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TEXTO PARA DISCUSSÃO

Mudanças no Papel do Estado e o Recente Desempenho Econômico e Institucional da América Latina: Uma nota segundo uma perspectiva brasileira

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The Changing Role of the State and Latin America's Recent Economic and Institutional Record: A Note from a Brazilian Perspective

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1. Introduction

As in other countries in Latin America (LA), since the early 1990s Brazil has embarked on a series of market-oriented reforms with the objective of increasing competition, productivity[2] and overall welfare. The previous import substitution industrialization (ISI) model had been based on widespread state intervention—which included as a main ingredient a control of supply through high entry barriers—and the transfer of rents and subsidies to producers to expand investment and compensate for low competitiveness.[3] The reforms reduced entry barriers, state intervention, and producer rents. Trade liberalization was an important step in this direction, involving significant declines in import tariffs and the end of various nontariff barriers. As in other countries in the region, Chile being a notable exception, the growth record up to the early 1990s was mediocre at best.[4] Perhaps even worse, growth was uneven in the rest of the 1990s as a result of crises (Mexican, Asian, Russian, LTCM collapse, Argentinean) that had negative effects on economic performance in all countries.

As the 2000s progressed, growth resumed in most countries. The region entered a phase of great optimism, especially after 2003, with improvements in its economic performance and, consequently, its global status. Social indicators also improved considerably, boosted by major declines in unemployment, poverty, and inequality. A new middle class, with greater access to credit has emerged, leading the boom in consumption that has caught the interest of foreign investors and attracted large capital inflows. In Brazil, as in other Latin-American countries, currency appreciation also played a role in enhancing a new social welfare perception: the so-called "feel good factor".

The good overall record can be explained by improved macro and financial policy frameworks, targeted social assistance and expansion of financial inclusion. These were concomitantly aided by favorable winds coming from a commodity cycle that benefitted resource-rich LA, the emergence of China as a source of cheap consumer goods and strong appetite for mining and agribusiness products, and a capital inflows bonanza (both FDI and non-FDI) which is at least partially due to high liquidity and low world interest rates after 2007. At the same time, the traditional Washington Consensus – markets as main problem solvers, government policies limited to enhancing market forces – gradually became discredited in most of the region. The stage was set for a change of course in many countries.

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[1] From the Brazilian Institute of Economics (IBRE), Getúlio Vargas Foundation (FGV), Rio de Janeiro, Brazil. Paper prepared for the session on "Rethinking Capitalism in the Post-Crisis World", Beijing Forum 2012, Beijing, China, November 2 – 4, 2012. The author thanks Armando Castelar Pinheiro and Luiz Guilherme Schymura for helpful comments to an earlier version and Maria Fernanda Mendes da Silva for research assistantship.

[2] In Brazil, both labor and total factor productivity growth were negative throughout the 1980s. See, for instance, Bacha and Bonelli (2012).

[3] See Pinheiro, Bonelli and Pessôa (2009) for an account of the effectiveness of reforms in Brazil.

[4] Indeed, the 1980s have been labeled in LA as the "lost decade" for economic growth, the foreign debt crisis being blamed as the main culprit.

In Brazil, high domestic interest rates, low levels of government debt, a budget under control, and large gains in the terms of trade helped attract foreign capital on considerable amounts, with the undesirable result of an overvalued currency. The country has also become a model of best practices in a number of areas, from financial regulation to conditional income transfer programs, and has become more assertive in global politics, with its international status bolstered by its active participation in the G-20 (Pinheiro and Bonelli, 2012, *passim*).

Many of these features are shared by other LA countries as well, as economic and social policies improved with: a shift to inflation targeting and flexible exchange rate regimes in many countries; poverty[5] and inequality reduction in most of them (exceptions: Honduras, Uruguay and Costa Rica); and declines in informality (exceptions: Mexico and Bolivia). It is worth noting that LA's share in world GDP measured in PPP fell between 1980, when it accounted for 11.4%, and 2003, when it represented only 8.4%. From then on it increased slightly to 8.7% in 2011. In current US dollar prices, however, LA's share increased substantially between 2003 and 2011, from 5% to 8%, reflecting improved terms of trade.[6]

Starting in 2008, the Great Recession has had a profound impact on growth prospects as one country after another promoted changes in economic strategies and in the relative roles ascribed to market versus state guidance. For some of them, this represented a reversal of previous trends, a partial one at least, Brazil being a notorious example. And although we do not believe that a profound systemic change is under way, not all countries in LA have behaved the same way with respect to the relative importance and roles ascribed to market forces versus state institutions in policymaking.

Despite all the difficulties involved in broad generalizations, it is possible to classify LA countries in two groups, according to the degree of state intervention in economic affairs. The first one, in which state intervention is the highest, includes Venezuela, Ecuador, Bolivia and Argentina. For lack of a better term, we will label this the country group 1, or G1. A second group, in the opposite side of the intervention spectrum, includes Chile, Colombia, Peru and Mexico, and forms G2.[7] Brazil, in turn, lies in between, as state intervention has increased as the world crisis progressed but not as much as in G1 countries. In addition, it is fair to say that perhaps for the first time LA countries responded to an external shock with counter cyclical monetary and fiscal policies.[8] The differentiated record on expenditures growth helps us in classifying the countries in the groups above, as government expenditures expansion was another common feature of post-2008 LA. The highest growth rates are found in Brazil, Argentina, Venezuela, Bolivia and Ecuador. Lower expenditures growth rates characterized Colombia, Chile and Mexico. Still lower were those of Peru.

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[5] Coincidentally, or not, poverty reduction gained speed from 2003 on.
[6] All underlying data were taken from the IMF internet site.
[7] It is fitting to note that these countries, plus Brazil, have adopted inflation targeting regimes over the recent past. The former group, in turn, follows an intermediate regime, except for Ecuador, which has a dollarized (fixed) exchange rate regime. Low inflation has been the norm, except in Argentina and Venezuela. The past couple of years has witnessed a higher tolerance with consumer price inflation in Brazil as well, but not as much as in the two countries just cited.
[8] In Brazil, the world crisis helped to reinforce a government policy trend towards increased state intervention that had begun somewhat timidly after 2005.

This note examines some selected issues currently key to Latin American economies having this broad frame of reference in mind. In particular, we look at macroeconomic outcomes such as the recent GDP growth record and prospects for the medium term; the evolution of institutional quality, as gauged by two governance indicators; other institutional quality indicators, such as those related to government effectiveness and economic performance. The next sections tackle these issues in turn, with the paper ending with an overall appraisal of the main themes in section 5.

2. Economic Performance since the Early 2000s: Sailing with Favorable Winds

GDP growth in LA has been stronger since the early 2000s, compared with previous decades. But growth only accelerated after 2003 in most countries (Table 1), as export demand and rising commodities prices gained momentum. Average per capita growth for the region was indeed negative between 2000 and 2003, the notable exceptions being Ecuador, Chile and Peru. After 2003, in turn, per capita growth reached rates last seen in LA in the 1970s, with average regional per capita GDP growth reaching almost 4% per year. Peru, Venezuela (due to increased oil prices from 2003 to 2008 and again in 2010) and Argentina (exports of agricultural products) were especially benefitted, the latter two after having experienced strong decreases in per capita GDP in previous years, as shown in the table. Fast demand growth from China, India, and other mining- and commodity-hungry Asian nations has accounted for this exceptionally good record in resource-rich Latin America.[9]

Table 1: Average GDP per capita Growth Rates: Latin America and Selected Countries (%)

Countries	2001-03	2004-08	2009-11	2001-11
Brazil	0.3	3.6	2.4	2.4
Chile	2.0	3.8	2.6	3.0
Colombia	1.1	3.8	2.4	2.7
Mexico	-0.5	2.3	-0.1	0.9
Peru	1.6	6.3	4.2	4.5
Venezuela	-6.3	8.5	-1.8	1.5
Argentina	-3.5	7.3	5.2	3.7
Bolivia	0.2	2.9	2.4	2.0
Ecuador	2.5	4.5	2.8	3.5
Latin America	-0.4	3.9	1.6	2.1

Source: CEPALSTAT internet site.

The collapse of 2009 left deep scars in many countries in the region, especially Venezuela and Mexico. But, in general, LA countries did well during the crisis. Post 2009 recovery was strong in some countries (e.g., Argentina and Peru) and decoupled from the performance of the advanced economies — although not as strongly as in Asian countries — thanks to growing commodity prices, up to 2011, and low interest rates on a global scale, factors that helped to expand exports and sustain growth in domestic demand.

[9] See Fishlow and Bacha (2010) for a useful account that also examines four countries: Brazil, Argentina, Chile and Venezuela.

For the 2001-11 period as a whole, the winners were Peru, Argentina — in which case fast growth in 2004-08 was in part the result of a huge GDP contraction of almost 20% accumulated in 1999-2002 —, Ecuador and Chile. To what extent do policy choices have a bearing on these past outcomes is a question that we will not pursue in detail here. Still, we will infer from institutional quality indicators that the future may not be as equally bright as the recent past for all countries in LA. We believe that part of the differences in future performance can be attributed to institutional change in the recent past. A less friendly external environment in the immediate future may also imply slower growth.

Another noticeable result is that favorable GDP results in LA have occurred even with typically low domestic savings and investment, which implies that changes in the productivity with which resources are used varies considerably among countries, some of them performing much better than the others. This is likely to be the case of the winners referred to above, but does not necessarily means that this outcome will continue into the future.

In addition, as already noted, growth was very much common to all countries in the sub-periods 2004-08 and 2009-11, albeit at slower rates in the latter. This aspect can be seen in the above table, where there are only two exceptions: Venezuela and Mexico. In both these cases, the poor performance between 2008 and 2011 was due to the severity of the 2009 recession in these countries (in Mexico, the record reflects its close dependency *vis-à-vis* the US economy), which caused per capita GDP to plunge 4.8% and 7.2%, respectively.

Still, countries that rely on commodity exports and access to cheap and abundant foreign financing, but that adopted quite different policies, had a similar record until recently. This striking similarity in performance, in which GDP and employment growth go hand in hand, resulting in low unemployment rates, reinforces the notion of underlying common causal factors (Table 2).[10]

Table 2: Comparison of Economic Performance, First Quarter 2011 and 2012, Year on Year (%)

	GDP growth		Employment growth		Unemployment rate	
Countries	**Q1/2011**	**Q1/2012**	**Q1/2011**	**Q1/2012**	**Q1/2011**	**Q1/2012**
Brazil	4.2	0.8	2.3	1.8	6.3	5.8
Chile	9.9	5.6	6.2	2.8	7.3	6.5
Colombia	5.0	4.7	3.1	5.2	12.7	11.8
Ecuador	7.0	6.1	-0.1	3.7	6.1	5.1
Mexico	4.5	4.6	1.0	3.8	5.1	5.0
Peru	8.8	6.0	na	na	na	na
Venezuela	4.8	5.6	0.3	-0.5	8.9	8.2
Regional average: LA	**6.3**	**4.8**	**2.1**	**2.8**	**7.8**	**7.1**

Source*:* CEIC database, National Statistical Offices, International Monetary Fund.

[10] We thank Armando Castelar Pinheiro for having brought this fact and source of data to our attention.

Indeed, Brazil's low rate is an exception with regard to GDP growth in early 2012. Moreover, it shares with Venezuela a relatively poor employment growth performance, relative to the regional average.[11] But low unemployment rates — indeed, even lower than one year before — characterize Brazil, Ecuador and Mexico in the beginning of 2012. For the region as a whole, GDP grew at healthy rates in early 2011 and 2012, although slower in the latter year. Still, employment growth remained buoyant and unemployment rates, at 7.1%, reached levels rarely seen in the region. Colombia and, to a lesser extent, Venezuela are the exceptions.

Prospects for the near future depend very much on the speed of recovery in the USA, the unraveling of events in Europe and the strength of China's growth. A recent study has found that under a (admittedly very favorable) scenario of a mild recession in Europe, recovery in the US, a rebound in Japan and a not too severe growth deceleration in China, LA can be expected to grow at 3.6% in 2012.[12] But a negative scenario of shocks in Europe that affect the workings of world financial markets, a weak global growth and a slowing China would lead to a recession in Latin America, with aggregate output decreasing 0.6%.

As for the medium term, the IMF recently updated its projections in a scenario that we find slightly optimistic (Table 3). Indeed, for the total of the nine countries in the table, the Fund foresees GDP growth of 3.8% per annum in the medium term, which represents an acceleration vis-à-vis 2009-11. The small variance of future growth across countries contradicts past performance and leads us to treat these projections as reflecting mainly past trends.

Table 3: GDP in 2011 (US$ billion) and Projected Growth rates for 2012-15 (%)

GDP in US$ billion 2011 prices	2011	Average growth 2012-15 (% p.a.)
Argentina	448	4.2
Bolivia	25	5.0
Brazil	2493	3.5
Chile	248	4.5
Colombia	328	4.5
Ecuador	66	3.9
Mexico	1155	3.6
Peru	174	5.9
Venezuela	316	3.5
Sum (nine countries)	5252	3.8

Source: IMF World Economic Outlook Database (except for Brazil in 2012, in which case a 1.5% GDP growth rate was assumed)

One implication of the picture briefly presented in this section is that, as happened in the past, all countries will be affected if or when the cycle turns downwards. Chile, Colombia Peru and Mexico, having recently performed better than the other countries, are in a better position to withstand downturns.

[11] In the case of Brazil this reflects slower than average population and labor force growth.
[12] IADB (2012). In June the World Bank predicted a 3.5% growth rate for LA in 2012.

Still, this possibility leads to the question: to what extent will future performances be impacted by different government policy and institutional orientations? The next two sections suggest that, although institutional change occurs at a slow pace, countries with better and/or improving institutions have a higher chance of performing better than the ones that lack them.

3. Changes in Institutional Quality, 2003 and 2010

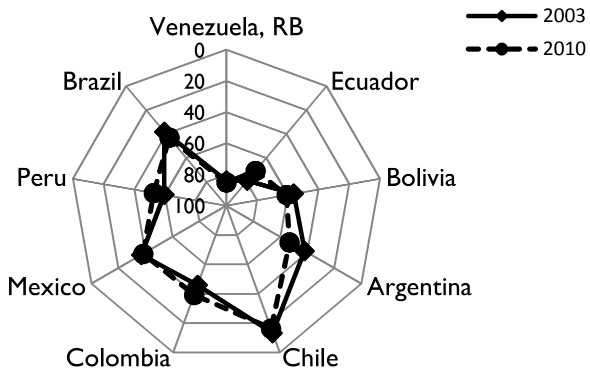
Surveys with Brazilian firms such as the ones carried out by the World Economic Forum show that the main barriers to doing business and increasing investment in Brazil, as in other countries in LA, are not related to a lack of funding, but to the poor quality of institutions: high taxes; inefficient, risky, complex and restrictive economic, labor and tax regulations; inefficient public bureaucracy, and so on. To what extent will institutional strengths and weaknesses affect the future performance of LA countries? This is a difficult question to tackle in the context of a note such as the present one. Still, it is our view that countries with better or improving government policymaking and that rely on market signals and good institutions will likely perform better than the ones that do not.

Accordingly, in this section we are concerned with comparative levels and changes over time in two dimensions representative of institutional quality, as gauged by the World Governance Indicators[13]: government effectiveness[14] and regulatory quality.[15] The analysis is based on a comparison of 2003 and 2010 (latest year with available data).

Figure 1 ranks the nine LA countries mentioned in the previous section according to the World Governance Indicators, from the World Bank.[16] Observe that Chile (rank: 13th percentile), Mexico (37th), Brazil (38th), Argentina (42nd) and Colombia (46th) hold the best positions in the overall group in 2003, followed by Bolivia (56th) and Peru (60th). Ecuador (79th) and Venezuela (84th) performed worst in terms of government effectiveness. Therefore, these last two countries, which belong in our typology to the G1, did not perform well in this dimension, while three in G2 (Chile, Mexico and Colombia) displayed better indicators of government effectiveness.

[13] The indicators are shown in percentile ranks as complements of the ones in the original database. The lowest the percentile, the better the position of each individual country. The data base includes 189 countries in 2003 and 200 in 2010.
[14] Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
[15] Reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
[16] In the diagram, the closer to the center, the worse.

Figure 1: Percentile Ranks of the Government Effectiveness Indicator, 2003 and 2010

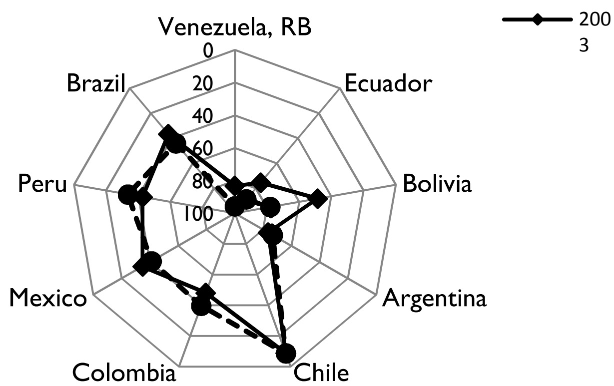


Source: WGI-World Government Indicators, World Bank, 2011.

Changes towards better positions between 2003 and 2010 were not substantial: Colombia (46 to 39), Peru (60 to 53) and Ecuador (from 79 to 71) are the highlights. Government effectiveness worsened in Argentina (42 to 53), Bolivia (56 to 61) and Brazil (38 to 43). Overall, the two countries at the extremes of the government efficiency spectrum (Chile and Venezuela) kept their positions, as did Mexico. In between, Group 1 countries Argentina and Bolivia (plus Brazil) performed worse; Colombia and Mexico, in G2, improved slightly.

The indicators on regulatory quality are shown next (Figure 2). Chile is the star in both 2003 and 2010 (ranked 9th, placing it among the top 10% best countries in the world in this dimension), but Mexico (35) and Brazil (37) did well in 2003 too. The lowest positions in 2003 were held by Ecuador (76), Argentina (77) and Venezuela (83), all of them Group 1 countries. Noticeable improvements between 2003 and 2010 were observed in Peru and Colombia, both of them Group 2 countries. Changes in the opposite directions characterized Bolivia, Venezuela and Ecuador (all in Group 1) and, to a lesser extent, Brazil and Mexico.

Figure 2: Percentile Ranks of Regulatory Quality, 2003 and 2010



Source: WGI - World Government Indicators, World Bank 2011.

We conclude that three countries in Group 2 improved their institutional quality (Colombia, Peru and Mexico, this one on regulatory quality), the fourth being the incontestable leader (Chile). Brazil and two countries in Group 1, Bolivia and Venezuela, lost positions in both dimensions of institutional quality. The remaining two countries in G1 (Argentina and Ecuador) did well in one dimension and badly in the other, but starting from a poor position.

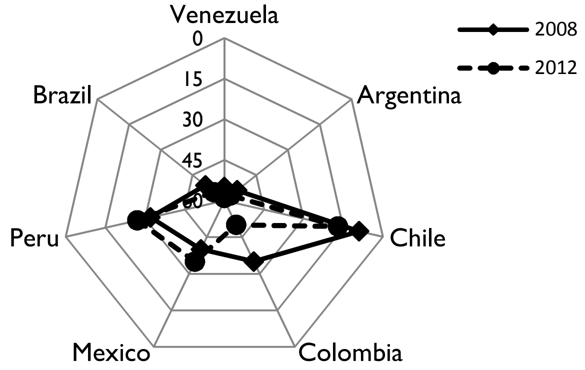
4. Government Efficiency and Economic Performance Indicators, 2008 and 2012

In this section we examine the comparative evolution of analysts' perceptions on two dimensions, government efficiency and economic performance, in 2008 and 2012, with reference to a subset of seven countries.[17] The next figure presents the evidence on the former dimension. Chile is the best performer in terms of government efficiency in 2008 (ranking 9th out of 55 countries), followed by Peru (32th) Colombia (35th) and Mexico (40th). All four belong to our country Group 2. The three remaining countries performed poorly in this dimension, with Brazil (51st) doing a little better than Venezuela and Argentina, the countries in the two last positions (both from Group 1).

There are slight changes in the ranks between 2008 and 2012: Chile and Colombia lost positions, while Peru and Mexico improved government efficiency even more. All the three remaining countries performed poorly, with Brazil dropping to the 55th position, Argentina to the 57th and Venezuela to the 59th. Thus, except for Colombia, all other countries in Group 2 kept good efficiency positions, while those in Group 1 continued to record the lowest grades.

Figure 3: Comparative Indicators of Government Efficiency, 2008 and 2012

(Ranks out of 55 countries in 2008 and 59 countries in 2012)



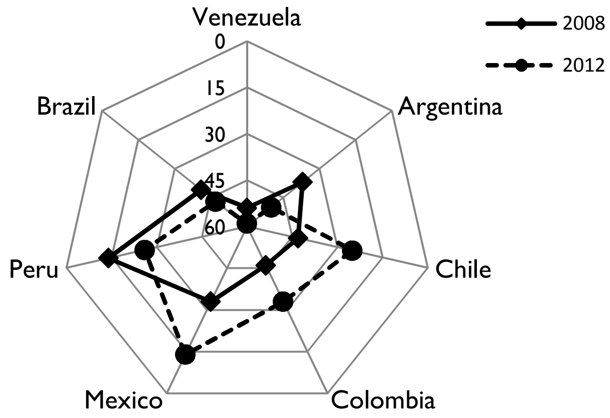
Source: WCO-IMD, World Competitiveness Yearbook, 2012. IMD - International Institute for Management Development.

[17] The International Institute for Management Development database does not include Bolivia and Ecuador. As a memo, the Annex presents the information from this and the previous section for the BRICS. Data are available on the site http://www.worldcompetitiveness.com/OnLine/App/Index.htm. 55 countries were compared in 2008 and 59 in 2012. Contrary to the indicators in the section before, in the present one the numbers in the graphs also refer to the ranks in the two years compared, but now they are absolute ranks. The highest the indicator, the better the position of the country.

Figure 4 shows a similar record with respect to another quality indicator, that of economic performance. Peru (14th) and Mexico (33th) lead the group in 2008, while Brazil, Chile and Colombia occupy positions in the third quartile. Again, Venezuela, as the 54th, in the second last position, is near the bottom.

Figure 4: Comparative Indicators of Economic Performance, 2008 and 2012

(Ranks out of 55 countries in 2008 and 59 countries in 2012)



Source: WCO-IMD, World Competitiveness Yearbook, 2012. IMD - International Institute for Management Development.

There are, though, substantial changes between 2008 and 2012. This is especially the case of Mexico (more recently in the 14th position), Chile (25th) and Colombia (33th), all of them members of Group 2. The other country in this group, Peru, also did well (26th), although losing a few positions. The remaining three countries lost positions: Brazil (to the 47th), Argentina (to the 50th) and Venezuela (to the 59th, the last one). We conclude, therefore, that almost all countries in Group 2 improved (Peru being the exception, but still on a favorable position) while those in Group 1, with the company of Brazil, lost competitive position, as gauged by the indicator of economic performance.

The following diagram summarizes the information presented in this and in the last section in terms of trends over time in the institutional quality and competitiveness indicators here presented. From the number of upward and downward pointing arrows we conclude that the typology fits the indicators, as group classifications point to the levels and / or directions predicted: countries with more state intervention, the first four in the diagram, perform worse in most, if not all, indicators. And in the few cases in which they improve, they do so from a very poor position. On the other hand, countries in which more market friendly policies and less state intervention are the norm, the last four in the diagram, usually had better positions and improved them over time, with few exceptions.

Where does Brazil stand? From the point of view of the diagram, and the indicators it reflects, Brazil definitely belongs to the first group. All four indicators reviewed suggest a worsening of institutional quality that goes into the present decade, as far as government efficiency and economic performance are concerned. Thus, from these indicators we conclude that Brazil should be included among the countries in Group 1.

Diagram 1: Changes Over Time in Selected Indicators of Institutional Quality

	Changes between 2003 and 2010		Changes between 2008 and 2012	
	Government Effectiveness	Regulatory Quality	Government Efficiency	Economic Performance
Argentina	↓	↑**	↓	↓
Bolivia	↓	↓	n.a.	n.a.
Ecuador	↑ *	↓	n.a.	n.a.
Venezuela	↓	↓	↓	↓
Brazil	↓	↓	↓	↓
Chile	↓ ***	=	↓ ****	↑
Colombia	↑	↑	↓	↑
Mexico	=	↑	↑	↑
Peru	↑	↑	↑	↓

Notes: * positive change, but from poor (low) ranks (79 to 71); ** (idem, 77 to 73); *** down, but from very high effectiveness indicators (13 to 16); **** down, but from very high government efficiency (9 to 17)

5. Conclusion[18]

Latin America has experienced very favorable external conditions during most of the last decade, with total and per capita GDP growth in the quinquennium 2004-08 reaching rates last seen many years in the past. The region's growth performance has worsened after the world crisis, but by less than in other parts of the world, with the exception of Asia.

The causal factors that made this performance possible are common to many countries in the region. But, what will happen when these conditions change, as they have been doing with the prospects of a continued overall growth slowdown? Do better institutions and policies have a say in the prospects for the future? We believe that they do. As the present downturn may not be so short-lived as the last one in 2009, LA countries will need to put more attention on growth inducing reforms, through institutional and economic policy changes.

Much of the pressures and challenges of the present point to a need to rebalance or, at least, review the roles played by the state and those played by market forces. The challenge is how to enhance the role of the state as regulator without resurrecting rent seeking and the inefficient public bureaucracies of the past.

[18] This section benefits from presentations made during the international seminar "Wither Latin America" sponsored by IBRE/FGV in August 9-10, 1012, especially those made by Drs. A. de la Torre (World Bank) and A. Powell (IADB), without holding them responsible for any eventual mistakes that may have been incurred here. The presentations made during the seminar can be found in http://portalibre.fgv.br/main.jsp?lumPageId=402880972283E1AA0122841CE9191DD3&contentId=8A7C82C538F4CE4C01392067BCF55ADE

This is not, though, the recipe followed by several countries in the region. In those countries, more state intervention has been increasingly regarded as a tool to eliminate growth bottlenecks. This includes giving a more prominent role to state-owned enterprises and interfering more directly in the business decisions of private firms, using the mechanism of subsidized credit and strong credit creation in a region that has been particularly credit-hungry for very long. But fast credit expansion does not always lead to healthy practices and financial stability. Promoting financial development without undermining financial stability is a challenge in many countries. What is particular to Brazil, in this regard, is a substantial increase in lending by public banks (accentuated after the 2008 crisis).

The recent trend in some countries in LA towards greater state intervention, or the search for a kind of mild state capitalism, has come together with the reinstatement of trade barriers, as well as greater tolerance with inflation and the erosion of the transparency of fiscal accounts. A related threat is the reemergence of populism in the region, a development that in Latin America often comes hand in hand with increased state intervention in the economy. In particular, although we do not think that Brazil has gone as far in reversing the reforms of the 1990s, as some of its neighbors did, nor do we think it will, the direction of change is similar.

After economic policymaking changes since 2008, a balance is clearly needed between counter-cyclical policies versus growth-inducing reforms. Counter cyclical policies respond to temporary downturns and should be temporary. The recent emphasis on poverty reduction (targeted transfers) in many countries is welcomed, but insufficient. A more difficult global environment and the downsides of a commodity-based model call for a reshaping of the state-market balance.

The region is currently in search for such a new balance, using strategies according to which countries can be classified into two main groups. In the first one, that we labeled Group 1 countries, policies have led to expansion of the role of the state in economic affairs in such a way that state institutions are the leading actors and/or replace market forces. The focus in this group — which includes Argentina, Bolivia, Ecuador, Venezuela — is on getting things done, even if state actions crowd out private activity. Two important questions for this group are: how to avoid the erosion of market signals and how to avoid political or bureaucratic capture?

In the second country group, policies are targeted at enhancing the complementary role of the state. Our examples of Group 2 countries include Chile, Colombia, Mexico and Peru, for which the emphasis of policies is, broadly speaking, on helping to complete and complement markets, on crowding in the private sector, and on enhancing the state's comparative advantage in solving collective action problems in interaction with markets.

For the future, the indications provided in the two previous sections point to clear implications: accepting that institutional quality affects performance, we would suggest that Group 1 countries, plus Brazil, will perform worse in the future than those in Group 2. If the prediction from the interpretation is correct, Chile, Colombia, Mexico and Peru stand a better chance in the years ahead as far as economic growth prospects are concerned. But a caveat is in order, because pragmatism — a not uncommon feature of Latin-American policymaking —

may lead to better policymaking in Group 1 countries if and/or when governments find out that increased state intervention is unable to deliver the expected welfare results. Changes are more likely to take place in democratic regimes than in authoritarian/autocratic ones.

One outstanding feature of a stylized Latin American development model is the low saving rates, especially when compared to the countries in Asia. This, however, has not prevented many countries from achieving relatively high GDP growth rates. Still, the ability to sustain good performance depends on new reform in several countries. In particular reforms should have at their ultimate objective to increase domestic savings.

The risks facing the region are many, but their relative importance varies substantially across countries. Overall, a list of potential threats includes: falling commodity prices; tight labor markets; high public deficits; rising inflation; and capital flight — either due to future rises in interest rates in developed countries or increased populism, investor insecurity, and political turmoil.

A related shortcoming is the prevalence of low savings in the region. How to overcome this issue — average domestic savings rates in LA countries are only a little higher than 20% of GDP, nearly half those of many Asian countries — and the threats it implies with respect to slow growth and, therefore, high vulnerability? This is a challenge that may be made easier with reforms towards better institutions, ones that enforce the role of market signals and use state powers to monitor and curb bad practices. Policies recently taken by some countries in Latin America, specifically those in our country group 1, however, does not seem to favor this course of action.

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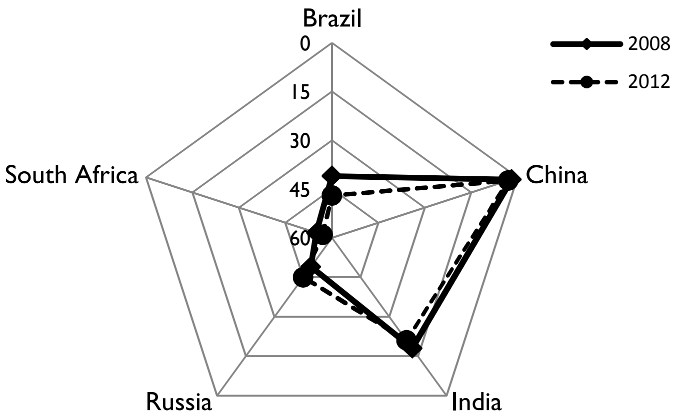
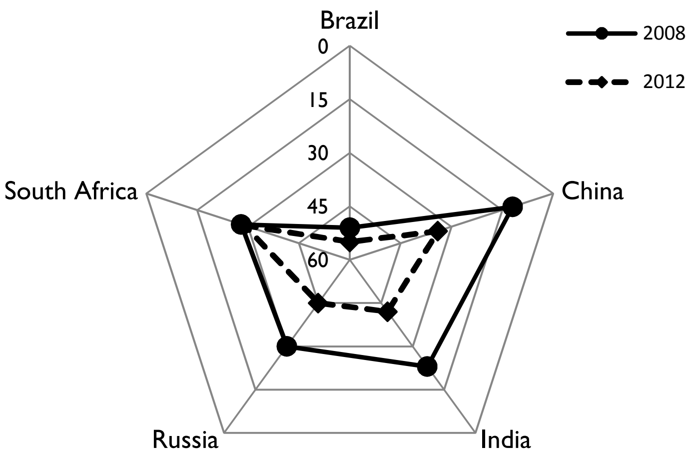
Annexes:

Institutional and Competitiveness Indicators for Brazil, Russia, India, China and South Africa

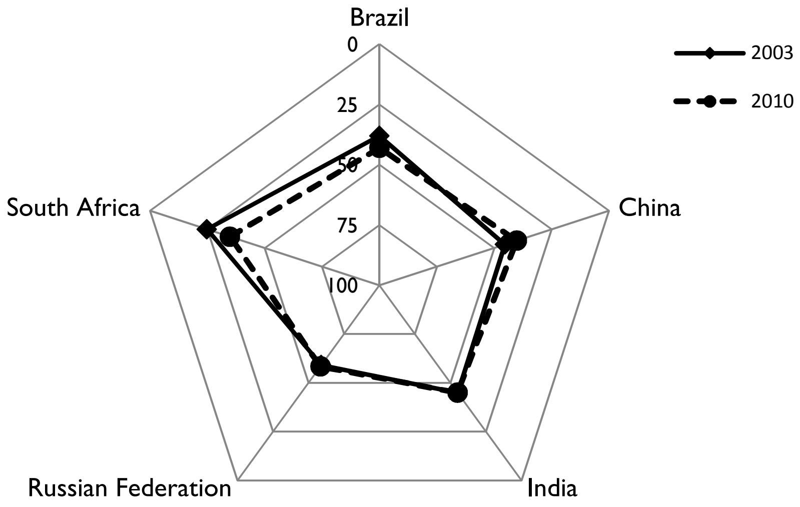
Economic Performance Indicators: BRICS



Government Efficiency Indicators: BRICS



Government Effectiveness Indicators: BRICS



Regulatory Quality Indicators: BRICS