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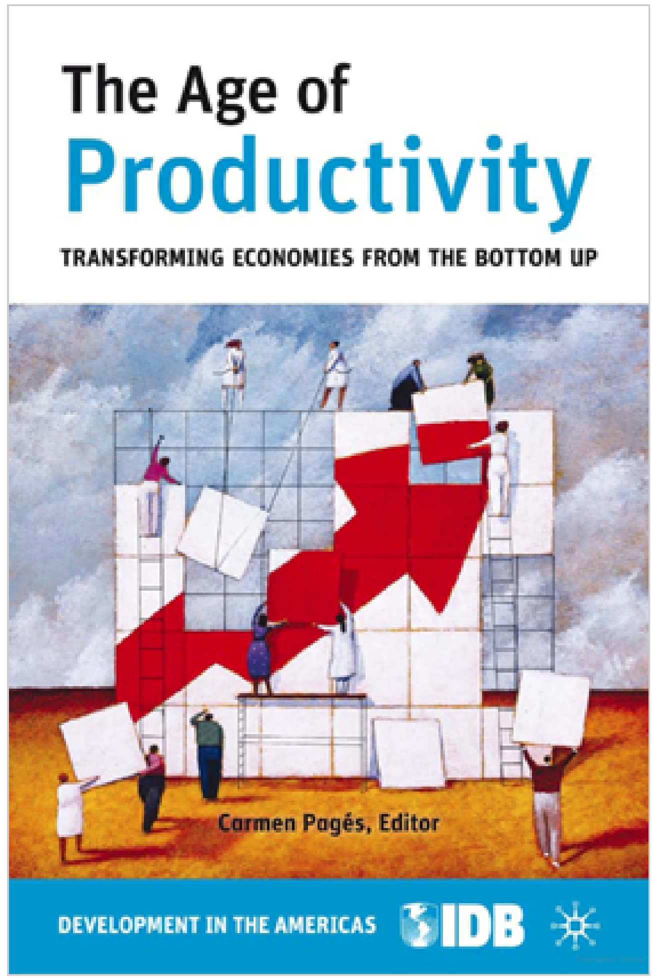
Economic development and growth in Latin American and Caribbean countries

The Age of Productivity: Transforming Economics from the Bottom Up. Edited by Carmen Pagés. Palgrave Macmillan, 2010, 348 pp., $35.00 paperback.



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.

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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.