

Causes and outcomes of new deal and isi model assignment

[History](#)



Discuss differences and similarities as to the economic, political and social goals pursued by the New Deal in the USA and the subsequent implementation of the SIS model in Latin America. Which economic and political policies shaped both approaches to economic growth? Why did the New Deal turn out to be more successful than the SIS model? The primary goals of any macroeconomic policy are to ensure stable prices, full employment, and economic growth.

Throughout history world economies have been subject to economic statistics and other tools to measure the current state of an economy, which are characterized by fluctuations in the level of economic activity. These different tools have been used by governments to estimate the level of success or failure of any applied economic policy. Furthermore, tools -?? such as the business cycle - is used by economist trying to explain the reasons for economic fluctuations resulting in booms and recession.

The analysis of the consequences and outcomes of different economic policies has, in modern history, been used to design and apply the most successful economic policies in an attempt prevent recession and obtain and secure economic growth and prosperity both in the global and domestic sphere. This essay will focus on describing the political and economic goals behind the implementation of the New Deal in US and the SIS-model in Latin America in the 1930 as a reaction to the Great Depression.

In order to do so, this essay will try to outline some of the similarities and differences between the two economic policies and then discuss some of the reasons to why the New Deal turned out to be more successful than the SIS-

model. In the United States, the pre-New Deal era of the sass was a time of economic Roth as a result of high levels of private consumption and investment. The productivity and size of the American industry was boosted by the war and high public demand combined with new technology resulted in mass production of cars, radios, white goods and other household electronics.

New products and services created a new market, which companies took advantage of. This led to rise In company stocks and created the stock market boom of the late twenties. GNP growth during the 1 sass was rapid, 4. 2% a year from 1920 to 1929 and the state of the US economy was only affected by short and Insignificant periods of recession. Smiley, G. (2004, June 29). US Economy In the sass.) Applied polices and the role of the Federal Government In the pre-New Deal era was highly affected by the economic boom.

The mall goal was to promote stability In aggregate economic activity to keep the level of private Investment and consumption high. The believe was that If the Fed could keep the social engine running trough government-provided goods and services to benefit the business market it would support and sustain the high level of growth and low level of unemployment. The economic golden rule of the era was that supply would life was that if the Fed did what it could to foster private business, prosperity would eventually encompass most of the population. Policies were intended to create the most favorable conditions for U. S industry.

For instance the Fed started a program of tax cuts to give the best conditions for investment in industrial enterprises. The president of the sass has been perceived as defender of the laissez-fairer economic policy and even when the stock market crash hit the US economy in 1929 the presidency of Herbert Hoover failed to recognize the need for overspent intervention and a turn away from the laissez-fairer principles to restore the economy. It was not before Franklin D. Roosevelt took the presidency that the US experienced a radical change in the role of the Federal government reflected in the New Deal policies. (Hurwitz, S. 2011, September 29). Hoover's Economic Policies.)

In Latin America the economic and political situation in the sass was driven by the state of the global economy. Exports were seen as the engine of economic growth. Latin American countries relied on the agricultural sector as the region was the world leader in primary product exports. The stability of most Latin American economies relied on a single-export commodity, making the region highly sensitive to changes in the international economy. Furthermore, the focus on the export-led economy in the region made little room for money spend on domestic- and social reforms.

As a result, Latin America lacked far behind the United States in terms of infrastructure, industrialization and living standards, as the commodity-led production of primary products, taking place in Latin America, did not stimulate production in other areas of the economy. When the stock market crash and the following Great Depression hit the United States, Latin America suffered tremendously. Growing protectionism and recession abroad limited the demand and thereby the export potential for Latin America. The

terms of trade (elaborated later in the essay) fell between 21 and 45% when the international market collapsed.

Latin America was unable to protect itself from external shocks and when the economic boom in the United States turned to bust and prices fell, the region was forced to turn away from the export-led economic policies. The Great Depression and the years after produced structural changes in Latin America, which meant a look away from the externally oriented economy. The region turned inward and focused on domestic development to restore the economy and break away from the dependency on the international economy.

The new economic tactics, which spread across the region became known as Import Substitution Industrialization, or the SIS-model, which will be elaborated on later in the essay. (Frank, P, chapter 2, p. 40-45) When Franklin D. Roosevelt took office on the 4th of March 1933 the American people put their faith in him to get the US out of The Great Depression and the long times of economic recession. As mentioned earlier the previous presidency had put the faith of the economy in the hands of the business environment and lack of control and supervision ultimately led to the stock market crash in 1929.

It would take a new style of government and a new set of government initiated policies to help restore the economy. The presidency of Franklin D. Roosevelt is known as the era of state style of government was based on the Keynesian theory that the laissez-faire approaches, taken prior to The Great Depression, did not secure full employment and economic growth due to the

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instability of the free-market economy and the believe that the economy would restore itself. Keynes theory proposed an active role for government intervention into the economy through monetary and fiscal policies to regulate the economy.

The government should pick up the slack and spend in order to restore and maintain the level of aggregate demand. The idea behind the Keynesian theory was that demand would create supply so the government had to play an active role through public spending to restore consumer confidence and generate strong aggregate demand, which in the end would boost economic growth. The FDA government dramatically expanded social welfare programmer, public infrastructure investment, financial regulation and industrial cooperation - collectively known as the New Deal.

From 1935 to 1939 a workable set of arrangements was put in place, which all resulted in a permanently larger public sector and a much more active national government than the United State had ever seen before. (Wallis Joseph, J. (2012). Lessons from the political economy of the New Deal.)

Going back to the introduction of this essay, the primary goals of any government is to secure economic growth and the FDA presidency and the New Deal elicits is no exception to this.

Supporters of the New Deal describe the economic goals and benefits of the policies by referring to the multiplier- and spill over effects. The concept of the multiplier suggest that an injection, such as an increase in government spending, will have a larger impact on GAP than only the injection itself. This is because those who are employed on public works projects spend the

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wages that they are paid, thereby adding to overall demand. Companies will respond to this by increasing supply and taking on additional workers. They then spend their earnings, thereby adding still further to total demand.

The spill over effect refers to wider and international economic effects of the public works projects. For instance, the building of a new road will permit goods to be transported at a lower cost and more speedily and thereby opening up the possibility for investment for neighborhoods regions. The New Deal policies succeeded in pushing up the GAP and at the same time control unemployment to create a social welfare state for the American public, partly due to the flow of the spill over effect. (Achebe, E. The US Economy today, chapter 2. P. 37)

In Latin America, the Great Depression also led to a change in the role of the government and a new set of economic and political policies. As previously mentioned, the export-led economic model suffered tremendously under the Great Depression, mainly due to the dependency on the international economy. Latin American countries, which exported primary products (such as fruit, tobacco and coffee) and imported almost all of the industrialized goods they consumed, were prevented from importing due to the sharp decline in foreign sales caused by the Great Depression.

Furthermore, the decline in demand for primary goods, also cost y international economic recession, meant less inflow of capital into the region resulting in internal deflation, fall in the value of the Latin American currencies and a environment to secure economic growth was destroyed and the region called for government regulation to stabilize the economy. The set <https://assignbuster.com/causes-and-outcomes-of-new-deal-and-isi-model-assignment/>

of economic policies adopted in Latin America after the Great Depression became known as the Import Substitution Industrialization model and was, as in the US, based on the Keynesian theory. The state was to serve as the employer and create jobs to increase level of consumption.

The main goal of the state and the first steps in the SIS-model were based on pragmatic choices of how to face the economic limitations caused by recession. One of the most significant differences between the goals and policies pursued by the SIS-model vs.. The New Deal were to be found in the scale of domestic tools' accessible to handle recession and get the economy growing again. To explain this further it is necessary to take a look at the economic scene prior to the Great Depression. As mentioned earlier, fast technological development and industrialization marked the sass in America.

The country fast became one of the world's strongest economies and did not rely on other nations to secure growth. When the Great Depression hit the United States, the Fed was able to take advantage of the already developed machinery, infrastructure and technology to enforce the New Deal policies.

In Latin America the story was different. The export-led economy serving the region, prior to the Great Depression, was highly sensitive and relied on the level of demand for primary goods and prices of manufactured imports from the international economy, especially in US and Europe.

In broad terms, the prosperity, velvetten and economic growth of Latin America relied completely on the performance of the international market.

When the Great Depression hit and the level of demand fell with drastic numbers it became clear that the focus and dependency on the global

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market had meant that the internal development and structure in the region lacked far behind the countries of the Northern Hemisphere. The Economic Commission for Latin America and the Caribbean (ECLAT)³ defined the problem in the need to promote growth in an international system controlled and exploited by advanced economies like the US.

The core of the problem, also referred to as the dependency theory, was that the leading economies or the industrialized countries defined the rules for the developing countries, who were pawns in the global pursuit of profit. Industrialized countries had access to cheap inputs for growth through the extraction of resources, the export of minerals and the exploitation of cheap labor in the underdeveloped world. Rich countries became richer by making other countries poor.

Furthermore, the exported resources from Latin America were owned by very few in the elite, who through collaboration with the international capitalist, secured the money-flow in the region to remain within a very restricted area leaving the rest of the region in poverty. The interests of the elite were protected by the local military supported by the international powers so the odds for carrying out a successful revolution were basically non-existing. A second aspect of the problem that Latin America faced as a consequence of an economy based on export of primary products was declining terms of trade.

What Latin America lacked was technologically advanced products, which they imported from preference in the two types of products showed to be very unequal in the level of demand. No matter how many money you have

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in your hands there is a limit to how many bananas you can eat and how much coffee you can drink. Due to the limited opportunities of development in the agricultural sector, the relative demand for primary products declines as the world economy grows. On the other hand the demand and prices of technology increases and the benefits goes to the industrialized and developed countries.

Declining terms of trade for primary products meant that as the prices for technological goods rose, developing countries loud need to export more primary products to afford the expensive technological machinery. In the sass, it became clear that Latin America would not be able to compete in the international market and advance without mastering the production of technological machinery themselves. (Frank, P. Chapter 3, p. 56-60) The arguments behind the dependency theory and the terms of trade limitations became the off-set for a change in Latin America and the real turning point was the Great Depression.

This period laid the foundations of the Import Substitution Model, which was briefly explained earlier in the text. The essay will now go on to elaborate on the economic and political policies and goals of the SIS-model seen in perspective to the New Deal programs. The main goal pursued by the SIS-model and the New Deal were in broad terms the same - to get the economy out of the recession-plague boosted by the stock market crash of 1929 and restore the publics faith in the economy, but the tools needed and the way to get there was different.

In Latin America there was a need to escape from the dependence on industrialized countries by making the machinery, needed for development, accessible within their own borders. Instead of relying on the international economy as the engine of economic growth, Latin American policymakers turned inward to promote internal sources of economic growth. The SIS-model consisted of establishing domestic production facilities to manufacture goods that were formerly imported. SIS was viewed as introducing a dynamic element into the Latin American economies, leading to higher rates of economic growth.

SIS was expected to make Latin America less vulnerable to the economic fluctuations originating in the industrial centers of the world. The SIS-programs spreading across Latin America in the 1950s were based on 5 literally fuelled initiatives; First, the implementation of protective tariffs and/or exchange controls to restrict the imports of manufactured products that were meant to be produced domestically. Secondly, special incentives for domestic and foreign firms importing capital equipment's for new industries. Thirdly, preferential import exchange rates for industrial raw materials, fuels, and intermediate goods.

Fourth, the government was to construct infrastructure designed to complement and fuel the new industries and finally the direct participation of the state in large industries setting limits on the possibilities for foreign investment. In contrast to the US, who had the necessities to carry out the state initiated New Deal program domestically, America. Although it never amounted to much more than 10% of total investment, foreign capital was

a crucial element in building key manufacturing industries, because it was one of the biggest agents to transfer knowledge and organizational techniques.

Foreign financing and technical aid was a fundamental importance in the creation of state-owned industry and infrastructure sectors in the Latin American region. Another interesting aspect in comparing the ISI-model with the New Deal program is the level of focus on social programs. The New Deal consisted in large part of a range of social welfare programs meant to raise the living standard of the American people.

Acts, such as The Federal Emergency Relief Act (1933), The Fair Labor Standards Act (1938) and The Social Security Act (1935) helped create better job opportunities, better working conditions and a security net for Americans – especially the lower- and middle class. In Latin America the story was different and the eagerness for becoming industrialized had its side effects. The level of labor-demand for the industrial production did not correspond to the high rate of population and population growth in Latin America, resulting in very high unemployment rates.

This had an effect on the income distribution since the few jobs available in the industrial sector favored certain types of skilled labor at the expense of poor workers, making the poor poorer and the rich richer. High inequality furthermore worsened the living standards for the large group living in the rural area of Latin America since the ISI-model neglected land reform and the agricultural production for the purpose of putting all capital into

industrialization. In other words, the industrialization process created a negative domino effect in the social sector.

Another difference between the SIS-model and the New Deal program is seen in the political area. In the US the democratically elected democrat Franklin D. Roosevelt was to get approval for his New Deal policies in Congress, (through the system of checks and balances) giving the opposition a say in the formation and more importantly in the restriction of the New Deal policies. In Latin America the spread of the idea behind the dependency theory and terms of trade conditions led to the emerge of nationalism and a resentment of the U.

S as a political tool to attack the traditional import-export power structure. The new urbanize upper and middle classes joined together and created populist groups that promoted domestic industrialization and there were no opposition or restrictions to the plans pursued by the populist leaders. Settling Barras in Brazil and Juan Person in Argentina are examples of leading populist leaders, who both saw domestic industrialization as a synonym for progress.

Their popularity were to some extent based on empty and unrealistic promises, fooling the public to put their faith in the hands of unstructured and corrupt governments formed by the elite and the military. (Bare W. (Spring, 1984). Industrialization in Latin America: Successes and Failures.) The handful of significant differences between the New Deal and the SIS-model of course had different consequences and the level of success

achieved by the two sets of policies were not quite equal either. Many economists argue that Franklin D.

Roosevelt New Deal programs did not end the Great Depression and that the moment economic conditions in America. The rate of GDP growth went from decreasing to increasing in the first years after FDR took office and, despite not ever reaching the low level of unemployment seen before the 1930s, the New Deal program managed to bring down the unemployment rate significantly. One could argue that the New Deal program gave US a great starting point, which contributed to the unprecedented period of prosperity that the country enjoyed in the decade and a half after WWII. (1945-1960) Finally, and maybe the most important the New Deal and the confident Dwight D. Eisenhower's presidency managed to restore the public's trust in the government and their belief in the American way of life. (Achebe, E. The US Economy today, chapter 2, p. 36-39) In Latin America, the ISI-model did not enjoy the same level of success - which became an undeniable fact in the 1980s.

Between 1950-1980 Latin American economies were growing comparatively faster than the Western economies and the new state-owned industries were able to meet the demand for production despite the rapid population growth.

Despite the apparent gains, the flaws of ISI became undeniable in the 1980s.

First of all, in many cases the domestic manufactured goods did not meet the international quality after being developed under protective tariffs and with a level of production not measured against the international market.

The protectionism idea behind the ISI policies led to overvalued exchange rates, which acted as a tax on exports. Hence, exports were notably

reduced. Secondly, the goods produced were only available for a limited part of the population due to the high level of inequality and the market dominance of the elite.

Thirdly, the agricultural sector was neglected as all capital went to the industrial sector. In some cases the decline in agricultural production meant an increase in the quantity of food imports, putting pressure on the balance of payments despite the high tariffs on imports. As mentioned earlier, foreign financing was a crucial element for Latin America in developing an industrial sector. SIS required massive borrowing to finance the state-owned enterprises and growing government bureaucracy, but the investments in large infrastructure projects did not pay off in promoting exports that could finance borrowing and pay-back the loan.

In addition to this, the populist governments promoted unrealistic programs to benefit the social sector, which could not be covered by taxes, forcing the Latin American government to run on a huge budget deficit while their foreign debt kept increasing. Latin American investors became attracted by the measures that were launched by the US in order to attract foreign capital investment to compensate for America's huge budget deficit. Caused by the government spending on the New Deal programs) While capital flight for the developing world increased balance of payments problems and further contributed to the foreign debt in Latin America, it provided funds for a consumer boom in the US and a modification of the US budget deficit. Furthermore, the Latin American economies did not manage to apply industry spill over effects, as was the case in the US, mainly due to bad

infrastructure, high inequality and small concentration of money flow. (Frank, P, chapter 3, p. 69-72, Lamb G, p. 6) This vulnerability to external shocks and reliance on foreign loans, which fuelled the debt crisis in Latin America is part of the answer to why the New Deal turned out better than the SIS-model. When the oil-crisis erupted in 1973, the Latin American countries the international economic crisis. Most of the region ignored the need to monumentally modify the anti-export orientation towards a large part of the national economy. The governmental decision to borrow more money to support state consumption rather than using those resources to stimulate production and promote exports brought the Latin American countries into further debt.

With a delayed adjustment due to external indebtedness, persistent hindrances to international trade, the overvaluation of the exchange rate and a region suffering from inequality and poverty the development gap between Latin America and the United States that we see today began to take its shape. Fauvism F. (2008). Falling Behind - Explaining the Development Gap Between Latin America and the United States.) The stock market crash of 1929 marked the beginning of the Great Depression, which put the world economy into deep recession.

In both the US and Latin America the Great Depression came as a shock to what was then the conventional wisdom of economics - that the market forces would naturally adapt to economic fluctuations. The emerge of Keynes economic theory shifted the thrust of macroeconomic thought from the concept of aggregate supply to the concept of aggregate demand. In the US,

Keynes theory was adopted in the New Deal where the state, by applying monetary and fiscal policies initiated intervention programs in the areas of social welfare, regulation of business, and management of the economy.

Although many critics argue that the Great Depression did not end until WW2, the New Deal helped the nation survive the Depression while preserving US constitutional democracy. Keynes inspired macroeconomic policies also emerged in Latin America as a result of the crisis of 1930s, but their major features were different from those in industrialized countries. The predominance of external shocks - on raw material prices as well as volatile capital flows - explains why the focus of macroeconomic management in Latin America leaned towards the management of balance of payments.

The SIS-model was adopted in the region and industrialization and development became synonymous for several decades. Despite experiencing rapid growth from 1950-1980 the inability to overcome external dependency, unequal social structures and governments who showed lack of macroeconomic discipline the debt crisis of 1980s hit the region hard and marked the beginning of a new paradigm shift moving away from the SIS-model. The differences between the SIS-model and the New Deal policies created different results and ultimately caused Latin America to fall behind in the development race. Frank, P. (3rd edition, 2007). *The Puzzle of Latin American Economic Development*. Maryland, United States: Rowan & Littlefield Publishers, Inc. - Achebe, E. (2010). *The US Economy today*. New York, United States: Manchester University Press. - Achebe, E. (2012). *US Politics today*. New York, United States: Manchester University Press. - Dry.

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