The Future of Economic Policy Making by Left-of-Center Governments in Latin America: Old Wine in New Bottles? [1]

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Introduction

When scanning the medium-term economic prospects and policies of Latin America, one crucial element to take into consideration is the recent prevalence of left-of-center governments in the region. What are the economic policies that they implement? How do they differ from the orthodox ones implemented by their predecessors? Will, as their passionate advocates proclaim, governments of this “New Left” [2] adopt economic strategies – radically departing from so-called neo-liberal ones – that will help Latin America to succeed in its elusive quest for high and sustained economic growth? Or, on the contrary, are their fierce critics correct in arguing that such alternative economic programs are revamped versions of populist experiments of the past and, thus, sooner or later, will provoke acute inflation, bloated fiscal deficits, and ultimately push the region into financial crisis and recession? Another key element to consider is the influence and constraints imposed by the global outlook, the imbalances of the world economy, and the international financial markets. We here advance a succinct assessment of these two elements in order to identify the likely changes in the evolution of economic policymaking in Latin America in the near future: the rhetoric, the risks and the reality.

Economic Roots

One key root in the region’s shift to the left in political preferences is certainly the disappointing results of the economic reforms – inspired by the Washington Consensus – implemented by previous governments. Indeed, after nearly two decades of putting in place drastic macroeconomic reforms and adopting policies centered on trade and financial liberalization, deregulation, and downsizing of its public sector, Latin American economies are still unable to enter a path of high and sustained expansion. Inflation has come down, but economic activity has been sluggish. In addition, in the last ten years, the region has suffered acute economic crises; among the most conspicuous ones were the Mexican *tequila* crisis and the collapse in Argentina.

During the 1980s the average real per capita GDP declined in Latin America due to the debt crisis. In the 1990s it expanded at 1.5 percent per year; four percentage points below the average of developing countries in Asia. Moreover, between 1980 and 2000 the income gap between Latin America and the OECD widened, and there was scant progress in the reduction of poverty. By the beginning of the millennium, close to

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[1] The opinions expressed in this paper are the exclusive responsibility of the authors and may not necessarily coincide with those of the United Nations Organization or of ECLAC.
[2] The term “New Left” is not used in the European sense of the last thirty years, but only to identify the left-of center governments currently in power in Latin America.

50 percent of its population lived in poverty –25 percent of it in conditions of extreme poverty. And, particularly worrisome, Latin America remained the most unequal region in the world.

Not surprisingly, Latin Americans became more and more critical of the, say, neo-liberal economic policies then implemented. As Latinobarómetro showed, by 2000 less than 30 percent of the population across the region believed that privatizations were beneficial, an approval rate 30 points lower than a few years before. Although the majority saw market economies as the only road to development, less than 25 percent claimed to be satisfied with their socioeconomic results, and an increasing majority disagreed with the idea that the state should not intervene in economic affairs. Physical insecurity and the lack of employment were becoming major fears among the people of Latin America. Moreover, by then a significant proportion of Latin Americans questioned the merits of democracy in so far as it had not led to a surge in economic expansion and job creation.

On the other hand, the success of China and India – and other Asian economies – in luring vast inflows of foreign direct investment and maintaining a rapid economic expansion based on non-conventional polices that granted the state an active role in the economy, contributed to further undermine the credibility of the Washington Consensus in Latin America. China's and India's success was frequently referred to by opposition parties in the region as a proof that Latin America's economic strategy was flawed. Thus, at the same time that the native population was becoming weary of the conventional economic strategies, the left-wing parties' campaigns in favor of a new development agenda were attracting respectability. An additional element in their favor was the fact that, after 9/11, Latin America appeared to be erased from the United States' list of priorities.

Rhetoric and Reality

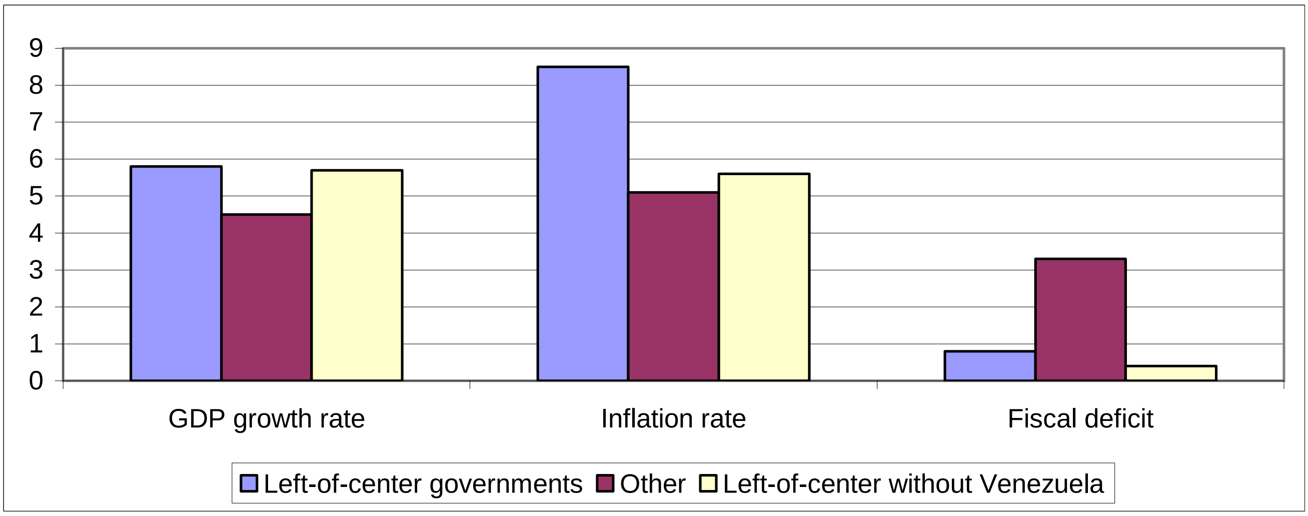
The above mentioned economic factors combined with other elements of a sociopolitical nature shifted political preferences in Latin America, allowing for a number of left-wing parties to be ushered into power through democratic elections. The debate about the macroeconomic policies adopted by these New Left governments is ideologically charged, with rhetoric tending to prevail over reality. Indeed, supporters of these policies passionately defend them as alternatives to counteract the adverse effects of the neo-liberal agenda, while their critics brand them as populist programs doomed to failure and economic destabilization.

A preliminary inspection of the recent economic performance of the region suggests that the macroeconomic policies put forward by the New Left governments to date are not the irresponsible populist public spending experiments that their critics describe.

Figure 1 indicates that during 2003-05, the performance of medium and large Latin American economies under left-of-center governments (with the exception of Venezuela) does not substantially differ from that of other medium and large economies in the region under governments with a right-of-center, or more centrist political orientation. During this period left-of-center governments have, on average, been somewhat more successful in sustaining a high rate of economic expansion, but much less so in achieving low rates of inflation. Note that the differences between both groups shrink noticeably if Venezuela is excluded. Particularly interesting is the fact that in these three years, the group of left-wing governments held tighter fiscal

Figure 1

Latin America: Comparative performance of left-of-center and other governments, 2003-05



Note: left-of-center governments include Agentina, Brazil, Chile, Uruguay (2005) and Venezuela; other governments include Bolivia, Colombia, Mexico, Peru and Uruguay (2003-04).
Source: Authors' elaboration based on data from ECLAC

positions than the other economies here considered. Indeed, independently of whether Venezuela is included or not, the former group registered an average fiscal deficit short of 1 percent of GDP, compared with an average over 3 percent for the other group. With the caveat that it is probably too early to draw firm conclusions, it seems that the New Left governments strictly observe fiscal prudence.

The case of Venezuela deserves a special comment to the extent that its fiscal position relies on oil revenues, though the same can be said of Mexico, where the oil sector contributes 33 percent of total public revenue. The fiscal situations of both countries are vulnerable and, unless additional sources of tax revenues are exploited, may become even more problematic if world oil prices decline significantly. In this event in particular, subsidies for food and health care for the poor in Venezuela may be subject to severe cuts.

To partially compensate for the adverse impact of high oil prices on consumers, many countries grant subsidies or set price controls on gasoline. In Argentina, the government has delayed the updating of utility rates, and set up agreements to impose price caps on a range of basic goods, including beef, to cut down inflation. These measures, however, may be ineffective in the medium run unless more stringent macroeconomic policies are implemented to slow down the expansion of the Argentine economy. After three years of growing at real annual rates of 9 percent or above, supply-side bottlenecks may be appearing that can be eliminated not by price controls but by imports and additional investment. Furthermore, the extraordinarily high rates of economic growth that both Argentina and Venezuela have experienced in the recent past will likely soon be dampened if they are to avoid destabilizing pressures and a surge of inflation.

A characteristic of the New Left's economic strategy is its marked effort to strengthen the margin of autonomy of macroeconomic policy by various means. One example is the reduction of public foreign debt. Argentina – against the advice of the IMF – negotiated with its foreign creditors and managed to restructure its external debt in the largest operation of its kind in history, obtaining a discount of 70 percent on close to US $100 billion. A second possible step, stressed by some New Left governments in mineral-rich countries, is to increase fiscal revenues, by renegotiating contracts with transnational companies on the distribution of rents from the exploitation of natural resources. Some of these countries have succeeded in increasing royalties and tax rates, though it is important to stress that a favorable view towards foreign direct investment generally prevails across the region. The aim is indeed to attract investment, albeit more selectively than in the past. Even Venezuela, which is trying to secure far greater direct control over oil production, stops short of expropriation. At the moment of writing it is unclear whether Bolivia will follow a similar line, or will decide to nationalize some companies.

The commitment to fiscal prudence has been accompanied in several countries by the adoption of inflation-targeting and floating exchange rates. Still others are attempting to reduce the extent of dollarization of financial systems, an unsurprising step given that currency mismatch was a prominent cause of the economic crises suffered by the Southern Cone in 1998-2002. These measures, together with a growing trend toward central bank independence, are enhancing the room for maneuver in monetary policy.

For fiscal policy to have the capacity to act in a counter-cyclical way, Latin America (on both sides of the political spectrum) needs comprehensive fiscal reforms to: 1) increase tax revenues as a proportion of GDP in at least 5 points above their current range of 10 percent-20 percent, and 2) implement a more progressive tax system that will affect income distribution. Some advances have been made, but fiscal reform has a long way to go. Recently adopted measures to tax exports of certain commodities and financial transactions will likely be only temporary fixes, soon abandoned to avoid their long-term distorting effect on production.

Another essential element in considering the adequacy of the New Left's macroeconomic policies is the extent to which the government interferes in wage settlements. While Uruguay and Argentina enacted some income policy measures to strengthen the purchasing power of low and middle income families, none of the new governments in the region has so far decreed an excessive hike in minimum wages. Such restraint may reflect the fact that policy makers are concerned more with creating jobs than with improving employees' earnings in formal labor markets. It may also reflect the recognition that, unless backed by increases in productivity, nominal raises in minimum wages may fuel inflation with no effect on real wages. In any case by 2005, with the exception of Chile, the real average earnings of workers in countries under left-of-center governments were still below those of 2000.

So far, radical measures to alter income and wealth distribution have not been included in the New Left agenda. In our view, they have been ruled out due to political and electoral constraints, and not to economic considerations. On the one hand, radical measures intended to achieve drastic, sudden changes in income and wealth distribution may weaken the business climate and alienate part of the electorate. Recall that, contrary to the old script, New Left governments took power accompanied not by the noise of bullets but by ballots in free elections. Consequently, these governments are more aware of the impact of their policies on the electorate than they were in the past. On the other hand, some of these governments are backed by coalitions of diverse political trends and sectors, coalitions that may be not be solid enough to support radical redistribution policies or fiscal reforms.

International relations are one area where the economic policies of the New Left governments depart from previous models, as virtually all left-leaning countries are moving toward greater independence from international financial institutions. Temporary agreements with the International Monetary Fund (IMF) on macroeconomic policy tend, in general, not to be renewed. Moreover, in a move that gained international prominence, Brazil and Argentina prepaid their outstanding debt with the IMF, seeking to minimize its leeway over government policy. Although its results have thus far been less than desired, regional integration is seen as a more attractive option for increasing commerce than bilateral trade agreements with the United States. Indeed, the Free Trade Area of the Americas (FTAA) project seems to have stalled. On the multilateral front, in contrast with the passivity in previous rounds, the New Left governments play an increasingly active role. Brazil's leadership in the Doha Round, coupled with the intransigence of some developed countries in eliminating agricultural subsidies and trade protection, was instrumental to enable developing countries to temporarily derail the Cancún Ministerial Conference.

Exogenous Risks: The Global Imbalances

There are two scenarios considering the impact of the world economy on the performance of these governments' novel policies. The first is characterized by an extension of the status quo, with the US and Chinese economies and world trade expanding at relatively high rates. This scenario downplays the likelihood of major adverse external shocks in the region, thus concluding that macroeconomic policies will not be particularly challenged. The major problems they will face are rather predictable. As the boom in commodity prices continues, governments in the Southern Cone will be pressed to avoid an appreciation of the real exchange rate that would crowd out manufacturing exports. The whole region will keep trying to meet the challenge presented by China in international markets, by finding ways to boost production of tradable goods and value-added services, as well as of commodities and inputs that the Chinese market demands.

An alternative scenario assumes that the imbalances in the US economy become unmanageable. In this case, the Latin American economies will be pressed to accommodate a fast depreciation of the dollar, a slowdown in GDP growth, and a likely increase in interest rates. This adverse external shock will pose a major challenge for macroeconomic policymaking, with countries fighting to avoid acute destabilization and recession.

Conclusions

With the exception of Chile's Concertación, New Left governments in Latin America are recent arrivals on the policymaking arena. Assessing and predicting the future course of macroeconomic policies is thus of a partial and preliminary nature.

With this caveat, the New Left's policies are apparently not in a populist, free-spending mode that seems to ignore budgetary constraints. On the contrary, New Left governments have shown strong fiscal prudence mixed with increasing state intervention in economic affairs.

If one poses the issue in terms of the tradeoff between inflation and economic growth, the New Left governments seem inclined to accept – within limits – higher inflation so long as it is accompanied by higher rates of economic growth. They have been very successful in pulling their economies out of deep recession, and register high rates of expansion. Whether they will be able to sustain such high rates of economic growth and preserve price stabilization in the medium term is yet to be seen. In any case, they emphasize the need for macroeconomic policies guided by development goals and not by price stabilization. But, in practice, their approach to achieving key social goals – poverty alleviation, income redistribution – has been gradual. They have not implemented high-impact social measures that run the risk of triggering large fiscal imbalances and debt spirals. Trade liberalization measures have not been rolled back. The starkest innovations on policy matters concern relations with international financial institutions and some transnational corporations.

It seems safe to say that macroeconomic policy seeks to provide a stable framework, given the volatility of the recent past, and a reduction of vulnerability to external shocks. To achieve a greater degree of freedom in macroeconomic policymaking, governments have lowered public debt ratios, rescheduled public debt maturity structures, issued bonds denominated in local currency, and, most notably, run high primary fiscal surpluses to improve debt sustainability.

The constraints that Latin American governments – left-wing and center/right-wing – face are formidable. Radical, drastic changes in macroeconomic policies are likely out of question given the weakness of public sector revenues and the commitment to trade liberalization and the free movement of capital flows. Nevertheless, certain changes in the composition of public expenditure, as well as in policies to promote innovation and to develop specific sectors, could lead to very different and positive outcomes in the medium term. Governments concerned with employment prospects will most likely avoid persistent appreciations of the real exchange rate in order to stimulate employment creation in export-oriented sectors.

Perhaps the main risk today is having a big gap between what is expected from the New Left governments in terms of social and economic development and what they will actually achieve. A large credibility gap may undermine support for New Left governments, and lead society to push for more radical – left-wing or right-wing – governments. In our view, the Left today in Latin America is in the process of building a new paradigm of economic development policies. Whether it will succeed in doing so is unclear. In other words, and contrary to the opening statement in the title of this essay, the New Left macroeconomic policies seem to be more a case of "new wine in new bottles". Whether this wine will age gracefully and have a rich and memorable taste or, on the contrary, sour and decay is too early to know.

Table 1: Latin America: Macroeconomic indicators of selected countries

	GDP growth rate, percent				Inflation rate, percent				Fiscal balance (percent GDP)			
	2000	2003	2004	2005	2000	2003	2004	2005	2000	2003	2004	2005
Argentina	-0.8	8.8	9.0	8.6	-0.7	3.7	6.1	12.0	-2.1	0.3	2.0	1.3
Bolivia	2.5	2.8	3.6	3.8	3.4	3.9	4.6	5.0	-3.9	-7.9	-5.7	-3.5
Brazil	4.4	0.5	4.9	2.5	6.0	9.3	7.6	6.2	-3.1	-2.5	-1.3	-1.7
Chile	4.5	3.7	6.1	6.0	4.5	1.1	2.4	3.6	-0.6	-0.4	2.2	3.4
Colombia	2.9	4.3	4.0	4.3	8.8	6.5	5.5	5.1	-5.4	-4.7	-4.3	-5.5
Mexico	6.6	1.4	4.2	3.0	9.0	4.0	5.2	2.9	-1.3	-1.1	-1.0	-1.2
Peru	2.9	4.0	4.8	6.0	3.7	2.5	3.5	1.1	-2.8	-1.8	-1.3	-1.2
Uruguay	-1.4	2.2	12.3	6.0	5.1	10.2	7.6	4.8	-3.5	-4.6	-2.5	-2.5
Venezuela	3.7	-7.7	17.9	9.0	13.4	27.1	19.2	15.3	-1.7	-4.4	-2.0	-1.5

Source: Authors’ elaboration based on official data from ECLAC