

Latin America in the Global Economy: Challenges and Opportunities

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November 18th, 2008

Richard Snape Lecture presented at the Productivity Commission in Melbourne, Australia.

1. Introduction

Introduction

- ✓ Latin America has been trying to find a place in the world economy since the end of World War II.
- ✓ Although up to the Great Depression the region had been quite integrated to the world economy, the great depression led to protectionist policies.
- ✓ After World War II, most Latin American countries found it difficult to change the import substitution/government intervention model (ISGI) that they had built up.

Introduction

- ✓ The ISGI model led to a highly distorted and inefficient economy with detrimental effects on long term growth:
 - ✓ a very protective and highly distorted trade regime;
 - ✓ widespread price controls;
 - ✓ multiple exchange rate systems;
 - ✓ a repressed financial system with a distorted process of credit allocation;
 - ✓ very restrictive labour practices.
 - ✓ A very inefficient economy.
- ✓ In parallel, institutions were weak: property rights, credible enforcement of contracts, the rule of law, mechanisms of conflict resolution, etc.

Introduction

- ✓ This development model was in place until the middle of the 1970s when some countries started to introduce reforms oriented to:
 - ✓ open up their economies to foreign trade;
 - ✓ abolish price controls and distortions against agriculture;
 - ✓ reduce the involvement of the government in economic activity;
 - ✓ reduce macroeconomic imbalances.
- ✓ After the debt crisis of the 1980s countries strengthened their macro policies and extended the scope of their reforms.

Introduction

- ✓ The Asian and Russian crises resulted in a sharp reversal of capital inflows, severe pressures on local currencies and sovereign debts spreads with detrimental effects on economic growth.
- ✓ The countries that suffered the most were the ones with the more rigid exchange rate regimes and larger fiscal and current account deficits.
- ✓ Important lessons were learned once again and as a result, the region is better prepared to deal with the current major international financial crisis.

2. Latin America in the Last Ten Years

Latin America in the Last Ten Years

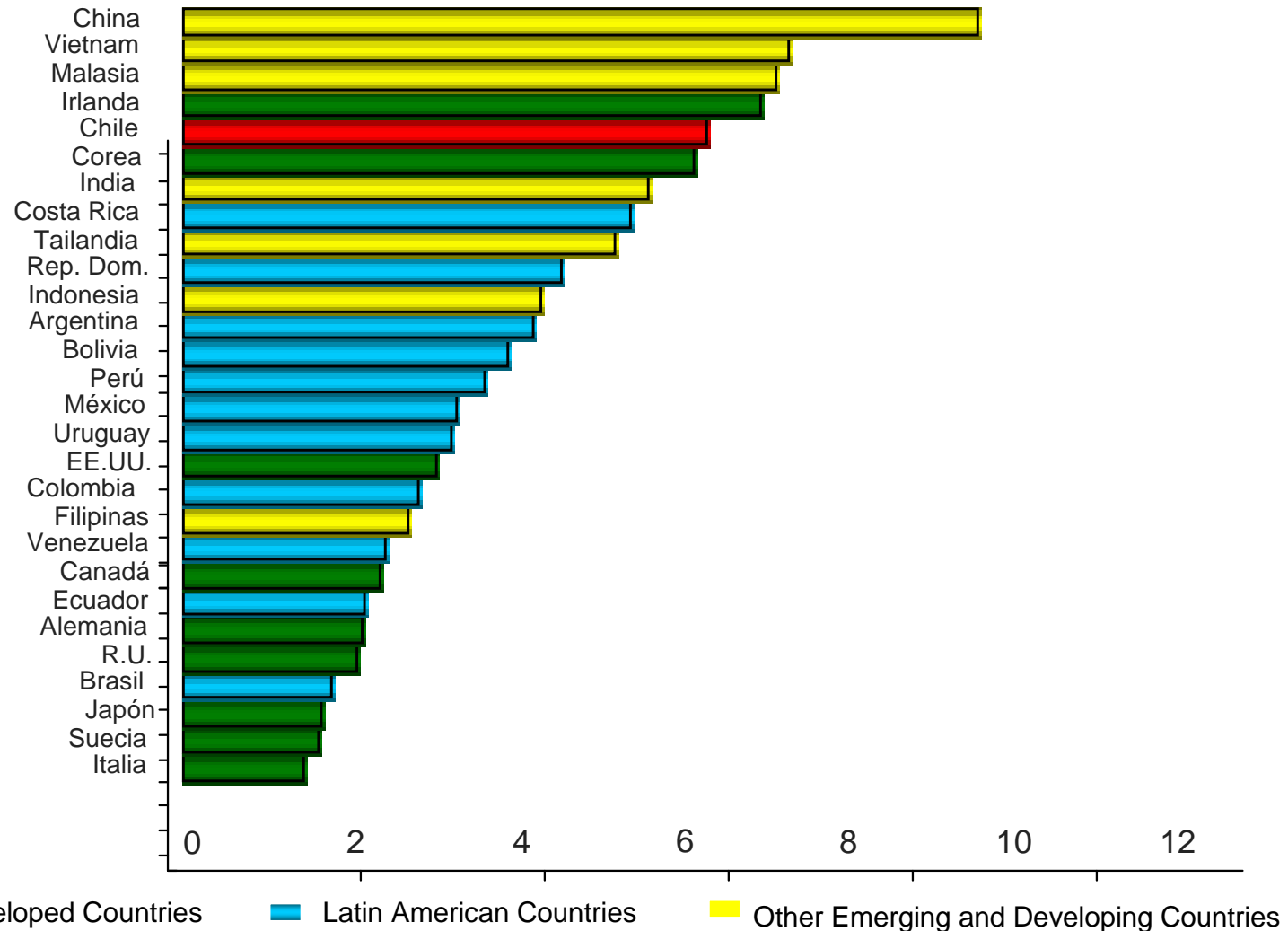
- ✓ The Crises of the 1980s and 1990s raised important questions about the appropriate institutions and macroeconomic policies required to make countries more resilient to external shocks.
- ✓ On the macro side two issues emerged: the choice of exchange-rate regime and the choice of a monetary regime to reduce inflation to industrial countries levels.
- ✓ As a response, in the last ten years Brazil, Chile, Colombia, Mexico and Peru have introduced more flexible exchange rate regimes and more prudent macro policies supported by inflation targeting frameworks.

Latin America in the Last Ten Years

- ✓ Further reforms were also introduced in trade, privatization and the financial system.
- ✓ However, despite the reform efforts the growth response has been disappointing.
- ✓ Income per capita gaps with G-7 countries have remained large and have widened in most countries.
- ✓ With the exception of Chile, improvements in poverty reductions have also been disappointing.
- ✓ The poor growth performance has created frustration and has facilitated the emergence of populist governments.

Economic Growth in the 1990s

(%)



Average of GDP per capita, PPP

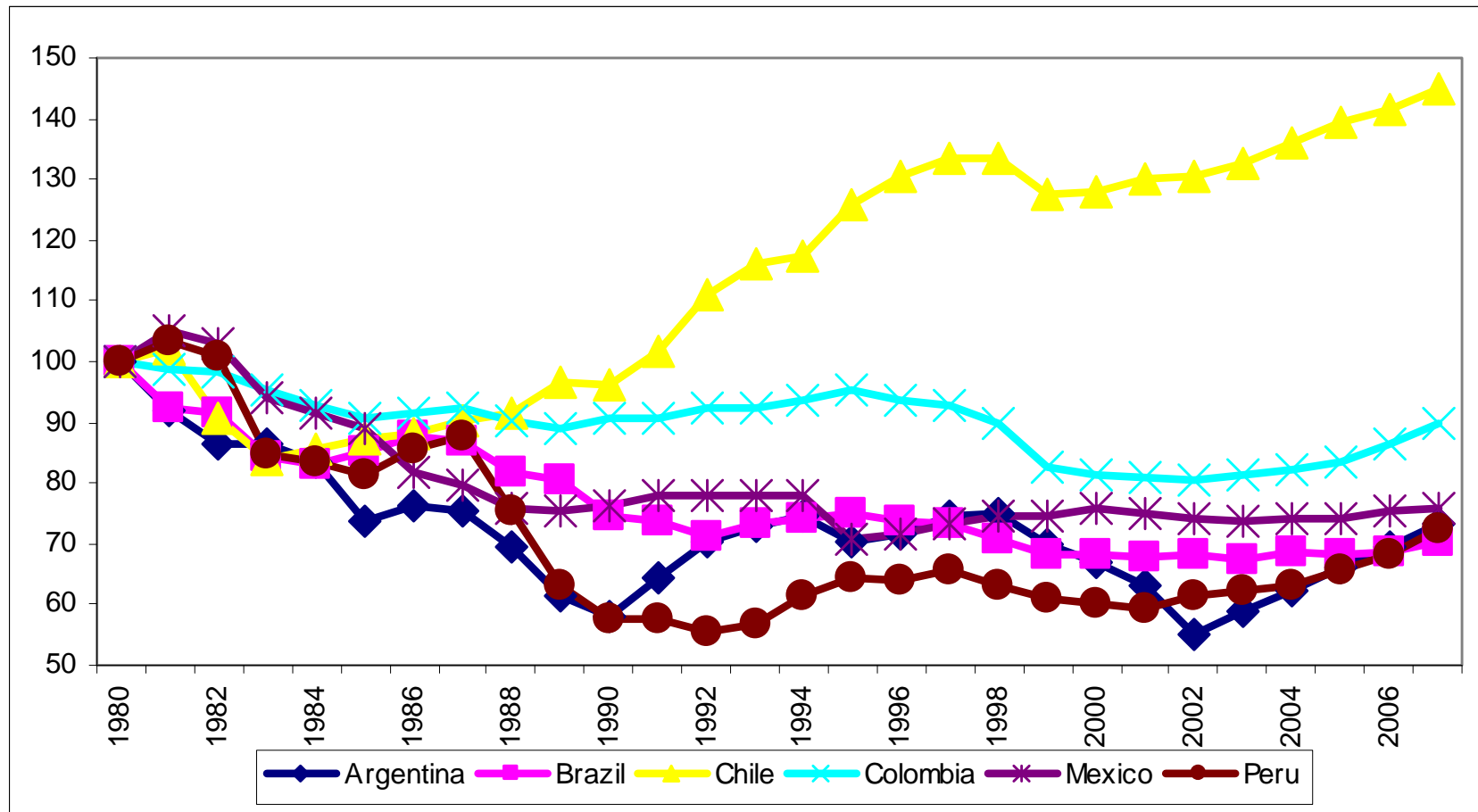
(2005 Constant US Dollars)

| | 1980-1989 | 1990-1999 | 2000-2007 |
|---------------|-----------|-----------|-----------|
| G7 | 23,786 | 29,363 | 34,440 |
| Latin America | 7,455 | 7,909 | 8,937 |

Source: World Development Indicators, World Bank (2008).

Output per Capita

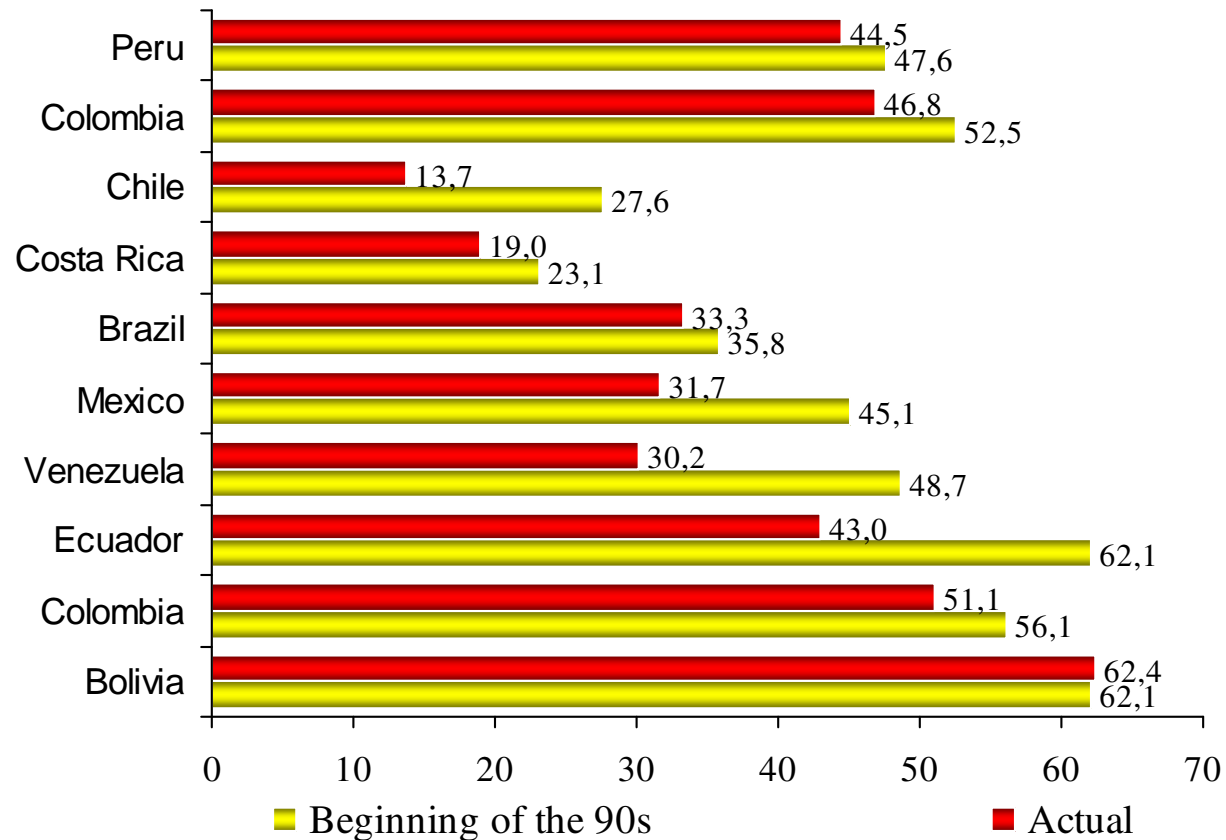
(per capita GDP/per capita GDP of G-7 (1980=100), PPP prices)



Source: World Development Indicators, World Bank (2008).

POVERTY RATE

(population below the poverty line, %)



Note: Actual refers to the years 2006 or 2005 depending on the country.

Source: ECLAC: Statistical yearbook for Latin America and the Caribbean, 2007.

3. Where are the Opportunities to increase Growth today?

Determinants of Growth

- ✓ Theoretical and empirical studies show that long run growth rate is determined by the conditions that affect the accumulation of factor inputs and the growth of TFP.
- ✓ Economic policies and institutions are the main determinants of these conditions.
- ✓ A recent report of the Growth Commission identifies the type of policies and institutions that have been used by “successful countries”.
- ✓ The gap with respect to the “pro-growth policies and institutions” of successful countries provides guidance on reforms that could follow Latin America to raise its sustainable growth rate.

Determinants of Growth

- ✓ The report identifies five features of successful countries:
 - ✓ (1) they exploited the opportunities offered by the global economy;
 - ✓ (2) they achieved and sustained macroeconomic stability;
 - ✓ (3) they allocated resources mainly by the market;
 - ✓ (4) they reached high investment and saving rates;
 - ✓ (5) they had a capable and efficient State with a pro-growth strategy; provider of public goods of good quality and low cost (property rights, contract enforcement, rule of law).

3.1. Integration to the World Economy

Trade Openness

- ✓ In spite of the important progress of the last fifteen years, Latin America still has a quite restrictive trade regime compared with other regions of the world.
- ✓ Many efforts to open the economies to foreign trade have been derailed by macro/financial crisis and/or by political economy factors.
- ✓ Furthermore, trade is restricted by high transportation costs and high levels of non-tariff barriers.
- ✓ However, some countries have made important progress (e.g. Chile and Mexico).

Trade Openness in Latin America

(% of GDP, $(X+M)/PIB$)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 13.8 | 16.6 | 15.6 | 21.6 | 33.2 | 44.0 |
| Brazil | 19.2 | 16.2 | 18.0 | 16.6 | 26.2 | 25.7 |
| Chile | 45.8 | 58.8 | 58.6 | 56.2 | 66.6 | 77.0 |
| Colombia | 26.6 | 29.8 | 34.8 | 35.8 | 41.8 | 43.7 |
| Mexico | 25.6 | 33.2 | 36.4 | 61.6 | 58.8 | 64.3 |
| Peru | 37.6 | 31.6 | 28.2 | 31.8 | 35.0 | 46.3 |

Source: World Development Indicators, World Bank (2008).

Import Tariffs

(%, simple average)

| | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-------------------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 27.5 | 13.9 | 14.7 | 14.0 | 10.5 |
| Brazil | 45.8 | 21.0 | 15.1 | 14.7 | 12.2 |
| Chile | 18.0 | 11.8 | 10.7 | 7.0 | 3.0 |
| Colombia | 29.4 | 16.6 | 12.7 | 12.2 | 11.3 |
| Mexico | 16.7 | 12.8 | 14.1 | 16.1 | 8.6 |
| Peru | 45.8 | 17.2 | 13.9 | 11.0 | 8.8 |
| Latin America | 28.2 | 15.4 | 12.3 | 11.4 | 8.9 |
| Emerging Asia | 32.9 | 32.1 | 15.8 | 10.8 | 7.6 |
| Eastern Europe | 19.2 | 9.4 | 8.7 | 5.7 | 3.3 |

Source: Data on Trade and Import Barriers, World Bank (2007).

Non-Tariff Trade Barriers

(1-10, index)

| | 1995 | 2000 | 2004 | 2005 | 2006 |
|-----------------------|------|------|------|------|------|
| Latin America | | | | | |
| Argentina | 7.17 | 6.18 | 4.95 | 3.81 | 3.68 |
| Brazil | 5.27 | 4.02 | 4.80 | 5.12 | 5.07 |
| Chile | 7.05 | 8.28 | 7.68 | 7.68 | 7.86 |
| Colombia | 5.15 | 4.90 | 5.41 | 4.83 | 4.98 |
| Mexico | 6.30 | 6.40 | 5.80 | 6.15 | 6.13 |
| Peru | 5.98 | 6.75 | 5.34 | 5.19 | 5.58 |
| Emerging Asia | | | | | |
| China | 4.63 | 4.35 | 4.99 | 5.14 | 5.52 |
| Hong Kong | 8.75 | 8.94 | 8.42 | 8.60 | 8.90 |
| India | 6.35 | 5.35 | 6.08 | 6.91 | 6.34 |
| Eastern Europe | | | | | |
| Czech Republic | 7.42 | 7.27 | 7.06 | 7.27 | 7.70 |
| Hungary | 7.13 | 8.20 | 8.15 | 7.30 | 7.59 |
| Poland | 5.70 | 6.23 | 6.22 | 5.19 | 5.60 |

Source: Gwartney, J., R. Lawson, J. Hall and S. W. Norton (2008). Economic Freedom of the World: 2008 Annual Report.

Financial Openness

- ✓ In financial opening there has been some progress:
 - ✓ practical elimination of capital controls;
 - ✓ advances in restoring macroeconomic stability;
 - ✓ deregulation of domestic financial activities;
 - ✓ privatization of banks;
 - ✓ opening up to foreign ownership of banks;
 - ✓ privatizations of non-banking activities;
 - ✓ pension reforms that replaced pay-as-you-go systems for defined contribution pension systems administered by private companies.

Financial Openness

- ✓ Financial openness accelerated in this decade once the crises of the 1980s and 1990s had been left behind, macroeconomic stability had been restored and financial regulation and supervision had been strengthened.

Financial Openness in Latin America

(% of GDP)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 |
|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 3.7 | 7.9 | 12.2 | 28.4 | 50.3 |
| Brazil | 13.9 | 11.2 | 14.4 | 24.4 | 45.4 |
| Chile | 20.8 | 23.0 | 35.4 | 64.4 | 108.3 |
| Colombia | 6.0 | 9.6 | 11.8 | 18.3 | 27.4 |
| Mexico | 5.5 | 10.5 | 17.7 | 29.4 | 35.6 |
| Peru | 6.2 | 5.1 | 7.8 | 29.2 | 42.1 |

Source: Lane and Milesi-Ferretti (2006).

3.2. Macroeconomic Stability

Macroeconomic Stability

- ✓ Macroeconomic stability is the area where much progress has been achieved in the last fifteen years:
 - ✓ the level and volatility of inflation have been substantially reduced;
 - ✓ the volatility of GDP growth has also been reduced;
 - ✓ fiscal accounts have been strengthened;
 - ✓ current accounts deficits have been reduced;
 - ✓ real exchange rate misalignments have been avoided.

Inflation

(%, annual rate)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 268.2 | 863.2 | 505.2 | 0.8 | 8.2 | 10.0 |
| Brazil | 132.5 | 532.2 | 1667.4 | 19.4 | 8.8 | 5.0 |
| Chile | 22.4 | 20.4 | 17.4 | 5.8 | 2.8 | 3.3 |
| Colombia | 23.0 | 24.0 | 26.6 | 17.8 | 7.2 | 4.7 |
| Ecuador | 24.8 | 43.0 | 44.8 | 33.2 | 31.4 | 2.3 |
| Peru | 83.8 | 878.6 | 1607.8 | 8.4 | 2.4 | 2.0 |
| Latin America | 76.3 | 357.8 | 289.0 | 12.5 | 8.7 | 5.4 |
| Emerging Asia | 9.7 | 6.0 | 8.0 | 7.8 | 2.4 | 4.4 |
| Eastern Europe | 31.1 | 44.6 | 308.0 | 51.1 | 16.5 | 6.5 |

Source: World Development Indicators, World Bank (2008).

Inflation Volatility

(5 year rolling window standard deviation of inflation)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 176.4 | 918.9 | 794.3 | 1.9 | 10.8 | 2.5 |
| Brazil | 33.5 | 610.1 | 966.5 | 406.7 | 3.4 | 2.7 |
| Chile | 9.3 | 4.6 | 5.0 | 2.0 | 1.1 | 1.0 |
| Colombia | 3.9 | 3.6 | 2.7 | 3.8 | 2.1 | 0.8 |
| Mexico | 25.7 | 42.2 | 16.2 | 9.9 | 2.7 | 0.3 |
| Peru | 25.9 | 1605.4 | 1967.9 | 6.7 | 1.7 | 0.6 |
| Latin America | 170.1 | 383.8 | 249.4 | 30.8 | 1.8 | 1.1 |
| Emerging Asia | 2.9 | 1.9 | 1.0 | 3.9 | 1.8 | 0.9 |
| Eastern Europe | 12.5 | 41.7 | 286.4 | 96.0 | 6.9 | 1.0 |

Source: Own calculations

GDP Growth Volatility in Latin America

(5 year rolling window standard deviation of the GDP growth)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 9.3 | 9.9 | 8.2 | 6.2 | 9.2 | 5.7 |
| Brazil | 7.2 | 4.5 | 4.2 | 2.3 | 3.3 | 3.2 |
| Chile | 9.0 | 4.4 | 4.8 | 3.9 | 2.6 | 2.3 |
| Colombia | 1.7 | 1.9 | 3.4 | 3.4 | 2.9 | 3.0 |
| Mexico | 6.0 | 5.0 | 3.5 | 6.4 | 3.4 | 2.2 |
| Peru | 9.3 | 10.3 | 6.1 | 5.7 | 3.3 | 3.4 |

Source: Own calculations

Exchange Rate Arrangements

| Country | In the Beginning of 1980s | Today |
|-----------|---|--|
| Argentina | Pre-announced crawling peg to US dollar | De facto crawling band around US dollar |
| Brazil | Managed floating | Managed floating |
| Chile | Peg to US dollar | Managed floating with rare interventions |
| Colombia | De facto band around US dollar/Multiple rates | Managed floating |
| Mexico | De facto peg to US dollar | De facto crawling band around US dollar |
| Peru | Freely floating/Parallel market | De facto crawling band around US dollar |

Source: Ilzetzki, Reinhart y Rogoff (2008). "The Country Chronologies and Background Material to Exchange Rate Arrangements in the 21st Century: Which Anchor Will Hold?" for the beginning of the 1980s, own classification for Today..

Macroeconomic Stability

- ✓ Public debt to GDP ratios and gross external debt to GDP ratios have been reduced.
- ✓ In parallel, current account balances have improved.

Total Government Debt

(Public and Publicly Guaranteed Debt, % of GNI)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2006 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 21.7 | 48.6 | 24.2 | 24.8 | 61.6 | 32.7 |
| Brazil | 24.6 | 29.1 | 20.8 | 12.6 | 17.5 | 9.6 |
| Chile | 30.9 | 73.1 | 24.6 | 7.4 | 9.7 | 7.8 |
| Colombia | 16.4 | 35.8 | 29.2 | 17.4 | 26.9 | 19.5 |
| Mexico | 31.6 | 49.6 | 22.7 | 25.0 | 15.7 | 13.0 |
| Peru | 36.3 | 71.7 | 47.3 | 36.3 | 36.9 | 27.9 |

Source: World Development Indicators, World Bank (2008).

External Debt in Latin America

(% of GNI)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2006 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 49.8 | 61.6 | 33.8 | 45.4 | 102.8 | 67.0 |
| Brazil | 40.4 | 39.2 | 30.6 | 27.6 | 41.4 | 20.5 |
| Chile | 77.8 | 108.4 | 49.4 | 39.0 | 57.0 | 40.0 |
| Colombia | 27.2 | 45.6 | 37.6 | 32.8 | 41.8 | 28.0 |
| Mexico | 48.2 | 64.0 | 35.4 | 44.4 | 26.4 | 20.5 |
| Peru | 51.6 | 101.6 | 66.8 | 55.8 | 50.8 | 36.0 |

Source: World Development Indicators, World Bank (2008).

Current Account Balances

(% of GDP)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | -4.0 | -2.2 | -1.2 | -3.4 | 2.6 | 3.3 |
| Brazil | -3.6 | -0.2 | 0.2 | -3.2 | -1.4 | 1.0 |
| Chile | -9.4 | -4.6 | -2.4 | -3.0 | -0.6 | 3.3 |
| Colombia | -5.2 | -1.0 | 0.2 | -3.8 | -0.8 | -2.3 |
| Mexico | -1.6 | -0.4 | -5.6 | -2.2 | -2.0 | -0.5 |
| Peru | -3.8 | -6.8 | -5.4 | -6.2 | -1.8 | 2.0 |

Source: World Development Indicators, World Bank (2008).

3.3. Role of the Market in Resource Allocation

Role of the Market in Resource Allocation

- ✓ The conditions for achieving a better allocation of resources have improved substantially in the last twenty years (trade openness, macro stability).
- ✓ However, although interest rate controls have been reduced, not much progress has been made in lifting price controls.

Interest Rate Controls/Negative Real Interest Rates

(0-10 index, 10 indicates more freedom to set interest rates)

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2004 | 2005 | 2006 |
|-----------------------|------|------|------|------|------|------|------|------|
| Latin America | | | | | | | | |
| Argentina | 0 | 0 | 0 | 10 | 10 | 9 | 10 | 9 |
| Brazil | 4 | 0 | 0 | 0 | 8 | 5 | 5 | 5 |
| Chile | 8 | 8 | 8 | 10 | 10 | 9 | 10 | 10 |
| Colombia | 8 | 8 | 8 | 8 | 8 | 10 | 10 | 10 |
| Mexico | 4 | 4 | 8 | 8 | 4 | 10 | 10 | 10 |
| Peru | 0 | 0 | 0 | 6 | 8 | 9 | 9 | 8 |
| Emerging Asia | | | | | | | | |
| China | 0 | 0 | 0 | 4 | 10 | 9 | 10 | 10 |
| Hong Kong | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 |
| India | 8 | 8 | 8 | 8 | 8 | 10 | 10 | 10 |
| Eastern Europe | | | | | | | | |
| Czech Republic | | | | 6 | 8 | 10 | 10 | 10 |
| Hungary | | 6 | 6 | 6 | 10 | 10 | 10 | 10 |
| Poland | | | 0 | 6 | 10 | 10 | 10 | 10 |

Source: Gwartney, J., R. Lawson, J. Hall and S. W. Norton (2008). Economic Freedom of the World: 2008

Annual Report.

Price Controls

(1-10 index, 10 indicates more freedom to set prices)

| | 1995 | 2000 | 2004 | 2005 | 2006 |
|-----------------------|------|------|------|------|------|
| Latin America | | | | | |
| Argentina | 8 | 8 | 1 | 1 | 0 |
| Brazil | 6 | 7 | 6 | 6 | 5 |
| Chile | 10 | 9 | 8 | 9 | 10 |
| Colombia | 5 | 6 | 5 | 5 | 6 |
| Mexico | 5 | 7 | 4 | 4 | 3 |
| Peru | 6 | 8 | 6 | 6 | 6 |
| Emerging Asia | | | | | |
| China | 4 | 3 | 2 | 2 | 1 |
| Hong Kong | 9 | 9 | 8 | 9 | 8 |
| India | 4 | 4 | 5 | 3 | 5 |
| Eastern Europe | | | | | |
| Czech Republic | 6 | 4 | 7 | 7 | 7 |
| Hungary | 8 | 8 | 6 | 7 | 8 |
| Poland | 7 | 4 | 1 | 2 | 3 |

Source: Gwartney, J., R. Lawson, J. Hall and S. W. Norton (2008). Economic Freedom of the World: 2008

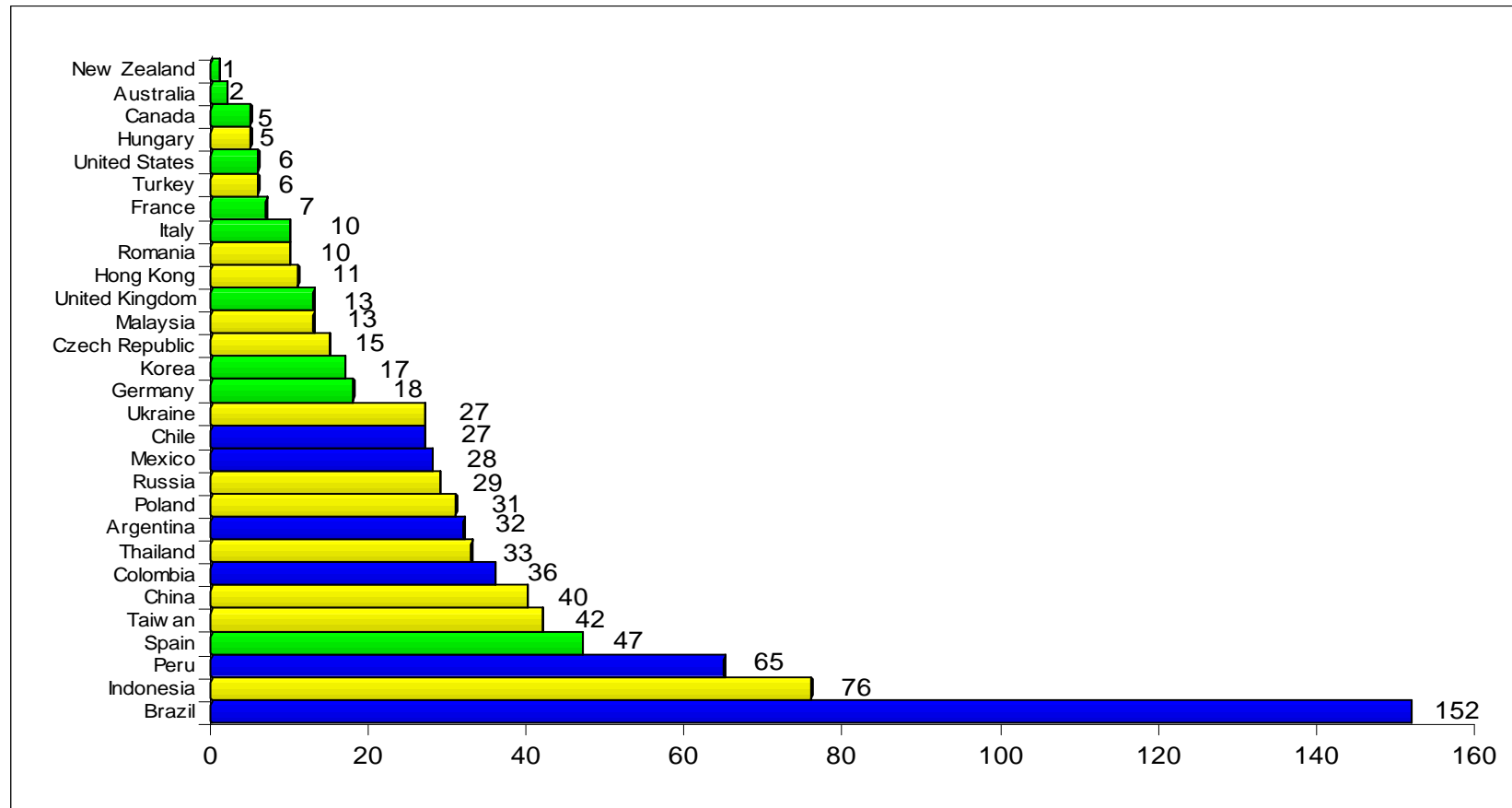
Annual Report.

Role of the Market in Resource Allocation

- ✓ However, there are important entry and exit barriers to businesses.

Time to Start a Business

(days)

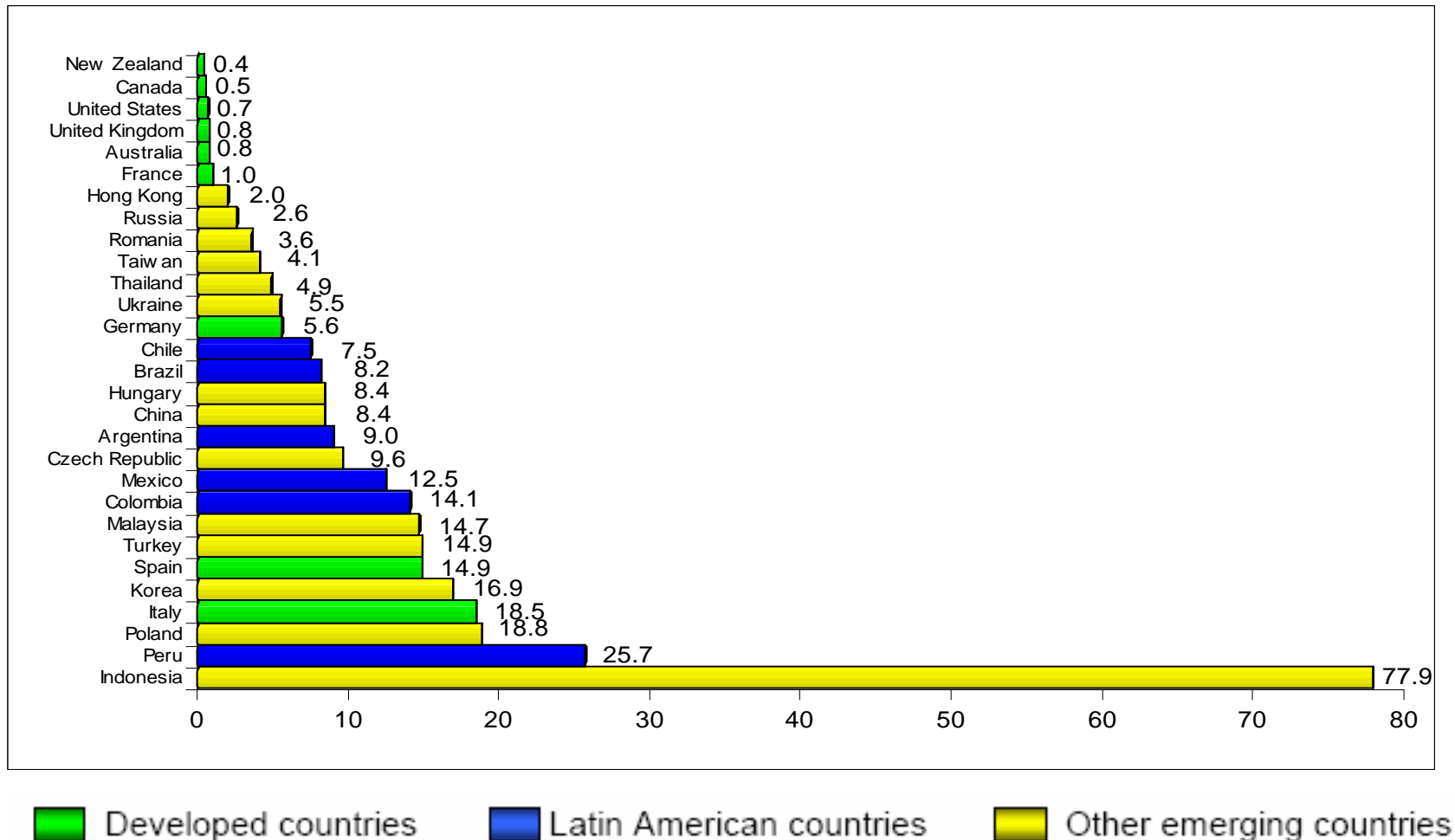


■ Developed countries ■ Latin American countries ■ Other emerging countries

Source: Doing Business 2009, World Bank (2008).

Cost to Start a Business

(% of income per capita)

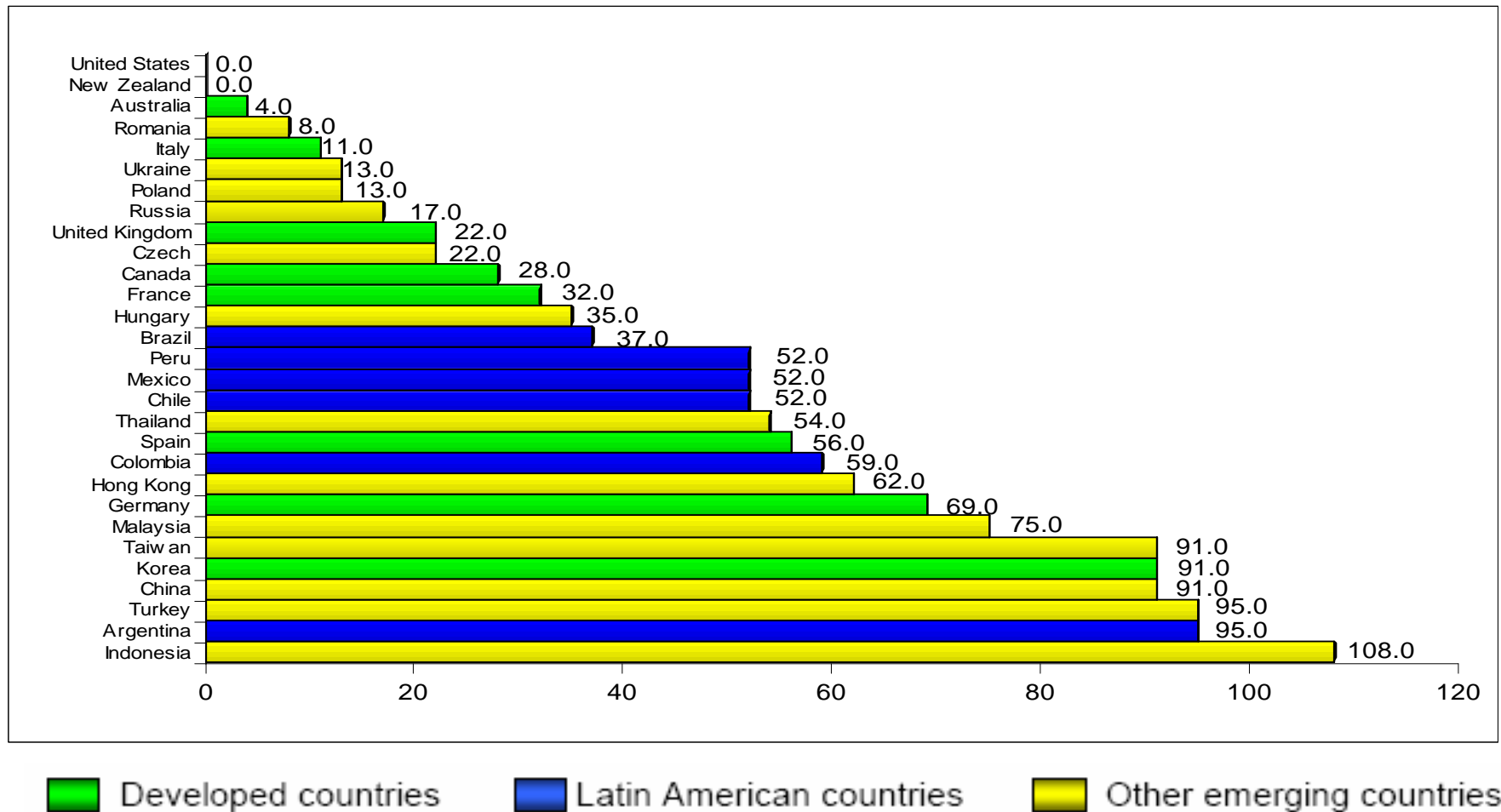


Source: Doing Business 2009, World Bank (2008).

Role of the Market in Resource Allocation

- ✓ Furthermore, adjustment to change in relative prices to achieve a higher efficiency in resource allocation is many times impaired by:
 - ✓ rigid labor laws in the form of minimum wages that distort wage structures;
 - ✓ limitations to adjust working hours and high firing costs.

Firing cost (weeks of salary)



Source: Doing Business 2009, World Bank (2008).

Minimum Wage

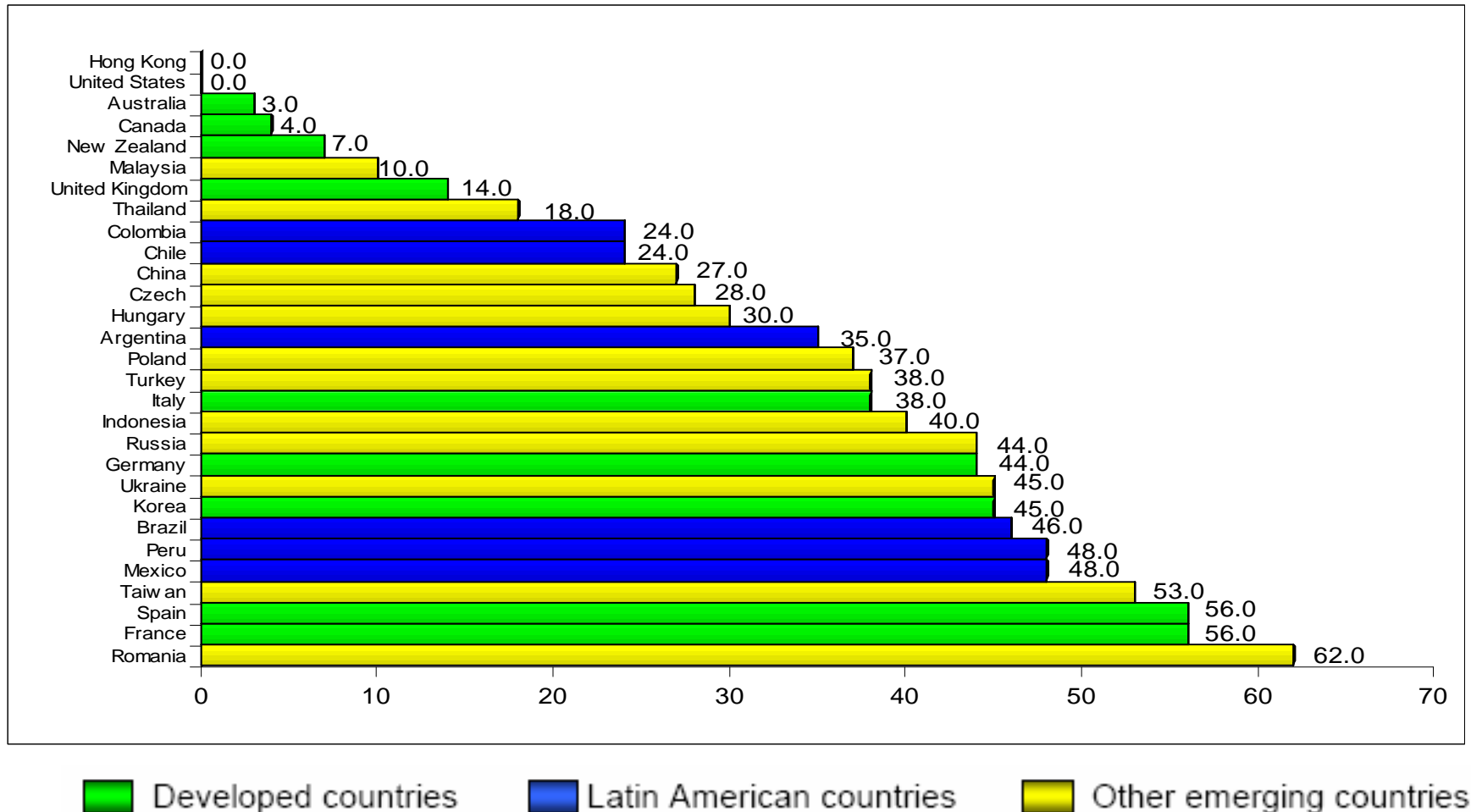
(1-10 index, 10 indicates more freedom to set wage rates)

| | 1995 | 2000 | 2004 | 2005 | 2006 |
|-----------------------|------|------|-------|-------|-------|
| Latin America | | | | | |
| Argentina | 5.95 | 4.42 | 6.21 | 6.21 | 5.24 |
| Brazil | 6.67 | 3.46 | 7.23 | 7.23 | 7.04 |
| Chile | 5.68 | 3.36 | 7.26 | 7.26 | 10.00 |
| Colombia | 6.83 | 2.85 | 3.17 | 3.17 | 3.65 |
| Mexico | 7.92 | 2.75 | 8.18 | 8.18 | 8.76 |
| Peru | 6.45 | 3.08 | 4.58 | 4.58 | 5.20 |
| Emerging Asia | | | | | |
| China | 5.80 | 4.37 | 5.07 | 5.07 | 4.96 |
| Hong Kong | | 7.40 | 10.00 | 10.00 | 10.00 |
| India | 6.23 | 4.35 | 3.42 | 3.42 | 7.89 |
| Eastern Europe | | | | | |
| Czech Republic | 6.58 | 5.09 | 7.28 | 7.28 | 7.08 |
| Hungary | 6.67 | 4.65 | 6.81 | 6.81 | 6.85 |
| Poland | 5.38 | 3.39 | 6.81 | 6.81 | 6.94 |

Source: Gwartney, J., R. Lawson, J. Hall and S. W. Norton (2008). Economic Freedom of the World: 2008

Annual Report.

Employment Rigidity index (0-100)



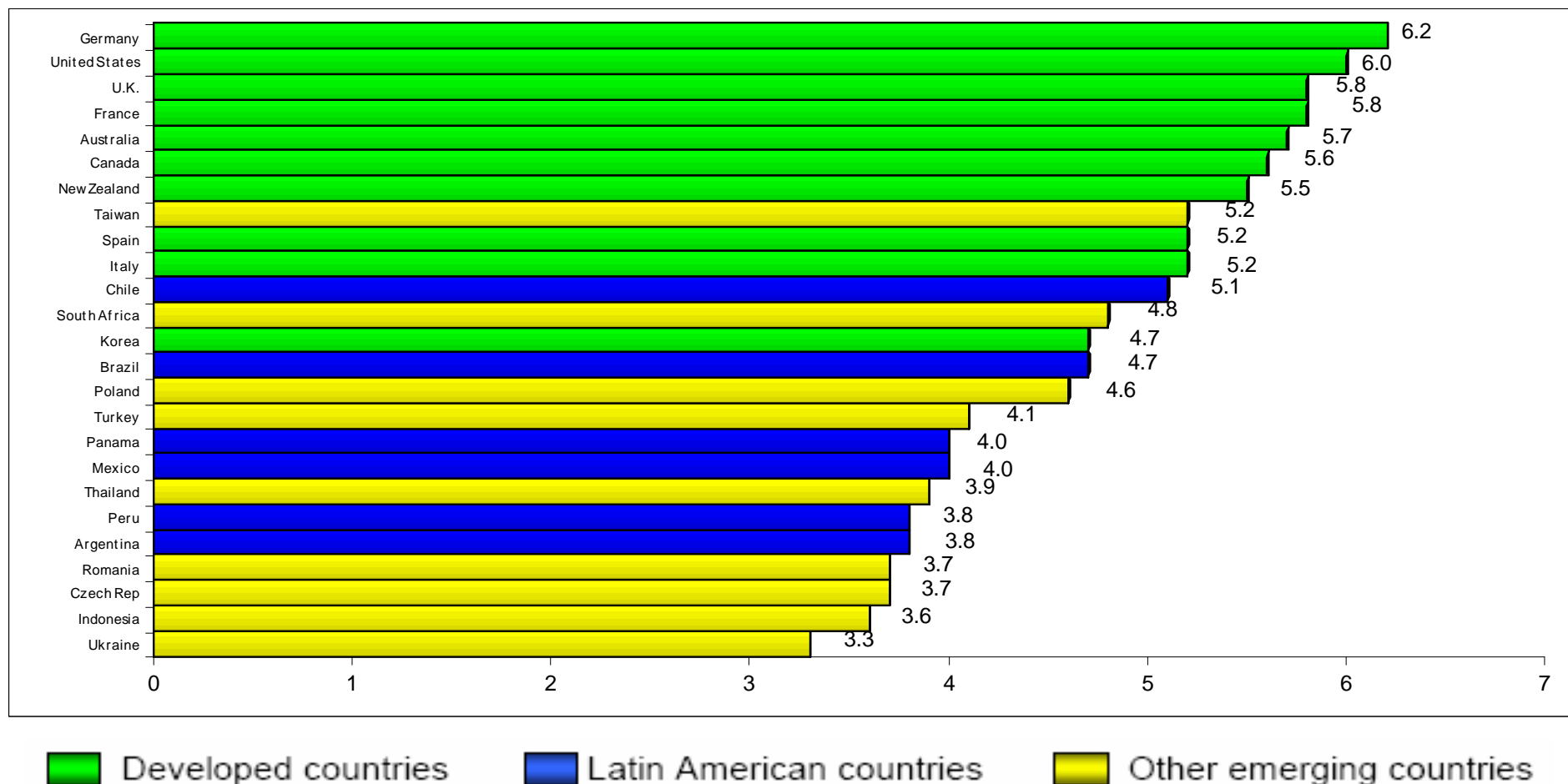
Source: Doing Business 2009, World Bank (2008).

Role of the Market in Resource Allocation

- ✓ As part of the reforms of the last fifteen years competition has been enhanced through the opening up to trade and from specific laws that promote competition in non-tradable activities, especially services.
- ✓ Also regulation policy has been revised to promote efficiency in the allocation of resources in public utilities run by the private sector.
- ✓ However, in this area there is much room for improvement both in the design and the enforcement of regulation.

Antimonopoly Policy

(1-7 index, 7 indicates that law effectively promotes competition)



Source: Nicholson, M. (2008). "An Antitrust Law Index for Empirical Analysis of International Competition". Journal of Competition Law and Economics.

Foreign Ownership/Investment Restrictions

(1-10 index, 10 indicates more freedom to foreign ownership)

| | 1995 | 2000 | 2004 | 2005 | 2006 |
|-----------------------|------|------|------|------|------|
| Latin America | | | | | |
| Argentina | 9.06 | 9.31 | 7.08 | 5.88 | 5.47 |
| Brazil | 7.29 | 7.56 | 6.40 | 6.16 | 6.05 |
| Chile | 7.98 | 8.61 | 8.57 | 8.38 | 8.22 |
| Colombia | 7.04 | 7.87 | 6.35 | 6.81 | 6.77 |
| Mexico | 7.77 | 8.70 | 7.21 | 7.54 | 7.58 |
| Peru | 9.22 | 9.30 | 6.85 | 7.27 | 7.47 |
| Emerging Asia | | | | | |
| China | 4.82 | 4.66 | 6.15 | 6.71 | 6.41 |
| Hong Kong | 9.40 | 9.92 | 9.08 | 8.96 | 9.05 |
| India | 4.67 | 4.05 | 7.43 | 7.40 | 7.13 |
| Eastern Europe | | | | | |
| Czech Republic | 6.44 | 7.92 | 7.82 | 8.42 | 7.84 |
| Hungary | 7.76 | 8.29 | 8.48 | 7.86 | 8.02 |
| Poland | 5.41 | 6.78 | 6.81 | 5.65 | 6.00 |

Source: Gwartney, J., R. Lawson, J. Hall and S. W. Norton (2008). Economic Freedom of the World: 2008 Annual Report.

3.4. Saving and Investment Rates

Saving and Investment Rates

- ✓ Saving and investment rates in Latin America have risen in recent years most likely as a result of:
 - ✓ the progress in macroeconomic stability;
 - ✓ the development of domestic capital markets;
 - ✓ the growth in private pension systems.
- ✓ However, they are still much lower than what is required to achieve rates of growth of 5% or higher per year and they are also below the levels in Emerging Asia and even in Emerging Europe.

Gross capital formation in Latin America

(% of GDP)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 22.2 | 18.0 | 17.0 | 18.6 | 15.2 | 22.5 |
| Brazil | 20.0 | 22.0 | 20.4 | 17.0 | 17.0 | 18.3 |
| Chile | 15.8 | 21.2 | 24.6 | 25.8 | 21.4 | 21.0 |
| Colombia | 20.0 | 19.0 | 19.8 | 20.4 | 15.8 | 23.0 |
| Mexico | 23.6 | 21.0 | 22.4 | 23.4 | 21.8 | 22.3 |
| Peru | 28.4 | 23.0 | 18.2 | 23.4 | 19.2 | 19.7 |

Source: World Development Indicators, World Bank (2008).

Gross domestic saving in Latin America

(% of GDP)

| | 1980-1984 | 1985-1989 | 1990-1994 | 1995-1999 | 2000-2004 | 2005-2007 |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Argentina | 23.4 | 21.2 | 17.0 | 17.0 | 22.0 | 28.0 |
| Brazil | 20.8 | 26.0 | 21.4 | 15.4 | 18.2 | 21.3 |
| Chile | 12.8 | 25.4 | 26.8 | 25.4 | 25.2 | 33.0 |
| Colombia | 17.6 | 22.8 | 21.0 | 15.6 | 16.0 | 21.3 |
| Mexico | 27.2 | 24.0 | 18.8 | 23.6 | 19.8 | 20.3 |
| Peru | 28.6 | 23.2 | 16.2 | 18.8 | 18.8 | 27.0 |

Source: World Development Indicators, World Bank (2008).

3.5. Quality of Public Policies and Institutions.

Quality of Public Policies and Institutions

- ✓ With the exception of Brazil and Chile, the capacity of the State in Latin America is quite limited and as a result public policies are unpredictable, slow to be implemented and costly for businesses.
- ✓ The merit system is not common in the public sector with the bureaucracy being selected more along political party lines than professional capabilities.

Features of Public Policies in Latin America since 1980

| Country | Stability | Adaptability | Enforcement and implementation | Coordination and coherence |
|-----------|-----------|--------------|--------------------------------|----------------------------|
| Argentina | Low | Medium | Low | Low |
| Brazil | High | High | High | High |
| Chile | High | High | High | High |
| Colombia | High | High | High | Medium |
| Mexico | High | Medium | High | Medium |
| Peru | Medium | Medium | Medium | Medium |

Source: Stein E. and M. Tommasi (2005) 'Democratic Institutions, Policymaking Processes and the Quality of Policies in Latin America'.

Features of Public Policies in Latin America since 1980 (cont.)

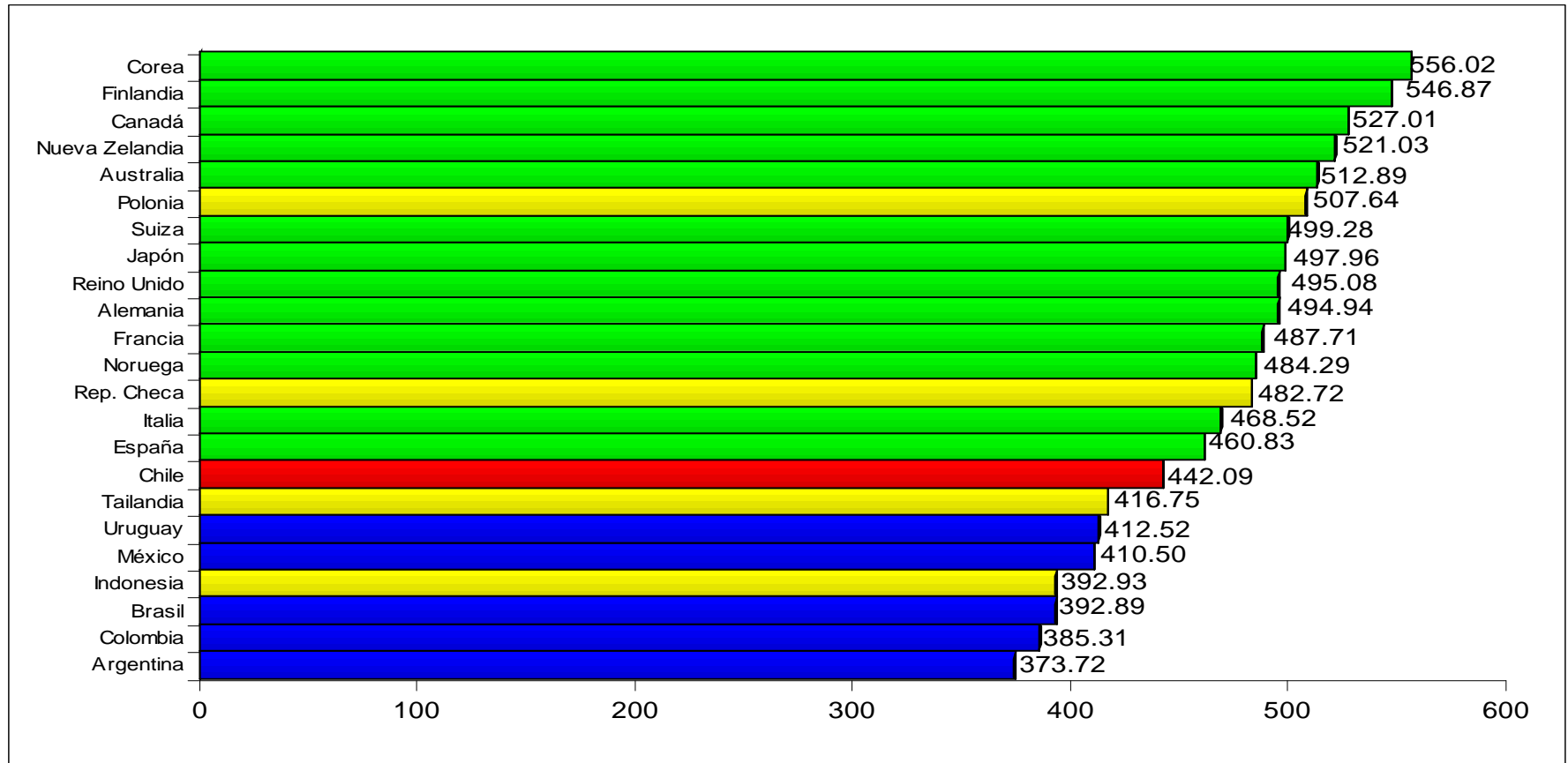
| Country | Public-Regardedness | Efficiency | Policy index |
|-----------|---------------------|------------|--------------|
| Argentina | Medium | Low | Low |
| Brazil | Medium | Medium | High |
| Chile | High | High | Very High |
| Colombia | Medium | Medium | High |
| Mexico | Medium | High | High |
| Peru | Medium | Medium | Medium |

Source: Stein E. and M. Tommasi (2005) 'Democratic Institutions, Policymaking Processes and the Quality of Policies in Latin America'.

Quality of Public Policies and Institutions

- ✓ One of the weakest areas of government policy is education and health.
- ✓ Public education and public health suffer the consequences of low budgets, poor incentives, lack of accountability and difficulties to introduce and implement measures oriented to improve efficiency.
- ✓ Latin American countries still rank very low in international achievement tests, even after controlling for the level of per capita income.

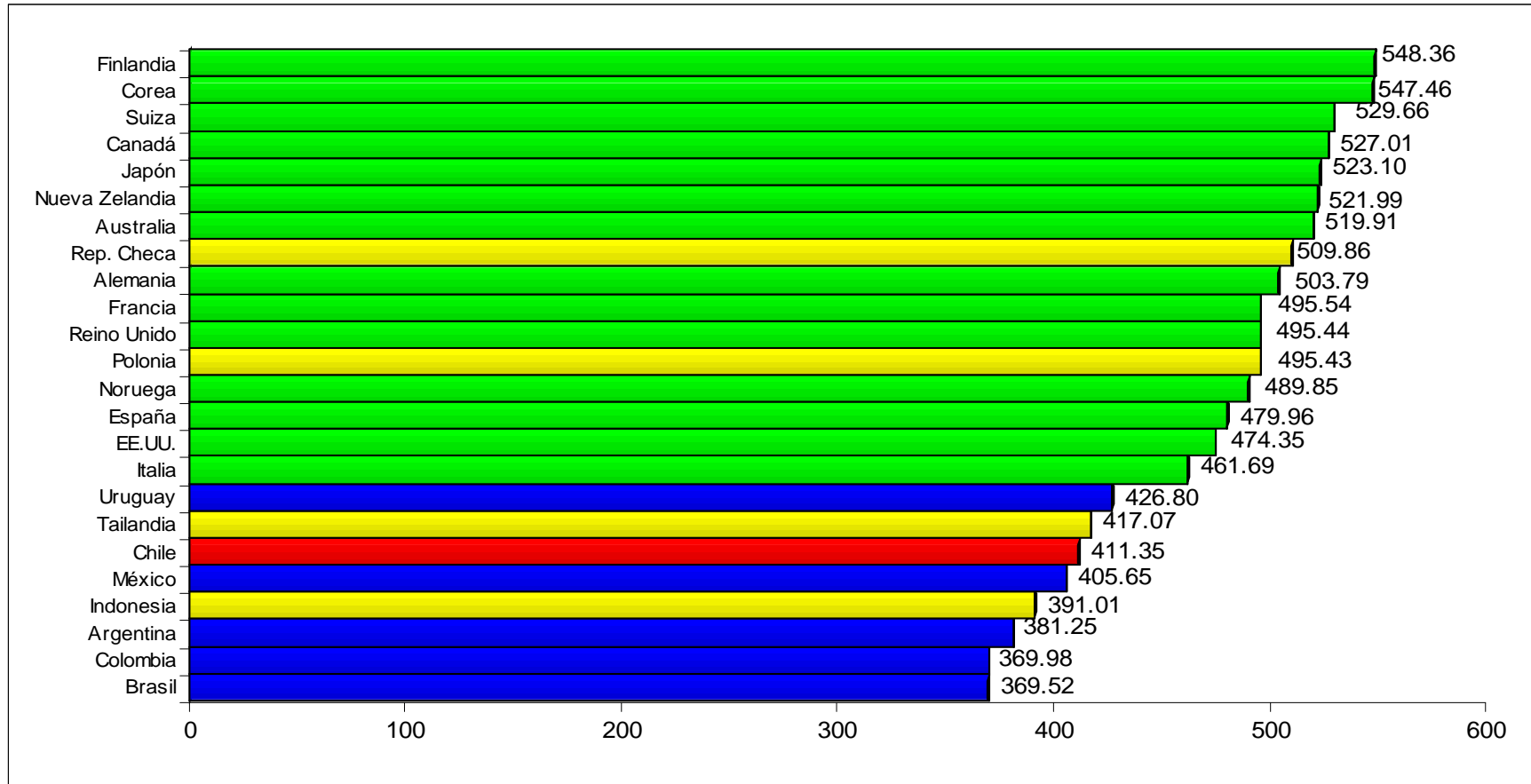
Mean Score of Student Performance in Reading



■ Developed countries ■ Latin American countries ■ Other emerging countries

Source: PISA 2006: Science Competencies for Tomorrow's World, OECD (2007).

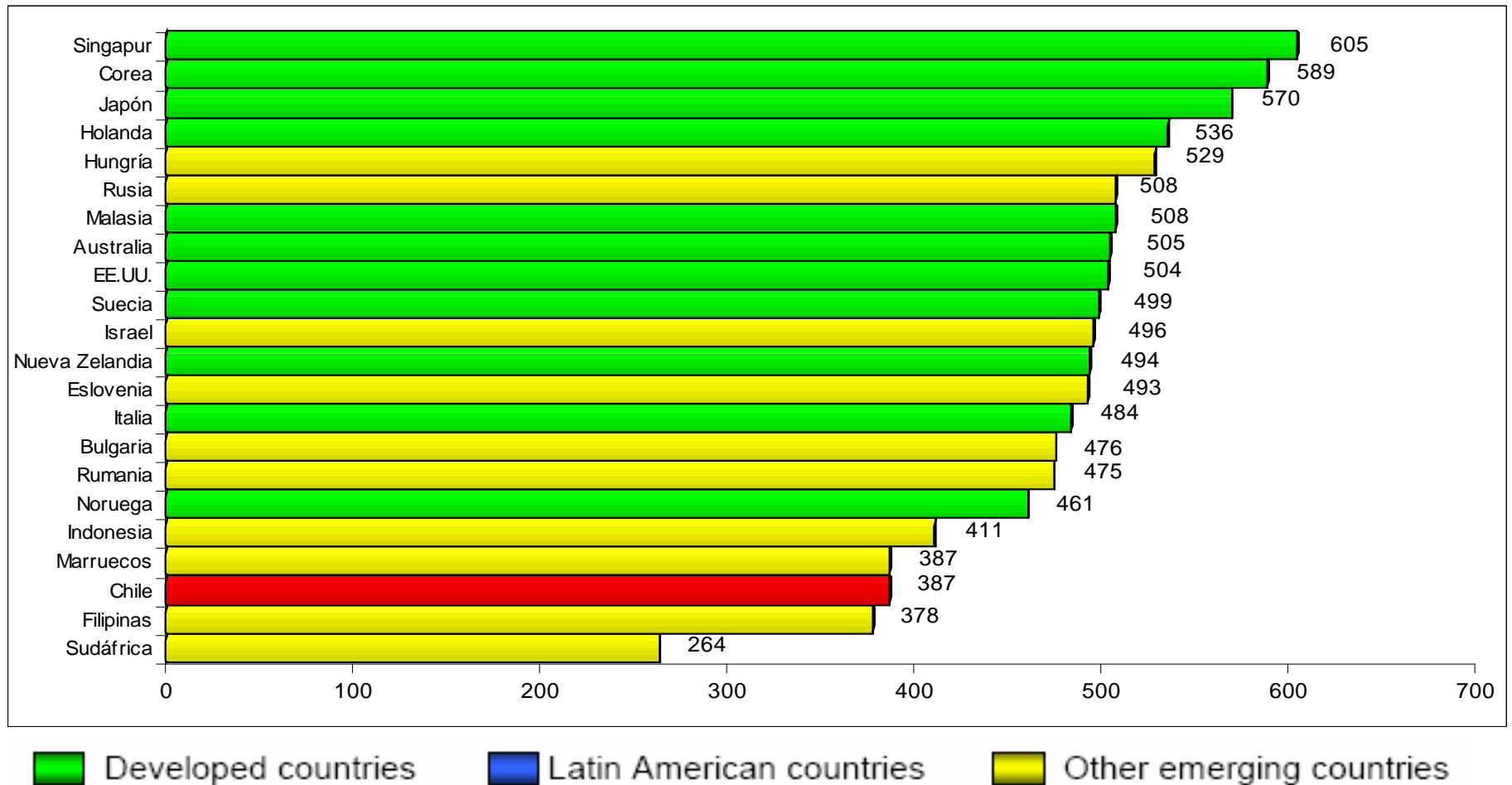
Mean Score of Student Performance in Mathematics



■ Developed countries ■ Latin American countries ■ Other emerging countries

Source: PISA 2006: Science Competencies for Tomorrow's World, OECD (2007).

Mean Score of Student Performance in Mathematics



Source: Highlights from the Trends in International Mathematics and Science Study (TIMSS) 2003.

Quality of Public Policies and Institutions

- ✓ The poor level of cognitive skills is a serious handicap, as these types of skills have powerful effects on individual earnings, on the distribution of income, and on economic growth. (Hanushek and Woessmann, 2008).
- ✓ All over Latin America, the education system lacks incentives to promote better student performance.

Quality of Public Policies and Institutions

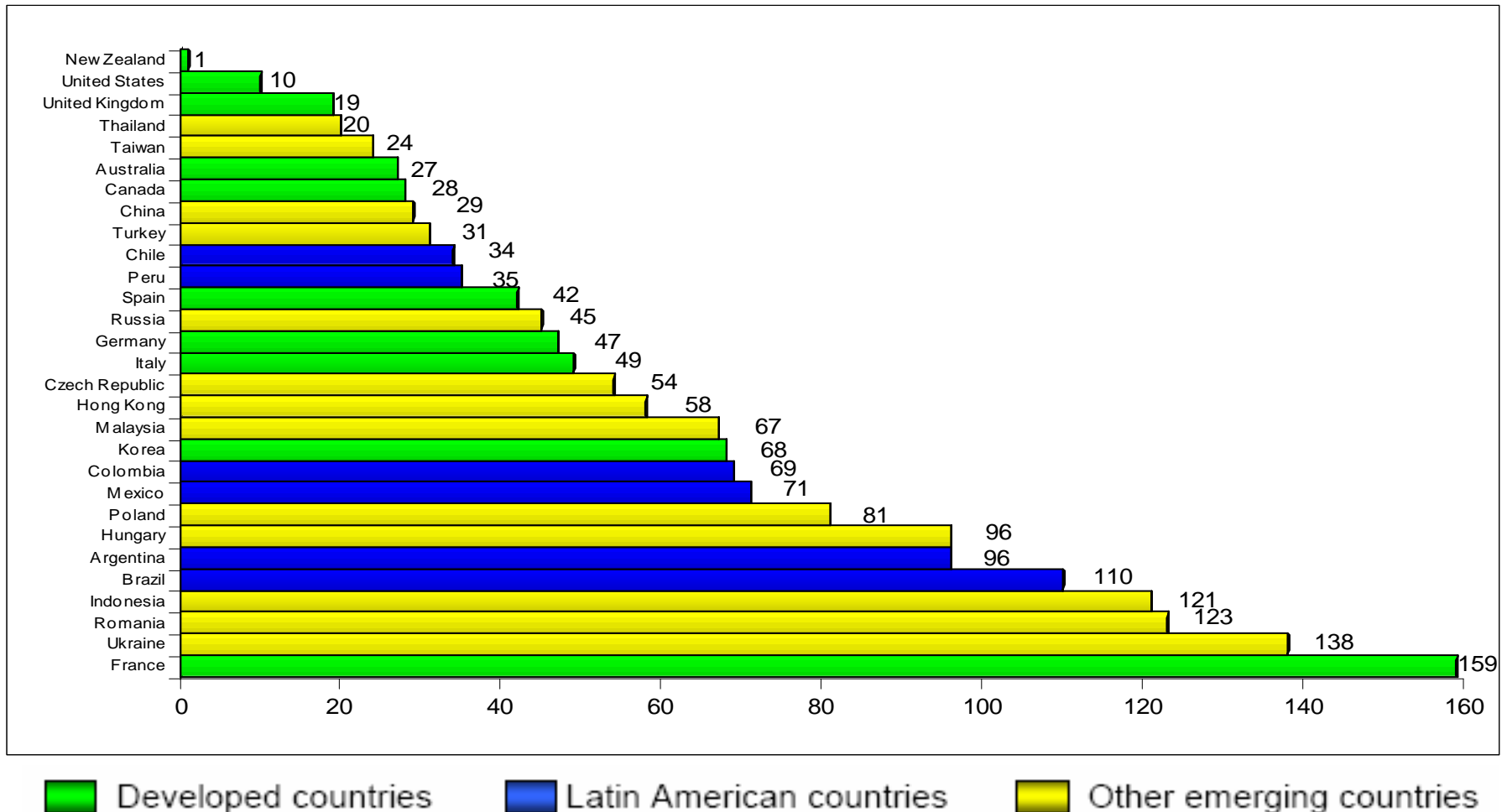
- ✓ Recent research (Hanushek and Woessmann, 2008) suggests that the best opportunities here are in:
 - ✓ improving accountability making public proper measures of student performance;
 - ✓ providing schools the autonomy to make educational choices of student material, teaching methods and the management of their resources (including teachers);
 - ✓ enhancing choice and competition among schools.

Quality of Public Policies and Institutions

- ✓ There are still important opportunities to improve policies and institutions that protect property rights, that affect the rule of law, and the efficiency of bankruptcy procedures.
- ✓ These factors play a central role in creating an enabling environment for business development, investment and growth.

Property Rights Protection

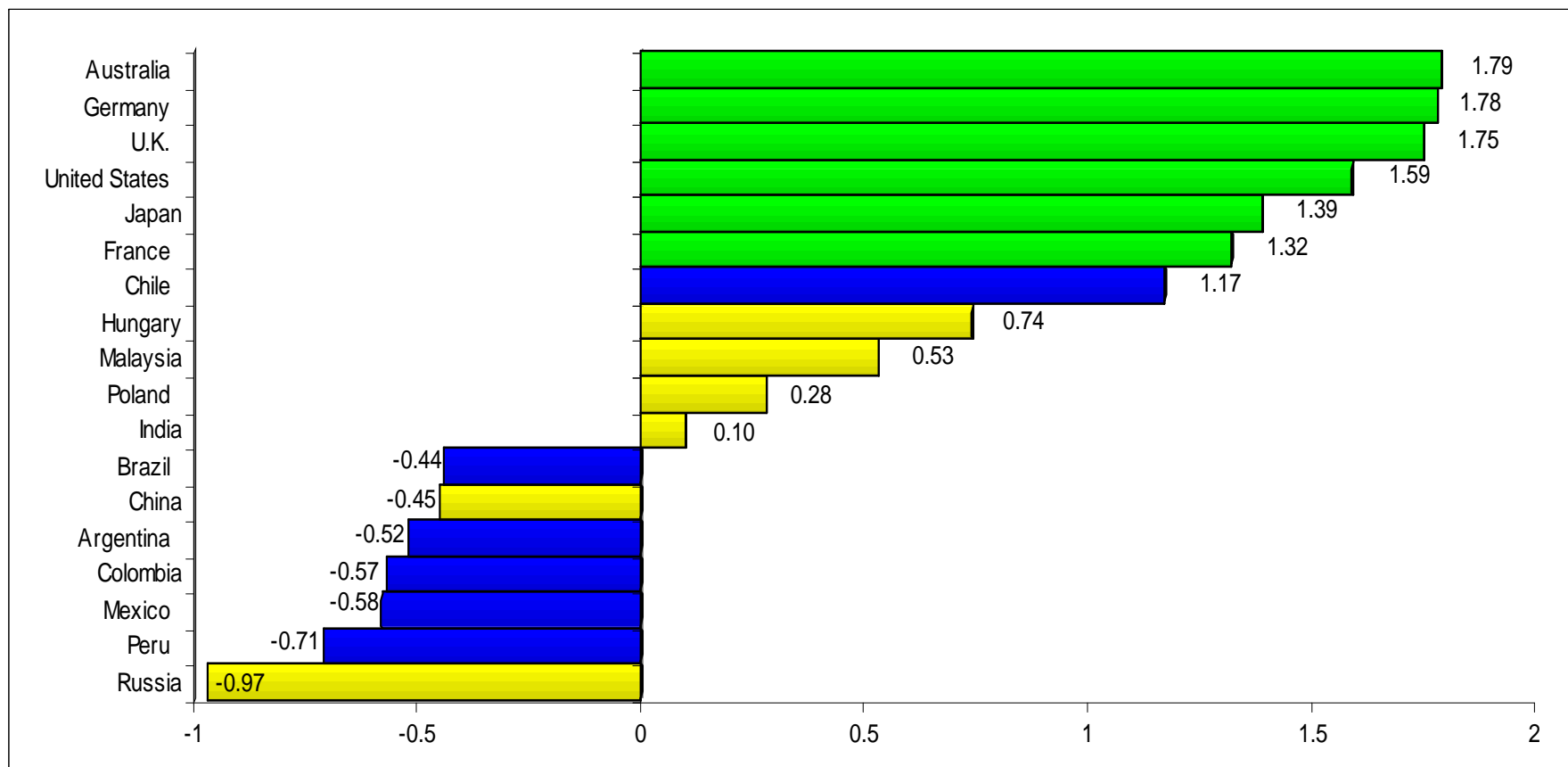
(ranking)



Source: Doing Business 2008, World Bank (2008).

Rule of Law

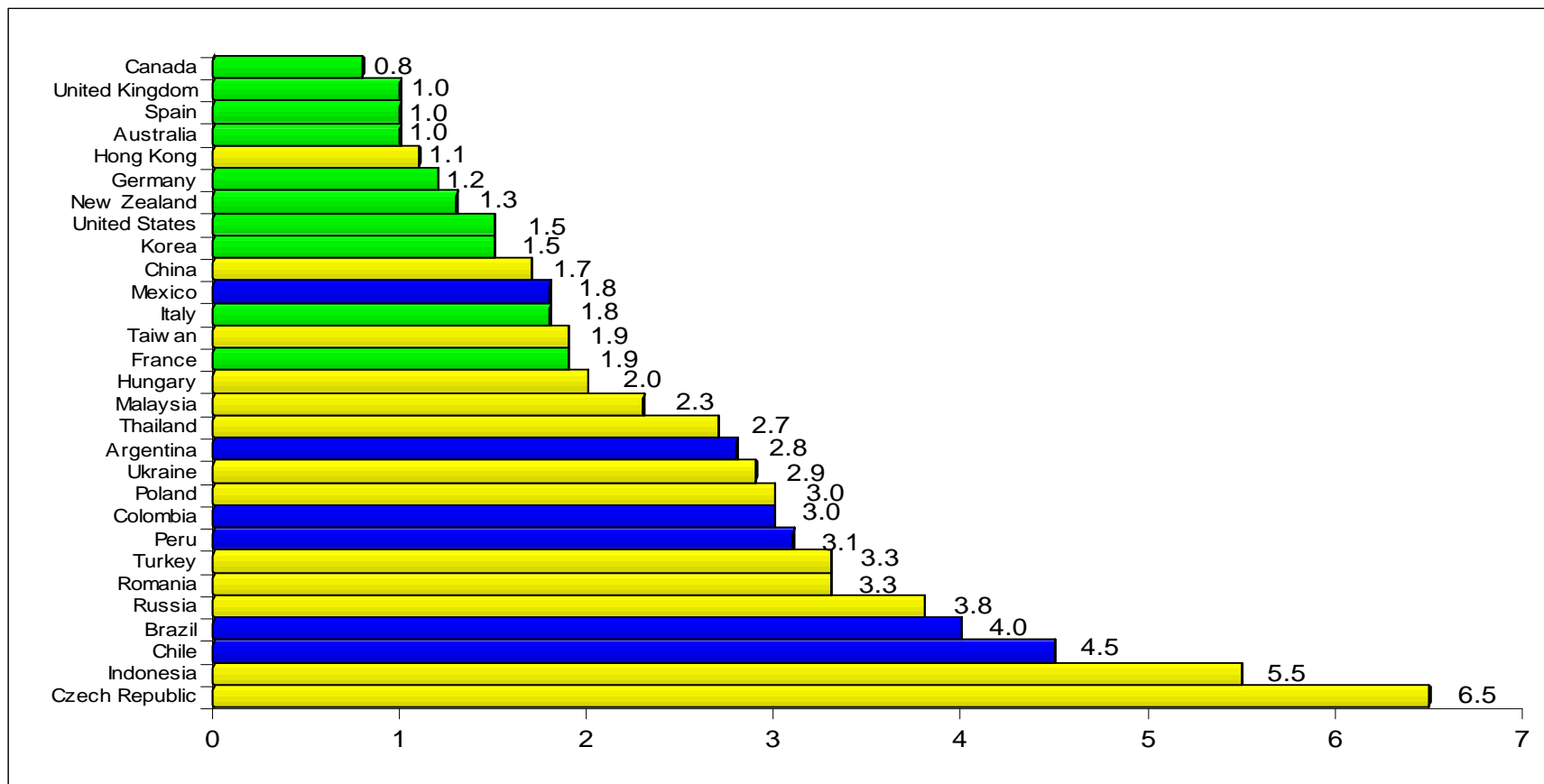
(Governance Score, (-2.5 to +2.5))



Developed countries Latin American countries Other emerging countries

Source: Kaufmann, Kraay, and Mastruzzi (2008). Governance Matters VII: Aggregate and Individual Governance Indicators 1996-2007. World Bank Policy Research Working Paper 4654.

Time to go through insolvency (years)

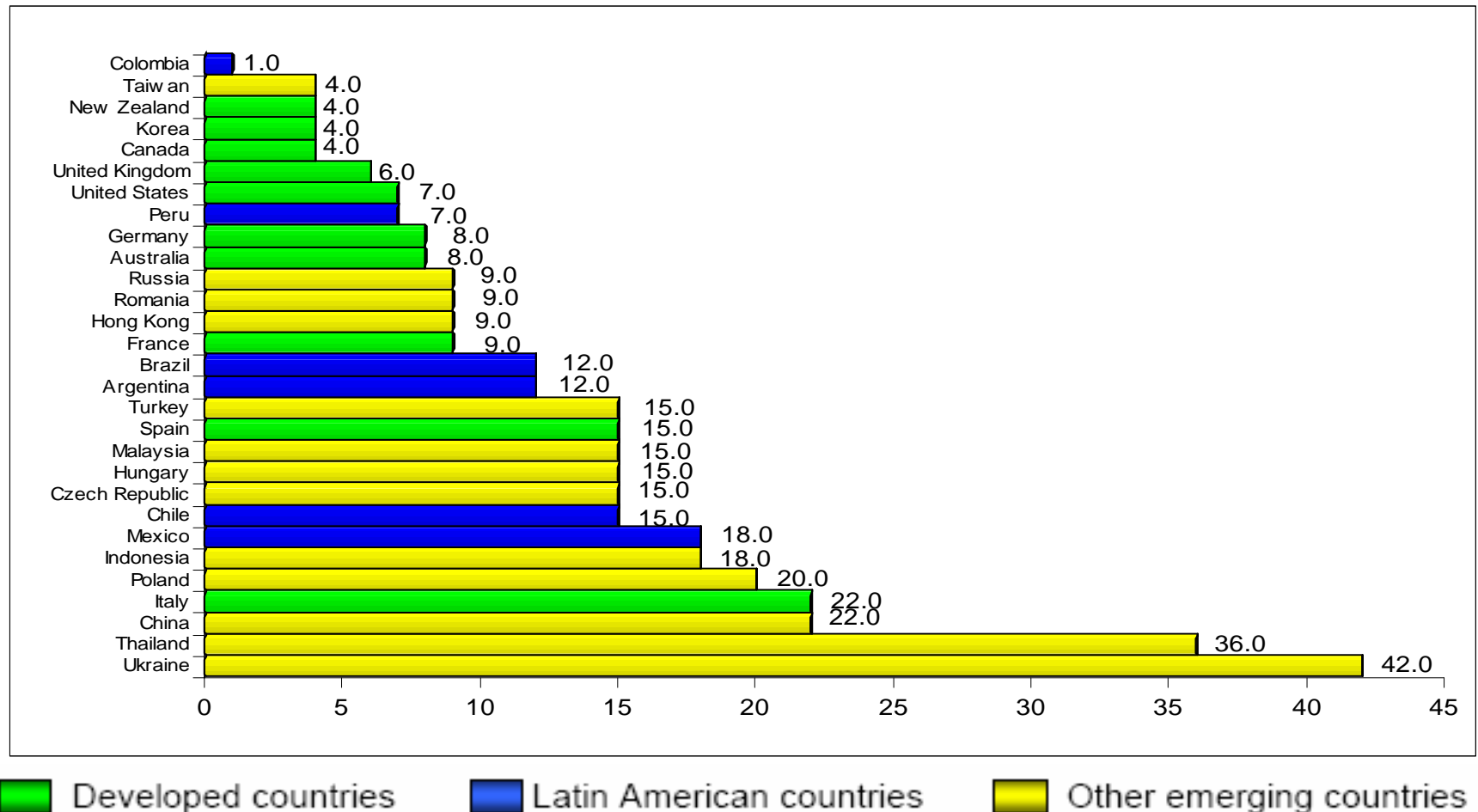


Developed countries Latin American countries Other emerging countries

Source: Doing Business 2008, World Bank (2008).

Cost of insolvency

(% of estate)



Source: Doing Business 2008, World Bank (2008).

Quality of Public Policies and Institutions

- ✓ Research and development and innovation policies suffer from the low human capital base and the low quality and low efficiency of public public policies and services in this area.

Final Remarks

Final Remarks

- ✓ Much progress has been achieved in opening up the Latin American economies to foreign competition and to achieve and maintain macroeconomic stability.
- ✓ But much it is still required to improve education, the quality of the state and the business environment.

Final Remarks

- ✓ Lack of progress in these areas could result in a frustration with macroeconomic responsibility and create the conditions for another round of populist policies.
- ✓ To make significant progress in these areas it is required to improve significantly the quality and independence of the public sector.
- ✓ Here there is much to learn from the experience of countries such as Australia, Canada, and New Zealand.

Latin America in the Global Economy: Challenges and Opportunities

Vittorio Corbo

November 18th, 2008