

Point of View | Steve H. Hanke



LATIN SINKHOLES

DURING THE PAST FIVE YEARS LATIN AMERICA HAS reaped the benefits of surging commodity prices and low interest rates. Unlike past commodity-driven booms, this one has not been accompanied by fiscal profligacy. Indeed, net public debt issuance has declined sharply, with many countries buying back some of their outstanding debt. Some have also continued down the free-market reform road toward flexibility and modernization, notably Colombia, El Salvador, Guatemala and Peru.

But not all of the politicians in this region believe in free markets. They have turned back the clock. Venezuela's President Hugo Chávez is the leader of the negative reformers. Following his bad example are Ecuador, Argentina and Bolivia. Chávez came to power in February 1999; he hails Cuba, the largest open-air prison in the Americas, as his model. His revolution's enemy is the marketplace.

According to the World Bank's recently released "Doing Business 2008" report, Venezuela is tied with Zimbabwe as this year's champion in smothering economic freedom. In terms of objective measures concerning the ease of doing business, Venezuela sank from 163rd to 172nd out of 178 countries covered. At present high oil prices are masking Venezuela's economic sins. What happens when oil's price comes back to earth? Don't expect any surge of entrepreneurship to take up the slack in Caracas.

Oil prices have increased almost eightfold since Chávez took office and now account for 90% of Venezuela's exports. Despite that, Venezuela's economic performance under Chávez has been anemic; its gross domestic product per capita has grown at an average rate of only 2% per year. Inflation has averaged 34% a year, the highest in Latin America.

When Chávez assumed power the bolivar, Venezuela's currency, was trading at 577 per dollar. In February 2003 the bolivar was pegged to the U.S. dollar at 1,600; in a desperate bid to stop the flight of hard

currency, Chávez also put exchange controls in place.

These didn't stem Venezuelans' desire to dispose of bolivars as rapidly as possible. The official rate now: 2,150 to the greenback. But on the black market the bolivar is worth 64% less, 6,000 per dollar.

Chávez plans to ring in the New Year by lopping three zeros off the currency and issuing a "strong bolivar" at the exchange rate of 2.15 per dollar. This cosmetic change won't alter anything.

Ecuador has been the most recent country to be caught up in Chávez's Bolivarian Revolution. Rafael Correa, a trained economist, was sworn in as Ecuador's new president on Jan. 15. Like Chávez, he is very popular, and clever like a fox.

Since assuming office Correa has been ruthlessly efficient. He has completely sidelined the Ecuadoran Congress and pushed through a popular referendum that approved the establishment of a Constituent Assembly to rewrite Ecuador's constitution. The new constitution will be the twentieth since Ecuador gained independence in 1830.

That's a neat ten times as many as we've had, if you count the Articles of Confederation (1777-89) as a constitution. Correa's objective is to amass executive power, as Chávez has in Venezuela, so he can do a better job of stomping out free-market economics.

But Correa isn't waiting for the Constituent Assembly to change the rules. He has already instituted a de facto nationalization of oil production by raising the state's share of oil companies' profits from 50% to 99%.

One big thing differentiates Ecuador from Venezuela, however. After a long history of bad money, Ecuador abandoned the sucre in 2000 and replaced it with the U.S. dollar. Since then the average GDP per capita growth rate has been 4.4%, and inflation is estimated at 2.1% for 2007. No wonder dollarization has an 82% approval rating.

To pull off a Bolivarian Revolution in Ecuador, Correa must either dump dollarization or undermine it. Given its popular support, Correa won't attack dollarization directly. Yet he has started to undermine it by proposing a 1% tax on capital flows into and out of the country. This form of exchange control is strictly verboten under orthodox dollarization. It is also a very worrying sign; it indicates that Correa will attempt to impair dollarization, which is the linchpin for the Ecuadoran economy.

When the commodity-driven boom abates, Latin America's economic sinkholes will take hard hits. The next round of revolutions and constitutions will not be pretty. **F**

What's going to become of Venezuela and Ecuador when the commodity boom subsides? Probably nothing nice.



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