More wealth *Chile is focusing on value-added products in industries like copper*

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As Easy as ABC. Argentina, Brazil and Chile are taking distinctly different routes to prosperity

BY TIM PADGETT

IT FELT LIKE THE END OF THE WORLD AT the edge of the earth. It was 2002, and Argentina was in economic free fall. The peso lost 75% of its value against the U.S. dollar, and the nation had defaulted on almost $100 billion of debt. Bank deposits were frozen to halt panicked runs, and an enraged middle class took to the streets. The country went through five Presidents in just two weeks. Wall Street feared that the crisis, one of the worst in South America's history, would spread next door to giant Brazil—where the élite predicted financial ruin if Luiz Inácio Lula da Silva, head of the left-wing Workers' Party, was elected President that year—and even to stable Chile, where executives groused over glasses of Chilean Cabernet Sauvignon that the U.S. Congress might block Santiago's free-trade pact with Washington.

ARGENTINA
Population: 40 million
GDP per capita (PPP): $16,000
Major industries: Grain, beef, manufacturing
WEF ranking: 85

BRAZIL
Population: 200 million
GDP per capita (PPP): $9,000
Major industries: Coffee, aircraft, iron ore
WEF ranking: 72

CHILE
Population: 16 million
GDP per capita (PPP): $13,000
Major industries: Mining, fishing, timber
WEF ranking: 26

Five years later, Argentina's rapid recovery still has analysts doing double takes. Since President Néstor Kirchner was elected in 2003, annual growth has averaged 9%, the best in Latin America. Argentina has parlayed a cheaper but stable peso into record export earnings. "Argentina," crows Central Bank president Martín Redrado, "is enjoying its most solid macroeconomic context of the past 30 years." In Brazil, Lula's election (and 2006 re-election) did not render the region's largest economy a leftist basket case. Instead, inflation has fallen from 12.5% in 2002 to less than 4% today. Brazil's real has climbed 56% against the U.S. dollar, and the São Paulo stock exchange, the Bovespa, is soaring. And since the U.S.-Chile free-trade agreement took effect in 2004, Chilean exports to the U.S.—including all that Cabernet—have risen 167%.

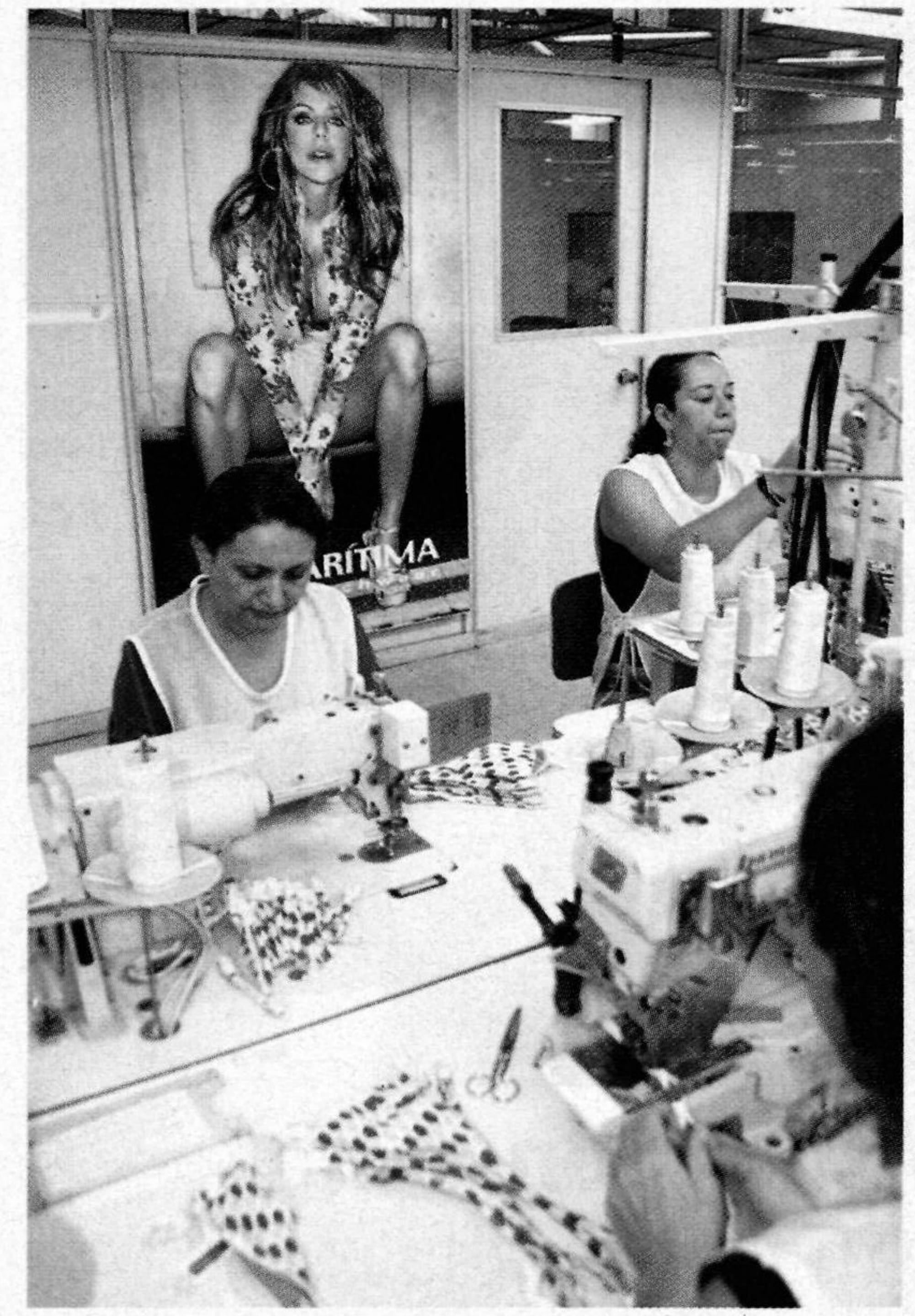
Although Latin America attracts nowhere near the foreign direct investment (FDI) that Asia or even Eastern Europe does, competitiveness is on the rise among South America's ABC countries—Argentina, Brazil and Chile. Like most other Latin countries, the ABCs were pulled on the economic torture rack during the 20th century between socially negligent capitalism and fiscally profligate populism. But today they lead a potent common market, Mercosur. (Chile is an associate member.) And while each has a leftist President—Chile's Michelle Bachelet is also a socialist—the ABCs are spelling a model, "pragmatic socialism," says Jerry Haar, an international-business professor at Florida International University in Miami and a co-author of *Can Latin America Compete?* "They're managing the precarious balancing act between Milton Friedman and Santa Claus," says Haar, "drawing both to a more globally competitive middle."

Argentina has danced the most difficult tango. Kirchner—whose wife Senator Cristina Fernández de Kirchner was elected to succeed him as President last month—took populist measures to keep the country of 40 million governable. He renationalized some utilities and set export limits on essential goods like meat to moderate prices. But rather than blow a windfall from commodity exports—prices for Argentine products like soybeans have hit all-time highs in recent years—Argentina replenished its foreign reserves (a record $44 billion today), pared debt and built a strong fiscal surplus. "Overspending and overindebtedness caused the crisis," says Redrado, noting that much of that excess occurred, ironically, during the more market-oriented government of President Carlos Menem in the 1990s. "This is no longer a policy of the right or the left. It is common sense."

Argentina is just as sensibly working to cut its dependence on commodities—the bane of almost every Latin economy. Argentina, which has one of the region's more skilled workforces, recently passed a biotechnology-promotion law to channel incentives to biotech firms. One, Bio Sidus, with $40 million in annual sales, is pioneering an affordable human-growth hormone from the milk of genetically modified calves cloned 60 miles (97 km) from Buenos Aires. "Our traditional cattle-ranching experience gives us a big advantage," says Bio Sidus president Marcelo Argüelles. "But our biggest challenge is obtaining financing at international rates."

There's the Argentine rub. Short-term, the country is booming; long-term, it's considered high risk. "There is still a sensation of uncertainty," says former Finance Under Secretary Miguel Kiguel, "a perception that we don't have clear long-term rules." FDI fell to just above 2% of Argentina's $212 billion gross domestic product in 2006, thanks to lingering doubts about creditworthiness that President-elect Fernández will have to confront.

By comparison, Brazil's competitive outlook is often described as a day in the Ipanema sun. Lula—who has adhered so faithfully to orthodox fiscal policies that he has alienated his own leftist party—recently boasted that Brazil's $1 trillion economy, the world's 10th largest, "is going through an auspicious moment."



Planes and panties *Brazil makes jets as well as bikinis*

CLAUDIO EDINGER FOR TIME

Feats like a $100 billion foreign-reserve cache have helped lower the country's risk premium, as measured by JPMorgan, to 175, vs. 1,445 when Lula took office. The manufacturing sector, including world-class regional jetmaker Embraer, now represents a quarter of GDP, and Brazilians feel more consumer confidence than perhaps at any other time in their history. "They now have the incentive to buy vehicles through long-term-financing programs," gushes Jackson Schneider, head of the National Association of Automotive Vehicle Manufacturers, whose members have added 27,000 direct jobs in the past three years. "They can more easily afford the installments."

Though Brazil expects 5% economic growth this year, many are asking whether it's because of Lula or despite his failure to tackle an array of problems. Aside from Brazil's reputation for epic corruption, gaping inequality and baroque bureaucracy—it takes 152 days to start a business there, according to a KPMG consulting study, compared with 32 in Argentina—there are more pressing issues of an overvalued real, high taxation, weak infrastructure and especially pension reform. Incredibly, Brazilian pensioners receive more money as a share of GDP than the rest of the population of 188 million, sucking investment from badly neglected areas like education. Says Renato Fragelli, director of the Graduate School of Economics at the Fundação Getulio Vargas think tank in Rio de Janeiro: "The time to fix a roof is when the sun shines—but when the sun shines, Brazilians go to the beach."

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Chile, meanwhile, seems to be doing everything right. Though it is small (pop. 16 million), its GDP is $145 billion, one of Latin America's highest per capita, and is expected to grow more than 5% this year with little inflation (though recent labor and student protests indicate Chileans want a larger slice of that wealth). Its size precludes large-scale manufacturing, so it heavily promotes value-added industries for its myriad commodities, like copper and timber. Compañía Sud Americana de Vapores, Latin America's largest maritime-transport concern, reflects how Chile has turned itself from a hemispheric outpost into a bridge to the Pacific Basin.

Chile's FDI measures more than 4% of GDP, also tops in South America, largely because Chile keeps corruption, bureaucracy and undue tax burdens out of investors' paths. Its judicial system is perhaps the most transparent in Latin America. "Investors realize our institutions function," says Osvaldo Rosales, international-trade director at the U.N.'s Economic Commission on Latin America and the Caribbean.

That includes the institution that means the most in the long run. Chile directs more of its public expenditure (almost a fifth) to education and gets more of its kids through primary school (more than 90%) than any other country in the region save Cuba. Investing in people—a concept too long ignored in Latin America—is what makes economies competitive. That's as basic as ABC. —WITH REPORTING BY ANDREW DOWNIE/RIO DE JANEIRO AND UKI GOÑI/BUENOS AIRES ■