

SHIFTING WEALTH, CHINA AND THE LATIN AMERICAN CHALLENGE

An OECD Perspective

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Outline

- 1 Shifting Wealth: continuing despite hurdles
- 2 China and Latin America: recent dynamics
- 3 Overcoming the middle income trap
- 4 After the diagnostic: public policies to overcome the challenge

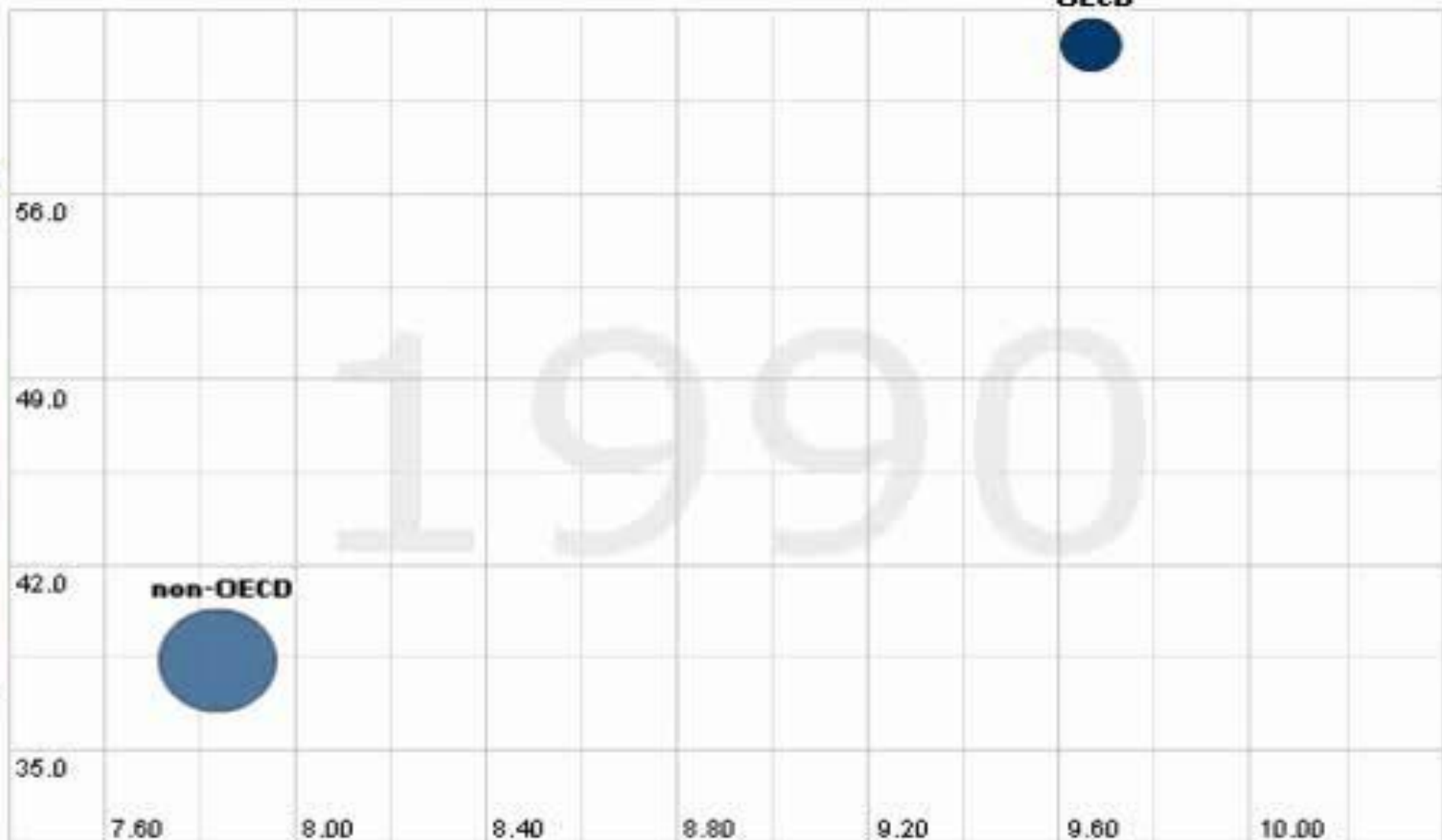
Dot Size

Population

OECD



Share of world economy



log GDP PPP/capita



Trails

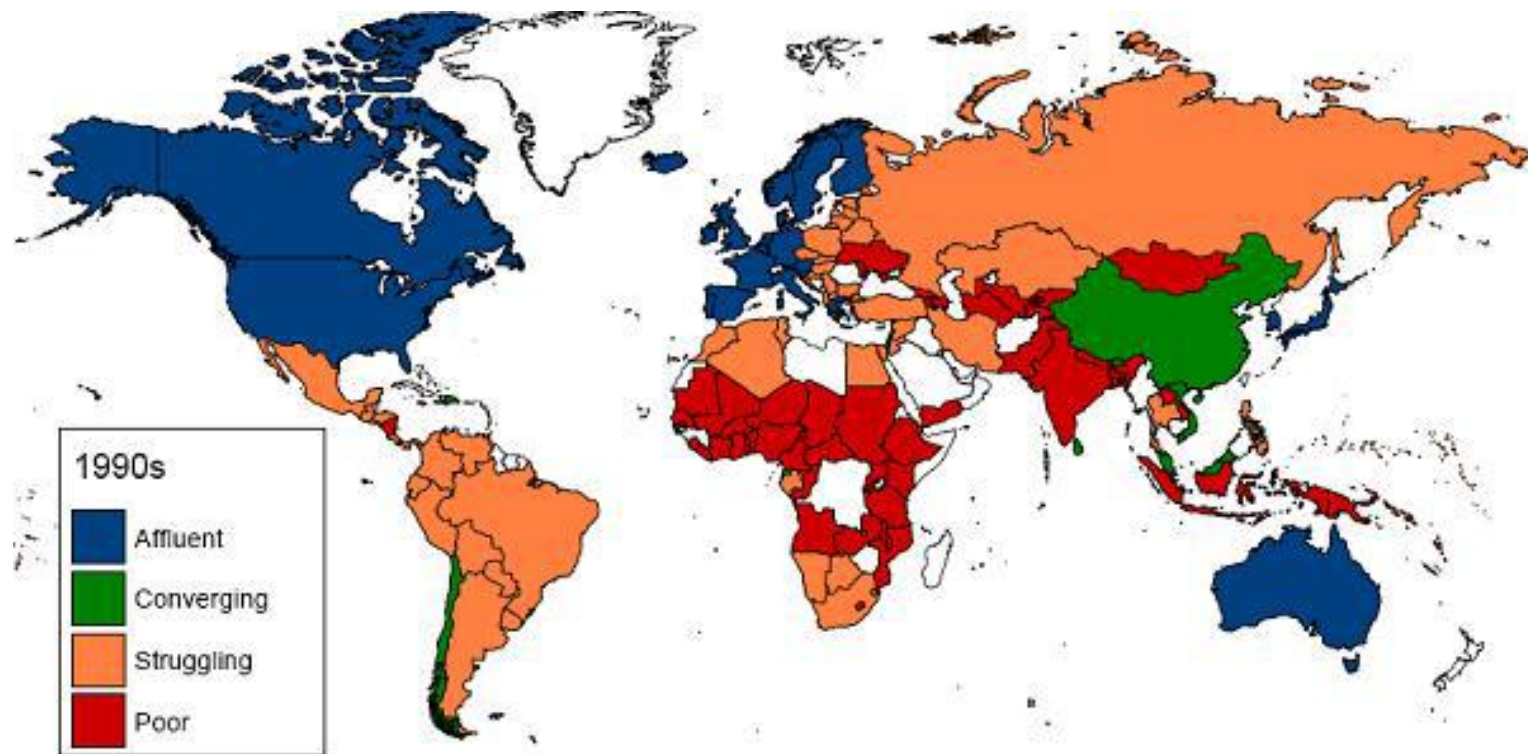


1990 1994 1998 2002 2006 2010 2014 2018 2022 2026 2030



New Geography of Growth: The Four-speed World in the 1990s

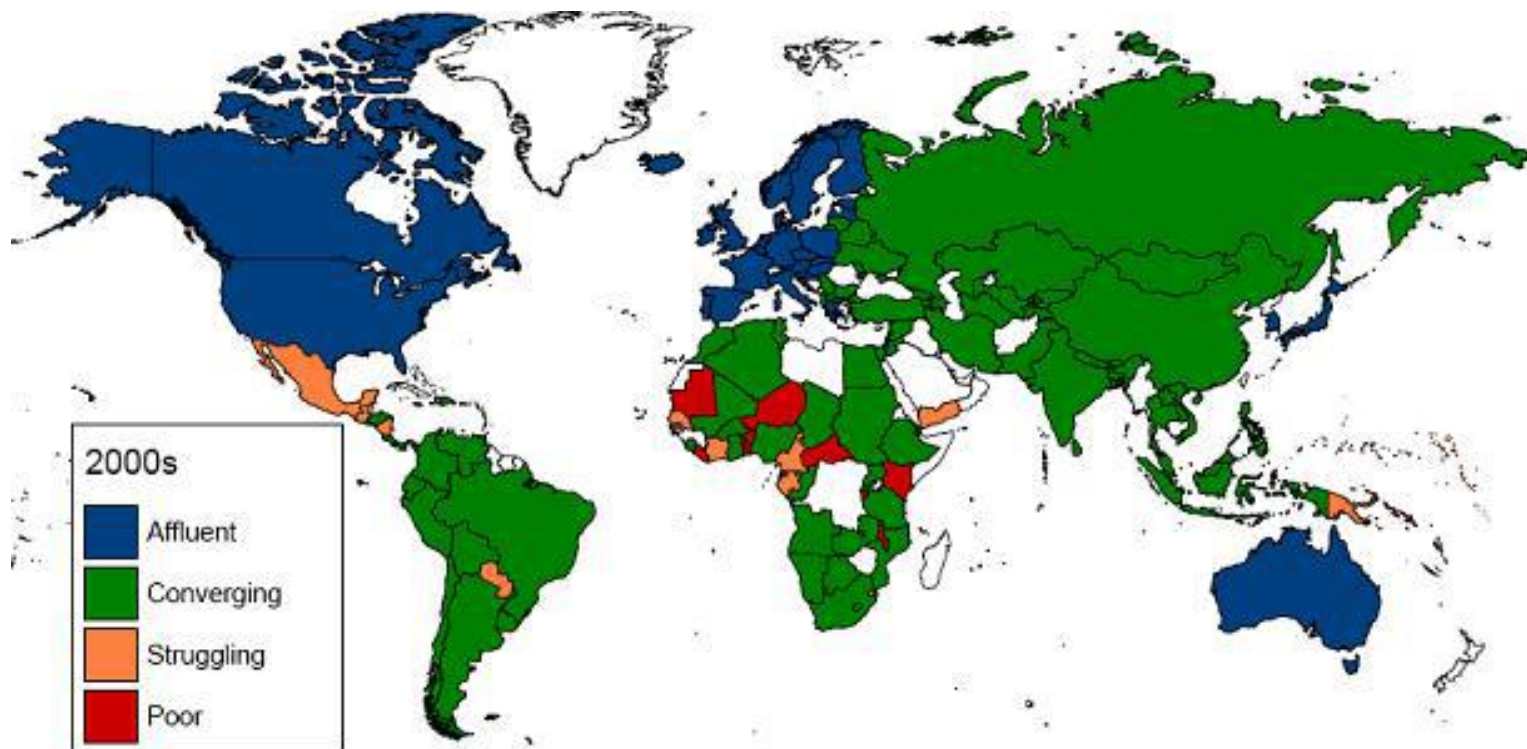
The disappointing reality



Source: OECD Development Centre, *Perspectives on Global Development 2012*

A New Geography of Growth: The Four-speed World in the 2000s

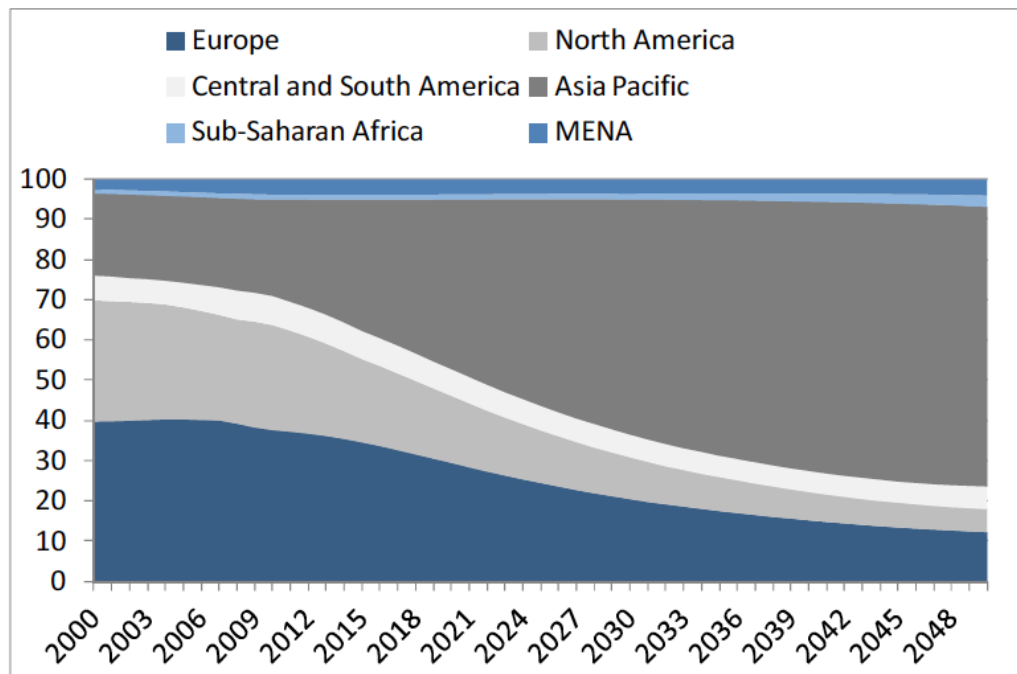
Goodbye divergence, hello convergence?



Source: OECD Development Centre, *Perspectives on Global Development 2012*

Global middle class consumption: catching up in the developing world

Global middle class consumption 2000-2050 (% of total)

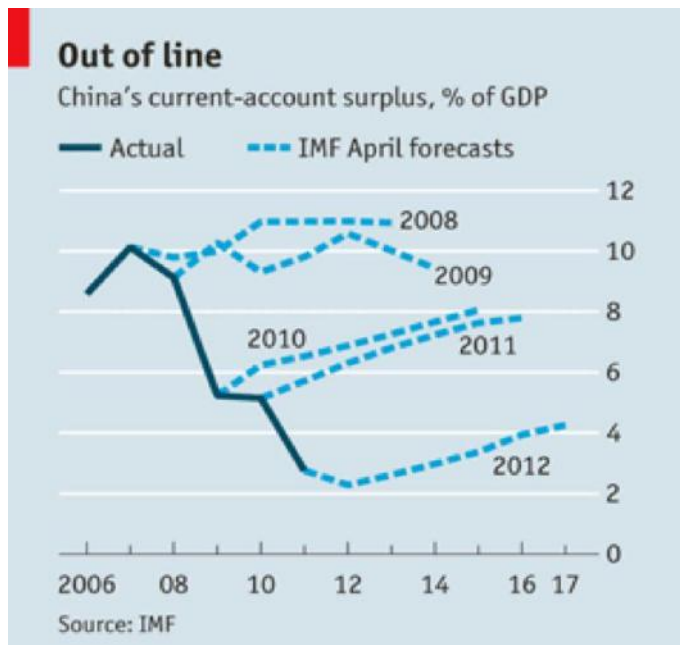


Note: Global middle class consumption is defined here as household consumption between USD 10 and USD 100 PPP/day. Projections hold most recent distribution constant (from PovcalNet database) and assume consumption equals income growth (projected by a Cobb-Douglas production function, a model of RER convergence based on the Balassa-Samuelson model, and UN population projections).

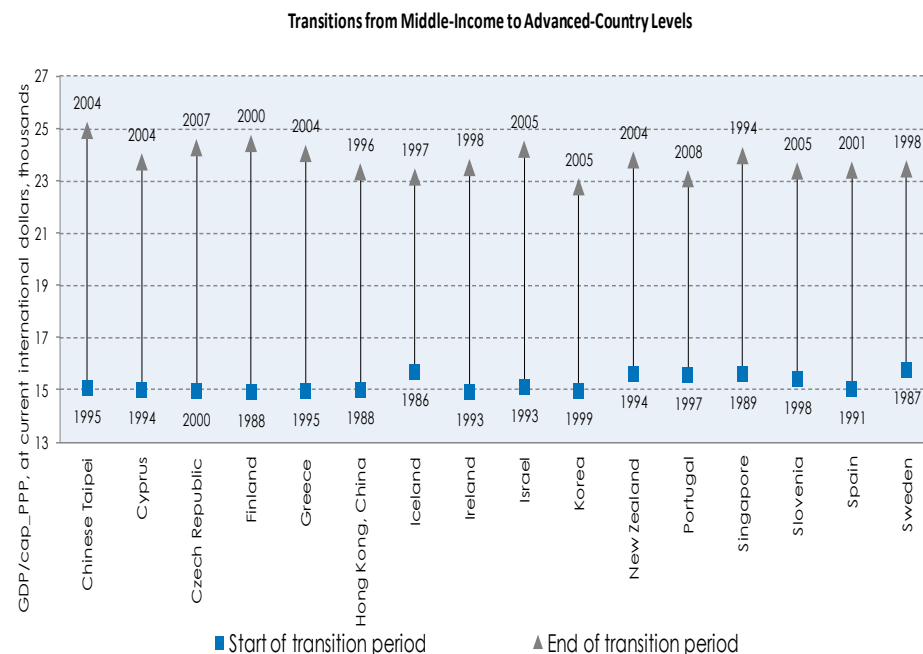
Source: OECD (2011) calculations based on Kharas (2010).

China and the middle income trap: What comes next?

Ever growing trade surplus?



Middle income trap

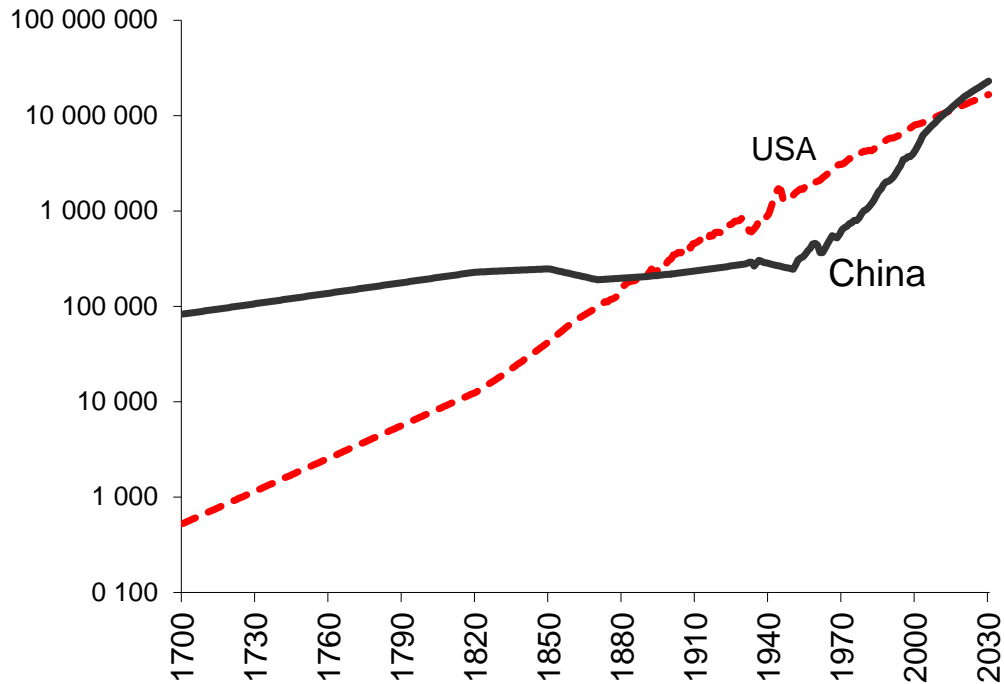


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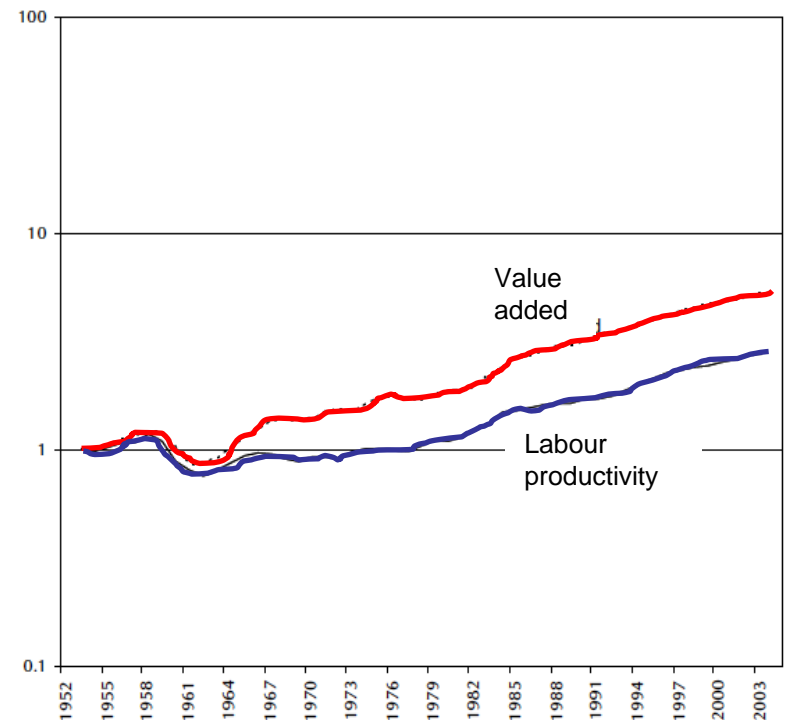
History matters: Chinese economy in the long run

Comparative Levels of GDP, China and the United States, 1700-2030
(million 1990 International dollars)



Source: OECD (2010), and Maddison (2007).

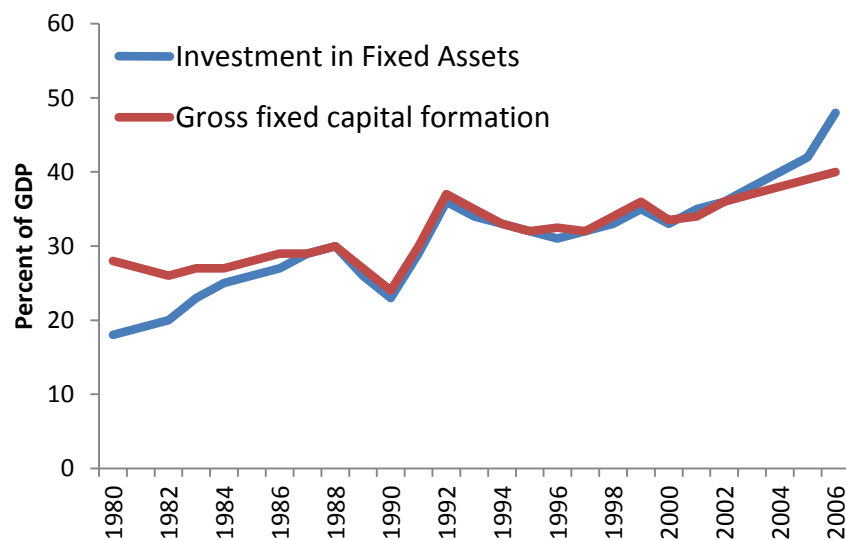
Gross Value Added and Labour Productivity in Agriculture, 1952-2003
(Index 1952=1)



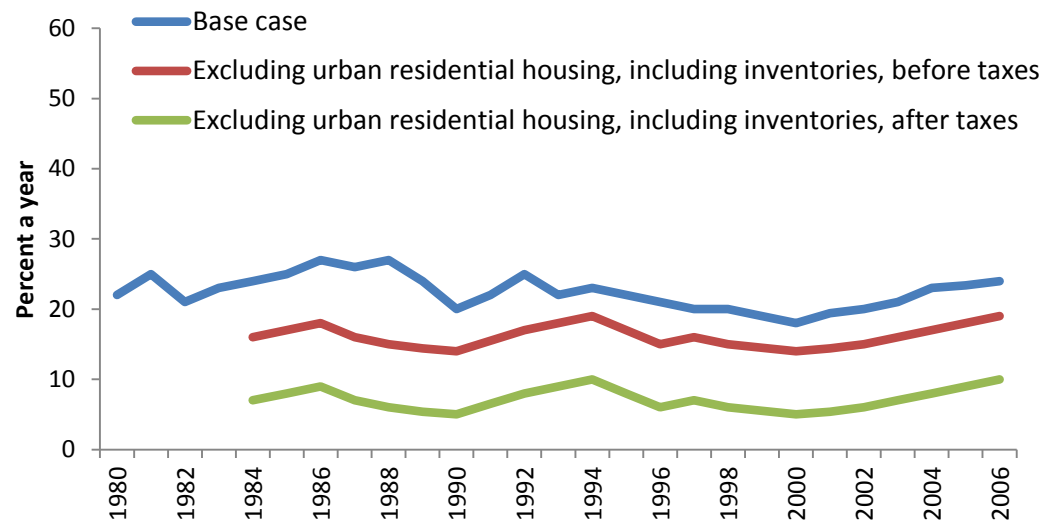
Myth: The main source of China's competitive advantage is cheap labour

Fixed Capital Investments in China as % of GDP and Return to Capital (1980-2006)

Investment in China



Return to Capital before and after taxes



Source: Bai, Chong-En, C. Hsieh and Y. Qian. "The Return to Capital in China". NBER Working Paper 12775. National Bureau of Economic Research. December 2006. Based on China Statistical Yearbook.

Shifting Wealth and World Development

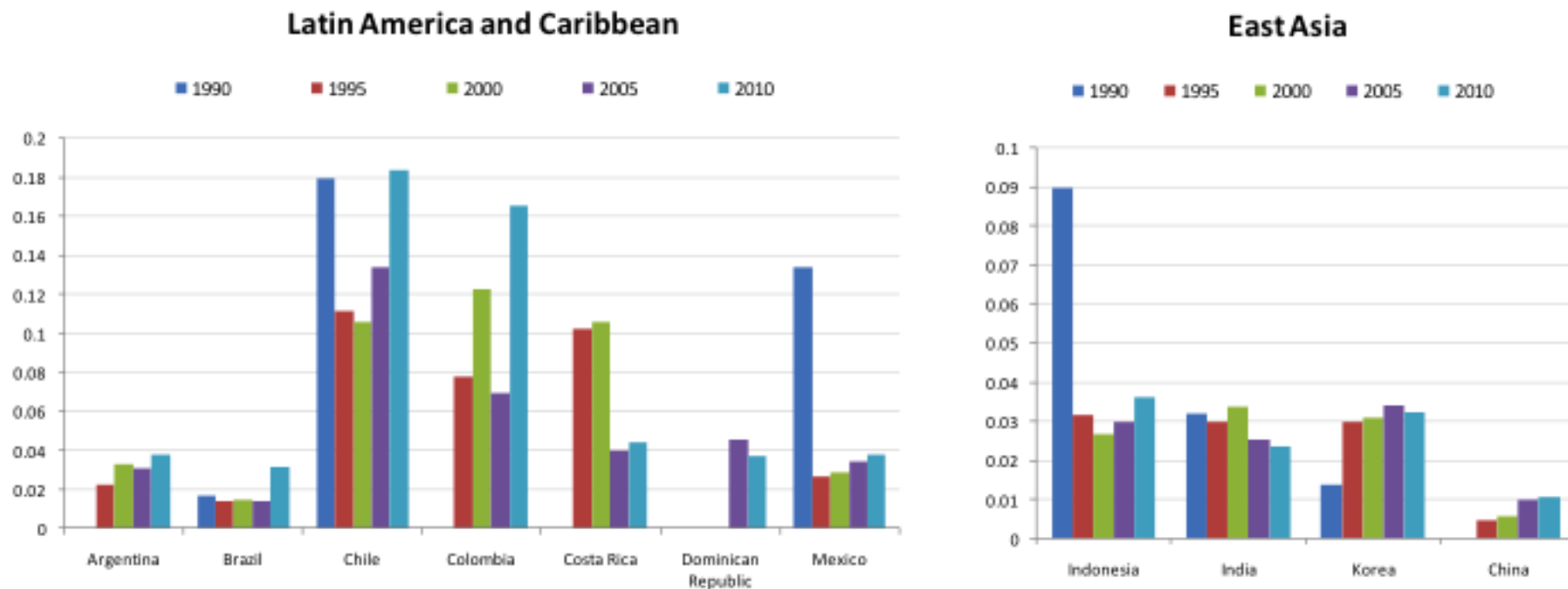
Shifting wealth and world development

- **Analogy:** Compare the world economy with a high jump event in track and field athletics. With the sustained growth of large emerging economies, the world economy has been moving from Straddle to Fosbury Flop technique. World economy is more complex, but it can jump higher – grow faster – than before.
- What will be the consequences of Fosbury for low and middle-income developing countries, the feet in the metaphor?



The rise of China still poses the risk of overspecialisation for the region

Herfindahl-Hirschman Index of concentration by Product



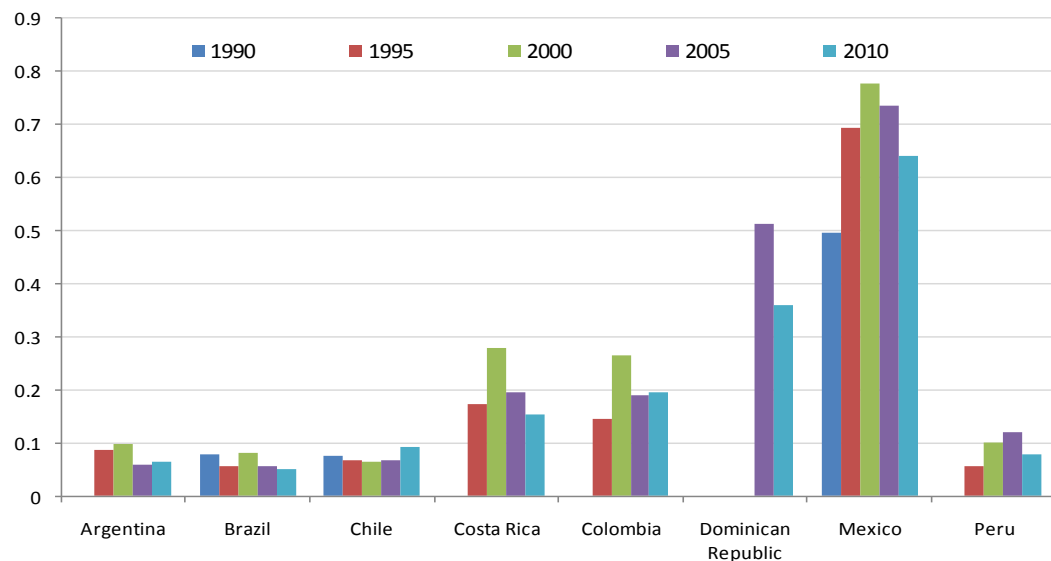
Note: Herfindahl-Hirschman index estimated as the squared sum of market shares of exports of country i to country j on all 4-digit levels of goods, corrected by the number of exported goods. Nomenclature SITC Revision 3, 2012.

Source: OECD Development Centre, based on Comtrade (2012).

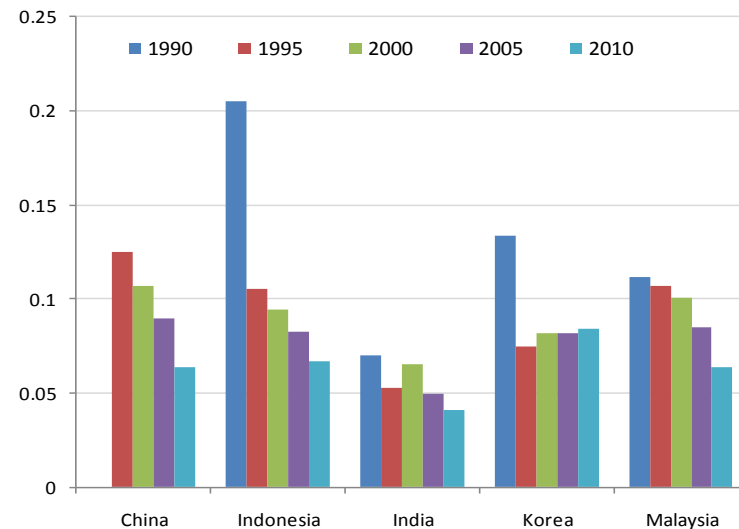
Latam more resilient by diversifying its export destinations

Herfindahl-Hirschman Index of concentration by destination

Latin America and Caribbean



East Asia

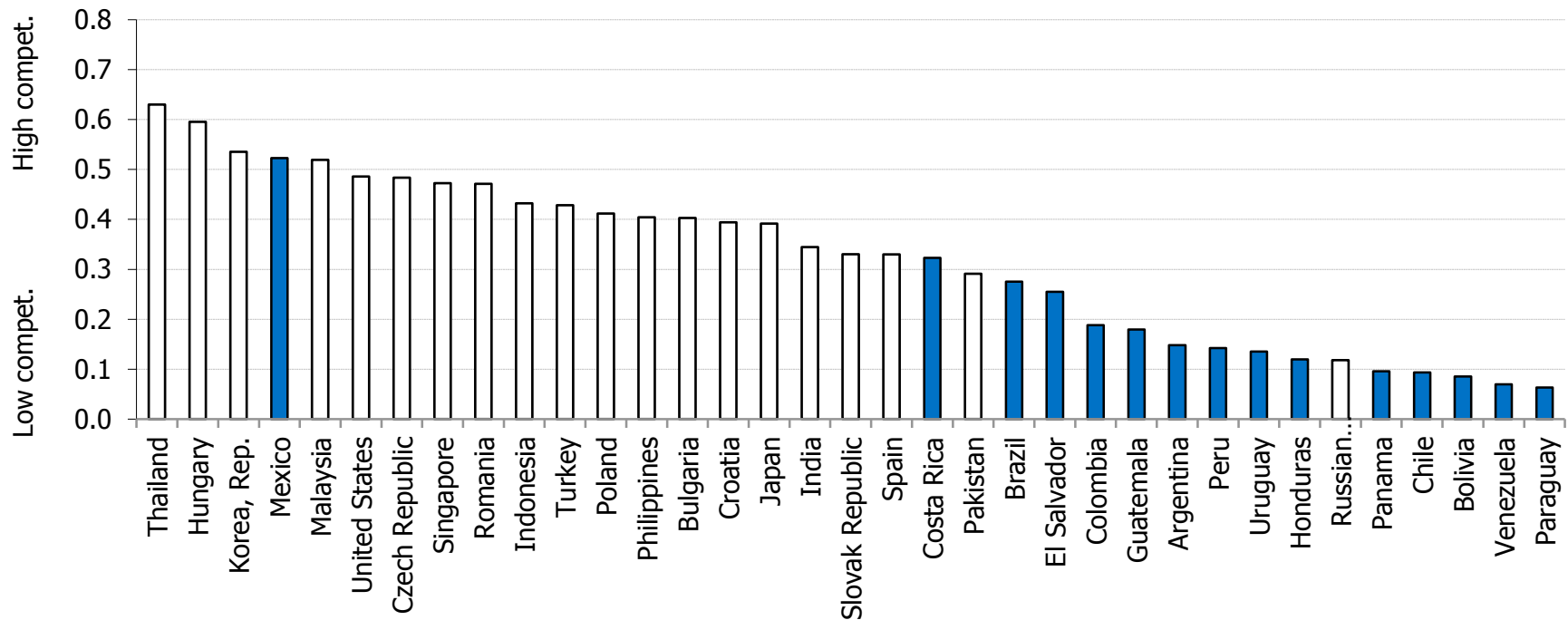


Note: Herfindahl-Hirschman index estimated as the squared sum of market shares of exports of country *i* to country *j* on all destinations, corrected by the number of country partners. Nomenclature SITC Revision 3, 2012.

Source: OECD Development Centre, based on Comtrade (2012).

Export competition with China is relatively low, with some exceptions

Export Competition with China for selected countries (2000-09)

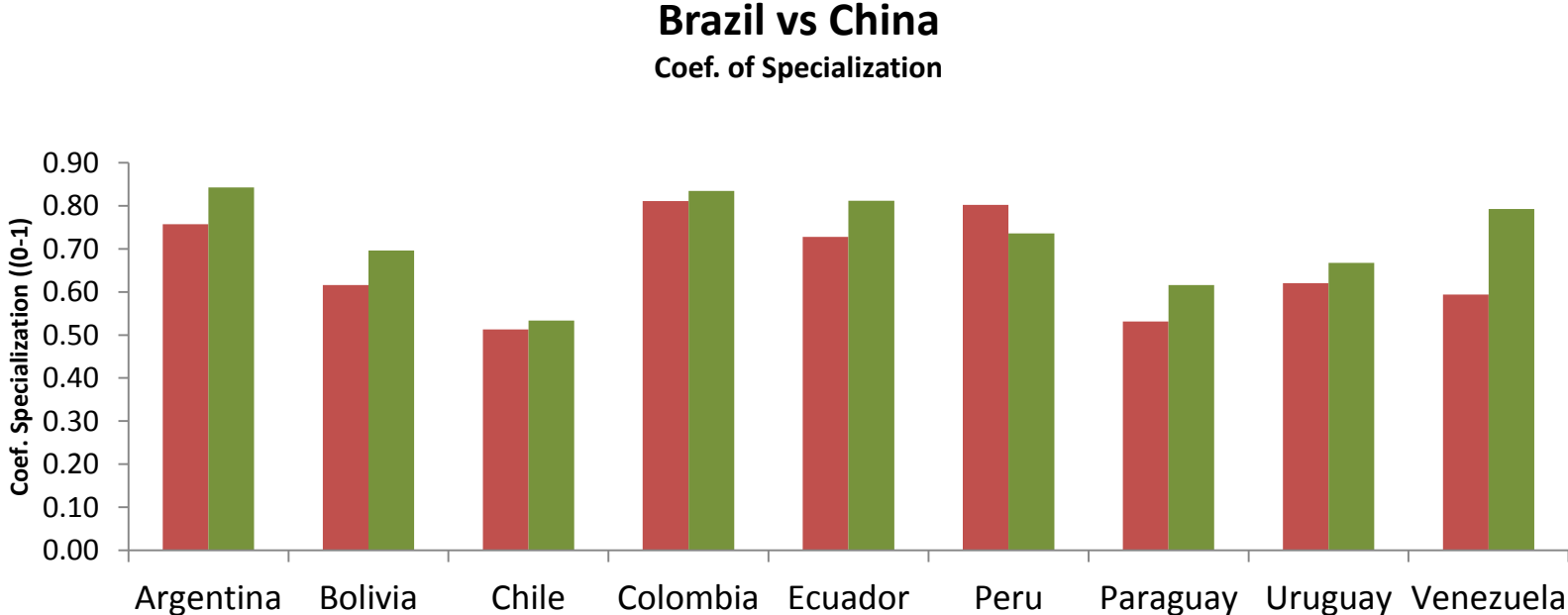


Note: CS and CC coefficients calculated with exports of country *i* and exports of country *j* (China).

Source: OECD Development Centre, based on WITS Database, 2012

What about competition in *regional* markets?

Trade Competition in South America (2000-08)



Note: CS and CC coefficients calculated with exports of country *i* and exports of country *j* to a specific region (in this case Latin America).

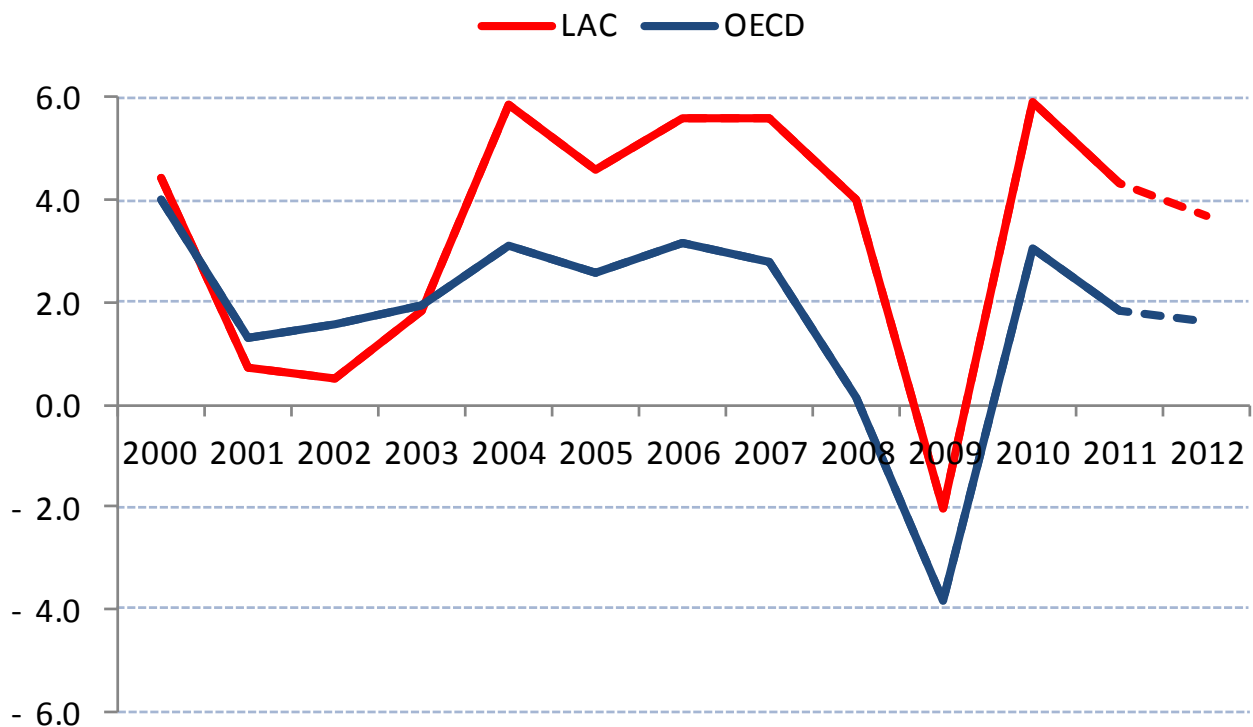
Source: OECD Development Centre, based on WITS Database, 2010.

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Economic growth has been relatively strong since 2003

Annual real GDP growth by region (in percent)



- **No decoupling**

LATAM is still high beta. Correlation with OECD growth: 0.79

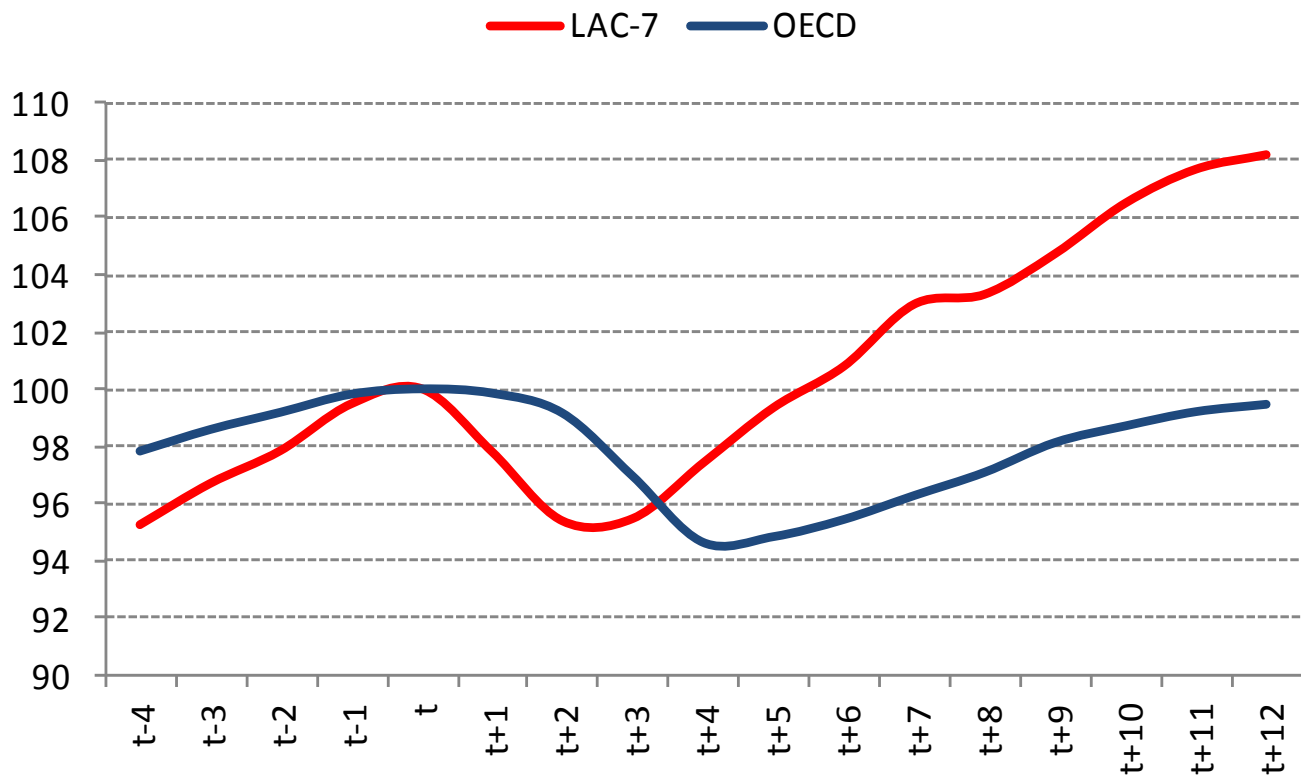
- **But higher alpha?**

Since 2004 LAC has grown 2.6 pps per annum more than the OECD

Source: Own calculations based on ECLAC (2011) and OECD (2011), forecast as of November 2011.

Fast recovery in LATAM with no impact so far on potential growth

Quarterly real GDP (seasonally adjusted) Peak = 100



- **Impact was strong**

Peak to through: 4.6 pps in LATAM versus 5.3 in OECD

- **But swift recovery in LATAM**

GDP reached pre-crisis GDP:

- 6 quarters after peak in LATAM
- In the OECD it took 15 quarters.

2011 Q3 (last figure):

- LAC-7 is 8.2 pps above peak
- OECD just 2.6 pps

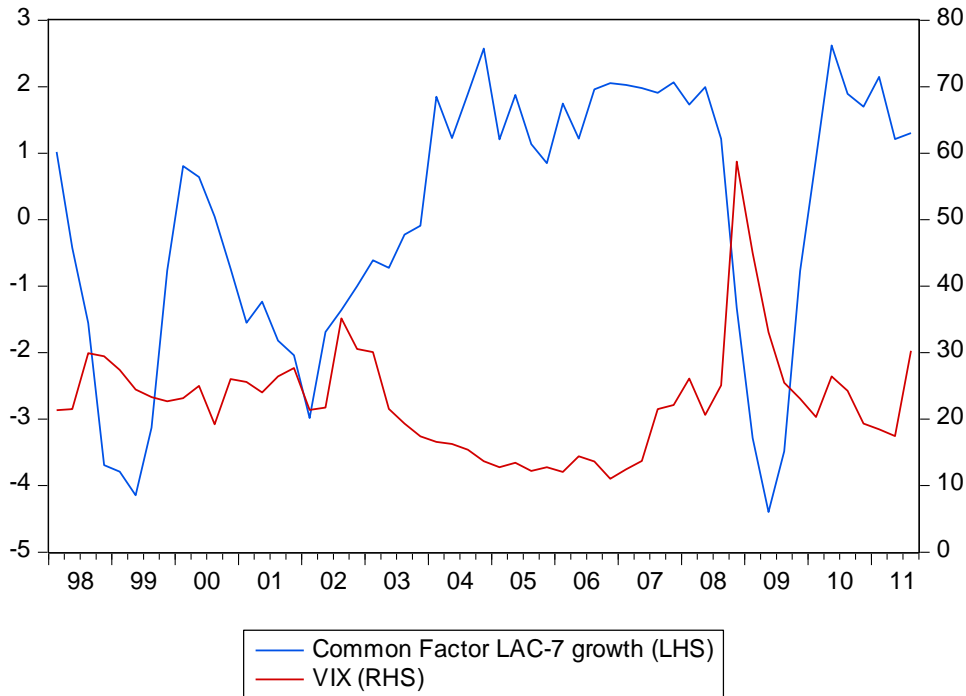
Average annual growth since through:

- 4.3% LAC-7
- 2.3% in OECD

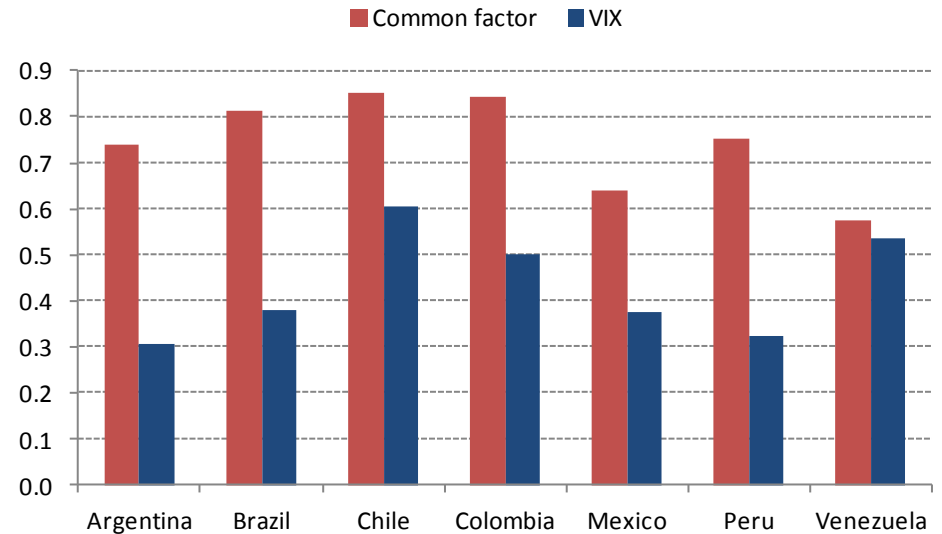
Source: Own calculations based on ECLAC, OECD and World Bank data.

The global risk cycle is a key driver of LATAM business cycle

Quarterly LAC-7 growth (y/y) and VIX



Simple correlation coefficients



Source: Own calculations based on Datastream.

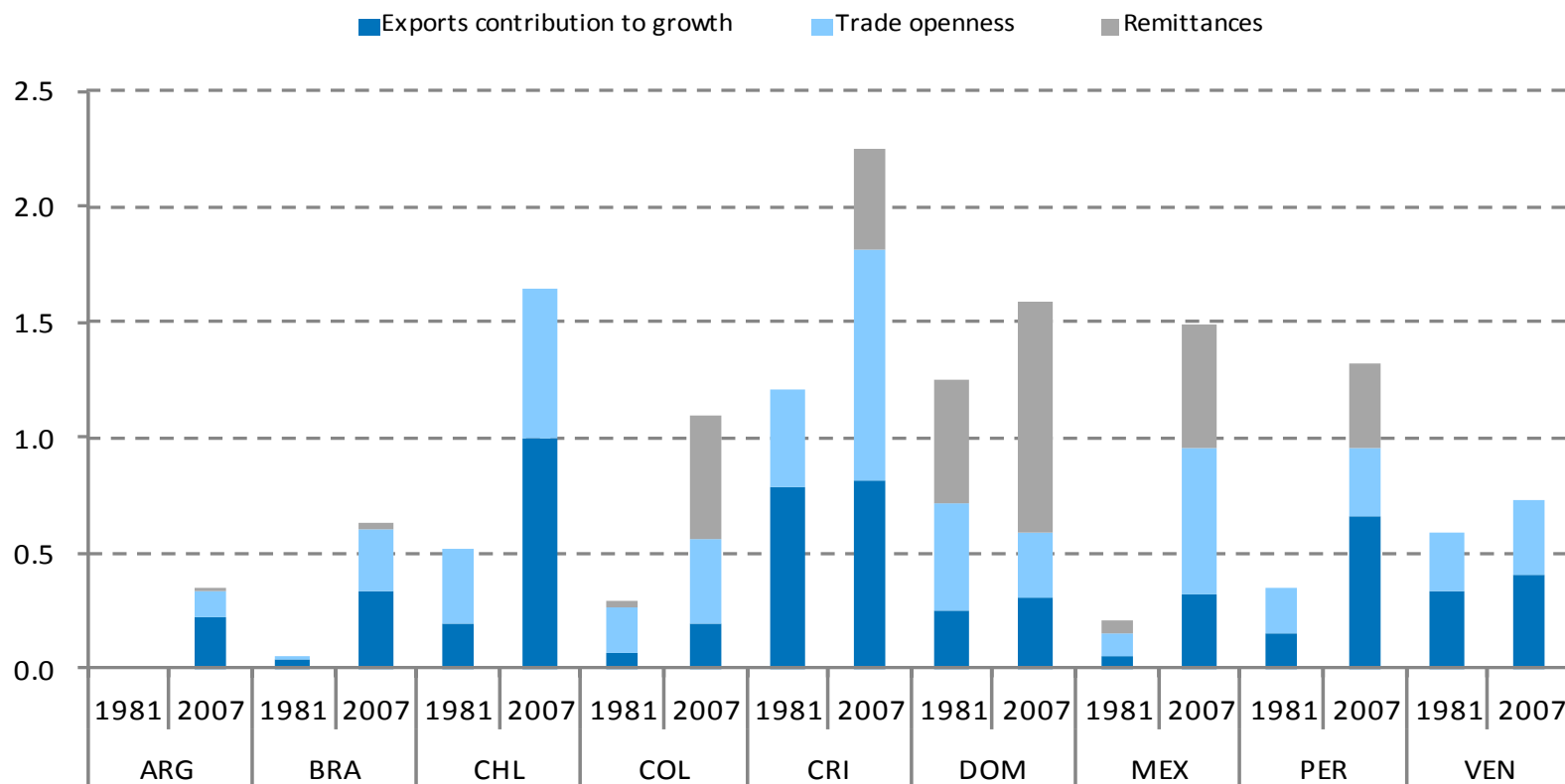
What explains this resilience: Good policies or good luck?

Three main factors explain the new dynamics in the region:

- A lesson learnt the hard way: sustainable fiscal policy & stable monetary policy
- Exposure versus resilience: the role of trade and financial openness
- The emergence of China: differences in head and tail winds within the region

Real channels: more exposure to external shocks

Current account exposure index

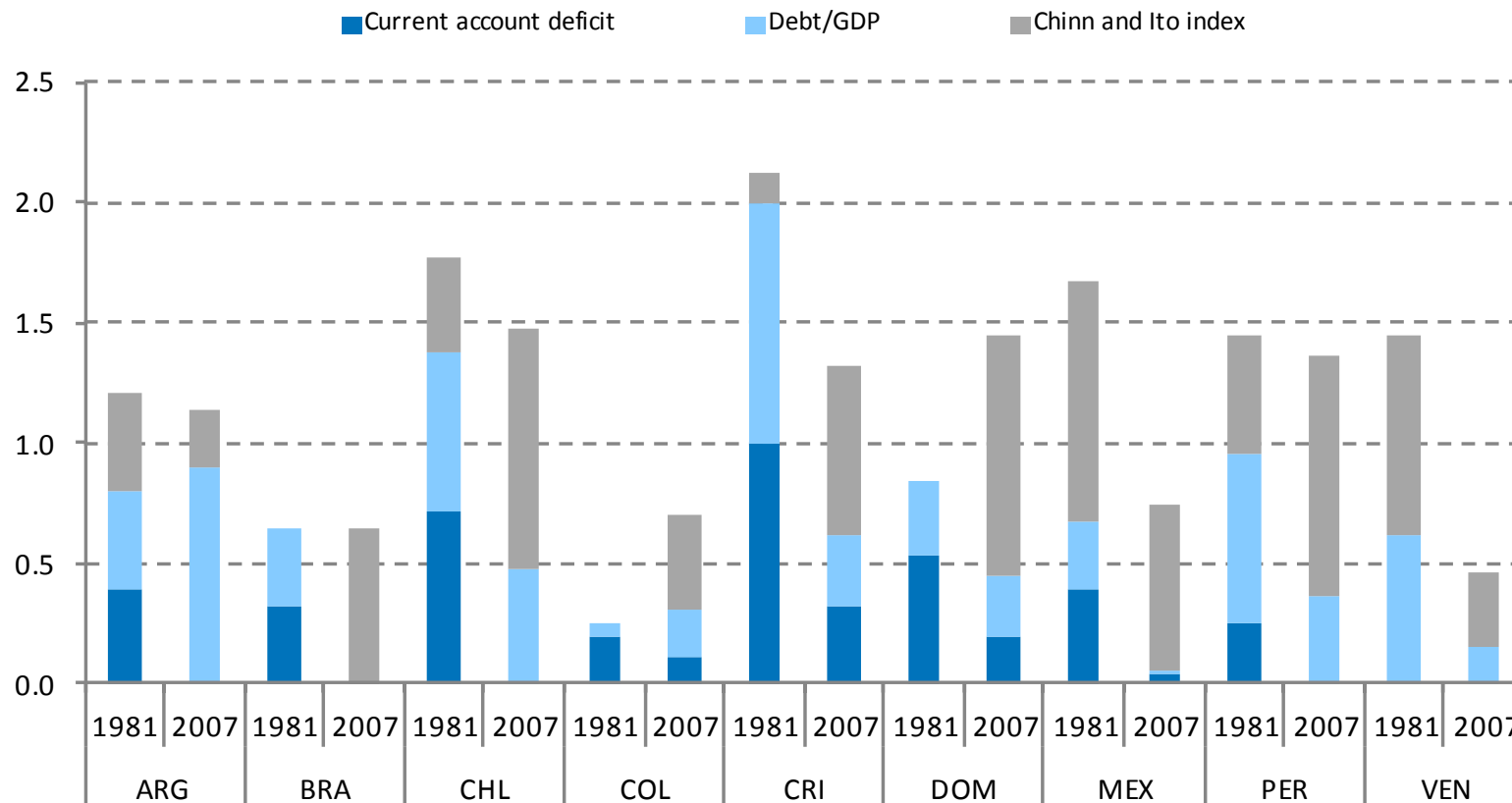


Note: Each indicator is scaled between 0 and 1, with higher values indicating a larger exposure.

Source: OECD (2010).

External finance: more openness but mixed exposure

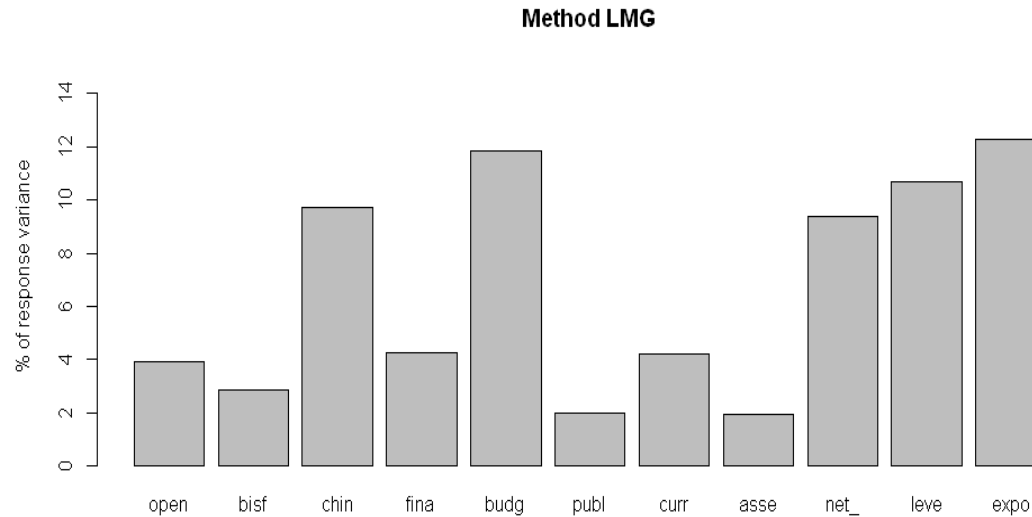
Financial exposure index



Note: Each indicator is scaled between 0 and 1, with higher values indicating a larger exposure.
 Source: OECD (2010).

Recovery in Latin America: What explains it?

Relative Importance for LAC recovery

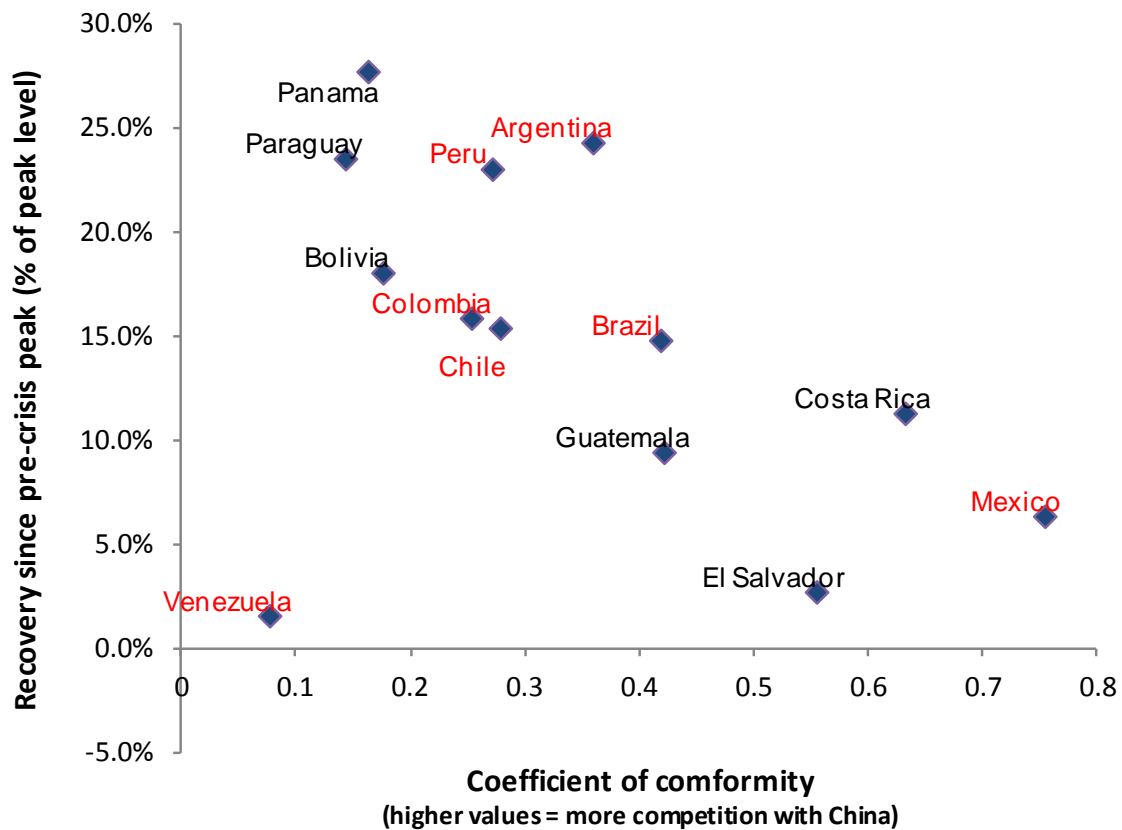


$R^2 = 73.03\%$, metrics are not normalized.

Note: Model includes leverage, exports, trade openness, BIS foreign claims to European banks, Chin-Ito index, financial integration index, budget balance, public debt, current account balance, asset and liabilities over GDP, net position,

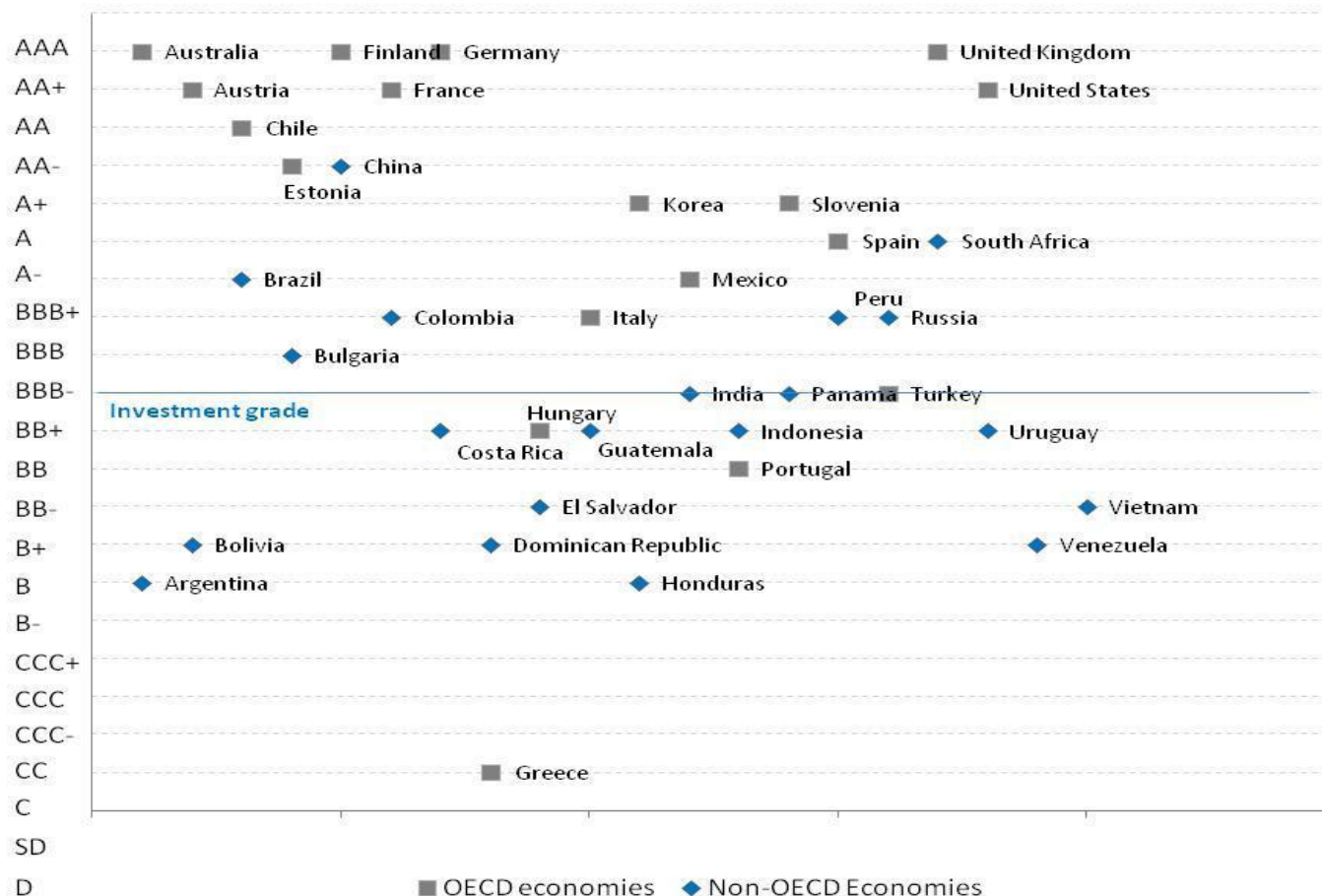
Source: Avendano and Daude (forthcoming)

Recovery since the crisis & trade competition with China



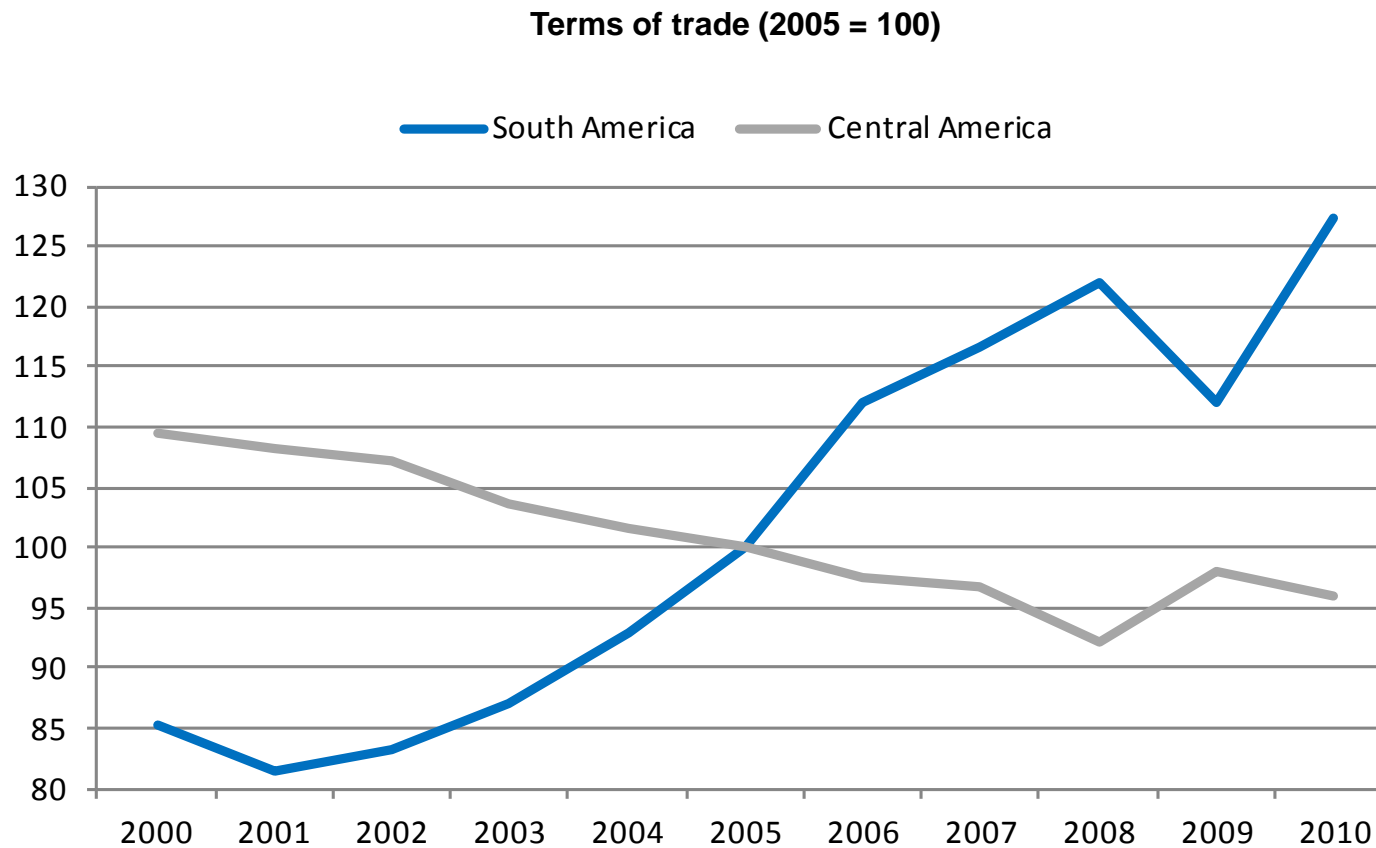
Source: Datastream.

Solid fiscal positions are reflected by ratings



Source: Standard and Poor's, 2012

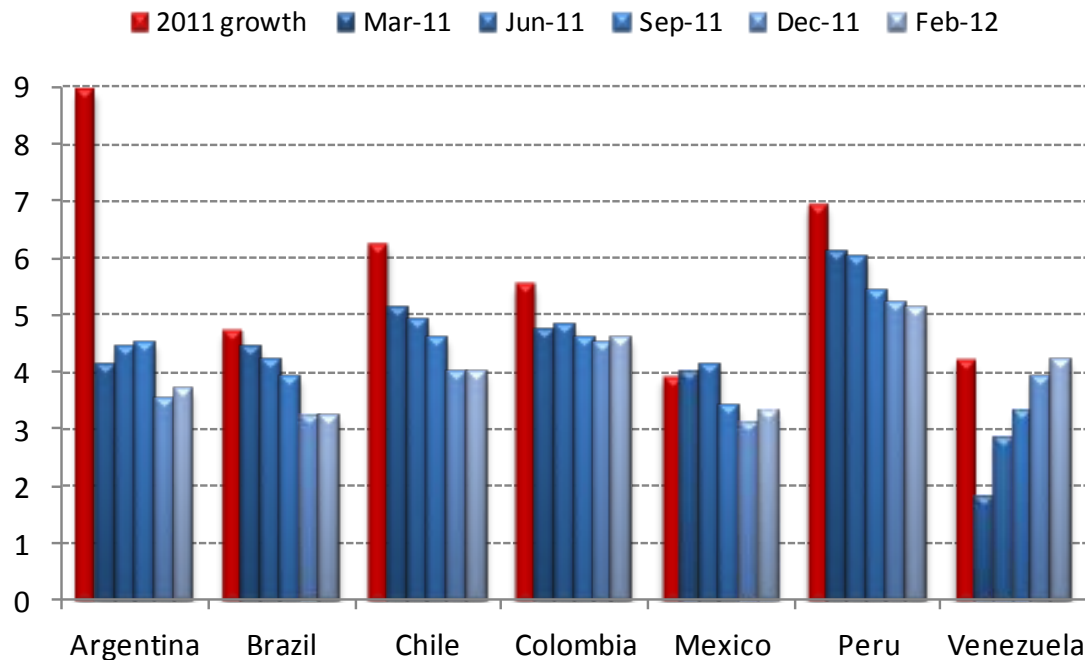
...with diverging effects across the continent



Source: OECD (2012).

Short-term outlook: economic growth

GDP growth in 2011 and monthly forecasts for 2012



Growth moderation for 2012

- Partly policy-induced
- Euro-area problems are responsible for 0.5 – 1.0 pps reduction.
- Mainly through lower external demand.
- Average growth forecasts:

	LAC	Total OECD
2012	3.7	1.6
2013	4.0	2.2

Source: Consensus forecast.

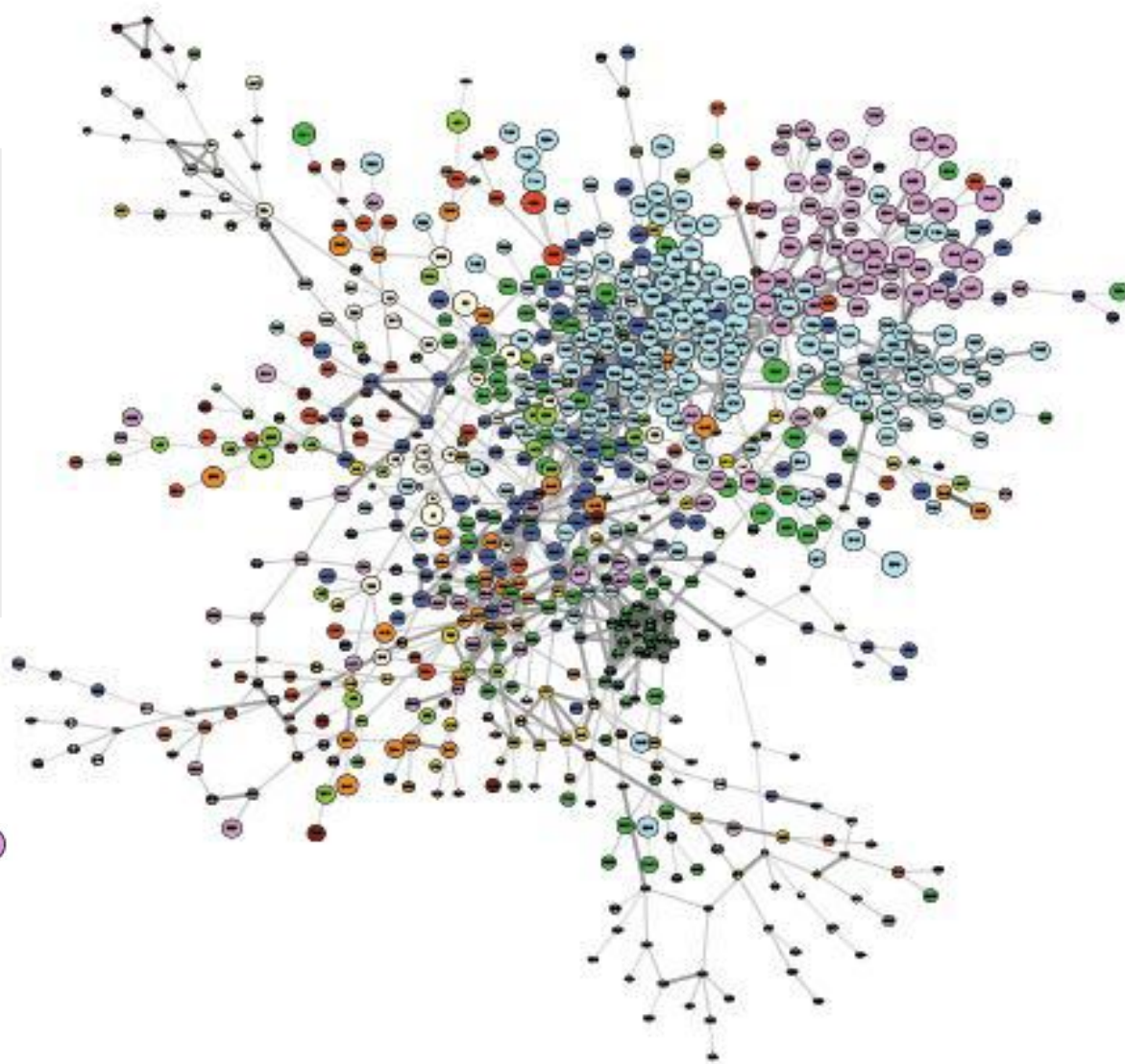
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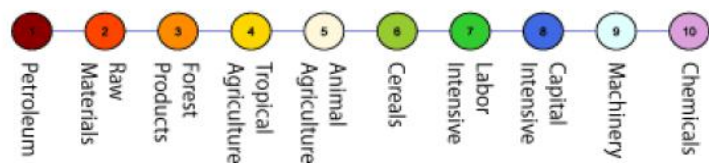
The product space - introduction

•The Product Space: network that formalizes the idea of relatedness (*proximity*) between products traded in the global economy.

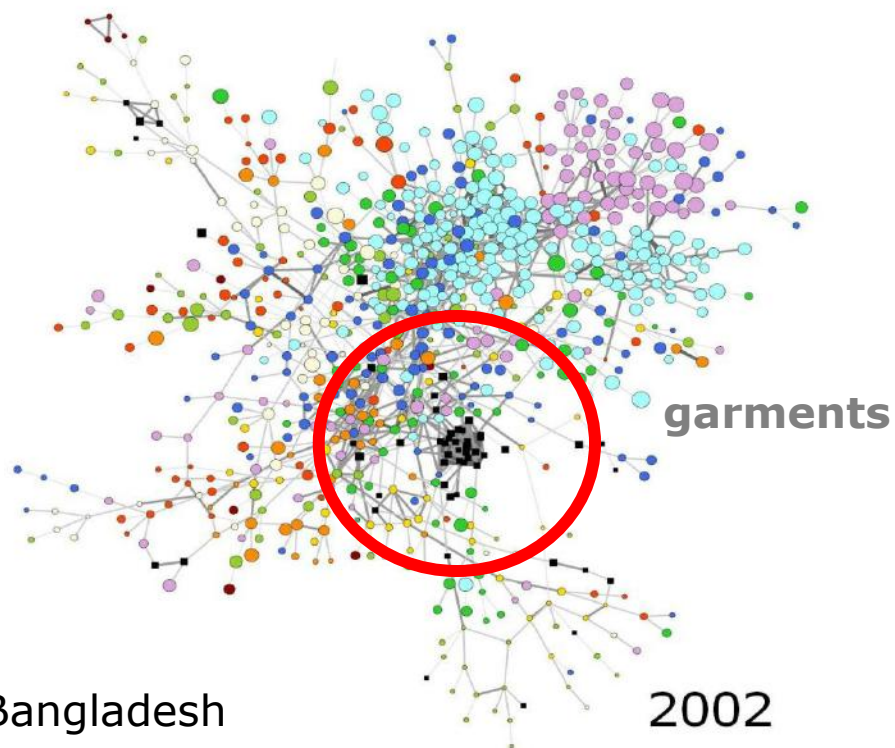
•A complementary notion is that of value embedded in the good exported.



node color (Leamer Classification)



Product Space: The “Structure” of export profiles



Bangladesh

2002

Number of exported goods:

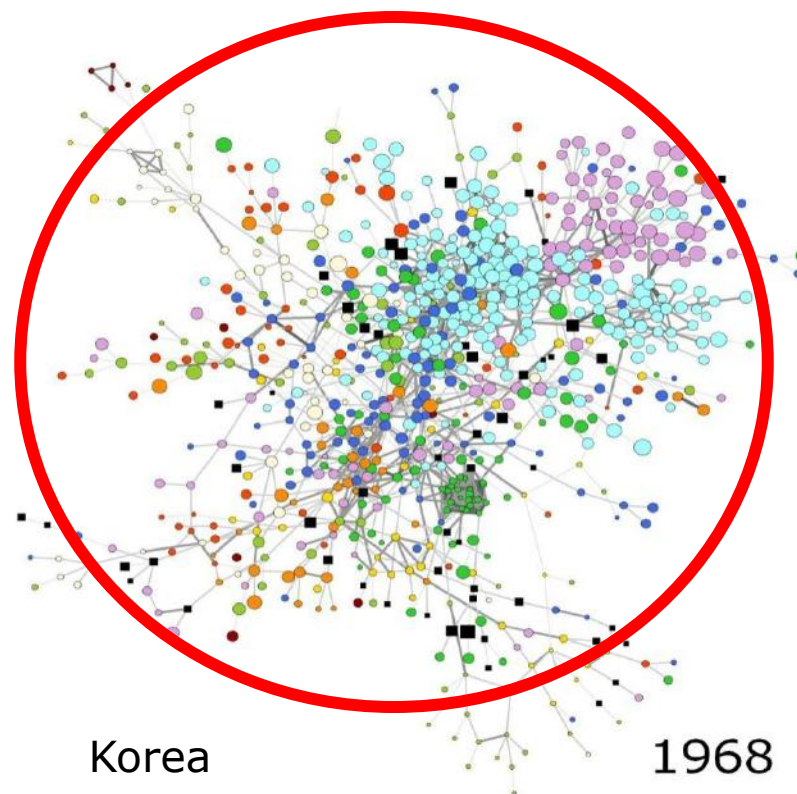
54

EXPY:

6728 US\$

Potential EXPY:

5168 US\$



Korea

1968

Number of exported goods:

53

EXPY:

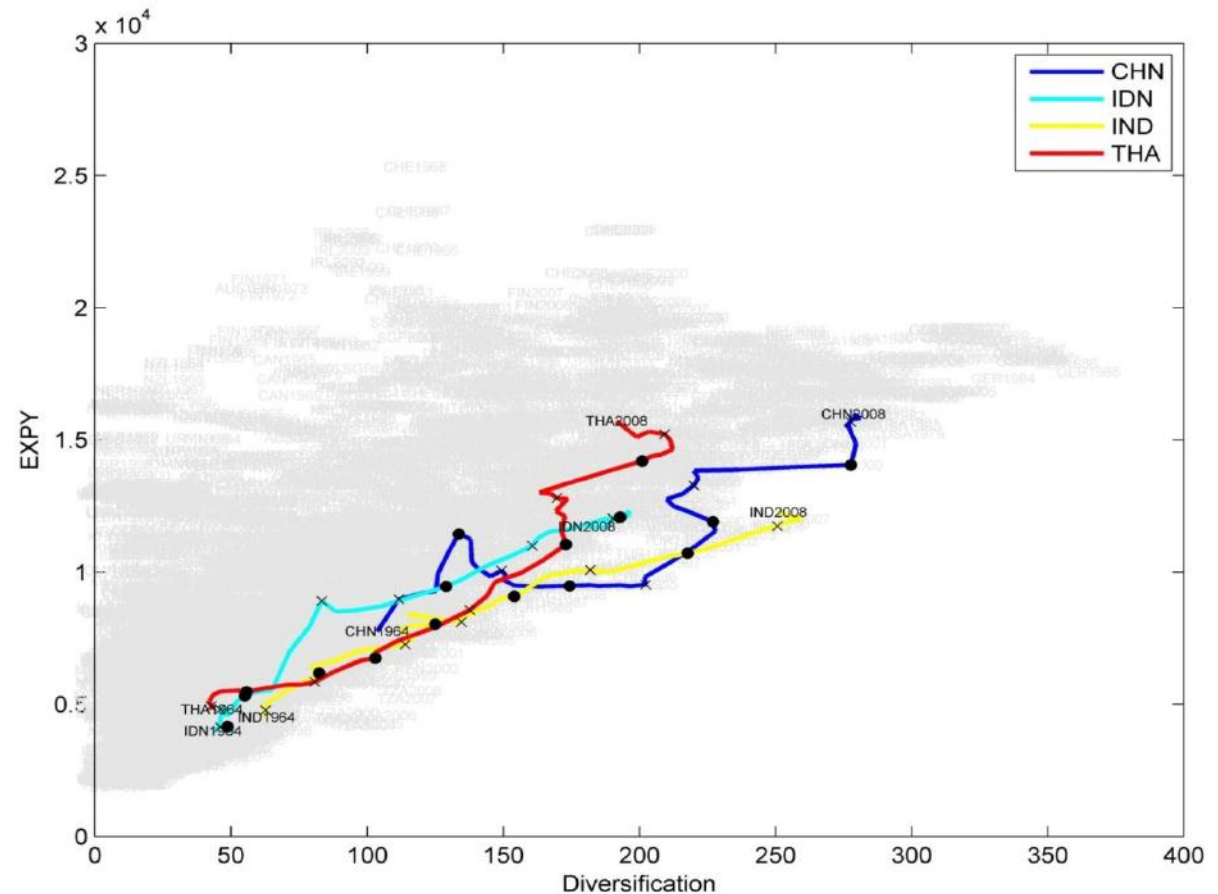
7501 US\$

Potential EXPY:

5425 US\$

Diversification vs Upgrading: Asia

- Large Asian markets: “45° line trackers”.
- Very low starting levels of diversification and sophistication (except CHN).
- The size of the economy allows for developing a wide array of capabilities.
- High diversification, although a more limited record in terms of upgrading.

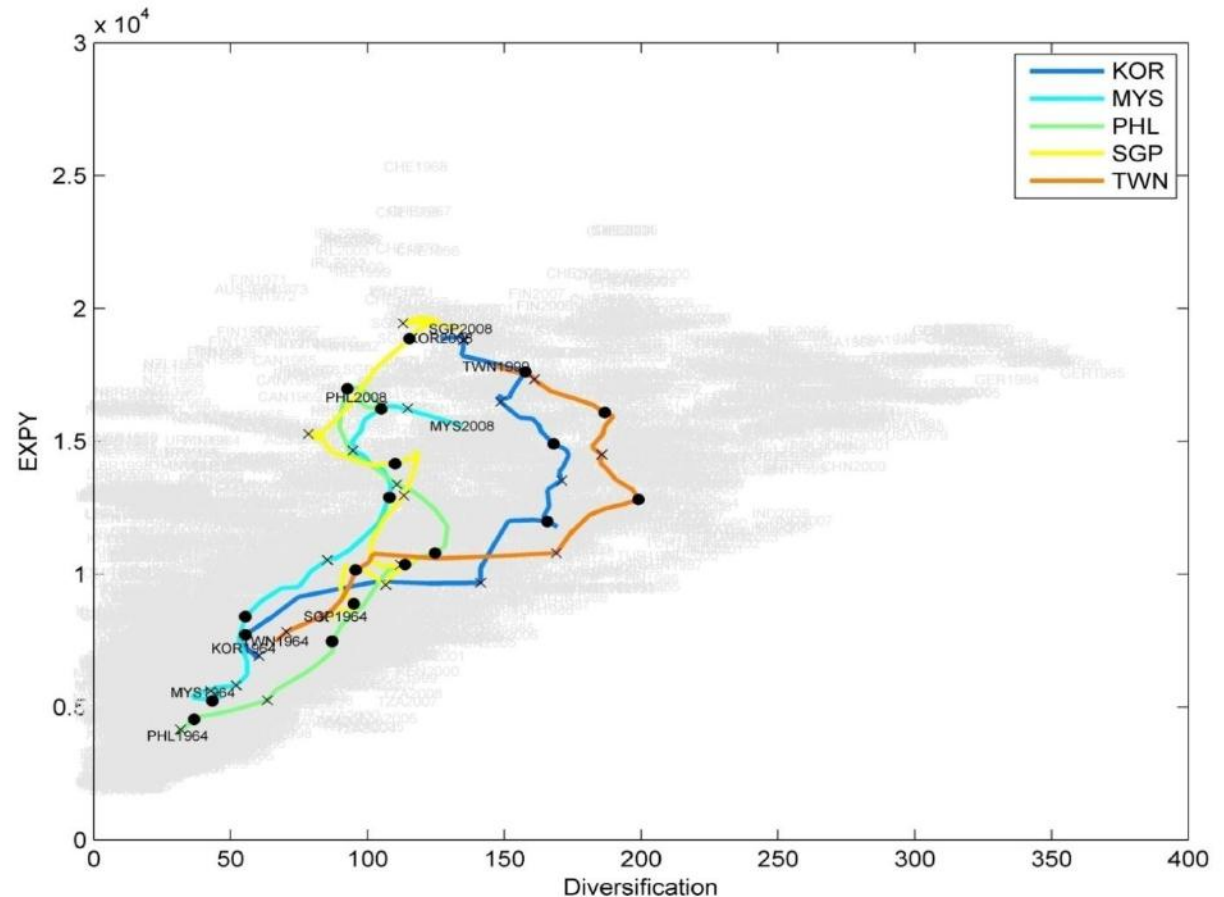


Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Diversification vs Upgrading: Asia

•“2-stage structural transformers” (KOR, TWN): early and –at times- intense increase in diversification, to later focus on upgrading, while maintaining or even reducing the number of sectors where they participate.

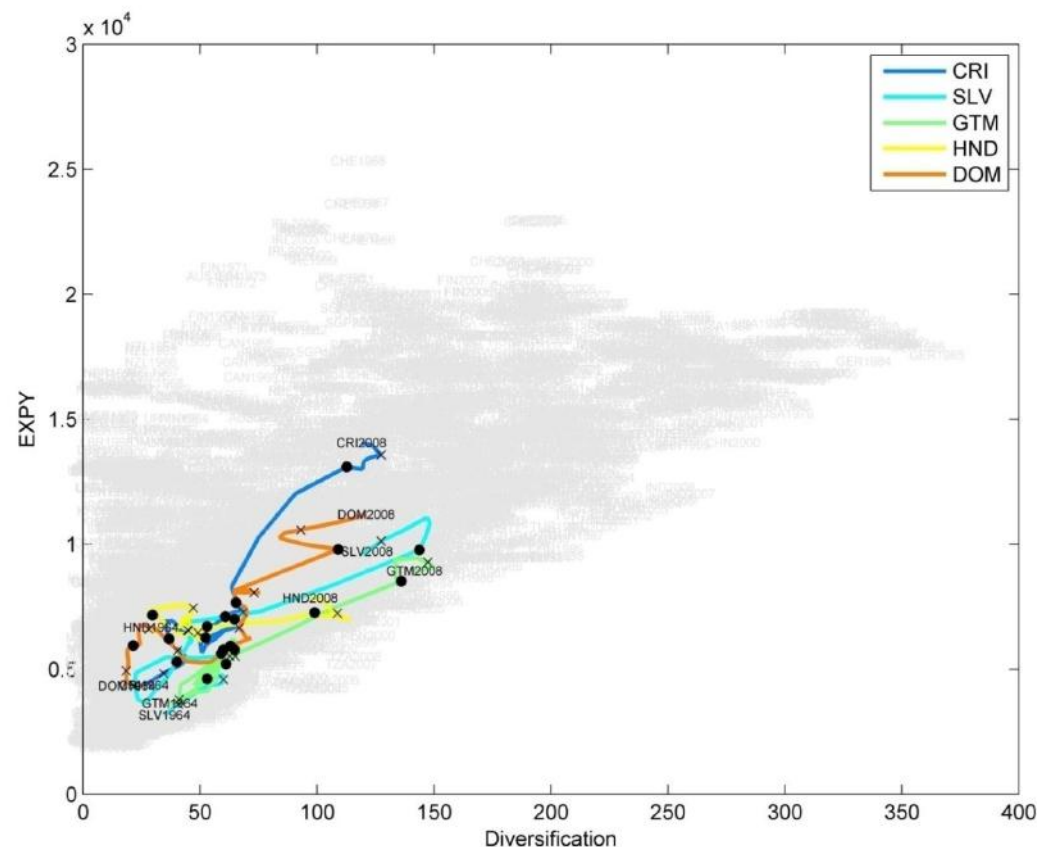
•Smaller countries (SGP, MYS) unable to reach the same level of diversification, but successfully placing themselves in high Expy industries.



Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Diversification vs Upgrading: Latin America

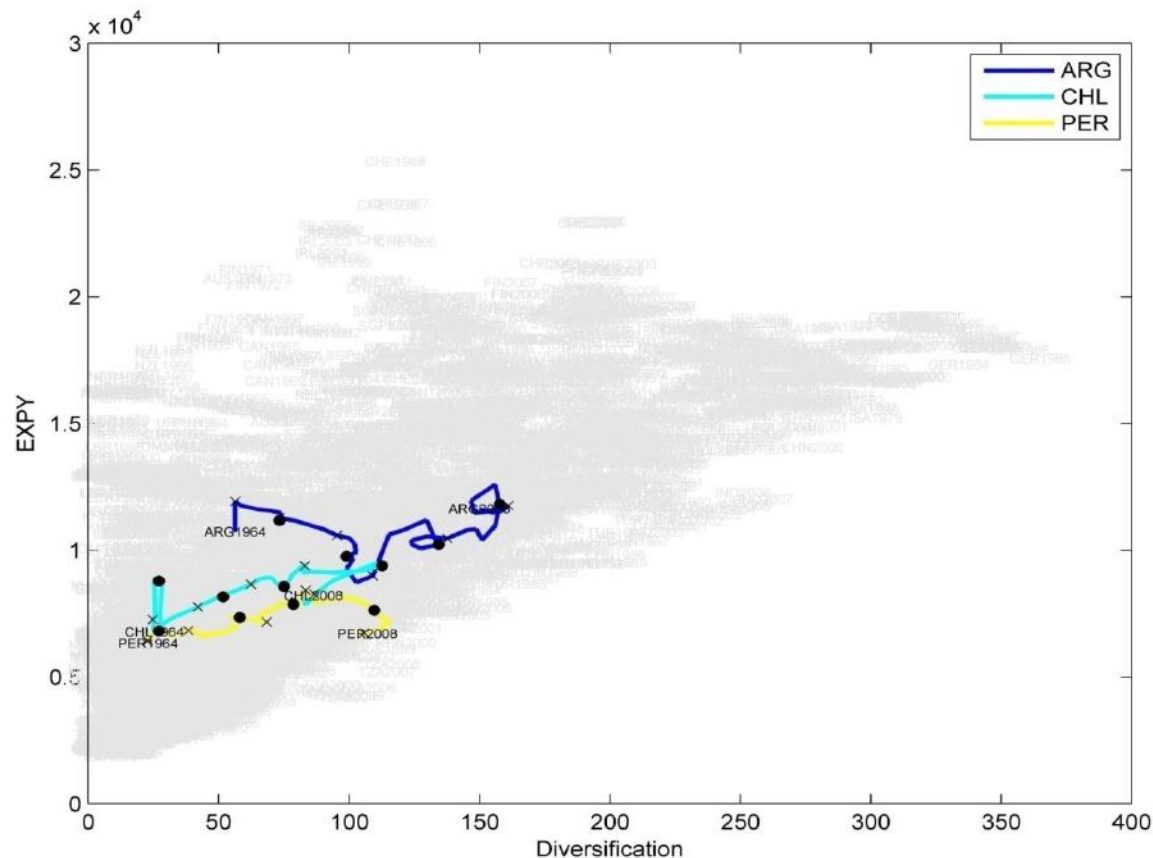
➤ Central America follows a roughly similar pattern, with CRI reaching a higher stage in product sophistication.



Source: Jankowska, A. Nagengast, A., Perea, J.R. "The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Diversification vs Upgrading : Latin America

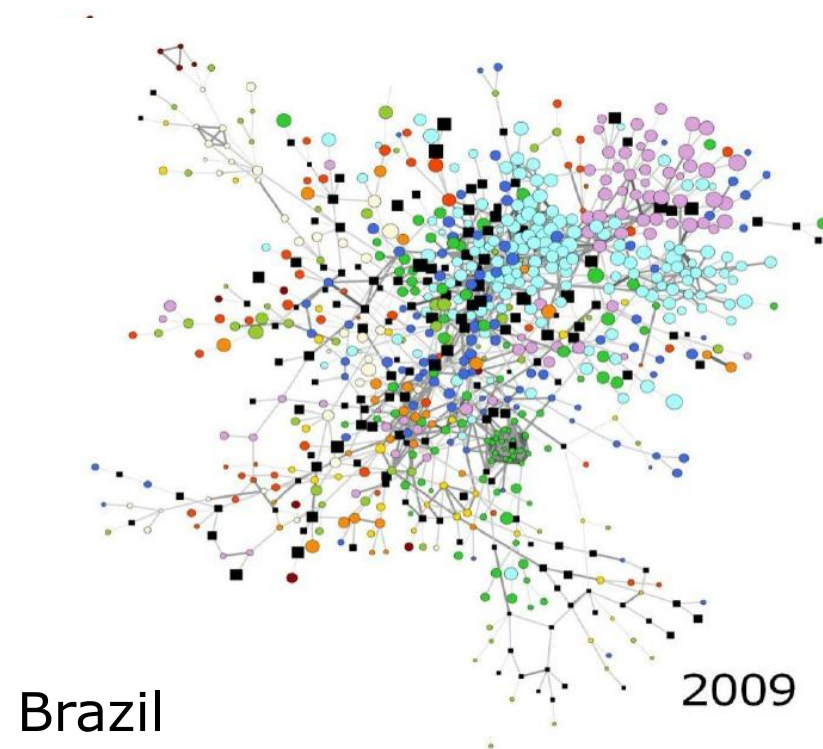
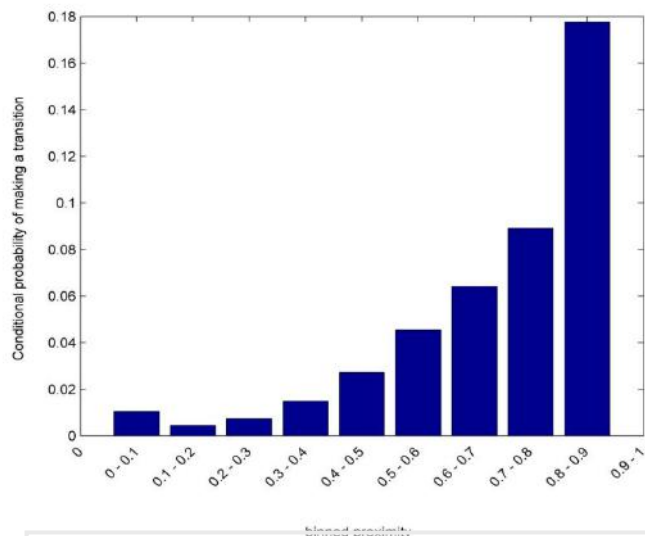
- The puzzling cases, no gains in Expy.
- ARG engages in the “wrong” kind of diversification, at times facing decreases in Expy.
- CHL, PER: Lower gains in diversification, disassociated from gains in EXPY.



Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Motivation: Proximity matters

- Where are the new products that countries transition into?
- Transitions into new products are more likely, the closer the products are to currently exported goods

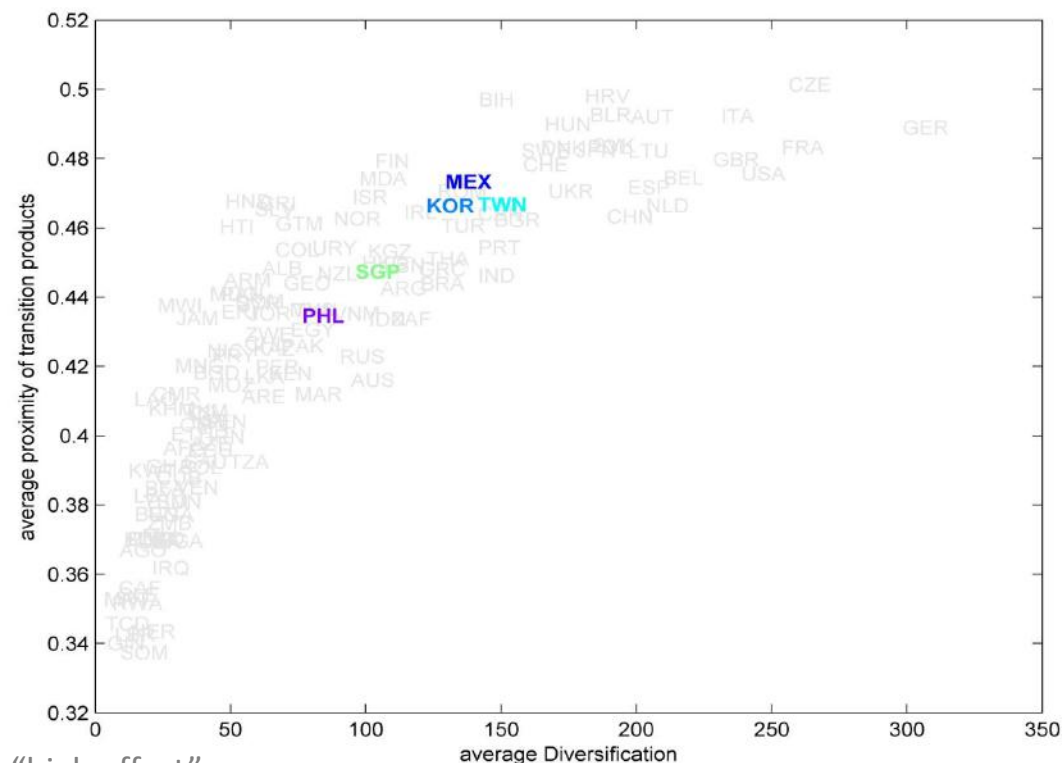


Source: Jankowska, A. Nagengast, A., Perea, J.R. "The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Transition analysis – “Structural transformers”

- Countries that did not substantially diversify, but transformed their export structure towards high value exports tended to transition into relatively proximate / median products (no evidence for a particularly high effort)

“low effort”

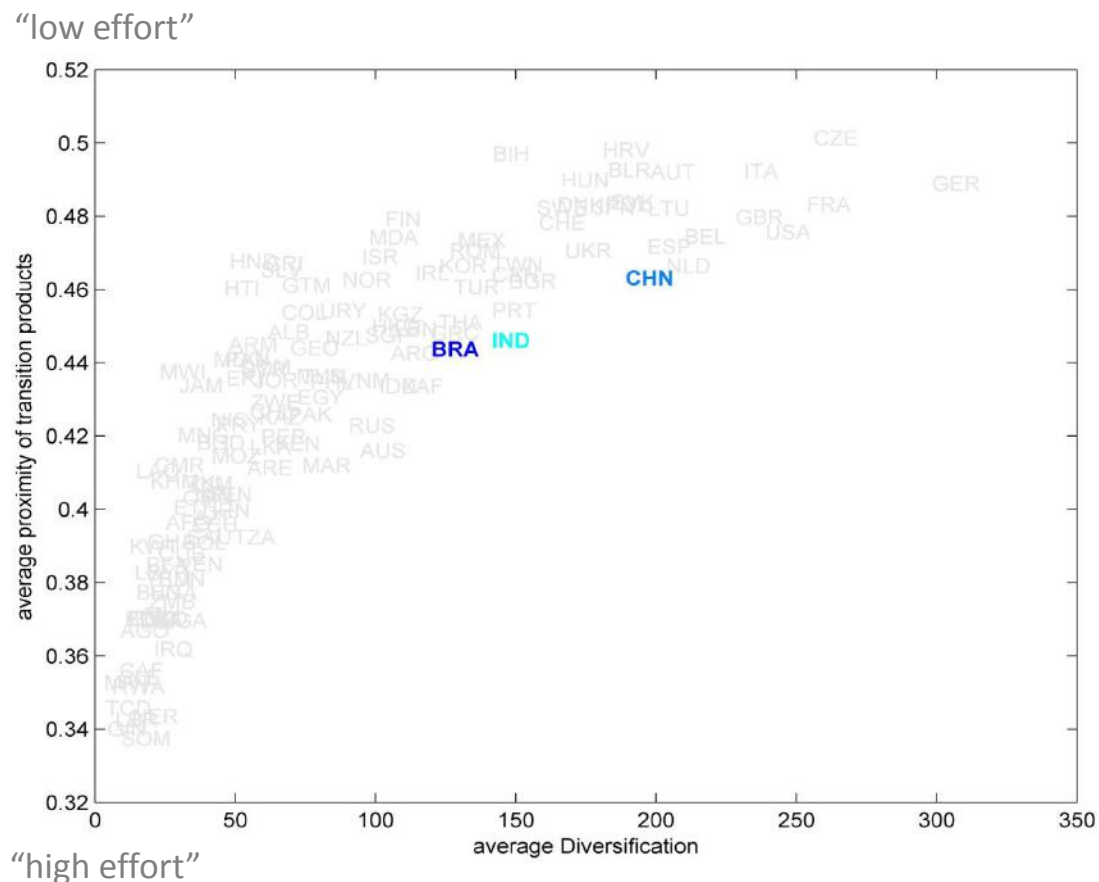


“high effort”

Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Transition analysis – “Diversifiers”

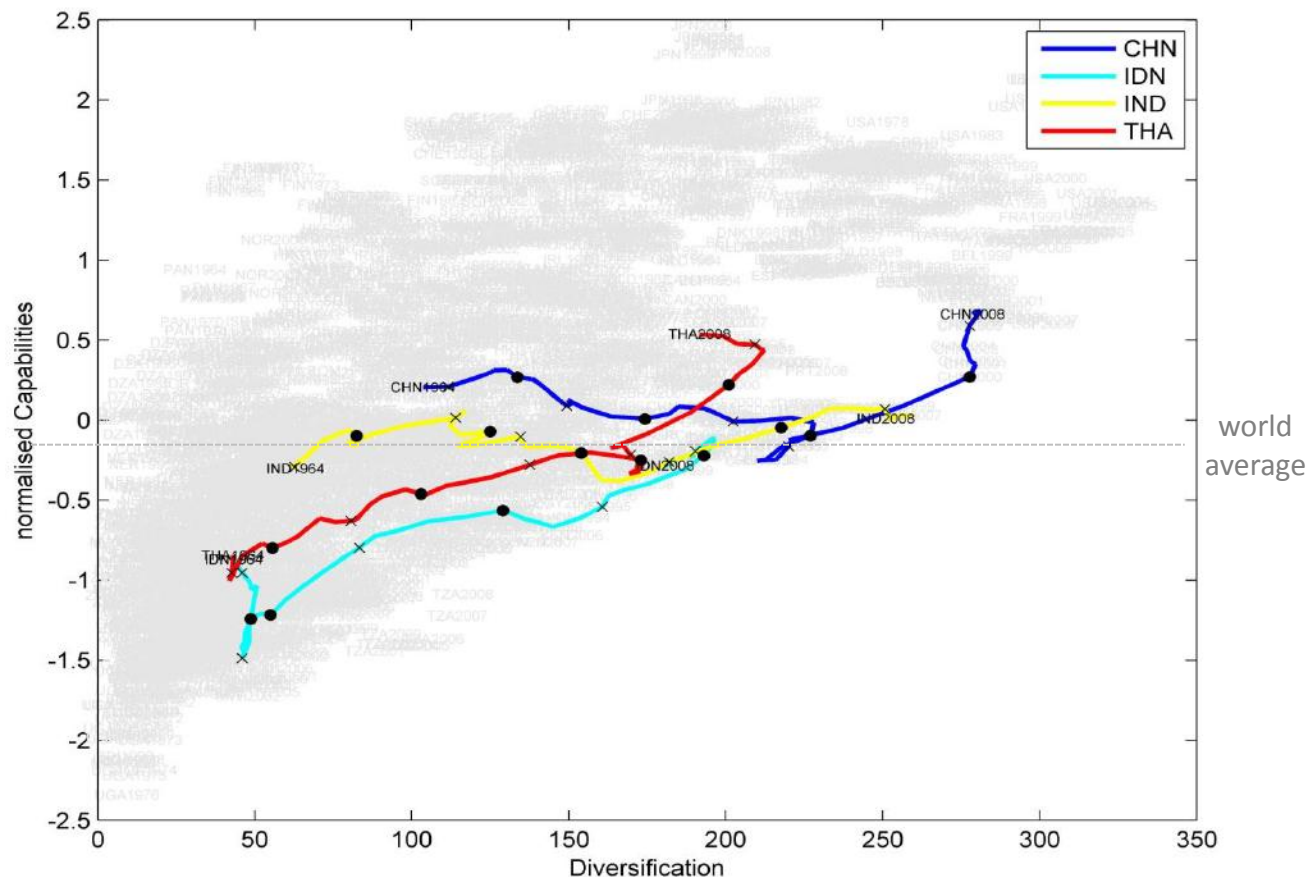
- Countries that substantially diversified their exports profiles tended to transition into relatively distant products (“high effort”)



Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

Capabilities – Asia

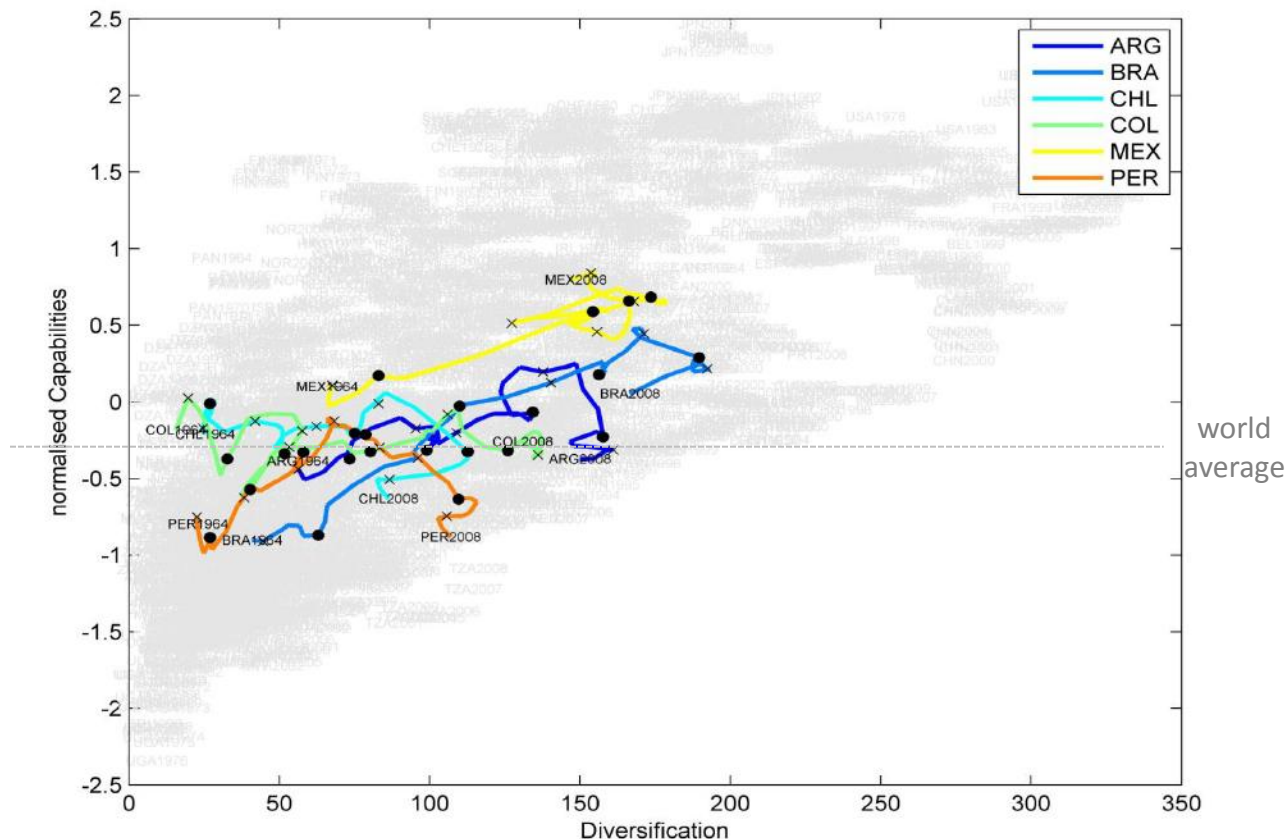
- China: Start already with a high value, substantial gains in relative capabilities only from 1990 onwards.
- General trend for other “diversifiers” – slow and gradual increase in relative capabilities with diversification.
- Only recently countries achieve capabilities that are close / above the world average.



Source: Jankowska, A. Nagengast, A., Perea, J.R. “The Product Space and the Middle Income trap: Comparing Asia and Latin American Experiences. OECD Development Centre Working Paper No. 311.

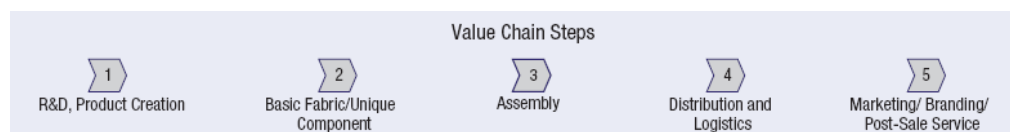
Capabilities – Latin America

- In general below average performance in Latin America.
- The exception being Mexico (high starting value) and slow increase across time) and the strongly diversifying Brazil (gradual increase in capability ranking over time).

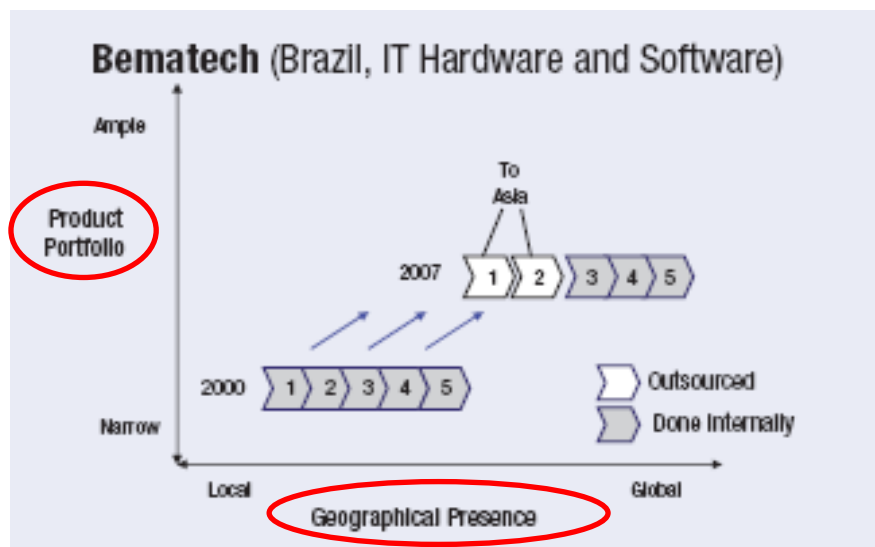


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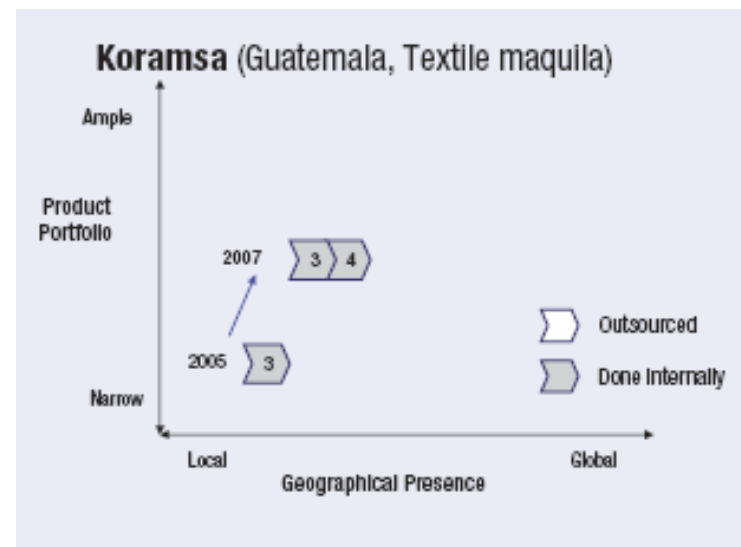
Adaptation strategies towards Chinese competition: Looking at the firm



High value-added niche to achieve global scale



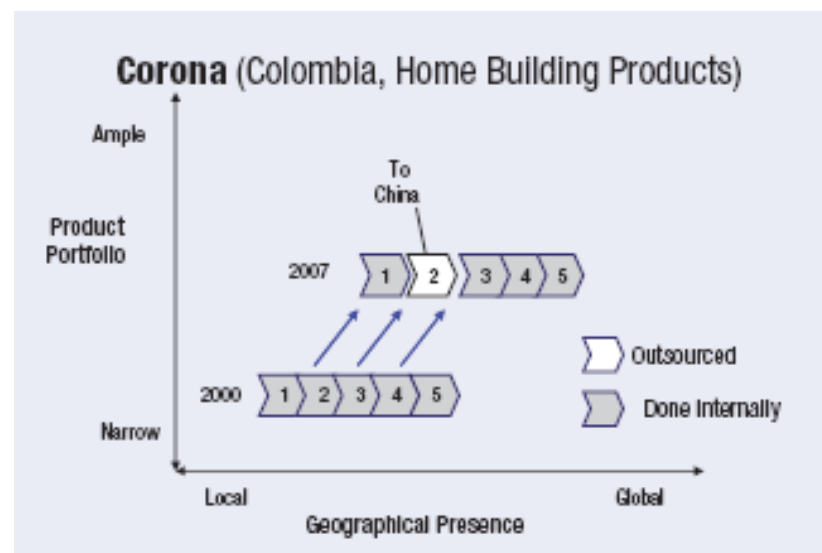
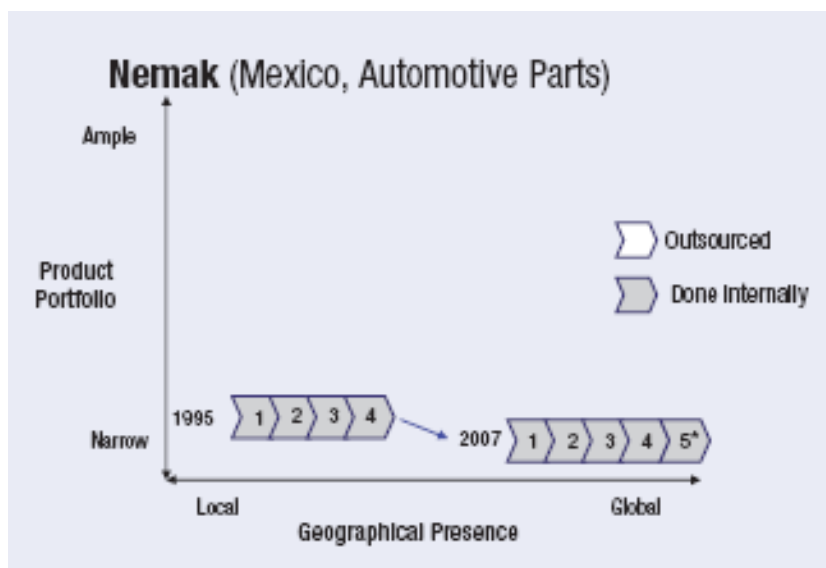
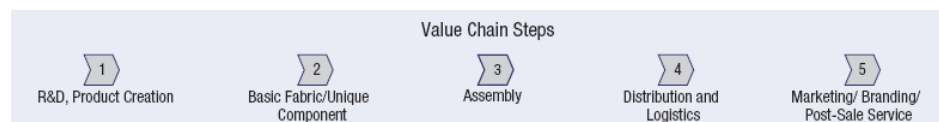
Products with high volatility and customization needs



Source: Alonso, A. Avendano, R. Estrada, J. “Adapting to the Rise of China: How Can Latin American Companies Succeed? ”. OECD/World Economic Forum Working Paper. 2009.

Latin American companies have started to adapt to new value chains

Upstream value chain integration



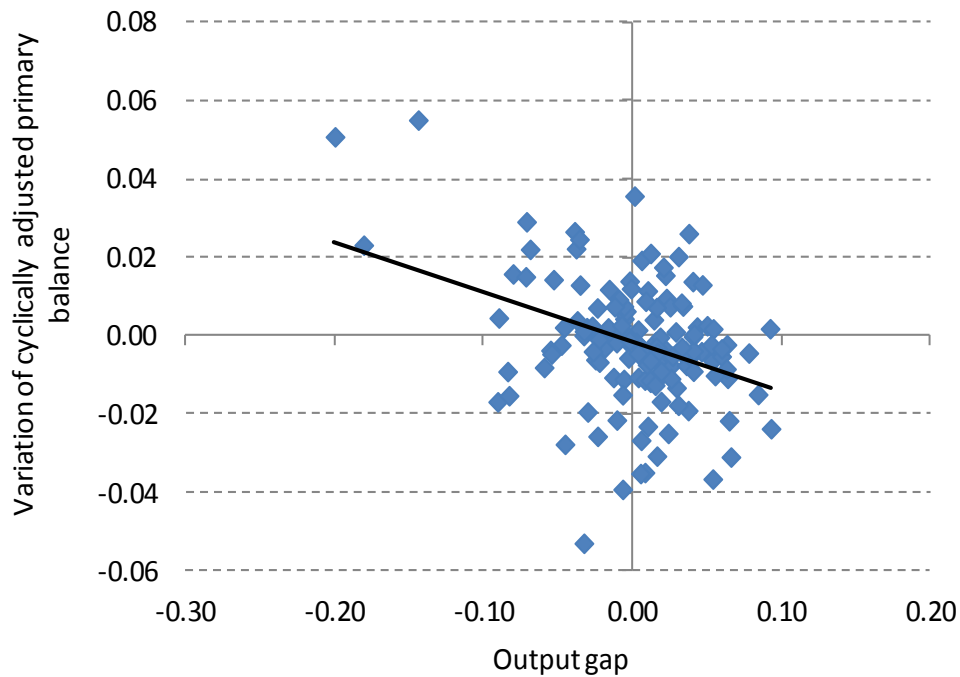
Source: Alonso, A. Avendano, R. Estrada, J. “Adapting to the Rise of China: How Can Latin American Companies Succeed? ”. OECD/World Economic Forum Working Paper. April 2008.

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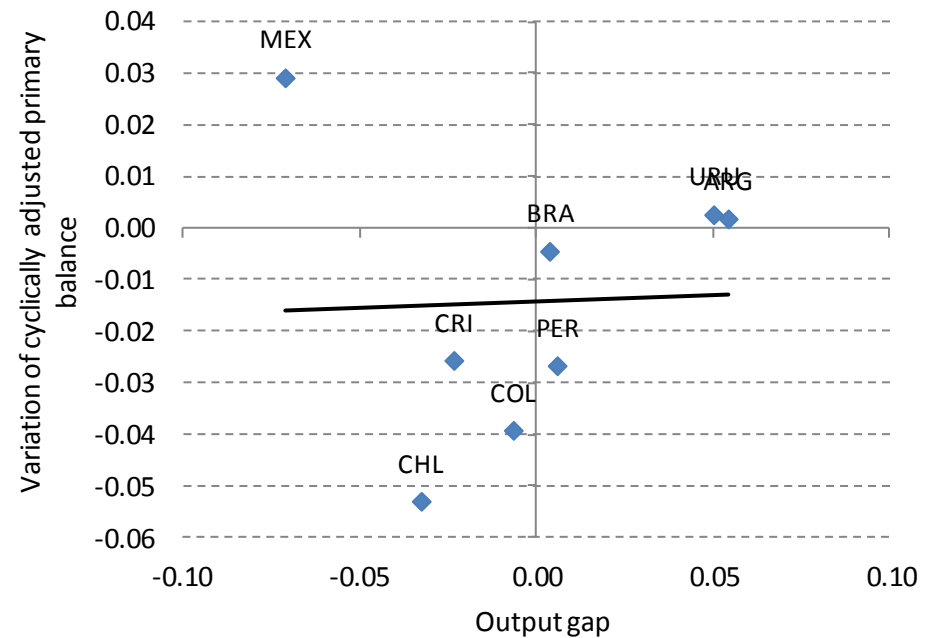
Next fiscal steps: reducing pro-cyclicality

Output gap and change in structural balance 1990 - 2009



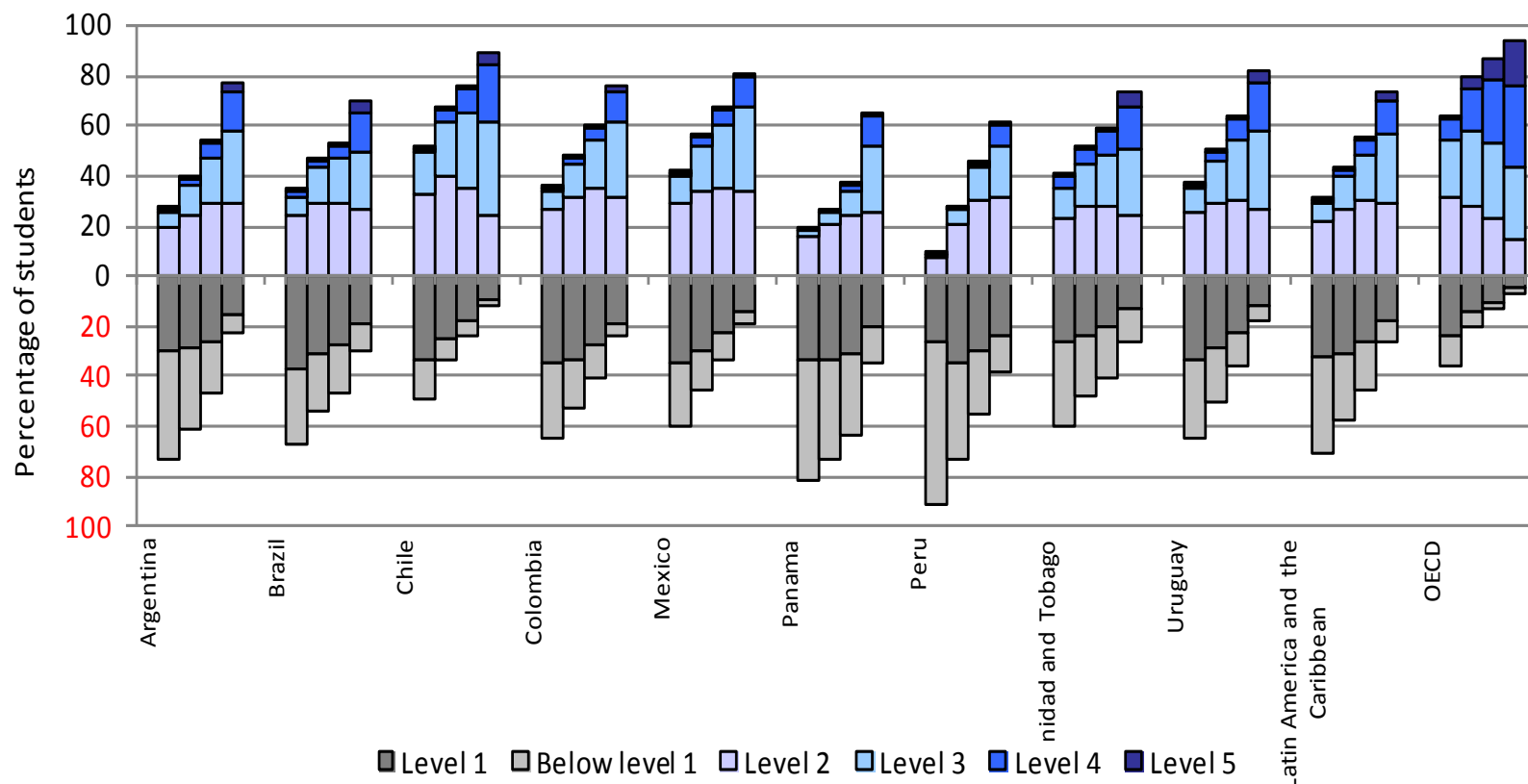
Source: Daude et al (2011).

Output gap and change in structural balance in 2009



Education: focus on quality and equity

Distribution of test score in PISA reading tests, according to socioeconomic and cultural household background quartiles, 2009

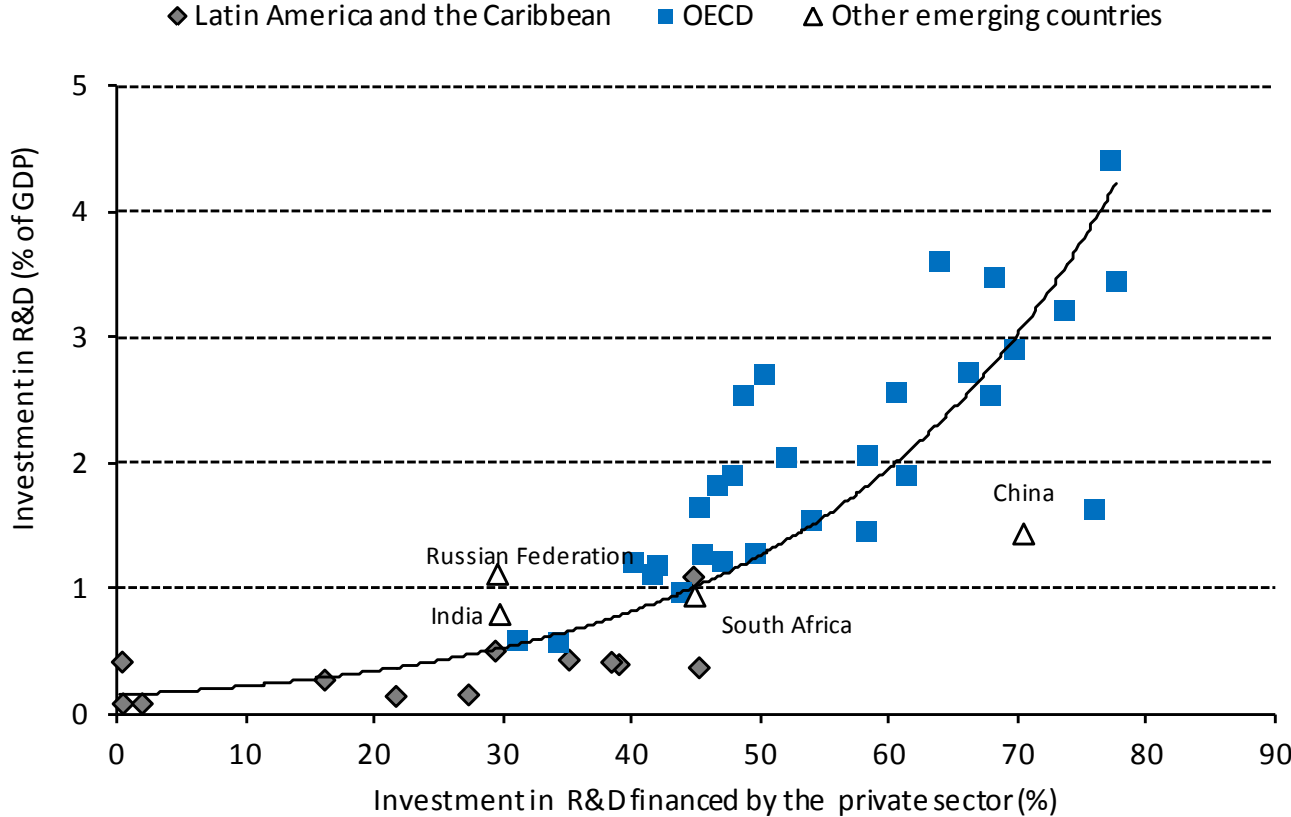


Source: Based on data from PISA 2009.

Note: The distribution by performance levels in Latin America and OECD refers to the simple mean of attainment level weighted at the national level for participating countries in PISA 2009.

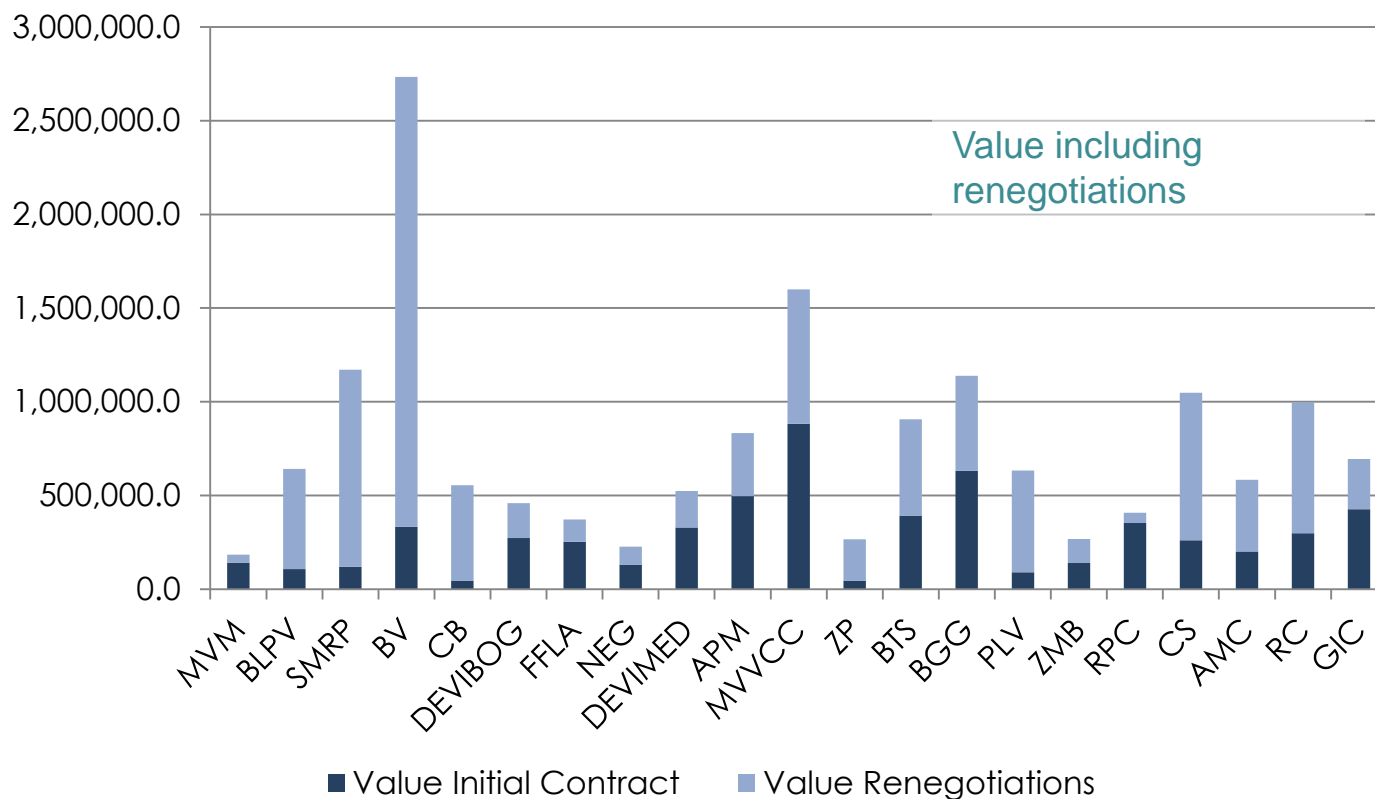
Innovation: Increase efforts to strengthen national innovation strategies

R&D Investment as percentage of GDP



Infrastructure: beyond resources, better regulation and coordination

Colombia: Cost increase from renegotiations



Source: Bitrán E., S. Nieto-Parra and J.S. Robledo (2011).

Note: Values in Millions of constant Pesos of Dic/09

Summing up

- *Shifting Wealth* is an established phenomenon with sustained effects, and Latin America needs to position in it.
- LATAM resilience: countries have built more buffers. Financial and trade openness have increased exposure to external shocks.
- Adaption strategies to Chinese competition are heterogeneous, depending on the sector and firms and country capabilities.
- Overcoming the “middle income trap” that Latin America is facing requires active public policies in innovation, education and infrastructure.
- Breaking away from the middle income trap has, almost always, encompassed an upgrading of the export base towards manufacturing.

The Future of Shifting Wealth: Policies

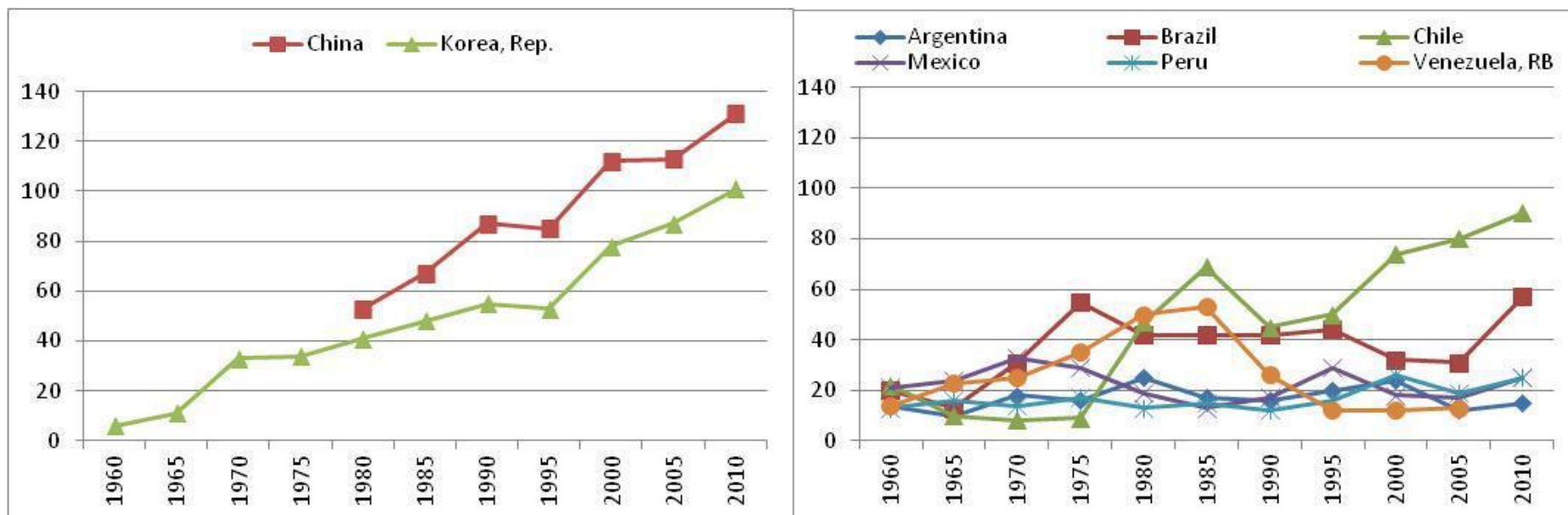
- Not all policies are right at all moments in time for all countries. The future of SW: which policies?
- Crucial: activate both within-sector productivity and cross-sector productivity rises.
- Competitive exchange rates, industrial & innovation policies, forced savings, flow restrictions and directed finance can be helpful for specific clusters of countries.
- OECD 'Going for Growth' policy prescriptions can be counterproductive for countries below certain income thresholds. How do we tell Big Brother?

Thank you!
www.oecd.org/dev

ANNEX

Access to Finance: A priority for firms

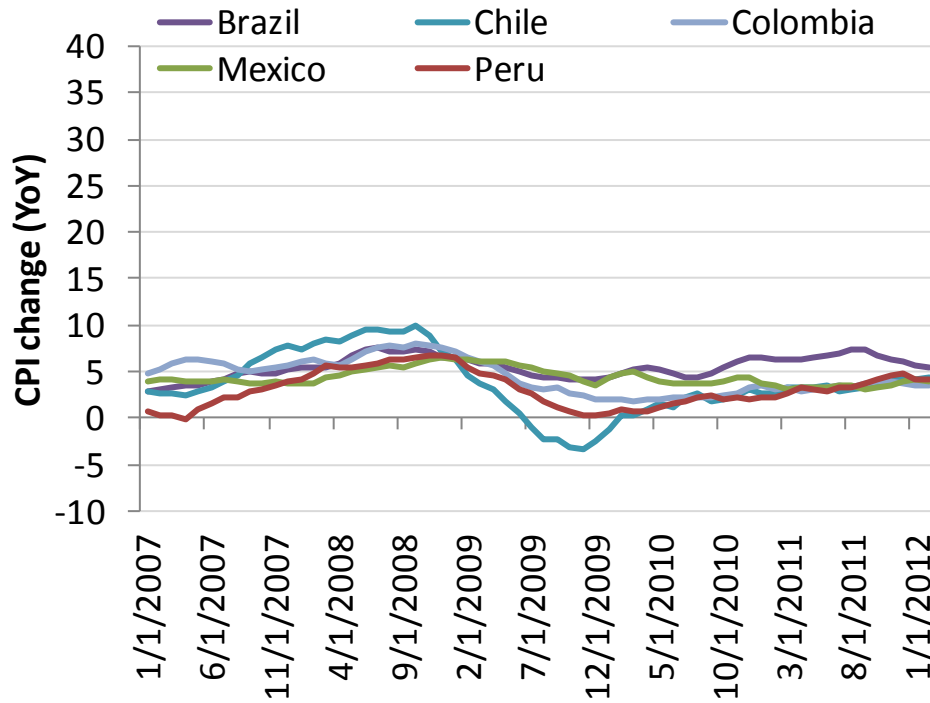
Domestic Credit to Private Sector (share of GDP)



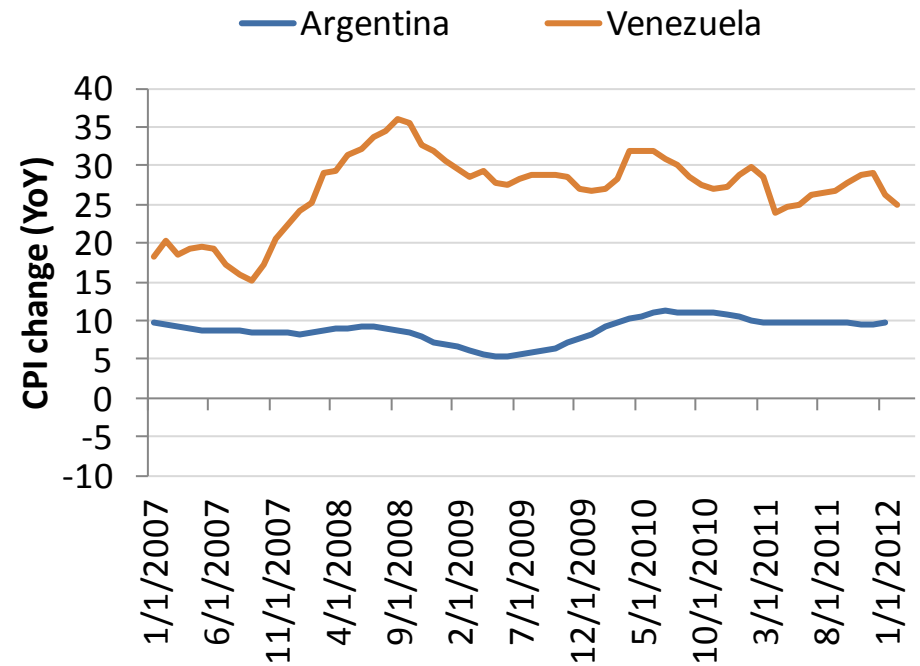
Source: World Bank WDI

Inflation remains low, stable and predictable in IT economies

Inflation - Targeting countries



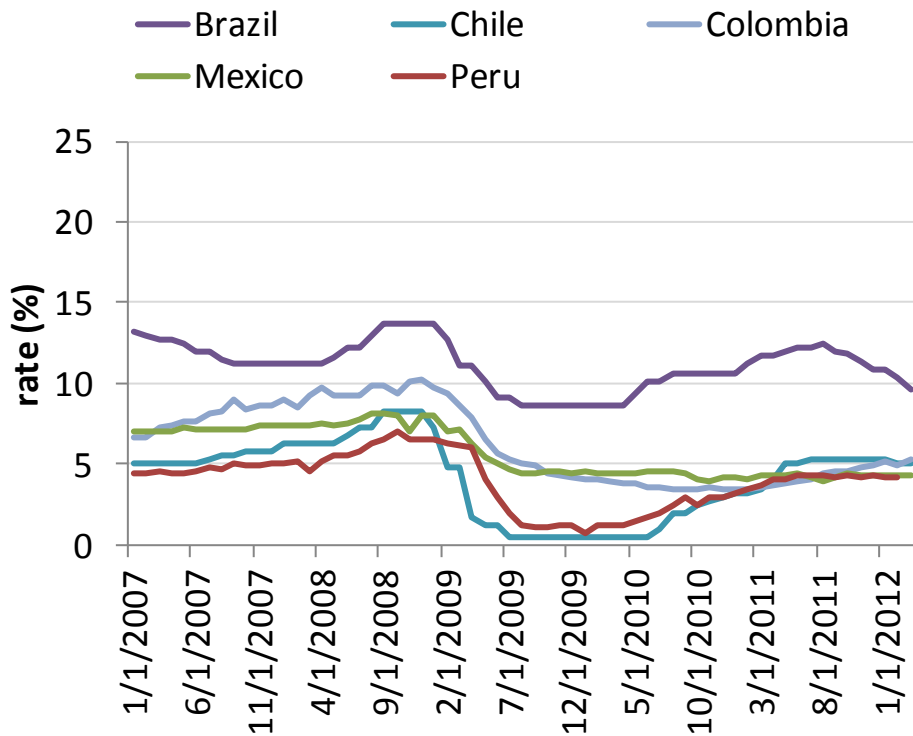
Inflation - Non targeting countries



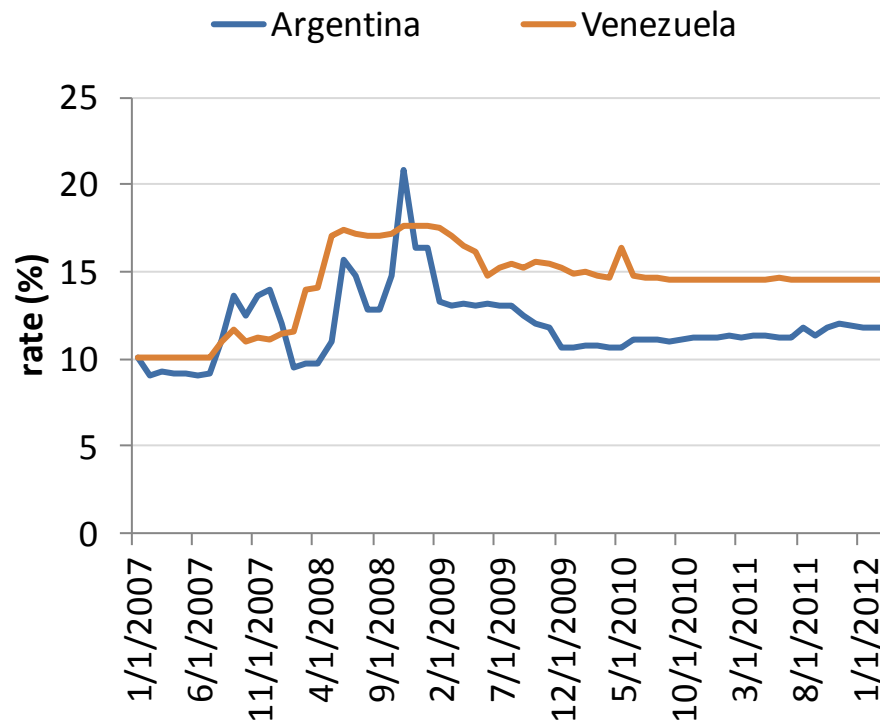
Source: Datastream.

In inflation targeting economies monetary policy was used counter-cyclically

Interest rates - Targeting countries

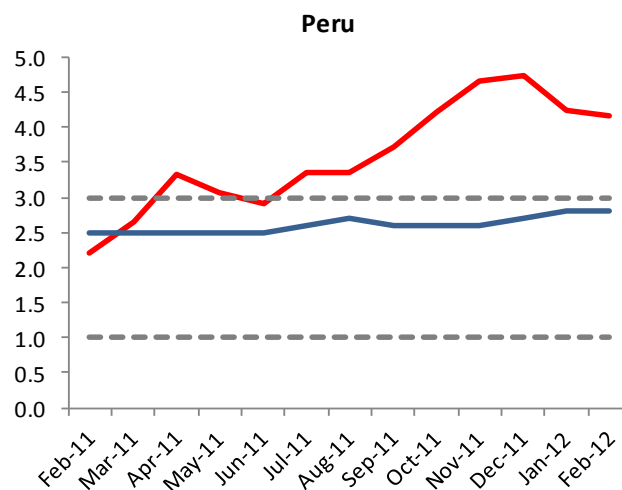
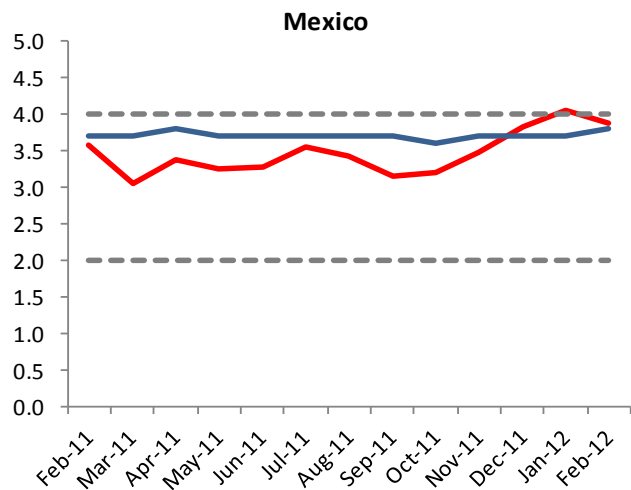
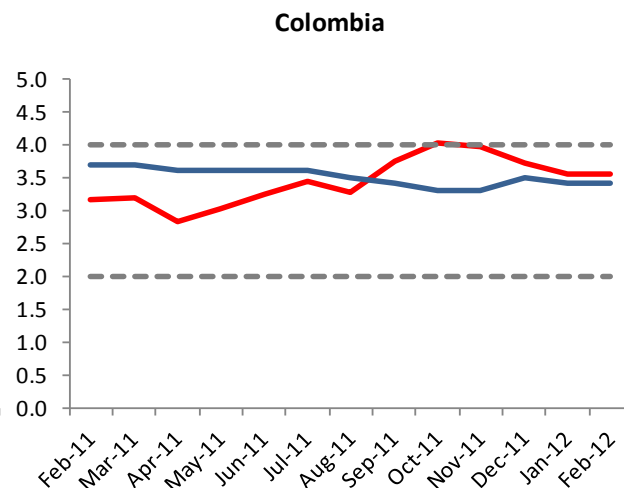
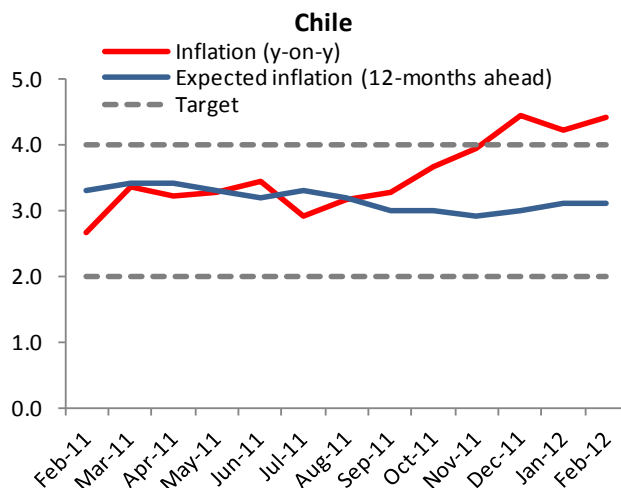
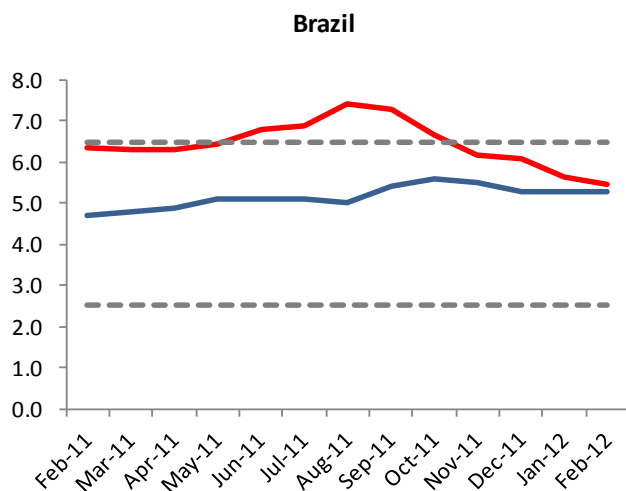


Interest rates - Non targeting countries



Source: Datastream.

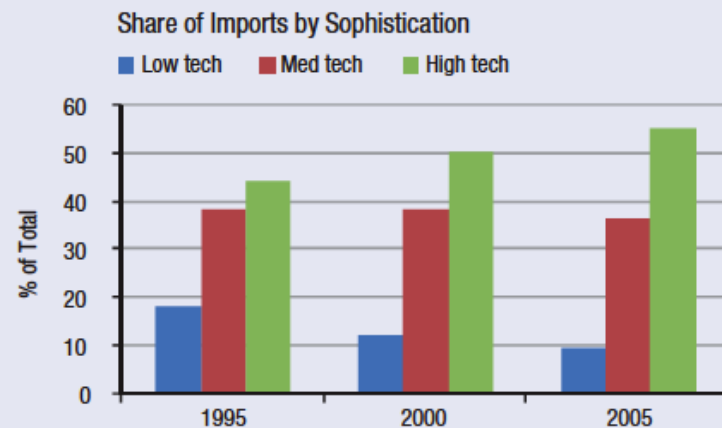
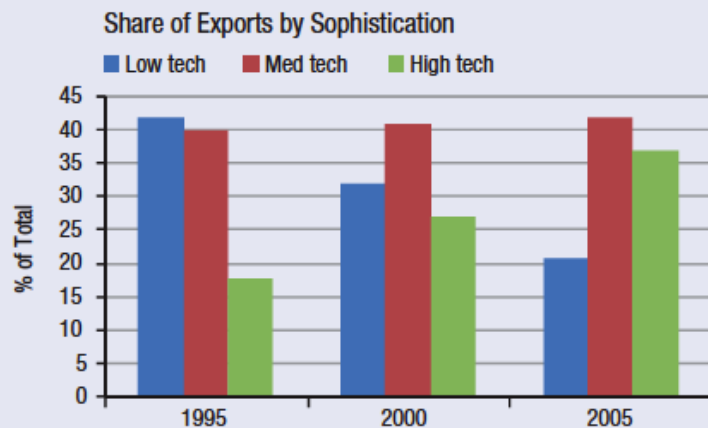
...without losing credibility



Source: Datastream.

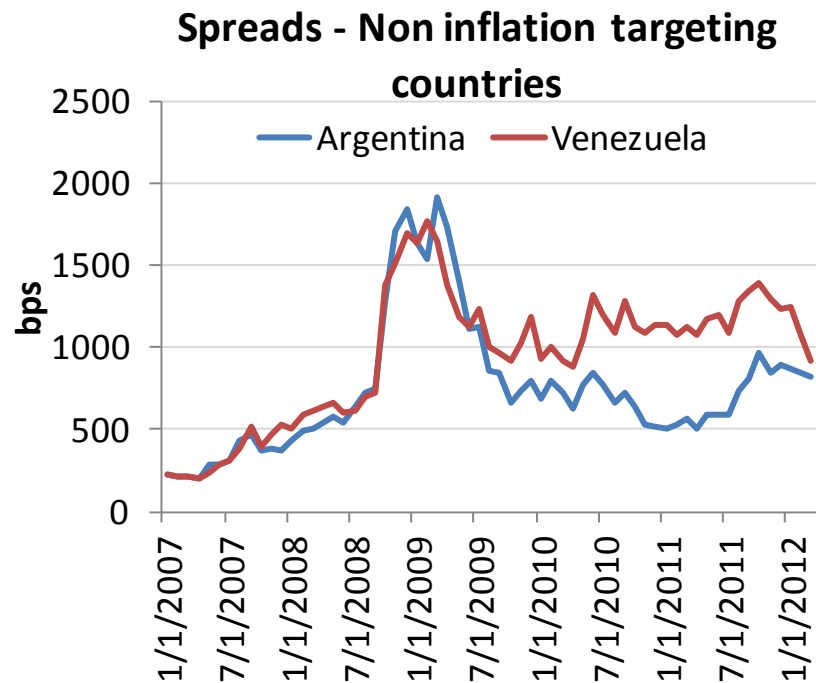
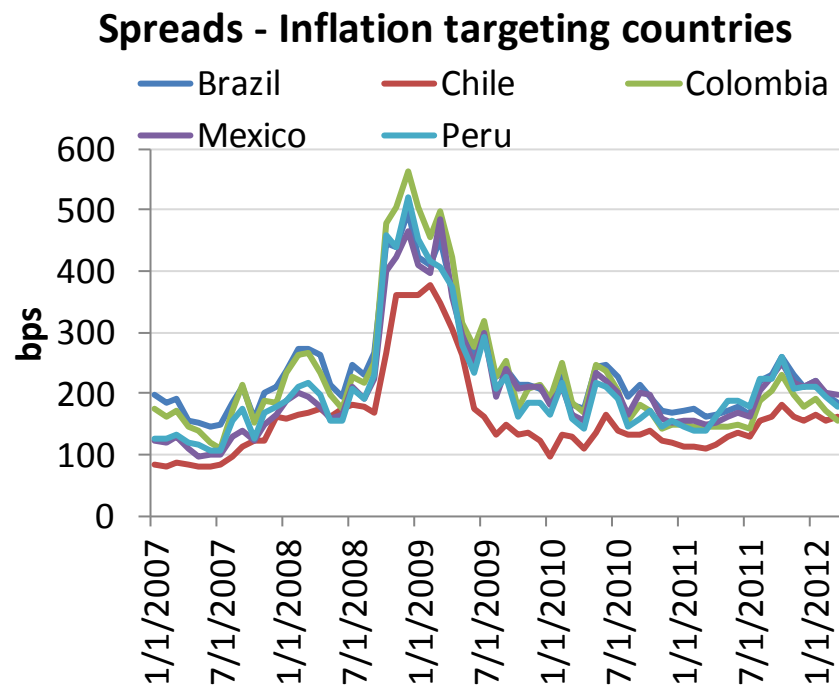
The Chinese economy today: Technological upgrade

Figure 2. The Chinese Economy and Technological Upgrading



Source: Alonso, A. Avendano, R. Estrada, J. "Adapting to the Rise of China: How Can Latin American Companies Succeed?". OECD/World Economic Forum Working Paper. 2009.

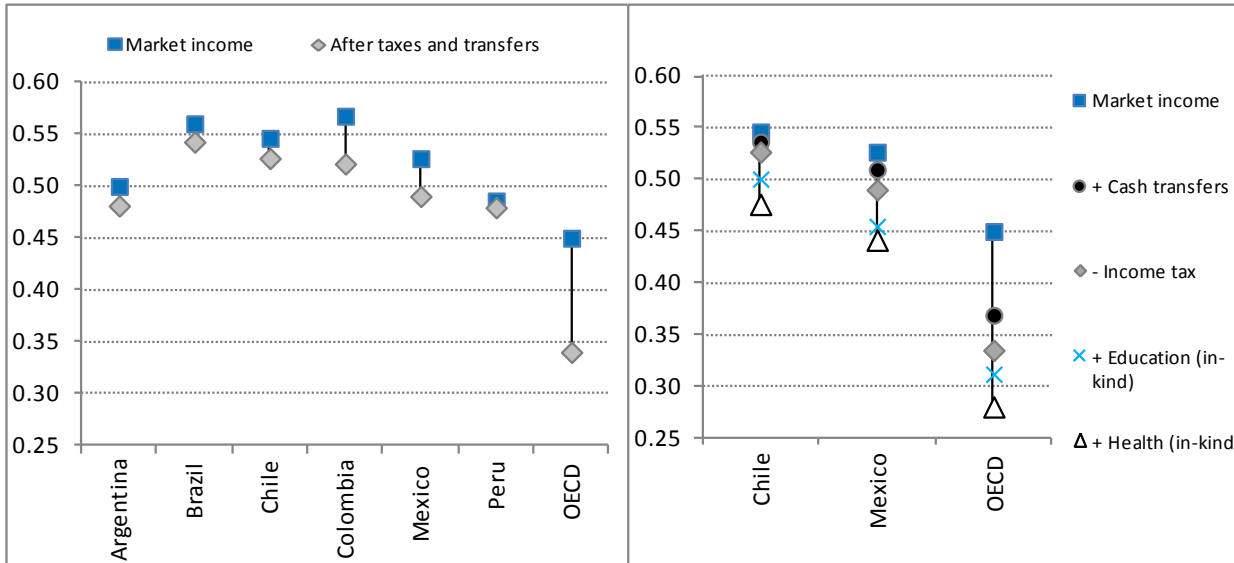
Medium term objective: Macro performance and risk perception



Source: Datastream.

Fiscal policy does little to reduce inequalities in Latin America

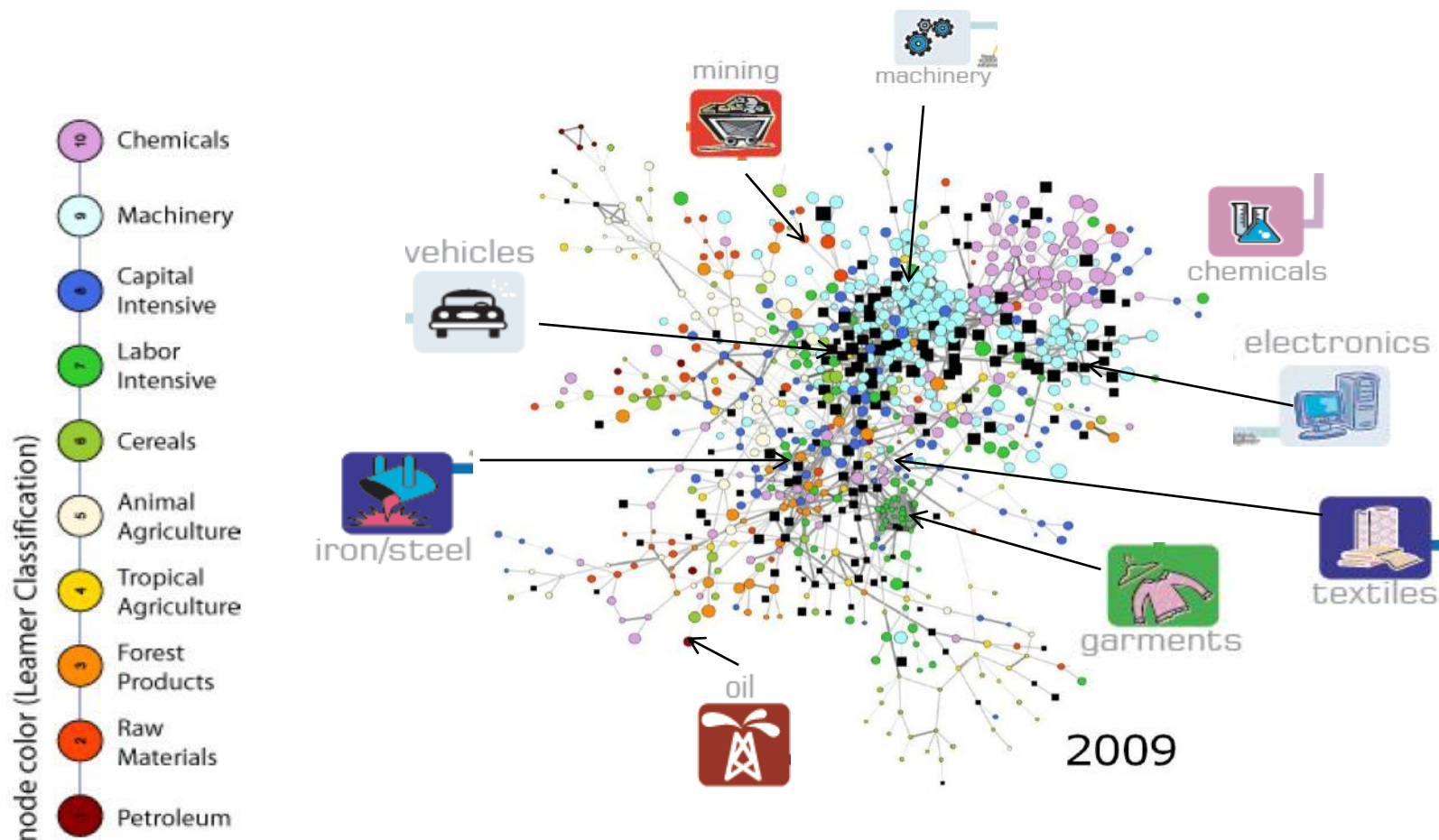
Income inequality and fiscal redistribution effects of different policy instruments
(GINI indices)



- Tax revenues are biased towards non-progressive taxes
- In particular, personal income tax is low in the region
- Low levels of social expenditures
- Targeting could also be improved

Source: OECD (2008a) for non-Latin American OECD countries, OECD (2008b) for Argentina, Brazil, Colombia and Peru, and estimations based on household surveys for Chile and Mexico.

The Product Space Map – Mexico - Hybrid



The Product Space Map- Brazil- diversifier

