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An excerpt from Sebastian Edwards, 2010.

Left Behind

Latin America and the False Promise of Populism

[ECON 3235 excerpt with my highlights and notes, for original online [version click here](#)]

Sebastian Edwards

Latin America: The Eternal Land of the Future

On January 1, 2003, Luiz Inácio da Silva, universally known by his nickname, Lula, was sworn in as Brazil’s constitutional president. The occasion was solemn and fraught with symbolism. Lula was the first trade union leader and self-declared socialist elected to the presidency of a Latin American country. For many years his political party, the Workers’ Party, or Partido dos Trabalhadores (PT), had advocated nationalization of large firms and banks, deep agrarian reform, and a move toward socialism. Lula’s election represented a dramatic change in Brazil’s history and a test for the country’s young democracy. For more than two decades, from 1964 through 1985, Brazil had been ruled by a military dictatorship that had persecuted, imprisoned, and even tortured its leftist opponents. Lula spent time in jail in the 1970s, and his predecessor, Fernando Henrique Cardoso, an affable academic and the son and grandson of military officers, had been forced into exile in the 1960s. [An excerpt from *Left Behind Latin America and the False Promise of Populism* Sebastian Edwards, <http://press.uchicago.edu/Misc/Chicago/184784.html>]

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Lula's inauguration, held in Brazil's modernist capital, Brasilia, was attended by numerous heads of state, dignitaries, and high-ranking officials from around the world. President George W. Bush, however, was not among those in attendance; nor was Vice President Dick Cheney, Secretary of State Colin Powell, or any other prominent member of the U.S. cabinet. The United States' delegation was headed by Robert Zoellick, the U.S. trade representative, who, in spite of being an able official, lacked the political and diplomatic stature that the occasion called for. With his traditional lightheartedness and keen sense of humor, Lula dismissed the slight and said that there would be many occasions for him to meet with his colleague from the North. Other Latin American heads of state and officials, however, were not so casual; they were offended. In their view the absence of an appropriate U.S. representative was a serious diplomatic affront and a clear reminder that, with few exceptions—including Cuba and, possibly, Mexico—Latin America was not a political or diplomatic priority for the United States. To them it confirmed that Latin America was a “forgotten continent.”

As it turned out, Lula was right. Four years after his election, the rift between his government and the Bush administration had been mended. Secretary of State Condoleezza Rice attended the inauguration for his second term in office, and he developed a close rapport with President Bush. In 2007 Lula became the first Latin American leader to be invited to Camp David. This improvement in economic and diplomatic relations was largely due to Lula's decision to eschew the left-wing policies that had long been espoused by his Workers' Party. Instead, he followed a market-friendly economic program that reduced inflation, revived credit markets, and attracted considerable volumes of foreign investments. In 2008 Lula's commitment to fiscal prudence, economic stability, trade openness, and market orientation paid off when Standard & Poor's granted Brazil's national debt the “much-sought-after” investment grade classification, which helped the country attract additional foreign investment and allowed it to borrow internationally at significantly lower costs.

But in spite of the happy ending of this Brazilian episode*¹, all is not quiet on the Latin American front. Since the early twenty-first century the Latin American public has moved increasingly to the left and has elected—sometimes by wide margins—presidents who are openly critical of the

¹ *Fall, 2017 Update: Brazil and Lula much less happy now as his handpicked worker's party successor Dilma Rousseff was impeached in August 2016 and replaced by center-right President Michel Temer. Moreover, Lula may not be able to run again as planned because he is fighting a prison sentence related to renovations to an apartment. To be fair, [Temer also faced but survived corruption charges related to meat packing inspections.](#)*

United States and its economic and foreign policies and who have pushed populist agendas in their respective countries.

Hugo Chávez of Venezuela has been the most vocal among Latin America's populist and anti-American leaders. But he is not the only one: Néstor Kirchner and Cristina Fernández de Kirchner of Argentina, Evo Morales of Bolivia, Rafael Correa of Ecuador, Fernando Lugo of Paraguay, and Daniel Ortega of Nicaragua have been outspoken in their criticisms of the United States and the market system. All of them have relied on populist rhetoric to attack globalization and to argue that the region needs to greatly increase the role of government in economic affairs. Over the last few years in most of these countries private companies have been nationalized, trade barriers have been hiked, and government controls on prices, investment, and business activities have been tightened. In many of these nations—including Bolivia, Ecuador, and Venezuela—new constitutions aimed at paving the path toward a socialist society have been enacted, and legal maneuvers have been initiated or approved to keep leftist presidents in office.

President Chávez has condemned capitalism, foreign investors, and the international business sector; he packed the Venezuelan supreme court with his supporters, closed a TV channel owned by his political opponents, severed diplomatic relations with neighboring Colombia (only to reinstate them a few days later), meddled in other countries' affairs, and became a close ally of ailing Fidel Castro. In a speech at the United Nations in September 2006, Chávez called U.S. president George W. Bush "the devil" and accused him of "acting as if he owned the world." Chavez's criticisms, however, have not been directed exclusively at the United States; in a meeting of the Ibero-American heads of state held in Santiago, Chile, in November 2007, he engaged in a serious argument with King Juan Carlos of Spain and accused Spain's former president José María Aznar of being a "fascist" and "a serpent." Chávez later threatened Spanish multinationals with expulsion from Venezuela. In May 2008 he criticized German chancellor Angela Merkel and said that her Christian Democratic Party shared "the political ideals of Adolf Hitler."

In February 2009, Hugo Chávez won a crucial referendum that will allow him to run for president as many times as he wishes. If things go his way and he is reelected once more, in 2013, he will be president of Venezuela until at least 2019, extending his tenure to no less than twenty-one years, longer than that of most of the region's recent strongmen, including Chile's Augusto Pinochet. Things could go even better for the former army officer, of course, and he could stay in power indefinitely. A few days after winning the referendum Chávez sent military squads to take over rice-producing companies throughout the country. Chávez then proceeded to condemn the government of newly elected president Barack Obama for allegedly maintaining George W. Bush's foreign policies and complained that the U.S. State Department continued to characterize Venezuela's record on human rights as less than pristine.

Of course, not every leftist leader has been as vocally opposed to open markets and globalization as Chávez, nor have all of them pushed populist policies. In contrast to the Bolivarian president and his supporters there is what former Mexican secretary of foreign affairs Jorge Castañeda has called the "New Latin American Left." In addition to Lula, past and current representatives of this moderate left include Fernando Henrique Cardoso of Brazil, Ricardo Lagos and Michelle Bachelet of Chile, Alan García of Peru, and Tabaré Vasquez of Uruguay. These moderates do not demonize globalization but understand the importance of the market—(despite their criticism of some of its excesses, including those that triggered the global crash of 2008) and acknowledge that innovation and efficiency are at the core of economic success. To be sure, they believe that more government intervention and regulation are

essential to reducing inequality. However, they are not hard-core socialists; their goal is to adopt the policies of Western Europe's social democracies.

The Economic Future of Latin America and the United States

The economic future of Latin America, a region with a population of more than half a billion people and vast reserves of natural resources, is important for the rest of the world. In particular, a mediocre economic performance in Latin America is bad news for the United States. If incomes, jobs, and wages grow sluggishly in Latin America—or worse yet, if they stagnate—the flow of illegal immigrants into the United States is likely to increase drastically. During the last decade, almost half a million illegal immigrants entered the United States every year. The vast majority of them—more than 80 percent—come from Latin American nations. Illegal immigrants are no longer only Mexicans and Central Americans. They are now arriving from every corner of Latin America: Argentina, Bolivia, Brazil, Colombia, Ecuador, Paraguay, Peru, and Venezuela. Not surprisingly, the harder economic conditions are at home, the larger is the flow of people who cross the border illegally. Illegal immigration also affects the European Union. In the twenty-first century large numbers of Latin Americans—many of them young, unskilled, and poor—have emigrated illegally to Europe, particularly to Spain, Portugal, Italy, and France. Beginning in 2005, European authorities redoubled airport controls in an effort to stem the flow of undocumented Latin American migrants. Since then, scores of Latin Americans of all ages and walks of life have been denied entry, detained, and sent back to their countries of origin.

An unsuccessful Latin America will be mired in poverty and inequality, and the population will blame capitalism and globalization for the region's misfortunes. Policies aimed at increasing protectionism and government controls will be implemented, and multinational corporations based in the United States, along with Spanish banks and European utility companies, will face stiffer regulations, changes in the regulatory landscape, and higher risks of nationalization. Failure is also likely to result in a lower degree of economic cooperation in areas such as intellectual property rights. And, of course, there is always the possibility that some petroleum-producing countries—Venezuela and Ecuador come readily to mind—may disturb the flow of oil and provoke serious economic dislocation in the United States.

In addition, there is the issue of diplomatic cooperation. Although many Latin American countries have been historical allies of the United States, the region has not always supported U.S. initiatives in the United Nations and other international forums. This was the case, for instance, in April 2003, when Secretary of State Colin Powell failed to obtain the support of Chile and Mexico in the UN Security Council on a key resolution on Iraq. Collaboration at such moments would become even more difficult if anti-U.S. sentiments were to become generalized throughout the region.

Moreover, a significant slowdown in the Latin American economies is likely to result in an increase in illicit activities such as drug trafficking, smuggling, counterfeiting, and money laundering. During 2008 and 2009 drug-related violence spiked significantly in Mexico, and according to various reports from law enforcement agencies, the Sinaloa cartel has now infiltrated several U.S. cities. In a scenario of economic distress it is possible that the region would be less vigilant in dealing with terrorism and terrorist threats. The border between Mexico and the United States is very porous and could become a preferred entry point for terrorists, and the “triple border” between Argentina, Brazil, and Paraguay is notorious for concentrating all sorts of unsavory characters, including some with well-known terrorist connections.

Of course, the future of Latin America does not have to be economic gloom and failure. It is possible that some countries will exhibit robust economic growth and improved social conditions in the next two decades and that the region will cease being the eternal “land of the future.” For this to happen, however, Latin America will have to encourage innovation, improve efficiency, and modernize its institutions. It will also have to put in place major reforms to improve the quality of education and equip new generations with the skills required in an increasingly sophisticated and competitive world. Whether the region is politically ready to give a new push to modernization is an open question, and one that I address in detail throughout this book.

From the Washington Consensus to the Resurgence of Populism: A Brief Overview

Latin America’s move to the left has been the result of a deep disillusionment with a number of market-oriented reforms implemented during the 1990s. These policies, which came to be known as the “Washington Consensus,” called for elimination of fiscal deficits, reduction of inflation, dismantling of restrictions on international trade, privatization of public enterprises, and deregulation of markets that for decades had been subject to a surreal array of controls, red tape, and restrictions that stifled investment and bred corruption.

The reforms of the Washington Consensus represented a dramatic change in policies throughout the region. Since the 1940s every country in Latin America had shunned the free market and had relied on massive tariff walls to protect its domestic industries. Most had also run large fiscal deficits, experienced runaway inflation, and faced recurrent currency crises. By the late 1980s Latin America had come to a standstill: average income per capita growth was negative for a decade—the so-called lost decade—unemployment was very high, and a number of countries had triple-digit inflation; in addition, the region had one of the most unequal income distributions in the world and an astounding incidence of poverty. It was at this time that, in country after country, politicians decided to embark on a major change in direction: suddenly the countries of Latin America welcomed foreign investment, lowered import tariffs, began to deregulate businesses, reduced fiscal deficits, and privatized state-owned companies.

During the early 1990s the Washington Consensus reforms bore fruit: inflation declined substantially, growth accelerated, and, adjusted for inflation, wages increased throughout the region. Optimistic observers, including officials of the International Monetary Fund (IMF) and the World Bank, believed that Latin America would stop being “the land of the future” and would finally take off. It was expected that growth, improved social conditions, and prosperity would replace decades of meager economic performance, pervasive and growing inequality, and recurrent economic and political instability. Throughout most of the region the first half of the 1990s was a period of hope and high expectations.

Progress, however, was short lived. Neither efficiency nor investment in equipment, machinery, and infrastructure increased sufficiently to sustain economic growth over the long run. Institutions were not reformed, property rights were not protected sufficiently, and there was scant improvement in the rule of law. Poverty did not decline significantly, and income distribution remained as skewed as in the past. Moreover, widespread policies that pegged the value of local currencies to the U.S. dollar at artificially high levels reduced exporters’ competitiveness by lowering the number of pesos or other local currencies they received per dollar for foreign sales. In addition, many countries were unable to lower expenditures or raise taxes—and thus to control their public finances—and continued to run large government deficits. Eventually, deep currency crises exploded in countries as diverse as Argentina,

Brazil, the Dominican Republic, Ecuador, Mexico, and Uruguay. Beginning in 1998 many Latin American nations entered severe recession and experienced heightened unemployment and increased levels of poverty. Between 1998 and 2002 Latin America's income per capita grew on average merely 0.2 percent; during the same period income per capita in emerging Asian nations—including China and India—grew ten times faster, at almost 2 percent per annum, and that of the so-called Asian Tigers (Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand) grew an average of 1 percent per year.

The crises of the 1990s and early 2000s resulted in disappointments and frustration. The Washington Consensus and international institutions—in particular the IMF—were blamed for the currency collapses, increase in unemployment, decline in wages, and rising incidence of poverty. Populist politicians used nationalistic and egalitarian rhetoric to justify increases in protectionism; harassment of foreign investors and businesses; nationalization of foreign companies; taxation of exports at almost expropriatory rates; hikes in regulations, red tape, and bureaucracy; and increases in the power of the executive branch of Latin American governments.

Populism, of course, is not new to Latin America. Some historical examples of strong populists include Juan Domingo Perón of Argentina, Getulio Vargas of Brazil, Luis Echeverría and José López Portillo of Mexico, and Alan García in his first presidency in Peru. Chile under Salvador Allende and Nicaragua under Daniel Ortega and the Sandinistas are examples of socialist governments that undertook populist policies. Historically, populist leaders have had charismatic and strong personalities. Many of them have had weak connections to traditional political parties. Historical populists also had a streak of authoritarianism and often rejected the rules and institutions of liberal democracies.

In 1991, MIT economics professor Rudi Dornbusch and I defined economic populism as “an approach to economics that emphasizes growth and income distribution and deemphasizes the risks of inflation, external constraints, and the reaction of economic agents to aggressive nonmarket policies.” We went on to argue that while populist experiments often begin with great euphoria and popular support, sustained prosperity cannot be financed with unlimited government debt or by simply printing money. As a result, populist episodes end up invariably leading to rapid inflation—or, in some cases, hyperinflation—higher unemployment, and lower wages. Time after time these policies ultimately fail, hurting those groups—the poor and the middle class—that they were supposed to favor. It is all the more distressing that this pattern is in the process of repeating itself, and paradoxically the global crash that began in 2008 seems likely to increase the appeal of populists precisely at the time when their policies are least likely to work—and most likely to backfire.

Before I proceed further, it is important to emphasize that Latin America is a large, diverse, and complex region. This means that any study that focuses on “Latin America” or on the “typical” Latin American nation is likely to oversimplify matters. However, by addressing the region as a whole I am able to concentrate on some of the structural and institutional features that are common to most countries. In order to provide as much context as possible, throughout the book I discuss a number of country-specific experiences and cases. In particular, I provide detailed discussions of the experiences of Argentina, Brazil, Chile, Colombia, El Salvador, Mexico, and Venezuela.

The Main Argument: A Summary

Contrary to the generalized view among analysts, journalists, and academics, during the 1990s and 2000s most Latin American countries made only limited progress in modernizing their economies. In most nations economic reforms have been incomplete, and thus it is not surprising that they have not transformed Latin America into an economic powerhouse.

A detailed analysis of the evidence shows that in spite of all the media attention, the so-called Washington Consensus reforms only scratched the surface of Latin America's inefficient policy environment. In fact, most Latin American national economies continue to be among the most regulated, distorted, and protectionist in the world. In many of them it is very costly to start a business, red tape is asphyxiating, and taxes are very high. With very few exceptions, institutions continue to be extremely weak: property rights are not protected adequately, the judiciary is inefficient, contracts are difficult to enforce, corruption is pervasive, and the rule of law is wanting. Moreover, throughout the region governments continue to be very large, powerful, and highly inefficient and fail to provide basic services such as quality education and infrastructure and support for research and development. Governments continue to be overreaching and incompetent; they often protect monopolies and are often the source of corruption.

Latin America's mediocre performance during the late 1990s and early 2000s was the result of not having implemented market reforms that were deep enough and not having adopted policies and institutions that would strongly encourage innovation, productivity enhancements, and lasting economic growth. Latin America, with very few exceptions, clearly suffers from fractured and incomplete economic reform. The region's setbacks during this period were not the result of a deep market-oriented reform program but of policies that, in country after country, pegged the value of local currencies to the U.S. dollar at artificially high levels. This meant that foreigners had to pay an excessively large number of dollars in exchange for pesos or other regional currencies (reals, córdobas, colones, and so on). As a result, many Latin American exports were priced out of the global marketplace, and sales shrank. Many countries experienced stagnation of exports, increasingly large trade deficits, and, eventually, deep currency crises that generated soaring unemployment, declining wages, and large income contractions. For example, in Mexico unemployment more than doubled after the collapse of the peso in December 1994, and in Argentina the incidence of poverty shot up to 40 percent of households after the 2001-02 currency crisis.

That so many countries pegged their currencies to the U.S. dollar at artificially high values is particularly ironic, given that this policy was neither a necessary condition for market orientation nor a central component of modernizing reforms. In fact, following Milton Friedman, it is possible to argue that pegging the value of the local currency to the U.S. dollar rather than allowing it to vary according to market forces contradicted the basic tenets of market orientation. These mistakes in the area of exchange-rate policy resulted from a combination of hubris and political expediency. During the 1990s many Latin American technocrats believed in certain economic propositions with religious zeal and labeled those who disagreed with them old-fashioned or ignorant. One of the ideas embraced with quasi-religious fervor was that pegging currency values to the U.S. dollar provided a credible way of eliminating inflation. Evidence that contradicted this view was dismissed as irrelevant or was simply ignored. As I show in the chapters that follow, not only was this belief mistaken but it also encouraged speculation and ultimately contributed to the succession of currency crises that afflicted the region

during the 1990s and early years of the twenty-first century. Political impatience also played a role, as many policy makers were convinced that pegging the value of the local currency to that of the United States would generate rapid price adjustment and that double-digit inflation would be eliminated in short order—in two years at most—generating great political gains.

Because the reforms of the 1990s and first decade of this century were superficial and incomplete, most Latin American countries continue to this day to be inefficient and to have low productivity and a high incidence of poverty. Low productivity means that most of these countries have difficulty competing in the global marketplace. This is true in most sectors, with the exception of commodities—copper, petroleum, iron ore, soybeans, beef, and coffee among others—where the region has strong natural advantages. The problem is that even if the demand for raw materials is very strong—as it was from 2003 to 2008—high commodity prices cannot generate lasting and generalized prosperity. A sustainable acceleration in economic growth and a comprehensive increase in wages and income require producing and exporting goods that have a certain degree of sophistication, or what economists call “high value added.” This, in turn, necessitates a skilled labor force and incentives—policies and institutions—that foster innovation and efficiency. However, as I show in this book, both in their policies bearing on competition and in their national institutions Latin American nations have done poorly for long periods of time—including the years of the Washington Consensus. Moreover, they are likely to do as badly in the future as they have done in the last two decades. The reality is that most Latin American countries show no political will to embark on the reforms required to generate a jump in productivity.

It is highly likely that in the next ten to fifteen years we will see a three-speed Latin America. There will be a first group of countries that will embrace populism. In these nations the quality of education will continue to be low and institutions weak; these countries will experience almost no improvements in productivity or efficiency. Policies that discourage entrepreneurship and innovation will be put in place in the name of the poor and the indigenous people. Economic growth is likely to be very low, unemployment will increase, black markets will emerge, inflation will accelerate, and social conditions—particularly the incidence of poverty—will worsen. Insecurity is also likely to rise, and the institutions of the state will lose ground in their struggle with organized crime and drug mafias.

A second group will consist of those countries that will neither fall for the populist temptation nor implement the policies required to generate large efficiency gains. Politicians in these countries will understand that government controls and intrusion, inflation, and protectionism are not the way to reduce poverty and achieve higher standards of living. However, they will not have the boldness or the political ability to implement the policies required to generate a massive jump in efficiency and growth. In these countries, economic performance will conform to the Latin American historical norm; that is, it will be mediocre at best. The reduction of poverty will be slow, inequality will continue to be significant, and people’s aspirations will be frustrated.

Finally, there will be a third, small group of countries that will embrace the path to innovative economic development. These will be the countries that will experience substantial income growth, improved social conditions, and reduced poverty and inequality. These countries will strengthen their institutions and will increasingly separate themselves from the rest of the Latin American region. They will see a convergence of their income and standards of living with those of the advanced nations of North America, Europe, and Asia.

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