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Daniel Ortega's Reality Check

Nicaragua's president is the latest Latin American populist to flirt with the market. But his political risks are high.

BY ROBERT LOONEY JANUARY 10, 2013 - 4:43 PM

In light of the passions stirred by Nicaragua's leftist revolution in 1978 and the subsequent U.S.-sponsored "contra" counter-revolution, it's striking how little attention is now paid to this tiny republic laid waste by the last proxy war between the United States and global communism. My guess is that few of the outsiders who once viewed the conflict as a grand struggle between the forces of good and evil even know that the Sandinistas, along with their leader, Daniel Ortega, have been back in power since 2006. And those who do know seem more concerned with Ortega's flirtation with Hugo Chavez than with Nicaragua's post-war transition.

That's ironic, because there's an interesting economic story here that transcends the country's political travails. For Nicaragua is attempting to reconcile a neo-liberal, market-driven development strategy with a state-centered, populist agenda — an approach adopted in varying degrees by Latin American countries ranging from Venezuela to Brazil to Argentina. Its success (or failure) will help clarify the degree to which fervent Latin populism is consistent with economic growth and stability.

In the wake of their defeat of the autocratic Somoza dynasty that ruled Nicaragua from 1936 to 1979, the Sandinistas introduced Cuba-inspired agricultural, health and education reforms designed to increase the living standards of the rural poor — and to secure their allegiance in the teeth of American and domestic opposition. Given the ongoing civil war, U.S. sanctions and an economic boycott by multilateral lending agencies — not to mention inexperience in economic management — it is not surprising that the initiative was largely ineffective. Agricultural output tanked, while budgetary and trade deficits ballooned. Inflation spiraled out of control, reaching 38,000 percent in 1988.

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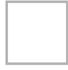

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We don't know how far the economy fell. But we do know that in 1994, the first post-revolution year for which reliable data is available, GDP was just 40 percent of its level in 1977. By the end of the experiment in socialism, Nicaragua was the second poorest country in the Western Hemisphere.

The Sandinistas were voted out of power in 1990 in favor of a broad coalition. And pressed by both the International Monetary Fund and conservative domestic elites, the emphasis on rural development was tempered in order reduce the budget deficit and stabilize prices. The coalition government also opened the door to greater foreign trade and investment, gradually becoming more dependent on the U.S. markets for its exports. Later, in 2004, they joined joining Costa Rica, El Salvador, Guatemala, Honduras and the Dominican Republic in a new regional trade group, the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR).

But in 2006, Ortega (shown above with Chavez and Ahmedinejad) and the Sandinistas returned (by election) to power. Although Ortega campaigned on the Christianity, socialism and solidarity platform of Venezuelan President Hugo Chávez's Alianza Bolivariana (ALBA), his regime has few of the trappings common to other ALBA countries such as Cuba, Venezuela, Bolivia, Ecuador, and several Caribbean islands. His actions to date suggest he is politically authoritarian, economically pro-business, socially populist — and, above all else, pragmatic. This mix translates as an eclectic set of policies that can best be characterized as Orteganomics.

The Marxist slogans of the revolutionary period are gone, as is direct government involvement in production. In fact, Ortega's economic model retains many of the legal and regulatory underpinnings of his predecessors' policies. In its October 2007 reconciliation with the IMF, the Sandinista government pledged to implement policies linked to targets on fiscal discipline, along with spending on poverty and energy regulation.

By most accounts, Ortega has done a decent job in managing his brand of political economy, attracting foreign private investment even as he cozied up to Chávez and burnished his own populist image. While initially opposed to membership in CAFTA-DR, the Sandinistas have approached its implementation with an element of creativity.

With labor costs rising in Mexico, Nicaragua has positioned itself to capture a share of the rapidly expanding U.S. supply-chain "near-shoring" business. To address leftist concerns over "sweatshop labor" in the country's free trade zones, Ortega coopted his labor union supporters by giving unions the "opportunity" to be included as a partner in negotiations with foreign investors — a policy that has been strikingly successful in creating low-wage manufacturing jobs and diversifying exports beyond agricultural commodities.

The economy has expanded briskly (by Latin American standards): After declining by just 1.5 percent in the world-wide recession year of 2009 (an achievement in itself), GDP grew at 4.5 percent in 2010 and 4.7 percent in 2011, and probably grew by 3.7 percent in 2012.

Moreover, growth has favored the poorest. According to the IMF, Nicaragua's poverty rate declined from 48 percent of the population in 2005 to 43 percent in 2009, with rural areas seeing the most improvement. But it should be remembered that Nicaragua remains a bitterly poor country, with a GDP per capita below India's and only slightly above Ghana's. Some 63 percent of rural households still live in poverty (as defined by the World Bank).

In the meantime, Ortega has managed to sustain government poverty-reduction programs in spite of close IMF budgetary scrutiny by soliciting some $2 billion in aid from Venezuela. Not surprisingly, he's done well by doing good: A good chunk of the cash has been funneled into patronage aimed at entrenching the Sandinistas. What's more, there are allegations that Ortega has found ways to enrich himself in the process.

Nicaragua has managed to grow at a reasonable pace, thanks to prudent macroeconomic policies, open trade, a friendly face toward foreign private investment, and the cash cushion provided by Chávez. But those factors have masked Nicaragua's poor record in establishing an institutional setting conducive to long-term growth — the mix of balanced regulation, legal due process, minimal corruption and equal access to capital consistent with small business creation and rapid increases in productivity. The IMF estimates that recent growth attributable to institutional reform (as opposed to increases in capital and labor) is among the lowest in Latin America. By no coincidence, Nicaragua lags significantly behind other CAFTA-DR countries in most of the World Bank Governance Indices, particularly in government effectiveness and regulatory quality.

With productivity growth lagging, Ortega's juggling act is likely to become ever more difficult to sustain. Nicaragua's macro stability, along with its ability to fund anti-poverty efforts, currently depend heavily on the patronage of Hugo Chávez. The Nicaraguan think-tank, Fundación Nicaragüense de Desarrollo (Funides), estimates that Venezuelan aid and preferential trade arrangements added a full percentage point to Nicaragua's GDP growth rate in 2010-11. And it is highly unlikely that a post-Chávez Venezuela will continue his adventures in influence-building in the region.

The threat of losing its financial assistance from Venezuela has plainly increased U.S. leverage over Ortega's policies. The United States, which has effective veto power over aid from international aid agencies including the Inter-American Development Bank and the World Bank, has allowed Nicaragua to receive multilateral support, conditional on ongoing payments for U.S. property confiscated during the revolution. But the Ortega government has recently gotten behind on these obligations, and would be even more hard-pressed to stay current without subsidies from Venezuela. That puts at risk some $1.4 billion in development loans from multilateral agencies over the next five years, which, on top of the loss of aid from Venezuela, would give Ortega little room to maneuver.

Viewed in its best light, Orteganomics falls into a class of mixed economic models that explicitly targets income redistribution even as it embraces free markets. Similar approaches have made real headway in Brazil and Chile. But Nicaragua is far poorer than either. Moreover, both are vibrant democracies whose leaders aren't as dependent as Ortega on patronage schemes to stay in power. A big question, then, is whether the Sandinistas are sufficiently flexible to embark on the serious reforms in regulation and governance needed to increase the rate of growth and to keep foreign capital — public and private — flowing.

One reason for optimism is that Ortega has a long record of changing his stripes to maintain his grip on power, tacking sharply to the right after the election in 2006 and embracing both free trade and market-driven wage policies when it became clear that the alternative was economic stagnation. The catch here is that the sort of reforms needed to succeed without Chávez would reduce the private sector's dependence on Sandinista favor and narrow Ortega's room to win elections through patronage or outright fraud.

To put it another way, Ortega's brand of authoritarian populism is inconsistent with free-market democracy in the long run. The question then becomes whether Ortega and the Sandinistas are prepared to put their own power at risk by doing what's needed to sustain economic development. Stay tuned.

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