Canadian Foundation for the Americas
Fondation canadienne pour les Amériques
Fundación Canadiense para las Américas
Fundação Canadense para as Américas

Human Prosperity Faces New Challenges

Nora Lustig

George Washington University

FOCAL
1 Nicholas St., Suite 720, Ottawa, ON K1N 7B7
Tel: 613-562-0005
Fax: 613-562-2525
Email: focal@focal.ca
www.focal.ca

About the Hemispheric Think Tank Working Group in Support of the 2009 Summit of the Americas

This paper was produced as part of the Hemispheric Think Tank Working Group in Support of the 2009 Summit of the Americas, a joint project of the Canadian Foundation for the Americas (FOCAL) and the Inter-American Dialogue (IAD) with the financial support of the Government of Canada provided through the Canadian International Development Agency (CIDA).

The Working Group brought together researchers and policy analysts from the Western Hemisphere's leading think tanks to engage in intensive debate and dialogue and develop a strong intellectual and policy foundation for preparing and conducting the Summit.

In meetings in Ottawa and Washington, D.C., attended by leading national and multilateral officials, the group explored the critical problems the Summit could address, identified key areas of agreement and disagreement among countries, deeply probed the disagreements, and, where possible, sought to develop pragmatic approaches. These discussions and research have resulted in a series of policy papers that hope to mobilize and raise awareness of the Summit amongst regional governments and civil society.

1. The *Draft Declaration of Commitment of Port of Spain: 'Securing Our Citizens' Future by Promoting Human Prosperity, Energy Security and Environmental Sustainability* includes many of the key goals and proposals that are needed to achieve equitable and sustainable growth.

2. The Declaration will be announced at a time in which some countries in the Americas will be in the midst of a recession and others will be facing a significant slow-down in economic growth. In particular, the United States— a key source of foreign (direct and portfolio) investments, remittances, export markets and revenues from tourism to the rest of the hemisphere and a key contributor to global aggregate demand— will be experiencing a recession defined by most analysts as the worst since World War II.

3. Although Latin America and the Caribbean countries are better prepared from a macroeconomic point of view to withstand external shocks than in the past, they will not remain unscathed. In the past several months, for example, commodity prices have plummeted, remittances are falling or at best growing more slowly, export demand is shrinking and international credit markets are drying up.

4. What does this mean for Latin America and the Caribbean? First and foremost, after five years of experiencing an economic boom (see Figure 1), growth will slow down and in some countries it might even become negative (see Table 1 for some recent forecasts). Real wages are likely to fall and unemployment is likely to increase. Private transfers, particularly from family members living abroad, are likely to shrink. Poverty is likely to rise and the progress made in the nutrition, health and education fronts might be reversed (see Table 2 for the changes in poverty during past crises).

5. The economic slowdown will reduce fiscal revenues and, thus, put restrictions on public spending. In some cases, the resources available to pay for poverty reduction and social protection programs might be insufficient to support existing beneficiaries or to expand them to include the people who became poor or unemployed as a result of the slowdown. In addition, while countries are in better shape than before in terms of poverty reduction and safety net programs, some of the poorest countries do not have poverty reduction or safety net programs or do not have them in sufficient scale (see Figure 2 for existing cash transfer programs in the region).

6. While the financial sectors in Canada and in Latin America have not faced a crisis similar to that which occurred in the U.S. and some European countries in 2008,[1] large private corporations in some countries did invest in risky financial instruments or have large dollar debt servicing commitments. When the currencies devalued in early October 2008,

many of the corporations were put in serious financial difficulties. Some of them even faced bankruptcy.

7. The financial vulnerability of the private sector took everybody by surprise and perhaps without the U.S. Federal Reserve's swaps program announced last October, currency devaluations might have spun out of control and a financial crisis in some countries would have ensued. Even though such crises have been avoided so far, companies and governments will continue to face difficulties in rolling over their debt and extreme scenarios. The so-called "sudden stop" of net capital inflows should not be ruled out in such an uncertain environment.

8. Furthermore, even if countries are able to avoid crises, as long as the global de-leveraging process and the flight to safety[2] continue and the U.S. demand for credit rises (an expected consequence of the stimulus package), access to international credit by governments and the private sector in Latin America will be scant. Large corporations will turn to domestic credit sources and crowd out the medium and small-size firms.

9. In addition, as the ripple effects of the global economic slowdown spread, small, medium and large firms in Latin America and in the Caribbean may face losses and difficulties in servicing their debt. If this happens in a significant scale, nonperforming loans will rise, putting a strain on the banking sectors in spite of their more prudent regulation.

10. Although many analysts hope that recovery in the U.S. will begin during the second half of 2009 and, as a result, global growth will recover shortly thereafter, the overwhelming majority expects a very tepid recovery and little growth until at least 2010. If this is the case, recovery of growth in Latin American and Caribbean is likely to take time.

11. What all this adds up to is that the goal of promoting human prosperity in the hemisphere faces considerable new challenges which were probably not foreseen a few months ago. What goals, commitments and mandates should be added to the Declaration to fulfill the overarching goal of promoting human prosperity?

    a. First, it is important that countries do not succumb to "beggar-thy-neighbor" policies. In particular, the Heads of State should commit to continue their efforts to lower trade barriers and foster economic integration; avoid the use of disguised protectionist measures (such as subsidies targeted to specific industries); avoid resorting to competitive devaluations or competitive lowering of interest rates.

    b. Second, more than ever before, frequent consultations among ministries of finance and central banks on macroeconomic prospects and macroeconomic policies will be essential to contain negative side-effects of individual countries' policies and be better prepared to address challenges individually and collectively.

c. Third, the Heads of State should request that, for example, the World Trade Organization carefully monitors countries' policies in terms of their commitments to open trade regimes and immediately puts out a public warning when there are violations or potential violations to these commitments.

d. Fourth, the Heads of State should request that the multilateral financial institutions give a realistic assessment of the Latin American and Caribbean region's external funding needs, where the resources will come from and how will they reach those who need them. Note that the funding needs are not just from governments but from the private sector as well. The assessment should contemplate the worst case scenario, which would occur if Latin America faces a "sudden stop".[3] In addition, this assessment should consider whether existing instruments and initiatives (such as the Heavily Indebted Poor Countries Debt Initiative) in the international financial institutions (IFIs) are adequate and sufficient to cope with the current challenges and if not what should change and how.

e. Fifth, the Heads of State should request that the International Monetary Fund (and the other IFIs) helps countries identify which policies can be implemented to mitigate the impact of the crisis on growth without compromising the macroeconomic stance in the medium-term. In particular, the IFI's should assess whether countries can safely implement fiscal stimulus packages, reductions in interest rates and/or measures to channel credit to the private sector (for example, through the domestic development banks) to prevent GDP from falling too much below its potential. Preventing excessive downward adjustments in GDP growth would be one of the most important ways to contribute to poverty reduction and human prosperity in the hemisphere.

f. Sixth, the Heads of State should request that multilateral development banks provide an immediate assessment of whether individual countries have adequate safety nets—both in terms of the institutional setup and the funding—to help poor and low-income families and vulnerable individuals cope with the effects of the economic slowdown. Where safety nets are nonexistent or inadequate or financing is insufficient, the Multilateral Development Banks should offer their help to quickly assist governments in resolving the binding constraints. Exchanging best practices among countries might be particularly useful.

Specific comments on the document structure:

1. For the purposes of monitoring the implementation of the Declaration, it might be useful to re-organize parts of its contents so that shared goals (both quantitative and qualitative), commitments on the part of the Heads of States and Government, and mandates/requests addressed to their ministries and multilateral organizations are clearly distinguished.

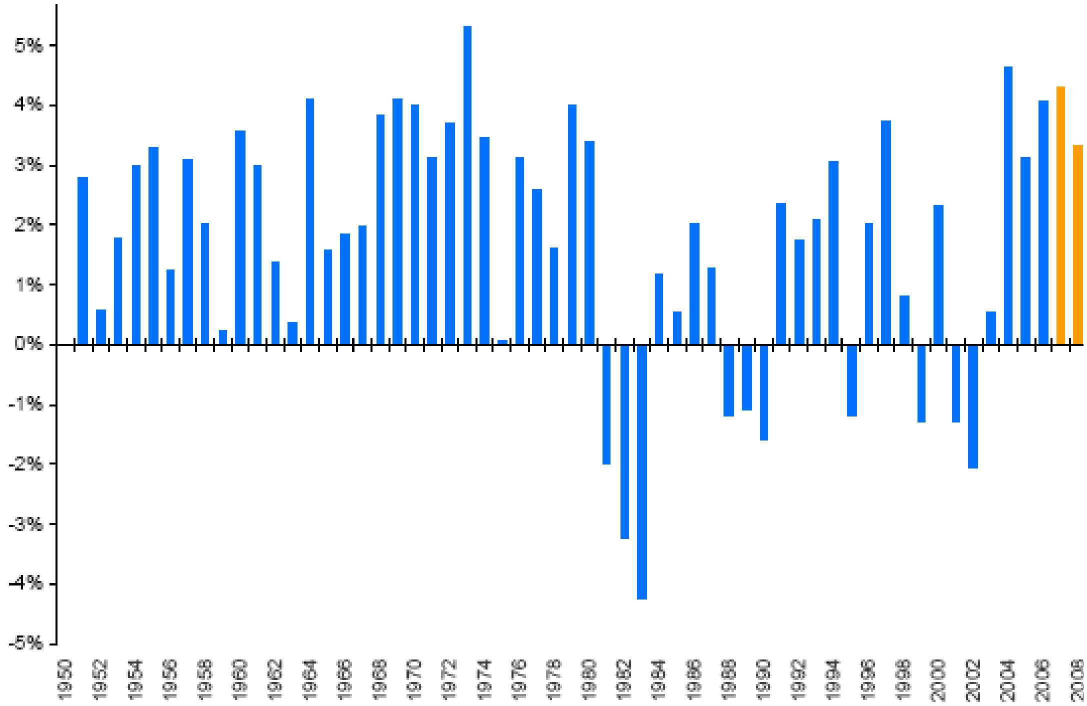
2. In paragraph five of the current version of the Declaration there is a mention of social protection programmes presuming that the concept is all-encompassing. However, in policy circles "social protection programmes" usually refer to contributory and non-contributory safety nets (pensions, unemployment insurance, employment programs, minimum pension schemes, health insurance, etc.) and do not include other anti-poverty policy measures. I suggest changing the wording to: "social protection **and poverty reduction programmes**."

Endnotes

[1] Primarily because LAC countries did not invest in the so-called toxic assets that decimated or severely crippled some of the most famous names in global finance.
[2] Investors shift their funds to instruments perceived as less risky such as U.S. Treasury bills and away from emerging markets.
[3] Referring to the abrupt discontinuity in net capital inflows as a result of the combined effect of lower inflows and capital flight.

Figures and Tables

Figure 1- Latin America and the Caribbean: Average Yearly Growth Rates



Source: ECLAC (2008).

Figure 2- Cash Transfer Programs in LAC

Without program	Pilot	Small scale (<25% poor)	Medium & large scale (>25% poor)
Bahamas	Guatemala	Argentina	Brazil
Barbados	Paraguay	Costa Rica	Colombia
bolivia		El Salvador	Chile
Haiti		Dominican Rep.	Ecuador
Nicaragua		Peru	Honduras
Belize			Jamaica
Suriname			Mexico
Guyana			Panama
Trinidad and Tobago			
Uruguay			
Venezuela			
11	2	5	8

Table 1

GDP Growth Forecasts for 2009
Percent change (over a year ago)

	Credit Suisse	Deutsche Bank	JPMorgan	Moody's economy.com	MorganStanley	UBS Pactual	AVERAGE
Argentina	1.5	-0.9	-1.0	3.0	-2.2	0.3	0.1
Brazil	1.3	2.2	2.0	3.5	0.0	2.8	2.0
Chile	2.5	2.2	2.5	3.0	1.5	3.2	2.5
Colombia	2.6	2.0	2.5	2.1	1.5	2.7	2.2
Ecuador	2.0	0.6	2.0	-	-	-4.0	0.2
Mexico	0.6	0.1	-0.6	1.4	-1.5	0.2	0.0
Peru	4.5	5.8	5.3	5.2	4.0	4.3	4.9
Uruguay	-	2.5	-	2.1	-	-	2.3
Venezuela	1.9	1.4	1.5	2.8	-1.0	1.5	1.4

Source: Luis Coutino, Latin American Advisor, December 24, 2008, p. 1.

Table 2

Poverty/head count ratio[a]

	Pre-crisis		Crisis			Post-crisis			Post-crisis per capita GDP[b]	
Country	*Year*	*Ratio*	*Year*	*Ratio*	*Change*[b]	*Year*	*Ratio*	*Change*[b]	*vs. year of crisis*	*vs. pre-crisis*
Argentina (Greater Buenos Aires)	1980	10.1	1985	20.6	+	1987	25.2	+	+	–
Argentina (Greater Buenos Aires)	1987	25.2	1989	34.6	+	1990	35.0	+	+	–
Argentina (Greater Buenos Aires)	1993	16.9	1995	24.8	+	1997	26.3	+	+	+
Brazil (All metropolitan areas)	1989	27.9	1990	28.9	+	n.a.	n.a.	n.a.	n.a.	n.a.
Chile (Metropolitan areas)[c]	1980	40.3	1982	n.a.	n.a.	1987	48.60	+	+	–
Costa Rica[d]	1981	29.6	1982	32.3	+	1983	29.7	+	+	–
Dominican Republic[d]	1984	37.3	1985	n.a.	n.a.	1986	38.2	+	+	+
Dominican Republic[d]	1989	35.7	1990	n.a.	n.a.	1992	39.5	+	+	–
Guatemala[c]	1980	65.0	1982	n.a.	n.a.	1986	68.0	+	–	–
Mexico	1984	28.5	1986	n.a.	n.a.	1989	32.6	+	+	+
Mexico[c]	1994	36.0	1995	n.a.	n.a.	1996	43.0	+	+	–
Panama[d]	1980	40.6	1983	n.a.	n.a.	1986	44.0	+	–	–
Panama[d]	1986	44.0	1988	n.a.	n.a.	1989	50.0	+	–	–
Peru[c]	1979	46.0	1983	n.a.	n.a.	1986	52.0	+	+	–
Peru (Urban)[d]	1985	32.2	1988	n.a.	n.a.	1991	50.0	+	–	–
Uruguay[c]	1981	11.0	1982	n.a.	n.a.	1986	15.0	+	–	–
Venezuela[c]	1982	25.7	1983	32.7	+	1985	34.8	+	–	–
Venezuela[c]	1988	40.0	1989	44.4	+	1990	41.5	+	+	–
Venezuela[c]	1993	41.4	1994	53.6	+	1996	48.2	+	–	–

Sources: For Argentina: data from Instituto Nacional de Estadística y Censos (National Institute of Statistics and Censuses); for Brazil: Barros, Mendonça, and Rocha (1995); for Chile: Lustig (1995, table 1.1); for Costa Rica, Dominican Republic, and Panama: Londoño and Székely (1997); for Guatemala and Uruguay: ECLAC (1996); for Mexico 1986: Lustig and Székely (1998); for Mexico 1995: ECLAC (1999); for Peru 1983: ECLAC (1986; 1989); for Peru 1988: Escobal, Saavedra, and Torero (1998); for Venezuela: Ruprah and Marcano (1998). Per capita real GDP data from World Bank, *World Development Indicators* (Washington, 2000).

a. Head count based on individual per capita household income unless otherwise noted.

b. + means an increase; – means a decline; n.a. not available.

c. Based on household.

d. Based on consumption.

This paper was produced as part of the Hemispheric Think Tank Alliance in Support of the 2009 Summit of the Americas, a joint project of the Canadian Foundation for the Americas (FOCAL) and the Inter-American Dialogue (IAD) with the financial support of the Government of Canada provided through the Canadian International Development Agency (CIDA).

March 2009

Publications Mail Agreement: 40012931

The Canadian Foundation for the Americas (FOCAL) is an independent, non-partisan think tank dedicated to strengthening Canadian relations with Latin America and the Caribbean through policy dialogue and analysis. By providing key stakeholders with solutions-oriented research on social, political and economic issues, we strive to create new partnerships and policy options throughout the Western Hemisphere. FOCAL promotes good governance, economic prosperity and social justice, basing our work on principles of intellectual integrity, racial diversity and gender equality.

La Fundación Canadiense para las Américas (FOCAL) es un instituto independiente que se dedica al fortalecimiento de las relaciones entre Canadá y los países de América Latina y el Caribe mediante el análisis y el diálogo sobre políticas. Buscamos la creación de nuevos vínculos y opciones de política para el Hemisferio Occidental a través de la investigación que aborda soluciones sobre temas sociales, políticos y económicos. FOCAL promueve buena gobernabilidad, prosperidad económica y justicia social, basando nuestro trabajo en principios de integridad intelectual, diversidad racial y equidad de género.

Additional copies of this document are available on FOCAL's website (www.focal.ca).

Copias adicionales de este documento se encuentran disponibles en el sitio de Internet de FOCAL (www.focal.ca).