Disappointing Latin American growth: Chile, welcome back

Ricardo Hausmann
Kennedy School of Government
Harvard University
The 90s looked promising

GDP Growth

<table>
<thead>
<tr>
<th>Year Range</th>
<th>Porcentaje</th>
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<td>1971-80</td>
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<td>1991-98</td>
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Fuente: IDB
...and seemed to be taking off
...thanks to an ambitious reform program

- Inflation stabilization
- Fiscal consolidation
- Trade liberalization and integration
- Financial reform
- Tax reform
- Privatization
- Labor market reform
- Social security
Significant structural reforms

Avance de las políticas estructurales

Variación relativa al máximo

Trade

Financial

Fuente: Lora, 1997
...that is still incomplete by area

Avance de las políticas estructurales

Variación relativa al máximo

- Trade
- Financial
- Tax
- Privatization
- Labor

Fuente: Lora, 1997
More reforms, more growth

Cambios en Crecimiento y en Políticas Estructurales (1993-95 vs. 1987-89)

Fuente: Lora y Barrera, 1997
Potential growth seemed to be decent

Potencial de Crecimiento Actual y con Más Reformas

- Ecuador
- Chile
- Costa Rica
- El Salvador
- Paraguay
- Mexico
- Peru
- Jamaica
- Guatemala
- Venezuela
- Argentina
- Colombia
- Uruguay
- Honduras
- Brazil
- Bolivia

0% 2% 4% 6% 8%

Políticas Actuales (1995) Con Mayor Estabilización y Reformas

Fuente: Lora y Barrera, 1997
…but growth collapsed
(s.a. GDP, annualized quarterly growth rate)

Deceleration  Recession  Recovery  Stalling

Includes: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
### Deceleration and Recession Phase
(GDP, annual growth)

<table>
<thead>
<tr>
<th>Country</th>
<th>1997.II (1)</th>
<th>1998.II (2)</th>
<th>1999.II (3)</th>
<th>Reversal (3)-(1)</th>
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# Recovery and Stalling Phases

(GDP, annual growth)

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Hypothesis 1
Insufficient reform
Hypothesis 1: insufficient reform

• But why is growth so lackluster in the best performers?
  • Chile, El Salvador, Peru, Argentina
• Which reforms? Why do they limit growth?
• First generation?
  – It is hard to do well on the fiscal front if you are not growing
• Second generation?
  – Are they suppose to pay off any time soon?
More reforms, more growth

Cambios en Crecimiento y en Políticas Estructurales (1993-95 vs. 1987-89)

Fuente: Lora y Barrera, 1997
Hypothesis 2:
The human capital story
Educational attainment

Mean years of schooling by birth cohort

Source:
- Latin America: Household Surveys for 13 countries
- Korea: UNESCO 1997
Is it education?

• Latin American educational progress has not been spectacular
• …but progress has taken place
  – Average increase in the education of the labor force of about 1 year per decade
• Little relationship between effort and outcomes
• High unemployment suggests human endowments are not the binding constraint
Hypothesis 3: The financial story
Financing is where the shoe hurts
Capital inflows collapsed

Private nonFDI flows
...when they were most needed
...prompting a severe import contraction

Comparing Recessions
(absolute change between periods)

Source: WEO
Real Growth in Latin America

…and a collapse in growth

Source: WEO
...that affected most countries

Fall in Growth (Average 1999-98 vs 1997)
Why?

- The dominant view: moral hazard
- The alternative view: willingness to repay
- Financial fragilities
  - Original sin
  - Sudden stops
- Implications:
  - Better domestic credit institutions
  - Better integration to the world economy
    - Monetary union
    - International lender of last resort
    - International bankruptcy court
  - Or will financial openness collapse?
Is the financial story only symptomatic?

• Suppose growth is not forthcoming for some other reason
  – Insufficient international integration
• Returns to additional capital will be low
• …justifying low capital flows
• The Eastern European accession countries have more growth prospects
• …and are getting more finance
The EU accession countries have ample finance

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<th>“Twin deficit” forecasts</th>
<th>Current account balance</th>
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...at cheap rates

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<td>15.91</td>
<td>n/a</td>
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Source: Bloomberg. Reflects prices and spreads at approximately 4:00 P.M.
Hypothesis 4: Insufficient integration
The insufficient integration assumption

• New growth requires large markets that support greater division of labor
• Domestic markets are small and fragmented by lack of infrastructure and institutions
• International markets are unreliable for lack of secure access and *incompatible policies*
• Evidence: EU and Mexico
• Implication: we need a deep ALCA
Hypothesis 5. It is obstacles to innovation

- Asset accumulation is not the secret of growth
  - Savings plus education
- …because the production function is not a black box
  - Entrepreneurs need to find ways to mix inputs and markets to supply
  - Their efforts generate spillovers (externalities)
  - Private risks may exceed social risks
- LA dismantled its entrepreneurial promotion structure
- And maintains bureaucratic obstacles to new firms
- Implication: Industrial policy
So take your pick

- Is it insufficient reforms
- Is it education?
- Is it international finance?
- Is it insufficient integration?
- Is it inadequate framework for innovation?