



Macroeconomic Challenges in Latin America to 2020

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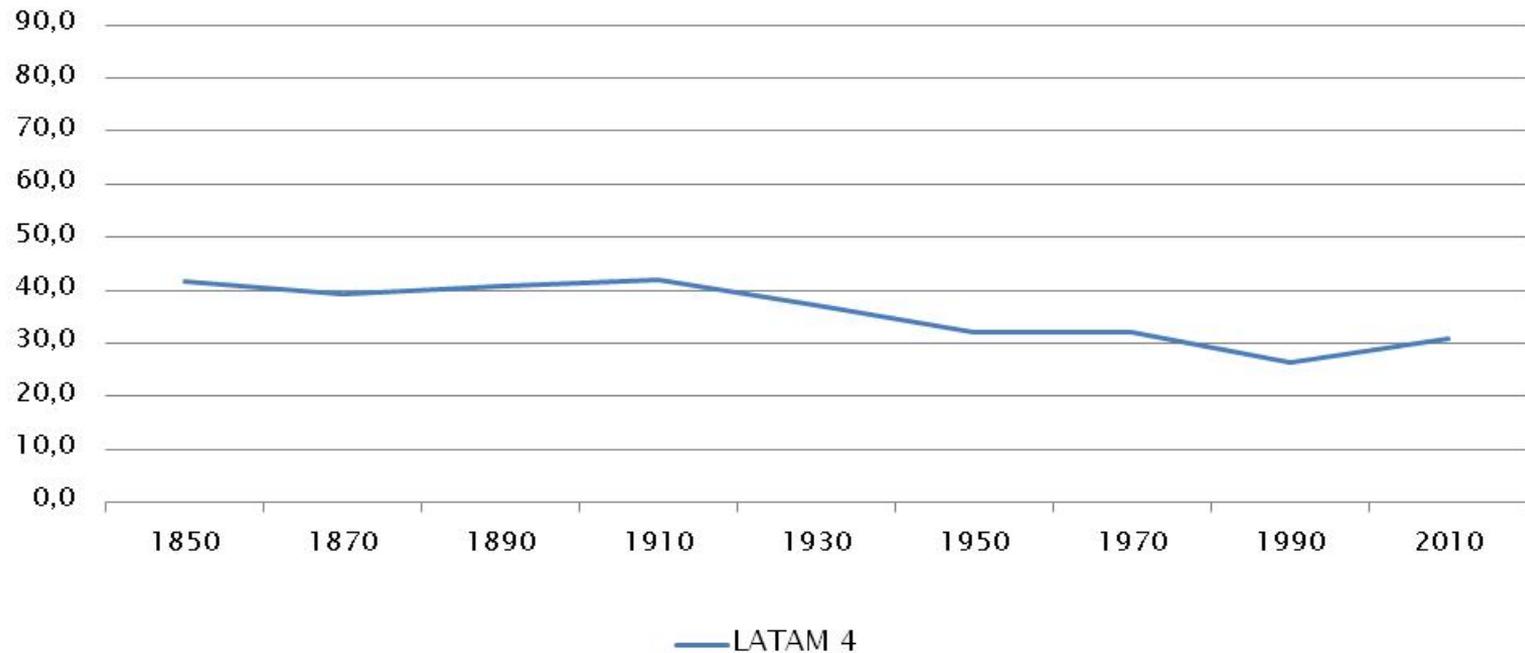
Main issues

- **Historical Background**
- Recent performance: Is it a new trend or just a fluke?
- The challenge of reducing dependence on Natural Resources
- The demographic challenge for Latin America



From Stagnation to Divergence: A short Economic History of Latin America

Per capita GDP as a fraction of US per capita GDP, selected countries 1850 – 2010



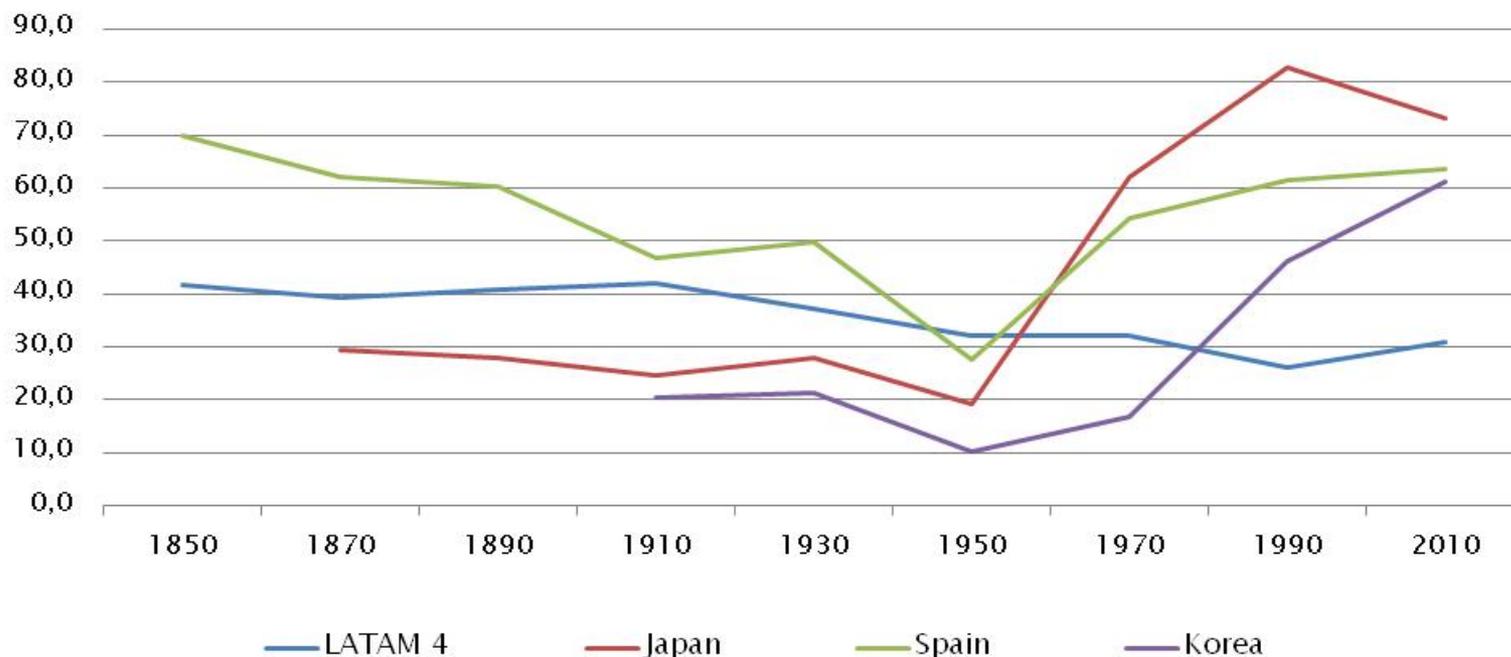
LATAM 4: simple average of per capita GDP of Argentina, Brazil, Chile and Mexico. Argentina's data start in 1870

Source: Maddison, 1995; World Bank, WDI.



Others have done much better than LATAM

Per capita GDP as a fraction of US per capita GDP, selected countries 1850 - 2010



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Source: Maddison, 1995; World Bank, WDI.



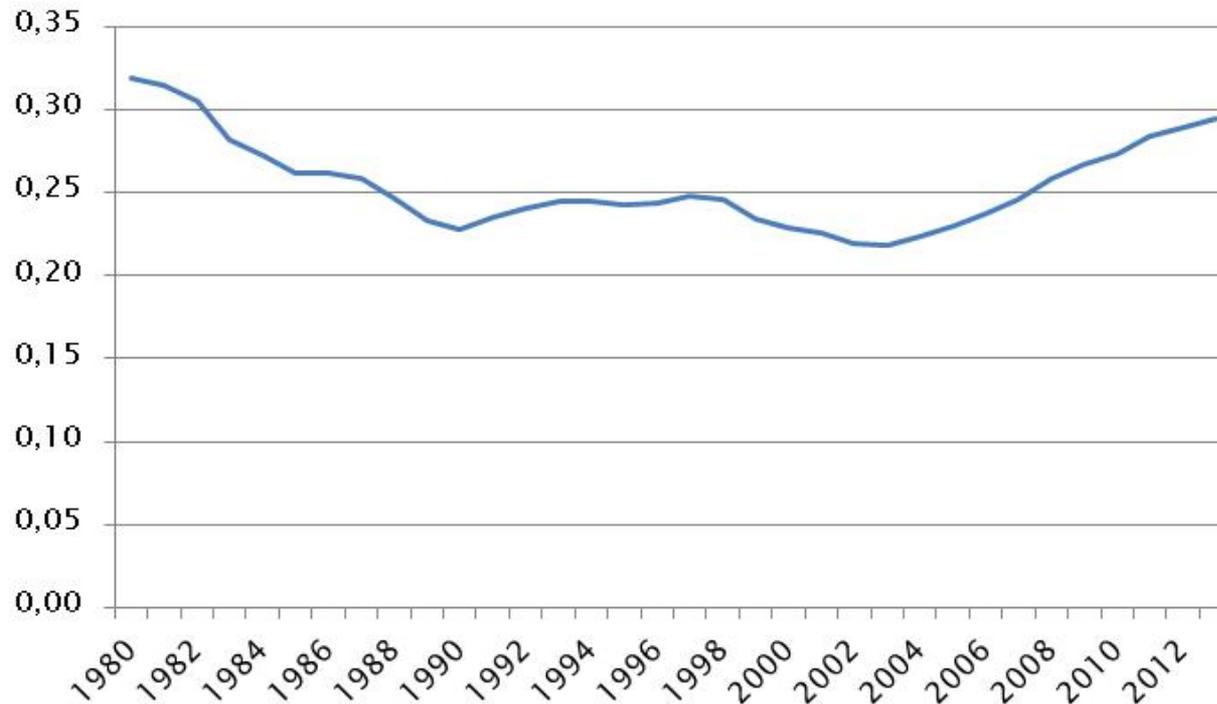
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XXI st Century: Is there a new trend or is it just a blip in the data?

Average of 13 LATAM Countries Per capita GDP as a fraction of US per capita GDP, 1980 - 2013



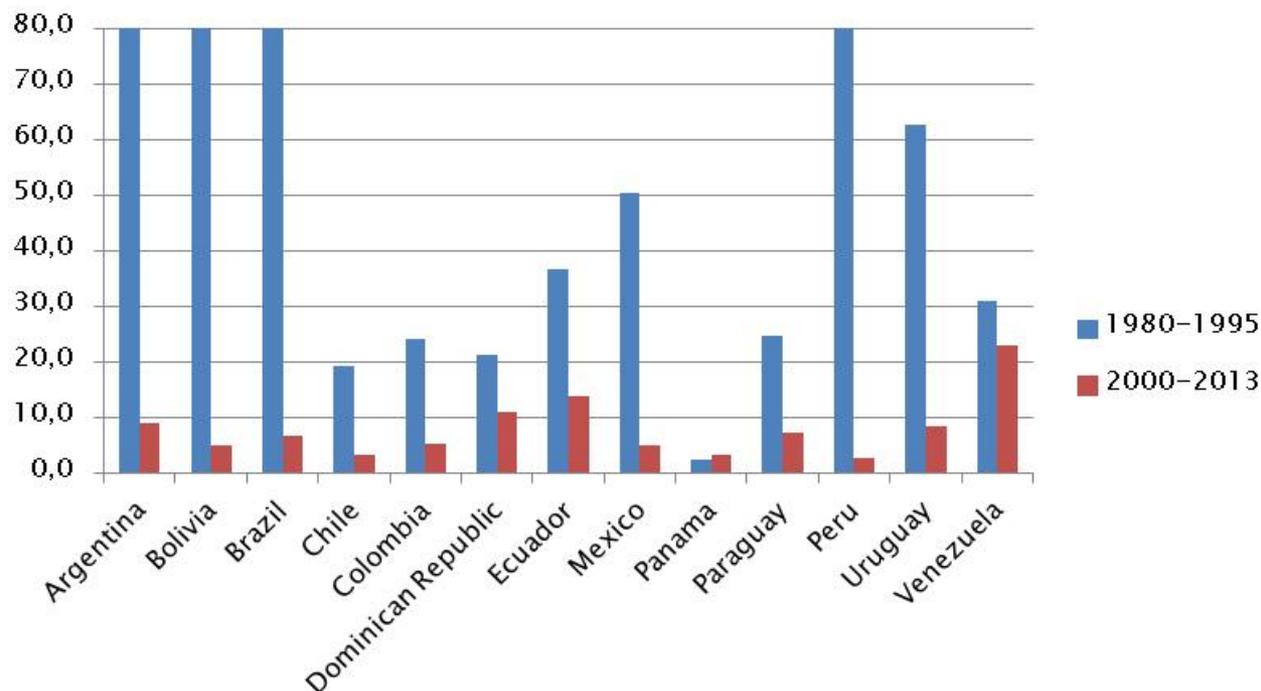
LATAM Countries included: Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Panama, Paraguay, Peru, Uruguay, Venezuela

Source: IMF, WEO Database.



Other things have changed, besides growth in the last 30 years: Inflation has been conquered (almost) everywhere in LATAM

Average annual inflation rates in selected countries in LATAM
(average 1980–95 and 2000 – 13)

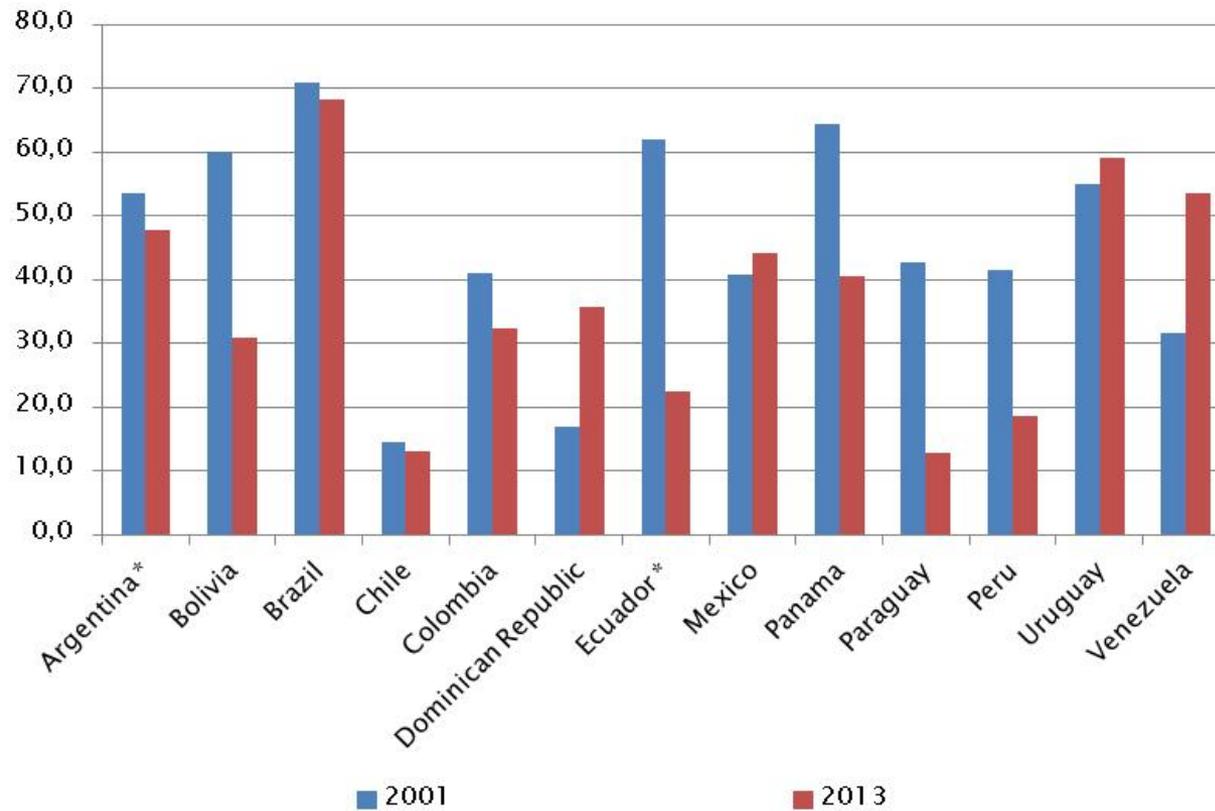


Source: IMF, WEO Database.



Other things have changed, besides growth in the last 30 years: Government Accounts have improved (almost) everywhere

Public Debt to GDP ratios (2001 - 13)



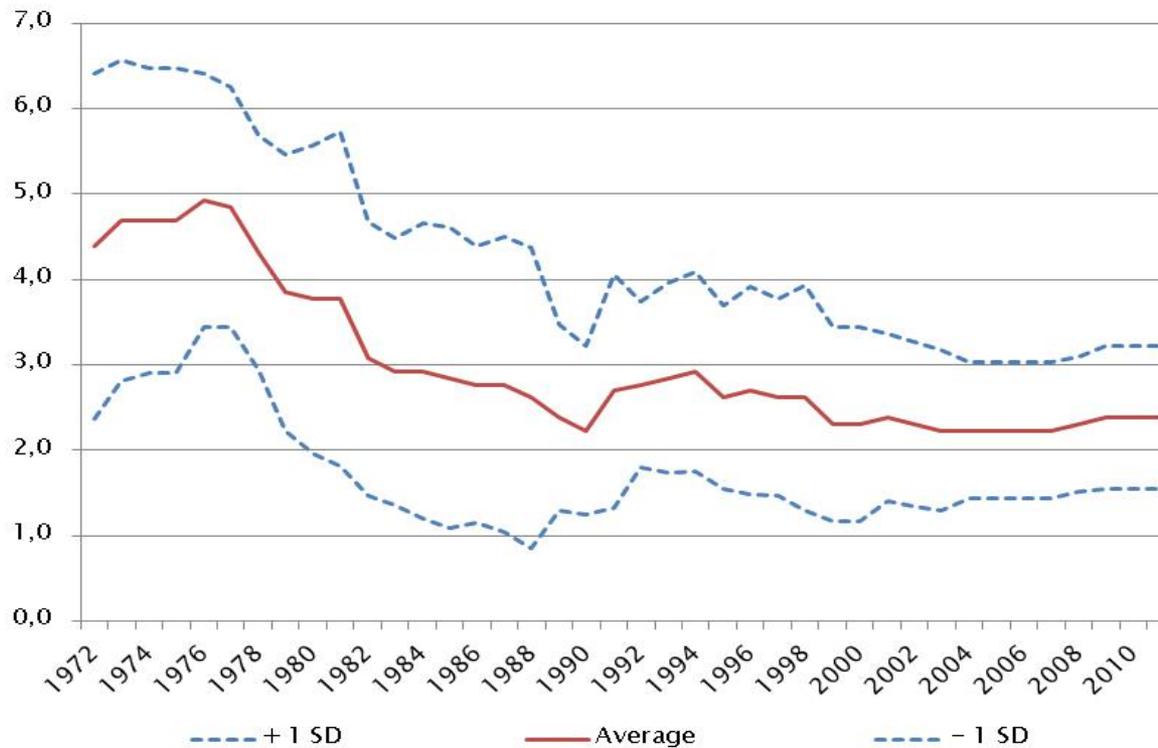
* Countries with Public Debt defaults in the period.

Source: IMF, WEO Database.



And the region has become more democratic

Average Political Rights Index for 13 Countries in Latin America (*)



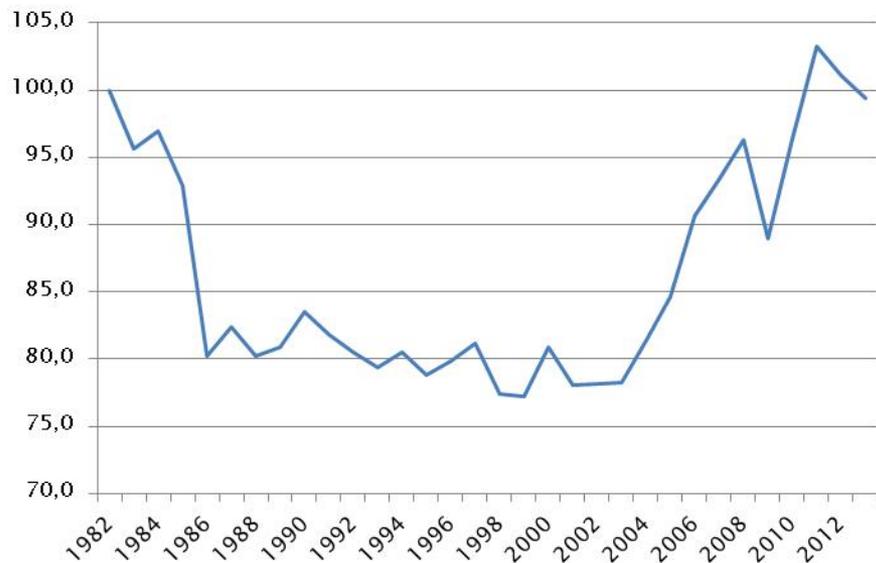
Political Right Index Scale: 1 – 7, with 1 being Most Free and 7 the Least.

Source: Freedom House

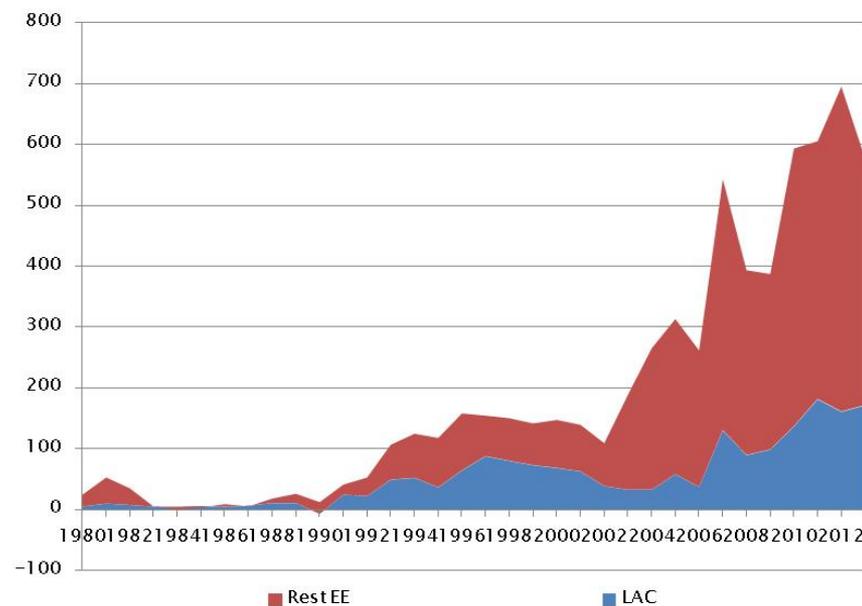


There has also been some good luck: Global conditions have been very favorable for the region

Terms of Trade Index for LAC (1982 = 100)



Net Capital Inflows to Emerging Economies (USD Billions)



Source: International Monetary Fund. World Economic Outlook Database, April 2013.



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What is the real problem with Natural Resource Dependence?

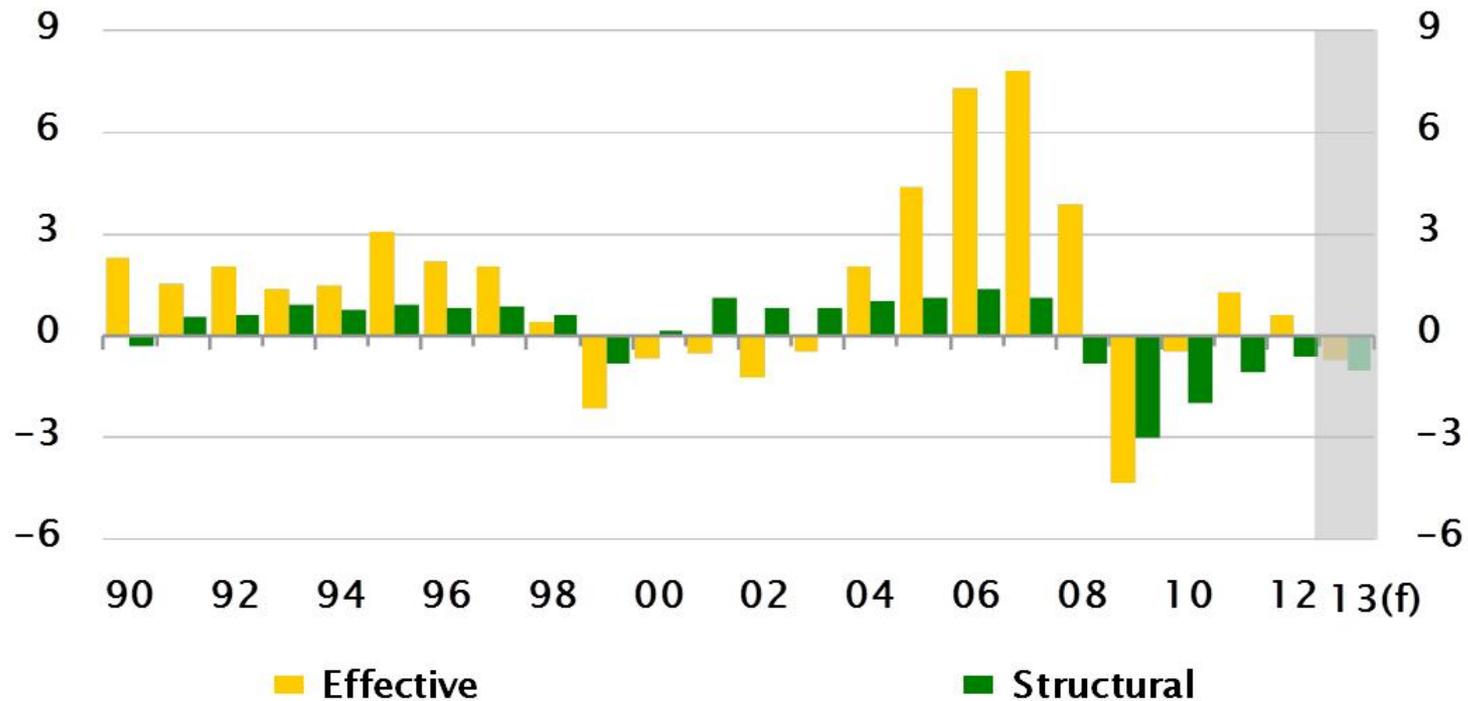
- High volatility of Exports and Government Revenues
- Rent – Seeking behavior (private and public)
- Dutch Disease

- Chile is a good Case Study:
 - Income tax was introduced in the 1920s, only after the collapse of the Nitrate Market.
 - Domestic Economic Cycle was strongly related to copper prices cycles up to the 90s
 - At the end of the 60s, copper exports represented 80% of exports, crowding out the rest.



The behavior of the Recipient of Rents is critical: Chile benefited from Fiscal Policy Rules designed to save copper windfalls

Public Sector Balance
(percent of GDP)

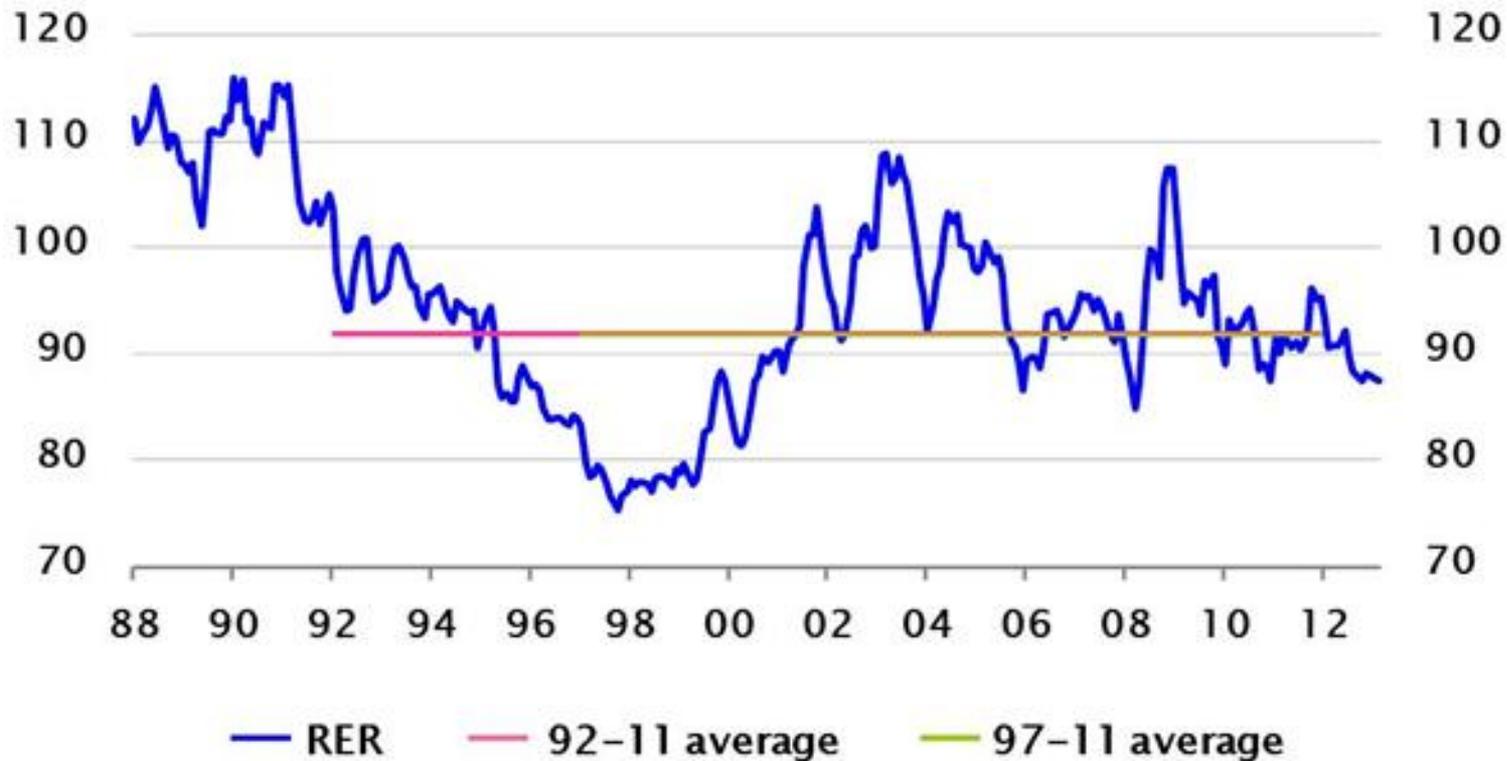


Source: DIPRES



The combination of macroeconomic policies has limited the extent of real appreciation and loss of competitiveness in the last copper price cycle

Real Exchange Rate (*)
(index, 1986=100)



Source: Central Bank



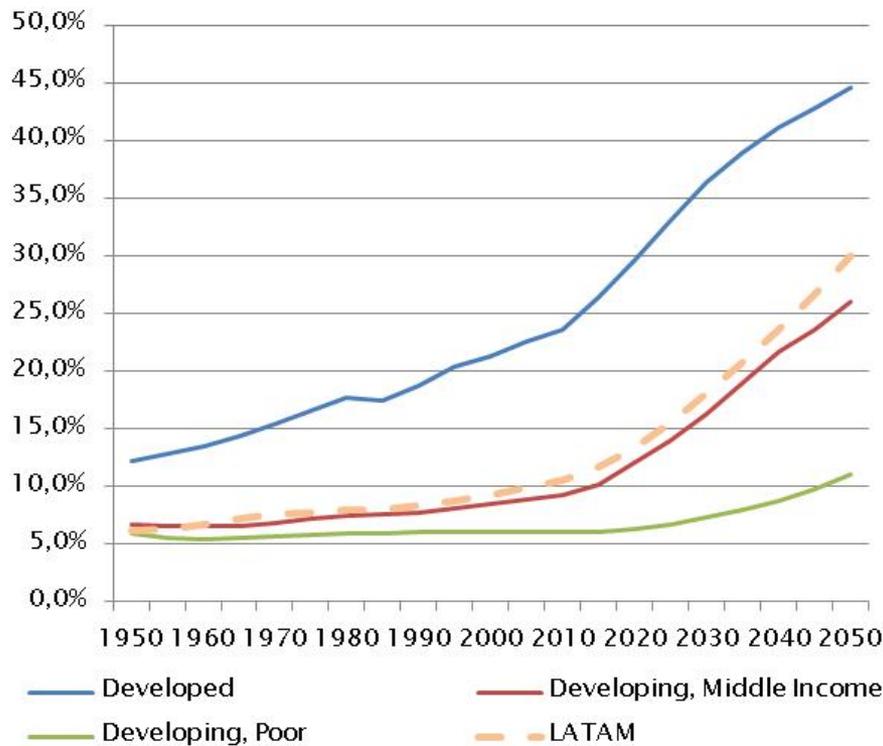
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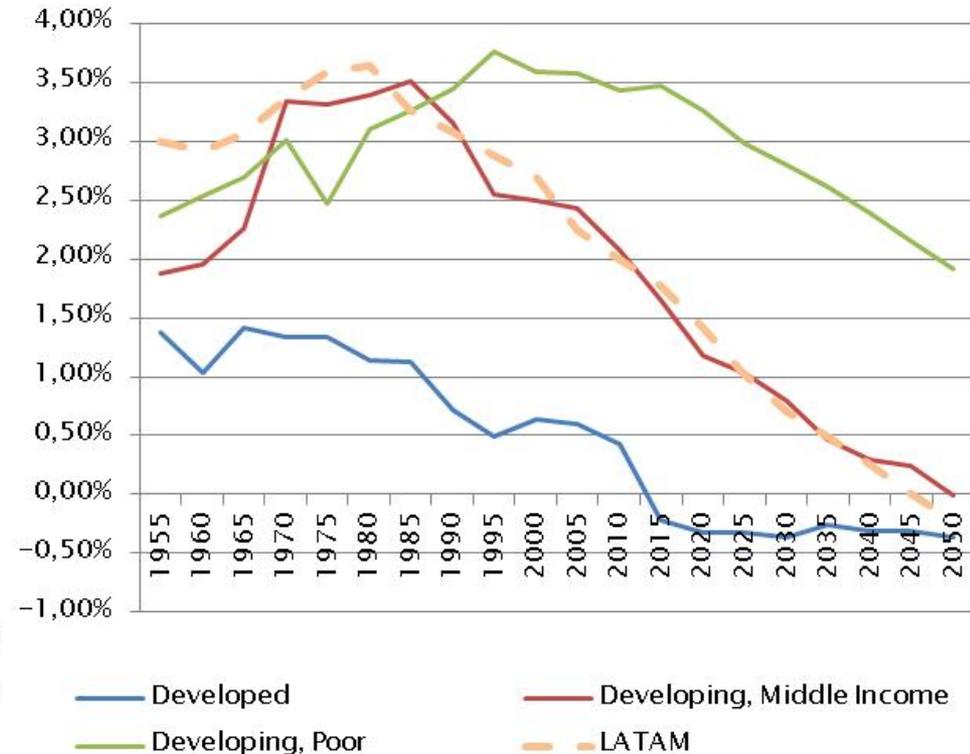


Latin America is undergoing a fast demographic transition, similar to other Middle Income Emerging Countries

Old-age dependency rates (over 65/ pop. 15-64 years)



Evolution of working-age population (annual change, percentage)



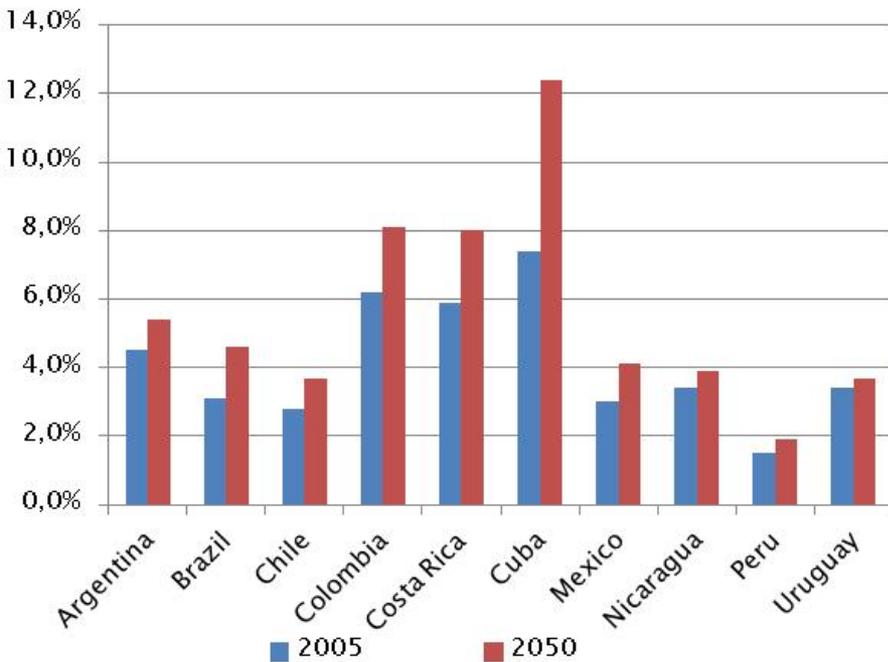
Source: United Nations (2011).



This will have most severe consequences on Health and Pensions Systems, with distinct impacts on Public Finances across the region. Systems design will be critical

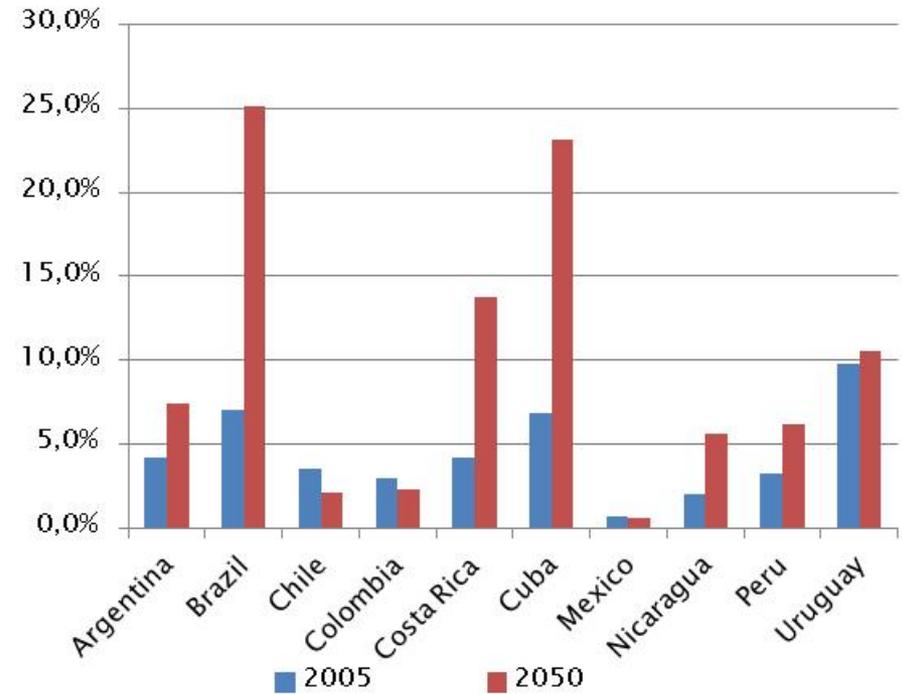
Public Health Expenditures changes due to Aging in LATAM

(% of GDP)



Evolution of working-age population

(annual change, percentage)

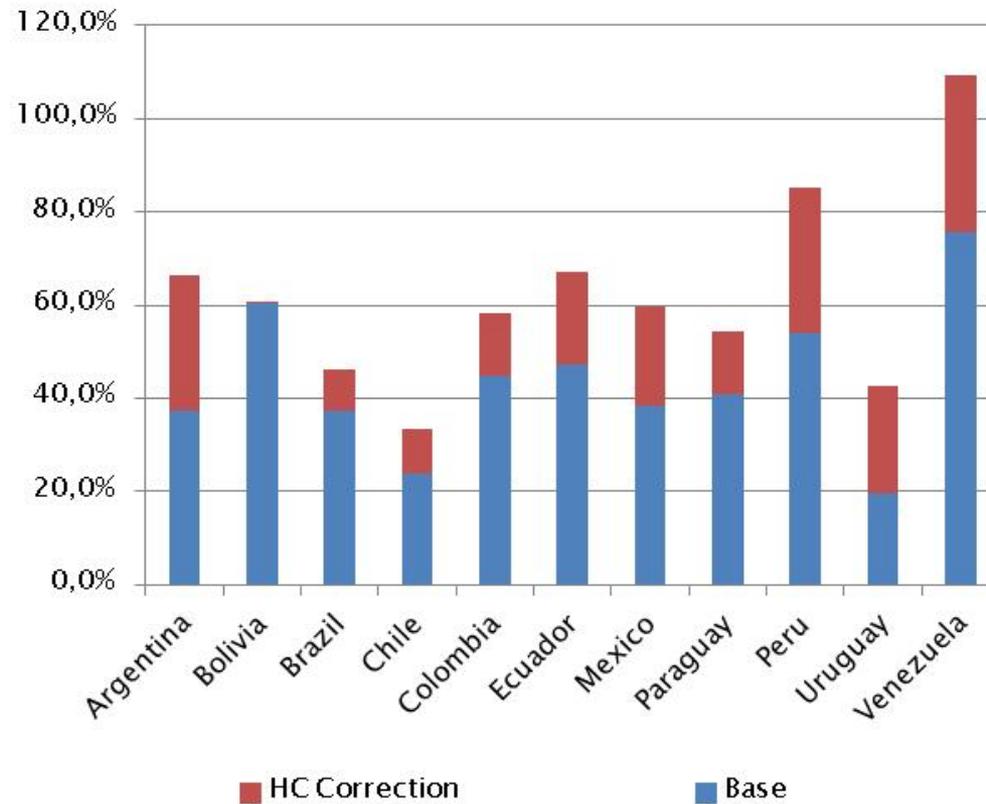


Source: Miller, Mason and Holts, World Bank, 2011. "Current trends" Scenario



This is a major challenge that has relied heavily on the abundance of cheap labor to sustain growth

Total Contribution of Labor Input to GDP growth 1960–1990 (%)

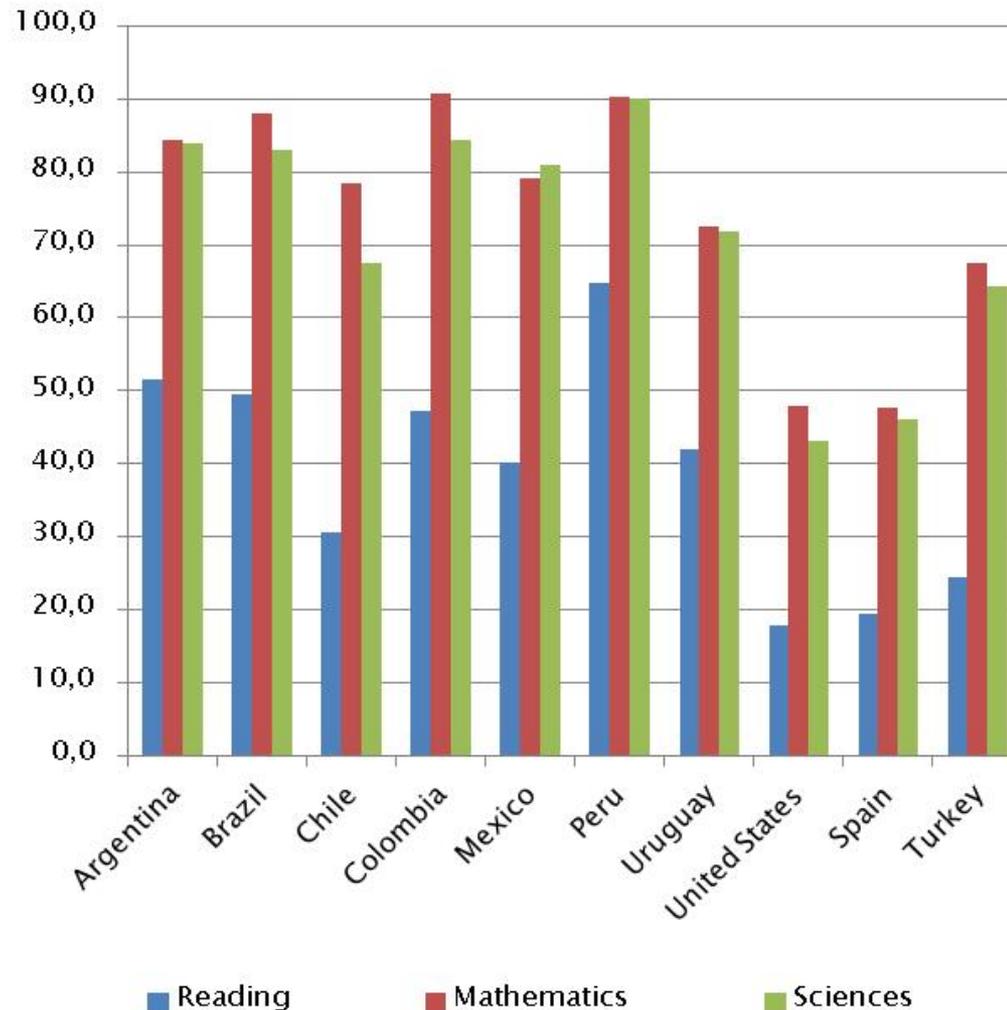


Source: Loayza et al. (2004)



This should make more urgent to solve Human Capital deficiencies as well as those of labor market institutions

Students in the lowest learning category in PISA Tests, 2009
(% of total students)





Concluding Remarks: The Two Scenarios

- The LATAM Success story:
 - Major reforms in Education, training and labor markets succeeds in raising levels of human capital
 - Higher productivity compensates for higher real wages
 - High employment levels, reduction in informality and higher wages have a significant positive impact in poverty and income inequality reduction.
 - Effective democracies gain legitimacy as a path to economic progress.
- The Big LATAM Disappointment:
 - Growing labor scarcity push up wages
 - Lower and stagnant levels of productivity means that investment becomes less attractive
 - Stagnation and zero – sum redistributive games proliferate
 - Increasing doubts about the effectiveness of democracy.



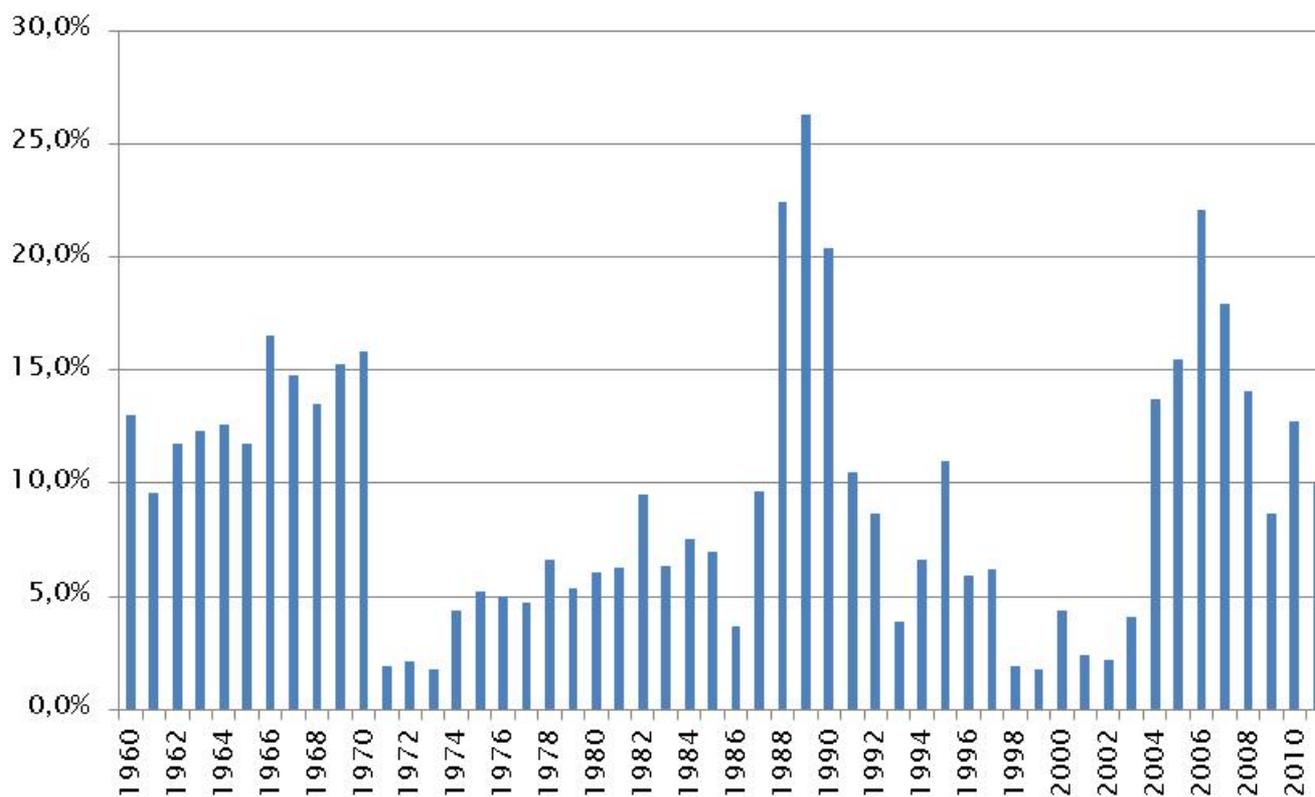
Macroeconomic Policy Challenges for (most) Latin America

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November 5, 2013



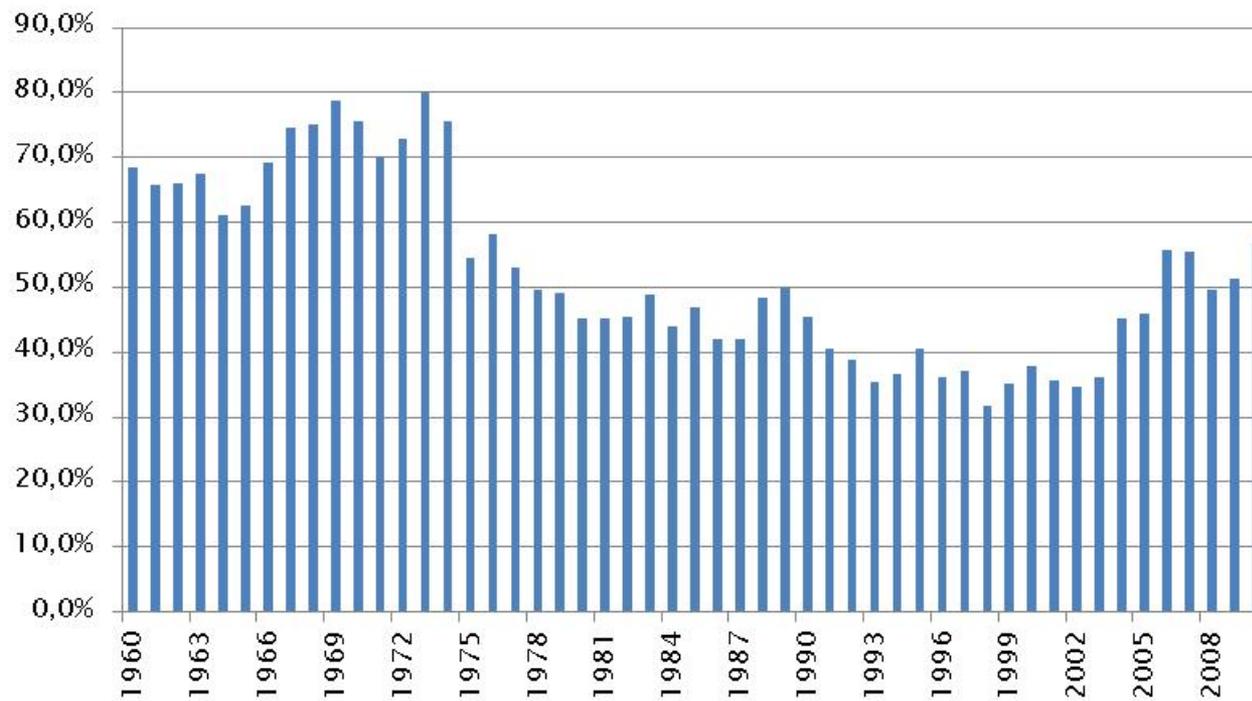
Share of Copper revenues in Central Government Revenues (%)



Sources: Braun et al. (1996); DIPRES



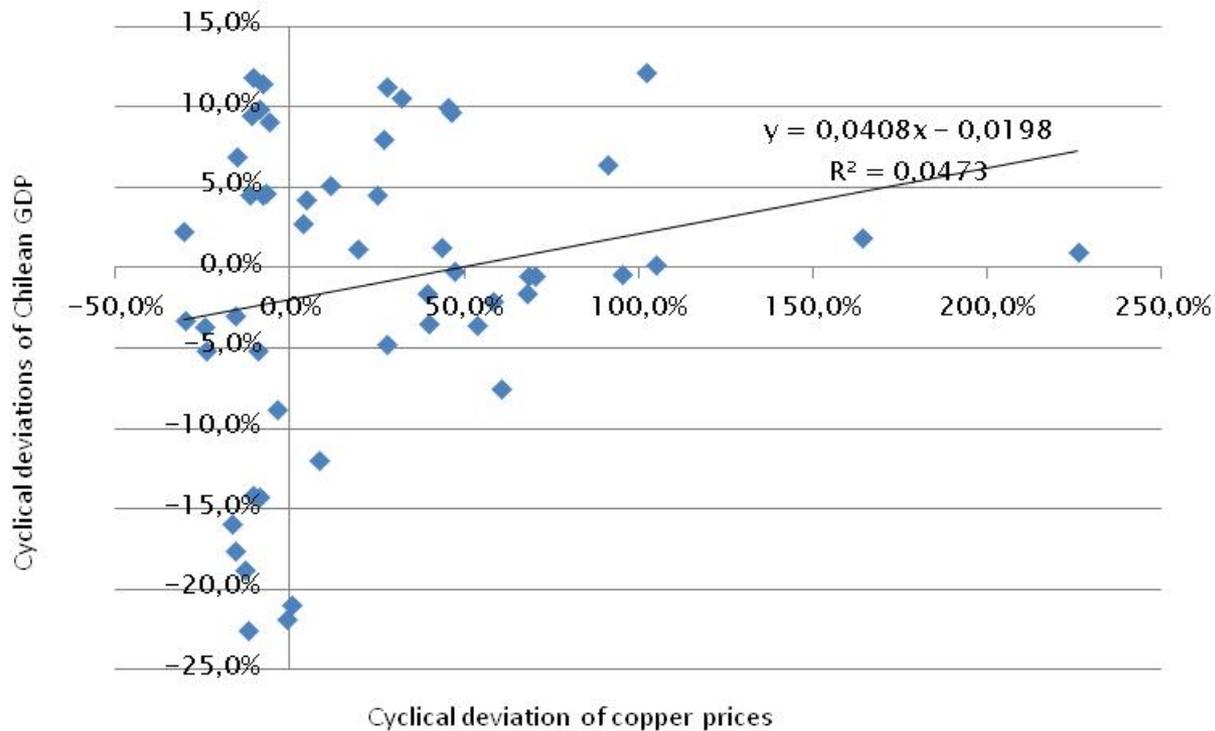
Share of Copper exports in total goods exports (%)



Source: Central Bank



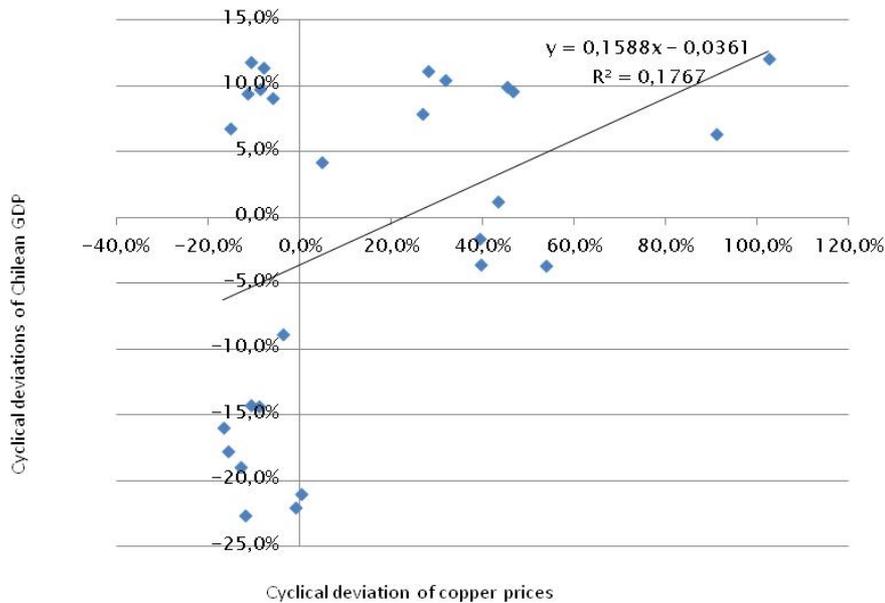
Chilean Economic Cycle and Copper prices 1960– 2011





Chilean Economic Cycle and Copper prices 1960–1986 vs. 1987– 2011

1960 – 1986



1987 – 2011

