
Growth and Trade in Latin America: Issues and Prospects

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*Office of the Chief Economist
Latin America & the Caribbean
The World Bank*

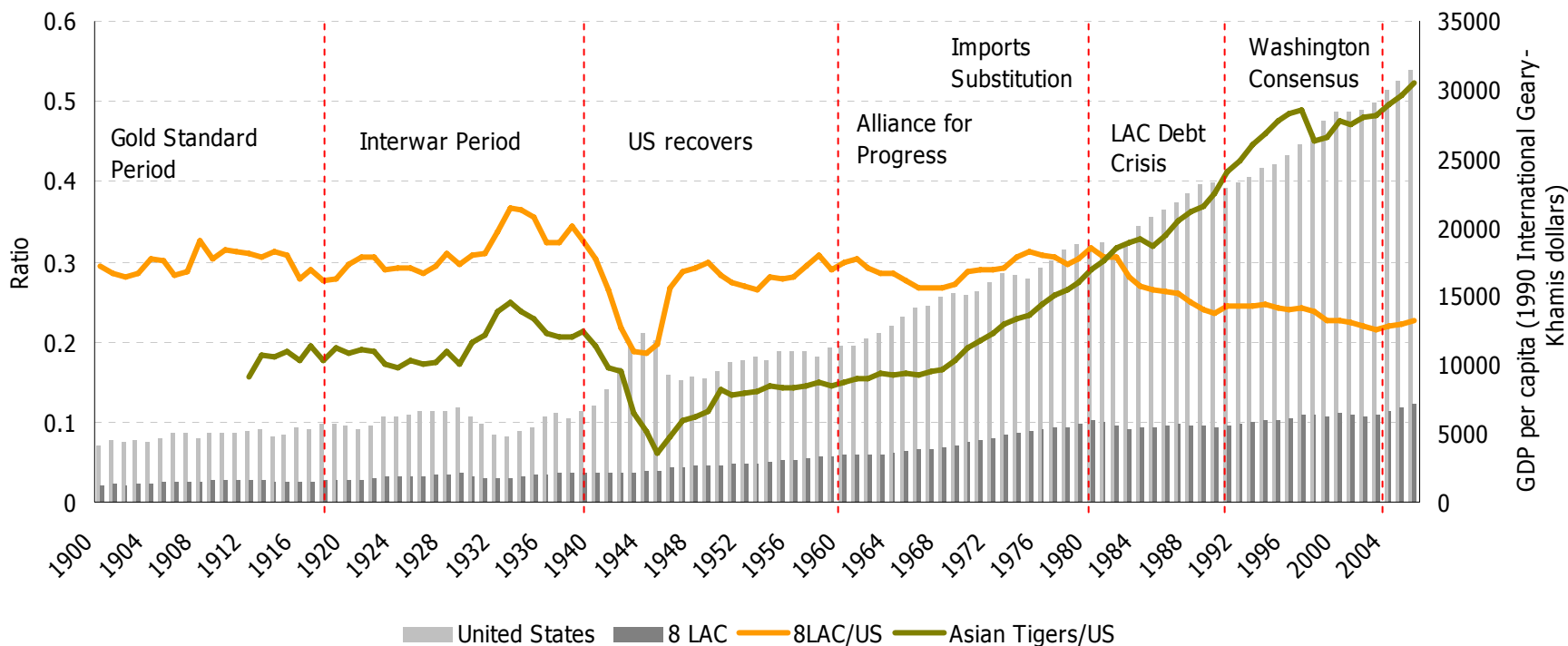
Structure of presentation

- Trade has not been as strong an engine of growth in Latin America as in the vibrant Asian economies
 - Historical and comparative trends in Latin growth and trade
- Can Latin America move to a higher growth path? ...
 - LAC's reduced macro vulnerability helps, but is not enough
 - Low-wage based export growth? – Not a realistic option
 - Natural resources? – Neither “curse” nor “destiny”
 - Productivity-based export-led growth? – The enduring route
- ... If so, what would it take?

Latin American growth and trade: historical and comparative trends

Average per capita income in Latin America has not been on a “converging” trend

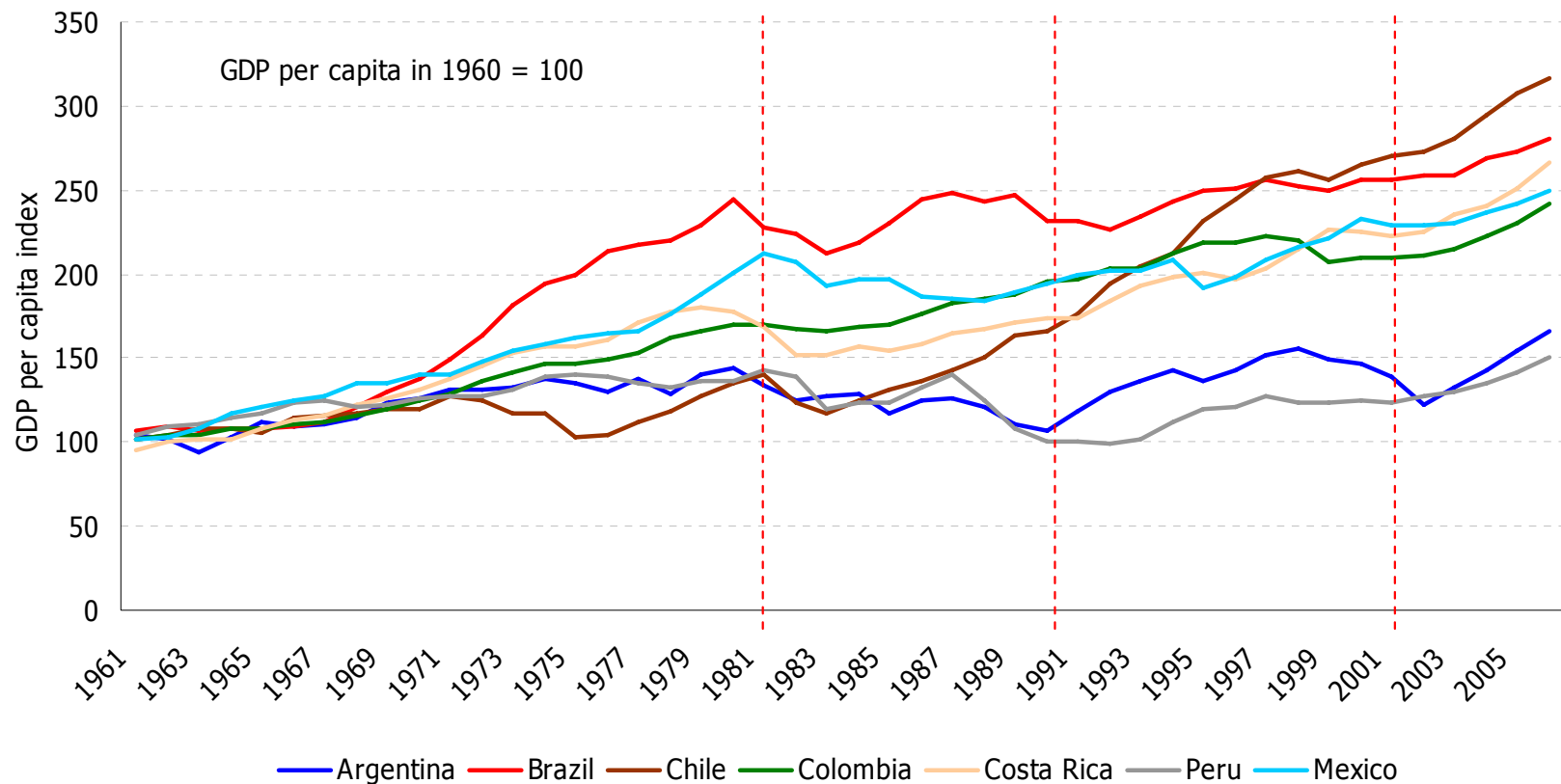
GDP per capita: LAC/US



Source: Angus Maddison Historical Statistics for the World Economy. The unit is 1990 International Geary-Khamis dollars

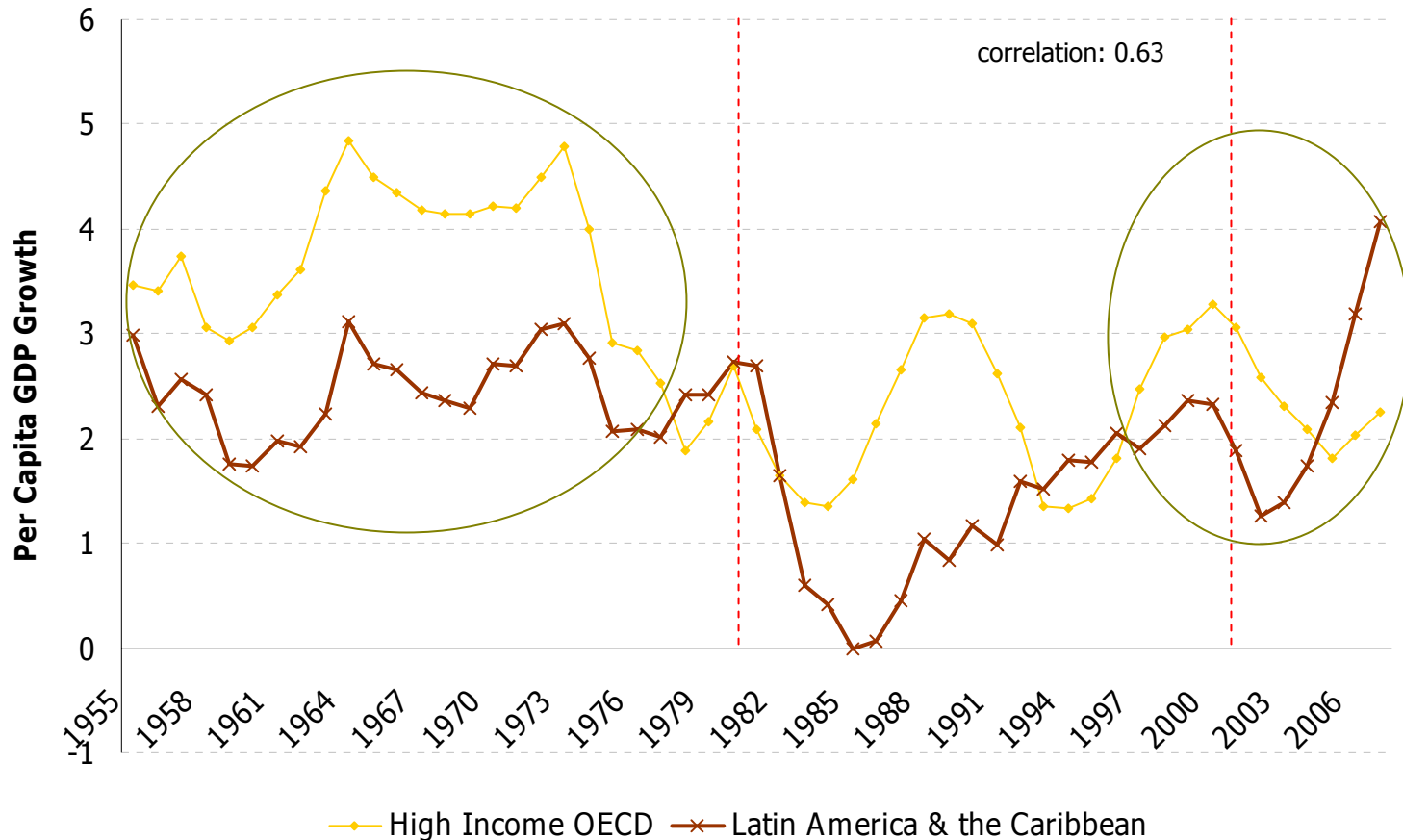
Note: The aggregated GDP per capita is a simple average of the countries in the region. GDP per capita for the United States and Latin America are in levels. 8 LAC: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela; Asian Tigers: Hong Kong (China), Indonesia, Malaysia, Singapore, South Korea, Taiwan (China), Thailand. Before 1950, the Asian Tigers sample varies. From 1950 on, Asian Tigers comprise all the seven countries.

But growth performance since 1960 has varied significantly across Latin countries



Source: WDI GDP per capita (constant 2000 US\$)

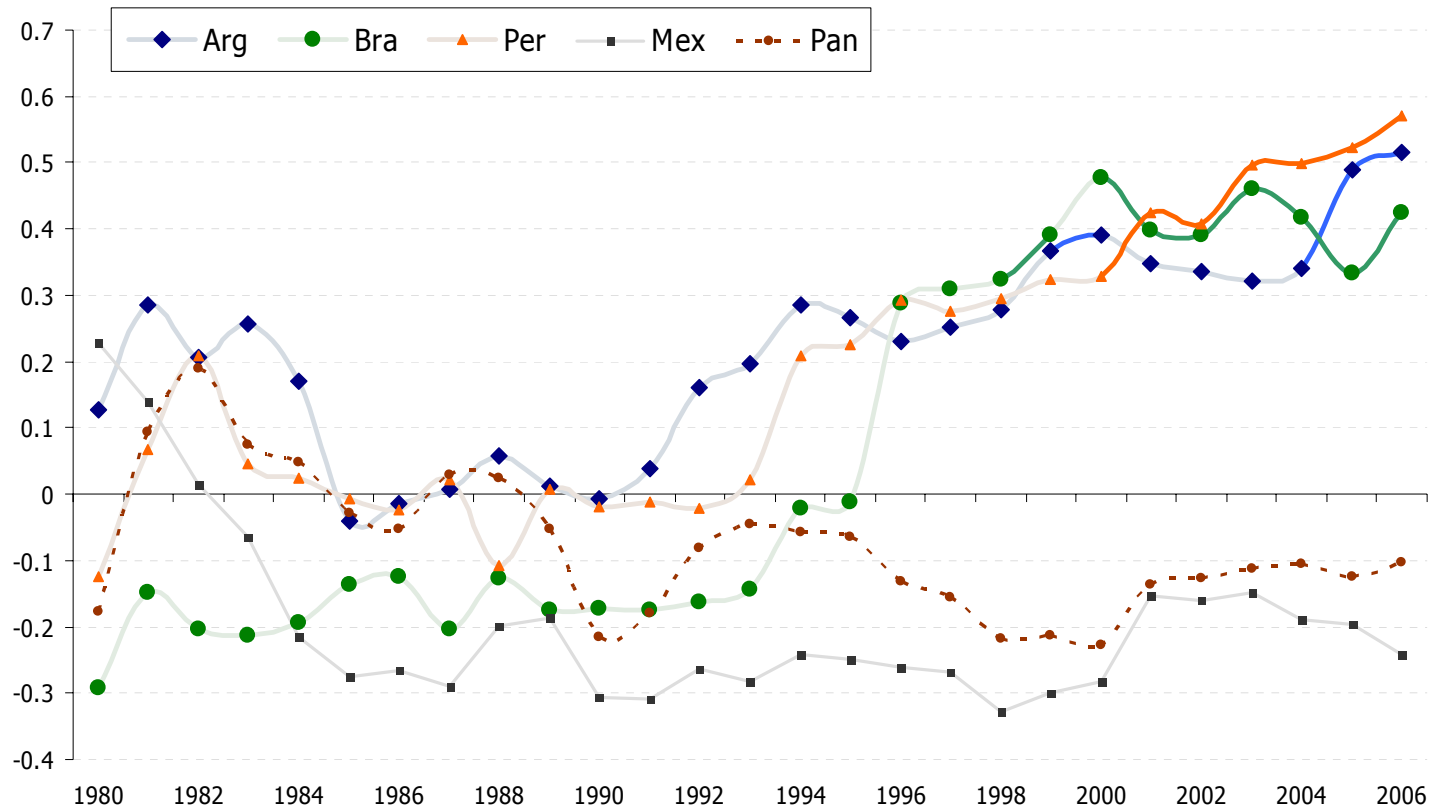
Except for the “lost decade,” Latin growth has been linked to growth in advanced economies



Note: The graph is a five-year moving average of the two series. High-Income OECD is Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, South Korea, Luxemburg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and United States. The aggregated growth is a simple average of the GDP per capita growth of the countries in the region. GDP per capita is PPP adjusted from Penn World Tables. From 2004 on, the data is from International Monetary Fund, World Economic Outlook Database 2007

Although China matters increasingly for growth in Latin America...

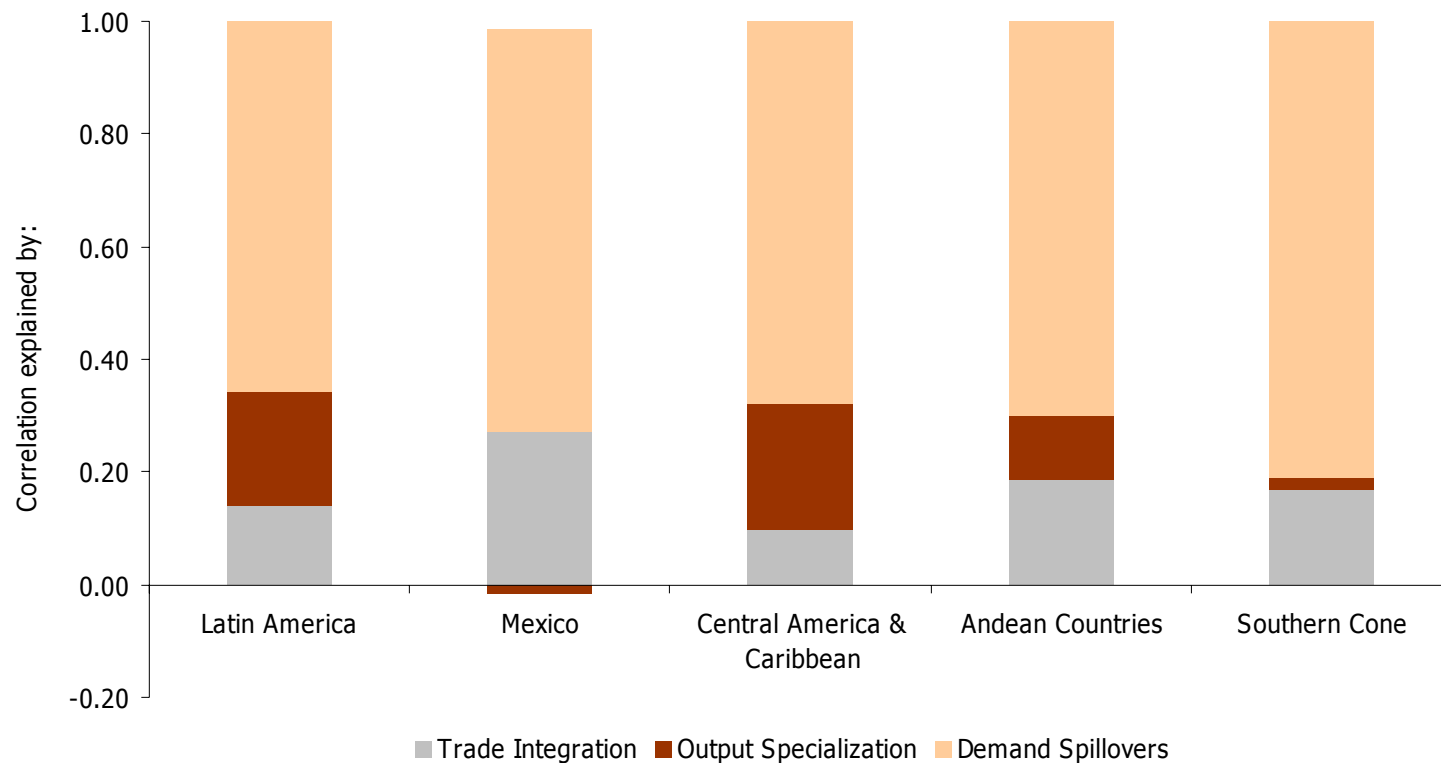
Output Co-Movement between LAC and China
20 years rolling correlation of the Real GDP growth



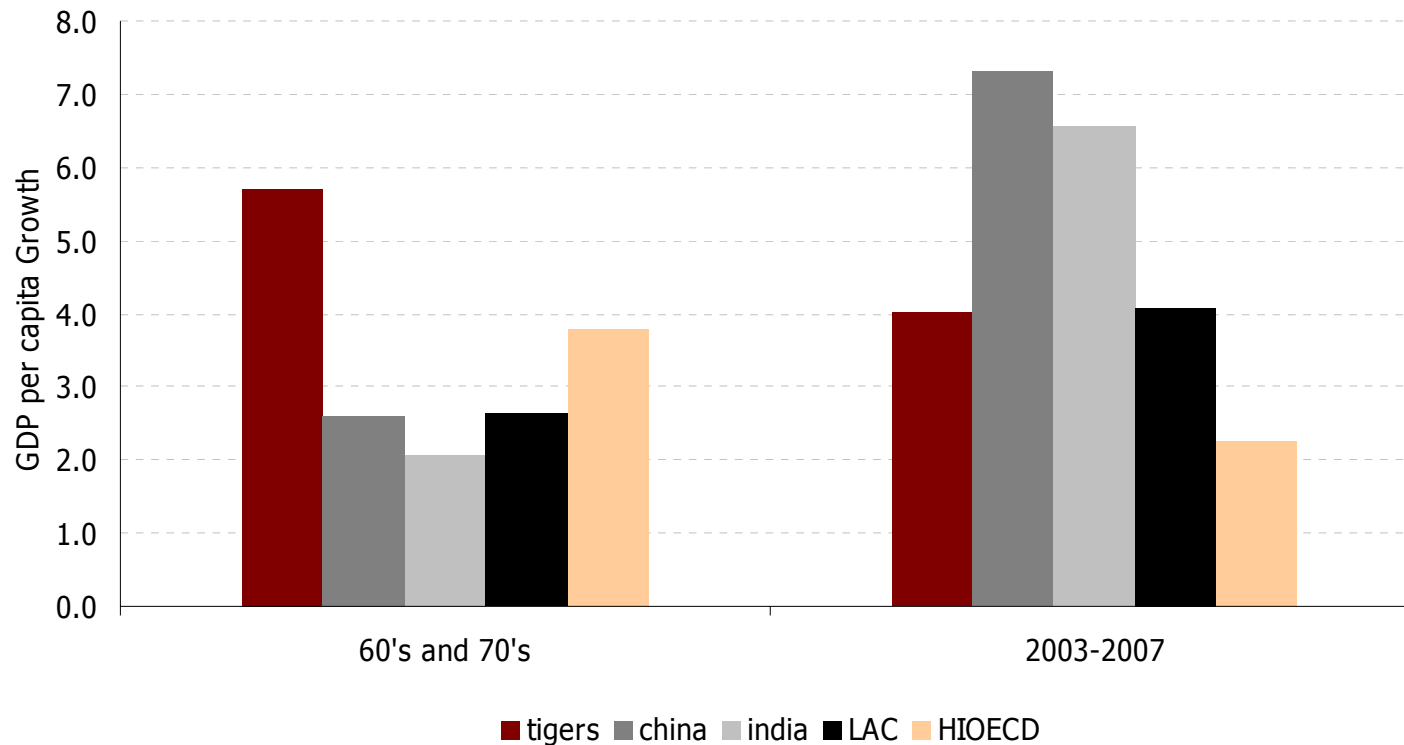
Note: Solid line colors reflect correlation values that are statistically significant at a 10% confidence interval.

The “China effect” on Latin America seems to be working mainly through demand spillovers

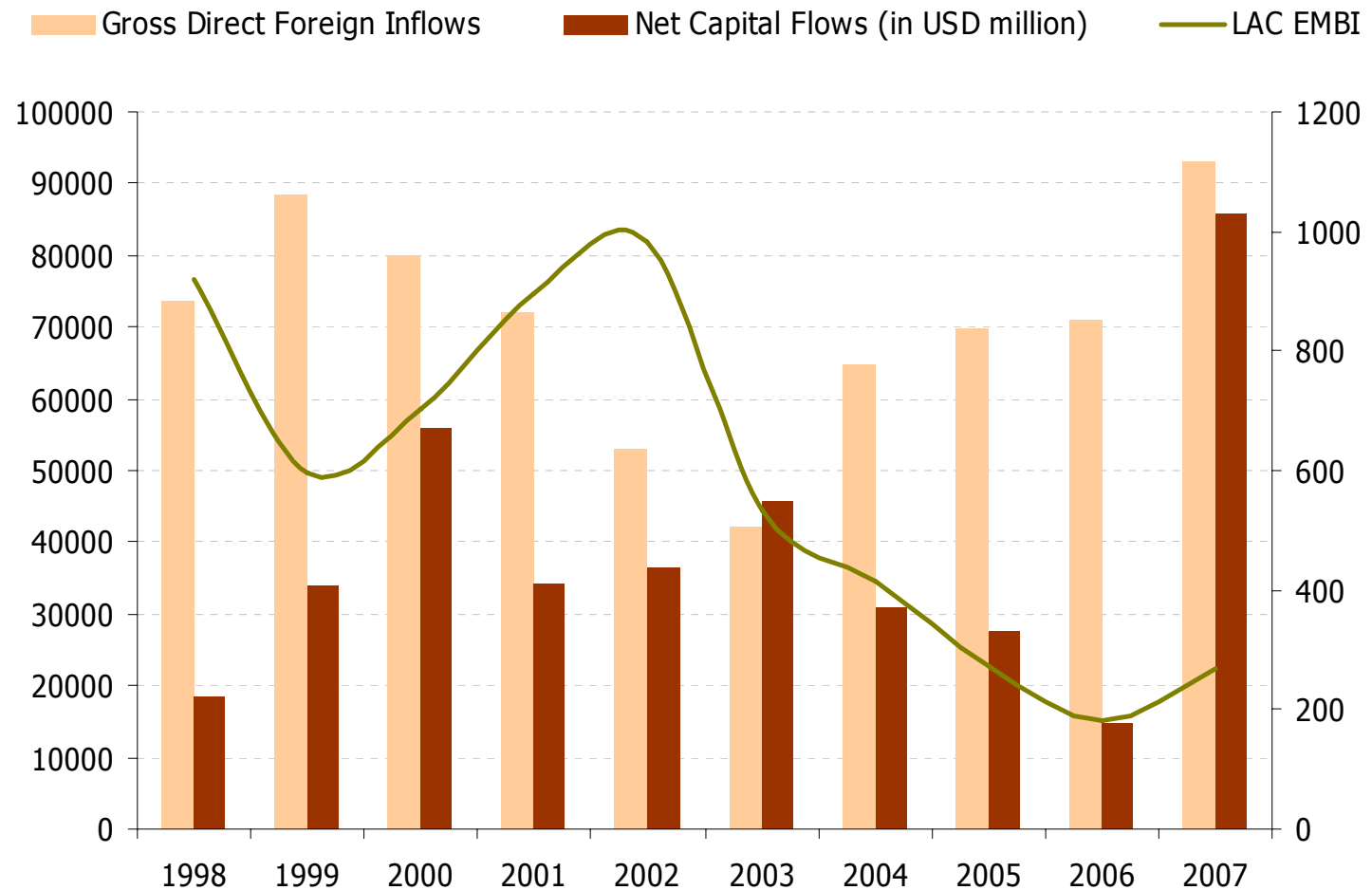
Explaining the rising correlation between LAC and China



The recent pace of growth in Latin America has been the best in decades...



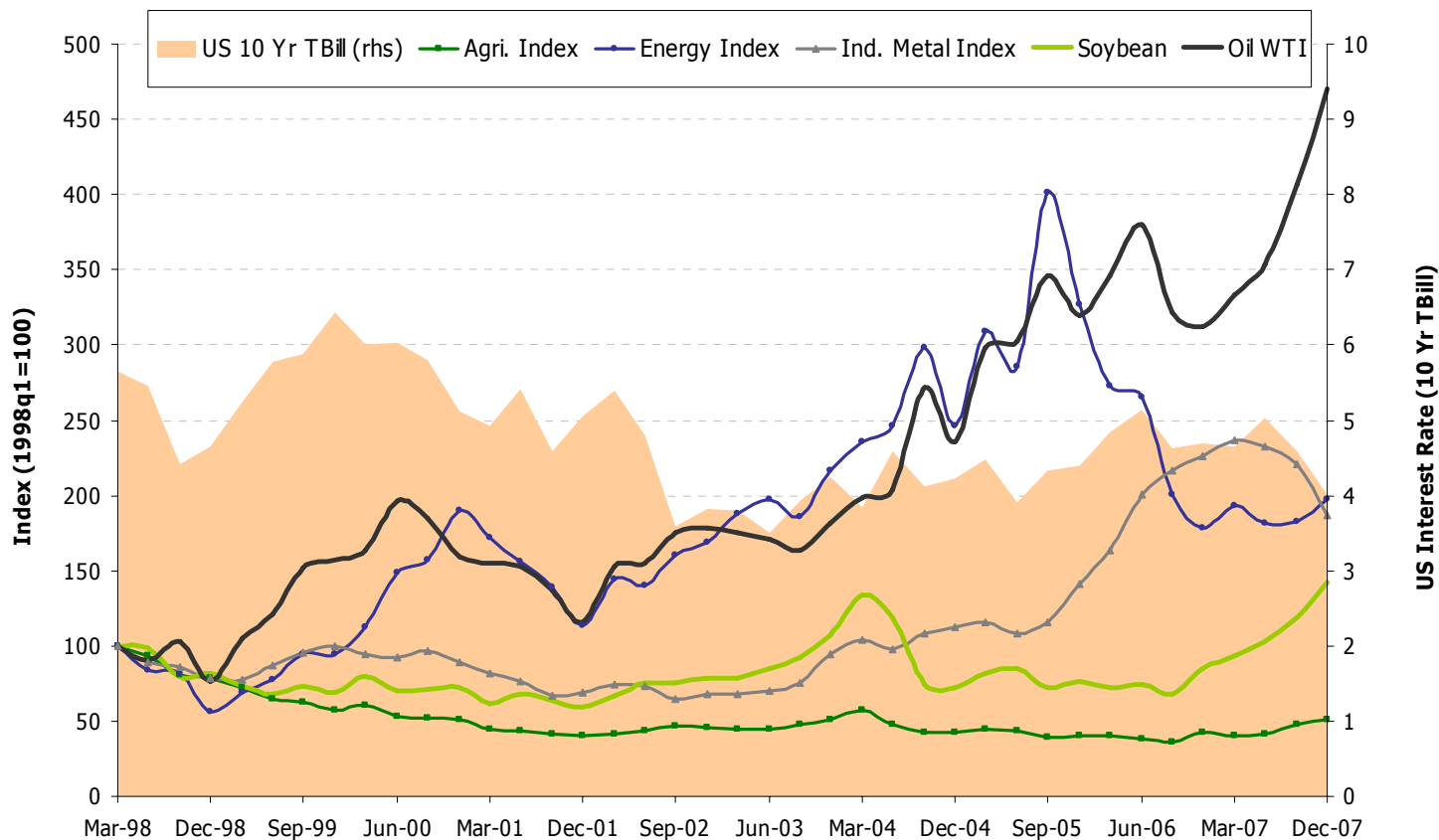
It has been aided by a benign external environment



Note: Capital Flows from IFS - IMF. LAC EMBI Spread is from Bloomberg - JP Morgan

... aided by a benign external environment

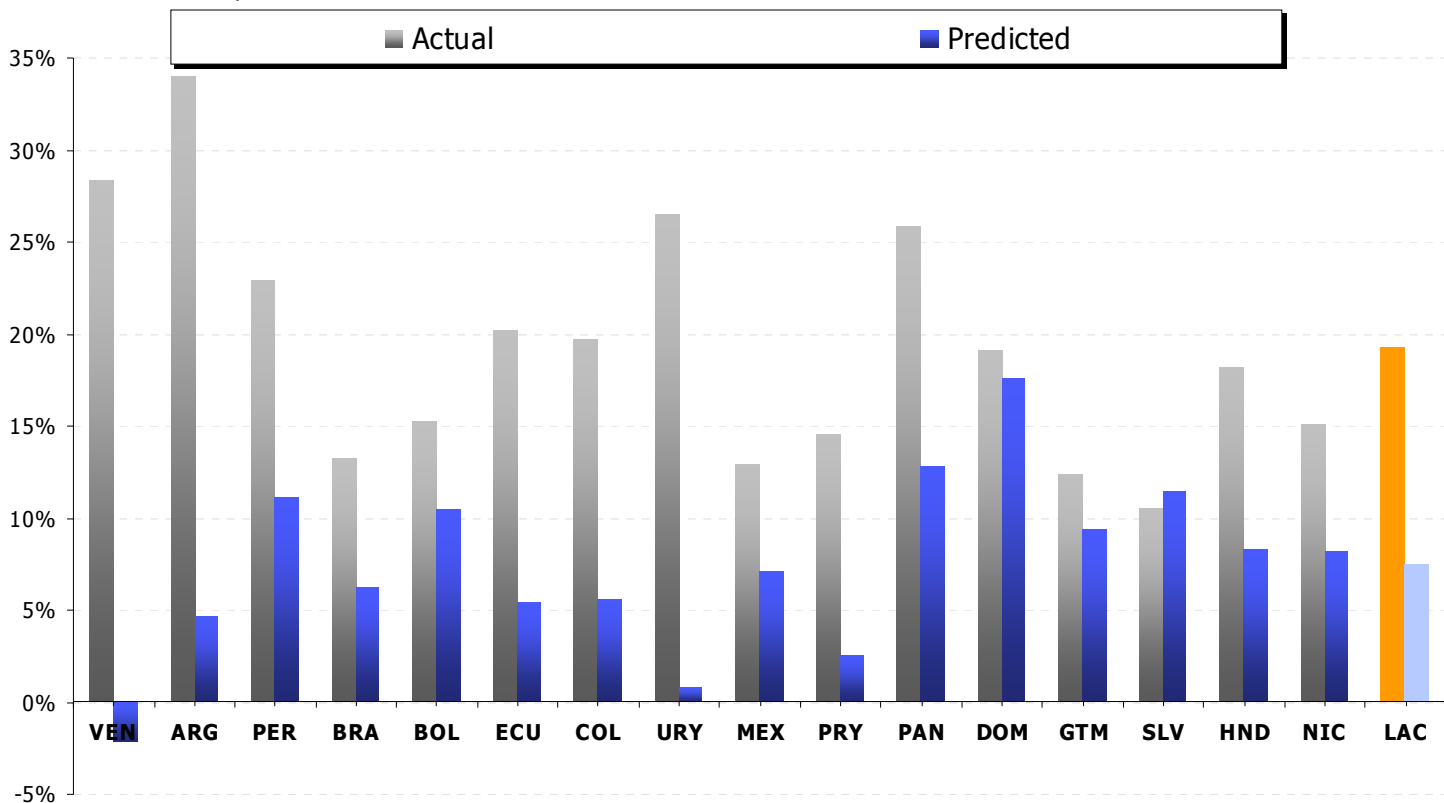
External Conditions for LAC
Real Commodity Prices



In fact, much of Latin America's recent growth is attributable to favorable external factors

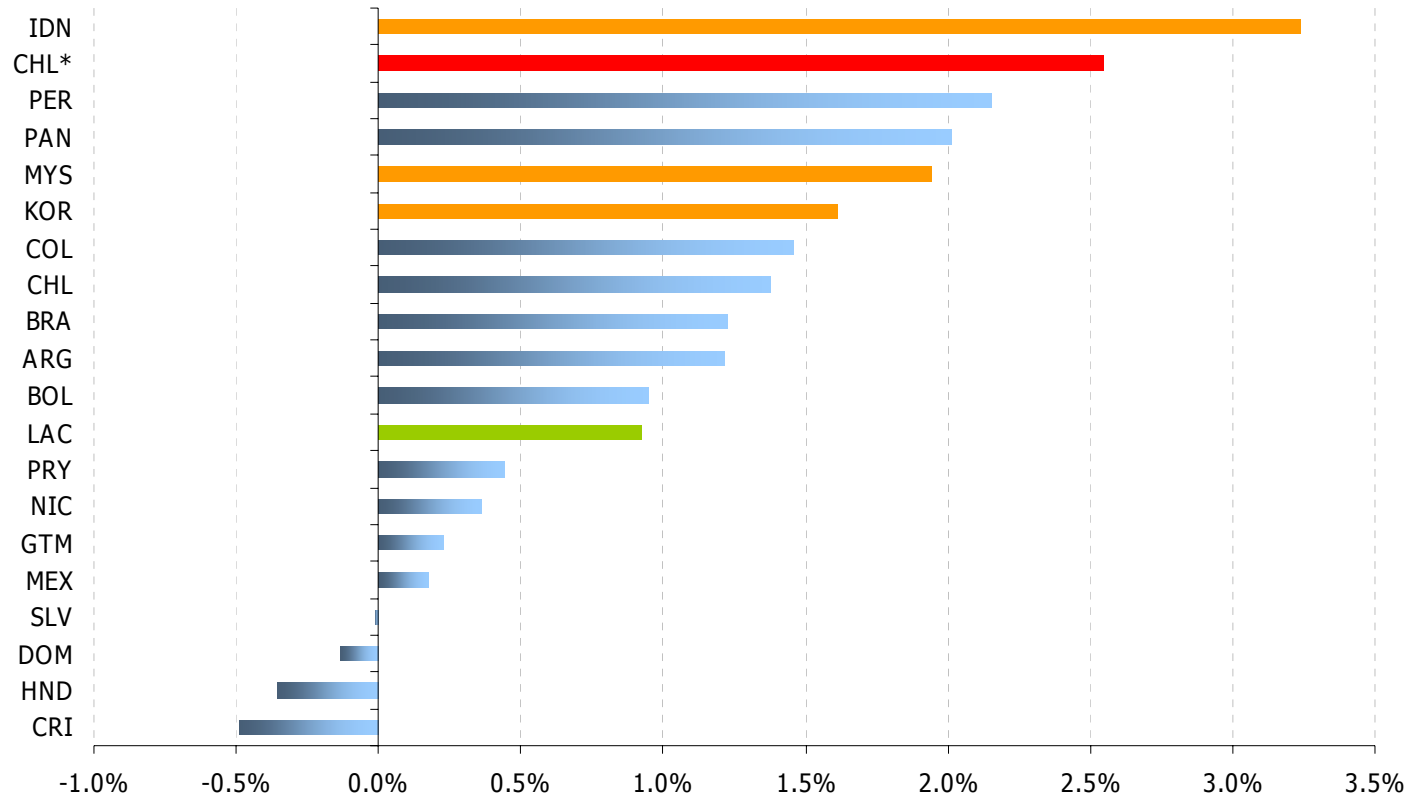
- Growth estimates assuming external factors had remained constant at 2002 levels

Long Run Cumulative Growth- Actual and Predicted
% variation 2002/06



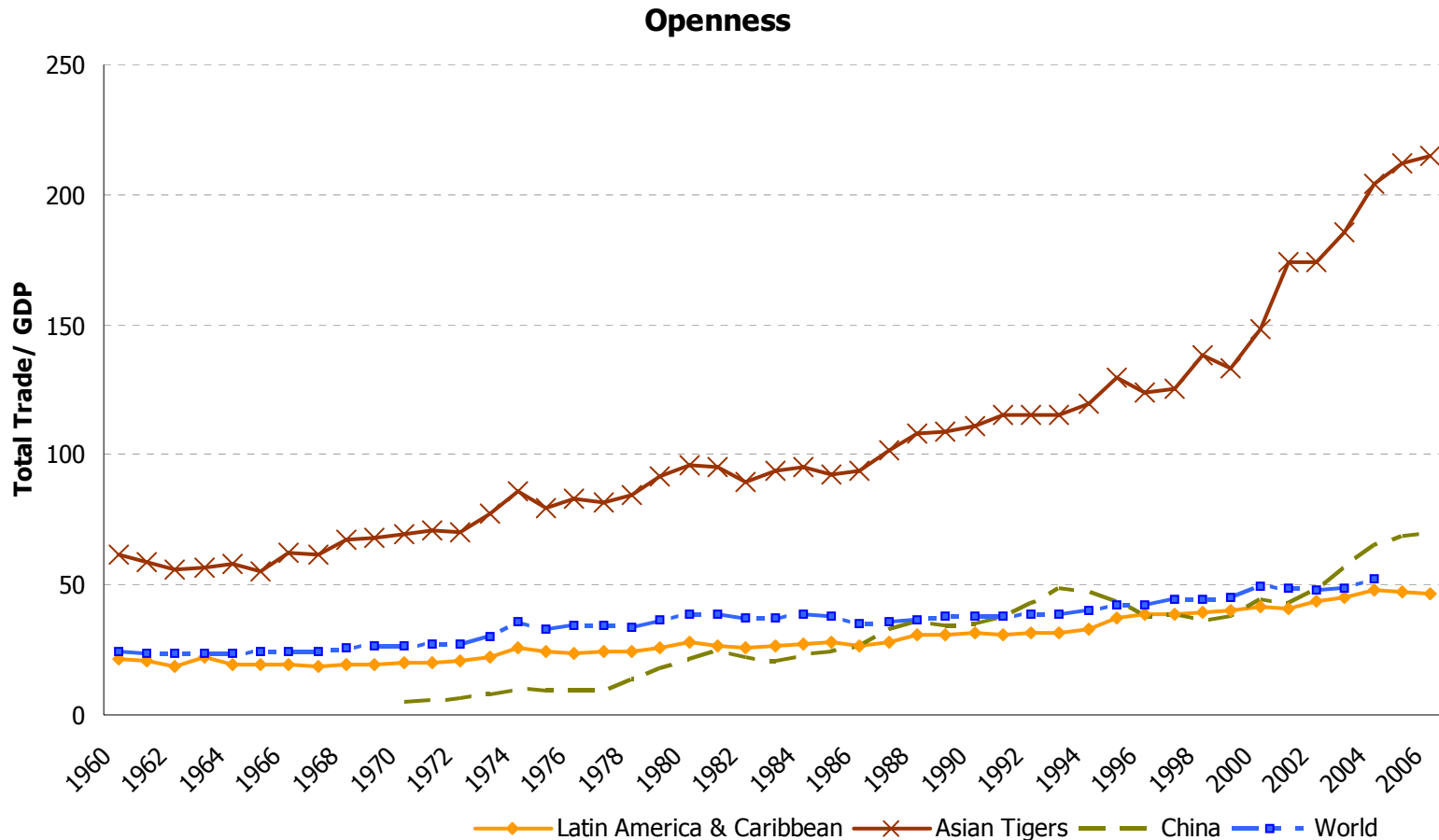
Comparatively, Latin countries have not fully capitalized on the benign global environment

Productivity Growth
average of productivity growth for 2001-2006



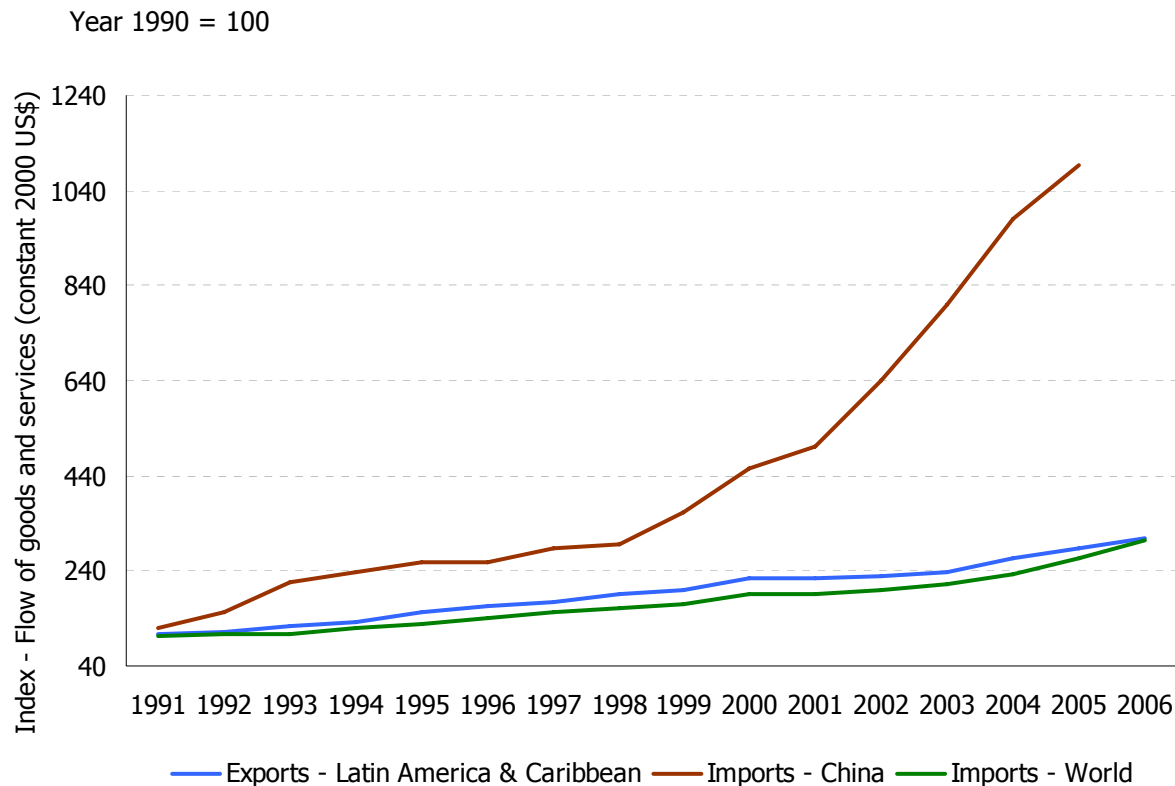
Source: Summers, Heston: WDI. *Chile average : 1991-2000

Latin American trade openness has increased modestly by int'l comparison since 1960



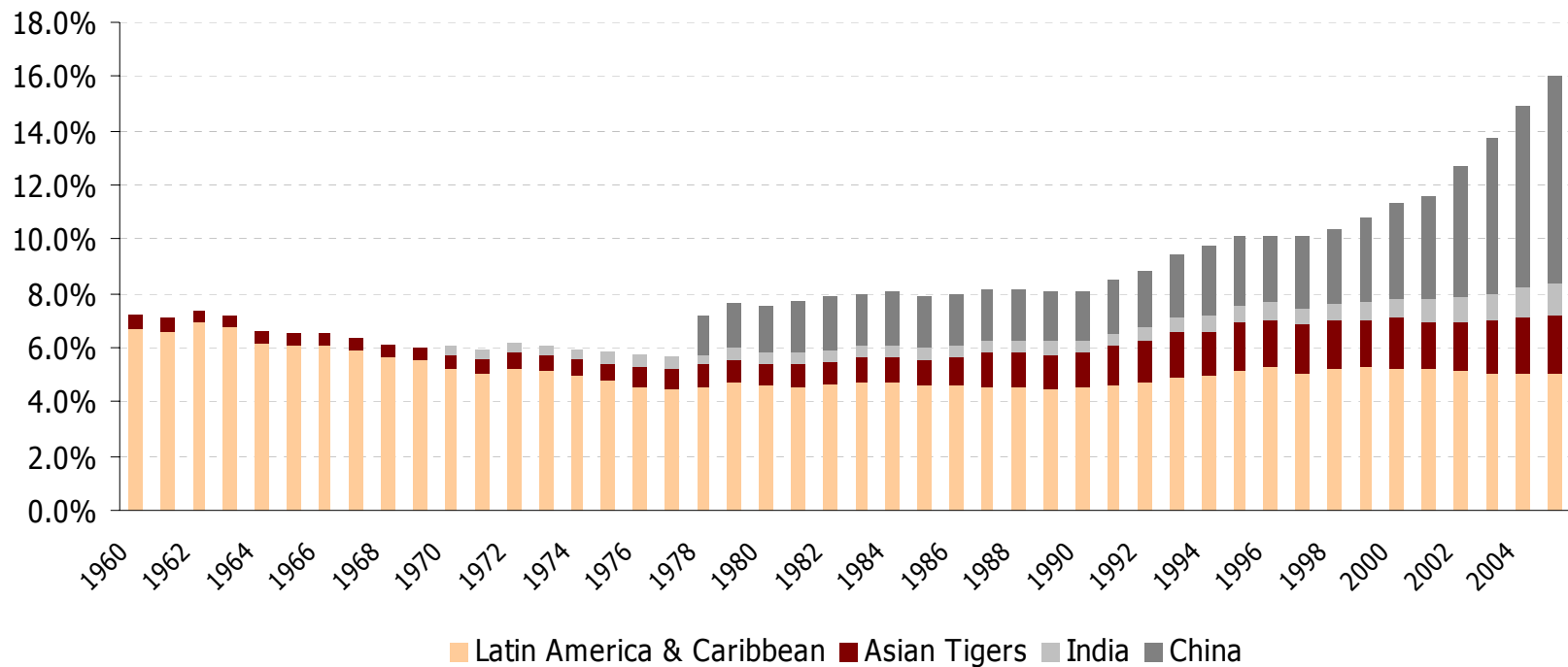
Note: Imports and Exports of Goods and Services over GDP from WDI. Asian Tigers: Hong Kong (China), Indonesia, Malaysia, Singapore, South Korea, Taiwan (China), Thailand. Before 2000, there is no data for Singapore.

Latin exports have risen with world imports, but lagged much behind China's imports



Hence, Latin America has not augmented its share in global trade

Share of World's Exports



Trade opening policies alone do not guarantee lasting growth. Yet there is no growth for LAC without trade.

Can Latin America trade *and* achieve a higher growth path?

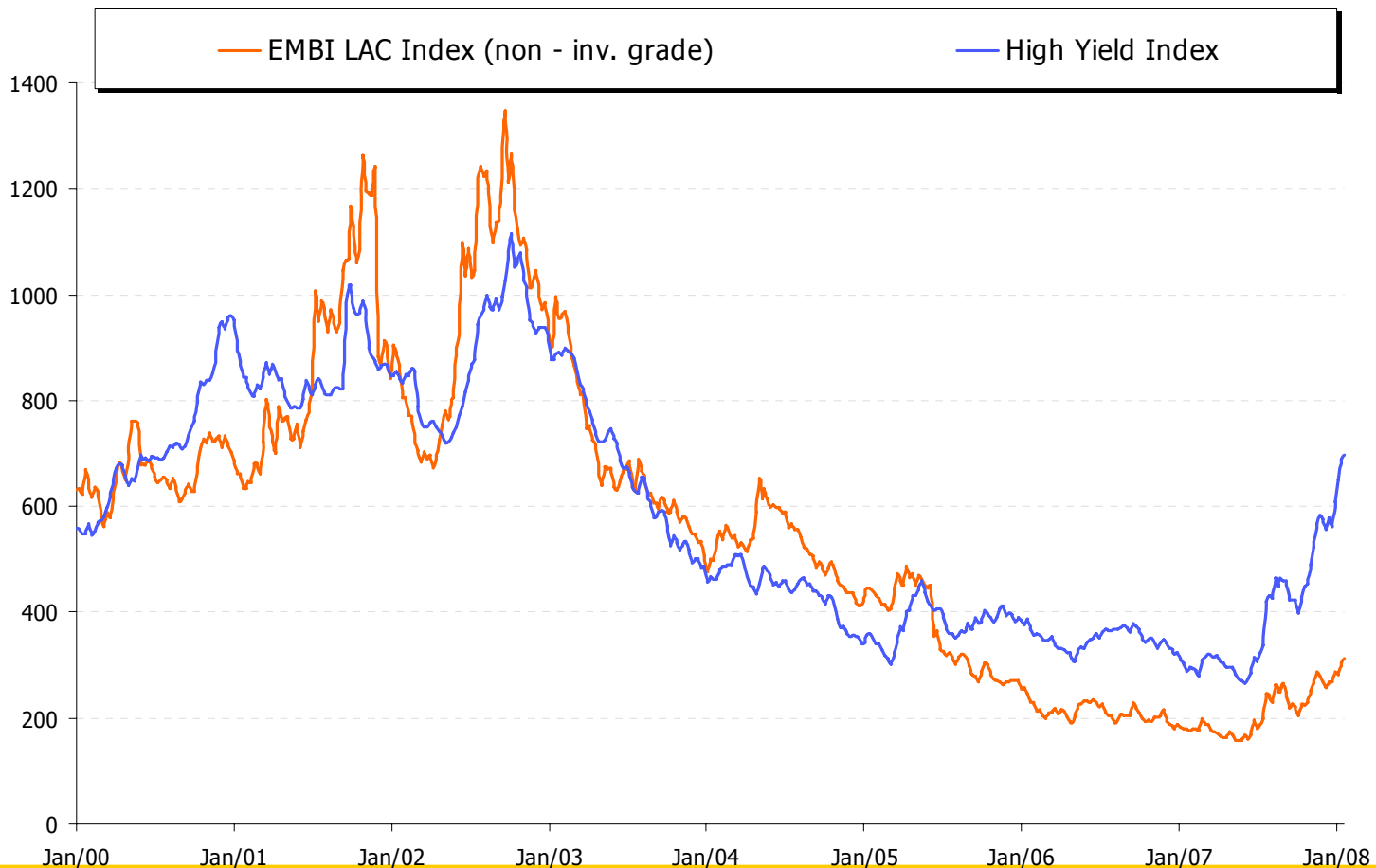
LAC is less vulnerable than in the past, which is necessary for sustained growth...

- A stronger immune system...
 - Substantial FX liquidity buffers
 - Stronger fiscal & external balances
 - More robust monetary policy frameworks
 - Less rollover & e-rate risks in government debt
 - → Much lower borrowing requirements
- ...has lowered Latin America's *beta*, on average

Latin America has become less vulnerable

Exhibit 1

Latin EMBI spreads on a declining trend, now lower & less volatile than U.S. high-yield



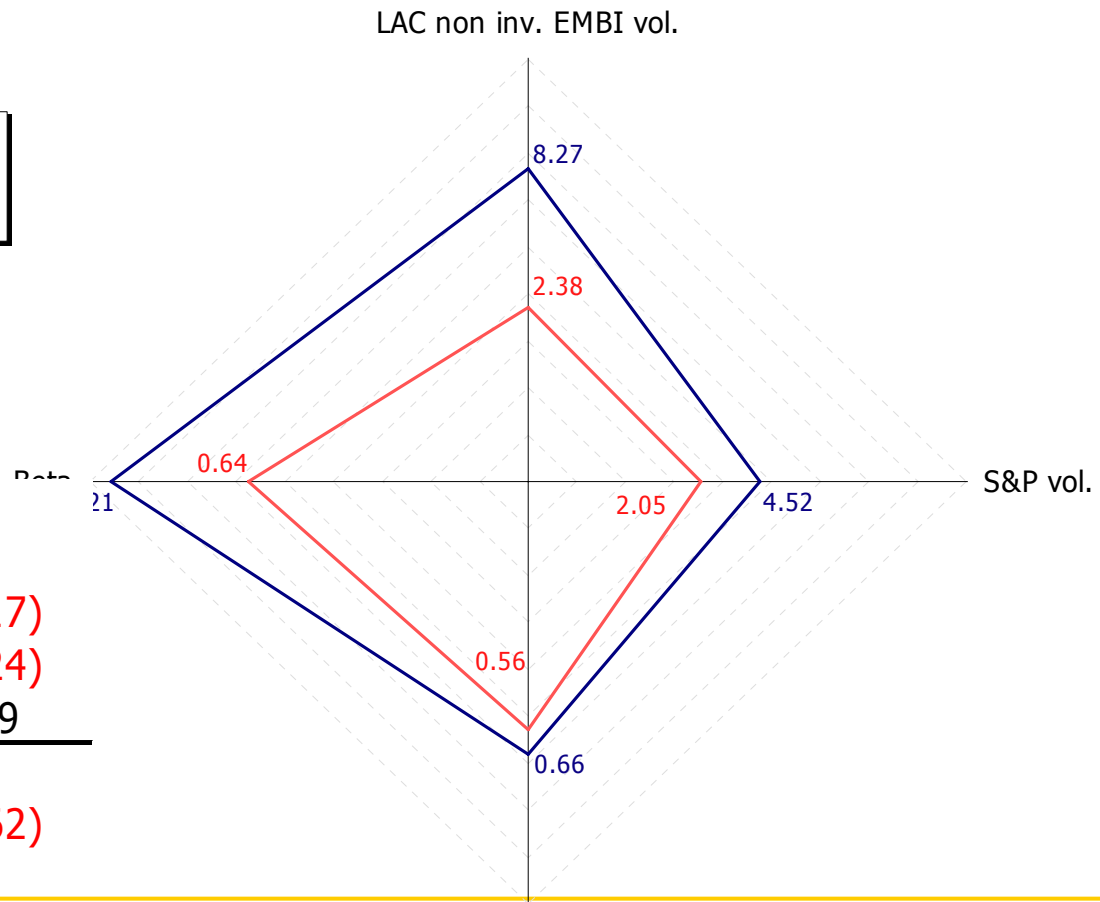
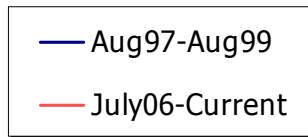
Source: Bloomberg - Credit Suisse High Yield Index, JP Morgan EMBI Global, EMBI Index Vol. = 4 month rolling (St. Dev. / mean)

Latin America has become less vulnerable

Exhibit 2

Latin America, as an asset class, has become relatively less risky

Beta decomposition



% Change

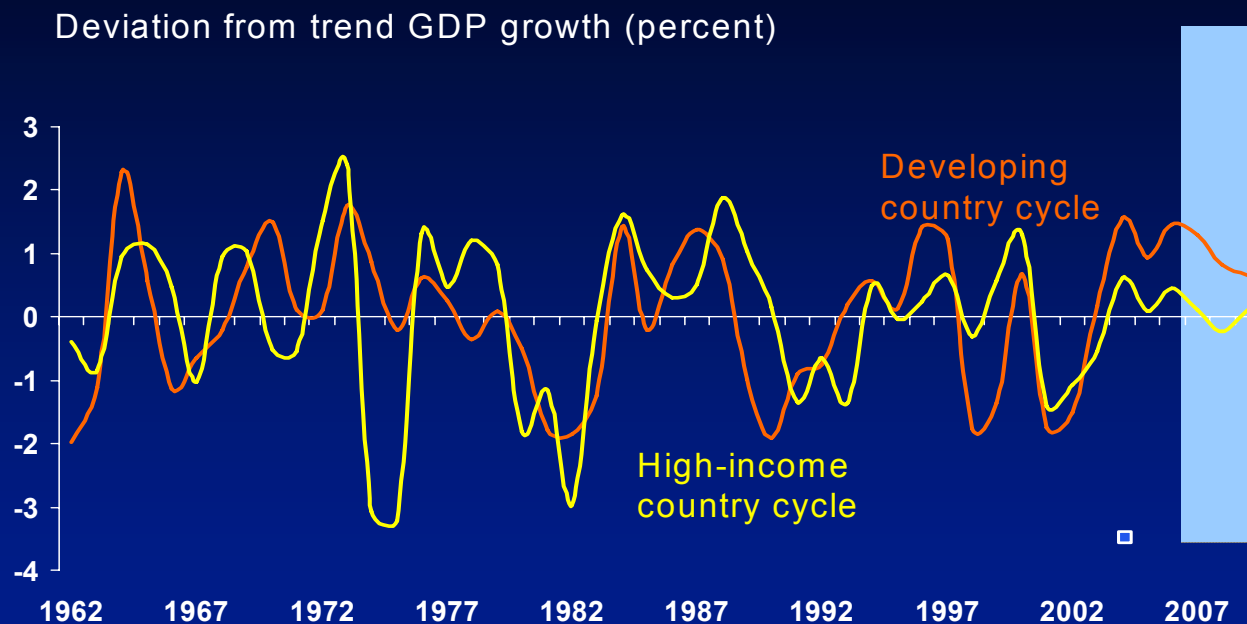
Correlation	(0.17)
LAC non inv. EMBI vol.	(1.24)
S&P vol.	0.79

Beta	(0.62)
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But a lower vulnerability (*beta*)
does not necessarily imply a
higher **trend** growth (*alpha*)

EM growth cycles are coupled with cycles in advance economies...

While the cyclical component of developing and high-income country growth remains coupled...

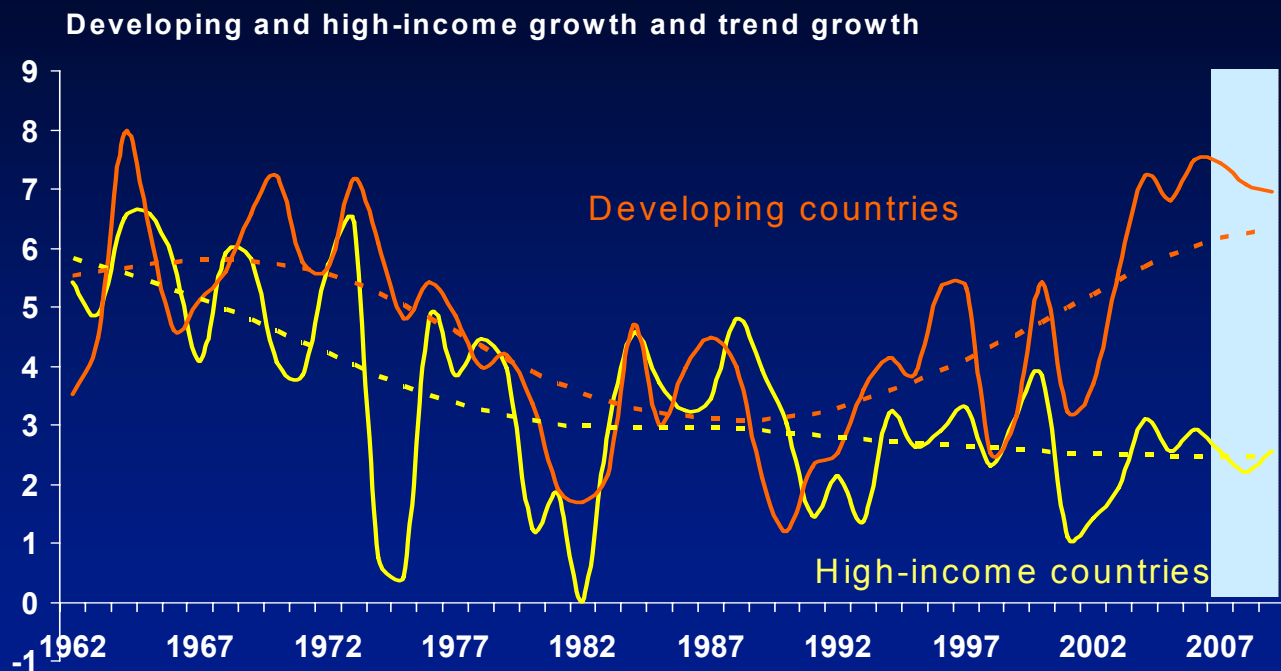


Source: World Bank, DECPG.



... but *trends* appear to be decoupling

... trend developing country growth has become decoupled from trend high-income growth

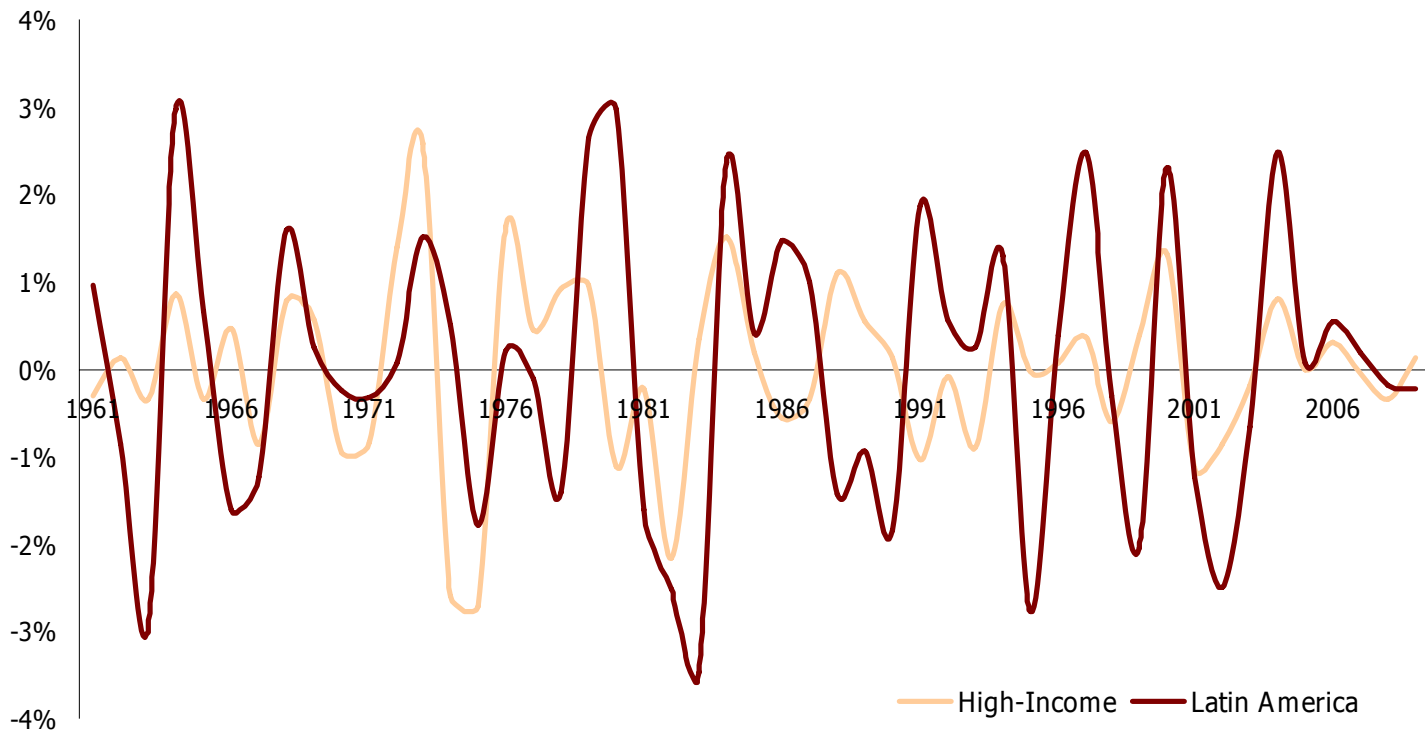


Source: World Bank, DECPG.



Latin America is not an exception in cyclical coupling...

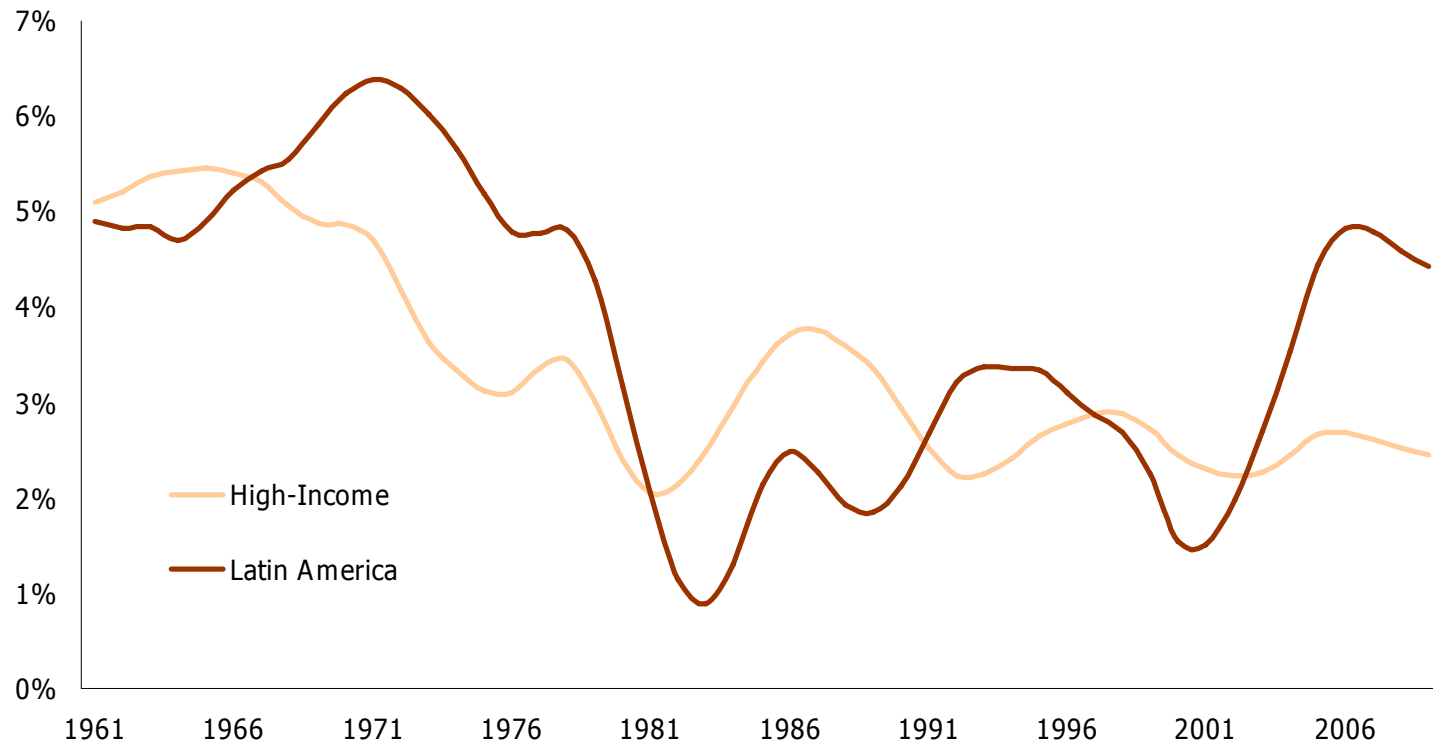
Cyclical component of growth in Latin America and High-Income Countries remained coupled



Note: Cyclical component of growth is computed using the band-pass filter. Data from WDI.

...but does the recent Latin growth episode signal the beginning of trend decoupling?

Trend Growth in Latin America and High-Income Countries

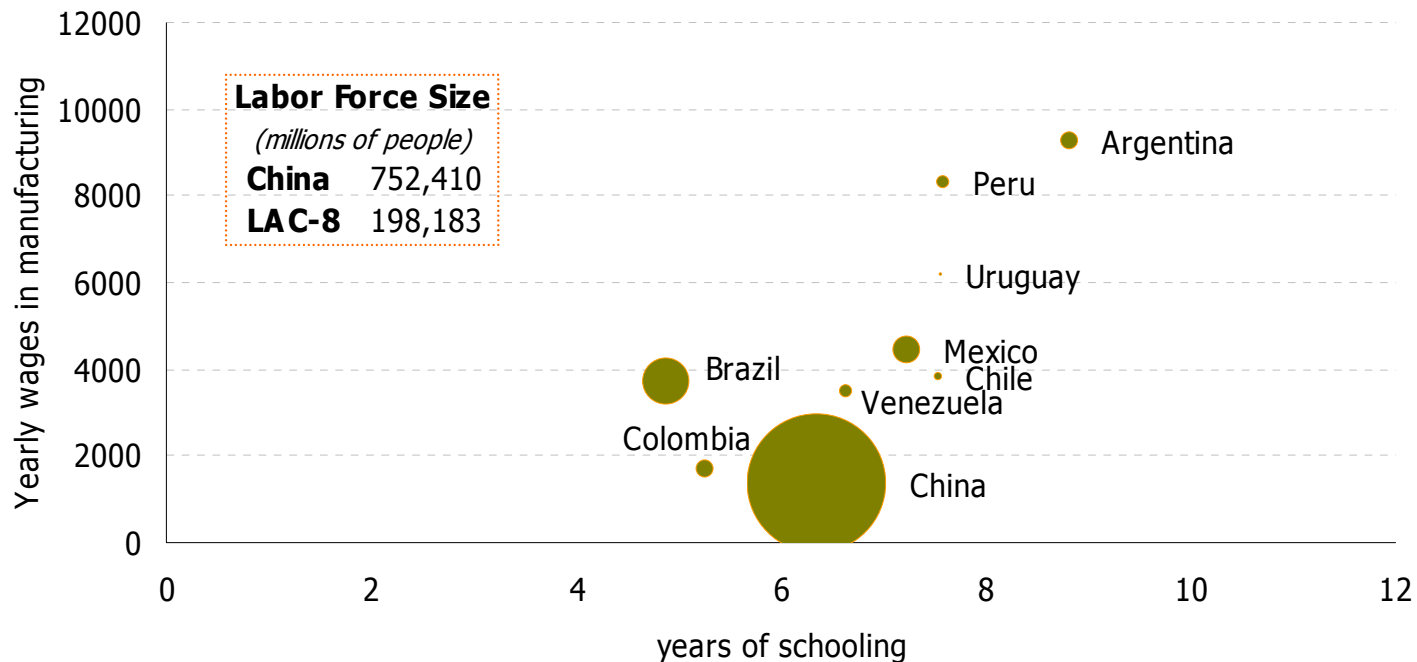


Note: Trend growth computed using the band pass filter. Data from WDI

Can Latin America boost trend growth
by relying on low-wage labor-intensive
manufacturing exports?

(The canonical path)

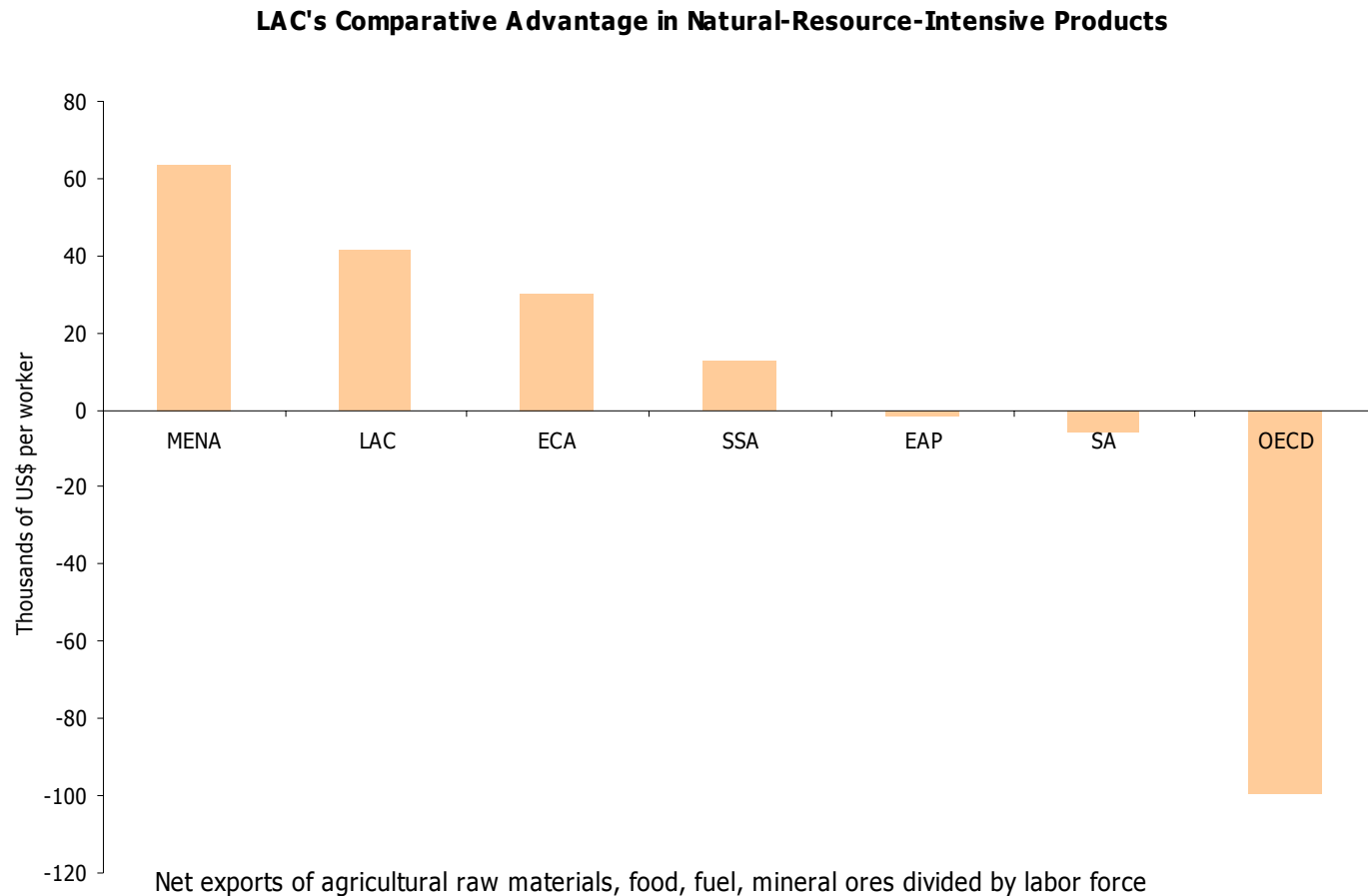
Progression from low-wage exports is not a realistic option for most of LAC



Notes: Yearly wages are manufacturing wages from LABORSTA (ILO) in 2002. Uruguay and Argentina are in 2001 and Venezuela in 1997. Labor force size is from WDI 2002. Years of schooling is the average number of years of school attainment of the population with 25 years or more from Barro and Lee 2000.

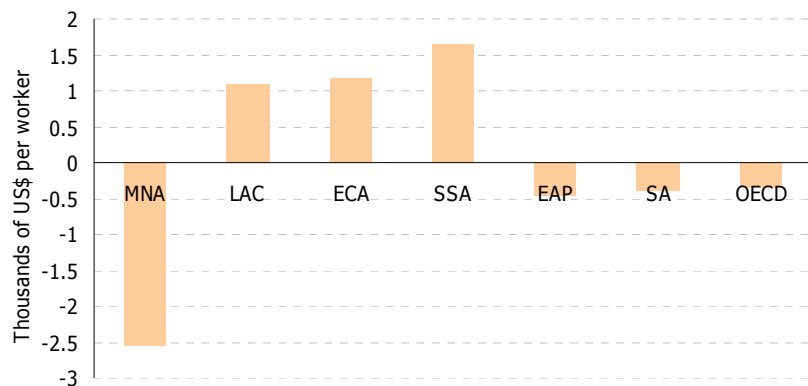
What about natural resources?

Many Latin countries have a comparative advantage in natural resources...

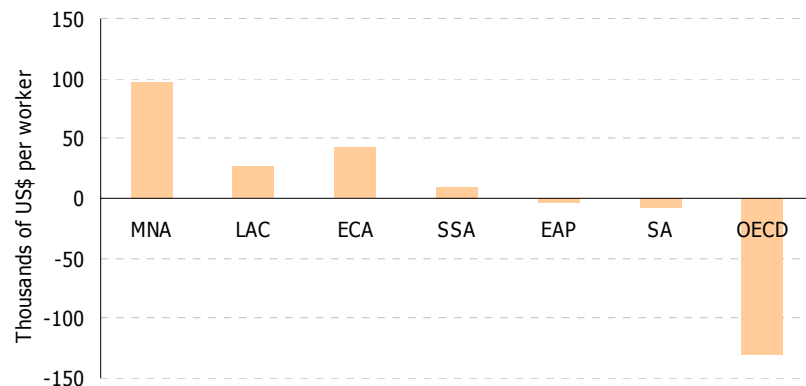


Many Latin countries have a comparative advantage in natural resources...

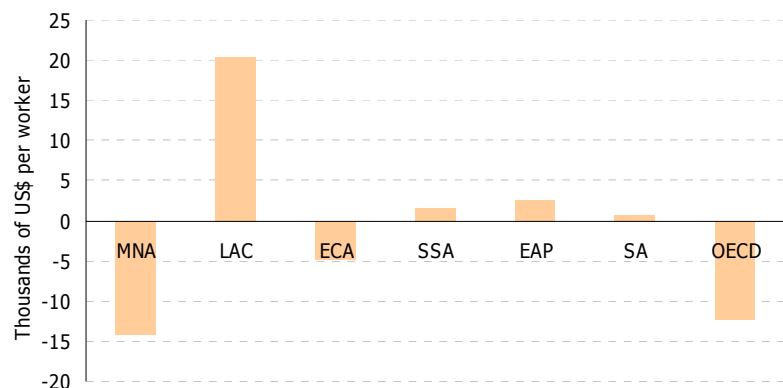
Agriculture and Raw Materials



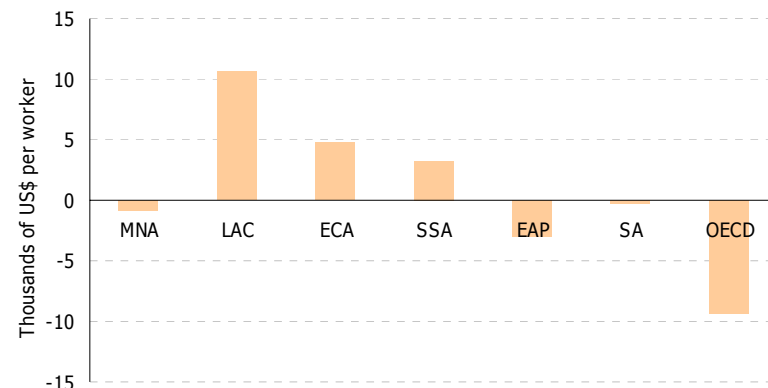
Fuel



Food



Ores and Metals



... even as China's colossal growth puts a premium on natural resources

- What makes commodity prices tick? It is China, stupid...

Agri Index	Energy Index	Ind. Met. Index	Pre. Met. Index	Soy Price	Copper	Oil WTI					
0.48	0.64	0.70	0.81	0.10	0.33	0.12	US\$ vs. EURO				
0.00	0.00	0.00	0.00	0.55	0.05	0.47					
0.34	0.15	0.13	0.09	-0.20	0.07	0.13	0.27	World %YoY			
0.02	0.29	0.38	0.51	0.17	0.62	0.37	0.12				
0.62	-0.23	-0.20	-0.17	-0.16	0.09	0.15	0.27	0.60	USA &YoY		
0.00	0.11	0.15	0.23	0.27	0.55	0.29	0.12	0.00			
0.05	0.44	0.66	0.75	0.30	0.31	0.17	0.84	-0.14	-0.09	China %YoY	
0.74	0.00	0.00	0.00	0.03	0.03	0.25	0.00	0.33	0.53		
0.19	-0.32	0.14	0.03	-0.02	-0.12	-0.07	-0.04	-0.03	0.30	0.02	Europe &YoY
0.17	0.02	0.34	0.81	0.87	0.42	0.65	0.82	0.84	0.03	0.92	

Source: Bloomberg, %YoY: Growth on the Real GDP (annual variation)

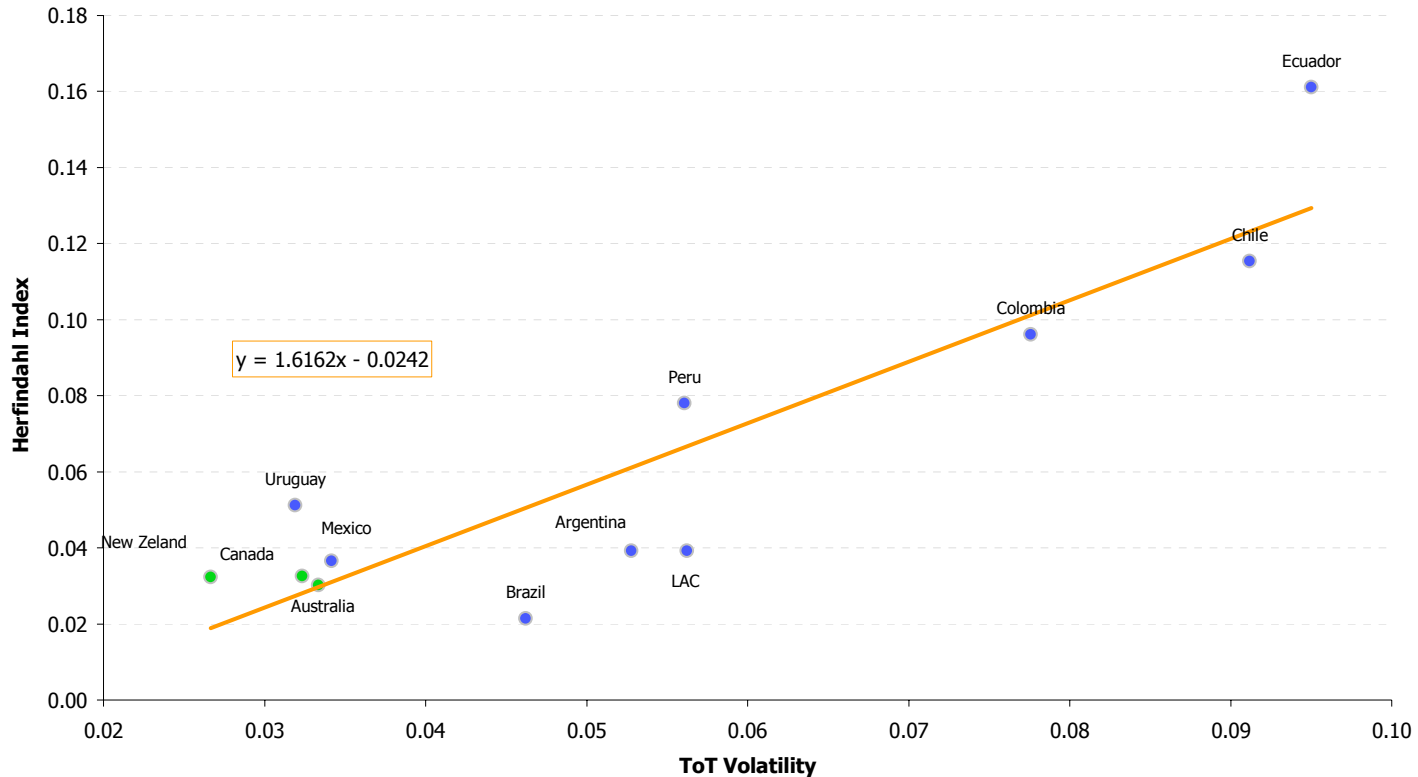
Commodity Indexes expressed in Total Returns. Commodity Prices expressed as variations

Sample: quarterly data, 1995q1-2007q2; averages

Can serving as the mine and granary to China make LAC more vulnerable?...

- Export product concentration seems destabilizing...

ToT Volatility and Export Product Concentration

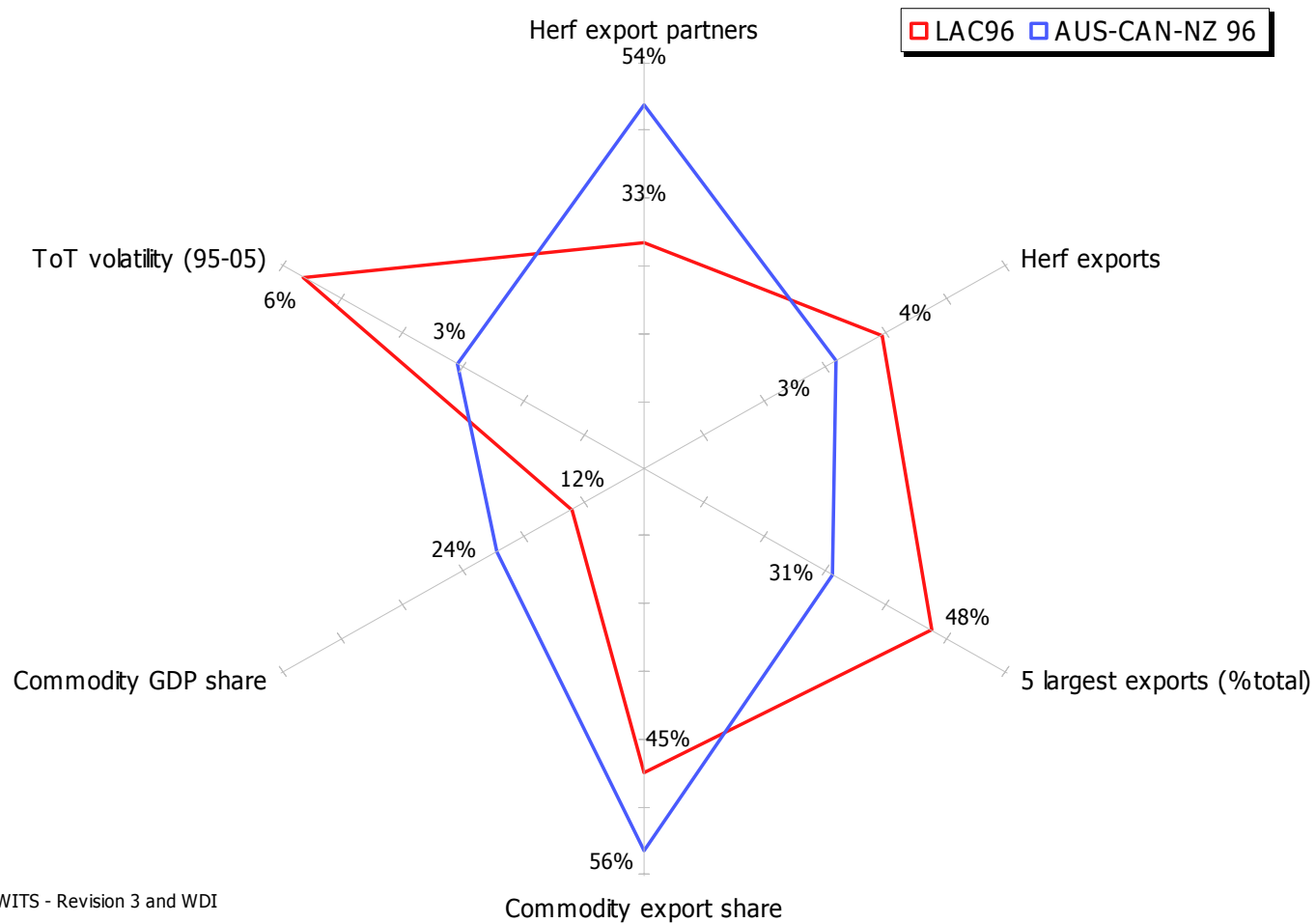


Note: Terms of Trade volatility as the St.Dev. of the growth of the ToT. Source: WDI & WITS Revision 3.

... Not necessarily

Real Fragilities and ToT volatility: 1996-2005

for average LAC countries and developed commodity exporters



Source: WDI & WITS - Revision 3 and WDI

Natural resources *per se* are not a curse

- Despite oft-heard “natural resource curse” argument ...
 - The claim that resource-rich developing countries have grown more slowly than other developing countries
 - Neumayer (2004); Mehlum et al. (2006); Sachs & Warner (2001)
 - The fact that some countries have squandered NR wealth
 - “Dutch Disease” and “rent seeking” in weak institutional environments
- ... there is no statistical evidence of a “curse” on average
 - Natural resources *per se* have a positive impact on development
 - Lederman & Maloney (2007); Sala-i-Martin et al. (2004); Stijins (2005)
- Squandering of natural resource wealth is not “destiny”
 - E.g., Chile, California, Sweden, New Zealand...
 - Even in Africa, after controlling for slave trade, minerals are shown to have a positive effect on development

With or without abundant natural resources, a productivity-based export orientation is needed to raise trend growth in Latin countries.

What will this take?

While there is no magic, one-size-fit-all policy reform formula...

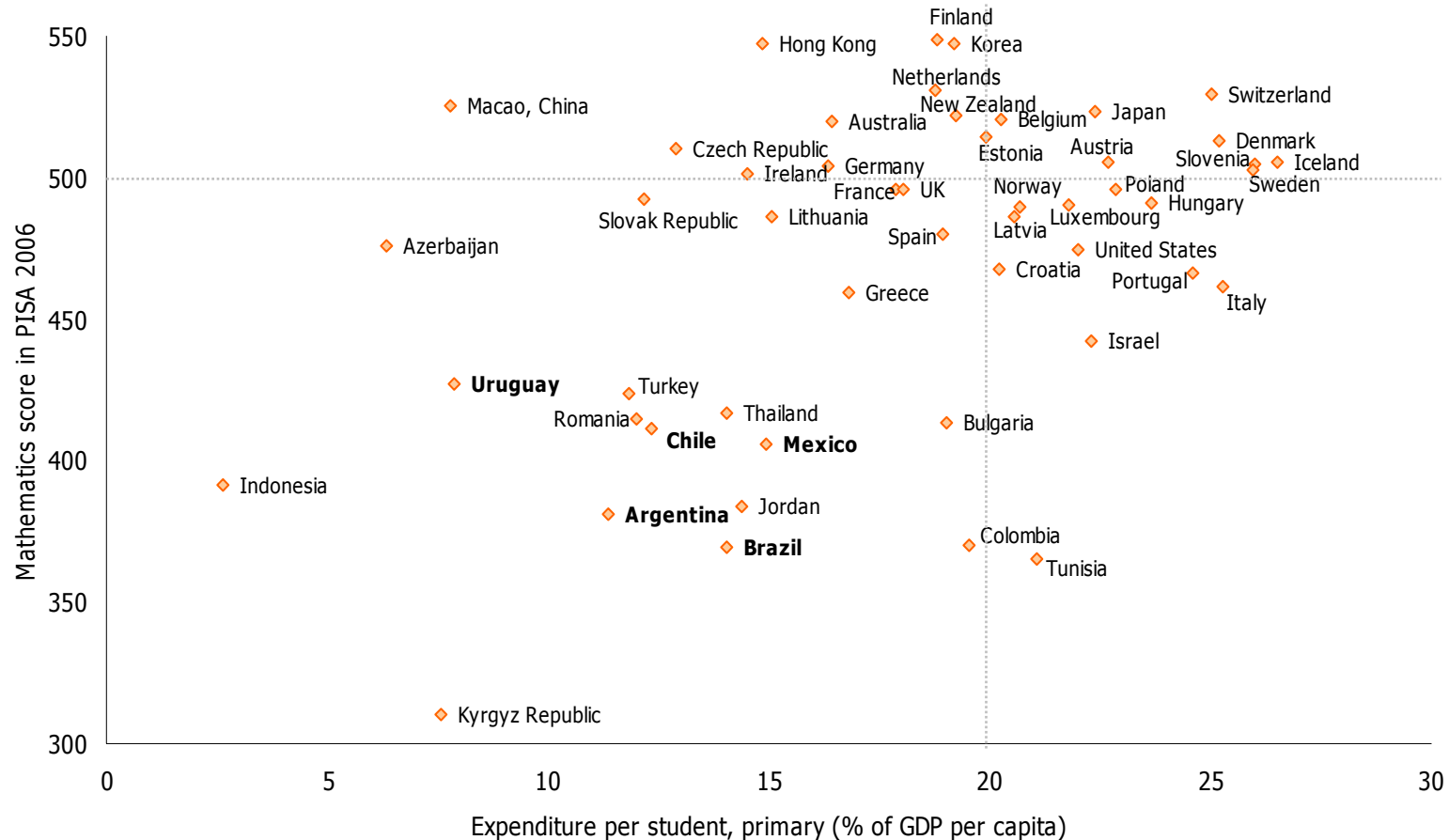
- Reforms that lead to productivity growth in a country do necessarily not do so elsewhere
- Research on growth determinants provides little guidance on specific reform packages
 - It emphasizes fundamentals: institutions, technological innovation, access to markets, financial development, etc.
 - Highlights first principles: competition, property rights, sound money, fiscal solvency, etc.
 - But correspondence to reform packages is elusive
- What ignites growth is different than what sustains it
- Secret of productivity growth is that – a secret

... it makes eminent sense to make the best out of existing Latin assets...

- Natural resources – through institutions and innovation, maximize the blessing
- Geographical advantages
 - Logistics
 - Natural beauty
- Relatively educated labor force
- Maturing financial systems (strengthened through crises)
- Cultural wealth

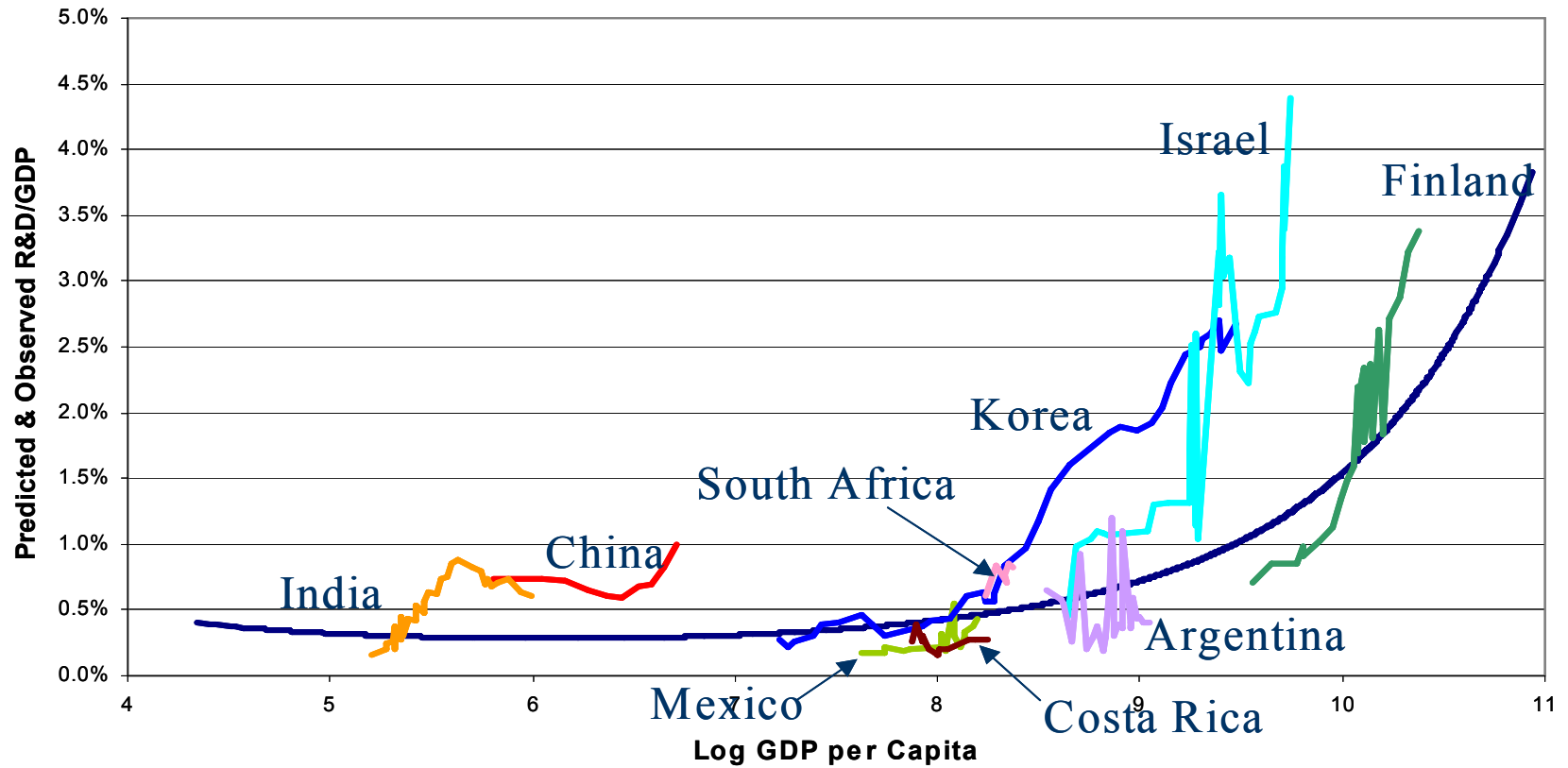
...and to close key gaps

The quality of education gap

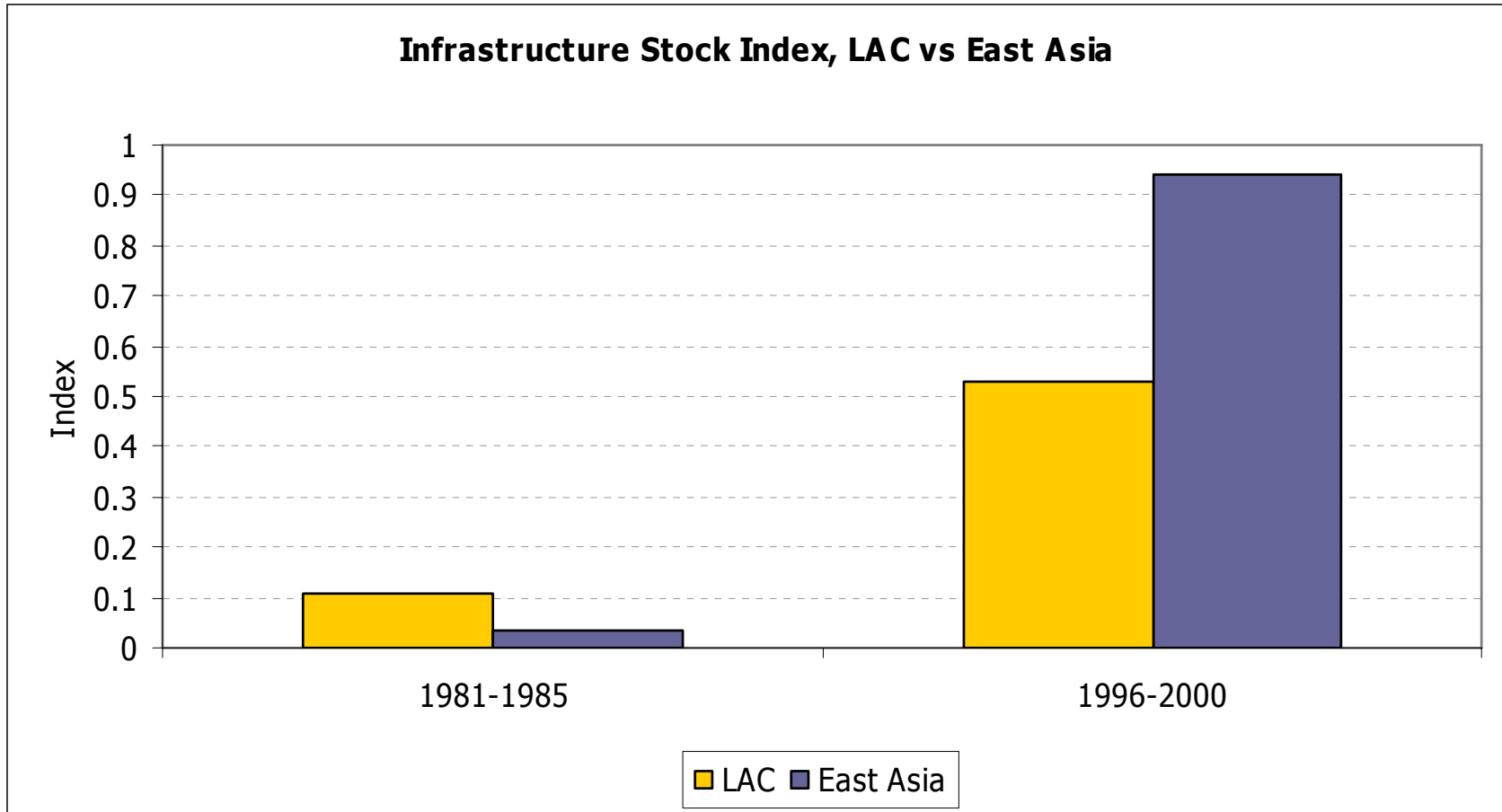


Source: Mathematics score from Pisa (2006). Expenditure per Student, primary (% GDP) is the most recent data available in WDI (2004 for most of the countries). Public expenditure per student is the public current spending on education divided by the total number of students in the primary level.

The innovation gap



The physical infrastructure gaps...

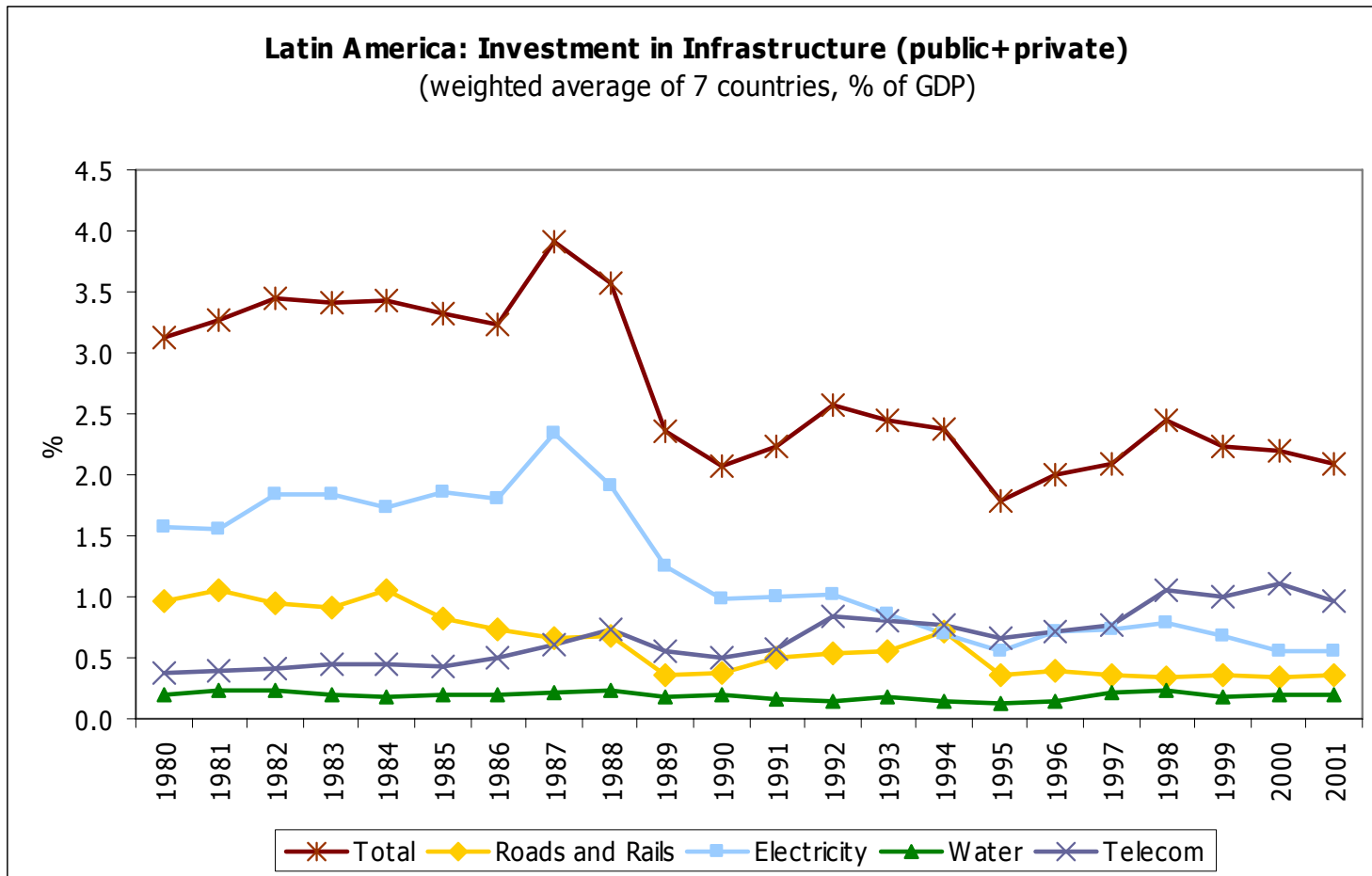


Notes: The index is the first principal component of (1) Telephone Main Lines (per 100 workers); (2) Electricity Generating Capacity (in MW per 1000 workers); and (3) Total Roads (in km. per sq. km. of surface area).

LAC includes 19 countries: ARG, BOL, BRA, CHL, COL, CRI, DOM, ECU, SLV, GTM, HND, JAM, MEX, NIC, PAN, PRY, PER, URY, VEN.

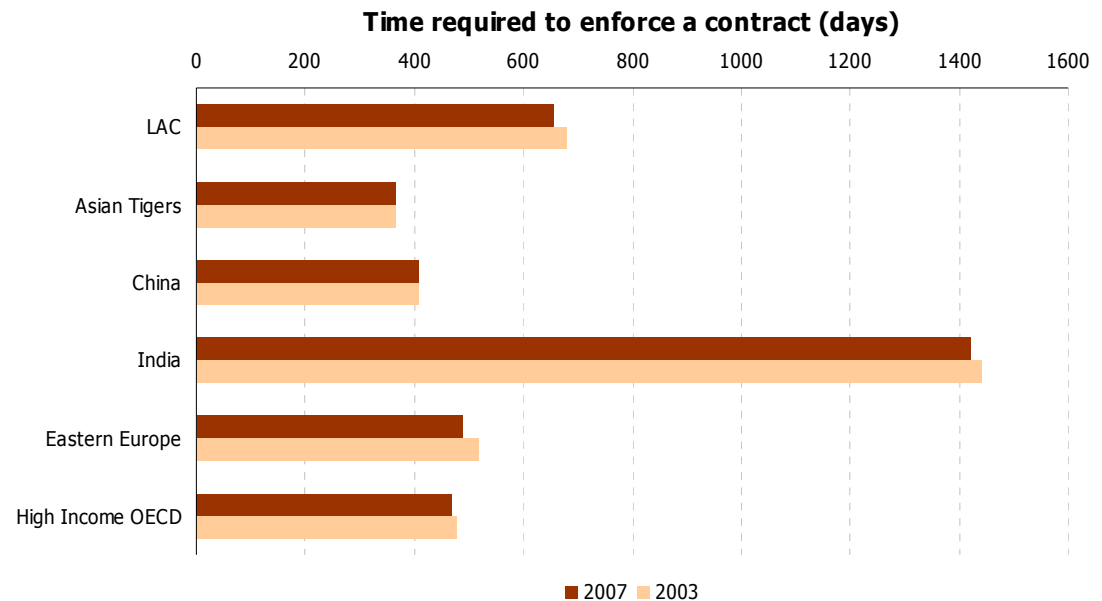
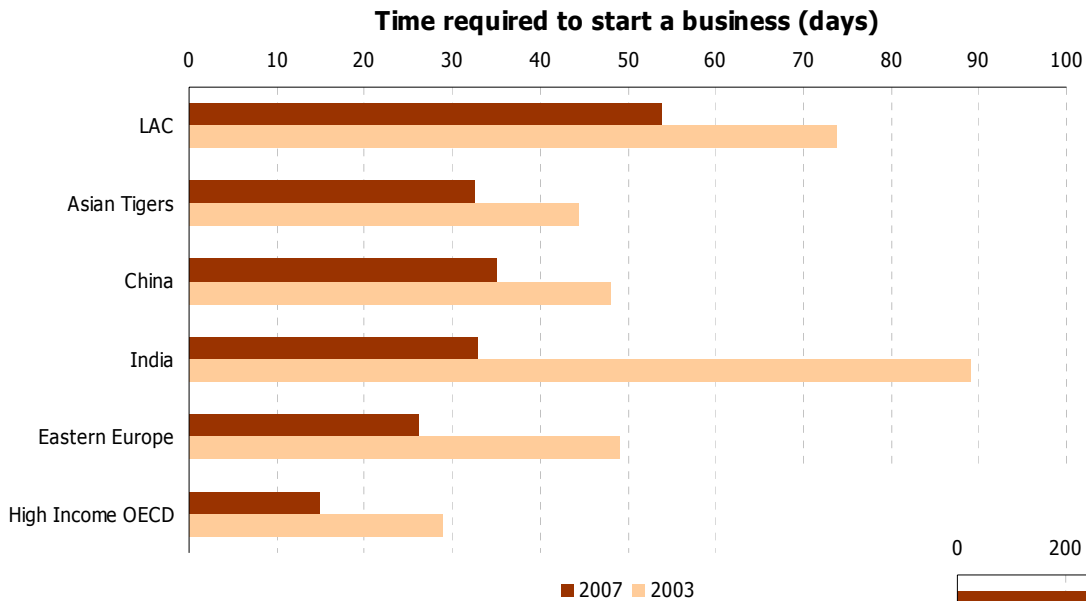
East Asia includes 5 countries: MYS, KOR, TWN, IDN, THA.

... the physical infrastructure gaps

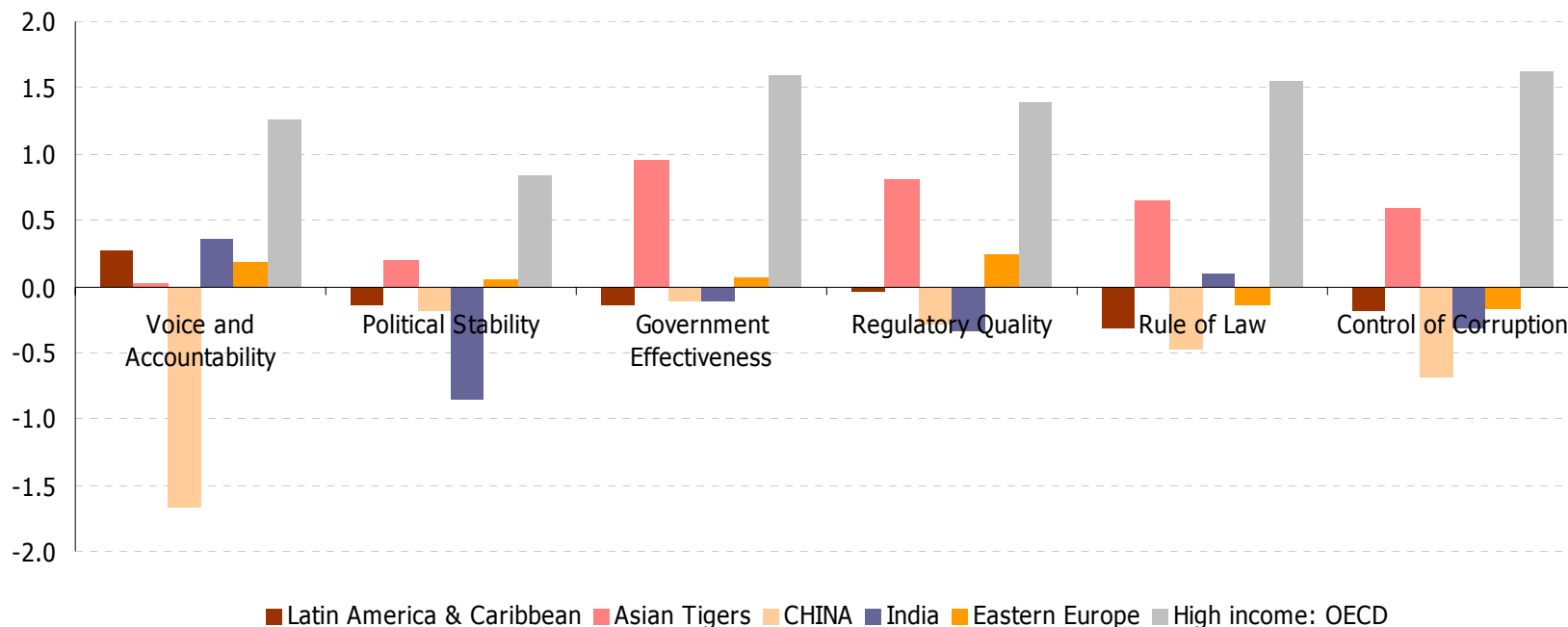


Note: & Latin American countries: Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Peru

The business environment gaps



The gaps in broader institutions...



... which are not independent of
high inequality and inequity

Birdsall, de la Torre and Menezes (2007), *Fair Growth:
Economic Policies for Latin America's Poor and Middle-
Income Majority*.

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