LATIN AMERICA: Falling behind East Asia

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Abstract (summary)

Latin America's falling competitiveness.

South American economies have been praised for the way they have confronted the global financial crisis, and countries such as Argentina, Peru and Brazil have benefited from high commodity prices to achieve broad-based improvements in living standards. Yet when placed in comparative and historical perspective, Latin America's recent record seems less stellar, diverging from the East Asian newly industrialising countries in technological upgrading and productivity growth over the last three decades. Less effective policies, weaker institutions and lack of regional value chains explain recent differences.

Full Text

SUBJECT:Latin America's falling competitiveness.

SIGNIFICANCE:South American economies have been praised for the way they have confronted the global financial crisis, and countries such as Argentina, Peru and Brazil have benefited from high commodity prices to achieve broad-based improvements in living standards. Yet when placed in comparative and historical perspective, Latin America's recent record seems less stellar, diverging from the East Asian newly industrialising countries in technological upgrading and productivity growth over the last three decades. Less effective policies, weaker institutions and lack of regional value chains explain recent differences.

ANALYSIS: Impacts.

Focus on primary products is limiting Latin American competitiveness and development prospects.

Investment rates in Latin America continue to lag significantly.

Institutional weakness and social discontent continue to limit prospects for Latin American structural reforms.

After economic turmoil during the second half of the 1990s, Latin American countries, particularly South America, have performed well recently:

Growth rates. While between 1998-2003, real GDP per capita in dollars fell by an annual average of -0.2% (compared to growth of 1.5% for the world as a whole), between 2003-08 the region had annual GDP per capita growth of 4.1%, almost twice the global rate of 2.2%. Expansion was particularly rapid in Argentina, Peru, Uruguay and Venezuela -- all of which performed better than at any other time since the 1950s.

Limited crisis impact. Latin American countries have traditionally had difficulty coping with global shocks and suffered repeatedly from financial crises. Yet the impact of the global financial crisis in the last four years has been moderate. Most countries have maintained positive growth and even adopted anti-cyclical policies. In 2012 real GDP is expected to increase by 3.7%, over twice that in developed countries (see LATIN AMERICA: Global uncertainties mar growth outlook - June 15, 2012).

Income distribution. Economic expansion has particularly benefited the poor. In Brazil, for example, household income per capita for poor families increased twice as fast as for rich families between 2002-07. As a result, the Gini coefficient improved from 0.59 at the beginning of the decade to 0.54 (see BRAZIL: Anti-poverty plan fails to tackle causes - June 15, 2011). In the same period, inequality remained stable or decreased in nearly all countries.

Latin America’s positive performance has been praised by international institutions, local policymakers and the media, highlighting the region’s pragmatic approach to macroeconomic and innovative social policy.

Long-term comparison with East Asia.

However, Latin America’s performance is less impressive when considered in historical and comparative perspective. The differences with many East Asian countries are particularly striking:

Labour productivity .

While newly industrialising East Asia (Korea, Taiwan, Hong Kong and Singapore) is catching up with the United States, Latin America has fallen behind. In 1977, for example, labour productivity in Korea and Brazil was 27% of US levels. By 2010, Korea’s productivity had reached 60% of that in the United States, while Brazil’s was only 20%. In Taiwan labour productivity in the manufacturing sector grew four times faster than in Mexico between 1980-2010.

Export structure .

East Asian countries have succeeded in export upgrading, moving from labour-intensive manufacturing to more sophisticated products:

By 2000, almost a third of Korea's exports were information and communication technology goods, compared to under 1% in Argentina and Chile and under 5% in Brazil.

By contrast, Latin America's primary good specialisation has intensified. Between 2000-10 the share of primary exports increased from 72% to 93% in Bolivia, 42% to 64% in Brazil and 58% to 74% in Uruguay (see INTERNATIONAL: Latin America wary of China dependence - May 17, 2012).

China has upgraded its export structure: by 2005 it was the world's second largest exporter of high-tech manufactures, joining Hong Kong (fifth), Singapore (sixth) and Korea (seventh) in the top ten. In recent years China has strengthened its leadership position as assembler of high-tech goods and begun focusing more on high value-added services.

Economic growth.

Between 2000-10, East Asia was the world's fastest-growing region, with an annual rate of 8.2%. Latin America (2.2%) grew less than South Asia, the Middle East or Sub-Saharan Africa. This asymmetric performance is even more striking over a longer perspective: China's real GDP per capita was 52% of that in Brazil in 2010, compared to just 5% in 1998.

Underlying causes .

East Asia's capacity to invest in capital goods and research and development (R&D) are behind the difference:

Investment. Between 2000-10 gross capital formation was 36% of GDP in East Asia compared to 20% in Latin America. Higher investment contributed to higher aggregate demand, faster development of new manufacturing activities and rapid growth of labour productivity.

Technological effort. Between 1996-2007, Latin America spent 0.4% of GDP on R&D compared to 1.2% in six Asian countries. This generated divergent results in terms of knowledge creation: Latin America only has 0.5 patents per million inhabitants compared to 30.5 in the same six Asian countries and 132.6 in the mature economies.

Industrialisation. While the contribution of manufacturing to total production has decreased or stagnated in most Latin American countries, it has increased steadily in East Asia. A comparison between Brazil, China and India is particularly illustrative: in 1980 Brazil was responsible for more than half of the combined manufacturing production of the three countries. In 2010 it accounted for less than 10%. A declining manufacturing sector may reduce opportunities for knowledge accumulation and the creation of more linkages and spillovers between different economic activities.

Structural change. Recent studies show that new employment in East Asia has concentrated in high productivity, manufacturing activities. By contrast, in Latin America, high productivity activities in mining and other natural resources create few jobs, while low productive services absorb a growing number of workers. Latin America thus faces diminishing opportunities for productivity growth and rapid economic expansion.

Some of these economic differences can be explained by initial endowments (eg Latin America's abundance of natural resources) and relative prices. Yet political factors may be even more important.

State capacity.

Countries like Korea and Taiwan have more effective public institutions than their Latin American counterparts. This is partly the result of a meritocratic civil service and decision-making concentrated in small, leading institutions. In most Latin American countries, improvements in recent decades have been minimal and concentrated in a few institutions like central banks and labour ministries. During the 2000s, left-wing governments have generally been reluctant to introduce public service reforms for at least three reasons: more urgent political priorities like the expansion of social programmes; unwillingness to eliminate discretionary political appointments that remain a major source of clientelism; and opposition by public servants themselves in areas like education (see LATIN AMERICA: Institutional performance remains weak - November 4, 2011).

Pragmatic policies.

Economic reforms in East Asia have generally been more pragmatic and consistent than in Latin America. Trade liberalisation and financial deregulation have occurred gradually and only when the economy was ready. Although in Brazil trade liberalisation was also gradual, it was accompanied by an excessively orthodox macroeconomic stand. Argentina has probably been the most extreme case in terms of policy discontinuity, with aggressive deregulation and privatisation followed by a sharp reversal in recent years. China and other East Asian countries have also been more pragmatic in managing financial inflows in recent years, maintaining implicit and explicit capital controls.

National champions .

While East Asia's leading firms concentrate in medium and high-tech sectors, most Latin American firms produce natural resources and resource-intensive manufactures, generally investing little in R&D. In Mexico, private sector R&D spending reaches only 0.17 % of GDP and America Movil and Telmex -- global leaders in telephone services -- have registered no recent patents. In Brazil, the median investment in R&D among the eight largest groups was just 0.23% of total sales, with only mining giant Vale and banking group Itau above 1.0%.

Global conditions and social pressures .

In Latin America, the combination of high commodity prices and high levels of inequality and social discontent have created incentives to focus on redistribution. Countries like Bolivia, Ecuador and even Argentina have concentrated on redistributing the growing rents from natural resources to reduce inequality and confront social demands. Unfortunately, this has reduced the opportunities and desire to implement structural change. In China, high economic growth and political repression have reduced demands for redistribution, while other East Asian countries are gradually combining redistributive and industrial policies.

Regional differences.

Differences between East Asia and Latin America extend to organisation of regional trade and investment flows. East Asia has developed regional value chains linking manufacturing production between neighbouring countries. In Latin America, despite integrationist political rhetoric, economic links are absent:

Between 2000-08, 50% of East Asian exports went to regional neighbours compared to less than 18% in Latin America. In 2008, East Asia received 45% of exports from Korea, 47% of those from Japan, 50% of those from China and 56% of those from Taiwan. In Mercosur - Latin America's most developed regional market -- these percentages are below 15%.

The composition of intra-regional exports also differs. Between 2000-08, 60% of Asian intra-regional exports were machinery and manufacturing inputs, compared to less than 40% in Latin America.

In East Asia, regional leaders like Japan and Korea have built close relations with suppliers in countries like Vietnam, responding to rising domestic labour costs by relocating different stages of the production process. In Latin America, large countries have limited relations with small neighbours. Argentina fundamentally exports primary goods to China and elsewhere. Brazil also exports primary goods to the rest of the world and capital-intensive manufacturing goods produced with local inputs or inputs from developed countries. Mexico is a major manufacturing exporter but is more integrated with the United States than with its Central American neighbours.

Different regional integration patterns result in asymmetric growth processes. In Latin America, the expansion of global demand boosts primary goods sales to the rest of the world, but does not have a significant regional multiplying effect. In East Asia, any increase in demand for Korean, Japanese and even Chinese goods has a direct positive impact on exports from neighbouring countries.

The development of regional markets also has a positive effect on learning and innovation. Knowledge generated by Korean or Japanese leading firms has some spillover effects on suppliers in poorer neighbours. In Latin America, Brazil is actually contributing to the consolidation of primary specialisation in small economies, for example, in Bolivia where Brazil has become a major investor in the gas sector.

In East Asia, informal economic integration has led to gradual but significant advances in political integration within ASEAN and other agreements. In Latin America, by contrast, insufficient economic integration has limited the success of political agreements like Mercosur or the Andean Community. In recent years, South America's integration efforts have focused on non-trade issues like monetary and financial integration, infrastructure and military cooperation. Yet the long-term success of these processes may be minimal unless accompanied by advances in regional trade and investment.

Outlook.

Advances in many South American countries in particular in recent years should not be minimised. The region has increased taxes, managed macroeconomic policy more effectively and created some successful social programmes. Nevertheless, most economies have failed to accelerate capital accumulation, invest in R&D and promote structural change towards sectors with higher technological content and more value-added. The extent to which new policies will be implemented in future remains unclear. In countries like Brazil, Chile and, to a lesser extent, Uruguay, policymakers are trying to tackle some of these problems and new industrial policies have been implemented. Yet even here the speed of reform may be insufficient to catch up with East Asia's leaders and the process of divergence may continue in the medium term.

CONCLUSION: South America will continue to benefit from high commodity prices at present, with growth remaining higher than in developed countries. However, primary specialisation could deepen the region's problems and China dependence. Some policymakers acknowledge the need to develop new comparative advantages in natural resource-based manufactures and high value-added services. Yet political conflicts and concentration on redistribution through social policy may reduce opportunities for much-needed reforms, increasing the divergence from the best global performers over time.

Indexing (details)

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