



## **Challenges in the Post-Crisis**

by

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Good morning. I would like to express my thanks to the Miami Herald for the invitation to speak this morning at the opening of the 13th annual Americas Conference. And on behalf of the World Bank, I would like to say it is an honor to serve, for the first time, as a cosponsor of this gathering.

For the first time in six years Latin America and the Caribbean will see its economy shrink this year. That is also why 2009 could still be best remembered as the year when regional leaders decided they could not afford to let a crisis go to waste.

As you know, a few weeks from now Latin America will be entering a busy political season with seven presidential contests in 13 months. And while it is very likely that the worst economic recession in 80 years will play a critical role in voters' choices, I am confident that at the end of the day Latin Americans will again choose leaders committed to policies that will accelerate regional recovery.

Whether they are labeled old left, new left, liberal, neo-liberal or conservative, leaders in the region have been embracing pragmatic solutions that wed sound economic and fiscal policies with human and social concerns. This pragmatism is helping reduce the region's tremendous inequality between rich and poor -- and it will prove particularly important for the region post crisis.

From 2003 to 2008, 60 million people were lifted out of poverty in Latin America and the Caribbean. Few periods -- perhaps none -- have seen so much progress in so little time. Yet today, the World Bank projections so far indicate that the crisis will push 8 million Latin Americans back into poverty, that is back to living on less than \$4 a day.

What's more, while Latin America and the Caribbean made significant strides before the recession, the region's social indicators remain well below those of other middle-income countries. In fact, compared with East Asia and Eastern Europe, the region's infant mortality is higher, educational achievement much lower, basic infrastructure much less developed and income disparity far greater.

We believe that human concerns should go hand in hand with economic ones. That is why World Bank President Robert Zoellick has insisted since the beginning of the crisis that the international community needs to act in support of the developing world to ensure that the global financial disaster does not become a human and social crisis. Together with other multilateral institutions we stand ready to help these governments - newly elected or not. During the fiscal year that ended in June we at the World Bank and the IFC, the private sector arm of the World Bank Group, almost tripled our lending to the region. We have provided almost \$17 billion, and this year we expect to do the same.

The World Bank customizes our programs to meet the increasingly diverse needs of countries in the region. For middle-income countries, the Bank is offering an integrated package of services, including analysis and advice, new financial products, and technical assistance. For Caribbean countries, our assistance recognizes their unique development challenges arising from their small size and vulnerability to natural disasters.

### **Looking ahead - The Recovery & Emerging economic challenges**

The road to recovery in Latin America and the Caribbean will depend largely on when rich and emerging economies around the world *themselves* recover. As those economies improve, demand will increase and also commodity prices on which the region is very dependent. We estimate that half the growth from 2002 - 2008 was due to robust commodity prices. Recovery in the region will also hinge on the availability of financial support from multilateral institutions and on prudent and effective policy responses.

In comparison to other regions, the road to recovery may be shorter for Latin America. Thanks to improved financial regulation and supervision, the region has weathered the downturn without massive currency devaluations, bank collapses, debt defaults,

inflationary spikes or capital flights. The same cannot be said of Eastern Europe, for instance, where the downturn triggered a banking crisis, devaluation of local currency and rising inflation.

As comforting as that might be, average growth in Latin America and the Caribbean has definitely shifted down from more than 4 percent in 2008 to minus 2 to 2.5 percent in 2009, largely driven by the downturn in Mexico. We expect growth to recover in 2010 to around 3 percent.

These averages mask important differences in growth among countries. Countries such as Peru, Uruguay and Panama are expected to avoid a downturn and experience positive, although weaker, growth. Mexico, on the other hand, could contract as much as 6 percent this year. Meanwhile, Chile is suffering more than one would expect from a country with sound economic policies.

Regardless of these disparities in growth, there do seem to be some emerging challenges to all countries post-crisis. These include permanent loss of human capital, middle class unemployment, lack of funds for stimulus packages and scarcity of foreign financing.

- In terms of human capital, past crises in Latin America have caused increased malnutrition, larger high school drop out rates, and reduced availability of preventive and primary health care. Today more mechanisms, from school feeding programs to decentralized health budgets, are available to soften the blow. And the costs involved are relatively small (possibly less than a tenth of one percent of GDP).

- Unemployment is expected to grow as global demand for exports continues to falter. The United Nations Economic Commission for Latin America and the Caribbean estimates that the volume of exports from the region will decrease 11 percent in 2009, the worst drop in 72 years, and will grow only 1 percent in 2010. This shortfall will disproportionately impact middle class workers. Unfortunately few countries in the region have sufficient unemployment insurance systems.

- On the fiscal side, only a few countries (Chile, Brazil, Colombia, Peru) have had the cash on hand to adopt counter-cyclical measures. The rest are hemmed in by low tax

rates and insufficient institutional capacity to quickly implement additional public investment.

■ The World Bank estimates that due to that lack of internal resources, Latin American governments will need to borrow between \$350 and \$400 billion in 2010. Even for investment grade borrowers this won't be simple. Already the supply of international financing is constrained by massive borrowing from developed nations seeking to pay for their own stimulus packages. Moreover, there are few lenders willing to finance enlarged deficit spending at a time of global crisis and many of the traditional intermediaries of Latin American debt (notably investment banks) are currently out of commission or out of business.

### **Policy responses - Don't let a crisis go to waste**

For all these problems the crisis offers an opportunity for the region to unleash its enormous potential.

Consider trade. Many countries in the region, large and small, are seeing their currencies appreciate uncomfortably. This puts a premium on trade competitiveness — even if only to preserve a slice of a smaller global trade market. Many of the long delayed reforms that make integration worthy, from infrastructure and logistics to tertiary education and property rights, will now become even more urgent.

This crisis should also prompt new thinking about universal subsidies. Latin America spends between five and 10 percent of GDP on such subsidies annually, with one-third captured by the wealthiest 20 percent of the population. While the region has a fairly advanced system of social assistance — 13 make direct cash transfers to the poor — such funds could triple if countries stop subsidizing everyone.

Worldwide the role of the State has grown in response to the crisis, in ways unthinkable years ago. The more optimistic economists at the Bank believe this historic recession also provides an opportunity for governments to demand more from citizens. With fewer resources available to the State but more expected of it — from regulating finance to facilitating job creation — the time seems right for taxpayers, particularly those who earn the most, to accept a slightly heavier tax burden.

According to the Organization of Economic Cooperation and Development less than 4 percent of state revenue in Latin America comes from personal income taxes, as compared to 27 percent in industrialized nations. To make up for the shortfall Latin American countries have adopted regressive, indirect taxes rather than progressive systems that tax more those who have more.

Still for taxpayers to be willing to pay more, governments will need to improve transparency and be held accountable. This is a matter not only of greater public access to government information, but also a matter of governments setting goals and benchmarks so that public spending can be evaluated on results. Citizens have the right to know what their money is being used for.

This year may be remembered as the year that abruptly derailed Latin American growth; or it may be remembered as the year when recession inspired smarter and more widespread development. Which way it goes depends greatly on how policymakers respond, and whether they see opportunity behind the crisis and proactively take on issues that were holding Latin Americans back well before subprime became a household term.

Thank you.