SOCIAL AND ECONOMIC CHALLENGES IN LATIN AMERICA AND THE CARIBBEAN: DEFINING A DEVELOPMENT AGENDA FOR THE REGION

José Luis Machinea
Executive Secretary
Economic Commission for Latin America and the Caribbean

March 14, 2007
OUTLINE

- The current economic and social situation in the Latin American and Caribbean region
- The region’s position in the world economy
  - Trade
  - Foreign direct investment
- Long-term challenges and opportunities
Current situation in the Latin American and Caribbean region

- The Latin American and Caribbean region is growing faster and better than in the past
Per capita GDP accelerates after a long period of stagnation.
2006: GDP growth totaled approximately 5.4%

* Data include Haiti and the Dominican Republic.
And a slightly lower rate of growth is expected in 2007.

Note: Data include Haiti and the Dominican Republic.
Current situation in the Latin American and Caribbean region

- The Latin American and Caribbean region is growing faster and better than in the past
- Unemployment is falling
Despite a strong increase in the economic active population, unemployment has dropped.

Good news in the short run, but over the long run faster productivity growth is needed.
Current situation in the Latin American and Caribbean region

- The Latin American and Caribbean region is growing faster and better than in the past
- Unemployment is falling
- Poverty has decreased in recent years
The percentage of poor and indigent persons has fallen since 2003, and this trend is expected to continue, but it has taken 25 years to bring poverty down to below its 1980 level.
In several countries there were reductions in poverty and indigence rates


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/ The figure does not include Guatemala or Nicaragua since they had no estimates for poverty available after 2002.

b/ Urban areas.
Social expenditures on per capita basis increased 40%.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Commission’s social expenditure database. Figures are updated to the second quarter of 2005.
Extreme poverty projections for 2006 show that the region is once again moving towards meeting the first target of the Millennium Development Goals, and progress in percentage terms is slightly higher than expected.

PROGRESS IN REDUCING EXTREME POVERTY BETWEEN 1990 AND 2006a/
(Percentages)

<table>
<thead>
<tr>
<th>Country</th>
<th>Progress 1990-2006</th>
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<tr>
<td>Latin America</td>
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<td>Argentina b/</td>
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<td>Bolivia</td>
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<td>Brazil</td>
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<td>Costa Rica</td>
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<td>Ecuador b/</td>
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<td>El Salvador</td>
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<td>Paraguay</td>
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<td>Peru</td>
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<td>Uruguay b/</td>
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<tr>
<td>Venezuela (Bolivarian Rep. of)</td>
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-10 0 10 20 30 40 50 60 70 80 90 100

**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/ The percentage progress is calculated by dividing the reduction (or increase) in indigence observed in the period expressed in percentage points by half of the indigence rate for 1990. The dotted line represents the percentage of progress expected by 2006 (64%).

b/ Urban areas.
Current situation in the Latin American and Caribbean region

- 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
  - More reserves and less external debt
  - High primary fiscal surplus compared to other periods
  - Reduction of public debt (and better terms and conditions)
  - More flexible exchange rates
- All this is in the context of favourable external conditions
  - Strong world growth
  - More liquidity
  - Improved terms of trade
  - High level of remittances
Main features of the current macroeconomic cycle

More reserves and less external debt

Latin America and the Caribbean: Short-term external debt and international reserves

- More reserves and less external debt
- Short-term debt (left axis)
- International reserves (left axis)
- Ratio short-term debt / international reserves (right axis)
Main features of the current macroeconomic cycle

- The primary fiscal surplus is high (compared to other periods) and growing

Latin America and the Caribbean: Change in the principal fiscal indicators (as a share of GDP)
Main features of the current macroeconomic cycle

Reduction in public debt

Public debt in Latin America, 1993-2006
(Percentages of GDP)

Improvement in debt structure
(maturities and local currency)
Main features of the current macroeconomic cycle

- Better fiscal conditions

![Graph showing revenues, expenditures, and primary balance over time.](image)
Better terms of trade…
but with differences across subregions

Variation in terms of trade between the 1990s and 2006

- Latin America and the Caribbean: 31.2%
- South America: 47.3%
- South America (excluding Chile and Venezuela): 17.1%
- Central America (including Haiti and Dominican Republic): -13.4%
- Mexico: 25.5%
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 (2005): 5.8

*Note: e/ Estimated*
Nevertheless...

- From a long-term viewpoint, Latin America and the Caribbean exhibit mediocre growth rates.
- Therefore: LAC diverges while East Asia converges.
Latin America: Mediocre growth rates over recent decades

(Per capita GDP growth rates, percentages)

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<td>Sub-Saharan Africa</td>
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<td>1.17</td>
<td>-0.73</td>
<td>-0.57</td>
<td>1.49</td>
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</table>

Source: ECLAC based on IMF/WB data.
Latin America diverges while East Asia converges

EAST ASIA AND LATIN AMERICA: PER CAPITA INCOME
(Percentages of U.S. per capita GDP, in PPP)

Source: Data from Maddison (2007).
Nevertheless...

- In terms of the long run, Latin America and the Caribbean exhibit mediocre growth rates
- Latin America diverges while East Asia converges
- And 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 rates, by subregion)
Nevertheless...

- In terms of the long run, Latin America and the Caribbean exhibit mediocre growth rates.
- Latin America diverges while East Asia converges.
- And the recent upturn in LAC growth is smaller than in other developing countries.
- The region has been unable to improve income distribution.
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 in the region 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.*
Risks and challenges

- Risks: External conditions
- Domestic policy
  - Despite the reduction in vulnerability, some countries are still highly indebted and some financial systems are highly dollarized
  - Increases in public expenditure in some countries should be carefully monitored
  - Countries must place more emphasis on countercyclical policies and strengthen fiscal institutions
  - The rate of investment is still insufficient (22%)
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)*

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<td>Panama</td>
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Note: The values represent gross capital formation as a percentage of GDP in dollars at constant 2000 prices.
Current economic and social situation in the Latin American and Caribbean region

The region’s position in the world economy
  • Trade
  • Foreign direct investment
The region’s position in the world economy

- During the last 15 years, LAC has experienced its fastest export growth in several decades
- As a consequence, LAC’s share of total world exports has increased over the last 15 years… but only after a sharp decline
LAC has experienced its fastest export growth in the last 25 years

Latin America: 10-year growth rates of export volumes

Note: Excludes Bolivarian Republic of Venezuela.
LAC’s share of total world exports has increased slightly over the last 15 years…but only after a sharp decline

LATIN AMERICAN AND CARIBBEAN EXPORTS, 1953-2005
(Total LAC exports as a percentage of total world imports)

Source: ECLAC.
Latin American, East Asian and Chinese shares in world trade

(Percentage shares of world exports, selected years)

Source: WTO.
Japan’s trade with Latin America and the Caribbean has been expanding and has shown a positive balance for over 30 years.

Japan – Latin America and Caribbean trade, 1962-2005
(Millions of dollars)

Source: ECLAC, Division of International Trade and Integration, on the basis of official information from the International Commodity Trade Database (COMTRADE).
Japan’s trade patterns with the region are similar to China’s: a deficit with South America and surpluses with Mexico, Central America and the Caribbean countries.

Source: ECLAC, Division of International Trade and Integration, on the basis of official information from the International Commodity Trade Database (COMTRADE).
Japan – Latin America and the Caribbean: Bilateral trade structure (2001-2005, annual averages) (Millions of dollars)

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<td>Commodities</td>
<td></td>
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<td>7086</td>
<td>-6395</td>
<td>-7073</td>
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<td>Resource-based manuf.</td>
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<td>724</td>
<td>705</td>
<td>2503</td>
<td>1888</td>
<td>-1778</td>
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<td>Low-technology</td>
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<td>928</td>
<td>236</td>
<td>291</td>
<td>667</td>
<td>637</td>
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<td>Mid-technology</td>
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<td>588</td>
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<td>High-technology</td>
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<td>2514</td>
<td>399</td>
<td>689</td>
<td>2569</td>
<td>1825</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>18336</strong></td>
<td><strong>17348</strong></td>
<td><strong>10136</strong></td>
<td><strong>10819</strong></td>
<td><strong>8201</strong></td>
<td><strong>6529</strong></td>
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</table>

Source: ECLAC, Division of International Trade and Integration, on the basis of official information from the International Commodity Trade Database (COMTRADE).

**Deficit in primary products:** Commodities & natural-resource-based manufactures

**Products with greater Latin American comparative advantages**

**Surplus** in more technology-intensive manufactures
In 1990 Japan was LAC’s main Asian trading partner, (5.6% of LAC total exports)

**Latin American exports, by main destinations: 1990**

- JAPAN: Mex + CA&Car + Ven = 3.8%  <  South America (exc. Ven) = 7.1%  LAC = 5.6%
- CHINA: Mex + CA&Car + Ven = 0.2%  <  South America (exc. Ven) = 1.2%  LAC = 0.9%
In 2005 Japan was surpassed by China, especially in Chile, Mercosur and the Andean Community.

Latin American exports, by main destinations: 2005

- **Mexico**: Mex + CA&Car + Ven = 0.6%
- **Central America & Caribbean**: South America (exc. Ven) = 3.7%
- **Venezuela**: LAC = 2.0%
- **Chile**: Others
- **A. Community 4**: China
- **MERCOSUR**: Japan
- **LAC**: USA

**Comparison**

- **Japan**: Mex + CA&Car + Ven = 0.6% < South America (exc. Ven) = 3.7% < LAC = 2.0%
- **China**: Mex + CA&Car + Ven = 0.6% < South America (exc. Ven) = 6.6% < LAC = 3.6%
The region’s position in the world economy

- LAC has experienced its fastest export growth in the last 25 years
- LAC’s share of total world imports has increased over the last 15 years… but only after a sharp decline
- LAC attracted one third of total FDI to developing countries between 1990 and 2005, but its share of total net inflows to the world and to developing countries has been gradually shrinking since the late nineties
LAC attracted one third of total FDI to developing countries between 1990 and 2005...

FDI inflows to developing countries, 1990-2005

- China: 22%
- Developing Asia (excl. China): 32%
- Latin America and the Caribbean: 33%
- Africa: 6%
- South-East Europe & Commonwealth of Independent States (CIS): 7%

Source: ECLAC on the basis of data from UNCTAD.
But the region’s shares of total net FDI inflows, both to the world and to developing countries, have been slowly shrinking since the late 90s.

**Latin America and the Caribbean: Share of net FDI inflows**

(Percentages)

Source: ECLAC, on the basis of data from UNCTAD (2006, 2007) and official data from the countries.
OUTLINE

- The current economic and social situation in the Latin American and Caribbean region
- The region’s position in the world economy
  - Trade
  - Foreign direct investment
- Long-term challenges and opportunities
Long-term challenges and opportunities

- Given the favourable external environment, LAC may be able to sustain its growth over the next few years.
- The challenge, however, is how to take advantage of this opportunity to lay the foundations for more rapid and sustainable growth in the medium and long run.
- Exports can play a key role. The question is not only how much, but also what is important to ensure that exports have the most beneficial impact possible on economic activity.
- Mid- and high-tech products usually have a more dynamic impact on the rate of growth.
Latin American exports in terms of technological intensity

STRUCTURE OF EXPORTS, BY TECHNOLOGICAL INTENSITY

(a) Latin America and the Caribbean

(b) Central America

(c) Mexico

(d) South America

Source: ECLAC
The downside risks of natural resources

Commodity exports may contribute less to growth:

- Less diversification in the production structure (a large share of production associated with natural resources can lead to Dutch disease)
Risk of Dutch Disease?

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATE
(October 2006 compared to October 2003 and to the 1990s)

Compared to the average for 1990-99
Compared to October 2003

Source: ECLAC
Risk of Dutch Disease?

Terms of Trade effect + Transfers as a % of GDP
(Average for 2005-2006 compared to average for 1990-1999)

Real Exchange Rate var. (%)
(Average for 2005-2006 compared to average for 1990-1999)

Source: ECLAC
The downside risks of natural-resource products

Commodity exports may contribute less to growth:

- Less diversification in the production structure (a large share of production associated with natural resources can lead to Dutch disease)
- Prices are more volatile
- Lower elasticity of demand
- Deterioration of terms of trade, although this appears to be changing (China and India)
- Difficulty in building linkages (especially in mining)
- Negative impact on income distribution
- Historically, fewer incentives for innovation
  - Less demand for product differentiation
  - Fewer technologies available for process innovations that could lower costs
However…

(1) Export structures of successful countries with abundant natural resources do not exhibit a clear pattern

STRUCTURE OF EXPORTS, BY TECHNOLOGICAL INTENSITY

(a) Australia
(b) New Zealand
(c) Malaysia
(d) Canada

Source: ECLAC
However…

(1) Export structures of successful countries with abundant natural resources do not exhibit a clear pattern

Source: ECLAC
However...

(2) Exports of high- and mid-technology products are not always the result of a sophisticated production structure

- In LAC, the countries with the most technology-intensive exports are not necessarily the ones that have the highest growth rates
- Exports with a higher technological content are important factors in fostering growth if local capabilities are present
- ...but not if they are simply the output of the final assembly stage for multinational companies without linkages with the domestic economy
However...

(3) Nowadays, innovation in the area of natural resources and low-technology products is more important than it was in the past

- Developed countries exhibit a greater capacity to innovate (in a broad sense) even in relation to primary products and natural-resource-based or low-technology manufactures.
- This capacity is reflected in the higher unit value of developed-country exports of these products (differentiation by design, branding, packaging, quality, speed-to-market, etc.). (forthcoming study).
- Innovation in natural resources has become more important:
  - Product differentiation
  - Higher profile of bio-technology
- Hence, there is a window of opportunity of which Latin America should take advantage.
The OECD’s experience is illustrative of the potential that exists for commodity exporters

- Several countries have been and/or are still reliant on exports based on primary commodities: Australia, New Zealand, Norway, Finland and Canada.
- Compared to Latin America:
  - Roughly similar X shares of raw and processed materials in total X.
  - Lower goods’ X concentration (and hence less vulnerability) than most of LAC.
    - Note: Considerably more diversification if services are taken into account.
  - X market share has undergone much less erosion.
  - Per capita X are between 6 and 18 times higher.
  - Per capita income is between 3 and 6 times higher.
Factors in OECD commodity exporters’ success

- Structural reforms
- Open and stable economy
- Better income distribution
- Political stability
- Education
- Government capacity
  - Fiscal scope
  - Dedicated technical professional bureaucracy
- Adding knowledge and technology to natural-resource production processes in order to:
  - Raise productivity and lower costs
  - Generate clusters of new competitive indigenous activities, products and services
    - Import substitution
    - Exports
  - Further raise capacity to globalize and export by seizing opportunities for direct investments abroad
The key is the diversification of the economic structure through linkages and knowledge

- The type of production structure that will serve as a basis will depend on the current structure of each country
- Adding knowledge to natural resources could be a road to diversification, a way to build the assets needed to discover new activities (What are the alternatives?)
- This process is not spontaneous: public policies are needed
Hence there is a role for public policy

- Long-term adaptive strategies in S&T for innovation/adaptation as well as export development
  - Assessing global positioning now and in the future
  - Identification of binding constraints (macro, micro, meso)
  - Strengthening government support capacities
  - Business development
- Coordination
  - Public/private sectors
  - Domestic and foreign firms
  - Business/academia/research centres
- Development of strong and credible mechanisms / institutions
- Incentives for new private-sector knowledge-based activities
  - Horizontal
  - Vertical
- Public accountability
The region needs to adopt a more strategic approach

- Develop long-term strategies to enhance
  - Export diversification and upgrading
  - Export-oriented FDI attraction
  - Local business development
  - Innovation
  - The quality of human resources

- Develop articulated national and regional public/private partnerships for the development of those strategies and related support instruments
  - Maximize forward-looking global strategic market information and perspectives
  - Consensus-building for effective and sustainable public interventions
  - Checks and balances, transparency and accountability
Summary

- Latin America and the Caribbean are doing better in terms of growth, poverty, unemployment and vulnerability indicators...BUT this is not enough.
- Although a great deal of progress has been made, there are many macroeconomic challenges still to face.
- A better income distribution should be an essential goal to improve social cohesion and enhance growth.
- Exports should be a key factor in the development strategy and their impact on the economic structure should be enhanced.
- Public policies have an important role to play in helping the region to capitalize upon its current natural resource prosperity to take a qualitative leap.
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