

Latin America's Left off-track

By Matías Vernengo

For several years, electoral results in Latin America have been shifting leftward. The victory of Tabaré Vázquez in Uruguay is the most recent example; the list also includes Néstor Kirchner in Argentina, Luis Inácio Lula da Silva in Brazil, Ricardo Lagos in Chile, Lucio Gutiérrez in Ecuador, and Hugo Chávez in Venezuela. The new left governments are a mix in their political provenance. Lagos is from the well-established Socialist Party, while Lula and Vázquez represent newer parties gaining power for the first time. Kirchner, from the Partido Justicialista (Peronists), Chávez, and Gutiérrez are more typical of the old Latin American populism in which personalities are more important than political parties.

Beyond these center-left electoral victories, it is clear that the majority of civil society in Latin America rejects the neoliberal policies imposed during the 1990s. Popular demonstrations against privatization and trade liberalization are widespread. Last October saw a dramatic revolt in Bolivia, for example, where a coalition of labor unions and indigenous peoples, spurred by the government's plan to privatize the nation's gas reserves, brought about the resignation of President Sanchez de Lozada and strengthened the position of the indigenous leader Evo Morales.

The resurgence of the left is a momentous step in Latin America. The election of Ricardo Lagos, Chile's first Socialist president since the 1973 military coup against Salvador Allende is a landmark, as are the victories in Brazil and Uruguay of new-style left governments embedded in deep-seated social movements. The political changes underway in Latin America today are comparable to the victories of Felipe Gonzalez after the long night of Franco's dictatorship in Spain, and the more recent revival of the Labor Party under Tony Blair following Margaret Thatcher's conservative reign. These victories are significant, especially because they reflect the region's long process of redemocratization, a political shift which has gone hand in hand with the revival of civic life: the rise of empowered indigenous movements, renewed struggles for land reform, worker occupations of factories to keep them operating in the face of economic collapse, the rise of *asambleas* (neighborhood assemblies) meeting to discuss the way forward for anti-neoliberalism protests.

Observers of the region have usually credited this left turn to dissatisfaction with the neoliberal, "Washington Consensus" policies imposed during the 1990s. The Washington Consensus basically required deregulating markets, liberalizing trade and finance, and privatizing public firms. The emphasis was on price stabilization, fiscal austerity, and market-friendly policies, a mix that ultimately favored international financial markets and the local elites who could benefit from a more open financial environment. Arguably, if the left is to stake out a new direction and change the region for the better, economic policies will have to be at the center of the social transformation. Notwithstanding the political importance of Latin America's recent left turn, however, there is little reason for

progressives to be optimistic about the economic policy direction of Latin America's new leaders.

Acceptable Leftists

Many observers have tried to sort the new left-leaning leaders into “good” and “bad” camps. Rutgers’ Tomás Eloy Martínez, an Argentinean writer, sees two antagonistic economic models at play. In his view, a “negative left,” embodied in Chávez’s Bolivarian Revolution, uses the windfall gains from higher oil revenues to promote an unsustainable redistribution policy without laying the foundations for future growth. The “positive left” is represented by Lula and his policy of macroeconomic austerity as the necessary prerequisite for sustainable growth, allowing, in a hoped-for second phase, redistribution of the fruits of prosperity to the less privileged.

Jorge Castañeda, ex-foreign affairs minister of Mexico and former advisor to Cuauhtémoc Cardenas, also argues that Latin America has voted two lefts into power. In his view, Lagos and Vázquez should be included with Lula in the responsible and pragmatic left that has learned that market discipline and macroeconomic stability are important for development. Castañeda groups Kirchner and Mexico City mayor and possible presidential contender Andrés Manuel López Obrador with Chávez as representatives of a nationalist and populist left of the past, one that has been less receptive to modernizing influences. (Despite parallels with Chávez, Ecuador’s Gutiérrez was timid in distancing himself from Washington and fulfilling his campaign pledge to overturn neoliberal policies, which may explain, in part, his recent fall from power.)

Unlike Eloy Martínez, Castañeda sees macroeconomic orthodoxy dominating the region as a whole, Chávez and Kirchner included. Unfortunately, his view is closer to the truth. Apart from some anti-imperialist rhetoric, the economic policies of the new governments in Latin America cannot be classified as leftist. Like Tony Blair, the new center-left leaders in Latin America have embraced so-called “Third Way” economic policies that are largely indistinguishable from neoliberalism. In a sense, everyone has caved in to Thatcher’s infamous notion that there is no alternative. Maria da Conceição Tavares, a prominent Brazilian economist and member of Lula’s Workers’ Party, recently said that there is no such thing as left-wing macroeconomics.

Adhering to Macroeconomics Orthodoxy

If Keynesian fiscal policies—progressive taxation, increased spending on social programs, and deficit spending to maintain full employment—are the hallmarks of a progressive government, then the new left governments in Latin America cannot be seen as particularly progressive.

Despite variations in political discourse, the countries’ macroeconomic policies are broadly similar, and represent little change from those of the previous regimes. The continuity of macroeconomic policies is most evident in the arena of fiscal policy. All the center-left governments in the region have accepted the logic behind an emphasis on

fiscal discipline: that high fiscal deficits cause inflation, and, by generating fears of default, cause capital flight and lead to balance-of-payments problems. All accept the dictum that they cannot pursue more progressive fiscal policies because international financial markets would punish their countries with a run on their currencies.

All of these center-left governments are prioritizing fiscal austerity to control government debt accumulation and are committed to maintaining primary surpluses even in periods of recession. (Primary surpluses correspond to the difference between spending and revenues, but excluding interest payments on outstanding debt. In other words, a government with revenues of \$100 that pays \$35 in interest payments and \$70 on other expenditures would have a nominal deficit of \$5 but a primary surplus of \$30.) This is a significant change compared to the Keynesian approaches that dominated policymaking in the region prior to the 1990s and is more extreme than the anti-Keynesian bias in the developed world. Maintaining primary fiscal surpluses has squeezed public investment and spending on social programs, dampened economic growth, and favored financial interests and the well-to-do.

Although exchange-rate policies vary somewhat, most Latin American governments across the political spectrum today emphasize the role of exchange rates in controlling inflation, and only secondarily their role in promoting external competitiveness. In other words, by controlling exchange rates, governments are able to keep the prices of imported goods, which crucially affect inflation, down. But this also means that the prices of domestic products are less competitive, and so hobbles the development of domestic industries.

At times exchange rate controls are seen as a temporary device to avoid balance of payments crises, but not as instrumental in promoting development. For example, Argentina adopted capital controls after the December 2000 crisis, but these are intended to be temporary. None of the left governments has made capital controls (such as foreign exchange controls or Tobin taxes) central to its economic agenda. Capital controls reduce the outflows and inflows of foreign currencies. With capital controls in place, the rate of interest does not need to be hiked to avoid capital outflows and can be adjusted for domestic purposes. Hence, capital controls put national governments in control of monetary policy.

If the macroeconomic policies of the region's left regimes are successful, perhaps it doesn't matter whether or not they are progressive. In fact, recent economic performance in Latin America has been exceptional. According to the Economic Commission for Latin America and the Caribbean (ECLAC), the economies of the region exceeded expectations in 2004, with an average regional GDP growth rate of 5.5%, surpassing the world average rate of 4%. Venezuela grew by an incredible 18%, Argentina by around 8%, and Chile and Brazil by slightly above 5%.

However, these strong growth rates have more to do with external drivers than with any innovative policies of the region's new leaders. Ultimately, the remarkable expansion of China, which has increased its trade with Latin America considerably, the United States'

mild recovery, and an improvement in the terms of trade—the relative price of Latin America’s exports—explain the positive Latin American performance. That external factors are propelling the region’s economies casts serious doubt on the sustainability of their growth. The economic policies pursued by the left will not be of much help if economic growth in China and the United States slows down in the near future, as many analysts expect. Good luck more than good policies is behind the new prosperity.

Macroeconomic Conservatism and Distribution

Economic growth alone is not enough to improve the lot of the region’s poor anyway. Brazil’s story illustrates the distributive consequences of the current fiscal policies in the region, and highlights the continuity with the policies of past administrations. Last year Lula signed his second agreement with the International Monetary Fund (IMF). The agreement, which requires Brazil to adopt the usual litany of neoliberal policies, particularly cutting government spending, was all but necessary, and Lula decided to sign it only to gain credibility with international financial markets.

In Brazil’s case, the primary surpluses (4.25% of GDP in 2003) go hand in hand with large nominal deficits (5% of GDP in 2003). The difference between a primary surplus and a nominal deficit represents interest payments made to the owners of government bonds. That is, almost 10% of Brazil’s GDP was transferred last year to bond holders, mostly corporations and wealthy individuals. Interest payments represent almost half of Brazilian government expenditures, and are considerably higher than the amounts spent on Zero Hunger, land reform, or First Job, to name a few of the well-publicized social programs of Lula’s Workers’ Party. The result is that the income distribution in Brazil, one of the world’s most unequal countries, is no better now than when Lula took office in 2003, and probably slightly worse. The share of wages in total income in Brazil fell from 36.1% in 2002 to 35.6% in 2003.

Argentina and Venezuela face similar constraints, but because of more closed capital accounts and lower rates of interest their plight is less extreme. In Argentina, Kirchner is negotiating fiercely with the IMF and the private creditors who allowed the country to obtain a favorable rescheduling of foreign debt. Yet, last year his government maintained a primary surplus even greater than the 3% of GDP its prior agreement with the IMF called for. The IMF has let it be known that future approvals of the debt-restructuring program and, hence, additional money will be forthcoming only if Kirchner maintains fiscal austerity.

More important, Argentina has tentatively agreed to gradually scrap all the capital controls implemented since its currency crisis in 2001. Argentina’s interest rates today are considerably lower than Brazil’s, and close to the U.S. real rate of interest. (Brazil does not impose controls on capital flows.) If Argentina complies, the country can expect higher interest rates in the near future.

Kirchner has been accused of promoting irresponsible economic policies and favoring unsustainable redistribution towards the poor, but it’s hard to see why. Argentina’s

current fiscal stance will require continued primary surpluses to pay for debt servicing. It's true that the government established a program of transfers to the unemployed (Plan Jefes de Hogar), but the benefits are insufficient, and other public investments are simply not being made. The maintenance of primary surpluses means that the resources available for social transfers, including the Plan Jefes de Hogar, are severely constrained. Overall, then, with the exception of the fixed exchange-rate system, Kirchner's government is adhering to basically the same set of macroeconomic policies that prevailed through the 1990s.

The Venezuelan story is similar. Chavez's 1998 government program (La Propuesta de Hugo Chávez para Transformar Venezuela) designated inflation as the country's central macroeconomic problem. Since then, his administration has used an overvalued exchange rate as the main instrument for reducing the price of imported goods and keeping inflation in check. The use of a managed and appreciated exchange rate to control inflation is also being used by Lula, as it was used by his predecessor Fernando Henrique Cardoso; by Argentina, under the 1991 Convertibility Plan, which pegged the country's currency to the dollar; and by Ecuador, with dollarization. In each case, overvaluation of the currency damaged external competitiveness, reducing the rates of output growth. Eventually, speculation forced depreciation.

More importantly, Chávez generated great expectations about using oil revenues to pay for social programs. His government did indeed implement a massive program of social spending, including an expansion of health assistance and distribution of foodstuffs; social spending as a share of total government spending did go up. Deficits soared, but less as a result of the increase of government spending than as the consequence of lower non-oil revenues due to recession. The social conflicts associated with the political resistance against Chávez exacerbated the fall in non-oil government revenues, and forced the government to increase the amount of debt finance. Public debt has soared; interest payments on outstanding debt corresponded to around 40% of total spending last year.

Like Argentina and Brazil, Venezuela has kept substantial primary surpluses—reaching 3% of GDP in 2004—even as its nominal deficits have grown. According to Leonardo Vera, a professor at the Central University of Venezuela, a vicious circle has developed in which reduced revenues lead to more indebtedness, and indebtedness, in turn, leads to higher debt service costs. As this vicious circle turns, wealth is redistributed, but not in the way Chávez hoped—rather, from the poor to the wealthy owners of public bonds.

Across Latin America, governments both center-right and center-left have pursued fiscal policies aimed at containing deficits and trying to reduce the burden of debt. As a result, they have shunned countercyclical spending programs and neglected the effects of fiscal policy on income distribution. The region as a whole obtained a primary surplus of 1% of GDP in 2004, while the nominal deficit was close to 2% of GDP. This means that Latin America, a region of highly unequal income distribution, transferred on average 3% of GDP to the owners of government bonds last year.

With permanent fiscal adjustment—that is, the maintenance of primary surpluses even in periods of crisis—and a sizable share of government spending channeled into interest payments—in other words, redistributed to the wealthy—it is not surprising that unemployment remains high across the region. The average rate of unemployment in 2003, according to ECLAC, was above 10%, with Argentina (15%) and Venezuela (18%) heading the charts. As high as these official measures of unemployment are, they underestimate the problems of underemployment and low-productivity jobs typical in the region. These numbers are particularly problematic because leveling the income distribution and reducing unemployment are essential if the region's high poverty rate is going to be addressed. Poverty fell in 2004, but not enough to make up for the increase that occurred between 2001 and 2003; around 43% of Latin Americans still live below the poverty line. And nothing in the macroeconomic policies of the new left governments suggests that their outcomes are likely to diverge from those in the rest of the region in the coming years.

Fiscal Policy and International Financial Reform

Fiscal policy was central to the development of the systems of welfare in the developed world, and for industrialization in the global South, including in Latin America. What is often forgotten about the role of fiscal policy is that it was most effective during the Bretton Woods period, the so-called Golden Age of capitalism from the end of World War II until the 1970s. The Great Depression and the rise of fascism and communism had led the leaders of the rich countries to adopt a fiscal pact that allowed higher levels of social spending in order to save capitalism from itself. Under the Bretton Woods regime, capital controls forced interest rates to low levels. This allowed governments to increase spending while keeping the burden of debt service within reasonable levels.

Today, a more comprehensive reform of the international financial system along the lines of Keynes' proposals at Bretton Woods, as advocated by some heterodox economists, is necessary not just to stabilize financial markets and reduce balance-of-payments crises, but to promote more just fiscal policies. Controls on capital flows would allow lower rates of interest, reduce debt-servicing spending, and allow for more public investment and higher levels of social transfers. These policies should be complemented with trade policies that promote full employment, and a coherent set of industrial policies to promote international competitiveness. The experience of the new left-leaning governments in Latin America suggests that as long as the existing rules of the international financial system remain in force, global South governments will be unable to adopt progressive economic policies whatever their political stripes.

Furthermore, international financial reform is unlikely to come as a result of the victory of the left in developing countries. (Admittedly, progressive observers hoped there would be less subservience to international financial markets in Latin America with left-of-center governments in power. China and India, for example, adopt strict capital controls.) Historically, reforms of the international financial system result from crises at the center, not in the periphery, of the global economic system. But it is still important to see things for what they are. The center-left governments in Latin America have maintained or

implemented macroeconomic policies that redistribute income towards financial markets and elites. Only Latin American magical realism explains how these policies could be seen as progressive alternatives to neoliberalism.

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Sources: Philip Arestis and Malcolm Sawyer, eds. *The Economics of the Third Way: Experiences from Around the World* (Edward Elgar, 2001); Jorge Castañeda, "Las dos izquierdas latinoamericanas," *La Nación*, 1/4/05; CEPAL (ECLAC), *Estudio Económico de América Latina y Caribe, 2003-2004*; Martínez, Tomás Eloy, "Bolívar quería otra cosa," *La Nación*, 12/31/04; José Antonio Ocampo, "Half a Lost Decade," *ECLAC Notes*, No. 24 (9/02); Leonardo Vera, "Interpretando la Agenda Económica de Chávez," www.analitica.com/va/economia/opinion/3817548.asp; Matías Vernengo, "Fear, Hope and Wishful Thinking in Brazil," *Dissent* (Winter 04).