

# **New Perspectives of Development for Latin America: Critiques of the Past and Proposals for the Future**

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- 2004-13: good times for the region
- Recent years have not been so good
- In the 1990s, we could identify a few key policy mistakes
- Is there a corresponding set of mistakes in the last decade?

# Key insight I

- Common mistake: failure to diversify structure of production
  - The region still exports mostly commodities
  - High vulnerability to external shocks

# Key insight II

- Development strategy based on Chicago school insights was a total failure
- Development strategy of East Asian countries did work—in East Asia
  - Markedly different from the Chicago School/Washington Consensus policies
  - But it cannot be replicated in Latin America
- Development strategy for Latin America must ensure three conditions
  - Macro/external consistency
  - Innovation
  - Inclusion—including of the labor force

Satisfying the three conditions will require a diversified structure of production, with multiple strategies for multiple sectors

# Key insights III

- Government policies need to pursue even wider range of objectives, using a wide range of instruments
- We need to broaden our analysis to go beyond thinking about the role of the state vs. the role of the market
  - More complex interactions
  - More actors, more institutional arrangements

# 2004-2013

- Sharp reduction in indebtedness
- Accumulation of foreign exchange reserves
- Improvements in human development due to increases in Social Spending/GDP
- Improvements in labor markets
  - Regional unemployment fell from 11.3 percent in 2003 to 6.2 percent in 2013 (ECLAC)
  - Employment in the informal sector went from 48.3 percent of total employment in 2002 to 44 percent in 2014
  - The portion of the population aged 15 to 64 with jobs increased by 4.6 percentage points
- Improvements in income distribution in most countries
- Marked reduction in poverty and a rise of the middle class
  - Proportion of people living on incomes between \$10 and \$50 a day grew from 23 percent to 34 percent of the population
- Strengthening of democracies

# 2004-2013

- But also:
  - Labor market informality still predominated in many countries
  - And even with the improvements in inequality, Latin America continued to have the worst income distribution in the world
  - The increase in availability of education has not been followed by improvements in performance
    - As shown by the OECD's Program for International Student Assessment (PISA) tests
  - Good economic performance was not just a consequence of domestic policies, but also of good external conditions—conditions that have recently changed
  - Non-diversified structure of production
    - Highly vulnerable to external shocks
    - Not conducive to long term sustainable *good* economic performance

# Commodity Dependence and Lack of Export Diversification in Latin America, 2010



Source: IMF, Regional Economic Outlook, Oct 2011



# The current scenario

- Growth fell in 2014 to just 1.1 percent (with population growth of 1 percent)
- There are reasons to expect same performance in 2015 (ECLAC and IMF forecast similar growth rates)
- Investment also declined in 2014, and will continue to do so in 2015 (ECLAC)
- Poverty ratios have stagnated at the levels of 2012
- Unemployment is still low, but the proportion of the working-age population with jobs fell in 2014

# The current scenario

- Significant regional differences
  - South America grew 0.6 percent in 2014 compared with 2.5 percent in Mexico and Central America
  - Venezuela went into a severe recession in 2014
  - Argentina and Brazil are also doing worse—Brazil will probably experience a recession in 2015
  - Other South American countries have continued to grow but experienced a slowdown in 2014 (Chile, Ecuador, Peru, Uruguay) or are experiencing one in 2015 (Colombia)
  - Bolivia and Paraguay are the exceptions (continue growing at 4 percent)

# The current scenario

- The benefits of the positive terms of trade were particularly strong for energy and mineral-exporting economies (Venezuela, Chile, Bolivia, Peru, Colombia, and Ecuador), followed by the major agricultural exporters (Argentina and Brazil)
- In contrast, oil-importing countries were hurt, notably those in Central America and the Caribbean
- Fall in non-oil commodity prices since 2012 and in oil prices since second half of 2014 reversed the situation
  - The new losers are the energy and mineral-exporting economies, while Central American countries are the new winners
- The economic slowdown in China explains the end of the commodity boom

# Capacity for macro policies

- The region is less able than it was in 2008 and 2009 to manage adverse external shocks
  - Because of rising external imbalances (which in some cases led to falling foreign reserves) and in some cases rising inflation; in some countries the capacity for monetary policy is more limited than what it was then
- Most of the countries of the region have switched from running primary fiscal surpluses to deficits, which may limit capacity for expansionary fiscal policies

- Still low external debt ratios
  - Although there is more appetite for borrowing
    - Bond issues by Latin America have gone from \$3.5 bn a month in 2004–07 to \$9.6 bn in 2010–14—with still low costs of financing for countries that issued bonds in international private capital markets
- The few countries that lack access to global private capital markets (Argentina, Ecuador, and Venezuela) have had financing from China
- Some countries may (and probably will) be tempted to use debt to manage the deterioration of the economic situation

- The region overspent in the commodity boom
  - But not sufficiently in economic diversification
  - Recent depreciations of many of the region's currencies will contribute to reduce current account deficits
  - But in the short term, improvements in the current account will come primarily from lower imports, the result of the economic slowdown
- Need for **coordination** of real exchange rate policies

# The structure of production: The quest for diversification

- Region still highly dependent on commodities (as shown earlier in exports map)
  - But a healthy economic structure should not be so dependent on external factors
- Growing trade with China is not necessarily a blessing
  - China imports almost only natural-resource-based goods from Latin America
    - A structure that is not conducive to innovation
    - And that it does not incorporate much skilled labor (demand side)
    - Hence it doesn't incentivize citizens to invest in human capital (supply side)
  - Many countries were “lazy” to implement reforms that might create a more diversified structure of production

- The region needs to diversify its structure of production
  - Approaches that relied on the market, that were the rule in the 1980s and 1990s, did not work
  - We now have a better theoretical and empirical understandings of these failures
- Macro instrument: **Competitive and Stable Real Exchange Rate Policies**
- Must be accompanied by **industrial policies** and **public investments**
  - And monetary policies that don't stifle the real sector



- The long-term strategy must place technological change and learning at the center
  - It also needs to ensure macro consistency, which requires a balanced strategy that includes traditional activities that generate revenues in foreign currency; and to ensure full employment of the less skilled population

- It is necessary to diversify trade with China
- Need for better education as part of the strategy
  - The strategy needs to ensure there are no bottlenecks in the supply of well-trained workers
    - Requires active state interventions: Markets do not internalize spillovers
- Need for update of infrastructure: investment in highways, ports, and airports
- Public-private partnerships should be designed to ensure an adequate distribution of risks

- The right strategy is more than just increasing exports
- Poverty reduction and a larger middle class will increase the size of domestic markets
  - Especially important in a development strategy in which domestic demand must play a key role
  - Full employment is the most important part of the strategy
  - Rewriting the rules of the market economy is also critical

- Need for better regional integration
  - North-South agreements often entail rewriting the rules in ways which will lead to more inequality, exclusion, and poor economic performance
  - It requires more political integration

# Conclusions

- Need for strengthening a more active role of the state
  - Arguments for exchange rate management and industrial policies
- Need for better state policies
  - Involving more actors and better institutional arrangements
- Need for regional cooperation and coordination

# Conclusions

- Markets do not work in a vacuum
  - They are structured by norms, laws, and regulations
- Markets on their own are neither efficient nor stable
- Unfettered markets do not lead to shared prosperity
  - Markets do not generate either a socially desirable distribution or one that maximizes economic performance

# Conclusions

- Government is an essential actor of the development process
  - And a central part of development policy is improving the performance of the public sector
- The most successful countries had a developmental state

# Conclusions

- There is some urgency to rethinking development strategies
- The strategies of the past with their ambiguous success record are likely to be unambiguously unsuccessful