Economic development and growth in Latin American and Caribbean countries


Productivity and growth are important issues in 21st-century development. Productivity is crucial to development because it affects various economic conditions (e.g., wages and profits) and people’s overall quality of life. Compared with countries in other regions, those in Latin America and the Caribbean suffer from especially low productivity and growth. Although low growth rates may not be a top priority for policymakers facing other pressing issues, they could be costly over time. For instance, if Argentina grew at the same rate as other countries since 1960, its income per capita in 2006 would have been similar to that of the United Kingdom. However, Argentina’s income per capita in 2006 was only $12,258, compared with $27,800 for the United Kingdom. While the rest of the world has benefitted from robust growth since the late 20th century, Latin American and Caribbean countries still face many hurdles on their path to productivity success.

In The Age of Productivity: Transforming Economies from the Bottom Up, a book published by the Inter-American Development Bank, editor Carmen Pagés and her team of contributing researchers argue that poor economic growth within Latin America and the Caribbean results from low productivity and misallocated resources. The authors emphasize the importance of developing plans to address productivity and to improve the standard of living of people in both regions.

The book explores why Latin America and the Caribbean lag behind other parts of the world in terms of growth, economic development, and productivity. Despite covering both regions, the discussion primarily references Latin
American countries. The introductory chapter considers how regional economies can increase productivity, identifying strategic approaches—such as reforming institutions and policies—that could promote the more efficient use of existing resources and factors of production. The following chapters are divided thematically, with each chapter discussing key factors that may affect productivity and policy. Aside from addressing the more obvious impacts of technological advances and education, the authors also highlight the negative impact of economic inefficiencies, such as inadequate trade infrastructure, lack of credit and innovation opportunities, tax evasion, poorly crafted social policies, and overabundance of small- and medium-sized enterprises (SMEs).

Many of these issues are interconnected. Tax evasion and the lack of access to credit, for example, leave no incentives or opportunities for SMEs to invest and grow. Resources are not allocated and used efficiently, which limits productivity growth. Within Latin America, there is a large number of SMEs. The region’s economy consists primarily of small companies with less than 10 employees, and the labor force contains many self-employed workers. However, bigger companies tend to be more productive and can use their resources more efficiently. In addition, many of the smaller firms benefit from extra subsidies, ending up with more resources than they need and distorting production processes. If distributed properly, the additional labor and capital can be used by other enterprises more productively. In the authors’ estimation, simply reallocating available resources “could increase aggregate productivity by approximately 50–60 percent” within Latin America. Therefore, SMEs that cannot invest—or choose not to expand—can be harmful to economic productivity.

Having access to credit lines is important because it allows smaller businesses to secure money for capital investment and innovation. The authors observe “a mismatch between talent and wealth” among SMEs, noting that these companies cannot innovate or invest in modern technologies in the way larger businesses can. Further, a lack of credit-sharing information complicates the implementation of credit contracts between lenders and businesses. There are no formal institutions that could enforce these contracts, so there are few consequences for businesses failing to repay loans or pay taxes.

The current tax systems of many Latin American and Caribbean countries are inefficient. Smaller firms are often exempt from paying any taxes, while larger businesses are subjected to very high tax rates to make up for this deficiency. In addition, the tax collection process is time consuming and tedious for the businesses that do file taxes. Smaller businesses that do not pay any corporate taxes have no incentive to expand, because of the high taxes imposed on larger corporations. The tax evasion rate among firms of all sizes is very high—even among the larger firms that are officially registered. The authors report that 48 percent of registered large firms do not pay any taxes, and this number is much higher among SMEs. Given the high percentage of SMEs and self-employed workers in Latin America, it can be problematic to have many small firms that cannot or will not expand.

As a result of these tax inefficiencies, regional governments do not have enough revenue to provide adequate services. Tax revenues are very low despite high tax rates, and there are substantial transaction costs to file taxes. In 2005, the tax revenues of Latin American countries averaged only about 17 percent of gross domestic product. The benefits of paying taxes are also minimal because of the low value placed on employee benefits and social security participation.

The authors explore various reasons why workers and companies disregard employee benefits. The low contribution and participation rates for social security among self-employed workers are particularly low. By not participating in social security and other mandatory benefit programs, employees profit from higher take-home pay, often opting to work for businesses that do not contribute to these programs. For workers in developing countries,
the value of having more money upfront is much greater than that of planning for the future or having other employee benefits. Because both employers and workers have little regard for their pension systems or employee benefits, they have little to no incentives to pay taxes. As a result, many businesses prefer not to register or to report their taxes, using the excess money from not paying taxes as a form of subsidy. This further perpetuates the cycle of tax evasion and misallocation of funds and resources throughout the economy. It also prevents wages from increasing and depletes labor supply in more “productive formal enterprises,” concentrating it instead in smaller companies.

*The Age of Productivity: Transforming Economies from the Bottom Up* would be a fascinating read for anyone interested in the international political economy of Latin America and the Caribbean. The book highlights and explains the various factors that can affect growth, productivity, and development. Despite the unique circumstances of each country or region, these factors are all interconnected. The authors do a great job of addressing each topic, offering data-driven research and analysis. In addition, they provide compelling arguments and specific examples to emphasize the importance of productivity in economic development, while also identifying many policy approaches to addressing problem areas. The authors stress the need for tradeoffs and timely policymaking in any efforts to increase the productivity of regional economies.
Would a Medicare-for-all system lower healthcare costs in the United States?

Jonathan Yoe

In many countries, such as Australia, Canada, France, and Germany, just to name a few, the government provides healthcare. These countries are the principal buyers of the inputs (pharmaceuticals, medical equipment, the wages of healthcare professionals, etc.) in their healthcare market and can negotiate lower prices for these healthcare inputs. The United States is not one of these countries. U.S. healthcare spending is roughly 18 percent of gross domestic product. If the United States had a Medicare-for-all system, would the U.S. government be able to use its “monopsony power” to curb healthcare spending?

In “The opportunities and limitations of monopsony power in healthcare: evidence from the United States and Canada” (National Bureau of Economic Research, Working Paper 26122, July 2019), Jullian Chown, David Dranove, Craig Garthwaite, and Jordan Keener (all of Northwestern University) imagine a counterfactual model of healthcare in the United States. In this model, the U.S. government would provide Medicare for all. They use this model to try to predict to what extent the U.S. government could use monopsony power to lower healthcare input prices, specifically labor and pharmaceuticals. Prices in these two areas account for 60 percent and 15 percent of all U.S. healthcare spending, respectively.

The authors compare their model’s price predictions to Canadian prices, because Canada provides “the best evidence of the potential optimal savings available from the creation of a single monopsonist in the United States.” A single payer system, such as the Canadian healthcare system, has been widely believed to depress wages of doctors, nurses, and other healthcare providers. Critics of a Medicare-for-all system worry that provider wages in the United States would drop to Canadian levels. However, the authors point out that this is not the case. Highly educated Canadian healthcare workers earn about 26 percent less than highly educated U.S. healthcare workers. If Canadian monopsony power were the reason for this wage gap, then we would not see this wage gap appear when comparing other highly educated employees in other areas of the economy. But, it does appear. Other similarly skilled, highly educated Canadian workers make 22 percent less than their U.S. counterparts. This 4-percentage point difference could be caused by many things, such as inefficiencies in the U.S. healthcare system, entry barriers into the healthcare field, tuition or licensing requirements, general conditions in the broader labor market, or, yes, the limited use of monopsony power by the Canadian government. However, the principal reason for the wage gap is not Canada’s use of monopsony power.

Canada does not use its monopsony power to negotiate provider wages because the labor supply of healthcare workers is elastic in the long run. If the Canadian government restricted wages, current healthcare workers would begin to seek different jobs and perspective medical students would study different subjects, shrinking the future
supply of healthcare workers. The United States, like Canada, would want to avoid this reallocation of talent and limit its use of monopsony power in the labor market.

In the long run, the relative size of a country’s pharmaceutical industry in the global market dictates the extent to which the country can use its monopsony power to suppress drug prices. Canada is able to depress drug prices. A consistent basket of pharmaceutical goods was 54 percent cheaper in Canada than those in the United States. If the United States were to use its monopsony power to this extent, it may not be possible, because the two countries face different long-run elasticities of supply. Canada is a relatively small part of the overall global market for pharmaceuticals, accounting for just 2.8 percent of global spending in the market. Canada does not affect global profits, which suggests that the long-run elasticity of supply for pharmaceuticals that it faces is relatively inelastic. This finding is why the Canadian monopsonist can leverage its buyer power in the market for pharmaceuticals. The United States accounts for 36.9 percent of global pharmaceutical spending, so any success that it might have capping prices would almost surely affect the long-run supply of pharmaceuticals. This result would most likely reallocate production capacity and reduce innovations.
I’ll be back . . . for your job

Cody Parkinson

The portion of national income that goes to workers, also known as the labor share, has decreased from about 63 percent in 2000 to 56 percent in 2018. One reason for the decline may be the loss of workers’ bargaining power as a result of outsourcing and offshoring, declining union membership, and noncompete clauses that restrict worker mobility. Another potential factor for the reduced labor share is automation. In “Are workers losing to robots?” (FRBSF Economic Letter, Federal Reserve Bank of San Francisco, September 30, 2019), Sylvain Leduc and Zheng Liu examine the contribution of automation to the declining labor share as a result of reduced bargaining power.

Traditional economic models suggests that increased productivity due to automation raises wages. Labor supply and demand would stabilize and eventually lead to full employment, and workers would be compensated for the added production. Using nonfarm payroll employment data from the U.S. Bureau of Labor Statistics, Leduc and Liu reevaluate the traditional correlation between automation and wages. They use a revised economic model that accounts for shifting bargaining power, technological improvements, and job search frictions. The model also includes inputs such as quarterly unemployment data, job vacancies, real wage growth, and labor productivity growth to help assess the role of automation.

Using the updated model, the authors compare the actual change in the labor share from 1985 to 2018 with the change in labor share if automation is kept constant at its long-run average. Leduc and Liu find that without automation, the labor share would have been around 59.5 percent in 2018, which is higher than the actual 56.0-percent labor share. The model implies that businesses are more likely to automate during economic expansions and less likely to automate during recessions. This cycle would lead to less bargaining power for employees during good economic conditions because businesses can simply automate the position. Reduced bargaining power lowers wages. The model also shows that productivity would have risen less and wages more had automation not become more prevalent over the previous two decades.

Although automation has lowered the labor share, it has also contributed to the decline in unemployment in recent years. Leduc and Liu argue that the option to automate a position generates an incentive for firms to create jobs because automation is a reliable fallback should the job search be unsuccessful. While some jobs are lost to automation, others are created because of it.

Consistent with other research on the topic, Leduc and Liu’s model finds that the labor share is reduced as increases in automation restrain wages. Since 2000, the labor share has decreased approximately 7 percentage points. The decline accelerated during the Great Recession (2007–09). As firms choose to automate jobs, workers’ bargaining power decreases. Despite increased productivity, “automation contributed substantially to the decline in the labor share since the early 2000s.”