The domestic market: Engine of the economy?



Alicia Bárcena

Executive secretary of the Economic Commission for Latin America and the Caribbean (ECLAC)

Solange Monteiro, Rio de Janeiro

For the Mexican Alicia Bárcena, in 2010 Latin America is demonstrating that, in the last global financial crisis, it was part of the solution rather than the problem. "Our region has learned the lessons of the past," she says, with praise for Brazil. A biologist trained at the Universidad Autónoma de Mexico with a Master's in Public Administration from Harvard University, Bárcena highlights the fact that "Brazil has succeeded in showing that as the poor's income increases the engine of the economy could be the domestic market." Executive secretary of ECLAC since July 2008 and previously former chief of staff to Kofi Annan, former secretary general of the United Nations, Bárcena says that LAC governments now have the challenge of building a public policy that promotes regional productivity and social cohesion as well as increasing intraregional trade.

***The Brazilian Economy* — How does ECLAC evaluate the economic performance of Latin American and Caribbean countries in 2010?**

Alicia Bárcena — Our region has learned the lessons of the past: it has adopted authentically prudential macroeconomic policy: greatly reducing foreign debt, accumulating international reserves, and keeping inflation low. We estimate that our region will grow over 5% this year — we had originally estimated 4.2%, but the dynamism of our economies has proven to be greater. Brazil leads, with growth above 7%. Mexico, where GDP fell last year by 6.5%, this year is expected to register growth of 4.2%, partly because exports have grown. World trade has recovered, especially trade within the region, among the countries of Latin America and the Caribbean.

The forecast of slower growth in developed countries has made emerging market consumers more attractive to both exporters and foreign investors. How do you think

countries like Brazil can leverage this interest by ensuring sustainable growth?
We find ourselves in a world situation where appreciation of the currencies in emerging countries is growing, with the exception of China. This has caused a great imbalance at the global level. It is important that there be a rebalancing in which surplus countries enhance their domestic demand and deficit countries reduce domestic consumption. I think the countries in the region must seek an appropriate mix of industrial, monetary, and fiscal policies. I always highlight the example of Brazil because it was able to balance incentives to domestic and exporting markets. Brazil and seven other countries [Peru, Uruguay, Costa Rica, Paraguay, Venezuela, Panama, and Colombia] have improved income distribution, boosting domestic demand. Domestic demand is the engine that enables some countries to go further than others.

Have the region's countries achieved this policy mix?
In our view at ECLAC, Brazil leads in industrial policy. There are countries that have not emphasized it and now suffer the consequences. Brazil has adopted a clear, explicit industrial policy that is associated with promoting innovation and specific investments in science and technology. This is the key. Some countries are making the mistake of using the exchange rate as industrial policy. I think that's asking too much of exchange rate policy. Countries that have managed their industrial capabilities and were able to diversify their activities are those that are structurally better positioned to move forward.

Which countries are wrong in their approach to industrial policy?
Fundamentally, Mexico has not adopted an explicit industrial policy. It has been building up reserves, trying to prevent exchange rate appreciation. This policy has a limit; you cannot get the best results by simply accumulating reserves by buying dollars, because that also may affect domestic productivity. What is needed is to separate currency appreciation due to improved productivity, which may result in more competitive exports, from that due to attracting foreign capital inflows. The latter needs policy adjustments. Brazil took a quick and correct step by increasing the tax on short-term capital inflows from 2% to 6%. I think this is a move that could greatly help to send signals to the market on capital inflows.

The significant appreciation of the Brazilian currency against the dollar and the unraveling of international exchange rates have provoked intense debate. What is your opinion? Does this situation carry a risk that would justify greater intervention?

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First, I think it requires global coordination. The measures that Brazil is taking are appropriate, timely, and clear but should be complemented with international agreements. Minister Guido Mantega was the first to make this warning clear in international forums and called forcefully on China and other surplus countries like Germany to consider the need to allow their currencies to appreciate to achieve better global balance. Undoubtedly, the definitive solution is to avoid an exchange rate war. That is what happened in the 1930s, causing a trade war, which could greatly affect the policy of developing countries. What Brazil has done is correct: give a clear signal that capital cannot freely enter the country. But it is necessary to solve the issue at a global level.

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All year China has been criticized for keeping its currency artificially undervalued to boost the competitiveness of its exports. At the same time China is a major buyer of our commodities and has been investing in Latin America. On balance, do you consider China to be good or bad for the region?

The United States had its time as a major engine of world growth, because it had huge demand for goods produced worldwide. What is important now is whether China will manage to sustainably replace U.S. demand. In Latin America, the role of China has different meanings: For South America it has been good news, because China is demanding more and more products, resulting in greater trade. For Central America and Mexico the situation is different. The impact of expansionary monetary policy on commodity prices (which are rising) is negative for Central American countries that are exporters of raw materials. Mexico is not benefiting from better oil prices because of problems in its oil sector and its terms of exchange, and its manufactured goods are facing increasing competition from China. What is necessary is a more balanced trade relationship than the current one in which China buys only raw materials and Latin America buys manufactures from China.

How about Chinese investments in the region?

In Latin America these investments are still low and concentrated in natural resources, targeted to areas where surveillance is less strict. Therefore, although China is an important partner, there is a need to define a regional plan to support a more strategic relationship between China and the region.

Do you think there is a risk in the increasing concentration of Latin American exports in commodities?

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A recent ECLAC report shows an increase in commodities exports from Latin America. This worries the region because it can generate Dutch disease — sustained appreciation of the exchange rate. It is also true that one could gain greater investment in more productive areas. However, our report, "Outlook for International Integration of Latin America," shows that it is possible to develop more productive sectors, because while it is true that commodity prices are rising and trade is increasing, it is also true that today our countries have clearer policies for investing profits from commodities in diversifying production and improving domestic productivity. Countries like Brazil with industrial policies may have a better future because they are taking advantage of this cresting wave of good commodities prices.

In a document released earlier in the year, ECLAC defends countercyclical government policies in times of crisis. Do you also suggest a limit to these policies?

Some areas require private investment and others require public investment. Government action is necessary to deal especially with income redistribution and greater regional convergence and social cohesion. Here the instruments are undoubtedly fiscal policy and income transfer programs. I want to highlight the extraordinary role of Brazil in implementing its income transfer program, the Family Grant. It is one of the few countries where we see a trend of reduced inequality, and that's good news. Brazil has succeeded in showing that the engine of the economy may be the domestic market as incomes of the poor increase and they demand more goods and services.

To solve the problems of Latin America, we should emphasize productivity, competitiveness, and innovation.

ECLAC is historically known for defending the policy of import substitution that influenced the economic policies of many countries in the 1950s. Today, is it possible to imagine a new version of that policy?

The import substitution policy occurred in a different historical context after World War II when there was a scarcity of inputs worldwide. At that time, Latin America adopted it out of trade reality, not for political reasons. Now things are different. What I think we should talk about now is how to strengthen intraregional trade. There have been times when intraregional trade has helped countries to be more resilient in the face of international crises. South-South trade has also increased significantly worldwide, and that could give more muscle to our economies. Today, South-South trade represents about 18% of world trade in goods and is growing at very high rates. Latin America has a chance to set up frameworks to facilitate this integration process. In no way should anyone be inclined toward protectionism. As I pointed out, an exchange rate war may encourage a trade war that is not constructive. Each country has defined its ability to open up as a function of its domestic market and its

productivity. To solve the problems of Latin America, we should emphasize productivity, competitiveness, and innovation.

Is the region moving toward trade integration?

I think so. Last year we saw a deepening of preferential and trade links between Central America, Colombia, Mexico, Peru, and Chile with the completion of commercial agreements between them, and a process has begun in the countries along the Pacific, which met in Peru seeking trade convergence. Also, Brazil and Mexico, the two major economies of the region, are talking about establishing a strategic association that would be of enormous benefit for the whole region, because this deal could give us a good opportunity to consolidate integration.

What about Mercosur?

The Mercosur meeting last August in San Juan city in Argentina shows that its member countries can move forward, as demonstrated especially by the agreement to eliminate double taxation, the agreement on infrastructure, and the theme of special funds to support small and medium enterprises. Mercosur has become more dynamic, and that's good news.

Some business people view this progress with caution due to problems such as trucks carrying Brazilian food being blocked at Argentina's border, which could be considered a nontrade restriction on Brazilian sales to a neighboring country.

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What I am seeing is better understanding between Argentina and Brazil. The Mercosur negotiations have taken a concrete step since the meeting in San Juan, particularly on the important issue of regional infrastructure. In 2009 there were negotiations between Mercosur and Chile that have liberalized trade in services, architecture, engineering, construction, and advertising, and addressed some important issues of infrastructure. In early 2010, 74% of the projects of the Initiative for the Integration of Regional Infrastructure in South America made concrete progress.

In your opinion, what kind of mark are the democratic governments of the last two decades leaving in the region?

In the last decade, some governments in the region have carried out prudent macroeconomic policies yet have been progressive on social issues. These were the countries that have advanced more: those with more equality, better income distribution, and better perspective in coordinating macroeconomic policies and development.

What everyone is looking for is development. President Lula said that economic development and social justice have become a priority, that democracy is installed in the continent, and that the engine of development can be the marginalized and excluded classes. But it certainly requires strong governments who must also work with the private sector to establish alliances and it also requires an attentive citizenship.