RESILIENCE IN DEVELOPING AND EMERGING MARKET ECONOMIES

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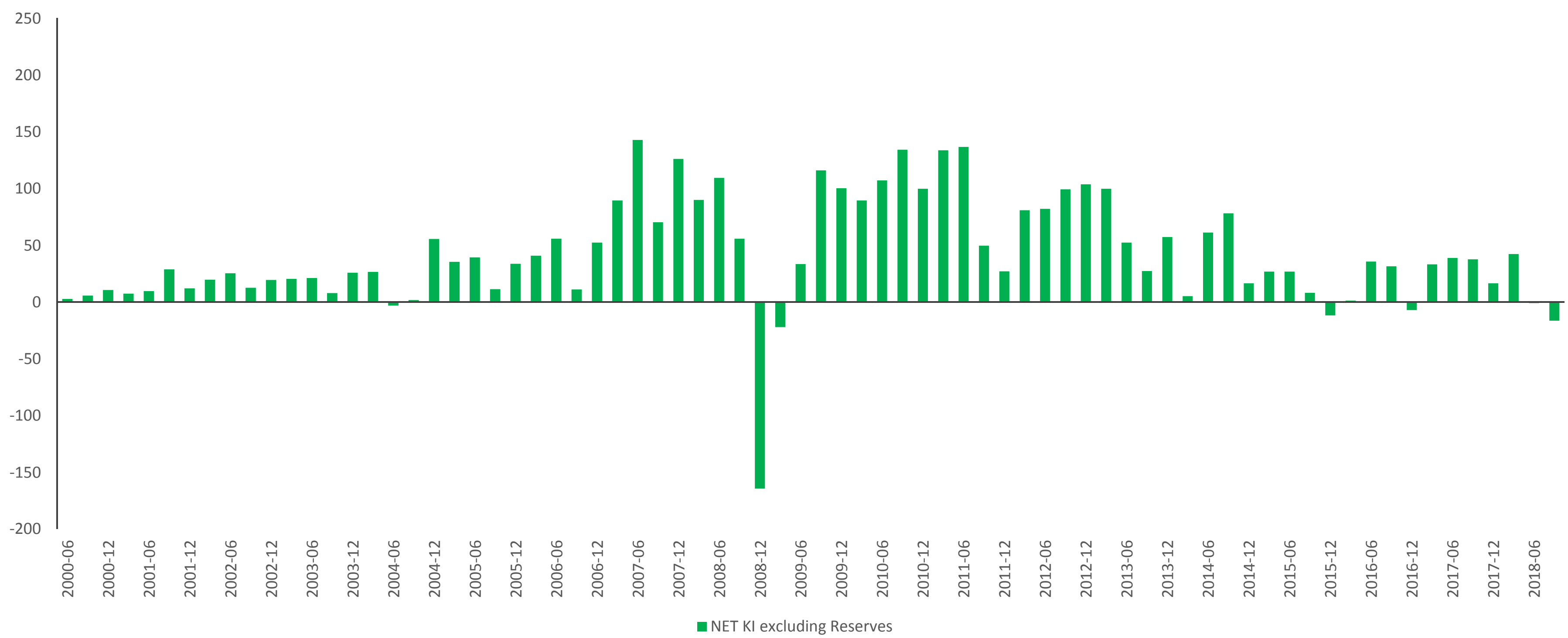
Agenda

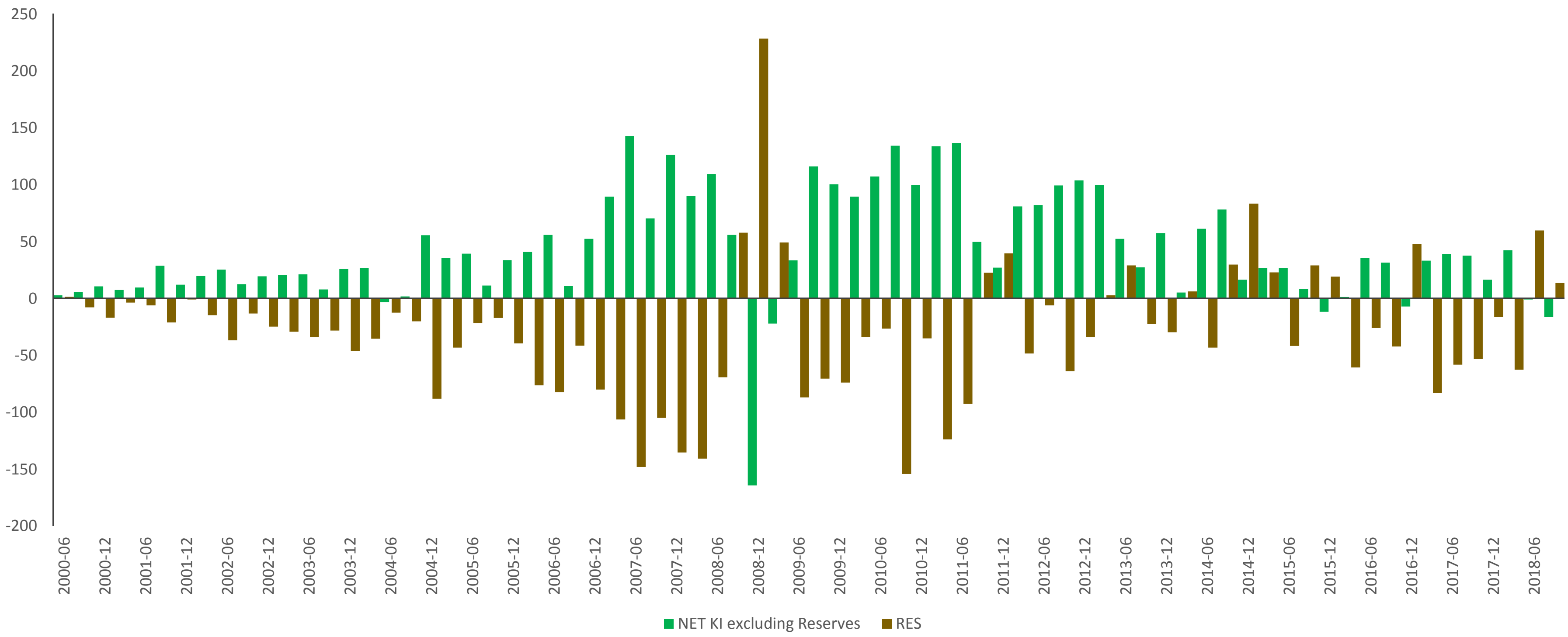
- Preliminaries: a good diagnosis is central, correlations not enough.
- A brief review of the evidence on macroeconomic policies and resilience.
- Structural reforms and resilience.

Capital Inflows to Emerging Markets



BIS, Annual Economic Report, 2019.

Capital Inflows to Emerging Markets



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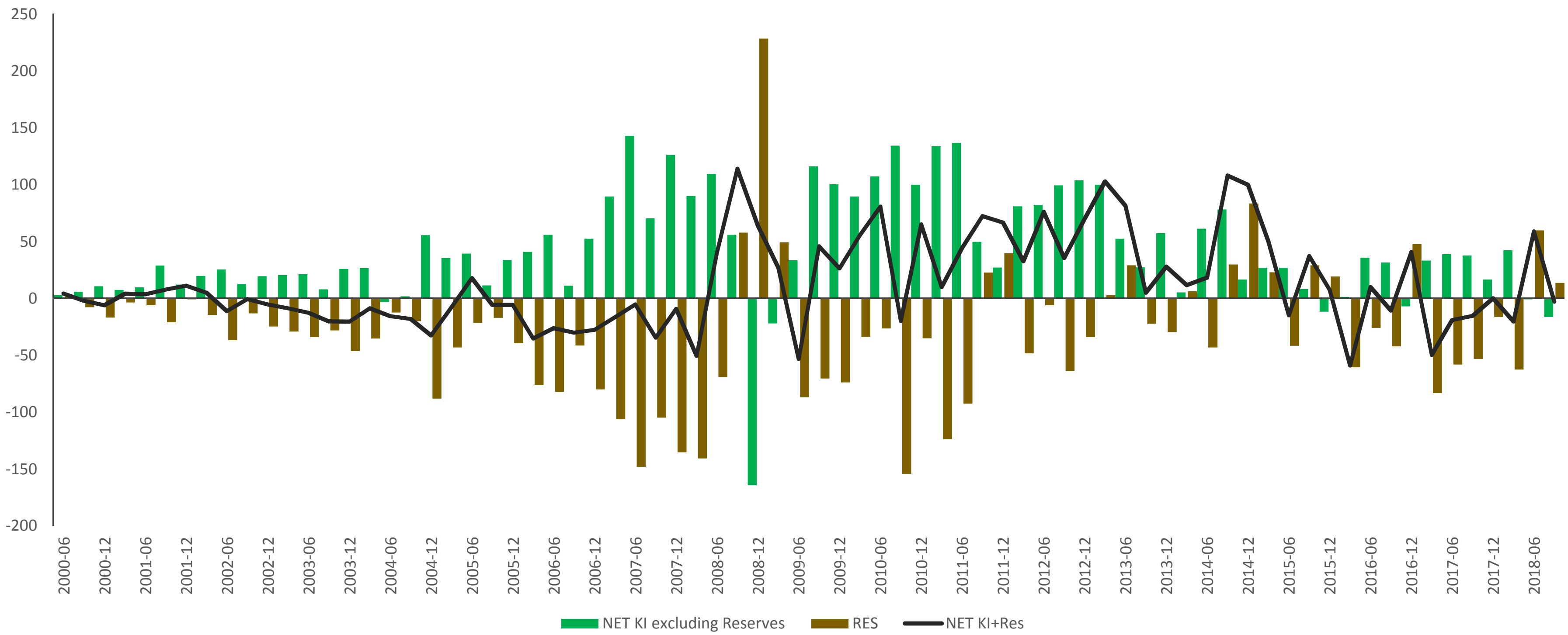
Capital Inflows to Emerging Markets



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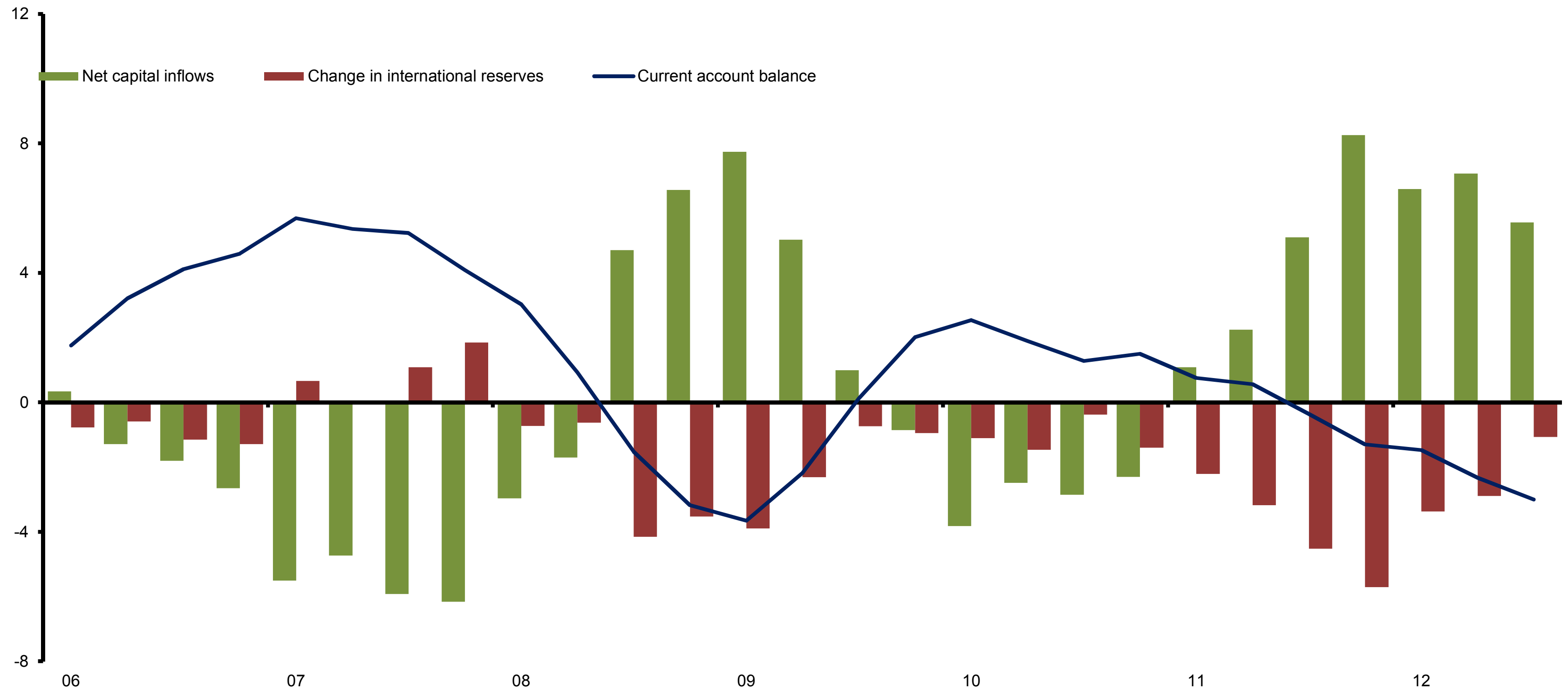
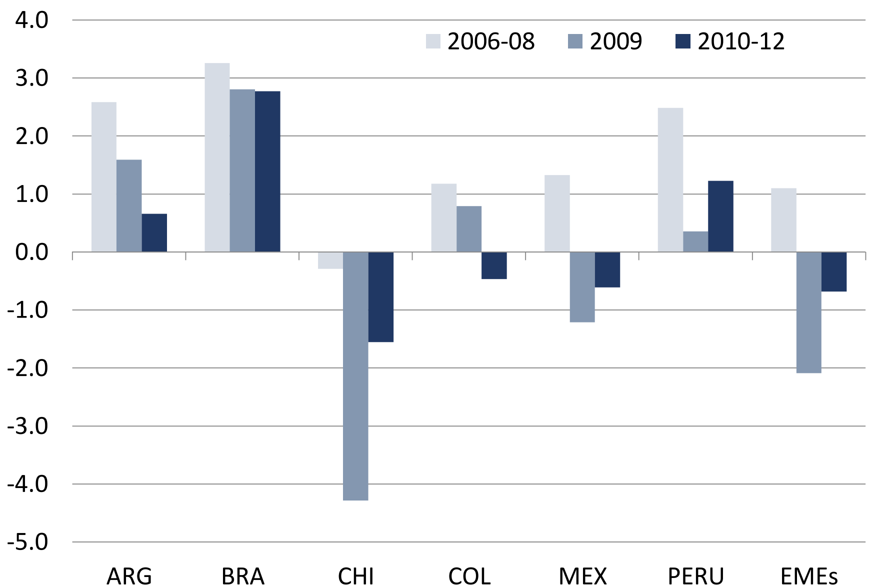
Capital Inflows to Chile

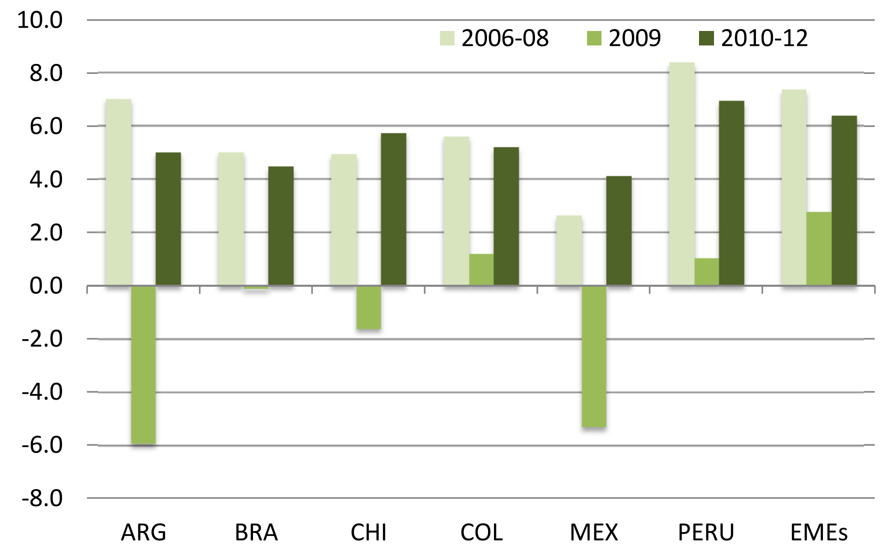


A brief review of the evidence

- Comparison of performance between the Asian crisis and GFC. Findings for DEMEs: Better performance is associated with *lower private credit growth, trade openness and monetary policy*…with a bit of luck (tot improvement). Within emerging market economies more financially open had worst performance (explained by foreign assets held abroad) and greater ER flexibility helps. No clear evidence on fiscal policy (see below) (Alvarez and De Gregorio, 2014).

Fiscal Policy LATAM during the GFC: cyclically adjusted balance (left) and GDP growth (right)





There is evidence on the benefit of counterciclycal fiscal policy, however in periods of extreme tension the fiscal expansion is not completely undone. Still the fiscal expansion alleviated the cost of the crisis specially within the poor.

Fiscal support contributes to employment resilience within OECD countries employment resilience (Hijzen, Kppeler, Pak and Schwellnus, 2017)

A brief review of the evidence

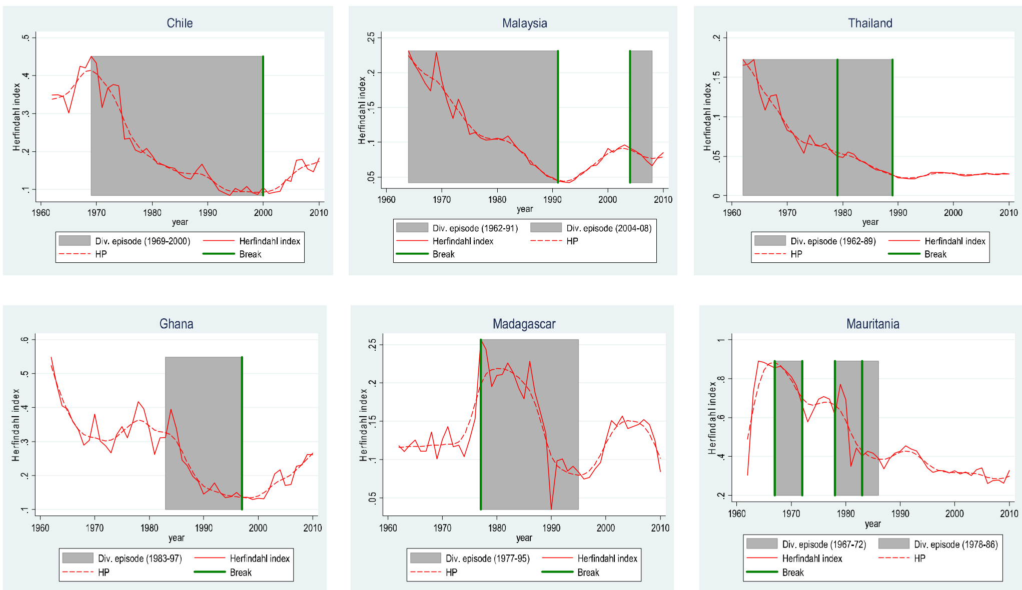
- The effects of financial openness on growth depend on the degree of institutional development (Prasad, et al. 2003). But also financial integration may contribute to sound financial development (De Gregorio, 1999, Kose et al. 2009), however the transition is challenging.
- Composition of capital flows, more FDI and portfolio and less external debt. Holding reserves also help (Kose and Prasad, 2009). However there are tensions with currency manipulation.
- Exchange rate flexibility, when possible and avoiding fear of floating, helps to absorb external shocks. Northern European countries with flexible ER performed better than those within the euro zone. The long run evidence regarding long term growth is unsettled (Terrones, 2019).

Export diversification. Resource rich countries

- Export diversification is good for growth (Hausman et al. 2007; Lederman and Maloney, 2007).
- More diversified economies tend to be less volatile (IMF, 2014; Koren and Tenreyro, 2007).

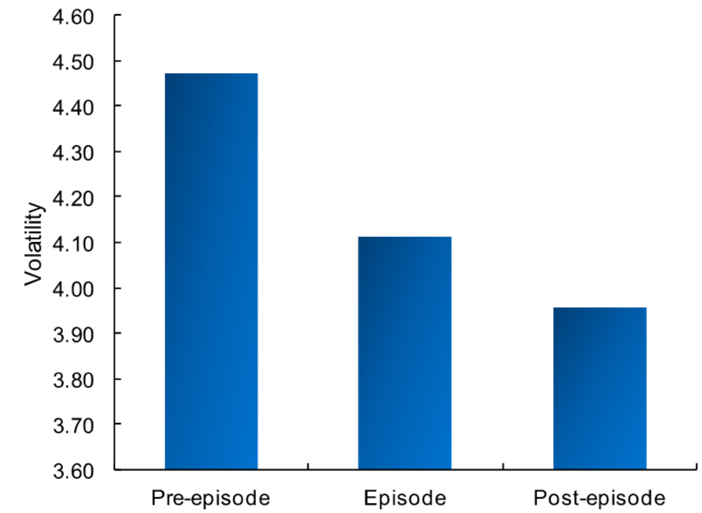
Export diversification. Resource rich countries

Figure 23. Product Diversification Episodes in Selected Countries



Source: COMTRADE, IMF staff calculations.

Figure 24. Export Product Diversification Spurts and Volatility in LICs, 1962–2010



Source: COMTRADE; World Bank WDI; IMF staff calculations.

Source: IMF (2014), 61 episodes of spurts in 51 countries.

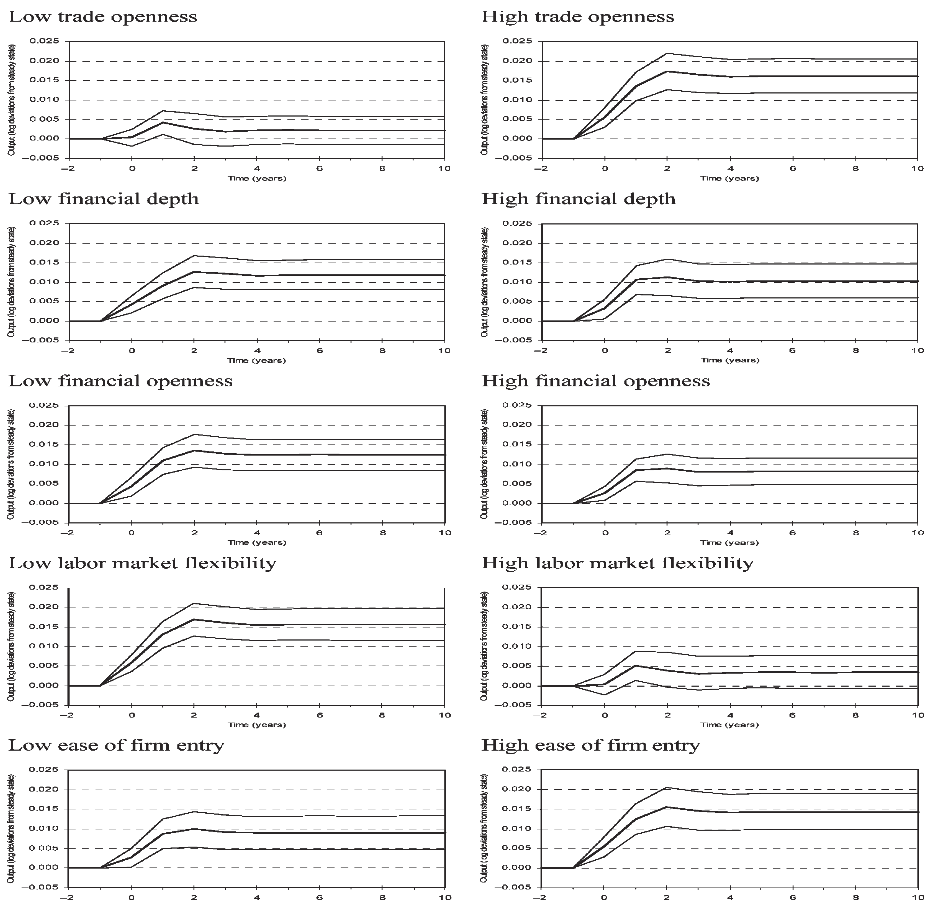
Export diversification. Resource rich countries

- Natural resource abundance is a determinant of economic concentration. Higher level of human capital, trade openness, higher quality of institutions and more developed financial system increase diversification.
- Is this enough, in particular in resource rich countries. There are experiences with successful advance economies and unsuccessful very poor economies. There are deeper issues that may create poverty and concentrated traps. An the countries in between?
- Industrial policy. It can help, but also could be captured by interest groups.

Labor and goods markets

- Effect of terms of trade shocks on output (Loayza and Raddatz, 2007) depending on trade openness, financial depth, openness in the capital account, labor market flexibility (flexibility of hiring, firing and conditions of employment), and an index of easy firm entry (registration procedures, cost and days to register, and burden of regulatory entry).

Cumulative Output Impact of Terms of Trade Shock (Loayza and Raddatz, 2007)



Labor markets

- Hiring or firing? There is some evidence that fluctuations in unemployment are mostly due to a decline in probability of finding a jobs (Shimer, 2012 for USA). Therefore policies that facilitates marching, probably subsidies to hiring in recessions. Trade-off workers protection-resource reallocation.
- Stringent firing regulations reduces labor destruction, but the reduce labor reallocation. Protect workers and not jobs. Unemployment insurance should facilitates reallocation, but it could be fiscally too costly and induce moral hazard.