



# A Mandate to **GROW**



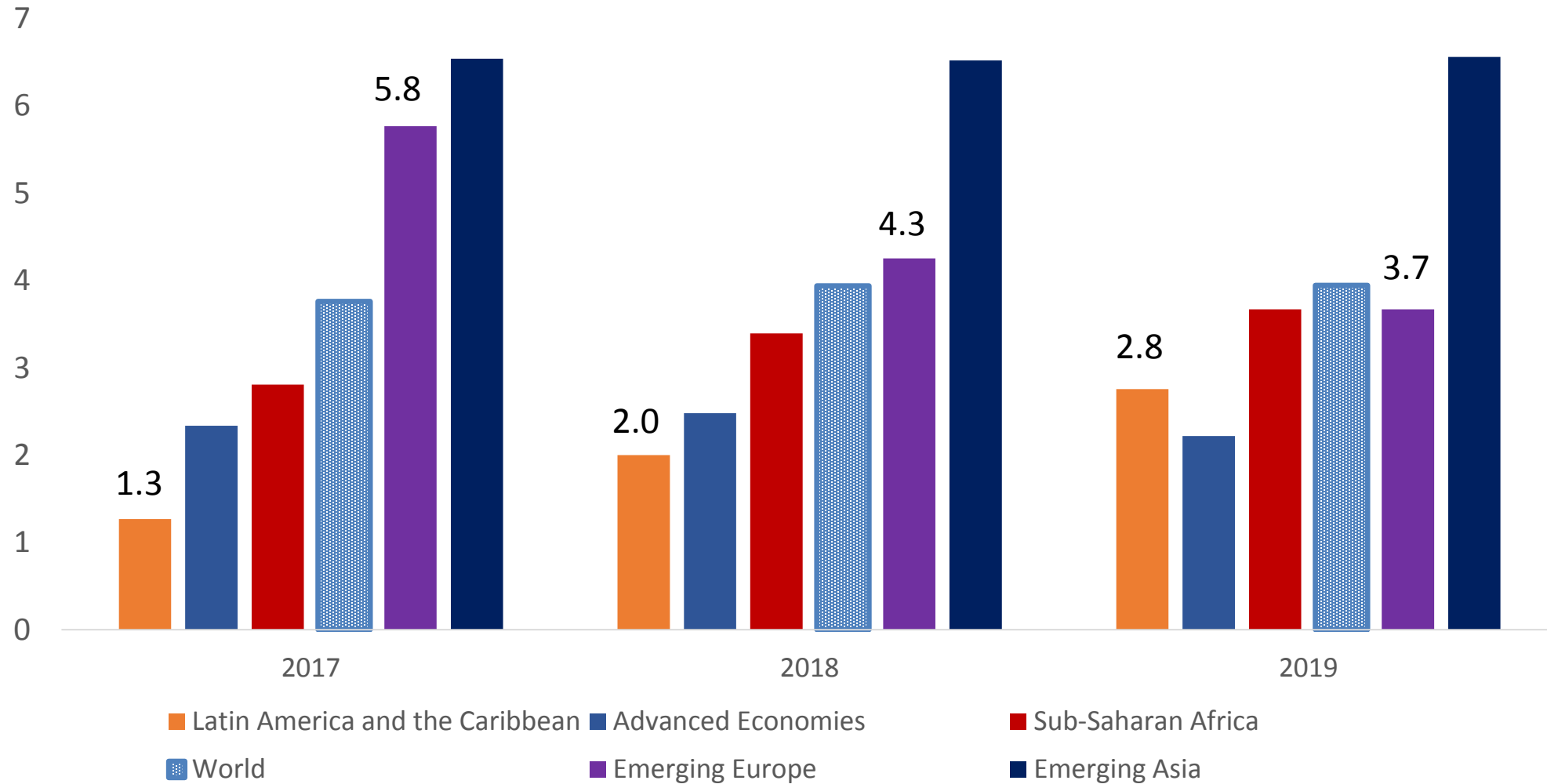
2018 Latin American and Caribbean Macroeconomic Report  
LSE-EBRD-IDB-CEPR workshop “Mind the Middle Income Trap”  
London, April 26<sup>th</sup> 2018



# Plan of the presentation

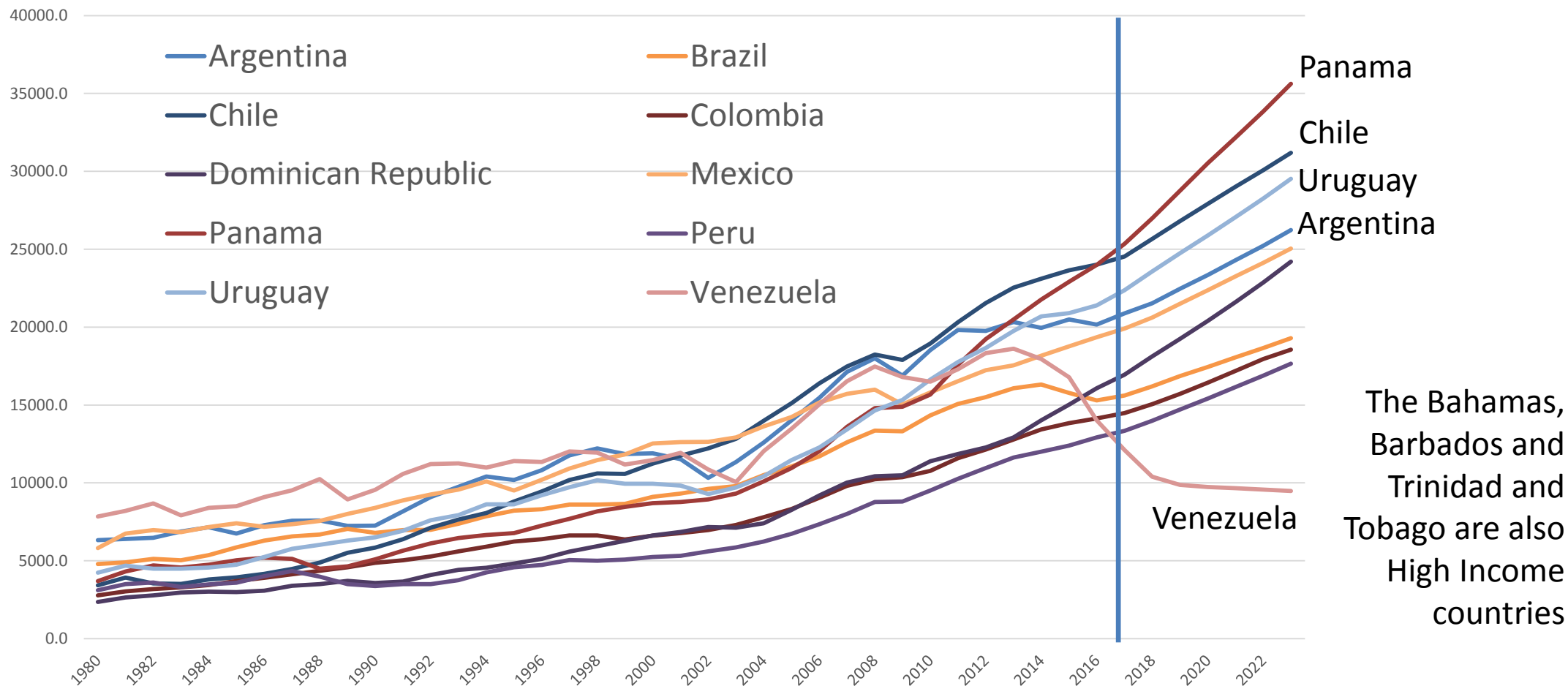
- The international context: risks and opportunities
- Growth accounting revised: investment quality and quantity
- Explaining low quality investment
- Explaining low investment
- Macroeconomic stability: Monetary and fiscal policy
- Conclusions

# Stronger global growth, Latin America and the Caribbean recovers...



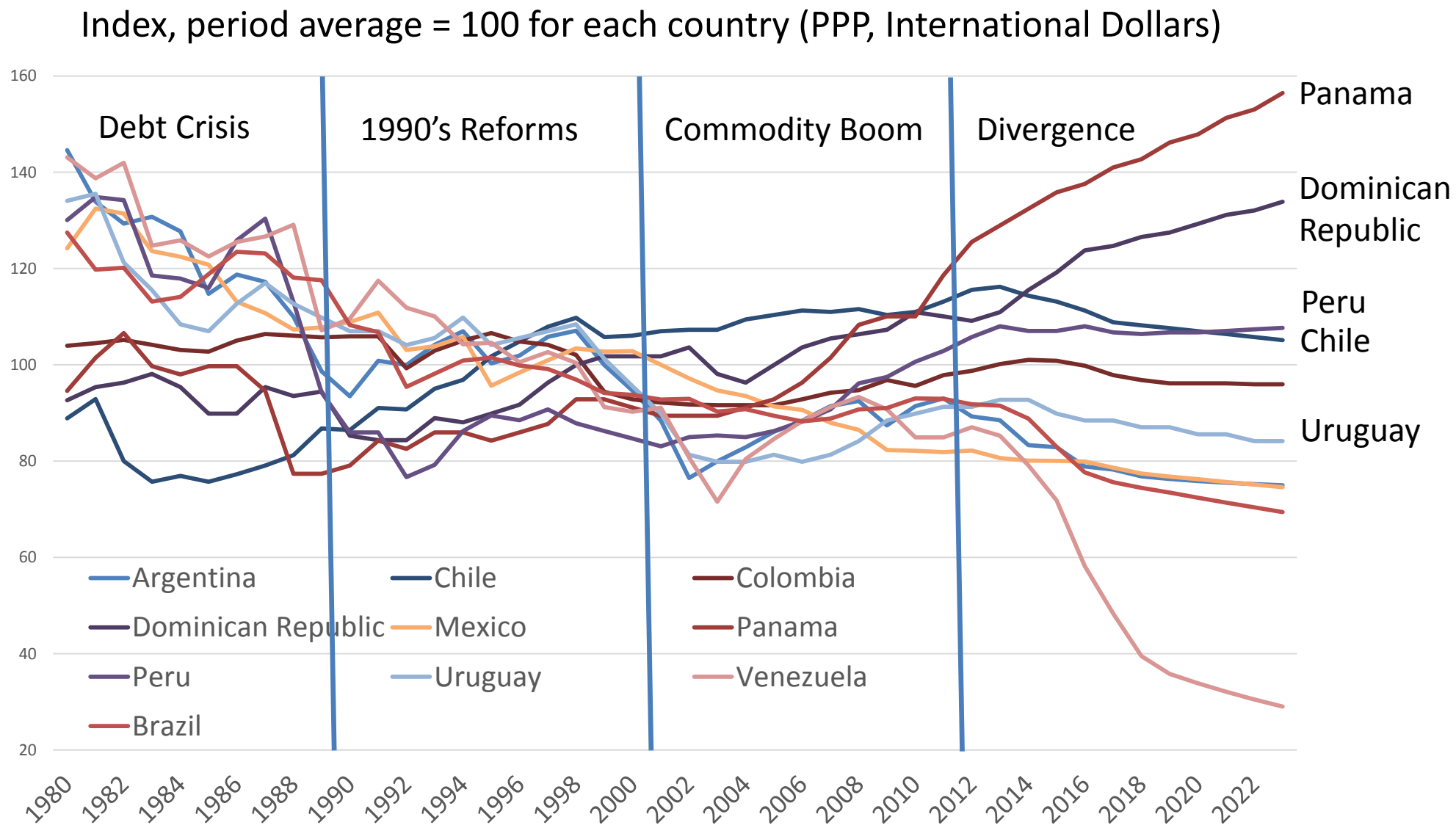
# Chile and Uruguay are high income, Panama should be (with GDP), Venezuela lost it, Argentina may regain it soon...

GDP per Capita - current prices, PPP, International Dollars



Source: IMF April 2018 WEO.

# Performance looks less positive employing comparative measures: Share of Global GDP



Source: IMF April 2018 WEO.

## And several risks to growth at the current time

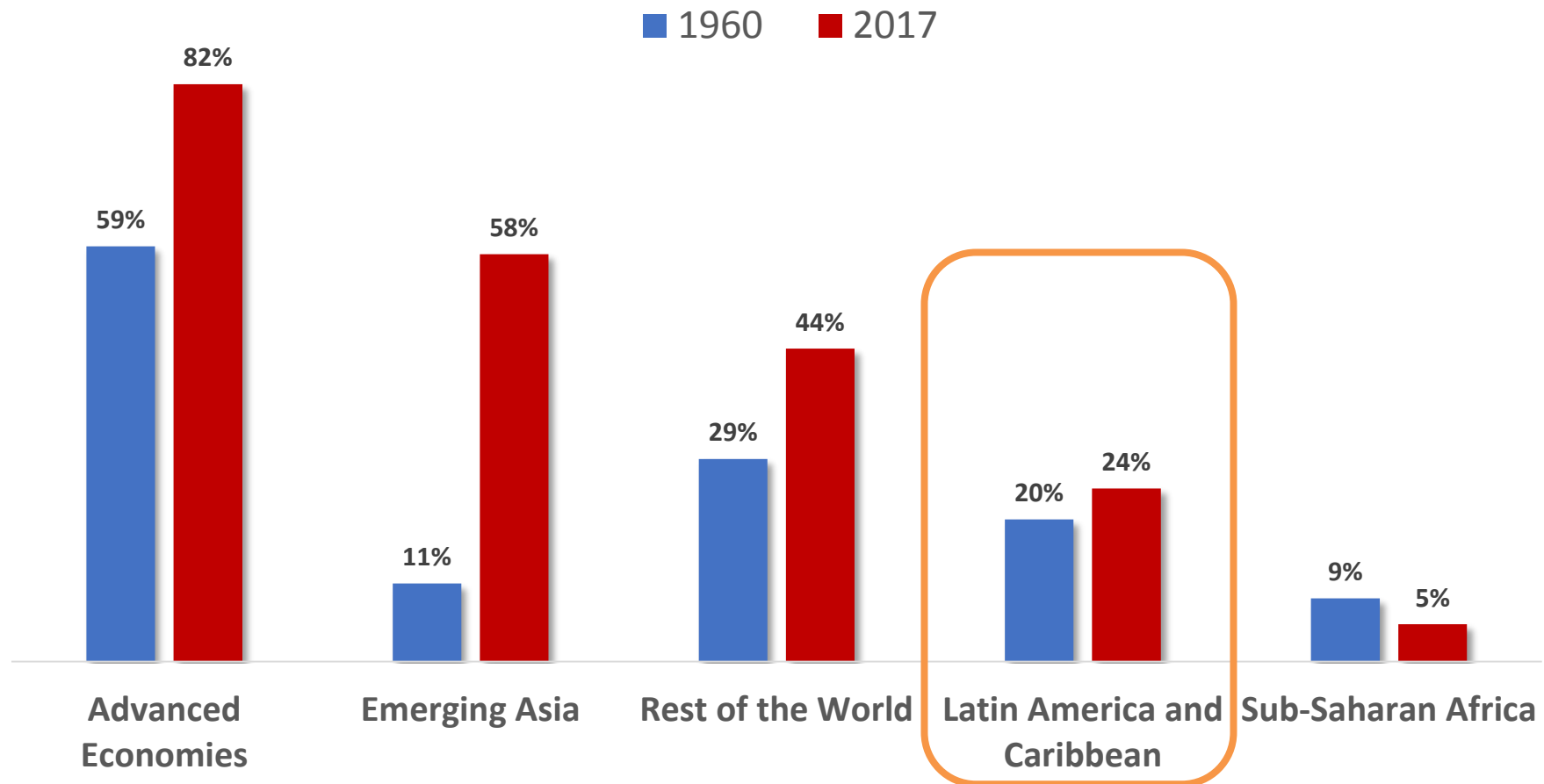
- **There are several risks** to projected moderate growth rates, we model some using a (G-VAR) statistical model
- **Shock 1: US Growth, interest rates (asset prices), trade**
  - Baseline growth 2.8% p.a. 2018-2020 (for 14 countries)
  - Lowered to 2.5% p.a., larger impact for Mexico: (2.7% to 2%)
- **Shock 2: Higher inflation, higher rates, larger asset price correction**
  - Baseline growth 2.8% lowered to 2.1%
  - Significant impact for Southern Cone ex Brazil (2.9% to 2.1%)
- **Boosting growth** is good in all scenarios and would act as a hedge against the external risks

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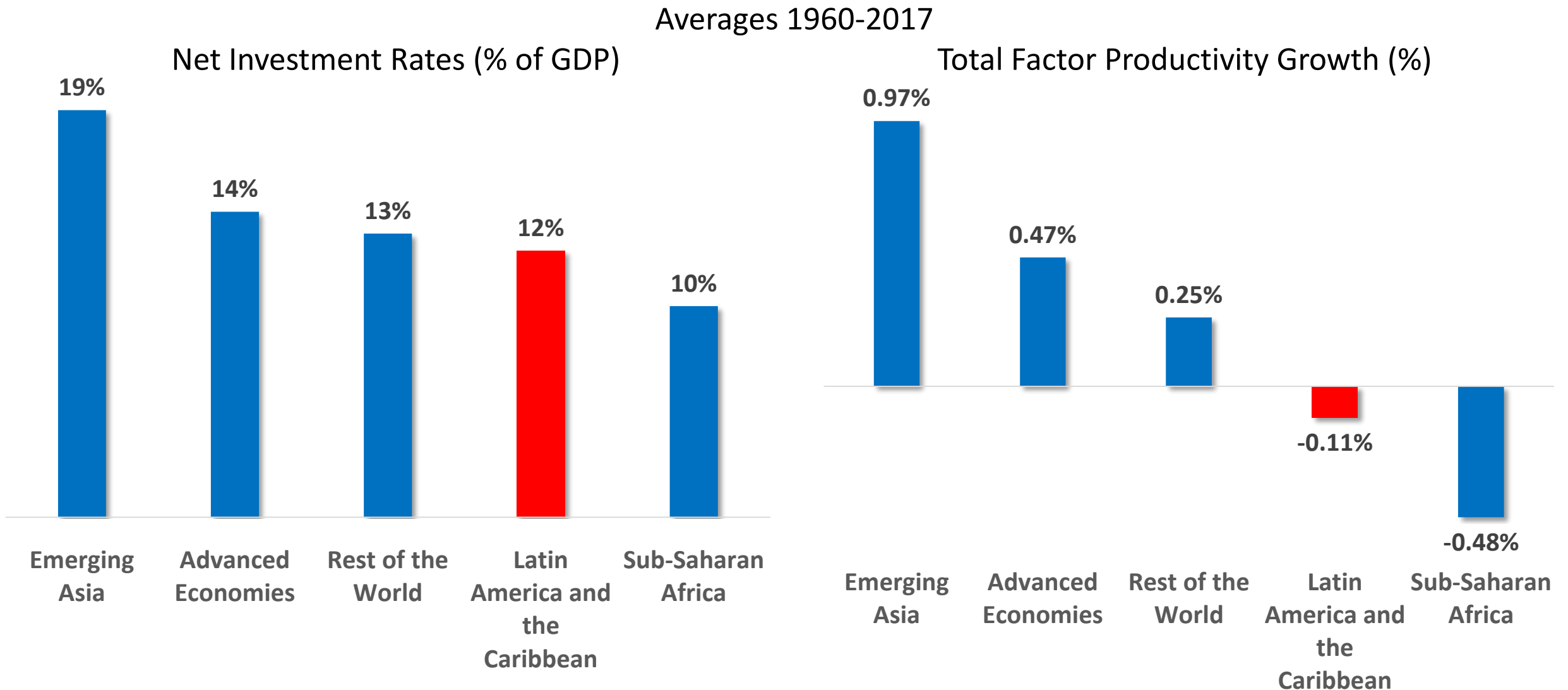
# Limited catch-up in living standards

Income per-capita, relative to the United States





# LAC lags in both investment and productivity



Source: IDB calculations based on PWT 9.0 database. Simple averages by country.

# What has driven long-run economic growth?

	Full period: 1960 – 2017				
	GDP growth (per capita)	Contribution of:			
		TFP	Capital Accumulation	Skills	Labor
Advanced Economies	2.71%	0.84%	0.92%	0.76%	0.20%
United States	2.04%	0.79%	0.28%	0.59%	0.38%
Emerging Asia	4.86%	1.72%	1.09%	1.28%	0.77%
Rest of the World	2.60%	0.45%	0.98%	0.98%	0.20%
Latin America and the Caribbean	2.40%	-0.20%	1.01%	0.92%	0.66%

Source: IDB calculations based on PWT 9.0 database. Simple averages by country.

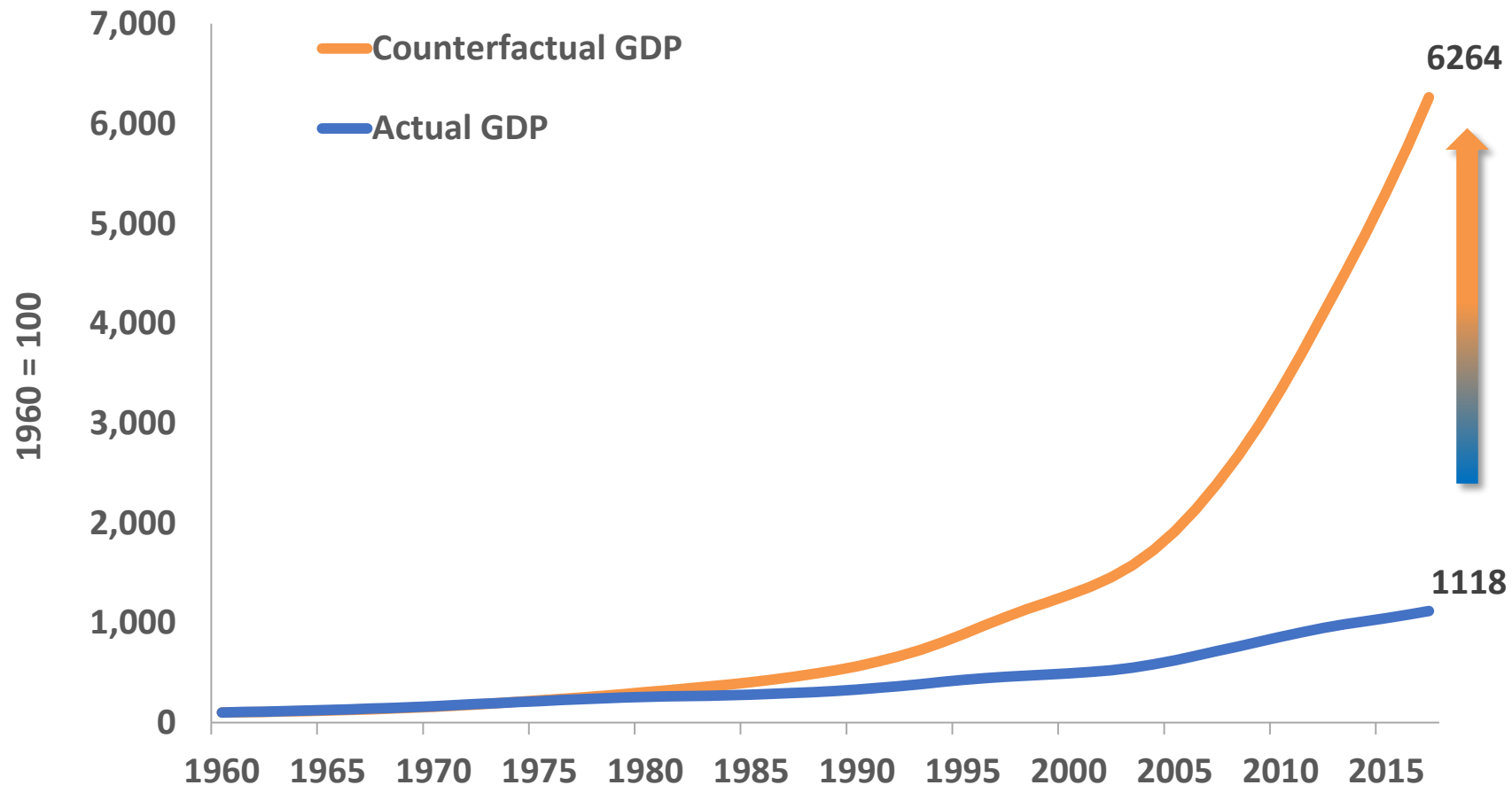
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# Investing more and better would produce yet higher growth

Growth in the Region with both Emerging Asia's investment rate and efficiency



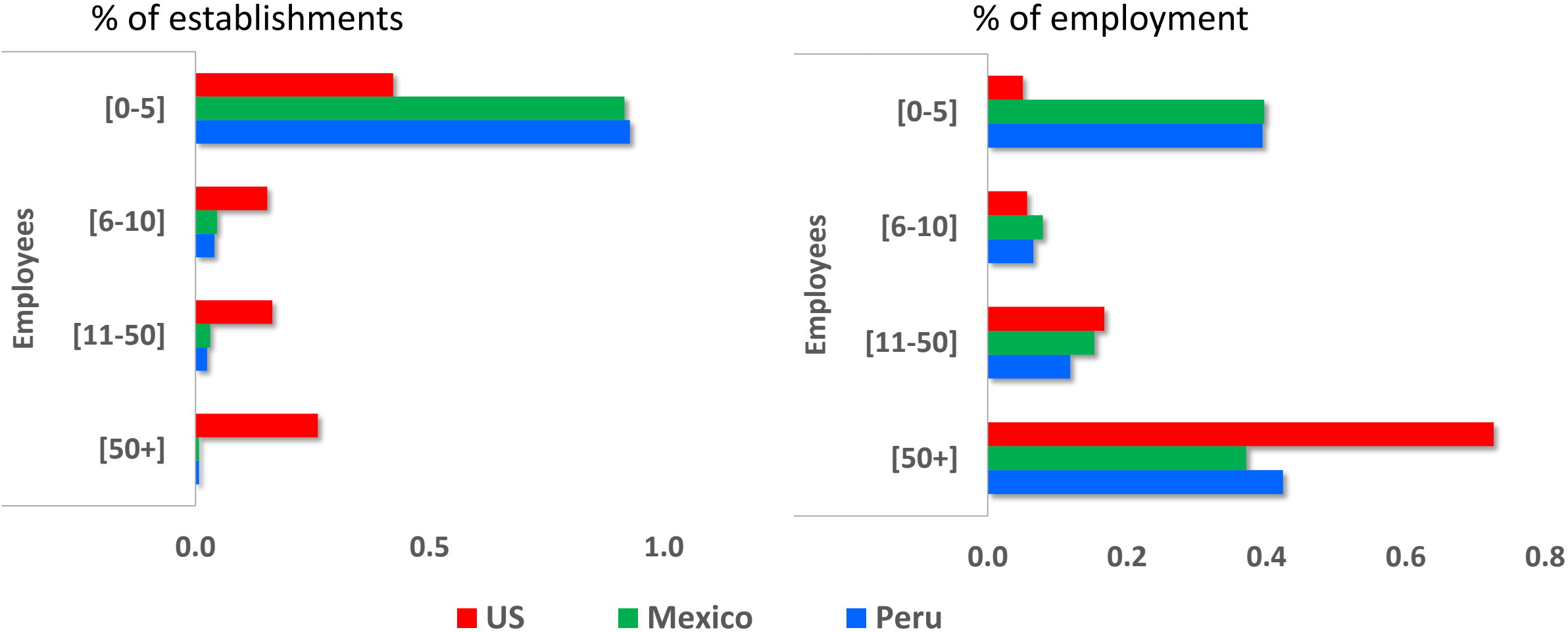
LAC invests as much and as efficiently as Emerging Asia

GDP would have been 5.6 times higher than observed

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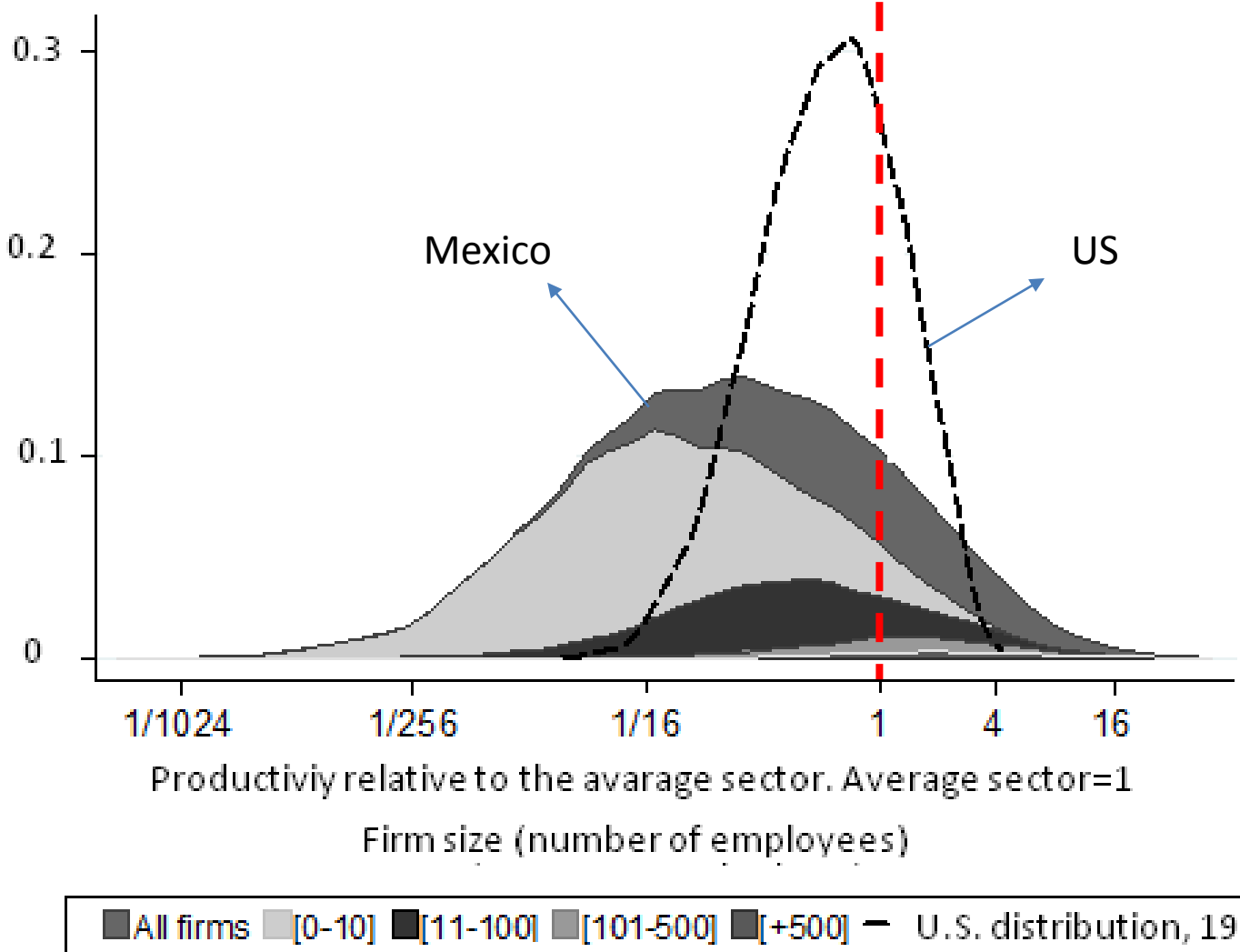
# In LAC, the vast majority of firms are small..



.....but account for substantial employment

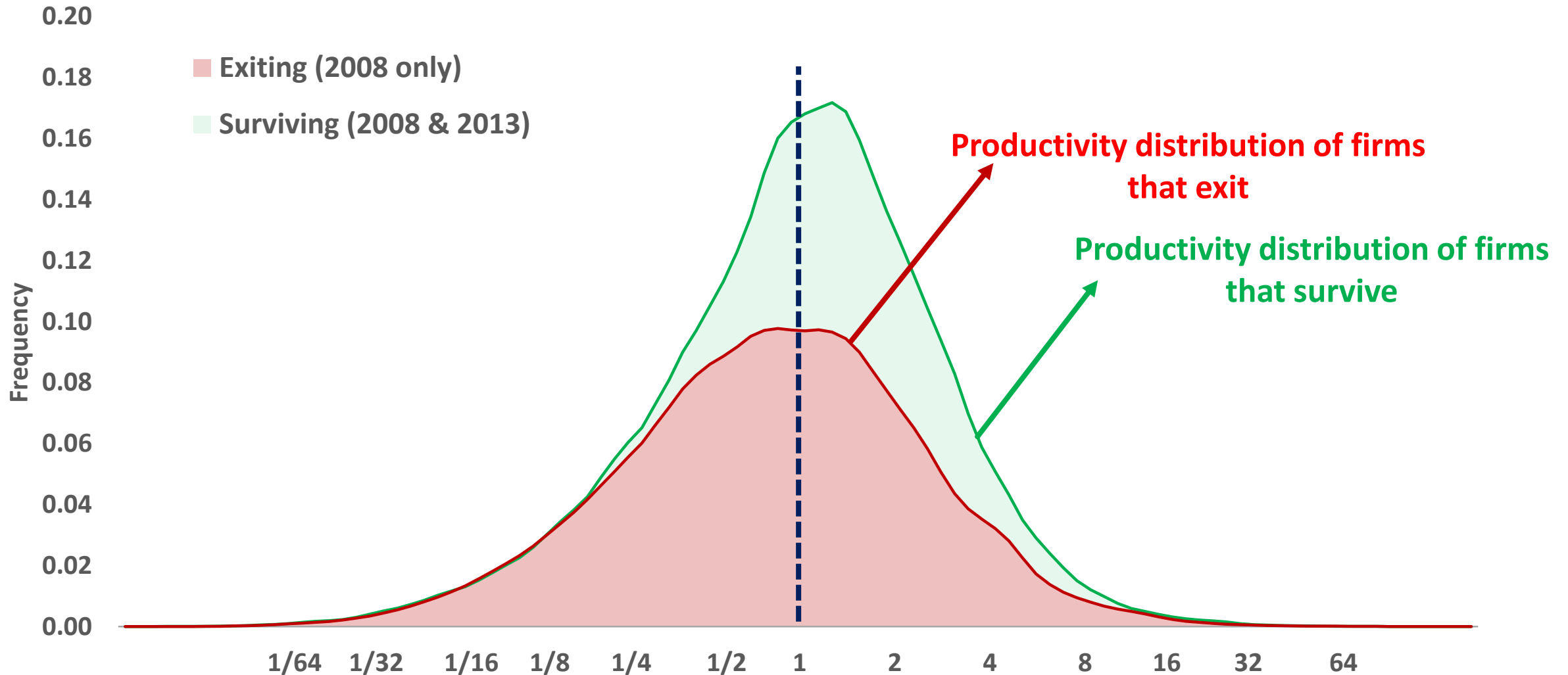
# Why is productivity low?

- Aggregate productivity is the **weighted average** of individual firms' productivities
- **The large tail** of low productivity (smaller) drags down the weighted average



# Moreover, many low productivity firms survive, and many high productivity firms appear to exit

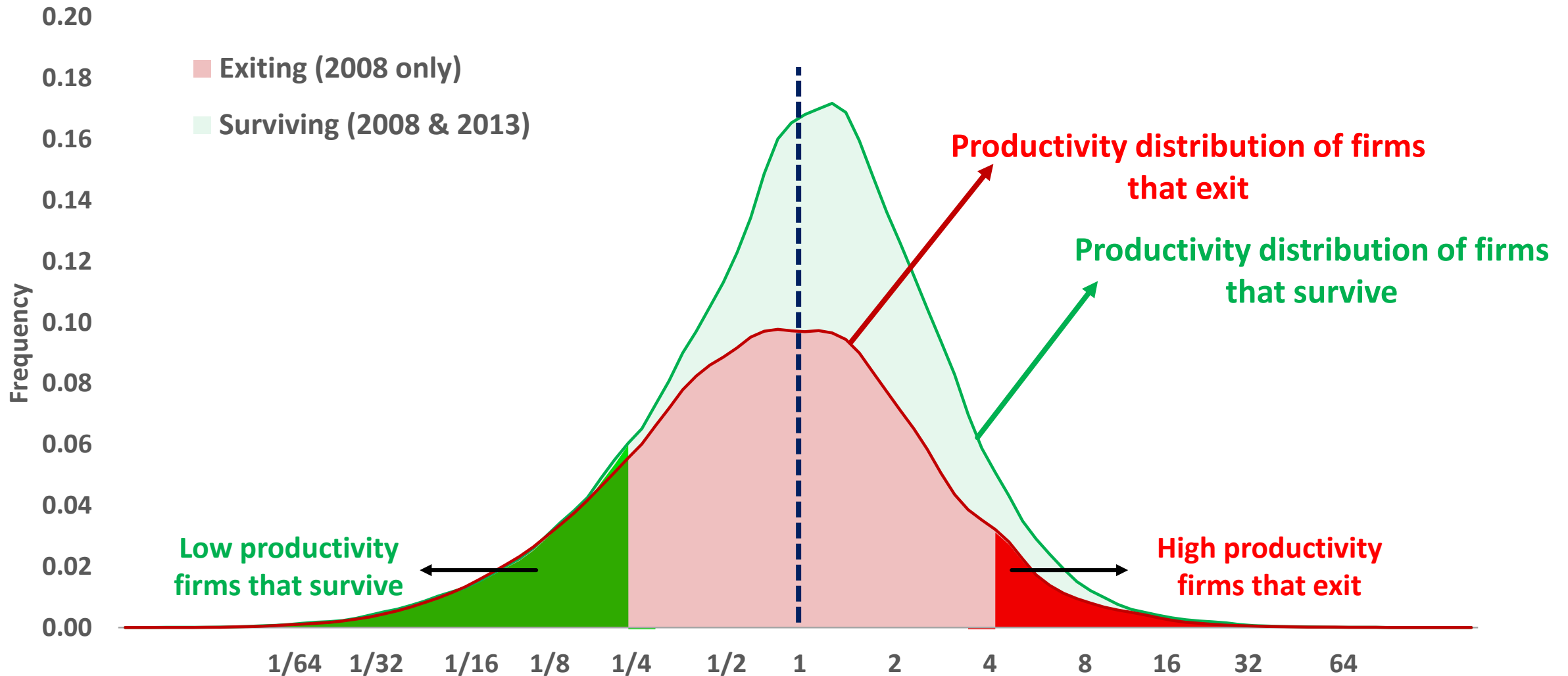
## Productivity Distributions of Firms in Mexico





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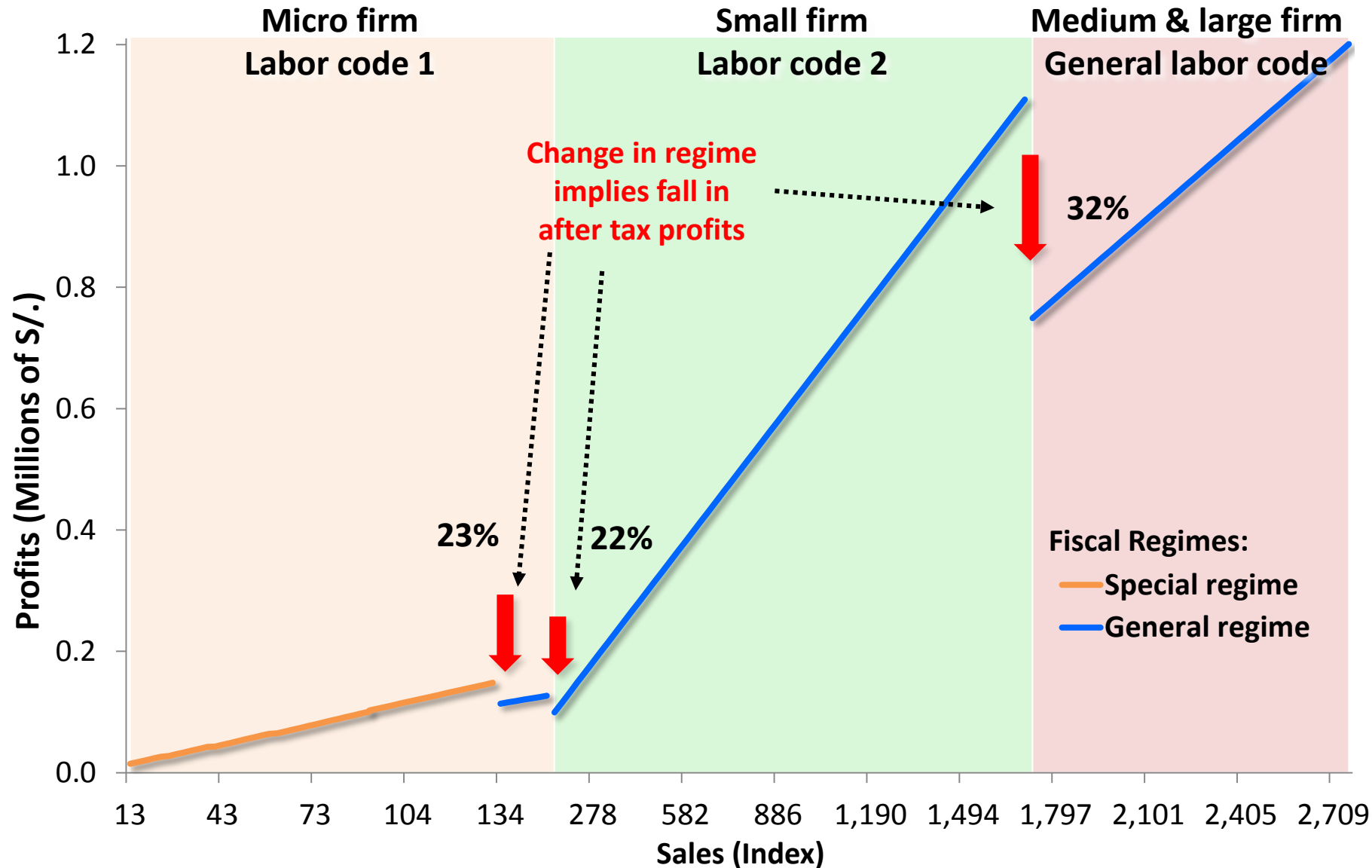
## Productivity Distributions of Firms in Mexico



# What lies behind these stylized facts?

- Credit constraints: Rationed or expensive credit may halt the growth of productive firms
- Enforcement efforts focus on larger firms leading to higher effective tax rates
- Special tax regimes reduce incentives for firms to grow
- Labor and social insurance policy may distort firms behavior
  - High payroll taxes discriminate against formal employment
  - Social insurance programs may tax formal employment, subsidize informal employment

# In Peru, the tax and labor market regimes create incentives for firms to stay small



## Tax regimes

Special: fixed rate of sales  
General: 28% of profits

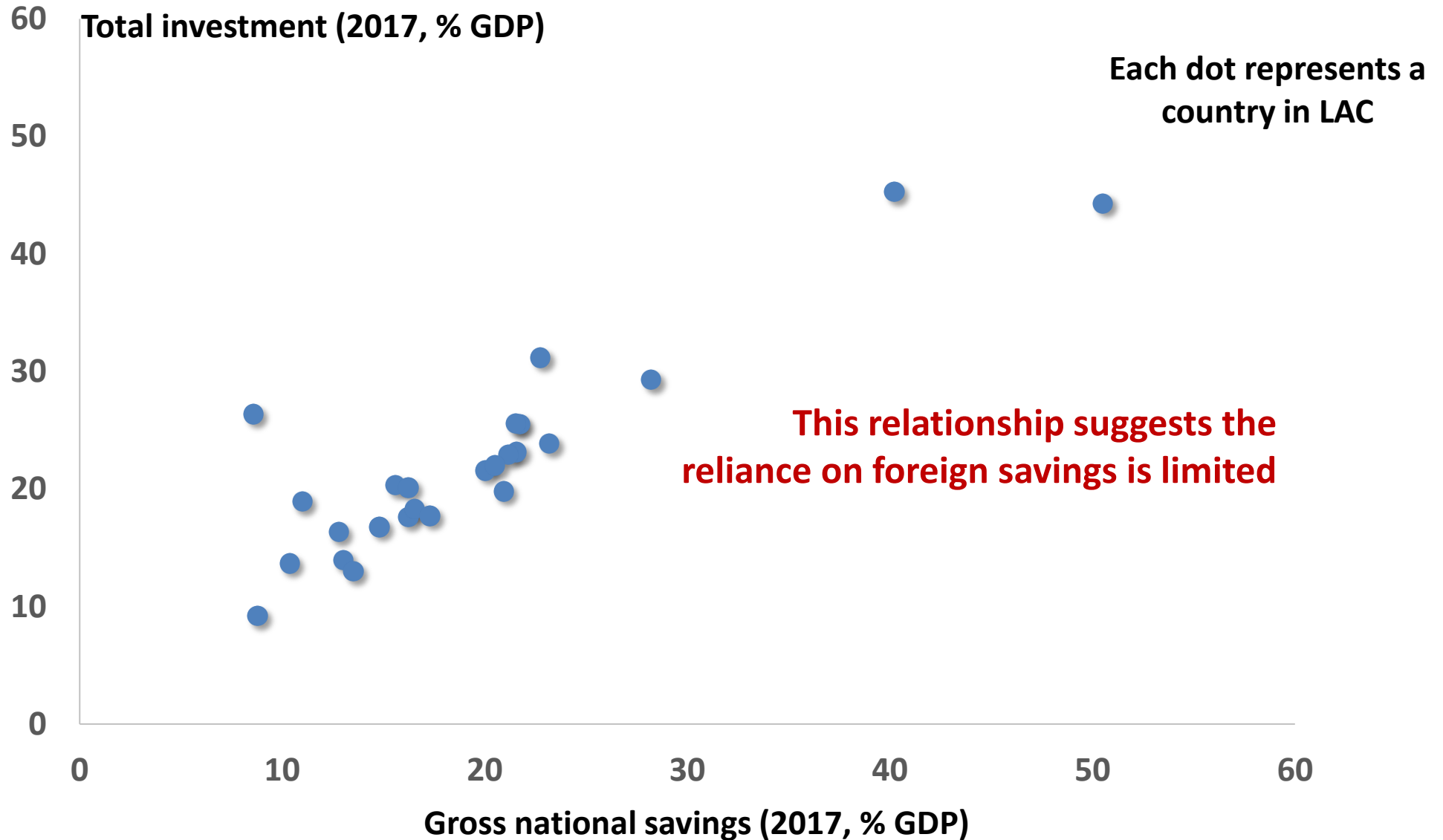
## Labor regimes

Codes 1 and 2: lower labor benefits than general code

# Plan of the presentation

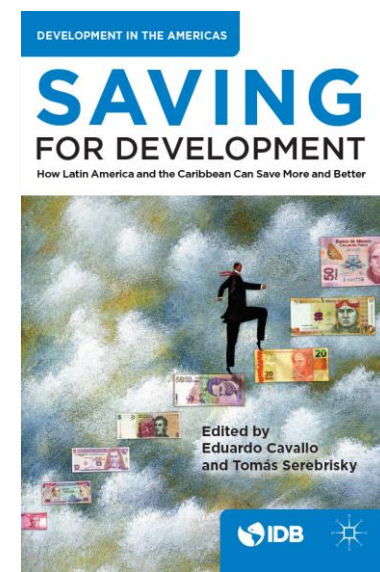
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# There is a relationship between total investment and gross national savings



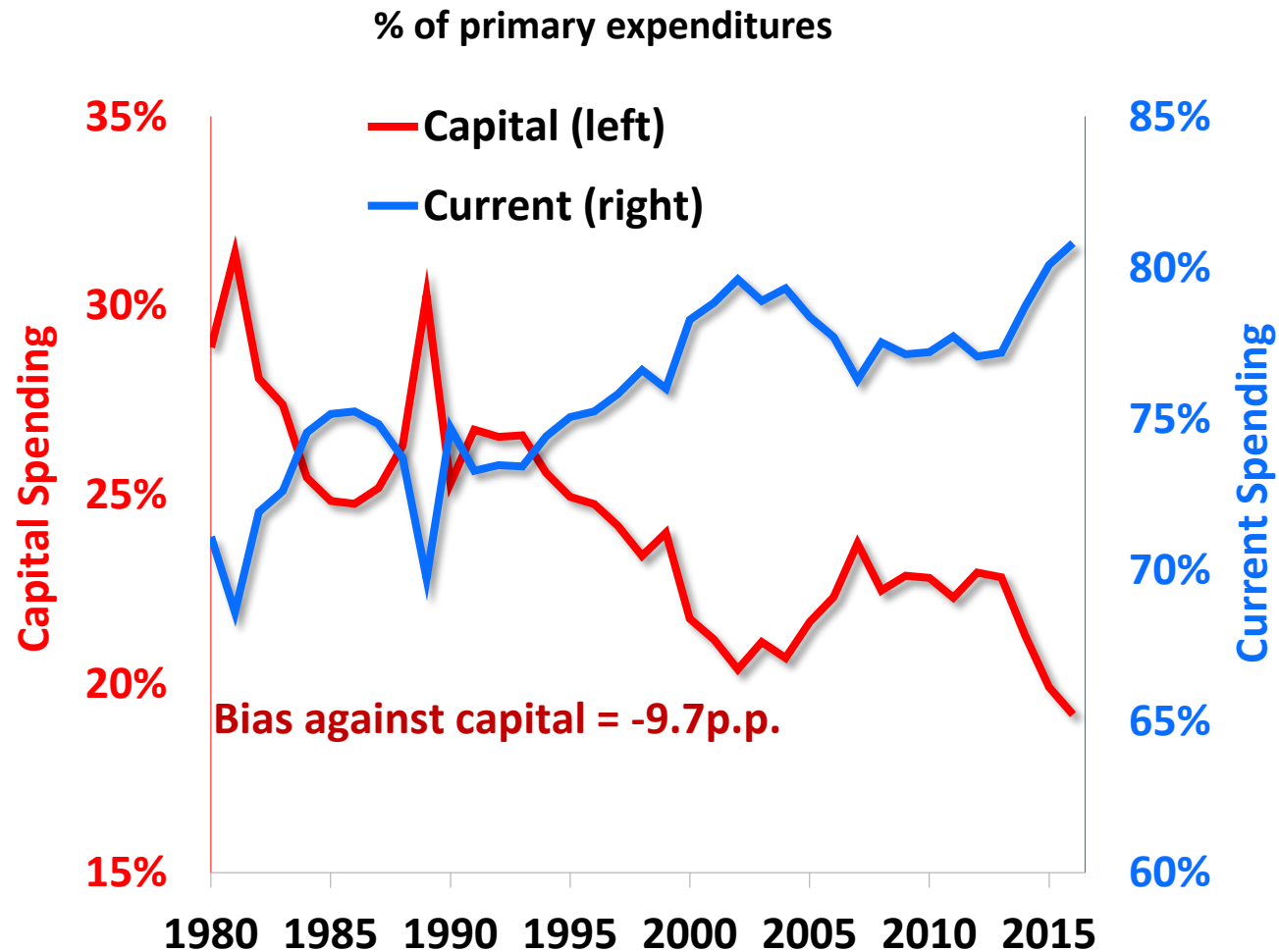
# The Savings Problem in LAC

- Small and inefficient financial systems
  - Limited savings channeled to productive investments
  - Poor contract enforcement
- Pension systems that are unsustainable
  - Low coverage, unequal, and very costly
- Fiscal issues affecting public savings
  - Low revenues and high expenditures
  - A bias against public investment



# The bias against public investment...

## LAC: Share of current and capital spending



- **The commodity boom:** expansion in inflexible current spending as a share of total spending
- **Post boom adjustment:** focused on more flexible capital spending
- See previous Latin American and Caribbean Macroeconomic Reports and forthcoming flagship on Public Spending.

# Low investment with low interest rates

- Some countries suffer low investment and have low interest rates
- Indicating a lack of profitable projects rather than a lack of savings *per se*
- Potential reasons may include:
  - Lack of appropriability
  - Lack of sophistication or poor “product space”
  - Lack of integration, competitiveness
- Re: Growth Diagnostics (Hausmann, Rodrick and Velasco 2005)



# Plan of the presentation

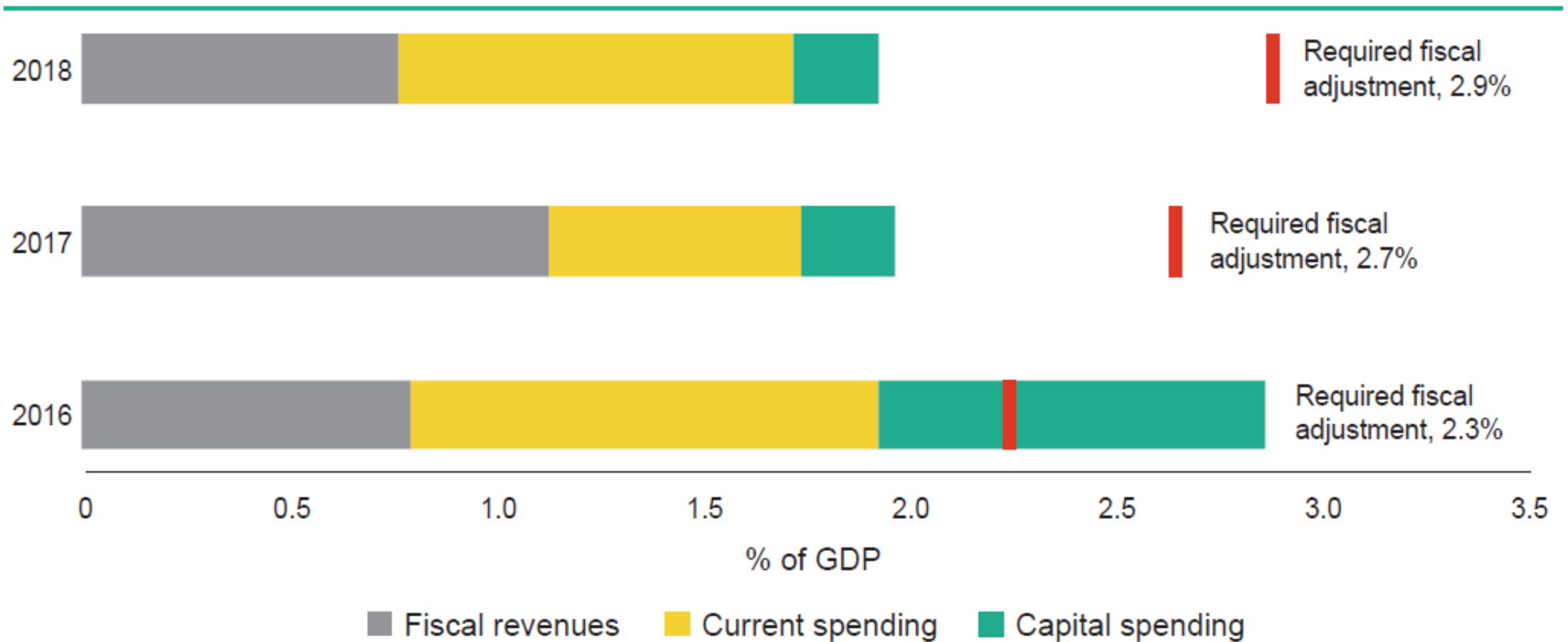
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# Monetary Policy – Inflation Targeters

- Inflation targeting: created a credible nominal anchor, allowed exchange rate flexibility
- Acted to absorb negative shocks (e.g.: in commodity prices), depreciations have likely been counter-cyclical, mostly through import-substitution (last year's report)
- Moderate pass-through, higher inflation: some CB's responded with higher interest rates
- These rate rises helped contain inflation, not so much impact on output
- Now, countries mostly in a loosening phase, can help boost output but should ensure inflation expectations remained anchored

# Most countries planning fiscal adjustment

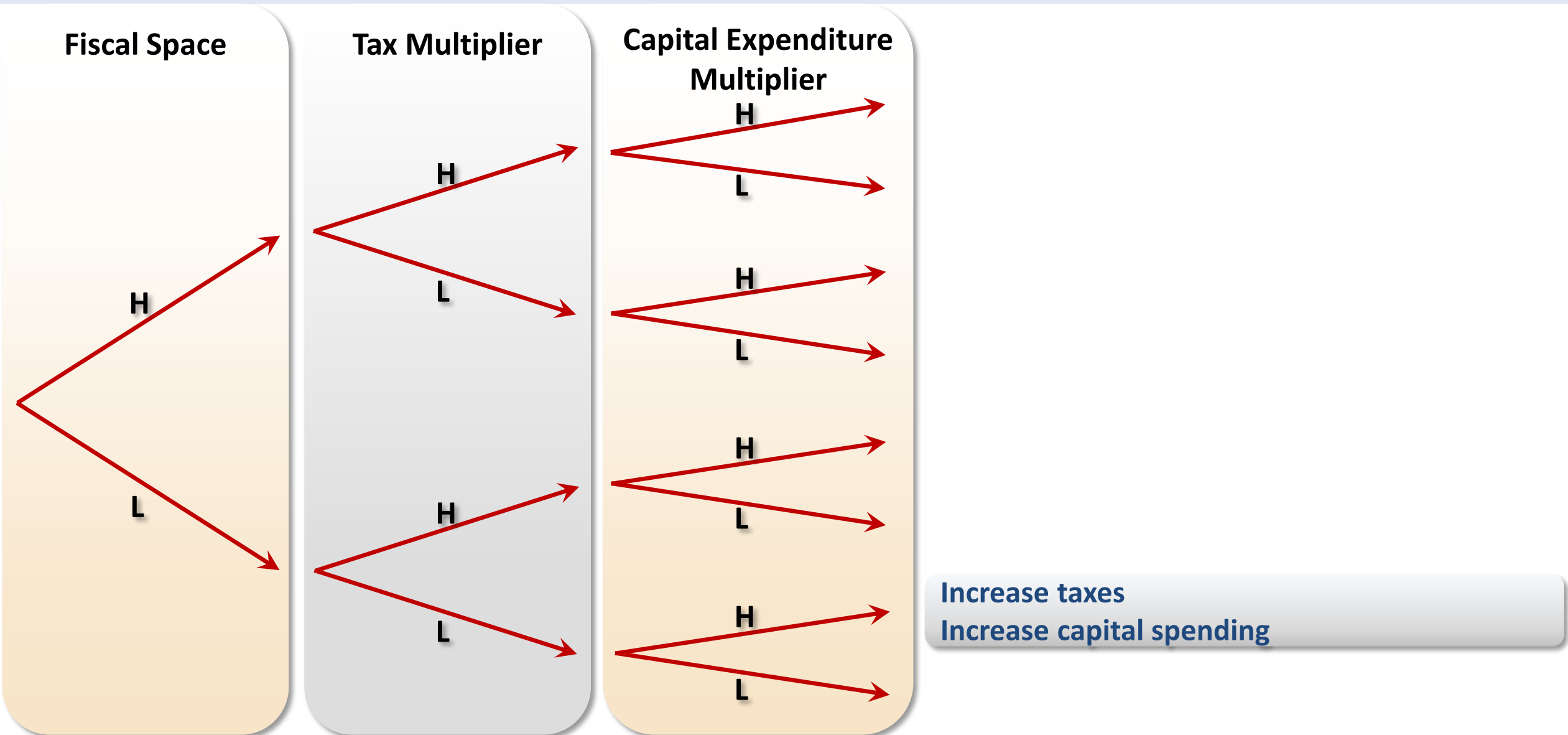
## Required vs. Planned Fiscal Adjustment



Source: IDB staff calculations based on national sources

Note: The required fiscal adjustment is the average for those countries that have an improvement in budgeted fiscal balances.

# Even with no fiscal space there are useful policy options...

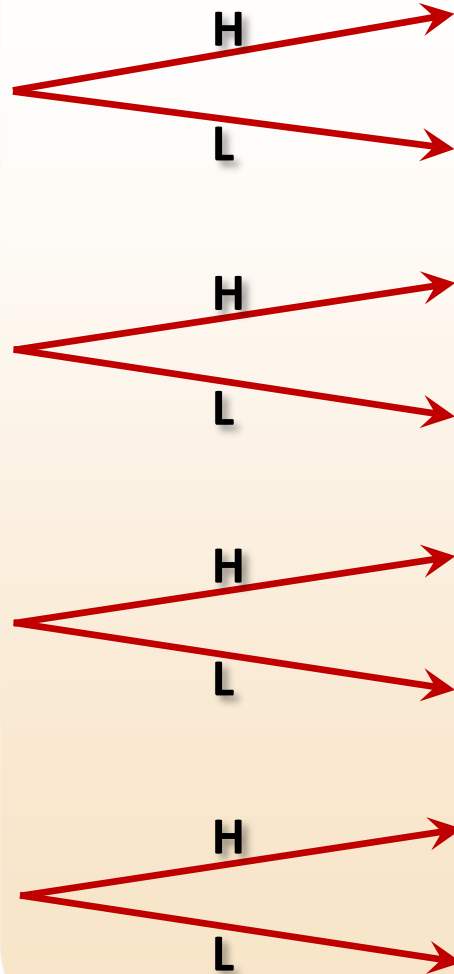
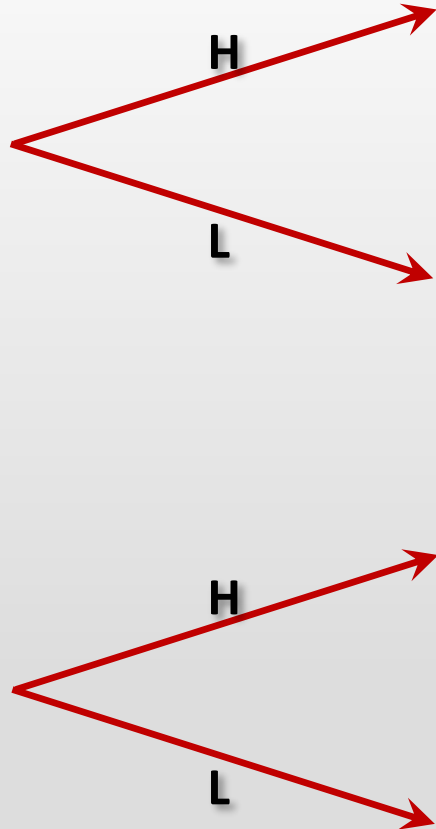
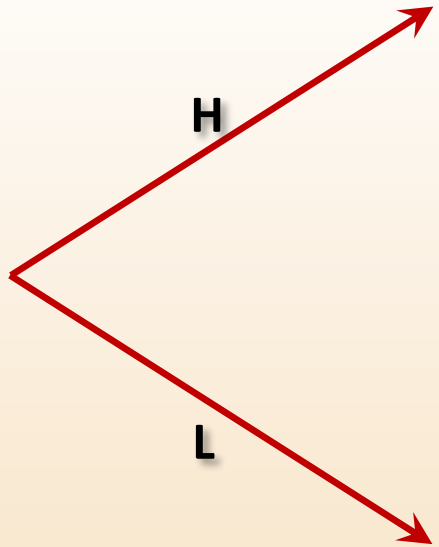


# All countries can increase efficiency and improve public investment frameworks, and for some it's a pre-requirement...

Fiscal Space

Tax Multiplier

Capital Expenditure  
Multiplier



Strengthen public investment framework and then boost capital spending, increase taxes

# Fiscal Policy Options – The full tree

(further details in the report)

Fiscal Space

Tax Multiplier

Capital Expenditure  
Multiplier

Lower taxes

Increase capital spending

Lower taxes

Strengthen public investment framework

Increase capital spending

Strengthen public investment framework

Revenue neutral tax reform

Seek greater efficiencies

Strengthen public investment framework

Increase taxes

Increase capital spending

Strengthen public investment framework and  
then boost capital spending, increase taxes

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# Plan of the presentation

- The international context
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- Explaining low investment
- Monetary policy and reserve management
- **Conclusions**

## Conclusions: Measures to boost growth...

- **Reduce micro-level distortions (tax systems, labor market, credit markets...)**
- **Fiscal policy options**
- **Critical sectors where there are growth opportunities**
- **Detailed country analysis...**



# Critical sectors with growth opportunities

## Methodologies Employed in IDB Country Analysis

- **Growth Diagnostics** (a focus on returns and prices to identify constraints)
- **Development Gaps** (where is a country behind relative to peers)
- **Priorities for Productivity and Income** (an econometric analysis suggesting where improvements are likely to payoff)

**Key**  
**Three methods agree**  
**Two methods agree**

Country	Potential Barriers to Growth					
Argentina	Financial Markets	Infrastructure	Innovation and Integration	Institutional Strengthening	-	-
The Bahamas	Financial Markets	Infrastructure	Education	Health	Innovation and Integration	-
Bolivia	Education	Financial Markets	Health	Infrastructure	Innovation and Integration	Institutional Strengthening
Brazil	Financial Markets	Infrastructure	-	-	-	-
Chile	Financial Markets	Health	Infrastructure	Innovation and Integration	Institutional Strengthening	-
Colombia	Infrastructure	Education	Financial Markets	Institutional Strengthening	-	-
Costa Rica	Financial Markets	Infrastructure	-	-	-	-
Dominican Republic	Financial Markets	Education	Infrastructure	Institutional Strengthening	-	-
Ecuador	Innovation and Integration	Financial Markets	Institutional Strengthening	-	-	-
Guyana	Innovation and Integration	Education	Financial Markets	Health	Institutional Strengthening	-
Haiti	Education	Infrastructure	Institutional Strengthening	-	-	-
Honduras	Education	Health	Infrastructure	Institutional Strengthening	-	-
Jamaica	Financial Markets	Innovation and Integration	Institutional Strengthening	-	-	-
Nicaragua	Education	Infrastructure	Innovation and Integration	Institutional Strengthening	-	-
Paraguay	Innovation and Integration	Education	Financial Markets	Infrastructure	Institutional Strengthening	-
Peru	Financial Markets	Infrastructure	-	-	-	-
Suriname	Innovation and Integration	Education	Financial Markets	Health	Infrastructure	Institutional Strengthening
Trinidad and Tobago	Education	Health	Infrastructure	Innovation and Integration	Institutional Strengthening	-
Uruguay	Financial Markets	Infrastructure	-	-	-	-

# Conclusions..

- Fiscal policy options
- Critical sectors where there are growth opportunities
- **Detailed country analysis, see the Country Development Briefs**  
[www.iadb.org/macroreport](http://www.iadb.org/macroreport)



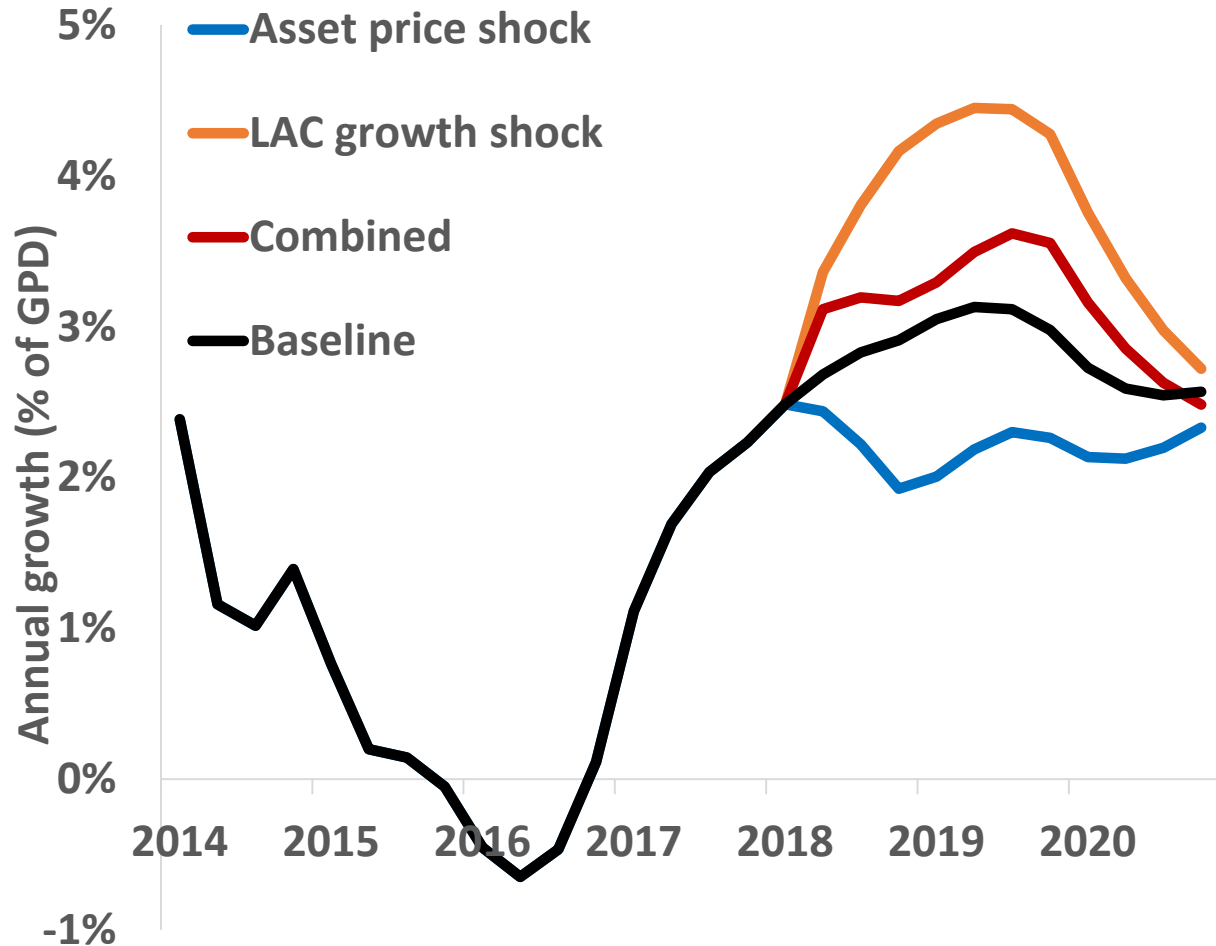
# A Mandate to **GROW**



**Thank You!**



# But even moderate recovery is at risk...



Country	Baseline growth	Difference in growth with respect to baseline (2018-2020 average)		
	Average (2018-2020)	Asset price shock	LAC growth shock	Combined shock
<b>Latin-America and the Caribbean</b>	<b>2.8%</b>	<b>-0.7%</b>	<b>1.0%</b>	<b>0.3%</b>
Southern Cone except Brazil	2.9%	-0.8%	1.3%	0.5%
Andean Region	3.4%	-0.5%	1.2%	0.7%
Central America and The Caribbean	3.0%	-0.2%	0.6%	0.3%
Brazil	2.6%	-0.5%	0.8%	0.2%
Mexico	2.7%	-1.0%	1.0%	0.0%