

Reforms, Populism, and the Commodities Boom

Angel Alvarado,¹ Fernando Arteaga,¹ Jesús Fernández-Villaverde,¹ and Ivan Luzardo Luna¹

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¹University of Pennsylvania

Reforms

Debt crisis as a critical juncture

- The central role of the state in Latin America's economies is revisited:
 1. By the growing awareness that the export sector was too small and insufficiently dynamic to finance the increase in debt service payments.
 2. By the decline in capital flows to state-owned enterprises (SOEs).
 3. By the emerging consensus favoring market-oriented policies and a smaller state.
- The emergence of a new growth model:
 1. Trade was liberalized.
 2. Financial markets were deregulated.
 3. Public Enterprises began to be offered for sale to the private sector.

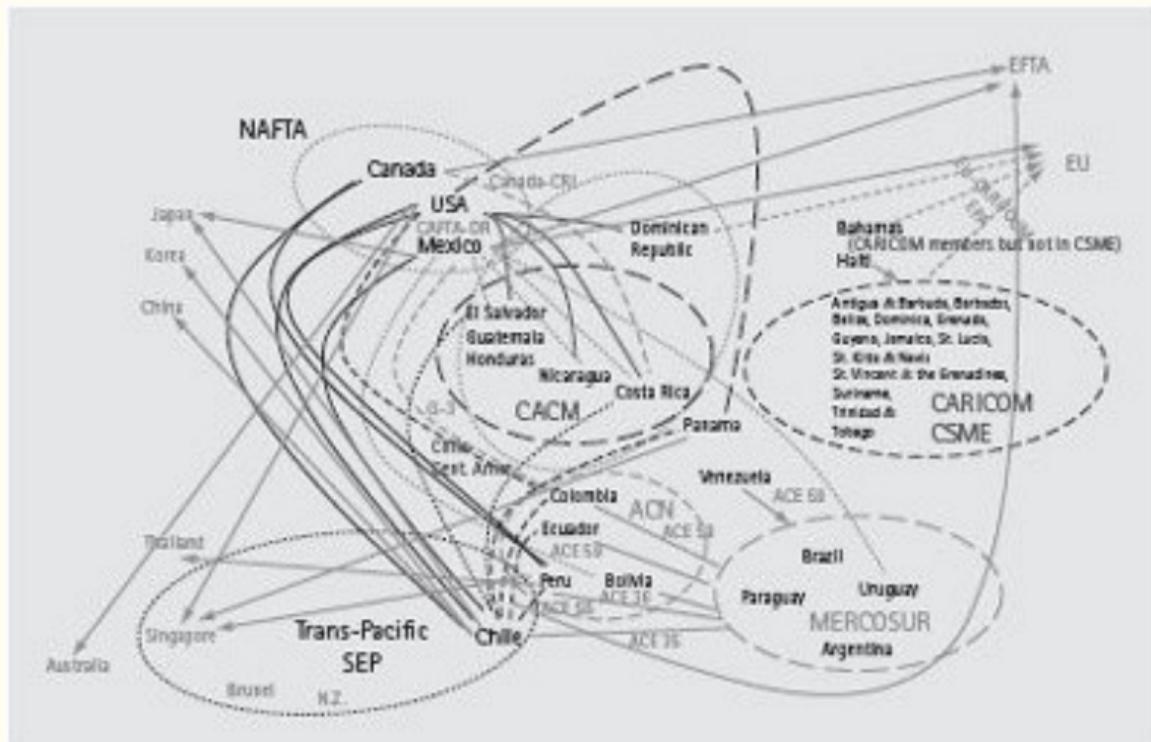
A changing international landscape

- End of the cold war.
- The war on drugs replaces communism in U.S. foreign-policy priorities.
- Latam is in the middle of this adjustment process when the world economy entered a new phase known as globalization or reglobalitazion.

The Washington consensus, I

- Listed a series of reforms supported not only by the international financial institutions in Washington but also by political-economic elites in Latin America.
- First stage (first half of the 1990s): trade and financial market liberalization, easy to implement.
 1. MERCOSUR (1991), Caribbean Community (1992), NAFTA (1993), FTAA (1994), Andean Pact (renamed the Andean Community) in 1995
 2. The best industrial policy is not to have an industrial policy.
- Second stage (Asian financial crisis in 1997): concentrating on the rule of law, the quality of institutions, and microeconomic reforms, which are much more difficult to implement.
 1. Weak states whose jurisdiction and enforcement capacities have remained weak.
 2. Open to traditional capacity-draining activities, such as rent-seeking and moral hazard.
 3. Growth of high-stakes politics.

The proliferation of trade agreements in the Americas

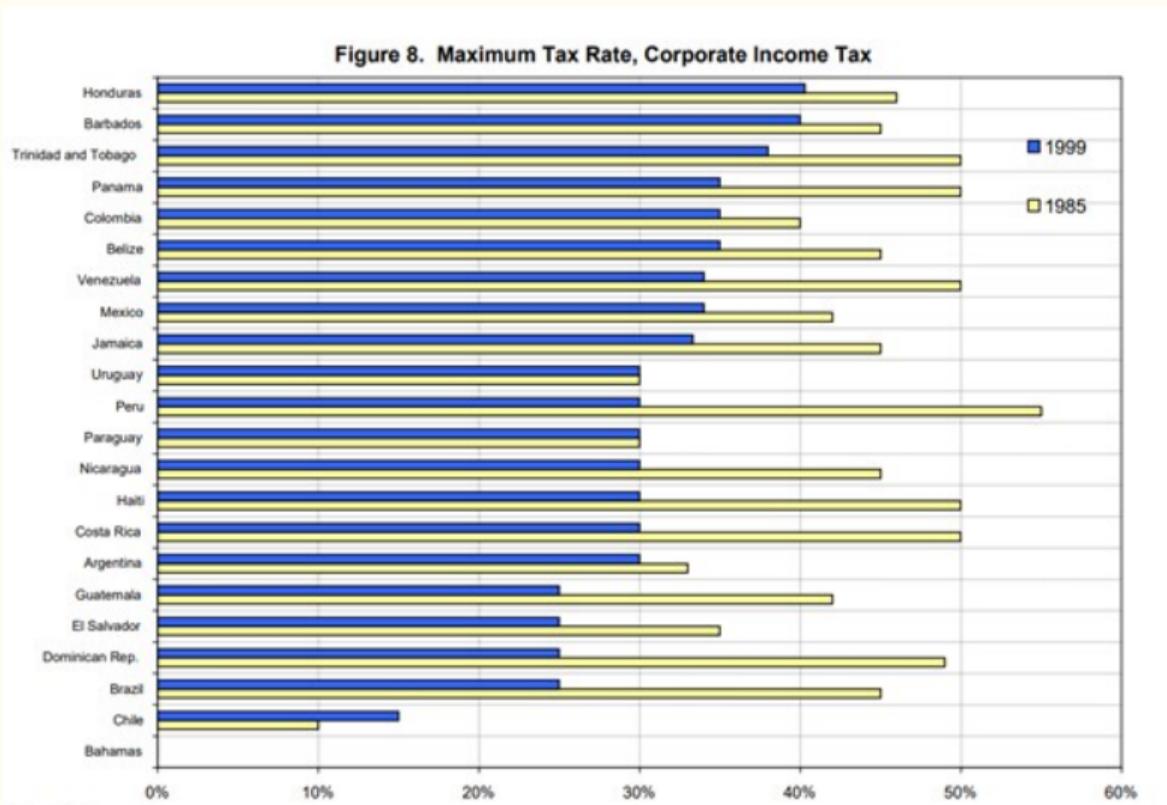


Source: IDB, Integration and Trade Sector (INT).

The Washington consensus, II

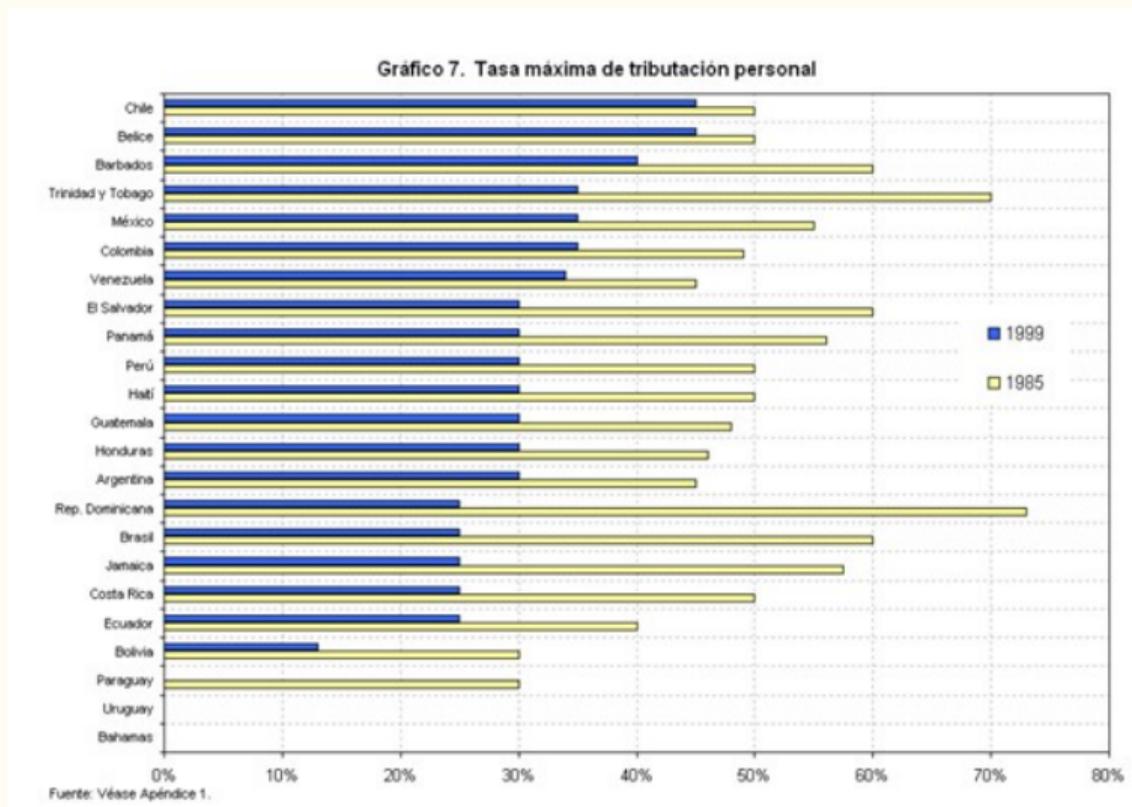
- The Washington consensus highlights the importance of fiscal discipline.
 1. Reducing expenditures rather than increasing tax revenues.
 2. Three major expenditure categories on which views are firmly held: subsidies, education and health, and public investment.
 3. Subsidies, especially indiscriminate ones (including those covering state enterprises' losses), are prime candidates for reduction or elimination.
- Interest rates should be market-determined: real interest rates should be positive, to discourage capital flight and increase savings.
- Outward orientation and expanding exports—essentially growth in nontraditional exports—and import liberalization.

Decrease in corporate tax rate



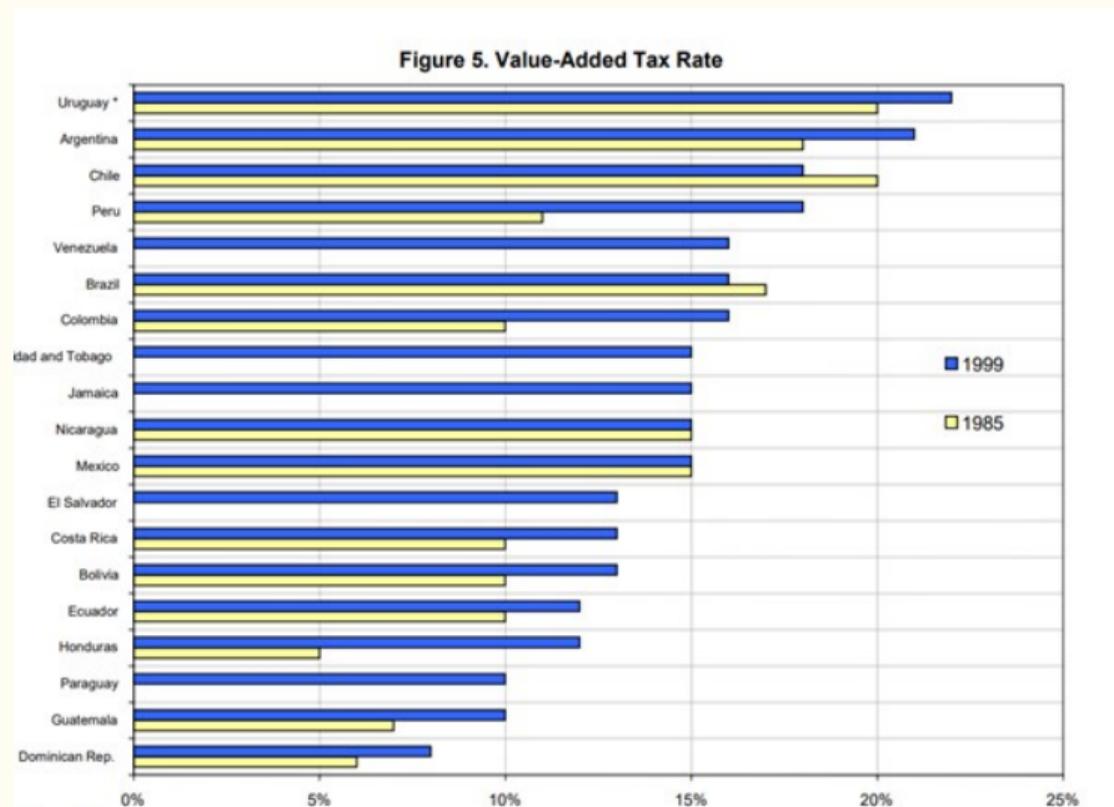
Source: Lora (2001)

Decrease in individual tax rate



Source: Lora (2001)

Increase in value added taxes rate

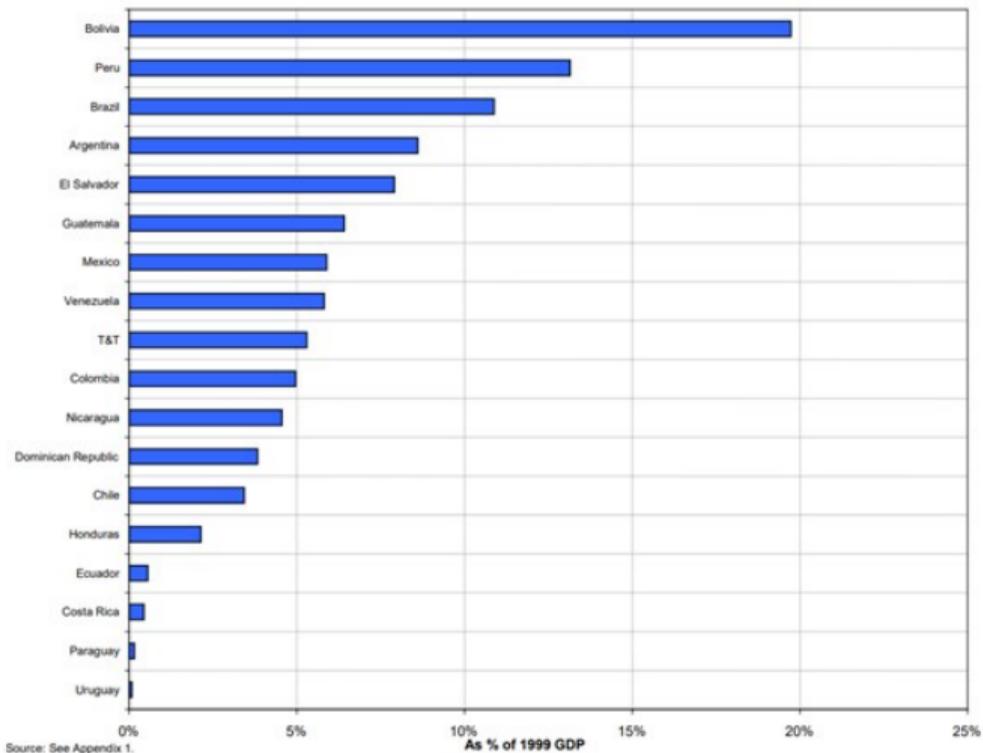


Source: Lora (2001)

The Washington consensus, III

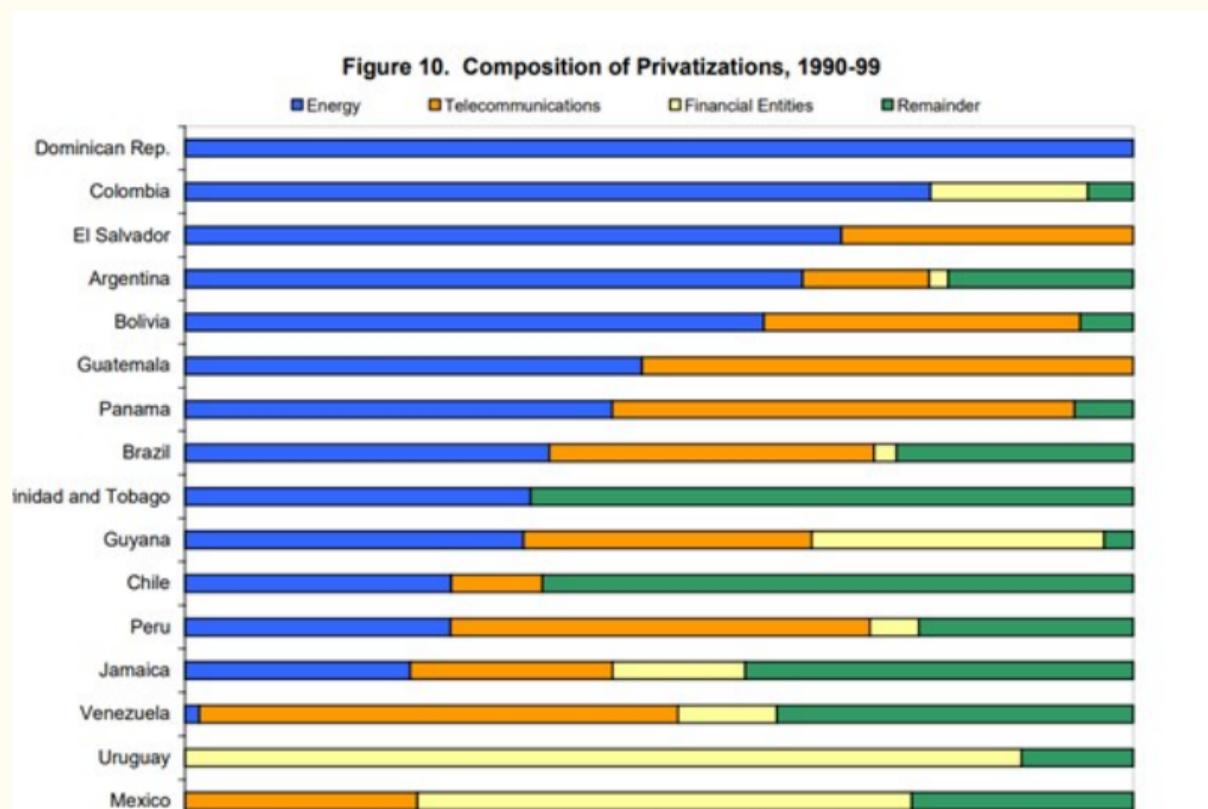
- A restrictive attitude limiting foreign direct investment (FDI) entry is considered foolish.
- The primary rationale for privatization is the belief that private industry is managed more efficiently than state enterprises.
- Promoting competition by deregulation.
- Economic policies suggested by Washington may be summarized as prudent macroeconomic policies, outward orientation, and free-market capitalism.

Figure 9. Privatizations: Cumulative Value, 1988-1999



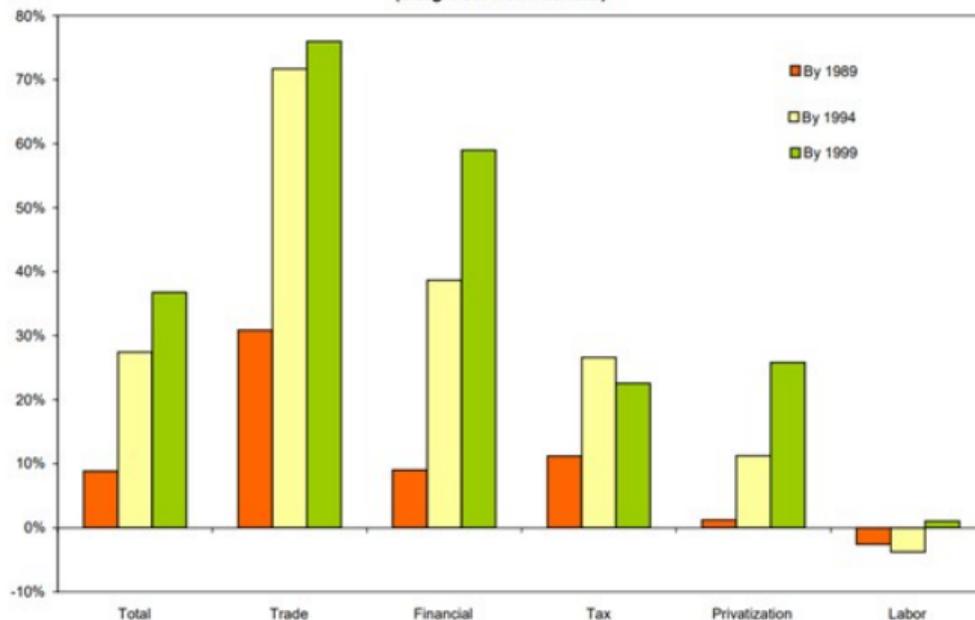
Source: Lora (2001)

Compositions of privatizations



Source: Lora (2001)

Figure 14. Advance of Reforms in Latin America
(margin of reform utilized)



Note: The advance of the reforms is measured as the margin for reform existing in 1985 that has been utilized by 1989, 1994 and 1999.
Source: See Appendix 1.

- Several central banks in the region succeeded in reducing inflation but failed to restore full confidence in their domestic currencies.
- Certain distortions endure. A high level of financial dollarization follows.
- Central banks experience “fear of floating.”
- Central Banks maintain high volumes of international reserves to tackle potential speculative attacks and banking crises.

Figure 7

A. Inflation rate in Latin America (CPI, annual percentage change)

A. Median

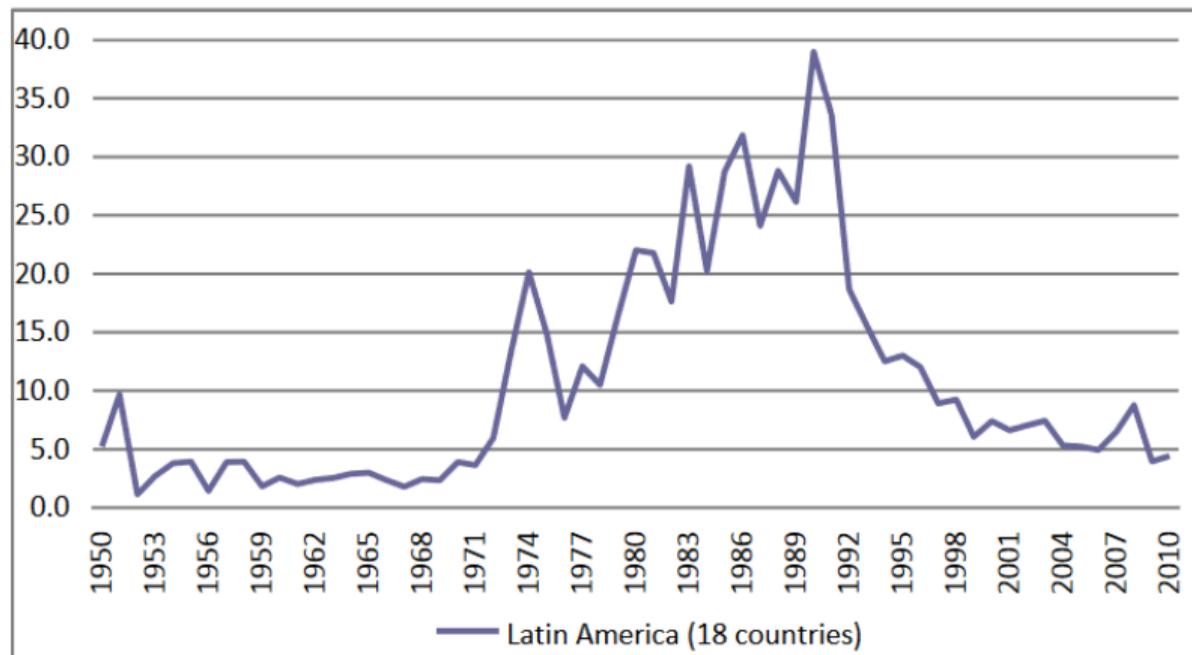
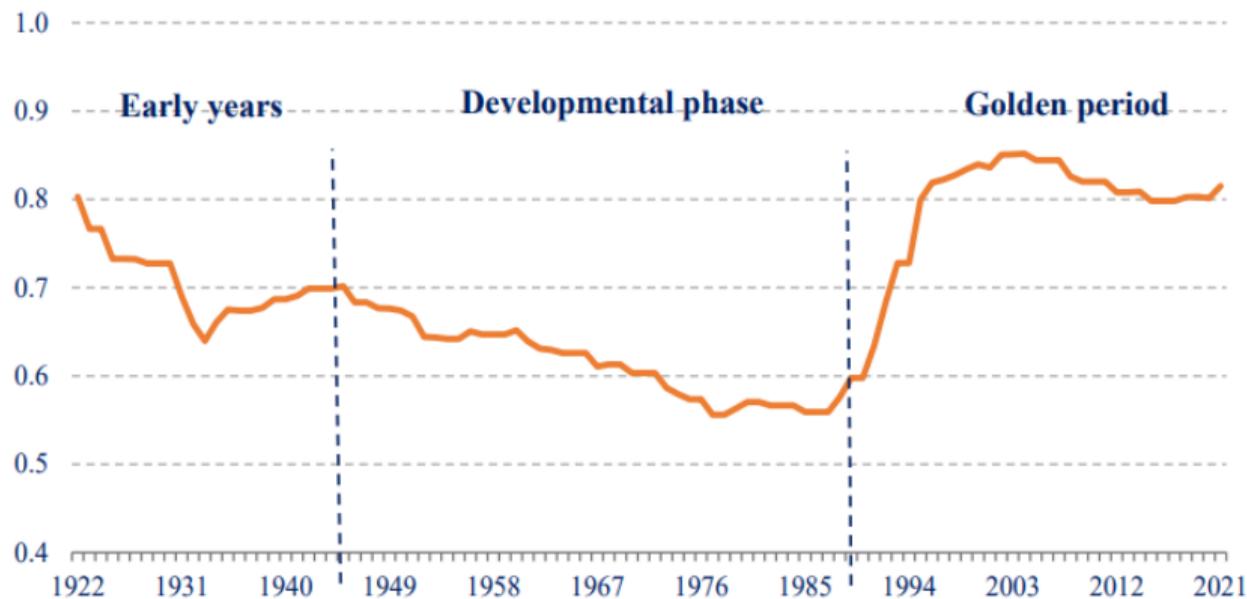


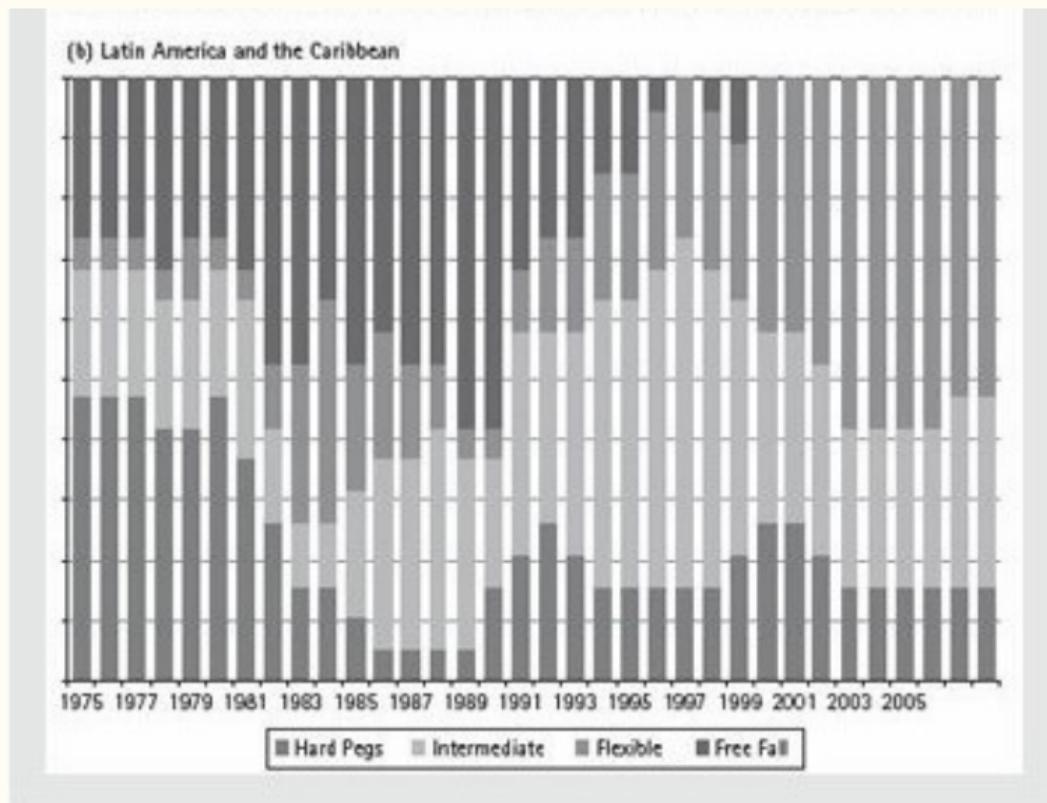
Figure 1: 100 years of central bank independence
(Average CBI index, 1922 – 2021. All Latin America, except Panama)



Source: Central bank legislation (central bank laws and reforms, and relevant constitutional provisions)

Source: Lora (2001)

Exchange rate regime in Latin America



Source: García-Silva and Marfán (2011)

Fujishock: market reforms and classical populism in Peru



The new free trade

- Support structural reforms vs. import substitution industrialization.
- Attract FDI vs. controlling or limiting it.
- Promote regional competition vs. limiting regional integration.
- Politic-led process vs. bureaucracy-led process.
- Market-based vs. industrial planning.
- Support democratic regimes only.
- Reduce protections.

Public opinion about trade liberalization (1998)

A summary of Latin Americans' opinions about trade liberalization

	%
Beliefs about the impact of free trade (1998) ^a	
Very good	37.3
Somewhat good	40.9
Somewhat bad	9.4
Very bad	4.6
No response	7.9

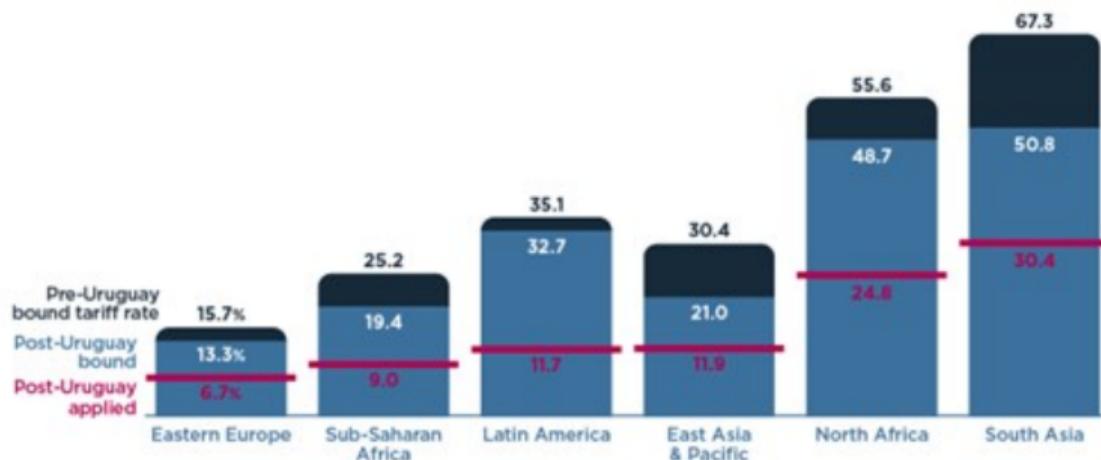
Source: Ferraz, Mortimore, and Tavares, 2012; Latinobarometro

Tariff reductions by regions

Figure 2

Developing economies set tariffs below their obligations under the Uruguay Round

Bound tariff reductions in Uruguay Round and applied tariffs in developing economies, percent



Note: Developing economies defined using World Bank classification.

Source: Finger, Ingco, and Reincke (1996).

Tariff reductions by source

Figure 1

Developing economies undertook most tariff reductions unilaterally between 1983 and 2003

Average applied tariff rate in developing economies and reductions by source, 1983 and 2003, percent

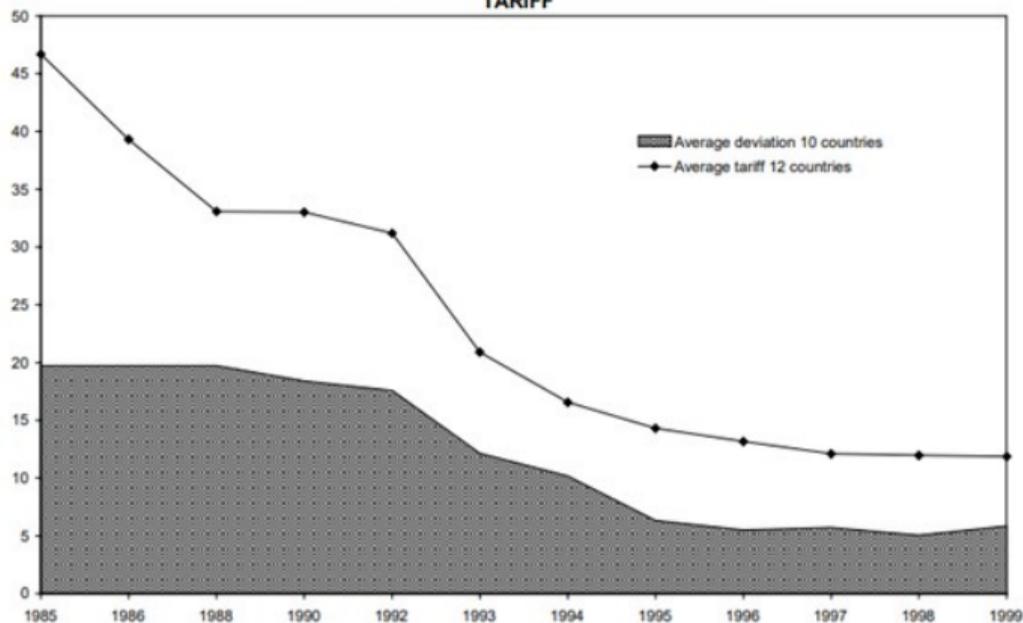


pp = percentage point

Note: Developing economies defined using World Bank classification.

Source: World Bank (2005, 42), based on Martin and Ng (2004).

Figure 1. Tariff Liberalization, Latin America
TARIFF

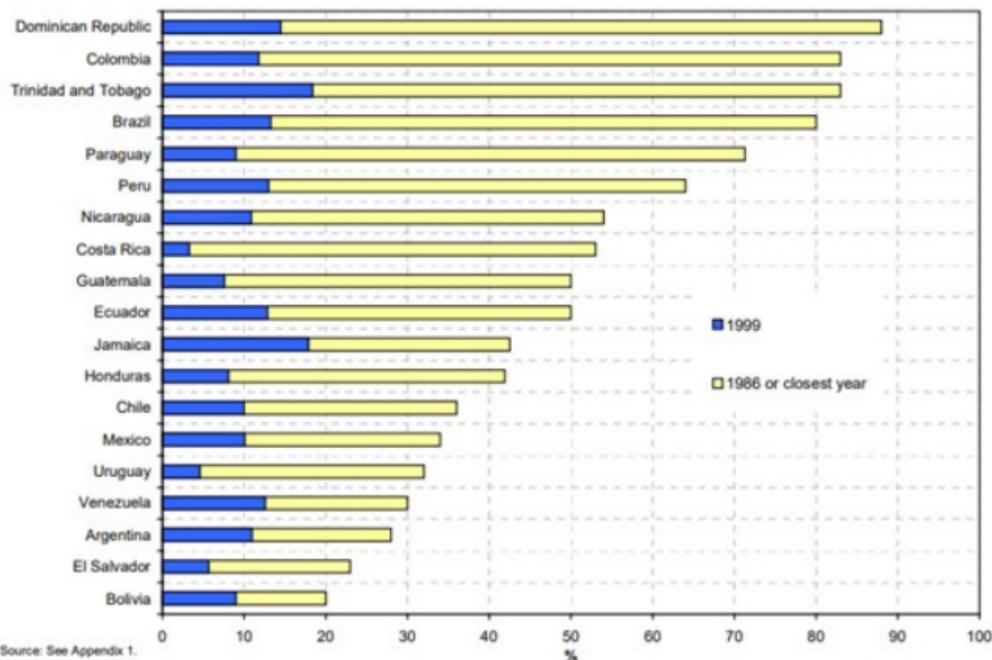


Note: The average of twelve countries includes Argentina, Bolivia, Brasil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela. In calculating the deviation, Costa Rica and Guatemala are excluded for lack of data. The value of the tariff deviation for 1985 is assumed to be the same as that of the next year.

Source: See Appendix 1.

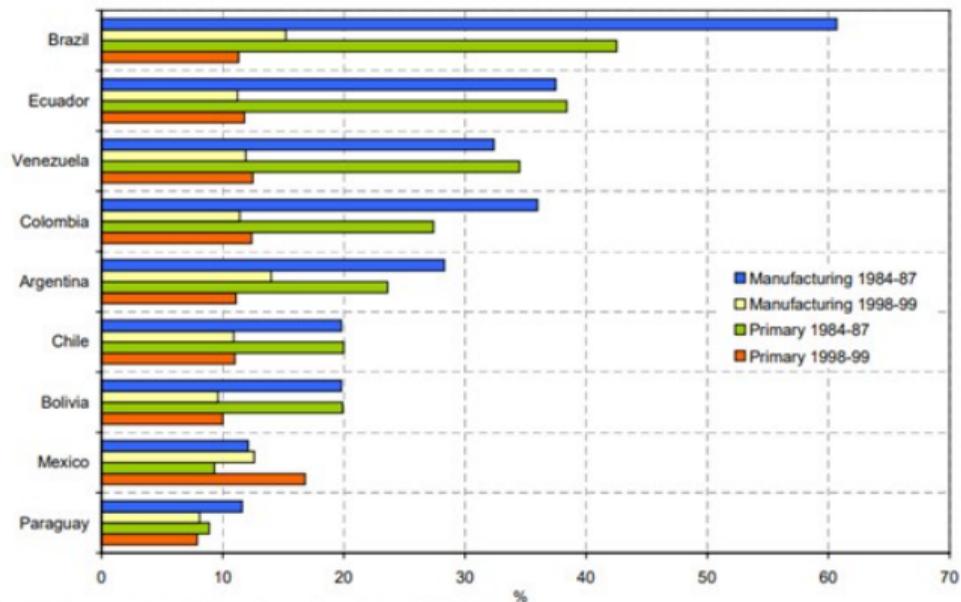
Tariff liberalization by country

Figure 2. Tariff Reduction in Latin America, 1999 vs. 1986



Tariff liberalization by sector

Figure 3. Tariff Structure by Type of Good



Source: World Development Indicators (2000) and Directory of Import Regimes, UNCTAD (1994).

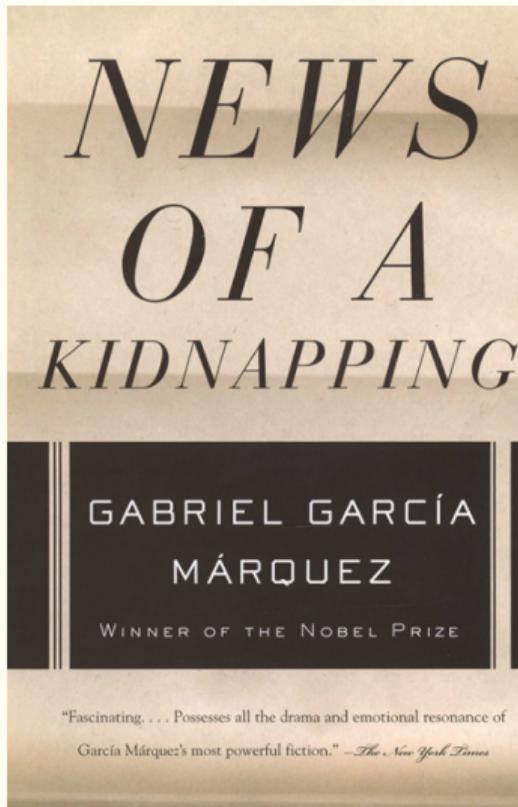
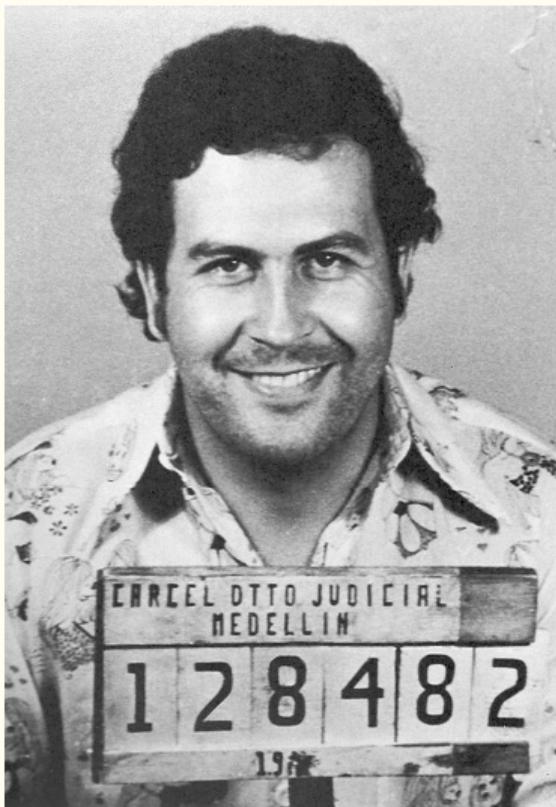
Table 6. Latin American Economic Performance
(1980–2003. In percentages)

	1980–1989	1990–1995	1996–2003
Per capita real GDP growth	-0.14	0.89	0.85
Inflation rate (period average)	149.19	227.85	9.93
Exports (volume growth rate)	8.01	8.24	8.99
Current account / GDP	-2.21	-2.20	-2.44
Fiscal balance / GDP	-3.79	-0.68	-2.63
External Public Debt / GDP	46.86	38.44	40.09

Source: Western Hemisphere Department, International Monetary Fund.

1/ Includes the Caribbean countries.

The only booming multinational industry ever created by Latin Americans



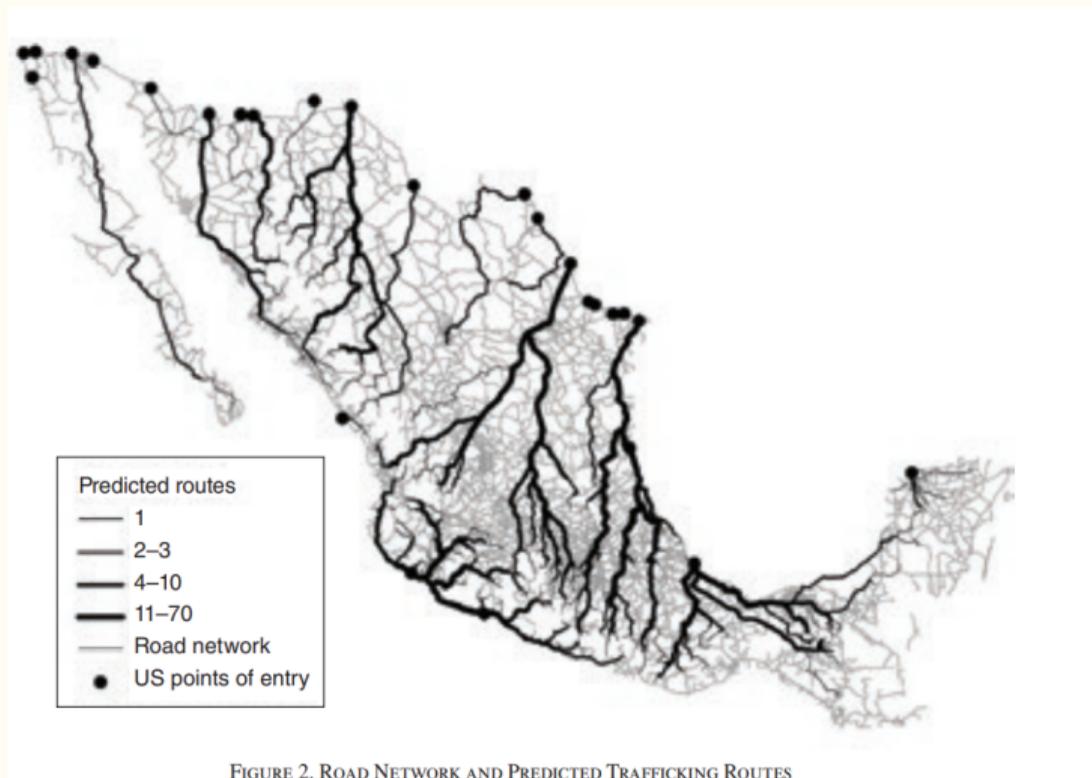


FIGURE 2. ROAD NETWORK AND PREDICTED TRAFFICKING ROUTES

Source: Dell (2015)

- Over 85% of the total drug-related murders.
- Mexican drug traffickers dominate the wholesale illicit drug market in the U.S., earning between \$14 and \$48 billion (2009).
- 90% of the cocaine consumed in the U.S. transits through Mexico (US Drug Enforcement Agency).

The Tequila Crisis (1994)

- In 1988, President Carlos Salinas de Gortari launched a major economic reform program to modernize Mexico's economy.
 1. The opening of the economy to international competition through a profound reduction of import tariffs and an eventual free trade agreement with the U.S.
 2. A privatization and deregulation process covering most sectors except oil, gas, and energy.
 3. A stabilization program aimed at controlling inflation. This program was based on maintaining a strict link between the value of the peso and the U.S. dollar.
 4. A broad social and economic agreement between the government, the private sector, and labor unions—known as the Pacto de Solidaridad Económica, or Pacto—aimed at controlling the rate of increase of wages and prices.

The Mexican miracle: A mirage?



A sudden stop

Sebastian Edwards:

The Mexican stabilization program succeeded in reducing inflationary inertia but not in eliminating it. As a result, inflation declined slowly, and throughout the early 1990s, local prices and costs increased at a faster pace than international prices. With the value of the currency almost fixed relative to the U.S. dollar, Mexico's international competitiveness gradually declined (...)

The resulting surge in capital inflows allowed the country to finance an increasingly large current account deficit, the broadest measure of a country's external transactions. From 1992 through 1994, this deficit averaged almost 7 percent of the gross domestic product, a level that many economists would find dangerously high. Because government finances were under control and the incoming funds were of a private nature, a number of analysts, especially senior Mexican officials, were persuaded that although these flows were very large, they were not a cause for concern.

Rudi Dornbusch (1942-2002)

Exchange rate-based stabilization goes through three phases: The first one is very useful. . . . [It] helps bring underway a stabilization. . . . In the second phase increasing real [currency] appreciation becomes apparent, it is increasingly recognized, but it is inconvenient to do something. . . . Finally, in the third phase, it is too late to do something. Real [currency] appreciation has come to a point where a major devaluation is necessary. But the politics will not allow that. Some more time is spent in denial, and then –sometime– enough bad news piles up to cause the crash.

In a 1998 document, the IMF said:

[I]t is questionable whether a freely floating exchange rate and an inflation target objective for monetary policy are feasible, advisable or fully credible for many developing and transition economies.

Carlos Menem (1930-2021) and Fernando Henrique Cardoso (1931-)



The Washington consensus: putting the country in the driver's seat

- Interpreted as a political imposition by Washington.
- “Washington Consensus” has come to be used to describe an extreme and dogmatic commitment to the belief that markets can handle everything.

Joseph Stiglitz critique

But what is disturbing to me is not that such decisions have been made, but that in many countries they have been made without adequate democratic debate.

El Caracazo (1989)



Why did the Washington consensus fail?, I

- Some alternative explanations:
 - Insufficient commitment to the original reform agenda. More liberalization was needed.
 - The agenda of market liberalization and strong macroeconomic frameworks was laudable but incomplete. It should have been complemented with a “second generation” of reforms based on strengthening domestic institutions and more active social policies.
 - Some of the basic assumptions of the liberalization process were wrong; thus, the first generation of reforms may have created some of the problems Latin America faces today. It is necessary to “reform the reforms.”
 - Lack of consideration of the role of institutions and local specificity of Latin America.

Moises Naim

What was implemented was usually an incomplete version of the model. Its results were quite different from what politicians promised, the people expected, and the IMF and the World Bank's econometric models had predicted.

Why did the Washington consensus fail?, II

- The Washington Consensus policies were oriented towards achieving efficiency, not equity.
- Social issues did not figure prominently on the initial market reform agenda.
- The view that development must be market-based has also endured in Latin America and throughout the developing world.
- IMF and the World Bank made their loans conditional on adopting consensus-inspired policy reforms.

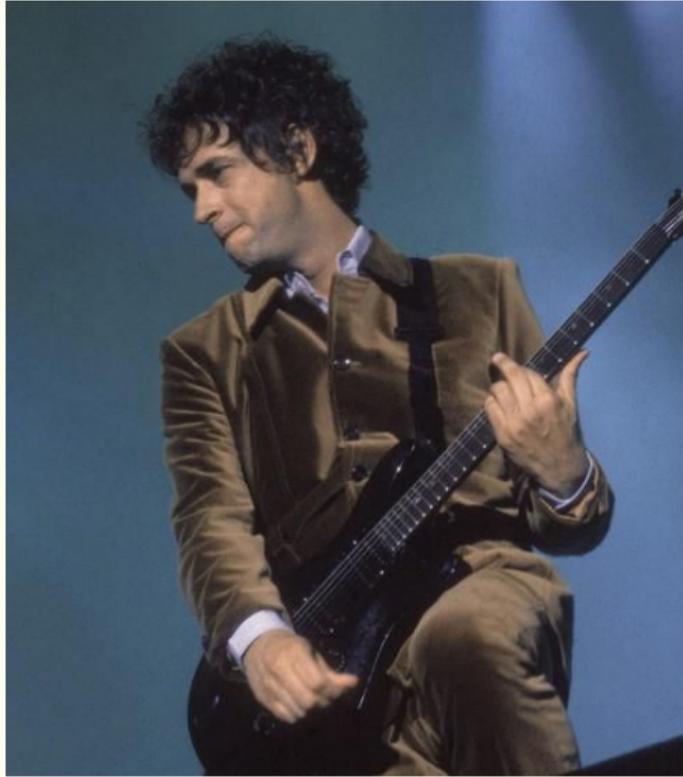
The mother of all crisis: Argentina (2001-2002), I

- President Carlos Menem enacted the so-called Convertibility Law. Its central feature was pegging the value of the domestic currency—originally the Austral and later the peso—to the U.S. dollar at parity.
- Argentina, however, did not maintain a prudent fiscal policy during 1991-2001.
- In the early 1950s, James E. Meade pointed out that countries that gave up exchange-rate flexibility and opted to peg the value of their currency to that of another country had to have very flexible labor markets.

Joseph Stiglitz

Suddenly Argentina's fortunes changed. The precipitating event was the East Asian crisis of 1997, which by 1998 had become a global financial crisis. Global interest rates to emerging markets soared. The strong dollar compounded these problems; since the Argentine peso was tied to the dollar, it was increasingly overvalued."

Meanwhile in Argentina: Ultimo concierto (1997) and Boca (2000)



The mother of all crisis: Argentina (2001-2002), II

- On December 20, 2001, after a week of riots and political unrest, Fernando de la Rúa, Argentina's constitutional president, resigned from office.
- A few weeks later, Argentina defaulted on its foreign debt.
- The peso, pegged to the U.S. dollar at parity for over a decade, lost two-thirds of its value.
- In four weeks, the country went through five presidents.
- This is one of modern history's most traumatic currency crises.

Sebastian Edwards

In many ways, Argentina epitomizes Latin America's historical proclivity toward macroeconomic instability, trade imbalances, and costly crises. The implosion of the Argentine economy in 2001-2 has become one of the most important arguments against globalization, market reforms, and so-called neoliberalism maintaining the peg even in the absence of supporting fiscal and other key policies

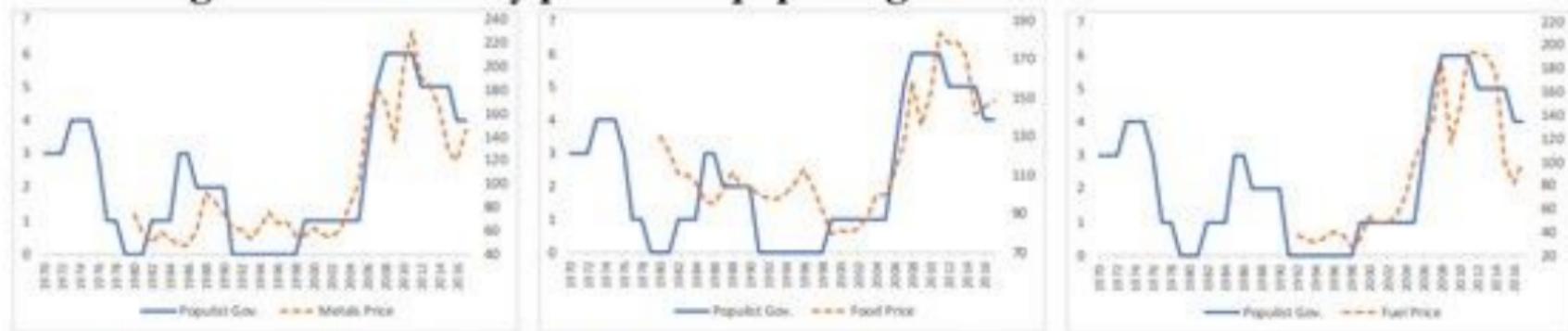
The Commodities boom and populism

Table 1. Populist Events

Event	Country	Period	Source
Perón	Argentina	1973-76	Dornbush-Edwards
Vargas	Brazil	1951-54	Dornbush-Edwards
Goulart	Brazil	1961-64	Dornbush-Edwards
Sarney	Brazil	1985-90	Dornbush-Edwards
Allende	Chile	1970-73	Dornbush-Edwards
Echeverría	Mexico	1970-76	Dornbush-Edwards
Velasco	Peru	1968-75	Dornbush-Edwards
Belaúnde	Peru	1963-68	Dornbush-Edwards
García	Peru	1985-90	Dornbush-Edwards
Pérez	Venezuela	1974-78	Dornbush-Edwards
Collor	Brazil	1990-92	De la Torre
Menem	Argentina	1989-99	Team Populism, Casullo, and De la Torre
Fujimori	Peru	1990-2000	Casullo and De la Torre
Morales	Bolivia	2006-18	Team Populism, Casullo, Edwards, and Finkelstein
Correa	Ecuador	2007-17	Team Populism, Casullo, Edwards, and Finkelstein
Ortega	Nicaragua	2007-17	Team Populism, Edwards, and Finkelstein
Alan García	Peru	2006-11	Team Populism
Chávez-Maduro	Venezuela	1999-2018	Team Populism, Casullo, Edwards, and Finkelstein
Fernandez de Kirchner	Argentina	2007-15	Casullo, Edwards, and Finkelstein

Commodity prices and populism

Figure 2. Commodity prices and populist governments in Latin America.



Source: authors' calculations based on Hawkins (2009) and WEO (Gas Live).

Source: Magud and Spilimbergo, 2021

Table 2. Duration of Populist Regimes—Past and Present

Past events		Recent events	
Episode	Duration (years)	Episode	Duration (years)
Perón (ARG), 1973-76	3	Fernández de Kirchner (ARG), 2007-15	8
Vargas (BRA), 1951-54	3	Morales (BOL), 2006-19	13
Goulart (BRA), 1961-64	3	Correa (ECU), 2007-13	10
Sarney (BRA), 1985-90	5	Ortega (NIC), 2007-13	6
Allende (CHL), 1970-73	3	Chavez-Maduro (VEN), 1999-19	20
Echeverría (MEX), 1970-76	6		
Velasco (PER), 1968-75	7		
Belaúnde (PER), 1963-68	5		
García (PER), 1985-90	5		
Pérez (VEN), 1974-78	4		
Collor (BRA), 1990-92	2		
Menem (ARG), 1989-99	10		
Fujimori (PER), 1990-00	10		
Average	5.1		11.4
Standard deviation	2.6		5.5

Source authors' calculations.

The new wave of populism

- The economic policies of the second wave focused on market-friendly reforms, presented as necessary to eliminate previous corruption and inefficiencies under the umbrella of the Washington Consensus.
- The third wave of populism in Latin America occurred in the late 1990s when the “pueblo” was described as suffering from the economic and social consequences of “neoliberal” policies.
- Examples of these regimes include Chávez/Maduro in Venezuela, Correa in Ecuador, and Ortega in Nicaragua.
- It led to a far larger increase in the size and role of the State in the economy. Especially in the energy sector.

Populism and ideologies

- Populist rhetoric may be related to a nationalist ideology (as is often the case in contemporary Europe), or it can be linked to a leftist ideology that emphasizes income redistribution (as is often the case in Latin America).
- Not all governments labeled populist by the political science literature implemented unsustainable economic policies (e.g., Bolivia between 2006 and 2019).
- Several countries took advantage of the commodity super-cycle during the early 2000s, implementing social policies that were macroeconomically sound (e.g., “Bolsa Familia”).
- Only two established left-wing parties had remained steadily in the opposition during the era of market reforms: the Brazilian Workers’ Party (PT) and the Uruguayan Broad Front.
- Free from the blame for economic pains, they gave voters who felt disillusioned with market-oriented reforms a fresh but institutionalized place to turn.

Luis Inázio Lula Da Silva (1945-)

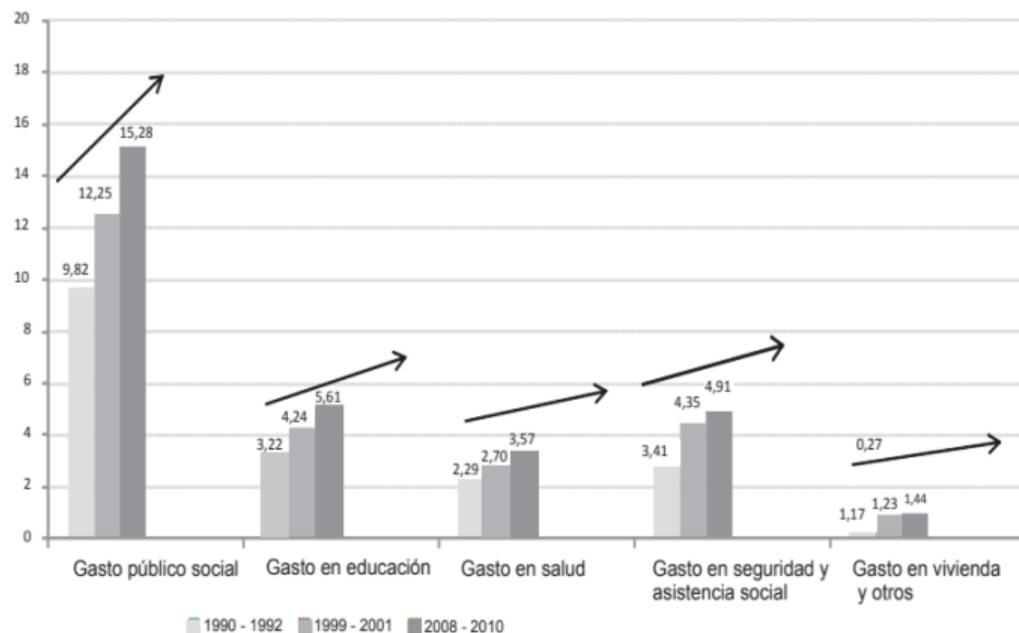


The temptations of rentier populism

- The commodities boom threw three temptations in the path of South American presidents:
 1. The “urge to expropriate temptation”: maximize the government’s rents due to the massive natural resources windfall.
 2. The “populist temptation:” to use the new income to boost short-term consumption rather than long-term investment. Temptation is tough for presidents to resist during election years.
 3. The “absolutist temptation:” usually comes to presidents who had succumbed to the first two temptations.

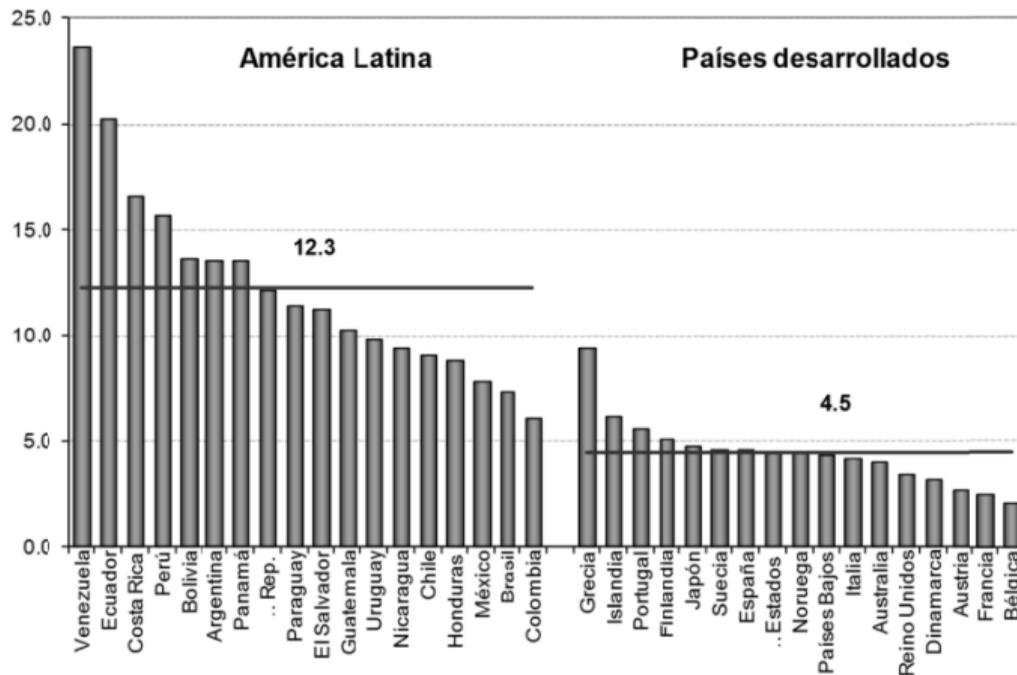
- In 2001, the two-year-old Chávez administration decided that Venezuela's state-owned oil company, PDVSA, should be the majority shareholder in all the country's oil fields.
- That decision affected 33 multinational companies with operations in the Orinoco Basin.
- A year later, Chávez raised royalties on private oil companies from 1% to 30% and hiked their taxes from 34% to 50%.
- A 2007 presidential decree raised the floor of PDVSA's share in exploitation joint ventures from 51% to 78%.
- Increased state control over oil rents allowed the creation of the so-called Bolivarian Missions, which comprised the institutional centerpiece of Chávez's strategy for incorporating the informal sector into his coalition.

Gráfico 11: América Latina y el Caribe (21 países): evolución del gasto público social según sectores, 1990-1992 a 2008-2010 (En porcentajes del PIB)



Fuente: "CEPALSTAT" (CEPAL 2012)

Gráfico 16: América Latina y países desarrollados: volatilidad de los ingresos tributarios (sin seguridad social, desviación estándar)



Fuente: Jiménez y Kacef (2011)

Hugo Chávez (1954-2013)



Expropriations and radicalizations

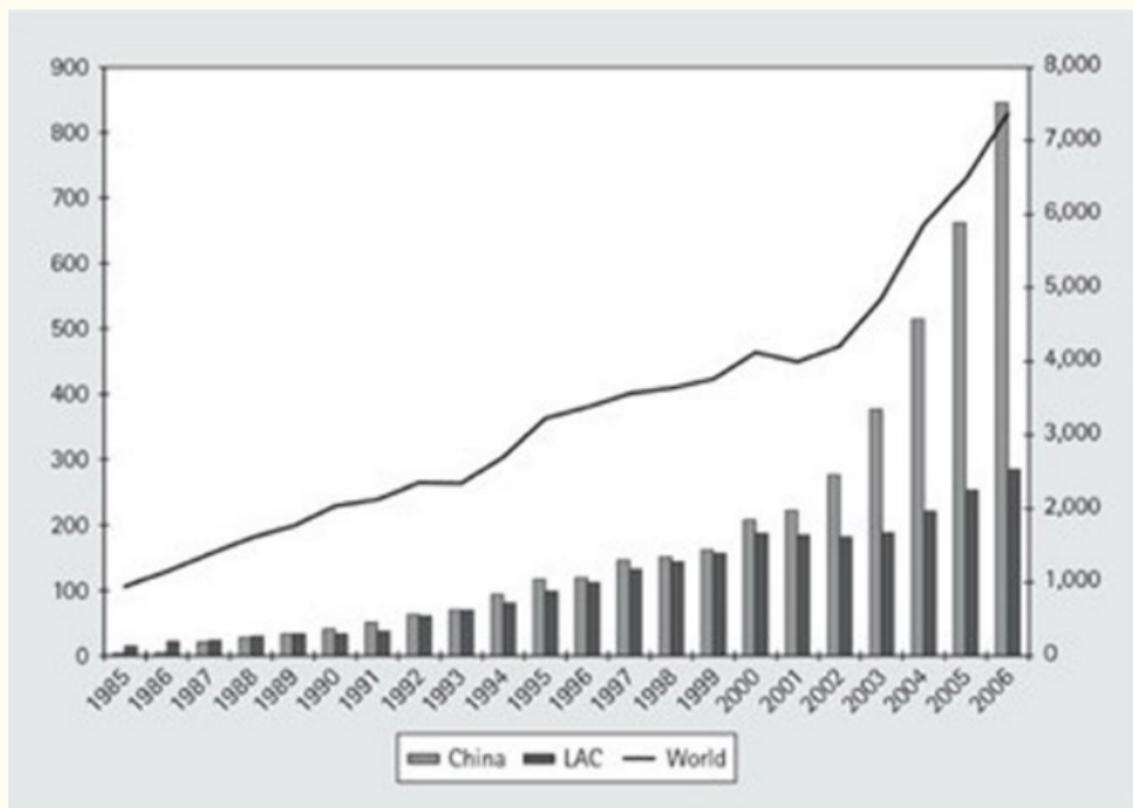
- In Bolivia, Morales nationalized the country's hydrocarbon resources four months after assuming the presidency. In a primarily symbolic action, he sent troops to occupy the Tarija natural-gas fields, the second-largest reserves in Latin America.
- Venezuela, the case that best approximates absolute rentier populism, is also the closest to plebiscitary super-presidentialism.
- Argentina is the case with the most tenuous attributes of both types, while Bolivia and Ecuador are somewhere in-between.
- Radical governments used nationalization, taxation, or some combination of the two to claim the lion's share of the rent derived from the newly elevated international prices.

- Rejection of free-trade treaties and support of regional integration.
- Greater presence of Latin American transnational corporations.
- Competition with China in manufacturing.
- The war on terrorism and the “Carmonazo.”

George W. Bush (1946-)

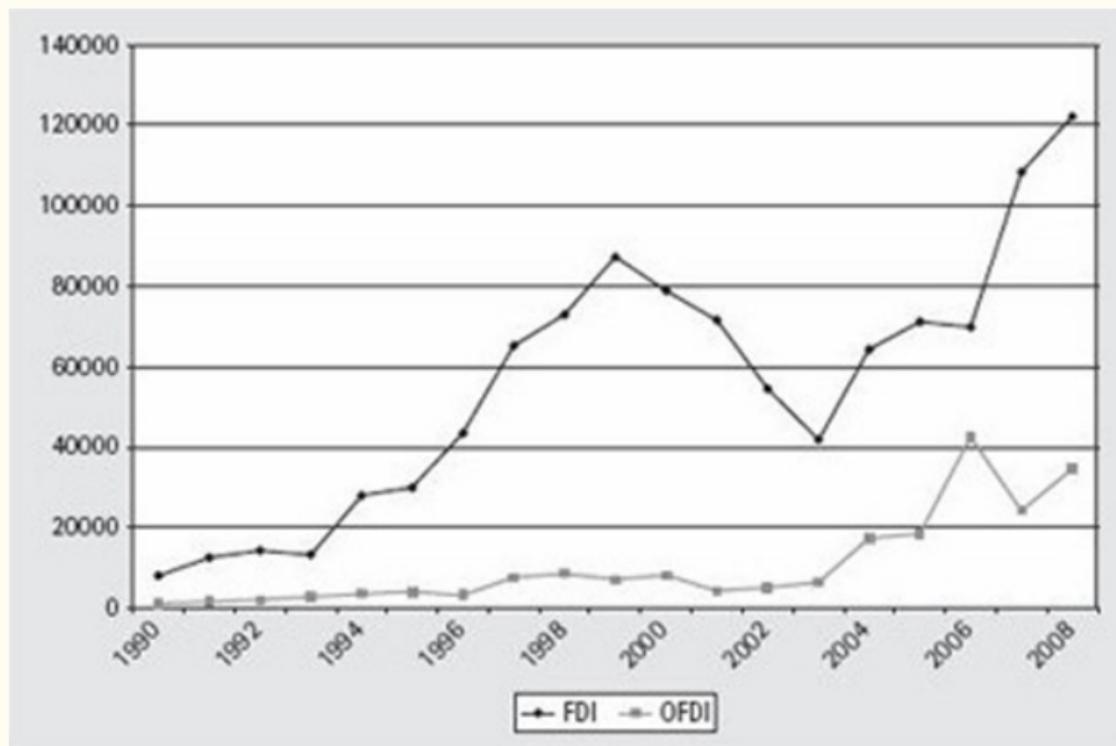


Manufacturing exports Latin America and China (1985-2006)



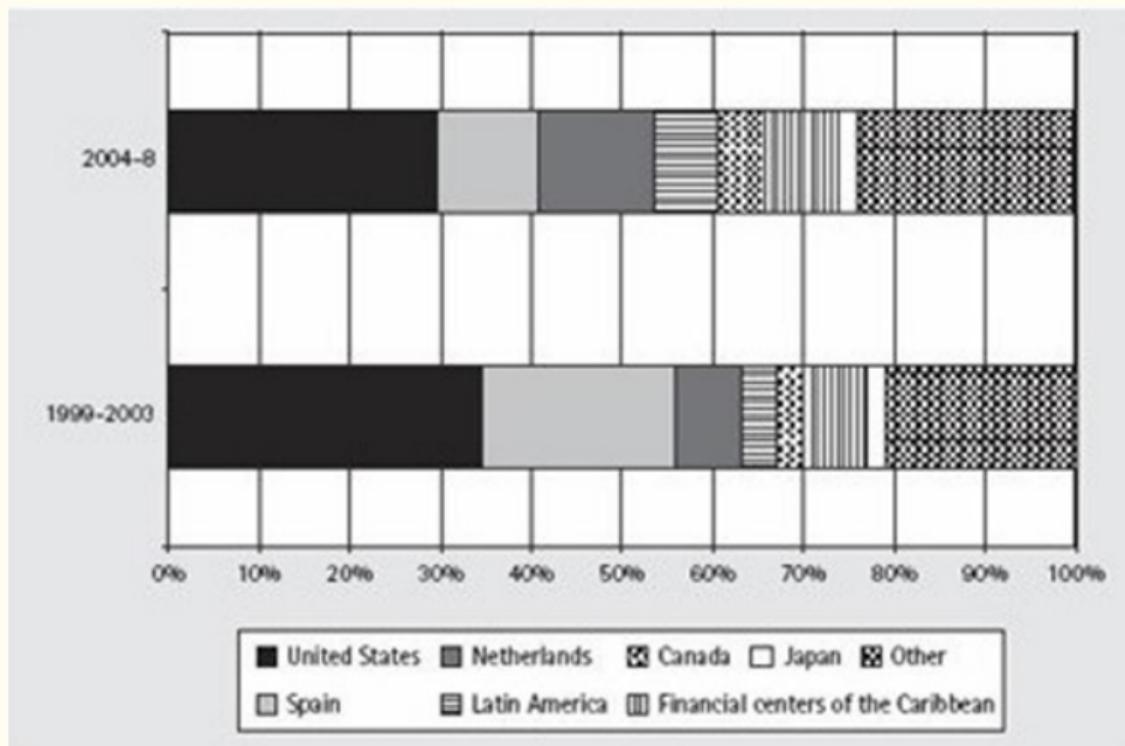
Source: Gallagher and Porzecanski, 2012

FDI inflows and outflows from/to Latin American countries, 1990-2008

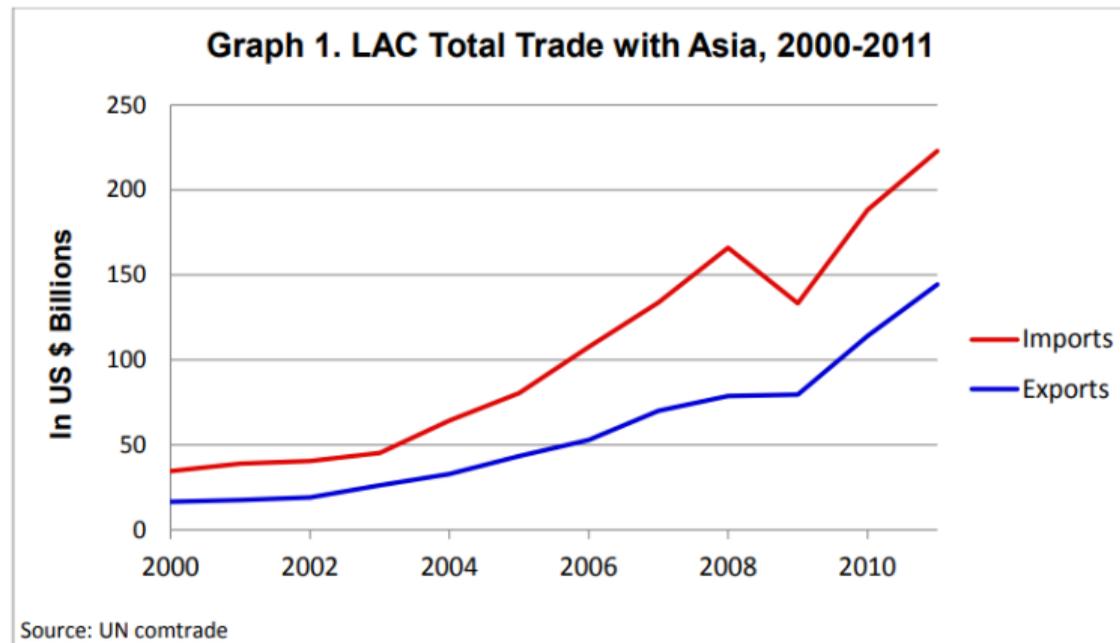


Source: Ferraz, Mortimore, and Tavares, 2012; ECLAC

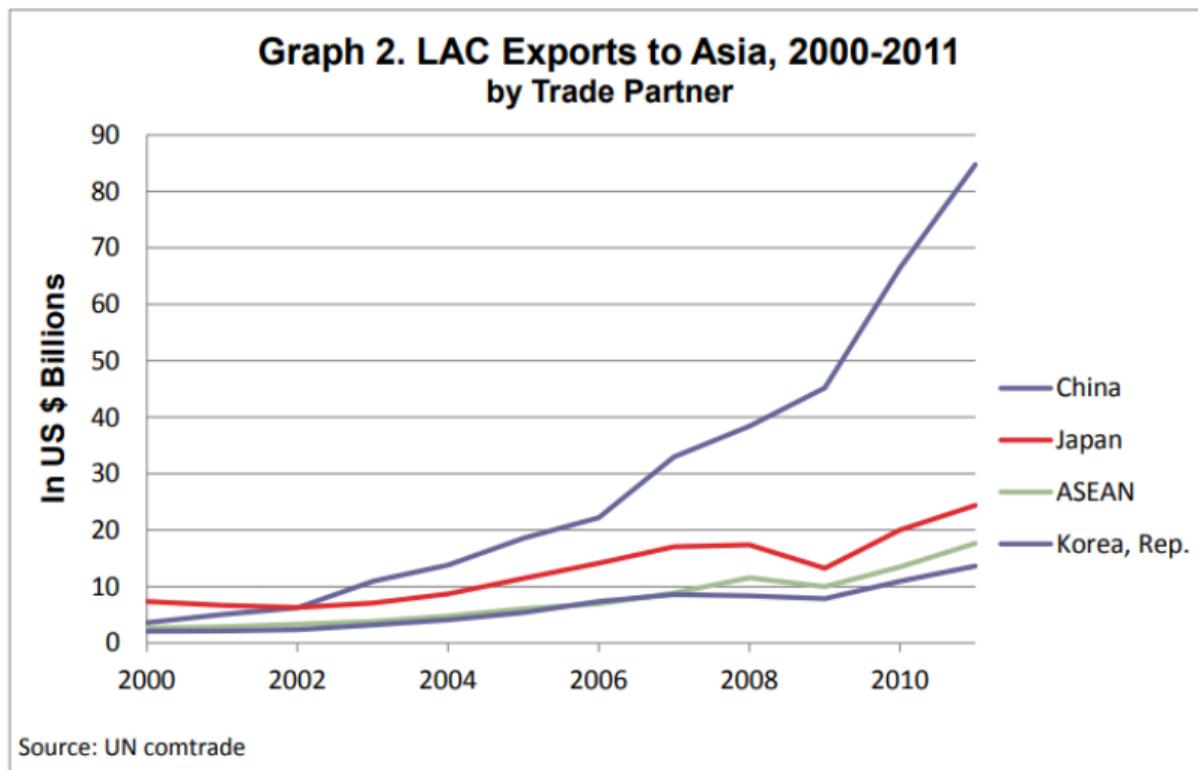
Origin of FDI flows to Latin America, 1999-2003 and 2004-8



Source: Ferraz, Mortimore, and Tavares, 2012; ECLAC



Latin America and Asia trade by partner



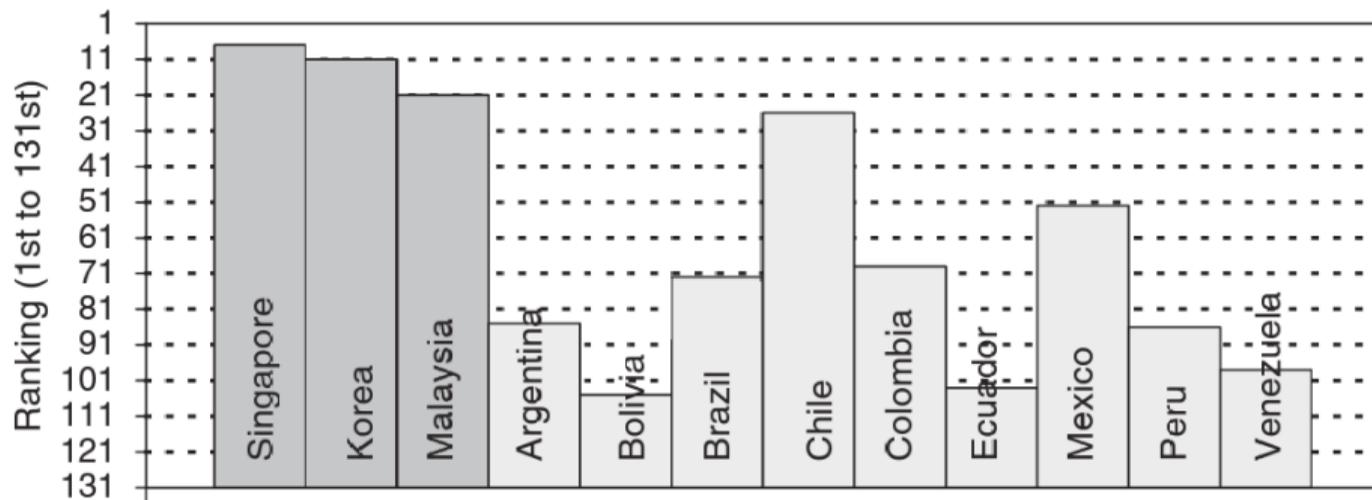


FIGURE 6.6 Growth Competitiveness Index Rankings, 2007–2008.
Source: World Economic Forum, *The Global Competitiveness Report, 2007–2008* (New York: Palgrave Macmillan, 2005), p. 10.

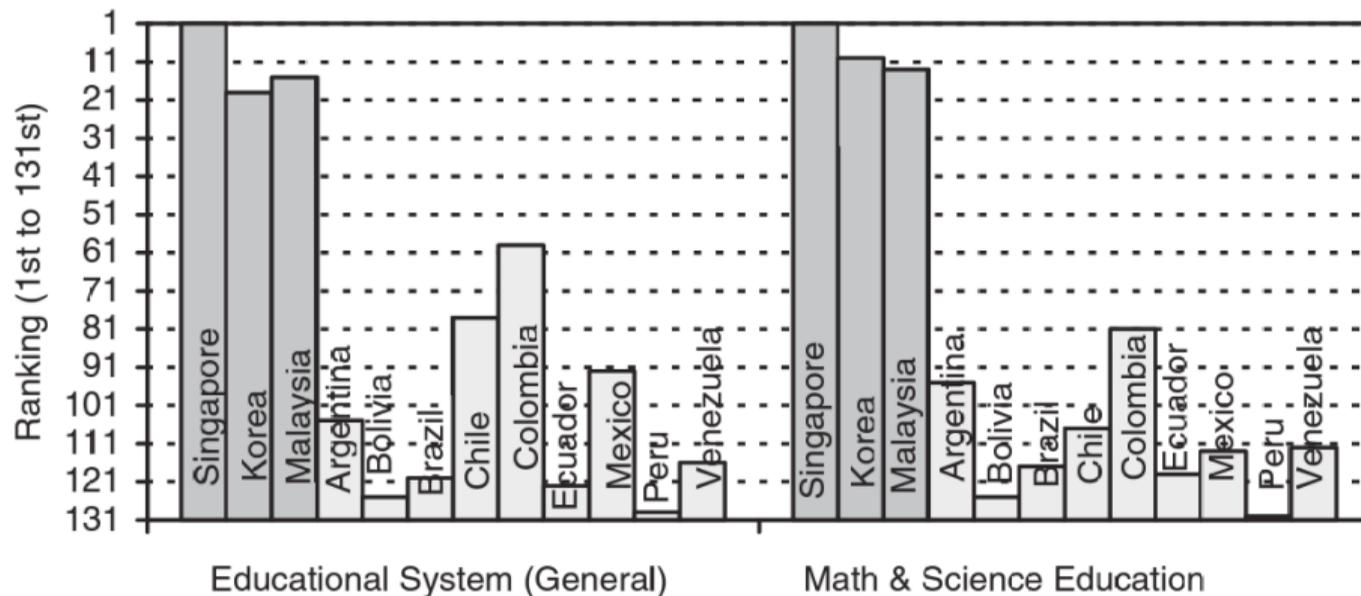
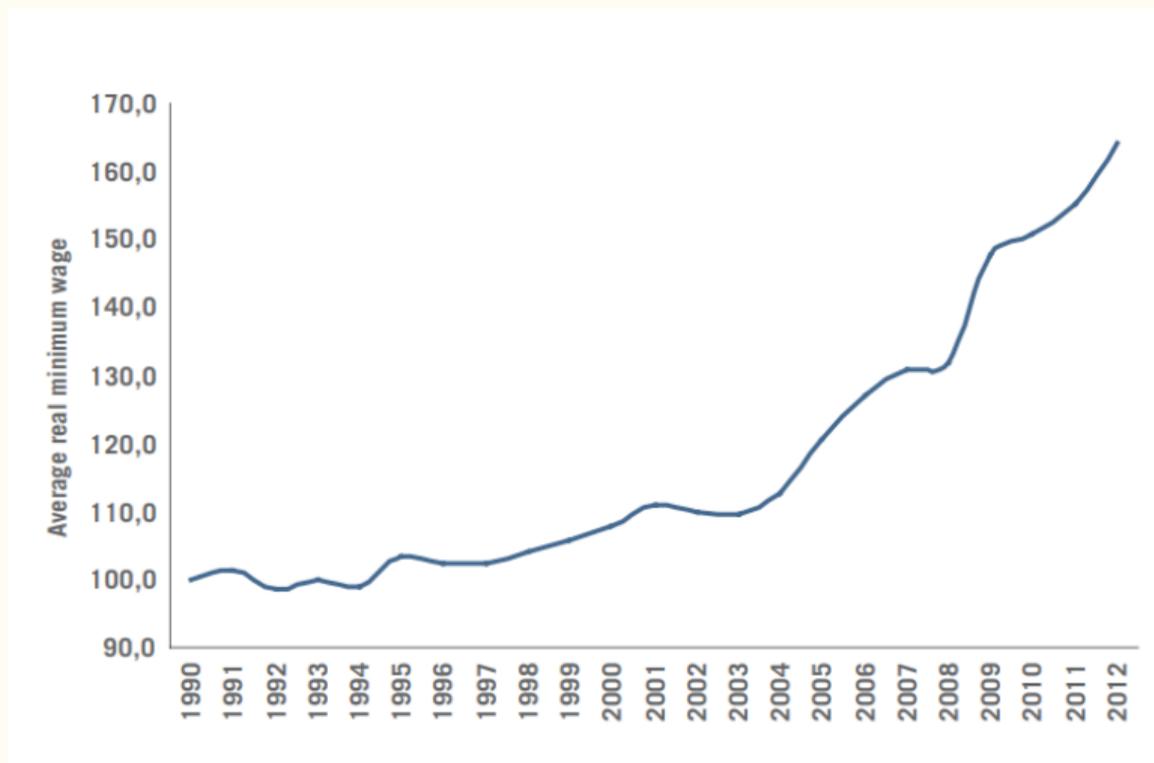


FIGURE 6.7 Quality of Education Rankings, 2007–2008. *Source:* World Economic Forum, *The Global Competitiveness Report, 2007–2008* (New York: Palgrave Macmillan, 2007), pp. 428–429.

- The region has made a political and institutional commitment to democracy. Never before have there been so many democracies in the region.
- The health of these market democracies is robust, as evidenced by the 2006-7 electoral cycle. Most of the elections were held in a fair and open environment.
- A growing sense of pragmatism in the institutional reform and public policy processes is increasingly apparent in the region, in contrast to the messianic solutions of the past that wrought so much harm.

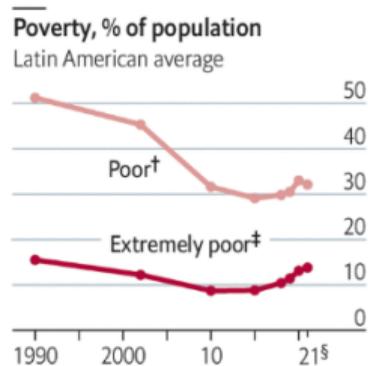
Economic performance

Average real minimum wage

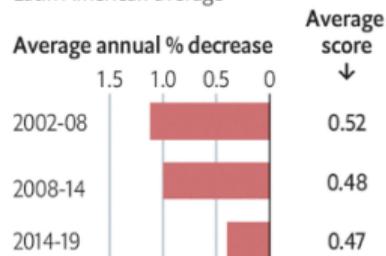


Source: ILO, 2013

Poverty (1990-2021) and inequality (2002-2019)



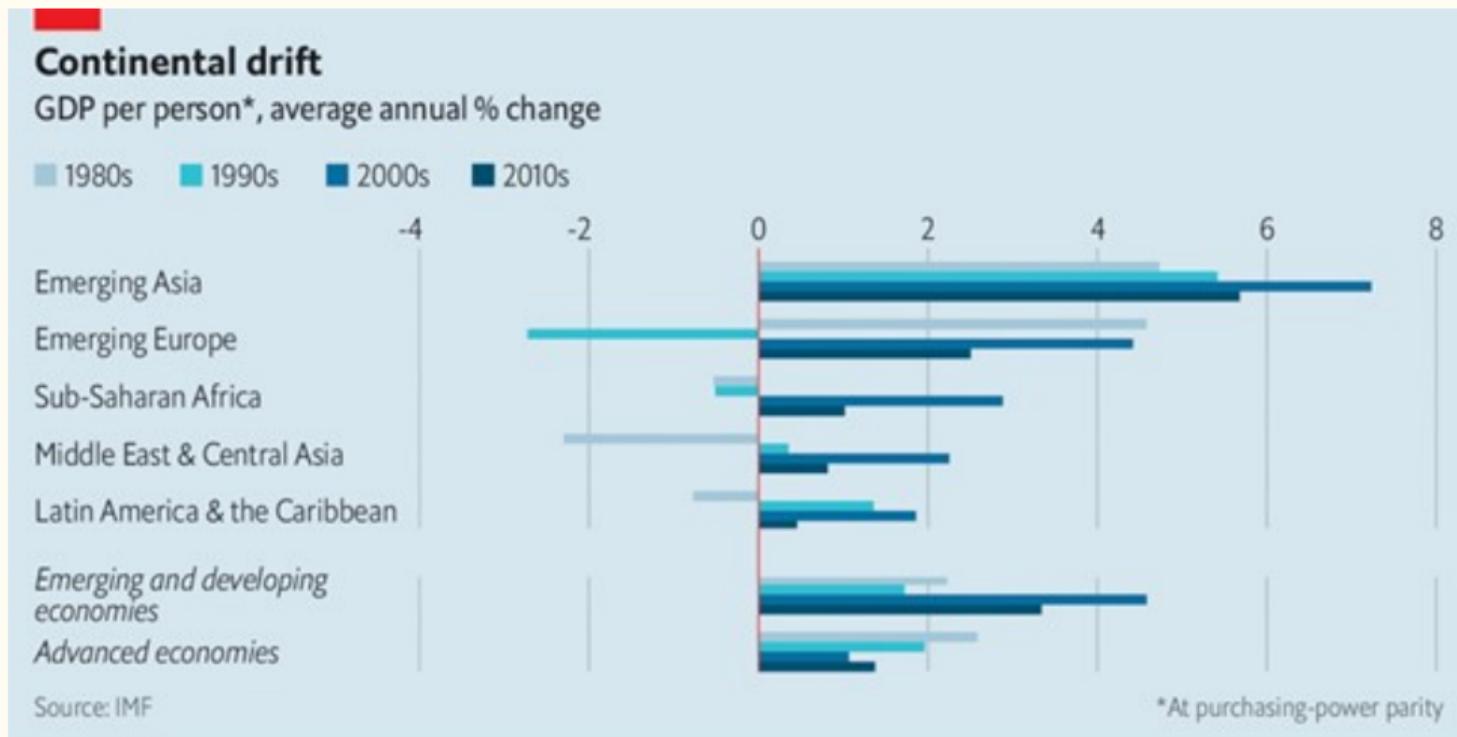
Gini coefficient, 1=maximum inequality
Latin American average



The Economist

Source: The Economist

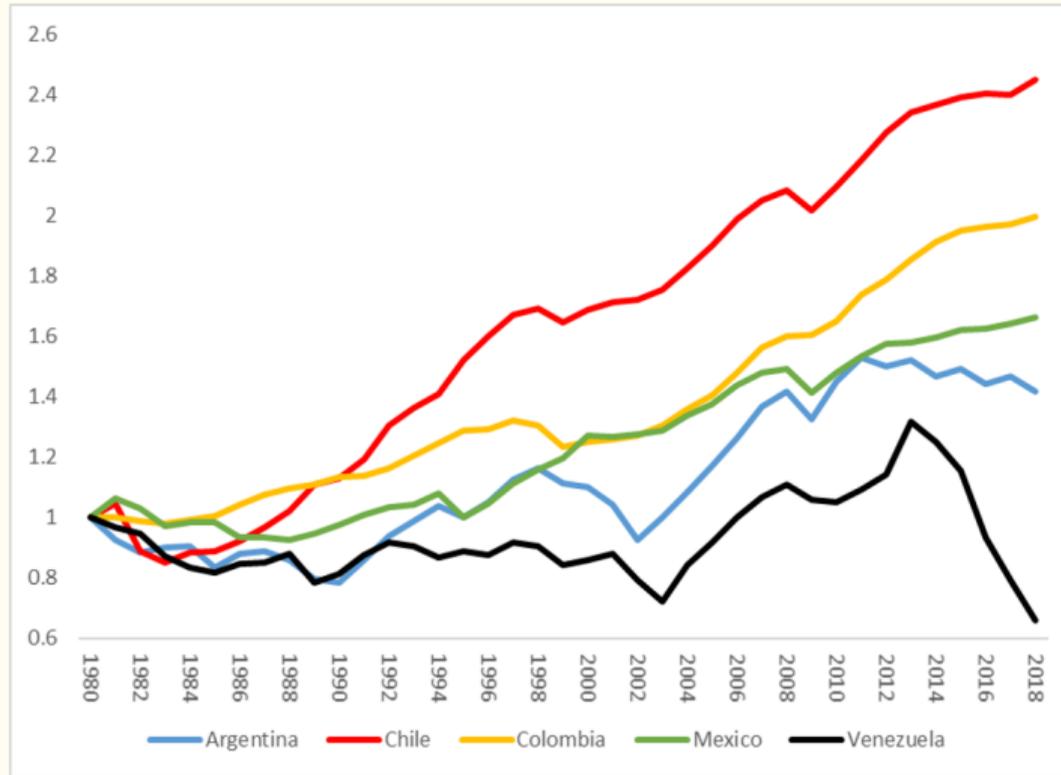
Performance of Latin America (1980-2020)



The Economist

Source: IMF via The Economist

Performance of Latin America by country



Source: Madison dataset