A New Vintage of Populism in Latin America?

THE PERILS OF THE NEW PARADIGM

Mauricio Cárdenas and Enrique Sanz Posse

Abstract

As the politics of polarization gain traction and electoral support, a new vintage of populism is emerging in Latin America. This new version shares some aspects with the type of cultural populism now common in advanced economies that divides societies into antagonistic camps. But there are also important differences. The new paradigm in Latin America undermines the system of checks and balances, including an active use of street power and social mobilization as well as changes to electoral rules, to enhance presidentialism. In the case of left-leaning leaders, the new Latin American paradigm is giving the State an increasingly relevant role in the economy. However, it explicitly preserves sound macroeconomic management, in contrast to previous versions of populism. The crucial question is whether macroeconomic stability will prevail under this hybrid model, with a larger role for the state and greater economic intervention, in the context of more divided societies facing low expected economic growth.

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A New Vintage of Populism in Latin America? The Perils of the New Paradigm

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1. Introduction

This paper discusses the emergence of new political paradigm in Latin America in the context of low growth, reversals in terms of social progress, and dissatisfaction with the outcomes of the Washington Consensus. Many aspects of the Latin America's paradigm borrow from the type of cultural populism now common in advanced economies, a definition based in what Mudde (2004, 2007) and Mudde and Rovira Kaltwasser (2017) call a 'thin-centered ideology' that divides societies into 'the pure people' and 'the corrupt elite,' (Guriev and Papaioannou, 2022). However, the confrontation between two homogeneous and antagonistic groups is far from a complete characterization of recent political trends in the region.

The new paradigm is also different from the old-school Latin American populism, defined in the classical work of Dornbusch and Edwards (1991). Politicians now seem to have internalized the importance of macroeconomic stability and do not directly challenge its main tools, such as inflation targeting (including central bank independence) and the use of fiscal rules. In this important sense leaders embracing a new paradigm are not classical populists.

Rather than a trade-off between inflation and redistribution, which was the key tension in the past, what has emerged is an identity struggle between "us" and "them" (see also Guriev and Papaioannou, 2022). Leaders on the left combine these elements with an agenda that empowers the State and reduces the role of the private sector. An active use of regulatory powers, a greater scope of action for State-Owned Enterprises (SOEs) and development banks, and the nationalization of pension savings are common elements of the new approach. Leaders on the right, in contrast, emphasize the importance of law and order, internal security, and the role of the private sector. Both camps share an appetite for the use of social media and mass mobilization in ways that undermine institutions and strengthen presidentialism.

However, the "politics of emotion" are not a sufficient characterization of current political trends in the region. Equally inadequate are the arguments that describe the current phase as a return of fiscal populism. In the case of leaders with a left leaning ideology, what is taking place is an attempt to increase the role of government in sectors considered "strategic," such as health, pensions, public utilities, energy, and mining. The climate agenda is also centerstage with many governments emphasizing the role of industrial policies (as in advanced economies) to accelerate the energy and climate transition. The growing influence of China in the region is another aspect to consider as part of the new paradigm. This is happening in tandem with political changes that empower marginalized and excluded groups.

The more statist vintage of the current paradigm—compared with its predecessor the Washington Consensus—can have two effects in the medium term. First, it is not supportive of private investment (domestic nor foreign), which could further deteriorate an already grim growth outlook.

Second, corruption, a key component of the frustrations that led to the change in paradigm, could worsen as the state is given more responsibilities and resources.

The rightwing version of populism has other consequences. Adherence to sound macroeconomic policy management can also be jeopardized by a gradual dismantling of the checks and balances on executive power, including economic institutions such as central bank independence. As argued by Acemoglu and Üçer (2019) in the context of Turkey, fiscal dominance over monetary policy did occur during a period of rightwing populism.

Leaders willing to fulfil undelivered promises to a growingly demanding electorate can lean towards old style populism and disregard macro stability, independently of their political ideology. A new form of hybrid populism where identity politics are combined with fiscal and monetary largesse is not an outcome that can easily be ruled out.

2. A new form of populism?

In the wake of the COVID-19 crisis and in the backdrop of a global "confluence of calamities", a new political paradigm has emerged in Latin America. A salient feature is its anti-establishment rhetoric and the constant clash with the liberal technocracy. Although these traits resonate with previous incarnations of populism in the region, especially the variety that was dominant during the second half of the twentieth century, there are more differences than similarities with the "old-school" populism.

The new paradigm does not share the disregard for the risks of inflation and deficit finance, which was a defining feature of Latin America's populism. Paraphrasing the classical definition of Dornbusch and Edwards (1991, p. 9), new leaders do not seem willing to ignore the existence of constraints on macroeconomic policy. In this important sense they are not classical populists.

It is tempting, however, to classify the new paradigm emerging as a new vintage of the populism that so well described Latin America in the past. In fact, Edwards (2019) argues that the new defining traits of populist leaders in the region include the widespread use of "blanket regulations, deep protectionist policies, large expansions of the public sector, and mandated minimum wage increases to redistribute income." In his view, the new populism contrasts with the classical version because fiscal dominance and runaway inflation are no longer at the center of the policy options and outcomes (see also Funke et al. (2020)).

For sure, uneven income distribution, high levels of dissatisfaction with economic performance, and lower living standards caused by the Covid-19 pandemic –a dynamic that is not too dissimilar of previous populist experiences—are present again. The new paradigm is emerging as a result the looming economic stagnation, in the context of high debt, deglobalization, and increasingly frequent extreme weather events. Reminiscent of the old-style populism, the new left-leaning paradigm puts inequality (in sharp contrast to the Washington Consensus) at the center of the policy agenda.

Past episodes of populism typically resulted in deep economic crises and were followed by adjustment and stabilization, often with the intervention of the IMF. Although crises may occur again, the lack of financial crises in the last two decades is a distinctive feature of Latin America. Despite significant shocks, such as the global financial crisis, the end of the commodities boom and, more recently, the Covid-19 crisis, the region is no longer the poster child of irresponsible or unsustainable macro policies. Although crisis can occur again, rather than macro imbalances, excessive government intervention in key markets, and limited effective capacity of the state to replace the private sector in certain areas, can become the triggers of a period of low growth.

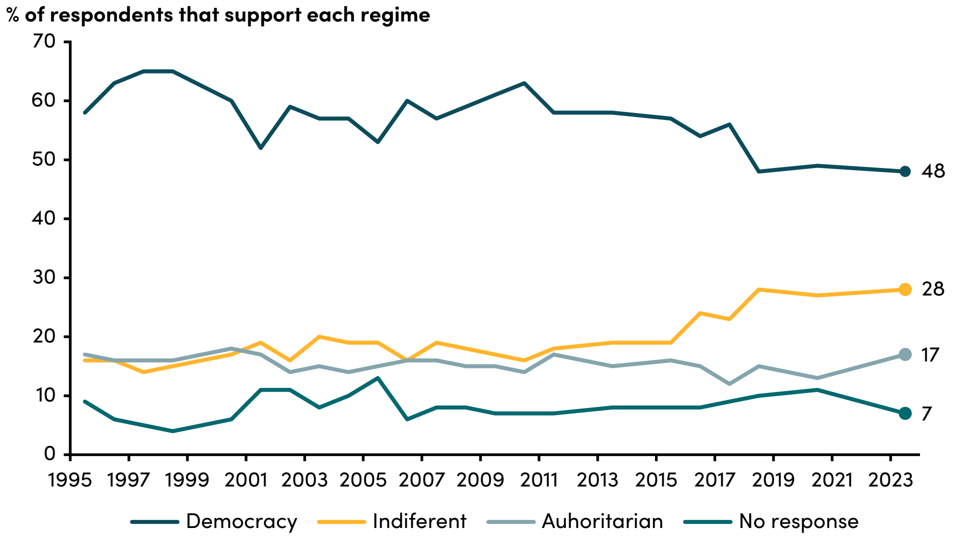
However, this description would be incomplete without considering the expressions of rightwing populism in Latin America. Interestingly, the episodes "rightwing" populism in advanced economies, most notably around the rise of the far and "alt" right in the United States, or the nationalistic movements growing in strength across European countries, have not sought to structurally alter the economic institutions that shape the high-level relationship between markets and the state (with the important exception of Brexit). This situation is not entirely different in Latin America.

Precisely for this reason, this paper focuses only on those cases where the new paradigm in Latin America goes beyond the use of identity politics and involves some fundamental economic and social changes. Although identity and cultural factors have played a role in shaping the new paradigm, the political struggle has been reflected in policy choices directly related to the way the economy operates and, importantly, to the role of the State.

3. A response to discontent and weak growth

LAC's new leaderships ride on a wave of discontent with the existing political system and its outcomes. According to Latinbarómetro (2023), support for democracy in Latin America has fallen dramatically over the past decade. **Figure 1** shows the steady drop in the fraction of the population that agrees with the statement that democracy is preferable to any other type of government (reaching only 48% in 2023). Indifference between democracy and autocratic rule reached 28%, with those who agree that an autocratic government is sometimes preferred to a democratic now at an all-time high of 17%. This rising anti-democratic sentiment emboldens populist leaders to challenge the "corrupt elites or castes."

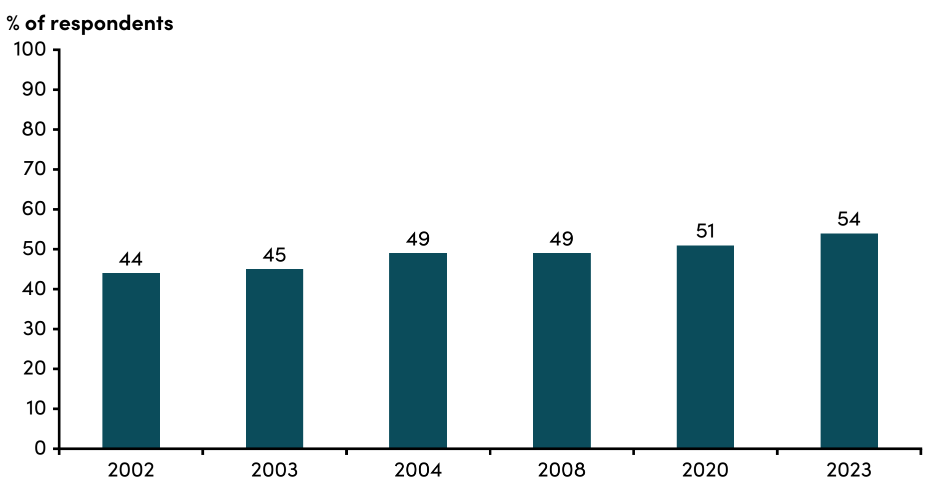
FIGURE 1. Democracy loses support across the region



Note: The survey asked respondents with which statement they agreed the most between: "Democracy is preferable to any other type of government", "In certain circumstances, an autocratic government is preferable to a democratic one", or "For those like me, we are indifferent between an autocratic or a democratic regime".
Source: Latinbarómetro (2023).

It is unsurprising that the region is increasingly more receptive of authoritarian rule: 54% of Latin-Americans would not mind if a non-democratic government took power (in contrast to 44% two decades ago) (see **Figure 2**). This worrying trend is consistent with the anti-establishment rhetoric, which can be transformed into an erosion of democratic institutions. The case of Nayib Bukele in El Salvador is paradigmatic.

FIGURE 2. Latin-Americans would not mind an authoritarian rule if it solved problems

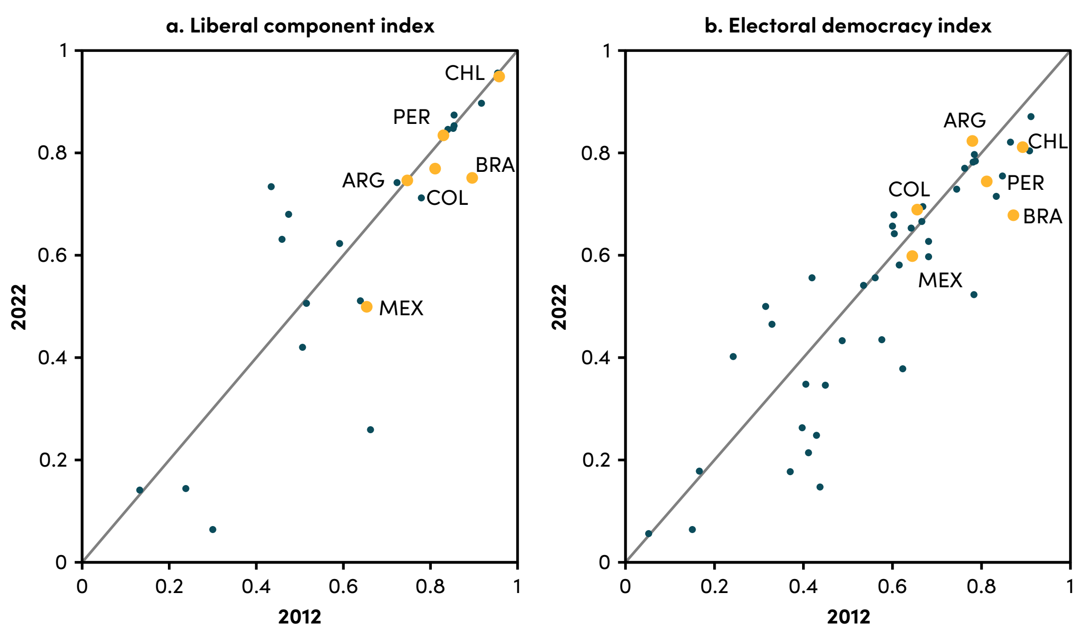


Note: The survey asked respondents with if they agreed or disagree with the statement "I would not mind if a non-democratic government assumed power if it solved issued". Pictured here the sum of those who responded "agree" and "very much agree".
Source: Latinbarómetro (2023).

To complete the picture, the Liberal Democracy Index (LDI), constructed by the Varieties of Democracy Institute (V-Dem), deteriorated in eight LAC countries between 2012 to 2022, while it improved only in three (see Papada et al. (2023)). **Figure 3** shows the two main components of the LDI comparing LAC's score in 2012 versus 2022 (dots below the diagonal line implying a deterioration of democracy). **Figure 3a** shows the Liberal Component which "captures the limits placed on governments in terms of two key aspects: The protection of individual liberties, and the checks and balances between institutions" (Papada et al., 2023). **Figure 3b** shows the Electoral Democracy component, which "reflects a relatively ambitious idea of electoral democracy where a number of institutional features guarantee free and fair elections such as freedom of association and freedom of expression" (Papada et al., 2023). On both accounts, scores for LAC's six largest economies deteriorated or remained the same between 2012 and 2022.

These results suggest how liberal democracy indicators across the region have been sliding, while autocratic governance styles have become more frequent. Overall, these results suggest that the narrative of the "pure-people" against the "corrupt-elite" will continue to permeate the political discourse in LAC. With the public's sentiment less supportive of liberal democracy, LAC's political leaders can take an autocratic turn at a lower political cost.

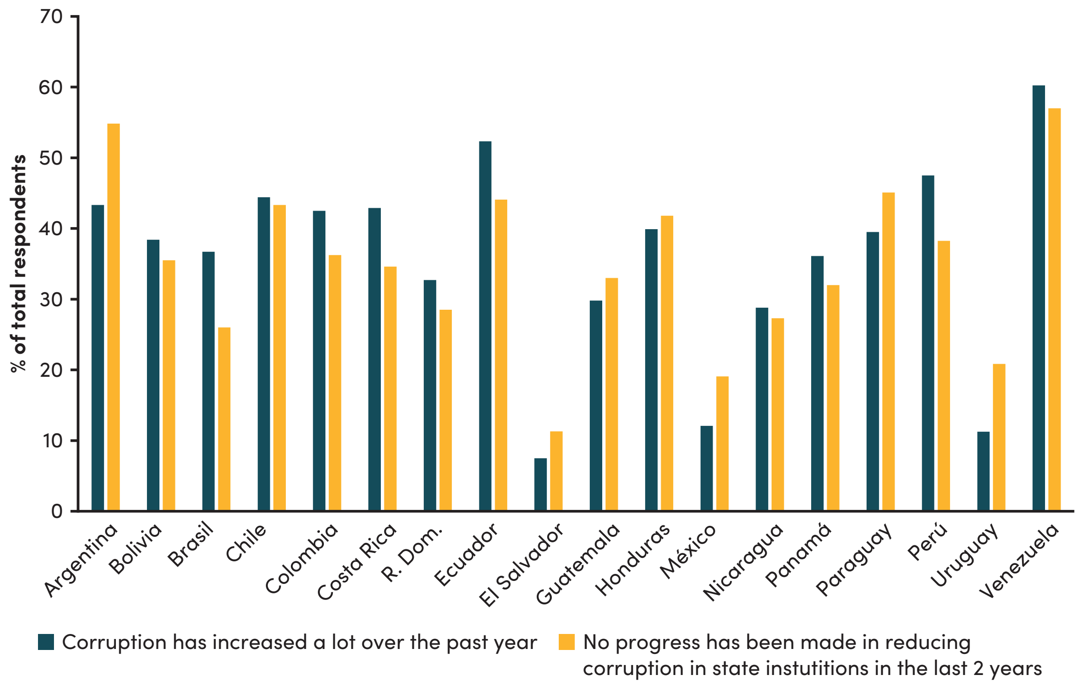
FIGURE 3. Liberal democracy index in LAC deteriorated between 2012 and 2022



Source: Papada et al. (2023). V-Dem Institute.

Strong posturing against corruption seems central to the political identity of many of the new leaders. Declaring themselves to be outsiders is also effective in seeking support from the "common citizen" against the traditional forces that have shaped policies in the past, including technocrats. Outsiders ride on the anti-corruption sentiment as the unambiguous perception is that no progress has been made in reducing this problem (see **Figure 4**).[1]

FIGURE 4. Latin-Americans sense corruption is on the rise and institutions do nothing to stop it



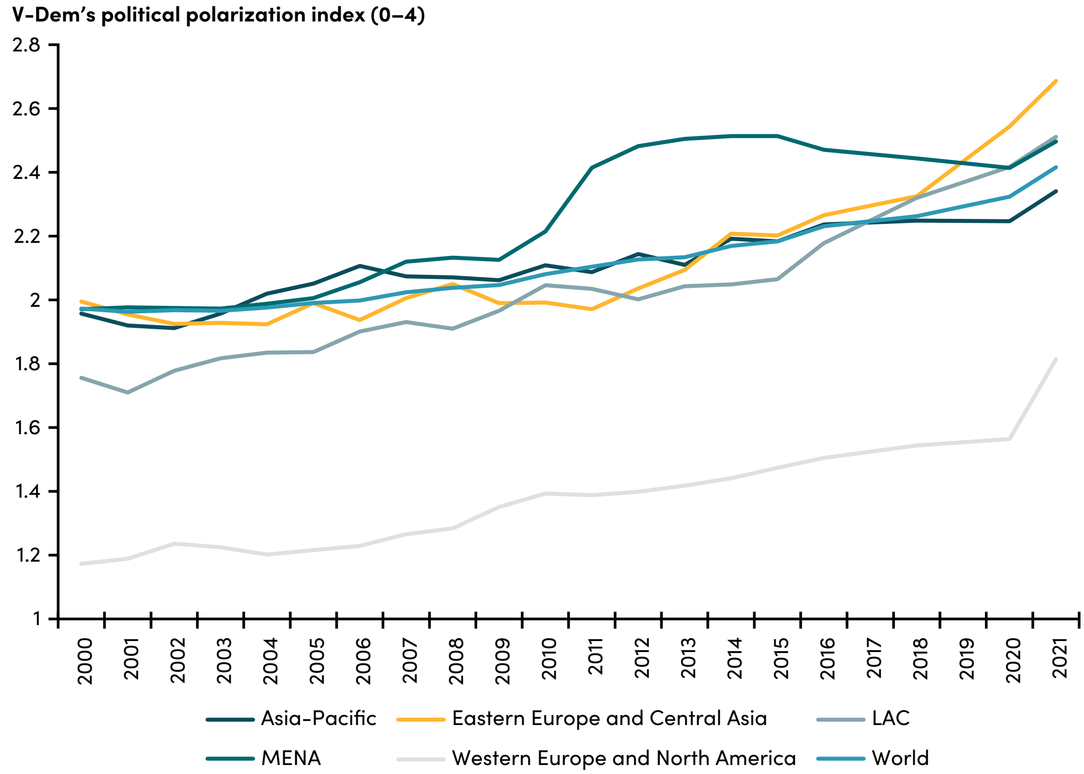
Source: Latinbarómetro (2021).

In addition to the disenchantment with democracy and the greater indifference towards autocratic means of government, the V-Dem Institute's polarization index (2023), has increased the most in LAC since 2000, relative to any other region.[2] For instance, **Figure 5** shows the secular rise in political polarization and how the increase in LAC, relative to the levels seen in 2000, has been the greatest. Increasingly divided societies between antagonistic camps feeds the "Us vs Them" narrative and further cements the shift away from pragmatism into radicalization, and from democracy into autocracy.

1 The questions asked are: In your opinion, over the past year, has the level of corruption in this country increased a lot, increased some, stayed the same, decreased some, decreased a lot? In the last 2 years how much progress has been made in reducing corruption in state institutions?

2 The V-Dem Institute (2023) measures polarization in a scale from 0 to 4 the extend at which is society polarized into antagonistic, political camps.

FIGURE 5. Political polarization is on the rise across the world



Source: UNDP (2023) using V-Dem's Institute database.

Turning to the economic outlook, the region's GDP is expected to remain growing at a moderate but low pace, which can increase levels of dissatisfaction (see **Table 1**). However, the main cause of the low growth projections is the state of the global economy. In fact, according to the IMF's World Economic Outlook (WEO) the global economy is entering a phase of low economic growth by historical standards—a 3.0 percent forecast until 2028 which is the lowest medium-term growth forecast published in all WEO reports since 1990. In a similar vein, the World Bank (2023) noted in its June 2023 report on Global Economic Perspectives (GEP) that weak growth prospects and heightened risks in the near-term compound a long-term slowdown in potential growth.

In the specific case of Latin America and the Caribbean (LAC), productivity growth and long-term economic growth are currently estimated at only around 2%—too low to meet the development goals of most countries in the region (IDB, 2023b). The IMF forecasts that the region will grow at a 2.8% rate during the present decade (up until 2028), which is only slightly higher than the 2.3% average in the "lost decade" of the 1980's. In cases such as Brazil, Chile, Colombia, Mexico, and Peru, growth will be below the levels seen in previous decades, including the 1980s.

TABLE 1. GDP growth: slow and moderate
% Change

	1980's	1990's	2000's	2010's	2020–2028*
ARG	–0.9	4.3	2.6	1.4	1.9
BRA	3.0	1.7	3.4	1.4	1.9
CHL	3.6	5.9	4.2	3.3	2.1
COL	3.4	2.9	3.9	3.7	3.0
MEX	2.3	3.7	1.3	2.3	1.5
PER	0.6	3.2	5.0	4.5	2.3
LAC	**3.1**	**3.2**	**4.3**	**3.3**	**2.8**
OECD	**2.9**	**3.1**	**2.7**	**2.4**	**2.0**
OECD ex-LAC	*3.0*	*3.0*	*2.7*	*2.3*	*1.9*

Notes: LAC average excludes Venezuela. *Forecasts by the IMF starting after 2022.
Source: IMF World Economic Outlook—WEO (October 2023).

In addition, tight financial conditions across the world are particularly problematic given the high post-Covid19 pandemic debt levels. Interest payments as a percentage of fiscal revenues have increased and will remain high. In fact, some estimates suggest that current debt levels in the region exceed a sustainability threshold level indicating higher fiscal risk (IDB, 2023b).

An additional challenge for LAC comes in the face of deglobalization and the rising geopolitical tensions. Concerns about supply chain security, as well as domestic political pressures, have prompted several countries to implement trade and investment restrictions (OECD, 2023).
The growing number of restrictive trade measures reflects a rising degree of geopolitical tensions and attempts by some major economies to follow more inward-looking policies (World Bank, 2023).
In addition, as Cavallo and Fernández-Arias (2023) argue, LAC economies are more susceptible to external crises in comparison to both advanced and other emerging economies due to the higher dependency on commodities and capital flows.

LAC is also exposed to the volatility of commodity prices. Empirical evidence suggests that in recent decades, commodity price cycles have become increasingly synchronized. Since 1996, global macroeconomic shocks have been the main source of commodity price volatility (World Bank, 2022). This means that LAC countries are now jointly exposed to global economic shocks.

However, it is important to underscore the lower current account deficits that are projected for the region, as shown in Table 2, which reduce the level of vulnerability to external shocks. In the past, large current account deficits were the norm during episodes of populism as internal shortages and inflationary pressures were alleviated through imports and the manipulation of the exchange rate. In contrast, there is no evidence that the region will run into large external deficits during the coming years.

TABLE 2. Current account balance: high deficits but lower than historical
% of GDP

	1980's	1990's	2000's	2010's	2020–2028*
ARG	–1.8	–2.3	2.2	–2.2	0.6
BRA	–3.1	–1.7	–1.0	–3.2	–2.2
CHL	–6.6	–2.6	1.0	–3.5	–4.3
COL	–2.1	–1.6	–1.4	–4.0	–4.5
MEX	0.4	–3.9	–1.1	–1.7	–0.7
PER	–4.8	–5.9	–0.7	–2.5	–1.7
LAC	**–2.2**	**–3.4**	**–1.1**	**–2.2**	**–2.1**
OECD	**–1.8**	**–0.8**	**–1.3**	**0.7**	**1.1**
OECD ex-LAC	*–1.5*	*–0.5*	*–1.3*	*1.1*	*1.2*

Notes: LAC average excludes Argentina. *Forecasts by the IMF starting after 2022.
Source: IMF World Economic Outlook (April 2023).

Taken together, this section underscores the dissatisfaction with democratic institutions in a somewhat somber economic environment. The region is experiencing a period of low growth, high debt, and high interest rates. In this sense, the new paradigm is a response to a complex context and a series of longstanding issues.

4. Some defining traits: Continuity despite the rhetoric

In addition to the "us" vs "them" rhetoric, a common recourse of Latin America's new paradigm is the criticism of neoliberal policies, epitomized by the Washington Consensus. In fact, the disdain for what the Washington Consensus represents is an important role in the anti-elite identity. Neoliberalism is a catch-all word that encapsulates the old order, including the belief in markets, the influence of International Finance Institutions, the benefits of globalization, and the policy advise of "misguided" or "ill-intentioned technocrats.

As argued by Goldfajn, Martínez and Valdés (2021), the Washington Consensus started as a raw model for policy makers but rapidly became the straw man of politicians. Although the label is now tainted—with many politicians arguing that the maladies of the region were the direct consequence of having adopted the wrong prescription—, some key aspects of the Washington Consensus remain in place and, contrary to what is commonly perceived, are part of the new paradigm.

John Williamson's 1989 original 10-point list of policy recommendations became a "set of economic policies advocated for developing countries in general by official Washington, meaning the international financial institutions (primarily the IMF and World Bank) and the US Treasury" (Williamson, 2004). **Table 3** summarizes the list "widely agreed in Washington to be desirable in just about all the countries of Latin America" (Williamson, 2004) as described by Goldfajn, Martínez and Valdés (2021). The two guiding principles are the limits the scope of the State intervention and engagement in the economy, and the emphasis on macroeconomic stability. These principles stand in sharp contrast with the lack of macroeconomic policy constraints favored by LAC's populists during the twentieth century (see Dornbusch and Edwards (1991)).

TABLE 3. Washington consensus

Original 10-Points WC	Description
1 Fiscal Discipline	Fiscal discipline, with a deficit of 1 to 2 percentage points of GDP considered adequate.
2 Reorientation of public expenditures	Public expenditure reallocation into priority sectors, namely, education, health, and public investment.
3 Tax reform	Tax schemes characterized by a broad tax base, moderate marginal tax rates, and a strong tax administration, as fiscal revenues had to support the needed public investment and expenditure.
4 Financial Liberalization	Market-determined interest rates and real rates at moderate positive (or at least not negative) levels.
5 Unified and competitive exchange rates	Competitive exchange rates to support export-led growth, while avoiding multiple exchange-rate regimes, where the exchange rate could either be market-determined or set at a level consistent with a sustainable current account deficit.
6 Trade Liberalization	Trade policy aimed at liberalizing imports to allow exporters access to the necessary capital and intermediate goods to be competitive in international markets; in particular, reducing tariffs to 10 to 20 percent, with low variance and removing all other forms of import barriers.
7 Openness to FDI	Opening to foreign direct investment (FDI) to obtain much-needed capital investment, along with skills and know-how.
8 Privatization	Privatization to relieve public deficits and improve efficiency and competition.
9 Deregulation	Deregulation to promote competition by eliminating different types of barriers to entry or privileges to specific firms.
10 Secure Property Rights	Strengthening of property rights, which were viewed as fundamental to the proper functioning of the economy and specifically the promotion of private investment.

Sources: Williamson (2004). Descriptions taken from Goldfajn, Martínez, and Valdés (2021).

LAC countries began implementing these policy recommendations in the 1990s, but it was in the wake of the end-of-century economic crisis that most of the recommendations took the form of policy actions. Although it is hard to disentangle the consequences of the policy package, mainly because at the same time the region benefited from rapid growth as result of the commodities super-cycle led by China's growth. It is well established that the region had a remarkable performance on social and economic grounds in the following years, lasting until the mid 2010s when the terms of trade deteriorated.

The new paradigm is not a complete departure from what is labeled as the "neoliberal" agenda, with the important difference that the State is brought back in with a focus on regulation and the rejection of privatization. Although this is the defining feature of the new paradigm, the relevance of sound macro policies is an equally important aspect.

Promoting an agenda focused on distribution and a more active role for government, with stronger intervention, wider scope of action for State Owned Enterprises and development banks, is at the core of the new model. This new direction contrasts with the Washington Consensus, with its pro-market reforms, deregulation, and reduced state intervention. Addressing the limited government capacities, including the need to increase tax revenues, is a component of the new paradigm.

Table 4 lists the key elements of today's Latin American paradigm. The first column reiterates the items from old consensus that have not been fully rejected (although neither wholeheartedly endorsed). This includes independent monetary policies, fiscal discipline, and free trade and capital flows.

TABLE 4. The new Latin American paradigm

Continuity	New Paradigm	Political
1. Independent monetary policy 2. Fiscal discipline 3. Trade liberalization 4. Openness to FDI and free capital mobility	5. Prioritize distributional issues (main tool are cash transfers) 6. Re-industrialize through climate action 7. Active use of SOEs and development banks 8. Use of regulatory powers to reduce scope of private investment 9. Deeper economic integration with China	10. Use of social mobilization to undermine institutional checks and balances 11. Attempts to strengthen presidentialism 12. Empower underrepresented groups (e.g., marginalized indigenous communities).

Source: Own elaboration.

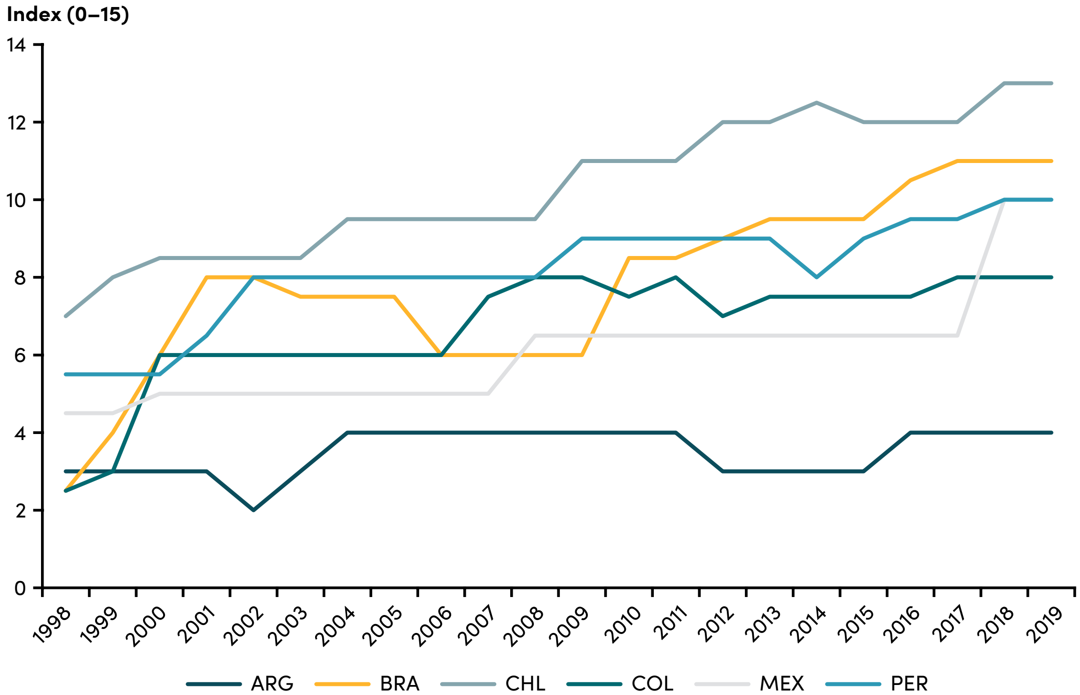
Central bank independence

According to Birdsall, de la Torre, and Valencia Caicedo (2010), one important aspect of the package adopted in the 1990s was central banking reform, which virtually eliminated the monetary financing of fiscal deficits leading to the reduction in inflation (which on average for the region was of 92.7% per year during the 1980's). Today's leaders are aware of the significant political costs of high inflation and thus central bank independence continues to be a cornerstone in the macro policy framework.

To illustrate this point, Dincer, Eichengreen, and Geraats (2022) build the Monetary Policy Transparency Index based on the IMF's Central Bank Transparency Code which ranges from 0 (low transparency) to 15 (high transparency). As shown in **Figure 6**, central bank transparency and accountability in Latin America has increased, apart from Argentina. Higher degree of monetary policy transparency implies greater accountability on the part of the monetary authorities and thus lowers the range of action by policymakers to manipulate monetary policy decisions.

The trend across the region towards greater monetary policy transparency is a salient feature, despite the changes in political preferences.

FIGURE 6. Monetary policy transparency index



Source: Dincer, Eichengreen and Geraats (2022).

Fiscal rules

The original Washington Consensus called for small budget deficits and a reorientation of public expenditures toward neglected areas with high economic returns and the potential to improve income distribution, such as primary health and education, and infrastructure (Williamson, 2004). Interestingly, the new paradigm is not at odds with this view. On the contrary, the use of prudent and sustainable fiscal policies has become a key vehicle to signal credibility to markets and investors. This has been especially true of left-leaning governments in Chile, Colombia, and Mexico.

Notoriously, Mexico's president has built a reputation of being a fiscal hawk, restraining fiscal deficits until recently (even during the COVID-19 pandemic).[3] In Colombia, the government has until now endorsed the fiscal rule (although recently has started questioning its benefits).[4] More broadly, LAC countries have fiscal rules or similar institutional arrangements that introduce constraints on fiscal policy, very much contrary to the type of populism documented by Dornbusch and Edwards.

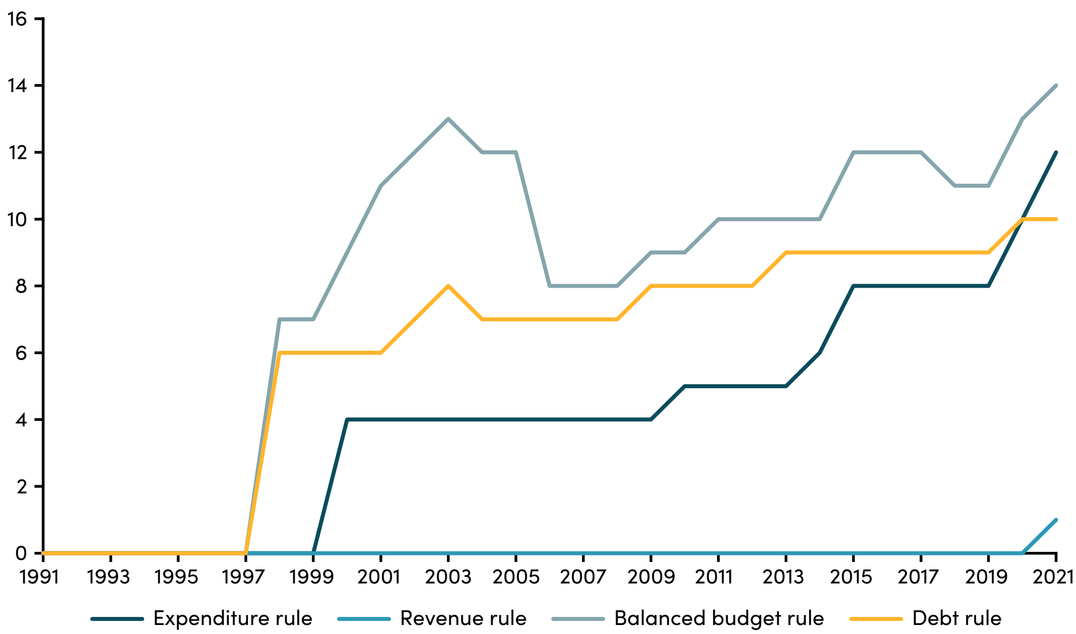
3 https://www.economist.com/the-americas/2023/06/29/amlos-austerity-has-hurt-mexico

4 https://www.larepublica.co/economia/estos-son-los-efectos-que-traeria-para-colombia-modificar-la-regla-fiscal-3750578

In fact, **Figure 7** from the IMF's Fiscal Rule's database shows how after 1997 the use of fiscal rules across LAC became generalized and has not experienced any major reversals (Davoodi et al., 2022). The new paradigm, for now, does not seem to contradict fiscal sustainability, at least directly.

One possible explanation is that LAC's voters could potentially punish governments that resemble old-style populists if inflation and deficits are rampant. Hence, appearing fiscally conservative, or at least sending signals associated with fiscal responsibility, allows the new leaders to break with the image of the traditional Latin-American populism. Another possible explanation is that new leaders in LAC inherited large stocks of public debt accumulated during the Covid-19 pandemic. Policymakers, faced with greater debt, have had a smaller margin of action to implement their own preferred political agenda as the risks associated with debt distress are evident.

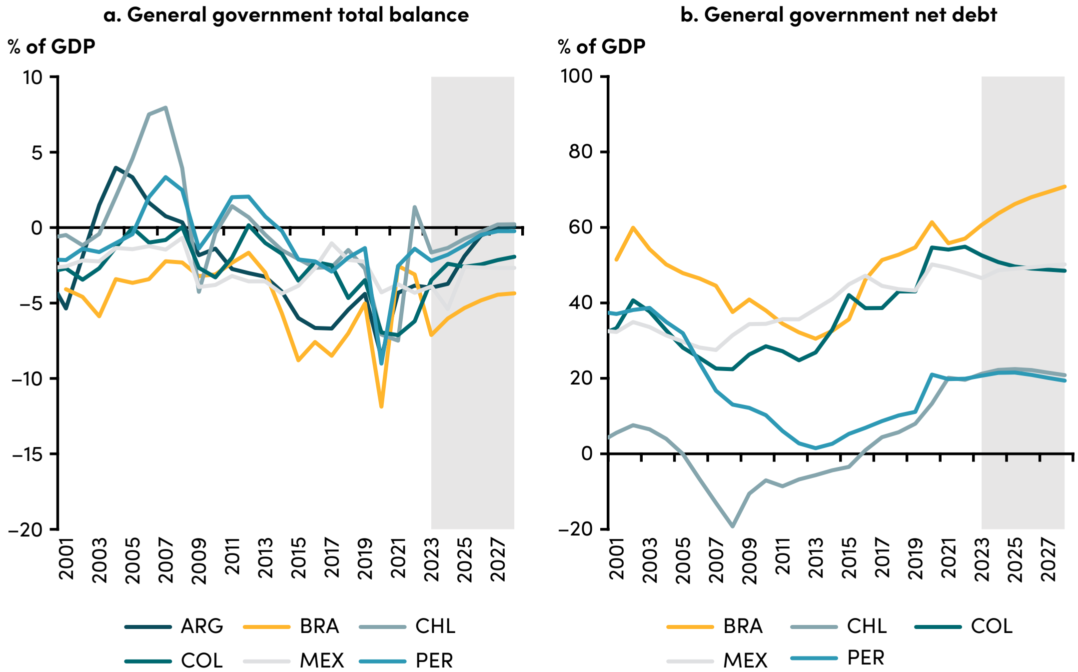
FIGURE 7. Fiscal rules in LAC countries by type



Source: IMF Fiscal Rules Dataset (2022).

In contrast with the old-school models, in which populists ignored macroeconomic constraints and established highly expansionary fiscal policies, the new paradigm has shown some degree of fiscal restraint. **Figure 8a** show the IMF's forecast of the General Government total balance until 2028. The paths of fiscal adjustment across LAC countries shows moderate fiscal policies following the large fiscal deficits resulting from the economic fallout of the Covid-19 pandemic. **Figure 8b** shows that although government debt increased over the last two decades across the region (for example, Brazil, Colombia, and Chile saw during the mid-2010's a period of debt accumulation) debt reductions are expected, with the exception of Brazil. Given that debt levels have risen to historical maximums, fiscal space will be tighter for the implementation of the new paradigm.

FIGURE 8. Fiscal policies: on a path to recovery



Note: Shaded area represents the IMF's forecast starting after 2022.
Source: IMF World Economic Outlook (October 2023).

Capital flows

Governments in LAC have not taken actions to restrict capital flows or ban FDI in key sectors, as was customary in the old-style populism. Until now FDI has remained dynamic, especially in the large countries (Brazil and Mexico, in particular). The new paradigm focuses on a greater role for public investment (reducing the scope of private sector engagement), but there is less emphasis on the relative roles of foreign vs. domestic private investment. In the past, restrictions on FDI were pervasive during populist episodes.

5. Some defining traits: What's new

Prioritize distributional issues

On the composition of government expenditures, Goldfajn, Martínez and Valdés (2021) rightly note that the reallocation of public expenditures into priority sectors was central to the Washington Consensus, and that since the second half of the 1990s increased social expenditures became an important part of the policy choices in LAC.

In this spirit, revamping social safety nets and reinforcing efforts related to poverty-reduction and redistribution are central to the new paradigm. The common element has been the generalized use of cash transfers. Although these programs were an integral component of the earlier policy package supported by the Washington Consensus, the new paradigm has emboldened poverty reduction initiatives. Colombia, for example, has just created the Ministry of Equality, and is redrafting the existing (conditional and unconditional) monetary transfer programs.[5] The new poverty-relief plan to "dignify citizens instead of offering alms"[6] called *Renta Ciudadana*, is set to replace an existing mesh of various program, such as *Familias en Acción* and *Ingreso Solidario*.[7] The decision to merge the existing conditional cash transfer (CCT's) programs has also brough an expansion of the number of beneficiaries. This contrasts with the more limited scope of the existing CCT's which were intended to give low-income families a steppingstone in human capital accumulation and financial inclusion.

It is also worthwhile to highlight the case of Mexico where President Lopez Obrador reformed the conditional cash transfers (CCT) program with a series of broadly targeted unconditional transfers (Borges, 2022). Analysts have pointed out at the fall in progressivity of the new programs.[8] According to Porter (2023), the poorest 10% of the Mexican population received 9% of the government's social spending budget in 2022, a sharp decline from the 23% share in 2018. The manipulation of social policies to benefit specific electoral demographics can be considered an element of the new paradigm. Designing programs with implicit electoral objectives, sacrificing better targeting schemes, is part of the new model. Chile's government has also increased social spending and the use of cash transfers. Interestingly, the language associated with the expanded role of cash transfers has also included the need to comply with fiscal responsibility (adding in the case of Chile their counter-cyclical nature, in perfect sync with the original Washington Consensus).

Empirical evidence across the region has shown how conditional cash transfers (CCT) programs appear to boost political participation (Schober, Gregory, 2019). Borges (2022) documents that CCT reached 20% of the population back in 2009, with a significant increase during the Covid-19 pandemic. Also, left-leaning governments tend to have higher levels of CCT coverage and spend more on their programs (Borges, 2022), while it is documented that CCT's boost electoral participation (see Camacho et al., 2012 for the case of Colombia's *Familias en Acción*) and support for the incumbent governments that implement them (Pavão, 2016). In addition to the expansion of these programs, the new paradigm has reduced the role of conditionality and, in many cases, changed targeting mechanisms and moving in the direction of universal subsidies, as in the case of non-contributory pensions in Mexico.

5 https://www.lasillavacia.com/historias/silla-nacional/revolcon-en-subsidios-de-petro-golpea-la-lucha-contra-la-pobreza/

6 https://www.lasillavacia.com/la-silla-vacia/envivo/rusinque-dice-que-renta-ciudadana-dignifica-ciudadanos-y-no-da-limosnas

7 *Familias en Acción* is a targeted conditional monetary transfer created as a response to the 1999–2000 crisis. *Ingreso Solidario* is a targeted unconditional monetary transfer created during the COVID-19 pandemic destined to low-income individuals that do not receive additional support or are part of their schemes such as *Familias en Acción*.

8 https://www.washingtonpost.com/business/2023/08/23/amlo-s-anti-poverty-success-in-mexico-has-a-dark-side/bd82d734-41a5-11ee-9677-53cc50eb3f77_story.html

Reindustrialize through climate action

Without doubt, climate action is a central component of the new policy paradigm in LAC. The region is heavily exposed to the consequences of climate change and has made ambitious pledges to reduce emissions. The Nationally Determined Contributions (NDCs) under the Paris Agreement indicate that the six largest economies in the region intend to reduce emission by 34% in 2030, relative to the baseline, and several of them have made net-zero emissions commitments by mid-century (Cárdenas and Orozco, 2022). Achieving these goals requires a significant fiscal and regulatory efforts, including actions by State Owned Enterprises (SOEs) operating in the energy space.

Resources are required not just for mitigation. Building resilient economies through adaptation, where public goods are even more necessary, is also a crucial component of the climate agenda (World Bank, 2023). In addition to the high vulnerability of the region to climate-change related events (physical risks), transition risks (i.e., the risks associated with the reduction in emissions and the lower demand for carbon-intensive products) are also very high. As argued in Cárdenas and Orozco (2022), the reduction in the demand for the fossil fuels (as well as some agricultural products with a large carbon footprint) could have a negative impact on the region's GDP. There are also opportunities, especially in the context of the transformation of clean energy and the availability of critical minerals, both of which are relatively abundant in the region.

Addressing the climate challenges and opportunities are at the core of the new paradigm. The nature of the problem provides an excellent justification for the need to strengthen the role of the State, through industrial policies, regulation, development banks and the redefined role of SOEs.
The climate agenda helps define the new paradigm, and the new paradigm -with its emphasis on the State—uses the climate agenda to support many of its policy and institutional preferences.

However, there are important differences across countries in the region regarding the climate agenda. Not all countries agree on the importance of climate mitigation. For example, Venezuela and Bolivia –two fossil fuel dependent economies—have not made commitments in this regard (or have made very minor ones). Mexico –a large oil producer—has made modest climate pledges and is making efforts to increase oil production and refining capacity as a matter of strategic national interest (while reducing the role of the private sector).

Colombia and Brazil are committed to decarbonization and share views on critical role of the Amazon and need to obtain some compensation from large emitting countries but have opposing views on the speed of the transition, and on the approach to oil production. In Colombia, the government has signaled the intention to no longer award oil exploration contracts. This approach has added to the country's risk premium as oil accounted in 2022 for 4.3% of GDP, 20% of government revenues, and 32.9% of total exports (DANE, 2023b).

In contrast, Brazil has committed to continue with oil exploration and production activities and plans to become the fifth largest global producer by 20230 (increasing production to 5 million barrels per day (bpd) in 2030 from 3.5 million bpd in 2023). Petrobras has signaled that will continue to explore and produce oil during the next four decades as well as sustain investment levels.[9]

Moreover, according to Brazil's Finance Minister Fernando Haddad, Brazil's plans for a green economy encompass both climate action and industrialization with an emphasis on green and renewable technologies. Brazil sees decarbonization and diversification from fossil fuels not as a cost but as an opportunity for creating jobs and raising income levels by expanding investment in industry and infrastructure thus highlighting the interplay between climate and industrial policies.[10]

Industrial policies

In line with the advanced world, the new paradigm includes a more active use of industrial policies to promote social and economic objectives. Intended to fix the failures of the neoliberal reforms, industrial policies support "mission- oriented" innovation and investment (Mazzucato and Penna, 2016; Detter, Fölster, and Ryan-Collins, 2020). This means that, after years in the shadows, industrial policy is back on the scene (Aiginger and Rodrik, 2020) as an instrument to address several developmental challenges, including climate change. Productive development policies are motivated by the need to invest in projects that are riskier and take a long time to generate returns. The range of policies is wide, including horizontal interventions that provide broad support to entire sectors or vertical interventions that focus on specific activities. The need to accelerate climate action has been the main driving force behind the revival of industrial policies, in advanced and emerging economies alike.

Policy instruments include de-risking (e.g., loan guarantees, feed-in tariffs, public procurement to guarantee initial demand for new products and services); investment promotion; R&D tax deductions and credits. Also, funding of universities and research institutes; grants for basic research; spending on education and job training are all part of this approach. Equity investments and lending though domestic development banks can be critical by providing patient capital. A common element in all these interventions is that their success depends on the existence of a robust institutional framework.

In the past, weak governance mechanisms—including the lack of checks and balances—, often resulted in poor outcomes, illustrated by the number of projects that did not provide the expected outcomes and became white elephants. Under the new paradigm there are stronger institutional checkpoints, forcing governments to become more creative in exploring new ways to advance their agendas. One important dimension is lack of fiscal space and overall state capacities, which have seriously limited the scope of industrial policies in LAC. As Brazil just announced, rather than focusing on expenditures, countries in the region are opting for favorable tax treatments

9 https://www.reuters.com/markets/commodities/petrobras-continue-producing-oil-next-4-decades-says-exec-2023-08-22/

10 https://www.ft.com/content/fda15a48-b6ab-44fe-9bc0-1127feedaa80

to incentivize investment in specific sectors, especially those that contribute to the climate agenda. However, much of the action in LAC related to industrial policies is taking place in the sphere of state-owned enterprises, in sharp contrast to the approach used in advanced economies.

Active use of SOEs...

An important aspect of the new paradigm is the criticism of deregulation and privatization –and the call for a new role for the State. The active use of State-Owned Enterprises (SOE) is a common theme across LAC today, and a central aspect of the anti-Washington Consensus narrative. SOEs are an attractive tool at times of fiscal stress, as most of them operate outside the perimeter of the central government's fiscal rules, but also because in many cases they have greater discretion relative to other branches of government (e.g., vis-à-vis Congress), while in some countries their operational capabilities exceed those of central governments.

Brazil's Petrobras, Latin America's largest National Oil Corporation (NOC), and Colombia's Ecopetrol are two good examples. Both companies are being actively used to advance climate policy goals. For instance, a recent emergency decree (later over-ruled by the Constitutional Court) gave Ecopetrol the possibility to invest in power generation, in opposition to preexisting anti-trust laws. This measure would have allowed Ecopetrol to vertically integrate its renewable energy business, making it a strong player in the energy transition.[11] While this can be desirable, NOCs across the region have also been actively used to provide fossil fuel subsidies to tame inflation.[12] In fact, Petrobras has stated that it intends to reduce fuel prices (and their volatility) in the domestic market.[13] Similarly, the chronic deficits of Pemex in Mexico have required constant support from the government to avoid debt distress. Also in Mexico, it is well known that the Comisión Federal de Electricidad (CFE) is taking a central role –reversing the previous private sector's engagement in the power sector.

The Chilean government's decision to rely on SOEs for the expansion in the supply of critical minerals goes in the same direction. The lithium-sector strategy unveiled by the government puts social and sustainability goals at the forefront with a leading role for two SOEs in the mining sector (Codelco and Enami), even though the Chilean state has neither the expertise nor the capabilities to run lithium operations (Jobet, Moerenhout, and Bordoff, 2023).

...and of development banks

In contrast to the Washington Consensus, that de-emphasized the use of public financing institutions, including development banks, the new paradigm reinforces their importance. Brazil and Mexico are prominent examples of the widespread use of subsidized credit to finance new projects

11 https://www.elcolombiano.com/negocios/ecopetrol-e-isa-se-integrarian-para-mandar-en-el-mercado-electrico-EG21721342

12 https://www.reuters.com/business/energy/board-brazils-petrobras-approves-prates-next-ceo-report-2023-01-26/

13 https://www.ft.com/content/c336df4a-d810-44f4-b5a6-eab88ae76b87

in sectors that are considered strategic or relevant for the developmental agenda. For example, Brazil's National Economic and Social Development Bank (BNDES) has provided subsidized long-term loans, financing up to 70% of total capital requirements for renewable energy projects. Also, through its National Climate Change Fund, BNDES has invested in wind, small hydro, and biofuels, accounting for nearly 50% of Brazil's new renewable energy projects. Similarly, Mexico through its state-owned financial institutions—Bancomext, Banobras and NAFIN—has provided low-cost loans that de-risk projects. In the case of Colombia, the state-owned bank (Banco Agrario) will be capitalized to provide lending at subsidized rate to sectors of the "popular" economy.[14] These examples further highlight how LAC's new paradigm expands the role of national development banks and the promotes direct involvement of the government in subsidized lending.

Use of regulatory powers to reduce scope of private investment

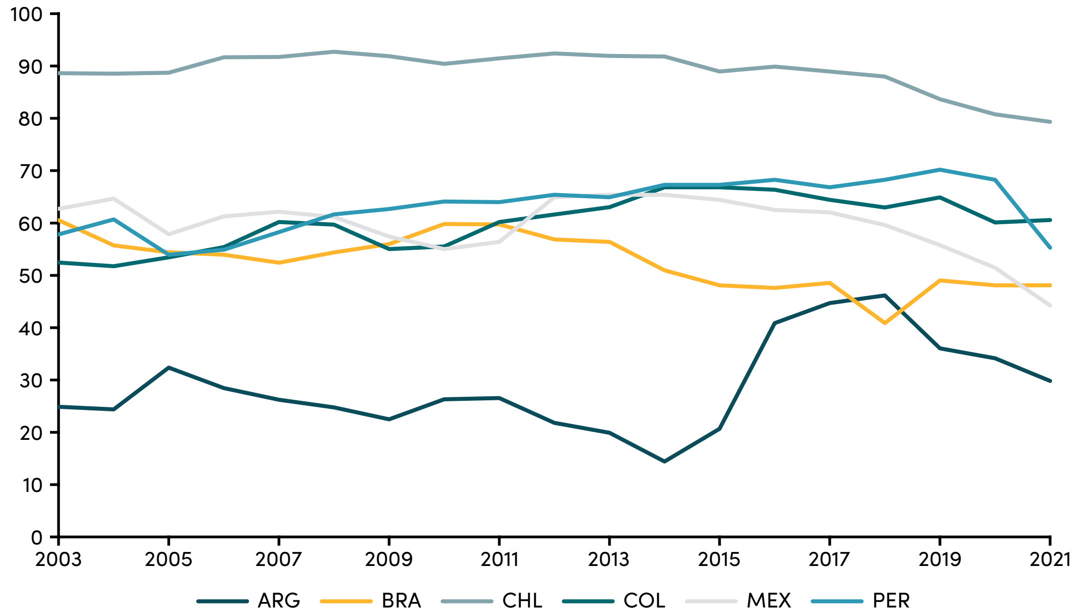
The active use of the regulatory agencies is another common aspect of the change in paradigm. Oftentimes using decree powers, but also introducing new legislation, governments have been active to intervene regulated markets where the private sector had become a major player. Examples abound. For example, the Colombian Congress is discussing legislation that will drastically augment the role of the government in the health and pension sectors. The government has also made efforts to undermine the role of independent regulatory bodies and directly intervene regulated markets to reduce utility bills.[15] The possibility of greater steps in this direction has discouraged private investors.[16] In a similar move, Petro's administration froze toll rates by decree throughout 2023.[17] Business associations issued warnings about the negative signals these decisions have on the infrastructure sector in high inflation environment.[18] An additional example is the statement by the Minister of Transport that the government is open to study regulatory changes to reduce the price of fuels for taxis after unionized drivers protested about the high cost of fuels.[19]

In the case of Mexico, the president's proposed regulatory changes have drawn the concern of major business associations as well which have warned that the regulatory uncertainty and the lack of

14 https://www.portafolio.co/economia/gobierno/petro-anuncio-la-transformacion-del-banco-agrario-588078
15 https://www.bloomberglinea.com/2023/02/16/petro-asume-desde-hoy-y-por-tres-meses-la-regulacion-de-servicios-publicos/
16 https://www.bloomberglinea.com/2023/01/27/los-riesgos-de-la-decision-de-petro-de-asumir-regulacion-de-servicios-publicos/ and https://www.lasillavacia.com/en-vivo/consejo-de-estado-suspende-intervencion-de-petro-a-la-creg/
17 https://petro.presidencia.gov.co/prensa/Paginas/MinTransporte-expide-decreto-que-congela-tarifas-en-los-143-peajes-a-cargo-230116.aspx
18 https://www.valoraanalitik.com/2023/09/21/peajes-colombia-en-que-quedo-la-subida-de-tarifas/
19 https://www.bloomberglinea.com/latinoamerica/colombia/estamos-abiertos-a-buscar-alternativas-de-regulacion-de-precios-minminas/

consultation with the private sector has led to a lower investor confidence.[20] **Figure 9** documents how regulatory quality in the region has deteriorated in recent years.[21]

FIGURE 9. Regulatory quality is slowly backsliding in the region



Source: Kaufman and Kraay (2023).

Deeper economic integration with China

In advanced economies, as argued by Rodrik (2018 and 2021), despite economic growth and welfare improvements during the last three decades, a deep sense of dissatisfaction has resulted in various forms of deglobalization or slowbalization. Some politicians were able to capitalize on these negative sentiments and found in globalization the enemy against which to rally the "disaffected". Although globalization –and its corollary of free trade—has also been blamed of many of the problems in LAC, the new paradigm in Latin America has not put trade at the top of the agenda in terms of policy actions. Although protectionism and criticism of Free Trade Agreements is part of the rhetoric, restrictive trade measures have not been part of the new paradigm.

20 https://www.forbes.com.mx/cambios-juridicos-propuestos-por-amlo-mandan-senales-negativas-a-inversionistas-alerta-ceeg/

21 Regulatory Quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. Percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to lowest rank, and 100 to highest rank. Percentile ranks have been adjusted to correct for changes over time in the composition of the countries covered by the WGI. (Kaufman and Kraay (2023))

However, in line with the recent geopolitical shifts, and the rise of China's global influence, LAC's new paradigm involves a pragmatic rethinking of its trade and investment relationships. It also comes as a natural development in the need to diversify sources of financing, to complement the role of the Bretton Woods institutions.

Figure 10 shows the evolution of trade between LAC's six largest economies (Argentina, Brazil, Chile, Colombia, Mexico, and Peru) and China since 2002. Both exports and imports have doubled in the last decade. Several studies (Albright, Ray, Liu, 2023; Ding, Vittorio, Lariau, Zhou, 2021; Raza, Grosh, 2022) expect that this trend will continue over the coming decade.

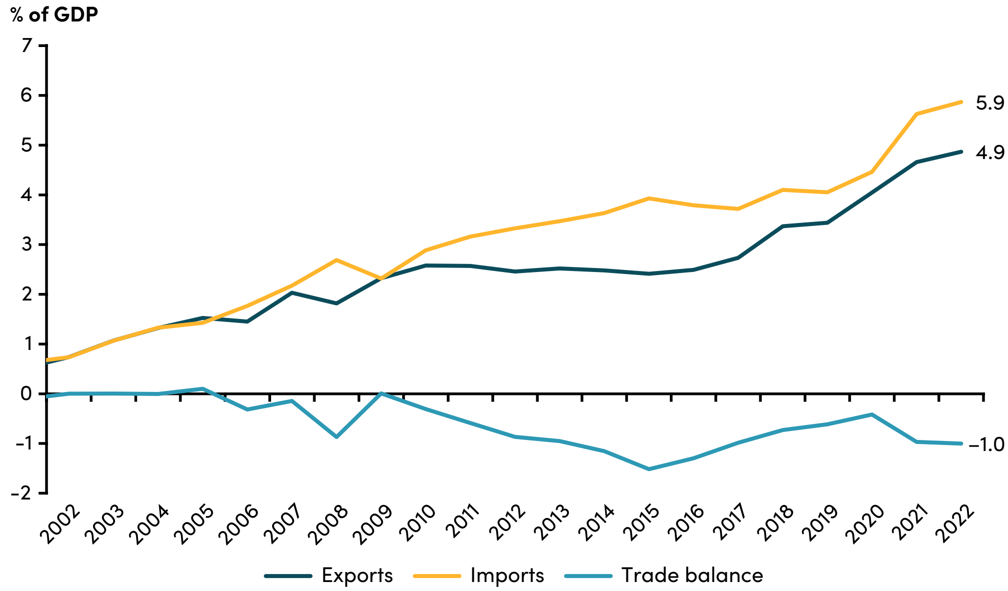
There is some regional heterogeneity as Chile, Brazil, and Peru have trade surpluses with China while Argentina, Colombia, and Mexico have trade deficits (see **Figure 11**). Pursuing greater integration with China is justified both for economic and political reasons. Trevisan (2021) documents how political preferences of constituencies across LAC are shifting in favor of trade with China, noting that initially in Brazil Jair Bolsonaro echoed anti-China rhetoric during his political campaign for president in 2018 but later changed his views and supported trade with China due to pressure from the Brazilian agribusiness sector, which overwhelmingly supported his campaign.

In addition to greater trade integration, Chinese lending and FDI to the region has also increased which helps to further diversify LAC's financing sources and grants greater financial leverage vis-à-vis western financial institutions. Albright, Ray, and Liu, (2023) show how after a peak in the mid-2010's, Chinese FDI to LAC has begun to increase once again, and now is centered on emerging supply chains in the renewable energy and critical minerals industries. Ding et al. (2021) find similar trends showing how Chinese investment in LAC has increasingly in manufacturing and services industries such as transport, electricity, financial services and information and communication technology. Overall, the new paradigm is consistent in the will to expand engagement with China.

In this spirit, LAC's countries show increasing interests in joining and being active members of the Belt and Road Initiative (BRI), China's infrastructure and development strategy spanning several countries across the globe. According to Nedopil (2023), 21 LAC economies have joined the BRI's Memorandum of Understanding (MoU) but to date, neither Brazil, Colombia nor Mexico have signed it. A related aspect is the expansion of the BRICS group, which serves as a counterbalance in multilateral finance to institutions led by the G7 countries. Mexico has expressed interest in joining.[22]

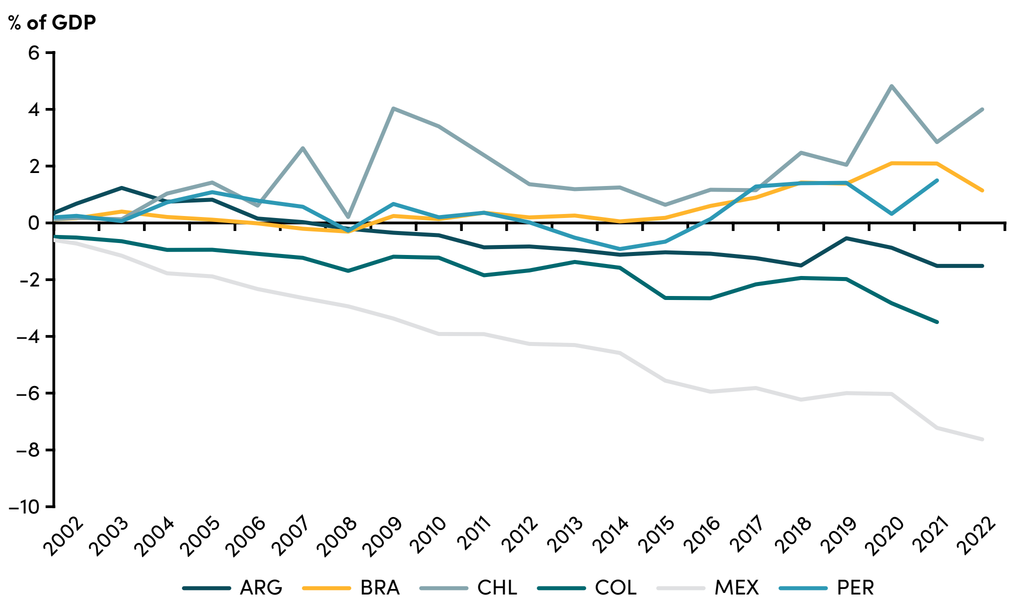
22 https://www.bloomberg.com/news/articles/2023-04-24/brics-draws-membership-requests-from-19-nations-before-summit#xj4y7vzkg

FIGURE 10. China plays an ever-increasing role in LAC's international trade



Note: Regional average comprised of LAC's biggest six economies: ARG, BRA, CHL, COL, MEX, PER.
Source: UNSD (2023), IMF WEO (2023).

FIGURE 11. Heterogenous trade balances with China



Note: Regional average comprised of LAC's biggest six economies: ARG, BRA, CHL, COL, MEX, PER.
Source: UNSD (2023), IMF WEO (2023).

6. Political dimension

The active use of social mobilization and constant attempts to strengthen presidentialism are two salient features of the new paradigm. Both are intended to alter the system of checks and balances —a central mechanism of liberal democracies—by influencing the agenda in the direction favored by presidents. Examples abound. The case of Nayib Bukele in El Salvador is paradigmatic of ways to undermine the independence of the judiciary. In Mexico proposed changes to the electoral commission to increase the influence of the Executive. In Colombia, the use of state of emergency powers (later overruled[23]) would have allowed the President to legislate trough decrees.

Importantly, convening street mobilizations to exercise pressure on the other branches of government or using state and social media to dominate the national conversation are tactics that play an important role in the new paradigm. For example, when facing pivotal congressional votes on key social reforms, the Petro Administration in Colombia has organized rallies in conjunction with trade unions and activist organizations to pressure the legislative branch. Using street unrest is a new component of the current paradigm. The judicial branches are not spared either of the political pressures stemming from the use of social mobilization.

This is not a surprise. In fact, a model developed by Acemoglu, Robinson, and Torvik (2013) predicts that the anti-elite sentiment is correlated with a gradual dismantling of systems of checks and balances. Coupled with perceptions on the extent of corruption, citizens perceive that some aspects of the systems of checks and balances have a pro-elite bias and decide to support populist leaders, at the cost of undermining democratic institutions. This is what happened in Bolivia, Ecuador, and Venezuela where citizens voted to strengthen the powers of the executive. Voters preferred a political system without checks and balances as a way of insulating politicians from the elites' influences. In this sense, the anti-elite and anti-corruption rhetoric can be used to weaken democratic checks and balances and soften limits on executive power, instead of the much-needed institutional strengthening and policy reform to improve government efficacy and efficiency.

Adherence to sound macroeconomic policy management can also be jeopardized by a gradual dismantling of the checks and balances on executive power. The experience of Turkey is illustrative of reversals in sensible macro frameworks. Some reforms during the early 2000's introduced constraints on economic policy—such as the Central Bank independence in 2001—with a mandate to achieve and maintain price stability in the context of inflation targeting and prohibited direct lending to the government (Acemoglu and Üçer, 2019). In addition, fiscal reforms greatly improved the macro policy framework. However, by the 2010's some of these reforms were being pulled back. Most notably, central bank independence came under attack adding greater fiscal dominance over monetary policy.

23 https://www.lasillavacia.com/en-vivo/corte-constitucional-tumba-de-nuevo-otro-decreto-de-emergencia-de-la-guajira/

Although the rise to power of the AK party and its leader, Recep Tayyip Erdogan, was fueled by a cultural struggle between two antagonist groups rather than by traditional fiscal populism (such as calls for economic redistribution and a disregard for inflation), ultimately low growth resulted in a deterioration of both economic and political institutions. Cultural populism ended up causing very high inflation and an unsustainable expansionary fiscal program. The transformation of cultural populism into the traditional forms of populism, including unsustainable fiscal expansions, large current account deficits and high inflation, can happen in Latin America as well.

Empirical evidence suggests that this would extremely costly. Funke et al. (2020) estimates that populists spells in LAC economies reduce GDP by more than 10% relative to the counterfactual GDP in absence of a populism.[24] Interestingly, this negative effect is similar for both left- and right-wing leaders. LAC is no stranger to these dangers, and thus negative economic implications of the current paradigm can go beyond the current lack of incentives for private investment. Large fiscal expansions are still a possibility.

7. Conclusion

The new paradigm taking hold in LAC can seem innocuous from the macroeconomic stability perspective. The use of monetary expansion has eased as several countries have adhered to central bank independence and inflation targeting. The same can be said about fiscal populism, that has been somewhat constrained by fiscal rules. In other words, the new political paradigm, centered around the use of the us vs them populist rhetoric, seems to be respecting a prudent macroeconomic policy framework. However, this does not mean that it will be harmless.

The new paradigm rather than representing a return to LAC's previous and failed experiments in economic policymaking is an amalgam of Washington Consensus macroeconomic policy framework with an active role for the State that implies greater intervention in many markets. SOE's are gaining influence and leaders are using regulatory powers to limit the scope of private investment. Social policies are pursued aggressively with a political intent to favor certain electoral demographics, and to mobilize the necessary support to advance the interventionist and statist agenda. Undermining the existent checks and balances constraints is an intended outcome of street mobilization.
The politics of us vs. them is used not just to win elections. It is an ongoing strategy to mobilize support for an agenda where the state is put in charge of key sectors. With a weak state, prone to the captured by special interest groups and vulnerable to corruption, the outcome is likely to generate further frustration.

24 The authors estimate this impact using synthetic controls for each countries using a sample of countries and 60 populist spells spanning 1946 to 2004.

Global risks abound, and the new leaders in the region will face an economic slowdown, greater geopolitical fragmentation and the risks posed by climate change to an already vulnerable region. With high levels of debt and financing costs, the fiscal space is tight. The risk of the new paradigm is clear: leaders set ambitious economic and social goals but finding themselves unable to fulfill them due to the difficult global and regional economic environment, but also because of lower private investment. The return to old forms of populism seems unavoidable under the new paradigm. The weakening of the institutional constrains will only facilitate that process.

LAC has better alternatives. The triad of lower growth, higher social demands, and weaker support for democracy require ambitious reforms that keep productivity, poverty, and inequality front and center. The alternative should preserve a sound macro framework, increase state capacity (including fiscal capacity) to invest in redistribution and public goods. Using evidence-based policies that recognize that both economic growth and reducing inequality are not mutually exclusive objectives, the new paradigm should promote public-private partnerships wherever possible and maximize private engagement. Importantly, the new paradigm should strengthen democratic principles and values, including a robust system of checks and balances.

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