

## Latin America's Quiet Revolution

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The Mexican government is locked in a vicious war against powerful drug cartels which assassinate public officials seemingly at will. Bolivian President Evo Morales's constitutional rewrites threaten to push the country toward civil war. Venezuelan President Hugo Chavez persecutes his political opposition, supports the FARC rebels in Colombia and is training a civilian militia supposedly designed to defend against an impending U.S. invasion.

A report by the U.S. Joint Forces Command released earlier this month calls Mexico a potential failing state, likening it to Pakistan. This assessment is particularly striking in light of the \$400 million per year that the United States provides in military and security assistance to Mexico. It also adds urgency to the U.S. government's plans to complete a 700-mile-long border fence and dramatically expand the number of Border Patrol agents, to over 20,000 by the end of 2009 from 11,000 in 2004 -- both of which have opened a rift between Washington and Mexico City. Our relationship to Venezuela is even more strained. In 2004 the Bush administration refused to continue our policy of selling military hardware and spare parts to the Venezuelans, prompting the Chavez government to not only purchase fighter-bombers, helicopters and 100,000 assault rifles from Russia, but to invite the Russian navy for joint naval maneuvers.

It is no mystery why so many people think that Latin America is plunging headlong into chaos. There is, of course, a group of troubled countries that includes Venezuela, Bolivia, Argentina, Ecuador and Nicaragua. The governments in these countries are hostile to the U.S., and act arbitrarily against their own citizens. What is taking place in these countries is not, however, a departure from a gloried past of rule of law, strong property rights and economic success. Rather, it is a continuation of a long history of mismanagement, overlaid with a thin patina of anti-imperialist rhetoric.

Most of Latin America is, however, undergoing a period of unprecedented political and economic transformation. In Chile, Brazil, Peru, Uruguay, Costa Rica, El Salvador, Panama, the Dominican Republic and, yes, Mexico -- which is most decidedly not a failing state -- there has been a quiet but substantial movement toward the creation of societies that are characterized by increased economic opportunity, social mobility and political democracy. This is not to say that Brazilians have achieved the same standard of living as the Dutch, or that the rule of law operates in Mexico as it does in Canada. It is to say, however, that these countries have undertaken a series of economic and political reforms that make them vastly different places than they were two decades ago.

The most obvious manifestations of this change are sound macroeconomic policies that have held down inflation, opened markets and encouraged investment, but these policies are often undergirded by changes in much deeper institutions, such as electoral rules that give rise to governments with centrist agendas or constitutional amendments that provide for independent central banks.

Chile provides perhaps the most obvious example of a country that has been undergoing dramatic changes -- and its success has served as a model for the rest of the region. Beginning in the 1970s, a series of reforms reshaped the economic playing field. Analysts often point to Chile's sound macroeconomic policies -- and rightly so. But these policies are the result of parliamentary rules that create incentives for legislators to converge on balanced budgets and of electoral rules that favor the two largest parties -- one of which is center-right and the other center-left, thereby minimizing the probability of a return to populist economic policies.

Other institutional reforms changed the nature of regulation and the enforceability of property rights. Under

the Chilean constitution, the government can only expropriate private property if Congress enacts a specific law, and even then compensation must be paid in cash at market prices; all economic activities are legal, unless Congress passes specific laws regulating them; and citizens can protect themselves from arbitrary government actions that reduce their rights to life, liberty and property by obtaining an injunction from an appellate court -- in which they need not be represented by legal counsel. Chilean gross domestic product per capita has doubled over the past 18 years, the fastest sustained expansion in the country's history. Poverty rates have fallen precipitously. Young Chileans from humble families are attending college and buying homes. Indeed, Chile has a homeownership rate roughly equal to that of the United States, about 70%.

Mexico provides a similar example. From 1929 to 2000 a single party, the Institutional Revolutionary Party (PRI), monopolized political power. After decades of corruption, economic mismanagement and arbitrary actions against the property rights of citizens -- which included the expropriation of the entire banking system -- the PRI was finally forced from power in 2000, when voters elected Vicente Fox, the presidential candidate of the center-right National Action Party (PAN). Voters again elected a PAN candidate, Felipe Calderoacute;n, in 2006.

Since 2000, PAN governments have enacted reforms that have enhanced the rule of law by establishing the legal principle of innocent until proven guilty, mandated government transparency through a freedom of information act, eased access to credit by increasing competition in financial services and encouraged homeownership via reforms to contract and banking law. Some sense of Mexico's transformation can be gleaned from one fact: In order to run competitively in the 2006 election, leftist Andres Manuel L&oacute;pez Obrador had to jettison most of his left-wing stances during the campaign in order to be competitive with the PAN -- and he lost anyway.

Many of Mexico's reforms are of a variety that only a CPA might find exciting. Not surprisingly, they have gone unnoticed in the foreign press. A 2001 reform allows banks to write mortgage contracts as bilateral trusts, in which the bank is both trustee and beneficiary, instead of as liens on property. This new form of contract means that a mortgagee can no longer default on a loan and prevent repossession for years on end by using the country's notoriously inefficient bankruptcy courts, because the assets being collateralized are held by the trust and are not part of an individual's bankruptcy estate. As a result, banks are more likely to make housing loans in the first place. Coupled to additional reforms that created a system of private housing accounts financed by payroll taxes, and that created a federal mortgage society that operates in a manner similar to Fannie Mae, homeownership has been placed within reach of millions of Mexican families.

Recent reforms have also encouraged competition in financial services. As a first step, the government allocated charters to nonbank financial intermediaries that could make housing and automobile loans. As a second step, it granted bank charters to retail giants, including American-owned Wal-Mart, thereby allowing families of modest means to open accounts and obtain credit to finance the purchase of consumer goods. The bottom line: Living standards, as measured by infant mortality rates, life expectancy and years of education, have all improved in Mexico over the past decade.

The Mexican state is weak when compared to the U.S., but incredibly strong when compared to places in Central Asia or Africa that are usually called failing states. There are no foreign troops on Mexican soil. There is no martial law. Garbage is picked up, streets are swept and children go to school. Middle-class couples take weekend getaways, and drive there on highways as good as those in the United States. After falling for a decade, Mexico's homicide rate increased in 2008, because the Calderoacute;n government courageously decided to take on the drug traffickers. If it keeps rising, it may soon be as high as that of...Louisiana.

Chile and Mexico are not isolated cases. Recent Brazilian governments have brought an end to the country's long history of hyper-inflation, privatized inefficient and corrupt state-owned banks and created a social welfare system based on the premise that families can only obtain public assistance if they keep their children in school. In Peru, recent governments have not only practiced sound economic and fiscal policies, they have taken the advice of reform-minded economists like Hernando de Soto seriously, granting title to some 1.2 million poor families between 1988 and 1995. The country has grown at better than 6% per year over the past decade.

The quiet nature of the changes occurring in most of the region tend to be lost among the din created by bombastic leaders such as Bolivia's Mr. Morales and Venezuela's Mr. Ch&acute;vez, and to a lesser extent by Argentina's Cristina Fern&acute;ndez, Ecuador's Rafael Correa and Nicaragua's Daniel Ortega. These leaders do not represent a break with a mythic past of strong private property rights, government accountability and sound economic policies. The 20th-century history of all five countries was characterized by fiscal profligacy and property expropriations.

Argentina's Ms. Fern&acute;ndez is a case in point. For all her ability to make headlines by pronouncing her friendship with Mr. Ch&acute;vez, she is not very radical by Argentine standards. Her predecessors partially expropriated the bank deposits of Argentine citizens -- on two different occasions within an 11-year period. Thus, her recent nationalization of the pension funds of millions of Argentines a new twist on an old story.

Mr. Ch&acute;vez's expropriations of domestic and foreign companies, as well as Chavista seizures of farm land and urban real estate, are also making a bad situation worse. Venezuela should have been a major beneficiary of the oil price hikes that began in 1973, but systematic mismanagement meant that, during the two decades preceding Mr. Ch&acute;vez's election in 1998, Venezuelan per capita GDP actually shrank by a staggering 21%.

Seen in this light, Mr. Ch&acute;vez's rise to power is easily understood. His regime is based on a simple principle: direct oil revenues toward the creation of public employment, subsidized food and other policies that benefit the country's poor, who, in turn, provide him with electoral support. Indeed, the civil militias he has created have nothing to do with defending the country against a foreign invasion, and everything to do with putting \$50 per month in the pocket of an unemployed young voter.

Every country in the region is now being hit by falling commodities prices and the contraction of credit. The economic and institutional modernizers have sound economic fundamentals and popular political support. That will not make them immune from calls from some quarters to return to populism -- and to cover that populism with anti-imperialist rhetoric and anti-American foreign policies. If that happens, we will have a difficult time stemming drug trafficking and combating terrorism. These economic and institutional modernizers are our natural partners; we need to be able to offer them more than border fences and platitudes about free trade. They will likely need technical and financial assistance -- and it is in our national security interest that they receive it.

The countries that have chosen leaders who think that bombast is a substitute for property rights are going to find that they have painted themselves into very tight corners. The most bombastic, Mr. Ch&acute;vez, will, in fact, find himself in the tightest corner of all. He has created a set of powerful expectations among Venezuela's poor that were difficult to satisfy even when oil prices seemed to have no end in sight. Now, as oil prices collapse, the mismatch between what his constituents have come to expect and what he can deliver grows larger by the week. In the short run, he has two options: print money or curtail imports. The outcome of both policies will be observationally equivalent: the very group that provides him with electoral support, Venezuela's poor, will see its standard of living fall dramatically.

If the history of Latin America's earlier populist regimes is any guide, the end will be predictable. As his base of support erodes, Mr. Chávez will be forced to increase repression, but that requires the absolute loyalty of the armed forces, something that he does not have. Mr. Chávez's situation, along with the deteriorating political futures of other populists, most particularly Ms. Fernández, is not lost on political elites in the rest of the region. They are, in short, becoming far less consequential to the rest of Latin America -- and to us.

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