MACROECONOMIC POLICIES AND A VISION FOR THE FUTURE OF LATIN AMERICA AND THE CARIBBEAN

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1. The region’s growth in perspective
2. Main characteristics of the business cycle
3. Risks and challenges ahead
4. What have we learned?
1. The region’s growth in perspective
Growth underpins an upturn in per capita GDP.
Yet the region is growing more slowly than the developing countries as a group.

GROWTH RATES
(Annual growth rates)

- World GDP
- Developed countries
- Latin America and the Caribbean
- Transition economies
- Developing countries
- Developing countries not including China

a/ Estimate.  
b/ Projection.
This is due partly to slower growth in the region’s two largest economies.

**MEDIAN ANNUAL PER CAPITA GDP GROWTH RATE**

- **Industrialized countries**
- **Developing countries (not including Latin America and the Caribbean)**
- **South America**
- **Central America and Mexico**

*a/ Estimate.  
b/ Projection.*
1. The region’s growth in perspective

2. Main characteristics of the business cycle
   a. Exports and the current account
Growth has been accompanied by a current account surplus.
Driven by the growth of exports

10-YEAR GROWTH RATES OF EXPORT VOLUMES

-1.4%  -1.9%
3.4%  5.0%
7.6%  7.8%  9.0%
Exports have grown faster in LAC than in other regions, but there are notorious differences among sub regions.

Source: ECLAC, on the basis of oficial information.
And for an improvement in terms of trade
World growth and China have boosted the terms of trade

Terms of trade may remain buoyant in the medium term (for South America)
Remittances amounted to about 2.2% of GDP in 2005.
1. The region’s growth in perspective

2. Main characteristics of the business cycle
   a. Exports and the current account
   b. Fiscal and external vulnerability
Less fiscal and external vulnerability

- Declining Public Debt/GDP ratio

![Graph showing the decline in Public Debt/GDP ratio from 1990 to 2004. The graph illustrates the comparison between simple average and weighted average of public debt.]
Less fiscal and external vulnerability

- Declining Public Debt/GDP ratio
- External debt ratios are shrinking (except in the Caribbean)

Net external debt as a percentage of exports of goods and services (simple averages)
Less fiscal and external vulnerability

- Declining Public Debt/GDP ratio
- External debt ratios are shrinking (except in the Caribbean)
- Short-term external debt, measured as a percentage of total debt, is also shrinking
- The region built up its reserves at an annual rate equivalent to 1.5% of GDP: short-term debt/reserves is about 40% (it was above 100% in the first half of the 1990s)
- Country-risk ratings have descended to record lows
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Risks: The international context

- A traumatic adjustment of macroeconomic imbalances may lead to a drastic downturn in global GDP and heighten uncertainty.

- The imbalances may generate an increase in protectionism.

- The high levels of political conflict that persist in various parts of the world may impair the operation of the economy.

- The rise of oil prices could lead to higher interest rates.
Challenges (I): grow more

- Three consecutive years of growth (2004-2006) at an average rate of around 4.8% is a very promising achievement.
- Nevertheless, this rate is insufficient to correct the imbalances that have been affecting the region’s labour markets for over a decade.
- If the economically active population grows at an annual rate of almost 2.5% and productivity rises, a 4.8% increase in GDP does not leave much room for reducing the unemployment rate.
Challenges (II): invest more

- Investment is not sufficient to sustain high growth rates

LATIN AMERICA AND THE CARIBBEAN: INVESTMENT
(As a percentage of GDP, in 1995 dollars)
Challenges (III): building competitiveness

- Keeping exchange rates competitive
- Diversifying and adding value to exports
- Clear and reliable rules (political agreements)
- Fiscal and sectoral reform
- Investment in infrastructure (public and private)
Challenges (IV): improve equality

High and growing inequality of income distribution as well as geographic, ethnic and gender inequity

Countries where inequality increased

Countries where inequality diminished

To promote social rights, reduce poverty and increase the growth rate
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4. What have we learned?
What have we learned? (1)

- Controlling inflation is important:
  - Increase equity
  - Help to reduce uncertainty and favor investment
  - But it does not automatically lead to lower real volatility

- Avoid large appreciation of the exchange rate
  - Reduces competitiveness and leads to greater vulnerability through large deficit in current account
  - Fixed exchange rates and especially “hard pegs” should be avoided
  - But totally flexible exchange rate is not the solution
In the last year, most of the region's currencies have appreciated. From a longer-term perspective, however, differences again emerge among the subregions.
What have we learned? (2)

- Trade liberalization: not always lead to faster growth
  - But exports generally play a role in successful countries

- Privatization:
  - Could help governments to focus in others areas (social policies, regulation, competition)
  - But success depend on how they are carried on (corruption, lack of regulation)
  - Be careful of the impact on the poor
What have we learned? (3)

- **Capital account liberalization:**
  - usually increase volatility (more when dollarization is important and there is lack of financial deepening)
  - Control of capital movement could help under certain circumstances

- **Foreign direct investment:**
  - Its importance depend on the impact on the productive sector, innovation, exports, human capital
  - Need to have specific policies to attract FDI with potential links into the productive sector
What have we learned? (4)

Financial liberalization:

- Financial deepening could help to reduce volatility
- But could generates a crises if it is done without the right institutions (regulation and supervision)
- But it does not automatically lead to more and better (term, rates, domestic currency) credits to S-M firms
- The importance of good development banks (beware of risk of corruption and mismanagement)
What have we learned? (5)

- Institutions are crucial, but they should include:
  - Creation and deepening of markets
  - Regulation
  - Nominal, but also real stability
  - Redistribution (legitimacy and human capital)

- Industrial policies should be part of the development agenda
  - Not necessary picking winners but looking for externalities and coordination failures
  - Importance of innovation (broadly define: adopt, adapt and create)
What have we learned? (6)

- The importance of human capital for growth and equity
  - Primary and higher education
  - Cash and food transfers should be associated to investment in human capital (health, education and work training)
- Inequity has a negative impact on
  - Growth
  - Poverty (less trickle down)
In Summary

- One size does not fit all
- There are important market failures
- The state should play a more important role than during the nineties
  - in social and productive policies
  - but not necessarily as producer

Good governance and consensus-building are essential for the creation of sound institutions
What is next?

- Improve the macroeconomic management
  - Counter cyclical policies
  - Avoid fixed exchange rates and large appreciations

- Maintain (in some cases deepen) trade openness
  - Deepen sub regional trade agreements
  - Stress the importance of multilateral round
  - Bilateral agreement could be a second best option

- Avoid full capital liberalization
What is next?

- Attract investment of better quality
- Invest in human capital
- Create national system of innovation (private and public sector plus universities and research centers)
- To improve equity is necessary facilitate the access to assets (education, technology, financing, capital, land, rural infrastructure)
- Improve institutions, especially
  - social institutions
  - regulation and competition
- Strengthening the public sector (Reinventing government)
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