Why Has Post-reform Growth Been Disappointing?

The expectations of the advocates of market reforms were that the change in the structure of economic incentives, the introduction of market competition, and a stable macroeconomic policy framework would result in high and sustained growth. In particular, the benefits of greater integration with the U.S. economy, exploiting a unique geographical position, were expected to trigger a process of convergence in incomes per capita similar to that which took place in countries such as Spain, Ireland, Greece, and Portugal after their entry into the European common market. Reality has been different, as we shall see in this chapter. Not only did Mexico face a severe macroeconomic crisis in 1995, as discussed in chapter 8, but its rate of economic growth has been mediocre while divergence, rather than convergence, with respect to the United States has taken place. This chapter examines the growth performance of the Mexican economy over the past two and a half decades and reviews the roles of trade, the productivity slowdown, human capital accumulation, and physical capital investments in accounting for the poor growth record.

Mexico’s development gap

In 1980, Mexico was an upper middle-income country with a gross domestic product (GDP) per capita that was well over 40% of the average of the high-income Organization for Economic Cooperation and Development (OECD)
Table 10.1  Mexico’s development gap in 1980 and 2005

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per capita</td>
<td>47</td>
<td>100</td>
<td>34</td>
<td>100</td>
</tr>
<tr>
<td>Participation ratio (%)</td>
<td>31</td>
<td>46</td>
<td>41</td>
<td>50</td>
</tr>
<tr>
<td>Output per worker</td>
<td>69</td>
<td>100</td>
<td>41</td>
<td>100</td>
</tr>
<tr>
<td>Agriculture</td>
<td>49</td>
<td>100</td>
<td>23</td>
<td>100</td>
</tr>
<tr>
<td>Industry</td>
<td>74</td>
<td>100</td>
<td>40</td>
<td>100</td>
</tr>
<tr>
<td>Services</td>
<td>88</td>
<td>100</td>
<td>49</td>
<td>100</td>
</tr>
<tr>
<td>Employment shares (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>28</td>
<td>9</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td>Industry</td>
<td>29</td>
<td>34</td>
<td>26</td>
<td>25</td>
</tr>
<tr>
<td>Services</td>
<td>44</td>
<td>58</td>
<td>58</td>
<td>72</td>
</tr>
<tr>
<td>Output shares (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>9</td>
<td>4</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Industry</td>
<td>34</td>
<td>37</td>
<td>26</td>
<td>26</td>
</tr>
<tr>
<td>Services</td>
<td>57</td>
<td>59</td>
<td>70</td>
<td>73</td>
</tr>
</tbody>
</table>

OECD = High-income countries.

* Purchasing Power Parity estimates in 2005 international dollars, OECD = 100. World Bank, World Development Indicators.

* Labor force divided by population. World Bank, World Development Indicators.

* Estimated as the ratio of per capita GDP to the participation ratio (OECD = 100).

* Estimated as the average output per worker multiplied by the sector’s output share and divided by the sector’s employment share (OECD = 100).


countries (see table 10.1). The difference in income per capita separating Mexico from the high-income countries in table 10.1—its development gap—can be decomposed as the sum of three components: (1) differences in the labor force participation ratio—the ratio of labor force to population—largely attributable to differences in the population’s age structure and women’s participation rates; (2) differences in occupational structure arising from the fact that the employment share of low productivity sectors is typically larger in developing countries than in developed countries; (3) differences in output per worker in individual sectors (leaving aside differences in occupational structure) or the productivity gap *stricto sensu*.

1. See Ros (2000b) for a formal analysis.
Table 10.2 shows the results of this decomposition exercise. In 1980, nearly two-thirds of Mexico's development gap was attributable to differences related to demographic and occupational structures. This was largely due to Mexico's high dependency ratio (more than 40% of the gap was related to differences in participation ratios), a legacy of very high rates of population growth in the past. Still significant, although probably less than in earlier decades, was the difference in occupational structure: about 21% of the gap, largely due to the still high employment share of low productivity agriculture. This is what leaves just over one-third to be accounted for by a "pure productivity component," arising largely in agriculture and industry productivity differences.

These results can be looked at as follows. With OECD participation ratios and occupational structures, Mexico's per capita GDP would have been almost twice its level in 1980, and therefore about 80% of the level of high-income OECD countries (a smaller development gap than that separating Spain from the high-income OECD countries). In other words, had the Mexican economy absorbed the rapidly growing labor force since 1980 while simply maintaining 1980 levels of output per worker and changing its occupational structure along past trends, it would have largely become a high-income country as its demographic and occupational structures and women's participation ratio in the labor market converged to those of a typical OECD country.

Had output per worker continued to grow at the rate of the period 1950-1981, this transition to high income levels would have been accomplished during the last 2½ decades. With the increase in the labor participation ratio since 1981 (1.2% per year) and the growth of output per worker from 1950 to 1981 (3.2% per year), per capita income would have reached by 2005 about 80% of today's level in the high-income OECD countries (and would have been 25% above the 1980
Table 10.3  Growth of per capita GDP and GDP per worker

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth rate of per capita GDP</td>
<td>3.2</td>
<td>0.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Growth rate of GDP per worker</td>
<td>3.2*</td>
<td>−0.5</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Source: Based on INEGI (1999a), World Bank, World Development Indicators, and Groningen Growth and Development Center, Total Economy Database.


level in these countries). The reason, of course, is that per capita GDP growth would have accelerated from 3.2% (in the period 1940–1981) to about 4.4% per year, thus multiplying per capita income by almost 3 times over 25 years.

This process of convergence did not happen. Instead, over the past two and a half decades the pace of Mexico’s economic growth suffered a severe slowdown compared to the historical record of the previous 40 years. Between 1981 and 2006, Mexico’s per capita GDP has grown at an average rate of only 0.6% per year (table 10.3), which is similar to that of the period 1910 to 1940 and compares very unfavorably with the historical record of 3.2% per year over the period 1940 to 1981. This poor performance is partly due to the decline in per capita income from 1982 to 1989, a period characterized by highly adverse external shocks, acute macroeconomic instability, and a continuous transfer of resources abroad (to cover the foreign debt service) in the context of severe external credit rationing. But even leaving aside this period, economic growth has been wanting: from 1990 to 2006, per capita GDP has expanded at an annual rate of 1.6% (table 10.3), and this in the context of great volatility in the level of economic activity.

Even such meager recent growth has to be attributed to the rapid increase in the labor force participation ratio, as GDP per worker has in fact fallen over the period 1981 to 2006 and has increased at a very slow pace since 1990 (see table 10.3). The growth slowdown is thus particularly serious to the extent that it implies wasting the “demographic dividend” associated with the transition toward low rates of population growth in the context of still very dynamic growth of the working age population. Indeed, while in other historical experiences this demographic transition is associated with an acceleration in

2. This calculation uses the identity by which the growth rate of per capita GDP is equal to the sum of the growth rates of GDP per worker and the participation ratio.

3. As shown in table 9.5, as a result of this transition, the dependency ratio fell from 95.8% to 56.4% between 1980 and 2005.
Table 10.4  Mexico’s per capita GDP as a ratio of per capita GDP

<table>
<thead>
<tr>
<th>Region</th>
<th>1981</th>
<th>1990</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>12.1</td>
<td>6.6</td>
<td>2.8</td>
</tr>
<tr>
<td>South Asia</td>
<td>11.1</td>
<td>7.7</td>
<td>5.3</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>6.0</td>
<td>6.0</td>
<td>6.8</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>2.3</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>World</td>
<td>1.7</td>
<td>1.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>n.a.</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>High income OECD</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: Based on World Bank, World Development Indicators.
Per capita GDP is in 2005 international dollars (Purchasing Power Parity).

a  Developing countries.

the growth of per capita income, what one observes in the Mexican case is an increasing underemployment of the labor force and a deceleration in the growth of per capita income.

The rate of growth of per capita GDP has not only fallen below the historical experience in the pre-debt crisis period, but as can be seen in table 10.4, by 2006 Mexico’s per capita income had fallen to about one-third of the level in high-income OECD countries, despite the fact that there had been a process of convergence in labor force participation ratios and occupational structures. The relative decline of the Mexican economy has taken place also with respect to the major developing country groupings, with the exception of sub-Saharan Africa and the transition economies of Europe and Central Asia. This includes middle-income and poor countries, oil exporters and oil importers, economic reformers and nonreformers. Moreover, this relative decline is not an exclusive feature of the lost decade of the 1980s since it has continued (albeit at a generally slower pace) in the period since 1990 (see table 10.4).

**Trade expansion without export-led growth**

In reviewing the causes of the slow growth of the Mexican economy we must first discard a lack of international trade integration and export growth. The

---

4. For an explanation of the slow growth rate of Latin American economies that emphasizes the still low degree of trade openness of the region (especially in comparison to East Asia), see de Gregorio (2005).
premises on which the trade liberalization process launched in the mid-1980s was expected to improve the growth performance of the economy were the following. First, exports, and foreign trade more generally, would be stimulated by trade liberalization as it removed the antiexport bias of protection and opened up domestic markets to foreign competition. Second, the expansion of international trade would act as an engine of growth by improving the allocation of resources and the dynamic efficiency of the economy as competition in domestic and world markets would force producers to adopt best practice techniques and thus accelerate the rate of technological progress, improve overall productivity, and strengthen international competitiveness.

As we saw in chapter 8, the first of these assumptions turned out to be correct. There is little doubt that trade liberalization, by eliminating the anti-export bias of protection, has greatly stimulated the growth of nonoil exports. Yet the second premise turned out to be wrong. Clearly international trade has not acted as a sufficiently strong engine of growth capable of leading to a substantial improvement in the growth performance of the economy. There has been rapid export growth, but no rapid export-led growth.

Why has this rapid export expansion failed to generate broad-based growth? In answering this question one must first look at what technological benefits firms derive from exporting and the associated issue of the causality between exports and productivity performance. The evidence from micro-econometric analyses of the relationship between exports and firm productivity performance using plant-level data sets suggests that causality seems to run from productivity to exports rather than the other way around as generally believed. In other words, efficient firms seem to self-select into export markets rather than deriving technological benefits from exporting.5

Second, the most careful studies of the relationship between trade liberalization and growth across countries do not find a clear-cut relationship between the two (see Rodríguez and Rodrik, 2001). Ultimately, the reason, we think, is that freer trade may contribute to growth or not depending on the structure of static comparative advantages that an economy has at a point in time and the dynamic potential of this structure. Recent models of endogenous growth have formalized old ideas on infant industry protection, showing that whether trade promotes growth or not depends on whether the forces of comparative advantage push the economy to allocate more resources to sectors

5. See Aw et al. (2000), Bernard and Jensen (1993, 1998), and Clerides et al. (1998). Note that the earlier literature on cross-country regressions of the relationship between exports and growth reached inconclusive results. For a survey of this literature, see Edwards (1993).
with increasing returns to scale and knowledge externalities or whether they prevent the development of such activities (see Feenstra, 1990; Grossman and Helpman, 1991; Matsuyama, 1992; Rodríguez and Rodrik, 2001). In other words, freer trade may promote more or less dynamic patterns of specialization depending on the present factor endowment of the economy.

At first glance, the nature of Mexican exports should have generated faster economic growth. Indeed, Hausmann et al. (2005a) show that the level of technological sophistication of a country’s exports relative to its per capita income is a good predictor of a country’s subsequent growth, and it is clear from their findings that Mexico has a relatively high level of sophistication of its export basket, higher certainly than other Latin American economies with similar or even higher levels of per capita income (Chile and Argentina, for example). Mexico acquired a comparative advantage in manufacturing during the import substitution industrialization (ISI) period, unlike many South American countries that maintained a comparative advantage largely in primary goods. As a result, Mexico has integrated into the international economy as an exporter of not only oil, but also of manufactures, both labor intensive (garment and assembly of electronic products) and of medium and high-technological intensity (automobiles, metal mechanic industries). Thus, as we saw in chapter 8, the share of manufactures in total exports climbed from less than 20% in the early 1980s to nearly 80% today at the expense of the share of oil exports, which fell from more than 66% of the total in the early 1980s to less than 20% today (see figure 8.2). This transformation is remarkable in the international context. Today, the manufacturing exports’ share in total exports is higher in Mexico than in several Latin American and East Asian countries (table 10.5). Moreover, as discussed in chapter 8, the share of high-technology exports in total manufacturing exports has been increasing over time and stands at about 20% today.

However, the evidence put forward in chapter 8 raises serious doubts about the ability of the current industrial structure to generate high, self-sustained growth. The counterpart of the processes of intrafirm and intraindustry trade specialization is that many, if not most, exporting sectors and firms, while dynamic, either do not have adequate domestic linkages or have

6. Within manufacturing, the most dynamic component both before and after NAFTA is associated with intraindustry and intrafirm trade, including, in particular, the maquiladora industry. The share of intraindustry trade (closely associated with the maquiladora industry) in the manufacturing sector increased from 62.5% in 1988–1991 to 73.4% in 1996–2000 (OECD, 2002).
Table 10.5  Composition of merchandise exports (in percent of total)

<table>
<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>Brazil</th>
<th>Chile</th>
<th>Indonesia</th>
<th>Korea</th>
<th>Malaysia</th>
<th>Mexico</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Manufactures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>23.2</td>
<td>37.2</td>
<td>9.1</td>
<td>2.3</td>
<td>89.6</td>
<td>18.8</td>
<td>11.9</td>
<td>25.0</td>
</tr>
<tr>
<td>1993</td>
<td>31.9</td>
<td>58.9</td>
<td>16.5</td>
<td>53.1</td>
<td>93.1</td>
<td>69.7</td>
<td>74.6</td>
<td>71.1</td>
</tr>
<tr>
<td>2006</td>
<td>32.0</td>
<td>50.8</td>
<td>11.1</td>
<td>44.7</td>
<td>89.5</td>
<td>73.7</td>
<td>76.0</td>
<td>76.0</td>
</tr>
<tr>
<td><strong>Agriculture</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>71.2</td>
<td>50.3</td>
<td>24.9</td>
<td>21.7</td>
<td>8.8</td>
<td>46.0</td>
<td>14.7</td>
<td>57.1</td>
</tr>
<tr>
<td>1993</td>
<td>57.4</td>
<td>28.4</td>
<td>38.3</td>
<td>15.0</td>
<td>3.8</td>
<td>18.1</td>
<td>8.5</td>
<td>25.8</td>
</tr>
<tr>
<td>2006</td>
<td>46.4</td>
<td>28.7</td>
<td>20.5</td>
<td>18.1</td>
<td>1.6</td>
<td>9.7</td>
<td>5.8</td>
<td>16.6</td>
</tr>
<tr>
<td><strong>Minerals and oil</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>5.7</td>
<td>11.2</td>
<td>65.4</td>
<td>75.8</td>
<td>1.3</td>
<td>34.9</td>
<td>73.3</td>
<td>13.9</td>
</tr>
<tr>
<td>1993</td>
<td>10.7</td>
<td>12.3</td>
<td>43.3</td>
<td>31.9</td>
<td>3.0</td>
<td>11.5</td>
<td>16.5</td>
<td>1.6</td>
</tr>
<tr>
<td>2006</td>
<td>20.2</td>
<td>18.5</td>
<td>66.4</td>
<td>37.2</td>
<td>8.5</td>
<td>15.1</td>
<td>17.9</td>
<td>6.2</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicators.

* Food and agricultural raw material exports.

b Ore, metals, and fuel exports.
seen their weakening in the past decades. The consequences have been negative for the trade balance and the growth effects of exports. Moreover, the fragility of Mexico's pattern of industrial production and trade specialization goes beyond the lack of domestic linkages in export-oriented activities and the dependence of export demand on U.S. economic activity. Indeed, the increasing dominance of the import-intensive industries, the maquiladoras, in export activities is a motive for concern for another reason. As the United Nations Conference on Trade and Development's (UNCTAD's) report (2002) points out, the statistics that show a significant share of manufacturing exports with medium or high-technology intensity in developing countries may be misleading. Most of the technology in these manufactures is in fact incorporated in the components produced in technologically advanced countries while developing countries are merely involved in the assembly of these components, a process characterized by low technological sophistication, the use of low-skilled labor, little value added, and low and stagnant labor productivity. This is certainly the case of most segments of the maquiladora industry, which, as we have seen, have vastly increased their importance in Mexico's manufacturing exports and employment. Given that these industries tend to be characterized by a low potential for productivity growth, the counterpart of their high capacity of employment absorption, the persistency of an appreciated real exchange rate in the recent past has led to a decrease in profit margins in these activities as wages in Mexico measured in U.S. dollars have tended to increase. This, together with increasing competition from China and the slowdown in the U.S. economy in the early 2000s, put a brake on the expansion of productive capacity and output in the maquiladora sector and led to a sharp decline in employment starting in the third quarter of 2000 from which the industry has yet to recover (see figure 10.1). With no productivity growth, the maquiladoras constitute a sector that can only expand on the basis of low wages. Given the tendency of wages to increase in other sectors along with productivity gains, the maintenance of the maquiladoras' capacity to attract resources from the rest of the economy would require a continuous undervaluation of the currency.

This is probably the major reason, along with the disintegration of backward and forward linkages that has accompanied the very fast growth of imports since trade was liberalized, why the pattern of specialization in Mexico has not been particularly dynamic. In some sense, the Mexican economy is trapped by the loss of comparative advantages in labor-intensive manufacturing to countries with lower labor costs and by the inability thus far to acquire comparative advantages in more human capital and technology-intensive goods that are produced by countries with high per capita incomes.
Figure 10.1  Employment in the maquiladora and non-maquiladora industries, 1990–2006 (Indices January 1990 = 100. Employment in non-maquiladoras is based on the Monthly Industrial Survey [Encuesta Industrial Mensual]). Source: INEGI, Banco de Información Económica.

Is productivity performance the culprit for the growth slowdown?

In accounting exercises that decompose the rate of GDP growth into the contributions of factor accumulation and total factor productivity (TFP) growth, it is customary to attribute Mexico’s growth slowdown since the early 1980s to a weak growth performance of TFP. A recent exercise (Faal, 2005) finds, for example, that about two-thirds of the decline in the rate of GDP growth (a reduction of 3.9 percentage points comparing 1980–2003 to 1960–1979) is explained by lower TFP growth, which in fact declined at a rate of 0.5% per year from 1980 to 2003 (see table 10.6). These findings are consistent with those of other similar decomposition exercises (see Bergoeing et al., 2002; Bosworth, 1998; Santaella, 1998; World Bank, 2000). In this view of the growth process, the weakness of productivity growth is in turn often attributed, without any

7. More generally, TFP growth is often seen as a major “source of growth” in growth accounting exercises (see, e.g., Easterly and Levine, 2001). It has also become almost commonplace to attribute the income gap separating developed and underdeveloped countries primarily to differences in productivity, that is, to differences in the efficiency with which the available factors are used in production (rather than to, say, the endowment of factors of production) (see Hall and Jones, 1999; Helpman, 2004; Klenow and Rodriguez-Clare, 1997; and, in the Mexican context, Bazdresch and Mayer, 2006).
## Table 10.6 Sources of growth

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>6.5</td>
<td>2.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Factor growth rates (in percent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>6.1</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Labor</td>
<td>3.6</td>
<td>3.0</td>
<td>2.4</td>
</tr>
<tr>
<td>TFP</td>
<td>2.1</td>
<td>-0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Factor contributions (in percentage points)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>2.0</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Labor</td>
<td>2.4</td>
<td>2.0</td>
<td>1.6</td>
</tr>
<tr>
<td>TFP</td>
<td>2.1</td>
<td>-0.5</td>
<td>0.7</td>
</tr>
</tbody>
</table>


Evidence being provided, to the incompleteness of market reforms or the lack of a second generation of structural reforms (in the areas of energy, the labor market, or the judicial system).

The growth decomposition exercises on which these claims are based are flawed in several ways, but it is not our purpose here to address this subject (see Cripps and Tarling, 1973; Felipe and McCombie, 2006; Kaldor, 1966; Lavoie, 1992). We want, however, to illustrate what is wrong with these claims in the Mexican case by using a different decomposition exercise.

Consider a sectoral decomposition exercise of labor productivity growth, a variant of a shift-share analysis. The analytical framework is discussed in Ros (1995) and shows the absolute change in labor productivity for the economy as a whole in a given period divided into four components:

1. The change due to the increase in productivity in agriculture (weighted by the initial agricultural employment share).
2. The change due to the increase in productivity in industry (weighted by the initial industrial employment share).
3. The change due to the increase in productivity in services (weighted by the initial employment share of services).

8. The decomposition is an approximation that assumes, as it is almost the case, that the productivity differential between industry and services is so small that it can be neglected.
Table 10.7 Sources of labor productivity growth in the Mexican economy
(percentage points)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>0.8</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Industry</td>
<td>0.7</td>
<td>0</td>
<td>0.4</td>
</tr>
<tr>
<td>Services</td>
<td>1.2</td>
<td>-0.7</td>
<td>0.2</td>
</tr>
<tr>
<td>Labor reallocation</td>
<td>2.7</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Total</td>
<td>5.4</td>
<td>-0.2</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Annual productivity growth rates

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>2.9</td>
<td>1.2</td>
<td>2.7</td>
</tr>
<tr>
<td>Industry</td>
<td>2.3</td>
<td>0</td>
<td>1.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2.4</td>
<td>0.6</td>
<td>1.9</td>
</tr>
<tr>
<td>Services</td>
<td>1.6</td>
<td>-1.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>3.2</td>
<td>-0.2</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: Based on employment data and data on value added at 1993 constant prices from Timmer and de Vries (2007).

4. The change due to the reallocation of labor from agriculture, with relatively low productivity, to industry and services with higher productivity levels (weighted by the end of period productivity differential between industry and services, on one hand, and agriculture, on the other).

Table 10.7 shows the results of the exercise for 1950–1981, 1981–2005, and 1994–2005, together with the annual growth rates of productivity in each of the three sectors and the whole economy. To facilitate comparison between periods, the total increase, as well as each of the four sources, is presented as an average annual percentage increase over the productivity level in the initial year (i.e., as the absolute contribution divided by the overall productivity in the initial year and by the number of years within each period). Each component can thus be seen as an average growth rate, the sum of which adds up to the average percentage increase in productivity in the whole economy.9

As shown in the table, in the period 1950–1981 the four sources of growth made a positive contribution to overall productivity growth. Particularly

9. The latter is not, however, the compound rate of growth of productivity (also shown in Table 10.7) since it is estimated as a percentage of the initial productivity level (and thus will only coincide with the growth rate for 1-year periods).
significant was the effect of labor reallocation (which explains half of the increase in overall productivity) derived from the strong expansion of the employment shares of industry and services and the high productivity differential between, on the one hand, industry and services, and on the other hand, agriculture.

The productivity growth slowdown in the period 1981–2005 (by 5.6 percentage points) is largely due to the decrease in productivity in the services sector. Indeed, this reduction operated on the growth of overall productivity through two mechanisms. First, through the decrease in the direct contribution of services (by almost 2 percentage points) to the increase in overall productivity, a reduction that is much greater than that of agriculture or industry during this period. This decrease in the direct contribution of services is the result of an absolute reduction of productivity in this sector (at an annual rate of 1.2%), the only sector that records an absolute decrease in productivity. In addition, the decrease in services productivity made an indirect contribution to the productivity slowdown by sharply reducing the productivity differential with agriculture (in contrast, the productivity differential between industry and agriculture remained relatively stable). This is what explains to a large extent the substantial reduction of the labor reallocation effect (which, as we have seen before, weights the increase in the labor force in industry and services by the productivity differential with agriculture in the final year of the period).  

Thus what appears to have happened is simply that as the economy was unable to absorb the new entrants to the labor force into the high-productivity sectors, the expanding labor force found its way into the low-productivity activities of the services sectors where, in addition, a decline in hours worked (per worker) could have taken place. This simultaneously increased the employment share of services and reduced the average output per worker in this sector.  

In other words, what explains the strong productivity slowdown is a massive increase in underemployment in the tertiary sectors of the economy that is also reflected in the well-documented decline in the share of wage and salary employment in the total labor force and in the increase in the size

10. The dominant role of the services sector in the decline of productivity growth after 1982 has been documented in other studies (see Bosworth, 1998; Escaith, 2006).

11. See also table 10.1. This phenomenon would probably reveal itself more clearly had we been able to adjust productivity for hours worked or had we been able to disaggregate the services sector at a high level. In that case, the decomposition exercise would probably show that the decrease in output per worker in the services sector is the result of an increasing employment share of the low-productivity activities of the services sector and of a decline in hours worked.
of the informal sector, largely made up of low-productivity activities in the services sectors (see Bosworth, 1998; OECD, 2003).

The message of the exercise is that the deterioration in the productivity growth performance of the Mexican economy since 1980 has to be seen as an endogenous consequence of the sluggish economic expansion. It was the slow growth of the economy that explains the disappointing productivity performance. Who really believes that the collapse of productivity in the services sectors of the economy is the cause, rather than a consequence, of the slow growth of the economy since 1982?12

**Human capital formation and the growth slowdown**

Is a slow process of human capital formation responsible for the growth slowdown? Has human capital accumulation been a binding constraint on the growth process? There are, we think, three reasons why the answers to these questions are negative. First, during the decades of slow growth, Mexico has in fact continued to record rapid improvements in educational and health indicators. As shown in table 10.8, enrollment rates have continued to climb at the secondary and tertiary levels of education and student:teacher ratios, helped by the demographic transition and the reduction in dependency ratios, have been falling since 1980, plummeting in the case of primary education. Illiteracy has continued to decrease, while average school attainment increased from 4.6 years in 1980 to 8.1 years in 2005. The annual growth rate of average years of schooling increased from 1.4% in 1940–1980 to 2.3% in 1980–2005 (see table A.3). Nor is there any evidence that educational indicators are lagging behind the rest of the world (as is the case with per capita GDP). As a percentage of the world average, the secondary enrollment rate increased

---

12. The cross-country evidence also points to the endogeneity of TFP growth. This evidence shows a strong and positive relationship across countries between the output share of investment in machinery and equipment and the rate of TFP growth, as well as a positive relationship between TFP growth and the rate of capital deepening (see, e.g., de Long and Summers, 1991). If TFP growth is an autonomous process of disembodied changes in technical efficiency, why should it be positively correlated with the rate of capital accumulation minus the growth of the labor force? And if TFP growth reflects the role of labor force reallocation, embodied technical progress, increasing returns to scale, and learning by doing, then of course it cannot be viewed as a separate factor, independent from capital accumulation, in the determination of economic growth.
Table 10.8  Educational indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>Primary</th>
<th>Secondary</th>
<th>Tertiary</th>
<th>Students/Teachers</th>
<th>Years of schooling</th>
<th>Illiteracy rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>53</td>
<td>3</td>
<td>2</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1960</td>
<td>92&lt;sup&gt;a&lt;/sup&gt;</td>
<td>17&lt;sup&gt;b&lt;/sup&gt;</td>
<td>3</td>
<td>50</td>
<td>11.8</td>
<td>7.3</td>
</tr>
<tr>
<td>1970</td>
<td>106</td>
<td>23</td>
<td>5</td>
<td>47.7</td>
<td>16.3</td>
<td>10.8</td>
</tr>
<tr>
<td>1980</td>
<td>120</td>
<td>49</td>
<td>14</td>
<td>39.1</td>
<td>18</td>
<td>12.7</td>
</tr>
<tr>
<td>1990</td>
<td>114</td>
<td>53</td>
<td>15</td>
<td>30.5</td>
<td>17.9</td>
<td>9.4</td>
</tr>
<tr>
<td>2000</td>
<td>113</td>
<td>75</td>
<td>21</td>
<td>26.7&lt;sup&gt;p&lt;/sup&gt;</td>
<td>17.4&lt;sup&gt;p&lt;/sup&gt;</td>
<td>9.7&lt;sup&gt;p&lt;/sup&gt;</td>
</tr>
</tbody>
</table>


n.a. = not available.
<sup>a</sup> 1965.
<sup>b</sup> 2002.
<sup>c</sup> 8.1 in 2005.

between 1993 and 2003 from 100% to 122%, while in higher education the enrollment rate remained constant at 92% (Presidencia de la República, 2006). In 2005, 16% of all Mexicans age 24 to 35 years possessed a university degree and Mexico had surpassed most of Latin America in terms of the fraction of its citizens who were university graduates (see Haber et al., 2008). Similarly, as we saw in chapter 9 (table 9.4), life expectancy has continued to increase, from 67.7 years in 1980–1985 to 73.4 in 2000–2005. If the growth slowdown is to be attributed to the lack of human capital formation, how are we to explain that a more educated and healthier labor force produces less output per worker today than in 1980?

Second, there are also unequivocal signs that slow growth has been constraining the use of human capital in production rather than vice versa. Indeed, there are two worrying trends in the Mexican labor markets. One is that the percentage of young people employed in the low-productivity occupations of the informal sector increased between 1989 and 2002 for the groups with relatively high educational level (10 to 12 years of schooling and 13 and more years of schooling), with an increase of almost 40% in the case of the second group (see table 10.9). In addition, youth unemployment rates have also increased for the groups with higher educational levels, more than doubling in the case.

13. We are grateful to Jurgen Weller for providing the data for tables 10.9 and 10.10.
of young people with 13 and more years of education (see table 10.10). In fact, these groups are the only ones for which the unemployment rate increased. Both of these trends suggest that the best trained young people are not finding jobs appropriate to their qualifications.

Third, if human capital formation has not been faster, this should be partly attributed to the growth slowdown itself. A comparison between Mexico and South Korea illustrates this point (see Birdsall et al., 1995). In 1970, public expenditure on basic education per eligible child was only slightly higher in Korea than in Mexico. Two decades later, it was only 25% of the Korean level, secondary enrollment rates were half of the Korean levels, and the gap in tertiary enrollment rates had grown even larger (39% versus 15%). Public expenditure policy does not explain this divergence: in fact, in the mid-1970s, after an expansion during the first half of that decade, expenditure in basic education as percentage of GDP reached temporarily higher levels in Mexico than in Korea. The explanation for these increasing gaps is the fact that Korea's
GDP grew at an annual rate of 9.6% compared to Mexico’s 3.5%. This difference in growth rates meant that, with the same percentage of GDP invested in education, the resources that Korea was able to invest in this sector expanded at a vastly higher rate.\textsuperscript{14}

All this does not mean that all is well with Mexico’s educational system. A major shortcoming is that the quality of primary education is on average very low, particularly in poor rural areas. The test for 2003 of the OECD Program for International Student Assessment (PISA), taken by more than a quarter of a million students in 41 countries, ranked Mexico in 38th place for the average of the three sections of the test (mathematics, reading, science and problem solving) (see OECD, 2003). In mathematics, Mexico was placed in last position with 375 points, way below the top performers, Korea and Finland (550 points). Moreover, the results of the test showed that only one-third of the group of 15-year-old students who participated had adequate basic skills in mathematics. A second major problem is that attrition rates are very high at the secondary level. As a result, in 2003 only 25% of the Mexican population age 25 to 34 years had graduated from high school. This rate is very low compared not only with the rates prevailing in developed countries, but also with those of other large countries of Latin America (Haber et al., 2008).

**Low investment, slow growth**

What then? The crucial factor in the slowdown of Mexico’s rate of economic expansion appears to have been simply weak investment performance. As shown in table 10.6, the rate of capital accumulation fell from 6.1% per year to 3.8% per year between 1960–1979 and 1996–2003 (being only 3.4% for the entire period 1980–2003). The failure of capital formation to grow at a fast pace—after the years of decline during the debt crisis—has reduced the expansion of employment in high productivity sectors and the modernization of productive capacity while simultaneously restricting the growth of aggregate demand.

This poor performance is evident in the evolution of the fixed investment:GDP ratio (see figure 10.2). During the 1970s and early 1980s this ratio oscillated with the business cycle between 18% and 26.4%, rapidly

\textsuperscript{14}. The demographic transition that began earlier in Korea than in Mexico also played a role. This explains why, during these two decades, the number of school-age children increased by 60% in Mexico while decreasing by 2% in Korea.
increasing toward the end of the period and reaching a historical peak in 1981 in the context of the high rates of economic growth associated with the oil boom. With the debt crisis, the investment rate decreased drastically in 1982–1983, reaching a value of 17.6% in 1983, some 9 percentage points below its value at the 1981 peak. It then hovered around 17% to 19% thereafter during the lost decade of the 1980s and the early 1990s. With the 1995 crisis and recession it dropped by more than 3 percentage points, to reach a low of 16.1%. In spite of its subsequent expansion, by 2004–2007 it stood at 20%, still well below its 1980–1981 levels. What are the causes of the disappointing performance of investment?

The failure of investment rates to recover their pre-debt crisis levels should not be attributed to a sluggishness of foreign direct investment (FDI). Despite a somewhat lethargic performance since 2002 (when FDI started decreasing as a percentage of GDP), the assumption that market-oriented reforms, FDI deregulation and privatization in particular, and NAFTA would significantly increase FDI has been validated by events as already discussed in chapter 8. Indeed, the inflow of FDI increased from about US$12 billion in 1991–1993 to more than US$46 billion in 2003–2005 (INEGI, Banco de Información Económica) while its amount soared as a proportion of total fixed investment from 6.7% in 1991–1993 to 11.8% in 2002–2004 (World Bank, World Development Indicators). The record is outstanding in the international context. According to Palma (2005), in the 1990s Mexico’s manufacturing sector
Table 10.11 Fixed investment rates (as a proportion of GDP)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>24.9</td>
<td>20.0</td>
<td>–4.9</td>
</tr>
<tr>
<td>Private investment</td>
<td>13.9</td>
<td>15.6</td>
<td>1.7</td>
</tr>
<tr>
<td>Public investment</td>
<td>11.0</td>
<td>4.4</td>
<td>–6.6</td>
</tr>
</tbody>
</table>

Source: INEGI, Cuentas Nacionales de México. Investment and GDP are at current prices.

alone attracted twice as much FDI as the manufacturing sectors of Brazil, Argentina, and Chile combined.

The proximate determinant of the decline in the investment rate is the retreat of public investment. As shown in table 10.11 (see also figure 10.2), while total fixed investment fell by 4.9 percentage points of GDP between 1979–1981 and 2004–2007,\(^{15}\) public investment actually fell by more (collapsing by 6.6 percentage points). Whether there are crowding-out or crowding-in effects of public investment on private investment is subject to controversy (for opposing views see Lachler and Aschauer, 1998, which finds a partial crowding-out effect, and Ramirez, 2004, which finds an important crowding-in effect). There is, however, consensus on the fact that, even if crowding-out effects exist, these are at worst partial, that is, an increase in public investment increases total investment rather than displacing fully an equal amount of private investment. It follows that the decline in public investment is partly responsible for the decrease in the overall investment rate and may even have had an adverse effect on private investment (if crowding-in effects predominate).

The decrease in public investment has partly to do with privatizations, but also with the type of fiscal adjustment followed after the debt crisis, as discussed in chapter 7. As shown by Giugale et al. (2001), there is a close correlation since 1980 between fiscal deficit reductions and the decrease in public investment (the correlation coefficient between the two is 0.82 between 1980 and 1997). Infrastructure investment, which has the largest potential to affect productivity growth and private investment, has suffered in this contraction. By the early 2000s, Mexico was last among the large Latin American economies

15. The decline in nonresidential investment (machinery and equipment and nonresidential construction) appears to have been greater, as residential construction increased its share in total investment (see chapter 8 and Moguillansky and Bielschowsky, 2001).
in infrastructure investment as a fraction of GDP, and this applied to both public and private investment (Calderón and Servén, 2004). The decrease in infrastructure investment occurs in road construction, water provision, and electricity. Only in the case of telecommunications was there a recovery of investment in the 1990s. However, even in this case, Mexico today is lagging behind other Latin American countries such as Chile and Brazil, which were behind Mexico in 1980.

The appreciation of the real exchange rate in 1988–1994 and later in the period since 2000 further conspired against investment in manufacturing and more generally in tradable goods sectors. While real exchange rate appreciation can encourage fixed investment in developing countries by lowering the relative prices of imported machinery and equipment, it also shifts relative prices in favor of nontradable goods sectors, reducing the profitability of the tradable goods sectors and inhibiting capital accumulation in these activities. There is ample evidence (Ibarra, 2006) that the overall effect on investment profitability is adverse and very significant in the Mexican case. Table 10.12, which shows the composition of FDI in alternative periods of undervaluation and overvaluation, reveals the connection between investment in manufacturing and the real exchange rate. As can be seen from the table, the periods of currency depreciation and undervaluation (1982–1990 and 1995–1999) were associated with a composition of FDI heavily biased toward the industrial sector (the overwhelming fraction of this investment being in manufacturing). In contrast, the periods of overvaluation (1991–1994 and 2000–2007) featured a composition of investment biased against manufacturing and in favor of nontradable goods sectors (commerce and services).

A third factor constraining the investment rate has to do with the reforms themselves, which had the explicit goal of eliminating all types of industrial policy incentives, including measures to promote domestic investment, both aggregate and in specific sectors. No attempt was made to orient domestic

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>1.6</td>
<td>1.6</td>
<td>1.3</td>
<td>1.7</td>
</tr>
<tr>
<td>Industrial</td>
<td>61.0</td>
<td>41.5</td>
<td>62.5</td>
<td>48.1</td>
</tr>
<tr>
<td>Commerce and services</td>
<td>37.5</td>
<td>57.0</td>
<td>36.3</td>
<td>50.2</td>
</tr>
<tr>
<td>Real exchange rate</td>
<td>100.5</td>
<td>81.7</td>
<td>93.8</td>
<td>70.5</td>
</tr>
</tbody>
</table>

Source: Based on INEGI, Banco de Información Económica.
spending to investment as opposed to consumption expenditure. The elimination of sectoral incentives had an especially strong adverse impact on manufacturing investment, given that manufacturing had traditionally been the most favored sector under the previous development model based on import substitution and state-led industrialization. The adverse effects reduced manufacturing’s relative rate of return, which in turn curbed investment.

The lack of bank finance for productive activities is an additional factor that has been constraining investment in recent years. As Banco de México’s figures show, commercial banks’ lending to the nonfinancial private sector has dramatically declined since 1995. For example, at the end of 1995 the outstanding balance was equivalent to 49.7% of GDP and at the end of 2000 it stood at 20% of GDP. Although it has somewhat recovered since then, at the end of 2007 it was 25% of GDP. If we focus on domestic lending from development and commercial banks to private enterprises—that is, excluding consumer and housing loans to the personal sector—the collapse of financial intermediation is even more dramatic. While at the end of 1995 the outstanding balance was equivalent to 35% of GDP, at the end of 2000 it had fallen to 21.2%, and at the end of 2007 it was even lower (18% of GDP). These ratios are well below those of typical OECD countries and stand at one of the lowest levels in the whole of Latin America. In fact, the size of Mexico’s banking system as a percentage of GDP was smaller in 2005 than those of Nicaragua, Honduras, and Guatemala (Haber et al., 2008). Thus Mexico’s privatized commercial banking system, especially after the 1994–1995 financial crisis, has been unable to provide sufficient credit for productive purposes, so that with the exception of the few large conglomerates that have close ties with the international capital markets, the large majority of Mexican enterprises—especially the small and medium ones—have faced acute bank credit rationing and have had to rely on their suppliers for financing (see Haber, 2005). Moreover, credit rationing has become worse over time. For example, while 29% of small firms obtained capital from banks in 1998, in 2005 only 18% did. This pattern of significant declines in the use of banks was similar for medium and large firms (see Haber et al., 2008).

In sum, our argument is that the proximate determinant of Mexico’s slow growth since the early 1980s is a reduced investment rate, and four factors are constraining investment: the low level of public investment (particularly in the area of infrastructure), an appreciated real exchange rate for most of the period since 1990, the dismantling of industrial policy during the reform period, and the lack of bank finance. The first factor contributes directly to a
slower rate of capital formation in the public sector, and possibly also in the private sector. The second and third have affected private investment profitability, particularly in the manufacturing sector, with deleterious effects on the process of economic development. The fourth has prevented the realization of potentially profitable investment projects.15

Liberal misperceptions at the turn of the century?

With macroeconomic stability (narrowly defined in terms of low inflation and small budget deficits) having been achieved, the currently dominant view in both government and international financial institutions alike attributes the growth and employment problems to a supposed incompleteness of liberalizing reforms. In a “permanent escape into the future,” this orientation recommends further market reform in the face of any difficulty arising in economic performance. Thus structural reforms in the fiscal area, the energy sector, and the labor market in particular are seen as the major development tasks and the key necessary conditions to resume high and sustained growth. To this, a wider list of so-called second-generation reforms is often added, ranging from the educational and health systems to the judicial system and the rule of law (see, e.g., Werner et al., 2006).

We believe that the dominant agenda among policymakers largely misses the point. With regard to fiscal reform, this is certainly part of the necessary effort to mobilize resources for the increase in public investment and social expenditures as well as to reduce the dependence of government resources on oil revenues. However, the Vicente Fox administration largely focused, unsuccessfully, on increasing the value-added tax base by eliminating tax exemptions on foodstuffs and medications, aiming at increasing tax revenues by only about 2 percentage points of GDP. The tax reform proposed by the Felipe Calderón administration, approved by the Chamber of Deputies in September 2007, aims to raise revenues by 2.5% to 3% of GDP. Central features of the reform are an increase in corporate taxes (a 16.5% charge on corporate income after deductions including, among others, investments) and

16. It is worth pointing out that our emphasis on the investment rate is quite consistent with the empirical literature on economic growth, where in cross sections of countries the investment rate is found to be the most systematic and statistically significant determinant of growth (Levine and Renelt, 1992; see also de Long and Summers, 1991, for the role of investment in machinery and equipment).
an attempt to increase tax collection in the informal sector by establishing a
2% tax on cash bank deposits exceeding a cumulative total of 25,000 pesos per
month. While more ambitious than the failed fiscal reform of the Fox admin-
istration, this recent tax reform falls short of what is needed, as the expected
future decline in oil production and revenues may be enough to practically
negate its effects. To make a significant difference in the state’s dependence on
oil revenues and its capacity to invest in infrastructure projects, as well as in
the area of social spending, will require an increase in the tax burden of about
8 percentage points of GDP (see Casar and Ros, 2004).

With respect to reform of the energy sector, recent initiatives have focused
on the oil industry. At the time of writing, there is a heated debate on the future
of PEMEX and the Calderón administration’s proposals to partially privatize
segments of the oil industry. It is clear that the country’s medium-term growth
prospects depend on the urgent reform of PEMEX, for unless considerable
investment in exploration occurs soon, Mexico’s oil reserves, extraction, and
exports will decline sharply in the next 10 years.

In our view, reform should focus on the following aspects. The first is the
appropriation and use of oil rents. How are they used? How much of these
rents is PEMEX allowed to use for investment purposes? As is well known,
the enormous gap between the costs of oil extraction and its sale price gen-
erates massive profits for oil companies. PEMEX is no exception. In 2007
its average cost of extracting a barrel of oil was about US$4 to US$5 in the
face of a sales price greater than US$80. These oil rents have been systemat-
ically captured by the state and, to a smaller, but not insignificant extent, by
the ruling party and PEMEX’s trade union. In the past 10 years PEMEX has
contributed 40% of total revenues (8% of GDP). In 2007 it recorded US$584
million in before-tax profits but paid US$583 million in taxes (Ibarra, 2008).
These practices have transformed PEMEX into a tax collecting agency, dra-
matically reducing PEMEX’s ability to invest in expanding or maintaining its
productive capacity, its exploration activities, and its proven reserves, as well
as undermining its capacity to become a key dynamic player in the interna-
tional petroleum and petrochemical products market. Moreover, its capaci-
ties for technological innovation have been drastically eroded, by decreasing
the fiscal, financial, and human resources allocated to the Instituto Mexicano
del Petróleo (PEMEX’s technological research institute).

A second aspect refers to the room to maneuver of PEMEX’s board of
directors. As it currently stands, PEMEX’s management functions are severely
bounded. Its chief executive officer (CEO) and governing board of direc-
tors lack the independence to make or implement key decisions regarding
investment projects, pricing mechanisms, employment plans, and labor relations. All of these aspects need to be revised. In particular, its pricing strategy of subsidizing gasoline for car transportation may help to keep inflation temporarily under control, but runs against the need to develop a more fuel efficient and environmentally sound industrial and transport structures.

A third aspect is the role ahead for PEMEX regarding insertion in the world economy and its linkages with the rest of Mexico’s industrial sectors. Indeed, since the 1982 debt crisis, Mexico has opted to accompany its quest for an export-led strategy with a path of specialization of PEMEX as merely an exporter of crude oil. Policymakers explicitly made the decision to abandon any plans to develop PEMEX as a major player in the petrochemical industry. Perhaps this decision may have appeared to be soundly based decades ago, given Mexico’s then tight credit rationing in the international capital markets and in a context where the prices of oil and gasoline were on a downward trend. But this is not so today. The medium-term outlook of the international petroleum and gasoline markets points in a different direction. Developing the national petrochemical industry will enhance PEMEX’s capacity to generate value-added, to build stronger forward and backward linkages with the local industrial sectors, and, much more important, it will strengthen Mexico’s long-term economic growth prospects.

In sum, the status quo in PEMEX and the oil industry cannot continue, as it means the state is failing to adequately fulfill its dual role as a principal and as an agent in matters regarding oil reserves and industrial capacities. Indeed, the strategy adopted in the past two decades has brought about a systematic decline in PEMEX, and thus Mexico’s oil reserves, as well as a systematic failure to augment or even maintain the physical, financial, and human capital of its oil and petrochemical industry. The state’s regulatory abilities are also wanting, having failed to put in place sound pricing and investment strategies and promote an industrial structure that accurately reflects the relative scarcity of oil and gasoline, not to mention to reduce Mexico’s fiscal dependence on oil revenues.

With regard to competitiveness and employment problems, the dominant orientation sees the institutional rigidity of the labor market as the most important obstacle and advocates “flexibilization” as the main policy instrument to resolve these problems. In this respect, a few points should be made. First, the international experience shows that there is a multiplicity of institutional arrangements in the labor market compatible with the achievement of a high level of economic development, so that it is far from clear why a reform in a given direction is indispensable to the achievement of high rates
of economic growth. Second, a clear relationship between labor market flexibility and job creation has not been shown, let alone a relationship between flexibility and productivity and growth (see, e.g., Chor and Freeman, 2005). Third, losses of competitiveness associated with currency appreciation have not been offset in the development experience by reductions in labor costs. Moreover, and more important from a normative point of view, even if processes of this kind are viable, they would surely be long and painful stories and promote a social structure that is even more unequal and unfair than the one we currently find in Mexico. These opinions should not be interpreted as a defense of existing labor legislation—which in many ways is obsolete and inefficient—but rather as a criticism of the prevailing idea that the “cause” of employment performance is located in the rigidity of labor market institutions and that, consequently, flexibilization is the most important policy orientation in this regard, if not the only one (for further discussion, see Frenkel and Ros, 2004; Bensusán, 2006).

In the area of other second-generation reforms, progress in the solution to such problems as lagging educational and health systems or the functioning of the judiciary and the enforcement of the rule of law is equivalent, in fact, to achieving an advanced stage of development in a two-way relationship of causality. In this relationship, the impact of economic development on the solution to these problems is likely to be much greater than the effect that solving them will have on economic development. In other words, it is difficult, if not impossible, to achieve, say, Swedish standards of health, education, and public services when one has a per capita income that is three times lower. This does not mean that one cannot, and that one should not, make progress in these areas. It simply points to the fact that its definitive solution requires as a necessary condition, although possibly not sufficient, to solve the problem of economic growth (see Casar and Ros, 2004; Rodrik, 2004).

The dominant agenda also misses the point because, as discussed previously, the most binding constraints on growth are today derived from the low level of public investment, the dismantling of industrial policy, the lack of bank finance and an appreciated real exchange rate. These are then the areas in which growth-oriented reform efforts should concentrate.

Removing the constraints on public investment leads directly to the question of fiscal reform, already discussed, and mobilization of the fiscal space given by the low levels of public debt. A priority area for investing increased resources is the development of the poor south. A “New Deal” that creates the conditions to take advantage of the productive potential of the south, and to allow it to reach the medium development level of the rest of the country,
would generate by itself a considerable additional impulse to the growth process, in addition to the reduction of regional inequalities. This requires eliminating and reverting the bias against these regions that most policies in public capital and development incentives have shown so far. Infrastructure investment in these regions and the introduction of positive discrimination in their favor would open up new areas of investment and new markets, thus liberating a growth potential that would contribute, for a considerable period, to a higher rate of growth in the economy as a whole (see Dávila et al., 2002).

The second area of reform concerns industrial policy in order to create the conditions for a rapid process of structural change. If Mexico is to succeed in its thus far failed quest to achieve high and sustained economic growth, there is urgent need to rethink key elements of its overall strategy and industrial policies. Mexico’s economy is at a crossroads. It cannot further base its international insertion on low wages and labor-intensive maquiladoras, but, at the same time, it has not yet successfully entered the international markets based on high value-added processes and products. The transition toward a new pattern of trade specialization based on activities with higher technological intensity and greater human capital intensity will require the reform or abandonment of existing policies and the undertaking of new tasks. The first category includes, in particular, reconsideration of the incentives currently in place to induce the tax-free entry of imported inputs for export purposes. In place of these incentives, priority should be given to the integration of productive chains that allow taking advantage of the competitiveness of certain activities in order to strengthen the competitiveness of other activities upstream or downstream, while at the same time enhancing the capacity of the export sector to generate growth in the rest of the economy. If special programs to promote the development of selected industrial sectors are implemented, they should be supported by sufficient financial and human resources as required by the daunting magnitude of the challenge. In this regard, the institutional framework should be tailored to guarantee, as best as possible, that all subsidies are granted in a temporary, transparent, accountable, and goal-oriented way.

There are also several new areas in which public action is indispensable. This includes the development of long-term capital markets, technology policies focused on innovation and the development of new sectors, investments in training and the acquisition of new abilities, and direct support to strategic sectors (i.e., those that generate strong positive externalities on other sectors). The task is, in short, to design policies that creatively address market failures in the factor markets, coordination problems among producers,
and information externalities in new activities, all of which generate less than socially optimal rates of investment in activities that are decisive for the successful transition toward a new pattern of specialization and development (see Hausmann and Rodrik, 2006; Ros, 2001b; Shapiro, 2008; and, for a skeptical viewpoint, Pack and Saggi, 2006).

Another area of reform relates to financial intermediation. As argued earlier, lack of credit to private firms, in particular to producers of tradable goods or to start-up enterprises, is a major constraint on investment and, thus, on the economy’s growth potential. The downsizing and weakening of development banks (NAFINSA and Bancomext) brought about by the reform process made bank lending to firms more scarce. The acquisition of the largest banks by foreign ones in the late 1990s failed to solve this problem. In fact, although the foreign banks established in Mexico are highly profitable, their activities concentrate much more on consumer lending and financial commissions than on lending to private businesses. In fact, Mexico’s ratio of banking lending to private businesses is among the lowest in Latin America. Such a situation implies that while large firms may have access to international credit markets, the vast majority of small and medium enterprises are severely credit rationed. Clearly, without a strong financial intermediation system, the Mexican economy will remain stuck in a path of low growth.

Part of the solution lies in strengthening the rule of law. Indeed, as some analysts have argued, the weakness of Mexico’s contract enforcement rules, in case of default, makes the banks’ repossession of collateral much more difficult in the case of loans to small and medium firms than to private consumers (see Tornell, Westermann, and Martinez, 2003). The reinforcement of the legal and judiciary power is certainly a must, not only regarding financial transactions but also regarding the full administration of justice.

However, by itself, this will be insufficient to solve the credit crunch and correct the acute fragilities and limitations of the financial system, such as the high segmentation and shallowness of the banking system, the lack of capital markets, and the scarcity of long-term finance, particularly for start-up innovative firms. To correct such structural limitations, we consider that the following additional measures are needed. The first is restoring the role of development banks to grant long-term credit mainly for innovative firms and for the production of tradable goods and services. Contrary to conventional views, we believe that, given Mexico’s far from fully developed financial system, the lending activities of such banks are complementary to those of the private banking system. Moreover, if correctly monitored and managed, they may promote financial deepening by strengthening long-term capital markets.
The second is putting in place regulations to effectively cap the commissions being charged by banks on banking transactions, like payment of services, checking facilities, and cash disposal (ATMs), thus creating incentives for the banks to allocate a greater proportion of their activity to lending to firms. The third is to facilitate the entry of small banks, if possible with regional specialization. The increased competition may help break the oligopolistic power of the large banks and reduce interest rates and commissions, as well as increase credit access to small and medium firms. This should be accompanied by a strengthening of the regulatory bodies to ensure a prudent regulation of the financial system.

Establishing a competitive real exchange rate calls for the reform of monetary policy. In this respect, if one accepts that price stability is consistent with multiple configurations of real wages, interest rates, and exchange rates, and that some of them are more favorable than others to economic growth, it follows that, without violating the constitutional mandate that requires the central bank to pursue price stability, monetary policy should seek such stability within the set of configurations favorable to growth. Moreover, given that the configurations of relative prices that inhibit growth have often proven to be unsustainable, prudence dictates seeking price stability only within a context that is favorable to growth. This requires systematically avoiding exchange rate overvaluation, especially in times of recession; to avoid, that is, the implementation of a procyclical monetary policy such as the one followed in the early 2000s. This would involve the flexibilization of the currently very strict inflation targeting framework\(^7\) and its combination with real exchange rate targeting. More precisely, the central bank could promote a competitive exchange rate by establishing a sliding floor to the exchange rate in order to prevent excessive appreciation (see Galindo and Ros, 2008). This would imply managing interest rates or intervening in the foreign exchange market at times when the exchange rate hits the floor but allowing the exchange rate to float freely otherwise. Thus, under this alternative, the central bank does not target a particular real exchange rate, but only establishes a floor on its value.

The orthodox objection to such a proposal is that by defending the floor the central bank loses control of the money supply, and this could imply

17. The evidence suggests that the central bank has adopted a strict inflation-targeting regime, focused exclusively on inflation targets, rather than a flexible framework that takes into account the output gap in the design of monetary policy (for a review of the evidence, see Esquivel, 2008).
giving up the achievement of the inflation target (for more discussion, see Frenkel and Rapetti, 2004). The problem arises at times of excess supply of foreign currency as a result, in particular, of massive capital inflows. It is worth noting, however, that speculative capital inflows will tend to be deterred to the extent that the central bank clearly signals that it will prevent the appreciation of the domestic currency, thus stabilizing exchange rate expectations. If necessary, however, the central bank, as in other Latin American experiences, can impose capital account regulations on short-term capital flows in order to recover control over the money supply.\textsuperscript{18}

Perhaps the divide over policy recommendations can be better understood if we express it in more technical terms. As such, it becomes clear that its deep roots date back to the origins of macroeconomics as a discipline, to Keynes’s analysis of the causes and remedies of the Great Depression’s unemployment and the debate Keynes sustained with his contemporaries. The dominant orientation we are criticizing asserts that there is only one equilibrium price configuration in every economy that yields full employment (or better, unemployment at its natural rate) in the labor market and a natural rate of growth. This view disregards the importance of the precise trajectory followed by the economy in the past and its influence over the present, the so-called hysteresis phenomenon, which implies that the current macroeconomic configuration may be heavily determined by the past.

In this regard, consider Mexico’s economic situation at two points in time: the second half of the 1980s and the first half of the first decade of the 21st century. During most of the first period, the international interest rate was high, the economy was financially rationed and made significant transfers abroad, absorption was lower than output, and inflation was out of control. In the second period, the international interest rate was lower, the economy had access to international financial markets and received transfers from abroad, absorption was greater than output, and macroeconomic stability had been restored. However, employment and growth performance in the second period was hardly better than in the first,\textsuperscript{19} even though there seems to be no doubt that there was a positive shock between the two.

\textsuperscript{18} When the increase in foreign currency is associated with massive inflows of family remittances or great improvements in the terms of trade, the challenge of avoiding a persistent real exchange rate appreciation may be more complex but is still manageable with appropriate interest rate management and intervention in the foreign exchange market.

\textsuperscript{19} GDP growth was 1.8% per year in 2000–2005 and 1.7% per year in 1985–1990 (World Bank, World Development Indicators).
The paradox we reach from the idea of a unique equilibrium configuration highlights the inadequacy of the dominant perspective. The alternative implies considering the possibility of multiple equilibrium configurations depending, among other circumstances, on the factors imposed by the external context and economic policies. Some configurations are more favorable to employment and growth. Others imply that the economy is being driven to low-growth and low-employment traps. The observed changes between 1985–1990 and 2000–2005 do not appear to be paradoxical from this perspective. The conjunction of real currency appreciation and the specific implementation of adjustment and liberalization policies drove the Mexican economy to low-investment and low-growth macroeconomic configurations. We believe that, just as a century and a half ago, the real obstacles to economic development are being misperceived in today's dominant orientation in economic policy.
Structural change and neoliberalism in Mexico: ‘passive revolution’ in the global political economy

ADAM DAVID MORTON

ABSTRACT This article examines an enduring context of ‘passive revolution’ in the making of modern Mexico by developing an account of the rise of neoliberalism during a period of structural change since the 1970s. It does so by analysing and understanding both the unfolding accumulation strategy and the hegemonic project of neoliberalism in Mexico since the 1970s as emblematic of the survival and reorganisation of capitalism through a period of state crisis. This is recognised as a strategy of ‘passive revolution’, the effects of which still leave an imprint on present development initiatives in Mexico. Therefore, through the notion of ‘passive revolution’, the article not only focuses on the recent past circumstances, but also on the present unfolding consequences, of neoliberal capitalist development in Mexico. This approach also leaves open the question of ‘anti-passive revolution’ strategies of resistance to neoliberalism.

In June 1998 a conference entitled ‘Forthcoming Latin America: A Hard Look at the Future of the Region’ was convened by Latin American Newsletters in London. Funded by the Inter-American Development Bank (IDB) in collaboration with the Institute for European–Latin American Relations (IRELA), the United Nations Industrial Development Organisation (UNIDO), the Economic Commission for Latin America and the Caribbean (ECLAC), and the WestMerchant Bank, the intention was to bring participants into contact with ‘the experts’ to focus on the region of Latin America.¹ The conference was opened by Enrique Iglesias (President, IDB), who commented on the ‘silent revolution’ that had swept across Latin America in the context of globalisation. Additionally, Ricardo Hausmann (Chief Economist, IDB) lamented the prevalence of ‘weak consumers’ across Latin America, Marcos de Azambuja (Ambassador of Brazil, Paris) resolutely affirmed that ‘the consumer is to the economy what the voter is to politics’ and that ‘there is no alternative intellectual discussion’ to the reality of globalisation, while Rogelio Pfirter (Ambassador of Argentina, London) asserted that ‘the policies of the 1970s took a long time to go away’.

At the same time as such ideologically anaesthetising analysis was under discussion, the Mexican intellectual Carlos Fuentes was publicly commenting on similar issues, in particular, some of the essential problems of the North...
American Free Trade Agreement (NAFTA) and the impact of ‘savage capitalism’ on the people of Mexico. According to Fuentes, ‘the problem of globalisation is that it is only interested in merchandise … and the unlimited movement of capital … with no productive purpose whatsoever’.2 Hence the need, according to Fuentes, to curb the untrammelled movement of capital which has totally speculative and non-productive purposes in order to correct the ‘bad face of neoliberalism’.3 Yet what processes have led to the development of these perspectives on the political economy of Latin America? Indeed, how have some of the leading elites from the region of Latin America come to champion a neoliberal consensus deemed irreversible? What is meant by the declaration that the ‘policies of the 1970s took a long time to go away’ and how does this relate to an understanding of globalisation? Most crucially, how are these processes specifically related to Mexico? This article develops a critical analysis of these unfolding processes commonly understood under the rubric of globalisation. It will do so by tracing the rise of certain social forces, shaped by a restructuring of relations of production within the form of state in Mexico, to suggest that a shift occurred in the 1970s, which began the move towards a neoliberal strategy of capitalist accumulation. This shift not only heralded an end to the phase of Import Substitution Industrialisation (ISI) growth, or ‘desarrollo estabilizador’, but also fundamentally altered and unravelled the social basis of the hegemony of the once-ruling Institutional Revolutionary Party (PRI). It was this dwindling hegemony that was finally ended by the victory of Vicente Fox Quesada in the 2 July 2000 elections in Mexico. Yet this electoral change raises questions about whether a second generation of neoliberal capitalist development is underway in Mexico, heralding an underlying continuity in policy, regardless of recent debate on the ‘post-Washington consensus’.4

To tackle these issues the article will elaborate upon an enduring context of passive revolution in the history of Mexico. This refers to conditions of socio-economic modernisation so that changes in production relations are accommodated within existing social and institutional forms but without fundamentally challenging the established political order. It is a theory of the survival and reorganisation of capitalism through periods of crisis, when crucial aspects of capitalist social relations are not overcome but reproduced in new forms, leading to the furtherance of state power and an institutional framework consonant with capitalist property relations.5 The main benefit of this recourse to the notion of passive revolution is that it leads one to analyse prevalent consensual aspects within conditions of hegemony. To put it in Hugues Portelli’s apt words: ‘There is no social system where consensus serves as the sole basis of hegemony nor a state where the same [mismo] social group can durably maintain its domination on the basis of pure coercion.’6 In contrast to earlier debates on bureaucratic authoritarianism and state corporatism in Mexico and Latin America, as well as more recent analyses on hegemony that develop similar conclusions, the following argument does not conflate hegemony with dominance or coercion, nor does it presume that conditions of hegemony are here one day and gone the next.7 Instead, the following argument draws attention to the variations in, and the gradual erosion of, conditions of hegemony as well as to the mix of consensual and coercive elements that have constituted these conditions within the making of
modern Mexico.

To promote this analysis the argument is structured into three main sections. A first section will briefly outline the centrality of a theory of passive revolution and hegemony in understanding the making of modern Mexico. Second, the analysis will concentrate on a context of passive revolution in the history of Mexico by developing an account of structural change to the political economy since the 1970s. This will proceed by 1) examining the accumulation strategy of neoliberalism and 2) analysing how this affected the hegemonic project of the PRI. While neoliberalism was to gain ascendancy as the chief accumulation strategy in Mexico through the 1980s and 1990s, this section draws initial attention to the context of the 1970s in order to account for contingent processes of struggle between social forces that provided the background for subsequent developments. Key developments in this period, linked to the restructuring of production relations, promoted cleavages between social forces in Mexico that would lead to a shift from the accumulation strategy of ISI to the eventual agenda of neoliberalism. It will be clear that the promotion of neoliberalism and the consequent struggle between social forces proceeded in a particular way in Mexico more attuned to specific sociopolitical conditions. Neoliberalism did not involve the rollback of the state in Mexico but was rooted in the restructuring of state–civil society relations that included a constant renegotiation of state–business–labour relations and the promotion of interventionist projects designed to harness social mobilisation. This is important because it becomes possible to show how social forces within the state in Mexico authored the globalisation of neoliberal restructuring.8 Put differently, the agency of particular social forces in constituting and reproducing the globalisation of neoliberalism is realised.

Finally, a third section will illustrate how conditions of passive revolution still prevail after the presidential election of Vicente Fox on 2 July 2000. In particular, it will show how there has been an attempt to shift politics putatively beyond neoliberalism, to modernise capitalist social relations and reconstitute social cohesion along the lines of the Alternativa Latinoamericana (Latin American Alternative), a variant of the ‘post-Washington consensus’ promoted by Roberto Mangabeira Unger and spearheaded in Mexico by Jorge Castañeda. While a detailed analysis of resistance movements is beyond the purview of this discussion, linkages will also be made to alternative social forces that have pursued dialectically opposed political strategies in the hope of creating new social and political relations. It will thus be clear how the overall discussion is linked through the notion of passive revolution by considering both the restructuring of capitalism, or the ‘counter-attack of capital’, organised by ruling social forces through neoliberal restructuring, and the articulation of ‘anti-passive revolution’ strategies of resistance by progressive forces in Mexico.9

The history of Mexico seen as a struggle of ‘passive revolution’?

In recent debates in International Political Economy (IPE) the concept of passive revolution has gained currency within a series of similar but diverse ‘neo-Gramscian perspectives’,10 to address historical processes of state formation in the industrialising world. While a focus is generally drawn to processes of
capitalist expansion in ‘developmentalist states’, within which the state mediates between classes, acting as an arbiter of social conflict, little attention is granted to specific conditions within states confronted by an impasse in social development. Rarely is there an effort to focus on the arrangements within particular forms of state that lead to the incorporation of fundamental economic, social, political and ideological changes in conformity with changes in capitalism on a world scale. In short, there has been little effort to address the imperatives of class struggle brought about by the expansion of capital and the internalisation of class interests within historically determined forms of state. At the same time, scepticism has also been raised about the lack of direct engagement with the thought and practice of the main exponent of the notion of passive revolution, namely the Italian Marxist Antonio Gramsci. Hence a turn, first, to the specific writings of Antonio Gramsci to outline in more detail the notion of passive revolution before, subsequently, considering how these conditions inhere within the specific circumstances of class struggle within the state in Mexico.

The Risorgimento, the movement for Italian national liberation that culminated in the political unification of the country in 1860–61, and a series of other historical phenomena throughout nineteenth century Europe were described by Gramsci as ‘passive revolutions’. The concept, rooted in his writings analysing the crisis of the liberal state in Italy, was linked to the rise of bourgeois revolutions, with the history of Europe in the nineteenth century seen as a struggle of passive revolution. According to Gramsci, the French Revolution (1789) established a bourgeois state on the basis of popular support and the elimination of old feudal classes yet, across Europe, the institution of political forms suitable to the expansion of capitalism occurred differently in a more reformist manner. Following the post-Napoleonic restoration (1815–48), the tendency to establish bourgeois social and political order was regarded as something of a universal principle but not in an absolute or fixed sense. ‘All history from 1815 onwards’, wrote Gramsci, ‘shows the efforts of the traditional classes to prevent the formation of a collective will … and to maintain “economic–corporate” power in an international system of passive equilibrium’. As Eric Hobsbawm has elaborated, this was indicative of mid-nineteenth century European national unifications during which people become ancillaries of change organised from above based on elite-led projects. In underdeveloped parts of the world this process was mimetic, as ‘countries seeking to break through modernity are normally derivative and unoriginal in their ideas, though necessarily not so in their practices’. A bourgeois revolution, therefore, was a revolution, marked by violent social upheaval, but it involved a relatively small elite giving a decidedly capitalist imprint to the changes, leading to the creation of state power and an institutional framework consonant with capitalist property relations.

The ‘passive’ aspect refers to the way challenges may be thwarted so that changes in production relations are accommodated within the current social formation. This might not be done in a ‘passive’ way but refers to the attempt at ‘revolution’ through state intervention or the inclusion of new social groups within the hegemony of a political order but without an expansion of mass control over politics. A passive revolution may therefore unfold thanks to popular demands and entail a ‘progressive’ element or fundamental change in the
organisation of a political order. Yet it was more likely to result in a dialectical combination of progressive and reactionary elements described as ‘revolution-restoration’ or ‘revolution without revolution’. While the ruling classes might garner real political support among the wider population, a passive revolution tends to indicate a highly restricted form of hegemony. Within conditions of passive revolution ‘the important thing is to analyse more profoundly … the fact that a state replaces the local social groups in leading a struggle of renewal’. This unfolds when the ruling class is unable to fully integrate the people through conditions of hegemony, or when ‘they were aiming at the creation of a modern state … [but] in fact produced a bastard’. It is one of those cases when a situation of ‘“domination” without that of “leadership”: dictatorship without hegemony’ prevails because it is possible for the state to dominate civil society, which is ‘shapeless and chaotic’ as it is in ‘a sporadic, localised form, without any national nexus’. However, there is also an intrinsic weakness within the state, which is ‘lacking effective autonomy’ linked to both ‘internal as well as international relations’, because of the narrow and debilitating interests of ‘a sceptical and cowardly ruling stratum’. Hence, through the expansion of state intervention, a partial or relatively fragile form of hegemony may only prevail, limited to a narrow social group rather than the whole of society. This may have various ‘path-dependent’ (but not deterministic) effects that shape and define the nature and purpose of state actions during particular phases of development and the distinctive institutional configurations of capitalism.

The conditions of passive revolution therefore differ from ‘the real exercise of hegemony over the whole of society which alone permits a certain organic equilibrium’. This expression of hegemony is based on the development of a “diffused” and capillary form of indirect pressure relying on the organic development of a relationship between leaders and led, rulers and ruled, where real predominance is concealed behind a veil of consent. In such cases, opposition elements are assimilated through ‘capillary articulations’ transmitted via channels of public opinion, albeit still with difficulty, friction and loss of energy.

The ‘normal’ exercise of hegemony … is characterised by a combination of force and consent which balance each other so that force does not overwhelm consent but rather appears to be backed by the consent of the majority, expressed by the so-called organs of public opinion.

A situation of passive revolution, by contrast, expresses a condition in which social forces are in conflict, without any prevailing in the struggle to constitute (or reconstitute) an organic equilibrium based on relations of hegemony. The equilibrium of a passive revolution is therefore unstable and contains within itself the danger of disintegrating into a catastrophic equilibrium. Within these structural conditions, ‘events that go under the specific name of “crisis” have then burst onto the scene’.

Finally, the concept of passive revolution has also been used to describe similar but discrete situations characterised by the expansion of capital and the emergence of the modern state. ‘The concept of passive revolution, it seems to me’, declared Gramsci, ‘applies not only to Italy but also to those countries that...
modernise the state through a series of reforms … without undergoing a political revolution of a radical Jacobin-type.' The task was to develop a critical analysis of different passive revolutions and draw out general principles of political science but without succumbing to mechanical application or a form of determinist fatalism. This involves advancing an understanding of processes of capitalist development in particular cases, by unravelling struggles over hegemony in state–civil society relations among social forces shaped by changes in the social relations of production, as part of general trends. The following section therefore poses particular questions about conditions of passive revolution in relation to a period of structural change in the history of Mexico, within which the rise of a strategy of neoliberal capitalist accumulation can be situated.

**Structural change in the form of state in Mexico**

One way of examining the constitution of neoliberalism in Mexico and the social bases of the state, meaning the specific configuration of class forces that supports the basic structure of state–civil society relations, is to distinguish analytically between an accumulation strategy and a hegemonic project. An accumulation strategy defines a specific economic ‘growth model’ including the various extra-economic preconditions and general strategies appropriate for its realisation. The success of a particular accumulation strategy relies upon the complex relations among different fractions of capital as well as the balance of forces between dominant and subordinate classes, hence the importance of a hegemonic project. This involves the mobilisation of support behind a concrete programme that brings about a union of different interests. An accumulation strategy is primarily orientated towards the relations of production and thus to the balance of class forces, while hegemonic projects are typically orientated towards broader issues grounded not only in the economy but in the whole sphere of state–civil society relations. My argument is that the rise of neoliberalism in Mexico can be understood within these terms. The conflicts of interest which eventually culminated in the accumulation strategy of neoliberalism, especially reflected in the Presidency of Carlos Salinas de Gortari (1988–94), were pursued while reconfiguring the hegemonic project of the PRI. This resulted in fragmentation, leading to a contemporary crisis of authority in Mexico. It now remains to give an account of the context within which the conflicts of interest between class forces took place that led to changes in the form of state in Mexico before considering more contemporary circumstances.

*The rise of a neoliberal accumulation strategy in Mexico*

In order to account for the period that Mexicans refer to as the ‘tragic dozen’ (1970–82), the determinant factor for the transition from an ISI strategy of accumulation to that commonly referred to as the neoliberal strategy of salinismo has been seen as a set of institutional changes within the organisation of the state. The crucial phase that laid the basis for this shift in accumulation strategy in Mexico was the period in the 1970s that set the stage for subsequent develop-
ments. As one informed commentator has put it: ‘You cannot explain what happened in Mexico without seeing events intrinsically connected to the global political economy in the 1970s’.

By the 1970s, during the sexenio (six-year term) of Luis Echeverría (1970–76), the government needed to revive its deteriorating legitimacy and responded with a neo-populist programme of political and social reforms. The Echeverría administration embarked on a macroeconomic strategy of ‘shared development’ within a supposed apertura democráta (democratic opening) to forge a populist coalition between national industrialists, peasants, urban marginals, disillusioned labour sectors, students and the middle classes. Yet, faced by pressure from internationally linked industrialists, Echeverría was unable to implement sufficient tax increases in order to support public spending directed towards national industry and the working- and middle-class sectors. Unable to implement tax increases on internationally linked capital, foreign borrowing therefore became the major source of finance for development policies. Also, because of expanded state intervention in the economy and its increasingly anti-private sector rhetoric, the government began to lose the support of significant sectors of capital. Such state intervention increasingly alienated the private sector and, as a result, ‘the alliance that ha[d] existed between state and national capital was severely strained’. An indication of this was the rise of the private sector in vocally articulating its opposition, notably with the founding of the Business Co-ordinating Council (CCE) in 1975, which proposed economic policies for the first time in opposition to the government following the impact of the oil crisis of 1973 on Mexico’s economic performance. It is important to note that, while neoliberalism had not taken hold at this time, crucial cleavages within the organisation of the state were developing that would lead to shifts in capitalist accumulation.

Pivotal in preparing the conditions for such changes was the Mexican financial crisis of 1976. As James Cockcroft has put it, ‘capital flight, noncompetitiveness of Mexican products, dollarisation of the economy, and IMF pressures forced a nearly 100 percent devaluation of the peso in late 1976, almost doubling the real foreign debt … as well as the real costs of imported capital goods—to the detriment of nonmonopoly firms and the advantage of the TNCs’. Yet the financial crisis can be seen to be as much related to the expansionary public-sector expenditure policies driven by the crisis of the PRI as to the macro-economic disequilibria driven by structural change in the globalising political economy linked to US inflation. While the IMF certainly imposed austerity measures and surveillance mechanisms on Mexico, it has been argued that these were less violatory than feared; however, they did have a strong impact by altering the internal distribution of power and resources between social classes in Mexico.

At almost the same time large oil reserves were also discovered which, by 1982, were estimated at 72 billion barrels, with probable reserves at 90–150 billion and potential reserves at 250 billion, amounting to the sixth largest reserves in the world. Hence the political economy of Mexico became dependent on petroleum-fuelled development under the administration of José López Portillo (1976–82) while attempts were made to balance the tensions between competing social classes. However, a coherent course, capable of
satisfying the interests of national and internationally linked capital in Mexico, was not set. By the time world oil prices dropped in 1981, leading to reduced oil revenues, accelerating debt obligations and a surge in capital flight, Mexico faced another financial crisis that initially led to the nationalisation of the banks on 1 September 1982. This was a ‘last-ditch effort’ to recoup revenues for the public sector and reassert some form of state autonomy but it resulted in reinforcing private-sector opposition, capital flight, inflation and balance of payments problems.45

Similar to the earlier crisis, the result of the 1982 debt crisis was a combination of mutually reinforcing factors both within the globalising political economy and the form of state in Mexico.

The crisis was precipitated by the world oil glut, a world economic recession, and rising interest rates in the United States, but its root causes were domestic: excessively expansionary monetary and social policies, persistent overvaluation of the peso, over-dependence of the public sector on a single source of revenue (oil exports), a stagnant agriculture sector (at least that part which produced basic foodstuffs for domestic consumption), an inefficient and globally uncompetitive industrial plant, excessive labour force growth ... a capital-intensive development model that made it impossible to create an adequate employment base, endemic corruption in government, and resistance by entrenched economic and political interests to structural reforms.46

This resulted in another IMF austerity programme—involving reductions in government subsidies for foodstuffs and basic consumer items, increases in taxes on consumption, and tight wage controls targeted to control inflation—which the Mexican administration implemented by exceeding planned targets. Therefore, the crisis arose as a result of a conjunction of factors that also included the rise of technocrats—underway throughout the 1970s—which led to the ascendency of the accumulation strategy of neoliberalism.47 Crucial at this time were the institutional career paths of the elite, which began to alter so that ministries associated with banking and finance planning provided the career experience likely to lead to the upper echelons of government. Notably this was the context within which the Ministry of Programming and Budget (SPP) came to rise to institutional predominance as a pivotal camarilla (clique) within the organisation of the state.

The SPP was formed in 1976 and created the process of taking economic policy making away from the Ministry of the Treasury and Public Credit (SHCP). Overall, not only was direct control over the most important resources of information for plans and projects in the bureaucracy secured, but competing factions within the PRI could also be circumvented. Significantly, the three presidents preceding Ernesto Zedillo (1994–2000) all originated from agencies related to these changes, with López Portillo (1976–82) hailing from SHCP and Miguel de la Madrid (1982–88) and Carlos Salinas (1988–94) from SPP. By 1983 almost 60% of all cabinet-level appointees had started their careers in these sectors and over 80% had some experience within them, while in the Salinas cabinet 33% had experience in SHCP and 50% had worked in SPP.48 The rise of such technocrats ensured that precedence was accorded to ministries of finance...
like SPP that would subordinate other ministries and prioritise policies more attuned to transnational economic processes. The growing influence of neoliberal ideas can therefore be linked to the existence of a transnational capitalist class connecting IMF analysts, private investors and bank officials, as well as government technocrats in and beyond the PRI in Mexico. To cite Gramsci, this was a process whereby, ‘in the political party the elements of an economic social group get beyond that moment of their historical development and become agents of more general activities of a national and international character.’

A pivotal factor in the formation of this transnational capitalist class in Mexico was the move during the Echeverría presidency after the oil boom of 1975–76 to expand scholarships to foreign universities as a method of integrating dissidents radicalised by the massacre of students at Tlatelolco on 2 October 1968. Thus, throughout the 1970s, not only was there a dramatic increase in the educational budget within Mexico, leading to a 290% increase in university students between 1970 and 1976, but the number of scholarships for study abroad increased even more dramatically. It has therefore been argued that the dissemination of foreign ideas in Mexico increased as a direct result of the oil boom. This led to many tecnócratas adopting a more conservative ideology while becoming dependent on the president for their subsequent governmental position, resulting in the crucial rise of camarillas that shifted institutional loyalty from a particular ministry or subgroup within the bureaucracy to close political and personal links with the president. It was this technocratic elite that took for granted the exhaustion of the previous ISI development strategy and engendered a degree of social conformism favouring the adoption of an accumulation strategy of neoliberalism. Yet it was hardly questioned to what extent such structural problems were not just intrinsic to ISI but related also to a series of exogenous shocks, such as the oil crisis, combined with erroneous decisions made in the 1970s following the oil boom. Overall though, the overriding significance of the above changes was that the rise of tecnócratas (or the ‘cult of technocracy’) in Mexico was advanced by links with transnational capital during a period of structural change in the 1970s.

For example, during this period of structural change or the ‘reformation of capitalism’ in Mexico, fractions of a transnational capitalist class became influential in shaping the maquila (in-bond) strategy of export-led industrialisation fuelled by foreign investment, technology and transnational capital. While the maquila industry has its roots in the Border Industrialisation Programme (BIP), introduced in 1965 after the USA ended the bracero programme (which provided a legal basis for labour migration from Mexico to the USA), it was not until the 1970s that economic promotion committees began to bring to fruition the earlier visions of border industrialisation, particularly under the auspices of the Secretariat of Commerce and Industrial Development (SECOFI), the industry ministry, within de la Madrid’s administration. Between 1979 and 1985 maquilas increased by 40% and their employees almost doubled.

At an early stage in this transformation the interests of private capital were represented by organisations within the National Chamber of Manufacturing Industries (CANACINTRA). Along with other capitalist groups—such as the Confederation of Chambers of Industry (CONCAMIN), the Confederation of
National Chambers of Commerce, Services and Tourism (CONCANACO) and the Employers’ Confederation of the Republic of Mexico (COPARMEX)—the major fractions of large and medium-sized manufacturers co-ordinated and consolidated capital’s influence over the state. This influence proceeded further when such capitalist organisations regrouped through the CCE in 1975, to represent the interests of large-scale monopoly capital within the state. The maquila industry was thus promoted, nurtured and supervised by fractions of a transnational capitalist class in Mexico through processes of carefully managed state–labour–business relations that developed into a full-blown export-led strategy of industrialisation. However, the interests of transnational capital also reached beyond the maquila industry to gradually secure the integration of Mexico into the global political economy. Hence, ‘the official agricultural policies of the Díaz Ordaz and Echeverría periods [also] promoted transformations which deepened the integration of local farmers into a transnational system of agricultural production’. One consequence of this effort to reproduce the accumulation strategy of neoliberalism in Mexico was the 1992 reform of collective ejido landholdings enshrined in Article 27 of the Mexican Constitution, undertaken as a prelude to entry into NAFTA in 1994.

A feature that also became crucial in the struggle over the neoliberal accumulation strategy was the introduction of the Economic Solidarity Pact (PSE) in 1987. The PSE was initially a mixed or ‘heterodox’ programme that aimed to tame the current account deficit and inflation based on a commitment to fiscal discipline, a fixed exchange rate and concerted wage and price controls. It has been heralded as instrumental in achieving a successful renegotiation of external debt following the debt crisis of 1982, in line with the Baker (1985) and Brady (1989) Plans, and further radicalising the import liberalisation programme following Mexico’s entry into the General Agreement on Tariffs and Trade (GATT).

Overall, three components of the PSE were crucial: the government’s pledge in favour of the acceleration of privatisation and de-regulation; the centrality awarded to the CCE; and the use of large retailers’ market power to discipline private firms and further ensure the participation of business elites. The CCE—itself formed from a forerunner of big business private sector groups within the capitalist class known as the Mexican Businessmen’s Council (CMHN)—became pivotal in initiating and implementing the PSE. As indicated earlier, the class interests of the CCE became centred around a ‘transnationalised’ segment of national capital including direct shareholders of large conglomerates tied to the export sector with experience in elite business organisations. Subsequently, many of the CCE leaders became more closely linked with the PRI via committees and employers’ associations to increase interest representation within the state. Little wonder, therefore, that the class interests represented by the CCE had a huge impact on the policies implemented by the PRI, including increased privatisation. One commentator has gone so far as to argue that the relationship between the private sector and the political class became part of a narrow clique exercising a ‘private hegemony’ so that, ‘it would be no exaggeration to say that this alliance was based on a carefully thought-out strategy to bring public policy in line with private sector demands, to effect a global reform of the relationship between the state and society, and hence to redesign Mexico’s insertion into the emerging...
neoliberal global order’. As a consequence, there was a shift in the PSE from a commitment to state–labour corporatist relations to a disarticulation, but not severing, of the state–labour alliance in favour of the overriding interests of capital. This has been variously recognised as a form of ‘new unionism’ or neo-corporatism, ‘an arrangement involving the reduction of centralised labour power and the participation of labour in increasing productivity’. The privatisation of the Mexican Telephone Company (TELMEX) in 1990, one of the pinnacles of the privatisation programme, particularly reflected the strategy of ‘new unionism’. This not only involved manipulation of the Mexican Telephone Workers’ Union (STRM), one of the key labour organisations used to secure privatisation. It also entailed Salinas permitting the leader of STRM, Hernández Juárez, to create an alternative labour federation, the Federation of Goods and Services Unions (FESEBES), to further facilitate privatisation. Hence labour became more dependent on the PRI during the privatisation of TELMEX, which generated new resources for corruption and clientelism and lessened union democracy within STRM. What is important here, then, is that the accumulation strategy associated with neoliberalism did not involve a wholesale retreat of the state. As Centeno has commented, ‘the pacto [PSE] demonstrated that the técnocratas were not generic neoliberals who applied monetarist policies indiscriminately but were willing to utilise a variety of mechanisms to establish control over the economy’. The analysis now turns from discussing the details of how the neoliberal strategy of accumulation privileged particular social relations of production in Mexico to address how the hegemonic project of the PRI was altered and undermined.

The changing circumstances of PRI hegemony

Intrinsically linked to changes in the social relations of production stemming from the 1970s was an increase in the sources of political instability in Mexico. ‘Political struggles over national economic policy began in the early 1970s when problems associated with import-substituting industrialisation began to mount.’ These struggles were manifest in the sexenios of Echeverría (1970–76) and López Portillo (1976–82) to the extent that the PRI faced problems involving an erosion of political legitimacy following the Tlatelolco massacre in 1968, a discontented urban middle class, disaffection with the ISI accumulation strategy, the emergence of new opposition movements outside the officially recognised party system, the additional emergence of urban and rural guerrilla movements and the declining ability of the PRI to compete with registered opposition parties. For instance, the National Co-ordinating Committee of Educational Workers (CNTE), founded in 1979, came to challenge, particularly in the peasant communities of Chiapas, the state-imposed and privileged position of the National Education Workers’ Union (SNTE), established in 1943. This was also the period when independent unions articulated a so-called insurgencia obrera (labour insurgency) to question the lack of autonomy and democracy of official unions and to articulate demands across a variety of sectors beyond purely economic concerns. Yet, as a harbinger of reforms under the neoliberal accumulation...
strategy, the López Portillo administration coercively suppressed many of these opposition movements and implemented economic reforms in favour of the private sector as a prelude to introducing the Law on Political Organisations and Electoral Processes (LOPPE) in 1977. Between 1976 and 1979 the dynamism of the insurgencia obrera faded and became dominated by the themes of economic crisis and austerity. At the same time the LOPPE became an attempt to manage political liberalisation within the current of the apertura democrática by enlarging the arena for party competition and integrating leftist political organisations while inducing them to renounce extra-legal forms of action. The measures, for example, involved the Mexican Communist Party (PCM) obtaining the official registration as a political party that led to its first legal participation (since 1949) in elections (those of 1979). Subsequently, in 1981, the PCM merged with four other left-wing parties to establish the Unified Socialist Party of Mexico (PSUM). Thus the PCM, the oldest communist party in Latin America at that time, effectively dissolved itself while attempting to compete electorally within the parameters of the LOPPE reform. The reform, therefore, was more than a simple co-optation measure. It was designed to frame and condition the very institutional context of opposition movements and constituted the construction of a specific legal and institutional terrain that was capable of containing popular demands by defining the terms and fixing the boundaries of representation and social struggle. It thus epitomised the structures of passive revolution: an attempt to introduce aspects of change through the state as arbiter of social conflict. In the words of Echeverría the political reform strove to ‘incorporate the majority of the citizens and social forces into the institutional political process’. As Kevin Middlebrook has argued, this was a limited political opening that was essential at a time of severe social and political tension in order to balance stringent economic austerity measures with policies designed to diffuse widespread discontent. The capacity of labour to articulate an alternative vision for Mexican economic and social development through either official or independent unions, evident in the 1970s, thus declined throughout the 1980s to become scarcely evident a decade later.

What was evolving in the social formation at this time in Mexico, therefore, within the context of structural change in the global political economy, was a shift in the hegemonic influence of the PRI. More accurately the attempt at political reform in the 1970s was an indication of the ailing hegemony of the PRI. No longer capable of representing class-transcending interests, the PRI began to reorient the social relations of production towards a new hierarchy in favour of particular class forces. As a result it is possible to perceive the fraying and unravelling of PRI hegemony in the 1970s. The LOPPE political reform was a clear indication of an attempt to balance the competing demands of subaltern classes with those of the private sector and transnational capital in Mexico. It was a response to the erosion of support for the basic structure of the political system.

Yet it is not easily explained as the exercise of ‘normal’ hegemony as outlined earlier. Hegemony in this sense relies on the organic equilibrium of a relationship between leaders and led, rulers and ruled, based on consent. Instead, the PRI became increasingly unable to conceal its real predominance and relied on more coercive measures. This was a situation when the party turned, ‘into a narrow
clique which tends to perpetuate its selfish privileges by controlling or even stifling opposition forces.\textsuperscript{80} It entails a shift in the threshold of power from consensual to coercive means indicative of state crisis and the disintegrative elements of catastrophic equilibrium. As a counterpart to the neoliberal accumulation strategy, the PRI began increasingly to reflect these traits of passive revolution throughout the 1980s.

For example, during the Salinas sexenio attempts were made particularly to reconstruct history in order to naturalise radical neoliberal changes to the political economy.\textsuperscript{81} As a result, neoliberalism came to represent a ‘hegemonic shift’ in the attempt to dismantle the nationalism of the Mexican Revolution linked to ISI and to displace its political symbolism as a focal point of national consciousness.\textsuperscript{82} Yet the government’s ideological use of the legacy of the Mexican Revolution was not merely a straightforward foil for neoliberalism but, instead, was adapted to specific conditions in Mexico. This fundamental reconstruction of the hegemony of the PRI and transformation of state–civil society relations within Mexico was particularly exhibited through projects like the National Solidarity Programme (PRONASOL).

Following the continued crisis of representation facing the PRI and the tenuous electoral majority Salinas received from the electorate in 1988, a significant attempt was made to try and maintain hegemony. A notable feature in this effort was PRONASOL, a poverty alleviation programme combining government financial support and citizen involvement to design and implement community development and public works projects. As the PRI had moved away from being an inclusive party designed to cover all segments of society to an exclusive one in which only some sectors were represented, PRONASOL was emblematic of the attempt to shore up the loss of hegemonic acquiescence.\textsuperscript{83} It combined material and institutional aspects focusing on social services, infrastructure provision, and poverty alleviation in order to rearrange state–civil society relations and the coalitional support of the PRI.\textsuperscript{84} There were three main objectives of PRONASOL. First, it attempted to adapt the state’s traditional social role to new economic constraints and to redefine the limits of its intervention in the context of a neoliberal strategy of accumulation. Second, it attempted to diffuse potential social discontent through selective subsidies, to accommodate social mobilisation through ‘co-participation’, and to undermine the strength of left-wing opposition movements. Third, it attempted to restructure local and regional PRI elites under centralised control.\textsuperscript{85} Clearly PRONASOL was therefore a targeted attempt to buttress both the accumulation strategy of neoliberalism and the hegemony of the PRI that was under threat from these very changes.

Emanating from the Salinas camarilla that had dominated the SPP, PRONASOL was officially described as an attempt to modernise, pluralise and democratise state–civil society relations in Mexico as part of the doctrine of ‘social liberalism’: ‘a mode of governance that ostensibly seeks to avoid the worst excesses of both unfettered, free market capitalism and heavy-handed state interventionism, by steering a careful middle course between these “failed” extremes’.\textsuperscript{86} Usurping the language and mobilising role of grassroots organisations, PRONASOL was itself portrayed as a ‘new grassroots movement’, empowering citizens through ‘an experience of direct democracy’, while also
redefining members of traditional corporatist organisations as ‘consumers’ of electricity, improved infrastructure, and educational scholarships. This new style of thinking among state officials, was reinforced by ideas recommending the involvement of the poor and NGOs in anti-poverty projects promoted by many international actors, including international financial institutions such as the World Bank and the Inter-American Development Bank, the United Nations, and international donors and development specialists. Between 1989 and 1993 the World Bank directly lent PRONASOL US$350 million to improve rural service provision and to support regional development in four of Mexico’s poorest states—Oaxaca, Guerrero, Hidalgo and Chiapas—while the Bank also supported a health and nutrition pilot project.

Despite the rhetoric, however, PRONASOL preserved and even reinforced presidential rule and complemented the established bureaucracy. As Denise Dresser states, ‘the politics of PRONASOL sheds light on why hegemonic parties like the PRI can survive even when threatened by powerful alternative organisations, and why the party has apparently been able to revive after a period of crisis and decline.’ Essentially PRONASOL was crucial to maintaining the lagging effect of the PRI’s hegemony because it provided the political conditions for sustaining the neoliberal accumulation strategy, notably through a modernisation of populism and traditional clientelist and corporatist forms of co-optation. This was carried out through a process of concertación, understood as the negotiation of co-operative agreements between social movements and the state involving division and demobilisation. The concertación strategies espoused by PRONASOL represented a convergence of interests between those of the popular organisations and the technocratic sectors within the PRI and the government. Thus, while the Salinas administration presented neoliberalism as a hegemonic project in Mexico, it used PRONASOL to create a sense of inclusion and a durable base of support within civil society. This objective was also fulfilled within PRONASOL by denying the existence of class antagonisms while at the same time claiming to transcend class differences.

By the time PRONASOL became institutionalised within the Ministry of Social Development (SEDESOL) in 1996, it was clear that the programme had been successful in sustaining the passive revolution of neoliberalism. It was intrinsic in changing the correlation of class forces in Mexico—to supervise the ‘counter-attack of capital’ through passive revolution—within which there was a transformation of the elite from arbiter of class conflict to ruling in its own interests. PRONASOL incorporated potentially threatening leaders, alternative programmes and ideas by nullifying substantive differences. Hence, despite the neoliberal accumulation strategy making it increasingly difficult to conceal the real predominance of its narrow basis of interest representation, the PRI still managed to exert some form of dwindling hegemony, albeit relying more on coercion than on truly hegemonic leadership. The increasing prevalence of coercion throughout the late 1980s and 1990s, particularly reflected in negligence of human rights violations evident in the rise in the number and profile of political assassinations and kidnappings, bears this out. As Wil Pansters puts it, ‘the combined result of neoliberal economic adjustment, institutional malfunctioning and the decomposition of personalistic networks and loyalties [w]as … an increase in
violence at all societal levels. This conflagration of protest was best epitomised by the resurgence of guerrilla insurrection in the 1990s, which included the activity of the Popular Revolutionary Army (EPR) in the states of Guerrero, Oaxaca, Chiapas, Michoacán, Puebla and Tabasco, as well as that of the Zapatista Army of National Liberation (EZLN) in Chiapas.

Hence the view that there was a worsening crisis of hegemony throughout the phase of neoliberal restructuring in the 1980s and 1990s in Mexico. It was a situation when, ‘the ruling class has lost its consensus, ie is no longer “leading” but only dominant, exercising coercive force alone’, meaning, ‘precisely that the great masses have become detached from their traditional ideologies, and no longer believe what they used to believe previously’. As the prominent intellectual Carlos Fuentes expressed it at the time: ‘It is as though the PRI has gone out to kill itself, to commit suicide. There are Priístas killing Priístas … What we see is the internal decomposition of a party, which has, in effect, completed its historic purpose.’ The PRI, to summarise, became a party that increasingly existed as ‘a simple, unthinking executor … a policing organism, and its name of “political party” [became] simply a metaphor of a mythological character’. Social order was increasingly regressive, to the extent that the party was ‘a fetter on the vital forces of history’ so that it had, ‘no unity but a stagnant swamp … and no federation but a “sack of potatoes”, ie a mechanical juxtaposition of single units without any connection between them’.

As a result, the changes inaugurated in Mexico that led to the promotion of neoliberalism can be understood as an expression of passive revolution. Neoliberalism continued to reflect the incomplete process of state and class formation in Mexico that was never truly settled after the Mexican Revolution. It represented a furtherance of particular ‘path-dependent’ responses to forms of crisis and thus a strategy developed by the ruling classes to signify the restructuring of capitalism, or the ‘counter-attack of capital’, in order to ensure the expansion of capital and the introduction of ‘more or less far-reaching modifications … into the economic structure of the country.’ Neoliberalism, therefore, can be summarised as less ‘tightly linked to a vast local economic development, but … instead the reflection of international developments which transmit their ideological currents to the periphery’. In Mexico, hegemony became limited to privileged groups and was based on a central core of elite and exclusionary decision making that enacted rhetorically ‘revolutionary’ changes in the social relations of production, through the neoliberal accumulation strategy, alongside engineered social and political reform. As Jorge Castañeda has described it, neoliberalism as a hegemonic project only achieved a relative degree of consensual acceptance within elite circles, while any mass support was usually based on misperceived or false pretences. It is more reasonable therefore to argue that, beyond a convergence of interests between technocratic finance ministers and global institutions, neoliberalism was imposed in Mexico. ‘Neoliberalism was put in place by fiat and it has stayed in place by fiat just the way most politics in Mexico has proceeded. There was no consensus it was just done.’ Needless to say, as the contradictions of neoliberalism become more apparent, the ‘path-dependent legacies of neoliberal errors’ will also need to be addressed.
However, it should not be presumed on the basis of the above argument that both the accumulation strategy and the hegemonic project of neoliberalism entailed the erosion of state power. Neoliberalism in Mexico did not involve the dismantling, or retreat, of the state, but the rearrangement of social relations into a new hierarchy. As Dresser has commented:

Even though neoliberal policy currents underscore the importance of reducing the economic power of the state, the Mexican case reveals that the imperatives of political survival will often dictate the need for continued state intervention through discretionary compensation policies.106

The modernisation, rather than dismantling, of the state through projects such as PRONASOL was thus based on a ‘neo-corporatist’ arrangement that was pivotal in bolstering the accumulation strategy and hegemonic project of neoliberalism.107

Updating the terrain of struggle

It remains to be seen, however, whether the victory of Vicente Fox will amount to radical changes to the accumulation strategy of neoliberalism. As the presidential candidate for the National Action Party (PAN)-supported Alianza por el Cambio, Fox won 42.5% of the votes cast, compared with Francisco Labastida, representing the PRI, who received 36% and Cuauhtémoc Cárdenas, representing the Alianza por México—consisting of the Party of the Democratic Revolution (PRD) and smaller parties—who received 16.6%. The PRI also lost its position as the biggest party in the lower house of congress, with 211 seats compared with the 223 seats held by the Alianza por el Cambio and the 66 seats held by the PRD and its allies.108 However, as one former PRI veteran admitted after the elections, ‘We Mexicans want a president who makes decisions that go beyond a political party’s own interests’.109 In this sense, Fox has been trying to build strong multi-party support in an endeavour to establish a ‘government of national unity’ by making overtures to centre-left intellectuals, the interests of large-scale monopoly capital and prominent Priístas. Referring to the latter, a report in Business Week declared that appointments in these areas ‘would guarantee a measure of continuity in economic policy in Mexico, something that investors would surely welcome’.110 It is in this regard that the so-called Alternativa Latinoamericana (Latin American Alternative) to the neoliberal Washington Consensus should be considered.

Co-founded by Roberto Mangabeira Unger, a Brazilian political scientist, and Jorge Castañeda, described by The Economist as a ‘self-anointed guru of Latin America’s “new left”’,111 the basis of this alternative is supposedly ‘a call for radical change in the institutions of the market economy and the state’.112 The original document drafted by the policy group behind Alternativa Latinoamericana—including figures such as Luiz Inácio da Silva (aka ‘Lula’) and Ricardo Lagos, as well as Vicente Fox—outlines an indistinct mix of proposals including the multilateral regulation of speculative capital; the stimulation of regional integration; and the revitalisation of taxation schemes, based on reconciling an increase in the level of indirect taxation of consumption, through value-added tax, with the imperative of promoting private savings and invest-
ment. The aim is ‘democratising development’ based on the reorganisation and refinancing of the state, the stimulation of small and medium-sized enterprises, and the deepening of citizen participation and social rights.113

Yet the Alternativa appears to be a modernisation of neoliberalism, in order to reconstitute social cohesion, involving a mix of renewed taxation, monetary and social compensation policies, rather than the promotion of a truly alternative paradigm.114 With a focus on market failure it remains, like much of the ‘post-Washington Consensus’, located within neoclassical economic debate about the sphere of exchange rather than production relations. As Castañeda has admitted, ‘it is only an alternative within the existing framework of globalisation rather than purporting to break with it, because you can’t’.115 Significantly, it seemed likely at one stage that recommendations within the Alternativa Latinoamericana might be developed as part of a rethinking of neoliberal precepts within a modernisation of capitalism in Mexico.116 Yet, with an inability to secure support for legislation in congress, what seems more likely in Mexico is less the emergence of a new form of hegemony, based on organising concepts developed around the Alternativa Latinoamericana. Instead, one might anticipate more molecular social changes as part of the ongoing passive revolution, whereby prevailing structures of political power are modified within conditions of recurring crisis. After all, the paramount issue, as Eduardo Bours Castelo (President of the CCE) stated, is to ‘assure society that we are not going to fall again into recurrent crises’.117 The likelihood, then, is piecemeal reform rather than radical transformation: continuity rather than change.

This is most recently reflected in the proposed Plan Puebla–Panama (PPP) initiative to build a Trans-Isthmus development project along the Pacific and Gulf coasts linking southern Mexico to North and Central America. Announced as Fox’s ‘revolutionary plan’, it is precisely the continuity embedded within such development proposals that provides a platform for the coalescence of ‘anti-passive revolution’ strategies of resistance.118 As the EZLN recently stated to Fox, ‘although there is a radical difference in the way you came to power, your political, social and economic programme is the same we have been suffering under during the last administrations’.119 Similarly, wider resistance is reflected in recent struggles such as that led by the people of San Salvador Atenco, who have embarked on direct action strategies of popular mobilisation to rebut the Fox administration’s plan to build an international airport on their land. The proposal to construct a new six-runway, US$2.3 billion airport at Texcoco on the eastern outskirts of Mexico City were opposed by the Atenco movement, which drew on symbols of peasant identity, notably through machete-wielding protests.120 They attracted the support of radical groups, both national and international, to quash the expropriation of 4000 hectares (10 000 acres) of land and halt the airport project, further highlighting the contradictions of neoliberal policies.121 Resistance is also mounting against second-generation neoliberal reforms in the case of the battle over energy privatisation led by the Mexican Electricians’ Union (SME). The proposals for privatising the electrical system have met opposition in the Mexican Congress but at stake is whether an alliance between the SME, the umbrella National Union of Workers (UNT) federation, and fractions within another electrical workers’ union—the General Union of Mexican
Electrical Workers (SUTERM)—can be successfully forged in order to raise broader questions about the direction of economic development. \(^{122}\)

**Conclusion: the shifting sands of hegemony**

The central contention of this article is that the process of historically specific interest representation and class struggle in Mexico, reflected in the transition from ISI to neoliberal capitalist accumulation, began in the 1970s as a result of structural changes in the nature of capitalism that contain within themselves contradictions. By focusing on these features it was possible to emphasise how the agenda of neoliberalism was constituted, or authored, by particular social forces in Mexico.

It was argued that the accumulation strategy of neoliberalism, especially reflected in the era of *salinismo*, seriously eroded the historical basis of PRI hegemony in Mexico. The demise of ISI and the rise of neoliberalism were accompanied by the exhaustion of PRI hegemony. \(^{123}\) Since the phase of structural change in the 1970s, the historical and social basis of PRI hegemony began to alter and seriously erode. Throughout the 1980s and 1990s, the PRI increasingly resorted to forms of dominance and coercion to project an increasingly dwindling form of hegemony. It is within this era of structural change that a crisis of hegemony unfolded.

In every country the process is different, although the content is the same. And the content is the crisis of the ruling class’s hegemony … [Hence] a ‘crisis of authority’ is spoken of: this is precisely the crisis of hegemony, or general crisis of the state. \(^{124}\)

By thus tracing these shifting sands of hegemony it was argued that the PRI was only hegemonic in a very narrow sense and it continued to lose a large degree of internal coherence and legitimacy from the 1970s onwards. While the lagging effects of such hegemony were evident during the restructuring of state–civil society relations within the accumulation strategy of neoliberalism, the historic purpose of the PRI was ended by the victory of Vicente Fox on 2 July 2000. It is beyond the scope of this article to determine whether a cohesive form of hegemony will be refashioned under the PAN or whether the PRI will be able to revive its historic role. Yet it was possible in this account to emphasise variations or lags in hegemony and how forms of hegemony were discernible but recessive over the period under consideration since the 1970s. This helps to avoid either assuming that hegemony is switched on and off like a light bulb or indulging in crude dichotomies between coercion and consent in understanding the role and influence of the PRI within the conditions of passive revolution and recurring crisis.

More generally the above analysis of neoliberalism in Mexico also highlighted how social forces engendered common perspectives on the importance of fiscal discipline and market-orientated reforms between technocratic elites of a common social background. Put differently, attention was drawn to an unfolding process of class struggle brought about by the expansion of capital and the *internalisation* of class interests between various fractions of classes within state–civil society relations. \(^{125}\) This involved focusing on how social relations...
within the form of state in Mexico were actively and passively implicated in transnational structures of the global political economy. The discussion of the PSE and PRONASOL, two coexisting measures both introduced to offset political instability resulting from the neoliberal accumulation strategy and the re-configured hegemonic project of the PRI, exemplify this process of struggle.

A further point that the argument has raised is that the case of Mexico does not signify the straightforward reproduction of a uniform ‘model’ of neoliberalism. Instead, the dissemination and acceptance of neoliberal values in Mexico has meant an adaptation of social relations to culturally specific conditions. To be sure, this may result in resemblances with similar processes elsewhere in the global political economy but, as the development of policies in Mexico demonstrates, there is a certain peculiarity to local tendencies in response to structural change in world order.

The final point that needs to be reaffirmed is that hegemony is always constantly under construction and contestation. The attempt to reconstitute hegemonic accord through the neoliberal restructuring of social relations in Mexico should not be imputed as an historically inevitable act but the outcome of social struggle and protest. Hence the importance of further considering ‘anti-passive revolution’ strategies of resistance to the impending second generation of neoliberal capitalist development in Mexico and the future of those social movements that are probing the social and political foundations of the state.

Notes

The financial support of an Economic and Social Research Council (ESRC) Postdoctoral Fellowship (Ref: T026271041) is gratefully acknowledged. I would also like to thank Andreas Bieler, Steve Hobden and Stuart Shields for comments on this article in draft and the advice and encouragement of Ngai-Ling Sum.

1 The rationale for the conference was reaffirmed within an environment constituted by an overwhelming number of (male) elites on the delegate and speakers lists and in the exclusive surroundings of the Bloomberg Suite in Finsbury Square, London. Matching the exclusionary conference fee, officially set at US$435, was the main social event consisting of a cocktail reception at the Embassy of the Argentine Republic. I attended the conference courtesy of a complementary ticket.


6 Hugues Portelli, Gramsci y el bloque histórico, Mexico: Siglo XXI, 1973, p 30. I am grateful to Bob Jessop for bringing this aperçu to my attention.


Gramsci, Selections from the Prison Notebooks, p 119.

Gramsci, Pre-Prison Writings, pp 20–21.

Gramsci, Selections from the Prison Notebooks, p 132.


It is worth noting that the concept of passive revolution was developed as an explicit elaboration of Marx’s ‘Preface’ to A Contribution to the Critique of Political Economy. See Karl Marx, A Contribution to the Critique of Political Economy, in Karl Marx & Frederick Engels, Collected Works, Vol 29, London: Lawrence and Wishart, 1987, pp 261–265.


Ibid, p 90.


Gramsci, Selections from the Prison Notebooks, p 396, emphasis added.

Ibid, pp 110, 188.


Gramsci, Further Selections from the Prison Notebooks, pp 220–221.


Personal Interview, Adolfo Aguilar Zinser, Mexico City, 15 March 1999.


Centeno, Democracy Within Reason, p 69.


Cockcroft, Mexico: Class Formation, p 261.


Gramsci, Selections from the Prison Notebooks, p 16.

Berins Collier, The Contradictory Alliance, p 66.

Centeno, Democracy Within Reason, p 152, n 25.


Personal interview, Alejandro Nadal, Mexico City, 8 and 15 March 1999.

Cockcroft, Mexico: Class Formation, p 217.


Ibid, p 70.


Academic sources cited:

90 Gramsci, _Selections from the Prison Notebooks_, p 155.
91 Ibid, pp 155, 190.
93 Gramsci, _Selections from the Prison Notebooks_, p 116.
94 Personal interview, Jorge Castañeda, Mexico City, 9 and 13 March 1999.
95 Personal interview, Lucy Conger, Mexico City, 4 March 1999.
104 As cited Cockcroft, _Mexico’s Hope_, p 375.
112 Personal interview, Adolfo Aguilar Zinser, Mexico City, 15 March 1999.
114 Poulantzas, _Classes in Contemporary Capitalism_, pp 73–76.
The Argentine Success Story and its Implications

Mark Weisbrot, Rebecca Ray, Juan A. Montecino, and Sara Kozameh

October 2011
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Summary</td>
<td>1</td>
</tr>
<tr>
<td>Introduction</td>
<td>3</td>
</tr>
<tr>
<td>Recession, Default and Recovery</td>
<td>3</td>
</tr>
<tr>
<td>Exports and Contributions to Growth</td>
<td>5</td>
</tr>
<tr>
<td>Social Indicators</td>
<td>8</td>
</tr>
<tr>
<td>Poverty</td>
<td>8</td>
</tr>
<tr>
<td>Income Inequality</td>
<td>8</td>
</tr>
<tr>
<td>Labor Market</td>
<td>9</td>
</tr>
<tr>
<td>Social Spending and Conditional Cash Transfer Programs</td>
<td>10</td>
</tr>
<tr>
<td>Health</td>
<td>11</td>
</tr>
<tr>
<td>Inflation and the Real Exchange Rate</td>
<td>13</td>
</tr>
<tr>
<td>Policy Implications of Argentina’s Experience</td>
<td>15</td>
</tr>
<tr>
<td>References</td>
<td>17</td>
</tr>
<tr>
<td>Appendix</td>
<td>19</td>
</tr>
</tbody>
</table>

## Acknowledgements

The authors thank Roberto Frenkel for helpful comments and Daniel McCurdy and Dan Beeton for research and editorial assistance.

## About the Authors

Mark Weisbrot is co-director, Rebecca Ray is a research associate, Juan Montecino and Sara Kozameh are research assistants at the Center for Economic and Policy Research, in Washington D.C.
Executive Summary

The Argentine economy has grown 94 percent for the years 2002-2011, using International Monetary Fund (IMF) projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period.

Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy’s downward spiral.

In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy then rebounded, and the IMF now projects growth of 8 percent for 2011.

Argentina’s real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

The country experienced this remarkable economic growth despite the default and difficulties borrowing from international financial markets over the past nine years, and relatively little Foreign Direct Investment (FDI). This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI should be the most important policy priorities for any developing country government.

Argentina’s rapid growth has often been dismissed as a “commodity boom” driven by high prices for its agricultural exports such as soybeans, but the data show that this is not true.

Poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen.

Income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich.

Unemployment has fallen by over half from its peak, to 8.0 percent. And employment, by early 2010, had risen to 55.7 percent, the highest on record.

Social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. In 2009, the government expanded the reach of its social programs, launching the “Universal Allocation per
Child’ (Asignación Universal por Hijo) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s Bolsa Familia and Mexico’s Progresa-Oportunidades programs, which have won widespread international praise, but is significantly larger relative to GDP.

There were also significant reductions in infant and child mortality over the last nine years, somewhat more than in similarly situated countries.

Inflation has risen sharply since 2007, peaking most recently at 27 percent at the beginning of 2011 -- according to non-official sources -- before beginning to decline somewhat again. This is a problem for the economy, but it is real income growth, employment, and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. The peso has appreciated about 20 percent in real terms since 2007.

It is remarkable that Argentina has achieved its success in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from “vulture funds” and their associated lobby groups, announced that it would oppose multilateral loans to Argentina.

Argentina’s success has important implications for Europe, including the weaker eurozone economies.

Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other weaker eurozone economies is similarly bleak. The attempt to adjust through “internal devaluation” in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession.

From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country’s debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina’s experience also calls into question the popular myth that recessions caused by financial crises must involve a slow and painful recovery. Argentina’s financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the
default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. The Argentine government has shown that Europe’s bleak current situation and projected scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.

**Introduction**

It is striking that Argentina’s economic growth over the last nine years has been given so little positive attention. China’s success as the fastest-growing economy in world history has been widely recognized, even if the Chinese government is often criticized in the Western press for its trade and currency policies. India’s rapid growth since 2003 (averaging 8.9 percent annually from 2003-2008) has also attracted much praise. But Argentina has not generally been seen as successful. Much of the press reporting has been negative, focusing on the high inflation of recent years.

But it is real income that matters in terms of living standards, and the Argentine economy has grown 94 percent for the years 2002-2011, using IMF projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period. It should therefore be of interest to policy-makers and economists.

As will be seen below, the Argentine story also has implications for macroeconomic policy in other countries, and particularly for countries such as Greece, and perhaps some of the other, weaker eurozone economies that are currently pursuing pro-cyclical policies in an attempt to reduce high and in some cases unsustainable debt burdens. Perhaps even more importantly, it has significant implications for a currently widely held view\(^1\) that recovery from recessions caused by financial crises must necessarily take much longer than recovery from other types of recessions.

Argentina’s deep recession from 1998-2002 was one of the very worst, in terms of lost output, of the past hundred years; and it was clearly caused by a financial crisis that culminated in a systemic financial collapse. Yet the recovery was very rapid.

This paper presents a brief overview of Argentina’s recent economic performance.

**Recession, Default and Recovery**

Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy’s downward spiral.

---

\(^1\) This view has been promoted most successfully by Reinhart and Rogoff (2009) and is widely accepted in the financial press.
In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy shrank by 0.9 percent in the fourth quarter of 2008, and by the same amount in the first quarter of 2009. But it rebounded quickly and grew by an annualized rate of 8.6 percent over the next 10 quarters (to the second quarter of 2011). The IMF projects growth of 8 percent for 2011.

As can be seen from Figure 1, Argentina’s real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

**FIGURE 1**
Real GDP: Actual and 20-Year Trend (Seasonally-Adjusted)

Source: INDEC 2011a, IMF 2011b and Authors’ Calculations.

---

2 Non-government estimates of real GDP hold that the 2008-2009 recession was deeper, and the recovery slower, than what is suggested by official sources. See Frenkel (Forthcoming). However, the IMF notes that “the difference between private and official estimates of real GDP growth has narrowed in 2010.”
It is worth noting that this recovery and growth was achieved without help from international lending institutions. In fact, the opposite took place: in 2002, the first year of the recovery, the IFI’s (international financial institutions) took a net 4 percent of GDP out of the Argentine economy. The IMF also pressured the Argentine government to pay more to the defaulted external creditors; recommended tighter fiscal policy in order to achieve the goal of paying more to creditors; and opposed a number of other policies that were helpful to economic recovery and/or were designed to alleviate the burden of the crisis on distressed sectors of the population. As a result of the default, and the refusal of a minority of creditors to accept the eventual restructuring agreement in 2005, and subsequent legal action by these creditors and “vulture funds,” Argentina has faced difficulties borrowing in international financial markets over the last nine years. Since it has not been able to settle its debt with the government creditors of the Paris Club, it has also been denied some export credits. FDI has remained limited, averaging about 1.7 percent of GDP over the past eight years, with a number of serious legal actions taken by investors against the government.

Yet in spite of all of these adverse external conditions that Argentina faced during the past nine years, the country experienced this remarkable economic growth. This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI, should be the most important policy priorities for any developing country government. While FDI can clearly play an important role in promoting growth through a variety of mechanisms, and foreign capital in general can, in some circumstances, boost growth by supplementing domestic savings, Argentina’s success suggests that these capital inflows are not necessarily as essential as is commonly believed. And it also suggests that macroeconomic policy may be more important that is generally recognized.

**Exports and Contributions to Growth**

As noted above, Argentina reached its pre-recession level of GDP after three years of growth; so the rapid growth that has continued since 2005 cannot be attributed to a simple rebound from recession. (Although the initial recovery was by no means easy or assured, as can be seen by the slow recovery of many countries today from the 2008-2009 financial crisis and recession, as well as the history of Argentina’s initial recovery.) Argentina’s rapid growth has often been dismissed as a “commodity boom” driven by high prices for its agricultural exports such as soybeans, but this is not true.

**Table 1** shows the real contributions to GDP growth by expenditure. It can be seen that the role of exports is not very large during the expansion of 2002-2008. It peaks at 1.8 percentage points of GDP in 2005 and 2010, and amounts to a cumulative 7.6 percentage points, or about 12 percent of the growth during the expansion. The story for net exports is even worse, with net exports (exports minus imports) showing a negative cumulative contribution over the period. The recovery is driven

---

3 The annual data show a decline of 11 percent in Argentine GDP for 2002. However, this is measured by taking the average GDP for 2002 and dividing by the average for 2001; as noted above, the Argentine economy actually started growing in the second quarter of 2002.

4 For more detail in the IMF’s role during the recovery, see Weisbrot and Sandoval (2007).

5 See Weisbrot and Sandoval (2007) and Frenkel and Rapetti (2007) for more detail.
by consumption and investment (fixed capital formation), which account for 45.4 and 26.4 percentage points of growth, respectively.

### TABLE 1
Argentina: Real GDP Growth, Contributions from Expense Categories (Percentage Points)

<table>
<thead>
<tr>
<th>Year</th>
<th>Private Consumption</th>
<th>Government Consumption</th>
<th>Gross Fixed Capital Formation</th>
<th>Exports</th>
<th>Imports</th>
<th>Change in Inventories and Stat. Discrep.</th>
<th>Total GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2.4</td>
<td>0.4</td>
<td>1.3</td>
<td>1.1</td>
<td>-1.1</td>
<td>-0.3</td>
<td>3.9</td>
</tr>
<tr>
<td>1999</td>
<td>-1.4</td>
<td>0.3</td>
<td>-2.7</td>
<td>-0.1</td>
<td>1.5</td>
<td>-1.1</td>
<td>-3.4</td>
</tr>
<tr>
<td>2000</td>
<td>-0.5</td>
<td>0.1</td>
<td>-1.3</td>
<td>0.3</td>
<td>0.0</td>
<td>0.6</td>
<td>-0.8</td>
</tr>
<tr>
<td>2001</td>
<td>-4.0</td>
<td>-0.3</td>
<td>-2.8</td>
<td>0.3</td>
<td>1.7</td>
<td>0.6</td>
<td>-4.4</td>
</tr>
<tr>
<td>2002</td>
<td>-9.9</td>
<td>-0.7</td>
<td>-5.8</td>
<td>0.4</td>
<td>5.6</td>
<td>-0.6</td>
<td>-10.9</td>
</tr>
<tr>
<td>2003</td>
<td>5.4</td>
<td>0.2</td>
<td>4.3</td>
<td>0.8</td>
<td>-2.4</td>
<td>0.5</td>
<td>8.8</td>
</tr>
<tr>
<td>2004</td>
<td>6.2</td>
<td>0.4</td>
<td>4.9</td>
<td>1.1</td>
<td>-3.2</td>
<td>-0.4</td>
<td>9.0</td>
</tr>
<tr>
<td>2005</td>
<td>5.9</td>
<td>0.8</td>
<td>4.0</td>
<td>1.8</td>
<td>-2.1</td>
<td>-1.3</td>
<td>9.2</td>
</tr>
<tr>
<td>2006</td>
<td>5.1</td>
<td>0.6</td>
<td>3.6</td>
<td>1.0</td>
<td>-1.7</td>
<td>-0.2</td>
<td>8.5</td>
</tr>
<tr>
<td>2007</td>
<td>5.9</td>
<td>0.9</td>
<td>2.9</td>
<td>1.3</td>
<td>-2.5</td>
<td>0.1</td>
<td>8.7</td>
</tr>
<tr>
<td>2008</td>
<td>4.3</td>
<td>0.8</td>
<td>2.1</td>
<td>0.2</td>
<td>-1.9</td>
<td>1.3</td>
<td>6.8</td>
</tr>
<tr>
<td>2009</td>
<td>0.3</td>
<td>0.9</td>
<td>-2.4</td>
<td>-0.9</td>
<td>2.7</td>
<td>0.2</td>
<td>0.9</td>
</tr>
<tr>
<td>2010</td>
<td>5.9</td>
<td>1.2</td>
<td>4.4</td>
<td>1.8</td>
<td>-3.9</td>
<td>-0.2</td>
<td>9.2</td>
</tr>
</tbody>
</table>


However, this measure of real (inflation-adjusted) contributions to growth does not measure the full impact of exports when there are significant price increases for exports. In this case, if the price increase is large enough and the affected exports are a big enough share of the economy, the increased income can contribute to growth and to living standards (through the consumption of imports that do not add directly to GDP) in other ways, that do not show up in the real contributions to GDP growth measured above.

To consider these other effects of the rising value of exports, Figures 2 and 3 show Argentina’s annual exports by value, and by category; this is shown both in current dollars and below, in percent of GDP.

As can be seen in the graphs, exports as a percent of GDP, as measured by dollar value, actually decreased during the recovery. And agricultural exports, as a percent of GDP, fell slightly from 5.0 percent of GDP to 4.7 percent, dipping as low as 3.4 percent in 2006 – again, this is measured by dollar value, so it reflects the large increases in commodity prices from 2005 to 2008. So agricultural exports are clearly not driving growth; and in fact they are too small a share of GDP to have anywhere near the kind of impact that is often attributed to them.6

---

6 This is true even if we include some of the manufactured goods (e.g. soybean oil), which are linked to commodity prices. These are also shown in Figure 2. These are flat over the expansion in terms of dollar value as a percent of GDP.
FIGURE 2
Argentina: Export Value by Category and Value, in US Dollars

FIGURE 3
Argentina: Export Value by Category and Value, in Percent of GDP

Note: Other manufacturing includes textile, wood and paper products.
Social Indicators

Poverty

As Figure 4 shows, poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen. In both cases, the rates have fallen to about their level in the early 1990s.7

FIGURE 4
Argentina: Poverty and Extreme Poverty, Percent of Individuals

Source: CEDLAS and the World Bank (2011) and authors’ calculations.

Income Inequality

As Figure 5 shows, income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich. As the tan bars show, since 2006 changes in the lower half of the income spectrum account for the majority of the improvement.

7 Figures 4 through 6 use the most recent data available, published through CEDLAS and the World Bank (2011).
FIGURE 5  
Argentina: Inequality, Income Ratio of 95th Percentile to 5th Percentile


**Labor Market**

Whereas poverty had one clear, dramatic peak in 2002, the labor market saw two distinct years of difficulty: 1996 and 2001. As Figure 6 shows, between 1992 and 1996, unemployment rose by over 150 percent, from 6.8 to 17.7 percent. It declined again to 12.5 percent in 1998, but within three years had risen to a record of 18.4 percent. Since then, it has fallen by over half, to 8.0 percent.

Employment showed a similar pattern, with the notable exception that its recent levels are even higher than its 1992 levels. Employment fell from 52 percent in 1992 to under half in 1997, briefly rose again to over 50 percent in 1998 and fell back to 46 percent in 2001. By early 2010, it had risen to 55.7 percent, the highest on record. This is not only because of women joining the labor force; men’s employment is also above its 1992 level, at 87.7 percent.
Social Spending and Conditional Cash Transfer Programs

The Argentine government presided over a huge increase in its social spending, as well as revenue, as a percent of GDP. Revenue increased from 15 percent of GDP in 2002 to 23.4 percent in 2009. Since the economy was growing rapidly through most of this time, this represents quite a large increase in revenue – it roughly tripled in real terms during this period. The vast bulk of this increase was not from the first few years of economic recovery but has occurred since 2005, after the economy had already reached its pre-recession level.

Spending on Social Security increased from 5.5 to 7.5 percent of GDP. The government also increased support to various sectors of the economy, from just 0.43 percent of GDP to 4.1 percent.

Like revenue, social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. It began as a response to the deep recession and its lagged effects in 2002 and 2003. One program provided a monthly stipend (150 pesos) to heads of households who were unemployed with children of up to 18 years-old (or disabled of any age), and to those where the head of the household was ill. At its height in 2003, the program reached 20 percent of all households, with 97.6 percent of its beneficiaries under the poverty line.
In 2009, the government expanded the reach of its social programs, launching the “Universal Allocation per Child” (Asignación Universal por Hijo) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s Bolsa Familia and Mexico’s Progresa-Oportunidades programs, which have won widespread international praise, but is significantly larger relative to GDP. Spending on the Universal Allocation per Child program has reached 0.6 percent of GDP in 2011, as compared with 0.4 percent of GDP for Mexico and Brazil.\(^8\) It is too early to say how much these programs have reduced poverty, but when the effect is measured it is almost certain to be quite large.

**Health**

Argentina’s health indicators have improved, not only over the past 9 years but also over the past 20 years; but to evaluate the recent progress, we need to compare it to the performance of similarly situated countries. To do that, the figures below compare Argentina’s 1990-2010 progress to that of other upper-middle income countries,\(^9\) starting at the year they reached Argentina’s 1990 level. In other words, these figures answer the question: what is normal progress for a country like Argentina, starting from where it was in 1990? We look at child and infant health here, as adult health depends on changes over a much longer period of time than the focus of this analysis.

**Figure 7** shows progress in infant mortality, which has fallen by approximately half in Argentina since 1990, from 26.9 to 13.8 deaths per 1,000 live births. However, for the first decade after 1990, Argentina’s progress was significantly slower than that of its peers. By 2000, infant mortality was 14 percent higher in Argentina than in its peer countries: 17.5 compared to 15.3 deaths per 1,000 live births. Beginning in 2001, Argentina began slowly closing this performance gap, and by 2010 it had essentially eliminated it, shrinking it to 0.6 deaths per 1000 live births, about the same as it was in 1990.\(^10\)

Argentina’s relative progress shows much the same story in child mortality. Though it has roughly halved its child mortality since 1990, for the first decade its progress was much slower than that of its peers (see **Figure 8**). By 2000, child mortality was 10 percent higher in Argentina than in its peer countries: 19.6 compared to 17.8 deaths per 1,000 children under age five. As with infant mortality, this performance gap slowly narrowed in the next 10 years, until Argentina actually surpassed its peer countries in 2010, continuing to make progress while its peer countries on average saw a slowdown in progress.

---


\(^9\) Using the IMF’s income groups.

\(^10\) In their first year of lowering infant mortality to 23.8 or lower, it is much more likely for rates to be slightly below 23.8 than to be exactly 23.8. Thus, the gap does not begin at zero.
FIGURE 7
Argentina: Infant Mortality, with Comparison to Similar Countries

Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their infant mortality rates dropped below 23.8. See Weisbrot and Ray (2011) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors’ calculations.

FIGURE 8
Argentina: Child Mortality, with Comparison to Similar Countries

Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their child mortality rates dropped below 26.9. See Weisbrot and Ray (2011) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors’ calculations.
Inflation and the Real Exchange Rate

Figure 9 shows inflation as measured by the CPI (Consumer Price Index) from INDEC (the National Institute of Statistics and Surveys), which is the main official government data; and the CPI-7, as measured by CENDA (an independent Argentine think tank). Many private economists believe that inflation is considerably higher than the CPI; private estimates are closer to the CENDA measure. The CPI-7 measures inflation by looking at the change in consumer prices in seven different provinces while the official CPI only measures prices in the Greater Buenos Aires area. We have included both estimates here.

Argentina’s inflation is one of the main emphases of most press reporting on the economy. It is often noted that – according to the CPI-7 and private estimates – Argentina has had one of the highest inflation rates in the hemisphere in recent years. Inflation quickly retreated from the brief spike brought on by the devaluation in 2002; but there was another jump in 2007-2008 that brought inflation to 31 percent. It retreated considerably as the country slid toward recession in 2009, to 13.2 percent. It then peaked again at 27 percent at the beginning of 2011, before beginning to decline somewhat again.

FIGURE 9
Inflation: Official and Independent Measures

Sources: INDEC (2011) and CENDA (2011).
Note: As measured by the CPI from INDEC, and CPI-7 as measured by CENDA.
Inflation may be too high in Argentina, but it is real growth and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. This happens each year that Argentina has inflation higher than its trading partners, and the peso does not depreciate enough to make up for the difference between domestic and foreign inflation rates.

**Figure 10** shows Argentina’s Real Effective Exchange Rate. The peso fell sharply\(^{11}\) in response to the devaluation. Then there was a correction for “overshooting,” and the peso appreciated somewhat, remaining fairly steady until 2007. Then it appreciated significantly in real terms relative to its trading partners, by about 19.8 percent. If inflation continues at current levels, it will be difficult for the government to carry out its policy of targeting a stable and competitive real exchange rate, and that could hurt the economy by making exports and import-competing industries less competitive.

**FIGURE 10**
Argentina’s Real Effective Exchange Rate

Source: Frenkel (Forthcoming).

---

\(^{11}\) Since it is the cost of the dollar (or foreign currency) in terms of pesos is being measured in the graph, the jump corresponds to a depreciation of the peso.
Policy Implications of Argentina’s Experience

Argentina’s economic policies have proven, over the last 9 years, to be very successful by a host of measures examined above. It is remarkable that this has been achieved in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from “vulture funds” and their associated lobby groups, announced that it would oppose multilateral loans to Argentina.

The success of Argentina’s macroeconomic policies, including the central bank’s targeting of a stable and competitive real exchange rate and its reluctance to sacrifice economic growth in order to hold inflation to a particular target, deserve more attention than they have gotten. But perhaps the most important implications of Argentina’s story over the past nine years are for Europe, including the weaker eurozone economies.

Figures A1 through A5 show (see the Appendix) the IMF’s latest projections for the weaker eurozone economies. Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other eurozone economies is similarly bleak, if not as terrible as that of Greece. None can foresee a return to trend-level GDP. The number of years to reach pre-crisis GDP ranges from five for Spain to at least nine years for Ireland and Italy. But these forecasts may turn out to be, as the projections of the last few years have been, overly-optimistic. Unemployment is currently 21 percent in Spain and shows no sign of dropping to normal levels in the near future.

The attempt to adjust through “internal devaluation” in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession. The biggest risk for Europe at present is that continued policy errors will push Italy down a similar road that Greece has followed. Greece’s debt-to-GDP ratio when it signed its first agreement with the IMF in May of last year was 115 percent of GDP; it is expected to hit 190 percent of GDP next year. As can be seen in Figure A3, the IMF has already lowered Italy’s growth projections significantly over the past six months, because of the 54 billion euro austerity measures that the government has adopted under pressure from the European authorities or “troika” (the European Commission, the European Central Bank, ECB, and the IMF). This raises the prospect of Italy following the path of Greece, where deficit reduction targets get increasingly more difficult because of falling revenues, to which the authorities respond with further fiscal consolidation, and so on in a downward spiral of falling income and a rising risk premium and therefore higher interest rates on the country’s sovereign bonds. The whole regional economy has been thrown into a state of crisis and uncertainty which will likely not be resolved until the European authorities can find a way to guarantee Italian and Spanish bonds, or they move away from the failed, pro-cyclical policies that they have implemented.

---

12 Including most notably the American Task Force on Argentina (http://atfa.org/). For more information on this topic, see Weisbrot (2009).
13 See Weisbrot and Montecino (2010).
From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country’s debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina’s experience calls into question the popular myth, as noted above, that recessions caused by financial crises must involve a slow and painful recovery. Argentina’s financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. It is these types of policies, along with the ultra-conservatism of central banks like the present ECB, that mostly account for the historical experience of delayed recoveries after financial crises. The Argentine government has shown that this bleak scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.
References


Appendix

FIGURE A1
Greece Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

Source: IMF and Authors’ Calculations.

FIGURE A2
Ireland Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)

Source: IMF and Authors’ Calculations.
FIGURE A3
Italy Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)

Source: IMF and Authors’ Calculations.

FIGURE A4
Portugal Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

Source: IMF and Authors’ Calculations.
FIGURE A5
Spain Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

Source: IMF and Authors’ Calculations.
Varieties of Populism in a Changing Global Context: The Divergent Paths of Erdoğan and Kirchnerismo

S. Erdem Aytaç
Department of Political Science
Yale University

Ziya Öniş
Department of International Relations
Koç University

Abstract

While the literature on populism is rich on specifying the characteristics of populist movements that distinguishes them from non-populists, much less attention has been paid on distinguishing between different types of populist movements. In this article we highlight and account for divergent trajectories of populist practice in two major emerging economies – Argentina and Turkey. We stress that both the Kirchner governments of Argentina and the Erdoğan governments of Turkey closely fit to the populist pattern of rule, yet a close analysis of their policies suggests a left-wing type of populism in Argentina and a right-wing type in Turkey. Beyond identifying divergent stands of populism in two national contexts, we also explain the mix of domestic and external factors that accounts for this divergent pattern.
Neo-liberal globalization as an on-going process since the mid-1970s or the early 1980s consists of distinct phases. The early years of neo-liberal reforms associated with the rise of the “Washington consensus” displayed a widespread optimism in the dominant policy and academic circles concerning the benefits of liberalization and free markets. The expectation was that the rise of the free market and the parallel retreat of the state would help to generate rapid growth, overcoming the stagnationist tendencies embodied in previous import-substitution regime, the benefits of which would trickle down to wide segments of society. There was no need according to this scenario to be directly concerned with relative income inequality, given the positive effects on growth in terms of poverty alleviation.

The early optimism associated with the Washington Consensus, however, experienced a serious reversal during the course of the 1990s, due to two principal reasons. First, the frequency of the financial crises experienced in the global south pointed towards a central weakness of financial and capital account liberalization, often engineered without adequate safeguards in terms of building regulatory institutions. Second, neo-liberal reforms in most national contexts have been highly unequal in terms of their income distributional distributions. Both of these factors have produced a serious backlash in many parts of the global south, leading to a new phase of neo-liberalism, the phase of the “Post-Washington Consensus”. The policies of key international institutions during the new phase focused much more explicitly on the need to regulate markets and to improve the income distributional profile through active interventionism, though within specified budgetary limits and the broad contours of the neo-liberal paradigm.

During this age of the “post-Washington consensus” Latin America has been marked by a pronounced leftist-populist turn. The literature on Latin America has focused on different variants of this pronounced shift, and tried to classify it in terms of the softer, more market-
friendly version associated with the Kirchners in Argentina or Lula in Brazil versus the more radical version often identified with Venezuela under Chávez. What is interesting, however, is that the shifts or reversals of neo-liberalism are not unique to Latin America, but are also visible in other parts of the emerging world. In this context, the Turkish case during the incumbency of Erdoğan’s Justice and Development Party (the AKP) in the post-2001 era constitutes a striking case for comparison with the soft versions of the leftist-populist turn in Latin America.

Our central hypothesis is that high public discontent accompanying the difficulties and crises associated with the policies of Washington Consensus has generated a variety of populist responses in the global south. While the literature on populism is rich on specifying the characteristics of populist movements that distinguishes them from non-populists, much less attention has been paid on distinguishing between different types of populist movements. The central objective of the present paper is to understand and classify these populist responses, and highlight elements of divergence as well convergence. Our focus is on Argentina under the governments of Néstor Kirchner (2003 – 2007) and Cristina Fernández de Kirchner (2007 to present) as a prototype example of left of center populism, whilst Turkey under the leadership of Erdoğan and the AKP is considered to be a typical example of a right of center populism. Beyond identifying divergent stands of populism in two national contexts, we also explain the mix of domestic and external factors that accounts for this divergent pattern.

**Erdoğan and the Kirchners as Populists**

Following Robert R. Barr, we define populism as “a mass movement led by an outsider or maverick seeking to gain or maintain power by using anti-establishment appeals and plebiscitarian linkages.” Such a minimal definition of populism is particularly appealing because it eschews from conflating populism with closely related but distinct concepts such as
opportunism and demagogy, and does not link it with particular economic policies, socioeconomic structure, or social constituency. Instead, the definition of populism that we adopt here considers such attributes as incidental and enables us to focus on populism’s central characteristic as a specific pattern of political rule.

The definition that we adopt emphasizes three aspects of the populist phenomenon. First, populist politicians frequently employ rhetorical appeals used in opposition to the power elite, referred to as anti-establishment politics. Such appeals are especially attractive for mass mobilization during times of political and/or economic crises, and seek to convey a view of society “where ‘the people’ (commoners) are pitted against the power elite.” Second, in order a politician’s claim of being people’s voice against the entrenched power elite to be credible, he or she must be considered either as an outsider to the political establishment (i.e., having gained political prominence as a political independent or in association with newly competitive parties) or as a maverick (i.e., rising to prominence within an established party but then either abandoning or radically shaping it). The final defining aspect of populism is its emphasis on plebiscitarian linkages between the political actors and the citizens where the latter do not have a meaningful control over the political processes and party platforms, and are frequently left with ‘take it or leave it’ choices presented by the incumbents.

Such an approach to populism does not consider some commonly cited attributes of populism (such as social constituency, charisma, and organization) as defining features. Populism’s target social constituency, for example, is a function of where the construction of the ‘us versus them’ conflict will most likely take hold, and thus targeting a particular constituency cannot be a core component of populism. Similarly, charismatic leadership is a valuable asset for mobilizing masses not just for populists but for any political movement. The proposed
definition also refrains from associating populism with any specific organizational form while
the emphasis on plebiscitarian linkages suggests an absence of autonomy within the
organizational structure of a populist movement. The benefits of employing a minimalist
definition of populism such as ours have been acknowledged in the literature. Kenneth M.
Roberts, for example, notes that populism’s “organizational malleability and association with
diverse patterns of sociopolitical mobilization” makes it difficult to define and operationalize in
empirical research.11 A minimal definition of populism, on the other hand, eschews such
setbacks by establishing a ‘lowest common denominator’ around the core features of populism
and stripping it of secondary characteristics. This approach both facilitates cross-regional
research and avoids postulating some normative assumptions about how democracy should
function.12 Similar pleas for employing a minimalist definition of populism have been voiced by
Kurt Weyland and Cas Mudde.13

The foregoing discussion implies that the three aspects of the populist phenomenon we
highlighted (i.e., leadership by an “outsider” or “maverick”, heavy use of anti-establishment
appeals, and emphasis on plebiscitarian linkages) must apply in order to label a government or
political movement as populist. From this perspective, we argue that the political movement of
kirchnerismo embodied by the successive Kirchner governments in Argentina can be safely
labeled as populist. First, even though the candidacy of Néstor Kirchner during the 2003
presidential election was endorsed by the Peronist interim president Eduardo Duhalde, being the
governor of the small Patagonian province Santa Cruz, he was little known to the Argentine
public.14 This marginal character of the Kirchner name especially in comparison to the other
well-known political figures of the day allowed him to present himself as an ‘outsider’ and
resonated well with the public spirit following the 2001-2002 crisis, incarnated in the popular
slogan of ‘¡Que se vayan todos!’ (‘All of them must go!’) towards the political establishment.\textsuperscript{15} Moreover, during the 1990s Kirchner repeatedly clashed with and distanced himself from the leading Peronist figures by forming Corriente Peronista, an initiative that attracted Peronist leaders who questioned Menem’s neoliberal model.\textsuperscript{16} The ascent of Cristina Kirchner to the presidency in 2007, on the other hand, did not result from intra-party competition but was all but certain when then highly popular president announced that he would not seek a re-election and supported the candidacy of his wife.\textsuperscript{17}

Second, the ability of the Kirchners to present themselves outside of the Peronist establishment allowed them to credibly use anti-establishment appeals which they employed extensively. Néstor Kirchner tried to establish himself as the leader of the ‘el pueblo argentino’ (‘the Argentine people’) and articulated a discourse contrasting ‘the people’ and ‘its enemies’ or the ‘elite’ who are embodied by, among others, Menemismo, the IMF, international creditors of the Argentine foreign debt, the Catholic Church, the multinational oil corporations, and the mainstream media.\textsuperscript{18} This rhetoric had a strong emotional tone with frequent references to ‘repair’, ‘rebirth’, ‘national recovery’, and a typical example of the rhetoric of Kirchner that puts ‘the people’ against ‘the elite’, in this case directed against Aguaas Argentinas, the water-utility company that held the Buenos Aires metropolitan area concession follows as: “May the Argentine people see how towns like Ituzaingo are suffering as these companies do not respect the right of the Argentines”.\textsuperscript{19} Cristina Kirchner closely followed his husband’s discourse of contrasting ‘the people’ versus ‘the elite’; during the conflict between her government and the agricultural sector and the subsequent strikes in 2008 following her decision to raise export taxes, she accused the dissident farmers of ‘trying to get rich at the expense of the Argentine people’ (‘aquellos que quieren enquierecerse a costa del pueblo argentino’) and of trying ‘to
dismiss the government and destabilize the homeland’ (‘destituir al Gobierno y desestabilizar a la patria’). In turn, she pleaded that ‘she needed the strength of the Argentine people’ (‘necesito la fuerza del pueblo argentino’) to ‘support the national and popular government’ (‘apoyar el gobierno nacional y popular’) and to ‘defend Argentina’ (‘defender a la Argentina’).  

Finally, the tenures of Néstor and Cristina Kirchner also displayed the third characteristic of the populist rule, namely the emphasis on plebiscitarian linkages between ‘the people’ and the ruler, as they greatly increased executive power at the expense of other institutions. Steven Levitsky and M. Victoria Murillo note that Néstor Kirchner “governed at the margins of Congress and other institutions of horizontal accountability”, and encroached on judicial independence. As an indicator of executive power concentration, during his term Néstor Kirchner signed a total of 270 decrees of necessity and urgency (DNU), in effect assuming powers which belong to the Congress. With an average of 60 DNU’s per year, he remains as the Argentine president who used this prerogative most frequently, even ahead of Menem who issued 54.5 DNU’s per year. Both Néstor and Cristina Kirchner rarely talked to reporters and gave no press conferences during their tenures; moreover, Cristina Kirchner closed her presidential campaign in 2011 without giving a single interview and is reported not to hold Cabinet meetings anymore. In a recent dispute regarding a new media law she criticized the judiciary and publicly announced that the Supreme Court should ‘respect the popular will’ (‘respete la voluntad popular’), again emphasizing the supremacy of vertical accountability.  

Similar to the case of Argentina, in Turkey the three consecutive AKP governments headed by Erdoğan (2002 to present) display the three characteristics of populist rule as well. First, before his rise to power in 2002 Erdoğan could credibly claim to be both an outsider to the political establishment and a maverick within the political movement that he was associated
with. He was outside the existing mainstream political community during the crises-ridden 1990s and became known to the public only after being elected as the mayor of Istanbul with 25% of the votes in a very tight race. While during his tenure he got a reputation for being a competent service provider, his rise and popularity began to cause unease among the political and bureaucratic elite. In 1998 he was given a ten month prison sentence and was banned from politics on the grounds of provoking public conflict by reciting a poem with militant Islamist tones. This sentence not only helped him to reinforce his outsider status but also allowed him to present himself as a victim of the political establishment. Additionally, after the 1997 military memorandum against the government Erdoğan began to distance himself from the leadership of the Islamist Milli Görüş movement and assumed leadership position in a new political movement that culminated in the foundation of AKP. Thus, he was essentially a maverick within the mainstream Islamist movement in Turkey who reshaped it in a new form that he designates as conservative democracy.

The frequent use of anti-establishment appeals and a discourse contrasting ‘the people’ versus ‘the elite’ as characteristics of populist rule is especially salient in the case of Erdoğan. Erdoğan frequently refers to his humble socio-economic background of his family and tries to depict himself as the ‘man of the people’. Here the contrast is with the political elite of the Republican tradition including the bureaucratic and military elite: While the AKP is ‘the party of the people…voice of the silent masses, protectorate of the defenseless’, the bureaucratic elite is disconnected from the popular values and have always kept a distance from the masses. This dichotomy is articulated quite succinctly by Erdoğan himself.

“My story is the story of this people. Either the people will win and come to power, or the pretentious and oppressive minority – estranged from the reality of Anatolia and
looking over it with disdain – will remain in power. The authority to decide on this belongs to the people. Enough is enough, sovereignty belongs to the people!“28

This characterization of Turkish politics as a struggle between ‘the people’ and ‘the elites’ resonates well with a plebiscitarian view of democracy and a disdain for institutions of horizontal accountability because in the eyes of Erdoğan it is precisely these institutions of ‘the political establishment’, such as the Constitutional Court, the High Judiciary, and the Presidency, that “formed an alliance to prevent people from achieving power, and thereby constituted ‘the elite’ in opposition to ‘the people.’”29 Accordingly, Erdoğan and the AKP leadership have embraced a strictly majoritarian understanding of democracy where democracy is equated with popular will and only majorities in the ballot box epitomize the ‘will of the nation.’30 This view permeates the discourse of Erdoğan.

“The degree of one’s power solely relies on the number of votes received from the people. A minority should not overpower the majority.”31

“It is going to be as you [the people] want. The Prime Minister and the President will be those whom you want. Of course, they will also be like you, one of you.”32

“Because our source of legitimacy is the people but theirs is not. They are trying to take legitimacy from certain institutions.”33
Lastly, just like in the case of the Kirchners, Erdoğan weakened the power and the reach of institutions of horizontal accountability, most notably through a constitutional referendum in 2009 which overhauled the judiciary and increased the role of the President and the parliament over the appointments of senior judges and prosecutors. As Erdoğan continues to win elections, he is facing fewer checks or balances, and it has been noted that analysts have increasingly begun referring to Turkey as ‘Erdoğan’s Turkey.’ It should also not come as a surprise that most observers point out to the diminishing intra-party democracy within the AKP as well where Erdoğan increasingly appears to be the sole decision-maker.

In short, by employing a minimalist and political definition of populism, we show that both the Kirchner governments in Argentina and the Erdoğan government in Turkey display the core characteristics of the populist pattern of political rule. In both cases we observe a political movement led by an outsider or maverick, heavy use of anti-establishment appeals, and a strong emphasis on plebiscitarian linkages. Additionally, both cases share some attributes that could be considered as secondary characteristics of populism, such as the charismatic leadership styles of the Kirchners and Erdoğan, and the dense organizational networks of the Peronist Justicialist Party (PJ) and AKP.

Divergence within the Populist Pattern of Rule

Despite sharing a distinctly populist pattern of rule, a close analysis of the Kirchner and Erdoğan governments’ policies reveals that the two cases represent quite different strands of populism. Specifically, we argue that while the Kirchner governments characterize a left-wing type of populism, the Erdoğan governments’ policies suggest right-wing populism. To clarify our characterization of left-wing vs. right-wing typologies, following Steven Levitsky and Kenneth M. Roberts we designate “political actors who seek, as a central programmatic objective, to
reduce social and economic inequalities” as left-wing. Such actors increase state expenditures, extend the coverage of social programs, put emphasis on employment, and frequently intervene in labor market to expand workers’ benefits and rights. Right-wing political actors, on the other hand, do not place redistributive policies and social equality at the top of their programmatic agenda; instead, they prioritize economic stability and physical security.

In the case of Argentina, we argue that four features that gave Kirchners’ policies a left-wing populist character are (i) emphasis on a competitive real exchange rate to support domestic industry and employment, (ii) support for labor, (iii) frequent and substantial state intervention in the economy in the forms of regulations, subsidies, social programs, and nationalization, and (iv) a nationalist policy outlook. It should be noted that the fundamentals of the Kirchners’ macroeconomic policies were put place during the interim presidency of Eduardo Duhalde (2002 – 2003) who rejected orthodox stabilization programs and abandoned convertibility. Thus, the reform process in post-crisis Argentina was well under way and the worst part of the crisis had already passed when Néstor Kirchner, who campaigned on a clearly anti-neoliberal program, was elected as the President in May 2003. Still, during his and his successor Cristina Kirchner’s terms the state began to take a bigger and more active role in the economy in line with a left-wing agenda.

One of the main factors behind the successful macroeconomic performance and rapid growth of the Argentine economy under the Kirchners was the official policy aimed at preserving a stable and competitive real exchange rate (SCRER) through controls and interventions in the FX market. During the Kirchner governments the exchange rate proved a critical tool of government policy and the Argentine central bank frequently intervened in the FX market to prevent the peso from appreciating in value. Given the availability of hard currency as
a result of foreign exchange receipts, the central bank purchased nearly USD 45 billion from the market during the tenure of Néstor Kirchner. Additionally, the government introduced controls on the capital account in 2005, subjecting all short-term capital inflows to a 30% unremunerated reserve requirement for at least a year. As a result, while most emerging market currencies significantly appreciated against the US Dollar until the global crisis of 2008–2009, the Argentine Peso diverged from this trend (Figure 1).

**Figure 1.** Argentine Peso, Brazilian Real, Turkish Lira, and Polish Zloty Indexed (2003 Q1 = 100) Against the US Dollar, 2003 Q1 – 2008 Q3.

Source: Oanda.com.
The SCRER policy had significant positive effects on economic activity, employment, and external and fiscal accounts. By effectively subsidizing and thus increasing the competitiveness of the domestic industry the SCRER encouraged the expansion of its production, employment, and investment. Labor-intensive sectors disproportionately benefit from such a policy because a competitive parity favors labor-intensive activities and promotes the substitution of expensive inputs in favor of labor. Moreover, while the resulting expansion of the exports and positive trade surplus eased the balance of payment concerns, the accumulation of international reserves by the Argentine central bank increased local confidence in the economy. The real exchange rate depreciation was the key factor in improving the trade balance, and Argentina recorded a USD 7.6 billion surplus in 2006 compared to a USD 14.5 billion deficit in 1998.

The SCRER combined with a loose monetary policy that emphasized growth in turn facilitated the government to ally itself with labor – the second feature of Kirchners’ economic policies. Being a weak president initially, upon taking power in May 2003 Néstor Kirchner was already courting the support of social groups that would share its anti–neoliberal critique, and thus he displayed a pro-labor stance in labor conflicts and collective bargaining. In cases of labor conflicts, the Kirchner governments did not quickly exercise its right to call for mandatory conciliation to allow union protest and was reluctant to use force against labor demonstrations. In addition to tolerating and encouraging labor conflict, the Kirchner governments facilitated collective bargaining as well: While the annual average of finalized collective bargaining agreements stood at 176 for the period of 1991 – 2002, it soared to 1083 for the period of 2003 – 2011. Additionally, for the first time since the neoliberal reforms of the 1990s the government directly intervened in wage policy by raising the minimum wage and stipulating wage increases.
in the private sector. As a result, both the real average wage and real minimum wage in Argentina took off during the Kirchner governments (Figure 2).

Figure 2. Real Average and Minimum Wages in Argentina and Turkey, 2000 – 2010*

*Real average wages reflect wages for private sector workers in both countries.


The third characteristic of the Kirchners’ economic policies that suggests a left-wing type of populism is the frequent use of state interventions in the economy in the forms of regulations, subsidies, social programs, and nationalization. Economic recovery of Argentina is accompanied
by inflationary pressures, and Kirchners’ approach to address this concern has been the introduction of ad hoc policies such as periodic limitations on exports and negotiations with supermarkets and producers for ‘voluntary’ price controls, which in practice has meant a constant process of monitory, exhortation and warning by government of the danger of pushing prices up.47 Additionally, the Kirchners have introduced extensive subsidies on a wide range of public services and wage goods to “protect popular sectors’ short-run income.”48 Upon assuming power, Néstor Kirchner significantly expanded the scope of the utility rate freezes and subsidy programs first implemented by Duhalde. Between 2003 and 2006 government spending on energy and fuels increased sevenfold, while transportation expenditures more than tripled. By 2010, federal spending on utilities subsidies reached USD 7.5 billion, around 10% of the budget.49 In addition, the Kirchner governments compensated producers of food for part of their costs to control domestic prices of wage goods like beef and wheat.50

The scope of the social transfers, services and pensions were also expanded significantly during the Kirchner administrations.51 Néstor Kirchner extended pension coverage to the previously unprotected workers outside the formal labor market, and by the end of his term the pension system was virtually universal. In 2009 Cristina Kirchner expanded the existing universal family allowances by establishing the Universal Child Subsidy and a conditional cash transfer program that covers 30 percent of the population under the age of 18. Upon re-election in 2011, she publicly announced that she would deepen the redistributive policies. Finally, the Kirchners engaged in a substantial nationalization effort of state-owned enterprises that were privatized in the 1990s.52 While Néstor Kirchner nationalized the main water utility company and the national post office, Cristina Kirchner nationalized the private pension system, the main national airline, and the nation’s largest oil company. All these policies significantly increased
the revenue requirements of the government: While in 2002 general government revenues constituted 23% of GDP, by 2010 they had risen to 37% of GDP (Figure 3).

**Figure 3.** General Government Revenues (% of GDP) in Argentina and Turkey, 2002 – 2010

![Graph showing General Government Revenues (% of GDP) in Argentina and Turkey, 2002 – 2010](graph.png)

Source: International Monetary Fund, World Economic Outlook Database, October 2012.

Finally, the Kirchners have a distinctly nationalist policy outlook that contrasts sharply with the 1990s. Argentina’s relations with international capital have changed fundamentally under the Kirchners who maintained a tough stance against the international creditors.\(^{53}\) During the negotiations with creditors Néstor Kirchner remained inflexible and decided not to pay the external debt until 2005, a decision that prioritized boosting domestic consumption.\(^{54}\) Eventually in January 2005 he presented a take-it-or-leave-it plan with the worst terms ever offered in a sovereign debt restructuring; a bond swap with a 70% haircut and repudiation of all past due
interest payments. He also decided to clear the account with the IMF in December 2005 by paying its outstanding USD 9.8 billion debt instead of making staged debt payments. It has been noted that this decision resulted from the “need to create an image inside Argentina of a sovereign state,” as well as to desire to have greater maneuverability in terms of economic policy. Cristina Kirchner displayed a similarly tough stance against the international creditors. When an Argentine warship was detained in Ghana at the request of one of Argentina’s former creditors, she declared that “Argentina will not bow to ‘blackmail by vulture funds’” and refused to negotiate.

In line with their overall nationalist outlook in economic policy, Kirchners tried to reorient the foreign policy of Argentina as well. Néstor Kirchner advocated that Argentina should end its “automatic alignment” with the United States – a signature policy of the Menem administration – and focus on improving its relations with other countries in Latin America. The development of a “pink tide” across Latin America has brought Argentina closer with other leaders of the continent and resulted in closer relationships with Brazil, Venezuela, and Bolivia. He also pursued deeper integration within the MERCOSUR (the Southern Common Market); at the same time opposing the creation a free trade zone encompassing 34 American countries (FTAA) that is supported by the US. Cristina Kirchner in particular developed very close relations with Venezuela’s Chávez which enabled her “to portray her government as part of an epic battle that unites Latin America against Western corporate interests.” She also increasingly ‘heated up’ the Malvinas/Falklands dispute which has ubiquitous popular and nationalist references in Argentine public life.

In parallel to the Argentine case, the year 2001 marked a decisive critical juncture in the Turkish political economy as well. The February 2001 economic crisis was particularly
important in terms of its consequences as it resulted in the largest economic recession in Turkey’s history and hit all segments of the society.\textsuperscript{61} Perhaps ironically, however, it was this very depth and breadth of the crisis that ushered a new round of structural reforms aimed at addressing some enduring institutional weaknesses of Turkish capitalism: The crisis broke the resistance of the coalition government against an ambitious reform program backed by the IMF, and led to the formation of a pro-regulation coalition.\textsuperscript{62} Thus, when voters punished the existing political elite by throwing all the parties in the coalition government out of the parliament and bringing Erdoğan’s AKP to power in November 2002, the positive effects of the program were already palpable: The economy grew by 6.2\% in 2002, inflation was on a sharply downward trend, fiscal balances were fast improving, and interest rates were declining. As Néstor Kirchner of Argentina followed the policy fundamentals of Duhalde, Erdoğan pragmatically chose to commit itself to this inherited reform drive; yet the direction of the economic policies were quite distinct from that of Argentina under the Kirchners: While we have seen that Kirchners’ policies had an left-wing populist character, we argue that the policies of Erdoğan suggest a right-wing strand of populism. Specifically, the three features of AKP’s economic policies that are important for this characterization are (i) the retreat of the state to a primarily regulatory function, (ii) the emphasis on pro-capital policies and a general neglect of labor interests, and (iii) a rather reactive and conservative macroeconomic policy-making.\textsuperscript{63}

First, while we stressed that the state assumed a significant role in the political economy of Argentina after the 2001 crisis, in the Turkish case we observe a retreat of the state to a regulatory role in line with the principles of ‘regulatory neoliberalism’.\textsuperscript{64} Essentially this move entailed taking economic assets and decisions away from the control of publicly elected bodies by (i) the formation of autonomous regulatory organizations for the management of key sectors
of the economy and (ii) the privatization of State-owned Enterprises (SOEs). The “strong economy” program implemented as a response to the crisis emphasized the unhealthy structure of the financial sector as one of the main reasons for the crisis; thus, a tighter regulation of the banking and financial sector was considered essential and the power and autonomy of the Bank Regulatory and Supervisory Authority (BRSA) was expanded considerably. Additionally, the program stipulated the enactment of several laws regarding the strengthening of the position of autonomous regulatory agencies in key sectors of the economy. In its early stages, the AKP government actually displayed a lukewarm attitude towards the independent regulatory bodies: While the government demanded greater political control and accountability of such institutions, the IMF insisted on prioritizing autonomy. When the government realized that this divergence with the IMF could jeopardize the economic program, however, it dropped its reservations.

A strong commitment to the privatization of SOEs constituted the second leg of the retreat of the state. While privatization was on Turkey’s economic agenda since the mid-1980s, its pace had been extremely slow until the early 2000s. After coming to power, Erdoğan was determined to reinvigorate the privatization efforts, pointing out that the private sector should take the lead in the economy. In line with this emphasis, more than USD 20 billion had been raised in privatization revenues from 2005 to 2007 alone, a figure that is more than double the amount of what had been raised during the previous 16 years. In addition to the high number of SOEs privatized, it is important to note that during the AKP government privatization had moved to infrastructure industries such as telecommunications, electricity distribution, highways, and ports. As a result, while in 2002 the SOEs employed close to 400 thousand people, this figure dropped to 170 thousand by 2011.
The second characteristic of Erdoğan’s economic policy that suggests a right-wing type of populism is its emphasis on pro-capital policies and a relative neglect to labor’s demands and concerns. The AKP governments dismantled administrative barriers to investment, reduced the corporate tax rate significantly, and improved the overall legal protection of foreign investors.\textsuperscript{72} The party’s 2002 election manifesto declared that one of its aims would be to make Turkey “an international brand [for investors]” and the government boasts itself for having brought the number of days required to start a business from 38 down to 9 days, well below the OECD average of 25 days.\textsuperscript{73} The new FDI regime also included important incentives such as easy access to real estate, guarantees to transfer proceeds, and no minimum capital requirement.\textsuperscript{74} As a result of these pro-capital policies as well as a favorable economic and political environment, FDI inflows to Turkey reached a record level of US$ 51.6 billion from 2005 to 2007 while they amounted to less than US$ 1 billion before 2004.\textsuperscript{75} Overall, it should not come as a surprise that the big business in Turkey, represented under the umbrella of TUSIAD, has been quite satisfied with Erdoğan’s economic policies, especially during its first term.\textsuperscript{76}

The Erdoğan governments’ stance towards the interests of the labor has been much less favorable, however. Just six month after its inauguration it adopted a new labor law (No: 4857) that was backed by the big business and heavily criticized by the labor unions for sanctioning temporary and flexible environment and thus in effect undermining job security of the workers. Additionally, the government has been quite negative towards the institutional rights of the working class such as the right to unionization and the right to strike.\textsuperscript{77} In several cases it remained silent on the attacks by employers on workers’ right to unionize, and “the postponement of legal strikes has been a telling feature of Turkish industrial relations under the [Erdoğan] government.”\textsuperscript{78} It is telling that the government did not hesitate to use its discretion to
postpone the strikes despite the insignificance of their number: There were just nine strikes in 2011 compared to twenty-seven when AKP took office in 2002.\textsuperscript{79} In addition, comparing the real wage increases in Turkey with that of Argentina in Figure 2, we see that during Erdoğan’s tenure they were quite modest; while in Turkey the real average wage and real minimum wage increased by 6.4\% and 43.3\% from 2003 to 2010, respectively, the corresponding figures for Argentina are 91.3\% and 283\%.

Lastly, a conservative and rather reactive macroeconomic policy-making has been the third characteristic of Erdoğan’s policies that point to right-wing populism. The AKP governments were committed to fiscal discipline and tight monetary policies as demanded by the IMF, especially until the 2008 – 2009 global financial crisis. The public sector primary surplus averaged 4.7\% of GDP over the period of 2003 – 2007, and unlike the Kirchner governments, general government revenues as a percentage of GDP remained virtually constant (Figure 3). Even during the height of the 2008 – 2009 crisis the AKP government refrained from a sizeable stimulus package and other interventionist measures that were observed in emerging economies, and focused on maintaining fiscal discipline.\textsuperscript{80} Additionally, both the government and the Central Bank pursued an anti-inflationary policy of strong currency, allowing the Turkish Lira to appreciate strongly in real terms due to very high real interest rates.\textsuperscript{81} The CPI-based real appreciation of the Turkish Lira reached 27\% from 2003 to 2010 and as a result both imports and import penetration in consumer and intermediate goods soared while the tradable sectors experienced competitiveness losses.\textsuperscript{82} The share of imported inputs in industrial production increased from an average of 15-20\% in the late 1990s to an average of 35-40\% in the mid-2000s, and while the average current account deficit stood at 0.55\% of GDP between 1990 and 2002, it jumped to 5.2\% of GDP for the period 2003 – 2011.\textsuperscript{83}
In sum, while it is appropriate to characterize both the Kirchner and Erdoğan governments as populist, a closer look at their policies suggests that they represent different types of populism, namely a left-wing populism in the case of the Kirchners and a right-wing populism in the case of Erdoğan. In Argentina, a combination of strategies including a competitive exchange rate and frequent state intervention in the economy in the forms of regulations, subsidies, social programs, and nationalization significantly increased the redistributive capacity of the state and strengthened traditional industrial sectors. In contrast, in Turkey the monetary and fiscal policy regime of the AKP governments prioritized the interests of capital while the state retreated to a mainly regulatory function, and the anti-inflationary policy of strong currency led to a loss of competitiveness of the tradable sectors. Additionally, a politically mobilized labor movement along with domestic industry and unemployed workers’ organization was a key component of Kirchners’ populist coalition, while the AKP governments were characterized by a conspicuous neglect of labor’s interests.

Factors behind the Divergence

What accounts for the Kirchner and Erdoğan governments’ divergent paths within the populist pattern of rule? We argue that four factors are essential for understanding why the Erdoğan governments followed a right-wing strand of populism while the Kirchner governments had a strongly left-wing tone. These factors are (i) the perceptions on the causes of the failure of previous economic policies that culminated in the crises of 2001 - 2002 in both countries, (ii) different integration patterns with the international economy, and (iii) the strength of labor, and (iv) regional dynamics.

First, while in Turkey the responsibility for the economic policies that led to the collapse of the economy in 2001 was attributed to the domestic political actors, in Argentina the blame
was directed primarily towards external actors such as the international financial institutions that were influential in the design and implementation of the policies during the 1990s. Turkey had experienced a series of “boom and bust” cycles during the 1990s where weak coalition governments pursued a ‘hot money’ policy of high real interest rates to attract short-term capital in order to finance bloating government expenditures. The result of such policies was “large fiscal deficits, chronically high rates of inflation, an unsustainable balance of payments situation, falling international reserves and the inevitable encounter with the IMF” Accordingly, the economic crises Turkey experienced were typically domestically generated where the “fiscal crisis of the state” as a result of reckless spending by the incumbent governments played a central role. In turn, external actors such as the IMF and the World Bank frequently intervened in the economy to restore equilibrium where the domestic political actors were not able to do so.

The systematic collapse of 2001 was just the most severe of the “busts” that Turkey experienced repeatedly during the 1990s. The depth of the 2001 crisis and the perceived lack of will and capacity of the political actors to impose fiscal discipline for sustained economic growth changed the balance of power in Turkey in favor of transnational and domestic actors favoring liberalization combined with regulatory reforms. The IMF (in addition to the EU) emerged as a powerful external anchor for fundamental fiscal and institutional reforms and for the construction of a broad consensus on the need to achieve macroeconomic stability and a clean break with the previous era. Thus, in the Turkish case the domestic interpretations of past crises motivated and facilitated the Erdoğan governments to implement right-wing policies that emphasized retreat of the state to a regulatory function and conservative macroeconomic policy-making.

In contrast, Argentina had emerged as a ‘neoliberal success story’ during the 1990s and the policies implemented during this period were designed with close collaboration with the
Upon assuming the presidency in 1987, Menem engaged in a series of neoliberal reforms including trade and financial liberalization, a massive privatization program including the privatization of the social security and several public utilities, and deregulation of the labor market. Additionally, he implemented a fixed exchange rate regime (the Convertibility Plan) to combat hyperinflation and to impose a strict monetary and fiscal policy. The structural reforms of this period were supported by the international financial institutions and the U.S. Treasury, and both the Minister of Economy Cavallo and Menem were “darlings of the IMF”.

While the neoliberal reforms were quite successful and popular in the short term, they proved to be fateful for the disastrous crisis of 2001. Unlike Turkey, in Argentina the perception was that the primary responsibility for the economic failure that culminated in the 2001 crisis lied with the international financial institutions that had strongly supported the neoliberal reforms. Thus, the economic crisis was accompanied by a massive wave of protests in which the IMF was a major target of attack along with the government. This sentiment is also shared by the IMF itself as its First Deputy Managing Director Anne Krueger remarked that “[Argentina] faithfully applied many of the lessons that we thought we had learned from the previous crises of the mid and late 1990s – but a combination of new mistakes and some old ones brought it to grief all the same”.

Thus, in the post-crisis Argentina the neoliberal policies of the previous decade were discredited, and the interim Duhalde government rejected orthodox stabilization programs. In turn, the disrepute of the neoliberal policies enabled the subsequent Kirchner government to adopt a left-wing political economy.

The second factor that caused a divergence in policies is the countries’ different integration patterns with the international economy in the sense that the post-2002 global economic environment presented different opportunities. During this period while Turkey’s
economic growth heavily depended on international capital flows, Argentina did not face such a constraint. The period from 2002 until the financial crisis of 2008 - 2009 was an exceptionally favorable global economic environment characterized by record capital and trade flows, relatively low inflation, low interest rates and strong demand for emerging market assets. Given that historically Turkey’s growth episodes are almost always financed by capital inflows, the AKP government had strong incentives to pursue pro-capital policies to attract foreign capital in order to finance the strong credit-financed, domestic demand driven growth. During this period Turkey offered one of the highest real interest rates among the emerging markets, and the cumulative portfolio investment of foreigners exceeded US$ 100 billion as of 2007 compared to just US$ 10 billion at the beginning of 2003. The majority of these inflows, however, went into sectors that do not generate any significant export earnings, e.g., banking, retail trade, and telecom sectors; thus, they did not have much effect on ameliorating the growing current account deficit which rose from 2.5% of GDP in 2003 to 9.9% of GDP in 2011. All these factors rendered the Turkish economy quite vulnerable to shifts in global market sentiments and the AKP government pursued orthodox monetary/fiscal and pro-capital policies to ensure the continuation of capital flows that were necessary for growth.

In contrast to Turkey, Argentina’s growth on this period was not dependent on capital flows, and this absence of external constraints was a historically rare occurrence. The single most important effect of the international economy on Argentina during the Kirchner governments was the commodity boom that began around 2003. As the world’s one of the major agricultural producers, Argentina’s agricultural exports - which accounts over half of Argentina’s total merchandise exports - soared thanks to rising international agro-industrial goods prices, reaching USD 45 billion in 2011 compared to USD 12 billion in 2002. The
Kirchner governments exploited this situation judiciously by undervaluing the exchange rate to promote exports and then heavily taxing the agricultural exports to raise revenue. As a result, taxes on exports alone accounted for 63% of the federal administration’s primary surplus of 3.5% of GDP in 2006, and the primary balance of the federal administration averaged 2.6% of the GDP for the period 2003 – 2008. Crucially, Argentina consistently gave current account surpluses during this period (unlike Turkey, see Figure 4), and this situation eased its dependence on capital flows and reduced the risks of expansionist monetary policies. As a result, in contrast to Turkey, the Kirchner governments did not need to court international capital to promote growth and the receipts from the commodity taxes facilitated the increase in state expenditures to pursue left-wing policies.

**Figure 4.** Current Account Balance (% of GDP) of Argentina and Turkey, 1990 – 2011.

Source: The World Bank, World Development Indicators 2012.
The difference in the levels of labor’s strength at the time when Erdoğan and Kirchner came to power in Turkey and Argentina is the third factor for explaining the divergent policy paths. In comparison to Turkey, the Argentine labor movement was much stronger at the beginning of 2000s and thus the Kirchner government found it beneficial to pursue pro-labor policies to ally itself with labor while the Erdoğan government did not feel such a need due to the weakness of labor in Turkey. The Turkish labor movement is historically characterized as weak and dispersed with the clear dominance of state; in addition, it lacks an ideology equivalent to Peronism in Argentina that identified itself with the workers. The military coup of 1980 which initiated a neoliberal restructuring program dealt an additional blow to labor: Strikes were forbidden, social rights abolished, collective agreements suspended, and many unions were disbanded (Laws 2821 and 2822). The subsequent 1982 Constitution made it harder for workers to become unionized and to establish new unions, increased the state’s political and financial influence on unions, put a number of limitations on strikes, and prohibited the unions to participate in political activities. The declining political clout of the Turkish labor movement is reflected in union membership numbers as well: While there were 2.5 million unionized workers in 1980, it dropped to 650 thousand by 2010.

In the case of Argentina, even though the country experienced a radical economic liberalization period in the 1990s, unions were able to preserve their associational power. Two factors were crucial in this outcome. First, market reforms in Argentina did not entail a shift in production to sectors that have been traditionally nonunionized as it is usually the case; in fact, the sectors that boomed in this period – such as food, transport, energy – were highly unionized. Second, labor unions were an important constituency of the governing Peronist party that
implemented the market reforms in the 1990s, and therefore the unions were able to obtain important concessions that preserved their institutional resources. The unions prevented major changes to collective labor law, retained monopoly of representation at the shop floor and the collective rights of centralized wage bargaining. These two factors implied that although the market reforms of the 1990s undoubtedly weakened the labor movement, the unions were able to preserve important institutional resources that “could be called on in the immediate context of economic recovery and a friendlier government” when Néstor Kirchner took power. Therefore, the strength of labor in Argentina motivated the Kirchner governments to court labor support and facilitated the implementation of left-wing policies. This strategy returned significant political dividends to Kirchner governments. For example, when Néstor Kirchner called for a large demonstration to mark his third year in power, the unions were among the main actors in the street demonstrations. Similarly, during Cristina Kirchner’s conflict with the agricultural sector the unions were again on the streets to support the government.

Finally, we argue that regional dynamics are essential for understanding the different policy paths. In Turkey, the post-crisis IMF program was legitimized and justified by appealing to European Union (EU) convergence; the Minister of Economy Derviş noted that “the economic program is prepared in full compliance with the National Program to the EU…Indeed, our economic program represents the economic dimension of the National Program to the EU.” Moreover, in the post-9/11 global environment US foreign policy was increasingly orientated towards the Middle East and the stability of Turkey in this region was an important consideration. Accordingly, the IMF was willing to lend several multiples of Turkey’s quota at the Fund and provided favorable repayment conditions to facilitate the reform process. The Kirchner governments’ tenure, on the other hand, coincided with the rise of leftist-populist
parties throughout Latin America. Commodity exports during this period provided the Latin American governments with the hard currency they needed for expansionist and redistributive policies while reducing their dependency on the international financial institutions. Karen L. Remmer reports that the odds of electing a leftist-populist president in the region rose with improvements in the terms of trade, in line with the argument that independence from capital flows enables the implementation of left-wing policies. The concurrence of Kirchner governments with the region-wide shift towards leftist rule further bestowed legitimacy to Kirchners’ left-wing policies in a regional context and also facilitated their desire to strengthen Argentina’s position vis-à-vis international institutions through closer relations with other Latin American countries.

**Conclusion: Sustainability and Implications for Democracy**

The emphasis in the present paper has been on highlighting and accounting for divergent trajectories of populist practice in two major emerging political economies. We stress that both the Kirchner governments of Argentina and the Erdoğan governments of Turkey closely fit to the populist pattern of rule, yet a close analysis of their policies suggests a left-wing type of populism in Argentina and a right-wing type of populism in Turkey. In turn, we have argued that a mix of domestic and external factors were crucial for this divergence within the populist practice. Specifically, we highlight the importance of the legacy of failed economic policies preceding the rise of populist leaders, different integration patterns with the international economy, the strength of labor, and regional dynamics that legitimize certain policy trajectories. While much of the literature on populism have focused on Latin American cases, we introduce a cross-regional dimension to the study of populism, and this framework should be useful for evaluating different populist patterns of rule elsewhere.
We should not assume that the left- or right-wing versions of populism depicted in the present study is necessarily stable. A major challenge to the populist equilibrium concerns the question of sustainability. In Turkey, the Erdoğan governments clearly benefited from inflows of external capital, especially during the favorable global liquidity environment between 2002 and 2007. The interruption of these inflows during the crisis of 2008 – 2009, however, dealt a serious blow to the Turkish economy and to the support for the AKP government. The economy contracted by a startling rate of 14.7% in the first quarter of 2009, and in the March 2009 local elections AKP registered one of its lowest levels of support during its ten-year rule. While capital inflows resumed in the aftermath of the crisis, the continuation of this pattern of growth is not inevitable given the highly adverse conditions in global economy. Indeed, there are signs that Turkey’s externally driven growth pattern is reaching its limits and the country may be entering into a new phase of slow growth by the end of 2012. The experience of 2009 suggests that a protracted period of slow growth may present serious challenges to AKP for maintaining its broad based electoral coalition.

A similar challenge is faced by Argentina whose populist model has also been based on favorable external conditions, notably the revenues generated by its commodity exports. A change in world market conditions such as a major commodities slump would significantly weaken the foundations to redistribute income in favor of the poor, a key element of the Argentine style left-wing populism. Cristina Kirchner had already to curb public spending significantly by reducing public utilities subsidies and by cutting discrentional transfers to provinces and municipalities by half. Additionally, chronically high inflation has become a major issue where unofficial estimates put it around 25%. As a response, Cristina Kirchner
asked unions to hold back calls for higher wages and to stage fewer strikes; yet union leaders rejected such appeals and by the end of November 2012 Kirchner faced the first general strike during her term. An additional anti-government march, the largest since Néstor Kirchner took office in 2003, took place in the most important urban centers of several provinces in September 2012; followed by an even bigger one in early November. The distancing of labor and growing public discontent with government policies suggest that the sustainability of kirchnerismo is all but certain.

Yet another challenge concerns the democratic deficits associated with both versions of populism. A plebiscitarian view of democracy and an accompanying disdain for institutions of horizontal accountability that is evident in the Turkish and Argentine cases do not bode well for a genuinely pluralistic, liberal democratic order. Both the Erdoğan and Kirchner governments especially during their later phases of rule have been increasingly criticized for authoritarian tendencies, most notably in the realms of the freedom of the press, judicial processes, excessive concentration of power at the hands of the executive, and a lack of tolerance for the opposition. These observations suggest that while the left- and right-wing versions of populism may follow quite different trajectories in terms of their substantive policies, they may be confronted with very similar challenges in terms of sustainability and establishing a liberal pattern of democratic governance.


6 Barr, p. 33. This definition is similar to that of Steven Levitsky and Kenneth M. Roberts who define populism as “the top-down political mobilization of mass constituencies by personalistic leaders who challenge established political or economic elites on behalf of an ill-defined pueblo, or ‘the people.’” Levitsky and Roberts, p. 6.


9 Barr, p. 32.

10 Ibid., p. 39.

11 Roberts, p. 127.

13 Weyland; Mudde.


20 For similarities between the discourses of Néstor and Cristina Kirchner and for the quotes given see *El País*, “La figura de Néstor Kirchner marca las elecciones presidenciales argentinas,” September 28, 2011,

La Nación, “Nunca Vi Tantos Ataques a Un Gobierno,” April 2, 2008,


21 Levitsky and Murillo, p. 19.


23 See El País, “La Señora,” May 6, 2012,

http://internacional.elpais.com/internacional/2012/05/04/actualidad/1336166100_360785.html;
The Economist, “Argentina Under the Kirchners: Socialism for Foes, Capitalism for Friends,” February 25, 2010,

http://www.economist.com/node/15580245?zid=309&ah=80dcf288b8561b012f603b9fd9577f0e;

El País, “Cristina, en Su Apogeo,” October 22, 2011,


Quoted in Yağcı, p. 116.


Akman; Yağcı.

Quoted in Dinçşahin, p. 634.

Quoted in Yağcı, p. 134.

Quoted in Yağcı, p. 135.

Quoted in Yağcı, p. 133.


Görener and Uçar.


Frenkel and Rapetti; Richardson.

Frenkel and Rapetti, p. 216.
In the first round of the 2003 presidential elections Néstor Kirchner obtained only 22.2% of the votes and came second after Menem who had 24.5% of the votes. Anticipating a landslide defeat, however, Menem forfeited the runoff and thus Kirchner was deprived of winning a majority in the runoff election.


Peter R. Kingstone, *The Political Economy of the Latin America: Reflections on Neoliberalism and Development* (New York: Routledge, 2011); Grugel and Riggiorazzi. Referring to these ad hoc measures and interventions to the economy, the influential conservative American think-tank Heritage Foundation ranked Argentina 158th among the 179 countries surveyed as of 2012 in its ‘Index of Economic Freedom’ available at [www.heritage.org/index](http://www.heritage.org/index) (accessed on November 9, 2012).

Etchemendy and Garay, p. 291.


Richardson.


Wylde.

Grugel and Riggirozzi.


Grugel and Riggirozzi, p. 99.


Grugel and Riggirozzi.


63 We should note that by characterizing the Erdoğan governments as right-wing, we do not imply that they refrain from redistributive policies completely or that the poor segments of the Turkish society do not benefit from economic growth. Crucially, however, their approach emphasizes mostly private compassion and informal networks as preferred mechanisms, and their understanding of redistribution resonates with the aim of ‘helping the poor’ only - not unlike many Christian Democratic parties in Europe. See Ziya Öniş, “The Triumph of Conservative Globalism: The Political Economy of the AKP Era,” Turkish Studies, 13 (June 2012): 135-52; Levitsky and Roberts.

64 Öniş, “The Triumph of Conservative Globalism.”

65 Yağcı.

66 Öniş, “Beyond the 2001 Financial Crisis.”


70 Atiyas.
Data from the Directorate General of SOEs, Undersecretariat of Turkish Treasury, www.hazine.gov.tr

Öniş, “Beyond the 2001 Financial Crisis.”


Ibid.


Öniş, “The Political Economy of Turkey’s Justice and Development Party”. The conservative American think-tank Heritage Foundation that ranked Argentina 158th among the 179 countries surveyed in 2012 in terms of ‘economic freedoms’ ranked Turkey as 73th, up from 110th place when AKP came to power in 2002.


Yıldırım, p. 251.


OECD, OECD Economic Surveys: Turkey (Paris: OECD, 2008); Bakır.


Ibid.

Bakır and Öniş; Öniş, “The Triumph of Conservative Globalism”.

86 Ibid.


88 Öniş, “Beyond the 2001 Financial Crisis”.


92 Krueger.

93 Öniş and Şenses.

94 Izmen and Yilmaz.

95 Ibid.

96 OECD.


Richardson.


Kaufman.


Etchemendy and Collier.

Ibid. , p. 367.

Ibid.

Ibid.

La Nación, “Nunca Vi Tantos Ataques a Un Gobierno.”

Quoted in Bakir and Onis, p. 87.

Öniş, “Varieties and Crises of Neoliberal Globalisation.”


Remmer.

Grugel and Riggirozzi.

The Economist, “Argentina: The President and the Potbangers.”


The Argentine Success Story
and its Implications

Mark Weisbrot, Rebecca Ray,
Juan A. Montecino, and Sara Kozameh

October 2011

Center for Economic and Policy Research
1611 Connecticut Avenue, NW, Suite 400
Washington, D.C. 20009
202-293-5380
www.cepr.net
Contents

Executive Summary .......................................................................................................................... 1
Introduction ........................................................................................................................................ 3
Recession, Default and Recovery ....................................................................................................... 3
Exports and Contributions to Growth ............................................................................................... 5
Social Indicators ............................................................................................................................... 8
  Poverty ............................................................................................................................................. 8
  Income Inequality ........................................................................................................................... 8
  Labor Market .................................................................................................................................. 9
Social Spending and Conditional Cash Transfer Programs ............................................................. 10
Health ............................................................................................................................................... 11
Inflation and the Real Exchange Rate .............................................................................................. 13
Policy Implications of Argentina’s Experience ............................................................................... 15
References ......................................................................................................................................... 17
Appendix ........................................................................................................................................... 19

Acknowledgements

The authors thank Roberto Frenkel for helpful comments and Daniel McCurdy and Dan Beeton for research and editorial assistance.

About the Authors

Mark Weisbrot is co-director, Rebecca Ray is a research associate, Juan Montecino and Sara Kozameh are research assistants at the Center for Economic and Policy Research, in Washington D.C.
Executive Summary

The Argentine economy has grown 94 percent for the years 2002-2011, using International Monetary Fund (IMF) projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period.

Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy’s downward spiral.

In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy then rebounded, and the IMF now projects growth of 8 percent for 2011.

Argentina’s real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

The country experienced this remarkable economic growth despite the default and difficulties borrowing from international financial markets over the past nine years, and relatively little Foreign Direct Investment (FDI). This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI should be the most important policy priorities for any developing country government.

Argentina’s rapid growth has often been dismissed as a “commodity boom” driven by high prices for its agricultural exports such as soybeans, but the data show that this is not true.

Poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen.

Income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich.

Unemployment has fallen by over half from its peak, to 8.0 percent. And employment, by early 2010, had risen to 55.7 percent, the highest on record.

Social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. In 2009, the government expanded the reach of its social programs, launching the “Universal Allocation per
Child” (Asignación Universal por Hijo) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s Bolsa Familia and Mexico’s Progresa-Oportunidades programs, which have won widespread international praise, but is significantly larger relative to GDP.

There were also significant reductions in infant and child mortality over the last nine years, somewhat more than in similarly situated countries.

Inflation has risen sharply since 2007, peaking most recently at 27 percent at the beginning of 2011 – according to non-official sources -- before beginning to decline somewhat again. This is a problem for the economy, but it is real income growth, employment, and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. The peso has appreciated about 20 percent in real terms since 2007.

It is remarkable that Argentina has achieved its success in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from “vulture funds” and their associated lobby groups, announced that it would oppose multilateral loans to Argentina.

Argentina’s success has important implications for Europe, including the weaker eurozone economies.

Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other weaker eurozone economies is similarly bleak. The attempt to adjust through “internal devaluation” in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession.

From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country’s debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina’s experience also calls into question the popular myth that recessions caused by financial crises must involve a slow and painful recovery. Argentina’s financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the
default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. The Argentine government has shown that Europe’s bleak current situation and projected scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.

**Introduction**

It is striking that Argentina’s economic growth over the last nine years has been given so little positive attention. China’s success as the fastest-growing economy in world history has been widely recognized, even if the Chinese government is often criticized in the Western press for its trade and currency policies. India’s rapid growth since 2003 (averaging 8.9 percent annually from 2003-2008) has also attracted much praise. But Argentina has not generally been seen as successful. Much of the press reporting has been negative, focusing on the high inflation of recent years.

But it is real income that matters in terms of living standards, and the Argentine economy has grown 94 percent for the years 2002-2011, using IMF projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period. It should therefore be of interest to policy-makers and economists.

As will be seen below, the Argentine story also has implications for macroeconomic policy in other countries, and particularly for countries such as Greece, and perhaps some of the other, weaker eurozone economies that are currently pursuing pro-cyclical policies in an attempt to reduce high and in some cases unsustainable debt burdens. Perhaps even more importantly, it has significant implications for a currently widely held view\(^1\) that recovery from recessions caused by financial crises must necessarily take much longer than recovery from other types of recessions.

Argentina’s deep recession from 1998-2002 was one of the very worst, in terms of lost output, of the past hundred years; and it was clearly caused by a financial crisis that culminated in a systemic financial collapse. Yet the recovery was very rapid.

This paper presents a brief overview of Argentina’s recent economic performance.

**Recession, Default and Recovery**

Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy’s downward spiral.

---

1 This view has been promoted most successfully by Reinhart and Rogoff (2009) and is widely accepted in the financial press.
In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy shrank by 0.9 percent in the fourth quarter of 2008, and by the same amount in the first quarter of 2009. But it rebounded quickly and grew by an annualized rate of 8.6 percent over the next 10 quarters (to the second quarter of 2011).\footnote{Non-government estimates of real GDP hold that the 2008-2009 recession was deeper, and the recovery slower, than what is suggested by official sources. See Frenkel (Forthcoming). However, the IMF notes that “the difference between private and official estimates of real GDP growth has narrowed in 2010.”} The IMF projects growth of 8 percent for 2011.

As can be seen from Figure 1, Argentina’s real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

FIGURE 1
Real GDP: Actual and 20-Year Trend (Seasonally-Adjusted)

Source: INDEC 2011a, IMF 2011b and Authors’ Calculations.
It is worth noting that this recovery and growth was achieved without help from international lending institutions. In fact, the opposite took place: in 2002, the first year of the recovery, the IFI's (international financial institutions) took a net 4 percent of GDP out of the Argentine economy. The IMF also pressured the Argentine government to pay more to the defaulted external creditors; recommended tighter fiscal policy in order to achieve the goal of paying more to creditors; and opposed a number of other policies that were helpful to economic recovery and/or were designed to alleviate the burden of the crisis on distressed sectors of the population.4

As a result of the default, and the refusal of a minority of creditors to accept the eventual restructuring agreement in 2005, and subsequent legal action by these creditors and “vulture funds,” Argentina has faced difficulties borrowing in international financial markets over the last nine years. Since it has not been able to settle its debt with the government creditors of the Paris Club, it has also been denied some export credits. FDI has remained limited, averaging about 1.7 percent of GDP over the past eight years, with a number of serious legal actions taken by investors against the government.

Yet in spite of all of these adverse external conditions that Argentina faced during the past nine years, the country experienced this remarkable economic growth. This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI, should be the most important policy priorities for any developing country government. While FDI can clearly play an important role in promoting growth through a variety of mechanisms, and foreign capital in general can, in some circumstances, boost growth by supplementing domestic savings, Argentina’s success suggests that these capital inflows are not necessarily as essential as is commonly believed. And it also suggests that macroeconomic policy may be more important that is generally recognized.

Exports and Contributions to Growth

As noted above, Argentina reached its pre-recession level of GDP after three years of growth; so the rapid growth that has continued since 2005 cannot be attributed to a simple rebound from recession. (Although the initial recovery was by no means easy or assured, as can be seen by the slow recovery of many countries today from the 2008-2009 financial crisis and recession, as well as the history of Argentina’s initial recovery.)5 Argentina’s rapid growth has often been dismissed as a “commodity boom” driven by high prices for its agricultural exports such as soybeans, but this is not true.

Table 1 shows the real contributions to GDP growth by expenditure. It can be seen that the role of exports is not very large during the expansion of 2002-2008. It peaks at 1.8 percentage points of GDP in 2005 and 2010, and amounts to a cumulative 7.6 percentage points, or about 12 percent of the growth during the expansion. The story for net exports is even worse, with net exports (exports minus imports) showing a negative cumulative contribution over the period. The recovery is driven

---

3 The annual data show a decline of 11 percent in Argentine GDP for 2002. However, this is measured by taking the average GDP for 2002 and dividing by the average for 2001; as noted above, the Argentine economy actually started growing in the second quarter of 2002.
4 For more detail in the IMF’s role during the recovery, see Weisbrot and Sandoval (2007).
5 See Weisbrot and Sandoval (2007) and Frenkel and Rapetti (2007) for more detail.
by consumption and investment (fixed capital formation), which account for 45.4 and 26.4 percentage points of growth, respectively.

### TABLE 1
Argentina: Real GDP Growth, Contributions from Expense Categories (Percentage Points)

<table>
<thead>
<tr>
<th>Year</th>
<th>Private Consumption</th>
<th>Government Consumption</th>
<th>Gross Fixed Capital Formation</th>
<th>Exports</th>
<th>Imports</th>
<th>Change in Inventories and Stat. Discrep.</th>
<th>Total GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2.4</td>
<td>0.4</td>
<td>1.3</td>
<td>1.1</td>
<td>-1.1</td>
<td>-0.3</td>
<td>3.9</td>
</tr>
<tr>
<td>1999</td>
<td>-1.4</td>
<td>0.3</td>
<td>-2.7</td>
<td>-0.1</td>
<td>1.5</td>
<td>-1.1</td>
<td>-3.4</td>
</tr>
<tr>
<td>2000</td>
<td>-0.5</td>
<td>0.1</td>
<td>-1.3</td>
<td>0.3</td>
<td>0.0</td>
<td>0.6</td>
<td>-0.8</td>
</tr>
<tr>
<td>2001</td>
<td>-4.0</td>
<td>-0.3</td>
<td>-2.8</td>
<td>0.3</td>
<td>1.7</td>
<td>0.6</td>
<td>-4.4</td>
</tr>
<tr>
<td>2002</td>
<td>-9.9</td>
<td>-0.7</td>
<td>-5.8</td>
<td>0.4</td>
<td>5.6</td>
<td>-0.6</td>
<td>-10.9</td>
</tr>
<tr>
<td>2003</td>
<td>5.4</td>
<td>0.2</td>
<td>4.3</td>
<td>0.8</td>
<td>-2.4</td>
<td>0.5</td>
<td>8.8</td>
</tr>
<tr>
<td>2004</td>
<td>6.2</td>
<td>0.4</td>
<td>4.9</td>
<td>1.1</td>
<td>-3.2</td>
<td>-0.4</td>
<td>9.0</td>
</tr>
<tr>
<td>2005</td>
<td>5.9</td>
<td>0.8</td>
<td>4.0</td>
<td>1.8</td>
<td>-2.1</td>
<td>-1.3</td>
<td>9.2</td>
</tr>
<tr>
<td>2006</td>
<td>5.1</td>
<td>0.6</td>
<td>3.6</td>
<td>1.0</td>
<td>-1.7</td>
<td>-0.2</td>
<td>8.5</td>
</tr>
<tr>
<td>2007</td>
<td>5.9</td>
<td>0.9</td>
<td>2.9</td>
<td>1.3</td>
<td>-2.5</td>
<td>0.1</td>
<td>8.7</td>
</tr>
<tr>
<td>2008</td>
<td>4.3</td>
<td>0.8</td>
<td>2.1</td>
<td>0.2</td>
<td>-1.9</td>
<td>1.3</td>
<td>6.8</td>
</tr>
<tr>
<td>2009</td>
<td>0.3</td>
<td>0.9</td>
<td>-2.4</td>
<td>-0.9</td>
<td>2.7</td>
<td>0.2</td>
<td>0.9</td>
</tr>
<tr>
<td>2010</td>
<td>5.9</td>
<td>1.2</td>
<td>4.4</td>
<td>1.8</td>
<td>-3.9</td>
<td>-0.2</td>
<td>9.2</td>
</tr>
</tbody>
</table>


However, this measure of real (inflation-adjusted) contributions to growth does not measure the full impact of exports when there are significant price increases for exports. In this case, if the price increase is large enough and the affected exports are a big enough share of the economy, the increased income can contribute to growth and to living standards (through the consumption of imports that do not add directly to GDP) in other ways, that do not show up in the real contributions to GDP growth measured above.

To consider these other effects of the rising value of exports, Figures 2 and 3 show Argentina’s annual exports by value, and by category; this is shown both in current dollars and below, in percent of GDP.

As can be seen in the graphs, exports as a percent of GDP, as measured by dollar value, actually decreased during the recovery. And agricultural exports, as a percent of GDP, fell slightly from 5.0 percent of GDP to 4.7 percent, dipping as low as 3.4 percent in 2006 – again, this is measured by dollar value, so it reflects the large increases in commodity prices from 2005 to 2008. So agricultural exports are clearly not driving growth; and in fact they are too small a share of GDP to have anywhere near the kind of impact that is often attributed to them.6

---

6 This is true even if we include some of the manufactured goods (e.g. soybean oil), which are linked to commodity prices. These are also shown in Figure 2. These are flat over the expansion in terms of dollar value as a percent of GDP.
FIGURE 2
Argentina: Export Value by Category and Value, in US Dollars

FIGURE 3
Argentina: Export Value by Category and Value, in Percent of GDP

Note: Other manufacturing includes textile, wood and paper products.
Social Indicators

Poverty

As Figure 4 shows, poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen. In both cases, the rates have fallen to about their level in the early 1990s.\footnote{Figures 4 through 6 use the most recent data available, published through CEDLAS and the World Bank (2011).}

\textbf{FIGURE 4}

Argentina: Poverty and Extreme Poverty, Percent of Individuals

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure4.png}
\caption{Argentina: Poverty and Extreme Poverty, Percent of Individuals}
\end{figure}

Source: CEDLAS and the World Bank (2011) and authors’ calculations.

Income Inequality

As Figure 5 shows, income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich. As the tan bars show, since 2006 changes in the lower half of the income spectrum account for the majority of the improvement.
**FIGURE 5**
Argentina: Inequality, Income Ratio of 95th Percentile to 5th Percentile


**Labor Market**

Whereas poverty had one clear, dramatic peak in 2002, the labor market saw two distinct years of difficulty: 1996 and 2001. As Figure 6 shows, between 1992 and 1996, unemployment rose by over 150 percent, from 6.8 to 17.7 percent. It declined again to 12.5 percent in 1998, but within three years had risen to a record of 18.4 percent. Since then, it has fallen by over half, to 8.0 percent.

Employment showed a similar pattern, with the notable exception that its recent levels are even higher than its 1992 levels. Employment fell from 52 percent in 1992 to under half in 1997, briefly rose again to over 50 percent in 1998 and fell back to 46 percent in 2001. By early 2010, it had risen to 55.7 percent, the highest on record. This is not only because of women joining the labor force; men’s employment is also above its 1992 level, at 87.7 percent.
Social Spending and Conditional Cash Transfer Programs

The Argentine government presided over a huge increase in its social spending, as well as revenue, as a percent of GDP. Revenue increased from 15 percent of GDP in 2002 to 23.4 percent in 2009. Since the economy was growing rapidly through most of this time, this represents quite a large increase in revenue – it roughly tripled in real terms during this period. The vast bulk of this increase was not from the first few years of economic recovery but has occurred since 2005, after the economy had already reached its pre-recession level.

Spending on Social Security increased from 5.5 to 7.5 percent of GDP. The government also increased support to various sectors of the economy, from just 0.43 percent of GDP to 4.1 percent.

Like revenue, social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. It began as a response to the deep recession and its lagged effects in 2002 and 2003. One program provided a monthly stipend (150 pesos) to heads of households who were unemployed with children of up to 18 years-old (or disabled of any age), and to those where the head of the household was ill. At its height in 2003, the program reached 20 percent of all households, with 97.6 percent of its beneficiaries under the poverty line.
In 2009, the government expanded the reach of its social programs, launching the “Universal Allocation per Child” (Asignación Universal por Hijo) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s Bolsa Família and Mexico’s Progresa-Oportunidades programs, which have won widespread international praise, but is significantly larger relative to GDP. Spending on the Universal Allocation per Child program has reached 0.6 percent of GDP in 2011, as compared with 0.4 percent of GDP for Mexico and Brazil. It is too early to say how much these programs have reduced poverty, but when the effect is measured it is almost certain to be quite large.

Health

Argentina’s health indicators have improved, not only over the past 9 years but also over the past 20 years; but to evaluate the recent progress, we need to compare it to the performance of similarly situated countries. To do that, the figures below compare Argentina’s 1990-2010 progress to that of other upper-middle income countries, starting at the year they reached Argentina’s 1990 level. In other words, these figures answer the question: what is normal progress for a country like Argentina, starting from where it was in 1990? We look at child and infant health here, as adult health depends on changes over a much longer period of time than the focus of this analysis.

Figure 7 shows progress in infant mortality, which has fallen by approximately half in Argentina since 1990, from 26.9 to 13.8 deaths per 1,000 live births. However, for the first decade after 1990, Argentina’s progress was significantly slower than that of its peers. By 2000, infant mortality was 14 percent higher in Argentina than in its peer countries: 17.5 compared to 15.3 deaths per 1,000 live births. Beginning in 2001, Argentina began slowly closing this performance gap, and by 2010 it had essentially eliminated it, shrinking it to 0.6 deaths per 1000 live births, about the same as it was in 1990.

Argentina’s relative progress shows much the same story in child mortality. Though it has roughly halved its child mortality since 1990, for the first decade its progress was much slower than that of its peers (see Figure 8). By 2000, child mortality was 10 percent higher in Argentina than in its peer countries: 19.6 compared to 17.8 deaths per 1,000 children under age five. As with infant mortality, this performance gap slowly narrowed in the next 10 years, until Argentina actually surpassed its peer countries in 2010, continuing to make progress while its peer countries on average saw a slowdown in progress.

---

9 Using the IMF’s income groups.
10 In their first year of lowering infant mortality to 23.8 or lower, it is much more likely for rates to be slightly below 23.8 than to be exactly 23.8. Thus, the gap does not begin at zero.
FIGURE 7
Argentina: Infant Mortality, with Comparison to Similar Countries

Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their infant mortality rates dropped below 23.8. See Weisbrot and Ray (2011) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors’ calculations.

FIGURE 8
Argentina: Child Mortality, with Comparison to Similar Countries

Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their child mortality rates dropped below 26.9. See Weisbrot and Ray (2011) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors’ calculations.
Inflation and the Real Exchange Rate

Figure 9 shows inflation as measured by the CPI (Consumer Price Index) from INDEC (the National Institute of Statistics and Surveys), which is the main official government data; and the CPI-7, as measured by CENDA (an independent Argentine think tank). Many private economists believe that inflation is considerably higher than the CPI; private estimates are closer to the CENDA measure. The CPI-7 measures inflation by looking at the change in consumer prices in seven different provinces while the official CPI only measures prices in the Greater Buenos Aires area. We have included both estimates here.

Argentina's inflation is one of the main emphases of most press reporting on the economy. It is often noted that – according to the CPI-7 and private estimates – Argentina has had one of the highest inflation rates in the hemisphere in recent years. Inflation quickly retreated from the brief spike brought on by the devaluation in 2002; but there was another jump in 2007-2008 that brought inflation to 31 percent. It retreated considerably as the country slid toward recession in 2009, to 13.2 percent. It then peaked again at 27 percent at the beginning of 2011, before beginning to decline somewhat again.

FIGURE 9
Inflation: Official and Independent Measures

Sources: INDEC (2011) and CENDA (2011).
Note: As measured by the CPI from INDEC, and CPI-7 as measured by CENDA.
Inflation may be too high in Argentina, but it is real growth and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. This happens each year that Argentina has inflation higher than its trading partners, and the peso does not depreciate enough to make up for the difference between domestic and foreign inflation rates.

**Figure 10** shows Argentina’s Real Effective Exchange Rate. The peso fell sharply\(^1\) in response to the devaluation. Then there was a correction for “overshooting,” and the peso appreciated somewhat, remaining fairly steady until 2007. Then it appreciated significantly in real terms relative to its trading partners, by about 19.8 percent. If inflation continues at current levels, it will be difficult for the government to carry out its policy of targeting a stable and competitive real exchange rate, and that could hurt the economy by making exports and import-competing industries less competitive.

**FIGURE 10**
Argentina’s Real Effective Exchange Rate

---

11 Since it is the cost of the dollar (or foreign currency) in terms of pesos is being measured in the graph, the jump corresponds to a depreciation of the peso.
Policy Implications of Argentina’s Experience

Argentina’s economic policies have proven, over the last 9 years, to be very successful by a host of measures examined above. It is remarkable that this has been achieved in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from “vulture funds” and their associated lobby groups, announced that it would oppose multilateral loans to Argentina.

The success of Argentina’s macroeconomic policies, including the central bank’s targeting of a stable and competitive real exchange rate and its reluctance to sacrifice economic growth in order to hold inflation to a particular target, deserve more attention than they have gotten. But perhaps the most important implications of Argentina’s story over the past nine years are for Europe, including the weaker eurozone economies.

Figures A1 through A5 show (see the Appendix) the IMF’s latest projections for the weaker eurozone economies. Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other eurozone economies is similarly bleak, if not as terrible as that of Greece. None can foresee a return to trend-level GDP. The number of years to reach pre-crisis GDP ranges from five for Spain to at least nine years for Ireland and Italy. But these forecasts may turn out to be, as the projections of the last few years have been, overly-optimistic. Unemployment is currently 21 percent in Spain and shows no sign of dropping to normal levels in the near future.

The attempt to adjust through “internal devaluation” in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession. The biggest risk for Europe at present is that continued policy errors will push Italy down a similar road that Greece has followed. Greece’s debt-to-GDP ratio when it signed its first agreement with the IMF in May of last year was 115 percent of GDP; it is expected to hit 190 percent of GDP next year. As can be seen in Figure A3, the IMF has already lowered Italy’s growth projections significantly over the past six months, because of the 54 billion euro austerity measures that the government has adopted under pressure from the European authorities or “troika” (the European Commission, the European Central Bank, ECB, and the IMF). This raises the prospect of Italy following the path of Greece, where deficit reduction targets get increasingly more difficult because of falling revenues, to which the authorities respond with further fiscal consolidation, and so on in a downward spiral of falling income and a rising risk premium and therefore higher interest rates on the country’s sovereign bonds. The whole regional economy has been thrown into a state of crisis and uncertainty which will likely not be resolved until the European authorities can find a way to guarantee Italian and Spanish bonds, or they move away from the failed, pro-cyclical policies that they have implemented.

12 Including most notably the American Task Force on Argentina (http://atfa.org/). For more information on this topic, see Weisbrot (2009).
13 See Weisbrot and Montecino (2010).
From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country’s debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina’s experience calls into question the popular myth, as noted above, that recessions caused by financial crises must involve a slow and painful recovery. Argentina’s financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. It is these types of policies, along with the ultra-conservatism of central banks like the present ECB, that mostly account for the historical experience of delayed recoveries after financial crises. The Argentine government has shown that this bleak scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.
References


Appendix

FIGURE A1
Greece Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

FIGURE A2
Ireland Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)

Source: IMF and Authors’ Calculations.
FIGURE A3
Italy Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)

Source: IMF and Authors’ Calculations.

FIGURE A4
Portugal Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

Source: IMF and Authors’ Calculations.
FIGURE A5
Spain Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

Source: IMF and Authors' Calculations.