Headwinds

Growth, Democracy, and the Middle Class in Latin America

Margaret Hayes

The decade of the 2000s was generally good for Latin America. Many countries grew robustly, driven by expanding trade relations and China's demand for commodities like agricultural products, minerals, and oil. The economic expansion led to a dramatic growth of the middle class in Mexico, Brazil, Columbia, Peru, and other countries. The 2008 economic crisis and the persisting slow recovery of the developed world, along with China's efforts to control its own growth rate, now weigh heavily on Latin America's return to robust growth. Exports, investments, and growth have slowed dramatically in several key countries. A wide range of recent reports concludes that the region is unlikely to return to the robust growth of the 2000s anytime soon.[1] The "tailwinds" of the past decade "are clearly receding" for Latin America.[2] The region must turn to domestic engines of growth and to growth-enhancing reforms that can drive each country's competitiveness.

Figure 1 depicts world and regional growth since 1999. Global growth has been led by countries of emerging and developing Asia: China, and more recently India, Vietnam, and other countries expanded at record levels, but have begun to slow and control their growth more recently.

Margaret Hayes is an Adjunct Professor at Georgetown University. She is also Vice President of Evidence Based Research, Inc. Dr. Hayes was formerly a founding Director of the Center for Hemispheric Defense Studies at National Defense University, and served as External Relations Advisor at the Inter-American Development Bank.

Advanced economies, the most economically mature, have posted the lowest growth rates. The Western hemisphere falls between these two, posting growth around 6 percent or more year-on-year during the latter half of the decade, and briefly following the crises of 2009 and 2010.

opment Bank, summarized the challenges to the region in a recent speech: "The direction of winds from the global economy impelling the regional economy have shifted, and we have to prepare to navigate with our own efforts and without the tailwinds that we have had in recent years."[3] The need to program

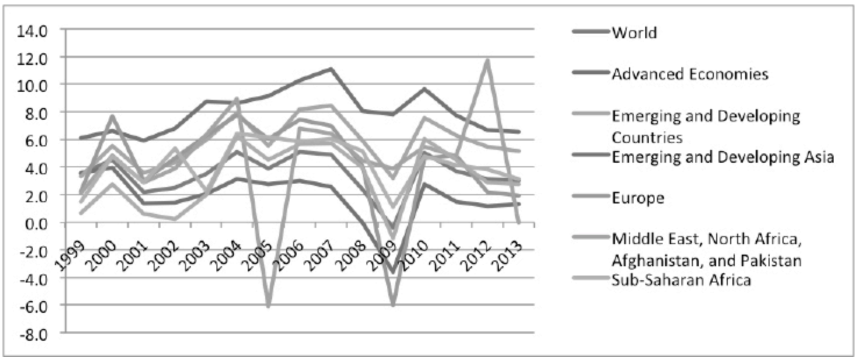

Figure 1 World GDP Growth, Year-on-Year

economic and social development with greater reliance on internal conditions underscores a fundamental role for economic integration of Latin America in present circumstances.

The challenges for Latin America, and particularly for its largest economies, are to diversify productive sectors, improve labor productivity, and enhance their competitiveness in the global marketplace. The region's middle classes were demanding these changes in their recent street protests calling for better education, better health services, better transportation and infrastructure, better business climates, and more efficient and responsive government. Many of these changes will take time to show results. Governments' responses to the new challenges will have profound influence on Latin America's evolving democracies and their future growth prospects.

Enrique Iglesias, the former Secretary General of the Economic Commission for Latin American and former President of the Inter-American Devel-

To address these challenges, Iglesias argues that Latin America should pursue selective regional cooperation, make serious efforts to increase the flexibility of existing integration agreements, and promote greater coordination. Doing so will require progressive cooperation in the areas of infrastructure, production sectors like the auto industry, and coordination of efforts in innovative research and development (R&D). The region also needs to take advantage of the more than 500 "multilatinas" (Latin American multinationals) that are already working and expanding their influence.[4] By creating new spaces for regional cooperation, Latin America will be able to unlock new frontiers of industrialization that no single country, no matter how big, could accomplish alone.

Latin America's Competitiveness. The World Economic Forum's (WEF) annual Global Competitiveness Index (GCI) provides insight into the region's challenges. The index is constructed from scoring competitiveness factors on twelve pillars allocated across three clusters: *Basic Requirements, Efficiency Enhancers, and Innovation and Sophistication Factors*.[5] *Basic Requirements* encompasses public and private institutional performance, including evaluations of property rights, ethics and corruption, government efficiency and security, infrastructure availability, the macroeconomic environment, and health and primary education. *Efficiency Enhancers* are comprised of the quantity and quality of secondary and higher education, market efficiency (including both domestic and foreign competition), trade restrictions, labor market efficiency, financial market development and technological readiness, and size of both domestic and export markets. Lastly, *Innovation and Sophistication Factors* assess the sophistication of businesses and innovative R&D.[6] The *Basic Requirements* sub-index components are critical for factor-driven economies that produce primary products, while *Efficiency*-driven economies rely on combinations of labor, capital, trade, and production. *Innovation*-driven economies combine knowledge, research, and technology to the above mix. Utilizing a wide variety of quantitative data and responses to the WEF's Executive Opinion Survey, these twelve pillars are aggregated and tallied on a seven-point scale, revealing the GCI. Table 1 summarizes the GCI performance scores of seven Latin American economies.

	Overall Competitiveness Index		Basic Requirements		Efficiency Enhancers		Innovation and Sophistication Factors	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Chile	33	4.6	30	5.25	29	4.68	49	3.88
Panama	48	4.43	53	4.82	55	4.29	46	3.95
Brazil	67	4.34	83	4.4	42	4.46	56	3.82
Mexico	61	4.27	69	4.59	60	4.2	59	3.73
Peru	65	4.24	74	4.52	62	4.19	99	3.34
Argentina	104	3.79	104	4.08	93	3.75	96	3.37
Venezuela	131	3.32	131	3.36	124	3.35	135	2.71

Table 1 Latin American Global Competitiveness Rankings

Switzerland possesses the top score of 5.7. Chile is the highest-ranked Latin American economy at 33. China precedes Chile at rank 28 and a score of 4.89. Panama is the second highest-ranking Latin American country in the list, and Venezuela, which recently earned the label of "probably the world's worst-managed economy," falls at the bottom of the rankings with only Haiti below it.[7] Most of these Latin American countries are transitioning to *Innovation*-driven economies. Peru and Colombia rank as *Efficiency*-driven but not yet in transition, while Venezuela falls between *Factor* and *Efficiency*-driven.

A closer examination of the three sub-indexes shows that Latin American competitiveness is seriously impacted by shortfalls in *Basic Requirements*. Several countries rank noticeably lower in these requirements than their overall ranking would suggest, while doing much better with respect to *Efficiency Enhancers*. Panama, Brazil, and Mexico rank reasonably well in terms of *Innovation and Sophistication Factors*, even though poor scores on institutional performance and infrastructure adequacy pull the countries down. Chile, Colombia, and Peru all score over 5.0 regarding their macroeconomic environments, and all of the listed countries score over 5.0 in their provision of heath and primary education. Only Mexico and Chile receive scores over 4.0 on infrastructure adequacy. Institutional performance scores range from 2.1 in Venezuela to 4.8 in Chile, with all other nations remaining at 3.5 and below. With respect to *Efficiency Enhancers*, most countries do well on assessments of higher education and training quality, and several receive a strong score boost from their overall market size. Nevertheless, quite low scores on goods and labor market efficiencies, and on technology readiness, offset the more positive ratings. Brazil, Chile, Colombia, Mexico, and Panama score above the scale's median regarding innovation and business sophistication, but these rankings are driven by their business sophistication, while their innovation scores are much lower. More generally, corruption remains a concern in most of these economies, except for Chile. Government inefficiency is also a widely expressed concern that negatively affects the ease of doing business and the viability of business sophistication and growth. In short, Latin America is very inconsistent in its competitiveness indicators, and this impedes the development of reinforcing synergies.

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The Importance of Education.

Education is an important component of the GCI. While education is generally available in Latin American countries, the overall quality, particularly at the primary and secondary level, is a subject of much discussion. This is demonstrated by Latin America's performance well below the Organization for Economic Cooperation and Development (OECD) average on the global Program for International Student Assessment (PISA) exam (see Table 2).[8] The OECD argues that "improvements in education have the potential to boost growth more than virtually all other types of structural reform."

A Brazilian study reflected the region's concern with its quality of education: "Brazil's several high-quality, free public universities must teach students arriving from the *notoriously weak system of public education.*"[9] In 2011, the country spent on college students almost five times what it spent on students in basic education. One result of this distortion is that while some 85 percent of Brazilians from ages fifteen to seventeen are enrolled in school, only half of them are at the appropriate grade level.[10] The minority of high performing students who raise overall national performance scores often attend private schools. Across the spectrum, however, the majority of students perform at the lowest levels. Only 1.6 percent of students who took the PISA exam in Chile, the region's best performer, fell into the OECD average share of top performers in math. Other Latin American countries were well below 1 percent. As a result, businesses in the region often have difficulties finding workers with the necessary skills to meet job requirements.

Criticisms of the education systems in the region are that they are "outdated," "too academic," and do not prepare students to compete in the global marketplace.[11] Curriculum changes are needed to incorporate technology and emphasize greater analytical skills. As one Brazilian commented: "We need to be bolder. We cannot have a school of the 19th century, with teachers of the 20th century, if we are to interest students of the 21st century."[12] Since most students will end education at the secondary school level, education should require greater access to technology and greater attention to practical skills at earlier ages. Mexico, with one of the most dynamic industrial sectors in the region, has just begun to introduce technology schools into its education system. This kind of skills training is also needed to draw workers into the formal market and out of the low-wage

	Mean Math Score	Share of Top Performers in Math	Mean Reading Score	Mean Science Score
OECD Avg	494	12.6	496	501
Chile	427	1.6	441	445
Mexico	421	0.6	424	415
Brazil	391	0.8	410	405
Argentina	388	0.3	396	406
Colombia	376	0.3	403	399

Table 2 Latin American performance on the OECD PISA Exam 2012

informal market.[13] Brazil launched a National Program for Access to Technical Education and Employment (Pronatec) in 2011. For Pronatec to work, there needs to be much closer collaboration between the private sector and the education community so that the skills being taught meet market requirements.

Resource curse? Growing external demand and rising prices for basic goods like agriculture, minerals and ores, and petroleum drove the past decade of Latin America's economic expansion. Analysts now urge the region to focus on "knowledge, technology and innovation" as a basis for development.[15] According to the U.S. Energy Information Administration, the Americas in 2013 accounted for one-third of proved world reserves of crude oil, one-tenth of proved natural gas reserves, and enormous amounts of recoverable reservoired resources like tight oil and shale gas.[16] Venezuela, Canada, the United States, and Brazil are the principal sources of these resources, but Argentina, Peru, Ecuador, Colombia, and Mexico are all producers and exporters of petroleum, and oil exports have been an important component of the recent energy expansion. Brazil, Chile, Colombia, and Peru are also major exporters of ores. Brazil's discovery of vast offshore pre-salt petroleum reserves has sparked national excitement, but bringing the reserves to market will be slow, given the challenging market environment, the requirement for advanced petroleum recovery technologies, and a still uncertain regulatory environment that has discouraged some of the most experienced offshore operators from bidding on the reserves' first auction.[17]

While the boom in oil, copper, and

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Teacher qualifications and training must also be better. Mexican President Enrique Peña Nieto bravely took on the entrenched national teachers union as one of his first actions in office. The unions predictably responded by violently protesting and shutting schools down. The teachers unions are a challenge to education reform in other countries as well, resisting any kind of change and any external evaluation of their performance. In many cases, teachers in primary and secondary schools are not licensed, especially in the final years of middle and high school.[14] If "improvements in education have the potential to boost growth more than virtually all other types of structural reform," they are going to have to change, and countries must insist on education that provides greater access to technology, an emphasis on analytical abilities, and improved teaching requirements. The region must begin to compete with countries at the top of the PISA scale.

iron-ore exports have captured news headlines in recent years, Latin America possesses a fairly diverse production environment. An examination of the percentage share of total exports for the top ten exports of the region's large economies shows considerable potential for diversification expansion. While several economies are obviously dependent on raw material exports—Chile, Colombia, and especially Venezuela—oil producers like Argentina, Brazil, and Mexico enjoy considerable diversity in their exports. Agriculture remains an important export for most countries, including Argentina, Brazil, and Ecuador. Manufacturing exports, including automobiles, automobile parts, sophisticated aircraft, and other products are important in Mexico, Argentina, and Brazil.[18] Only Venezuela is overwhelmingly dependent on oil for 88 percent of its exports, and that country unfortunately has allowed its non-oil sectors to languish in the past two decades. Most other countries are consciously seeking to diversify exports, but they still lack the regional coordination of efforts that Enrique Iglesias suggests is needed to fully exploit synergies.

What is to be done? Analysts agree that Latin American countries must undertake major efforts to improve productivity and increase economic competitiveness. This requires investments in education and worker training, expanding the use of information and communication technologies, and promoting and rewarding innovation. It also requires addressing serious infrastructure bottlenecks: road networks, lack of rail communication, ports that are inefficient and inadequate for the volume of goods that already should pass through them, insufficient power supplies in critical urban and industrial areas, and others. Reducing bureaucracy and corruption in decision-making apparatuses is also important to facilitate business expansion and to reduce the "corruption taxes" that affect far too many countries. Finally, countries must make the hard political decision to level taxes on incomes and profits that can generate the revenues needed to address infrastructure shortfalls. Together, these reforms should help countries move into the *Efficiency*-driven phase of competitiveness and acquire more diversified participation in the global value chain.

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The OECD, World Bank, and Economic Commission for Latin America have all listed structural and policy changes that need to be implemented. In a new report, the Inter-American Development Bank also argues that these changes will require important adjustments in the public sector policy-making bureaucracy.[19] Governments will have to be more flexible in addressing problems, implementing policy changes, and operating more as "learning organizations" by learning empirically about best practices to address their shortcomings. They will have to work more closely with the private sector while avoiding "capture" by specific sectors and firms. Finally, government agencies must learn to coordinate more effectively with each other to implement solutions in the best possible manner.[20]

Enrique Iglesias also argues that Latin America must make better use of its existing trade agreements, and address trade barriers, like high tariffs, that could enhance the Latin American share in the global value chain. Moreover, Latin America must pursue new agreements with new partners. Chile, Peru, Colombia, and Mexico are actively pursuing the Trans-Pacific Partnership. Greater Latin American integration would very likely draw Brazil and Argentina into that Partnership, furthering regional gains from trade. Brazil is considering negotiating directly and alone with the European Union, despite reluctance on the part of MERCOSUR partners. MERCOSUR and other regional agreements should be streamlined and made more efficient and less bureaucratic.

Implications for Democracy. Public opinion research reports strong support for democracy in most Latin American countries. Even while expressing concerns about different aspects of democratic performance, citizens support the idea that "democracy is the best system"—what the Latinobarometro poll calls the "Churchillian" concept. Nevertheless, protests over the availability and quality of government services have been increasing. The protestors tend to be young, single, and well educated—the youth of the emerging middle class. From 2011 to 2012, Chilean students marched in the streets protesting against the high cost of secondary and higher education, which are largely private, and demanding more state support for middle schools and colleges. In 2013, demonstrators in Brazil protested against government corruption, low-quality education and insecurity, as well as the large sums of money being spent in preparation for the FIFA World Cup despite the nation's poor healthcare services. Protestors demanded, "We want FIFA-quality healthcare!" In early 2014, Venezuelans protested against the high levels of violence, increasing inflation, and the absence of the most basic goods in stores. Some Venezuelan demonstrators demanded the resignation of President Nicolas Maduro. All too often, protests were met by heavy-handed police responses.[21]

Regional frustrations with government and democracy tend to be focused on the quality and delivery of public goods. Citizens are most supportive of their governments when the economy is growing, insecurity is contained, and corruption is controlled. Support for political parties is low, at 36.8 percent, while support for the Catholic Church and the armed forces is high at 63.1 percent and 62.2 percent, respectively.[22] Survey respondents expressed low levels of confidence in political leaders and political parties, when questioned "Do political parties listen to people like me?" or "Are political leaders interested in what people like me think?" In Mexico, Argentina, Chile, Colombia, and Brazil, fewer than 40 percent of respondents answer affirmatively to these questions.[23]

Conclusion. Latin American governments' abilities to face the challenging "economic headwinds" of the coming years and introduce policies that can contribute to enhanced productivity, increased competitiveness, and greater insertion into the global value chain are particularly important for building the foundations for stable regimes. In addition, the ability to deliver better education and healthcare, while growing the middle class and expanding opportunities for more challenging jobs, is necessary to address the rising expectations of people in the region and build their confidence in governments that serve the public's interest. Ultimately, Latin American governments will need their citizens to share in the reshaping of the region's economic and political development if they are to be successful.

NOTES

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