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Editor's Remarks

America isn't so much a tradition to continue as a future to realize.

— Octavio Paz

AFTER YEARS of exceptional macroeconomic performance and notable improvements in poverty reduction, education and health standards, and regional integration, Latin America faces the challenge of adapting to a new period of decelerated growth and a changing global environment. The region is expected to grow at 2.9 percent in 2014, a modest improvement from 2013, but lackluster compared to the average growth rate of the previous decade. As advanced economies continue to scale back their fiscal and monetary stimulus programs, and emerging countries such as China experience an economic slowdown, Latin America's resilience to external factors will be tested again. At the same time, commodity prices are likely to continue falling, exerting additional pressure on national budgets.

As the global environment becomes less favorable, the region should look inward for homegrown solutions to its shared social and economic problems. In the third volume of the Latin America Policy Journal, we bring together the experiences and opinions of former presidents, scholars, policy makers, and students to address issues related to poverty, corruption, insecurity, and development. We offer a holistic view of the region, focusing on strategies to promote economic and social progress amid changing circumstances.

By presenting a range of experiences and proposals along two broad topics, economic development and political institutions, we strive to contribute to a new conversation on regional development. With presidential elections in Bolivia, Brazil, Colombia, Costa Rica, El Salvador, Panama, and Uruguay, as well as the potential for greater social unrest across the region, national leaders will have to tread carefully to maintain stability in a period of slower growth. From efforts to promote research and development and foreign direct investment, to strategies to fight corruption and harness global value chains, Latin American countries can learn from each other as they craft new strategies for growth.

Cities should play a leading role in this new development agenda, given that they have more flexibility to engage in innovative policy design to tackle issues like poverty, insecurity, and climate change. Two former presidents, Oscar Arias of Costa Rica and Leonel Fernández of the Dominican Republic, remind us in this edition that our strategy toward economic progress and social justice must be

based on solid democratic principles and a commitment to peace. Lastly, we highlight the fact that economic and democratic progress has not occurred uniformly across the region.

We would like to dedicate our third volume to Mariana Filgueira Risso, cofounder and former editor-in-chief of the Latin America Policy Journal, who passed away tragically in Buenos Aires in December 2013. Mariana was a woman of incredible talent and passion, a vibrant leader and beloved friend, who inspired all of us with her contagious energy, unconditional love for others, and unyielding commitment to public service. As we strive to make Latin America the more prosperous and just society that Mariana dreamed of, her memory will continue to motivate and guide us.

Alexandra De Filippo
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The Need for a Peaceful Revolution

Lessons Latin America Can Learn from the Central America Peace Process Twenty-Five Years On

BY OSCAR ARIAS SÁNCHEZ

IN ONE OF HIS key addresses on Latin America, U.S. President John F. Kennedy famously said that “those who make peaceful revolution impossible will make violent revolution inevitable.” As a corollary, peaceful revolution, which is never inevitable, can only be achieved by those who make violence impossible—those who exclude it as an option through the sheer power of their belief and the force of their will. To be a part of such an achievement is a rare and delicate privilege. To have had the opportunity to change the world through the power of negotiation and compromise is to have glimpsed a better path for humanity, an oasis of reason amidst a dreary desert of brutality. Just as veterans of war might feel a duty to teach others how to avoid their own suffering, veterans of a peaceful revolution are obliged to do all they can to look for ways that their extraordinary experience might serve to turn the tide of violence for others.

I count myself among that privileged

group. In 1987, Central America and its five presidents achieved a peaceful revolution. By gathering around the negotiating table and setting pen to paper, by ignoring the well-trodden escape route of war and striking out instead on a new path of compromise and agreement, and by trusting in the institutions of democracy rather than the institutions of violence, we changed the face of our region forever. In 2012, we celebrated the twenty-fifth anniversary of the signing of the Central American Peace Accords. We celebrated this milestone with the pomp and circumstance it deserved, but also with the introspection it demanded. Those of us who participated in the process are called to transmit, as best we can, the lessons of our peace to the next generation and to figure out for ourselves what those lessons might be. The past can help us confront the present, despite the dramatic differences between the two eras.

When we made our peace in 1987, the world’s superpowers were fighting a war in

***Peaceful revolution,
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impossible.***

which they supplied the weapons and Central America supplied the dead. The United States and the Soviet Union saw their interests threatened by an independent agreement among Central American leaders, and we faced tremendous opposition from those who wanted military outcomes in our region, no matter the human cost. Even Costa Rica, a country that had abolished its army in 1948, found its borders breached and sovereignty ignored by a U.S. administration that was using our territory for military training—seeking, as it were, to beat our plowshares into swords.

It was a tremendous shock to Washington, DC, and the White House when Central America refused to capitulate to outside instructions and instead found its own solution. Against all odds, on 7 August 1987, I joined the other presidents of the region in signing the document I had presented to the group. The accords contained ten priority actions, including the condition of suspending all military action while beginning dialogue. It was a historic achievement that allowed our region to wake up from a nightmare of violence, put an end to the domestic conflicts and civil wars that had plagued us throughout the 1980s, and enter into a new era of peace.

What are the fruits of our labor a quarter century on? While we should not be too satisfied with our achievements as a region, there is certainly progress to report. The fact that young Central Americans today learn about war only in history class is progress for us. Youth today no longer rec-

ognize the trembling of the earth as a tank passes by, nor are they familiar with the smell of gunpowder. That, too, is progress. Indeed, the impact of the Peace Accords is best measured today in terms of what does not exist: the soldiers who no longer die, the families that no longer flee.

But we have achieved more than just that. Central America has returned its soldiers to civic life on a scale not accomplished by any other region in the world. Our region's economies have grown considerably since the wars ended, and our quality of life is much improved. We have advanced in social terms as well; the probability that a Central American child will die before the age of five has been reduced almost by half, and adults today live much longer than they did during the age of conflict.

At the same time, however, Central Americans today suffer in new ways. While young guerrillas no longer die, members of young gangs do. While mothers no longer cry because their children are at war, they do cry because their children have dropped out of school. While Central Americans no longer emigrate because of violence, they do emigrate because of a lack of opportunities. For a host of reasons, Central America has failed to take advantage of the real opportunities we have had to move our region out of the past and into the developed world. I believe that the legacy of our Peace

***We need to stop
playing victim and
blaming others for all
our problems.***

Accords offers at least four lessons that could be applied today to make Central America and all of Latin America a more prosperous, peaceful, and inclusive region.

The first lesson of our peaceful revolution is that we need to stop playing victim

and blaming others for all our problems. In the 1980s, the countries in my region faced real interference from the United States, but our greatest success came when we put that aside, ignored the many excuses for failure, and found our own way out of the conundrum before us. If we managed that in that difficult context, it is all the more absurd that today so many Latin American countries continue to use the United States as an excuse for inaction. It is all the more absurd that many leaders continue to complain about the Spanish empire that made off with our riches, an American empire that continues to bleed us dry, and laws of globalization that were deliberately designed to keep our region in the shadows. Some Latin American leaders blame our underdevelopment on anyone but Latin America itself.

texts and justifications instead of delivering results. The failure to take responsibility is an epidemic that has afflicted leaders not only in Latin America, but also around the world. The price we pay for our reluctance to look in the mirror is a population that is increasingly tired of empty words and meaningless promises.

These leaders need a wake-up call—a mighty shout to bring to their feet countries accustomed to living on their knees. If we choose to take responsibility for our failures, then we can finally understand that we ourselves are capable of rewriting our history.

The second lesson of our peaceful revolution is to respect democracy, which has been dangerously eroded in recent years. As I have said many times, the ceasefire we achieved in Central America was only

If we choose to take responsibility for our failures, then we can finally understand that we ourselves are capable of rewriting our history.

But consider this: when Harvard University opened its doors in Cambridge in 1636, there were well-established and nearly centennial universities in the Dominican Republic, Peru, Mexico, Bolivia, Colombia, Ecuador, Chile, and Argentina. We won our independence one hundred or one hundred and fifty years before countries such as South Korea and Singapore, which, despite their colonial past and lack of significant natural resources, today exceed—several times over—our per capita income. Our region has faced terrible troubles and injustices, but pointing the finger of blame at others is no longer justified. And even more surely, it is no longer useful.

Time has run out on the many generals and comandantes dedicated to waging war against the phantoms of their own minds and imaginary foreign threats, as well as on the governments that invent pre-

the overture of the Peace Accords. The leit motiv was the democratization of the region. Those of us who signed the document agreed that no attempt at peace would ever succeed if we failed to ensure respect for human rights and the rule of law, if we failed to create strong and independent democratic institutions to guarantee social stability, or if we failed to equip our nations with the distinctive features of any democracy. We knew that the success of the Peace Accords depended on Central America's ability to give its citizens a prosperous, democratic life.

Fast-forward to the present. I do not think I need to mention any names for us to understand that in today's Latin America there are leaders who have made use of democratic structures to subvert the very basis of democracy. Upon election by the people, these leaders interpret their

mandate as a *carte blanche*. They use their power not to promote the human development of their peoples, but to persecute their opponents, shackle the media, and seek reforms that allow them to stay in power forever. We must never confuse the democratic origin of a regime with the democratic function of the State. A government born of democracy loses its right to use that word when it resorts to dictatorial vices. That is precisely what has happened all too often in Latin America. And as long as the region fails to reach the threshold of development, the phantom of authoritarianism will rise again and again.

Across the region, we can benefit from assuming the kind of commitment to democracy that united those of us who signed the Peace Accords. We must make it our priority to convince the citizens of Latin America that democracy works. It is urgent that we reform the workings of our States so they are better able to execute public policy. Improving the public response to citizen demands, and increasing our fiscal

longer cherish such a hope. It is unrealistic in today's Latin America, which, despite an almost total lack of credible threats, continues to lavish upon its armies the money it should lavish upon its children. Just look at the recent example provided by Brazil. With citizens already up in arms over the government's choice to spend an estimated \$3.5 billion on stadiums and infrastructure for the 2014 World Cup, rather than schools and other urgent priorities, Brazil recently approved a \$4.5 billion purchase of Swedish fighter jets. In a word, this is madness. Foolish choices like this are made all over the world, every day, by rich and poor nations alike.

Real change in any sovereign nation's spending habits must come from within, but there is much that the international community could do to exert a positive influence in Latin America and throughout the developing world. During my second presidency, I formulated a proposal I called the Costa Rican Consensus. It is a simple idea that I believe has the power to

As long as the region fails to reach the threshold of development, the phantom of authoritarianism will rise again and again.

resources by taxing the richest among us, is essential if we are to move toward a true culture of liberty.

But increasing public income is not enough. We must also spend those funds with conscience, which brings me to the third lesson of our Peace Accords that has not yet been fulfilled in Latin America—indeed, far from it. That is importance of investing in people before investing in armies.

In the first years after our peace agreement, I dreamed that Central America might become the world's first demilitarized region. But now I must admit I no

change the world. It calls on international financial institutions such as the World Bank to change their policies so that aid calculations take into account the spending habits of recipient nations, rewarding those countries that invest in education, health care, and conservation rather than their militaries. It is ridiculous for any world leader to talk of peace when the calculus of foreign aid creates a powerful incentive for developing nations to waste their budgets on weapons and war and punishes countries such as Costa Rica that invest in human development. This is an idea whose time has come. I hope that, in the years

ahead, a champion will emerge for the concept at the financial institutions that have the power to make it a reality.

The fourth and final lesson that I would like to mention, one with relevance for peace and conflict resolution not just in Latin America but around the world, is that the international community has an urgent responsibility to regulate the global arms trade. Arms suppliers from the developed world irresponsibly channeled weapons to Central America during the 1980s. For decades to come, those weapons were found in the hands of the gangs that roamed the countryside of Nicaragua, or in the hands of teenage boys on the streets of San Salvador and Tegucigalpa. Other weapons were shipped to Colombian guerrilla or paramilitary groups or drug cartels, ready to destroy yet more lives. Central America learned the hard way that a shipment of weapons into a developing country is like a virus in a crowded room. It cannot be contained; we do not know whom it will attack, and it can spread in ways we would never have imagined.

In 1997, I, along with other Nobel Peace Laureates, began an effort to establish a comprehensive Arms Trade Treaty that would prohibit the transfer of arms to States, groups, or individuals, if sufficient reason exists to believe that those arms will be used to violate human rights or international law. After more than fifteen years of hard work by people all over the world, the Arms Trade Treaty was finally approved at the United Nations last year. The United States has since signed the treaty, along with more than one hundred other countries. For the treaty to enter into force, fifty countries must choose to ratify it; nine have done so to date, and France, one of the world's largest traders of arms, has now chosen to join this group as well. We need all the support we can get for forty more countries to ratify the treaty, including the United States, whose support is a long shot but essential if the world is to learn, at long

last, this fourth lesson of Central America's triumph of peace.

I sat down to write thinking of the words of Kennedy, and I find myself returning to him now. When he launched his Alliance for Progress in 1961, he said something that I, and I suspect many others throughout Latin America, have never forgotten:

We propose to complete the revolution of the Americas, to build a hemisphere where all men can hope for a suitable standard of living and all can live out their lives in dignity and in freedom.

It is sometimes tempting, after a long career in public service, to feel that the moments of progress one has experienced were a few paltry steps forward among many steps back. It is sometimes tempting to believe that a peaceful revolution is the exception to the rule of violence. However, these are temptations we must resist. We must choose, with Kennedy, to believe in the destiny of the Americas to fulfill the lofty ideals that marked our independence. We must choose to believe that a moment of progress, such as the signing of the Central American Peace Accords, was not an exception, rather a prelude. And we must redouble our efforts to ensure that its lessons are not confined to the pages of history, but rather become a living legacy.



Oscar Arias was born in Heredia, Costa Rica, in 1940. He studied law and economics at the University of Costa Rica and received a doctoral degree in political science at the University of Essex, England. Arias was appointed Costa Rican Minister of Planning and Economic Policy, then won a seat in Congress in 1978 and was elected

Secretary-General of the National Liberation Party in 1981. In 1986, he was elected President of Costa Rica, assuming office at a time of great regional discord, with civil wars and unrest throughout Central America.

In 1987, Arias drafted a peace plan to end the regional crisis. His initiative culminated in the signing of the Esquipulas II Accords, or the Procedure to Establish a Firm and Lasting Peace in Central America, by five Central American presidents on 7 August 1987. He was awarded the Nobel Peace Prize later that year. In 1988, Arias used the monetary award from the Nobel Peace Prize to establish the Arias Foundation for Peace and Human Progress, which allowed him to continue his pursuit of global peace and human security after leaving office.

In 2006, he was elected to a second term as President, becoming the first Nobel Laureate in history to be elected to a nation's top office after winning that prize.

After leaving office in 2010, Arias has dedicated his time to the Arias Foundation and, in particular, the effort to implement a comprehensive Arms Trade Treaty to address the unchecked flow of arms across borders, especially into the developing world. The treaty, which began as a Code of Conduct on Arms Transfers drafted at a meeting that Arias held with fellow Nobel Peace Laureates in 1997, was approved by the United Nations last year.

Arias has received approximately sixty honorary doctorates from colleges and universities and numerous prizes, among them the Martin Luther King Jr. Peace Award, the Liberty Medal of Philadelphia, the Prince of Asturias Award, and the Albert Schweitzer Humanitarian Award.

Latin America

Transition to Democracy and Development Paradigms

BY LEONEL FERNÁNDEZ

Abstract

THE TRANSITION to democracy in Latin America was not a straightforward path, since it has coexisted with extreme poverty and inequality in the region. Even though democracy remains as the ideal political system, people's demands today are not only for protection of human rights, but also for better education and economic and social prosperity. China's request for commodities at the turn of the twenty-first century helped Latin America experience an economic bonanza, which translated into a reduction of unemployment, economic growth, and increased life satisfaction. However, many challenges persist, and innovation is key to guarantee sustainable economic development with inclusive societies.

Introduction

Since achieving their independence, the Latin American and Caribbean nations always aspired to install democracy

within their respective societies. With few exceptions, this was not possible during the twentieth century when most of the countries in the region were plagued by economic stagnation, social unrest, and political instability.

Various attempts were made during this period to move away from traditional authoritarian regimes to pluralistic, democratic, and inclusive societies.

From the end of World War II until the 1970s, the political pendulum swung on different occasions from dictatorial to democratic forms of government, even though it was not until the 1980s that a full transition took place in what Harvard professor of political science Samuel Huntington referred to as the "third wave of democratization."¹

At the beginning, people's reaction toward democracy was one of rejoicement. Freedom, political participation, and full recognition of human rights and human dignity were achieved. There was a wide-

spread sense of support, hope, and social change in the hemisphere. Organizations that had been involved in armed revolutionary struggles put down their arms and integrated themselves with the democratic process to participate through the electoral system as the only legitimate way of attaining power.

Nonetheless, this happened within a context of not only illegitimate military regimes but of deep economic and social crisis as well. Consequently, in its first stage, the transition to democracy in Latin America coincided with what has been labeled the “lost decade.”

In spite of its recognized achievements, the present and future of democracy in Latin America is not free of challenges. The region continues to be the most economically and socially unequal of the world. The current global economic crisis has begun to take a toll on these countries’ abilities to fulfill some of their populations’ needs, leading to disappointment with elected governments and massive social protests.

Different social sectors are claiming that their leaders must focus on increasing the quality of education and encouraging innovation in order to guarantee development and prosperity.² Such demands are rapidly increasing and are at the center of the many protests that occurred in 2013 in countries like Brazil, Colombia, Mexico, and Chile.

Transition to Democracy

In Latin America, the transition to democracy occurred very differently from other parts of the world. In other regions, this transition was preceded by a period of sustained economic growth and social development. For instance, in Asia, particularly in South Korea, economic and social development resulted in people’s claims for freedom and respect for human rights and dignity.

Democracy was therefore a byproduct of the economic and social develop-

ment that had occurred. In other words, sustained economic growth together with increasing levels of prosperity led to the need for a democratic transition.

However, in Latin America, the transition emerged from other causes. The military regimes’ disrespect for civil liberties and disregard for human rights, along with their inability to manage the economic crisis, helped to further destroy the political legitimacy of the dictatorships, leading the way to the installment of elected civilian governments.

Washington Consensus

In spite of the political feats of the 1980s, due to the inheritance of mismanaged economies, very little progress was achieved. The region’s high levels of external debt, low growth, and high unemployment and inflation rates were difficult for the new elected governments to tackle, resulting in a loss of appeal and support of democracy from different sectors of society.

All this came as a result of different factors, but most importantly, from the end of the post–World War II economic development model, characterized by import substitution reforms, industrialization, and state-centric system that had prevailed until the 1970s.

In reaction to the shortcomings of the previous economic and social paradigm, and in trying to overcome the lost decade, the Washington Consensus was introduced in 1989 and further implemented during the first half of the 1990s. It sought to promote macroeconomic stability, free trade, foreign investments, deregulation, privatization, and the reduction of hyperinflation, among others.³ Nevertheless, the Washington Consensus lacked a social policy and generated adverse effects on the well-being of the majority of the countries’ populations. Once again, the economies of the region failed to reach levels of sustained economic growth that would enable them to meet the challenges of reducing poverty,

Satisfaction with Democracy

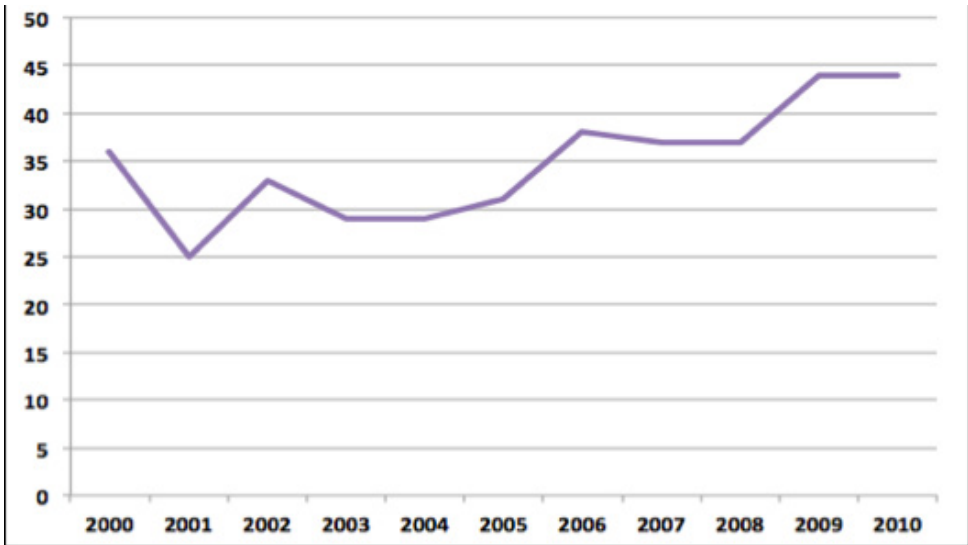


Figure 1 — Satisfaction with Democracy in Latin America, 2000-2010.

generating prosperity, and stimulating progress.

The democratic governments' inability to address issues of poverty, inequality, weak public institutions, corruption, criminality, and violence, as well as the inefficient provision of basic public services, contributed to the "loss of faith" in democracy. At the time, it seemed that the democratic honeymoon in Latin America had come to an end.

The Latin American Decade

At the beginning of the twenty-first century, Latin America began a process, never experienced before, of sustained economic growth, increased foreign direct investments, infrastructure development, poverty alleviation, and social prosperity. These successes, together with the important social policies that had been implemented in the region during the 2001-2010 period, are what Sir Martin Sorrell, CEO of WPP, referred to as the "Latin America decade" at the World Economic Forum 2011.⁴ These changes helped not only to improve the life of citizens, but also to

restore confidence and achieve major advances in the consolidation of democracy.

According to Latinobarómetro, a well-recognized polling firm, in 2001, only 25% of the region preferred democracy to any other form of government; and 41% expressed satisfaction with their lifestyle. While in 2010, 44% of those polled indicated their preference for democracy; whereas 71% showed comfort with their quality of life (see Figures 1 and 2).⁵

The same firm established that there is also a high appreciation in the region of what democracy has brought in terms of respect for human rights, free and fair elections, freedom of the press, independence of the judiciary, the rule of law, and government accountability.

This clearly indicates a shift in the public's perception toward democracy and social conditions, given the astonishing and positive changes that have materialized in the majority of nations in the region.

The Chinese Factor

The Latin American decade, which has been a period of economic bonanza,

Life Satisfaction in Latin America

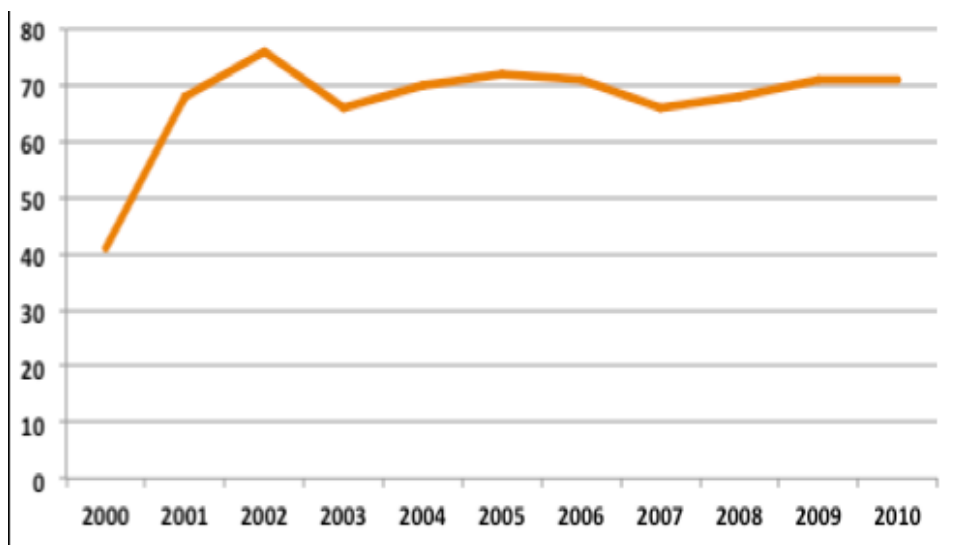


Figure 2 — Life Satisfaction in Latin America, 2000-2010.

can best be explained by the commodities export boom, in which China, the second largest economy in the world, has played a pivotal role by increasing its world and regional demand for raw materials.

This trend even continued during the unfolding of the global financial crisis in 2007-2008, and it has been only recently, as a result of China's relative economic slowdown, that the Latin American region has begun to feel the impact of a global economic downturn.

According to data from the World Bank, by 2004 China was growing in double digits, reaching an astonishing 14.2 percent in 2007. Even though it continued to grow after the beginning of the global financial crisis, the percentage decreased to approximately 8 percent, which eventually led to the drop of their raw materials demand.⁶

The 2010 report by the Economic Commission for Latin America and the Caribbean (ECLAC), *Latin America and the Caribbean in the World Economy*, established that after the economic contraction of 2009, Latin America managed to bounce

back in 2010 with an annual growth of 5.8 percent, while other developed countries and regions were still struggling, especially the United States and the European Union (see Figure 3).⁷

Hence, China's demand for primary products and its enormous economic growth has served as a locomotive for the changes experienced in the region, especially in countries like Argentina, Bolivia, Brazil, Chile, Colombia, Peru, Uruguay, and Venezuela, which are commodity producers. Consequently, these countries have seen improvements in their economies, transformation of their infrastructures, increases in their populations' income, a reduction of their jobless rates, mitigation of poverty levels, and the upgrading of general well-being (see Figure 4).⁸

Challenges to Democracy

It has become clear that, due to the economic and social changes that occurred in Latin America during the last decade, an enormous and unprecedented transformation within a democratic setting has been accomplished for the first time in two

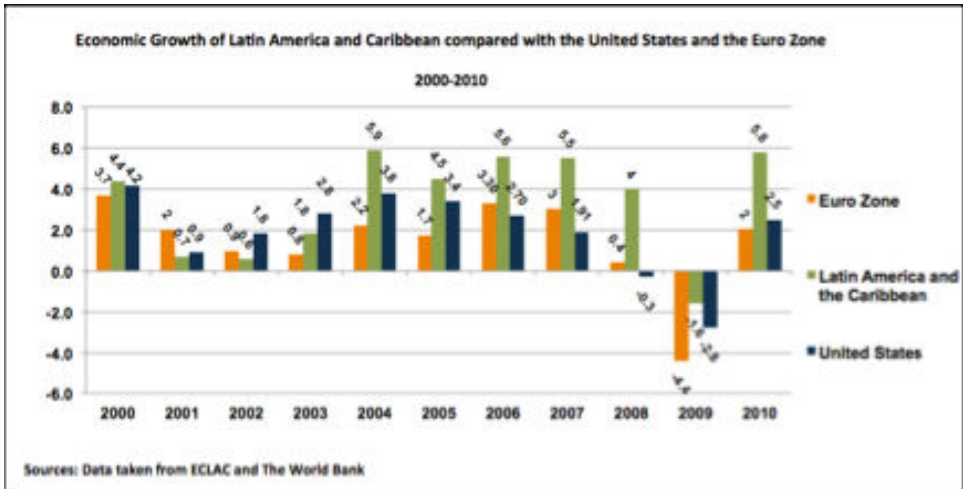


Figure 3 — Economic Growth of Latin America and the Caribbean, 2000-2010.

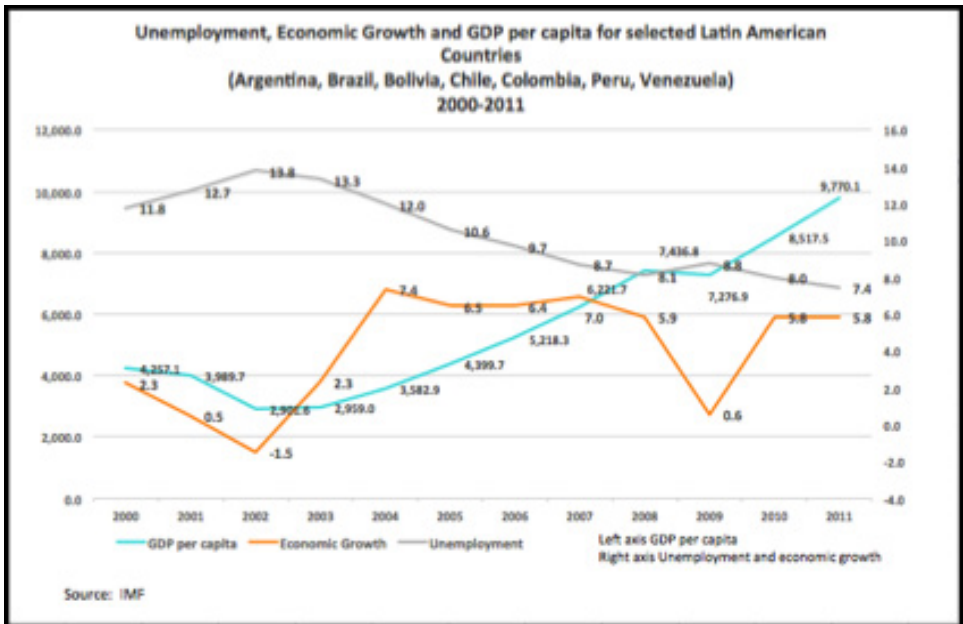


Figure 4 — Unemployment, Economic Growth, and GDP per Capita for Latin American Countries, 2000-2011.

hundred years, since the declaration of independence.

According to the 2012 Office of the Chief Economist for Latin America and the Caribbean Region of the World Bank report, despite the current global economic climate, Latin America managed to break

the trends and achieve a historical low on its unemployment rates, with an average of 6.5 percent, adding 35 million new jobs during the last decade.⁹

Although Latin America has made great strides in favor of democracy—such as the achievements of fundamental rights,

widespread election of civilian-based governments, and establishment of a free and independent press—many challenges remain.

Unlike in Europe and the United States, where democracy endures alongside great wealth, in Latin America it has historically coexisted with widespread poverty and inequality. According to ECLAC's 2013 report, nearly 164 million people (27.9 percent of the population) live in poverty, of which 68 million live in extreme poverty (11.5 percent of the population). Crime and corruption continue to proliferate, the informal economy still prevails, and social protests have risen.¹⁰

The Future of Democracy in Latin America

With the consolidation of democratically elected governments in the region, people's priorities shifted. The population now believes that in a democracy, not only will civil and political rights be protected, but a wider set of economic, social, and cultural rights should also be promoted.

Therefore, there seems to be a correlation between the level of support in favor of democracy as a political system and the accomplishment of major economic growth, social development, poverty reduction, and social mobility. This explains why in 2013, 56 percent of the population pointed to democracy as their ideal political system and 77 percent approved their quality of life.¹¹

What is at stake today in Latin America is not the fear of a possible rollback to military dictatorships, but rather, how to guarantee sustainable economic development, transparent and accountable democracies, a growing middle class, and more cohesive and inclusive societies.

The future of democracy in the region will depend upon our ability to overcome these challenges. In order to achieve that, the region needs a new set of policies that is able to balance the role of the State with that of the market and implement social

policies upheld by a deeper cooperation and stronger partnership for development.



Leonel Fernández was Head of State of the Dominican Republic for three terms (1996-2000, 2004-2012). In 1996, he became the youngest democratically elected president of the Dominican Republic and the first from the Dominican Liberation Party, over which he currently presides. His administration focused on the modernization of the State, institutional strengthening and transparency, public services, and economic and social development. Additionally, he is president of the Global Foundation for Democracy and Development (FUNGLODE).

From a young age, Fernández was attracted to progressive ideas, which led him to work with Professor Juan Bosch, a former president and distinguished Dominican scholar, who became his guide and mentor. He graduated with honors from law school at the Autonomous University of Santo Domingo in 1978, where he later became a faculty member. He also taught several generations at the Latin American Social Sciences Institute.

For his contributions to political science, he was honored with the title of Doctor Honoris Causa by several renowned universities, including La Sorbonne University, Universidad Nacional Pedro Henríquez Ureña, Seton Hall University, the State University of Santiago de Chile, Lehman College, Stevens Institute of Technology, Nova Southeastern University, the University of Massachusetts, the State University of Panama, Chinese Cultural University in Taiwan, and Hankuk University in South Korea.

In addition to his local responsibilities, Fernández is a member of various international institutions, such as the Montevideo

Circle, the Council of Freely Elected Heads of Government, Inter-American Dialogue, and the Club of Madrid. Since 2000, he has chaired the Executives Club USA-Caribbean, organized by the Center for Strategic and International Studies. Fernández is vice president of the Eminent Persons Group of ACP Countries and a founding member of the Advisory Board of the Center for Latin American Studies at Georgetown University.

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In Memoriam

Mariana Filgueira Risso Basombrio

BY EMILIA GONZÁLEZ

IN THE LATE eighteenth and early nineteenth centuries, a group of women fiercely fought for the liberation of Latin America; these women gave their lives with dignity and hope for a free and independent region. From Javiera Carrera to Policarpa Salavarrieta and Josefa Ortiz de Dominguez, women used their privileged social position to advocate for their countries' self-determination. Although they are rarely mentioned in the official history, their courage and bravery were fundamental during the struggle for independence.

Since then, the leadership of Latin American women has been exercised on new stages and has embraced new causes. Four countries in the region are currently led by women: Argentina, Brazil, Chile, and Costa Rica. The region has experienced a steady increase in female legislative representation, reaching an average 23.2 percent¹ in 2012, and female leaders play a growing role in civil society. Around two hundred years after the independence

struggle, we, Latin American women of the twenty-first century, have before us a new task: the challenge of building a more just and integrated region.

This shared mission requires leaders who are able to trust one another past their differences, develop a common understanding of the complexities of the region, learn from the shared experiences, and, above all, profess a genuine love for our land and its people. It is the human dimension of the region where large development and collaboration projects thrive, and it is in places like the John F. Kennedy School of Government at Harvard University that we have a unique opportunity to grow in knowledge and humility while sharing our dreams for a more just and prosperous Latin America.

In this editorial, we remember with love a woman who embodied all these attributes of these strong yet gentle women, as well as regional vision, passion, and generosity: our dear Mariana Filgueira

Risso Basombrio, former editor-in-chief of this journal, who passed away suddenly in December 2013. Mariana was born in Patagonia, Argentina, and took her vocation of service first to medicine, as a psychiatrist, and then to public policy, as chief of staff of the Ministry of Health of the City of Buenos Aires. While at the Harvard Kennedy School, Mariana was characterized by the strong personal ties she built with her peers, but particularly by the deep connections she helped cultivate among others. She led projects that favored the integration of different cultures, always putting the dreams of a better world at the center. Latin America and the reality of women in the region occupied a special place in her heart, and so she cofounded the League of Latin American Women at Harvard. During 2013, the League hosted guests as diverse as Valeria Mazza and Margarita Zavala de Calderón, showing how different yet how similar the efforts of women in the public sphere are across Latin America.

We want to honor Mariana's example, inviting all women in the region who dream of taking a leading role in the development of our countries to join Let's Connect, an initiative that seeks to develop women leaders in the region by fostering collaboration and support, both professional and personal. We need more women like Mariana in the public arena, women with passion and determination, willing to follow the path set by our ancestors, eager to become heroines of the twenty-first century, ready to tackle the modern challenges our region faces. Let's Connect!

Facebook page:

Let's Connect : A Tribute to Mariana
Filgueira Risso

Twitter: @letsconnect4mfr



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SIMILARLY TO OTHER emerging countries, Latin America has been growing at a considerably fast pace during the last years, partly as a consequence of the “commodity boom” and the high level of capital inflows to the region. In this context, poverty rates were reduced in almost every country, and, with a few exceptions, macroeconomic stability was maintained even during the world economic crisis of 2008-2009. Furthermore, although growth had not reached everyone at the same level, countries have been trying to improve their social policies by taking advantage of the enhanced fiscal positions.

In this context, some crucial questions arise: Does this progress mean that the region has structurally changed? Is Latin America now in a sustainable, balanced growth path, or have we just passed through the ascending curve of the cycle? Moreover, have we been able to translate growth into better and more efficient social policies? This section aims to shed some light onto these issues, analyzing regional trends and special cases.

David Bullón and Francisco Monge describe and analyze the case of Costa Rica and its public policy-led introduction into the global value chain of production. Through active industrialization policies, the country strongly increased foreign direct investment (FDI) for productive greenfields and successfully diversified its production. In another insightful article, Moisés Wasserman describes the situation of Colombia with regard to science and technology policies. The author shows how the country has lagged behind the region in terms of research and development and presents the new national policies designed to spur investment in science using resources derived from primary sectors, like mining. Michael Penfold also analyzes the idea of investing in innovative sectors; he explores whether the “new wave” of FDI into the region is focused on new ventures and linked to more dynamic industries, as opposed to the huge FDI inflows of the 1990s, which were primarily directed toward privatizations of utilities and other public companies. Santiago Levy makes a thorough and precise assessment of the social policies implemented in Latin America beginning in the early 2000s. The author shows how the current social protection programs in the region sometimes amount a subsidy to informal employment, which explains the high level of informality in the region. He proposes an integrated reform, especially focused on changing the method of financing social insurance, in order to avoid distortions in the labor market. Finally, Miguel Ángel Santos and Ricardo Villasmil present the case of Venezuela, arguing that the country has not matched the economic, social, and institutional progress experienced elsewhere in the region.

Nicolas Ajzenman
Content Editor

Is Social Policy in Latin America Heading in the Right Direction?

Beyond Conditional Cash Transfer Programs

BY SANTIAGO LEVY

Abstract

CONDITIONAL CASH transfer (CCT) programs in Latin America have been effective in reducing current poverty and improving human capital indicators, but they are far from a complete strategy to eliminate poverty. The segmentation of the Region's social insurance system as a result of the formal-informal dichotomy is a major obstacle for poor workers to find more productive jobs. The recent expansion of social insurance programs for informal workers is enhancing distortions in the labor market that already taxed formality and reduced productivity. Trapping poor workers in low-productivity informal jobs will limit the returns to the investments in education effected by CCTs, and increasing transfers through these programs to raise workers' incomes may not serve the long-term interests of the poor. The core objective needs to be creating more productive jobs, and this requires a revision of the architecture of social insurance programs

in the direction of universal provision with unified sources of finance.

Introduction

Over the last decade and a half, countries in Latin America (henceforth, LA or the Region) have by and large crafted societal consensuses in favor of macroeconomic stability and have invested heavily in policies and institutions necessary for that stability. Seen from the prism of previous decades, this is a major achievement.

Over roughly the same period, these countries also developed new programs to combat poverty. Beginning in Mexico in 1995, and in parallel in Brazil, a simple idea has taken hold: rather than transferring income to the poor through price subsidies, food stamps, or direct distribution of food-stuffs (milk, tortillas, bread), it is better to transfer income directly in monetary form. However, to ensure that such transfers are not permanently needed, it is convenient to condition them on poor households invest-

ing in their human capital, in particular, their health, nutrition, and the education of their children. The bet is that healthier and more educated youngsters will enter the labor market under better conditions than their elders, allowing them to earn more income through their own efforts, breaking the intergenerational transmission of poverty. In short, rather than “transfers of income today and transfer of income tomorrow,” the new paradigm emphasizes “transfers of income today to facilitate greater earned income tomorrow.”

Greater macroeconomic stability and these new poverty programs, more commonly known as conditional cash transfer (CCT) programs, have allowed the Region to reduce the proportion of households living in extreme poverty and to lower income inequality. Other forces have also contributed, such as the expansion in coverage of primary education, potable water, and electricity. But it is the combination of faster growth and lower inflation associated with macroeconomic stability, along with more effective transfer to the poor through CCTs that has meant that, for the majority of the poor in LA, the present is better than the past. Equally important, the promise that the future can be better than the present is more credible now than in the past.

I argue here that these notable achievements are insufficient to bring about further and lasting gains in social welfare and that some trends in social policy are worrisome and may be acting against the long-term interests of the poor. There is a deep flaw in the overall architecture of the Region’s social policy (“social policy” referring to a broader set of programs than those transferring income to the poor through CCTs). This flaw is a major obstacle to reduce inequality further and to construct a more effective social safety net that goes beyond the elementary goals of providing poor households with minimum levels of consumption and facilitating their investments in nutrition and education.

More sharply, I argue that under the current architecture, the Region’s governments are caught in a dilemma between increased productivity and faster growth on one hand, and increased social spending on the other. And I argue that in the context of more democratic contests for political power, governments will incline in the direction of higher social spending at the cost of faster growth and, eventually, long-term fiscal sustainability. My main point, however, is that if this flaw is corrected—no minor matter—countries in the Region can make a qualitative jump in the direction of reduced inequality, greater social inclusion, and faster growth.

Insurance Versus Retribution

Two dimensions of social policy need to be separated. The first concerns objectives, and for our purposes here I distinguish between programs that provide social insurance and programs that redistribute income. The first help households manage events like losing jobs (unemployment insurance), getting sick (health insurance), suffering an accident (disability insurance), or facing old-age poverty (retirement pensions). Social insurance programs are targeted to all households regardless of their income level and their objective is to protect households against risks. In most member countries of the Organization for Economic and Cooperative Development (OECD), these programs have broad coverage, are a core component of their social policy, and absorb a significant percentage of public spending. Programs that redistribute income, on the other hand, are focused on a subset of households, usually the poor; their objective is to increase their consumption. In OECD countries, these programs take various forms (food stamps, negative income taxes), but their coverage is more narrow and are substantially less onerous to the public purse.

The second dimension relates to access. Since the origins of social insurance in

		<u>Social Insurance</u>	
		Formal	Informal
<u>Income Transfers</u>	Non-Poor		
	Poor		
Productivity		High	Low

Figure 1 — Dimensions of Social Policy

LA in the middle of the past century, access has been limited to workers with a salaried job (an inheritance, as it happens, from Bismark's first social insurance programs in Germany at the end of the nineteenth century!). The reason is that these programs are paid by firms, with contributions based on workers' wages. But many workers do not have a salaried job because they work on their own; others are employed by firms that evade these contributions. As a result, many are left without access to these programs ("informal workers" in the Region's lingo). Anchoring social insurance on salaried labor has resulted in Latin America's "truncated welfare State": formal workers are covered, informal ones are not. This is a key flaw, as it is evident that informal workers can also get sick, lose their jobs, suffer an accident, or face old-age poverty.

Figure 1 depicts these two dimensions. The rows classify workers by income level: poor and nonpoor; the columns by labor status: formal and informal. Note that formal and informal is not equivalent to nonpoor and poor. A large informal sector is a distinguishing feature of LA economies vis-à-vis those belonging to the OECD. Its social implications have already been noted, but the bottom of Figure 1 highlights a key economic one: on average, firms and workers are more productive in the formal sector.

Redistribution with Investments in Human Capital

Perhaps the most important innovation in social policy in the Region over the last fifteen years concerns the bottom row of Figure 1. A myriad of programs to transfer income to poor households through various means have been gradually replaced by programs that give direct monetary transfers while imposing conditions associated with attendance to school and health clinics: LA's flagship CCTs. Evaluations of Mexico's Progres-a-Oportunidades, Brazil's Bolsa Familia, Colombia's Familias en Acción, and similar undertakings in Honduras, Nicaragua, the Dominican Republic, and Ecuador among others, show that these programs have been more effective than previous ones in reaching the poor and have had a positive effect on critical indicators like school attendance, grade progression, nutrition, and health status. They have also helped, indirectly, to reduce inequalities in the distribution of income.

Three things need to be noted about CCTs. First, all poor households benefit from them, regardless of whether their workers hold formal or informal jobs. Second, the size of the income transfer, by itself, is not meant to raise households from poverty. The transfer complements the household's own income and is set to provide some minimum consumption and

to compensate parents for the lost income of having their children in school and not helping on the family farm or begging in the streets; however, larger transfers can undermine households' incentives to work, creating a "poverty trap." Third, these programs do not create jobs, although they should help poor youngsters getting more education today find jobs with higher productivity when they enter the labor market tomorrow; the program's exit door is a more productive job. Differently put, CCTs are not meant to be permanent welfare, but rather, temporary investments in the human capital of the poor.

Two Systems of Social Insurance

The majority of workers in Latin America are informal and, by design, excluded from social insurance. This creates a major problem, because governments cannot leave them unprotected against risks. As a result, and in addition to the CCT programs described above, governments in the Region have been creating programs to provide social insurance to informal workers. These programs have been less noted and are usually confused with CCTs, as they are all lumped together under the label of social safety nets (and, because they increase social spending, are applauded by all, *comme il faut*). But the distinction is critical because their objectives are different (insurance versus redistribution), their time horizon is different (permanent versus temporary), their target population is different (informal versus poor), and, as noted below, so are their economic implications.

In the early 2000s, a program to provide free health insurance to informal workers was created in Mexico (although similar efforts started decades before); in Colombia, there is a legal mandate to provide informal workers with the same health benefits as formal ones (paid partly with taxes on formal workers). Programs to provide income to retired workers without a pension have been created in Uruguay,

Panama, Brazil, and Mexico. Argentina recently extended to informal workers family allowances previously reserved only for formal workers.

More programs will emerge, or existing ones strengthened, for three reasons. First, increased life expectancy, population aging, and previous histories of informality imply that many workers are reaching retirement age with no pension. Second, the transition from preventable to chronic degenerative diseases generates more expensive health challenges. The third is of a different nature but equally relevant: in the Region's more democratic environments, governments rightly feel the need to overcome the limitations of their "truncated welfare State" and extend social insurance to the informal sector. Willy-nilly and to various degrees across countries, a system of social insurance for informal workers parallel to the existing one for formal workers is being created; a different phenomenon from CCTs, which, it is useful to reiterate, are transitory programs to enhance the human capital of the poor.

Having two parallel systems of social insurance is not a good idea. As noted, programs for formal workers are paid with wage-based contributions. But because for a variety of reasons, workers and firms consider that the programs' costs exceed their benefits, they perceive them partly as a tax. The same happens with employment protection rules (regulations that make it very difficult or costly to fire workers), an important component of social insurance in a region where unemployment insurance is the exception rather than the rule: they create barriers to formal jobs that are also equivalent to a tax on formality. On the other hand, even if informal workers do not fully value the benefits of the social insurance programs at their disposal, they are free; moreover, in some cases, informal workers lose access to their benefits if they get a formal job. *De facto*, this setup results in a tax on formal employment and a sub-

sity to informal employment, a combination that goes a long way in explaining the very large informal sectors observed in LA.

How workers and firms react to these taxes and subsidies is of critical concern. Consider the message to a firm: if it hires a salaried worker legally, it must pay for his health insurance, but if it does so illegally, the worker will get the insurance for free (or subsidized). If the firm is small and unlikely to be detected by the authorities—the situation of the vast majority of firms in LA—the temptation to evade is large indeed. Now consider the message to the worker: if she is formally employed, she is obliged to save for her pension, but if she is informally employed, she will receive a free pension from the government. In the end, the most important social institution in these countries, the labor market, is strongly distorted.

None of this is good for productivity. Informal firms tend to be small, underexploiting economies of scale, and engage little in labor training, technology adoption, or innovation. Informal workers peddle wares in the streets instead of learning new skills in firms. It is also not good for fiscal sustainability: a small formal sector narrows the tax base while social insurance programs for informal workers increase spending and erode the tax base. And it is clearly not good for the rule of law.

The economic shortcomings start with the original design of social insurance, limited only to formal workers, funded through a tax on labor that creates costly distortions, and characterized by counterproductive employment regulations. But these shortcomings are compounded by adding a parallel system for informal workers. The social *raison d'être* for this addition is unquestionable; doing nothing to protect large segments of the labor force from various risks is evidently unacceptable. But that should not deny that from the economic point of view, these programs are aggravating, not mitigating, the long-

standing problems in the labor market that social insurance programs and employment regulations for formal workers had already created.

Opening the Doors to Escape Poverty

Returning to Figure 1, the labor force in LA is divided between the four quadrants. As a general proposition, the upper left and lower right quadrants are more populated than the other two. This is exactly the opposite of what one would expect, particularly in a region where more than two-thirds of the total population is urban. Poor workers have low education and few financial resources; the expectation is that they would be salaried and therefore formal. But if formal jobs are taxed and informal ones subsidized, this expectation is unrealized; all the more so if, as it also happens in the Region, many social insurance programs for informal workers are targeted to poor workers. The point here is that the distribution of the labor force between quadrants is not independent of the incentives implicit in social insurance programs including their form of financing, and that in some cases these programs may be contributing to trap poor workers in low-productivity informal jobs.

More generally, the formal-informal dichotomy is a major stumbling block to break the intergenerational transmission of poverty. As a result of the Region's CCTs, in the years ahead, poor youngsters will enter the labor market with more human capital than their earlier peers but they may not find more productive jobs. Differently put, the exit doors from CCTs are being obstructed by the flaws in the Region's social insurance architecture.

Critically, note that the problem is in the columns of Figure 1, not in the rows. Thus, the problem cannot be solved by creating new CCTs or increasing transfers in the existing ones. Moreover, attempts to reconvert or extend existing CCTs to also

provide social insurance for the poor may deepen the problem. A targeted program to invest in the human capital of the poor cannot simultaneously provide them with social insurance conditioned upon their holding informal jobs, while at the same time expect the poor to transit out of poverty by finding higher-productivity formal jobs. And if the poor's earnings lag behind those of the rest of the population as a result of their lagging productivity, inequality will increase and with it the temptation to reduce it by increasing transfers to the poor—focusing on the rows, not on the columns.

LA has reasons to feel proud of the CCTs that it pioneered over a decade ago. *Mutatis mutandis*, they are being replicated in other regions of the world, including the United States. In some countries, such as Colombia, Mexico, and Brazil, these programs provide benefits to around one-quarter of the total population, sometimes exceeding the population estimated to be in poverty; they need to grow no longer. In other countries, like Peru, Guatemala, and Paraguay, there is a need to expand their coverage. In all, there is room to improve their operations, focusing more, in particular, on early child development. These programs have already made a large contribution to poverty alleviation. To continue to do so effectively, the programs need to focus sharply on their objectives to invest in the human capital of the poor; they must resist the temptation to use them to respond to any circumstance, to be the only instrument to reduce poverty through ever-increasing transfers, or to transform them into hybrids with many goals, in the end reaching none, like the eagle that pursues two rabbits at the same time.

After reaching full coverage of those in need, the greatest triumph of LA's CCTs would be to gradually shrink and, in the long run, be unneeded as extreme poverty is progressively eradicated from a region benefiting from macroeconomic stability

and a healthier and more educated labor force. To reach that, LA needs to eliminate the tax on formality and the subsidy to informality and provide all workers with the same social insurance programs. Poor workers need, most of all, a more productive job; they also need to benefit from unemployment, health, life, and disability insurance, as well as retirement pensions and related protection mechanisms enjoyed by other workers—not much different from what currently occurs in OECD countries. Reaching this is essential for genuine social inclusion. Therefore, after ensuring that CCTs reach all of the target population and operate effectively, additional efforts need to focus on raising the productivity of the poor; this requires facilitating their getting a higher-productivity formal job. It is time for LA to move on and tackle new social challenges beyond those that can be solved through CCTs.

Conclusion

Looking forward, a large challenge for social policy in LA is to focus on the root causes of the formal-informal dichotomy. This requires revising regulations in the Region's labor markets and the methods of financing its social insurance programs; more bluntly, tax and labor market reform. These issues, long unaddressed, are as difficult as they are urgent. In fact, one can see the gradual emergence of social insurance programs for informal workers as a way of bypassing these issues—a bypassing facilitated perhaps in some cases by a favorable international environment characterized by high commodity prices and associated revenue windfalls. This is understandable, but it is unlikely to be a fiscally sustainable solution over the long run and is a costly solution from the point of view of productivity and growth. It is also questionable whether this solution strengthens social inclusion, as workers are permanently segmented into formal and informal categories, and whether a social

contract based on asymmetries in rights and obligations across labor categories is politically desirable.

The technical difficulties in an integrated reform of taxes and labor regulations are large, and reasonable people can have different views as how best to address them. But at this point, this is not central. What is central is to recognize that, given where we are today, further lasting advances in social policy in the Region can hardly be obtained if we continue along the route of ever higher transfers for the poor, which distort the original intent of CCTs, on one hand, and more taxes to formality and subsidies to informality, on the other.

Tax and labor reforms will occur only if there is a societal consensus for them, much the same as what happened with macroeconomic stability. But there is a political opportunity to construct this consensus, noting that these reforms, rather than being ends in themselves, acquire meaning as building blocks for an ambitious social reform; one, in particular, that resolves the design flaws at the root of the Region's truncated welfare State, extends the same social insurance to all and in particular the poor, and amplifies opportunities for productive jobs. This will provide a sound basis to effect a clearly desirable increase in social spending, without augmenting costly economic distortions, and will enhance the foundations of a lasting prosperity based on higher productivity. This will need technical expertise and ideological agility but, most of all, bold political leadership. The Region faces a great opportunity.

The author's opinions do not necessarily coincide with those of the institution he is affiliated with.



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He is the author of at least 80 articles, monographs and book chapters on such diverse subjects as poverty reduction, competitiveness, foreign exchange policy, export imbalances, pricing, microeconomics and energy. His paper *Poverty in Mexico* won the 1992 National Research Prize in Economics awarded by the Bank of Mexico.

His recent published books are: *No Growth without Equity? Inequality, Interests and Competition in Mexico* (edited with Michael Walton), Palgrave-Macmillan and the World Bank, 2009; *Good Intentions, Bad Outcomes: Social Policy, Informality, and Economic Growth in Mexico*, Brookings Institution Press, 2008; *Progress Against Poverty: Sustaining Mexico's Progres-a-Oportunidades Program*, Brookings Institution Press, 2006; *Sin Herencia de Pobreza*, Editorial Planeta, 2005 (with Evelyne Rodríguez); and *Ensayos sobre el Desarrollo Económico y Social de México*, Fondo de Cultura Económica, Mexico, 2004.

Science in Colombia

BY MOISÉS WASSERMAN

Abstract

THIS ARTICLE presents a brief description of specific, discontinuous, and discrete developments of science in Colombia during its colonial period and early days of the Republic. Starting in the second half of the twentieth century, scientific activity was institutionalized through the issuance of legislation in government agencies, universities, and other centers. Nonetheless, there has been a divorce between the official discourse and the actual facts. Such divorce manifested in scarce funding, far from the government goals and the general purposes in the region.

Despite the lack of support, the scientific community grew, and the number of scientific articles increased significantly over the last fifty years, but at a slower rate than in other countries in the region. There is a weak relationship between university research and the industry. The number of patents in Colombia is below the regional average, and innovation is recently emerg-

ing. Such lag has a negative impact on how the country will deal with free trade agreements recently signed with various countries.

In 2011, the distribution of royalties from mining activities was changed, and 10 percent of those monies were assigned to science and technology. Such a change has generated great expectations, but also there is great fear that a regulation created a parallel system of science—a system too sensitive to local politics and short-term needs.

Introduction

Science in Colombia had specific developments when it was a Spanish colony. The most important of them, the Botanical Expedition, was also a seedbed for young intellectuals who promoted the pro-independence and republican ideas. For more than a century, science was characterized by small individual and isolated initiatives. By the mid-twentieth century, the institu-

tionalization of science as an activity was undertaken and promoted in a professional and organized fashion at institutes and universities. The most important milestones in the process of institutionalization were the formation of Colciencias as the principal institute; the organization of a very inclusive National System of Science, Technology and Innovation; and the issuance of two legislations accompanied by their respective regulations.

The importance of science as a factor of economic, social, and cultural development was included in the political discourse but not reflected in political action, evidenced by the low investment indicators. The investment in research and development (R&D) was less than 0.2 percent of the gross domestic product (GDP), and the investment in STIA (scientific, technological, and innovation activities), which includes activities related to science but not strictly research, was only 0.47 percent of the GDP. National competitiveness indicators are poor, largely due to weak scientific development. In spite of it, the scientific community has grown dramatically, between 300 percent and 600 percent over the past twenty years.

Recently, Congress amended the Constitution to allocate 10 percent of the mining royalties to science and technology projects. The injection of funds generates great expectations and hopes, but also some fears because a new management and administration mechanism, parallel to the National System of Science, Technology and Innovation, has been created. The fear is that the new mechanism may become contaminated by strange and short-term-oriented handling, not in line with the processes established in the scientific community.

Historical Background

I begin with a brief account of scientific activity in Colombia. The knowledge of some historical facts will help under-

stand previous developments as well as the current situation.

As mentioned earlier, during the Spanish colony, the most important scientific achievement was the Botanical Expedition. The expedition was entrusted to the priest José Celestino Mutis by Carlos III. His purpose was to improve the economy of the kingdom and the vice kingdom by surveying useful plants, but there were multiple collateral results. There are different views about Mutis's personality, which are complex and contradictory. He was a physician, but chose to teach physics and mathematics. He also promoted scientific thinking based on methodological doubt and promoted research-based education in the traditional scholastic system. He was a monarchist, but encouraged a group of native intellectual revolutionaries.

More than 20,000 plant and 7,000 animal species were surveyed, and an astronomical observatory was created. That was the starting point of Colombian science, but in fact it was the dissemination of European science, rather than the generation of the country's own scientific knowledge. The collection generated by the Botanical Expedition was brought to Spain.

The consolidation of a group of young people—full of scientific and libertarian ideas and who promoted independence and the republic—was an important side effect of the expedition. Mutis's collaborators began to forge independence and a new republic. Unfortunately, almost all of them were shot during the campaign undertaken by the Spanish Crown to subdue the revolution. If that group had survived, the role of science and education in the context of the new republic would have been different.

It is said that when leniency was requested for Francisco José de Caldas, one of those remarkable young people, the commander of the Spanish Army responded that "Spain does not need wise men, but rather good subjects." That statement

seemed to be a premonition of what was to come during most of the republican life, not only in Colombia but also in the entire Latin American continent.

In the early Republic, General Francisco de Paula Santander, as vice president, founded the Central University in Bogota, Caracas, and Quito. He also built a National Library, a Museum of Natural History, and the School of Mining. Such initiatives were short lived and not in the context of the Botanical Expedition. In addition, the scientists and heroes involved in these efforts were not recognized. In the second half of the nineteenth century, two important initiatives stand out: the creation of the National University and the Chorographic Commission. The latter was conceived as a mission to explore the country, practically proposing its rediscovery: a survey and inventory of its physical and human resources, in addition to cartography, which would facilitate development. A divorce between the discourse and the facts was evident from the start. The resources allocated to these efforts were always insufficient. The Commission lasted only nine years and was suspended once immediate results were obtained; it was never conceived as a long-term knowledge enterprise.

Colombia did not have a true scientific development policy. Actions changed from government to government, which caused a chronic lack of institutionalization of science and higher education. One example was the Military College, which oscillated between an emphasis on training military engineers and civil engineers. This institution was founded and closed three times in a few years. The only institution that had stability—possibly because of its directives, which defended the need for science in the development of the country—was the National University. This position is evident in the following quotation from its second chancellor, Antonio Vargas Vega: “an argument has been made to point out that college education is the legacy of a privi-

leged class, without thinking that science is like a river, which subjugates all obstacles, constantly growing and spreading fertility and life through its course.”

The Institutionalization of Science

During the first half of the twentieth century, incipient institutions began to appear, mostly personal initiatives in the fields of health, agriculture, and mining and geology. There were also some more general institutions, such as the Academy for the Exact, Physical and Natural Sciences, at the initiative of the government and some private professional unions. But one can say that until the mid-twentieth century, there was no policy in Colombia for the support of science, and its institutionalization was very weak.

In 1968, during the administration of President Carlos Lleras Restrepo, a significant effort was made to institutionalize science. Major national institutes in various areas of knowledge were established. Various initiatives previously mentioned converged in these institutions. Examples of these efforts include the National Institute of Health in which multiple interests flourished, such as control of yellow fever, vaccine manufacturing, and special programs for epidemiological surveillance. Similar efforts were undertaken in agriculture with the Instituto Colombiano Agropecuario (ICA); in geosciences, chemistry, and mining with INGEOMINAS; in geography and planning with the Geographic Institute; and so on. However, the most significant initiative of institutionalization was the creation of Colciencias, a blend between promotion and funding for the sciences.

These and other similar developments demonstrated that the need for scientific research was a government concern. In fact, the entire region began to move in a parallel direction due to policies promoted by multilateral agencies. Through similar efforts, agencies dedicated to sciences were created in other countries, such as the

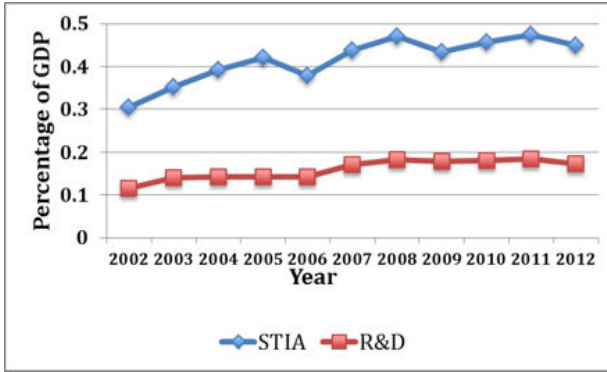


Figure 1 — Investment in Science as Percentage of Gross Domestic Product.

Source: Data from the Observatorio Colombiano de Ciencia y Tecnología. R&D figures correspond to internationally accepted indicators as used by the Organization for Economic and Cooperative Development (OECD). STIA corresponds to additional indicators that include activities related to research such as consulting, doctoral training and others.

Conselho Nacional de Desenvolvimento Científico e Tecnológico (CNPq) in Brazil (1951), the Consejo Nacional de Investigaciones Científicas y Técnicas (CONICET) in Argentina (1958), the Comisión Nacional de Investigación Científica y Tecnológica (CONICYT) in Chile (1967), El Consejo Nacional de Investigaciones Científicas y Tecnológicas (CONICIT) in Venezuela (1967), and the Consejo Nacional de Ciencia y Tecnología (CONACYT) in Mexico (1970). The Declaration of the Presidents of America in Punta del Este in April 1967 raised the need to increase investment in science, from 0.2 percent of GDP to 1 or 1.5 percent.

Colciencias dramatically changed the scientific activity of the country. For the first time, the government formed a body to promote and fund sciences. While funding has been discontinuous and chronically insufficient, Colciencias has remained over time and has organized a national policy. Science also received strong support with two pieces of legislation: Act 29 of 1990 and Act 1286 of 2009, which regulated the activity and set mechanisms to stimulate and develop it. In addition, these laws defined a functional national system, with great programs and a structure that supports broad participation, resource allocation, and tracking of achievements.

Two national missions of high academic level were organized to analyze the development of science in the country. The

second, the Mission for Science, Education, and Development—known as "The Mission of the Ten Wise Men"—gave precise recommendations for the construction of science policy in the country.

The Situation Today

Unfortunately, one of the major features of the development of science in Colombia has been the distance between political discourse and the facts. The political discourse universally recognizes the importance of knowledge and the role that it plays in the generation of economic, social, and cultural development. The facts, on the other hand, show a lack of concrete actions and lack of decision making, especially to adequately fund research.

Figure 1, taken from the 2012 report of the Observatorio Colombiano de Ciencia y Tecnología (OCyT), shows how investment has not grown relative to GDP in the last ten years. The observatory presents two data series: one named investment in R&D, which uses the same indicators as the Organization for Economic and Cooperative Development (OECD) and does not exceed 0.2 percent of GDP; and another one, approaching 0.5 percent of GDP, is named STIA (scientific, technological, and innovation activities) and includes factors such as industrial and feasibility studies and training activities. The use of two different indicators (one standard measure used by developed countries and a second

one that includes activities that these countries report as investment in education and industrial or infrastructure projects) gives the impression of greater investment, and it aims, somehow, to justify the precariousness of true scientific development efforts. Thus, we are far from the goals established by the Latin American presidents in Punta del Este in 1967 and far from the investment indicators of the leading countries of the region, who invest little in science as well. Only Brazil has exceeded 1 percent of its GDP. Mexico, Argentina, and Chile, who do not invest like Brazil, triple the Colombian indicator.

The OCyT report shows that the share of industry in funding for 2012 is less than 40 percent of the total (STIA), despite calls and initiatives to involve the private sector. The number of patents approved for Colombian residents according to the International Patent Treaty during 2012 is fewer than ten. The patents approved for Colombian nationals goes up to 30; on the other hand, international patents approved in the country are above six hundred. Those numbers reinforce the perception of a poor relation between research groups (which are 90 percent university) and private sector. Such low rates are due possibly because the Colombian industry in general is not innovative and prefers to import technologies, including some already outdated rather than risking a substantial investment

in local developments. There is also a traditional cultural barrier: the private sector feels that research is too academic and not directed to answer their problems. Researchers think that the private sector has no real interest in original developments, but rather in discrete solutions or improvements in production lines. No doubt the free trade agreements will push for greater interaction between the two sectors.

The OECD report on Colombian innovation reinforces the previous findings in the following words: “The Colombia innovation system is still small and lacks a strong business support. R&D is only 0.2 percent of GDP, while in Brazil [it?] is 1.2 percent, and OECD’s is 2.4 percent. Other measures of innovation such as patenting and scientific publications per capita situate Colombia behind some of its neighbors such as Brazil, Chile, and Argentina. One can learn a lot from other emerging economies that are major players in the global innovation.” The Colombian government has applied for membership to the OECD, but their indicators of science and technology and educational attainment are bad. That, again, reflects the clear separation between political discourse and facts.

Despite the above, the activity in science and technology in Colombia has grown significantly in recent years. Figures 2 and 3, constructed with data from the Observatorio Colombiano de Ciencia y

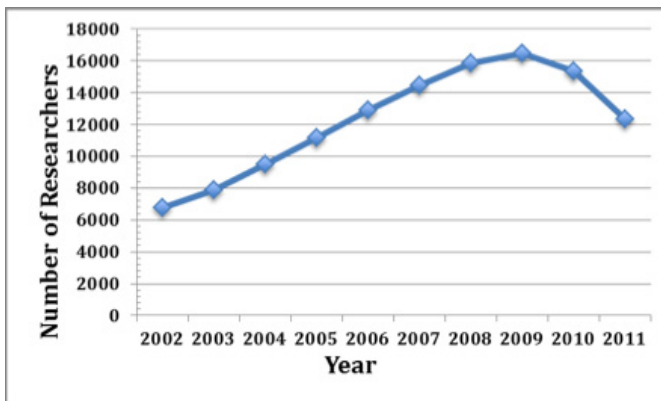


Figure 2 — Active Researchers.

Source: Data comes from the Observatorio Colombiano de Ciencia y Tecnología. Defined as active researchers who have created some form of scientific output (publications, patents, and others) over the past two years.

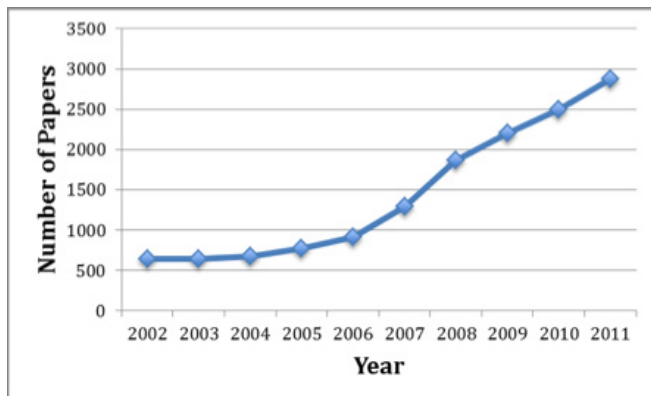


Figure 3 — Number of Indexed Publications.

Source: Data comes from the Observatorio Colombiano de Ciencia y Tecnología as publications reported in the Scopus, ISI, and other internationally recognized database systems.

Tecnología, show the growing number of researchers and scientific publications. This is perhaps the most remarkable fact in Colombian science in the last twenty years. The scientific community and the potential for national research have both grown dramatically in parallel with the growth in high-level graduate programs, especially doctoral degrees. Concerning, however, is the fact that in the last three years the number of active researchers has stagnated and even declined.

Possibly, this is happening because with an increase of the research groups also increased the number of projects submitted for funding at Colciencias. Unfortunately, the growth of its budget is not proportional to the growth of applicants; therefore a smaller percentage of the projects get funded. In the last term, fewer than 2.5 percent of projects submitted were funded. Surprisingly, this fact apparently did not generate concern amongst the highest levels of Colombian science, and no measures to counter such negative trends have been announced.

Notwithstanding the growth in human capacity and scientific publications, low investment levels produce an economic competitiveness inferior to that of other countries with similar population size. In the Global Competitiveness Report from the World Economic Forum (WEF), Colombia ranks 69 among 144 countries

considered. While factors specific to the country's economic potential rank in better position—market size, 31; macroeconomic environment, 34—those dependent on efforts in science and education rank far worse—technological readiness, 80; innovation, 70; and quality of institutions, 109. In contrast, regional leaders present better results; for example, Brazil ranks 48 overall and 49 in innovation, Chile ranks 33 overall and 44 in innovation, and Mexico ranks 53 overall and 56 in innovation. Some much smaller countries have had good performance as well: Panama ranks 40 and Costa Rica ranks 57 overall. Also countries whose regimes do not put priority on research occupy low positions, most notably Venezuela, which ranks 126. Although this is only an indirect indicator assembled of various components, there appears to be a correlation between persistent and aggressive scientific research policies and the degree of economic global competitiveness.

Royalties for Science: A New Era?

Among the Colombian efforts to institutionalize science, there are two special pieces of legislation, which gave science a boost but lacked something very important: an ensured and constant funding source for programs and projects. A special fund was created with the 2009 Act, but it was a fund with no resources. The year 2011 saw what could have possibly been the most daring event in the history of the

country to fund science. Congress issued the Legislative Act 5 (an amendment to the Constitution) by which the distribution of royalties from mining activity was reformed and 10 percent of it was awarded to science and technology projects with regional impact. This is a significant sum that could increase the indicator of STIA to 0.7 percent or 0.8 percent of GDP.

Act 5 is cause for optimism in the Colombian scientific community. However, there are serious concerns about how the implementation of these resources was regulated. Instead of financing the agreed policies and capitalizing the fund created by the 2009 Act, that 10 percent royalty established a new policy that was not designed based on studies, knowledge, or previous plans. It emerged from the conciliation of political interests in Congress, especially the House of Representatives in which its members are elected regionally and defend very local political interests.

Such resources were distributed at the departmental level and based on "unmet basic needs." It is unusual that a scientific plan is based on those needs. While science brings long-term improvement of living conditions, it isn't its mandate to build aqueducts or basic health services. There is no reason to base science policy on the same parameters in which an equality policy is based. This dependence of funding based on poor local conditions predicts on one hand that the largest investment will be made in areas where there is less capacity in technological applications to solve immediate problems. On the other hand, there will be no resources to fund broader projects with national scope and long-term impact. In addition, a system for approval and management of projects was created in parallel to the National System of Science, Technology and Innovation, a fact that affects the existing institution of science in several ways.

Colciencias went from being the governing body of science, technology, and

innovation to being the technical secretariat of a committee, which even though it has participation from academia, it also has assured majority for the government. The decision-making body has a fundamentally political composition with three votes: one from the national government, one from the department, and one from "academia." This parallel system generated for project approval, excludes national disciplinary and sector programs that are established after the issuance of the science and technology laws on wide consultations with the academic community. Such academic community, although it should not have "established rights" on the national science and technology plan, does provide an excellent sensor of national needs and has knowledge of global developments needed to solve them.

The governors have, in this new system, the veto power in the approval process and can also exert a pre-filter of relevance. This pre-filter ensures the coherence of the project with the management program, which has a maximum horizon of four years (to prevent the cancellation of projects in the event of a change in governor). The aim of the system is to support regionalization, but it does not have a well-grounded plan. The system was not conceived as a great national project, but rather as a fragmented set of local projects.

From the projects approved so far, is very difficult to see the full picture of a departmental plan, let alone a regional or national one. Projects that would result from careful analysis of the indicators, such as the strengthening of research groups, the repatriation of brain drain, the strengthening of doctoral programs, and the financing of a greater number of projects and initiatives (underfunded in the regular budget), among others are not possible. It is very difficult for researchers to access funds from royalties, if not through an open bid. Because of this approval mechanism, they see themselves forced to solicit mediation

and lobbying mechanisms alien to their training and academic ethos.

In addition, investment in projects approved so far, focuses more on STIA rather than R&D. In some cases, the projects are only tangentially science and technology, which in addition to being inefficient for scientific development; they generate confusion for the indicators.

In short, a system for submitting and managing projects has been generated, one that is completely foreign to the usual mechanisms of science management. Also, new entities with complex personnel management were created, causing on one hand, the growth of bureaucracy and on the other, the dilution of human capital in universities.

In summary, it can be said that the Colombian system of science and technology is young, that it has an appropriate level of institutionalization and organization, perhaps better than other countries in the region, and that has grown consistently despite a chronic lack state funding and attention. On the other hand, the recent award of mining royalties to science and technology is a mixed blessing. It generates unprecedented available resources in the country, but also generates risks and challenges that if not addressed properly, could squander a great effort. That is the most serious dilemma facing the Colombian science today.



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Wasserman has been honored with several distinctions, among them: the Colombian National Science Prize "Alejandro Angel Escobar" (1984), the Exceptional Teaching Prize from the National University of Colombia (1995), the National Prize for Scientific Merit (1996), the Prize for Life in Science (2012) from the Colombian Association for the Advancement of Science, the medal for scientific achievements from the National University of Colombia (2001), and a doctorate honoris causa from the Universidad de Antioquia.

Dr. Wasserman holds a PhD in biochemistry from the Hebrew University at Jerusalem and was a postdoctoral fellow at the State University of New York at Stony Brook. He writes a column for Colombia's El Tiempo newspaper and has written more than eighty essays on science and society and published close to ninety scientific papers.

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Riding Waves of Change

The Case of Costa Rica's Global Value Chain–Driven Economic Transformation

BY DAVID BULLÓN AND FRANCISCO MONGE

Abstract

THERE IS A VIBRANT policy discussion about the way in which countries might harness the evolving trends in global production to drive economic development. Most of Latin America has remained largely disconnected from the global value chains (GVCs) that have developed. In contrast, Costa Rica has ridden three waves of policy reforms, which have enabled significant GVC-driven growth over the past twenty-five years. This article strives to use the case of Costa Rica to illustrate the type of policy-making approach that may be useful to small economies throughout the region.

The Promise of Global Value Chains for Development

Global value chains (GVCs) emerged on the global scene as a consequence of the information and communication technology (ICT) revolution, which has significantly reduced coordination costs, trigger-

ing an unbundling of production stages.¹ Activities that used to be performed in one country to build a final product are now dispersed across international borders as countries engage in the stages of the GVC in which they can best compete. Developing and sustaining a comparative advantage no longer depends on acquiring the capabilities to host an entire production chain, but rather on making use of the competencies necessary to focus on specific activities in the production chain.² This shift offers countries a valuable development opportunity, because developing a comparative advantage in one activity requires a narrower set of capabilities than building expertise in the range of activities required to produce a final good. Furthermore, capabilities such as management skills, sources of capital, and advanced technology can be borrowed from foreign sources to leverage domestic production potential in order to kick-start development. Integration into GVCs may start with low-value-added activities that

may not lead to high productivity initially, but it sets the stage for upgrading toward higher-value-added activities that can drive significant improvements in productivity.

At the dawn of the era of GVCs in the mid-1980s, Latin America was in the middle of the so-called “lost decade,” struggling to recover from a deep recession. The import substitution industrialization (ISI) policies that were adopted across the region from the 1950s to the 1970s were ineffective in sustaining growth-enhancing structural transformation for the majority of Latin American countries.³ In small countries, internal demand proved insufficient to drive vibrant industrialization, and much of the light industry that had developed was not globally competitive. The relative success that Brazil has had with its inward-oriented approach has relied on the large size of its domestic market, but this leaves a question about the sustainability of this strategy in the medium term. Most

countries in the region emerged from the aftermath of the crisis with a comparative advantage in mineral extraction or agricultural activities.⁴ Despite the opportunities presented by the fragmentation of global production, a significant proportion of the countries in the region have specialized in nontechnological sectors that create limited opportunities for growth-enhancing structural transformation.

However, Figure 1 demonstrates that Mexico and Costa Rica have been able to harness the power of GVCs for industrial development. Mexico has favorable conditions for economic development because the demand from its wealthy neighbor, the United States, and its own sizable population allow firms to build significant economies of scale. In contrast, Costa Rica is a small economy in a disadvantaged neighborhood, which is far more representative of the majority of the countries in the region. The case of Costa Rica’s development

Figure 1 — Evolution of Manufacturing Exports as a Percentage of Merchandising Exports for the Most Successful Latin American Industrializers Compared to the Rest of the Region.



Source: Author’s elaboration using World Development Indicators, World Bank.

is relevant because it illustrates some of the quintessential policies that are necessary for countries to leverage participation in GVCs in order to drive improved economic performance.

The Evolution of Costa Rica's Economic Structure

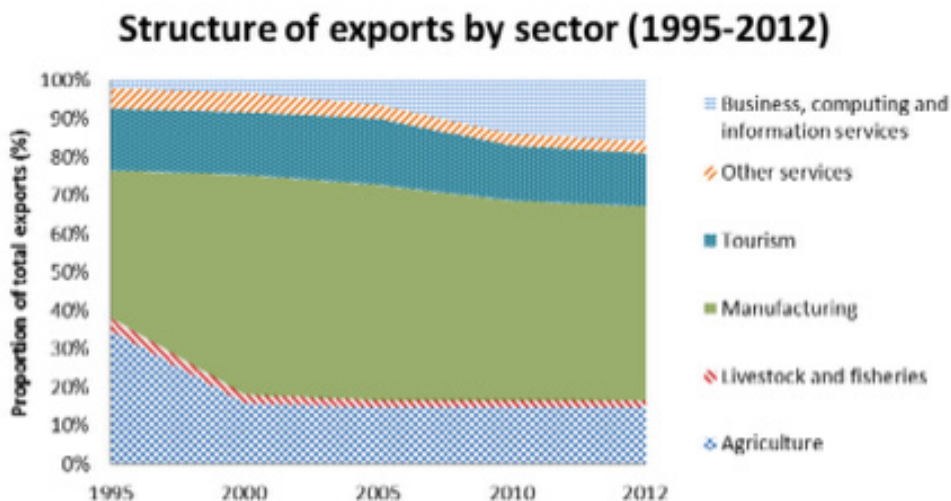
Over the last twenty years, the Costa Rican economy has evolved from traditional agricultural activities toward skills-based products and services that are integrated in global production networks. Agricultural exports dropped from representing 35 percent of total exports in 1995 to 14.9 percent in 2012, whereas manufacturing exports increased from 38.4 percent to 50.6 percent, and business, computing, and information services exports rose from 2 percent to 15.8 percent (see Figure 2). Despite its name, Costa Rica (“rich coast” in English) is not rich in mineral resources. As a consequence, the country was initially an agrarian society in which agriculture boomed as soon as independence from Spain enabled the use of trade routes through neighboring countries.⁵ Up until the mid-1990s, Costa Rica’s two main ex-

ports were coffee and bananas, even as the country’s popularity as a tourist location grew rapidly after the 1980s.

However, a significant change occurred in the mid-1990s as a growing number of world-class multinational enterprises (MNEs) established operations in Costa Rica, giving the country a foothold in advanced manufacturing and sophisticated services GVCs. While a few foreign firms established operations in Costa Rica prior to 1990, it was Intel’s decision to establish operations on Costa Rican soil in 1997 that marked a turning point. Since then, the country has attracted a series of firms in advanced manufacturing, life sciences, and services. Figure 3 shows the steady growth in foreign direct investment (FDI) as a percentage of GDP from 1982 to 2012 relative to the rest of Latin America and the Caribbean (LAC), demonstrating that FDI has grown faster in Costa Rica than in the rest of the region.

The MNEs that have established operations in Costa Rica are, for the most part, integrated in GVCs, since they import intermediate inputs from other countries, transform them by adding value in Costa

Figure 2 — Composition of Costa Rica’s Total Exports from 1995 to 2012.



Source: Ministry of Foreign Trade, with data from Trade Promotion Agency and Central Bank.

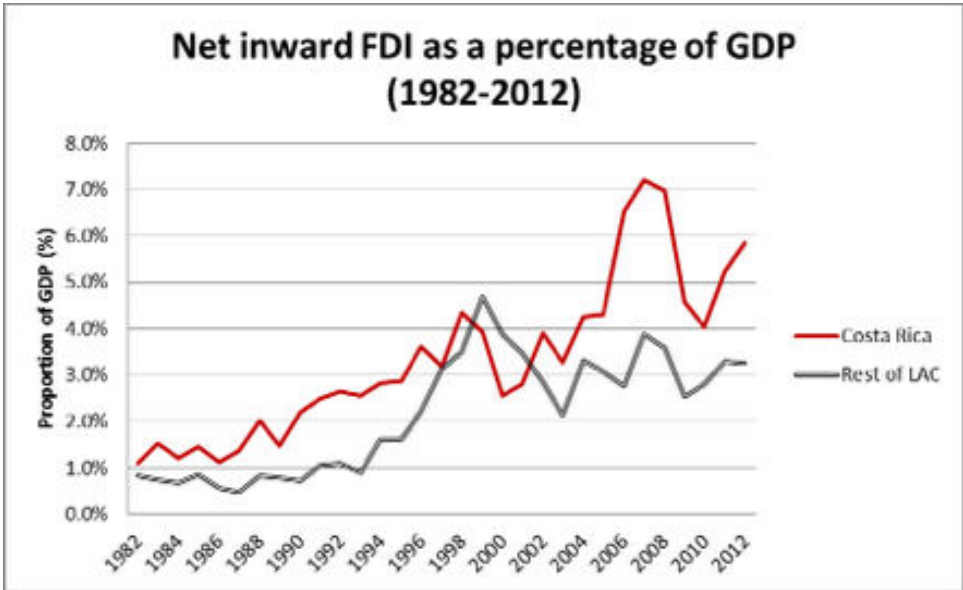


Figure 3 — Evolution of Costa Rica’s Foreign Direct Investment (FDI) as a Percentage of Gross Domestic Product (GDP) Compared to the Rest of Latin America and the Caribbean (LAC).

Source: Author’s elaboration using World Development Indicators, World Bank.

	Offshore Services	Aerospace	Electronics	Medical devices
No. of foreign firms (2011)	104	18	36	46
% Established after 1995	100%	83%	67%	96%
2011 Employment *	37,049	2,000 - 3,000	8,800	12,500
2011 Exports (M USD)*	1,565	90**	2,573	1,283

Figure 4 — Multinational Firms Established in Costa Rica by 2011 and Their Impact on Employment and Export Activity in Key Sectors.

Source: Author’s elaboration using Duke University, Center on Globalization, Governance, and Competitiveness data⁶

*Employment and export data are for the entire sector including domestic and foreign companies.

** For the aerospace value chain, the most recent data available is for 2008.

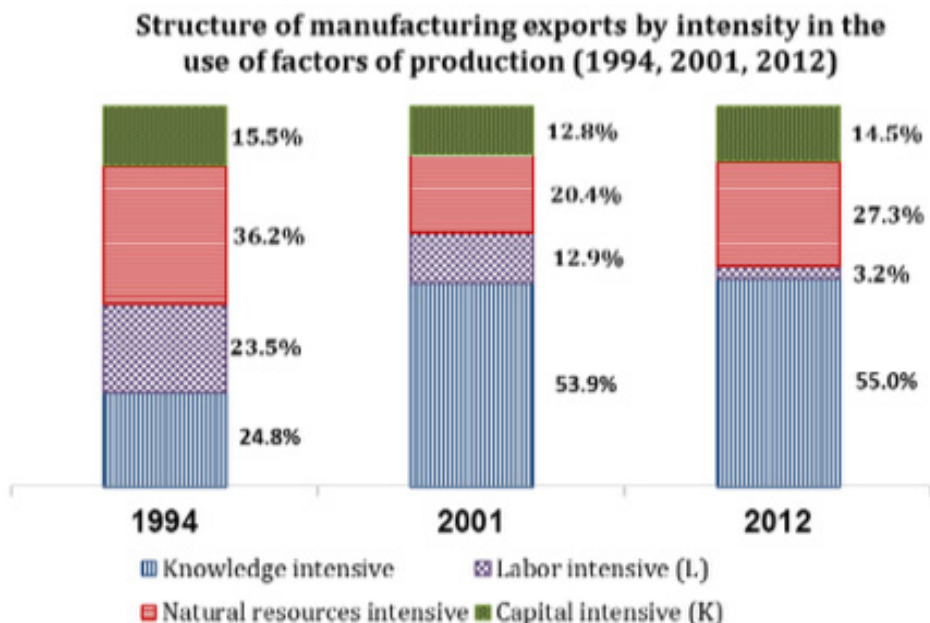


Figure 5 — Structure of Costa Rican Industrial Exports by Intensity in the Use of Factors of Production (1994, 2001, and 2012).

Source: Costa Rica Investment Promotion Agency (CINDE), using Procomer data.

Note: The following classification was used to determine the use of factors of production:

Natural resource intensive: activities that require significant natural resource inputs, such as manufacturing of food, leather, wood, and mineral products.

Labor intensive: activities that require significant labor inputs, such as manufacturing of textiles, furniture, accessories, and metal products.

Capital intensive: activities that require high investment in fixed assets, such as manufacturing of containers, paper boxes, plastics, glass, and printed materials.

Knowledge intensive: activities that relate to the production of specialized products or that require significant technological knowledge such as motors, turbines, machinery, electric equipment, paints, pharmaceuticals, chemical products, and professional and scientific equipment.

Rica, and then export them to the countries that host the next stage in the value chain. Companies based in Costa Rica have operations in various stages of the GVCs in which they participate, including research and design (R&D), manufacturing, marketing, and administrative services, to name a few. Figure 4 quantifies the way in which the establishment of foreign firms has given the country a presence in some key GVCs, leading to significant growth in these sectors in terms of employment and exports.

Costa Rica's participation in GVCs has driven structural transformation that can be observed in the way exports have shifted from low- to high-productivity sectors,

and in the way that industrial exports have become more sophisticated through greater reliance on knowledge-intensive inputs. Figure 2 shows the way in which Costa Rica's exports in manufacturing and services have boomed relative to agriculture since the mid-1990s. The two main export product categories shifted from coffee and bananas in 1994 to microprocessors and medical devices in 2012. Similarly, whereas in 2000, IT and business services exports were only one-quarter of tourism exports, by 2011 they already outnumbered tourism exports. In 2012, IT and business services exports accounted for the same share in GDP as agricultural exports. It is important

to point out that the agricultural sector has continued to grow, but at a slower pace than other sectors.

Figure 5 shows that the reliance on knowledge-based inputs has significantly increased while the reliance on unskilled labor has fallen. This evolution has occurred in several GVCs, but the evolution of the medical devices industry is most telling. The industry began to develop in 1987 with manufacturing of medication delivery systems. By 2000, the sector consisted of twenty-four firms, a figure that has almost tripled since, making Costa Rica the second largest medical device exporter in Latin America. The sector has developed human resources with sector-specific skills and has attracted suppliers of sophisticated components and services. These developments have fueled significant growth in the manufacturing of class III cardiovascular, orthopedic, gastroenterology, urology, and women's health products. Moving forward, there is potential for product upgrading in capital equipment, process upgrading among local suppliers, and functional upgrading toward R&D and marketing.⁷

Thus, Costa Rica has inserted itself in GVCs and achieved significant upgrading in less than two decades leveraging FDI, which has played a key role in planting the seeds that have started to grow into clusters. But, how exactly did Costa Rica create the enabling environment that is attractive to multinationals? What was the sequencing of policy reforms that enabled a small agrarian society to move toward high-tech industrial activity? What are the reforms that are currently underway to guarantee continued upgrading toward knowledge-based activities? It is the answers to these questions that make Costa Rica an interesting case study.

Waves of Change: Leveraging GVCs for Development

Economic development is about upgrading nontradable capabilities at

three levels: the individual, the firm, and the economy. Cesar Hidalgo and Ricardo Hausmann refer to this range of capabilities and their interactions as “economic complexity,” because higher levels of productivity require a more sophisticated set of building blocks.⁸ Individuals must learn skills that enable them to engage in sophisticated activities. Firms, in turn, must be able to organize production in order to make use of the skills that are available in the labor force. At the highest level of aggregation, economy-wide investments must be made that enable industries to remain competitive. Advanced capabilities at these three levels are, by nature, difficult and costly to develop and are therefore scarce. This allows countries that have mastered the right set of capabilities to engage in activities that are valued highly in the global marketplace, generating high profits and well-paid jobs. Costa Rica has succeeded in harnessing GVCs for development because it has adopted a set of policies that have developed higher capabilities in individuals, firms, and the economy as a whole.

The process through which Costa Rica has adopted the right set of policies is as telling as the policies it has adopted. In a perfect world, all-knowing and all-powerful policy makers would design and rapidly implement the appropriate policies to maximize economic growth. In the real world, the policy-making process is a complex, nonlinear activity with many unknowns, involving not only technical concerns but also political negotiations and administrative constraints. In this context, an approach aimed at targeting binding constraints can be more effective than a strategy based on wholesale reform.⁹ Costa Rica is an example of a country that has achieved steady progress by implementing waves of reforms that have been able to relieve binding constraints through the acquisition of new capabilities. The country has been able to ride each wave of policy changes until the next reform opportunity

arises. In recent history, it is possible to identify three waves of policy changes, each of which has sought to resolve the binding constraint of the moment, creating a self-reinforcing virtuous cycle.

The first waves of reform started in the late 1940s and early 1950s, with a strategic decision to strengthen democracy and boost investment in human capital. When the new constitution was written in 1949, after the civil war of 1948, the country adopted several measures to prevent small groups from overthrowing the government in the future, including the abolition of the standing army, the establishment of an independent body in charge of ensuring the legitimacy of elections, significant restrictions to the executive branch's powers, an extension of suffrage to a broader base of citizens, and democratization of access to credit. These measures have guaranteed peaceful political transitions ever since, making Costa Rica the longest-standing democracy in Latin America.

The new constitution also established the Ministry of Public Education and declared public preschool and secondary education to be free (in addition to primary education, which was already free and compulsory).¹⁰ The elimination of military spending allowed the government to invest in human capital, and by 1980 Costa Rica was spending 7.35 percent of its GDP on public education, ranking second out of the ten¹¹ Latin American countries for which data is available.¹²

From 1950 to 1980, Costa Rica rode this wave, constructing capabilities that have been important to the country's development. For the economy as a whole, the establishment of a stable political environment created the enabling environment for economic activity, while at the individual level investment in public education built an easily trainable workforce. During this period, Costa Rica was one of the Latin American countries with the greatest gains in education. Out of a list of nineteen Latin

American countries,¹³ Costa Rica ranked sixth in terms of the improvement in average years of schooling achieved by fifteen to nineteen year olds between 1950 and 1980, with a gain of 3.55 years of schooling, almost doubling from 3.68 to 7.23.¹⁴

The aforementioned reforms provided grounds for growth during this period of ISI. However, the ISI model's protectionist policies restricted competition, preventing firms from developing the capabilities necessary for the private sector to fully capitalize on the stable environment and well-trained labor force. These capabilities were not fully utilized for many years.

The second wave of reform unlocked and magnified latent local potential through policies of openness in trade and attraction of foreign investment in order to take advantage of the rapidly changing global production trends. After the debt crisis of the 1980s, the country reduced trade barriers in order to make the country a viable location for globally oriented companies. Unilateral trade liberalization started in the 1980s, and the average import tariff dropped from 46.3 percent in 1982 to 16.8 percent in 1989.¹⁵ In 1990, Costa Rica joined the General Agreement on Tariffs and Trades (GATT) and in 1995 it became a member of the World Trade Organization (WTO). Although Costa Rica's first preferential trade agreement (PTA) was signed in the 1960s when the country joined the Central American Common Market, the PTA with Mexico marked the beginning of a process of deeper trade liberalization. The country now has PTAs with fifty-eight countries.¹⁶ These trade agreements not only reduced barriers to trade, they also served to drive other reforms that have been important to increase the country's competitiveness. For example, the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) played a fundamental role in driving reforms to foster healthy competition in the telecommunications and insurance markets.¹⁷

In addition to building a broad and robust trade platform, in the 1980s Costa Rica also started to implement a series of other actions that complemented the strengths that were developed in the first wave of reforms: (1) nondiscriminatory investment rules and thirteen bilateral investment treaties (BITs) provide a favorable policy framework; (2) the Free Zone Regime offers attractive fiscal incentives; and (3) a well-coordinated inter-institutional investment promotion strategy facilitates the process of establishing operations in Costa Rica.¹⁸ Since the mid-1980s, foreign firms have been well positioned to leverage advantages that Costa Rica has always had, such as its geographical location, and advantages that it developed in the first wave of reforms, including high-skilled human capital and stability, by acquiring other necessary capabilities from foreign sources, including access to international finance and technological know-how developed abroad.

Since the 1980s, Costa Rica has ridden this second wave, allowing market forces to determine the GVC stages in which the country is best positioned to compete. This has brought a three-tiered FDI-driven transformation. First of all, there has been upgrading in capabilities at the individual level as professionals have acquired world-class skills. Foreign companies have created jobs through which workers have been able to learn industry-specific skills at a globally competitive level. Many of these professionals then chose to establish their own spinoffs, which have a much higher success rate than other startups.¹⁹ The best indicator of the upgrading in individual-level skills is the fact that companies that participate in each of the aforementioned GVCs have upgraded toward activities that require more skill-intensive domestic labor.²⁰

Second, there has been upgrading in firm-level capabilities. This has occurred in part through the attraction of key suppli-

ers that enable the growth of clusters, such as companies that provide sterilization services for the medical devices industry. It has also occurred through the knowledge transfer process that occurs when MNEs establish linkages with local firms. For example twenty out of the sixty-six firms that participate in the medical devices GVC are domestic firms linked to MNEs, nine of which were founded after 1990 to supply the industry.²¹ Finally, there has also been upgrading of country-level capabilities, since MNEs have been able to lobby for country-level improvements that bring broader benefits to foreign and national firms and individuals. For example, large MNEs have been successful in convincing local public universities to broaden their offering of engineering programs, which develops the country's talent pool in general. Since Intel established operations in Costa Rica, the company has worked with the University of Costa Rica and the Costa Rican Institute of Technology to increase the number of IT graduates in electronic engineering from roughly fifty to close to three hundred per year.²²

The challenges today revolve around climbing toward higher value-added activities in GVCs. Since the beginning of the current decade, there has been a gap opening between the demand for human resources by companies establishing operations in Costa Rica and the supply of professionals that local universities are able to graduate. This reveals that the latent pool of human capital has now been put to use, which is confirmed by the market pressures that are leading to rising wages. For example between 2006 and 2010, the average salary for a range of key technical and managerial professions rose by more than 60 percent in both services and manufacturing. To name a few, the average salary for quality engineers in manufacturing rose 100 percent and the average salary for a bilingual associate at a contact center rose 130 percent.²³ These wage increases

highlight the fact that it is important to continue to invest in keeping Costa Rica's competitive advantages in terms of human capital, stability, trade openness, and FDI attraction. However, they also point to the fact that there may be other conditions that need to be improved in the economy in order for a greater proportion of Costa Rica's most skilled human capital to engage in high-value activities, whether they are oriented toward science and technology or high-impact entrepreneurship.

The third wave of reforms involves fully unlocking the potential captured in the capabilities built during the first and second waves by investing in policies to stimulate a thriving innovation ecosystem that will attract knowledge-intensive FDI and stimulate local innovation. At the individual level, interesting partnerships between MNEs and academia have emerged to create joint masters programs to graduate research-oriented professionals that companies require to move toward R&D. The government is also pursuing loans with international organizations to strengthen university programs in science, technology, engineering, and mathematics (STEM areas) and to provide funding to train research-oriented professionals in key areas abroad. At the firm level, seven incubators and accelerators have been established to foster innovation-oriented entrepreneurship. The Trade Promotion Agency's export linkages program is also playing a key role in supporting the development of the capabilities of firms so that they can provide high-value products and services to MNEs. At a national level, the Doing Business reports show that Costa Rica is one of the countries that has made the most progress in streamlining processes to reduce unnecessary transaction costs for firms. In the Doing Business index, between 2012 and 2013, Costa Rica was the sixth best performer out of 189 countries in reducing the distance to the frontier in terms of starting a business, and in 2011

and 2013, Costa Rica was the ninth best performer out of 186 countries in reducing the distance to the frontier in terms of dealing with construction permits.²⁴ There are also important financial reforms underway. For example, in 2013 the banking system for development help the first publicly funded seed capital competition. That same year, a law proposal was submitted to the legislative assembly to enable the use of intangible collateral for loans.

As Costa Rica continues to strengthen the nontradable capabilities required to engage in knowledge- and innovation-based activities, foreign and domestic firms will continue to climb toward more sophisticated activities, capturing more value in the GVCs in which they participate. There is still plenty of momentum behind this third wave, which means that the main results are still to come. However, Costa Rica is already ranked the most innovative country in Latin America in the Global Innovation Index in 2013,²⁵ which is a promising sign that the economy is moving toward knowledge-based activities. It is also encouraging to observe that high-value innovation-based activities are already taking place. Multinational enterprises such as HP and Intel engage in R&D activities. In addition, local firms, such as Etipress,²⁶ have developed innovative technologies for the medical industry, and globally oriented startups in creative industries, such as Saborstudio,²⁷ have taken advantage of support from incubators and accelerators to make inroads in global markets. These are the type of success stories that will continue to fuel policy makers' efforts to strengthen the national innovation system.

Conclusion

The case of Costa Rica illustrates a few key points that can be of use to other small economies throughout Latin America. The first is that GVCs offer countries an unmatched opportunity for development; GVC-driven development is neither

inward- nor outward-oriented nor is it focused on domestic or foreign agents, but rather it is focused on creating capabilities that allow a country to engage in global production networks. The second is that development requires nurturing capabilities at all levels—individual, firm, and national. The third is that there are no shortcuts to developing these capabilities, but there are some paths that are less steep than others. In Costa Rica's case, reforms have come in waves, each of which has served as a building block for the next. Finally, the case of Costa Rica confirms that an inward-oriented approach is not advisable for small, developing countries, particularly in a world in which increasing connections create valuable opportunities. Economic development in an interconnected world often requires leveraging external pressures to catalyze reforms and making use of external resources to unlock the potential of domestic capabilities.

The views and opinions expressed in this article are those of the authors.



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- ¹¹ The others being Cuba (8.37 percent), Chile (4.44

percent), Panama (4.28 percent), Venezuela (3.88 percent), Nicaragua (3.26 percent), Honduras (2.99 percent), Argentina (2.61 percent), Uruguay (2.16 percent), and Colombia (1.73 percent).

¹² World Development Indicators. World Bank Web site, 2014.

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²⁷ Saborstudio is a local software startup that was accelerated by Carao Ventures, which created the application Pota-Toss, a location-based game.

Current Trends and a New Agenda for Foreign Direct Investment in Latin America

BY MICHAEL PENFOLD

Abstract

CURRENTLY, LATIN AMERICA is in a favorable situation despite the uncertain conditions of the global economy. The region's economic dynamism, a consequence of the renewed interest of foreign investment, has led to a reduction in its poverty rates. This article will analyze thoroughly the behavior of foreign direct investment in Latin America during the period of 2000 to 2011 as compared to the 1990s, indicating the factors that have strived changes in the source of investment, the impact of political and economic trends, and potential challenges to achieve sustainable growth.

Introduction

Latin America is currently in a favorable economic situation despite the uncertain conditions of the global economy. In particular, the region shows relatively high growth rates, coexists in an environment of democratic opening and, with certain

exceptions, has achieved a reduction in its poverty rates. A central element behind this great economic dynamism has been the renewed interest recovered by foreign investment increasing its participation in Latin America.

Interestingly, foreign investment in the region shows some positive contrasts in regard to its behavior in the 1990s—a decade that was also characterized by high investment, although marked by the privatization processes of numerous state assets in a context of fiscal adjustments and trade liberalization. With regard to the contrasts, the following transformations can be identified: (1) a greater diversification in the origin of the foreign direct investment (FDI) (which was initially highly concentrated in foreign investment originating from Europe and the United States) toward greater participation from Asia, especially China, as well as foreign investment originating from Latin American companies that have expanded to other

countries (known as multilatinas); (2) the region has started to see the entry, although very incipient, of foreign investment linked to the venture capital industry, oriented toward the identification of dynamic and innovative companies and sectors; (3) the growth in domestic markets, especially of the middle class, has been an important source of attraction for foreign investment in the area of services, for the purpose of taking advantage of the expansion in consumption, as well as physical infrastructure (airports, ports, telecommunications, highways, etc.) and social (health) needs, raising the standards of educational demand as well as supply; and (4) the specific decision, albeit in incipient form, of some foreign companies to install research and development (R&D) centers in countries such as Mexico, Chile, Panama, and Brazil, which could result in the strengthening of the potential for innovation and increase the technological content of some nontraditional sectors within the Latin American economies.

However, the continuities in the behavior of foreign investment are equally

outstanding: (1) the increased growth in FDI is concentrated in sectors linked to the export of commodities based on natural resources (energy, mining, and agriculture) and also in services; (2) FDI oriented toward using Latin American countries as export platforms in nontraditional sectors remains scarce; and (3) the dynamism of FDI is closely linked to the opportunities generated by changes in government policies—in the 1990s by the privatization processes, and currently by the processes of concessions or public-private investment projects in infrastructure and services and in the opening up of capital intensive sectors, such as oil, gas, and mining.

Characterization of FDI in Latin America

Investment Inflows

In general terms, Latin America has shown relatively high foreign investment figures during the last decade (see Figure 1). FDI inflows have been growing consec-

Flow of FDI of Latin America

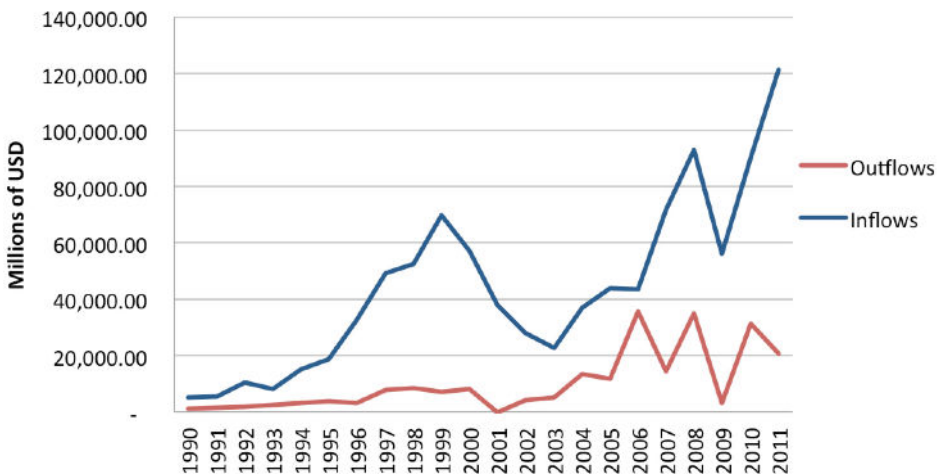


Figure 1- Inflow of Foreign Direct Investment into Latin America

Source: UNCTAD (2011)

utively, with the exception of 2008, which showed a decrease as a consequence of the global financial crisis. By the year 2011, foreign investment inflows in Latin America had not only recovered but had achieved maximum historic levels, exceeding 120 billion dollars, with Brazil, Mexico, and Colombia attracting the greatest amount of inflows in the last few years.

From 2006-2011, a large part of the annual inflows of FDI in Latin America have been concentrated in a small group of countries: Brazil, Mexico, Colombia, Chile, Peru, Uruguay, and Panama. For example, in the cases of Panama and Chile, FDI is close to or higher than 8 percent of gross domestic product (GDP); it is close to 3.5 percent and 2.5 percent of GDP in Brazil and Mexico, respectively. In Colombia, Uruguay, and Peru, there has been a significant increase in FDI, comparing the importance of the amounts they attracted from 1996 to 2000 in relation to the high levels of attraction achieved for the period of 2006 to 2011; in Uruguay and Colombia, FDI for 2006-2011 reached 5.5 percent and 3.5 percent of GDP, respectively. Countries like Venezuela, Bolivia, and Argentina, on the other hand, have shown a significant fall in the importance of FDI as a percentage of GDP throughout the last decades.

Origin of the Investment

The origin of FDI in Latin America has changed significantly upon comparing the periods of 2000 to 2005 and 2006 to 2011. In the first period, both the European Union and the United States had a very high percentage weight in terms of their participation as originators of FDI. In particular, the European Union had a clear leadership in the process, representing almost 45 percent of the origin of the annual inflows. In the second period, the European Union maintained its leadership, but despite that, it declined in importance with 40 percent of the total amounts. The investments from the United States fell

from 37 percent in 2000-2005 to almost 28 percent in 2006-2011.

Curiously, the emergence of other alternative sources of origination marked the dynamism of foreign investment in Latin America during this second period. The participation of Asia in FDI went from 11 percent in 2000-2005 to almost 17 percent in 2006-2011. Furthermore, Latin America began to observe in both periods the expansion of the companies known as multilatinas, which have been dominated by processes of strong expansion of their markets within the region itself, through the extensive use of FDI mechanisms. From 2000 to 2005, the Latin American origination of FDI represented little more than 10 percent of the annual inflows; while from 2006 to 2011, these flows reached almost 17 percent of the total amounts received by the different countries. In other words, in the period of 2006 to 2011, both Asian and Latin American sources grew strongly in terms of importance, while the FDI from Europe and the United States—which continued to represent the greatest proportion of funds—experienced a clear decrease in terms of their relative importance.

Sectorial Behavior

The sectorial behavior of the FDI has shown some interesting changes, particularly when compared to the 1990s. During that decade, the FDI in Latin America was highly concentrated in the attraction of investments in the service sector, mainly due to the opportunities generated by the privatization processes and the opening applied to the financial sectors, telecommunications sectors, and public service sectors (electricity and water). In this same period, the FDI also took advantage of opportunities in the manufacturing sector, especially to capitalize on the opportunities of the economic opening that certain markets such as Brazil, Argentina, Mexico, Venezuela, and Costa Rica represented. It should be stated that during the 1990s,

Mexico had a high performance in the attraction of investments in manufacturing oriented toward exports, taking advantage of its commercial integration with the United States and Canada. In this manner, 60 percent of the FDI in Latin America was concentrated in the service sector and 23 percent in the manufacturing sector. The FDI in industries based on natural resources barely represented 12 percent.

By the end of the first decade of the millennium, some new sectorial trends began to be observed. The proportion of FDI in the service sector maintained its importance (although declining), attracting 43 percent of total flows from 2006 to 2011. FDI in the manufacturing sector reached 33 percent between 2006 and 2011, representing a significant increase compared to previous periods of time. The FDI in natural resources also increased significantly, representing in this same period 17 percent of the total flows of FDI in Latin America. Interestingly, in the last few years, FDI in natural resources increased to 28 percent of total inflows toward Latin America.

Various causes explain these trends. In the service sector, there has been a clear transition from the specific opportunities that were generated by the privatization processes, especially in the financial and telecommunications sector, toward a growing expansion of the internal markets marked by the growth of the middle classes and the reduction in the poverty gaps. This new social and economic reality has created downscaling opportunities, which have allowed many of these foreign companies to reinvest to increase the expansion of their services to the various sectors of the population, even the lowest-income sectors.

Regarding natural resources, the emergence of public policies more favorable to the entry of foreign capital in sectors such as petroleum and mining, accompanied by the discoveries of new deposits in various Latin American countries including Co-

lombia, Brazil, and Peru, have promoted a large inflow of FDI. This is particularly true for countries like Chile, Peru, Colombia, and Brazil that consolidated a regulatory framework that permits the participation of private investment in various large-scale projects. On the other hand, other countries, such as Argentina, Bolivia, and Venezuela, which modified their public policies to seek a more strategic control of these industries by the State, have experienced disinvestment processes. Despite this, the investments in the exploitation of natural resources that the first group of countries has been able to attract (those with more open investment frameworks) have been really large.

Finally, from 2005 to 2007, the central component of FDI in Latin America was provided by capital contributions. In effect, more than 48 percent of the net income of foreign investment was of this nature. Between 2009 and 2011, this same percentage had reduced to 40 percent, increasing instead the importance of the reinvestment of the profit (which came to represent more than 50 percent of all the components of the net income of FDI). This quantitative change reflects the perception by the foreign companies in Latin America of a fall in the risk levels and a greater desire to finance their expansion in the region through reinvestment processes. This is undoubtedly an obvious change and a process that can have positive long-term effects on the economic and productive performance of the region. However, FDI in Latin America continues to respond more to the search for high returns derived from opportunities that arise from changes in the regulatory frameworks (privatizations or opening of sectors), than the attractiveness itself of the countries with regard to their competitive improvements.

Some New Tendencies of FDI in Latin America

Venture Capital

Although to a lesser extent than Asia or Eastern Europe, Latin America has seen the appearance of new forms of foreign investment, especially in the form of venture capital funds. This phenomenon has been mainly concentrated in Brazil and Mexico and with an incipient presence in Chile and Colombia. For the year 2011, these funds had committed close to 6.5 billion dollars in investment for the region, which represents close to 5 percent of the total funds invested globally.

These amounts are scarcely relevant on a global level. Additionally, many of these funds operate more as development capital—oriented toward equity investment in ongoing companies—than in the financing of risk investments per se. However, as a recent phenomenon, this process is tremendously significant. For the first time, Latin America is beginning to receive investment oriented toward identifying dynamic growth companies as well as the identification of new, innovative projects. This is a fundamental boost for business development that permits the injection of dynamism to the growth of medium companies with high potential. However, the sustainability of this process will depend on the capacity of the countries not only to attract risk capital but also to strengthen their capital markets, as well as their national and regional innovation systems and the existence of a greater flow of business projects that are attractive for this type of investor.

Research and Development

One of the most outstanding characteristics of the recent behavior of FDI in Latin America is related to the fact that the most significant component in net income is being provided by the reinvestment of profit. As mentioned previously, this reality

shows that the region has been earning the trust of foreign investors with regard to their future growth decisions, which has had an impact on the expansion of the range of activities carried out by multinational companies within the different industries in which they have established themselves.

Additional evidence of the increased confidence is the expansion of the spectrum of activities of some multinational companies that have chosen to install R&D centers in certain Latin American countries. This process is still very new and requires an adequate public policy (in matters of sector policy as well as science and technology) to be able to stimulate and consolidate the economic and scientific impact of this type of investment.

Although the total investment in terms of R&D in Latin America is comparatively low, it is also true that the public component is the most important and the private component presents significantly low levels of investment. However, certain countries, such as Brazil, Mexico, and Chile, have started to show some changes that deserve to be highlighted. The private sectors in Chile and Mexico are financing almost 50 percent of the total investment in R&D. In Brazil, this amount is a little more than 40 percent. Among these amounts, the increase in private financing reflects the decisions of various multinational companies—Siemens, General Electric, Cargill, and Procter & Gamble among others—to open their R&D centers in some of these Latin American nations. This tendency undoubtedly reflects one of the most positive aspects of the recent dynamic of FDI in the region, since it permits the leverage of innovation processes based on technological transfers with a higher productive impact in the economic development of these countries.

China as Investor

Although the growth of the invest-

ment of Chinese origin is a global process that began more than a decade ago and that reflects the growing economic importance of this country on a global level, it is a relatively new process in Latin America. The presence of Chinese FDI in Latin America has basically concentrated on the sectors related to the exploitation of natural resources (petroleum and mining) and incipiently in the agricultural and telecommunications sectors.

It is evident that the main driver behind the Chinese investment is the need to ensure the provision of certain raw materials considered strategic to guarantee China's future economic growth (fundamentally, energy) and for which Latin America plays a privileged geopolitical role. Besides this, in many of these investment processes, especially in the petroleum sector, the state companies of China have played a preponderant role, financed additionally through their development banking institutions. In this sense, the tendency of a greater presence of Chinese investors in Latin America is something new due not only to its "origin" but also to the characteristics of the companies that have driven this process (i.e., state companies) and to their high sectorial focus (i.e., raw materials).

In terms of relative importance, the region has become the second geographical destination for China for FDI. Of the total amounts, during the last decade, China has invested close to 26 billion dollars, which represents close to 11 percent of its total flows. Very few of these investments have been carried out by private companies, while the rest involve companies with state participation. In terms of the amounts of the transactions, the FDI promoted by the state companies represents more than 80 percent of the total invested amounts. Most of these transactions are concentrated in sectors related to raw materials, especially petroleum and mining, and most recently some operations in the agriculture sector are observed.

The Multilatinas

The emergence of the multilatinas reflects how globalization has a reverse side: the growing role of originators of FDI from developing countries toward countries also in the process of development (south-south) and even also of developing countries to developed countries (south-north). In fact, of the one hundred biggest companies of the emerging markets, nine have their headquarters in Latin America: Cemex, Telcel, Embraer, Votorantim, and Vale Do Rio Doce, among others, represent some of the most emblematic multilatina companies.

On a global level, the multilatinas went from originating 0.5 percent of the global amounts of FDI in the period from 1970 to 1990 to 3.7 percent for the period from 2000 to 2009. These amounts currently represent 27 percent of the total FDI flows originated in the developing countries, since more than 60 percent are being made by companies based in Asia. Although compared to Asian companies, the multilatinas are far from wielding the global leadership of this new process, it is no less true that their growth is significant and has, among Mexican and Brazilian companies, its most distinguished examples.

Contrary to the dynamic observed in the case of FDI from China in Latin America, the sectors in which the multilatina companies show greater activity are more diversified. In particular, investments in food and beverages, engineering and construction, steel and metallurgy, transport, petroleum, and mining stand out. Furthermore, this is a process in which there is a growing participation of medium-sized companies that attempt to emulate the internalization patterns of the large Latin American companies through which they tend to be integrated as suppliers. This expansion in the size range of the investors (from large to medium and their greater diversification) is probably showing that the FDI originating from the multila-

tinias is having a growing regional integration impact.

The New Agenda of FDI in Latin America

The trends that have been described show some notable changes in the behavior of FDI in Latin America. These changes are accentuated when compared with the 1990s. In general terms, Latin America continues to increase its attraction for FDI as a result of the consolidation of its economic and commercial liberalization processes. Simultaneously, Latin America achieved greater diversification in the origin of FDI, and the presence of new types of investment as well as activities more oriented toward innovation objectives are also evident. These processes have been the result of the appearance of venture capital funds as well as the decisions of multinational companies to install R&D centers in some specific countries, in the context of growing domestic markets characterized by a larger middle class. However, foreign investment has shown growth in primary sectors and a decrease in the manufacturing sector. Therefore, there are some challenges that deserve to be mentioned as part of a new development agenda.

A second matter is the need to stimulate a greater link between competitiveness and the investment attraction agenda on a country level and also of the territorial localities. This link necessarily requires the attraction of a greater number of investments—especially in the manufacturing sector and with a greater export focus—that generate sufficient demand to sophisticate the competitive agenda of the countries and drive the territorial development of the localities. This process is irrevocably related to the productive consolidation of business clusters (new and old) located throughout the entire territory, so that given increases in the levels of association between the various actors, the attraction of new investments and technological dis-

semination and adoption, demands that stimulate competitive solutions for the business challenges being faced are generated.

The emergence of the multilatinas as a new investment channel is undoubtedly another matter that arises from this analysis, especially for its regional integration effect as well as its greater sectorial diversification. Some of the multilatina companies, especially the largest ones, have advanced to compete not only regionally but also globally. However, there is evidence that the investment of Latin American firms is not only limited to major companies, but is also being expanded to the medium companies of the region. In this sense, a new agenda must include the most rigorous analysis of the profile of these medium companies and the characterization of their internationalization strategies.

Finally, Latin America observes in an incipient manner the appearance of new forms of foreign investment (venture capital) as well as new related activities (research and development). This leads us to assume that innovation will be one of the central elements of a certain type of foreign investment in the region, especially in those countries that show competitive improvements in their institutional frameworks. Based on this it becomes imperative to document the characteristics and the experience of the venture capital funds and the type of investments that they are carrying out. Furthermore, it is also necessary to better understand the various business cases that led to the installation of some R&D Centers in order to understand the success factors and the public policy requirements that were demanded by the companies. These types of findings are fundamental to be able to promote adequate regulatory frameworks that make the region more competitive and to identify potential innovative sectors in which greater FDI levels could be attracted.



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The Economic Legacy of Hugo Chávez

BY MIGUEL ANGEL SANTOS AND RICARDO VILLASMIL

Abstract

ALTHOUGH IT IS too soon to assess late Venezuelan President Hugo Chavez's political legacy, we argue that taking an economic perspective allows for three important conclusions to emerge: (1) his rise to power can be largely explained by the abysmal economic performance of his predecessors; (2) the consolidation of his rule is partly the result of spectacular increases in private consumption generated by wildly expansionary policies in the context of price and exchange rate controls; and (3) Chavez passed away leaving his political heir holding the bag of financial excess and his countrymen at large the much heavier legacy of paying the price of his political success.

Introduction

One could say that they painted themselves into a corner. Buttressed by the largest and most prolonged run in oil prices in Venezuelan history, the country rulers de-

cidated to finance an unprecedented boom in private consumption through expansionary macroeconomic policies. Ever-expanding fiscal spending was coupled with interest rate, price, and exchange controls, as well as general subsidies and massive cash transfers to the poor. They supplemented this mix with left-wing revolutionary rhetoric, a systematic dismantling of checks and balances on executive power, and aggressive administrative, legislative, and judicial actions against private property, media outlets, and opposition leaders.

Year after year, the administration of Venezuelan President Hugo Chavez managed to survive the ominous predictions of mainstream economists as domestic and external constraints kept pushing forward. The figures are quite revealing. Between 2005 and 2012, the compounded annual growth rate of oil exports was 14 percent and that of the stock of foreign debt was 16.8 percent.¹ They both allowed the value of imports to grow 17.4 percent and real

government spending another 9.1 percent.² While real gross domestic product (GDP) per person grew only 3.1 percent and real wages fell 0.2 percent, private consumption per head increased 5.6 percent. Poverty rates dropped from 53.9 to 25.4 percent, extreme poverty from 22.5 to 7.1 percent, and the Gini coefficient of inequality fell from 0.46 to 0.39. These results would prove instrumental to the government's phenomenal success at the polls (see Appendix I and II).³

By October 2012, however, expansionary policies had reached their limits. The recipe was simply not sustainable. When oil prices stumbled as a result of the 2008 financial crisis, the authorities decided to finance their way through, a strategy that continued unabated after oil prices rebounded to their precrisis levels but failed to continue their upward trend. Various sources of financing have been tapped since then: foreign public debt increased from \$38 billion to \$103 billion, and domestic debt went from \$17 billion to \$39 billion between 2009 and 2012. The authorities also resorted to printing money. After growing 14 percent and 19 percent in 2009 and 2010, respectively, money supply (M2) grew 51 percent in 2011 and 60 percent in 2012, partly as a result of Central Bank loans to the national oil company, *Petróleos de Venezuela, S.A (PDVSA)*, and to other State-owned enterprises. Finally, arrears ballooned in 2012 as other sources proved insufficient. Most of these arrears are not documented or consolidated in any report coming from official sources; estimates of their tally have to be obtained from the corresponding chambers and other private associations.

In addition to these hard-pressing financial matters, Venezuela faces other significant and immediate challenges. According to public opinion polls, personal security is the most pressing concern. Intentional homicides have soared from a rate of 20 per 100,000 population in 1999 to 73 in

2012, making it the second most violent country in the world and Caracas the sixth most dangerous city on the planet.⁴ Public infrastructure is also a big problem: the overall quality of life and the country's competitiveness have been affected by the congested and outdated state of the nation's network of roads, ports, airports, electricity, water, and sewage systems, among others. Institutions are crumbling as well: Venezuela ranks 134 out of 148 countries in the 2013-2014 World Economic Forum's Global Competitiveness Report and 180 out of 185 in the 2012 Doing Business index. Out of the 214 countries included in the World Bank's 2011 Worldwide Governance Indicators, Venezuela ranks 162 in voice and accountability, 191 in political stability and absence of violence, 184 in government effectiveness, 196 in control of corruption, and 211 (fourth to last) in rule of law.

Political and Economic Background

It is tempting to see Hugo Chavez and his Bolivarian Revolution as a historical mishap, a political cyclone that destroyed what not too long ago stood as one of the strongest and most successful democracies in South America. To be sure, Chavez had all the characteristics of a messianic leader. His oratory skills, charisma, and indisputable talent to stir up the base emotions of the masses made him an indispensable ingredient of any attempt to explain not only the highly controversial appeal of his Bolivarian Revolution, but more importantly, the all but absolute control of the Venezuelan State he managed to muster throughout his fourteen-year rule.

The problem with such an interpretation, however, is that it fails to take into account the fertile soil that his violent and vindictive message found when he decided to run for president in 1998, after his failed coup attempt in 1992. Had this rabble-rouser tumbled into the spotlight two or three decades earlier, he would have at best

become the leader of a small political fringe group.

In the early 1970s, Venezuela was, by all accounts, the richest and most promising country in Latin America. An astonishing feat, to be sure, for a country that only fifty years before stood as one of the most backward nations in the Western Hemisphere. It was precisely at that time that a new setting of civil and political order combined with the discovery and subsequent exploitation of huge oil deposits, allowing for the possibility of channeling growing fiscal revenues into much-needed public goods and services. Although not always wisely spent, sustained increases in government spending during the next fifty years allowed Venezuela to become one of the top economic and social performers in Latin America and the world.⁵ Incomes grew eightfold in per capita terms, life expectancy increased from thirty-one to sixty-five years, and literacy rates went from 32 percent to 77 percent. After 1958, the country turned itself into a model of democracy in a region marred by guerrilla warfare and brutal military dictatorships.

By the early 1980s, however, the magic had vanished. Between 1978 and 1998, income per head fell 20 percent in real terms, making Venezuela the worst performer in the region and sending the share of the population living under poverty from 23 percent to 57 percent. Although the causes behind such a drastic reversal of fortune are still hotly debated, an angry and frustrated population saw little more than widespread corruption in the political system behind this turn of events. Hugo Chavez could not have picked a better time to burst into the political scene. At the time of his coup attempt, the population was emerging from the adjustment phase of an International Monetary Fund (IMF)-sponsored reform package that had taken the population largely by surprise. By 1998, the country was in tatters: oil prices had plummeted below ten dollars a barrel, ter-

rible news for a country where oil earnings represent about 50 percent of government income and 90 percent of export revenues.

Traditional parties, long since out of touch with the day-to-day lives of common Venezuelans, underestimated Chavez as well as the appeal of his rhetoric, paving his way to the presidency in 1998. The first five years of his rule were particularly difficult from an economic point of view, partly as a result of increasing but still relatively low oil prices and also due to the very low levels of private investment. From a political perspective, however, it was during this time that Chavez's acute gambling instinct allowed him to induce a politically inept and arrogant opposition into a costly series of mistakes that resulted in him taking personal control of the key powers of the State: the Armed Forces after the coup attempt of 2002, PDVSA after the national strike of 2003, 20 of 22 governorships and 270 out of 337 municipalities through the opposition's partial boycott of the regional elections of 2004, and finally, the National Assembly as a result of the boycott of the 2005 elections.

This accumulation of power in the hands of the president is without precedent in the country's contemporary history. Between 1958 and 1998, the main political parties alternated in power in contested elections. The Parliament, the Attorney General's office, and the Supreme Court, albeit imperfectly, did provide checks and balances on the Executive's power. President Chavez's will, in contrast, has become, over time, all but uncontested.

2005-2012: The Macroeconomics of Populism

As oil prices began to increase in 2004, the administration learned quite rapidly the political benefits of stimulating private consumption. In a surprisingly faithful remake of the set of policies described by Rudiger Dornbusch and Sebastian Edwards in *The Macroeconomics of Populism*, the authorities decided to loosen monetary

and fiscal policy; set a fixed and overvalued currency; and imposed foreign exchange, price, and interest rate controls. In order to better capitalize the political returns of the consumption boom generated by these policies, they diverted the proceeds of the oil price boom from PDVSA, the budget, and from the Central Bank into FONDEN, a newly created investment fund managed with absolute discretion by the president.⁶

The Venezuelan economy responded to this distorted set of incentives by abandoning domestic production in favor of import and consumption-related sectors. Year after year, oil price increases allowed for large increases in imports to cover for shortcomings in domestic production, thus keeping the expansion in private consumption from getting bogged down in bottlenecks.

As a result of the government's policies, significant qualitative changes in the economy also took place in terms of the share and the role of the public sector in the provision of goods and services. Starting in 2004, the government took aggressive steps toward enlarging its relative scope and size through more regulations, takeovers, and outright expropriations. Between 2004 and 2010, the government expropriated 779 private businesses.⁷ The authorities took control of companies and sectors they deemed as strategic, such as oil service contractors and steel and cement production, and enlarged its presence in banking as well as in food production and distribution and retail of basic consumer goods.⁸ Even in sectors where it did not possess a large share of total production, the government heightened its control by setting producer and consumer prices, wages, the size of the workforce, and import quantities. It also prohibited exports, and fixed shipment size and frequency for each destination according to estimated demand in order to prevent hoarding. The government also ventured into a wide array of industries such as automobile and farm

equipment production, pharmaceuticals, and paper. Usually this came as a result of an expropriation and in association with political allies in a given private company's workforce, but also resulted from new ventures with political allies such as Iran, China, and Belarus. One important indicator of this policy is that between 2005 and 2012, the government share of total imports went from 17 percent to 44 percent.

2012: The Final Showdown

Whenever his political survival has been at stake, Chavez has never been willing to leave loose ends. Back in 2006, in spite of leading the polls by a wide margin, he engineered an increase in nominal public expenditure of 51.7 percent (29.2 percent in real terms), augmenting liquidity by 61.7 percent and dollar imports by 20.1 percent. Booming oil prices and spare capacity allowed for 9.9 percent GDP growth, with real private consumption increasing 14.4 percent per capita, paving his way to a crushing victory (62.8 percent). The circumstances in 2012 were different. Six years of high public expenditure and socialism had depleted spare capacity, leading to frequent shortages in different industries that have been addressed through imports. Foreign debt had increased fourfold, leaving monetization, internal debt, and arrears as the only financing options. In the context of a close presidential race, the need to compensate for his diminished presence on the campaign trail seemed to complete the recipe for a perfect storm.

The oil price boom that began in earnest in 2005 marks the last fiscal surplus (4.1 percent) to date. From then onward, the consolidated fiscal balance⁹ has registered an expanding deficit, a tendency that deepened throughout 2009-2012 as oil prices recovered from the financial crisis to later surpass the hundred dollar per barrel barrier. This unlikely result was caused by a number of factors:

- Oil revenues measured in domestic currency plunged as the government continued to use the exchange rate as an anchor against inflation
- A nationwide election held every year from 2007 to 2010 forced the government to maintain high fiscal expenditure
- The exhaustion of demand-driven growth, with the industrial apparatus out of spare capacity and little investment, rendered public expenditure ever more inefficient

The consolidated fiscal balance in 2009, 2010, and 2011—the three years prior to the presidential election—shows a deficit of 8.8 percent, 10.4 percent, and 12.6 percent of GDP, respectively (see Appendix III). The fiscal outlook by year end 2012 was even worse. None of the three factors mentioned above would change. Oil prices stabilized, and oil production and export volumes were stagnant. The government quadrupled its stock of foreign debt in six years, and sovereign risk remained above 1,000 basis points. There were only three possible ways to finance the expanding fiscal gap: (1) printing money, (2) issuing domestic debt to gather idle liquidity in the banking system, and (3) arrears.

The situation was much worse than the one portrayed by official statistics. Starting in 2005, the government gradually but steadily pursued a strategy of fragmenting the fiscal accounts (revenues and expenses alike) into different pockets, draining resources from the central government budget and public scrutiny. This move was eased by the implementation of a series of increasingly complex schemes that were passed by Congress and dutifully executed by the Central Bank. The money funneled away was deemed “extraordinary income” and therefore not subject to the 20 percent earmark the central government must

transfer automatically to the regional and local governments (*Situado Constitucional*).¹⁰ As the opposition regional strongholds starved, a number of funds were created to collect deviated public revenues. These funds, not subject to any mechanism for accountability, became a vehicle for discretionary public expenditure. The most prominent of these funds was FONDEN, which has received from inception to 2012 a total of US \$94 billion. Accountability is almost nil, both on the uses and remaining balance. According to internal sources, FONDEN has always been administered directly by President Chavez and his immediate entourage, and questions regarding the destination of the funds or the actual balance of its holdings have never been welcomed.

Figures for consolidated fiscal balance, including FONDEN, Chinese Fund, *Fondo Independencia*, and other funds, are not public. The Ministry of Finance only provides a financial summary comprising the joint fiscal accounts of the central government and PDVSA. According to internal sources, fiscal deficit reached 13.3 percent of GDP and 18 percent of GDP in 2012 (see Appendix IV). A fiscal summary of Chavez’s last year in power follows:

- Consolidated public expenditure for 2012 is totaled at 51.2 percent
- Only 52.7 percent of public expenditure is executed by the central government
- The fiscal deficit is estimated at 18.0 percent of GDP
- 48 percent of the financing (8.7 percent of GDP) is expected to come from Central Bank
- 37 percent (6.9 percent of GDP) will come from domestic debt issues
- The remaining sources are Chinese Fund (1.4 percent of GDP) and PDVSA (1.3 percent of GDP)¹¹



The Aftermath

As we write these lines, Venezuela has just completed the first year of its transition post-Chavez. Under the rule of his heir, Nicolás Maduro, the country had a gloomy year. Preliminary estimates of the consolidated fiscal balance indicate that 2013 closed with a 15 percent of GDP deficit, financed by printing money and issuing domestic debt in equal shares. The monetary base grew by 71 percent, pushing consumer prices up by 56.1 percent and food prices by 80.1 percent. As the government continued to rely on price controls, shortages became rampant.

The parallel exchange rate depreciated by 85 percent, going from 12 units of domestic currency per dollar to 80. International reserves are roughly enough to cover four months of imports, and 90 percent of them are composed by gold reserves held at the Central Bank. The foreign exchange cash balance has been depleted, and the economy now lingers on the flow. Shortages of electricity and basic goods are rampant.

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**APPENDIX I
BASIC ECONOMIC AND SOCIAL INDICATORS 1998-2012**

Year	real wages				Per capita				
	Overall	Private		Government	Oil Exports (MMUS\$)	Imports (MMUS\$)	Expenditures (MIMMBs 2011 prices)	GDP (MIMBs 1997 prices)	Private Consumption (MIMBs 1997 prices)
		Overall	Private						
1999	1472	1457	1534	709	783	7196	1657	906	
2000	1532	1480	1739	1155	876	8845	1687	931	
2001	1637	1515	2116	885	965	9714	1712	969	
2002	1449	1356	1817	860	685	9177	1533	884	
2003	1200	1134	1460	864	545	8887	1389	831	
2004	1203	1089	1651	1265	824	11273	1614	943	
2005	1235	1092	1802	1818	1104	14356	1750	1073	
2006	1297	1106	2055	2152	1463	18841	1891	1218	
2007	1319	1112	2135	2290	2102	17945	2023	1400	
2008	1254	1047	2073	3202	2313	17853	2095	1465	
2009	1182	995	1920	1924	1880	13604	1996	1399	
2010	1118	971	1700	2174	1789	14160	1935	1352	
2011	1156	976	1867	3024	2135	18302	1986	1385	
2012	1222	1024	2004	3162	2608	21636	2066	1460	

Source: Venezuelan Central Bank, Ministry of Finance, and National Institute of Statistics.

APPENDIX II BASIC ECONOMIC AND SOCIAL INDICATORS 1998-2012

Year	Oil Exports (MMUS\$)	Imports (MMUS\$)	Share of Public sector imports (%)	Expenditures (MMMMBs 2011 prices)	GDP (MMMMBs 1997 prices)	Foreign debt (MMUS\$)	Private Consumption (MMMMBs 1997 prices)	Poverty (%)	Extreme poverty (%)	Inequality (Gini)	Population (MM)	CPI (Dec 2007=100)
1999	16917	18683	15.4%	171.8	39.6	25463	21.6	48.7	20.1	0.47	23.9	22
2000	28070	21300	14.2%	215.0	41.0	23198	22.6	46.3	18.0	0.48	24.3	26
2001	21912	23892	14.7%	240.6	42.4	22800	24.0	45.4	16.9	0.46	24.8	29
2002	21693	17282	12.9%	231.4	38.7	24302	22.3	55.4	25.0	0.49	25.2	36
2003	22187	13995	15.3%	228.2	35.7	26421	21.3	62.1	29.8	0.48	25.7	47
2004	33042	21518	24.7%	294.5	42.2	29502	24.6	53.9	22.5	0.46	26.1	57
2005	48320	29347	17.2%	381.5	46.5	32106	28.5	43.7	17.8	0.47	26.6	66
2006	58161	39537	17.1%	509.3	51.1	29476	32.9	36.3	11.1	0.44	27.0	75
2007	62937	57760	18.9%	493.2	55.6	35774	38.5	33.6	9.6	0.42	27.5	89
2008	89440	64618	24.3%	498.7	58.5	37774	40.9	32.6	9.2	0.41	27.9	117
2009	54604	53368	30.4%	386.1	56.7	55749	39.7	31.8	8.8	0.42	28.4	151
2010	62692	51594	35.1%	408.3	55.8	72270	39.0	32.5	8.6	0.39	28.8	194
2011	88522	62503	41.7%	535.8	58.1	85154	40.5	31.6	8.5	0.39	29.3	247
2012	93976	77503	42.4%	591.6	61.4	102325	43.4	25.4	7.1	n.a.	29.7	299

Source: Venezuelan Central Bank, Ministry of Finance, and National Institute of Statistics.

APPENDIX III RESTRICTED PUBLIC SECTOR - FINANCIAL SUMMARY

	2005	2006	2007	2008	2009	2010	2011
	MM BS. (% PIB)	MM BS. (% PIB)	MM BS. (% PIB)	MM BS. (% PIB)	MM BS. (% PIB)	MM BS. (% PIB)	MM BS. (% PIB)
TOTAL INCOME	114,356	148,360	163,878	212,869	173,870	215,722	365,166
Recurrent income	37.6%	37.7%	33.7%	31.9%	24.8%	21.2%	26.9%
Tax revenues	36,756	48,073	62,478	76,646	173,870	215,722	365,166
Income tax	7,086	11,503	17,028	20,727	24,852	104,019	152,687
Other	29,670	36,571	45,451	55,920	61,920	75,883	115,988
Non-tax revenue	77,600	100,286	101,400	136,243	87,098	111,703	212,478
Supervit of PDVSA and other non-financial public	55,337	66,678	74,903	92,838	31,143	84,165	112,953
Interests, dividends, commissions, and other income	22,263	33,608	2,597	2,775	1,951	27,338	99,525
Transfers	29	0	23,350	40,629	54,373	0	0
Other income	28	1	0	0	0	0	13,309
TOTAL EXPENDITURE AND NET LENDING	101,961	154,681	177,803	236,341	235,303	321,105	535,834
Recurrent expenditure	21.3%	24.2%	22.5%	22.9%	33.6%	31.6%	39.5%
Salaries	11,594	16,270	20,953	30,538	37,476	50,492	71,018
Government purchases of goods and services	4,586	10,298	8,341	10,914	11,581	4,804	13,392
Other recurrent expenses	800	1,275	1,806	2,059	2,457	11,618	11,356
Interests and commissions	9,046	8,223	8,037	9,800	10,356	17,643	29,646
Quasifical loss of Central Bank	0	0	0	0	0	0	0
Transfers	38,463	57,422	69,867	97,302	90,700	157,995	276,269
Other recurrent public expenditures	554	1,767	557	2,608	762	0	0
Capital expenditures	11.5%	14.3%	13.6%	11.6%	11.0%	6.6%	8.3%
Investment in fixed assets	41,989	17,587	27,768	23,850	39,184	38,700	112,017
Capital transfers	22,800	38,269	38,603	53,514	37,884	28,235	58,488
Other	0	0	0	0	0	0	0
Extrabudgetary expenditure	1,416	1,894	519	273	519	2,159	327
Net Lending	835	1,276	1,455	5,483	4,377	9,280	21,808
PRIMARY SURPLUS OR DEFICIT	21,441	1,901	-5,888	-13,651	-51,077	-87,740	-141,021
RECURRENT SURPLUS OR DEFICIT	49,513	16,331	54,417	59,669	20,538	-26,929	-36,515
SURPLUS OR DEFICIT	12,395	-4,141	-13,925	-23,452	-61,433	-105,383	-170,668
FINANCING	-12,452	6,321	13,925	25,452	61,433	105,383	157,359
Internal	-14,286	-4,731	-6,340	-16,403	43,730	88,761	124,407
External	1,814	4,290	20,265	5,049	17,703	16,622	32,952

Source: Ministerio del Poder Popular de Planificación y Finanzas (MPPFP) y Petróleos de Venezuela S.A. (PDVSA).

1/ Preliminary figures. Subject to revision.

2/ Preliminary. I only comprises Central Government and Petróleos de Venezuela (PDVSA)

Source: Ministry of Finance

APPENDIX IV CONSOLIDATED NONFINANCIAL PUBLIC SECTOR

	2012		2012		2012		2012		2012		2012		2012	
	MM Bs	(% PIB)	MM Bs	(% PIB)	MM Bs	(% PIB)	MM Bs	(% PIB)	MM Bs	(% PIB)	MM Bs	(% PIB)	MM Bs	(% PIB)
Revenues														
External	355.126	21,0%	339.672	20,1%	7.661	0,5%	41.368	2,4%	2.571	0,2%	562.369	33,3%	562.369	33,3%
Internal	0	0,0%	323.641	19,1%	0	0,0%	42	0,0%	821	0,0%	324.504	19,2%	324.504	19,2%
Intra public sector	219.580	13,0%	16.031	0,9%	0	0,0%	504	0,0%	1.750	0,1%	237.865	14,1%	237.865	14,1%
Intra private sector	135.546	8,0%	0	0,0%	7.661	0,5%	40.822	2,4%	0	0,0%	0	0,0%	0	0,0%
Expenses														
Primary	456.676	27,0%	455.646	26,9%	28.457	1,7%	68.378	4,0%	41.525	2,5%	866.653	51,2%	866.653	51,2%
Interest	407.410	24,1%	269.710	15,9%	22.747	1,3%	68.378	4,0%	41.525	2,5%	809.770	47,9%	809.770	47,9%
Intra public sector	44.205	2,6%	12.678	0,7%	0	0,0%	0	0,0%	0	0,0%	56.883	3,4%	56.883	3,4%
Intra private sector	5.061	0,3%	173.258	10,2%	5.710	0,3%	0	0,0%	0	0,0%	0	0,0%	0	0,0%
Fiscal Balance	-101.550	-6,0%	-115.974	-6,9%	-20.796	-1,2%	-27.010	-1,6%	-38.954	-2,3%	-304.284	-18,0%	-304.284	-18,0%
Net Borrowing														
Internal	83.091	4,9%	11.314	0,7%	12.328	0,7%	10.000	0,6%	0	0,0%	116.733	6,9%	116.733	6,9%
External	77.189	4,6%	12.900	0,8%	12.328	0,7%	10.000	0,6%	0	0,0%	112.417	6,6%	112.417	6,6%
Central Bank Financing	5.902	0,3%	-1.586	-0,1%	0	0,0%	0	0,0%	0	0,0%	4.316	0,3%	4.316	0,3%
Other	0	0,0%	82.805	4,9%	17.672	1,0%	46.485	2,7%	0	0,0%	146.962	8,7%	146.962	8,7%
Other														
Rest of the economy	1.570	0,1%	20.149	1,2%	380	0,0%	-8.600	-0,5%	32.616	1,9%	46.115	2,7%	46.115	2,7%
Intra-sector	0	0,0%	21.719	1,3%	380	0,0%	0	0,0%	24.016	1,4%	46.115	2,7%	46.115	2,7%
Inter-sector	1.570	0,1%	-1.570	-0,1%	0	0,0%	-8.600	-0,5%	8.600	0,5%	0	0,0%	0	0,0%
Deposit variation														
Internal	16.890	1,0%	1.706	0,1%	-9.584	-0,6%	-20.876	-1,2%	6.338	0,4%	-5.526	-0,3%	-5.526	-0,3%
External	20.962	1,2%	1.706	0,1%	-9.584	-0,6%	-4.836	-0,3%	0	0,0%	8.248	0,5%	8.248	0,5%
Total	-4.072	-0,2%	0	0,0%	0	0,0%	-16.040	-0,9%	6.338	0,4%	-13.774	-0,8%	-13.774	-0,8%
Total Financing	101.551	6,0%	115.974	6,9%	20.796	1,2%	27.009	1,6%	38.954	2,3%	304.284	18,0%	304.284	18,0%

Source: Authors' estimates.

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¹ All rates mentioned in this section are compounded annual growth rates (2005-2012).

² Throughout this document, official statistics are used unless otherwise noted.

³ Chavez managed to win thirteen out of fourteen major referendums or elections between 1998 and 2012, with four presidential elections among them. The only loss he sustained was that for his proposed Constitutional Reform of 2007.

⁴ Honduras takes first place. Robberies, kidnappings, and other violent crimes are also on the rise, but the data is not as reliable. Data on homicides has been taken from United Nations Office on Drugs and Crime (2012). Venezuelan data for 2012 comes from Observatorio Venezolano de Violencia.

⁵ Using Angus Maddison's Historical Statistics, we find that out of fifty countries with GDP per capita data from 1922 onwards, Venezuela tops the chart with an average growth rate of 6.16 percent per year between 1922 and 1957, and is surpassed only by the former USSR between 1922 and 1977 (4.09 against 4.38 percent).

⁶ FONDEN: Fondo Nacional para el Desarrollo Endógeno (National Fund for Endogenous Development). Created 20 July 2005.

⁷ Observatorio Venezolano de la Propiedad, CEDICE.

⁸ The public share of banking assets, for instance, went from 10 percent in 2005 to 35 percent in 2012, mostly as a result of takeovers of private banking institutions.

⁹ The Ministry of Finance reports the "restricted fiscal sector" fiscal balance as the aggregate of the central government and PDVSA.

¹⁰ In 2011, Congress passed the Bill for the Special Contribution Due to Extraordinary and Exorbitant Prices in the International Oil Market (the authors' spontaneous translation of *Ley que Crea la Contribución Especial por Precios Extraordinarios y Precios Exorbitantes en el Mercado Internacional de Hidrocarburos*). This instrument places a cap of US \$70 on the price of an oil barrel used to calculate the royalties (recurrent revenues). As the price of the Venezuelan oil basket remained above \$100 per barrel throughout 2011 and 2012, this change had a significant negative impact on the *Situado Constitucional*.

¹¹ The Chinese Fund most likely represents the net financing obtained from the Chinese Development Bank (i.e., the line of credit not netted out by oil shipments). The figures comprised in PDVSA "Other:

Rest of the economy" are less certain. Some internal resources pointed out that oil shipments to China were registered at full price in income, and as they are not collected they are registered as PDVSA contribution to the financing of the fiscal deficit.

Rethinking Growth in Latin America

During the last decade, most of Latin America has undergone a period of political, economic, and social changes, resulting in overall progress and economic development. As a region, Latin America has achieved remarkable results in poverty reduction, health and educational outcomes, and public policy innovation, painting an optimistic scenario for upcoming years, powered by new approaches and visions. However, inequality remains the most present, complex challenge. At the same time, the region-wide economic slowdown, mainly driven by global trends, will require innovative, cost-effective policy solutions to maintain the trend toward sustainable development.

This section offers a mix of experience, opinion, and analysis, exploring some of the factors that drove our recent progress and highlighting mistakes to be avoided when crafting new policies. Mauricio Macri, Head of Government of the Autonomous City of Buenos Aires, shares his experience, claiming that cities have the resources and flexibility required to implement the innovative public policies needed to promote progress, placing citizens as a central player in any growth strategy.

Two interviews contribute to the debate on institutional reform and public safety. Alejandro Ordóñez Maldonado, Colombia's controversial Inspector General, explains his dual role overseeing compliance with the law and enforcing the Colombia Code of Ethical Conduct for civil servants. Furthermore, former Argentinian Ministry of Security and current Ambassador to the Organization of American States, Nilda Garré, offers a candid opinion on public safety issues related to urban crime and drugs, proposing alternatives to counteract these problems through public policy. Finally, Guillermo García analyzes the energy reform in Mexico and its potential implications on international law.

Amanda Beaujon
Content Editor

The Role of Cities in the Promotion of Growth

My Experience in Buenos Aires and Great Opportunities for Argentina

BY MAURICIO MACRI

IN A WORLD where changes occur at a rapid pace, it is increasingly important to understand that decisions aimed at promoting growth should be made in a very different scenario than years past. Today's challenges are not the same ones as before: urban planning, inequality, sustainable local development, and regional economies have become central issues on the agenda of growth in Latin America, especially for countries with large territories and federal governance systems like Argentina.

This new reality requires that we consider new questions and propose creative solutions. The challenge of the future is to articulate a development agenda between the different levels of government, understood not only from an economic growth perspective but also from a human growth perspective. We know that in order to improve the quality of the lives of people, it is not enough to improve economic growth levels. It is essential that this new agenda has the citizen as the protagonist, and its

main goal should be to provide this citizen with the tools to achieve realization and happiness.

Argentina finds itself today before a historic opportunity. We celebrate thirty years of uninterrupted democracy, and we live in a favorable global context for Argentines to project to the world our ability to learn, engage, and innovate in the production of goods and the provision of services. We have a huge potential not only in the wealth of our land but also, and above all, in the talent of our people. This allows us to be optimistic and to trust that if we fully develop regional economies and maximize the creative and hardworking energy of the Argentine people, we will be able to generate genuine development and growth in all of our cities.

Latin America, The Most Urbanized, But Unequal, Region in the World

In Latin America, two realities converge with huge implications for

discussions related to growth, namely the relationship between urbanization processes and structural conditions that increase inequality. In this context, our region is both the most urbanized in the world, with over 80 percent of its population living in cities, and the most unequal in terms of income gap and access to educational and economic opportunities.

According to the Inter-American Development Bank, currently between 60 percent and 70 percent of regional gross domestic product (GDP) is generated in urban areas. And according to reports from UN-Habitat, the top forty cities in Latin America produce more than 30 percent of the regional income. Of that percentage, almost half comes from four cities: São Paulo, Mexico City, Buenos Aires, and Rio de Janeiro.

We live in a multicentered world, where cities are no longer emerging actors of globalization but, rather, the protagonists. Such a role is supported by the development of institutional capacity to project itself internationally in order to find cooperation with other cities to achieve common goals and confront common threats. Such cooperation includes the sharing of best practices for the development of sustainable mobility and making commitments to reduce greenhouse gases to mitigate the effects of climate change.

Global talent migrates to cities like Bangalore, San Francisco, or Shanghai, and not necessarily to contribute to the wider social, political, and institutional construction representing India, the United States, or China. Innovation and entrepreneurship proliferate in local environments like Tel Aviv, London, or even Buenos Aires itself more than any other city in Israel, the United Kingdom, or Argentina. This phenomenon happens thanks to the impact of territorial, institutional, and human capital factors, which are determinants for the generation of growth.

Unlike federal politics—ruled by

geopolitics and the logic of the so-called national interest, which is often restricting and selfish in nature—cities have been able to build a more pragmatic and positive agenda made up of common interests and aimed to solve the problems of their citizens.

Thus, such international effort of local governments should be architected not in competition with the authority of sovereign states but, rather, fundamentally as a complement. A new dimension of architecture of global governance and multilateral networks of cities emerges along with the international regimes created by countries after the Second World War—all because the main challenge of the twenty-first century forces us to think globally and act locally.

The challenge of rethinking the public agenda of growth in the twenty-first century should combine national and local strategies for economic expansion, with policies aimed to correct inequality of income and improve quality of life, as well as measures of territorial and social integration.

This has been one of our top management guidelines in the last six years, since we established the government of the Autonomous City of Buenos Aires. With an eye always on improving the quality of life of our people, we seek to promote dynamic activities, which are integrated to the twenty-first century economy, while improving opportunities for access to public services such as education and health. We have accomplished our goals so far by favoring historically neglected areas of the city, which are mainly concentrated in the south.

The Transformation of the South as an Axis of Growth in Buenos Aires

We are transforming the city of Buenos Aires. The southern neighbors once again have the same opportunities as the rest of the city, with new proposals that generate jobs and better living conditions.

In terms of housing, we are working so that increasingly more people can fulfill the dream of owning their own home. We delivered more than 2,900 homes and over 7,600 ownership documents. We also launched home loans through Banco Ciudad, with the lowest interest rates in the market for residents to purchase their homes. Health care is also increasingly present. We made a reality the first stage of the Hospital of Lugano, with the construction of a High-Resolution Care Center for some 180,000 citizens.

In the field of education, after twenty years of delay, we completed the megas-structure of the Saavedra Educational Complex, which includes preschool, primary, and secondary education and will benefit more than 2,500 students. By settling a historic debt, we built sixteen schools that 5,500 children will be able to attend near their homes. We have made expansion work in sixteen schools, which allowed the addition of another 1,600 youths to the public education system.

In terms of public transit, we are making it increasingly easy, convenient, and safe to move around town. We opened two Subte stations of the H line and connected it to the B line, the line most used in the city. We also built three new bus rapid transit (Metrobus) corridors, which improved the way 250,000 people travel every day, reducing commuting time by 15 percent. It has a total length of 23 kilometers and two branches where twenty bus lines run.

We created a Technology District, a before and after for those living south of the city. Every company that settles in that district becomes a new opportunity for neighbors. Already more than 160 companies have settled in the district, creating more than 9,500 new technology-related jobs and revitalizing the commercial activity in the area.

We opened a new bank branch of Banco Ciudad in the impoverished neighborhood of Los Piletones, the first branch

of a public bank in a villa (shantytown). With the opening of the branch, more than 10,000 residents have modern technology available to access banking services as well as personalized attention to apply for loans. In addition, we are developing the new headquarters of the bank in the Parque Patricios neighborhood, which will employ 1,500 people and will be built with cutting-edge design and environmental standards.

Finally, with the Metropolitan Design Center in the neighborhood of Barracas, the Usina del Arte Cultural Center in La Boca, the Museum of Humor in Costanera Sur, and both the Museum of Modern Art and Polo Circo in Buenos Aires, culture and art fill the south of the city, offering thousands of young people tools to be inserted into the dynamic world of creative industries and talent.

Cities: Protagonists of Sustainable Growth

Like in the Mediterranean system many centuries ago, in recent decades the cities of Latin America have consolidated themselves as spaces where culture and innovation give shape to mostly urban modern civilizations. They represent the new frontier of human development, concentrating the bulk of world food consumption, energy use, and production activities.

The urbanization phenomenon has had a significant environmental cost. Currently, more than 70 percent of global emissions of greenhouse gases originate in cities. This reality, however, is being challenged by a growing environmental commitment of a significant portion of local leaders worldwide.

While national governments have failed again and again to assume multilateral commitments to reduce greenhouse gases, mayors and governors from around the world are becoming increasingly assertive in the implementation of public policies for sustainable mobility, electricity consumption reduction, and clean energy

use. There is still much to do, but there is every reason to think local leaders are at the forefront of sustainable growth.

Old cleavages, such as the countryside versus the city or agriculture versus industry, which unfortunately are still present in the discourse of antiquated political sectors, have lost prevalence in light of the new challenges posed by the pursuit of sustainable development. They only impoverish the discussion on growth in our region. The work we have ahead in Latin America is to go beyond this threshold, by building consensus on a vision of improvement and empowerment. This way we can balance, once and for all, a historic debt of democracy: a federal system according to the realities of the twenty-first century, always focusing on improving the future we provide to our children.



***Mauricio Macri** is Chief of Government of the City of Buenos Aires, Argentina. He was elected in 2007 and reelected in 2011. He is a candidate to the Argentinean presidency in the 2015 election. Before becoming Chief of Government, he served as House Representative at the National Congress. He holds a degree in civil engineering from the Universidad Católica Argentina. Prior to his career in politics, he was president of Boca Juniors for eight years, leading the club to its most successful decade in history.*

Fighting Corruption in Colombia

Interview with Alejandro Ordóñez Maldonado, Colombian Inspector General

BY JUAN PABLO REMOLINA

ACCORDING TO THE 2013 Corruption Perceptions Index, Latin America obtained a 39 point average score¹ (on a scale where 0 is highly corrupt and 100 is very clean), indicating that the region suffers from a serious corruption problem. Most of the Latin American countries have similar legal frameworks to fight against corruption, but only one, Colombia, has an institution with the scope and authority of the Procuraduría General de la Nación (PGN). The closest translation of PGN into English is Inspector General's Office; however, it is not completely accurate. The PGN is an independent body from the executive branch, tasked with overseeing compliance with the law as well as enforcing and promoting the Colombian Code of Ethical Conduct for civil servants.² The PGN achieves its mission through disciplinary, preventive, and judicial intervention.

The disciplinary function of the PGN is the most known. In December 2013 and early 2014, the PGN raised attention

in the international press for its disciplinary sanction against the mayor of Bogota, deposing him from his post and banning him from public office for fifteen years.³ Since Alejandro Ordóñez was elected as Inspector General in 2008, the number of disciplinary sanctions reached historic levels: 828 mayors, 49 governors, and 23 congressmen.⁴ Moreover in the preventive and judicial intervention functions, the PGN has also shown significant changes, becoming a principal player in Colombian public affairs.

In the summer of 2013, Juan Pablo Remolina from the *Latin America Policy Journal* had the opportunity to interview Alejandro Ordóñez. Ordóñez shared with us the special features of the PGN, concrete tools for fighting corruption, his main challenges, and also his opinion about the peace process in Colombia.

LAPJ: Why is it said that the Inspector General's Office is a *sui generis* institution

in the world? What is its role within the Colombian State?

Ordóñez: The Inspector General's Office was established as an entity without parallel, the only one in the world where the following three functions converge. First is the preventive function, which is considered the primary responsibility of the Inspector General's Office. This function is performed through overseeing public servants' behavior and raising awareness to those that might not be compliant with the laws. This function is exercised without intervening as coadministrators or interfering with the public agencies' management.

The second function is that of judicial intervention. In the context of due process, the Inspector General's Office seeks to guarantee the rights of the parties in conflict.

Finally, the third function is the disciplinary. The Office is responsible for conducting investigations on disciplinary offenses against all public servants at the national, departmental, and municipal levels, as well as individuals exercising public functions or those who manage public funds.

In addition to these three functions in a single state agency, the Office has a nature of autonomy and independence in decision making and broad competence in the protection of judicial assets. Other competencies include guaranteeing the protection of the rights of individuals, ensuring the proper exercise of the functions entrusted to public servants, and protecting public assets. For these reasons, the Inspector General's Office is a *sui generis* institution in the world.

LAPJ: Corruption is a major problem faced by nations. How to fight corruption?

Ordóñez: The inability of states to enforce the rules, according to Jakob de Haan in his work "The Determinants of Corruption," is the most significant cause of corruption.

In addition, the ethical crisis in today's

society—where issues such as coherence and good example are no longer part of the equation—contributes to perpetuate the paradigm of bad reputation given to public servants. Exercising authority is "to serve" and not "to benefit from" power for personal gain. This ethical crisis fosters a breeding ground where one loses sight that public service is an apostolate in the interest of the general population, and sacrificing it for individual benefit puts us in a state of corruption.

In such context, to really tackle corruption, one should attack the causes that generate it by ensuring the enforcement of existing anticorruption rules, which are usually dispersed in multiple regulatory bodies. There is a need to create a simple, easy-to-understand, and comprehensive structure of analysis that draws on the purpose of the anticorruption laws. In the case of Colombia, the Inspector General's Office is working on initiatives such as the Open Government Index [OGI] and the Integrity Index [INTEGRA], consisting of concrete tools that measure and promote compliance.

Last but not least, working to develop good citizens is necessary on the premise that the good citizen is ethical and that the citizen exercises the civic virtues. Such work is being accomplished through a project called Culture of Lawfulness.

LAPJ: Do you believe that the Inspector General's Office has been successful in the fight against corruption? What are its main achievements?

Ordóñez: The main concern of the Inspector General's Office during the past five years has been to develop a clearly defined strategy to combat corruption from two perspectives. The first approach involves punitive, a forceful and unrelenting effort to appropriately sanction corruption. The second approach is preventive, aimed at erecting administrative, procedural, and social barriers designed to contain poten-

tial risks of corruption. Such an approach has been developed through four specific instruments.

First is the OGI, a system of monitoring and control for compliance of strategic regulations to fight corruption in territorial governance. The IGA aims to generate early warnings of administrative irregularities, to promote compliance, to share best practices, to encourage various forms of monitoring and control, and particularly to avoid disciplinary action in local authorities.

Second, the Culture of Lawfulness Project is aimed at the Colombian citizen to observe its ethical structure and begin to understand that the fight against corruption is also an educational and cultural process because, before becoming public servants, we are educated to become good citizens.

Third, the Anticorruption Observatory is a space for analysis, engineered to evaluate and adjust public policies, by creating strategies that bring us closer to solving various social problems. The observatory aims to raise the level of discussion on the concept of corruption, fostering a place to deepen the analysis of punishable human behavior, but focusing on prevention.

Fourth, the Integrity Index (INTEGRA) allows for the analysis of the results of the probability of compliance in the administrative function by public entities in their own governance processes (planning, finance, human talent, contractual, internal control, and mission management). Likewise, INTEGRA also permits the analysis of a set of variables that "explain" the factors that influence the probability level obtained for the different observed entities.

LAPJ: What remains to be done?

Ordóñez: The fight against corruption is a daily task, one for which one cannot spare any effort. Convinced with the idea, we persist in strengthening the preventive sphere, working to consolidate those already established instruments, and seek-

ing to create a change in attitude, both in public servants and common citizens.

In addition, there is ongoing effort to strengthen the disciplinary sphere in order to ensure efficient and effective investigations that will, in cases that require it, appropriately punish corrupt officials.

LAPJ: How do you see the fight against corruption in Latin America?

Ordóñez: According to the Corruption Perceptions Index of 2012, published by Transparency International, Latin American countries except Chile and Uruguay obtained a score less than 50. Such a scenario makes clear the need for a continued effort in the fight against corruption, implementing measures to ensure greater transparency and lower levels of impunity.

This reality shows an opportunity to improve, joining forces from all areas, aiming to build strong institutions that work to meet the needs of [their] members, and preventing the access of corrupt individuals to public resources.

LAPJ: One solution to the phenomenon of corruption in Colombia is to achieve lasting peace, which largely depends on a successful peace process. Why so much criticism of the peace process efforts currently taking place in Havana?

Ordóñez: The Inspector General's Office has the duty to protect the rights of victims of armed conflict and to guarantee the compliance with the existing regulatory framework, within which the instruments on human rights and international humanitarian law have been ratified by Colombia.

The concern of the Inspector General's Office about the peace process is to be able to safeguard justice that applies to those who have seen their rights violated by the insurgents. Building peace without justice not only violates the rights of the victims, but rather goes against international instruments ratified by Colombia, in which case the country could be subject to intervention by the International Criminal Court.



Juan Pablo Remolina is a student in the master in public administration program at the John F. Kennedy School of Government at Harvard University, expected to graduate on May 2014. He is from Bucaramanga, Colombia. Remolina's interests are governance and territorial development. He earned a bachelor's degree in government and international relations from the Externado University in Bogota, Colombia, and a master's degree in public affairs from the Paris Institute of Political Studies (Sciences Po).

Remolina has worked in the public sector at the Colombian Ministry of Finances and at the Colombian Inspector General's Office (Procuraduría General de la Nación). At the Inspector General's Office, he worked on anticorruption and transparency issues. In the private sector, Remolina has worked in Paris at Accenture–Science Po Think Tank of Public Performance and at the Royal Bank of Scotland. In the nonprofit sector, he cofounded and is currently the executive director of the Public Policy Institute for the city of Bucaramanga, capital of the state of Santander, Colombia. Previously, Remolina was a professor of public management at the Externado University in Bogotá.

Alejandro Ordoñez is the Colombian Inspector General. Ordoñez was elected by the Senate in 2008 and reelected in 2012. He is a prominent lawyer from Bucaramanga city. He has an extensive career at the judicial branch. He passed from being the president of the administrative court in Santander to be the president of the State Council, the highest administrative court in the country. Ordoñez has been professor at several universities. In May 2012, Ordoñez received a honoris causa master's degree from Salerno University in Italy as recognition for his efforts against corruption. Ordoñez is also known for his strong conservative convictions.

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From Michoacán to Buenos Aires

Nilda Garré's Insight into Regional Security Challenges

BY MARTIN MAXIMINO

THIS INTERVIEW was conducted in December 2013 at the headquarters of the Argentine Mission to the Organization of the American States (OAS) in Washington, DC. Nilda Garré's opinion comes at a point at which the traditional approach to reducing drug trafficking is being revisited, by both scholars and policy makers. Garré offers expert opinion on this topic and clearly discusses two strategies: one that she is optimistic about (decriminalization of marijuana in Uruguay) and the other one she has categorically rejected on a practical and normative basis (laws allowing the Air Force to shoot down aircrafts suspected of carrying drugs).

On the other hand, she states that police reform is one of Latin American democracies' biggest debts. According to her, there is an urgent need for comprehensive police overhaul, not only to promote human rights and gender policies within the security forces, but also to address and eradicate the extended and rooted as-

sociation between the governments, the police, and violent criminal groups in Latin America.

Garré not only exposes the corrupt alliances that may exist between politicians and police forces around the issue of drug trafficking, but also explains how these partnerships may hinder, from within, processes of reform and modernization in an informative and revealing way.

LAPJ: Which do you think are the most important and most urgent challenges concerning public safety in Latin America?

Garré: Latin America is extremely diverse. Particularly, I think that the reality of insecurity in Central America is considerably different from what happens in South America. There are two realities, not only in the levels of violence—for instance, the number of homicides per 100,000 in Honduras . . . versus the levels of homicides in Argentina, Uruguay, or Chile¹—but also in the complexity of the actors involved.

In El Salvador, the involvement of particular organizations, such as the *maras*,² introduces a specific aspect that needs to be studied independently. I may oversimplify, but I would say that, with differences, drug and human trafficking are, in general, major concerns for every Latin American country.

LAPJ: What is your opinion on the recent decriminalization of cannabis in Uruguay?³

Garré: Uruguay has acknowledged the problem of drug trafficking and has addressed this issue in a well-thought and responsible way. The government of Uruguay has not only heard academic and experts' recommendations on the topic, but has also taken direct action through a cutting-edge legislative initiative. Over the last decade, attempts to reduce drug trafficking have focused primarily on the supply of drugs, rather than on the demand. Today, we need to pay special attention to the demand: who is consuming, why they are consuming, what are the limits and control that the state is responsible for, why should the quality of cannabis be regulated by the state, etc. Right now, not only is the price higher, but also the quality is lower. The question that remains to be answered is not only whether Uruguay's initiative will work or not, but also if it is scalable to countries such as Argentina or Brazil.

In any case, what is clear is that the war on drugs, as historically conceived by the United States, has been lost in Latin America. The securitization of the drug problem has not brought any visible solutions. On the contrary, the number of drug-related homicides has increased, and figures show that many of the financial investments to declare the well-known war on drugs have not affected the levels of drug trafficking. This strategy is anachronistic and exhausted. Even [Colombian] President [Juan Manuel] Santos has expressed this on several occasions, not only in the Organization of American States

but also in the United Nations General Assembly.⁴ On the same vein, I believe that earmarking those funds to specific educational or health-related purposes would have largely contributed to the inclusion of vulnerable groups.

LAPJ: On the other side, a great fraction of Latin American citizens, excluding many academic researchers, has reacted in a negative way to marijuana decriminalization. Opposition groups are very vocal and have a strong determination to prevent the scalability of these types of programs. What would it take for the public opinion to progressively accept this line of thought after decades of the war on drugs?

Garré: There is a need to have a responsible and informed debate. As the main responsible for the security of its citizens, the state should simultaneously launch intelligent prevention campaigns and design rehabilitation programs for addicts. But in the particular case of cannabis, there is a cultural component in society that should be changed. As shown by recent studies, by no means will a greater availability of marijuana increase the amount of addicts. Moreover, there is still no conclusive evidence about whether marijuana per se generates an addiction. Finally, it is not clear whether marijuana has a foot-in-the-door effect, leading to the consumption of other illegal substances.

LAPJ: What would happen to the traditional mission, structure, and values of the police forces in Latin America if drugs were decriminalized?

Garré: In the case of South America, a part of the federal police forces would be worried, to some extent, because this would imply the end of their corrupt business that is linked to drug trafficking. As in many law enforcement agencies in the world, one part of the police has partnered with drug traffickers. In Argentina, this is a parallel business and generates more illicit revenue than historical illegal activities that were

protected by the police, such as clandestine gambling or prostitution.

I believe this new approach to fighting drug trafficking by decriminalizing personal consumption involves massive retraining of police officers, mainly to move away from the traditional view under which there is always “a war against someone” rather than an intelligent approach using sophisticated investigative, scientific, and strategic planning tools. In the specific case of Argentina, there is also a general view among police officers that involves treating drug consumers as if they were bad people per se.

The police “build statistics” that are functional to their inefficiency with the drug issue. Seizures receive media coverage, but arrests of small consumers generally involve the least important node of the drug trafficking chain—and the most vulnerable.

This discussion seems anachronistic in light of the ruling of Argentina’s Supreme Court (in August 2009, the Supreme Court unanimously declared it is unconstitutional to punish marijuana consumers if that action does not harm third parties). Even though Argentina’s national law (Law 23.737) explicitly bans personal consumption of drugs, the Arriola case overruled the ban for drug users and urged all the state powers to implement policies against illegal drug trafficking and to adopt preventive health measures while focusing its policies on drug trafficking networks rather than on drug users.

LAPJ: Current proposals to prevent drug trafficking by some politicians in Argentina include bringing down aircrafts that enter the country’s air space illegally. What is your opinion on this particular policy?

Garré: That is a rather absurd idea, advocated by people that only want to impact the public opinion in order to take political advantage of the terrible problem that insecurity poses to the government in Argen-

tina. Some politicians are trying to convey a message to society that has nothing to do with real crime reduction and is mostly guided by opportunistic notions of public safety. I believe what they are trying to say is, “If we are government, we will take the toughest measures, the most difficult ones, to end crime.” In my opinion, it is irresponsible to design public safety policies on this basis.

In general, punitive measures (i.e., a tough hand on crime) as this one are presented as if they were a magical solution that would reduce crime in a few months, but they rarely do. Previous examples of *mano dura*, or iron fist, in Latin America show that these types of measures have only led to questionable short-term results with no significant impact on crime and, in some cases, an increase in violence. Take for instance the increase in conviction times for violent crimes in Argentina: it introduced complex inconsistencies within the penal code, prisons started to be overpopulated, and there was no significant crime reduction. This argument is even clearer when we talk about an organized and complex crime such as drug trafficking.

On the normative side, this policy would be unconstitutional in Argentina (against Article 18). Argentina has signed and ratified numerous international treaties that have been granted constitutional status, including the American Convention on Human Rights and the Convention on International Civil Aviation, which strictly forbid these sort of initiatives. Shooting down a suspicious airplane would simply imply death sentence without previous judgment and the right to a defense. In other words, it would imply denying the right to due process of a democratic society.

On the practical level, the underlying principle of this policy is not considering the fact that crime displaces, not only geographically but also tactically and operationally. Simply put, when drug

smugglers take notice that our country is shooting down suspicious airplanes, they will start implementing new techniques to enter drugs through land and water. Not to mention that current studies show that drugs enter our country first by land, then by sea and rivers, and finally, in very small amounts, by air.

At the end of the day my question is, why are Latin American countries that have passed laws to shoot down suspicious civil aircrafts not using them (e.g., Colombia, Peru, Brazil, and Venezuela)?

LAPJ: Increasingly, the feeling of insecurity, or fear of crime, as a field of study has attracted the attention of several Latin American academics. Do you think that these topics should be a priority within the security policies or that governments should only address actual crime incidence?

Garré: In the specific case of Argentina, Chile, and Uruguay, the three countries have low levels of homicides (relative to the rest of Latin America) but experience the highest levels of feeling of insecurity, according to several studies. These countries could be considered cases of extremely scared societies with relatively low levels of homicides. I speak of homicide, not only because it involves the loss of lives but also because it has the lowest underreporting rate across different types of crimes and allows for fairly precise comparisons across countries. But it is not, by any means, a comprehensive indicator of violence.

In general, I believe fear of crime could be associated with certain types of property crimes that usually take place in urban settings, affect the life of citizens in a direct way, and receive large media coverage. These include thefts, home burglaries, and vehicle crime, to mention only some of them. I believe these sort of crimes, rather than complex criminal activities, interrupt everyday life and are particularly shocking to citizens—take for instance, the disturb-

ing feeling of someone breaking into your house at night. The existence of media that overinform about crime and insecurity is one of the key factors behind fear of crime. Moreover, the existence of news channels that inform 24/7 create the opportunity to watch a violent episode at least three times, even if you do not watch television regularly.

According to recent research, fear of crime is affected by a variety of causes, and crime may not be a particularly salient one. In other words, crime is often an additional variable to explain fear of crime, but it is certainly not the only one, even less the most important one. For example, the Latinobarometro Report 2010 found that people who have been victims of a crime do not necessarily identify it as their country's main problem. By the same token, people who have not been victims of a crime may identify crime as the main problem in the country.

LAPJ: During your tenure as Minister of Security of Argentina, you emphasized the concept of Democratic Security, which involved stressing the importance of community feedback through regular meetings with neighbors, as well as with social and political organizations. What was the main purpose of this policy?

Garré: Society should be directly involved in public safety, because citizens start feeling responsible about it, but mainly because they become agents of change, rather than passive observers of the security policy. The state is the main party responsible for security, in normative and practical terms, but there is a need for community participation in the design, implementation, and evaluation of public safety policies. First, to make an accurate and precise diagnostic of what is happening, particularly in their neighborhoods. Second, to enhance prevention strategies, because citizens often know what are the flaws and strengths of current policies.

A timely warning by society allows the state to intervene with the required public agency to prevent crime, which is often not the police. The police on [their] own will not solve the problem of insecurity. Surprisingly, the police [are] only one of the many agencies, often the less efficient and most violent one, to help reduce crime. There is an urgency to design policies that involve a pluralistic approach to security, including the Health, Education, Labor, and Social Development Ministries, just to mention the most important ones.

Over the last decades, there has been a general belief that the police own the know-how and proficiency to design and deliver public safety services, under the assumption that “security knowledge is owned by the police” (the same happened in the Ministry of Defense, where expertise would be attributed to the military, rather than to civil authorities). Political authorities used to delegate the handling of public safety policies to the police, reducing political oversight of security.

The tacit pact between politicians and police is a very well-known strategy to lead security agencies, but rarely an effective one in the long term. I think this corrupt agreement between police and politicians to guarantee mutual benefits has destroyed and eroded the symbolic component of being a police officer. Today, the majority of police officers enter the institution with that symbolic component and have high expectations, not only with regard to their own professional life but most importantly to their intention to serve others. Once inside the police, some of them are corrupted by internal mechanisms and perverse incentives. Others are outraged by corruption, report it, and are not willing to be a part of a dishonest organization.

LAPJ: What is your opinion on the current structure and functioning of police forces in Latin America?

Garré: In general terms, the police are

inefficient and their missions, values, and activities should be modified, shifting away from the traditional policing model toward an evidence-based policing one. My opinion about the police forces in Argentina is that the investigative and the operational structures should be clearly divided. Currently, the police investigational skills are low: either voluntarily or as a result of ill-informed procedures, officers tend to contaminate the crime scene. In Argentina, we implemented training courses to reduce the level of destruction of evidence and increase the preservation of the crime scene. There are also new technologies (e.g., the Federal Biometric Identification System for Security [SIBIOS] and the Automatic System of Ballistic Identification [SAIB]) that help clarify crimes and find the perpetrators, but this sort of change requires political commitment. In short, Latin American police structures and activities need to be revisited to provide an effective service to society. Some early efforts in Central America have moved toward these goals, and South American governments have also shown some significant initiatives.

However, I believe there is still much to do in terms of the involvement of community in the control of police activities. It is not enough to have the Bureau of Internal Affairs controlling the police—I would say it is rather useless; the community should be an active actor in the oversight of police activities.

Public safety is a service to the community, and current police structures often don't reflect that. There is a need to shift away from the traditional policing system. Police forces need to be more coordinated and provide a useful service to society, and they are not delivering that today. The lack of strategic planning is visible and hinders the opportunities for lasting and sustainable reforms.

LAPJ: Going back to the guidelines of Argentina's security policy, as Minister of

Defense and later as Minister of Security, you introduced strong policies related to gender and the protection of human rights within the military and the federal police forces. What were the main obstacles to implement these policies, and what were your strategies to overcome them?

Garré: Gender and human rights are two key topics for development and are included in almost every international convention and treaty, as well as in many Latin American countries' domestic legislation. These are clearly two pillars that have been neglected, mainly due to traditional and cultural practices that have been in place within the police forces for decades—and in some forces, for centuries. In this sense, there is a natural resistance to these initiatives, particularly in the sort of institutions that were created to maintain public order and impose social discipline.

In the particular case of human rights, there are two issues that need special attention. First, the lack of political oversight over the police and the military has given way to high levels of institutional violence by the police, often in the form of illegal repressive activities to maintain public order. This included, for example, the exercise of violence on public demonstrators—in many cases deadly—through the use of firearms, but also through the criminalization of minorities and poor people. The police forces in Latin America were mostly guided (some still are) by a repressive and reactive content in their activities, rather than a preventive one.

Second, the human rights topic also pertains to the corporatist protection of the police and the military members that were involved in past coup d'états in the region, or in some sort of illegal activities such as torture or kidnapping of political and social leaders during the military dictatorships. These members fear being brought to justice for their acts, and hence react and tend to promote internal resistance to change.

To overcome this resistance in Argen-

tina, both a reform in police education and the promotion of community participation have been key: the first one, to eradicate rooted practices and beliefs that were deeply antidemocratic and were inherited from the National Security Doctrine; the second one, to prevent police abuse and help provide evidence in court when officers are held accountable.

The case of gender is somewhat different, because it does not threaten the police's ideology or the officer's professional aspirations. During my tenure as Minister of Defense, we created Gender Commissions within the Air Force, the Navy, and the Army, and we also decided to include men in those spaces, because we believed that the problems of women are issues that should concern the society as a whole, as opposed to only the women that are victims of discrimination or violence. In particular, we addressed domestic violence within the military and we found out that, for decades, there had been a large number of cases of violence against women in the forces. But make no mistake; this is not a matter of relevance to women only, it is a problem of the entire society.

Within the police, resistance would not be communicated formally, but existing informal values suggested that there was resistance. But the police understood that the political commitment with these policies was unambiguous; for instance, we appointed the first female commissioners in some of the most critical police precincts and a woman as Head of the Internal Affairs Bureau, so the higher ranks eventually cooperated with the administration.

LAPJ: In federal countries such as Argentina, Mexico, and Brazil, the primary responsibility of public safety lies in the States or Provinces. What strategies were implemented under your tenure as Minister to overcome the problems of coordination and integration between different jurisdictions?

Garré: If when we look at the region we see anachronisms and obsolescence in public safety policies, within countries this is also true. In the case of Argentina, the lack of coordination is visible and hinders the impact of national policies at the local level. My opinion is that there are two major problems. The first one is that there are Provinces in which police forces receive outdated operational training. In some subnational contexts, police forces are still militarized and often affected by a bias to “make the war to criminals.” The second problem I see is that this approach to security generated a complex phenomenon of institutional violence and police abuse, particularly on the underprivileged—including recent cases of torture and rape to arrested citizens in Argentinian Provinces. Therefore, I think local authorities should have strong political determination to end this vicious cycle and expel from the forces any officer that incurs any type of abuse of authority.

When I was appointed Minister of Security in 2010, what we found in the subnational police forces (in terms of training, technology, transparency, criminal intelligence, and operations, to mention some critical aspects), was discouraging. There was an absolute lack of coordination with the national government. The first measure we took was to create an Interior Security Council (COSEIN, for its name in Spanish) where we could speak directly with the public officers responsible for the security of the Provinces in regional meetings. We also signed several protocols, we provided cutting-edge technological resources, and revised training programs to improve coordination between the Provinces and the National Government.

LAPJ: Regarding the protection of the officers’ well-being, what did you find when you were appointed, and what was your strategy to overcome these problems?

Garré: Our vision was to hold police of-

ficers accountable and demand hard work and commitment in everyday activities. On the other side, we were conscious that their welfare is an obligation of the government that should not be delegated. We need to take care of them. The work of the police involves high levels of stress, long periods of standing and walking, working extra hours to improve their salaries, bad nutrition, and lack of exercise and sport activities (as opposed to the military). We created and equipped mobile medical cabinets to reach out to police officers (so that they did not have to commute to the Police General Hospital) and assessed their health and psychological condition to have an initial diagnostic. What we found out was surprising, to say the least. The levels of overweight, cholesterol, and diabetes were extremely high (on average), and they wore no glasses even in the absence of short- and long-sight vision. Moreover, their dental health [had] serious problems, even though we are speaking of relatively young people. We implemented a health program for police officers, and we renewed the Police’s Central Hospital because we knew this was also a key element in public safety. We incorporated new bulletproof vests (with a special design for women, for the first time in the country’s history), we provided health guidelines, we conducted regular health checks, and we tried to shift the culture of sedentary lifestyles within the forces.

LAPJ: Thinking about the future of the Organization of American States, in what specific ways do you believe that the OAS could contribute to increase the levels of security in the region?

Garré: I believe the provision of public safety should be guided by accurate and comprehensive diagnoses of Latin America’s current situation. In this sense, the OAS provides the reports and statistics to have a clear sense of what is exactly happening. For different reasons, many countries do



not publish these figures, and, hence, multilateral organizations step in and have a critical role in gathering, systematizing and publishing the data. In some other cases, multilateral organizations develop very successful models of police education and training, particularly in the fields of gender and human rights.

The need to share visions and experiences is critical to security. There has got to be international cooperation, in terms of intelligence, training, and coordination, particularly in light of the complexity of transnational crime. Regarding this topic, Argentina is prioritizing South American spaces over global and Latin American ones, because national authorities believe there are common topics to be addressed in a targeted way.

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Before that, she was appointed Minister of Security (2010-2013) by Argentine President Cristina Fernandez de Kirchner, and Minister of Defense (2005-2010) by former President Nestor Kirchner. She was the first woman in Argentina's history to serve in either post.

As head of both Ministries, Garré initiated a set of reforms in the military and the federal police forces by including a strong gender and human rights approach, promoting the involvement of community councils in the oversight of police performance, and incorporating cutting-edge technological resources to fight crime.

In the year 2000, Garré was appointed Deputy Interior Minister. She has also a vast legislative experience, as a result of having been elected Deputy at the House of Representatives of the National Congress in four occasions. She also served briefly as Argentine Ambassador to Venezuela in 2005.

Originally from Argentina, Martin Maximino is a master in public policy candidate (2015) at the John F. Kennedy School of Government at Harvard University. He holds a bachelor's degree in political science from Universidad de San Andrés. During his undergraduate studies, he was an exchange student at the Institut d'Études Politiques (IEP) de Paris, in France.

Upon graduating, Maximino joined Poliarquia Consultores, a polling firm specialized in campaign management and public opinion research. After that, he worked at the National Ministry of Security in Argentina for almost three years, first as an Advisor to the Secretary for Planning and later as Head of the Department of Imagery Intelligence.

As a graduate student, his policy area of concentration is social and urban policy, focusing primarily on criminal justice topics in Latin America. He is particularly enthusiastic about public initiatives that lie at the intersection of public safety, technology, and public opinion.

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¹ Garré refers to the number of annual intentional homicides per 100,000 inhabitants, as recorded by the World Bank in 2012–2013, in order to illustrate and compare the level of violence of Honduras (92) and El Salvador (69)—two of the most violent countries in the world—to the cases of Argentina (5.5), Uruguay (6), and Chile (4).

² The *maras* (the Central American term for gang) is the rising form of organized violence that is the scourge of El Salvador, Honduras, Guatemala, and southern Mexico—increasingly expanding into Colombia, Brazil, and other South American countries.

³ On 10 December 2013, the General Assembly of Uruguay approved a law that made the country the first in the world to fully regulate the cultivation, trade, and consumption of cannabis for medical, industrial, as well as recreational purposes.

⁴ In 2013, President Santos addressed the General Assembly of the United Nations and referred to the Single Convention on Narcotic Drugs of 1961, saying: “Right here, in this same headquarters, fifty-two years ago, the convention that gave birth to the war on drugs was approved. Today, we must acknowledge, that war has not been won. And I say this as the president of the country that has suffered more deaths, more bloodshed, and more sacrifices in this war, and the country that has also achieved more results in the fight against this scourge and the mafias that underpin it.” See Trotta, Daniel. “Colombian President Tells U.N. the Drug War Has Not Been Won.” *Reuters*, 24 September 2013.

The Energy Reform in Mexico

Lessons and Warnings from International Law

BY GUILLERMO J. GARCIA SANCHEZ

Abstract

THE ARTICLE ANALYZES some of the contents of the Mexican energy reform of 2013 and warns on the international legal implications that the path that Mexico has chosen to follow could bring to its economy and international relations. Concretely, it argues that in order to avoid falling into the same mistakes made by other Latin American countries in the region, Mexico must consider its obligations contained in international treaties signed with the United States on transboundary resources as well as its obligations in bilateral investment treaties that protect foreign investors from certain government acts and policies.

In December 2013, the international media reported, to the surprise of many, that the Mexican Congress approved an energy reform that will radically transform a seventy-year-old state-oriented policy that was an essential part of Mexico's national identity.¹ The central theme of this article

is to analyze some of the contents of this reform and to make a cautious warning on some of the international legal implications that the path that Mexico has chosen to follow could bring to its economy and to its international relations. Concretely, the article argues that the legislative process that will implement the energy reform in the upcoming months needs to attend to two elements regarding Mexico's international legal obligations: the provisions contained in the 2012 Agreement Between the United States of America and Mexico Concerning Transboundary Hydrocarbon Reservoirs in the Gulf of Mexico (the 2012 Treaty)² and the obligations contained in several bilateral investment treaties (BITs) signed by Mexico that protect foreign investors from certain government acts and policies. Other states in the region have gone down this path before and for a diversity of reasons have ignored the international obligations to which they agreed, triggering numerous disputes and conflicts that eventually cost

millions in damages and compensations. Mexico has the chance to learn from the mistakes of its peers in the region and even to be institutionally creative in the way it assumes its international obligations in the future; otherwise, the story of States repenting years later will repeat itself, to the detriment of Mexico's national finances.

The Energy Reform of 2013

Before addressing the international law aspect of the reform, it is important to understand the essence of the constitutional amendment.³ The most important aspect in relation to this article is the fact that the energy reform amended the Mexican Constitution to open up the possibility for the Mexican State to sign contracts with private parties, including multinationals, for the exploration and exploitation of hydrocarbon resources (article 27). Before the reform, only *Petróleos Mexicanos* (Pemex), the State-owned petroleum company, could conduct these activities on behalf of the State. The Constitution still prohibits the signing of concession agreements, but in the transitory articles, it allows the State to sign a variety of contracts that were forbidden before. For example, the reform affirms that the State can sign joint profit and production contracts, service contracts, and licenses with private companies (transitory provision 4). The transitory provisions also mention that the State can pay the private party: cash, in the case of service contracts; a percentage of the profit, in the case of joint profit agreements; a percentage of the production, for joint production agreements; and an onerous transfer of the hydrocarbons once they have been extracted, for the license agreements; or a combination of all of the above. The decision on which contract will be adopted according to the reform depends on the one that will maximize the government's income in the long term. In terms of the authorities in charge of implementing the reform, the Secretary of Energy, the National Com-

mission on Hydrocarbons, and the Energy Regulatory Commission have joint powers to execute and regulate different aspects of the agreements (article 27 and transitory provisions 6 and 10).

The 2012 Treaty Between Mexico and the United States

In December 2013, just a couple of days after the Mexican Congress adopted the energy reform, the U.S. Congress approved as part of the Bipartisan Budget Act of 2013 the integration of the Agreement Between the United States and Mexico Concerning the Transboundary Hydrocarbon Reservoirs in the Gulf of Mexico.⁴ With this act, the treaty that took more than twenty years to negotiate and was signed in 2012 entered into force between both countries and regulates the resources that, according to international law, both States are entitled to exploit.⁵ The treaty, in essence, will change the way the energy relations between Mexico and the United States can develop in the future since it opens the possibility of exploiting an estimate of 172 million barrels contained in deep water reservoirs.⁶ Furthermore, it places the security of the hydrocarbon resources located in the Gulf of Mexico under the protection of an international treaty and fosters a joint development between Mexico and the United States to exploit them efficiently, equitably, and in a secure way. There are many aspects of the treaty that are interesting for the development of international law in the matter, but for the sake of this article, four points are relevant and need to be stressed to avoid future conflicts between both States.

First, the treaty's heart and soul is located in its preamble, where it states the principles that will guide the life of the legal framework of the treaty to archive "safe, efficient, equitable and environmentally responsible exploitation of transboundary hydrocarbon reservoirs." The treaty does not expand on what the parties consider

to be an “efficient,” “equitable,” “safe,” or “environmentally responsible” exploitation, hence it leaves open to interpretation how these principles might develop in the life of the treaty. This has several risks in light of the energy reform: for example, by not determining the understanding of each principle and by not hierarchizing them, the operators of the agreement, or an arbitrator if a dispute arises, will have to interpret each one and balance them in case there is conflict. What if the unitization agreement is efficient but not safe or environmentally responsible? What if it is equitable but inefficient? And even more important for the sake of the energy reform, what if the domestic legislation in Mexico defines efficiency in terms of government revenues and not in terms of profitability to the private contractors? The answers cannot be obtained from the language drafted in the treaty and hence are left subject to interpretation.

Second, to achieve the above-mentioned principles, Mexico and the United States agreed that the treaty would design “cooperative agreements based primarily on principles of unitization.” Articles 6 and 7 of the treaty establish the process to sign and the content of the unitization agreements. In essence, they must be negotiated by the licensees from each side of the border treating the reservoir as a unit, which entails that the States must share the costs and the profits of its exploitation equitably. In addition, the unitization contracts proposed by the licensees must be approved by each of the State agencies. This raises several questions in the face of the energy reform. The regulatory framework of the reform must include a chapter that deals with the contracts in the borderline with the United States. The way things stand today, it is unclear the type of contractual relationship that the Mexican government could have with private companies in those areas that could respect the agreement signed with the United States. The

treaty only mentions one type of contract: licenses. But the Mexican legislation, as explained above, contains several options, and each one, according to the reform, must maximize in the long term the government’s profit from the exploitation of these resources. Balancing the rights of the State, the rights of the contractors, and the provisions of unification in the treaty is going to be a hard task and must be addressed in the secondary legislation if the Mexican State wants to avoid a dispute with the United States on the issue.

Finally, the dispute resolution mechanisms of the treaty are far from efficient. For instance, the treaty created a Joint Commission to determine many elements of the life of the treaty, including resolving disputes regarding its interpretation. This, however, does not make the Commission a strong and independent body; in fact, it’s the opposite. The members of the Joint Commission are designated by the parties, but there are no qualification requirements regarding them; the Commission is composed of four members, two designated by each State, and does not contain any procedure in case its decisions are locked. In the case the Commission is unable to reach an agreement in many aspects of the treaty, the issue is thrown back to the parties or to an arbitrator—only if it’s a technical issue it is resolved by an expert. Finally, the Commission does not have an independent budget and each State has to financially support its designated members. Hence, as opposed to being an independent and strong body that could make unbiased decisions on the benefit of the treaty’s life, the Joint Commission is closer to a binational political commission that tries to coordinate policies but has almost no power over the parties. Mexico and the United States have done better in the past when it comes to creating this type of organism. In fact, in a very similar situation, the case of transboundary rivers, both States signed an agreement back in 1944 where they created

a commission with the rank of an “international organization” that has a joint budget to technically determine apportionment of inland water between both countries.⁷ This binational organization has been relatively efficient in its tasks and has been able to work even under pressure of governors, mayors, and farmers on both sides of the border.⁸

The Protection of Foreign Investors in Mexico

Mexico has signed more than thirty bilateral investment treaties and several free trade agreements that contain a section on the protection of investment, like Chapter 11 of NAFTA, where in essence the State agrees to give foreign investors a particular set of rights and legal resources.⁹ In general, these include the right to a fair and equitable treatment, principles on the procedure and calculation of compensation for expropriations, nondiscrimination, national treatment, and full protection and security of their investment.¹⁰ Most importantly these treaties give the right to the foreign investor to initiate mandatory arbitration proceedings against the government if the investor considers that his or her rights have been violated due to state action or inaction. Mexico has been found guilty in the past for certain acts against foreign investors and has paid a substantial amount of money in damages and compensation.¹¹ Nevertheless, one of the industries that was excluded from these treaties was the hydrocarbon sector. This is so because it was considered that only Pemex would develop activities in these areas and that foreign investment was expressly forbidden in this area.

With the entry into force of both the treaty of 2012 and the energy reform of 2013, questions will emerge regarding the protection of the investors that will be subject to both regimes. In principle, international foreign investment law protects the contracts signed by the investors with the

government.¹² These are considered as any other investment in the foreign country. The risk with the energy reform now is that if the secondary legislation is not drafted in an efficient way, clearly establishing the type of acts that the government can take—such as forcing a unification agreement in the borderline, for instance—international disputes could arise in the future. For example, if a petroleum company agrees to invest in Mexico under certain terms, and the government decides to correct the agreement to regain control of the production of the field or it modifies the legal context in which the investment was done in the future, then Mexico could face claims in an international investment arbitral tribunal. This has happened in the past to other countries in the region. It is not uncommon to find stories of Latin American governments that decide to open particular sectors of the economy that were previously fully controlled by the State and then change their minds years later when they realize that the reforms are too aggressive and that they left the government on the wrong side of the equation. Any amendments to the legislative and contractual context when the foreign investor arrived to the State can be translated into claims of breaches of a BIT and hence the State would have to pay damages and compensation for modifying its policies. Examples of the above can be found in the case of Ecuador when it modified its fiscal law on the exploitation of hydrocarbons¹³ and Venezuela when it modified its national hydrocarbons law to strengthen the control of the State over the exploitation of the oil fields in the Orinoco Belt.¹⁴

Conclusion

If the purpose of the 2012 treaty and the 2013 energy reform is to expand the investment in the hydrocarbon sector of Mexico, then a deep study and understanding of the international law implications of these innovations is necessary. The risk of



making a mistake or of being too ambiguous regarding the policies adopted and the legislation implemented could provoke several claims and years of costly litigation with the U.S. government or with foreign investors. This story has been told before in the region, there is no need to replicate it in Mexico if things are done appropriately. On the contrary, if Mexico is able to draft a modern secondary law that integrates more deeply the energy relation with the United States and foreign companies in an efficient, equitable, and secure way, the future of the North American regions could be secured and it could serve as an excellent model for other relations. For example, it is a fact that transboundary resources are also located with the borders of other parts of the Gulf, like the borderlines between Mexico, the United States, and Cuba, or the borderline between Guatemala and Mexico. Furthermore, the shale gas reservoirs in the borderline between Mexico and the United States could also benefit from the experience that the exploitation of the fields according to the treaty of 2012 could bring.

If things are done in an inappropriate manner and Mexico is forced to modify legal contexts after the investments are done or if the agreements in the borderline end up in claims tribunals, then the political turmoil in Mexico when the news of the arbitrations are out will force the State to go back to nationalistic rhetoric that can only bring more tension to the region. Rather than being an example of the development of a secure energy region, Mexico will become one more case of a wrongly implemented opening to foreign investment and a consequent fall back into nationalistic policies that not only keeps the State from using its resources efficiently but that translates into litigation that could eventually cost millions of dollars of national income in damages and compensation.

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⁹ For a complete list of the international investment treaties, see the Web site of the Secretaria de Economia de Mexico.

¹⁰ See, in general, Dolzer, Rudolf, and Christopher Schreuer. *Principles of International Investment Law*. Oxford University Press, 2008.

¹¹ For a complete list of the cases, see the Web site of the Secretaria de Economia de Mexico.

¹² Dolzer and Schreuer, *Principles of International Investment Law*.

¹³ See, for example, *Repsol YPF Ecuador, S.A. and Others v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (PetroEcuador)* (ICSID Case No.

ARB/08/10); *Burlington Resources, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/08/5).

¹⁴ *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V., and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/07/30).

GUIDELINES FOR SUBMISSIONS

The *Latin American Policy Journal (LAPJ)* at the **John F. Kennedy School of Government at Harvard University** is now accepting submissions for its fourth edition, to be published in the spring of 2015.

The *LAPJ* is a student-managed publication that collects perspectives from academics and practitioners on contingent policy issues and gives them a platform to engage in constructive dialogue with each other in the search for best practices and collective learning. The *LAPJ* aims to present Latin American perspectives about Latin America, to a Latin American and US audience.

Our mission is to initiate respectful, thought-provoking debate between consolidated and emerging leaders across Latin American and their American counterparts. We envision a region where collaborative efforts between countries improve the quality and scope of policy making.

The *Latin American Policy Journal* is inclusive, nonpartisan, independent, and opinionated.

What to Submit

We strongly encourage submissions from writers of all backgrounds, including scholars, policy makers, civil servants, journalists, advocates, and organizers.

We are accepting pieces in the following formats:

ARTICLES

- Original and in accord to the theme of this publication
- 6-10 double-spaced pages (1,800-2,500 words)
- All figures, tables, and charts must be submitted as entirely separate files
- Include a 100-150-word abstract

COMMENTARIES, INTERVIEWS, OR SHORT ESSAYS

- 3-6 double-spaced pages (900-1,800 words)

BOOK REVIEWS

- 3-6 double-spaced pages (900-1,800 words)
- Include full citation for book, including publisher and year of publication
- Book reviews should critically assess recent books that innovate beyond the frontier of current thinking about Latin American politics and policy

ARTWORK

- Original and unpublished visual artwork
- High-resolution digital images (3000+ dpi) in .jpg files
- A description of the image title, author, year, and medium

LANGUAGE Articles can be submitted in English or Spanish. They will be professionally translated.

Selection Criteria

The best pieces will be chosen based on the following criteria:

- Relevance of the topic to Latin American policy issues and timeliness to current policy debates
- Originality, sophistication, and style of argument(s)
- Contribution to scholarship and policy making on Latin American issues

All submissions must comply with the following in order to be considered:

- Work must be original and unpublished
- Citations should be formatted as endnotes according to *LAPJ* guidelines
- Include a cover letter with the author's name, address, e-mail address, daytime phone number, and a brief biography (maximum of 300 words)
- Authors are required to cooperate with editing and fact checking, and to comply with journal-mandated deadlines
- Authors who fail to meet these requirements may not be published

Submissions will be considered for the print or online versions of the *Latin America Policy Journal*.

Process

Articles will be published on a rolling basis on the *LAPJ* Web site. Please e-mail your submission to lapj@hks.harvard.edu by **15 December 2014**.