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World Economic Outlook

A Watershed Moment for Latin America: Nine Takeaways from our High-Level Conference

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(Versions in Español and Português)

Latin America has reached a critical moment. So much better off than two decades ago, and still facing deep-seated problems that get in the way of sustained strong growth and economic development. To better understand these problems from countries' perspectives, and explore ways the IMF and others can help address them, we brought together experts from the region and beyond—central bankers, finance ministers, and academics—for a high-level conference in Washington, D.C. earlier this week.

Under the theme of "Rising Challenges to Growth and Stability," participants engaged in lively debates about the current difficulties facing Latin America and the policy priorities for now and the future.

Here are my main takeaways from the event:

1. Savor the progress. Everyone recognized that Latin America has come a long way since the days of hyperinflation and debt crises of the 1980s and 90s. Countries have strengthened their economic policy frameworks, and exchange rate flexibility now provides an important buffer for external shocks in many countries. Simultaneously, poverty rates have fallen, inequality has come down, and the middle class has grown. These economic and social advances have been underpinned by the broad-based establishment of democratic societies.

The first session featured (l-r) Mario Blejer, Guillermo Ortiz, Alejandro Werner, Arminio Fraga, and Charles Collyns (IMF photo).

2. Life after the bonanza. The optimism of 2010, when the region made an impressive rebound from the global financial crisis and grew more than 6 percent, has faded. Economic activity has been slowing every year since then, and most panelists agreed that medium-term growth is also likely to be mediocre, as the "good luck" of booming commodity markets is over and structural weaknesses—in the form of low saving, low investment, and low productivity—have come to the fore. In the words of Mario Blejer, there can be no doubt that "the party is over."

3. Risks. There was a broader range of views on how much the region will be affected by rising U.S. interest rates, which could potentially lead to capital outflows, higher funding costs, and weaker domestic currencies. One view was that balance sheets are quite resilient, as a lot of government debt is now denominated in domestic currency, foreign exchange reserves are ample, and firms have learnt the lesson from past crises and only take on foreign-currency debt for which they have appropriate hedges. But others still saw important vulnerabilities now that firms across Latin America are facing a combination of increased indebtedness, lower growth, and weaker commodity prices. Adding the potential risk of further commodity price declines, perhaps in the context of weaker-than-expected growth in China, the period ahead could still be, in the words of one participant, “a rough ride.” I certainly agree that vigilance will be key.

4. Policies matter. Although the general outlook is relatively dim, there are important differences across the region. Many speakers emphasized the relatively more favorable prospects for countries with stronger macroeconomic fundamentals, which are better prepared to handle challenging times. In other countries, speakers argued that misguided policies (or “self-inflicted wounds”) played an important role in creating today’s difficult mix of low growth and elevated inflation. Carmen Reinhart put it well when she said that preventing macroeconomic crisis—with the large output losses that past crises have typically entailed—is crucial for raising living standards across Latin America on a sustained basis.

5. Macro vs. micro. Ensuring good economic policies alone clearly isn’t sufficient. As our second panel discussed in depth, growth in Latin America lags behind other emerging market regions, despite important gains in macroeconomic stability. To put it simply, macroeconomic conditions have improved in many countries (notwithstanding a few important exceptions), but microeconomic problems remain a major obstacle to productivity and growth across the region. One reflection of these problems is the persistence of very high informality in many economies.

IMF First Deputy Managing Director David Lipton delivered opening remarks (IMF photo).

6. Reform priorities. Once the focus shifts from macro to micro, the discussion naturally becomes quite rich and diverse, and so we heard a range of ideas on what are the “most binding constraints” on growth. Nonetheless, there was a general sense that labor markets, education, infrastructure, and governance quality are key problem areas. In a nutshell, to generate a sustained rise in investment and economic dynamism, Latin America will need to upgrade its physical and human capital as well as the institutions supporting the market economy.

7. Economic diversification and trade. Many panelists also argued that progress would have to involve greater diversification of economic structures along with deeper integration through trade—both within the region and with respect to other dynamic parts of the global economy, such as Asia’s famed value chains. In this context, several speakers saw a case for smart industry-level intervention. Personally, I agree with the objective to put Latin America’s economies on a broader basis. But I remain cautious about attempts to fine-tune economic development. As we noted in our recent*Regional Economic Outlook*, there are still a lot of basic things to get right (in education, infrastructure, and governance) before turning to more activist sectoral policies that are fraught with risks.

8. Political buy-in. Securing popular support for reforms remains a key political challenge. In this context, several panelists stressed the region's legacy of high inequality, which tends to hamper the emergence of a broad consensus on desirable policies. An extended period of low growth could compound this challenge, given high expectations for further social and economic progress. However, there is also significant scope to achieve better outcomes without additional resources. As one of the panels discussed, current government policies in many Latin American countries—even those with high taxes and extensive transfer schemes—fail to effectively improve the distribution of income. Clearly, more targeted, better-designed policies are needed to secure shared prosperity.

9. Turning challenge into opportunity. Any difficult situation is also an opportunity for making decisive improvements that countries could not achieve during normal times. The ongoing corruption scandals in several countries may be a good example—if they are now used to bring about lasting improvements in governance and the rule of law. As Arminio Fraga said, this could be a "watershed moment." I believe this is true more broadly: Latin America today is facing very significant challenges; the task ahead is to rise to those challenges and turn them into an opportunity.

THE ROAD TO LIMA 2015

I look forward to deepening our discussion on these important issues over the months ahead, as we continue our close engagement with the region on the "Road to Lima."

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