Latin America and the Caribbean:

After forty years of pendular shifts in economic policy, is the pendulum still swinging?

Latin America and the Caribbean region (LAC) has been a sort of real laboratory for the widest variety of economic experiments that range from the application of the purest neo-classical theory to the highest level of government intervention in almost of spheres of the economy. Those "experiments" that had some initial positive results in terms of main macroeconomic indicators such as inflation, exchange rate stability, economic growth, just to mention a few, unfortunately ended up in output growth decline, if it was not in a generalized economic collapse with serious social consequences. Economic mismanagement, model exhaustion, and unfavourable international conditions are often quoted as the main reasons for the fatal result. Whatever the reason, they have demonstrated the incapability of Latin American governments to cope with their minimal functions as providers of macroeconomic stability and equalizer of social inequalities.

This article presents a panoramic view of the post-war economic evolution in Latin American countries and how the prevailing paradigm has swayed from one theoretical extreme to the other. A salient characteristic of this coming and going trend is that it becomes common and synchronized to most regional countries. This is the so-called and feared "domino" effect that gains momentum this year of presidential elections in Latin America, particularly when after nearly one decade and a half of Washington Consensus, an opposite political left-oriented wave, in certain cases accompanied by economic policy of the same orientation, seems to be sweeping the area. Once more, Latin America is witnessing a political and economic change that may instigate uncertainty among foreign investors and affect directly the availability of external financing. It is widely known that these countries rely on capital inflows as a complement of their meagre savings which are insufficient for inducing a sustained economic growth.

From ubiquitous government intervention to the most liberal economic model in democratic and military regimes, and all possible combinations among them, the article stresses the transition from the Washington Consensus to the current administrations: Venezuelan President Chavez, one of the most active promoters of this challenging attitude toward the mainstream that it is practically embodied in the United States policies, his clearly disciple the newly-elected Bolivian president Morales, and the two Peruvian running-off candidates Garcia and Humala, the later publicly has manifested his admiration for Chavez, the Chilean president Bachelet, and the recently elected presidents Uribe and Arias in Colombia and Costa Rica, respectively.

Before the 1990s

Starting in the mid-1940s, most LAC countries followed a development strategy based on high degree of protectionism, government-led industrialization, and broad involvement of the state in economic activities. This inward-looking policy financed by foreign borrowing allowed the state enterprise sector to grow at such a fast pace that crowded out private initiatives (Edwards, 1995). During the 1970s, international real interest rates were low or even negative and capital was readily available. Countries in the region invested
then in projects with very high capital/output ratios. This was the period of heavy energy investments in hydropower generation, oil exploration and development, aluminum factories in Venezuela, large mining operations in Brazil, Colombia, and Venezuela, colossal hydroelectric and irrigation projects in Peru, and urban metro systems in Chile, Mexico, Venezuela and Brazil. Also state-owned enterprises (SOE) became an important source of fiscal deficit due mainly to the several objectives that it was supposed to pursue regardless entrepreneurial criteria. The secondary stage of import substitution that followed the early stage, turned into the production of intermediate and capital goods. Exports did emerge from these sectors in some countries in direct response to policy shifts in favor of the export sector, but not in the volume necessary to support an export-led economic growth. On the contrary, ISI (import substitution industrialization) created the basis for a protected, subsidized and inefficient industrial sector.

In the middle of this full-fledge-ISI trend Southern Cone countries carried out trade and capital liberalization, trade reform and privatization process that were the first glimpses of neoclassical experiments in the region. Chile started timidly its privatization program with the sale of a large number of relatively small government enterprises, and Argentina and Uruguay conducted isolated and unfortunate-timing liberalizations of their commercial and capital accounts. By mid 1970s certain LAC countries that coincidentally were also ruled by junta, abandoned the ISI model. The military governments dismantled the state-centric ISI structures and replaced them with politically safer "free market" mechanisms, which later on made those countries economic policy makers realize that "laissez faire" policies not always lead to desirable outcomes.

As it can be seen in Table 1, the 1980s inherited a heavy outstanding external debt that increased almost eight times from 1970 to 1980. Therefore, Latin America not only became the largest debt holder of all developing regions, but it also had the most rapid increase, from which Brazil, Mexico, and Argentina accounted for almost 70 percent of the total. In relative terms, the total external debt to GDP ratio has also been doubled in these three decades for the region as a whole, but for some countries, like Ecuador and Nicaragua this ratio was even 5 or 10 times more, respectively.

Besides, growing domestic macroeconomic imbalances that coupled with the adverse world economic conditions resulted in severe balance of payments crisis and produced sharp economic downturns in most LAC countries. Among those factors are to be mentioned the fall of commodity prices in the early 1980s, the recession in developed countries, higher world interest rates, and the sudden cut back in external financing especially from private sources. All this cascade of events led to the 1982 debt crisis, an accumulated growth rate in per capita GDP either negative or close to zero for the whole decade, and the implementation of drastic economic adjustments under the surveillance of multilateral organizations, particularly the International Monetary Fund and the World Bank. However, the prescription given by these organizations based on fiscal tightening and monetary discipline had recessive impact on economic growth and employment.
particularly in a context of scarce foreign credit.

In order to face these adverse conditions and continue their path to growth, LAC countries embarked in a new heterodox experiment by focusing on exchange rate and price controls, and fueling consumption levels by issuing money. Positive short-term results derived from these non-orthodox policies were immediately evident but the negative results did not take long to appear, because consumption-stimulating policies are not sustainable. The acceleration of inflation that took place during the 1980s may be explained by the fiscal crisis and monetary mismanagement, which create a vicious circle where as inflation accelerates, it tends to become more and more rigid downwards, because economic agents "learn" to be more inflation conscious. The formal and informal indexations of the economy cause origin to the inertial type of inflation, that on its turn leads to a larger public deficit. Regarding the external front, after the debt crisis many LAC countries increased tariff and non-tariff restrictions on imports, among them Argentina, Chile, Brazil, Peru and Colombia. The financial and commercial liberalization of the Southern Cone countries and Colombia was almost reversed.

The fiscal crisis and its more critical outcome, the inflationary process, provoke the questioning of the region's prevailing development model and socioeconomic structure. Bankrupted governments had no funds to finance new economic policies, socioeconomic infrastructure, and alleviation programs for the population in need, which had led to a state legitimacy crisis threatening the political system and aggravating the incapability of the government to cope with its main roles.

Although the decade of the 1980s, also dubbed as the "lost decade," has been disastrous from the economic point of view, it was an important step regarding democratization process in the region. Latin American countries have been struggling to achieve democracy and freedom since independence, but with very few exceptions, they had not been successful. During the eighties only Colombia, Costa Rica and Venezuela had democratic elected governments, while most countries just started their transition from military-totalitarian regimes to governments elected in free and fair elections.

The 1990s: the Washington Consensus

The experience in the 1980s made Latin American countries realize that the government, while constantly expanding the scope of its intervention in the economy by undertaking new and questionable activities, had failed in fulfilling some key functions - such as preserving the rule of law and internal security, basic macroeconomic equilibrium, in general addressing market failures. One of the most questionable outcomes of the 1980s is the increase of poverty and inequality gap in these countries.

The Washington Consensus emerged, on the basis of theoretical and empirical grounds, as a strategy to address the deepest roots of present Latin American instability and lack of growth, by following neoclassical principles of market economy. By mid-nineties almost all economies in the region had undergone to some extent economic stabilization and structural reform programs, including the major economies as Mexico, Brazil, and Argentina. Some medium economies can be singled out, like Chile for being an earlier reformer and others such as Peru for implementing a radical economic program in the shortest period of time.

The economic paradigm was changed to a market-oriented one, sound macroeconomic fundamentals, efficiency in private and public sector, a small government (see Table 2), and complementary measures to alleviate poverty and give more opportunities to the poor by expanding education and health programs, in the hope that the disequilibrium will be turned into an equilibrium by itself, as long as the institutional obstacles were removed, in line with the purest neoclassical approach.
Table 2
LAC countries: Government size

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Expenditure over GDP</th>
<th>Government Consumption over GDP</th>
<th>Current Expenditure over GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>17.0</td>
<td>21.0</td>
<td>12.1</td>
</tr>
<tr>
<td>Bolivia</td>
<td>n.a.</td>
<td>32.2</td>
<td>17.8</td>
</tr>
<tr>
<td>Brazil</td>
<td>17.8</td>
<td>20.7</td>
<td>26.8</td>
</tr>
<tr>
<td>Chile</td>
<td>33.5</td>
<td>31.0</td>
<td>21.5</td>
</tr>
<tr>
<td>Colombia</td>
<td>32.0</td>
<td>14.3</td>
<td>10.0</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>18.0</td>
<td>21.1</td>
<td>19.7</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>9.5</td>
<td>8.5</td>
<td>4.7</td>
</tr>
<tr>
<td>Ecuador</td>
<td>n.a.</td>
<td>12.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Guatemala</td>
<td>7.6</td>
<td>9.3</td>
<td>7.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>24.5</td>
<td>23.8</td>
<td>15.5</td>
</tr>
<tr>
<td>Panama</td>
<td>25.6</td>
<td>26.6</td>
<td>23.6</td>
</tr>
<tr>
<td>Paraguay</td>
<td>31.2</td>
<td>10.0</td>
<td>10.2</td>
</tr>
<tr>
<td>Peru</td>
<td>33.2</td>
<td>14.3</td>
<td>13.3</td>
</tr>
<tr>
<td>Uruguay</td>
<td>25.1</td>
<td>24.5</td>
<td>28.7</td>
</tr>
<tr>
<td>Venezuela</td>
<td>22.2</td>
<td>25.9</td>
<td>16.2</td>
</tr>
</tbody>
</table>

Source: Calculations based on data from World Bank, 2006. Mean values of per capita data for LAC countries were used.

However, Washington Consensus policies have been criticized for their approach toward what are considered endemic issues in LAC countries, mainly poverty alleviation, income inequality and long-term economic growth. This lack of complete effectiveness has called for another round of regional consensus known as the New Washington Consensus or Santiago Consensus in 1998, or at global scale in the year 2000 when developing countries at the United Nations agreed on the Millennium Development Goals (MDG), which is a set of ambitious targets mainly concerning direct improvements in human well-being: poverty alleviation, education, gender equality, health, and environmental sustainability.

What was left after the Washington Consensus?
If we take a look at Figure 1, where the last forty-year economic performance of LAC countries is depicted, it can be clearly observed that positive output rates of the period of ISI were offset by the negative rates of the 1980s, and finally in the 1990s positive growth rates were surrounded by some reverse hiccuping in 1994-95, 1998, and 2001-02 due basically to the Tequila, Brazilian and Argentinian crises, and the global effects of the Southeast Asian and Russian crises.

Figure 1

<table>
<thead>
<tr>
<th>Latin America: Growth rate and GDP per capita</th>
<th>Yearly growths</th>
</tr>
</thead>
<tbody>
<tr>
<td>UN 1995 dollars</td>
<td>2000-06</td>
</tr>
<tr>
<td>Latin America: Growth rate and GDP per capita</td>
<td>2000-06</td>
</tr>
</tbody>
</table>

Source: Calculations based on data from World Bank, 2006.

The financial crisis in Southeast Asia marked the beginning of the deceleration phase for Latin America economic growth, and it lasted until 2002. The last three years have been progressively favorable in terms of export commodity prices for the region's countries, particularly oil, silver and gold prices.42

After more than 10 years of neoclassical policies which were associated with conservative political positions, the pendulum is again swaying, this time to the left. It started in Brazil in 2002, when the leftist presidential candidate Luiz Inacio "Lula" Da Silva won last elections, defeating the free-market candidate Serra. The same year in Bolivia, the market-oriented-thinker Sanchez de Lozada was elected president of the nation, receiving only a little more than one fifth of the votes, followed closely by the left-wing candidate Morales, who obtained just one percentage point more than Sanchez de Lozada, who finally was forced to step-down. In March 2006 Morales was elected, as he proclaims himself, the first indigenous president of Bolivian history. In Chile, Bachelet, a center-left candidate beat in run-off elections the conservative candidate. Peru is also joining this trend. The second round of presidential elections will take place the first week of June and the contenders are of center-left and left origins, both defeated the right-wing candidate. On the other side, president Arias from Costa Rica and president Uribe from Colombia, both considered conservative were also elected this year. These two countries
have the longest democratic tradition among LAC countries.

Although it seems there is a tilt to the left, the truth is that there are many "lefts" in Latin America, and each of them with different economic approach. It is important to clarify that what we call "left" in LAC countries is the contraposition of the "right", and not necessarily a full-scale left wing. Presidents Lula and Bachelet, and Kirshner, clearly of left and populist orientation, respectively, are not reluctant to implement pro-free market policies. The duet that could become a trio if Humala is elected- Chavez from Venezuela and Morales from Bolivia, supported by the Cuban president Castro, is attracting world-wide attention, due to its anti-neoclassical stance that has additional political components: traces of caudillo attitude, nationalism and populism that are leading these two figures to embrace nationalizations and to be against bilateral Free Trade Agreements with the United States, and the Free Trade Area of the Americas.

Conclusions

The 1990s was the decade for macroeconomic stabilization and structural reform, and as any adjustment, their implementation implied the imposition of certain costs that affected economic agents, depending on their economic vulnerability. Even though, accepting the "bitter prescription" and "taking the medicine" have been debatable issues in the region, Latin Americans and their governments have learnt the importance of macroeconomic fundamentals as the basis for further economic growth.

Likewise, there is consensus in other areas regarding international markets competitiveness, export-led policy, foreign investment promotion, property rights and institutionalization, and poverty and income inequality abatement. In a globalization context the 1990s has been the decade of openness to commercial and capital markets that have provided the region with technological transfer via trade and investment, making possible the increase of total factor productivity as a complement of the other two production factors, capital and labor, still scarce or inadequate in LAC countries. A general agreement on the necessity of fighting against income inequality and poverty is observed, because as far as they remain unsolved, social unrest will be a permanent menace to the region's political stability.

This time politically the entire region is swaying but economically only a few countries are challenging the economic fundamentals. The attitude of these countries and their leaders responds to favorable economic conditions due to high commodity prices that have increased certain countries leverage power, or to ethnic issues in opposition to traditionally conservative sectors usually associated with ruling minorities of European descent and the introduction of liberal economics, and this in turn ultimately represents the prevailing paradigm.

In the hope that this outburst of regressive trends would be only isolated manifestations of ethnicity and identity, whose necessity can only be judged by the constituents of these countries, it can be stated that there is still a long way to go for Latin American and Caribbean economies, but the region's prospects that certainly vary across countries are heading toward sound fundamentals as necessary condition for economic growth. Institutional and political reforms, along with more profound economic reforms, in particular in poverty alleviation and income redistribution, are still needed.

References


Edwards, Sebastian (1994) "Macroeconomic
1: In this analysis we will refer to 19 countries that represent more than the 95 percent in terms of GDP and population in the region, according to the United Nations Economic Commission for Latin America and the Caribbean data: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela. Cuba, a very uncommon case into the region with a completely different political and economic system, was excluded from the analysis as well as the following 12 countries: Antigua and Barbuda, Barbados, Belize, Dominica, Granada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Saint Lucia, Surinam, and Trinidad and Tobago.

2: In the early 1980s non-financial state enterprises were producing between 15 and 20 percent of GDP in Argentina, Brazil, Chile, Mexico, Peru and Venezuela, and they made similar contribution to total investment (Fukuchi and Kagami, 1990: 312).

3: In December 1999, the country's official name was changed to Republica Bolivariana de Venezuela. However from now on, only Venezuela will be used.

4: Just to name a few, employment generation, income redistribution, production stimulation, regional decentralization, and provision of subsidized goods and services.

5: Southern Cone countries are Argentina, Brazil, Chile, Paraguay and Uruguay.
6: Chilean military overthrew the socialist government in 1973, the Uruguayan military took over the same year, while the Argentinean Junta in 1976. In Peru also a military regime came into power after a coup d'etat, but differently from the Southern Cone countries, it did not implement free-market-oriented economic measures, on the contrary, the state played a predominant role in the economic activity, defining itself as neither a capitalist nor a communist regime. It called itself nationalist, anti-oligarchy, and socialist regime. Fitzgerald (1981) named it a capitalism of state, and Linz and Stepan (1996) classified it as a statist-organic model.

7: It is well known that the 1982 crisis, which especially hit Southern Cone countries, was mainly caused by external shocks (increase of U.S. interest rates, deterioration of terms of trade, and scarce international credit), but cannot be denied that the isolated and open liberalization of capital markets and international trade in those countries turned their economies more vulnerable when corrective measures were not taken on time.

8: The onset of the debt crisis was in 1982 when Mexican President Lopez Portillo nationalized the banking system and announced that all principal payments on the foreign debt would be suspended. This crisis originated by an external shock was expanded to other countries in the area, especially Southern Cone countries and Peru.

9: In Argentina, the Austral Plan in June 1985, in Brazil the consecutive Cruzado (February, 1986), Bresser (June, 1987) and Summer (January, 1989) Plans, and in Peru the economic policy measures carried on by the APRA government in August 1985. In Mexico the Pact program implemented by the de la Madrid Administration although comprised income policies and price controls as wages, public prices and exchange rate, including a large dose of heterodox measures; it did not reach the pernicious effects as the Argentinean, Peruvian, and Brazilian experiences did, mainly due to strict fiscal discipline, credit tightening, trade liberalization process, and concerted economic policy with the private sector.

10: Latin America history has taught us that social conflict breeds social conflicts that can be the seeds for terrorist movements and guerrillas. In Peru Sendero Luminoso (Shinning Path) and MRTA (Tupac Amaru Revolutionary Movement), in Colombia the FARC-EP (Revolutionary Army Forces of Colombia and People's Army) and in Mexico the EZLN (Zapatista Army of National Liberation) each of them in different degree has actively entered into the political scene particularly when the economic crisis was evidently unmanageable.

11: By the middle of 1970s, few democracies were left. Countries in the region were ruled by military or non-democratic regimes or civilian presidents unable to resist to the military, mainly during the 1970s and 1980s: Southern Cone countries (Linz, 1996), like Uruguay (1973-1985), Brazil (1974-1990), Argentina (1976-1983), Chile (1973-1990), Peru (1968-1980), Ecuador (1972-1979), Bolivia (1970-1982), Paraguay (1954-1989), Guatemala (1970-1986), El Salvador (1931-1979), Honduras (1972-1982), Panama (it is considered as return to democracy when U.S. troops invaded the country in 1990), and Nicaragua (1979 when the Sandinistas overthrown Somoza in 1979, but it is not until 1984 when they had democratic elections).

12: Williamson termed the "Washington Consensus" as "the political Washington of Congress and senior members of the administration and the technocratic Washington of the international
financial institutions, the economic agencies of the US government, the Federal Reserve Board, and the think-tanks" (Zini, 1992).


14: Since 2002 world crude oil and silver prices have increased threefold and gold price twofold.

15: In May 1st of this year, president Morales signed a decree nationalizing all natural gas reserves. Therefore the state recovers ownership, possession and control of hydrocarbons in Bolivia.
Latinoamérica y el Caribe:

Después de 40 años de cambio pendular en la política económica ¿el péndulo aún oscila?

El presente artículo ofrece un recuento de la evolución económica de posguerra de los países de Latinoamérica y del Caribe, donde se analiza cómo el paradigma económico y político ha sufrido cambios extremos y oscilantes que han involucrado a la mayoría de los países de la región, con consecuencias en gran escala en crecimiento económico, pobreza y distribución del ingreso. Después de una década y media de políticas neoclásicas, este año de elecciones presidenciales en Latinoamérica nos trae una ola opuesta de tendencias de izquierda que podría implicar un cambio en el modelo económico y político que prevalece en la actualidad.

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