Democratic Consolidation and Economic Policy Options in Latin America

Based on the
OECD Latin American Economic Outlook 2009

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The crisis and Latin America

Historically, when the U.S. sneezes, Latin America catches cold

### Effect of US Recessions on Latin American growth
(Median for Region)

<table>
<thead>
<tr>
<th>Year</th>
<th>United States</th>
<th>Latin America</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974-75</td>
<td>-7%</td>
<td>-6%</td>
</tr>
<tr>
<td>1980</td>
<td>-3%</td>
<td>-2%</td>
</tr>
<tr>
<td>1982</td>
<td>-1%</td>
<td>-0%</td>
</tr>
<tr>
<td>1991</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>2001</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>All Recessions</td>
<td>-1%</td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF, 2007

### Export Exposure to the US
(change in average output gap during recessions)

- Least exposed
- Most exposed

Source: Lane and Milesi-Ferreti, 2006

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The charts illustrate the impact of US recessions on Latin American growth and the export exposure of different countries to the US during recessions. The data shows that Latin America tends to experience a decline in growth during US recessions, with the severity varying across different years and economic groups.
The impact is worsening...

And remains highly vulnerable to international capital markets’ volatility...
...but – at least for the public sector – sensitivity is lower now than in the past

**Spreads are now much less sensitive to external shocks**

Sovereign bond spreads and “global risk aversion”

![EMBI Global LatAm vs. VIX (1998-2004)](chart1)

![EMBI Global LatAm vs. VIX (2005-2009)](chart2)

Source: OECD Development Centre based on Thomson Datastream, 2009

The VIX index (CBOE Volatility Index) is the implied volatility of S&P500 index options.
Why such confidence? Public debt management has improved

External debt is falling and countries can increasingly borrow abroad in local currency

External Public Debt in Latin America (% of GDP)

“Original Sin Index”

Source: OECD Development Centre calculations based on World Bank and Consensus Forecast, 2009.

Source: OECD Development Centre calculations based on Dealogic, 2009.
Presidential and Legislative elections in Latin America

Presidential elections in Latin America

Legislative elections in Latin America

Source: OECD Development Centre 2009, based on IFES (Election Guide)
Capital Markets, Democracy and the Cost of Debt

The political cycle and capital markets

There are clear links between political processes, particularly elections, and instability in the debt and currency markets.

Real Exchange Rates around Elections

Correlation Between Exchange Rate and Sovereign-bond Spreads During Elections

Source: Nieto Parra and Santiso (2008a), based on Datastream database.
Investment banks’ recommendations and portfolio allocation to bonds

Latin America (2002-2007)

Brazil (2002-2007)

Source: Nieto Parra and Santiso (2008a), based on Datastream database.
The political cycle and capital markets

Bank recommendations are downgraded prior to elections, but tend to move positively again once the uncertainty has passed.

**Investment-Bank recommendations around elections**

**Brazil 2002 and 2006:**
From *Lula Preta* to *Lula de Mel*

Source: Nieto Parra and Santiso (2008a), based on Datastream database.
Are Capital-market Jitters around Elections Justified?

The market’s fears have some justification: elections are indeed associated with fiscal volatility.

Impact of Elections on Fiscal Policy, 1990-2006 (% of GDP)

Note: The impact of elections on fiscal policy is calculated as the difference between the fiscal variable (as percentage of GDP) during the election year and non-election years.

Source: Nieto Parra and Santiso (2009, forthcoming)
Are Capital-market Jitters around Elections Justified?

Across Latin America, considerable variation in electoral fiscal expansion

Impact of Elections on Fiscal Policy, 1990-2006 (% of GDP)

Note: The impact of elections (percentage of GDP) during the election year and non-election years.

Source: Nieto Parra and Santiso (2009, forthcoming)
Is Latin American Democracy Maturing In the eyes of the Capital Markets?

2006 saw elections in all large Latin America countries other than Argentina

The election effect has been much less marked since 2006 than before partially supported by higher primary surplus due to high GDP growth rather than spending restraint. There has been no decrease in non-credible policy pronouncements.

Note: The impact of 2005 and 2006 elections on fiscal policy is calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years.

Source: Nieto Parra and Santiso (2009, forthcoming)
Revenues and expenditures in Latin America

Latin America Fiscal Performance – Recent improvements

Fiscal policy measures

Fiscal policy volatility

Source: OECD Development Centre calculations based on the ECLAC ILPES Public Finance database for Latin America, and OECD General Government Accounts data for OECD countries.
Fiscal policy does little to reduce inequality in Latin America

While taxes and transfers reduce the inequality by 19 Gini points in Europe, the difference is less than two Gini points in Latin America.

OECD-Latin American tax gap: lower levels, different sources

**Tax (and non-tax) revenues in Latin America and OECD countries**

### OECD

<table>
<thead>
<tr>
<th>% of total revenues</th>
<th>OECD</th>
<th>Latin America</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nontax revenue</td>
<td>26.0</td>
<td>37.0</td>
</tr>
<tr>
<td>Direct taxes</td>
<td>14.8</td>
<td>28.2</td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>20.6</td>
<td>11.3</td>
</tr>
<tr>
<td>SSC</td>
<td>37.0</td>
<td>40.3</td>
</tr>
<tr>
<td>Other/unclassified</td>
<td>0.0</td>
<td>17.7</td>
</tr>
</tbody>
</table>

**Source:** OECD Development Centre 2008, based on the ECLAC ILPES Public Finance database, OECD Development Centre Latin American Revenue Statistics Database, the OECD Revenue Statistics database and OECD General Government Accounts data

### Notes:

a) Where possible, coverage corresponds to general government, otherwise the statistics are restricted to central government.

b) The Latin American countries covered are Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Mexico, Peru and Venezuela.

c) OECD America-Pacific comprises Australia, Canada, Japan, Korea, Mexico, New Zealand and United States.

Source: OECD Revenue Statistics database for OECD countries and OECD Development Centre 2008 for Latin America.
A Stark Contrast: Latin America and Finland

Income tax paid per head by income brackets

Taxpayer distribution by income bracket

Source: OECD Development Centre calculations based on statistics provided by national tax agencies.
Public spending on education and performance in PISA

Education spending per pupil is still five times lower in Latin America than in OECD countries...

But quality is as big a problem as quantity.

Notes:
a) Public spending is calculated as average of available data since 2000.
b) Countries performance average on the PISA science scale

Source: OECD Development Centre 2008 based on PISA 2006 Science Competences for Tomorrow’s World and OECD and UNESCO World Educational Indicators, UNESCO’s Institute of Statistics database.
Average performance on PISA and equity of educational systems

Source: Centre de développement de l’OCDE (2008), d’après le rapport PISA 2006 Compétences scientifiques pour le monde de demain
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¡Gracias!
Merci beaucoup!

www.oecd.org/dev/leo

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