The Political Economy of Development Finance in Latin America

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Summary and Keywords

Finance is frequently, but incorrectly, judged a technical matter best left to experts. Equally mistaken is the exasperated conclusion encapsulated in the phrase "people, not profits," which holds that capitalism, private investors, and markets are simply evil. Finance is necessary for economic development, but also has profound, and often unexamined, implications for social and political spheres. Channels for financial intermediation may be public or private, and national or foreign, implying tradeoffs among organizational forms. Public banks typically are superior in providing public goods and implementing national strategic plans, but private banks and capital markets normally are more efficient, assuming competitive markets. Savings may be sought within the national economy or from abroad, with domestic savings implying a smaller pool yet less subsequent international vulnerability, and foreign inflows offering potential abundance at the cost of external dependence. This framing yields four ideal-types of long-term finance (LTF): national public finance from state development banks; national private finance from domestic private banks and capital markets; foreign public finance via bilateral or multilateral aid or state investment (including from non-traditional lenders, such as China); and foreign private finance sourced from global investors seeking returns.

Both national public and foreign public finance dominated long-term investment in Latin America in the early postwar decades of import-substituting industrialization. In the 1970s through the 1990s, they were succeeded by foreign private bank loans, followed by crisis and retrenchment. In the 21st century global political and market conditions brought a resurgence of foreign capital, including from both global private investors and non-Western public sources. Worries about problems arising from Chinese public finance to Latin America are likely overblown, as the quantity remains small, except in some Bolivarian Alliance countries. However, private foreign inflows, strongly promoted by Western-led multilateral actors, from the Organisation for Economic Co-operation and Development (OECD) to the World Bank, during the 2010s, may be more problematic. Excessive dependence on private securities markets funded by globally mobile capital often undercuts achievement of other valued societal goals such as reducing inequality and ensuring democratic accountability. Notwithstanding their predictable flaws, it may be time for a reemphasis on national, and possibly regional, public development banks.

Keywords: finance, investment, development bank, capital markets, financialization, democratic accountability, international financial institutions, foreign aid, public-private partnership, foreign direct investment, foreign debt, patient capital, Latin American politics, Latin American political economy

Overview

Conceptualizing four ideal-types of long-term finance (LTF) makes it possible to theorize typical benefits and costs of each type, as well as to track important shifts in Latin American policy preferences among them, by decade and across countries. A comparison of the institutions of LTF in Latin America with those in faster-growing East Asia highlights the fact that the latter relied on state leadership to invest savings drawn mainly from national sources, while Latin American countries have been more dependent on private foreign capital inflows. All options carry risks, but relying on foreign capital for development finance may be especially problematic. Nonetheless, beginning in the mid-2010s, several of the most influential Western-led multilateral clubs, including the Organisation for Economic Co-operation and Development (OECD) of the advanced industrial democracies, the large economies Group of Twenty (G20), and the international financial institutions (IFIs), joined in promoting the option of increasing foreign private capital flows for long-term development in Latin America and other middle-income countries (MICs). Looking forward, Latin American policymakers will do well to recognize that decisions to prioritize alternative types of LTF have implications for an array of both economic and political outcomes, including future inequality, democratic accountability, and state capacity.

Seeing Past the Invisibility Cloak: Finance and Politics

Four initial considerations orient the analysis. First, finance is deeply and inevitably political. National economic regulatory frameworks are frequently, but wrongly, perceived as merely technical, or as natural and inevitable, and thus non-controversial. Instead, the distributional and developmental implications of national finance are enormous. Economic institutions, regulations, and behavioral norms impose path dependence and create distributional outcomes, as recognized by canonical political economists including Polanyi (2001), Gershenkron (1962), Hirschman and Adelman (2013), and Lindblom (1980). Latin American LTF patterns reflect, encourage, allow, and constrain elected rulers' political choices. Adverse financial patterns undermine political leaders' ability to govern.

Second, governments should regulate finance with the view that it exists to serve the real economy—not vice versa. The real economy encompasses activities related to the production, distribution, and retailing of goods, plus non-financial services such as healthcare and education. Finance has four legitimate functions (Kay, 2015, p. 6; see also Levine, 1997). Most importantly, a nation's financial sector should provide smooth intermediation between social groups which are net savers and entrepreneurs with potentially productive investment projects. Normally, in a modern capitalist or mixed economy, it is assumed that the household sector, consisting of individuals and family groups, is a net saver, as citizens stockpile funds for large expenses and emergencies. Conversely, non-financial businesses and the government usually are net borrowers, investing in productive facilities, including physical and social infrastructure. National financial institutions and markets that do not generate significant financial intermediation are thus, by definition, problematic. A well-functioning financial sector also performs subsidiary functions, including facilitating payments, enabling households to manage their income prudently over lifetimes, and providing insurance. These activities serve society as a whole. Pursuit of other goals, such as profits for investors in financial assets, is legitimate insofar as it supports one or more of these core financial functions. The analysis thus begins from the initial ethical position, which remains controversial, that the goal of maximizing shareholder value, or profits to investors, should not be the overriding aim of a country's financial policymakers and regulators, as this constitutes a case of the cart driving the horse. As socioeconomic inequality in the global North has increased, some chief executives of major corporations have begun to defect from the long-dominant shareholder value ethos (Tett, 2019).

Third, although financial modernization is essential, more finance is not always better, even in emerging markets and developing countries (EMDCs). National financial structures have profound implications for economic growth, which requires long-term investment. Although basic macroeconomic identities define societal savings as equal to investment, savings cannot become investment without financial intermediation, except when each firm saves for its own investment, which is wildly inefficient. Ergo, there is limited growth in the absence of a modern financial system. Previous generations of development economists therefore tended to argue that a larger, more sophisticated, more liquid financial sector always would be preferable to a smaller, undifferentiated, illiquid one (Fry, 1994; Goldsmith, 1969; Levine, 2005; Shaw, 1973; World Bank, 1989), but this assumption has been increasingly questioned, especially since the global financial crisis (GFC) of 2008–2009 that began in the United States, the hub of international financial networks (Beck, Degryse, & Kneer, 2012; Grabel, 2017; Kirshner, 2014; World Bank, 2013). Nonetheless, few scholars dispute the titanium links joining modern finance and economic growth, especially for MICs (Rousseau & Wachtel, 2011).

Fourth, prudent Latin American policymakers can learn from a comparison with EMDCs elsewhere, especially in East Asia and more recently South Asia (which has been less likely to appear in these cross-regional comparisons, as its high growth story is more recent than East Asia’s). As shown in the first two rows of Table 1, growth has been consistently higher in East Asia than Latin America since 1990. In addition to the now well-accepted observation that East Asian developmental states employed export-promotion as well as import-substituting industrialization (ISI) strategies (Deyo, 1987), various important structural socioeconomic differences between Latin America and East Asia have been suggested as explanations for Latin America’s inability to escape the so-called middle-income trap, including East Asia’s lower inequalities of land ownership and wealth (Rueschemeyer, Huber Stephens, & Stephens, 1992), higher education and health spending (Huber & Stephens, 2012; McGuire, 2010), ability to engage in top-down resource mobilization without offering overgenerous side-payments to economic elites and other crucial constituencies (Hanson, 2014), and less-fragmented business lobbies and labor representatives (Doner & Schneider, 2016; Schneider, 2013). However, Latin America performs better in democratic checks and balances, rule of law, and possibly control of corruption, early-21st-century upheavals notwithstanding.

A portion of the apparent East Asian growth advantage may stem from the performance of the financial system (Stallings, 2006). Certainly, Latin America has lower levels of investment/GDP and infrastructure spending, as also shown in Table 1. In fact, Latin America places last in a comparison of infrastructure spending to GDP across world regions, averaging only 2.3% between 1992 and 2011 (MGI, 2013, p. 12). In 2019 the Inter-American Development Bank (IDB) assessed Latin America’s infrastructure “financing gap” as 2.6% of GDP annually (WFDFI, 2019). Obviously, comparative financial patterns cannot be reduced to quantities of investment thrown at development problems. One careful econometric study suggests that, while there are persistent gaps between Latin America and emerging Asia in terms of levels of investment, education, and the availability of labor, the huge cross-regional difference in output is mostly “explained” by the mysterious residual variable total factor productivity, which is the “everything else” category in the standard economic growth equation, wherein all of the difficult-to-quantify dimensions reside (Cavallo & Powell, 2018, Table 1, n.p.). Such analyses return us to the more qualitative dimensions of governance and so-called “soft” economic infrastructure, including the characteristics of financial institutions and markets.

Table 1. Latin America and Developing East Asia: Suggestive Comparisons.

Indicator	**Latin America**	**East Asia**	**Comments**
Growth, GDP/capita 1990–2000 (World Bank, 2019B)	3.2%	3.7%	EA grows faster
Growth, GDP/capita 2001–2017 (World Bank, 2019B)	3.0%	4.6%	EA grows faster
Investment/GDP 2012–2018 (ECLAC, 2019, p. 45)	24%	30%	EA invests more
Mean infrastructure spending 1992–2011/GDP, 2010 (MGI, 2013, p. 12)	2.3%	China: 8.5% [India: 4.7%]	EA invests more LA regional weighted average reflects low spending in Brazil
Domestic financial liberalization and privatization (Heritage Foundation, 2019; Financial Freedom Index)	55	47	0 (least) to 100 (most) LA more neoliberal
International financial liberalization (Heritage Foundation, 2019: Investment Freedom Index)	57	47	0 (least) to 100 (most) LA more neoliberal

Institutional differences in cross-regional financing patterns are large and persistent over time. In Latin America as compared to East Asia, national financial systems since the 1990s have been notably more privatized and more open to foreign capital (Stallings, 2006). Thus, the conservative Heritage Foundation (2019) think tank awards Latin America consistently higher scores than the Asia Pacific region on its index of “financial freedom,” a composite of light government regulation of finance, low or no state ownership of banks, no targeted credit, large private capital markets, and no discrimination against inward direct investment by foreign banks (i.e., "trade" in financial services). The companion index of "investment freedom" assesses openness to foreign capital, allocating points for low capital controls, few quantitative or sectoral barriers to foreign direct investment (FDI), no restrictions on foreign ownership of land, no burdensome bureaucracy for FDI, and so forth. Both indices run from a low of 0 (percent "unfree") to a maximum of 100 (percent "free"), and Table 1 reports the regional comparison scores. In practice, this means that national financial regulations in Latin America have provided governments with fewer financial policy instruments than their East Asian counterparts, implying lower "financial repression" to those committed to freer markets (Levine, 1990; Roubini & Sala-i-Martin, 2001), but less "policy space" to analysts more worried about global power inequalities (Chang, 2003; Kentikelenisis, Stubbs, & King, 2016; Wade, 2003).

Overall, as compared to East or South Asia, Latin American financial systems are both more privatized and more globalized. Aizenmann, Jinjarak, and Park (2015, esp. Figure 2, n.p.) confirm that bank credit, still the dominant form of domestic finance in both regions but comparatively more important in East Asia, shows up in World Bank metrics as better governed in Latin America, which boasts superior insolvency procedures, along with wider citizen financial inclusion. However, in terms of economic bang for the buck, East Asia scores better, with higher total credit/GDP, lower lending/deposit spreads (measuring cost or efficiency), and better credit access for small- and medium-sized enterprises (SMEs). Credit for SMEs is important because a unit of invested capital in a smaller business has been shown to have significantly more positive implications for employment than in a large firm. It seems that more neoliberal finance in Latin America has not generated more investment, or greater efficiency in financial intermediation, as compared to East Asia. Correlation is not causation, and other variables abound, but these outcomes are suggestive.

This introduction has argued that financial systems implicitly are political, because national regulatory frameworks respond to and differentially reward societal interests, and also close off some policy options for governments. A principal function of a successful national financial system should be intermediation between savers and those engaged in productive investment. Latin American financial regulatory frameworks are more neoliberal than those in East and South Asia, yet perform worse on key indicators of financial intermediation.

Latin American Financial Trends

One may distinguish four principal conduits for LTF. Each is an ideal-type, or a stripped-down representation of a messier reality, and all of Latin America's MICs possess some of each. Nonetheless, different countries, and diverse administrations within a country, vary the mix. There are two broad sources of savings, national or foreign, and investment decisions may be made by either the government or the private sector. This schema yields four essential varieties of LTF for national economic development: national public; national private; foreign public; and foreign private (see Table 2). Before continuing, it should be emphasized that the discussion here focuses narrowly on *financial* institutions and markets and thus leaves aside the large and important questions of state capitalism within non-financial firms, including the distinctions that Musacchio and Lazzarini (2014, pp. 7–9) term: "Leviathan as entrepreneur" (i.e., firms with 100% public ownership); "Leviathan as a majority investor" (i.e., firms having the state as a majority investor, yet substantial private equity as well); and "Leviathan as minority investor" (i.e., firms with important, albeit non-controlling, blocks of equity or debt held by state banks and investors).

Table 2. Ideal-Types of Long-Term Finance in Middle-Income Countries.		
Allocation of Funds	**Source of Funds**	
	Domestic Savings	***Foreign Savings***
By Government	National Public Finance	Foreign Public Finance
Via Private Markets	National Private Finance	Foreign Private Finance

Latin America has seen large shifts among these four categories of LTF from the mid-20th century through the present. In the 1950s and 1960s the importance of national public finance increased, with the larger, more industrialized, mixed-capitalist countries of the region pursuing state-led ISI with significant roles for national development banks and state-owned enterprises (Kingstone, 2018). The 1970s, especially after the significant rise in world petroleum prices of 1973–1974, saw the addition of foreign private LTF, in the form of foreign commercial bank debt borrowed by national governments (Devlin, 1993; Frieden, 1991; Ugarteche, 2018). National public finance remained central, as most foreign loans were allocated by the state, often to state enterprises or public sector banks. Shifts in international market conditions, especially a surge in U.S. interest rates, triggered the region-wide sovereign debt crisis of the 1980s, causing Latin America's former ISI stars to experience net capital outflows for a decade or more. Newly democratic governments throughout South America, politically constrained and only tenuously in control of policy initiatives in the face of strong demands from their militaries, private businesses reliant on ISI protections, and unionized civil servants, responded to the cessation of foreign private capital inflows by increasing rather than cutting public spending, triggering macroeconomic disarray, and even hyperinflation, including in Argentina, Bolivia, Brazil, Ecuador, and Peru (Armijo, 1996; Pastor, 1992).

The 1980s and 1990s saw fiscal retrenchment and macroeconomic stabilization, a policy mix encapsulated by the subsequently infamous phrase the "Washington Consensus" (Williamson, 1989, 2004). For the most part, the specific set of policies to ensure reasonable price stability, positive interest rates, and macroeconomic rebalancing was sensible, given the time, place, and economic conditions. But enduring problems resulted when contextually necessary market reforms hardened into an uncritical ideological bias toward a small and ever smaller state, private capital, and global financial openness under any and all external and domestic conditions. This ideology became known as neoliberalism, and has been profoundly influential both in the Anglo-American world and throughout Latin America (Blyth, 2003; Roy, Denzau, & Willett, 2012).

In the 2000s and 2010s Latin American financial policies were notably more neoliberal than those in any other region of EMDCs, except Eastern Europe. Nonetheless, substantial intraregional variations, corresponding to national differences in partisan politics, also existed. The Heritage Foundation (2019), using a mean of the financial and investment indices described above, judged the institutional inheritance of the assertively leftist Bolivarian Alliance (ALBA) countries as 5% (Venezuela), 28% (Bolivia), and 38% (Ecuador) economically "free." The mixed capitalist, and in the early 21st century mostly politically center-left, Common Market of the South (MERCOSUR) group earned marks of 50% (Brazil), 58% (Argentina), 53% (Uruguay), and 68% (Paraguay). Finally, the Heritage Foundation judged the Pacific Alliance countries, politically leaning center-right for most of this period and economically the most neoliberal among the larger Latin American states, to be 68% (Mexico), 68% (Peru), 75% (Colombia), and 78% (Chile) financially "free." These substantial differences in national financial regulatory frameworks, despite the common heritage of ISI, sovereign debt crisis, and IFI-imposed austerity, incidentally suggest that a considerable scope remains for independent national policy choices.

The next sections examine the trajectory of each ideal-type of LTF in Latin America. Each section begins with brief theoretical expectations of the likely benefits and costs of a type of LTF, followed by an evaluation of Latin America's experiences.

National Public Finance, Latin America's Once and Future Leader?

The source of funds for *national public finance*, the first category in Table 2, is domestic savings, which the state must raise via taxes, fees, public borrowing, or related activities. Financial resources are allocated by the government, often via public banks, and only partially according to market criteria. (Managers of public banks often claim to allocate resources according to market-conforming criteria, or even according to what a true free market would prioritize were it not politically biased. Such justifications do not belie this point.) The core rationales for non-market allocation are the twin assumptions that only government can provide public (non-rival, non-excludable) and collective or common pool (rival, but non-excludable) goods, and that such goods and services, particularly long-range planning and strategic investment, are essential to escape the middle-income trap.

Public banks include both development finance institutions (DFIs) and other state banks. Analytically, the category also includes that share of private commercial bank lending which is allocated according to obligatory government guidelines mandating minimum shares to small business, farmers, green energy, and similar categories. The share of targeted in total credit may be considerable.

Unlike commercial banks, whether public or private, most development banks do not accept citizens' deposits, and receive the majority of their funding from government. Initially this occurs via direct budgetary transfers. Later, as both governments and national financial systems become more sophisticated, DFIs typically are funded, partially or fully, via dedicated, and conveniently off-budget, sources of funds, including various pools of long-term forced or voluntary savings such as social insurance funds, public sector pension funds, or deposits in state-run commercial or savings banks. DFIs also may issue long-term bonds via domestic or global capital markets. Decisions about allocation among prospective borrowers normally are made by the DFIs themselves, yet their resources are also available to governments for national emergencies, as with counter-cyclical lending during the GFC (Brei & Schlarek, 2018)—and sometimes for less exalted purposes, such as pre-election pump-priming. Both funding and allocation decisions remain primarily within the public sector.

These presumed benefits of domestic public finance are offset by a typical set of macroeconomic costs. Public banks are infamous for inefficient financial intermediation and high shares of non-performing loans (NPLs) and other assets, which are wasteful of society's resources. DFIs often become a direct fiscal drain, especially when their funding derives from government's budgetary funds. Where DFIs instead are funded through stable access to various pools of forced savings, they are less fiscally problematic, but not necessarily more efficient. Public officials will be tempted to use DFIs for politicized distribution and political corruption. To address these challenges, financial regulatory and oversight institutions must be strong, able to impose significant penalties, and autonomous in their personnel selection processes and funding. Overall, the option of national public finance is attractive for anyone who believes conscious and coordinated planning is necessary to construct a rational, integrated national infrastructure grid or propel a middle-income economy to high-income status. And yet, the public oversight, monitoring, and regulatory requirements are demanding and typically unmet.

In Latin America, DFIs and state-owned commercial banks were in fashion and endorsed by the IFIs during the 1950s through the 1970s, but discouraged by foreign economic experts thereafter. Although this article's primary interest is in LTF, the main task of DFIs, comparative data on public sector commercial banks, which should share most of the hypothesized political economy characteristics of DFIs, is more readily available. From 1970 to 1995, the share of state banks in total commercial banking assets declined in 17 of 18 Latin American and Caribbean countries, from an unweighted average of 65% to only 40%. By 2001, public banks had no assets in Mexico, and only 10 and 20% of total banking assets, respectively, in Chile and Argentina (Micco & Panizza, 2005, pp. 2, 29, 41). Unsurprisingly, the post-1980 decline of the share of public banks was greatest in several of the larger, more industrialized Latin American countries, where policymakers were both more willing and more able to implement the latest views on economic development. Using a different dataset that includes DFIs, Brei and Schlarek (2018, p. 284) report that, by 2014, all public banks held only 37.8% of banking assets (10.8% in DFIs and 27.0% in state-owned commercial banks), while private banks held 62.2% of banking assets (36.9% in domestic private banks and 25.3% in foreign banks).

The microeconomic performance of Latin America's state banks tends to confirm the analytical expectations, yet depends considerably on the time period analyzed and how one constructs the categories. Thus a study discriminating among public, private, and foreign (private) commercial banks from 1993 to 2003 found that public banks, as compared to the other two groups, charged borrowers less and had a larger share of loans to the local private sector in total bank assets, yet also paid depositors less, and had higher overhead costs, more NPLs, and lower returns on assets (IDB, 2004, p. 7). Once state-owned commercial banks are separated out, the DFIs often look better. Brei and Schlarek (2018, pp. 284–286) find that DFIs, like other public banks, charge borrowers less and are less profitable than private or foreign banks. However, in contrast to state-owned commercial banks, DFIs dedicate a larger share of their total assets to funding business, rather than consumer lending, and have greater access to long-term funding sources. Moreover, DFIs display the lowest levels of NPLs of any banks.

Brazil's National Economic and Social Development Bank (BNDES) illustrates most of these themes (Armijo, 2017; Cavalcante, 2018; Montoro, 2014, pp. 114–128; Musacchio & Lazzarini, 2014, pp. 233–258; Studart & Ramos, 2018). Established in 1952 to fund and coordinate an ambitious national infrastructure and heavy industry plan designed jointly by Brazilian and U.S. experts, by 2013 the BNDES had grown to be one of the world's premiere industrial development banks, with assets of USD363 billion, and a loan portfolio exceeded only by those of the China Development Bank and Germany's KfW. At almost 23%, its loans constituted the highest share of any major DFI in total credit to the private sector within its home country (Além & Madeira, 2015, pp. 110, 113). In 2014, total BNDES assets and loans either exceeded or matched those of both the IDB and the World Bank, including the latter's activities worldwide, not merely in Latin

America (Armijo, 2017, p. 233). Despite periodic flurries of central government activity to establish vibrant private capital markets, the BNDES has been the major, often virtually the only, domestic source of LTF for infrastructure and business investment in Brazil since the late 1960s.

During the 1990s, the bank helped key economic actors through the stresses of economic stabilization, running the government's privatization program and converting corporate long-term debt into BNDES equity participations instead. Two factors then generated rapid BNDES expansion in the 21st century. First, the unprecedented late 2002 election of Workers' Party (PT) President Lula da Silva led to the appointment of unabashedly developmentalist economic policymakers to the finance portfolio and as BNDES president. Second, the Brazilian government used the BNDES and its national network of retail bank partners to implement a massive counter-cyclical stimulus during the GFC. Once Brazil exited the global downturn, partisan political considerations (the political–business cycle) dictated a continuation of stimulus policies, which became pro-cyclical, and moreover increasingly relied on direct budgetary transfers. In addition to expanding infrastructure funding at home, the BNDES fielded a novel industrial policy program to fund "national champions," or large Brazilian multinationals expanding in South America and worldwide, perceived by policymakers as a complement to President Lula da Silva's ambitious geopolitical strategy of South–South diplomacy.

The costs of the strategy gradually became evident. First, opposition economists were incensed by the increasing reliance of the BNDES on direct budgetary transfers, which expanded from 10% to 58% of its total funding between 2002 and 2015. Meanwhile, the BNDES offered below-market-rate loans to Brazil's largest corporations, extended at rates well *below* the federal government's own borrowing costs (Afonso, 2016; Studart & Ramos, 2018, pp. 93–94). Second, senior corporate executives of many of Brazil's glitzy national champions, from the state-owned energy giant, Petrobras, to top firms in mining, telecoms, heavy construction, and food processing, ended up jailed along with the senior politicians that they had bribed in Brazil's tidal wave of corruption scandals beginning in 2016. Third, the BNDES took bullets for funneling Brazilian taxpayers' funds to the governments of Cuba and Mozambique to finance port construction abroad rather than projects at home. In response, the BNDES struggled to reinvent itself, for example by doubling its funding of SMEs from just over 16% of loans in the early 1990s to around a third of all loans after 2010 (*Brazilian Report*, 2019). Subsequently, some neoliberal economists, encouraged by the late 2018 election of far-right President Jair Bolsonaro, have hoped to shut it down, although Brazil's business community would vigorously resist. Nonetheless, and rather impressively, the BNDES throughout retained its prior reputation for competence. Frustration with the remaining alternatives for LTF has inspired many defenders of national public finance, both within Brazil and abroad, to continue to view the BNDES as something of a model (Butzbach & Mettenheim, 2014; Griffith-Jones & Ocampo, 2018; Zeidan & Filho, 2017).

National Private Finance and the Limits of Domestically Funded Capital Markets

With *national private finance*, the second category in Table 2, , the ultimate source of funds is also domestic savings, but these are raised by private financial institutions and markets directly from private savers. Allocation decisions are made within markets, whose participants are driven by profit motives. There are two broad options for expanding national private finance. The first is financial intermediation through private banks. Commercial banks accepting liquid deposits then risk a maturity mismatch if they try to extend LTF. One possible response is the integrated commercial-financial-industrial group. In Latin America throughout the 20th century commercial and industrial businesses often created their own associated (i.e., captive) commercial banks, collecting deposits from citizens and firms and using them as a source of capital for the non-financial businesses within the group (Leff, 1978). However, self-finance through integrated (often family-managed) business groups, while functional for early capitalism and the achievement of lower middle-income status, since at least the 1980s has been widely assumed by both economists and other social scientists to equate to crony capitalism, with its implications of rent-seeking, oligopoly, a frozen socioeconomic system, and resistance to more equitable and dynamic economic growth. And in practice, private commercial banks in Latin America offer relatively little LTF period. An IDB (2004) study found that private domestic banks allocated only 12%, and foreign banks only 13%, of their total assets to credit of any kind, including short-term working capital loans. Although credit from all types of financial institutions doubled as a share of GDP from the 1990s through 2016, as shown in Figure 1, it seldom finances long-term investment. Frustratingly, much bank credit in Latin American MICs finances consumption (de la Torre, Ize, & Schmukler, 2012, p. 1).

Instead, the only realistic alternative for LTF allocated by the national private sector is has been the development of local capital markets trading corporate shares (i.e., stocks or equities), government and corporate bonds, and other securitized assets. Creating and nurturing modern private capital markets requires a three-pronged policy strategy, focused simultaneously on investors, firms willing to raise funds and markets for trading securitized assets, and regulators. First, functioning securities markets imply investors, including individuals but especially institutional investors such as investment (merchant) banks, pension funds, insurance companies, and mutual funds. Second, there must be attractive assets in which to invest, implying both that businesses are willing to raise funds in this way, and that minimally liquid markets for financial assets exist. Finally, competent and authoritative regulators are needed to ensure honesty and protect minority investors. All these components must be built. Consequently, in the 1990s and 2000s, the World Bank and other IFIs allocated substantial resources to theorizing, and nurturing, stock markets and other capital markets in EMDCs (for example, Demirguc-Kunt, 1992; for a brief intellectual history, see de la Torre, Gozzi, & Schmukler, 2006).

The great advantage of domestic capital markets, as compared to public banks, as a form of financial intermediation should be efficiency (Demirguc-Kunt, Feyen, & Levine, 2011). Private investors will insist on making returns, pushing entrepreneurs to work hard and managers to move projects forward. Political and other non-market interferences in allocation decisions should be relatively sparse, and losses due to malfeasance will fall on investors, not taxpayers. There are also typical costs and risks from capital markets. Securities markets imply risk for investors, so investors also need the availability of safer if less remunerative forms of savings, such as bank accounts with deposit insurance for individual investors and statutory limits on the exposure of institutional investors such as pension funds. At the level of the macroeconomy, securities markets tend to be pro-cyclical, working against government efforts to stabilize markets in a crisis. Finally, relying primarily on private domestic savings, rather than volatile foreign capital inflows, implies that the size of national securities markets in most EMDCs will be relatively small and illiquid. This last challenge has led the Pacific Alliance countries (Chile, Colombia, Mexico, and Peru), whose overall national economic policy frameworks are the most economically liberal among the region's major economies, to attempt to create a larger market through cross-listing equities and other assets on one another's exchanges. Yet through mid-2019, the Integrated Market of Latin America (MILA), created in 2011, had had only limited success. In fact, many top Latin American firms have delisted on their local exchanges and decamped to the New York Stock Exchange instead (de la Torre et al., 2012, p. 6).

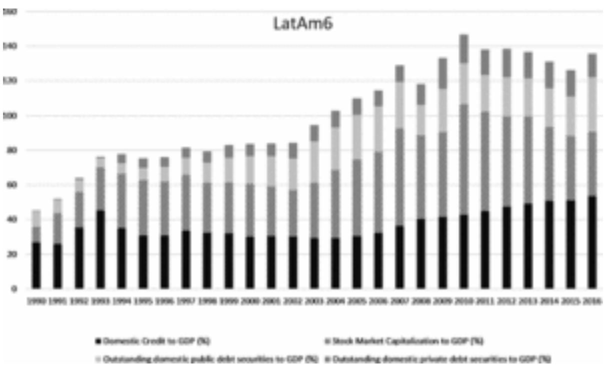

Figure 1. Evolution of domestic financial structure, Latin American 6 (World Bank, 2019A, 2019B).

Note: Unweighted means of annual values for total stocks of financial assets/GDP (both in USD terms at market rates) for Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

Figure 1 tracks the unweighted mean of the evolution of the major categories of domestic financial assets since 1990 in the Latin American 6, a group including all of the larger, more industrialized countries except Venezuela, in deep crisis since 2013. The categories for which comparable data are available are “domestic credit to the private sector,” which includes outstanding loans from both public and private banks, and total assets in each of three subsets of the capital markets: the stock market, private bonds, and public bonds. The mean ratio of total domestic financial assets/GDP among these six countries almost tripled between 1990 and 2016, rising from 45.5% to 135.9%. By the end of the period, Chile and Brazil had the “deepest” domestic financial markets, at 238% and 210% of GDP, respectively, and Argentina the shallowest one, at 46%, with the remaining three countries clustered around 100% (despite some missing data for the final three years, the broad story is consistent). The relative importance of the capital markets in total domestic financial assets expanded in all six of these larger Latin American MICs, rising from an average of 40% of the total to 60%. In USD terms, Brazil and Mexico have the largest capital markets. Within the capital markets, on average corporate shares (“stock market capitalization”) accounted for 45%, public debt securities for 38%, and private debt securities (i.e., loans taken out by businesses, securitized, and sold as bonds or other debt paper to investors) for roughly 17% of assets. Chile is ahead of its neighbors in having significant local institutional investors, a legacy of pension fund privatization under General Pinochet in the early 1980s, which, despite further reforms under democratic auspices, has come under fire for its limited coverage (de la Torre & Rudolph, 2018). Moreover, although Chile’s stock market looks quite large, with a 2016 market capitalization of 85% of GDP, about twice that of its nearest rivals Brazil and Peru, Chilean shares hardly trade. Chile’s trading volume is only 10% of GDP, as compared to 32% in Brazil, 10% in Mexico, and less than 5% elsewhere (Modi, 2018, p. 16). Outside the most industrialized six, other countries in the region have essentially no domestic capital markets.

The implications for development and democracy of this substantial growth of private capital markets in Latin America MICs are unclear. Private capital markets may be the antidote to the bad old days of crony capitalism with entire national economies dominated by a few family-run groups, or to grossly inefficient public banks, not to mention outright corruption in public finances. Nonetheless, some senior economists in academia, Southern-led research centers such as the Economic Commission on Latin America and the Caribbean (ECLAC or CEPAL), or the the United Nations' Conference on Trade and Development (UNCTAD), and even the Northern-dominated IFIs, now worry about "too much finance" (i.e., "financialization"), or the rapid growth of financial sector trading profits without a corresponding expansion in in funds for productive investment. In the careful phrasing of senior World Bank economist Thorsten Beck and his colleagues (2012, pp. 5–6), "In developing countries … expansion of the financial sector along dimensions other than intermediation does not seem to result in either higher growth or lower volatility."

One glaring hole in the publicly available data, and a topic many enthusiasts for capital markets in EMDCs reliably deflect, is the role played by foreign private investors in domestic Latin American securities markets. One may deduce from qualitative data such as interviews and news reports, as well as from data on the entry of portfolio inflows, that a very significant component of Latin America's domestic equity and debt markets actually corresponds to holdings by global institutional investors (and thus represents the fourth ideal-type of LTF). It remains unclear whether the vision of vibrant capital markets largely funded by domestic savings is a viable option in an emerging economy, even a larger one such as China, India, or Brazil. Regional stock exchanges are in principle an intermediate option, but thus far have been unsuccessful in Latin America.

Overall, Latin America's experience confirms the intuitions that private domestic capital markets probably allocate society's savings more efficiently, with less leakage to rent-seeking activities, than do public banks, while also implying lower direct fiscal costs. Yet government's policy space shrinks as private capital markets expand: state incumbents possess fewer levers for shaping industrial policy, providing public goods, or responding to international financial contagion from a crisis generated in the markets of some other country. The mix of benefits and costs associated with these first two ideal-types of LTF are rough mirror images of one another.

Governance Challenges of Developing with Foreign Capital

The major presumed advantage of foreign vis-à-vis domestic finance is the larger pool of savings the former makes available for domestic investment. Since the 1990s Latin America has once again received large net inflows of foreign capital. Despite limitations in the data, such as not all flows being included and not all included flows being LTF, it may be inferred that regional investment levels would be substantially lower without the contribution of foreign savings. The major disadvantage of foreign funding is increased national vulnerability to global market conditions and foreign preferences. Heightened external dependence combines economic and political dimensions. Economically, any accumulation of foreign liabilities in a currency that the borrowing government does not control, and cannot easily hedge against, implies the very real likelihood of a possible future financial crisis, a problem aptly baptized as a currency's "original sin" (Eichengreen, Hausmann, & Panizza, 2002). Politically, the incentives to, and policy preferences of, foreign lenders and investors are at best imperfectly aligned with those of host country governments and citizens.

Figure 2 shows shifts in annual net foreign capital inflows. Between 1990 and 2016 they rose from about 2% to about 5.5% of GDP for the Latin American 10, representing nine South American countries (all but Guyana, Paraguay, and Suriname), plus Mexico. Readers should note that

Figure 1 tracks the annual means of national patterns of total accumulated *stocks* of domestic financial assets, while Figure 2 covers annual *net inflows*, and is an absolute figure, not a group mean, implying that larger countries such as Brazil and Mexico have the greatest weight in the regional pattern.

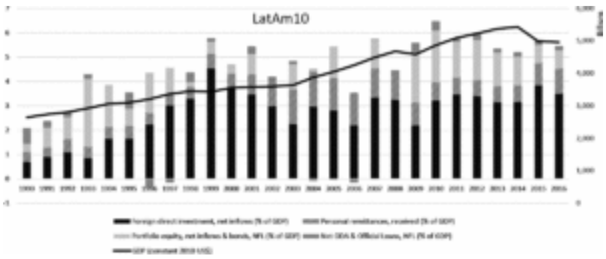

Figure 2. Evolution of foreign capital inflows, Latin American 10 (World Bank, 2019B).

Note: Total annual USD net inflows as a share of group GDP for Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela.

Foreign Public Finance: Shrinking and Shifting

Foreign public finance, the third type of financing in Table 2 , refers to all international financial flows for which the foreign creditor or investor represents a foreign government or group of governments, including a public agency, bank, firm, or sovereign wealth fund, or a multilateral financial institution (whose members are sovereign governments). Most often the recipient of the funds is also a public sector entity, although some multilateral banks, notably the World Bank's affiliate, the International Finance Corporation, lend directly to private projects. The external public sector lender or investor will have a large say in what is financed. Foreign public investors, like the domestic public sector in an EMDC, have a mix of commercial and political motives: although foreign state banks desire repayment, they also have other goals, from providing public goods as a consequence of altruistic motives, to future access to natural resources, to political support in global fora, to access to military refueling rights in ports or airports, even if these are not always explicit. One challenge is that, when money flows to EMDC governments who have not had to raise these funds domestically, corruption is always a risk. Many football stadiums and other white elephant projects named for now-deposed dictators have been financed with public foreign inflows from donor countries that wanted something in addition to reliable repayment.

Throughout most of the post-Second World War period, foreign public investment came in the form of Western foreign aid. The category of "Net ODA and Official Loans," seen in Figure 2, combines official development assistance (ODA, or non-military foreign aid, from the mainly Northern donors reporting to the OECD) and other public sector loans, mainly from the Western-led IFIs, including the World Bank, IMF, and IDB. What is notable is how relatively unimportant public finance from these traditional aid donors has become. While bilateral and multilateral foreign assistance from the global North was once a significant source of LTF in Latin America, it is now hardly relevant for the region's MICs, except as a source for emergency, and at most medium-term, balance of payments funding during a financial crisis, as with the IMF's unprecedented USD57 billion package for Argentina in 2018. Between 1990 and 2016, net inflows of foreign public finance decreased from 0.6% to 0.2% of the 10 countries' combined GDP, and from a third to only 3% of total net inflows. One reason for the drop is that the advanced industrial democracies whose ODA and IFI contributions are tracked in Figure 2 no longer control the preponderance of the global investible surplus (Armijo, Tirone, & Chey, 2019).

Meanwhile, new lenders have arisen in the global South. The IFI databases consulted for Figure 2 do not yet include most capital flows from the new, and secretive, sovereign lenders such as China, Russia, and Saudi Arabia, or the new multilateral financial institutions created by the global South, such as the Asian Infrastructure Investment Bank (AIIB), yet scholars such as Bunte (2019), Kaplan (2016), and Myers and Gallagher (2018), each report rising Chinese public flows to Latin America. Chinese state finance has concentrated in a few countries in Latin America, especially natural resource exporters with leftist governments. From 2005 to 2017, accumulated debts to China from Brazil and Argentina were large in USD terms, yet only 2% and 3% of GDP, respectively. However, Chinese loans to Venezuela over the same period summed to a nontrivial 30% of GDP, and also reached 10-20% of GDP in Ecuador, Jamaica, Bolivia, and Trinidad and Tobago (di Vittorio, Lauriau, & Rodriguez, 2018, p. 6). In 2018, China's largest loan to Latin America was a USD5 billion credit to Venezuela, in what was likely a futile effort to protect its earlier investments (Myers & Gallagher, 2018, p. 1).

Both the older and the new state lenders and investors in Latin America have had mixed market and non-market motives, although specifics have varied over time and across donor states. Most scholars agree that, among Western development lenders, bilateral public lenders impose more political, but fewer economic, conditions than multilateral lenders. The newer Chinese and other Southern bilateral lenders have demanded even less economic conditionality than Western bilateral lenders from Latin American borrowers (see Bunte, 2019, pp. 30–47; Kaplan, 2016). However, as the Venezuelan economy spiraled down in the latter 2010s, both Chinese and Russian state banks gradually began to be less generous. Multilateral public creditors usually are somewhat more concerned with repayment than bilateral public creditors, and even the newer Southern-led multilateral lenders, such as the AIIB, increasingly favor co-financing projects with the traditional IFIs as a means of reducing creditor risks.

At the same time, the supposed divorce of multilateral banks from politicized lending is imperfect. For example, in March 2019 the United States, wielding 30% of IDB shareholder votes, insisted the bank recognize opposition leader Juan Guaidó as Venezuela's president. When China, the incumbent Maduro government's largest creditor, refused Guaidó's representative a visa, the IDB abruptly cancelled its intended first annual meeting in China (Zhen, 2019). Some donor initiatives, such as "green" bonds, health bonds, debt-for-nature swaps, and other foreign public inflows intended to compensate an EMDC government for making costly but socially useful public policy shifts, may be closely aligned with the goals of the recipient (ECLAC, 2015, pp. 28–36, 2019, pp. 25–26). Yet even here, politicized conflicts over national sovereignty easily arise. For example, Brazilians and Peruvians resent foreign references to the Amazon as the "common heritage of mankind."

The Siren Song of Foreign Private Finance

Foreign private finance, the fourth category introduced in Table 2, encompasses the major categories of private voluntary capital flows: commercial bank loans, FDI, portfolio inflows (foreign purchases of Latin American equity and bond securities), and worker remittances. As shown in Figure 2, worker remittances, which are unrequited transfers and typically counter-cyclical for recipient countries, steadily averaged around 18% of net foreign capital inflows during the study period. Among our sample, remittances were in 2017 most significant in Bolivia, Mexico, and Ecuador, at 3.5%, 2.8%, and 2.7% of GDP, respectively. They have been even more important throughout Central America, and poorer Caribbean countries, reaching over 15% of GDP in Jamaica, Honduras, El Salvador, and Haiti in 2018, and even becoming the major source of capital inflows (Orozco, 2019). Remittances enter the recipient country's commercial banking system, finance consumption, and are generally welcomed by Latin American governments. They seldom provide LTF, except directly to small family enterprises, and will not be discussed further.

Long-term commercial bank lending, which was the major modality for private foreign finance to EMDCs in the 1970s, virtually disappeared with the advent of securitized sovereign bond debt in the late 1980s and after (Armijo, 1999), and thus does not appear in Figure 2. The Brady bonds (named after then U.S. Treasury Secretary Nicholas Brady) that "solved" the Latin American debt crisis in the late 1980s, at least from the viewpoint of the Northern lending banks, initiated the shift to securitized lending to EMDCs. As shown in Figure 2, between 1990 and 2016, during a period in which all net capital inflows to the Latin American 10 more than doubled as a share of GDP, FDI plus portfolio flows increased their share from half to about 80% of the total. Unless countries wish to rely on domestic savings, or increasing yet still comparatively small public inflows from non-traditional state investors such as China, global private markets are where the money is.

Yet there are numerous dangers for a country that relies on global private inflows for LTF. The three most important are currency mismatch, incentives mismatch, and the fact that capital-importing EMDCs have little influence over the variables to which global investors respond. First, currency mismatch, or the challenge of repaying funds in a currency that cannot be earned within the national economy, is in principle the same for funds accessed from foreign public or foreign private investors. However, as foreign public sector donor-investors in EMDCs possess both non-economic and economic motives, foreign public capital providers may also be more inclined to exercise case-by-case discretion when confronted, for example, with a missed interest payment. Second, private foreign investors and recipient country governments in EMDCs typically lack closely aligned incentives. The single goal of global private investors is to make profits, yet the incentives of incumbent political leaders in Latin America are to develop the country—or at least to win elections due to their success in achieving growth and good governance. Global private investors seek industries and sectors that are efficient and competitive—*or* which are reliable earners of foreign exchange, as with commodity exporters. Competitive pressures for increased productivity probably are useful: this is the core argument behind the proposition that export-oriented industrial policy, as in East Asia, is probably a better bet than import-substituting industrialization policies that never require their infant enterprises to compete in world markets. However, if one believes, as most development economists do, that long-term national development requires substituting higher value-added production for mining and unprocessed commodity exports, then adding the interests of the commodity-export sector's foreign creditors into the domestic political mix may be problematic.

In particular, both theoretical and empirical analysts have found that foreign private investors demand a strongly conservative, neoliberal bias in host country macroeconomic, labor, and financial policies (Bunte, 2019; Kaplan, 2016). By the logic of their structural position, foreign private investors also want liberal capital account rules, enabling them to make a quick exit in times of turbulence, and legal dispute settlement mechanisms that they understand, which will be those of their home jurisdictions, not the host country—and they will wield their influence with their home governments, in international fora, and with opinion leaders in academia and the media to enforce institutions and ideas consistent with these outcomes on EMDC governments. Host country governments, in contrast, want to bind foreign investors to entice or oblige them to provide patient, long-term capital. Ceteris paribus, this implies constructing regulatory frameworks to make cross-border capital flows stickier and increase benefits for local actors. Governing foreign investment is thus an ongoing bargaining game, potentially positive sum, yet with zero-sum outcomes on many of the particulars.

Third and finally, many of the variables to which international investors respond—such as global interest rates and financial contagion emanating from other emerging economies—are exogenous to capital-importing countries, and thus are not policy variables even notionally under the control of EMDC governments (Campello, 2015). Moreover, with the substitution since the 1990s of a relatively large number of global private investors for a relatively small number of dominant international banks lending to Latin America in the 1970s, even the identification of a counterparty with whom to bargain in cases of disagreement over the terms and conditions of private external finance is complex.

What can be done? Middle-income capital importers are not without options. Necessarily, they involve variables that host country governments can try to control, usually by constructing national regulatory frameworks to prefer certain types of capital inflows over others, in order to maximize their own freedom of action (Armijo, 1999; Biersteker, 1993; Bunte, 2019; Campello, 2017; Frieden, 2016; Frieden & Stein, 2001). The standard wisdom since the 1980s Latin American debt crisis has been that FDI, in which the foreign capitalist becomes the controlling owner, is the least volatile, and thus the least dangerous, form of foreign private LTF; investments in local plant and equipment, employees, and markets cannot easily be sold, so a precipitous exit is more difficult. Moreover, FDI does not add to country's foreign debt, although dividends and intragroup transfer pricing still may lead to large outflows. UNCTAD, which, along with ECLAC, for decades has functioned as a premiere multilateral think tank for the global South, promotes but also monitors FDI, which brings not only capital, but also potential access for host countries to global "best practices," including production processes, management techniques, and marketing networks.

Among the Latin American 10, FDI inflows dominated private commercial inflows in the early 21st century. Nonetheless, FDI is not a perfect solution. Inflows intended to create new businesses, or "greenfield" FDI, generally are assumed to be better for host country development than mergers and acquisitions (M&A), or "brownfield" FDI. M&A investment can recapitalize existing businesses, but sometimes operates merely to strip assets, booking a financial profit for the investor while destroying jobs and productive capacity in the host country, as sensationally memorialized in Perkins (2004). Privatization, or the sale of state firms and other assets, is brownfield FDI. In South America in 2017, the overall ratio of greenfield to brownfield investment was a robust and encouraging 414%. However, and more worryingly, in Mexico and Central America greenfield FDI was only 74% of foreign capital entering for M&A activities (UNCTAD, 2018A).

FDI implies that foreigners hold either the majority or the controlling interest in the business, although the definition of "controlling interest" varies dramatically across researchers, ranging from 10% to 51%. However, most global private investors are not prepared to start and run businesses in emerging economies. To successfully tap global private capital markets for developmental purposes, EMDCs must also attract foreign portfolio investors, and must somehow construct the rules of the game (their national laws and regulatory frameworks) so that footloose, profit-seeking, global private capital is transformed into long-term finance. There are intense debates over whether this is possible. One option is for the EMDC government to issue foreign-exchange denominated bonds, and then have the recipient country's public sector invest the money. Alternatively, private banks and financial firms, or non-financial businesses, may raise funds directly in global capital markets via the issue of corporate shares (equity) or private bonds, often reaching Northern investors as packages of securitized debt. The problem with portfolio investments is that investors often choose them precisely in order to access liquid assets, creating a maturity mismatch between short-term funding and long-term investment.

The iconic crisis associated with private foreign capital inflows was Argentina's explosive currency and banking meltdown of 2001–2002, which was technically ended only in 2016, and whose adverse effects still lingered in mid-2019 (Blustein, 2005; Campello, 2017; Frieden, 2016). Following Argentina's democratic transition from a brutal military regime in 1983, insecure democratic politicians in the remainder of the decade sacrificed fiscal stability to the need to purchase the support of various social actors, including the military and public sector unions, who otherwise could derail Argentina's democratic transition. The exit from the resulting hyperinflation came with President Carlos Menem's implementation of the 1991 Convertibility Law, whose key provision was a currency board, in effect putting the country on a U.S. dollar-linked Argentine peso as inflexible as a classical gold standard. Monetary expansion, and thus inflation, were immediately halted; the IMF supported a rigidly fixed exchange rate; and foreign capital poured in, in the forms of both FDI to purchase privatized state assets and purchases of government debt. By the late 1990s disguised inflation resulted in overvaluation, external deficits, and falling growth, yet policymakers believed that abandoning parity of the Argentine peso with the dollar would be too dangerous. A forced, yet still controlled, devaluation by Brazil, Argentina's major trading partner, in January 1999 set off Argentina's slow-moving but seemingly inevitable meltdown over the next three years, featuring emergency IMF loans, multiple finance ministers, federal government austerity policies crashing up against provincial governments trying to make payroll and keep the lights on by issuing their own quasi-currencies, a freeze of the bank accounts of the middle class and SMEs, a foreign debt default, multiple presidents over the course of two weeks in late 2001 to early 2002, with a final break with convertibility only as the very last resort in January 2002.

Following two years of frustrating negotiations with a decentralized group of global private investors, in 2004 President Nestor Kirchner declared a unilateral debt write-down and attempted to move on. Instead, disgruntled junk bond investors, labeled "vulture funds," sued, and won a judgment against Argentina in a New York district court. Due to the extraordinary extraterritorial reach of U.S. financial jurisdictions and financial sanctions laws, Argentina's government and its firms for years remained virtually excluded from global private markets, although the country received some LTF help from foreign public sources, including China and Venezuela (Labaqui, 2014).Only following the late 2015 election of center-right President Maurício Macri could Argentina finally settle with the holdout investors. Argentina meanwhile became, along with smaller European countries such as Iceland, Portugal, and Greece, a painful example of the need for a functioning global sovereign debt mechanism. Argentine democracy has survived, which is impressive, but the country's finances continue precarious and difficult. One lesson has been the distressing observation that even a government, such as that of President Macri, willing to implement almost all the austerity policies demanded by international private capitalists, and supported by the IMF's largest ever loan of USD57 billion in 2018, seemed unable to convince portfolio creditors to remain invested.

The International Context: Diffusion of Investment Designs From the Global North

Major shifts in patterns of LTF in Latin America since 1990 thus pose different governance challenges for policymakers. Accessing mostly national rather than foreign savings, although attractive in principle for countries affected by the “original sin” of lacking a globally demanded currency, has been difficult in Latin America due to historically low savings. Increasing national savings, whether through higher taxes or inducements to citizens to move hidden assets into the formal financial system, is not an easy fix. The other option is to import or borrow the capital from abroad.

Foreign public finance in principle could be sourced from the traditional Western donors, from new Southern donors, or from within Latin America. The discussion so far highlighted the large drop from 1990 to the present in official flows from the nations of the capitalist West. Increasing, but opaque, foreign public inflows now originate with rising authoritarian powers, including China, Russia, and Saudi Arabia, although they flow in smaller quantities to Latin America than to many other regions of EMDCs. Due to the Western Hemisphere’s physical distance from these new money states, their associated political dilemmas are not at present acute for Latin American MICs. Nonetheless, for most of the region’s larger countries, China is likely to remain for the foreseeable future more important as a trading partner than an investor.

Periodically the option of boosting non-trivial and developmental public capital flows via regionally based, multilateral development banks based in Latin America has been mooted. In reality, regional DFIs in the Western Hemisphere thus far have worked only when an economically powerful state was willing to fund them in exchange for diffuse political influence. During the Cold War, the United States, the hemispheric hegemon, bankrolled the IDB, a regional lender for Latin America and the Caribbean. In common with the other Western-led IFIs, the IDB today offers ample useful advice but limited funds. Under President Hugo Chávez (2002–2013), a Venezuelan state flush with petroleum revenues briefly became a significant source of external funds for several small, left-leaning countries in the Caribbean, and the major international customer for Argentine government bonds, until Venezuela’s own subsequent economic collapse (Cusack, 2019; Labaqui, 2014). Neither of Venezuela’s regional projects, the Bank of the South, encompassing all 12 South American states, or the ALBA Bank, serving Latin American and Caribbean members of the Bolivarian Alliance, ever functioned, having been overtaken by the combination of the fall in international petroleum prices and Chávez’s own early- 2013 death from cancer. The multilateral Andean Development Corporation (CAF), rebranded in 2014 as the Development Bank of Latin America, is, like the larger IDB and even the much larger World Bank, significant within Latin America as a thought leader on development issues, yet relatively unimportant as a source of investible funds for the region, as its capital base is simply too small. Brazil’s state in the early 21st century in fact supported significant infrastructure investment in its neighbors—but these capital infusions were booked as BNDES loans to Brazilian multinational firms, and thus as greenfield FDI in host countries, not as regional development bank loans.

In practice, therefore, the really important policy decisions for Latin American policymakers in the near future concern the conditions of entry for global private investors. How might capital-importing governments acquire greater control over outcomes? Governments of several Asian EMDCs also have observed that the problem with private portfolio capital inflows is that global investors lack strong reasons to care about what happens to the government or citizens of host countries. Countries such as China and India therefore have designed national regulatory frameworks that prioritize inward investments by their global diaspora communities, in the hopes that these investors will be more patient and understanding suppliers of capital. Yet constructing new capital controls prioritizing diaspora portfolio investors is not a viable policy option for most Latin American countries. Their capital accounts are already too open, and existing investors would resist. Moreover, most countries already have signed bilateral and multilateral investment treaties with the United States and other Northern governments that explicitly prohibit differential treatment of investors on the basis of citizenship or identity ties.

Strategically, the better option, and the path increasing taken by Latin American governments, would be to design frameworks consistent with trends in Northern-dominated global financial governance. In 2012 the OECD agreed to study options for transforming private portfolio capital into long-term investment in infrastructure among its own member states. The result has been a major push, from international clubs such as the OECD and the G20, and also from business-funded research centers including McKinsey Global Institute (MGI) and the World Economic Forum, for private investment in a new legal and institutional modality: the public-private partnership, or PPP (MGI, 2013; OECD, 2014). The PPP is a corporate form designed to leverage relatively small quantities of long-term public capital with much larger quantities of private portfolio investment in order to invest long-term in projects that otherwise would be unattractive to private investors. In essence, the PPP design constructs a legal framework that transfers more of the risk to the public sector while guaranteeing profits for the private partners.

Originally promoted as an option for boosting infrastructure investment in advanced industrial countries, the PPP solution has been enthusiastically embraced by the IFIs. An association of multilateral DFIs led by the World Bank and IMF proposes PPPs as the solution to the structural problem of declining foreign public financial flows coming from the advanced industrial democracies and going to EMDCs, employing the catchy phrase "from billions to trillions" (Development Committee, 2015). The IFIs can provide the expertise, while private institutional investors put up the money. Argentina, the 2018 chair and summit host for the G20, chose "mobilizing private resources to reduce the infrastructure deficit" as the second of its three priority themes.[1] Advocates of PPPs for infrastructure investment are confident that Latin American governments that employ well-thought-out institutional designs for special purpose investment vehicles (SPVs), a type of PPP designed for large and complex projects such as dams or ports, will be able to stimulate foreign portfolio (non-managerial) and limited direct investment in large new infrastructure undertakings, while still maintaining sufficient political control of national development plans and investor behavior (Engel, Fischer, & Galetovic, 2015; Pinheiro, Monteiro, Gondím, & Coronado, 2015).

However, the diffusion of PPP enthusiasm from the global North to Latin America brings into play several additional considerations that have hitherto received less attention in the PPP literature. First, SPVs are complex to design and difficult to regulate, and none of the more industrialized Latin American countries, except probably Chile, have a strong recent record of controlling corruption and regulating finance. Arguably, this deficiency is nonetheless more readily addressed than the remaining two, which are inherent in the structure of incentives to EMDC governments versus those confronted by prospective investors.

Second, the challenge for MIC governments in the global South is not only to entice footloose private (national) portfolio capital to remain invested long term, which is the primary focus of the most of the current technical literature on PPPs, but also to keep foreign private capital within the national economy. International private investors strongly prefer conservative domestic macroeconomic policies and fully open external capital accounts, since neoliberal regulations maximize their freedom of choice. If major national investment decisions are made by those with no counter-balancing emotional or patriotic reasons to be loyal to a territory or its people, this inevitably has negative implications for both sovereignty and democratic accountability (Armijo, 1999, 2001; Rodrik, 2011).

A third worry is the concern that the Anglo-American pattern of decentralized capital markets for LTF is closely, likely causally, associated with increasing societal *inequality* in the national distribution of income and wealth. Notwithstanding decades of efforts to "democratize" shareholding and popularize a culture of eager individual investors, profits from capital markets activity in advanced industrial countries flow disproportionately to the highest income groups (Stiglitz, 2017, pp. 13–14). Similar trends hold in Latin America, where inequality is already the highest of any world region. Recently even analysts at the IMF and World Bank have begun to worry about "too much finance" going to use unrelated to financial intermediation or other socially desirable functions in EMDCs (Arcand, Berkes, & Panizza, 2012; Beck et al., 2012). Supposedly, international capital markets allocate investible funds efficiently, yet this claim is increasingly contested (Abeles, Pérez Caldentay, & Valdedecantos, 2018; Dymski, 2018; Kay, 2015; Ocampo & Stiglitz, 2008). IMF researchers employ more restrained language than those associated with Southern-led international think tanks such as UNCTAD or ECLAC, but also worry that foreign capital inflows may substitute for, not supplement, national savings and investment in the EMDC host (e.g., di Vittorio et al., 2018, p. 6). Some new evidence suggests that *net* flows to EMDCs over the medium term may be surprisingly modest, as most foreign investors seek risk diversification, not profitable long-term opportunities (Abraham & Schmukler, 2018). Moreover, global bonds create debt buildup (UNCTAD, 2018B, p. 5), especially worrisome as there is still no multilateral framework for sovereign debt restructuring (Hagen, Obstfeld, & Thomsen, 2017; Helleiner, 2009; Bohoslavsky & Raffer, 2017). If the past is any guide, foreign creditors and their Northern home governments will insist that EMDC governments make good even on sums borrowed by their private sectors.

Conclusions

It is useful to conceptualize LTF in Latin America in terms of the dilemmas posed to the governments of MICs that must choose different combinations of national or foreign sources of savings, and their allocation to priority uses via the public or private sector. *National public finance* (public banks and DFIs), although out of fashion throughout the hemisphere from the debt crisis of the 1980s through the GFC, remains very significant in several countries, including Brazil and Colombia, and has undergone something of an intellectual rehabilitation among development economists since 2010 (see Griffith-Jones & Ocampo, 2018). In contrast, since 1990 most Latin American governments have had limited success with policies to expand *national private finance* (private national banks or capital markets primarily relying on domestic investors). With few exceptions, private banks in Latin America do not provide LTF. Although Brazil has the five largest deposit-accepting banks in the region by assets, only one engages seriously in LTF, and that is primarily for construction and purchase of residential housing (Kurt, 2019; Shapiro & Pereira, 2019). Three Mexican banks (two of which are subsidiaries of foreign banks) and two Colombian banks round out the top ten—but nine of the ten focus on capturing retail deposits to employ in short-term credit and purchases of government bonds. These same three countries, plus Chile, dominate private capital markets development, which also has been only a limited source of LTF, despite decades of concerted efforts by the IFIs and local leaders during center-right, more pro-business administrations.

Foreign public finance (foreign aid) from Northern/Western sources has shrunk dramatically since the 1980s, and become relatively trivial in the aggregate, at least for the larger Latin American countries. Meanwhile, both loans and investment coming from non-traditional public banks in other emerging powers, notably China but also others, including Russia and Saudi Arabia, have risen rapidly. Although the political conditionality associated with Chinese loans and FDI is more muted in Latin America than in Eurasia, which is more geo-strategically consequential for China, these non-market investments bring with them non-market pressures and conditionality. However, the quantity of non-traditional foreign public finance remains relatively small in the region. Finally, *foreign private finance*, including portfolio inflows, has become the great hope of major Northern governments and the international organizations and multilateral banks that they dominate, possibly because they would like to remain influential in Latin America, but have little in the way of public finance to offer these days. And yet, the same governance conundrums of bubbles and busts, regulatory inability to keep pace with financial market innovation, and a severe mismatch of incentives between private global investors and national policymakers and regulators that became apparent in the GFC of 2008–2009, would appear to apply to Latin America going forward.

A wider perspective on national development suggests four meta-considerations for conceptualizing the institutional, market, and regulatory frameworks for long-term finance in the larger, mostly middle-income, countries of Latin America. First, one should recognize that national financial designs inevitably are political. “Political” here does not mean overtly partisan, or even involved in financing politicians or parties, but instead refers to both the inevitable distributional consequences of national financial designs and the likely dangers of separating important public policy decision-making from possibilities for citizen accountability. This has been the crux of the doubts noted here about the wisdom of funding long-term investment in EMDCs by global private capital inflows. Second, the central goal of financial modernization policies should be increased intermediation to provide funds for productive investment, especially long-term investment in infrastructure and dynamic businesses. This is a different regulatory imperative and ethical value than the proposition that a corporate executive’s overriding goal should be to maximize shareholder value.

Third, more sophisticated and larger domestic financial sectors in EMDCs are not necessarily superior if the government’s goal is to increase steady and stable economic growth without worsening distribution. Fourth and finally, cross-regional comparisons with other EMDCs are painful, and inevitably somewhat ambiguous, yet frequently are instructive. If the middle-income countries of East and more recently South Asia have been more successful than their Latin American counterparts at raising income per capita in the decades since the end of the Cold War, it may be that their greater reliance on national savings and public allocation of LTF has been, after all, significant. This is not what most policymakers, business leaders, or intellectuals anywhere in the Western Hemisphere wish to hear. But it may be worth considering.

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Notes:

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Tables & Figures for Armijo. 2020. "The Political Economy of Development Finance in Latin America," *Oxford Research Encyclopedia, Politics.* Oxford University Press.

Table 1. Latin America and Emerging/Developing East Asia: Suggestive Comparisons

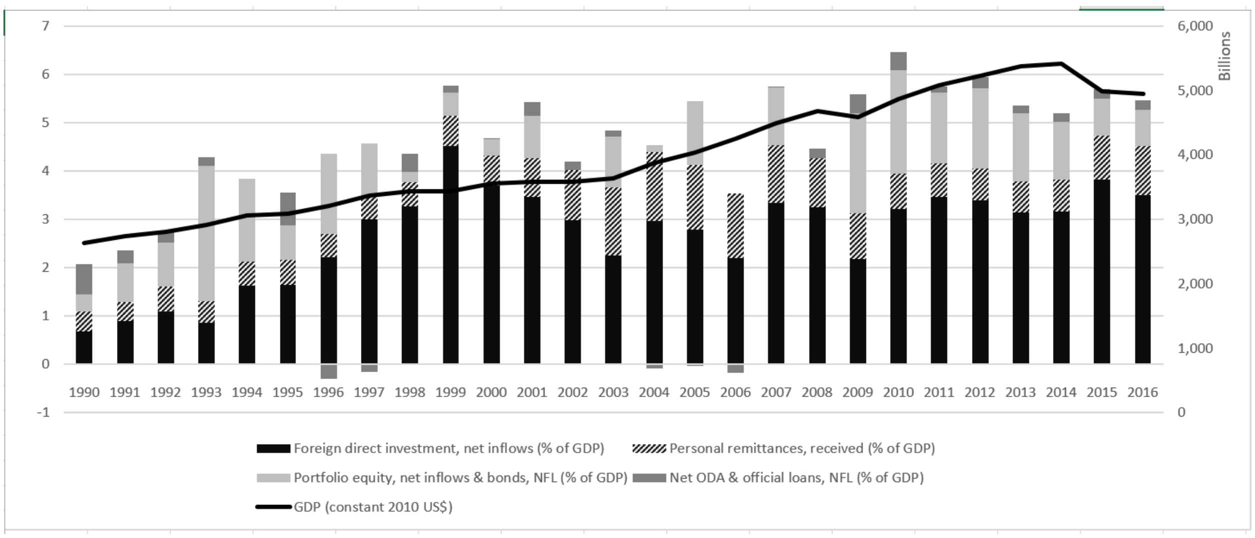
Indicator	**Latin America**	**East Asia**	**Comments**
Growth, GDP/capita 1990-2000	3.2%	3.7%	EA grows faster
Growth, GDP/capita 2001-2017	3.0%	4.6%	EA grows faster
Investment/GDP 2012-2018	24%	30%	EA invests more
Mean Infrastructure Spending 1992-2011/ GDP, 2010	1.8%	China: 8.5% (India: 4.7%)	EA invests more LA regional weighted average reflects low spending in Brazil
Domestic financial liberalization & privatization	55	47	0 (least) to 100 (most) LA more neoliberal
International financial liberalization	57	47	0 (least) to 100 (most) LA more neoliberal

Sources: Rows 1&2: World Bank, 2019b. Row 3: ECLAC, 2019:45. Row 4: MGI, 2013:12. Row 5: Heritage Foundation, 2019: Financial Freedom Index. Row 6: Heritage Foundation, 2019: Investment Freedom Index.

Table 2. Ideal-Types of Long-Term Finance in Middle Income Countries

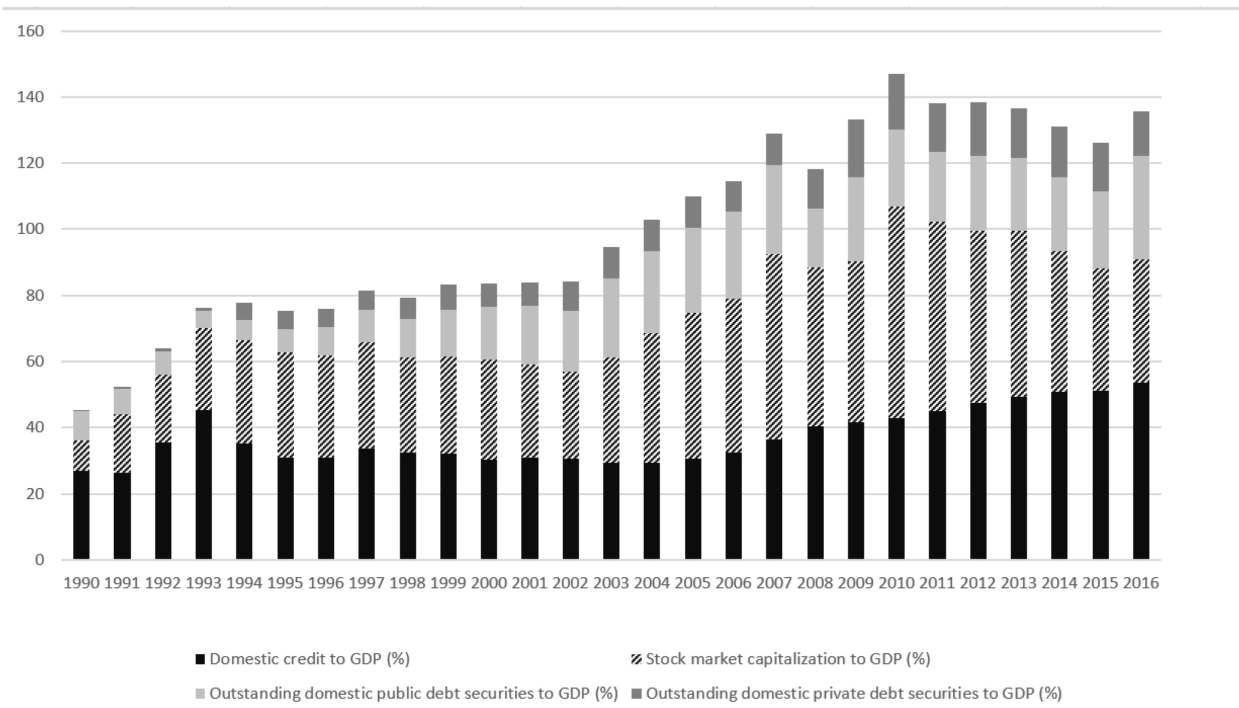
Allocation of Funds:	*Source of Funds:*	
	Domestic Savings	*Foreign Savings*
By Government	**National Public Finance** *E.g.*, industrial development banks	**Foreign Public Finance** *E.g.*, loans from IFIs; investment from Chinese state banks
Via Private Markets	**National Private Finance** *E.g.*, Domestic capital markets	**Foreign Private Finance** *E.g.*, FDI; private portfolio inflows

Figure 1. Evolution of domestic financial structure, Latin American 6 (World Bank, 2019A, 2019B).



Note: Unweighted means of annual values for total stocks of financial assets/GDP (both in USD terms at market rates) for Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

Figure 2. Evolution of foreign capital inflows, Latin American 10 (World Bank, 2019B).



Note: Total annual USD net inflows as a share of group GDP for Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela.