# Solving the productivity problem

BETWEEN 2003 AND 2012, thanks to commodity prices Latin America grew 4.1%. Several countries made structural reforms, domestic consumption shot up, and gradually poverty was reduced. Today, with growth in the rest of the world minimal, Latin American countries must now reform their economies to raise productivity so that growth can resume. The IMF estimates in 2015 that the region can be expected to grow only 1.3%—far below the previous prosperity.

Although some countries in the region managed the recent boom in commodity prices well, Brazil and others have been culpably complacent about the need to boost productivity. Productivity growth will be crucial to ensure that growth is sustainable as the boom in commodity prices winds down and the demographic labor dividend fades.

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In March the Inter-American Development Bank highlighted the importance of improved productivity in *2014 Latin American and Caribbean Macroeconomic Report*. The report explains the role of productivity in widening the per capita income gap between Latin American countries and the United States. The shortfall in performance was not driven by a shortage of labor and physical capital: in fact, in relative terms the labor force and capital stock expanded faster in Latin America than in the United States. Rather, the problem was a marked relative decline in the region's total factor productivity (TFP)—a measure of how efficiently an economy uses its capital and labor.

For the last 50 years Latin America's economic performance has been characterized by a decline in TFP relative to both the most advanced economies and other emerging economies. Relative to the United States, the typical Latin American country had faster factor accumulation (physical and human capital gaps with advanced economies were reduced) but meanwhile relative TFP dropped from 78% to 53%—a loss of 25 percentage points.

A study by researcher Fernando de Holanda Barbosa Filho of the Brazilian Institute of Economics (IBRE) found that after averaging 1.7% for 2003–10, growth in Brazil's TFP fell to 0.4% for 2011–13. Growth of labor productivity alone was 1.8% in 2011–13, down from 2.2% in 2003–2010. IBRE researchers Regis Bonelli and Julia Fontes call the problem of productivity Brazil's "long-run challenge." They estimate that the Brazilian economy will once again be able to grow 4.4% a year only if productivity increases by 3.4% annually. Sustaining that kind of productivity growth will require tremendous efforts to create new products, invest in education, upgrade infrastructure, and dramatically streamline the business environment.

It is quite possible to have both compassionate social policies and sound economic policies. Social policies well targeted to improve the education and health of the poor in fact have high social and economic returns. As Otaviano Canuto points out in the interview the way to protect social spending is to closely monitor the quality of that spending and eliminate unjustified privileges.

What is clear is that future administrations must patiently pursue the needed reforms over the long run. Too often Latin American countries have succumbed to the populist temptation for ease and quick fixes that do the economy no good. That option must be rejected.