LESSONS IN LATIN

AUSTRALIA AND LATIN AMERICA FACE THE ASIA-PACIFIC CENTURY

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This publication is the result of an ‘airport economist’ style speaking tour to the major Spanish-speaking economies of Latin America over late 2012 and early 2013 initiated by Australia’s former Ambassador to Mexico, Katrina Cooper, who was ably assisted by Ms Rachel Moseley.

After Katrina returned from post, Rachel kindly co-ordinated my visit and I was hosted in Mexico City by Katrina’s successor, Ambassador Tim George, who has made an important contribution to the publication. As well as Mexico City, I was also hosted by the Australian Embassy’s excellent staff and their Austrade colleagues in Mexico City, Bogota, Santiago, Lima, Buenos Aires and Montevideo.

The aim of the visit was to raise Australia’s economic and education profile in Latin America, through speaking engagements, media appearances on TV and in print and social media and also, by means of this publication, to tell Australian audiences more about Latin America. Some of my own observations of individual Latin American countries were published during my visit and will appear in my forthcoming book Trading Places – The Airport Economist’s guide to International Business (New South Publishing – UNSW Press), so I thought this publication would be well served by inviting six distinguished economists to tell the story of their own countries. Accordingly, I would like to thank my co-authors for their excellent contributions.

Whilst the views expressed are those of the authors alone, my trip was well supported by the diplomatic community in both Australia and Latin America so thanks are due to the Ambassadors:

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Claudia Jarjoura, of Jarjoura Design, a successful Latin American ‘import’ to Australia, again showed her magnificent design skills in the creation and lay out of the publication. Like everything Claudia does, the product is world class.

LATIN LESSONS – AUSTRALIA AND LATIN AMERICA FACE THE ASIAN CENTURY CAN BE USED AS A COMPANION TO ANOTHER COALAR PUBLICATION I CO-AUTHORED WITH THE LOWY INSTITUTE ON BRAZIL TITLED GREAT SOUTHERN LANDS – BUILDING TIES BETWEEN AUSTRALIA AND BRAZIL PUBLISHED THIS TIME LAST YEAR.

I hope that with Great Southern Lands, and Trading Places, that Latin Lessons will become a useful guide for business, students and others in the community wanting to learn more about Latin America and Australia.

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FROM COMPETITION TO COLLABORATION

Australia and Latin America have been separated by geography, culture and their different economic links. Historically, because of their respective colonial ties, Latin America looked to Europe whilst Australia looked to England, and we’ve been in different hemispheric ‘spheres of influence’ ever since.

But things are changing in the 21st century, as Asia and the emerging markets are on the march and Australia and Latin America find they have more in common in the Asia-Pacific century than they have had in the past.

Both continents are resources rich. Both continents have strong agricultural sectors. Both rely on immigration in part for their human capital. Both combine a rich indigenous culture with former colonial institutions. Both survived the global financial crisis and the sub-prime crisis largely in-tact.

Whilst in the 20th century, Latin America and Australia were considered to be distant competitors as commodity exporters, in the 21st century they are now working together through intra-industry investment and technological and management exchange to feed Asia (particularly China) and supply the region with industrial raw materials and professional services. Also, we are both looking to collaborate in international economic institutions (like the WTO, APEC and G20).
Latin America and Australia also have strong potential to work together because we share common values like openness, democracy, human rights and the rule of law. In fact, it was our democratic Parliamentarians who drove the bilateral relationship and recommended establishing institutions like COALAR to provide policy advice and enhance business engagement. The Parliamentarians also encouraged Australia and Latin America officials to work together and become great allies in multilateral institutions that govern the international economy such as the WTO, APEC and the G20. Classic examples of this is the co-operation are the Cairns Group in the GATT/WTO, spearheaded by Australia and the agricultural exporting nations of Latin America and, more recently the G20.

Following the Parliamentarians’ lead, businesses are now looking to form similar relationships and institutions as have been developed in the political sphere. And naturally, our research and academic institutions are looking to complement this with wider and deeper education partnerships and people relationships between Australia and Latin America.

In fact, it is the emphasis put on the need to strengthen economic and political institutions that has led Latin America to look to Australia in the first place. Many of my Latin American hosts and guests say that Australia is the place that Latin America could be “if it turns out right”. Whilst younger generations know democracy and relative economic prosperity, those leaders in business, government and community who have experience of darker times know how economic institutions are contributing to political stability, economic prosperity and social cohesion. And it is Australia’s economic institutions, not the sunny beaches and love of sport (that Latin America has already), that explain why many leaders in political, business and community in Latin America aspire to be like Australia.

In this regard, this report has been influenced by two books: firstly, the work by two Harvard/MIT scholars, Daron Acemoglu and James A. Robinson Why Nations Fail; and secondly, Ian McLean’s excellent economic history of Australia, entitled Why Australia Prospered. Both works tell us why institutions are so important in determining a nation’s future economic prosperity and political stability.

Acemoglu and Robinson take a journey through the history of the world to see why some nations have succeeded economically and others have been a disaster even when they had similar endowments of natural resources, climate or historical culture. The central thesis of their argument is that nations
that build inclusive and democratic political and economic institutions will do better economically than nations that don’t. It doesn’t matter if a nation has an abundance of mineral wealth and natural resources, because if they don’t get the institutions right, with democratic inclusivity, fairness and the protection of property rights so citizens have the incentive to invest, save and innovate, the nation can squander its inheritance.

McLean’s book tracking Australia’s economic history stems from his historical work comparing lands of recent settlement, in particular, Australia and Argentina (a comparison also made by Acemoglu and Robinson in Why Nations Fail).

A century ago, both Argentina and Australia (and Buenos Aires and Melbourne in particular) were two of the richest place in the world. But whilst Australia developed inclusive institutions and resisted the squattocracy, Argentina allowed land-owning oligarchs to flourish, with extractive and exclusive institutions, which forced the mass of the population to support Peronist policies. This had an adverse impact on the historical development of economic institutions and the eventual economic performance of Argentina relative to Australia, despite both coming from good starting points in the late 19th century.

Even in recent years, at the beginning of the 21st century we can see how economic institutions and their capacity to allow economic reform still matter when external shocks affect export-orientated countries like Argentina and Australia.

In fact, Australia’s recent economic success is due to the reform of its economic institutions. For example, in opening up to Asia, the Hawke-Keating Government in the 1980s brought fundamental reforms such as the floating of the dollar, reduction of tariff barriers, the introduction of superannuation and other domestic restructuring. This enabled Australia to prosper in the Asian Century, turning our historical ‘tyranny of distance’ position into ‘the power of proximity’.

But as McLean shows, the contrast with Argentina, a similarly resource-endowed southern hemisphere economy, couldn’t be greater. Whilst Australia floated the dollar, enabling the economy to have a shock absorber whilst we reformed our economic structures, Argentina fixed the peso to the US dollar, making exports too expensive and imports cheap, which, coupled with debt and default, destroyed confidence in Argentina’s institutions and security in their property rights and banking system. Now Argentina knows it needs to rebuild trust and confidence in its institutions, so it can take full advantage of its natural resources and highly educated, sophisticated workforce. And that is perhaps why Latin America – particularly Argentina – has been interested in Australia’s institutional story as much as our economic indicators.
Of course, even beyond the study of institutions, when Latin America looks to engage with Australia, ours is a straightforward picture as we are an island continent - a continent for a nation and a nation for a continent. But for Australia to look at Latin America, it is not as simple. Latin America is such a diverse and exciting place that we decided in this report to focus on the key Spanish-speaking economies that have potential trade ties with Australia – Mexico, Colombia, Peru, Chile, Argentina and Uruguay as we had already concentrated solely on Portuguese-speaking Brazil in the companion to this report titled: Great Southern Lands – Building ties between Australia and Brazil.

In each chapter a distinguished economist tells the story of their native land – its economy, its society, its political institutions and the potential for forging trade links in the Asia-Pacific and with Australia in particular.

The narrative covers trade and commercial links in ‘rocks and crops’ (mining and agriculture), manufacturing, professional services and education, travel and tourism, as well as the creative industries.

In the first chapter on Mexico, Jose Antonio Ardavin, the Director of the OECD in Mexico City, explains the chequered 19th Century economic history of Mexico complicated by its relationship with the USA (which had annexed California, Texas, Arizona and New Mexico). He takes us through the recent experience of re-establishing democracy in Mexico in the 2000s, and the impact of NAFTA, the so called ‘tequila crisis of 1994’ and the 2008 global financial crisis stemming from the collapse of Lehman Brothers, an event that hit Mexico particularly hard. He believes that Mexico has now put that period behind it and in a new spirit of openness, democracy, moderate economic growth and macroeconomic stability, that the world may experience ‘The Mexican Moment.’ But to fulfil its potential, Mexico must, he believes, undertake serious economic reform in education, human capital, pension reform, energy reform and competition - a process that has begun under President Pena Neito’s ‘Pact for Mexico’ reforms.

For Australia, along with the bilateral ties in resources, most collaboration comes in education and human capital (strong ties in higher education institutions and technical skills), and Mexico has been studying Australia’s Productivity Commission and other economic institutions. Mexico is a member of the G20 and would be a strong player in the TPP if it were to establish itself in world trade and Mexico and Australia recently joined fellow middle power G20 countries Indonesia, Turkey and South Korea in
the MITKA alliance, showing Mexico’s pivotal status in Asia-Pacific strategic economic policy.

Mexico’s size and scale has impressed the Australian Ambassador to Mexico, Tim George, who says: “What has really struck me is Mexico’s significance globally as a major exporter of increasingly sophisticated manufactured goods, its depth of integration into North American supply chains, and its enormous economic potential more broadly. Its sound macro-economic credentials, the outward orientation of its economy, its impressive and far-reaching reform agenda, and its demographics all mean Mexico is on a very good trajectory. It will be a top ten economy before long, and could go significantly higher.”

In Colombia, world renowned academic Mario Garcia-Molina explains the improving economic performance of Colombia that has been overshadowed by its drug cartel and security issues of past decades. The peace dialogues with FARC (the main guerrilla movement) are key to the country’s revival, along with major investments in the health system, education and social policies to reduce inequality. Colombia is an enthusiastic member of the Pacific Alliance and APEC and attempting to escape its past and being overly tied to an Andean trade bloc alone. Australian businesses in mining and education have long considered Colombia the Latin American economy with the most potential – given its outstanding reserves of human capital with its cohort of highly educated, sophisticated, services-orientated young people – and the nation has made great strides to improve its National ‘Brand’ status and trade ties in the Asia-Pacific.

**PERU IS A CLASSIC EXAMPLE OF THE GREAT IMPROVER IN THE LATIN AMERICAN ECONOMIC STAKES.**

Pablo de la Flor describes Peru as ‘The Andean Jaguar’ and highlights its strong growth rates (6.4 per cent p.a. on average over the decade), low inflation (averaging 2.5 per cent) and improving its per capita income stakes so it has achieved middle income status, like a hiker reaching Machu Picchu in record time. Peru’s success is a trading story not just within the Andean states and Latin America but also beyond the continent into Asia (China takes 17 per cent of Peru’s exports and trade with Beijing is now more important to Lima than trade with Washington). Australia’s contribution to Peru’s success has mainly been in mining but also in agriculture, education and tourism (Machu Picchu is famous but Lima has become a gastronomical destination for Australian ‘foodies’). Australian Business Leader Chris Gale, the Managing Director of Latin Resources, has highlighted Peru’s “tremendous upside as a mining country with excellent geology, very user friendly in terms of exploration and the Peruvian government has been more than helpful in terms of green fields and resource definition.”
Peru has also pushed APEC and the Pacific Alliance (being a member along with Chile, Colombia and Mexico). Peru’s main fear is that it could run out of steam after its spectacular growth and fall into the ‘middle income trap’, hence its search for new markets in Asia and the Pacific to maintain rising living standards.

**Chile has of course been the poster child for Latin American economic performance for many years and has kept that reputation as it transformed itself from dictatorship to a fully-fledged democracy after a carefully managed national reconciliation.**

As Nicolas Munoz of the Foreign Investment Committee of Chile points out, free-trade and an open economy has been a cornerstone of Chile’s economic strategy and in many respects Chile has been the model that other aspirational nations in Latin America have been looking to as an example. As Munoz notes, Chile is an attractive destination for foreign investors with many Australian companies like BHP Billiton and WorleyParsons basing their Latin American operations in Santiago.

But the question for Chile is, what next? You can only open your economy once and only negotiate so many free-trade agreements with so many countries. In this regard, ‘Red Hot’ Chile is already ahead of the game, concentrating on innovation and investment as well as trade, making Chile a launch pad for innovation into third markets. Hence the importance of the work of CSIRO Chile in providing mining and minerals processing technology and training in Santiago and for Peruvian post-graduate students in the northern Chilean mining town of Antofagasta. The rise of ‘Chilecon Valley’ and other examples of Chilean innovation is attracting attention - and investment - from Australia.

In the chapter on Argentina, high profile Argentine economist Tomas Bulat explains the role of economic institutions in Argentine history and how economic reform can unleash the potential Argentina has in agriculture, viticulture, human capital and education and even in mining if the institutional framework were to be improved. **Bulat cautions of the “mood swings” of the Argentine economy but still sees ‘potential for growth’ if Argentina follows a more open economy framework being “respectful of international rules and agreements.”**

Of course, many economic historians and scholars like Acemoglu and Robinson and McLean have twinned Argentina and Australia in terms of economic development, but what of Argentine-Australian bilateral ties? The Australian Ambassador to Argentina, Patricia Holmes, sees potential for Australian-Argentine collaboration and is making higher education ties a priority so future generations of Argentines have exposure and access to Australia in terms of their professional development so they can apply these skills in their home country. Her nominated sectors for further bilateral collaboration are primary industry and related professional services: “The big interest is in investment and the potential of mining services; in agriculture, it’s
technology, water management and genetics.”

Finally, in the chapter on Uruguay, Mariana Ferreira, Head of the Competitive Intelligence Unit of Uruguay XXI, tells the economic story of a nation whose geography seemed to work against its economics, particularly at the turn of the 21st century when its giant neighbour Brazil suffered a devaluation in 1999 and then Argentina was hit by an overall economic crisis in 2002.

Despite this setback early in the new millennium Uruguay has recovered with a respectable 6 per cent growth rate (between 2005 and 2012) and reasonable fiscal and monetary policy management. Uruguay is an export-orientated open economy with most of its foreign investment stemming from neighbours Brazil and Argentina, the USA and Europe rather than Australia and the Asia-Pacific. Had Uruguay been able to be more like Chile and not hemmed in by Mercosur (the trade pact with Brazil, Argentina, Paraguay and now Venezuela), its trade and investment story could have been much different. However, as the author says, Uruguay is a ‘plucky’ or ‘maverick’ country and has moved fast in terms of social reform under its colourful but frugal President. Progress in social issues, in health and education, family arrangements and reducing the digital divide has been prominent. The strong interest in Public Private Sector Partnerships (PPP) has attracted attention and guidance from Australia as Uruguay attempts to balance economic prosperity and social cohesion in how it develops its national infrastructure assets. Ricardo Varela, Uruguay’s Ambassador to Australia, has highlighted resources and agriculture as potential areas for bilateral collaboration: “Globalisation is bringing our regions closer. Uruguay is starting some mining activities, which has brought new opportunities to do business and exchange experiences. Both countries need to feed the world, and by sharing this responsibility we shall work together.”

WHAT IS APPARENT AFTER LOOKING AT EACH ECONOMY IN DETAIL IS THAT THERE ARE DIFFERENT CHALLENGES FACING LATIN AMERICA IN TERMS OF POLITICAL ECONOMY.

There are the open economies of Mexico, Chile, Peru and Colombia that have formed the Pacific Alliance and are signing trade agreements with Asia and each other to spread the benefits of trade and investment to their population to improve living standards. Then there are more closed economies like Argentina which are more interventionist and populist, running positions closer to Venezuela. Then there is Uruguay who given its open agricultural sector, could perhaps be more like a Pacific Alliance country but is constrained by being tied to its larger neighbours Brazil and Argentina via the Mercosur trade pact. Accordingly, could Uruguay combine the strong social justice focussed policies of its President...
with the open economy model of its Pacific Alliance partners?

Overall, the report’s co-authors are cautiously optimistic about the forging of stronger ties between Australia and Latin America, particularly as the Asia-Pacific region becomes more influential in the global economy and international political institutions. Just as we economists have collaborated to produce this report on Latin America and Australia in the Asia-Pacific century, we hope our respective nations can do the same thing in terms of trade and people flows in years to come.

We hope this is a sound start along that journey.
Throughout its long history, Mexico has been one of the vital economic drivers of the American continent. In ancient pre-colonial America, what we know today as Mexico and Peru were the most important economic and trade centres.

This importance was reinforced during the Spanish colonial period, with New Spain (as Mexico was called) becoming a relatively prosperous economy, with important mining, agriculture and trading industries. During the colonial period, Mexico’s GDP per capita was greater than that of the United States. At the time of Mexico’s independence, in 1821, that ratio was close to 60 per cent, and has declined since then towards a level between 20 and 30 per cent (See Figure 1).

The 19th century is a very complex stage of Mexican history, both in political and
economic terms. Instability and internal conflicts derived from foreign intervention and the loss of more than half of the territory to the United States (what today is California, New Mexico, Arizona and Texas). However, the century ended with a period of relative stability, known as the “Pax Porfiriana” whereby the country established an important railroad infrastructure, created a modern financial and banking system, and its trade with various nations of the world flourished. However, growing inequalities and the urge for a change after a 30-year dictatorship led to the Mexican Revolution, which again translated into significant economic losses. From 1920 to 1935, while Mexico started a new period of institution-building (including, for example, the Central Bank), the country grew at only 1.6 per cent, driven in part by the significant impact of the Great Depression on the Mexican economy, which produced a decline of 12.9 per cent in 1932.

More recently, during a large part of the 20th century, Mexico had a period of relative prosperity and growth, which was even characterised as the “Mexican miracle”. During the fifty years
that followed the recovery from the Great Depression, Mexico grew at an average annual growth rate of 6.6 per cent. It was a time of rapid industrialisation, based on the import substitution industrialisation (ISI) model, which many countries of the Latin American region and other Asian countries pursued. This was also a time of significant structural transformation, with migration from rural areas to urban areas, and, at least until the mid-70s, a period of macroeconomic and financial stability, with a fixed currency exchange of 12.5 Mexican pesos per US dollar which lasted for close to 30 years.

At the risk of oversimplifying, it can be said that the period of high growth and stability (1950-1970) known as “desarrollo estabilizador” (stabilising development) was followed in the 1970s by a period of very high growth without stability, then in the 1980s, by a period of low growth without stability, and finally in the 1990s and 2000s by a period of low growth with stability. Let me further elaborate on this.

By the 1970s, the model of growth with stability that allowed Mexico to grow at rates close to 7 per cent per year, started to show weaknesses. In particular, most of the low-hanging fruit of import substitution were already in place (consumer and intermediate goods and some capital industries), but having the economy closed at a time of important industrial and technological advances limited the absorption of technology and created an overly protected industrial sector not familiar with external competition. At the same time, growth was not sufficiently capable of reducing income and regional inequalities.

A NEW STRATEGY WAS IMPLEMENTED THEN, MORE FOCUSED ON REDISTRIBUTION OF INCOME, INCREASING SOCIAL PROGRAMMES THROUGH GREATER ECONOMIC DEFICITS.

Mexico was confident in assuming a larger debt, to a great extent because of the very favourable circumstance of the discovery of the largest oil reserves in Mexican history, the so-called Cantarell oil field, which has allowed Mexico to return to the international markets as a net oil exporter since 1974. However, the very favourable external conditions current until then started shifting radically in 1973 with the oil embargo and the abandonment of the Bretton Woods system. This put Mexico in a very complicated situation, forcing a large devaluation of more than 60 per cent in 1976, and by the time a new external shock in the terms of trade

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1 The use of this typology, in particular the reference to the last period of Mexico as “estancamiento estabilizador” (stabilized standstill) could be attributed to Francisco Suarez Davila. See Suarez Davila (2013). 2 Ortiz, Romero and Diaz (2010) Expansion Magazine
came in the early 1980s, Mexico had no alternative but to stop debt payments, initiating the Latin American debt crisis.

A dramatic process of fiscal adjustment and economic reforms started, including the opening of the economy to international trade and the reduction of the government apparatus through privatisations. This occurred not only in Mexico but also in the rest of Latin America. Mexico was, however, one of the most active reformers of the so-called Washington consensus. The immediate results did not increase growth levels. The decade of the 1980s, which for the world represents a revolutionary decade in many technological, economic and social respects, is known by many Mexicans and Latin Americans as the “lost decade”.

A new wave of hope came in the 1990s, as Mexico, having regained access to international financial markets and earned a good reputation with a number of important political and economic reforms, was ready to embark on a major project, the North American Free-trade Agreement (NAFTA), which came to effect at the start of 1994. A number of events, including

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3 Lustig N (1995)  
4 While there is some debate, this phrase is usually attributed to Michel Camdessus. See for example Ortiz Martinez (1998), Fischer (2001), Boughton (2001).
due to the need to rescue several banks and financial institutions. Therefore, the credibility of the reforms implemented up to the point that was seriously damaged.

A new wave of hope came in 2000, as the country made a major step in its democratic life by electing the first president from a party other than the PRI, which had ruled for the previous 70 years.

Markets responded very favourably to this achievement, but unfortunately international conditions changed after the dot-com bubble burst. While other Latin American countries managed to grow at record levels from 2003 to 2008, linked among other factors to growing Chinese demand and high commodity prices, the Mexican economy, so closely linked to the US industrial cycle and facing tough competition from China in its exports to the United States, had a relatively disappointing 2 per cent average annual growth, partly because there was no consensus on major economic reforms.

The 2008 global financial crisis hit Mexico quite hard, mainly through the real estate sector, as result of its economic integration with the United States. In 2009, Mexico’s GDP declined close to 7 per cent. However, in comparison to previous crises, and particularly to the one of 1995, the better macro-economic conditions allowed the country for the first time in many years to pursue countercyclical measures that avoided a massive decline in employment (4 per cent) and in the purchasing parity of salaries (-2 per cent only). Moreover, the performance of the Mexican economy since 2010 has been quite remarkable, with double the rate of growth of OECD countries and avoiding a financial or fiscal crisis, as had been the case for so many other regions. Indeed, macroeconomic stability finally paid its dues, and most economic and political actors recognised its value.

Against this background, and after having had a second peaceful political transition, Mexico is experiencing a new wave of hope. Many observers, knowing recent Mexican history, insist on keeping optimism at a moderate level. With the majority of the Mexican population having lived in either a period of crises or a period of relatively slow growth, there is a young generation who are sceptical whether Mexico can ever achieve high rates of growth and become a prosperous nation. Nonetheless, a number of cumulative changes over the past decades might be starting to bear fruit in setting stronger foundations for growth. The next sections provide an assessment of Mexico’s recent achievements and remaining challenges, along with relevant opportunities of engagement and partnership with a country such as Australia.
At present, Mexico is the 14th-largest economy in the world and is set to be part of the top ten by 2030 and become the 7th-largest economy in the world some time between 2040 and 2050.\footnote{Goldman Sachs projections, Wilson Trivedi Carlson and Ursua (2011)}

Mexico is comprised of 32 very diverse states, some as large as Chihuahua with 247,460 km², close to the area of New Zealand, or as populated as the State of Mexico, with around 16 million people, not very far from being the population of Australia. While during the past two decades the country has not reached the high growth rates that other emerging markets achieved, Mexico has been able to grow moderately in a balanced fashion, gaining market share in the North American market, expanding its own consumer market with a growing middle class, and strengthening its economic and political institutions.

One of the major achievements of the recent decades is macroeconomic stability. Mexico has maintained fiscal and monetary discipline since the aftermath of the 1995 crisis. At present, the country is subject to a floating exchange rate regime and inflation has been single-digit for close to two decades near the annual inflation target of 3 per cent with a band of +/- 1 per cent. This has allowed for a better environment for investment, with the lowest real interest rates and the longest maturity of government and private bonds in recent history. On the fiscal front, all political actors (government, congress and more recently local governments) have been subject to self-imposed fiscal rules that leave Mexico today with a much better fiscal position than many of its OECD and emerging market peers. In addition, over the past decade, the private and public pension systems have been reformed, creating a system of individual accounts which has created a good amount of fiscal space and provided a new source of funding for long-term investment.

All this has contributed to enhancing the scope of the financial market.
| TABLE 1 | MEXICO : MAIN ECONOMIC AND SOCIAL INDICATORS 2009 AND 2014 |
|-----------------------------------------------|-------------------------|-------------------------|
| DEMOGRAPHICS | | |
| Total Population | 000 Persons | 98,439 | 110,023 |
| Population Growth Rates | % | 1.4 | 0.7 |
| Youth Population Aged Less Than 15 | % of Population | 34.0 | 27.0 |
| Elderly Population Aged 65 and Over | % of Population | 4.7 | 6.3 |
| PRODUCTION AND INCOME | | |
| GDP | Bln USD Current PPPs | 985.9 e | 2012 |
| GDP Per Capita | USD Current PPPs | 10,034 e | 18,288 |
| Real GDP Growth | Annual Growth % | 6.6 e | 3.9 |
| ECONOMIC STRUCTURE | | |
| Agriculture, Forestry, Fishing | % of Total Value Added | 3.3 | 3.0 * |
| Industry | % of Total Value Added | 37.8 | 36.0 * |
| Services | % of Total Value Added | 56.3 | 60.0 * |
| SELECTED MACROECONOMIC INDICATORS | | |
| Government Deficit | % of GDP | .. | -0.1 * |
| General Government Debt | % of GDP | .. | 37.7 ** |
| Inflation Rate | Annual Growth % | 100.0 | 4.1 |
| Exchange Rate | MXN per USD | 9.46 | 13.17 |
| SELECTED TRADE AND FDI INDICATORS | | |
| Imports of Goods And Services | % of GDP | .. | 34.6 |
| Exports of Goods And Services | % of GDP | 29.1 e | 33.0 |
| Inflows of Foreign Direct Investment | Mln USD | 18,001 | 8,946 |
| Outflows of Foreign Direct Investment | Mln USD | .. | 19,554 |
| SELECTED SOCIAL INDICATORS | | |
| Tertiary Attainment in Population Aged 25-64 | % | 14.6 | 17.4 ** |
| Unemployment Rate: Total Labour Force | % | 2.5 | 5.0 |
| Life Expectancy At Birth | Years | 74.1 | 74.4 |
| Infant Mortality | Per ‘000 | 23.3 | 13.6 * |

% = per cent; e = estimation; * = 2011 figure; ** = 2010 or latest available figure.

For example, between 2009 and 2012, close to 26 Development Capital Certificates (CKDs) were placed on the Mexican Stock Exchange (BMV). These are innovative financial instruments designed to enable Retirement Fund Administrators (AFORES) to invest in private equity infrastructure projects in the country, for an accumulated amount of close to 68.5 billion pesos\(^6\). Notwithstanding this, Mexico still faces the challenge of extending financial services to large parts of the population and SMEs which lack access to these services, and thus increase financial intermediation as a lever of the economy, which is still relatively small compared to other industrialised and emerging markets. The country also benefits from a large demographic bonus which started approximately in 2006 and will end towards 2028. During this period, the dependency ratio (children 0-14 and elder population over 60 divided by the working-age population) will be at historically low levels. At present, 29 per cent of the population are less than 15 years old and 64 per cent less than under 35 years\(^7\). All these young people are joining and are expected to join the economically active population and increase it from approximately 50 million in 2010 to close to 64 million by 2030 and reach a historic maximum of around 66 million towards 2042\(^8\).

This is both a window of opportunity and a challenge, since during the first years of the 21st century Mexico has already had to create over 800,000 jobs per annum. This has been a tough target to reach at the rate of growth of the economy, and many of these young people have had to join the informal market. Informality is very widespread; according to some measures, half of the employees in the country have an informal job and this is one of the main causes of the low productivity of the Mexican economy, which is for many people, including the current government, the greatest challenge to tackle. Informality is also linked to the education system, which, despite having reached practically universal coverage in primary education, has many students who leave the system during the secondary stage, and the quality of education has significant room for development. According to the PISA 2012 survey, less than 70 per cent of 15-year-olds are enrolled in school, and close to half of them (55 per cent in mathematics, 41 per cent in reading) obtained results considered as insufficient to perform productively in the modern working environment.

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More recently, the country has benefited from low energy prices, linked to the greater availability of unconventional gas in the United States.

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\(^6\) Promexico. Negocios Magazine III-IV 2013 \(^7\) CONAPO (2013), projections for 2013. \(^8\) idem
This new energy paradigm has provided a fresh degree of competitiveness for Mexican industries, building on other comparative advantages such as its close proximity to the US market (see next section). In the energy field, however, Mexico still has important challenges to overcome. Although the country is an oil exporter, in 2013 Mexico produced around 2.5 million barrels per day, almost 1 million barrels less than in 2005. Since the energy industry had been (until very recently) restricted to the public sector, much of the investment needed to increase production capacity, explore new oil fields in deep waters and exploit the significant reserves of shale gas that the country has, it had to compete with other investment and expenditure needs of the government. Every year, between 30–40 per cent of the revenues of the government come from the state-owned oil enterprise, PEMEX.

In 2004, a group of Mexican economists produced a number of ideas about why Mexico was not growing rapidly enough. The main factors they identified are not very different to some of those already described: low productivity of investment; an inefficient system of financial intermediation; a relatively low use of the advantages of free trade; a weak internal market; insufficient creation of formal employment; the inadequate education system; lack of equal opportunities; insufficient technological innovation; a weak government in economic terms (with low revenues, strongly dependent on oil revenue streams) prone to inflationary financing and with an ambiguous agenda; lack of capacity to reach political and democratic accords and implementing efficient public policies and weak rule of law.

Many of these challenges have been addressed incrementally over the past decade. Since 2012, however, it merits highlighting that there has been a marked change in the last point referred by this group of economists: the capacity to reach political and democratic accords. After having undergone its second change of federal government, (with the return of the centre-left PRI after twelve years of the centre-right PAN. It is important to note the fact that neither of these two parties have governed the capital, Mexico City, over the past 15 years, which has been ruled by the left-wing party PRD) there has been a mature recognition by the three most important political parties of the need to advance a common, transformational reform agenda.

THE RESULTS HAVE BEEN QUITE IMPRESSIVE, WITH A NUMBER OF IMPORTANT PENDING STRUCTURAL REFORMS APPROVED BY CONGRESS IN THE PAST FEW MONTHS:

- The labour reforms, approved during the transition between President Calderon’s administration and President Pena Nieto, significantly updated labour market regulation which had been unchanged since 1970. The law establishes new types of contracts such as temporary and training contracts, and provides much more certainty to businesses and provides better incentives to workers by establishing a limit to the cost of unfair dismissal cases, which due to the extended length of hearings, could reach extraordinarily high levels. These changes are expected to favour young people and women who faced difficulties in accessing the formal labour market.

- A constitutional reform of education and subsequent reforms in secondary education legislation have established a new framework for evaluation, professionalisation and advancement of teachers in their careers, as well strengthening the independence of an existing National Institute for Evaluation of Education. In addition, the once strong influence of the national teacher’s union in education policy has been limited to labour related issues. The changes in this field are still subject to strong resistance from some of the more radical teachers. Notwithstanding this, the greater control of the state over education policy will strengthen and facilitate a good number of reforms previously achieved and oriented towards improving the quality of education.

- On competition, in 2010-2011 Mexico passed an important reform aimed at strengthening the competition authorities. In 2013, a new constitutional reform was passed, along with the reform of the telecommunications industry, granting to the competition authority and to a new telecommunications regulator, IFETEL, constitutional autonomy and strong powers to enforce the law. This will foreseeably improve the efficiency of markets and competition in many sectors, benefiting consumers who, until 2012, paid prices on average 30 per cent higher due to high concentration in many industries. This was particularly relevant for the telecommunications sector, which despite incremental advances, remained very dysfunctional with a very strong dominance of a single operator in mobile and fixed telephony as well as broadband services. The reform also intends to promote a more efficient use of the Mexican spectrum to increase connectivity rapidly throughout the country as a means to enable greater productivity across sectors.
• **More recently, Mexico approved a major financial reform in September 2013.** This reform is aimed at broadening access to credit to a larger proportion of individuals and businesses, and to promote greater credit provision incentives to banks. Mexico’s Central Bank has estimated that this reform could add 0.5 percentage points to growth in two to three years.

• A fiscal reform was approved in October 2013 along with a new budget that includes a broadened old-age pension scheme and a new unemployment insurance programme. According to many observers, while the fiscal reform was not the transformational one that many expected, it does close a number of loopholes and simplifies the income tax system and equalises VAT rates throughout the country (the Northern states had a lower rate). Though many exemptions remained in this tax, special consumption taxes were introduced on flavoured drinks and so-called “junk” food as a measure to combat and prevent obesity. A number of ecological tax measures were also introduced.

• **The energy constitutional reform approved in December 2013 is a major breakthrough in Mexican politics, which, while keeping the ownership of oil and natural resources with the Mexican state, and strengthening the capacity of its regulatory bodies, ends the monopoly of the state over the oil sector and over energy production and commercialisation.** The reform introduces new contractual schemes allowing complementary investment by the private sector into exploration for oil and natural gas. The reform also provides for greater autonomy for the state oil company, PEMEX, and the electricity company, CFE, to improve their operations and achieve greater efficiencies. It is expected that the entry of private investors into this sector will add significant dynamism to the Mexican economy.

**Mexico started this battery of reforms not under the stress of a recession but while growing in 2012 at a rate double that of other OECD countries.**

During 2013, a number of factors diminished its growth, including the lower-than-expected performance of the US industrial sector, lower government expenditure during the first half of the year linked to the transition of government during the year, and a relatively complex year for the housing sector which faced a new regulatory environment promoting compact cities contrasting with their previous investment strategies in city peripheries. Despite this situation, markets and investors are already incorporating in their analyses positive growth perspectives for Mexico for the rest of the decade, as shown by the long-term GDP growth consensus forecasts (see Figure 2). The full implementation of the mentioned reforms will be critical for maintaining this positive perspective. The efforts of the country to improve security and strengthen the rule of law would certainly reinforce this trend.
Mexico is a country in the world that actively takes advantage of its multiple ‘citizenships’: it is Latin American in its deep roots, culture and language, North American in its deep economic ties with the United States and Canada, and closely linked to Central America and engaged in the latter’s development. It is also a country of the Caribbean, sharing with these countries the beauty of its beaches as a worldwide tourist destination, but also sharing with them the risks of climate change and the challenges in terms of disaster risk management. It is also a country in the Pacific basin, increasingly linked to the growth and opportunities that this region offers. Finally, Mexico takes part in the OECD and in the G20, and has played a key role in those groups as a bridge between industrialised and emerging countries.

The opening up and integration of Mexico to the world started in the 1980s when the country joined the GATT. During that decade a major transformation occurred in the economy, with Mexico successfully diversifying its export base from being an oil-exporting-country, with oil exports representing 80 per cent of its exports, and turning itself into a manufacturing hub, where by 1995, just one year after NAFTA started, oil exports represented only 11 per cent of exports (see figure 3, Panel A).
NAFTA significantly transformed the country. The US-Mexican border is one of the busiest in the world, where USD$1 million in merchandise is traded across the border every minute and 1 million people cross every day. As shown in Figure 3 (Panel B), since NAFTA, trade has increased in almost every field of the economy. Agricultural exports more than tripled, extractive-industry exports increased six-fold by 2010 and have been experiencing a new boom, being twelve times larger in 2012 than in 1994. However, agricultural and extractive-industries exports only represented 3 per cent and 2 per cent of total non-oil exports in 2012, with manufacturing exports, which have also grown six-fold during the NAFTA years, reaching USD$300 billion that year, covering the remaining 95 per cent.

In that regard, Mexico could be considered a trade liberalisation success story. Trade represents 60 per cent of its GDP and it is now the world’s 14th largest exporter of goods, and the 35th largest exporter of services. Mexico currently has trade, investment and economic co-operation treaties with more than 40 countries, which jointly represent 75 per cent of world GDP. These impressive changes, notwithstanding, at least two important challenges limit the country’s capacity to take full advantage of that success: firstly, the benefits of trade have been strongly regionally localised in the Northern states; secondly, while the in-bond “Maquila” industry, which has been responsible for a great part of Mexico’s trade success (more than 5,100 production units which represent approximately 17 per cent of GDP according to INEGI, and providing jobs to 2.3 million people), this type of production tends to generate less value-creating activity upstream and downstream in the production process.

Therefore there are wide opportunities for better integration of Mexican SMEs into Global Value Chains (GVCs), so as to improve the productive capacity of the whole Mexican economy and produce many of the high-quality inputs and services required in more sophisticated parts of production processes.

The cluster of automotive industries in Mexico is a good example of the degree of integration of the Mexican economy into GVCs and its regional impact in terms of the creation of a sophisticated labour pool. Mexico is the world’s eighth-largest car producer, assembling 3 out of every 100 cars produced globally. This industry, which accounts for 4 per cent of GDP, 20 per cent of manufactured goods, and 27 per cent of total exports, is distributed across the central and northern axis of the country, with relevant specialisations. States in central Mexico account for 62 per cent of vehicle production while Northern states produce 57 per cent of auto parts.

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PANEL A. STRUCTURE OF MEXICAN EXPORTS (PERCENTAGE OF TOTAL EXPORTS)

% = per cent. Source: INEGI (2013)

PANEL B. EVOLUTION OF EXPORTS BY SECTOR BEFORE AND AFTER NAFTA (1994=100)
Five States (Puebla, Coahuila, Aguas Calientes, Sonora and Estado de Mexico) produce close to 75 per cent of light vehicle production (cars, SUVs and pick-up trucks).

The cluster is composed of 19 assembly plants and more than 300 tier 1 suppliers for leading companies worldwide, located in the same states or neighbouring states where large auto manufacturers have their plants. The Mexican automotive industry is expected to continue growing at an annual rate of 6.8 per cent until 2015, with sales growing at 7.46 per cent during the same period.

Other relevant high-tech clusters have been established in Mexico taking advantage of its relatively large pool of engineers and technicians. Despite the previously mentioned challenges in the field of education, Mexico’s universities and specialised schools graduate 130,000 engineers and technicians a year\(^\text{12}\), more than Canada, Germany or even Brazil, which has nearly twice the population of Mexico. The electronics industry (communication, audio, video and medical appliances, computers and semiconductors) and more recently the aerospace industry are good examples of high value added industries thriving in Mexico.

The electronics industry employs close to half a million people and exported more than USD\$75 billion in 2012\(^\text{13}\). More than half of the Mexican States have productive capacity in these fields, especially in Baja California, Tamaulipas and Chihuahua. Mexico is also strong in the home appliances industry, being the number one global exporter of fridge-freezers, number two in washing machines, and the third-largest exporter of air conditioners, gas stoves and electric water heaters, and other similar goods\(^\text{14}\). Mexico’s Aerospace industry, for its part, was established just one decade ago, and has evolved at a fast pace, with a 20 per cent average growth rate since 2004, from manufacturing simple parts and assemblies to larger scale production of turbines, fuselage, harnesses and landing gear, among other products; and it has become the sixth-largest provider to the US market and the 14th-largest worldwide, reaching a volume of exports of USD\$5.04 billion. In 2012, there were 270 aerospace companies established in Mexico which in that year alone created 32,000 jobs, mainly in the two important hubs of the industry, Baja California and Queretaro\(^\text{15}\).

\(^{12}\) Association of Universities and Higher Education Institutes (ANUIES, for its acronym in Spanish)  
\(^{13}\) Promexico Negocios Magazine September 2013  
\(^{14}\) idem  
\(^{15}\) Promexico Negocios Magazine, May 2013
FIGURE 4. SPECIALISATION IN THE AUTOMOTIVE INDUSTRY

Panel A: 1980 State Level
Panel B: 2003 Municipal Level

LQ = Location Quotient, calculated on the basis of value added
Source: Own calculations based on INEGI Economic Census Data

TABLE 2. MEXICO’S NON-OIL AND TOTAL TRADE BALANCE FIGURES BY REGION (JAN-SEP 2013)

<table>
<thead>
<tr>
<th>Region</th>
<th>Non-Oil Exports</th>
<th>Total Exports</th>
<th>Non-Oil Imports</th>
<th>Total Imports</th>
<th>Non-Oil Balance</th>
<th>Total Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>244,103</td>
<td>281,311</td>
<td>252,577</td>
<td>284,188</td>
<td>-8,474</td>
<td>-2,877</td>
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<tr>
<td>North America</td>
<td>200,527</td>
<td>227,729</td>
<td>120,855</td>
<td>146,705</td>
<td>79,672</td>
<td>81,023</td>
</tr>
<tr>
<td>United States</td>
<td>193,498</td>
<td>220,010</td>
<td>113,981</td>
<td>139,561</td>
<td>79,517</td>
<td>80,449</td>
</tr>
<tr>
<td>Latin America</td>
<td>18,690</td>
<td>19,446</td>
<td>10,292</td>
<td>10,749</td>
<td>8,397</td>
<td>8,698</td>
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<tr>
<td>Europe</td>
<td>11,684</td>
<td>17,181</td>
<td>32,215</td>
<td>35,667</td>
<td>-20,531</td>
<td>-18,486</td>
</tr>
<tr>
<td>Asia</td>
<td>10,516</td>
<td>13,715</td>
<td>87,304</td>
<td>88,555</td>
<td>-76,787</td>
<td>-74,480</td>
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<tr>
<td>China</td>
<td>4,141</td>
<td>4,799</td>
<td>44,838</td>
<td>44,991</td>
<td>-40,697</td>
<td>-40,192</td>
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<tr>
<td>Oceania</td>
<td>844</td>
<td>845</td>
<td>713</td>
<td>714</td>
<td>131</td>
<td>131</td>
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<td>Australia</td>
<td>754</td>
<td>754</td>
<td>410</td>
<td>410</td>
<td>345</td>
<td>345</td>
</tr>
</tbody>
</table>

Source: Banco de Mexico
Being a neighbour of the largest market in the world has benefited the country and developed close industrial ties to the North American market.

Notwithstanding this, Mexico has been engaging in important efforts to broaden the range of its exporting partners. It has signed a free-trade agreement with Europe that came into force in 2000, and while Mexico has had a deficit of around USD$20 billion with Europe over the past 5 years, it is making efforts to increase exports to the region and FDI from the EU reached an all-time high of USD$16 billion during the first half of 2013. Trade with Latin America has significant growth potential. Mexico exported USD$19 billion to the region during the first 9 months of 2013, practically doubling the figure of imports from the region. The recent creation of the Pacific Alliance is a major breakthrough, intended to create a single market for goods, services, capital and people between the four member countries that account for 35 per cent of Latin American and Caribbean GDP and 36 per cent of its population. With Asia, Mexico has registered a deficit of between USD$65 and USD$95 billion over the past five years, linked mainly to a large trade deficit with China, which reached USD$40 billion during the period January–September 2013.

The prospects also look bright in light of the promising future of the Trans-Pacific Partnership negotiations, of which Mexico is a part.

Mexico’s future and areas of possible partnership with Australia

The context described above sets out very concrete opportunities for the relationship between Mexico and Australia to strengthen. Mexico’s trade with Australia has been growing in the past five years. The volume of Mexican exports to Australia almost doubled from 2007 to 2012, reaching USD$1 billion in that year. Imports from Australia also grew to a lesser degree from USD$785 million in 2007 to USD$984 million in 2011 and USD$934 million in 2012, the first year in which the Mexican-Australia trade balance turned from deficit to surplus.
PANEL A. MEXICO–AUSTRALIA TRADE BALANCE (MILLION USD)

Source: INEGI (2013)

PANEL B. FOREIGN DIRECT INVESTMENT FROM AUSTRALIA IN MEXICO (MILLION USD)

Source: INEGI (2013)
There is, however, a vast opportunity for Australia to deepen its ties with Mexico, in particular through foreign direct investment, which has declined from USD 134 million in 2007 to only USD$9.6 million in 2012.

**BESIDES TRADE AND INVESTMENT, MEXICO AND AUSTRALIA HAVE SYNERGIES TO EXPLOIT IN VARIOUS DOMAINS.**

Australia went through a major transformation of its economy during the 1990s, similar to the one that Mexico is undergoing right now. Indeed, the case of Australia’s regulatory and competition reforms and the role played by the Australian Productivity Commission have been brought to the attention of Mexican policymakers on several occasions. The last OECD Economic Survey on Mexico mentions this opportunity of sharing experiences, given that Mexico set as a major policy goal in its National Development Plan 2013–2018 the aim of increasing productivity and creating a productivity commission.

Productivity and skills are deeply related. The experience of the Australian Workforce and Productivity Agency (AWPA) and its 2013 National Workforce Development Strategy would be of critical relevance for Mexico to upgrade the skills of its young population. Universities in Mexico have been adapting themselves to the new realities and new fields of expertise. For example, Mexico already has 21 institutions that offer 52 programmes for the recently created aerospace industry. Increasing student exchange programmes between the two countries could extend the technical skills offering and would also contribute to reducing the knowledge gap between these two countries. In addition, both Australia and Mexico have vast territories and dispersed population. Collaboration and exchange of best practices in the field of regional development would be very pertinent.

Finally, a recent initiative that brings Mexico and Australia together is MITKA, a country grouping that gathers together Mexico, Indonesia, Turkey, South Korea and Australia. All of them are G20 countries, have democratic constitutions and open economies. An initial meeting of this group took place in 2013 and two more meetings and a joint declaration are expected to occur in Mexico in 2014. This could be the beginning of a long standing partnership, not only to prosper together but to find national and international solutions to common challenges.

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16 World Bulletin (2013)
With a GDP of USD$369.789 billion in 2012, Colombia has the 28th-largest economy in the world, and has held this position for more than a decade. Colombia’s per capita GDP of USD$10,110 places it 72nd in the world, and in the group of middle income countries.

It actually moved from low- to upper-middle income in the World Bank’s classification in a couple of decades. The Colombian economy is the fourth-largest in Latin America, after Mexico, Brazil, and Argentina, and its main feature is stability. Over the long run, the economy has grown at an annual rate of 3.7 per cent. While Colombia has not experienced the spectacular growth of others, not having surpassed 6 per cent in any single year, it has had negative growth only once during the last 70 years. Colombia has had neither high nor hyper-inflation episodes for over a hundred years.
During the second half of the 20th Century, the Colombian economy underwent an industrialisation and modernisation process while experiencing a persistent scarcity of foreign currency, which was cushioned by exports of coffee and, to a lesser extent, oil. However, during the last two decades, the country has experienced structural changes that will create opportunities and uncertainties for the decades to come.

During the first half of the 20th century, Colombia was a rural, agricultural country with a single dominant product, coffee, which accounted for two-thirds of exports. 60 per cent of the population lived in the countryside, life expectancy was around 44 years, and birth and mortality rates were high.

By the 1970s, the country had undergone dramatic changes. It had become an urban country with two-thirds of the population living in cities. Mortality rates had fallen, while birth rates had halved, thanks to a very successful birth control program and increased urbanisation. The fall in the birthrates in Colombia during the 1960s is still one of the sharpest on record worldwide.

Protectionism and a mild ISI policy (import substitution industrialisation) helped build light industry during the 1960s, which was mainly geared to the local market. In addition to its normal role in monetary policy and as a lender of last resort, the central bank (Banco de la Republica) also functioned at that time as a development bank that allocated resources according to considerations of employment and growth. Industry accounted for 23 per cent of GDP, while agriculture had declined to 22 per cent. By contrast, the diversification of exports was a slower process. In the 1970s, it became clear that the limits of the ISI policy were being reached. Regional integration was used in order to increase the size of the market. However, the 1980s brought the debt crisis in Latin America and the collapse of the international coffee agreement, all of which affected exports. By the end of the 20th century, coffee was still important, but had definitely lost its hegemonic role. Exports were still highly concentrated, with eight items accounting for 80 per cent of exports: oil, coffee, coal, bananas, flowers, food and drinks, garments, and chemical products. In addition, Colombia’s exports were mainly primary products.
Balance of payments constraints were a constant problem throughout most of the 20th century, except in some boom episodes.

The economy was adapted to the scarcity of foreign currency by means of crawling peg and exchange controls. Nevertheless, commodity price spikes caused severe imbalances and inflationary pressures. Indeed, coffee booms caused Dutch disease in the 1950s and mid 1970s. Marijuana and cocaine booms caused similar economic problems from the 1970s.

Despite the difficulties, Colombia enjoyed stable, if modest, performance. Its rate of growth was almost identical to the average among Latin American countries throughout the century, but with narrower oscillations. Colombia did not suffer the acute crises that affected the rest of the continent. The fall in GDP of 1998 has been the only one since the 1930s. In addition, the country has not had high or hyper-inflation since 1903. The aforementioned stability is due to a cautious approach to policy. Colombia followed the widespread trends of industrialisation by import substitution in the 1950s and 60s, and liberalisation in the 70s and 90s, but avoided some of the extremes of these tendencies. The size of government was kept under control, and debt (both foreign and internal) was maintained at a sustainable level, Colombia being the only country that did not have to reprogramme its foreign debt during the 1980s Latin American debt crisis.

Inflation was recurrent during the second half of the 20th century, although, again, it was fairly stable (between 14 per cent and 25 per cent per year for several decades). This stability allowed an inflation-linked long-term mortgage system to work well. In fact, the highest inflation figure in recent decades, an annual rate of 30 per cent in 1991, compares well with 40 per cent or more per month in several other Latin American countries. Like Brazil, Colombia learned to live with inflation by adapting its institutions to deal with it. Unlike Brazil, the fact that Colombian inflation was tolerable, not high, meant that there was a wider scope for these institutions to work, because potential maladjustments were smaller and somewhat easier to handle.

A crawling-peg exchange rate system (with a devaluation rate similar to the inflation rate) kept the income of exporters relatively constant. The coffee growers’ syndicate had a say in decisions, which avoided an extreme anti-agricultural bias.

There was a political side to the economic stability. Colombia had neither populist regimes nor military dictatorships, though there was a brief period of rule by a military junta in the 1950s, before elections were quickly called.
A bipartisan system has been predominant since independence. Elites have managed to maintain control of the country by means of a clientelist political system that has provided favours to some groups of voters to win elections, but at the cost of maintaining inequality. Colombia ranks among the countries with the greatest inequality in Latin America, as measured by the Gini coefficient. As a result of this persistent inequality, and without the escape valve of increases in salaries and prices (as in countries with populist regimes), armed conflict also became a persistent factor. Colombia is the only country on the continent that has had an active guerrilla movement for half a century.

Unemployment has traditionally been high, rates of 9–10 per cent being the norm, with peaks during periods of crisis, such as the mid-1980s, of up to 15 per cent, and 1999, when the rate reached 20 per cent for two years. The recent tendency in both unemployment and inflation has been downwards.

After a period of slow growth (the Latin American “lost decade”) in the 1980s, and violence related to the war against drug cartels, there were major changes in the early 1990s.

Following a peace process with one of the guerrilla movements, elections were called for a Constituent Assembly, which drafted a new Constitution. This was a major breakthrough, as the Constitution had remained basically the same since 1886, and did not acknowledge several rights. The 1991 Constitution declared that the country was a social state governed by the rule of law. It introduced mechanisms to guarantee human rights and broaden decentralisation, and declared the independence of the central bank. The government started a program to open and liberalise the economy, privatize government enterprises, and reduce inflation. The liberalisation of markets (banking) and privatisation of public utilities (particularly electricity and telecommunications) and the health sector, by the adoption of reforms similar to those previously introduced in the UK and Chile, led to a state more concerned with regulatory issues and less involved in the actual production and provision of goods and services. This coincided with increasing capital inflows to Colombia, some of which took the form of foreign direct investment in the privatised sectors, mining, and energy. In the meantime, industry has shrunk. Some sectors have expressed concern, as the economy seems to be becoming a service economy without having been through a strong industrial phase.
THE INDUSTRIAL STRUCTURE OF COLOMBIA AT PRESENT SHARE OF GDP

% = per cent. Source: World Bank, DANE, CIA World Factbook, Fedesarrollo

COMPOSITION OF INDUSTRY 2000-2010

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Industry Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.9%</td>
<td>Oil Refining</td>
</tr>
<tr>
<td>8.6%</td>
<td>Other Chemicals</td>
</tr>
<tr>
<td>8.6%</td>
<td>Drinks</td>
</tr>
<tr>
<td>5.4%</td>
<td>Milling, Starch, Starch Derivatives, Animal Food</td>
</tr>
<tr>
<td>4.6%</td>
<td>Basic Chemical Substances</td>
</tr>
<tr>
<td>4.4%</td>
<td>Non-metallic Mineral Products</td>
</tr>
<tr>
<td>4.3%</td>
<td>Plastic Products</td>
</tr>
<tr>
<td>3.9%</td>
<td>Processing And Conservation Of Meat And Fish</td>
</tr>
<tr>
<td>3.7%</td>
<td>Basic Iron And Steel Industries</td>
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<tr>
<td>3.7%</td>
<td>Paper And Cardboard Products</td>
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<tr>
<td>3.4%</td>
<td>Dairy Products</td>
</tr>
<tr>
<td>3.3%</td>
<td>Other Food Products</td>
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<tr>
<td>3.1%</td>
<td>Clothing</td>
</tr>
<tr>
<td>2.4%</td>
<td>Fruits, Vegetables, Oil, Fat</td>
</tr>
</tbody>
</table>

% = per cent. Source: World Bank, DANE, CIA World Factbook, Fedesarrollo
ANNUAL GROWTH OF INDUSTRY SUBSECTORS 2000-2010

- 2.6% Food
- 2.8% Drinks and Tobacco
- 5.9% Textiles and Shoes
- 5.0% Wood, Paper and Others
- 1.6% Oil Refining
- 5.6% Chemicals and Metals
- 8.0% Machinery and Equipment

% = per cent. Source: World Bank, DANE, CIA World Factbook, Fedesarrollo

GENERAL INDICATORS

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value</th>
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</thead>
<tbody>
<tr>
<td>GDP (PPP)</td>
<td>USD $369,789,000</td>
</tr>
<tr>
<td>GDP Real Growth Rate 2012 (Estimate)</td>
<td>4%</td>
</tr>
<tr>
<td>GDP Real Growth Rate 2011</td>
<td>7%</td>
</tr>
<tr>
<td>Investment (Gross Fixed) 2010</td>
<td>56</td>
</tr>
<tr>
<td>Budget Deficit (-) (2012 Estimate)</td>
<td>-0.5% of GDP</td>
</tr>
<tr>
<td>Public Debt (2012 Estimate)</td>
<td>40.2% of GDP</td>
</tr>
<tr>
<td>Annual Inflation Rate (CPI) (2012)</td>
<td>3.2%</td>
</tr>
<tr>
<td>Annual Inflation Rate (CPI) (Nov 2013)</td>
<td>1.76%</td>
</tr>
<tr>
<td>Unemployment (Oct 2013)</td>
<td>7.8%</td>
</tr>
<tr>
<td>Life Expectancy</td>
<td>74</td>
</tr>
<tr>
<td>Commercial Banks Prime Lending Rate (31 Dec 2012)</td>
<td>12.7%</td>
</tr>
</tbody>
</table>

% = per cent. Source: World Bank, DANE, CIA World Factbook, Fedesarrollo
The shift to a more liberal economy increased volatility and reduced average growth. While it had been growing at a rate of 4.5 per cent in the period 1970-1990, the economy only grew at an average rate of 3.6 per cent between 1992 and 2012. Even if the crisis year of 1999 is not counted, the average rate is still lower (4.0 per cent) than in the previous period.

Colombia embraced free-trade in some sectors, but at the same time it promoted biofuel production by means of 1960s-style subsidies for oil palm and sugar cane. It should be noted that the ownership of these crops is highly concentrated. The increase in biofuel agriculture was a move toward a cleaner economy, but has also raised concerns about food security.

Since the 1960s, Colombia had had a crawling peg exchange system. Between 1994 and 1999, in accordance with the opening and liberalisation of the economy, an exchange rate band was adopted. After resisting several speculative attacks on the band that caused high interest rates, the central bank decided to adopt a floating exchange rate, which operates at present.

Also, during the 1990s, restrictions on capital flows were reduced, and exchange control was eliminated, leaving only a tax on foreign debt (similar to the one in Chile).

The central bank began targeting inflation, and by the end of the 1990s, it had been reduced to single-digit figures. Although the central bank has claimed the credit for this, and did certainly manage to reduce inflation from 30 per cent in 1991 to 18 per cent in 1999, the main reduction took place in that year, 1999, when it fell from 18 per cent to 11 per cent. Thus, it can be argued that the crisis of 1999 played a role. Nevertheless, inflation has remained under control since then. During the past few years it has remained between 2 per cent and 4 per cent. By the end of 2013, it had reached its lowest level in more than 50 years (1.76 per cent). At the same time, unemployment has been falling, from a peak of 11.5 per cent in 2009. By the end of 2013, it had hit its lowest level in more than a decade (7.8 per cent).

The large size of the country, its difficult topography, and persistent inequality and poverty made the guerrilla rebels resilient. However, in general terms, open conflict was confined to specific areas of the country, the rest of the nation continuing with business as usual.

A series of export booms, coffee in the 1970s, marijuana and cocaine in the 80s and 90s, and later oil and coal, have caused persistent real appreciation, which has put industry in a difficult spot. Growth is now heavily based on mining and energy (coal, oil, ferronickel, gas, gold, and others), which has brought environmental problems and Dutch disease.
In the Global Competitive Index calculated by the Global Economic Forum, Colombia ranked 69th in the world and seventh in Latin America, after Chile, Panama, Brazil, Mexico, Costa Rica and Peru.

The index classified Colombia as an efficiency-driven country. According to the report, the five most problematic factors for doing business in Colombia were corruption, inefficient government, bureaucracy, inadequate supply of infrastructure, and difficulties in access to finance. With regard to institutions, the main problems had to do with security issues, namely the business costs of terrorism, crime, and violence, as well as with organised crime and diversion of public funds. At the same time, protection of investment was very good.

In terms of infrastructure, the main problems have to do with the quality of roads and ports, while the strengths were related to the availability of air travel and freight and the quality of the electricity supply. It should be noted that Colombia has a very diverse topography. For instance, looking at just the four main cities, Bogota is at an altitude of 2,600 metres above sea level, Medellin at 1,495m, Cali at 997m and Barranquilla is located at sea level. In addition, the tropical weather with rainy and dry seasons, and with wide changes in temperature within one single day has been an obstacle to the integration of the territory, as landslides are common during the rainy season. Different altitudes, difficult topography and challenging weather conditions have made it difficult to create communication links between the main cities on land.

It is no accident that one of the oldest commercial airlines in the world (Scadta, now Avianca) was created in Colombia in 1919 in order to carry the mail between Barranquilla and Bogota.
Since the trade liberalisation of the 1990s and the free-trade agreement with the US, there have been initiatives to improve port and road infrastructure, although the results are materialising slowly. In contrast, telecommunications infrastructure is changing rapidly. An ambitious plan to increase the use of the internet has tripled the number of municipalities with an optical fibre backbone. “Online government” constitutes an already established program to manage official paperwork online that is considered as the leading Online Government Program in Latin America. In addition, the country introduced 4G mobile broadband technology in 2013.

**THE MACROECONOMIC ENVIRONMENT, PARTICULARLY ITS LOW INFLATION AND HIGH CREDIT RATING, IS ONE OF COLOMBIA’S STRENGTHS.**

One of the main policy problems related to competitiveness has been real appreciation. The central bank has tried to intervene, buying dollars from time to time during recent years, but has not been able to reverse the trend. Industrial exports have suffered, but it is hard to see an easy solution for this problem in the face of incoming capital flows and mining exports.

With respect to human capital, there are problems with health due to the number of cases of malaria, and the business impact of tuberculosis and HIV/AIDS. The incidence of tuberculosis had been decreasing in the second half of the 20th century, thanks to the improvements in the living conditions of workers, but an increase after 1997 has been linked to internal forced displacement. Another factor is a trend of increasing bacterial resistance to drugs.

Education shows once more the particular kind of inequality typical of the country. Enrolment in primary education is low and has quality problems, while enrolment in higher education is high. A good higher education system allows fast absorption and adaptation of the latest technologies, which has an impact on innovation and productivity despite deficiencies at the lower levels. For instance, two Colombian researchers developed one of the first successful pacemakers in the world in 1958; and research done in Colombia played a key part in the development of a vaccine for cervical cancer, that led to a 2013 Nobel Prize.

A current policy challenge is the reform of the health system. The market system created in the 1990s had two different benefit plans: one for workers and employers, and a different one for informal workers, the unemployed, and the homeless, which introduced yet another inequality. In 2008, the Constitutional Court ordered the government to unify the plans, and consequently changes were implemented during the following years. However, corruption scandals, as well as problems with the provision of services, have led to a debate on whether it is the system itself that should be changed.
There is still no consensus in this debate.

Part of the problem with the health service has to do with high-cost diseases. As Colombia had a third-party payer (the government), some health industry companies took advantage of the situation to fix higher prices for Colombia. The result was that various pharmaceutical prices were higher in Colombia than in European countries. However, a threat to import of medicines from countries where the same company was selling them cheaper did force a reduction in several prices. Recently, there have been attempts to include a cost/benefit analysis in the decision-making process, and a system similar to NICE (the British National Institute for Health and Care Excellence) was created. Furthermore, Colombia has a small but growing industry of health tourism as some complex treatments, and dental services are available at lower prices and yet are of high quality by international standards.

The current peace talks with the main guerrilla movement (FARC) have advanced further than at any previous time.

This opens a window for a peace process that might unleash the country’s potential. For instance, biodiversity in Colombia ranks among the greatest in the world, indicating good possibilities for tourism and bio-products. It goes without saying that a reduction in kidnapping would dramatically improve investor confidence. If the talks are successful, several challenges will emerge, such as the re-integration of former rebels into civil society, and their participation in politics, which is a controversial topic.

In order for Colombia to make peace permanent, the country will need to find a way, not only to grow faster, but also to reduce inequalities and improve standards of living in both rural and urban areas. A recent strike by small-scale farmers demonstrated that the rural situation is a pressing issue.

Colombian biodiversity is second only to that of Brazil. As mining became an engine of growth, controversy arose about its environmental implications. Part of the problem is illegal mining, carried out by very poor people under unsafe conditions. However, it has also been argued that legal mining is affecting the ecosystem. This is an open debate, but the effects of Dutch disease make the question even more urgent.
After the Cartagena Agreement in 1969, Colombia was, for several decades, a member of the Andean Pact trade bloc, which included Peru, Ecuador, Venezuela, and, for a few years, Chile.

The Pact was a strategic trade agreement that attempted to achieve common industrial policies and make the most of industrial complementarities, but faced difficulties because industrialisation by import substitution was the main concept behind development policies in all countries. The main difficulty at the time was matching protectionism with integration. The Andean Pact had relative success and its member countries became an important market for Colombian manufactures. However, its limits were soon evident and the 1982 debt crisis reduced trade in the area.

The rise of Mercosur, an economic and political agreement between other South American nations made in the 1990s, gave new impetus to Andean integration, this time under the name of the Andean Community. The fundamental difference between this agreement and the Andean Pact was that now the integration was about a liberalisation, with Peru and Colombia signing free-trade agreements with the USA in 2006 (although Colombia’s agreement was only implemented in 2012).

Venezuela promoted a different kind of Latin American integration, without the USA, and eventually left the Andean Community.

While Venezuela is still an important consumer of Colombian manufactured goods, trade relations have been strained and irregular, as they have been affected by political relations between the two countries. These relations have, however, recently tended towards normalisation.

After the collapse of the ALCA negotiations aimed at creating a free-trade area which would cover the whole American continent, Colombia followed a strategy of bilateral free-trade agreements, first with the USA, and then other countries and the European Union. More recently, Colombia has looked to the Pacific region, becoming a member of the Pacific Alliance (see below) and signing a free-trade agreement with South Korea.
CONCERNING FREE-TRADE AGREEMENTS, COLOMBIA’S SHORT EXPERIENCE HAS SHOWN THAT THERE IS A NEED TO LEARN FROM PAST MISTAKES AND TO MAKE ADJUSTMENTS, SUCH AS IN THE CASE OF SMALL FARMERS UNABLE TO GROW THEIR OWN TRADITIONAL POTATOES BECAUSE THEY WERE NO LONGER LEGAL.

Colombia is member of the Pacific Alliance trade bloc, along with Chile, Peru, and Mexico. The Alliance was initiated in 2011 with an orientation towards Asia. Besides free trade among its members (supported by bilateral agreements), it aims to develop a visa-free travel zone and a common stock exchange. Central American countries, Paraguay and the United States have shown interest in joining. One seed of this Alliance was the 2009 agreement to create a common stock exchange uniting those of Chile, Peru and Colombia, as well as Mexico in 2014, which would make this a USD$1 trillion stock market. Australia and New Zealand are Pacific Alliance observer countries (i.e. interested).

Hence, during its dry seasons, Colombia imports electricity from Ecuador, and sells to Ecuador during the latter country’s dry season. This lowers prices, makes the grid more robust, and diminishes CO2 emissions, as it reduces dependence on thermal power generation (based on coal and other fossil fuels). Colombia has made advances in future interconnection with Central America and the rest of South America and is a member of CIER (Commission for Regional Energy Integration, a diplomatic and corporate organisation for Latin America and the Caribbean). Furthermore, Colombia, Ecuador and Peru have signed an agreement adopting regulatory principles for the operation of international transmission lines, as well as for the management of international transactions. This is a slow process, as it requires the building of physical (e.g. transmission lines) as well as institutional (e.g. regulation) infrastructure, but it has been advancing steadily.

Another energy project was to be the building of a polyduct pipeline to transport hydrocarbons from Venezuela to the Pacific coast, the idea being to open the Pacific market for Venezuelan oil and gas products and break the USA’s dominant position as Venezuela’s main customer for these products. This idea has not been realised, due to both external and internal political factors.

A frequently forgotten chapter in the history of international ties is energy integration. Colombia and Ecuador built a market for international transactions that takes advantage of complementary weather systems.
Colombia has managed to diversify its export markets, but basically with the same products as before. Moreover, Colombia’s main exports have low technological content, i.e. they are commodities.

Although the mining and energy boom prevented Colombia from suffering the effects of the international crisis, the main challenge for Colombia is to increase other exports, particularly industrial ones and those related to specialised services (e.g. health, engineering).

In this respect, the loss of the Venezuelan market was particularly damaging for Colombian exports, which had been made up of value-added products with a certain level of technology, for example clothing, chemicals, leather, textiles, paper, food, and vehicles, rather than raw commodities.

An important input for the country’s development would be a successful peace agreement. If achieved, this would enable the economy to realise its full potential. However, any stable peace would require the reduction of inequality. Colombian macroeconomic stability would then provide a good basis for sustained development.
Peru is one of the most successful economic performers in the developing world, registering average growth rates of 6.4 per cent per year in 2002-2012, with the lowest inflation in Latin America (2.5 per cent per year), a healthy fiscal position, low public debt ratios and record high foreign reserves.

Over the last decade Peru has become a middle-income country, with annual per-capita output increasing from USD$2,300 in 2000 to USD$6,700 (or USD$10,700 PPP). Unlike previous episodes of short-lived economic expansion, this time Peru has experienced accelerated growth while reducing poverty and improving income distribution. According to the Inter-American Development Bank, more than half of
the population now belongs to the middle-class, in stark contrast to prevailing conditions twenty years ago, when a majority of the population lived below the poverty line. The significance of Peru’s transformation becomes more dramatic if one considers that in the early 1990s, the economy was contracting, marred by hyper-inflation, and under the threat of a bloody internal conflict. The economic and social turnaround since then has been truly extraordinary.

Starting in 1968, Peru experienced twelve years of military rule that brought about the implementation of state-centred economic development, including the nationalisation of companies, an interventionist industrial policy, redistribution of agricultural land, imposition of international trade restrictions, price controls and the dramatic expansion of public expenditures.

As a result of the policies implemented and external shocks, the country experienced rapid economic deterioration, with negative economic growth and crippling inflation forcing the military to retreat to their barracks. Although President Belaunde fully restored civil liberties, he failed to tackle the critical structural problems that had beset the economy, leaving in place the distortionary policies earlier introduced by his predecessors. His administration was further hampered by the effects of the El Niño, which wreaked havoc on agriculture, leading to negative GDP growth of 12 per cent in 1982. Furthermore, the new civilian government had to face the emergence of the Maoist Shining-Path and Tupac Amaru terrorist organizations. This paved the way for the Aprista party’s victory in the 1985 elections under the stewardship of Alan Garcia, whose economic policies further exacerbated the economic crisis and led to growing fiscal imbalances, expanding current account deficits and spiralling hyper-inflation (1,600 per cent in 1989). In the context of a contacting economy (25 per cent output drop in 1987-1990) and heightened social tensions, terrorist groups increased their attacks nationwide.

By Pablo de la Flor
The 1990 elections were won by Alberto Fujimori, who implemented an ambitious package of economic stabilisation and structural reform policies that brought inflation under control and created the basis for resumed economic growth.

His administration privatised public enterprises, slashed fiscal deficits, eliminated price controls, and liberalised the economy more broadly, reducing administrative red tape and creating a business-friendly environment. The new administration also defeated both terrorist organisations. On the political front, Fujimori closed Congress and crafted a new constitution, winning a second term in 1995.

His efforts to secure an illegal third term, came to an abrupt end in 2000, amid a growing corruption scandal that engulfed the government and led to Fujimori’s resignation.

The main pillars of the free-market economic policy framework put in place in the early 1990s have been maintained by subsequent governments, with some small changes and adjustments. Thus, the government of President Alejandro Toledo (2001-2006), emphasized the integration of Peru into the global economy through the negotiation of Free Trade Agreements with the country’s main commercial partners, a strategy that was also embraced by the administration of re-elected President Alan Garcia (2006-2011).

In a reversal of the policies pursued during his first term in office, Garcia actively courted private investment, attracting important FDI flows and securing record economic growth.

In 2011, former army major Ollanta Humala was elected President on a platform of economic change, leading a nationalist left-of-centre coalition. However, once in government, like his predecessors, President Humala has maintained the existing policy framework, strengthening social programmes to reduce poverty. The drop in mineral prices associated with the slowdown of the Chinese economy has led to a moderation of growth in Peru.

Nevertheless, medium-term projections indicate the Peruvian economy will continue expanding at a robust pace (5.5-6 per cent).
The reforms of the early 1990s dramatically transformed the economy and helped anchor its three key distinguishing features: trade openness, limited state role, and prudent macroeconomic management.

This framework was fundamental to unleashing output growth, which in 1992-2012 averaged 5.4 per cent a year, and 7 per cent in 2006-2012, one of the four highest in the world for a mid-sized economy. The country’s impressive economic performance has been driven primarily by private investment and domestic consumption, which have both experienced a sustained expansion. The improvement in the country’s terms of trade, which in 2012 were 60 per cent above levels reached in 2000 due to higher mineral prices, has been another contributing factor. Economic growth has also been fuelled by the “demographic bonus”, measured as the record number of young workers joining the labour force in relation to non-working age individuals.

Growth acceleration has been associated with a surge in job creation. Accordingly, the number of adequately employed workers more than doubled over the last decade and unemployment dropped to a record low 6 per cent in 2013. Despite these positive employment trends, however, underemployment continues to pose an important challenge. Another outstanding aspect of Peru’s growth trajectory is its anti-poverty bias. Indeed, the proportion of the population living below the poverty line plummeted from 55 per cent in 2001 to 26 per cent in 2012. Equally important, income distribution, as measured by the Gini coefficient, has also improved (0.45 in 2010).

Economic expansion has taken place alongside price stability, with inflation averaging 2.4 per cent a year. The independent Central Bank’s strict handling of monetary policy has played a critical role in this process. The same is true for the handling of fiscal accounts, which since 2005 has yielded consistent surpluses. An exception to this trend occurred in 2009-2010 when small counter-cyclical deficits were generated to mitigate the negative impacts of the deteriorating international environment. Budget surpluses of 1.5 per cent and 0.9 per cent were secured again in 2012 and 2013. As a result of high economic growth and prudent fiscal handling, public debt has been steadily declining since 2003, when it reached 47 per cent of GDP. At the end of 2012, total public debt had dropped to 20 per cent, one of the lowest in the world.
** Latin Lessons : Peru **

**AVERAGE GDP GROWTH : 2006 - 2012**

Countries with GDP higher than US$150 billion. Source: WEO, IMF

![Average GDP Growth Chart](chart)

**PERU : KEY ECONOMIC INDICATORS**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013 (E)</th>
<th>2014 (P)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (US$ MM)</td>
<td>153,964</td>
<td>176,761</td>
<td>199,682</td>
<td>208,434</td>
<td>217,219</td>
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<tr>
<td>GDP Real (Var %)</td>
<td>8.8</td>
<td>6.9</td>
<td>6.3</td>
<td>5.2</td>
<td>5.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.1</td>
<td>4.7</td>
<td>2.7</td>
<td>2.9</td>
<td>2.4</td>
</tr>
<tr>
<td>Gross Fixed Investment/GDP</td>
<td>25.1</td>
<td>24.1</td>
<td>26.7</td>
<td>27.2</td>
<td>27.4</td>
</tr>
<tr>
<td>Exchange Rate, End of Period</td>
<td>2.81</td>
<td>-2.8</td>
<td>2.55</td>
<td>2.80</td>
<td>2.83-2.85</td>
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<tr>
<td>Exchange Rate (% Yr Change)</td>
<td>-2.8</td>
<td>-4.0</td>
<td>-5.4</td>
<td>9.4</td>
<td>1.8</td>
</tr>
<tr>
<td>Fiscal Balance (% del PBI)</td>
<td>-0.3</td>
<td>1.8</td>
<td>2.1</td>
<td>0.9</td>
<td>0.0</td>
</tr>
<tr>
<td>Trade Balance (US$ MM)</td>
<td>6,750</td>
<td>9,302</td>
<td>4,527</td>
<td>-625</td>
<td>215</td>
</tr>
<tr>
<td>Exports</td>
<td>35,565</td>
<td>46,268</td>
<td>45,639</td>
<td>42,206</td>
<td>44,759</td>
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<tr>
<td>Imports</td>
<td>28,815</td>
<td>36,967</td>
<td>41,113</td>
<td>42,831</td>
<td>44,544</td>
</tr>
<tr>
<td>Current Accounts Balance (% of GDP)</td>
<td>-3,782</td>
<td>-3,341</td>
<td>-7,136</td>
<td>-10,839</td>
<td>-9,752</td>
</tr>
<tr>
<td>International Reserves</td>
<td>-2.5</td>
<td>-1.9</td>
<td>-3.6</td>
<td>-5.2</td>
<td>-4.5</td>
</tr>
</tbody>
</table>

% = per cent; Var = variation; Yr = year; (E)Estimates; (P)projections. Source: Statistical institute, BCR, BCP
Peru has been running a moderate current account deficit in recent years, fuelled primarily by high investment.

In 2013, the current account deficit peaked at 5.2 per cent of GDP, a manageable level in light of the overall health of the Peruvian economy. These gaps have been financed primarily by FDI flows (equivalent to almost 10 per cent of GDP in 2013), linked to large mining and other infrastructure projects. By the same token, international reserves climbed due to export growth and the associated trade surplus of 2002-2011. At the end of 2013, net international reserves hovered at close to USD$66 billion or 30 per cent of GDP, more than six times the USD$10 billion held by the country a decade earlier.

The business-friendly and stable macroeconomic environment has triggered a significant wave of productive investment, both domestic and international. Flows grew at the rate of 13 per cent a year in 2002-2012, with gross fixed levels climbing to 28 per cent in 2013, a record level for the country and the highest in the region. Although mining and hydrocarbons have absorbed a significant proportion of the investment flows, manufacturing, real state, electricity, and tourism have also attracted increasing interest. Investment growth slowed in 2013 to 4 per cent as a result of uncertainties surrounding the international economy and domestic concerns with the direction of some government decisions. These flows are expected to accelerate again starting in 2014 driven by new mining and infrastructure projects.

In recognition of its outstanding performance, Peru is one of the few countries in the region that has gained investment-grade status from all major credit rating agencies. The country’s legal system accords foreign investors the same treatment as their local counterparts. Furthermore, there are no sector restrictions nor performance or national content requirements for foreign owned operations. The constitution guarantees the rights of investors to freely repatriate their capital, dividends or royalties. Moreover, investors that meet certain requirements can enter legal stability agreements that fix tax, labour and other conditions applicable to their operations. In addition, Peru has entered several bilateral Investment Protection Treaties and has included similar protection provisions in most of the Free Trade Agreements it has entered into in recent years. Not surprisingly, FDI has been on the rise, reaching more than USD$12.2 billion in 2012.
As part of its stabilisation and structural adjustment efforts in the early 1990s, Peru revamped its foreign trade regime, reducing and rationalizing its tariffs and doing away with almost all restrictions that hindered international trade.

In recent years, the country has continued to unilaterally reduce its customs duties and has narrowed their scope. The weighted average tariff rate now stands at only 1.2 per cent, one of the lowest in Latin America.

The dynamism of its international trade is another important aspect of Peru’s recent growth story. In 2001-2012, export growth averaged 5.8 per cent a year, one of the highest in the region. Exports climbed from USD$6.3 billion in 2000 to a record-setting USD$49 billion in 2011, but dropped to USD$45.6 billion in 2012 and $42 billion in 2013 due to lower mineral prices.

**Commodities Account for Almost 85 Per Cent of Exports, with Minerals Representing Close to 60 Per Cent of the Total. Copper and Gold Are the Most Important Exports, with Shares of 23 Per Cent and 20 Per Cent, Respectively. Other Exported Minerals Are Zinc, Silver and Molybdenum.**

With over USD$2.2 billion in exports in 2012, fish-meal and fish oil are among Peru’s top five exports. Coffee exports are also significant with close to USD$1 billion in sales during the same year. Shipments of other non-traditional agricultural products such as avocados, grapes, paprika and asparagus are gaining in importance (USD$3 billion), have shown continued growth over the last decade. Among manufacturing exports, textiles are the most significant, with over USD$2 billion in 2012.

In parallel to booming exports, Peru has seen a steady increase in its import bill, from USD$7.4 billion in 2000 to almost USD$42.8 billion in 2013, mostly explained by the increase inflow of capital goods and intermediate inputs associated with the implementation of large investment projects. Continued import growth and lower exports resulted in a negative trade balance of USD$625 million in 2013, the first in eleven years.
VOLUME OF EXPORTS (2000=100)

Source: WEO - IMF (Oct 2012) and BCRP.

EXEPORTS

Source: Central Bank
Peru’s export/import markets are among the most diversified in Latin America, with a growing presence of Asian markets in the trade matrix. Whereas a decade ago the US was the country’s largest trading partner, that position is now occupied by China (17 per cent of total trade). The US has seen its participation drop from 25 per cent to 13 per cent of total trade. Switzerland is ranked third, thanks in large measure to its purchases of Peruvian gold. However, if we take the European Union (EU) as a block, its trade with Peru is comparable in size to that of China. In terms of exports, the largest destination market for Peru is China, with the US coming in second place. The US still ranks as the most important country of origin for Peruvian imports.

Unilateral trade liberalisation efforts have been complemented with bilateral free trade agreements (FTAs), which Peru has pursued actively, starting in 2006, when it negotiated an ambitious trade accord with the US. Since then, the country has entered similar FTAs with all its major trading partners, including the EU, China, Japan, Canada, EFTA and Korea. In addition, Peru has been an active participant in regional integration efforts and is a member of the Andean Community of Nations (encompassing Colombia, Ecuador and Bolivia). It has also liberalised trade with MERCOSUR and other neighbours in the region, including Chile and Mexico. Peru’s FTAs currently cover 51 countries, representing 45 per cent of the world population and 85 per cent of global GDP. Over 95 per cent of Peru’s exports and 90 per cent of imports benefit from the preferential treatment of FTAs. The country is an APEC member and is currently involved in the Trans-Pacific Partnership negotiations. It is also part of the Pacific Alliance with Colombia, Chile and Mexico.

Mining has become one of Peru’s most important growth engines. Peru is the world’s third-largest producer of copper, second-largest producer of silver and zinc, and the sixth-largest producer of gold.

Not surprisingly, the most important mining multinationals operate in the country, including Teck, BHP Billiton, Anglo-American, Rio Tinto, Glencore, Newmont, and China’s Minmetals and Shougang. The relative weight of the industry has been expanding over the last decade (it currently stands at 14 per cent of GDP), leading some critics to argue that the current mining boom has deepened the country’s dependence on primary resources and crowded out
other higher value-added productive activities. The evidence shows, however, that domestic industrial production has broadened and increased in complexity. Measured in volume terms, non-traditional exports more than trebled their size over the last decade, outpacing the volume growth of mineral production. Nevertheless, because the price of minerals reached historic highs, the contribution of mining to the country’s total export account grew significantly. Equally important, macroeconomic data demonstrate that Peru has been able to avoid the negative consequences of Dutch disease that often plague commodity exporters.

MINING HAS BECOME A MAGNET FOR FOREIGN DIRECT INVESTMENT (FDI) AS WELL. IN 2013, THE INFLOW OF FDI INTO MINING REPRESENTED USD$8.5 BILLION.

The pipeline of planned investments, including the expansion of existing operations, and the development of new mines, many of which have secured the approval of Environmental Impact Assessments (EIAs) and other authorisations, could top USD$53 billion by 2020. The future of mining will hinge, however, on what happens with the wave of social conflicts and community opposition that has engulfed many mining projects. According to the National Ombudsman Office’s 2013 reports, active social conflicts have tripled over the last five years. Of the total 148 socio-environmental conflicts identified, 70 per cent are related to mining. Protests and strikes in Cajamarca, located in the northern highlands, brought about the suspension of the USD$4.8 billion Conga gold project. Similar objections have affected other mineral producing regions, hindering the implementation of many promising projects.
Economic reforms and responsible management enabled Peru to seize the opportunities presented by a favourable international context to accelerate economic growth over the last decade.

However, if the country is to sustain high growth into the future and broaden its economy to include more value-added productive activities, it will need to deepen structural reforms. In order to enhance competitiveness and productivity, it is critical for the government to enhance human capital, narrow its current infrastructure gap and strengthen institutions. Not surprisingly, Peru occupies the 61st position out of 144 participants in the global competitiveness index (third in Latin America after Chile and Mexico).

**PERU HAS MADE IMPORTANT STRIDES IN PROVIDING UNIVERSAL PRIMARY AND SECONDARY SCHOOLING, ACHIEVING ACCESS LEVELS THAT ARE SUPERIOR TO THOSE OF COUNTRIES WITH COMPARABLE GDPs.**

**GLOBAL COMPETITIVENESS INDEX 2013–2014 (144 PARTICIPATING COUNTRIES*)**

*(*) 1=better and 144=worse. Radar indicates place in the ranking.

*Source: World Economic Forum.*
Nevertheless, expanded enrolment has not been matched by improvements in the quality of education. Peruvian children spend on average more time in school than in any previous era, but that does not mean they are achieving the age-specific learning needed to become productive workers upon graduation.

In the 2012 PISA international exam, Peruvian students ranked last among participants from 65 countries in reading, maths and science. Although more resources are being earmarked for education (3 per cent of GDP), those efforts will be insufficient to bring about the changes needed if decisive steps are not taken to tackle the most critical problem affecting schools: low-quality teaching.

It is important to point out that some promising measures have been implemented to revamp teacher recruitment, training and promotion. These reform initiatives, however, have met with the opposition of the National Teachers Union, which staunchly opposes measures that link performance evaluations to compensation.

Higher education has also seen a similar transformation, with expanded enrolment (close to 30 per cent of students who complete high school) but significant quality gaps exist. The international QS ratings put Peruvian universities at the bottom, with only two of them classified in the 550th to 660th range. The numbers of professors with doctoral and other graduate degrees are limited, and very few universities have research programs. Efforts are underway to implement a university accreditation system aimed at improving the quality of training, and an office is being established that will keep track of labour market participation for graduates of different subject and universities. The data provided will help correct the information asymmetries that currently plague the higher education market.

Sustained future growth will also hinge on the capacity of the Peruvian economy to innovate in order to diversify its productive capacity towards higher-value sectors. Unfortunately, Peru devotes very few resources to research and development (0.1 per cent of GDP), less than other countries of similar size in the region. Not surprisingly, Peru’s ratio of registered patents (0.12 per 100,000 people) is one of the lowest in Latin America. Consistently with these gaps, the WEFs Competitiveness Report Index ranks Peru in the 117th place when it comes to measuring innovation (its lowest position in the ranking).

Lack of adequate infrastructure is another important issue that threatens to restrict future economic growth.

According to some estimates, Peru currently has an infrastructure deficit of close to USD$90 billion, concentrated in roads, ports, air transport, railways and electrification, among others. Although some progress has been
made in recent years, the infrastructure gap remains significant. The Global Competitiveness Index places Peru well behind its neighbours when it comes to the quality of infrastructure, with the lowest scores registered in railway and road systems. The current administration is trying to promote Public-Private Associations to build and operate needed infrastructure and is expected to put over USD$10 billion in large projects out to tender in 2014.

Another area where important progress is urgently needed is institutional quality, broadly understood as the set of rules needed to dispel economic and political uncertainty and lower transaction costs. Although there have been some improvements, significant deficits persist when it comes to accountability, control of corruption, government effectiveness and regulatory quality. In the latter sphere, although Peru does relatively well in the World Bank’s Ease of Doing Business Ranking (43rd out of 185 participants - second in Latin America after Chile), there is still considerable scope for improvement, particularly in the streamlining of authorisation procedures that currently hinder private investment. Although public administration has some islands of excellence, such as the ministries of the economy

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**EASE OF DOING BUSINESS 2013**

*(185 PARTICIPATING COUNTRIES*)

*Source: World Bank’s Doing Business 2013.* (1=better and 185=worse.)
and international trade, weak institutional capacities are the norm as reflected in the low levels of capital budget execution (70 per cent in 2013). By the same token, according to opinion polls corruption has become the second most important problem facing the country, only just behind personal security.

Thanks to the ambitious economic reforms it has implemented, Peru has been able to transform its economy dramatically, becoming the fastest-growing economy in the region. The country’s impressive performance has been driven primarily by private investment and domestic consumption. Responsible macroeconomic management and the establishment of a market-friendly business environment are key to explaining Peru’s recent growth trajectory. As a result of the policies put in place to facilitate private investment and the free-flow of goods and services, Peru was able to seize the opportunities made available by improved terms of trade. Although the recent contraction in mineral prices associated with the slowdown of the Chinese economy has brought about a moderation of Peru’s growth rate, it is projected to remain among the highest in Latin America (5-6 per cent) in the coming years.

**PERU HAS PROGRESSED SIGNIFICANTLY OVER THE LAST TWO DECADES, IMPROVING THE QUALITY OF LIFE OF ITS POPULATION, REDUCING POVERTY AND INEQUALITY CONSIDERABLY.**

These achievements have been made thanks to sustained economic growth. Whether the country is able to maintain these trends and escape the “middle-income” trap will depend on its ability to successfully overcome key structural constraints. To that end, it will need to enhance human capital and improve the quality of education. Likewise, infrastructure will have to be upgraded in order to fuel continued growth. Finally, it is critical that the country strengthen its institutions, building on top of recent advances in order to bolster government efficiency and accountability. **The conditions are in place for Peru to consolidate its position as the New Andean Jaguar.**
In the 1930s, arguably the most significant weakness of Chile’s economy was its vulnerability to international economic fluctuations.

In fact, a steep economic recession triggered by the Great Depression in 1929 severely affected the country, highlighting Chile’s high level of reliance on natural resources, such as nitrates and copper. The economic downturn spurred the government of Pedro Aguirre Cerda to push ahead with the creation of the National Development Agency (Corporacion de Fomento de la Produccion de Chile - CORFO) with the primary objective of industrialising the country and encouraging import-substitution of goods considered...
to be critical for the economy. Thus, protectionism emerged as a central component of government policy.

Despite an initial dramatic increase in economic growth, protectionism soon proved unsuccessful. The government ended up paying large amounts in subsidies and domestic state-owned firms failed to find new markets in which to expand and grow. Furthermore, copper was still the main export and remained an important source of government income.

Between 1950 and 1970, the Chilean economy grew at marginal rates and GDP expanded at an average of 3.8 per cent a year. Together with a policy of import substitution, local currency was highly overvalued, which undermined non-traditional exports. Inflation became more prominent from the 1950s, reaching as much as 84 per cent in 1955, arguably due to poor fiscal policy. Despite all the efforts of successive governments, inflation remained an important issue during much of the 1960s.

Chile’s political and economic scenario changed dramatically in 1970 when Salvador Allende took power, supported by the Popular Coalition which had a number of radical measures in the pipeline, including, amongst others, the expropriation of strategic state-owned companies, an increase in real wages and reduced economic dependence on international markets. One underlying foundation of the new economic policy was that the country’s economy possessed an important idle capacity. This, according to the new government, had been caused by two factors: the monopolistic nature of domestic manufacture; and income distribution. Based on this diagnosis, it was believed that redistribution of income among lower-class segments would boost domestic demand and industrial production.

Soon after taking power, radical measures were implemented, including reform of rural land ownership and nationalisation of big copper mining companies.

During the 1960s, and especially during the administration of President Eduardo Frei Montalva, a number of initiatives were launched to reform the economy, including rural land ownership, a limited liberalisation of external trade relations and a policy of limited devaluations aimed at preventing currency exchange deterioration.
AT THE SAME TIME, WAGES DRAMATICALLY INCREASED BY AN AVERAGE OF 48 PER CENT. INITIALLY, THE ECONOMY EXPERIENCED A BIG BOOST, AND REAL GDP GREW BY 7.7 PER CENT AND UNEMPLOYMENT DECREASED BELOW 4 PER CENT, BUT MOST IMPORTANTLY, INCOME DISTRIBUTION IMPROVED TO LEVELS NEVER SEEN BEFORE.

Unfortunately, by 1972 a number of major macroeconomic problems became apparent. Inflation soared to over 200 per cent, the fiscal deficit grew to 13 per cent over GDP and international reserves fell to as low as USD$77 million. Given such profound economic problems, relations between different political parties reached a crisis such that on 11 September 1973 the government of Salvador Allende was brought to an abrupt end by a military coup.

After the military took over the government in 1973, radical economic changes were implemented. Chile experienced a transition from an economy isolated from the rest of the world, with strong government intervention, into a liberalised, world-integrated one, where market forces were allowed to guide most economic decisions. One of the fundamental objectives of the government was to open the economy to the rest of the world by increasing exports as well as inbound foreign investment. The liberalisation and modernisation of the banking system was another important component of the economic agenda, implemented by privatising state-owned banks, as well as freeing interest rates.
With a geographical area of 755,776 km², and endowed with mineral resources and great biodiversity, Chile is one of the narrowest and most remote countries in the world.

The Republic of Chile is a unitary state made up of 15 regions comprising 345 communes and is governed by a presidential system, with direct universal suffrage and elections held every four years: the president is the head of government and state; 38 senators look after the interests of the 19 subdivisions; and 513 deputies take care of 60 districts.

Chile has a population of 16,634,603 inhabitants according to the 2012 census. 86.9 per cent of the population resides in urban areas, Santiago being the most populous city, with 4,977,637 inhabitants (30 per cent of the country’s population), followed by the provincial cities of Concepcion with 971,368 inhabitants and Valparaiso with 734,406 inhabitants.

In economic terms, Chile’s gross domestic product (GDP) amounts to USD$285.703 billion (nominal). This makes Chile the 38th-largest economy in the world, ahead of Malaysia, Singapore and Nigeria, according to the IMF. Chile also occupies 40th position in the United Nations Development Programme’s Human Development Index, and falls into the category of Very High Development (four positions up compared to 2012).

### GDP BREAKDOWN 2012

- **2.4%** Electricity, Gas & Water
- **5.6%** Financial Services
- **6.6%** Transport & Telecommunications
- **8.3%** Construction
- **11.7%** Hotels, Retail & Hospitality
- **11.2%** Manufacturing Industry
- **13.6%** Agribusiness, Forestry, Fishery & Real Estate
- **14.6%** Mining
- **26.5%** Professional Services

% = per cent. Source: SOFOFA (Association of Chile’s Industrial Companies)
GENERAL ECONOMY STATISTICS

Population (Millions) 17.4
Population Growth (5 Year Average) 1%
GDP (USD In Billions) 286.6
GDP Growth (Average, Last 5 Years) 3.8%
GDP Per Capita (PPP) $22,400
2012 Inflation Rate 3%
Value Added By Primary Activities 3.4%
Value Added By Industries Including Mining 39.1%
Value Added By Services 57.5%
Gross Financial Debt As Percentage Of GDP 12.2%
Net Financial Debt As Percentage Of GDP -6.9%

Exchange Rate In 2012 (CLP Per USD) 486.8
Export Of Goods And Services (As A Share Of GDP) 34.2%
Import Of Goods And Services (As A Share Of GDP) 33.9%
Current Account Balance (As A Share Of GDP) -3.5%
Total FDI Between 2010 – 2012 (USD In Billions) 68.62
Gross Domestic Expenditure On R&D (As A Share Of GDP, 2011) 0.4%
2012 Unemployment Rate 6.4%
Income Inequality (Gini Coefficient, 2011) 0.501
2009 Relative Poverty Rate 30.2%

% = per cent. Source: ‘Chile 2014, Pacific Alliance’ International Investor

CHILE : 2013 INTERNATIONAL RANKINGS

<table>
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<tr>
<th>RANKING</th>
<th>INSTITUTION</th>
<th>POSITION IN LATIN AMERICA</th>
<th>WORLDWIDE POSITION</th>
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<td>World Economic Forum</td>
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<td>Transparency International</td>
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<tr>
<td>Logistic Performance Index</td>
<td>World Bank</td>
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Chile is also one of Latin America’s fastest-growing economies. Over the past 20 years the country has recorded an average annual growth of 3.5 per cent and per capita income has almost doubled in real terms. During 2013, Chile entered the group of economies classified as high-income by the World Bank. The country’s GDP per capita, measured in purchasing power parity (PPP), tripled between 1985 and 2012 rising from USD$6,238 to USD$18,211. The inflation rate has been reduced from more than 30 per cent in the mid-1980s to a stable range of between 2 and 4 per cent per year. The poverty rate has dropped from 45 per cent in 1987 to 14.4 per cent in 2011, while indigence has been reduced from 17.4 per cent to 2.8 per cent in the same period.

The banking system has undergone many changes since the 1970s. At that time, it was characterised by a limited product offering, minimal competition, high margins and almost non-existent professionalisation.

Several reforms have been enacted since then, such as liberalisation of credit loans, the reduction of the reserve requirement on domestic currency deposits, access to external credit and the liberalisation of interest rates. In addition, several mergers and acquisitions have taken place, resulting in larger banks with significant market share. In recent years, the system has faced lower growth rates, domestic inflation in the range of 2 to 4 per cent per annum, and historically low interest rates. This has had consequences for the banking system: placements have disrupted the high growth trend that has been the outstanding feature for approximately 12 years; and the provisioning that has been made and the write-offs that have occurred have been unlike anything seen in the last 15 years.

All this has generated the need to increase internal efficiency levels. Consequently, a new scenario seems to be evolving in the banking system, and it will likely be characterised by stabilised portfolio risk, a more open system allowing the entry of new institutions, the emergence of new sources of business financing such as credit unions, commercial houses and compensation funds and more flexible regulation. Today, it is not just banks and financial institutions that are involved in financial business. New players are constantly entering the market, especially retail sector companies financing consumer operations. This reality has imposed a more demanding climate in which banks, traditional
or otherwise, have to operate. At present, Chilean banks are embarking more and more on internationalisation ventures, which occur through three channels: cross-border loans and financial investments; the establishment of branches or representative offices abroad; and direct investment in shares of banking companies established abroad.

For the past 20 years, as a result of legislation passed in 1980 establishing a privatised pension fund system, the asset industry in Chile has been largely dominated by the large pension fund managers (Administradoras de Fondos, or AFP). The legislation made it mandatory for all employed people to belong and contribute to a local pension fund of their choice.

**Historically, the pension funds, together with the insurance companies, have channelled, and continue to channel, the bulk of the local capital to investment managers.** Because of this, the assets under management (AUM) are highly influenced by the AFP’s specific requirements. However, there has been recent growth in retail investment, as the Chilean economy continues steadily to grow, resulting in a larger base of high net worth individuals and family groups.

Chile has long been a mining-oriented country and even though a significant portion of Chile’s current mining legislation was enacted during the 1970s (including foreign investment contracts, an updated mining code and tax benefits), most world-class deposits discovered from this period onwards were not developed until Chile returned to democracy in 1990 and a new wave of foreign investment began.

While the National Copper Corporation of Chile (Corporacion Nacional del Cobre de Chile - Codelco) has remained state-owned since its creation, over the past 30 years the private sector has increased its participation and has contributed to the consolidation of the industry, increasing production more than twenty fold. In 1980, production from the private sector amounted to approximately 160,000 tons of copper, equivalent to 15 per cent of that year’s total production.

At present, private sector copper production amounts to approximately 3.5 million tons out of a total 5.3 million tons, a remarkable 66 per cent.
IN THE NEXT TWO DECADES, IT IS PREDICTED THAT 70 PER CENT OF THE COMMITTED INVESTMENT WILL COME FROM THE PRIVATE SECTOR.

Copper is not Chile’s only resource: gold, zinc, iron ore, nitrates, iodine and molybdenum all benefit from the economies of scale provided by copper mining. Chile’s geography can accommodate an extensive and robust logistics infrastructure, including railroads, highways and port facilities.

In the period 2006-2011, almost 25 per cent of Chile’s revenue came from mining, totalling USD$62 billion. In addition, during the same period, the industry contributed 16.4 per cent of the country’s GDP and 64 per cent of Chile’s total exports. One sector of the economy that has reaped huge benefits from mining is seaborne transport: more than 50 per cent of total cargo comprises mining and mining-related products.

The huge pipeline of mining investments slated for the next two decades engenders a number of significant challenges, many of which are related to energy, water and human resources.

AGRIBUSINESS

In regards to agribusiness, Chile is a southern hemisphere leader in the export of fresh fruit and the horticultural industry is one of Chile’s most important economic sectors. The industry is also regarded as one of the most crucial in terms of economic development and in generating investment and employment at all levels, together with a number of positive externalities.

The fruit industry involves over 14,000 producers, more than 60 processing companies, packing stations and other industry-related suppliers. The export sector encompasses around 7,800 producers and more than 600 export companies. The industry also generates more than 450,000 direct jobs, which include permanent and seasonal work, and indirectly employs more than one million people in industry-specific positions totalling more than 1.5 million jobs.
**EVOLUTION OF PROJECT PORTFOLIO 2008 - 2013**
(USD in billions)

![Graph showing the evolution of project portfolio from 2008 to 2013.](image)

Source: COCHILCO (Copper Chilean Commission)

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**COPPER EXPORT DESTINATION 2012**
(000’ tonnes)

![Bar chart showing copper export destinations for 2012.](image)

Source: COCHILCO (Copper Chilean Commission)
After the establishment of neoliberal policies during the mid-1970s and consolidation of the economic model implemented by the so-called “Chicago Boys” in 1982, Chile entered one of the deepest economic recessions in the country’s history since the Great Depression.

This economic crisis was caused mainly by an over-valued currency and high domestic interest rates, which rendered investment extremely difficult for most industries. In addition, highly deregulated commercial banking placed overwhelming strains on the country’s financial sector. As a result, GDP shrank by 14.3 per cent, unemployment reached 23.7 per cent and the Chilean peso devalued by 18 per cent.

On 1985, President Augusto Pinochet appointed Hernan Buchi Finance Minister. Buchi is credited with creating the so-called “Chilean miracle” by implementing the following measures:

• Major reductions in government spending.
• Promotion and development of private investment by reducing profit taxes and VAT.
• Strong currency devaluation in a bid to foster exports.
• Privatisation of state-owned companies such as CAP (Pacific steel company), ENDESA (electric generation), ENTEL (telecommunications), IANSA (sugar manufacturer), LAN CHILE (the national airline)
• Interest rates set by the Central Bank instead of the market.

After the implementation of these reforms, Chile entered a period of prosperity and one of the fastest-growing stages in the country’s history took place during the years 1986 to 1997, witnessing growth rates of as much as 12 per cent in 1993, with an average of 8 per cent.

In 1998, Chile’s economy was badly impacted by the Asian Crisis, which resulted in an abrupt shrinking of exports, a considerable fall of GDP growth to 0.9 per cent and an unemployment level of over 10 per cent.

Since the late 1990s, Chile has signed a number of free-trade agreements with numerous countries in Latin America as well as the rest of the world. Up to this point, Chile has signed 22 FTAs involving more than 60 countries, reaching a global market of
more than 4.2 billion potential consumers. In terms of foreign direct investment, Chile has gradually been attracting more and more international corporations keen to exploit Chile’s natural resources, seek new markets and drive cross-border efficiencies.

Chile’s GDP is expected to grow at 4.0 – 4.5 per cent in 2014 according to Chile’s central bank. Domestic demand has been growing strongly over recent years but it is expected to cool slightly in 2014-2015. On the other hand, external demand is expected to recover, and this may boost exports, especially to traditional markets which have seen signs of recovery.

The price of copper seems to have peaked, as forecasts for the first time in several years have projected a price lower than in 2013, which would adversely affect Chile’s fiscal revenue. Copper demand is expected to increase by 3 per cent, however, reaching 21.2 million tonnes according to the Ministry of Mining. The major challenge for the industry is to increase productivity and reduce production costs, in particular energy, labour and water, which have been soaring over the last few years. In political terms, some important objectives and reforms have been announced by the new government coalition, including tax reform, achieving a structural balance by 2018 and an increase of expenditure on education.

Unemployment remained low during 2013 and it is expected to stay that way in 2014 and 2015. Some 250,000 new jobs were created in 2013 and the majority of these new workers are females (57 per cent), which is in line with the government’s objective of increasing female participation in the workforce. In addition, 90 per cent of such jobs take place in the formal market which provides access to pension funds, unemployment insurance and “permanent” status. Having said that, the OECD has projected a slight increase in unemployment to 6 - 6.5 per cent.
According to the Global Competitiveness Report 2013-2014 released by the World Economic Forum, Chile is ranked 34th out of 148 countries (one position down from 2012-2013), where it exhibited outstanding scores in “pillars” such as institutions (28th), macroeconomic environment (17th), an efficient government (18th) with a balanced public budget and low levels of public debt, and competitive markets with high levels of domestic competition (32nd) and openness to foreign trade (29th).

In addition, the country has made significant efforts to boost information and communication technologies (ICT) indicators, almost doubling its international internet bandwidth capacity from 20 to 40 kb/s per user (43th) as well as increasing its number of internet users (45th). Despite these strengths, Chile's relative position suggests a degree of stagnation in the country’s competitive model and an urgent need to diversify its economy and move to higher-value-added activities. A poor education system and lack of specialised skills can create additional challenges to local companies wishing to undertake innovative projects. This, along with low innovation investment, especially in the private sector (58th), results in a low overall innovation capacity (63rd).

Note: For the list above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Significant economic growth and reforms have noticeably reduced unemployment as well as poverty. To some extent, this has had a positive impact on improving income inequality, though this remains remarkably high. Women and young people have enlarged the labour force, but their participation rate remains low compared to OECD standards. During the period 2003 to 2012, female participation grew from 36.6 per cent to 47.5 per cent, while male participation shrank from 73 per cent to 72.2 per cent.
# GLOBAL COMPETITIVENESS INDEX

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<th>Category</th>
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* Out of 148 countries; ** 1-7.  
Source: World Economic Forum

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# THE MOST PROBLEMATIC FACTORS FOR DOING BUSINESS IN CHILE

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<tr>
<th>Factor</th>
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<td>Inadequately Educated Workforce</td>
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<td>Inefficient Government Bureaucracy</td>
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<td>Insufficient Capacity To Innovate Tax Regulations</td>
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<td>Access To Financing</td>
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<td>Inadequate Supply Of Infrastructure Tax Rates</td>
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<td>Poor Work Ethic In National Labour Force</td>
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<td>Poor Public Health</td>
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<td>Crime And Theft</td>
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Source: World Economic Forum
according to ECLAC. Barriers and deterrents persist for females to enter on employment, including attitudes toward work, childcare commitments as well as regulations regarding childcare provision. Even though overall education quality and access to higher education have improved, early stages of compulsory schooling remain the priority. According to the OECD, Chile’s high minimum wage and strong employment protection hamper access to the job market among low-skilled workers. In addition, public employment services and training systems remain underdeveloped.

Some recommendations provided by the OECD to overcome the issue include extending high-quality childcare, promoting flexible working hours, expanding the reduced minimum wage for youth under 18 to those under 25 years and implementing the reformed apprenticeship contracts, strengthening the public training framework through quality standards and performance assessments for training providers.

Chile’s overall growth has been achieved by an accumulation of incremental factors over the past decade, and there has also been a recent increase in productivity. Research and development is conducted mainly by universities as business R&D intensity and innovative outputs are low. In addition, technological progress is hampered by shortage of qualified graduates in disciplines such as the sciences, technology and engineering management. Government policy has become more supportive of innovation over the last several years, with reforms enabling new entrepreneurs to open businesses more easily and quickly, as well as gaining access to financing. R&D tax credit regulations have made it easier to claim, and its usage is increasing. However, there remains plenty of room to expand innovation policies and to implement new programmes and incentives.

Some recommendations provided by the OECD to boost entrepreneurship and innovation include further co-ordination and association among different national stakeholders by establishing the Ministry of Innovation and facilitation of industry and research linkages, and promotion of public-private coordination to exploit natural resources.
Macroeconomic policies and commodity prices have carried Chile through a long phase of economic growth and job creation. The banking system is healthy, and the sound government financial position has been rewarded by low sovereign spreads and credit rating upgrades. The economy is expected to continue growing steadily and inflation has remained at historic lows. Strong domestic demand coupled with weakening foreign markets have pushed the current account balance into deficit, which has been financed mostly through FDI.

OECD recommendations in this regard include maintaining the sound macroeconomic policy framework and keeping a medium-term budget target consistent with a strong government net financial position. In addition, further development of high-quality education and efficient, well-evaluated social protection programmes should be implemented and funded by combating tax evasion.

Reliance on copper exports has, however, increased Chile’s exposure of risk to commodity price fluctuations.

Strong economic growth has resulted in significant deterioration of Chile’s environment due to intense natural resources exploitation, notably impacting air quality and the availability to clean water, which have both been significantly degraded. The use of renewable energy is limited almost entirely to hydropower, and fossil fuel sources of energy, which are mostly imported, accounted for 65.9 per cent of energy consumption in 2012. Mechanisms to overcome environmental externalities have been implemented yet remain insufficient. There is plenty of room for the mining sector to reduce its emissions and soil contamination.

The OECD’s recommendations include formulation of a strong green growth strategy which should support the achievement of emissions and renewable energy targets, the development of effective mechanisms to optimise water use and ensure the enforcement of obligations on owners of mining licenses to mitigate pollution and negative externalities.
Chile is currently experiencing an energy crisis which has somewhat hampered its industrialisation and has adversely affected its business competitiveness.

At present, Chile is reliant on international supplies of oil and gas, which accounted for 65.9 per cent of its energy in 2012. In addition, Chile’s growth is correlated with energy demand such that consumption is expected to increase by 5-6 per cent a year. By 2020, demand is expected to be 100,000 GWh.

It should be noted that mining accounts for 37 per cent of energy consumption, which is expected to increase given the mining projects announced for upcoming years. At present, the price of energy in Chile is around USD$0.14/KWh, which is one of the highest among OECD countries and this has affected the development of energy-intensive projects such as those in mining and manufacturing.

From a government standpoint, the Ministry of Energy has set an agenda based on six pillars, namely: a boost in efficiency; development of renewable energies; a new role of conventional energy fostering optimal use of hydroelectricity; focus on transmission; more competitiveness in the electricity market; and regional integration and cooperation.

Source: Chilean Commission of Energy
Chile has a consolidated its position as a free-trade oriented and open economy. It has signed more than 20 free-trade agreements (FTAs), gaining access to a global market of more than 58 countries and 4.2 billion people. Bilateral FTAs have been signed with the European Union, EFTA countries, India, Mercosur, Japan, Australia, South Korea, China and Hong Kong, Vietnam, the United States, Turkey and Malaysia, among others.

Chile’s main export partners are China (23.9 per cent), USA (12.2 per cent), Japan (10.6 per cent) and Brazil (5.5 per cent) with principal products being copper and its derivatives, fruit, fish-based products, paper, cellulose and wines. Its main import partners are the US (21.9 per cent), China (18.2 per cent), Argentina (6.7 per cent) and Brazil (6.5 per cent) where the main items imported are oil and its derivatives, chemicals, electrical equipment and telecommunications, industrial machinery, vehicles and natural gas.

With regard to foreign direct investment, Chile is presently one of the world’s largest recipients of foreign capital. In 2012, overall inbound FDI reached USD$30.323 billion, which ranked the country 11th globally and was an increase of 32.2 per cent from 2011. The most important investing countries in 2012 were the United States (19 per cent), Spain (18 per cent), Canada (12 per cent) and Japan (8 per cent). So far as capital recipients are concerned, mining accounts for 34 per cent, followed by financial services (33 per cent) and electricity, gas and water (8 per cent) (FDI stock).

Not only has inbound investment witnessed a dramatic increase, but outward investment has significantly picked up as well. Interestingly, in 2012, Chile was the 17th-largest investing country worldwide with a total figure of USD$8.553 billion, which was an
increase of 47 per cent above 2012 levels (USD$5.819 billion). In 2012, Colombia was the main destination of Chilean investment (USD$5.315), followed by Brazil (USD$916 million), the United States (USD$552 million), Peru (USD$477 million) and Canada (USD$243 million).

A key driver for Chilean companies expanding abroad is the rapid saturation of its small domestic market, making international expansion the only growth avenue. This has been the case for retailers, food and beverage manufacturers and transport companies. Thus, companies like Cencosud, Falabella, Ripley, CCU, Embotelladora Andina, Concha y Toro, Carozzi, CSAV and LAN have expanded into neighbouring countries, taking advantage of the geographical proximity and cultural similarity.

Another important driver has been the cross-border exploitation of natural resources to build competitive advantage. Forestry-related firms CMPC and Arauco for instance, have replicated their domestic business models in Argentina, Brazil and Uruguay; they have integrated vertically to manage both forest management, processing and subsequent sales domestically and/or exports abroad. Wine producer Concha y Toro has also taken advantage of its production capabilities to manufacture in Argentina and the US.

With a different approach, minerals producers SQM and Molymet have kept their extraction processes in Chile but have taken more control over distribution, marketing and processing facilities in foreign countries.

The Pacific Alliance is an important initiative implemented by Chile, Mexico, Peru and Colombia, created in April 2011. Its main objectives are to build an integration zone with a firm commitment toward free movement of capital, goods and people, to foster growth, development and competitiveness of the member countries and to become a hub of regional integration in economic and commercial terms with special emphasis on Asia-Pacific. Home to 38 per cent of the population of Latin America and the Caribbean and 34 per cent of its GDP, the group already accounts for half of intraregional trade, 50 per cent of regional trade with Asia and 42 per cent of foreign direct investment in Latin America, according to the Inter-American Development Bank. Panama and Costa Rica have said they are eager to join the Pacific Alliance, and some thirty countries have already been granted observer status, including Australia, Canada, China, India, Japan, New Zealand, Singapore, Spain, the United Kingdom, the United States and Uruguay.
PAST, PRESENT AND FUTURE OF A COUNTRY LOOKING FOR A PATH OF ITS OWN

“Peruvians descend from the Incas; Mexicans, from the Aztecs; Argentines, from... boats”

This saying is a good starting point to try to understand the social makeup of Argentina, a country with a vast, sparsely populated territory and enormous potential.

Let us take a quick look at the history.
Argentina, like all of the Americas, was first conquered by the Spaniards and was a part of the so-called Viceroyalties – that is, the King’s delegations for the administration of the Americas. The main Viceroyalties were those of Mexico and Peru; the ones further south were considerably less important. In fact, although the conquest began in 1500 and Buenos Aires was founded as early as 1582, the city was of no political significance. The Viceroyalty of the River Plate was only established in 1776, and for practical reasons: Buenos Aires was the port of entry for smuggled goods headed for Bolivia, the main mining centre.

Argentina was therefore only a Viceroyalty for less than 50 years. By 1810, Argentina had broken with Spain: it was one of the first countries in the Americas to achieve its independence. The reason for its successful break with the colonial power was precisely its remoteness from Spain. There are two important aspects to this: first, that Argentina was never very dependent on Spain and accordingly its society was used to making its own rules; and second, the country developed close relations with the United Kingdom, given that a large proportion of the smuggled goods entering Buenos Aires came from Britain.

At war with Napoleon and his ally, Spain, the British saw a valuable imperial asset in Argentina and attempted to take over Buenos Aires in 1806. The population’s successful resistance of this invasion gave them the courage to shake off Spain; and in 1810 the country gained its independence from the Spanish crown. Thereafter, Argentina exerted significant influence in Latin America, given that its army took part in the independence of Chile and Peru, under the command of General San Martin. In other words, Argentina had a major presence in America in those early years, only to turn inward again later on.

Like any country that becomes independent, Argentina took a long time to achieve some degree of order. A succession of civil conflicts gradually established the balance of power in the country, creating a divide that lingers to some extent today – Buenos Aires, as the main port and urban centre, versus the hinterland, the rest of the country. This division was referred to as the conflict between “Unitarians” and “Federalists”. The Unitarians wanted a strong national State, with its seat of government in Buenos Aires, and weak provinces; and the Federalists wanted strong provinces and a weaker national State.
In seeking to understand the essence of Argentina, this is a useful pointer: ultimately, the Federalists won, and the Constitution of 1860 was Federal – but in practice, the country is Unitarian.

**AS WE WILL SEE, THIS IS EMBLEMATIC OF ARGENTINA – TO CLAIM IT IS ONE THING AND ACTUALLY BE ANOTHER.**

1860 saw the start of the boom years in Argentina’s economic history, when land was first allotted for beef and agricultural production. Argentina began to open up to overseas trade and immigration. The initial waves of European immigrants arrived, mainly from Spain and Italy, and to a lesser extent Germany, the Netherlands and Denmark. The other significant current of immigration was from Lebanon, Turkey and Syria. These migrant cultures gradually moulded today’s Argentine nationality.

The way land ownership was allocated played a fundamental role in Argentina. While in the US, pioneers were given a square league of land on a first-come-first-served basis, in Argentina land was assigned to military officers or leaders of bourgeois society. As a result, when large waves of immigrants started to arrive there was no land left to give – the land had its owners and what was lacking was a labour force.

So immigrants came here to work other people’s lands, not their own.

Argentina’s economic growth in those years rested on three pillars. The first was a strategic alliance with Britain. The country’s capacity as a supplier of beef, wheat, cotton, tanned hides and the like was huge, and in turn the UK supplied it with industrial goods.

This was not just about trade however – it extended to investments in Argentina. The railways, power companies, tramways and the ports all involved British investments that gradually developed the country’s infrastructure.

The second pillar was the establishment of democracy, albeit subject to fraud and elite compacts: from 1860 onwards, presidents could remain in office no longer than six years, after which they were required to pass on the job to someone else. 1916 saw the introduction of compulsory voting and the secret ballot, thus broadening the social basis of democracy.
The third and highly significant pillar was Law No 1420 on Compulsory Education. At the time, this law paved the way for the greatest education drive in Latin America. Most of the immigrants from Europe were illiterate or had 2 or 3 years of schooling at best. Education was also important as a unifying force, providing a common identity to all the nationalities that now had to coexist.

Additionally, in 1918 there was a major university reform – from that point on universities became autonomous and broke free from the strong influence of the Church. This produced a significant leap forward in university education.

**SO IT WAS ON THE STRENGTH OF THESE THREE PILLARS THAT ARGENTINA BECAME ONE OF THE WORLD’S RICHEST COUNTRIES AND THE MOST IMPORTANT NATION IN LATIN AMERICA. IT WAS A COUNTRY WHOSE GROWTH WAS HIGHLY DEPENDENT UPON IN ITS TRADE WITH THE WORLD, AND ESPECIALLY WITH THE UK.**

**In the 1930s, the three pillars of Argentine growth all collapsed.** The 1930s crisis hit an open economy like Argentina’s head on. The fall in UK demand left the country with a major economic contraction. This led to a crisis and the attempted solutions for the nation’s troubles only made matters worse.

**First,** from a political viewpoint, President Yrigoyen was overthrown and the first military dictatorship was installed. There was no more democracy: parliament was dissolved and the judiciary subdued. A few years later elections were resumed, but with exclusions and fraud, generating increasing social divisions.

The main divide was between those who could take part in politics and those who could not.
Once again, there was conflict among Argentines. In fact, the 1930s were labelled by several Argentine historians as a “decade of infamy”.

Secondly, the economy. Argentina’s ruling class wanted to preserve the previous economic programme, based on trade with the UK, at all costs; but it was effectively defunct. The country’s political leaders, either out of short-sightedness or self-interest, failed to accept that the world had changed and sought to maintain the status quo.

This led to a well-known 1933 trade treaty, known as the “Roca-Runciman Pact” after the officials who signed it, which was a symbol of an Argentina that wanted to return to the past and did not understand the future.

**UNEXPECTEDLY, THE AGREEMENT WAS A FAILURE.**

Thirdly, education. In this case the best symbol of decline came with the government of Juan Domingo Peron, when the phrase “shoes, not books” was coined, as Argentine society gradually began to lose its regard for education.

The process of educational decline, which was slower than the others, came to a head in 1966 – under another military regime – on the so-called “Night of the Long Sticks”, when truncheon-wielding police stormed university buildings and drove teachers out by force, leading a large proportion of Argentina’s intellectual elite to head overseas. Cesar Milstein, Argentine recipient of the Nobel Prize for medicine, was among those who left, heading to the UK.

The erosion of the three pillars continued up to and during the worst dictatorship Argentina endured – in the global context of the Cold War –, which ended with the Malvinas (Falklands) War in 1982.
The loss of political stability led in turn to instability in the economy, as economic policy began to reflect a short-term view. Elected governments simply did not know how long they would remain in power.

Neither did military regimes – but the latter had to justify the coups that installed them by highlighting the blunders of the ousted administrations and by launching plans to set things right. These plans, in turn, were short-lived. Between 1955 and 1983, the average government lifespan was less than two years, and only one government made it to five, while the constitutionally-mandated presidential term was six years.

Consequently, presidential instability made it impossible to develop long-term policies. So it was that Argentina swung back and forth between periods of liberalisation and protectionism, with neither trend lasting very long. The only constant were the changing rules.

ARGENTINA’S ‘MOOD SWINGS’ INSPIRED A WELL-KNOWN ARGENTINE ENGINEER TO WRITE A PAPER CALLED ‘THE ARGENTINE PENDULUM’, EXPLAINING HOW THE RAPID SHIFTS FROM ONE PROGRAMME TO THE NEXT PREVENTED THE ADOPTION OF CONSISTENT POLICIES ALLOWING FOR ECONOMIC GROWTH.

During these years, Argentina’s economy did grow but with significant ups and downs and increasing inflation. Inflation became “a part of Argentina’s social and political culture”. As a means of putting off actually having to deal with problems, inflation suited a society with no long-term view.

The worst of times came in the 1970s with the emergence of guerrilla organisations, linked to Peronism but not answering to Peron himself. A wave of bombings, kidnappings and takeovers of military facilities began, in an escalation of violence. In July 1975, General Peron died and in March 1976 there was yet another coup.

This marked the start of the so-called “Process of National Reorganisation”, a dictatorship that was responsible for the disappearance of over 10,000 people – human rights NGOs speak
of 30,000, but 9,900 cases were officially recorded – and the deaths of many others occurred in armed combat.

This regime, the worst in Argentina’s history, came to an end after going to war against the United Kingdom over the Malvinas Islands. The military government invaded the islands in April 1982 and by 10 June it had surrendered. The war, as terrible as it was futile, had the sole aim of preserving the political power of the regime.

The defeat at the hands of the British gave way to the restoration of democracy, after seven years of blood and death in Argentina.

On 10 December 1983, democracy was restored to Argentina and, unexpectedly, the Peronists were beaten in the presidential elections. The winner was the traditional middle-class party, the Union Civica Radical (UCR), under the leadership of Raul Ricardo Alfonsin.

The elected government faced many challenges – multiple political demands for justice, participation and freedom, together with a heavy economic legacy of 300 per cent-plus annual inflation, a foreign debt default and a badly crippled industrial sector.

**THE HISTORIC TRIAL OF THE MILITARY JUNTAS**

The new government’s main challenge was to uncover the truth about the ‘disappeared’ and bring those responsible to justice. Never before in Argentina’s history had the generals who staged a coup been put on trial.

After a two-year trial, the generals were found guilty of the forced disappearance and murder of several people. But what was most important was that the trial was public and, as a result, all of the proceedings were publicised and widely followed. This generated a heightened awareness among Argentine society of what had happened and led to the publication of a book called *Never Again*, representing the country’s will never again to allow a dictatorship to come to power.

Thus Argentina has had democratically elected governments since 1983: there are elections every two years, this has provided the country with clearer political settings.
SINGLE-PARTY RULE UNDER PERONISM

However, Argentina’s democratic institutions are still very weak, and power has become increasingly concentrated in a single party, the so-called Peronist party. Since the inauguration of Carlos Menem in 1989, with the exception of two years (1999-2001), Peronism has always been in government.

The fact is that this party has cleverly managed to present itself as government and opposition at the same time. Thus Menem’s main opposition came from Eduardo Duhalde, his Vice-President. Later on, Duhalde backed Nestor Kirchner for President, only for the latter to, in turn, break with Duhalde. And today, once again, the main opposition to the Peronist government is from Peronism itself.

Consequently, Peronism constantly succeeds itself in power, with fluctuations in its economic policies: populist tendencies in the boom years and a more rightist inclination in harder times – all within the one political party.

In fact, Peronism is not driven by any political standpoint (or notion of whether the country should have a free-market or socialist makeup), but by the will to power. The ideology changes as required by the need to remain in power. This explains why every Peronist president toys with the idea of constitutional reform, with a view to eluding presidential term limits.

In this context, Argentina’s democracy needs to evolve further and see the establishment of at least two parties to alternate in power, as well as the renewal of the political bureaucracy.

In any case however, the holding of free elections every two years provides a measure of institutional stability that is requisite to Argentina’s development.

ECONOMIC INSTABILITY

Argentina is slowly building its political stability, but economic stability is pending.

At the outset of democracy, and weighed down by a legacy of default and inflation, President Raul Alfonsin launched the first anti-inflation programme implemented by a democratic government in Argentina, the so-called “Austral Plan” of June 1985. The plan was successful at first, bringing monthly inflation down from 20 to 1.5 per cent.

But social unrest and the inability to balance the fiscal situation saw the government defeated in mid-term elections in 1987, and thereafter inflation ballooned to hyperinflationary levels. In 1989 it reached nearly 5000 per cent p.a., with a monthly peak of 196 per cent in July 1989.

After 1989 there was a second burst of hyperinflation in early 1991, leading in March of that year to the introduction of a programme known as “convertibility”. This anti-inflation programme involved two basic principles.
The first was that the Argentine peso was pegged to the US dollar at a one-to-one parity. The second was that the Argentine Central Bank was required to acquire one US dollar for every Argentine peso it issued – in other words, the printing of money to fund public spending, or for any purpose other than the acquisition of US dollars, was forbidden.

The programme was initially a great success, lowering inflation from 1340 per cent p.a. in 1990 to just 4 per cent p.a. in 1992, and inflation stayed very low until the end of convertibility in December 2001.

A fixed exchange rate provides a short-term advantage, in that it lowers expectations and organises the economy. It was, in that context, a powerful tool against inflation. But over time, with productivity in Argentina growing at a slower pace than in the US, the economy lost competitiveness and maintaining the fixed exchange rate became impossible.

In an effort to preserve the currency peg, the Argentine government turned to capital markets and took on debt to an unrepayable level. Convertibility came to an abrupt end with a steep devaluation of the Argentine peso, which went from one to the US dollar to four to the dollar in just two months.

The devaluation meant the government was unable to pay its external debt: the country declared itself in default and began renegotiation discussions with creditors that became a recurring feature of those years. Argentina successfully renegotiated a large proportion of its foreign debt, but many issues remain unresolved to this day, such as the Paris Club debt and the matter of the so-called holdouts (private creditors who turned down the 2005 debt swap), who are litigating in New York.

After the hard years of the worst economic crisis in Argentine history, there was nowhere to go but up: already by 2003, Argentina’s economy was recovering at rates of 8 per cent a year and it continued to do so until 2008, the year a conflict broke out with farmers over an extraordinary tax the government sought to push through despite issues concerning its legitimacy. That year the economy began to lose its momentum.

Once again, the penchant for economic mismanagement that is typical of Argentine governments reared its ugly head, and as of 2012 the economy slipped back into a process of stagnation with high inflation (above 25 per cent p.a.).

Clearly, Argentina’s economy is highly cyclical. This is a country where economic growth can shoot up over 8 per cent in a year only to plummet by 6 per cent just as easily. A tremendously volatile country, whose average per capita growth rate, in spite of the peaks, is low.
In the here and now and there are constant demands to meet immediate needs, regardless of future consequences.

However, as a community we are slowly progressing. This may be a society that has slipped into reverse, but it has bounced back before.

Argentina is the world’s eighth-largest country, but only the 44th in terms of its population. This means its territory is largely uninhabited. Although Australia is bigger and its population smaller, the proportion of desert is much lower in Argentina. The greater Pampas region boasts over 40 million hectares of arable land, with the capacity to produce food for 600 million people.

Argentina also has large amounts of minerals, and the world’s third largest shale gas reserves. So, Argentina has the potential to produce abundant supplies of the food and resources that the world needs and is ready to pay for.

Learning from the experience that Australia went through in the eighties in opening up its economy and setting clear regulations for economic activities would allow Argentina to reset its course onto a path of growth. Australian know-how and both intellectual and financial capital will be of enormous help to Argentina in the coming years.

After all these years of crisis, Argentina is in the position Australia found itself in during the late twentieth century. By learning its own lessons, Argentina can reshape its economic rules, incentives and institutions for a much better, brighter future.

Argentina can return to a path of stable and sustainable growth, leading to an improved quality of life for all of its people, just as it experienced in the heady days of the nineteenth century as one of the most prosperous societies in the world.
Like most Latin American countries, the economic history of Uruguay is characterised by intense cycles of boom and bust in GDP, living with high levels of inflation, external imbalances, but above all, of continuous learning.

The difficulty of sustaining extended periods of growth placed the output growth rate at 1.4 per cent between 1955 and 2004. Structural reforms implemented in the country in the last thirty years', along with the economic policies applied, have increased the long-term growth rate of the economy, which currently stands at 4 per cent.
The 1980s marked a period of great economic hardship across Latin America, referred to as the "lost decade". In Uruguay, this period was characterised by an economic and foreign debt crisis in 1982 and the restructuring of the political system, with the restoration of democratic government in 1984, after a dictatorship that had lasted over 10 years.

Uruguay entered the 1990s with the need to strengthen its political and democratic institutions and implement structural reforms that would sustain the process of economic growth. After the dictatorship\(^2\), Uruguay was able to consolidate one of the strongest democratic regimes in the region\(^3\). There is also strong legal certainty and respect for the fundamentals of economic activity. This has been the case in Uruguay regardless of which party is in power. In fact, since the return to democracy the three main political parties have rotated, maintaining a strong commitment to respect the rules of the game and strong political and social stability.

In the 1990s, most of the economies in the region promoted the so-called "second generation reforms" driven by the vision of the Washington Consensus (seeking to complement those of the "first generation" that had begun in the 1970s that aimed at a greater liberalisation of markets). Although Uruguay did not undergo the process of privatising state companies that took place in other countries in the region, there were grants and partnerships that operated as alternatives to privatisation, keeping public companies in state hands, which remains the position today. Similarly, there was a gradual opening up to competition in some markets: mobile telephony, water, insurance, port services and higher education.

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\(^1\) Commercial and financial openness
\(^2\) Uruguay suffered a dictatorship from 1973 to 1985
\(^3\) Uruguay ranks first in Latin America in the Democracy Index prepared by The Economist Intelligence Unit (2012).
One of the main reforms was the one undertaken on the social security system (1995), which passed from a state system to a mixed system with two pillars: intergenerational solidarity (managed by the State) and individual savings (managed by the AFAP⁴). Among the reforms of the 1990s, the most notable was that of the capital market (Securities Market Law of 1994), which has been complemented by the emergence of institutional investors: insurance companies, investment funds and pension managers.

Finally, the reform process to open up to external markets began with the liberalisation of trade restrictions, reducing tariffs and signing bilateral agreements (CAUCE and PEC) with major trading partners Argentina and Brazil, respectively. In 1991, Uruguay, Argentina, Brazil and Paraguay signed the Treaty of Asuncion creating MERCOSUR, deepening the trade liberalisation process initiated in the mid-70s. In 2006, Venezuela joined Mercosur and in August 2012 joined the bloc as a full member.

In 2002, Uruguay faced its worst-ever economic crisis, brought on by the recession (Brazilian devaluation in 1999 and an economic-financial crisis with devaluation in Argentina in 2001), coupled with a highly dollarised Uruguayan economy with its fixed exchange rate as a nominal anchor. Also, there was a strong commercial and financial dependence on Brazil and Argentina, with significant external imbalances that resulted in a financial crisis and severe economic recession. During the crisis, GDP dropped 14 per cent, unemployment soared (20 per cent), poverty and homelessness in the following years reached almost 40 per cent and 5 per cent respectively, among other effects that left deep scars in the country.

The Uruguayan economy managed to recover and social and political stability played a crucial role in this. In order to support the process of debt restructuring, the political system and all actors involved committed to working together, which reflected the maturity of the Uruguayan democratic system. This enabled Uruguay to avoid default and thus maintain the historic pledge to pay the sovereign debt. This “successful” response has provided the basis for the growth that the economy has been experiencing for several years.

⁴ Pension Fund Administrators.
In contrast to what happened during most of the twentieth century, in the last decade Uruguay’s growth has been characterised by high rates, a significant increase in investment and strong exports.

The Uruguayan economy grew at an average annual rate of 6 per cent between 2005 and 2012, which enabled its GDP to reach a record high of almost USD$50 billion in 2012. The orderly management of maco-economic policy is also mirrored in its fiscal and monetary performance. In the last ten years, the primary result has remained in positive and stable values and inflation has stayed in single digits.

The country also has an orderly management of its public debt. The debt-output percentage was gradually reduced due to a lower degree of public indebtedness, while significantly reducing its dollarisation. Additionally, a major re-profiling of the debt was made, improving terms and rates. This process occurred in parallel with a relative increase in reserve assets, which shows that the country has financial backing.
This orderly macroeconomic management led Uruguay to achieve investment grade\(^5\) rating. This reflects the trust generated by the country’s institutional framework and the management of economic policy and has had positive impacts on public finance by reducing the State’s financial costs and making it easier to obtain credit internationally.

Uruguay has been characterised as being a country with low investment rates. Between 1983 and 2004, the investment rate (in GDP per cent) was 15 per cent. Between 2005 and 2012 this percentage increased reaching an average of 20 per cent. This improvement occurred due to, among other factors, the key role played by Foreign Direct Investment (FDI).

With regard to FDI, in the last few years, Uruguay has positioned itself as a trustworthy and attractive destination for foreign investors, by virtue of a favourable investment climate and promising macroeconomic performance. In response, the FDI inflow in 2012 registered its historic peak of USD$2.775 billion, representing 5.4 per cent of GDP.

FDI RECEIVED BY URUGUAY COMES MAINLY FROM ARGENTINA, SPAIN, THE NETHERLANDS, BRAZIL AND THE UNITED STATES.

In the past few years, productive FDI inflow has been mostly aimed at the construction, farming and industry sectors. What is most important is that this investment has focused on new projects and capabilities, concentrating on sectors that export goods and services internationally.

\(^5\) Granted by Standard & Poor’s and Moody’s in 2012, and by Fitch Ratings and DBRS in 2013. Uruguay lost its investment grade in the crises of the beginning of the 21st century.
This strong investment growth occurred thanks to an appropriate framework for domestic and foreign investors established by the Investment Law. In Uruguay, local and foreign investors are guaranteed equal treatment and incentives to promote investment are available for both. There are no limits to the transfer of income or capital repatriation and no prior permits are required.

Within the framework of the Investment Law, various sectors have received incentives and have been increasingly important in the transformation of our productive structure, for example renewable energy, shipbuilding, the electronics industry, agricultural machinery and equipment manufacturing, planting of fruit trees, forestry, biotechnology, tourism and export global services among others. Other attractive benefits for the investor are the Free Zone regime, Industrial Parks, Customs warehouses, Free Ports and Airports schemes.

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6 They sepecialise in mega projects and global export services
In recent years, the export of Uruguayan goods and services has recorded a substantial growth in value. The export of goods increased from USD$2 billion in 2002 to a record of USD$10 billion in 2012. The cumulative annual growth rate was 16 per cent during this period.

This growth took place in conjunction with an important process of technological modernisation, diversification and value adding to traditional products (mainly meat, leather, wool and dairy). In particular, in the case of meat, Uruguay has become internationally renowned for implementing a unique electronic traceability system that enables to follow meat products from “farm to fork”.

In addition, the country is diversifying both its products and their export destinations. In the past few years, the country has exported new products such as cellulose (with the opening of UPM\textsuperscript{7} and the future Montes del Plata\textsuperscript{8} plant), grains (soybean and wheat, mainly), auto parts and medicines. Uruguayan goods were exported to over 160 countries in 2012.

Moreover, between 2002 and 2012 export of services from Uruguay increased fivefold, reaching USD$4 billion in 2012. This growth is partly due to the boost in tourism, but also as a result of the significant development in global export services, among which software, audio-visual productions, life sciences, professional and financial services are notable.

Additionally, Uruguay has gone through a profound shift in production activities in the past two decades, as reflected in the change in composition of Uruguayan exports (see P.91).

\textsuperscript{7} From Finland \textsuperscript{8} Chilean, Swedish and Finnish capitals
**EXPORT GOODS AND SERVICES (MILLION US$)**

Source: Uruguay XXI based on data from Central Bank of Uruguay, Ministry of Economic Affairs

**MAIN EXPORTS (PER CENT)**

Source: Uruguay XXI based on data from Central Bank of Uruguay, Ministry of Economics Affairs and Free Zone Census 2010
Latin Lessons: Uruguay

In the coming years, the Uruguayan economy is expected to continue growing at rates of around 4 per cent, extending the decade of uninterrupted growth. In the following table some of the projections that support this trend are shown.

INDICATORS

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<th>INDICATOR</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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<th>2014*</th>
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<td>20.5</td>
<td>22.6</td>
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<tr>
<td>Exchange Rate (Av Ann Var)</td>
<td>7.73</td>
<td>-1.12</td>
<td>-3.7</td>
<td>5.2</td>
<td>1.2</td>
<td>9.7</td>
</tr>
<tr>
<td>Consumer Prices (Ann Acc Var %)</td>
<td>5.9</td>
<td>6.9</td>
<td>8.6</td>
<td>7.5</td>
<td>8.9</td>
<td>8.8</td>
</tr>
<tr>
<td>Export Of Goods (Million US$)</td>
<td>5,425</td>
<td>6,727</td>
<td>8,022</td>
<td>8,751</td>
<td>9,057</td>
<td>9,148</td>
</tr>
<tr>
<td>Imports Of Goods (Million US$)</td>
<td>6,907</td>
<td>8,622</td>
<td>10,676</td>
<td>11,656</td>
<td>12,015</td>
<td>11,962</td>
</tr>
<tr>
<td>Commercial Superavit/Defict (Million US$)</td>
<td>-1,482</td>
<td>-1,895</td>
<td>-2,654</td>
<td>-2,905</td>
<td>-2,958</td>
<td>-2,814</td>
</tr>
<tr>
<td>Commercial Superavit/Defict (GDP %)</td>
<td>-4.9</td>
<td>-4.9</td>
<td>-5.7</td>
<td>-5.8</td>
<td>-5.3</td>
<td>-4.8</td>
</tr>
<tr>
<td>Global Fiscal Result (GDP %)</td>
<td>-1.7</td>
<td>-1.1</td>
<td>-0.9</td>
<td>-2.8</td>
<td>-2.1</td>
<td>-2.7</td>
</tr>
<tr>
<td>Investments (GDP %)</td>
<td>17</td>
<td>18</td>
<td>19</td>
<td>21</td>
<td>22</td>
<td>20</td>
</tr>
<tr>
<td>Gross Debt (GDP %)</td>
<td>7.6</td>
<td>615</td>
<td>582</td>
<td>62.4</td>
<td>62.8</td>
<td>6.3</td>
</tr>
<tr>
<td>Foreign Direct Investment (Million US$)</td>
<td>1,529</td>
<td>2,289</td>
<td>2,505</td>
<td>2,775</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Foreign Direct Investment (GDP %)</td>
<td>5.1</td>
<td>5.9</td>
<td>5.4</td>
<td>5.6</td>
<td>5.4</td>
<td>5.1</td>
</tr>
</tbody>
</table>

Ann = annual; Av = average; % = per cent; Var = variation; Acc = accumulated.
Source: Central Bank of Uruguay, Ministry of Economic Affairs. National Institute of Statistics, Uruguay 100
Uruguay is a socially integrated country since it does not have ethnic or religious conflicts or groups that have been excluded from its social or institutional framework. In this context, the sustained economic growth of the past decade has been reflected in an improved quality of life. Rated as the most transparent, stable and safe country in Latin America by numerous international rankings, it also has a pleasant climate and hospitable and welcoming population.

Regarding progress in social issues, according to a recent World Bank study, the middle class grew from 40 per cent of the population to 63 per cent, which turns Uruguay into the region’s country with the highest proportion of middle class people. This is also reflected in the decrease of the Gini Inequality Index, transforming Uruguay into the most egalitarian country in Latin America.

Additionally, there has been a sharp reduction in households living below the poverty line and in indigent conditions. While in 2004, 29 per cent of the households were poor and 2.5 per cent indigent, in 2012 these figures dropped to 8.9 per cent and 0.3 per cent respectively.

Among the reforms that kept pace with this process of growth it is worth mentioning the creation of the National Integrated Health System in 2007, which enabled a significant portion of the population to access new benefits, and the tax reform that achieved considerable improvements in the efficiency and equity of the tax system.

Finally, Uruguay has stood out internationally for being the first country in the world to implement the program “One Laptop Per Child (OLPC)”, through the Ceibal Plan, that provides a laptop to every public school, high school and technical college student.

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The Ceibal Plan is yet another success story that Uruguay has exported to the world. In particular, it has allowed for a substantial reduction of the digital gap, while requiring the creation of new capabilities among the population and opening an important window of opportunity for the future.

**Uruguay is anticipating the challenges of economic growth. Work is underway to build a more efficient country, creating new business opportunities for companies.**

In this regard, there has been a continuous process of adjusting the rules and laws to the reality of the twenty-first century. In 2007, the Law on Protection of Competition was passed in favour of maximising the welfare of economic agents and in 2008 the Bankruptcy Law was passed seeking to simplify, unify and facilitate the process of bankruptcy.

A new **Customs Code** is being developed that will update terminology and customs regulations to international standards and will enable greater consistency and unification of legislation. This new Customs Code gives equal weight to the customs role of being both facilitator and operational overseer of trade operations. Furthermore, progress is being made in improving **state processes**, including some milestones such as the customs modernisation process (digitisation of procedures, decentralized payment, **Single Window for Foreign Trade**), facilitating payments to the tax office as well as social security and the implementation of a programme to open a business in one day.

**Likewise, in Parliament a new law is under consideration in order to update the Free Zone regime; this bill has been a model across Latin America.**

In addition to all benefits that have already been granted to companies, the new regime proposes a more effective targeting of incentives.
In order to consolidate the process of productive transformation, growth should be aligned with investments in physical and human capital. The economic growth of the last decade has absorbed the vast majority of the skilled human capital, leading to new challenges for the future. At the same time, it is necessary to invest in infrastructure required to provide support to the increasing economic activity.

In this context, it is important to consider the agenda of priorities for the years ahead so that challenges become opportunities. Thus, the government has developed a Public Private Partnership regime (PPP). Through these partnerships, they seek to solve many of the existing infrastructure problems. The government expects to enhance the development of the railway system that is currently underutilised. Given that the large increase of goods to be transported will entail major investments in roads, the government is actively seeking out PPP investment in this sector. Lastly, the building of a deep-water port in the Atlantic zone has approved by law and will begin in 2014.

**SMALL BUT WILLING TO TAKE UP BIG CHALLENGES**

Uruguay is historically known for being a country at the forefront of social legislation since it made significant progress in its early days: it was the first country in Latin America to grant women the right to vote, it implemented a major educational reform allowing it to achieve high levels of literacy and developed a Welfare State in the early twentieth century, thus fostering the creation of an extensive platform of civil and labour rights.

In recent years, Uruguay has implemented new legislation that has led to wide international recognition. In 2008, an anti-tobacco Law was passed which has been taken as a model by several countries and has been praised by various international organisations. In 2013, the Sexual and Reproductive Health Law was approved, providing support to women with an unwanted pregnancy. In 2013, the Equal Marriage Law passed enabling marriage between persons of the same sex.
In late 2013, Uruguay appeared on the radar agenda of the international media for passing a law that legalizes the purchase and sale of marijuana, as well as permitting cultivation for personal use. This initiative has been praised internationally as a powerful tool to fight drug trafficking, since the State would be responsible for producing and distributing goods and it would be combined with strong market regulation and education policy to raise public awareness.

IT IS ON THE BASIS OF THIS PROGRESS, WHICH ENABLED THE COUNTRY TO IMPROVE THE QUALITY OF LIFE OF ITS PEOPLE, THAT 'THE ECONOMIST' MAGAZINE RECENTLY CHOSE URUGUAY AS "COUNTRY OF THE YEAR" FOR 2013.

In recent years Uruguay has shown significant growth, which together with the reforms passed and more that are currently under way, has made significant progress on its development agenda. This has demonstrated that, despite of being a small country, it has the capacity and potential to face and live up to big challenges. This has positioned it as a “Maverick” country, a country that seeks to improve the quality of life of its people, a country that breaks conventional wisdom and dares to incorporate new practices.
Foreign trade between Uruguay and Australia does not yet involve large volumes of goods. In 2013, exports from Uruguay to Australia were approximately USD$750,000 and were mainly wood, fruit juice, ceramic ornaments, rice and wine. Uruguayan imports from Australia reached USD$20 million in 2013.

Despite the low bilateral trade flows, there are strong ties between the two countries. From the commercial point of view, both countries can readily act as gateways to their respective regions. In particular, Uruguay has plenty to learn from the best practices of a country with the level of development of Australia in different fields. First, Australia has vast experience in the mining sector and Uruguay has started some initiatives that could benefit from Australia’s experience. Second, the Australian educational system has yielded significant benefits to its population and Uruguay could benefit from the Australian model in order to improve opportunities for all Uruguayans. Third, given that both countries have an important livestock base (in dairy farms and meat and wool producing ranches), there are interesting opportunities for the exchange of innovative practices both in the use of technology, as well as biotechnological advances. In this respect, the association between Uruguay and Australia to develop, innovate or enter third markets (as has happened with the INIA and Latrobe University and some sales transactions in which meat producers of the two countries joined forces) could be exploited to a greater degree. Australia has also been a pioneer in the implementation of projects in public-private partnerships, which is one of the main sectors Uruguay seeks to develop in the coming years.

Last but not least, there is the large community of Uruguayans living in Australia, who can certainly enhance and facilitate trade and investment in the future.
| INTRODUCTION |


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Australia and Latin America have historically been separated by geography, culture and different economic ties. Because of their respective colonial links, Latin America looked to Europe and Australia looked to England, and we’ve been in different hemispheric ‘spheres of influence’ ever since.

But things are changing in the 21st century, as Asia and the emerging markets are on the march and Australia and Latin America find they have more in common in the Asia-Pacific century than they have had in the past.

Join Tim Harcourt ‘the airport economist’ and six of the most eminent economists in Spanish speaking Latin America for their take on the economic outlook for the region and the opportunities for Australia.

*Latin Lessons* is the companion piece to Great Southern Lands – building ties between Australia and Brazil also produced by COALAR.