Comment

César Calderón: Diego Restuccia's paper addresses one of the key stylized facts of Latin America's development: over the last hundred years, relative income per capita in the region (with respect to the United States) has remained roughly flat. Some practitioners have dubbed this pattern the one hundred years of solitude, as the region has failed to converge to the living standards of higher-income countries.[1] In fact, the relative income per capita of the eight largest Latin American economies relative to the United States has fluctuated around 0.25 and 0.30 since 1900. This behavior is appalling when compared to the notable catch-up engineered by East Asia (which quadrupled over the last 60 years). The paper attributes the region's failure to catch up to institutions and policy distortions—and, more specifically, to policies and regulations that impede market contestability and an efficient reallocation of resources.

Growth Accounting: Measurement Issues

I agree with the author that Latin America's failure to catch up with the United States is likely to be attributed to systemic differences in total factor productivity (TFP). However, there are some measurement issues that the author should have discussed further. Although accounting for all these issues would not have changed his results qualitatively, they are worth mentioning as caveats as they may alter the productivity ranking among countries within the region.

Measuring TFP is not a trivial issue. The TFP component of growth is, by definition, a residual. It is typically computed as the difference between output growth and a weighted average of the growth in the quantity and quality of factors of production. As such, any measurement errors present in the variables used to measure labor and capital are mechanically imputed to TFP. For instance,

1. De la Torre (2011).

failure to account for improvements in the quality composition of capital stocks or the labor force will tend to overestimate the TFP component. Analogously, if the labor and capital actually used in production are considerably lower than their available stocks (or installed capacity), the resulting TFP estimates will be underestimated.[2] The following points should also be taken into account in the discussion.

—*The capital share.* In several papers that conduct growth accounting exercises, the share of capital (α) has been calculated using the labor income share in total income. This share tends to be overestimated, however, because it does not take into account the labor income of the self-employed and other proprietors.[3] This is key in Latin America given the importance of informality.

—*Human capital.* There is a wide discussion on the contribution of human capital (and, more specifically, education) to growth. Pritchett argues that the returns to education may be overstated as a result of low educational quality and perverse incentives created by the institutional and governance environment.[4]

—*Independence between factor accumulation and TFP growth.* This is a crucial underlying assumption in the growth accounting literature, yet it can be invalidated on theoretical grounds. For instance, Klenow and Rodríguez-Clare point out that TFP growth can revive investment projects that were previously not profitable.[5] In addition, technological innovations embodied in capital goods will render a significant relationship between TFP growth and the speed rate of capital accumulation.[6]

Explaining Latin America's Underdevelopment: What the Paper Omits

The paper fails to mention two major factors that may explain the lack of convergence of the Latin America region vis-à-vis advanced countries: namely, the instability of political institutions and macroeconomic instability. These

2. For instance, Loayza, Fajnzylber, and Calderón (2005) add controls for the rate of utilization or employment of capital and labor in the growth accounting analysis for Latin America. They adjust for the degree of utilization of the capital stock by using the rate of labor employment as a proxy. With regard to labor, they deduct from the working-age population the number of inactive and unemployed people and adjust for the number of hours actually worked.
3. Gollin (2002).
4. Pritchett (2001).
5. Klenow and Rodríguez-Clare (1997).
6. Hulten (1992).

two dimensions are important because they create the set of economic incentives that will determine agents' behavior and also condition agents' risk management practices and their ability to take risks in the economy.

With regard to political instability, economic institutions shape economic incentives and set constraints.[7] These institutions are, in turn, determined by the political process—and, hence, by political institutions. In the case of Latin America, the history of the region has been plagued by heightened political instability.[8] Some countries have had repressive, nondemocratic governments, while others have experienced episodes of civil conflict and war, terrorism and drug trafficking, and rampant crime and violence and inequality. All these events have generated a lot of political turmoil, which represents a major barrier to development in the region. As political turmoil increased, economic policy became more volatile and uncertain, leading economic agents to defer saving-investment decisions.

With regard to macroeconomic instability, economists and historians typically describe the dismal performance of Latin America in the 1980s as the Lost Decade. This decade was characterized by macroeconomic mismanagement that resulted in large macroeconomic imbalances, recurrent balance-of-payments crises, and high inflationary episodes. Inflation reached the three-digit level, and in some countries it even hit four digits (for instance, Argentina, Bolivia, Brazil, and Peru). Macroeconomic instability led to a massive outflow of capital. Government officials, in their attempt to control inflation and prevent a massive depreciation of the currency, conducted contractionary monetary and fiscal policies that ended up deepening the recessionary phase of the cycle.

This pervasive high inflation constituted a major barrier to development in the region. Several papers show that high inflation lowers growth, and the effect is transmitted through a reduction in business investment and a decrease in productivity.[9] High inflation shortens the planning horizon of households and entrepreneurs. As inflation erodes the storage value of the domestic currency, it holds back the development of domestic financial intermediaries—for instance, savings dwindle, long-term contract markets disappear, and the economy engages in a process of dollarization.

7. See Acemoglu and Robinson (2012).

8. Easterly (2005) points out that the twelve major Latin American countries had 174 revolutions over 1950–2001.

9. Khan and Senhadji (2001); Andrés and Hernando (1999).

Conclusion

Living standards in Latin America have improved in recent years. Historically, however, we have been unable to catch up with advanced economies. To make matters worse, other dynamic emerging markets have taken off and managed to distance themselves from the region in terms of income per capita. An interpretation of the underdevelopment problem in the region should, to a large extent, rest on the inadequacies of the political process that shaped incentives toward cronyism. The inherent instability of this process led to uncertain and unsustainable policies that ended up generating high inflation, greater economic instability, and, hence, lower long-term growth.

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