Section I: Economic Growth and Development

1. Latin America 2060: Securing Economic Development for the Longer-Range Future

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Latin America is growing, and growing fast. The question is whether it is developing, in the sense of securing the basis for sustained inclusive growth, or merely experiencing an upswing in its historically cyclical, natural resource dependent model.

Few would assert that growth itself constitutes development, even if, arguably, growth makes good development policies feasible. True development must include opportunities for democratic participation, less vulnerability to natural, military and economic calamities, social inclusion of marginalized groups, sustainable resource use and lifestyles that are healthy, productive, and pleasurable.

While it isn't possible to measure progress precisely on these dimensions, we can assess income, education, maternal and infant mortality, violence, as well as inequality and poverty rates. With the exception of violence rates, Latin America is making progress. Every country in the region has seen infant mortality decline sharply in the past two decades (Table 1). Maternal mortality—arguably a greater

Table 1. Infant Mortality: Rate per 1,000 Live Births

	Argentina	Bolivia	Brazil	Chile	Colombia	Costa Rica	Ecuador	El Salvador
1990	25	84.3	46	18.3	28.1	15.8	41.3	48.2
2000	18.8	62.4	28.2	9.4	22.0	11.5	28.0	27.8
2009	13	39.7	17.3	7.0	16.2	9.6	20.4	14.6
	Guatemala	Honduras	Mexico	Nicaragua	Paraguay	Peru	Uruguay	Venezuela
1990	57	43.2	36.4	51.5	34	62	20.5	26.5
2000	38.6	32.6	22.1	34.2	25.4	35.1	15.4	19.9
2009	32.6	25	14.7	21.8	19.4	19.4	11.3	15.3

Source: World Bank, World Development Indicators (WDI), 2010.

1 I am grateful to Jonars Spielberg for valuable research assistance.

Table 2. Homicide Rates, Deaths per 100,000 Residents

	2000	2009
El Salvador	39	71
Honduras	51	67
Guatemala	26	46
Venezuela	33	49
Colombia	65	35
Brazil	26	20
Mexico	14	15
Argentina	7	5
Chile	6	4

Source: Organization of American States, Observatorio Interamericano de Seguridad, accessed 06/28/2011

challenge to public health systems—has fallen by similar magnitudes. Only rising violence fueled by drugs and gangs suggests a reversal of progress, and such activity is concentrated in a few northern countries (Table 2).

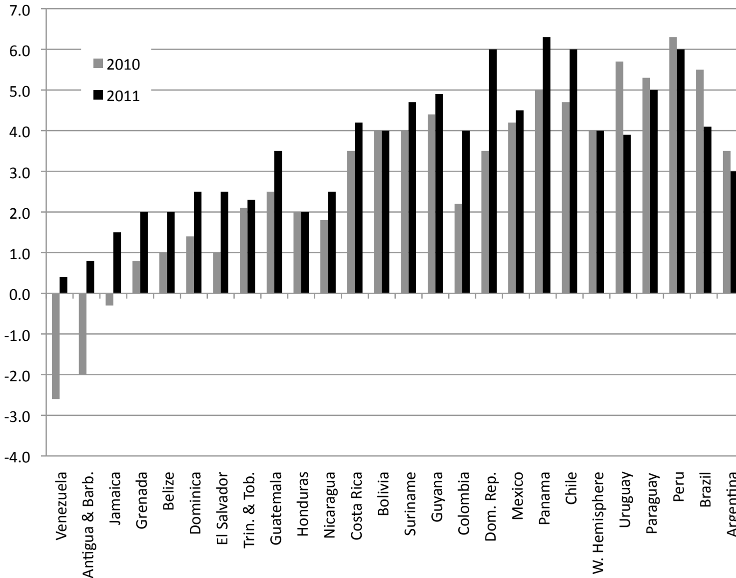
Other contributions to this volume address the extent to which the underpinnings of democracy—beyond elections—have been established. My concern is the extent to which longer-term economic stability has been achieved. Growth itself is helpful; avoiding the economic instability that characterized Latin America's past is essential to securing its increased development by 2060.

ARE THE COMMODITY-DRIVEN BOOMS IN SOUTH AMERICA SUSTAINABLE?

Latin American growth topped five percent in 2010, with growth in Brazil, Peru, and Argentina exceeding seven percent (See the IMF forecasts in Figure 1). This is not merely a rebound from the recession of 2009. Between 2004 and 2008, regional growth averaged four percent with several countries exceeding six percent. When one considers that regional growth in the 1980s, 1990s, and early 2000s hovered around two percent, this resurgence is remarkable.

A recent World Bank report attributes this success to: 1) Improved macroeconomic policies, including strong currencies, countercyclical fiscal policies, and liquidity and capital provisions in banking regulation; 2) Better integration into global financial markets, involving less reliance on external debt "that exposed it to rollover risks, interest rates hikes, and sentiment changes, that could wreak havoc in its finances" and new flows of foreign investment; and 3) Diversification

Figure 1. GDP Growth Forecasts for 2010 and 2011 Selected Latin American Countries



Source: International Monetary Fund (IMF), World Economic Outlook 2010

of its trade structures, which "desensitize it" to the economies of Europe, the United States, and Japan (World Bank 2010, October 6).

The World Bank is not alone in its enthusiasm for Latin America's economic prospects. Brazil's stock market has returned an average of 18.5 percent per year since 2005 despite the 2008 crash (Bloomberg, Bovespa Brazil São Paulo Stock Exchange Index). This is compared to a loss of 0.5 percent per year in the S&P 500 over the same period. Such sustained growth can create jobs and reduce overall rates of poverty. Indeed, poverty rates fell throughout the region between 2000 and 2007 (Table 3). If the optimists are right, Latin America is well on its way to becoming "developed" by 2060. However, there are reasons to be concerned about the sustainability of rapid growth in South America, and the prospects for even modest growth in Central America (Mexico is on a distinctly different trajectory, to be discussed later).

Despite refrains that "this time is different," a commodity boom is evident throughout South America. Much of the macroeconomic dynamism is concentrated in the export sector, and much of that growth is attributable to higher commodity prices rather than output (although production has increased). The

Table 3. Poverty Headcount Ratio at $2 a Day (Purchasing Power Parity—PPP, % of Population)

Country Name	2002–2003	2006–2007
Argentina	19.7	7.34
Bolivia	34.2	21.9
Brazil	21.5	14.6
Chile	5.34	2.38
Colombia	26.3	27.9
Costa Rica	11.5	4.25
Dominican Republic	16.3	12.9
Ecuador	22.4	12.8
El Salvador	24.5	13.2
Guatemala	29.8	24.3
Honduras	33.4	29.7
Mexico	13.1	4.79
Panama	20	17.9
Paraguay	28.1	14.2
Peru	24.4	18.2
Venezuela, RB	31.7	10.2

Source: World Bank, WDI, 2010

exports that have fueled the region's boom (Table 4) are volatile primary commodities, including copper, gold, iron, soy, and oil. Table 5 presents trends in prices of minerals: all have more than doubled in the past decade. Soybean prices alone have doubled since 2005 (Figure 2), and oil prices are more than twice what they were a decade ago in real terms.

Additionally, China's imports into the region have fueled commodity demand and confidence. Between 2000 and 2008, trade between China and Latin America grew at an annual rate of 31 percent, almost all of it in the Southern Cone (Inter-American Development Bank 2010). China's growth could give rise to

Table 4. Exports of Goods and Services 2004–2007 (% Annual Growth)

Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Mexico	Paraguay	Peru	Uruguay	Venezuela
9.5	9.7	9.0	7.5	9.1	8.9	8.8	9.4	9.2	13.9	1.6

Source: World Bank, WDI/Global Development Finance (GDF), 2010

Table 5. Mineral Export Prices, 2001–2009
Index, 2001=100

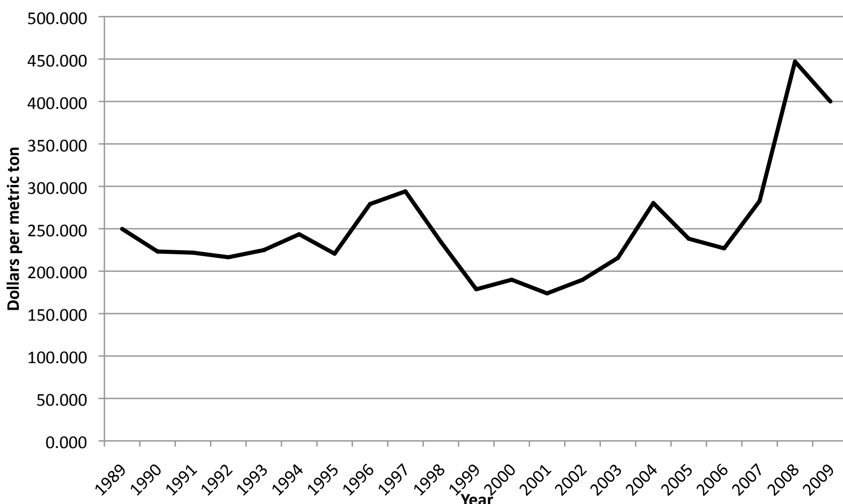
	2001	2005	2007	Dec-09
Copper	100	231	428	424
Tin	100	175	351	380
Gold	100	164	258	417
Silver	100	166	304	405
Iron	100	175	206	218

Source: Baca et al., 2010

a "super-cycle," a decades-long commodity boom. If so, Latin America will have the luxury of financing better schools, housing, roads, ports, and parks.

But China's rapid rise has also created supply bottlenecks that are likely to be relieved over time, leading to lower prices. A decline in gold and copper prices to half of the 2009 level—a return to healthy 2005 prices—would reduce Peru's exports by nearly a third. Global reserves of iron and copper are massive, particularly if recyclable stocks are included. While Brazil is home to Vale, the world's largest iron ore firm, the country produces just 15 percent of global iron ore, compared to nearly half of global output in China itself. Moreover, China has aggressively invested in Africa, where cheap production may finally take off in the next decade.

Figure 2. Soybean Prices, Brazil ($/MT)



Source: IMF, International Financial Statistics Database, 2010

Similarly, soybeans are produced in many highly efficient developed countries. The United States, whose folly in diverting land to corn-ethanol is close to an end, may compete fiercely with Brazil and Argentina as the dollar weakens. U.S. soybean output, one-and-a-half times that of Brazil's, grew faster than Southern Cone output from 2006 to 2010. Monsanto and Brazil's Embrapa have also developed seeds and strategies to enhance the productivity of soy farming on marginal lands throughout the tropics. Even if China's demand for grain-fed meat continues to grow, prices may well return to historical trends.

The fluctuating price of oil reflects such factors as efforts to reduce carbon emissions through efficiency, the growth of competing energy sources (e.g., nuclear power, wind, and natural gas), perceived supply gluts from new discoveries, and OPEC policies. Brazil, with its massive Tupi and Libra fields, is poised to become one of the world's largest oil producers. Former president Luiz Inacio Lula da Silva described this new resource as "the opening of a direct bridge between natural wealth and the eradication of poverty," a feat previously anticipated by Mexico in 1976. Yet the difficulty of accessing this oil, 18,000 feet beneath sea level, means large scale production will likely not occur for another decade. Should it succeed, its impact on other energy producers—Venezuela and Ecuador in particular—will not be favorable.

High commodity prices have undermined the competitiveness of other sectors, a classic case of Dutch disease. Foreign capital has been drawn into the region to pursue both commodities and currencies, exacerbating exchange rate appreciation (Table 6). In truth, Latin America has been unable to compete with

Table 6. Real Exchange Rates, 2000–2009 (per US Dollar, 2005 Base Year)

	2002	2005	2008	2009
Argentina	3.66	2.90	2.64	2.93
Bolivia	7.29	8.08	6.18	5.78
Brazil	3.52	2.43	1.77	1.84
Chile	679	560	491	517
Colombia	2,749	2,321	1,842	1,939
Peru	3.45	3.27	3.02	2.73
Uruguay	26.71	24.48	18.61	18.66
Venezuela	1.98	2.09	1.33	1.03

Source: United States Department of Agriculture, 2010

Asia in assembly work for years; in addition, corruption—another element in the "natural resource curse"—seems to have worsened. South America's lack of broad trade competitiveness is evident in its current account deficits. The IMF forecasts substantial deficits in 2010 for every country (except Argentina, Ecuador, and Venezuela) even as it proclaims that Latin America is "advancing with strength" (International Monetary Fund October 2010, 79).

INFLUENTIAL FACTORS IN LATIN AMERICAN DEVELOPMENT

The Real Role of Commodities: Optimists arguably overstate the role of China, as well as the demand for commodities themselves, in the Latin American boom, and underestimate the importance of global liquidity. Low U.S. interest rates, a weakening dollar, excess savings in China, and soft European growth have fueled capital flow to emerging markets. Gold prices, in particular, reflect fears of U.S. inflation and global banking failures, as well as uncertainty about currency re-alignments as global economic power shifts. Gold, which is used almost exclusively for jewelry, is most likely in a speculative bubble as a hedge against continuing economic uncertainty. It is also Peru's largest export.

A loss of growth can hurt Latin America's development as a downturn in foreign investment cools aggregate demand. Investment, aimed at increasing production capacity or capturing rising equity values, is the leading edge of a softening business cycle. And the financial unwinding of excessive optimism has hurt the region before.

The relatively low risk premium on Latin American bonds reflects both confidence in the current generation of finance ministers and a lack of good investment alternatives in the North. A similar phenomenon occurred in the 1970s with petrodollar recycling. A very substantial difference is that external debt is far smaller as a share of GDP (Table 7).

National and Private Debt: Despite lower dollar-denominated debt, and a far healthier financial profile than in the past, recovery of the U.S. economy and higher

Table 7. External Debt as a Percent of GDP

	Argentina	Brazil	Colombia	Ecuador	Honduras	Mexico	Peru
2004	74.1%	13.1%	21.9%	36.0%	53.2%	11.0%	35.2%
2006	27.1%	6.9%	15.6%	26.4%	33.9%	7.4%	25.4%
2009	17.6%	4.2%	14.1%	15.1%	16.1%	9.4%	16.3%

Source: Inter-American Development Bank, Latin American and Caribbean Macro Watch, 2010

interest rates could make it harder to finance deficits in local currency (Brazil's public debt in 2009 was 43 percent of GDP, almost entirely in local currency). Domestic debt is not immune to speculative attack. A loss of confidence in Latin American economies can trigger sales of domestically denominated debt, capital flight, and a currency collapse. This scenario was starkly demonstrated during Mexico's peso crisis as Cetes bonds lost favor in the course of a few months.

Eliminating risk in the private financial sector is also challenging. Although banking regulation in Latin America is better than ever, it is difficult for regulators to assess risk and enforce reserve requirements during a boom, as the evidence points to strong balance sheets until the bubble bursts.

Tax Reform: Absent a commodity boom, the capacity to engage in counter-cyclical fiscal policy is hampered by the region's long-standing failure to engage in tax reforms. Government balances remain beholden to non-tax revenue. Peru, for example, depended on minerals for 11 percent of its revenue in 2009, compared to four percent in 2002 (Baca, Ávila, Muñoz 2010). Tax revenues represent only 16 percent of GDP in Latin America, compared to 35 percent in OECD countries, as volatile commodities are relied upon for non-tax revenue (Dayton-Johnson 2008, 1–2). Tax structures ought to be reformed to capture a wider base, but as Baca et al. (2010) argue in the case of Peru, it is difficult to do so:

> The rapid rise in taxes of these industries—that originates in the extraordinary rise of prices of minerals and oil—generates an optical illusion: tax pressure has passed from 13 percent to 16 percent of the GDP with no effort by SUNAT, thus the idea of a tax reform has vanished from the public agenda …[C]orporate groups have begun to suggest a reduction of income tax rates, the elimination of the ITF (tax to financial transactions), among others, which to us seem unacceptable.

And even though Brazil's tax base is far broader than Peru's and twice the share of GDP compared to other countries in the region, its deficits are also larger as a share of GDP.

The Middle Class: Since 1998, Latin America's middle class in six countries—those rich enough to have savings but not financially savvy enough to move money abroad—has lost its savings due to banking failures and appropriation by bankrupt regimes. Argentina's *cacerolazo* in the wake of the 2001 currency board collapse is a classic example. Overall, the region is still in far better shape than it was a decade ago—and worlds apart from the chaotic inflation of the

early 1990s—but perhaps the middle class should not put its pots back in the cupboard just yet.

The points discussed above are not intended to forecast trouble, but to identify vulnerability that warrants attention to secure long-term growth. A confluence of factors has fueled growth in South America: China's rapid economic expansion, low global interest rates, uncertainty about OECD growth and currencies, and an influx of capital directed at commodities. Notably absent are fundamental improvements in productivity driven by skills and technological advancement, although new wealth has financed improved infrastructure. The main result has been a case of Dutch disease: currency appreciation, biased investment, and fiscal dependence on commodity revenues. Perhaps those who benefit from this boom will not see it collapse in their lifetime, but the factors behind growth seem unlikely to endure for many decades.

EVEN IF FEASIBLE, IS NATURAL RESOURCE DEPENDENCE THE RIGHT DEVELOPMENT STRATEGY?

There are reasons to ask whether the current model is a good development strategy, even if it is durable. Does it improve lives and increase opportunities for most citizens? Much of the export growth has happened in capital-intensive sectors that create few jobs for the region's unskilled labor force.

For ordinary Latin Americans, most of whom are quite poor, the boom has had mixed effects. The urban poor have benefited from improvements in infrastructure and generous welfare payments. Poverty rates are sharply down in urban areas. There are jobs for unskilled workers in the private and public sector, particularly in construction and services.

Government spending on housing, sanitation, and police has vastly improved the quality of life in urban *favelas* and shantytowns. Generous welfare payments through conditional cash transfers like Brazil's *Bolsa Familia*, Chile's *Solidario*, Colombia's *Familias en Acción,* and Mexico's *Oportunidades* now serve 93 million Latin Americans providing support that few experienced before 1998 (United Nations 2010). Less hopefully, this figure suggests that a substantial share of Latin Americans have been unable to secure their own means of improving standards of living.

Inclusion of the rural poor has been more elusive. Rural poverty rates remain far higher than urban rates, despite the boom in agriculture and mining (Table 8).

Table 8. Urban and Rural Poverty Rates ($2.50 USD) Percent of Population

	Urban	Rural
Brazil		
2004	21.4	42.2
2008	12.7	30.8
Ecuador		
2004	20.2	46.0
2008	12.6	33.2
Mexico		
2004	9.4	33.7
2008	8.8	32.2
Peru		
2004	8.8	50.9
2008	5.1	40.2

Source: Socio-Economic Database for Latin America and the Caribbean (CEDLAS and The World Bank), November 2010

Some of the poorest geographic regions have been left out of the boom altogether. In Peru, much of the agricultural expansion has occurred among mid to large growers of fruit and vegetables along the coast, while Andean mining communities remain mired in poverty despite generating more than half of the country's exports. The Northeast of Brazil actually saw a slight decrease in agricultural income that has been compensated for by social transfers (Table 9).

This is partly because modern agriculture and surface mining involve relatively little labor. The number of jobs in Brazilian soy cultivation fell from 741,000 in 1996 to 335,000 in 2004 despite rising output (Pérez, Schlesinger, and Wise 2008). A joint Food and Agricultural Organization/United Nations (FAO/UN) study of 10 Latin American countries concluded that despite rising productivity, rural wages have failed to increase throughout the region (Da Silva, Gomez, and Castañeda 2010). Mining—an even more capital-intensive activity—not only fails to create jobs, but also destroys land and waterways that support subsistence farmers.

The prospects for occupational mobility are not much brighter as we look ahead. Education rates for adults are low for a middle-income region, a problem that

Table 9. Brazil: Composition of Household Income by Region (2006 constant R$)

Source of income	Northeast		Southeast		South		Central East	
	95–96	05–06	95–96	05–06	95–96	05–06	95–96	05–06
Income per capita	117	135	225	278	247	341	244	306
Agricultural income								
Average	48	46	101	93	122	156	136	155
Share of total income	0.41	0.34	0.45	0.34	0.49	0.46	0.56	0.51
Non-agricultural income								
Average	41	35	93	115	84	101	83	98
Share of total income	0.35	0.26	0.41	0.41	0.34	0.29	0.34	0.32
Social security and pensions								
Average	26	41	26	57	34	71	18	39
Share of total income	0.22	0.30	0.12	0.21	0.14	0.21	0.08	0.13
Other income								
Average	3	13	6	13	7	14	7	14
Share of total income	0.02	0.10	0.03	0.05	0.03	0.04	0.03	0.05

Source: Da Silva et al. 2010

can only be solved in the longer term. Brazilians over age 25 have an average of 6.67 years of schooling—barely a primary school education—and less than 12 percent of the population has completed high school (Guilhoto 2010). Among poor Mexican heads of household in 2004, 89 percent had no more than a primary school education. In rural areas, the disadvantages are even greater. Few poor workers will be able to transcend the gaps in skill needed to compete in a capital-intensive export sector.

Policymakers are well aware that low education levels hinder growth. Spending on education has long been generous in Latin America, but the quality of schooling is poor, and illiteracy among parents poses challenges to what can be accomplished with the current cohort of students.

A BRIEF COMMENT ON MEXICO AND CENTRAL AMERICA

Mexico and Central America have not experienced the same growth as South America, and there is uneven progress in implementing policies to secure long-term growth. El Salvador, Guatemala, Honduras, and Nicaragua have suffered from poor governance and an economic model that relies too heavily on the export of labor. Remittances account for a share of GDP comparable to that of exports in South America (Table 10), yet the growth of remittances slowed sharply after 2007. The agricultural value-added sector has barely grown: in Nicaragua it grew by a mere 0.7 percent per year between 1990 and 2007. Rising coffee prices—today's short-term hope—repeatedly proved unsustainable in the 20th century. The belated pursuit of gold is likely to prove environmentally unwise and unprofitable, particularly if it exacerbates social tension. Given the poverty that prevails in these countries, external support for training, education, infrastructure, public security, and trade promotion is essential.

Table 10. Remittances, % of GDP, 2009

El Salvador	15.7%
Guatemala	9.8%
Honduras	19.3%
Nicaragua	10.3%

Source: World Bank, Migration and Remittances Data, 2010

Mexico, the subject of much derision as a failed state, actually has a more diversified economy than many South American countries. Its manufacturing sector is integrated with the United States (for better and for worse) and much of what it produces involves medium-skilled labor. The challenge is to support small farmers in the South, to improve the quality of education, and to stem violence to maintain foreign investment. It has chosen a different master—the rich aging U.S. economy over the vast rising Chinese market—but its proximity to the United States may justify this.

The current commodity-driven boom in South America has provided much needed hope for a region that has endured three difficult decades. As the region looks to 2060, it must secure itself against cyclical fluctuations and create new job opportunities for its people. Latin America's enduring wealth is in its human capabilities, not the minerals beneath its earth or in the crops produced by mechanized agriculture.