BY ALBERT FISHLOW

Socialism, we all know, was long ago consigned to the ashcan of history. But someone forgot to inform the voters of Latin America.

In some countries – notably Venezuela and Uruguay – leftist alliances have replaced long-established center-right ruling parties. And even where there has been apparent continuity – as with Peronism in Argentina – dissatisfaction with the consequences of more than a decade of free market reforms has led politicians to trim their sails. Indeed, across Latin America, the failure of deregulated markets to kindle Asian-style economic growth or to relieve grinding poverty seems to be generating a nasty backlash.

Today's political environment, however, only superficially resembles the atmosphere of the 1970s and 1980s, when fire-breathing politicians from Chile to Peru to Nicaragua promised Socialist revolution and delivered only inflation and economic paralysis. But in searching for an explanation of what is happening now in Latin America, the past is still a good place to start because the legacy of economic failure helps to clarify why the New Left is for the most part avoiding that well-trod path. Indeed, a close look suggests that Latin America's political left isn't really straying very far from the market-oriented economic policies of the 1990s.

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POPULISM, TAKE ONE

Past governments of the left in Latin America (which, by the way, weren't all that common) had a clear vision of priorities. Their implicit economic model turned on a dash for growth underpinned by greater self-sufficiency and redistribution of income to the poor. To boost domestic demand, both minimum wages and public-sector salaries were raised. And to jump-start investment, governments made loans to enterprises (both private and state-owned) at interest rates far below the real cost of capital. Overvalued fixed-exchange rates for home currencies made it cheap to import essential inputs for domestic production, while high tariffs restricted sales of foreign-made goods that competed with domestic ones.

This approach to industrialization was followed relatively successfully by Brazil and Mexico (and much less successfully by Chile and Argentina) in the 1950s. But, back then, the hard currency needed to make these experiments practical was generated by booming markets for raw-materials exports. In the 1970s and 1980s, by contrast, commodities were in a worldwide glut, so populist policies required heavy borrowing that pushed both domestic budget deficits and foreign trade deficits to unsustainable levels. In Chile, the end came with a right-wing military coup and the bloody Pinochet dictatorship. Peru

Venezuela's Hugo Chavez

and Nicaragua, for their part, eventually rejected left-wing governments in democratic elections.

Underlying the revival of populist policies in the 1970s was a belief in the value of central planning. This was an era in which new mathematical techniques – and the apparent success of more-sophisticated planning methods in Eastern Europe and the Soviet Union – raised expectations that planning would improve economic growth and reduce poverty. Indeed, we often forget that this view was shared by the Washington establishment: In the 1960s, John F. Kennedy's Alliance for Progress required national plans to be formulated as a condition for United States aid. Infrastructure investments were generally directed by state enterprises, which were supported by loans from the Inter-American Development Bank and the World Bank, as well as by direct private foreign investment.

By the 1980s, however, foreign banks and governments were balking at extending more credit to Latin America; a decade of the debt-crisis gridlock descended on the region. The only way to cope was to sharply curtail imports – and that meant both lower living standards and economic stagnation. Military regimes retreated, in some cases giving up power in the face of clear economic failure. Argentina's generals and admirals tried a diversionary tactic, picking a fight with Britain over the Malvinas (Falklands). In this environment, with memories of the failures of populist experiments so vivid, pragmatic leaders looked elsewhere for fixes. The focus became macroeconomic stability – and more particularly, the goal of stopping inflation.

LIBERAL REFORM

Price stability – inflation fell from a regional average of more than 1,500 percent in the late

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1980s to less than 10 percent in 2005 – followed from a variety of strategies. But the common link was a new commitment to monetary prudence. Prices had ballooned because governments had allowed domestic money supplies to rise in step with domestic demand. To restore credibility to central banks, governments needed to limit money-supply growth to the amounts required to sustain stable foreign exchange rates.

This commitment, in turn, required leaders to reign in budget deficits. And to manage that, they needed to beef up revenues in societies in which taxes were often extremely difficult to collect from those most able to pay them. Thus, the path of least resistance proved to be the sale of state enterprises – and in most cases, sales to foreigners bearing hard currency.

Such divestment generated cash that was badly needed in the early stages of disinflation. It also yielded a bonus in terms of productivity, as new owners shed overpaid, underemployed labor and applied more-modern management techniques. But there was a downside: to make enterprises salable, government were forced to guarantee their future profitability through regular adjustment of regulated rates, thereby ensuring monopoly profits.

Another feature common to what were called "heterodox" price-stabilization policies (in contrast to the orthodox programs that relied on orthodox belt-tightening) was new reliance on competition from foreign producers. In Brazil, for example, the government allocated hard currency to allow imports of products in markets where domestic competition was weak or nonexistent. This did not require a big commitment; the threat of foreign competition typically proved sufficient to ensure restraint by domestic producers with market power.

An additional element should be stressed here: heterodox price stabilization typically served the interests of the poor. In an inflationary environment, skilled and unionized workers could protect their incomes through contracts that indexed wages to prices, just as lenders and landlords could insist on inflation-indexed returns. By contrast, the bottom half of the pecking order – pensioners, unskilled, non-unionized workers with little leverage and those with no jobs at all – had no way to fight back. Thus, price stability often meant gains in the incomes of the disenfranchised, and translated into political support for the politicians in charge – among them, Presidents Carlos Menem of Argentina, Carlos Salinas de Gortari of Mexico, Alberto Fujimori of Peru and Fernando Cardoso of Brazil.

In many aspects, then, the strategies used to tame inflation were homegrown. Indeed, they frequently did not receive support from abroad. But history has a way of being distorted to the ends of its interpreters. And when the decade of the 1990s turned out to be another period of stagnation for the region in spite of the reforms, economic failure was often blamed on the multilateral lenders in Washington.

The IMF rationalized the failures of the 1990s by arguing that additional measures were needed to set the stage for growth. But that didn't sit well with unemployed urbanites or malnourished, landless peasants. It did not help that international lenders were deeply complicit in the events leading up to the collapse of the peso in Mexico, the Asian currency meltdown in 1997, and Russia's default on its debts a year later.

Brazil was subsequently forced to devalue its currency in 1999. Argentina succumbed at the end of 2001 – its fixed-exchange rate was no longer viable. And neither was its political system: there were five presidents within a month. Compounding the region's economic

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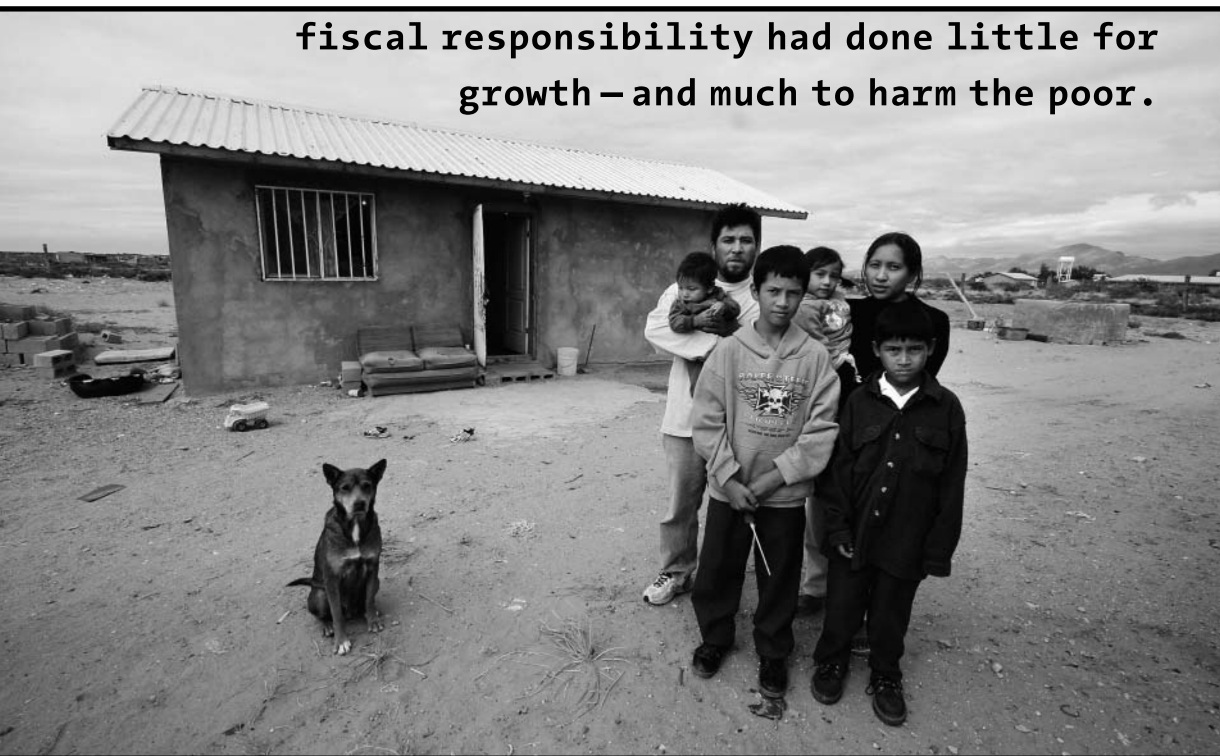

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problems, the American recession in 2000 reduced the demand for (and prices of) Latin American exports.

It should not be surprising, then, that the left has gained strength. Populist politicians charged that fiscal responsibility had done little for growth – and much to harm the poor. They preached on behalf of greater state initiative and questioned the value of exposing fragile domestic enterprises to more foreign competition. Older political parties in the Andean countries began to fragment and new ones appeared. In Brazil, an invigorated populist party headed by perennial presidential candidate Luiz Inacio Lula da Silva – or just plain Lula – gained strength from the political middle.

But only in Chile, which finally shed General Pinochet for good in a plebiscite on his rule in 1988, did a coherent alternative fully surface. There, two aspects of the transformation should be noted. First, most of the center-left opposition created a stable coalition known as the Concertacion. Second, the center-left resolved to retain many of the free market reforms that radically altered the Chilean economy in the 1980s, and to modify others in a deliberate and careful fashion. In particular, no dramatic anti-inflationary initiative was needed. Rather, after the sharp decline of the 1980s, all that was required was a new commitment to sober, intelligent policy. And that is what Chile got, raising domestic savings and investment and economic growth under democratic auspices.

Ernesto Zedillo, elected president of Mexico in 1994, faced a deep recession when he took office. But his administration remained committed to market liberalization, accepting a significant decline in living standards as the price of reassuring foreign investors that

Mexico would meet its financial obligations. The economy benefited from the North American Free Trade Agreement, as well as from the porous border with the United States, which served as a safety valve for unemployed Mexicans. Even so, the crony-ridden PRI political coalition was driven from office in the presidential election of 2000, ending 70 years of one-party rule.

THE RISE OF THE LEFT

Economic disappointment with the meager fruits of free market reforms brought populists to power in much of South America as the 21st century began. But the spasm of rejection of what was widely perceived as policies dictated by foreign financiers left open the question of what the newcomers could really do to satisfy their constituents.

Luck intervened. Explosive economic growth in Asia sharply increased the price of Latin America's core exports – minerals, farm products and, above all, oil. Yet the prices of manufactured goods on world markets continued to fall, making it possible for countries in the region to buy more with a lot less of what they had to sell. These good years have largely eliminated the continent's dependence on foreign financing to cover external trade deficits. Now, for the first time, domestic savings exceeds investment, and foreign exchange reserves are increasing.

In broad terms, the new governments adopted one of three approaches to economic policy. In Venezuela, President Hugo Chavez concentrated economic power, using increased oil revenues to buy the allegiance of the country's disenfranchised. Venezuela's economic policies do not represent a sharp break from those of past boom years – a mix of price controls and subsidies effectively lock in dependence on oil revenues and government patronage. What's new are bold spending programs aimed at improving the lot of those at the bottom of the economic pecking order. Tax revenues from petroleum exports are being spent on programs that broaden access to education and medical care, as well as on subsidizing food for the poor. Indeed, instead of saving the windfall gains, as Chile is doing with its copper bonanza, Venezuela is spending like there is no tomorrow.

By contrast, Brazil's nominally populist government has not broken with the centrist economic policies of the previous administration. The government still runs a budget surplus – indeed, it has allowed the surplus to grow. And it has largely left monetary policy to the technocrats at the central bank. In fact, it stood by when the bank sharply raised interest rates in 2003 and again in 2004 and 2005, to check inflationary demand.

Brasilia has intervened to reduce the cost of capital in favored sectors – notably agriculture and export industries. But it has resisted the standard mix of populist policies, including sharply higher minimum wages, fatter government budgets and protection against imports.

The third approach is exemplified by Argentina's eclectic response to economic crisis in 2001. It imposed heavy costs on foreign creditors in settling its outstanding debts. And it used a variety of measures to favor Argentine producers over foreign competitors – a policy that has led to considerable political friction with Brazil. But in a break with conventional populist doctrine, the currency exchange rate has been deliberately undervalued – increasing inflationary pressures, but giving exporters a break. The policies have paid off, albeit modestly: the economy is growing, the budget is balanced and the country is no longer on the IMF's short leash. Foreign investment has not boomed, but

(Left to right) Presidents Nestor Kirchner of Argentina, Evo Morales of Bolivia, Luiz Inacio Lula Da Silva of Brazil and Hugo Chavez of Venezuela.

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One striking fault line in Latin America is between countries seeking closer economic ties with the United States and those eager to distance their economies from gringo power.

there are signs of interest.

A big issue in all the Latin countries enjoying the fruits of the commodities boom is the prospect of "Dutch Disease" – the condition in which windfall revenues from raw-materials exports drives up the exchange value of the currency and undercuts the development of a diversified industrial sector that can compete in international markets. This time around, however, there seems to be greater sensitivity to the problem (think Argentina, with its undervalued exchange rate). Chile's large fiscal surplus is being squirreled away for the future, and the central bank is plainly conscious of risks of appreciation in the exchange rate. In Brazil, ongoing reduction of the central bank's official overnight lending rate (begun last September) was in part motivated by the worrying rise in value of the Brazilian real.

One striking fault line in Latin America is between countries seeking closer economic ties with the United States and those eager to distance their economies from gringo power. The Mercosur trade treaty countries – Argentina, Brazil, Paraguay, Uruguay and now Venezuela – want nothing to do with the effort to conclude a regional free trade pact with the United States. By contrast, Chile and the Central American economies have bilateral free trade agreements ratified by the United States Congress; Columbia and Peru have also signed up, and Ecuador is likely to follow suit.

Note, too, that even within the Mercosur

Education is hardly the only element explaining the region's wretchedly unequal income distribution, but it is widely viewed as a principal one.

countries, there are mounting differences over external political and economic policies. Brazil is intent upon securing a permanent seat on the United Nations Security Council – a prospect that raises hackles in Argentina – and is promoting a global trade deal in the current Doha Round discussions at the World Trade Organization. Venezuela, for its part, is keen on building a massive gas pipeline extending all the way to Argentina that would symbolize its aspirations to become a major player in regional politics. With Venezuela's support, Bolivia's new president, Evo Morales, is nationalizing the country's oil and gas fields – a move that brings Bolivia into direct conflict with Brazil, which has been the largest investor in the Bolivian energy industry. Uruguay is battling Argentina over the environmental consequences of large investments in paper mills along the Plate River – the border between the two countries.

The glue that keeps Latin America countries together despite these real differences is opposition to United States policies. Chile and Mexico, members of the United Nations Security Council in 2003, firmly opposed the invasion of Iraq that year. And the irritations with U.S. policies are exacerbated by a variety of ongoing political and economic concerns about illicit drugs, immigration and access to U.S. markets. Instead of being the central concern of U.S. foreign policy, Latin America finds itself in line behind the Middle East, China and now, even Africa.

BRIDGING THE GAP WITH THE BORN-AGAIN POPULISTS

Those who believe that free market capitalism still constitutes Latin America's main chance for sustained economic growth could meet the new populists halfway by focusing on strategies that serve the long-neglected inter-

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ests of the poor. Start with a substantial commitment to more and better education. For a host of reasons, Latin America has been inexcusably late to recognize the importance of universal education to both economic growth and a fair distribution of income. The catch-up has begun, but most of the region lags far behind Asian countries at comparable levels of development.

Education is hardly the only element explaining the region's wretchedly unequal income distribution, but it is a principal one. Most relevant, the quality of education in Latin America is dramatically inferior for the children of the poor, undermining the prospects for social and economic mobility.

A second issue is fiscal policy. The region's fiscal concerns may start with achieving macroeconomic stability that protects the purchasing power of the poor as well as improves the business climate. But they hardly end there. Even in countries with high levels of public spending, investment in both physical and social infrastructure has been inadequate. Little, for example, has been invested in appropriate research and development capacity. Consequently, the region is less likely than India, East Asia or Eastern Europe to be able to capture the dividends from imported foreign technology.

By the same token, Latin America must sharply increase savings rates if it is to narrow the income gap with developed economies. Something on the order of 25 percent of GDP is needed to meet capital needs without heavy (and dangerous) reliance on foreign investment. Historically, the region's savings were generated by the private sector and then funneled into public investment. What's needed is just the opposite – public saving (i.e., fiscal surpluses) that permits private firms to borrow at lower interest rates and for longer periods.

Nor should policy strategists lose sight of the region's need for more – and more geographically diverse – trade. With the price of oil and other commodities booming, open borders are seen as benign. The real test will come when commodity prices slacken. Latin America has had that experience before. And the sad consequence in a region inclined to view globalization as, at best, a necessary evil, was a strengthening of protection against import competition rather than to upgrade the quality and diversity of its exports.

A last, but equally important, issue is institutional reform. This refers to the need not only for an independent judiciary to enforce property rights and contracts, but also for sophisticated regulation of the newly privatized activities. And not just economic institutions are involved. Political reform is needed in much of a region in which democracy means government by political machine, and loyalty in public sector employees trumps competence.

LAST THOUGHTS

The countries of Latin America find themselves globally challenged once again. Not so long ago, they compared themselves to South Korea and Taiwan. Now they must compete with economic newcomers ranging from India to South Africa to Vietnam.

Bolstered by the windfalls from the commodity boom, a new generation of populists is advocating a regression to the big-government policies of the 1960s and 1970s – only this time with a greater commitment to reducing poverty. That approach puts at risk the modest gains from a generation of reforms. Plainly, the last generation of free market policymakers erred in giving short shrift to the needs of the poor. But the fact remains: only through productivity growth, fueled by advances in technology and greater domestic savings, will Latin America be able to dig its way out of the morass. M