LATIN AMERICA: Productivity key to sustained growth

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Abstract

Outlook for regional productivity and growth potential.

A study published earlier this month suggests that, without significant productivity gains, the next five years may bring a significant drop in the growth of most Latin American and Caribbean (LAC) countries.

Full text

SUBJECT:Outlook for regional productivity and growth potential.

SIGNIFICANCE:A study published earlier this month suggests that, without significant productivity gains, the next five years may bring a significant drop in the growth of most Latin American and Caribbean (LAC) countries.

ANALYSIS: Impacts.

The impact of population ageing on labour as a factor of production is already apparent in LAC.

Despite recent gains, the contribution of total factor productivity to LAC's growth remains modest.

Investment in education would boost not only labour quality but also productivity through, for example, innovation.

The sustained growth seen in LAC over most of the past decade -- when it averaged around 4%, up from closer to 2% in 1980-2000 -- was partly the result of improved macroeconomic management (see LATIN AMERICA: Gradual growth recovery likely in 2013 - December 19, 2012) but also of positive external conditions in the form of high and, in some cases, record prices for its commodity exports and favourable international financing conditions. This raises the question of the extent to which, beyond the effects of this positive cycle, the region will be able to maintain its growth in the medium term.

In a bid to answer this question, a new study, "Is the Growth Momentum in Latin America Sustainable?", by three IMF economists examines LAC's growth over the past 20 years from the perspective of its supply-side drivers, looking at the respective contributions of factor accumulation (capital and labour) and total factor productivity (TPF). Taking 19 countries (due to lack of data, excluding Argentina and Guatemala), they find that important changes occurred between 1990-2002 and 2003-12.

Labour contribution .

Labour, adjusted for average years of schooling, was the largest contributor to GDP growth in both periods and, for example, in Brazil, Chile, Colombia, Mexico, Peru and Uruguay, accounted for 1.9 percentage points of average 3.1% growth in 1990-2012 and 2.0 points of 4.4% growth in 2003-12. In Central America, its contribution was, moreover, even larger -- accounting for 2.9 points of 3.8% growth in 1990-2002 and 2.4 points of 4.4% growth in 2003-12.

However, while in 1990-2002, this mainly reflected increases in the working-age population and higher labour force participation, the importance of these factors, although still positive, declined significantly in 2003-12. Instead, the key factor was lower unemployment which, according to the UN Economic Commission for Latin America and the Caribbean (ECLAC), dropped from 11.1% in 2003 to 6.4% in 2012. The recent study points out that this was not a wholly cyclical phenomenon but also reflected structural changes such as the development of the services sector.

Capital contribution.

This showed a small increase in 2003-12, which the study attributes partly to improved macroeconomic policies and favourable external financing conditions but also to a sharp increase in foreign direct investment, particularly in South American commodity-exporting countries (see LATIN AMERICA: Record FDI is balance-of-payments risk - May 16, 2013).

TFP.

The study found that, after declining in most of LAC in the 1980s and 1990s, TFP -- defined as the part of output not explained by inputs -- showed an increase in most countries in 2003-12. Its contribution, albeit still smaller than that of either labour or capital, was, therefore, a key factor in the acceleration of the region's growth in this period.

One exception to this trend was Chile, where GDP growth averaged 4.5% in 2003-12 but TFP declined at an annual average rate of 0.5% after increasing at an annual 2.4% in 1990-2002 as the country reaped the benefits of earlier structural reforms and privatisations. The recent decline has been attributed partly to the energy crisis triggered in Chile by Argentina's suspension of its liquefied natural gas exports (see CHILE: Dependency on Argentine gas raises crisis risk - June 4, 2007) but is also likely to be linked to the mining industry's productivity which has been adversely affected by factors that include ageing mines and lower ore grades (see CHILE: Copper growth to have muted GDP impact - June 25, 2010). The study notes that a similar phenomenon has been seen in advanced commodity-exporting economies such as Australia, Canada and Norway and, in this sense, Chile may be a harbinger of future trends in other LAC commodity exporters.

	Capital	Labour	TFP	GDP
1990-2012				
LA6*	1.3	1.9	0.1	3.1
Other South America**	1.0	2.3	-1.0	2.3
Central America	1.5	2.9	-0.7	3.8
Caribbean***	0.6	1.5	0.0	2.1
2003-12				
LA6*	1.7	2.0	0.7	4.4
Other South America**	1.3	2.2	0.6	4.1
Central America	1.4	2.4	0.6	4.4
Caribbean***	0.7	1.1	0.1	1.9

Contribution to GDP growth (annual average, %)
* Brazil, Chile, Colombia, Mexico, Peru and Uruguay
** Bolivia, Ecuador, Paraguay and Venezuela
*** Only Barbados, Jamaica and Trinidad & Tobago
Source: S Sosa, E Tsounta and H Kim, "Is the Growth Momentum in Latin America Sustainable?", IMF, 2013

Comparison with emerging Asia.

In both 1990-2002 and 2003-12, average GDP growth in emerging Asian economies well exceeded that of LAC; the study attributes this principally to the latter's stronger TFP performance. This was particularly the case in the past decade when TFP's contribution to growth in emerging Asia doubled to around 2 percentage points and approximately matched the contribution of labour (historically lower in Asia than in LAC) and of capital (which, in Asia, dropped slightly in 2003-12 as compared to 1990-2012).

Lessons for the future.

On the basis of these results, the study concludes that LAC will be hard pressed to sustain its present growth momentum without significant gains in TFP:

Labour constraints. In quantitative terms, the region is close to full capacity as regards its labour force. This reflects not only currently low unemployment but also population ageing which is already quite advanced in most South American countries (see LATIN AMERICA: Rapid ageing poses policy challenges - April 5, 2012), with the resulting increase in the dependency ratio, and the fact that, in many countries, female workforce participation is now quite high by international standards. In this context, labour's future contribution to LAC's growth will depend primarily on qualitative progress through improvements in educational standards (which would also indirectly benefit TFP). This, however, not only calls for significant public investment but is also seen over generations, rather than years.

Investment in capital. Both domestic and foreign investment in LAC would decelerate over the coming years if, as expected, conditions in international financial markets tighten and commodity prices, albeit still high, remain below the record levels of recent years.

As a result, the study concludes that, if TFP maintains its current growth rate and even if there is no drop in the rate of capital investment, LAC's GDP growth potential would decrease to approximately 3.25% in 2013-17, down from the region's annual growth of around 4.0% over the past decade.

CONCLUSION: After two decades in which quantitative increases in the factors of production -- particularly labour but also capital -- rather than the productivity of their use, have driven the region's growth, it now faces the more complex challenge of bucking the generally pro-cyclical trend by increasing productivity through qualitative improvements. This includes educational standards, infrastructure and the depth and efficiency of financial markets.

Details

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