

## **Overview: Development in transition in Latin America and the Caribbean: A new approach for inclusive and sustainable development in the region**

The *Latin American Economic Outlook 2019* (LEO 2019) presents a new approach to support Latin America and the Caribbean's (LAC) transition to inclusive and sustainable development called "Development in Transition" (DiT). This represents an opportunity to advance towards the goals of the 2030 Agenda for Sustainable Development (Agenda 2030) by rethinking the concept of development, the strategies countries should pursue and the role of international co-operation in facilitating these efforts. In the face of significantly evolving domestic and global contexts, DiT calls for improving domestic capacities and adopting more innovative modalities of international co-operation for development. In so doing, it could support both national development objectives and international efforts to advance regional and global public goods.

This new approach is needed for various reasons. First, progress towards higher income levels in LAC is creating new and increasingly complex development challenges – the "new" development traps – which should be transformed into greater development opportunities. Second, LAC is reaching per capita levels of gross domestic product (GDP) where income loses relevance as a component of well-being. This demands a multi-dimensional approach to development. Third, the global context is increasingly complex. Various megatrends and the emergence of new actors in the global arena have rendered traditional policies outdated. They demand innovative policy strategies to enhance inclusive and sustainable development.

To respond to these evolving domestic and global contexts, the DiT approach stresses the need to achieve the following:

**Improve domestic capacities:** This will be crucial to address development traps and foster a multi-dimensional approach to sustainable development in LAC. LEO 2019 focuses on two key cross-cutting capacities that are fundamental to exploit untapped opportunities for development:

- *Improved policy making for development* includes issues related to continue building technical capacity to design, implement and monitor strategic National Development Plans (NDPs). It also includes building capacity to spend better, and to create the political consensus and citizens' support to overcome the complexities of the political economy of reforms in LAC.
- *Improved financing for development* focuses on mobilising sustainable domestic financing for development, both public and private, to invest in structural policies and support the sustainable development agenda.

**Strengthen international co-operation as a facilitator for LAC:** International co-operation needs to be more innovative to adapt to a complex and multipolar global context. It needs to serve as a facilitator of countries' efforts to respond to the needs of economies and societies in transition in several ways:

- Allow for countries at all income levels to build and participate in policy partnerships, as equal partners, and address common concerns.
- Place LAC national strategies front and centre, and strengthen countries' domestic capacities. It could help LAC countries set policy priorities, implement and evaluate development plans, and increase alignment between domestic and international priorities. It could also help them play an active role in the global agenda.
- Include an expanded toolbox of international co-operation modalities and instruments that brings in the expertise from a wide range of actors, and sectors, promoting a "whole of government" approach. This toolbox comprises instruments

for greater technical co-operation, such as knowledge sharing, multilateral policy dialogues, capacity building, access to technology and co-operation on science, technology and innovation.

These recommendations present ways forward for LAC countries to overcome their development traps and transform them into broad opportunities. In this sense, they can support LAC countries to achieve a scenario of greater openness to the world economy, commitment to the global sustainable agenda (e.g. the Agenda 2030 and the Sustainable Development Goals [SDGs]), agreement on the reduction of climate change, reduction of poverty and a consolidation of the middle class.

Four development traps stand in the way of further inclusive and sustainable growth. Although countries are climbing the income ladder, they still face both old and new challenges, which are linked to the transition to higher income levels. These traps are the productivity trap, the social vulnerability trap, the institutional trap and the environmental trap.

Policy actions are needed to move from vicious circles to virtuous circles of development. Policy actions should address key structural challenges, including poor productivity, increasing vulnerability levels, persistent inequality rates and rising citizen discontent. Strengthening domestic capacities in close partnership with international co-operation is fundamental to face the region's vulnerabilities under more complex international conditions. And this must be done while considering the relevance of preserving global public goods and the importance of co-ordinating domestic strategies with the broader sustainable development agenda. The path to sustainable and inclusive development must embrace development's multidimensional process. It requires a new vision for international co-operation as a facilitator to make progress inclusive for all.

### **Latin America and the Caribbean as a region in *development in transition***

The world is going through a period of major transformations. Ten years after the economic crisis, the global economy is still facing structural challenges that call for new development strategies. Awareness of the social, environmental and economic limits of the prevailing models has generated a deep feeling of dissatisfaction. This has called into question conventional wisdoms on development and international co-operation for development.

The Agenda 2030 and the SDGs represent a renewed consensus for a new development paradigm and an important political step forward. They restore the multidimensionality of development needs and the principle of shared but differentiated responsibilities among the countries in the environmental, economic and social spheres. This ambitious development agenda cannot be achieved in isolation of each other or by merely improving financial aid. It sets commitments for the entire international community, demanding national, regional and international policy actions.

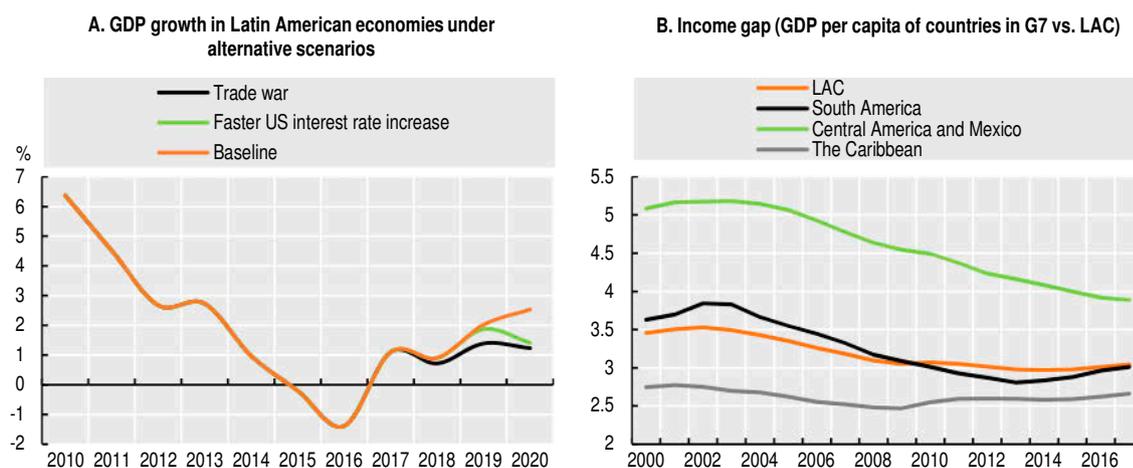
LAC faces evolving and complex development challenges that call for a DiT approach. Universally, the DiT approach stresses the need to rethink both domestic policies and international co-operation. Ultimately, it seeks to help countries turn income gains into lasting development gains. LAC's state of development presents some features that largely resonate with the DiT approach. Although these features are not exclusive to this region, they deserve particular attention. Indeed, they are critical for defining the role of international co-operation as a facilitator for the region's future development.

## Macroeconomic and socio-economic performances are symptoms of structural challenges in the region

Economic growth in LAC is expected to improve, but it remains relatively weak. Macroeconomic conditions point to different “Americas Latinas”, with significant heterogeneity across countries. This highlights differences in exposure to external shocks, main trade partners, differences in policy frameworks and idiosyncratic supply shocks. In 2018, as global and idiosyncratic shocks affected output dynamics in the region’s major economies, recovery stalled on average (Figure 1, Panel A). Though activity is expected to regain some momentum in 2019-20, growth performance would be subdued compared to the previous decade. Current and expected growth is insufficient to close the income gap relative to the most advanced economies. Since 2011, GDP growth has been below the high rates achieved in the mid-2000s; the gap in terms of GDP per capita with advanced economies has remained considerable (Figure 1, Panel B). In the long term, evidence indicates that potential GDP annual growth at 3% is lower than previously expected. Low potential growth is a matter of concern because of its economic and social effects.

The region is vulnerable to a complicated global context. In 2018, LAC economies benefited from still-solid global activity, but for 2019 and 2020 a soft landing is expected. Following a rebound in 2017, global trade slowed in 2018 and will continue to soften in 2019 (OECD, 2018a; IMF, 2018). Moreover, commodity prices are expected to ease, leaving behind the slump between 2014 and 2016. Geopolitical tensions boosted oil prices in the first half of 2018. However, fears about a trade war and tighter credit conditions in the Chinese economy curbed the uptrend. At the same time, global liquidity tightened in 2018. Capital flows to emerging markets receded, widening spreads, depreciating currencies against the US dollar and sinking stock market values. The external context, then, is volatile. It could include global financial tightening and escalating trade tensions between the United States and China that could derail economic recovery in LAC (Figure 1, Panel A).

Figure 1. GDP growth and income gap in Latin America and the Caribbean



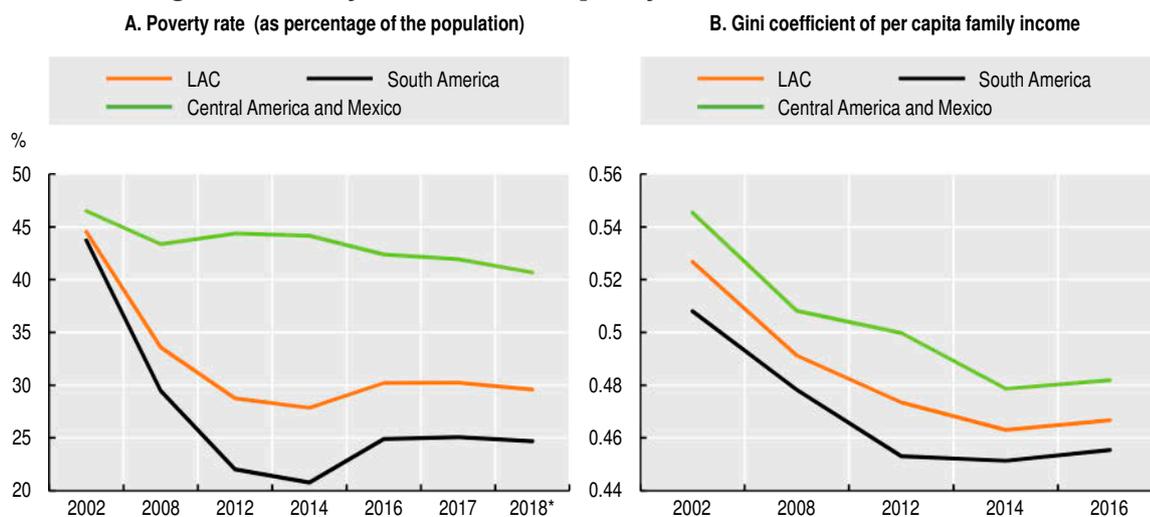
Notes: For Panel A, weighted average for Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela. An interest rate increase scenario contemplates an additional and cumulative 0.25 basis points (bp) rise on short-term interest rates in the United States compared to the baseline (where interest rates plateaued after 2019). This implies a cumulative rise of 200 bp by 2020 compared to the baseline scenario. Trade war scenario is modelled on Oxford Economics projections for the impact of American and Chinese GDP trade tariffs on USD 250 billion (25% for 50 billion and 10% for 200 billion) of Chinese exports to the United States with a similar response from the People’s Republic of China (hereafter “China”). Between 2018 and 2020, GDP would decline 0.37 bp in China and 0.26 in the United States with respect to the baseline.

Source: ECLAC (2018a), CEPALSTAT (database); IMF (2018) and World Bank (2018).

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Insufficient economic growth in LAC is holding back reductions in poverty and income inequality (Figure 2). Poverty is closely linked to the business cycle in LAC. Consequently, the economic slowdown entails that poverty and extreme poverty levels should be similar to those of 2016, although with differences across countries. Moreover, considering population growth, the number of people who are poor and extremely poor is likely to increase by approximately 1 million (ECLAC, 2018a). Income inequality recorded an unprecedented drop between 2002 and 2014. However, for 2016 (the latest figures available), inequality increased slightly for the first time since 2002, with significant heterogeneity across countries.

Figure 2. Poverty and income inequality in Latin America and the Caribbean



Note: \* Poverty data for 2018 are estimates. Circa years for the Gini coefficient.

Source: ECLAC (2018a) and ECLAC (2018b).

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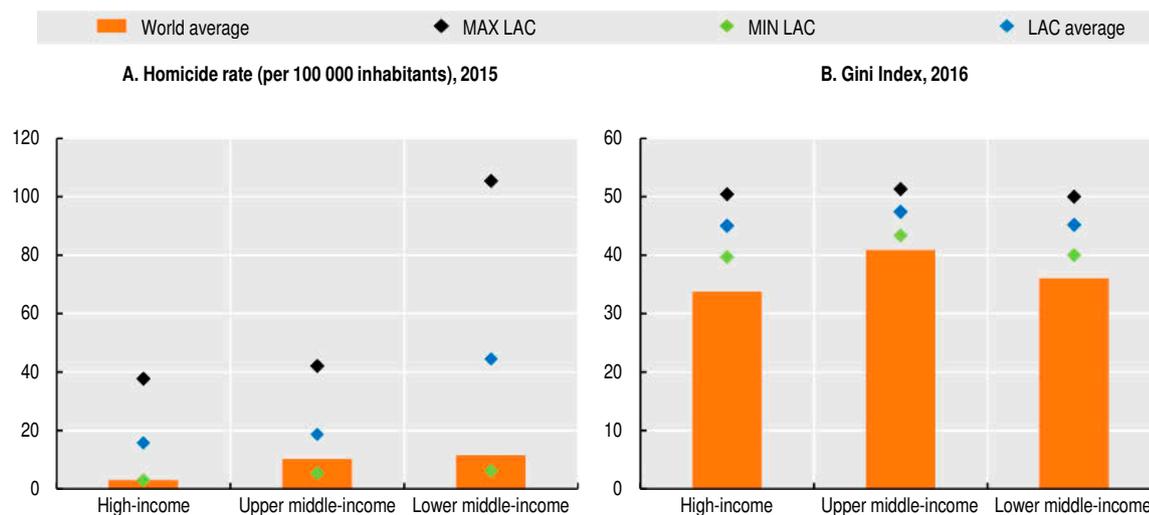
### Greater national income is not automatically turning into greater well-being for all Latin Americans

A single universal path to development does not exist. Development processes are not marked by a succession of stages characterised by linear increases in per capita GDP, homogeneous elements and similar policies. Indeed, while income per capita and well-being are associated, outcomes gradually delink as countries become wealthier in terms of GDP per capita. As economies grow, several development dimensions other than GDP per capita become more important in improving people's lives. This is the case of most LAC countries. Using an average income, such as GDP or gross national income (GNI) per capita, as a measure of development can provide a ballpark idea of the development challenges. Yet, it fails to draw the detailed roadmap that policy makers need to achieve inclusive and sustainable development since it can hide strong disparities across and within countries in different essential aspects of people's lives.

The region has undoubtedly registered progress in terms of higher per-capita income; however, a deeper look at multidimensional indicators of development presents mixed results. LAC over-performs for its level of per capita GDP in terms of life expectancy, employment, social connections, air quality and overall life satisfaction. For example, primary school enrolment has increased considerably beyond expectations given countries'

income level. However, quality education lags behind. Violence and income inequality remain relatively high and informality is still a persistent problem. Furthermore, real wages have increased at a slower pace than in other countries in the world with similar GDP per capita since the 1950s.

Figure 3. Selected development indicators by country income groups



Note: Simple averages are used for both LAC and world averages. LAC lower middle-income countries include Bolivia, El Salvador, Honduras and Nicaragua. LAC upper middle-income countries include Belize, Brazil, Colombia, Costa Rica, Cuba, Ecuador, Grenada, Guatemala, Guyana, Jamaica, Mexico, Paraguay and Peru. LAC high-income countries include Argentina, Bahamas, Barbados, Chile, Panama, Puerto Rico, Trinidad and Tobago, and Uruguay.

Source: Calculations based on World Bank (2018).

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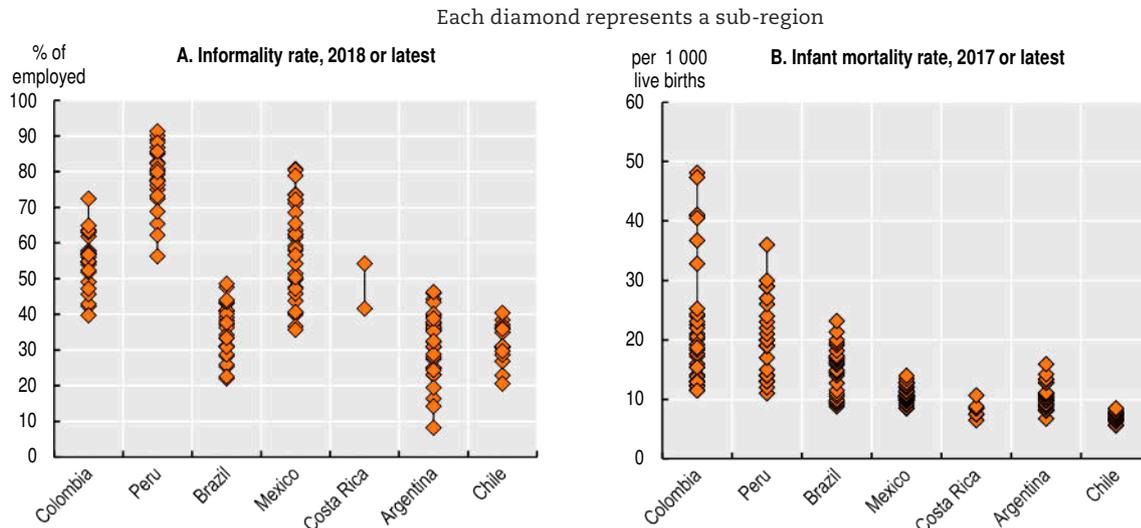
Additionally, cross-country disparities in well-being outcomes at a given level of GDP per capita are glaring in LAC. For instance, the homicide rate of El Salvador is 17 times that of the Plurinational State of Bolivia (hereafter “Bolivia”), although both countries are lower middle-income economies (Figure 3). Similarly, there is almost a 40 percentage point difference between the best- and worst-performing upper middle-income countries in LAC in terms of vulnerable employment (49.7% in Peru compared to 10.3% in Cuba). Furthermore, heterogeneity is also large across countries with different levels of income. Several development outcomes in lower-income countries in LAC are better than in middle-income and even high-income countries. For instance, Trinidad and Tobago, and Uruguay, both high-income countries, present homicide rates greater than Bolivia, a lower middle-income country.

National measures of GDP per capita generally hide large diversity across sub-national regions in all continents, but the pattern is especially pronounced in LAC. Territorial disparities are large for several dimensions, including education, health, citizen security, poverty and informal employment (Figure 4). For instance, in Mexico only 14% of the population of Nuevo León lives below the poverty line, while the poverty rate of Chiapas is 77%. Within some countries in the region, informality rates jump from 8.2% in Ushuaia-Río Grande (Argentina) to 91% in Huancavelica (Peru).

In line with the Agenda 2030, a multidimensional approach to development is needed that moves beyond income metrics as the sole indicator of success. GDP per capita is

not the only feature shaping development. In particular, as countries grow, quality jobs, health, education, democracy, personal security and inequality are equally important. Looking at development through a multidimensional lens serves as a good compass to design, monitor and evaluate policies to improve people's lives. Yet it requires measuring for a broad range of development outcomes. This includes data on how well-being outcomes are distributed across a population and local areas, as well as on sustainability.

Figure 4. Sub-national disparities across selected development indicators, selected Latin American and Caribbean countries



Note: Countries are ordered by GNI per capita levels in current values.

Sources: CONAPO (2018), DANE (2018), IBGE (2017), INDEC (2018; 2017), INE (2015), INEC (2016), INEI (2015).

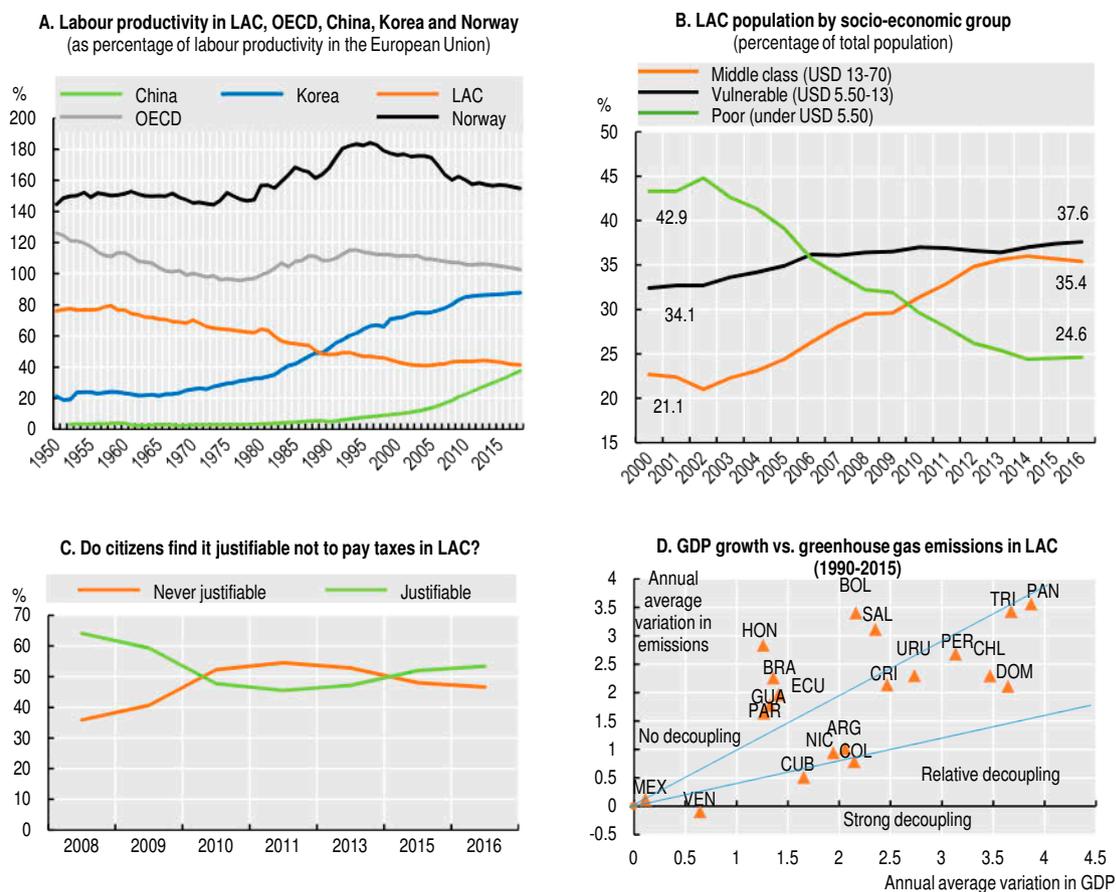
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### As Latin America and the Caribbean countries climb the income ladder, they face new development traps

Following socio-economic and institutional improvements in the past decades, LAC countries are facing a number of “new” development traps that stand in the way of further inclusive and sustainable growth (Figure 5). Progress towards higher income levels is bringing development challenges to the surface, and creating new ones. These are mainly the result of longstanding weaknesses that have been exacerbated. They are becoming more relevant as countries advance in their respective development pathways. Several indicators suggest that former drivers of progress are no longer sufficient. These include stagnant – or even declining – levels of productivity; the persistent and increasing vulnerability of large segments of the population, with unequal access to public services across socio-economic groups; the growing dissatisfaction of citizens with public institutions; and the visible impact of climate change.

These development traps involve circular, self-reinforcing dynamics that limit the capacity of LAC countries to move towards greater levels of development. In this sense, and following the literature on development economics, LEO 2019 highlights the self-fulfilling nature of these traps, and how better co-ordination and/or collective action can overcome them (Myrdal, 1957; Hirschman, 1958).

Figure 5. Main symptoms of the “new” development traps in Latin America and the Caribbean



Note: In Panel B, socio-economic classes are defined using the world classification: “Poor” = individuals with a daily per capita income of USD 5.5 or lower. “Vulnerable” = individuals with a daily per capita income of USD 5.50-13. “Middle class” = individuals with a daily per capita income of USD 13-70. Poverty lines and incomes are expressed in 2011 USD PPP per day (PPP = purchasing power parity). The LAC aggregate is based on 17 countries in the region for which microdata are available: Argentina (urban), Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay (urban). In Panel C, unweighted average for Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela. The specific question is: “Please tell me for each of the following statements whether you think it can always be justified to cheat on taxes, never be justified, or something in between”. For practical purposes, we classify those as “never justifiable” to the share of respondents that answered 10 (the highest note); “slightly justifiable” is the fraction of respondents who answered between 9 and 6; and “justifiable” is the fraction of answers between 1 (the minimum possible) and 5.

Source: Own calculations based on The Conference Board (2018), The Conference Board Total Economy Database for Panel A; LAC Equity Lab tabulations of SEDLAC (CEDLAS and the World Bank, 2018) for Panel B; Latinobarómetro (2015) for Panel C; ECLAC (2018a) for Panel D.

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The four main “new” development traps identified are as follows:

- 1. Productivity trap:** Persistently low productivity levels and poor productivity performance across sectors in LAC are symptoms of a *productivity trap*. The concentration of exports on primary and extractive sectors with low levels of sophistication creates a structure that does not generate backward linkages in the economy and presents barriers to entry, given the high capital intensity of

these activities. This, in turn, makes it difficult for micro, small and medium-sized enterprises (MSMEs), which are abundant in LAC, to connect to international markets. Consequentially, the region has poor insertion into GVCs. This is associated with low levels of technology adoption and few incentives to invest in productive capacities. In all, competitiveness remains low, making it difficult to move towards higher added-value segments of GVCs. This fuels a vicious circle that negatively affects productivity. Such a dynamic has gained relevance given the decline of demand for commodities derived from the current stage of “shifting wealth”. The stage is marked by two trends. First, China is shifting from an investment-based economic model to one based on consumption. Second, new drivers of growth are needed in LAC to boost productivity.

2. **Social vulnerability trap:** Income growth paired with strong social policies since the beginning of the century have reduced poverty remarkably. Yet most of those who escaped poverty are now part of a new vulnerable middle class that represents 40% of the population. This comes with new challenges, as more people are now affected by a vicious cycle that perpetuates their vulnerable status. Those belonging to this socio-economic group have low-quality, usually informal jobs associated with low social protection and low – and often times unstable – income. Because of these circumstances, they do not invest in their human capital, or lack capacity to save and invest in a dynamic entrepreneurial activity. Under these conditions, they remain with low levels of productivity, and, hence, only have access to low quality and unstable jobs that maintain them vulnerable. This trap operates at the level of the individual, who is locked into a vulnerable status; this contrasts with the productivity trap, which refers to the whole economy.
3. **Institutional trap:** The expansion of the middle class in LAC has been accompanied by new expectations and aspirations for better quality public services and institutions. However, institutions have not been able to respond effectively to these increasing demands. This has created an institutional trap, as declining trust and satisfaction levels are deepening social disengagement. Citizens are seeing less value in committing to the fulfilment of their social obligations, such as paying taxes, as illustrated by the decline in tax morale (54% of the population justified not paying taxes in 2016). Tax revenues are thus negatively affected, limiting available resources for public institutions to provide better quality goods and services, and respond to the rising aspirations of society. This creates a vicious circle that jeopardises the social contract in the region.
4. **Environmental trap:** The productive structure of most LAC economies is biased towards high material and natural resource-intensive activities. This concentration may be leading these countries towards an environmentally and economically unsustainable dynamic for two reasons. A concentration on a high-carbon growth path is difficult – and costly – to abandon; and natural resources upon which the model is based are depleting, making it unsustainable. This has also gained importance in recent years, with the stronger commitment with global efforts to fight the causes and consequences of climate change.

Policy actions should move LAC from these vicious circles to virtuous circles. The growing importance of the development traps has relevant policy implications and demands putting in place a new set of structural reforms that deal with ever-more complex issues. These new reforms require more sophisticated policy mixes and further policy co-ordination and coherence. Among others, policies should: i) go beyond access to education, and focus on quality and skills to improve employability, particularly

in a context of technological transformation; ii) foster the creation of formal jobs and expand the coverage of social protection systems across different socio-economic groups; iii) improve connectivity thanks to more complex logistics infrastructure and support a model of growth that is environmentally sustainable; and iv) improve the credibility, openness and efficiency of public institutions, promoting more co-ordination between sectors and across levels of government.

Policy responses to overcome these development traps in LAC must be designed by considering their interactions, as they reinforce each other. Better understanding the links and common causalities between different policy issues and objectives will be critical to develop responses that address their complex interactions effectively. In this respect, it is critical to identify win-win policies that can promote synergies and help in dealing with trade-offs. An example is the productivity-inclusiveness nexus, which suggests the existence of numerous linkages between these two policy objectives and calls for policies that can boost both at the same time (OECD, 2018b).

### **Exploiting untapped opportunities for development in Latin America and the Caribbean**

The new global context is linked to national strategies and highlights the need to broaden the concepts of development, national planning and international co-operation for development. The increasing interconnectedness reinforces the relevance of including support for regional and global public goods in national development strategies. In particular, engaging in a regional perspective is crucial to tackle global challenges, which is fundamental for greater global economic and social stability.

### **Strengthening domestic capacities to address development traps**

Domestic capacities must be improved to better respond to the development traps, which demand more sophisticated and adapted policy responses. Previous editions of the LEO focused on various public policy issues that are crucial for sustainable and inclusive development in the region. These included fiscal policy; migration; small and medium-sized enterprises (SMEs); infrastructure and logistics; education and skills; trade integration and the relationship with China; youth, skills and entrepreneurship; and the relevance of rethinking institutions to support greater development. These editions analysed some horizontal issues present across all LEOs, such as low productivity, labour markets and the persistence of informality, and the socio-economic implications of the expansion of the middle class.

Considering the breadth of sectoral and horizontal challenges for development covered in previous editions, LEO 2019 focuses on strengthening capacities on two cross-cutting issues. These are the policy-making process and domestic financing for development, which are considered to be key elements for a holistic development strategy. First, better policy making for development refers to improving the planning, execution and monitoring of public policies. Ultimately, this connects policies to the objectives of inclusive and sustainable development and ensures capacities are in place to overcome the complexities of the political economy of reforms. In that context, the design and implementation of NDPs, as well as more and better public spending, are fundamental in the development agenda. Second, domestic financing for development refers to improving available financial resources to support structural reforms that can address the development traps. In a region where tax revenues are relatively low and financial markets are not sufficiently deep and inclusive, improving mechanisms to mobilise domestic resources for development will be crucial.

### Better policy-making process for development

Development planning has experienced a significant evolution in recent years in LAC, mainly through the adoption of NDPs. Traditional planning focused almost exclusively on fostering economic growth. Contemporary planning promotes a more comprehensive and multidimensional view of development with a strong emphasis on equality, social inclusion and poverty eradication. Development planning today identifies regulations, public investment and private-public partnerships as its preferred policy instruments. Crucially, these strategies underscore the importance of citizen participation and empowerment in planning (ECLAC, 2017a, 2017b; Máttar and Cuervo, 2017).

Based on the four major development traps, LAC countries are prioritising their most pressing policy issues. The first priority is institutional strengthening in terms of modernising public services, citizen security, justice and international co-operation. The second major issue is productivity, including macroeconomic stability, growth and employment, infrastructure development and investments in science and technology. Social vulnerability comes in third place and includes social and human development, inclusion and social cohesion, equity, quality of education and access to basic services. The less-mentioned topics are those related to the environment and the adaptation and mitigation of climate change (Figure 6).

Figure 6. Intensity of specific topics in development plans in selected Latin American countries

	Productivity trap	Institutional trap	Environmental trap	Social vulnerability trap
Argentina				
Bolivia				
Brazil				
Chile				
Colombia				
Costa Rica				
Dominican Republic				
Ecuador				
El Salvador				
Guatemala				
Honduras				
Mexico				
Nicaragua				
Panama				
Paraguay				
Peru				

Note: The colours indicate the intensity of the topics included in the strategic objectives according to the challenges of the development in transition. As a colour darkens, its priority within the plan increases. The figure is based on the latest development plan (or its equivalent) approved by the end of 2018. See Chapter 6 for the Caribbean small states. Source: Own elaboration based on the information contained in development plans.

As planning becomes increasingly more complex and participative, LAC countries struggle to implement long-term, inter-sectoral and co-ordinated NDPs. They need broad social consensus to ensure that government turnover and political interests do not put continuity at risk. Two main problems have been identified. First, countries lack technical capacity for designing planned reforms and programmes. Second, implementation processes lack sufficient continuity owing to frequent government turnover. Additionally,

there is not enough money allocated for implementing plans and limited co-ordination between plan design and budget. As a result, little value is given to planning as an instrument for effecting change or anticipating unfavourable results (Stein et al., 2005; ECLAC, 2017a; Máttar and Cuervo, 2017).

From a political economy perspective, the design, adoption and implementation of planning strategies are largely the result of the policy making process (PMP). This represents a complex set of bargains and exchanges among political actors with their own interests, incentives and constraints. There are institutions or “rules of the game” where these interactions take place. A specific context affects that particular stage of the life cycle of policy reform (Stein et al., 2005; Stein and Tommasi, 2006; Dayton-Johnson, Londoño and Nieto Parra, 2011). In this perspective, co-operation and agreement among the principal actors in the PMP are the pillars for adoption and implementation of successful and sustainable NDPs.

In most LAC countries, business groups have been influential in the PMP. These groups influence the design and implementation of NDPs through formal or informal associations, bargaining, lobbying, government appointments, political financing and, in some cases, corruption (Schneider, 2010). Technical staff, and effective and transparent interest intermediation may serve to impede rent-seeking.

Actions that contribute to improve the PMP and, in particular, to making NDPs more effective in addressing the region’s development traps include the following:

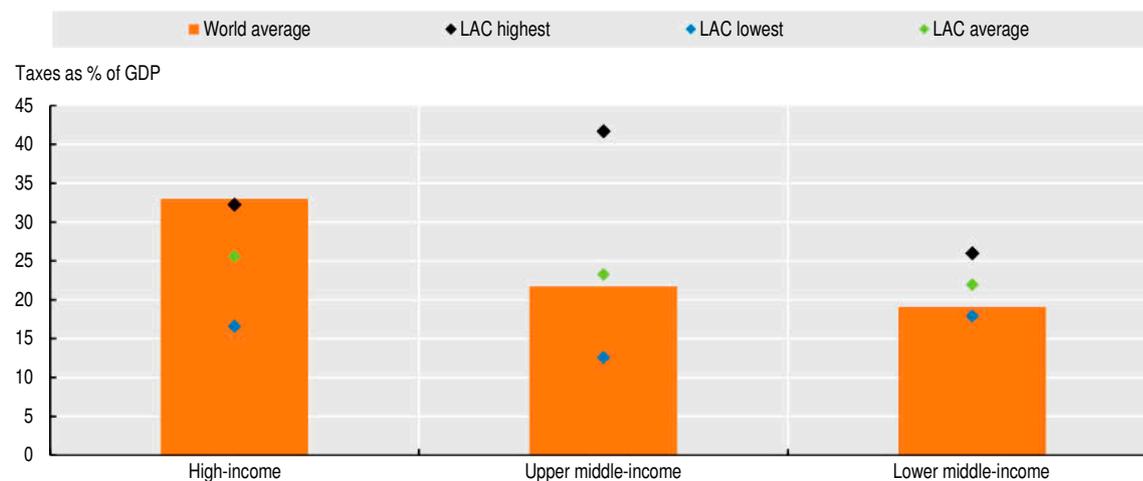
- **Building capacities of key actors in the PMP to develop long-term strategic plans.** Such actors include political parties, as well as executive, legislative, judicial and sub-national authorities. This should be achieved by strengthening public entities (e.g. improvements in human capital and skills of public servants, effective regulatory processes, sound institutional frameworks), which have traditionally served rent-seeking and clientelist behaviour.
- **Improving statistical capacity to better shape NDPs.** If measurement tools are flawed, policy making will be distorted (Stiglitz, Sen and Fitoussi, 2009). Moving beyond GDP metrics as the sole indicator of development success requires measuring development from a multidimensional perspective. This means including data on how well-being outcomes are distributed across a population and local areas, as well as data on sustainability. LAC countries should invest in better data collection to measure and monitor multidimensional metrics that are most important for the region across their territory and population groups.
- **Using digital technologies to develop more effective NDPs in LAC.** These technologies are a powerful tool to improve citizens’ participation (including open government) and empowerment in designing planning strategies. They also facilitate the impact evaluation of government programmes and projects connected to the sustainable development agenda. Finally, digital technologies enhance the state’s capabilities to develop more accurate and rigorous long-term and forward-looking scenarios that are essential in establishing consistent and sustainable development strategies.
- **Towards more and better public spending for development in LAC.** The levels and quality of spending in the region are insufficient to overcome development traps and accomplish the Agenda 2030. The region needs to increase and improve spending on social components, including health and education. It also needs to boost investment in research and development, and other innovation policies to strengthen competitiveness.

## Expanding domestic financing for development

The new development agenda requires mobilising vast resources to finance long-term policy reforms. Several risk factors limit the capacities of LAC countries to achieve this agenda. These include weak mobilisation of domestic revenue, relatively low flows of official development assistance and the difficulty of channelling private flows for development.

The level of taxes in relation to GDP has been increasing in the past years. Yet, most LAC economies need to mobilise further domestic resources to implement their development plans and achieve the Agenda 2030. Despite an increase by close to 2 percentage points in the past decade, tax revenues as a percentage of GDP are, on average, relatively low in LAC economies compared to the OECD. In 2016, the average tax-to-GDP ratio in LAC was 22.7%, compared to 34% in OECD member countries (OECD/ECLAC/CIAT/IDB, 2018) (Figure 7). Some upper middle-income countries in LAC, such as Dominican Republic, Mexico, Panama, Paraguay or Peru, might be unable to meet their financial needs for development; their tax levels are below the lower middle- or low-income world average (OECD, 2018c, 2017, 2015). Similarly, high-income countries, such as Chile, Panama and Uruguay, register levels of taxes over GDP well below OECD and high-income world averages. The same is true for economies expected to graduate to high income during the next few years, such as Colombia or Costa Rica. This reality undermines their capacity to meet socio-economic needs and improve the well-being of their citizens.

Figure 7. Tax-to-GDP ratios in Latin America and the Caribbean, OECD and world average by income group, latest year available



Note: Orange bars represent the world average across the 80 countries covered in the OECD Global Revenue Statistics (25 in LAC, 18 in Africa, 35 in the OECD and 4 in Asia). In Latin America and the Caribbean, high-income economies include Argentina, Bahamas, Barbados, Chile, Panama, Trinidad and Tobago, and Uruguay. Lower middle-income economies include Bolivia, El Salvador, Honduras and Nicaragua. Upper middle-income economies include Belize, Brazil, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, Guatemala, Jamaica, Mexico, Paraguay, Peru and Venezuela. The black diamond represents the country with the highest tax-to-GDP ratio in the LAC region within each income group, while the blue diamond represents the country with the lowest tax-to-GDP ratio in each group. The green diamond represents the simple average of LAC economies depending on their income group. Countries are classified by income groups according to World Bank methodology (<https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>).

Source: OECD Global Revenue Statistics (OECD, 2018c) (database).

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Most countries in the region need to improve the structure of the taxation system to increase financing for development. As a result, the political economy of fiscal reforms calls for a comprehensive approach to overcoming the “institutional trap”. LAC countries need to complement crucial tax measures (e.g. progressivity of the taxation system, measures to reduce tax evasion and avoidance, elimination of tax expenditures that do not contribute to competitiveness) with complementary actions. These additional elements should i) communicate clearly the benefits of such reforms to overcome other development traps; ii) show the efforts made by governments to achieve more effective and efficient public spending thanks, in part, to implementing NDPs; and iii) launch a package of reforms where citizens see and experience tangible benefits.

Public-private partnerships (PPPs), driven by efficiency, quality and sustainability, can complement improvements to the tax system and help the state finance the delivery of public goods and services. PPPs should result not from fiscal budget constraints but rather from a purposeful and sound process built on effective regulatory and institutional frameworks. These include pre-feasibility and value-for-money analyses, independent supervisory bodies for PPPs, a transparent and efficient process for environmental licences and land permits, and dialogue with local communities.

Additionally, most countries in the region identify well-developed and well-functioning financial markets to promote sustainable and inclusive growth, as well as the different dimensions of development, as a policy priority (Izquierdo et al., 2016; Melguizo et al., 2017). Strong financial systems also contribute to economic development and technological innovation (King and Levine, 1993; Jayaratne and Strahan, 1996; Rajan and Zingales, 1998; Levine, 2018, 2005). Access to finance through different modalities is key for bridging development gaps. These modalities include:

- **Developing financial technologies (FinTech)**, which apply technology to improving financial activities (Schueffel, 2017). FinTech provides financial services as an end-to-end online process, consisting of new applications, processes, products or business models.
- **Accessing National Development Banks (NDBs)**, which can promote financial inclusion and access to certain business segments. These include micro-, small- and medium-sized enterprises in some sectors. Some LAC countries should consider expanding NDB activities and promoting greater innovative frameworks in these banks’ business models.
- **Tapping sound and sustainable capital markets**, which requires prioritising the improvements of such markets, including in their quality (e.g. liquidity, low concentration) and inclusion (e.g. number of firms issuing securities) rather than just in their size (e.g. market capitalisation).

### **International co-operation as a facilitator of the LAC development agenda**

The LAC region is fertile ground for rethinking how international co-operation can – and should – facilitate pathways to sustainable and inclusive development. The region faces certain development traps associated with productivity, social vulnerabilities, institutional capacity and environmental challenges. However, it simultaneously demonstrates a firm and mature resolve to address these roadblocks to its greater prosperity. The region is acting on this resolve in three interconnected ways. It is harnessing domestic strengths and development plans. It is engaging globally on mutually relevant development issues, including the achievement of the Agenda 2030 and the SDGs. It is also increasingly linking the domestic and international spheres to sustain development that will make a lasting difference in the lives of its citizens.

Stronger institutional capacities, increasing social aspirations, deeper political will for reform and growing non-dependence on aid are just some of the region's attributes. They confirm the time is ripe to rethink how to rebalance use of various co-operation tools. Indeed, LAC realities and prospects call for a renewed international co-operation with the region. Such co-operation should be holistic, provide integrated approaches and responses to development, consider a larger number of actors and tools, build new synergies from renewed interactions and facilitate the region's own development priorities.

International co-operation facilitates countries' development in several ways. It promotes nationally-driven development processes and aligns countries on an equal footing as peers for exchanging knowledge and learning. It also builds on a country's capacities and creates new ones to spur national and global reforms, and supports aid as a catalyser for additional and varied sources of funding. While ensuring continued engagement with countries in the region at all levels of development, international co-operation helps create the domestic conditions that will drive LAC countries towards achieving the SDGs.

Still, moving towards international co-operation as a facilitator for sustainable development needs to be a gradual process. It entails working inclusively, building stronger domestic capacities and operating with a different and broader set of knowledge tools.

First, by working inclusively, international co-operation as a facilitator seeks to engage countries at all development levels on an equal footing. As peers, countries can build and participate in policy partnerships, tackle development challenges with multilateral and multidimensional responses, and enhance the participation of key actors, such as the private sector and civil society. The world needs new partnerships, new finance approaches and new governance arrangements to face an increased array of development challenges. This is not only legitimate, but also beneficial for addressing common concerns more effectively and ensuring that development challenges receive the necessary global multidimensional responses.

Second, it would place national strategies front and centre and strengthen countries' domestic capacities. By building stronger domestic capacities, international co-operation as a facilitator would help LAC countries design, implement and evaluate their own development policy priorities. This, in turn, would place these priorities at the core of their actions and encourage their alignment with shared global challenges and global public goods. It will also support LAC countries to better align planning with international co-operation. In this way, they can make planning more efficient and facilitate an active participation of countries in the region in the global agenda.

Third, it will take holistic and integrated approaches. As LAC countries develop, they require a different balance between financial transfers and other modalities of co-operation. By transcending traditional tools and actors, and mobilising wider policy experiences, international co-operation as a facilitator fosters a more technical co-operation among partners. Such co-operation is based on knowledge sharing, including policy dialogue, training, technology transfer and co-operation for joint R&D. Most prevalently, it is based on capacity building, including in key areas of science and technology. It uses the potential of South-South and Triangular co-operation as a stepping stone for harnessing this broader box of tools. In addition, placing these tools in the hands of a wider range of actors, including those across various ministries in a whole-of-government approach, might create richer interactions. Ultimately, co-operation benefits from access to diverse sources of expertise needed to tackle complex social, economic and environmental sustainability issues.

**Table 1. Key dimensions for rethinking international co-operation as a facilitator for sustainable development in LAC**

Dimensions	Description
Working inclusively	Engaging countries at all development levels on equal footing as peers, to build and participate in multilateral and multi-stakeholder partnerships to tackle shared multidimensional development challenges with multidimensional responses.
Building domestic capacities	Strengthening countries' capacities to design, implement and evaluate their own development policy priorities and plans, encouraging the alignment between domestic and international priorities, and ensuring integrated approaches to more complex and interlinked challenges.
Operating with more tools and actors	Expanding instruments for greater international co-operation, such as knowledge sharing, policy dialogue, capacity building, technology transfers, and embracing more actors, including public actors in a "whole-of-government" approach.

Source: Own elaboration.

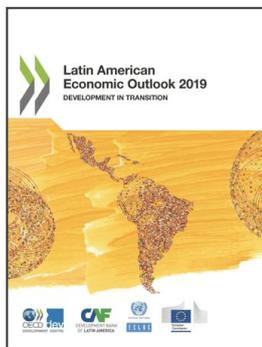
The universality and comprehensive approach to the shared global challenges of the Agenda 2030 calls for the world to adapt how it looks at development and how it uses tools for co-operation. In short, this requires flexible and dynamic approaches to development, and a commitment to put principles immediately into practice.

Drawing on its many positive examples, successes and valuable lessons, the LAC region can be the testing ground to respond to this call for action. Now it is critical to put the above-proposed principles into practice. A robust dialogue with stakeholders in the LAC region and beyond can analyse how to implement this holistic vision and machinery for international co-operation as facilitator. Ultimately, these efforts may well be the starting point for a stronger, more powerful, more participatory and more inclusive multilateralism.

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