Economic and social panorama of Latin America and the Caribbean

José Luis Machinea
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Economic Commission for Latin America and the Caribbean

Germany, April 23, 2007
Our view of the economic situation of Latin America could be summarized in two words: ‘Cautious Optimism’

- **Optimism** because the region is growing faster and better than in the past

- But, **cautious** because of:
  - Increasing uncertainty regarding the international economic context
  - Concerns over the sustainability of the current rates of economic growth
  - Disappointment with the lack of change of income distribution
GDP growth reached around 5.6% in 2006

LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH, 2006
(annual growth rates)

(*) Central America includes Haiti and Dominican Republic
And we expect a rate of growth of near 5% this year.
A longer-term view: Per capita GDP increases after a period of stagnation

Growth 2003-2007: 16%
Main features of the current macroeconomic cycle

- More saving, investment and exports than in the previous upswing.
- Current account surplus (with differences among countries)
- More reserves and less external debt.
- Better fiscal performance
- Reduction of public debt and improvement of its structure in terms of maturity and currency.
Unemployment is falling but is still higher than in the first half of the 1990s

The EAP is growing by 2.5% per year, while the total population is growing by 1.5% per year
The percentage of poor and indigent persons falls since 2002 and this trend is expected to continue. But it took 25 years to reduce poverty below the 1980 level.
Since 2005 the region has brought poverty rates down to level in early 1980s but with a 17% higher average per capita GDP.

**LATIN AMERICA:** \(^a/\) POVERTY RATES AND PER CAPITA GDP, 1980 - 2006

*(Percentages and dollars at 2000 prices)*

Source: ECLAC, on the basis of special tabulations of household surveys in the relevant countries.

\(^a/\) Estimates for 19 countries of the region, including Haiti.

\(^b/\) Projection.
A relative poverty indicator similar to the one used by the European Union reflects a more homogeneous situation in the region. These results usually are not aligned with trends in absolute poverty.

Although absolute poverty is the most urgent problem, relative poverty measurements may be more relevant for countries with lower absolute poverty rates, however.
Between 2002 and 2005, the number of poor and indigent population declined by 12 and 16 million persons. This might show a change in trend, but now there are still more poor people than in 1980.
Reasons for the decline in the poverty rate are: higher growth, increasing (and better) employment and rising social expenditure

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<td>Jamaica</td>
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<td>Costa Rica</td>
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<td>Brazil</td>
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<td>Argentina</td>
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<td>Uruguay</td>
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<td>Cuba</td>
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Projections of the extreme poverty rate up to 2006 indicate that the region is back on track towards the first target of the Millennium Development Goals (actual progress is greater than the time elapsed).

**LATIN AMERICA (17 COUNTRIES): LEVELS AND PERCENTAGES OF PROGRESS IN REDUCING EXTREME POVERTY BETWEEN 1990 AND 2006 a/**

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<tr>
<td>Latin America</td>
<td>50.9</td>
<td>14.7</td>
<td>69% (expected progress, 2006)</td>
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<tr>
<td>Argentina b/</td>
<td>33.1</td>
<td>8.4</td>
<td>73%</td>
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<tr>
<td>Bolivia</td>
<td>17.1</td>
<td>10.3</td>
<td>66%</td>
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<tr>
<td>Brazil</td>
<td>18.3</td>
<td>3.6</td>
<td>66%</td>
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<tr>
<td>Chile</td>
<td>15.9</td>
<td>6.6</td>
<td>68%</td>
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<td>Colombia</td>
<td>10.8</td>
<td>3.4</td>
<td>79%</td>
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<tr>
<td>Costa Rica</td>
<td>14.5</td>
<td>10.8</td>
<td>73%</td>
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<td>Ecuador b/</td>
<td>15.8</td>
<td>3.4</td>
<td>73%</td>
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<td>El Salvador</td>
<td>30.9</td>
<td>8.4</td>
<td>69%</td>
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<td>Guatemala</td>
<td>40.5</td>
<td>14.7</td>
<td>69%</td>
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<td>Honduras</td>
<td>31.6</td>
<td>14.5</td>
<td>52%</td>
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<tr>
<td>Mexico</td>
<td>50.9</td>
<td>14.4</td>
<td>73%</td>
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<td>Nicaragua</td>
<td>31.6</td>
<td>14.5</td>
<td>42%</td>
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<tr>
<td>Panama</td>
<td>31.6</td>
<td>14.5</td>
<td>73%</td>
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<td>Paraguay</td>
<td>14.5</td>
<td>10.8</td>
<td>68%</td>
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<td>Peru</td>
<td>31.6</td>
<td>14.5</td>
<td>73%</td>
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<td>Uruguay b/</td>
<td>31.6</td>
<td>14.5</td>
<td>73%</td>
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<td>31.6</td>
<td>14.5</td>
<td>73%</td>
</tr>
</tbody>
</table>
External conditions have boosted regional growth

- World growth
- Liquidity of financial markets
- Improvements in Terms of trade
Better terms of trade….. but with differences among sub-regions

VARIATION IN TERMS OF TRADE BETWEEN THE 1990S AND 2006

LATIN AMERICA AND THE CARIBBEAN: 31.2%
SOUTH AMERICA (excluding Chile and Venezuela): 47.3%
SOUTH AMERICA (incl. Haiti and Dom.Rep): 17.1%
CENTRAL AMERICA: -13.4%
MEXICO: 25.5%
External conditions have boosted regional growth

- World growth
- Liquidity of financial markets
- Improvements in Terms of trade
- High level of remittances
Remittances are by far the main source of external financing in Central America.

LATIN AMERICA AND THE CARIBBEAN: RESOURCES FROM MIGRANT WORKERS’ TRANSFERS
(percentages of current GDP)

- South America: 1.2
- Central America: 11.1
- Mexico: 2.8
- Caribbean: 5.8
Summing up the reasons for optimism…

- The region is growing faster and better than in the past
- Unemployment is falling
- Poverty has been reduced in recent years
- The region is less vulnerable than before to external shocks
- All this is in the context of favorable external conditions
And the reasons for caution?
Some Caveats

- **External conditions**
  - Uncertainties about the prospects for global growth
  - Volatility of financial markets
Some Caveats

- External conditions

- Economic policy challenges for LAC
  - Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
  - The rate of investment is still insufficient.
The rate of investment is still insufficient (and differs substantially across countries)

LATIN AMERICA: GROSS CAPITAL FORMATION AS A PERCENTAGE OF GDP
(in dollars at constant 2000 prices)
Some Caveats

- **External Conditions**

- **Economic policy challenges for LAC**
  - Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
  - The rate of investment is still insufficient.
  - Increases in public expenditures in some countries should be carefully monitored.
Some Caveats

- **External Conditions**
- **Economic policy challenges for LAC**
  - Despite the reduction in vulnerability, some countries in the region are still highly indebted and some financial systems are highly dollarized.
  - The rate of investment is still insufficient.
  - Increases in public expenditures in some countries should be carefully monitored.
  - Countries must place more emphasis on countercyclical policies and strengthen fiscal institutions.
  - Appreciation of the real exchange rate
There has been real exchange appreciation in some countries.

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATE
(February 2007 compared to February 2004 and for the 1990s)
But the causes of appreciation are beyond the control of monetary policy
Some Caveats

- External conditions
- Economic policy challenges for LAC
- From a long-run perspective:
  - Latin America and the Caribbean exhibit mediocre growth rates
  - The recent upturn in LAC growth is smaller than in other developing countries
LAC nations grow less than other developing countries

PER CAPITA GDP GROWTH RATE BY SUB REGION
Some Caveats

- External conditions
- Economic policy challenges for LAC
- From a long-run perspective:
  - Latin America and the Caribbean exhibit mediocre growth rates
  - The recent upturn in LAC growth is smaller than in other developing countries
  - The region has been unable to improve income distribution
Latin America and the Caribbean are the most unequal region in the world

WORLD REGIONS: GINI COEFFICIENT, AROUND 2002
(Per capita income concentration, by deciles)

Source: World Bank, World Development Indicators and ECLAC.
In recent years four countries have achieved sizeable reductions in the Gini coefficient and several others have shown trends towards better distribution.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of household surveys conducted in the respective countries.

a/ Calculated on the basis of per capita income distribution. The figure for Latin America refers to a simple average of the Gini coefficients of 13 countries with comparable information for the period 1990 - 2005. Data on urban areas for Argentina, Ecuador, Panama and Uruguay.
From a long-term perspective, inequality in income distribution remains without change...

**CHANGES IN GINI COEFFICIENT, 1990-2003/2005**

*Source:* Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of household surveys conducted in the respective countries.

*a* Calculated on the basis of per capita income distribution. The figure for Latin America refers to a simple average of the Gini coefficients of 13 countries with comparable information for the period 1990 - 2005. Data on urban areas for Argentina, Ecuador, Panama and Uruguay. Data for Argentina refer to Greater Buenos Aires and those for Paraguay, to the metropolitan area of Asunción.
Income distribution, by deciles


Income share

Poorest 40%
Next 30%
20% below the richest 10%
Richest 10%

Income ratio (times)

Poorest 40%  Next 30%  20% below the richest 10%  Richest 10%  D10/D(1 - 4)
Inequality is also manifested in the inequitable structure of social protection contributions...

LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTING EMPLOYED PERSONS (c. 2002)

<table>
<thead>
<tr>
<th>Urban</th>
<th>Rural</th>
<th>Formal Urban</th>
<th>Informal Urban</th>
<th>Q5 (rich)</th>
<th>Q1 (poor)</th>
<th>Men (% of working age)</th>
<th>Women</th>
</tr>
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<tbody>
<tr>
<td>45.4%</td>
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<td>21.7%</td>
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<td>54.9%</td>
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<td>32.3%</td>
<td>18.9%</td>
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Average coverage: 38.7%
.. And only 4 out of every 10 persons over 70 years of age receive some sort of pension
Some Caveats

- External conditions
- Economic policy challenges for LAC
- From a long-run perspective:
  - Latin America and the Caribbean exhibit mediocre growth rates
  - The recent upturn in LAC growth is smaller than in other developing countries
  - The region has been unable to improve income distribution
  - Minor improvements in sustainable development (degradation of the environment, inadequate energy consumption, poor institutional development)
The positive short-run results should not make us lose sight of the fact that:

- Growth is based on natural resources exports, and this could work against the necessary diversification of the production structure.
- Inequality is a regional characteristic, and the current global trend is towards greater inequality in income distribution.
- The poverty rate is still very high.
- In this context, more active public policies are required, but we also need a suitable institutional structure to prevent ‘capture’.

The challenge is how to ensure a sustainable growth rate while at the same time achieving greater social cohesion.
Components and dimensions of the system of social cohesion indicators

- Distance indicators
  - Income
  - Employment
  - Education
  - Health
  - Housing
  - Pensions
  - Digital Gap

- Institutional indicators
  - Democracy
  - Public policy
  - The market

- Inclusiveness indicators
  - Multiculturalism
  - Confidence
  - Participation
  - Expectations
  - Social solidarity

Indicators: Objective and subjective
Quantitative and qualitative
Two major issues

- The financing dilemma:
  - The tax issue
  - Solidarity in social security contributions
  - Public expenditure
The tax burden is too small and differs sharply across countries.

**TAX REVENUES**
(% GDP, 2005)

- **Total: 21.9%**
- **Tax rev. + SS: 17.9%**

### Countries
- Argentina
- Bolivia
- Brazil
- Chile
- Colombia
- Costa Rica
- Ecuador
- El Salvador
- Guatemala
- Haiti
- Honduras
- Mexico
- Nicaragua
- Panama
- Paraguay
- Peru
- Dominican Rep.
- Uruguay
- Venezuela (BR)

**Legend:**
- Tax revenues
- Social security contributions
- Other revenues
- Capital income
And there is room to increase it
Two major issues

- The financing dilemma:
  - The tax issue
  - Solidarity in social security contributions
  - Public expenditure

- The political foundations for a new social covenant
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