Latin America’s Long-Term Growth: Made in China?

The Americas Families in Business Conference

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Latin America and the Caribbean
The World Bank
The Framework

*The Economic Development Diamond*
The economic development diamond

“[The world] is too unstable; it is too unequal, and it is completely unsustainable”

Bill Clinton
Yale Commencement
May 2010
LAC has impressed itself and the world
LAC comes out of the crisis without impaired balance sheets, in sharp contrast with rich countries.

<table>
<thead>
<tr>
<th></th>
<th>Systemic Banking Crises</th>
<th>Foreign Currency Debt</th>
<th>Currency Crises</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. Of Crises-Hit Countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td>19</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>OECD only</td>
<td>18</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Middle East &amp; N. Africa</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>South Asia</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>0</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>1</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Europe &amp; Central Asia</td>
<td>3</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>0</td>
<td>11</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>42</td>
<td>1</td>
</tr>
<tr>
<td>As a Percentage of All Crises Countries</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>High Income</td>
<td>83%</td>
<td>14%</td>
<td>0%</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>17%</td>
<td>86%</td>
<td>100%</td>
</tr>
<tr>
<td>Middle Income</td>
<td>17%</td>
<td>67%</td>
<td>100%</td>
</tr>
<tr>
<td>Low Income</td>
<td>0%</td>
<td>19%</td>
<td>0%</td>
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</tbody>
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<tr>
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<tbody>
<tr>
<td></td>
<td>Antigua and Barbuda (96)</td>
<td></td>
<td>Mexico (94)</td>
</tr>
<tr>
<td>Argentina (95)</td>
<td>Haiti (94)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bolivia (94)</td>
<td>Jamaica (96)</td>
<td></td>
<td>Suriname (94)</td>
</tr>
<tr>
<td>Brazil (94)</td>
<td>Mexico (94)</td>
<td></td>
<td>Venezuela (94)</td>
</tr>
<tr>
<td>Colombia (98)</td>
<td>Paraguay (95)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costa Rica (94)</td>
<td>Venezuela (94)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ecuador (98)</td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>
Impressive and de-coupled economic recovery of EMs in general, and LAC in particular

World Industrial Production

Index Apr-08 = 100

Note: The group of developed countries refers to OECD countries excluding Turkey, Mexico, Republic of Korea, and Central European countries. Source: CPB (Netherlands Bureau for Economic Policy Analysis).
Growth rates slowing down in EMs but still satisfactory for LAC, as it bumps against capacity constraints

Source: IMF WEO (April - 2012), and Consensus Forecast (March – 2012)
To be sure, within-LAC heterogeneity is significant...

Sources: Potential GPD is computed as the average rate of growth between 2007 and 2003. Simple averages are used to construct the composite. The categorization of each group is as follows: Slow-growth are those countries that showed a less than 4.0% in their 2011-2008 GDP real growth rate; Medium-growth are those between 4.0% and 10%; High-growth are those with 10% or more. WEO (April - 2012).
... and it is mutating, with geography mattering less

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<tbody>
<tr>
<td>Low growth (13)</td>
<td>4.9%</td>
<td>-1.6%</td>
<td>1.3%</td>
<td>-0.1%</td>
<td>4.3%</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>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 (<4%):** 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 (4%-10%):** Belize, Costa Rica, Ecuador, Guatemala, Haiti, Honduras, and Nicaragua

**High growth (>10%):** Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Guyana, Panama, Paraguay, Peru, Suriname and Uruguay

Notes: Potential GDP is calculated computing the annual average real growth rate for the 2002-2007 to 2007 GDP. Weighted averages (2007 Nominal GDP in USD Billions).
The commodity super-cycle has clearly helped...

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.

Source: Bloomberg, and World Bank Global Economic Monitor
... and so has the global savings glut and liquidity tsunami

**Gross Capital Inflows to LAC-7 Countries**

*US$ Millions, Annual Flows*

Source: Bloomberg, and World Bank Global Economic Monitor
The China connection is an increasingly important driver of LAC’s economic performance

Output Co-Movement Between LAC and China
20 years rolling correlation of the Real GDP Growth

Source: Penn World Tables
Whither LAC?

Stability
The improved macro-financial immune system is, arguably, LAC strongest economic asset.

Before
- Fragile/unviable/pro-cyclical
- Weak/noncredible/pro-cyclical
- Fragile/unsound

Now
- More viable
- Credible/counter cyclical
- Sounder
The recovery of an independent and counter-cyclical monetary policy is most impressive.
But LAC is also moving towards a much more viable and less pro-cyclical fiscal policy.
LAC has become a net creditor in debt contracts vis-à-vis the ROW – turning around the “sudden stop” syndrome.
LAC banking systems have stronger prudential buffers than most other regions in the world.
But the only certainty in LAC’s path is uncertainty...

- Mood swings and market fickleness characterize the current juncture
- Disproportionally large reactions to news can create sudden waves of optimism or pessimism
Reduced probability of a tail-risk event combined with low rates in rich countries is unleashing a “search for yield”

- Increases in capital flows to LAC, especially of portfolio flows, add tensions to macroeconomic management:
  - Keeping inflation expectations anchored in the face of economic overheating;
  - Avoiding an “excessive appreciation” of the currency in a context of high but volatile commodity prices and capital flows.
Whither LAC?

Fairness
Finally, clear and steady progress in the equity agenda

Per Capita GDP Growth and Poverty

**LAC Countries**

<table>
<thead>
<tr>
<th>Year</th>
<th>Gini Coefficient, Change (2000-2009)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>0.0</td>
</tr>
<tr>
<td>1995</td>
<td>0.5</td>
</tr>
<tr>
<td>2000</td>
<td>0.7</td>
</tr>
<tr>
<td>2005</td>
<td>0.9</td>
</tr>
<tr>
<td>2010</td>
<td>1.0*</td>
</tr>
</tbody>
</table>

Note: * denotes final year between 2004-2006
Source: SEDLAC

**Sources:**
- Barro-Lee (2010), US Energy Information Administration
- LCSPP based on Socio-Economic Database for Latin America and the Caribbean (CEDELAS and the World Bank).
LAC still has a high degree of inter-generational immobility

Impact of one sd. of parental education on educational attainment of the children

Note: The graph shows the average impact of a standard deviation in the years of education of the parents on children's years of education. One regression is run separately for each country and birth cohort, using survey weights and each bar represents the average across birth cohorts. Source: Own calculations based on Hertz (2007)
The fairness challenges

- Targeted social assistance systems not yet in place in all of LAC and un-targeted, regressive subsidies subsist, esp. in energy
- LAC appears to be the region with greater social immobility, where middle classes tend to opt out of public services
- Human capital investment – the great equalizer
  - Quality of education is the next frontier
  - Not clear why return to higher education is falling
- Un-truncation of welfare state focused on social assistance...
- ... while reform of social insurance has barely begun
  - The premium on it rises as poverty shrinks and growth advances...
  - ... but revenue mobilization is not in sync with demand for equity
Whither LAC?

Growth
Can LAC break free from the MIC trap in the midst of major shifts in economic tectonics?

By 2030, emerging and developing countries will be 2/3 of global economic activity

But the past has been uninspiring
100 years of growth solitude!

Sources: Penn World Tables and LCRCE’s Staff own calculations.
And the low-growth syndrome has been generalized across LAC countries

Notes: Maddison (2007-2009) was used from 1900 to 2006 and Real Per Capita GDP growth from WDI was used to calculate the levels from 2006 to 2010. Source: LCRCE Staff calculations based on Maddison (2007, 2009) and WDI.
LAC economic engine hits speed limits at low growth rates

Inflation and Growth In Middle Income and Advanced Economies

Source: IMF WEO (September 2011).
The challenge is to find a path to higher, sustainable growth, leveraging on China and commodities.

The pickup in productivity growth is very encouraging.
And there are hopeful signs that LAC may avoid the commodity curse this time around

- Commodity production per se is not “inferior” to others...
  - Biotechnological revolution and connectivity in Argentina and Brazil
  - Climbing the quality ladder in metal production
  - Clusters of activity (employment, SMEs) around copper production and salmon farming in Chile

- Improved institutions and policy frameworks enhance the chances of avoiding the curse and rather raise the hopes of realizing the blessing

The foundations of long-term growth
Accumulation – savings and investment

Source: Penn World Tables and World Development Indicators.
The foundations of long-term growth

Accumulation – human capital

Source: Author’s calculation based on Household datasets and Barro-Lee (2010)
The foundations of long-term growth
Accumulation – human capital (quality)

Education Gap

Mathematics score in PISA 2006

Expenditure per student, primary (% of GDP per capita)

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.
The foundations of long-term growth
Accumulation – physical capital

Source: Barro-Lee (2010), US Energy Information Administration
The foundations of long-term growth

Productivity – technological change

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.
The foundations of long-term growth

Productivity – institutions

Log of GDP per capita PPP in 2010

Control of Corruption

Rule of Law

Regulatory Quality

Government Effectiveness

Source:
Thank you!