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78. U.S. Policy toward Latin America

Policymakers should

- facilitate dollarization for any country that wishes to adopt the dollar as its national currency;
- merge all hemispheric trade agreements into a single Free Trade Area of the Americas;
- end the Alliance for Prosperity in the Northern Triangle of Central America; and
- end the hemispheric war on drugs.

For the past 15 years, Latin America has grown more confident and assertive. Buoyed by decent growth rates, marked declines in poverty and inequality, and the rise of a new middle class, the days when Washington exerted an overbearing influence in the region seem long gone. This phenomenon was compounded by the ascendancy in several countries of left-wing governments which, to various degrees, distanced themselves, or openly antagonized, the United States.

However, Latin America is now entering a period of low growth, largely because of the fall in the price of commodities, which could imperil some of its socioeconomic gains. That environment creates an opportunity for Washington to positively influence economic policy in Latin America in limited but important ways.

From 2001 to 2015, economic growth in Latin America averaged 3.8 percent per annum. That is not a stellar rate, particularly when compared with the Asian "tigers" in the 1980s and 1990s. But it is a welcome departure from previous decades that saw stagnation and economic crises. More than 70 million people have escaped poverty since the turn of this century. Panama (6.5 percent) and Peru (5.3 percent) are the economies with the fastest growth rate in this century, while El Salvador (1.9 percent) and Mexico (2.1 percent) are the lowest. Those numbers show that, despite some regional trends, there are significant differences in how Latin American economies have performed.

The 21st century started with Latin America mired in yet another economic downturn. Mexico's economy went into a mild recession. Brazil was still reeling from its currency crisis of 1997–98. Argentina defaulted on its debt and suffered its worst economic contraction in decades, with its ensuing contagion in Uruguay—which was bailed out by Washington. But the region's misfortunes soon reversed. The structural reforms of the 1990s, commonly identified with the Washington Consensus, laid the groundwork for macroeconomic stability in the 2000s. In particular, low levels of inflation and, to some degree, sound government finances were the norm in most countries.

The Commodities Boom

For much of Latin America, the leading driver of economic growth for nearly a decade was the favorable global headwinds of high commodity prices. According to Ernesto Talvi and Ignacio Muyo of the Brookings Institution, from 2003 to 2008, the average price of commodities increased by 75 percent compared with the previous five-year period. After a brief crash during the financial crisis, prices recovered and remained high until mid-June 2014. The economies of most South American countries benefited tremendously, propped up by the export of oil, copper, gas, iron ore, soy, and other raw materials. As a result, governments profited handsomely too, either by imposing windfall taxes on extracting industries or by exploiting natural resources themselves through state-owned enterprises.

This bonanza had a two-pronged effect on the economic policies of the region. First, it encouraged complacency, which meant that, with few exceptions, meaningful liberalizing measures were largely absent. Second, it empowered populist regimes in several countries; those governments not only reversed previous reforms, but also went further down the road of implementing what they called "Socialism of the 21st century." Venezuela is the most emblematic case.

In fairness, some gains from the previous decade were consolidated in the 2000s. Perhaps the most important has been the control of inflation. According to Steve Hanke of Johns Hopkins University, Latin America witnessed seven episodes of hyperinflation from the 1970s through the 1990s. Runaway inflation has been a scourge for most countries in the region, contributing to stubbornly high levels of poverty and inequality, as well as economic instability. However, reforms granting independence to central banks—along with other measures such as liberalizing exchange rate regimes and opening up capital markets—put a lid on inflation. Between 2000 and 2013, the median inflation rate in Latin America was 6.4 percent.

Similarly, many countries pursued trade liberalization since the turn of the century. There has been a proliferation of trade agreements within the region and also between Latin American countries and the United States, the European Union, Canada, and China, among others. Following the implementation of the North American Free Trade Agreement (NAFTA) in 1995, Washington negotiated deals with Chile (2004), the Central American nations and the Dominican Republic (2006–2009), Peru (2009), Panama (2012), and Colombia (2012). What most of these agreements have done in the short term is to consolidate the market access that already existed when they were first negotiated and to set common standards on rules of origin and nontariff regulations. Meaningful market openness will take place in the ensuing decade as the lengthy periods of tariff phaseouts are completed.

The exception to the slow-motion approach to trade liberalization is the Pacific Alliance, a promising bloc made up of Colombia, Chile, Mexico and Peru, whose goal is to abolish all the barriers to the free movement of goods, services, capital, and people among its member states. The protocol that eliminates tariffs on 92 percent of the products traded within the bloc went into effect on May 1, 2016, and it stipulates that the remaining 8 percent will be phased out by 2030. Several Latin American countries have expressed interest in joining the bloc as full members; but unlike other regional groupings that pay lip service to economic integration, the Pacific Alliance is requiring firm commitments to freer movement of goods and people and only admits as members those nations that agree to fully comply with its ambitious goals.

The "Pink Tide"

The advent of the Pacific Alliance exposed an ideological—and nearly geographical—regional divide between those countries that based their economic and political models on open markets and the strengthening of democratic institutions—largely found on the continent's Pacific rim—and those that opted for populism and strong government intervention in the economy.

The rise of the so-called "Pink Tide"—populist, left-wing governments that came to power primarily in the 2000s—requires a more nuanced analysis since there have been different shades of pink—or red. Venezuela and its closest allies—Bolivia, Ecuador, and Nicaragua—are the most radical regimes since they openly promote their slogan of "Socialism of the 21st century." Their leaders employed a premeditated strategy of using democratic means to achieve power only to dismantle democratic institutions—such as the separation of powers, free press, a nonpolitical military—from within. Along with Cuba and other small island nations in the Caribbean, they founded the Bolivarian Alliance for the Peoples of Our America (ALBA), as a counterweight to the aborted Washington-led Free Trade Area of the Americas (FTAA).

Despite similarities in the mechanisms that ALBA governments employed to subvert democracy in their countries, there are wide disparities in their economic policies. Venezuela has pursued the most aggressive socialist agenda—nationalizing hundreds of industries and farms, imposing rigid exchange and price controls, dramatically expanding public spending, and debasing the national currency—but its allies have not been able or willing to follow the same path. For example, the economy is dollarized in Ecuador, which has prevented the government from inflating the currency and has somewhat limited its ability to increase public spending recklessly. Bolivia nationalized energy companies, public utilities, and airports but has maintained a prudent monetary policy with low inflation levels and the world's largest foreign exchange reserves as a proportion of gross domestic product. Nicaragua is the most puzzling case of the ALBA: although its government espouses the group's socialist rhetoric, it has a free trade agreement with the United States and one of the region's most orthodox economic policies; as evidence, the International Monetary Fund recently closed its office in Managua because of "Nicaragua's success in maintaining macroeconomic stability and growth."

Venezuela is the flagship populist regime in Latin America. During the course of a decade and a half, the government received nearly $1 trillion in oil revenues. That was enough to mask the effect of hundreds of expropriations, burdensome economic controls, and, in general, the government's seeming determination to run the private economy into the ground. However, even when oil prices were hovering above $100 per barrel, the government's finances went increasingly into the red. The external debt has gone up by 115 percent in the past decade, and inflation is out of control: according to official figures, year-on-year inflation reached 487.6 percent in June 2016. Behind the macroeconomic figures is a deepening humanitarian crisis. The government lacks the dollars to pay for imports that, compounded with price and capital controls, have caused widespread shortages of food and medicines. Socialism has turned Venezuela into a basket case. The silver lining is the demonstration effect that this chaos has had for the rest of Latin America about the perils of populism, a lesson reinforced by the absence of U.S. intervention, which so often proves counterproductive.

Outside the ALBA, the Pink Tide has consisted of mainly moderate social democratic governments that took advantage of the commodity boom to increase public spending while respecting democratic institutions. There are exceptions. In Argentina, the left-wing administrations of the late Nestor Kirchner and his successor—and wife—Cristina Fernández, became increasingly authoritarian as they implemented policies similar to those of Venezuela, such as nationalizations, currency and exchange controls, and unsustainable levels of public spending financed by inflation. By the time Fernández left power in December 2015, Argentina was the country that followed Venezuela's economic policies most closely.

Brazil's left-wing governments under the Workers' Party were seen for several years as a model of moderate politics and sensible social policies. Brazil's economy grew decently during most of the last decade and, as a result, witnessed significant reductions in poverty. However, the fall in the price of commodities exposed many of the country's shortcomings, such as a bloated bureaucracy, high and complex taxes, and stifling business regulations. Those shortcomings, along with the mismanagement of the economy by President Dilma Rousseff, brought Brazil to its worst recession since the 1930s. Adding to the country's economic misfortunes, a massive corruption scandal involving the state-owned oil company Petrobras has rattled the political class and led to the impeachment of Rousseff. A new government led by her former deputy, Michel Temer, promises much-needed economic reforms, but it remains to be seen whether he can deliver them given the tumultuous political environment.

A worrying development is taking place in Chile, a country that became Latin America's wealthiest and most successful society thanks to its free-market model. After the return of democracy in 1990, successive left-of-center governments deepened the reforms that were initially introduced during the years of the military dictatorship. But that changed with the second term of Michelle Bachelet beginning in 2014 and her efforts to undermine Chile's successful economic policies with higher taxes, heavier regulations, and new entitlements such as free higher education. Her government is even proposing a new constitution whose stated aim is to replace the country's free-market model with a Scandinavian-inspired welfare state. Chile is a stark reminder that the siren song of populism can have an effect even in countries with a successful economic and social record.

A Positive Role for U.S. Policy in Latin America

Despite Latin America's newfound assertiveness, there are several areas where Washington can still exert a positive influence, either by facilitating economic reforms or by discontinuing programs that have a negative impact in the region.

Dollarization

As the example of Ecuador shows, dollarization facilitates macroeconomic stability even when a country has a populist government. In Latin America, El Salvador and Panama also use the U.S. dollar as their national currency. Since currency volatility is still a problem in many countries, and the use of the dollar is widespread in the region, it is possible that other nations may wish to replace their currencies with the dollar as well. The United States should neither discourage nor encourage those moves but should facilitate official dollarization where it occurs. That may mean sharing the dollar's seigniorage—the profit that derives from printing currency—with countries that decide to dollarize. In that way, the United States would neither gain nor lose money as a result of another country's decision to dollarize, but the dollarizing country might more easily dollarize if it could still earn seigniorage from the currency it uses.

Dollarization alone cannot solve a country's economic problems. But for countries with poor monetary policies, dollarization would end currency risk, reduce interest rates, and help stimulate investment and growth.

Free Trade Area of Most of the Americas

The idea of creating a hemisphere-wide free trade area that stretches from Alaska to Patagonia has been dead since Argentina, Brazil, and Venezuela killed it in 2005. Some experts say that calls for expanded trade with Latin America are not realistic since Washington already has deals with all the Latin American countries that want trade agreements with the United States; those that do not, such as Brazil and Argentina, are not interested in one. However, that does not mean there is no room for a substantial hemispheric trade agenda. The countries Washington has free trade agreements with in the Americas also have similar deals among themselves. There are some missing links, but overall, these countries have created a fragmented version of a free trade area of the Americas.

One obvious problem with the current situation is what Columbia University economist Jagdish Bhagwati has called the "spaghetti bowl effect" of so many trade agreements with different rules of origin, tariff schedules, and nontariff regulations. The United States should lead an effort to merge all the regional free trade agreements into a single Free Trade Area of the Americas for the nations willing to be part of it. The negotiations could also help to complete those missing links in the hemispheric trade jigsaw puzzle. The FTAA would leave the door open for other Latin American countries that might want to join in the future. Uruguay and Paraguay are the most likely candidates given their growing dissatisfaction with their membership in the protectionist Southern Common Market (Mercosur), which also includes Argentina, Brazil, and Venezuela.

End the Alliance for Prosperity

The United States should discontinue the Alliance for Prosperity in the Northern Triangle Plan, a conditional program that began in 2016 and whose purpose is to give El Salvador, Guatemala, and Honduras $750 million in extra aid to help them fight poverty and crime. These Central American countries suffer from some of the most acute economic and security challenges in the Americas, some of which Washington has played a significant role in causing through the war on drugs. However, throwing money to governments with serious institutional flaws will not solve these problems—and may exacerbate them. After all, for almost a decade, both El Salvador and Honduras have received hundreds of millions of dollars in U.S. aid from the Millennium Challenge Corporation for supposedly meeting thresholds in fighting corruption and improving governance. During this period, the grades of both countries on the Rule of Law dimension in the World Bank's "Worldwide Governance Indicators" actually deteriorated. This shows that despite the conditionality guarantees included in the Alliance for Prosperity, Washington has a well-documented record of disregarding the evidence of whether it is accomplishing its goals or being counterproductive.

End the Hemispheric War on Drugs

Washington must end its destructive war on drugs in the region, which works at cross-purposes with important U.S. policy priorities (see Chapter

75). In drug-source and -transit countries such as Colombia, Mexico, and the Central American and Caribbean nations, the drug war is fueling corruption and violence, undermining the rule of law, and otherwise debilitating the institutions of civil society. According to the 2013 Global Study on Homicide by the United Nations, 8 of the 10 countries with the highest murder rate in the world are located in the cocaine route that goes from the Andes to the United States. Drug violence in Mexico has killed over 100,000 people since 2006. The effect of the U.S.-led war on drugs south of the border has been imperceptible in the United States, but its consequences in Latin America are completely at odds with Washington's stated goal of encouraging free markets and civil society.

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