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MYTH AND REALITY IN LATIN AMERICA: WHY ALL THE EFFORT?

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Growth in 1999 in Latin America? You've got to be kidding. But why? After receiving so many compliments on its structural reforms, how is it possible that Latin America is unable to maintain a sustainable level of growth?

This year in particular will be dismal. Recession has seriously hit the region, with estimated growth rates that range from a depressing –7% in Ecuador to a moderate 3% in Mexico. Even in the few countries experiencing positive growth, these numbers are quite low, especially compared to what the region was able to achieve early in this decade.

Even worse, during 1999 Latin America has suffered dramatic setbacks that hurt the possibilities for growth in coming years and that bring back painful memories of the lost decade of the 1980s. Ecuador has fallen into political and economic chaos, including the likely restructuring of its Brady bonds by the end of September. If improperly managed, this action could have dreadful consequences not only for Ecuador itself but also for the rest of Latin America. Venezuela is delaying much-needed economic reform, concentrating on a political agenda that borders on authoritarianism and that may pose a threat to its democratic institutions. Brazil devalued its currency, prompting a crisis that has brought President Cardoso's popularity to previously unknown lows. In Paraguay, the Vice President was shot dead in a clear political vendetta. Argentina's capital market is drying up, with gross investment falling more than 10% from last year. Chile is seeing its lowest growth rate in the last 15 years, along with mounting unemployment and labor unrest. Insurgents in Colombia control 40% of its territory, and Colombia's credit rating was downgraded, which had a negative effect on foreign investment. And so the story goes.

All these setbacks are disappointing, especially considering all the talk about the "era of adjustment and reform in Latin America," the passage from despair to hope. So, was it worthwhile to democratize, privatize, deregulate, and open up? With the poor prospects for growth and with a sense of increasing inequality, the reform process is losing many of its defenders. However, the fact is that relatively little true reform ever took place.

The perception that bold reforms were the rule in Latin America is pure myth. Most countries undertook some change, but the truth is that most of them did not embrace far-reaching market reforms. Out of twelve countries in South America, only three (Chile, Argentina, and Peru) are truly bold pro-market reformists (see Table 1).

The results speak for themselves. Bold reformers achieved positive results in both growth and inflation rates. Halfhearted reformers achieved fair growth but saw inflation remain high. The stragglers (typically the most aggressive anti–reformists) achieved a flimsy growth rate with a troublesome inflation rate. Indeed, when exercising reform, the old axiom holds true: no pain, no gain.

For another example, compare Peru and Ecuador. Both countries were hit by similar natural shocks: Both were similarly affected by their war, and both were severely hindered by El Niño. However, their performances stand in great contrast. For the 1990s, Peru boasts an average growth rate of 4.7%, whereas Ecuador's growth averages 2.3%. During 1995–1998, Peru's inflation rate was 9.3%, whereas Ecuador's was 30.8%. Even more disturbing is that while Peru is heading for a positive though tight 1999, Ecuador is struggling hard to avoid complete disaster. These contrasts in performance reflect past reform efforts. Ecuador did not privatize, did not undertake a tax or expenditure reform, has not deregulated, has not created opportunities for private investment, and has a banking mess. Peru's efforts have been exactly the opposite.

Unfortunately, since 1995 the myth of reform has lulled into complacency even the most aggressive reformers, who have, in response, slowed the pace of change to a trickle. This loss of momentum is most dangerous. It has resulted in much higher volatility in the region, higher sensitivity to external shocks, and lower growth rates in these countries. In fact, this deceleration is the reason that Argentina is now worse off than Peru and Mexico. By concentrating on estimated growth figures for the last five years (rather than for the whole decade), we see a change in the order of countries (see Table 2).

This reshuffling is related to the momentum of the reform process. Chile started instituting change back in the 1980s, and although it has stopped its reformist efforts during the last five years, it has maintained sound macroeconomic policies. Lately, Chile has been slow to recognize changes in the world economy, and it has not introduced further reforms. As a result, Chile now shows many weaknesses in the face of external shocks, and it has abruptly ended its 15-year expansion. Peru started reforms much later, but it has accelerated the pace during the 1990s, allowing it to grow even under the current difficult circumstances. Mexico's recent success stems not from deep reforms but from consistent macroeconomic policies and mostly from its integration within NAFTA. Argentina has tried to put its macroeconomy on auto-pilot and has moved backwards in structural changes since 1995. Its growth rates are telling. Neighboring Brazil started with a strong impetus when it implemented the "Real" Plan, but then it simply halted reform efforts. Venezuela and Ecuador have merely procrastinated. But never was a crisis foreseen as far in advance as the current crisis in Ecuador. Yet, despite all the forewarning, Ecuador's government remained paralyzed. Had it reacted in time, it could have partially offset the effects of the current low prices of commodities, the strong dollar, and Ecuador's dependence on (unstable) foreign capital markets.

In these critical times, Latin America is under the delusion that a major effort has been undertaken in vain, and it is trying to find a scapegoat for its current illnesses. One easy way out is to blame foreign creditors and international financial institutions. Why not convince ourselves that our problems started in the early 1980s with the debt crisis, that we did all we could, but that it was a futile effort, and now all we can do is wait until the next debt crisis appears? Indeed, Latin America now claims that foreign creditors should implement debt relief for our unfairly suffering populations.

The lessons from the lost decade of the 1980s should have been learned by now. Some countries tried the easy way out of debt, but with poor results. For example, after a debt write-off organized around its Brady deal (with no conditions for structural reform attached), Brazil has managed to dramatically increase its debt burden once again. Other easy answers are simply nonsense, such as the argument that it takes only political courage to get rid of debt burden by confronting foreign creditors. Peru had a seemingly "courageous" leader who did just that. Alan García decided to put a stop to the debt hemorrhage, but the results were not what he promised. He drove his country into hyperinflation and a massive collapse of living standards. Unfortunately, reducing debt for its own sake is no good either. Consider Romania in the late 1980s: President Ceaucescu refused to "bow to foreign creditors" and decided to pay off Romania's entire debt. But by 1990 Romania was left with a mere US$200 million (0.6% of GDP) from a high of US$7.5 billion (22% of GDP) ten years before. Ceaucescu instituted no reforms and carried out his decisions under the most dictatorial of regimes. Romanians paid an extremely high price for his whims: extreme poverty, no growth, and totalitarianism. Today, Romania has managed to pile up debt again. In fact, in 1997 Romania's ratio of foreign public debt to GDP was worse than ever, and the country is probably the worst performer of the Eastern European transition economies.

However, one country consistently stands out as an example to be followed. Chile suffered a most burdensome debt, accumulating in 1986 a foreign public debt that was higher than 90% of GDP (the highest in Table 3). Nevertheless, Chile not only serviced its debt punctually but also made important efforts to diminish its foreign debt through continuous fiscal surpluses and debt-equity swaps. Since 1983 Chile has consistently decreased its fiscal deficit, achieving a surplus in 1987 and maintaining a positive balance ever since. More important, the country deepened the structural reforms begun in the 1970s and stuck to pro-growth policies. This commitment has left the Chilean government with almost no foreign debt, only 6.6% of GDP in 1997. Because of its reduction of debt and its rapid GDP growth, Chile today places foreign bonds at an enviable rate of 6.875%, just 175 basis points above U.S. Treasuries, while Argentina and Brazil pay spreads of 800 and 950 basis points respectively.

Some people underestimate the value of Chile's commitment to reduce its debt. They argue that this reduction was only possible because it was undertaken by an authoritarian government that could impose its will regardless of public sentiment. But that commitment was respected and even fostered by the democratic governments that followed. Furthermore, unlike Romania, Chile did not starve its population. It fought debt while simultaneously promoting growth.

Good economic policies bring successful political performance, but despite all the evidence, this lesson has escaped many leaders in the region. Unfortunately, the converse is also true: Bad policies bring political disaster. Latin America is starting to show several signs of moving in that direction. Some countries are even starting to show signs of democratic meltdown.

The emerging consensus in the hemisphere is that Latin Americans are unhappy with the "social costs" of market reform. But this opinion is wrong. The so–called social costs are much more closely related to the lack of crucial reforms than to the results of any reforms that were imposed. In fact, those countries that show the greatest problems in social areas are those that have not yet begun an agenda of economic reform.

It is remarkable that politicians and journalists spend so much energy speaking against reforms. The truth is that, in most countries, only half-hearted efforts have been made. In countries making stronger efforts, societies have grown wealthier and more stable. True enough, many problems remain. But postponing reform will not make them go away. Throughout Latin America, many new administrations have recently been inaugurated, or will be in the near future. The people in these new administrations must take to heart the lesson that sound economic policies are a necessary condition for successful social development. Lack of reform leads only to greater chaos. In order to start conscientious change, Latin America must stop fooling itself with the myth of past reforms. Hopefully, the current crisis will ignite a renewed effort toward deep and widespread reform.

Table 1: Growth and inflation rates by reform activity

COUNTRY	GDP GROWTH (1990–1998)	INFLATION RATE (1995–1998)
BOLD REFORMERS:	6.08%	5.68%
Argentina		
Chile		
Peru		
MILD REFORMERS:	3.71%	20.02%
Bolivia		
Mexico		
Columbia		
Uruguay		
STRAGGLERS:	2.61%	30.64%
Brazil		
Ecuador		
Paraguay		
Venezuela		

Table 2: Growth rates 1994–1999

COUNTRY	ESTIMATED ACCUMULATED GROWTH RATE (1994–1999)
LEADERS:	
Chile	31.3%
Peru	21.6%
Mexico	13.1%
FOLLOWERS:	
Argentina	12.0%
Brazil	9.0%
Colombia	9.0%
STRAGGLERS:	
Venezuela	0.3%
Ecuador	0.2%

Table 3: Foreign public debt over GDP (1980–1997)

YEAR	CHILE %	PERU %	BRAZIL %	ROMANIA %
1980	18.63	32.16	17.54	21.76
1981	15.34	**25.64**	17.23	20.83
1982	24.19	30.65	18.53	17.86
1983	39.45	47.18	31.25	19.07
1984	60.34	50.34	**37.09**	18.75
1985	88.62	**64.14**	34.98	13.37
1986	**90.92**	45.28	33.21	12.26
1987	86.67	31.60	32.43	10.08
1988	60.90	38.97	28.22	3.77
1989	44.47	33.96	22.36	0.37
1990	38.89	42.89	19.25	**0.60**
1991	30.46	37.76	21.28	3.96
1992	22.98	38.96	23.42	12.67
1993	20.28	41.95	21.06	12.70
1994	17.94	37.09	17.41	15.18
1995	11.50	33.57	13.88	15.12
1996	7.46	35.24	12.27	23.81
1997	**6.60**	32.45	**10.79**	**27.25**