

The Economic Future of Latin America: Growth and No Crises?

by

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Outline

- Background: Crisis and stagnation
- Background: Reforms in the 1990s
- A “success” story: Chile
- A “crisis” story: Argentina
- What to expect going forward
 - Crisis?
 - Growth?
 - Populism?

Background

Background: Pre-1990

- Declining growth; ISI had become exhausted
- Macroeconomic instability: high inflation and crises (Crawling peg)
- High degree of protectionism (Apex, Mexico 1983)
- High degree of inequality
- 1980s: “The Lost Decade”

Background, 1985-2000: Reforms

- Bolivia and Chile pioneering countries
- “*Washington Consensus*”
 - Trade opening
 - Privatization
 - Fiscal discipline (balanced budgets, users’ fees)
 - Deregulation
 - Independent central banks
 - Pension reform
- Brady Plan: Overnight creates secondary market for EM bonds

Results from Reforms, 1985-2000

- Lower inflation
- Some privatized services experience remarkable improvement (telecoms)
- Some growth (Until 1997; Argentina, Chile)
- More stability
- Rapid debt accumulation
- A major crisis in Mexico (*“The first crisis of the 21st Century”*)
- Vulnerability to contagion

Results from Reforms, 1998-2003

- No growth
- Disappointment at the reforms
- Crises:
 - Brazil, 1999
 - Ecuador, 2000
 - Argentina 2001-2002
 - Brazil, 2002
 - Dominican Republic 2002
 - Uruguay 2002

Results: 2004-2006

■ Macro stability

- The “hard way”: Brazil Interest rates at 19%
- Inflation in Mexico lower than in the U.S. for the first time in 50 years

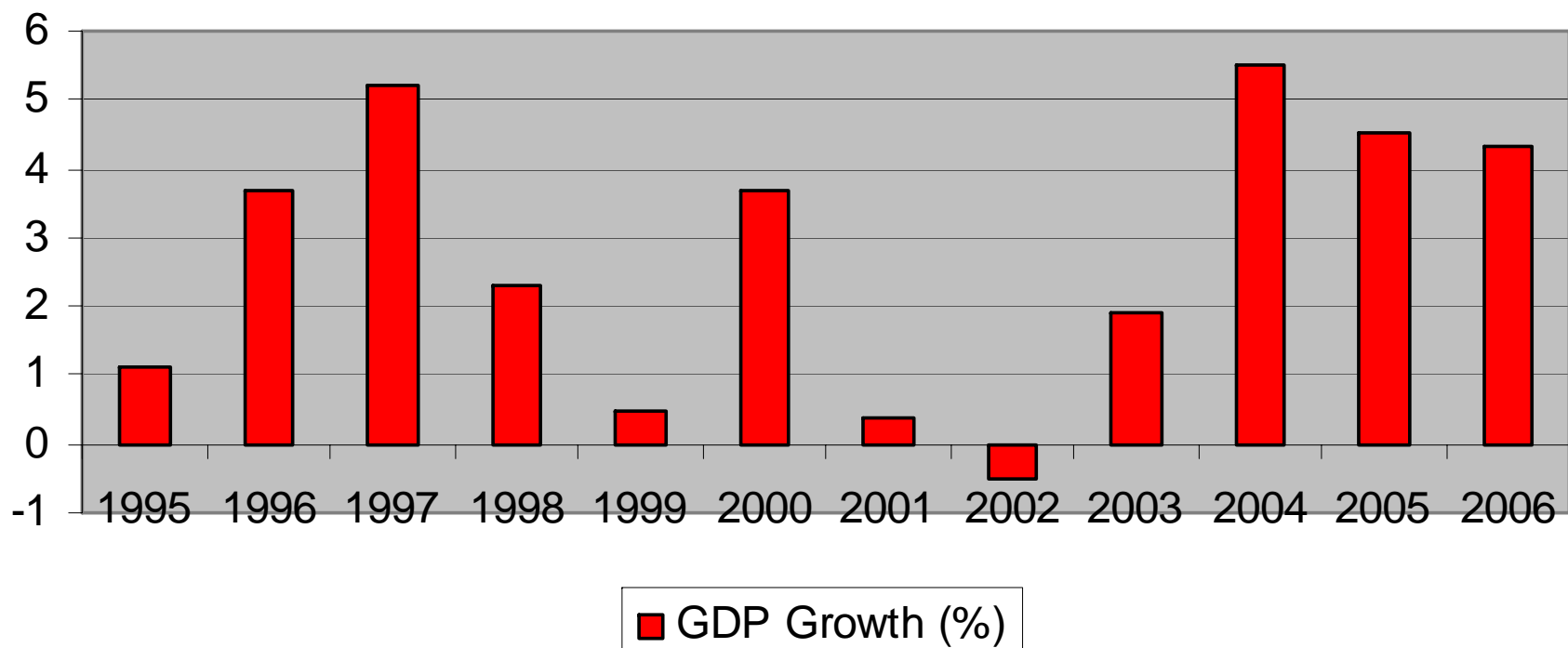
■ Growth pick-up

- Commodity prices
- Low global interest rates

■ Current account surpluses

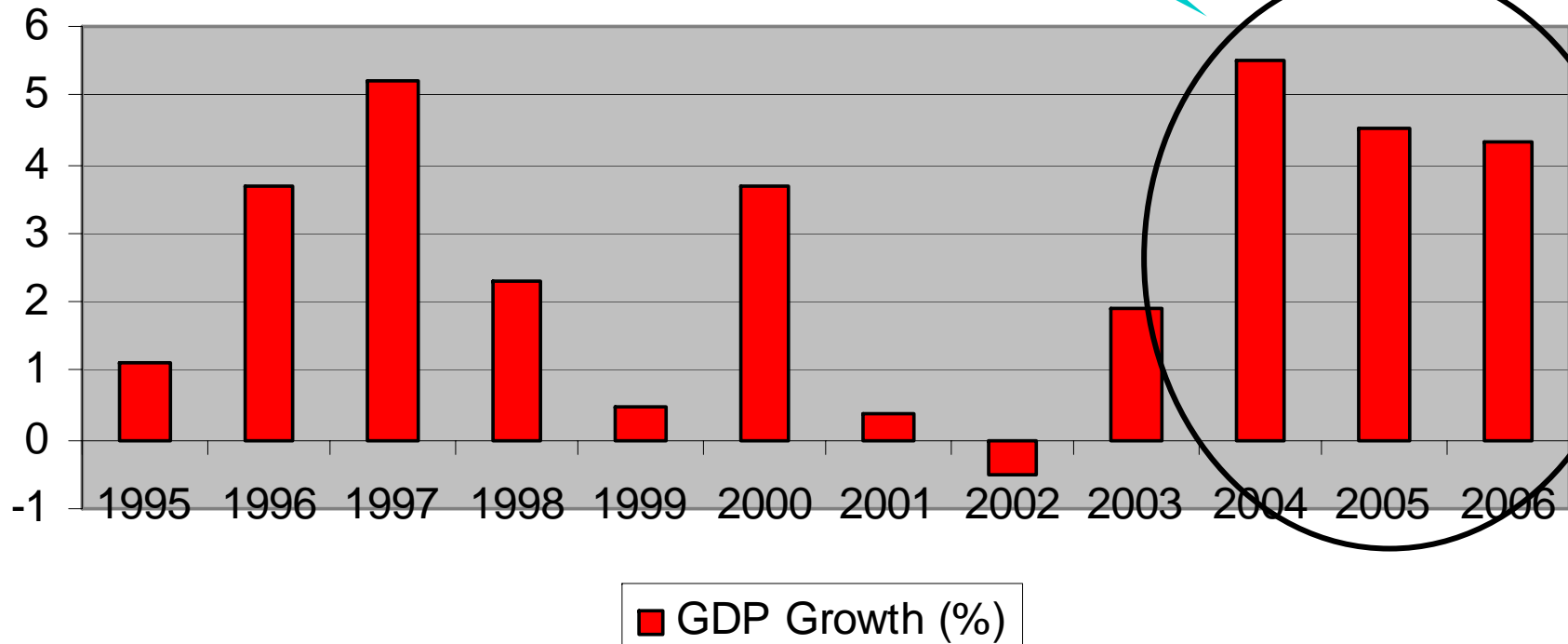
- ## ■ Political discontent: movement to the left.
- What type of left?

Latin America: GDP Growth (%), 1995-2006



Is this pick-up in
growth sustainable?

Latin America: GDP Growth (%) 1995-2006



A “success” story and a “crisis” story: Chile and Argentina

Chile: Asia in the Southern Cone?

Sources of Growth in Chile

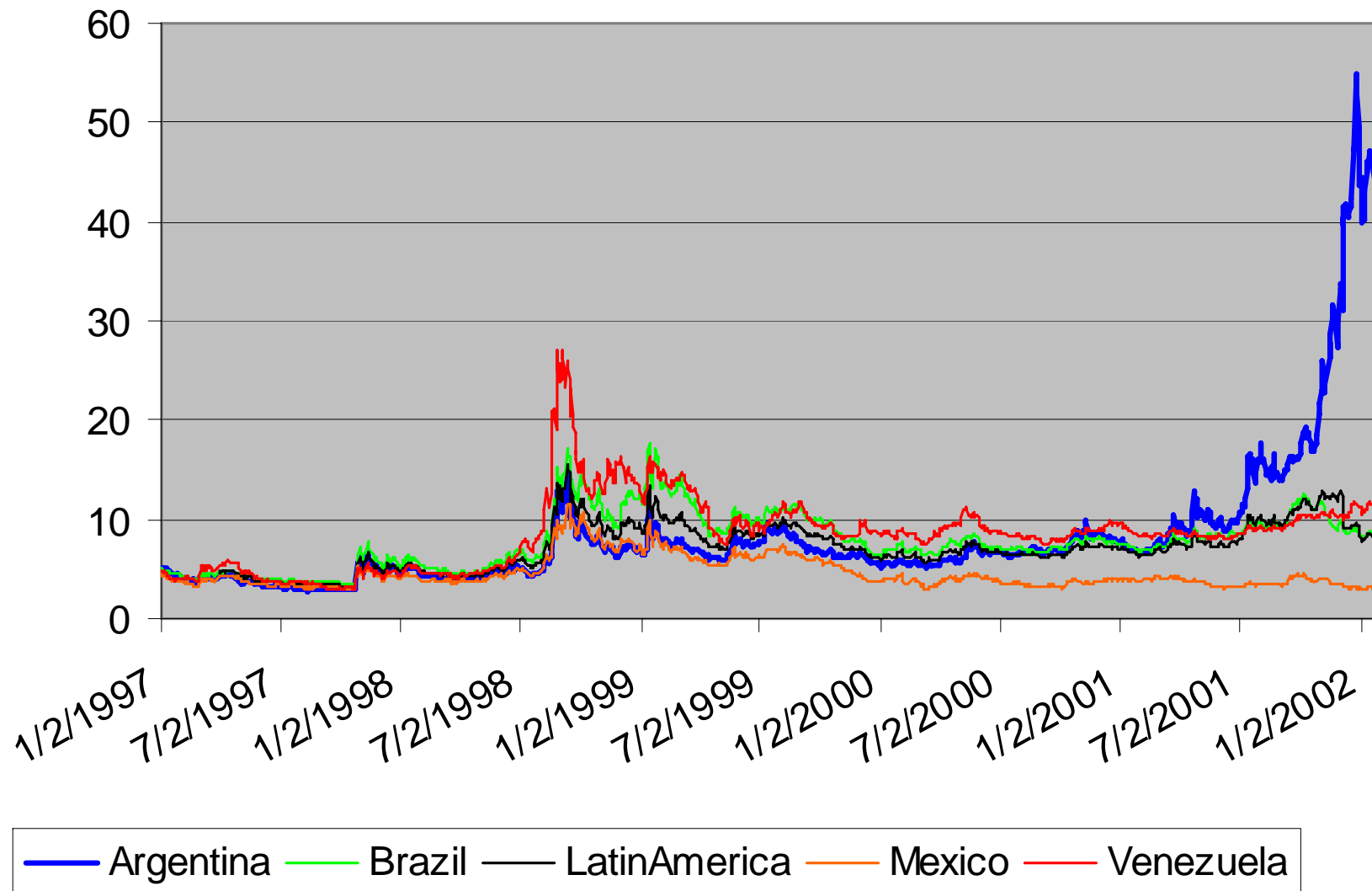
	GDP GROWTH	TFP GROWTH	CAPITAL	LABOR
1976-1980	6.8	3.7	0.8	2.3
1981-1985	-0.1	-2.2	0.9	1.2
1986-1990	6.8	2.3	1.9	2.5
1991-1995	8.7	3.7	3.5	1.5
1996-2000	4.1	0.1	3.6	0.5
1998-2001	2.4	-0.6	2.8	0.1

Chile managed to get into the proper “dynamics” of growth

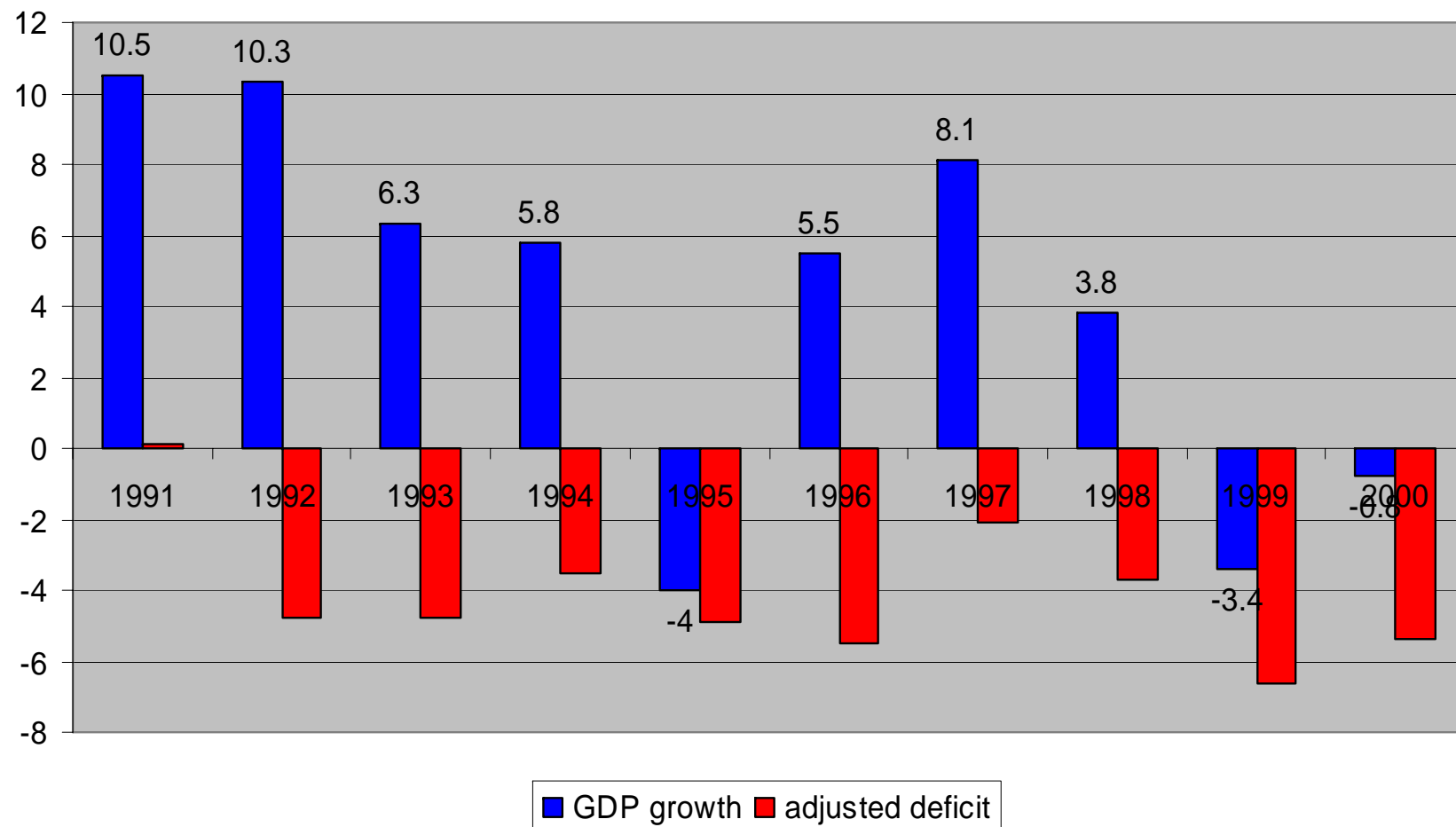
- Reforms created jump in TFP growth
- This resulted in increase in “profitability”
- Increase in FDI
- More growth
- Increased in savings
- Higher capital accumulation
- NO other country in LA has achieved this virtuous cycle
- New challenges: diversify exports?

Argentina: The saddest story of them all

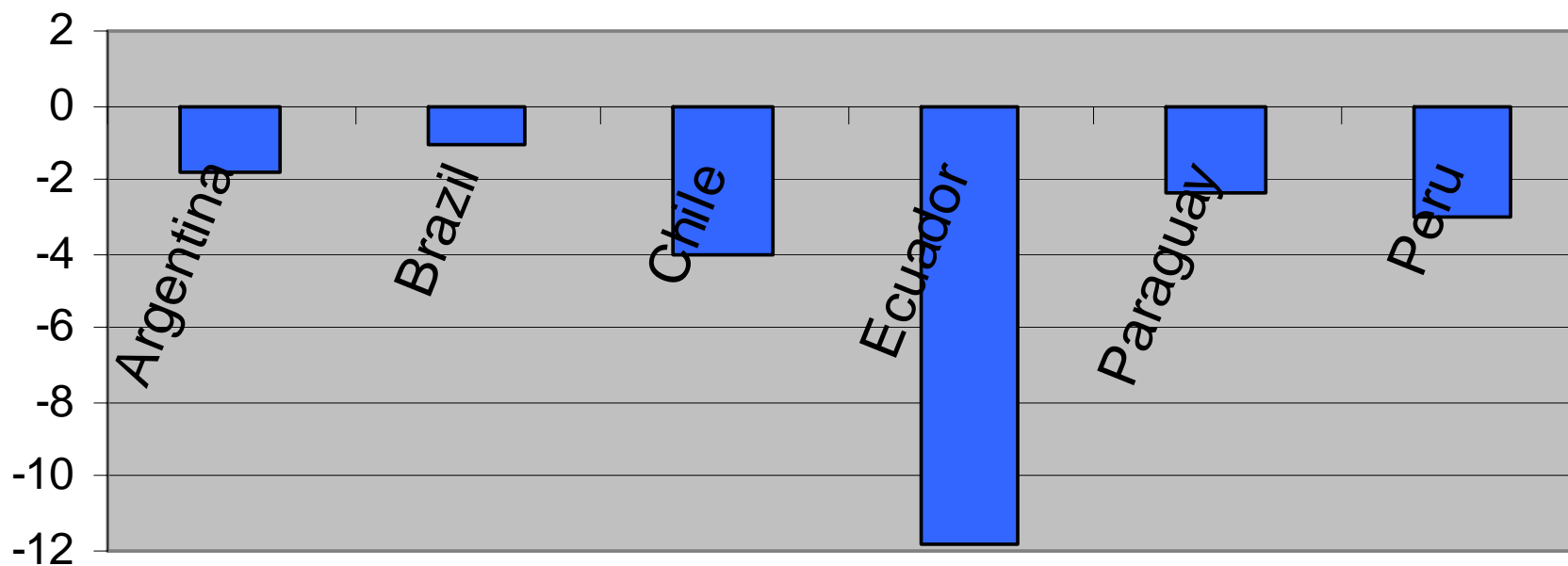
Country Risk Premia: Selected Countries, 1997-2002



GDP Growth and Fiscal Deficit: 1991-2000

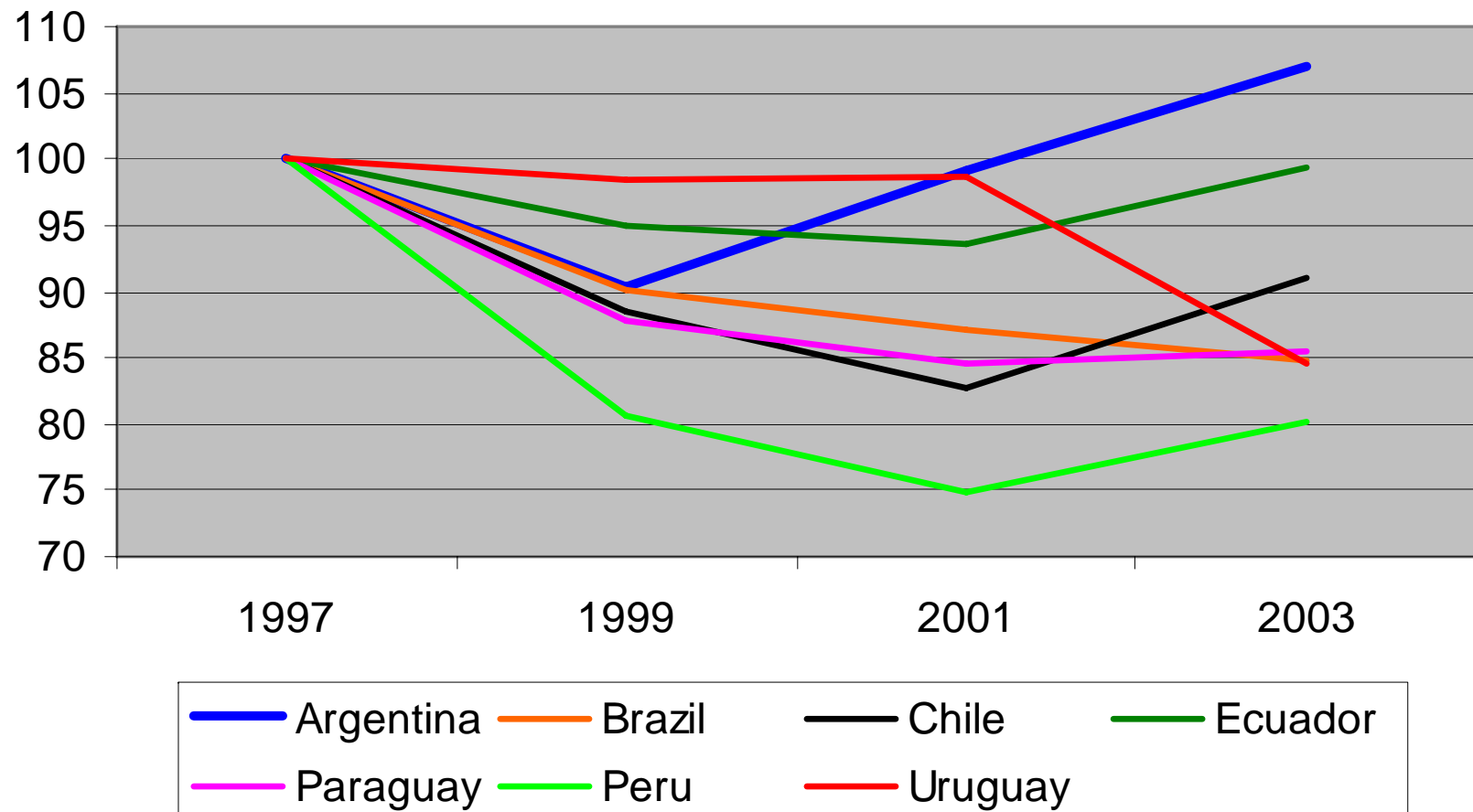


Change in Net Capital Flows: 2000 vs 1995-98



■ Change in net resource transfer 2000 vs 1995-98

Terms of Trade Index: 1997-2003





The background is a blue gradient, darker at the bottom. Several diagonal stripes of a lighter blue shade run from the top-left towards the bottom-right.

What to expect going forward?

On Latin America and Crises

Table 4
Incidence of Reversals*

Panel A: Reversal A

<i>Region</i>	<i>No reversal</i>	<i>Reversal</i>
Industrial countries	98.0	2.0
Latin American and Caribbean	87.7	12.3
Asia	87.7	12.3
Africa	83.4	16.6
Middle East	85.0	15.0
Eastern Europe	88.9	11.1
<i>Total</i>	88.2	11.8
Observations	2678	
Pearson		
Uncorrected χ^2 (5)	65.41	
Design-based F(5, 13385)	13.08	
p-value	0.00	

Latin America and Caribbean

	No sudden stop	Sudden stop	Total
No reversal	578	23	601
	96.17	3.83	100
	87.2	44.2	84.1
Reversal	85	29	114
	74.6	25.44	100
	12.8	55.8	15.9
Total	663	52	715
	92.7	7.3	100
	100	100	100
Pearson χ^2 (1) = 18.35 p-value = 0.000			

Table 8
Incidence of “International Reserves” and “Exchange Rates” Crises

<i>Region</i>	<i>Exchange-Rate Crises</i>	<i>Reserves Crises</i>
Industrial	2.8	2.4
Latin America	8.6	2.1
Asia	8.2	6.3
Africa	10.4	8.1
Middle East	4.7	2.3
East Europe	12.7	3.8
<i>Total</i>	<i>8.0</i>	<i>2.6</i>
Number of Observations	2528	2528
Pearson		
Uncorrected $\chi^2(5)$	32.86	31.26
Design-based F(5, 12565)	6.57	6.24
P-value	0.00	0.00

Table 13
Current Account Reversals, Sudden Stops and Growth

(Random Effects GLS Estimates)

	(13.1)	(13.2)	(13.3)	(13.4)	(13.5)
<u>A. Large Countries</u>					
Growth gap	0.77 (21.91)*	0.72 (23.35)*	0.71 (21.34)*	0.72 (21.32)*	0.73 (22.69)*
Change in terms of trade	0.08 (6.99)*	0.08 (8.09)*	0.07 (6.57)*	0.07 (6.41)*	0.09 (7.79)*
Reversal I	-3.18 (5.41)*	--	--	-3.52 (4.80)*	--
Reversal II	--	-4.61 (9.27)*	--	--	-4.10 (7.41)**
Sudden Stop	--	--	-1.47 (2.21)**	-1.49 (2.23)**	-0.47 (0.72)
Constant	-0.28 (2.11)**	-0.19 (1.50)	-0.29 (2.15)**	-0.19 (1.38)	-0.18 (1.36)
Observations	721	751	715	686	714
Countries	44	44	43	43	43
R-squared	0.41	0.45	0.40	0.42	0.45
<u>B. All Countries</u>					
Growth gap	0.82 (40.26)*	0.82 (42.10)*	0.81 (40.18)*	0.82 (38.93)*	0.82 (40.76)*
Change in terms of trade	0.07 (11.77)*	0.08 (12.65)*	0.07 (11.31)*	0.07 (11.10)*	0.08 (12.18)*
Reversal I	-1.04 (3.00)*	--	--	-0.73 (2.03)**	--
Reversal II	--	-2.01 (6.64)*	--	--	-1.80 (5.50)*
Sudden Stop	--	--	-1.23 (2.82)*	-1.02 (2.28)**	-0.53 (1.19)
Constant	-0.30 (2.26)**	-0.15 (1.16)	-0.27 (2.62)*	-0.26 (2.33)**	-0.14 (1.32)
Observations	1723	1821	1641	1546	1635
Countries	90	90	81	81	81
R-squared	0.48	0.49	0.51	0.52	0.51

Absolute value of t statistics are reported in parentheses; country-specific dummies are included, but not reported; *significant at 1%, **significant at 5%, *** significant at 10%.

Table 5
Current Account Reversals: Random Effects Probit Model – Unbalanced Panel

Large Countries

Variable	(5.1)	(5.2)	(5.3)	(5.4)	(5.5)
Current-Account deficit to GDP	0.165 (7.51)*	-- --	0.174 (7.20)*	0.165 (6.43)*	0.153 (5.59)*
Fiscal deficit to GDP	-- --	0.035 (2.07)**	-0.003 (0.21)	-0.002 (0.10)	0.009 (0.54)
Sudden stops in region	2.335 (3.15)*	2.731 (3.84)*	2.094 (2.73)*	2.327 (2.70)*	2.261 (2.50)**
Changes in terms of trade	-0.013 (2.30)**	-0.019 (3.50)*	-0.013 (2.33)**	-0.013 (2.08)**	-0.014 (1.92)***
Domestic credit growth	-- --	-- --	-- --	-- --	0.0001 (1.36)
Flexible exchange rate	-- --	-- --	-- --	-0.379 (2.00)*	-0.298 (1.62)***
GDP per capita	-0.127 (2.18)**	-0.180 (2.71)*	-0.140 (2.36)**	-0.104 (1.69)***	-0.127 (1.71)***
Observations	881	822	822	694	608
Countries	42	36	40	40	36

Absolute value of z statistics are reported in parentheses; explanatory variables are one-period lagged variable; country-specific dummies are included, but not reported.

* significant at 1%; ** significant at 5%; *** significant at 10%

Table 6
Current Account Reversals: Marginal Effects and Predicted Probability^{a,b}
(Computed from the estimates in Equation 5.3)

Variable	(6.1)	(6.2)	(6.3)	(6.4)
Current-Account deficit to GDP	0.011 (5.70)*	0.042 (4.53)*	0.007 (2.69)*	0.040 (3.75)*
Fiscal deficit to GDP	-0.000 (0.21)	-0.001 (0.21)	-0.000 (0.20)	-0.001 (0.21)
Sudden stops in region	0.128 (2.43)**	0.509 (2.75)*	0.090 (2.09)**	0.435 (2.92)*
Changes in terms of trade	-0.001 (2.20)**	-0.003 (2.38)**	-0.001 (2.01)**	-0.003 (1.87)***
GDP per capita	-0.009 (2.40)**	-0.034 (2.44)**	-0.006 (2.95)*	-0.033 (2.81)*
Predicted Probability	0.026	0.160	0.017	0.149

^a: For details on the computations in each column, see the text.

^b: Absolute value of z statistics are reported in parentheses. For (6.1) sample means are 1.567 for current account deficit to GDP, 4.074 for Fiscal deficit to GDP, 0.092 for sudden stops in region, 5.459 for changes in terms of trade, and 9.744 for log of GDP per capita.

* significant at 1%; ** significant at 5%; *** significant at 10%

On Latin America's Future Growth

- Very low productivity growth
- Stalled reforms
- Dismal educational system
- “Culture” and issue
- Very low domestic savings
- Few countries likely to move into the “virtuous” cycle of growth dynamics

Latin America's Political Future

The good, the bad and the ugly?



