

Globalisation, development financing and “Chindia” in Latin America

Latin American Economic Outlook 2008

Javier Santiso

Director & Chief Development Economist
OECD Development Centre

■ Bern, 11th March 2008 ■

Swiss Agency for Development Cooperation

The OECD and Latin America: An emerging commitment

- Latin American market democracies matter for the OECD and its member countries
- The Latin American dimension at the OECD:
 - Mexico: Member since 1994; Chile: candidate since May 2007; Brazil: enhanced cooperation, May 2007
 - Economic Surveys:



1992, 1995, 1997, 1998, 1999
2000, 2002, 2003, 2005, 2007



2003, 2005, 2007



2000, 2005, 2006



- **Latin American Economic Outlook 2008**

The Development Centre: A bridge between the OECD and emerging regions



- **Membership of the Development Centre**

With a Governing Board open to OECD non-member countries, the Development Centre provides a framework for dialogue and experience sharing with emerging regions all over the world.

- **Three Latin American countries are members of the Centre:**

- Mexico
- Chile
- Brazil

Latin American Economic Outlook: The key tools

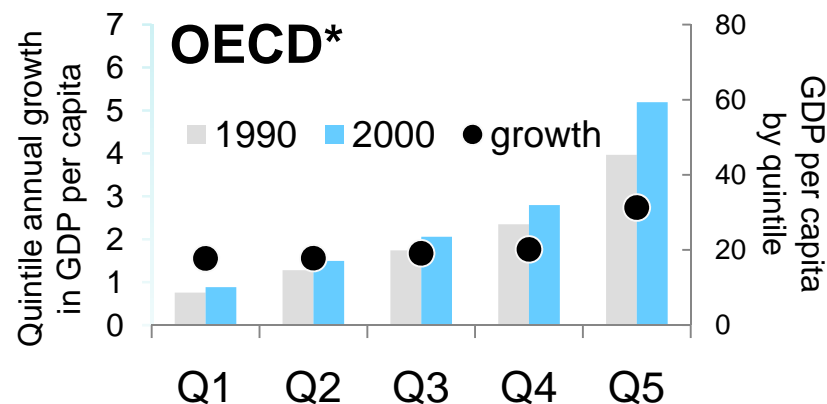
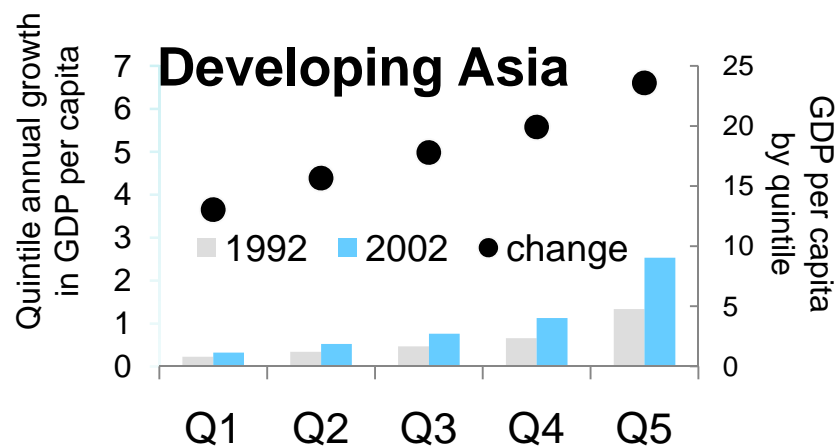
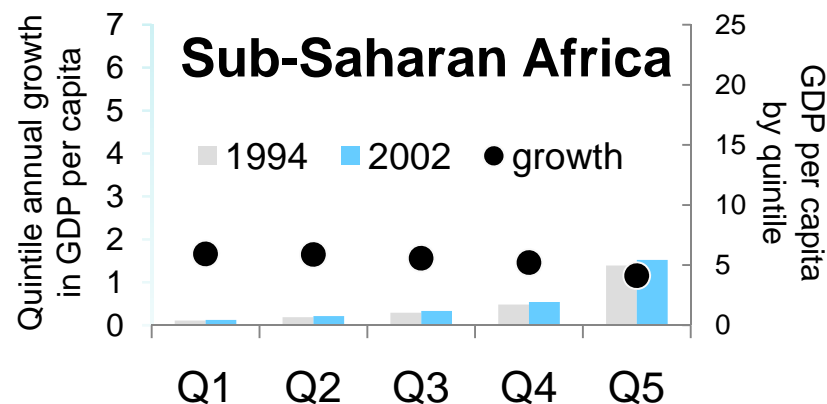
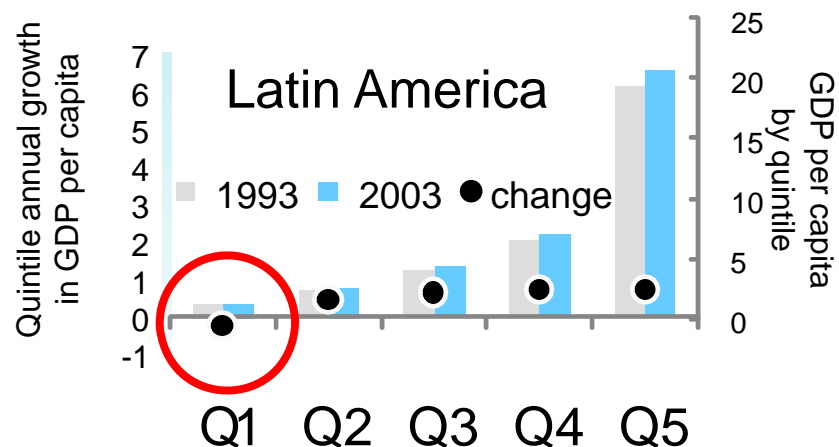
- **Informal Advisory Board:** Scholars and policy makers from Latin America and OECD countries enrich the analytical work of the project.
- **Research and Publications:** The Development Centre collaborates with OECD experts, international organisations and various Latin American think-tanks.
- **Dialogue Forum:** Key government officials from OECD and Latin American countries share experiences about the design and implementation of public policies.

I Fiscal Policy and Legitimacy

II Pensions, Capital Markets and Corporate Governance

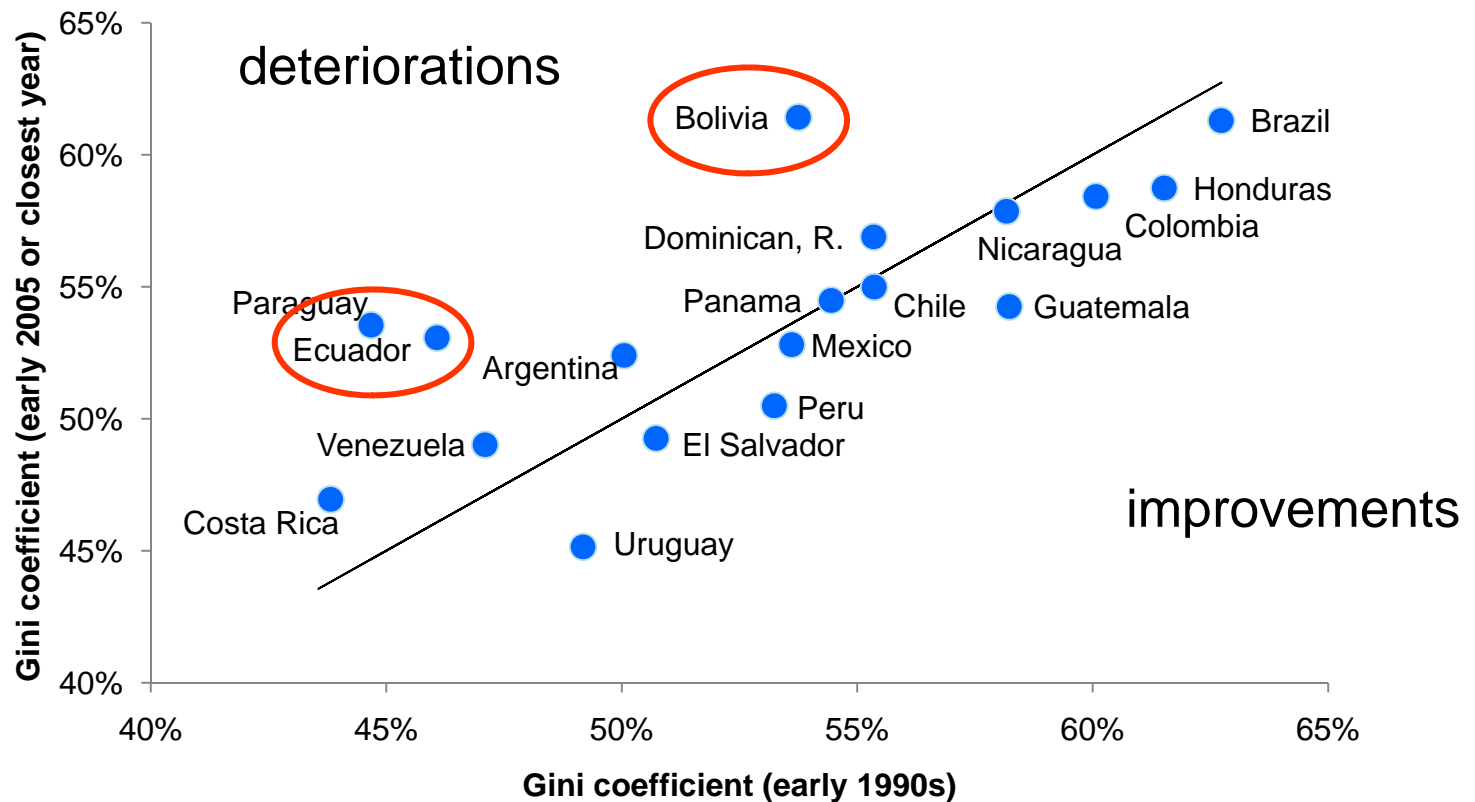
III China, India and the Challenge of Specialisation

Economic growth is slower than in other regions and it has left out the poor



Improvements in inequality are slight or non-existent

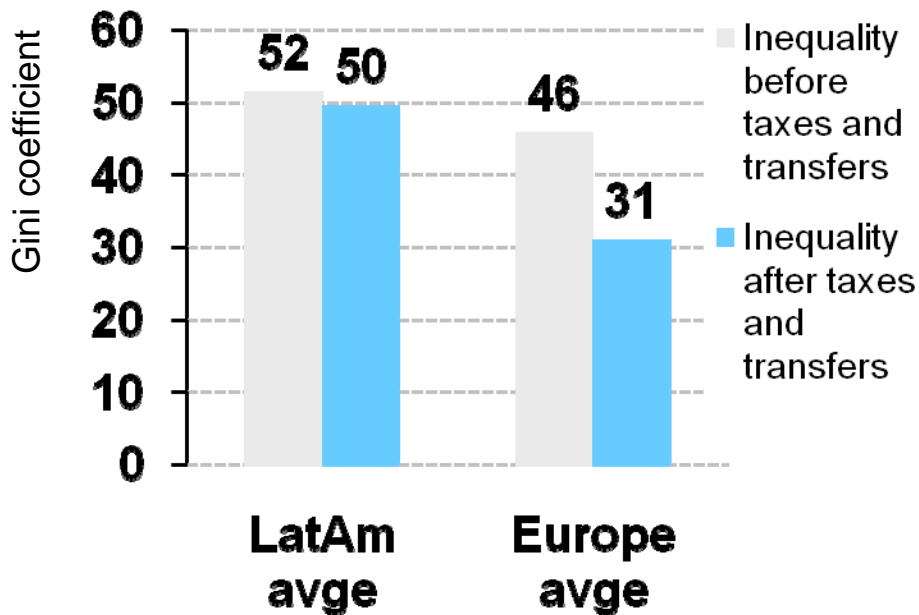
Changes in inequality during the last decade



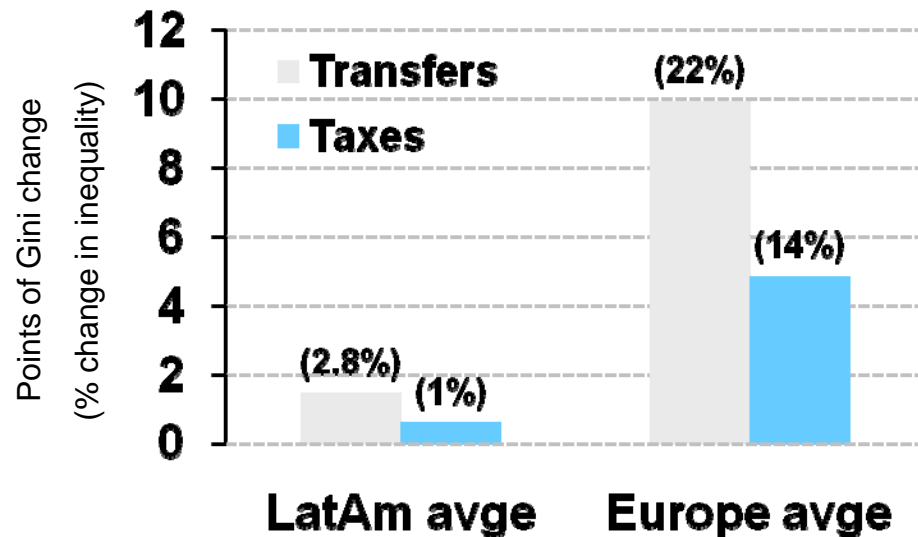
Fiscal policy plays a very limited redistributive role, especially taxation

Public spending is a key instrument for tackling inequality

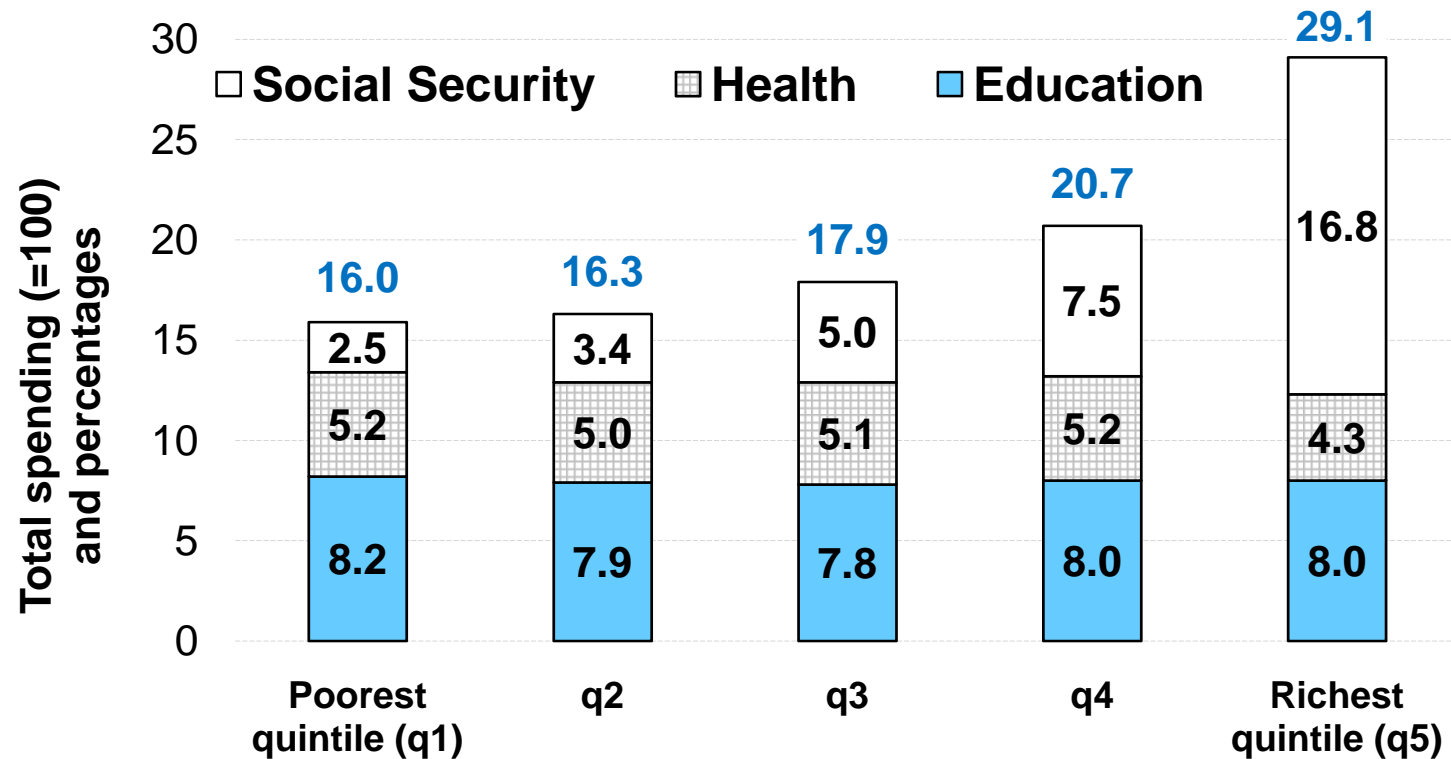
Inequality before and after taxes and transfers



The effects of taxes and transfers



And also... in many cases social spending is regressive

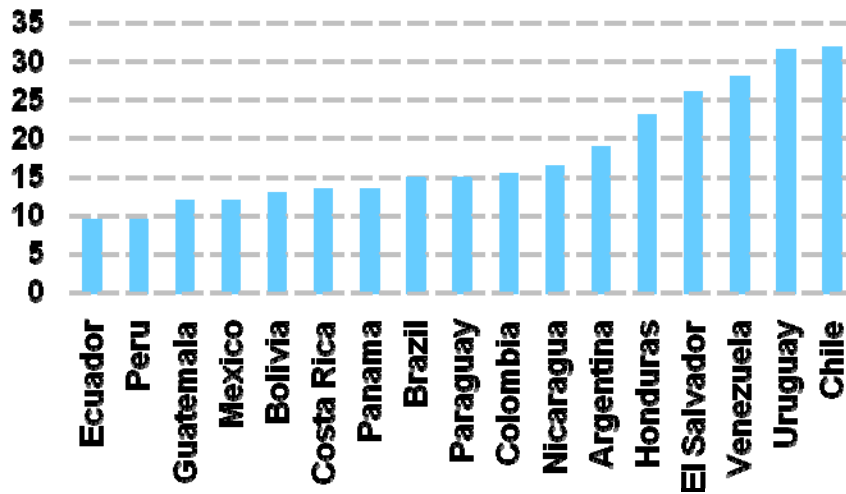


Source: OECD Development Centre, 2007. Based on ECLAC's *Panorama Social*.

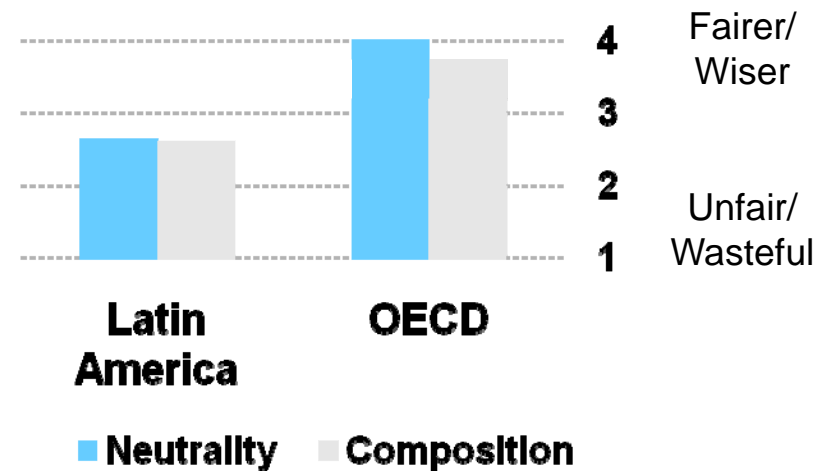
Source: OECD Development Centre, 2007. Based on Latinobarómetro (2003) and ECLAC's *Panorama Social*.

The result is very limited political capital to work with... fiscal legitimacy is low

% of citizens who trust tax revenue is well spent (2003-05)



Firms' assessment of the neutrality/composition of government decisions/spending (2003-2006)

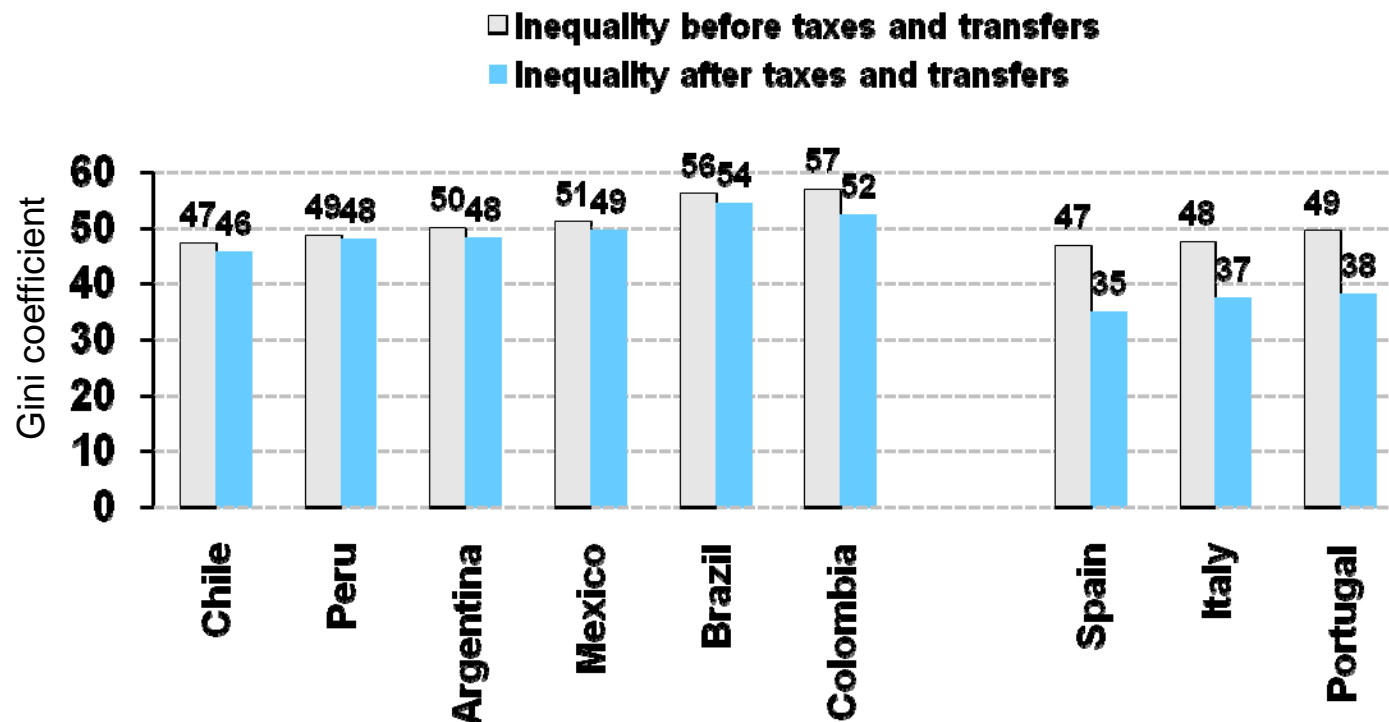


Source: OECD Development Centre, 2007. Based on Latinobarómetro (2003, 2005) and World Bank Institute, Governance Indicators Database. Based on World Economic Forum, Global Competitiveness Report, 2003-2006.

There is no Latin curse: Quality of fiscal policy is not a matter of DNA

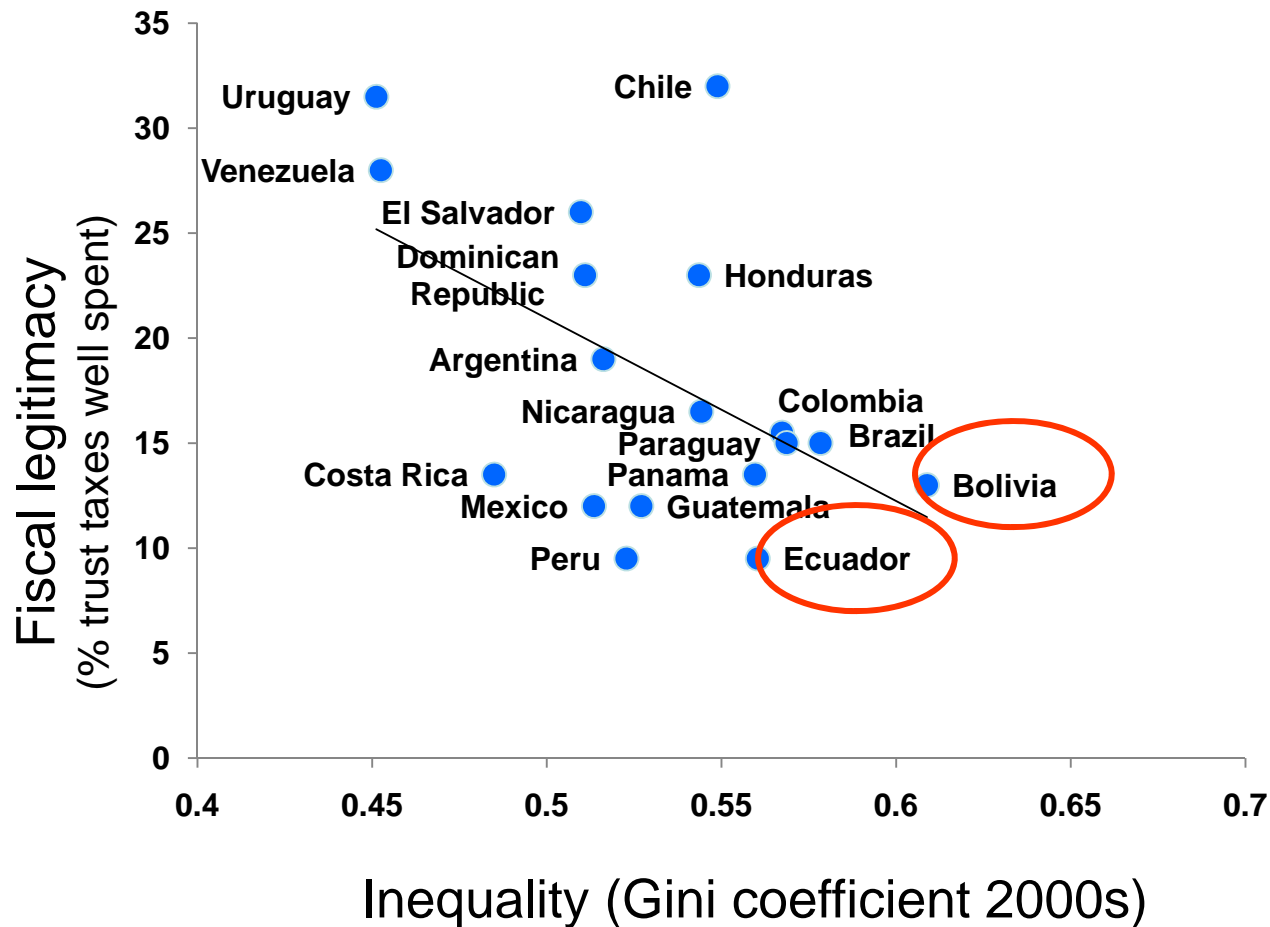
**Fiscal policy is more efficient in Europe (even in its Latin countries)
in reducing inequalities and stimulating social cohesion**

Inequality before and after taxes and transfers

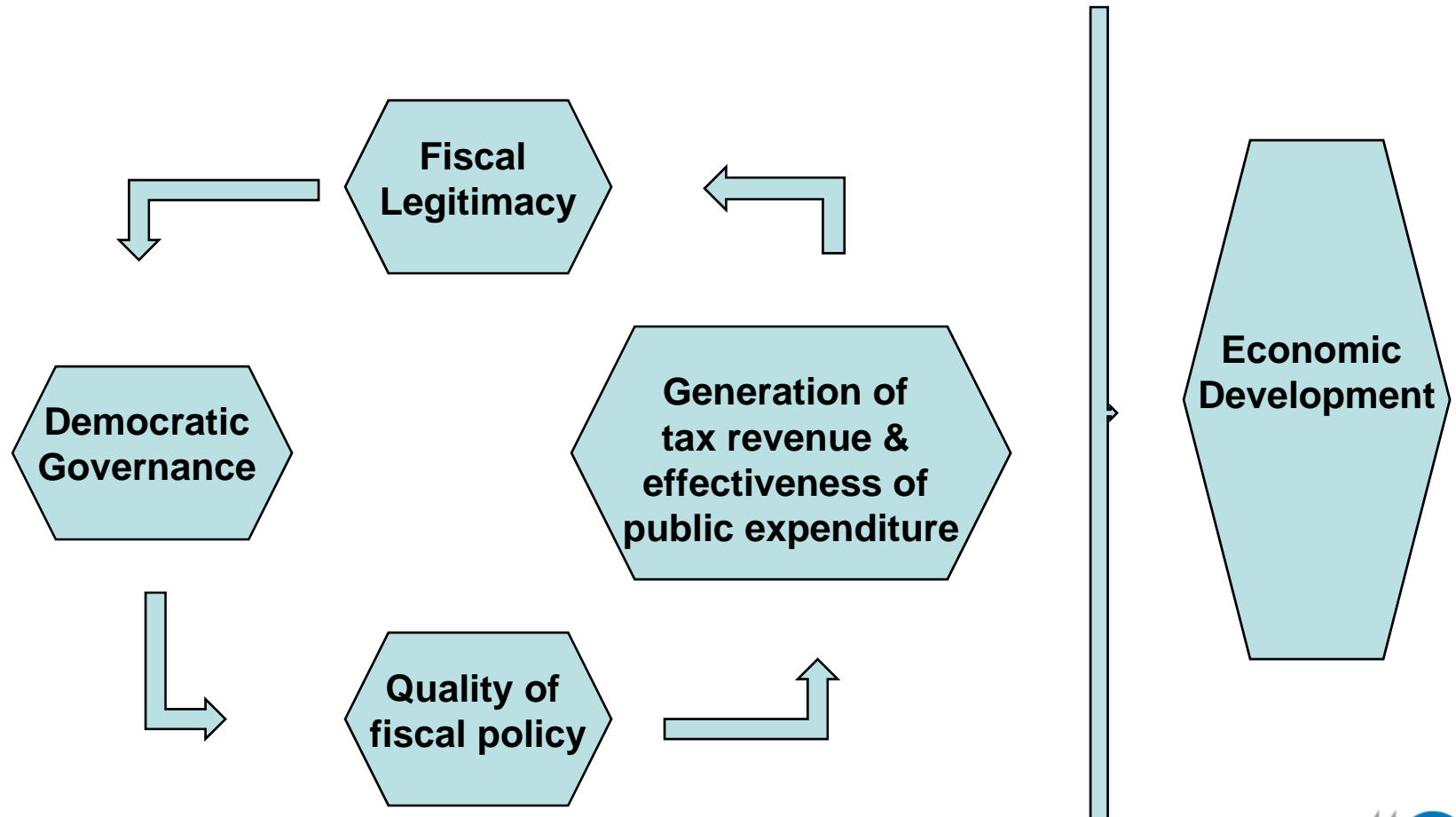


Source: OECD Development Centre, 2007. Based on data by Goñi, López, and Servén (2006).

Social cohesion is becoming an increasingly important issue in the region

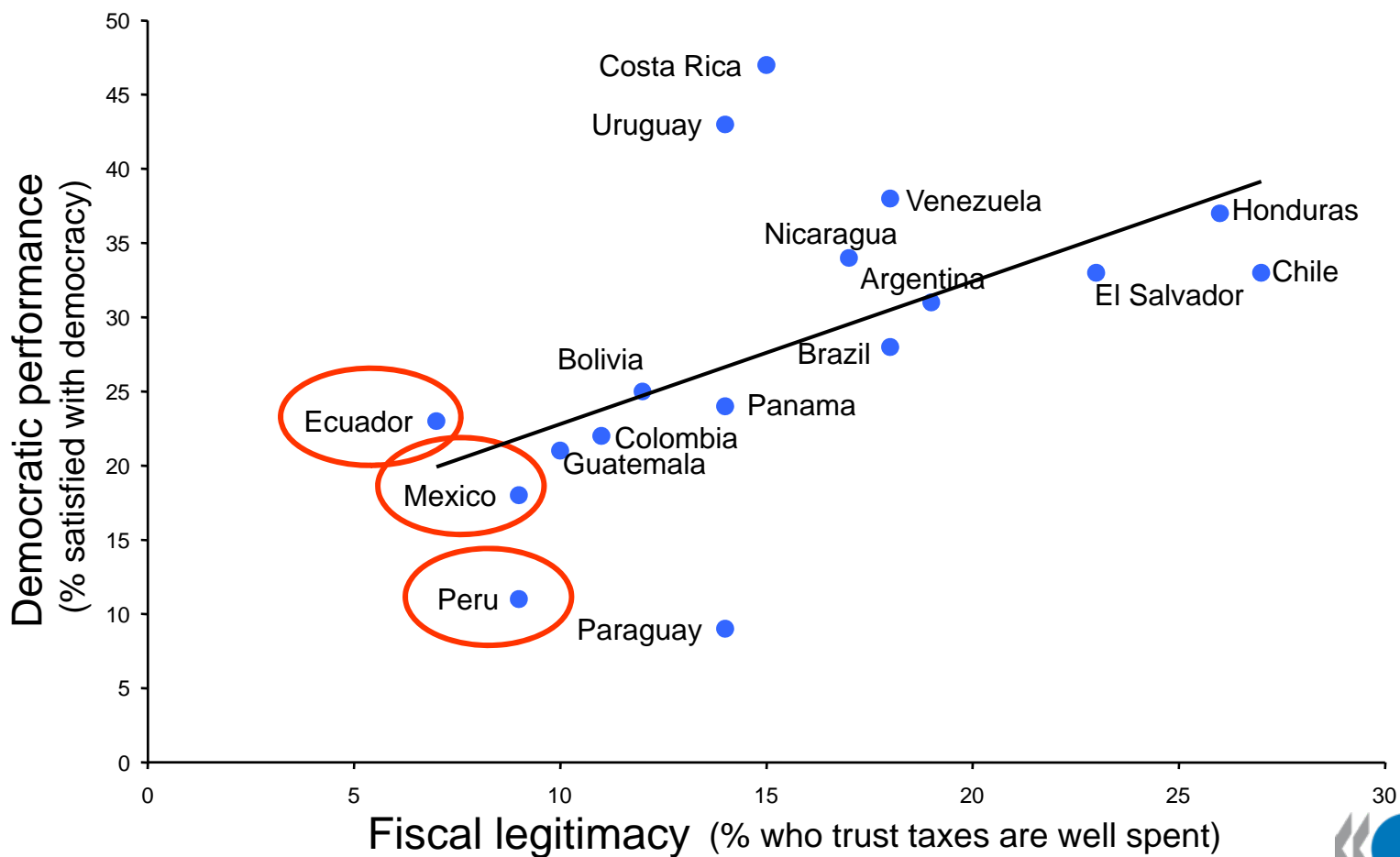


Development financing: The importance of the link between fiscal policy, democratic governance and development



Fiscal policy can help democratic consolidation in Latin America

It is not simply a technical matter

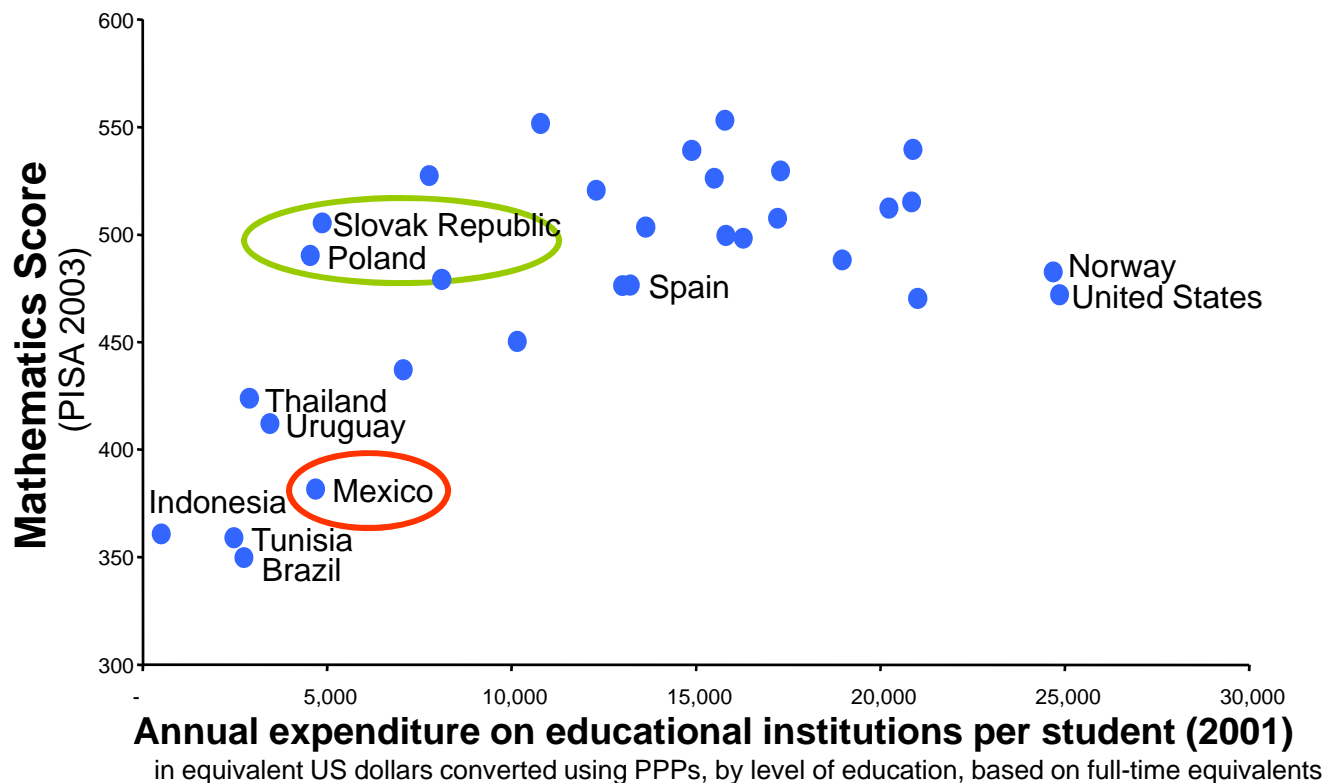


Source: OECD Development Centre, 2007. Based on Latinobarómetro (2003).

Improving public spending is crucial (efficiency and progressivity)

Improving the efficiency and equity of public spending is a crucial challenge for the region

Education Expenditures and Performance



Traditional weaknesses of fiscal policies in Latin America

- Tax revenue is generally low and tax structures unbalanced
- Direct taxation is particularly low
- Tax base is narrow (some of the reasons are informality and tax exemptions)
- Excessive reliance on volatile revenues from natural resources
- Countries still rely heavily on transfers from the central government

Fiscal Reforms in Latin America

- Results of the 1990s fiscal reforms have been mixed in part because many of the reforms were not fully implemented.
- Contrasting experiences of Brazil and Mexico suggest that rather than pursuing technical perfection, a wise approach to fiscal reform may involve focusing with perseverance on reforms that are feasible (“political economy of the possible)

Some recommendations

- Enhancing transparency and accountability in fiscal policy (role of independent third parties for auditing and evaluation – Local think tanks)
- Better, fairer and more public spending
- Broadening tax base and making tax systems fairer and more balanced (elimination of special exemptions in direct and indirect taxes, increasing direct taxation)
- Decentralisation – reinforcing the capacity, authority and accountability of sub-national government bodies, especially through their greater use of direct taxation to finance expenditure

I Fiscal Policy and Legitimacy

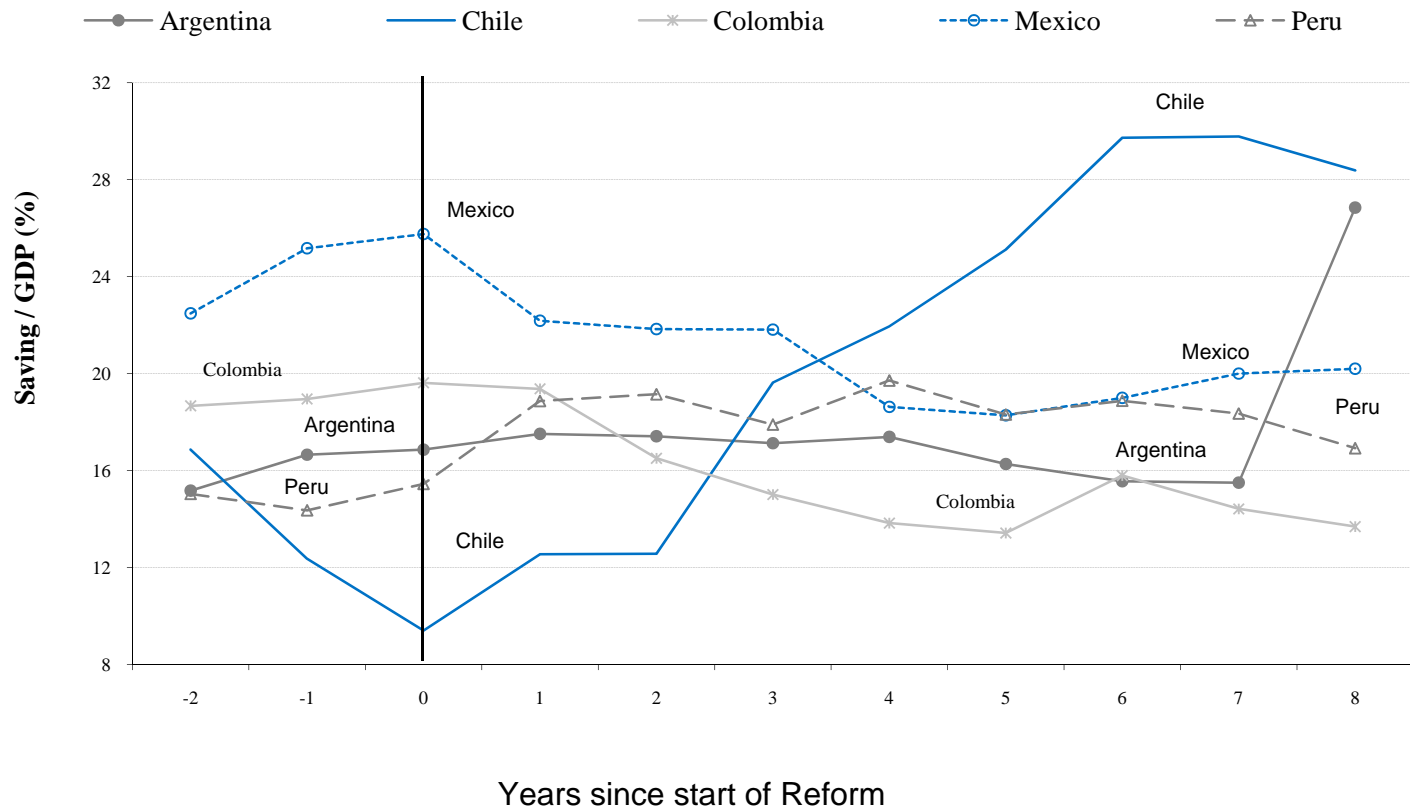
II Pensions, Capital Markets and Corporate Governance

III China, India and the Challenge of Specialisation

Pension Reform in Latin American Countries

- **Latin America is at the forefront of pension reform.**
 - Chile launched the process in 1981 and many countries in Latin America and Eastern and Central Europe have found inspiration in the Chilean experience.
- **More efforts are needed in refining the mechanisms in various countries to improve:**
 - 1) commercial practices 2) competence and administration of pension funds 3) investment regulations and 4) the contributions paid by members.
- **Improving the social dimension of pension reform is also necessary to:**
 - 1) extend coverage 2) ensure timely payment of contributions 3) enhance efficiency of management of funds and 4) reduce costs to members.

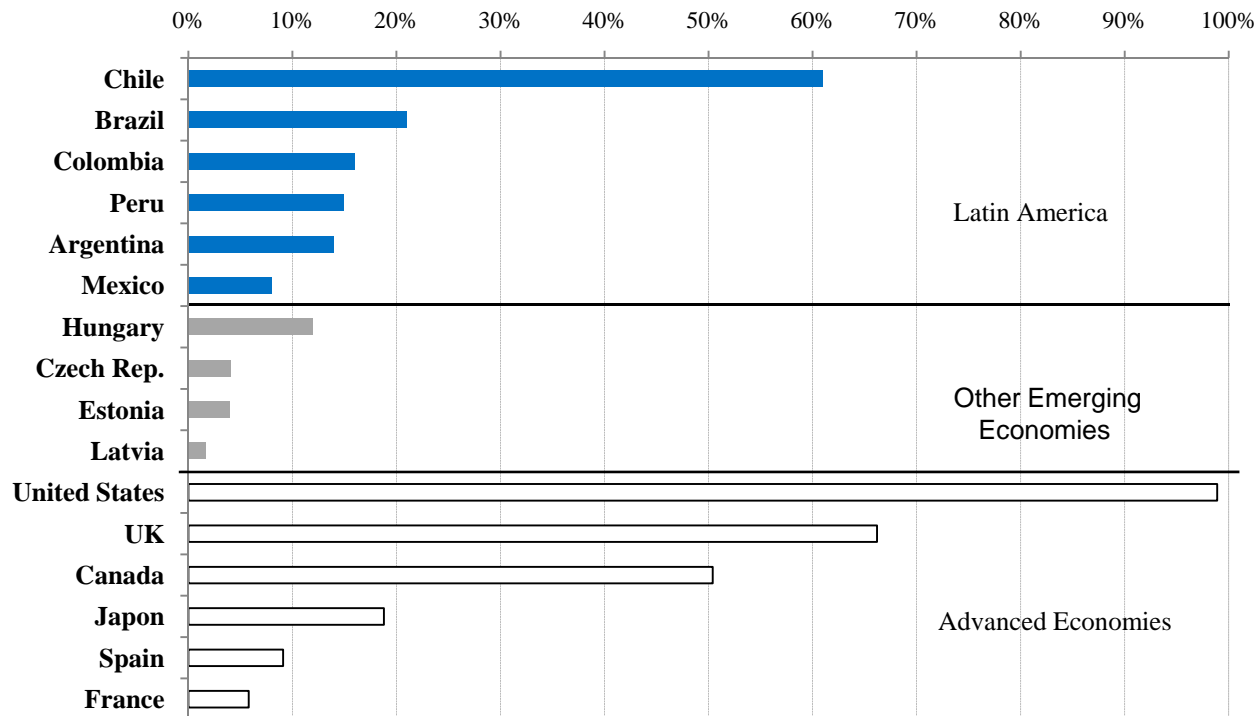
Pension reform has had a mixed impact on national savings



Source: OECD Development Centre (2007), based on World Bank Development Indicators.

But they have become a force for the development and deepening of financial markets

Pension Fund Assets as percentage of GDP, 2006



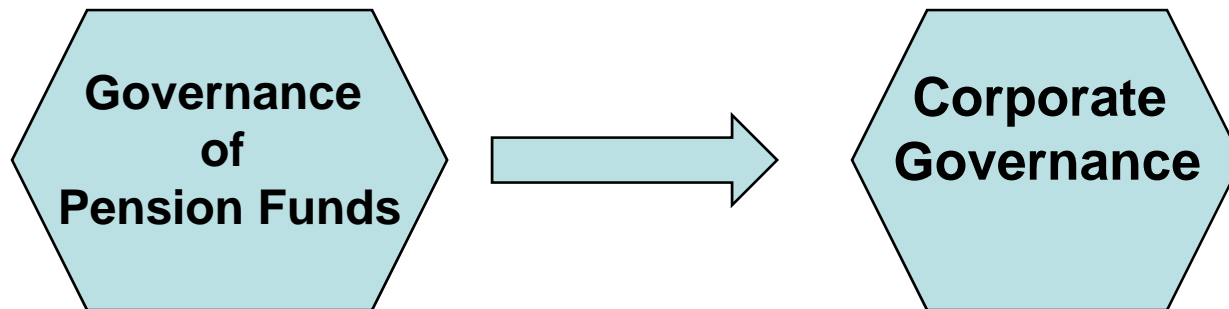
Source: OECD Development Centre (2007), based on Global Pension Statistics database.

Impact on capital markets

- On financial securities markets
- On the creation of new instruments
- Increasing the size and the depth of the local stock market
- Modernisation of trading systems in stock exchanges
- Reducing volatility of transactions
- Reducing costs faced by enterprises
- Creating greater competition between the institutional investors in the market
- Improving the allocation of financial resources
- On the development of the life – insurance industry

The importance of strengthening the Governance of Pension Funds

The quality of the governance of the pension funds is critically important not only for the own financial performance and the benefits they provide to their members, but also for the considerable indirect impact on the quality of corporate governance of the enterprises in which pension funds invest.



I Fiscal Policy and Legitimacy

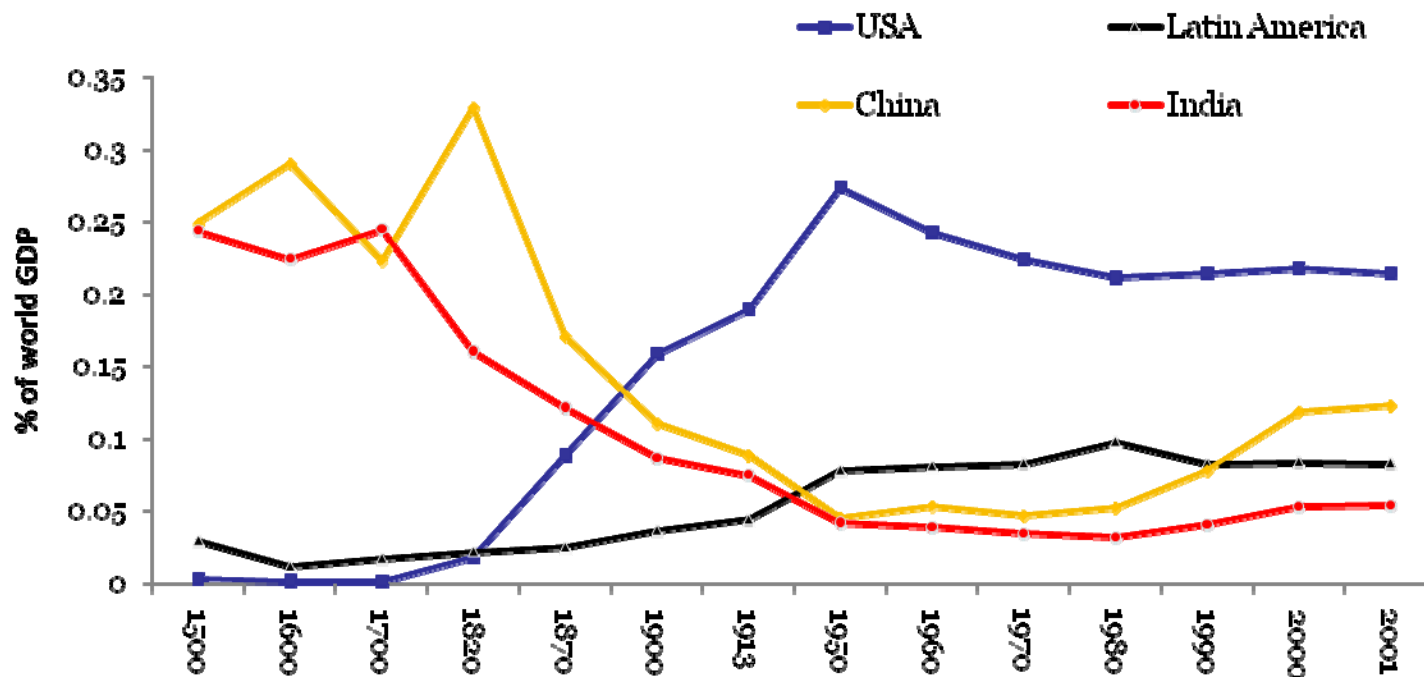
II Pensions, Capital Markets and Corporate Governance

III China, India and the Challenge of Specialisation

Emerging economies are increasingly present on the global scene

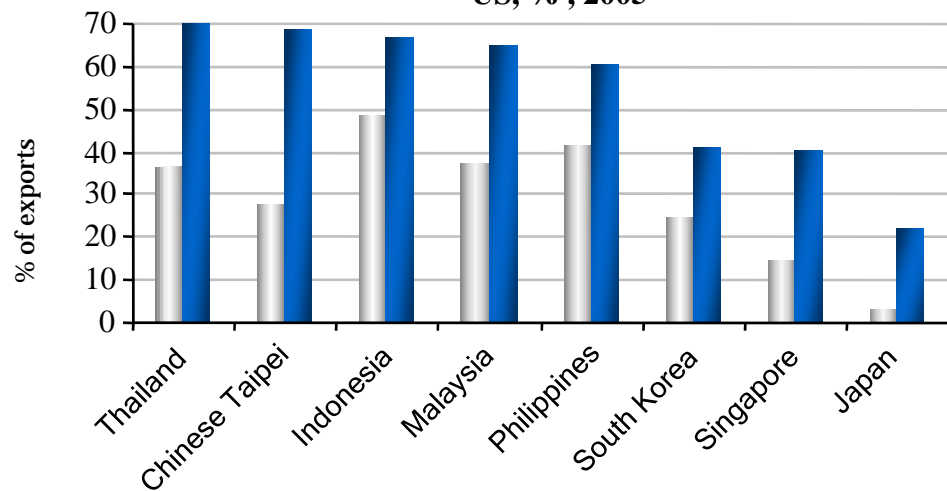
When the OECD was founded, its member countries accounted for 75% of world GDP, today they represent 55% of world GDP

Evolution of share in world GDP



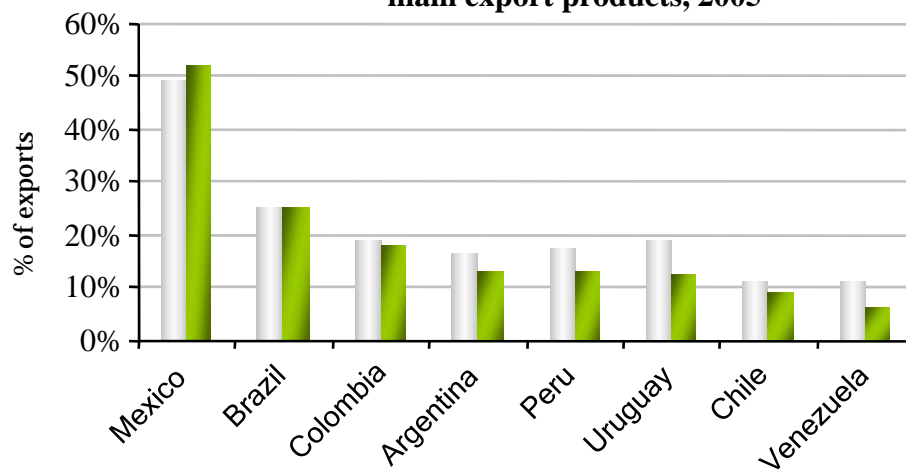
China and India could be angels rather than demons for Latin America's commercial development

Asian countries competition* vs. Chinese exports to US, % , 2005



*Value of exports to US from China in same product categories as country's exports, as % of country's total exports to US

Latin American countries competition* vs. Chinese main export products, 2005



Arithmetic average of the following indexes: $CC = \frac{\sum_i a_{it}^ a_{it}}{\sqrt{\sum_i (a_{it}^*)^2 \sum_i (a_{it})^2}}$ and $CS = 1 - \frac{1}{2} \sum_n |a_{it}^n - a_{it}^n|$

where a_{jt} and a_{it} equals the share of item "n" over total exports of countries j (China) and i in time t.

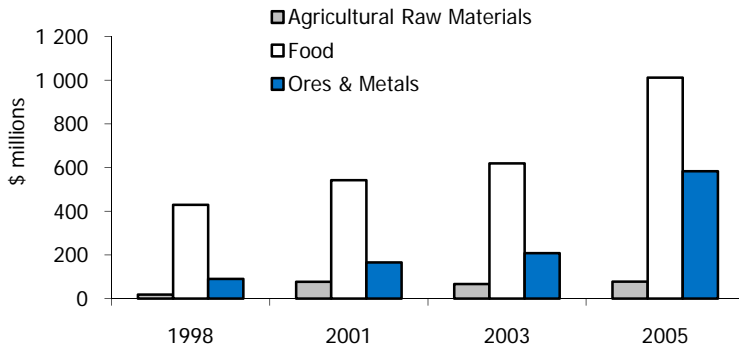
Source: C.HJ.Kwan, Nomura Institute of Capital Markets Research

Source: OECD Development Centre, 2006

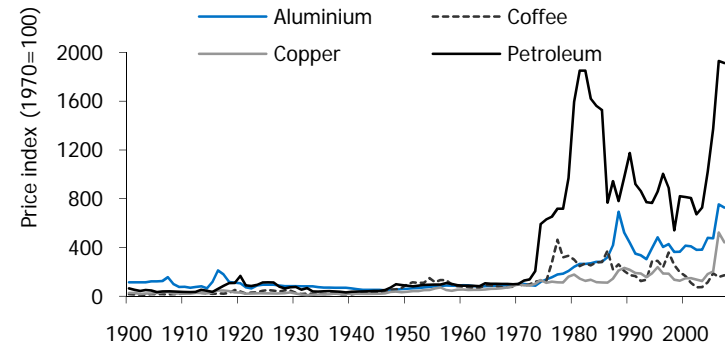
Based on Working Paper by Blázquez, Rodríguez and Santiso, 2006

The Asian boom has had a strong impact on the trade balance of several Latin American countries

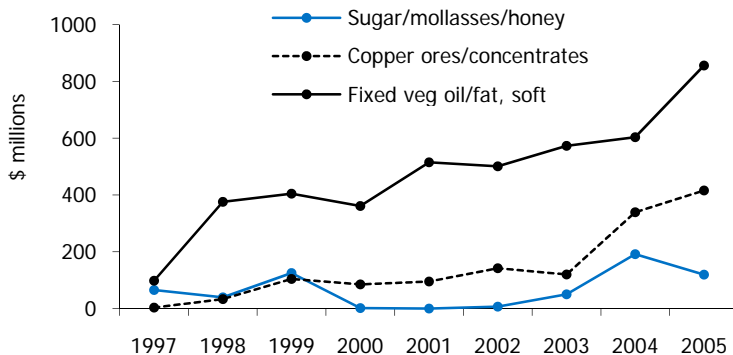
China's and India's rising demand for Latin American commodities (1998-2005)



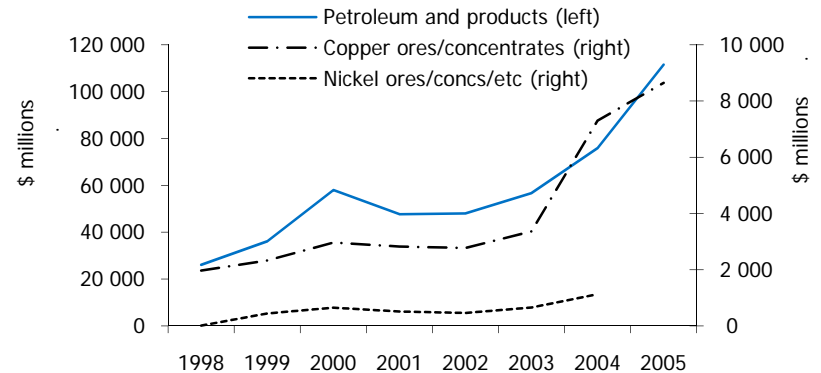
Increasing commodities prices (1900-2005)



Rise in Indian imports from Latin America (1997-2005)



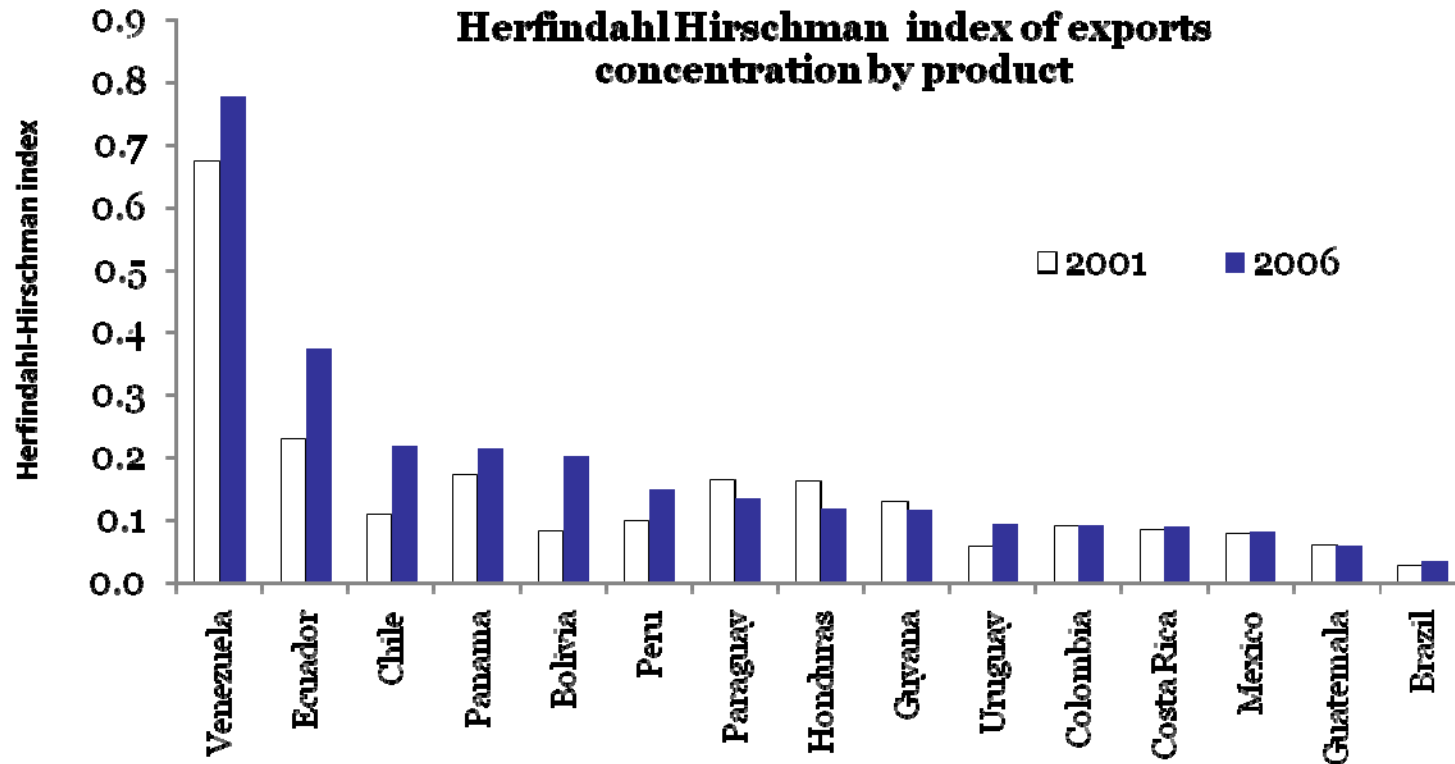
Rise in mineral exports from Latin America (1998-2005)



Source: OECD Development Centre, based on WITS Database, 2007.

The rise of China and India also represents a wake-up call: The challenges of specialisation

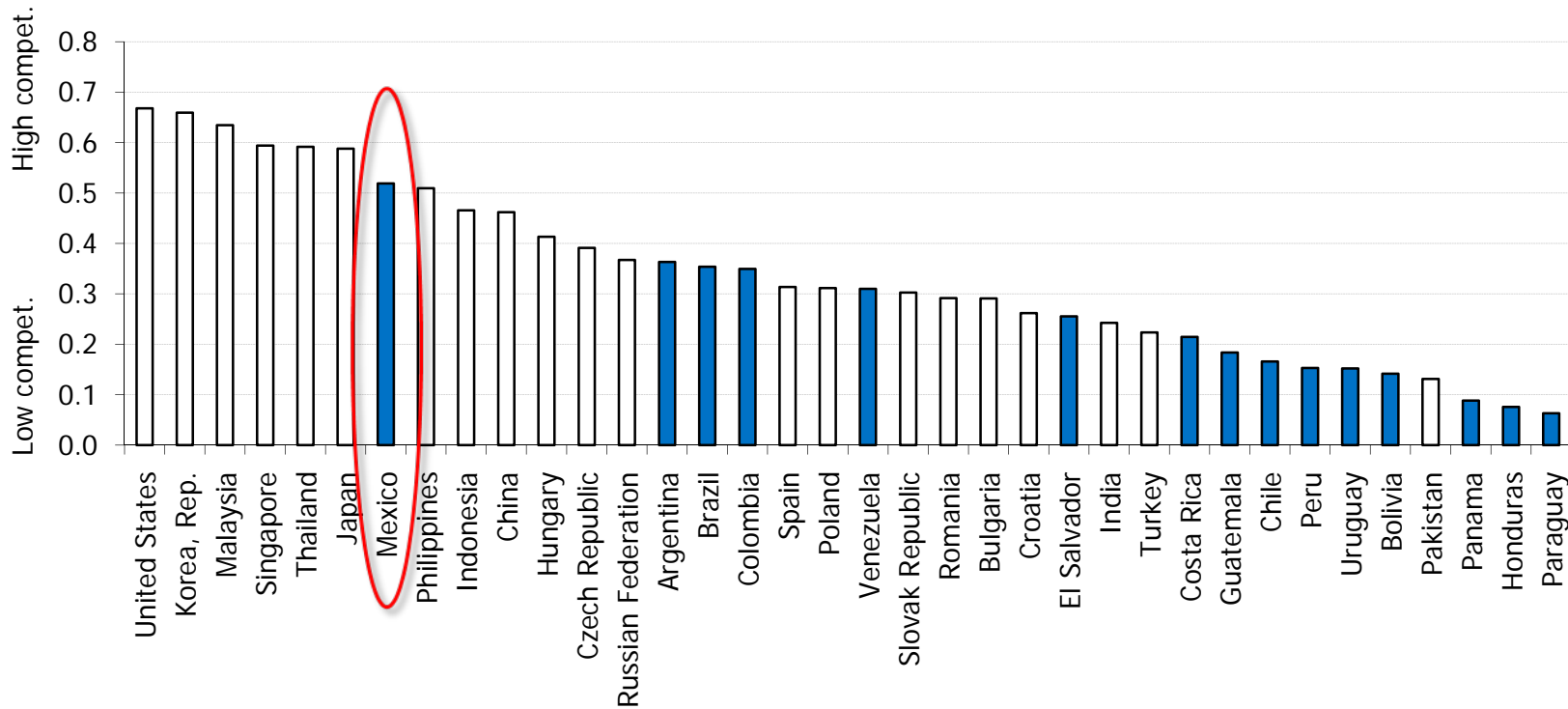
Latin America risks to fall on an excessive raw-material specialisation



Source: OECD Development Centre, 2007. Based on WITS and Comtrade data.

Trade complementarities with China remain unexplored today...

Trade Opportunities with China for selected countries (2000-05)

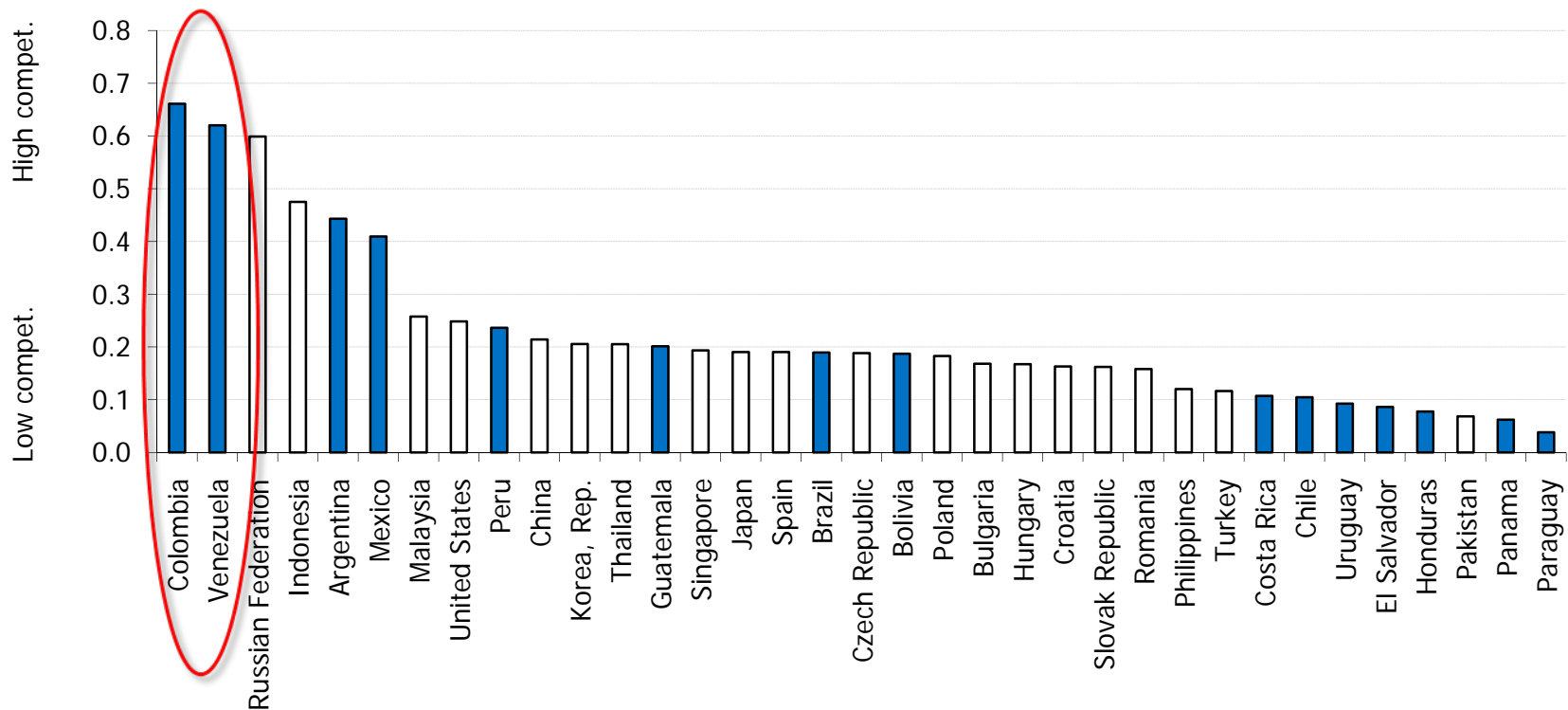


Note: Modified CS and CC coefficients calculated with exports of country i and imports of country j (China, India).

Source: OECD Development Centre, based on WITS Database, 2007.

Major economies in the region have a lot to win from increasing trade with Indian partners

Trade Opportunities with India for selected countries (2000-05)



Note: Modified CS and CC coefficients calculated with exports of country *i* and imports of country *j* (China, India).

Source: OECD Development Centre, based on WITS Database, 2007.

Beyond commodities: Trade potential to export to China and India

There are also substantial opportunities for intra-industry trade:

- Mexico: telecommunications equipment and electric circuit equipment
- Brazil: aircraft, telecommunications equipment and motor-vehicle parts
- Colombia: manufacturing sectors
- Argentina: Processed food

Agriculture and agri-business are probably among the most promising areas for Latin America in terms of trade potential with India and China

Exploiting comparative advantages: The proximity to export markets

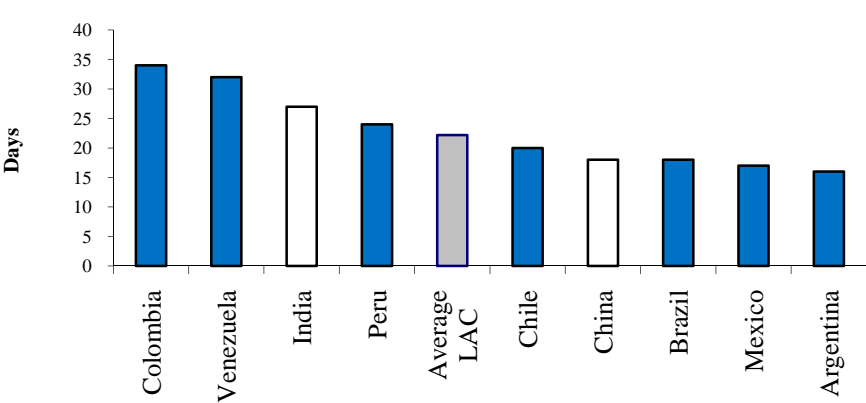
Mexico benefits from its geographic proximity to its major export markets



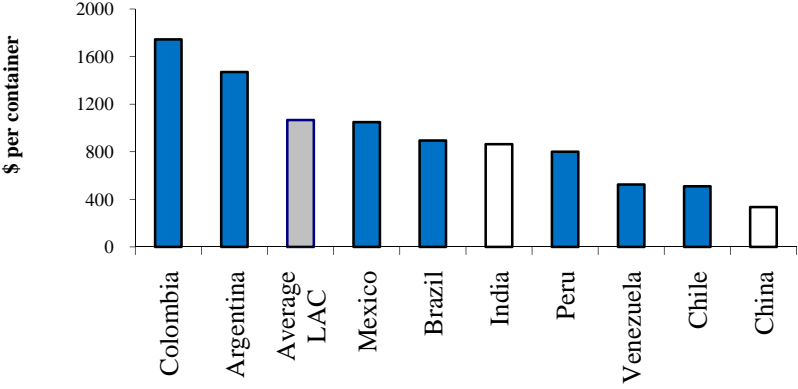
Mexico is more competitive in manufacturing more sophisticated products which require short delivery times

Infrastructure is a serious drawback for Latin America's trade development

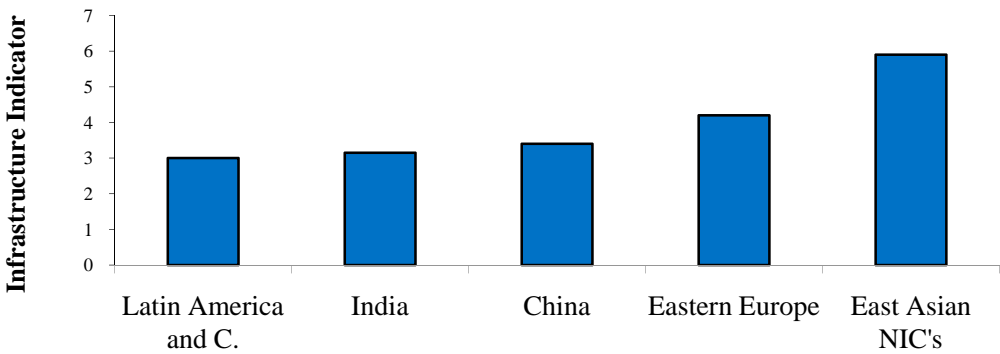
Time for exports



Cost of exports



Regional performance in the infrastructure pillar



Source: Doing Business Report. World Bank, 2007.



Ways to deal with Dutch disease and other challenges

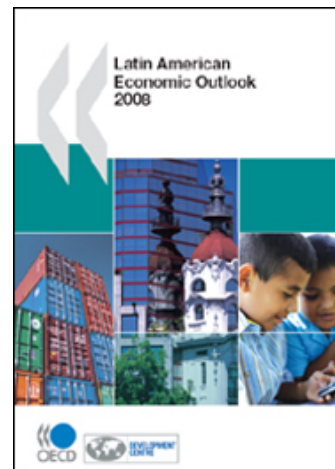
- **Introducing new mechanisms to prevent appreciation (stabilisation funds, counter – cyclical fiscal rules, issuing of debt)**
- **Diversification**
- **Innovation**
- **Involving the private sector in R&D**
- **Infrastructure**

Latin American Economic Outlook 2009 and more

- **Fiscal Policy and development.**
- **Migration and development.**
- **Innovation and development.**

Latin American Economic Outlook 2008

www.oecd.org/dev/leo



Thank you
Merci
Obrigado
Gracias