Preface

In discussions about saving in Latin America and the Caribbean, a common critique is that the region saves little. Indeed, the data support this statement: the region saves from 10 to 15 percentage points of GDP less than the most dynamic countries of Emerging Asia. At the Inter-American Development Bank (IDB), we know that understanding why this occurs and, above all, how and in what way Latin America saves is crucial for the region's economic growth and the well-being of its people. That is why we have decided to devote the 2016 edition of our institutional publication *Development in the Americas* (DIA) to studying this topic and to proposing solutions to address this critical problem.

We believe this publication comes at an opportune moment. The engines of economic growth in Latin America and the Caribbean following the most recent financial crisis have been gradually weakening. The region can no longer count on a favorable external environment, and so it is time to look for new domestic sources that can drive our economies forward.

The standard response to the relative lack of saving in the region is that its impact on growth is low since countries ultimately can turn to external saving to finance the region's investment needs. We believe that this view ignores a crucial consideration: it is very difficult to attract external capital on favorable conditions if Latin Americans themselves do not save or invest in their countries. Besides, in the current environment, when interest rates in developed nations are rising and capital is no longer abundant, the prescription to turn to external financing as a palliative for our low saving is probably more uncertain and risky than in the immediate past.

Saving in Latin America and the Caribbean is low not only in comparison with other regions; it is also fundamentally low in relation to the region's need for development and its need to improve equity. The low level of saving also reinforces the very low level of productivity growth, since whatever scarce resources are generated from saving are for the most part not invested in projects that would increase levels of long-term growth. Consequently, this nonproductive allocation of saving keeps the region from reaching the levels of income and well-being of more prosperous countries.

For all of these reasons, one of the greatest challenges for Latin America and the Caribbean is to increase saving levels in a way that is sustainable and improve the allocation of that saving to more productive activities so as to boost overall productivity. All of these challenges are closely linked. It will not be possible to invest more if we do not generate the resources to finance that investment; but neither will it be possible to sustain higher levels of saving if we do not generate productive opportunities for investment.

One of the main contributions of this publication is to focus the discussion within a framework that identifies the source of the problems affecting different agents—households, businesses, and governments—and proposing concrete solutions for each one of them.

Saving more and saving better are not necessarily associated either with the traditional recommendation to undertake a fiscal adjustment or with the traditional recourse of providing tax incentives to promote certain types of saving. Nor is such saving associated with paternalistic public policies. What "saving more and better" really means is rethinking public policies, especially in the area of social security; increasing the efficiency of public expenditures and giving investment more weight over current spending within the structure of public expenditure. It also means eliminating distortions that impact the effective functioning of the financial system, the labor market, and fiscal and regulatory systems.

One cannot talk about saving in Latin America and the Caribbean without making reference to pensions. Contributions to pensions are the main mechanism by which people save for retirement. The region has long debated whether pension systems should be pay-as-you-go (PAYG) or fully-funded, defined-contribution schemes. However, this is not necessarily the most relevant debate. Many contribution systems in the region, whether based on PAYG or funded contribution schemes, have structural problems that require immediate correction. It is an illusion to believe that saving can only be generated through funded contribution systems. Transitions to such systems can also generate large fiscal costs that reduce national saving, so these systems need to be carefully designed. At the other extreme, PAYG systems can and should increase savings while they have surplus contributions to ensure long-term sustainability and guarantee that they generate adequate returns. This, in turn, requires that the management of these systems be strictly professional and without political interference.

At present, the debate needs to revolve not around whether pension systems should be PAYG or funded contribution schemes, but around the fact that less than half of the Latin American population contributes to any type of pension system. This reflects serious problems in the functioning of the region's labor markets, beginning with high levels of informality. It is urgent to refocus the debate on reforms that can help all pension systems improve coverage, as well as increase saving. The population is aging rapidly, and if action is not taken now, resources will not be available to address the growing needs of this population segment.

Another major topic addressed in this publication is that in Latin America and the Caribbean there is not only little saving, but that this low amount of saving is not effectively channeled toward the economy. This stems in part from a lack of instruments that are adequate for long-term saving, given the underdevelopment of our financial markets. An example of this problem is the lack of investment instruments to channel public and private saving to infrastructure. In Latin America and the Caribbean, there is a significant investment gap in infrastructure: transport, telephone networks, energy generation and distribution, and potable water, among other sectors. This gap constrains long-term growth because if the investment is well planned and executed, the returns to investment in infrastructure are very high and encourage private investment in the economy. However, it is difficult today to channel national saving toward infrastructure because there are no instruments with which to do so. To foster this process, it is necessary to adapt the regulatory framework for infrastructure investment so as to generate the mechanisms and vehicles to remove the bottlenecks that currently exist in the region.

Despite advances in recent decades, financial systems in Latin America and the Caribbean are still small, expensive, and inefficient. Not surprisingly, many families do not use those financial systems as a preferred vehicle for saving, and businesses face significant problems obtaining financing at reasonable rates and terms. Low saving is the flip side of scarce credit, and the poor allocation of that credit is, for its part, a product of inefficiencies in the operation of financial systems. In order to expand the use of financial systems, and above all to promote saving through formal financial systems, a culture of saving must be developed. This effort should be supported by interventions that, on the one hand, help reduce the costs of operating with the financial system and increase returns for savers, and on the other hand, mitigate the problems that drive families and businesses away from banks. One of these problems is the lack of trust. No one can blame those who have been harmed in the past by recurring financial crises that have wiped out their savings. However, financial systems in general today are much more solid, in part because they have learned the lessons from past crises. The lack of trust today is more related to the lack of understanding about how banks operate and about the advantages and opportunities, as well as the risks, of using formal financial systems. Financial education, particularly at an early age when cognitive capacity is still being developed, represents a good opportunity to foster a culture of saving.

On the fiscal front, the good news is that the region has enormous opportunities to improve the delivery of public services with fewer resources. This could generate significant savings without the need to turn to traditional fiscal adjustment recipes that translate into higher taxes and reduced expenditures. What is needed now is to redirect public expenditure, placing more emphasis on investment than in the past. In turn, there is a margin to increase public saving by eliminating waste in expenditures related to subsidies, tax expenditures, and social assistance programs. Those efforts can complement one another, increasing the efficiency of expenditure in such sectors as health and education. This publication presents new data that allow policymakers to identify sources of waste and opportunities to increase the efficiency of expenditures.

This publication does not aim to be a recipe of good practices or to indicate a single path that all countries should follow. Every country is different, and in each case the emphasis should be placed on those aspects that are most relevant. The objective of this publication is to generate awareness among public officials, business persons, and workers that promoting saving—and particularly the efficient use of resources that are generated through saving—is an essential part of the solution to the problems of low growth, little investment, and the growing needs of a rapidly aging population. More and better saving is the path that leads toward a region with greater stability and confidence, and where lack of capital is no longer a constraint for economic and social development.

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Acknowledgments

Development in the Americas (DIA) is the flagship publication of the Inter-American Development Bank (IDB). This issue was produced under the direction of Eduardo Cavallo, lead research economist of the Research Department, and Tomás Serebrisky, sector economic advisor for the Infrastructure and Environment Sector.

This book would not have been possible without the exceptional editorial work of Rita Funaro, the publications coordinator of the Research Department. Rita worked tirelessly and patiently to translate complicated technical concepts into a language accessible to a broader audience. She made this book possible, and much, much better. Rita was assisted by Cathleen Conkling-Shaker, Nancy Morrison, Matías Marzani, and Jaime Ramírez Cuellar. John Dunn Smith edited many background papers and technical notes associated with this book.

Orazio Attanasio, Peter Montiel, and Klaus Schmidt-Hebbel were external advisors. Their advice throughout all the phases of this book has been invaluable.

Santiago Levy, vice president for Sectors and Knowledge, José Juan Ruiz, the chief economist and general manager of the Research Department, and Andrew Powell, principal advisor of the Research Department, provided constant guidance and technical advice throughout the life of this project. Valuable comments and suggestions were also provided by the IDB's Programming Committee of Management.

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Carola Pessino was the author of the box on taxation and saving (Box 8.1). A special word of gratitude goes to her for stepping in to provide her expertise and knowledge on this difficult and important topic.

Special thanks go to Aglae Parra, the administrative coordinator of this project. She devoted immense effort and provided efficient administrative support. Other members of the administrative team provided invaluable support throughout the life of this project, in particular, Mónica Bazán, Beatriz Contreras, Myriam Escobar-Genes, David Gómez, Elton Mancilla, Sofía Meléndez, Mariela Semidey, and Federico Volpino.

Javier Caicedo, Camila Fonseca Sarmiento, Melany Gualavisi, Jonathan Karver, Pamela Mendoza, Liu Mendoza Pérez, Mathieu Pedemonte, Dario Romero Fonseca, Mariano Sosa, Maria Laura Oliveri and Juan Miguel Villa all provided excellent research assistance. Matías Marzani and Jaime Ramirez Cuellar deserve special recognition for their dedication to this project.

Pablo Bachelet, Carlos Gerardo Molina and Kyle Strand helped immensely with the communication and dissemination strategy.

Many other people contributed their technical input to this report, including Joshua Aizenman, Jorge Alonso, S. Gabriela Andrade, Raúl Andrade, Gabriela Aparicio, Martín Ardánaz, Edna Armendáriz, Daniel Artana, Viviane Azevedo, Nick Barr, Alberto Barreix, Ricardo Bebczuk, Óscar Becerra, Juan Luis Bour, Rodrigo Cerda, Juan José Cruces, Fernando de Olloqui, Edgardo Demaestri, Víctor Dumas, Barry Eichengreen, Emilio Espino, Antonio Estache, Vicente Fretes, Rodrigo Fuentes, Lourdes Gallardo, Néstor Gandelman, Gustavo García, Martín González-Rozada, Catalina Granda Carvajal, Werner Hernani, Diego Herrera Falla, Ayse İmrohoroğlu, Luis Carlos Jemio, Enrique Kawamura, Juan Ketterer, Mariano Lafuente, Carlos Madeira, Ángel Melguizo, Alejandro Micco, Alejandro Morduchovicz, Oscar Natale, Fernando Navajas, Sergio Navajas, Andrés Neumeyer, Ilan Noy, Carmen Pagés, Mónica Panadeiros, Ugo Panizza, Diana Pinto, Lucas Ronconi, Gabriel Sánchez, Alfredo Schclarek Curuchet, Miguel Socías, Marco Stampini, Nuria Susmel, Miguel Székely, José Tessada, Jorge Tovar, Verónica Trujillo, Patricio Valenzuela, Fermín Vivanco, and Rodrigo Wagner.

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the Inter-American Development Bank, its board of directors, or the technical advisors.

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