

The Structural Reform Agenda:

Revisiting the Role of the State in Promoting a Competitive Economy

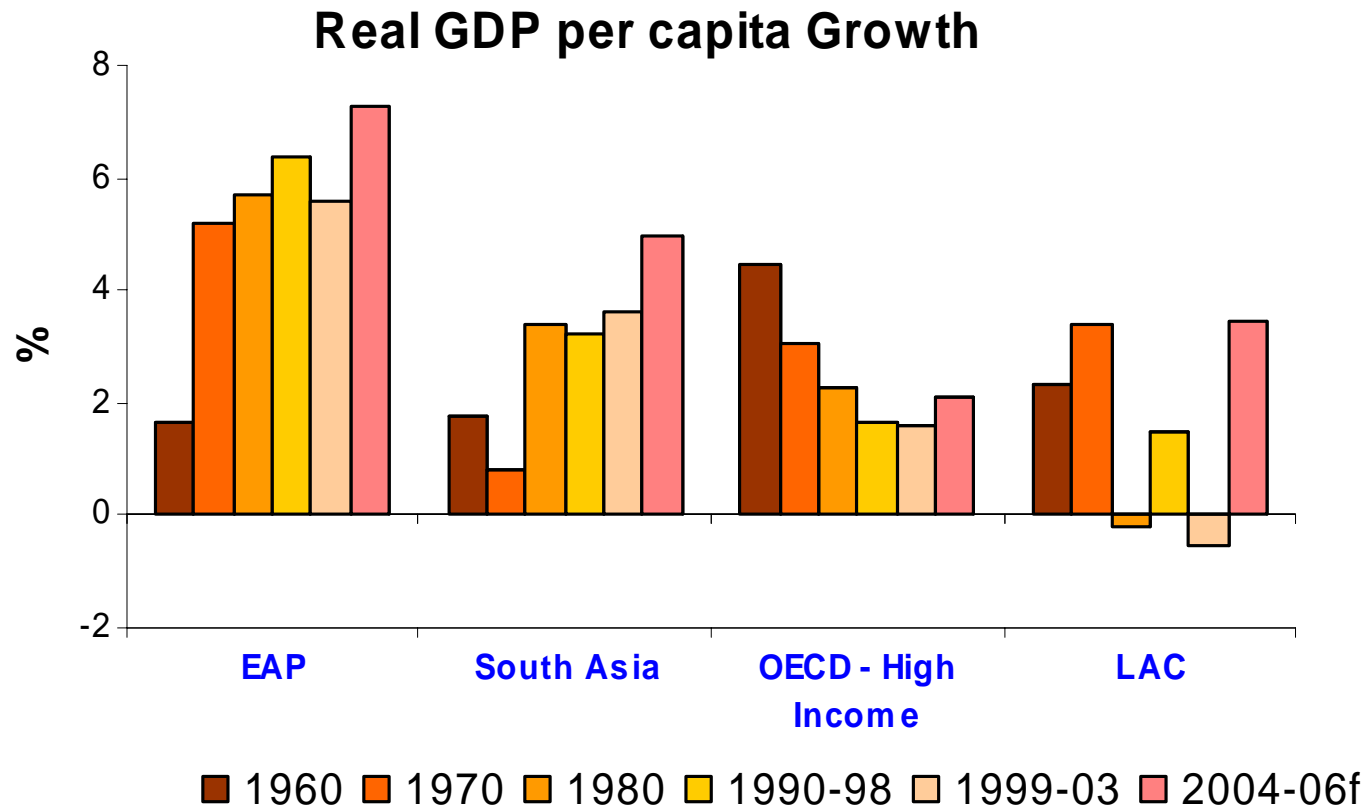


Guillermo Perry
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May 4, 2006

Disappointing long-term growth

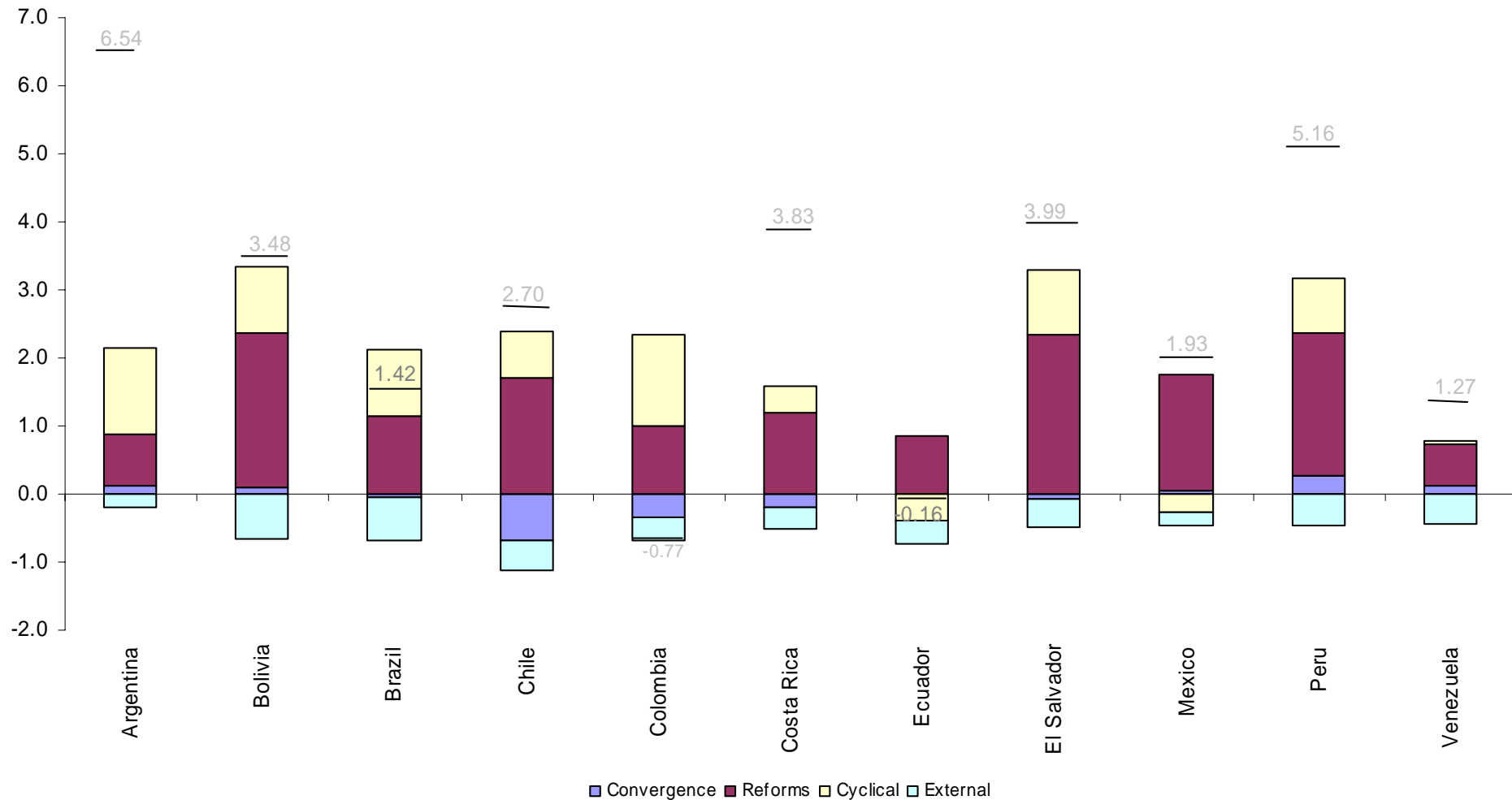
Moderate in the 60s, 70s and 90/98;
negative during 80s and 99/03



Disappointing long-term growth

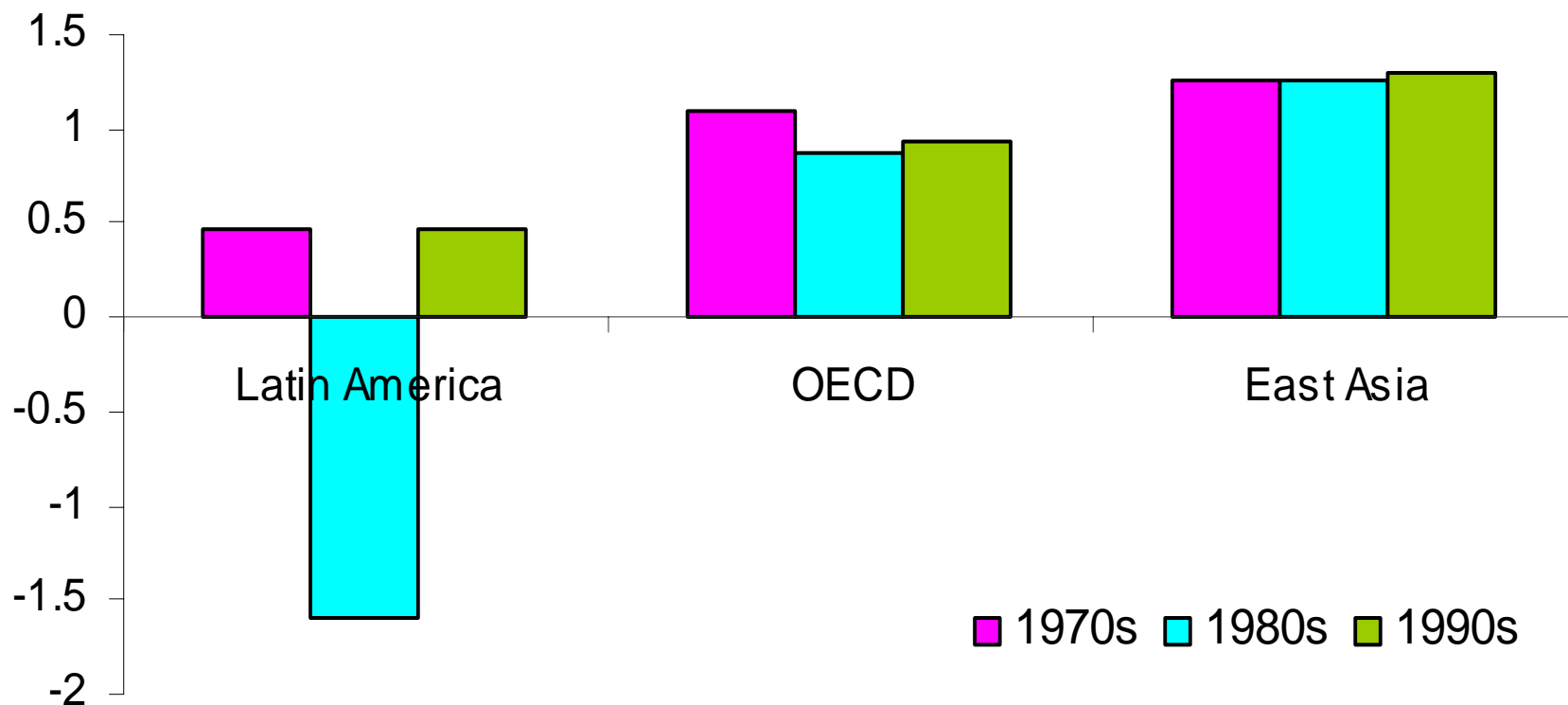
Reforms did pay, but we oversold them

Contribution of reforms to growth: 90's vs 80's



Latin American deficient productivity growth

Annual Growth of TFP





Main causes of deficient growth

1. Weaknesses in Investment Climate
 1. Over-regulation
 2. Poor quality of basic institutions
2. Slow accumulation and utilization of knowledge
 1. Education gaps
 2. Weak Innovation System
3. Deficiencies in Factor Markets
 1. Low financial development
 2. Labor market rigidities
 3. Underinvestment in Infrastructure

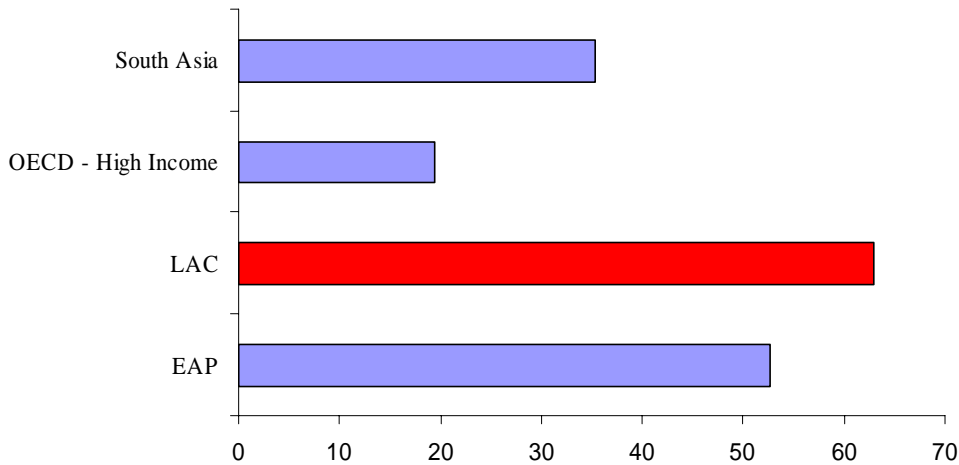


1. Weakness in Investment Climate

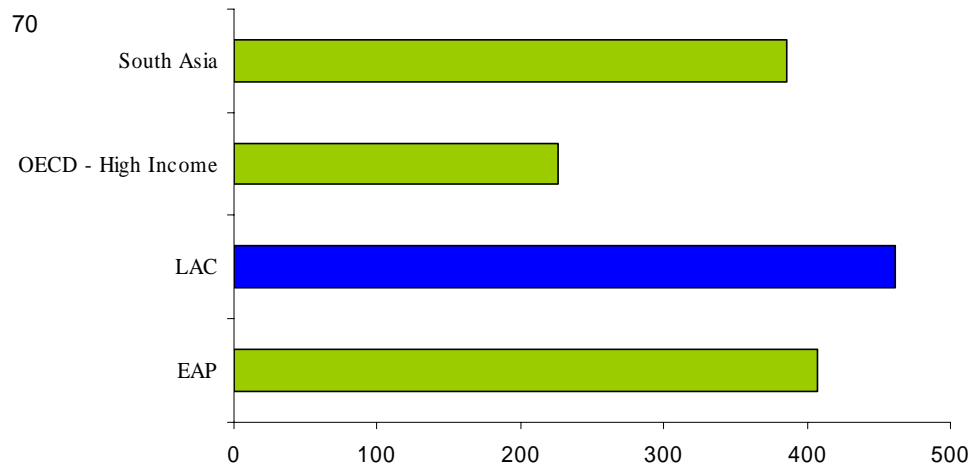
1.1 Over-regulation

Reducing cost of doing business

Time Start a Business - in Days



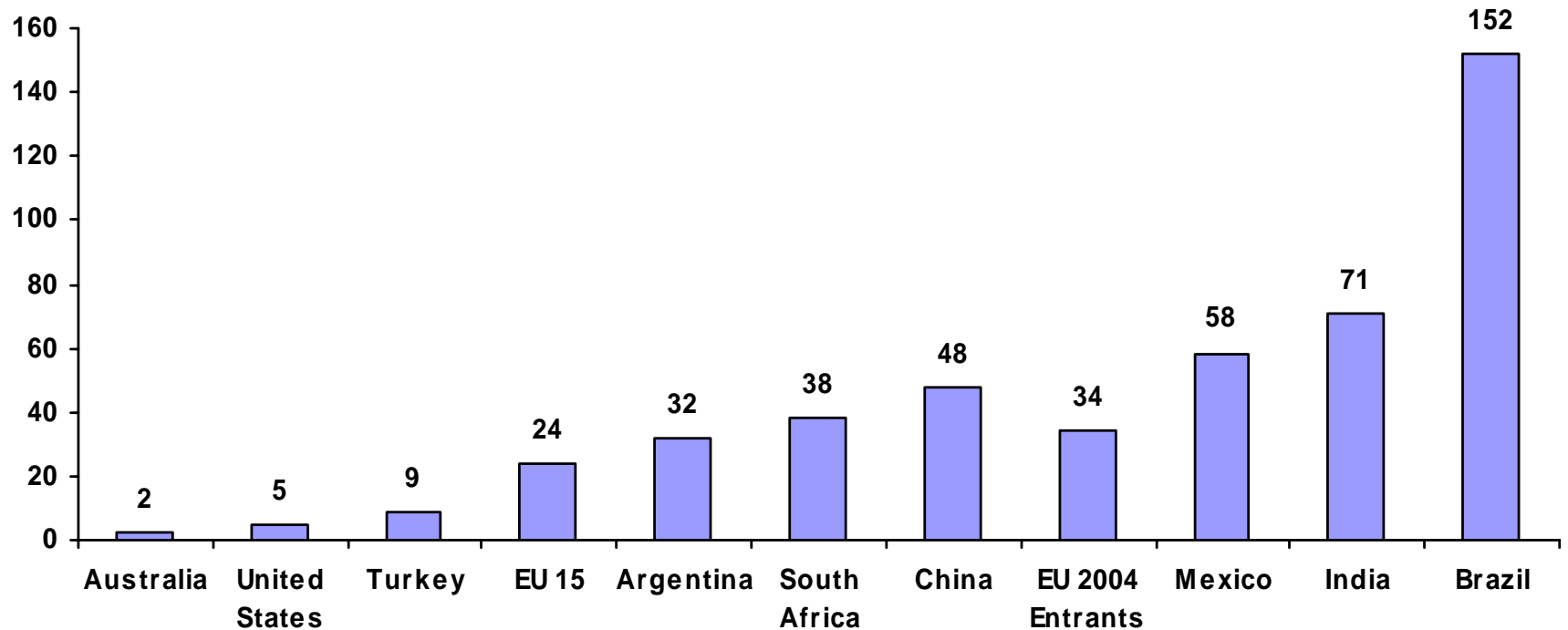
Time to Enforce a Contract - in Days



Over-regulation

Reducing cost of doing business

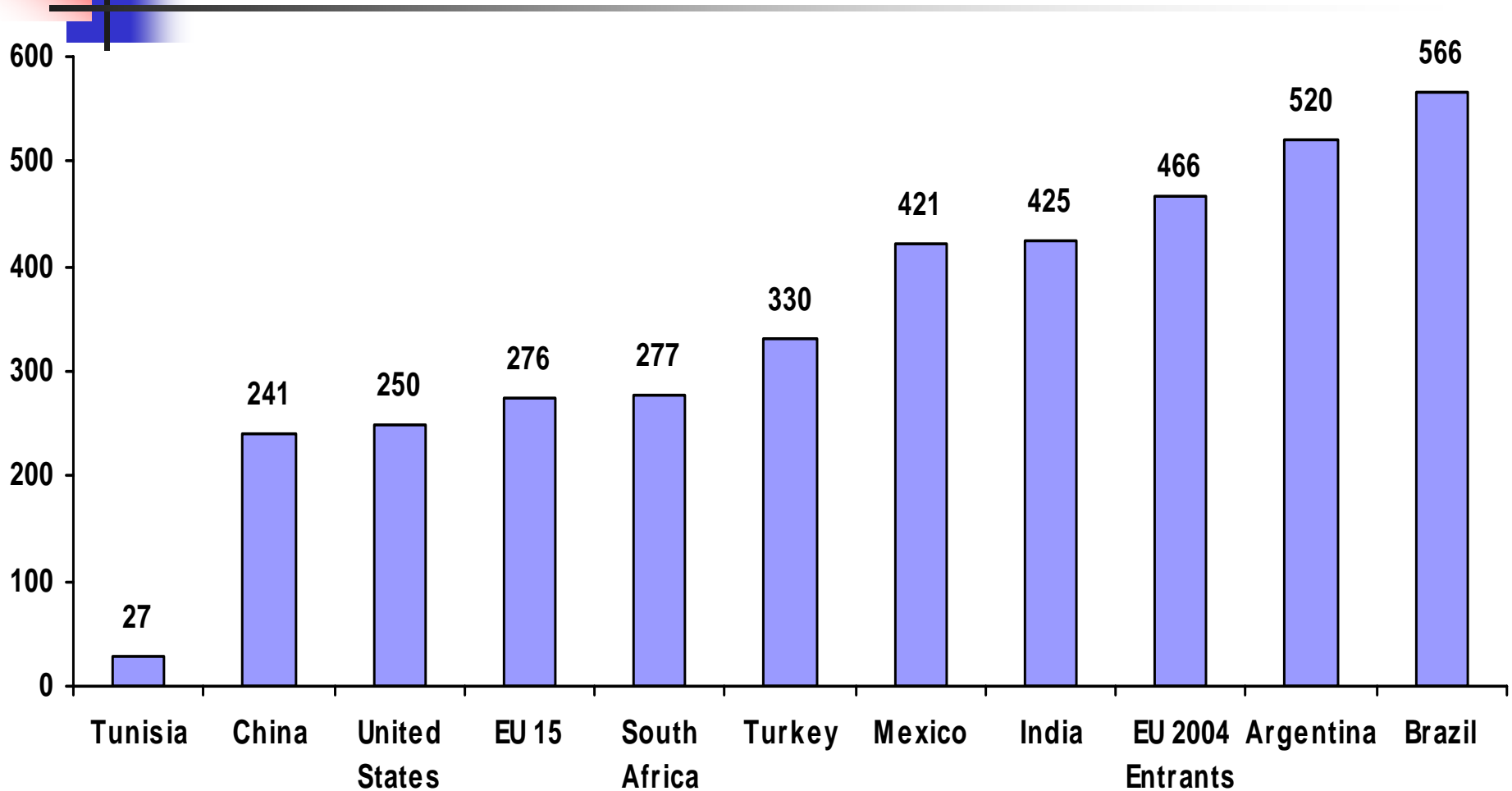
(Time to Start a Business - in Days)



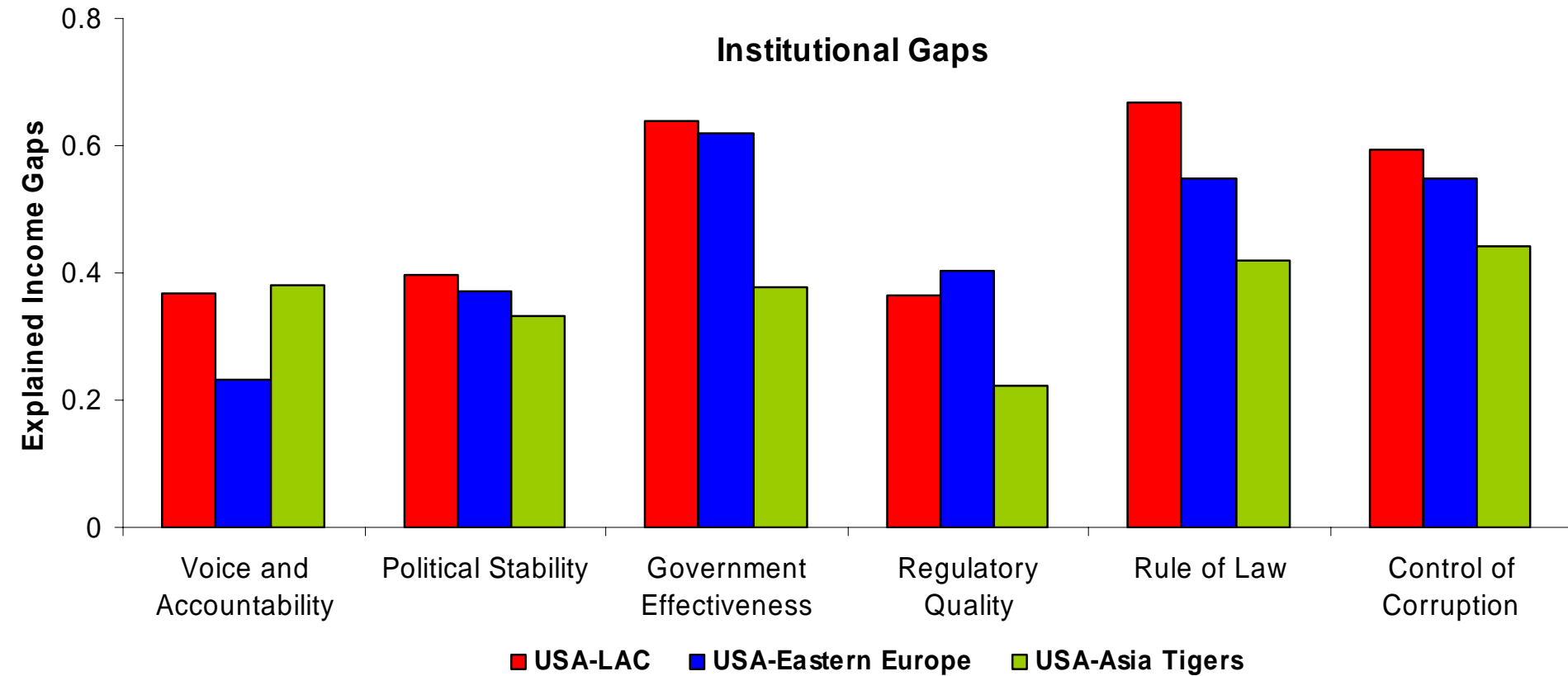
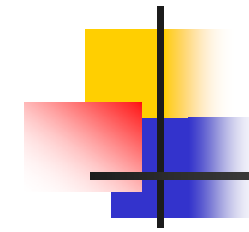
Over-regulation

Reducing cost of doing business

(Time to Enforce a Contract -- in Days)



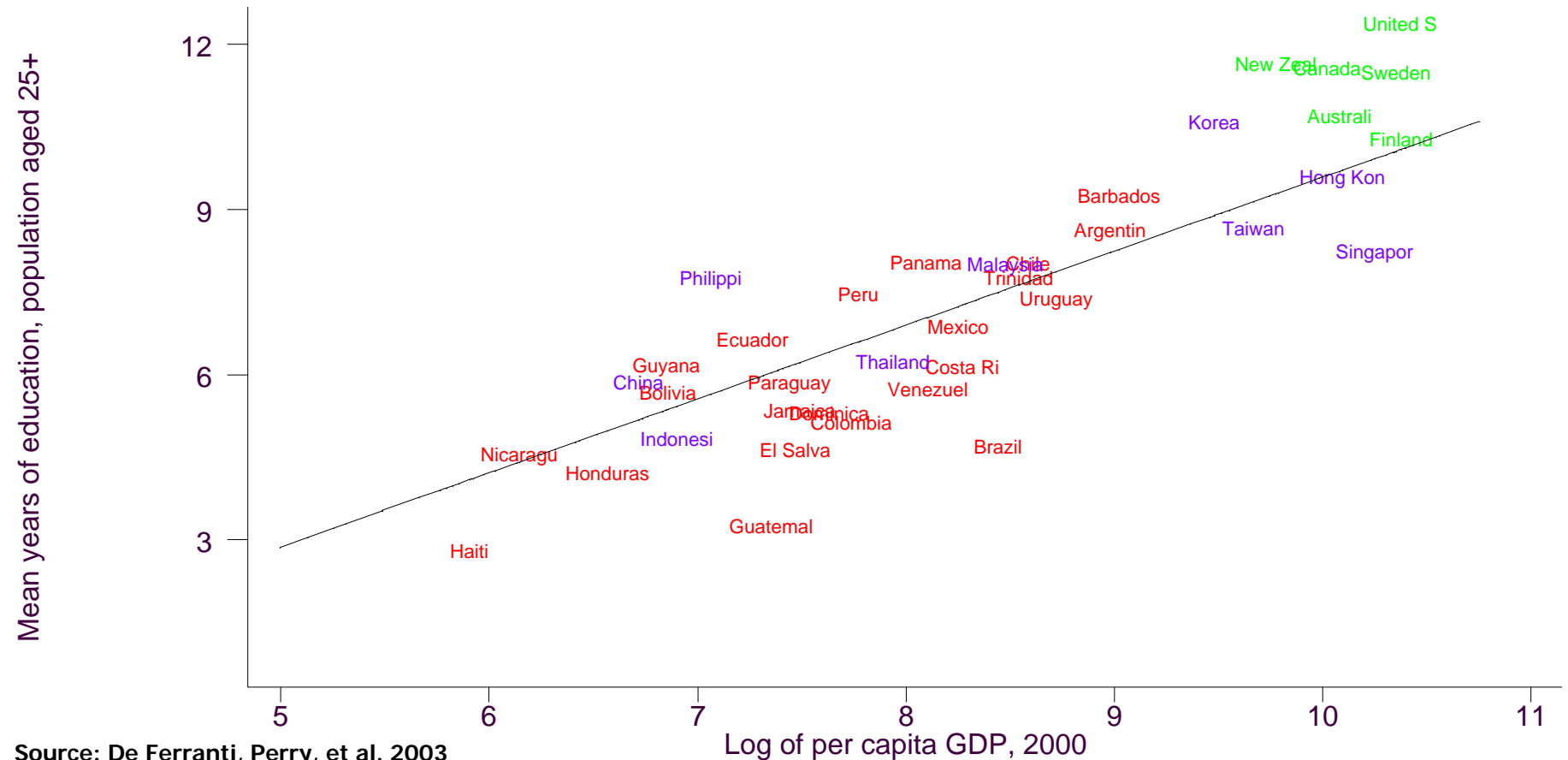
1.2 Poor quality of basic institutions





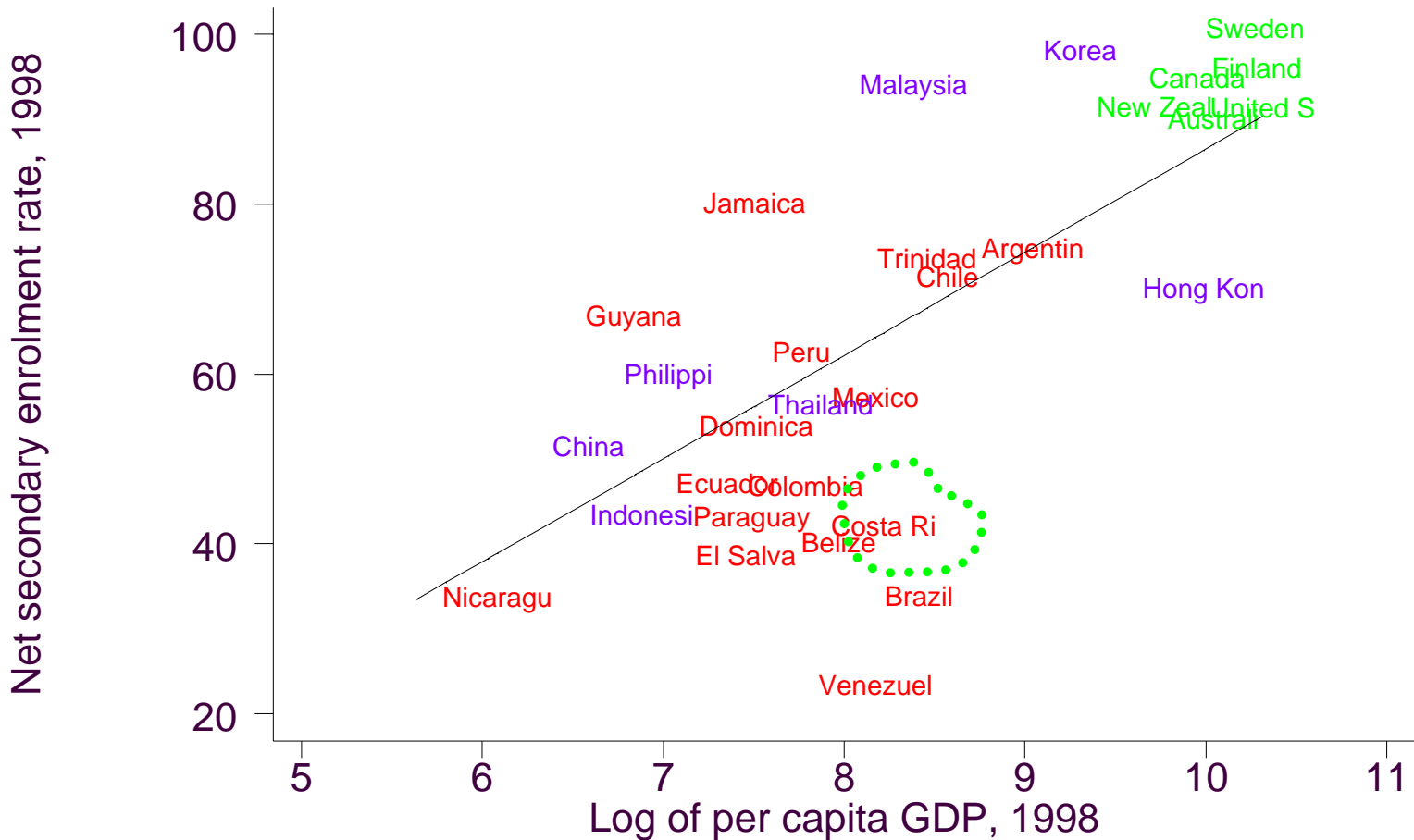
2. Slow accumulation and utilization of knowledge

2.1 Gap in schooling years

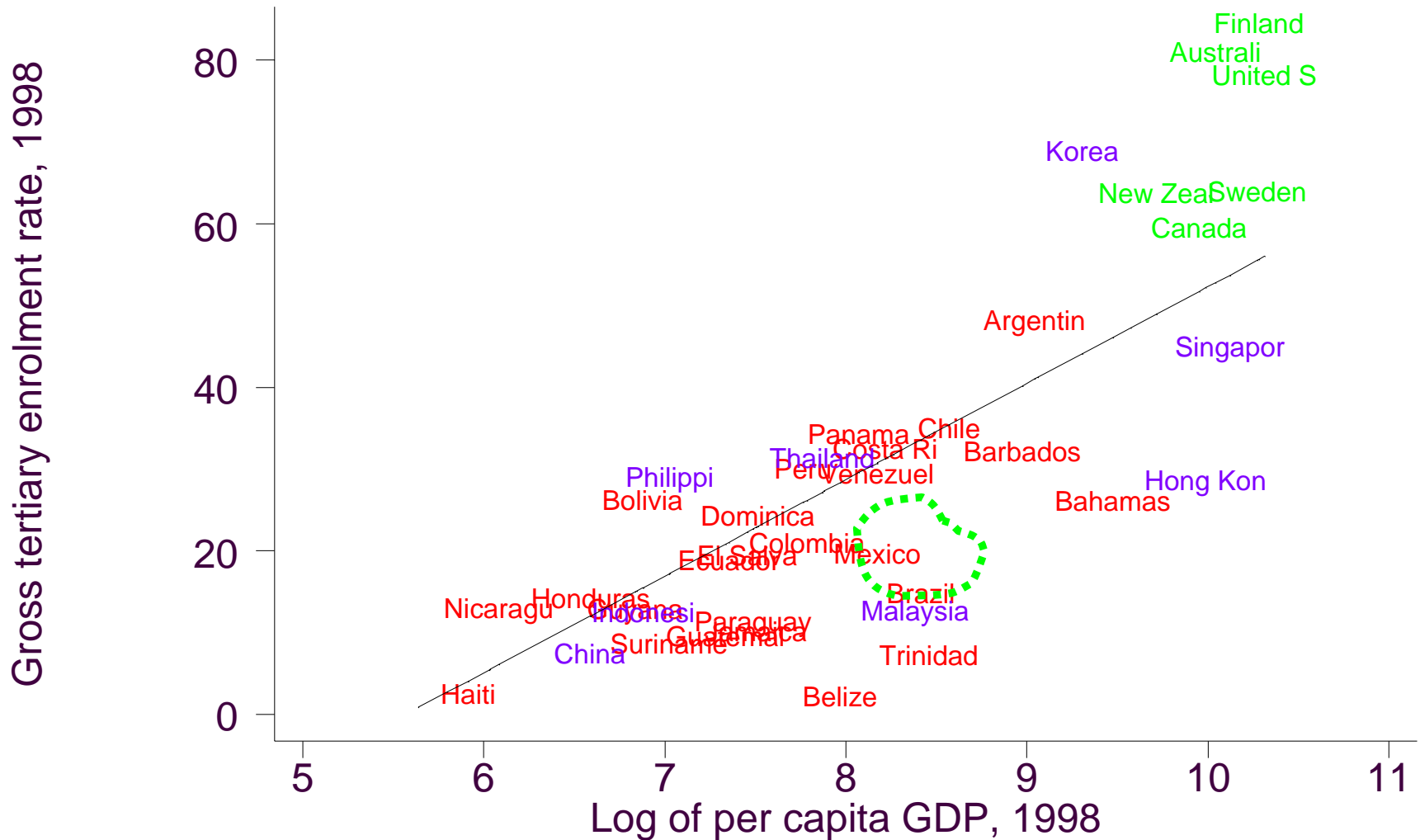


Source: De Ferranti, Perry, et al. 2003

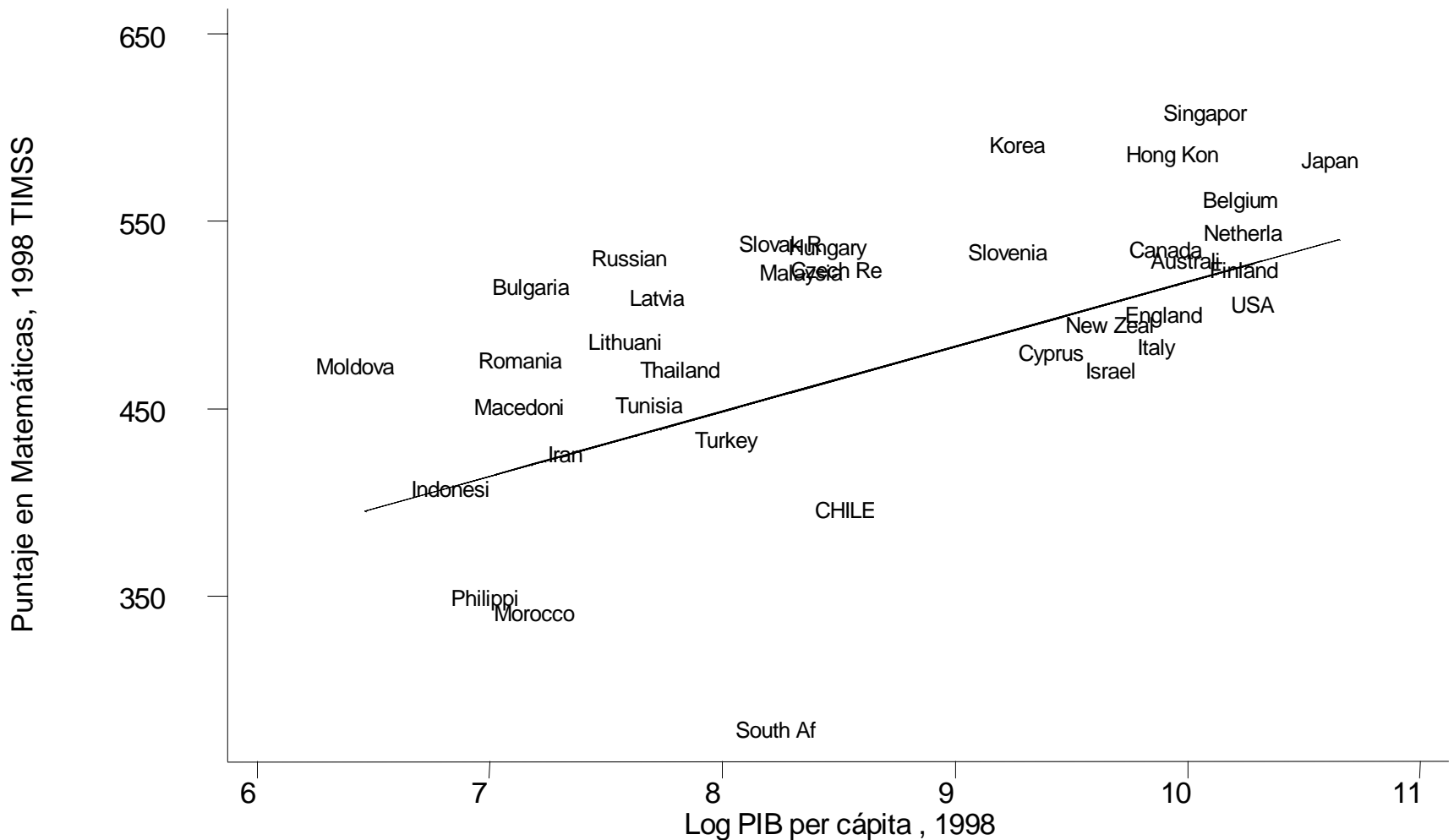
Gaps in Secondary enrollment



Gaps in Tertiary enrollment



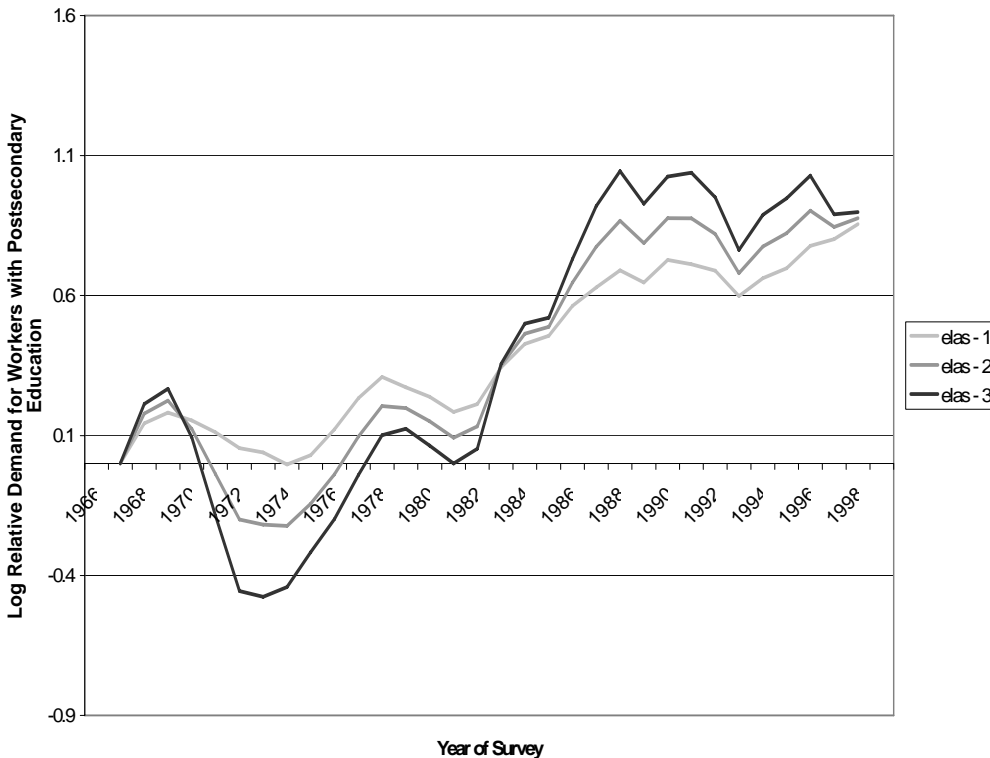
Gaps in the quality of education



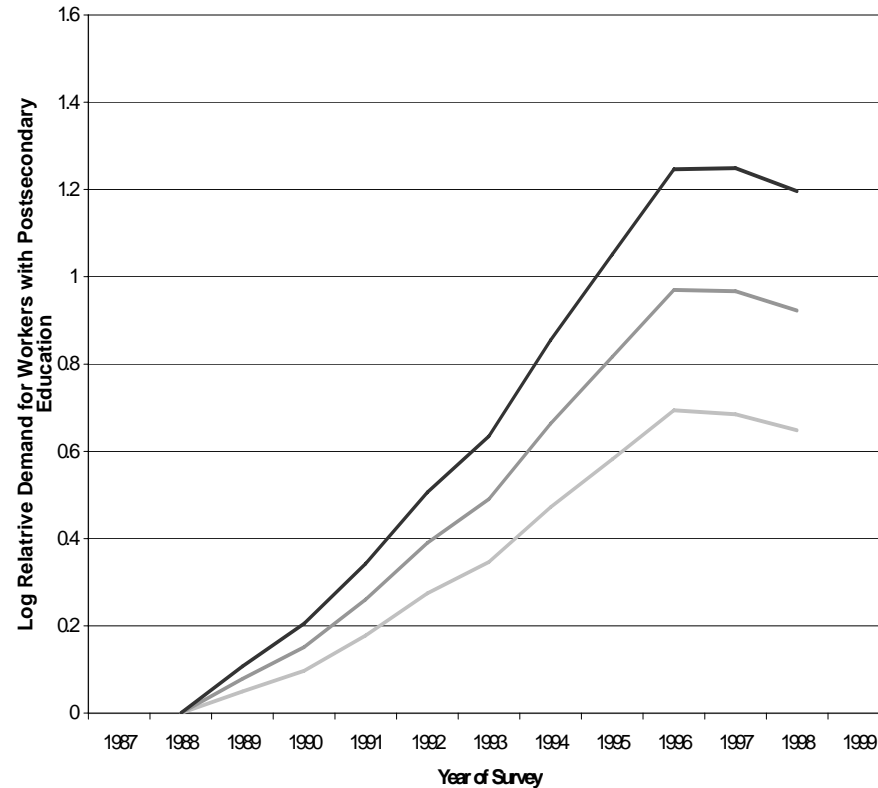
Evidence of increased demand for education since trade opening

Tertiary vs. Secondary

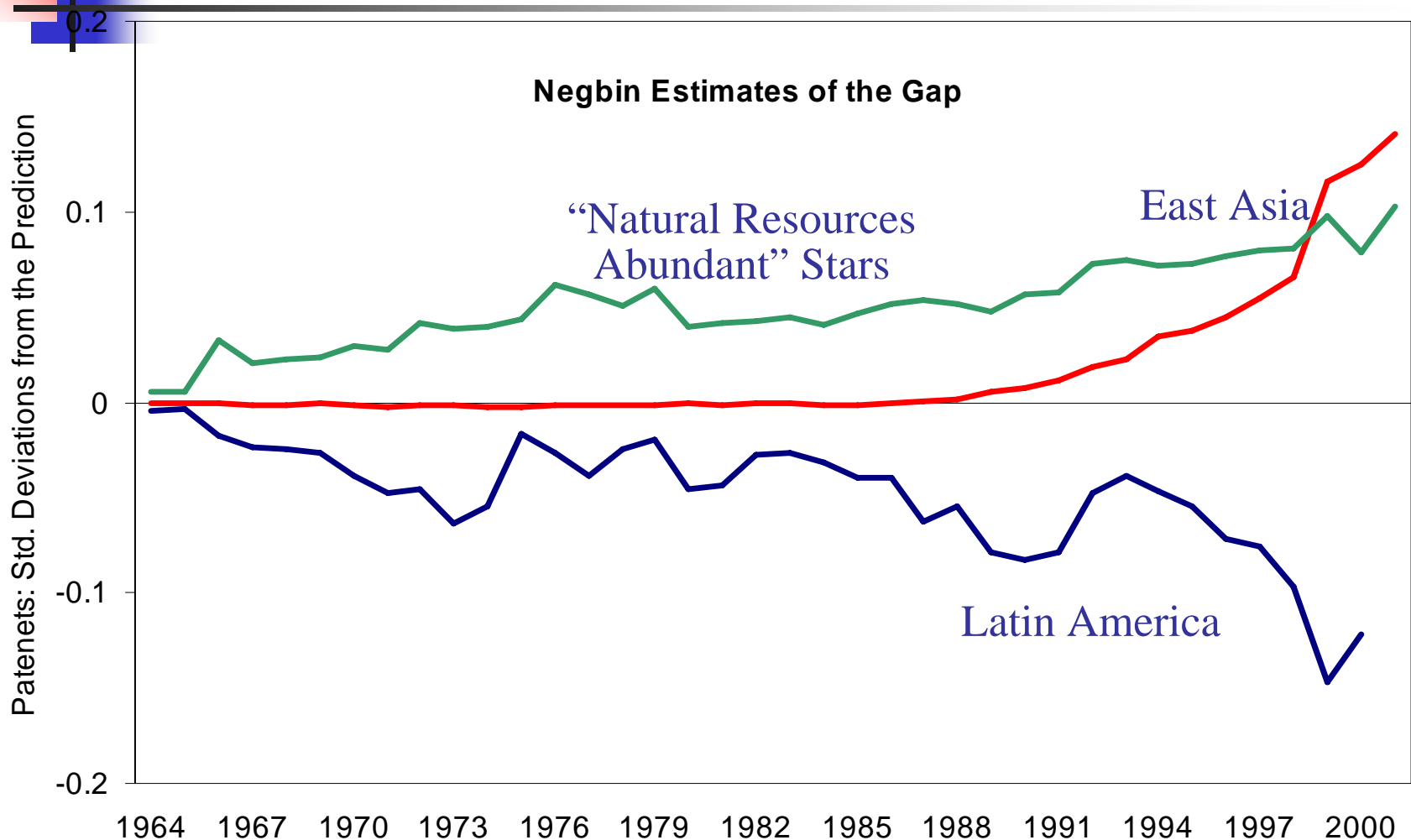
Chile: Estimated Relative Demand



Mexico: Estimated Relative Demand

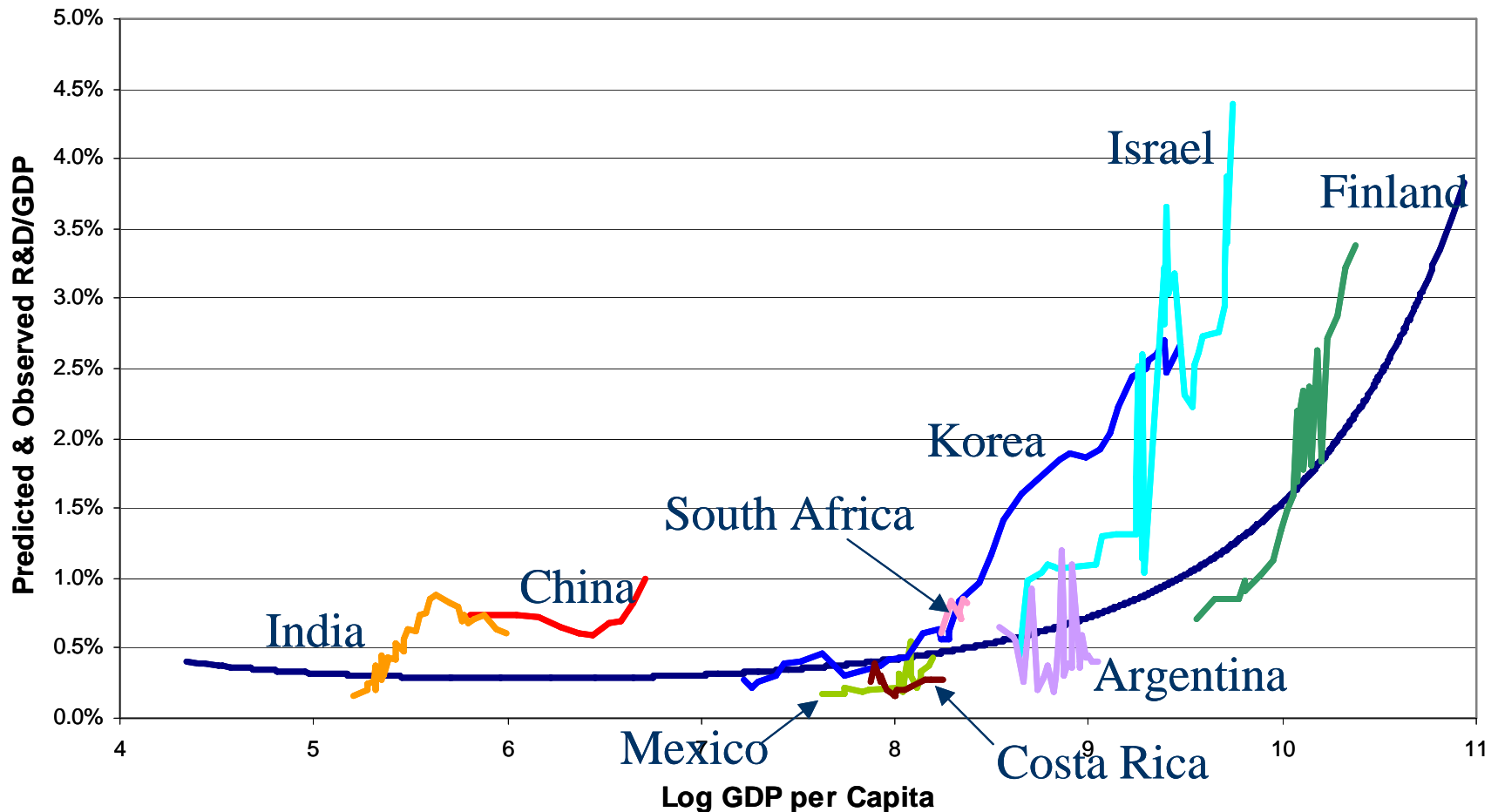


2.2 A measure of the innovation gap: Patents - deviations from prediction



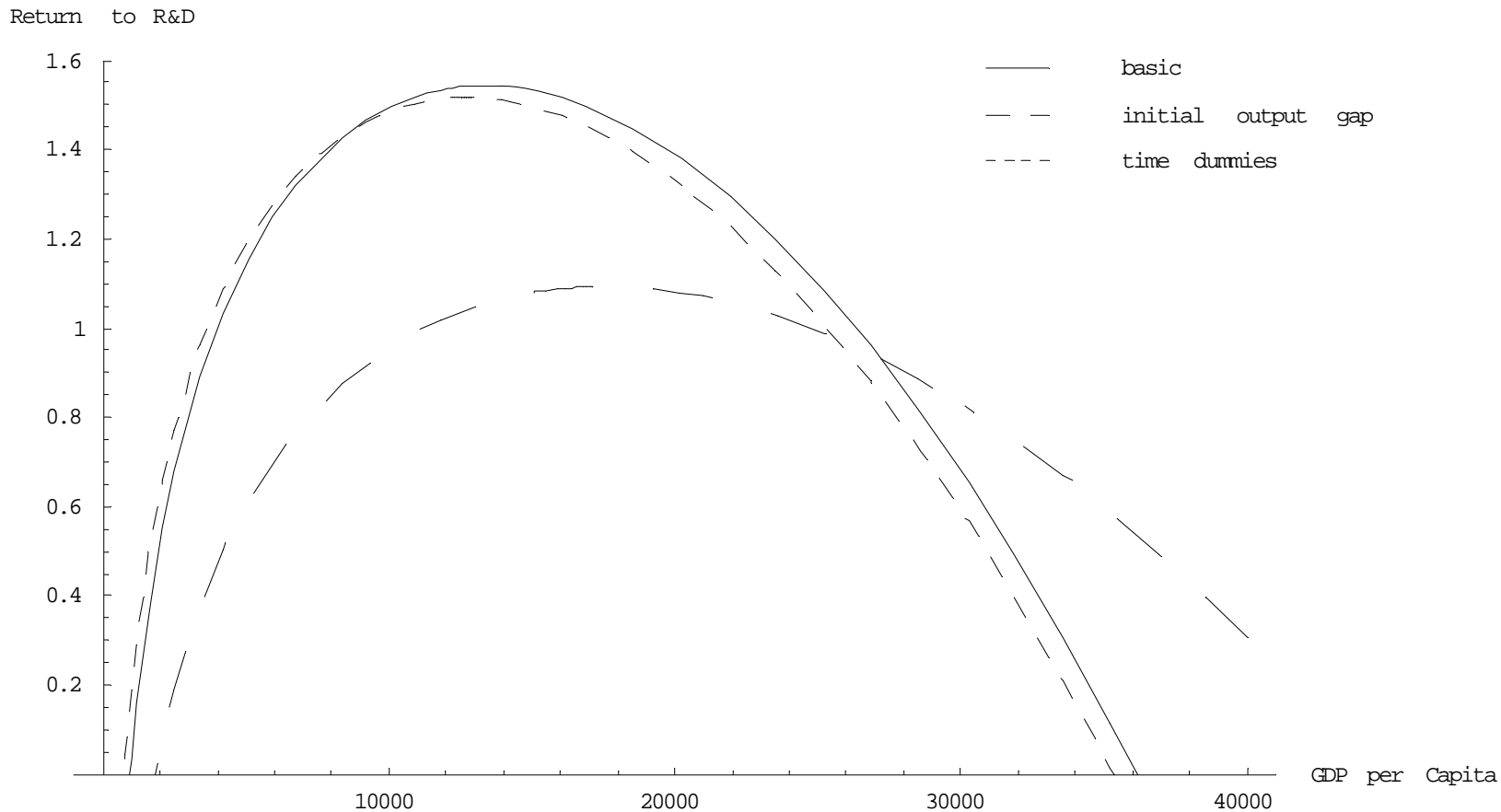
Innovation pays: a major driver behind high growth episodes.

Predicted vs. observed R&D/GDP



Innovation Pays:

Higher rates of return on R&D than on Physical Investment





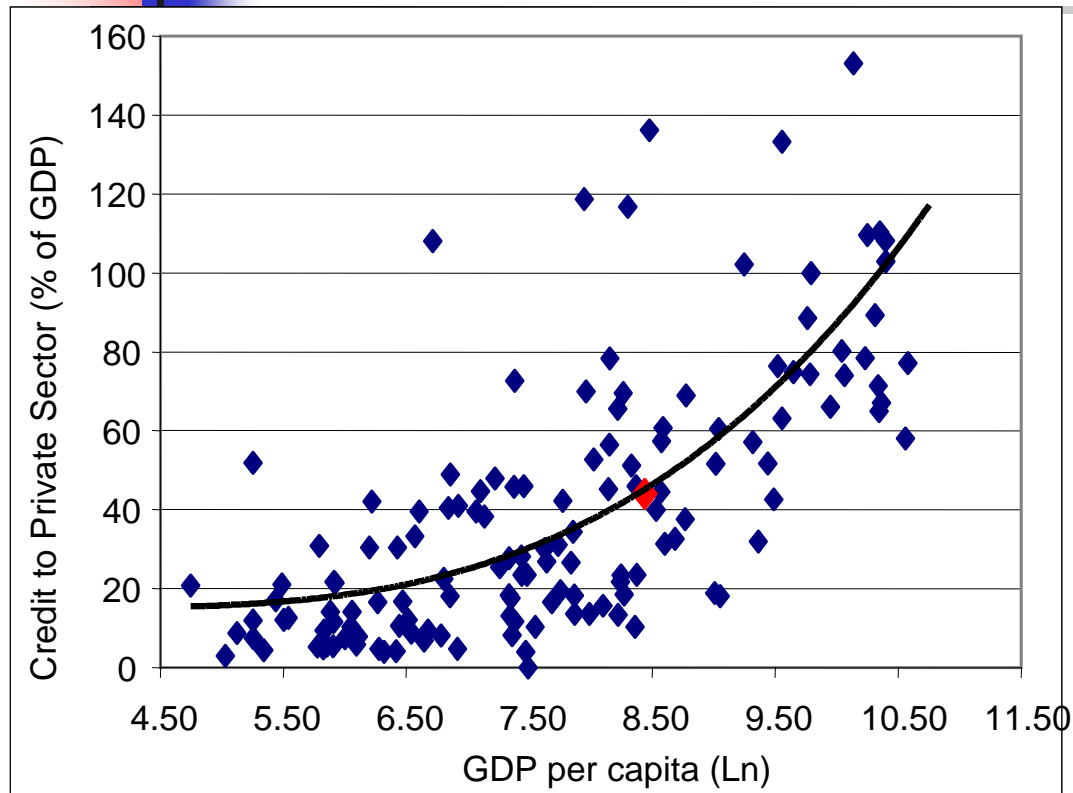
Innovation by firms depends on:

- Institutions (over-regulation, property rights and contract enforcement) and macro stability
- Competition (trade openness, internal markets): U-shape
- Skills (workers skills; engineers and scientists)
- “National Innovation System”:
 - Intellectual Property Rights protection
 - Universities&Public Research Institutes links with Firms
 - Innovation Subsidies&Tax Incentives/”Innovation clusters”/
”International Antennae”/”Incubators”
- Availability of Risk Capital and Labor Market Flexibility



3. Deficiencies in Factor Markets

3.1 Financial development matters for growth



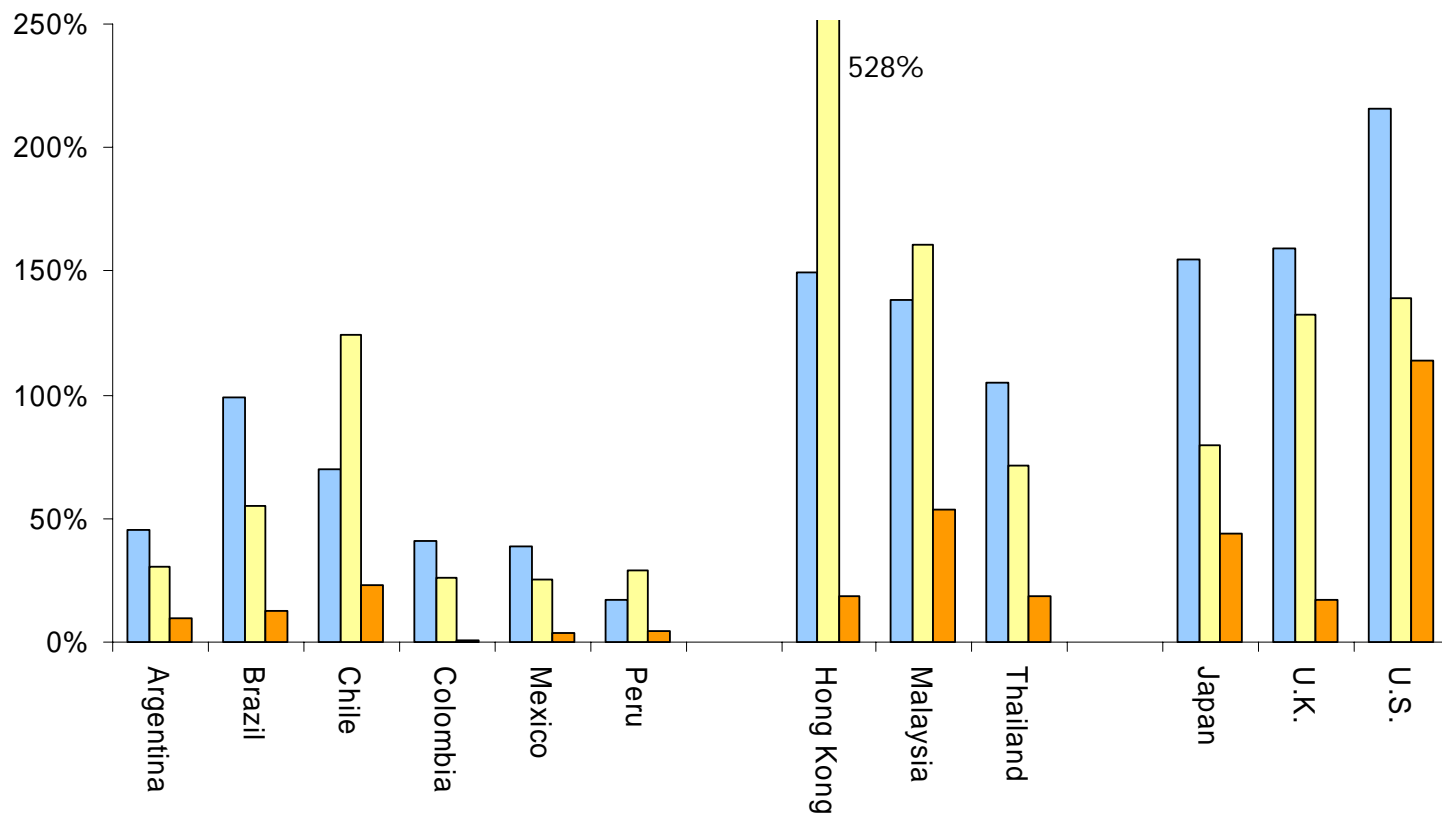
Empirical Evidence:

- Rajan & Zingales (1998) -
- Wurgler (2000) –
- Carlin & Mayer (1998) –
- Levine et al (various)

3.1 Underdevelopment of financial markets in LAC

Financial Sector Size Across Countries

Percentage of GDP, 2004




Bank Credit to the Private Sector

Stock Market Capitalization

Amount Outstanding of Domestic Private Sector Bonds

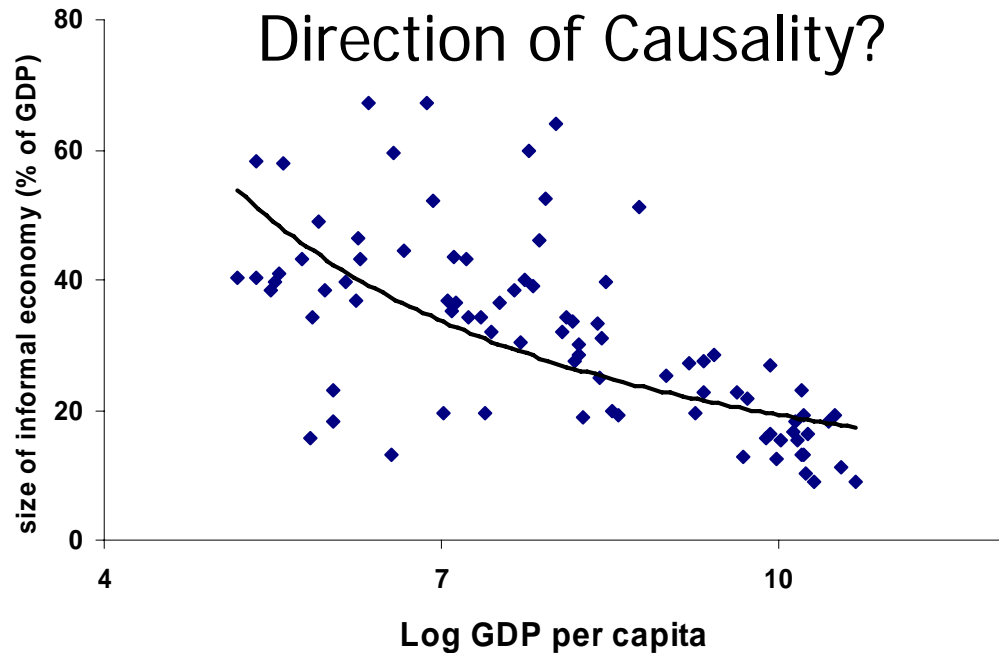
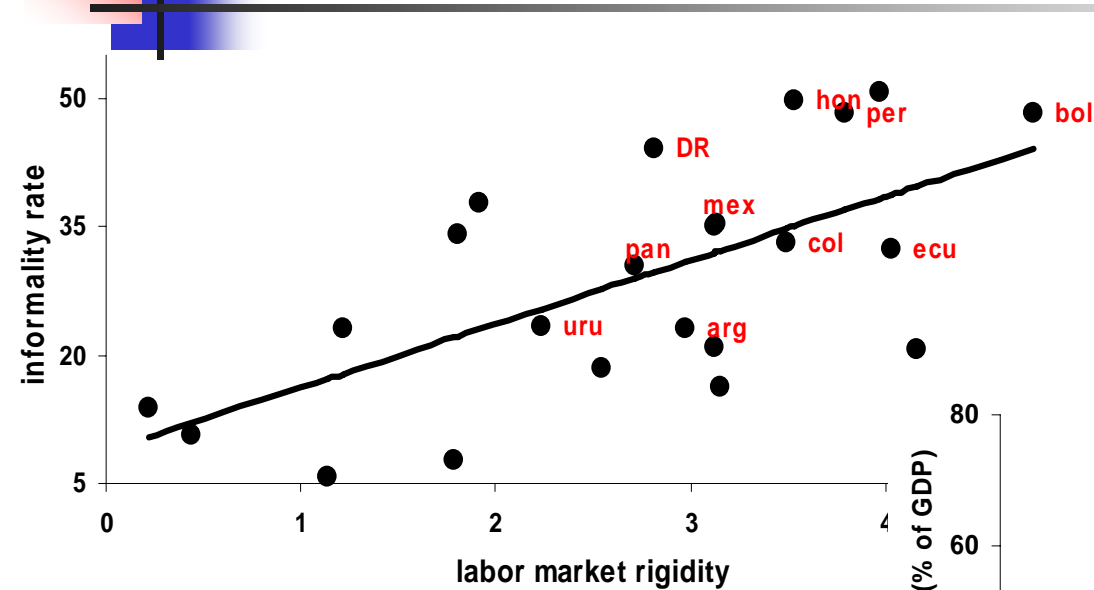
3.1 Determinants of bond market development

- 
- Better macroeconomic and institutional fundamentals foster *both* local and foreign currency bond markets
 - Less flexible exchange rate policies induce foreign currency bonds issuance against domestic currency bonds
 - Size matters – larger countries and local financial sectors facilitate the development of local currency bond markets
 - Investor base matters: pension funds, insurance companies
 - Market regulation and Infrastructure matters
 - Government bonds may crowd out or in corporate bonds
 - Inflation indexing helps

3.1 Determinants of stock market development

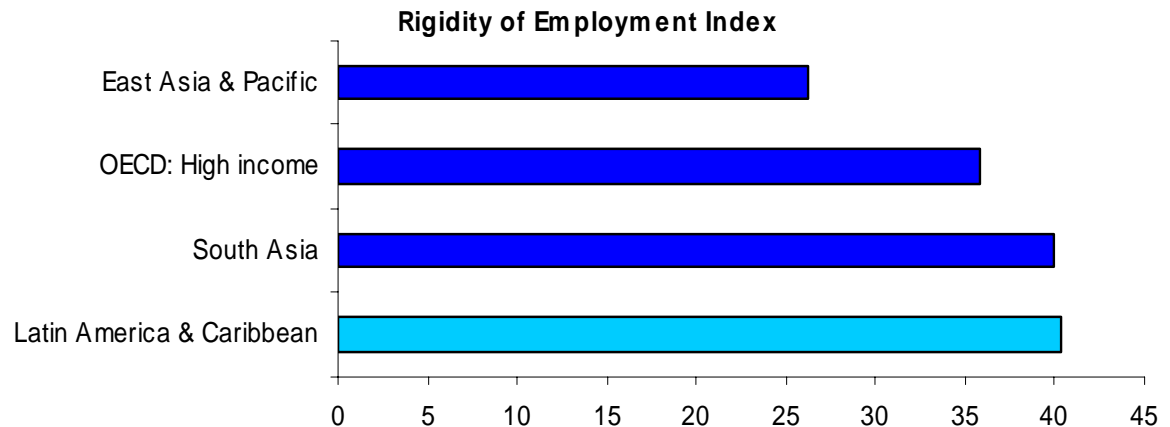
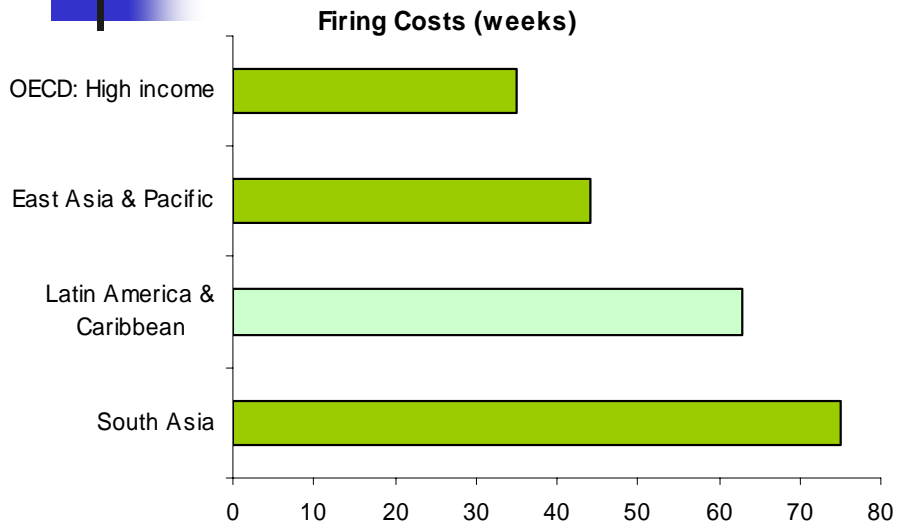
- ✦ Better macroeconomic & institutional *fundamentals* foster
 - Domestic stock market development, as well as the internationalization of equity trading and issuance
 - But there is a pro-internationalization bias –
- ✦ *Reforms* are found to have similar impacts (on domestic & internationalization dimensions) over time within countries
 - Results are not just driven by cross-country variations
- ✦ *Internationalization* adversely affects turnover of domestic (non-internationalized) firms
 - Trade migration, negative spillovers, and trade diversion
- Size matters

3.2 Labor market rigidities



Source: Heckman & Pagés, 2000; and ILO-LABORSTA database. (top)
Botero et al. (2002) (right)

3.2 Labor market rigidities are high in LAC



3.3 Insufficient infrastructure:

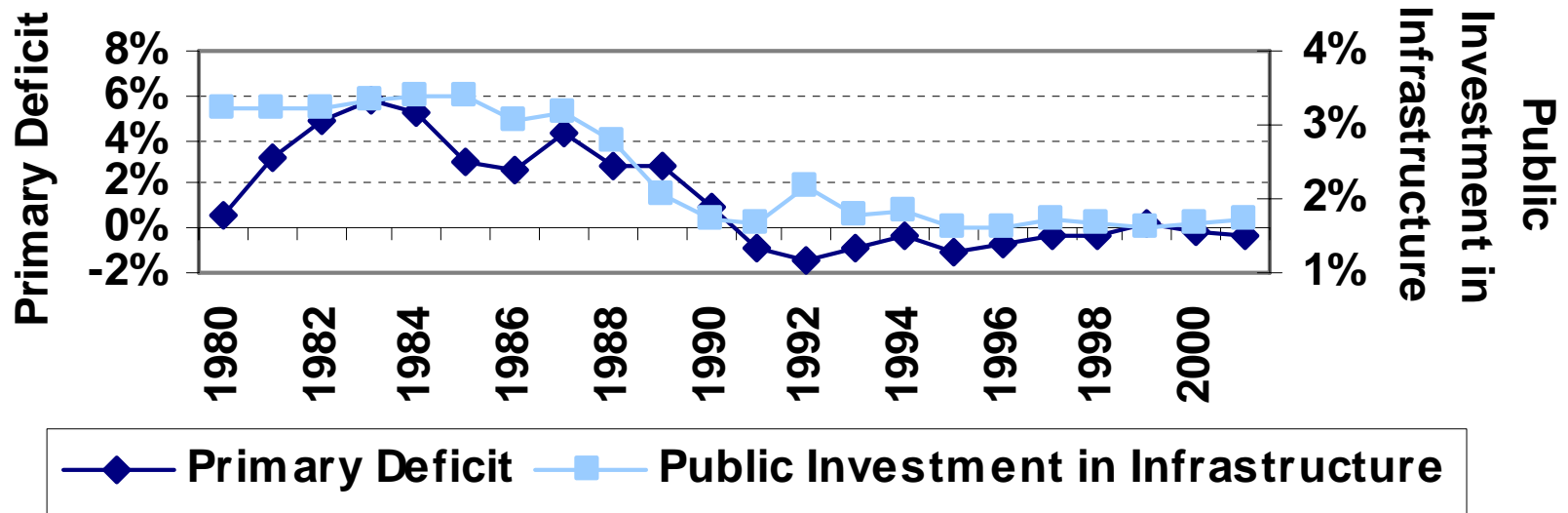
Gap explains 1/3 of growth differences with EA

The cost of the widening infrastructure gap: EAP vs LAC

	Avg. 1991-00 vs. Avg. 1981-90	Avg. 1996-00 vs. Avg. 1981-85
<i>1. Change in relative infrastructure endowments (%)</i>		
Main Phone Lines	27.6	41.1
Electricity Generating Capacity	37.9	58.0
Roads	30.3	50.3
<i>2. Change in Relative GDP per worker (%)</i>	31.6	41.9
<i>3. Contribution of the infrastructure gap</i>	9.3	14.5
<i>4. Relative contribution (as % of [2])</i>	29.2	34.7

3.3 Insufficient infrastructure: Adjustment biased against public investment

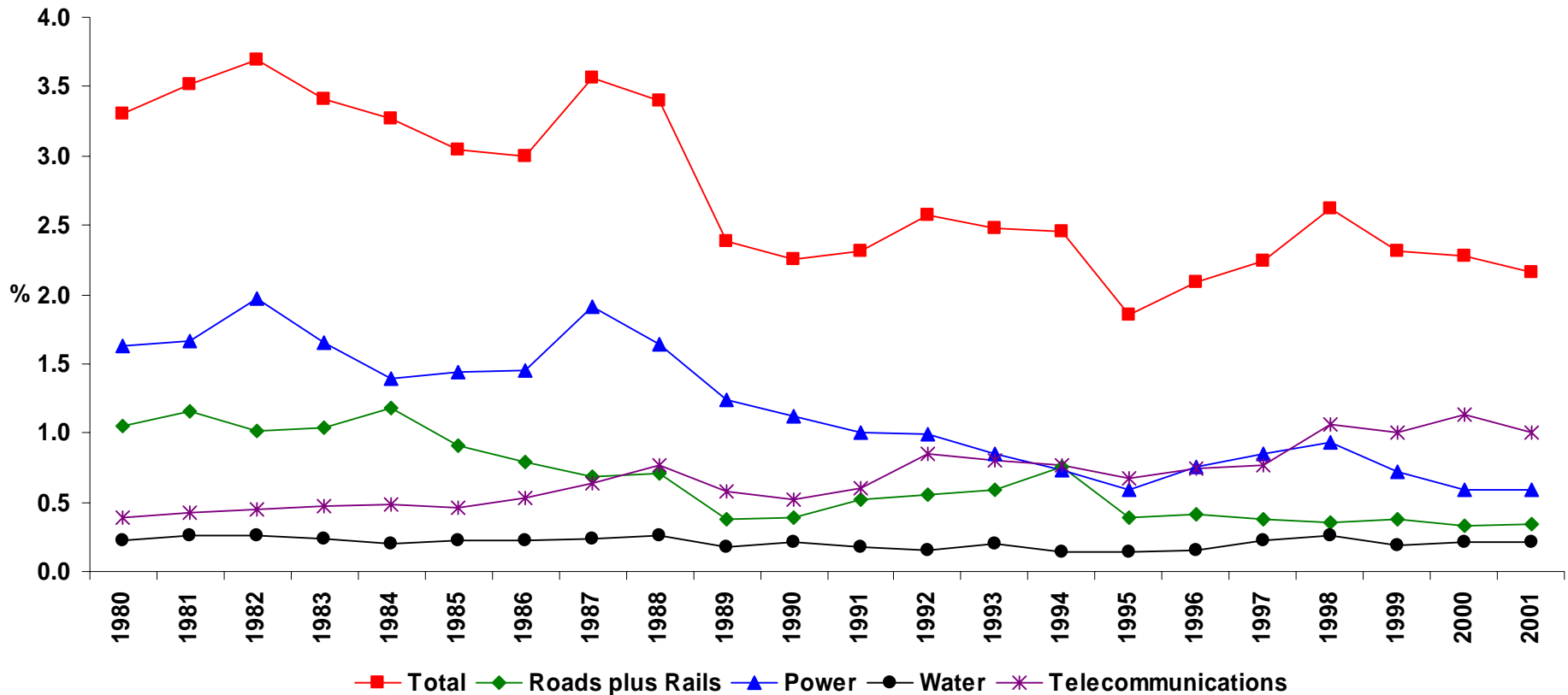
Latin America: primary deficit and public infrastructure investment (percent of GDP, average of 8 countries)



Source: Calderón and Servén (2004); and FITCH.

3.3 Insufficient infrastructure: “Fiscal Space” and regulatory issues

Latin America: Investment in Infrastructure (public + private)
(weighted average of 7 countries, percent of GDP)





Political economy of reform

- Is there reform fatigue or backlash? – backlash only in Venezuela and Argentina
- The “new left”: consolidation but slower progress?
- Chile, Brazil, Uruguay
- When social tensions get in the way: is inclusion a pre condition of sustained growth? - Bolivia, Ecuador, Guatemala..
- When governance problems get in the way: wait and see? - Haiti, Nicaragua
- Will deeper democracy help sustained growth? - let's hope!!

The end

