Summary

Towards **transformation** of the **development model** in Latin America and the Caribbean: **production, inclusion and sustainability**

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ECLAC

Thirty-ninth session of ECLAC

Buenos Aires, 24–26 October 2022

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This document was prepared by the substantive divisions, subregional headquarters and country offices of the Economic Commission for Latin America and the Caribbean (ECLAC).

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– Three dots (...) indicate that data are not available or are not separately reported.
– A dash (-) indicates that the amount is nil or negligible.
– A full stop (.) is used to indicate decimals.
– The word “dollars” refers to United States dollars, unless otherwise specified.
– A slash (/) between years (e.g. 2013/2014) indicates a 12-month period falling between the two years.
– Figures and percentages in graphs and tables may not always add up to the corresponding total because of rounding.

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Foreword

In a highly complex macroeconomic, social and environmental context in the region that demands a rethinking of short- and long-term public policies, the Economic Commission for Latin America and the Caribbean (ECLAC) is fulfilling its mandate at its thirty-ninth session, by presenting the countries of the region with a proposal for economic reactivation and transformation of development models in Latin America and the Caribbean.

The worst economic and social crisis that the region has ever experienced, amid the coronavirus (COVID-19) pandemic, is now being followed by times of great difficulty and uncertainty generated by a series of cascading —climate, health, employment, social, educational, food security, energy and cost-of-living— crises.

The region faces major short-run economic and social policy challenges, given the need to reconcile policies to simultaneously foster economic recovery, address inflation and the cost-of-living crisis, maintain support for the most vulnerable households, and strengthen the sustainability of public finances. Yet, difficult as the current global juncture is, the greatest challenges are posed by long-term structural factors: the need to increase productivity, transform economic and productive systems to create more and better jobs, move toward more technologically sophisticated low-carbon economies to address climate change, reduce structural gaps and heterogeneities, turn education systems into true drivers of social mobility and growth, end gender gaps and advance towards universal social protection systems in the framework of solid welfare states, to mention only a few of the most pressing.

Moreover, an inflationary process in the global economy such as has not been experienced in 20 years is weighing heavily on monetary policy both in developed economies and in Latin America and the Caribbean. The fiscal and monetary stimulus policies adopted during the pandemic have given way to more restrictive policies, reflected in rising monetary policy interest rates almost across the board in the region. At the same time, most of the countries have seen their fiscal situation deteriorate as a result of the major fiscal efforts made to combat the worst moments of the COVID-19 crisis and its social fallout. The social situation in the region has also deteriorated, with considerable increases in poverty levels reflecting the effects of the pandemic and the ensuing economic contraction. Moreover, income inequalities increased significantly after the outbreak of the pandemic, leading to a deterioration of living conditions and economic prospects not only for the poorest segments, but also for the middle-income sectors, with significant political and social implications. This has been compounded by large migratory flows, which need to be addressed.

It is essential to ensure that public spending is sustainable and to avoid making adjustments that would deepen the economic slowdown and compromise support for the most vulnerable sectors. This means expanding the fiscal space and building a macroeconomic governance that will make cyclical downturns shorter and shallower and render expansionary cycles more sustainable over time.

In addition to facing the difficult challenges posed by the current conditions, the region's economies must also tackle the challenge of reversing the low productivity and investment growth of the past three decades, which have become structural constraints to development. Productive policies need to be rethought to allow the region to become rapidly integrated into the technological revolutions that have changed the production paradigm. Productive policies for recovery must have a sectoral dimension in addition to the appropriate macroeconomic and financial framework. Although sectoral specifics will have to be defined in each national context, ECLAC proposes affording special attention to at least nine sectors that have strong potential to galvanize and transform the productive structure: the energy transition, e-mobility, the circular economy, the bioeconomy, the health-care manufacturing industry, digital transformation, the care economy, sustainable tourism, the micro- small, and medium-sized enterprise (MSME) sector, and the social and solidarity economy.

Technological revolutions generate waves of creative destruction with transformative socioeconomic effects. The policy challenge is ensuring that creative and innovation-driving dynamics prevail over destructive dynamics, and that the social and labour sectors affected benefit from social protection systems and active labour market policies (labour market integration and training), in order to take advantage of the opportunities of the new world of work that the technological revolution is creating.

The reactivation and transformation of the productive apparatus must also be environmentally sustainable if it is to be successful in reducing the effects of climate change —which affect the less developed countries most severely. These countries, which produce the least greenhouse gas emissions and are the least prepared to cope with the adverse effects of climate change, suffer its strongest effects.

The transformation of the productive structure needed in Latin America and the Caribbean will be the outcome of policy choices —as has historically been the case for all countries that have escaped the middle-income trap and become high-income countries— and not the sole result of factor endowments. The institutional and political economy dimensions, in co-evolution with the productive structure, define the development model. Countries that have adopted productive transformation and diversification policies and maintained them over time have achieved better long-term growth outcomes than those that have not. The region's low and falling investment and productivity levels over the past three decades are the result of its countries' limited capacity to make and sustain the required changes in the production structure, and thus in the quantity and quality of employment.

States in Latin America and the Caribbean need to develop a much stronger institutional capacity to design, implement and evaluate the public policies necessary for sustainable structural change.

Public policies must have disruptive effects on the composition of the region's productive structure, so they need to be carried out by ministries and secretariats with the political influence and institutional capabilities to do so. If they are to be implemented effectively, productive, industrial and technological policy initiatives require institutional and political support and must be backed by adequate capacity.

Countries also find themselves lacking solid welfare states and systems. The transition towards universal access to certain goods and services (such as health and education) that are crucial to well-being and productivity growth is a challenge that the region's public policies have yet to fully incorporate. Combating poverty and inequality requires more formal employment and social policies leading towards universal social protection systems. Both dimensions must recognize and attack other sources of inequality, such as those relating to gender, race or age and those stemming from environmental deterioration. Universal social protection is not only a moral imperative for development; it also contributes both to social justice and to economic growth and resilience: this is why the region must set about developing welfare states.

If the region is to overcome the problems that are holding it back and locking it into a path of slow investment, low growth and great inequality, it must implement a wide range of macroeconomic, productive, social and environmental policies with a strong sectoral slant. A series of important points emerge from the strategies and policies proposed by ECLAC at its thirty-ninth session: the urgency of reactivating investment and growth; recognition that the role of the State is crucial and irreplaceable in all its dimensions, from articulating proposals and providing financing on a scale not readily accessible to the private sector, to defining regulatory models and formulating and implementing policy; and the need to join up sectoral and economy-wide policies and to create spaces for stakeholders to negotiate, make decisions and take action while acknowledging their different capacities, advantages and limits.

The proposed agenda is ambitious, but this is not a time for gradual or timid changes, but a time for bold and transformational ones. Only by raising the level of ambition can the region respond to the multiple simultaneous challenges and shocks it faces, with due consideration for the complexity of its economies and societies. Coordinating the proposed strategies and policies and ensuring their effective implementation and adjustment to new realities over time will require new forms of experimentalist governance, based on iterative and participatory processes of policy formulation and implementation. In some cases, new fiscal, productive, social and environmental compacts will be needed to resolve the problems of the current juncture and underpin long-term progress towards sustainable, cohesive and resilient societies. These are the hallmarks of the welfare states the region needs to build within the framework of more efficient and productive economies.

José Manuel Salazar-Xirinachs
Executive Secretary
Economic Commission for
Latin America and the Caribbean (ECLAC)

Introduction

The international outlook for the coming years is fraught with uncertainty. Weak growth and inflationary pressures driven by the crisis caused by the coronavirus disease (COVID-19) pandemic have been intensified by the war between the Russian Federation and Ukraine, which has worsened the slowdown in trade and global growth and accentuated geopolitical tensions, inflation and global financial system volatility.

Added to this are challenges arising from changes in the dynamics of globalization associated with multiple, convergent technological revolutions that are altering the production paradigm, business models, supply chains and goods and services trade flows, as well as new geopolitical realities that have affected the composition of world trade and the mechanics of what are termed the "global factories".

The current global juncture is marked by what many analysts and international organizations have described as a series of cascading —climate, health, employment, social, educational, food security, energy and cost-of-living— crises, all of which have impacts of varying intensity and nature across many countries, including those of Latin America and the Caribbean.

In the region, the challenges posed by various recent shocks, in particular the pandemic and the war in Ukraine and their consequences, and longer-term structural changes related to globalization and the climate, have worsened, exacerbating and deepening existing structural problems of inequality, productivity, the uneven production structure, labour informality, low access to social protection systems, the digital divide, gender inequality and education. These structural characteristics of the region and the associated social and political demands not only compromise its ability to move towards environmentally sustainable growth and development but also affect countries' capacity to respond to external shocks, the demands of the economic cycle and longer-term transformations.

The short-run ramifications for the region pose major economic and social policy challenges, as policies to foster economic recovery, address inflation and maintain support for the most vulnerable households must be reconciled without compromising the sustainability of public finances.

The region therefore needs public policies with a clear focus and direction —with the necessary space to promote a transformative reconstruction— as well as stronger public institutions. The set of measures required by the economies of the region must not only reactivate economic and production systems but must simultaneously rebuild and transform them in order to underpin progress towards low-carbon, technology-intensive economies capable of addressing climate change and reducing gaps, structural heterogeneity and the historic dualities that characterize the countries of the region.

This document includes an analysis of the short-term challenges that macroeconomic and social policies must address in order to reactivate the economy and provide protection for the most vulnerable households. It also examines the productive structure and sectoral policies that will guide the countries of the region towards a path of sustainable development.

Challenges for a sustainable recovery

In the wake of subdued economic growth between 2014 and 2019, at an annual average of 0.6%, a historic contraction of 6.9% in 2020 and a recovery of 6.5% in 2021, the Economic Commission for Latin America and the Caribbean (ECLAC) estimates that the region's economies will grow by 3.2% in 2022. Similarly, the downturn is expected to become steeper in the coming years, marking a return to the previous low-growth trend in the region.

Recently, flagging economic growth has gone hand in hand with markedly higher inflation. In June 2022, the 12-month average inflation rate in the region was 8.4%, more than twice the average of 4.1% observed between January 2005 and December 2019.

Inflation trends have been a significant consideration for the countries of the region in setting their monetary policy; stimulus policies adopted at the onset of the pandemic have been replaced by a more contractionary stance, reflecting steep monetary policy rate hikes in nearly all the countries of the region. Despite these measures, inflation is expected to remain high in the near future, driven by the preponderance of supply-side factors, including the prices for key categories such as food, fertilizers and fuel.

Meanwhile, the fiscal situation of the countries of the region has deteriorated owing to considerable outlays to confront the worst of the pandemic crisis and its social consequences. On average, countries are facing wider fiscal deficits and deeper debt than before the pandemic. Gross central government public debt in Latin America reached 56.6% of GDP in 2020, and while it fell to 53.4% in 2021, levels remain at historic highs, similar to those seen 20 years ago. The result has been significant fiscal spending cutbacks compared to 2020, in particular with regard to subsidies and current transfers. In Caribbean countries, central government debt levels rose to 89.3% in 2020, then fell back slightly in 2021 to 88.1%. This high rate of indebtedness is particularly notable in six countries whose debt exceeds 90% of GDP.

The social situation in the region has also deteriorated and poverty levels have spiked, reflecting the effects of the pandemic and the accompanying economic recession. ECLAC estimated that, by 2020, poverty and extreme poverty had reached 33.0% and 13.1%, respectively. By 2021, the incipient economic recovery had resulted in a very modest decline in poverty, to 32.1%, and a marginal but steady increase in extreme poverty, to 13.8%. There was also a significant uptick in income inequality after the onset of the pandemic, halting the downward trend that had been observed in the region since 2002. As discussed in chapter III, rising income inequality continues to weaken the middle-income strata, which has important political and social implications.

As such, public policy dialogue in the region is taking place in a context of significant macroeconomic policy constraints and growing social demands. The countries of the region must therefore adopt policies that boost sustainable growth, ease inflationary pressure, create quality jobs and mitigate social costs while reducing poverty and inequality. These factors pose major challenges for political and governance systems and the technical, operational and political capacities of public institutions.

Fiscal space must be expanded to ensure the sustainability of public spending and avoid unnecessary adjustments that could further deepen the economic slowdown and compromise the capacity to support the most vulnerable. To achieve this, short-term policy options are available that could increase fiscal revenue in the region through measures to reduce tax evasion, review tax expenditures to reduce forgone revenue and update tax codes with new good practices in international and digital economy taxation. Over the medium term, there is a need to consolidate personal income tax, extend the scope of wealth and property taxes, review and update the fiscal frameworks for the exploitation of non-renewable resources and consider environmental and public health taxes. Fiscal and social compacts that make tax regime reform in the region feasible are needed to drive this agenda forward.

On the monetary policy front, authorities need to recognize that price stability, although critical, is not the sole determinant of macrofinancial stability; exchange-rate stability, the management of the economic cycle and capital flows are also important factors, as seen during the pandemic. This point is crucial if monetary policy is to strike a balance between achieving price stability and the need to re-establish growth and investment.

The scope of macroprudential policy in the region is relatively broad and can contribute to monetary policy implementation. The use of macroprudential policy has been trending upward since the global financial crisis of 2008 and became even more widespread during the COVID-19 crisis. Given the current need to stabilize inflation without deepening the recession, central banks need to use all tools at their disposal —both conventional and non-conventional— in a complementary manner.

Conventional monetary instruments, such as interest rate adjustments or changes in reserve requirement rates, should therefore be complemented by other macroprudential policies, such as increases in the provisions for high-risk loans to slow the credit growth rate, if necessary. Similarly, in order to dampen exchange-rate volatility and its impact on price trends, monetary policy rate adjustments should be used along with other instruments, such as exchange-rate interventions (both in the spot and derivatives markets) and macroprudential measures (such as increasing foreign-currency reserves) to manage capital flows.

In addition to facing the difficult challenges of the current context, the economies of the region must reverse the lacklustre investment growth that has prevailed over the last three decades, becoming a structural barrier for development.

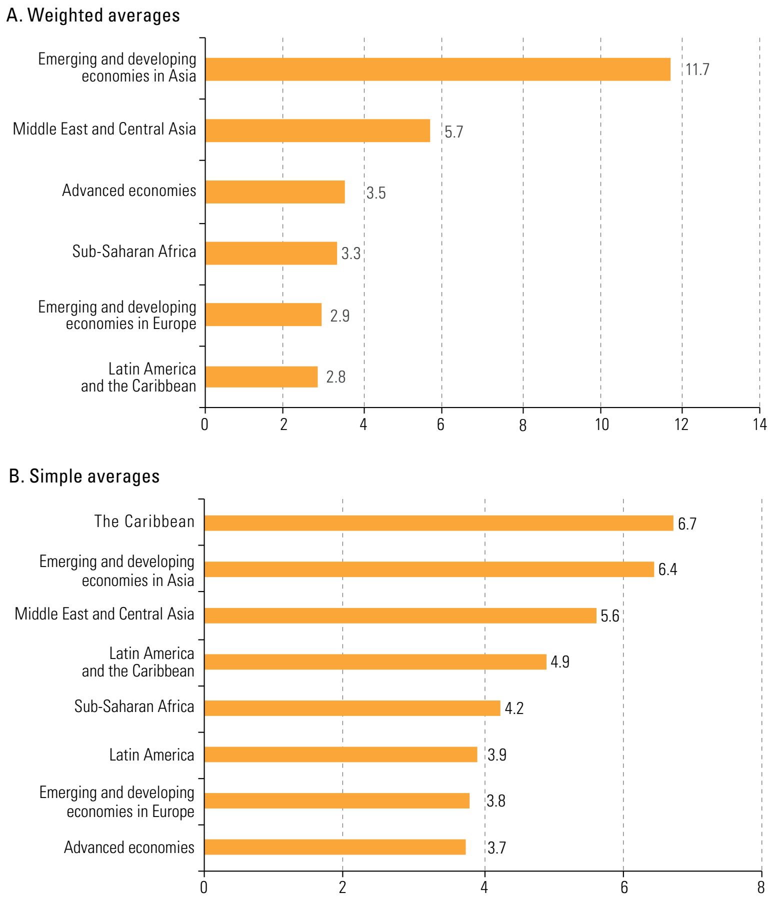
An increase in investment would support the removal of barriers that hinder the adoption of new and better technology and that impede productivity growth in the region's economies.

It is noteworthy that the level of public investment in Latin America and the Caribbean is lower than in other regions of the world in both absolute and relative terms. On average, general government gross fixed capital formation in the region has been significantly lower than the levels seen in emerging and developing Asian economies in recent decades, a period in which Asian countries have built fast-growing and diversified economies (see figure 1).

Limited investment flows have resulted in a stock of public capital that is insufficient to provide economic and social services, boost growth and lay the foundations for sustainable and inclusive development in the region.

In light of the range of short-term challenges the region is facing, there is a need to reconcile different policies aimed at spurring economic recovery and addressing rising inflation and the cost-of-living crisis. It is also important to continue to support the most vulnerable households while strengthening the sustainability of public finances.

Figure 1
Selected groupings and regions: general government gross fixed capital formation, 2019
(Percentages of GDP at constant prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF) "Investment and Capital Stock Dataset" [online] https://data.imf.org/?sk=1CE8A55F-CFA7-4BC0-BCE2-256EE65AC0E4.

Note: Weighted averages are calculated on the basis of purchasing power parity GDP in international dollars at current prices.

One characteristic of economic growth in the region is high real volatility and limited capacity to sustain the expansionary phases of the economic cycle, which tend to be shorter and less buoyant than in other regions, although the contractionary phases tend to be similar. Investment volatility exceeds output volatility and it has been trending upward since the 1990s.

This feature of the economic cycle means that the region faces the challenge of crafting macroeconomic governance approaches that improve its capacity to address and attenuate the effects of adverse shocks through the use of countercyclical policies that spur the expansionary phase of the cycle while also boosting investment. This macroeconomic governance is key to address the challenges of transforming production and supporting that process over the long term.

The main messages and policy recommendations of the chapters of this document are presented below.

I. The present and future of globalization: crises, environmental emergencies and the technological revolution

This chapter underlines that the economic, social and environmental sustainability of Latin American and Caribbean countries is determined not only by internal conditions and restrictions but also by external conditions. Figure 2 shows that, since 2008, the global economy has sustained a series of shocks that have affected the countries of the region. These shocks include the global financial crisis of 2008–2009, economic tensions since 2017 between the United States and Europe, on the one hand, and China on the other, the pandemic crisis since 2020 and the war between the Russian Federation and Ukraine since February 2022.

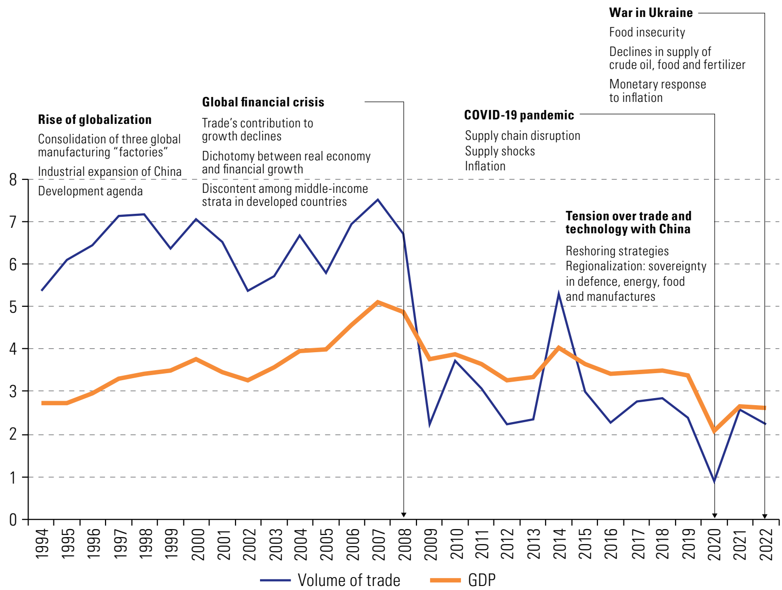
The inflationary process that began in the second half of 2020 and intensified after war broke out in Ukraine has led central banks to withdraw aggregate demand stimulus by raising monetary policy rates and reducing asset purchase programmes. The ability of such policies to anchor inflation expectations can be limited if expectations shift based on factors related to the war, supply chain problems and rises in international transportation costs. In addition, restrictive monetary policy would stifle economic growth and present greater risks for financial systems, potentially heightening the risk of stagflation, in particular in a context of simultaneous rate hikes by the main central banks.

For emerging economies, including those in Latin America and the Caribbean, the picture is even more complex, as efforts to stem inflation have accentuated the tightening of global financial conditions, feeding financial market volatility and global risk aversion. This has affected capital inflows to emerging markets, triggering substantial depreciation of currencies and amplifying shocks from rising energy and food prices.

Figure 2

The rise and downturn in globalization: annual change in world GDP and volumes of international trade, 1994–2022[a]

(Percentages and five-year moving averages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Trade Organization (WTO) and the International Monetary Fund (IMF).

[a] The figures for 2019 are projections.

The cyclical trends of the global economy are developing against the backdrop of two megatrends transforming the structure of globalization and affecting trade and value chains in particular: the environmental emergency and the technology revolution.

While the global economy is facing a growing risk of stagflation, societies are also facing an increasingly acute and uneven environmental crisis. The most alarming indications of the environmental crisis are the loss of biodiversity and ecosystems, pollution and the threat from climate change. To prevent the most severe impacts of climate change and limit temperature increase to 1.5 °C, a reduction in greenhouse gas emissions by 2030 of 38%–63% with respect to 2019 levels is required. By the middle of the twenty-first century, emissions would need to be reduced by around 75%–98%, meaning that the global economy would be virtually carbon-neutral.

The asymmetry in the causes and effects of climate change is twofold. The most developed countries contribute the most to the generation of greenhouse gas emissions and are better prepared to face the negative effects of climate change, while the least developed countries produce the least emissions and are less prepared to face the adverse effects of climate change. Within countries, the wealthiest groups produce more emissions per capita and are better prepared to face the effects of climate change, in contrast with the situation of poorest, which is just the opposite.

In this context, the war between the Russian Federation and Ukraine has triggered a further increase in energy prices whose effect on the energy transition is not yet clear. High fuel prices provide an incentive to substitute fossil fuels with renewable forms of energy; however, high prices may also encourage a new wave of investment in the fossil fuel sector.

In addition, the loss and degradation of biodiversity and terrestrial and marine ecosystem services has important implications for production systems and social well-being and is contributing to the deepening of global crises.

Another important transformation over the last decade is the one driven by digital technologies, which have led to the creation of new goods and services, new business models and value networks, and the emergence of new companies that have reshaped some industries and have become globally dominant. These waves of creative destruction are having transformative socioeconomic effects and have the capacity to alter countries' development trajectories through changes to wealth generation and distribution, owing to their potential impact on well-being, productivity and environmental sustainability. This represents a paradigm shift in both production and employment, which is accelerating transformations in the world of production and in the world of work. The policy challenge is to ensure that creative and innovative trends prevail over and outpace destructive ones, and that the affected social and labour sectors benefit from social protection systems and active labour market policies (employment and training) to take advantage of the opportunities in the new world of work that the technological and digital revolution is creating.

Leveraging the digital transformation's contribution to recovering and rebuilding from the damage caused by the pandemic and to overcoming structural challenges will require comprehensive policy frameworks and governance and implementation mechanisms, which steer the basic factors or drivers of digital transformation, such as: connectivity infrastructure, regulatory frameworks, skilled human resources and institutional and governance architectures. Without a systemic approach to digitalization that reduces inequalities in access and levels the playing field, its potentially beneficial effects could turn detrimental in terms of concentration and inequality. This is particularly important for developing countries that are far from the technological frontier and whose competitive advantages are based on abundant unskilled labour and natural resources, inputs whose relative importance could decline as a result of the expansion of robotics and artificial intelligence and the efficiency gains achieved through smart solutions.

The combination of the fracturing of synergies among the three "global factories" of globalization —East and South-East Asia, Europe and North America— and the war in Ukraine could hasten countries' moves towards self-sufficiency or sovereignty in areas such as health, food security, access to renewable and non-renewable energy sources and production of manufactured goods that are considered strategic, whether high-tech (microprocessors) or mature technologies (fertilizers), as well as their moves towards national or regional control over the companies that produce such goods. Tendencies towards regionalization of the global market could intensify, prioritizing investments in economies that are geographically close or based on national security criteria. In this regard, a new stage of globalization is becoming increasingly apparent, with at least two key characteristics: (i) geopolitical considerations tending to take priority over economic ones in investment decisions and in the organization of global supply chains, as reflected in various forms of renewed regionalism; and (ii) a trend, already abundantly clear in statistics, whereby trade in services is considerably more dynamic than trade in goods, linked to the digital revolution, e-commerce and trade in services enabled or facilitated by information and communications technologies and the Internet. These relatively new trends present both challenges and opportunities for the countries of the region, linked to factors such as nearshoring and the possibility of entering new value chains, not only for goods but also for services.

The global financial crisis, globalization tensions, the pandemic and the effects of the war between the Russian Federation and Ukraine have afflicted a region which was already marked by low growth, underinvestment, deindustrialization, labour informality and underuse of the regional market. The factors that have led to the region's low growth rates and specialization in technologically unsophisticated sectors with sluggish external demand have combined with a very limited acceptance of productive policy approaches that foster creation of new sectors with competitive advantages in terms of technology and external demand. Even at the current juncture, with developed economies launching wide-reaching industrial plans focusing on sustainability and energy and technological sovereignty, the positions of the countries of the region with regard to productive development policies are either ambiguous or are limited to proposals only.

As ECLAC has frequently said, this economic pattern is combined with social patterns of exclusion and inequality stemming from low-growth productive structures, uninclusive educational and vocational training systems, a culture that fuels and reproduces various types of discrimination and exclusion, and with a global environmental crisis that disproportionately affects the region. These circumstances are both the origin and the result of acute shortcomings in the current development model. Remedying the situation will require focused policy efforts and collective action by societies in all areas addressed by the 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals. The following chapters address this appraisal in greater depth and propose policy actions.

II. The production structure and policies for sustainable development

Chapter II of the document discusses the structural forces that have shaped the performance of Latin America and the Caribbean over the past 30 years, in a comparative analysis that sets it beside other regions, to identify the factors that led to the economies of the region failing to achieve convergence with the most developed economies in terms of capacities and income. The starting point is recognition that the global economy is made up of countries with pronounced economic, productive and technological asymmetries that interact closely with distributive and well-being factors, with causality in both directions.

Two main arguments are put forward in this chapter. The first is that the countries that have achieved higher growth rates and successfully narrowed their per capita income gaps with the most advanced countries (convergence) are those that have diversified their production structure towards more technology-intensive sectors that are experiencing faster growth in demand in world markets. In other words, the production structure matters; producing technology-intensive goods is by no means the same as producing low-technology goods, and producing goods with a high income elasticity of demand is not the same as producing goods with slowly expanding global demand. Some specialization patterns are more dynamic than others (on both the supply and demand sides), and this determines the long-run performance of economies.

The second argument is that transformation of the production structure is the outcome of policy choices rather than a fate determined by factor endowments. Factor endowments set their stamp on the growth trajectory, but whether they are a trap or a prop for growth depends on policy. The institutional and political economy dimensions, evolving in tandem with the production structure, determine the pattern of development. Countries that have adopted production transformation and diversification policies and sustained them over time have achieved better long-term growth outcomes than those that have not. Understanding international convergence success stories entails understanding how policies have reshaped prices and incentives to stimulate the emergence of dynamic new sectors.

Some sectors of the economy have higher technology content than others, create more opportunities for innovation and learning, and make larger productivity leaps. The more a country's output and exports are concentrated in these sectors, the more likely it is that its rates of innovation and productivity will be higher than in countries specializing in lower-technology sectors. International data suggest that in Japan and the Asian tigers, 61% of exports come from the specialized and science-based supplier sectors, compared to 52% for the United States and 21% for Latin America and the Caribbean. The share of modern services in total service exports is higher, at around 40%, in advanced economies than in emerging or developing economies, where it is under 30% (except China). In particular, Latin America and the Caribbean is one of the regions with the lowest shares of modern services in exports, accounting for just 19.6% of total services, reflecting the enormous potential for growth and structural transformation of production and employment.

Another indicator that affects the expansion of external demand and foreign markets is the income elasticity of exports and their distribution in each country's export basket. Demand tends to be more income-elastic for goods linked to manufactures, particularly higher-technology goods, than for goods related to natural resources. Moreover, external demand for natural resources is not only slower-growing, but also more vulnerable to sharp fluctuations and price instability in markets.

These data show that technology intensity and income elasticity of demand overlap considerably and can interact beneficially to form virtuous circles. This is a key source of higher returns involving innovation, structural change and growth. In short, there are higher returns when innovation and market expansion (and growth in effective demand) support each other.

Data also indicate that increased economic sophistication is closely tied to lower greenhouse gas emission intensity per unit of value, as well as lower per capita greenhouse gas emissions, after controlling for GDP. This is a result, first, of a higher GDP share of manufacturing, which is less emissions-intensive, and second of low-carbon innovations, technologies, practices and solutions necessarily entailing an increase in the amount of knowledge embedded in the production structure of an economy, which is part and parcel of economic complexity. In other words, structural change not only enables a shift to segments with higher economic value, but also a reduction in pollution per unit of economic value.

The low levels of investment and productivity seen over the last three decades, and their downward trends, are the result of the limited capacity of the countries of the region to make and maintain necessary changes to their production structures.

In addition, public investment has not acted as a driver for private investment. In 2019, weighted average general government gross fixed capital formation in the region was 2.8% of GDP, which contrasts sharply with the values for advanced economies and emerging and developing Asia. The region's low level of public investment is evident when compared with emerging and developing Asia (weighted averages of 2.8% and 11.7% of GDP, respectively), driven by the rapid growth of China, whose public investment in 2019 was equivalent to 17.3% of GDP.

Together with unfavourable trends in productivity and investment, since the 1990s productive policies and the institutional capacity of the State have both diminished in the countries of Latin America and the Caribbean.

Although the countries of the region have applied productive development policies, they have not disrupted the make-up of the productive structure of Latin America and the Caribbean, owing to the characteristics of the policies implemented and the institutional framework that has pursued them. The policies were often discontinued or assigned to ministries and secretariats with limited political influence and institutional capacities. The productive, industrial and technological policy initiatives were not completely abandoned, but they never received the institutional and political support or capacities necessary for effective implementation.

This reflects the importance of having more proactive productive development policies to promote technological sophistication and productive diversification, accelerate productivity growth, hasten learning processes, increase innovation capabilities, foster productive linkages, increase the capacity to assimilate medium and high technologies, enter new industries, markets and value chains and change the vicious pattern of structural transformation for a virtuous one in which workers move from low-productivity to higher-productivity sectors. Productive development policy itself is where the key tools lie for pursuing these objectives and driving patterns of structural change, growth and employment.

COVID-19 has caused enormous damage to the productive fabric of all countries. The severe economic contraction of 2020 brought with it a tragedy in terms of employment and severe damage to the productive fabric and human capital, widespread company closures and badly damaged sectors, whose recovery will take years.

The need for change in productive development policies was clear even before the pandemic, but the health crisis has made the issue one of the top priorities of public policy and a core element of any national strategy for reconstruction with transformation.

III. Inequality, employment and social policy

Growth in formal employment and social policies were two key factors behind the good results achieved in the fight against poverty and inequality in Latin America and the Caribbean between 2004 and 2012. Chapter III of the document looks at these two factors and their interaction with other sources of inequality, such as those relating to gender and race and those originating from environmental degradation. The chapter argues that productive transformation is vital to creating more formal jobs with higher productivity, that inequality limits productivity growth meaning that reducing inequality also contributes to economic and job growth, and that universal social protection is not only a moral imperative of development but also contributes to both social justice and economic growth and resilience. This is why the region must aim to move towards welfare states.

A. Productive transformation and employment

The productivity gap between the economies of the region and developed economies is widening. Productivity gaps, however, tend to be even wider within countries, between urban and rural areas and among economic sectors such as agriculture, commerce, services and industry, between the formal and informal sectors of economies, and between production units focused on international markets and those that serve local markets.

This chapter explains how more diversified and more technology-intensive production structures enable higher productivity levels and support higher employment rates. In addition, higher growth rates make labour productivity growth compatible with employment growth.

Structural heterogeneity is most visible in the proportion of low-productivity employment in total employment. Low productivity can be seen as a quantitative proxy for labour informality, which is a structural phenomenon in Latin American and Caribbean countries. The two concepts —very low-productivity jobs and informal jobs— are used interchangeably in this section.

In 2000, around half of urban employment was in the informal sector, whose productivity accounted for just 30% of overall productivity and 20% of formal sector productivity. Figure 3 shows the widening gap between formal and informal sector productivity in eight countries in the region and the large wage gap between the two sectors. The burden of structural heterogeneity magnified successive crises, especially the crisis caused by the COVID-19 pandemic.

Figure 3
Latin America (8 countries):[a] productivity gap and wage gap between formal and informal sector workers, 2000–2018
(Percentages)

A. Productivity gap

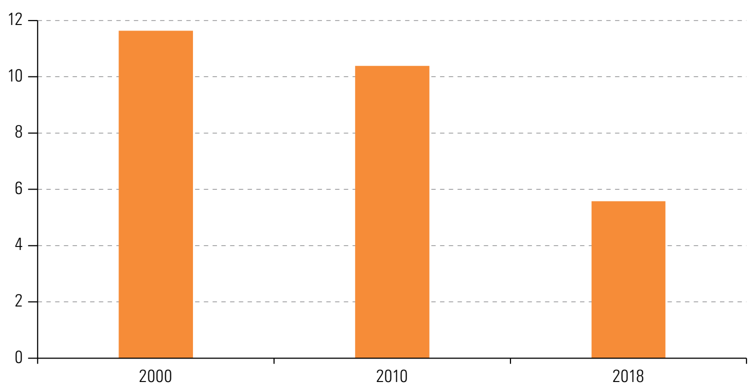
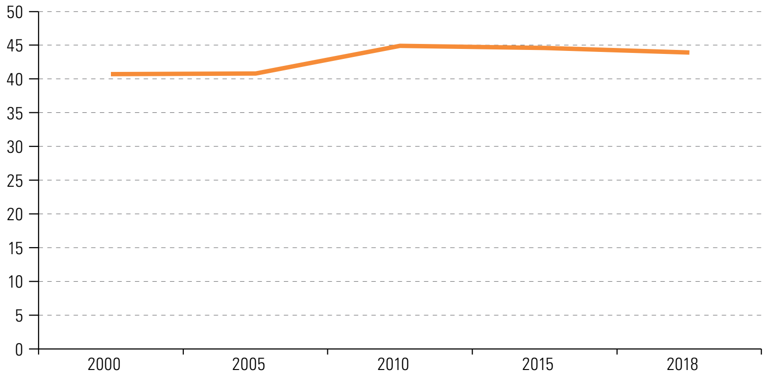


Figure 3 (concluded)

B. Wage gap

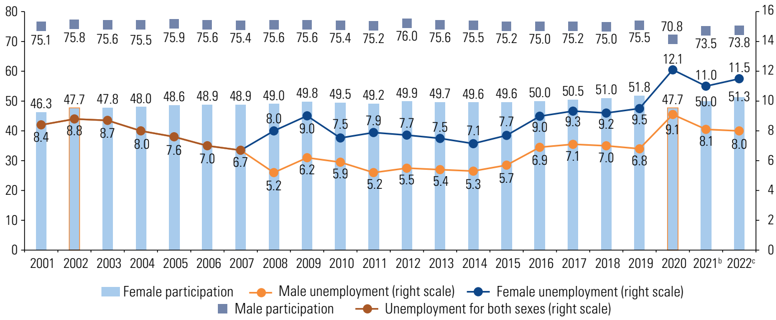


Source: Economic Commission for Latin America and the Caribbean (ECLAC).
Note: The informal sector comprises low-productivity activities and includes the following categories: domestic service, non-professional wage earners, unpaid family workers, and persons employed in microenterprises with fewer than five workers. Estimates of employment distribution and labour productivity are based on ECLAC data derived from national household surveys. Labour productivity in the informal sector is estimated from the average income of informal workers, which is considered a good proxy for the value added generated by the informal sector, owing to the nature of the activities performed in it.
[a] The countries included in the sample are Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and the Plurinational State of Bolivia.

In the first quarters of 2020, the health crisis had noticeable effects on the region's labour markets and weighed heavily on informal workers in particular. This was unprecedented, since in other crises, while formal employment fell, informal jobs played a countercyclical role and increased. During the COVID-19 pandemic, however, informal employment did not serve as a refuge or alternative for wage earners who had lost their jobs to access employment. This decline in access to informal jobs affected young people, lower-skilled workers and women the most.

Moreover, the aggregate employment rate masks considerable gender differences. As shown in figure 4, the labour force participation rate is much lower for women than for men in Latin America and the Caribbean. Similarly, the unemployment rate is higher for women than for men, a gap that widened during the pandemic.

Figure 4
Latin America and the Caribbean (24 countries):[a] participation rate and unemployment rate, by sex, weighted average, 2001–2022
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean, 2021* (LC/PUB.2022/1-P), Santiago, 2022, official figures from the countries and projections.

[a] Includes Argentina, Bahamas, Barbados, Belize, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia, Trinidad and Tobago and Uruguay. Figures for 2019 do not include the Bolivarian Republic of Venezuela.

[b] Estimates for 2021 from *Preliminary Overview of the Economies of Latin America and the Caribbean, 2021.*

[c] Projections for 2022 from *Preliminary Overview of the Economies of Latin America and the Caribbean, 2021.*

One characteristic of the region's economies is the vulnerability of the middle-income sectors. Between the early 2000s and the mid-2010s, a large number of households moved out of poverty and into the middle-income strata, from 26.9% of the population in 2002 to just over 41.1% in 2017.

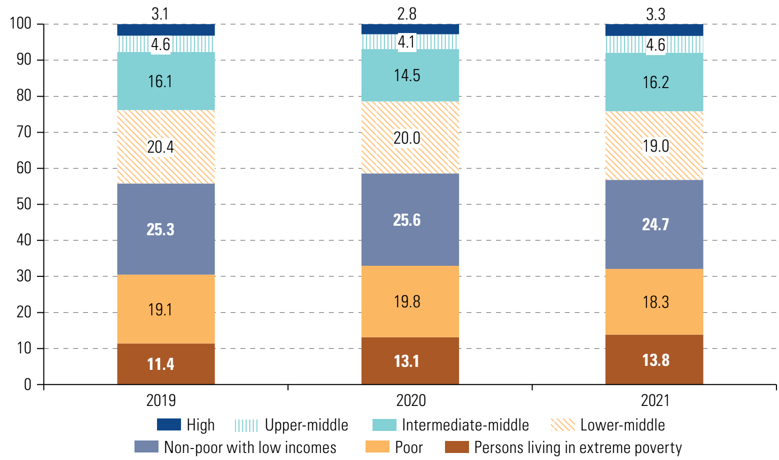
In 2019, the middle-income strata continued to represent 41.1% of the population, but amid the pandemic, the situation of these strata worsened and the number living in poverty increased. For 2021, ECLAC projections pointed to a recovery in the share of the middle- and upper-income strata, albeit at lower levels than before the COVID-19 pandemic (see figure 5).

For reasons related to both the production structure and gaps in social protection systems, and to the complex global and regional juncture, there are no guarantees of the stability and continuity of advances made in the expansion of the middle-income group. On the contrary, as the pandemic has shown, people in vulnerable strata make up most of the population, whether they are living in poverty or are likely to fall back into poverty in the event of any negative economic shocks.

Figure 5

Latin America: population distribution by income stratum, 2019–2021[a]

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America*, 2021 (LC/PUB.2021/17-P), Santiago, 2022, on the basis of Household Survey Data Bank (BADEHOG).

[a] The figures for 2021 are projections.

In recent years, migration has intensified among the countries of the region. Through their work and the taxes they pay, international migrants contribute to the development and GDP growth of destination countries. The work of migrants also makes significant contributions to countries and households of origin through remittances, which provide income to meet basic needs. Remittances have been resilient during the social and health crisis caused by the pandemic: flows to Latin America and the Caribbean amounted to US$ 127.6 billion in 2021, 26% more than in 2020.

In terms of access to formal employment and social protection, significant gaps remain in Latin America and the Caribbean between the native-born population and the migrant population. The lack of decent work is a key factor affecting migrant workers in the region and is related to problems with legalization and the absence of institutions to foster their labour market inclusion.

B. Social protection, growth and resilience

Inequality is a distinctive feature of the region and, among its determinants, climate change has significant distributional effects within and between countries. Although climate change is a global phenomenon, its distributional effects are highly unequal, as it reflects and reinforces a fundamental asymmetry, at both the international and national levels: those who contribute the most to generating it are those who suffer the least from its effects or have the best chance of minimizing them.

One particularly important aspect of the regressive effects of climate change is the increase in poverty levels in Latin America and the Caribbean. Estimates indicate that a 1 °C increase in the average annual temperature leads to a reduction in the real per capita GDP growth rate of around 1 percentage point, pointing to an increase of between 2 million and 16.7 million people living in poverty and between 1.1 and 9.6 million people in extreme poverty by 2030 as a result of climate change.

The problems of informality, migration, poverty and inequality are aggravated by the lack of universal and good-quality social protection systems. In Latin America and the Caribbean, the welfare state is truncated, with piecemeal and fragmented social protection systems.

The countries of the region are lagging behind in building a welfare state. Public policy has yet to fully assume the challenge of transitioning towards systems with universal access to certain goods and services that are key to well-being and increasing productivity (for example, health and education). This transition is the necessary complement to the issues of productivity and international competitiveness in sustainable development policies.

The pandemic produced renewed appreciation of the value of public action in general, and of public services and social protection systems in particular, as societal assets for facing adversity and building resilience for managing change and transitioning towards sustainable models, while ensuring dignity and well-being and limiting the uncertainty and vulnerability faced by all, not only those in the lowest strata of society. In that regard, ECLAC has called for the building of true welfare states as a foundation for sustainable development in a context of greater equality. ECLAC has envisioned a social compact as a political instrument based on broad and participatory dialogue that enables the attainment of long-term consensus and agreements that are adapted to this new reality. From this perspective, the concept of a social compact must be accompanied by a progressive fiscal covenant and very specific goals, such as providing financial sustainability for broad-based social protection that benefits the population as a whole and receives sustained social and political support.

IV. Sectoral considerations: drivers of sustainable development

ECLAC has insisted that macroeconomic policies are very important for structural change and productive development, but also that microeconomic and sectoral policies are key. In other words, both cross-cutting and sectoral industrial or productive development policies are required. Countries that have focused on having a stable macroeconomy but lack sectoral strategies at the microeconomic level have not performed well. In other words, the policy instruments for accelerating growth and economic transformation, and moving the needles of productivity, innovation and productive development are based on sectoral policies, with a modern vision that productive development is a social construct and an iterative collaboration between the key agents and actors of the productive chains and sectoral agglomerations of companies or clusters.

ECLAC has proposed that the region consider a group of sectors that can boost productive and structural transformation, along with investment and job creation. These sectors are: energy, e-mobility, the circular economy, the bioeconomy, the health-care manufacturing industry, digital transformation, the care economy, tourism, micro-, small and medium-sized enterprises (MSMEs) and the social and solidarity economy. The following is a summary of the driving potential of each of these sectors, which is discussed at length in chapter IV of the document.

A. The energy transition

The energy transition to tackle the environmental crisis is central to advancing on a path of sustainable development. In the past 50 years, renewable sources have risen sharply in the region, increasing from 25% of primary supply in 1971 to 34% in 2020, which has reduced the energy intensity of GDP, although progress remains to be made in energy efficiency by sector. Public policies for energy transition must be encouraged in order to advance in five areas: increasing renewable sources in the energy mix; universalizing access to electricity and reducing energy poverty; increasing energy efficiency; strengthening regional energy integration and interconnection; and increasing energy security and resilience to external shocks. The equivalent of 1.3% of GDP per year must be invested over a decade to universalize access to fully renewable electricity and create seven million green jobs, modernize infrastructure and update regulation to attract investment and eliminate fossil fuel subsidies. It is crucial to promote renewable sources, mainly wind and solar, to make progress on these objectives. Two areas of growing importance should also be incorporated: green hydrogen and lithium.

In this context, the region requires a strategic vision and a sense of urgency to implement national public policies and regional institutional arrangements that —based on the lithium industry and other key minerals— boost the capacity to produce technologies in niche markets in the battery sector and linkages in a regional e-mobility market. In particular, it is necessary to develop more efficient technologies for water use in lithium extraction from salt flats; increase the production of battery-grade lithium carbonate; advance in direct extraction technologies without increasing environmental footprints; advance in the production of active materials (precursors), cathodes, cells and batteries; and foster the circular economy around lithium-ion batteries.

B. E-mobility

Urban mobility is undergoing profound transformation and presents significant opportunities. Global trends indicate that the future of the automotive sector will be electric, amid the adoption of new regulations in many countries, mainly developed economies. Latin American and

Caribbean countries have been unable to assume a clearly defined position in an international scenario characterized by the rapid consolidation of new market dynamics, business models, leading companies and technological options. In the electric car segment, more ambitious and long-term coherent policies are required to boost demand. That support should be combined with actions to accelerate the transformation of existing local capacities and to create ventures for the development of the production chain. Public policies should statrt by offering incentives for accelerating the refitting of production lines and by giving signals regarding the creation of a stable and growing local electric vehicle market.

In electric bus manufacturing, the deployment of the industry in the region requires the creation of a market that ensures predictable demand and an adequate scale of production. The regional outlook appears favourable, albeit challenging, for the automotive sector's transition to the new technological model. Demand predictability —in terms of the unit numbers required and their technical specifications— and a rising supply require an explicit, credible and clear political will to align the various interests and needs involved.

C. The circular economy

Another strategic sector is the circular economy, a transformational model of production and consumption which involves the optimization of resources, technological innovation and the development of new business models that reduce resource extraction and dependence on imported inputs in global chains. Initiatives in the region include national circular economy road maps and strategies, waste management policies, extended producer responsibility laws, initiatives to promote material resource efficiency and recycling targets.

To leverage the positive effects of the circular economy on GDP, job creation and greenhouse gas emission reductions, comprehensive and more collaborative solutions are needed among businesses to use resources efficiently. Training and research, the development of information systems and coordination and cooperation between actors are necessary, while trade agreements are an opportunity to include circularity principles and criteria.

D. The bioeconomy

The bioeconomy is also suited to the development of policies aimed at structural change that promotes sustainability and the transformation of the extractive development model. Of particular importance are the areas of knowledge creation and its application in high value added products, such as biotechnology applications in agriculture (development of bioinputs and genetic improvement of plants for adaptation to climate change, among others), agroindustry (such as the use of secondary metabolites in plants to be used as colourants, flavourings, texturizers), pharmacology (drug development) and biomanufacturing (substitution of fossil inputs with biological inputs in the production of intermediate and final goods). In order to take full advantage of the potential of the bioeconomy, integrative policy approaches are needed that promote convergence between productive development and environmental protection policies, collaboration between the public, private and science and technology sectors, along with the coordination of incentives, investments and efforts in research, development and innovation. An enabling environment is also essential, including investment in science and technology in biological and life sciences, fostering vocations in science, technology, engineering and mathematics (STEM), building regulatory and oversight capacity, developing innovative financing mechanisms, and building infrastructure to facilitate collaborative design and prototyping.

E. The health-care manufacturing industry

The pandemic highlighted health, economic, social and productive vulnerabilities and positioned the health-care manufacturing industry as an important sector for future investment. Critical episodes of lack of access to medical equipment and then to vaccines stemmed not only from asymmetries in access for developed and developing countries, but also from long-standing structural problems, in particular the insufficient development of regional productive capacities in the industry.

The region runs a persistent deficit in its trade in pharmaceutical products, and the value of its imports in 2018–2020 was almost five times that of its exports. The heavy reliance on extraregional supply for medicines with valid patents and active ingredients explains the region’s persistent trade deficit.

It was against this backdrop that in 2021, ECLAC, at the request of the Government of Mexico in its capacity as pro tempore Chair of the Community of Latin American and Caribbean States (CELAC), prepared a regional plan for self-sufficiency in health matters.[1] This plan defines an agenda and a multilateral approach to enhance the productive capacities of the health manufacturing industry at the regional level. It consists of seven lines of action to strengthen regional capacities for research, development and production of vaccines and drugs. Thus, the aim is to strengthen mechanisms for pooled international procurement of vaccines and essential medicines, use public procurement mechanisms for medicines to develop regional markets, create consortiums for the development and production of vaccines, implement a regional clinical trials platform, take advantage of regulatory flexibilities to gain access to intellectual property, strengthen regulatory convergence and recognition mechanisms, and strengthen primary health systems for equitable distribution of vaccines and universal access to them.

F. Digital transformation

The digital revolution is shaping the future of globalization. Countries' competitiveness will depend increasingly on the ability of companies in traditional sectors to create value by incorporating digital technologies into their business and production models. Digitalization can also improve aspects related to quality of life, in addition to income levels and working conditions, by creating work opportunities through entrepreneurship or professional development linked to digital capabilities, or providing options that facilitate work-life balance, such as teleworking solutions. Similarly, in the health, education and government sectors, the use of digital solutions can improve service provision and coverage.

The region's development strategy should aim to promote the digital economy through the emergence of new sectors linked to technological ventures and to accelerate the digitalization of the productive sectors in which it is competitive (e.g. agriculture and food, mining and oil), in order to make processes more efficient

1 *Plan for self-sufficiency in health matters in Latin America and the Caribbean: Lines of action and proposals* (LC/TS.2021/115), Santiago, 2021.

and sustainable. In this sense, competitive advantages will depend increasingly on countries' ability to develop the technologies of this new paradigm and to adopt them in their economic apparatus in the three dimensions that determine digital development: the connected economy, the digital economy and the digitalized economy.

The countries of the region are moving in this direction, albeit with different priorities depending on their degree of development in digital transformation and their production structure. Despite advances in connectivity, there is still a significant gap that excludes the poorest segments and inhabitants of rural areas, as well as smaller companies, from the benefits of digitalization.

The region's digital development must be accelerated with policies aimed at: (i) building an inclusive digital society, expanding service coverage and improving the quality of broadband services with affordability; (ii) fostering digital transformation in the production sector through the adoption of advanced technologies and solutions in value chains and innovative ecosystems; (iii) strengthening digital trust and security in the use of digital services and solutions; (iv) promoting fair and competitive digital markets with adequate regulation; (v) strengthening regional digital cooperation through greater coordination on cross-border issues, promoting a regional digital market and taking advantage of the platform offered by the Ministerial Conference on the Information Society in Latin America and the Caribbean; and (vi) ensuring there are financing mechanisms for the lines of action corresponding to these policies.

G. The care economy

The care economy is a central economic sector for boosting growth, reducing gender inequalities and facilitating women's participation in the labour market. Gender inequality in Latin America and the Caribbean is structural and inseparable from the development model.

The pandemic has thrown into relief the consequences of the sexual division of labour and the persistence of patriarchal cultural patterns that assign women the main responsibility for paid or unpaid care. In particular, there was an enormous outflow of women from the labour market between the second quarter of 2019 and the same period in 2020 that represented an 18-year setback in women's labour force participation. Although there has been some recovery in this participation since 2021, it is still slow and uneven, as it does not match the levels of recovery in men's employment. Investment in care policies is strategic as it breaks the vicious circle of poverty and exclusion, and at the same time can lead to a virtuous circle to advance sustainable and inclusive development. First, this investment alleviates women's excessive care burden and lowers the opportunity cost of their participation in the labour market. Second, it can generate jobs and boost other sectors of the economy, public works or indirect services linked to care. This increased economic activity can pay back the initial investment through increased tax revenues.

H. Sustainable tourism

One area of growing importance in many countries in the region is sustainable tourism for job creation. Tourism is a key generator of foreign exchange, income and employment in Mexico and Central America (Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua and Panama), and in the Caribbean. The pandemic caused a prolonged suspension of tourism activities.

While some economies recovered rapidly, others continue to lag behind. The tourism sector must be rebuilt in a more inclusive, sustainable and resilient manner. It is necessary to increase investment in health, safety and risk management; work to provide favourable and inclusive labour, business and socioeconomic conditions; understand the increasingly important role of environmental sustainability; take advantage of the benefits of digitalization and foster cooperation between countries to ensure resilient responses to future crises.

I. MSMEs and the social and solidarity economy

Another strategy to boost job creation is to leverage the potential of MSMEs and the social and solidarity economy. The economies of the region are characterized by a pronounced dualism between large fast-growing companies and microenterprises with low productivity. This dualism is even more marked in the case of the informal economy, which is composed largely of smaller companies, especially microenterprises. There are large schooling gaps among workers and income gaps among companies of different sizes and among levels of formality of employment, reflected in a lower capacity to learn and adapt to ongoing technological transformations. Consequently, smaller companies and production processes that make use of informal employment have a lower capacity to maintain employment and build productive and technological capabilities.

There is also a territorial element of productive heterogeneity, since the fastest-growing productive capacities are concentrated in countries' capitals, where large companies and technological capacities are generally located, while in non-central, semi-peripheral or peripheral regions microenterprises account for a larger proportion of employment. Overcoming this heterogeneity requires policies to enhance the productive capacities of the less advantaged segments and foster their integration with the faster-growing and more innovative segments. One sector that has received increasing attention in the countries of the region is the social and solidarity economy, which has also been a focus of productive development policies to address the challenges faced by smaller enterprises and informal employment. The social and solidarity economy comprises organizations such as cooperatives, associations, mutual institutions, foundations, social enterprises, self-help groups and other entities that operate according to the values and principles of mutual assistance and participation.

V. Policies to transform the development model

Chapter V of the document discusses the severe impact of the succession of crises that have affected the region over more than a decade and how that impact has combined with long-standing structural problems. Overcoming those problems and the lock-in effects that hold the region back and keep it on a slow-investment and low-growth trajectory requires implementation not only of macroeconomic policies for development but also a wide range of industrial, social and environmental policies with a strong sectoral dimension. Of the strategies and policies proposed in the document, some deserve to be emphasized.

Firstly, it is urgent to take action to recover the required levels of investment and growth. Secondly, it is vital to recognize that the role of the State is crucial and irreplaceable in all its dimensions, from interlinking proposals and providing financing on a scale not easily accessible to the private sector to defining regulatory models and formulating and implementing policy. Thirdly, there is a need not only to interlink sectoral and general policies but also to create space for stakeholders to negotiate, make decisions and take action while acknowledging their different capacities, advantages and limits.

In order to coordinate such a plethora of problems and policy alternatives, ECLAC has reiterated the need to move forward with fiscal, productive, social and environmental pacts, to overcome the problems of the current situation and to transition, over the long term, to sustainable, cohesive and resilient societies, in short, progressing towards a welfare state that is part of a care society.

Planning can open up space for participatory discussion so that development stakeholders, led by the State, can build a sustainability narrative and a shared vision of the future they seek. Development planning should be strengthened, especially with respect to the foresight capacities of States, in order to build scenarios for probable futures and deepen ownership by society, by working with academia, the private sector and civil society. There is also a need to strengthen capacities for openness, participation, negotiation and planning for territorial development and to mainstream risk and disaster management. Lastly, collaborative leadership will be needed to ensure the effectiveness of coordination of sectoral policies and cross-cutting approaches in national planning.

To address the current economic and social situation, comprehensive macroeconomic policies must be formulated and implemented, interlinking goals in areas such as of price stability, strengthening of the financial sector, promotion of employment, protection of the most vulnerable and encouragement of an investment pattern focused on closing structural gaps.

In terms of monetary policy, monetary authorities in the region should therefore continue to use multiple tools —such as intervention in foreign-exchange markets, diversification of foreign-exchange instruments and macroprudential measures focused on foreign-currency balances and capital control— to maintain macrofinancial stability and avoid amplifying the channels for pass-through of excessive exchange-rate fluctuations.

Cultivating a paradigm shift in fiscal policy in the region will require new fiscal and social compacts, strengthening recurrent tax revenues to ensure the sustainability of the growing spending needed to meet social demands and the investment challenges that must be addressed to boost productivity and respond to climate change. In this context, the sustainability of fiscal policy should be based on strengthening tax revenues and making tax systems more progressive. In addition, a strategic approach must be adopted with regard to public spending, to improve its effectiveness and target actions with high economic, social and environmental returns.

An agenda for a new fiscal framework must take into account the need to pursue administrative and tax management measures that successfully shore up revenues in the short term, and the need to forge political and social compacts, so that in the medium term, tax systems can be reformed to make them more progressive and increase recurrent revenues, with a view to meeting well-being, investment and environmental sustainability needs in the countries of the region. There are multiple opportunities to boost tax collection in the short term, including by reducing tax evasion, which results in significant loss of tax revenues in the region, estimated to have amounted to US$ 325 billion in 2018, equivalent to 6.1% of regional GDP. Another area to reconsider in the short term is the application of preferential tax treatment (also known as tax expenditure), which results in average forgone revenue of around 3.7% of GDP in Latin America, equivalent to 17% of central government budgeted spending. There are also substantial opportunities in the region to broaden the tax base for environment-related taxes —such as selective taxes on energy and fuel consumption— and taxes related to public health objectives. In the medium term, it will be important to move forward with measures to strengthen collection of direct taxes on income, property and wealth to close tax gaps between the region and Organisation for Economic Co-operation and Development (OECD) countries.

A central task in moving towards sustainable development is the consolidation of welfare states. In turn, social protection is key to achieving structural change with equality and sustainability and is at the core of the gradual construction of welfare states. At a time of great uncertainty characterized by a multitude of risks and shocks, the creation of comprehensive, sustainable and resilient social protection systems is essential. Efforts to strengthen social protection systems should aim to guarantee access to universal, quality public services from a life-cycle perspective, beginning by safeguarding children and their families and establishing minimum guaranteed protection levels for older persons.

As labour inclusion is the key to closing inequality gaps, coordination is needed between policies for labour regulation, social protection and economic and production development. It is essential to adopt active policies aimed at removing access barriers for persons and groups that experience various types of inequality, discrimination and exclusion, including older persons, migrants, indigenous peoples and Afrodescendent populations.

Care systems are a pillar of rights-based and socially conscious States. Building a care society, in the context of a transformation towards sustainable and equitable growth, is the way forward —in synergy with the economic and environmental dimensions— to reverse social and gender inequality, counter the increasing precariousness of care and highlight the multiplier effects of the care economy. The right to care is universal, indivisible and must be guaranteed for all people throughout their lives. In order to guarantee the right to care, States must strengthen their coordination and regulation capacities to achieve efficient public policy management capable of ensuring quality and avoiding segmentation in access to care services.

The promotion of gender equality policies, universal access to social protection and the creation and strengthening of care systems will only be possible through consensus-based and participatory action on the basis of development compacts. Firstly, fiscal agreements are needed to expand fiscal space and promote progressive taxation to support social investment. Secondly, actions and policies must be implemented in the area of social protection to address changes in the world of work. Lastly, a gender-sensitive environmental compact must be reached.

One of the main challenges of the transition to low-carbon economies involves redirecting incentives to shift relative returns towards these economies. This concerted effort should be deliberate, coordinated and coherent; it is a task that governments alone can perform, within an international framework of shared values for this new orientation and therefore with an effective combination of regulatory, fiscal and financial signals.

Proper regulation strengthens the legal framework and provides legal certainty for alternative energy sectors. Regulations are required to open up value chains to zero-emissions vehicles, recycled materials and the production and consumption of green hydrogen and to bridge the gap in quality housing. This calls for business models that make private investment viable through legal certainty.

Continuity in policy and systems of incentives and disincentives requires both global and local sociopolitical agreements on sustainability, which are easier to consolidate in peaceful, just and inclusive societies. The link between sustainable development, the right to a healthy environment, building fair, informed and participatory societies and strengthening institutions and the rule of law is acknowledged and promoted in the Regional Agreement on Access to Information, Public Participation and Justice in Environmental Matters in Latin America and the Caribbean (Escazú Agreement). The Agreement, which has been in force since 22 April 2021, has 13 States parties and 24 signatories, and emphasizes democratic principles that are essential for progress in sustainable development policies.

Moving toward low-carbon economies requires a new form of governance of natural resources. The region has large endowments of biological and other natural resources, whose management does not adequately contribute to inclusive and sustainable development. In light of the climate emergency, progress must be made on gradual decoupling (absolute and relative) of the economy from materials, water, energy and pollution.

The region must make strategic transitions in the governance of natural resources to enable those resources to contribute to sustainable structural change. The document identifies key factors in ensuring that natural resource management in the region focuses on an environmentally sustainable and socially just transition, supported by renewed fiscal frameworks to increase transparency and capture economic rents.

Progress on implementation of industrial and technological policies is central to sustainable development. To overcome the new challenges it faces, Latin America and the Caribbean must adopt a new approach to production policy that broadens both its objectives and intervention mechanisms and instruments while strengthening its underlying institutional framework. The goal of industrial policy is no longer simply to contribute to gradual structural change; it is now also an instrument of change that can contribute in a deliberate and direct way to other societal objectives such as improving the environment and fostering strategic autonomous production and social inclusion. Given the magnitude of the efforts needed to achieve these objectives, the battery of industrial policy instruments needs to be perfected and expanded. In addition to those that are sector-specific, other mechanisms and incentives form part of policies on science, technology and innovation, foreign trade, attracting foreign direct investment, research and capacity-building, decentralization, MSMEs and public procurement.

Regional integration must play a central role in supporting these efforts. Intraregional trade, which peaked in 2008 at 22% of total exports in the region, has been trending downward since, reaching just 15% of total exports in 2021, one of the lowest rates in the world.

For new regional production chains to be economically viable, a broad and stable market must be fostered. It should create efficiencies of scale while minimizing the transaction costs related to the cross-border integration of production. Better provision and quality of regional infrastructure would reduce the transaction costs associated with moving inputs and end products, thus allowing production from rural and remote areas to reach markets at competitive prices and facilitating the development of new economic activities. The reinvigoration of regional economic integration requires greater coordination on digital matters among the subregional groupings, with a view to establishing thematic priorities and determining how to put them into operation.

This calls for integration initiatives that transcend existing agreements and foster convergence between the various subregional groupings. In addition to tariffs, where significant headway has been made, the convergence agenda includes crucial topics such as the strategic use of national procurement systems, regulatory harmonization and the drafting of regional trade facilitation agreements.

In a regional and international context of weak growth, high inflation and growing inequality, the countries of Latin America and the Caribbean must focus policies on reactivating, rebuilding and transforming economic and production systems to advance towards low-carbon and high-tech economies that address climate change and reduce their historical gaps, structural heterogeneity and dualism.

This document considers the complex conditions that pose significant challenges to accelerating growth, tackling high inflation and the cost-of-living crisis, maintaining transfers to the most vulnerable households, mitigating the social costs of the crisis and boosting investment.

Its chapters analyse the dynamics of globalization and the policy challenges in changing the production structure and moving towards sustainable development. In addition, they consider strategies for reducing inequality and creating universal protection systems and decent jobs in a challenging world. Nine strategic sectors expected to drive a big push for sustainability are examined through the prism of green growth. The document concludes with policy recommendations for advancing towards a renewed model for inclusive and sustainable growth.

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