

LATIN AMERICA IN A NEW GLOBAL ECONOMIC ORDER: TOWARDS A NEW DEVELOPMENT MODEL

St Antony's College | University of Oxford | Friday 17th February 2012

INTRODUCTION

On Friday, February 17th, 2012, the conference “Latin America in a New Global Economic Order: Towards a New Model of Development”, organised by the Latin American Centre, University of Oxford and CAF – Development Bank of Latin America was held at the Nissan Institute at St Antony's College. On this occasion, senior members of the CAF and internationally renowned scholars discussed Latin America's political, economic and social challenges. Contributors to the conference highlighted the following important lessons:

- Rapid recovery. In contrast to much of Europe, Latin America's economies have recovered relatively quickly from the recent global financial crisis, which illustrates how far the region has come since the late 1980s and early 1990s.
- China as a challenge and opportunity. China has become a key trade partner and an engine of regional (and global) economic growth. Unfortunately, however, China may also be contributing to lock Latin America into primary specialization.
- Political reform. While the majority of democratic regimes in the region appear to be stable the next challenge will be to enact reforms that open up these political systems and improve legitimacy, but in a way that also further strengthens representative institutions.
- The unfinished distributional challenge. In terms of social development, the reduction in income inequality has been modest and redistribution remains a key obstacle to development that Latin American countries will need to address.



OPENING REMARKS

In his address, President and CEO of CAF Enrique García stressed the Bank's role in fostering intellectual thinking and policy innovations inside and outside Latin America. The collaboration between CAF and the Latin American Centre of the University of Oxford, which includes a scholarship scheme as well as the organization of academic events, should make a significant contribution to future development thinking.

Following García, Angus Lapsley, of the Foreign and Commonwealth Office, spoke about the process of British reengagement with Latin America, which has taken place over the last 12 months. Politically, this reengagement has been advanced through more frequent ministerial visits and an increased diplomatic presence in the region. However, he cautioned that the reengagement process could take at least a decade, as British companies have been slow to recognise the opportunities in the region and key British embassies in both Mexico and Brazil continue to be significantly understaffed. Similarly, he stressed the need to focus on other areas of co-operation beyond economic issues, such as climate change and energy policy.

PANEL I: THE NEW GLOBAL ECONOMIC ORDER IN LATIN AMERICA

The first panel focused on the changing international environment and its impact on Latin America's opportunities for development. Participants highlighted:

- The growing importance of trade relations between Asia (particularly China) and Latin America.
- The need to move beyond a traditional pattern of specialization through which China imports manufacturing regions to Latin America and purchases commodities. Latin America must find ways to use the current trade expansion to add value into commodities and promote industrialization.
- The importance of regional integration.

There was also a healthy disagreement about the comparative importance of China and more traditional partners like the European Union for Latin America's development in upcoming decades.



Alicia García-Herrero from the BBVA focused on the increasing role of China in the global economy and its implications for Latin America. According to her estimations, China will contribute US\$13.7 billion (PPP) to global growth in the next decade compared to only \$3.8 billion (PPP) in the case of the US and even less in the case of the European Union. As a result of Latin America's recent work, the contribution of countries like Brazil to global expansion will also be significant. Garcia-Herrero highlighted the opportunities and challenges that China represents for Latin America. On one hand, China's growth is driving the expansion of the share of commodities in Latin America's exports—a process that has also taken place in other parts of the world like Australia. On the other hand, China presents an opportunity for Latin America: its middle class is growing and could become a major consumer of imported consumer products as well as commodities. Similarly, it is predicted that China will become a key provider of FDI, which Latin American countries could benefit from. At the same time, she warned against the idea that Latin American countries will succeed in competing with China in labour-intensive manufactures.

Enrique Iglesias, General Secretary of the *Secretaría General Iberoamericana* centred his remarks on the implications of the recent global financial crisis for different parts of the world, including Latin America. He stressed the severity of the crisis and the unique impact that it will have on the European Union and other developed countries. Enrique Iglesias highlighted the extent to which Latin American countries have learned from previous mistakes: their ability to recover

from the crisis suggests that the region has adopted more sound policies than in previous decades. In terms of future developments in international trade, he suggested that it would be a mistake for Latin American countries to only focus on China and neglect their traditional markets.

José Antonio Ocampo from Columbia University also recognized Latin America's recent positive economic performance, particularly in terms of debt reduction and economic expansion. Nevertheless, he questioned the sustainability of the recent commodity-led growth based on China's increasing demand. Professor Ocampo presented interesting calculations that demonstrate Latin America's structural deficits in the current account: if commodity prices go down, most Latin American countries will face large trade deficits. To become more competitive, particularly in manufacturing production, Latin America should concentrate on promoting regional integration and diversifying the basket of exports that go to Asia.



PANEL 2: PRODUCTIVE TRANSFORMATION IN LATIN AMERICA

The second panel dealt with the challenges that the region faces to transform its production structure and increase technological learning and innovation. The panel offered some important lessons:

- The need to consider active state policies to promote learning and innovation at the local, regional and national level. These policies should be comprehensive but also recognized the limitations from past policy approaches.
- The need to learn from the East Asian experience—particularly in terms of capital accumulation and productivity growth.
- The differences that exist between countries north and south of Panama in terms of their recent experience and future challenges and opportunities.

Michael Penfold from CAF stressed how Latin America's healthy fiscal position and rapid economic growth has put the issue of structural transformation on top of the political agenda. Compared to the 1980s and early 1990s, there is evidence that primary exports are gaining importance, although there is still significant variations across the region. It is clear that Latin America still suffers from under-development of technological capacities and insufficient levels of intra-regional trade (due to lack of regional value chains). Dr Penfold proposed a comprehensive policy approach to structural transformation that includes: (a) Investment in trade facilitation including improvement of airports and ports; (b) Strengthening of business associations, institutional capabilities and regulation; (c) Concentration on productive innovation, small and medium enterprises and the role of local government in promoting learning and business development. Dr Penfold warned against implementing traditional policies of import substitution and illustrated many of his proposals with examples from CAF's recent interventions.



João Carlos Ferraz from the Brazilian Development Bank (BNDES) highlighted the region's recent success in employment creation and economic expansion but warned against on-going problems. Latin America has low capacity to compete as low skill levels are impeding productivity gains and capacity to finance long term development is insufficient. Ferraz stressed that most countries in the region never had a strong manufacturing base in the past and thus criticised the idea that Latin America is experiencing a process of "re-primarisation". He further underlined that Latin America has a diversity of models of productive transformation. For example, north of Panama and the Caribbean there is a strong articulation with US economy based on services. South of Panama, natural resources have played a more significant role in promoting economic growth. These different models will all be transformed by the expansion of Information and Communication Technologies (ICT) and biotechnologies.

Gabriel Palma from the University of Cambridge focused on the lessons that Latin America can learn from Asia. He showed striking comparative data on investment, productivity and growth performance: in 1980, for example, both Korea and Brazil had similar levels of labour productivity but now Korea has three times more. Latin America's historical problem has been the lack of continuous economic growth and insufficient investment. He used a graphic expression to explain it: "Latin American countries are middle distance runners, while Asian countries are marathon runners". Professor Palma also emphasized the importance of learning not only how to grow, but also how to produce a sustainable rate of growth. Not a single Latin American country has been able to sustain the growth rates of Indonesia, the worst performing Asian economy and a country with recurrent political instability. The Chilean case is probably the most notable: a period of high productivity growth stopped abruptly in 1998 without having



experienced a major financial crisis (as in Argentina) or political crisis (as in Peru). Asian countries also have greater capacity to recover from economic crisis. To produce sustained growth, the role of the elites is critical. The problem is that while Latin American elites have 'tenure'— e.g. they tend to remain at the top of the income distribution and maintain political influence for a long time—many Asian oligarchies have continuously to deliver if they want to go on enjoying their power and privileges. Further investment from the elite it is important to increase levels of investment per worker. In Brazil for example, by 2008 investment per worker was still 22% below that of 1980. Finally, factor accumulation, especially physical and human capital, must also increase.

PANEL 3: POLITICAL CHALLENGES IN LATIN AMERICA

The third panel highlighted the problems of legitimacy that many democracies in Latin America still face as a result of different factors:

- High inequality creates problems of legitimacy and, unfortunately, is also sustained by the political system itself. Some of the reforms that have recently been adopted to confront these problems have resulted in the unintended consequence of weakening political parties.
- Drug trafficking, organised crime, the political influence of the media and the lack of independence of the judiciary were also considered to be persisting challenges for democratic governance and legitimacy.

Martín Torrijos, former President of Panama, noted that the structural adjustment programs advanced shortly after Latin America's democratic transitions exacerbated income inequality in the region and that persisting income inequality continues to contribute to popular disenchantment with democracy today, as evidenced by the recent events in Honduras and Ecuador. He attributed this state of affairs to the inability of Latin American governments to broaden their tax bases despite 20 years of growth. He argued that political parties needed to adapt to changing economic realities and that all the economic predictions of the previous panels ought to be translated into policy.



Manuel Alcántara, from the *Universidad de Salamanca*, presented his work on governability scenarios facing Latin America's elected presidents. This research measured the distance between the ideological position of recent elected presidents on a left-right scale, and that of the average legislator. Based on the size of this gap presidents were classified as facing negative, neutral or positive governability scenarios, with only Mexico and El Salvador falling into the first category. Beyond the potential for gridlock between presidents and legislatures, he argued that a continuing political challenge which Latin America faces has to do with the relationship between the media and politicians and the ability of the media to advance its own political agenda. He also highlighted the problems of the politicisation of the judiciary in some cases compared to increasing judicial influence over political decisions in others.



Martín Tanaka, from the *Instituto de Estudios Peruanos*, urged Latin American countries to implement reforms to address the exclusionary nature of their institutions—a precondition to sustain economic and political development in the region. He argued that in some cases previous reforms that aimed to open up the political system, such as the introduction of proportional electoral systems and decentralisation of government also led to the weakening of political parties and higher levels of party fragmentation. He pointed to the 2003 reform which moved Colombia to a party list system and the 2003 party law in Peru as examples of reforms that have strengthened the legitimacy of political parties. Unlike the first wave of reforms, the recent ones did not lead to the situations of party fragmentation in which personalist anti-system candidates seem to thrive.



PANEL 4: SOCIAL CHALLENGES IN LATIN AMERICA

The fourth and final session focused on the recent evolution of income inequality. The three speakers highlighted:

- The importance of the recent reduction of the Gini coefficient in one of the most unequal regions of the world. In fact, 13 out of 17 Latin American countries experienced approximately 1% a year of reduction of inequality between 2000 and 2009.
- Doubts about the sustainability of the recent positive performance due to insufficient taxes, low redistributive social spending and heterogeneous productive structures.

Leonardo Villar from CAF underlined the role of fiscal policy in mitigating income inequality. Two fiscally induced changes have been central in the reduction of inequality in Latin America: (a) targeted transfers (non-contributory pensions and Conditional Cash Transfers, CCT), which helped to reduce poverty and inequality through non-labour income; (b) larger public revenues and growing size of governments allowed for a higher public social expenditure. Moreover, during the 2000s, there has been an important change in labour market conditions. Labour income has become more equally distributed because of a fall in the skill premium, which contrasts with its increase in the 1990s. Real minimum wages have also been increasing in most of Latin American countries since 2000. Despite these positive trends, Villar also recognized significant bottlenecks: (a) limited state capacity; (b) tax collection is still too low and too dependent on external factors such as the commodity boom; (c) the need to reinforce the complementarities between universal and targeted public provisions; and (d) excessive levels of informality despite recent improvements. As a result of the weak state capacity and the informality in the labor market, Latin American countries do not have a tax structure that is sufficiently progressive to reduce inequality.

Nora Lustig from Tulane University discussed her recent research on the reduction of inequality in Latin America. This decline, she argued, can be explained by the fact that everyone is gaining more but the bottom is gaining more than the top. She emphasized the role of the fall in the skill premium and progressive government transfers. These tendencies and policies have taken place in countries with different political colours: left “populist”, left social-democratic, centre, and centre-right governments. Yet Professor Lustig warned against complacency. Inequality is still very high and its decline has lost momentum in recent years. The main reason for this is that the

decline in inequality resulting from the educational upgrading of the population will eventually hit the 'access to tertiary education barrier', which is much more difficult to overcome. Inequality in quality and 'opportunity cost' are high and costly to address. As a result, the region faces the problem of having young people with university degrees of low quality that are not valued by the market. The recent student protests in Chile are a good example of the frustration this might generate.

Diego Sánchez-Ancochea from the University of Oxford focused on the importance of productivity convergence to reduce inequality. He stressed the need to reduce structural heterogeneity (i.e. productivity differences between leading sectors and the rest of the economy) to sustain the reduction of inequality in the future. Economic sectors that have high productivity need to absorb more workers than other sectors. Finally, mechanisms of redistribution such as universal programs and/or conditional cash transfers need to be in place. The expansion of non-labour income in the bottom deciles is important in all Latin American countries. In Brazil for example, non labour income was responsible for 40 percent of the reduction in the Gini coefficient between 2001 and 2007. Countries like Chile are implementing universal programs such as the AUGE, a tendency that had not been seen since the 1980s.



SUMMARY

China was identified as the key external factor that will influence the development trajectories of Latin American economies over the next 10 years. While it was generally agreed that demand for commodities from China has been good for Latin American economies overall and contributed to Latin America's success in overcoming the recent financial crisis, it was also recognised that the commodities boom could have negative effects for Latin American economies in the long term. An over-reliance on commodity exports not only has the potential to reverse the process of industrialisation but could also make Latin American economies vulnerable to a balance of payment crisis should this demand suddenly falter. These problems may be avoided however, if alternative growth strategies are also pursued. In particular, Latin American countries should seek to diversify the profile of their exports to China and also strengthen trade links within the Latin American region.

The good economic performance and political stability of Latin American countries provide a good opportunity to discuss how the region will secure future sustained and high levels of

growth. As was highlighted in many of the expositions, the growing importance of China and other Asian countries in the global market makes this challenge of paramount importance. If the countries of the region do not focus on the transformation of their production models, they might fall behind more than they are already doing. Central dimensions for productivity transformation that were highlighted in the conference are innovation, small and medium enterprises, and the role of national and local government in promoting development. Furthermore, attention should be drawn to the level of structural heterogeneity and its role in achieving productivity growth.

The presentations also stressed the need to address inequality at the political level. It was argued that not only do governments in the region need to place a greater emphasis on redistributive efforts but that the exclusionary and elitist character of many democracies in the region presents a continuing threat to democratic legitimacy in the region. The challenge will be for governments to introduce reforms that open up the political system without compromising the strength of political parties.

Sustained economic growth rated will be central to advance in what was pointed out as the main social challenge in the region: the reduction of inequality. While the paper gives recognised that inequality has decreased since the early 2000s, it was also stressed that this is only a return to the Gini coefficient levels of the early 1980s. The progress that has been made can be explained by a fall in skill premium and progressive government transfers. To advance these positive results further, public policies such as targeted transfers and higher public social expenditure must be pursued. A political economy perspective that analyses the structure of production and the nature of the elite at the same time can help us to understand what is necessary to achieve sustained and high levels of growth to reduce inequality and what are the challenges we face.



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