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