Leonardo Martinez-Diaz is a political economy fellow of The Brookings Institution and deputy director for the Partnership for the Americas Commission.

Latin America: Coming of Age

Leonardo Martinez-Diaz

These are the best of times in Latin America and the Caribbean. With very few exceptions, all of the hemisphere's countries are now stable democracies. Civil war is a malady of the past, and peaceful transitions of power have become the rule, not the exception. Economic growth has been positive and robust across the region in recent years, hyper-inflation is a fading memory, and sound fiscal management has never been so widespread. The region's people are richer and living longer than ever before. Even inequality—that chronic bane of Latin American societies—has fallen in Brazil and Mexico.

Yet over the next quarter century, this region of 33 nations and 600 million people faces powerful forces of change from outside and within. Latin American societies are aging rapidly, and demographic change is forcing them to confront new social and economic problems. The rise of India and China is generating enormously lucrative opportunities for some Latin American countries but creating serious competitive difficulties for others. Climate change potentially threatens Central American and Caribbean nations with destruction and dislocation. A growing middle class is changing domestic political dynamics. What will these trends mean for Latin America in the next 25 years? What will the region look like in 2033?

A few themes will be central to Latin America's story in the next quarter century. To undertake crystal ball-gazing exercises that produce useful insights, the key is to focus on variables that are critical to a society's future but that are relatively inflexible in the short- or medium-term—for example, a country's industrial structure and the age distribution of its population. These characteristics provide clues about how a society's more volatile dimensions, such as its politics and economy, might evolve.

The Graying of Latin America

As countries get richer, they experience demographic change. Over the past half-century, as the economies of Latin America grew, life expectancy increased, infant mortality declined, and parents chose to have fewer children. The number of children per woman fell from 5.9 in the 1950s to 2.5 by the early twenty-first century. Today, the average Latin American lives roughly 72 years, almost as long as his or her European and North American counterpart. These trends are likely to continue. According to the United Nations, Latin America's birthrate will fall further, to 1.9 children per woman by 2030. Life expectancy at birth may ap-

© 2008 World Policy Institute

proximate 78 years by then. As a result, the number of Latin Americans aged 65 and older will rise steadily—indeed, that age group will increase faster than other age groups, at about 3 percent per year.

By 2033, Latin America will look a lot like the advanced economies of Europe and North America today, at least in demographic terms. Cuba and Uruguay will have the most people over 60 as a percentage of their populations, followed by Chile and Argentina. In 25 years, Brazil will have a ratio of old to young comparable to that of Canada today. Chile will have the age distribution of present-day Austria, and Argentina will look like today's Norway.

To keep things in perspective, overall Latin America will remain more youthful than Europe and Japan. In 2033, some 15 percent of Latin Americans will be over 60, but in Europe, the number will be closer to 30 percent. Still, by the standards of developing Asia and Africa, Latin America will be at a distinctly more advanced stage of maturity. Latin America, along with the United States, will come to occupy an intermediate position between the richest but demographically stagnant, societies of the global North and the poor, but fast-growing, countries of the developing South. (One key exception is China, which will come to resemble Latin America's more mature countries.)

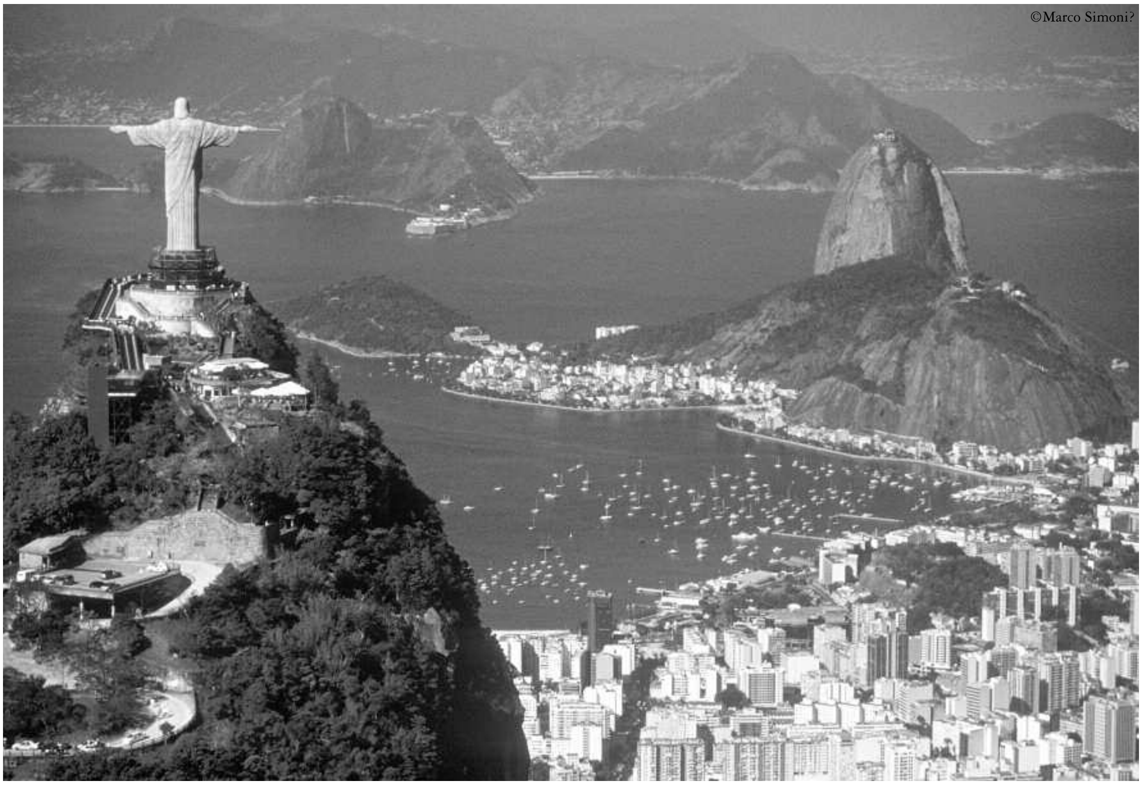
Narrowing Window of Opportunity

What will these demographic changes mean for the economies of the region? First, the good news. In the next quarter century, Latin America will enjoy what is known as a "demographic bonus." The economically active population will grow more quickly than the total population during this period, and the workforce will expand. Latin America will have 127 million more economically active people in 2033 than in 2006. At the same time, the "dependency ratio"—the proportion of non-working people (children and the elderly) relative to the working population—will fall. The dependency ratio has been dropping across the region already, but it will continue to fall for years. In 1990, for example, Latin America had approximately 300 economically inactive persons for every 100 economically active ones. By 2033, the ratio will be 180 to 100.

As a result, Latin American countries will enjoy a narrow window of opportunity to save and invest. The expansion of the workforce will sustain new economic activity. Savings, instead of going to support large numbers of children and retirees, could be put to work in new business ventures or asset accumulation. Meanwhile, governments will have more freedom to invest in education, the health care system, and infrastructure.

The bad news is that this window of opportunity will begin to close around 2030. At that point, the dependency ratio will halt its decline and begin to rise. As this window closes, the countries of the region will face challenges similar to those confronting West European societies today. Demands on the health care infrastructure will grow, more retirees will begin to draw down their pensions, and some pension systems will face deficits. Fiscal pressures will rise. Households and governments that invested poorly during the period of demographic bonus will find themselves in dire trouble.

In Latin America, it has traditionally been families, rather than the state or the private sector, that have taken care of the elderly. But with more parents and grandparents at home and fewer young people to care for them, families will turn to the government as well as the non-profit and private sectors for help. Eventually, some countries may require migrant workers from Latin America's more youthful countries to care for their elderly.



Further, my God, from Thee.

The demographic bonus, by itself, will not guarantee economic prosperity. Latin Americans will have to increase their savings rate, and they will require more and better access to financial services so that these savings can be efficiently channeled to the rest of the economy. Fiscal discipline will have to be maintained. This will be especially difficult in countries that already face high pension liabilities, as they will have to spend the demographic bonus to pay for the unfunded pensions of the previous generation.

Finally, economies will have to generate jobs for the millions of new entrants into the labor market, and only countries that can find the right niche in global supply chains will be able to provide their people with good jobs. Much will depend on how Latin American countries adapt to a world economy that is being fundamentally reshaped by the rise of China and India, and this is where the options among countries and sub-regions will diverge considerably.

Closer to God

Roughly speaking, there are two kinds of economies in Latin America—those that will be pulled further toward the U.S. orbit in the coming decades and those that will continue to globalize, doing much of their business with countries other than the United States. Nations in the first category include most in Central America, the larger economies of the Caribbean, and Mexico. These countries are already tied closely to the hemisphere's largest economy through trade, investment, tourism, aid, immigration, and remittance flows. The gravitational pull of their links to the U.S. economy will draw them even closer to the United States over the next quarter century.

The countries of Central America and the Caribbean are all in a similar position.

They currently send about half their exports to the United States, and for the countries of the Caribbean Community (CARICOM), the U.S. share of their exports climbed steadily over the past decade. The ratification of a 2004 free trade agreement between the United States, Central American countries, and the Dominican Republic (CAFTA-DR) will further orient these economies toward the United States.

Another important link is remittances. For Haiti, Honduras, Nicaragua, El Salvador, Guatemala, and the Dominican Republic, remittances from their U.S.-based diasporas account for between one-tenth and one-third of their gross domestic product. Remittances will remain a vital lifeline for these countries, especially if migration continues. Projections suggest that migration will slow somewhat as the population ages, but will not cease as long as a large wage gap exists between the United States and its neighbors, assuming the U.S. labor market remains strong.

Several Central American and Caribbean countries—especially Nicaragua, Honduras, and Haiti—are among the world's poorest and most vulnerable. They are also major recipients of U.S. economic assistance. Despite Hugo Chavez's recent oil-fueled foreign aid programs, Washington's aid will likely remain vital to these countries for the foreseeable future, especially if climate change results in more frequent and destructive storms. If this comes to pass, a steady stream of humanitarian relief and resources for reconstruction will be required, and moral pressure to provide assistance will fall first and foremost on the United States.

Meanwhile, generational and political change in the United States and Cuba will likely lead to greater economic engagement between those long-estranged countries. When the U.S. embargo is finally lifted, trade, investment, and two-way migration will resume. Two generations of Cuban-Americans eager to re-engage and do business in their ancestral homeland will pull Cuba quickly into the U.S. economic orbit.

The future of Mexico's relationship with its northern neighbor is a special case. No other country is as deeply integrated with the United States. Almost 85 percent of Mexico's exports to go the U.S. market, in a country where exports account for one-third of gross domestic product. Roughly 10 percent of Mexico's population has emigrated to the United States, and these immigrants send tens of billions of dollars back in remittances annually. Each day, about a million people cross the U.S.-Mexico border legally. Some 12,000 trucks and 250,000 personal vehicles cross into the United States daily. Mexican industry remains an integral part of production chains for many U.S. and foreign companies that supply goods to the North American market. Over 18,000 U.S. companies have operations in Mexico, and U.S. investors account for nearly half of the country's foreign direct investment. Despite efforts to combat them, trans-border links associated with the illicit economy are also extensive.

Its deep integration with the United States is simultaneously Mexico's greatest strength and vulnerability. The country has harnessed itself to the largest and most dynamic economy in the world, but at the same time, its future is singularly dependent on that relationship. This is what led former Brazilian President Fernando Henrique Cardoso, when asked about Mexico's capacity to act independently as a regional leader in Latin America, to wave his hand dismissively and reply, "Too close to God."

There is little doubt that the links that connect the United States and Mexico will remain robust and will probably deepen further in the coming decades. Less clear is how trade and investment flows between Mexico and the United States will change in response to the rise of China. Of all the countries in Latin America, Mexico has the export structure that most closely resembles China's—which makes the Asian giant a dangerous competitor. Oil aside, Mexico's top ten exports to the United States are all manufactured goods that compete head-to-head with Chinese manufactured exports.

> "Mexico's deep integration with the United States is simultaneously it's greatest strength and vulnerability."

In the coming quarter century, one of Mexico's central challenges will be keeping China from eating away its share of the U.S. market. This challenge will become increasingly urgent as Mexico's status as an oil producer declines over the next 25 years, as many analysts expect. Mexico can no longer compete with Chinese manufacturers on wages, but it should still be able to capitalize on a big asset—its physical proximity to American producers and consumers. Even today, shipments of high-tech components from China take 15 days to reach the United States; from central Mexico, they take a single day. High energy prices will further reinforce Mexico's geographic advantage. Capitalizing on geography will not come cheaply, however. Mexico will have to invest heavily in state-of-the art logistics, just-in-time delivery systems, and industrial clustering to protect its commercial relationship with the United States—and with it, its own economic future.

Going Global

The second category of Latin American economies is composed of those that will pursue their economic future by diversifying their economic relationships away from the United States. Countries in this category include Brazil, Argentina, Chile, and Peru. These economies already have highly diversified export profiles—trading as much with Europe and with the rest of Latin America as they do with the United States. But in the coming decades, they will most likely globalize further as they exploit a lucrative niche as suppliers of food, energy, and raw materials to China's giant manufacturing machine and to the booming middle classes of other emerging economies.

It is still early days, but the trend toward greater global diversification is already clear. The original members of Mercosur—Brazil, Argentina, Uruguay, and Paraguay—now trade nearly as much with developing Asia as they do with each other. Argentina, Brazil, and Chile have become Latin America's top exporters to both India and China. In the last 10 years, the exports of Argentina and Brazil to India each grew by 500 percent, while Chile's rose by 1,400 percent. Likewise, Brazil's exports to China grew by 1,500 percent, Argentina's by 600 percent, and Chile's by over 2,200 percent.

To be sure, these numbers started growing from a low base and are partially inflated by the spike in commodity prices, which are bound to moderate in coming years. However, these statistics also reflect what should be a significant long-term shift in trade patterns. If even the most conservative projections of Indian and Chinese economic growth hold up, demand for commodities such as Brazilian soybeans, meat, and coffee, Chilean copper, and Peruvian iron ore will remain robust over the next 25 years. In addition, if Brazil's new offshore oil finds can be exploited in a cost-effective way—a process that will take the better part of the next decade—they will further diversify the structure of Brazilian trade.

Venezuela is an ambiguous case. Despite President Chavez' fiery anti-American rhetoric, Venezuela's largest export market remains the United States, which buys about half of its exports, consisting almost entirely of petroleum and oil-based products. The reason is structural—few places outside the United States can refine Venezuela's heavy crude. However, Caracas is aggressively trying to diversify its export markets by promoting the construction of heavy-crude refineries in countries such as China and South Africa. Whether Venezuela succeeds in pulling away from the U.S. economic orbit will largely depend on whether these efforts at infrastructure development bear fruit, and on whether Chavez's successors continue his pursuit of export-market diversification.

For Latin America's commodity exporters, particularly for those with relatively small economies and high levels of commodity-export dependence, the great challenge of the coming decades will be how to channel commodity wealth into productive, non-commodity sectors. Development economists point to Australia, New Zealand, Norway, Finland, Sweden, and the United States as examples of successful "commodity-led development" that could serve as a model for Latin American countries. The trick, they argue, is to shift income from commodity exports to investment in human capital and technological innovation through taxation and retained earnings, paving the way for high value-added industries that can power future development.

In the next quarter century, the dilemmas of globalization will be debated most intensely in Latin America's largest economy, Brazil. That nation's elite remains ambivalent about globalization and to what degree to open its economy to the world. On one hand, Brazil is home to globally integrated corporations that are quickly becoming world leaders in the agribusiness, energy, and service sectors. On the other hand, Brazil retains a relatively closed and protected economy. Tariffs on capital goods, for example, are three times as high as in other exporting economies such as China, Thailand, and South Korea. Whether Brazil will become more fully integrated into world trade in the coming decades will depend on whether its exporters can build a domestic constituency for trade liberalization with enough political clout to change trade and investment policies.

Can Democracy Deliver?

What will politics look like in Latin America in a quarter century? Trying to predict the ups and downs of parties and politicians over such a long time-horizon is a fruitless endeavor. However, we can draw three broad conclusions about Latin America's political future based on our economic and demographic analysis.

First, Latin America's people will demand—and expect—more from their governments than ever before. An aging population will demand more health care, more public services, and adequate pensions. New entrants into the labor market during the demographic window of opportunity will demand more and better jobs. Groups displaced by foreign competition and technological change will demand protection and compensation. Finally, if Latin America's future economic growth is of the kind that tends to concentrate income in the hands of a few sectors, regions, or firms—as is the case with commodity-led growth—demands will grow on government to redistribute that wealth in a more equitable way.

Demands on the state will increase not only because citizens will have more needs and higher expectations. Thanks to Latin

America's return to democratic governance, they also will have more political vehicles to channel their demands. Before Latin America's transition to democracy in the 1980s and 1990s, social demands were either channeled through government-sanctioned vehicles (such as the ruling party or government-affiliated labor unions) or suppressed entirely. Those demands can now be voiced through independent parties, grassroots social movements and organizations, and Internet-based activists. Latin America's elderly—the "gray vote"—may become a vociferous and potentially powerful constituency of swing voters. Also, the rise of a rights-based political culture in Latin America may well stimulate demands for European-style "economic rights"—a secure pension, a living wage, and unemployment insurance.

The second conclusion is that to meet these mounting social demands, Latin American governments will have to increase their own capacity to deliver. In many countries, this will mean boosting government revenue and reducing the size of the informal economy. It will also entail increasing the state's capacity to redistribute wealth and income through more progressive taxation, better-targeted social programs, while closing avenues for capital flight and tax evasion. Public-private partnerships will become increasingly important, possibly drawing on lessons from Japan, the United States, and Europe, which by then will have had ample time to experiment with them. Finally, Latin American countries will have to invest in institutions—financial, fiscal, and regulatory—to capitalize on the demographic bonus.

On a darker note, the final conclusion is that if Latin American governments fail to deliver on the most important demands, democratic institutions will be in peril. As historians have often reminded us, there is nothing permanent or inevitable about democracy. Historically, this form of government has tended to emerge and recede in waves. Democracy in Latin America today is still in its consolidation stage. Polling data shows that satisfaction with democracy varies widely over time, within countries and also among countries, ranging from high satisfaction in Costa Rica and Uruguay to low satisfaction in Paraguay and Peru.

In most Latin American countries, powerful groups remain ready to take advantage of mass disappointment to push politics in illiberal, if not authoritarian, directions. Key social demands can be met and democracy can preserved, but the necessary, long-term investments have to be made now, while the window is still open. It threatens to close all too quickly in a quarter century to come. ●

Julia Guerreiro and Nazanin Berarpour provided valuable research assistance and Mauricio Cardenas offered important suggestions.