Latin America under Fire! What is to Be Done?

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The past few months have witnessed violent demonstrations in several Latin American countries, including Chile, the only country from the region (other than Mexico) to have joined the OECD, the rich-country club. Moises Naim and Brian Winter recently published a thoughtful article in *Foreign Affairs*, titled "Why Latin America Was Primed to Explode" (October 29), in which they make a strong case that following the commodity boom of the early part of the previous decade the recent past has seen a sharp deceleration of economic growth. "Against the backdrop of stagnating wages and rising costs of living, indignities such as inequality and corruption have become more difficult for many people to swallow," they persuasively argue. I put forward here some reflections on the economic growth debate and what this means for Latin America.

What about economic growth?

Economists—I am one of them—have long studied and argued about the sources and consequences of economic growth. The great development economist Arthur Lewis[1] observed that "the advantage of economic growth is not that wealth increases happiness, but that it increases the range of human choice…The case for economic growth is that it gives man greater control over his environment, and thereby increases his freedom." For a large portion of humanity, the last

[1] Sir Arthur Lewis was awarded the Nobel prize in Economics in 1979 "for his pioneering research into economic development research with particular consideration of the problems of developing countries."

several hundred years have involved an inhuman struggle for subsistence, characterized by periods of famine, disease and unremitting drudgery. High infant mortality and brutishly short life spans have been a permanent feature of our existence. Economic growth, said Lewis, “enables him to escape from this servitude” and from the many other menaces which detract from the quality of life. Economic grow allows women to escape from the drudgery of household work and other backbreaking tasks and empowers her to develop many other capacities. Growth and the increased production it brings, coupled with the technological innovations that accompany it, create leisure and open up a world of new possibilities. More people can be spared for other activities and new occupations emerge, including the doctor, the philosopher and the poet.

Economic growth creates an awareness of the needs of others. As societies prosper, more resources are allocated for the disadvantaged, vulnerable groups in society, for the training and education of children. In societies with little or no economic growth—a broadly accurate characterization of the world prior to the industrial revolution—the demands of one group in society can only be met by imposing sacrifices on others, a zero-sum world, often characterized by social strife. According to the economic historian Angus Maddison, real GDP per capita in the world expanded at an average annual rate of 0.05 percent in the 800 years before 1820, with only minor regional variations. It equalled zero in the previous 10 centuries. At a rate of growth of 0.05 percent per year, an economy expands by 50 percent in 811 years. In other words, there is no visible growth within the lifetime of any one individual. Without economic growth and the prosperity that it brings, governing becomes a bitter occupation. Since legitimate aspirations for some material progress cannot be met, the outcome is often political repression. But this is a dead end; in time lack of growth will lead to complacency and resignation, a sense that “stability” is the primary attribute of life and that there is little sense in searching for opportunities for economic gain: there are none to be had. Politicians have come to understand this from painful experience: their desire to promote economic growth is linked to the opportunities that rising incomes then affords for redistribution and for acquiring legitimacy as rulers.

Lewis was impressively clear-eyed about some of the potential problems associated with rapid economic growth. He thought that economic growth tended to be associated with the disappearance of the extended family, the erosion of social systems based on status and their replacement by systems based on contract, equality of opportunity and high levels of vertical social mobility. These, he said, had the potential for upsetting existing relationships and interacted—sometimes in unpredictable ways—with issues of class, religion and political authority. Thus, growth was not without its dangers—think of rapidly-growing Iran in the 1960s and 70s and its metamorphosis in 1979 into a repressive theocracy ruled by corrupt mullahs. Economic growth could coexist with rising *inequality* and, if unchecked, could put increasing pressures on the environment. In the Soviet Union, rapid economic growth was associated with an appalling deterioration in the quality of the physical environment. Moreover, its rulers did not think that its benefits should be tied to the need to improve the standard of living of the average citizen. By the time it collapsed, the Soviet Union was a military giant with an impoverished population, a classic case of “immiserating growth.”

While emphasizing the substantial benefits of more rapid economic growth, Lewis accepted the possibility that the growth process could have costs “in social or spiritual terms” and that societies should carefully weigh, in light of their individual circumstances and values, the benefits against the costs. While firmly on the side of economic growth, he understood that some could be ambivalent in their attitudes to it. He said: “we demand the abolition of poverty, illiteracy and disease, but we cling desperately to the beliefs, habits and social arrangements which we like, even when these are the very cause of the poverty we deplore.” In the end, where societies situated themselves in this debate would depend on the value they attached to the expansion of knowledge, equality of opportunity, improved public health and increased life expectancy.

Lewis thought two factors would play a critical role in how the debate on the benefits and costs of economic growth evolved. First, the forces of globalization were leading to a faster expansion in aspirations than in economic production. Second, mortality rates were falling faster than birth rates. A growing gap between aspirations and production could be dangerous and lead to political instability. As part of this, one could see the rise of “native breeds of fascism”—for example, warlordism and Latin American “caudillos”—or the arrival to power of religious fanatics. As for population growth, rising living standards were needed to check its growth and this was one of the strongest arguments in favour of faster economic growth, particularly in the developing world.

A moral dimension

Half a century later, Harvard University’s Benjamin Friedman revisited the case for economic growth in his 2005 book *The Moral Consequences of Economic Growth*. If Lewis had focused attention on the benefits of economic growth, Friedman had much to say about the ramifications of its absence. Because of increasing concern about the environmental impact of rapid economic growth, the undesirable side effects of rapid industrialization and globalization, including the erosion of cultural diversity, we had begun to see growth not merely in terms of its ability to improve living standards, but also in its moral dimension. The whole debate about sustainable development had a strong moral underpinning, articulated in terms of our responsibility for the welfare of future generations and their ability to sustain broadly similar standards of living. For Friedman, however, the weighing of “material positives against moral negatives” needed to be buttressed by a closer examination of the ways in which rising living standards shaped “the social, political, and ultimately the moral character of a people.” The gist of his thesis is that economic growth “fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy,” while economic stagnation can often lead to retrogression with respect to these worthy social goals. Furthermore, this thesis will be true even for countries in relatively advanced stages of development, where considerable progress has already been made in their achievement. Friedman provides multiple historical examples to support his thesis, mainly from high-income countries.

If anything, the evidence from the developing world is even more compelling because episodes of economic stagnation and instability are more frequent phenomena, given the early stages of development of these countries’ policies and institutions: one thinks of the deadly anti-Chinese riots in Indonesia in the wake of that country’s currency collapse in 1998; urban riots in Argentina in early 2002 when that country’s banking system imploded as a result of debt default; the collapse of the Russian government in August of 1998 in the aftermath of a sudden plunge in the ruble and the sharp contraction of economic output; to say nothing of the countless premature fatalities in civil wars and other strife in Africa, against the background of falling or stagnant incomes during much of the post-colonial era—all help make the case. Moreover, rising standards of living shape people's attitudes, for it is easier to be open and tolerant when unemployment is low and confidence in the future is high.

Governments find it easier to frame policies around a fairer distribution of rising incomes than to have to manage diminishing expectations in what increasingly looks like a zero-sum game. Indeed, awareness of this phenomenon may be the most powerful incentive for working democracies to commit to implementing sensible economic policies, which deliver economic growth. And, at the level of the individual, it may explain why prosperous societies value thriftiness, hard work, education and the acquisition of knowledge, as well as a range of personal behaviors that reinforce the clear connection between moral values and rising prosperity. In contrast, authoritarian regimes typically care far less about the link between economic growth and rising prosperity and openness, tolerance, and fairness. In such societies, governing is often not about bringing prosperity to the people, but rather about other ends, from rent seeking to the maintenance of the levers of power by ruling elites, to loyalty to some outdated ideology, as contemporary Iran, North Korea, Syria and Venezuela, among multiple other countries, make abundantly clear.

So, Friedman makes the case that economic growth has become the primary engine of social stability and well-being. Growth has become a social and political imperative everywhere. In the developing countries, because it is the locomotive of poverty reduction and improvements in living standards; in the rich countries because we live in a world of rising expectations in which the values of a consumer society and materialism have created their own compelling logic, one of endless accumulation, regardless of whether it leads to greater happiness or spiritual fulfilment. The unanswered question is whether unbounded economic growth is consistent with the key parameters that determine the sustainability of life on our planet.[2]

What about Latin America?

Corruption

The references to corruption and inequality in Latin America made by Naim and Winter are entirely justified. Today we understand much better the destructive consequences of corruption. Corruption reduces government revenue, is associated with the growth of the underground economy, discourages private sector development, worsens income distribution, increases uncertainty, reduces the legitimacy of the government in the eyes of civil society and the business community, and leads to other forms of crime; in short, it has devastating consequences for human prosperity.[3] The most frequently used international measure of corruption is Transparency International's *Corruption Perceptions Index (CPI)*, published annually for 180 countries. The table below shows the results for the most recent CPI, for the top 10 least corrupt countries and several countries in Latin America. Uruguay and Chile are the best performers in the region, well ahead of Argentina, Brazil, and Mexico, to say nothing of Venezuela. Indeed, Uruguay and Chile are ahead of 16 members of the European Union, or in the top half of its 28 members. A decade ago, Chile used to share the top spot with Uruguay (23) and in 2003 it was, without doubt, the least corrupt country in Latin America with a rank of 20, compared to Uruguay (33) and ahead of Japan, France and Spain. The World Bank's *Worldwide Governance Indicators* broadly confirm this

[2] On this, see my blog "Is there a spiritual dimension to economic development?"
[3] See my blog "Nine reasons why corruption is a destroyer of human prosperity."

picture. So, Chile has slipped a bit over the past decade and a half, possibly reflecting political campaign finance scandals which have tarnished the reputation and ended the careers of many political figures. However, I am sceptical that, in and of itself, corruption in Chile has been a trigger for the recent massive demonstrations and the associated destruction of physical infrastructure (e.g., the metro) that have taken place.

Country	CPI Score 2018	Rank
Denmark	**88**	1
New Zealand	**87**	2
Finland	**85**	3
Singapore	**85**	3
Sweden	**85**	3
Switzerland	**85**	3
Norway	**84**	7
Netherlands	**82**	8
Canada	**81**	9
Luxembourg	**81**	9
Germany	**80**	11
Uruguay	**70**	23
Chile	**67**	27
Costa Rica	**56**	48
Argentina	**40**	85
Colombia	**36**	99
Brazil	**35**	105
Peru	**35**	105
Ecuador	**34**	114
Bolivia	**29**	132
Mexico	**28**	138
Venezuela	**18**	168

Source: Transparency International

Inequality

In Latin America, the much more serious problem is *inequality*. The most frequently used metric, the Gini coefficient, shows clearly appalling results for the region, at least compared with the European Union, the region of the world with the lowest levels of inequality.[4] The table below presents Gini coefficients for a handful of countries in Latin America and several members of the European Union, including Norway and the United States as valuable reference points. The average Gini for the Latin American countries listed is 46.3 whereas in the European countries it is 31.1, a gap of 15 percentage points, huge for a coefficient that, for all the countries in the world

[4] The Gini coefficient is the most commonly used measure of inequality. Developed by the Italian economist Corrado Gini in 1912, the coefficient is typically normalized to be between 0 and 1 (or 0 and 100), with higher scores signifying higher levels of inequality.

for which we have data, ranges from 26 to 59. This is worrisome, to say the least. Economic growth will reduce poverty; there is a close correspondence between the growth of per capita GDP and the gains made by the poor. But it will not necessarily reduce income inequality. Indeed, in some cases, depending on the country's stage of development, it may well widen it.

There is ample empirical evidence suggesting that growing inequality engenders political instability as well, and this is not a recent finding. In a pathbreaking study, Edward Muller (1988) long ago established two important results: first, that democracies with highly inegalitarian distributions of income had a much higher probability of breakdown than those with a more egalitarian income distribution; second, that the longer democratic institutions are in place, the higher is the likelihood that there will be a gradual reduction in income inequality. My guess is that the connection between inequality and political chaos and social breakdown has strengthened in recent decades because of developments in communications technologies. Income disparities are much more glaring (and dispiriting) than they were three decades ago. My colleague Branko Milanovic has established that 62 percent of the gains in global income over the past 30 years have been concentrated on the top 5 percent of the income distribution and people can see this and be reminded of it every day. So, the sooner governments in the region come to grips with the serious problem of inequality, the higher the probability that the region will not become ungovernable.

Country	Gini
Argentina	41.2
Brazil	53.3
Chile	46.6
Colombia	49.7
Costa Rica	48.3
Mexico	48.3
Peru	43.3
Uruguay	39.5
Venezuela, RB	46.9
Denmark	28.2
Finland	27.1
France	32.7
Germany	31.7
Ireland	31.8
Norway	27.5
Portugal	35.5
Spain	36.2
Sweden	29.2
United States	41.5

Source: World Development Indicators, World Bank.

Poverty

Much has been made of the sharp reduction in the levels of extreme poverty seen in the world during the past 30 years. The latest data from the World Bank shows about 760 million people living on less than $1.90 a day, the Bank's extremely austere poverty line. Much of the reduction in numbers to this level (from about 2 billion in 1990) is accounted for by high economic growth rates in China and, to a much lesser extent, in India. If one considers a poverty line of $3.20 per day, then the number of poor people today jumps to close to 2 billion, still an unacceptably high number. I am very sympathetic to the idea of using something like a $5.50 per day poverty line which, according to the American economist Nancy Birdsall, still leaves people struggling to make ends meet. At this poverty line, the number of poor in the world jumps to 3.5 billion people, or about 46 percent of the world's population. And of these, 170 million live in Latin America. So, we still have an unresolved poverty problem. And since, to paraphrase Lewis, aspirations are growing much more rapidly than incomes, this becomes another festering problem in the region, which interacts in toxic ways with income inequality.

Solutions

Enough diagnosis. Let me offer some possible solutions:

Take inequality seriously. Governments need to move more aggressively to reduce income inequality. This will mean more proactive use of tax policies and the budget as an instrument of distribution. This is what EU members have been doing for the past several decades, in a clearly deliberate way. Of course, this is easier done when governments are credible and citizens and the business community are convinced that higher taxes will not be stolen or otherwise wasted, but will be reflected in better schools, better quality infrastructure, improved public health services, and so on. The EU has a formal mechanism, embedded in EU law, which channels resources from members with higher incomes to members with incomes below the EU average. These resources are channeled through the EU budget and have had vast implications for the poorer members. When Spain and Portugal joined the EU in 1986, they were "poor" in relation to the more established members, and they began to receive close to 5 percent of GDP on an annual basis as "structural" funds and other inflows which, within a generation, literally transformed and helped modernize the Spanish and Portuguese economies. Latin America, regrettably, does not have in place such an ambitious program of economic and political integration, and has paid a heavy price for not creating an integrated economic space that might lead to economies of scale and improved efficiency (see below).

Improve the structure of government spending. Whatever revenue is collected needs to be better deployed. The problems here are multiple and insidious. In some countries too much is spent on wasteful government subsidies which, in the case of energy, go largely to benefit the upper income groups, who drive their cars in polluted cities and own the bigger houses. Subsidizing energy worsens income distribution and accelerates climate change; it is, in fact an idiotic public policy, followed gleefully in many countries in the region, with huge opportunity costs in terms of schools not built, hospitals not modernized, old-age pensions not boosted to more dignified levels. Other countries have tied their hands in senseless ways, by embedding in their laws various (sometimes seemingly well-meaning) restrictions on the structure of spending which seriously limit the ability of governments to redirect resources to more productivity-enhancing areas, instead of, for example, generous pensions for the military, who, in many countries, can retire at an unusually young age, given life expectancy levels. Latin American countries spend annually US$64 billion in their various military establishments, and that in a region of the world where the last major interstate conflict took place more than 80 years ago— the Chaco war between Bolivia and Paraguay in the 1930s. The IMF calls military spending "unproductive expenditures," to highlight the well-known fact that there is not much to be gained by, say, modernizing the air force, when airplanes will actually hardly ever be used, other than to occasionally impress the populations on national independence day and the associated military parades. More countries should imitate Costa Rica, where military spending is zero and the government instead has focused on human capital development and, yes, having a well-trained police force to enforce the law, deter crime and ensure appropriate levels of safety within national borders.

More rule of law. We in Latin America have a mistaken understanding of this concept. At various times and to various people "rule of law" has meant any of a number of things, including government bound by law, equality before the law, law and order, the presence of a predictably efficient system of justice, and the existence of a state that safeguards human rights. Some have argued that the concept is linked to notions of liberty and democracy, necessarily implying constraints on the power of the state and guarantees of basic freedoms for citizens, such as speech and association. In this view, the rule of law has elements of political morality and is very much a foundation for a just society. It is certainly inseparable from the morality underpinning contemporary democracy, with its emphasis on the protection of individual rights, including those of free expression, voting, and the right to private property. In Latin America, however, our politicians have generally taken a much narrower view. Instead of asking ourselves whether the laws are of general application, are well-known to the affected parties, are understandable, not subject to internal contradictions, not applied retroactively, not subject to frequent and arbitrary changes, etc., we have instead interpreted the rule of law to mean the rule *by* law, meaning that the there is no presumption of government subordination to the law, which is seen as a vehicle not to limit its power, but rather to serve its purposes. This is what some authoritarians mean when they talk about the "dictatorship of the law"—that is, the government may do as it pleases. People in the region, particularly the young, may not be able to articulate these distinctions precisely, but they readily recognize abuse when they see it (i.e., rigged elections) and are no longer willing to tolerate it. Going out into the streets to remind politicians that insulting the people's intelligence is not a recipe for good governance will be an increasingly frequent tool to promote social and political change.

Empower women. This may surprise some, but the fact remains that the region, while not the worst performer in the world in terms of its treatment of women as second class citizens, is still very much a male-dominated culture where much remains to be done in terms of the political and economic empowerment of women. In Brazil, the largest country in the region, with a population in excess of 200 million, only 15 percent of the members of parliament are women. The presence of women on the boards of publicly listed companies is, likewise, pitifully small. The issue here is not just one of justice and opportunity, it is also one of economic efficiency, as there is overwhelming empirical evidence that educating and empowering women has multiple benefits for productivity and economic growth.

Tackle corruption. I will not review here the utterly destructive consequences of corruption, as there is an extensive literature on the subject. But it is clear that there is profound discontent in the region with this particularly lethal form of economic and social cancer. In his magnificent book on bribery and corruption, John Noonan (1984) said that the damage inflicted by corruption "goes beyond any material measurement. When government officials act to enrich themselves, they act against the fabric on which they depend, for what else does government rest upon except the expectation that those chosen to act for the public welfare will serve that welfare?" Furthermore, bribery and corruption are deeply at odds with the moral basis of most of the world's great religions, which have often provided the moral underpinnings of the modern state. Anticorruption strategies have to be supported by moral education and the strengthening of the ethical principles underpinning society. This may mean reinforcing the civic responsibility component of secular education. It may require religious leaders to set aside narrow doctrinal differences and return to the spiritual roots of their respective faiths to revitalize their ability to lead individuals and societies to a stronger identification with the spiritual, rather than the material dimension of human nature. In particular, it will involve partnerships with all the organizations and social forces that have a strong ethical foundation. In a society with strong ethical standards, the struggle against corruption will gain a new source of strength that will complement the progress made in recent years in improving the legal framework designed to combat bribery and corruption.

A new idea to revitalize Latin America. Against the background of the chaos and destruction of World War II, the nations of Europe came together and founded the European Community in 1957. Initially intended to strengthen international cooperation and create an enlarged economic space, free of restrictions to the flow of goods and services, in time the EC evolved into the most important experiment in economic and political integration and gave rise to the largest trading block in the world. The process has not been smooth and progress in some areas has sometimes been followed by setbacks in others. But there is little doubt that, in a longer-term perspective, the experiment has been remarkably successful; 15 of the 30 countries in the world with the highest income per capita are members of the European Union. Latin America would benefit greatly from greater economic integration, from freer mobility of the factors of production, from creating an enlarged economic space where synergies and complementarities could be exploited to improve productivity and efficiency, as opposed to being a chaotic collection of sovereign states competing with each other and often acting at cross purposes. The EU evolved gradually; its first decade was largely characterized by the gradual elimination of tariffs on intra-European trade. Supranational institutions (e.g., a parliament passing EU law binding on its members) was decades away. But the idea of a united Europe was a powerful cohesive force and, for prospective new members (e.g., countries in Central and Eastern Europe in the late 1980s after the collapse of the Berlin Wall and thereafter) served as an effective catalyst for change and modernization and, as noted earlier in our discussion of inequality, a powerful mechanism for "convergence," the narrowing of income gaps between countries.

Without an exciting new vision of economic revival, the region is likely to continue to be gripped by the malaise alluded to by Naim and Winter. This will be bad for Latin America's 641 million citizens, and, in an increasingly interdependent world, bad for the rest of the world as well.