Development Challenges in Chile

Country Department Southern Cone

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POLICY BRIEF Nº 283

June 2018

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Inter-American Development Bank

Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library
Miller, Sebastián.
Development challenges in Chile / Sebastián Miller.
p. cm. — (IDB Policy Brief ; 283)
Includes bibliographic references.
1. Economic development-Chile. 2. Fiscal policy-Chile. 3. Investments-Chile. 4. Chile-Economic conditions. 5. Chile-Social conditions. I. Inter-American Development Bank. Country Office in Chile. II. Title. III. Series.
IDB-PB-283

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Medium-Term Economic and Social Trends

Over the last 30 years, Chile has made great strides toward social, economic and institutional development. Between 1990 and 2015, the country's per capita income increased from US$10.5 thousand to US$25.3 thousand, the highest in Latin America, and Chile currently has the highest human development index in the region. Following several internationally acknowledged waves of reform and state modernization efforts, Chile was the first country in South America to achieve full OECD membership in 2010. Strong institutions and a robust policy framework focused on price stability, fiscal discipline, exchange rate flexibility, financial soundness, and trade openness have been at the core of the country's performance.

Sustained economic growth delivered social progress, improving the standards of living of the less well-off. Poverty reduced markedly from 20% to 4% between 1985 and 2015, while access to basic services improved. This contributed to halving infant mortality and to increasing life expectancy by 11 years during the same period. Tertiary education enrollment has increased significantly, although quality issues remain. Real median incomes grew an average of 3% per year amidst increased female labor force participation.

Nevertheless, growth has been slowing down for the past 15 years. Weak productivity growth affecting both mining and non-mining sectors has been largely responsible for this trend, more recently aggravated by less favorable external conditions. Total factor productivity on average accounted for 2 percentage points of annual growth in the 1990s, but it has fallen to 0 since 2010.

Risk Factors

External factors constitute an important source of risk—particularly copper price dynamics, which have direct macroeconomic implications. There are also internal risk factors stemming from reform uncertainty and country-specific challenges to promoting dynamism in productivity. Another key risk factor is the increase in the frequency and intensity of natural disasters affecting the country.

Development Challenges

Innovation is critical for Chile's long-run development. From a growth potential perspective, several studies point to lackluster innovation as a key challenge. Econometric analysis of development gaps identifies clear room for improvement in technological innovation when compared to the OECD benchmark (Borensztein et al., 2014). This result holds across different innovation dimensions, particularly in R&D and high-tech activities. Gaps are also observed in sectors such as financial markets. Other methodologies, such as the Priorities for Productivity and Income, also indicate a large gap in innovation, both with respect to Chile's own comparative income group and with respect to the next cluster of economic development

(Izquierdo et al., 2016). Lackluster innovation goes hand-in-hand with other structural features of the Chilean economy such as limited export diversification.

Demographic trends and human capital development are also critical. Demographic trends have limited the contribution of labor. While during the 1990s a large young population entered the workforce, replacing older workers and powering growth, more recently an aging population, combined with low fertility rates and limited female labor force participation, has worked in the opposite direction. Moreover, there is scope for improving the quality of human capital. Educational outcomes still fall short of the OECD norm, and workers can be better equipped with information and communication technologies as well as managerial skills.

Growth constraints are also related to bottlenecks in the accumulation of physical capital that reduce the marginal product of investment. While terms of trade shocks have held down investment more recently, the outlook for capital accumulation depends on additional structural factors such as stronger private sector confidence and renewed trust in the ability of the government and its institutions to deliver fair and effective public policies. Against this backdrop, dealing effectively with social and environmental issues is also key for guaranteeing investment in large projects.

Improving long-term productivity growth is also associated with social progress. For instance, improving gender parity policies is a cost-effective way to expedite the contribution of talented and creative young women to productivity and output growth. In the same vein, relieving income inequality will expand opportunities for important segments of the population, delivering a more efficient use of labor resources. Finally, promoting more efficient access to public and private services (roads, education, health, water quality, among others) for rural minorities, including indigenous peoples, can be a key factor for local development.

More effective public policies are needed to address social demands and support growth. Citizens have voiced their desire for greater transparency and accountability, both from the public and the private sector. Social demands include enhancing mobility in cities (traffic), pollution control, and readiness for coping with natural disasters, all of which offer opportunities to harness innovation and technology in favor of productivity growth.

Conclusion

With more than three decades of experience in structural reform and modernization of the state, Chile is in a strong position to confront its pending development challenges. Institutions are solid, the macroeconomy is well managed, and political processes are stable.

References

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