulted in the end of the Supreme Director rule and the first hiatus following the outbreak of independence movements against Spain a decade before. For most, the era of independence brough hardships, however, there were also beneficiaries, namely merchants and foreign adventurers. From the mid-1810s, British merchants entered Buenos Aires in numbers and soon eclipsed both the local merchant communities and the Spanish competition in trading. By 1822 Britain was the source of almost half of Buenos Aires' total imports (Rock, 1987). A few years after independence, in 1825, the United Kingdom officially recognized Argentina – at the time The United Provinces of the River Plate – as an independent nation-state through the Treaty of Friendship, Commerce, and Navigation (Shumway, 1991). As the United Kingdom was the most powerful country of the time, and the United States had announced the Monroe Doctrine, the treaty limited the chances of Spain to reconquer its former colony.

The victory of the *caudillos* over Buenos Aires in 1920 proved to be short-lived, and in 1821 the Centralists in Buenos Aires resumed blockading the Paraná, therefore monopolizing trade. However, this time, the other provinces lacked military capacity to retaliate and had to settle for a peaceful stalemate (Rudolph, 1985). In the following years the same cycle of events followed: the

[10] It refers to a system of political-social domination, based on the leadership of a strongman, that arose after the wars of independence from Spain in nineteenth-century Latin America.

provinces wanted freedom from Buenos Aires, but once free, economic needs forced them to resume relations, which often put them on the back foot forcing them to accept Buenos Aires' dominance until able to launch another attack to the centralist power.

In 1826 Buenos Aires enacted another centralist constitution, with Bernardino Rivadavia being appointed as the first president of the country. However, the provinces soon rose against him, distrusting his promises of revenues' sharing, forced his resignation, and discarded the constitution. Civil war resumed and the Federalist faction prevailed in 1831, forming the Argentine Confederation led by Juan Manuel de Rosas, who remained governor until 1852. He was appointed governor with extraordinary powers and much political support from the conservative gentry, mercantile, and religious elites, whose goals were peace and stability, law, and order. Rosas' period in power was a period of restoration. He strengthened the army, protected the church, established government financial credit, protected agrarian interests, and promoted pastoral industry – all at the expense of education and freedom of expression (Rudolph, 1985). During his regime, he faced a French blockade, the War of the Confederation, and a combined Anglo-French blockade, but remained undefeated and prevented further loss of national territory. His trade restriction policies, however, angered the interior provinces, and in 1852 Justo José de Urquiza, another powerful *caudillo*, beat him out of power (Lynch, 1986).

4.2 Rise of the modern nation

The fall of Rosas was followed by a wave of change. Politically, the country ceased to be a complicated entanglement of *caudillos* and started to resemble a nation-state. Forty years of civil wars had precipitated the economy in segmentary, largely isolated local economies and a profusion of microstates. Urquiza was committed to a process of national re-organization. As new president of the Confederation, which comprised all provinces but Buenos Aires, Urquiza enacted the liberal and federal 1853 Constitution which established the government as representative, republican, and federal. The promulgation of the Constitution also instituted free trade and foreign investments in the country, and the development of a stable Argentine market for British manufactures (Rudolph, 1985). The administration also promoted immigration through the establishment of agricultural colonies and, as the problem of land transportation became evident, the construction of railroads began. Political unity and economic stability were mutually reinforcing.

Overpowering Urquiza in the 1861 Battle of Pavón, Bartolomé Mitre secured Buenos Aires' predominance and was elected the first president of the reunified country. As he took formal command in 1862, he immediately established new organs of state. The Mitre years saw an institutional revolution, as the country's jurists were given the task of creating a national legal system, a bureaucracy, and a taxation system. The first fruit of their work was the establishment of a national treasury and national customs office in 1862. A national judiciary followed the year after when Congress passed a national voting law. In 1864 the embryo of a new national army was formed. Subsequently, attempts were made to create a national postal system, and a civil law code was promulgated in 1870. By the early 1870s Argentina had also acquired its two great establishment press organs, La Prensa and La Nación (Rock, 1987). At first the new order was largely sustained by the wool export boom. Prosperity alleviated political tensions and gave the government a store of resources to augment its popularity. The government also made great concession to the provinces, the most important being a government-sponsored railroad between Rosario and Córdoba. Mitre was followed by Domingo Faustino Sarmiento and Nicolás Avellaneda; these three presidencies set up the basis of the modern Argentine State. Starting with Julio Argentino Roca in 1880, ten consecutive federal governments emphasized liberal economic policies. The correct functioning of the electoral process would be interrupted only in 1930 with a coup d'état that gave way more many more to follow (Rudolph, 1985).

The deep political change of this period was closely shaped by economic growth, which in turn resulted from a simple, mutually reinforcing, trinity: foreign investment, foreign trade, and immigration. The British investments wave in Argentina in the 1880s was of such magnitude that by 1890 they had inundated the country with an estimated £157 millions of investment capital. The great symbol of the new British connection was a burgeoning railroad system (Murray, 1960).

Foreign trade expanded similarly: in 1861 total foreign trade, both imports and exports, was valued at 37 million gold pesos; in 1880 at 104 million; and at more than 250 million in 1889. Meanwhile, the nation's population increased from an estimated 1.1 million in 1857 to approximately 3.3 million in 1890, with the rate of growth much faster in the littoral than in the interior (Corden, Essays on the economic history of the Argentine Republic, 1972). Growing opportunities for profit attracted foreign investment, while relatively high wages and prospects for social mobility drew immigrants. Both were the result and the source of Argentina's success in carving out new overseas markets for its primary goods.

Driven by this immigration wave and decreasing mortality, the Argentine population grew fivefold and the economy 15-fold: from 1870 to 1910 the amount of Argentine wheat and beef exports placed the country as one of the world's top five exporters (Lewis, 1990). Between 1878 and 1884 the so-called Conquest of the Desert occurred, with the purpose of giving by means of the constant confrontations between natives and Spaniards in the border, and the appropriation of the indigenous territories, tripling the Argentine territory (Rudolph, 1985).

The year 1880 can be taken as a watershed moment for Argentine history: the federalization of Buenos Aires as the capital completed the process of national organization, general Roca's War of the Desert against the Indians had greatly increased the effective size of the national domain, and various technological advances in refrigeration, transportation, cattle breeding, meat packing, and other areas transformed the economy and brought an outpouring of foreign capital, mostly British (Corden, Essays on the economic history of the Argentine Republic, 1972). These developments were all interrelated, but they began with the transformation of the pastoral economy. Improved strains of cattle were introduced which required alfalfa as feed; but alfalfa requires ploughed land and regular cultivation by agricultural labor on a very large scale. There was no such labor in sufficient amounts, and there was only one way to get it: immigrants, and lots of them.

This massive wave of European immigration that the federalist governments promoted, second only to the United States, led to a near-reinvention of Argentine society and economy that by 1908 had placed the country as the seventh wealthiest developed nation in the world (Corden, Essays on the economic history of the Argentine Republic, 1972). Railway mileage rose. Furthermore, real GDP grew so fast that, despite the huge immigration influx, in 1865 Argentina was already one of the top 25 nations by per capita income. Argentina's per capita income was 70% higher than Italy's, 90% higher than Spain’s, 180% higher than Japan’s, and 400% higher than Brazil’s (Crassweller, Perón and the enigma of Argentina, 1987). The long cycle of expansion and national consolidation that began with the political settlement of 1862 reached its apogee around 1914. Once one of the world's emptiest backwaters, Argentina at the beginning of the twentieth century was among the most prosperous countries. Yet amid prosperity was striking ambiguity. Throughout this period Argentina remained a producer of food and raw materials; it lived from the pampas, still failing to diversify substantially into manufacturing. By 1914 and again in 1930 disparities between the littoral and the interior became more pronounced. The east was the center of investment and consumption, and its heart, the city of Buenos Aires, an embodiment of advanced civilization. Much of the area beyond still exemplified the most backward parts of Latin America: rambling haciendas, an impoverished Indian or mestizo peasantry, feeble towns, inertia, and stagnation. The country was slow to meet its original goals of industrialization: after steep development of capital-intensive local industries in the 1920s, a significant part of the manufacturing sector remained labour intensive in the 1930s (Rock, 1987). Indeed, Argentine comparative advantage lies primarily on agricultural goods, broadly defined so as to include both primary products and agro-manufactures.

By 1914 Argentina had thus evolved into an extremely mixed and diverse society. Expectations remained high that the imbalances would steadily recede as the present wave of growth continued, for there was still much to accomplish. Argentina appeared perhaps to be reaching a saturation point in its capacity to absorb foreign capital and immigrant labor force, and despite the recent growth of manufacturing, the country was far from being a fully-fledged industrial society. Manufacturing was heavily dependent on a market that grew in proportion to exports and the inflow of foreign investment. Overall, in 1914 Argentina's economy was a high-wage, high-consumption complex that largely disclaimed the need or attractiveness of diversification (Dorfman, 1970).

The period between 1913 and 1929 can be divided into two cycles of depression followed by recovery. The first depression, between 1913 and 1917, was succeeded by recovery and renewed boom between 1918 and 1921; the second, between 1921 and 1924, by an expansion that continued till 1929 (Corden, Essays on the economic history of the Argentine Republic, 1972). These recessions, which resembled those in the last quarter of the nineteenth century, sprang from contractions in international demand for Argentine goods. The resultant balance-of-payments deficits were corrected eventually by falling imports, but at the cost of falling government revenues. The periods of depression were exacerbated by a cessation in foreign investment and as mattered seemed to improve, World War I brought international trade to a halt (Rock, 1987). Having barely recovered from the 1921-1924 depression, Argentina was hit by the 1929 Great Depression, which had a profound political effect in Argentina because it highlighted the weakness of the political and economic arrangements of the liberal period, and gave strength to political aspirations within the military (Rudolph, 1985). The country suffered the consequences of its dependent economic role as a producer of primary products for the international market and an importer of capital, finished goods, and labor input. As world trade collapsed after the Great Depression and the 1932 Ottawa Conference marked the end of multilateralism in international trade, the UK, Argentina’s foremost trading partner, shifted its trade to members of the Commonwealth. A protectionist pandemic spread throughout the world, and after 1930 the economic system was modified through greater state participation in the organization and direction of the economy (Dorfman, 1970).

The year 1930 ended decades of political stability and electoral fairness. A military coup led by José Félix Uriburu ousted Yrigoyen from power (Rudolph, 1985). This coup d'état marks the start of the steady economic and social decline that pushed the country back into underdevelopment. Uriburu ruled for two years; then Agustín Pedro Justo was elected in a fraudulent election. For the following decade, Argentina would witness various incidents of government repressions, rigged elections, economic depression, and oligarchical rule. In 1943 a military coup d'état, led by General Arturo Rawson, toppled the short-lived, democratically elected, government of Ramón Castillo. The regime change was caused by a secret Nationalist military organization, the Unification Task Force (*Grupo Obra de Unificación* — GOU), a group of young military officials. The conspirators were strongly influenced by Italian and German nationalist military organizations, and they perceived the army in a redeeming role. Under this view, they were committed to rule Argentina and achieve national industrial development and social reforms, which they viewed as necessary for national unification and the creation of a strong professional army. As a result, political power was transferred from the old landed and mercantile aristocracies to the new military bureaucracy (Rudolph, 1985).

4.3 The Peronist years: nationalization

In the realm of politics, Argentina represented, for over half a century, a virtual archetype of an unstable Latin American system with a high degree of military participation. Since 1930, twenty-five governments rose to power, fourteen of them by coup d'état or by less overt forms of military persuasion, in a country that before 1930 had looked back upon seventy years of unbroken civilian supremacy. Representative government was twice abandoned for years at a time. Riots and strikes, assassinations, and waves of guerrilla insurgency and official counterviolence had roiled society on every level. Political instability resulted in economic misfortunes. As world trade doomed with the Great Depression of the 1930s, Argentina formally began of the import substitution process (Brambilla, Galliani and Porto, 2018).

The Argentine coup d'état of 1943 established the military government that incubated Peronism. Indeed, Juan Domingo Perón was among the young colonels of the GOU and during the initial period of military consolidation (1943-1946) developed his power base as a major leader of the young officers. Perón quickly became the head of the newly created Secretariat of Labor and Social

Welfare, and from this vantage point, he was able to take over the labor organizations and to direct and subject them to his personal control (Crassweller, Perón and the enigma of Argentina, 1987). Finally, in 1946 Perón was elected president. Soon after his inauguration, he signed the Eady-Miranda Treaty, which regulated the acquisition of all British-owned railroads in Argentina. Although it did serve to recover some of the capital that had been held in Britain during the war in the form of revenues generated by the Argentine export sector, it also depleted Argentina's post-war gold reserves (Skupch, 2009).

The period following World War II saw the once well-integrated Argentina to embark on a rapid industrialization program, closing its economy off from world markets, and creating a situation of autarky. The Argentine economy had experienced a period of 'forced ISI' provoked by the inability to import industrial supplies from Europe and the US during World War II. Perón feared that after the War the nascent industry would be wiped out by imports from the recovered industrial countries; therefore, in his five-year plan, he erected a system of almost complete protection against imports (Crassweller, Perón and the enigma of Argentina, 1987). Shortly before Perón's access to power in June 1946, the Farrell government created the Argentine Institute for the Promotion of Exchange (IAPI). This institution held the monopoly over the country's foreign trade and originally had an evident anti-agriculture bias. The IAPI withheld around 50% of world agricultural export prices to both finance imports and support newly created public companies. In the meantime, import tariffs were raised, the multiple exchange rate system was maintained, and a scheme of import permits was created. In addition, Argentina suffered from the nationalization of railways, telephones, electricity, public transport, and other utilities and services between 1945 and 1950 – the early Peronist years (Brambilla, Galliani and Porto, 2018). Perón's industrialization program reflected a full-fledged strategic commitment to make industry the nation's driving economic force (Maxfield and Nolt, 1990).

The Peronist government implemented across-the-board tariff protection, and participated in the production of basic industrial goods and in the financing of key industrial sectors (Casaburi, 1998). The main industrial policy tools employed were import quotas, foreign exchange rationing, provision of soft financing for local manufacturers, and the promotion of strategic sectors of the economy. The latter included preferential exchange rates, import privileges for machinery, and a higher level in remittance allowance in order to attract foreign capital. The government's goal was the expansion of existing activities through the enlargement of the internal market. As a result of these industrial incentives, the manufacturing share of GDP grew by 3.6 percentage points. By contrast, the traditional agricultural sector, which had generated most of the foreign exchange until the 1930s, underwent a serious contraction. Agricultural production in 1950-1952 fell by 20% compared to the period 1940-1942 (Casaburi, 1998). The transfer of resources from the agricultural to the industrial sector by means of taxation and differential exchange rates had also a negative effect on agricultural exports, thereby contributing to generate balance of payment problems. However, Perón was opposed to borrow from foreign credit markets, and he refused to sign the GATT in 1947 and join the IMF (Crassweller, Perón and the enigma of Argentina, 1987).

During the 1950s and the 1960s, several external factors conspired against Argentine agricultural exports, thus encouraging further domestic protection. First, in the late 1940s, the restrictions faced in the international grain market as a result of the country's exclusion from the Marshall Plan hit Argentina's exports very hard. Second, while world trade recovered in the 1950s, the composition of trade shifted against Argentine comparative advantage: exports of manufactured goods grew consistently more than exports of primary products. This coincided with the emergence of intra-industry trade (mostly among Western Europe, the US, and Japan). Third, the agricultural protectionism that followed the end of World War II hindered Argentine exports. Argentina thus turned towards inner development (Brambilla, Galliani and Porto, 2018).

Perón began his second six-year term in June 1952, but he endured scarcely three more years, until the coup of September 1955. Newly re-elected, he issued the second five-year plan (Noth, 1985). Compared with its 1946 predecessor, this plan struck a much more sober and modest note. Instead of self-sufficiency, the new goal was to achieve the maximum growth in industry compatible with economic and social equilibrium. The plan's primary objective was the suppression of inflation, now perceived as the source of myriad ills, from recent political unrest to low investment in agriculture and industry, and the development of the heavy and basic input industry as well as the oil sector (Rock, 1987).

4.4 Post-Peron era: new trade policies

Peron's removal in the military coup d'état of 1955 (the *Revolución Libertadora*) reflected popular discontent with inflation, corruption, demagoguery, and oppression, and was followed by a period of political instability and further military coups. Chronic high inflation eroded savings and living standards, and unemployment rose (Maute, 2018). The country failed to regain prosperity and growth, and the recurrent cycles of recession and recovery arrested its progress toward industrialization; at the same time, social and political divisions grew increasingly tense and violent (Rock, 1987).

Toward the end of the 1950s, it was becoming clear that the world was entering a new free trade era and that the woes of the inter-war mercantilist period were over (Halperin, 1994; Mallon and Sourrouille, 1975). However, taking advantage of the new international conditions required a painful period of readjustment, and the Argentine governments between 1955 and 1973 had no intention of reverting the protectionist period implemented by Perón. Indeed, they tried, to the extent of their possibilities, to deepen the import-substitution process. Argentina's effective rates of protectionism remained the highest in Latin America (Galiani, 2017). Protectionism and hostility toward the rural producers of the *pampas*[11] were hardly limited to the Peronist movement, neither was a strong nationalist stance toward foreign capital. As with export incentives, governments zigzagged in their policies toward foreign capital during this period. However, foreign corporations were nonetheless used as key instruments in expanding industrial production in consumer durables and in intermediate and capital goods (Casaburi, 1998). The Argentine economist Raul Prebisch opposed Perón's excessive nationalism, and as adviser to the first post-Peron military government, he recommended policies that helped alleviate many specific internationalist

[11] The large, flat areas of land covered in grass in Argentina.

grievances. However, after a short-lived attempt to follow Prebisch's reccomendations in 1957, the successive governments favored policies that would emphasize employment and welfare of the urban masses by maintaining the effective protection of existing industries, whereas powerful agricultural export interests opposed ISI altogether. The struggle among these factions made it difficult for Argentina to pursue any policy course consistently and, therefore, achieve medium- and long-term economic stability (Maxfield and Nolt, 1990).

These years also saw a steep increase in the consumption of services, many of which were provided by highly educated workers living in cities. Over time, sustained growth required more government intervention. The state had to finance the deficits run by public-sector enterprises, subsidize the substitution of capital-intensive imports, and promote non-traditional exports. Yet it became less and less able to do so as trade revenues began to shrink under increasing autarky and as the surplus enjoyed by the social security system created under Perón melted away, turning into a deficit by the mid-1960s. Moreover, the increased urbanization and centralization aggravated the historic regional disparities: rural areas were increasingly cut off from commerce (Rock, 1987).

To complete this dim picture, the outlook for markets brightened briefly in 1960 with the creation of the European Economic Community (EEC), but it soon became clear that Europe strived for agricultural self-sufficiency, such that the Argentine economy was relegated to a status of reserve supplier. The main export successes came in the mid-1960s with the opening of trade with China and the Soviet Union (Rock, 1987).

The industrialization process in this period was guided by an alternation of administrations with different strategic objectives, and research found that it failed to achieve self-sufficiency or even a more rational or coherent industrialization process (Galiani, 2017; Taylor, 2018). This led to an essentially disproportionate development process that promptly ran into a vicious economic cycle: (a) the inadequate growth of exports was a very serious obstacle to the industrialization process, which required growing inputs of capital and intermediate goods; and (b) the intensification of the industrialization process, especially the development of heavy industry, required larger subsidies that needed to be financed in some way. The government's inability to accomplish this task with fiscal resources drove inflation up to levels that were inconsistent with a healthy economic performance.

To sum up, chronic inflation and recurrent cycles of recession and recovery, associated with substantial changes in income distribution arbitrated by the state were salient economic features throughout this period (Mallon, and Sourrouille, 1975). At the same time, social and political divisions grew increasingly tense, reaching such a point that violence dominated the political and economic life of the country. As a result, Argentina failed to regain its prosperity and to achieve a consensual political order; instead, it was stumbling along in a volatile impasse. Nevertheless, the darkest hour for Argentina was yet to come.

4.5 Dictatorship, stagnation, and foreign debt

Juan Perón returned to Argentina on June 20, 1973, and in September he was elected president together with his wife, Isabel, as vice president. Perón was committed to achieve political peace through a new alliance of business and labor to promote national reconstruction. In early 1974, however, the economy was on the brink of collapse. As in the 1950s, Perón resorted to foreign borrowing in order to subsidize consumption, thereby producing huge budget deficits. Workers' real wages continued to drop as regular wage increases did not, keep pace with the rising cost of living. Despite any gestures to the contrary, Perón's ideas were the same as twenty years earlier. The core of his programs was income redistribution in favor of the labor force, the expansion of employment, and renewed social reforms. He wanted to revive the IAPI, increase food subsidies, and tax farming, and allow the state to once more control the banks, support native industry, and regulate trade through highly protective tariffs (Rock, 1987; Crassweller, Perón and the enigma of Argentina, 1987).

By early 1974 the Peronist restoration had lost the little support it had. To control workers and activists, the administration resorted to police actions, and a series of reforms of the Penal Code provided the government the legal means to institutionalize the repression. Popular demonstrations became illegal and subject to police intervention; political exiles were repatriated or repressed in

Argentina; and the media were placed under state control. Perón was nevertheless able to hold onto his office until he died suddenly on July 1, 1974 (Crassweller, Perón and the enigma of Argentina, 1987).

After his death, Isabel Perón, his wife and vice president, succeeded him in office. During her presidency, high inflation was coupled with violence and state repression. In 1976, a military junta, along with the Peronists' far-right fascist faction, once again became the de facto head of state. Her short presidency was marked by the collapse of Argentine political and social systems, leading to a constitutional crisis that paved the way for a decade of instability, left-wing terrorist guerrilla attacks, and state-sponsored terrorism (Crenzel, 2019). With the 1976 military coup, the Dirty War officially began.

The final populist experiment of the early 1970s enacted by Perón before and his wife later, left the country in a state of economic and political disorder. On the political side, it failed to curb the spiral of violence that leftist guerrillas had ignited in the late 1960s. On the economic side, the oil crisis exposed the weakness of the import-substitution strategy. The increase in the price of imported oil, a vital input of the manufacturing sector, fueled inflation and reduced real wages. The main economic objective of the newly established military administration was to reduce inflation (Brambilla, Galliani, and Porto, 2018). By the mid-1970s, the structural failures of the ISI model became apparent. In general terms, it could be said that Argentina experienced problems common to those countries following ISI: it over-protected its internal market and lacked competitiveness in its manufacturing sector. The increasing deterioration of economic conditions had important socio-political consequences. Although establishing a clear causal relationship is almost impossible, the economic instability of this period ran parallel to the socio-political turbulence that characterized it, probably resulting from a crossed-causation process (Casaburi, 1998). A significant market-oriented financial and trade liberalization program was also implemented, and it culminated in the military's announcing import substitution as a failed experiment. With the reform agenda in mind, the new military junta launched an economic program based on unilateral economic deregulation and liberalization in 1976. In 1977, the government embarked on a program of financial reform which deregulated capital markets, freeing interest rates that had been regulated for decades (Casaburi, 1998). The combination of this rapid trade liberalization and the sharp appreciation of the currency had a dramatic effect on the trade balance. This attempt at economic liberalization did little to promote manufacturing competitiveness. Paradoxically, industrial exports grew in 1980, but this growth resulted from the maturity of previous private and public investment in the manufacturing sector. This increased output could not be absorbed by the local market, and the low local demand thus encouraged the Argentine entrepreneurs to export their surpluses. The accumulation of all these macroeconomic imbalances led to a severe crisis in the early 1980s. High and rising inflation affected production costs, and the industrial sector was hard hit by the recession. Agricultural exports, too, became prohibitively expensive. Trade flows diminished rapidly: by 1982, exports fall to 2 percent of their record level, and imports also declined (Taylor, 2018).

In the middle of this deep depression, the Argentine government led by general Galtieri suffered from increased criticism due to the economic mismanagement and the brutal repression. Anxious to restore the junta’s power and to assert Argentine sovereignty – hoping it would also spark nationalism feelings in the country – Galtieri approved Argentina’s invasion of the British Falklands Islands in 1982. This move provoked a sharp military reaction by Great Britain, and a swift reaction from the US administration: indeed, the Reagan administration supported the Thatcher government by imposing military and economic sanctions on Argentina (Rock, 1987; Daudi and Dajani, 1983). On June 15, Galtieri acknowledged the military defeat. It was not only the war that had been lost, but the military's professional competence was also brought into question, as well as its capacity to provide political leadership for Argentina (Rudolph, 1985). The war dealt a fatal blow to Galtieri’s political aspirations and prompted the president’s resignation a few days later. The frustration of an entire nation, suffering from decades of military oppression and torture, could be heard in the demands for the return of civilian rule.

With the authoritarian rule, it also definitely ended Argentina’s isolation from the world. Starting in 1985, Argentina signed several integration treaties to reduce trade barriers among Latin American countries, abolishing all quantitative restrictions, including quotas, on imports and exports (Maute, 2018).

Up to the 1930s, Argentina was well integrated into the world economy and, though some protectionism naturally developed after the Great Depression of the 1930s, it was only after the Second World War that the country closed itself off from world markets. It then remained in a situation close to autarky until the mid-1970s (Galiani, 2017) History shows that the long period of absolute economic decline overlapped with a period of political instability, economic coups and, in some extreme cases, massive state repression.

Concluding remarks

The question of whether governments should pursue a policy of selectively encouraging specific manufacturing sectors relative to others has been a staple of economic analysis and policy for many years.

Particularly, developing countries, according to the developed world and the international institutions of trade, should adopt a set of ‘good policies’ and ‘good institutions’ to foster their economic development. According to this agenda, ‘good policies’ are broadly those prescribed by the so-called Washington Consensus. They include restrictive macroeconomic policy, liberalization of international trade and investment, privatization and deregulation. The ‘good institutions’ are essentially those that are to be found in developed countries, rather than in developing ones. The key institutions include: democracy, ‘good’ bureaucracy, an independent judiciary, strongly protected private property rights, and transparent and market-oriented corporate governance and financial institutions – including a politically independent central bank.

However, both in developing and developed countries we can find contradictory examples of industrial policies. For example, it is generally accepted that Britain became the world's first industrial superpower because of its laissez-faire policy, while France in the nineteenth century fell behind as a result of its interventionist policies. Similarly, it is widely believed that the US abandonment of free trade in favour of the protectionist Smoot-Hawley Tariff at the outset of the Great Depression (1930) was “the most visible and dramatic act of anti-trade folly” (Bhagwati, 1985, p. 22).

It is now widely accepted that the countries that managed to catch up with the old industrialized and high-income countries are the ones whose governments proactively promoted structural change, encouraging the search for new business models and markets, and channeling resources into promising and socially desirable new activities. Evidence of failed industrial policy experiments, however, is also abundant. Hence, while market failure justifies public intervention in principle, inappropriate policies may have worse results than non-intervention.

This thesis started from the hypothesis that political stability is another factor to take into consideration, especially for developing countries, when considering ways to achieve economic stabilization or growth. Indeed, the widespread phenomenon of political (and policy) instability in several countries over time and its negative effects on their economic performance has arisen the interest of several economists. Developing countries, by definition, are characterized by a lack of development both in industrialization, and in political and economic institutions. This, in turn, if not already caused by, causes political instability. The three cases analyzed in this thesis are all examples of developing countries trying to industrialize and promote economic growth in the midst of political upheaval and violence. The lack of development in post-World War II Latin American countries has been studied systematically, and the Argentine economists Prebisch and Singer (1950) argued that resources flow from a 'periphery' of poor and underdeveloped states to a 'core' of wealthy states, enriching the latter at the expense of the former. It is a central contention of their theory that poor states are impoverished, and rich ones enriched by the way poor states are integrated into the 'world system'. The analysis in this thesis showed that Nicaragua, Colombia, and Argentina proved to fit this description. The US, and the UK in the case of Argentina, got richer at their expenses. Therefore, the findings of my investigations were not that unusual. When the world's rich, core economies chose autarky in the 1920s and especially in the 1930s, Nicaragua, Colombia, and Argentina, having been exposed to the downside risks of openness, shifted towards protectionism, through ISI policies.

Moreover, when looking at political instability, the course of history has been astonishingly clear. All the countries analyzed have suffered from political instability resulting from regime changes, coups d'état, internal struggles from power, autocratic regimes, and, at times, foreign interventions. The latter proved to be the case especially for Nicaragua, where US interventionism took the form of both overt and covert interventionism in domestic political and economic matters. At the beginning of the century the US Marines occupation of the country meant the complete surrender of the national economy to Washington and then, a few decades later, the US anti-communist stance translated into a five-year embargo (and other economic sanctions) which hurt the Nicaraguan economy immensely. However, US imperialism has not been the only culprit of disastrous economic performance. The various Nicaraguan governments who succeeded in power seem to have been unable to bring about neither political stability nor durable economic growth.

The research conducted on Colombia showed a very fractured and polarized society where the tradition of mostly fair electoral competition has existed alongside a history of widespread political violence. After a mere decade of political, and therefore economic, stability (1930s-1940s), violence erupted in 1948 and has never really left the country.

The third and final case study, Argentina, resembles the first two regarding political instability, but its mid-century ISI policies came after a period of sustained economic growth, foreign investments and, in general, prosperity. Yet, amid prosperity was striking ambiguity: the once prosperous country indeed had been slow to industrialize and depended primarily on agricultural products. Therefore, it was not surprising to find that as the world trade collapsed in the 1930s-1940s, the Argentine economic system was modified through greater state participation in the organization and direction of the economy. At the same time, decades of political stability and electoral fairness met an abrupt end.

All three cases exhibited patterns of political instability and social violence. At the same time, their economic performance in the period analyzed – from their independence in the nineteenth century to the 1980s – has been wobbly at best. Figure 1 provides a visual representation of the key dates of political instability of the twentieth century and the economic performance of the countries.

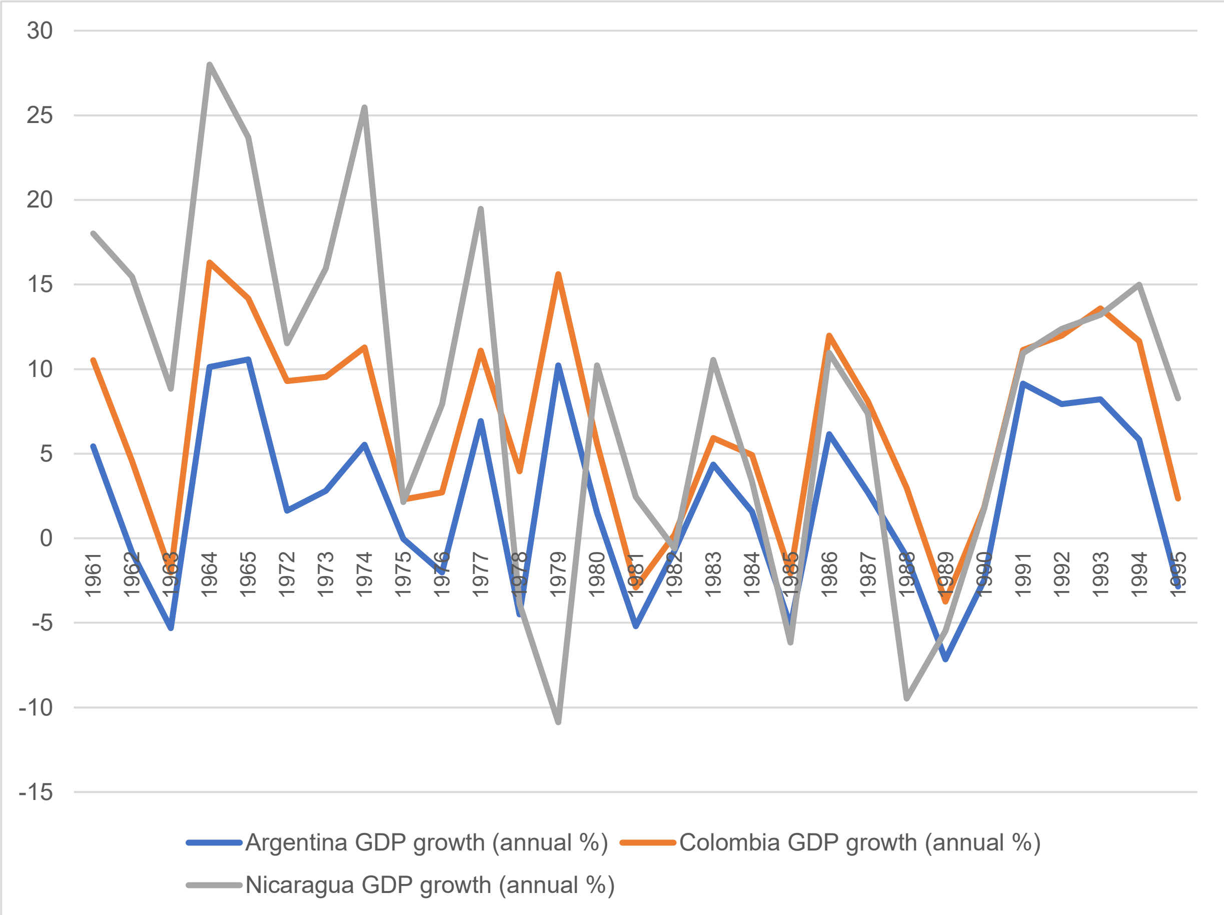

Figure 1: economic growth and political instability (key dates). World Bank data

The findings presented in the thesis proved my initial hypothesis: there is indeed a correlation between political stability and economic performance. However, it is hard to establish a causal link on which one of the two causes the other. Regardless, the literature proved that a country plagued by political instability, which often results in social violence, can hardly thrive economically.

The debt crisis that hit the Latin American countries in the 1980s forced them to resort to the international institutions' help and, therefore, comply with their rules. Moreover, the three cases analyzed have also suffered from extensive foreign intervention in their economic policies. Given that developing countries were not able to pursue protectionist policies to the extent they liked, areas of further investigation can be pursued to assess whether developing countries should or should not implement the set of policies prescribed by the 'Washington Consensus'. Further insights could also be gathered on the role that developed countries played and the impact they had on developing countries' economic performance.

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