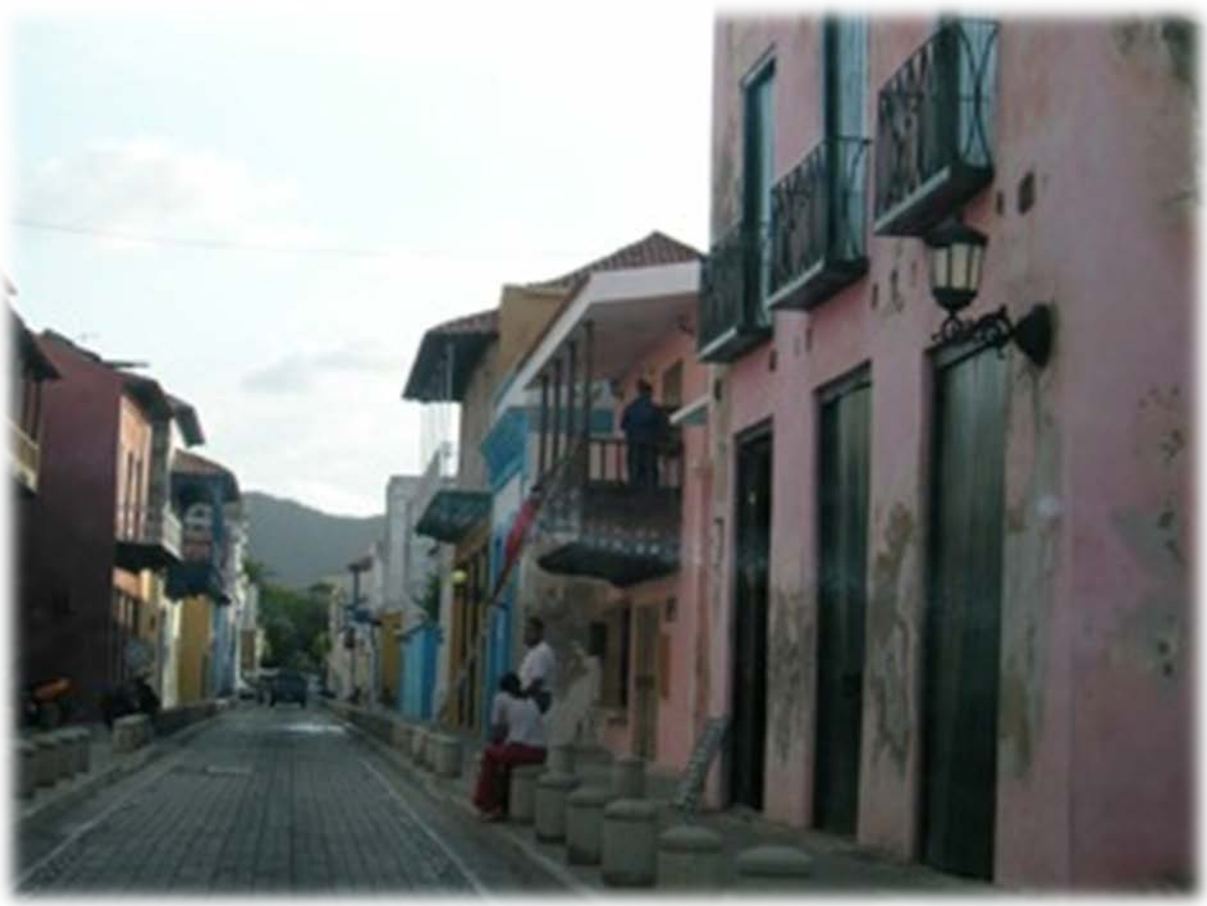
Chapter 1

Introduction to Latin America



When people travel to Latin American countries they usually find natural similarities throughout the region, from the way in which its population approaches life in general to the way in which day to day decisions are made. Even when we consider the perception that Latinos have about their well-being to the expectations that they have for future generations, it is clear that most Latin Americans think and behave in a very similar manner. This should not be surprising, after all the Latin American culture was influenced and shaped by the colonization process established by Spain and Portugal in the XV century. Since the languages spoken in these countries descend from Latin, the conquest of the native cultures of the Americas and the imposition of Spanish and Portuguese as the predominant languages of the region gave way to the description of the region as Latin America.

The typical description of Latin America usually highlights the immense and wonderful diversity of its natural habitat, which is home to thousands of species of animals and plants, and ranges from the high mountains of the Andes and Sierra Madre to the exuberant lowlands of the Amazon and Central America. For people from the more developed countries, the cultural differences between the countries of the region make Latin America an attractive destination to explore and discover. Brazil is very different than Peru, and Peru is very different than Colombia. It also offers visitors an opportunity to experience life under distinct social and cultural arrangements, experiences that provide an insight into the values of the people from the region that can help us enrich our world view.

Advances in communications and quicker and more secure transportation is allowing millions of people to travel to exuberant destinations, with tourists usually looking for ancient Inca and Maya archaeological sites or metropolitan lifestyles like those found in Mexico City, Bogota, Rio the Janeiro, or Buenos Aires. But students are also looking for cultural lifestyles that are more similar to their world views, embarking in adventures in tropical jungles or enjoying the innumerable beaches of the region, or just living *la vida loca* with the wild and friendly parties typical in the region – like the carnival in Rio the Janeiro. There are also a number of people with more altruistic reasons who are interested on the problems and challenges affecting the population of the region, which in many cases result from slow dissemination of knowledge, practices, and technology, but in some other cases arise from the negligence of their leaders. Groups are travelling to the poorest regions of Latin America to help build schools, hospitals, churches, etc., but are coming back with a newer appreciation for the region.

We are now living in a globalized world that has made places that we could only dream of in the past a lot more accessible to us, especially to the ones that are curious enough and willing to give up a little bit of comfort in order to explore those places that captured our imagination. While a book, a movie, or the stories that we hear from relatives or friends are usually the reason why we become interested in visiting a particular place, more and more often we are finding that what is driving the interest of travelers is just the peculiarities – and perhaps lifestyle – of the people of a particular country, region, or culture. More travelers are exploring places just to uncover the secrets that make the people of the region one of the happiest in the world – at least according to the recent report of the Happy Planet Index. Their newest measure places Costa Rica (#1), Colombia (#3), El Salvador (#5), Panama (#7), Nicaragua (#8), Venezuela (#9) and Guatemala (#10) in the top 10 places (the U.S. places in the 105th position (out of 151 countries), Australia in the 76th position, and Germany in the 46th position). Traveling around the region exposes us to the inherent friendliness towards visitors, never-ending social engagements, acoustic guitar *serenatas*, culinary delicacies, traditional customs, and of course the traditional slow pace and tranquility of the region.

The typical description of Latin America should also incorporate the friendliness of their population, both towards tourists and to their countrymen, allowing visitors to mix-in their daily lives and understand their cultures. Traveling around the region is relatively cheap, with many goods being priced at levels accessible to the average person in the more developed countries. Travelers can find bargains when paying for taxi rides (i.e. for 50 cents of a U.S. dollar in Bolivia), a pack of top-brand cigarettes (i.e. for 60 cents of a U.S. dollar in Ecuador), or for a comfortable room by the ocean (i.e. for $35 U.S. dollars in Costa Rica), all of which makes our vacations more enjoyable when we are travelling with limited budgets. It is not rare to also hear encounters of tourists with other co-nationals who have moved down south to be able to live a more pleasant life, especially for those retired people who live on a fixed income. Furthermore, while we are used to hearing about Latin Americans migrating to the U.S. or Europe, as reflected by the large settlement of migrants from this region in the more developed countries, a reversal of flows has been taking place since 2010. With the growth rates in many Latin American economies exceeding those of the traditional economic powers, entrepreneurial migrants from advanced economies experiencing economic difficulties are finding it attractive to move to the region to take advantage of the economic opportunities brought about by fast growing economies.

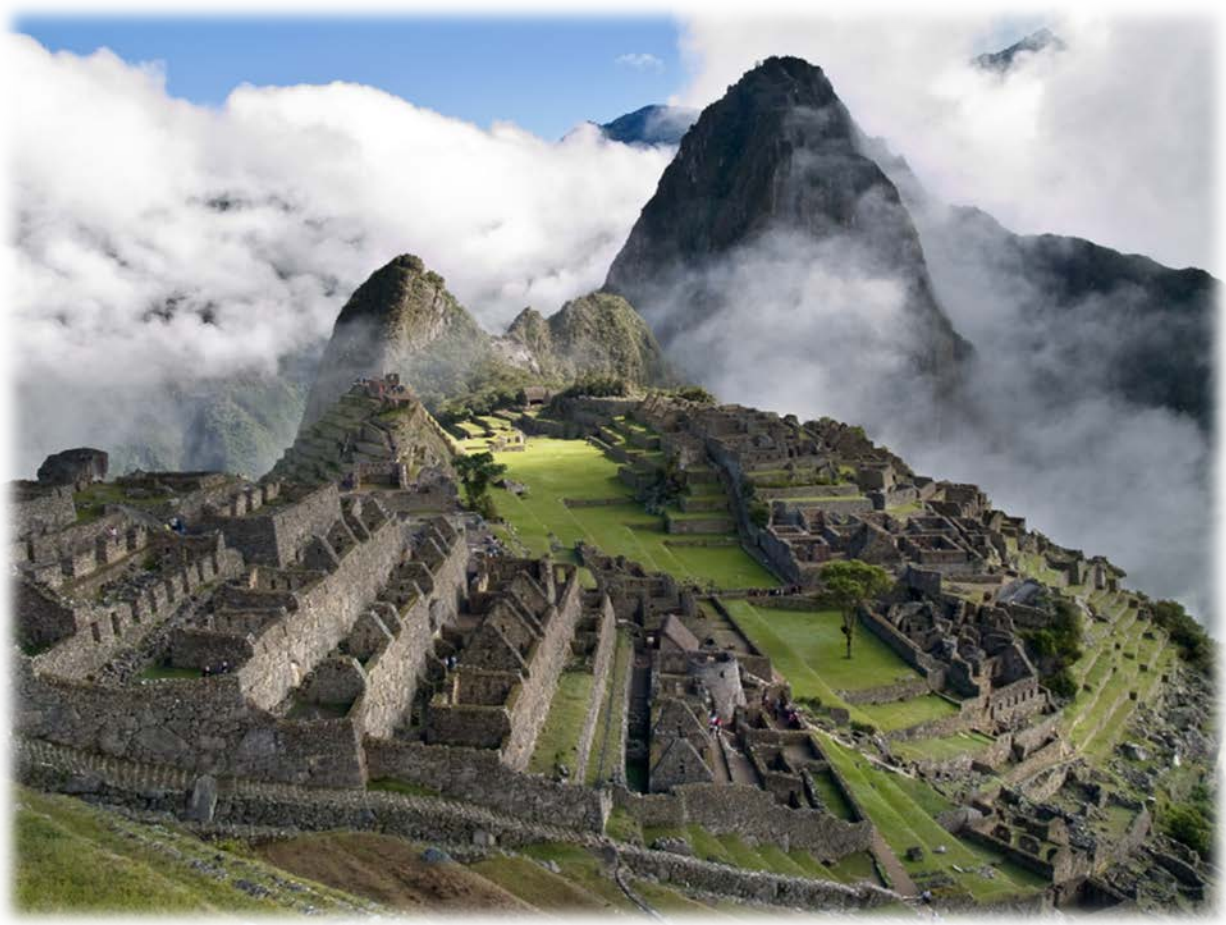
While in many cases this migration responds to the economic difficulties in their home countries, like those experienced in Spain and Portugal, the relatively better opportunities in Latin America to grow professionally and thus secure a job and better pay in these new destinations is proving to be more and more influential. The growth rates in the region have increased the demand for qualified workers beyond the availability in the region, and employers are having difficulty filling new openings with domestic workers and are offering a premium to attract experienced people from abroad. This movement of young risk-taking professionals to Latin America is helping propel record growth rates in most countries of the region, and is alleviating the brain-drain that the region usually experiences as its most educated and entrepreneurial people migrate to the more developed countries. This new migration pattern is being reflected by the flow of funds –remittances – that migrants traditionally send to their families back home, which is usually taken as a payment back to the household for the human capital that it loses with the migration of one of its members, usually the father or mother. In fact, workers' remittances from countries like Brazil to Portugal or from Mexico to Spain have reversed and are now larger than the inflows that these Latin American countries were receiving before.

But not everything is glowing in the region. It would be hard to omit the perception that many people have of an economically backward system, blamed in many cases to the relaxed and unselfish personality of its people – like the stereotypical ranchero with a big sombrero waiting laying down under a tree for the day to go by. In many instances this perception of backwardness arises from the overlapping interaction between formal economic establishments operating under relatively efficient levels of productivity with the web of informal businesses producing all kinds of hand-made and light manufactured products at much lower productivity levels. Such perception perhaps also arises from the frequently observed disparity in terms of wealth, as one can observe poor people living almost next door to affluent neighborhoods. Such disparities are to a large extent the results of a highly unequal distribution of resources that has created a level of inequality that precludes an efficient participation of a large portion of the population in the development of the region, limiting the strength of internal markets needed for sustainable growth.

Most of the time visitors stay in modern and even metropolitan suburbs, both because of comfort and security concerns. This type of accommodations in many cases limit the exposure that one can have with the local people, leaving us with a partial view of reality. While in many cases these living arrangements are so closely connected to surrounding impoverished villages and slums that tourists have a glimpse of reality, only those audacious enough to explore in the less touristic areas are able to have a more realistic view of the poorest portion of the cities, where in many instances the majority of the population lives. The most curious tourists that seek the more traditional lifestyle that the typical Latin American faces will probably also describe the traditional and sometimes old and uncomfortable transportation system, plagued by dirt roads and old buses full of people and even animals. This is compounded by the chaotic and un-ordered layout of the new urban settlements, with its lack of signaling making it extremely difficult to locate less important destinations. This unfriendly – at least for visitors – and confusing setup is sometimes exacerbated by the perceived lack of laws and regulations in traffic management, where it is not rare to observe that the driver of the biggest vehicle or the most audacious one would seem to take control of the roads.

While most of us will primarily hear accounts of the extravagant lifestyles in Buenos Aires and Sao Paolo, the astonishing social balance found in the great Mexico City and Lima, the magnificence of

Machu-Picchu in Peru or the Mayan ruins of Chichen Itza in the Yucatan Peninsula of Mexico, or the happiness of the people in Rio de Janeiro or Barranquilla, only a few of us will hear about the encounters with the indigenous populations of the Andes or the Amazon. This lack of exposure to the native population of the region precludes many of us from realizing the precarious way in which most peasants of Central America and South America live, the lack of sanitation and infrastructure that most of the impoverished slums and rural areas have to endure, or the struggles that the poor face in order to make ends meet to provide food for their families. People are working hard, but their standard of living of a significant portion of the population is barely improving. This is particularly true for the ethnic minorities – who in some cases are actually majorities – that have been systematically segregated and are still living in conditions similar to that of their ancestors.



Machu Picchu (the “Lost City of the Incas”) is the ancient Incan city build in the top of a mountain in the Peruvian Andes, located at approximately 2,430 meters (about 8,000 feet) above sea level. Machu Picchu attracts tens of thousands of tourists every year and it is considered by UNESCO as one of the “most amazing urban creation of the Inca Empire at its height.”

When we talk about the Latin American economies we usually hear about the above average performance of countries like Brazil, Chile, and Costa Rica, and praise the institutional changes undertaken to promote free market economies. But even among these best performers we find an intriguing but well established connection between the state and the private sector. The patterns of economic development in the region implemented since the 1950s have created a great dependency of most of these local economies to their governments, reaching levels of up to 50 percent of total production connected to the state. You will also hear about the great dependency on the production of primary commodity products – those that are exported without any or little processing, like minerals and grains. And lastly, you will also hear about the dualistic structure of the industrial sector, with those firms engaged in international trade using state-of-the-art machinery and management practices while the producers for domestic consumption sometimes using obsolete equipment, processes, and techniques that sometimes date back to the last century.

Moreover, the dualistic economy of Latin America puts the formal and informal sectors on conflicting paths. While firms producing in the informal sector sometimes produce the same type of goods that formal firms are producing, in other instances they complement each other, with the informal sector sometimes producing intermediate goods that are used as inputs by the formal sector. The informal sector also provides perhaps the only opportunity for the unemployed to earn some income for their daily subsistence, giving that most countries do not provide unemployment benefits that could alleviate the transition from one job to the next. But the informal sector also creates an unfair competition to the formal establishments when they produce similar products, as they lower their costs by omitting the payment of taxes to the state or social benefits to their employees. Employment in the informal sector is frequently perceived as inferior because of its low usage of capital, which affects productivity negatively. But strict labor laws make it hard for the formal sector to accommodate new entrants, especially in response to demand fluctuations. Most laws were implemented to protect jobs, and temporary labor expansions would force firms to keep labor increases permanently even when demand for their goods falls, affecting their long-term profitability. This reluctance to expand employment by the formal sector and the lack of unemployment insurance pushes most unemployed to any easy-access job to earn a living, making the informal sector the sector with the highest growth rate in terms of employment – it creates almost 75 percent of all new jobs in the region.

Latin America is a complex economic system, where wealthy people live next to the poor. It is interesting to note that the second wealthiest person in the world in 2014, Carlos Slim, is from Mexico, with a net worth of $72 billion dollars (surpassed by Bill Gates in the newest ranking). A small portion of the population is wealthy enough to live in very similar conditions to the wealthy in the more developed countries, with access to the newest technology, luxury goods, and world-class education. But we can also find people who are so poor that they can barely afford the luxury of taking time to plan their future. For example, Rogelio Quispe, in the highlands of Peru, works 14 hours a day caring for his llamas or transporting salt and other goods on the backs of his herd to supplement his income, but he manages to live only a little bit better than his ancestors did 200 years ago. These contrasts between rich and poor in the region are exacerbated by the huge inequality in access to health care, education, opportunities, and decision making, giving rise to one of the greatest income inequality gaps in the whole world. This income inequality is in many cases exacerbated by discrimination and a lack of opportunities for social mobility, a result of a social and political structure that makes it extremely difficult for the poor to improve their skills, shape the institutions that affect their condition, and improve their well-being.

All these disparities, economically and socially, were initially determined by the colonization process and have been reinforced by institutions that were often centralized and responsive to particular interest groups, labor and social relations that benefited the wealthy, and trade patterns that relegated the development of human capital. While at the beginning of the XX century most Latin American countries had standards of living comparable to the leading economies of the world, or not too far below, economic development in the region has slowed down significantly during this past century. While the whole world has experienced huge increases in productivity due to the industrialization of most production processes, the average growth rates achieved by most countries in the region were significantly below those posted by much of the rest of the world. Even the best performers of the region are having difficulty sustaining their recent performance, and they are all trying to adjust to the new economic and geopolitical conditions of the world to improve the standard of living of their populations. Growth seems to come in cycles, and every cycle seems to come with its own specific opportunities and challenges. Adapting quickly and efficiently to the new environment is crucial for the economic performance of the countries of the region.

The understanding of the factors and reasons that have slowed down economic development in the region becomes imperative to understand how these countries have performed the way they did, and with this understanding figure out the ways in which the countries of the region could achieve economic development in the future, hopefully to catch up with the more developed countries. The understanding of economic growth and development in the region is a tall task to achieve in a single book, but the historical episodes of economic growth in the region provide a natural structure to examine the performance of the region. We will use economic theory to explain economic performance, as individuals, households, and organizations behave in a rational way to maximize well-being. By first building the theoretical background is helpful because it provides us with a rational framework with which we can examine the specific policies that were implemented in the region and have achieved a given outcome. Economic interactions have shaped the colonization of the region, the development of independent states, the integration to world markets, political tendencies, market structures, and development efforts. These topics will be fully developed in the next chapters, but before we go there let's clarify some basic distinctions between economic development and economic growth.

Economic Development versus Economic Growth

Latin America, like most of the countries of the world, has grown economically over time, although at a different speed. Although the countries of the region have performed at different pace, what is more notorious is the systematic decline of the countries of the region relative to the United States (another country colonized at a similar time). Argentina, Brazil, and Mexico used to have comparable standards of living to the U.S. in the XVI and XVII centuries, but their economies have slowly and consistently fallen behind the economic performance of their northern neighbor. As time went by, the common perception was that economic development in the region was lagging behind those of the U.S., Canada, and Europe. In order to talk about the relative performance of Latin American countries compared to the rest of the world, however, we need to make sure that our understanding of the measure that we will use to gauge economic performance is reflective of the factors that we care about when talking about economic development.

The general measure traditionally used to gauge economic development used to be Gross Domestic Product (GDP), or its per capita measure, after all the higher your production per person the higher the income of the average person and the greater the amount of goods and services that this average person could potentially acquire. Consequently, as long as the average person could produce a higher level of output then we could safely assume that they could enjoy a higher standard of living. If we would go by this measure of economic development then we could compare the performance of the countries of the region to one of the leading economies of the world in a given period of time. For example, we could compare it to the U.S., a country that had a GDP per capita of $48,442 in 2011 – in Purchasing Power Parity (PPP) dollars. In that year, Mexico had a GDP per capita of $15,340, Argentina of $17,674, Ecuador of $8,486, and Nicaragua of $2,941, all these figures in PPP to account for varying costs of living (World Bank's World Development Indicators). Clearly, people in Latin American countries were generating less than one-third of the average income of this more developed country in 2011. In order to achieve better incomes in the countries of the region, then it follows that these countries would need to increase production by a higher rate than the increase in their population, such that GDP per capita would rise. Improvements in the "standard of living" of these countries could then be achieved.

However, this concept is better termed economic growth, as it only reflects improvements in productive capacity but it only implies that this higher production is distributed in such a manner that the average person in fact improves its standard of living. We could just assume that if the bulk of additional output is produced by a multinational corporation (MNC) who sends its profits back to its headquarters outside the country then no additional revenue will be filtered down to the population. In such a case more output does not lead to better standard of living. It is actually better to leave the definition of economic development to a concept or measure that characterizes a wider and more systematic improvement in the livelihood of the average person. The idea is that economic growth does not necessarily involve improvements in the standard of living of people. To really measure improvements in standard of living, one would like to include aspects that deal with the way that people live (like access to electricity, basic sanitation, phones, internet, etc.), the state of our health (like life expectancy, the number of children that survive past the age of 5, access to health care, etc.), the environment that we live in (like the amount of pollution, waste disposal, clean water, etc.), and the engagement of people in determining how their institutions operate (like gender representation, democratic institutions, etc.). Most recently we have expanded our definition of economic development to also account for the importance of equity, empowerment, and opportunities.

A more precise and inclusive definition of economic development would then include opportunities for people to improve their lives, policies that are geared to reduce inequality, the efforts implemented to alleviate poverty, the access to education and health care, and the participation and involvement of the people in the decision-making process of their region and country. In fact, one of the most comprehensive definitions of economic development is provided by the following quote from the 1991 World Development Report published by the World Bank:

> *"The challenge of development …. is to improve the quality of life. Especially in the world's poor countries, a better quality of life generally calls for higher incomes – but it involves much more. It encompasses as ends in themselves better education, higher standards of health and nutrition, less poverty, a cleaner environment, more equality of opportunity, greater individual freedom, and a richer cultural life"*

The Human Development Index (HDI) is one of the measures that have been created in order to facilitate the study of quality of life within a country and throughout time, and to gauge economic development between countries. Mahbub ul Haq and Amartya Sen created this index in 1990 to be used by the United Nations Development Programme, shifting the focus from an economic-based measure to one that concentrates in human well-being instead. The HDI tries to measure development by combining measures of economic activity (gross national income per capita at purchasing power parity), education attainment (both in terms of 25-year-olds school attainment and 5-year-olds expected years of schooling), and health (life expectancy at birth), producing a unique measure for all member countries that can be used by policy-makers to compare relative improvements in the well-being of the population of a particular country. The measure ranges from 0 to 1, with the highest level representing a “higher level of development”. Although the HDI provides a consistent measure of well-being for comparison, both between countries and through time, it is not free of criticism. Some people find it too egalitarian, too reflective of “Western” values, and with little attention to environmental considerations. While this single statistic can be too broad to examine the reality of specific countries, the availability of disaggregated data allows one to compare different groups, different ethnicities, or different regions within a country. It should be noted that there is a high correlation between the HDI and GDP per capita in many instances, as should be expected, but this is not always the case.

Table 1 below shows some of the main economic indicators for the countries of the region. The first column presents the 19 Latin American countries of the region, with the data for the U.S. shown in the bottom for comparison. The second column provides information on the size of these countries in terms of population, and it can clearly be seeing that the region is composed of countries with different sizes, with the largest one being Brazil with 196 million people in 2011 and the smallest one being Uruguay with less than 4 million people. Both countries are also the largest and smallest in terms of area. The size of the population is important in determining the size of the market in terms of potential demand and in terms of resources (labor) that can be used for production. The third column presents data on average income, expressed here in GDP per capita in Purchasing Power Parity terms (PPP) – with a PPP dollar being able to buy the same amount of a goods and services in all countries. The data shows that the country with the highest GDP per capita is Argentina, where the population earns on average one-third of what is being earned in the U.S., and the country with the lowest average income is Nicaragua, where the population is earning $2,941 PPP dollars, one-twentieth of what is being earned in the U.S. Table 1 also shows that 40 percent of Latin American countries are generating GDP per capita that are below $10,000 PPP dollars.

The fourth column of the table shows the life expectancy for the population of these countries when one is born. Here we find an interesting outcome since the population being born in Chile, Costa Rica and Cuba can expect to live on average for 79 years, expectation that is higher than that of people in the U.S. – even if their average incomes are significantly below. However, we also find a country where the life expectancy at birth for its population is only 66 years (Bolivia), 17 percent less time than in the best performing countries. We should keep in mind that these are averages, for males and females but also for people from different regions within a country. Life expectancy is much lower in Chiapas then it is in Mexico City, on average much lower in rural regions than in the urban centers, and significantly lower for ethnic groups than for the white population. Just like with income inequality, life expectancy at birth fluctuates greatly within countries.

The last column of Table 1 presents data on a broader indicator of human well-being, the Human Development Index (HDI). Here we find that there is a significant gap between the U.S. and the best performer (Chile) and a much greater one with respect to the worst performer of the region (Nicaragua). Twelve countries score between 0.80 and 0.87, which can be considered more developed in this sample, and 7 countries score between 0.66 and 0.79. While there is a general pattern indicating that the countries with the highest average income achieve higher scores in the HDI and that the countries with the lowest average income are situated at the bottom of the scale in terms of HDI, it is worth noting some discrepancies, reflecting the importance of educational attainment.

Table 1 – Main Indicators for 2011

	Population (millions)	GDP per capita (PPP in thousands)	Life Expectancy (Years)	Human Development Index
Argentina	40.76	**17.674**	76	0.86
Bolivia	10.09	5.130	***66***	0.72
Brazil	**196.66**	11.719	73	0.81
Chile	17.27	17.125	**79**	**0.87**
Colombia	46.93	10.103	73	0.80
Costa Rica	4.73	12.236	**79**	0.85
Cuba	11.25	.	**79**	0.86
Dominican Republic	10.06	9.863	73	0.77
Ecuador	14.67	8.486	75	0.80
El Salvador	6.23	6.877	72	0.74
Guatemala	14.76	4.963	71	0.70
Honduras	7.75	4.066	73	0.73
Mexico	114.79	15.340	77	0.85
Nicaragua	5.87	***2.941***	74	***0.69***
Panama	3.57	15.695	76	0.84
Paraguay	6.57	5.419	72	0.76
Peru	29.40	10.318	74	0.80
Uruguay	***3.37***	15.181	76	0.86
Venezuela	29.28	12.836	74	0.84
United States	**311.59**	**48.442**	**78**	**0.95**

Note: Statistics from World Development Indicators – World Bank. GPD per capita is in purchasing power parity terms, life expectancy at birth, and Human Development Index.

These data provides some indication of the level of development of the countries of the region, but we have to keep in mind that those differences in these countries can be driving some of these different results. Geographical considerations can be important in determining the life expectancy of the population of this set of countries, with people born in countries with better climate – like Costa Rica and Cuba – allowing its people to have a higher life expectancy. But it is also true that the policies in place can be conductive of a given outcome. For example Cuba does not have a high GDP per capita, but its government invests heavily in education and health care, and this is reflected in their high life expectancy.

We can also look at the consumption of certain goods or services (which can make live more amenable) to determine what type of standard of living the people from different countries in the region are experiencing. Table 2 continues to provide information on access to technology and energy. The second column presents data on internet penetration, measured as internet usage out of 100 people. Here we can see that the country with the highest internet penetration is Uruguay, but such usage is less than 65% of that of the U.S. The country with the lowest internet usage is Nicaragua with only 10 percent of its people using the internet, but with Honduras and Guatemala also following almost identical levels of penetration. In terms of cellular phone usage we find an interesting result in the data, as we find that people in Panama use cell phones at a rate of 1.85 per person. You may wonder how this can be possible.

Part of the answer lays on the fact that access to cell phones is much cheaper than access to fixed lines in the region, but also is a result of the bad coverage offered by the different service provider – people usually have to carry more than one provider to stay connected as they move to different parts of the city or the country. Of course, the low usage of cellular phones in Cuba can be explained by the existing regulations in the island, which precludes free communication between its people.

Table 2 – Main Indicators for 2011

	Internet Users (per 100 people)	Cellular subscriptions	Energy Use (kg of oil eq. p. c.)	Consumption of Electricity (KWh)
Argentina	36	142	1853	2759
Bolivia	20	72	638	558
Brazil	41	104	1243	2206
Chile	45	116	1826	**3283**
Colombia	37	96	697	1047
Costa Rica	37	65	1067	1813
Cuba	16	***9***	1022	1348
Dominican Republic	40	90	826	1358
Ecuador	29	102	796	1115
El Salvador	16	124	828	845
Guatemala	11	126	701	548
Honduras	11	125	592	678
Mexico	31	81	1497	1943
Nicaragua	***10***	65	***540***	***460***
Panama	43	**185**	896	1735
Paraguay	20	92	749	1056
Peru	34	100	550	1136
Uruguay	**48**	132	1224	2671
Venezuela	36	96	**2357**	3152
United States	**74**	**90**	**7225**	**12914**

Note: Statistics from World Development Indicators – World Bank. Internet users is per 100 people, cellular subscriptions is per 100 persons, energy use is kilograms of oil equivalent per capita, and electric power consumption is kilowatts per capita.

The last two columns of Table 2 describe the usage of energy and electricity in the region. Column four indicates that Venezuela is the country of the region with the highest usage of energy – expressed in terms of kilograms of oil equivalent per capita – and that Nicaragua is the country with the lowest use of energy. It is well known that Venezuela is an important oil producer and that energy is heavily subsidized in the country, but even after controlling for that, its population is only consuming less than one-third of the energy consumed on average in the U.S. In terms of electricity consumption – expressed in terms of kilowatts per hour – we find that Chile is the country of the region with the highest usage of electricity (closely followed by Venezuela). Here the disparity relative to the U.S. is accentuated, as it reaches almost one-fourth of the usage in the U.S. When talking about environmental protection, this lower level of energy consumption is one of the points that are traditionally brought up by the countries in the region to push for more action to reduce pollution in the more developed countries, and more leniencies in the policies pushed to the developing countries.

However, it is not all about consumption, so we should also be wary about the measure of economic development that we use when we are comparing people with different backgrounds, cultures, and social pressures. For instance, the perception of economic development for a person from a more developed country can be significantly different than that of an indigenous person from the Amazon basin, a *quechua* community in the Andes, or a peasant of Chiapas. So, is the overall standard of living of the developing region any worse than the rest of the world? A significant percentage of people in the region are happy living the way they are (as we saw in the Happy Planet Index). They claim that the social network that exist in their society provides them with a pleasant life, that the demanding work of the "first world" would definitely reduce their free time that they are currently using in social activities, and that the contamination levels of the "developed" countries are not seen in their environments and thus not affecting them. They also argue that the need of "luxury goods" are not really necessary to achieve happiness, and to some of the people in the region, that the way in which things work (having poorly paid maids and even almost slaved people to work for them) is what provides their standard of living. Of course, what people really value is conditioned by their standard of living, and different social structures value certain arrangements more than others. Trying to find a measure for economic development that fits all cultures and social structures can be hard, but we have to find, and use, a measure that reflects the aspirations that most people in the world would feel inclusive in order to use it for comparison purposes.

Salar de Uyuni, located in the south of Bolivia, is considered one of the most beautiful places in the region. The immense salt deposit creates the effects of a lake. Here the Tunupha volcano in shown in the background of the salt flats.

William Bluske, author of "Underdevelopment and Happiness", a popular book in the south of Bolivia, recalls the beauty of the past when people could go back to their rural properties in the summer and enjoy nature and the fruits typical of the season, and when people could embark in expeditions in the countryside and have a delicious meal waiting upon their return, or when national and international issues where hardly discussed and didn't have large repercussions in the regional economy. All these memories could be taken as a sign that the past was actually better than the present, or that happiness was present because development had not appeared yet. But we have to be careful to draw such conclusions before taking into consideration the perspective used to interpret the book. If you were from the economically well-off portion of the population then you could identify with the narrative of the author that things were good and you rarely worried about the rest of the world or about economic conditions. But if you were one of the workers on the farm, or the maid that was serving the upper-middle class – and perhaps even the middle class – then those days were not as nice as the book portraits. You were probably working long hours to serve your employer, and didn't have much time to enjoy with your family and provide the goods and services that your employers were consuming. The change that has happened since then was actually good for most of the poorest portions of the population, giving them new opportunities to participate in a larger market, and find jobs in different sectors. Higher levels of migration have brought new economic agents and institutions to previously secluded areas, and expanded markets that created larger and more interdependent economies, with newer opportunities. Therefore development has been happening all along, but its impact on society has had different effects on various classes – some finding new opportunities and others confronting new challenges.

However, we should not compare levels of development by just using the traditional measure of development, as development can mean different things for different people. It is true that there is a great level of satisfaction and even happiness amongst the poorest portions of the population in Latin America – and in many parts of the world for that matter – simply because people are not in touch with the newer products available for consumption or the newer services that can positively affect your standard of living. It is true that if you are unaware that something is available then your world view and your approach to life will not take them into consideration. One could perhaps be satisfied with less, and even happier than somebody with more material wealth. It is amazing to see how happy many farmers are in the valleys of the Andes and the countryside of Central America, even if farmers are relatively poor.

But we should be careful of not using the lack of knowledge of certain advances to draw excuses for the state of our societies, especially when you fail to account for the overall improvements in the well-being of the whole society, which is reflected in the HDI for example. In many instances we hear people describe their satisfaction with their state in comparison with the difficulties experienced in the more developed countries, bringing stress from working long hours, the excessive time spent commuting back and forth from work, and the de-personalized relationships that are frequently found in neighborhoods in the "first world". While these perceptions about living in the more developed countries have some validity, it can also serve to validate ones standard of living and form a sense of satisfaction about its own structure. It is like looking for excuses to substantiate your position, but doing it by picking up only the negative trends from modernization and excluding the beneficial aspects of the more developed economies, like economic stability, higher access to education and health care, less dependence on patronage and political influence, etc.

In many instances we concentrate so heavily on what is better that we fail to account for the environment in which people operate. Economists and policymakers would frequently try to understand behavior from an optimality ideal, and try to achieve efficiency given the concepts validated in the advanced economies. But efficiency achieved in a developed country is not always feasible or implementable in developing countries, due to the state of markets, the quality of institutions, or cultural differences. For example, the traffic problem that affects many of the large cities of the region and that calls for the implementation of mass transportation systems (with large buses for example) has proven almost impossible to solve. Because the drivers of the small “trufis” that create most of the congestion are organized in unions or cooperatives, they can protest, strike and paralyze the city, or overthrow the elected authorities if they feel their interests and livelihood are affected. The same thing happens with educational initiatives that try to reform the sector to improve education outcomes, where the powerful teachers unions will block changes even if they are for good. Sectors that protect their particular interests prevent necessary reforms from being implemented.

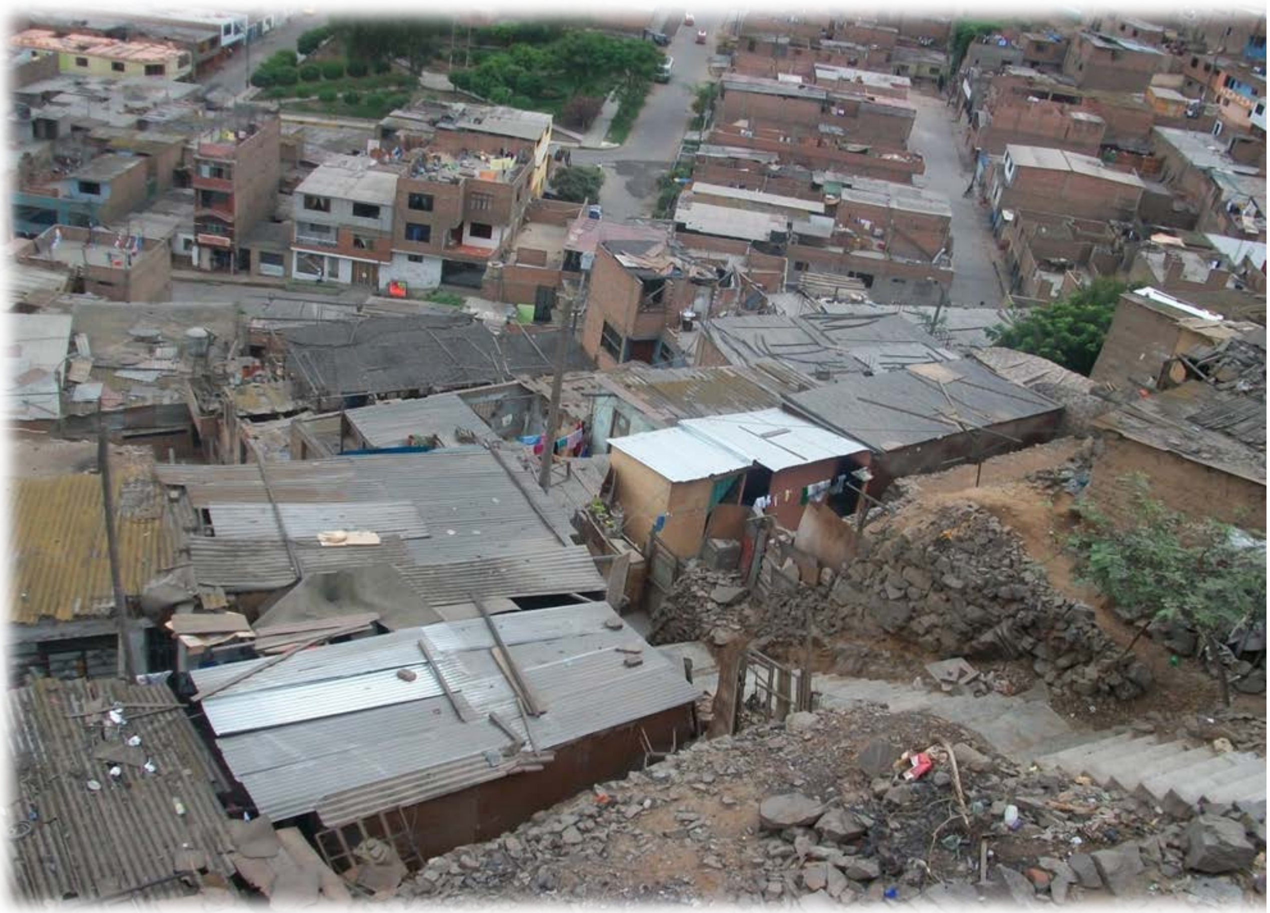
Current Conditions

Latin America is currently enjoying a period of remarkable macroeconomic stability, which together with the high primary commodity prices has created a period of economic growth that compares to the period of the Asian miracle (1970-1990). While historically Latin America has grown at an average of 2.2 percent per year, since 2004 the average growth rate for the region has been 4.7 percent, including the contractionary period experienced in 2009 due to the financial crisis in the more developed countries of the world. Real GDP for the region has almost doubled since 1990, experiencing a 95 percent increase in 23 years and inching close to 3 trillion U.S. dollars (approximately a fifth of the U.S. economy). However, real GDP per capita in the region has only increased by 53 percent during this period (62 percent in Purchasing Power Parity (PPP) dollars), reaching $4,000 U.S. dollars ($8,900 PPP dollars).

The higher demand for primary commodities (minerals, soy beans, etc.) from the region has pushed some countries into trade surpluses, allowing them to accumulate international reserves and thus reduce their vulnerability to external shocks, becoming financially more solvent. In fact, Latin American countries where able to increase their foreign currency reserves by 473 percent during the last 13 years, even after implementing significant increases in their social programs. This above average growth rates has also allowed Latin American countries to reduce their external debt and access funds at lower rates. External debt has decline from its peak of 138 percent of Gross National Income (GNI) in 1989 to 33 percent of GNI in 2011, hovering around this level for the last 5 years. In contrast, the national debt for the U.S. has been increasing and is hovering around 100 percent of GDP. The structure of the external debt has also improved, in terms of maturity (longer term), rate (lower rates), and currency denomination (with more debt now being denominated in the domestic currency). The region continues to depend on global demand for its exports, but this demand has shifted to emerging markets from Asia, with less reliance on the American and European demand.

These sound macroeconomic conditions, strong financial system, and improved terms of trade are allowing governments to increase their public spending in social and productive projects. Consumer spending is becoming the main growth engine in many countries of the region, with strong household credit and rising personal income from higher wages and lower unemployment levels fueling internal demand. Of course, this higher demand has to be accompanied by increases in productive capacity to make it sustainable, or inflationary pressures can arise. In some countries this higher internal demand is also being propelled by the workers remittances that many families are receiving from family members residing abroad, representing more than 10 percent of GDP in countries like Nicaragua, Honduras, and El Salvador.

We have also entered into a window of opportunity in terms of the demographic profile of the region, as a larger proportion of the population of the region is now in the working-age group and thus able to contribute to the production process. This favorable period is expected to go from 2010 to 2025, and will have the percentages of the elderly and the young being at their lowest levels. While this can be important in terms of production – more workers should lead to higher levels of output – it also has implication for the quality of education in the region. Educational systems will experience smaller pressure in terms of students, such that for similar budgets they should be able to concentrate on quality, something that the region desperately needs in order to keep competitive in this globalized world. In order to sustain the current growth rates we have to improve the productivity of the labor force. The region is still plagued by weak productivity fundamentals, for example productivity in Brazil is only 15 percent of that of the U.S.



A neighborhood in the outskirts of Cuzco, Peru. Most urban areas are clearly distinguished by the more developed and modern centers and the poor neighborhoods of the outskirts.

This renewed growth, experienced in the region for the past 15 years, is also enhancing the role that Latin American countries play in world issues. Payments of debt to the International Monetary Fund (IMF) has allowed countries to enhance its voting rights and influence, with countries even eliminating their debt and thus becoming more independent in the implementation of policies of their own choosing instead of following directives from the IMF. Brazil, and other countries of the region, has opened dozens of new embassies and consulates around the world in the last 10 years. The rise of China and India, amongst other emerging economies, have opened important markets for the countries of the region and has allowed them to build stronger ties with these countries, giving new political sway to some countries of the region. We have also experienced a strong performance by many Latin American multinationals, catapulting them into the global market – the Brazilian investment group 3G Capital for example has joined forces with Warren Buffet to purchase the iconic brand Heinz. This newly found strength is also allowing some Latin American countries to experiment with alternative economic models, incorporating social and environmental considerations into their systems.

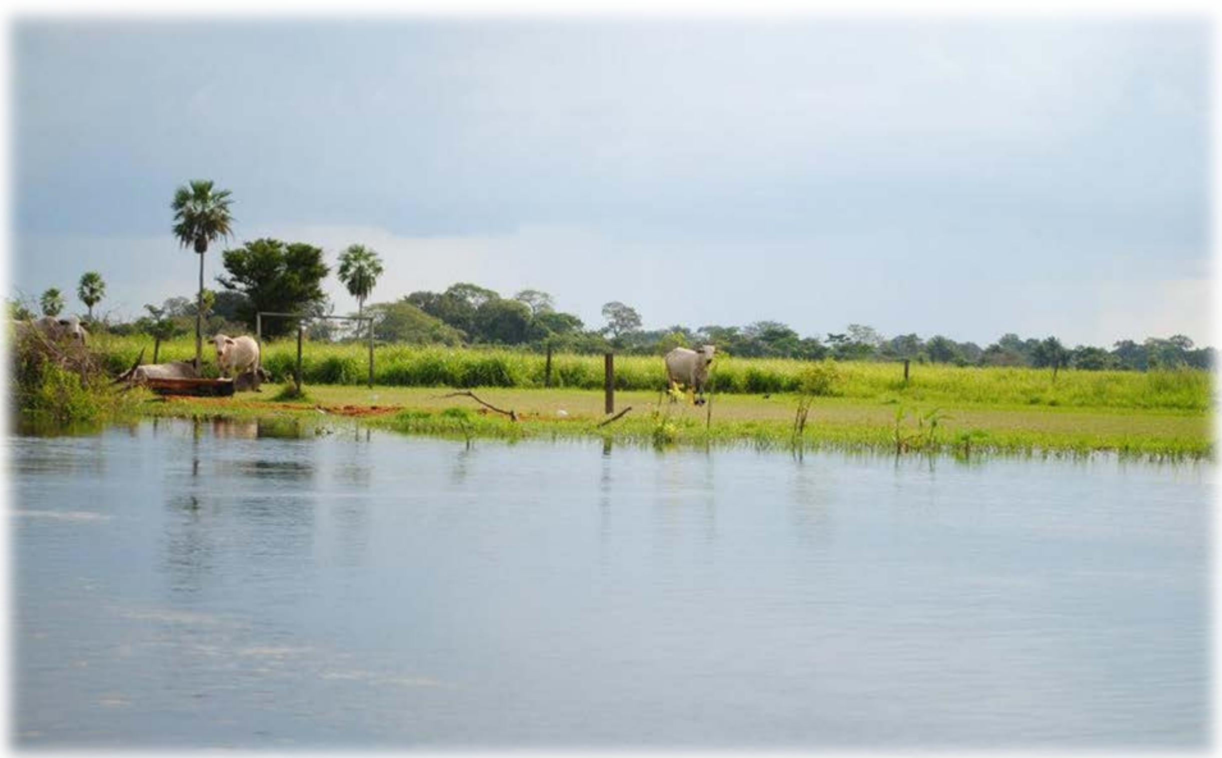
Current Challenges

While we will try to understand the performance of the Latin American countries in terms of economic growth and development in the remainder of the book, it would be important to keep in mind that the region presents certain characteristics that in some cases make it different from the rest of the world. While we will try to understand the behavior of the people from the region, we should keep in mind that there are some challenges that are going to be common to the whole region, and perhaps to all developing countries of the world.

The first problem that most Latin American countries face is the balancing of macroeconomic policies affecting the internal market and external market differently. Traditionally, the region has experienced high levels of poverty and inequality, which has made saving any significant portion of their income, if any at all, difficult. This lack of savings has resulted in a high dependency on international financial capital to finance domestic investment, and consequently on the implementation of policies geared to attract foreign capital. Unfortunately, these capital scarce countries have to offer high interest rates in order to attract foreign capital, given their implicit higher risk, but these high interest rates act as a drag on domestic investment. Just imagine the margin profit that your company will need to make in order to be able to pay the 45 percent interest rate per year charged in Colombia in 2002. Countries also have to respond to exchange rate pressures, especially those countries that operate under fixed exchange rates. On one hand, the exchange rate will determine the burden of your international debt, which is usually denominated in dollars for developing countries, and on the other hand it would determine the capacity to import new technology and thus determine the competitiveness of your exporting sector. A country could be devaluing its currency to repay its foreign debt with cheaper money and at the same time making its goods relatively more attractive to the rest of the world, but while it could be achieving these goals it will also be deteriorating the terms in which it could import new technology. Finally, since the region is capital poor and the governments are usually insolvents, the frequent push to attract foreign investors to establish productive capacities in their countries has led most countries to weaken their labor laws to make them more attractive, and while such changes can achieve that objective they also reduce the protection that labor unions were able to build through decades if not centuries. In fact, incentives to attract foreign firms can also be detrimental for domestic firms, if domestic firms cannot access the favorable incentives offered to foreign multinationals.

The second challenge that has proven to be persistent is the one that deals with the investment climate. Governments of the region are constantly balancing their need to implement changes in order to modernize their institutions and regulations with the need to provide a stable climate for investment to flourish. This is especially true for the latest quarter century, as countries tried to implement rapid structural changes to move away from the large, inefficient states to more market friendly economic institutions. While the changes are necessary, investors are caught with increased uncertainty and that feeling is translated in reduced investment, which diminishes growth prospects, at least initially. This also affects the quantity and quality of information that is necessary for investment purposes, as new regulations and even new constitutions introduce additional noise to the forecasting necessary for the implementation of any business. Perhaps all those changes being implemented are geared to solve the immense injustices of the region, but not knowing exactly what will come out from the process provide enough uncertainty to reduce or stop investment for prolonged periods of time. Developing countries have to transmit confidence and stability, which can take time and effort, but the necessary changes need to be implemented in such a way that the uncertainty introduced is reduced to a minimum.

The third challenge deals with the identification and prioritization of the many competing demands. The region is confronted with a high degree of income inequality, where the poor is challenging the establishment to obtain better participation of government resources and access to more decision making. It is also confronted with a productive structure that encompasses a technologically competitive formal sector together with a traditional and perhaps backward informal sector, both pushing for policies that can advance their interests. On top of those competing interest, we also have those related to the ethnic composition and cultural backgrounds of the population, as majority groups that have been traditionally relegated and even ignored and now pushing to get better access to the power structure of their countries. In a similar fashion, but with regards to the gender differences, the famous "machismo" of the region has secluded women from advancement opportunities, but they are gaining ground in terms of rights and opportunities. The struggle to implement new laws to address such neglect and discrimination without punishing the other sector too much has taken center stage.



A large portion of the region is tropical, like the Pantanal in Brazil, and in many cases underdeveloped. Agricultural efforts are pushing this frontier with new varieties and techniques, causing environmental concerns in some regions

The fourth challenge that is reshaping the way how governments in the region function has to do with the political repositioning of the internal constituencies and its consequent adjustment of the structure that governs political, social, and economic issues. The region has traditionally had a powerful group that pushed for free market policies, supporting individual decision making as the means to achieve an efficient allocation of resources, and a broad and popular group that has promoted the need for a large and socialist state. This last group argues that the structure of the market in developing countries does not function as theory suggest, often creating market imperfections and failures that only government intervention can address. While both camps have a conflicting view of the role that the state should play in promoting economic activity, both have continuously intervened in the market and altered the degree of government intervention. This fluctuations between these two tendencies temporarily changes the rewards from production, distorting economic activity. The region, and the economy, is now again increasingly dependent on the actions of the state, from its direct intervention in the production process to the determination of prices and other regulation.

The region has also been confronted with the need to continue growing to improve the standard of living of its impoverished people, who sometimes don't even have access to basic human needs, with the need to protect the environment. The extreme levels of poverty is some parts of the region is leading people to subsist through the over-exploitations of natural resources, overtaking the government's ability to enforce environmental laws. Most environmental regulations in the region are, in general, similar to those enforced in the more developed countries, but there are not enough resources to enforce them or the political will to go against the needs of their poor constituencies. The structural changes and the daily challenges make it very hard for governments to implement long term policies. It is also difficult to implement environment protection with international resources, as the interest of both will clash. The international community tries to spend the least to protect the environment, perhaps knowing that the poor sells for cheap, and the resources devoted to the task end up being short of what local governments need to enforce protection.

Although the countries of the region have increased their expenditures in social policies, like education and health care, most of the additional resources have been used to extend these services but not necessarily to improve its quality. These efforts have effectively expanded its reach to areas that previously lacked these services, but we have experienced a very small gain in terms of quality. Governments of the region need to devote parallel emphasis on achieving higher efficiency if they want to compete with other developing countries that are investing heavily in human capital. There is a need to move from quantity to quality.

Similarly, while the region has benefited from the extraordinarily high commodity prices, we should take history into account and plan for future conditions. Like in the export booms of the past there is too much concentration on single commodity exports, leaving countries vulnerable to price fluctuations that could affect significant portions of the economy.

Final Remarks

This book will help you navigate through the development process of Latin American countries from the colonial time to the present, starting with the understanding of the influence of the colonial period in the behavior of its people to the global fluctuation and its effect on the structure of the economies of the region. The material will then examine the impact that foreign influence, and inherence, has had in the development of the region, fueling intellectual tendencies that has given way to a more socialistic view of how governments should be structured. The reader will be required to remember the internal social and economic differences in the region and the special characteristics of its people to understand the implementation of specific policies. Such factors were extremely important in shaping the behavior of the population in Latin American countries, behavior that is perfectly rational from the perspective of the people from the region but can seem awkward or even irrational to outsiders.

Latin America is expected to continue growing at similar rate than the one achieved in the last decade, with the leading international organizations forecasting moderate growth for the region for the next five years. The average growth rate for the region was 4.3 percent in 2013, is forecasted to be 3.5 percent in 2014, and reach 3.6 percent in 2015 – this average growth rates already consider the expected sluggish growth in the more developed countries. While the growth rate for the U.S. for 2014 is forecasted to be 2.8 percent, the growth rate for Panama is expected to be 7.2 percent, for Peru 5.5 percent, and Bolivia 5.1 percent. For 2015 the growth rate in the U.S. is expected to improve to 3 percent, but the faster growing economies of Panama, Peru and Bolivia are expected to continue performing at above 5 percent growth rate per year. Argentina is expected to experience a significant slowdown in the short term, and Venezuela is expected to contract during these next two years.

Table 3 – Real GDP growth rates, annual percentage change

		Projections	
	2013	2014	2015
Argentina	4.3	0.5	1.0
Bolivia	6.8	5.1	5.0
Brazil	2.3	1.8	2.7
Chile	4.2	3.6	4.1
Colombia	4.3	4.5	4.5
Costa Rica	3.5	3.8	4.1
Cuba	.	.	.
Dominican Republic	4.1	4.5	4.1
Ecuador	4.2	4.2	3.5
El Salvador	1.6	1.6	1.7
Guatemala	3.5	3.5	3.5
Honduras	2.6	3.0	3.1
Mexico	1.1	3.0	3.5
Nicaragua	4.2	4.0	4.0
Panama	8.0	7.2	6.9
Paraguay	13.0	4.8	4.5
Peru	5.0	5.5	5.8
Uruguay	4.2	2.8	3.0
Venezuela	1.0	-0.5	-1.0
United States	**1.9**	**2.8**	**3.0**

Note: Latest IMF projections.

Currently many Latin American countries are on a somewhat stable foundation, trying to find the right balance between the free market and institutional strength. There is still much work to be done, but recent development indicates that the future for Latin American economic growth is bright. That doesn't mean that we should be complacent with the performance of the economy, but we should indeed be cautious with the international and domestic forces currently boiling. After a decade of extremely favorable conditions for many of the products from the region, we are experiencing a stabilization of the demand for primary commodities and a leveling off in the prices for these products. Countries of the region should put greater emphasis on promoting and encouraging higher internal demand, to create a more stable environment to sustain growth in the region. As the more developed countries wind down, their monetary policies that initially increased the flow of capital around the world and reduced the cost of borrowing are now reversing action, so countries should take precautionary actions and be prepared to confront these less favorable financial conditions.

The countries that have moved to the left and implemented more socialistic policies will face the challenge of keeping their productive capacity competitive while they engage in their distributive policies. What we have observed in the last quarter century is that institutional development and its strengthening was achieved after the debt and inflationary crises (1980s and 1990s), and that institutional framework has enabled the new administrations to secure the benefits from the higher primary-commodity prices experienced since the early 2000's. However, many times the productive capacity of these countries has faltered due to the populist polices implemented by these type of administrations, like in the case of Venezuela, slowing down the economic development of these countries and forcing their population to question the benefits of a better distribution of the wealth if the wealth is shrinking with these policies.

Which road Latin America takes will be determined by the policies implemented by the two types of administrations. Socialist administrations are expanding the size of the state, increasing its direct participation in the production process. Capitalistic administration are pushing for a broader free-market economy, expanding the regulatory framework that cements its use in their countries. The international support for either side can become influential in the performance of each view, and consequently on the incentives to the worst performers of the region to adjust their economies to the system that is producing the most welfare for its population. The countries of the region are still searching for the optimal size of the state, size that would allow them to produce the most efficient allocation of resources, both in terms of production and distribution. Given the large state participation in the economic activity of the countries in the region, the benefits that the population ends up getting will be the main factor that determines how much dependence on strong governments will the people of the region will be willing to tolerate. Remember that sustainable growth requires higher levels of investment, investment usually provided by the private sector and at faster rates.

The following chapters provide a broad analysis of the economic policies implemented in the region and their repercussions in the economic performance of Latin American countries. It provides a theoretical framework at the beginning of each chapter in order to understand the efficiency of the policies being implemented in the functioning of the markets in the region. It develops the theory of production, markets, exchange rates, inflation, trade openness, profit maximization, and property rights, and it also incorporates a formal treatment of political economy, factor payments, and inequality. Greater emphasis is put in incorporating cultural considerations in order to understand the logic of policymakers when choosing certain policies over more sound ones (at least according to standard economic theory), and the role that societies and interest groups have played in the enactment and enforcement of these policies. It is common in the region to find second-best policies being implemented instead of profit maximization and efficient production, and allocation of resources, which can only be understood by considering social pressures in the enactment of policy. This book does not pretend to provide an extensive analysis of the issues affecting the performance of the region, which can be obtained from the more specialized studies of specific issues available in the literature, but provides a good depiction of economic development in Latin America.

This book will also incorporate the view of Latin Americans in the issues and events covered in the chapters. The view that Americans and Europeans have about Latin Americans and their issues is heavily influenced by the coverage of the topics in their new-casts or by their governments, which are not necessarily the same than the view in the specific country in question. At the end of 2013, when Brazil was experiencing some social protests, a demonstration in Austin, Texas was organized to back those in Brazil. However, many participants were misinformed and were even asking if Fujimori was still the president of Brazil – he was actually the president of Peru between 1990 and 2000. While Americans think that they know Latin America, it depends on what they have been taught. If you get your news from CNN you will probably have a predominantly democratic view of events, and if you get your news from Fox then you will probably receive a more predominantly republican view of events. News broadcasts are increasingly tailored to inform a specific niche of people, providing the views that are more acceptable to such niche, and consequently we are getting more and more polarized in the news that we get, a bias that influences our thinking.

Depending on the part of the developed world that you belong to, you can also be influenced by the immigrant majority in your region or country. For example, people in the United States are heavily influenced by Mexican immigrants – for their overwhelming proportion amongst the Latino population in the country – and usually think that all Latinos are Mexicans or are very similar to Mexicans. While it is true that all Latinos have many characteristics in common (i.e. language, sports, dancing, music), there are many factors that make Latinos from different countries and regions very different than the others. Sometimes, established Latino immigrants don't want to be related to other Latinos as they move up in the social structure. Views can change according to your level of assimilation to the local culture.

People in the more developed countries are increasingly being exposed to cultures from around the world, especially the younger generations, with libraries, TV programs and the internet facilitating information about other parts of the world. Many people are taking a more proactive stance and they are even traveling abroad to learn about these other cultures and places, many to Latin America. Large Universities tend to attract a significant number of foreign students, creating interactions conducive of cultural integration – large campuses have larger representation of Latinos and do have more venues to make their culture known. They are also more engaged in study abroad programs, which prepare our students for a more globalized world. While knowing another culture definitely has its pros, allowing you to have a worldview instead of the view of a particular country, it does have some drawbacks. Learning other cultures allows you to see different ways to do things and value actions in alternative ways, probably leaving you with good traits to adopt and bad ones to ignore. Once you are exposed to another culture, then you start to adopt behaviors or ways of thinking from the cultures where you were living in. Your own world view grows, and your behavior becomes more reflective of the mixture of the cultures being embedded. People that have spent a significant amount of time living in another culture learn to appreciate their traditions and way of life, picking up the best qualities from each culture and molding our personalities with those traits.