Whither Latin America?

Augusto de la Torre and Alain Ize

Para onde vai a Economia da América Latina?

Seminar Organized by FGV and IBRE

Rio de Janeiro, 9-10 August 2012
The organizing framework – the development triad
A decade to remember

*Taking advantage of tail winds*
Stability

Much improved macro-financial immune system

Before

Weak/non credible/pro-cyclical

Fragile/unsound

Fragile/unviable/pro-cyclical

Currency/Monetary Policy

Banking/Prudential Policy

Debt process/Fiscal Policy

Now

Credible/counter cyclical

Sounder

More viable/less pro-cyclical
Shift to inflation targeting, a more robust monetary regime

Source: Ilzetzki, Reinhart and Rogoff (2011) and LAC Chief Economist Office calculations.
Stability

Counter-cyclical monetary policy

Notes: Due to lack of data, interest rates in selected LAC countries is represented by money market interest rates for the period of January 2007 to October 2003 and by monetary policy rates for January 2006-August 2012. Source: Bloomberg
Stability

Stronger prudential buffers than in other regions

Stability
Safer form of international financial integration

Stability
Discernible move towards less pro-cyclical fiscal processes

Source: Frankel, Végh, and Vuletin (2011).
Social Equity

Stunning poverty reduction

Moderate and extreme poverty in Latin America over 15 years

- Extreme Poverty
- Moderate Poverty
- GDP per capita PPP (constant 2005 international $)

Social Equity

Widespread reduction in income inequality...

Change in the Gini Coefficient (Points), C 2000-2010

Social Equity

...reflecting a fall in the inequality of wages and education

Annualized changes in the labor income Gini, 1995-2010

Changes in the years of education Gini

Social Equity

*Substantial expansion of the middle class...*

Source: *Economic Mobility & the Rise of the Latin American Middle Class* (Forthcoming, LCRCE, World Bank).
Social Equity

...reflecting impressive intra-generational upward mobility

<table>
<thead>
<tr>
<th>Circa 1995</th>
<th></th>
<th>Circa 2009</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Poor</td>
<td>Vulnerable</td>
<td>Middle Class</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor</td>
<td>49.3</td>
<td>46.0</td>
<td>4.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vulnerable</td>
<td>2.6</td>
<td>43.0</td>
<td>54.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Class</td>
<td>0.4</td>
<td>2.6</td>
<td>97.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>c1995 Margins</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>45.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>33.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>20.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>c2009 Margins</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>23.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>35.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>40.7</td>
</tr>
</tbody>
</table>

Source: *Economic Mobility & the Rise of the Latin American Middle Class* (Forthcoming, LCRCE, World Bank).


Social Equity

Widespread decline in informality...but not in Mexico

Change in the Share of Informal Workers

Source: Gasparini (2012) – Data SEDLAC
Growth
Per capita income has been converging in the past decade

Note: The trend growth of per capita GDP is computed using the band-pass filter. Source: WDI-World Bank.
Growth

The post-2009 recovery has been strong and de-coupled

Note: The group of developed countries refers to OECD countries excluding Turkey, Mexico, Republic of Korea, and Central European countries; the group of emerging economies includes LAC countries. Source: CPB (Netherlands Bureau for Economic Policy Analysis).
Growth

But recent growth performance has been heterogeneous

Notes: Trend GPD for each group is computed by extrapolating the simple average of growth rates during 2007-2003. Sources: Consensus Forecasts (July 2012) and WEO (April 2012).
# Growth

**Heterogeneity: connections mattering more than location**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Simple Average</td>
<td>Simple Average</td>
<td>Simple Average</td>
<td>4.9%</td>
<td>-1.6%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.3%</td>
<td>-0.1%</td>
</tr>
<tr>
<td>Low growth</td>
<td></td>
<td></td>
<td></td>
<td>4.3%</td>
<td>8.7%</td>
</tr>
<tr>
<td>Medium growth (7)</td>
<td>4.5%</td>
<td>1.7%</td>
<td>3.4%</td>
<td>2.6%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Panama</td>
<td>8.8%</td>
<td>9.5%</td>
<td>8.4%</td>
<td>8.4%</td>
<td>8.4%</td>
</tr>
<tr>
<td>High growth (12)</td>
<td>5.9%</td>
<td>4.5%</td>
<td>6.0%</td>
<td>4.5%</td>
<td>8.7%</td>
</tr>
<tr>
<td>LAC (all countries)</td>
<td>4.8%</td>
<td>1.1%</td>
<td>3.5%</td>
<td>-0.1%</td>
<td>8.7%</td>
</tr>
</tbody>
</table>

**Low growth**: Antigua and Barbuda, Bahamas, Barbados, Dominica, El Salvador, Grenada, Jamaica, Mexico, St. Kitts and Nevis, St. Vincent and the Grenadines, St. Lucia, Trinidad and Tobago, and Venezuela

**Intermediate growth**: Belize, Costa Rica, Ecuador, Guatemala, Haiti, Honduras, and Nicaragua

**High growth**: Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Panama, Paraguay, Peru, and Uruguay

---

Sources: World Bank’s World Development Indicators (December 2010), IMF’s World Economic Outlook (April 2011), and Consensus Forecasts.
Whither LAC?

The going likely to get tougher
The past decade’s gains in part reflect good policies taking advantage of the tail winds...

- Improved macro-financial policy frameworks
- Targeted social assistance programs
- A leap forward in financial inclusion
... but the strength of the tails winds made it possible to achieve large gains with little sacrifice

- **Commodity price super cycle** – purchasing power of income outstripped output growth

- **China connection** – China as the source of cheap consumer goods; LAC as China’s mine and granary

- **High remittances inflows** – boosting poverty reduction and consumption

- **Global savings glut** – capital inflow bonanza
The commodity super-cycle

Commodity Prices
Oil WTI in Current US$, Wheat, Copper and Soybean: Index base Jan-05=100

Around 93% of LAC population and 97% of LAC economic activity are located in net commodity exporting countries

It has been the longest and most comprehensive and synchronized cycle (since data are available), affecting virtually all commodities that matter for LAC

The China connection

Output Co-Movement Between LAC countries and China

20 years rolling correlation of the Real GDP Growth

Brazil    Chile    Colombia    Mexico    Peru    Argentina    Panama    Guatemala

Note: Solid lines denote statistical significance. Source: Penn World Tables
Notes: High level of remittances is defined as superior to 10% of GDO. Mid Level as between 4% and 10% of GDP. Low level as between 1% and 4% of GDP. Data for 2011 are estimated.

Source: WDI, Migration & Remittances Statistics from the World Bank, IFS, and Haver Analytics.
Global savings glut and surges in capital inflows

Gross Capital Inflows to LAC-7+URY Countries
US$ Millions, Annual Flows

FDI
Non-FDI

Notes: Data for 2012Q1 is estimated. Source: IFS, Haver Analytics, and EPFR.
However, consolidating and expanding the gains in the future will depend on the steadiness of the tail winds...

- First, there are questions (doubts) about the trends
  - Will the region’s terms of trade continue to rise?
  - Will remittances remain high?
  - Will capital inflows continue to pour in?

- Then, there are concerns about a shift to higher volatility
  - Will commodities prices steady themselves in the future?
  - How will capital flow volatility and external financial shocks affect the region in an increasingly globalized (and unstable?) environment?

- Hence, one key focus of the policy response must be on building up buffers – strengthening resiliency
Yet even with continued favorable winds, LAC will face major long-run growth challenges...

- Under a commodity-induced growth, rents tend to concentrate and must be redistributed, which is not be easy
- The Dutch disease (real exchange rate appreciation) may continue to spread...
- ...which is likely to continue to shift employment to the (currently) low productivity service sector
- ...even more so where real interest rates continue to be high and domestic (public and private) savings low
- Rent-seeking behavior may thrive, possibly corroding institutions...
- ...promoting corruption and perhaps even stimulating organized (or disorganized) crime
Whither LAC?

*Can LAC avoid a bad equilibrium of low savings, low diversification, low growth, and high vulnerability?*
Having been unable to converge for more than a century, will LAC break away from the MIC trap this time around?

GDP Per Capita Relative to the US

Notes: The aggregated GDP per capita is a weighted average of the countries in each region since 1950; it is a simple average before since samples are not complete. East Asian Tigers are composed by Hong Kong, Malaysia, Singapore, South Korea, and Taiwan. 2012 data are estimates.
Sources: Penn World Tables, WDI, WEO(April 2012), Maddison(2009), and LCRCE’s Staff own calculations.
The failure to converge is typical across most LAC countries.

Notes: Maddison (2007-2009) was used from 1900 to 2009; WEO (April 2012) was used to complete the series until 2011 and to get the forecast for 2012. Source: LCRCE Staff calculations based on Maddison (2009) and WEO(April 2012).
LAC’s economic engine bumps against speed limits at relatively low growth rates

Inflation and Growth In Middle Income and Advanced Economies

Source: IMF WEO.
Export bases are becoming more concentrated in much of the region...
...and fiscal spending has risen significantly in much of LAC, mainly on the strength of commodity-related revenues

Note: LAC average for 11 countries. Source: IFS and WEO.
LAC is a low-savings region...

Gross Domestic Savings
Percent of GDP

Note: East Asian Tigers includes Malaysia, Hong Kong, South Korea and Singapore. Taiwan is excluded because of data limitations. Source: WDI.
...which tends to manifest in high real interest rates and appreciated exchange rates...

Source: IFS
LAC lags behind in human and physical capital formation...

Source: Mathematics score from Pisa (2006). Expenditure per Student, primary (% GDP) is the most recent data available in WDI (2004 for most of the countries). Public expenditure per student is the public current spending on education divided by the total number of students in the primary level.
... and has not shown a strong capacity to adopt and adapt technical change...

Source: Lederman and Maloney (2003)
The scope for saving effort is further constrained by inequality of opportunities (effort does not pay)...

Association between parental education and children’s years of schooling

Source: Economic Mobility & the Rise of the Latin American Middle Class (Forthcoming, LCRCE) – Data SEDLAC
...even as public policy is under new and nasty pressures – including from rising insecurity, crime and violence.

Source: UNODC (2010).
The policy response will be hindered by remaining institutional weaknesses

Source: Kaufman, Kraay, and Maturazzi (2010).
Much of the pressures and challenges point to a need to rebalance the roles of the state and markets

- The traditional Washington Consensus – markets as main problem solvers, states limited to being market enablers – is discredited
- The more recent emphasis on poverty reduction (targeted transfers) is welcome but insufficient
- A thornier global environment and the downsides of a commodity-based model call for a reshaping of the states-markets balance, to
  - Efficiently redistribute commodity rents across income groups and generations
  - Internalize the externalities associated with a more diversified export base (a modern version of industrial policy?...)
  - Promote financial development without undermining financial stability
- Ultimately, the challenge is to enhance the role of the state without resurrecting the bloated public bureaucracies of the past
The region is currently in a bifurcated search for such a new balance

- **Type I: Enhancing the complementary role of the state**
  - Harnessing the state’s comparative advantage in solving collective action problems (including risk spreading) in healthy interaction with markets
  - Focus on *additionality* (helping complete and complement markets, crowding in the private sector)
  - Big questions: How to lead and induce from behind? How to limit private rent-seeking? How to calibrate social protection while promoting saving? And how to do all this while producing visible results relatively quickly?
  - Chile, Colombia, Mexico, Peru, Uruguay

- **Type II: Boosting the *dirigiste* role of the state**
  - Leading markets or (partially) replacing (crowding out) market forces
  - Focus on *finality* (getting things done, even if it stifles private activity)
  - Big questions: How to avoid an erosion of market signals? How to avoid political or bureaucratic capture?
  - Argentina, Bolivia, Ecuador, Venezuela (whither Brazil?...)
Thank you