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New Challenges for Latin America

The good news is that for most countries in Latin America the last 10 years have been largely good ones; in fact, many survived the initial shock of the Great Recession rather well and some even benefited from its initial aftermath by attracting new flows of capital, even too much in some cases. At the same time, due to booming commodity prices and strong macroeconomic policies, economic growth produced many new entrants to the emerging middle-class of the region. Of course, these generally favorable trends did not preclude some economies from generating high rates of inflation, declining currencies and dwindling reserves, but these outliers were the result of recidivist policies last seen many decades ago. Nevertheless, most of the region did well.

These generally favorable trends do not guarantee continued positive outlooks, however, and in fact, given the global trends of slower world trade, lower growth and greater economic uncertainty, the Latin American region may be in for a rougher ride going forward. Why this is and what can policymakers do about it are two compelling questions. The IMF's latest forecast shows economic growth below 2 percent for the region as a whole, and there are concerns of reversals of fortune for those having recently escaped poverty. Commodity prices have fallen, government budgets are less ample, and capital flows less plentiful. Still, society's expectations continue to be high.

The general consensus that global growth will be lower than previously thought prevails. As growth, even in emerging markets, slows and as Europe is again in recession and Japan struggles to make "Abenomics" work, there is a sense that countries need to be more domestically reliant for growth stimuli or in the economists' jargon, sources of aggregate demand. To promote more domestic demand, one can think of tools to raise consumption or investment. The former is largely private and unless fueled by excessive borrowing is an outgrowth of greater employment and income generation, and hence part of a virtuous growth cycle. The latter can either be government led or private sector led and herein lies the conundrum.

Business is reluctant to invest when growth prospects are weak. Moreover, the investments that the private sector can undertake often need the inducement effect of public investment, say in energy or infrastructure. And the reality is that governments are spending much more on safety nets and social expenditures than they are on investments in transport and energy. In fact, Latin America ranks quite poorly in measures of logistics efficiency, administrative costs, and actions to crowd-in private investment. In Brazil, the region's largest economy, investment levels are well below 20 percent, total factor productivity hasn't risen in two decades, and government is ignoring many needed investments in transport, preferring to invest in long-term energy resources located deep on the ocean floor. Hence, needed infrastructure investment is being ignored.

The second element to consider in an attempt to generate more growth without relying so much on globalization is domestic demand and regional trade that could be fostered by greater competition and integration. That would require something that has largely eluded the region to date. It is noteworthy that intra-regional trade is at levels roughly a third of those in Europe and less than half those in Asia. Impediments to trade are significant, from trade restrictions to logistics costs of moving goods, to domestic protection in many markets. Without substantial structural reforms at the micro-level, Latin America will be stuck for many years and continually dependent on global cycles. There is a general consensus about macro policies, but many vested interests prevent the reforms in competition laws, regulation, trade, and capital markets that would serve the region well in current times of low world growth.

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