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The redemption of the Washington Consensus in Latin America

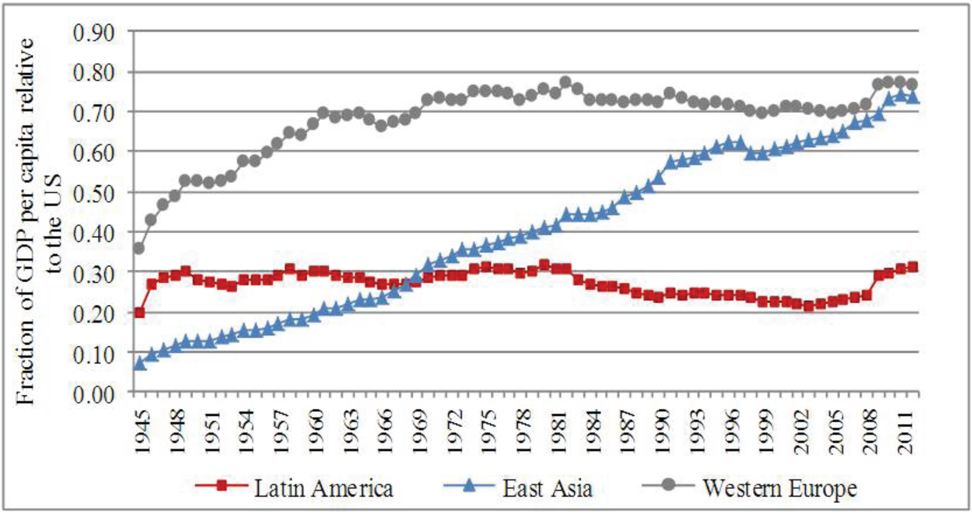
This article revisits the key developments of the experience of Latin American countries with structural economic reforms since the decade of the 1980s. It discusses the historical and policy dilemmas that these countries have faced upon the economic consequences of the policy prescriptions from the so-called 'Washington Consensus'. It is argued that despite the initial meager benefits from these policies, recent economic progress can be seen as redemption for the region.

1. Introduction

In the last twenty-five years, Latin American countries embarked on the most significant shift in economic policy since the end of the Second World War. Countries moved from a closed state-led economy to a more open, market-oriented development strategy. The core change in policy consisted in a series of 'market-friendly' reforms to liberalize trade, deregulate sectors, and privatize state-owned companies in order to achieve fiscal discipline, financial stability, and economic growth. The complete set of these policies is commonly known as the 'Washington Consensus' coined by economist John Williamson in 1989. After the mid-1980s, governments in the region embraced these reforms with the promise of transforming their economies bottom-up and pave the way to catch up with the developed world.

However, present-day Latin America is still way behind the United States and Western European countries, and unlike some countries in East Asia, instead of reducing the gap and catching up, the distance has remained mostly unchanged throughout the years. Figure 1 illustrates this point. In more than half a century, the average Western European and East Asian country have reduced the gap of GDP per capita that distances with the levels of the United States. The most impressive overtaking occurred from the 1970s onwards when East Asian economies after being poorer than its Latin American counterparts were able to catch up to similar levels of Western Europe, whereas the average Latin American country has never reached to more than one-third of the fraction of the United States' GDP per capita.

Figure 1. Gap of GDP per capita relative to the United States, 1945-2012
(Weighted averages by region in 1990 international GK dollars)



Source: Author's elaboration based on Maddison (2003), and The Conference Board (2013).
Note: Western Europe country group includes: Austria, Belgium, Denmark, Finland, France, Germany, Netherlands, Norway, Sweden, Switzerland and the United Kingdom. The East Asia group comprises: Japan, South Korea and Taiwan. Latin America includes: Argentina, Brazil, Colombia, Chile, Mexico, Peru, Uruguay and Venezuela.

Many specialists argue that this global divergence in the last century obeys to differences in industrial policies across countries and regions.[1] It is argued that the economic takeoff of current developed countries like Germany, Japan, and the United States predates the twentieth century having its origins in the late-nineteenth century supported by the establishment of national 'growth strategies'. Economic growth in these leading economies was ignited and nurtured with protectionist policies, strong state intervention, and then, after reaching a high level of income and industrial development, their policies switched into an innovation-based strategy allowing higher competition, trade openness and less state intervention. However, even if these ever become stylized facts in development, the paradox for many Latin American countries is that industrial policy has followed a similar direction, trying to emulate 'successful' policies from advanced economies but without yielding equivalent results.

Development economist Dani Rodrik claims that most of the meager results from the Washington Consensus come from the lack of adaptation on the implementation of the development policy packages to local conditions. He argues that the 'one fits-all' policy recipe will continue to disappoint unless each Latin American country adapts its policy into a strategy of 'self-discovery', identifying the binding constraints for growth, exploiting their own comparative advantages, and setting a local-based design of 'appropriate institutions'.[2] Conversely, other authors and policymakers disenchanted with the apparent little benefits from the 'Consensus' have suggested that Latin American countries should reject this paradigm and adopt a new consensus that embraces previous development strategies characterized for a more proactive role of the state in the promotion of industrial upgrading similar to the economic policies from the mid-twentieth century.[3]

This dilemma on whether to adapt or reject the ideas from the Washington Consensus has been a matter of recurrent discussion and debate among policymakers, scholars, and civil society since the beginning of the reforms. Indeed, overall economic performance during and soon after reform was insufficient considering the high expectations after years of stagnation. However, in the last decade economic growth has finally resumed across the region. In the last decade some countries, after adopting the paradigm from the 'Consensus', have already rejected some of its ideas and leaned towards a heterodox policy of redistribution, whereas other countries have continued reforming de-regulating their economies, and improving their institutions which has brought a noticeable improvement in terms of economic growth. Is this positive trend an indication that the Washington Consensus has finally redeemed in Latin America?

This article discusses these inquiries and revisits the historical and policy dilemmas in Latin American development since the decade of the 1980s until present. Being a highly heterogeneous continent in terms of policy experimentation, different initial conditions regarding their institutional and political arrangements have mattered in the implementation and performance of structural reform. Despite this, in the last years nearly all countries have experienced a great progress in terms of growth and redistribution but at a different pace; those who have continued and adapted the 'Consensus' have grown faster in average, but at the same time these have reduced income inequality at a slower pace compared to countries that have rejected it.

2. The past, the crisis, and the Washington Consensus

From the end of the Second World War to the late-1970s, nearly every single developing country followed a strategy based on import-substituting policies in order to catch up to the industrial core. Right after the Second World War (1945), import-substitution emerged in Latin America with the aim of developing internally a manufacturing sector, granting high levels of trade protection to domestic producers, and essentially closing their economies to global competition. Countries raised trade tariffs to increase the price of imported goods to favor local producers, promote infant industries and strengthen the selected ones by national governments as engines for growth and employment. Industrial policy during these years had the objective to substitute the production of consumption, intermediate, and capital goods from abroad with domestically produced goods in those categories.[4]

However, this protectionist strategy ran into several problems around the 1960s and government policies were unable to mend them due to the nature and structure of their economies. Some of such structural problems consisted on the fact that domestic markets were too small to produce minimum sufficient scales of production together with a tendency to over-diversify production rather than to specialize. But more importantly, there was insufficient competitive pressure to induce productivity growth.[5]

As a consequence, by the mid-1970s state-owned industries which represented a large share in the economy were highly inefficient. To maintain job creation and stimulate growth, most of the Latin American governments tried to palliate these structural problems by maintaining the levels of public investment with foreign loans. This external dependency proved costly.[6] As the international oil crisis exacerbated in the mid-seventies, international interest rates went through the roof. Latin American external debts, public deficits, and inflation rates sky-rocketed, causing subsequently a collapse on real wages throughout the region. Currency devaluation, hyperinflation, and zero GDP per capita growth were common denominators in the 1980s, a period also known as the 'the lost decade'. As governments defaulted on their debt obligations, a long and hard road of stabilization policies had begun.

Table 1. Timing of reforms and inflation in selected countries

	Stabilization	Structural Reform	Annualized inflation rate prior to stabilization (%)
Bolivia	1985	1985	23,455
Mexico	1987-88	1985-1988	159
Argentina	1991	1987-1991	1,344
Peru	1990	1990	12,368
Brazil	1994	1988-1990	2,103

Source: Dani Rodrik, "Understanding economic policy reform." *Journal of economic Literature*, 34.1 (1996): page 26.

Economic stabilization was accompanied with structural reforms (Table 1). Although Chile undertook previously market reforms in the mid-1970s, high rates of inflation and unemployment were common factors that kick-started structural changes across the region from the mid-1980 onwards. In 1986, a multilateral negotiation meeting held in Uruguay known as 'The Uruguay Round', the majority of Latin American governments agreed to the framework of the General Agreement on Tariffs and Trade (GATT), with the main purpose of liberalizing trade. Although a free-trade policy played a central role in shaping subsequent policy changes, structural reform encompassed many other areas which John Williamson enumerated a few years later.

The birth of the Washington Consensus and its controversies

The label of 'Washington Consensus' originally comes from a paper that economist John Williamson coined in a conference paper in 1989.[7] In that paper he listed ten reforms that he thought economists and policymakers in the United States and Latin America would agree on. As Williamson has asserted, he was later suggested by other economists to re-label that list as "The Universal Convergence", but apparently the original label had already spread among academics. According to him, the original list never intended to be a prescription for development policy. However, he agrees that upon his ten policies listed "were being already widely adopted in Latin America".[8]

Certainly, the policy agenda in Latin America at the end of the 1980s was influenced by the urge to change the existing development paradigm considering the painful economic adjustments experienced from the debt crisis and financial instability. Therefore, the immediate adoption of the ideas coming from Williamson's decalogue was a sensible reaction in Latin American policymakers in order to break free from the past and embrace a new paradigm for sustained development.

The ten policies originally encompassed a series of key concepts focused solely on economic reforms that allegedly lagging countries should follow in order to catch up to the developed world. Many of these were 'obvious' policies to implement with little to argue such as establishing fiscal discipline (reducing the deficit), the reorientation of public expenditure (towards education, health, and infrastructure development), and/or strengthening the laws for the security of property rights. However, among the original ten, trade liberalization, privatization, and de-regulation caused (and it is still causing) noise among its critics. Objections such as: who wins from trade liberalization? Or, is there a potential generation of monopolies after privatization? Therefore, the initial list was augmented with another ten points focused more on institutional reforms and the acknowledgment of a social dimension. Table 2 summarizes these points and amendments.

The 'augmented' format of the Washington Consensus comes from the recognition of the existence of 'market failures' and that there are other crucial areas within governance which Latin American countries needed to reinforce so the first ten points were bound to be effective (often called second-generation reforms). There have been controversies associated to the extent that the set of policies is an external imposition of 'market fundamentalism' coming primarily from international financial institutions and the United States.[9] Following this, also some argue that Williamson's ideas are an indication of the new imperialism on Latin America.[10] According to Williamson, his paper in 1989 had the intention of convincing the Washington establishment for debt relief on Latin American countries. But, most notably, it is now difficult to contend that most of the ten points plus the addendum were a mandatory guideline that Latin American governments had to follow after servicing and finishing repaying their external debts.

Table 2. The Washington Consensus

Original Washington Consensus	'Augmented' Washington Consensus The original list plus:
1. Fiscal discipline	11. Corporate governance
2. Reorientation of public expenditures	12. Anti-corruption
3. Tax reform	13. Flexible labor markets
5. Financial liberalization	14. WTO agreements
6. Unified and competitive exchange rates	15. Financial codes and standards
7. Trade liberalization	16. "Prudent" capital-account opening
8. Openness to foreign direct investments	17. Non-intermediate exchange rate regimes
9. Privatization	18. Independent central banks/inflation targeting
10. Deregulation	19. Social safety nets
	20. Targeted poverty reduction

Source: Dani Rodrik. "After neoliberalism, what." In *Alternatives to Neoliberalism Conference sponsored by the New Rules for Global Finance Coalition*, vol. 23, p. 24. 2002.

The policy ideas in the 'Consensus' were originally sketched in general terms, and did not go into the specifics of how to implement the actual policies. Many of the policy points were interpreted differently at the government level and some of them were never even considered. In fact, the strategy on how to implement policy changes has varied across countries due to different political and institutional configurations affecting the speed, deepening and effectiveness. For instance, although all countries conquered the problem of inflation after reform, areas such as the expenditure re-allocation and budget cuts were not automatic processes. Parliamentary budgetary processes have differed greatly in the region.[11] Different constraints on the deficit and voting rules are associated with differences in fiscal discipline and budget transparency. For example, parliamentary rules for balancing the budget are not the same in Chile and in Mexico. Whereas in Chile there is commitment by rule to maintain a fiscal surplus (structural) at one percent, in Mexico such rule does not exist.

Similarly, these differences exist in other important areas such as the flexibilization of labor markets, the privatization of state-owned companies, and the de-regulation of selected sectors.[12] Consequently, cross-country institutional differences within Latin America were (and still are) direct determinants of the performance in almost each of the points of Williamson's policy decalogue.

3. The outcomes from the Washington Consensus

The broad outcome

Different implementation strategies yielded different results. Some countries pursued a more 'radical' strategy for implementation, and others relied on a more 'gradualist' approach. For instance, the reform sequencing in Chile, Uruguay, and Costa Rica has been characterized for a more gradual approach regarding the liberalization of trade, finance (capital account liberalization), labor markets, and fiscal reform.

Chile as an earlier reformer has been one of best performers in terms of economic growth in Latin America in the last twenty-five years. Although Pinochet's trade reform was promoted unilaterally in the late-1970s, this was sequenced at different stages and at a gradual speed according to the political support to it.[13] The case of Uruguay it is also well-known among the region for its gradualist approach to structural reforms, which is closely related to the active participation of opposition groups in the parliament. Trade was liberalized quickly, but privatization and labor market flexibilization were slow. A systematic opposition to reforms in Uruguayan politics has been combined up to date with a gradual market-friendly reform.[14] Costa Rica has been exemplified as another country that has fared well during and after economic reform as a result of gradual reform. A history of democratic institutions and social cohesion has characterized the country that promoted a 'strategic' liberalization process across its economic sectors.[15]

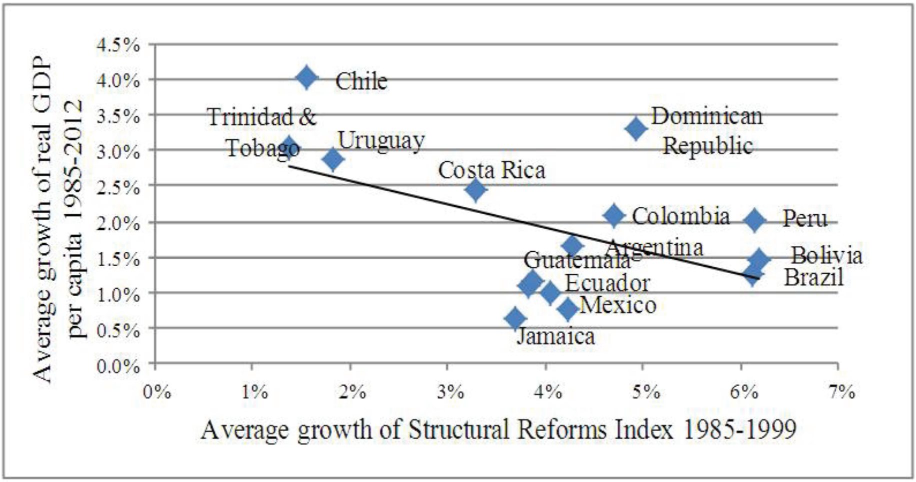
Conversely, the great majority of other Latin American countries such as Peru, Mexico, Argentina, Bolivia, and Brazil, followed a radical approach to reforms. Similar to a 'shock therapy' in Eastern Europe after the collapse of socialism, these countries embarked on a strategy of 'need for speed' on economic reform. According to prominent American economist Anne Krueger, a longer transition enables pressure groups to organize an opposition to reform.[16] Therefore, under that logic, policymakers in some of these countries considered that the faster the pace on the reforms was, the faster the economic adjustment and growth would be.

Countries like Bolivia in 1985 under hyperinflation and extreme unemployment had no choice but to accelerate the program reforms due to the immediate circumstances for stabilizing the economy. For Mexico and Argentina, the 1980s were also characterized by economic stagnation and structural adjustments. However, by the start of the 1990s with relatively stable macro-indicators, instead of applying a gradual approach to reform, policymakers accelerated deliberately the pace to reform.

To sketch broadly these developments, figure 2 shows the correlation between the pace of growth of structural reforms until 1999 and the rate of economic growth until 2012. The results are mixed, but display an important feature. Countries with a slower pace in reforming the economy after 1985 have grown faster, and vice versa. Many other factors that are not controlled in this inverse relation may have played a role, such as rise of the price in natural resource commodities in the high-growth Latin American countries, but what is clear is that the 'radical' reformers were outperformed by the 'gradualists'.

As it has been argued, the majority of Latin American championed the reforms promoted by the Washington Consensus after the 1980s and especially during the decade the 1990s; however the observed outcomes at the end of the decade were disheartening and puzzling. They were disheartening because of what was arguably too meager as payoff relative to the intensity of the reform efforts, and they were puzzling because of the lack of clarity on what went wrong.

Figure 2. Correlation between structural reforms and economic growth



Source: Author's elaboration based Lora (2001) and The Conference Board (2013)
Note: Structural reforms index is the cumulative change in five reform areas: trade policy, financial policy, tax policy, privatization, and labor legislation. See data appendix from Lora (2001). Eduardo Lora. "Structural Reforms in Latin America: What Has Been Reformed and How to Measure it." (2001).

Why Latin America has not caught up despite reform?

In order to reduce the income gap with a leading economy, the rate of growth of the 'catch up' economy should be higher than the leader at a certain period in time. However, as has been mentioned, during the 1980s the structural adjustment programs in Latin American countries generated a near to zero average growth in their real per capita income that lasted until a decade later when policies promoted by the Washington Consensus began. On the other hand, in the United States these developments contrasted with the IT (information technologies) revolution that raised labor productivity and income per capita growth during the same period, widening the existing gap with Latin America.

Given this growth divergence, an extensive literature emerged in the last few years on the explanation of what went wrong with the reforms in Latin America by not promoting the expected 'catch up growth' as intended. There are at least three different views about what went wrong.[17] The first one is the argument that claims that 'the reforms did not go far enough'. For instance, according to specialists like Harold Cole and associates, since the reform package did not go deeper in some countries, these should not expect to accomplish the results that the reforms intended in the first place. Slow economic growth is associated with slow growth in total factor productivity, which is a consequence of the competitive barriers that there are still in place despite reform and are preventing these countries to catch up.[18]

The second view is that 'the reforms went too far'. Anti-globalization critics argue that the results were meager because the reforms were only focused on economic growth and not on equity. Therefore, these countries should consider going back to the old development paradigm of state *dirigisme* and protectionism where equity played an important role in the economic success during the post-war era in many of these countries.[19] And lastly, the third view is that 'the reforms missed the point'. It is argued that the reforms did not remove the growth constraints that each particular country has.[20] Since there is no universal growth constraint, a unified policy package (like the Washington Consensus) cannot tackle the problem effectively. Each country has a different institutional configuration where many political interests are entrenched; therefore a single set of institutional reform will likely fail to succeed if local context is not considered.

These three views may not be mutually exclusive. Some economic policies can be context-dependent. Policies that once generated high-growth in an earlier development stage may fail to deliver subsequent growth. Therefore, maintaining a growth strategy with the same policies for too long and failing to switch them according to the local environment may have generated a Latin American non-convergence trap.

Considering that there is a time delay on the long run effects of the reforms, the first decade of the 2000s is a reasonable period to evaluate the different outcomes from the 'Consensus'. The disappointment from the limited progress in terms of growth in the last years in countries that pursed an aggressive strategy in reforming the economy has already being reflected in a revival of economic populism. In the last few years, countries like Venezuela, Bolivia, Argentina, and Ecuador have elected officials with an agenda that has reversed some of the reforms promoted by the Washington Consensus. Abandoning fiscal orthodoxy, erecting trade barriers, and nationalizing banks and mineral-extractive companies have been some of the measures that these countries have pursed in the last decade in their quest for income redistribution and sustained growth.

But if the current contention is on income distribution (or inequality), how have other countries fared in this regard? Table 3 displays two groups of Latin American countries according to their current political regime; 'left' and 'centrist'. The table shows that from the year 2000 onwards nearly all countries have succeeded in reducing income inequality (% change in the *gini* coefficient). An important highlight emerges from this fact: countries with a political regime leaned to the 'left' have reduced inequality faster than current 'centrist' regime countries. However, this development comes at the expense of per capita income growth. 'Centrist' regime countries have reduced in average income inequality at a less faster rate but their income per capita have grown faster than 'left' regime countries.

Table 3. Growth and income inequality in selected Latin American countries

	Annual % GDP per capita growth 1985-1999	Annual % GDP per capita growth 2000-2012	Annual % change in Gini 2000-2011
Current "Left" populist regime`s			
Argentina	1.50	1.95	-1.23
Bolivia	1.03	1.93	-0.64
Ecuador	-0.38	2.66	-1.47
Venezuela	-0.23	1.77	-1.21
Average	0.48	2.08	-1.14
Current "Centrist" democratic regimes			
Brazil	0.47	2.00	-1.07
Chile	4.61	3.12	-0.66
Colombia*	1.41	2.71	-0.60
Costa Rica	2.36	2.60	-0.05
Mexico	0.74	0.88	-1.16
Peru	0.03	4.25	-1.22
Uruguay	2.87	3.03	0.21
Average	1.78	2.66	-0.65

Source: Author's elaboration based on data from The Conference Board (2013) and SEDLAC (2013).
Note: Annual real GDP growth rates are expressed as annual compound averages in 1990 international GK dollars.
* Colombia's change in gini coefficient refers to the years 2001 to 2004.

Table 4. Institutional quality in Latin America, 1985 and 2010

	Size of Government		Property Rights		Sound Money		Freedom to trade internationally		Regulation		General index		Change in general index
	1985	*2010*	*1985*	*2010*	*1985*	*2010*	*1985*	*2010*	*1985*	*2010*	*1985*	*2010*	
Argentina	5.2	6.3	4.6	3.8	2.5	6.6	1.7	6.2	4.0	6.0	3.6	5.8	38%
Bolivia	6.9	6.3	1.7	3.6	0.0	8.7	5.3	7.1	-	6.0	3.5	6.4	45%
Brazil	5.1	6.6	5.7	5.2	0.0	8.0	0.9	7.1	4.3	5.1	3.2	6.4	50%
Chile	5.7	7.8	5.0	7.0	7.1	8.9	4.8	8.4	5.7	7.1	5.7	7.9	28%
Colombia	5.9	6.1	3.4	3.7	6.7	8.2	4.1	6.6	5.2	7.0	5.1	6.3	20%
Costa Rica	5.2	7.9	5.3	7.0	5.4	8.0	4.0	8.0	6.8	6.4	5.3	7.5	29%
Ecuador	5.1	5.6	5.3	3.3	6.9	6.4	2.2	6.8	3.9	6.3	4.7	5.7	18%
Jamaica	6.9	7.6	3.5	5.9	4.1	8.0	5.3	6.7	5.6	6.7	5.1	7.0	27%
Mexico	6.2	7.2	5.4	4.5	3.7	8.1	4.4	7.0	3.7	6.6	4.7	6.7	30%
Paraguay	7.8	8.3	4.0	2.7	7.5	8.6	3.1	6.9	-	6.4	5.6	6.6	15%
Peru	5.4	7.5	2.2	4.8	0.0	9.3	1.3	8.4	3.4	7.5	2.5	7.5	67%
Uruguay	7.0	6.3	5.4	6.0	3.7	9.0	8.3	8.0	6.4	6.8	6.2	7.2	15%
Venezuela	6.9	5.0	5.3	1.5	8.3	4.7	4.6	3.4	5.4	4.4	6.1	3.8	-60%

Source: Classification and data based on James Gwartney, Robert Lawson, and Joshua Hall. "Economic Freedom of the World 2012 Annual Report (Vancouver, British Columbia: Fraser Institute)." (2012).
Note: Score range in each institutional category goes from 0 to 10. For the category 'Size of Government', countries with low levels of government spending as a share of the total, with a smaller share in state-owned industry, and lower marginal tax rates earn the highest rating score.

It appears that the great progress both in terms of growth and inequality in the region has been also a matter of trade-off between these. The question now is how long countries can maintain this trade-off as equilibrium for subsequent development. However, this relationship was not instantaneous. An improvement of their economic institutions has been the key for these achievements. As empirical studies have shown, institutions have an effect on growth and equity in the long run.[21]

A vast historical amount of literature has documented how most of Latin American countries have struggled in changing and adopting appropriate institutions to promote growth and sustained development. Many specialists argue that low-quality institutions perpetuated for many years the bad practices inherited from their Spanish and Portuguese colonial systems where schemes to evade taxes and circumvent courts were a common feature.[22] Although many of these are still present, there has been a remarkable improvement in institutional quality since the start of the reforms. Table 4 depicts this positive change. With the exception of Venezuela, virtually all countries have glimpsed of a positive change in their economic institutions.

4. A postmodern Washington Consensus? Some policy challenges

Many scholars consider that Latin America is currently in a post-Washington Consensus era and should consider adopting the type of policies that China has been pursuing in the last decades in order to accelerate growth.[23] However, despite the bad reputation that the label 'Washington Consensus' had for many Latin American citizens due to the unsatisfying results shortly after reform, the reality is that many of these reforms have not been reversed and are finally yielding positive dividends for Latin America.

Unquestionably an effective social policy through cash transfers targeted to poor families has been part of this relative success in declining inequality, but at the same time these social programs would have not been possible without the improvement of institutional quality and sound economic fundamentals that the policies inspired by the Washington Consensus initially promoted. Also, this positive market environment generated by the reforms has shielded the region against external shocks like the current global financial crisis, a common vulnerability that was hardly avoided in the past. Although the gradualist approach to market reform followed by Chile and Uruguay resemble the current Chinese development strategy, embracing the Chinese paradigm based on state capitalism, authoritarism, and export led-growth could be a step backward to what Latin American countries have accomplished in the last two decades.

Some specialists call to Latin American countries to do better at addressing negative externalities and argue that they should consider increasing the role of the state in the economy by intervening and targeting manufacturing sectors as industrial engines for growth. However, the 2010s are not the 1950s. It is unlikely that the relative success of 'hard' industrial policies that characterized these countries after the Second World War can be replicated.

Firstly, sixty years ago, China was not a dominant global export competitor like today, and even though Latin American manufacturing wages are becoming competitive again due the recent rise in Chinese labor costs, a growth based on increasing the share of manufacturing in the economy is a type of development that Latin America should not bet on considering the structural change towards a service sector-based economy that the world is currently experiencing. And secondly, industrial production is now governed by 'global value chains'. Multinational companies locate their production activities in different countries around the world determined mainly by the cost of labor. This fragmentation of production has redefined international competition and the role of the government. Since global production by multinationals lacks of nationality and do not respond to specific national interests, governments have less policy instruments to directly influence and guide the specialization of the country. Instead, governments have had to compete with others in the provision of incentives (such as cutting corporate income taxes) to attract these production activities, especially the ones that undertake research & development within the country.

Therefore, it could be said that Latin Americans are now living in a post-modern Washington Consensus where the 'original' decalogue has set up the foundations for growth, but at the same time, this can be considered as a transition process to find a balance between growth and inequality, where there is no universal policy recipe to maintain a stable equilibrium between these. In other words, the Washington Consensus has been a necessary but not sufficient condition to achieve sustained growth. Rejecting it would be a step backward, but likewise, by not adding and experimenting with new policies that balance growth and inequality taking into consideration specific local conditions would be a greater obstacle for subsequent development. However, policy experimentation does not mean nihilism. There are common features in which the region needs to move forward and should be part of a continuously renewed policy consensus:

State capacity: Democracy is neither a necessary nor a sufficient condition for good governance. In spite of the progress in the quality of state bureaucracies, governments in the region lack effectiveness in mobilizing resources for judicial procurement. State capacity is a not only a matter of law enforcement and the ability to collect and spend efficiently public resources. Political scientist Francis Fukuyama claims that a government may take advantage of the benefits of an 'embedded autonomy' or the capacity to carry effective reforms without too much red tape.[24] But in many Latin American countries the problem has not been the lack of bureaucratic autonomy or policy discretion; on the contrary, it has been the excess of it.

Participatory budgeting: The social contract in public decision-making is evolving around the world. City budgets in the United Kingdom and the United States are now being decided by ordinary citizens in order to get an effective and direct allocation of local taxpayer resources. Successful cases in Latin America are found in some Brazilian cities; however, the change is not widespread across the region. The implementation of the participatory budgeting scheme in Latin American cities has been slow because of the reluctance of municipality officials to give in power and voice to citizens to participate in deciding the allocation of city budgets, which is precisely an outcome of low institutional quality such as poor accountability that still remains in the region. A refurbished 'Consensus' should acknowledge the need to consolidate a direct citizen's participatory decision-making in public finance.

Education, education, and education: There is nothing new about this challenge. It is a well-known historical fact that Latin American countries have lagged behind the rest of the world in education at almost all levels (from primary to tertiary).[25] But the issue is not only on the allocated share of their national budgets to public education, science, and technology. The real challenge relies on the institutional reforms to basic and higher education systems that are affecting the overall quality and performance of human capital formation. If Latin American countries intend to sustain growth and support social mobility and inclusion in the long run they have to modernize basic educations programs and promote labor market competition in their higher education systems which many of them are still controlled by powerful teacher's trade unions that often refuse to allow transparent evaluations on teachers' performance.

National innovation systems: Instead of picking winners or national industrial champions, governments should promote an appropriate environment for innovation. Tax incentives for R&D (Research and Development), venture capital programs, and local technological startups are incipient. Although some countries in the Southern hemisphere like Brazil and Uruguay have already started with this strategy in accumulating technological capabilities, it is still insufficient compared to other countries outside the region. Certainly the lack of R&D in the region is in part an outcome of the existent low human capital stock and an over-specialization on natural resource-based industries, but if governments commit to enforce intellectual property rights and invest and incentive the emergence of technology clusters, Latin America could make great progress overcoming its innovation shortages.

Yet again, economic reform is a continuous process, and as the new reform agenda broadens, learning from their own economic histories is key to resist temptation from a populist backlash. During the so-called 'first globalisation' in the late-nineteenth century, most of Latin American countries profited from the rise of international trade which relatively increased their living standards. Currently, the challenge is if leaders can find a way to harness again the forces of the 'second globalisation' for the benefit of the region.

Notes

1. See for instance, R. Wade, *Governing the market: Economic theory and the role of government in East Asian industrialization.* (Princeton, 1990); H.J. Chang, Kicking away the ladder (London: Anthem Press, 2002); D. Rodrik, *One economics, many recipes: globalization, institutions, and economic growth* (Princeton, 2008).
2. Dani Rodrik, "Growth strategies." *Handbook of economic growth*, 1 (2005): 967-1014.
3. M. Cimoli, G. Dosi, and J.E. Stiglitz. *Industrial policy and development: The political economy of capabilities accumulation* (Oxford, 2009).
4. Albert Hirschman, "The political economy of import-substituting industrialization in Latin America." *The Quarterly Journal of Economics* 82, no. 1 (1968): 1-32.; Werner Baer. "Import Substitution and Industrialization in Latin America: Experiences and Interpretations." *Latin American Research Review* 7, no. 1 (1972): 95-122.
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