The Washington Consensus and Latin America:  
A Recipe for Social and Economic Instability

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Abstract

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Key Words: Washington Consensus; neoliberalism; Latin America; instability; regionalism; Nicaragua; Peru; Argentina; The Washington Consensus has become an umbrella term for a broad range of neoliberal capitalist policies aimed at developing low- and middle-income countries. Although countries have followed these policies in good faith, results have been problematic and popular opinion resonates the dissatisfaction with United States-imposed capitalism.

Why has neoliberalism become so unpopular in the region? This essay attempts to assess the weaknesses of neoliberal capitalism, better known as the Washington Consensus, as a developmental strategy. Although Latin America has reaped benefits from capitalism, the goal of this essay is to highlight the problems with neoliberal economics.

I argue that neoliberalism has not been popular for two reasons: First, given the conditions of Latin America, neoliberal capitalism is not the appropriate prescription to develop the region; second, neoliberalism too often serves the economic interests of international investors and a wealthy Latin American elite. As a result, most Latin Americans do not feel that they receive benefits from neoliberalism; in fact, neoliberal policies have given rise to protests and civil unrest throughout the region. Policymakers, therefore, must find alternative policies.

In order to ferret out the weaknesses of neoliberalism, I give a comprehensive understanding of the Washington Consensus, explaining its roots and rationale as a current developmental policy; next, I give a historical analysis of the development of Latin America and the region’s economic and political relations with the United States, concluding that the recent backlash against U.S.-imposed capitalism is just another episode in a historical series of problems and protests concerning neoliberalism.

Finally, I explore three cases studies, highlighting specific drawbacks of neoliberal policy: Nicaragua demonstrates the inherent problems caused by the rapid privatization of public institutions; Peru underscores the weaknesses of the criteria the Washington Consensus uses to measure economic success; Argentina shows the drawbacks of following the Washington Consensus in exchange rate policy and the conflicts of interests such policies can have with the interests on Wall Street. I conclude by emphasizing the role regionalism can play in Latin America in order to defend the region from the disadvantages of the Washington Consensus and to create more suitable policies.
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Introduction

The Washington Consensus has become an umbrella term for a broad range of neoliberal capitalist economic policies aimed at developing low- and middle-income countries. Although countries have followed these policies in good faith, results have been problematic and popular opinion resonates the dissatisfaction with U.S.-imposed capitalism.

On December 3rd, 2006, anti-capitalist and anti-United States candidate Hugo Chavez won a decisive victory, again, in the race for the presidency of Venezuela. In fact, anti-capitalist candidates have been rejoicing throughout Latin America. From the more moderate leftwing faction, represented by Luiz Inacio Lula da Silva of Brazil and Michelle Bachelet of Chile, to the fiery anti-neoliberal socialist camp, personified by Nestor Kirchner in Argentina, Daniel Ortega in Nicaragua, Rafael Correa in Ecuador, Evo Morales in Bolivia, and Chavez (not to mention close wins by Andrés Manuel López Obrador in Mexico and Ollanta Humala in Peru), social movements and political candidates skeptical of the benefits of neoliberalism have mushroomed. Correa, now president of Ecuador, often reminds the public of “the long dark night of neoliberalism” (as cited in “Tightening his grip,” 2007, p. 39).

Why has neoliberal capitalism, so advocated by the United States, become so unpopular throughout Latin America? Built upon the academic research of history, economics, and political science, this essay attempts to assess the weaknesses of neoliberal capitalism, better known as the Washington Consensus, as an economic strategy for developing Latin America. Although Latin American countries have reaped benefits from capitalist policies, the principal problem is that the great majority of Latin
Americans do not feel that they have also profited and benefited from neoliberal economics; in fact, neoliberal policies, often pushed on Latin America by the United States, have been a principal variable behind social instability, poverty, and even war.

The failures of the neoliberal developmental strategy stem from two principal reasons: First, given the conditions and needs of Latin America, neoliberal capitalism is not the appropriate economic prescription to economically and socially develop the region; second, neoliberal capitalism too often serves the economic interests of powerful international investors and a wealthy Latin American elite instead of improving the lives of the average citizens. As a result, policy makers must design more appropriate and compassionate economic and social policies that benefit the masses, not just a selected few.

For the purpose of this essay, I aim, first, to give a comprehensive understanding of the Washington Consensus, explaining its economic roots and rationale as a current developmental policy. Furthermore, I give a historical analysis of the development of Latin America and its economic and political relationship with the United States, concluding that Latin America has historically had problems with U.S.-imposed capitalism. I also delve into the historical creation of the International Monetary Fund (IMF) and the World Bank, as well as the changes in their ideological underpinnings.

Moreover, I focus on three case studies that highlight the damage neoliberalism can cause to Latin American countries. Nicaragua demonstrates the problems caused by the privatization, a major principle of neoliberalism, of public institutions; although Nicaragua privatized its energy sector, the country never had in place the adequate policies and governmental institutions to compensate for market failures; as a result,
many people had worse access to electricity than before the privatization. Peru underscores the weaknesses of the criteria the Washington Consensus uses to measure economic success; although Peru achieved macro-economic stability, fiscal discipline, high gross national product (GDP) growth, increased trade, and favorable balance of payment receipts, the wealth and success never trickled down to the average Peruvians. Argentina highlights the drawbacks of following the Washington Consensus in exchange rate policy and the conflicts of interests such policy recommendations can have with the powerful interests on Wall Street; investor interests appear more important than the rising unemployment and suffering of the Argentine people. As a result of exploring these case studies, I conclude by emphasizing the role regionalism can play in Latin America; regionalism can help defend the region from the disadvantages of the Washington Consensus and help create and implement more suitable economic and social policies.
What is the "Washington Consensus"?

The impact of John Williamson

To begin with, one must have a firm understanding of the origin and characteristics of the controversial Washington Consensus. Economist John Williamson was originally using the term "Washington Consensus" in the late 1980s and formally coined the term in his 1990 book Latin American Adjustment: How Much Has Happened? Geared to debt-ridden Latin America, Williamson (1990/2002a) laid out ten economic reforms countries could use in order to revitalize their economies: Fiscal discipline, the alteration of public expenditures, tax reform, the liberalization of interest rates, the liberalization of trade, the liberalization of foreign direct investment, secure property rights, privatizations, deregulation, and more competitive exchange rates.

Over a decade later, the Washington Consensus has become a pejorative term to describe insensitive neo-liberal capitalist policies that affluent developed countries have imposed on weaker impoverished ones. Williamson (2002b) himself dislikes the idea of the Washington Consensus being negatively associated with insensitive capitalist economic policy. "[T]he world over seem[s] to believe that this signifies a set of neoliberal policies that have been imposed on hapless countries by the Washington-based international financial institutions and have led them to crisis and misery," Williamson (2002b) protests, "[m]y own view is of course quite different". Williamson (2002b) points out that the essentials of his plan—economic openness, economic discipline, and market economics—all have wide acceptance and even leftists such as Luiz Inácio Lula da Silva, the president of Brazil, have had to embrace such policies in order to be "electable." In fact, Williamson (2002b) argues that he has never enshrined all neoliberal
economic policies to begin with; for example, he is against the liberalization of capital accounts in developing nations, a current policy that's very popular with neoliberal adherents.

**Neoliberalism and its ideological development**

Nonetheless, the Washington Consensus has become inseparably linked to neoliberalism. It serves as an umbrella term for a cornucopia of neoliberal ideas on how not only to develop an economy but also to measure economic success. The neo-liberal economic approach emphasizes limited governmental intervention, the privatization of state institutions, favorable conditions for foreign investment, the free flow of capital, utility maximization, low inflation, export-led growth, and deregulated free market capitalism. The evaluative tools economists have used are gross domestic product (GDP) growth, inflation rates, balance of payments statistics, foreign investment figures, fiscal equilibrium, and stable exchange rates.

Essentially, advocates of neoliberalism find most state intervention in the economy suspect. The state either precludes economic development at its best, or destroys it outright at its worst. “State-bashing” is often ubiquitous in neoliberal circles. Let the people benefit from the invisible hand of market economics adherents rejoice. The free market knows better than the government; thus, the private sector should grow unhindered by regulation. This often means no environmental regulation, no taxes on foreign investors, and certainly no unions. In fact, keeping macroeconomic stability is a number one priority. Fiscal deficits must be controlled even if it means tough choices. Cutting public expenditures such as healthcare and education, at times, are important
sacrifices for maintaining fiscal equilibrium, keeping low inflation, and sustaining international monetary reserves.

Neoliberal economists trace their roots back to the physiocrats, a group of French economists in the eighteenth century. Although the physiocrats created elaborate theories and focused principally on agriculture, their importance for understanding neoliberalism lies in their opposition to Mercantilism. Mercantilists, the most influential being Thomas Munn (1571-1641), advocated that the government must have a predominant role in economic policy; the ruler must encourage exports, restrict imports, and acquire as much gold and silver as possible. Wealth was measured by increased reserves; and trade, since the goal was to restrict other countries' imports and increase your own exports, was a zero-sum game. The physiocrats attacked mercantilism, pointing out that the individual, opposed to the government, should produce and trade what he or she wanted which, in turn, could benefit everyone. This laissez-faire approach—"hands off" in French—advocated private property, individual self-interest, and the improvement of human conditions through the natural progress of individuals competing and fulfilling their own interests; government intervention, in the form of taxes and regulation, only hampers the progress.

Based on the fundamentals of the physiocrats, classical economics was born. Throughout the centuries classical economics has been subject to modifications and paradigmatic shifts by famous brilliant economists and intellectuals such as Adam Smith (1723-1790), David Ricardo (1772-1823), and William Stanley Jevons (1835-1882). Although there are differing ideas concerning the benefits from and the definition of neoliberalism, the fundamentals are the same. Economics is the study of scarcity. Every
society has scarce resources and economics endeavors to find the most efficacious ways to develop, utilize, and distribute such resources. Neoliberals passionately believe that the free market, through private initiatives unhindered by government intervention, is the most efficient way to take advantage of our scarce resources.

**Neoliberalism and its current supporters**

Currently, a number of world-renowned economists swear by the benefits of neoliberal economic policies. Arvind Panagariya, Ann Krueger, Deepak Lal, Hernando de Soto, and Jagdish Bhagwati all advocate, to some degree, neoliberal economics for developing countries. Hernando de Soto, a famous Peruvian economist, has written extensively on how governmental inefficiency, ineptitude, and corruption actually preclude economic development. In his acclaimed book *El Otro Sendero (The Other Path)* (1986/1991), de Soto argues that government policies in Third World countries, regardless of intentions, create an informal black market and undermine the growth of successful business classes in low and medium income groups. “[I]n countries like Peru,” author and neoliberal enthusiast Mario Vargas Llosa writes in the prologue, “the problem isn’t the informal economy, the state is” (p. XVIII). Bhagwati, in his book *In Defense of Globalization* (2004), even labels certain critics of neoliberalism and globalization “know-nothings” and “ignoramus[es]” (pp. 5, 6).

Many social activists, academics, and even policymakers (see, for example, MacEwan, 2002), however, passionately disagree. They argue that the neoliberal Washington Consensus is merely a clever way for rich countries like the United States to economically take advantage of poor ones. Through international financial institutions (IFI) such as the International Monetary Fund (IMF), the World Bank, and the World
Trade Organization (WTO)—not to mention the United States Government itself—developed countries impose their will, allowing their business class and multinational corporations (MNC) to rule poor countries freely without any regard for the local populace. For example, with privatization, US MNCs can simply go to Latin America and buy up all the previously public-own companies; in fact, when capitalists earn a profit in these poor countries, the free flow of capital allows them to send the money out of the country without reinvesting into the local communities.

Others have argued that the Washington Consensus is an economic ideology gone mad. Neoliberalism became popular in the 1980s when conservative governments came to power in many developed nations. The most infamous faces of the capitalist "revolution" were Ronald Reagan, the U.S. president, and Margaret Thatcher, the prime minister of Great Britain. Reaganism and Thatcherism took the world by storm; neoliberalism became a popular economic policy. "Government is not a solution, government is the problem," Reagan would bellow to enthusiastic crowds.

The failure of Communism and the end of the Cold War also gave neoliberal capitalism a gust of invincibility. Socialism became the losing ideology. Neoliberal capitalism, as a result, became the only road to development; all countries had to adopt neoliberal economics, the panacea to help the world's poor develop and climb out of poverty. Capitalism simply couldn't be criticized. Nobel prize-winning economist Joseph Stiglitz (2002) calls this obsession with neoliberalism "market fundamentalism."

Stiglitz (2002) observes that economists, most of whom are coming from the developed west, parochially and irrationally apply a very narrow view of neoliberalism, regardless of the economic situation of the particular country, in order to create economic
development in the third world. Although such economic policies may not be adequate for a particular country, due to various reasons such as weak regulatory institutions and the lack of any governmental social safety nets, Stiglitz points out, they are still imposed on countries, exacerbating economic problems and even creating new ones.

Both arguments clearly have validity. The type of neoliberalism imposed on weaker countries is often compatible to powerful economic interests in developed countries. This is especially true with U.S.-Latin American relations. At the same time, many economists, with noble intentions, have often prescribed the wrong economic policies. Although economists, most coming from U.S. institutions, may be brilliant in the classroom, they may have no veritable understanding of the complexity of impoverished nations. “These experts offer sophisticated concepts, elegant theoretical structures, and complex econometric models of development,” developmental economist Michael P. Todaro (1999) astutely points out, “that often lead to inappropriate or incorrect policies” (p. 92). However, to get a complete understanding of U.S.-Latin American economic relations, one must look at the historical development of these two very distant neighbors.
Latin America and the United States: The Development of A Historical Structure of Power and Dominance

Although economic self-interest and inappropriate economic consultation help us understand the present debate roaring over the Washington Consensus, the United States influence and interest in Latin America date much farther back than the current literature and discussions on global economic policy. The recent backlash, personified by Hugo Chavez, Evo Morales, Andrés Manuel López Obrador, and other influential Latin American leaders, against the United States and its neoliberal capitalist ideology is just the latest episode in a historical series of problems and protests related to U.S.-Latin America relations. In order to grasp the current conflicts, as well as the economic and social relationship between the United States and Latin America, which entails a certain inescapable power structure, one must first have a historical understanding of these two close, yet very different parts of the world.

In the beginning

Washington has had its eye on its southern neighbor ever since independent rebels began mounting successful military campaigns against their Spanish colonial masters. Beginning in the early 1800s, independent movements began mushrooming throughout continental Latin America\(^1\). By 1820, Spain, the mother country, was witnessing her precious royalist forces in a quagmire of defeat and retreat. Revolutionary names such as Miguel Hidalgo, a rebel Mexican priest beheaded by Spanish forces, José de San Martín, a military leader in the southern part of the Americas, and Simón Bolívar, Latin America’s most famous revolutionary hero who, till this day, is evoked by Latin

\(^1\) Continental Latin America is quite different from, say, the islands of the Caribbean; many obtained independence from Spain much later, such as Cuba did formally in 1902.
American nationalists like Hugo Chavez, became synonymous with heroism and nationalism. By 1824, when General Antonio José de Sucre defeated the royalists in the famous Battle of Ayacucho, most of continental Latin America had won its independence from Spain.²

The United States finally had the opportunity to seek influence in Latin America. Before the Latin Americans were able to fight for independence, the U.S., as well as other countries, couldn’t get a foothold into the New World. Spain, along with Portugal, jealously guarded their colonial positions. They didn’t want to share Latin America’s fertile soil and mineral wealth with other competing states. The Spanish Crown went as far as to invest her riches into the construction of securely armed castles and forts to protect her colonies. They continue to dot the Latin American landscape, especially on the Caribbean cost. In fact, Thomas Gage, one of the only known non-Spaniards to penetrate colonial Latin America, was forced to hide in a barrel in order to embark on a dangerous journey to the New World. In his account *Thomas Gage: The English-American* (1625-1637), Gage describes the cornucopia of riches and wealth of the New World and reveals why Spain jealously cherished and guarded her colonial possessions. His journals are strewn with words such as silver, cattle, gold, and tropical fruits. And he describes Spaniards “thought to be worth a million crowns” (for a complete discussion, see Ripley, 2003).

**The Monroe Doctrine and quest for influence**

With Spain out of the picture, however, Washington didn’t hesitate to take advantage of the situation. In December 1823, President James Monroe issued what later would

² Belize didn’t gain its independence from Great Britain until 1981. Suriname received its independence from the Netherlands in 1975.
become known as the “Monroe Doctrine.” Most historians see the doctrine as a statement supporting the non-transfer principle. That is, now that Spain has lost her colonies, other European would not be allowed to take over where the Spanish Empire left off; Latin America was in the United States sphere of influence. As one history text writes: “Americas closed to further European colonization and discouraging European interference in the affairs of the Western Hemisphere” (Berkin, Miller, Cherny & Gormly, 2006, p. 279).

Monroe, however, had much more in mind. He wanted direct influence in the region. By March 1822, over a year before he announced the Monroe Doctrine, president Monroe had already successfully requested money from Congress in order to set up diplomatic posts in the new emerging countries; less than a year later, the U.S. government had already nominated diplomatic ministers to work in Peru, Mexico, Chile, Argentina, and Gran Columbia (Perkins, 1993). A British newspaper of that time sums up the United States’ motive: [T]he United States wish to monopolize to themselves the privilege of colonizing . . . every . . . part of the American Continent” (as cited in Ibid, p. 160). And why wouldn’t the U.S. want to reap some economic benefits from its neighbors? Latin America was full of mineral wealth such as gold and silver; it grew tropical fruits such as bananas and pineapples; the thousands of navigable rivers would be favorable for the expansion of trade. Even if Washington couldn’t monopolize the Americas, Monroe could at least advance investment and trade agreements.

Latin America, however, couldn’t count on the comparable economic strength to negotiate with its increasingly powerful northern neighbor. The crumbling Spanish Empire had left an impoverished rural society with political and military factions vying
for power. A wealthy oligarchic elite of Spanish heritage began to rule over a vast population of poor indigenous and mestizo (a mix between European and indigenous blood) populations. The oligarchy, small in number, ruled over the masses like a semi-feudal mid-evil society. Linked closely with the Roman Catholic Church, they had power, wealth, and land, while the majority eked out an indigent living toiling in mines or on the landlords' soil.

Moreover, Latin America fell apart. Bolivar’s nationalistic vision of a united Gran Columbia, an attempt to keep the Spanish-speaking south united under one country, fell victim to vicious infighting by 1826. Internal disputes proliferated. Columbia was invaded by Peru; Bolivar’s precious republic was abandoned by Quito and Venezuela; Bolivar himself, the great liberator, was cast into exile (Adams, 1993). Mexico and Central America would suffer a similar fate. In 1822, a year after independence, Central America integrated into the Mexican Empire (Booth, Wade & Walker, 2006). A year later, Central America, except for Chiapas, broke with Mexico to form the United Provinces of Central America, only to break up into five small countries by 1838 (Ibid). The small rural countries of Latin America would now have to confront the United States on their own!

The Exploited Colony

Latin America ended up a weak, impoverished and fragmented society because it was an exploited colony. Historian Clarence H. Haring, in his seminal study The Spanish Empire in America (1947/1963), differentiates European colonization into two types: “Exploitation colonies” and “farming colonies.” Exploitation colonies, usually in tropical climates, Haring (1947/1963) points out, cultivate staples such as gold and sugar for
export. The economy is essentially outward-looking, with all the resources and profits benefiting the mother country and a small amount of elites. What develops is a feudal system in which the majority works as serfs to serve the privileged landlords. Since small farmers and families wouldn’t be attracted to immigrate to such an exploited system, society becomes based on forced illiterate labor. Although colonization patterns are more complex than this dichotomization (see Halperin Donghi, 1993, chap. 1, for an in depth discussion on colonization), it does give us an understanding of the vast differences between the Northern and Southern Hemispheres of the Americas and the subsequent power structure between the two.

Latin America epitomizes the exploitation colony. When the Spanish conquistadors, under the command of Hernán Cortés, landed in the Yucatan in 1519, their goal was not to till the land. “[They were] the hardest warriors Spain produced!” Stuart Sterling, historian and actual ancestor of Cortés, exclaims (as cited in Wood, 2001). These warriors, or reconquistadores, military men fighting to regain land lost from the Spanish conquest of the Moors, aimed to conquer their enemies, subjugate the indigenous peoples, and rape the land for immediate wealth. After months of vicious battles, Cortés and his men were able to defeat the Aztecs in present-day Mexico. Francisco Pizarro was able to imitate Cortés in the south, conquering the Inca Empire, while Pedro de Alvarado conquered Central America. Huge tracks of land, through a system called the encomienda, in which conquistadores would obtain the right to rule indigenous villages, were immediately granted to high Spanish officials, the indigenous peoples were enslaved, and all economic activity, in the form of exportation, was designed to benefit the Spanish Crown.
The pattern of impoverishment and land concentration had begun. In Mexico, for example, the Spanish Crown doled out most of the land to less than 5,000 conquistadores (Adams, 1993). Cortés himself received indigenous villages with over 23,000 native workers (Divine, Breen, Fredrickson & Williams, 1987). All the wealth went to benefit the colonial master. In the south, millions of kilograms of silver was mined from Potosí, located in present-day Bolivia, and exported to Sanlúcar de Barrameda, a major Spanish port (Galeano, 1973). The economic and social gap between the elites and poor grew ever wider. John A. Booth & et al. (2006) sum up the outcome perfectly:

The economy had become externally oriented, with the Spaniards controlling the region’s human and natural resources to produce articles for trade among the colonies and with the mother country. The remaining indigenous population (still more numerous than their white masters) supplied the labor that produced the gold, silver, timber, and cattle products . . . for export. Most of the wealth that this economy produced went to the white elite. The culture and process of dependent underdevelopment had begun. (p. 42)

This economic gap between the small circle of oligarchic elites and the impoverished masses still stubbornly persists today. Using the Gini-coefficient for land, a measurement to mathematically determine the distribution of income, land, and other resources, Latin America has the most uneven land distribution, thus income and power, in the world (Todaro, 1999).

The exploited colonies in the south stand in stark contrast with the farming colonies in the north. In North America, from the middle of Canada down to Georgia, the land was settled, for the most part, by small farmers, indentured servants, and yeomen. This is not
to deny, however, the horrors of colonization: The massacre of indigenous peoples, the enslavement of African-Americans, and the concentration of political power in the hands of white males. Nonetheless, most settlers, whether they liked to or not, tilled their own land to survive and created a self-sufficient, inward-looking economy. The famed Pilgrims were only humble farmers from England, bringing their wives and children to the New World. Even in Jamestown, Virginia, which was originally populated by colonists who wanted quick wealth, found itself with a “no work, no food” policy (Berkin et al., 2006).

In fact, the original 13 colonies of the U.S. experienced a number of land distribution policies. Colonists, for example, were encouraged to immigrate to the colonies by giving land incentives. New colonists who emigrated to Maryland or Virginia before 1616 received up to one hundred acres (Seavoy, 2006). The Virginia Company, after 1612, began the head right system. This system offered new settlers, even women and children, 50 acres of land (Berkin et al., 2006)! Even indentured servants, those who were forced to till the land of others for a specific amount of time, were able to access their own land. High percentages of these servants, most of whom were on one of the lowest notches of the economic and social ladder, were able to purchase their own small plot of land (Seavoy, 2006). Other laws doling out land would follow. The Homestead Act, signed into law in 1852 by Abraham Lincoln, gave any citizen 160 acres of public land if she or he was able to cultivate it for five years.

Moreover, the role of economic externalities is crucial for understanding the North-South relations. Externalities are defined as spillovers or costs and benefits that affect a third party not involved in the normal economic transaction of supply and demand.
There are negative and positive externalities. An example of a negative externality is pollution. An industry manufactures a product to sell on the free market; however, the pollution that comes from the industry negatively affects a third party, say, a bordering neighborhood. The negative effect becomes a “public bad.” Examples of positive externalities are infrastructure projects such as highways and even the development of public education in order to meet the demands businesses have for skilled labor. These positive spillover effects are important for the development of a society.

The Southern Hemisphere does not produce many positive externalities. Based on agriculture, work is merely ripping things from the ground and selling them for export. In fact, most agricultural societies have a built-in incentive to maintain low wages and to keep workers uneducated. The owners of plantations sell their crops on the world market; the peasantry is used merely for work, not consumption. This is why slavery perniciously took hold in the south, but not in the north.

The role of positive externalities can even be seen between the development of the northern and southern parts of the original 13 colonies. In New England, for example, literacy and education was extremely important to the yeomen because they were engaging in craftsmanship, marketing their extra crops, and producing household manufacturing items to be sold in the local markets. This work, considering the time, required skilled labor. As a result, schools began cropping up throughout the north. By 1789, New York had eleven public primary schools and Massachusetts had twenty-three (Seavoy, 2006).

Rural Virginia and Maryland, on the other hand, didn’t do so well. These two agricultural states gave way to big plantations ripe with export crops such as tobacco and
cotton. The elite had an interest to keep the peasantry and slaves, used as cheap labor, uneducated. "I thanks God there are no free schools nor printing," Virginian Governor William Berkeley proclaimed in 1671, "and I hope we shall not have these (for a) hundred years" (as cited in Seavoy, 2006, p. 28). As a result, although these two states had larger populations than in the north, Virginia had only two public primary schools and Maryland just one (Ibid). It's no wonder then that currently up to 70% of the world's most impoverished people live in rural areas (Todaro, 1999).

Looking at the colonization patterns of the Americas, one can see that the relationship between the United States and Latin America wouldn't be on the same footing. The rapidly industrializing north\(^3\) was growing increasingly more powerful than its southern, predominantly rural, neighbors. Washington began to learn, with Latin America in its sphere of influence, that it was able to impose its will, often militarily, on the southern part of the Americas.

**United States exercising power over Latin America**

Starting with the Mexican-American War in 1846, the United States began exercising its full power over Latin America. Under the command of General Zachary Taylor and later General Winfield Scott, the U.S. military was able to defeat the Mexican army, marching all the way to the capital, Mexico City. With the signing of the Treaty of Guadalupe-Hidalgo in 1848, the United States expanded its empire over present-day New Mexico, California, most of Arizona, and the disputed areas of Texas.

The United States, however, didn't stop in Mexico. Washington began to exercise its power throughout Central and South America. Between 1898 and 1920, the United States

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\(^3\) The United States, principally in the north, developed rapidly during the second industrial revolution after the Civil War. This industrialization was fueled by natural gas and oil, along with the inventions of Thomas Edison and Graham Bell (for a complete discussion, see LaFeber, 1995, chap. 2).
sent marines to the Caribbean over 20 times (LaFeber, 1995). In 1920, the U.S. still had occupying forces in Panama, Haiti, the Dominican Republic, and Nicaragua (Berkin et al., 2006). Washington was even extending itself to the most southern parts of the continent. The U.S. almost went to war with Chile. In 1881, after the overthrow of the pro-U.S. regime of José Manuel Balmaceda, altercations between the two countries erupted; Chile later apologized in order to avoid war. A few years later, the U.S. took another bellicose stand against Great Britain in order to protect its interest in the important navigable river Orinoco in Venezuela (LaFaber, 1995).

Even private U.S. citizens, independent from the government, got into the game of expansion. William Walker, for instance, a filibuster from Tennessee, entered Nicaragua in 1855 with a group of mercenaries. With the help of disgruntled liberals, a Nicaraguan political faction, he was able to overthrow the incumbent conservatives, the liberal rivals, proclaiming himself president. Walker was finally kicked out of Nicaragua in 1857. Although he tried to invade again, he was captured in Honduras and executed there in 1860. Walker was not the only filibuster to take advantage of America’s weak neighbors. The United States learned early on that Latin America was their “backyard.”

U.S. politicians, investors, and even media outlets tried desperately to couch the interventionism in diplomatic language. The talk of freedom, peace, and democracy swirled around military expeditions. With the invasion of Nicaragua in 1926, for example, the U.S. media were quick to give the news, the first piece of news the American public had ever heard concerning this small Central American country, a positive spin. Dateline, Nicaragua, 1926, old footage of the marines chasing the rebel Augusto Sandino, glorified the invasion and occupation, all of which lasted almost a
decade. "The United States proved once again," the narrator says, "its dedication to peace and freedom around the world" (as cited in Davis, 1987, p. 27).

The United States, however, was not exactly concerned with freedom and peace. After all, before leaving Nicaragua in 1933, the U.S. military had been training the Nicaraguan National Guard and supporting its leader, Anastasio Somoza García, the strong man whose pro-United States family would brutally govern the country for almost half a century. Washington was much more interested with American business interests. United States investment in the region reached a whopping $3.5 billion by 1929 (Berkin et al., 2006). American investors such as the United Fruit Company and Standard Oil had a host of profitable businesses in mining, agriculture, oil, and other capitalist ventures. The United States government was going to do anything it could in order to protect U.S. interests from European competitors, unfriendly leaders, and unfavorable investment climates. At times, this protection even called for military force. Brigadier General Smedly Butler (1935/2003), two-time winner of the Medal of Honor and leader of military adventures into Latin America, writes:

I helped make Mexico, especially Tampico, safe for American oil interests in 1914. I helped make Haiti and Cuba a decent place for the National City Bank boys to collect revenues in. I helped in the raping of a half a dozen Central American republics for the benefits of Wall Street. The record of racketeering is long. (p. 10)

The Latin Americans themselves had already understood Washington's expansionism for quite sometime. By the 1800s, Latin American newspapers were observing "the suffocating pressure of the Colossus" trying to "found a single colonial state extending
from the North to the South Pole” (LaFeber, 1995, p. 126). The United States was “establishing a protectorate over all Latin America,” lamented one Chilean minister (Ibid). Even Latin American poetry was aware of American force, power, and expansionism. “The United States is grand and powerful/Whenever it trembles, a profound shudder/runs down the enormous backbone of the Andes.” Writes Ruben Darío, a nineteenth century Nicaraguan poet in To Roosevelt, “Roosevelt, you must become, by God's own will/the deadly Rifleman and the dreadful Hunter/before you can clutch us in your iron claws.”

Although the penetration of the United States and capitalism into Latin America brought certain benefits such as the construction of railroads, the transfer of technology, and the growth of a business class, since the Monroe Doctrine up to World War II, the benefits did not always trickle down to the average citizen. Trade and investment in and of themselves did not guarantee an improved life for the population. In fact, as American influence, through trade, investment, and military initiatives, expanded throughout Latin America, so did, unfortunately, anti-American sentiment, economic and social instability, and even all-out war and invasion.

**Mexico and the Inundation of U.S. Capital**

Mexico typifies the problem. U.S. trade and investment significantly increased in Latin America during the latter part of the 1800s. Mexico, due to the country’s fertile land, mineral wealth, and proximity to the United States, had close economic ties with America. In 1860, for instance, U.S.-Mexican trade equaled roughly $7 million; by 1900, it had jumped to $64 million (LaFaber, 1995). Direct investment also poured into every economic area that could turn a profit: Agriculture, mining, transportation, especially
railroads, and so forth. Mining alone attracted up to $30 million (Ibid). And powerful Americans got involved. Senator Henry Teller from Colorado had big mining investments along with Solomon Guggenheim, an American capitalist who made his money from silver-lead smelting industries (Ibid). Even William Randolph Hearst, the infamous newspaper magnate, got into the action. He had land holdings in Campeche, Chiapas, Tabasco, Oaxaca, and Chihuahua (Raat, 1992).

Everything, through the eyes of capitalism, was going great in Mexico. President Porfirio Diaz, although a brutal dictator who ruled the country for almost 30 years, carried out all the right economic policies and won the admiration and support from America's most prominent politicians and investors. Mexico, during the porfiriato, which the time began to be known as, seemed to be progressing. Railroads were expanding. By 1911, the railroad system had reached over 14,904 miles, 24 times the amount from what the country had in 1880 (Ibid). With growing trade, new ports were constructed on both costs, the Atlantic and the Caribbean (Riding, 1989). A diversity of businesses and factories began to crop up throughout the country. These included the production of furniture, sewing machines, and even two English-written newspapers (La Faber, 1995).

Moreover, Mexican laws and policies reflected the capitalist spirit and development. The Tax Law of 1887 and the Code of 1884 proved to American investors that Mexico was a capitalist-friendly country. The Tax Law exempted taxes on mining while the Code essentially rescinded any governmental control and ownership over the mining of subsoil resources (Raat, 1992). Other laws opened up indigenous communal lands to private development. In fact, all governmental statistics indicated that Mexico had a
healthy and robust economy. Under the guidance of José I. Limantour, the brilliant finance minister, the Mexican government achieved impressive results. The government was able to maintain a fixed ratio between silver and gold; this was important for trade due to the return of the gold standard (Raat, 1992). The government was also able to eliminate the interstate tariffs called alcabalas (Ibid). Mexico even experienced a budget surplus with revenue surpassing public expenditures (Riding, 1989).

Mexico was certainly a success when one measures the economy by neoliberal (or even Washington Consensus criteria, though the term wasn’t conceived yet) criteria: Growing foreign direct investment (FDI), increasing trade, fiscal discipline, stable exchange rates, non-government intervention, investor-friendly policies, and GDP growth. The success, however, never trickled down to the average Mexican. For the majority, life became progressively worse. “Little of the wealth filtered down to the mestizo miners and factory workers . . .,” Alan Riding (1989, author of Distant Neighbors: A Portrait of the Mexicans, asserts, “land concentration intensified. Some 3,000 families owned half the country and lived in magnificent haciendas, while million of Indian and mestizo peasants were virtual serfs” (p. 40).

The reason many Mexicans couldn’t reap the benefits of capitalist development is due to their inability to compete with the affluent and powerful foreign investors. By 1910, U.S. citizens had acquired up to 43% of all Mexico’s land, more than the private Mexican citizenry had (LaFaber, 1995). William Randolf Hearst alone had bought up more than seven million acres of land across the country. U.S. investment also owned roughly 81% of all the industries in the country; the American Smelting and Refining Company (ASARCO), owned by Guggenheim, was the largest private company in all of Mexico,
followed by the Anaconda complex, a mining company and ASARCO’s closest competitor; it was owned, of course, by Americans (Raat, 1992).

The maldistribution of land and resources that had been a gross iniquity since the colonization was getting worse. Mexicans became foreigners in their own land. Indigenous people were hit hard. Roughly 5,000 indigenous villages had been pushed off their farms to make way for mining and haciendas (Adams, 1993). Although indigenous people had access to 40% of agrarian land in southern and central Mexico in 1810, by 1911, they only controlled 5% (Raat, 1992). The loss of land, it’s important to note, was extremely significant because the greater part of the population lived in rural areas during the nineteenth century. Roughly 90% of the Mexican people lived in what could be considered rural zones (Lopez-Alonso, 2007). Mexico had become “the mother of foreigners and the stepmother of Mexicans,” one Mexican nationalist lamented (Riding, 1989, p. 40).

In addition to the lack of access to land and resources, the human development for most Mexicans didn’t improve. In most cases, it got worse. Human development focuses on education, literacy, life expectancy, wage increases, and other humane variables. Unlike the economic measurements, these didn’t fare too well. Education and healthcare for the poor remained inadequate; infant mortality was high; workers in mines and factories suffered from poor environmental conditions and meager wages; life expectancy was roughly 30 years old (Raat, 1992). In fact, Moramay Lopez-Alonso (2007) correlates the declining living standards for the rural population with the decrease in adult height for those born in the latter quarter part of the nineteenth century. Using data from the Mexican military recruitment centers, he infers that a decrease in adult
height is partly attributable to the loss of land and, thus, the standard of living and intake of calories many suffered in rural areas during the great economic boom.

Moreover, much of the economic boom was cosmetic. Although during the porfiriato great buildings with classical architectural designs were built and businesses were created, all the big machinery and labor- and capital-intensive equipment were imported from the United States. Mexico imported steel rods, chemicals, electrical machinery, machine belts, and other finished goods (Raat, 1992). Mexico was basically producing only light industrial products such as glass, paper, shoes, and beer (Ibid). The railroads were also of little use for the population and the over all development of the country. Most were only leading to agricultural areas to move products for exports, and the rail network did little to link the country together (Halperin Donghi, 1996). Historian Tulio Halperin Donghi rightly labels big and grandiose infrastructure projects throughout Latin America during this time, such as buildings and railroads, the “superficial signs of progress” (116).

As a result of the growing inequality and the increasing impoverishment throughout Mexico, instability began to shake the country. The Mexican Revolution (1910-1920) had begun. Emiliano Zapata, a peasant of mestizo origin, personified the struggle of the peasantry and indigenous who lost their land from the modernization under the porfiriato. Realizing that horses often lived better than the average Mexican (Adams, 1993), Zapata grew angry at the significant land loss the peasants and indigenous were experiencing in his small village Ananecuilco and elsewhere (Riding, 1989). Working originally under the command of Francisco Madero, whom Zapata later denounced for not allowing the poor to keep the land they had seized, Zapata and his army began seizing haciendas close
to Mexico city (Riding, 1989). Other groups took up arms against Díaz, including female soldiers, soldaderas, such as Dolores Jiménez y Muro (See Adams, 1993, chap. 14).

Although Díaz was disposed of by 1911, infighting ensued, along with political assassinations. Even revolutionary heroes such as Madero and Venustiano Carranza were killed by competing factions. The revolution didn’t cease, though there was still fighting up until 1923, until the end of 1920, when Álvaro Obregón Salido became president. He was able to consolidate his power and create, to a certain extent, stability.

Although up to one million Mexicans died in the revolution, Washington was still concerned with one thing: American investment. The United States refused to recognize the new government until all economic interests were protected. The U.S. was demanding compensation for money and property lost during the revolution. Big U.S. investors such as the Oil Producer’s Association successfully lobbied President Warren G. Harding to defend their interests (Ratt, 1992). In 1923, Obregón and the United States finally hammered out the Bucareli Agreements. These negotiations gave American investors protection from any land reform initiatives, compensation for loss property, oil concessions, and guarantees of payment on Mexico’s outstanding foreign debt (Riding, 1989). The United States finally recognized the government after the agreement!

**Guatemala and U.S. economic interests**

Wall Street would continue to influence policy into the next century. Guatemala serves as a tragic example. Under Jacobo Guzmán Arbenz, the 1950 democratically elected president, Guatemala tried to carry out progressive economic and social policies. The government legalized unions, carried out land reform, built public infrastructure, and
eliminated laws against the peasantry, such as the requirement, only for peasants, to carry proof that they had employment (Barry, 1987).

Out of all the government’s initiatives, Arbenz was most proud of his land reform. The reform carried out was important and fair. With 90% of the population residing in rural areas, land reform would be the principal way to improve people’s lives. Moreover, the reform only expropriated uncultivated land, and stipulated that farms with less than 223 acres would be untouched; farms with 223-670 acres and one-third of that land cultivated would also remain untouched by the law (Schlesinger & Kinzer, 1990). In fact, in order to demonstrate the fairness, 1,700 acres of the president’s own land was also expropriated (Ibid)! As a result of the reform, up to 100,000 peasants received farmland (Booth et al., 2006).

The Guatemalan population certainly needed land reform. Land distribution was highly unequal and landlessness was growing significantly. Like Mexico under the porfiriato, the Guatemalan government, under the dictatorship of Justo Rufino Bárrios 1873-1875), opened indigenous land to “economic development.” In the case of Guatemala, the main development was the growth of coffee for export. Land concentration, which was already high after the colonization of Spain, significantly increased because the indigenous on communal lands and the poor metizos didn’t have the capital and know-how to grow coffee beans. Moreover, many peasants lost their land with the expansion of railroads, banana plantations, and other construction being carried out by foreign investors. “[A]ll but a very small portion of the people are landless,” reported one professor from Minnesota in 1940, “In spite of the fact that land is still available to buyers in large amounts” (as cited in Schlesinger & Kinzer, 1990). In fact,
even the World Bank at the time, before it adopted the dogmatic neoliberal mantra, recognized that Guatemala desperately needed socially oriented economic policies (see p. 40 of this paper for further discussion).

The social and economic progress initiated by the Arbenz government, however, was short lived. Arbenz stepped on the interests of a powerful United States multinational corporation: The United Fruit Company. The government expropriated 100,000 acres of idle land owned by the company (Barry, 1987). Furthermore, Arbenz initiated the construction of highways and ports that would have competed against the United Fruit's monopoly over the railroad it owned. And unions flourished under Arbenz. More than 500 unions and leagues benefiting the Guatemalan peasants emerged under the government (Booth et al. 2006). United Fruit had consistently been opposed to unions.

The United Fruit Company began lobbying the Eisenhower Administration to overthrow Arbenz. The company, along with other influential American businesses in the region, had powerful friends. John Foster Dulles, Secretary of State under Eisenhower, and Allen Dulles, CIA Director under the administration, were both previous executive partners for Sullivan and Cromwell⁴, a law firm that negotiated lucrative contracts for United Fruit in Guatemala in 1936. Bedell Smith, undersecretary of state, was even looking for an executive position at United Fruit when the company was lobbying Eisenhower; he later landed a job on the board of directors (Schlesinger & Kinzer, 1990).

Moreover, the Dulles brothers were fanatically anti-communist. John Foster Dulles went so far as attacking containment, the idea that the U.S. must contain Soviet influence;

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⁴ Ironically, Sullivan and Cromwell, attributable to financial reasons, also played a major role in convincing the United States government to build the canal in Panama instead of Nicaragua (see Diaz Espino, 2001, for details).
he replaced containment with what he called “brinkmanship,” the idea that the U.S. must come to the brink of war with the Soviets. In order to use this fanaticism to their advantage, the United Fruit Company created a propaganda film for the White House called *Why the Kremlin Loves Bananas*, linking Arbenz to the Soviets and communism (Barry, 1987).

As a result of the lobbying of the United Fruit Co., the Eisenhower Administration decided to overthrow Arbenz. In 1954, a CIA-inspired coup, called Operation Success, removed Arbenz from power, replacing him with Colonel Castillo Armas, a brutal dictator that rolled back all the social and economic reforms achieved in the previous government.

The Guatemalan experience is a very important one. It gives Latin America a powerful message. Any government that strays from what the United States see as the proper path will be brutally brought back into line. Being in the sphere of influence of the powerful northern neighbor and its economic interests precludes, to a certain extent, the ability to carry out much-needed economic and social reform. The United States will continue to invade, directly or through proxy armies, Latin American countries that deviate from the capitalist path. The Dominican Republic in 1965, Chile in 1973, and Nicaragua throughout the whole decade of the 1980s all serve as powerful examples.

Although some cite the threat of communism—another Castro—that argument wouldn’t explain the large number of times the United States has interfered or even sent troops to Latin America. The U.S., taking advantage of its power, has always invaded its poor southern neighbors for economic and geopolitical interests. The U.S. invaded Honduras six times between 1911 and 25 and occupied Cuba (1898-1902), Haiti (1915-
1934), the Dominican Republic (1916-1924), and Nicaragua, (1926-33). And one mustn’t forget the U.S. intervention in Colombia. The government of Theodore Roosevelt sponsored the break away of Panama from Colombia in order to initiate the construction of the canal.

**Nicaragua and the United States: Economic intervention**

In addition to these economic interests in Mexico and Guatemala, the United States was obsessed with commercially strategic interests in Central America, especially those linked to the Panamanian canal. Since Theodore Roosevelt played a major role in the separation of Panama from Columbia in order to gain exclusive rights to the construction of the canal, the U.S. did anything it could to monopolize the transisthmsian route. So when Nicaraguan president and liberal dictator José Santos Zelaya (1893-1909) tried to make canal deals with American trade competitors Japan and Germany, the United States, by supporting a group of local conservative rebels, disposed of Zelaya and even sent marines in order to protect the rebels. In 1916, the U.S. puppet government in Nicaragua and the United States signed the Chamorro-Bryan Treaty; the agreement gave the U.S. exclusive rights to build a canal in Nicaragua. The objective was not to actually build a canal but to preclude the other countries from trying it themselves.

Moreover, the United States received other benefits. U.S. investment in Nicaragua, tied up in primarily mining and agriculture, was secure. Even Philander C. Knox, the Secretary of State for President William Howard Taft and major architect of the removal of Zelaya, had significant investment in fruit plantations throughout Central America (LaFeber, 1995). In fact, the puppet regime installed by the U.S. gave New York financiers majority interests in the national bank and the railroad system (Ibid).
The American-installed governments, however, did nothing to help the local population. The Nicaraguan people loathed them. Adolfo Díaz, one of Washington’s favorites, is still spoken of with disgust by the Nicaraguans to this very day. Taft even went to the extent of dispatching 26,000 American troops in 1912 in order to protect him from revolt (Ibid). When Elliot Northcott, a U.S. minister, toured Nicaragua, he was shocked at the antipathy he felt from the Nicaraguans: “[T]he natural sentiment of an overwhelming majority of Nicaraguans is antagonistic to the United States” (as cited in Ibid, p. 219).

Washington didn’t seem to care about the sentiments of the local population. The U.S. was just glad to have their immediate interests protected, even if this meant sending troops regularly to protect hated despots and chase troublemakers like Augusto Sandino, a Nicaraguan nationalist who fought against foreign troops in Nicaragua. Even Franklin D. Roosevelt, a supporter of the “Good Neighbor Policy” towards Latin America, was quick to validate a ruthless despot. After inviting the Nicaraguan brutal dictator Anastacio Somoza to the White House, F.D.R. uttered his famous quote: “Somoza may be a son of a bitch, but he’s our son of a bitch.”

By the time F.D.R. met up with Somoza, economic and strategic interests had dominated United States relations in Latin America. U.S. policy aimed to promote American investment and trade in the region, making sure Americans involved always turned a profit; policy was also obsessed with strategic concerns, protecting, for example, the passages of important waterways such as the Orinoco River and the Panamanian Canal. These interests were paramount, even to the horrific detriment of the local populations.
To his credit, F.D.R. did try to change relations with Latin America, putting a friendlier and more benevolent face on foreign policy with his “Good Neighbor Policy,” aimed at halting interventionism in the region for economic reasons. He did make a positive impact. When Mexican President Lázaro Cárdenas nationalized oil fields owned by American and British companies, investors lobbied F.D.R. to overthrow him. The U.S. president refused.

But F.D.R. had a lot more on his mind than Latin America. He had to tackle the depression, win a world war, and create a post-war economic world order. Of course, the president was able to achieve these goals. Franklin Delano Roosevelt would be rolling in his grave, however, if he knew that his post-World War II order gave birth to three of the most vilified intergovernmental institutions the world has ever seen: The World Bank, the International Monetary Fund (IMF), and the World Trade Organization (WTO)\footnote{Although the WTO didn’t come into being until 1995, the idea was laid out during the Bretton Woods Conference.}.
The Post-Second World War Economic Order

F.D.R. and many other participants in the creation of these institutions never intended to create a purely neoliberal world; and they certainly didn't set out to create institutions that would allow the U.S. to exploit their poor neighbors. The IMF and World Bank were predicated on New Deal principals, not classical economics. In order to understand the current problems with the Washington Concensus and its harm on Latin American countries, one must first understand the development of the Post-World-War II economic world, the birth of the IMF and World Bank, and the ideological changes these controversial international financial institutions (IFI) have undergone.

The United States and Bretton Woods

After World War II, the United States grew economically prosperous whereas Europe, as well as other parts of the world, found itself devastated by years of war. The Soviets suffered the most casualties. Over 20 million citizens of the Soviet Union lost their lives (Cohen, 1995). Western Europe was in terrible shape too. In 1946, Great Britain began rationing bread for the first time (McKay, Hill & Buckler, 1987). European economic production couldn't even reach pre-war levels (Cohen, 1995). "You saw nothing but destruction," lamented Sam Young, a U.S. military officer in charge of policing the American-controlled side of Germany, "wherever you looked, all around, it was terrible . . . I'd never seen anything like that before" (as cited in Adler, Berkel, & Maushbach, 2006). The U.S., however, was on the path to becoming an economic global superpower, ready and willing to shape the post-World War II world. "[U]nlike the aftermath of World War I," historian Warren I. Cohen (1995) observes, "they were determined to assert American leadership. This time they would create a world order conducive to the
interests of the United States, which would allow it to increase its wealth and power” (p. 3).

The United States began to initiate its influence when it met with over 40 other Allied nations in Bretton Woods, New Hampshire for the 1944 United Nations Monetary and Financial Conference. During the conference, the horrors of the Great Depression, the breakdown of international trade, and the ensuing war lingered in the minds of the participants. As a result, the major goal was to avoid another international economic crisis that preceded World War II and create international economic stability and cooperation.

Based on the idea of creating an economically stable liberal world order, opposed to a communist or socialist one, the International Monetary Fund (IMF) and the International Bank of Reconstruction and Development (IBRD), later known as the World Bank, were born. Although the paper will focus more on the IMF and World Bank, it is important to note that the conference also hatched the idea of an institutional organization that would foster free trade. The World Trade Organization (WTO) finally came to fruition in 1995 by replacing the General Agreement on Tariffs and Trade after the Uruguay Round trade talks.

The IMF, armed with a staff of over 2,000 bureaucrats from all over the world (“The IMF at a glance,” 2005), was created to expand trade. Expanding trade is important because many economists argued at the time that trade contraction and the breakdown of the international economic system exacerbated, if not partially caused, the Great Depression. In order to ensure that member countries don’t withdraw from international trade and the liberal capitalist system, the IMF promises low interest loans in case
balance of payments are running a large deficit, export commodities, such as copper or cotton, are experiencing price declines on the world market; or domestic spending is outpacing the amount of tax collection (Pugel, 2004). Essentially, members can go to the IMF to make up for the shortfall. Furthermore, the IMF does its utmost to sustain a stable system of exchange rates. Through surveillance, the institution monitors the exchange rate policies of different members and ensures a stable and unrestricted international flow of the world’s foreign currencies (Ibid). Expanding its purpose, the IMF is currently a major data-collecting institution; it collects and stores the economic data of the 180 plus member countries. It has also begun technical and educational assistance to developing and emerging countries.

The World Bank was initially created to facilitate the development of war-torn Europe. Destroyed by war, not many private banks would be inclined to lend money to high-risk areas of the world, although money was gravely needed. As a result, the World Bank would step in and provide money and assistance for infrastructure, education, and other much-needed projects.

**Economic Success in Europe**

The World Bank and IMF were successful in Western Europe. Although the war-torn countries also received help through the Marshall Plan, increased trade with the United States, and other policies, the two international financial institutions helped governments with money and assistance for post-war reconstruction. The World Bank lent over $500 million to European countries for the purpose of rebuilding. Money, as the World Bank (2007) recollects, was doled out to high-risk, war-torn countries that couldn’t attract money from private lenders. France was the first to draw a loan from the World Bank.
The country received $250 million, one of the largest loans in real-term dollars, to help it rebuild after the war. The Netherlands obtained the next for $195 million. Money went to important infrastructure projects. For example, the bank gave Luxembourg $12 million for railway and steel projects. The IMF also played a significant role. In 1947, France, the United Kingdom, and the Netherlands, for instance, all received money from the institution in order to cure fiscal deficits, maintain stable exchange rates, and participate in international trade.

These monetary initiatives by the World Bank and the IMF are considered successful because they helped achieve the goals of the Bretton Woods Conference. The objectives were to rebuild the European economies, promote production, and create jobs. Communist parties were gaining credibility and popularity in war-ravaged Western Europe, a lot like the fascist parties strengthened during the Great Depression, and the United States wanted to undermine this through creating robust, job-creating economies. Charles de Gaulle, France’s nationalist president, was forced to resign in 1946 since communists gained a parliamentary plurality in the preceding November elections (Cohen, 1995). The Italian government was also coming under extreme pressure from the extreme left (Ibid). The proliferating popularity of Communism in the west, in the eyes of Washington, was frightening with such a growing threat already coming from Eastern Europe, didn’t want.

The European economies, however, grew significantly. By 1963, the countries of Western Europe had a production level almost three times as high as it did before the war (McKay et al., 1987). Economists, politicians, and businessmen were all talking about an “economic miracle” (Ibid). In addition, the European countries engaged in international
trade, opposed to during the Great Depression, in which countries withdrew from trade and erected protectionist measures. Six European countries even participated in the creation of the Common Market in 1957.

The IMF and World Bank were able to assist in Western Europe's economic success because the two financial institutions were designed and created specifically for those countries. That is, the International Bank of Reconstruction and Development was the correct prescription. Europe, already once economically developed and competitive internationally, simply needed funds for reconstruction. The countries already had the essential tools to rebuild an economy, such as education, managerial skills, and industries. "In 1945 impoverished Europe was still rich in the sense that it had the human skills of an advanced industrial society," historians McKay et al. (1987) observe, "[s]killed workers, engineers, managers, and professionals knew what could and should be done, and they did it" (p. 972).

**Keynesian Economics**

Moreover, it's imperative to note that the World Bank and IMF didn't preach the neoliberal mantra at their inception. The two principle economists, Harry Dexter White representing the United States and John Maynard Keynes representing the United Kingdom, understood that free-market capitalism had weaknesses. Keynes, the more famous of the two, dedicated his life's work to ferreting out the problems with liberal economics and creating public policies to cope with and compensate for these problems. A paramount theme to Keynesian economics is that economic recessions and depressions (a severe recession) can be explained by a lack of aggregate demand. This lack of demand does not necessarily fix itself. In fact, it can persist for years!
As a result, the government must take an active role to increase demand. This can take place through fiscal spending, tax reduction, or both. Keynes’ idea was heretical to liberal economists such as. Many liberals argued, based on Say’s Law\(^1\), that demand would adjust itself, at least in the long term. But during horrific economic downturns like the Great Depression the masses may suffer for only so long. Keyne’s response to the liberals has become one of his best-known quotes: “In the long run we are all dead.”

Although Keynesian economics have been modified over the years and have experienced paradigmatic shifts, the ideas still have had a profound and indelible impact on public policy and economics. First of all, Keynes gives us insight into the weaknesses of market economics. If we don’t use an active government policy to counter economic downturns, recessions can turn into depressions, and unemployment, thus social instability, will continue to increase. But Keynesian economics doesn’t have to stop there. The ideas of Keynes clear room for a wider understanding of the weaknesses with free-market, laissez-faire economics. Maybe the government must get involved where the private industry doesn’t. For example, a country may need unemployment insurance, welfare, and other social safety nets in order to create a stable society.

Keynesian economics were incorporated into the post-World War II reconstruction plans. The idea alone of the World Bank lending to war-torn countries that private banks would avoid illuminates the fact that free market economics can’t solve all of society’s problems. But reconstruction went much father than loans. A welfare state, based on embedded liberalism, took hold of Western Europe. Those involved in post-war rebuilding, from politicians to brilliant economists, knew that market economics and the

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\(^1\) Say’s law, based on the ideas of Jean-Baptiste Say, a nineteenth-century economist from France, stated that supply creates its own demand; this became a pillar of classical economics, now neoliberalism, which emphasizes non-governmental intervention.
private sector would not be adequate. And the European masses understood this reality the best. They weren’t going to remain mired in post-war poverty and misery and wait for the invisible hand of the free market to do its magic.

In 1945, British voters tossed out the conservatives and Winston Churchill, opting for the Clement Attlee and the socialist-oriented Labour party (McKay et al., 1987). Throughout Western Europe, an active government took center role in public policy. Public housing, health insurance, family allowances, and other welfare initiatives were carried out; public enterprises that couldn’t do well in post-World War II, such as coal mines, insurance companies, and even the car company Renault, were nationalized by governments (Ibid). Due to the situation in Europe, the government had to get involved.

The United States was also influenced by Keynesian economics. Many Keynesians point to the 1946 Full Employment Bill. The measure essentially gave the federal government the responsibility to use its resources in order to sustain high employment levels (Samuelson & Nordhaus, 2002). But that’s not the only active government policy. The government became integral to help create economic and social stability throughout the United States. The 1944 Servicemen’s Readjustment Act, known better as the G.I. Bill, entailed an active government and fiscal spending in order to incorporate World War II veterans back into society. Fearing the protests and revolt of roughly 16 million unemployed and disgruntled veterans, the federal government, with the support of the House and the Senate, took action by providing job training, education payments, unemployment insurance, housing and business loans, and even a full paid year of unemployment benefits (Roberts, 1997).
In fact, initially the World Bank and IMF often recommended progressive economic policies\(^2\) to the Third World, even Latin America. This would shock many current anti-capitalist protestors. The World Bank, for instance, under Eugene Black, the president of the bank for 13 years, recognized the unequal distribution of wealth and called for active government policies for Guatemala in the early 1940s. Black issued a report recommending government regulation of foreign businesses and energy companies, along with increased public spending on education, health, and transportation; the report continued criticizing the wealthy upper class and “the unequal distribution of national income in Guatemala” (as cited in Schlesinger & Kinzer, 1990, p. 52).

**The Neoliberal Revolution**

Although there were protests against the IMF and World Bank in the 1970s, the real change to their ideological landscape took place in 1980. A new neoliberal revolution was sweeping the developed nations, especially The United States and the United Kingdom. Free markets, non-governmental intervention, deregulation, privatization, and other cherished characteristics of liberal economic were in vogue.

These neoliberal policies may have been the correct economic prescription for the economies of developed countries at the time. After years of active government and welfare policies, which were needed after World War II, neoliberalism had its place. The government of Margaret Thatcher privatized public industries by selling off over $31 billion of government shares in companies such as Rolls Royce, British Gas, and British Airways while France and Italy followed up with their own privatizations (Amacher & Ulbrich, 1992).

\(^2\) Progressive economics refers to policies considered left of the center; for example, progressives would support land reform, unions, welfare, minimum wage laws, and other socially-oriented policies.
The problem with the neoliberal revolution is that it also hijacked the World Bank, IMF, and the whole international economic system. Basically, it became globalized. Gone were the economists who recognized the need for an active government to compensate for market failures, such as Eugene Black and Robert McNamara. Gone were wealth-distributing policies. Gone were Keynesian economics. In 1981, William Clausen and Ann Krueger became the World Bank’s president and chief economist, respectively; for the new team, free-market capitalism was the solution for the world’s poor and active government was the problem (Stiglitz, 2002). These neoliberal policies of the World Bank would spread to the IMF and the whole global economic system.

Unfortunately, however, Latin America wouldn’t even benefit from progressive policies such as those recommended by Eugene Black. Although many Latin America countries, due to the increasing concentration of wealth and the marginalization of the poor, could have used some progressive policies such as land reform and the development of public projects, being in America’s sphere of influence would preclude much-needed policy and reform. One begins to appreciate the old Latino saying: “So far from God, yet so close to the United States.”

**Benefits from capitalism; but we could do better?**

The same perennial questions, however, remains. Do the American interventions and capitalist policies benefit Latin America? Do the interests of the U.S. compliment those of our poorer neighbors? Some say they often do. “The 19 years that the United States was in Haiti were the 19 best years of Haiti’s existence,” Ivan Musicant, author of *The Banana Wars*, argues, “[w]e left that country a far, far better place than we found it” (as cited in Rohter). Larry Rohter (1994) of the New York Times observes:
In at least the material sense, many of the occupied countries benefited from the American presence. Highways, railroads, bridges, and streets were built; telephone, electrical and telegraph systems installed or extended; docks, ports and lighthouses modernized, and schools and hospitals constructed... Infant mortality rates fell and life expectancy rose. (Section 4, p. 1)

Even Stephen Schlesinger and Stephen Kinzer, authors of *Bitter Fruit* (1990), an indictment of the United Fruit Company and its corrupt influence in overthrowing Arbenz, concede that workers for the company “enjoyed better conditions than most farmers in Guatemala” (p. 71).

There is no doubt that such benefits exist. Anti-capitalist and anti-globalists often forget that capitalism, free trade, the policies of the IMF and World Bank, and the United States itself have brought benefits to Latin America, from reducing inflation to creating much-needed work. Stiglitz himself (2002) concedes that globalization and capitalism “has brought so much good” (p. 4).

The goal here, however, is to ferret out the problems with the United States capitalist policies in Latin America, the causes of the backlash against such policies, and policy recommendations in order to improve economic and social policies so the Latin Americans themselves can reap the benefits of economic growth. Recent case studies, studies that have profound similarities with past policies, will help us understand the weaknesses of neoliberal policies and the improvements we can make in order to advance better economic and social policies.

Nicaragua helps us understand the problems of privatization in an impoverished developing country that has had little experience with neoliberal economics. Peru
demonstrates the weaknesses with the Washington Consensus’s criteria for measuring economic success. Argentina gives us an understanding that neoliberal economic policies may not always be for the benefit of the local population; powerful interests from Wall Street may have more influence than one could imagine!
Nicaragua and Energy Privatization: Lights Out!

Privatization is one of the most important pillars of the Washington Consensus. In theory, it sounds great. The private sector can develop and distribute resources, in this case energy, more efficiently than the inept government sector. A country needs, however, certain conditions for privatization to work. Nicaragua serves as an example of problems an impoverished Latin American country may face when it tries to privatize crucial public industries.

Privatization: The first steps

In October 2000, the Nicaraguan government privatized the Nicaraguan State Energy Company (ENEL). The two energy distribution companies, Disnorte and Dissur, were privatized, along with a number of energy generators. Union Fenosa, a Spanish multinational company, bought both distribution companies, and number of other multinationals, such as Enron, Coastal International, and Isrealí Ormat International, bought the generators. Moreover, Nicaragua liberalized its energy sector, allowing an inflow of foreign capital to invest. In the end, up to 90% of the Nicaraguan energy sector fell into private hands (Acevedo, 2005).

Privatization has brought benefits. Union Fenosa, for example, has invested $75 million within five years into the distribution sector (Bodán, 2006). This is a significant amount for an impoverished Central American country with serious budgetary constraints. After all, Nicaragua is a small country with, according to the World Bank (2004), up to 70% of its 5.2 million people living off less than $2 a day and one of lowest annual GNI per capita, $710, in Latin America. However, many promises concerning privatization have not been fulfilled. The most current and immediate problem to be
addressed entails frequent blackouts lasting over 10 hours. Moreover, there has also been a transference from a public monopoly to a private one, an absence of policy to deal effectively with exogenous shocks, a lack of the promised rural electrification, multi-million-dollar losses for the state, huge rate increases, and electricity cuts for the most vulnerable citizens of the society.

As policy makers, we must ask ourselves: What policy lessons can be drawn from Nicaragua’s experience and how can we remedy the current immediate problems that the Nicaraguans face? For the purpose of this case study, I delve into the problems of the privatization process, as well as the ensuing negative effects. These problems include the lack of regulatory institutions and the lack of state-sponsored initiatives to compensate for market failures. Moreover, I give suggestions on how to successfully manage and rectify Nicaragua’s current energy problem. Finally, I discuss the lessons that can be learned from the Nicaraguan crisis.

**Lack of institutions and laws**

First of all, the idea of having the proper regulatory institutions and social safety nets when entering the global capitalist system has become a ubiquitous presence in public policy research, spanning across a broad ideological spectrum. Not only Nobel-Prize winning economist Joseph Stiglitz (2002) and Harvard economist Dani Rodrik (1999) emphasize the need for institutional frameworks, but pro-globalization neoliberal advocate Jagdish Bhagwati (2004) also highlights the importance of institutions and adjustment aid. In fact, recent research for the World Bank concede that privatization, carried out in developing countries, functions better with the adequate institutions
(Gonzalez & Mendoza, 2004). As a result, focusing on institutions is not a radical policy agenda.

The lack of the proper institutional framework and oversight was a principal problem for Nicaragua. Deregulation and privatization, two pillars of the Washington Consensus, require a regulatory framework. When Great Britain carried out her deregulation and privatization initiatives, colloquially called “the Big Bang,” the country had strong institutions such as the Department of Trade and Industry and the Securities and Investment Board; other Western European countries also had similar governmental institutions to assist in such drastic policy undertakings. (For deeper discussion, see Fabozzi, Modigliani & Ferri, 1996, ch. 3). Moreover, the country could count on a highly skilled workforce to monitor and participate in the privatization and deregulation processes. Great Britain has economists, accountants, and engineers, among other highly educated workers. And Great Britain, like other developed countries, counts on a social safety net for those who lose their jobs from such drastic alterations in their economies.

Nicaragua, however, had no such conditions. It’s imperative to note, first, that the country was virtually cut off from economic globalization for nearly two decades. Nicaragua was racked by civil war, first during the 1970s, with gorilla movements jockeying to overthrow the dictator Anastacio Somoza Debayle, and later in the 1980s, with the “contras” trying to overthrow the Sandinista government. In addition, the left-leaning government in the 1980s did not attract foreign investment. In 1990, when the Sandinistas were voted out of power, there was almost no foreign investment in the country; in 1991 and 1992, the first years of economic openness to the global capitalist system, the country had only attracted $42 million a year (Vargas, 2000, p 141). This
was an incredibly low amount compared to other Latin American countries, most of which were in the billion of dollars. Moreover, the new government, beginning in 1991, had other priorities, opposed to building the adequate institutional framework and managing liberalization successfully, such as disarming the gorillas and soldiers in order to hamper the return of civil war.

As a result, when privatization was initiated in the mid 1990s, the government, with limited experience in the global neoliberal system, couldn’t count on the necessary institutions and oversight. The country only had the National Institute of Energy (INE), as well as ENEL itself, to help regulate the process. There was little funding and few veritable policy makers. In fact, the vice-president at the time, Enrique Bolaños, became head of ENEL by default. Even a private company, Coastal, that participated in the privatization process, admitted that Nicaragua “wasn’t ready to carry out privatization right away” (as cited in Bodán, 2000).

**The proper institutions and preparation**

But what exactly makes up proper institutions? Transparency is a principal characteristic. Transparency is defined as quick and easy access to timely and accurate information concerning the finances of a government (Peterson & Freire, 2004, p 22). In order to increase transparency, accounting standards are extremely important. Up to date and relevant accounting standards are imperative to access budgetary transactions and mitigate the growth of fraud. Essentially, accounting affords us with data concerning financial-related operations and expenditures of a particular area under scrutiny. Many developing countries lack the most basic accounting tools. One province in Brazil, for example, didn’t even have a balance sheet to show its asset position when the country
was receiving international private loans (see Ibid, p. 23b2.2, for further details).

However, when accounting standards are in place, a country can have better disclosure of its finances. After setting up the Commission on Audit, for example, the Philippines have reformed and improved, though with some weaknesses, its oversight over financial matters (see Gonzalez & Mendoza, 2004, for further details).

A certain type of education and technical skills are also required. Liberalization and privatization are a complex processes. National participants need to know everything from computers and software to exchange rate regimes. Developing countries, however, often don’t have the adequate education to deal with entering the global capitalist world (Alamgir, 2006). Therefore, international consultants are needed to prepare a country to economically open up (Ibid). A good example, using accounting again, is the use of outside auditors. Many developing countries don’t have experienced accountants, standards in auditing, or a large pool of professionals to oversee financial transactions; it’s frequently necessary to find international firms to carry out appropriate oversight (Peterson & Freire, 2004).

Moreover, a public institution needs regulatory oversight. All societies utilize, to some extent, regulatory institutions. The United States has a host of regulatory agencies, such as the Securities and Exchange Commission (SEC), the Federal Aviation Administration (FAA), and the Environmental Protection Agency (EPA) just to name a few. In the case of privatization, antitrust and anticompetitive laws, as well as a vehicle to enforce them, are extremely important. The capitalist system is suppose to promote competitive behavior which, in turn, brings benefits, such as lower prices, more efficiency, public choice, and so on. In the absence of strong institutions, a country may
just have a public monopoly turn into a private one. Virtucio and Lalunio (2001) found, for instance, that, due to a lack of the appropriate regulatory framework, the privatization of the Philippines’ North Harbor went from a public monopoly dealing with cargo-handling operations to a private one (as cited in Gonzalez & Mendoza, 2004).

However, public institutions have to regulate more than just anticompetitive behavior. Privatization is not a cure-all panacea. There are many market imperfections—Keynesian economists have astutely recognized these imperfections whereas adherents of the Washington Consensus have chosen to ignore them—that must be tackled. And Nicaragua, being the poorest country in the Americas after Haiti, is prone to experience many profound market failures. Studies suggest that developing countries need, due to their pervasive market failures, more comprehensive and responsive regulation than just financial supervision and antitrust laws (see Rodrik, 2002, for more information).

Southern hemispheric states, like mentioned before, have high percentages of rural poor. Therefore, the neoliberal economic prescription may not be appropriate. The profit driven motives emphasized in capitalism may not address the basic needs of the rural population. Some countries have managed this problem successfully, but by deviating from the non-governmental intervention principal. After the privatization of the public telecommunications companies, both Chile and Peru, through state regulatory institutions, ensured that rural needs were met. The Peruvian government incorporated substantive obligations to install telephones throughout the rural areas, whereas the Chilean government subsidized the rural installation of telephones with $2 million in order to compliment the $40 million of private funds that was invested in the country as a
whole; Chile, subsidizing the consumer, even used vouchers to assist vulnerable areas, such as public education, to pay their bills (Kenny, 2004).

Another problem stems from exogenous shocks. Developing countries need some type of institution and policy to cushion dreadful shocks. In the case of the privatization of the energy sector, the focus would be on skyrocketing oil prices. It’s extremely difficult for poor nations to absorb high oil prices. As a result, public policy must play an active role. Costa Rica, Nicaragua’s neighbor, used the state to fund alternative energy sources, reducing its dependency on imported petroleum. Investment was funneled into, for example, the country’s hydroelectric capacity (Acevedo, 2005). In 2003, the United Nation’s Economic Commission on Latin America (ECLA) concluded that only 21% of Costa Rica’s electrical energy was dependent on imported oil, roughly a third of the other Central American countries (as cited in Ibid). As a result, Costa Rica was much more apt to successfully manage the recent oil shocks.

**Problems from the privatization emerge**

Unfortunately, Nicaragua had no such institution when it began privatizing the energy sector. ENEL and INE were essentially paper tigers. Although it had codified antitrust laws, nothing was enforced. “We have very weak institutions,” Fernando Aguerri, the representative for Iberdrola, a Spanish energy firm, says (as cited in Bodán, 2000). Legally, the two distribution companies, Dissur and Disnorte, were supposed to be sold separately; however, Union Fenosa bought both for only $115 million (Corea, 2001). Although law 271 prohibited the monopoly, the privatization flouted the regulation (Hernández, 2000). The distribution sector, therefore, went from a public monopoly to a private one.
Currently, many national economists and consumer activists attribute, in part, the skyrocketing prices to the distribution monopoly. Nicaragua has the highest energy price increases and mark-up costs in Central America (Acevedo, 2005). Mark-up costs entail the price increase distribution companies charge after buying energy from the generator. According to the World Bank, Union Fenosa adds 61% to the generating price and another 9% in “distribution losses;” the distribution losses are attributable to indigent citizens tapping into the electricity illegally (cited in Ibid). Although the monopolistic company is not the only variable contributing to the crisis, the incredibly high mark up increase plays an important role.

Moreover, there were virtually no accounting standards or oversight. KPMG and Grant Thornton, two international accounting and consulting firms, came to the conclusion that the government lacked accounting professionals, technical skills, and any veritable oversight of the privatization process. Minor Mora (2004), a top-level accountant and consultant for KPMG, points out that during the Arnoldo Aleman administration (1996-2001), when the privatization was carried out, bureaucrats in the government didn’t use computers to store data concerning governmental purchases; workers would just jot information on pieces of paper. As an example, Mora used school desks: “If they bought 100 desks, they would write 100 desks and the price on a piece of paper; no computers or anything.” This, he continued, made it very easy to steal and embezzle.

Grant Thornton found multi-million dollar losses for the state. These losses came directly from the privatization of the distribution companies and a number of generators. For example, San Jacinto Power SA, a private corporation, used the Nicaraguan state’s
geothermal field, Intergo-term, and all its physical infrastructure and wells; however, according to the auditing, ENEL and the state, after investing over $10 million into the installations, didn’t receive any benefit, be it financial or social, from the contract (Loáisiga, 2003). Essentially, the private corporation, Grant Thornton continues, simply obtained the right to sell the energy when the state was investing in the field’s infrastructure (Ibid). The same problem occurred, according to Grant Thornton, with Plant Momotombo, owned by the state, and the private company Ormat International (Ibid). “[T]ransfering the rights . . . without obtaining any benefit also caused economic damage to ENEL and the state of Nicaragua,” the financial auditing read (as cited in Ibid). Three days later, the Controller General’s Office of Nicaragua concurred with Grant Thornton’s conclusion (Olivas, 2003).

Losses were also accrued by embezzlement. Over $5 million of the money Union Fenosa paid the Nicaraguan government was later found in a Panamanian bank account named the “Taiwanese Donation” (Galeano, 2004). The Alemán years were marred by corruption scandals. Multi-million dollar scandals began to surface early in his administration (see Vargas, 2000, for in-depth details). However, privatization initiatives were still encouraged by international institutions. By the end, Arnoldo Alemán and his bureaucratic cronies, such as Esteban Duquestrada, the former Treasury Secretary in charge of the privatization funds, sacked the state for hundreds of millions of dollars, most of which were found oversees (Ibid). Much of the money, it’s important to note, came from privatizations. In addition to the losses of ENEL (these losses are still being traced today), Grant Thornton found a “flight” of up to $17 million from the privatization of ENITEL, the state telecommunications company (Narváez, 2006).
It's also important to note that these accounting initiatives took place years after the privatization process. Although countries have used outside auditors and higher accounting standards, it's often too late. Studies have found that promptness, or after the fact, remains a weakness in creating financial transparency (see Gonzalez & Mendoza, 2004, p. 99, for further details).

But even more importantly, there were absolutely no state initiatives to compensate for market failures. Privatization was considered a cure-all panacea. State investment in energy generation and distribution was supposed to be replaced by foreign investment. But what happens when foreign investment doesn't cover all the needs? If the state doesn't compensate for the failures of the market, a country has crisis on its hands.

This is the case for Nicaragua. First of all, Nicaragua suffers from the biggest energy deficit in the region. At times, the country must ration up to 50% of what it consumes (Olivares, 2006). Needing 100 megawatts, generators are often only producing 40 megawatts (Ibid). The deficit is generating blackouts throughout the country. Power outages last for up to 10 hours in Managua, the capital, and even longer in the surrounding cities and towns (Martínez, 2006). In fact, severe power outages are expected to continue in 2007 (Ibid). Although there were power outages before privatization, they were never so long and frequent.

The loss of power has caused serious economic problems. Local businesses, most of which don't have the resources to rely on their own private compensatory generators, have been gravely hurt. Local dairy producers, for instance, argue that they have lost millions of dollars. I witnessed them demonstrating their outrage by throwing bags of sour milk at Union Fenosa's building. Other economic sectors, in addition to production,
have been hurt as well. Granada, suffering serious outages, the colonial city, has experienced a sharp decline in tourism; tourism-related businesses attribute the decline to energy problems (Zambrana, 2003). And, it’s important to understand, the lack of energy also hampers the circulation of water due to electric pumps.

Moreover, the country never prepared for exogenous shocks. In the case of energy privatization, a shock would stem from international oil price increases. When oil prices began to increase in the early 2000s, Nicaragua was more adversely affected than other Central American countries. Nicaragua depends on oil more than any other country in the region. 72% of Nicaragua’s capacity to produce electrical energy, according to ECLA (2003), comes from imported petroleum (Acevedo, 2005). The oil dependency for El Salvador, Honduras, and Costa Rica, ECLA continues, hovers around 48%, 55%, and 21%, respectively (Ibid). In fact, predicated on the insistence of multilateral lending institutions, Nicaragua based its energy policy on giving concessions to multinational companies, such as Enron, Amsfels, and Coastal, in order to install combustion-based thermal power plants and other oil related businesses (Ibid).

The country is also suffering from a lack of rural electrification. The government, during privatization, promised electricity in rural areas (Castillo Zeas, 2000). However, the distribution company has no profit incentive to expand in impoverished areas. Before the privatization, only about half the country had access to energy connections (Bounds, 2000). Five years later, it remains roughly the same (Acevedo, 2005). Being a rural country, rural electrification is extremely important. Agriculture production, most based in the rural areas, is important to the economy. Electricity is essential in order to add value to crops, such as plantain, a big export product for the country.
The most vulnerable of society are also experiencing energy problems. The elderly, the poor, and the public universities have been confronted with a lights-out policy. The Nicaraguan constitution stipulates that retirees, schools and other vulnerable areas have the right to an energy subsidy (Castillo Zeas, 2000). However, after privatization, subsidies were cut completely (Ibid). There were no obligations or state initiatives to fill in the gap. The free market fulfills energy needs now. When asked about the lack of rural electrification and cuts for the vulnerable, Union Fenosa responded: “The thing we can’t do is subsidize because Union Fenosa is a corporation that has to develop a business, and develop it well” (as cited in Ibid).

But don’t think the government is saving money by letting private companies do some investing. Recently, Union Fenosa has requested a $9 million subsidy from the Nicaraguan state (“Lights Out,” 2006). Union Fenosa owes the generators million of dollars. For instance, the Spanish company owes $4.1 million to Enron (Olivares, 2006). Union Fenosa, after raising rates in the first few years by 35%, alleges that the subsidy is actually for the consumers; then, they don’t have to raise rates more (Bodán, 2006). However, studies strongly suggest that subsidizing the consumer directly—in the form of vouchers, for example—is much more efficient (see Kenny, 2004).

Economic problems, social unrest, and organized protests now dot the country and swell the streets (see Martínez, 2002, for reports on protests in the early years after privatization, and Ibarra, 2006, for recent ones). Consumer groups and ordinary citizens chant in unison “que se vaya Union Fenosa” (“Leave Union Fenosa” in English). The protest spans across ideologies. The Prensa, a pro-United States newspaper that even received money from the CIA during the 1980s, is filled with anti-privatization stories.
Jamie Morales Carazo, a prominent businessman, congressman, and ex-contra, has been on the local news pointing out that privatization has been fraught with failures. Privatization has become a dirty word, eliciting a strong feeling of dissatisfaction, throughout the country.

**Policy recommendation: Compensating for market failures**

Many lessons can be drawn from Nicaragua’s case. One of the most important lessons is gradualism. Countries that haven’t had ample time and experience dealing with economic globalization need space to develop the proper institutional framework. Quick fixes don’t exist, especially when we are dealing with such a complex process as privatization. Moreover, markets aren’t perfect. Preparing ourselves for their failures will be a lot more prudent and efficacious than waiting for the failures to crop up. Market failures may be even more acute in impoverished countries, where liberalization is taking place, because poverty will inhibit many of the benefits that stem from profit-driven motives. We must also be prepared for exogenous shocks; whether the shock comes from international “contagion,” devalued exchange rates, or high oil prices, we must create policies to mitigate their effects. Finally, the state, along with the private industry, must be utilized as a compensatory policy tool in order to manage this relatively new economic globalization successfully. Essentially, the process of privatization, a pillar of the neoliberal ideology, must be modified in order to bring benefits to the great majority of Latin Americans.

Steps can be taken to assist Nicaragua as well as other countries with privatization problems. The Nicaraguan energy problem is a public policy issue linked to our global economy because the international community gave Nicaragua strong incentives to
quickly privatize the state-owned energy sector. Nicaragua’s entrance into HIPC, which eliminated parts of the country’s multilateral debt, along with important loans and aids, was linked to privatization (Hernández Ramos, 2001). In fact, multilateral financial institutions recommended Nicaragua to take the path of replacing state assistance with that of private foreign investment (Acevedo, 2005). And cutting public subsidies in the energy sector was a condition of the structural readjustment programs encouraged by the IMF (Ibid). Our professional and moral goal as national and international policymakers is to successfully manage the global economy so that developing countries can benefit the most from their new openness.

As a result, we must tackle the most pressing problem: Energy deficiency. In the case of Nicaragua, the state, although the mere mention of the state is antithetical to the neoliberal orthodoxy, must play an active role in investing in energy generation in order to make up for the deficit. Before 2000, international institutions played a significant role. In 1997, when INE released a report that Nicaragua would need an extra 1,179MW to cover energy needs over a couple decades, ENEL, run by the state, invested up to $61.6 million dollars, most of which came from IDB, in order to cover the basic needs (“Energy Lacking,” 1997). Moreover, in order to cushion the negative externalities of the oil price shocks, alternative energy must be a principal focus. The country has important water resources and volcanoes, for example, for alternative developments. Nicaragua has volcanoes and hundreds of miles of fast-running rivers; in fact, due to the water resources, Nicaragua was chosen first to be the land for the present-day Panama Canal (see Espino, 2001, for complete details on Nicaragua’s geography, resources, and canal treaties). And with sun all-year round, solar energy could be pondered!
Although funding energy, especially alternative energy, may sound expensive, and we understand budgetary constraints, some estimates are reasonable. A study by Germany and the Netherlands showed a number of energy projects costing, at least in estimates, only $471,188 (Convenio con Alemania, 2006).

Moreover, the state and private companies must work together to reach rural electrification. The lack of energy directed at the poor rural areas, as well as in some poor urban areas, serves as an indication that markets aren’t perfect. A project, similar to what Chile did with telecommunications, could suffice. The Chilean government itself set up the telephonic infrastructure and then allowed the private companies to distribute the needs (Kenny, 2002). Energy infrastructure can be initiated by the government in order to reach vulnerable areas. Furthermore, subsidizing, possibly through vouchers, could assist those that need energy resources. This would be motivated by the concern for long-term growth, in addition to altruism. If university students don’t have access to computers, the digital divide—those that have access to technology and those who don’t—could increase. Stiglitz (2002) points out that after the privatization of the telephone company in Côte d’Ivoire, costs grew so high that college students reportedly lost their connection to the internet (p. 56). Such a loss could reduce the skills of the work force.

If we don’t act to assist Nicaragua, the backlash against privatization, international institutions, and the whole global system will grow. Arch-nemesis of the United States during the Cold War, Daniel Ortega, has recently won the Nicaraguan presidential election. Although the US tried to hamper his electoral win by, for instance, cutting off aid, discontent with the economy was strong. One of Ortega’s whipping boards
throughout the election, and even before, was Union Fenosa and privatization (see Pantoja, 2006, and Hernández & Roa, 2002, for in-depth details).
Peru: What’s in the Numbers?

President Toledo and Peru

When Alejandro Toledo became president of Peru in 2001, there were high hopes for him. Toledo grew up poor, shining shoes as a little boy; yet he was able to make it all the way to the prestigious Stanford University where he received a Ph.D. in economics. Using the criteria of the Washington Consensus—GDP, exportation, balance of payments receipts, foreign investment, and so on—his presidency was a smashing success. However, his administration was fraught with problems. Protests and unrest plagued the country. Everyone from truck drivers to schoolteachers periodically went on strike. The population loathed him. He was the least popular president in the Americas, albeit his country had the highest economic growth rate. How could someone so loved by the IMF, World Bank, and the United States State Department be so hated by his own people?

This case study looks deep into Peru’s economic miracle (2001-2006). Although the country did incredibly well by Washington Consensus standards, these results did not trickle down to the average citizen. Essentially, this study is an indictment of how the Washington Consensus actually measures success. Detailing Peru’s impressive accomplishment, I aim to explain the weaknesses of the economic measurements of the Washington Consensus; furthermore, I continue to try to persuade the reader that other measurements are as, if not more, important than the current conventional measurements; I conclude that, albeit the standards of the Washington Consensus have an important place in understanding the development of an economy, those standards in and of themselves are not going to improve peoples’ lives. Serious social policies and goals must accompany neoliberal economics.
The Republic of Peru, with over 27 million inhabitants, borders on the Pacific Ocean as well as five different South American countries: Ecuador, Columbia, Brazil, Bolivia, and Chile. Being the cradle of the great Inca Empire, the capital being Cuzco, Peru still has a sizable indigenous population, most of whom still converse, though Spanish is the official language, in their native tongue. Currently, research puts the indigenous people at roughly 40% of the population, though numbers are commonly disputed (see Salazar, 2006). Nonetheless, the sizable indigenous population would be another strength for Toledo. Unlike the heads of government in other Latin American countries, which usually are whiter and more European, or, at least meztizo, Toledo is indigenous himself. As a result, the president had a great mythical image to sell: He was born poor and indigenous; he was a shoeshine boy; but he made it all the way to Stanford!

When Toledo took power in 2001, the transition was quite difficult. He was replacing the presidency of Alberto Fujimore, a strong man—many would say a dictator—whose administration (1990-2000) was marred by corruption. His notorious chief of the National Intelligence Services, Vladimiro Montesino, is being tried for drug trafficking and even murder. The reliable evidence against him, however, lies in the videotapes of Montesinos bribing elected officials. The most infamous recording entails him bribing an opposition politician for $15,000. Fujimori also has corruption charges against him, along with murder charges; the state of Peru links him with death squads during the 1990s. He awaits extradition in Chile. Toledo would often mention that taking over after Fujimore was certainly no picnic. “It was very, very difficult to govern in the transition, coming after a corrupt dictator,” Toledo notes, referring to Fujimori (as cited in “Toledo espera,” 2006).
Toledo’s economic policies

Being an economist, Toledo knew exactly what economic problems would have to be
tackle. Inflation was in double digits and growth was inching forward at a mere 0.2%
(Barr, 2003). Furthermore, Toledo had to face the fiscal deficit, a pet peeve of the
Washington Consensus (The neoliberal ideology would much rather bare witness to a
“zero deficit,” as the case study on Argentina will demonstrate). By 2001, the deficit had
reached 2% of GDP (“Toledo in trouble,” 2003).

Toledo understood economics. By following the IMF structural adjustments, he cut
spending in order to decrease fiscal spending, pay the national debt (Ballve, 2003) and
curb inflation. In 1990, in fact, inflation had hit 7000% and still hovered in high double
digits throughout the 1990s (Barr, 2003). Toledo, however, was able to cure inflation for
good. In 2004, it was reduced to 3.5% (Gallegos, 2006). By 2005, inflation was at an
historic low: 1.5% (Ibid). Toledo was also able to reduce the fiscal deficit (Ibid).

Moreover, Toledo pushed ahead for free trade agreements. In addition to making
deals with his Andean neighbors, he sought out agreements with a diversity of countries
such as South Korea and, later in his term, the United States. Toledo even tried
connecting neighboring countries. Under his government, the Interoceánica Sur, 1,600
miles of two-lane highway connecting Peru to Brazil, was constructed (Conger, 2006).
The international business media rejoiced! “Peru can more readily ship fresh vegetables
and fruits to Brazil,” exclaimed the magazine Institutional Investor, “while Brazil can
more easily send soy products, beef and timber to Peru (Ibid, p. 116).

Toledo’s efforts at expanding trade were successful. Exports skyrocketed to historic
highs. The Washington Consensus views exportation as a significant part of economic
development. In fact, Harvard economist Dani Rodrick (1999) observes that neoliberal developmental strategies actually have an “export fetish.” As a result, Peru was developing extremely well. By 2005, Peru’s trade surplus had reached $4 billion (Economist, 2005). Compare that with the surplus from another Andean Pact country Columbia. Columbia reached an impressive $1.8 billion (Ibid). And it’s important to note that the surplus stemmed from significant increases in exports, not a decrease in imports. Peruvian exports sales were worth $7.714 billion in 2000; for 2005, export sales reached roughly $17 billion (“Toledo espera,” 2006).

GDP growth is one of the most important economic indicators for the Washington Consensus. It measures the dollar amount of finished goods a country produces within its borders. Toledo achieved enviable success in this area too, having one of the highest growth rates of Latin America and the Caribbean. The economy grew by about 4% in 2001 (“ Strikes, sleaze,” 2004). In 2002, GDP growth averaged 5.2% (Toledo in trouble, 2003). In 2004, growth remained at 5.07% despite predictions of only 4% (Weitzman, 2005). By 2005, growth had reached nearly 7%, the best economic expansion in Peru’s history (“Toledo espera,” 2006).

With such statistics, international financial institutions, the US State Department, and foreign investors were more than elated. Billions of dollars in FDI poured into Peru’s mineral wealth such as copper and gold. The hydrocarbon and mining sector was expanding by 5.41% (Weitzman, 2005). Peru issued its first sovereign bond in roughly 74 years (Barr, 2006). Peru was even awaiting one of the most precious accolades of the international investor community: A credit rating marked up to investment grade (“Peru’s election,” 2006). International investment newspapers and magazines continued lauding
the administration. "President Alejandro Toledo achieved an enviable record of economic success," wrote the Financial Times (Ibid).

Like Mexico over a century before, Toledo did everything right, following the neoliberal capitalist road to development. However, most Latin American leaders wouldn't find much enviable about the Peruvian president. Protests against the administration mushroomed throughout the country. Farmers, teachers, and transportation and healthcare workers, among other civic groups, participated in nationwide strikes. Teachers were often at the forefront of the protests. They were striking for a better salary. Public school teachers' demands entailed, most importantly, a $60 to add to their $200 monthly wage ("Toledo in trouble," 2003). Pharmacists, doctors, and airport workers were also striking for salary increases ("How Alejandro Toledo," 2004).

**Protests and resentment**

Protests grew increasingly more violent by 2003. 2,000 farmers, demanding lower taxes on crops and some protection from imports, began blocking important highways throughout the central part of the Andes (Schulte, 2003). Up to 35,000 nurses and doctors refused to work (Ibid). In northern Peru the riot squad had to use against 5,000 protesting teachers (Ibid). In southern Peru, students joined and marched in protest with the teachers, even seizing a public university in the city of Puno (Ballve, 2003).

Toledo, due to the extent of the protests, finally had to declare a state of emergency on May 27, 2003. The president sent up to 70% of the Peruvian Army to the streets in order to quell the civic unrest (Ibid). When students and teachers clashed with soldiers in Puno, they opened fire ("Toledo in trouble," 2003). A 22 year-old student, Edil Quilca,
was killed (Ballve, 2003). Throughout the country, roughly 50 people were wounded ("Toledo in trouble," 2003).

In the opinion polls, Toledo's approval ratings were appalling. Studies had him at 11% (Ballve, 2003), 10% (" Strikes, sleaze," 2004), and 15% ("Toledo in trouble," 2003). The highest found put him in the low 20s (Gallego, 2006). In fact, more than half of the public thought he should have left before his tenure ended in 2006 (" Strikes, sleaze," 2004).

By the next election, Toledo's candidate (the "official candidate" for the party) for presidency, Lourdes Flores, couldn't even make it in the first run off. Although papers predicted that she'd at least come in second (see Gallego, 2006), she was beaten by Ollanta Humala, a Peruvian nationalist with links to Hugo Chavez, and ex socialist president Alan García. Humala's mantra was: "There's been growth, but no development" (as cited in Forero, 2006). García finally won in the second round. Toledo felt, overall, that he wasn't being judged fairly considering his economic record. "I hope history will be more fair in its final judgment about my government," he lamented (as cited in "Toledo espera," 2006).

What went wrong? Although Toledo's achievements looked, when using the criteria of the Washington Consensus, spectacular on paper, wealth, much like Mexico under the economic expansion under the Porfiriato, never trickled down to improve the lives of the average Peruvians. Even international financial newspapers had to recognize the fact. "To pretend that the benefits of economic growth trickle down naturally to raise all living standards is naïve," writes the Financial Times, "[t]hey need to give a fresh emphasis and urgency to social policy" (as cited in "Peru's election," 2006).
But how great was the economic miracle?

Excluding the criteria of the Washington Consensus, indicators were quite poor in Peru. Over half of the Peruvians live on $1.25 a day (Schulte, 2003), many in the rural areas, and even liberal capitalist newspapers have questioned whether the FDI in those regions has improved the lives of the people (see “Peru’s election,” 2006). Albeit GDP growth was increasing, a more important indicator didn’t: Employment. Unemployment remained stubbornly high, one of the highest in Latin America and the Caribbean, throughout his presidency. It was at a persistent 10% (Schulte, 2003).

Underemployment, defined as the percentage of those working less than they would like, was precariously high too: 40% (Barr, 2003).

Moreover, even if one had a job, the salaries weren’t always livable. Many couldn’t even cover the cost of living. Following IMF recommended efforts to tighten the fiscal budgets, not much was left for important sectors of the economy. Teachers only received, for instance, half of what they were demanding: $30 (Ballve, 2003). $230 monthly would still not cover the basic needs. According to el Instituto Apoyo (2003), the cost of living, measured by the Peruvian Consumer Price Index (CPI), was $314 (1,100 soles in Peruvian currency).

Other indicators clearly demonstrated the Peruvians weren’t benefiting in the economic miracle. The United Nations Human Development Report (UNHDR) consistently showed Peru at the bottom of continental Latin America. The percentage of GDP growth spent on public health care during Toledo’s administration, according to UNHDR (2006), was a pathetic 2.1%. Impoverished Central American countries spent
almost double that percentage. According to the same report, Honduras stood at 4.0%, whereas both Nicaragua and El Salvador spent 3.7%.

Peru also did poorly as a percentage of education. According to the United Nations, Peru was only spending a mere 1.84% of GDP on primary and secondary public education, whereas Columbia was spending 3.43% and El Salvador was able to reach 2.21%. In fact, a UN study (2003) shows that the amount of children studying primary and secondary school only increased by 1.7%.

There have been other arguments for Toledo’s low popularity. He gave himself a pay raise, at a time others were suppose to be tightening their belts, that resulted in a whopping $18,000 a month. He also had problems due to not admitting that he gave birth to an illegitimate child. These arguments, however, are not very strong. If people benefit economically, they have the inclination to overlook personal troubles.

The reality is that Toledo not only became unpopular but neoliberalism did as well. “Nevertheless, neoliberalism, privatization, and free trade are becoming dirty words in Peru as well as around the region,” Robert R. Barr (2003), a researcher on the region, points out, “[t]he public has lost much of its tolerance for bearing the continued costs of austerity, from which only the elite appear to be benefiting” (p. 1172). This is true. Humala only had to make nebulous promises such as to “build an alternative model to this neo-liberal model” (as cited in Forero 2006) in order to defeat the neoliberal candidate. In fact, up to half those polled admitted not experiencing any economic benefits from Toledo’s policies at all (“Toledo espera,” 2006)! Toledo’s economic success was paradoxically harmful for the Washington Consensus. Capitalism couldn’t deliver the goods.
Policy recommendation: Modifying how we measure economic success

Many lessons can be learned from Peru’s case. The objective here is to ferret out the weaknesses of how we measure “success” in economic development. Criticism of how we measure economic and social advancement has a long past. Geneva-born Simonde de Sismondi (1773-1848) was quick to criticize classical economics and its mathematical measurements in the late seventeen and early eighteen hundreds. He denounced the “cold calculus” of numbers and the “mathematical chain of theorems” (as cited in Ekelund and Hébert, 1992, p 254). Instead, Simonde de Sismondi argued that the people themselves would have to benefit from increased production and wealth; increased production and wealth, in and of themselves, is often meaningless (see Ibid ch10). Many (Ibid p 254) say Sismondi initiated the first research into “social economics.”

Almost 200 years later, Nobel prize-winning economist Amartya Sen (1999) would question the validity of how we evaluate economic progress. Although Sen is by no means an extreme leftist—he, for instance, is a true believer in private property, as well as supply and demand economics—liberal capitalist outlets, supportive of the Washington Consensus didn’t like his work from the beginning. A day after Sen won the Nobel Prize, The Wall Street Journal was quick to disparage him as an economist who “has done little but give voice to the muddleheaded views of the establishment leftists” (See Pollock, Oct. 15th, 1998, p1, for full article).

Sen, however, makes a lot of sense. In his insightful book Development as Freedom (2000), the author astutely observes that there is more to development than GDP growth and other mathematical indicators. Sen attempts to re-evaluate the evaluative assessment we use to promote and measure progress:
Growth of GNP or of individual incomes can, of course, be very important as means to expanding the freedoms enjoyed by the members of the society. But freedoms depend also on other determinants, such as social and economic arrangements (for example, facilities for education and health care) as well as political and civil rights (for example, the liberty to participate in public discussion and scrutiny). (p. 3)

Sen continues questioning measured progress by emphasizing the importance of addressing “poor economic opportunities as well as systematic social deprivation, neglect of public facilities . . .” (p. 3).

Toledo, as well as other leaders in the developing world, should have read Sen’s book. While the president of Peru, he received accolades from financial institutions, foreign investors, and the United States. However, in his own country, Toledo was loathed by his own people whilst the great majority didn’t benefit from the miraculous growth.

As a result, we must change the evaluative tools we use to measure success. Although GDP growth is important, along with balance of payments statistics, FDI, and foreign reserves, economic success can’t be declared by those assessments alone. As policymakers, we must incorporate education and health care access, income distribution, employment and underemployment data, and other social concerns, other than bond ratings. Then, we can conclude that development has been a success.
The Argentine Economy: Up in Smoke

By the turn of the millennium, Argentina was in the midst of one of its worst financial crises ever. As rioters swelled the streets and economic deterioration reigned, one important question obviously comes to mind: What happened? After all, international institutions such as the International Monetary Fund (IMF) and the World Bank were lauding Argentina as an example of economic success. How did the country fall into such a horrific economic abyss? For the purpose of this case study, I aim, first of all, to explain the strengths and weaknesses of the controversial Convertibility Plan; moreover, I explain how the inherent weaknesses of the plan made convertibility incapable of successfully managing the economic problems and shocks Argentina would face throughout the 1990s and early 2000s; these weaknesses, or limitations, of convertibility inevitably dragged Argentina into a financial crisis; finally, I give suggestions on how to avoid similar crises.

La Convertibilidad

One must understand, first of all, the economic policies that made up the Convertibility Plan. The most important policy of the plan affected Argentina’s currency, the peso. In 1991, the Argentine government, under the guidance of the powerful Treasury Secretary Domingo Cavallo, pegged the Argentine peso to the US dollar. The policy created a one-way one-to-one peg, meaning that Argentina, without any assistance from the United States, would accept full responsibility to defend the fixed exchange rate. The exchange rate would be regulated under the currency board system. Essentially, the currency board ensured that the one-to-one peg was maintained. If the peso was weak, the Central Bank of the Republic of Argentina (BCRA) alone would have to intervene,
buying pesos and selling dollars in order to strengthen the currency; if the peso was appreciating ahead of the dollar, the BCRA would have to sell pesos and buy dollars. The currency board system also gave every peso-holder the right, at any time, to change his or her pesos to dollars at the one-to-one rate. This meant that the amount of dollar reserves would have to be tied to the amount of pesos in circulation.

But the Convertibility Plan entailed much more. It was an umbrella name encompassing a cornucopia of neo-liberal economic policies. These include opening the country to foreign investment, controlling fiscal spending—the government promised a “zero deficit”—and following laissez faire (apart from defending the exchange rate) principals. And, of course, the privatization of state businesses was a major initiative. The government privatized everything from airports to the state oil companies. Big companies, such as Enron, Duke Corp., and Pérez Companc of Argentina, bought up oil fields, telecommunications companies, and anything else they could get their hands on (Pilling, 1995). Essentially, Argentina was the cherished baby of the Washington Consensus.

But why was the Convertibility Plan, an economic approach that many believed to be a bit radical, initiated in the first place? The Argentine president at the time, Carlos Menem, and Cavallo veritably believed that the plan was the only way to tackle the country’s serious economic problems. Unbelievable hyperinflation was one. Throughout the 1980s, inflation was averaging 200% a month (Feldstein, 2002). In 1989, the annual inflation rate had reached 5,000% (Pastor and Wise, 2001)! Economic growth was also a problem. GDP was growing at merely 0.1% in 1990 (Zabala, 2004). And foreign investment, seen by many policy makers as essential for growth, was stagnant. It was
only averaging around $1.2 billion a year, substantially lower than other emerging economies (Ibid). In addition, poverty was growing. Argentina, a country that had the same per capita income as France and Canada prior to World War II (Pugel, 2004), was now considered “Third World.” In 1974, those living in poverty represented only 5.1% of the population; by 1989, the amount had reached 42% (Buscaglia, 2004).

**Initial economic benefits**

Neoliberal economics did initially bring results. The short-term economic benefits of the Convertibility Plan were amazing. Although there are always many variables influencing economic performance, such as increasing world prices for a countries exports and influential growth in the rest of the world, serious researchers from a broad ideological spectrum recognize that the Convertibility Plan played a major role in Argentina’s economic recovery. Even Nestor Kirchner, Argentina’s current president and outspoken critic of the plan, recognizes its benefits. “‘[W]hen the convertibility law was enacted in 1991 . . . [it] helped curb inflation,”’ the president observes, “‘. . . there was a certain improvement in Argentina’s economy. Poverty went down . . . you could see improvement in the middle-class’” (as cited in Kirchner & Krugman, 2004, p. 4).

Kirchner was right. First of all, the plan helped to tackle galloping inflation. Many policy makers at the time were looking to use fixed exchange rates as a currency anchor in order to undermine inflationary pressures (See Shatz & Tarr 2004). By limiting the increase in the domestic money supply, the fixed exchange rate tamed inflation. By 1994, inflation was less than 5%; it was even lower in the following years (Buscaglia, 2004). Furthermore, with a fixed currency, investors didn’t have to worry about exposing themselves to exchange-rate risk and hedging against unforeseeable peso depreciation.
As a result, investors weren’t nervous about investing in the country. They invested in many areas, as well as in the newly privatized companies. In 1993, investment reached up to $6 billion, increasing fivefold from the previous years (Zabala, 2004).

Moreover, a whole host of economic indicators was improving. Between 1991 and 1994, the economy grew at an average of almost 10% a year (Pastor & Wise, 2001). Unemployment was relatively low, hovering around 6% in the early years of the plan (Buscaglia, 2004). Savings were also up. Domestic bank deposits in Argentina were less than 5% of GDP in 1990 (Ibid). By 1994, the percentage had reached 20% (Ibid)! And, it’s important to note, GDP was much higher. In fact, Argentine policy makers managed, in “heroic fashion,” to weather, though with some problems, the Mexican “Tequila” crisis of 1995 (Pastor and Wise, 2001, p. 64). This breathed a gust of credibility, even invincibility, into Cavallo’s economic management and vision.

However, short-term benefits began to give way to long-term crises. Although the Convertibility Plan was useful in the beginning, its inherent limitations to tackle different economic challenges surfaced in the latter part of the 1990s. The principle problem with convertibility was the fact that Argentina inevitably lost its macroeconomic management over the economy. The two essential macroeconomic tools are fiscal and monetary policies. The former involving taxing and spending while the latter entails adjusting interest rates. Being in a fixed exchange rate severely limits their use. With its exports at an uncompetitive advantage, which I’ll explain later in the paper, the demand for the Argentine peso decreased. As a result, in order to defend the one-to-one peg, Argentina had to prop up the weak peso—its demand was low due to the plummeting demand for the country’s exports—by buying pesos and selling dollars.
Neoliberalism becomes problematic

Two inimical effects emerge. A country that carries out such a policy, first of all, loses hard reserves. In the case of Argentina, this had the potential to produce dire consequences. Convertibility law stipulated that peso holders could automatically convert their holdings to dollars. A lack of dollars would undermine the whole economic system. Second, scooping up pesos and selling dollars reduces the domestic money supply; therefore, interest rates increase, growth decreases, along with tax revenue, and unemployment figures rise. The positive effect of this economic contraction is a decrease in inflation; and a decrease in hyperinflation is exactly what the Argentine government promised the masses and investors.

However, what happens if policy goals need to be changed. Let’s say a country, after getting inflation under control, becomes mired in recession and high unemployment? Policy makers need to expand the economy and promote export production. Here in lies the problem. There’s an intrinsic conflict between internal goals, maintaining growth and reducing unemployment, and external goals, maintaining a fixed exchange rate. The inflexibility of the Convertibility Plan precluded Argentina from using the appropriate policy options in order to successfully manage a series of interconnected economic problems.

One titanic problem was the appreciating dollar. While Argentina was weathering crises that began in Mexico and later Asia, the dollar began appreciating significantly relative to other currencies. In 1996 and 1997, the dollar soared high above the yen and other Asian currencies (Feldstein, 2002). The Euro also plummeted 25% to the dollar
(Ibid). In fact, the appreciation was so significant, many US export companies were severely damaged (see “A strategy for managing,” 1997, for more details).

The strong dollar affected Argentina because, being fixed to the dollar, its currency was appreciating as well. This currency reality rendered Argentine exports uncompetitive. Although many argue that the peso wasn’t overvalued when it was in the fixed exchange rate, these economists fail to take into account Argentina’s major trading partners. Economists such as Hanke (2002) and Schuler (2002), both supporters of the fixed exchange rate, observe that the peso was never overvalued like others allege. Schuler cites the Economist’s Big Mac Index (April, 2001), showing that the peso was actually, by 2%, undervalued when compared to the dollar. However, the United States isn’t Argentina’s principal trading partner. The US market only represents 12% of Argentina’s exports (Pastor & Wise, 2001). Brazil represents 30% and the EU 20% (Ibid). The dollar remains overvalued compared to these and other currencies, Argentina’s competitors. In fact, when Brazil’s currency, the real, depreciated in 1999, after almost a decade of being fixed to the dollar, the Argentine peso, already strong from being pegged to the dollar, became even stronger relative to the country’s most important trading partner. The real plummeted by roughly 40% (Ibid).

Although many policy makers recognize that a currency must depreciate (market forces) or be devalued (by government intervention) in order to cure the imbalances, a fixed exchange rate forfeits these options. As a result, Argentina’s exports were overpriced on the international market. Exports to Brazil immediately dropped by 30% (Ibid). And with the real at a competitive advantage, Argentina lost a significant amount of export trade with Mercosur, the regional integration area (RIA) that Argentina, Brazil,
Uruguay, and Paraguay formed in 1991. The loss of trade to Brazil, Argentina’s main competitor in everything from car parts to shoes, produced bitter trade disputes between the two countries (Banega et al., 2001). Although Argentina tried to make the workforce more flexible, in an attempt to make exports cheaper and, thus more competitive, through policies such as “temp workers” (Pastor & Wise, 2001), exports never gained a competitive edge. By the end of the 1990s, Argentina’s current account deficit reached 5% of its GDP (Buscaglia, 2004). This amount stood in stark contrast to only 0.4% for the first yearend of the Convertibility Plan in 1991 (Ibid).

Such a large current account deficit produced terrible results for Argentina. In order to cover the deficit, Argentina must have a surplus in its capital account. This essentially means more debt for the country. And debt piled up. By 2001, Argentina’s national and provincial foreign debt was worth 53.8% of its GDP compared to just about 30% in 1994 (Buscaglia, 2004)! And the percentage was attributable to escalating debt, opposed to decreasing growth. In 1991, foreign national debt stood at roughly $50 billion; by 2001, it almost doubled (Ibid). Interest payments alone were eating up 22% of the national budget (Zabala, 2004). On top of that, when one adds both the provincial public debt with the national (Argentina is a federal country, allowing provinces to borrow money, it comes to over $150 billion (Ibid)! In fact, by 2001, every single Argentine province, 24 in all, ran a fiscal deficit, averaging 2.4% of provincial GDP growth (Ibid).

A titanic current account surplus, as a percentage of GDP, along with skyrocketing indebtedness, also caused severe harm to Argentina’s economy. First of all, weak exportation hurt economic growth and employment in Argentina. The export sector, which proved to be an integral part in Argentina’s recovery, was and continues to be a
significant aspect of the economy. But this was lost. In 1999, for example, the country ran a historically high current account deficit of $11.9 billion ("Where now for Deposits," 2003).

Moreover, the current account undermined the confidence many investors and businesses had in Argentina. After all, a current account deficit of 3% begins to make investors and policy makers nervous in developed countries (Kapler, 2006). Larry Summers (2004), former US Treasury Secretary, ominously observes that of the United States’ current account deficit, inching towards 5% of the GDP, should worry policy makers. He calls it “startlingly large” (p. 48). If 5% is frightening for the most powerful country in the world, what will it mean for an emerging economy? After all, before the turn of the millennium, Argentina’s current account, as a percentage of GDP, was inching towards 5% as well (Buscaglia, 2004). We begin to see the beginning of the end of the Convertibility Plan.

Another problem stemmed from the Mexican crisis in 1994, Southeast Asian crises of 1997, and the Russian crisis of 1998. Two crises that also begin to show the problems with the Washington Consensus (For in depth details, see Stiglitz, 2002, ch. 5). Although Argentina performed better than other emerging economies, there were losses. The crises made investors nervous, causing them to withdraw from a number of emerging economies. In 1995 alone, Argentina lost $6 billion in portfolio investment (Pastor & Wise, 2001). $6 billion was an incredible amount for Argentina at the time. It was roughly equal to the same amount of FDI the country had attracted between 1991 and 1993 (Zabala, 2004)! Due to this flight of capital, the government, unable to maintain the fixed exchange rate with limited dollars, responded by limiting fiscal spending (Ibid).
Moreover, in an effort to maintain dollar reserves, mitigate a large exchange of pesos for dollars (in case the domestic population got nervous about holding pesos), and stem the tide of more capital flight (many emerging were experiencing capital flight at the time), the government was annually increasing interest rates. Between 1993 and 2000, the Argentine interest rates almost doubled (Buscaglia, 2004). Decreasing fiscal spending and increasing interest rates, however, slow down the economy.

As a result of these difficulties, a horrific economic situation mired in a vicious cycle involving a growing number of interrelated variables began to emerge in Argentina. In order to maintain the fixed exchange rate and follow the currency board, the government couldn’t promote exports, increase the money supply, decrease taxes, nor reduce interest rates. Therefore, low growth, due to a lack of expansionary policies, leads to lower tax revenue and higher unemployment. An unhealthy obsession with maintaining the external objectives makes one forget about the internal ones.

This is exactly what happened to Argentina. Although the BCRA maintained the Convertibility Plan, the economy was becoming a mess. GDP growth plummeted to negative numbers three out of the six years after 1995 (Buscaglia, 2004). 2001 was the worst year of the Convertibility Plan. Its growth rate fell to – 4.4% (Back in the Crisis, 2003). The recessions, especially in 1998, severely reduced revenue (“Presidente argentino,” 2001). Lower taxes meant more decreased spending and more initiatives to find compensatory tax revenue. In the latter half of the 1990s, the government increased taxes in a number of ways. The government, for example, increased taxes on meals (Blount, 1996). It also eliminated tax-exempt status, worth up to $5 billion for many domestic companies (“Cavallo anuncia,” 2001).
The government also severely slashed spending. For example, it went after state workers and pensioners. In 2001, Cavallo, who had returned (though lasting only nine months) to the same post he had almost a decade before, single-handedly cut public workers salaries and assistance to the elderly by 13% ("Cavallo: De mimado," 2001). These cuts were on top of a large number of cutbacks years before. According to the Confederation of Health Professionals, an Argentine civic group, beginning in 1995, the government initiated deep cuts in spending on education and healthcare, even including reductions in the salaries of doctors and nurses (Gaudin, 2002). However, Argentina wasn’t reaching the “cero fiscal deficit” it promised in the early years of convertibility. In 2000, the fiscal deficit was 3% of the country’s GDP (Zabala, 2004).

Privatization revenue also couldn’t help. In the early 1990s, the government used funds from the massive privatization initiatives it carried for roughly a half a decade. However, there was not much more to privatize. In the first five years of the Convertibility Plan, the privatization of state companies raked in about $7 billion (Buscaglia, 2004). The following five years (excluding 1999, in which the government did make $2 billion due to the privatization of the last parts state oil company) averaged only $196.2 million (Ibid).

The International Monetary Fund (IMF) had to get involved. Argentina was, at least when the country was doing well, the poster child for the success of neo-liberalism capitalism enshrined by the IMF and World Bank. To use Nancy Birdshall’s words, the president of the Center for Global Development, Argentina was “the spoiled child of the Washington Consensus” (as cited in Blustein, 2005). In August of 2001, the IMF gave Argentina a rescue package of $8 billion. The goal was to close the widening fiscal
deficit and meet the payments to private and public lenders. There was, however, conditionality to the package. Argentina had to cut back on spending and raise revenue, policies that hadn’t been do too well before. But instability followed. All the cutbacks and taxes, some initiated by the Argentine government, some imposed by the IMF, just contracted the economy more and more.

The recessions in the mid 1990s culminated into a “Second Great Depression” by 2001 (Hershberg, 2002, p. 30). The unemployment rate was reaching 20% (MacEwan, 2002) and underemployment, defined as those who are working less than they would like, was approaching 30% (“Q & A: Argentina,” 2003). Income per person had plummeted by 14% between 1998 and the end of 2001 (MacEwan, 2002). Protests swelled the streets, leaving over 20 people dead. Ordinary citizens looted grocery stores just to get something to eat. The provinces, strapped for cash due to their own lack of revenue and a decrease of funds from the federal government, began printing their own money. One province, La Rioja, for example, printed “Evitas,” named after Eva Peron, in order to pay workers (“Q & A: Argentina,” 2003).

With titanic current account deficits, fiscal imbalances, negative growth rates, mounting debt, and high unemployment, Argentina was also under attack by an equally ominous force: The speculator. Speculators come in a variety of shapes and sizes. One could be a powerful international investor in portfolio investments, whereas others could be bureaucrats at credit rating corporations such as Standard & Poors. Essentially, for the case of Argentina, powerful people bet that the country was unable to maintain a fixed exchange rate. Therefore, many became jittery. Would Argentina pull out of the Convertibility Plan, causing a depreciation of the peso? Would Argentina default on its
debt? Due to the fixed exchange rate, investors weren’t hedging their investments. Ordinary citizens, holding pesos, would also lose; 10,000 pesos, worth $10,000 could be halved over night if the currency were allowed to float!

Before the turn of the millennium, speculators were all over Argentina, causing fear that the government would inevitably pull out of the Convertibility Plan and default on its debt. The negativity created a self-fulfilling prophecy; as more investors, bureaucrats, and influential publications conveyed incredulity about the credibility of Argentina, more people wanted less to do with the country. Portfolio investors began to pull out, peso-holders began to exchange the local currencies for dollars, and important foreign direct investment (FDI) began to be withheld. Investment plummeted by 25% between the first quarters of 1998 and 2001 (Pastor and Wise, 2001). Speculators began dumping their Argentine pesos on the international market (Hanke, 2001). Argentine bonds were losing their value (Karmin & Murphy, 2001). Peso-holders were also turning in their pesos. By 2001, bank reserves fell by 25% as peso-holders were exchanging the Argentine currency for dollars (Pastor and Wise, 2001). Even the inflow of much-needed FDI was hampered. South American Commercial Centers Group, a Chilean investment group, announced that it would suspend $40 million worth of investment projects, such as supermarkets and commercial centers (“Reacciones chilenas,” 2001). Rafael Guilisasti, the union president for the Association of wine-producers, announced: “If one’s thinking of investing in Argentina, it would be prudent to wait” (Ibid).

Domingo Cavallo, along with President Fernando de la Rúa, tried effortlessly to undermine the negative speculation concerning Argentina. “The flotation of the peso or a devaluation won’t occur,” Cavallo confidently announced in 2001 (“Argentina debate,”
2001). However, hope was lost. No one believed him. An influential Argentine financial daily, *Ambito Financiero*, ran stories, at the same time government bureaucrats were saying don’t worry, stating that the government didn’t even have sufficient dollar reserves to cover all the pesos in circulation (Ibid). By December 2001, Argentina had defaulted on over $150 of its debt (MacEwan, 2002). In January 2002, in the midst of economic chaos, bloody street riots, and five presidencies in just a few weeks, Argentina finally pulled out of the Convertibility Plan, allowing the peso to float. Within the first day, the peso lost 40% of its value (“El peso,” 2002). About a year later, it had fallen by 70% (“Q & A: Argentina’s,” 2003).

There are two areas to address regarding the case study on Argentina. The first is the technical area regarding exchange-rate policy. Although this maybe a dry economic analysis, one must attack this issue and give sound advice. The other is the bigger picture. Why did the successive Argentine governments allow its people to suffer for so long? Wall Street interests, along with an ideology gone mad, can help give us an answer.

**Policy recommendation #1: The optimum exchange-rate policy**

Exchange-rate policy, first of all, is crucial for Argentina and other Latin American countries. What countries need is a middle ground, along with the recognition that one type of exchange rate, in this case the fixed regime, does not fit every need of every country. The middle ground here is somewhere, depending on the conditions of the country, between a hard peg and the floating exchange rate. The key is flexibility. The Argentine crisis affords us with the understanding that nothing lasts forever. As a result, a country could opt for a fixed peg, in order to, for example, control inflation; the case of
Argentina shows that the early years of the Convertibility Plan was successful in curbing hyperinflation.

However, a country can opt to float when the initial benefits of the fixed exchange rate regime dry up and the domestic pressures indicate that internal goals must be met. For example, although inflation was under control, the shrinking money supply in Argentina, due to defending the fixed exchange rate, was increasing interest rates, hampering economic growth, and pushing up unemployment figures. Policy makers can decide to jettison external goals in order to carry out internal ones, such as expansionary growth to create employment, before domestic problems turn into an untamable crisis. In the case of Argentina, policy makers could have measured, just to use one example, rising unemployment figures to indicate when maintaining the fixed exchange became untenable.

Using certain indicators such as unemployment figures as an indicator to change economic policy is actually quite reasonable. The United States Federal Reserve uses unemployment figures to gauge the level of interest rates, knowing that if unemployment grows too much, interest rates must come down and vice versa; this is called the non-accelerating inflation rate of unemployment (NAIRU) (See Stiglitz, 2003, chap. 3, for more details). Although the Fed’s policy doesn’t pertain to exchange rates, it shows that economic decision makers, using specific indicators, must change a course of action in order to tackle and accomplish specific domestic goals.

Another option is a managed float. Many countries fear exchange rate volatility. Instead of fixing a currency straight to the dollar or allowing a full float, countries use a basket of currencies. The currencies within the basket could represent the principal
trading partners of the particular countries. In the case of Argentina, Brazil’s real would be one, along with the euro. A number of countries, such as Malaysia, Singapore, and China, have used the system of a managed float in order to preclude sharp falls and rises in their currencies; they lock their own currencies to those of their principal trading partners (“Yeah baht,” 2006).

Countries have even recently opted for capital controls. Capital controls can control the flow of “hot money,” basically international investment flows such as bonds that are easily and readily taken out of a country at a moments notice. Thailand, in an effort to slow down speculative capital inflows and, thus, undermine the appreciation of the baht, has tried to unilaterally control capital flows (Aglionby et. al, 2006). In fact, Malaysia successfully enforced capital controls in the aftermath of the Asian crisis that took place in 1997 and 1998 (“Yeah baht,” 2006).

The weakness, however, of these alternatives is the confidence of international investors. Capital controls, a managed float—which some pejoratively call a “dirty float” (Pugel, 2004, p. 481)—and other alternatives may repel investors. “‘The Thai authorities seem intent on committing financial hara-kiri,’” Christopher Wood, chief financial strategist of CLSA, says concerning capital controls (Aglionby et. al, 2006, p. 5).

**Policy recommendation #2: Challenging the interests of Wall Street investors**

The interest of investors leads us to a critical point. For whom is economic policy designed? Although I don’t subscribe to the idea that Wall Street, in cahoots with the IMF and World Bank, is trying to take over the world, one can not ignore the tremendous impact investors have over policy matters. As in the case of Mexico and the Bucareli Accords, and United Fruit and the overthrow of Jacobo Arbenz, investors will continue
exerting their influence. In fact, a group of Wall Street investors were the ones who, for their own financial gain, convinced Washington to build the interoceanic canal through Panama instead of Nicaragua, which was previously planned (See Diaz Espino, 2001). Currently, even political moderates see the influence. Global capitalist enthusiast Thomas Friedman concedes that Wall Street exercises considerable pressure:

The Electronic Herd [the agglomeration of the world’s investors] can impose pressure that few governments can resist. It has a self-interest in doing so and it generates in others the self-interest to comply. . . . The Electronic Herd turns the whole world into a parliamentary system, in which every government lives under the fear of a non-confidence vote from the herd. (as cited in Blustein, p. 6, 2006)

In the case of Argentina, a principal problem was inflation over employment. Countries have the option of expanding an economy in order to create growth and employment. However, the risk is inflation. The opposite is true. Contracting the economy, which happens with a fixed exchange rate, reduces inflation but increases unemployment. A society needs a balance. Economists (Alamgir, 2006) point out that the working class, albeit inflation is important, are more concerned with working than with inflationary pressures. This is especially true when unemployment reaches crisis levels like in Argentina. Investors, on the other hand, are more interested with inflation. Stiglitz (2002) sums it up perfectly:

Wall Street regards inflation as the worst thing in the world: it erodes the real value of what is owed to creditors, which leads to increases in interest rates, which in turn lead lead to declines in bond prices. To financiers, unemployment is far less of a concern. (p. 172)
And Wall Street made a killing in Argentina. Security firms, underwriting the government bonds of Argentina throughout the 1990s, earned roughly $1 billion in fees alone (Blustein, 2003).

It’s no wonder why the economic policy that international investors, the Wall Street Journal, the IMF, with the support of the U.S. government, were pushing on Argentina was flagrantly in the interest of the investors. International investor lawyer Felipe Gónzales, representing Spanish citizens who had lucrative investment in Argentina pleaded for the successive Argentine governments not to break with the fixed exchange rate and contractionary fiscal policies. Foreign bankers echoed the same sentiment (Bonelli, 2001).

The Wall Street Journal was peppered with stories concerning the crisis, all focusing on the point of view of bondholders, as well as debt repayment. Articles spoke of and did interviews at Morgan Stanely Asset Management, Merril Lynch, and the Institute for International Finance, among other firms. These institutions reflect, of course, the investors. The Wall Street Journal (2003), supporting Argentina’s crisis-causing neoliberal agenda, even denounced Argentina as a country “unwilling to implement serious reform” and then pushed the country into “restoring national integrity.” And the most horrible thing Argentina could do is not to pay back its debt. It would mean terrible “prospects not just for the Argentine bonds but for other emerging-market bonds too” (Karmin and Murphy, 2001). The unemployed, however, are less interested in the J.P. Morgan Emerging Market Bond Index.

International financial institutions and The United States wouldn’t give in either. The IMF and Paul O’Neill, the US Treasury Secretary at the time, were still imposing the
reduction of public spending in the Argentine federal and provincial governments; this was part of an austerity program in April 2002 ("Argentina tightens," 2002). The Argentine people, however, were suffering! Stiglitz (2002) asserts Argentina was a "failure" due to the IMF's "insistence once again on contractionary fiscal policy" (p. 129).

Economist Arthur MacEwan asserts that the IMF and US government prescribe neoliberalism "because those policies serve important and powerful interests in the U.S. and world economies . . . the interests in firms based in Europe, Japan, and elsewhere" (p. 95). There's truth to that. After all, when Malaysia successfully used capital controls, the financial media, reflecting the interests of Wall Street, were quick to denounce the country. Aglionby et al. (2006) wrote in the Financial Times that the country "has paid a price among foreign investors" (p. 5).

As a result, countries must deviate from the Washington Consensus and adopt policies that are more appropriate for the population. MacEwan (2002) even argues, along with other policy makers, that United States and the ISIs have to create alternative policies. He describes more "egalitarian" and "democratic" ways of economic development (p. 96). This development would entail, MacEwan continues, regulating the private sector so it is not motivated just by profits, investing in public services, and expanding government revenue.

The problem, however, is that the IMF, World Bank, and the Washington Consensus will be hanging over the head of Argentina and the rest of Latin America. If a country needs funding, the conditionality the IMF imposes will be a dogmatic neoliberal prescription again. Modifying the whole international system's ideology, though for the
better, would be extremely difficult. Market fundamentalism, along with powerful
interests of the international financial community and local Latin American elite, is too
entrenched in policy. Therefore, reforming the economic ideology of the IMF, World
Bank, and the United States government would be difficult. Is there another way,
however, for Latin American countries to defend themselves from the drawbacks of
neoliberal capitalism? The next part focuses on regionalism, using the Southern
Common Market (Mercosur) as an example, as a viable alternative.
Regionalism: A Counterbalance to the Washington Consensus

After profoundly looking at a historical analysis and three case studies concerning Latin America and economic policy, one can see that powerful economic interests from the developed world and an equally powerful messianic economic ideology called the Washington Consensus exercise considerable influence over the policy decisions of Latin America.

I conclude by highlighting a viable policy option that could protect Latin America from the excess influence of neoliberalism and Wall Street interests: Regionalism. For the purpose of this section, I aim, first, to explain Mercosur and its strengths and weaknesses as a regional block; next I’ll delve into the positive potential impact Venezuela will have on Mercosur, and how this impact can help shield Latin America from U.S. interests, protect the region from neoliberalism, and add significantly to the overall economic development of Latin America. I use Brazil as an example, focusing primarily on the Brazilian energy sector; I also detail current developing events between regionalism, in the form of another regionalism called ALBA, and Nicaragua’s energy sector; I conclude by highlighting the significance of the creation of the Southern Bank (“el Banco del sur” in Spanish), which is on the table for Mercosur and the rest of Latin America.

Regional integration entails reaching certain profound levels of policy harmonization between participating member states. Although the European Union (EU) serves as the paramount example of deep successful integration, the Southern Common Market (Mercosur) has been heading on a path, albeit quite bumpy, towards deeper integration.
The original four member countries, Argentina, Brazil, Uruguay, and Paraguay, have taken the integrative processes very seriously, serving as a model for other regions.

**The origin and benefits of Mercosur**

Mercosur, formed by its four original members—Argentina, Brazil, Paraguay, and Uruguay—came into being with the Treaty of Asunción in 1991. This regional integration area (RIA) is essentially an ongoing agreement aimed at harmonizing economic, political, and foreign policies and creating institutions, such as the Joint Parliamentary Commission, the Mercosur Trade Commission, and the Group for Foreign Affairs, in order to facilitate those goals. Although one of the major successes of the regional area has been simply staying together, it has been, and continues to be, fraught with serious problems.

First of all, there are many weaknesses. One of the major weaknesses entails the lack of developmental spending on the smaller economies. Brazil is the biggest economy in Latin America, compared with Paraguay, one of the poorest. As a result, a serious portion of member countries’ budgets should be earmarked to help the poorer countries and iron out the titanic gap between the rich and poor members. The EU serves as a model in this area, with larger economies helping smaller ones, such as Ireland; the effects have been remarkable.

Moreover, there have been many setbacks. The crises that hit Brazil in 1999 and Argentina in 2001, for example, have hurt the integration process. Brazil was forced to devalue its currency, the real, in 1999, while the Argentine peso remained pegged to the dollar until 2001. As a result, Brazil’s products became more competitive than the exports of other member countries, causing profound trade disputes, especially in the
areas of shoes, steel, paper, and automotive parts (Banega, Hettne, & Soderbaum, 2001). Uruguay also challenged the cohesiveness of Mercosur when it was entering in bilateral trade deals with the United States earlier this year. Mercosur’s laws strictly forbid bilateral trade agreements with non-member countries.

Countries have even almost withdrawn from the RIA. Paraguay, for instance, has recently threatened to pull out of Mercosur to defend its trade interests. The president of Paraguay, Nicanor Duarte Frutos, cites the asymmetries between the smaller and more powerful economies (Mander, 2006). “[The] selfishness and even hypocrisy,” Duarte laments, describing the trade policies of Argentina and Brazil, the two more powerful members of the RIA; he continues arguing that their “protectionism” against the products of Paraguay and Uruguay merits “[a] profound correction, a historic reparation” of Mercosur if the group wishes to survive (as cited in Ibid).

So what does Mercosur have to cheer about? First of all, it has reached and maintained the level of a customs union. This means that all member countries maintain the same external tariffs and quotas against the products of non-member states. The external tariff averages around 12% for most imports except for automobiles, the most protected sector, which are subjected to a tariff of 34% (Pugel, 2004, p. 263).

Furthermore, trade among member countries has increased significantly. There’s more trade between Mercosur members than between any other Latin American countries; the value of trade went from $3.6 billion in 1990 to $12 billion in 1994 (Banega et al., 2001). In fact, although the net effects of Mercosur trade are still nebulous, one study concluded that real national incomes have increased by about 2%,
with benefits coming from increased competition from domestic firms and increasing economies of scale (Pugel, 2004).

Mercosur has also served important political ends. Member countries have successfully worked together to increase their bargaining power in the international arena. This is not only beneficial for the two smaller countries, but for the two bigger ones as well. The EU is economically powerful on the world stage; thus, countries need all the strength they can get when negotiating with this economic giant. During the trade talks between the two, the EU realized that Mercosur is no pushover. Mercosur has stood firm against the EU’s unfair trade practices it has erected against Mercosur’s poultry, beef, and other agricultural goods. “We will not sign an agreement just for the sake of signing,” warns Regis Arslanian, a Brazilian negotiator, “we have to have commercial benefits from it.” (as cited Minder, 2005). Many negotiators attribute Mercosur’s, along with other RIAs, ability to stand strong against powerful trading partners to the cohesive integration of weaker states. “It [regional integration] will strengthen the region in its trade negotiations with developed countries,” observes Brazil’s former foreign minister, Celso Amorim (as cited in Colitt, 2004).

It’s also important to note that Mercosur member countries were dominated by brutal rightwing dictators for most of the 1970s and 1980s. Mercosur may very well be a strong causal variable in upholding the tenuous democracies of these South American countries. Mercosur rules stipulate that, in order to be a member, all participating countries must adhere to democratic values. This was tested, for instance, back in 1996. Institutions were weak in Paraguay and there was a strong domestic movement for a military coup
against the civilian government. However, many observe that the pressure from Mercosur precluded the actual coup from taking place (Hoeckman & Schiff, 2002).

**Regionalism, Venezuela, and oil refineries**

Another development that gives Mercosur a reason to cheer is its new member: Venezuela. In July of 2006, (actually formalized in November) Venezuela became a member of the RIA. It goes without saying that the accession of Venezuela, headed by the outspoken anti-capitalist Hugo Chavez, to Mercosur would be extremely controversial. Bureaucrats are reluctant about Venezuela’s entrance, denouncing everything from Chavez’ messianic leftist agenda to the lack of serious research concerning Venezuela’s ability to adhere to the customs union and compete with the other members in intra-regional and international trade. “We don’t even know the inventory of potential exportable Venezuelan products for Mercosur,” José Luis Betancourt, president of Fedecámaras, points out (as cited in Gastelú, 2006).

The criticisms of Venezuela are valid and should be taken into serious consideration. However, there is one sector that Venezuela will be beneficial: Energy. Although all members could benefit from cheaper oil and the massive funds the Venezuelan government has garnered from the record-high oil prices, Venezuela itself, through regionalization, can assist in the veritable development of Latin America. Take Brazil. The Brazilian government, armed with the titanically large state oil company, Petrobras, has vowed to increase oil exploration, related infrastructure, and energy efficiency, as well as all the related positive externalities, such as more jobs, education, and cheaper oil. Venezuela will be integral in this process.
It’s imperative to note, first of all, however, that oil wealth isn’t always a blessing. At times, it can be a curse. Nigeria epitomizes this case. The largest oil-producing country in Africa, one would think Nigeria would clean up economically; however, it has ironically been the opposite. Due to a lack of refinery capabilities and oil-related infrastructure, Nigeria is doomed to export just crude oil. This means that it not only has to import the expensive processed oil, but the country doesn’t benefit from the positive economic externalities, like the good jobs refineries and the spin-off industries create.\(^1\) "Lack of refining capacity is a major obstacle to lowering fuel prices," writes journalist Dino Mahtani, “something that many in oil-rich Nigeria find objectionable.” In fact, in addition to having to subsidize gas for domestic consumers, Nigeria found itself in a state of chaos when oil prices began to increase in 2003, causing long lines at gas stations throughout the country (Peel, 2003).

Brazil, although with some differences, along with other Latin American countries, has the potential to follow in the footsteps of Nigeria. Although Brazil has the second largest oil reserves in South America, it continues to be a net importer of processed oil and gas. In fact, Brazil is processing very little of its oil reserves. For example, in 2003, Brazil was producing an average of 1,842 million barrels a day of oil, natural gas, and other liquids; however, less than 346 of these barrels were actually subjected to some type of refining ("An Energy Summary"). That’s less than 20%! Most of Brazil’s oil is refined in developed countries, especially the United States. The US, due to the economic benefits, wants to continue refining the oil. This stark reality surfaced in 1999

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\(^1\) Positive externalities of refineries and other related industries mustn’t be underestimated. A small refinery, named Coryton, in ESSEX, Great Britain, for instance, creates over one thousand direct positions, not including indirect employment; and many positions absorb well-paying skilled labor, such as chemical engineers (see Inside an industry).
when Brazil experienced depreciation in the real. Expensive imported oil exacerbated the economic crisis.

The reason Brazil produces mostly crude oil and imports a significant amount for its domestic consumption is quite obvious. The country does not have the adequate infrastructure and refinery capacity for its oil-related industry. Brazil hasn’t even built a new refinery in over 20 years (Pimental, 2005). As a result, Brazil has tried to entice foreign investment by weakening Petrobras’ monopoly over the production and exploration of oil. In 1997, the government passed the Oil Law, allowing foreign capital to bypass the Petrobras tight monopoly and invest independently in the Brazilian oil industry (Schneyer, 2005). The initiative was met with mixed results. Only Royal Dutch Shell made a major investment in a large oilfield (Ibid). This means more money is desperately needed. Investment estimates for pipelines, offshore infrastructure, and new plants for power generation run to about $20 billion; the government has set aside only $6 billion for the next five years (Ibid).

This is where Venezuela and Mercosur come in. Being in a RIA with Hugo Chavez, if one’s able to brook his verbose rhetoric, may just be what Brazil, along with other Latin American countries, needs. The Venezuelan government has already vowed to make the development of refineries and other oil-related infrastructure a top priority. It has, to cite just one example, already begun an initiative to resuscitate the dormant refinery, Cienfuegos, in Cuba. Other energy-related projects are aimed at Antigua, Haiti, and other Caribbean countries. This is important because much of the refinery processes remain in the developed world. Crude oil from Venezuela and elsewhere are shipped to
places like Lake Charles, Louisiana, home to a refinery that produces 100,000 barrels a day (Dunne, 2001).

It’s important to note that Venezuela has the capital to carry out such projects. In addition to huge financial gains from high oil prices, Venezuela is gaining control over its own energy resources. The country has forced foreign multinationals to make 32 oil-operating contracts joint ventures with Pdvsa, the Venezuelan state oil company; the country has also taken control of oilfields controlled by Italy’s Eni and France’s Total; all this in order to increase governmental revenue (Webb-Vidal, 2006).

Mercosur will now serve as a great vehicle to increase economic relations between Venezuela, Brazil, and other Latin American countries. Even before Venezuela’s accession to Mercosur, there was talk, as far back as 1999, of investing in the Brazilian energy sector. Now it’s becoming a reality. Chavez and his Brazilian counterpart, Lula da Silva, are laying the foundation for a much-needed refinery in Pernambuco named after a hero from the wars of South American Independence: General José Ignácio Abreu e Lima, (Barroso, 2006)! The project has finally been spelled out and initiated, but only after Venezuela had joined Mercosur. This will be the first refinery built in over 20 years! Another initiative that’s taking place is the extraction of oil in the Orinoco strip (Ibid). Although all the details haven’t been made public, the oil will be processed, about 200,000 barrels a day, in the Brazilian refinery, opposed to over seas, of Pernambuco (Ibid). In fact, Venezuela now has 13 projects planned with Brazil, as well as the construction of a gas pipeline in southern Brazil (“Petrobras, cómoda,” 2006).

The development of refineries, just to note one example, is an extremely important development for Latin America. Since independence, Latin America has not generated
the creation of jobs to meet the demands of the work force. Although by the criteria of the Washington Consensus Latin America has often done well—export and GDP growth, fiscal discipline, privatization, and so on—job creation has not kept up with GDP growth.

In fact, the IMF has recently praised Latin America and the Caribbean for its GDP growth (see “IMF praises,” 2006). However, Todaro (1999) points out that industrialization, measured by the manufacturing sector, has grown by a factor of roughly 4 to 1 over job growth; the trend is projected to continue. Essentially, this means that albeit GDP is growing, the growth is not even coming close to absorbing those looking for work, especially those who migrate from the country to the city. This phenomena is called output-employment lag or, more colloquially, jobless growth. GDP increases, but the demand for work doesn’t.

Jobless growth is quite dangerous. Latin America and the Caribbean is a region of the world suffering from the most unemployment. The number of those jobless grew by 1.3 million between 2004 and 2005 (Khor, 2006), pushing the number unemployed to 18 million by 2006 (“Economic Survey,” 2006). Unemployment hovers around 10% (Ibid). But underemployment, those who work less than they otherwise would (for example, seasonally work in the field or part-time), is often quite high. As mentioned earlier, Argentina and Peru were experiencing 30% and 40% underemployment respectively. And high unemployment figures, it’s important to note, played a significant role in causing civil unrest.

In addition, refineries not only create jobs, but such work requires a high level of skills: Engineering, accountants, and so on. Moreover, there are a lot of spin-off industries such as plastics. Developed countries want these job-producing industries for
themselves. As in the aforementioned case of Mexico, under the modernization of the porfiriato, the country only produced light-industry products, whereas the United States produced the labor- and capital-intensive products. And even when Latin America does produce higher-tech products, most are owned by the United States and Europe, and profits are not reinvested in the local economy, but sent overseas. Capital liberalization, which allows the quick movement of monies, is a principal idea behind the Washington Consensus. In fact, the repatriation of funds was an important economic point in the North Atlantic Free Trade Agreement (NAFTA) between Mexico, the United States, and Canada.

With regional development, however, capital and profits are more likely to stay in the region; and Latin American will be more inclined to obtain jobs, opposed to American and European citizens. To cite NAFTA again, the agreement whittles away any governmental requirements that stipulate foreign-owned corporations or businesses have to use a certain percentage of Mexican workers.\(^2\) That’s laissez faire!

**ALBA as a counterbalance**

The influence of regionalism is also expanding to a country that needs it the most: Nicaragua. Under the 2004 initiative La Alternativa Bolivariana para las Américas (ALBA), initiated originally by Venezuela and Cuba, which now includes other states, Latin America is trying to produce regional agreements to counter and compete with the power of the United States. It’s also try offer alternatives to the neoliberal free trade

\(^2\) Trade related investment measures (TRIMS) stipulate that governments can’t legally bind foreign-owned companies to certain requirements such as hiring local workers; for example, before NAFTA, the Mexican government stipulated the auto industries had to buy up to 70% of automotive parts from Mexican businesses. Such requirements, however, are eliminated in the neoliberal trade system.
agreements pushed by the United States. In the case of Nicaragua, ALBA could work well.

Nicaragua, as mentioned before, has serious energy problems. Venezuela has initiated the construction of refineries to be built in June 2007 in the municipalities of León and Nagarote (Loásiga, 2007) in order to alleviate the country from its energy shortages. Refineries are exactly what Nicaragua needs. The predominantly rural country generates few positive externalities with the production of coffee and pineapples. Refineries could help not only alleviate energy needs but also create industries and employment. The United States, World Bank, and IMF would never suggest such a project, especially one that competes with US interests. It’s also imperative to note that privatization of the refineries will not be pushed upon Nicaragua as it is by the international financial community; Nicaragua can carry out the policy suitable for itself, such as half owned by the state and half owned by private investors.

El Banco del sur

Moreover, a Southern Bank is being introduced. A Southern Bank, based on the increasing regionalization of the South American nations, would offer an alternative to the IMF, World Bank, and even international investors. When a country borrows money from the IMF, that particular country is forced into following neoliberal economic policies, whether or not such policies are appropriate for the country. The Southern Bank will allow Latin American countries to draw money and seek advice without being forced to bow to the demands and interests of the U.S. and foreign investors. In the case of Argentina, for instance, the government would have been able to obtain funds and advice without pressure to continue with an exchange rate policy that was exacerbating
unemployment. “We don’t have any interest in asking for more loans from the International Monetary Fund (IMF),” Ricardo Patiño, and economic minister at a recent meeting on the subject, asserted, “for us, the Southern Bank has been an aspiration of the people of South [America] for many years” (as cited in “Izquierda insiste,” 2007). The hope is to have roughly $7 billion for the bank this year.

In fact, the development of regionalism and el Banco del sur has recently provoked two important responses. The economically conservative The Economist, in an effort to salvage the neoliberal system in Latin America, has already tried to undermine the significance of the bank, pointing out the weaknesses of a developmental bank, in the magazine’s opinion, ruled by Hugo Chávez. “But the next time a financial crisis shakes Latin America,” the article concludes, “expect governments to turn again to the IMF rather than Caracas” (as cited in “Hugo Chávez moves into banking,” 2007).

Moreover, Mercosur members have already collectively made attempts to negotiate with the European Union (EU). This has important implications. First, the EU is often, though not always, more flexible with enforcing the policies of the Washington Consensus. The EU has already vowed to promote fair trade deals with the region. Second, Mercosur’s ability to negotiate intrinsically gives the region an alternative economic and political partner to deal with. Later, China will become an alternative, providing the region of Latin America with more competitive options.

Although I’m not suggesting cutting out the United States completely, regionalization could offer different alternatives. Instead of relying completely on the United States, the international financial institutions, and foreign investors, along with their accompanying pressures, interests, and ideology, Latin America, through regionalism, could give itself
alternative options for funding and for designing more suitable economic policies, satisfying Latin America’s own interests for a change!
Conclusion

Latin America, along with other parts of the world, has followed the Washington Consensus—the embodiment of neoliberal capitalism—in good faith. The resultant problems, measured by social and economic instability as well as the popular discontent that has emerged throughout the region, indicate that it’s time for a change in economic and social policy.

Nicaragua shows the problems with the neoliberal principals of market perfection, non-governmental intervention, the profit motive, and rapid privatization; although the country followed the neoliberal model, the Nicaragua population never reaped the benefits of seriously improved energy services, as was promised. Peru serves as an example of the weaknesses of the tools the Washington Consensus uses to measure economic success. GDP, balance of payments, fiscal discipline, and other measures have their place in analyzing a country, but they are not enough. Social policy, aimed at increasing education, health care, wages, employment and wealth distribution are just as imperative; we must refrain from calling a country a success until these criteria are met as well. The Argentine study begs us to ask the question: For whom is economic policy? We need to focus on the issues and needs of the people as much, if not more, as we do on those of the investors.

However, many powerful economists, supported by equally powerful investor interests, messianically push and impose the neo-liberal agenda, often with good intentions, on Latin America. Kenneth Rogoff, a prestigious economist who has worked tirelessly in the research department of the IMF is one. He has openly attacked economist Joseph Stiglitz, whom this paper cites quite often. Rogoff (2002) has
challenged the criticism Stiglitz has levied against the IMF, World Bank, and neoliberalism in general, pointing out, "You condemn the IMF because everywhere it seems to be, countries are in trouble. Isn't this a little like observing that where there are epidemics, one tends to find more doctors?" (as cited in Pugel, 2004, p. 545). Rogoff (2002) continues to praise Stiglitz for being brilliant, but adds, "as a policymaker, however, you are just a bit less impressive" (as cited in Ibid).

As a result, regionalism may be the optimum counterbalance to the neoliberal agenda. By advancing competing alternatives, regionalism can offer different policies, perhaps more appropriate than those of the Washington Consensus, to develop Latin America. Mercosur, ALBA, and other regional agreements, for example, have initiated the pooling of resources in order to create banks that can compete with the IMF, World Bank, and the United States. Countries drawing off the regional banks will not be subjected to the Washington Consensus and investor interests. Moreover, it's important to note, regionalism will allow Latin America to negotiate collectively, instead of individually, increasing their ability to resist neoliberal agreements and obtain better terms of agreements with the United States and European Union.

The United States will continue to play a role, but will not be able to impose its agenda and interests on Latin America so easily. The United States, however, is not enchanted with the development of regionalism. In fact, the US has tried to undermine its growth by participating in other regional agreements and making individual agreements with individual countries. The Asia-Pacific Economic Cooperation (APEC), for instance, has allowed the United States to deal with Peru and Chile, pulling them
away from the Andean Pact and Mercosur. The United States has even initiated trade agreements with Uruguay in an effort to undermine the customs union of Mercosur.

Currently, however, Latin America has more impetus than ever before to stick together. The anti-American and anti-neoliberal sentiment that’s mushrooming throughout the region has been sending anti-capitalist candidates to the presidencies and cementing closer relations between the different countries. Although only time will tell, it looks as if the Latin American people themselves, through popular discontent, are currently forming alternatives to the Washington Consensus.
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