Latin America's Stunted Growth

The region is suffering the effects of a quarter century of bad advice from economic-policy mavens. Time to change course

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Latin America is headed toward an unhappy anniversary: 25 years of failed attempts at economic growth. The world has no comparable period of failure anywhere else in at least the last century, including the Great Depression. From 1960 to 1979, these economies grew at a decent rate, chalking up an 80% gain in income per person. In spite of Latin America having the world's worst inequality in income distribution, this was enough to substantially improve living standards for the vast majority of the population, including most of the poor.

But then something went wrong, and it has as much to do with policies advocated by the "Washington consensus." From 1980 to 1999, per-capita income grew by only 11%. The 1980s were known as Latin America's "lost decade," when the region's income per person actually fell. The 1990s produced only modest growth, and the first decade of the 21st century is now looking like it might also count itself among the missing. Using the International Monetary Fund's [IMF] projections for 2004, the first half of the new decade [2000-04] shows a gain of about 1% for the whole five years.

MEXICO'S MALAISE. Amazing, isn't it? One would think that after 25 years of reforms -- opening up to international trade and investment, privatization of state-owned enterprises, enforcing budget and monetary discipline, and other measures that have caused quite a bit of pain and dislocation to the region's citizens -- these countries would have something to show for it.

The fact that this problem has received so little attention is even more astounding. Remember, 2004 is also NAFTA's 10th anniversary. And while a number of press reports have hailed the huge increase in trade and foreign direct investment that Mexico has experienced over the last decade, few mentioned how low the growth rate has been.

This is comparable to evaluating a professional baseball player without including his batting average. He may be a great fielder and a good team player, but if he bats .125, can he make it in the major leagues? That's a fair analogy to Mexico's economic performance during the NAFTA decade: less then 1% annual growth in gross domestic product [GDP] per person -- not even a quarter of what was achieved in the decades prior to 1980.

Economic growth -- not tariff reduction or a balanced budget -- is what determines whether people have a higher standard of living than that of their parents or grandparents. And when the economy grows, it's at least possible to direct a larger share of the new income and wealth to people who are less well-off. When the economy doesn't grow, it means that any gains at the bottom must come at the expense of someone else.

LACKLUSTER AT BEST. When pressed, defenders of the "Washington consensus" reforms say we really shouldn't count the 1980s, since there was a lot of hangover from over-borrowing during the 1970s. They also say the growth in prior decades was unsustainable. But Latin America had decent growth for 30 years, going back to the 1950s, so the idea that it isn't sustainable is hard to fathom. South Korea maintained a per-capita growth rate averaging more than 6% annually -- much higher than Latin America at its best -- for four decades. And whatever Latin policy mistakes were made in the 1970s, it's a bit of a reach to keep blaming them for economic failure into the 21st century.

And it's fair to use 1980 as a dividing line for looking at Latin America's economic performance, because 1979 was a business-cycle peak for the U.S., which is the destination for about two-thirds of Latin America's exports. But even if we restrict our focus to the 1990s, the region's growth performance was lackluster: just 14% for the decade. If this is the best that can be done while the U.S. is enjoying its longest-running economic expansion in history, something is very wrong.

It's not hard to see what that might be. Look at Brazil, which once had one of the fastest-growing economies in the world. From 1960-79, its per-capita income grew by 160%. If that growth had continued, the country would today have living standards approaching those of Western Europe. But it has grown at about one-eighth that rate since 1980. And in 2003, the Brazilian economy shrank.

WRONG PRESCRIPTION. Yet Brazil's central bank is currently keeping short-term interest rates at 16%. With inflation running at about 6%, this means a real interest rate of more than 10%. That's terribly high for an economy struggling to come out of a recession. For comparison, the U.S. Federal Reserve has kept short-term rates at 1% more than two years into an economic recovery. Imagine if it had chosen 11% or 12% instead. There wouldn't have been much of a market for home mortgages or much chance of an economic recovery.

Brazil has also upped its primary budget surplus to 4.25% of GDP. Again, this is the opposite of what the U.S. does in response to a slow economy. America went from a budget surplus of 2% of GDP to a deficit of more than 4% -- a stimulus of more than $6 trillion dollars -- since the economy

slowed down in 2001.

These kinds of procyclical economic policies are often promoted by the IMF, which is dominated by the Treasury Dept., and its partner, the World Bank. Nobel Prize-winning economist Joseph Stiglitz likes to joke that the IMF made a mathematical "sign error" on the blackboard back in the 1950s -- writing a minus instead of a plus -- and hasn't corrected it yet.

More independence and departures from the "Washington consensus" will be needed if Latin America is to resume a normal growth path. And they probably will be forthcoming. But it would help if more policymakers north of the Rio Grande were at least willing to recognize that they may not know what's best for their Southern neighbors.

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