Unlocking the Potential of Latin America

Introductory Remarks by Commissioner Almunia

to

Joint DG ECFIN-OECD Seminar on the Latin American Economic Outlook
(Brussels, 13 December 2007)

It gives me great pleasure to be here today to give these introductory remarks on this first OECD report on Latin America's economic outlook. As one of the members of the LEO Advisory Board, I was pleased with both the publication and the opportunity this has afforded many people to further discuss Latin American issues.

This is an important document in several respects. It not only provides – as we have come to expect from the OECD – an intelligent and thought-provoking analysis of the economic issues at stake. Maybe more importantly, by publishing this report, the OECD also conveys the message that **Latin America matters**. These days, other regions in the world, notably Asia and the Middle East, draw much of the attention of policy-makers and the press here in Europe often overlooks Latin America, despite its potential and its close ties with Europe..

From that perspective, the OECD's initiative to publish regularly a Latin American Economic Outlook (LEO) is a commendable attempt to correct this skewed perception of the world, and I can only congratulate the OECD, Javier Santiso and the team responsible for this.

Let me now say a few words about the economic **outlook of Latin America** and provide a few reflections on **EU-Latin American relations.**

1. Latin America's economic outlook

In recent years, Latin America has seen a remarkable shift in economic fortunes, with **strong economic growth** coming hand in hand with increased **macroeconomic stability**. In fact, the last four years of sustained economic expansion in the region constitute the best performance since the debt crisis of the early 1980s.

Rapid economic growth is being coupled with stronger macroeconomic fundamentals, including:

- sound current account positions (in many cases showing a surplus),
- a rapid accumulation of foreign exchange reserves and
- improved fiscal balances,

all of which bodes well for the sustainability of the current expansion.

The recent episode of financial market turbulence shows that the resilience to external disturbances of many Latin American economies, and of emerging economies in general, has increased.

This also seems to be the view of many foreign companies operating in the region, which generally provide very positive projections of the future growth of their Latin American markets.

Latin America nonetheless faces important challenges. The first is that, in spite of increased resilience, it is still too vulnerable to **external shocks**, which may come from an unexpectedly sharp slowdown in Asia or the US or from a downward correction in commodity prices. Countries with less solid underlying macroeconomic and structural conditions are also more at risk should international financial conditions significantly worsen.

The second major challenge is that, despite the impressive macroeconomic performance of the last four years, **poverty and inequality** remain a serious problem for the region, a point to which I will return in a moment.

2. EU-Latin American relations

Let me now look at **EU-Latin American relations** and their potential to develop further in the future.

Over the last 15 years, Europe has intensified its links with Latin America through increased trade and investment, a closer political dialogue, and increased economic cooperation.

Today the European Union is Latin America's second most important trading partner - and the first trading partner for the four Mercosur countries and for Chile. European Union imports from Latin America more than doubled between 1990 and 2005 (increasing from € 26.7 to € 70.9 billion) and exports to the region rose from € 17.1 to € 62.2 billion. The European Union is also Latin America's most important source of foreign direct investment (FDI).

The new external lending mandate of the **European Investment Bank** also testifies to the importance that the EU attaches to investment in Latin America. The new lending plan, which covers the period 2007-13, foresees for the first time a separate section for Latin America amounting to € 2.8 billion. This implies an increase of about 70% compared to the previous mandate.

The inter-regional cooperation agreements signed in the 1990s with the main Latin American sub-regions are now being replaced with more ambitious **association agreements.** These aim at strengthening our political and economic cooperation but also at establishing free trade areas.

Such agreements already exist with Mexico and Chile and we are negotiating similar agreements with the Andean Community, Central America and Mercosur, though the latter has encountered problems and negotiations are on hold, also pending progress on the Doha trade negotiations. Indeed, regarding **Mercosur**, the European Union remains committed to restart technical talks as soon as possible with the Mercosur partners, with a view to make concrete progress before the EU-Latina America Summit, which will take place in Lima in May 2008.

However, the stronger partnership that we are trying to build with Latin America is **not just about trade and investment**. The relationship between the two regions is deeply rooted in **a common history and common values**. Common values about what we want our societies to be, and common values about how we think international relations should be conducted, with a special emphasis on multilateralism.

Indeed, as agreed in the various EU-Latin American summits, our cooperation focuses on two important objectives of **regional integration** and **social cohesion**. Following from our European experience, we see both as essential for stability and prosperity in the Latin America continent

This brings me to what I consider one of the most important themes in the OECD report, namely, **the redistributive role of fiscal policy**. Latin America’s high inequality is largely explained by the insufficient redistributive action of the state. I find particularly telling that, before taking into account the intervention of the state, Latin America's inequality, as measured by the indicator of income inequality, the Gini coefficient , is only a bit higher than in Europe (52 compared to 46 for Europe). However, as the report points out, tax and public transfer systems reduce inequality in Europe by 15 points, while they do so only by 2 points in Latin America.

There is no doubt that it is public action which determines this difference. In particular, the tax and public transfer systems, together with the quality of public finance, are the key determinant of the reduction in inequality in Europe compared to Latin America.

- In fact, I share the analysis that tax over GDP ratios in most Latin America countries are too low to undertake a more ambitious redistribution policy.
- They are also less progressive than in Europe.
- Latin American public expenditure has little impact on income distribution because it is dominated by transfer programmes, notably pensions, that are either neutral or regressive.

I can therefore only support the LEO's emphasis on increasing the legitimacy of fiscal policy by making tax systems more progressive, reducing tax exemptions and better targeting social expenditure on the poor. The conditional-transfer programmes introduced by several countries in recent years (such as Brazil's *Bolsa Familia* and Mexico’s *Oportunidades*), which are well targeted on the poor and appropriately linked to investment in human capital, seem a step in the right direction, though they still represent only a small share of public expenditure.

The reform of the pension system can also make a contribution to social cohesion by improving its coverage of the poor and by releasing resources for other more progressive social expenditure.

And I would add, that the European experience in improving the quality of public finance is also something that the Latin American authorities should be looking at.

There are some encouraging signs that better targeted social policies may be starting to improve social outcomes in some Latin American countries. However, like other structural reforms, policies in this area must be applied in a perseverant manner since their fruits are only slow to appear. We at the Commission are determined to continue working with our Latin American partners to make a difference in this important area of fiscal policy.

Indeed, on the whole the EU needs to strengthen its partnership with Latin America. We have devoted a great deal of energy in recent years to our relations with key economic powers such as China, India and the US. And while this strategy is prudent and efforts are proving fruitful, I believe that we risk missing important opportunities by not paying enough attention to Latin America.

The region provides enormous potential for development and is playing a growing role in the international arena. As a bloc of almost 500 million people with rising purchasing power, it represents an important potential market. The region also boasts considerable natural resources. As Latin America continues to grow both politically and economically, we should make sure we fully take into account the potential Latin America holds for the EU and focus on developing our mutual ties.

In this respect, the launch last July of the EU's Strategic partnership with Brazil is an important step forward that will raise the level of cooperation in a range of areas such as trade, environment, and human rights and poverty reduction.

Concluding remarks

Let me stop here to give the floor to Javier, who will provide us with interesting insights into the findings of the report.

Before concluding, however, let me again stress the importance of raising the profile of Latin America and of our relationship with this continent. Europe shares so much affinity in terms of culture, shared history and commerce with Latin America, and the economic and political opportunities to further deepen our relationship are significant.

The Commission will continue to do its part to keep forging, through all the instruments at its disposal, a stronger economic and political relation with our Latin American partners.

Thank you for your attention and I am looking forward to the detailed presentation by Javier of the LEO and to more such reports to come.