LATIN AMERICA AT A CROSSROADS

Edited by Antonella Mori and Loris Zanatta

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First edition: January 2017

Print ISBN	9788867055807
ePub ISBN	9788867055814
Pdf ISBN	9788867055821
DOI	10.14672/67055821

ISPI. Via Clerici, 5
20121, Milano
www.ispionline.it

Catalogue and reprints information: www.ledizioni.it

Contents

Introduction

November 2009. A buoyant picture portraying Rio de Janeiro's statue of Christ the Redeemer taking off like a rocket from the Corcovado mountain dominated the cover of *The Economist*. The title, "Brazil takes off", spoke volumes. A shiny symbol of Latin America's remarkable growth performance during the first decade of the new millennium, Brazil – the BRICS' proud "B" since 2001 – deserved making the famous magazine's cover page. Indeed for its economy had literally taken off under Luiz Inácio Lula da Silva and was expected to blossom over the next years. Even in the wake of the 2008 Lehman Brothers' collapse, not only did Brazil still grow by 7.5% in 2010, it also won the bid of the 2014 World Cup and of the 2016 Olympic games.

But only a few years later, in September 2013*, The Economist*'s headline read "Has Brazil blown it?". All that glitters is not gold, not even in Brazil. On the new cover page, the once sparkling statue of Christ rocketing across Latin America's skies had switched off the engines, ready to fall back down to earth with a thud. Like Brazil did. Under Lula's successor and protégée Dilma Rousseff, the country's growth rate plummeted to 0.9% by 2012. Today the situation is even worse. With growth rates into negative territory in 2015 and 2016, hundreds of thousands of embittered Brazilians took the streets last year. How hard Brazilian authorities tried to tarnish the popular discontent boiling beneath the 2016 Summer Olympics' polished façade is no secret anymore. Not to mention Dilma Rousseff's political career, buried under a bribery scandal surrounding the national oil company Petrobras and alleged manipulation of public accounts.

What went wrong? Finding a comprehensive answer is no easy task. To draw a clearer picture, one should first of all bear in mind that the Brazilian case does not stand alone. Rather, the rise and fall of Brazil (a *voo de galinha*, a chicken flight, as Brazilians describe it) is just a piece of the broader Latin America puzzle.

At the dawn of the new millennium, the whole region – and not only Brazil – started to emerge as an interesting laboratory of new ideas and unpredictable political experiments. Left-leaning governments achieved significant electoral victories on the back of popular discontent about the negative effects of the neo-liberalist economic models adopted in the previous decades. From Venezuela to Bolivia, to Ecuador and, to a lesser extent, Argentina and Brazil, a national-populist "pink tide" gained momentum. The political manifesto was crystal clear: the time was ripe to reverse privatizations, reduce poverty and income inequalities while fighting financial speculation and restraining dependence on foreign capital.

As ambitious as it was, this program did not appear unrealistic at that time: on the contrary, the great commodity boom driven by China's industrialization, in the context of an (apparently) healthy international economic environment, enabled governments to keep at least in part their promises. After all, in times of abundance, revenues can be distributed, some reforms can be implemented, poverty reduced, welfare and social programmes scaled up. The best recipe for populist leaders across the region to maintain their bond with "the people". Despite rising concerns about the sustainability of such measures, popular support was still high and populist leaders seemed firmly in the saddle.

All this rapidly changed when China's economy began to slow down and the commodities bubble burst. In a nutshell, the "pink tide" ran out of energy, as did the commodity revenues needed to redistribute wealth and gain political legitimacy. This is where the nice story came to an end and where Latin America stands today. Economies growing at a steady pace for several years are now declining at an alarmingly fast pace, with Brazil spiraling into recession and Venezuela in freefall. As a result, millions of people who had joined the ranks of the "new middle class" now run the risk of being swallowed by the poverty belts of their own country. Throughout the region, populists have lost their ability to attract people and, politically, they are in retreat, dismissed by electoral defeats, political turmoil and/or charges of corruption. Their promises of an equitable society through an apparently never-ending redistribution of wealth crashed against the reality of shortsighted and unsustainable policies.

Today Latin America is at a crossroads, struggling between the end of a *golden age* and the beginning of a new order. And this "great transformation" is precisely what this volume is all about. Leading international scholars and experts scratch beneath the surface of such transformation to have a clearer glimpse of what the future holds for Latin America.

Loris Zanatta's introductory chapter guides the reader through a detailed overview of the manifold reasons that explain the "crisis of populism" affecting the whole region today. On the one hand, populism has simply lost its exceptional nature and appeal by participating in the game of democracy. On the other, it is challenged by the rising expectations of the new middle-classes, and especially the younger generations, demanding more opportunities, efficiency and inclusion. Above all, Latin America's populists have lost their links with their traditional social base, the very *pueblo* they had promised to emancipate from poverty and exclusion: poverty is on the rise again, and so is social exclusion of the most disadvantaged. Evoking the "external threat", the USA and its *golpes*, would be of no use anymore, since the United States is simply not perceived as a threat (the effects of the Trump administration remain to be seen). However, the author concludes, a new opportunity is arising for Latin American democracies: the end of the populist phase might open an unprecedented – and to some extent promising – era, marked by a more pragmatic and less ideological, more rational and less emotional political paradigm.

With a view to drawing an even clearer picture of this situation, Peter Schechter and Rachel DeLevie-Orey's second chapter examines the dramatic changes the region has undergone during the last two decades and its current shift away from leftist and populist movements. In this process, the main and most urgent issues that will drive the region's global engagement and dominate relations with outside actors for the foreseeable future are the need to resume economic growth, improve business climates and encourage major investments in infrastructure. This is why, contextually, the region's leaders will have to deal with several sensitive matters, such as: regional integration; the growing relationship with Asia and with China in particular; the endemic problem of political corruption and impunity; the struggle against organized crime; and, last but not least, security cooperation, peacekeeping and the prevention of natural and humanitarian catastrophes. As Latin America is opening up to the world, the West – and Europe above all – should grasp the economic, political and social opportunities the region offers today. The sooner the better, as new alliances with Asia might just be around the corner.

"How can Latin America return to grow at high rates in a scenario of lower commodity prices?" is the crucial question of Antonella Mori's chapter. The author offers an in-depth analysis of the rationale behind Latin America's weak economic performance in recent years. While the internal factors are the result of a mix of bad economic policies and political/institutional crises (which might be overcome in the near future), external factors are here to stay, as they depend on mid-to-long-term processes (the sharp global decline in commodity prices and slowdown of the Chinese economy). A prospect that requires a comprehensive rethinking of Latin America's economic models. Bearing this in mind, the author describes the mandatory changes and measures to bring the continent back to satisfying growth rates, while preserving its social achievements and emancipating it from dependence on commodity markets. A new Latin American economic model is possible. In particular, it should build upon greater regional integration, intraregional trade, specialization in high value-added products, institutional reforms and the fight against corruption. Needless to say, this should go hand in hand with new investments in education, research, innovation and infrastructure.

Along with the rise of the "pink tide", the beginning of the millennium marked another turning point: with the commodity boom, income inequality began to trend downward in most countries of Latin America, where it had sharply risen for decades. Measured through traditional inequality indicators, this positive trend apparently continued even during the years following the great global financial crisis of 2008 and 2009. But thanks to a number of alternative measurements (absolute inequality, top incomes and functional inequality) and indicators covering areas other than income (education, basic services, housing and new technologies) Alicia Barcéna's chapter gives us a more nuanced view of this rosy picture. Although some improvements were certainly made – not only in income distribution, but also in public transfer policies and distribution of labour earnings – in absolute terms inequality is not falling but rising in many countries of Latin America, and there has been no widespread increase in the GDP share of earnings. Taking stock of these findings, this chapter offers a number of policy suggestions for decision-makers in the region to move not only towards greater equality, but also to restore a "moral" pre-condition needed to reverse Latin America's current crisis: a culture of equality.

Shifting the spotlight to energy, Lisa Viscidi and Rebecca O'Connor's chapter analyses the impact of the sharp decline of oil and commodity prices in terms of economic growth, political stability and, most of all, resource nationalism. In fact, its destabilizing effects might already have engendered a general shift of the political climate throughout the region: away from state-led economic models and towards the support of more market-oriented economic policies. The countries that increased state control over the oil sector during the "commodities supercycle" of the last decade are now undoing those policies in order to draw private sector investment (Brazil and Argentina). Other countries (Colombia and Mexico) that had already introduced market-friendly policies before the current downturn are further liberalizing their markets. At last, even resolute nationalist incumbent politicians (Venezuela and Ecuador) will be forced to introduce reforms, since the economic crisis is rapidly eroding their political legitimacy. If the oil-dependent economies of the region wish to continue to use oil wealth to achieve social and political gains – comparable to those of the "age of abundance" – they will need to make the energy sector more efficient and attract private investment. But they also need to look for alternative sources of revenues.

Along with the current economic and political crisis, another specter is haunting the Latin American region: organized crime. To be sure, it is anything but a new threat, it is an increasingly powerful one. Not only due to its well-known violence – as Aníbal Gutiérrez puts it in chapter six – but also (and maybe even more) because of its power to corrupt public officials and erode democratic procedures, taking advantage of the current crisis. To date, single national responses have proved insufficient in confronting this threat, as they tend to focus on punitive measures for small drug producers, distributors or consumers, while neglecting the need to provide more structural and wide-ranging answers to the challenge. However, this phase of momentous change for Latin America provides a unique opportunity to promote a more integrated and coordinated regional response to organized crime: a response that could play a major role in pulling Latin America out of the current crisis and making its democracies more resilient to an enemy that by now is widely perceived as almost "endemic".

It is striking that in times of increasingly inward-looking and discouraged countries in the liberal West, Latin America might be at the dawn of a new era. An era inaugurated with the retreat of populism and the need to replace inadequate, demagogic economic models. Is this an opportunity? Maybe. If the old liberal adage that "good politics make good economics possible, and vice versa" still holds true, Latin Americans – and the rest of the world – ought not to waste it.

Paolo Magri
ISPI Executive Vice President and Director

1. The Pink Tide Recedes: Latin America Turns a Page

Loris Zanatta

Stuck midstream, or at a crossroads; on a ridge: that is where Latin America stands today. What is the meaning of all this? Where is the region heading? One can only wonder. As always happens, change is not affecting the whole area at the same time, or in the same way. Yet Latin America is at a political turning point. Facts speak for themselves: after two decades, the much-celebrated pink tide is now in full ebb. Never mind the validity of the definition itself: I never subscribed to it. However, there is no doubt that Chávez's 1998 triumph in Venezuela, Lula's 2002 in Brazil, together with the 2001 Argentine crisis and the attempt to institute a Bolivarian area shattered the Washington Consensus[1] that some regarded as the meeting point between a free market economy and a social democratic model. The political significance of all this was obvious: many in Latin America felt straitjacketed by representative or liberal democracy, or they fully outgrew it. As in the past, an anti-liberal reaction followed the spread of liberal values to the region within a single decade. People called for an alternative form of democracy: a direct and participatory one, in a word, a populist one. Such democracy claimed to include the *pueblo* as a shared community, the keeper of an eternal, unanimous identity. As such, the *pueblo* was impervious to political and ideological pluralism, which it saw as a threat to its integrity and virtue. Of course, not all governments have been equally hostile to the ideal of liberal democracy and its institutional features. Lula and the Brazilian Workers Party,

[1] F. Panizza, *Contemporary Latin America: Development and Democracy beyond the Washington Consensus*, London, Zed Books, 2009.

just to name the most important example, never questioned it. Nevertheless, this new era was marked by the return of anti-liberal tropes, as its key players strived to follow in the footsteps of the great Latin American populist regimes, from Peronism to Castroism.

Such was the predominant – albeit not unique – mark of the first decade of the century. Today's landscape is totally different: a dense chain of events points at a new swing of the regional political pendulum, this time from a national popular pole to a liberal democratic one. It is not a one-way movement, and it is possible that some countries will move in the opposite direction. There is even the chance that, in the future, the pendulum will swing back. But the main trend is the decline of populism. Just like the Argentine crisis appeared to be signaling the end of the neoliberal era to many, the everlasting Venezuelan crisis is the death-knell for populist governments. Evidence of this trend keeps piling up. Chavism is drowning and to remain afloat it can only disregard elections (the tool of people's sovereignty), which in the past were its main claim to legitimacy. The remaining members of the Bolivarian front are trying not to sink as well. But the main trend is the decline of populism. In Ecuador, social conflicts and electoral defeats in a number of cities have convinced Rafael Correa not to attempt being reelected in 2017 and to hand his power over to a successor. In Nicaragua, Daniel Ortega is now behaving as a typical *caudillo* drawing on a powerful familial and clientelistic network. Even in Bolivia, where Evo Morales' success is undeniable and the leader still enjoys widespread popularity, the end of the cycle may be drawing nearer, as evidenced by unforeseen electoral defeats, both in municipal elections and in the referendum with which Morales hoped to open up a path to reelection. And then there is Cuba, where the stale political regime pales in comparison to the stamina of its people, all the more so as the country opens up and the private sector grows[2].

[2] C. De la Torre, C.J. Arnson, *Latin American Populism in the Twenty-First Century*, Baltimore, Johns Hopkins U.P., 2013.

However, it was the major South American countries to have set the tone for the latest regional political trends. In Argentina, Mauricio Macri defeated the Peronists and is now trying to restore credibility in republican values and the liberal democratic system, undermined by years of Kirchnerism. In Brazil, meanwhile, the Workers' Party was brought down by corruption. While it never identified itself as a populist party, it often lent populist governments in other nations support and protection. While one can doubt that the series of events that brought down Dilma Rousseff was either juridically legitimate or politically wise, subsequent local elections dealt a heavy blow to Lula's party, sanctioning its loss of consensus and its political crisis, pushing Brazil away from the national popular front. Add to this the outcome of the latest Peruvian elections, where Pedro Pablo Kuczynski, the candidate most committed to liberal-democratic values, emerged as the winner. Furthermore, consider Colombia's failed peace agreement referendum that, on the one hand, jeopardized the peace process, but on the other revealed Colombians' unambiguous hostility towards the Revolutionary Armed Forces of Colombia (FARC), a movement that constantly flirted with populism.

An underlying trend runs through this long chain of events. Regardless of one's opinion, it signals the crisis of populism[3] and the opening of a new era. Liberal democracy, ever the Cinderella of Latin American history, and the "sick man" of our times, has finally the chance to put down new roots in a region where it seldom enjoyed solid ground.

Why the wind veers

So why did the political wind shift? Why are populist regimes in crisis? Populism is such a well-rooted feature in regional political systems that its crisis makes one wonder whether we are

[3] P. Barbieri, "What is Killing Latin American Populism?", *Foreign Affairs*, June 2016.

witnessing a physiological decline or long-run, structural change. It would be tempting to play down the scale of the phenomenon and trace everything back to well-known and tangible reasons. First of all, the abrupt turn of the economic cycle. It would be understandable and somewhat legitimate. As the *década dorada* draws to a close, one can only expect a political change. It was long overdue for Latin American governments to prepare for the fall in commodity prices, after their long-lasting stellar performance thanks to Chinese demand. Thus, the most robust economic growth the region ever experienced for a century fizzled out and died, as the recession set in: regional GDP was down in 2016, and economists do not foresee an outstanding recovery. At the same time, to argue that populist regimes suffer from anemic growth like any other government would be simplistic. It would be only fair to say that populist regimes pay a harsh toll for squandering the huge resources at their disposal. When one removes Venezuela and Argentina from regional aggregates, macroeconomic indicators turn from negative to mildly positive. It is not surprising that voters punished those two governments' awful performances[4].

To really gauge the extent of the crisis, we must judge populist regimes on political and social grounds, where they have always proved stronger. Since its inception, populism pitted the liberal concept of democracy based on the separation of powers, individual rights, and an open society against the defense of "social justice". A powerful concept, albeit vague and controversial. Such a noble purpose called for the use of any means necessary, including the violation of the rights of minorities, the concentration of power, the inhibition of free and fair electoral competition. Moreover, the price of present consensus-building was unloaded upon future generations through recourse to unsustainable redistributive policies. In the face of frail liberal democracies, with a narrow social base, populism had an easy time proclaiming its

[4] CEPAL, *Estudio económico de Amèrica Latina y el Caribe 2016*, Santiago de Chile, 2016.

pueblo as the only legitimate *pueblo*, the vessel of national identity, the personification of virtue against oligarchs imbued with foreign ideas. For a long time this was a winning argument: it managed to turn the normal political dialectic into a Manichean fight between the people and the oligarchs, the nation and the anti-nation, good and evil, and it allowed populist regimes to win election after election. This was both due to its actual ability to give voice to the huge share of the population who felt left out by liberal democratic parties and to the fact that, once in power, populists concentrated financial and political resources and thwarted the opposition. This same pattern was followed by Peronism, by the Mexican Institutional Revolutionary Party, by Cuban Castroism (to the point that it banned competitive elections), by Chavism, and so on. This often led to an inextricable dilemma: where populists won, democratic institutions were distorted to the point that they could not ensure fair political competition; where populists lost, sometimes via coups, no liberal democracy could muster sufficient popular support to stand on its own. This gave rise to a chronic swing between populism and militarism[5]. However, this time the very core of the populist narrative appears to be falling apart at the seams. It would be a momentous change, albeit a change that could take decades.

What is weakening the longstanding populist narrative, once so powerful in defeating liberal democratic discourses, to the point of derailing it? Briefly, it could be argued that over the past thirty years Latin America went through a number of changes that little by little chipped away at the populist narrative's credibility and its ability to explain the world. These changes are multidimensional: it is, therefore, key to expand upon the political and social sides of the equation, and their impact on political culture. Taken together, all these help explain the progressive inadequacy of this narrative, and its increasing and unprecedented exposure to resounding defeats.

[5] L. Zanatta, *El Populismo*, Buenos Aires-Madrid, Katz Ed., 2014.

Populism without the people

Let's start from political changes. The first and most important – so glaring, and thus often overlooked – is the diffusion and the stable preservation of representative democracy systems by Latin America as a whole (except for Cuba). It would be shortsighted to deny that these democracies are often marred by mediocre or even insufficient institutional quality, and that there is a deep chasm between Chile's and Uruguay's long-run, high-quality democratic systems and the inefficient and arbitrary systems of so many other countries[6]. To be clear: the liberal democratic system has come a long way in the whole region, but way too often it only acts as an unstable *façade* under which ancient patrimonialistic habits, of remote Hispanic heritage, thrive. As the story goes, if you rule in the name of the people, those same people validate your use of power to reward who is loyal and punish who is not. Limiting this power is tantamount to an attack on the sovereignty of the people that are governing through you. Widespread corruption is nothing but the innate reflex of this heritage. These forms of democracy have been kept afloat in times of abundance, when there were enough resources to coopt clients and buy consensus. But now that resources are scarce the day of reckoning has come. We are now able to tell who took advantage of those times of abundance to lay solid, institutional foundations, and who simply tried to bottle up political abuse and sell it as democratic wine. Now more than ever, Latin American democracies must prove their worth: their mere existence is not enough anymore.

On the other hand, the institutional dynamic of representative democracy triggered a virtuous inertia that slowly but steadily shaped the behavior of political actors. This is the key change. Such inertia often prevented populist governments from amassing as much power as they did in the past. It ensured a higher

[6] D.H. Levine, J.E. Molina, *The Quality of Democracy in Latin America*, Boulder CO, Lynne Rienner, 2011.

degree of autonomy at different state institutions, so that they could exert greater control on government power itself. It favored a more pluralistic public debate that governments could not suppress without having to deal with the consequences. Finally, it sanctioned the multi-party system as the only legitimate political system and established the need for elections to be free and fair. It may not seem much, but it is, and it explains why populist movements had to change, so much so that today they cannot dismiss liberal democracy and, by living within it, they end up internalizing some of it[7].

Such inertia partially eroded some tenets of the populist mantra. First of all, it challenged the idea of democracy as a social reality, independent from the political and institutional framework, its "pure form" denounced as a misleading superstructure. Liberal democracy bestowed upon politics the autonomy and dignity that populism used to deny it. The very concept of "social justice", over which populists always claimed a sort of monopoly, moved from being a dogma to a subject for debate. Secondly, the daily practice of liberal democracy, with its customs and networks, its constant recourse to negotiation and compromise, partly defused populism's Manichean penchant. It juxtaposed new actors to the classic narrative opposing the *pueblo* to oligarchs, it added new colors to its stale black-and-white palette, it nuanced the political debates that populism reduced to crude religious wars, and by doing so it laid the foundations for a more complex and rational political life. Finally, as liberal democracy endured, it pushed populism to play its own game. This was most evident in Venezuela, where populism's authoritarian tension violated both the letter and the spirit of democracy[8]. But even there, Chavism stopped short of totally eradicating democratic institutions, so much so that it suffered electoral defeats. In most other cases, the customs and institutions of representative

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[7] Y. Mény, Y. Surel, *Populismo e Democrazia*, Bologna, il Mulino, 2002.

[8] C. De la Torre, "In the Name of the People: Democratization, Popular Organizations, and Populism in Venezuela, Bolivia, and Ecuador", *European Review of Latin American and Carribean Studies*, no. 95, October 1993, pp. 27-48.

democracy forced populist movements to recognize constitutional boundaries and rules. All this brings us to a simple but important conclusion: while populist movements grew up believing themselves different from everybody else (not just parties among parties but the repositories of the people's morality, and therefore superior), by taking part in the liberal democracy game, such movements lost their one-of-a-kind quality to become political actors like any other. Willingly or not.

But there is more. In the past, when populist regimes seized power, they used to ring-fence it in order to prevent others from challenging it. Alternatively, they were overruled by the army. This way, what they would lose in power, they would gain in prestige. Given that their downfall wasn't due to an electoral defeat, but to an abuse of power by the military, this strengthened their standing as "avengers": their mission to unshackle the people had been prevented only by brute force. People's judgment of their government's legacy was wiped out by the fact that they were not allowed enough time to make the dream come true. This proved to be true for Apra in Peru, Acción Democrática in Venezuela, the Peronist parties in Argentina, the Revolutionary Nationalist Movement (MNR) in Bolivia, Jacobo Arbenz in Guatemala, and many others[9]. Unlike before, today democracy's resilience ensures that populist governments stay in power until the end of their term, and can be judged for what they have actually done. Identity voting loses ground in favor of more pragmatic, informed, and result-driven citizens. Reality tends to dispel the myth, so much so that, come election time, populist parties get punished more often than they ever thought could happen.

Speaking of elections: electoral defeats by populist movements, both at a local and at a national level, used to be rare for those Latin American regimes that until a few days beforehand appealed to the *pueblo* by claiming to embody it. These movements, the *pueblo*'s champions against greedy oligarchs bribed by

[9] M.L. Conniff, K. Roberts (eds.), *Populism in Latin America*, Tuscaloosa, University of Alabama Press, 2013.

foreign enemies, couldn't even dare to think about defeat. How could populism become the movement of a minority? Can populism survive if a country's citizens in a democracy do not match with its mythical image? What is populism without the people? No wonder that when confronted with electoral defeat, populists panic. In the 2015 legislative elections, Nicolás Maduro's party got only 30% of votes, but Maduro refused to concede and said he would continue leading along with the *pueblo* – as if the *pueblo* had not just turned its back on him. Cristina Kirchner never dealt with being defeated by – as Peronism put it – the oligarchy. How could an oligarchy turn into a majority and defeat her? Evo Morales conjured up conspiracies and plots to explain why Bolivians would not allow him to run again for election. If an oligarchy is no longer an oligarchy, the populists' *pueblo* is no longer the same *pueblo* as before. Populism as a Manichean archetype is wearing thin: its interpretation of reality does not suit the contemporary world.

Has the *pueblo* (almost) vanished?

If the traditional populist narrative is losing its grip, it is not just because of the democratic discourse but also because of social transformations. Granted, national and regional differences are such that generalizations are impossible. Having said that – and even admitting that the notion of a "middle class" is very often misrepresented and inflated in social mobility analysis – it can be argued that every polity in the region went through complex changes that will have huge consequences on political representation[10].

Consider the last decade: the figures expressing economic change and its social consequences speak loud and clear. By 2015, Latin American gross domestic product had grown by 35%; unemployment rates were down to 6%, an all-time low;

[10] CEPAL, *Panorama Social de América Latina*, Santiago de Chile, 2015.

the volume of international trade had doubled. This was coupled with marked social mobility, rising expectations, and a change in the relationships between social classes, generations, citizens, and institutions. For example, the share of college students went up ten points in seven years. Tens of millions of people were lifted up from poverty, which declined from 43.9% to 28.2%, and just as many paved their ways to a better future in what is still a little far from middle-class by European standards, but nevertheless grants them access to unprecedented goods and services. Even inequality – a sore point in Latin American society – is down 10 per cent thanks to state aid and especially to the effects of a more integrated labor market and higher wages.

Take note: these changes are not permanent, and they have their highs and lows. Latin America is still plagued by a huge informal labor market, low local productivity, high economic volatility, and vulnerability, especially among the lower-income classes[11]. More than one-quarter of the Latin American population – albeit with huge variation across social classes and countries – lives on the outskirts of legality, has no access to the formal economy and has no social welfare. It is a massive crowd that gathers in lawless and unsanitary suburbs, falling prey to the pandering of the *caudillos* and their patrimonialistic ways. However, it is a complex scenario with many contradictory effects that, taken together, are shaking the pillars of populist dogmas.

Of these effects, the first could be defined as "the crisis of rising expectations" and mainly affects the fastest-growing classes, who are well educated and live in urban areas[12]. They want more from democracy. They take democracy for granted and ask for more with no fear that it may tremble or fall. It was not so in the past. This is particularly true for the millions of young people who never experienced dictatorship in their lifetime and for the millions of citizens seizing all the opportunities the economic

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[11] *OECD Regional Programme for Latin America and the Caribbean*, Santiago de Chile, 13 October 2016, http://www.oecd.org/latin-america/regionalprogramme/

[12] F.H.G. Ferreira (ed.), *Economic Mobility and the Rise of the Latin American Middle Class*, World Bank editions, Washington, 2013.

boom of the last decade opened up. For all of them, democracy is not just voting rights. It also entails inclusion, opportunity, efficiency, transparency: all that is lacking from Latin American democracies today. For these citizens, the *pueblo* as a populist lure no longer evokes a close and homogeneous community waiting for salvation. They do not owe their prosperity to the state, nor to those who are in control of the economy. Their newfound independence shields them from the welfarism of the populist regimes and makes them prone to criticize the government: especially if – as is often the case – the state making those promises does not guarantee adequate public services, such as infrastructure, hospitals, schools, transportation. These citizens are fed up with clientelistic practices perceived as the reason for underdevelopment, inefficiency, injustice, and corruption.

There is a second way in which social changes can undermine populism. There is no doubt that populist regimes used to promote, in their own way, the rise of very specific social classes with whom they were strongly interconnected; but, as of today, they have lost touch with them. Populist regimes are simply managing poverty, overseeing networks of ever-poorer people. They are hindering the poor's emancipation, pushing them to the fringes of society. This is a very different world from the one where Mexican peasants could count on Lazaro Cárdenas or Argentinian workers could look up to Perón: Chavism and Kirchnerism are nothing like that[13]. It is no coincidence that populist governments in Ecuador and Bolivia are faring much better: their worldview ascribes to ethnicity the role played in the past by social classes. Contemporary populism has lost its grip on social causes: it has surrendered its strong identity and thus the power to mobilize the masses. Its ideological stamina is coming to an end. It is a fact: the *pueblo* that populist discourses address – an ideal, homogeneous community – does not exist anymore, if it ever existed, and has been replaced by a liquid and

[13] S. Colazingari, V. Palermo, *Peronismo clásico y peronismo plebeyo. El populismo de la globalización*, Buenos Aires, 2016, unpublished.

heterogeneous society to whom this narrative sounds stale and rhetorical, as quaint as a black and white movie.

Once upon a time, there was an ogre…

Another key factor contributes to the populist crisis: the new role of the United States in the region, no longer a menace. In the sixties, when Fidel Castro denounced the threat of US intervention, Latin America listened to him because the threat was real. Today, however, when a Bolivarian leader accuses Washington of plotting *golpes*, the population as a whole (except for a few devotees) responds with apathy to this unconvincing ritual. However, the ogre from those fairy tales that used to conveniently evoke a *pueblo unido* to defend sovereignty and identity is not scary anymore. The United States is just a paper tiger and using it to call for a *union sacrée* is an outdated strategy. This is not so much due to the so-often advertised US decline – although it is true that the US is no longer ruling the Western hemisphere. The drastic demotion of Washington's role and the US' gradual transformation from hegemon to partner, albeit a more powerful partner, can be explained by much deeper historical reasons[14].

US hegemony hinged upon the intent to spread liberal values (representative democracy, political and civil rights, a free market economy) to the Western hemisphere as a whole. It was Pan-Americanism at its best, although the United States was not always true to it. Be that as it may, the US always faced the strong anti-liberal reactions of populist movements. But now that the whole region is converging – more or less successfully, more or less convincingly – towards those values and that political system, the US has been deprived of its historical mission, under whose banner it exercised a sort of tutelage of the Americas. Manifest destiny accomplished. From this standpoint, the decline in US influence is the other side of success. What

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[14] P. Magri (ed.), *Il mondo di Obama. L'America nello scenario globale, 2008-2016*, Milano, ISPI-Mondadori, 2016.

mission can Washington embark upon in the Americas, when liberal values have become the lowest common denominator for the Western hemisphere, just as in post-1945 Western Europe and in post-1989 Eastern Europe? Barack Obama's U-turn on Cuba came not as a shock but as the natural outcome of this process. The message is clear: for better or for worse, Latin America is the master of its own destiny. Anti-American populism is just a boorish way of crying wolf to keep the sheep fenced in and condone abuses and failures while blaming the enemy. Its partial defusing can only contribute to weakening populism's political and emotional appeal[15]. Unless it's the United States itself to give it new credibility, positing a return to the anachronistic and self-wounding forms of hegemony that serve only to proffer on a silver platter that old and by now blunted weapon to the numerous enemies of liberal democracy that in Latin America thirst for revenge. It seems absurd but that's precisely what Donald Trump is threatening to do.

What now?

All these factors explain both the weakening of and the crisis in populist challenges to liberal democracy. Given its deep cultural and social roots, it would be a mistake to expect its complete demise. However, it is fair to say that the populist challenge – barring context-dependent exceptions – will manifest itself in less extreme forms than before. No longer an alternative, it will increasingly occur as a trend within liberal democracy. This is, nevertheless, a crucial historical development. The future of populism will be the result of a complex interaction between a number of features in each country: liberal democracy defeated populism in Uruguay but was defeated in neighboring Argentina; it triumphed in Costa Rica but lost in Nicaragua; it is advancing in Peru and Colombia while populism is still alive and well in

[15] J.I. Domínguez, R. Fernández de Castro (eds.), *Contemporary U.S.-Latin American Relations: Cooperation or Conflict in the 21st Century?*, Routledge, 2016[2].

Cuba and is not losing its grip in Venezuela. It will also depend on whether and to what extent the political culture of the region will change: a region whose republican ideal of a representative democracy has always appealed only to a minority, and where populism could always tap into a coherent popular mythology[16].

Latin American democracies, today, are mainly low-intensity, low-quality democracies, thus vulnerable to grievances. They ensured stability – which is a blessing – and granted an unexpected continuity. Yet there is continuity and continuity: it is one thing to provide stability and preserve political power by constitutional means, as it is the case for some countries; but to manipulate the constitution time and again to remain in power is a whole different matter. In the former case, political conflict mainly focuses on public policies and does not call the republican nature of the regime into question. Therefore, elections never put a strain on a fragile institutional fabric. In the latter, populism is so deeply rooted that the political conflict ends up embroiling the regime itself. It is no coincidence that the clash eventually becomes an armed confrontation between the populist and the anti-populist front, the latter consisting of political trends so heterogeneous that in every liberal democracy they would spread out across the whole ideological spectrum. In this context, political instability lurks: the continuity of a regime that shares both monarchist and plebiscitary traits hinders a pluralist dialectic, forces dissatisfied minorities to challenge its legitimacy and turns every election into a war.

This being the case, faced with Latin America's unambiguous changes and the unmistakable crisis of the populist narrative, one can only wonder which features will define the next cycle. Those who conjecture a shift from populism to neoliberalism (or from left to right) are distorting the truth and oversimplifying reality: it is as if they are not grasping the deeper meaning of the changes

[16] L. Zanatta, "El populismo, entre religión y política. Sobre las raíces históricas antiliberalismo en América Latina", *Estudios Interdisciplinarios de America Latina y el Caribe*, Tel Aviv, vol. 19, no. 2, July-December 2008, pp. 29-44.

taking place in the region. No one can foresee Latin America's destiny nor the destiny of each and every one of its countries: but one thing is for sure – whatever that destiny is, it will not be as soaked in ideology as in the recent past[17]. With regard to the current milieu and the steps taken by the governments taking office, it looks like Latin America is moving toward a more pragmatic, less ideological stance – more rational, less emotional, driven by consensus-seeking and problem-solving and not by dispute-avoidance or the search for magic bullets. I might be wrong: and certainly there will be exceptions to the paradigm that one could call, famously, "the politics of possibility"[18]. However, I strongly believe that this is simply the aftermath of thirty years of binges on neoliberal ideologies first, and populist ideologies afterwards. The more the middle class grows, secularization spreads, and generational turnover takes place, the more old political habits lose their relevance. Clientelistic practices, state paternalism, patrimonialism, nepotism and corruption do not disappear, but lose social acceptance. The same applies to those redeeming ideologies that used to arouse the masses by bestowing the features of holy wars upon political battles.

If Latin America will be able to take the leap from populism to liberal democracy (the region's constantly missed rendezvous with history) and head towards a common institutional model and shared values, the path to regional integration will benefit from it. The old ideological disputes will lose their *raison d'être.* If this were the case, it would just be a start. Once democracy is secured, most Latin American regions will have to breathe life into it to validate it and proceed to uphold the rule of law. A far too distant scenario. Yet this is what people ask when they assert their need to inclusive educational systems, efficient public services, protection against abuse of power, security and personal freedom, transparency against corruption, and the fight against

[17] D.F. Wajner, "La inminente era del neoprogresismo en Latinoamérica", *Foreign Affairs en español*, January 2016.

[18] J. Santiso, *Latin America's Political Economy of the Possible, Beyond Good Revolutionaries and Free-Marketeers*, Cambridge MA, MIT Press, 2006.

chronic tax evasion. Democratic institutions should pair with the rule of law, and free and fair elections should go hand in hand with an independent judiciary, personal freedoms, public officers' accountability, effective pluralism, and social inclusion. Without all this, history will repeat itself and Latin America's house of cards will collapse: it would not be the first time that a liberal democracy fails and loses its credibility. What bodes well for the region, though, is that civil society is growing in numbers, education, secularization, autonomy, and awareness of the intrinsic value of political institutions. Latin American citizens know that economic development and social inclusion are built upon those very political institutions that are the bedrock of liberal democracies.

2. Latin America and the World. The Right Time for Engagement?

Peter Schechter, Rachel DeLevie-Orey

The world is going through a time of profound disruption – some changes seem to serve the societal common good, others seem to only create instability and social ferment. Technological developments, mass movements of peoples, rising incomes with accelerating middle class demands, and changing social norms are forcing developed and developing economies alike into a whipsaw of far-reaching, shifting developments. This is also tangible in Latin America, a region that has undergone dramatic political and economic transitions in recent decades.

Too often, views about Latin America in the United States and Europe are stuck in the past. Talk with the average Italian government official, Polish EU parliamentarian, or English civil society leader – and their views on the region will somehow still overflow with half-impressions of drugs, violence, human rights abuses and democratic insufficiencies. There is little understanding of the massive transformations that have occurred over much of the region in the past 15-20 years. Notwithstanding today's news about Brazilian corruption or Argentine inflation, the region has changed profoundly in the past two decades.

Indeed, with some stark exceptions in Central America, Venezuela, and Cuba, the trend lines far outshine the headlines. Latin American nations have mostly moved from the dictatorships of the 1980s to thriving democracies today. As evidenced by the 70 million people who have come out of poverty and joined the middle class in the past decade, this is a region with rising potential.

Today, Latin America is host to peaceful borders; recent boundary disputes between Colombia and Nicaragua or between

Peru and Chile have been solved through arbitrations. A bubbling civil society advocates loudly – in analog and digital – for everything from minority rights to more transparent governments. An increasingly engaged and well-educated population has also raised concerns about a long history of political corruption and impunity in many countries; one need only look at Brazil to see that citizens will no longer stand for such practices. Security, while still a central issue for many in the region, is improving, with crime rates decreasing in many countries.

Movement towards the market

The past few years have seen a sudden, clear shift away from leftist politics in the region. The spectacular failure of nationalist populism in Venezuela, stagnant economies in Brazil and Argentina, and five years of economic success in Peru have demonstrated that voters in these countries seem to accept that globalization and engagement are the right way to go. As Latin American countries reach for new levels of economic development, there is clear movement towards open-border, market-friendly policies of engagement and commerce. Ironically, this is happening at the very moment that trade, open borders and international engagement are in doubt in the United States and Europe.

Indeed, such growth represents Latin America's central new challenge. In the past, protesters demanded the creation of schools and healthcare systems; today, protesters demand higher quality education and healthcare, transforming these requests into those illustrative of a middle class expectant of well-functioning government services. To meet these demands, Latin American countries will need their economies to grow; conditional cash-transfer programs that redistribute monies will no longer be sufficient. Spurring the economic growth necessary to feed the demands of the region's growing middle class is no easy feat; it will require accelerating policies that increase productivity and incentivize growth.

Yet as Latin American countries are emerging from an era of closed-door, populist policies into an era of outward-facing engagement, many Western nations are beginning to look inward. Brexit was the warning shot about the strength of anti-trade, anti-globalization, and nationalistic political messages. Upcoming French and German elections will further test the new populist movements. But of all the changes, the stunning election of Donald Trump will certainly have the greatest impact on Latin America, given the deep ties between the US and the region. Already US companies are retreating from opening plants in Mexico – an immediate and tangible impact even before Trump is formally sworn into office.

This chapter begins by taking a tour of the global political economy landscape in which Latin America seeks to grow its economies and improve the lives of its citizens. We follow by looking at the changes in Latin American societies; in particular, a close look at the reforms that will facilitate Latin America's renewed global engagement. This paper will not take on the intractable problems of the Northern Triangle of Central America – although drugs, violence, lack of institutional capacity, corruption, and migration are critically important and affect international relations, these small countries exert almost no influence on the rest of the hemisphere. We conclude with tracking the trends that will likely affect the region's international relations, its negotiations, and the pursuits of its leaders in the coming years.

Quo vadis, Western nations?

In the midst of swirling, contradictory global trends, Latin America is renegotiating its global position. Until recently the region's international relationships centered almost exclusively on the United States and Europe. Even in the 1970s and 1980s, the discussion tended to be simple: Latin American countries were reprimanded for a democratic deficit, insufficient governance, and the abysmal state of human rights. Problems still persist today, of course. But, notwithstanding a few important exceptions, these conversations are no longer at the center of Latin America's foreign affairs. Now, most of the region's most important, middle-income countries base their international relations on trade and economics; foreign aid and finger-wagging seem far in the past.

But the mere fact that international political economics will be the driving force for engagement and change in the hemisphere does not make the way forward clear. Latin America is trying to find firm footing in a world suddenly covered in uneven ground.

The United States and Western Europe are facing a crisis of trust. Citizens seem to have lost faith in institutions, in political leadership, and in business elites. As connectivity and integration increase through technology, trade, and increased ease of moment, so too have calls for protectionism, nationalism, and populism. From Brexit to Spain's Podemos to the failure of the Italian constitutional referendum, citizens are rejecting the recommendations of the political class and demanding new leadership. Donald Trump has looked far beyond the typical pool of nominees to staff his cabinet, instead selecting private sector titans and long-time military leaders to chart the course of his presidency. Uncertainty about the future seems to be rampant.

Europe and America today are grappling with the re-emergence of issues once thought to be in the past. The refugee crisis in Europe is creating strains on the union, while fomenting racism and nationalism not seen in nearly half a century. Borders that seemed settled have been thrown into question with Russia's occupation of Crimea, spreading angst throughout the entire NATO alliance. Those who have preached an expanding, integrated world are faced with the reality of Britain's imminent departure from the European Union.

New challenges, symptomatic of an increasingly globalized economic system and a rapidly changing technological era, are also disrupting a previously established way of life. In the United States, the rise of automation, technology's replacement of humans, has made countless jobs redundant. And while free trade ultimately benefits nations and consumers, these agreements bring growing pains, during which many industries suffer lay-offs and individuals seek retraining to remain competitive in a shrinking job market.

Thus, for the moment, the United States and Western Europe – the world's two largest economic spaces and the giant post-World War II catalysts of integration, trade, and open borders – seem to be retrenching into a new state of nationalist activism and protectionism. Calls for policies which keep jobs within national borders and focus public resources on citizens – not refugees or foreign aid or trade deals – read as exclusionary and often times aggressive; but the support for such rhetoric is demonstrative of a world in flux, unsure of how to continue growing while caring for its own.

This is Latin America's curious international relations conundrum. It is a profoundly Western region of nearly 600 million people who talk increasingly about more trade and engagement. But they may find far less willing Western partners. Instead, Asian countries – particularly China – seem to understand this dichotomy and have sought to engage the region across the Pacific. With China's currency recently joining the International Monetary Fund's basket of international reserve currencies, this could be the dawn of a whole new era for Chinese investments and opportunities in the region. As Latin America looks to increase international trade and investment opportunities, it may find more opportunities with Asia than with the United States or Europe.

The changing Latin political economy

Over the last several years Latin America has begun to see a movement toward open-market economic policies, and to elect politicians looking to engage with the world, rather than to shut it out. This was not without growing pains: indeed, countries like Argentina, Brazil, and Venezuela spent the 1990s and the early part of this century electing leaders who implemented vast arrays of social programs. These were initially instrumental in combatting poverty. However, most of these programs proved unsustainable, and were too often coupled with international economic policies which deterred foreign investment, resulting in stalled growth.

In the last five years alone a series of national and congressional elections in many of these countries has brought a dramatic shift towards openness and engagement. Some countries are already reaping the benefits today; others are still muddling through the growing pains of transition. But it is clear that centrist, free-market policies are being favored while hyper-leftist and anti-US sentiment is increasingly becoming obsolete. In this moment of global upheaval, Latin America seems determined to be a region of open economies.

How did this happen? Let us take a quick tour of the region:

Mexico

In 2012 the election of Mexican President Enrique Peña Nieto was quickly followed by a series of constitutional reforms, many of which were targeted at opening an economy burdened by insufficient foreign investment, private and public monopolies, and a deep lack of productivity. Tax reform was designed to attract more companies as well as to ease the way for the creation of new ones. Indeed, Guadalajara and Mexico City have become hubs of innovation and technological development, earning the nickname "Southern Silicon Valley," diversifying the Mexican markets and bringing in new investors. Telecommunications reform broke up the infamous cellular monopolies of Carlos Slim, quickly putting money back in the pockets of consumers. At the same time, the government launched one of the largest e-governance programs in the hemisphere, promoting citizen engagement and facilitating the provision of government services. Perhaps most controversially, the Mexican oil market was opened to foreign investors for the first time in seventy years. Though the recent drop in oil prices has prevented this reform from achieving its full potential, the move signified Mexico's commitment to global engagement. This avalanche of reforms has forced multinational corporations and countries to reconsider Mexico as a serious market force.

With 2,000 miles of shared border with the US and with the aggressive, anti-Mexican, anti-immigrant sentiment Donald Trump has espoused, the change in US administration will likely hit Mexico the hardest. The peso has already fallen dramatically, while Ford's decision to build a new plant in Michigan instead of Mexico is indicative of the tumult ahead. Given the rising tensions, Mexico will be further pressed to look beyond its own borders and northern neighbor for growth opportunities.

Despite the bruising 2016 presidential campaign, both Mexico and the United States both have a vested interest in calming tensions. If framed simply as a need to update and improve the relationship between neighbors and partners, few will argue with modernizing NAFTA, a 25- year-old trade agreement, and redoubling efforts to increase control over the southern border of the United States.

But handled clumsily, the US-Mexico relationship has the potential to spiral out of control. Tone will be almost as important as substance. No Mexican president could withstand the political avalanche that would occur should the new US administration renew threats to "tear up" NAFTA (The North American Free Trade Agreement), build a wall and deport millions of Mexicans. Two years before Mexico's next presidential election, this seeming attack on Mexico and Mexicans would put massive pressure on Peña Nieto from leftist leader Andrés Manuel López Obrador, now second in the polls. Peña Nieto would be forced to retaliate: Mexico could halt joint efforts in the narcotics control and security areas. Importantly, following the example of Turkey's Tayyip Recep Erdoğan, Mexico could end its highly successful efforts – executed at the request of the United States – to police the country's Guatemalan border to the south. Indeed, the US-Mexico border could become rife with tension for the first time in modern memory.

Argentina

In Argentina the election of Mauricio Macri was a clear rejection of the twelve-year rule of Nestor and Cristina Kirchner and the precarious state in which their policies had left the country's economy. Social programs drained public coffers, and inflation was reaching more than 40%. But the call for change did not end with economics; Macri struck a tone of greater engagement with the United States and other more open-market allies. Currency restrictions all but disappeared, taxes on exports have been reduced and Argentina is determined to bring inflation down 25% by year's end. Argentina quickly joined the Pacific Alliance, a four-country effort at integrating like-minded, open-market nations, as an observer. Additionally, Macri took a decidedly more confrontational tone with longtime ally Venezuela, declaring that the country needed to comply with democratic clauses in order to continue its membership in Mercosur. This new approach did not go unnoticed, with President Obama visiting Argentina just three months into President Macri's term, signifying a warming of relations and support for the new president's agenda.

Peru

In June 2016 Pedro Pablo Kuczynski replaced Ollanta Humala as Peru's President. Despite initial fears that Humala was a "Chávez of the Altiplano", the former president's appointment of a cabinet of capable technocrats – in particular former Finance Minister Luis Miguel Castilla – turned Peru into one of the fastest growing countries in the world. With commodity prices providing a tail-wind, Castilla opened up the country to investment and created the conditions for Peru to become a productive, export-oriented economy. Humala ended his term with low approval ratings as commodity prices fell and the economy slowed.

Kuczynski won the elections by a hair against Keiko Fujimori, the populist heiress of the Fujimori legacy. That Peruvians voted for a former businessman and a former World Bank economist who, until the campaign, also held a US passport, is nothing less than astounding. Peru is a famously tough place to run and yet, its citizens have essentially re-upped their membership into a program of open markets, investment and integration with global production chains. Kuczynski plans to run a fiscal deficit of up to 3% of GDP because Peru's public debt is low and its credit rating strong. He plans to take steps to formalize the economy by simplifying things such as registering real estate ownership and easing business transactions and bank accounts. Kuczynski has said this will bring millions of small and medium-sized entrepreneurs into the tax base. Another goal is to free up some US$22 bn in investment in mining and energy projects presently stalled by local opposition. The president must also build on Humala's efforts to improve education, health and social protection. Little can get done without a consensus with Ms. Fujimori's Popular Force party – but disagreements between the President and Congress are about politics, not about taxes and social issues.

Brazil

Brazil is now reckoning with a host of complications due, in large part, to the perfect storm of a painful recession and a widespread political corruption scandal. This, of course, has resulted in a weakening of public trust. As painful as the public investigation of the "Lava Jato" (car wash, as the operation has become colloquially known) scandal has been, it is worth noting that such an investigation could not have happened a decade ago. Not for lack of corruption, but because there was a passive acceptance of such operations. Now, though, the strong judicial investigation and the resulting public outcry have made clear that such activities will no longer fly under the radar. The purging is a difficult pill to swallow, but it should also be recognized as progress that Brazil is taking the necessary steps to ensure strong, legitimate institutions with worthy leadership.

Political turmoil is not alone in fomenting national frustration: economic stagnation is a major contributor, due largely to decades of protectionist policies. The infamous social costs known as "Custo Brasil" limited both foreign and domestic investment. The newly installed Temer administration will need to make difficult choices about how to maintain social programs while jump-starting a sluggish economy. Recent declarations show that Temer may indeed be willing to suffer some short-term political backlash in order to shoulder the burden of much-needed economic reform. Nobody knows what will happen in Brazil after the next elections in 2018; yet with the PT party in tatters, there seems to be little doubt that Brazil, long an inward-looking nation, is trending – slowly – towards much of the rest of the hemisphere.

Colombia

Colombia has earned the title of poster child for reform in Latin America. The longest-running spate of violence in the hemisphere – a war between the state, guerrilla groups such as the Revolutionary Armed Forces of Colombia (FARC) and drug mafias – has left 220,000 Colombians dead, and millions displaced. The drug violence of the 1980s and 1990s – now made infamous in the TV show *Narcos* – stamped Pablo Escobar's city of Medellin with the unenviable title of "Murder Capital" of the world.

Yet, only two decades later, in 2013, the city became a symbol of the country's transformation when the *Wall Street Journal* awarded Colombia's second-largest city the honor of being "most innovative city of the year". Since then, transformations continue apace. Today, Colombia is on track to join the Organization for Economic Cooperation and Development (OECD). Colombia is one of the region's most open countries and has enacted economic policy targeted at growing the middle class by attracting foreign and domestic investment, thereby increasing the wealth in the country, not just sharing the existing resources. At the same time, Colombia invested heavily in improvements in health, education, and social services. This has resulted in one of the most impressive national turnarounds on the global scene.

Not all is rosy, of course. President Juan Manuel Santos has dedicated his presidency – and his political capital – to negotiating a comprehensive peace negotiation with the FARC. For four years the president's team worked with FARC leadership in Havana, with help from Norway, Cuba, and the United States to draw up a six-part agreement addressing issues from land and political reform to disarmament and victims' reparations. While many in and out of Colombia found this laudable, Santos' predecessor (and former mentor) President Álvaro Uribe took a confrontational view of the negotiations, and became the voice of opposition. Given the length of the conflict and the domestic divide on this issue, Santos agreed to put a final peace accord up for a national plebiscite vote. It was expected to pass by a two-to-one margin, with polling showing broad support for the accord. But low voter turnout on 2 October 2016 resulted in a "no" vote. Though the margin of victory was fewer than 55,000 votes, this, too, was credited with being another rebuke to "the establishment" and emphasized deep-seated mistrust in the political class.

With a renegotiated peace agreement now a law passed by Congress, Colombians will have to wait until the 2018 presidential elections to have their final say about peace. In the interim, Juan Manuel Santos and Álvaro Uribe will continue to foment the polarization reigning in the country.

The new wild card is, of course, the new US administration. Until now the US has been a staunch supporter of peace. It is likely that President Donald Trump will be more receptive to Uribe's argument that Colombia has been too generous with the FARC. How that will affect US support for Colombia is difficult to foresee.

Are the outliers changing?

Several countries throughout the region are experiencing political, economic, and even humanitarian turmoil. Even with rampant economic stagnation and an authoritarian bent in Cuba and Venezuela, it seems clear that gravitational forces are pushing the people of both nations to demand greater engagement with the global market.

Venezuela

Venezuela is buckling under the failing populism now synonymous with Hugo Chávez. Under current President Nicolás Maduro, the country has catapulted from a sluggish economy with restricted political freedoms to an all-out, free-fall of stagflation, political oppression, and food and medical shortages. This is creating a full-fledged humanitarian crisis. Venezuelans infuriated by rising crime and impossible living standards voted in December 2015 to put a record number of opposition members into Congress. The subsequent rulings by a Supreme Court loyal to the administration have, unfortunately, gutted the power of these elected officials, but it was a clear statement to both the Maduro government and the outside world that the people are tiring of the price of nationalism. The famously fractured opposition is finding ways of cooperating, joining together to demand a recall referendum vote against the President. Though it is unlikely their demands will be met, the hundreds of thousands of protesters who took to the streets on 1 September of this year are a sign that sooner or later Venezuela's socialist experiment will collapse.

Cuba

Perhaps most anxious about the ongoing crisis in Venezuela, Cuba is seen as the last holdout of leftist policies, still carrying the banner of nationalist slogans and the political ethics of the Cold War. Indeed, even with the passing of Fidel Castro, Raul still runs the country, and there is almost nothing resembling a market economy. Cuba receives tens of thousands of barrels of oil from Venezuela each day, though that number has been declining dramatically due to falling oil prices and Venezuela's own crisis. It is no coincidence that the decline in Venezuelan support occurred at the same time Cuba began to implement new economic policies designed to attract more diverse foreign investment. The port of Mariel is host to a special economic zone modeled after a market economy, and Cuba has been making aggressive efforts to settle old economic and property disputes with European countries in hopes of advancing a more modern and engaged economic relationship.

Most telling, of course, is the rapprochement with the United States. Despite decades of rhetoric damning its northern neighbor, Cuba has recognized that reconciliation with the United States is key for reviving a floundering economy. The country is also permitting the development of a limited private sector, issuing licenses for small businesses such as beauty salons, restaurants, and tourism agencies. Many of these operations receive their seed money from remittances coming in from the United States. Once a staple of rhetoric from Cuban leadership, it is increasingly rare to hear the Castros rail against the US or the evils of capitalism, finding that this does not drum up the kind of fervent support it used to. Instead, citizens are seizing upon newfound access to the internet, embracing the budding private sector which now employs nearly 15% of the workforce, and speaking more openly about their desire for economic reform. The country has a long list of issues to tackle in order to stimulate serious, sustainable economic growth, but there has been more movement on this front in the last decade than the previous four, giving many people reason to hope for further changes.

It is entirely unclear how far back the new Trump administration intends to take US-Cuban relations. Certainly, there will be a clear curtailing of the rapprochement between the two countries. But this does not mean that the new Trump administration will renege on the recently restored diplomatic relations between the two countries or rescind numerous mutually beneficial agreements on tourism and transportation.

Where will Latin American engagement arise in the coming years?

This chapter has argued that issues of political economy – economic growth, improving business climate, and major investments in infrastructure – will be the preoccupation of many of the region's leaders. These matters will overwhelmingly dominate relations with outside actors: political leaders, business groups, private sector investors, and international financial institutions will all have major bearing on the speed, quality, and reach of Latin America's growth.

Yet, as Latin America confronts both domestic and international changes, certain issues will likely arise in the coming years as key issues of engagement with the world. Here is a list of some of the most likely issues of engagement. We have also included some less likely ones; Latin America should aim to surprise.

a. Regional integration and international trade

It is unlikely that there will be any major new free-trade agreements (FTAs) with countries in the hemisphere anytime soon. It is not that trade agreements have been ineffective; indeed, the opposite is true. The network of free-trade agreements in the hemisphere – 58 negotiated and implemented so far – has boosted the total regional share of foreign trade as a percentage of GDP from 31.7% in 1988 to 44.7% in 2010.

But now the more difficult ones remain. The EU - Mercosur discussions will be delayed by intractable problems in specific sectors and because of Europe's inability to come to a common decision. Full-fledged agreements with Brazil or Argentina are difficult to imagine because of the profound agricultural competition these countries pose to US and EU markets.

But there is still a plethora of opportunities for engagement. The objective in the coming years will be to ease market access, particularly for SMEs. Such agreements could move to synchronize labor and health standards as well as customs practices to reduce bureaucracy. By harmonizing and converging these standards across multiple countries – including those with which the US and Europe already have FTAs – countries like Brazil and Argentina could more easily engage in trade and investment with both the United States, the EU, and other nations in the region.

Furthermore, several Latin American countries are looking to increase regional integration and streamline trade and economic policies. The most prevalent example of this is the Pacific Alliance, made up of Mexico, Peru, Chile, and Colombia. These four countries have made strides towards harmonized financial systems, visa programs, and established the Integrated Market of Latin America (MILA), a regional stock exchange designed to promote greater financial integration. Much more remains to be done – yet, this integration effort is admirable and progress continues.

It is no coincidence that these four countries also pursue economic integration outside of the region. All four countries have free trade agreements with the United States, and three out of the four are party to the Trans Pacific Partnership (TPP), with Colombia hoping to join at a later date. The TPP is demonstrative of both Latin America's outward-facing policies, as well as its pivot to Asia.

While the United States and Europe remain the region's closest political, economic and cultural ties, Western nations should be aware of China's determination to become an indispensable economic power in Latin America. For this reason alone, the United States and Europe must lean into trade agreements and existing investments in order to solidify their presence in Latin America.

b. The role of China

In predicting Latin America's global engagement it is important to consider the growing relationship with Asia and in particular, with China. In recent years, China has taken a much more active role as an economic power in Latin America. Investing in infrastructure and making large commodities purchases, China has become a major trading partner for many Latin American countries. In several cases China has also become a "lender of last resort", willing to offer loans and continue investments in countries where unsustainable economic policy has left the country lacking in options. Examples include Venezuela, Ecuador, and Argentina (though this dynamic will change under the Macri administration). China has become the financial go-to when relationships with Europe and the United States have become rocky.

This relationship is likely to increase in intensity for two main reasons. First, the Chinese will certainly exploit the increasingly anti-trade and anti-investment rhetoric emanating from the United States and Europe. China is now poised to expand its role in the hemisphere as regional governments grow concerned about reduced foreign direct investment and commercial flows from Western partners.

Secondly, in October 2016 the Chinese Renminbi (RMB) joined the list of international reserve currencies. This has tremendous potential to grow the economic relationship between China and Latin America. Observers believe that transactions in RMB will facilitate and incentivize a new tier of smaller Chinese companies to begin exploring an interest in Latin America. These new companies would have shied away from complicated transactions with currency exchange, but now will have the ability to pay and be paid in RMB.

While this is certainly an opportunity for all parties to establish a more beneficial, sustainable relationship, Latin American countries need to be strategic about these new investments. The internationalization of the RMB means that a whole rash of Chinese companies previously unable to access international markets will now be viable investors. Growing investments can be positive, but it is also important that Latin American countries do their due-diligence before diving into agreements. Trade with China can sometimes hurt domestic players. While Chinese exports grew to Latin America, Latin America's exports of high-value-added and complex goods diminished. The facts are indisputable: over the time the region's share of industrial exports, along with the diversity of those exports, has declined.

The share of domestic consumption met by imported goods has risen. Its industries – and the training and jobs that accompany them – suffered.

It is vital that the region clearly understands the importance of careful negotiations so that Chinese commerce and investments do not undercut local industry and manufacturing. It is easier for China to maximize its interests in the region through individual, bilateral negotiations with governments that are not in an economic or political position to require concessions from the Chinese. Governments in the region should join forces in order to negotiate trade and investment agreements with the Chinese from a position of greater strength.

c. Political corruption and impunity

Latin Americas are high on the list of peoples in the world who are losing credibility in their governments' capacity to improve the lives of citizens. The "Lava Jato" operation in Brazil along with the impeachment of President Dilma Rousseff and a host of other government officials have fomented public outcry. In Mexico, President Enrique Peña Nieto is suffering record-low favorability as citizens question his leadership during the disappearance of 43 students two years ago, his personal financial dealings, and are skeptical about the operations of some of his cabinet members. Public backlash throughout the region has been loud, furious, and should be seen as progress. Painful as these moments are, the pushback is a sign that citizens are no longer accepting corruption but demanding more transparent, legitimate leadership.

Corruption and impunity will affect Latin America's international relations in a few key ways:

- **Investment risks cut-backs unless Latin America is seen to be dealing with this issue head on.** Mexico is a nation confronting seemingly growing levels of corruption, and it seems to be doing very little to tackle it. Mexicans today have little faith in their government's ability to combat rising violence from drug cartels, and are horrified by the lack of response to crimes like the disappearance of the students two years ago. More mundane judicial action seems out of reach, too, with quotidian procedures like divorces and parking tickets presenting obstacles for citizens trying to work within an opaque and slow system. Unless action is taken, Mexico will be struggling to attract investment in energy, infrastructure, and social programs as potential investors become wary of operating in a corrupt and unpredictable system.

- **On the other hand, positive examples of Latin America's progress against corruption are best-practice examples for international organizations, aide groups and bilateral government negotiations.** Indeed, aide organizations targeting change in Africa or Southeast Asia may prefer using Latin America's successes as a baseline instead of the recent anti-corruption efforts in Sweden or Canada. Brazil's judicial system has gained international recognition throughout the political investigation process by making public everything from the names of politicians to the charges levied to the details of ongoing investigations. This has been driven by a new generation of judges, internal security forces, and politicians unwilling to propagate the impunity of the past. In Chile, campaign finance laws are limiting the role of money in elections.

d. Confronting the tentacles of organized crime and the "new illegals"

Once synonymous only with drug cartels, organized crime now includes a breadth of illegal activity. Latin America and the world will need new instruments to fight money-laundering, human trafficking, illegal mining, and illegal agriculture. The tentacles of these industries stretch into the United States, Africa, and Europe where criminals store their earnings in bank accounts and real estate holdings. While strong internal security and judiciary capacities are obvious tools to help combat these networks, repression alone will not make sufficient strides toward eradicating these growing activities.

Combatting the "new illegals" will require imaginative solutions and a brand new security partnership. The US and the EU should expand information-sharing mechanisms like the Egmont Group of Financial Intelligence Units, which includes most Latin American countries, and promote intelligence-sharing between Latin American governments. Brazil's bilateral border security agreements with Colombia, Paraguay, Peru, and Argentina provide an interesting model. The region will need a broad intelligence-sharing agreement with the United States and other allies. In the Northern Triangle, where Colombia's military already trains soldiers and police, this partnership should be expanded to encompass strategic guidance on investigating and prosecuting organized crime, and tackling gang violence.

e. Security cooperation and peacekeeping

As the rest of the globe becomes more fractured, Latin America's relative peace will become a prized asset. Latin American countries are already trusted partner in enhancing security cooperation in other parts of the world and among themselves. Colombia is already successfully exporting pieces of its security model – to Africa, Central America, and elsewhere. Working with the governments of Kenya, Uganda, and Nigeria, Colombians are sharing experiences about their strong internal security apparatus. Colombian police and military units will soon expand efforts with UN peacekeeping duties. The Brazilian navy works with several West African nations to help combat piracy and maritime poaching. Argentina and the US have recently resumed intelligence-sharing operations.

f. Catastrophes without borders

Integration is not only an economic endeavor: to combat modern threats of natural disasters, violent extremism, climate change, and refugee crises, nations will need to work collaboratively across a number of sectors. Lines of communication and a sense of shared responsibility are clearly faltering in much of the world. The ongoing atrocities in Syria demonstrate a lack of global coordination, while rising tides and increasingly devastating storms show a world unwilling to collectively combat climate change. Latin America has played a leading role in organizations and missions designed to promote coordination and cooperation on issues that do not heed national borders. A primary example of this effort is the Brazilian-led United Nations Stabilization Mission in Haiti (MINUSTAH, as it is known by its French acronym). This mission, initially installed in 2004 to help bring political stability, ultimately managed the disaster relief and reconstruction of Haiti after the earthquake. Latin American cooperation at the United Nations and other international organizations is destined to grow.

g. Elections

The populist movements seizing parts of the world are happening through entirely democratic procedures, with political parties earning votes and leadership positions through legitimate mechanisms. Any shift in power must come through elections that are both legitimate and popularly perceived as legitimate. To have a viable government, it is crucial for citizens to believe that the ballots they cast are those that put their leaders in office.

But in Latin America elections have become a point of pride. Brazil runs its elections entirely electronically, and both Mexico and Brazil have internationally recognized electoral commissions, credited for modernizing systems and running elections deemed transparent and legitimate by international observers. The Organization of American States flounders in many areas, but on election monitoring and support, it excels. Latin Americans will be able to bring their knowledge and consulting services for elections to the world stage in the coming years.

Conclusion

This is an exciting, albeit precarious moment for Latin America. With so many countries in the hemisphere eager to engage, it would seem like an excellent opportunity for allies in Europe and the United States to embrace a newly-opened region of like-minded politicians, businessmen, and civil society. But at present Americans and Europeans are looking inward, leaving Latin Americans wondering if the West will indeed be the future foundation of economic growth. While the cultural and heritage connections with the West remain strong, new alliances with Asia may prove increasingly important in the absence of more engagement from other regions.

As the region seeks to elevate itself to higher incomes, many nations are wisely embracing policies to attract greater investment, cognizant that growth comes from opening, not closing. Latin America's opening offers ample opportunities for economic, political, and social engagement. Hopefully, these countries will find enthusiastic and like-minded partners across the globe.

3. After the Commodity Boom: Towards a New Economic Model?

Antonella Mori

In recent years Latin America's economic growth has been much lower than in the previous decade. This unsatisfactory economic situation is the result of both external and internal factors. Important external factors include the sharp decline in commodity prices and the slowdown of the Chinese economy. Regarding the internal factors the current situation is very heterogeneous, but some large countries are in recession as a result of bad economic policies combined with political and institutional crises. In 2017 internal causes are expected to improve in almost all countries, whilst the negative external factors will continue to persist. In particular, the primary commodity prices, though unlikely to fall more, could remain low for a long time.

How then can Latin America return to grow at high rates in a scenario of lower commodity prices? Can this negative phase stimulate the rethinking of economic models to ensure that the region has more sustainable and inclusive future growth? The new economic model must take into account two other important trends: first, the general slowdown in world trade and secondly, the coming end of the demographic bonus in the region, i.e., of the favorable phase of the demographic transition characterized by the increase in the population of working age. After the election of Mr. Trump as President of the United States, a strong recovery of global trade is even less likely in the short-term.

A transformation of the production model should aim at enabling Latin American countries to specialize both in the production of manufactures with high added value and in the service sector. In the coming decades, economic growth must be more and more driven by increases in labor productivity. Consequently, this new economic model will require greater investments in human capital, technological innovation and infrastructure, as well as other institutional changes to improve the business environment. Furthermore, to compensate for the slowdown in world trade, Latin American countries are strengthening regional trade within the numerous trade liberalization agreements already in place, such as the Pacific Alliance and Mercosur. An extra boost to regional integration could come from smart import substitution policies, i.e. policies that aim to produce quality products for the regional market without imposing new protectionist barriers to imports from the rest of the world.

Weak economic outlook

In recent years, Latin America's economic growth has been much lower than in the previous decade. In 2016 the Latin American and Caribbean economy is estimated to shrink by 0.6%, as some of the large countries are in recession, i.e. Argentina (-1.8%), Brazil (-3.3%) and Venezuela (-10%). However, growth rebound in Argentina and Brazil are expected to result in an economic expansion of 1.6% for the region in 2017[19]. The current growth in output is much lower than the average annual growth rate from the previous decade, which was 3.2% for the whole of Latin America and the Caribbean (LAC). Brazil, the biggest Latin American economy, that produces about 35% of total regional output and is currently in recession, expanded on average by 2.8% yearly between 2006 and 2015. Recent economic performance has been worse than in the previous ten years in all of the seven major countries (Table 1). The big decline in commodity prices, the slowdown of the Chinese economy and the repressed recovery of advanced countries are common factors explaining the drop in economic activity of the region.

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[19] Data in this section are from the International Monetary Fund (IMF), *World Economic Outlook*, October 2016.

Table 1. Output Growth (%)

	Annual 2006-2015	2016*	2017*
Argentina	4.3	- 1.8	2.7
Brazil	2.8	-3.3	0.5
Chile	3.8	1.7	2.0
Colombia	4.6	2.2	2.7
Mexico	2.4	2.1	2.3
Peru	5.9	3.7	4.1
Venezuela	2.1	-10.0	-4.5
LAC	3.2	-0.6	1.6

In addition to the common external factors, some large countries are in recession as a consequence of bad economic policies combined with political and institutional crises. In 2017 internal causes are expected to improve in almost all countries, but negative external factors will still be present.

Beyond the similarities in the region, there are important differences that require a brief analysis of some countries. In Argentina the economic situation remains very difficult because the benefits linked to the economic reforms carried out by President Macri, elected in December 2015, have not yet materialized. Economic changes include the elimination of the fixed exchange rate, the debt default solution, the elimination of subsidies on some utilities, the removal of taxes on exports and capital movement controls, and the reform of the National Institute of Statistics. Inflation and budget deficit, however, still remain high and limit possible macroeconomic policies. The Central Bank has formally announced the adoption of an inflation-targeting regime from 2017 as it seeks to bring inflation down to single-digit levels in the medium term. The return of private investment, both domestic and foreign, should be the trigger to return to positive growth in 2017.

In 2015-2016 Brazil experienced the deepest recession in decades, which perhaps will end in 2017. The recession was aggravated by the political crisis that paralyzed economic policy. Accused of violating the Law of Fiscal Responsibility in 2014, former President Rousseff was impeached and on 31 August 2016 she was removed from office. The corruption investigation linked to Petrobras contributed to the economic crisis by lowering investment. The high budget deficit in recent years (10.4% in 2016) caused a major increase in public debt: the public debt to GDP ratio was 60.4% in 2013 and will be 78.3% at the end of 2016. Next year Brazil is expected to return to positive but low growth, thanks to stronger exports and higher private investment. However investment will materialize only if the new Temer Administration is able to restore stability and confidence.

The economic and social situation in Venezuela is dramatic. After three consecutive years of recession, the economy has contracted by about 20%. The collapse in the oil price has led to a decline in the funds available to the Venezuelan government, which will end up with a budget deficit of more than 25% of GDP in 2016. Moreover, public spending is financed by printing money, leading the country towards hyperinflation. The latest forecasts by the International Monetary Fund (IMF) estimate inflation of over 700% at the end of 2016 and that it will reach more than 2000% in 2017. In order to return to positive growth in a low oil price scenario, Venezuela must implement radical reforms at the macro and microeconomic levels, from exchange rate reform to fiscal system redesign. Since the country is going through a deep institutional crisis and political confrontation between government and opposition, it is unlikely that reforms will be implemented in the short term.

The four countries of the Pacific Alliance (Chile, Colombia, Mexico and Peru) continue to grow, albeit at a lower rate than in the previous decade. After the October referendum in Colombia the prospect of a peace agreement between the government and the Revolutionary Armed Forces of Colombia (FARC) guerrillas remains more uncertain, but if a final agreement is reached, the positive effect on the Colombian economy will be significant.

Commodity prices: boom, bust and new normal

In the past fifteen years commodity prices underwent an exceptional boom followed by a bust. The boom started at the beginning of the XXI century and peaked in 2011. In 2011 the average for all primary commodity prices was twice the 2005 level, whilst at the end of 2015 it went back to the 2005 level[20]. For about 10 years commodity prices remained very high. All Latin American commodity exporters benefitted hugely from the commodity boom: higher terms of trade, higher export earnings, and higher fiscal revenues. Countries increased investment in primary commodity sectors in order to expand production and exports. For example, between 2000 and 2013 the value of Brazilian exports quadrupled (in dollar terms) and they became much more concentrated in primary commodities: in 2000 the shares of primary commodities and manufactured products were respectively about 40 and 60% of total exports, while in 2013 the composition was the opposite, i.e. 60% primary commodities and 40% manufactured products[21]. During the commodity boom, manufacturing industries suffered from lower investment and weak competitiveness due to stronger real exchange rates.

After 2014 primary commodity prices fell and the price of oil collapsed. In 2016 commodity prices recovered partially. Except for the energy price, which in September 2016 was 15% lower than in 2005, other raw materials continue to have higher prices than in 2005: on average, food is about 40% higher, beverages 70% higher and metals 20% higher. There seems to be a wide consensus about the fact that commodity prices will not continue to fall over the coming months, but will remain at the present level for a while (new normal)[22].

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[20] IMF, Indices of Primary Commodity Prices, 2006-2016.

[21] Harvard University, Center for International Development, The Atlas of Economic Complexity.

[22] IMF and A. de la Torre, F. Filippini, and A. Ize, *The Commodity Cycle in Latin America – Mirages and Dilemmas*, LAC Semiannual Report, Washington DC, World

Social achievement must be preserved

Thanks to sustained growth during the last commodity boom and to policy innovation like Brazil's Bolsa Família, Latin American countries have achieved a significant reduction in poverty and income inequality over the past 15 years. The percentage of poor people went progressively down from 44% in 2002 to 28.1 in 2013. However, the decrease in poverty ended with the recent economic crisis and the poverty rate was up by 1% in 2015[23]. The inequality in income distribution is very high: the best-performing Latin American country, Uruguay, has a more unequal income distribution than the worst case in the European Union. Having said this, the inequality in income distribution is now much lower than it was at the beginning of the 2000s in all Latin American countries but Costa Rica. Bolivia and Brazil, which used to be amongst the most unequal countries in the world, with a Gini coefficient of over 0.6 in 2001-2002, experienced a huge decrease in inequality (in 2013-2014 the Gini coefficient was 0.49 in Bolivia and 0.548 in Brazil). The reduction in inequality in Brazil is clearly the result of a combination of general public policies aimed at guaranteeing basic social rights such as education and health care, of good economic growth, and of targeted anti-poverty policies. Bolsa Família, Brazil's flagship conditional cash transfer program, has had a considerable equalizing impact. From 2004 to 2014 the number of beneficiaries rose from 16 million to 56 million, reaching about a quarter of the country's population.

Towards a new economic model

In a future scenario of low primary commodity prices, Latin American countries need to change their economic models and transform their productive structures by increasing their output

Bank, April 2016.

[23] ECLAC, *Social Panorama of Latin America 2015*, Santiago, Chile, March 2016.

of industrial products with more value added and boosting the service sector. This new economic model requires greater investments in education, research, innovation and infrastructure, as well as other institutional changes to improve the business environment. In the coming decades, economic growth must be more and more driven by increases in labor productivity. To compensate for the slowdown in world trade, Latin American countries are looking with more interest to strengthen regional trade within the framework of the numerous trade liberalization agreements. Instead of regressing back to old, unsuccessful import substitution industrialization (ISI) policies, Latin American countries should pursue smart import substitution policies that aim to produce quality products for the regional market without imposing new protectionist barriers on the rest of the world[24].

The demographic bonus will end soon

Latin America is currently enjoying a demographic bonus: that is, a period of time when the proportion of the working-age population is high due to the impact of declining fertility. The proportion of the economically active population, which has been increasing since 1965, will reach its maximum (about 60%) around 2025 and will decrease after that with the impact of population ageing.

This favorable age composition provides opportunities for higher economic growth through various channels. Labor supply increases as the generations of children born during periods of high fertility enter the labor force. At the same time, as fertility declines, women's labor force participation is also likely to increase. Saving is expected to increase too as there are more individuals of working age who are expected to live longer. This can lead to higher investment in physical and human capital. In about 10 years, however, the expected changes in the

[24] A. de la Torre, A. Ize, D. Lederman, F.Bennett, and M. Sasson, *The Big Switch in Latin America - Restoring Growth through Trade* LAC Semiannual Report, World Bank, Washington, DC., October 2016.

population and labor force composition due to the ageing of the population will pose challenges to economic growth. When increases in labor force will stop contributing to economic growth, Latin America will need to invest more in boosting labor productivity.

Higher productivity becomes imperative

Increasing overall GDP when the number of worked hours remains stable requires that each hour produce more output, i.e. requires an increase in labor productivity. Workers become more productive if they are better trained and educated, if they can work with more technologically advanced physical capital, and if their companies operate in a well-functioning, transparent and well-regulated business environment. Hence, a higher future growth rate in Latin America will depend on governments' ability to provide higher quality public education, to strengthen the business climate, to enhance competition in product and labor markets, to improve infrastructure, to promote more efficient financial markets, to enhance research, development and innovation, and to strengthen institutions that secure property rights and stamp out corruption.

Human capital. A population that is well educated and well trained helps a society to increase its capacity to carry out technological innovation, to use relevant knowledge, and to adopt available technology. In analyzing the latest assessment of 15-year old students (PISA – Programme for International Student Assessment) in 65 countries conducted by the Organisation for Economic Cooperation and Development (OECD) in 2012, Latin America was found to have poor results. The eight participating countries (Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru, and Uruguay) ranked near the bottom in all subjects, i.e. mathematics, reading and science.

The World Economic Forum's *Human Capital Report 2016* ranks 130 countries on how well they are developing and deploying their human capital. The Human Capital Index evaluates the levels of education, skills and employment available to people in five distinct age groups, starting from under 15 years to over 65 years. The Index is composed of two themes: learning and employment. The learning theme considers the transition from primary to vocational and tertiary level education, the quality of education, as well as learning in the workplace. The employment theme includes economic participation, mismatch in qualifications, and quality of employment in each country. The 24 Latin American and Caribbean countries ranked scored in the middle range of the Index. In the region the five best-performing countries are Cuba, Chile, Panama, Ecuador and Argentina. At the bottom of the regional list are Venezuela, Honduras, Guatemala, Nicaragua, and Haiti (the worst case).

Latin American and Caribbean countries have to make further progress in improving the quality of human capital. For example, despite being one of the most advanced countries in the region in terms of education, Chile is aware that it should further improve labor productivity and move closer to the average of OECD countries. The 2017 budget calls for a rise of 6.2% in spending on education. More than half of the increase will fund the changes recommended in the Ley de Educación Superior (the higher education reform bill) presented by the government in July 2016 and currently under discussion in congress. The biggest change is an increase in the provision of free university education for poorer students.

Infrastructure. Improvements in physical infrastructure (for example, roads and electricity grids) and in information and communication technology infrastructure have a strong and positive impact on productivity. Many Latin American governments are encouraging infrastructure investment. In Argentina the congress is discussing a new bill on public-private partnerships (PPPs) that is part of plans to boost infrastructure investment. On 13 September the Brazilian government launched a concessions plan for infrastructure projects for 2017-2018, with four important regional airports, roads and railways, oil and gas auctions, electricity distribution lines, and water and sewage systems. The plan should provide clearer rules than in the past. From late 2016 in Chile a new state-owned firm will manage a newly created public-private infrastructure fund, initially capitalized with $US9 bn. The fund is designed to attract private investment of up to US$10 bn over the next five years, to be channeled mainly into road and urban transport. Energy investment will also remain a focus, as Chile suffers from high costs and is vulnerable to energy shortages.

Business Environment. According to the World Bank, which assesses countries each year on the quality and efficiency of the regulations involved in setting up and operating a business, Latin America and the Caribbean still have a lot of room for progress in improving regulation of businesses. In the 2017 ranking[25] only one country in the region, Mexico, had an overall score that places it in the top quartile among the 190 surveyed nations in ease of doing business, and 21 countries are in the bottom half of the ranking, including Argentina, Brazil, and Venezuela. The ranking measures and tracks changes in regulations affecting eleven areas: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency and labor market regulation. The area where the region could improve the most is paying taxes. A local entrepreneur in the region spends 361 hours a year on average to prepare, file, and pay taxes, compared with 177 hours on average in OECD high-income economies.

[25] World Bank, *Doing Business 2017. Equal Opportunity for All,* Washington DC, October 2016.

Corruption is still a huge fact in many Latin American countries. According to Transparency International – an organization that tracks corrupt practices worldwide – the majority of Latin American countries have a serious corruption problem. Overall in the 2015 list, which ranks countries on their perceived levels of public sector corruption, 22 out of 25 Latin American and Caribbean countries scored below 50, on a scale from 0 (highly corrupt) to 100 (non-corrupt). The best-performing countries are Uruguay, Chile and Costa Rica; the worst is Venezuela, which is amongst the 10 worst countries in the world. Corruption is an avoidable cost of doing business and governments should commit to fighting corruption. Indeed, there are very promising signs in the region: recent corruption investigations against powerful figures in some countries, e.g. Brazil, Guatemala and Honduras, and mass mobilizations of citizens against corruption[26].

At the first meeting at a regional level of the OECD Regional Programme for Latin America and the Caribbean, held on 13 October 2016, Alicia Bárcena, Executive Secretary of ECLAC, claimed that productivity remains the "Achilles' heel" of the Latin American economy. The OECD Regional Programme for Latin America and the Caribbean, launched in June 2016, aims to support the region in advancing its reform agenda along three key regional priorities: increasing productivity, advancing social inclusion, and strengthening institutions and governance[27]. The programme involves representatives of OECD, Latin American, and Caribbean countries as well as regional organizations, such as the Economic Commission for Latin America and the Caribbean (ECLAC), the Inter-American Development Bank (IDB), and the Development Bank of Latin America (CAF).

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[26] J.G. Castañeda, "Latin Americans stand up to corruption" *Foreign Affairs*, January-February 2016, pp. 145-152.

[27] OECD, *Promoting Productivity for Inclusive Growth in Latin America*, Better Policies Series, Paris, June 2016.

More specialization in higher added value products and regional integration

The transition to more added-value economies based on manufacturing and services requires not only simplifying the tax code, improving infrastructure and adopting more market-friendly policies, but also increasing trade opportunities. Trade liberalization triggers productivity and increases gains from competitiveness. Latin American countries remain relatively closed compared with advanced and emerging countries in other regions. Global trade integration is important, but the current scenario is unfavorable. Global trade growth has decelerated significantly since 2012. The volume of world trade in goods and services has grown by about 3% a year since 2012, less than half the average rate of increase during the previous thirty years. The reasons behind this slowdown are several: the protracted weakness in global economic demand, particularly investment; the slower pace of trade liberalization and the return of protectionism; a slower reduction in trade costs and a slowdown in the expansion of global value chains[28]. The new Trump administration in the US will contribute to the protectionist rebound. Factors driving the trade slowdown are a combination of cyclical and structural factors, making it difficult to forecast if and when global trade will significantly recover. Thus, Latin American countries should prepare for a new scenario of weak global trade growth.

As a consequence, further integration within Latin America becomes more important. Intraregional trade represents only about a fifth of total trade in Latin America, versus more than a half in Asia. More regional trade integration would allow countries to increase effective market size, stimulate competition, and support the development of regional value chains of intermediary goods. Regional integration would also help economic specialization and the diversification and sophistication of exported products by fostering cross-country technology transfers and a

[28] IMF (2016).

reorganization of production at the regional level. Specialization in turn can increase productivity and growth, while reducing the region's strong dependence on exporting commodities. By fostering cross-border production and regional supply chains, Latin America can become globally competitive and increase its participation in world trade. Indeed, in October 2016 Brazilian President Temer and Argentinian President Macri announced that Mercosur would seek to get closer to the Pacific Alliance, which is likely the most open and market-friendly regional agreement in Latin America. President Maduro does not agree with the convergence between Mercosur and the Pacific Alliance, but this may not be a real obstacle as it is not certain that Venezuela will remain in Mercosur. On 13 September 2016 the four founding members of Mercosur in fact decided to suspend Venezuela from the regional bloc if the country does not meet the Mercosur trade and human rights commitments by 1 December 2016.

If the end of the cycle of high commodity prices has had a short-term negative impact for many Latin American countries, the medium-term effects for the region can be positive. In fact, the end of the commodity boom seems to be leading to a new development model based on the revival of industrialization and regional economic integration. The new economic model must provide the region with sustainable and inclusive future growth in order to continue reducing poverty and improving income distribution.

4. Is Inequality Declining in Latin America?

Alicia Bárcena

Today we face a dizzying process of change – a change of era, in fact. The prevailing global economic and social trends are deepening the contradictions of a development pattern that has become unsustainable. These contradictions are undeniable, as evidenced by the unprecedented increase in global inequality in recent decades[1].

Worldwide, income inequality rose sharply between the early 1980s and the year 2000, and still slightly more thereafter. As a result, in the developed world and in several developing regions, inequality is at its highest level in more than three decades. The Gini coefficient – a measure of inequality which ranges from 0 (perfect equality) to 1 (maximum inequality) – of the member countries of the Organization for Economic Cooperation and Development (OECD) increased from 0.29 in the 1980s to 0.32 in 2013. This trend is found in developed countries that have traditionally recorded higher levels of inequality (such as the United States, whose coefficient rose from 0.34 in 1985 to 0.39 in 2013), in developed countries with a strong egalitarian tradition, such as Denmark and Sweden, as well as in most developing countries.

The last decade and a half in Latin America – where inequality is an historic and structural characteristic of its societies and economies, heavily determined by the productive structure – has been the exception to this trend. Most countries of the region

[1] UN Economic Commission Latin America and Caribbean (ECLAC), *Horizons 2030: Equality at the Centre of Sustainable Development*, Santiago, Chile, United Nations, 2016a, p. 9.

have succeeded in reducing income inequality since the early 2000s, albeit starting from levels that were initially – and still are – some of the highest in the world. It is a very well-known fact that income distribution in Latin America is among the world's most unequal. Although certain methodological details limit the comparability of inequality indicators across countries and regions, this does not change the fact that the region's average Gini index (0.50 around 2010) is higher than any other's: the Gini coefficient averages 0.45 in Sub-Saharan Africa, 0.41 in East Asia and the Pacific, 0.37 in North Africa and the Middle East, 0.34 in South Asia, and 0.33 in Eastern Europe and Central Asia[2].

In this chapter, we aim at analyzing the peculiar traits of the Latin American experience with respect to the reduction of high and persistent inequality over the last decade and a half, presenting alternative measures of income inequality as well as discussing some of the other dimensions of inequality that characterize Latin American societies, contributing to give a fuller picture of the situation.

But first we will briefly discuss how central the issue of inequality is in the work of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) and highlight the renewed interest in inequality that currently exists at the global level.

The equality agenda is becoming a cornerstone of development

Inequality and its different facets, in particular those relating to the distribution of income and wealth, has been identified by the ECLAC since its inception in 1948 as a key stumbling block

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[2] A. Bárcena, *A complex international context and the 2030 Agenda The Latin American and Caribbean perspective*, April 2016, www.cepal.org/sites/default/files/presentation/files/a_complex_international_context_4_april_.pdf (last retrieved on 10 January 2017).

to the development of Latin American countries[3]. Several problems are associated with high inequality: the most unequal countries tend to have worse economic performance, greater political instability and more restrictions on the exercise of citizenship. Greater inequality also makes it more difficult to reduce poverty, with the result that efforts in this regard are even more dependent on economic growth[4].

Today ECLAC is reaffirming that equality is a fundamental value for the development of the region's societies, and this vision has gained strength in a world which is not finding a clear direction in the global management of the economic, social and environmental problems that affect us all. Even though it is difficult to permeate much of the international political arena, the common concern about the scale of the challenges we are facing to ensure economic growth, social inclusion and environmental sustainability invites us to rethink development and place equality at its centre. From ECLAC we have contributed seminally to this debate over the last few years, especially through four key documents, presented respectively at the Commission's sessions in Brazil, El Salvador, Peru and Mexico: "Time for Equality: Closing Gaps, Opening Trails" (2010), "Structural Change for Equality: An Integrated Approach to Development" (2012), "Compacts for Equality: Towards a Sustainable Future" (2014), and "Horizons 2030: Equality at the Centre of Sustainable Development" (2016)[5]. In these documents we define equality as the development horizon, structural change as the path, and policy as the instrument.

Globally, the need to prioritize concern about equality has gained ground in the public and intellectual debate, especially since the international financial crisis of 2008 and 2009. Rising inequality contributed to that crisis, initially in the United States

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[3] A. Bárcena, A. Prado, *El imperativo de la igualdad: Por un desarrollo sostenible en América Latina y el Caribe*, Buenos Aires, Argentina, Siglo Veintiuno Editores, 2016, p. 8.

[4] ECLAC (2016a), pp. 19-20.

[5] A. Bárcena, A. Prado (2016), pp. 7-8.

and later worldwide. As the wage share of income fell, families resorted to borrowing, mostly to purchase homes. Meanwhile, sectors that had benefited from the concentration of wealth used their income to invest in financial assets rather than in consumption or production investment. Rising household indebtedness, together with increased leverage, the multiplication of financial assets and an irrational exuberance, led to the collapse of vast numbers of securities built on very fragile grounds.

We can thus argue that inequality, for many years considered to be an uncomfortable and even inappropriate topic by some economists, is now at the forefront of the international debate. Various multilateral organizations, as well as academia and political and civil society actors have contributed to the revitalization of the equality agenda. Piketty's 2013 book, *Capital in the Twenty-First Century*[6], was important in drawing the public's attention to this subject, and its great impact reflected concerns from across society regarding the marked concentration of income and wealth[7].

Even more importantly, the broad and ambitious United Nations 2030 Agenda for Sustainable Development, which reflects consensus on the need to move towards more egalitarian, cohesive and solidarity-based societies, includes one goal on inequality among its 17 internationally-agreed Sustainable Development Goals (SDGs): SDG 10, "Reduce inequality within and among countries". Furthermore, Agenda 2030 calls for "no one to be left behind" on the road to development. In resolution 70/1, adopted by the General Assembly in September 2015, "Transforming our world: the 2030 Agenda for Sustainable Development", the Member States of the United Nations expressed their "wish to see the Goals and targets met for all nations and peoples and for all segments of society", and pledged to "endeavour to reach the furthest behind first".

This universal, comprehensive agenda has rights-based equality

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[6] T. Piketty, *Capital in the Twenty-First Century*, Paris, Éditions du Seuil, 2013.

[7] ECLAC (2016a), p. 19.

at its core and seeks equality not only of opportunities, but of outcomes too, which is crucial for Latin America.

Latin America has the highest income inequality in the world, but it has declined over the last decade and a half

The most common way of describing and analysing inequality is by considering disparities in income distribution within the population. In the yearly editions of ECLAC's "Social Panorama of Latin America", a series of income inequality indicators is provided. According to these indicators, during the 1990s and up until the early 2000s, inequality in the region was characterized either by marked downward rigidity or a slight upward trend.

The years 2002 and 2003 were a turning point when inequality began to trend downward in a large group of countries, whether measured by the income shares of the groups at the bottom and top of the distribution or by synthetic indicators of income inequality. Although the decline in inequality has been small, and has not been enough to change Latin America's status as the world's most unequal region, it is nonetheless positive, especially in the wake of a prolonged period when general distributional improvements were lacking. If we consider the cumulative changes between 2002 and 2010, 11 countries presented distributional improvements within their inequality levels, irrespective of the indicator used to measure them: Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Mexico, Panama, Peru, Uruguay and the Bolivarian Republic of Venezuela[8]. If we consider changes in the Gini coefficient alone, between 2002 and 2014, inequality decreased in 15 of 16 Latin American countries analyzed, which contributed to lowering the regional Gini coefficient from 0.547 in 2002 to 0.491 in 2014 (a 10.2% decrease,

[8] ECLAC, *Social Panorama of Latin America 2011*, Santiago, Chile, United Nations, 2012, pp. 49-52.

corresponding to an annual average decrease of 0.9%). The greatest reductions occurred in Argentina, the Bolivarian Republic of Venezuela, El Salvador, Paraguay and the Plurinational State of Bolivia, with rates declining by more than 4% a year. Over that period of time, the Gini coefficient increased only in Costa Rica[9].

Inequality continued to decline during the 2010s. Between 2010 and 2014 there were statistically significant changes in the Gini coefficient in 9 of 16 countries. As a result, the regional Gini coefficient, which stood at 0.507 in 2010, dropped to 0.491 in 2014, which implies a cumulative fall of 3.2%, equivalent to 0.8% a year. Between 2013 and 2014 the average Gini coefficient fell from 0.497 to 0.491, a 1.2% decrease.

Between 2010 and 2014 not only the Gini coefficient, but also the Theil and the Atkinson indices – which are more sensitive than the Gini coefficient to progressive transfers of income – dropped simultaneously in 11 countries and increased in two (Costa Rica and the Bolivarian Republic of Venezuela). Only in three countries did the indicators move in different directions. Furthermore, between 2010 and 2014 the ratio between per capita incomes of the lowest-income 40% of households (deciles 1 to 4) and the highest-income 10% (decile 10) fell in 13 of 17 countries analysed over the period, with the average regional ratio dropping by 10.6%, from 15.6 to 14.0.

Despite recent progress, this means that as of 2014 for every 100 monetary units of income received on average by the poorest 40% of the population, the richest 10% received an average of 1,400. As with other indicators, there is great heterogeneity, with the ratio ranging in 2014 from a low of 6.6 in Uruguay to a high of 21.4 in Honduras[10].

High objective inequality in Latin America is coupled with high levels of perceived unfairness. In 2011 79% of the region's population felt that income distribution in the country in

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[9] ECLAC (2016a), p. 120.

[10] ECLAC, *Social Panorama of Latin America 2015*, Santiago, Chile, United Nations, 2016b, pp. 23-25.

question was very unfair or unfair[11]. However, trends in subjective indicators of inequality have also experienced a downward trend over the last decade: the share of the population believing that distribution was very unfair or unfair in 2011 was 8 percentage points lower than in 2002. Perceptions improved in particular between 2002 and 2007, when Latin American countries recorded strong economic growth.

With respect to country data on perceptions, in 2011 Chile fared the worst, with 94% of the population feeling that income distribution was very unfair or unfair. After Chile, the Dominican Republic, Colombia and Honduras had the highest shares of the population feeling that income distribution was unfair or very unfair. The opposite was the case in Ecuador, where 56% of those polled said that income distribution was very unfair or unfair, followed by Panama, the Bolivarian Republic of Venezuela and Uruguay. Between 2002 and 2011 the countries that posted the largest drop in the percentage of the population feeling that income distribution was very unfair or unfair were Ecuador, Panama and Uruguay[12].

Factors behind the decline of income inequality

The decline in inequality in the region over a number of years is unprecedented in recent decades and represents a call to explore the factors underlying this trend. Studies that have addressed the issue, using different methodologies, tend to agree on at least two aspects. One is that the most important driver of the decline in inequality has been the labour market, essentially through more equitable distribution of earnings per person employed. Explanatory factors mentioned to account for this include the progressive improvement in the distribution of education and the reduction in pay gaps between more and less skilled workers, often sustained

[11] Latinobarómetro database, www.latinobarometro.org/lat.jsp (last retrieved on 10 January 2017).

[12] ECLAC (2012), pp. 87-91.

by minimum wage policy. The second aspect highlighted is that public cash transfers have been a source of income that has helped to reduce the concentration of per capita income distribution[13].

Beyond general patterns, national experiences are dissimilar and various factors may have contributed to the lessening of inequality. In Argentina between 2002 and 2010 the improvement in non-work income distribution was due almost exclusively to an extension of the coverage and increase in the amount of non-contributory retirement benefits. In Brazil, most of the change has come from monetary transfers to households as part of the *Bolsa Família* programme, as well as from minimum wage policies. In Chile, the distributive improvement has come both from retirement benefits and pensions and from government subsidies. In Ecuador, the whole of the distributional improvement has come from the Human Development Grant, a conditional cash transfer programme for poverty reduction, while in Panama it has come from retirement benefits and public subsidies[14]. In the Central American economies, sources of non-labour income, including remittances, have had a positive effect on poverty and, to a lesser extent, on inequality. It is in the Dominican Republic, El Salvador, Nicaragua, as well as in the Plurinational State of Bolivia, where remittances have produced a reduction in income inequality[15].

Alternative measures of inequality: absolute inequality, top incomes and functional inequality

Inequality is usually described and analysed by measuring the relative income distribution of the population, which refers to proportional differences in incomes, measured in household surveys. However, alternative measures, such as absolute measures of income inequality, measures considering top incomes thanks

[13] ECLAC (2012), p. 53.

[14] ECLAC (2012), pp. 53-57.

[15] ECLAC (2016a), p. 121.

to the use of tax records or measures comparing the share of wages and capital, give us a more nuanced view of the progress made in Latin America in reducing inequality.

Absolute inequality refers to income gaps in absolute terms, while relative inequality refers to the ratio between households' incomes and the average income in the economy. Using relative measures, if all incomes increased in the same proportion, inequality would not change. The Gini coefficients to which we have referred so far in this chapter are a relative measure of inequality. Absolute inequality, however, will remain unchanged only if households' incomes vary by the same amount (not in the same proportion), which is an extremely demanding condition. If individuals who accumulate greater wealth experience larger upward changes in their incomes, absolute inequality will increase. Clearly, inequality is much more likely to increase when absolute inequality is the yardstick. Neither of the two approaches can be said to be right or better; both have their uses and the choice is ultimately a value judgement[16].

The results on the decline in inequality in Latin America begin to look less auspicious when income inequality is analysed in absolute terms, for instance by looking at the variation of income by percentile in purchasing power parity (PPP) dollars at 2011 prices rather than calculating the percentage change in income. Between 2002 and 2014 the traditional method applied to the household surveys of 16 Latin American countries shows the percentage change in income as positive in all percentiles, with the lower percentiles showing larger rises. However, when analysis is conducted in absolute terms, we find that the changes in income increase with income distribution: the higher percentiles of the Latin American population saw a significantly greater increase than the lower percentiles. This indicates that the wealthiest percentiles of the population reaped larger income gains in absolute terms than the poorest percentiles, even though these variations

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[16] ECLAC, *Compacts for Equality: Towards a Sustainable Future*, Santiago, Chile, United Nations, 2014, p. 75.

represent a higher percentage of the poorest group's income than of the richest group's[17].

In recent years, attention has also been drawn to the failure of household surveys to adequately capture the income of the upper end of the distribution, i.e. the richest groups, with the implication that the estimates derived from them are systematically underestimating inequality. The difficulties surveys face in capturing very high incomes may be due to several factors. One is truncation, whereby the richest households are not included in the sample (either because they refuse to participate or because of sample design problems). Another factor is underdeclaration: people may make mistakes when reporting their income (for the wealthiest individuals, this is made more difficult because their incomes usually come from a wide range of assets, with flows that are difficult to quantify), or they may underdeclare them intentionally. The way in which extreme values are processed may also have an effect: sometimes, these figures are removed or top-coded.

To overcome these limitations, an alternative that has been gaining ground in recent years, boosted by Atkinson's and Piketty's research[18], is to include other data sources in the analysis, particularly information on income and wealth taken from tax records.

In Latin America inequality measurements based on tax data (or other secondary sources, such as national accounts) are still few and far between, but have become more common in recent years. Comparing the income capture of the richest – by combining information from various data sources – confirms the high levels of inequality prevailing in region. Studies have been carried out in Argentina, Brazil, Chile, Colombia, Mexico and Uruguay. Colombia is the country where the richest 1% has the largest share of total income: as of 2010, this segment captured 20.5% of total income in the country.

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[17] ECLAC (2016a), p. 124.

[18] A.B. Atkinson, T. Piketty, *Top Incomes: A Global Perspective*, Oxford, Oxford University Press, 2010.

Tax data can be employed alongside surveys to produce corrected estimates of the Gini coefficient. When the tax data for the richest 1% are combined with the income captured by surveys for the remaining 99%, the corrected Gini coefficient for Colombia and Uruguay comes out between 2 and 4 percentage points higher than was estimated on the basis of surveys alone. In Chile the inclusion of capital gains increases the corrected coefficient for 2010 from 0.58 to 0.62. If undistributed profits are taken instead of capital income, the Gini coefficient reaches 0.67. All these values are far higher than the 0.55 estimated for 2006-2010 on the basis of the National Socioeconomic Survey (CASEN) alone. In Brazil the corrected coefficient held steady between 2006 and 2012 (values of around 0.7 in all years), in contrast with the findings obtained from household surveys alone, which show a drop in income concentration in the same period.

However, it must be noted that measurements of inequality that use tax data are not without their limitations. Most notably, they: (i) only capture what happens to high-income brackets and ignore what happens to the rest of the distribution; (ii) consider pre-tax income, which means that they take no account of income adjustments resulting from fiscal policy; (iii) are based on concepts of income and tax units that differ between countries, which raises comparability issues; (iv) are very sensitive to changes in tax legislation; and (v) can produce biased estimates of inequality because of weak tax systems and the pervasiveness of the informal economy in the region. The latter is perhaps the most serious criticism, as the very high rates of tax evasion (especially in the case of income taxes) and the existence of a significant mass of untaxed income in Latin American countries may reduce the quality of the estimates[19].

Lastly, alternative distribution indicators, such as the wage bill as a percentage of GDP, show the imbalance between capital and labour and further reveal less favourable facets of the regional distribution situation. Besides the dynamic of income distribution

[19] ECLAC (2016b), pp. 25-28.

among individuals and households, it is very important to consider distribution among agents in the production process, i.e. the way the fruits of growth are appropriated by different agents in society. The functional approach to income distribution analysis measures the share of labour income in the total income (or GDP) generated in the economy. Measuring the earnings of wage workers with information included in System of National Accounts (SNA) data, we find that around 2009 the total wage share ranged from 24% in Peru to 56.7% in Costa Rica. The evolution of this share between 2002 and 2009 indicates a decline in most of the countries, the exceptions being Argentina, Brazil and Costa Rica. Thus, while income inequality began to fall from 2002-2003 onwards, this was not matched by a larger share for wages in total GDP.

This means that distributive improvements at the household level have not, broadly speaking, been reflected in a more egalitarian share-out between capital and labour. However, measuring the wage share on the basis of SNA data leaves out self-employment, which encompasses own-account workers and employers and accounts for a huge proportion of employment in the region (almost 32% on average in the countries considered). To deal with this limitation in the data, ECLAC carried out an estimation using information from household surveys, in order to gauge the ratio between total wage earnings and total self-employment earnings and use this to correct the wage share of GDP. This adjustment produces a significant increase in the wage share compared with the SNA data. The share of earnings ranges from 31% of GDP in Peru to 65% in Costa Rica. Taking the average for all the countries covered, the earnings share is 10 points higher than if wages alone are considered[20].

[20] ECLAC (2014), pp. 72-75.

Trends in other dimensions of inequality[21]

Differences in average incomes between the groups at either end of income distribution extend into other areas that are key to proactive participation in society. Here we will describe and compare in particular the situation of the different income groups and the trends over time with regard to the levels of educational attainment in secondary and post-secondary education, access to basic services (water, sanitation and electricity) and quality of housing, as well as access to new information and communication technologies.

Measures that increase educational levels, particularly among the most vulnerable groups, are essential for greater equality. In Latin America, educational attainment gaps between income quintiles have narrowed over the last decade and a half, a situation which is at least partly the result of efforts by the region's countries to expand educational coverage, first at the primary level and then at the secondary level. In 2013 92% of the population aged 15 to 19 had completed primary education, while the proportion of young people of secondary school-leaving age who had completed the secondary level rose from 37% in 1997 to 58% in 2013. Nonetheless, the gaps are still quite substantial and there is also a great deal of variation between countries as regards both the size of the gaps and their evolution over time.

The gap between the secondary education completion rates of the top and bottom quintiles of the income distribution narrowed between 1997 and 2013: whereas in 1997 the secondary education completion rate in the lowest-income quintile was 22% of that of the highest-income quintile, by 2013 it was 42%. With regard to post-secondary education, the percentage of people who had studied at this level, whether they had completed their courses or not, between 1997 and 2013 reveals an increase in the percentage of people entering tertiary education across all quintiles.

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[21] ECLAC (2016b), pp. 28-44.

However, regional aggregates mask deep heterogeneity between countries. In 2013 Chile had the smallest gap in secondary school completion rates between the top and bottom quintiles, with the poorest quintile's rate being 79% of the richest quintile's, followed by the Bolivarian Republic of Venezuela and Argentina, with figures of 65% and 61%, respectively. The countries with the biggest gaps between the top and bottom quintiles were Honduras and Guatemala. In Honduras the poorest quintile's secondary school completion rate was barely 12.7% of that of the richest, and in Guatemala the figure was only 4.7%.

Socioeconomic gaps in access to basic services have also narrowed over time, although lower-income households in the rural areas of some countries still experience significant levels of deprivation. The population with inadequate access to basic services (water, sanitation and electricity) in Latin America declined from 22% to 14% between 2002 and 2013. The greatest reductions were in the lower-income quintiles: in quintile I, for example, the incidence of inadequate access to basic services decreased from 43% in 2002 to 28% in 2013, while in quintile II it decreased from 32% in 2002 to 19% in 2013. However, socioeconomic disparities remained, since around 2013 the rate of inadequate access to basic services was 4.5 times higher in the poorest quintile than in the richest.

Typically, rural populations have been most affected by deprivations in access to basic services. This was still the situation around 2013, given that approximately 4 in every 10 rural residents in the poorest income quintile had inadequate access to basic services. However, an improvement took place between 2002 and 2013 and was greatest, measured in absolute terms, in the lowest-income brackets. In the three lowest-income quintiles in rural areas, inadequate access to basic services decreased by between 18 and 20 percentage points between 2002 and 2013.

With regard to housing, the incidence of deprivation with respect to building materials fell in absolute terms between 2005 and 2013, particularly in the lowest-income brackets. The percentage of the population living in houses built using substandard materials decreased in the four lowest-income deciles by between 6.0 and 6.9 percentage points, while in the other deciles the decreases ranged from 5.5 to 0.6 percentage points. In the latest year with data available, the number of people living in housing built with substandard materials was much greater in rural areas than urban ones, with the highest levels of deprivation being found among the lowest-income quintiles in rural areas. In turn, the largest decreases, measured in absolute terms, were in the lowest-income quintiles in rural areas.

Finally, an important finding is that the access of lower-income households to new technologies has improved, especially with respect to mobile phone ownership, which has helped to reduce the connectivity problems of lower-income populations and those living in rural areas.

Around 2013 the proportion of people living in households with a computer and the proportion with access to the Internet were substantially higher in higher-income quintiles. Although both increased in all income quintiles between 2008 and 2013, those increases, measured in absolute terms, were more modest in the poorest quintile. The gap in home computer access between the richest and poorest quintiles decreased in 3 of the 12 countries for which data were available around 2008 and 2013: Uruguay (-37 percentage points), Chile (-14 percentage points) and Brazil (-5 percentage points). The gaps widened the most in El Salvador, Honduras, Mexico and Paraguay; in these countries, absolute differences between the richest and poorest quintiles grew by over 15 percentage points.

A similar heterogeneity can be seen when the evolution of home Internet connections in quintile I households between 2008 and 2013 is analysed. Countries with increases of 20 percentage points or more were Chile, Uruguay and Costa Rica, while in El Salvador, Guatemala and Honduras the change over the period was less than 1 percentage point. Although home Internet access increased in the poorest quintile in all countries with data available for 2008-2013, the absolute gap between the highest and lowest quintiles grew by over 15 percentage points in 10 countries, as growth was much stronger in the highest-income segment. The largest increases (22 percentage points or more) in the gap between the highest and lowest quintiles were in Paraguay, Peru, Honduras, Colombia and Guatemala. Chile was the only country where the home Internet access gap between the highest and lowest quintiles narrowed (10 percentage points).

A different picture emerges when mobile phones are examined, as in this case there was a substantial increase of access in the lowest-income group. Taking a simple average of 14 countries, the share of people living in households where at least one person had a mobile phone increased from 67% in 2008 to 86% in 2013. The poorest quintile saw the greatest absolute increase (28 percentage points) and the richest quintile the smallest (10 percentage points). The strong expansion of mobile telephony in the poorest segment has been partly due to its relatively low cost, while growth has been much more limited in the richest quintile because access to mobile telephony in this income bracket was already quite high in 2008. This led to a significant reduction in the average difference between the highest and lowest quintiles: whereas in 2008 the absolute difference between the two groups was 32 percentage points, by 2013 it had dropped to 15 percentage points.

As with other technologies, the percentage of the population with access to mobile phones was higher in urban areas than in rural ones in 2013, but differences by area of residence were much less than in the case of home computers and Internet access. Mobile phone access tended to increase more among rural populations than the urban between 2008 and 2013. Combined with the fact that the rise in mobile phone access was greater in lower-income groups, this meant that the highest absolute growth in home access to mobile phones was in lower-income quintiles in rural areas.

Concluding remarks: policies for equality

Improvements in income distribution in the region's countries, supported by better distributed labour earnings and a more active role being played by the state in public transfer policies, is undoubtedly good news. However, figures from alternative measures as well as indicators covering areas other than income, such as education, basic services, housing and new technologies, suggests that the glass is half full and half empty in the region. Causes for concern arise in particular from the information gleaned from the absolute distribution and functional estimates of inequality. Absolute inequality is not falling but rising in many countries, and there has been no widespread increase in the GDP share of earnings. This is worrying because the way the fruits of growth and rising productivity are appropriated by the different production agents needs to change if progress is to be made with this structural component of distribution[22].

Although there is no silver bullet in the fight against inequality, tax reform is a good place to start to make a big difference, as additional revenues are key for public investment to reduce some of the region's historical gaps. Poorly designed tax systems, tax evasion and tax avoidance are costing Latin America billions of dollars in unpaid tax revenues – revenues which could and should be invested in tackling poverty and inequality. From 2002 to 2015 the fortunes of Latin America's billionaires grew by an average of 21% per year – an increase that Oxfam estimates is six times greater than the growth of the whole region's GDP. Much of this wealth is held in offshore tax havens, which means that a sizeable portion of the benefits of Latin America's growth are being captured by a small number of very wealthy individuals, at the expense of the poor and the middle class. ECLAC also estimates that in 2014 evasion and avoidance of personal and corporate income tax cost Latin America more than US$ 190 bn, or 4% of GDP. With the critical loss of revenues from commodities and many countries'

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[22] ECLAC (2014), pp. 79.

economies now stagnating, the people of Latin America simply cannot afford for such a large proportion of the continent's income and wealth to go untaxed. Ensuring that everyone pays their fair share of taxes according to their means is absolutely essential if we are to finance sustainable and inclusive growth[23].

The region's tax systems and public social spending are less effective than those in the developed world at improving the distribution of disposable income. In Latin America the Gini coefficient falls only 3 percentage points as a result of direct fiscal action, whereas the public provision of education and health services would reduce it by an additional 6 percentage points. In comparison, in the OECD economies, the joint redistributive effect of monetary transfers and personal income tax reaches average rates of around 17 percentage points in the Gini coefficient, while redistribution through public spending accounts for 7 percentage points.

Moving towards greater equality thus requires recovering an active role for the state in regulation, supervision and redistribution, through active public policies in numerous domains. These include social protection systems to provide a guarantee of a basic income; policies for decent work and production and labour inclusion, especially those targeting poor and vulnerable groups, women, youth and indigenous and Afro-descendent people; and policies for educational inclusion and the development and strengthening of integrated care systems[24]. As inequality is also affected by gender and racial and ethnic factors, which cross-cut and cross-fertilize each other, understanding those determining factors and their dimensions and interrelations is essential in developing policies for making progress towards equality[25].

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[23] A. Bárcena, W. Byanyima, *Latin America is the world's most unequal region. Here's how to fix it*, January 2016, www.cepal.org/en/articles/2016-latin-america-worlds-most-unequal-region-heres-how-fix-it (last retrieved on 10 January 2017).

[24] ECLAC, *The social inequality matrix in Latin America*, Santiago, Chile, United Nations, 2016c, p. 77.

[25] ECLAC, *Inclusive Social Development. The Next Generation of Policies for Overcoming Poverty and Reducing Inequality in Latin America and the Caribbean*, Santiago, Chile,

Looking back at the first decade and a half of the twenty-first century, the region has clearly understood that systematic exclusion undermines the social fabric and democracy and that, therefore, the culture of privilege and social injustice must be left behind, and a culture of equality built in its place.

Those people whose social rights have been violated for centuries and who have been rendered invisible by exclusion and segregated by a system that favours a privileged few are now demanding equality and dignity. Moving towards a culture of equality requires, on the one hand, the abolition of privilege and the firm establishment of equal rights for all individuals, irrespective of their national origin, social class, sex, race, ethnicity, age, territory, religion, sexual orientation or gender identity, in accordance with the Universal Declaration of Human Rights of the United Nations and the successive covenants signed by the international community. On the other hand, resources in society must be distributed in such a way as to allow all its members to exercise their rights effectively. Equality refers to rights, social justice and a socioeconomic and political structure that promotes this. Equality also means combating the cultural reproduction of multiple mechanisms that allow and encourage discriminatory treatment and that perpetuate inequality. The gender perspective, for example, highlights discriminatory sociocultural patterns, the sexual division of labour and the accumulation of power by men throughout history, and underscores the need to reverse inequality by means of differential affirmative action. Clearly, affirmative action should not be limited to gender, but must also address other dimensions of inequality and discrimination, such as race and ethnicity, age, sexual orientation, nationality and disability. Moving towards a culture of equality will not be viable or sustainable if efforts are not made within communities, schools, the media, legislation and policy design to highlight equality and solidarity as the guiding principles behind well-being, development and quality of life. The principle of real or substantive equality must be posited in the

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United Nations, 2015, p. 20.

different spheres of social life and the principles of universality and solidarity recognized as the compass of public policy and social relations. By entrenching and legitimizing the status quo, the culture of privilege helps to reproduce inequalities, thereby making it impossible to achieve high, sustained rates of economic growth. A culture of equality will help to reverse this situation in the region[26].

[26] ECLAC (2016c), p. 83.

5. Oil and Commodities: The End of the "Age of Abundance"

Lisa Viscidi, Rebecca O'Connor

Sweeping changes in energy policy are on the horizon for Latin America's oil-producing countries. Across the region, the sustained decline in global oil prices has had a profound impact on economic growth, political stability and the viability of resource nationalism – when governments assert more control over the nation's natural resources. During the "commodities supercycle" of the last decade, many Latin American governments used the record oil windfall to institute energy policies that gave their state oil companies a larger role in the industry and to redistribute more oil wealth to citizens.

But two converging and intertwined trends now developing in the region promise to chip away at oil nationalism and introduce more market-friendly policies. On one hand, the drop in the prices of oil and other commodities is contributing to an economic downturn in oil-dependent countries that is weakening incumbent politicians – many of whom are in leftist governments that favor more state control over the oil industry. The US benchmark crude oil price WTI (West Texas Intermediate) dropped from an average of US$95 in 2011 to US$52 in 2015 due to slowing demand growth, especially from China, and oversupply, mainly as a result of the US shale boom. Most oil market analysts don't expect prices to surpass US$70/barrel before 2020. Other commodities, including minerals, metals, and agricultural products have also seen sharp declines in the last few years. In response to the downturn, governments have been forced to increase their debt, raise taxes on non-commodity sectors to replace revenue and to cut spending, including popular social programs that have lifted millions out of poverty across the region.

As more market-friendly opposition leaders gain power and the political clout to fight the initiatives of weaker presidents, they are pushing to reverse resource nationalist policies.

On the other hand, the collapse of global oil prices since mid-2014 and forecasts for prices to remain low in the short to medium term have forced international oil companies to cut budgets and scrutinize investments more carefully. Moreover, in Latin America, most major oil producers were already facing production declines. The majority of countries in the region did not take advantage of the boom to increase oil production and investment. This means that governments must offer increasingly favorable terms to attract investment, eroding the power that producing governments enjoyed when oil prices were high.

In other words, the political climate is shifting in support of more market-oriented economic policies as the state-led model is delivering fewer gains in living conditions, while at the same time the economic case for adjusting terms to boost investment in the oil sector is strengthening. This is not the first time the region has gone through such shifts in energy policy. Resource nationalism was first championed in the 1950s and 1960s by Latin Americans such as Juan Pablo Pérez Alfonzo, the Venezuelan Oil Minister who helped found OPEC (Organization of the Petroleum Exporting Countries), and Brazilian President Getúlio Vargas who created state oil company Petrobras in 1953 with the slogan "*O petróleo e nosso*" – "the oil is ours". In the 1990s Latin America witnessed a trend toward privatization amid historically low prices as shares in Petrobras were floated on the São Paulo and New York stock exchanges and Argentina's state oil company YPF was privatized. At the start of the millennium, the pendulum swung back toward state control and a more limited role for private companies.

But now several countries in the region that had increased state control over the oil sector, like Brazil and Argentina, are undoing those policies in order to draw private sector investment. Other countries that had already introduced market-friendly policies before oil prices collapsed, such as Colombia and Mexico, are further adjusting terms to attract capital. In the future, if oil prices remain low, even the resolute nationalists, such as Venezuela and Ecuador, will likely have to introduce reforms. These shifts also mean that National oil companies (NOCs), which have served as an important economic engine, supplied funds for a vast range of social benefits and been a source of national pride, are likely to play a smaller role in their respective domestic markets. Several Latin American NOCs are facing declining oil production and reserves as well as deteriorating finances, with lower profits, higher debts and declines in stock prices.

It remains to be seen whether these unmistakable signs of more investment-friendly oil policy will persist and whether they will actually boost investment. Many Latin American leaders and citizens still back the idea of heavy state control over the oil industry, and a return to 1990s era privatization is clearly not in the cards. Overall, the region will likely see a small increase in investment that would not have come without the recent policy changes. Even so, over the next few years production is projected to decline – or at best remain flat – in the region's major oil producing countries. This is following a decade of decline in Latin American oil supply. Between 2003 and 2013 the region's total oil production decreased by 3% while consumption grew by almost 30%. Refining throughput is further behind; meaning even net oil exporters are importing increasing volumes of refined oil products. Current investment in oil exploration is also being curtailed, so future production will be lower. As sustained low crude prices take their toll on Latin America's oil-dependent economies, governments will be under pressure to find new solutions to sustain production or diversify their exports.

Brazil

Buoyed by the promise of huge returns from the commodities boom and growing demand from China, Brazil's government massively increased public spending over the last 15 years.

Federal expenditures grew from 14% to 20% of GDP between 2000 and 2015[1]. Some of this spending helped finance needed health and education programs, but large amounts were lost to inefficiency and corruption, and just 2% of GDP was allotted for public investment in critical areas such as infrastructure[2]. In 2011 growth began to slow as exports to China fell and the commodities downturn intensified and in 2015 Brazil suffered its largest budget deficit on record – US$151 bn, or 10.34% of GDP[3]. According to Moody's, the country's economy will contract by 3.5% in 2016, contributing to rising unemployment[4].

President Dilma Rousseff narrowly won re-election in 2014, campaigning on a promise to keep stimulus spending measures in place. But upon taking office, Rousseff failed to rally congressional approval to raise taxes. With the country facing a possible credit rating downgrade, she turned to austerity measures in an effort to reduce debt. While Brazil's economy continued to languish, many members of Rousseff's Workers' Party (PT) were implicated in a massive bribery scandal involving Petrobras. Rousseff was never directly connected to the scandal, but amid plummeting popularity, she was removed from office in August 2016 on charges of manipulating the country's budget to mask the depths of the economic deficit, and replaced by her Vice-President Michel Temer.

Revelations of the Petrobras corruption scheme were a heavy blow to the state company, which is Brazil's largest corporation. The scandal led to the CEO's resignation, landed several of its top executives in jail and resulted in the blacklisting of many of its top suppliers. At the same time, Petrobras was weighed down by huge debts, a steep currency devaluation and operational

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[1] G. Ip, "Brazil's Boom-Era Missteps Now Haunt Economy", *The Wall Street Journal*, 23 March 2016.

[2] *Ibid.*

[3] M.S. Lima, "Brazilian Budget Gap Hits Record as Commodity Boom Turns to Bust", *Bloomberg*, 29 January 2016.

[4] L. Magalhaes, "Brazil's Economy Probably Starting to Rebound, Moody's Says", *The Wall Street Journal*, 27 September 2016.

challenges. Petrobras held about US$126 bn in obligations, making it the most indebted oil producer and one of the most indebted non-financial companies in the world. The devaluation of Brazil's currency, the *real,* has also hit the company hard, as 80% of its debts are dollar-denominated but most of its sales are on the domestic market in the local currency, meaning Petrobras now earns fewer dollars for its sales in Brazil. The company has also struggled to manage its many complex deep-water projects, and faced delays in launching production platforms and acquiring environmental licenses. Oil production has been rising, but much less than projected. Petrobras' domestic oil production has increased by only 300,000 b/d (about 15%) in almost a decade. Management has been forced to repeatedly cut oil production targets and is now projecting output of 2.77 million barrels per day (b/d) by 2020 – far short of the more than 5 million b/d it projected for 2020 in its 2013 business plan[5].

With Temer at the helm, Brazil now looks poised to reverse its nationalist oil policies. In 2015 José Serra, then an opposition senator and currently Temer's Foreign Minister, proposed legislation that would end Petrobras' monopoly over operating pre-salt fields, noting the company's inadequate financial capability. The bill reverses a major energy reform introduced by former President Luiz Inácio Lula da Silva of the PT. Lula's reform, introduced immediately following Petrobras' discovery in 2007 of vast offshore "pre-salt" oil reserves, increased the government's stake in Petrobras and made the company the exclusive operator with a minimum 30% stake in all strategic fields. The bill was approved by the senate in March 2016 and the lower house in October, and Temer is expected sign it into law in the coming weeks. Temer's government also plans to court investment by lifting onerous local content requirements.

Without a Petrobras monopoly on operatorship, new opportunities for increased foreign investment and production may be

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[5] "Strategic Plan and 2017-2021 Business and Management Plan", *Investidor Petrobras*.

on the horizon. The new government announced in September that it would auction licenses in 2017 to produce oil from areas adjacent to previously awarded pre-salt blocks where the reservoir extends beyond the licensed area[6]. Petrobras is also hoping to farm out some of its stakes in onshore and mature fields to raise capital.

Major changes are occurring in Brazil's oil sector. Production will still grow, but much more gradually than was projected in recent years, and Petrobras will become a leaner company focused primarily on its core business of oil production[7]. The company has a US$15 bn divestment plan for 2016 and has sold or promised to sell almost US$10 bn in assets in Brazil, Chile and Argentina[8]. Petrobras' leadership had initially looked to shed non-core assets and minority stakes. However, given lower oil prices and Brazil's weak economy, investors have been hesitant to take minority stakes in Petrobras-controlled companies. As a result, the company has started to divest from entire market segments, selling majority stakes in fuel and natural gas distribution. Other sectors such as pipelines, power generation, logistics facilities and refineries could be next on the chopping block, which would reshape Brazil's midstream, downstream and natural gas businesses. As a result, new opportunities will open up for private investment from international and Brazilian companies.

Argentina

Argentina's economy was left in tatters after a prolonged recession in the 1990s and the country's 2001 default. But soon after, the country enjoyed a period of relatively robust economic

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[6] L. Alves, "Brazil Announces Onshore and Pre-Salt Field Auctions", *The Rio Times*, 16 September 2016.

[7] L. Viscidi, "Beyond the Political Crisis: the Future of Brazil's Energy Sector", *Inter-American Dialogue*, 2 May 2016.

[8] S. Valle, P. Millard, "Petrobras Ratchets Up an Asset-Sale Push That Bond Traders Love", *Bloomberg*, 26 September 2016.

growth amid generous public spending and strong demand for Argentine exports like soybeans. The public also benefited from social spending during the administrations of President Néstor Kirchner, who governed from 2003 to 2007, and subsequently his wife President Cristina Fernández de Kirchner.

However, the economic policies of the Kirchners, both members of the Peronist Party, ultimately proved unsustainable. Generous energy subsidies and heavy public spending led the country's budget deficit to swell to 6% of GDP[9]. Trade restrictions and currency controls hampered investment and productivity. And the Kirchners' protracted refusal to pay bondholders – combined with the nationalization of state oil company YPF and private pension funds – significantly eroded investor confidence.

President Fernández de Kirchner's popularity was eventually battered by soaring inflation and a weakening economy amid the decline in commodities prices. Last year Argentine voters removed the Peronists from office, electing a market-oriented president from the opposition, Mauricio Macri, who prevailed over Peronist candidate Daniel Scioli in the second round of the presidential election. Macri campaigned on a promise to repair the economy and boost growth while tackling inflation and the deficit. He also pledged to reach settlements with "holdout" bondholders and return Argentina to international capital markets. After taking office the president eliminated foreign exchange restrictions, devalued Argentina's peso and reached deals with more than 200 of these bondholders, giving the country access to international finance with a US$16.5 bn debt sale in April[10].

In the oil sector Fernández de Kirchner's administration had introduced a number of incentives for oil companies but the government's nationalist macroeconomic policies and the lack of access to capital continued to deter investment. Argentina's

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[9] "The end of kirchnerismo", *The Economist*, 24 October 2015.

[10] E. Moore, B. Mander, E. Platt, "Argentina returns to international markets with $16.5bn debt sale", *The Financial Times*, 20 April 2016.

oil production fell by 17.2% between 2005 and 2015, while natural gas production (the source for nearly half of electricity generation) declined by 16.8% over the same period[11]. Though traditionally a net energy exporter, Argentina became a net importer in 2011 as production fell while demand soared. After YPF's nationalization was finalized, foreign investment declined by 41% between 2013 and 2014, the lowest level since 2009[12]. In the power sector, Argentina faced repeated blackouts as the government had set the price of electricity below the cost of generation, which discouraged infrastructure investment and stimulated electricity consumption. By 2014 energy subsidies had reached 2.9% of GDP, and cost 12% of all federal spending[13].

President Macri has taken a more market-oriented approach to managing the country's oil and gas industry, hoping that a new investment climate will bring fresh capital to the sector and help boost development of Argentina's vast shale reserves. According to estimates by the US Energy Information Administration, Argentina has the fourth largest technically recoverable shale oil reserves and second largest shale gas reserves in the world. But so far shale projects are all in pilot phases or early-stage commercial production. Unconventional gas production accounts for only 15.5% of the country's total natural gas production, with just 27% of that coming from shale[14]. Since oil prices fell, exploration and production activity has slowed in Argentina's largest shale play, Vaca Muerta[15]. Energy imports are set to reach record highs in 2016, increasing 13%[16]. The existing shale projects are led by YPF, in partnership with Chevron, Dow Chemical and Petronas.

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[11] "Argentina", *Global Climatescope*, 2015; "Producción de petróleo y de gas", *Instituto Argentino del Petróleo y del Gas*, 2015.

[12] "Foreign Investment Plunges", *The Buenos Aires Herald*, 28 May 2015.

[13] R. O'Connor, T. Lorenzo, "Energy in Argentina: A New Investment Climate", *Inter-American Dialogue*, 16 March 2016.

[14] I. Gomes, R. Brandt, *Unconventional Gas in Argentina: Will it become a Game Changer?*, The Oxford Institute for Energy Studies, October 2016.

[15] *Ibid.*

[16] "Energy imports set to reach record levels", *The Buenos Aires Herald*, 9 June 2016.

International oil majors, such as ExxonMobil and Shell, smaller local and international companies and NOCs, such as China's Sinopec and Russia's Gazprom, have all expressed interest in developing Argentina's shale reserves.

The liberalization of energy prices has been among the government's top energy policy priorities. To keep the industry from deteriorating in the face of the oil price collapse, Argentina has kept domestic oil prices at around US$70/barrel, but the Macri administration plans to realign domestic and international fuel prices. Almost immediately after taking office the new government also declared an electricity emergency through 2017, granting the Energy Minister extraordinary powers to repair the country's deteriorating national electricity system. These measures included slashing subsidies and introducing new wholesale prices for power nationwide. As a result, utility bills shot up at rates of up to 400% and inflation spiked, hitting 47% in July[17]. Though these measures were unpopular, the new policy also makes the sector more attractive for investment.

Macri has taken a much more market-oriented approach to managing Argentina's energy sector, appointing former Shell Argentine CEO Juan José Aranguren to lead the Energy Ministry and former Telefónica President Miguel Gutiérrez as Chairman of YPF. These leadership changes and Macri's decision to separate YPF's Chairman and CEO roles limit the President's influence and increases transparency, a move designed to improve investor confidence[18].

Although Macri took office at a difficult time for Argentina, when prices for oil and other commodities were relatively low, and his market-oriented economic policies are painful in the short term, his approach is likely to boost oil and gas production in the longer term.

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[17] C. Devereux, "Argentina's Recession Deepens as Macri's Reforms Bite", *Bloomberg*, 22 September 2016.

[18] R. O'Connor, T. Lorenzo (2016).

Colombia

Colombia enjoyed a large influx of foreign direct investment and government revenue in the early 2000s as the oil sector experienced a boom thanks to the government's introduction of investment-friendly terms and high oil prices. But the country's fiscal position has deteriorated over the past two years as oil revenue, which had accounted for nearly a fifth of its income in 2011, dwindled to 3% in 2015 and almost zero in 2016[19]. Colombia's oil export revenue dropped by more than half in 2015 compared to the previous year[20]. The costs associated with the implementation of Colombia's peace accord will further strain an already tight budget in the coming years.

Colombia's government has responded with a policy mix that includes increasing the deficit, raising taxes on non-oil sectors and cutting spending. Colombia's "fiscal rule" allows for larger budget shortfalls during temporary market shocks, and the country's fiscal deficit will reach a six-year peak in 2016[21]. To bridge the budget gap, the government plans to cut spending by US$1.8 bn, sell US$3 bn in foreign debt and raise another US$3 bn in multilateral loans in 2017[22]. President Juan Manuel Santos also presented a tax reform bill to congress in October 2016 aimed at raising non-oil revenue. The tax reform would cut the national deficit in half by 2020 to preserve the country's credit rating.

Colombia's economic downturn, as well as the controversial peace negotiations with the Revolutionary Armed Forces of Colombia of Colombia (FARC) guerilla group, has pushed the

[19] N. Bocanegra, H. Murphy, "Colombia's fiscal risks may mean more cuts to meet goals", *Reuters*, 10 March 2016.

[20] A. Alsema, "Colombia's 2015 exports plummet 35% amid low oil prices and in spite of cheap peso", *Colombia Reports*, 5 February 2016.

[21] O. Medina, "Colombia Sees Worst Fiscal Gap Since 2010 as Oil Revenues Vanish", *The Washington Post* with *Bloomberg*, 15 June 2016.

[22] N. Bocanegra, H. Murphy, "Colombia's fiscal risks may mean more cuts to meet goals", *Reuters*, 10 March 2016; O. Medina (2016).

President's support levels to historic lows. The President enjoyed approval ratings above 75% when he took office in 2010, but his support plummeted to just 21% in a May poll[23].

Meanwhile, Colombia's oil industry is struggling. Crude production hovered around 1 million b/d in 2013 and 2014 but dropped off sharply in 2015, and the country's 2016 production is expected to fall to 800,000 b/d[24]. Moreover, at the current rate of production, Colombia's oil reserves would run out in just six years, a very low "reserve life" by most standards. Most geologists believe Colombia does not hold large oil reserves, so producers have to drill many wells to keep production steady. For Colombia to maintain its status as a net oil exporter the government must continue licensing new areas for oil exploration. But since oil prices fell drilling activity has slowed and the number of exploratory wells has dropped sharply. After peaking at 56 in April 2014 the number of wells drilled totaled just 5 in April 2016, according to the Mines and Energy Ministry[25]. Exploration success, the number of wells drilled that produce commercial quantities of oil, has also been lower than historical rates. However, the oil price collapse is just one of several challenges for Colombia's oil industry. Investment has also declined because of the lengthy process for gaining local community approval for drilling, legal uncertainty resulting from several cases where drilling licenses were approved and later revoked due to environmental or community opposition and the high fees for crude transport through pipelines.

State-controlled oil company Ecopetrol has also faced a host of challenges associated with the oil price decline. Though its production growth rate since 2006 was among the highest in the

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[23] A. Alsema, "Santos' approval rating plummets in first poll of 2016", *Colombia Reports*, 1 February 2016; "Imagen favorable de Santos es la más baja desde que es Presidente", *El Tiempo*, 4 May 2016.

[24] A. Willis, "Oil Industry Fears More Chaos After Colombia Rebels Disarm", *Bloomberg*, 13 September 2016.

[25] L. Viscidi, R. O'Connor, "The Future of Oil & Gas Exploration & Production in Colombia", *Inter-American Dialogue*, 23 May 2016.

world, in the wake of the oil price drop the company lost more than US$100 bn – 90% of its market capitalization – between 2012 and 2015, and shares dropped 55% in dollar terms in 2015 alone[26]. With an average oil price of US$42/barrel projected for 2016, the state oil company will be unable to pay a dividend[27].

Officials in the Finance and Energy Ministries and the National Hydrocarbons Agency (ANH), Colombia's oil regulator, are seeking to maintain investment in spite of lower oil prices and a lack of large oil discoveries since the 1990s. Colombia has cut taxes on the oil sector, allowed companies to extend exploration and production periods and reduced minimum investment requirements in an effort to reverse the decline in investment. The government has developed specific regulations governing the development of offshore resources in an effort to spur investment. In offshore free trade zones, it has reduced oil revenue taxes from 25% to 15% and eliminated the value added tax[28]. The ANH is also taking steps to modify the process through which new blocks are assigned in order to further incentivize exploration and production. However, given the sector's challenges, Colombia is unlikely to see an increase in production in the near term.

Mexico

Unlike many Latin American oil producers, Mexico's economy is much more reliant on exports of manufactured goods than of raw materials. Nevertheless, the federal government remains heavily dependent on oil export revenue, which currently contributes 20% of total government income. Prior to a 2014 tax reform, which increased Mexico's reliance on non-oil tax revenue,

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[26] A. Willis, M. Bristow, "$100 Billion Evaporates as World's Worst Oil Major Plunges 90%", *Bloomberg*, 16 December 2016.

[27] *Ibid.*

[28] L. Viscidi, R. O'Connor (2016).

oil sales funded 30% of Mexican federal government spending[29]. In 2015 Mexico's Finance Ministry was able to shield the government from the oil price decline through its hedging program – whereby the government pays banks a premium giving it the right to sell oil exports at a pre-set price, even when the price of Mexican oil exports falls below the strike price. However, with most analysts expecting oil prices to remain lower for longer, the Finance Ministry attained a strike price of just US$49/barrel in 2016 and US$42/barrel in 2017, compared to US$76/barrel in 2015.

Faced with lower oil revenues as well as sluggish US economic expansion, the Mexican government has already slashed growth projections twice in 2016 and cut its budget to reduce ballooning debt. In its 2017 budget proposal to congress, the administration cut spending by US$12.83 bn, presenting the larger-than-expected cuts as a precautionary measure designed to protect against future low oil prices that might prevent hedging at an attractive price[30].

The economic downturn has damaged President Enrique Peña Nieto's popularity. Other scandals, such as the Ayotzinapa case in which a local mayor allegedly ordered the disappearance of 43 students, corruption allegations, a rise in violent crime and the highly unpopular visit of US President-elect Donald Trump during the US election campaign, have also contributed to his meager 23% approval rating[31].

Mexico's oil industry itself has also suffered from the drop in prices, coupled with large declines in production. State oil company Pemex has faced steadily declining production from a peak of 3.4 million b/d in 2004 to 2.16 million b/d today, due

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[29] A. Harrup, "Mexico's New Finance Minister Inherits Tight Budget Goals", *The Wall Street Journal*, 7 September 2016.

[30] J.L. Arce, A. Alper, "Mexico 2017 budget cuts to squeeze Pemex, primary surplus eyed", *Reuters*, 8 September 2016.

[31] B. Column, "A discredited profession" ,*The Economist*, 1 October 2016.

largely to a lack of investment[32]. The company's output may fall even further to about 1.6 million b/d by 2020, according to investment bank Morgan Stanley, owing to its inability to increase oil recovery from aging fields and lack of technical capability to exploit the country's more promising offshore reserves[33]. The increasingly indebted state company has experienced cash flow shortfalls since 2013, with an unprecedented US$22 mn gap in 2016, and was downgraded two notches by Moody's in May[34]. In total, the company has more than US$87 bn in debt, in addition to 100 bn pesos in payments owed to service providers[35]. As the production decline has led to lower government revenues, the government has in turn made steep cuts to Pemex's budget. Indeed, US$5.36 bn – more than one-third of the government's budget cuts for 2017 – fall on Pemex. The cuts will further curtail the company's ability to invest in oil exploration and production[36]. To avoid Pemex's collapse, the 2017 budget includes measures focused on lowering the company's tax burden, such as raising the tax deduction ceiling, which will provide US$2.9 bn in additional 2016 revenue to Pemex[37]. The federal government also provided Pemex with an almost US$4 bn capital injection in April, assumed US$10 bn of its pension liabilities and transferred Pemex US$2.5 bn in bonds to boost the company's liquidity[38].

While its cash flow has significantly deteriorated since oil prices declined, Pemex's financial and technical weaknesses were widely recognized for years. To bring fresh capital and expertise to the oil industry, Peña Nieto's government secured

[32] A. Harrup, "Mexico's Pemex Makes Offshore Crude-Oil Discoveries," *The Wall Street Journal*, 13 September 2016.

[33] J.E. Arrioja, A. Williams, "Pemex Woes Snowball as Cash Crunch Deepens Production Plunge", *Bloomberg*, 18 August 2016.

[34] *Ibid.*; N. Cattan, A. Williams, E. Martin, "Pemex Gets Tax Break and $1.5 Billion Relief to Tackle Debt", *Bloomberg*, 13 April 2016.

[35] *Ibid.*

[36] J.L. Arce, A. Alper (2016).

[37] N. Cattan, A. Williams, E. Martin (2016).

[38] J.E. Arrioja, A. Williams (2016).

congressional approval in late 2013 – while oil prices still averaged over US$100/barrel – to end Pemex's decades-long monopoly over oil exploration and production and allow private companies to book oil reserves and market their own crude produced in the country.

The oil price collapse has forced the government to offer more favorable terms. After an unsuccessful first phase of "Round 1", the first bid round, the government revised the contract terms to attract stronger bids for later phases. After requesting industry input, the National Hydrocarbons Commission sweetened fiscal terms, provided lower corporate guarantees and published minimum bid thresholds in advance, among other changes. The second and third phases of Round 1 were much more successful, and interest is even higher for a December 5th auction of 10 deep-water oil blocks that will allow international producers to bid to develop the fields without having to partner with Pemex. To date, 26 companies have pre-qualified to bid for those prospects, including most major international oil companies.

Pemex will continue to play a dominant role in Mexico but its share of production and reserves will shrink as private companies start to buy exploration rights in licensing rounds and produce their own crude oil. Pemex has said it will not put in bids to operate any of the fields in the December 5th deep-water auction, where Mexico is awarding the fields believed to have the highest potential reserves in the country.

Venezuela

Venezuela is the most oil-dependent country in Latin America and indeed among the most oil-dependent countries in the world. During the boom the Venezuelan government was able to redistribute oil wealth to millions of people, providing free housing, medical care and other benefits. But now the country is facing its most tumultuous political and economic period in decades. More than any other country in the region, Venezuela's economy has been wrecked by the global oil price collapse. The country is suffering widespread shortages of food, medicine, and other imports due to a sharp decline in foreign currency inflows – oil represents over 95% of Venezuela's exports and few goods are produced domestically. According to the International Monetary Fund (IMF) forecasts, the economy will shrink by 8% and inflation will reach 700% by the end of 2016[39]. After incurring massive debts when oil prices topped US$100/barrel, Venezuela is now struggling to meet payment obligations to its bondholders and pay off billions of dollars in oil-backed loans from China. The Venezuelan government and Petróleos de Venezuela, S.A. (PDVSA) together owe bond payments of US$4.3 bn in late 2016 and US$7.3 bn in mid-2017. China, its largest creditor, has extended the repayment deadline for some loans, but President Nicolás Maduro is seeking additional flexibility. Cash-strapped Venezuela faces the risk of a default, though the government appears determined to make its 2016 payments by offering a debt swap, further cutting imports and drawing down international reserves.

The economic crisis has severely eroded support for the already unpopular Maduro. In December 2015 the opposition won a majority in National Assembly elections for the first time since former President Hugo Chávez was elected in 1998. Promising a more market-oriented economic approach, the opposition pledged to encourage private investment, remove price controls and introduce a free-floating exchange rate. Numerous large-scale protests against the government have ended in violence and some 75% of Venezuelans want Maduro removed from office, according to recent polls. The outcome signals voter frustration with the economic hardships resulting from the tightly state-controlled economic policies that have been in place for over a decade.

As government revenue declines amid lower prices, Venezuela's oil sector – the country's sole economic engine – is rapidly deteriorating. Venezuela's oil production has been declining for

[39] D. Biller, "IMF Sees Venezuela Inflation Rocketing to 720 Percent in 2016", *Bloomberg*, 22 January 2016.

years but in recent months output has dropped more rapidly and multiple sources, including the Organization of the Petroleum Exporting Countries (OPEC) and local consulting firms, have reported record declines in production in 2016. From a peak of 3.2 million b/d in 1997, crude output has shrunk to just above 2 million b/d at present. In addition, as lighter oil output from aging fields drops, Venezuela's crude export basket includes increasingly heavy grades, diminishing its value and forcing the country to import growing volumes of light oil. PDVSA faces a lack of cash flow because of the decline in the price of its oil exports, a government policy that froze domestic gasoline prices at about US$0.01/gallon for almost two decades, and its ongoing obligations to finance many of Venezuela's social programs. The company is not investing in enhanced oil recovery to boost light oil production from aging fields, or even in basic maintenance of equipment and facilities like oil pipelines and refineries.

Private companies operating in Venezuela, including Western oil majors, NOCs from China, India and Russia and local players, are also reluctant to invest. PDVSA has held majority stakes in most oil projects since the industry was nationalized under Chávez and controls operations and marketing for the bulk of its oil projects. PDVSA's joint venture partners have been frustrated by their inability to control operational decisions and to access their share of profits from oil sales[40]. Private company partners have also seen their profits tumble because of exchange rate controls. While the unofficial exchange rate has reached almost 1,000 bolivars per dollar, international oil companies are forced to use the official rate of 10 bolivars per dollar for the majority of their sales. With 70% of their project costs in the local currency, private oil producers have seen production costs soar because of inflation. In addition, many oil service firms and suppliers have stopped working because they are owed millions of dollars in back payments from PDVSA.

[40] L. Viscidi, "Venezuela on the Brink: How the State Wrecked the Oil Sector - and How to Save It", *Foreign Affairs*, September/October 2016.

With the government facing a shortage of foreign currency, PDVSA's President Eulogio del Pino has promised incentives for private companies in an effort to boost investment and production. Such measures include allowing oil companies full access to a floating exchange rate, giving more financial and operational control to PDVSA's private partners in joint ventures, and lowering taxes on oil companies in Venezuela, where the government's take (about 90% of the total revenues collected from private operations) is among the highest in the world. In the longer term, however, the government will be forced to reduce the burden on PDVSA by decreasing its stake in Venezuelan oil fields in order to maintain production. If the opposition ultimately gains power, it will likely align Venezuela's oil industry with regulatory frameworks that are more common around the world, for example by creating an independent regulator to oversee the sector, reducing reliance on PDVSA's revenues to fund massive social programs, eliminating fuel subsidies and introducing more market-oriented macroeconomic policies[41].

Ecuador

Fueled by high oil prices in recent years, Ecuador has spent heavily on social programs, lifting more than a million of its citizens out of poverty and investing in education, health and infrastructure[42]. Oil production looked likely to rise substantially after the government's controversial decision in 2013 to let state-owned oil company Petroecuador develop the Ishpingo-Tambococha-Tiputini (ITT) oil fields in Yasuní National Park, an ecologically sensitive area that is thought to hold around 900 million barrels of reserves.

But today Ecuador is in trouble. The drop in oil prices has cut oil export revenues by nearly half even as oil production has

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[41] *Ibid.*

[42] B. Lee, "Ecuador Protests: Correa's Oil Crisis, Policies Could Spell End Of Latin America Success Story", *International Business Times*, 20 August 2015.

remained flat, but Ecuador's dollarized economy means it does not benefit from the currency devaluation that has made exports from other sectors more competitive in most emerging markets. Oil income represents 25% of Ecuador's public budget and over half of exports[43]. Amid lower prices the economic growth rate declined from 3.7% in 2014 to around zero in 2015, and the country is bracing for a projected 2.3% contraction in real GDP growth for 2016[44].

To weather declining dollar inflows as the country heads for its worst recession since at least 1999, the Ecuadorian government has raised taxes and tariffs and reduced budgeted spending, including in social investments[45]. Despite its 2008 default, Ecuador maintains access to oil-backed loans that help fill its budget gap and in 2016 offered US$1 bn in bonds[46]. The government has also gone deeper into debt with China, gaining access to a US$5.3 bn credit line in 2015 and announcing another US$7.5 bn loan from China in 2016[47].

Throughout his time in office, President Rafael Correa has consistently enjoyed approval ratings of around 55-80%, but his popularity fell in 2015 as controversial social spending cuts and tax increases ignited protests around the country[48]. Although Ecuador's National Assembly eliminated term limits in 2015, Correa introduced a clause preventing himself from seeking re-election until 2021 and has publicly said he will not run in 2017. Correa claimed he believed one president should not become "indispensable" to the country, but many speculate that he

[43] "Ecuador Economy Profile", *IndexMundi,* 2016.

[44] *Ecuador and the IMF*, International Monetary Fund, 8 October 2016.

[45] "In Ecuador, Changes in Term Limits Will Not Fix Economic Woes", *Stratfor*, 9 December 2015.

[46] A. Jaramillo, L. Pronina, "Ecuador Offers $1 Billion of Bonds at Highest Coupon Since 2000", *Bloomberg*, 25 July 2016.

[47] A. Valencia, P. Murphy, "China grants $5.3 billion credit line to Ecuador", *Reuters*, 6 January 2015.

[48] "Índices de aprobación a la gestión, credibilidad y forma de ser del presidente Ecuatoriano Rafael Correa", Cedatos; B. Lee (2015).

does not want to be in charge during the economic downturn.

Ecuador's oil industry is also struggling due to low oil prices, troubles at Petroecuador and a lack of investment. The largest company in the country, Petroecuador was hard hit by the commodity price drop with a 49.8% decline in export revenues from 2014 to 2015, though export volumes declined only slightly from 380,000 b/d to 360,000 b/d during the same period[49]. To make matters worse, Petroecuador was engulfed in scandal after costs for a project to upgrade its largest refinery exceeded the budget by more than US$1 bn. Former Petroecuador CEO Alex Bravo stands accused of influence trafficking, bribery and embezzlement in managing contracts for the upgrade and is now believed to be part of a larger corruption network at the company.

Although Petroecuador started drilling in the ITT in September, overall drilling activity has slowed considerably as the costs of production exceed the value of exports for many oil producers in Ecuador. The number of active rigs in the country has dropped from 27 in August 2014 to only 1 in February 2016, according to data from oil services firm Baker Hughes. The decline in exploration and production is tied to lower oil prices combined with Ecuador's image as a politically risky place to invest. In 2010 President Correa nationalized the oil industry, forcing companies to transfer their production-sharing agreements to service contracts, in which the government owns the oil and gas produced. This deterred most new investors, with the notable exception of Andes Petroleum, a consortium of Chinese state oil companies, China National Petroleum Corp (CNPC), and China Petroleum Chemical Corp. Andes Petroleum reportedly spent US$80 mn to buy the rights to develop an Amazon field located just outside of Yasuní National Park. The country's protracted legal dispute with Chevron over allegations that Texaco, which Chevron acquired in 2000, was responsible for oil contamination, has also been a source of concern.

[49] *Bajo precio del petróleo marcó las cifras de Petroecuador en el 2015*, EP Petroecuador, 31 December 2015.

Ecuador has so far maintained control over the oil industry. However, given the country's unfavorable investment climate and dismal economic forecast, Correa's successor may have to adjust terms to attract foreign investment if he or she hopes to increase its oil revenues.

Conclusion

The recent shifts in oil policy across the region raise critical questions about how the industry can serve as a catalyst for economic and social development going forward. In the new era of lower prices, national oil companies will find it much more difficult to fund projects that are unprofitable or outside of the normal scope of oil operations. The ability to use the oil industry and oil revenue for economic development could be diminished. Private companies' corporate social responsibility programs are not likely to match the breadth of programs that companies like PDVSA or Petrobras have sponsored. Oil revenues will still be redistributed to populations but perhaps not in such a generous – and inefficient – manner as during the age of abundance. In order to use oil wealth to achieve the same gains in social and economic equity, policymakers will have to find more effective ways to use revenue from the sector or look to alternative sources.

6. Organized Crime and Drug Trafficking, a Never-Ending Threat

Aníbal Gutiérrez

According to the *Human Development Report for Latin America and the Caribbean 2016*, since 2003, thanks to the implementation of inclusive social policies, more than 72 million people have been lifted out of poverty and nearly 94 million have joined the middle class.

At the same time, governments face the challenge of implementing policies aimed at ensuring these achievements. With this unfavorable global economic scenario, between 25 and 30 million people are likely to relapse into poverty.

In this context, described by the United Nations Development Programme (UNDP), we need to include the rise in illicit markets ranging from drugs, weapons and goods trafficking, the smuggling of humans (especially young women and girls) forced into prostitution, and other types of organized crime.

This is a reality shared by almost all the countries of the region today, which affects both the strength and the depth of democratic values, which have been consolidated for more than thirty years. Not to mention the state's ability to maintain the exclusive exercise of law enforcement.

On the other hand, the corruption arising from the large amount of money circulating in illicit markets resulted in an increase in public corruption at such high levels the region had never seen before.

Lastly, over the last years the complex scenario shaped by the political ups and downs in the region, namely, changes of government with opposed ideological views, peace processes, international cooperation experiences aimed at fighting organized crime, etc. poses a great challenge for the Latin American region as a whole.

Organized crime as a threat to democracy

In all countries of the region, prominent representatives of the political and economic world are involved in criminal activities they try conceal behind other legal activities. Undoubtedly, this is one of a series of factors that have contributed to the increase in organized crime in Latin America.

Serious evidence shows that criminal networks have infiltrated public institutions using their economic weight. Indeed, these networks managed to place their allies in key positions through the funding of their election campaigns.

This actual cooptation of the state is not only limited to the executive and legislative branches, but also includes senior justice officials and representatives of security forces. An example could be the so-called "Cooptación del Estado (Cooptation of the State) de Guatemala", prosecuted by the International Commission against Impunity in Guatemala (CICIG) working in close collaboration with the Guatemalan Justice Department. In this case, the prosecutors charged more than fifty people (including the former President of the Constitutional Court, Otto Pérez Molina, his Vice-President and other senior government officials) with overseeing a criminal network. Through democratic election, this network took power in order to enrich the officials who were part of it.

According to CICIG, this structure has been in place since 2008, that is, four years before the rise to power through the Patriot Party (PP) of Pérez Molina and his Vice-President, both now detained. In this way, a political party no longer fulfils its democratic role – which is serving as a school for executives, who can be elected and take forward a government's proposal – and becomes a criminal institution.

The consequences of these behaviors are harmful to society. Social and cultural relationships begin to change and the values that should prevail in society are subverted to such an extent that they lose all the attributes that used to define them as an organized human group. Thus, organized crime infiltrates communities, alters their patterns, and becomes part of these communities and of their economic and political life.

Organized crime in Latin America

Organized crime in the Latin American region is the result of multiple causes and facets that need to be understood and addressed conjointly. All the criminal activities that fall under the name of organized crime show different levels of development in each country of the region. However, crimes linked to illicit substances trafficking have reached record levels. For this reason, it would be preferable to talk about narco activity instead of narco trafficking, since illegal drug abuse poses a much more serious and complex problem than substances trafficking.

Today, millions of people consume marijuana, cocaine and synthetic drugs and a significantly increasing number of young people are involved in drug-related illegal activities. On the other hand, every month thousands die due to the escalation of violence and insecurity generated by small gangs and large cartels linked to drug production, transit, and sales.

This violence is related to territorial control, which is necessary in order to move the merchandise from manufacturing places to sales points. The same thing happens with other criminal activities, such as contract killings, weapons/people trafficking, the exploitation of women and girls, kidnappings, extortion, organ trafficking, etc. As a result, it is clear how organized crime activities in the region of Latin American are mainly related to drug trafficking. All of the world's cocaine comes from three Latin American countries (Colombia, Peru and Bolivia). In addition, Mexico, Colombia and Paraguay are large-scale marijuana producers. In recent years, the production of synthetic drugs has grown significantly in Argentina and Brazil, where major ephedrine imports (supported by major chemical industries) along with violent deaths have been recorded.

How Latin America addresses organized crime

Overall, the whole region addresses organized crime erratically. Although all countries adhere to the existing international conventions on the subject and apply punitive policies, personal drug consumption is decriminalized and only small producers, distributors or sellers are prosecuted.

Next, we will focus on the measures taken by some of the Latin American countries.

Mexico

Mexico declared war on organized crime networks, involving its armed forces (especially the army) in police operations.

In this country can be found the most powerful and sophisticated organized crime networks of the whole region. Its geographical position makes it a big hub for illegal substances flowing into the United States. The state's response was to declare war on existing networks, involving armed forces, which were incorporated with an interim measure during the term of former President Felipe Calderón (2006-2012). His successor Enrique Peña Nieto decided to keep this measure.

This measure was harshly criticized by security experts and by the army itself, claiming (with reason, according to this author) that they were not trained to perform police tasks. Moreover, the implication of Mexican security forces in serious human rights violations only poses a further threat to the population.

Despite this, the urgent need for more security led to the fall (by death or detention) of several leaders of existing criminal networks. This fall resulted in a fragmentation of traditional cartels (Gulf Cartel, Juárez Cartel or Tijuana Cartel) and generated several small organizations responsible for generating a big wave of violence aimed at replacing former leaders. The consequences of this situation are extremely high rates of violence and a lack of confidence in security forces.

According to Mexico's Citizens' Council for Public Security and Criminal Justice (a Mexican civil association), Mexico is home to five of the 50 most dangerous cities in the world. Acapulco is the most violent city (ranked as the 4th globally) with 104.74 homicides per 100,000 inhabitants. On the other hand, Mexico's National Institute for Statistics and Geography (INEGI) released its latest survey on victimization and perceptions of public safety. According to the study, 72.4% of the Mexican population feels unsafe, while 76% of respondents believe that police are corrupt. Again, the aforementioned survey estimated that the total economic impact of violence and crime in Mexico was US$12.5 bn.

Central America

In recent years, Central America has been the area most affected by violence.

It was one of the Cold War's hot spots and the scene of bloody conflicts between groups of armed insurgents and the regular armed forces of many countries of the isthmus. Several decades of internal armed conflicts, the political and institutional instability that led to several c*oup d'état*, and third-party interventions generated high levels of violence and extremely weak public institutions.

According to the ranking released by the Mexico's Citizens' Council for Public Security and Criminal Justice, out of the world's 10 most dangerous cities, three are located in Central America with figures ranging from 73 to 111 homicides per 100,000 inhabitants.

Institutions appealed to international cooperation (the USA and some European countries) for help in tackling the situation. The CICIG is one of the existing models of cooperation, and perhaps the most successful. Guatemala suffered more than 30 years of internal conflict that killed more than 200,000 people, left 45,000 civilians missing and created about 1 million refugees.

At the end of 1996, under the auspices of the international community and after years of negotiations, representatives of the state and of the insurgent organizations signed an agreement of Firm and Lasting Peace that put an end to the conflict. This agreement also set the minimum conditions for starting to rebuild democracy. As part of the agreement, the state committed to prosecute illegal institutions or clandestine security structures that could operate with impunity. The inability of the state to stop organized crime networks' activities and impunity led it to ask help from the international community. That is how the CICIG originated.

CICIG is an international investigative body, established under an agreement between the UN and the Guatemalan government in order to support Guatemalan institutions in identifying, prosecuting, and ultimately sentencing the members of criminal networks infiltrated into state apparatus. In accordance with its mandate, CICIG is able to conduct its own criminal investigations; and, working in close collaboration with the Public Prosecutor's Office (MP) can act as prosecutor, propose regulatory reforms aimed at supporting national institutions in addressing any challenge, and implement all measures that justice and security bodies may require in order to strengthen institutions.

The CICIG was created at the end of 2007 and since then has been working intensely, achieving important results in uncovering structures that infiltrated the state apparatus to enrich themselves. The answer that still remains unclear is whether national institutions will be able to actively face organized crime once the international "crutch" is removed. The successes achieved by CICIG in Guatemala led civil society organizations of other Central American countries to request similar commissions. El Salvador and Honduras pressured the most to have these commissions. This is mainly due to high levels of impunity in these countries.

After quite some time of public and private meetings, the Organization of American States (OAS) decided to install a body similar to the Guatemalan Commission in Honduras.

The committee, called Mission to Support the Fight against Corruption and Impunity in Honduras (MACCIH), has one important difference from its Guatemalan counterpart: it cannot carry out any independent investigation. This is a great difference. In this way, any achievement will be subordinated to the country's security and justice authorities.

MACCIH, which began work in 2016, will perform the following functions: advise and assess during investigations and prosecutions related to emblematic public corruption cases; work to build an observatory to monitor and assess progress of the judicial system; propose recommendations on strengthening key institutions; promote the implementation of a new legislative framework in terms of elections, political party funding and the fight against corruption. As reported, MACCIH will focus its activity on more than a hundred existing public corruption cases within the National Social Security Institute and police forces. However, a few weeks after creation of the committee, the environmental campaigner and human rights defender, Berta Caceres, was murdered. Berta Caceres campaigned against the construction of hydroelectric power plants without consent of the local indigenous communities on behalf of the Civil Council of Popular and Indigenous Organizations of Honduras (COPINH).

This case drew the attention of both the international community in general and of the MACCIH, specifically, on the functioning of the country's judicial system. During the first months, advances were made and some of the murder suspects were arrested. However, last October, when the pressure around the case started to decrease, the case file was stolen. This murder brought the issue of corruption to the table again, an issue that Honduras justice has not yet solved.

We have yet to see how effective this cooperation attempt will be, with a country that has become one of the poorest and most dangerous places in the world. Thanks to these – perhaps positive – results it is likely that more countries, with needs similar to Honduras', will speak out.

Colombia

Colombia is undoubtedly the country where the bloody spiral of violence, drug trafficking and organized crime began.

At the beginning of the 1970s, the poor farmers of the country switched from legal crops to marijuana cultivation. A few years later, small criminal organizations started to process coca leaves coming from Peru and Bolivia. Two major cocaine cartels emerged in the 1980s, the Medellín Cartel and the Cali Cartel. Two criminal organizations both dealing with the same business, but employing opposed methods in managing them. To these criminal groups we must add the activity of insurgent groups that had already been active in the country for a long time. They needed permanent funding for political reasons.

After several years of conflict, the Medellin and Cali cartels were dismantled (due to Pablo Escobar's death and to its leaders' detention, respectively) and replaced by the North Valley Cartel and small armies competing for the control of cocaine production.

After dismantling the North Valley Cartel, drug trafficking (production, transfer and sales) was controlled by a series of small groups whose members included former paramilitaries and other criminals. Meanwhile, the Revolutionary Armed Forces of Colombia (FARC), the country's major insurgent organization, is engaged in a long and complex dialogue process with the government. This may lead to the end of the guerrilla movement, with the organization's members' incorporation into Colombian democracy.

This dialogue process led the government of Colombia and FARC leadership to sign a peace deal that was supposed to be ratified by Colombians with a referendum that took place on 2 October. Surprisingly, voters rejected the peace deal. This situation jeopardizes the dialogue process since the government and guerrilla leaders are urged to reopen a dialogue to find a new agreement, which would need to satisfy both parties and Colombians. Once this situation is clarified, it will be possible to address organized crime and drug-related illegal activities.

Brazil

Brazil is the largest country of South America, sharing the border with the world's three biggest cocaine producers (Bolivia, Peru and Colombia). Its 8,000-kilometer coastline is the ideal setting for shipping drugs to Europe.

According to Mexico's Citizens' Council for Public Security and Criminal Justice, Brazil plays a significant role. Out of the 50 most dangerous cities in the world, 21 are in this country, ranging from 30 to 60 homicides per 100,000 inhabitants. Criminal groups began to rise in the 1970s in Rio de Janeiro and Sao Paulo state prisons. The two most important groups are the Red Command and the First Capital Command. Big drug producers moved to Brazil in the 1980s, during the cocaine boom. The Colombian cartels began to establish very important bases in the country, establishing schemes of conjoint work with the two existing local organizations.

In this complex criminal landscape local groups, such as the First Santa Catarina Group and Family of the North arose in the south and in the north of the country, respectively.

This country currently represents one of the world's largest drug markets, and organized crime controls the area where its "soldiers" live, favelas. Favelas are extensive slums within urban areas where the two aforementioned criminal organizations (Red Command and the First Capital Command) exercise absolute social control.

Where the state is not able to exercise its power, criminal organizations impose their own forms of justice, often with the complicity of corrupt state agents, and taking advantage of a complex social background.

Argentina

Argentina experienced an alarming increase in organized crime and drug-related activities in recent years. High levels of poverty and exclusion, corruption among public officials along with the state's inability to address these challenges are the ideal breeding ground for the rise of organized crime in this country.

In Argentina drug circulation has been intensifying across urban areas over the past few years. Buenos Aires and Rosario host several rather small organizations that monopolize this market. The slums on the outskirts of Buenos Aires, known as Villas, are home to drug trafficking organizations. Here Colombian, Peruvian and Paraguayan gangs constantly fight over territorial control. An example was an armed conflict during a religious procession between the members of the Shining Path (a Peruvian revolutionary organization) to get control of Villa 1-11-14. These criminal organizations can freely operate both inside and outside of the villa thanks to the complicity of security forces and politicians, receiving significant amounts of money in return.

The poorest districts of the province of Buenos Aires are in the same situation. The measures implemented by Governor María Eugenia Vidal's administration show they are on are on the right track, since they received several threats, some of them attributed to police officers that have now been suspended from duty. The state's complicity is so great that imports of ephedrine have skyrocketed over the last ten years, generating numbers of urban laboratories where synthetic drugs are produced.

These deaths and the links with senior officials of the Argentinian government, which ended its mandate in 2015, have yet to be clarified. However, this shows that the ties between political institutions and drug trafficking organizations were close.

On the other hand, the arrest of some important Colombian drug traffickers such as Henry de Jesus López, aka "Mi Sangre", a criminal who began his career in the Office of Envigado, then joined the paramilitary group United Self-Defenders of Colombia (AUC) and ended up with the Urabeños, shows that Argentina plays a significant role for the most important criminal organizations of the region.

The rise in the smuggling of people forced into prostitution, big money laundering operations that have been reported since the new government was established and increased levels of insecurity prove that organized crime has become dangerously entrenched in Argentina, from which it exports to Europe and Asia.

Trump's presidency

The beginning of Trump's presidency requires an analysis of what could happen since the presidential campaign was based on hostility, especially toward all the minorities living in the country.

Several analysts, journalists and politicians, both from the US and other countries, agree that this new government will favor bilateral relations with specific countries rather than multilateral agreements, which have hitherto been put in place.

This news will be welcomed by those who are accused of integrating organized crime networks and public corruption, since the international pressure (specifically exercised by the United States Embassy, which is very powerful in some Latin American countries) will decrease. Thus, those countries, which started their fight against impunity, might experience a new wave of illicit phenomena.

The support (financial support, in particular) received by organizations fighting against corruption, drug trafficking and impunity, such as the Merida Initiative or the International Commission against Impunity in Guatemala (CICIG) might be decreased, affecting significantly their activity.

Immigration came to define Trump's presidential campaign. During his first TV interview, which took place three days after his election, Trump claimed that, once in office, he would immediately begin the process of deporting illegal immigrants with criminal records. He said that the number would be between two and three million people.

This statement, coupled with the reiterated threat to build a wall on the US-Mexico border, proves his intention to secure the borders, while showing a “zero tolerance” approach toward illegal immigration.

This decision has direct consequences on US neighboring countries, on the violence generated by the control of drug trafficking routes, and on the value of the goods entering the US.

On the one hand, a stricter border control, including the potential building of the border wall, will make the illegal trade routes more burdensome, leading to an increase in violence between cartels, struggling for control.

On the other hand, the deportation of millions of people (mostly from Mexico, Guatemala, El Salvador and Honduras) will become the breeding ground both for pervasive urban violence and for the recruitment of (ruthless) labor for organized crime.

As far as the cost is concerned, it is obvious that the increase in logistics, required to stock illegal products, will consequently increase the price of the product itself.

Conclusion

Throughout these pages, we have seen that organized crime, ranging from drug trafficking to other criminal activities such as money laundering, people trafficking for purposes of sexual slavery, contract killings, etc. is a reality that is impossible to hide in Latin America. This criminal phenomenon is due to multiple causes. High levels of inequality, poverty, social exclusion and unemployment have to be considered as the main reasons why many young people decide to join these criminal armies.

On the other hand, public corruption levels are extremely high and show that the power of money coming from criminal organizations prevails over the probity of public officials. Every day in the region we hear news that links several public officials to members of criminal organizations, trying to conceal their own misdeeds.

All the institutions of the states of the region are unable to face a complex crime network that requires high-level skills. This inability of the public institutions is mainly due to scarce knowledge of the problem in each country and to the ongoing implementation of partial solutions.

The lack of an actual crime map that makes it possible to know precisely where and how crime organizations operate is another tool that Latin American countries don't have at their disposal. Undoubtedly, the region needs a comprehensive solution to tackle organized crime.

In order to succeed, it is necessary to build effective coordination channels, both internal and external, for analysis, investigation and prosecution purposes. Internal coordination means that states are willing to build a genuine public policy that needs to be implemented in conjunction with provincial and municipal governments. External coordination means that states are required to act conjointly in order to understand and address this problem all together.

Improving social indexes will be the best way to prevent organized crime from recruiting young people with uncertain future prospects.

Conclusions. Policy Implications for the EU

Antonella Mori, Loris Zanatta

Latin America has recently entered a phase of changes and transformations, which are affecting the region at different rhythms and in different ways from country to country. On the political front the "pink tide", as many experts defined it, is in obvious decline. The populist phenomena (such as Chavism or Peronism) which, at the beginning of the century, experienced a great deal of popularity, are now losing vigor and, in many cases, their ability to attract people. At the same time, it would be wrong to take for granted the success of more democratic systems, of more transparent and representative political institutions, of a more effective rule of law. Latin America faces a delicate transition at the political level. From an international perspective, the scenario that prevailed for over a decade, replicating the opposition of a coalition linked to Pan-Latin ideals and a group of countries loyal to Pan-Americanism, seems to lose importance today.

After rising dramatically for almost a decade, the prices of many commodities, especially those of energy and metals, have dropped sharply since 2014, and output growth has slowed considerably in the Latin American countries which are net exporters of commodities. Latin America faces the challenge of resuming growth and diversifying production, while at the same time protecting the achievements of the last decade in terms of poverty reduction, improved income distribution and social inclusion.

In a scenario of low primary commodity prices, many Latin American countries need to change their economic models and to increase the production of industrial products with more added value. Higher future growth will depend on governments' ability to provide higher quality public education, to strengthen the business climate, to enhance competition in product and labor markets, to improve infrastructure, to promote more efficient financial markets, to enhance research, development and innovation, and to strengthen institutions that secure property rights and stamp out corruption. **The European Union (EU) can be a very important partner in many areas**, e.g. education, research, innovation, infrastructure, the fight against corruption and criminal activities. The improvement of the social situation and of economic opportunities will serve to stem the spread of criminal activities and narco-trafficking. At the same time combatting those illegal activities will require imaginative solutions and brand new security partnerships. **The EU should expand information-sharing mechanisms with Latin American countries**, with real channels of coordination, both internal and external. On the other hand, the corrupting power of the immense amounts of money circulating in illegal markets has resulted in an increase of public corruption and the EU should cooperate with Latin America in the fight against corruption and money laundering.

The EU and the Latin America and the Caribbean (LAC) have already built a strong strategic partnership. The two regions share "historical, cultural and human ties, international law, full respect of human rights, common values, and mutual interests", as stated in the latest Brussels Declaration. Similar commitments were made at all the previous seven biannual EU-LAC Summits held since 1999 and now form a solid common vision. **The EU should aim at turning this common vision into a reality**. The emphasis should be on the proposed actions, their coherence with the common vision and the effectiveness of their implementation.

The Brussels Declaration and the Political Declaration made at the end of the II EU-CELAC (The Community of Latin American and Caribbean States) Summit reiterate the commitments to the bi-regional partnership and acknowledge the major global challenges that the two regions face but the associated Action Plan is feeble and not fully consistent. For example, the Brussels Declaration reaffirms the central role of increasing bi-regional trade and investments (points 45-49) but in the EU-CELAC Action Plan there is no Key Area dedicated to trade and there are virtually no initiatives related to bi-regional trade.

The EU should undertake initiatives aimed at increasing bi-regional trade and investments and do so in ways that help LAC countries to gradually move from exporting predominantly raw materials to selling more value added goods. One policy measure consistent with this goal would be for the EU to adopt cumulative rules of origin with the countries that have already signed or are in the process of negotiating free trade agreements with Europe. A suitable starting point could be the Pacific Alliance, given that Mexico, Chile, Colombia and Peru have already signed free trade agreements with the EU. The cumulative rules of origin would sustain the development of regional value chains within the Pacific Alliance – a model that could be eventually extended to all LAC.

The EU should also make market access easier, by reducing bureaucracy for customs' practices, technical standards, sanitary and phytosanitary measures. This is particularly important for SMEs and for countries without free trade agreements with the EU, i.e. Mercosur's members, Bolivia and Cuba.

As a consequence of the deceleration of global trade growth, deeper integration within Latin America becomes more important. More regional trade integration would allow countries to increase effective market size, stimulate competition, and support the development of regional value chains of intermediary goods. Regional integration would also help economic specialization and the diversification and sophistication of exported products, by fostering cross-country technology transfers and a reorganization of production at the regional level. **The EU should share its successful experience regarding the completion of the single market and the free movement of goods, services, persons and capital**.

Latin America is still the most unequal region in the world.

Better tax systems and public transfer policies are crucial to improve the region's income distribution. **The EU should assist Latin American governments willing to implement tax reforms aimed at increasing revenues available for public policies**. Also, **the EU should support Latin American governments to improve their way to direct public expenditures towards poor and vulnerable groups**. In fact, tax systems and public social spending in the EU are much more effective than those in Latin America at improving the distribution of disposable income.

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