

21 June 2001
Caracas, Venezuela

***Economic Development in Latin America:
The Contentious Way Ahead***

Based on:

***Washington Contentious -- Economic Policies for
Social Equity in Latin America***

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with Rachel Menezes**

The Setting

- ◆ Disappointing results despite impressive reforms
 - Reforms in the 90s -- higher quality and intensity than in the past
 - Low growth, stubborn poverty, widening inequality gaps (domestic & int'l)
 - Globalization not working as expected -- financial crashes

- ◆ Elusiveness of productivity potion
 - Reforms not part of the problem...
 - ...but linkage of reforms to productivity not obvious

- ◆ Problematic context to revise reform and growth recipe
 - Unequalizing effects of globalization with sense of uncertainty and insecurity
 - Rising expectations with search for participatory democracy
 - Legitimacy of reform no longer comes easy

- ◆ Faded sense of direction

Convergence in Rhetoric but not in Policies

- ◆ Poverty reduction and increased equity -- key point of agreement
 - Dramatic shift in rhetoric, nationally and internationally
 - Poverty not only the result of low growth but also as impediment to growth

- ◆ High time to identify actions behind the shared objective
 - Many actions already underway

- ◆ The limitations and contentiousness of the “tool-kit” approach
 - No unifying thread (other than the objective)
 - No pretension regarding priorities, sequencing, trade-offs
 - No recipe for the “right” combination of ingredients
 - Highly contentious choice of categories

The 10+1 Sets of Tools

1. Rule-based fiscal discipline
 2. Smoothing booms and busts
 3. Social safety nets that trigger automatically
 4. Schools for the poor, too
 5. Taxing the rich and spending more on the rest
 6. Giving small business a chance
 7. Protecting workers' rights
 8. Dealing openly with discrimination
 9. Repairing land markets
 10. Consumer-driven public services
- Plus 1. Reducing rich country protectionism

Cross-Cutting Themes?

◆ **Undelying themes**

- Resonance of the “three antipoverty pillars” -- opportunity, empowerment, and security
- “Complex” institution building and governance issues

◆ **What is left out**

- Geography and development (infrastructure, agricultural and health R&D, problematicity of borders)
- Political economy of reform

Smoothing Booms and Busts

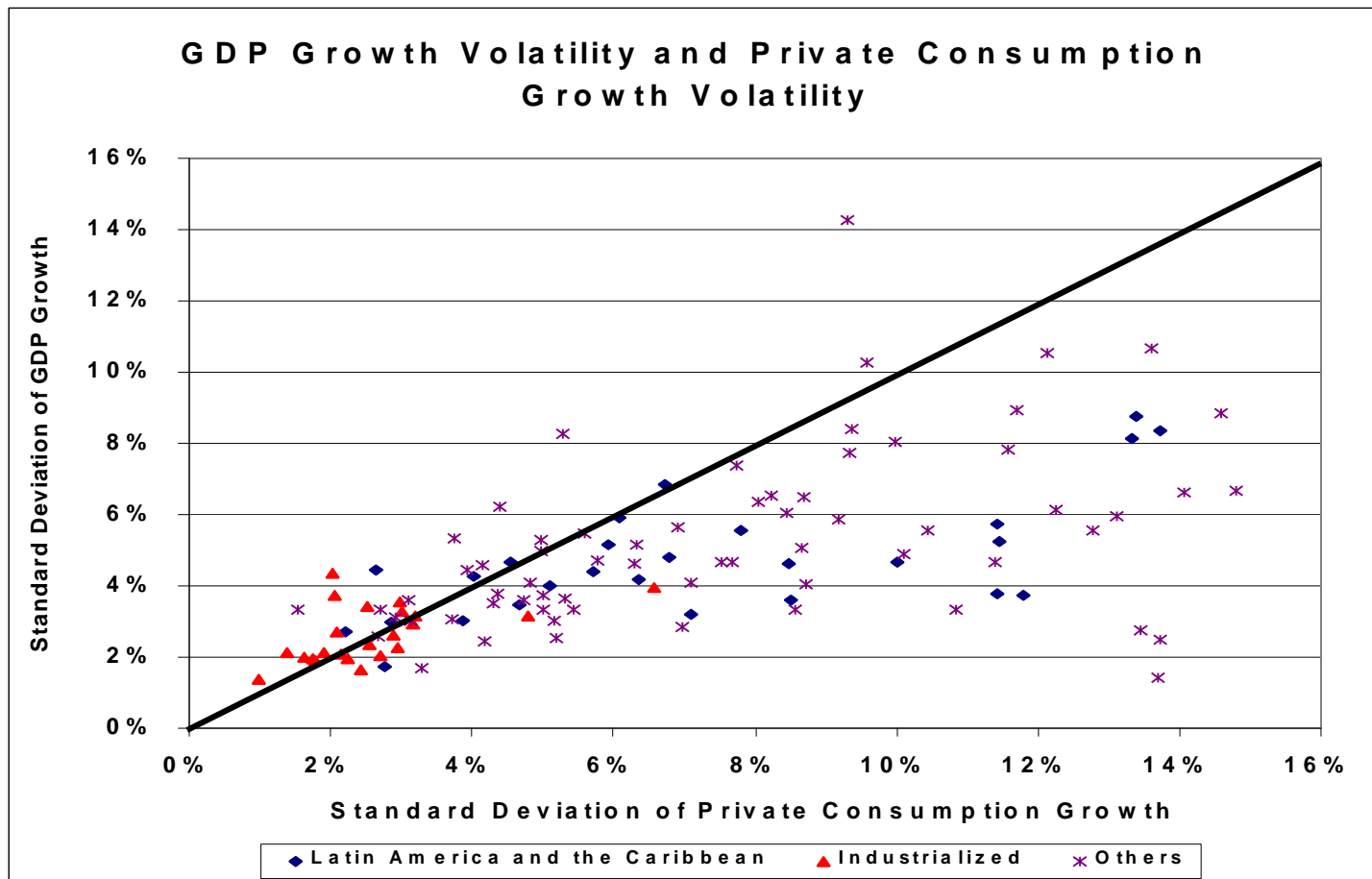
◆ The problems

- Latin America unable to smooth consumption relative to income fluctuations
- Lack of traditional counter-cyclical macroeconomic policy
- Pro-cyclical capital flows, with sudden-stop phenomenon
- Time inconsistencies and political economy dynamics hinder self-protection

◆ The “tools” -- rules and institution building

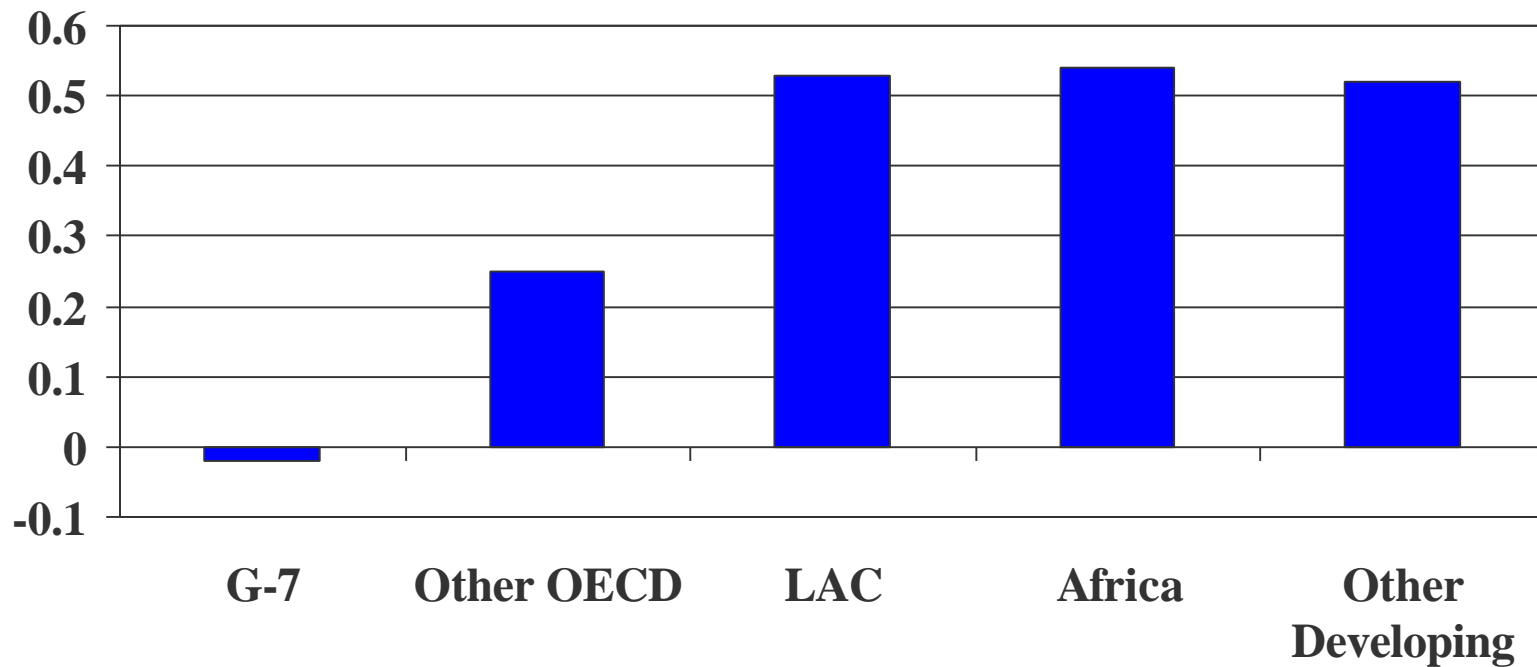
- **Fiscal sector:** Rules to ensure fiscal saving in booms for use to stabilize spending in downturns --the Chilean “structural surplus,” stabilization funds
- **Banking sector:** Countercyclical loan-loss provisioning and liquidity requirements
- **Other:** LT strategy to develop mkts for national currency denominated, long term debt; schemes to diversify catastrophic risk internationally

Developing Countries cannot Smooth Private Consumption



Only G-7 have Countercyclical Public Consumption

Correlations of Business Cycle with Government Consumption



Taxing the Rich...

- ◆ The problems
 - Only a few LA countries have raised progressivity of overall fiscal process
 - Relatively weak tax revenues, regressive tax systems
 - Systems not perceived as fair
 - Divorce between tax-paying and citizen rights

- ◆ The “tools” -- improving reality and perception of fairness
 - Sustained stepping up of enforcement and loophole reduction
 - Increase share of personal income tax in total revenue and strengthen citizen-tax payer connection: lower threshold of personal income subject to tax but shift to a system of individual filing coupled with tax refunds
 - Other progressive taxes: property; gross assets/presumptive taxes

Strengthening Labor Rights

◆ The problems

- Heavy regulations focused on job security fail to protect workers
- LA labor markets not particularly rigid (informal sector not necessarily; formal sector productivity and opportunity cost of training matter)
- With falling inflation, less real wage flexibility appears accompanied by higher variability in employment and nominal rigidities more noticeable
- Job and income uncertainty

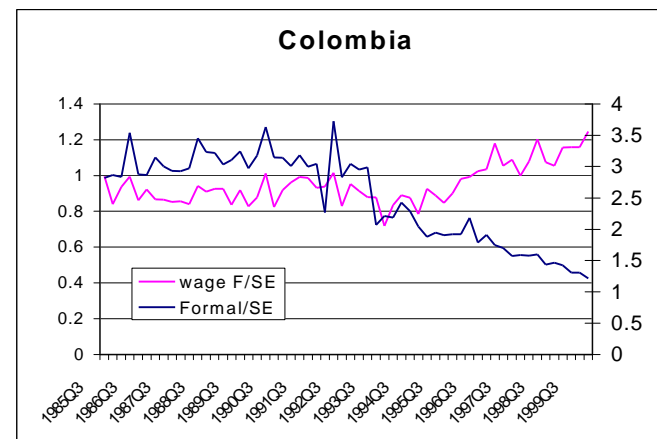
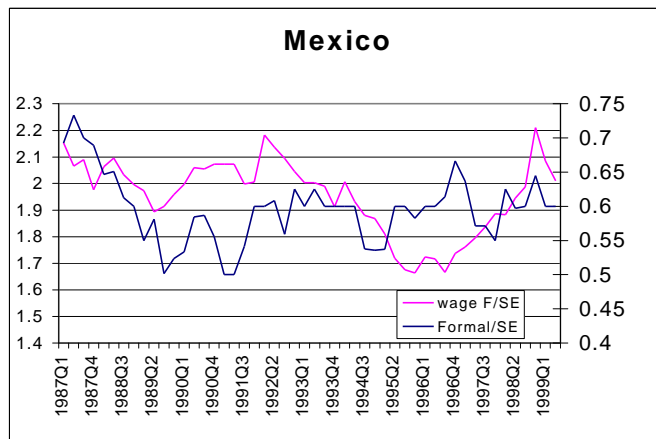
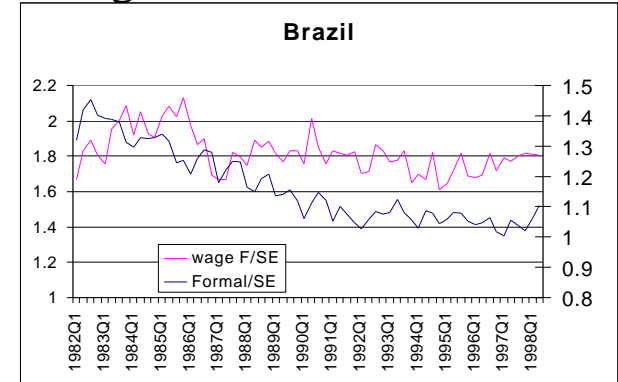
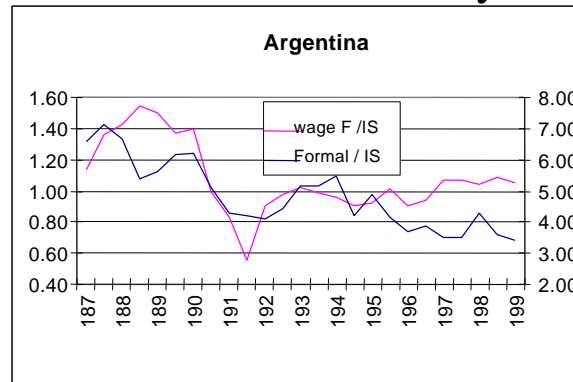
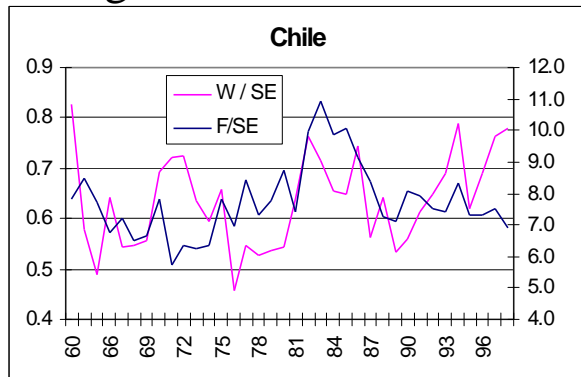
◆ The “tools” -- security with greater mobility

- Focus on reducing transaction costs
- Simplify regulatory framework and avoid prohibitions of flexible hiring
- Emphasize rights of association at firm level (perhaps sectoral guidelines)
- Life-long education/training, financed with matching subsidies
- Improvements in job matching and signaling -- information, skill certification
- Individual accounts, portability of pensions, limited collective insurance

EVIDENCE OF (IN)FLEXIBILITY IN LABOR MARKETS:

Relative wages and proportion of workers in the formal sector

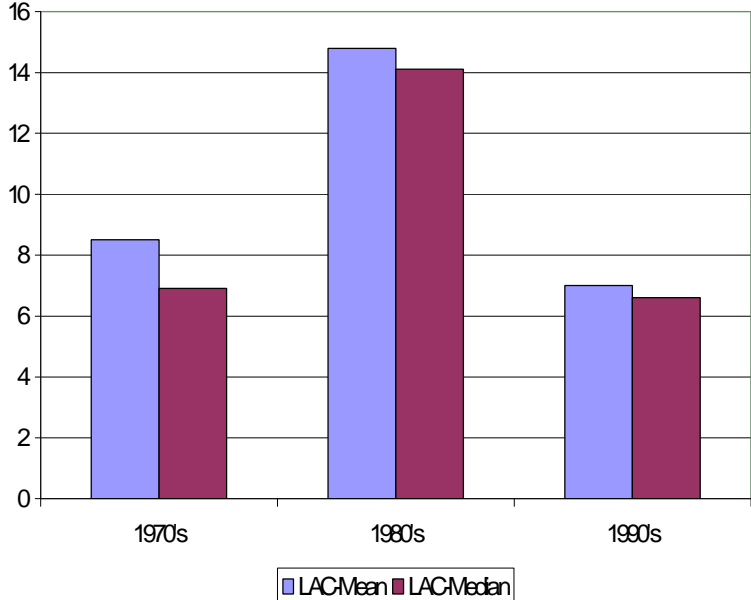
Argentina, Chile and Colombia show less flexibility due to fragmented labor markets



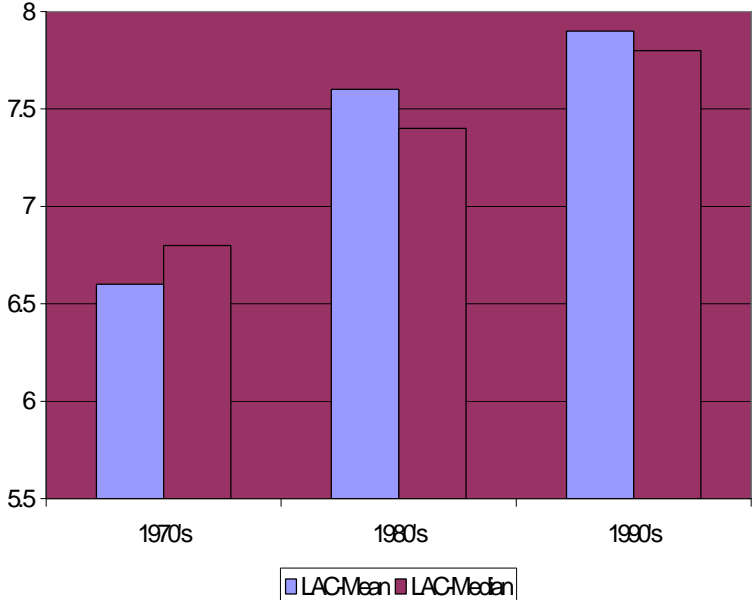
Source: Maloney, Fiess, Fugazza (2001).

Unemployment Up and Real Wage Volatility Down

Real Wage Volatility in Latin America



Unemployment Rates in Latin America



Giving Small Business a Chance -- Finance

- ◆ The problems
 - Credit to SMEs --an unsolved problem in the region
 - Initial effect of greater stability and internationalized banking system is less access to credit for small businesses
 - Public banks -- not part of a solution

- ◆ The “tools” -- focus on contractual & informational infrastructure
 - Contracts with improved enforcement features
 - Making collateral (particularly movable) usable
 - Non-bank finance --leasing and factoring
 - Creditor rights/obligations in contexts of corporate reorganization/bankruptcy
 - Debtor information systems
 - Corporate governance, disclosure/accounting, minority shareholder rights -- but problem of lack of economies of agglomeration