6

From Macroeconomic Policies to Long-Term Growth

Latin America has made important progress in both macroeconomic and financial policies. It was able to weather the global financial crisis, but the road ahead is not risk-free.

In this chapter I discuss some important challenges that need to be addressed in order to take advantage of good macroeconomic policies to go from resilience to sustained economic growth. I also delve into some current trends produced by a deceleration in emerging markets, the downward pressures on commodity prices, and the prospects of an end to quantitative easing in the United States.

Today, countries are recognizing the need for policies that increase productivity and growth. The first phase of growth is the easier one and usually goes as follows: An economy is stabilized; a strong macroeconomic framework is put in place, perhaps opening up the economy; and then strong growth follows for several years. These well-known growth accelerations flow from the removal of basic, first-order distortions and achievement of macroeconomic stability. Acceleration concludes once the economy reaches its potential level of output. Increasing this potential growth is more difficult. It is not obvious which reforms are the most important to undertake. Also not obvious are the characteristics of those reforms. The devil is in the details.

Two sources of constraints limit the implementation and effectiveness of reforms. The first is populism. Dornbusch and Edwards (1991) define *economic populism* as "an approach to economics that emphasizes growth and income distribution and deemphasizes the risks of inflation, external constraints, and the reaction of economic agents to aggressive nonmarket policies." The emphasis is sound; the deemphasis is the tragedy. Because of inequality, populism is always a temptation, but it is an ineffective shortcut to social progress.

During the current period of cyclical deceleration, the chances of taking populism in the wrong direction are higher.

The other source of constraint in the implementation of reforms in conflict with vested interests. Many institutions and policies in Latin America have been put in place to favor particular interest groups, who are the first to oppose reforms. Historical rights or some other arguments are used to maintain special privileges. But privileges at the cost of the rest of the population are neither fair nor efficient. At other times, the arguments are subtler, such as the threat that reforms pose to economic growth and even social progress. Policies must be promarket, not probusiness. Most of the time, what is good for markets is also good for business, but when differences emerge, well-functioning markets must be the goal. Meanwhile, arbitrary policies or expropriations should not be pursued. The insecurity of property rights severely handicaps investment. Thus a strong institutional framework is needed to advance reforms that stimulate growth and social progress. In many Latin American countries, corruption and weak rule of law hinder reforms.

Inequality and Institutions

Inequality in Latin America has been persistent, dating back to either colonization or the late 19th century, and resilient—it has survived many economic experiments and many growth strategies. Moreover, it creates distortions in policymaking that hamper economic growth. Classic cases are the introduction of unsustainable social policies or market distortions for the purposes of redistribution. Inequality reduces potential growth primarily because of its negative impact on the quality of economic policies.

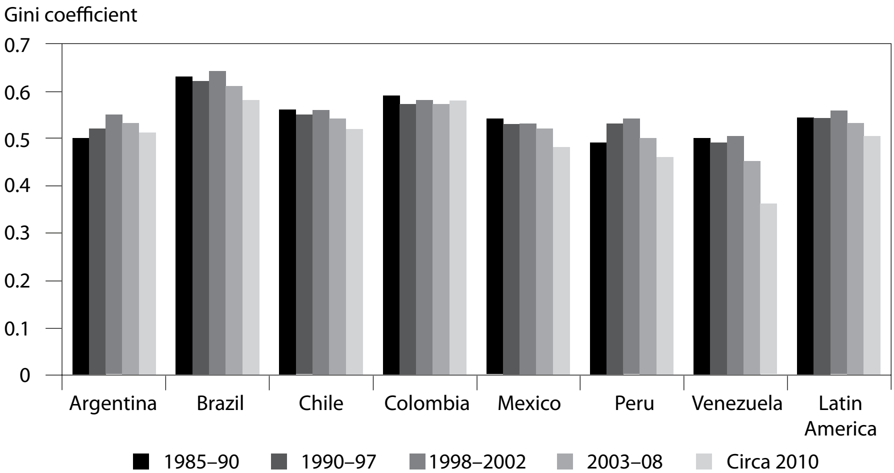
In Latin America, inequality widened in the 1980s, remained stable for some countries and widened for others during the 1990s, and narrowed during the 2000s.[1] The evolution of income inequality parallels that of economic performance. Performance was poor in the 1980s, normal in the 1990s and early 2000s, and better afterward. Regardless of policies and politics, the trends are relatively homogeneous, and thus they support the view that high growth and low inflation are determinants of the decline in inequality in the region.

The evolution of income distribution in Latin America is presented in figure 6.1 for the seven largest countries, the LA-7.[2] From the mid-1980s to the early 2000s, inequality remained stable in some countries, while in others it increased. In all countries but Colombia, inequality fell during the last decade.

1. See De la Torre, Messina, and Pienknagura (2012), González and Martner (2012), and Lopez-Calva and Lustig (2012), among others.

2. International comparisons of inequality are difficult because countries are not fully comparable. In some countries, coverage is national; in others only big cities are covered. Moreover, adjustments are made to achieve consistency with other national figures. In Chile, strong assumptions are used to make household surveys compatible with national accounts. This adjustment would have systematically increased inequality as measured by the Gini coefficient by 7 percent (Bravo and Valderrama 2011).

Figure 6.1 Income distribution in Latin America, 1985–2010



Note: The Gini coefficient is a measure of income distribution in a country. It ranges from 0 (perfect equality) to 1 (perfect inequality).

Source: Economic Commission for Latin America and the Caribbean.

The largest decline was in Venezuela, although whether it will last is questionable. Most remarkable, inequality did not increase during the global financial crisis. The last observations are for 2010, except for Brazil and Chile, where the data are for 2009, the worst year in terms of output. Macroeconomic resilience and income support for the poor during the recession played an important role in mitigating the social costs of the decline in output.

Little is known about specific policies to change income distribution significantly in the short run and on a long-lasting basis. Even the effects of growth are unclear. The evolution of inequality and income would follow the Kuznets curve, but the specific form of this relationship—for example, at which level of income inequality declines—is also unclear. This finding implies that at low income levels inequality increases as economies grow, then inequality reaches a maximum after which inequality declines as income grows. This is the famous inverted-U of Kuznets. However, the break point is country-specific and depends on many other factors influencing the evolution of inequality.

Some progress has been made recently, however, in understanding the factors underlying the decline in inequality in Latin America. This decline has been characterized by a decline in labor income inequality and therefore a decline in the skill premium.[3] The educational expansion and investment of the 1990s

3. The factors underlying the skill premium are beyond the scope of this discussion, but they may be related to improved terms of trade. As argued by De la Torre et al. (2012), the break in inequality in 2003 coincided with the onset of the terms of trade boom. As exchange rates appreciated, labor

and even earlier had then paid off. However, the effects of improved education do not affect measures of inequality overnight. As better-educated people gradually enter the labor force, this effect will gradually influence the overall measures of income inequality. Improvements in education are the most durable and effective way to reduce inequality and increase social mobility, but the distribution of human capital counts as well. The decline in inequality has also been a result of economic growth and stimulated by good macroeconomic conditions.

Social policies that provided cash transfers to the poor led to a decline in inequality. According to Lopez-Calva and Lustig (2012), the implementation of large-scale conditional cash transfer programs in Argentina, Brazil, Mexico, and Peru has been effective. Therefore, fiscal policy through conditional transfers directly affects income and its distribution, and it can alleviate the living conditions of the disadvantaged. For this reason, a strong fiscal policy must be in place to have permanent financing for permanent expenditures. The procyclicality of fiscal policy, discussed in chapter 4, is not only bad from a macroeconomic point of view but also unfavorable for social policy priorities. Tightening the budget during slowdowns usually affects social expenditure disproportionately. The progress in Latin America in recent years, together with the windfalls of the commodity price boom, has allowed effective social policies. Countries that have not built fiscal buffers for a fall in commodity revenues may have to face difficult policy choices as terms of trade decline. As already noted, relying on terms of trade has its limits. Terms of trade may remain high, but they will not continue to grow at the rate of the economy and social needs. It is quite likely that in the next years this boom will recede.

Finally, income distribution is perhaps the most important variable in terms of equity, but it is not the only relevant dimension. Improving the distribution of opportunities and correcting market distortions to level the playing field may bring the poor important benefits. Improving the functioning of markets, many times constrained by monopolistic behavior and uneven market relations due to asymmetric information, can have first-order effects on welfare and fairness. Many of the policies needed to advance in this area will have to deal with rooted vested interests that will oppose these reforms. Competition and consumer protection laws are important in this regard. Opaque political campaign finances open the door to political capture.

Institutions provide people with the incentives to devote their efforts and talents to different activities. According to Acemoglu and Robinson (2012), institutions can be inclusive or extractive. Inclusive economic institutions are those that "secure property rights and opportunities for not just the elite but for a broad cross-section of society." By contrast, extractive institutions are those "designed to extract incomes and wealth from one subset of society to

moved to the nontradable goods sectors, which are less skill-intensive, thereby reducing the skill premium.

benefit a different subset." Extractive institutions can generate growth but not in an enduring way.

Weak and extractive institutions have characterized Latin America since its days of colonization. Figure 6.2 shows one of the most pervasive features of Latin America, corruption. Except for Chile and Uruguay, and to a lesser extent Costa Rica, Latin American countries rank very poorly in terms of corruption, according to Transparency International's Corruption Perceptions Index. Corruption creates insecurity in property rights, induces rent-seeking behavior, and reduces the incentives for investment and productivity-augmenting activities. Corruption is also linked to drug trafficking, a major problem in some countries of the region.

On most indicators of institutional strength such as rule of law, ease of doing business, and competitiveness, Latin America ranks poorly, and the rankings resemble those for corruption. Chile, Uruguay, and Costa Rica are the exceptions in quality of institutions, and Chile, Colombia, Mexico, and Peru are the exceptions in ease of doing business.

Economic policies geared to efficiently reducing inequality and strengthening institutions are key to promoting growth. Improvements can be made in many country-specific areas. Avoiding the temptations of populism and kowtowing to special-interest groups are important to create an environment of inclusive institutions, which produces the appropriate incentives for widespread economic prosperity.

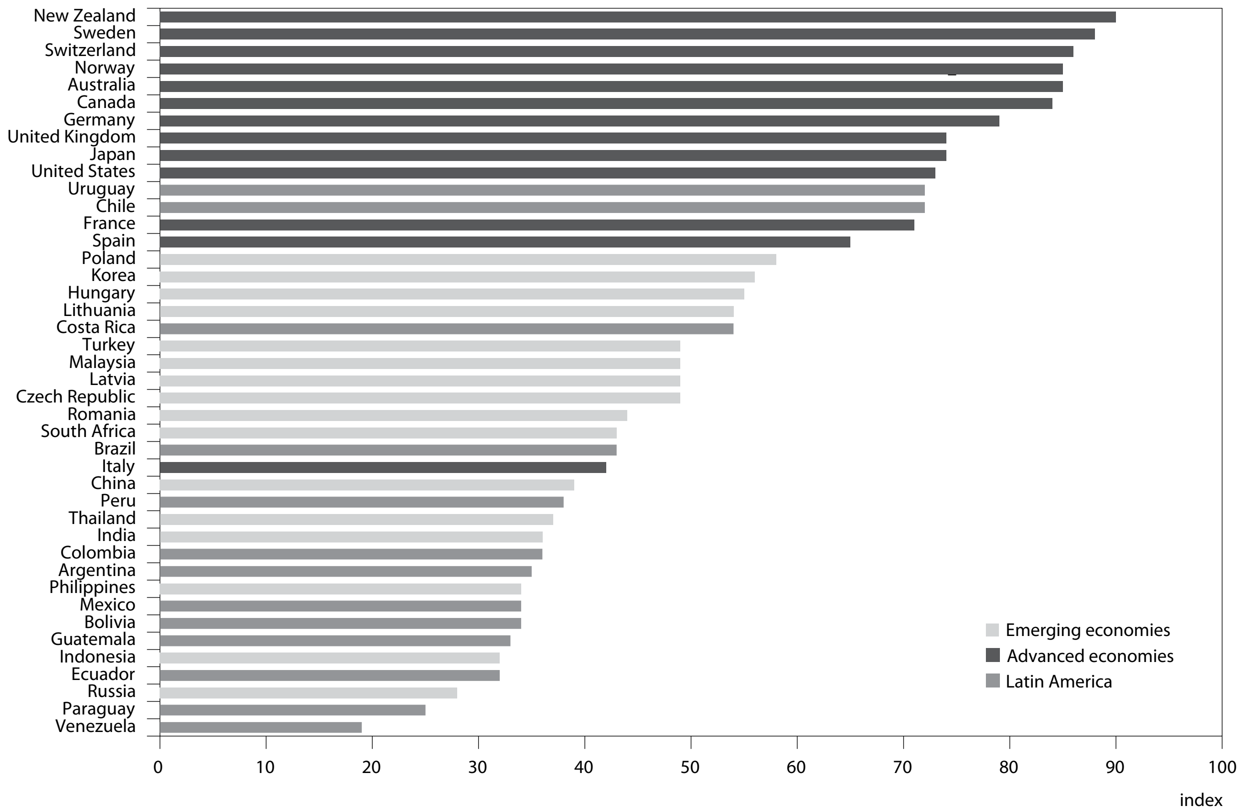
Macroeconomic Policies: Virtuous and Vicious Cycles

Good macroeconomic policies foster economic growth, which, in turn, promotes macroeconomic stability. Good terms of trade may facilitate this process, but a change in external conditions can reverse all gains. There is a virtuous cycle of growth, low inflation, and strong fiscal policy. However, that virtuous cycle can turn into a vicious cycle of instability and stagnation, as in figure 6.3.

High economic growth improves public finance by strengthening revenues, but also, in the other direction, sound fiscal policy fosters growth by, among other things, reducing sovereign risk and the cost of financing. In turn, sound fiscal policy does not require inflationary finance, contributing in this way to price stability. Finally, a low inflation rate and stability increase economic growth. This is a virtuous cycle, but low growth, weak public finance, and high inflation may turn out to be a vicious cycle of stagflation. This cycle can feed into the health of the financial system, producing something similar to what has been going on today in Europe, except for inflation, which is low.

Europe's monetary union has not proven to be a panacea, and the lack of exchange rate adjustments generates longer recessions. Flexible exchange rates are thus the preference noted in this book. However, belonging to a currency union is quite irreversible. The cost of exiting is probably much higher than the costs of gaining flexibility. The recent experience with the euro area shows the costs of rigidities and irreversibility on economic adjustment. In the euro

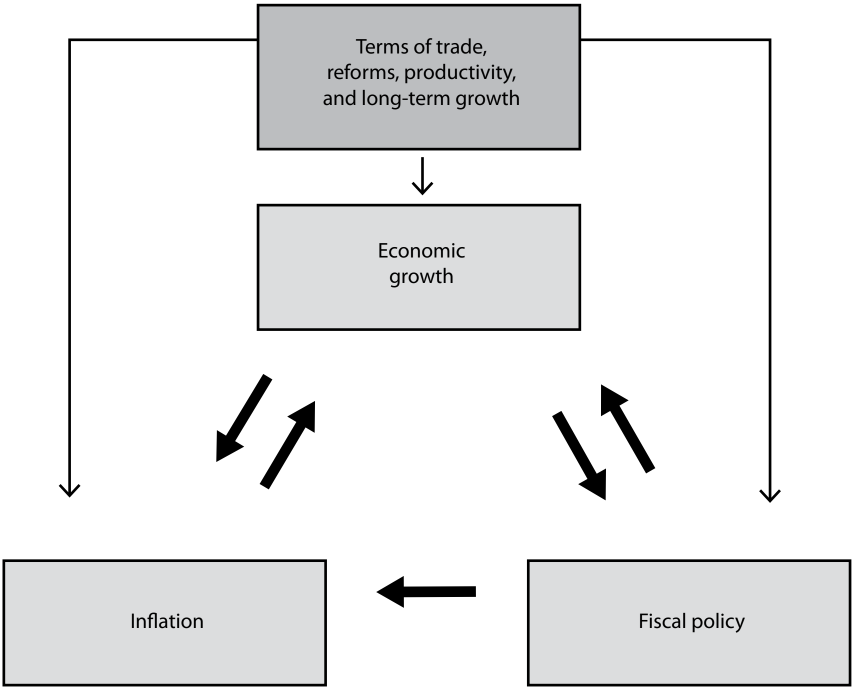
Figure 6.2 Corruption Perceptions Index, 2012



Note: Higher values indicate low perceived corruption.

Source: Transparency International.

Figure 6.3 The virtuous and vicious cycles of macroeconomic stability



Source: Author's illustration.

area, the size of countries is not as heterogeneous as in Latin America. In addition, the most central and largest country in the euro area is also the richest and most stable economically and financially, unlike in Latin America. For this reason, the idea of creating a currency union in Latin America is a nonstarter. It is much more important to increase economic integration in the context of fairly open economies than to try to integrate macroeconomic policies.

High terms of trade, as illustrated in figure 6.3, may trigger the virtuous cycle. They increase growth through the impact of higher income on the domestic expenditure and the fall in the relative cost of inputs. They also improve public finances directly by the revenues earned from commodities and indirectly through higher growth. And finally, high terms of trade put downward pressures on inflation as the exchange rate appreciates. A deterioration in the terms of trade, however, can have damaging consequences for stability and growth.

That said, rising terms of trade can initiate a vicious cycle, which seems to have been the tragedy in Latin America during the debt crisis. An abundance of natural resources and the production of commodities can become a curse because positive terms of trade shocks can exacerbate procyclicality of the business cycle. The boom-bust cycle then becomes very pronounced. Government's windfall gains are spent, and the improvement in creditworthiness leads to overborrowing, private and public. From an institutional point of view, improvements in terms of trade also encourage rent-seeking behavior. And management of the exchange rate induces further inflows and a correction that must be even more intense. This time, however, the situation, in most countries at least, was different. But the real strength of countries will not be revealed until an important decline in terms of trade occurs, which could happen in the near term.

To avoid falling into the vicious cycle of terms of trade, countries need to adopt policies that reduce the impact of the external environment on the business cycle. Indeed, reducing the impact of terms of trade on short-term fluctuations and inflation is desirable to reduce fluctuations in employment and activity. As argued in earlier chapters, Latin America's greater resilience is built in part on the reduced impact of terms of trade on the domestic economy. However, reducing the impact of weak global conditions on the domestic economy means that in good times the strengths of the global economy are also dampened domestically. This is precisely how beneficial output stabilization works. As discussed throughout this book, inflation targets, prudent fiscal policy, flexible exchange rates, and sound financial regulation and supervision are central to this endeavor.

Promoting long-term growth is another way to trigger and sustain the virtuous cycle. Increasing productivity and long-term growth helps reduce inflation as potential output rises and thus inflation declines. It also contributes to public finances, reduces poverty, and is a necessary condition for sustained social inclusion.

Periods of genuine productivity and income catch-up, in contrast to overheating, have contributed in important ways to the conquest of inflation. Indexation and other forms of inertia become less relevant as the economy grows. As for wage inertia, if wages are indexed to past inflation and productivity is growing, it is possible to have real wage growth, indexation, and falling inflation, because the increase in wages does not translate into an increase in costs as productivity rises. In other words, as productivity grows, indexation may become a nonbinding constraint to reducing inflation. As low inflation consolidates because the deep causes of inflation have been removed, inertia becomes much less important.[4]

By contrast, when wages are indexed to past inflation but growth is low, reducing inflation becomes more difficult and slower to achieve. As nominal wages grow at the pace of past inflation, and productivity fails to grow, the

4. The disinflation in Chile in the 1990s can be attributed to strong public finance and to granting independence to the central bank. But the speed of disinflation, faster than originally expected, and the decline in the relevance of indexation can also be attributed to the rapid growth in productivity in the 1990s (De Gregorio 2004).

wage behavior feeds entirely into costs and prices and inflation becomes sticky. This scenario is at the core of the decline in inflation inertia in the region. It may, however, mask cosmetic reductions in inflation.

Eliminating the deep roots of inflation—the fiscal and monetary roots discussed in chapter 2—and productivity growth have fostered a decline in inflation in most countries in the region. Beyond the key role played by the central banks in conducting monetary policy within a flexible inflation targeting regime, the decline in inflation inertia has also contributed to this achievement. The task is now to avoid returning to inflation, and flexible inflation targeting regimes have proven to be a successful way of accomplishing this.

Macroeconomic and Financial Policies

Progress in macroeconomic and financial policies is fundamental to understanding the resilience of Latin America to the global financial crisis and the strong recovery that most of the region has been enjoying. Overall, advances in structural reforms have lagged in most countries of the region.

Macroeconomic Policies

One important policy lesson from the crisis is the need for macroprudential financial policies. They limit the vulnerability of the financial system to fluctuations in the business cycle. Macroprudential policies should aim to avoid excessive procyclicality from the financial system to the business cycle. A natural first reaction to the policy lesson just noted would be that there is no need to introduce new measures because of the resilience of Latin America's financial system to the crisis. However, it is in tranquil times that fragilities build up and policies to prevent crisis must be implemented. Equating resilience to immunity could aggravate the incubation of future problems. This is a sure recipe for booming asset prices and credit and the onset of fragility.

No matter how useful, macroprudential tools come with a risk: They are too broad and can be used for many purposes. As one policymaker put it, macroprudential policies could become a "license to kill." Indeed, today in the policy discussions of capital controls, controls are not mentioned. Rather, they are called macroprudential tools—it sounds better. It is true that some versions of capital controls are a form of macroprudential policy, but they are mostly used for exchange rate purposes.

Capital controls are far from a panacea. In the financial dimension, they must focus on the composition and volume of gross flows. Measures can be taken if the evolution of flows suggests increasing vulnerabilities because foreign borrowing is deemed to be excessive and volatile. However, when used as an exchange rate defense their effectiveness is more elusive, especially in financially open economies. As economies open, financial markets find ways to channel investment into the economy—but controls are not uniform for all types of flows. Still, their effectiveness is country- and context-specific.

It is important to remember that the use of capital controls is problematic when the deep root of appreciation is very large interest rate differentials, on the order of two digits. The false sense of security given by capital controls could lure authorities into overlooking the fact that they may not be the victims of a global currency war, but rather a local currency suicide.

As the toolbox of macroprudential regulation continues to grow, macroprudential tools may appear for exchange rates, inflation, and so forth, thereby creating confusion about what exactly are the appropriate policies for various circumstances. Misuse of the term *macroprudential* weakens the policy advice and makes international coordination more difficult. In spite of recent discussions, the area between capital controls and macroprudential regulation remains gray, and policymakers should be wary of a new period of financial repression in advanced economies triggered by the need to rebalance the public finances.

On the monetary side, flexible inflation targets have worked well in Latin America, a region that has the highest and most persistent inflation rates in the world. Inflation targets have helped anchor inflation and provide room for monetary policy, thereby playing an important role during the global financial crisis. Inflation targets are not a rigid scheme, and they can be complemented with other policies such as financial ones. They are fully consistent with exchange rate intervention, as long as the target does not become subordinate to an exchange rate objective.

Inflation targets have often been blamed for a narrow focus on stability. The significant monetary loosening during the global financial crisis revealed that employment and output are important inputs in monetary policy decisions. And yet challenges remain. Today, Latin America is moving closer to its potential level of activity. The tensions on the exchange rate front may produce a reluctance to tighten because of fear of appreciation. Replacing fear of floating with fear of tightening could be a problem. Fiscal policy may help, but the scope for tightening is limited. As noted in chapter 2, the retrenchment of fiscal expansion after the crisis has been only partial. There is heterogeneity in the region, and several countries are slowing down, which may require loose monetary policy.

Financial Policies

Countries can be classified into three categories: (1) financially closed, (2) financially open but fragile, and (3) financially open and resilient. The second category is the worst, because countries end up there typically because of opening the capital account in the context of weak domestic financial regulation and supervision. The best is the third type of economy, but unfortunately it appears that a country cannot achieve that status without crossing the second one. To avoid the second stage is the challenge.

Recent experience in Latin America indicates that being more financially integrated and open does not mean being more vulnerable. This finding adds a new complication to the discussion of financial stability. A process of financial integration does not necessarily lead to a collapse or fragility, as perhaps was thought some time ago.

Indeed, in their review of the effects of financial integration, Kose et al. (2006) argue that any positive effects are quite elusive. They give "qualified support" to the claim that developing countries benefit from financial integration, but they also add that "we find there is very little meaningful empirical support to underpin the more polemical claims of those who argue that capital account liberalization (as opposed to, say, inappropriately rigid exchange rate regimes) is the root problem underlying most developing country financial crises of the past fifteen years" (page 7).

As argued throughout this book, exchange rate rigidities have been important factors in crises in Latin America. Opening capital accounts in the context of a weak financial system is also a recipe for trouble. The massive evidence on financial integration and economic growth suggests that the beneficial effects of financial integration depend on thresholds. In particular, a financially open economy with strong macroeconomic and financial institutions and policies can reap the benefits of integration and be resilient.

An important concern in the region is the destabilizing effects of capital inflows. However, from the current account point of view recent experience shows there is no significant demand for foreign financing. But net inflows have been relevant. As discussed in chapter 5, their relevance stems to some extent from the fact that central banks have been accumulating reserves. Therefore, capital inflows from advanced economies to emerging markets may largely be the result of official demands for international reserves. This process may be changing, however, because the current account balances in Latin America and many emerging markets are deteriorating.

Current account deficits have traditionally been a concern of policymakers in the region, and it is not surprising. A large number of crises have been currency crises triggered by unsustainable deficits. Exchange rate misalignments (*atrasos cambiarios*) have been the underlying cause of this problem. Exchange rate flexibility is the most important policy for limiting the risk of external crisis. If the exchange rate is allowed to adjust when international conditions deteriorate, the adjustment becomes less costly. During a crisis, the responses of exchange rates in countries that float, as shown in chapter 3, reveal that the inflationary impacts are small and that there are no threats to financial stability.

Good terms of trade and good international conditions in the years before the global financial crisis were important in the performance of the Latin American region. They were also important to the recovery. Despite global financial turbulences, external conditions have remained sanguine: high terms of trade and easy financial conditions. However, the heterogeneity of terms of trade gains in the region, in view of its general resilience, shows that better macroeconomic frameworks and greater policy space were important to implementing expansionary policies.

Table 6.1 Growth performance in Latin America, 2009–14f (percent)

Country	2009	2010	2011	2012	2013f	2014f
Argentina	0.9	9.2	8.9	1.9	3.0	2.2
Brazil	–0.3	7.5	2.7	0.9	2.4	2.5
Chile	–1.0	5.8	5.9	5.6	4.2	4.3
Colombia	1.7	4.0	6.6	4.0	3.8	4.5
Mexico	–6.0	5.3	3.9	3.6	1.5	3.4
Peru	0.9	8.8	6.9	6.3	5.5	5.8
Venezuela	–3.2	–1.5	4.2	5.5	1.0	1.5

f = forecast

Sources: International Monetary Fund, *World Economic Outlook*, October 2013; JPMorgan; Consensus Forecasts; surveys of national central banks.

A Final Look at the Region

The countries in Latin America are growing at different speeds. After severe swings in activity during the 2008–09 crisis, most countries are approaching what would be for now their growth potential. This is the perfect time to consolidate macroeconomic and financial policy gains, to look at vulnerabilities, and to build the buffers and policy space needed to remain resilient. It is also a good time to recognize what has worked and identify the challenges that lie ahead in order to foster not only macroeconomic stability but also true social and economic progress.

Most emerging-market economies exhibited strong economic performance after the global financial crisis, but their pace of growth has begun to slow. This moderation has repercussions for commodity prices, which have been declining but still remain relatively high. Declining terms of trade and closing the output gap lead to inflationary pressures and a slowdown in activity. Indeed, the super commodity-emerging-market cycle seems to be coming to an end. Macroeconomic frameworks have improved in most countries, but they can only dampen, not avoid, a slowdown. Difficult times may be ahead.

Table 6.1 shows actual economic growth since the global financial crisis (2009–12) and estimated growth for 2013–14 for the seven largest Latin American countries. Growth has weakened in the region as has been happening in all emerging markets, which is not surprising. When macroeconomic policies are appropriate, as those applied in most emerging markets, economies recover faster than potential. There is a recovery bonus given that output is below full capacity. After the recovery has taken place growth normalizes at the pace of potential output growth. The table reveals that long-term growth across countries in the region may vary between 3 and 5 percent. More efforts have to be made in order to increase long-term growth, especially in the countries with the lowest income in the region.

During the crisis, performance was very dispersed. Consider the two largest countries in the region. Mexico was the hardest hit country because the crisis took place next door. Although oil is not a very important export item, it is quite relevant from the public finance point of view, and the crisis hit not only trade with the United States but also fiscal revenues. Economic prospects are improving. The case of Brazil is remarkable since during 2009–10 its relative performance was great but seems to have been more dominated by good cyclical conditions and macroeconomic impulse than genuine high long-term growth, which is more likely to be about 3 percent or even less. Indeed, inflation has been rising, despite low growth. As I discussed in chapter 2, it is not growth but the output gap that induces inflation. Hence, the resurgence of inflationary pressures is a sign that the economy has reached full capacity. The good performance in 2009–10 has ignored some more fundamental problems that need to be resolved to spur growth. A high and distortionary tax burden, industrial policy implemented through discretionary credit allocation, and significant trade distortions impair long-term growth.

The global economic situation in recent months is what the global adjustment should be delivering. The strong monetary expansion in advanced economies, implemented through nonconventional monetary policy after they reached the zero lower bound for monetary policy, is beginning to pay off, particularly in the United States. Its economy is gaining momentum, and there are more concrete signs that its quantitative easing is coming to an end. As argued at the end of chapter 3, the weakening of emerging-market currencies in relation to the US dollar should begin once the US recovery is under way, and that is exactly what has started happening since mid-2013. This process has been reinforced by the risk of a slowdown in China, triggered by financial tensions and difficulties in changing the patterns of growth to better meet domestic demand and softening of commodity prices. It is remarkable that today the capital inflow, overheating, and currency war rhetoric has been replaced by one of slowdown, tapering of quantitative easing, and financial turmoil in emerging markets.

To a rigorous observer the change of language of public officials in emerging markets may sound awkward. At the beginning of 2013 all the problems were blamed on loose monetary policy in advanced economies and the anticompetitive effects of the appreciation of emerging-market currencies. This changed with the announcement of the potential tapering of quantitative easing in May 2013, and the reversal of currencies led to a shift in sentiments. Currencies depreciated significantly, prompting the return of fear of turmoil. Nevertheless, first, this is exactly what should happen once advanced economies start performing better, while emerging markets should see an improvement in competitiveness. And second, current tensions are minor compared with what countries had to struggle with during late 2008 and early 2009, and economies that have preserved healthy macroeconomic and financial policy frameworks as well as enough policy space should be able to handle these tensions without major problems.

Indeed, the Latin American economies have implemented sound macroeconomic frameworks, and they have the policy space to contain negative external shocks. The big risk is the capacity to use fiscal policy and the cost this may entail for the future. As discussed in chapter 2, in emerging markets, and Latin America in particular, the full extent of the fiscal expansion was not eliminated after the crisis. If the pressure to increase social expenditures is added to the mix, the financing is essential; otherwise, well-deserved creditworthiness could be damaged.

Meanwhile, weakening economic growth is fertile ground for populism. Politicians impatiently search for shortcuts and measures that will deliver quick results, regardless of their long-term consequences. As the economies have progressed, massive demonstrations have been held from Brazil to Chile to demand fairer economic conditions. Not facing the real problems and choices and postponing solutions, or rushing in with populist answers, are risky not only to macroeconomic stability but also to long-term growth.

Whether the region's macroeconomic management has been successfully upgraded will be revealed in the next few years because the exceptional external environment the region has faced in recent years is deteriorating. The region has a unique opportunity to show that its well-deserved credit for successfully managing the global financial crisis is well grounded. And this should be the basis for tackling the much-needed reforms to foster economic growth and improve social conditions.