Cry for Latin America

BY DESMOND LACHMAN

Those narrow sovereign debt spreads and booming stock markets have been a mirage.

It has often been quipped that Brazil is a country of the future and will always remain so. Looking at recent Latin American economic and political developments, one has to wonder whether the same might not be said of the entire region. While one Asian country after another has set itself firmly on the path of convergence with the world's most developed economies, the countries of Latin America, with the possible exception of Chile, turn in economic performances that are mediocre at best, widening the gap with the developed world. And the strong ill political winds that are now blowing through the region would seem to place even that already mediocre economic performance at serious risk.

Latin America's clouded long-run economic outlook is perhaps best underlined by its recent sub-par economic performance at a time of unusual global prosperity. If ever Latin America faced an external environment conducive to rapid economic growth, it has to have been that of the past four years. World economic growth has been at its strongest level in over twenty years, while prices of international commodities—their primary exports—have gone through the historical roof. Indeed, the International Monetary Fund estimates that over the past four years record international commodity prices have boosted export earnings of many Latin American countries by

Desmond Lachman is a Resident Fellow at the American Enterprise Institute.

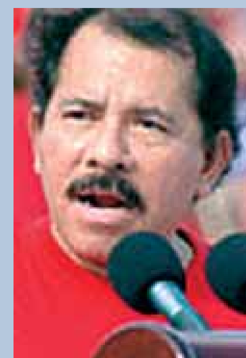
THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W.
Suite 740
Washington, D.C. 20006
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com

Evo Morales,
President of Bolivia

VALTER CAMPANATO/AGÊNCIA BRASIL

Hugo Chávez,
President of Venezuela

Rafael Correa,
President of Ecuador



Daniel Ortega,
President of Nicaragua

Unreconstructed Populists: The New Doctors of Demogoguery

It should also have come as no surprise that post-election pronouncements by the presidents of these countries give every indication that they will again be going down the previous generation's well-trodden path of populist and anti-market policies.

—D. Lachman

anywhere between 5 and 10 percentage points of GDP (see Figure 1).

As if that were not favorable enough, ample global liquidity conditions continue to blind international investors to the possible risks of investing in many countries in that region. This seemingly misplaced investor optimism is still reflected today in booming equity markets in Brazil and Mexico, as well as in record low sovereign debt spreads across the region and in record inflows of local currency investment.

Yet, despite such a favorable external environment, and the direct boost from healthy commodity sales, Latin American economic growth averaged only 4 percent between 2002 and 2006. At the same time, the region's population continued to grow at 1.6 percent per year. To be sure, this was Latin America's best economic performance since the 1970s and it was a far cry from that of the 1980s "lost decade." However, it still left Latin America as the slowest growing of any of the world's developing regions. And it was not simply a question of China and India growing at over twice the Latin American pace, but rather it was the fact that Latin America's growth rate even lagged behind that of war and famine-ravaged sub-Saharan Africa (see Figure 2).

Latin America's lackluster economic growth performance over the past decade is to be explained at least in part by its general lack of consistency and depth in implementing economic reform. To be sure, over the past decade Latin American countries generally tamed inflation and reined in excessive budget deficits. However, with the notable exception of Chile, Latin American countries failed to make the deep labor market, budget expenditure, and

Latin America still has the most inequitable income distribution in the world.

Political Pimp Job?

Rather than drawing any lessons from the many mistakes of his country's tragic economic past, Néstor Kirchner is again obliviously resorting to pervasive price controls and anti-market regulations that are anathema to both domestic and foreign investors. He is doing so to suppress inflation and to artificially boost growth ahead of next year's presidential election without paying any regard to those policies' time tested long-run costs.

—D. Lachman

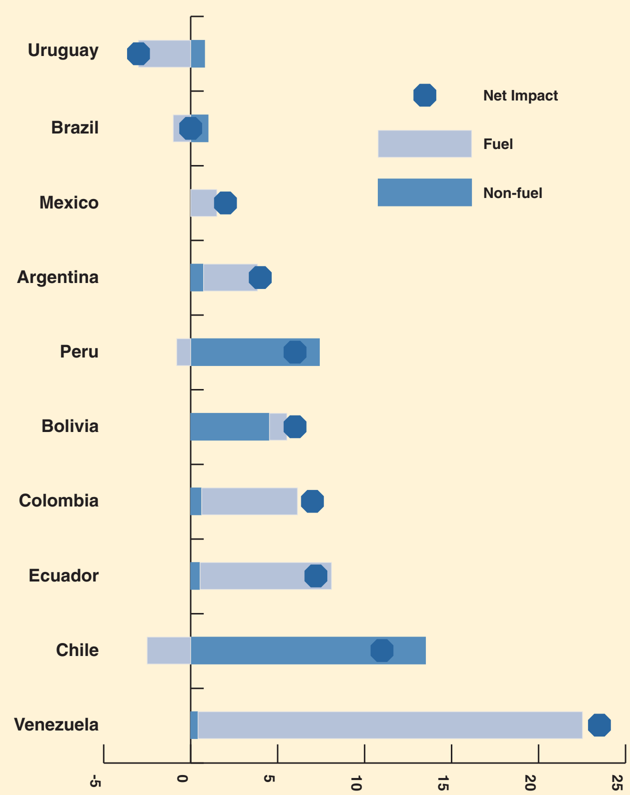
Argentina's
Néstor Kirchner

social security reforms that might have materially improved their international competitiveness and that might have raised Latin America's appallingly low saving and investment ratios. Worse still, as political conditions changed beginning in the mid-1990s, the reform effort all but stalled in Menem's Argentina, Lula's Brazil, Fox's Mexico and Chávez' Venezuela.

Even more disturbing than Latin America's tepid economic growth is the fact that its stuttering and half-hearted attempt at economic market reform over the past two decades has barely made a dent at reducing the region's mass poverty and chronic income inequality. In fact, various academic and multilateral bank studies suggest that Latin America still has the most inequitable income distribution in the world. They also suggest that there is more poverty and inequality in Latin America today than there was in the early 1980s when economic reform programs were being initiated.

The dimensions of the region's socio-economic problems are perhaps best illustrated by a recent Inter-American Development Bank study which estimates that the lowest fifth of the region's population received only 4.5 percent of its national income while the highest fifth accounted for 55 percent. Further compounding the inequality problem is the fact that poverty today is

Figure 1 Impact of Commodity Price Movements Since 2002 on Trade Balances Percent of 2006 GDP



Source: IMF

Small Comfort

Taking comfort in Lula and Calderón's electoral victories glosses over the fact that neither of those two leaders won a mandate for deepening their countries' halting economic reform programs. It also overlooks the fact that both Lula and Calderón will be confronted with divided and fractious Congresses that likely will result in a prolonged period of policy paralysis. Far from being receptive to reform, both the Brazilian and Mexican Congresses show little appetite for more of the same Washington-consensus style policies that in their view have delivered so little to the average Brazilian or Mexican worker.

—D. Lachman

Mexico's President **Felipe Calderón** *(left) and Brazil's President* **Luiz Inácio Lula da Silva.**

concentrated especially among those living in the rural sector, among women, and among the region's indigenous population.

Against this dismal economic backdrop, it should have come as no surprise that unreconstructed populists would win presidential elections this year in Bolivia, Ecuador, Nicaragua, and Venezuela. It should also have come as no surprise that post-election pronouncements by the presidents of these countries give every indication that they will again be going down the previous generation's well-trodden path of populist and anti-market policies.

It would seem all too probable that Latin America's unprecedented commodity boom will soon fade as global growth moderates, while its international borrowing costs will rise as global liquidity dries up.

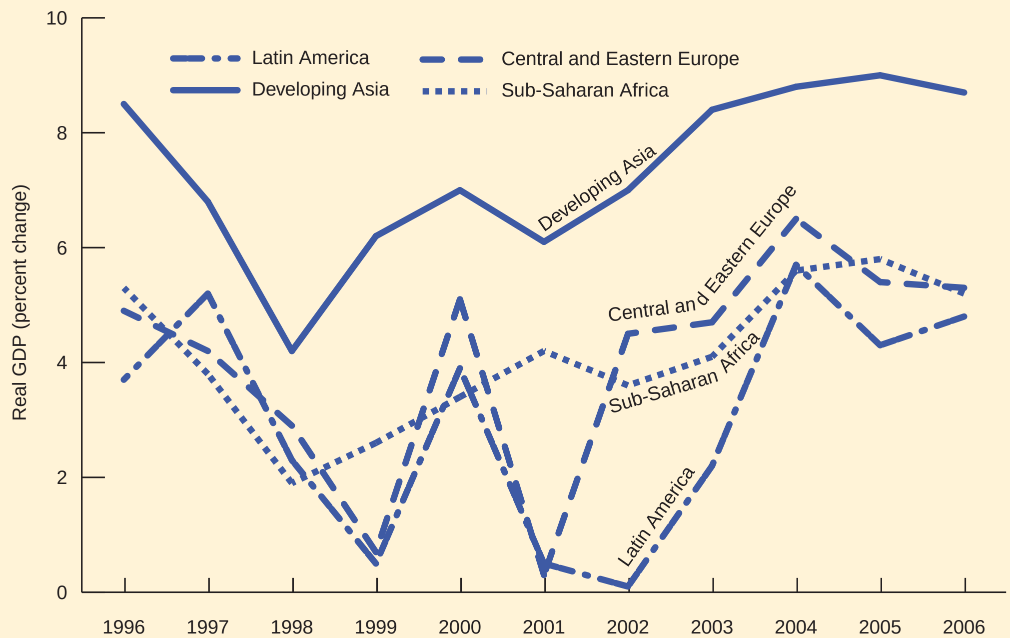
Keeping those countries company in their backwards application of economic policy will be Argentina under President Néstor Kirchner. For rather than drawing any lessons from the many mistakes of his country's tragic economic past, Kirchner is again obliviously resorting to pervasive price controls and anti-market regulations that are anathema to both domestic and foreign investors. He is doing so to suppress inflation and to artificially boost growth ahead of next year's presidential election without paying any regard to those policies' time tested long-run costs.

It is fashionable in some Washington circles to dismiss the rise of Hugo Chávez, Evo Morales, Néstor Kirchner, and Rafael Correa as somewhat of a sideshow for the region as a whole given that these countries are economically relatively insignificant. After all, it is argued, did not a reformed Lula just win a second term of office in Brazil, the region's most populous country? And did not a conservative Felipe Calderón manage to stave off the populist López Obrador in Mexico's recent six-yearly presidential election?

Taking comfort in Lula and Calderón's electoral victories glosses over the fact that neither of those two

Continued on page 61

Figure 2 Real GDP Growth
Percent change



Source: IMF

Continued from page 39

leaders won a mandate for deepening their countries' halting economic reform programs. It also overlooks the fact that both Lula and Calderón will be confronted with divided and fractious Congresses that likely will result in a prolonged period of policy paralysis. Far from being receptive to reform, both the Brazilian and Mexican Congresses show little appetite for more of the same Washington-consensus style policies that in their view have delivered so little to the average Brazilian or Mexican worker.

The very real prospect that Latin America will now be backtracking on its reform agenda could not come at a worse time for the region. It would seem all too probable that Latin America's unprecedented commodity boom will soon fade as global growth moderates, while its international borrowing costs will rise as global liquidity dries up.

More menacing still is the almost certainty that competition from China will only intensify in the years ahead. This poses the very real danger that the process of China's hollowing out Latin America's manufacturing sector will only gain pace. Notwithstanding the considerable advantages which Mexico enjoys in its dealings with the United States under NAFTA, China has already overtaken Mexico as a U.S. trade partner and it has already diverted substantial foreign direct investment away from the region. If the rest of the region, outside of Colombia and Chile, continues to oppose further trade integration, whether through the World Trade Organization or through an Free Trade Area of the Americas effort, that trend will likely accelerate.

If Latin America is to avoid the fate of being reduced to the world's slowest growing region and to a mere commodity supplier, which current political movements would only make more likely, it urgently needs to deepen its economic reform effort. It should do so with a view to making its economy more competitive to stave off the Chinese challenge as well as to raising its dismally low savings and investment rates. And it needs to do something about income inequality and poverty that is more constructive than repeating the populist mistakes of the past.

Yet the necessary labor market, budget, social security, and market deregulation reforms so desperately needed to attain those goals now look farther down than ever on the region's political agenda. This has to make one reverse Evita's song and cry for almost all of Latin America, wondering whether the region's time will ever arrive. ◆