Growth in LAC and in Chile

Klaus Schmidt-Hebbel
Catholic University of Chile

Lima, Peru, 9-10 July 2015
Outline

1. LAC’s Disappointing Growth Performance: Some Key Issues
   • Institutions and Human Capital
   • Income Distribution
   • Economic Diversity/Complexity
   • Saving
2. Chile’s Growth Stop: A (Wo) man-made Disaster
3. Conclusions on LAC and Chile

References
1. LAC’s Disappointing Growth Performance: Some Key Issues
(1) Institutions, Human Capital, and Growth

- North and Thomas (1973): “The factors we have listed (innovation, ecs of scale, education, capital accumulation, etc.) are not causes of growth; they are growth”
- Glaeser et al. (2004): HK → I
- Acemoglu, Gallego, and Robinson (2014) test for the role of institutions (I) and human capital (HK) in explaining growth, controlling for potential endogeneity of both. Findings:
  i. I → HK (not the reverse)
  ii. Once endogenized, HK has low return on growth (consistent with Mincerian micro studies), much lower than I returns on growth
- Research challenge: investigate bi-causality I-HK
- LAC policy challenge: work on closing gaps of both I and HK
(2) Economic Complexity and Growth

- Hidalgo and Hausmann (2009): economic complexity (EC) is key for growth
- Rodriguez Bastos and Wang (2015) run world panel growth regressions and report statistic and economic significance of EC and export diversification, inferring, for example, that Mexico (Ecuador) grows by 0.5 pp more (0.4 pp less) than average LAC because of higher (lower) EC
- Problematic findings: omitted variables, including growth determinants that are highly correlated with EC: education, infrastructure, health, market efficiency, etc.
- Policy implications:
  (i) IMF (2015) is careful in not drawing the wrong lessons (if results taken at face value) on implementing incentives to EC
  (ii) More generally (LAC): avoid vertical industrial policies (e.g. clusters, among other sector-selective picking of winners)
(3) Income Distribution and Growth

• Most traditional theories show that higher income concentration lowers growth: higher demand for redistribution by the median voter (political economy), more social instability reducing investment, capital market imperfections that lead to under-investment in human capital or lobbying by the rich

• Some models allow for a positive concentration-growth link while others posit that the relation could be ambiguous

• Cross-country correlation: a non-monotonic relation between income concentration and growth (similar in shape to “old” Kuznets Curve for income concentration and per capita income level)
Inequality and Growth in the World, 2005-14
(3) Income Distribution and Growth

- They show that at high (low) levels of concentration relation is negative (positive) because median voter votes for positive (zero) transfers, and remaining spending goes to productive capital services and public consumption good.
- Hence concentration-growth relation is inverted-U shaped, consistent with cross-country data.
- This suggests that in LAC, the region with the world’s most concentrated income distribution, the relation is still negative. But if income concentration improves, the relation may become positive.
(4) Saving

- On average, national saving rates are low in LAC - but highly heterogeneous across LAC countries
- Grigoli, Herman, and Schmidt-Hebbel (2014, 2015) present new evidence on saving behavior for the world and LAC and conclude:
  (i) saving is **boosted** by: growth policies, public saving, sovereign pension wealth funds to cover public pension liabilities, sovereign commodity wealth funds, trade openness, fully-funded pension systems;
  (ii) saving is **reduced** by: population ageing, some tax reforms
  (iii) saving is **not affected** by adoption of frontier macro regimes: flexible exchange rate, inflation targeting, fiscal rules (which have other benefits).
Saving in LAC

Private Saving Rates / GPDI

<table>
<thead>
<tr>
<th>Region</th>
<th>Countries</th>
<th>Mean</th>
<th>Coefficient of Variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>164</td>
<td>20.4</td>
<td>0.65</td>
</tr>
<tr>
<td>Africa</td>
<td>43</td>
<td>13.4</td>
<td>1.12</td>
</tr>
<tr>
<td>Asia and Pacific</td>
<td>22</td>
<td>26.7</td>
<td>0.38</td>
</tr>
<tr>
<td>Europe</td>
<td>41</td>
<td>24.4</td>
<td>0.32</td>
</tr>
<tr>
<td>Middle East and Central Asia</td>
<td>27</td>
<td>26.1</td>
<td>0.58</td>
</tr>
<tr>
<td>Western Hemisphere</td>
<td>31</td>
<td>16.4</td>
<td>0.55</td>
</tr>
<tr>
<td><strong>LAC</strong></td>
<td>29</td>
<td>15.6</td>
<td>0.58</td>
</tr>
<tr>
<td><strong>LAC7</strong></td>
<td>7</td>
<td>20.0</td>
<td>0.28</td>
</tr>
<tr>
<td><strong>Middle LAC</strong></td>
<td>12</td>
<td>15.0</td>
<td>0.35</td>
</tr>
<tr>
<td><strong>Small islands</strong></td>
<td>10</td>
<td>13.1</td>
<td>0.98</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations.
2. Chile’s Growth Stop: A (Wo-) Man-made Disaster
Chile’s External Conditions are good

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in Terms of Trade (%)</td>
<td>-3.0</td>
<td>-1.4</td>
<td>1.3</td>
<td>-0.2</td>
</tr>
<tr>
<td>Copper Price (US$/lb.)</td>
<td>3.32</td>
<td>3.11</td>
<td>2.80</td>
<td>2.90</td>
</tr>
<tr>
<td>Oil Price (Brent and WTI avge.) (US$/b.)</td>
<td>103</td>
<td>96</td>
<td>60</td>
<td>66</td>
</tr>
<tr>
<td>Trade Partners’ GDP Growth (%)</td>
<td>3.1</td>
<td>3.4</td>
<td>3.4</td>
<td>3.7</td>
</tr>
<tr>
<td>US$ Libor (6-m), Euribor (3-m) and Yen rates (6-m) (%)</td>
<td>0.4;0.2;0.2</td>
<td>0.3;0.2;0.2</td>
<td>0.7;0.0;0.1</td>
<td>1.9;0.1;0.1</td>
</tr>
</tbody>
</table>

Sources: Banco Central de Chile: *Informe de Política Monetaria*, junio 2015; Bloomberg, European Central Bank and Bank of Japan.
Bachelet’s Main Reforms

1. 2014 Tax Reform: required for larger government, bad for growth, neutral or bad for distribution. In need of “reform of the reform”

2. Education Reforms in stages, 2015-16: end of private education provision, public teacher careers (in the working), free tertiary education: respond to demands of student movements and public teacher unions; inefficient, unfair, unlikely to raise education quality

3. 2015 Labor Reform: strengthens unions (insiders) beyond OECD standards and recommendations: responds to national labor federation; hurts outsiders (non-union members), raises labor costs, informality, capital intensity

4. 2015-16 “New Constitution Process”: contents and process highly uncertain; but there is commitment to weaken property rights and strengthen social rights
Reforms

• Large reforms have two effects:
  (1) Uncertainty of future reforms (and their implementation) hurts growth temporarily
  (2) Certainty of bad reforms (in design and/or implementation) hurts growth rates (or per capita income levels) permanently

• Chile is suffering from both short-term uncertainty of future and longer-term certainty of adopted bad reforms

• Government has not provided any study or evaluation of fiscal and efficiency effects (saving, investment, education quality, employment, growth), nor of poverty and equity effects of its reforms

• Neither have academia, think tanks or international organizations
Inferring from international studies about efficiency costs of Chile’s tax reform

| Efecto promedio de alza de 3% en la relación de ingresos tributarios a PIB (7 estudios) | -4.6% en el nivel del PIB (de -1.1% a -9.0%) |
| Efecto promedio de alza de 3% en la relación de ingresos tributarios sobre PIB (1) | -0.5% en la tasa de crecimiento del PIB (de -0.3% a -0.6%) |
| Efecto promedio de alza de 3% en la relación de ingresos tributarios sobre PIB (3) | -2.5% en el nivel del consumo (de -0.4% a -6.0%) |
| Efecto promedio de alza de 3% en la relación de ingresos tributarios a PIB (2) | -17.6% en el nivel de la inversión (de -0.69% a -33.0%) |
| Efecto promedio de alza de 5 puntos porcentuales en la tasa de impuestos a las utilidades devengadas de empresas (2) | -0.8% en la tasa de crecimiento del PIB (de -0.5% a -1.0%) |
| 19 estudios internacionales sobre distintos aumentos de impuestos | Reportan efectos negativos y significativos sobre ahorro, inversión, PIB y/o crecimiento del PIB |
| 2 estudios internacionales sobre distintos aumentos de impuestos | Reportan ausencia de efectos significativos sobre inversión y/o crecimiento del PIB |

Nota: Utilizando elasticidades reportadas en estudios internacionales, los efectos se calcularon empleando la magnitud de los cambios de la reforma chilena: 3 puntos porcentuales del PIB en mayor carga tributaria y 5 puntos de alza (de 20% a 25%) en tasa de impuesto a utilidades devengadas de empresas. Fuente: K. Schmidt-Hebbel 2014.
Investment Collapse, 2013-15
Fixed-Capital Investment (rate of growth, yoy, %)

Source: Banco Central de Chile.
Long-term Productivity Stagnation, 2000-15

TFP growth (yoy, %)

Source: CLAPES, Chile.
Growth Collapse, 2013-15
IMACEC (s.a. level and annualized growth rate)

Source: Central Bank of Chile.
Political Collapse

Collapse in Bachelet and Reform Approval Rates, 2014-15

[Graph showing approval and disapproval rates for three reforms: R. Tributaria, R. Educacional, and R. Sindical.]

Fuente: CADEM
What happened to Chile’s Growth? (1)

1. It’s not the world economy – but lower copper prices have ended mining (and related) investment boom (Fornero and Kirchner 2014)
2. 2015 growth raised by lower oil price + super-expansionary fiscal policy
3. Bachelet reforms lower growth – uncertainty plus certainty effects
4. Declining returns to past structural reforms and no important reforms since late 1990s
What happened to Chile’s Growth? (2)

5. Major corporate and political crises since 2012 (and exploding in 2015):

5.1 Corporations / private sector: market control, corruption, tax evasion, financial crime

5.2 Politics, Bachelet and her government, Congress (government and opposition parties): corruption, tax evasion, influence-peddling

5.3 Spiraling common crime + violence (Araucanía region = failing state)

5.4 Inequality + unfairness in opportunities and outcomes

How much is cyclical and how much is structural?

Time will tell
3. Conclusions on LAC and Chile
Conclusions on LAC and Chile

(1) How much of the growth reduction is cyclical and how much is structural?
• Time will tell
• Yet considering acceptable external conditions (in particular if the country is an oil importer), much of the downturn is structural

(2) What is required to reignite growth?
• Strategic, systemic, long-term vision
• Anchored in sound economics
• Grounded in assessing political feasibility of deep and well-thought institutional and structural reforms
References


