Development Traps in Latin America and the Caribbean

Vital Transformations and How to Manage Them

Fortieth session of ECLAC

Lima, 9–11 October

2024

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Foreword

This report posits that Latin America and the Caribbean faces three development traps: low capacity for growth; high inequality and low social mobility and cohesion; and weak institutional capacities and governance. These traps pose significant obstacles to a more productive, inclusive and sustainable future; it is, therefore, no exaggeration to say that the region is in a development crisis. Added to these traps are the challenges of climate change and fostering environmentally sustainable development.

This development crisis coincides and is interwoven with an international context that has changed considerably in the last decade —both on the geo-economic and geopolitical fronts— and which is shifting towards a new set of rules for trade and investment. This new context presents challenges and opportunities for the countries of the region.

The confluence of the reshaping of globalization —and its attendant technological, demographic, climate-related and geopolitical trends— and the three development traps as well as the legacy of gaps the region has not yet bridged highlights the need for new and creative thinking on how to break from these traps and close these gaps. While a "business as usual" approach may help in some areas where policies are yielding results, there is a great need to rethink policies, not only in terms of what to do but also how to do it.

For its fortieth session, the Economic Commission for Latin America and the Caribbean (ECLAC) is presenting countries with some innovations with regard to the analysis of and the ways to address regional development challenges.

In its analysis, ECLAC identifies the three abovementioned traps and a decalogue of development gaps, some of which are related to the traps. In terms of "what" must be done, 11 great transformations deemed vital for moving towards more productive, inclusive and sustainable development are suggested. Of these, three have been selected for in-depth analysis, with an emphasis on 'how' to achieve them: (i) the great productive transformation for higher, sustained, inclusive and sustainable growth; (ii) the great transformation to reduce inequality and foster inclusion and social mobility; and (iii) the great transformation to boost sustainability and combat climate change.

Latin American and Caribbean countries have a long history of reforms designed to transform different aspects of their development patterns, from State-led strategies to strategies relying more on markets, deregulation and economic opening. The State-market dichotomy does not offer adequate solutions, but potentially even a harmful way of thinking about the conditions and processes of transformation, because it oversimplifies the complexity of these processes and can lead to discussions that are more ideological than practical.

For this reason, in answer to the question of "how", instead of a discussion centred on the State-market dichotomy, a more pragmatic conversation is being encouraged on how to manage transformations, in particular looking at the forms and characteristics of governance of the transformation in each area; the technical, operational, political and prospective capabilities of the institutions leading these transformations; the spaces for social dialogue; and the political economy of the reforms.

International experience shows that the process whereby policies are designed, adopted and implemented is as important as their content, since they are formulated and implemented in specific contexts with certain institutional capacities shaped by the challenges posed by global economic and geopolitical conditions. Therefore, States' institutional capacities and the interaction and dialogue between State and non-State actors affect the efficacy of policies and the success of transformations.

The task of building a new regional consensus on how to approach development challenges and how to overcome them may be an ambitious objective, but it is without a doubt a necessary and desirable one. Moving towards a more productive, inclusive and sustainable future requires long-term vision and strategies, the real participation of all stakeholders and a competent State and institutions with the capacity to guide, mobilize and provide quality services.

A country's development is a complex process that happens over the long term and is not automatic owing to market forces, which nevertheless can play a major role with appropriate forms of governance and regulation.

If we are to overcome traps and close gaps, if we are to realize the often-delayed dream of more productive, inclusive and sustainable development, the time to act and work together is now.

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

Introduction

For its fortieth session,[1] the Economic Commission for Latin America and the Caribbean (ECLAC) is putting forward a new proposal for the consideration of the governments of the region, which examines a number of gaps and the transformations needed to close each one in order to advance towards more productive, inclusive and sustainable development. This proposal not only offers a list of recommendations on what must be done, that is, which transformations are indispensable (the "what"); it also seeks progress in terms of how to carry out these transformations, that is, how they should be managed with a view to overcoming the development traps affecting the region (the "how"). Thus, beyond mere goals and aspirations, this document offers analyses and recommendations to systematically address challenges linked to governance, institutional capacities and social dialogue to manage the great transformations required.

As a starting point, the international context is analysed. The world is experiencing a period in which the rules of globalization are changing and being redefined in line with geoeconomic and geopolitical changes (Grynspan, 2023; Salazar-Xirinachs, 2023; Goldberg and Reed, 2023; Aiyar and others, 2023). This process of redefinition presents challenges and opportunities for the region. This document posits that the most relevant changes include the following: (i) growth in international trade and foreign direct investment flows has slowed sharply in recent years, owing in part to the geographical reconfiguration of global supply chains; (ii) geopolitics and national security have become central criteria in the economic policies of the world's major economies, with consequences for trade and investment rules; (iii) industrial or productive development policies have regained prominence in the developed economies of the West, which also has implications for trade and investment rules and options; (iv) new international taxation rules reduce the scope for the use of tax incentives as productive development policy instruments; and (v) rapid technological changes are giving rise to drastic economic, social and political transformations.

Latin America and the Caribbean is facing what ECLAC has termed a development crisis characterized by three main traps: (i) low capacity for growth; (ii) high inequality and low social mobility and cohesion; and (iii) weak institutional capacities and ineffective governance (Salazar-Xirinachs, 2023). The development trap concept refers not only to a series of negative medium- and long-term trends; it also suggests the existence of mutually reinforcing vicious cycles that limit the region's ability to achieve its development goals (OECD and others, 2019).

The trap of low capacity for growth

Over the past 10 years, the economies of Latin America and the Caribbean have registered feeble growth. Between 2015 and 2023, the region's GDP grew at a weighted average annual rate of 0.9%, even lower than the level seen during the "lost decade" of the 1980s —when annual growth averaged 2.3%— and significantly lower than that recorded between 1951 and 1979 (5.5%). Per capita GDP increased by just 0.2% per year between 2015 and 2023.

The trap of low capacity for growth is primarily associated with three factors that negatively feed back on each other. First, low productivity growth: average labour productivity in the region was slightly lower in 2023 than in 1980. Second, insufficient investment in the region; moreover, investment levels have declined in recent decades. Third, a perverse process of structural and productive change, resulting in a majority of jobs shifting towards lower-productivity sectors. This trap is analysed in depth in chapter II, and the question of how to break out of it and achieve stronger, sustained, inclusive and sustainable growth is discussed in chapter IV.

[1] The session is the Commission's most important biennial meeting and a forum to steer the Commission's work, review the progress of the its activities and examine the issues of greatest importance for the economic and social development of the countries of the region. At the session, ECLAC reports to the governments of the 46 member States on the work carried out by the Commission and by its subsidiary bodies over the previous two years. Through the adoption of the programme of work and the calendar of conferences during the session, the mandates that will guide the future work of the Commission are defined.

The trap of high inequality and low levels of social mobility and cohesion

The high level of inequality in many forms that characterizes Latin America and the Caribbean is a trap that hinders progress towards sustainable development. Over the past 30 years, the region has consistently recorded the highest level of income inequality in the world, as measured by the Gini index. Inequality is multidimensional, both in terms of its manifestations and the factors that create and perpetuate it. In the region, it extends beyond income to the exercise of rights, capacity development and access to power and decision-making. These aspects, in turn, are associated with limited social mobility and cohesion, resulting in a vicious circle. Weakened social cohesion is reflected in high levels of interpersonal and institutional distrust, which can adversely affect governance, as well as a diminished sense of belonging and a tenuous attachment to democracy, among other phenomena. Limited social mobility in the region is manifested in rigid social stratification, with large segments of the population living in precarious conditions and highly vulnerable to multiple risks —especially poverty—, and an occupational structure that has remained largely unchanged over time. The trap of high inequality and low levels of social mobility and cohesion is discussed in chapter II, and chapter V attempts to answer the question of how to overcome it.

The trap of weak institutional capacities and ineffective governance

The third trap analysed is that of weak institutional capacities and ineffective governance. It is cross-cutting in nature as it is linked to the various development gaps in Latin America and the Caribbean. Institutional capacities in the region, in general, are insufficient, hence the need for improvements in administrative efficiency, technical, operational, political and prospective (TOPP) capabilities of public institutions, and spaces for social dialogue in order to build broadly shared visions of development policies.

Decalogue of structural gaps and their corresponding great transformations

In addition to the assessment and analysis of the three traps, ECLAC has proposed a decalogue of structural gaps in the development models of Latin America and the Caribbean (Salazar-Xirinachs, 2023), which provides additional detail to the aforementioned assessment and introduces other structural dimensions to the analysis. These 10 structural gaps are as follows: (i) low, volatile, exclusionary and unsustainable economic growth; (ii) high inequality and limited social mobility and cohesion; (iii) social protection gaps; (iv) weak education and vocational training systems; (v) marked gender inequality; (vi) environmentally unsustainable development and climate change; (vii) the digital divide; (viii) growing intraregional migration flows; (ix) inadequate regional economic integration; and (x) limited fiscal space and high financing costs. In addition to these 10 gaps, the region faces an eleventh cross-cutting gap of weak institutional capacity and ineffective governance. There are 11 major areas of work that require transformation and improvement; that is, they comprise a list of areas where work should be focused in order to move towards more productive, inclusive and sustainable development.

The three traps encompass several of the structural gaps mentioned above. First, the low-growth trap corresponds directly to the low, volatile, exclusionary and unsustainable economic growth gap. Second, the

trap of high inequality and low social mobility and cohesion is associated with several social gaps, including those related to social protection, education and vocational training systems, and gender inequality. Lastly, the third trap aligns with the cross-cutting gap of weak institutional capacity and ineffective governance.

Against the background of global geoeconomic and geopolitical changes, coupled with the structural challenges faced by the region's economies, ECLAC advocates answering the questions of what Latin American and Caribbean countries should do to move towards more productive, inclusive and sustainable development and how the necessary transformations can be managed more effectively and successfully.

For the purposes of this document, the assessment of the structural gaps and traps facing the region can be summarized in three great transformations that ECLAC considers essential priorities for the region: (i) the achievement of stronger, sustained, inclusive and sustainable growth; (ii) the reduction of inequality and the promotion of social inclusion and mobility; and (iii) the promotion of sustainability and the fight against climate change. It is also vital to mobilize the necessary financing to achieve these and other transformations to drive development.

How to manage transformations

Thus far, the discussion has centred on what needs to be done to move towards more productive, inclusive and sustainable development. However, it is equally important to define how to do so. This requires analysing issues such as governance, TOPP capabilities of institutions and spaces for social dialogue in order to forge broad shared visions and implement policies, as well as to ensure the continuity of these efforts and safeguard them from the disruption that often affects public policy implementation in the region when there is a change in government. Chapter III expands on the importance of TOPP capabilities, political economy, social dialogue and governance, all of which are necessary to manage the above-mentioned transformations and escape from development traps.

Chapter II lists the 11 great transformations needed in the development models of the region's countries if they are to move towards a more productive, inclusive and sustainable future. These transformations are associated with each of the 10 structural gaps defined above, together with an additional cross-cutting gap in terms of how to manage these transformations —the strengthening of institutional, governance and social dialogue capacities for public policies— that corresponds to the third trap affecting the region. The three transformations selected for further analysis in this document are briefly mentioned below.

How to manage the great productive transformation

Poor performance in terms of productivity and structural change play a central role in the low-growth trap. According to the new perspective presented herein that emphasizes the pivotal role of governance and public-private collaboration, productive development policy design and implementation are central to advancing the structural transformation of economies and fostering higher-productivity sectors, in addition to diversifying and increasing the technological sophistication of economies, which is essential for overcoming the aforementioned trap. In contrast to the old, vertical and subsidy-focused models, a multi-stakeholder, experimentalist and multilevel governance framework is proposed. In a context of limited resources, prioritization is essential. For this reason, ECLAC has defined a group of sectors that drive or stimulate growth and can bring about a great productive transformation. This document analyses some of these sectors in detail and discusses what needs to change in order to achieve this productive transformation and how to carry out these changes.

How to manage the great transformation of reducing inequality and increasing social mobility and cohesion

This document presents recommendations for strengthening TOPP capabilities of institutions, governance and social dialogue in six areas considered to be the root causes of the trap of high inequality and limited social mobility and cohesion: (i) low growth that generates sluggish labour markets with high levels of informality and significant disparities in productivity that result in segmented labour markets with substantial wage gaps; (ii) regressive tax systems; (iii) weak social and social protection policies that do not reduce the effects of deep-rooted production-based inequality; (iv) education systems that present serious deficiencies —not only because of high secondary school dropout rates, but also owing to poor learning outcomes—, that do not respond to new labour market needs linked to the technological revolution and that, moreover, are segmented and thus do not fulfil their potential as a powerful mechanism for social mobility; (v) gender inequality; and (vi) the high level of inequality and spatial segregation in urban areas, where 80% of the region's total population lives. It should be noted that breaking out of the trap of high inequality and limited social mobility and cohesion requires integrated and coordinated policies that simultaneously address the various causes mentioned above. Acting on only one or two of these fronts, without adopting a comprehensive approach to the problem, is unlikely to improve the current situation in the countries of the region.

How to manage the great transformation towards sustainability

This document recommends adopting environmentally sustainable development models through a new, broad approach to productive development policies, prioritizing those sectors capable of providing a big boost to environmental sustainability in the region. To this end, it analyses seven sectors that ECLAC considers critical to achieving the great transformation towards sustainability —electromobility, critical minerals, the energy transition, water resources management, the circular economy, the bioeconomy and sustainable tourism— and discusses how to manage and accelerate the necessary transformations in each of them. For each sector, emphasis is placed on the challenges of governance, strengthening of the TOPP capabilities of institutions and social dialogue (see chapter VI).

How to mobilize resources to finance development

Central to the analysis of how to successfully carry out the proposed great transformations is the question of how to mobilize the financing required to achieve the region's development objectives. Chapter VII examines several key areas of financing, including national public finances such as fiscal resources, monetary policy and development banking; private sector financing; and international financial flows such as foreign direct investment, family remittances and the international financial architecture.

The countries of Latin America and the Caribbean have a wide scope of action in all these areas, in accordance with their respective resource allocation and public policy decisions. The region cannot wait for further progress in or completion of reforms in the international financial architecture to meet its financing needs and satisfy the legitimate aspirations of its population. While supporting these reforms is a key strategic objective, while they are being negotiated, the region must act and undertake decisive, integrated and coordinated action to overcome development traps and promote the great transformations described above. This document is intended to guide the discussion, present the transformations that are considered essential in the region and provide recommendations on how to strengthen capacities to manage them.

The document has seven chapters:

- The first chapter examines the transformations in globalization and the challenges and opportunities that these transformations represent for Latin America and the Caribbean.
- The second chapter describes the development crisis that the region is facing, focusing on the development traps and structural gaps defined by ECLAC.
- The third chapter presents a conceptual and methodological framework for analysing the action that the region must undertake to manage the transformations needed to overcome development traps. To this end, the concept of governance, TOPP capabilities of institutions and the importance of social dialogue and political economy are discussed.
- The fourth chapter focuses on the first of the great transformations selected for in-depth analysis. It discusses how to achieve stronger, sustained, inclusive and sustainable growth, emphasizing the importance of having a productive development policy.
- The fifth chapter analyses the second great transformation selected, concerning how to reduce inequality and foster social inclusion and mobility. It underscores the importance of strengthening TOPP capabilities, governance and social dialogue to combat the main causes of the high inequality that characterizes the region.
- The sixth chapter addresses the third great transformation selected, regarding how to foster sustainability and the fight against climate change, highlighting the sectors that ECLAC considers fundamental to achieving productive transformation and boosting sustainability.
- The seventh chapter considers strategies for mobilizing the required financing for development, both domestically and internationally.

Lastly, some final remarks are presented.

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CHAPTER

I

Globalization redefined

Introduction

A new international order is emerging, with globalization undergoing shifts that the Economic Commission for Latin America and the Caribbean (ECLAC) has characterized as tectonic. This transformation of the global landscape presents challenges and opportunities for the regional development strategy.

Slowing globalization (or "slowbalization") is not a new trend; indeed, it dates back to the period following the global economic and financial crisis of 2008–2009. What is new, however, is the incorporation of criteria other than efficiency in the design of global value chains, together with the fragmentation of trade and of capital flows. These trends, which emerged with the beginning of the trade war between the United States and China in 2018, have intensified since the coronavirus disease (COVID-19) pandemic and the outbreak of war between the Russian Federation and Ukraine.[1]

A series of global shocks in recent years revealed inherent weaknesses in the organization of the international economy around global value chains, triggering discussions about the need to incorporate resilience and risk-distribution criteria into their design. Data indicate that these discussions did not immediately produce significant shifts in the geographical distribution of economic activity. However, prospects changed with the outbreak of the war in Ukraine, the ratcheting up of tensions between China and the United States, and the resurgence of industrial policy in developed and emerging economies.

Since then, strategies to build resilience in supply chains and to prioritize national, energy and food security have become more prevalent. They include, in particular, increasing domestic manufacturing capacity (reshoring); establishing new supply chains with countries that have similarly aligned interests (friendshoring); and reducing dependency on countries with conflicting interests (de-risking) (Lovely, 2023).

In the United States, the initial push towards a new industrial policy was linked to the energy transition, microprocessors and the post-pandemic recovery. Reindustrialization and job creation objectives were quickly joined by national security targets. In fact, national security became paramount.

Public policy has swung away from the model of the previous era, in which the market reigned nearly supreme in determining the allocation of resources, not just among sectors and activities but also in terms of remuneration and the geography of production.[2] Now, government intervention in economic affairs is considered fundamental to productivity, economic development and national security.

Geoeconomic fragmentation, decentralized globalization, polyglobalization, globalization redefined —whatever their name, this new set of trends clearly constitutes a new reality, one which the countries of Latin America and the Caribbean must understand, as it will necessarily frame any discussion of economic development strategies.

This chapter is divided into sections that address topics crucial to understanding the transformations and implications of this dynamic and evolving environment. Following this introduction, section A reflects on the post-hyperglobalization transition and reviews its main characteristics. Section B explores the relevance of productive development policies in the current context. Section C analyses the impact of changes to international tax law, drawing a distinction between the implications for developed countries and those for developing economies.

Section D discusses key differentiating factors affecting the reorganization of international trade and investment flows. Section E reviews the profound technological shifts that are redefining key sectors and stakeholders in the global economy. Section F addresses the economic and environmental costs of climate change. Lastly, section G focuses on the positioning of Latin America and the Caribbean and the challenges that it faces in this new, redefined model of globalization.

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1 Previously, global value chains were configured mainly on the basis of efficiency criteria, and while political risk criteria did carry some weight, security criteria were not a significant consideration. This configuration was the result of deliberate strategies, such as lean manufacturing, just in time, total quality management, kaizen and other modern manufacturing techniques.

2 With the notable exception of intellectual property rights, which were strengthened despite their restrictive effect on competition.

A. From hyperglobalization to deglobalization?

The 1980s marked the start of a period of fast-growing integration of the global economy —owing to advances in information technology and transportation, and to the dawn of the "great liberalization"—, which included:

- Increased share of global trade in global GDP.
- Transformation of international capital flows, traditionally dominated by loans and official assistance, with foreign direct investment (FDI) taking on an increasingly important role.
- Geographical restructuring of value chains. In terms of both physical processes (manufacturing) and services (from the use of call centres to design, research and development processes), these value chains can now be broken down into distinct components, which can then be distributed geographically on the basis of economic convenience.
- Increased share of trade in intermediate goods in total trade, at least for countries with greater participation in global value chains.

As a result, a considerable portion of manufacturing activity was relocated from advanced economies to developing countries. At the same time, traditionally industrial areas in developed countries saw a decline in well-paid, stable jobs that did not require higher education, and the geographical concentration of many of these jobs meant that their elimination affected not just certain population groups but entire regions.

The 1990s saw the rise of a certain disillusionment with globalization, as described in the 1997 publication *Has Globalization Gone Too Far?* by Dani Rodrik and, later, *Globalization and its Discontents*, published by Joseph Stiglitz in 2002. The memorable events of the Third Ministerial Conference of the World Trade Organization, held in Seattle, United States, in 1999, showed that discontent with globalization had itself become globalized. Thousands of activists gathered to protest under different banners: for example, unions complained of the effects of globalization on lost jobs and industries, and environmentalists warned of the degradation of the environment, the proliferation of plastics, the loss of biodiversity, unregulated fishing and the harming of dolphins and turtles, among other effects. Collectively, the protesters opposed what they viewed as a globalization designed to benefit multinational corporations and business interests at the expense of people and the planet.

The period that Dani Rodrik termed "hyperglobalization" (1980s–2010, approximately) produced major positives, including growth in international investment and trade, a huge reduction in global poverty and a growing number of women in the work force, amid an accelerating technological revolution. However, there were also negatives, which gave rise to considerable dissatisfaction: (i) a sharp increase in inequality in both developed and developing countries; (ii) the acceleration of premature deindustrialization; (iii) an increase in the vulnerabilities and fragilities of developing countries, in particular; and (iv) heavy energy dependence on fossil fuels.

With the rise of China came a struggle for technological and productive supremacy in relation to new technologies, in particular regarding the digital revolution, artificial intelligence, Internet standards and a number of high-technology industries, such as microprocessor and battery manufacturing, and electromobility.

This geopolitical rivalry changed the very nature of the multilateral trading system of the hyperglobalization era, which was built on broadly accepted rules, highly fragmented production and geographical distribution of global value chains determined by productive efficiency concerns and comparative advantages, as well as a general faith in the concept of economic interdependence.

Circumstances have changed drastically since then. Scepticism has replaced confidence in interdependence, now considered a high-risk proposition. Security, associated mainly with military concerns in the post-war period, is now applied to a range of concepts, including food, energy, supply chains and strategic high-technology industries. The prevailing strategy is to reduce dependence on trading partners perceived to have diverging interests.

However, it would be misleading, or at least inadequate, to characterize the ongoing transformation of globalization simply as a transition from free trade to protectionism, or from globalization to deglobalization. These characterizations may capture part of the transformation but not its essence, which is the overhaul

of the ground rules for trade and investment. Understanding these new rules is crucial, given how easy it is to lose one's way in a period of transition and complexity such as this (Grynspan, 2023). By understanding evolving and emerging rules, countries can formulate policies to successfully navigate this transition, guarding against its risks while harnessing its benefits.

The world is transitioning away from a set of rules that privileged efficiency criteria to one that incorporates the demands and objectives of national security, the development of national productive capacity, job creation, protections for nature and the planet, safeguards against the risks of the digital revolution and artificial intelligence, and the consideration of the negative social impacts of interdependence and investment, among other things.

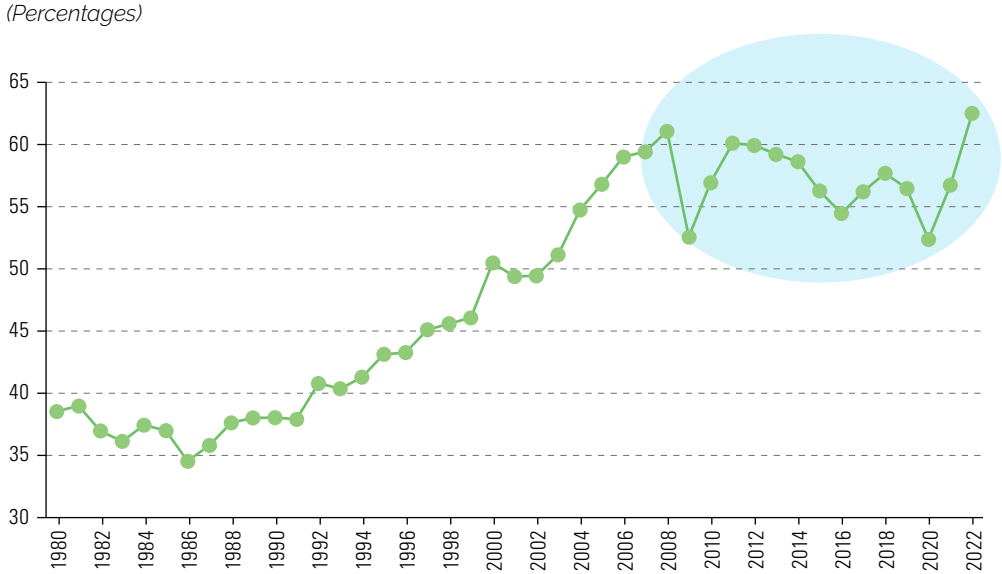
1. Key indicators and terms related to globalization

Two key indicators, namely the percentage shares of trade and FDI in global GDP, grew rapidly between the 1990s and the global financial crisis of 2008–2009, a period that came to be known as the era of hyperglobalization. Both indicators stabilized following the crisis (see figures I.1 and I.2), leading some to suggest that hyperglobalization had given way to slowing globalization (Aiyar and others, 2023).

The percentage share of total trade in goods and services in global GDP, specifically, fell between 1980 and 1985 as a result of the debt crisis at the time, then grew at an accelerated pace from 1986 onward, peaking at 61.0% in 2008. In 2009, the global financial crisis marked the beginning of a downturn, with total trade in goods and services as a share of GDP falling to 52.6% by 2020. Following the COVID-19 pandemic, that figure rebounded considerably, to a record high of 62.5% in 2022.[3]

Annual global FDI flows also accelerated beginning in 1986 and, despite three consecutive years of declines (2001–2003), quickly rebounded to a high of 5.4% of global GDP in 2007. After the financial crisis in 2008–2009, FDI as a share of global GDP ranged from 2.2% to 2.9%, then dropped to 0.8% in 2018. This decline was indicative of problems that had been building up well before the economic crisis caused by the pandemic in 2020. Despite its post-pandemic recovery to 2% in 2022, this figure has yet to regain the levels achieved in the period following the global financial crisis.

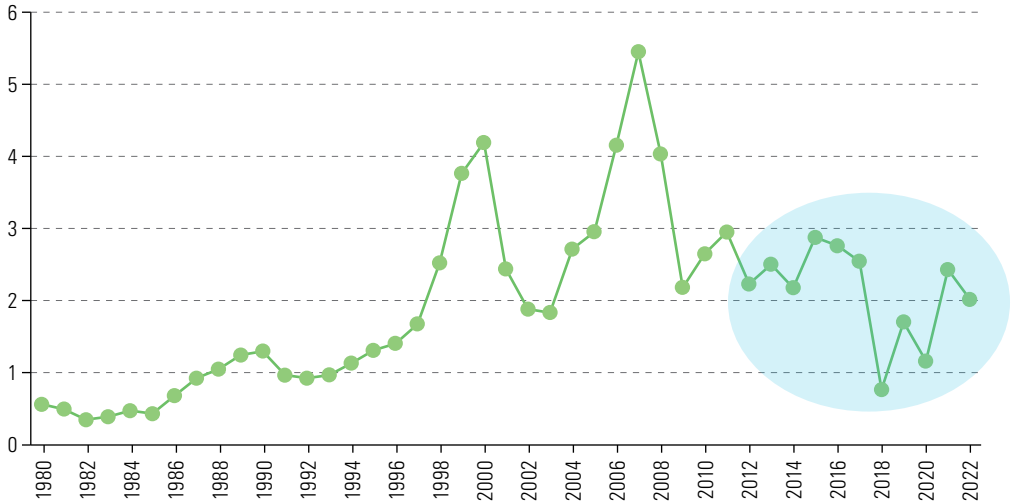
Figure I.1
Total trade in goods and services as a share of global GDP, 1980–2022
(Percentages)



Source: World Bank database, World Development Indicators (WDI).

[3] See Aiyar and others (2023) for estimates of trade as a share of GDP from 1870 onward.

Figure I.2
Foreign direct investment as a share of global GDP, 1980-2022
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators (WDI).

Amid rising geopolitical tensions since the outbreak of the war in Ukraine, the growing imposition of international trade restrictions has led to concerns about the possibility of geopolitical fragmentation (IMF, 2024b).

A distinction should be made, however, between the concerns that arose in the wake of the global financial crisis of 2008–2009 and those that have emerged since the pandemic and the beginning of the war in Ukraine. In the first instance, the main concern was the economic slowdown and was not limited to globalization: since 2010, economic growth has not recovered its pace of the 2000s.

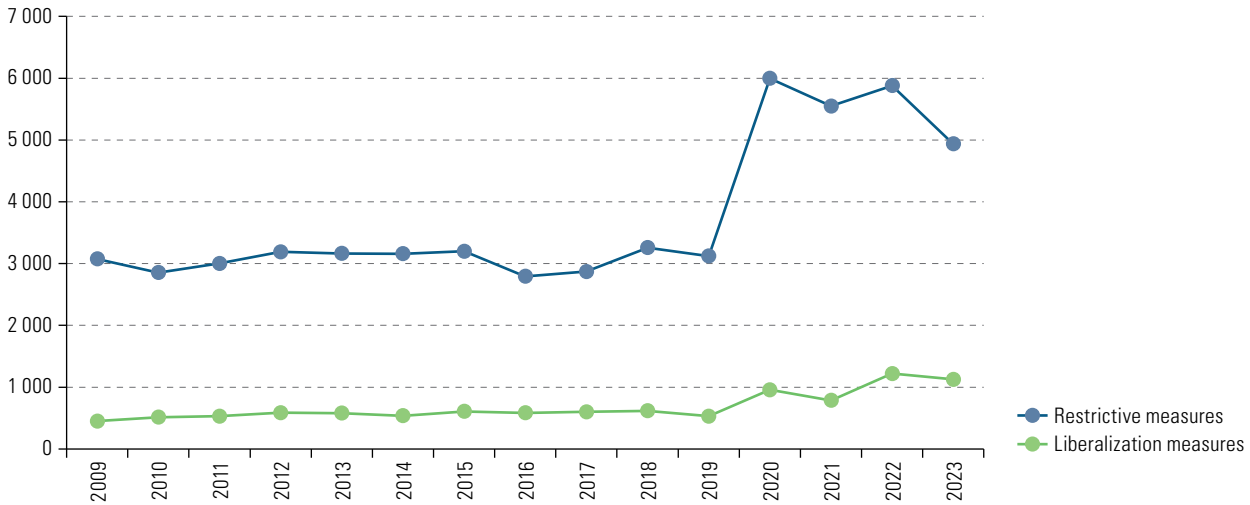
The pandemic and attendant disruptions to global value chains prompted a different concern. Previously, efficiency had been the main criterion for their configuration, with the adoption of the aforementioned production methods initially implemented in Japan (i.e. lean manufacturing, just in time and kaizen) (Sabel, 2017). Now, the reconfiguration of global value chains on the basis of resiliency criteria to safeguard against potential trade flow disruptions has gained ground in discussions surrounding the global organization of production, both in business circles and among international development agencies (Brenton, Ferrantino and Maliszewska, 2022; Aiyar and others, 2023; WTO, 2021 and 2023). It is against this backdrop (as mentioned in the introduction) that strategies such as reshoring, nearshoring and friendshoring have risen to prominence.

Even as discussions have focused on this topic in recent years, data suggest that there were no significant changes in patterns of trade, investment flows or the organization of global value chains in the period immediately following the pandemic (Brenton, Ferrantino and Maliszewska, 2022).

During the COVID-19 crisis, trade restrictions were imposed as a response to the disruptions to trade flows and the resulting need to secure a domestic supply of food and medical necessities, among other things. The resurgence of industrial or productive development policies and the intensification of geopolitical tensions, however, have fuelled the increased adoption of protectionist measures, whether as complementary policies to subsidies for the development of strategic sectors, or as a matter of national security. Regarding national security, Goldberg (2023) proposes that protectionism has played a fundamental role in increasing geopolitical tensions by undermining confidence in international cooperation and promoting a narrative of trade as a zero-sum game.

Globally, despite the recent implementation of a significant number of restriction and liberalization measures, the latter have been outstripped by protectionist measures, especially since the pandemic (see figure I.3). Restrictive measures apply not only to trade in goods but, increasingly, to trade in services and FDI flows (Aiyar and others, 2023); nor are they limited to tariff and non-tariff barriers. For example, with regard to advanced microprocessors and the machinery used in their manufacture, measures include export bans, as in the case of the United States and China (Goldberg and Reed, 2023).

Figure I.3
New restriction and liberalization measures implemented worldwide, 2009–2023
(Number of measures)



Source: Global Trade Alert [online] https://www.globaltradealert.org/.

Goldberg and Reed (2023) warn that the resurgence of protectionism could obstruct the development of certain economies by restricting their access to international markets —a concern relevant to many Latin American and Caribbean countries. Certain norms established in trade agreements present obstacles that some countries will find very difficult to get around. The lack of access to profitable foreign markets will prevent them from overcoming poverty and economic stagnation. Thus, the return of protectionism is unlikely to reduce inequality or foster the development often linked to globalization. In fact, it could worsen socioeconomic conditions in various regions of the world.

The ground rules of globalization have changed, with a nascent yet discernible impact on international economic relations. The key aspects of this change are discussed in the sections that follow.

B. The return of productive development policies

Productive development policy, understood as government intervention to increase productivity and alter the sectoral composition of the economy, was broadly discarded during the era of hyperglobalization and the Washington Consensus, although it was never abandoned outright (Fernández-Arias, 2010), and ECLAC defended the concept throughout (Salazar-Xirinachs, 2023b; Salazar-Xirinachs and Cornick, 2017).[4] Over time, even the Washington Consensus institutions have come to reconsider their previous position (IMF, 2024b; Cherif and Chami, 2019; Crespi, Fernández-Arias and Stein, 2014). Renowned economists have advocated for its normalization (Stiglitz, 2017; Rodrik, 2008) and weighed arguments in its favour, even within the framework of mainstream economics (Harrison and Rodríguez-Clare, 2010), and even before the global financial crisis laid bare the deficiencies and blind spots of the market left to its own devices.

In recent years, productive development policy has gained prominence in the public discourse, with an increasing number of mentions in important economics and business publications. For example, a recent IMF document (Evenett and others, 2024) presents data from the New Industrial Policy Observatory and analyses trends in interventions associated with the resurgence of these policies. The data show that the majority of these measures

[4] Productive development policy is also referred to as industrial policy. The term "productive development policy" is preferred in this document for two reasons: (i) to distinguish it from initiatives that exclusively target the manufacturing sector, as a new approach that encompasses primary activities and services; and (ii) because there are differences between the type of instrument used, namely that traditional industrial policies prioritize the use of tariffs or subsidies, while productive development policies favour governance and cooperation mechanisms among key stakeholders in each sector (as seen in the use of cluster initiatives), and may or may not be complemented by subsidies.

have been implemented by advanced economies, which deploy subsidies as their main tool. Meanwhile, emerging markets and developing economies tend to favour import and export restrictions. Grynspan (2023) warns of the difficulty that many developing countries face in successfully implementing productive development policies "while the major poles, especially the major industrial powers, are fighting a subsidy war".

The return of productive development policy in the United States, though motivated in part by a domestic agenda for economic revitalization and job creation (The White House, 2023b), is inextricably linked to the country's national security policy (Sullivan, 2023). Predictably, this has led some economies to implement policies aimed at remaining economically competitive with the United States. While many other countries have launched their own initiatives, the United States, China and Europe account for nearly half of productive development policies implemented globally (Evenett and others, 2024).[5] Accordingly, this section is focused on their initiatives.

1. Productive development policy in the United States

The three pillars of the new productive development policy in the United States are the Inflation Reduction Act, the Bipartisan Infrastructure Law and the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act. The main provisions of each of these laws with regard to productive development policy are described below.[6]

- Inflation Reduction Act (2022): authorizes the allocation of public resources in the amount of US$ 39.7 billion to fund innovative projects in the areas of energy, manufacturing, environment, electromobility, agriculture and water, and US$ 367 billion in tax incentives and subsidies to stimulate investment in clean energy and climate change measures, over the course of 10 years (Badlam and others, 2022; The White House, 2023a). A year after the Act was passed, the Government of the United States reported US$ 110 billion in investments in electromobility and clean energy, but a public-private breakdown of the investments has not been provided (The White House, 2023a).
- CHIPS and Science Act (2022): authorizes US$ 280 billion in spending over 10 years, including US $200 billion for research, development and commercialization; roughly US$ 52.7 billion for semiconductor manufacturing, labour force development, and research and development; US$ 24 billion in tax credits for chip manufacturing; and US$ 3 billion for technology and wireless supply chains (Badlam and others, 2023).
- Bipartisan Infrastructure Law (2021): allocates resources for public infrastructure in the amount of US$ 1.2 trillion over 10 years, including US$ 550 billion in spending in the five years after its enactment, comprising US$ 284 billion for transportation infrastructure and US$ 266 billion for basic infrastructure projects, such as electricity, grid automation, water, broadband, and environmental resilience and restoration. The Government of the United States reported that, in November 2023, US$ 400 billion of those funds were committed to finance more than 40,000 projects (The White House, 2023c).

The impact of these measures appears to be substantial. While rigorous studies have yet to be conducted, the changing behaviour of manufacturing investments in the United States and the European Union since the enactment of the first two laws mentioned above suggests cause and effect. Between the enactment of the first in August 2022 and the second in November 2023, investment in manufacturing construction is estimated to have risen by 225.5% in the United States and fallen by nearly 40% in the European Union (Graham, 2024), despite the productive development policies in the European economy described in the next subsection.

According to government estimates, in the year following the enactment of the CHIPS and Science Act, US$ 166 billion in investments were announced for the manufacture of semiconductors and electronic components in the United States, and additional investments in the sector pushed total commitments to US$ 231 billion (The White House, 2023d). During the same period, US$ 110 billion in manufacturing investments were announced for the production of clean energy (The White House, 2023a).

[5] This percentage refers to the number of initiatives. Data are unavailable regarding the magnitude of resources mobilized, but it is reasonable to estimate, given the relative weight of these three economies, that the share of resources is much greater than the number of initiatives. This is supported by data presented further on.

[6] Although some of this legislation is broader in scope, this discussion will be limited to the industrial policy components of each.

2. Productive development policy in the European Union

The European Union has a broad set of policies in place to stimulate productive development. The scope of this subsection is limited to a series of recent initiatives that constitute a response both to emerging geopolitical conditions and to the new productive development policies in the United States and China.

- The European Green Deal and the Green Deal Industrial Plan are the European Union's answer to the need to reduce its dependence on the Russian Federation's natural gas supply and transition to a net zero economy by 2050. In that regard, 300 billion euros in investments are planned from various funds, such as REPowerEU, InvestEU and the Innovation Fund, as well as from the budget of the European Union. The plan has four pillars: (i) a predictable and simplified regulatory environment; (ii) faster access to funding; (iii) enhanced skills; and (iv) open trade for resilient supply chains (Economic Commission, 2021 and 2023).
- The European Critical Raw Materials Act lists 34 raw materials, including 17 strategic materials, that are considered critical to achieving the objectives of the European Union in the areas of renewable energy, digital technology, aerospace technology and defence, with a view to reducing its dependence on third country suppliers. For example, China supplies 100% of the European Union's heavy rare earth elements; Türkiye provides 98% of its boron; and South Africa supplies 71% of its platinum. The Act establishes the following benchmarks for the European Union's consumption of raw materials: 10% from local extraction; 40% to be processed in the European Union; 25% to come from recycled materials; and not more than 65% for each strategic raw material to come from a single third country (European Council, 2024a and 2024c).
- Projects of common interest and projects of mutual interest:[7] public financial support for major common interest projects for Europe has theoretically been available since 2006, but it was not until 2018 that the first such project was approved. Projects have been approved since then at a rate of one per year (in microelectronics, batteries, hydrogen, infrastructure and cloud services), with 34.8 billion euros in public funding commitments and an expected 56.8 billion euros in private funding.

These three initiatives are part of a vision for greater technological and industrial sovereignty in a context in which, as Emmanuel Macron, President of France, put it, "the two leading international powers have decided to stop respecting the rules of trade".[8] The aim of realizing the concept "Made in Europe" is at the heart of efforts to accelerate the European Union's productive development policy (Macron, 2024).[9]

Another key component is the adoption of the European Defence Industrial Strategy, the first of its kind in the history of the European Union, and the proposal for a European defence industry programme. This seeks to increase investment in European defence industries and their autonomy, which would effectively increase European value added in defence equipment procurement (European Commission, 2024). It is essentially the same strategic independence concept that is being applied to strategic and critical raw materials.

3. Productive development policy in China

Given the lack of available official data and details regarding the characteristics and magnitude of China's current productive development policy, this analysis is based on secondary sources outside the country.

A recent study conducted by the Centre for Strategic and International Studies (DiPippo and others, 2022) identifies China's main productive development policy instruments as follows: direct subsidies and tax incentives, subsidized lending, government guidance funds and real estate subsidies. Using data from 2019, the authors estimate national spending on productive development policies at approximately 1.48% of GDP.[10] Spending in the Republic of Korea —the country closest behind China— is 0.67% of GDP, and in the United States

7 See [online] https://energy.ec.europa.eu/topics/infrastructure/projects-common-interest-and-projects-mutual-interest_en.

8 Interestingly, the concerns raised by the President of France regarding the industrial policy of the United States are nearly identical to those raised by the Office of the United States Trade Representative regarding the industrial policy of China.

9 The concept is a clear reference to the Made in China policy, which is discussed in the next subsection.

10 The calculations do not include the productive development policy instruments specific to China that have no equivalent in the rest of the world.

it is 0.39% of GDP. However, given that these estimates do not reflect the impact of the three main productive development policy initiatives in the United States, industrial policy spending relative to GDP in China, the United States and the rest of the developed economies may have changed substantially.

The *Financial Times* reports, on the basis of data from companies traded on the Chinese stock market, that business subsidies in priority sectors increased from US$ 5.5 billion in 2008 to US$ 27.6 billion in 2021. Although limited in scope to publicly traded companies, the analysis suggests that the Made in China 2025 plan, despite having receded from the public discourse, remains a central element of the country's productive development policy (Kawase, 2022).

C. Changes to international tax law

In the wake of the global financial crisis of 2008–2009, a reform of international corporate taxation rules began in order to curb the erosion of the tax base and the transfer of profits to jurisdictions with tax mechanisms that favour multinational corporations but which are away from the locus of the underlying economic activity.[11]

Following extensive negotiations, a group of 136 nations (now 142) reached an agreement in 2021 known as the "two-pillar solution". Pillar one establishes rules for the allocation of profits between different tax jurisdictions. Pillar two, which entered into force in several countries in 2024, establishes a global minimum tax, at an effective rate of 15%, on the profits of large multinational corporations with annual revenues of over 750 million euros (OECD, 2023).

Pillar two has already come into effect in the European Union, as well as Australia, Canada, Japan, Norway, the Republic of Korea and the United Kingdom, while other countries are preparing legislation for its implementation (OECD, 2023). Notably, neither of the two largest economies in the world —the United States and China— have announced plans for implementation of the global minimum tax, although both are signatories of the 2021 agreement.

The global minimum tax was designed to reduce tax avoidance and place a floor under tax competition between different jurisdictions. It is important to note, however, that the countries where multinationals' head offices are located —chiefly developed countries— stand to benefit most from the increase in tax revenues.

Another factor to consider is that there are provisions which, to ensure the minimum effective rate of 15%, will affect the use of tax incentives not linked to the economic substance of the business of the big multinationals subject to the tax. This implies that incentives such as tax exemptions, including tax holidays, reduced rates, partial exemptions, and tax allowances and credits, cannot be deducted from the tax base of the minimum tax. Consequently, a country providing these tax incentives to a large multinational subject to the global minimum tax would forgo tax revenue, while the jurisdiction of the multinational's headquarters would impose the 15% minimum effective tax rate without recognizing the tax incentive received in the other country.

It will therefore be vitally important for Latin America and the Caribbean, and for developing countries in general, to design tax incentives aimed at attracting investment such that they align with this regulation and are linked with the economic substance of the activities of large multinationals that fall under the minimum tax regime. Those incentives could include accelerated tangible asset depreciation, deductions for research and development costs or reinvestment of profits from the sale of tangible assets.

D. Reorganization of international trade flows and foreign direct investment

The geographical organization of value and supply chains has been in a constant state of flux. Technological changes reshape global work distribution patterns, while costs and productive capacities fluctuate across countries and regions, prompting a continuous geographical reconfiguration of global production and trade.

[11] Refers to base erosion and profit shifting (BEPS).

The narrative is familiar: areas that initially drew investment owing to their competitive advantage of abundant and low-cost labour were subsequently propelled by their own success towards more knowledge-intensive activities, which in turn required greater efficiency and production and a more skilled workforce.

Following the pandemic and the outbreak of the war in Ukraine, and amid escalating geopolitical tensions, the question is whether the world is on the threshold of a reconfigured, different and perhaps even intensified globalization, driven by geopolitics, national security and an enhanced role for the State in strategically guiding economic development.

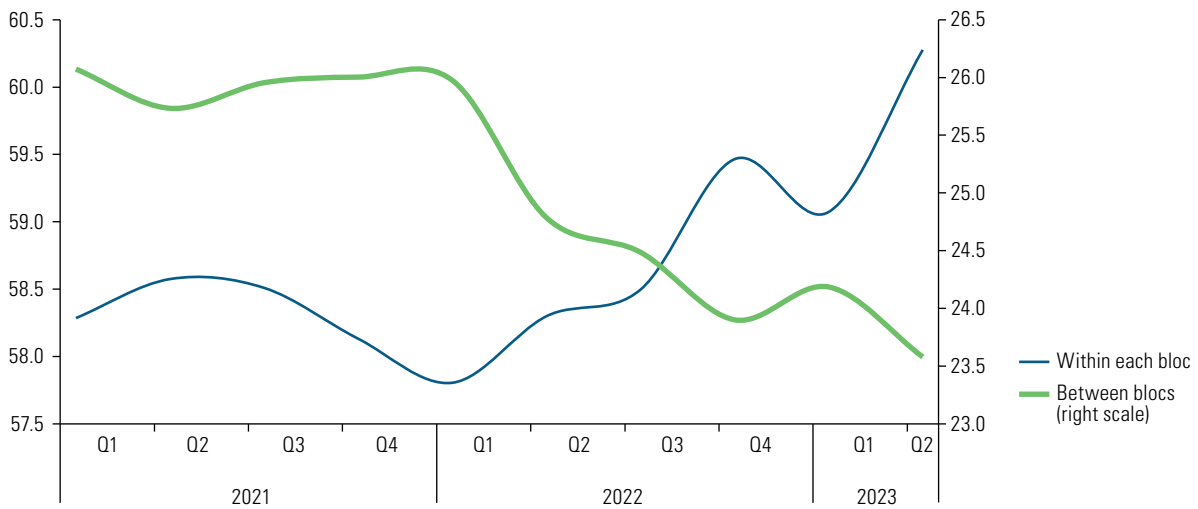
If so, the trend towards ever-increasing integration of national economies within the global economy could be setting the stage for fragmentation into geopolitical blocs (Aiyar and others, 2024), or to a "globalization disrupted" (Grynspan, 2023). Under such circumstances, there is a risk not only of losing the efficiency gains of globalization but also of a "technological decoupling", which could constrain the interoperability of goods and service platforms and the possibility for trade between countries that operate under different technological regimes.[12]

This section briefly examines the available data, which suggest that it would be premature to speak of "deglobalization" or a "great reallocation" (Alfaro and Chor, 2023) of global value chains. However, there are significant changes, mainly to trade flows, in two specific cases: (i) foreign trade of the Russian Federation, under the effect of the sanctions imposed by the United States and its allies; and (ii) bilateral trade between the United States and China.

1. Trade flows

According to the classification system developed by Capital Economics, which divides countries into blocs aligned with the United States or China, trade within each bloc (intrabloc trade) is rising in parallel with a decline in trade between blocs (interbloc trade), especially since the outbreak of the war in Ukraine (see figure I.4).[13]

Figure I.4
Global trade in goods within and between blocs, 2021–June 2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Capital Economics.

[12] This would contrast with the gradual —albeit incomplete— convergence towards common standards that characterized the previous period.

[13] On the basis of the hypothesis that the global economy is fracturing into blocs aligned with China or the United States, Capital Economics classifies countries according to the closeness of their bilateral relationship with these countries. This is done using several economic and political closeness indicators, including alignment of voting at the General Assembly of the United Nations, such that each country is classified into one of the following five categories: (i) the United States and its close allies; (ii) countries that lean towards the United States; (iii) the unaligned; (iv) those that lean towards China; and (v) China and its close allies. In figure I.4, close allies of either bloc and countries that lean towards it are combined into a single category.

There was a noticeable change in the trade patterns of China, India, the Russian Federation and the United States between 2019 and 2022. For China and the Russian Federation, trade sanctions imposed by the United States and its allies may have directly affected both export destinations and import origins. In the case of India, the changes are more likely to have been an indirect repercussion. Like other countries, such as Mexico and Viet Nam, India may have indirectly benefited from the sanctions, which, as discussed above, imposed at least a partial reconfiguration of global value chains, in terms of investment flows. Examples of the changes in the export destinations and import origins of the Russian Federation and China are discussed below.

(a) Russian Federation

In response to the outbreak of the war in Ukraine, the United States and its allies imposed a series of progressively widening economic sanctions on the Russian Federation, including restrictions on international financial transactions, export controls on certain technologies, suspension of most-favoured-nation treatment and a price cap on oil exports (Nelson, Casey and Schwarzenberg, 2023). The European Union has also imposed an increasingly wide range of sanctions on the Russian Federation, which are coordinated with those of the United States and are quite similar (European Council, 2024b).

Between 2019 and 2022,[14] the most noticeable change in the export pattern of the Russian Federation was growth in exports[15] to China, from 13.9% to 20.7%, and to India, from 1.6% to 8.3%, as shown in table I.1. The relative share of exports to Asia and Europe also shifted. While Asia received 40% of Russian exports in 2019 and Europe 50%, those shares had reversed by 2022, with Europe's decreasing to around 40% and Asia's rising to just over 50%.

Table I.1
Russian Federation: main export destinations, 2019 and 2022
(Percentages)

	2019	2022	Change *(Percentage points)*
China	13.9	20.7	6.80
India	1.6	8.3	6.70
Germany	4.6	5.7	1.15
Türkiye	3.9	5.2	1.28
Italy	4.0	5.2	1.18
Netherlands (Kingdom of the)	9.9	3.6	-6.33
France	1.2	3.3	2.03
Japan	2.8	2.7	-0.12
Republic of Korea	3.9	2.6	-1.26
Poland	2.9	2.6	-0.30
Czechia	1.2	2.1	0.88
Belgium	1.6	2.1	0.49

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Observatory of Economic Complexity (OEC) [online] https://oec.world/en.

The change in the origin of Russian imports over the same period was even more marked. Imports from China rose, from 20.6% of the total in 2019 to 38.6% in 2022, while imports from three of the four European countries with the largest share in 2019 (namely Germany, Italy and Poland) decreased by 4.5, 0.51 and 0.86 percentage points, respectively, and imports from Belarus fell from 5.7% in 2019 to 0% in 2022.[16]

[14] The most recent year for which information is available from the source of these data is 2022. Changes that were already on the horizon in 2022 may have accelerated in 2023, as suggested by the information on new FDI project announcements, presented in section D.2, and by the latest information on imports to the United States, presented in subsection (c) of section D.1.

[15] Analysis of export destinations and import origins refers exclusively to trade in goods.

[16] There has also been a shift in the composition of exports from the Russian Federation to the European Union, as the latter has virtually ceased to rely on natural gas from the former.

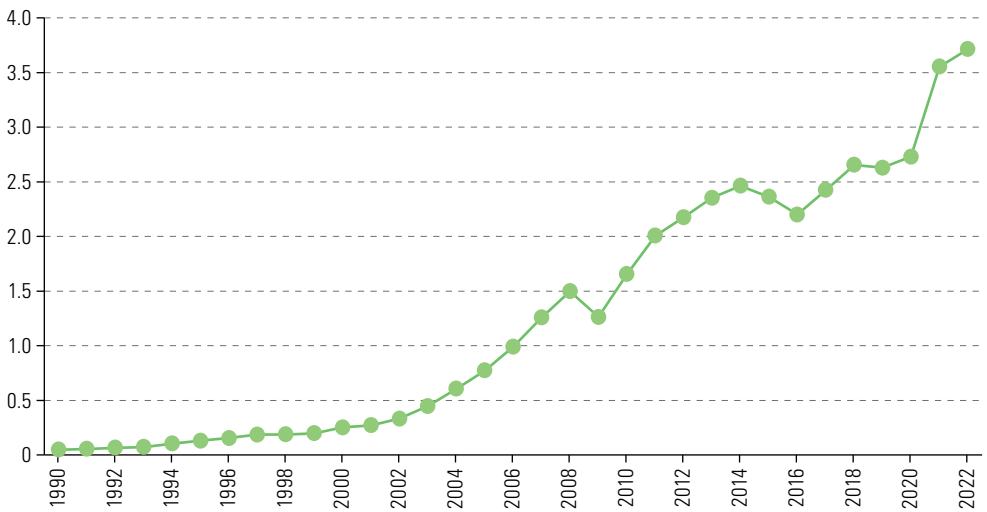
(b) China

Regarding China, an important point of departure is growth in total export value, which began accelerating in the early 2000s when it became a member of the World Trade Organization. This process was only slightly disrupted by a drop in 2009 during the global financial crisis, and by more moderate declines in 2015 and 2016.

The value of China's total goods exports continued to grow, even in 2020 during the COVID-19 pandemic. As with exports from the Russian Federation, the imposition of increasingly broad and stringent sanctions failed to dampen the global growth of Chinese exports in terms of value, although it did affect the relative shares of both export destinations and import origins.

Paradoxically, the main impact of the sanctions against these two nations may be the economic, political and military rapprochement between them and other developing countries, notably Brazil, India and South Africa, the other BRICS countries. Although the relative importance of some export destinations declined between 2019 and 2022, the value of exports, even to the United States, continued to grow (see figure I.5).

Figure I.5
China: value of total exports of goods and services, 1990–2022
(Trillions of dollars at current prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators (WDI).

Between 2019 and 2022, Chinese exports to the United States dropped by almost 2 percentage points.[17] However, this did not prevent the United States from remaining its main export destination, accounting for 16.6% of the total value of Chinese exports, trailed at a considerable distance by Japan, at 5.3% (see table I.2).

Between 2019 and 2022, the relative share of imports to China from Australia, Japan and the Republic of Korea declined, coinciding with increased geopolitical tensions with those countries. However, imports from the United States rose by almost 1 percentage point over that period, as did those from Brazil, Indonesia, the Russian Federation and Saudi Arabia. Once again, the evidence suggests shifting international trade patterns, raising significant concern about the potential for decoupling, although the data remain inconclusive in that regard.

[17] Exports from mainland China to other Chinese territories, except Taiwan Province of China, are excluded from the calculation.

Table I.2
China: main export destinations, 2019 and 2022
(Percentages)

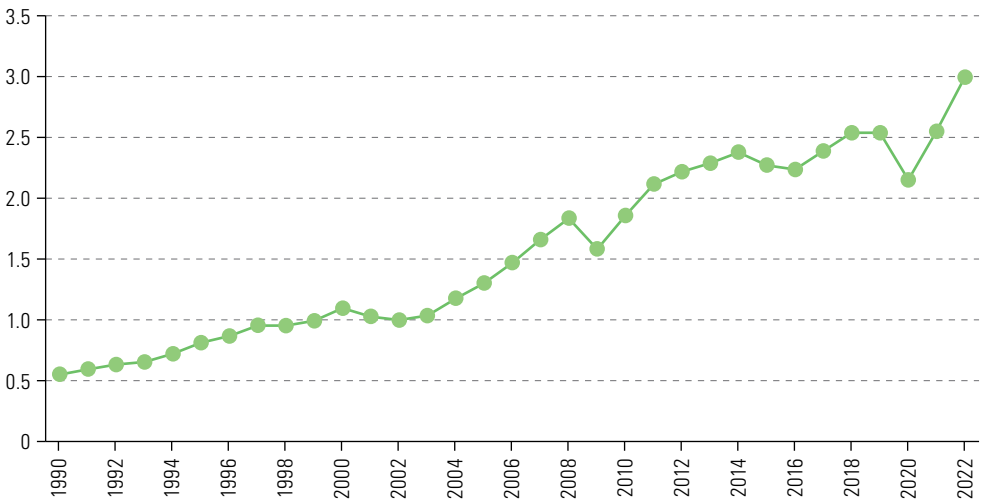
	2019	2022	Change *(Percentage points)*
United States	18.5	16.6	-1.9
Japan	6.6	5.3	-1.3
Germany	4.2	4.6	0.4
Republic of Korea	4.7	4.5	-0.2
Viet Nam	3.9	4.1	0.2
India	3.1	3.3	0.2
Netherlands (Kingdom of the)	2.8	2.8	0.1
United Kingdom	2.8	2.8	0.0
Mexico	2.9	2.7	-0.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Observatory of Economic Complexity (OEC) [online] https://oec.world/en.

(c) United States

There has been a clear upward trend in exports from the United States over the last 30 years, albeit more moderate than in the case of China. The rapid recovery of exports from the United States in the wake of the 2020 crisis has mirrored that of China, and their value in 2022 is already well above the pre-pandemic level (see figure I.6).

Figure I.6
United States: value of total goods and services exports, 1990–2022
(Trillions of dollars at current prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators (WDI).

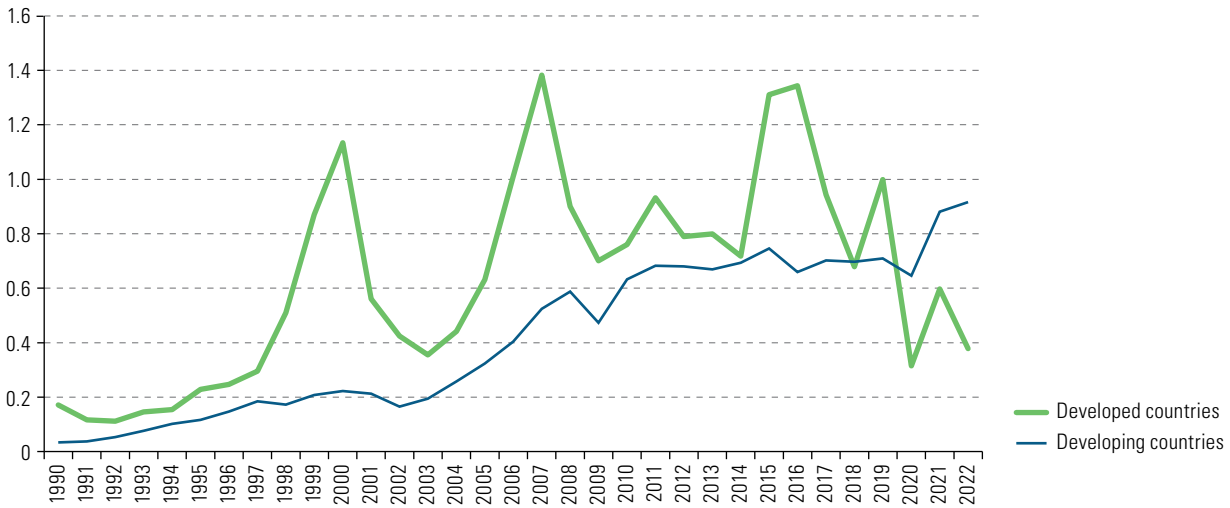
In terms of destinations, exports from the United States are concentrated in Canada and Mexico, which accounted for just over 30% of the total in 2022, followed by China, which accounted for 7.7% (up 1 percentage point from 2019).

Imports to the United States from Mexico grew steadily, surpassing those from China by 2023, and while imports from India and Viet Nam remained modest, they grew rapidly, especially from 2020 onward.

2. Foreign direct investment flows

One notable feature of the change in FDI flows by destination between 1990 and 2019 is growing investment in developing economies and at the same time less investment in developed countries. However, the pace of FDI growth in developing countries began to slow in 2010, as shown in figure I.7. Although the war in Ukraine began in February 2022, there was no indication of any change in that trend by the end of the year.

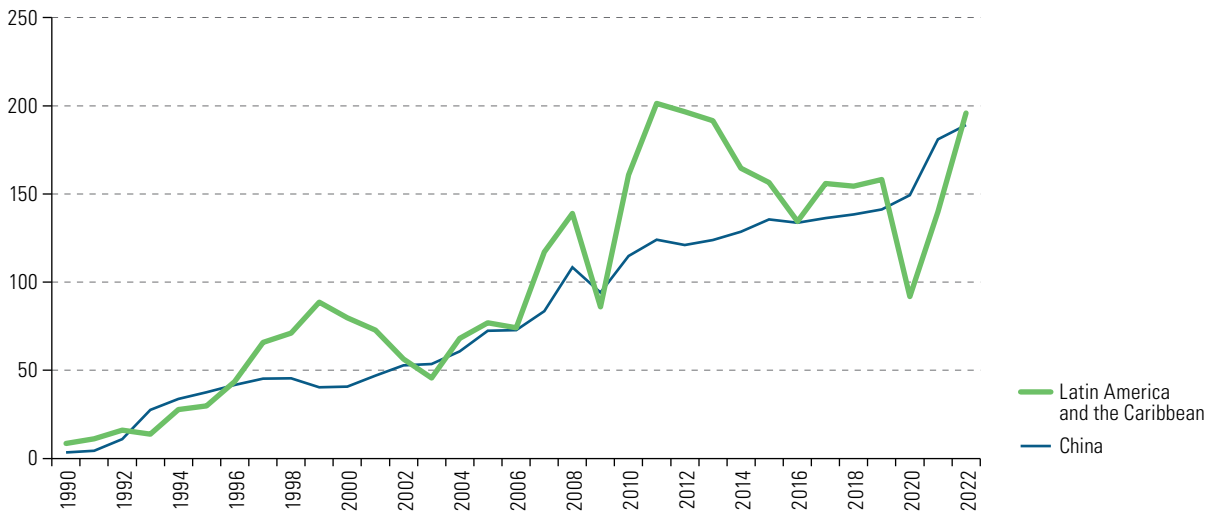
Figure I.7
Developed and developing countries: foreign direct investment, 1990–2022
(Trillions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the United Nations Conference on Trade and Development (UNCTAD).

Figure I.8 shows that FDI surged in China between 1990 and 1993 (at an annual average of 229.7%), followed by more subdued growth, except for steep upswings in 2008 and 2021. In Latin America and the Caribbean, growth was rapid between 1990 and 2000, more moderate and volatile between 2000 and 2010, and significantly slower thereafter.

Figure I.8
China and Latin America and the Caribbean: foreign direct investment, 1990–2022
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the United Nations Conference on Trade and Development (UNCTAD).

Analysis of the value of investment flows received by China and other major destinations does not suggest a reversal of globalization or a specific reduction in economic integration between China and the rest of the world. Analysis of the flows in terms of percentage share of total global FDI shows an increase for China compared with pre-pandemic levels, from 8.27% to 14.6% between 2019 and 2022. India, Mexico and Viet Nam are smaller destinations, but their share also grew markedly over the period, as shown in table I.3.

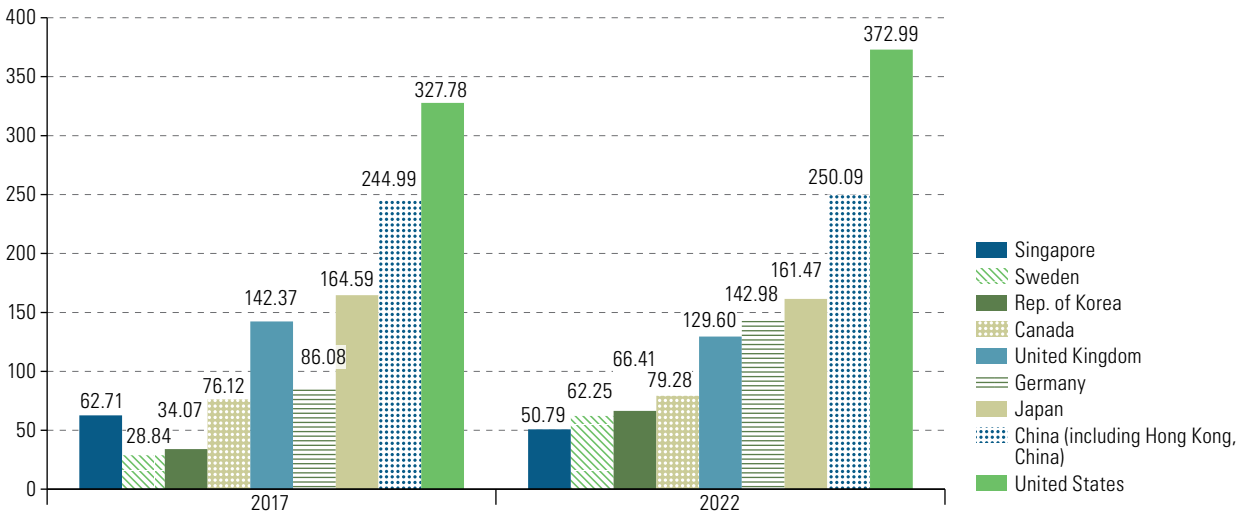
Table I.3
Selected economies: FDI inflows as a percentage of world total, 1990–2022
(Percentages)

Year	Developed economies	United States	Developing economies	China	Viet Nam	India	Mexico
1990	83.60	23.63	16.40	1.70	0.09	0.12	1.29
1995	66.18	17.03	33.82	10.87	0.52	0.62	2.76
2000	83.58	23.15	16.42	3.00	0.10	0.26	1.34
2005	66.16	10.98	33.84	7.59	0.20	0.80	2.70
2010	54.59	14.22	45.41	8.24	0.57	1.97	1.95
2015	63.71	22.74	36.29	6.59	0.57	2.14	1.75
2020	32.79	9.97	67.21	15.52	1.64	6.66	2.93
2021	40.41	26.23	59.59	12.24	1.06	3.03	2.13
2022	29.22	22.02	70.78	14.61	1.38	3.81	2.73

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the United Nations Conference on Trade and Development (UNCTAD).

With regard to the origin of FDI inflows, the United States remained in the lead in 2022. It was followed by China (including Hong Kong, China), Japan, Germany, the United Kingdom, Canada, the Republic of Korea, Sweden and Singapore. A comparison of 2017 and 2022 data also shows no variation in FDI patterns (see figure I.9).[18]

Figure I.9
Foreign direct investment by origin, main sources, 2017 and 2022
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the United Nations Conference on Trade and Development (UNCTAD).

[18] In this case, comparison with 2019 figures is not useful, as the Tax Cuts and Jobs Act of 2017 triggered repercussions in both 2018 and 2019. The elimination of dividend repatriation taxes prompted repatriations from Bermuda, Ireland and the Kingdom of the Netherlands, driving a substantial albeit temporary decline in net FDI from the United States to the rest of the world over the biennium (BEA, 2019).

The position of China, which for decades was a net recipient of FDI, shifted significantly in 2023. As reported by fDi Intelligence, estimates of the State Administration of Foreign Exchange show that China emerged as a net exporter of capital in 2023, with FDI outflows surpassing inflows by US$ 142.600 billion. In that year, announcements of new investment outflows, by value of investment, surpassed inflows by a factor of four (fDi Insights, 2024).

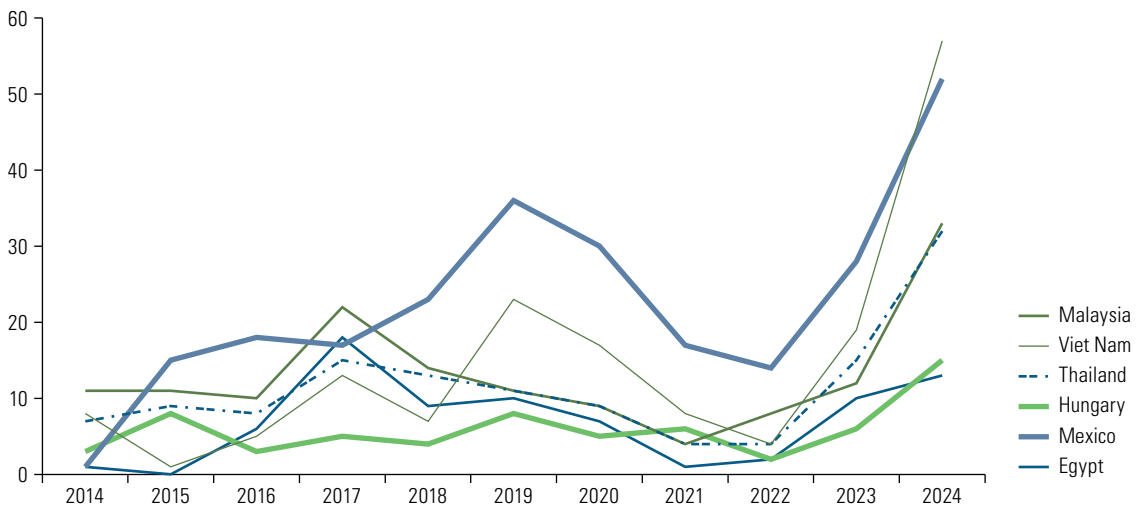
3. Nearshoring and the potential for shorter global value chains

The shortening of global value chains continued to be vigorously debated in 2023 and 2024. Trends in international FDI flows have yet to demonstrate that trade tensions between China and the United States and other developed economies are driving a global decoupling or significant decline in FDI flowing to China. However, there is evidence of higher FDI inflows to countries in close proximity to the United States, the European Union and China, the three main global economic hubs.

Mexico would be a leading beneficiary of nearshoring by the United States, as a neighbour with an extensive network of trade agreements and a manufacturing base established over several decades. Most of the benefits of European Union nearshoring would accrue to Eastern European countries, in particular Hungary, Slovakia, Poland and Romania, while in Africa, Egypt and Morocco would benefit. The major beneficiaries of investment targeting destinations other than China have been countries of the Association of Southeast Asian Nations, such as Indonesia, Malaysia, Singapore and Thailand, as well as India.[19]

As noted previously, the declining share of China in United States imports has been accompanied by an increasingly prominent role for other countries, in particular Mexico and certain South-East Asian countries. However, as their share of the global imports of the United States grew, so did their share in Chinese FDI and exports (see figure I.10). Gopinath and others (2024) have noted a significant positive association between increasing Chinese presence in a country, whether measured through exports or FDI announcements, and stronger trade relations between that country and the United States.

Figure I.10
Selected countries: announcements of FDI from China, 2014–2024
(Number, 12-month moving average to May)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from fDi Intelligence.

[19] In all cases, these are announcements of investments in manufacturing. The energy sector is not included.

E. Technological transformations

1. Emergence of new technologies

In recent decades, the world has witnessed rapid technological changes that have brought about profound economic, social and political transformations. The digital revolution, which began in the 1980s with the mass adoption of personal computers and the rise of information technology, laid the foundations for the information age. The emergence of the Internet in the 1990s marked a turning point, enabling unprecedented global connectivity and giving rise to the digital economy. The expansion of broadband, together with the development of mobile technologies and the popularization of smartphones in the first decade of the twenty-first century, enabled real-time access to information and services, redefining the way people communicate, work and do business.

More recently, the introduction and refinement of emerging technologies such as artificial intelligence, machine learning, the Internet of Things and blockchain technology have been further redefining economic capabilities and opportunities. These innovations are driving process automation, boosting operational efficiency and enabling large volumes of data to be analysed, establishing new business models and transforming traditional industries. While technological change has been a key driver of globalization and has accelerated the exchange of goods, services and capital worldwide, it also poses significant challenges for regulation, security and equity.

Several studies have thoroughly examined these technological transformations, which have intensified and compounded in recent years (Bitar, Mattar and Medina, 2021; Cabrera and others, 2024; ECLAC, 2022). The most significant contemporary global technological changes include the following:

- Robotics
- Synthetic biology and genomics
- Cloud computing
- Analytics and big data
- Artificial intelligence and automation
- Augmented reality
- Nanotechnology
- The Internet of Things
- 3D printing
- Renewable energies and clean technologies
- Blockchain technology and decentralized finance

Salazar-Xirinachs (2021) argues that these technological and digital transformations present an opportunity to mitigate the region's legacy of development gaps and traps, including by enabling countries to enhance productivity, connectivity and human talent and well-being. The most significant economic and societal impacts of the ongoing technological transformation are outlined below.

2. Economic and societal impact of new technologies

New technologies have had a profound economic impact, transforming entire sectors and creating new opportunities for growth and development. Digitalization and automation have significantly boosted productivity, enabling companies to operate more efficiently and reduce operating costs. This has led to the emergence of new business models and markets, creating jobs in sectors such as information technology, digital commerce

and financial technology (fintech). However, it has also created challenges, including labour market polarization. The demand for highly skilled, technology-driven jobs has risen, with commensurate wage growth, while routine, low-skilled jobs continue to lag, worsening existing economic disparities.

On the social front, new technologies have redefined human interaction and access to information. Social media platforms, instantaneous communication and access to online educational resources have transformed connection, learning and participation in society. Despite these benefits, concerns have arisen with regard to privacy, data security and emotional and mental well-being.

The digital divide has reached a critical juncture, placing people and communities who lack access to cutting-edge technologies at risk of falling behind, both educationally and financially. In the context of a digital future, the challenge of digitalization must be tackled to achieve inclusive development. ECLAC has thus included the digital divide in the 10-point catalogue —or decalogue— of the structural gaps of development models. While digitalization can be a powerful tool for addressing structural problems in education, health, security, justice, institutional strengthening and productive transformation (Salazar-Xirinachs, 2021 and 2023b), failure to promptly and effectively harness the opportunities of the digital economy can substantially limit its potential benefits.

Adopting a Schumpeterian perspective, ECLAC (2022) and Cabrera and others (2024) contend that the potential of technological transformations extends beyond merely boosting economic growth by improving productivity to encompass the establishment of an environment that fosters convergence towards more developed economies through significantly improved living conditions. The waves of creative destruction unleashed by such technological revolutions drive significant socioeconomic transformations that have the potential to alter countries' development trajectories by changing wealth generation and distribution.

New technologies are thus transforming economies and societies worldwide. However, these great innovations are also escalating the global race for technological dominance, shaping economic leadership and redefining the contours of geopolitics.

3. Rivalry for technological dominance

Technological rivalry among companies and countries is certainly not a new phenomenon. It could be argued that it is one of the key drivers of innovation and economic productivity and growth. In the specific case of China and the United States, while trade conflicts and a growing technological rivalry date back at least to the administration of President Trump, the outbreak of the war in Ukraine worsened the conflict (Campanella, 2022). As a result, trade and technology issues have been incorporated into national security discussions, which lends a greater sense of urgency to their resolution and legitimizes the adoption of measures that would not necessarily be justified through purely economic arguments.

The National Security Advisor of the United States has spoken of "protecting our foundational technologies with a small yard and high fence" (Sullivan, 2023), and already in 2021 President Xi declared that technological innovation had become the main battleground on the global playing field and that the competition for technological dominance would be of unprecedented intensity (Xi, 2021). China has displaced the United States in the manufacturing of high-technology products and has become a serious competitor in the foundational technologies of the twenty-first century: artificial intelligence, 5G, quantum information science, semiconductors, biotechnology and green energy (Allison and others, 2021).

This rivalry has already moved on from political declarations to actual restrictions on the export of strategic products and technologies, as well as on the use of technologies produced by strategic rivals. In 2023, China restricted the use of Micron microprocessors (Venkat, 2023) and in 2024 it decided to phase out the use of Intel and AMD processors, as well as the use of the Windows operating system in government computers (Reuters, 2024). China also banned the export of rare earth processing technologies (Liu and Patton, 2024).

Meanwhile, the United States began imposing export restrictions on some semiconductors in 2015, extended them in 2021 (Ghoshal, 2023) and imposed new ones on semiconductors and other advanced computing components in 2022 and 2023 (BIS, 2023).

The purpose of these restrictions, whose scope was defined again in 2024, is to address the threats to United States national security posed by the Government of China's military and civil fusion strategy by controlling items needed for the development and production of technologies used in military applications, such as artificial intelligence (BIS, 2024).

Since 2019, the United States has imposed a series of increasingly stringent restrictions on exports of equipment and technology destined for Chinese telecommunications company Huawei, as well as restrictions on its business operations in the United States (Associated Press, 2022; Congressional Research Service, 2022).

The specific sanctions cited above are part of a broader set of sanctions on a number of Chinese individuals and companies, which have perhaps received the most media coverage. The United States has placed Chinese individuals and entities on three lists: (i) the list of Specially Designated Nationals and Blocked Persons (SDN); (ii) the non-SDN Chinese Military-Industrial Complex list; and (iii) the Entity List (Kilcrease and Frazer, 2023).

In response, China has equipped itself with instruments that allow it to impose sanctions on foreign companies and entities, such as a list of unreliable entities, rules to counter unjustified extraterritorial application of foreign legislation and a law against foreign sanctions. However, limited information is available on the implementation and effectiveness of these regulations (Malkawi, 2023).

4. Who regulates new technologies?

Regulation and governance are key elements to take into account when discussing technological transformations and the current and future impacts of these changes on society. They are also critical factors for analysing the rivalry for dominance in the development and use of new technologies.

The rapid adoption and evolution of new technologies has created a pressing need to establish both national and global regulatory frameworks. As technologies advance, concerns arise around data privacy, cybersecurity and consumer protection. The massive collection and use of personal data by technology companies pose serious risks to individual privacy and require regulations to safeguard transparency and informed consent. In addition, the increasing incidence of cyberattacks and the misuse of advanced technologies such as artificial intelligence call for more robust and internationally coordinated security measures. The development of consistent and harmonized regulations may help to prevent abuses and foster a secure and reliable technological environment. Thus, countries' decisions on how they regulate new technologies, and how they support them, affect aspects such as civil liberties, wealth distribution, domestic and international trade, social and democratic stability and national security, among many others (Bradford, 2023).

Global cooperation among nations is essential to address the cross-border challenges posed by new technologies. Standardization of regulations may facilitate international trade and ensure a level playing field for companies from different countries. There is also a need to establish global governance mechanisms that can address issues such as technological competition between nations, the protection of digital rights and the advancement of an inclusive digital economy.

Bradford (2023) discusses three regulatory models that are beginning to dominate the international landscape: the United States model, the Chinese model and the European model. The model adopted by the United States is guided by the digital and technological free market, in which the State plays a very limited role confined to issues such as national security. The China-driven model relies on decisive State involvement to regulate

technology and the digital economy, maximizing innovations while maintaining firm control over communications and social harmony. Lastly, the model promoted by the European Union is based on a mechanism grounded in the fundamental rights of individuals and the concept of fair markets to regulate technology.

International institutions and global forums can play a key role in promoting policies that encourage innovation, while ensuring that the benefits of technologies are distributed equitably and the associated risks are minimized. In this regard, the Secretary-General of the United Nations, António Guterres, has proposed the creation of a Global Digital Compact with "shared principles for an open, free and secure digital future for all" (United Nations, 2023). Effective and coordinated regulation is essential if the potential of new technologies is to be maximized and their negative impacts on global society are to be mitigated. It is imperative for Latin American and Caribbean countries to make progress on national regulations and to participate in international dialogues on this matter (Salazar-Xirinachs, 2023a).

F. The climate invoice

Decades ago, the scientific community warned of the consequences of climate change if the trajectory of greenhouse gas emissions was not radically altered. Although this trajectory changed following the twenty-first session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 21) held in Paris, the goal of limiting the average temperature increase to 1.5°C above pre-industrial levels no longer seems attainable. Even if countries meet their national commitments, the projected temperature increase will be between 2.0°C and 2.9°C this century, compared to pre-industrial levels (UNEP, 2023).

This realization does not detract from, but rather adds urgency to, the need to decarbonize the economy.[20] The impacts of climate change that have already occurred, in addition to those that seem inevitable, will have important consequences in the region. This section provides a preliminary exploration of the nature and costs of such consequences, hence its title: the climate invoice —that is, the cost for the region of the impacts of climate change thus far.

Clearly, without climate change mitigation, the cost will continue to increase. While options for mitigation are discussed in chapter VI of this report, this initial chapter is limited to examining the overdue invoice.

1. Impact on key sectors

In 2023, a drought severely affected Argentina, Brazil and Uruguay, resulting in water shortages and heavy agricultural losses. Extreme heat and heatwaves were recurrent in the region. Brazil experienced devastating floods in the south, while record low levels of the Rio Negro were recorded in the Amazon basin. The drought also had significant impacts in Central America. Mexico, meanwhile, had its driest year on record, which affected water availability and agricultural production. Hurricane Otis, which struck Mexico's Pacific coast, became a category 5 hurricane at unprecedented speed and caused massive destruction and significant economic losses (WMO, 2024).

In Latin America and the Caribbean, the current policies scenario is associated with an increase of about 3°C, which would lead to 65% of the region's territory being affected by high temperatures, an additional two to eight days of drought per year and a reduction of 66% to 97% in the volume of tropical glaciers (Reyer and others, 2017).

Table I.4 summarizes the estimated impact of four climate change scenarios on key sectors and resources in the region, considering an increase of 1.5°C to 4°C with respect to the baseline.

[20] This expression is used for the sake of brevity but, in reality, there is a need to reduce all greenhouse gas emissions.

Table I.4
Latin America and the Caribbean: climate change impacts on key sectors under various temperature increase scenarios

		1.5°C	2°C	3°C	4°C
Land area and drought	Longer droughts *(Number of additional days)*	1 to 4		2 to 8	8 to 17
	Land area affected by unusual heat *(Percentages of affected land area)*	30	30 to 40	65	90
Sea	Fish catch potential *(Percentage decrease or increase in catch)*			-50 to 100	
	Probability of annual coral reef bleaching in the Caribbean *(Percentages of probability)*	20 to 60	60 to 100		
	Sea level rise *(Centimetres)*		27 to 39		46 to 66
Glaciers	Glacier volume loss in the southern Andes *(Percentages of glacier volume loss)*		21 to 52	27 to 59	44 to 72
	Volume loss of tropical glaciers *(Percentages of glacier volume loss)*		78 to 94	66 to 97	91 to 100
Biodiversity	Variation in annual damages due to river overflow *(Percentages compared to 1986–2006)*	19	33	62	
	Increase in run-off in the Río de la Plata *(Percentages)*			10 to 30	
Health	Increase in dengue *(Percentages of cases)*	12 to 22		40	
	Increased risk of diarrheal disease *(Percentage increase in risk)*	5 to 13		14 to 36	
Food	Variation in annual wheat yields *(Percentages compared to 1986–2006)*	1.2	1.2	-3.5	
	Variation in annual soybean yields *(Percentages compared to 1986–2006)*	4.2	7.8	3.7	
	Variation in annual maize yields *(Percentages compared to 1986–2006)*	-1.9	-2.1	-10.6	
	Variation in annual rice yields *(Percentages compared to 1986–2006)*	2.1	4	0.5	
	Decrease in beef cattle production in Paraguay *(Percentage decrease in production)*		-16	-27	
Work	Change in labour productivity due to heat stress *(Percentages compared to 1986–2006)*	-5	-8	-13.7	
Economy	Acute impact of drought on GDP *(Percentage decrease in GDP)*	4.2	5.8		
	Acute impact of floods on GDP *(Percentage decrease in GDP)*	0.8	1.0		
	Acute impact of heatwaves on GDP *(Percentage decrease in GDP)*	0.8	1.7		
	Acute impact of tropical cyclones on GDP *(Percentage decrease in GDP)*	0.4	0.5		

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from C. P. O. Reyer and others, "Climate change impacts in Latin America and the Caribbean and their implications for development", *Regional Environmental Change*, vol. 17, No. 6, 2017 and Climate Analytics, 2022.

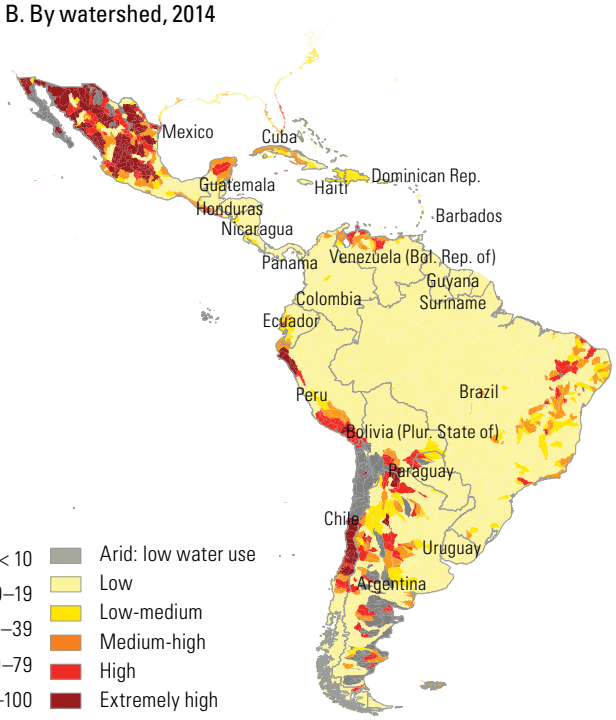
2. Stresses caused by water scarcity

Map I.1 shows the stress levels associated with water scarcity throughout the region, by country and by watershed. The situation is aggravated, in some cases, by the location of large urban concentrations in arid or semi-desert areas (as in the case of Lima or Santiago) or at high altitudes, where the water catchment area is lower (as in the case of Bogotá, Mexico City or Quito).

Map I.1
Latin America and the Caribbean: water scarcity stress, by country and watershed, latest available year
(Water stress indices)

A. By country, 2018–2022

B. By watershed, 2014



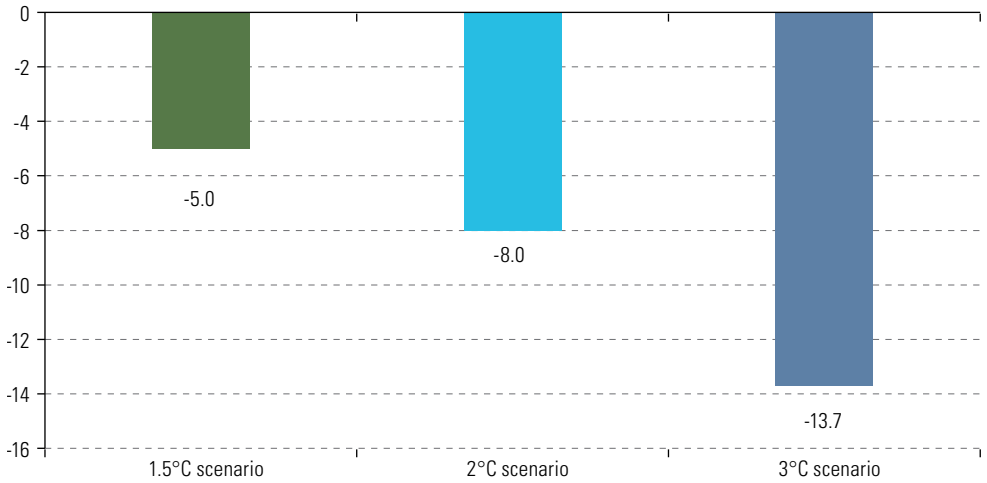
Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Natural Resources Outlook in Latin America and the Caribbean*, 2023 (LC/PUB.2024/4), Santiago, 2024.
Note: The values shown on map B are estimates from a model obtained by performing a regression of water stress conditions over the period 1960–2014.

Water availability within each country is highly unequal. The areas with the highest water stress include the small island States of the Caribbean, northern and central Chile, the Cuyo region in Argentina, the coasts of Peru and southern Ecuador, the Cauca and Magdalena valleys in Colombia, the Bolivian altiplano, north-eastern Brazil, the Pacific coast in Central America and much of northern Mexico (FAO, 2016 and FAO/UN-Water, 2018). The stress levels of those areas exceed 80% for periods of between 3 and 12 months per year (Mekonnen and others, 2015). In addition, the increasing frequency of storms, droughts and floods makes access to water and sanitation more unstable and deteriorates water infrastructure. This also affects production processes, as discussed below.

3. Agricultural yields

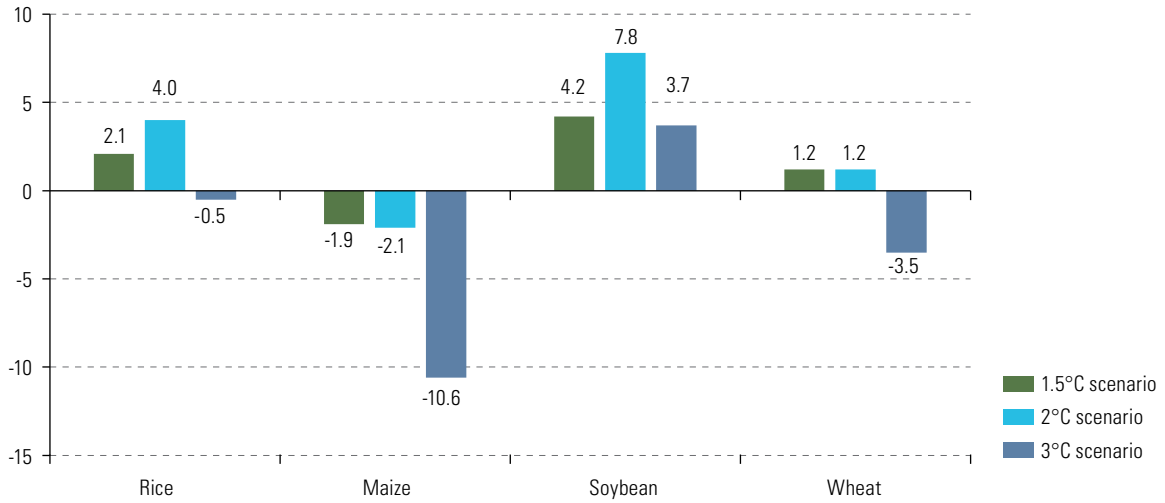
Climate change is having and will continue to have a negative impact on labour productivity in agriculture. The impact on agricultural labour productivity, under various scenarios, is presented in figure I.11, while figure I.12 shows estimates of the change in yields of selected crops.

Figure I.11
Estimated impact of climate change on agricultural labour productivity, by increase in average temperature, change from 1986–2006 average
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Climate Analytics, 2022.

Figure I.12
Estimated variation in yields by crop, by climate change scenario, change from 1986–2006 average
(Percentages)



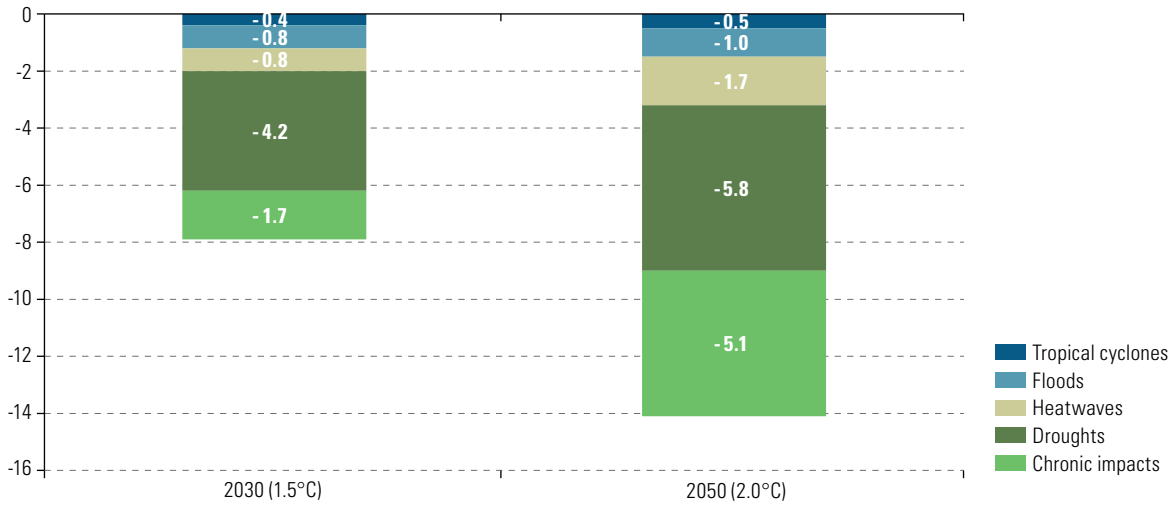
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Climate Analytics, 2022.

4. Cost of losses as a percentage of GDP

While it is impossible to account for all the potential impacts of climate change, there are several recent estimates of its global economic impact. The estimated impacts, which differ in scope, methodology and time horizon, indicate global per capita GDP losses ranging from 4.6% to 30% under the 3°C scenario, six times higher than the range of estimates applicable to the 1.5°C scenario, which indicate losses of 0.8% to 5% of GDP per capita (Alatorre and Fernández Sepúlveda, 2022; ECLAC, 2024a). It is crucial to note that these estimates take into account only the impacts of temperature changes on GDP and do not consider other transmission mechanisms or the impacts of extreme events; they therefore represent lower bound estimates of potential impacts.

In this respect, the cost estimate of the impacts of extreme events can be added to the chronic impacts (temperature increase) mentioned above (NGFS, 2024).[21] In the case of Latin America and the Caribbean, a warming level of 1.5°C would lead to an estimated annual loss of about 8% of GDP, which would materialize over the next decade if the current emissions trend continued. Under the current trajectory, the loss would almost double with a temperature increase of 2°C by mid-century, and droughts would be the main causes of damage in the region, as shown in figure I.13.

Figure I.13
Latin America and the Caribbean: climate change-related losses as a share of GDP, by climate change scenario, 2030 and 2050
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (CELAC), on the basis of Network for Greening the Financial System (NGFS), "NGFS Phase 4 Scenario Explorer", 2024 [online] https://data.ene.iiasa.ac.at/ngfs/#/about.
Note: Macroeconomic data are from the National Institute of Global Econometrics Model of the United Kingdom; Data on climate and the impact of physical hazards on GDP are from the Model for the Assessment of Greenhouse-Gas Induced Climate Change.

5. Economic and social vulnerabilities

Some countries are more vulnerable than others to the impacts of climate change, depending on their level of exposure to different risks and their capacity to cope with them. At times, this situation is coupled with high macro-financial vulnerability, that is, reduced fiscal space and high levels of debt relative to GDP, which limit their capacity to respond to various types of emergency (Bedossa, 2023). This double vulnerability already exists in some countries, and others are likely to suffer in the future with the intensification of climatic conditions. Countries with double vulnerability have a narrow response capacity, owing to their limited fiscal space if they are weakened by an extreme event, which could plunge them into a climate-financial trap (Bedossa, 2023).

Seventeen of the 33 countries in Latin America and the Caribbean are considered highly vulnerable to extreme weather events and 18 countries are also vulnerable to chronic worsening of climatic conditions. These are mainly countries located in the Caribbean and Central America, and almost all of them have macro-financial vulnerabilities. However, countries with a stronger macroeconomic position may also be threatened by climate risks, as in the case of Colombia.

[21] The estimates presented here are drawn from the database of the Network for Greening the Financial System. Macroeconomic data are sourced from the National Institute Global Econometric Model and data on the impact of physical risks on GDP and climate are from the Model for the Assessment of Greenhouse-Gas Induced Climate Change. Estimates of GDP losses from chronic physical hazards vary considerably according to the climate sensitivity assumptions used and the method employed to estimate damages. The methodology does not include sea level rise or broader societal impacts such as migration. In addition, the estimates do not fully reflect adaptation, which would reduce impacts.

The impact of climate policies on socioeconomic variables is another source of risks to be taken into consideration (transition risks). Insufficient climate action at the global level and growing rifts at the geopolitical level portend an abrupt transition to the goal of creating low-carbon economies. As with physical impacts, an economy's level of exposure and vulnerability to transition risks varies, and this is where economic structure plays a central role.

When an economy's level of exposure to transition is measured in terms of the degree of dependence on declining activities or industries, using employment (social), tax revenue (economic) and exports (external) as indicators, the Latin American and Caribbean countries studied show medium to high vulnerability in all three indicators (see table I.5) (Alatorre, Lalanne and Lavalleja, 2023).

Table I.5
Latin America and the Caribbean: degree of vulnerability by dimension

Degree of vulnerability	External Exports	Fiscal Revenue	Socioeconomic Employment
High	Bolivarian Republic of Venezuela, Colombia, Ecuador and Plurinational State of Bolivia	Bolivarian Republic of Venezuela, Ecuador, Guyana, Plurinational State of Bolivia and Trinidad and Tobago	Bolivarian Republic of Venezuela, Chile, Colombia and Ecuador
Average	Mexico and Peru	Chile, Mexico and Peru	Argentina, Brazil, Peru and Plurinational State of Bolivia

Source: J. E. Alatorre, A. Lalanne and M. Lavalleja, "Exposición macroeconómica de los países de América Latina en la transición verde", *Studies and Perspectives series-ECLAC Office in Montevideo*, No. 60 (LC/TS.2023/187-LC/MVD/TS.2023/4), Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

G. Concluding remarks: Latin America and the Caribbean facing a redefined globalization

The initial section of this chapter described two slowdowns that are changing the international development context for Latin America and the Caribbean. The first was the slowdown in economic growth and the second was the slowdown in the process of global economic integration, that is, a shift from "hyperglobalization" to more moderately paced globalization. Three substantial changes in the rules and dynamics of international relations, in both their political and economic dimensions, were also addressed: (i) the return of geopolitics as a central element in the foreign policy of the world's major economies; (ii) the resurgence of industrial or productive development policies based on heavy subsidies and protectionism, particularly in developed economies; and (iii) a change in international taxation rules, which will limit the capacity of developing countries to offer tax incentives as mechanisms for attracting foreign direct investment and fostering productive development.

Taken together, these three changes are having an incipient but significant impact on the geography of global value chains and foreign direct investment flows. In addition to the possible formation, albeit partial and limited, of trade blocs with substantial reciprocal barriers, there is also the potential for technological blocs to emerge. While the West restricts exports of certain services and technologies to countries perceived as geopolitical rivals and seeks greater strategic sovereignty (not only in technology and manufacturing, but also in access to critical resources), China is looking to reduce its dependence on Western technologies and products, both in software and microprocessors, that is, key technologies for information, telecommunications, automation and the development of artificial intelligence.

Added to all these changes is the climate invoice, which refers to the consequences and costs that the region will have to face as a result of climate change that has already occurred and that is inevitable given greenhouse gas emissions. This is an additional cost on top of the considerable investment requirements needed for the energy transition, which is a shared objective of the international community and the countries of the region.

In the context of this redefined globalization —or to be more precise, a globalization that is in the process of being redefined— the old development challenges of Latin America and the Caribbean are compounded by the new challenges listed below:

- How to compete in attracting foreign direct investment and stimulate domestic investment in sectors capable of boosting economic growth, particularly when developed countries offer direct subsidies that are framed in active productive development policies, which the region cannot even try to emulate (nor would that be desirable), and the fiscal and regulatory space to offer tax incentives is reduced.
- How to navigate geopolitical and trade conflicts between the world's major economies from a perspective that favours the region's economic interests, social aspirations and climate transition imperatives. Some countries may choose to move closer to one of the blocs that are formed, while others may try to remain equidistant and take advantage of the trade and cooperation opportunities offered by each bloc. In either case, the diplomatic dimension of international economic relations will be more complex and challenging than it was during the hyperglobalization period.
- How to reconcile the aspirations for technological and productive development with the potential technological decoupling between conflicting economic and geopolitical blocs, especially if technological cooperation and development projects associated with one bloc were to require the use of technologies incompatible with those of another bloc, which would create potential problems in the management of electricity and telecommunications networks, information systems, data processing and artificial intelligence.
- How to maximize trade opportunities and attract foreign direct investment with both blocs, without incurring the risk of economic sanctions by either of them.
- Lastly, there is a triple funding challenge related to climate change: (i) how to finance repairs to the damage caused by rising temperatures, changes in precipitation patterns and in the frequency and intensity of extreme weather events; (ii) how to finance the adaptation of cities, transportation infrastructure and productive activities to climate change; and (iii) how to finance the energy transition in its dual dimensions of clean energy production and technological transformation to reduce or eliminate fossil fuel use in energy-intensive activities, such as steel and concrete production, transportation and extraction of minerals (including those required for clean power generation and electromobility).

This series of changes shapes the general context that Latin America and the Caribbean will have to navigate in the coming decades. The following chapters analyse the major gaps and transformations that the region will face within this shifting context.

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CHAPTER

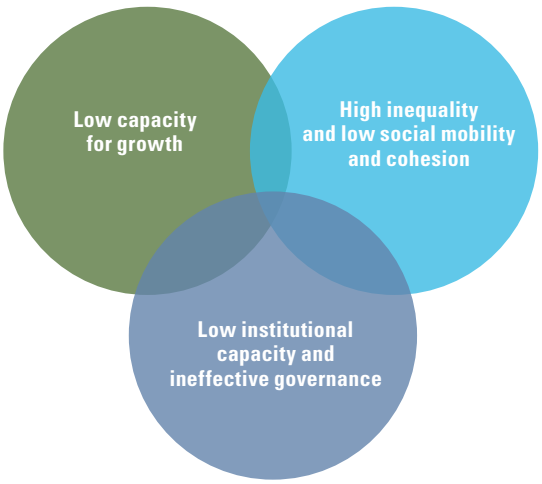
II

Development traps in Latin America and the Caribbean and vital transformations

Introduction

Latin America and the Caribbean is in the midst of a development crisis, reflected in three main traps (see diagram II.1): (i) low capacity for growth; (ii) high inequality with low social mobility and cohesion; and (iii) low institutional capacity and ineffective governance (Salazar-Xirinachs, 2023).

Diagram II.1
Development traps



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The development trap concept refers not only to a series of negative medium- and long-term trends; it also points to the existence of vicious circles that limit the ability to achieve higher levels of development (OECD and others, 2019). This feedback loop leads to stagnation, and in some cases, deterioration of economic, social, institutional and environmental conditions, among others. For example, the inequality trap is self-reinforcing in that it allows inequality to persist, meaning that inequality in the present begets inequality in the future.

These traps hinder progress in the implementation of the 2030 Agenda for Sustainable Development and the attainment of the Sustainable Development Goals (ECLAC, 2021). These interconnected challenges have gained prominence in a fast-changing global context that poses new and increasingly complex challenges (OECD and others, 2019). Overcoming the traps shown in diagram II.1 and turning the vicious circles into virtuous ones will enable the region to transition towards more productive, inclusive and sustainable development.

This chapter begins by presenting data on the three development traps in the region. This is followed by a description of the decalogue of gaps or structural challenges in the development models of Latin America and the Caribbean, as put forward recently[1] by the Economic Commission for Latin America and the Caribbean (ECLAC), and a subsequent presentation of the 11 great transformations ECLAC is proposing to move towards a more productive, inclusive and sustainable future. The chapter then ends with some conclusions.

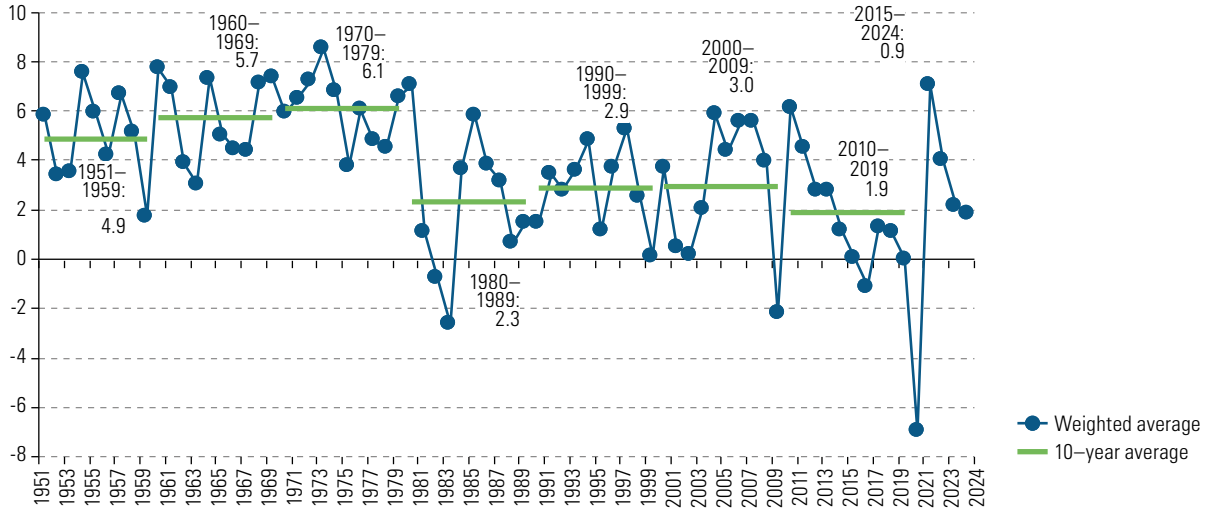
A. The trap of low capacity for growth

Between 2015 and 2023, the economies of Latin America and the Caribbean grew at an annual rate of 0.9% (weighted average), less than half of the 2.3% registered during the "lost decade" of the 1980s. This low growth has not been restricted to the last decade, but is rather a long-term trend. Average growth in the region

[1] For example, see the *CEPAL Review* special issue, No. 141 (ECLAC, 2023c).

fell from 5.5% in the almost 30 years from 1951 to 1979 to 2.7% in the following 30 years (1980 to 2009 and just 1.6% from 2010 to 2024 (see figure II.1). As a result, average per capita GDP in the region was the same in 2023 as in 2013 (ECLAC, 2024). Moreover, annual growth rates have been highly volatile, including at aggregate level, and even more so when each country is analysed separately (Salazar-Xirinachs and Llinás, 2023).

Figure II.1
Latin America and the Caribbean: growth in GDP, 1950–2024
(Percentages, on the basis of dollars at constant 2018 prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The countries of the region have ever less capacity to grow at high and sustained rates. Indeed, economic growth per se is not the main objective. What is needed is inclusive growth, in other words growth that reduces levels of poverty and informality and generates good jobs and an environment that is more conducive to reducing inequality. An essential condition for the region to adopt a more inclusive and sustainable pattern of development is that it achieves a higher and more sustained growth rate (Salazar-Xirinachs and Llinás, 2023).

The factors behind the low economic growth rate in Latin America and the Caribbean are manifold. Studies thereon have been conducted for specific countries or for the region as a whole, using a variety of quantitative and qualitative techniques. Some of the elements that have been associated with a low growth rate include: (i) low coverage and quality of education (Hanushek and Woessmann, 2012; Esquivel, 2015); (ii) lack of infrastructure (Calderón and Servén, 2004); (iii) institutional weaknesses (North, 1990; Acemoglu and Robinson, 2012); (iv) lack of economic diversification (Haussman and Rodrick, 2003); (v) high levels of inequality (De Ferranti and others, 2004); (vi) dependence on natural resources (Sachs and Warner, 1995); (vii) high frequency and incidence of disasters (Rivas Valdivia, 2014); (viii) contractionary bias of stabilization policies (Titelman and Pérez Caldentey, 2015); and (ix) low investment rates (World Bank, 2024).

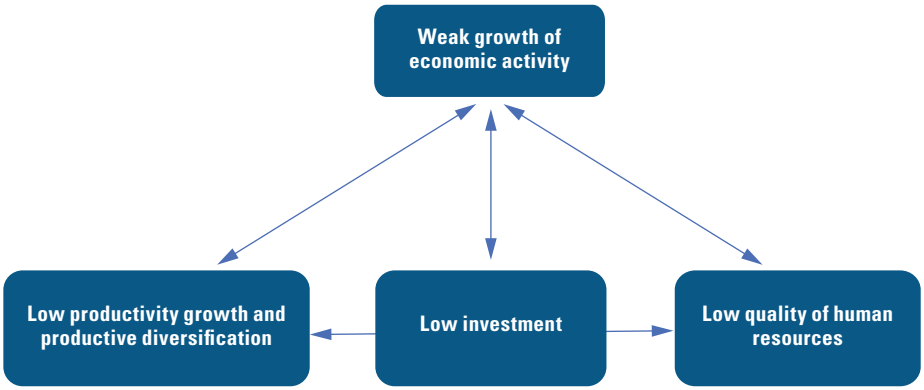
The trap of low growth capacity that exists in the region is primarily associated with three factors that have a negative feedback loop: (i) low productivity growth, (ii) low investment and (iii) low quality of human resources (see diagram II.2). Each of these is discussed in turn below.

The relationship between growth in economic activity and the expansion of productivity has been the subject of extensive theoretical and empirical research.[2] Productivity growth, linked to technological progress and the accumulation of knowledge, drives economic growth in the long run (see, for example, Solow, 1956; Romer, 1986; Barro, 1991; Hall and Jones, 1999; Bosworth and Collins, 2003; Díaz and others, 2020; Klenton, 2024).

[2] Productivity is commonly defined as a ratio between the volume of output and the volume of inputs to used to produce a given output (OECD, 2001). It is related to various economic forces, such as technological change, efficiency, living standards and production cost savings. Labour productivity is calculated on the basis of value added per worker.

There is a two-way relationship between these two variables: a high growth rate allows for the allocation of public and private resources to increase productivity (Aghion and Howitt, 1992); OECD, 2003; World Bank, 2009; Acemoglu, 2009).

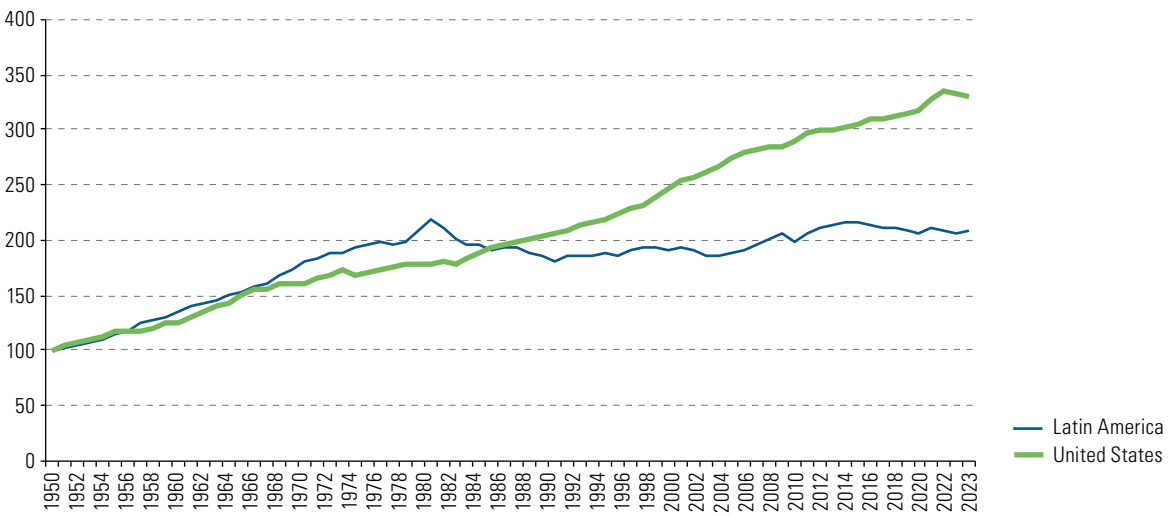
Diagram II.2
Main factors of low capacity for growth



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Between 1950 and 1980, Latin American and Caribbean economies more than doubled their labour productivity levels. However, 43 years on from the debt crisis, the region has been unable to regain the pre-crisis productivity levels. Between 1980 and 1990, average labour productivity in the region contracted by 16.5%. From 1990 onwards, there was a period of fluctuating productivity growth, which lasted until the end of the commodity price supercycle in 2013. Despite a 23-year recovery, labour productivity in the region in 2013 was slightly lower than in 1980. Since then, it has again trended downward, with a slight increase owing to the collapse in employment during the pandemic, which outpaced the contraction of GDP (see figure II.2). Figure II.3 also shows the changes in labour productivity in the United States, which, unlike in the region, has grown steadily between 1950 and 2023.[3]

Figure II.2
Latin America and the Caribbean (16 countries)[a] and United States: labour productivity, 1950–2023
(Index: 1950 = 100)

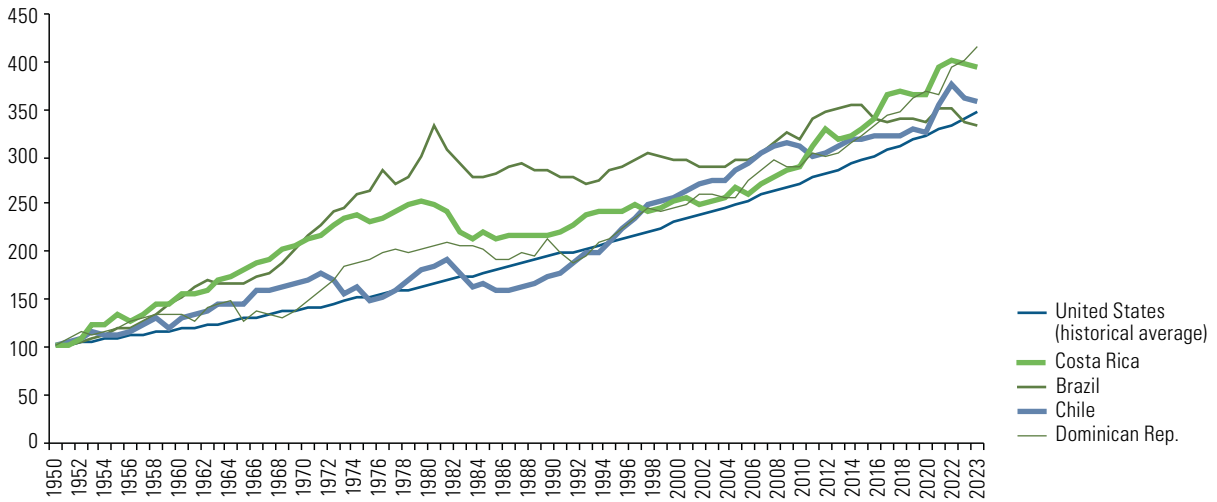


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from The Conference Board.

[a] Argentina, the Bolivian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Jamaica, Mexico, Paraguay, Peru, the Plurinational State of Bolivia, Trinidad and Tobago and Uruguay.

[3] Labour productivity in the United States is given to provide a benchmark for comparison with a high-income economy and one that is a major trading partner for many countries of the region.

Figure II.3
Latin America (selected countries) and United States: labour productivity, 1950–2023
(Index: 1950 = 100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries, and The Conference Board.

The behaviour described above has been rather widespread in Latin America and the Caribbean. Since 1950, only in four countries in the region for which data are available (Brazil, Chile, Costa Rica and the Dominican Republic) has the rate of growth of labour productivity been steadily higher than that of the United States (see figure II.3).

Likewise, technological change, the diversification of the production structure and the potential for economic growth are closely interrelated (ECLAC, 2012; UNCTAD, 2022). Sustaining high rates of economic growth will require moving towards more diversified, complex and technologically advanced production structures that will boost productivity. Experience shows that all success stories where countries have experienced rapid economic growth have been related to the promotion and emergence of new sectors or activities (CAF/ECLAC/OECD, 2013). The economic complexity index developed by Harvard University (2024) shows that in 2021, productive diversification stood above the global average in only five Latin American and Caribbean countries, illustrating the work that remains to be done in the region.

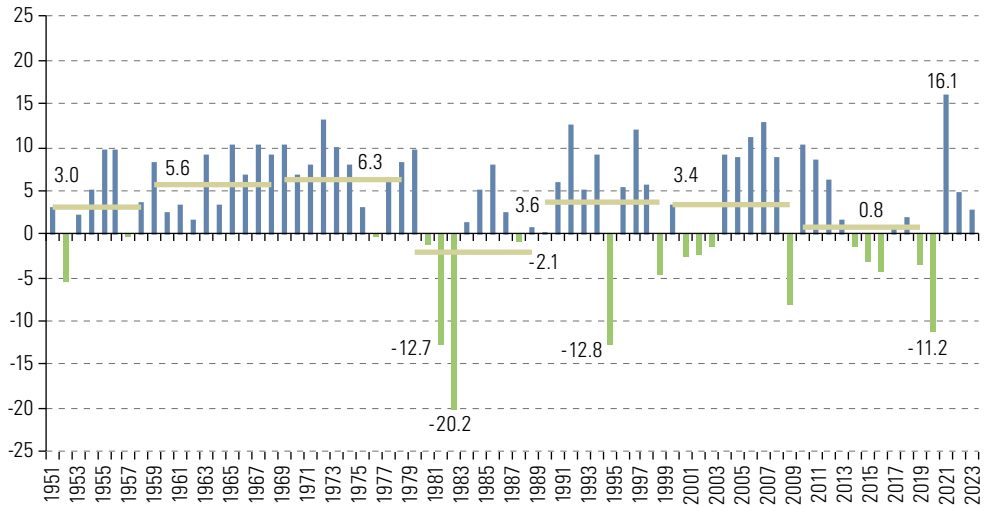
Investment has a multiplier effect on production, while economic activity is a determinant of gross fixed capital formation. There is circularity between both variables. The marked slowdown in investment in Latin America and the Caribbean since the 1990s (with decreases in some years) has had an adverse effect on the region's capital stock, productivity and economic growth (Mischke and others, 2024; De Long and Summers, 1991). In turn, the slower pace of economic activity has had a more than proportional negative effect on investment (ECLAC, 2018a), which has slowed output.

In an analysis on the determinants of investment in Latin America and the Caribbean between 1995 and 2017, ECLAC highlighted the existence of a two-way causality between investment and economic activity. Investment "both depends on economic growth (accelerator effect) and determines it through the channel of aggregate demand (multiplier effect). When growth quickens, firms invest more and create production capacity (accelerator effect)" (ECLAC, 2018, p. 21).

Insufficient investment in advanced infrastructure, as well as in science, technology and innovation, has been associated with the fact that a significant number of countries around the world remain trapped as middle-income countries (Agenor, 2016). Investment in basic infrastructure projects, such as roads, railways, airports and ports, among others, is crucial for boosting productivity and economic growth.

The annual rate of change in investment, measured through gross fixed capital formation, has slowed considerably in Latin America and the Caribbean in the last 70 years (see figure II.4). In the 1960s and 1970s, investment grew at average annual rates of 5.6% and 6.3%, respectively. In the 1980s, investment contracted at an average annual rate of 2.1%. In the 1990s and 2000s, growth was 3.6% and 3.4%, respectively, while in the 2010s it averaged a mere 0.8% (see figure II.4). In addition, the investment cycle has been shorter than the business cycle, leading to greater volatility (ECLAC, 2022; Titelman and Pérez Caldentey, 2015). Cyclical downswings in investment have been more frequent, longer lasting and more contractionary than recessionary phases of GDP. Even worse, the accumulated loss from investment during the recessionary phase of the business cycle was greater than the gains in periods of expansion (ECLAC, 2018a).

Figure II.4
Latin America and the Caribbean: real variation rate of gross fixed capital formation, 1951–2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2022* (LC/PUB.2022/9-P/Rev.1), Santiago.

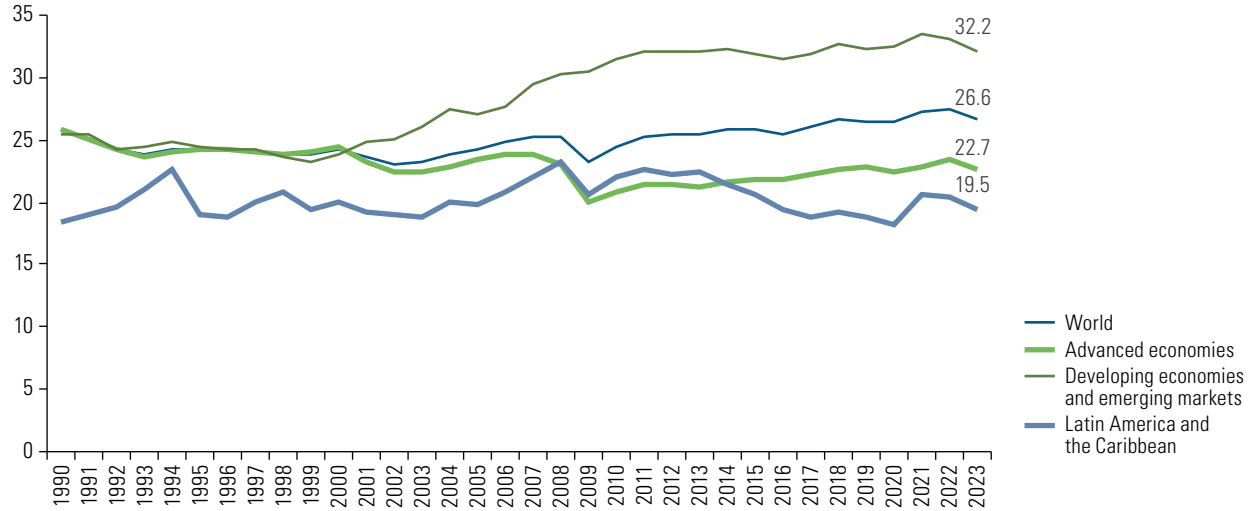
While there has been a slowdown in both private and public investment, it has been more marked in public investment. Public investment trends have been negatively affected by fiscal adjustment, weakening potential economic growth and leading to a decline in the acquisition of fixed assets to provide basic social services, such as education and health (ECLAC, 2022). In the 2010s, private investment increased at an annual average of 3.1%, while public investment contracted by 2.8%.

Concomitant with the slowdown in investment growth in the region, investment as a share of GDP has been declining steadily since the global economic and financial crisis of 2008-2009. Latin America and the Caribbean has not regained the 22% investment-to-GDP ratio registered in the 1970s; this figure held steady at around 20% in the 2010s. In 2021, investment as a share of GDP in the region stood at 19.7%, lower than the figure in advanced economies (22.5%) and significantly lower than in developing economies and emerging markets, where it stood at 32.7% (see figure II.5). This low level of investment is one of the main causes of low economic and productivity growth in the region (Salazar-Xirinachs and Llinás, 2023).

Education and skills acquisition are widely recognized as being positively associated with long-term economic growth (Harris, 2002; Lucas, 1988; Mincer, 1974). Levels of schooling directly influence productivity growth and increase individuals' earnings (Romer, 1990; Shultz, 1975; Becker, 1964). Specifically, schooling enhances labour skills and adaptation to new technologies, which in turn allows for greater productivity growth. Several empirical studies have found a positive relationship between economic growth and years of schooling

(Barro, 1991, 1996; Mankiw, Romer and Weil, 1992; Osiobe, 2019; Wang and Lui, 2016).[4] Likewise, higher economic growth provides resources for greater investment in education and in building labour force capacity (Psacharopoulos and Patrinos, 2004; Hanushek and Woessmann, 2008; OECD, 2012, and World Bank, 2018).

Figure II.5
World and selected regions: investment to GDP ratio, 1990–2023
(Percentages, on the basis of dollars at constant prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

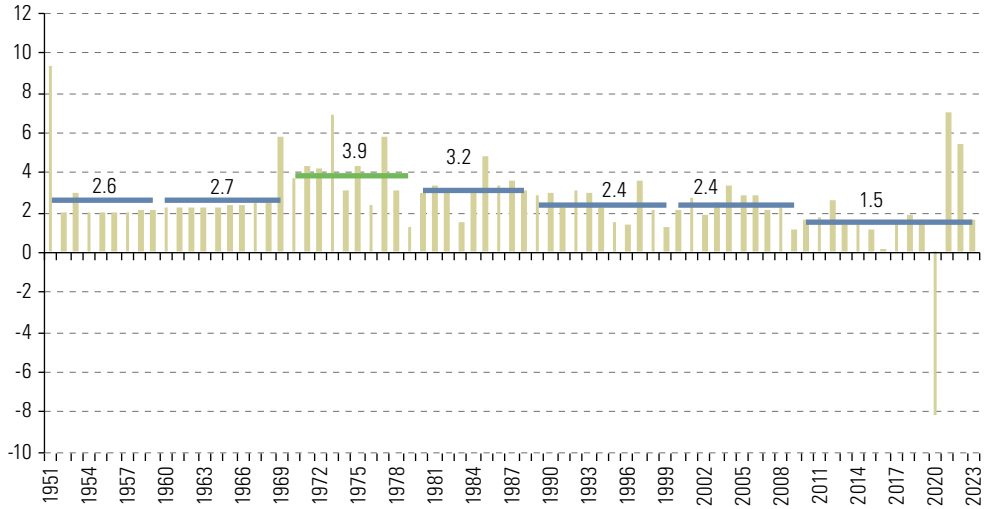
Several studies on Latin America and the Caribbean have shown a strong association between modest economic growth rates, slow labour productivity growth and low levels of education (Rannis and Stewart, 2002; McKinsey Global Institute, 2014; ECLAC, 2016). In addition, the productive sectors with the highest growth and employment generation in the region have a low labour productivity index (ECLAC, 2024).

There is a strong correlation between low growth and a low rate of employment generation. The lowest average annual rate of job creation in the last 70 years (1.5%) was registered in the period 2011–2019. As figure II.6 shows, job creation has been declining since the 1970s, when the regional average growth in employment was 3.9%. In addition, almost half of all job creation is informal and characterized by low productivity (ECLAC, 2024; Álvarez and Ruane, 2024; Levy, 2018), as discussed in greater detail in chapter V. This close correlation between growth and job creation, particularly the creation of quality employment, is unsurprising, as it would be difficult to have a dynamic labour market without robust growth. This is one of the main reasons why it is important for countries to achieve higher, sustained, inclusive and sustainable growth.

To ensure and maintain a higher and sustained growth rate, continuous improvement in education and in the quantity and quality of human talent is also essential. In Latin America and the Caribbean, the average years of schooling of the population has increased. In 2022, the population aged 15 and over with more than 13 years of schooling accounted for 22.4% of the region's total population, compared to 12.6 % in 2000 (ECLAC, 2024). However, the region remains behind East Asia and the Pacific and far behind North America. With regard to average years of schooling, in Latin America and the Caribbean the figure stands at 9.2 years for the total population, while in East Asia and the Pacific it is 9.8 years, and in North America 13.5 years (see figure II.7). In addition, in most Latin American and Caribbean countries, secondary education dropout rates are very high. On average, only 41.4% of the region's labour force has completed secondary school (Salazar-Xirinachs and Llinás, 2023).

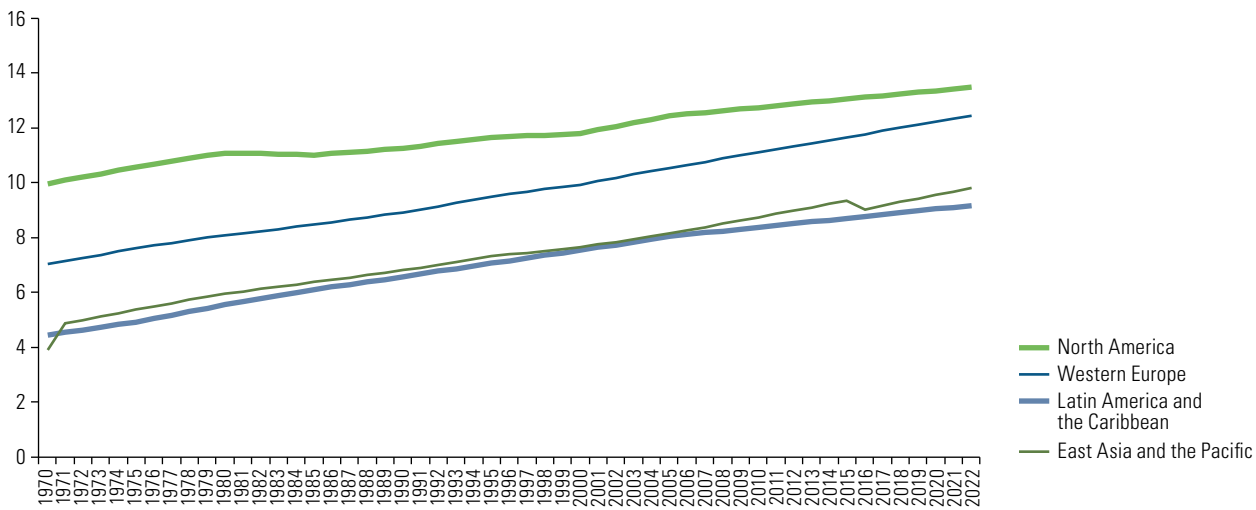
[4] However, as Pritchett (2024) argues, the correlation between more years of schooling and higher economic growth is not evident in all countries. Therefore, years of schooling alone are not enough, but also years of learning and skills development. He posits that in order for education systems to yield better results, they must be aligned not only with schooling rates, but also learning outcomes.

Figure II.6
Latin America (17 countries):[a] annual rate of growth of employment, 1951–2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and data from the International Labour Organization (ILO).
[a] Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

Figure II.7
Selected regions: average schooling of the population aged 15 and over, 1970–2022
(Years of schooling)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "Education Statistics (EdStats)", 2024 [online database] https://datatopics.worldbank.org/education/home.
Note: Linear interpolation and extrapolation techniques were applied between the five-year periods for which data were reported.

For those who do complete secondary school, the quality of learning is generally low and has been deteriorating in recent years, as suggested by Programme for International Student Assessment (PISA) test scores. Table II.1 shows the PISA test scores for Latin American and Caribbean countries where the test has been conducted. The highest average in mathematics is achieved in Uruguay, while Chile has the highest scores in reading and science. The table also shows the results for several countries of East Asia and the Pacific. With the exception of Indonesia, most of the averages scores in that region are above the average for Latin America and the Caribbean.

Table II.1
Latin America and the Caribbean and East Asia and the Pacific (selected countries): PISA test results, by country
(Average score)

Country	Mathematics	Reading	Science	Country	Mathematics	Reading	Science
Argentina	390.96	402.3	405.22	Australia	514.93	516.03	523.03
Brazil	368.98	403.49	394.32	China	581.35	539.79	557.5
Chile	412.34	440.2	438.48	Hong Kong, China	553.59	529.25	541.63
Colombia	379.24	406.7	401.05	Indonesia	375.12	390.04	391.57
Costa Rica	405.55	436.87	426.48	Japan	535.35	515.36	542.33
Dominican Republic	327.7	357.74	331.64	Republic of Korea	543.46	534.56	534.05
Mexico	402.95	417.38	413.77	Macao, China	531.9	498.84	519.14
Panama	359.75	370.73	375.9	Malaysia	423.63	414.2	428.23
Peru	352.94	369.62	368.12	New Zealand	516.12	518.95	523.32
Trinidad and Tobago	415.64	421.86	417.39	Singapore	566.56	534.4	549.59
Uruguay	420.6	424.08	428.99	Thailand	421.14	423.18	429.51
United States	481.44	498.79	495.88	Viet Nam	502.93	497.5	526.53
Average	**385.15**	**404.63**	**400.12**	**Average**	**505.51**	**492.68**	**505.54**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, *Competition: The Missing Ingredient for Growth?*, Washington, D.C, April 2024.
Note: Average does not include the United States.

The region also has fewer university graduates in science, technology, engineering and mathematics (STEM) areas relative to other countries. This poses a challenge, as these are the professionals most in demand in twenty-first century production paradigms (Salazar-Xirinachs and Llinás, 2023). For example, according to the most recent figures from UNESCO (2024), in Argentina, Brazil and Costa Rica the number of tertiary education graduates in STEM areas represented 15.0%, 17.5% and 15.7%, respectively, of the total number of graduates. In contrast, in India this figure was 29.3% and in the Republic of Korea, 30.4%.

When capital investment takes place in a context of low human resource capacity, this tends to lead to two types of structural change. First, there is a technological change with a bias towards higher skills, which pushes up wage inequality as higher-skilled occupations are better paid. Second, there is a perverse structural change, as jobs in sectors with higher productivity levels (manufacturing) are reallocated towards lower-productivity sectors (services), which at the aggregate level weakens both productivity and investment attraction (ECLAC, 2024; Padilla Pérez and Villarreal, 2017).

B. The trap of high inequality and low social mobility and cohesion

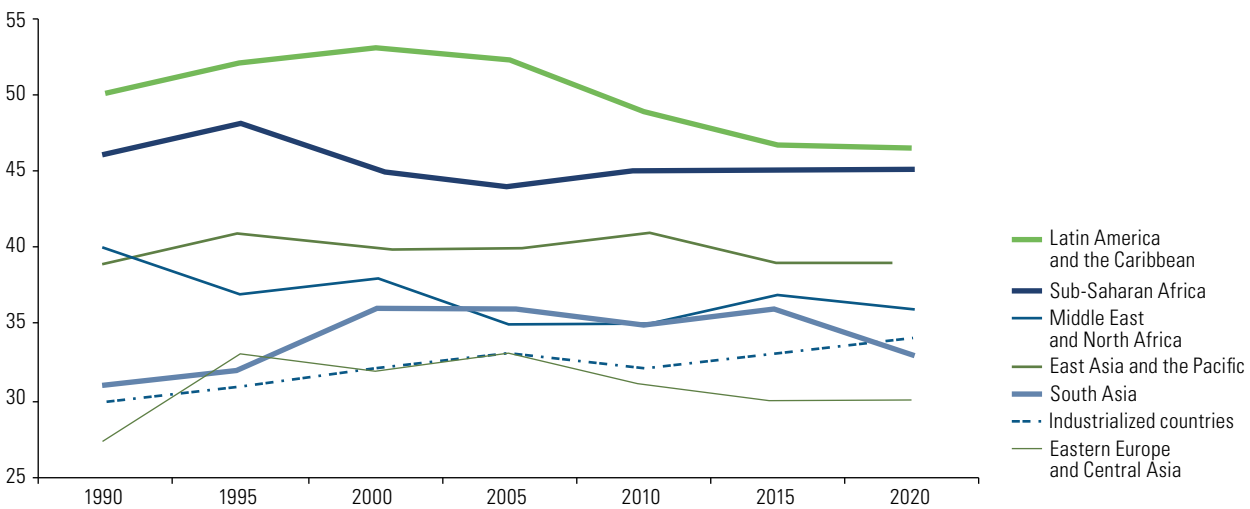
The high level of multiple types of inequality in the region is a trap that hinders progress towards sustainable development. First, inequality is unacceptable from the point of view of the effective enjoyment of rights and the basic concepts of social justice, and is also inefficient for growth and corrosive for social cohesion and for the stability of social pacts. (Salazar-Xirinachs, 2023). Second, inequality serves to entrench the other two structural development traps, namely, the inability to grow in the long term and low institutional and governance capacity. The following sections look at the relationships between the high inequality trap and the other traps mentioned above, and present an analysis of the dynamics, linkages and interdependencies of inequality, mobility and social cohesion. Lastly, some of the main policy implications of integrated strategies for development are presented.

1. Inequality and its links to low-growth traps and limited institutional capacity

Inequality is economically inefficient, because it reduces dynamic efficiency in economies in several ways. Access and quality gaps in areas such as health, education, basic services and housing affect skills creation and labour inclusion, and thus have adverse impacts on economic productivity and on people's income. In turn, inequality is reflected within local areas and between one district and another, as its costs weigh not only on productivity, but also on energy inefficiency and environmental deterioration (ECLAC, 2018b). Inequality also curtails innovation and creativity, and thus impedes greater productivity, which partly explains why the countries of the region have been unable to foster greater technological sophistication and productive diversification or to reposition their economies by increasing the productivity of companies and sectors (Llinás and Salazar, 2023). Furthermore, the interaction between low growth capacity, high inequality and weak institutional capacity considerably limits the countries' response and adaptation ability in light of the need to adopt sustainable development strategies and build resilience to the effects of climate change and environmental degradation.

Inequality in Latin America and the Caribbean is a historical and structural phenomenon. The productive structures, factor endowments and certain institutions inherited from the colonial era helped shape, perpetuate and exacerbate high levels of economic inequality, along with other factors that followed independence in these territories (Eslava and Valencia Caicedo, 2023; ECLAC, 2012 and 2018b). Inequality is thus related to the structural heterogeneity that has been the region's historical hallmark and reflects sectoral differences in the productivity of production systems (Salazar-Xirinachs, 2023). Figure II.8 clearly shows that, in terms of income, Latin America and the Caribbean has remained the world's most unequal region over the past 30 years (by the Gini index). Although income inequality has fallen during this period, the region still has the most concentrated income distribution in the world. In 2022, income inequality measured by the Gini index was 44.9, lower than in the early 1990s (when it was close to 50.0) (ECLAC, 2023a).

Figure II.8
Latin America and the Caribbean and other world regions: inequality levels and trends, Gini index, 1990–2020



Source: F. Alvaredo and others, "Seventy-five years of measuring income inequality in Latin America," *IDB Working Paper Series*, No. IDB-WP-01521, Washington, D.C., Inter-American Development Bank (IDB), 2023.
Note: Data for Latin America and the Caribbean are based on household surveys from the ECLAC Household Survey Data Bank (BADEHOG).

ECLAC describes six main factors that explain inequality and low social mobility and cohesion in the Latin American and Caribbean countries: (i) low growth, which leads to sluggish and highly informal labour markets, and large disparities in productivity, which generate segmented labour markets with large pay disparities; (ii) regressive tax systems; (iii) weak social and social protection policies that do little to reduce the effects

of production-based inequality; (iv) education systems with serious deficiencies, not only in terms of high dropout rates in secondary education, but also in relation to poor learning outcomes that are unequal to the new needs arising from the technological revolution and the labour market, and that are too segmented to act as the powerful mechanisms of social mobility they ought to be; (v) gender inequality; and (vi) large inequalities and spatial segregation in urban areas, where 80% of the region's total population lives.

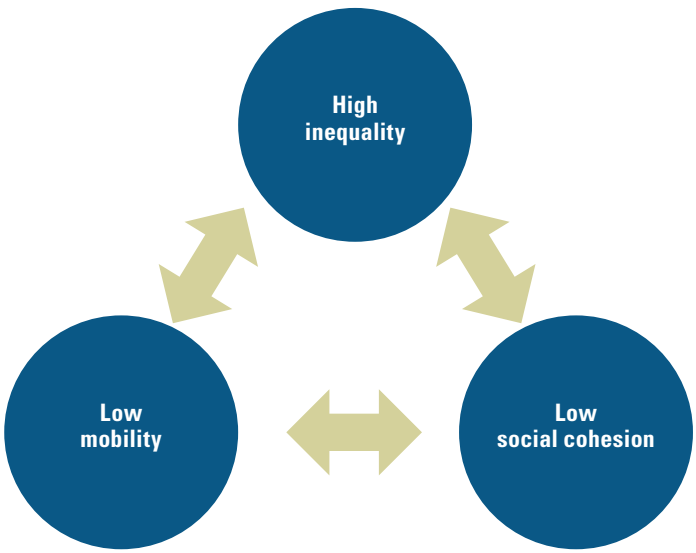
These sources of inequality in income distribution are compounded by large disparities in power and agency. All this tends to create a vicious cycle whereby inequality reduction policies are less likely to be adopted and implemented in contexts with relatively high inequality (Robinson, Fergusson and Torres, 2023; Guizzo Altube, Scartascini and Tommasi, 2023). Given that Latin America is sadly distinguished by having the world's highest income inequality, the political economy of redistribution and inequality reduction is crucial. Notwithstanding differences in distributive capacity and policy efficiency among countries in the region, generally speaking, high inequality affords certain actors greater power to advocate for reducing the tax burden and limiting redistribution (Guizzo Altube, Scartascini and Tommasi, 2023).

Accordingly, inequality is also linked to poor institutional and governance capacity, because this hinders the adoption of comprehensive, efficient development strategies to reduce inequality through ongoing, broad and representative dialogue and governance capable of settling differences and producing greater convergence and coordination among political, economic and social agents. In addition, resources and prioritization of sustainable development strategies are needed to generate institutional capacities, especially technical, operational, political and prospective (TOPP) capabilities, and this is less likely to happen if the actors with the greatest power over these choices do not see them as a priority. In this sense, the concentration of political and economic power reduces the incentives to invest in expanding State capacities (Cárdenas, 2010).

2. High inequality, low mobility and poor social cohesion: a development trap

Inequality —in its various manifestations— is multidimensional, as are the factors that generate and perpetuate it, which ECLAC has characterized as the social inequality matrix (ECLAC, 2016). In other words, the region's high levels of inequality extend beyond income to include the exercise of rights, capacity development and access to power and decision-making. In turn, it is associated with low mobility and social cohesion, in a vicious circle (see diagram II.3).

Diagram II.3
High inequality and low social mobility and cohesion: interdependent and mutually reinforcing forces



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

High inequality is a result of the interaction between and reinforcement of several axes, associated with exclusions and discrimination of individuals and groups. The extent and variability of inequalities between individuals and population groups are amplified and exacerbated by several factors that operate as interrelated axes, such as socieconomic level, gender, race and ethnicity, age, territory, disability status, migration status or sexual orientation and identity. Social inequality is reflected in several areas of social development and rights, ranging from income to employment, education, health, access to social protection and care, food, basic services, the distribution of time, and participation and agency in political decision-making (ECLAC, 2016).

Similarly, inequality often translates into considerable disparities in power and agency, systematically excluding large sectors from having effective representation and a voice in public debate (Guizzo Altube, Scartascini and Tommasi, 2023; Oxfam International, 2045). Historically, socioeconomic status has been one of the main focuses in policy analysis and design, with little regard for importance of and interaction with other factors, in particular race and ethnicity, which have lacked prominence despite their being among the main determinants of inequality in various spheres (Telles and others, 2023).

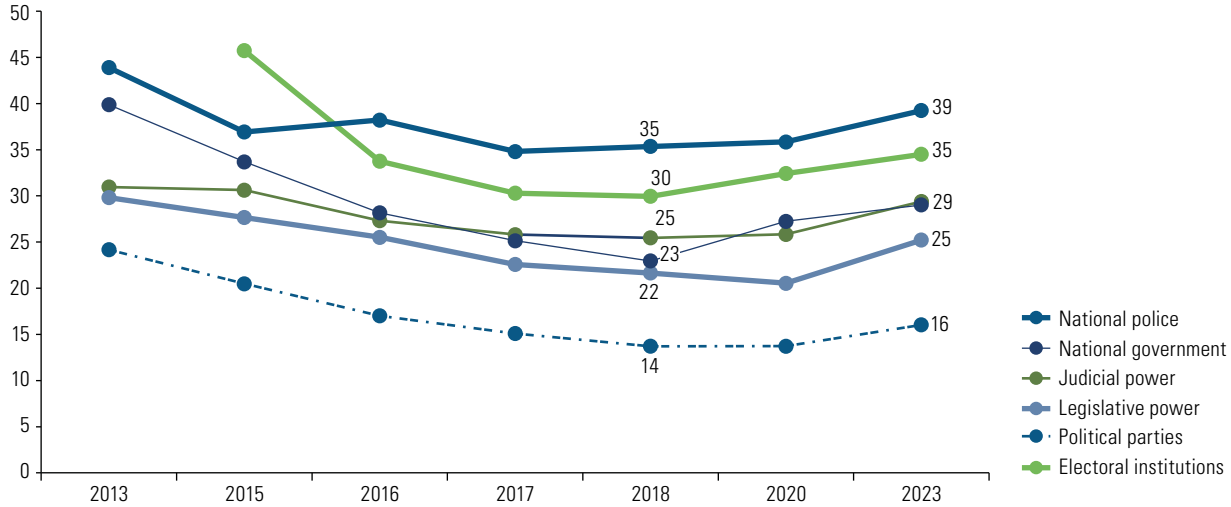
Further efforts are needed to address the interaction between inequalities in these areas of social development and the axes of inequality before a systematic multidimensional measurement can be developed. The first issue to consider is income, without disregarding how it interacts with the other areas and dimensions of social development mentioned above, including its impact on social mobility and stratification (Bourguignon, Ferreira and Lustig, 2023; Martínez and others, 2023).

The high inequality in all the aforementioned areas is associated with a low level of social cohesion. This cohesion is the invisible binding force that holds societies together and which gives a sense of identity and motivates people to live together and cooperate voluntarily without the need for continuous external coercion or immediate interest. It is difficult to consolidate this sense of unity in highly unequal societies. This is even more important if, in the context of sustainable development, the aim is to build a model of social cohesion that is not based on rigid and inherited hierarchies, but on the capacity of a society and its institutions to promote equality in social relations and to generate, on that basis, a sense of belonging and a focus on the common good that is considered legitimate by its members (Maldonado Valera and others, 2021).

The low level of social cohesion is reflected in high interpersonal and institutional distrust, with adverse effects on governance and efficiency, a widespread sense of vulnerability, helplessness and injustice among the population, low expectations for future social mobility, little sense of belonging based on the effective enjoyment of rights, and a tenuous attachment to democracy as the best form of government (Corporación Latinobarómetro, 2022). Compared with other regions, along with high levels of inequality, high levels of interpersonal and institutional distrust have been hallmarks of Latin America and the Caribbean (Scartascini and Valle Luna, 2020). Figure II.9 illustrates levels of institutional trust and shows that, in recent years, trust in key bodies such as national governments, the judiciary, the legislative branch, electoral bodies, the police and political parties has remained below 39%. Against this backdrop of low social cohesion, there is also considerable social unrest and social and political polarization that make it difficult to establish dialogue that takes all voices into account and lays the foundations for broad consensus to refocus development strategies (ECLAC, 2021). Low social cohesion inhibits the development of comprehensive social and fiscal covenants for reducing inequality through public policy and for adopting sustainable development strategies.

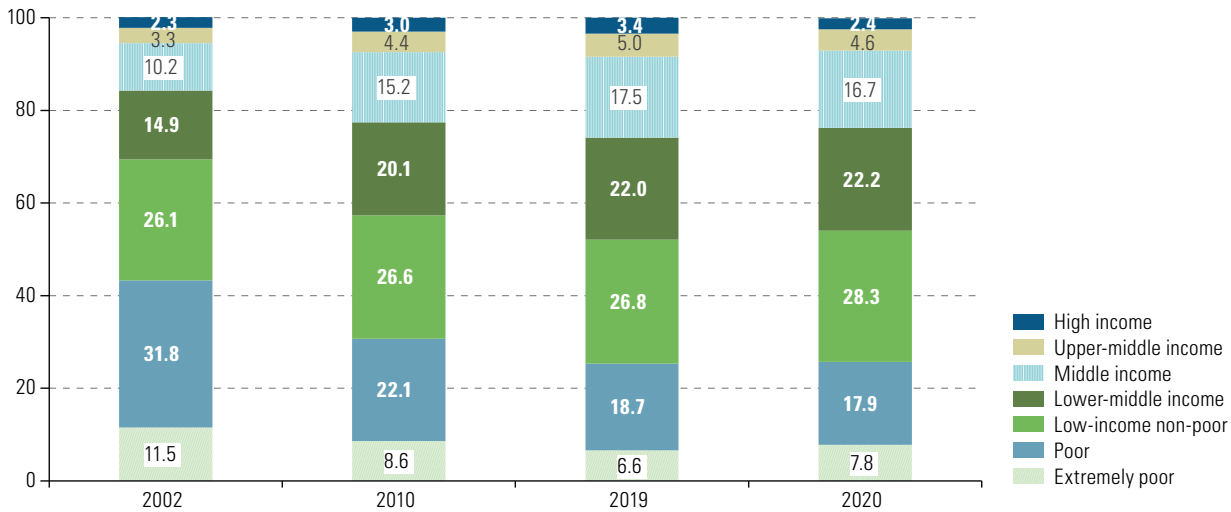
The region is also characterized by a low level of social mobility, or considerably rigid social stratification, which makes it harder for people in the most disadvantaged strata to achieve greater well-being for themselves and their descendants. For example, figure II.10, which presents the national population distribution by income stratum for the twenty-first century thus far, shows that a considerable percentage of the population remains at income levels close to or below the poverty line. There is a high level of labour insecurity and informality and a lack of access to social protection in the lower and lower-middle strata, making them highly vulnerable to poverty. This low social mobility is linked to high levels of inequality perpetuated through channels aligned with the axes of the social inequality matrix and low social cohesion. High inequality and low social mobility are closely related. Although the percentage of the population living in poverty has declined significantly in recent years, social mobility has been limited: a large percentage of the population remains highly vulnerable (with income equal to or below three poverty lines). As shown in figure II.10, the percentage of the population in vulnerable situations (i.e. medium-low income and below) changed little in recent years, decreasing from 77.4% in 2010 to 76.2% in 2020.

Figure II.9
Latin America (18 countries): trust in selected institutions, 2013–2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations from the Latinobarómetro Survey.

Figure II.10
Latin America (15 countries):[a] national population distribution by income stratum, 2002, 2010, 2019 and 2020
(Percentages)



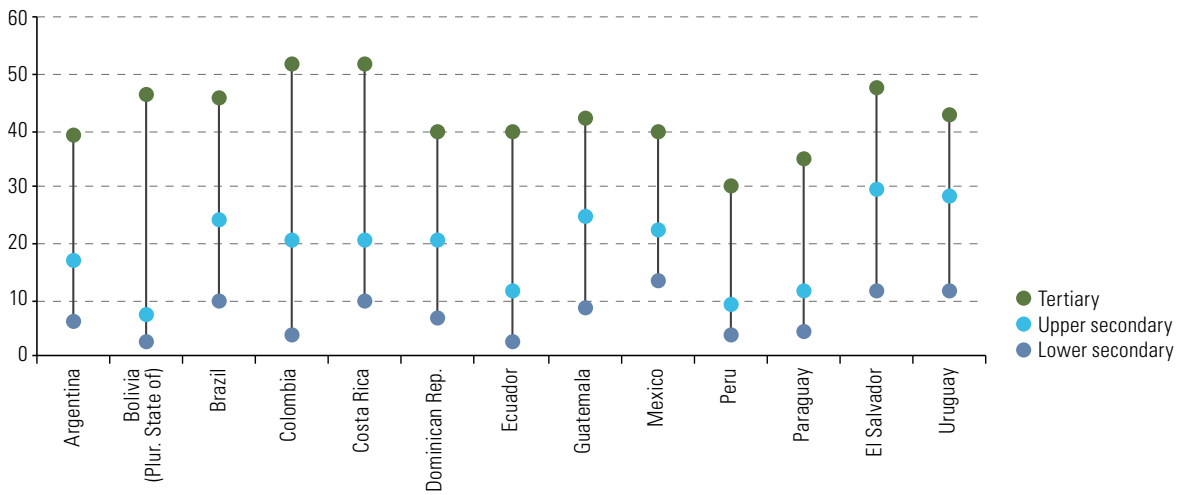
Source: R. Martínez and others, "Estratificación y clases sociales en América Latina: dinámicas y características en las dos primeras décadas del siglo XXI", *Project Documents* (LC/TS.2022/214), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2022.

[a] Simple averages for Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

Multiple dimensions can be used to approximate the lack of flexibility, or rigidity, of the social structure, such as income and consumption, types of employment and jobs, and accumulation of assets and wealth. Individuals' self-perception can also shed light on the structure of opportunities that determines social stratification (Martínez and others, 2022). Gaps in skilled labour (especially in the education and health sectors), labour inclusion, and access to social protection and care limit people's chances of improving their own well-being and personal development throughout the life cycle. These gaps also limit opportunities for future generations to achieve greater well-being and enjoyment of rights, owing to discrimination and exclusion in the early stages of the life cycle and the intergenerational transmission of poverty and inequality.

Deficits in education access and quality are the most significant mechanisms for the perpetuation of social class; they are key determinants for income level, access to decent jobs and, from a symbolic perspective, achievement of valued social status and prestige. Figure II.11 presents information on 13 countries of the region, showing that the probability of labour market participation increases considerably as the number of years of schooling increases. For example, in all countries, the probability increases for people with tertiary education relative to those with lower-secondary or upper-secondary education. Health is also influenced by social determinants throughout the life cycle, including ability to access affordable, quality health care in a timely manner without jeopardizing well-being, labour market participation or income, which constitutes a barrier to social mobility for the middle and low strata (Marinho, Dahuabe and Arenas de Mesa, 2023; Bancalari and others, 2023; Brunori and others, 2023).

Figure II.11
Latin America (13 countries): probability of formal employment at tertiary, upper-secondary and lower-secondary levels of education relative to primary or lower levels, 2023 or latest year
(Percentage points)



Source: M. Székely and others, "Retornos a la educación en América Latina y el Caribe", *El desafío de la sostenibilidad financiera de la educación en América Latina y el Caribe*, M. Huepe, *Project Documents* (LC/TS.2024/1), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC)/World Bank/Ford Foundation/United Nations Educational, Scientific and Cultural Organization (UNESCO), 2024.

Note: Data refer to employed persons aged between 25 and 55. Lower secondary refers to a person with 7 to 9 years of schooling; upper secondary refers to a person with 10 to 12 years of schooling; and tertiary refers to a person with more than 12 years of schooling. The data show the marginal effects of a probit estimation, controlling for education level, gender and territory (rural or urban). Formal employment for the purpose of this estimation is defined as employment affiliated to a social security system.

Low social mobility is reflected in rigid social stratification —with large sectors of the population living in precarious conditions and highly vulnerable to multiple risks, especially poverty— and an occupational structure that has remained largely unchanged over time (Martínez and others, 2022). In turn, low social mobility is associated with low social cohesion, which widens gaps of belonging and of interpersonal and institutional trust. In particular, low expectations of achieving intra- and intergenerational social mobility through education or the accumulation of wealth fuel persistent social unrest, undermine institutional trust and weaken attachment to democracy as an effective system for channelling social demands (Espinoza and others, 2023). Regarding people's perceptions of their current and future situation, expectations of achieving intra- and intergenerational social mobility through education, effort or available opportunities are low, and social assets are viewed as having a central role. Low social mobility, in addition to magnifying gaps in belonging and interpersonal and institutional trust, lowers the probability of achieving broad consensus on more sustainable and productive development strategies.

Moreover, limited institutional capacities compromise the effectiveness of public measures, exacerbating mistrust in institutions, policies and public officials. Even where public policies are responsive and accountable, this mistrust, coupled with scepticism of guarantees of access to education, health and social security or

the proper functioning of democracy, means that the possible expansion of fiscal space or the search for more redistributive mechanisms lose legitimacy in the eyes of broad segments of the population, who are unconvinced by assurances of the efficient and relevant use of public resources (Arenas de Mesa, 2016; De la O, Rossel and Manzi, 2023).

In this sense, overcoming the trap of high inequality and low social mobility and cohesion is inextricably linked to strategies for inclusive social development that aim to break from the traps of low growth and of weak institutional capacities and ineffective governance, as part of a comprehensive approach to sustainable development. Stronger social protection systems, an expanded welfare state and the general improvement of social policies are particularly effective in overcoming the high inequality trap because they mitigate multiple equality gaps, helping to lay the groundwork for greater productivity and growth. Improving access to education for the poor and vulnerable strata of the population while pursuing a more equitable quality of education at all levels is key. The foundation of sustainable upward mobility should be built on strengthening household resilience through non-contributory social protection programmes alongside expanded labour inclusion, with access to social security and unemployment insurance to protect income and well-being from adverse shocks (Amarante, Lustig and Vigorito, 2024; Arenas de Mesa, 2024; and Trucco, 2024).

C. The trap of low institutional capacity and ineffective governance

ECLAC has identified low institutional capacity and ineffective governance as the third development trap facing Latin America and the Caribbean. According to Salazar-Xirinachs (2023), strengthening institutional capacities and governance is crucial to address the development crisis in the region and manage transformations.

This section focuses on two key aspects. First, indices are used to rank countries of the region in terms of their institutional capacities and governance. Regardless of possible methodological limitations, these indicators show that the region is lagging significantly behind countries with more solid institutions; thus, they are relevant in highlighting the need to address this issue in greater depth.

The trap of low institutional capacity and ineffective governance involves vicious circles that make it difficult for countries to address their development challenges. Chapter III explores this issue in greater depth by analysing four key concepts: (i) governance; (ii) institutional capacities; (iii) political economy; and (iv) social dialogue. These concepts help not only to outline important challenges but also to highlight specific aspects and thus identify possible solutions.

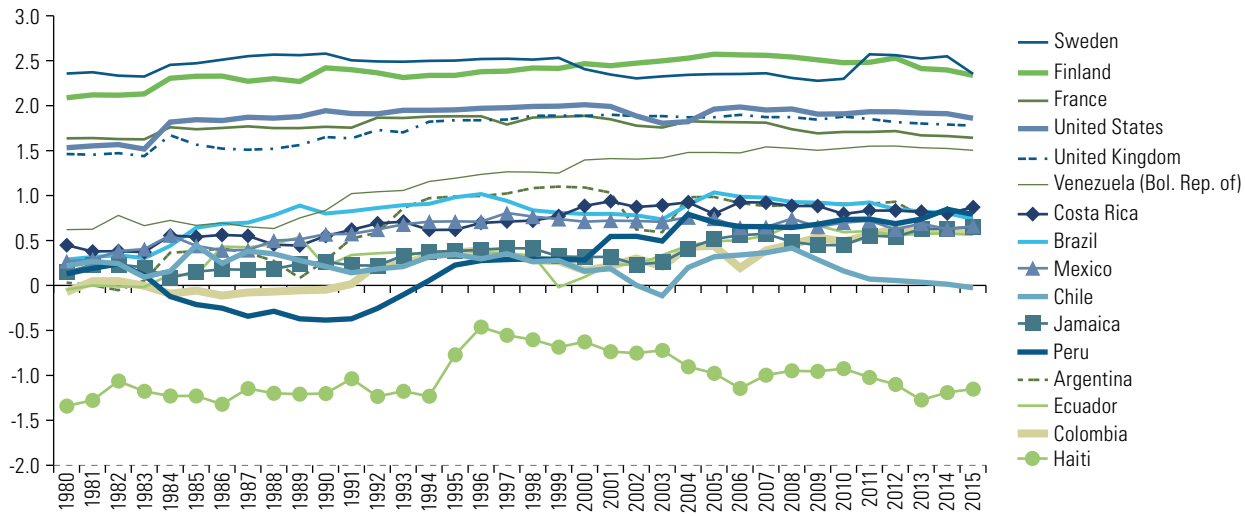
1. State capacity index

The State capacity index, developed by Hanson and Sigman (2021), provides a comprehensive methodology for measuring the ability of States to deliver effective public services, implement policies and maintain public order.[5] By combining qualitative and quantitative data, this index assesses different aspects of State capacities

[5] The authors analyse 21 indicators of State capacity. These include (i) administrative efficiency (Adelman and Morris, 1967): this indicator covers three categories of public administration efficiency, namely the level of tenure and training of civil servants, the extent to which corruption, inefficiency and incompetence hinder the functioning of government and the extent to which policy instability at higher levels of administration promotes inefficiency; (ii) bureaucratic quality: the institutional strength and quality of a country's bureaucracy is evaluated on a five-point scale (0 to 4), where high values indicate strength and experience to govern without drastic changes in policy or disruptions to government services; (iii) quality of public administration: the World Bank evaluates countries according to the degree to which the central government's civilian personnel structure facilitates the design and implementation of government policies and the effective delivery of services; (iv) rigorous and impartial public administration: this measure is derived from a model based on Bayesian item response theory using expert survey data, in which respondents rate countries according to categories that address the degree to which public officials respect the law and the arbitrary or biased manner of administration; and (v) Weber's characteristics: an index created from expert ratings, measuring the degree to which State agencies involved in economic policy exhibit Weber's characteristics, such as hiring through meritocratic processes, stability of employment in the agencies, opportunities for promotion within the agencies, retention of agency personnel in public service rather than moving in and out of the public sector, wage parity with the private sector in positions requiring comparable training, proportion of income from salary rather than from bribes, and availability of employment options outside the public sector for graduates of elite universities.

based on three key dimensions: (i) extractive capacity to generate revenue; (ii) coercive capacity to enforce the law; and (iii) administrative capacity. Herre, Arriagada and Roser (2023) have used this methodology to create a database that classifies Latin American and Caribbean countries along with some high-income countries. The results, presented in figure II.12, show considerable variation among the countries, which can be divided into three groups: (i) those with strong State capacities, such as Finland and Sweden; (ii) those with intermediate capacities, such as Chile, Costa Rica, France, the United States and Uruguay; and (iii) those with weak State capacities, such as Argentina, Brazil, Colombia, the Dominican Republic, Jamaica, Mexico, and, significantly further down in the ranking, the Bolivarian Republic of Venezuela and Haiti.

Figure II.12
Selected countries: State capacity index, 1980–2015



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Hanson and R. Sigman, "Leviathan's latent dimensions: measuring state capacity for comparative political research", *The Journal of Politics*, vol. 83, No. 4, 2021 and Our World in Data, "State capacity index" [online database] https://ourworldindata.org/grapher/state-capacity-index.

2. Worldwide Governance Indicators

The World Bank's Worldwide Governance Indicators are a consolidated set of indicators combining data from 30 sources, with expert views and survey results from public, non-governmental and commercial organizations.[6]

The Worldwide Governance Indicators address six broad dimensions of governance.

(i) Voice and accountability: citizens' perceived ability to participate in selecting their government, as well as freedoms of expression, association and the press.

(ii) Political stability and absence of violence and/or terrorism: perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism.

(iii) Government effectiveness: perceived quality of public services, civil service, policies and their implementation.

(iv) Regulatory quality: government's perceived ability to formulate sound policies and regulations that promote private sector development.

(v) Rule of law: perceptions of confidence in the rules of society, in particular enforcement of contracts and property rights, as well as trust in the police and the courts.

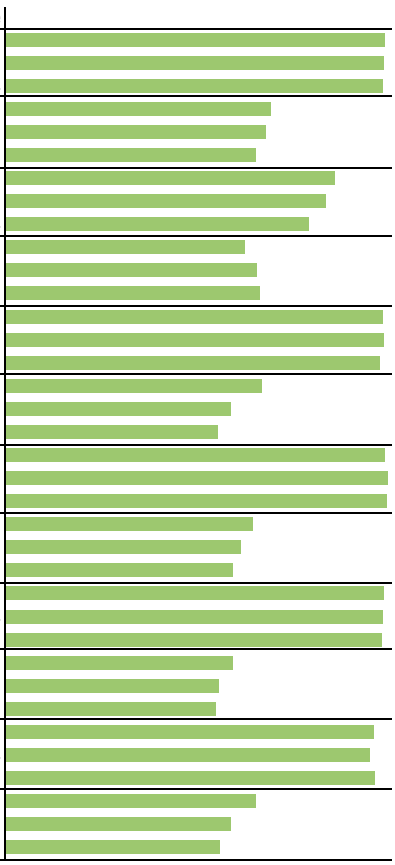
(vi) Control of corruption: perceptions of the extent to which public power is exercised for private gain, prevalence of corruption and "capture" of the State by elites and private interests.

6 For further detail, see [online] https://www.worldbank.org/en/publication/worldwide-governance-indicators/documentation#2.

Figure II.13 compares the relative position of Latin America and the Caribbean with high-income countries of the Organisation for Economic Co-operation and Development (OECD) for all indicators. In general, high income OECD countries are around or above the eighty-fifth percentile in all selected indicators, while Latin American countries are concentrated around the sixtieth percentile. The trend in the region is worrying: with the exception of political stability, all indicators declined between 2012 and 2017 and again by 2022.

Figure II.13
Latin America and the Caribbean and high-income countries of the Organisation for Economic Co-operation and Development: Worldwide Governance Indicators

Indicator	Country	Year	Percentile
Voice and accountability	High income: OECD	2012	86.8
		2017	86.7
		2022	86.4
	Latin America and the Caribbean	2012	60.8
		2017	59.6
		2022	57.3
Political stability and absence of violence/terrorism	High income: OECD	2012	75.5
		2017	73.3
		2022	69.4
	Latin America and the Caribbean	2012	54.8
		2017	57.6
		2022	58.2
Government effectiveness	High income: OECD	2012	86.3
		2017	86.6
		2022	85.7
	Latin America and the Caribbean	2012	58.7
		2017	51.7
		2022	48.5
Regulatory quality	High income: OECD	2012	86.9
		2017	87.5
		2022	87.3
	Latin America and the Caribbean	2012	56.7
		2017	53.8
		2022	52.0
Rule of law	High income: OECD	2012	86.7
		2017	86.4
		2022	86.1
	Latin America and the Caribbean	2012	52.0
		2017	48.9
		2022	48.1
Control of corruption	High income: OECD	2012	84.3
		2017	83.4
		2022	84.5
	Latin America and the Caribbean	2012	57.2
		2017	51.7
		2022	49.0



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of D. Kaufmann and A. Kraay "Worldwide Governance Indicators, 2023", 2023 [online database] www.govindicators.org.

The Worldwide Governance Indicators present an overview that, although based on perceptions rather than objective measures of country and regional performance, is a crucial barometer of confidence in governance among the public and businesses. The data for Latin America and the Caribbean show a concerning trend of decline in practically all areas evaluated by the Worldwide Governance Indicators. This has serious implications for the effectiveness of public institutions, the business climate and the health of democratic processes in the region.

There is considerable variation between the region's high performers, such as Chile and Uruguay, and other countries that performed lower; however, even the highest performing countries are seeing declines. Figure II.14 shows selected countries and key governance indicators, such as government effectiveness, regulatory quality and the rule of law, which are included in the analysis in chapter III.

Figure II.14
Worldwide Governance Indicators in Latin America and the Caribbean: selected countries and indicators
(Percentile ranking)

Country	Year	Government effectiveness	Regulatory quality	Rule of law
Argentina	2012	46.4	21.8	32.4
	2017	58.6	43.8	45.7
	2022	42.0	25.9	34.9
Brazil	2012	50.2	56.9	52.6
	2017	40.0	47.6	42.9
	2022	30.7	43.9	43.4
Chile	2012	84.4	92.4	86.9
	2017	76.7	89.0	80.5
	2022	69.3	81.1	72.6
Costa Rica	2012	66.8	73.9	66.2
	2017	61.4	69.0	66.7
	2022	55.7	71.2	64.6
Guatemala	2012	25.1	43.1	13.6
	2017	26.2	38.6	12.9
	2022	16.5	41.5	13.2
Jamaica	2012	58.8	57.3	44.6
	2017	72.4	56.7	50.0
	2022	71.7	59.0	51.9
Mexico	2012	63.0	64.9	38.0
	2017	50.0	61.4	31.0
	2022	42.5	46.7	20.8
Peru	2012	47.9	65.4	34.3
	2017	44.3	66.2	31.9
	2022	35.4	59.9	32.5
Dominican Rep.	2012	36.0	51.2	29.1
	2017	38.1	52.4	37.6
	2022	50.0	54.2	50.5
Uruguay	2012	64.9	69.7	69.0
	2017	66.7	72.9	70.0
	2022	77.4	74.1	75.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of D. Kaufmann and A. Kraay "Worldwide Governance Indicators, 2023", 2023 [online database] www.govindicators.org.

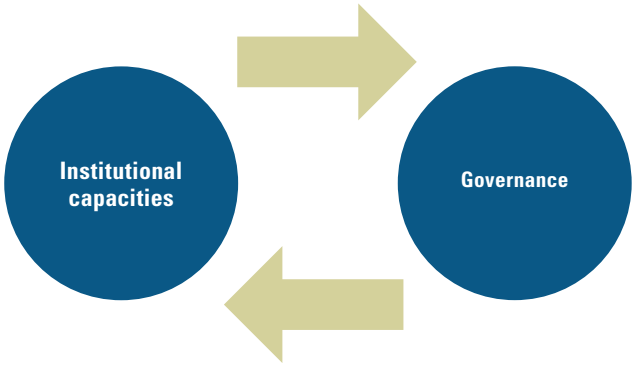
In summary, although there is still no definitive methodology for measuring institutional capacities and effective governance, approaches have been developed to shed light on the matter. When several indicators are moving in the same direction, one can have reasonable confidence in trends and comparisons between countries, if not in precise measurements.

The State capacity index shows an initial improvement for Latin American and Caribbean countries from 1980 to the mid-aughts of the twenty-first century, followed by stagnation and subsequent decline, with low capacities observed in most countries and intermediate capacities in a few. In terms of Worldwide Governance Indicators, in all the dimensions analysed, the gap between Latin America and the Caribbean and the high-income OECD countries is significant and likely to widen. At the national level, results in many instances indicated that performance in the areas of government effectiveness, regulatory quality and rule of law had declined every single year in the period analysed.

3. Low institutional capacities and ineffective governance: a development trap

In Latin America and the Caribbean, the combination of low institutional capacities and ineffective governance creates yet another development trap. Weak institutional capacities, which include administrative inefficiency, poor bureaucratic quality, poor public administration quality and deficiencies in Weber's characteristics, such as neutrality and professionalization, limit the ability of governments to implement effective policies and respond efficiently to the needs of society (see diagram II.4).

Diagram II.4
The trap of low institutional capacities and ineffective governance



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Ineffective governance exacerbates this situation, reflecting a perception that the private sector and civil society are underrepresented and that those in power are not sufficiently held to account. In addition, the region is experiencing political instability, violence and organized crime, reduced government effectiveness, low-quality regulations and uncertain rule of law, together with inadequate control of corruption. These factors undermine public confidence in institutions, weaken the rule of law and create a climate of uncertainty and inequality. Lack of transparency and inequitable application of laws and regulations contribute to legal uncertainty, which discourages private investment and effective policymaking.

Taken together, these conditions create a negative feedback loop that significantly hinders progress towards more effective governance and stronger institutional capacities, thereby perpetuating the structural problems that hinder economic and social development.

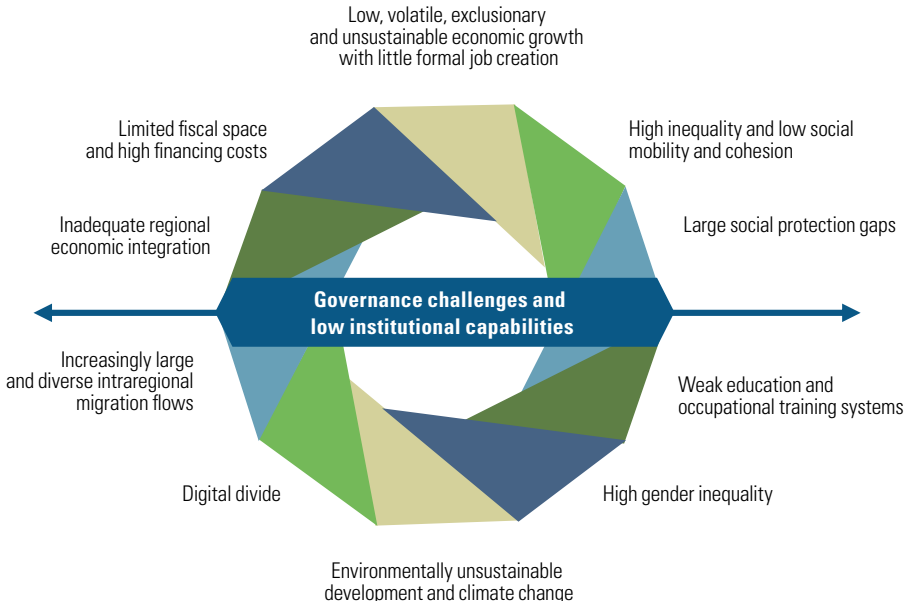
Lastly, the key message of this chapter bears repeating: these three traps are interrelated and mutually reinforcing. In a context of low regional economic growth, where resource generation is limited and access to scarce resources is increasingly unequal, low institutional capacity and ineffective governance are barriers to more productive, inclusive and sustainable growth. They limit governments' ability to effectively implement public policies and adequately manage economic resources, which exacerbates inequalities and perpetuates structural problems in the region. This is compounded by the challenge of understanding and adapting to new and disruptive geopolitical and economic changes, hindering countries' development of the institutional and governance capacities needed to stimulate growth. The discrepancy between needs and response capacity perpetuates the gap and limits adaptation to global changes and the effectiveness of public policies to address emerging challenges.

4. Ten structural gaps in the development model[7]

In an effort to synthesize and clarify the diagnosis of the situation in the countries of the region, José Manuel Salazar-Xirinachs, Executive Secretary of ECLAC, has proposed a decalogue of structural gaps in the development model, which is presented in diagram II.5.

[7] This section is based on Salazar-Xirinachs (2023). For an in-depth discussion of each of these areas, see *CEPAL Review*, No. 141 (ECLAC, 2023c).

Diagram II.5
Ten structural gaps in the development model



Source: J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

As shown in the diagram, the decalogue of gaps is as follows:

- Low, volatile, exclusionary and unsustainable economic growth. As noted, the region suffers from a chronic problem of low growth, which is not an issue limited to the last decade but rather a long-term trend.
- High inequality and low social mobility and cohesion. It is a well-known fact that Latin America and the Caribbean is the most unequal region in the world. Inequality not only runs counter to basic concepts of social justice, but is inefficient for growth and corrosive for social cohesion and for the stability of social pacts.
- Social protection gaps. The region continues to be characterized by high levels of poverty and vulnerability, limited access to pension systems and very limited access to universal protection systems.
- Weak education and occupational training systems. In recent years, the pace of progress in this area has been slowing, and the education blackout associated with the COVID-19 pandemic caused serious setbacks. There are stark inequalities in completion rates, and learning outcomes on various standardized tests were very poor even before the pandemic.
- Marked gender inequality. Gender inequality in the countries of the region remains unacceptably high. This is not only a human rights issue: it is a moral imperative and it is economically inefficient.
- Environmentally unsustainable development and climate change. The increasing effects of climate change and high vulnerability to extreme events (e.g. hurricanes, heatwaves, droughts and floods) are a major drag on economic development. The region has suffered significant environmental deterioration, including an accelerated rate of deforestation and increasing air, water and soil pollution.
- The digital divide. Gaps in access to and use of digital technologies are large in the countries of the region. This is a challenge for development because the future is digital, and the longer it takes for countries to increase not only access but smart and large-scale use of the opportunities of the new digital economy, the longer it will be before its benefits are reaped.

- Growing intraregional migration flows. International migration has taken centre stage in the policy debate in Latin America and the Caribbean. Virtually all the countries in the region are part of migration cycles as countries of origin, destination, return or transit. Migration is a development and rights issue that faces significant social, security, economic and cultural challenges in the region.
- Inadequate regional economic integration. Trade and foreign investment flows between the region's countries are generally low. Although the integrationist project has led to the creation of numerous regional institutions, progress has been modest and uneven.
- Limited fiscal space and high financing costs. It is imperative that the region increase investment, in a context where its capacity to do so is affected by limited fiscal space and high financing costs.

In addition to these 10 gaps, the region faces an eleventh cross-cutting gap, which also constitutes one of the three development traps: low institutional capacities and ineffective governance. Sections C.1 and C.2 presented two ways of characterizing and measuring institutional capacities: Hanson and Sigman's (2021) State capacities index and the World Bank's Worldwide Governance Indicators, which address six governance dimensions. As mentioned, although there is no single methodology for measuring institutional capacities and the quality of governance, these two confirm the weaknesses of Latin American and Caribbean countries in this regard. These weaknesses limit the capacity of public policies and the ability of States to manage the transformations needed to reduce the 10 gaps and break from the traps.

The three traps analysed in this chapter are central to explaining the region's current development crisis. These traps correspond to several structural gaps mentioned above: (i) the low-growth trap corresponds directly to the low, volatile, exclusionary and unsustainable economic growth gap; (ii) the trap of high inequality and low social mobility and cohesion corresponds to several of the social gaps identified in diagram II.5, including gaps in social protection, education and vocational training systems and gender inequality, as well as gaps in terms of the digital transition and the management of migration flows; and (iii) the third trap is aligned with the cross-cutting area of governance challenges and low institutional capabilities as seen in diagram II.5.

The items in this decalogue of structural gaps are not independent of one another, but are interrelated and often mutually reinforcing, creating vicious circles. For example, low growth hinders the reduction of poverty and informality and the creation of quality employment (i.e. more inclusive growth). Likewise, social protection gaps and deficiencies in education and vocational training systems limit social mobility and the more equitable distribution of income.

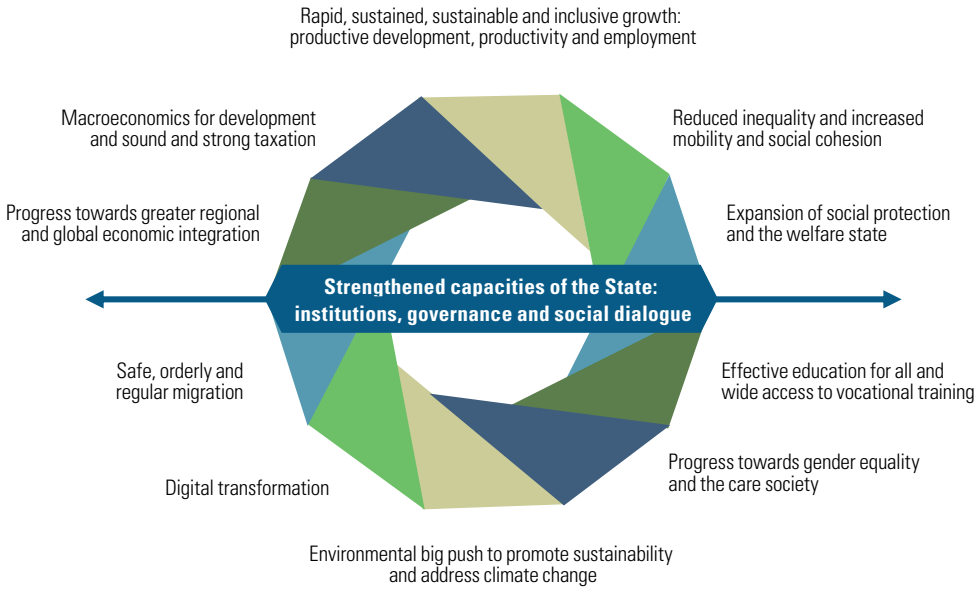
5. The 11 vital transformations in the development model[8]

In contrast to diagram II.5, which presents the decalogue of structural gaps for diagnostic purposes, diagram II.6 is prescriptive, showing 11 great transformations needed in the development model of the region's countries if they are to move towards a more productive, inclusive and sustainable future, with a view to stimulating a discussion about what should be done, and how, for these gaps to be closed or narrowed. These 11 great transformations in the region's development model are considered vital for moving towards a more productive, inclusive and sustainable future. Each of the transformations corresponds to one of the structural gaps identified in the decalogue, including the eleventh cross-cutting gap and third development trap, which raises the question of how to strengthen institutional capacities, governance and social dialogue for public policies.

A fundamental ingredient in the ECLAC proposal for "what" should be done and "how" in order to avoid a third lost decade, boost economic growth and make this growth more sustained, inclusive and sustainable is for countries to expand their productive development policies, with a focus on the new generation of these policies. This necessitates sectoral commitments and the use of the cluster approach as a concrete and effective way of organizing collaboration and management for productive development and improving the governance of productive development policies.

[8] As with the previous section, this section is based on Salazar-Xirinachs (2023).

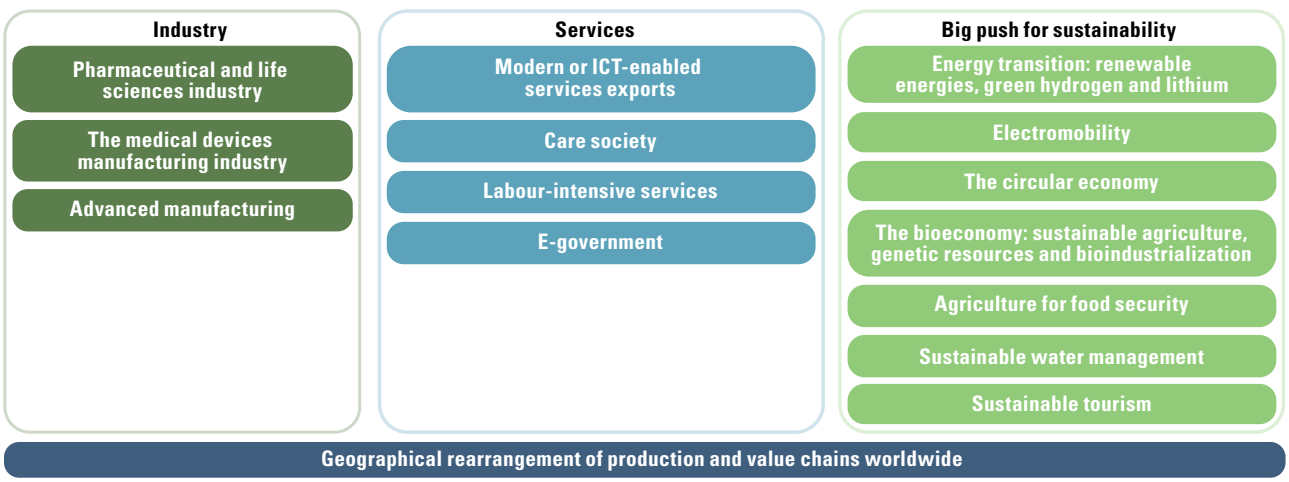
Diagram II.6
Eleven great transformations in the development model



Source: J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

To promote this great productive transformation, ECLAC has proposed a portfolio of 15 growth-driving sectors or areas (see diagram II.7). Because of their pull effects (and their impact on innovation and decent job creation), and in many cases because they are aligned with the countries' potential competitive advantages, in addition to their favourable impact on the energy transition and nature- and planet-friendly production, these sectors have major potential in their different ways to spearhead productive transformations that can not only endow growth with greater dynamism and higher productivity, but also provide greater traction in job creation and greater environmental sustainability.

Diagram II.7
Great productive transformation: portfolio of driving sectors



Source: J. M. Salazar-Xirinachs and M. Llinás, "Towards transformation of the growth and development strategy for Latin America and the Caribbean: the role of productive development policies", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P/-*), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

An important caveat is that this list of sectors is not necessarily applicable to all countries, but is rather an example of what a set of sectoral choices with high returns for development could look like, it being understood that each country or each territory within a country must set its own priorities, removing some sectors from the list and adding others, to arrive at a balanced set of productive choices consistent with its own competitive advantages and institutional capabilities.

D. Conclusions

Latin America and the Caribbean faces a development crisis that is summarized in the three development traps and the decalogue of structural gaps identified by ECLAC and presented in this chapter. The three traps are paramount in understanding this crisis. It is not just a matter of medium- or long-term negative trends across a range of economic and social indicators: it is a series of vicious circles that limit the capacity to advance towards higher levels of development. The low-growth trap is a vicious circle of low productivity, low investment and inadequate human resources. The second trap is a vicious circle of high inequality and low social mobility and cohesion, including gaps in social protection, gender equality and education. The third trap is a vicious circle of low institutional capacities and ineffective governance.

All this is transpiring in an international context that presents significant challenges for the region, but also opportunities, as discussed in chapter I. Economic growth and opportunities to deepen regional integration are affected by the slowdown in global economic growth and trade. Geopolitical and geoeconomic changes in the ground rules and dynamics of international relations, such as rising geopolitical tensions, the return of productive development policies and changes in international taxation rules, are also major factors.

Facing the gaps and escaping the traps in the current international context requires profound transformations in the development model, which ECLAC has summarized in 11 great transformations. The remaining chapters address the following matters in detail: (i) the great productive transformation to achieve higher, sustained, inclusive and sustainable growth; (ii) the great transformation to reduce inequality and increase social mobility and cohesion; and (iii) the great transformation for greener, more sustainable growth and combating climate change. The final chapter addresses the challenge of mobilizing the financial resources needed to achieve these transformations and make progress towards the SDGs.

International experience shows that it is not enough to list objectives and aspirations if there are no clear strategies to bring about change and if institutions do not have the capabilities to drive forward the necessary transformations (Salazar-Xirinachs, 2023). Thus, a central focus of the following four chapters is to present an analysis of the technical, operational, political and prospective capabilties that must be built, together with some governance challenges, to manage these transformations.

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CHAPTER

III

The challenge of managing transformations

Introduction

The need to transform development models in Latin America and the Caribbean stems from the development crisis analysed in chapter II of this publication, which has led the region's countries into three interrelated traps: low capacity for growth; high inequality with low social mobility and cohesion; and low institutional capacity and ineffective governance. This chapter takes a deeper look at the third trap and the factors to consider in analysing how to escape it.

Unlocking progress will involve not only identifying the requisite action but also addressing what may be an even greater challenge: how to manage transformations and guide them in the desired direction. This will entail tackling the technical dimensions of policy but also the capacity to lead and coordinate collective action. To that end, it is important to bear in mind the ideas of Swilling (2020), who highlights that in an uncertain, complex and changing world, it is critical to recognize three types of knowledge that are essential for effective action: (i) technical knowledge of socioeconomic, ecological and technological systems; (ii) prospective knowledge, which implies designing and understanding desired futures and considering possible disruptive impacts and trends; and (iii) transformation knowledge, which encompasses the change and transitions required for progress towards desired goals, including governance skills to lead collective action.

Technical knowledge is examined throughout the chapters of this document through narratives supported by the theory and empirical data of ECLAC. The other two types of knowledge, which are more societal in nature, are key for spurring collective action grounded in a shared understanding of systems and are analysed in this chapter.

This chapter is organized into four sections. After this introduction, section A addresses the challenge of managing transformations and breaking out of the trap of low institutional capacity and ineffective governance. In section B, the concept of governance and the role of the private sector and civil society as development stakeholders are clarified. In section C, an analysis is presented of what ECLAC calls the technical, operational, political and prospective (TOPP) capabilities of institutions, which are critical for effectively managing transformations. Lastly, the importance of the political economy and social dialogue for successfully managing transformations are addressed in section D.

A. The challenge of managing transformations and breaking out of the trap of low institutional capacity and ineffective governance

Understanding of the scope of the challenge of managing transformations will be supported by addressing four distinct but interrelated themes and their concepts: (i) governance (what is it and how can it be improved?); (ii) institutional capacities (what are they?); (iii) the political economy (how can coalitions that can overcome resistance to change be built?); and (iv) social dialogue (what types of social dialogue can be developed and which are most suitable for what purposes?). Although other themes may arise, these four touch on key aspects for successfully fostering meaningful change and effectively managing transformations, not only as challenges for the public sector but for society as a whole, which transcend any one government administration, and indeed, are perennial.

Doing so entails investing in contextual knowledge and aligning policies with the implementation capacity of each country. It must also be understood that transformation is complex, dynamic and cloaked in uncertainty, and should therefore be managed through a combination of technical, operational and political capabilities, and iterative approaches to policy design, implementation, evaluation and reformulation.

In the quest to transform development models, innumerable political and economic reforms have been enacted in recent decades in Latin America and the Caribbean, ranging from State-led development

approaches to liberalization, deregulation and openness strategies. In many cases, a panacea has been sought to comprehensively address the region's development problems. However, the results have not only been uneven; they have also revealed that there is no one paradigm that offers simple, straightforward solutions and lays the groundwork to drive development forward.

It has also been demonstrated that policy design, adoption and implementation are as important as content. Implementation does not occur in a vacuum, but rather in a context that is shaped by a country's institutions and political and cultural traditions. Policy effectiveness will therefore be shaped by the State's institutional capacity and the actions —and interactions— of a range of State and non-State stakeholders as they design and implement social, economic and institutional policies or reforms in a variety of scenarios. For these reasons, analysing the "how" means not only studying the specific content of policies and their impact on economic and social variables but also State capacity and the critical processes that mould and operationalize it —in short, the steering capacity and effectiveness of public policies.

To adequately respond to citizen demand for effective solutions, governments and public institutions must be equipped to lead the transformation of development models. The State's institutional capacity to design, implement, evaluate and reform public policies amid changing circumstances must be strengthened to achieve these transformations. Capacity gaps are evidenced by the often inadequate institutional responses of the region's countries to highly complex and uncertain situations, such as the lag in meeting the Sustainable Development Goals (SDGs),[1] rising polarization and conflict, the political governance issues seen in many countries, and declining rankings on global public governance, corruption and transparency indices. It is therefore essential to understand and research aspects of the capacity for governability —and in particular for governance— as well as issues related to technical, operational, political and prospective (TOPP) capabilities, the political economy and social dialogue, as enabling factors for policy and strategy coordination and to ensure effective implementation.

B. Governance to manage transformation processes and escape from traps

1. The scope and meaning of governance

The concept of governance has been widely employed by makers and implementers of policy, as well as by international organizations, especially those tasked with fostering countries' social and economic progress. Much has been said about governance: it is a bridging concept, an umbrella concept, a descriptive concept, an approach, a theory and a perspective (Levi-Faur, 2012). Its ambiguity lies in the ability of each author to define its shape or scope on the basis of subjective experience, ideological perspective or intellectual preference.

As regards public policy, governance essentially refers to how the public sector, working with non-governmental and non-political stakeholders, or on its own, is able to steer and control society and the economy (Levi-Faur, 2012). Some narratives and analysis in the governance literature see governance somewhat less as a matter of power and somewhat more as one of steering. Boyer (1990) argues that focusing on governance means analysing the action of government and its interaction with non-governmental partners in the process of governing, in particular their collective action on the economy and public policy.

The growing complexity of the problems faced by governments, as well as fiscal and policy constraints, have led to an increasing reliance on societal stakeholders to effectively steer and manage responses, in a context in which cooperation and support are critical for problem-solving. Governance evokes the image and

[1] At the seventh meeting of the Forum of the Countries of Latin America and the Caribbean on Sustainable Development (15–18 April, 2024), countries were urged to renew their commitment to the 2030 Agenda for Sustainable Development and to revitalize and embolden policies and initiatives to accelerate progress towards the SDGs, given that just 22% of the related targets were on track to be met, while progress towards 46% of the targets continued, but not fast enough to meet them, and the remaining 32% of targets would be missed.

meaning of transformation, which in turn implies a change that may refer to new processes of governing or new methods by which society is governed (Rhodes, 1996). These shifts or transformations may relate to many areas, which significantly broadens the scope and range of subjects encompassed by the study of governance.[2]

Governance thus refers to a steering process in which the government is a necessary agent, but not the sole one, although it may have the requisite capacities. In such a case, the capacities and resources of non-political and non-governmental stakeholders are valued and equally necessary. Governance thus implies a social process by which a society's trajectory and steering capacity are defined. It is a collective initiative because many stakeholders participate in its design and implementation, and it therefore requires a government body or agency whose purpose is to solve or find solutions for the two core problems that must be addressed by all forms of collective action: establishing cooperation (coordination and complementarity) and ensuring its effectiveness (Aguilar, 2007, p. 19).

The literature suggests at least four ways of understanding governance: as structure, process, mechanism or strategy (see table III.1).

Table III.1
Analytical dimensions of governance

Analytical pillar	Definition	Description
Structure	Architecture of formal and informal institutions	– This area has received the most academic scrutiny, through research approaches that include topics such as the systems for rules; legal regimes, court decisions and administrative practices; institutionalized modes of social coordination; and the regulatory institutional framework, including non-hierarchical and multilevel entities
Process	Steering characteristics and functions involved in lengthy policymaking processes	– Aims to capture more dynamic aspects of governance – Conceives of governance not as a stable or enduring set of institutions but as an ongoing steering process, in which institutional capacity to lead and coordinate must be strengthened
Mechanism	Institutional decision-making, compliance and control procedures	– Governance is also about the institutionalization and naturalization of decision-making procedures
Strategy	The specific coordination of stakeholder efforts to manage change in governance systems and processes	– Governance as strategy is the design, creation and adaptation of governance systems – As such, it refers to governance-in-action and to the institutional designs by actors that go beyond the formal institutions of government

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of D. Levi-Faur, *The Oxford Handbook of Governance,* Oxford University Press, 2012.

Consequently, good governance enhances the capacity of the State to steer change or transformation and to foster such change with non-State stakeholders participating in the design and implementation of public policies, aiming to make governance more efficient and fail-safe. From that perspective, governments would improve governance capacity by strengthening their own institutional capacity and establishing closer ties with non-State stakeholders, an approach that establishes a new way for the government to interact with society to process public policy interests, goals and solutions (O'Donnell and others, 2015; Levi and others, 2015; Acuña and Chudnovsky, 2017).

2. Governance and governability

Governance and governability are related but distinct concepts, used interchangeably, as synonyms, by analysts and international organizations and in politics and government, although in fact they are not.

Governability refers to the capacity of a political system to enforce the law, maintain stability, operate efficiently and ensure the legitimacy of decision-making. As such, it refers to institutional autonomy, complexity, cohesion and legitimacy (Bobbio, Matteucci and Pasquino, 1985). Good governability implies that institutions function properly, there is an appropriate balance of power among the branches of government, the rule of

[2] There are many types and applications of governance concept and instrument. They may include economic governance, such as cluster initiatives in the area of productive development; global or regional governance; governance in politics or public management, which leads into democratic governance and the governance of State reforms; and risk governance, notably climate change governance. The concept of experimentalist governance has also been developed for rapidly changing and uncertain contexts, an approach that views policy management as a collaborative, recursive process in which problems and solutions are identified collectively (by the public and private sectors, academia and civil society), through multiple iterations, learning and constant course correction.

law is respected, and public participation in decision-making is encouraged. In contrast, diminished citizen trust in government institutions and lack of credibility among leaders hinder the capacity of the latter to address problems, in a vicious circle that may be defined as the spiral of ungovernability (Bobbio, Matteucci and Pasquino, 1985). Governability therefore implies that a political system is able to operate in an effective, legitimate and stable fashion, contributing to the achievement of political stability, economic development and social cohesion (Montero Bagatella, 2012).

In any case —and perhaps this is why the terms are used interchangeably— governance and governability are closely linked. To some extent, one implies the other, since governance necessitates an enabling environment of governability within a political system.

Many authors and multilateral institutions have expressed concern regarding the quality of governance and the state of governability in the countries of Latin America and the Caribbean, amid increasing doubt that "the region's political systems have the capacity to respond effectively to the socioeconomic needs and expectations of the population, as well as to channel the growing social conflicts and political polarization in the region. There is therefore increasing pressure on democratic institutions (International IDEA/UNDP, 2022).

The classic definition of governance is "a series of (inter)actions between state and non-state actors to formulate and implement social, economic, and institutional policies and reforms related to the access and/or exercise of power" (International IDEA/UNDP, 2022). In particular, analysis has focused on the institutional framework that underpins the incentives that, in practice, shape policy, in the study of what is known as "the policy on public policies".

> *Policies are important, not only for their technical content, but also because they may possess certain features, such as stability, adaptability, coherence, the ability to be implemented effectively, an orientation toward the public interest (public-regardedness), and efficiency. The extent to which policies attain these features depends on the way in which actors in the policy process interact. The cycles of the policy process are vicious or virtuous according to the institutional incentives influencing the behavior of various actors in the process and according to the dynamic effect that interactions among these actors produce in the final result ... Institutions and processes are not neutral or merely instrumental; they are the crucible in which policies are forged and shaped and acquire their true form and meaning (Stein and others, 2006, p. 256).*

According to this approach, certain basic institutions are key for public policy adoption and implementation: a professional and stable bureaucracy, an independent judiciary, a system of parties with an institutional, programmatic identity and a legislature that is capable of actively contributing to public policy discussions. Policy characteristics are thus the outcome of the policymaking process, which by definition is a political process that involves many stakeholders who interact in a variety of formal and informal spaces (e.g. in Congress or on the street), and which in turn may be more or less transparent.

A paper jointly prepared by the International Institute for Democracy and Electoral Assistance and the United Nations Development Programme (International IDEA/UNDP, 2022), highlights four themes that are key for understanding the challenges of governance in Latin America and the Caribbean. The first is poor economic performance as a driver of social unrest. Poor performance is reflected in low economic growth, rising income and wealth inequality, labour market segmentation and tax systems with weak redistributive impact. The link between these trends and social unrest is evidenced by the various forms of exclusion that they trigger, which in turn serve as fodder for governance and governability crises.

The second is representative and democratic disaffection. The paper identifies factors that heighten risk in that regard, such as a lack of legitimate and effective institutions to represent collective interests, which makes it difficult to achieve broad social and political consensus. It emphasizes the importance of addressing political fragmentation and polarization, and the weakening of traditional political parties.

Third, the paper analyses the limited progress and setbacks in strengthening the rule of law. Immediate reforms are essential to safeguard and enhance it; otherwise, the integrity of the region's electoral processes could be in jeopardy, potentially exacerbating political polarization and infringement of fundamental rights.

Lastly, the democratization of the digital space is examined as an emerging aspect of governance in the region. The growing use of social media platforms has transformed political discussions and the channels used by citizens and governments to communicate. Although these new methods present opportunities to improve participation and governability, they also pose challenges related to rights infringements and inappropriate uses that may erode democracy. In that regard, it is important to strengthen international cooperation to address these issues and encourage inclusive discussions on digital governance.

3. Anticipatory governance: a modern approach to managing transformations

Although the concept of anticipatory governance emerged four decades ago, it only began to garner greater attention from governments and international organizations in the past fifteen years (Medina Vásquez, 2023). According to Strategic Foresight (n.d.), anticipatory governance means systematically integrating and applying strategic foresight throughout government structures, including in policy analysis and decision-making processes. Rather than avoiding or underestimating uncertainty, this approach seeks to explore it and understand its implications for both current and future decisions (Quay, 2010). It therefore entails collaborative and participatory processes and systems for exploring and envisioning possible futures, setting a strategic course, developing strategies and evaluating options for a specific region, city or State (Ramos, 2020).

Anticipatory governance encompasses a structured series of interactions among stakeholders from the public and private sectors, academia and civil society, aimed at envisioning new futures, building relationships for the medium and long term and transforming attitudes and collective behaviours (Scapolo, 2011; Van der Heijden, 2004). Prospective exercises therefore support mutual learning, enabling participants, especially political leaders, to gain a deeper understanding of future scenarios on the basis of today's decisions.

The United Nations is an enthusiastic proponent of this approach. The Secretary-General, António Guterres, is aiming to rejuvenate the organizational culture of the United Nations with a forward-thinking vision empowered by cutting-edge skills for the twenty-first century, as set out in the report entitled *Our Common Agenda,* through what has been called "the quintet of change", promoting United Nations 2.0. UN 2.0 focuses on foresight analysis, seeking to ensure that the organization has the capacity to identify emerging trends and anticipate and respond proactively to change. It emphasizes the use of data to improve the collection, processing and use of information from several sources; promotes a culture of innovation to create environments that stimulate creativity and continuous learning; and encourages the development of behavioural science skills, promoting a culture grounded in a deep understanding of human behaviour.

ECLAC is actively committed to promoting and advancing a strategic foresight and anticipatory governance agenda. As part of that effort, the Commission organized the First Regional Conference of Parliamentary Committees of the Future on 20 and 21 June 2024, with support from the Committee on Future Challenges, Science, Technology and Innovation of the Senate of Chile and the Committee of the Future of the House of Representatives of Uruguay. The event underscored the importance of establishing institutions and mechanisms with the ability to interpret context and anticipate future developments by exploring a variety of scenarios. Transforming institutions to improve efficiency and cultivate trust is vital for strengthening democracy in the region.[3]

Strategic foresight is essential and should be a permanent exercise in which all political powers with parliamentary representation participate. The specific purpose of legislative foresight is to anticipate the State's strategic options and effectively coordinate public agendas. This means establishing an ongoing social dialogue aimed at building bridges, coordinating stakeholders, generating broad consensus and forging partnerships that can tackle major challenges, today and in the future.

[3] The *Human Development Report 2023/2024* of UNDP emphasizes the urgent need to break the gridlock and reimagine cooperation in a polarized world, as these factors hinder human development. The following recommendations have been made to overcome those challenges: (i) create spaces for social dialogue and consensus, in which gatherings such as committees for the future could play a key role; (ii) establish a forward-looking vision for public goods, in particular in areas such as climate change and new technologies, topics that commissions for the future could highlight on their agendas and in public discussions; and (iii) establish communication processes grounded in trust, that can yield tangible results, investing in effective communication strategies to ensure that citizens are receptive.

For ECLAC, anticipatory governance is more than simply talking about the future; it means thinking about future scenarios to bring forward and improve on topics that are important in the present, and presents an opportunity to establish a propitious political climate that helps to reduce polarization and foster progress in the desired direction. Anticipatory governance is a discipline with methodological approaches and must be supported by robust institutions. One example is seen in Chile, where the Committee on Future Challenges, Science, Technology and Innovation of the Senate adopted innovative methods by involving a broad range of stakeholders and establishing technical commissions in which academics and scientists participated. The initiative resulted in concrete policies on artificial intelligence, green hydrogen and other topics.

What is distinctive about these kinds of commission is their ability to design evidence-based public policies with a long-term approach and effective implementation mechanisms.[4] Their actions transcend rhetoric, translating into decisive measures that actively shape the future. They also craft national strategies to spur the development of innovative technologies and propose legislation that explores the boundaries and opportunities of science.

Beyond the still-limited experiences in the countries of the region, examples from other global regions, such as the Centre for Strategic Futures of the Prime Minister's Office in Singapore, show that these kinds of institutional capacity, whether in the legislative or executive branches, play a vital role, including in identifying emerging trends and factors that can have an impact on national priorities; improving and informing decisions for the future; and developing strategic foresight capacities and skills. The objective is clear: be prepared to respond to the impact of disruptions that can affect the system, focusing on anticipating unexpected events and handling potential crises.

The European Union also has significant experience in that regard. The European Strategy and Policy Analysis System (ESPAS) and its foresight strategy emerged after a series of crises that hit Europe and the world, including the 2008 global financial crisis, the Arab Spring and the migration crisis. These events underscored the need to adopt a long-term vision. ESPAS began in 2010 as a pilot project and evolved into an inter-agency system, following successful collaboration involving many institutions that demonstrated its added value. A series of lessons emerged from the European experience. The appropriate tools and skills must be in place; organizational structures must facilitate foresight; leaders must be identified and spotlighted; and effective communication, that tailors information to each institution and makes it usable, must be achieved.

In Latin America and the Caribbean, some ideas for implementing strategic foresight and anticipatory governance include the following:

- Establish a regional network of political leaders who are committed to foresight.
- Develop interparliamentary platforms to facilitate knowledge-sharing.
- Establish a foresight network that includes regions and cities.
- Use, share and analyse existing data to inform foresight exercises, in order to avoid unnecessary duplication.
- Support international parliamentary networks that are engaged in strategic foresight.
- Support countries, ministries and parliaments to develop concrete proposals by preparing a manual of recommended practices.

Initiatives such as these can strengthen the region's capacity to anticipate and manage future challenges more effectively.

[4] It is critical to strike a balance between innovation and risk management capacities, in particular in the area of legislation. Risk management must not hobble the capacity to innovate and legislation must be flexible and adaptable enough to circumvent obsolescence in a context of rapid change. It is also essential to distinguish between reaction and anticipation. Avoiding a solely reactive stance is crucial; efforts should focus on consistently being prepared to foresee future challenges. Data quality and availability play a critical role, meaning that strengthening data systems and enhancing transparency is vital for progress in this regard.

4. Cooperation between the State, the private sector and civil society organizations

As discussed, governments cannot govern or manage transformations singlehandedly; achieving this is a social process that requires multisectoral mobilization and cooperation. To achieve transformations, the way forward must be defined. To manage them, collective action must be mobilized and many stakeholders must participate.

There are many channels through which the private sector —including firms and the business sector— can contribute to transformations. Evidently, the main way is through investment, production and job creation. In that regard, the private sector operates through the market and responds to incentives. Its contribution to transformations will thus hinge on factors such as the regulatory frameworks established by public policy, the strength of the rule of law, the institutional landscape, education and skills training policies, and the efficiency of markets and the institutions that comprise them.

Enterprises are therefore major development stakeholders, but their contribution to more productive, inclusive and sustainable development is subject to a wide range of conditions that are influenced by public policy, for good or ill. This position document returns to this topic, looking at specific aspects of the productive transformation, social policies and sustainable growth. For example, the proposal of ECLAC for a portfolio of driving sectors for productive development policies is a growth strategy that aims to accelerate and align the efforts of the public and private sectors, academia and civil society to develop those driving sectors and their respective governance structures, including through cluster initiatives.

Ways in which policymakers, business stakeholders and other interested parties can shape the societal outcomes of business activity are also explored, through market system and value chain interventions and on the basis of specific productive development policies and their governance, including strategies within business groups (cluster initiatives), policies for financial service inclusion or alternative models of economic organization.

The business sector's contribution to transformative processes may be less than optimal in the presence of market or government failures. However, as proposed by Mazzucato (2023), the best way to conceive of the role of the State is not as a fixer of market failures, but instead as a market maker and a creator of new opportunities that guide private enterprise in certain directions, one of the most significant ways of fostering transformational change.

This is also the view of Cohen and DeLong (2016, pp. 1–2) on how the United States spurred and managed the major transformations of its development model since the time of Alexander Hamilton:

> *From its very beginning, the Unites States again and again enacted policies to shift its economy onto a new growth direction –toward a new economic space of opportunity. These redirections have been big. And they have been collective choices. They have not been the emergent outcomes of innumerable individual choices aimed at achieving other goals. They have not been the unguided results of mindless evolution. They have been intelligent designs. And they have been implemented by government, backed and pushed by powerful and often broad-based political forces, held together by a common vision of how the economy ought to change. […] The new direction has always been selected pragmatically, not ideologically, and presented concretely.*

Well-known and more recent examples of fostering and managing economic transformations can be found in China, Japan and other Asian countries, albeit with their own vision, at other times and under very different circumstances.

Beyond seizing the investment and productive opportunities created by public policy and markets, there are many ways in which the private sector and firms can cooperate with governments, academia, civil society and many other stakeholders in managing transformations. These include the following:

(i) Promoting operational transparency and complying with applicable laws and regulations.

(ii) Fostering an ethical business culture, based on honesty, integrity and respect for human rights.

(iii) Adopting corporate social responsibility policies that contribute to societal well-being and sustainable development.

(iv) Combating all forms of corruption, in both the private and public sectors, including by fostering a culture of integrity in operations.

(v) Working with the government and public institutions to tackle shared challenges.

(vi) Investing in training employees and supporting training and skill-building for public servants.

(vii) Promoting diversity and inclusion, not only in businesses but in the broader workforce, as a way of contributing to gender equality, equal opportunity and social cohesion.

(viii) Participating in public-private social dialogues and working groups to contribute innovative proposals and solutions for development problems and challenges, including those related to governance and institutional development.

There is extensive literature and a multitude of examples of how the private sector collaborates in managing transformations, and it can do even more, in these and other ways.

Civil society organizations can also play a key role in public policy design and implementation and in contributing to managing the transformation of development models. Of course, civil society is not a monolithic unit. Instead, it represents a broad array of interests and perspectives, including women, young people, Indigenous Peoples, local communities, non-governmental organizations and unions. When civil society stakeholders participate in decision-making, many voices and experiences are considered. Including citizens in the policies, plans and programmes that affect their lives and communities can also enhance the legitimacy of policymaking processes and policy acceptance.

Civil society also plays a part in overseeing public policy implementation and in demanding transparency, accountability and respect for human rights. Civil society cooperation in the implementation of public policies contributes to their long-term sustainability by fostering community ownership and engagement.

Civil society also contributes knowledge, experience and empirical data, and complements the technical analyses conducted by governments and multilateral organizations with detailed information on local realities and sector-specific population needs. Incorporating the perspectives and knowledge of a range of civil society sectors enriches the policymaking process, leading to more informed, relevant and effective policies that are better suited to addressing social and economic issues and challenges.

Through awareness-raising and education campaigns and community mobilization, civil society organizations can encourage citizens to take action and can boost their engagement with policies and the SDGs. Their objective is to generate a major impact, for example in enhancing citizens' understanding and commitment, advocating for their interests with governments and decision makers, driving transformative agendas and strengthening multi-stakeholder partnerships and collaboration.

For the private sector and civil society to participate in policy design and implementation and as co-authors of transformative policies, a series of capacities and processes must be in place in public institutions. The topic of skills is discussed in section C, where the technical, operational, political and prospective (TOPP) capabilities of public institutions are analysed. In terms of processes, the role of the various spaces for social dialogue and broader mechanisms for citizen participation are also discussed, in section D.

C. The centrality of technical, operational, political and prospective (TOPP) capabilities

1. Capabilities for transformation

Development economics has analysed the concept of capabilities for productive transformation and catch-up growth from two perspectives: (i) the structural change perspective, which considers capabilities for the development of new products and the adoption of technologies, and (ii) the process perspective, which focuses on companies' learning processes to perform tasks related to coordination, investment, innovation and identifying and solving problems. However, as Nübler argues, "mainstream growth models have largely neglected capabilities" (2014, p. 114). For this reason, Nübler (2014) sets herself the task of developing a theory of capabilities for productive transformation and learning for catch-up growth. The author makes a distinction between productive capacities that exist in the "material sphere" of the economy (factor endowments) and those in the "non-material sphere", thereby developing a "knowledge-based concept of capabilities" and a concept of "collective learning". These two concepts, together with the concept of catching up, form the basis for a theory of capabilities for productive transformation, which seeks to better understand capabilities, where they reside, how they are created and their role in economic development.

In a separate study, Crespi, Fernández-Arias and Stein (2014) present the concept of institutions' technical, organizational and political capabilities for productive development. Building on this, Cornick and others (2018) develop the concept more broadly and raised the question of how institutions generate capabilities for productive development while analysing them in Argentina, Brazil, Costa Rica and Uruguay.

On the basis of this work, ECLAC has expanded the concept of technical, organizational and political capabilities in two ways. First, foresight capabilities have been included, that is, institutions' capacity to consider the future and use foresight techniques to envisage scenarios and their policy implications. Second, the application of this concept has expanded beyond productive development policies to institutional capabilities in any policy field, e.g. social, environmental, digital transformation and gender. Thus, the study of the technical, operational, political and prospective capabilities of institutions is central to the conceptual framework proposed by ECLAC to respond to the challenge of managing transformations.

The active role of the State and its institutions is fundamental in the transformations required to move towards a model of productive, inclusive and sustainable development (ECLAC, 2012, 2014, 2018 and 2022). Carrying out these transformations requires the design of development strategies, a revaluation of public policy and the role of the State in the broadest sense, and an emphasis on the importance of public sector capabilities. This section will examine how technical, operational, political and prospective capabilities are essential if public policies are to be effective in transforming realities in their areas of competence. At the same time, these capabilities allow the public sector to adapt effectively to changing conditions and respond proactively to the evolving needs of society and citizens (Medina Vásquez, 2020).

This section will reflect on technical, operational, political and prospective capabilities in the public sphere since they have been the subject of relatively little analysis. For this reason also, ECLAC is advancing a research agenda to understand how these capabilities may ensure more effective and efficient policymaking, thereby helping to transform development models.

2. Technical, operational, political and prospective capabilities for transformation of the development model

Technical, operational, political and prospective capabilities constitute a conceptual framework for analysing public institutions' capacities to effectively address complex challenges in changing environments. An explanation of each of these dimensions is provided in table III.2.

Table III.2
Technical, operational, political and prospective (TOPP) capabilities: institutional capabilities needed to drive transformations in the development model

Capability	Characteristics
Technical	– Integration of medium- and long-term strategic planning into the public policy cycle. – Formulation of comprehensive policies with cross-cutting approaches in key areas of development. – Establishment and management of comprehensive information systems to support policy implementation. – Evaluation of policy impact and programme outcomes. – Improvement of coherence between regulatory mandates and the capacity of public agencies. – Establishment of accountability mechanisms to optimize the civil service. – Creation of a culture of continuous learning.
Operational (operating dimension of public management and administration)	– Use of modern public management tools for budgeting, planning, performance management and evaluation, and accountability procedures. – Establishment of mechanisms to assess productivity and ensure efficient and effective delivery of public goods and services. – Design of modern interfaces based on digital government, to improve interaction with citizens and the provision of services. – Creation of mechanisms for effective coordination between public entities. – Optimization of meaningful participation by the private sector and other stakeholders. – Implementation of mechanisms for the transparent and honest execution of public resources. – Guarantee of timely access to financial resources for public policy implementation. – Measurement and continuous follow-up of citizen satisfaction with public services and institutions.
Political	– Facilitation of spaces for social dialogue between development stakeholders for public policy formulation and implementation. – Development of public leadership that builds trust and enhances coordination and collaboration with civil society, the private sector and academia. – Promotion of effective collaboration and coordination between different levels of government. – Creation of peer-to-peer collaboration networks at local, national, regional and international levels. – Consensus-building within and among communities, government, the private sector, civil society and other relevant stakeholders.
Prospective	– Monitoring of global megatrends affecting regional development. – Participatory approach to building desired future scenarios and their adoption by development stakeholders. – Facilitation of the design and implementation of State public policies through the formulation of alternative future scenarios. – Agile and effective responses to unexpected high-impact events that disrupt development. – Promotion of a culture of dialogue to anticipate and manage conflicts between development stakeholders.

Source: J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

In addition to technical, operational, political and prospective capabilities, institutions must have sufficient funding to develop and maintain these capabilities over time. However, having the necessary funding does not automatically guarantee that an institution possesses these capabilities, which presents an additional challenge beyond the financial aspect.

Overall, the technical, operational, political and prospective capabilities approach provides a useful framework for organizing the discussion and analysis of institutions' capabilities to manage transformations. Several Latin American and Caribbean success stories may be better understood by applying the concept of technical, operational, political and prospective capabilities to the institutions that have led and coordinated these efforts. A selection of these cases is presented in table III.3.

In conclusion, the technical, operational, political and prospective capabilities approach provides a better understanding of some of the factors behind successful and efficient public sector management in specific areas. Adaptability, flexibility in resource management, agility in policy implementation and promotion of innovation are just some of the areas in which these capabilities are manifested. The potential integration of emerging technologies, change management and policy coordination are essential aspects that contribute to the success and relevance of public institutions. By strengthening and developing these capabilities, the public sector will be better prepared to face current and future challenges.

Table III.3
Latin America: cases in which one or more technical, operational, political and prospective (TOPP) capabilities have helped to address complex economic, technological, social and environmental challenges

Capability	Case
Prospective	– **Parliamentary committees for the future in Chile and Uruguay**. The purpose of legislative foresight, such as that seen in Chile and Uruguay, is to better understand trends in science and technology, demographics, geopolitics, climate change and other areas in order to anticipate future scenarios and make the most appropriate decisions in the present. The Second World Summit of the Committees of the Future (2023), held in Montevideo, brought together more than 300 parliamentarians from 70 parliaments around the world. On that occasion, the importance of thinking ahead to develop sustainable and evolutionary solutions to achieve the SDGs was highlighted.
Political and prospective	– **Social inclusion policies in Brazil**. Social inclusion policies and programmes have been successful thanks to the effective application of political and prospective capabilities, which have enabled the design of comprehensive and sustainable strategies to promote equity and social development. · Political capabilities: the capacity for inter-agency coordination between different levels of government and social stakeholders has been fundamental to ensure the coherence and effectiveness of policies and programmes such as *Bolsa Família*, as well as capacity-building and training programmes to improve employability. · Prospective capabilities: impact assessment and strategic planning have helped to identify areas for improvement and tailor interventions to maximize their effectiveness and long-term sustainability. This has allowed Brazil to move towards a more comprehensive and proactive approach in the fight against poverty and inequality, anticipating and responding to emerging socioeconomic challenges more effectively.
Technical and operational	– **Technology development in Latin America**. In recent years, the region has witnessed remarkable growth in technology development and implementation, which has contributed significantly to economic and social progress. Countries such as Argentina, Chile and Uruguay have led this effort by promoting and investing in the creation of thriving and internationally competitive technological ecosystems. This progress stems from the successful application of advanced technical and operational capabilities. · Technical capabilities: these have been essential for software development, systems engineering and other key technology areas. These countries have cultivated a highly skilled workforce in science, technology, engineering and mathematics, which has driven innovation and the creation of high-quality technology products and services. · Operational capabilities: these have played a crucial role in efficient project management and process optimization in the technology sector. The ability to plan, execute and oversee technology development projects has been critical to ensuring the viability and success of ongoing initiatives. In addition, process optimization has increased productivity and efficiency in the implementation of technological solutions, which has contributed to the region's competitiveness in the global market.
Technical and political	– **Chile's leadership in the field of renewable energies**. In recent years, the country has stood out as a regional leader in the adoption of clean energies, taking advantage of its advanced technical and political capabilities. · Technical capabilities: the application of renewable energy technologies and energy systems engineering has enabled the country to develop and implement innovative solutions to make efficient and sustainable use of its natural resources. · Political capabilities: the formulation and implementation of sustainable energy policies and the creation of incentives for clean energy investments have laid the foundation for continued and stable growth in this sector.
Technical, operational and political	– **Transformation of Mexico's tourism industry**. In recent decades, Mexico has undergone a remarkable transformation in its tourism industry, positioning itself as one of the most visited destinations in the world. This success has been achieved through a combination of technical, operational and political capabilities that have driven the growth and competitiveness of the sector. · Technical capabilities: Mexico has made significant investments in tourism infrastructure development, including airport modernization, road construction and improved connectivity in key tourism areas. In addition, the use of technology in the sector has allowed for more efficient management of tourism services. · Operational capabilities: Mexico has excelled in effective management of tourism services, ensuring high-quality experiences for visitors. The effective promotion of the country as a tourist destination has been fundamental, through innovative and strategic marketing campaigns that highlight its cultural, historical and natural wealth. · Political capabilities: the country has demonstrated a strategic vision in the formulation and implementation of tourism policies through the creation of favourable regulatory frameworks that promote public-private collaboration. Partnerships between government, industry and civil society have been central to fostering sustainable and diversified tourism development initiatives that generate economic and social benefits for local communities.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

D. Management of reforms: political economy and social dialogue

1. The political economy of reforms

Interest in political economy is resurgent in academia, extending to top economics and political science departments and business programmes, as well as in the discourse and analysis of international organizations.[5] Several factors have motivated this renewed interest in political economy analysis. The first is the fact that policy reforms often fail, even when they are designed to advance priority areas of public policy for achieving

[5] In the policy arena, however, this understanding has been more difficult to attain, owing to numerous reforms that fail mainly because they do not adequately consider political economy and governance factors (North and others, 2008).

transformations towards a more productive, inclusive and sustainable future. Such failures may be attributed to various factors, such as resistance from established interest groups, lack of political consensus, weaknesses in technical, operational, political and prospective capabilities, and deficiencies in implementation. Second, increasing the likelihood of implementing policies and reforms requires better governance and a deeper understanding of the relationship between policies and political power. This entails improving governments' understanding, action and capacities, as well as how they interact with non-governmental partners in the process of governing. A third aspect, increasingly evident in the past decade, is that improvements in governance are difficult to achieve (Fritz, 2012), which points to the need to adopt a more strategic approach that takes into account the complexities and dynamics of political power, as well as the challenge of managing transformations.

Political economy provides an analytical framework to better understand how policies and reforms are defined and implemented, considering power relations, actors' interests and institutional contexts. In particular, it analyses the impact of political forces on the economy, where voters and interest groups play a pivotal role in shaping policy, while also examining the economy's influence on policy, for example, how macroeconomic conditions can facilitate or hinder the implementation of policies and reforms by governments (Frieden, 2020).

The above demonstrates that the design and implementation of policies and reforms are phenomena that transcend the purely economic and technical dimension to also encompass political processes and interests. Political economy thus emerges as an essential analytical tool for understanding the ways in which policies and reforms are discussed and agreed upon, their degree of acceptability and, ultimately, why they fail or succeed (Juhász and Lane, 2024). Addressing problems such as insufficient economic growth, lack of inclusion and sustainability, high inequality and limited social mobility, coupled with deficiencies in education and vocational training, gender inequality, negative environmental impacts on productive processes and limited regional and global economic integration, pose an enormous challenge. However, political economy does not consider the constraints imposed by the political and institutional environment to be insurmountable; instead, it provides analytical tools to design proactive strategies to mitigate such obstacles.

When addressing political constraints or conditions, it is important to recognize that those who design reforms and policies are operating within a given political and institutional context. These institutions are shaped by a series of factors that seek to preserve the capacity for influence, such as coalitions or parties, the electoral base and public opinion.

This section delves into how political economy analysis may help to foster coalitions for change and overcome resistance, and examines the factors that may facilitate or hinder such efforts. To this end, the analysis will focus on three specific aspects: (i) the way in which a reform or policy is structured; (ii) the importance of having a strong political and electoral mandate; and (iii) the management of different time frames in the implementation of reforms.

First, the way in which a reform or policy is structured may make a significant difference in its implementation.[6] Governments should have a thorough understanding of the nature of the challenges, the potential effects of policy alternatives and the trade-offs involved. Paying specific attention to the political feasibility of reforms and defining and creating incentives to implement them are critical factors for their success (Robinson, 2013). In this regard, a number of factors should be considered (Aphecetche and others, 2022):

[6] From a political economy perspective, institutional capabilities are considered critical for carrying out policies or reforms. Limited capabilities in the public sector may weaken the implementation and impact of reforms. Political economy underlines and enhances the importance that ECLAC attaches to the analysis of capabilities, especially the expanded technical, operational, political and prospective capabilities. In that sense, political economy indicates that government capabilities are the result of the resource allocation decisions made by governments, which in turn are influenced by the political environment (Besley and Persson, 2011). This entails, among other aspects, the technical and political capacity of public sector officials to interact and share information with the private sector and other stakeholders, which may be crucial for the success of public policies (Evans, 1995). Interaction with the private sector and other stakeholders may be a highly relevant policy design mechanism (Sabel, 2004; Rodrik, 2014). However, such practices must not lead to the capture or depredation of the government apparatus by non-State actors. To avoid this, the State must maintain its independence and autonomy. The balance between external participation and State autonomy is what Peter Evans (1995) defined as "embedded autonomy". This combination prevents an autonomous State from running the risk of formulating and implementing policies in isolation and without guidance from key stakeholders, while also avoiding that linkages without autonomy engender inconsistencies and policies influenced by private interests.

(i) The political capacity to structure reforms, moderate their scope and pace, and identify the levels and areas in which to initiate efforts may weaken resistance and cultivate support. This highlights the importance of political leadership and commitment, as well as the political skills needed to design and manage reforms. Political leadership styles will vary across countries according to their political context and the nature and relevance of the forces opposing reforms.

(ii) Effective stakeholder consultation and constructive negotiation with opposition parties may help to build support and long-term sustainability of policies and reforms. In addition, it is essential to involve non-State actors, especially the private sector and civil society organizations. Including a consultation process in the design phase may help to build consensus by establishing clear, long-term objectives and allowing sufficient time to discuss the various policy options available. It may also help to build trust and make stakeholders or opposition parties more willing to compromise.

(iii) Likewise, the quality of the process of preparing and implementing a reform or policy may have a positive impact on general disposition towards it. A culture of ex ante and ex post policy evaluation increases transparency, contributes to the effectiveness and efficiency of reforms and helps to build trust in the decision-making process. This requires ensuring that sufficient technical capacity is available to support evidence-based policies and enable effective implementation.

(iv) Reforms that are part of a broader package tend to meet less resistance and may also be more effective, as they form a coherent set of mutually reinforcing measures. In this case, proper sequencing within a reform plays a decisive role.

(v) Effective communication supported by objective, evidence-based policy design may foster acceptance of reforms and facilitate their overall implementation.

(vi) Advocacy and cooperation at the international level may help to raise awareness of the need for reform or promotion of certain policies among citizens and politicians. Recommendations issued by international agencies may help governments to better explain the need for the proposed policy changes and the expected results. However, the potential of this advocacy to drive reforms at the international level may be severely limited in the absence of ownership by national governments.

Second, a strong political and electoral mandate may facilitate the adoption of reforms and policies. Democratic support plays a crucial role in the ability to approve proposals for change. As a result, governments with strong parliamentary support are more likely to succeed in implementing innovative policies. In addition, when policies or reforms have been high on the campaign agenda of the winning party or coalition, the government has the political backing to prioritize these initiatives after the election. Against this background, it is important to consider the following three characteristics of the relationship between policy and society that may influence the implementation of reforms (Robinson, 2013):

(i) Institutional depth: greater longevity, flexibility, adaptability and legitimacy of formal and informal institutions —through which agreements between conflicting social groups are reached or "losers" are compensated— strengthens support for reforms and reduces the cost of change. In addition, the expectation that political institutions will endure may increase confidence in public policy decisions and help to build the credibility and predictability of the reform process, even if they are subject to shortcomings.

(ii) Diversity and breadth of civil society: a diverse civil society may incentivize the ruling class by responding positively to reforms and offering political support to counter opposition to change.

(iii) Composition of ruling elites: the degree to which traditional elites may hinder the formation of pro-reform coalitions and the emergence of new social groups committed to change must be understood and considered.

Third, the sequencing, timing and pace of reforms also play an essential role, since the management of such efforts requires the consideration of initiatives and policies with widely varying timelines.

(i) Stakeholders have different rationales and bases for legitimacy, meaning that the timing and speed of their actions also vary. The various actors involved in the management of reforms may target very different time horizons. For policymakers, it may be critical to show results within a short time frame, while for the bureaucracy, solutions and results may require more time. Managing reforms involves harmonizing these different time frames and short-, medium- and long-term perspectives (Máttar and Cuervo, 2017).

(ii) Reforms may also be structured so that they produce initial "winners" who support subsequent reforms or dispel resistance through a gradual approach that builds public support. At the same time, it is important to keep in mind that rapid and ambitious reforms may garner public support, but they may also provoke political and bureaucratic resistance (Robinson, 2013).

(iii) The electoral cycle should also be taken into consideration, as it may affect the momentum of the reform. During general election years, governments typically show less interest in implementing reforms that may generate short-term costs. While newly elected governments tend to be more willing to adopt reforms whose benefits are perceived in the long term, according to Aphecetche (2022), reforms are more likely to be implemented when they are perceived as urgent. This perception of urgency not only reduces policymakers' time horizon, but also strengthens the legitimacy of policy action in the eyes of the public. At such moments of opportunity, the cost of reform is more easily tolerated in order to obtain what are expected to be significant long-term benefits.

For these reasons, it is essential to consider the political dynamics underlying policies and to reflect on the relationship between policy and political power (Roland, 2002). This includes understanding the political constraints that emerge during the policy design process, particularly in regard to political incentives and the management of potential sources of opposition and resistance through approaches that are appropriate to the prevailing political environment. The choice of policies or reforms may be the result of a political equilibrium shaped by decision makers who favour the status quo in the interest of preserving their power (Acemoglu and Robinson, 2013). Conversely, the political environment may evolve into one in which leaders support more far-reaching policies or reforms, for instance, as a result of substantial changes in political institutions, shifts in power among elites or significant externally driven transformations.

In other words, political economy points out that decision-making on a reform or policy may be influenced by various factors, including the political environment, political institutions, the distribution of power and the incentives of policymakers. Policies or reforms fail when those implementing them overlook their indirect effects, particularly those that affect the balance of power. Moreover, it is clear that the challenges facing policymakers are not limited to technical or economic aspects alone. Dialogue to reach consensus on objectives, government credibility and management of the time frame may have a significant impact on the effectiveness of a policy or reform.

In conclusion, knowledge of political economy helps to identify ways to strengthen government capacity to implement policies and reforms. The constraints imposed by the political and institutional environment are not immutable and strategies may be sought and designed to overcome them. Political economy helps to understand why reforms or policies succeed or fail by considering the roles played by various actors, with particular focus on their political influence and interest in decision-making. Successful policies and reforms depend, among other things, on knowing who the stakeholders are, what they have to gain or lose and how to involve them in the development process. Successful political economy analysis may improve the effectiveness of policy or reform implementation because potential obstacles are identified and addressed in advance.

2. Social dialogue for successful management of transformations

Social dialogue —understood as the process of interaction between different social, economic and political actors to seek common objectives and solutions to emerging challenges, drawing on broad support— plays a pivotal role in managing transformations.

Without seeking to encompass what is an extremely broad and intricate subject, the field may be narrowed down to four areas or modalities of dialogue: (i) social dialogue for macroeconomic stabilization; (ii) social dialogue on labour policies; (iii) social dialogue for productive development; and (iv) dialogues for territorial development (Salazar-Xirinachs, 2023).

Social dialogue for macroeconomic stabilization is usually initiated in times of crisis, be it inflationary, financial, recessionary or employment-related. The objective of these dialogue processes is to negotiate packages of macroeconomic measures whose distributional aspects have a major impact on how the costs of adjustment will be distributed among different groups in society. Some countries have undergone negotiation processes to reach comprehensive agreements, with varying results in terms of success and subsequent implementation.

Social dialogue on labour policies focuses on the negotiation of wages, working conditions and various types of labour legislation, with the participation of representatives of the government, employers and workers. This type of tripartite negotiation is promoted and regulated by the International Labour Organization through various labour conventions. Most such negotiations take place in the context of institutions specifically set up for these purposes, such as minimum wage councils or work councils.

Regarding social dialogue for productive development, there is a wealth of experience in vocational training, both at the international and regional levels. This approach has been used to address specific needs and define policies and programmes related to labour skills. In Latin America and the Caribbean, the model of vocational or professional training centres has always incorporated a tripartite approach into governance, involving government, employers and workers (Salazar-Xirinachs and Vargas-Zúñiga, 2017). Moreover, councils promoting productivity and competitiveness have been popular in several countries for the past two decades. With few exceptions, these councils were set up with bipartite representation and governance, that is, as public-private partnerships, where the private side consisted only of business leaders or representatives. Cluster-based policies, which are analysed and discussed in this position document, are one of the most effective types of interaction for productive development, which is less about dialogue and more about joint construction through multiple interactions and collaboration.

In general, social dialogue for productive development differs from labour and wage dialogues because it seeks a "positive-sum" joint solution that benefits all stakeholders, rather than being a situation that is generally perceived —albeit accurately— as "zero-sum", with one party's gain seen as the other party's loss.

Lastly, dialogues for territorial development are crucial for defining regional strategies and breaking the centralized decision-making tradition that is characteristic of many countries. These processes are of particular interest at the local level in the definition of infrastructure projects and in other aspects of local and territorial development policy.

The distinctions between the various areas and modalities of social dialogue are important, but are only part of the much broader political and collective action challenge of how to reach agreements, pursue continuous processes of policy reform in various fields, and promote broad citizen participation in reform and transformation projects. In this framework, the role of leadership, not only at the national level but in all sectors, is fundamental. There is a need for the institutional framework of Latin American and Caribbean countries to incorporate new modalities of participation, dialogue and consultation at the national, subnational and local levels to improve governance processes and facilitate the necessary transformations.

In conclusion, institutional capabilities and the processes and types of governance of public policies constitute a critical area of knowledge that requires greater attention and dissemination among leaders of all sectors who are interested in promoting policies to allow the countries of the region to escape from the traps they face and advancing vital transformations in development models.

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CHAPTER

IV

How to achieve stronger, sustained, inclusive and sustainable growth?

Introduction

As chapter II explained, the first of the three traps the region is caught in is one of low growth capacity. As a result, per capita GDP in Latin America and the Caribbean grew at an average annual rate of just 0.1% between 2014 and 2023, which has weighed heavily on the population's well-being. This low growth capacity has been associated with a declining rate of investment growth and, most importantly, with stagnant or falling productivity, which in turn reflects a profound difficulty in incorporating greater knowledge and technology into the production sphere and an inability to achieve a structural shift towards higher-productivity activities (ECLAC, 2019 and 2024a). To reverse the situation, the countries need to carry out a major productive transformation, and this is one of the 11 great transformations in the region's development models proposed in chapter II.

While improving productivity will require efforts on multiple fronts, the historical experience of both Latin America and the Caribbean and other countries and regions, and indeed the current experience of the world's fast-growing countries, shows that productive development policies are a precondition for high and sustained productivity growth and a structural shift towards more diversified and technologically sophisticated activities (Evans, 1995; Chang, 2002; Salazar-Xirinachs and Llinás, 2023).

Although the region has implemented a variety of productive development policies over its history, with significant growth achievements up until the 1970s, today's growth and productivity challenges call for another approach that is not only more ambitious in scope but also has some different characteristics. The new productive development policy vision does not focus exclusively on industrialization or on the horizontal policies pursued in past decades. The new vision for these policies that ECLAC[1] has been advocating is based not on traditional industrial policy instruments such as tariffs and subsidies but on collaboration between stakeholders vital to productive transformation in the public and private sectors, academia and civil society. The new productive development policies focus on establishing collaborative processes with effective governance for productive development, along with solid public institutions capable of creating the conditions for strong coordination and teamwork. In addition, they must target the institutional capacities of subnational governments, not only because that approach may allow for more "capillarity" —i.e. the ability to permeate the productive fabric and reach segments that policies designed and implemented by the national government would find harder to access—, but also because the new generation of these policies is intended to be implemented in a context of greater democratization and public participation, in line with experimentalist, multilevel and multi-stakeholder approaches to governance. A new vision for productive development policies must also recognize the challenges and opportunities arising from the profound global transformations under way, as discussed in chapter I of this document.

A preliminary diagnosis of productive development policies in the region, however, reveals a general picture that does not match this new vision (ECLAC, 2024a). Although there are success stories, some of them illustrated in this chapter, most of the region's institutions, governance systems and productive development policies in general are highly dispersed, fragmented, uncoordinated and inconsistent over time, as well as insufficiently evaluated. Particular features include great use of horizontal financing mechanisms (largely dominated by tax expenditure) with little prioritization of sectors, a combination of weak multilevel governance and limited involvement of territories, and relatively little inclusion of stakeholders from the private sector and academia or relevant civil society organizations in the design and implementation of these policies.

To address the challenges involved in bringing the region's practices closer to the new productive development policy vision, the requirements are, above all, firm belief and the political will to prioritize efforts aimed at creating strong institutions and governance mechanisms capable of supporting the implementation of larger-scale, more ambitious and selective productive development policies that are legitimized by social stakeholders (and thus able to survive changes of government) and integrated with one another.

[1] See Salazar-Xirinachs and Llinás (2023) and ECLAC (2024a).

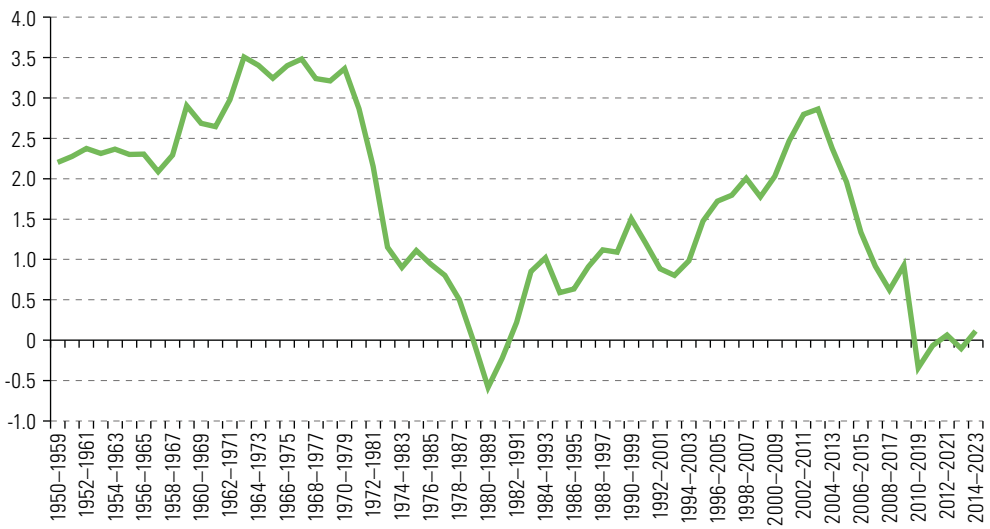
The following sections of this chapter explore these ideas in more depth. Section A presents a brief diagnosis of productivity developments in the region. Section B introduces the new productive development policy vision by considering how it differs from traditional industrial policy approaches, stressing the importance of prioritization, analysing the role of collaboration and governance mechanisms, and describing the different areas of action of these policies. Section C provides a diagnosis of current productive development policies in the region, including an overview of budgetary efforts, the public institutions involved in productive development, multilevel and multi-stakeholder governance, and subnational efforts in this area. Section D presents some guidelines for productive development policy efforts, the institutional framework underpinning these policies and their governance, with an emphasis in this last case on multilevel governance and experimentalist governance approaches. Lastly, section E summarizes the elements discussed in the chapter.

A. Diagnosis: low growth with stagnant and heterogeneous productivity

Some years ago, Robert Devlin (1987, p. 75) wrote that by most estimates the 1980s would be a "lost decade" for Latin America in terms of economic growth and socioeconomic development. He made this claim because all the indications from the data at the time were that the region's per capita GDP was set to contract by the end of the 1980s, leaving people in Latin America and the Caribbean poorer on average than at the beginning of the decade.

Unfortunately, on any measure, Latin America and the Caribbean had another lost decade between 2011 and 2020, with negative per capita GDP growth leaving average incomes lower than 10 years earlier (see figure IV.1). By 2023, with the COVID-19 pandemic crisis behind it, the region had yet to recover its economic momentum, and per capita income was still lower than in 2012.

Figure IV.1
Latin America and the Caribbean (20 countries): average annual per capita GDP growth by moving decade, 1950–2023
(Percentages based on constant dollars at 2000 prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] https://statistics.cepal.org/portal/cepalstat/index.html?lang=en.

High economic growth is important not for its own sake, but because it can increase people's well-being. This is particularly true in a region such as Latin America and the Caribbean, where much of the population lives on subsistence incomes, with poor material living conditions and large deficits in various aspects that

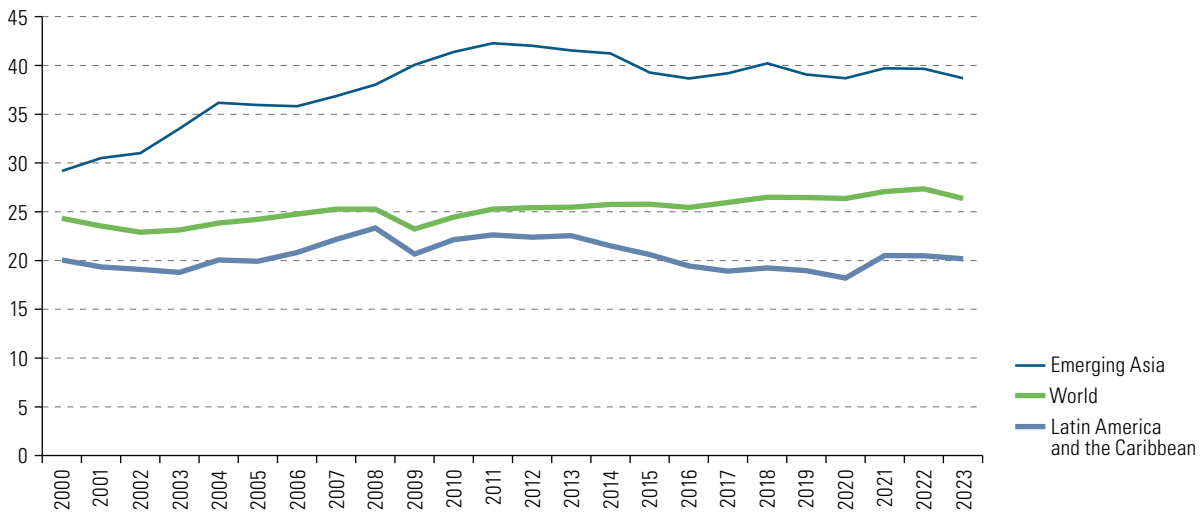
affect quality of life. However, what is needed is not just any growth, but growth that as well as being high is sustained, sustainable and inclusive. Experience shows that this outcome cannot be the spontaneous product of market forces, but comes from collective, directional action, i.e. growth needs to be guided and managed.

Because the economy is a complex system, the causes of this stagnation are to be sought in a varying number of factors, depending on how deeply the phenomenon is analysed. The secular fall in commodity prices has certainly played an important role in the region over the last decade (ECLAC, 2023a). This, however, only confirms the region's heavy reliance on a production mix characterized by the extraction of raw materials, slow technical progress and a basket of products and services with little added knowledge. Thus, the region's poor economic performance can ultimately be attributed to the stagnation of productive development.

Productive development is the process of capacity enhancement and productive transformation in an economy, resulting in improved productivity. This includes technological sophistication, meaning improvements in the productivity of existing activities; diversification, meaning a step change towards the implementation of a greater number of new and more productive activities; and positive or virtuous structural change, which is the migration of factors from lower-productivity to higher-productivity activities, resulting in higher aggregate productivity in the productive apparatus.[2] For example, the value of each country's natural resources depends on the technology applied by the country to turn those resources into value. Many environmental challenges are also technological challenges, examples being the energy transition and the circular economy.

As mentioned in chapter II, low growth is associated with inadequate investment. Investment as a percentage of GDP began to fall in Latin America and the Caribbean in 2014, so that by 2022 it was one of the regions of the world with the lowest investment as a share of GDP (see figure IV.2).

Figure IV.2
Latin America and the Caribbean, emerging Asia and world: total investment, 2000–2023
(Percentages of GDP)

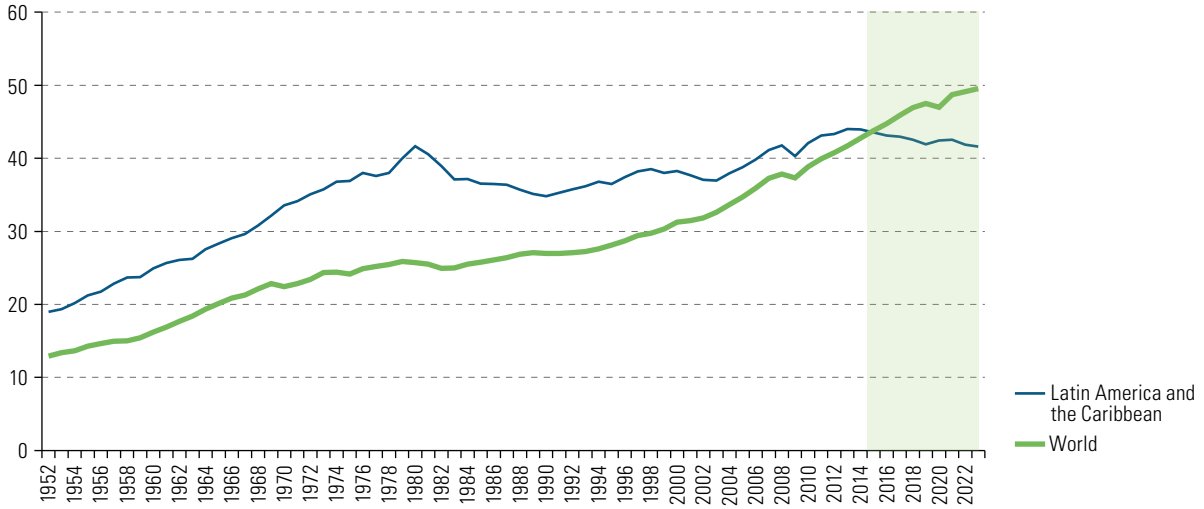


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: Navigating Global Divergences,* Washington, D.C., 2023.

Another factor associated with the drop in per capita income in the region is stagnating or declining labour productivity (ECLAC, 2019 and 2024a). In a historical perspective, several studies have shown how labour productivity in the region began to show signs of flagging from 1980 onward (ECLAC, 2024a). The poor performance of labour productivity in the region, coupled with remarkable productivity growth in Asian countries, made 2015 the first year in which labour productivity in the region was below the average for the rest of the world (see figure IV.3).

[2] Productive development thus turns on what the literature calls "sophistication and diversification within firms and sectors" and "structural change", meaning a structural transformation in the composition of the sectors in an economy (McMillan, Rodrik and Verduzco-Gallo, 2014; Verhoogen, 2023; Cusolito and Maloney, 2018; Andrews, Criscuolo and Gal, 2015).

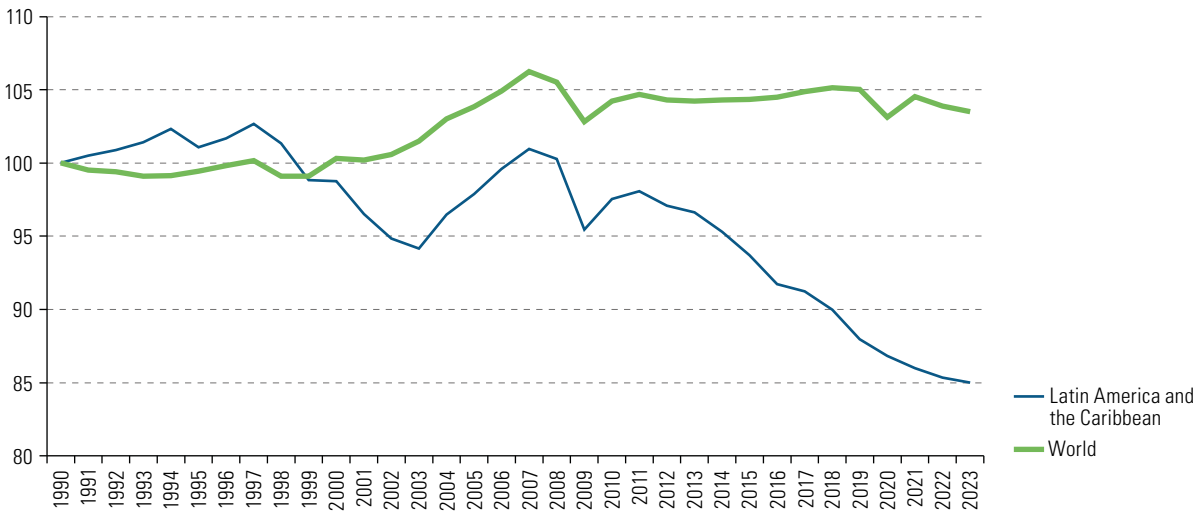
Figure IV.3
Latin America and the Caribbean (13 countries) and world (133 countries): labour productivity, 1952–2023
(Thousands of international dollars at 2022 prices and at purchasing power parity)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of The Conference Board.

Closely related to the trends in labour productivity is the behaviour of total factor productivity,[3] which has stalled and even declined in recent decades (see figure IV.4). Addressing the challenge of development and economic growth depends critically on how policies deal with the productivity challenge. This means boosting productivity so that it becomes an engine of high and sustained growth.

Figure IV.4
Latin America and the Caribbean (13 countries) and world (133 countries): cumulative growth in total factor productivity, 1990–2023
(Index: 1990 = 100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of The Conference Board.

[3] Total factor productivity is defined as the ratio between the volume of output and the combined contribution of the inputs used. It reflects efficiency changes in the use of factors of production, the incorporation of new technologies, economies of scale and changes in capacity utilization, among other factors.

Another factor behind the region's poor productivity performance is the great heterogeneity in the level and trends of productivity across different sectors of economic activity, different firm sizes and different subnational territories within the same country, known as "productive dualism". It is not surprising that these productivity gaps exist, but what is worrying is that they are much wider than in more developed countries. Chapter V presents an analysis of productivity gaps in the region, distinguishing between sectors, firms of different sizes, formal and informal firms and subnational territories. As mentioned, improving the region's productivity performance will involve efforts on numerous fronts, and these must include medium- and long-term agendas to reduce this heterogeneity, with a particular focus on productive development policies.

B. A new vision for productive development policies[4]

Productive development policies are defined as all policies that contribute to sophistication, diversification and structural change in the economy and that lead to an increase in productivity, with the aim of achieving more productive, sustainable and inclusive development and enhancing the well-being of the population.

They include both "horizontal" and "vertical" policies, i.e. cross-cutting efforts aimed at the entire production structure and those targeting certain sectors and economic activities which countries and their territories prioritize within the framework of these policies. The policies act by providing incentives to increase productive capacities, productivity and the creation of good jobs. Accordingly, the objective of productive development policies is not only to increase productivity per se, but also to guide and manage economic growth so that it likewise becomes more sustainable and inclusive.

1. A new vision for sectors, firm sizes and territories

From the definition given, it is clear that productive development policies can be aimed at any economic sector, including agriculture, mining, tourism, commerce and manufacturing, among others. Hence, they are not confined to policies that aim at countries' industrialization, but incorporate a more holistic vision of the productive apparatus.[5] Although industrialization (now also called "reindustrialization" or "neo-industrialization" in some countries) has been and continues to be a major source of economic growth and development, comparative experiences show that other sectors are also great drivers of development (Dasgupta and Singh, 2005; Sen, 2023). Technological revolutions have changed production paradigms and meant that, whereas decades ago industry was the only economic activity characterized by large economies of scale, tradability, innovation capacity and the generation of linkages and knowledge spillovers, these characteristics are now also found in many service and agricultural activities. This means that today's productive support efforts need to be "broadband", i.e. not confined to industrial sectors alone (Salazar-Xirinachs and Llinás, 2023).

As regards firm size, productive development policies do not only target micro-, small and medium-sized enterprises (MSMEs) but also consider the role of large firms and projects that need greater economies of scale to operate efficiently. Having large companies that are also great companies in every sense of the word helps to accelerate the productive development process.

Great firms enormously stimulate productivity via innovation and the incorporation of knowledge into production, create the conditions for quality job creation and bring momentum and greater productive capacity to activities where the workforce is underutilized. Great companies are also able to draw smaller companies along with them, especially medium-sized ones, and contribute to their development, while successfully engaging with international markets, integrating national economies with the rest of the world economy and

4 See Salazar-Xirinachs and Llinás (2023) and ECLAC (2024a) for more details of the "new vision".

5 Strictly speaking, ECLAC uses the term "productive development policies" for what are called "industrial policies" in academia and in other regions. See Salazar-Xirinachs and Llinás (2023) for a detailed explanation of the use of these concepts.

implementing the best management standards and the most advanced technologies available globally. Great companies also participate in collaborative agendas and spaces created to improve conditions in the specific economic environment of their business, such as cluster initiatives, benefiting not only themselves but the other companies in their territory.[6]

Many public enterprises in the region fall into this category, as they require economies of scale to operate. Large State-owned enterprises come to be considered great ones when they acquire the qualities that make them positive contributors to countries' productive development and all-round human development.[7] Thus, the scope of this new generation of productive development policies encompasses the entire productive ecosystem with its different sectors and company sizes.

Furthermore, the new vision for productive development policies stresses the importance of territorializing these, considering the territorial diversity of production and productivity that characterizes the countries of the region.[8] Productive development policies therefore include the action not only of national policies, but also of intermediate (State, departmental, provincial or regional) governments and, what is increasingly important, of local (municipal, district, cantonal, parish or communal) governments (ECLAC, 2024a).

Subnational territories exhibit not only different production structures, but also specific cultures, histories and preferences that influence the pathways of economic and productive development. In turn, territories' different levels of productive development mean that certain national policies which are successful in one place may not be as successful elsewhere. National policies generally operate through competitions open to the whole country, with the winners tending to be those actors with the most time and capacity to present attractive projects. The neglect of territorial specificities by national policies that may result from this in some countries can widen the gaps between central and peripheral territories, affecting national unity and domestic political harmony (Rodríguez-Pose, 2018). Hence, there are not only technical but also political reasons to take a territorial approach to productive development policies (Salazar-Xirinachs and Llinás, 2023). For all these reasons, the new productive development policy vision encompasses the actions not only of national governments but also of subnational governments, by virtue of the logic of what have been called "place-based policies" (McCann and Rodríguez-Pose, 2011; Rodríguez-Pose and Wilkie, 2017; Bartik, 2019).

2. The need to prioritize

Although productive development policies can include all sectors of economic activity, all sizes of firms and all territories, it must be recognized that there are limits to their ability to modify the production mix and accelerate productive development, largely because of obvious financial, human and institutional capacity constraints. Although there have been instances in the past of high economic growth and increased productivity under authoritarian political regimes, these experiences are of little help today under the conditions of democratic governance aspired to in the world's most developed countries and in those of Latin America and the Caribbean (ECLAC, 2024a). Thus, one of the challenges for the new vision for productive development policies is to find ways of implementing these within a framework of wide-ranging civil and economic freedoms and in a democratic electoral regime.

Resource and institutional capacity constraints restrict the number of sectors and the range of areas of action that can be addressed by productive development policies. While countries and their territories should strive to increase public policy "bandwidth", and particularly their capacity to design and implement productive development policies (ECLAC, 2024a), the constraints they are under mean that efforts need to be prioritized. This is particularly important in the context of Latin America and the Caribbean, where public management is subject to severe budgetary and capacity constraints.

6 This is an example of what has been called "shared value" (Porter and Kramer, 2011).

7 The contrast between large firms and great firms is analogous to the distinction Max-Neef (1986, p. 165) makes between large cities and great cities: large cities are defined by their size, while great cities are so called because they meet a number of conditions that allow their inhabitants to achieve a high level of well-being. The same logic can be used for great firms, in that they are enterprises which provide a high level of well-being both for their owners and workers and for other stakeholders.

8 See Salazar-Xirinachs and Llinás (2023) for a more detailed discussion of the importance of a territorial approach to productive development policies.

There are many possible ways of setting productive priorities within the framework of productive development policies. For example, besides prioritizing sectors, economic activities or clusters, another option is to prioritize intersectoral challenges or "missions", meaning collective efforts to address major issues affecting the whole of society (Mazzucato, 2018). Prioritization should answer the question about the relationship between the costs and benefits of policies, with costs being understood as human and financial resources and benefits as development improvements, measured not only by productivity gains and economic growth, but by gains in well-being. Finding effective ways to measure costs and benefits is not easy, especially considering the inadequacy of the information available on production structures and well-being in many countries of the region. Nonetheless, the criterion is valid even when the answers to the question of what to prioritize are qualitative ones based on the instincts of agents familiar with the production and public policy ecosystem.

Among the most difficult prioritization decisions is the dilemma of how far to invest productive development efforts in the sectors that are most dynamic (now or potentially) or deal with the problems of the sectors that are struggling the most. The difficulty arises because both approaches to productive development have major advantages and disadvantages.

Targeting more dynamic sectors for support usually also means concentrating on countries' more urbanized core territories and on large firms with greater technological capabilities. Focusing on this has the advantage of offering large gains in terms of output, productivity and good jobs. The disadvantage of modern sectors is that they tend to be capital-intensive and relatively disconnected from the rest of the production apparatus and, in general, stand further apart from existing productive capacities in a number of countries or territories. The decision to back leading-edge sectors with a view to the overall development of the region is generally based on the assumption of a trickle-down effect, which does occur to a certain extent, but not enough to prevent modern and traditional modes of production from becoming increasingly divorced, leading to fragmented societies with enclaves of both affluence and deprivation. Productive development focused exclusively on promoting the sectors, companies and territories with the greatest potential for momentum and productivity is unlikely to be able to include a large mass of the population in a country or territory that does not possess the minimum technical skills to ride the current technological wave. That is no reason not to back these sectors, but it is important to be clear that this kind of support will not be enough.

Addressing the problems and needs of lower-productivity agents also has the advantage of fulfilling the moral imperative of "leaving no one behind", i.e. the criterion of maximizing the well-being of those who are less well-off. This is no minor consideration in Latin America and the Caribbean given that, in 2022, 29% of the region's population were living below the poverty line (ECLAC, 2023c). It must be recognized, though, that however considerable the productivity gains and the effects on the well-being of these segments of the population may be, change tends to be slow, if not very difficult, because of their generally limited potential for productive momentum.

Productive development policy prioritization in the region should adopt an approach that balances these two polarities, such as the one proposed in section D.2 for guidelines relating to a group of growth-leading sectors. There is a need, on the one hand, to raise productivity in sectors where it is lower and, on the other, to tap the productivity-enhancing potential of more technologically advanced and higher-productivity sectors so that there is a spillover from these sectors to the rest of the economy. A balanced approach to productive development policies also brings benefits in terms of political and social legitimacy.

As part of this same quest for legitimacy, it is important for prioritization not to stem from a unilateral decision by the government, but rather to be the result of collective construction exercises, as indicated in section B.3, based on the concepts of multi-stakeholder collaboration and productive development policy governance. It is also essential for productive priorities to be supported and committed to by a private sector that is willing to play a leading role in these productive development agendas (Llinás, 2021).

At the same time, prioritization exercises undertaken within the framework of productive development policies should be accompanied by conditionalities that make any government support or special treatment

subject to targets for productivity or exports, for example, or any other productive performance variable, being met (Mazzucato and Rodrik, 2024). This conditionality may be even stricter when, fiscal space allowing, instruments such as tax credits and subsidies are used, although these should be the exception rather than the rule in the light of the productive development policy vision outlined here. In such cases, this support or special treatment can be designed with sunset clauses that limit its effects to a set period, after which they should expire, which would generate the right incentives and minimize the fiscal cost.

3. Productive development policies as a collaborative process and the importance of governance

The theoretical basis for stakeholder collaboration in the framework of productive development policies rests on at least five principles: (i) no one actor has all the necessary information about problems or solutions, so information has to be aggregated; (ii) not only does information need to be aggregated, but perspectives need to interact with a view to the collective discovery of ever more efficient and effective ways of acting in the interests of competitiveness; (iii) collaboration leads to greater economies of scale, specialization of functions and thus higher productivity, a principle that applies both to firms and to multi-stakeholder governance mechanisms; (iv) collaboration is essential for innovation and the generation of new knowledge as an interactive phenomenon; and (v) multi-stakeholder collaboration increases the legitimacy, stability and social acceptance of productive development policies, making it possible to implement further-reaching policy processes with longer lead times, so that policy pendulum swings and volatile efforts, two characteristics of the region's policies hitherto, can largely be consigned to the past.

The emphasis on collaboration between stakeholders entails the need for governance, i.e. the organization of collaborative processes for formulating and implementing actions and policies. One definition of governance calls it "a new mode of governing that is distinct from the hierarchical control model, a more cooperative mode where State and non-State actors participate in mixed public/private networks" (Mayntz, 1998, p. 7). Thus understood, governance may take on different manifestations, depending on where the emphasis is placed. Some of these manifestations will be discussed in what follows, in particular multi-stakeholder governance, market governance, experimentalist governance and multilevel governance, all of which have a critical role to play in the new productive development policy vision.

The need to prioritize, aggregate information and coordinate stakeholders is what, in reference to productive development policies, has been called "multi-stakeholder governance" (Sotomayor and others, 2023). This governance involves stakeholders from the private and public sectors, academia and civil society in what has also been called the "triple or quadruple helix model", and entails not only aggregation of information but also joint preparation of diagnoses and road maps for action and active participation in monitoring implementation. In some cases, the role of the public sector is to convene and lead the process (although there are also cases, such as cluster initiatives, where the private sector itself or other stakeholders often take the initiative), to act as a facilitator and, importantly, to implement the policy action identified.

This productive development policy vision is also associated with the concept of "market governance", based on the idea that productive development is socially constructed by coordinating and aligning the efforts of all major stakeholders (Wade, 1990). This new vision transcends the old State versus market debate, in which the "pro-market position" relies on the "magic of the market" and the "pro-State" position on the "magic of the State". In contrast, the new generation of productive development policies relies on the "magic of process", that of multi-stakeholder collaboration with a focus on the practical: solving problems, pursuing processes of discovery and accelerating the learning of the institutions and actors involved.

The theory behind the operation and governance of collaborative systems has also drawn recently on the experimentalist governance approach (Sabel and Zeitlin, 2012) or its analogue, "problem-driven iterative adaptation" (Andrews, Pritchett and Woolcock, 2017). This form of governance is particularly suited to polyarchic situations, where effective power is distributed among a number of relatively autonomous units, and situations of strategic uncertainty, i.e. rapidly changing environments (like those companies have to deal with), which means that effective solutions can only be defined on the basis of a collaborative process involving key stakeholders, and not a priori. Thus, the key to the concept of experimentalist governance is to understand policy management as a collaborative, iterative process in which problems are both identified and solved through collaboration between multiple stakeholders via ongoing iterations and, most importantly, their sustained implementation over time. In other words, it is a model in which recursiveness prevails: implementing, evaluating, adjusting and implementing again in a continuous iterative learning process (Salazar-Xirinachs, 2020).

With productive development policies, lastly, much of the action must take place at the local level and with local actors, which means that the activities of the different levels of government have to be coordinated (Salazar-Xirinachs and Llinás, 2023). This creates a need to approach the deployment of productive development policy efforts from a perspective of multilevel governance, which has been defined as "a system of continuous negotiation among nested governments at several territorial tiers —supranational, national, regional, and local— as the result of a broad process of institutional creation and decisional reallocation" (Marks, 1993, p. 392). In recent years, ECLAC (2017) and the Organisation for Economic Co-operation and Development (OECD, 2017) have adopted the conceptual framework of multilevel governance as helpful for a more comprehensive view of policy, with a strong awareness of the capacity for action and self-realization of territories through the action of subnational governments.

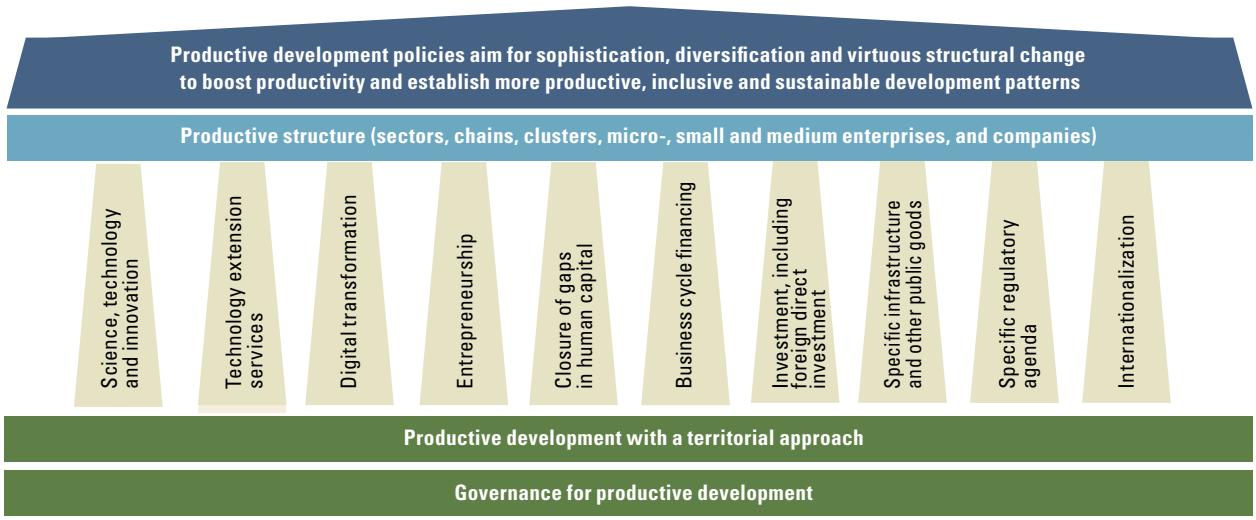
In sum, governance for productive development is crucial. This governance is broadly taken to mean the mechanisms for coordinating and linking collective action, including both local and national bodies such as committees and working groups, characteristics, ground rules and incentives, which allow multiple stakeholders, resources and efforts to be aligned around strategic agendas for productive development.

4. Areas of action

Fostering capacity-building and productive transformation through productive development policies involves dealing with bottlenecks and pursuing investments and action related to different policy areas. The combination of efforts in the different areas will largely depend on the strategies identified for the productive priorities decided on. Thus, for example, the amount and type of efforts to be made when working on a given sector or cluster will depend on the strategic vision and road map developed for that sector or cluster as a result of the collaborative process.

Diagram IV.1 describes 10 policy areas that are generally included in productive development policies (Salazar-Xirinachs and Llinás, 2023). This is not intended as an exhaustive list but is meant to give an idea of the number of fronts that need to be combined and coordinated in the framework of these policies. The areas are: science, technology and innovation; technology extension services; digital transformation; entrepreneurship; the identification and closing of human talent gaps; financing over the whole life cycle of businesses; investment, including foreign direct investment (FDI); specific infrastructure and other specific public goods; specific regulatory agendas; and internationalization.

Diagram IV.1
Definition and scope of productive development policies



Source: J. Salazar-Xirinachs and M. Llinás, "Towards transformation of the growth and development strategy for Latin America and the Caribbean: the role of productive development policies", *CEPAL Review,* No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

There is a vast literature on the importance of science, technology and innovation (STI) for improving productivity (e.g. Crespi and Zuñiga, 2012; Polder, de Bondt and van Leeuwen, 2018). This is not to say that any STI effort will have a direct impact on productivity. It is therefore crucial to coordinate efforts in this area as part of the productive development policies of countries and territories, so that they actually result in productivity gains.[9] Productive development policies encompass STI work because the incorporation of knowledge into production operates as a major catalyst for productivity growth.

Technological extension services are interventions, mentoring and other forms of support that facilitate the adoption of available technology and knowledge by firms (Shapira and others, 2015). The technology and knowledge concerned can range from things as basic as managerial skills (such as accounting or process management) to the incorporation of knowledge-intensive tools such as artificial intelligence or robotics. This area complements STI efforts, since to accelerate productive development it is not enough to generate new knowledge and technologies; they also need to be disseminated and adopted. While some efforts are being made in this direction in the region, they are marginal when compared to the potential for such interventions (Llinás, 2021).

Digital transformation must also be part of productive development policy efforts. For one thing, in a region where many companies seem not yet to have caught up with the third technological revolution, the adoption of both mature and emerging digital technologies in the productive sphere is a priority (Vilgis, Jordán and Patiño, 2023), making digital technology extension efforts crucial. Efforts at digital transformation for productive development should also aim to strengthen the supply of digital technologies, i.e. to boost the companies, sectors or clusters that supply this type of technology. In addition, and more generally, digital transformation efforts should also drive the sustainable development agenda in the region (see box IV.1).

[9] For more details, see the guidelines for the period 2024–2025 of the ECLAC Conference on Science, Innovation and Information and Communications Technologies (ECLAC, 2024b).

Box IV.1

Latin America and the Caribbean: digital transformation as a key driver of the sustainable development agenda

Over and above its role in productive development policies, digital transformation, as an item in the 10-point list presented in chapter II of this document, is a key driver of the productive, sustainable and inclusive development agenda more broadly. The adoption of digital technologies not only improves efficiency and productivity in a variety of sectors, but also has the potential to be an agent of change when it comes to addressing social, economic and environmental challenges.

Connectivity: the basis of digital transformation

Connectivity is an essential requirement for digital transformation. Without access to the Internet and broadband services, the opportunities offered by digital technologies remain out of reach for much of the population. In Latin America and the Caribbean, substantial gaps in Internet access persist, particularly affecting low-income households and rural areas. For example, the digital divide between higher- and lower-income households in the countries can be as great as 70 percentage points, while the divide between urban and rural households can be up to 50 percentage points. This illustrates the need for infrastructure investments and targeted policies to bring connectivity to rural areas and ensure equitable access to the opportunities offered by digitalization.

Digital government: a catalyst for State modernization and transparency

The digitalization of government services not only optimizes their coverage and quality, but also promotes social inclusion and strengthens institutional transparency. In this context, the State establishes itself as a catalyst for digital transformation, implementing innovative solutions that generate a positive impact on society. In 2023, according to an analysis by ECLAC, 84% of the region's countries had a digital platform for government procedures. However, the extent to which procedures are digitalized varies: strongly digitalized areas such as social benefits and personal certificates contrast with areas such as personal identification, taxation and migration, showing that there is great scope for improvement.

Digital technologies to address social challenges

In the social sphere, digitalization can improve access to basic services such as education and health care. Telemedicine platforms can bring medical care to remote areas, while online learning tools expand educational opportunities for people of all ages. In the area of education, however, gaps persist in infrastructure, connectivity and digital skills for both teachers and students, hampering equitable access to online education. In the health sector, meanwhile, technological infrastructure needs to be strengthened, data privacy ensured and medical staff trained in the use of digital tools.

Digital innovation for environmental sustainability

In the environmental sphere, digital technologies can contribute to the transition towards a greener and more sustainable economy. Monitoring ecosystems, optimizing energy consumption and implementing smart waste management are just some of the applications that can help improve the efficiency of production processes and reduce the environmental footprint of human activities.

Digital transformation: a cornerstone of productive development

Digitalization is vital for economic growth and poverty reduction in Latin America and the Caribbean. A 10% increase in digitalization correlates with a 5.7% increase in multifactor productivity. However, more than 70% of MSMEs lack an Internet presence, and some key sectors, such as agriculture and manufacturing, show a low level of digitalization. To improve, it is crucial to align productive development policies with digital initiatives, promote digital literacy, invest in infrastructure and implement emerging technologies. With a population of 650 million people and high Internet penetration, the region can significantly expand its digital economy.

In summary, digital transformation holds out great promise as a driver of sustainable development in Latin America and the Caribbean. However, it is essential for this transformation to be inclusive and equitable, ensuring that the benefits reach all sectors of society. This means not only investing in infrastructure and connectivity, but also developing digital skills in the population, fostering innovation and creating a regulatory environment conducive to the adoption of digital technologies.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *A digital path for sustainable development in Latin America and the Caribbean* (LC/CMSI.8/3), Santiago, 2022.

Policies and other efforts to support entrepreneurship are an essential part of productive development policies. Productive development partly depends on the emergence of new firms, especially if they are more efficient and better serve the needs of the population than existing ones. The creation of new and more efficient firms is a necessary condition for "creative destruction" leading to factors of production being reallocated towards their optimal use and thereby increasing the overall productivity of an economy (Aghion, Antonin and Bunel, 2021). In particular, productive development policy efforts in this area should aim to nurture the ventures that have the greatest potential for rapid growth and job creation.

Specific human talent gaps can constrain the emergence or growth of certain economic activities. A central task of productive development policies is therefore to identify and close gaps between the supply of and demand for human talent, particularly in specific sectors. Closing gaps may entail the implementation of a number of actions of different kinds, including the development or adjustment of study curricula, the creation of arrangements to match the supply of human talent to demand, vocational guidance and more active participation by business in training (Gontero and Albornoz, 2019; Gontero and Novella, 2021).[10]

Financing includes not only seed funding for start-ups, but also the provision of resources for enterprises throughout their life cycle, on affordable terms. The role of development banks and guarantee fund systems that cover part of the credit risk is critical here (Griffith-Jones and Ocampo, 2018; Ocampo and Torres, 2021). This includes financing for both microenterprises and large public and private investment projects that are needed to support the strategic agendas of the production priorities set within the framework of productive development policies. In addition, development banks can use the information provided by their lending activity to carry out intelligence functions that allow them to identify new activities which could potentially be carried out in a given economy and the failures that prevent them from emerging or developing (Fernández-Arias, Hausmann and Panizza, 2019).

As regards investment, it should be recalled that there is a two-way relationship between investment and productivity. On the one hand, higher investment, and gross fixed capital formation in particular, translates into increased productivity (De Long and Summers, 1991), while on the other, higher productivity translates into increased returns to the factors of production, including capital, and thus into increased incentives for their accumulation. It is therefore essential for investment promotion policies to be aligned with the priorities set in the framework of productive development policies. In the case of policies to attract foreign investment, these should include selective investment attraction efforts and post-investment investor assistance services (Gligo, 2007; García, López and Ons, 2021) aimed at maximizing productive linkages and the transfer of technology and knowledge from foreign companies to the host productive system (ECLAC, 2024c).

The absence of infrastructure or other specific public goods can also become a bottleneck that prevents or limits the emergence or deployment of the full potential of a given sector or economic activity. It is therefore essential for the productive development policies of countries and territories to have instruments and mechanisms to identify and meet these needs for infrastructure or other specific public goods related to productive priorities under such policies. An example of this type of infrastructure could be the establishment of a cold chain so that a given dairy cluster can sell its production on external markets.

Specific regulations, meanwhile, are those that have a direct impact on productive activities by stimulating or restricting them because of the existence or lack of some standard or regulation or because standards are inappropriate. Particularly important in the area of productive development policies are regulations, standards and certifications that have a direct impact on the quality of production. Important issues here include the infrastructure needed for quality purposes (e.g. metrology), compliance assessment, outreach services in the area of quality and sanitary and phytosanitary measures.

The tenth policy area is internationalization. This relates, first, to efforts to position products and services in international markets, which involves understanding and meeting the needs of external markets, including knowledge not only of international consumer demand, but also of the various requirements of destination markets (Hallak and López, 2022). Also identified as important in this pillar is the need for productive development

[10] See Llinás (2021) for a more detailed explanation.

policy efforts in the region to focus on internationalization, in order to compete successfully not only in international markets, but also with competitive imports in local and regional markets. Besides contributing to economies of scale and access to new knowledge and helping to improve productivity, internationalization can be used as a criterion for applying conditionality when granting assistance and support.[11]

Lastly, the new productive development policy vision includes two key elements that cut across the various policy areas mentioned above: the application of a territorial approach to productive development policies, and the institutional and governance framework of productive development, as described above. If well managed, these elements provide and maintain consistency and effective harmonization of efforts in the different policy areas, as well as supporting the prioritization of sectors and challenges.

Now that the new productive development policy vision has been laid out, section C provides a diagnosis of current policies in Latin America and the Caribbean, based on a number of studies carried out for a subset of countries.[12] One goal of this diagnosis is to validate or discard the following hypotheses about the productive development policy efforts being made in the region: these efforts are marginal in relation to the productivity challenge the region faces and the measures other countries have been taking in this area; they are by no means well connected or coordinated with one another; they have lacked continuity and been subject to sharp swings with changes of government; the approach to their management has mainly been centralist, without much involvement of territories; they have been insufficiently evaluated; they are not necessarily aligned with the new productive development policy vision presented in this chapter; and, in general, they have not had the impact hoped for, when assessed in the light of the region's poor productivity and growth record.

C. Panorama of productive development policies in Latin America and the Caribbean

1. Budgetary efforts for productive development policies

ECLAC (2024a) recently conducted an exercise to characterize and quantify productive development policy instruments in five countries of the region in 2021 and 2022: Argentina, Brazil, Chile, Colombia and Mexico.[13] This exercise was limited to instruments used by firms directly to improve their operations and did not include those designed to improve access to infrastructure or the general environment in which firms operate. The following types of instrument were considered: subsidies (non-refundable financial contributions), tax incentives (e.g. exemptions, discounts and tax credits), financial incentives (loans and guarantees), capital contributions (venture capital) and direct support services (non-financial support such as technical advice, provision of information and training).[14]

Although this exercise was not free of methodological difficulties and weaknesses,[15] its virtue is that it presents a first quantification of productive development policies using a common comparative methodology, applied not only to the countries evaluated but also to the OECD countries. Because of the constraints mentioned above and explained in greater detail in ECLAC (2024a), the results of this exercise represent a "floor" for productive development policy spending, and the caveats indicated must be taken into account when they are compared across countries.

11 See Studwell (2013) for a description of how some Asian countries have used internationalization as a conditionality in their industrial policies.

12 See ECLAC (2024a) for more details of the method used, the countries studied and the results.

13 In that period, these countries accounted for 79.6% of Latin America and the Caribbean's GDP and 69.7% of its population.

14 There are many ways to characterize productive development policy instruments: by sector or type (Juhász, Lane and Rodrik, 2023); by taxonomies of supply, demand and governance (Criscuolo, Lalanne and Díaz, 2022); and by goals, dimensions and rationales (Ciarli, Madariaga and Foster, 2024), among others. An attempt was made to align the taxonomy used in this exercise with that of OECD (Criscuolo, Lalanne and Díaz, 2022) so as to be able to make international comparisons.

15 These include, for example, the exclusion of tax instruments in Mexico and financial instruments in Colombia, while support services were only quantified in Chile and Colombia.

The five countries analysed allocated public resources worth between 0.2% and 1.2% of GDP to the five categories of instruments considered. These amounts look low when compared with the quantification conducted in nine OECD countries (Criscuolo, Lalanne and Díaz, 2022), where the average expenditure on productive development policy instruments, including subsidies and tax and financial incentives, was 3.25% of GDP in 2021 (excluding the agricultural sector).

Spending on subsidies in the OECD countries averaged 0.45% of GDP, tax incentives 1.0% of GDP and financial incentives 1.8% of GDP, a figure that falls to 0.7% when export finance is excluded. There were large variations between countries. In Canada, for example, export finance alone represented 4.46% of GDP. In contrast, financial-type instruments in countries with information available in Latin America ranged from 0.02% to 0.22% of GDP.

With respect to the type of instrument, tax-type instruments were generally predominant in all the countries assessed except Chile, a fact that provides quantitative support for the assessment presented in the previous session document (ECLAC, 2022).

In Argentina and Brazil, tax instruments represented between 61.5% and 87% of expenditure, depending on the year and country. In Colombia, tax instruments represented an average of 64%, but financial instruments were not quantified in this case, so a comparison with the total for all instruments cannot be made. In Chile, by contrast, subsidy instruments predominated, accounting for between 84% and 70% of the total in 2021 and 2022. In Mexico, when subsidies are compared with financial incentives, the former also predominated in the period of analysis.

Brazil was the country where financial instruments were most important, accounting for 38% of total spending on productive development policy instruments in 2021 and 34.8% in 2022. This highlights the importance of development banking in the country, which is home to institutions such as the National Bank for Economic and Social Development and Banco do Nordeste do Brasil.

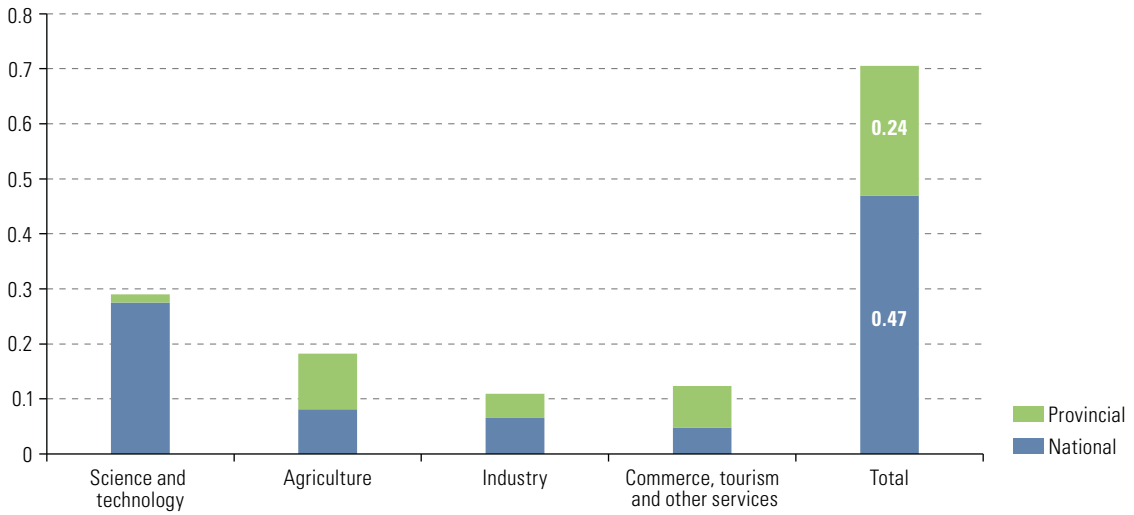
In the cases of Chile and Colombia, the category of support services was included. These services accounted for an average of 16.5% of total expenditure on productive development policy instruments in Colombia and 1.5% in Chile. In the latter, support services are executed through third parties, mainly through projects submitted to competitive funds.

In Brazil, Colombia and Mexico, instruments were identified that supported entrepreneurship via venture capital stakes in companies, although these mechanisms accounted for only a small percentage of the total resources allocated to productive development policies.

The great importance of tax expenditure in Latin America and the Caribbean for the benefit of certain sectors of economic activity, territories and types of enterprise can be read as a demonstration of the weakness of public institutions in the region and of their inability to target resources, reflected in the fact that the most important instruments from the funding point of view are those that in principle do not call for public institutions sophisticated enough to execute and target resources. Again, the allocation of large amounts of resources to preferential tax treatment tends to erode yet further the capacity of the region's countries to mobilize revenues for public policy, at a time when financing has become increasingly challenging and volatile for them (ECLAC, 2023b). This aside, the importance of tax expenditure as a productive development instrument in Latin America and the Caribbean is evidence that productive development policy efforts there are not necessarily aligned with the new vision for these policies that ECLAC has been promoting.

When it comes to public spending, subnational governments sometimes play an important role. In Argentina, for example, the provinces spent about half as much as the national government on productive development policies in 2022 (see figure IV.5). The provincial share of spending on agriculture and on commerce, tourism and other services was even higher. The national government accounted for more than half only in science and technology and in industry.

Figure IV.5
Argentina: spending on productive development policies by level of government, 2022
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of L. Cassini, "Estudio sobre política de desarrollo productivo desde las gobernaciones provinciales de la Argentina", Buenos Aires, 2024, unpublished.

In other countries, spending by subnational governments was substantially lower. In Chile, for example, regional governments, acting through the mechanism of National Regional Development Fund projects, allocated only 10.7% as much funding to productive development policies as the national government in 2019 (Yañez and others, 2024; Correa, Dini and Letelier, 2022).

The relative contribution of subnational governments to productive development policies depends, first, on the total resources at their disposal and, second, on the competencies and functions that the law establishes for intermediate and local levels of government. Partly because the public resources managed by subnational governments are, with some exceptions, considerably smaller than those managed by national governments (Jiménez and Ruelas, 2018), and because in many countries the law is unclear when it comes to assigning specific productive development policy functions and powers to subnational governments, these governments are constrained in their territorial productive development actions. The lack of institutional structures and public employees at the subnational level is, in turn, a consequence of the smaller budgets managed by subnational governments and a cause of their difficulty in increasing the amounts of public resources they mobilize and administer (Yañez and others, 2024).

2. Institutional frameworks for productive development

This position paper has argued that, to break out of the low growth capacity trap, the countries of the region need to strive for a major productive transformation, and that answering the question of how this may be done must mean analysing not only what kind of policies it is best to implement, but also what governance mechanisms and institutional capacities are needed to manage transformations, in this case a major productive transformation via productive development policies (see chapter III).

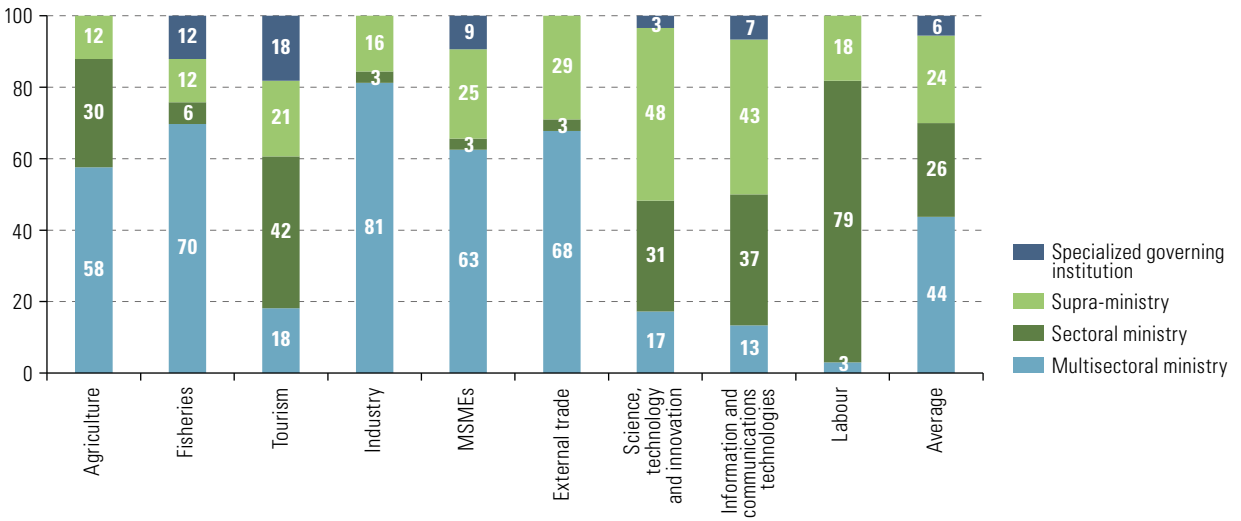
National ministries, also known as "secretariats" in some countries of the region, play a central role in productive development policies. Although general policy directives in this area are often handed down directly from the national president's office (in the form of a government programme or plan), it is the ministries responsible for productive development that implement these guidelines and translate them into policies, programmes and projects.

Ministries working directly in the following areas or sectors, among others, can be considered productive development ministries: agriculture, fisheries, tourism, industry, MSMEs, foreign trade, labour, STI, and information and communications technologies. These categories may vary depending on the emphasis placed by the region's national governments on the issues directly involved in productive development.[16]

Some countries in the region have at least one ministry specializing in each of these sectors (sectoral ministries), although it is more common for there to be multisectoral ministries covering two or more sectors under the same ministerial leadership. Sometimes the ministries dealing with certain of these issues are also responsible for areas that lie outside the thematic range directly associated with productive development policies (such as when they also deal with matters of culture, finance and education, among others). These can be classed as supra-ministries. Lastly, in addition to sectoral and multisectoral ministries and supra-ministries, there are cases in which one or other of these thematic areas does not fall under the purview of any ministry but is governed by a specialized institution that plays a coordinating role, sometimes reporting directly to the office of the president or to the Council of Ministers. These specialized governing institutions may be called institutes, councils, authorities or agencies, or go by some other name.

An overview of the region reveals that these issues are usually dealt with by multisectoral ministries. On average, national governments approach these sectors through multisectoral ministries in 44% of cases. Sectoral ministries come next (27%), followed by supra-ministries (24%) and, less often, specialized governing institutions (6%) (see figure IV.6).[17]

Figure IV.6
Latin America and the Caribbean: distribution of public institutions in executive branch dealing with productive development policies, by sector, 2024
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Panorama of Productive Development Policies in Latin America and the Caribbean, 2024* (LC/PUB.2024/15-P), Santiago, 2024.

16 Latin America and the Caribbean currently has bodies that formally coordinate productive development institutions with those in charge of other dimensions of development, such as social development (health and education ministries, among others), political development (defence and justice ministries, among others) and sustainability (environment ministries). This dialogue has been beneficial, allowing ministries not directly involved in production to take on some productive tasks in their own work, on the one hand, and production ministries to consider the other dimensions of development in their agendas and in productive development policies, on the other. A recent example of this is the joint work of Chile's Ministry of Economic Affairs, Development and Tourism, Ministry of Energy and Ministry of the Environment in the Committee of Ministers for Sustainable Productive Development.

17 See ECLAC (2024a) for more details on the ministerial institutional framework for productive development policies in the region.

It would be illogical to think there was a single formula for organizing an institutional framework for productive development policies that would work optimally in all countries. The institutional system adopted by each country is influenced by many variables, including the economic structure, political priorities, resource availability and the country's historical and institutional evolution. A sectoral ministry may be created because a government wants to give an impetus (via ad hoc resources, visibility and even political or institutional autonomy) to some area that is considered strategically important or highly promising. Excessive fragmentation makes coordination difficult, as every new ministry or specialized institution that is added causes the number of interactions between these entities to grow exponentially.[18] This is an even greater difficulty when the entities concerned are at the same hierarchical level, as none will necessarily have the legitimacy to lead a coordination process. Moreover, the energies and time required for coordination are not easily reconciled with the heavy burden of work on ministerial leaders in their own areas of responsibility.

From this perspective, the existence of multisectoral ministries or supra-ministries[19] could be explained as an attempt to improve coordination and reduce the political entropy produced by the existence of a large number of ministries. In these cases, each issue is dealt with by a vice-ministry (known in some countries as secretariats, under-secretariats or departments). However, there is not yet enough empirical evidence to show unequivocally that these structures are more effective, and logic suggests that the existence of a higher hierarchical authority should facilitate coordination. There are in fact recent examples in the region of national governments adopting this solution and creating multisectoral ministries or supra-ministries by integrating sectoral ministries for this purpose.[20]

Moreover, in the case of supra-ministries that cover issues beyond the realm of productive development policies, such as public finance, energy, the environment and mining, there is a risk that the focus on productive development policy will be diluted and that aspirations in the areas of production, productivity and employment will be relegated to a secondary place in policy priorities.

It is also possible that the answer to the problem of designing an efficient and effective ministerial organization lies not so much in a specific institutional engineering solution as in the implementation of a different mode of institutional functioning whose main pillars are: (i) the construction of political agreements on clear and sustained strategic priorities based on strong cross-cutting compacts between stakeholders from the public and private sectors, academia and civil society; (ii) the implementation of incentives and rules that reward collaborative behaviour; and (iii) the adoption of mechanisms that allow results to be constantly reviewed and facilitate adjustments in strategy and work plans.

In the current context of a proliferation of sectoral ministries, each dealing with different areas of productive development, several countries have had recourse to a set of coordinating bodies and institutions. These include supra-ministerial coordinating bodies, advisory bodies attached to the office of the country's president or vice-president overseeing economic and productive development committees or councils, and ministries explicitly empowered by the president's office to lead the overall productive development strategy vis-à-vis the other ministries.

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18 When there are 2 ministries, the number of possible interactions is 1; when there are 3 ministries, the number of interactions is 3; when there are 4 ministries, the number of interactions between them is 6; and when there are 9 ministries, as in one of the region's countries, the number of possible interactions between them is 36. The ratio between the number of participants in a system and the number of interactions is summarized in the formula n*(n-1)/2. The subject of group formation and the implications of the number of members has been extensively studied by anthropologist Robin Dunbar and applied to team organization by Mathew Skelton and Manuel Pais (Skelton and Pais, 2019).

19 In 70% of cases, productive development issues are dealt with by multisectoral ministries or supra-ministries.

20 One such example is the 2022 creation of the Ministry of Economic Affairs in Argentina, which grouped the areas of agriculture, fisheries, industry and MSMEs (among others) under the same leadership, with secretariats or under-secretariats assigned in accordance with the particular importance attached by the country to each area. This has been maintained by the current government, which reflects a consensus spanning more or less the whole political spectrum, motivated by the need to improve the coordination of productive development policies.

3. Multilevel governance of productive development policy

Multilevel governance analysis, as applied to productive development policies, studies and evaluates actions at all levels of government that are directly oriented towards productive development and the way these are coordinated to avoid contradictions and duplication and, ideally, to generate synergies in the actions of the different levels of government.

In a system of multilevel governance, each level of government specializes in a certain function, much as in the logic at work in the theory of comparative advantage proposed by David Ricardo. This means that even though the national government may have more capabilities or absolute advantages for policy implementation in all areas, it is efficient for this level of government to concentrate on the areas and functions in which it has a comparative advantage from a multilevel perspective.

The comparative advantage of the national government derives partly from its greater economies of scale and partly from its inherent function of ensuring a degree of national unity, for which it must prevent economic, social and cultural inequalities between territories from becoming so stark as to jeopardize the unity of the State.

The advantage of local governments, for their part, derives from their greater proximity to their populations and the realities of the local productive apparatus, something that is important, for example, when it comes to implementing programmes aimed at the growth of microenterprises and training for the informally employed.

The comparative advantage of intermediate governments derives from their ability to play an intermediate role between the economies of scale of national governments and the closeness of local governments to citizens, which helps to reduce the distance between these two levels of government, while ensuring that any support provided by the national government to the territories actually reaches all the localities in the country via local governments. Depending on the size of each country, it is sometimes practically impossible for a national government to get assistance to each territory by dealing directly with every local government while ensuring territorial relevance with policies matched to the reality of each territory. The structure that allows this is the intermediate government. In turn, multilevel collaborative coordination prevents disputes arising at the territorial level between the different levels of government operating in the same territory (the government of the territory itself and the higher-level government), while respecting the relative autonomy of the territories.

In some countries, task specialization for productive development is made explicit in national laws regulating the functions and organization of subnational governments. When it is not, there is an implicit specialization derived from the contents of the development plans or strategies of the various levels of government. Thus, for example, local governments' municipal development plans or strategies tend to give great importance to issues such as entrepreneurship, training, public-private and public-public coordination, partnerships, tourism and rural development, among others (Correa and Dini, 2019; Montero, Medina and Correa, 2024). For their part, national governments tend to specialize, relative to local governments, in areas that require large economies of scale, such as STI (Cassini, 2024).

Drawing on the comparative experience of productive development policy at the different levels of government in the region's countries, it is possible to present a preliminary proposal for the specialization of productive development functions among the different levels of government (see table IV.1).

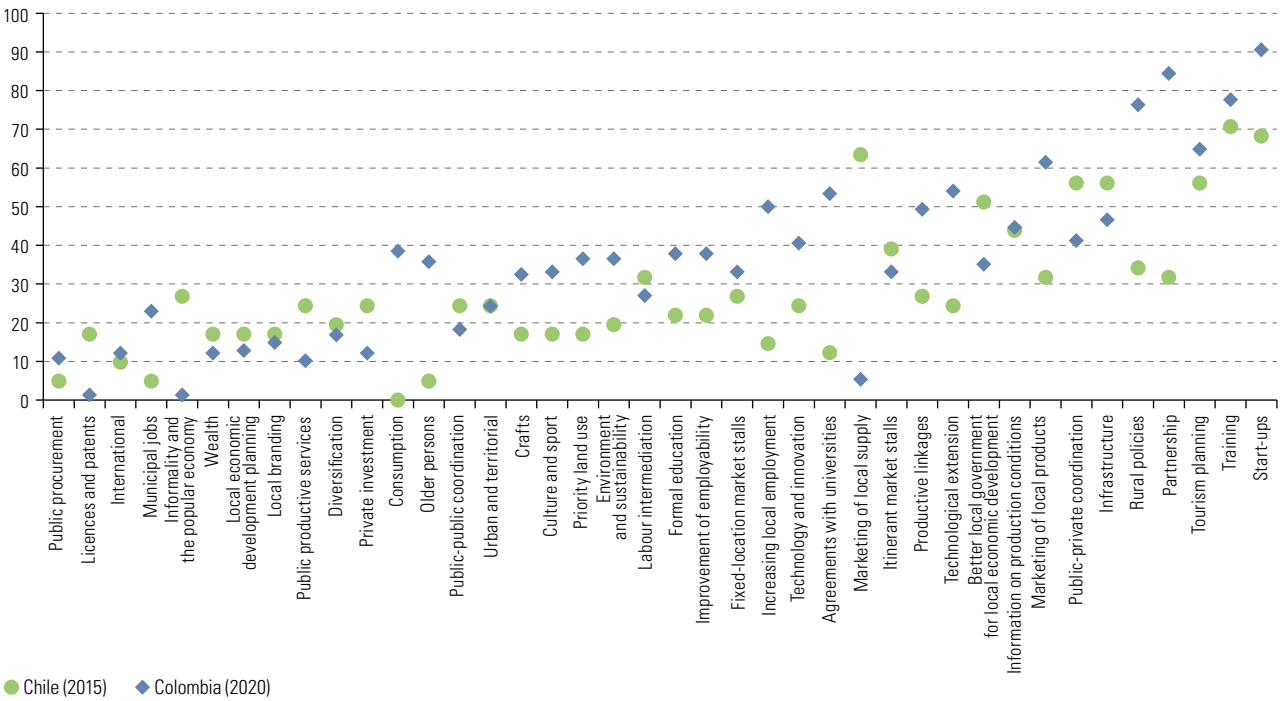
Local governments can take as their specializations support for microenterprises, incentives for the formalization of firms and start-ups, vocational training and technical or professional education in specific sectors of economic activity such as tourism and agriculture (or rural development). These areas are in fact what local governments specialize in, according to recent studies analysing the municipal development plans of more than 200 municipalities in Chile and Colombia (Correa and Dini, 2019; Montero, Medina and Correa, 2024). In both countries, local governments tend to concentrate on certain categories of action. Of these, entrepreneurship and training are the most frequently mentioned, coming up in 90.5% of local development plans in Colombia and 68.3% in Chile (see figure IV.7). Although not currently making very noticeable efforts in the area of informality, local governments can still play an important role in this area. This is because national and regional governments struggle to reach smaller enterprises with fewer capacities. Local government action in this area can provide the capillarity necessary for formalization policies, always in coordination with the regional and national levels of government.

Table IV.1
Proposed specialization of competencies for productive development policies, by level of government

	International relations	Major infrastructure	Internationalization	Regulations and standards	Science, technology and innovation	Attraction of foreign direct investment (FDI)	Prioritized sectors	Clusters	SMEs	Technical education	Vocational training	Agriculture	Tourism	Microenterprises	Formalization	Entrepreneurship
National government	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Intermediate government					■	■	■	■	■	■	■	■	■	■	■	■
Local government										■	■	■	■	■	■	■

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Panorama of Productive Development Policies in Latin America and the Caribbean, 2024* (LC/PUB.2024/15-P), Santiago, 2024.

Figure IV.7
Chile and Colombia: frequency of local economic development measures contained in municipal or communal development plans of provincial capitals or subregions, by category, 2015–2020
(Percentages)



Source: Economic Commission for Latin America and the Caribbean, on the basis of F. Correa and M. Dini, "Local economic development policies in Chile's municipalities: beyond welfarism", *CEPAL Review*, No. 127 (LC/PUB.2019/6-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), April 2019, and Montero, Medina y Correa, 2024.

Although local governments tend to specialize in certain areas of productive development policy, they are also greatly affected by budgetary and human capacity constraints. This is why strengthening local-level public institutions is essential to give local governments a more central role in productive development policies. In this regard, a statistically significant relationship has been found between the existence of a secretariat or department of economic development in a local government (ranking at the top of the organizational structure) and the scale on which the government plans its productive development policies (Montero, Medina and Correa, 2024).

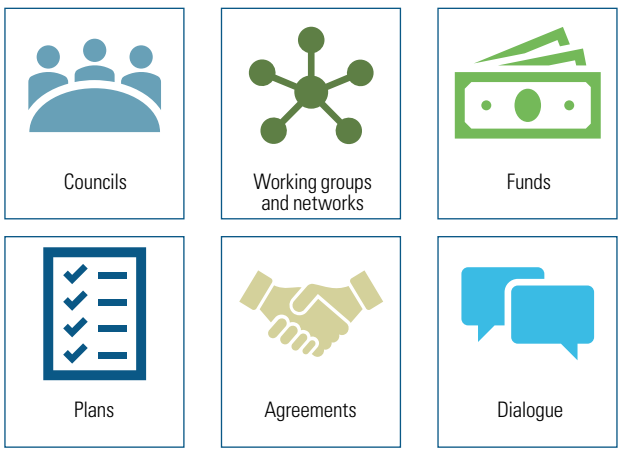
Intermediate governments, meanwhile, can specialize in supporting small and medium-sized enterprises (SMEs), which account for 20% of employment in the region (ECLAC, 2022), which in turn will incentivize business partnerships based on cluster and other productive coordination initiatives. The prioritization of productive activities may also be one of the features of the development strategies or plans brought out by intermediate governments. Likewise, these governments can perform a support function for local governments in the field of productive development policies by financing programmes implemented through municipal offices that report to both levels of government (Correa and Díaz, 2022). Supporting local governments in their activities entails intermediate governments also working on the issues that these governments specialize in, not necessarily by implementing policies directly, but by supporting what they do in these areas.

National governments, for their part, can centre their specialization on regulatory aspects, support for large production projects that involve major infrastructure investments, efforts to internationalize companies and action to assist different sectors that have been prioritized at the national level, in addition to the support they provide to intermediate governments, especially those in less developed regions. They may even work with a number of intermediate governments simultaneously on certain territorially identified priority sectors. This means that national governments must have institutions, budgets, knowledge and policy programmes across the whole spectrum of productive development policies, including the specialist areas or functions of intermediate and local governments (ECLAC, 2024a).

Lastly, it should be considered that specializations by level of government depend critically on the scale of the intermediate territories and the interregional externalities that exist in each country (Pelkmans, 2006). This is due, in particular, to the fact that intermediate governments in small countries have lesser economies of scale on average than intermediate governments in large countries. The specializations proposed in table IV.1 are therefore approximate and should be considered in the light of the particular situations of countries, regions and localities.

An analysis of multilevel governance mechanisms for productive development in the region shows that there are at least six ways in which different levels of government participate in joint arrangements and action (see diagram IV.2). This occurs both in the interaction between national governments and intermediate governments and in the interaction between intermediate governments and local governments. Interaction between all three levels of government is less common and not very practical for various reasons, mainly the large number of local governments in each country.[21] As from 2024, there are 408 intermediate territories (States, provinces, departments, regions or counties) and 15,940 local territories (municipalities, parishes, districts, communes, cantons or the like) in Latin America and the Caribbean.

Diagram IV.2
Multilevel governance mechanisms



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

[21] One way in which this interaction has occurred, though, has been through joint dialogue between national ministries, associations or federations of intermediate governments and national associations or networks of local governments in the countries. Although there are instances of ad hoc dialogues in the form of meetings and seminars, there are no formal or continuous arrangements for such three-level interaction for productive development policy purposes.

Councils are the first multilevel governance mechanism for productive development. These are bodies institutionalized by law, decree or resolution which meet at set intervals, bring together representatives of two levels of government (national and regional, or regional and local) and aim to channel efforts in a given area of productive development policies. Councils are mainly composed of government officials from both levels, although they sometimes reserve the right to invite stakeholders of other kinds. Examples of these councils are the Federal Councils in Argentina (Cao, Rey and Serafinoff, 2016; Sabatto, 2023), the Committee for Territorialization of the National System of Competitiveness and Innovation in Colombia, the Plurinational Economic and Productive Council in the Plurinational State of Bolivia and the National Commission for Micro and Small Enterprises in El Salvador (ECLAC, 2024a).

Working groups or networks are the second mechanism. Unlike councils, these are non-formalized mechanisms that operate for shorter periods of time and are intended to address a particular problem, programme or project. Working groups, although involving officials from two levels of government and private sector organizations, are not usually participated in by all smaller-scale (provincial or local) territories, since usually the particular issues addressed do not apply to all territories but concern very specific economic activities. Networks, meanwhile, tend to bring together institutions of a particular nature, examples being networks of entrepreneurship offices or networks of innovation and development agencies.

Funds are the third mechanism. Multilevel management funds are established by the highest-level (national or regional) government and financed by contributions from the private sector and grants from the public sector. Because of their often public-private nature, these funds usually have multi-stakeholder governance, and they are used to implement productive development projects that are aligned with the highest-level government's productive development policy. They are usually competitive funds, which helps to align the incentives of governments and actors at different levels (Llinás, 2021), but they have the disadvantage of rewarding those subnational governments, companies and other actors with the greatest capacity to develop and submit projects, which ends up widening the gaps between territories. To avoid this undesirable result, funds often set quotas and caps per territory or pre-allocate resources. An example of this type of multilevel management fund is the Subnational Management Support Programme in Chile (Ropert, 2009).

Plans are the fourth mechanism. Development plans, sometimes called "comprehensive development strategies" or a similar name, provide a road map for government action over a certain period of time, which usually matches a government's term in office, but can be longer. These plans or strategies are often developed with the participation of subnational governments at the next level down, thus constituting a multilevel coordination mechanism. There are also cases in which plans and strategies are specifically aimed at productive development or one of its areas or spheres. Examples of this have been Argentina's Strategic Winemaking Plan 2030 (Hernández and others, 2023) and the Departmental Competitiveness and Innovation Agendas in Colombia (Llinás, 2021).

Agreements are the fifth mechanism. Sometimes also called "contracts", these are documents signed usually by two governments, one at a higher and one at a lower level, establishing a joint arrangement to work for a common general objective, their respective responsibilities and the activities to be carried out. In most cases they include resource transfers, usually from the higher-level government, with possible minority cofinancing by the lower-level government (Correa and Díaz, 2022).

The sixth and last multilevel governance mechanism is dialogue. As a generic method of coordination, it makes all the mechanisms mentioned above possible, and it is largely informal, with meetings and coordination between officials from different levels of government and of different ranks. This type of communication helps subnational governments to access key information on the policy lines of higher-level governments, enabling them to disseminate it to potentially interested stakeholders and assist them in becoming beneficiaries. Dialogue also facilitates the adaptation of higher-level programmes to the requirements arising from the heterogeneous situations that coexist in territories. In addition to dialogue between officials, there is dialogue between government leaders, mayors, governors or presidents, in which the broad thrust of productive development policies is also coordinated. Sometimes the accord reached between the parties takes the form of an agreement or contract of the type mentioned.

4. Multi-stakeholder governance of productive development policies

Cluster initiatives are another form of coordination involving multiple stakeholders, if not necessarily multiple levels, and an experimentalist approach.

A natural cluster of firms is an economic phenomenon whereby firms in the same sector or in related and supporting sectors tend to cluster geographically as an efficiency-seeking strategy to take advantage of what economic theory calls "Marshallian agglomeration economies". In this case, agglomeration occurs because of the "invisible hand" of the market. In contrast, cluster initiatives introduce a dimension of intentionality or a "visible hand", not only to increase the benefits of natural clusters, but also to generate greater value added and accelerate learning, innovation and productivity through collaboration and coordination (Salazar-Xirinachs, 2020; Llinás, 2021). The purpose of such collaboration and coordination is to identify and deal with bottlenecks that limit growth and productivity, generally associated with the policy areas outlined in diagram IV.1. Thus, a cluster initiative has been defined as "organized efforts to increase the growth and competitiveness of clusters within a region, involving cluster firms, governments and/or the research community" (Lindqvist, Ketels and Sölvell, 2013, p. 1).

Cluster initiatives develop strategic agendas through the organized participation of multiple public, private, academic and civil society stakeholders who link up to work on projects and action aimed at improving the productivity of firms in the cluster underlying the initiative. This coordination usually takes place in the framework of relatively simple institutional arrangements involving, for example, a technical secretariat (led by a cluster manager), an executive committee, working groups and the cluster's general assembly, in which the various actors, and in particular the companies forming part of the different links in the cluster, are represented.

Of great importance is the fact that cluster initiatives usually produce a strategic vision and a list of the most important projects and actions for achieving it. Accordingly, and given the need to use resources as strategically as possible, cluster initiatives combine productive prioritization, a territorial outlook, coordination of multiple actors and a strategic approach, which make them an effective instrument for carrying out productive development efforts.

In the region, there are already numerous examples of this approach being used to implement productive development policies. They include the Querétaro aerospace cluster in Mexico (Moreno-Brid and Dutrénit, 2018), the wind energy cluster in Uruguay (Bértola, 2018), the agricultural machinery cluster in Argentina (Ferraro and Rojo, 2018), the medical devices cluster in Costa Rica (Salazar-Xirinachs, 2020), the high-technology (electronics, biotechnology and automotive) clusters in the State of Jalisco (Mexico) (Ferraro and Rojo, 2018) and cluster initiatives in the Bogotá region (Llinás, 2021). These and other cluster initiatives that have been successfully implemented for years have in one way or another, not always explicitly but in practice, used the experimentalist governance approach. Another example of this approach outside of cluster initiatives is the executive working groups (*mesas ejecutivas*) model implemented in Peru between 2014 and 2016, which sought to deal with the main obstacles to growth in some sectors by establishing certain institutional arrangements and characteristics (Ghezzi, 2019).

Clustering efforts have increased in recent years in Latin America and the Caribbean (O'Neil and García, 2015; Monge-González, Salazar-Xirinachs and Espejo-Campos, 2018; Aboal, Perera and Rovira, 2020; Llinás, 2021). Even so, there is considerable scope for improvement by expanding the use of this type of initiative in all countries of the region; increasing the resources invested; reducing heterogeneity in the quality and scope of their agendas; strengthening the professional capacity of the people involved; and improving the quality of management. It is also important to better coordinate the efforts of cluster initiatives with the other productive development efforts being made by both national and subnational governments.

From information in the ECLAC Platform for cluster and other territorial productive articulation initiatives,[22] it is known that, in 2024, there are about 300 territorial productive coordination initiatives in 12 countries of the region, which may be cluster initiatives, production chain initiatives, local production initiatives, business

[22] See [online] https://geo.cepal.org/dp-clusters/index.html?lang=en.

network initiatives or initiatives to develop supplier relationships (ECLAC, 2024a). All meet requirements that include the pursuit of collective strategic action aimed at productive development, the inclusion of multi-stakeholder coordination and collaboration arrangements, and sectoral or territorial proximity or similarity between participants.

Of these productive coordination initiatives, 70% have internal regulations that establish collective management procedures and 51% have the public sector as their main funder. With regard to their governing bodies, private actors are the majority in 75% of cases and territorial (as opposed to national) actors in 69%.

These initiatives are driven by both national and intermediate-level governments, using similar methods. The policy instruments employed by such programmes can be classified into seven categories: non-refundable subsidies, credit facilitation, tax deductions, information (especially about new markets), coordination with other institutions, training, and direct support from the initiating institution. The most common instrument in six programmes identified is direct support, in part probably because of the active budgeting constraints under which the entities pursuing these programmes operate (ECLAC, 2024a). It is also consistent with the relatively low budgets for these programmes, which confirms that territorial productive coordination initiatives may be implemented with relatively small investments (Llinás, 2021).

5. A summary of the situation in the region

From an initial diagnosis of the region's productive development policies, including the institutional, budgetary and multilevel governance aspects, it can be said that while there are features of interest and good practices worth replicating, the region's productive development institutions, governance and policies in general are not built on foundations conducive to a sustained acceleration of the productive development process. In other words, there is enormous room for improvement in the scope and quality of these policies in the region.

For one thing, budgetary efforts are still small in comparison with other public expenditure items, leaving productive development policies relegated to an almost marginal role in government efforts. This is even plainer if they are compared with the large investments being made in policies of this type by the most developed countries, in particular China, the European Union and the United States. Furthermore, productive development policies in the region are characterized by fiscal efforts that do not require great institutional or governance expertise, with little prioritization of specific sectors, and tax expenditure is one of the main avenues of action.

It is also observed that productive development policies in the sense of collaborative action involving different stakeholders are far from being the predominant form in the region. Not only is there little formal coordination between different stakeholders, but there are major difficulties of coordination even between actors in the public sector itself, owing to the great dispersion of policy among different entities. In general, the countries lack an institutional framework for productive development policies that would give these a clear and unified leadership, a common direction and a joint working agenda, with monitoring to ensure its implementation.

Lastly, productive development policies are found to be highly centralized in national governments, since although there are examples of multilevel governance mechanisms, these are still only outposts of good practice and not the norm in the region. As far as it has been possible to diagnose, the centralization of budgetary efforts in national governments remains the rule rather than the exception, even in cases where subnational governments are demanding more funding, powers, capacities and support to contribute to productive development policies in the country.

In view of all this, it can be said that, as things stand, productive development policy implementation consists largely of marginal, uncoordinated, discontinuous and low-impact efforts that for the most part are centrally managed, insufficiently evaluated and poorly aligned with the productive development policy vision set out in this chapter.

D. Some guidelines for productive development policies in Latin America and the Caribbean

From what has been said here, it is clear that there is great scope for improvement in the ambition and execution of productive development policy efforts in Latin America and the Caribbean. To make progress, however, it is not enough to simply enunciate a list of policy aspirations, such as "the export basket needs to be sophisticated and diversified", "investment in research and development (R&D) needs to be increased" or "the relationship between universities and business needs to be strengthened".

Genuine progress will entail, first, a further-reaching discussion about what needs to be done to more effectively pursue a productive transformation that can increase productivity in the region. It will be necessary, for example, to identify not only which instruments and interventions have the greatest impact in the different policy areas presented above, but also which of them should actually be used, given the institutional capacity of the different countries and territories to design, implement and monitor them.

At the same time, it will require a more in-depth examination of the "hows" of productive development policy, meaning the way these policies should be managed and, in particular, the transformations they are intended to bring about. Thus, the "hows" relate mainly to systems of governance, including forms of social dialogue and other mechanisms that enable multiple stakeholders, resources and efforts to be aligned around these agendas; to technical, operational, political and prospective (TOPP) capabilities (Salazar-Xirinachs, 2023), as described in chapter III; and to an understanding of the political economy behind productive development policies, so that any obstacles standing in the way of changes to the status quo can be identified and dealt with.

In the interests of progress with the "whats" and "hows" of productive development policies, a set of guidelines are presented below to provide the countries of the region and their territories with guidance on how to scale up and improve these policies.

1. Increase productive development policy efforts in line with the new vision proposed

The quantification exercise presented in the text clearly shows the need to increase resources and step up productive development policy efforts in the region's countries and territories. This means not only "doing more" with more resources, but "doing better" with the resources available. Accordingly, both an increase in the resources invested in productive development policies and improved allocation and management of those resources are recommended.

Increasing funding for productive development policies is undeniably a difficult challenge in a context of budgetary constraints. Nevertheless, it is possible to make an extra effort and set aside certain predetermined percentages of tax revenues for productive development policies and programmes that have been properly discussed and agreed upon (as is already done for training or SME support institutions, or with certain funds derived from royalties). Furthermore, the empowerment of territorial actors and their participation in policy design and implementation also expands the efforts, capabilities and funds available at the local level.

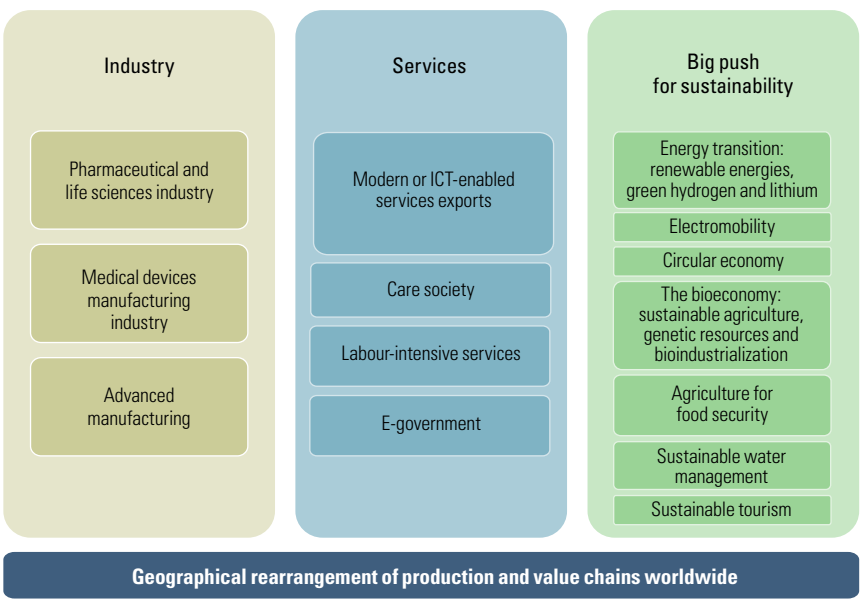
When it comes to improving allocation in productive development policies, it would be helpful to review current allocations in order to minimize duplication, maximize synergies (focusing on the priority areas that will be detailed in point D.2) and reduce the percentage of non-executed or poorly executed funds, which are sometimes substantial.

With regard to management improvements, in line with the new vision proposed by ECLAC, it is suggested that emphasis be put on implementing or strengthening systems of governance that enable multiple stakeholders, resources and efforts to be coordinated around strategic productive development policy agendas. This entails, for example, scaling up and improving the use of cluster initiatives or other productive coordination initiatives that allow these strategic agendas to be pursued in specific territories or production chains. Implementing initiatives of this type does not call for large budgets, but it does require teams to organize and lead coordination spaces or arrangements involving stakeholders from the public and private sectors, academia and civil society. The work done in these spaces or arrangements will lead on to the need to implement projects and actions geared towards the achievement of the strategic vision for the clusters or sectors concerned, and funding sources will therefore have to be available to meet these needs.

2. Set production priorities within the framework of productive development policies

In line with the need for prioritization set out in this chapter, ECLAC has established an illustrative (not exhaustive) set of 15 driving sectors or strategic areas that the countries of Latin America and the Caribbean and their territories can prioritize in the productive development policy framework. The growth- and productivity-enhancing characteristics of these sectors give them the potential to make major contributions to a productive transformation in the desired direction, including an orientation towards greater inclusiveness and environmental sustainability. These sectors are listed in diagram IV.3, which groups them into three categories: industry, services and the big push for sustainability. The opportunities presented by the geographical rearrangement of production and value chains worldwide are a cross-cutting area, as this is a key trend spanning several of the other sectors listed.

Diagram IV.3
Great productive transformation for productivity, inclusion and sustainability: portfolio of driving sectors



Source: J. Salazar-Xirinachs and M. Llinás, "Towards transformation of the growth and development strategy for Latin America and the Caribbean: the role of productive development policies", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

Sectors should be identified and prioritized in the context of the specific conditions in each country, and other sectors and activities can also be added as the characteristics and priorities of each country or territory determine. Even so, all the productive activities presented here open up new opportunities for the countries and their territories as regards not only investment and growth, but also collaboration and strategic partnerships in the international arena (ECLAC, 2024a).

3. Align efforts and resources around productive priorities within the framework of productive development policies

The research has also revealed that there are opportunities for improvement in the way productive priorities are set and efforts and resources are aligned around these priorities in the framework of productive development policies. To ensure that all stakeholders are strongly and actively committed to implementing these policies, it is essential for these stakeholders, whether in the public or private sector, academia or civil society, to participate actively in setting productive development policy priorities. It is when there is broad, stable agreement on the goals to be prioritized that the action required can be expected to receive strong support, ensuring continuity over time and allowing the resources, experience and knowledge of the different actors to be brought to bear. At the same time, when such agreements are reached, it is important to ensure that productive development policies can be aligned with the goals prioritized, thereby correcting the current situation in which the use of resources for such policies is not always consistent with the goals set. When it comes to setting priorities and aligning policies with the goals prioritized, the key is not so much to hold sporadic meetings and dialogue between actors as to use these meetings and dialogue to design and implement a continuous working procedure which can ensure that their efforts converge and are aligned with the agreed priorities, and that action plans can be adjusted via constant review of the results achieved.

This challenge must also include a balanced relationship between the targeting needs identified at the national level and the decisions taken by subnational governments and their territories, using whatever leeway they possess to act independently in the area of productive development policies. All this calls for the construction of multi-stakeholder and multilevel governance arrangements, as described in point D.4.

4. Enhance cooperation between public, private, academic and civil society stakeholders at different levels of government

Empirical information indicates that practically all the countries of the region have multi-stakeholder coordination bodies (e.g. councils, committees and working groups) that bring together public, private, academic and civil society stakeholders to address the challenges of productive development. Often, however, their policy prioritization and policy implementation and management roles, competencies and capacities are not clearly defined or guaranteed. To strengthen coordination capacity, then, there is a need to map the coordination bodies that exist, assess the scope for improving them and identify any bodies that could potentially be abolished or merged because they do not make a significant contribution to productive development policies.

It should also be noted that coordination is not achieved exclusively via arrangements that bring actors together, but also via the adoption of other governance mechanisms, such as ground rules, characteristics or routines,[23] and incentives. An example of these last are the multilevel funds described above, whose practical application has been seen in the case of the European Commission's structural funds for STI, in the framework of smart specialization strategies.[24]

[23] See Ghezzi (2019) and Sabel and Jordan (2015) for examples of the use of characteristics or routines to align multiple stakeholders and efforts in the framework of productive development policies.

[24] See Aranguren and others (2019) for more details.

Another concrete method of strengthening coordination is to create platforms or single windows that bring together the productive development support provided by different ministries, bodies and other actors. Such tools not only facilitate access to these support instruments for target clients but also aid the identification of possible areas of overlap between different development actions or of areas that have been neglected, making it easier in turn to adjust the programmes proposed by the bodies responsible for productive development policies.[25]

5. Strengthen institutions' technical, operational, political and prospective (TOPP) capabilities in the field of productive development policies

The implementation of productive development policies requires an institutional framework with the capacity to carry out the design, administration, monitoring and evaluation of these policies in the different areas of competence, with adequate leadership and technical, operational, political and prospective (TOPP) capabilities. For countries that do not have institutions with these capabilities, it may be helpful to invest in the development of specialized entities that bring together the technical expertise needed to implement productive development policies, with guaranteed annual funding and a degree of independence from the authorities in charge of the policies concerned. At the same time, there is an urgent need to reduce the dispersion found between the institutions responsible for these policies. One strategy that may allow progress to be made in this direction, besides the governance mechanisms described above, is to modify the current institutional structure, which is organized by sector, in order to experiment with working methods based on strategic projects, missions or goals by country or territory.

In addition, the capabilities of the subnational institutions involved in productive development policies need to be expanded, enhanced and consolidated, with a special focus on intermediate and local governments. This must often involve expanding the operational capacity of intermediate governments, enlarging (where necessary) their professional staff or establishing specialized entities coordinated by them to implement these policies. When it comes to institutional capacity-building in local governments, it may be useful to encourage the creation of secretariats or departments specializing in economic (or productive) development where they do not yet exist, promoting the creation of networks of municipal economic development offices that foster the sharing of experiences and the implementation of joint projects in this area, with a special focus on the integration of poorer territories.

In connection with the above, it is essential to strengthen the TOPP capabilities (as defined in chapter III of this document) of the different actors, public and private, involved in productive development policy agendas at both the national and subnational levels (see table IV.2). A whole array of technical capabilities are needed for productive development policies. Many bear on the capacity to identify problems affecting the productive sector in the policy areas shown in diagram IV.1; to design instruments, interventions and efforts (including project management) for solving the problems identified; and to evaluate and learn in order to make adjustments and continue working for greater impact, in line with an experimentalist governance approach. Technical capabilities also include the ability to collectively build and implement mutually consistent productive development strategies that interact with strategies in the other dimensions of development, within a framework of integrated development planning. It is also vital to have the technical ability to operate statistical systems capable of providing information for the different territorial levels, from the local to the national, that can serve as a basis for policy design, evaluation and monitoring.

[25] The Coordination for Competitiveness Methodology in Colombia is an example of such a platform.

Operational capabilities concern the ability to manage programmes, instruments and efforts within the existing administrative and institutional framework. They include, first of all, having the resources to be able to design and implement productive development policies. Although it has been stressed that the new vision for this type of policy emphasizes multi-stakeholder collaboration and does not prioritize instruments such as subsidies and tax incentives in the way that productive development policies do in other parts of the world, resources are still needed, particularly for the implementation of projects and actions deriving from strategic agendas such as those arising within the framework of cluster initiatives. Operational capabilities for productive development policies also encompass mechanisms and systems that allow efforts to be properly linked up and coordinated, since these policies, as already pointed out, need a high degree of coordination. This includes not only the governance mechanisms already discussed, but also platforms that enable the different ministries, bodies and other stakeholders involved in productive development to unite their offerings. It likewise includes progress towards the interoperability, and ultimately the unification, of the information technology systems of public agencies engaged in productive development, to facilitate this coordination and linkage.

Political capabilities relate to the ability to establish and maintain relationships between the different actors working on these agendas, and to manage coalitions with a view to altering political equilibria that are holding back productivity improvements. They also include the capabilities required to set policies and agendas for the medium term and the long term, since these are the time horizons over which productive development policies operate. These capabilities thus include a capacity for dialogue between the public sector and other actors that can contribute to collaborative work and the continuity of these policies over time. In the light of all that has been said, one of the most important policy capabilities in this context is leadership for productive development. As Llinás (2021) argues, these productive development agendas represent more of a leadership challenge than a technical challenge. First, there is a collective leadership problem, namely that of inducing multiple stakeholders, operating at multiple levels of government and through multiple governance bodies, to work on agendas that maximize synergies and minimize duplication and conflict. Second, as discussed by Heifetz, Linsky and Grashow (2009), there is an adaptive leadership problem, which is that of inducing the different actors involved to recognize the need to change individually, transforming what is produced and how, but also to change the way bottlenecks are identified and dealt with, and the way capabilities for this transformation can be developed.[26]

Lastly, prospective capabilities relate, among other things, to knowledge about technology and market trends, along with the ability to generate future scenarios and routes towards them. This last includes exercises in the collective construction of strategic productive development agendas at the country, territory or cluster level that identify visions, goals and targets, together with projects, actions and institutional arrangements for achieving them. In line with the experimentalist governance approach, these exercises should be carried out swiftly so that it is possible to move promptly on to action, evaluation and adjustment and then to subsequent iterations. Exercises of this type should draw on inputs provided by offices specializing in technology and market foresight and surveillance and by international organizations carrying out ongoing work in this area.

Having identified this preliminary and certainly incomplete list of the TOPP capabilities needed to manage the transformations involved in working on productive development policies, it is essential to move forward with actions to strengthen these capabilities in the countries of the region and in their territories. A number of analyses, including some conducted by ECLAC (ECLAC, 2024a; Yañez and others, 2024), suggest that there is great heterogeneity in these capabilities not only between countries but also within them, at the subnational level. It will therefore be vital to establish programmes and other actions to narrow the gaps between the leaders and those countries and territories that are further behind. Links with the higher education and training system will be essential for this, as they will enable civil servants and other actors to continuously acquire greater policy, programme and project planning and implementation capabilities. It will also be crucial to establish spaces for dialogue at the regional level that allow best practices in productive development policy design and implementation to be shared, such as the Platform for cluster and other territorial productive articulation initiatives and the emerging network of subnational governments for productive development, led by ECLAC.

[26] See Llinás (2021) for more details on the subject of productive development as a leadership challenge.

Table IV.2
Latin America and the Caribbean: technical, operational, political and prospective (TOPP) capabilities of institutions for productive development policies

Type of capability	Characteristics
Technical	– Identification of problems affecting the productive sector. – Design and management of instruments, interventions and projects. – Inclusion of a productive development strategy in national and territorial development plans or strategies. – Collective construction and implementation of productive development strategies that interact with strategies in the other dimensions of development. – Implementation of locally, regionally and nationally representative information systems based on socioeconomic surveys and administrative data for the preparation of diagnoses and the design and evaluation of productive development policies. – Establishment of ministerial offices dealing exclusively with the evaluation of public programmes, including productive development policies. – Creation of curricula for continuing higher education in economic and productive development subjects with a multilevel approach.
Operational	– Management of resources so as to be able to design and implement productive development policies. – Implementation of mechanisms and systems that allow efforts to be adequately linked up and coordinated. – Design of platforms that allow the productive development offerings of the different ministries, entities and other actors to be combined. – Establishment of common computerized management systems for public bodies to track the relationship that is established between productive agents (companies and workers) and productive development policies. – Creation of national, regional and local economic and productive development councils in a quadruple helix format to prepare and monitor the implementation of productive development policies. – Further development of multilevel governance mechanisms for economic and productive development, especially in the linkages between the national and regional level and the regional and local level.
Political	– Establishment of medium- and long-term policies and agendas. – Pursuit of dialogue between the public sector and other actors that contributes to collaborative work and to the continuity of productive development policies over time. – Development of collective and adaptive leadership skills for productive development. – Establishment of permanent forums for open discussion of issues vital to the continuity of productive development policies. – Creation of joint learning arrangements with academics to share research related to economic and productive development. – Creation of permanent spaces for dialogue and debate between the executive and legislature, so that representatives of other coalitions and political parties besides those in government can take part in the policy and programme discussion.
Prospective	– Exercises in the collective construction of strategic productive development agendas at the country, territory or cluster level that identify visions, goals and targets, together with projects, actions and institutional arrangements to achieve them. – Creation of specialized offices in productive sector ministries to deal with planning and foresight issues. – Creation of arrangements for dialogue between the national government and subnational governments in the area of foresight. – Establishment of links between national foresight offices and international organizations for joint work in the area of foresight.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

6. Strengthen the territorialization of productive development policies

Consolidating and enhancing the territorial dimension of productive development policies is crucial if the policies created are to match the needs and potential of the different territories. To strengthen this dimension of policies, it is necessary to implement actions that encompass a large number of dimensions and variables at the same time. Some of these actions have been referred to in this chapter, namely the need to further develop multilevel governance and strengthen the capabilities of subnational institutions.

The following recommendations could also be relevant in many countries seeking to increase the territorialization of these policies: (i) revise the current legal framework so that the productive development policy powers of intermediate governments are clarified and strengthened; (ii) strive to accelerate and extend the decentralization to subnational actors (especially intermediate governments) of powers and resources that mainly belong to national entities, designing formal protocols for transfers from the national to the intermediate level where needed; (iii) implement technical assistance agreements between national entities and intermediate governments (especially those of less developed regions) for the roll-out of programmes in specific thematic areas of productive development; and (iv) develop arrangements for sharing good practices, particularly between territories that have attained a greater level of institutional maturity for productive development and those that are further behind.

7. Strengthen the role of the private sector and especially of large companies in productive development policies

The experience of many industrialized countries, such as Germany and the Republic of Korea, and of regions such as the Basque Country shows that private companies, especially large ones, have a central role to play in the productive transformation of national economies. In particular, they can perform a very important function in boosting production chains and clusters, accelerating technology and knowledge transfer, generating marketing opportunities for smaller companies or simply venturing into new sectors and economic activities.[27]

Business associations, for their part, can also actively contribute to the design, implementation and management of productive development policies, collaborating with national or subnational governments on the design of productive development programmes or the implementation of collective goods. This would make it possible to increase the available resources and give continuity to productive transformation efforts, generating more relevant and effective policies and programmes.

Although there are a number of instances of private sector engagement in productive development in Latin America and the Caribbean, collaboration between the private sector and the public sector is often hampered by a lack of mutual trust and a lack of clarity about what the roles and contributions of each side should be. Moreover, all indications are that there is room for improvement as regards more active participation by business associations and companies themselves, particularly large ones, in the productive development policies of the countries and their territories, especially when it comes to generating collaborative initiatives for productive development, such as the cluster initiatives that are being implemented throughout the region.

To bring about this improvement, it will be necessary, first, to continue working to sensitize and educate the private sector about the leading role it will need to play in the framework of these policies and, second, to do the same in the public sphere, emphasizing the need to work in partnership with the private sector in the area of productive development.

8. Create or strengthen cluster initiatives or other territorial productive linkage initiatives

A powerful instrument for enhancing and expanding joint action by public, private, academic and civil society stakeholders to design and implement productive development strategies and programmes with a partnership-based territorial approach is the establishment of programmes (at the national and subnational levels) that contribute to the emergence or strengthening of territorial productive coordination initiatives, such as cluster initiatives, business networks, production chain initiatives or supply networks. These programmes could aim at providing technical support to these initiatives and joint financing for cluster managers and projects and action related to strategic agendas, including the financing of specific public goods, among other things.

It is also crucial for initiatives of this type to be used as a spearhead for implementing national and subnational productive development policies, including policies on STI, technological outreach, entrepreneurship, digital transformation, human talent and foreign investment. In other words, cluster initiatives and other territorial productive coordination initiatives should be understood not as one tool among others, but as a way of combining different types of productive development instrument and effort.

These initiatives can be strengthened by sharing good practices at the regional or international level, on the basis of a research agenda that serves to extend and systematize the review of experiences and lessons learned. ECLAC has taken a step in this direction by launching the Platform for cluster and other territorial productive articulation initiatives in Latin America and the Caribbean, one of whose objectives is to provide a basis for a regional community of practice that can generate collective action on strategic issues, such as the development of circular economy projects or strengthening of the supply of digital technology by ICT clusters in the region.

[27] See, for example, Hausmann (2013).

9. Adopt the experimentalist approach and strengthen evaluation capabilities

As explained in section C.3, the new generation of productive development policies is based on an experimentalist approach to management, which is essential when managing in polyarchic environments characterized by uncertainty and shifting conditions. The experimentalist approach facilitates the adaptation of plans, programmes and policies themselves to the constantly evolving economic, competition and institutional context in which they have to be implemented. For experimentalist governance to work, it is essential to incorporate evaluation and monitoring of public policies as an intrinsic part of results-oriented public management. However, experimentalism calls for just-in-time evaluation routines that differ greatly from traditional evaluation approaches. In general, it is important for the countries of the region and their territories to strengthen their productive development policy evaluation and monitoring capabilities with the aim of improving these interventions, and not for disciplinary or bureaucratic reasons. They must create or reinforce clear mandates to evaluate policy (and not just instruments in isolation), promote the use of cost-effective methodologies, generate explicit strategies for employing the results in the design and redesign of programmes, get away from the perception of evaluations without sanctions for the civil service, and foster networking among productive development policy evaluation and monitoring agencies in the region, among other initiatives.

10. Ensure the continuity of productive development policies

The effectiveness of productive development policies depends greatly on their dynamic consistency and cumulative effects, i.e. on the ability to give continuity over time to actions that adapt to changes in the context, thereby giving depth to transformation processes aimed at sophisticating and diversifying production sectors. This outcome requires multiple efforts, some of which will now be highlighted. First, the countries should consider the possibility of forging compacts or agreements that endow priorities, goals and strategies with solid legitimacy, seeking to stimulate the empowerment and participation of private actors, academia and civil society in the management of productive development policies and programmes. Moreover, the aim should be for many of these agendas to be led or co-led by the private sector itself, which would increase the prospects for continuity in these efforts.

A second goal, as mentioned above, should be to create and consolidate technical institutions that have their own resources and a degree of autonomy from the respective policymaking entities, in order to reinforce the continuity of the work plans that are put into effect to implement productive development policies. Measures such as strengthening the civil service can also be included to help reduce turnover among personnel in charge of managing productive development policies, with a view to stabilizing professional teams and reducing the impact of changes of government.

11. Create linkages with industrial policies in other countries and leverage the opportunities from the ongoing reconfiguration of global value chains

In view of the industrial policies that have been adopted in other parts of the world, the countries of the region would do well to explore ways of ensuring that at least some of the benefits being granted by other countries to companies in their territories to encourage relocation and investment can also be granted to the investments that companies from those countries make in Latin America and the Caribbean. Consideration should also be given to the possibility of extending these benefits to firms from the region that are connected to value chains involving firms from other countries. That would require the region to establish agreements with these

countries with a view to extending these benefits, as some have already done. The European Green Deal and the Inflation Reduction Act and the CHIPS and Science Act in the United States are a good starting point for exploring this possibility, as are the agendas set by China in this area.

It is also important to try to align opportunities for investment and collaboration between Latin America and the Caribbean and the rest of the world with the production priorities set by the countries of the region as part of their industrial or productive development policies, at both the national and subnational levels. It is vital that complementarities be generated between the interests of international investors and the public-private productive development agendas of the countries of the region and their territories. This would allow foreign direct investment financing to be complemented by agendas aimed at dealing with other bottlenecks, thereby making investment and collaboration opportunities a reality.

E. Summary

Latin America and the Caribbean has just gone through another lost decade in terms of economic growth, with all the attendant political and social difficulties. Breaking out of the low-growth trap requires productive development policies that treat productive transformation and diversification and productivity growth as central to their efforts to increase people's incomes and well-being.

A preliminary diagnostic approach to productive development policies in the region, and to their institutional frameworks and governance, reveals a general picture characterized by high levels of dispersion, fragmentation, lack of coordination and inconsistency over time, and by the use of horizontal financing mechanisms, with little prioritization of sectors, weak multilevel governance and relatively little inclusion of stakeholders from academia, the private sector and civil society in the design and implementation of productive development policies. Moreover, in the region at present, these policies are largely marginal efforts managed for the most part centrally, with little involvement of territories. In general, then, it can be said that the productive development policies that have been implemented in the region have little in common with the new vision proposed for such policies by ECLAC.

This new vision for productive development policies involves the consolidation of effective governance, and requires sound public institutions that are capable of creating the conditions for strong coordination and teamwork. The application of a territorial approach is another feature of the new vision for productive development policies, as is the development of experimentalist, multilevel and multi-stakeholder approaches to governance.

This chapter has presented a set of guidelines aimed at narrowing the gap between the new vision for productive development policies and the current state of these policies in the region, so that budgets and political priorities can be reoriented towards the construction of more integrated institutions, forms of productive development policy governance like those discussed here, and agendas, programmes and projects that include a variety of relevant stakeholders in productive ecosystems.

However, the information presented here suggests that greater attention needs to be paid to the institutional and governance aspects of productive development policies in the region, not least in spheres that have received insufficient attention so far, such as the industrial organization aspects of the region's economy, competition policies, sustainable productive development policies or the green economy, the potential for regional integration of productive development policies, the business partnership landscape and the specific roles of the private sector, academia and civil society in productive development policies, among other issues which merit greater consideration and which will constitute an important part of the efforts of ECLAC in the coming years.

It must also be said that addressing the challenges involved in bringing the region's policy closer to the new vision for productive development policies, in a context of financial constraints that may not allow fiscal efforts to be expanded to the levels achieved by the more industrialized countries, requires firm belief and the political will to prioritize efforts aimed at creating strong institutions and governance mechanisms capable of supporting the implementation of more selective productive development policies that are legitimized by social actors (and thus able to survive changes of government) and integrated with one another.

Lastly, it should be said that the region will need to continue working on a long-term agenda to improve its economic fundamentals and thence its productivity.[28] This agenda should include, among other things, improvement of public sector productivity in the provision of public goods (e.g. health and education), efficiency problems generated by high transport costs in cities, infrastructure agendas, strengthening of institutions, deepening of financial markets, and regulatory frameworks for the labour market. The countries of the region will need to continue working on these fronts even as they extend and intensify their productive development efforts.

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[28] Improving the economic fundamentals means strengthening the conditions of education, governance, infrastructure and macroeconomic stability, among other areas (Rodrik and Stiglitz, 2024).

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CHAPTER

V

How to reduce inequality and promote inclusion and social mobility?

Introduction

As indicated in chapter II, one of the three traps confronting the region consists of high levels of inequality, low social mobility and weak social cohesion. Over the last 30 years, Latin America and the Caribbean has systematically been the region with the highest level of income inequality in the world, as measured by the Gini index. In 2022, this indicator stood at 44.9 —slightly lower than in the early 1990s when it was close to 50.0 (ECLAC, 2023a), but still higher than in the other regions of the world.

Six main factors explain much of the inequality and lack of social mobility and cohesion in the region's countries: (i) sluggish growth, which generates listless labour markets with high levels of informality, compounded by major productivity disparities that result in segmented labour markets, with wide pay differentials; (ii) regressive tax systems; (iii) weak social policies and protection that fail to mitigate the effects of inequality rooted in the production domain; (iv) education systems that have serious weaknesses, with high secondary school dropout rates, and also poor learning outcomes that do not respond to the new needs related to the technological revolution in labour markets; as these are also segmented, they do not play their role as powerful social-mobility mechanisms; (v) gender inequality; and (vi) high levels of inequality and spatial segregation in urban areas where 80% of the region's population lives. Planning and management shortcomings mean that the region's cities can be viewed as "inequality factories".

Chapter II also noted that high levels of inequality, compounded by the lack of social mobility and cohesion breed major distrust in public institutions and in the State, with adverse effects on governance and a weakening of people's faith in democracy as the best form of government. This generates a vicious circle that reinforce the three development traps, because democratic life is incompatible with a stagnant economy (trap 1) and with high levels of inequality and weak social mobility and cohesion (trap 2). This produces a frustration and a sense of hopelessness among citizens and erodes their trust in institutions and in democracy itself. The vicious circle can also be viewed in reverse: its inability to generate stronger and more inclusive growth and reduce inequality means that democracy is not meeting citizens' expectations.

Diagram II.5 enumerated the 10 fundamental gaps or structural challenges in the region's development model. Several of these are linked directly with the trap that is analysed in this chapter: high levels of inequality, low social mobility and cohesion per se, compounded by gaps in social protection; weak educational and vocational training systems; and egregious gender inequality.

Breaking free from this trap of high inequality and low levels of mobility and social cohesion requires adopting an integrated approach that simultaneously addresses the six fundamental factors mentioned above. Tackling just one or two of them in isolation will not be enough to generate the change needed to escape the trap. This is perhaps one reason why inequality has been one of the region's best-known characteristics, yet also one that is most resistant to change —along with the different interests and powers that oppose improvement in some of these issues.

Each of these six factors is discussed below, highlighting the policies and institutional arrangements that can contribute to breaking free from the trap of high inequality and low levels of social mobility and cohesion.

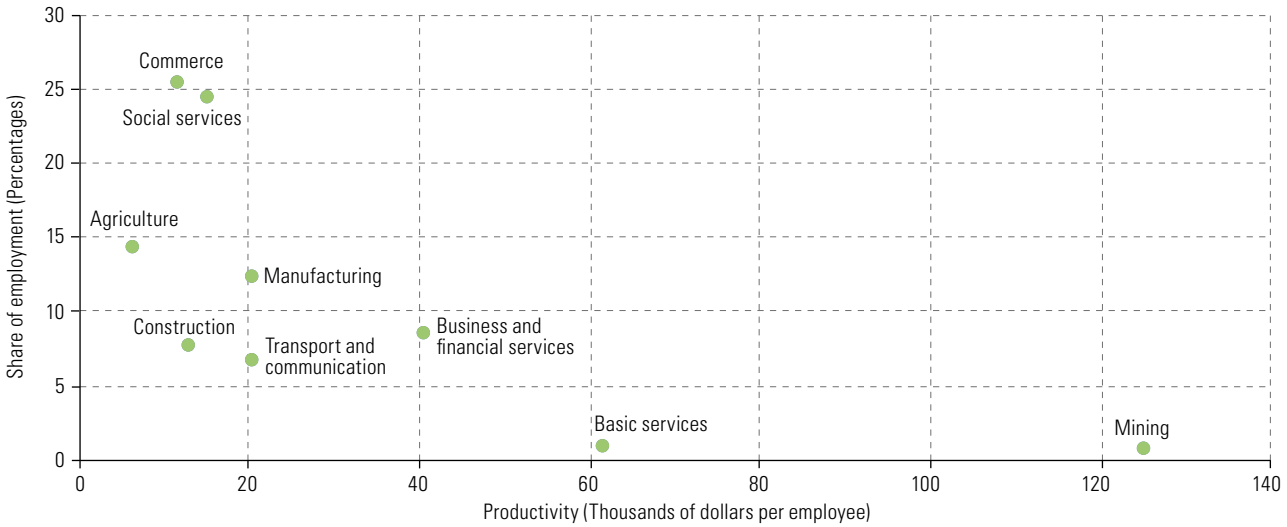
A. Policies for growth and productive transformation

1. Productivity gaps

Income inequality and low social mobility stem not only from the lacklustre economic and productivity growth analysed in chapters II and IV, but also in the productivity differences that exist between the different sectors, firm sizes and subnational territories. This section focuses on these differences.

An initial manifestation of productive heterogeneity is the difference in the level and rate of growth of productivity between the different sectors of economic activity. In the region, sectors that generate relatively little employment (mining and basic services) are highly productive, but those that provide more than half of the region's jobs (agriculture, commerce and social services) display very low productivity (see figure V.1). Overcoming low productivity in these labour-intensive sectors is a key challenge for the region, especially in view of the large volume of employment that they absorb and the urgent need to generate quality jobs for the population (Rodrik and Sabel, 2020).

Figure V.1
Latin America and the Caribbean (8 countries):[a] labour productivity and share of employment by economic activity, 2021
(Percentages and thousands of dollars per employee)



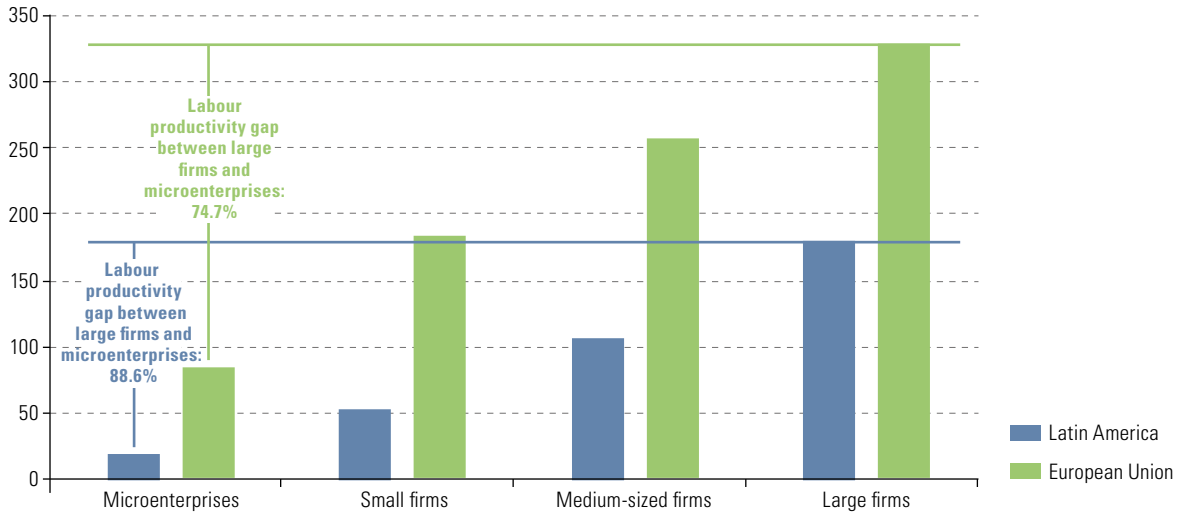
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD) and others, *Latin American Economic Outlook 2023: Investing in Sustainable Development*, Paris, 2023.
[a] Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and Uruguay.

A second dimension of unequal labour productivity can be seen in firms of different sizes (measured by number of employees). In the region, labour productivity in formal microenterprises is equivalent to 11.4% of the productivity of large firms, while in small firms the figure rises to 29.7%, and in medium-sized enterprises it is on the order of 59.5%. It is not surprising that larger firms have higher productivity, given the existence of economies of scale. What is worrying is that the gaps are much wider than those seen in more developed countries, such as in the European Union.[1] As shown in figure V.2, while in Latin America the labour productivity of large firms is 88.6% higher than that of microenterprises, in the European Union the gap is 74.7%. The inequality of capacities between the two groups makes it difficult for large firms to stimulate progress in smaller ones (Correa, Leiva and Stumpo, 2022).

The low productivity of micro, small and medium-sized enterprises (MSMEs) reduces the region's average productivity, given the enormous weight and predominance of these firms, and particularly microenterprises, in its economies. In 2020, microenterprises generated 65% of total employment in Latin America and the Caribbean, and MSMEs accounted for 86% (ECLAC, 2022a). In many of the region's countries, MSMEs represent more than 98% of the total number of enterprises.

[1] The reason why the gaps in Latin America and the Caribbean are larger than in the European Union is not because the productivity of large firms in the region is very high and, as a result, the gap with smaller firms is larger. In fact, as figure V.2 shows, the labour productivity of large firms in the region is around 55% of that of the counterparts in the European Union.

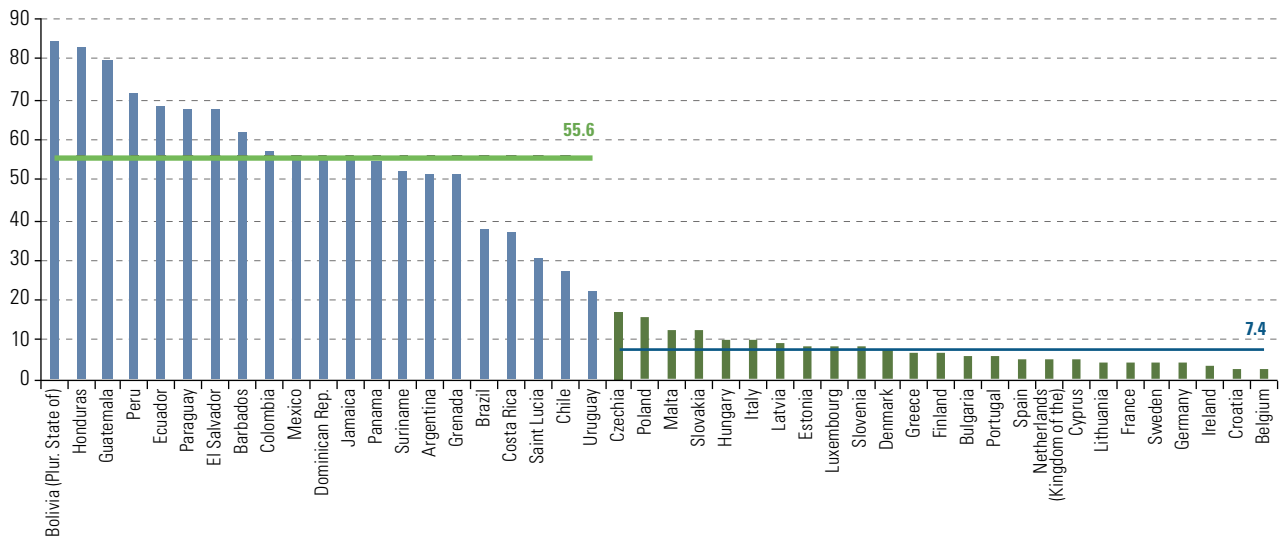
Figure V.2
Latin America (4 countries)[a] and European Union: labour productivity by firm size, 2018
(Thousands of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of F. Correa, V. Leiva and G. Stumpo, "Mipymes y heterogeneidad estructural en América Latina", *Mipymes en América Latina: un frágil desempeño y nuevos desafíos para las políticas de fomento*, Project Documents (LC/TS.2018/75/Rev.1), M. Dini and G. Stumpo (coords.), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2022.
Note: Following the method proposed by Correa, Leiva and Stumpo (2022), labour productivity is defined in this case as the value of sales (turnover) per employee.
[a] Argentina, Brazil, Chile and Mexico.

Heterogeneity is even greater if the analysis includes informal enterprises, which account for a large share of both employment and the total number of firms in many of the region's countries. Informality is a structural feature of the labour markets of Latin America and the Caribbean (Salazar-Xirinachs and Chacaltana, 2018). In 2023, more than half of all persons employed in the region were working informally, unlike the situation in more developed countries. Currently, all countries in Latin America and the Caribbean have higher informality rates than any of the European Union countries (see figure V.3).

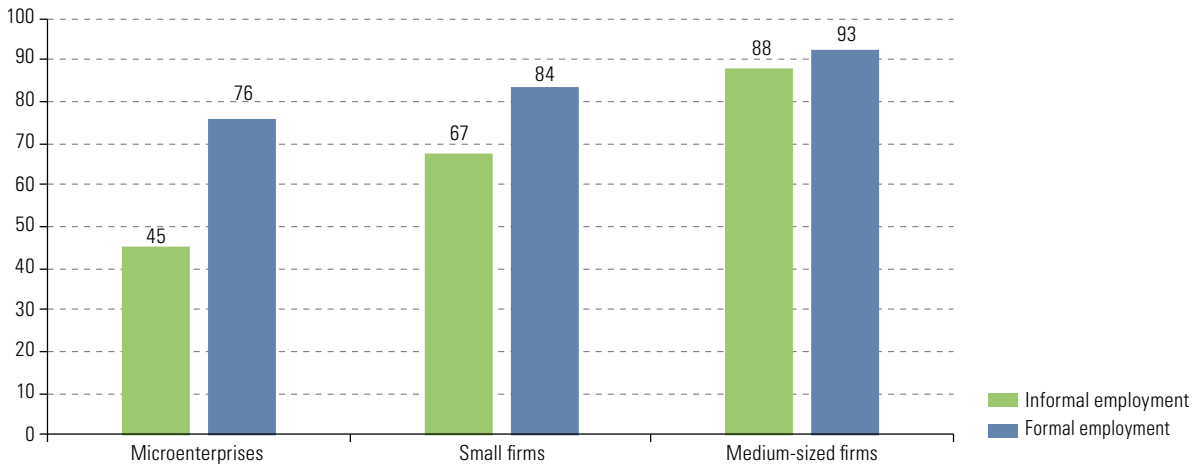
Figure V.3
Latin America and the Caribbean (21 countries) and the European Union (25 countries) labour informality rate, 2023 or latest year with information available
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] https://statistics.cepal.org/portal/cepalstat/index.html?lang=en.

Income disparities are considerably larger among informal enterprises than in the formal sector, particularly in the case of microenterprises (see figure V.4). In 2020, the income gap between formal and informal microenterprises —including sole proprietorships or self-employed workers— was more than 30 percentage points (ECLAC, 2022a).

Figure V.4
Latin America and the Caribbean (14 countries):[a] labour income of all persons employed in the formal and informal sectors relative to that of employees in large firms, by firm size, 2020
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), *Towards transformation of the development model in Latin America and the Caribbean: production, inclusion and sustainability* (LC/SES.39/3-P), Santiago, 2022.

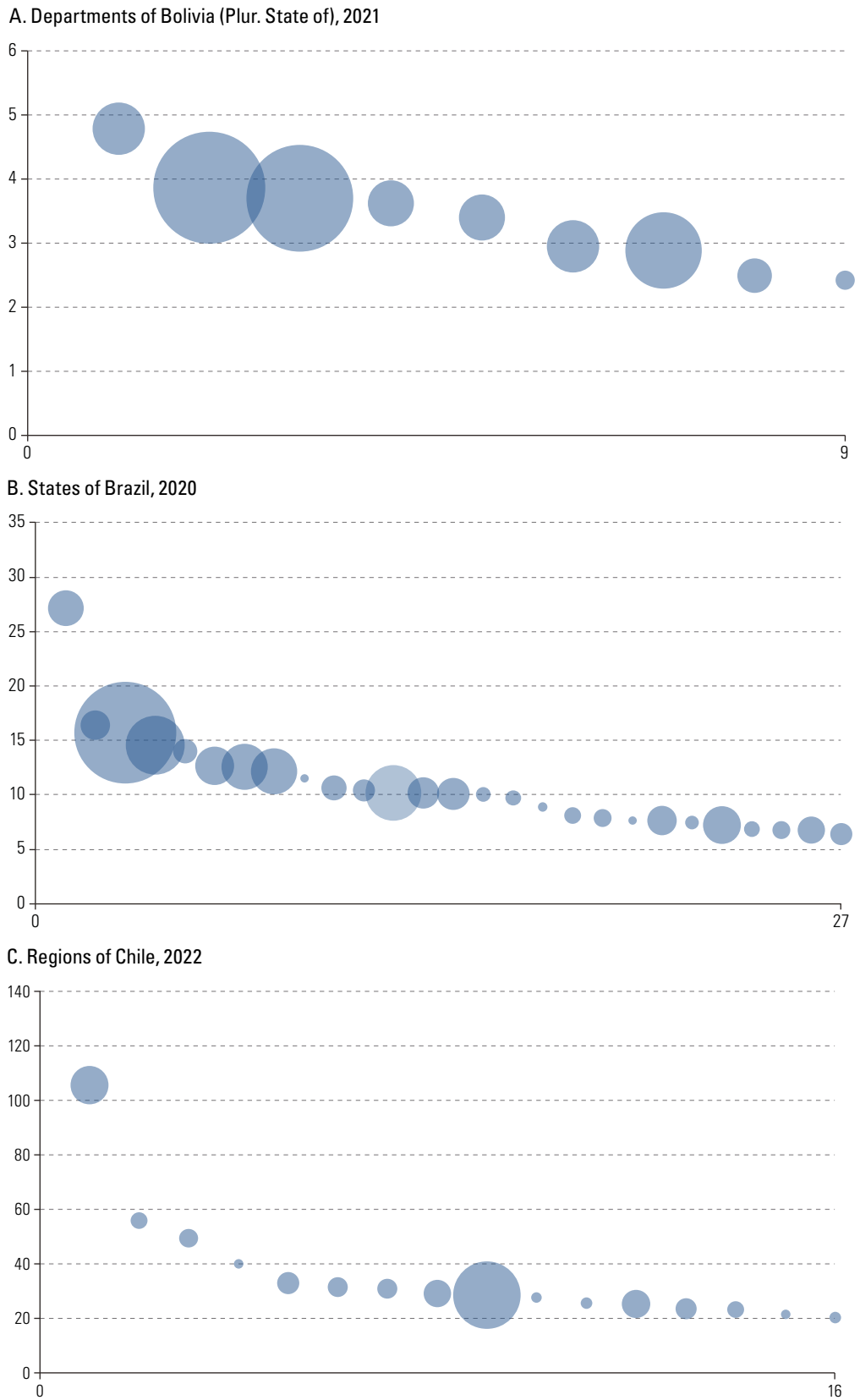
[a] Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

A third manifestation of heterogeneous productivity concerns the differences between regions. The wide inequality in income within the countries of Latin America and the Caribbean is well known, especially compared to that prevailing between the regions of the more developed countries (OECD and others, 2023b).[2] Income disparities are associated with differences in labour productivity between the regions of each country. In some countries of Latin America and the Caribbean, such as Panama, productivity in the richest subnational region is more than 12 times that of the poorest (see figure V.5).

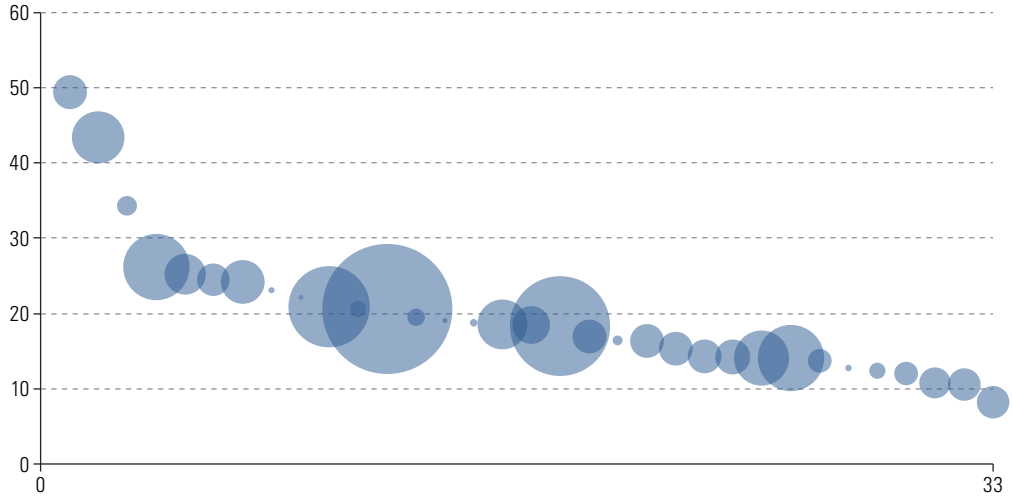
Productivity gaps can also be discerned in other dimensions, such as in the market orientation of production (that is, whether firms target the domestic market or are exporters) (ECLAC, 2016). Beyond the heterogeneity that exists in labour productivity levels in the aforementioned areas, there are also significant disparities in productivity growth rates (ECLAC, 2024a). For example, between 1980 and 2016, the region's labour productivity in the transport, storage and communications sector grew at an average annual rate of 1.2%, while manufacturing productivity declined by 0.3% per year (Correa and Stumpo, 2017). The poor performance of manufacturing productivity in the 1980s, which declined by 4.2% per year on average, weighed on the entire period. This occurred in the midst of deep economic crises, high inflation and low rates of investment, and resulted in this stage being called the "lost decade". Other sectors, such as mining and hydrocarbons, recorded labour productivity that was six times the region's average total productivity in 1986 and 15 times in 1997, but dropping to just 7.5 times in 2015, reflecting the major influence of fluctuations in international prices of non-renewable resources. The sectors that have most increased their productivity in recent decades include transport, storage and communications —a variation probably explained by the emergence of telecommunications and the digital revolution— and electricity, gas and water, thanks, partly, to the implementation of a number of technical advances in that sector.

[2] The inequality in territorial productivity in Latin America is even clearer to see relative to that of the OECD regions. While, in the Latin American countries for which information is available, the gap between the highest and lowest productivity regions of the same country is 4.8 times on average, in OECD countries it only 2.1 times (OECD, 2020).

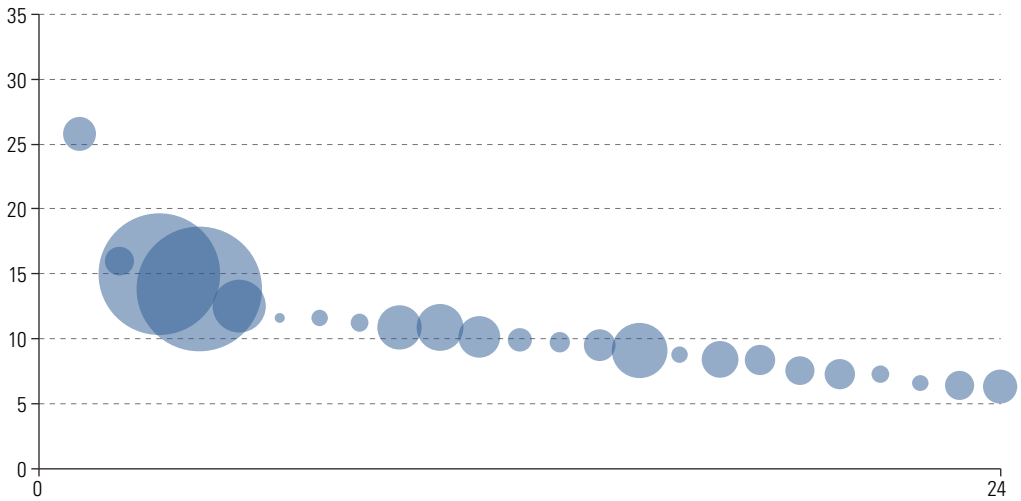
Figure V.5
Latin America (8 countries): territorial labour productivity, 2020–2022
(Thousands of dollars at current prices)



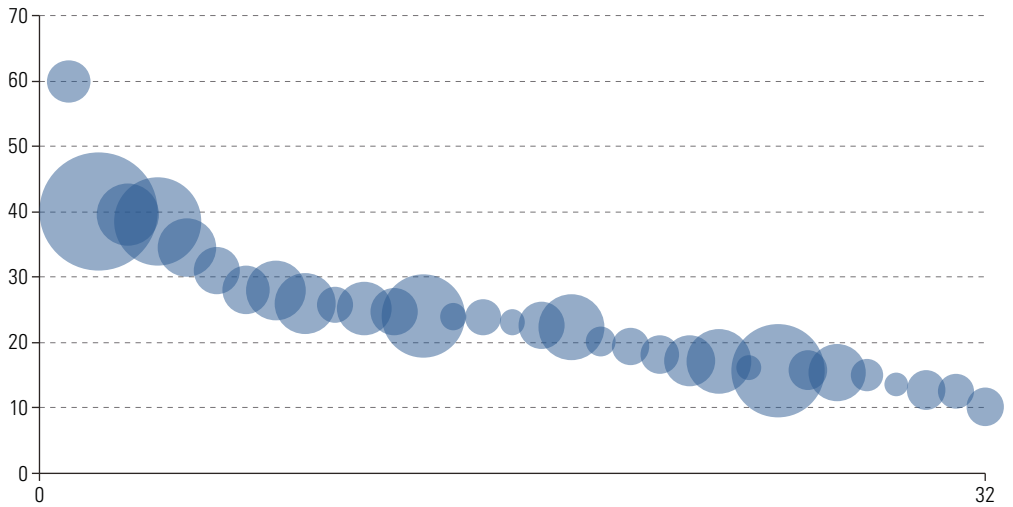
D. Departments of Colombia, 2022[a]



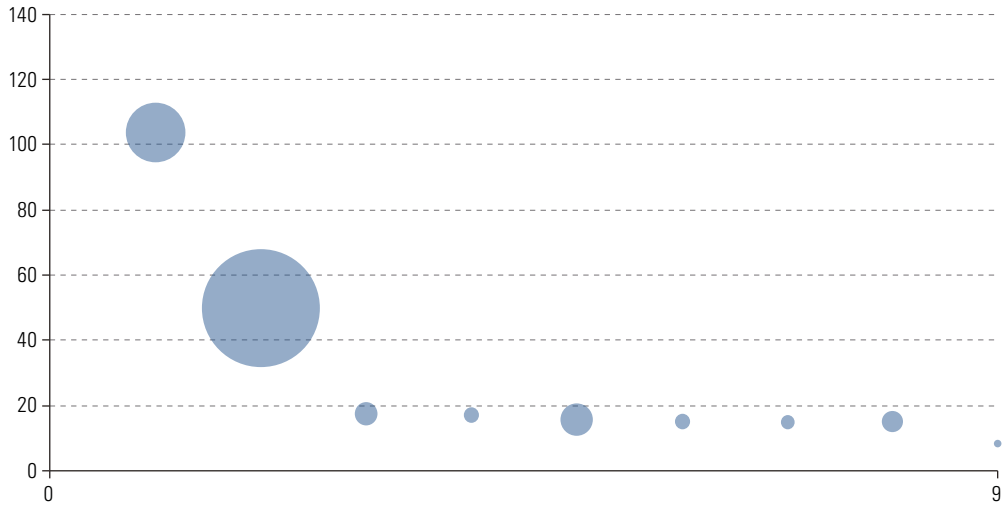
E. Provinces of Ecuador, 2020



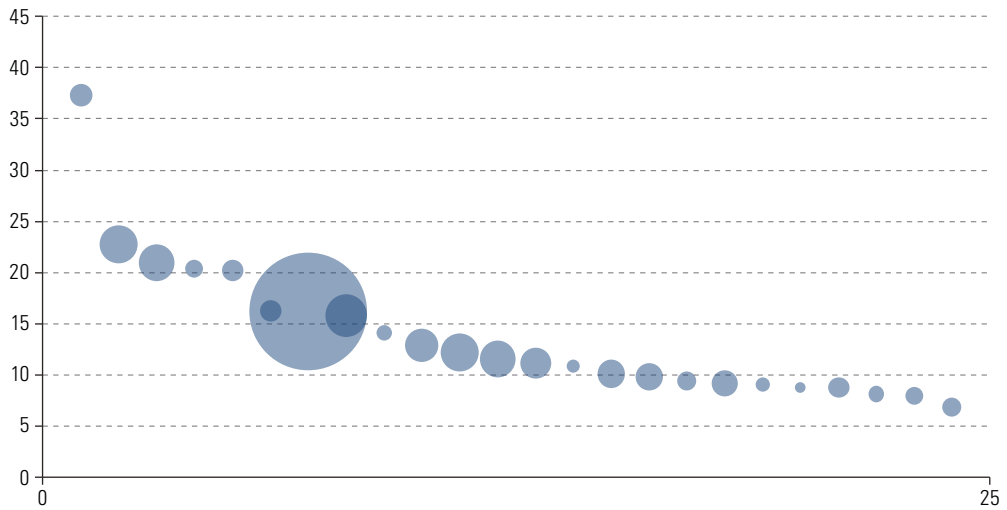
F. Federative entities of Mexico, 2021



G. Provinces of Panama, 2021



H. Department of Peru, 2021



Source: Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] https://statistics.cepal.org/portal/cepalstat/index.html?lang=en.

Note: The vertical scale measures the productivity of the regions, and the horizontal scale represents the number of regions per country. The size of the circles represents the contribution made by each subnational region to the country's value added. In the case of Colombia, the Capital District is included in the departments.

Given the region's need to reduce inequality and enhance social mobility, it is essential to level-up productivity and, hence, incomes across sectors, segments, firm sizes and territories.

The predominance of low-productivity microenterprises and small firms in the countries' production fabric means that a combination of efforts is required to stimulate productivity growth in smaller firms, where this is possible. Productive development policies are needed that can shift the industrial structure to increase the number of medium-sized and large firms of higher productivity, taking advantage of economies of agglomeration among firms by promoting cluster initiatives, and also increase internationalization and export activity, since evidence shows that exporting boosts productivity.

2. Governance and TOPP capabilities for productive development policies

Chapter IV noted the importance of governance for productive development and distinguished the following types: market, experimentalist, multi-actor and multilevel governance. In practice these governance concepts take the form of a variety of coordination and articulation mechanisms —including the different mechanisms (such as committees or roundtables at both the national and the local levels), dynamics, rules of the game and incentives— that enable multiple actors, resources and efforts to align around strategic productive development agendas.

The same chapter mentioned the importance of strengthening the technical, operational, political and prospective (TOPP) capabilities of the different actors involved, in order to facilitate management of the transformations underlying the productive development policy agendas (see chapter IV).[3]

It also highlighted the fact that the region's high level of income inequality is rooted both in low growth rates that do not support dynamic labour markets, and in pronounced productivity differences between sectors, firms and territories. The greater this production-based inequality, also known as "market inequality", the more difficult and demanding it is, in terms of resources, to compensate partly through social policies and social protection. Hence the importance of productive development policies for reducing inequality and fostering social mobility. Nonetheless, while a major boost for productive development policies is needed to break out of the trap of high inequality and low social mobility and cohesion, it is also essential to work on the other transformations mentioned in the introduction to this chapter, as analysed below.

B. More progressive tax systems

1. Insufficient resources and regressivity of tax systems

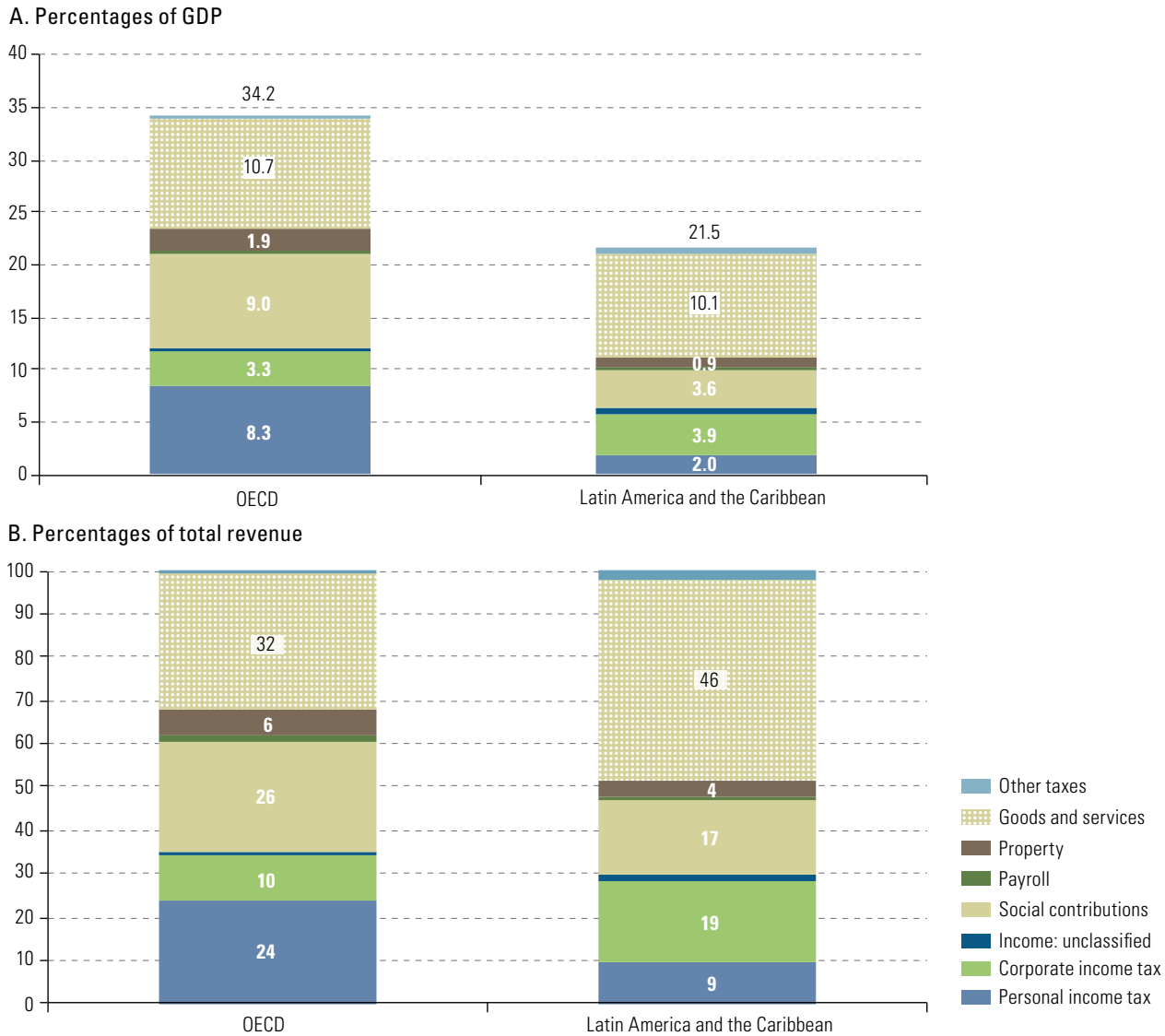
The region's tax systems not only tend to generate insufficient revenue to meet public spending needs, but their structure is biased towards indirect taxes, which are inherently regressive.

On average, the region's tax structure differs substantially from that of the Organisation for Economic Co-operation and Development (OECD) (see figure V.6), since it is based on taxes on the consumption of goods and services. These generate 46% of revenue, equivalent to 10.1% of GDP, while income taxes (both personal and corporate) account for 29.6% of revenue, or 6.3% of GDP.

In contrast, the tax structure in OECD countries is based on income and capital gains taxes, which account for 35.1% of revenue (12% of GDP), with taxes on goods and services raising 31.9% of total tax revenue, equivalent to 10.7% of GDP. Specifically, the main difference in tax revenue between the region and OECD relates to personal income tax, which generates 9.2% of revenue in Latin America and the Caribbean (2% of GDP) and 23.7% in OECD (8.3% of GDP).

[3] For a more detailed and thorough description of TOPP capabilities related to productive development, see section IV.D.5 of this document.

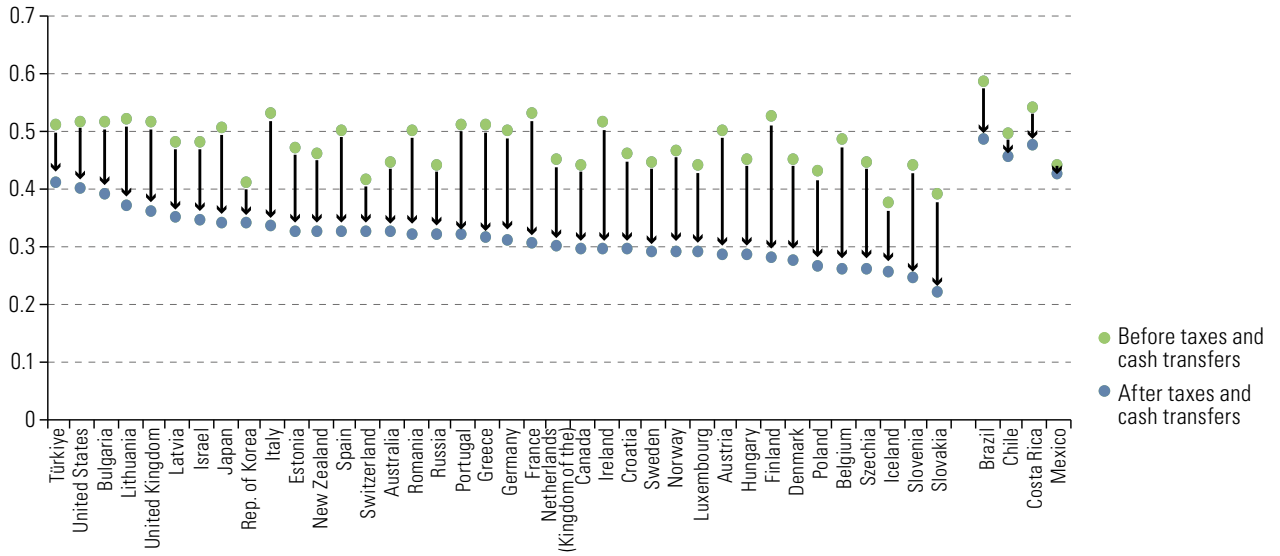
Figure V.6
Latin America and the Caribbean (26 countries)[a] and Organisation for Economic Co-operation and Development (OECD): general government tax revenues, by tax, 2022
(Percentages of GDP and percentages of total revenue)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD), OECD Data Explorer [online database] https://data-explorer.oecd.org/.
Note: The data shown for OECD refer to 2021.
[a] Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Brazil, Chile, Colombia, Costa Rica, Cuba, the Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia, Saint Lucia, Trinidad and Tobago and Uruguay.

This structure biased towards indirect taxes significantly limits the redistributive power of the tax system in the region. As figure V.7 shows, the application of taxes and cash transfers jointly reduce the Gini coefficient only minimally in Latin American countries, whereas the reduction is significant elsewhere in the world, particularly in European Union countries.

Figure V.7
Selected countries: Gini coefficient before and after taxes and cash transfers, 2022 or latest year with information available



Source: J. Hasell, "Income inequality before and after taxes: how much do countries redistribute income?", 3 July 2023 [online] https://ourworldindata.org/income-inequality-before-and-after-taxes#article-citation; Organisation for Economic Co-operation and Development (OECD), OECD Income Distribution Database (IDD) [online] https://www.oecd.org/en/data/datasets/income-and-wealth-distribution-database.html; Luxembourg Income Study (LIS), LIS Database [online] https://www.lisdatacentre.org/our-data/lis-database/.

A key explanation of this result is the meagre contribution of personal income tax. For example, the reduction in the Gini coefficient generated by this type of tax varied between 0.3% in Paraguay and 5.9% in Mexico, averaging 2.0% across 18 of the region's countries,[4] compared to an average of 12.5% among European Union countries (ECLAC, 2017a). It is worth noting that, in several countries, monetary transfers, mainly in the form of pensions, are also regressive (Hanni, Martner and Podestá, 2015).

The weak redistributive power of personal income tax in the region is explained by four factors: (i) preferential tax treatments (exemptions and reductions); (ii) large tax-free allowances, equivalent on average to the value of per capita GDP in 2021, which is more than double the taxable minimum of the average of OECD countries; (iii) narrow tax bases, which are mainly confined to wage-earners; and (iv) high rates of tax evasion and avoidance (Barreix, Benítez and Pecho, 2017).

These factors are compounded by the use of tax expenditures, which tend mainly to benefit high-income individuals and, in the case of direct taxes, diminish the redistributive efficacy of the tax system. In 2021, the revenue forgone through tax expenditures in Latin America[5] averaged 3.7% of GDP and was equivalent to 19% of general government tax revenues (ECLAC, 2023b). However, there is little evidence that these instruments are effective in achieving their objectives, especially in the case of tax incentives for investment. In the region, the revenue forgone to promote investment averaged 1.4% of GDP around 2019 (ECLAC-Oxfam International, 2019).

Another key factor is the high rate of tax evasion in Latin America and the Caribbean. The Economic Commission for Latin America and the Caribbean (ECLAC) estimates that evasion of income tax and value-added tax cost US$ 433 billion in lost revenue in 2023, equivalent to 6.7% of the region's GDP (ECLAC, 2024b). Available studies suggest that many countries collect less than half of the revenue that their systems should theoretically generate, which indicates a very high rate of non-compliance.

4 Ranked by the size of the reduction: Paraguay, the Plurinational State of Bolivia, Guatemala, the Dominican Republic, the Bolivarian Republic of Venezuela, Colombia, Honduras, Ecuador, Costa Rica, Nicaragua, Peru, Panama, Chile, Brazil, El Salvador, Uruguay, Argentina and Mexico.

5 Argentina, Brazil, Chile, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru and Uruguay.

Other direct taxes that could play a positive role in the distribution of income and wealth have limited scope in the region. These include property taxes, which in 2022 generated 4.0% of the region's tax revenue (0.9% of GDP), compared to 5.5% for the average of OECD countries (1.9% of GDP) (OECD and others, 2023a). In terms of the composition of these taxes, in 2022, property tax revenue in the region was based on real estate ownership (0.4% of GDP) and on financial and capital transactions (0.4% of GDP). In OECD by comparison, in 2021 taxes on real estate generated the most revenue (1.0% of GDP) (OECD and others, 2023a). Revenue obtained from taxes on net wealth represents just 0.1% of GDP in the region, compared to 0.2% in OECD. Wealth taxes are currently applied in Argentina, the Bolivarian Republic of Venezuela, Colombia, the Plurinational State of Bolivia and Uruguay.

2. How to make tax systems more progressive and more effective in reducing inequality

Driving the great transformations in the development model outlined in chapter II, including those that contribute to reducing inequality and promoting social inclusion and mobility, will require the public sector to play an active role. Tax systems are essential when generating the domestic funding for these transformations; and strengthening tax revenues is a necessary, but insufficient, condition for reducing inequality. Moreover, taking advantage of the equalizing potential of the tax system also requires measures to make it more progressive, by bolstering direct taxes on income, property and wealth.

The successful design and implementation of the reforms needed to improve the revenue and progressivity of the tax system depend largely on strengthening the TOPP capabilities of finance ministries and tax administrations. In particular these capacities need to be strengthened to expand the revenue potential and progressivity of personal income and property taxes (ECLAC, 2021a and 2023b). To this end, table V.I lists the elements of these that are critical for making tax systems more progressive.

Table V.1
Technical, operational, political and prospective (TOPP) capabilities of institutions that are needed to make tax systems more progressive

Capacities	Characteristics
Technical	– Investment in the technological capacities of tax administrations and the technical skills of their staff to use artificial intelligence and exploit large databases to identify areas of tax evasion. – Generalization of electronic invoicing.
Operational	– Implementation of strategies to reduce tax evasion. – Articulation, coordination and exchange of information between the public entities with which taxpayers interact, such as social security or housing institutions, and social beneficiary registers.
Political	– Encouragement of dialogue and cross-cutting support to generate political agreements for reforms. – Promotion of effective fiscal collaboration and coordination between different levels of government.
Prospective	– Capacity building to adapt tax systems to international tax standards such as the base erosion and profit shifting (BEPS) of OECD, the United Nations Framework Convention on International Tax Cooperation, of the decisions of international tax coordination groups such as the G20 and others. – Capacity building to monitor national and global trends that could impact tax systems.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review,* No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

Social dialogue is a precondition for formulating lasting fiscal pacts. Reform processes need to be implemented on the basis of broad consensuses that afford political and social viability to the changes being promoted, and for creating governance mechanisms that contribute to the implementation and monitoring of these pacts. Recent experience in the region demonstrates the importance of reaching agreements among all economic actors to implement tax reforms focused on increasing not only permanent levels of tax revenue, but also the progressivity of the tax structure and its capacity to reduce income and wealth inequalities.

Progress on personal income taxation should form part of broader strategies aimed at increasing formalization of the economy.

Addressing the needs of social protection, health, education, housing, quality of life and environmental sustainability, which will contribute to reducing inequality and fostering social inclusion and mobility, requires more efficient and effective public spending, allocated strategically to improve social welfare in a comprehensive manner. More efficient and effective public spending is not only an important end in itself, but it is also a decisive factor, in terms of the political economy of tax reform, in enabling any increase in taxation. The chances of generating support for the necessary tax reforms will be greater if citizens and the relevant political actors validate public expenditure management.

C. Social policies and social protection policies

Social protection systems and the construction of the welfare state are fundamental elements for reducing inequality and increasing social mobility and cohesion. Although their importance is recognized, there are still major deficits that require urgent attention. This section analyses two fundamental types of social policy: active labour market policies and social protection systems as such. The final subsection discusses the challenge of strengthening the governance and TOPP capabilities of institutions for social policies and social protection policies.

1. Active labour market policies

Labour markets can transmit and reproduce inequality, inequity and discrimination and thus be corrosive to social cohesion; or else they can function as major drivers of social mobility, increased income, fulfilment of labour rights and higher living standards, and thus contribute to social cohesion.

The buoyancy of labour markets and their job creation capacity are closely related to economic growth rates, so for employment policies to be successful, it is important to achieve high and sustained growth that boosts the creation of quality employment, not just jobs of any kind.

Ways to galvanize growth were analysed in chapter IV. This section reviews a subset of employment policies, referred to as active labour market policies, which will be defined below. Labour markets in the region are characterized by a highly varied productive structure, with scant generation of productive and decent jobs, high rates of unemployment and heavy segmentation that is reflected in the fact that almost half of employment is informal and, therefore, more precarious (unstable, low-paid, without social protection coverage, among other deficiencies) (ECLAC, 2023c; Arenas de Mesa and Espejo, 2023; Espejo, 2022). This delicate situation is aggravated by technological, environmental, demographic and geopolitical trends that exacerbate historical gaps, and whose cumulative effects have an unprecedented impact on social inequality (ECLAC, 2022b and 2023c).

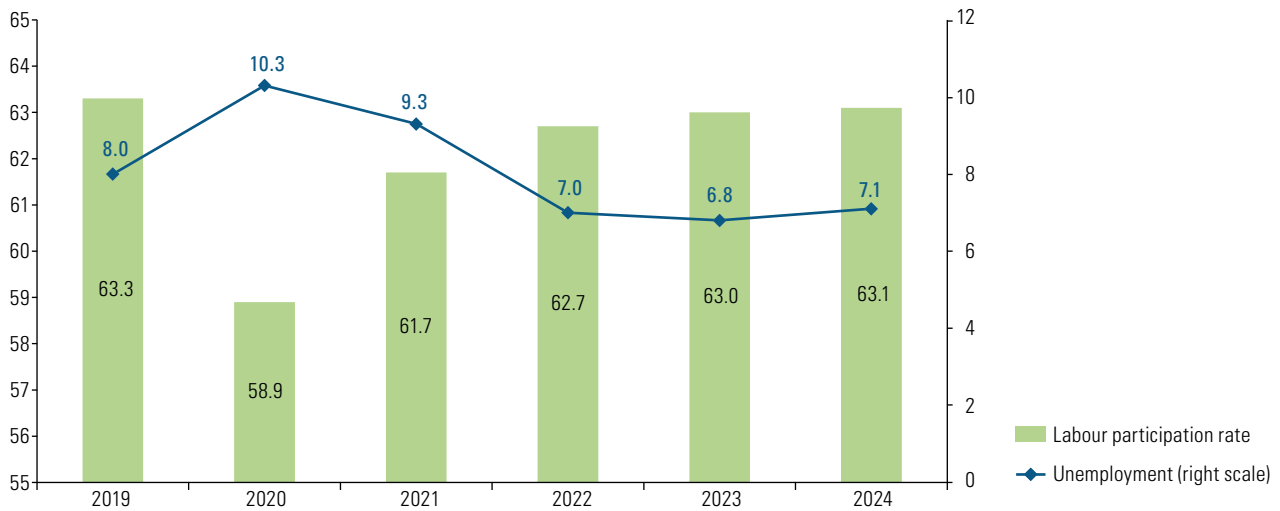
To strengthen the role of the labour market in reducing inequalities in the region, it is not sufficient to consolidate employment levels; it is also necessary to move towards higher levels of labour inclusion, that is towards employment under decent working conditions. For ECLAC, this is an objective of inclusive social development that seeks to ensure that all participants in the labour force have access to more stable productive jobs that guarantee adequate levels of pay and social protection (ECLAC, 2023c).

The coronavirus disease (COVID-19) pandemic triggered the greatest labour crisis in Latin America and the Caribbean in the last 70 years. In 2020, job creation was negative for the first time since 1950 (see figure II.8). Despite the rapid response made to the health crisis through the implementation of economic and labour policies, the post-pandemic recovery has not been strong enough to regain the pre-crisis levels. The annual

average rate of job creation between 2015 and 2024 is estimated at just 1.2%, much lower than the 3.2% recorded in the "lost decade" of the 1980s, which underscores the importance of empowering growth.

Following the sharp contraction of employment in 2020, the regional labour market has been recovering incompletely and unevenly. Estimations by ECLAC indicate that, in 2024, the labour participation rate will increase for the third consecutive year, although it is likely still to be below the pre-pandemic levels of 2019. Nonetheless, the unemployment rate will continue to hover around 7%, which is lower than in 2019 (see figure V.8). Moreover, as extensively documented in *Social Panorama of Latin America and the Caribbean 2023* (ECLAC, 2023c), the process of recovery in labour markets has been unable to close the historical gaps that characterize the region's labour markets and societies, including those relating to socioeconomic level, age group, gender, territory, ethnic-racial status and others.

Figure V.8
Latin America and the Caribbean (20 countries):[a] trend of labour participation and unemployment, 2019–2024[b]
(Percentages)

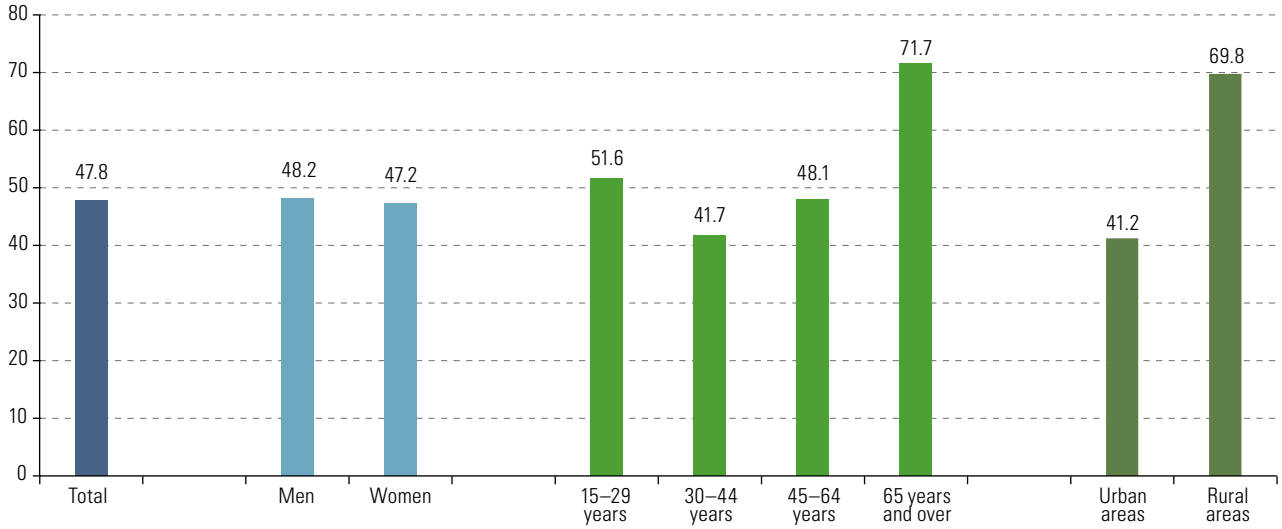


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2023* (LC/PUB.2023/11-P/Rev.1), Santiago, 2023; employment surveys and projections.
[a] Argentina, Barbados, Belize, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia, Trinidad and Tobago and Uruguay.
[b] The figures shown for 2023 and 2024 are estimated in ECLAC (2023e).

Although the pandemic brought the main challenges and weaknesses of the labour market in Latin America and the Caribbean to the forefront of public and political debate, the data show that these are not new problems, but historical challenges that have become more acute since 2020.

Informality in the region is intersected by the axes of social inequality, involving significant age, territorial, gender and socioeconomic gaps. Informal employment is more prevalent among young people (51.6%) and in the population aged 65 and over (71.7%); and it is concentrated mostly in rural areas (69.8%) (see figure V.9). Although there are no significant differences between men and women in the aggregate (a difference of around one percentage point), women are overrepresented in the most vulnerable jobs in the informal economy, for example as domestic workers, contributing family workers or digital platform workers providing services in private households (ECLAC, 2023c). There is also a larger proportion of informal workers in the lowest income quintiles. Owing to the low productivity of their occupations, informal workers are four times more likely than formal ones to belong to low-income households (ECLAC, 2023c).

Figure V.9
Latin America (9 countries):[a] informality rates, by sex, age group and geographical area, third quarter 2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of employment surveys.
[a] Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Peru and the Plurinational State of Bolivia.

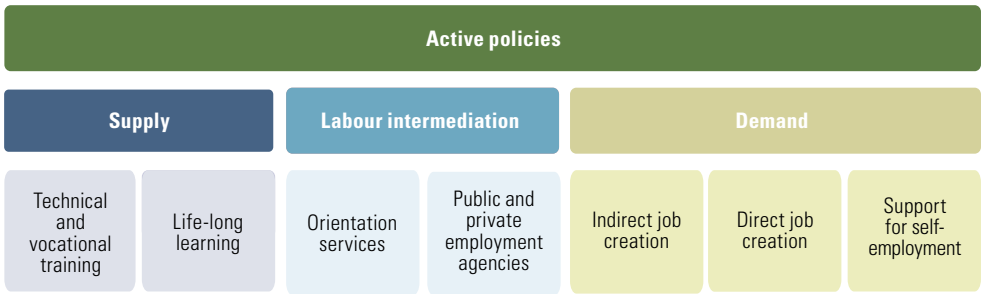
The new, unconventional or atypical forms of employment, associated with changes in the labour market and technological transformations, pose new challenges for reducing informality and inequality, by obstructing labour inclusion. This employment modality has been growing steadily worldwide, to absorb an estimated 10% of the labour force in European countries and about 9.4% in Latin America (Robles, Tanenbaum and Jacas, 2023). Key features of this type of employment are lower rates of pay, highly variable earnings and working hours, along with widespread lack of protection associated with regulatory shortcomings (Robles, Tanenbaum and Jacas, 2023). Abramo and others, (2021) argue that the expansion of atypical forms of employment poses even more complex challenges in Latin America and the Caribbean than in more developed countries. This is due to the region's marked informality and accentuated structural inequalities in labour markets, with low rates of social protection coverage (for further details see section V.C.2) disparities in access to decent working conditions, and deficits in areas such as labour rights, union organization and collective bargaining.

This situation makes it essential to achieve greater coordination between labour policies and social protection systems, in order to address these new risks and help reverse the increased precarity of the new forms of employment (ECLAC, 2023c).

Employment policies are part of economic and social policy and, as noted above, have aspects related to both demand and supply, as well as other aspects related to intermediation or connection between the two. Labour market policies also include instruments and programmes through which the public sector intervenes directly to address people's unemployment problems, promote their integration into the labour market, and mitigate the effects in terms of income loss when such integration is not achieved or is lost.

The most significant labour market policies in the region include active labour market policies. With a comprehensive approach, these include training measures, public employment programmes, employment subsidies, programmes to support self-employment and micro-entrepreneurship, as well as employment services and labour intermediation infrastructure. The region's countries have made progress in implementing these policies in various domains in which labour inclusion programmes operate (see diagram 5.1). Some programmes focus on improving labour supply while others aim to expand demand in the labour market. Situated between these two dimensions are labour intermediation policies aimed precisely at connecting labour supply and demand.

Diagram V.1
Typology of active labour market policies



Source: A. Espejo and others, "Políticas activas de mercado de trabajo en América Latina y el Caribe: desafíos para la inclusión laboral con protección social", *Project Documents* (LC/TS.2023/192), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023; L. Abramo, S. Cecchini and B. Morales, *Social programmes, poverty eradication and labour inclusion: Lessons from Latin America and the Caribbean,* ECLAC Books, No. 155 (LC/PUB.2019/5-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2019; Economic Commission for Latin America and the Caribbean/Organization of American States/International Labour Organization (ECLAC/OAS/ILO), "Protección social y generación de empleo: análisis de experiencias derivadas de programas de transferencias con corresponsabilidad", *Project Documents* (LC/W.398), Santiago, 2011; Economic Commission for Latin America and the Caribbean/International Labour Organization (ECLAC/ILO), "Universal social protection in labour markets with high levels of informality", *Employment Situation in Latin America and the Caribbean,* No. 12 (LC/L.3998), Santiago, 2015; S. Ruesga and others, *Economía del trabajo y política laboral,* Madrid, Ediciones Pirámide, 2014.

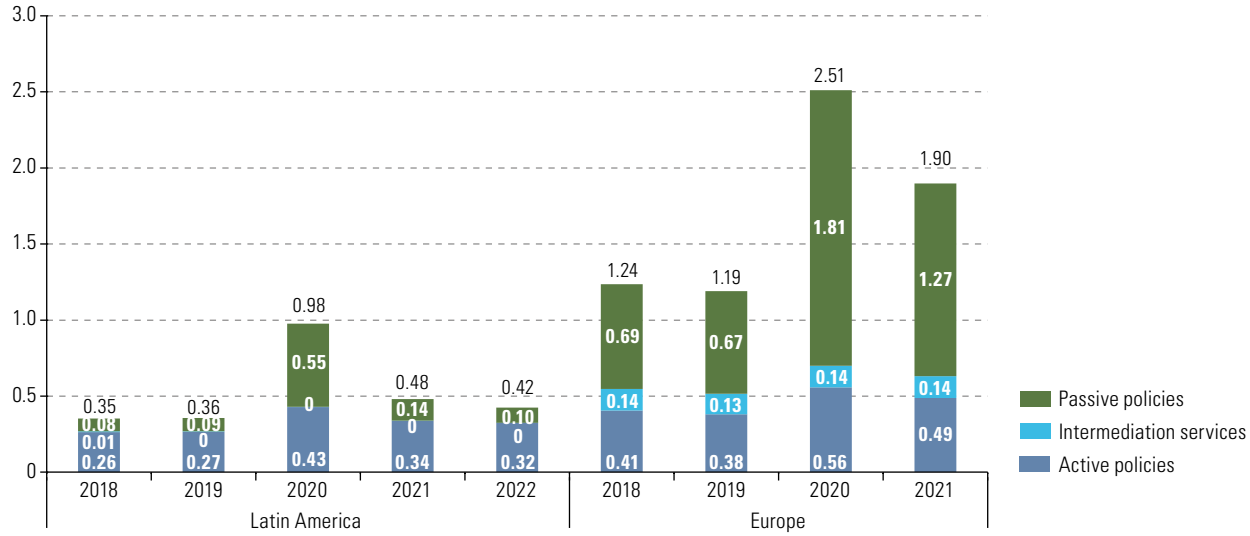
To advance the goal of reducing inequality in the region, active labour inclusion policies need to be linked closely to social protection systems. This entails designing measures that not only facilitate labour market integration, but also provide benefits to mitigate unemployment, illness or similar risks, with special emphasis on reducing the gaps that hinder the construction of less unequal and more cohesive societies.

In Latin America, the average level of public spending on labour market policies has remained relatively stable, growing significantly in 2020 before retreating to levels slightly above those of the pre-pandemic years (see figure V.10). Between 2014 and 2019, public spending on such policies averaged around 0.37% of GDP, with active labour market policies absorbing about 73% of this amount (Espejo and others, 2023). In 2020, the distribution of spending changed considerably, owing to a significant increase in passive labour market policies (unemployment income support, unemployment insurance, and early retirement incentives), in response to the social and economic impact of the pandemic. In that year, passive labour market policies accounted for more than half of public spending on labour policies. In 2022, active policies again absorbed the largest share of spending (76%), equivalent to 0.32% of GDP. Nonetheless, this figure is still insufficient to overcome the inequality and structural problems that the millions of people in precarious employment have to confront.

Financial sustainability is an essential requirement for developing a framework of social and labour institutions that can meet the challenges of moving towards inclusive social development. Nonetheless, this is a necessary but insufficient condition to ensure the sustainability of labour policies and their effect on reducing inequalities. This also requires that labour policies guarantee the coverage and sufficiency of the benefits (Arenas de Mesa, 2023). In other words, countries need to invest more and sustainably in labour policies, in order to reduce informality and inequalities in access to decent work —two structural phenomena that hinder inclusive social development and, therefore, the countries' sustainable development.

Providing incentives for the role of the labour market in reducing inequalities requires addressing not only the barriers to gaining employment, but also those that restrict workers' participation in productive jobs under decent working conditions. The region needs to make progress in the design, expansion and articulation of active labour policies, linking them firstly with productive development policies, promoting employment in the driving sectors with the greatest potential for creating decent jobs; and, secondly, with social protection systems, targeting the most vulnerable populations, strengthening their institutional framework and guaranteeing their financial sustainability. Labour inclusion is fundamental for reducing inequalities and activating the drivers of economic growth; it therefore constitutes a central pillar in a strategy that seeks to help the region to emerge from the development crisis it is currently facing.

Figure V.10
Latin America (15 countries)[a] and Europe (25 countries):[b] average annual public expenditure on labour market policies, 2018–2022
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).
[a] The figures correspond to the simple average of the following Latin American countries: Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru and Uruguay.
[b] The figures correspond to the simple average of the following European countries: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, the Kingdom of the Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.

2. Strengthened social protection systems and welfare states

Social protection systems, which are analysed in this section, are fundamental policies for addressing the trap of high inequality and low levels of social mobility and cohesion. According to the formulation of the Regional Agenda for Inclusive Social Development, social protection aims to guarantee universal access to adequate income levels, basic social services and housing, and to labour inclusion policies and decent work (ECLAC, 2020a and 2021b). Social protection systems contribute directly to the eradication of poverty and the sustained reduction of inequalities through their instruments aimed at improving living conditions and developing capacities. Moreover, by providing a set of certainties and welfare guarantees in an environment of high uncertainty and "permacrisis" (Brown, El-Erian and Spence, 2023; Salazar-Xirinachs, 2023), social protection systems can make a decisive contribution to enhancing social cohesion and inclusion in the region, generating mechanisms to redistribute risk exposure and a common minimum level of protection in a context of profound transformations (Robles and Holz, 2023).

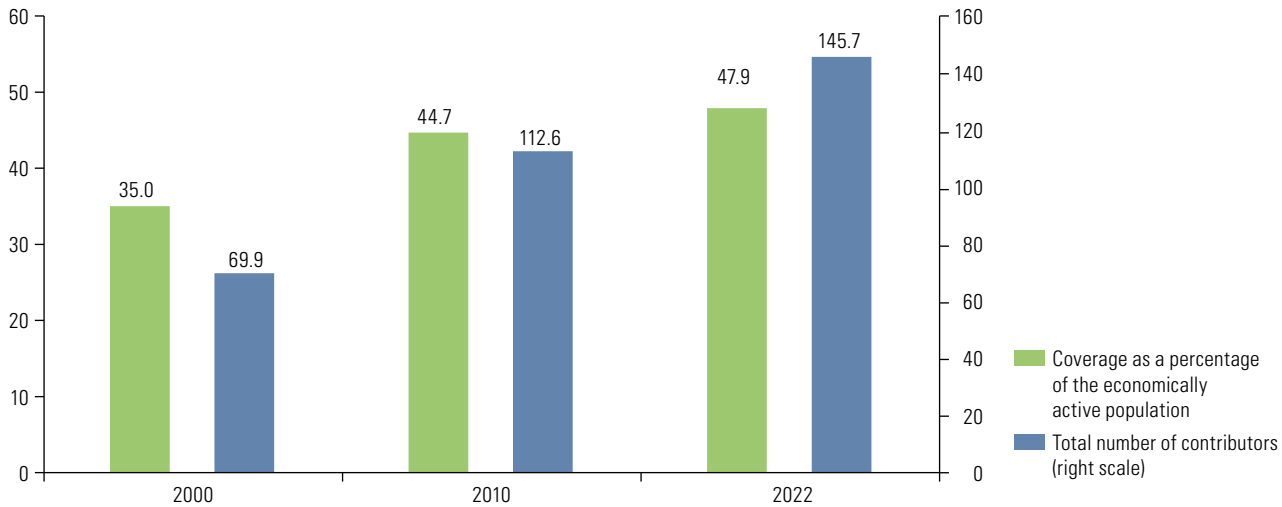
This section provides a brief overview of some key indicators of social protection systems in the region.[6] It delves deeper into the structural deficits that exist in health systems, which are among the core components of social protection systems. Based on this diagnostic assessment, it makes recommendations for moving towards universal, comprehensive, sustainable and resilient social protection systems.

In Latin America and the Caribbean there are major gaps and inequalities in access to social protection, which have various causes and are related to the way in which social protection is financed, gaps in coverage, and cost and other barriers to the formalization of employment (ECLAC, 2006). This context is becoming more complex as a result of a reconfiguration of the structure of social risks that exerts additional pressure on social protection systems, widening the gaps and inequalities linked to them (Robles and Holz, 2023).

[6] Other key analyses for understanding the functioning of social protection systems in terms of access to quality education and labour inclusion are discussed in section V.C.1 on the labour market and social mobility.

Although the indicators of poverty and extreme poverty both improved in 2022 relative to the immediately preceding years (ECLAC, 2023a), gaps in access to social protection persist in the region. Contributory coverage displays significant deficits: for example, despite having increased in Latin America since 2000, effective pension coverage amounted to 47.9% in 2022. In other words, only one in every two persons in the economically active population was contributing to a pension system in that year (see figure V.11). Moreover, there are profound inequalities in this coverage. For example, in 2021, 72% of the economically active population in the highest income decile were contributing to the pension system, compared to just 7.1% in the lowest decile.[7]

Figure V.11
Latin America (17 countries):[a] proportion of the economically active population contributing to contributory pension systems, 2000, 2010 and 2022
(Percentages and millions of people)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Labour force estimates and projections: 2023 Revision" [online] https://www.cepal.org/en/subtopics/demographic-projections/latin-america-and-caribbean-population-estimates-and-projections/population-estimates-and-projections-excel-tables; and administrative data from the countries.

[a] Weighted average of the following countries: Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

In addition, non-contributory social protection policies have expanded considerably in the last two decades, particularly conditional transfer programmes and non-contributory pension systems. The coverage of these two policies expanded to play a key role in closing the gaps in access to social protection, especially for persons living in poverty and greater vulnerability. In 2021, spending on conditional transfer programmes represented 0.26% of GDP, reaching 25.9% of the population in Latin America and the Caribbean (Figueroa and Holz, 2023). Despite this significant coverage, the benefits in question are insufficient, reflecting the low levels of social investment they involve. In 2021, information available for 13 countries in the region for which information is available showed that these benefits covered an average of just 36.3% of poor households' income shortfall (Figueroa and Holz, 2023).[8]

Non-contributory pension systems, in contrast, made very significant progress between 2000 and 2022, expanding their coverage in Latin America and the Caribbean from 3.4% to 31.0% of persons aged 65 years and over, according to information available for 23 countries in the region (Arenas de Mesa and Robles, 2024). In 2021, investment in these systems represented 0.42% of GDP (Arenas de Mesa, Espíndola and Vila, 2024). In Latin America, the consolidation of non-contributory pension systems has made it possible to expand the coverage of the pension system as a whole, to reach 75.5% of the population aged 65 years and over in 2022.

[7] Based on data from the Household Survey Data Bank (BADEHOG). The analysis uses the weighted average of the following countries: Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Peru and Uruguay.

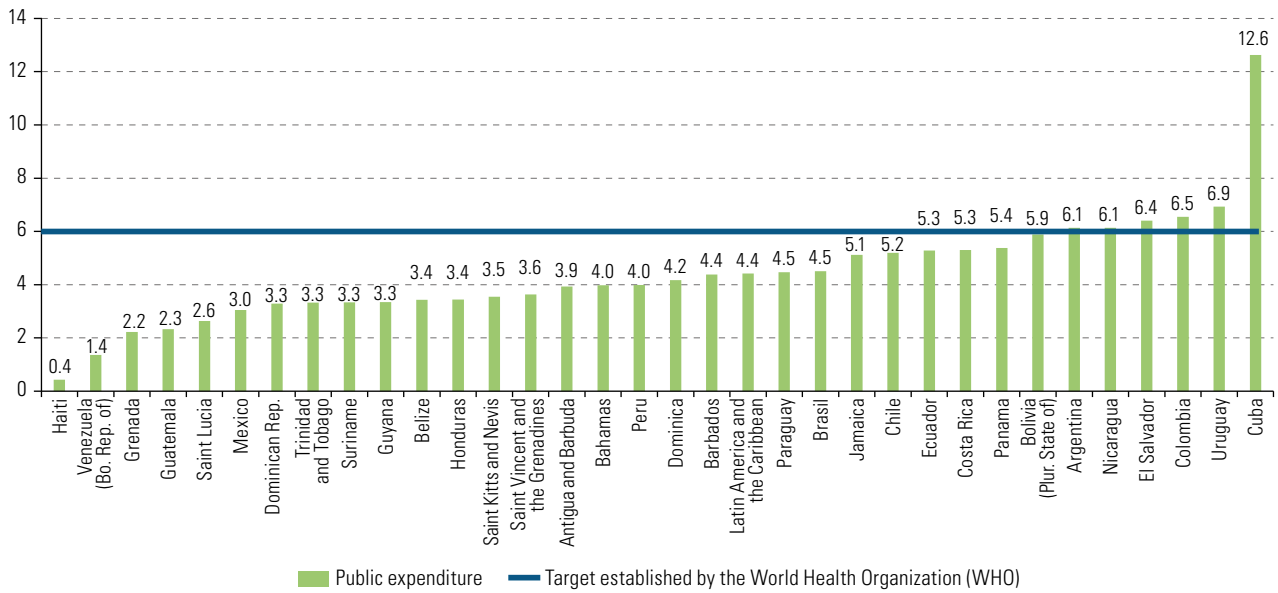
[8] According to information from special tabulations of the Household Survey Data Bank (BADEHOG) for the following countries: Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Mexico, Panama, Paraguay, Peru and the Plurinational State of Bolivia.

In that year, 52.3% of this age group in the region were receiving a contributory pension, so non-contributory pension systems have contributed to closing access gaps (Arenas de Mesa and Robles, 2024). Nonetheless, a quarter of the population over 65 years of age currently lacks access to the pension system, and challenges persist in terms of the adequacy of the benefits paid.

These data show the importance of fostering a wide-ranging social dialogue to achieve broad consensuses and gradually consolidate the necessary progress towards the universalization of social protection and strengthening of the welfare state in the region. Compounding the context described above are ongoing transformations that contribute to reconfiguring the structure of risks that social protection systems have to confront. This includes technological transformations in the world of work, the demographic transition, the climate crisis, disasters and the challenges of the epidemiological and nutritional transition (ECLAC, 2019; Robles and Holz, 2023). Despite the significant efforts made by the countries of Latin America and the Caribbean to guarantee their populations' right to health, health systems display a series of structural weaknesses that cause problems related to their coordination, access and efficiency, and have repercussions on health outcomes, exacerbating inequalities and hindering people's right to health.

Firstly, the health systems of the region's countries suffer from chronic underfunding. In 2021, public spending on health in the region averaged 4.4% of GDP, well below the 6.0% recommended by the World Health Organization (WHO). Although there is much regional heterogeneity, only 4 countries meet or exceed the 6.0% threshold, while 12 fail to reach 4.0% (see figure V.12). This situation results in a shortage of resources and inputs, including infrastructure, health personnel, and information and communication technologies (ICT), thereby limiting the capacity to respond to the needs of the population in a timely and equitable manner (ECLAC/PAHO, 2021). The situation is exacerbated if one includes the high level of private spending that accompanies it, which accounted for 39% of total health expenditure in 2021, almost all of which corresponds to out-of-pocket spending. This type of expenditure exposes the most vulnerable households to catastrophic financial risks and contributes to inequalities both in access to health care and in its quality, hindering universal health; so it is essential that the countries of the region intensify their efforts to reduce it.

Figure V.12
Latin America and the Caribbean: public expenditure on health, 2021
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Health Organization (WHO), Global Health Expenditure Database (GHED) [online] https://apps.who.int/nha/database/Select/Indicators/en.

This problem is compounded by health system segmentation that divides the population into different watertight and disconnected subsystems. As a result, access to health care and its quality depend largely on people's ability to pay and their affiliation to the social security system, while solidarity mechanisms that contribute to reducing inequalities in health are either absent or very deficient.

High degrees of fragmentation in the provision of health services result in insufficient coordination between the different levels of care, generating interruptions in the continuity of care, duplication of services and infrastructures, underutilization of available resources, and weakness or absence of integrated health service networks (ECLAC, 2022b). Moreover, disproportionate attention to more specialized services relegates the first level of care to a secondary and more precarious position, revealing the fragility of the primary health care strategy, which should have the capacity to integrate the different services and levels of health care.

Faced with these structural deficits, health management needs to be made more efficient in its various dimensions, including the financial dimension. Along with increasing investment in health to guarantee access to quality health care for all, according to their need and not their ability to pay, this investment must be managed efficiently to make it possible to correct the main shortcomings of the systems, promoting economies of scale and comprehensive systems that operate as integrated health service networks that respond satisfactorily to the population's expectations.

These structural weaknesses, interacting with the structural axes of the social inequality matrix and the social determinants of health, foster the reproduction of the glaring inequalities that characterize the region. Thus, profound disparities can be observed both in terms of access to health services and care, and also in health outcomes between and within the countries of Latin America and the Caribbean. Key epidemiological indicators such as life expectancy, maternal mortality and infant mortality vary widely between the countries of the region. Moreover, they display a clear association with socioeconomic indicators such as the national average years of schooling, levels of labour informality and the extreme poverty rate, which partly explain the inequalities observed (Marinho, Dahuabe and Arenas de Mesa, 2023).

Taken together, these structural weaknesses pose a fundamental challenge for consolidating universal, comprehensive, sustainable and resilient health systems at the regional level, which allow progress towards sustainable development. Target 3.8 of the 2030 Agenda for Sustainable Development is to "achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality and affordable essential medicines and vaccines for all" (United Nations, 2015, p.19). Failure to achieve this target not only impedes exercise of the population's right to health, but also hinders progress towards inclusive and sustainable social development, since, without health, achieving this development model will be impossible (ECLAC/PAHO, 2021d; Marinho, Dahuabe and Arenas de Mesa, 2023).

One of the factors underlying the trap of high inequality, with low levels of social mobility and cohesion, is the fact that government social institutions have little capacity to transform this reality through quality social development policies that are effective, efficient, sustainable and transparent, as proposed by the Regional Agenda for Inclusive Social Development (ECLAC, 2020a, 2022b and 2023a). Such policies must be capable of determining which factors promote inequality and discrimination in different areas of social development and the exercise of rights, and of managing the necessary transformations. Strengthened social institutions provide the strategic framework needed to accompany a profound and structured reorientation of social development policies.

Technical, operational, political and prospective (TOPP) capabilities occupy a central place in the strengthening of social institutions and State governance. Implementing quality social development policies requires social institutions to ensure consistency between regulatory mandates and the capacity for implementation and coordination among public agencies; the possibility of evaluating impacts and outcomes and accountability, and the capacity to create and manage comprehensive information systems (Salazar-Xirinachs, 2023). In organizational terms, horizontal and vertical coordination at the central level, between levels of government and with key social development actors, are also essential for ensuring the political capabilities of institutions needed in the process of structural transformation towards inclusive social development. Social development policies also require prospective capabilities to be created and strengthened in the institutions, such as for

monitoring and foreseeing trends and conflicts; with a high capacity to anticipate and respond to change and social vulnerabilities, and the participatory formulation and management of social policies. Lastly, a framework of social institutions with greater capacities and scope for action in the decision-making process contributes to better governance by providing the necessary framework and support for the design, implementation, evaluation and continuous improvement of social policies (ECLAC, 2023a).

As noted in chapter III, good governance involves increasing the State's capacity to establish pathways for change and transformation, incorporating non-State actors in the formulation and implementation of public policies to improve their effectiveness. In the social sphere, this capacity consists of strengthening social institutions, understood as the set of rules, operational, financial, human and technological resources, and organizational structures that support and manage social development policies, from the diagnostic study and prioritization of objectives to the implementation and evaluation of their results (ECLAC, 2023a). From the analytical standpoint, the social institutional framework consists of four interdependent dimensions: (i) the laws, rules and regulations governing social policy (legal-normative); (ii) the authority and its mandates, structure and human resources and coordination mechanisms (organizational); (iii) the capacities and instruments for policy management and implementation (technical-operational); and (iv) the financial resources and sources of financing for social investment (financial). Their strength in the social sphere provides the basis for the actors involved in social development policies to improve their performance in the public conversation and political-institutional relations for decision-making (ECLAC, 2022b, 2023a and 2023c; Martínez and Maldonado, 2019).

The strengthening of social institutions enables good governance and vice versa —a dynamic that allows for the development of quality social development policies to make headway in eradicating poverty and reducing inequality in the region. An institutional framework that meets the present and future challenges of social development policies requires simultaneous and sustained progress in the four dimensions mentioned above, and an essential requirement for their consolidation is to strengthen the TOPP capabilities in the design and operation of the institutions in charge. As explained in chapter III, the TOPP capabilities of the institutions are key components for strategic governance, since they make it possible to adequately determine the key factors and actors in the public policy process, and enable a better projection of results, processes and foresight of action required to mitigate risks and make it easier to achieve the objectives.

3. Strengthening the TOPP capabilities of social protection institutions

In the area of social protection policies, which are systemic in nature and often operate by harnessing various instruments and even institutions, TOPP capabilities become more important. Challenges in this regard include the growing need for intersectoral harmonization and coordination between various levels of the State, and strengthening the planning function for the design of strategic policies in the midst of simultaneous transformations. The following describe the most important TOPP capabilities that need to be created and strengthened to advance in developing social protection policies, based on a strengthened social institutional framework (see table V.2).

The information contained in table V.2 refers to the TOPP capabilities that need to be created or developed in institutions to strengthen the impact of social protection policies in the region, to enable them to contribute to overcoming the three development traps, including that of high inequality and low levels of social mobility and cohesion. Addressing the gaps that often arise between the mandates and responsibilities of social ministries and other entities linked to social protection policies, and their institutional capabilities, requires careful planning by the directors and managers of these policies at the highest levels of the State and public institutions. This process can result in a cross-cutting strategy to strengthen the entities in charge; and it can be used to create and design new social protection policies. Nonetheless, each of these institutional capabilities needs to be addressed specifically.

Table V.2
Technical, operational, political and prospective (TOPP) capabilities of institutions that are needed to strengthen social protection

Capacities	Characteristics
Technical	– Strengthening of strategic planning for the design of policies and instruments that make social protection systems sustainable. – Investment in comprehensive information systems and social registers to support the management and implementation of social protection policies. – Consolidation and creation of systems for monitoring and evaluating social programmes, as well as accountability for their results. – Strengthening of consistency between regulatory mandates and the objectives of social protection policies.
Operational	– Adoption of single window models with various access channels, to enable citizens to access all social protection programmes and benefits through one channel. – Design of strategies to optimize operational processes in line with progress in digitalization and automation. – Development of policies and strengthening of human resource management to make sure social protection policies and programmes are effective. – Strengthening of protocols to facilitate the interoperability of social information systems, as well as mechanisms of contact with citizens and dissemination of the information contained in these systems and registers. – Strengthening of inter-agency collaboration and cooperation to advance the interoperability of information systems and social registers.
Political	– Definition and establishment of modalities and mechanisms of social dialogue to reach broad agreements on social protection policies. – Design and implementation of intersectoral coordination mechanisms and between the various levels of the State with responsibilities in the different phases of implementation of social protection policies and programmes. – Creation of communication strategies to disseminate the social protection policies that are being designed and implemented, as well as their results and progress. – Definition of modalities and mechanisms for social participation in the various stages of design and implementation of social protection policies.
Prospective	– Analysis and strengthening of the resilience of social protection policies in the face of a risk structure that is being reconfigured. – Surveillance of existing social protection gaps and development of prospective mechanisms for policies that contribute to closing gaps and estimating the costs of their implementation. – Preparation of prospective studies and promotion of coordination between entities that implement social protection policies with actors that follow up on technological, demographic and migratory changes. – Development of future scenarios for the sustainability of social protection that include the dimensions of coverage, adequacy of benefits and financial sustainability.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

In the case of technical capabilities, it is essential to strengthen planning activities to provide strategic guidelines for the process of implementing social protection system policies as a whole. For example, the existence of specific regulations for the creation of benefits, such as cash transfers or even non-contributory pension systems, is not verifiable in all cases; and only some countries have comprehensive regulatory and planning frameworks for social protection systems or their benefits (Arenas de Mesa and Robles, 2024).

One of the areas that requires greater attention in the region is that of comprehensive information systems and social registers of potential beneficiaries (Berner and Van Hemelryck, 2020). These are fundamental instruments in all phases of social development policies (design, implementation, monitoring and evaluation), and they also make it possible to coordinate action, detect areas of complementarity and avoid potential overlaps. Social information systems can incorporate various subsystems or types of record, such as the following: (i) records of potential recipients; (ii) participant records of users of social programmes and services; and (iii) administrative records, as well as geo-referenced records and social surveys (Van Hemelryck, 2021). Information systems and social registers are conceived as the backbone of social protection systems, because they provide fundamental information for the design of policies and programmes, while also reaching people who need timely social protection. Their relevance was demonstrated amply during the COVID-19 pandemic and, in a context of permanent crisis, it is expected to continue to grow (Holz and Palma, 2023). In the region, however, coverage of the social registers of the potential recipients of social protection systems is very uneven, and practically non-existent in some countries.

In terms of operational capabilities, it is essential to have human resources with the levels of training, competencies and commitment needed to meet the multiple challenges and requirements of social protection policies. This is a critical factor for the success of these policies and for progressing from "what to do" to "how to do it", in other words how to implement the social development policies. Operational capabilities play a crucial role, starting at the policy design phase —because they make it possible to prepare viable and strategic proposals— through to the implementation, monitoring and evaluation, data collection and analysis, and accountability

stages (ECLAC, 2023a). Investing in the human talent of social institutions requires a human resources policy in the public sector that includes planning, development and training components, including digital capabilities, as well as the evaluation of performance and the management of talent and change (ECLAC, 2023a; Holz and Palma, 2023). In particular, the existence of career civil servants is a mechanism that can strengthen social institutions, providing them with key experience and competencies for informed decision-making, a commitment to country interests, continuity, and the stability required for public policy implementation (ECLAC, 2023a).

Also in terms of the operational capabilities of institutions, it is essential to design strategies to optimize operational processes in line with advances in digitalization and automation, preparing protocols to safeguard the rights of persons receiving benefits and the protection of their information. In addition, protocols should be strengthened to guide and facilitate the interoperability of social information systems, as well as mechanisms of contact with citizens and dissemination of the information contained in these systems and records, to reaffirm the central role of social protection for inclusive social development.

Political capabilities, meanwhile, are a priority for consolidating universal, comprehensive, sustainable and resilient social protection systems. These will enable adequate consideration of the variables linked to the political economy of the countries that can facilitate or, on the contrary, hinder progress in social protection policies in the process of creation, reformulation or implementation. They are also fundamental when considering the need to move towards broad agreements on the levels of financing that may be required to make social protection systems financially sustainable and consolidate a set of public policies that can contribute effectively to the eradication of poverty and a significant reduction in inequalities.

Developing mechanisms to foster broad social dialogue that provide support and legitimacy to the required economic and social transformation processes and allow progress to be made in social and fiscal agreements that provide support and financial sustainability to the social protection policies, requires coordinating multiple interests and having participation by various stakeholders. The political capability of institutions to generate in-depth transformations partly involves making detailed evaluations of the short- and long-term margins for action, and the potential windows of opportunity (or reticence) that can arise throughout the public policy cycle, as well as analysing potential scenarios for reaching the broadest possible agreements (technical and political) in decision-making. Hence the importance of building effective coordination and leadership bodies, such as social offices, to give social institutions a weight equal to their mandates and importance for public action.

Lastly, in terms of prospective capabilities, it is essential to make progress in anticipating the implications of a changing structure of social risks. The region is undergoing rapid changes and transformations resulting from a set of structural and emerging challenges of inclusive social development, in addition to the poverty, inequality and high levels of informality that affect the results of that development. These challenges include the increase in disasters and the impacts arising from the climate crisis, demographic, epidemiological and nutritional transitions, technological transformations and upheavals in the world of work, and the various forms of violence (ECLAC, 2019). The simultaneity with which these occur could generate a renewed source of vulnerability for individuals and households, strengthening a reconfigured risk structure that will put the future of social protection systems in doubt (Robles and Holz, 2023). The capacity of social protection systems to adapt to this scenario demands a complex set of actions that transcend mitigation responses and, instead, require a focus on sustainability. It is therefore essential to strengthen the capacity to anticipate and prevent the possible consequences of these challenges for the well-being of households and individuals, and to generate responses and mechanisms that allow a rapid response to their occurrence, in order to simultaneously advance with actions that make it possible to transform the conditions that increase vulnerability levels (ECLAC, 2021a). All of this requires strengthening the prospective capabilities of the institutions of social protection systems, in a context of recurrent crises.

Among the TOPP capabilities of institutions needed to promote transformative and quality social policies, the development of strategic and prospective planning is essential to have proposals that are not only technically adequate, but also politically viable. In this context, developing prospective studies on the sustainability of social protection that give equal weight to the dimensions of coverage, adequacy of benefits and financial sustainability will be fundamental for meeting the challenges of the future of social protection in the region (Arenas de Mesa, 2024).

The tools of strategic and prospective planning can help key social policy and protection actors, such as Ministries of Social Development, to obtain detailed information on the existing governance mechanisms and characteristics of the decision-making processes they face, in the light of current regulations. They can also help to identify internal strengths and weaknesses, along with the external opportunities and threats that can facilitate or hinder a proposal.

In short, it is crucial to invest in the TOPP capabilities of institutions mentioned, because they are indispensable for consolidating the State's social institutions and efficient governance, which make it possible to harmonize transformative and quality social development policies that make progress in eradicating poverty and reducing inequalities in the region.

D. Improving education systems and learning

1. Education as a factor in promoting equality and social mobility

Education is a human right and one of the Sustainable Development Goals (SDGs) to which countries committed in 2015 by adopting the 2030 Agenda for Sustainable Development. Goal 4 is to "ensure inclusive, equitable and quality education and promote lifelong learning opportunities for all." Education thus forms the base on which it is possible to achieve peace, tolerance, fulfilment of human rights and sustainable development. Its objective is to foster the development of skills, competencies and learning to promote human dignity, self-confidence and self-esteem. In the current global context of heightened uncertainty and constant changes, education needs to respond not only to the new demands generated by technology, the robotization of work and care for the environment, but also to make good on the promises that remained unfulfilled in the twentieth and early twenty-first centuries, including breaking out of the inequality trap (Huepe, Palma and Trucco, 2022).[9]

Education can act as a mechanism for both mitigating and reproducing the inequalities that exist in a society. The more closely the education system is aligned with the demands of the labour market, the more it will be able to expand opportunities for people from the most vulnerable backgrounds to access a decent job. It can thus contribute to higher levels of social and labour inclusion and to the achievement of other development objectives, such as poverty reduction, increased productivity and faster economic growth. Education is an investment that has the potential to increase labour incomes and enhance workers' productivity; and the data show clearly that, on average, the higher the level of education, the higher the economic income received (Huepe, 2024). It thus plays a key role in the countries' social mobility.

However, one of the main structural gaps that exist in Latin America and the Caribbean is precisely the weakness of the education and vocational training systems, which is why this was included in the decalogue of the region's fundamental gaps prepared by ECLAC (see diagram II.5). The potential of education as a factor promoting upward social mobility can be undermined if teaching and learning processes, as well as the returns to education in the labour market, reproduce social inequalities. In other words, if access to quality education and the returns to education are biased in favour of certain groups in society, social mobility may be hindered, thus perpetuating intergenerational inequality. The expansion of educational coverage in recent decades has been accompanied by a greater segmentation of students into educational pathways of different quality (Acosta, 2022). Individuals from more privileged backgrounds are not only more likely to be effectively involved in teaching and learning processes and have higher access and completion rates at the different educational levels (ECLAC, 2022); but they also have access to schools that provide higher quality education, obtain better learning outcomes and follow educational trajectories that have better income prospects (OECD, 2023; UNESCO, 2021). These inequalities undermine the role of education in achieving more cohesive societies: if education is segmented according to the socioeconomic conditions of households of origin, the educational return will reproduce these inequalities.

[9] Chapter II of this document describes the inequality trap in Latin America and the Caribbean.

Various studies that analyse the situation of education in the region reveal significant disparities in the scholastic attainment of different population groups, according to income level, gender, territory, ethnic-racial status and other factors (ECLAC, 2022b; Huepe, Palma and Trucco, 2022; UNESCO/UNICEF/ECLAC, 2022). These disadvantages are reflected in the labour market and in individuals' opportunities for labour inclusion—particularly in their chances of obtaining less precarious jobs, greater access to social protection and better paid jobs (see section V.C). Therefore, they diminish the impact of education in promoting societies with lower levels of inequality, by limiting possibilities for personal, academic and professional development, and hindering the upward mobility of the most disadvantaged population groups.

Education systems alone are incapable of completely overcoming the challenges of the region's social inequality matrix (ECLAC, 2017b and 2022b). To activate the role of education towards greater social mobility and cohesion, equal opportunities need to be guaranteed —that is, quality education for all, but also ensuring that all children, adolescents, young people and adults have the material, cultural and social conditions needed to be able to engage in educational processes on equal terms. The lack of material resources in homes and schools, which is reflected, among other things, in digital connectivity gaps and lack of educational materials and adequate study spaces, diminishes students' use of educational practices (ECLAC, 2022b).

In view of the above, to develop the virtuous circle between education and the reduction of inequalities, the region needs to address two challenges in a coordinated manner. The first of these involves transforming education systems to make them more inclusive, more relevant and of better quality; the second entails addressing the underlying social, cultural and economic disparities that obstruct the educational and employment paths of the most vulnerable populations.

2. Education as a factor driving economic growth and the productive transformation

Education can play a fundamental role in processes of economic growth and productive transformation. Initial growth theories in the 1950s saw it as a process of accumulation of physical and tangible capital; however, experience showed that much more than physical and tangible capital was required for growth. Attention shifted to the role of the world of work, and not just the number of workers, but their skills and competencies, what they could do and how well they did it, of course in combination with physical capital and technology.

Although there had been a broad consensus in many countries since the nineteenth century on the fundamental role of education for achieving prosperity and development, it is true that long before economists started to focus their attention on this and to incorporate this "intuition" into their growth theories, a number of economists "rediscovered" the topic and incorporated it into their theories and mathematical models of growth (Becker, 1964; Mankiw, Romer and Weil, 1992).

This gave rise to the concept of "human capital", according to which education and training were considered not only as a cultural and humanistic experience, but also as an investment; and not only of each individual to enhance his or her human development, but also of society at large to improve its growth, productive development and per capita income level.

Recognition of the role of knowledge in growth meant that diminishing, or even constant, returns, ceased to be the predominant elements in theories of growth and productive development. Innovation and new ideas were also capable of generating increasing returns, that is ever greater growth and productivity. This is why in modern knowledge societies, and according to the new technology-intensive production

paradigms, the role of education and vocational training is more important than before; and societies have long paid attention to the coverage and quality of education as part of their development and productive transformation strategies.

What is known and what is not known about when and how education drives or causes growth and when it does not? What kind of educational policies can help achieve a great productive transformation and improve social mobility? This was the topic of a lecture given by Lant Pritchett, one of the leading researchers on the subject, as part of ECLAC's 75th Anniversary celebrations. According to Pritchett, the answers to these questions can be summarized as follows.

The starting point is to recognize that: "the expansion of schooling since 1950 has been one of the most striking successes of humankind of the late twentieth and early twenty-first century" (Prichett, 2024). However, the relationship between education and growth poses an enigma, because many countries have produced massive expansions in schooling but have not experienced rapid and sustained growth. This suggests that the expansion of schooling is not by itself a "sufficient" condition for growth. Specifically, the empirical results show that there is no correlation between the percentage increase in enrolment rates and productivity growth. Part of the solution to this enigma is that education does not drive economic growth unless it succeeds in generating learning.

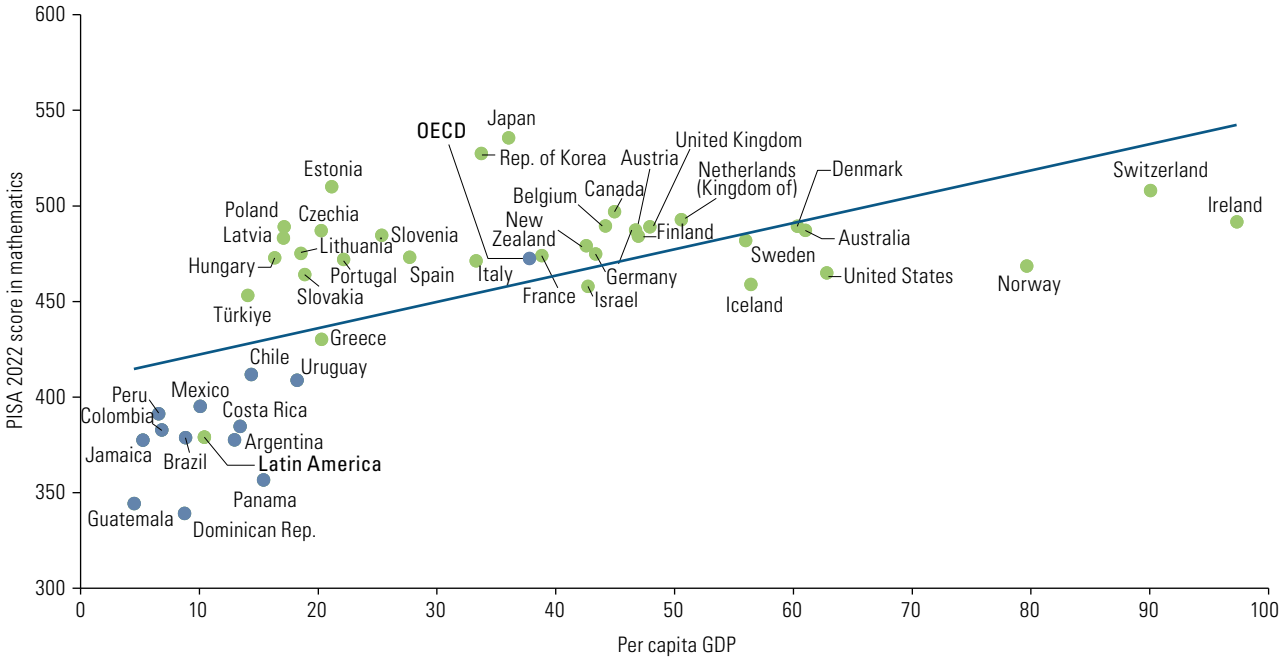
Between 1950 and 2015, the average number of years of schooling among 25–34 year-olds in Latin America and the Caribbean increased from 3.0 to 10.2 (most youth completed at least lower secondary education), which represents an extraordinary expansion. In fact, young people in nearly all Latin American and Caribbean countries had completed more years of schooling in 2015 than those in developed countries had in 1950. Thus, the region's failure to converge toward the labour productivity levels (GDP per worker) of the most advanced countries cannot be blamed on a failure to increase schooling rates as rapidly as developed countries. Moreover, not all the fastest-growing East Asian countries achieved a faster and more complete expansion of schooling than the countries of Latin America and the Caribbean: rates of schooling in the Bolivarian Republic of Venezuela and the Plurinational State of Bolivia increased at the same rate as those of the Republic of Korea.

According to Pritchett (2024), the reasons why increased schooling does not systematically lead to higher economic growth fall into two categories: (i) schooling is not producing the learning outcomes (skills, competencies, capabilities and characteristics) that lead to a labour force with higher productivity; and (ii) the economy is structured in such a way that, although the expansion of schooling is producing a labour force with greater productive potential, this "higher human capital" is not being deployed in the most dynamic and highest productivity sectors.

The data for the first category are clear: a country's economic growth is closely related to education when analysing indicators of student learning outcomes. Using a learning-adjusted years-of-schooling index, the correlations between education and growth and between education and per capita income levels are significant. In other words, a significant part of the growth deficit in Latin America and the Caribbean is due to deficiencies, not in terms of schooling, but in learning outcomes. The serious damage to learning caused by the pandemic threatens to further aggravate the region's ability to grow in the short and medium term.

Figure V.13 shows the positive association between education —in terms of learning outcomes as measured by the OECD's Programme for International Student Assessment (PISA) tests— and per capita GDP. However, unlike most OECD countries, Latin American and Caribbean countries show worse educational outcomes than would be expected given their level of economic development (below the trend line).

Figure V.13
Latin America and the Caribbean (12 countries) and OECD (37 countries): PISA 2022 results in mathematics[a] versus per capita GDP 2022,[b] by country



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD), *PISA 2022 Results (Volume I): The State of Learning and Equity in Education,* Paris, 2023; World Bank, World Bank Open Data [online] https://data.worldbank.org/.
Note: Simple averages. Chile, Colombia, Costa Rica and Mexico are included in the group of OECD countries.
[a] Mean of plausible values.
[b] Dollars at constant 2015 prices.

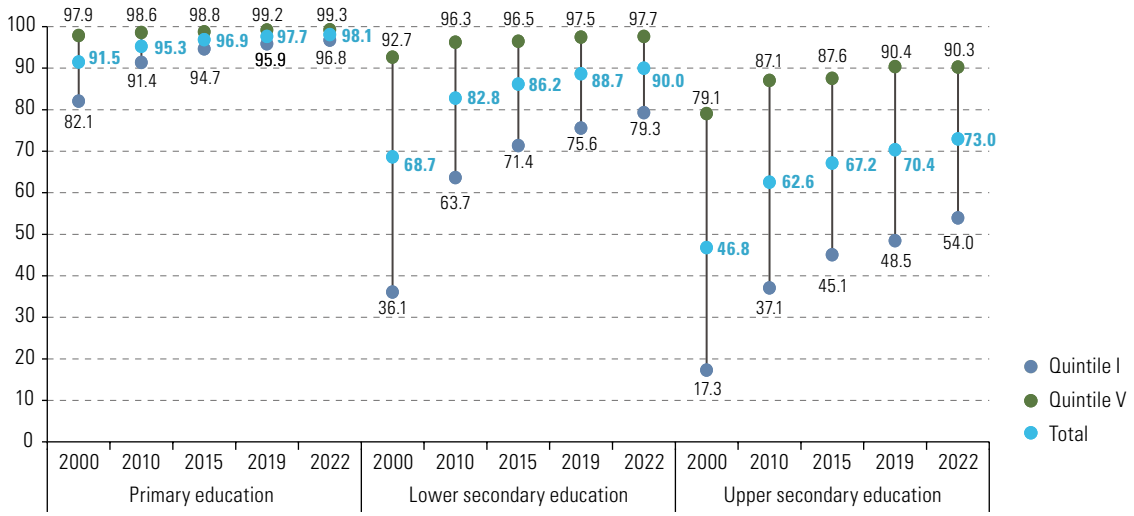
In short, over the last 50 years the region has successfully improved its rates of schooling, but now, to grow more, confront the challenges of its productive transformation and promote greater upward social mobility, it is an urgent priority to improve students' learning outcomes, albeit without neglecting the task of closing the gaps that exist in access to the education system. In other words, if the budget is increased, but the same old methods continue to be applied, the results will continue to disappoint. The great educational transformation that countries need to undertake to achieve greater prosperity and productivity and more quality employment is in fact a transformation of the quality of learning.

The second category of reasons mentioned by Pritchett, which would explain why a higher level of schooling does not in itself generate greater economic growth, even if it leads to better learning outcomes, concerns the failure to open up opportunities to productively deploy this more skilled and potentially more productive workforce. Expanding such opportunities is precisely the objective of the productive development policies discussed in chapter IV.

3. Educational inequality in Latin America and the Caribbean

Despite the significant progress that has been made over the last two decades in school education in the region, in terms of access, progression and completion, major coverage and quality challenges remain. Moreover, the rate of improvement observed in schooling indicators is flagging. Socioeconomic inequality significantly affects opportunities for access to education and, above all, its completion. Differences between income quintiles are still very marked in secondary education (see figure V.14).

Figure V.14
Latin America (14 countries):[a] completion rates in primary, lower-secondary and upper-secondary education,[b] in the extreme income quintiles, 2000, 2010, 2015, 2019 and 2022
(Percentages)

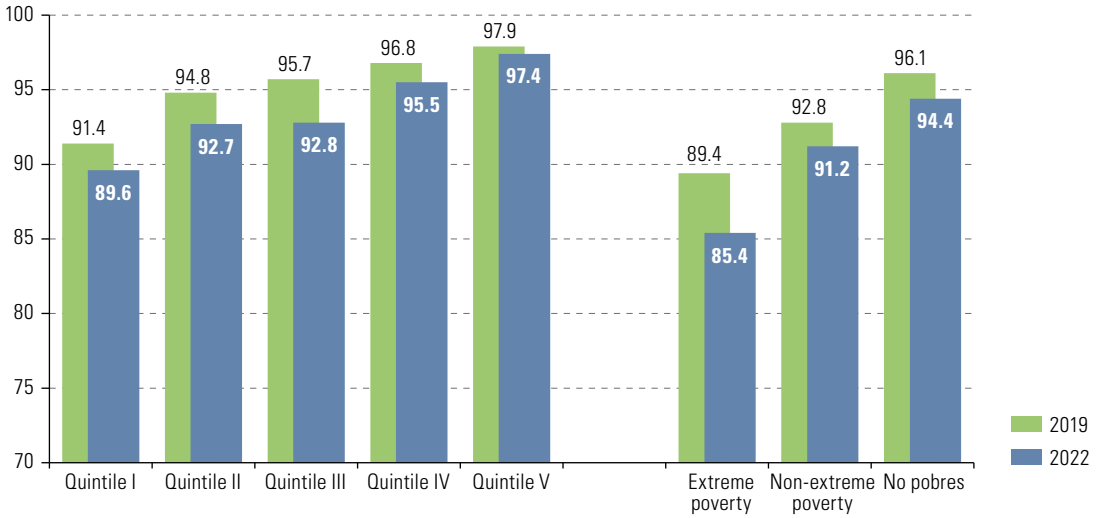


Source: Economic Commission for Latin America and the Caribbean (ECLAC), Household Survey Data Bank (BADEHOG).
[a] Weighted average of the following countries: Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Mexico, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.
[b] Primary school completion among population aged 15–19 and lower and upper secondary school completion among population aged 20–24 were reviewed.

The prolonged interruption of face-to-face education during the crisis caused by the COVID-19 pandemic had an uneven impact in this area (ECLAC, 2022b; Huepe, Palma and Trucco, 2022; UNESCO/UNICEF/ECLAC, 2022). The consequences of school closures during the pandemic were not the same for everyone. Existing inequalities were widened, resulting in slower recovery for certain population groups. Early childhood education was one of the worst affected educational cycles, experiencing a setback in age of entry. This effect was greater in the case of lower-income children. Figure V.15 shows that, in 2022, school attendance levels among students belonging to households in the first income quintiles were further behind those recorded before the pandemic than those of students in the fifth (wealthiest) quintile. The same trend is observed among students living in households in poverty (especially extreme poverty), whose attendance levels were even further below the pre-pandemic levels (ECLAC, 2024b; ECLAC/UNICEF, 2023).

The various indicators of educational achievement also display differences that originate in the structural axes of the matrix of social inequality in the region's countries (socioeconomic stratum, gender, ethnic and racial status, territory, life cycle, disability status and migratory status) (ECLAC, 2017b). These axes constrain students' educational pathways, often resulting in the reproduction of patterns of social inequality in terms of opportunities for social mobility. School dropout rates in the region increase from secondary education onwards; and the differences arising from these structural axes of inequality, as well as how they intersect and combine, can be seen more clearly. Thus, for example, the proportion of Indigenous People and Afrodescendants of secondary school age who are not attending school is greater than that of the non-Indigenous and non-Afrodescendent population. The gap is even greater in the case of Indigenous People living in rural areas (see figure V.16). It is essential to understand these and other differences, in order to develop and implement strategies to reduce and avoid interruption of schooling in a way that is more appropriate to the different needs of the marginalized population (ECLAC/UNESCO/UNICEF, 2024).

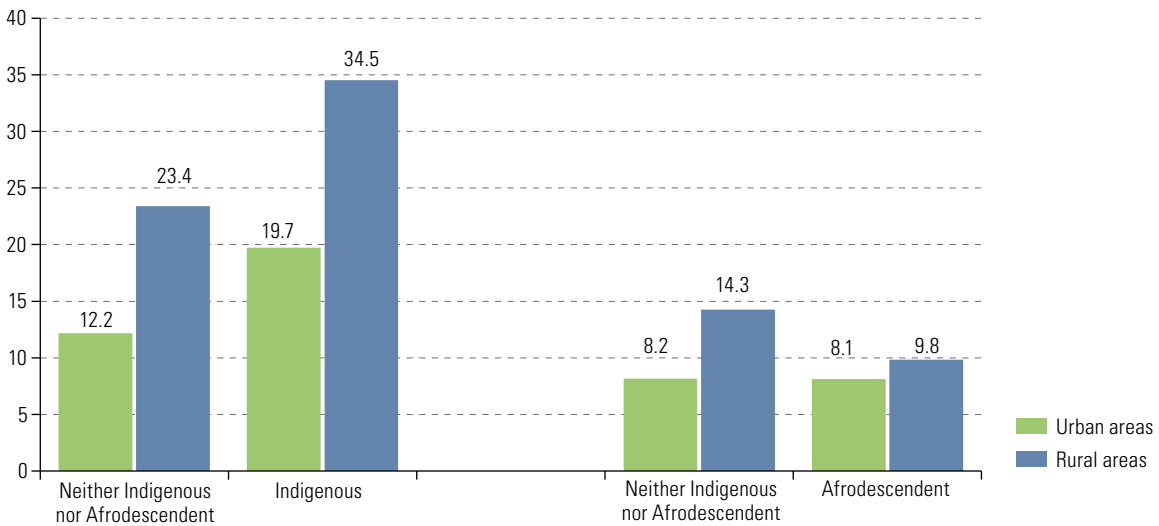
Figure V.15
Latin America (14 countries):[a] pre-primary attendance rate among children reaching the official age of entry into primary education within one, by income quintile and poverty status, around 2019 and 2022
(Percentages)



Source: Economic Commission for Latin America and the Caribbean/United Nations Educational, Scientific and Cultural Organization/United Nations Children's Fund (ECLAC/UNESCO/UNICEF), "Preventing and reducing school dropout in Latin America and the Caribbean", Santiago, 2024.

[a] Weighted averages estimated from information from the following countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Mexico, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

Figure V.16
Latin America (8 countries):[a] proportion of young people of upper-secondary school age not attending school, by area of residence and ethnic-racial status, around 2022
(Percentages)



Source: Economic Commission for Latin America and the Caribbean/United Nations Educational, Scientific and Cultural Organization/United Nations Children's Fund (ECLAC/UNESCO/UNICEF), "Preventing and reducing school dropout in Latin America and the Caribbean", Santiago, 2024.

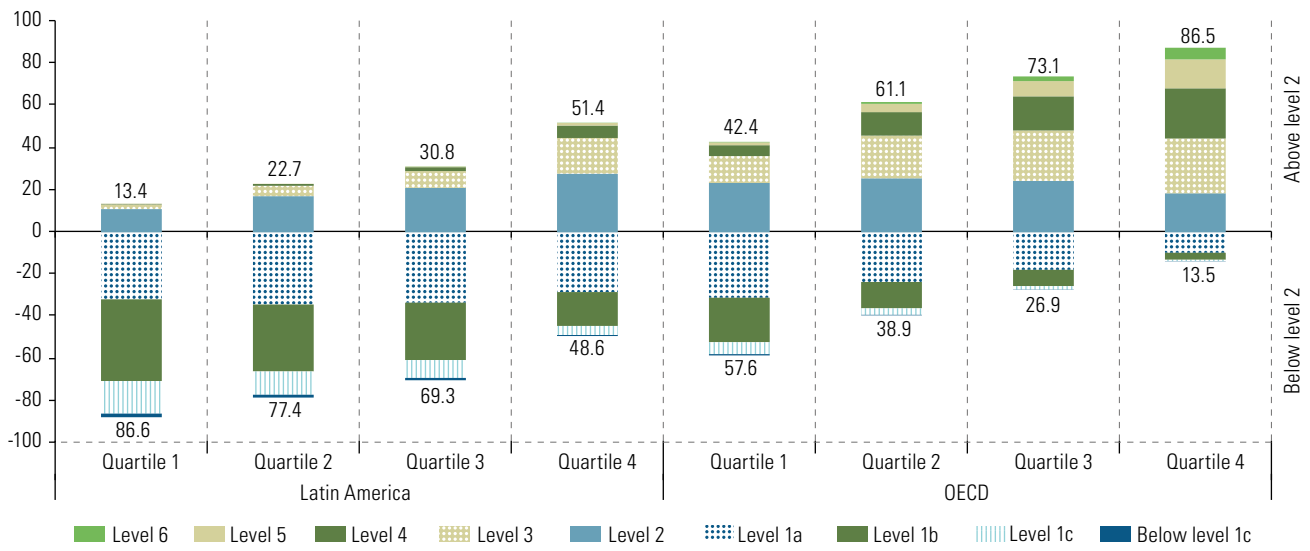
[a] The information on the Indigenous and neither Indigenous nor Afrodescendent population, bars 1 to 4, corresponds to the weighted average of the following countries: Brazil, Chile, Colombia, Ecuador, Mexico, Panama, Plurinational State of Bolivia and Uruguay.

The information on the Afrodescendent and neither Afrodescendent nor Indigenous population, bars 5 to 8, corresponds to the weighted average of the following countries: Brazil, Colombia, Ecuador, Panama and Uruguay. In the case of Colombia and the Plurinational State of Bolivia, the data correspond to 2021.

The educational challenge facing the region is twofold: there is an enormous debt in terms of inclusion and, at the same time, the region is going through a learning crisis (ECLAC, 2022b). It is not sufficient for people to complete their educational path; it is important to ensure that they achieve learning outcomes from it that are relevant to the challenges of a changing world. Despite being limited instruments for measuring education quality, international standardized tests provide approximate knowledge of learning outcomes in terms of basic cognitive skills, which are the minimum needed to be able to continue education throughout the life cycle. The results of these measurements at the regional level reveal major challenges and structural gaps.

According to the Regional Comparative and Explanatory Study (ERCE), conducted for 16 of the region's countries in 2019 by the UNESCO Office in Santiago, Chile, only 17% of sixth-grade students attained the minimum level of learning achievement in mathematics, and was 31% in the case of reading. Between 50% and 94% of lower-income (first quintile) students did not attain the minimum performance level in mathematics at primary school (ECLAC, 2022b). As noted above, the learning crisis was exacerbated after the prolonged interruption of face-to-face education during the COVID-19 pandemic. The results of the 2022 PISA tests revealed a deterioration in the average performance of the region's countries since the previous measurement conducted in 2018. Figure V.17 illustrates the achievement levels in mathematics proficiency among 15-year-old students assessed by the 2022 PISA tests. Students whose scores are below level 2 are considered to fall below the minimum level to be considered proficient in the subject. In contrast to results in OECD countries, most students participating in this test in Latin American and Caribbean countries do not attain the minimum level in mathematics at age 15 (see figure V.17). The situation is actually more serious considering that, in some countries, a large proportion of 15-year-olds do not attend school and so do not even participate in the measurement. Moreover, the results are highly unequal, since students who do not reach the minimum level of competency are disproportionately from the lowest socioeconomic and cultural level (for example, 86% of students in the lowest quartile).

Figure V.17
Latin America and the Caribbean (12 countries)[a] and OECD (37 countries):[b] average number of students at each mathematics performance level in PISA 2022, by socioeconomic and cultural quartile
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD), *PISA 2022 Results (Volume I): The State of Learning and Equity in Education,* Paris, 2023.

Note: Weighted averages.

[a] Countries included for Latin America and the Caribbean: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Guatemala, Jamaica, Mexico, Panama, Peru and Uruguay.

[b] Countries included for OECD: Australia, Austria, Belgium, Canada, Chile, Colombia, Costa Rica, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Kingdom of the Netherlands, Latvia, Lithuania, Mexico, New Zealand, Norway, Poland, Portugal, Republic of Korea, Slovakia, Slovenia, Spain, Sweden, Switzerland, Türkiye, United Kingdom and United States.

Although women, on average, have more years of schooling than men in most countries in the region, educational outcomes still display significant gender gaps. According to the PISA tests (OECD, 2023), women tend to outperform men in reading, but do worse in mathematics.

In OECD countries, the average number of students who do not attain the minimum level in each skill is much lower than in Latin American and Caribbean countries; and the gender gaps are smaller in the cases of reading and mathematics and non-existent in the case of science. These marked differences in performance by sex in the region influence the future educational and occupational trajectories of the students, and contribute to reproducing gender gaps in their employment paths, since occupations associated with science, technology, engineering and mathematics (STEM) —in which men are overrepresented— are not only better paid, but will be valued increasingly in the future.

4. How to enhance the role of education as a driver of upward social mobility?

Enhancing education as a social mobility mechanism requires an approach that encompasses the entire life cycle, from childhood to adulthood, focusing on development of the skills and knowledge needed to succeed in an increasingly uncertain and changing world. Effective education systems and broad access to vocational training are two of the factors that can help drive the major transformations needed to advance towards an inclusive social development model.

ECLAC (2022b) recommends continuing to expand the coverage of early childhood education, while making sure this is of high quality. The foundations of educational inequalities start to develop during the first few years of life, so increasing investment in education during this stage of the life cycle is a central hub of the public policy agenda to reduce inequality. Early childhood education has a long-term impact on an individual's cognitive development, increasing the return on future investments in education and enhancing labour performance and income in adulthood (Heckman and Masterov, 2007; Schweinhart, 2004; Rossel, 2023).

Bearing in mind that, in Latin America and the Caribbean, secondary education is the minimum level for ensuring inclusive social development and promoting the inclusion in the labour market, it is necessary to accelerate progress towards universal access to and completion of this level education, with an inclusive perspective (ECLAC, 2022b). Among other measures, transitions between different educational levels (from primary to lower secondary education and, subsequently, to upper secondary) need to be supported, as these are turning points at which many students truncate their educational trajectories.

Although the diversification of education supply has made it possible to expand the coverage of secondary education among historically excluded population groups, the expansion has gone hand in hand with the segmentation of students into educational tracks of different quality. These reproduce the region's structural inequalities and do not always develop the competencies needed to participate fully in society (ECLAC, 2022b). The objective should not just be to increase the number of years of schooling received, but also to improve the quality and outcomes of the corresponding education processes.

Completion of secondary school is the most important factor in improving students' access to higher education. This is the education level that generates the greatest economic returns, so promoting access to it is essential for achieving greater upward social mobility. However, this is not a sufficient condition by itself: improving inclusion in higher education also requires targeted strategies or affirmative action aimed at closing the access gaps and disparities in completion of studies that depend on factors such as socioeconomic level, gender, territory and ethnic-racial status. In the case of gender inequality, in addition to advancing towards policies of social co-responsibility for care, measures are needed to modify cultural stereotypes that result in women being underrepresented in careers of greater future demand and better pay, such as those related to the STEM subjects (ECLAC, 2022b; Valenzuela and Yáñez, 2022).

At the same time, expansion of the coverage of higher education, both technical and vocational, must be accompanied by initiatives to guarantee minimum quality standards that foster the development of the cognitive, socioemotional and digital competencies that make it possible to construct more productive and higher-income labour trajectories (Valenzuela and Yáñez, 2022). In the current context of uncertainty and rapid changes, both young people and adults must continuously train to update their skills (*upskilling*) or acquire completely new ones (*reskilling*), to be able to respond to the needs of labour markets, which are constantly changing. Thus, an education that aims to foster upward social mobility and reduce structural inequalities in the countries of the region does not end with the award of a higher education diploma, but continues to provide learning opportunities throughout the life cycle (ECLAC/OEI, 2020).

In addition to greater interaction between the education and productive sectors, placing education at the centre of a long-term development strategy also requires closer coordination between education policies and policies in other areas of well-being, such as health, care, social protection, transportation and youth. This would create the conditions needed for people to engage effectively in teaching and learning processes, and to make a better transition from the education system to the labour market (ECLAC, 2022b; Abramo and others, 2021). This multidisciplinary articulation also has governmental and institutional dimensions: coordination between ministries of education and their counterparts in the social, labour, economic and other domains, must continue to be promoted.

To enhance the role of education as a promoter of upward social mobility, ministries of education must strengthen their capacity to overcome institutional inertia and place education at the centre of a development strategy aimed at overcoming the region's twin challenges of low growth and high inequality. In particular, they need the vision and leadership to convene a broad group of public and private actors and forge a political, social and fiscal agreement that recognizes and strengthens the role of education in inclusive social development, which is the fundamental basis for sustainable development. Specifically, this requires formulating a development strategy in which education is considered a fundamental sector, with financial sustainability enabling it to implement stable educational policies while improving efficiency and equity in the use of resources. Table V.3 summarizes the TOPP capabilities needed to strengthen education systems.

Table V.3
Technical, operational, political and prospective (TOPP) capabilities of institutions that are needed to strengthen education systems

Capacities	Characteristics
Technical	– Strengthening of strategic planning and construction of a vision and leadership for managing consensuses on the importance of the role of education. – Strengthening of technical capacities to make education policies financially sustainable. – Consolidation of information systems, evaluation and monitoring of education policy outcomes and management.
Operational	– Maximization of the use of digital tools in educational management and improvement of teaching processes. – Strengthening of early warning systems to support the implementation of strategies targeted to students at higher risk of school dropout. – Monitoring of learning achievement as defined in the school curriculum and establishment of accountability measures. – Strengthening of the human resource policies of education ministries at the central and local levels, to enhance technical, professional and administrative capacities. – Strengthening of vocational teacher training and careers as drivers of educational transformation.
Political	– Definition and establishment of modalities of social dialogue mechanisms to manage broad agreements on educational policies. – Strengthening of coordination between education and other sectors (productive, social protection and health sectors, among others) to improve education supply. – Strengthening of the consistency and coordination of national policies with subnational and local ones.
Prospective	– Prospective determination of the skills that need to be developed to meet future labour demand by establishing a labour observatory or carrying out regular studies in each territory. – Establishment of curricular updating processes based on a participatory and prospective dialogue with all relevant stakeholders (experts, productive sectors, the Government, civil society, students). – Development of future scenarios to make education financially sustainable, in accordance with demographic changes and existing coverage gaps.

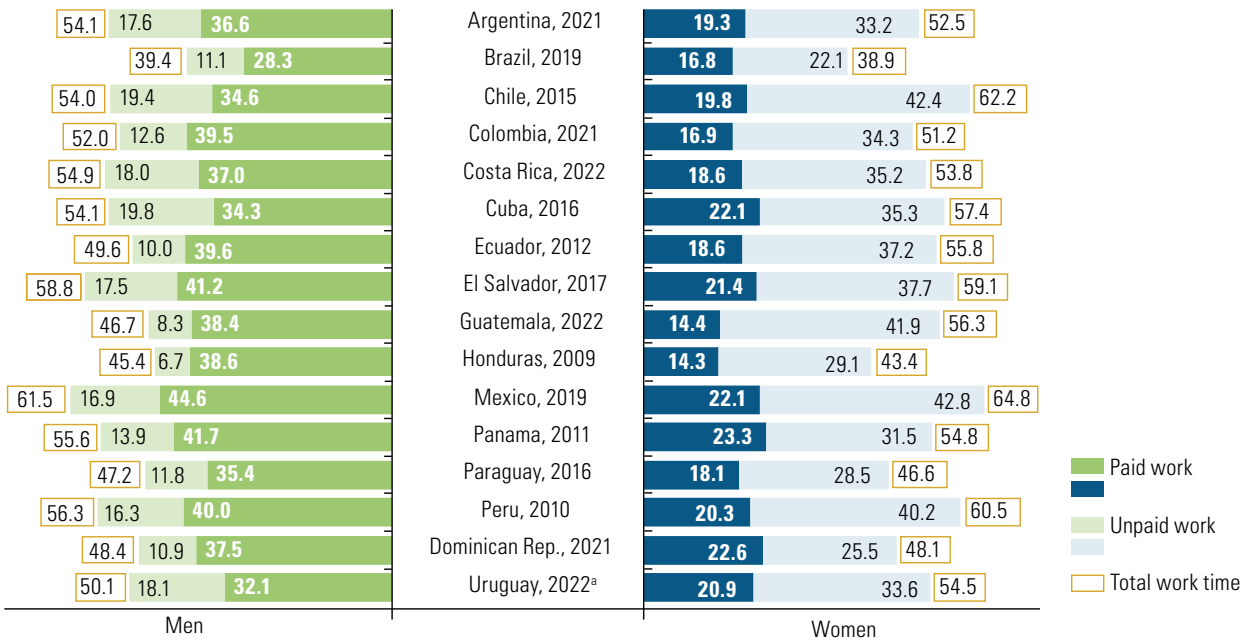
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

E. The care society: a development strategy for reducing inequality

One of the fundamental dimensions of inequality in the region is gender, which is included in the decalogue of structural gaps in the region's development (see diagram II.5).

In 2020, 67.4% of women aged 20–24 in the region had completed secondary school, compared to 60.9% of men in the same age group (ECLAC 2022b); and, in 2022, the gross female enrolment rate in higher education reached 65.7%, compared to a rate of 47.5% among men (ECLAC/UN-Women, 2024). However, these educational achievements have not been reflected in labour participation. In 2022, 50% of women in Latin America and the Caribbean were participating in the labour market, compared to nearly 75% of men (ECLAC, 2023a). According to time-use measurements conducted in various countries of the region, women spend three times as many hours as men on unpaid domestic and care work (see figure V.18).

Figure V.18
Latin America (16 countries): average total time spent by men and women aged 15 years and over on paid and unpaid work, latest year with information available
(Hours per week)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), Repository of information on time use in Latin America and the Caribbean.
Note: No regional average is presented because methodological differences mean that the data are not comparable between countries.
[a] Preliminary data.

The region is currently immersed in a care crisis, since there is a shortage of carers relative to current demands for care in the population, which stems from the fact that the sexual division of labour in households and in the labour market remains unchanged (ECLAC 2009 and 2020b; Fraser 2015). This crisis is exacerbated by population ageing, changes in epidemiological trends and the effects of climate change, which portend a sustained increase in the demand for labour in the care sector, whereas the time and number of people available to provide unpaid care is expected to decline (ECLAC, 2022b). Unlike other sectors, where productivity gains may reduce the need for labour, in the care sector the total demand for labour is expected to increase, despite the incorporation of new technologies (ECLAC, 2022b; ILO, 2019). In this context, it is essential to reorganize caregiving activities to galvanize economies through a sector that is expanding.

This diagnostic assessment reveals the need to strengthen the care sector, recognizing, redistributing and reducing unpaid work, and generating quality employment that represents those who work in it and pays them adequately. This would aim to achieve gender equality, improve social well-being and foster economic growth with decent employment. Investing in a care economy with a gender perspective is essential, not only for reasons of justice and inclusion, but also because it involves a strategic investment to energize the economy as a whole. For example, the implementation of comprehensive care systems[10] and policies to reduce and redistribute care work could encourage more women to enter the labour market. Estimations by ECLAC show that closing gender gaps in labour participation could boost the region's GDP by 6.9 percentage points between 2016 and 2030 (ECLAC, 2022c). Moreover, unpaid domestic and care work contributes between 15.9% and 27.6% of GDP to the economy, with 74.5% of this contribution being made by women (ECLAC, 2022c).

The care society thus emerges as a transformative proposal —a development model that places the sustainability of life and the planet at the centre, from a gender perspective and framed by human rights. The care society constitutes an essential alternative to the current development model that reproduces gender, socioeconomic, ethnic-racial and territorial inequalities.

Galvanizing the economies and constructing more egalitarian societies by strengthening the care economy require robust States with strong capacities. The State must create the conditions needed to ensure care as a human right and ensure the provision of quality care goods and services, irrespective of a person's economic, social, ethnic-racial or cultural conditions and throughout their life cycle. Although the State has a predominant role in the regulation and oversight of care services, the private sector, communities and families are key actors in the social organization of care. Achieving the transformation to a care society requires an intersectoral vision and efficient and articulated public management. This means establishing and strengthening long-term economic compacts and integrating the care dimension into all public policies, as established in the Buenos Aires Commitment (ECLAC, 2023d), as well as strengthening the relevant TOPP capabilities.

Managing the transformation to a care society requires strengthening capacities to adapt to change, adopting new paradigms and reorganizing existing structures. Institutional capabilities must be expanded to design economic, social, environmental and cultural programmes and policies with a territorial and intersectional approach that recognizes demographic, social, economic, cultural and territorial diversity. The countries of the region have identified the structural challenges that perpetuate gender inequality, and this has enabled them to target their strategies and action: socioeconomic inequality and the persistence of poverty; discriminatory and violent patriarchal cultural patterns; the sexual division of labour and the unfair social organization of care; and the concentration of power and hierarchical relations in the public domain (ECLAC, 2017c).

Developing and strengthening TOPP capabilities is essential for promoting effective policies that overcome these structural challenges and foster greater equality. These capabilities are also fundamental for advancing application of the Montevideo Strategy for Implementation of the Regional Gender Agenda within the Sustainable Development Framework by 2030, which serves as a roadmap organized in 10 pillars for implementing comprehensive policies (ECLAC, 2017c). A fairer and more equitable social organization of care promotes greater equity in the division of labour and power relations, in both the private and the public domains, thus contributing to closing gaps and reducing inequality in all its forms. Table V.4 specifies the TOPP capabilities that are necessary for moving towards the care society.

[10] Care systems are the harmonized set of policies, programmes, services and infrastructures that aim to ensure universal and equitable access to quality care services for all people throughout the life cycle (Bango and Cossani, 2022).

Table V.4
Technical, operational, political and prospective (TOPP) capabilities of institutions that are needed to develop a care society

Capacities	Characteristics
Technical	– Strengthening of analytical frameworks, compilation of data and systematization of research on gender and women's autonomy. – Strengthening of standardized methodologies and the use of classifiers such as the Classification of Time-Use Activities for Latin America and the Caribbean (CAUTAL), in some cases adapting them to the national context. – Design of labour policies that consider the care dimension. For example, the implementation of policies that allow for flexible working hours and guarantee labour rights, as well as paternal, parental and caregiving leave. – Development of management tools, such as the incorporation of geo-referenced information on the available supply of care, and systematization of socio-territorial aspects of the demand for care in digital platforms that facilitate decision-making on the implementation of care policies.[a]
Operational	– Effective implementation of labour policies that consider the care dimension, which requires not only time and monetary resources, but also strategies for professionalizing the services, the regulation of work through digital platforms and the construction of suitable working environments.[b] – Maintenance of financial sustainability for care policies and systems, since the implementation of a regulatory framework and capacity building requires sufficient budgetary funding to make policies sustainable, as well as fiscal and macroeconomic policies with a gender and human rights approach (ECLAC, 2021c; UN Women 2022).
Political	– Strengthening of democratic governance, promotion of social dialogue and establishment of consensuses. – Interaction and cooperation between government, civil society, the private sector and other stakeholders. – Promotion of mechanisms for collaboration and effective coordination between the different levels of government —national, subnational and local— to design and implement comprehensive care policies that recognize this as a shared responsibility. – Development of an institutional structure that guarantees intersectoral and inter-agency cooperation and coordination. This governance should allow for coordinated work between the different ministries and sectors, as well as between the various levels of government and different government agencies (ECLAC, 2022b and 2022c; Bango and Cossani, 2022).
Prospective	– Continuation of the region's drive to create intergovernmental mechanisms for monitoring and projecting trends that affect regional development, thereby making it easier to foresee future challenges, evaluate scenarios and create adaptive strategies. – Continuation of the region's efforts to foster a culture of regional dialogue that drives joint progress toward the future, on gender equality and women's autonomy, social and gender co-responsibility, sustainable investment in the care sector and its integration into macroeconomic policies, gender mainstreaming in the production of statistics and social protection systems, and other issues.[c]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023; Economic Commission for Latin America and the Caribbean (ECLAC), Social Panorama of Latin America, 2020 (LC/PUB.2021/2-P/Rev.1), Santiago, 2021; *Social Panorama of Latin America, 2022* (LC/PUB.2022/15-P), Santiago, 2022; *The care society: A horizon for sustainable recovery with gender equality* (LC/CRM.15/3), Santiago, 2022; United Nations Entity for Gender Equality and the Empowerment of Women (UN-Women), *Gender-Responsive Budgeting: A Roadmap for its Implementation from Latin American Experiences*, Panama City, 2022; J. Bango and P. Cossani, *Towards construction of comprehensive care systems in Latin America and the Caribbean: Elements for their implementation* (LC/TS.2022/26), Santiago, United Nations Entity for Gender Equality and the Empowerment of Women/Economic Commission for Latin America and the Caribbean (UN-Women/ECLAC), 2022.

[a] Analysing care in terms of its territorial dimension has meant compiling new data and reorganizing existing information. ECLAC has led efforts in this area by working with the District Secretariat for Women of the Office of the Mayor of Bogota to develop a map with georeferenced data on care. It has also provided technical assistance to the Government of Argentina in the development of the Federal Care Map (See ECLAC/IGO, Ministry of Women, Gender and Diversity, "Mapa Federal del Cuidado" [online]https://mapafederaldelcuidado.mingeneros.gob.ar/.

[b] See Bango and Cossani (2022); ILO Maternity Protection Convention, 2000 (No. 183); ILO Workers with Family Responsibilities Convention, 1981 (No. 156), and Recommendation on Workers with Family Responsibilities, 1981 (No. 165). The latter proposes measures related to parental leave to care for dependent children.

[c] The Regional Conference on Women in Latin America and the Caribbean has been meeting for more than 45 years to address issues of gender equality and women's autonomy; and care has been a central theme over the last 15 years. The importance of social and gender co-responsibility, sustainable investment in the care sector and the integration of these objectives into macroeconomic and fiscal policies have also been emphasized. The Statistical Conference of the Americas of the Economic Commission for Latin America and the Caribbean has also played a key role in the process of mainstreaming gender in the production of statistics and in the measurement of time spent on domestic and care work. The Regional Conference on Population and Development, together with the Montevideo Consensus on Population and Development, recognized the centrality of women's physical autonomy, comprehensive education on sexuality, and the implementation of comprehensive care policies to overcome the sexual distribution of work and achieve sustainable development. Similarly, the Regional Conference on Social Development and its Regional Agenda stress that comprehensive care systems are essential components of social protection systems, advocating their universalization and harmonization with other components to achieve universal, sustainable and resilient systems. The United Nations Water Conference emphasizes that the scarcity of access to water mainly affects women, who spend more time obtaining it, thereby harming their quality of life and job opportunities. It highlights the need to recognize their role in water management and implement inclusive policies (ECLAC 2024d).

F. Urban planning and management to reduce inequality and improve social cohesion

1. The Latin American and Caribbean city as an inequalities factory

Latin America and the Caribbean is the most urbanized region in the developing world. Its cities are epicentres of production and wealth creation, the largest energy consumers and also spaces in which profound social inequalities are expressed (ECLAC, 2022a).

According to each country's official definitions, in Latin America and the Caribbean, 8 out of every 10 people live in cities, and half of this population is located in the 74 cities of more than 1 million inhabitants that exist in the region (United Nations, 2019). Accordingly, reducing inequality and fostering the inclusion of a large part of the region's population undoubtedly calls for a significant change to the current urban development model. This entails understanding the historical dynamics and outlining various scenarios for the future.

Latin American urbanization, which is a mature and consolidated process, has been unable to shake off its original characteristic: informality. It has been said that, in Latin America and the Caribbean, the city is built first and then it is made. Informal occupation of land (which is a non-reproducible resource) and building without respecting government regulations persist as significant practices in the region's cities. The lack of inclusion in a society is made clearer when livelihood activities that take place on its margins. Given that housing is most households' greatest asset, accessing it in conditions that break the law and regulations is an unfortunate indicator of the weaknesses inherent in the current urban development model, because it reveals the failure of both the market and the public guarantee of a right.

In a city, exclusion has a very practical expression: spatial segregation, which means the differentiation and distancing of part of the population, which originates and is manifested in land occupation phenomena (Clichevsky, 2000). Seeking lower costs, low-income sectors are forced into peripheral locations or hazard zones. In the first case, households will then face high mobility costs and, in the second, they will be exposed to increasingly recurrent vulnerabilities owing to the impacts of climate change.

Another clear and palpable manifestation of inequality and social exclusion relates to overcrowded housing. This is an indicator of deprivation and implies a loss of well-being, as it entails lower levels of comfort and privacy for its inhabitants. Inequality in access to water, sanitation and electricity services, and their affordability, round out the picture.

Urban segregation is the result of a complex cause-effect iteration involving several dimensions: insufficient private and public savings and investments, land speculation, the political economy of decisions, weak planning and governance, and outdated institutional arrangements.

In short, the way a city is organized —the location and characteristics of housing; the quality and affordability of public services and access to them; land use and informal urbanization processes— both reinforces and reflects exclusion in society. Consequently, it is vital to adopt decisive public measures led by the government, incorporating the private sector and civil society. The following lines of action are proposed to address the problems identified.

2. Components of urban inequality

Urban inequalities should be understood as disparities in access to economic, educational, cultural and leisure opportunities. The spatial distribution of these opportunities in a city, and how they are accessed by households, play a fundamental role in determining the city's inclusiveness. The way in which society —explicitly or implicitly— organizes urban space is key to combating inequality and exclusion. Low-income households frequently occupy land outside the confines of urban planning, or build without observing the regulations, or both. In doing so they seek to participate in the city and its benefits, but their alternatives for accessing well-located housing are restricted by an exclusionary household budget constraint.

Exclusion originates in historical patterns of land occupation that discriminate against low-income households, which are confronted by higher transport costs (monetary and time) because they are located in peripheral areas where land is cheaper. However, the resulting difficulties in accessing job opportunities have negative repercussions on both individual well-being and urban productivity (see box V.1).

Box V.1
Urban productivity

Alongside inequality, one of the greatest problems of Latin American and Caribbean cities is low productivity. The need to change this situation has been recognized in the principles and commitments of the New Urban Agenda, adopted in 2016 in Quito. One of these is to "Ensure sustainable and inclusive urban economies by leveraging the agglomeration benefits of well-planned urbanization, including high productivity, competitiveness and innovation" (United Nations, 2017, p. 7).

Urban productivity can be determined by several factors. For example, institutions and the existence of a clear and well-defined metropolitan governance system are associated with higher productivity in Europe (OECD/ECLAC/CAF, 2014). Approaching cities as spatially bounded labour markets that grow on the back of agglomeration inspires studies such as Grover, Lall and Timmis (2021), which conclude that doubling city size increases productivity by 19% in China, 12% in India and 17% in Africa. In Latin America and the Caribbean, where there are significant differences between the urban systems of the countries in the sample (Brazil, Colombia, Panama and Peru), a 10% increase in city size generates wage growth of close to 1%, resulting directly from the gains obtained from agglomeration economies (Alves, 2021). In the case of Colombia, wages rise by 30% when urban density doubles, as a result of changes in wages based on educational level and increases in value-added (Araque, 2024) However, from the standpoint of optimal urban size, several Colombian regions, including Bogotá, display diseconomies of agglomeration (Araque, 2024), that is, the benefits that can be obtained from the spatial concentration of goods and services are inferior to the corresponding costs. Given that cities originate from the accumulation of activities and resources, it is crucial to understand the levels of concentration (generally measured by population) and the conditions under which cities signal that the costs of continuing to grow outweigh the benefits.

Congestion is a negative externality that can represent significant economic losses. In Buenos Aires and Mexico City, for example, the value of time lost due to congestion can represent 0.5% and 1.1% of local GDP, respectively (Calatayud and others, 2021). In the case of Trinidad and Tobago, the figure amounts to 1.4% of GDP (Phillips, Thorne and Chong Ling, 2023). Poorly functioning land and housing markets also conspire against higher levels of economic activity by restricting residential mobility, obstructing quick and cheap access to economic opportunities, and hindering a closer match between the supply of and demand for productive activities. Public policy should therefore consider the productivity impacts of: (i) having efficient transportation systems that reduce travel costs, improve access to economic opportunities, facilitate the movement of goods and people, and reduce congestion; and (ii) well-located and affordable housing.

Source: United Nations, *New Urban Agenda* (A/RES/71/256), New York, 2017; Organisation for Economic Co-operation and Development/Economic Commission for Latin America and the Caribbean/Development Bank of Latin America and the Caribbean (OECD/ECLAC/CAF), *Latin American Economic Outlook 2015: Education, Skills and Innovation for Development* (LC/G.2627), Paris, 2014; A. Grover, S. Lall and J. Timmis, "Agglomeration economies in developing countries: a meta-analysis", *Policy Research Working Paper,* No. 9730, Washington, D.C., World Bank, 2021; G. Alves, "Medición de los niveles de productividad de las ciudades en América Latina", *Policy Paper*, No. 6, Caracas, Development Bank of Latin America (CAF), 2021; A. Araque, "Productividad urbana: perspectiva y acciones de política pública", 2024, unpublished; A. Calatayud and others, *Urban road congestion in Latin America and the Caribbean: characteristics, costs, and mitigation,* Washington, D.C., Inter-American Development Bank (IDB), 2021; W. Phillips, E. Thorne and E. Chong Ling, "Assessment of the economic costs of vehicle traffic congestion in the Caribbean: a case study of Trinidad and Tobago", *Studies and Perspectives series,* No. 122 (LC/TS.2023/191-LC/CAR/TS.2023/8), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

Inadequate residential location also widens social gaps by hindering access to education services and recreational or cultural opportunities. It also imposes greater burdens on caregiving tasks, which fall disproportionately on women. For example, in Mexico City, 77% of journeys for shopping, bureaucracy and personal matters (dropping off, picking up or accompanying someone) are made by women. In addition, women spend more time travelling than men, by one third, reflecting a mobility pattern that is associated with care and less access to private vehicles (Samaniego and others, 2024).

There are also widening environmental gaps caused by the expansion of vehicle fleets in which private automobiles predominate in absolute terms. This responds to territorially expanding urban dynamics that involve longer journeys with the consequent time and costs involved. The rapid increase in the number of vehicles leads inevitably to congestion and longer travel times. This is a good example of the opportunity for a course correction: strengthening the public service as opposed to perpetuating a development model that gives primacy to the private car. It is vital to enhance the advantages of planned agglomeration, instead of haphazard urban sprawl.

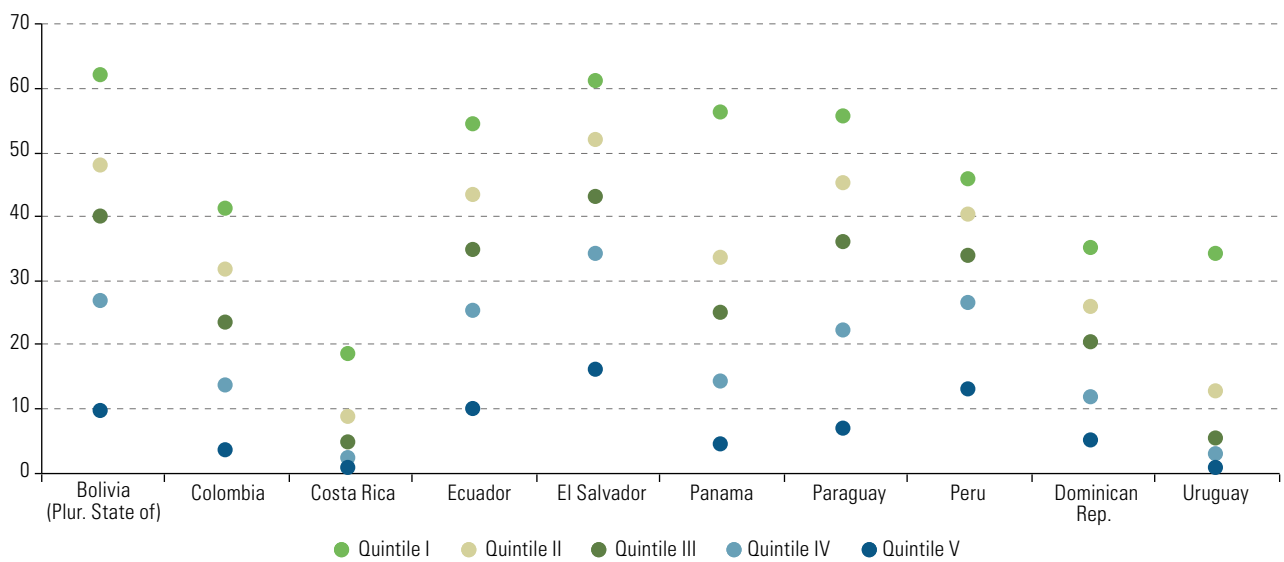
Despite their benefits, the efficiency and quality of public transport services have been threatened by their weak financial situation. In many cases, they face serious difficulties in maintaining the continuity of their operations, so it is critical to finance future expansions and/or technology changes. For example, in none of the region's four most populated cities (Bogotá, Buenos Aires, Mexico City and São Paulo) have the fares charged by the public transport subsystems (subway, rapid bus transit, bus, metropolitan trains, and so forth) been sufficient to cover the corresponding operating expenses (Sandoval, 2022; Goytia, 2022; Marín, 2022; Roman, 2022).

Consequently, if the service is reduced or made less frequent, citizens will find it harder to access certain city zones, which clearly promotes labour, cultural and educational exclusion. At the same time, households in the lowest quintiles of the income distribution are those that devote the largest share of their expenses to public transport: on average, 4.7% of expenditure in the first four quintiles (Samaniego and others, 2024), compared to 3.1% in the higher-income population. Accordingly, fare hikes will have repercussions on the budgets of these households.

Spatial segregation in Latin America and the Caribbean is also sustained by piecemeal approaches to public policy on urban infrastructure. Sector-specific approaches to intervention strategies that ignore the non-neutral nature of public investment often reinforce exclusion and inequity. Examples include the quality of public recreational facilities (the availability of playground equipment is a paradigmatic case).

In addition to location, the cost of land, along with the characteristics of housing and access to services such as transport, water and sanitation, are also related directly to the capacity for social inclusion and mobility in cities. Inadequate housing is another of the dimensions of poverty or deprivation. It has been shown that there is a direct relationship between poor-quality housing and school performance, the latter being a fundamental variable for achieving social mobility and breaking the poverty generating cycle (Cunningham and MacDonald, 2012; ECLAC, 2022b). The relationship between poor housing conditions and overcrowding in poor households was revealed even more clearly during the pandemic. It is interesting to note the incidence of these negative conditions in lower-income compared to higher-income households (see figure V.19).

Figure V.19
Latin America (10 countries): population living in overcrowded homes by income quintile, 2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] https://statistics.cepal.org/portal/cepalstat/index.html?lang=en.

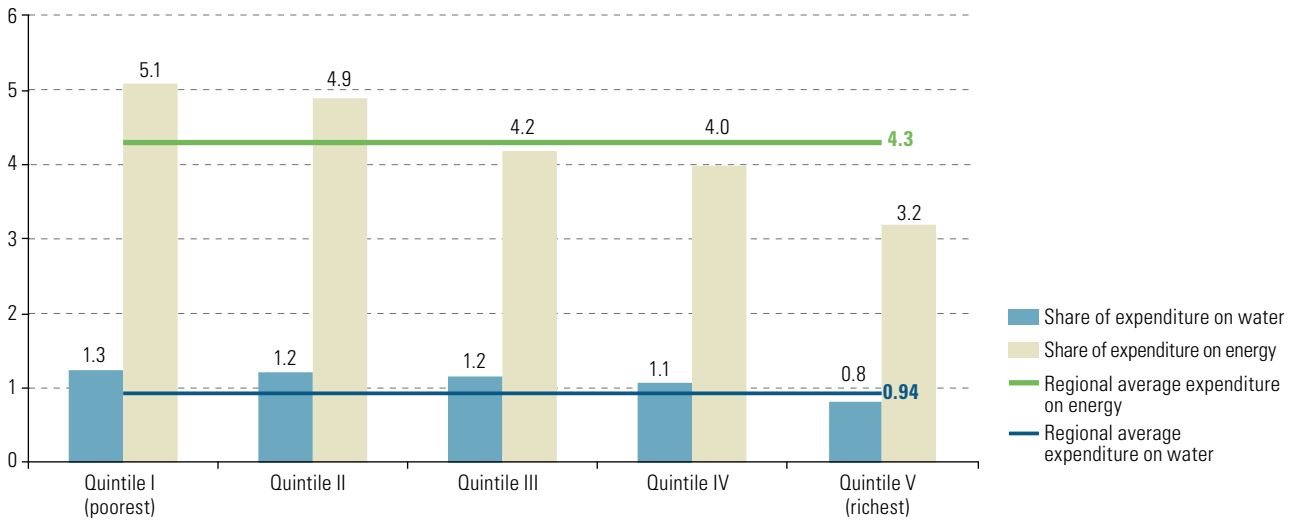
Access to water, sanitation and electricity services reveals and reinforces patterns of poverty and exclusion in Latin America and the Caribbean, both in the urban space and between urban and rural areas. There are currently 149 million people in the region without access to safe drinking water and 321 million without safely managed sanitation services (JMP, 2023). In the early 2020s, only 67% of the population was connected to a sewerage system, while in rural areas the figure barely reached 19%. Furthermore, only 34% of the population had access to a sewerage system that incorporated safely managed wastewater treatment (JMP, 2023), and only 41% of wastewater was found to receive treatment (UN-Habitat/WHO, 2021). This contrasts with the global average treatment rate of 55.5% and is well below the average for OECD countries of over 80% (Saravia and others 2022).

In terms of household energy use, although the number of families without access to electricity and clean fuels has decreased significantly in recent decades, in 2022 there were still 16 million people without access to electricity and 83 million without clean cooking systems, which entails serious health consequences. Moreover, the most vulnerable quintile is, on average, nine times less likely to have access to electricity than the highest income quintile; and the gap almost doubles among the rural population. In addition, more than a third of the Indigenous and Afrodescendent population lacks access to electricity.

Unequal access is expressed not only in the availability of infrastructure to provide services, but also in the relative cost to families. In the case of water and sanitation services, the most vulnerable quintile pays 1.6 times more as a proportion of their expenses than the richest quintile (see figure V.19), and the most vulnerable population receives lower-quality services. Compounding the above is unequal consumption of water and sanitation services, which increases with wealth, since the two highest income quintiles together consume more than half of the services provided in the sector (55.1%).

Although 99% of the population in urban areas has access to energy (electricity and fuels for cooking and heating), the availability of income also determines expenditure on this item. The lowest-income quintile devotes an average of 5.1% of its total expenditure on energy, compared to just 3.2% in the case of the highest quintile (see figure V.20). Added to the fact that lower-income households spend more of their income on these services, the quality of service is also unequal, thereby exacerbating energy poverty and social inequality.

Figure V.20
Latin America (17 countries):[a] average share of water and energy in total expenditure by quintile, latest year with information available
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), Household Survey Data Bank (BADEHOG).
Note: The data presented are averages that may vary significantly between countries. In addition, energy subsidies can also influence household spending, especially for lower income groups.
[a] Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

Although this section highlights urban inequality, given the huge importance of these geographic spaces in the region, reducing the gaps that exist between rural and urban areas is a central challenge facing Latin America and the Caribbean (see box V.2).

Box V.2
Structural gaps between urban and rural areas

Latin America and the Caribbean display major structural gaps, both between rural and urban zones and between the various territories. In different studies for the countries of the region, Rivas Valdivia and Gaudin (2021) find that, despite progress, the gaps between rural and urban areas are deep and persistent; and they are diminishing very slowly and unevenly. The region is characterized by very wide disparities between rural and urban incomes; poor access to both education and adequate health services in rural areas compared to urban ones; low productivity in the countryside; less financial inclusion; and deficient public goods and services and infrastructure in rural areas. These inequalities intersect and are reinforced throughout the life cycle; they interact through simultaneous or cumulative processes, generating hard cores of poverty.

Statistical data indicate, for example, that a larger proportion of the rural population lives in poverty or extreme poverty than in urban areas. Although both categories of poverty retreated in rural and urban zones in Latin America and the Caribbean between 2001 and 2022, the incidence of poverty and extreme poverty still differs widely between cities and in rural areas; and the extent of the differences did not narrow significantly. In fact, although the poverty and extreme poverty gaps narrowed, this resulted from a rise in the rates of both categories of poverty in urban areas between 2013 and 2022 (convergence to negative levels). Thus, the rural-urban gap and the poverty trap confronting the population of Latin America and the Caribbean clearly persist.

Reducing all of the gaps through a single, comprehensive public agenda would be difficult in a situation of scarce public resources. Accordingly, it is necessary to identify and prioritize specific gaps and establish a collective drive to create synergies and focus efforts locally, with the aim of reducing the gaps and paving the way for a more productive, inclusive and sustainable future.

Source: J. Rivas and Y. Gaudin, "Diagnóstico de las brechas estructurales en México: una aproximación sistémica general", *Project Documents* (LC/TS.2021/207-LC/MEX/TS.2021/26), Mexico City, Economic Commission for Latin America and the Caribbean (ECLAC), 2021.

3. The financing challenge

In terms of the financing of urban development, and despite the principle that the city should finance its own development, it should be noted that little revenue is collected from real estate taxes. Given that two-thirds of the world's total wealth is concentrated in land and real estate (Woetzel and others 2021), it is striking that the countries of the region recover barely 0.9% of GDP from taxes on this item. This figure represents half the European average and only 4.0% of total tax revenues at the national level (OECD and others, 2023a). In recent years, the central government budget allocation for housing programmes and community services has been around 0.6% in Latin America and 1.0% in the Caribbean, which is insufficient to address the major backlogs that exist in this area (ECLAC, 2023b).

Financing and investment in basic services is also insufficient. For example, achieving universal access to safely managed drinking water and sanitation throughout the region would require investments equivalent to 1.3% of regional GDP every year for a decade (ECLAC, 2024c). It is essential to mobilize long-term public financing to reduce infrastructure gaps, as the return on such investment generates social and environmental benefits. In the face of fiscal constraints, it is equally important to rely on the private sector, although it provides services to less than 5.0% of the urban population in Latin America and the Caribbean and is highly concentrated in a few countries. It is also essential to ensure that users pay the cost of the service. In the region, average household spending on water and sanitation services barely reaches 1.0% of total family expenditures. According to international studies, the average household expenditure should be between 3.0% and 5.0% to achieve adequate maintenance of the provision of these services (Komives and others, 2006).

4. Action to achieve SDG 11: making cities and human settlements inclusive, safe, resilient and sustainable

Sustainable Development Goal 11 (on sustainable cities and communities) is the Goal most closely related to urban inequality and exclusion. However, achieving it poses major difficulties, because the reduction in the percentage of the population living in slums reversed in the middle of the last decade. In addition, information is only available for a few of the targets, and there is a risk that they will not be met (ECLAC, 2023c and 2024d).

The following strategies are included to overcome the stagnation and weakness of the indicators and meet the challenges mentioned in the previous section:

- Strengthening of public policy coordination through a big push for sustainability, in which its various dimensions are structured: planning, regulation, investments, institutional framework, management and incentives.
- Adoption of an integrated approach to urban development, highlighting the synergies and shared benefits derived from sectoral interventions. Examples of this are the industrial and manufacturing opportunities created by the electrification of public transport fleets or the development of distributed energy. Public policy fragmentation prevents taking advantage of opportunities to achieve social inclusion processes, while neglecting the interrelationships that could be exploited if, for example, regulatory or investment coordination were intensified.
- Higher levels of public and private investment to:
  - Achieve universal access to basic water, sanitation and electricity services and clean fuels.
  - Increase the availability of (quasi) public goods at the local level: cultural facilities and parks, among other items, which foster inclusion and guarantee the right to the city.
  - Facilitate broader and prudent access to long-term financing for home purchase, construction, expansion and renovation.
  - Promote specific public bank financing mechanisms aimed, for example, at expanding coverage and improving public services or neighbourhood improvement programmes, and increasing the supply of affordable urban land.
- Wider application of public policy instruments (permits and regulations) that promote smart densification of cities, facilitating mixed uses (housing and commercial) to foster inclusion and mitigate urban segregation.
- Promotion of urban renewal programmes based on a circular economy perspective that promotes the reutilization of abandoned buildings in consolidated city zones, facilitating the integration of new occupants into the existing urban fabric that already has access to public services and a good location, thus improving social inclusion. This can be promoted through the creation of fiscal land banks, using State-owned assets, that should be prioritized for social housing and public facilities.

In addition, the constraints imposed by inadequate housing location can be overcome through two major strategies. Firstly, a compact city should be nurtured that reduces the need to travel and, therefore, generates less pollution and energy consumption. In other words, the aim is to promote smart densification to take advantage of agglomeration economies. Secondly, it is necessary to increase the supply of housing on a sustained basis, making sure that it is well located and affordable for households. Support for access to housing should include not only owner-occupied and recently built homes, but also improvements and extensions, including the (qualified) acquisition of existing housing units. This would generate greater liquidity in the real estate market, reduce the large qualitative deficit, be a cost-efficient option and support consolidation of the built city.

In general, a wider range of alternatives for accessing housing is required, since sociodemographic changes impose different needs than in the past, which are expressed in several housing submarkets. In recent years, the number of home-owning families has been steadily declining and currently stands at 66% —more than

4 percentage points lower than in 2010 (ECLAC, 2024e). While increased residential mobility facilitates labour market integration, it is also true that difficulties in gaining access to property, especially for younger people, could impair social cohesion by diminishing the sense of belonging to a local community.

Local governments need greater financial autonomy, to be able to generate their own resources for the construction of urban infrastructure. Aside from the obvious role of property tax, there are three major areas of intervention:

(i) Partial capture of the increase in land values resulting from public investment or urban regulation.

(ii) Harnessing of mobility investments with the opportunities arising from them to create new sources of income.

(iii) Implementation of systems of charging for basic public services that reflect maintenance and operating costs and are supported by regulatory frameworks that promote efficiency and take ability to pay into account.

In the first case, there are practical experiences that demonstrate the potential of land-based financing mechanisms. Some instruments, such as revaluation or the special contribution for improvements, are deeply rooted in local government regulations and action in several of the region's countries. When these instruments are applied, the cost of public investment is distributed among the properties that benefit from the works in question. Although updated and reasonably complete cadastres are needed as far as possible, the barrier to their implementation is political.

The second case refers to urban operations promoted or executed by public entities, such as transport system operators. Examples include real estate projects that capitalize the benefits generated by investments in new mobility infrastructure. Exploiting land reserves or the greater densities made possible by the new investments, and the adaptation of regulations, provides a potential funding source, while offering the possibility of encouraging mixed land use and fostering social inclusion.

Lastly, another way forward that is simpler to implement in the short term involves adopting measures that increase revenue and articulate land use and mobility, such as charges for the use of public space (parking), congestion charges and regulations stipulating parking requirements in real estate projects. These measures also discourage the use of private cars, which helps to reduce congestion and pollution. Nonetheless, they must be accompanied by strategies that improve the quality of public mobility.

5. Ways to address the challenges in moving towards inclusive cities

Implementing the measures described above requires a major effort by several actors. Multilevel coordination and inter-agency coordination are essential to advance along the path of sustainable urban development.

National governments should plan their interventions in the territory in conjunction with local authorities. Given that 25% of investments in the region are executed at the subnational level, it is essential to reduce the bureaucratic and administrative barriers that exist between entities, and to explore the advantages of metropolization and local government associations (Radics and others, 2022). Of the 29 countries in the region that have specific ministerial portfolios for housing or urban development, only four incorporate water and sanitation, and only three include mobility among their responsibilities. This is a clear manifestation of the large gap that makes it impossible to formulate integrated and coherent policies. It is therefore crucial to strengthen capacities and modify institutional arrangements, in order to achieve a new vision of the city and engage in a permanent dialogue with the private sector and civil society, to thereby enable the State to provide responses that meet current challenges.

The new realities and the economic, socio-demographic, political and cultural challenges of Latin American and Caribbean cities will not be resolved with institutional arrangements designed to address 20th century problems. It is vital to promote new public policy perspectives that are not limited to conceiving urban development primarily as a physical and spatial problem, with a future evolution dependent on the conditions of the past.

Realizing that there is no single deterministic future, a participatory process is needed that allows for the creation of future scenarios that are more than extrapolations of current trends (UNDP, 2018). Consequently, a narrative should be developed that incorporates the multidimensional nature of urban development, recognizes the existence of institutional patterns conditioned by the past (path dependence) and includes the formulation of potential future scenarios from a political economy perspective.

This new narrative should pay special attention to inclusion and productivity, an essential pairing that requires mutual reinforcement. The following elements, at a minimum, must therefore be included:

- Prioritize the potential of inclusive urban policies, such as smart densification, increase in the quality and financing of public services, and improvement of the location of housing and the functioning of land and housing markets.
- Highlight the role of the city as a factor of production, particularly the importance of agglomeration as a driver of urban productivity.
- Raise public awareness of the role of the State, at both the national and the local level, in creating and multiplying wealth through urban regulation and public investment.

A good narrative without technical, operational, political and prospective capabilities will not succeed in changing the urban development model. Moreover, overcoming ineffective governance requires clear public leadership, social dialogue among development stakeholders and overt linkage between the participatory construction of future scenarios and the use of public management tools.

These considerations clearly demonstrate the need for an urban transformation rather than a transition.[11] The following table sets out the institutional capabilities that are needed to drive such a transformation, based on the conceptual framework described in chapter III.

Table V.5
Technical, operational, political and prospective (TOPP) capabilities of institutions that are needed to progress towards inclusive cities

Capacity	Characteristics
Technical	– Integration of the various dimensions of urban policy —economic, social and environmental— overcoming the vision of watertight compartments. – Production of empirical data on the outputs of urban interventions and infrastructure and their impacts on inclusion and equity. – Propagation of the view that a well-functioning city makes a significant contribution to the national economy. In the world's most urbanized developing region, higher city productivity contributes to national development. – Deepening of coordination between national urban policy and the strategies promoted by local governments. – Adoption of the view of the city as a system, in which the result is greater than the sum of its parts. – Updating of institutional architecture designed to meet the challenges of the twentieth century but is unsuitable for new challenges.
Operational	– Expansion of the capacities of institutions responsible for urban planning to incorporate cross-cutting visions. – Implementation of mechanisms that compile and process timely data on urban activities to inform action strategies (smart cities). – Use of technology and big data to optimize the supply of public utilities and mobility services. – Generation of financing —via land-based instruments— for green infrastructure to expand coverage and improve the quality of public services and both public and semi-public goods. – Optimization of linkages with the private sector and civil society in the design and monitoring of public policy and its projects. – Influence on the formation of new public management teams based on the new narrative and aware of the importance of analysing impacts, not just outputs.
Political	– Government leadership in the formulation of shared comprehensive visions for the city, fostering trust and cooperation among stakeholders. – Creation of a new narrative on the need to view the city from different perspectives, beyond the physical-spatial dimension. – Respect for the competencies and knowledge of local authorities, guaranteeing their participation in the design of national public policy and intervention strategies. – Implementation of mechanisms for public consultation and participation in planning processes, which could follow the guidelines of the Regional Agreement on Access to Information, Public Participation and Justice in Environmental Matters in Latin America and the Caribbean (Escazú Agreement).
Prospective	– Definition of future scenarios that could affect the city in strategic urban planning instruments. – Differentiation between desired and feasible scenarios, building them collectively and with the presence of multiple stakeholders. – Identification of trends in the demand for urban services based on sociodemographic developments and changes in the city's economic base.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

[11] The concept of "transformation" expresses the need to significantly and modify structural pattern of urban growth. In contrast, a transition would mean moving from one point to another without making significant structural changes.

G. Summary

Latin America and the Caribbean continues to be the most unequal region in the world. As noted in chapter II, the region is trapped by high inequality and low levels of social mobility and cohesion. Inequality in the region encompasses other domains in addition to income, such as the exercise of rights, the development of capabilities and access to power and decision-making. These, in turn, are associated with low levels of social mobility and cohesion, resulting in a vicious circle of mutual reinforcement.

This chapter analysed the six causes that ECLAC considers central to explaining this trap. Firstly, income inequality and low social mobility are rooted not only in low rates of economic and productivity growth, but also in the productivity gaps that exist between different sectors, firm sizes and subnational territories. Secondly, the region's tax systems generate insufficient revenue to meet public spending needs, and their structure is biased towards indirect taxes, which are inherently regressive. Thirdly, labour markets in the region are characterized by a very heterogeneous productive structure, with scant creation of productive and decent jobs, high unemployment rates and strong segmentation. This is reflected in the fact that nearly half of employment is informal and thus more precarious. Latin America and the Caribbean also displays large gaps and inequalities in access to social protection. Fourthly, the region shows significant disparities in the educational attainment of different population groups according to income level, gender, territory, and ethnic and racial status, among other factors. These disadvantages are evident in the labour market and in opportunities for labour inclusion. Although the region has successfully improved its schooling rates over the last 50 years, it must now urgently prioritize improving learning outcomes. Fifthly, gender inequality is one of the fundamental dimensions of inequality in Latin America and the Caribbean, which is why it is included in the decalogue of structural gaps in the region's development proposed by ECLAC (Salazar-Xirinachs, 2023). The unequal and unfair distribution of care tasks is a central driver of gender inequality in the region. Lastly, urban areas, where 80% of the region's total population lives, are characterized by high levels of inequality and marked spatial segregation, which is manifested, for example, in differentiated access to water, sanitation, electricity and transportation services.

Breaking from the trap of high inequality and low levels of social mobility and cohesion facing Latin America and the Caribbean requires developing integrated and coordinated public policies that simultaneously address the root causes of the trap. This chapter recommends measures that could be adopted by the Governments of Latin America and the Caribbean to overcome the trap of high inequality and low levels of social mobility and cohesion in each of the six causes analysed (the "what"). It also analyses how they can adopt them (the "how"), which is related to the development of TOPP capabilities and the strengthening of governance. The latter is a distinctive element of this document, which is also discussed in chapters IV, VI and VII.

Developing TOPP capabilities is essential to comprehensively and efficiently address the six causes of inequality identified here. The tables at the end of each section listed a range of issues, such as: the knowledge and skills that should be promoted among the institutions and individuals tasked with designing and formulating policies to reduce inequality; the key characteristics that policies should have in each of the six areas; the opportunities for establishing monitoring and evaluation mechanisms; the centrality of financial resource management and the need to foster dialogue among actors and improve coordination among the different levels of government, as well as the importance of carrying out collective prospective exercises.

Strengthening governance and social dialogue is key to processes such as the formulation and implementation of social policies and social protection policies, through multilevel and multi-stakeholder mechanisms; the harmonization of lasting fiscal pacts; horizontal and vertical coordination between levels of government and with key social development actors, to promote the structural transformations needed to move toward inclusive social development; and the promotion of public leadership practices, social dialogue and participatory construction of future scenarios that contribute to reducing territorial gaps, among other actions.

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CHAPTER

VI

How to promote sustainability and address climate change?

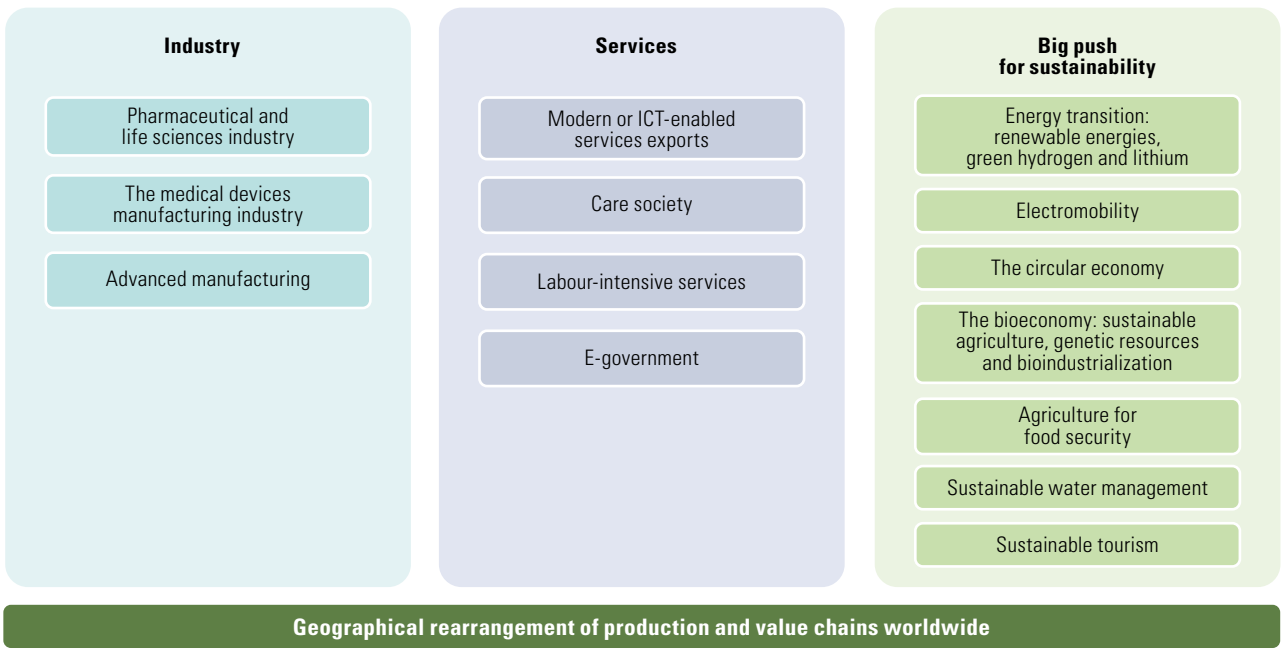
Introduction

As noted in previous chapters, lacklustre economic growth with scant creation of quality employment, accumulation of unsatisfied demands, environmental degradation and increasing climate disturbances, exacerbates socioenvironmental conflicts, erodes the population's trust in institutions and places discussion on how to achieve just, responsible and sustainable transitions at the centre of the agenda.

Environmental sustainability —as both an opportunity and a problem— is already playing a significant role in domains such as competitiveness, productive development policies, the adoption of new technologies, innovation, market decisions and policy options for economic growth strategies (De Miguel and Sánchez, 2023). The challenge is to take advantage of the region's opportunities for productive development and competitiveness in sectors that are essential for the global carbon transition, while making the most of traditional comparative advantages, but acting responsibly and ensuring that the costs and benefits are distributed fairly.

The environmental dimension is thus an integral part of the new growth and development strategy proposed by ECLAC, which focuses on growth-driving sectors such as those shown in diagram VI.1. Although this was presented in chapter II, it is reproduced here because of its relevance for understanding the content and structure of this chapter. Many of these growth-driving sectors correspond to what have been called the "big push for sustainability". The great transformation for productivity being proposed is a paradigm shift in the region's economic growth: its objective is not only to achieve higher and more sustained rates of growth, but also growth that is more inclusive and sustainable, as explained in chapter IV. The sectoral analyses performed in this chapter will make this point clearer and shed light on how to promote the transformations needed in each of the sectors considered.

Diagram VI.1
Growth-driving sectors for the great productive transformation



Source: J. M. Salazar-Xirinachs and M. Llinás, "Towards transformation of the growth and development strategy for Latin America and the Caribbean: the role of productive development policies", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2023.

These growth-driving sectors, which will vary across countries, would have the capacity to promote productive transformations that enhance inclusiveness and environmental sustainability, in addition to generating synergies and feedback effects to strengthen the region's growth. As shown in diagram VI.1,

the sectors prioritized by ECLAC that would contribute to sustainability and address climate change include: energy transition (renewable energies, green hydrogen and associated mining resources such as lithium); sustainable mobility, including electromobility; the bioeconomy, which would encompass sustainable and regenerative agriculture, the use of genetic resources, bio-industrialization, among other elements; sustainable water management; ecotourism and sustainable tourism; and the circular economy (Salazar-Xirinachs, 2023; Salazar-Xirinachs and Llinás, 2023; ECLAC 2022).

This chapter firstly addresses the challenge of climate change as the driving force behind many of the transformations that will provide productive opportunities for the region; and it then analyses the situation and development of the aforementioned driving sectors. The presentation starts with the energy-transport- minerals pillar, representing three sectors that are critical for the transition. It then considers growth-driving services related to water and tourism; and, lastly, it references two economic transformations: the bioeconomy and the circular economy. In all cases, the chapter analyses the institutional capacities needed to address the transformations in each sector and the necessary aspects of governance and social dialogue. It ends with an analysis of the virtuous circle that exists between the institutional framework, environmental performance and technological transformations.

A. Climate change: driving transformations and economic growth

The impacts of climate change and the responses to this phenomenon are shaping the global economy. The transition to a low-carbon economy will require a structural transformation of unprecedented scale, scope, and speed (IPCC, 2023; Pisani-Ferry and Mahfouz, 2023). The changes involved are driven by policy action, in particular productive development policies.

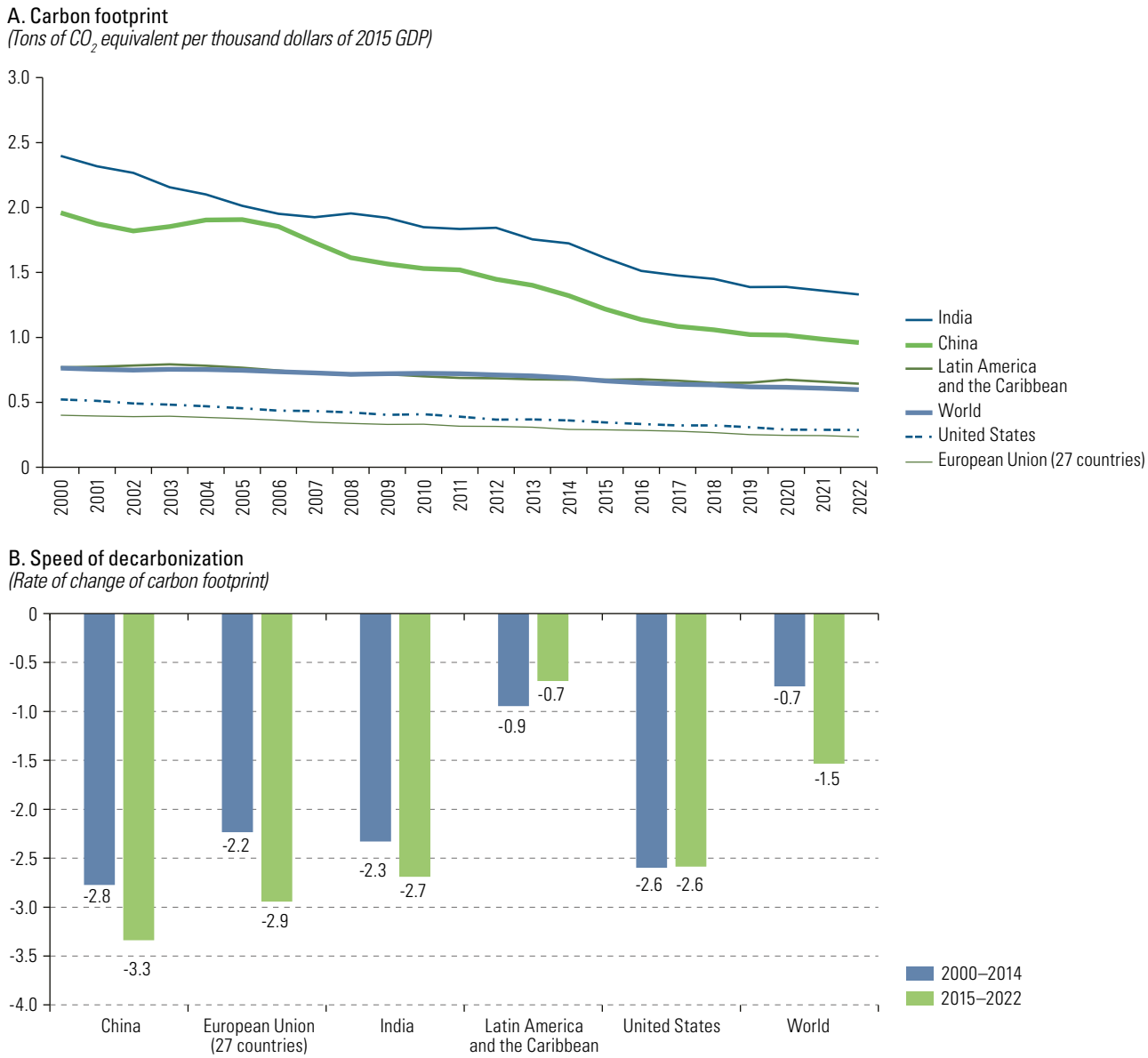
The scientific community has estimated that the world needs to decarbonize rapidly, to keep the temperature rise below 2°C and preferably below 1.5°C. The 1.5°C scenario requires emissions to be cut by 43% from their 2019 levels by 2030 and by 84% by 2050; whereas the 2°C target requires reductions of 21% by 2030 and 64% by 2050 (IPCC, 2023).

Emissions are closely tied to economic activity. However, technological development and other productive changes have weakened this relationship over time, leading to lower emissions per unit of global output. This decoupling is the result of developments such as improvements in energy efficiency, a larger share of renewables in the energy matrix and the spread of electromobility. However, the pace of decoupling is far slower than what is needed to achieve the aforementioned goals.

In 2022, the world emitted an average of 0.6 tons per thousand dollars of 2015 GDP, compared to 0.8 tons in 2000. This indicator is a measure of the economy's carbon footprint. Globally, between 2000 and 2014, the economy decarbonized at a rate of 0.7% per year; and the rate has doubled since the Paris Agreement was signed in 2015. Latin America and the Caribbean generate practically the same amount of emissions per unit of GDP as the global average. Nonetheless, while the region decarbonized at the same rate in the period prior to the Paris Agreement, it has not kept up with the world as a whole in accelerating its rate of decarbonization; on the contrary, the pace slowed between the two study periods (see figure VI.1).

Assuming the global economy maintain growth of 3% per year until 2030 (IMF, 2024), achieving the 1.5°C target requires a decarbonization rate of 10%, in other words almost seven times that achieved between 2015 and 2022. To attain the 2°C target, the pace of decarbonization must increase to 6%, that is four times the rate recorded in the last eight years. Although, as discussed below, the transition to low-carbon economies is already under way —associated with factors such as renewable energies, electromobility or the emergence of green hydrogen— this is happening at a scale and speed that are still far less what is required.

Figure VI.1
Selected countries and regions: carbon footprint and speed of decarbonization of economy, 2000–2022



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "World Development Indicators" [online] https://databank.worldbank.org/source/world-development-indicators and M. Crippa and others, *GHG emissions of all world countries*, Luxemburgo, Publications Office of the European Union, 2023.
Note: Emissions exclude land-use change.

Decarbonizing economies by reorganizing energy, food, transportation and production systems, adjusted to climate objectives, requires large investments. The global transition is estimated to require annual investments on the order of US$ 9.2 trillion until 2050, representing an additional US$ 3.5 trillion per year over and above current levels (McKinsey Global Institute, 2022). For Latin America and the Caribbean, fulfilling climate action commitments requires an annual investment of between US$ 215 billion and US$ 284 billion, equivalent to between 3.7% and 4.9% of regional GDP until 2030 (ECLAC, 2023c).

The necessary investment effort is framed by the low growth-capacity trap explained in chapter II. This combination of investment needs and weak economic growth means that investments to address climate change provide an opportunity not only to fulfil climate commitments, but also to energize economies, promote innovation and increase productivity —both in Latin America and the Caribbean and globally (Zenghelis and others, 2024; World Bank, 2023; ECLAC, 2022).

Investments in climate action can only be accelerated to the required pace by strengthening productive development policies. Some countries already have ambitious plans, such as the European Union's European Green Deal (2019), the Inflation Reduction Act (2022) of the United States, and the Green Transformation Plan which forms part of Brazil's Growth Acceleration Programme (2024). These highlight climate action as a catalyst for economic growth by channelling investments in key sectors —thus inducing faster growth in either quality employment or production, while simultaneously reducing the environmental footprint. In addition, investments have the potential to alleviate pressure on the balance of payments by substituting the demand for imported fuel with local production (see table VI.1).

Table VI.1
Summary of characteristics of climate change aspects of main plans worldwide

Component	United States Inflation Reduction Act (2022)	European Green Pact of the European Union (2019)	Brazil's Ecological Transformation Plan (2024)	China's 14th Five-Year Plan 2021–2025
General objectives	Reduce carbon emissions, promote energy security and improve economic competitiveness.	Make Europe the first climate-neutral continent by 2050, promote a clean and circular economy, protect biodiversity and ensure a just transition.	Promote sustainable development by reducing emissions and promoting clean technologies, to ensure inclusive and sustainable growth.	Promote high quality economic and social development, with special emphasis on green development and innovation as the core of modern development.
Investment amounts	Approximately US$ 369 billion earmarked for clean energy and action to reduce carbon emissions. In support of domestic manufacturing, US$ 30 billion in tax credits will be provided for the manufacture of solar panels, wind turbines and critical mineral processing. In addition, US$ 10 billion in investment credits will be provided for clean energy manufacturing.	The European Commission has undertaken to mobilize at least €1 trillion in sustainable investments for the next decade, including 30% of the EU multi-year budget and the NextGenerationEU instrument for post-COVID-19 recovery. The European Global Gateway strategy aims to promote smart, clean and secure links in the digital, energy and transport sectors, and to strengthen health, education and research systems worldwide. It seeks to mobilize up to €300 billion in investments in quality infrastructure between 2021 and 2027.	R$ 1.7 trillion (approximately US$ 347.5 billion) will be allocated to boost sustainable development through public-private partnerships.	The plan does not specify a total investment amount, but establishes frameworks for the transition to a low-carbon economy and sustainable development.
Priority sectors	Clean energy, domestic manufacturing of clean technologies, clean transportation, energy infrastructure.	Clean energy, sustainable transportation and mobility, biodiversity, circular economy, energy-efficient construction and renovation, and sustainable agriculture.	Investment in sustainable infrastructure, renewable energy and low-carbon transportation.	Clean energy, circular economy and green transformation of industrial and urban sectors.
Tax incentives	These include tax credits for clean energy, electric vehicles, and household energy efficiency improvements.	Includes the Just Transition Mechanism, which is part of the Investment Plan of the European Green Deal and seeks to mobilize resources for the regions that are most reliant on fossil fuels and least prepared for the green transition.	Financial incentives and support policies will be used to stimulate private investments in sustainable technologies.	Policies and reforms are promoted to facilitate a transition to greener and more sustainable development.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of K. M. Sutter and M. D. Sutherland, "China's 14th five-year plan: a first look", *In Focus*, Congressional Research Service, 2021; E. L. F. Schipper and others, "Climate resilient development pathways", *Climate Change 2022: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change*, H.-O. Pörtner and others (eds.), Cambridge University Press, 2022; United Nations Development Programme (UNDP), "China's 14th 5-year plan: spotlighting climate & environment", *Issue Brief*, 2021 [online] https://www.undp.org/china/publications/issue-brief-chinas-14th-5-year-plan-spotlighting-climate-environment; UNDP, "China's 14th five-year plan", *Issue Brief*, 2021 [online] https://www.undp.org/china/publications/issue-brief-chinas-14th-five-year-plan; Asian Development Bank (ADB), *The 14th Five-Year Plan of the People's Republic of China—Fostering High-Quality Development*, June 2021; European Commission, "Delivering the European Green Deal", 2021 [online] https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/delivering-european-green-deal_en; European Commission, "Achievements of the von der Leyen Commission", 2024 [online] https://ec.europa.eu/commission/presscorner/api/files/attachment/878870/3%20European%20Green%20Deal.pdf; Government of Brasil, "Nuevo Programa de Aceleración del Crecimento (PAC)", 2023 [online] https://www.gov.br/mre/pt-br/embaixada-madri/madri-arquivos/apresentacao-do-novo-pac; McKinsey & Company, "The Inflation Reduction Act: here's what's in it", 24 October 2022 [online] https://www.mckinsey.com/industries/public-sector/our-insights/the-inflation-reduction-act-heres-whats-in-it.

Recent estimations (NGFS, n.d.) show that if the world embarks on an immediate and rapid transition to low-carbon economies (orderly transition scenario), by 2050 the GDP of Latin America and the Caribbean could be some 8% larger than it would be under current policies. These net gains are achieved by avoiding the damage caused by climate change, even considering the potential costs of emission reduction policies.

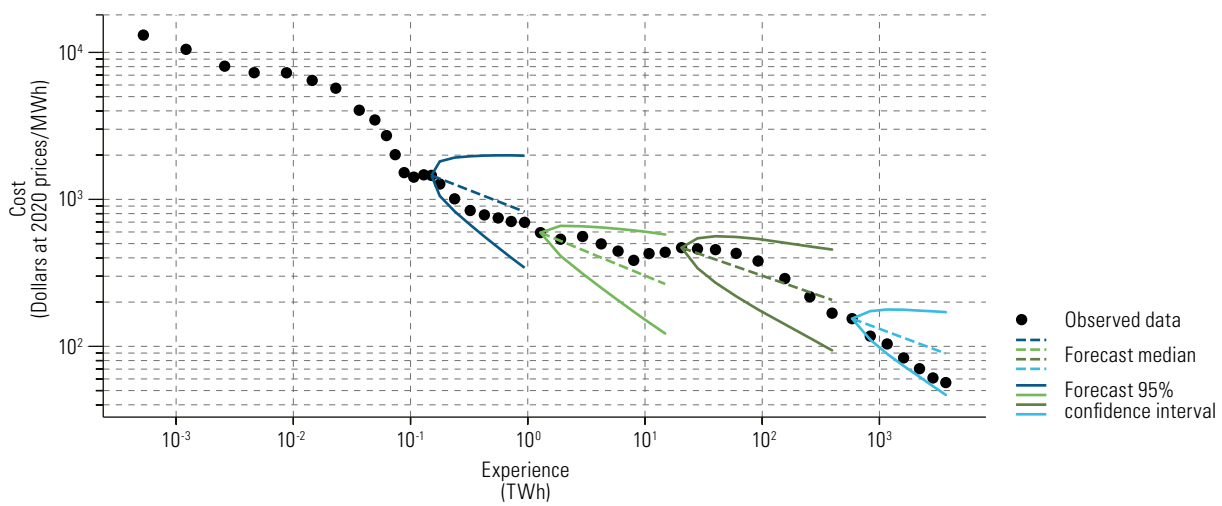
The transition to low-carbon economies will create new sectors while reducing or eliminating others. This is an example of the Schumpeterian concept of the "creative destruction of technical progress", but this time it is occurring on a massive, systemic scale. Each economy's exposure depends on its economic structure. Thus, economies that are biased heavily towards carbon-intensive activities will be more vulnerable to the transition; and the more abrupt this is, the more disruptive or potentially costly it will be. Investing in low-carbon activities creates an economy that is less exposed to the transition; and it reduces the likelihood of creating stranded assets, while these activities position themselves among the new dynamic sectors.

Investment is also a generator of innovation and productivity. Technologies related to the production and storage of solar and wind energy have become cheaper, mainly as a result of an investment push in these sectors. This can be explained by the learning-curve phenomenon, or Wright's law, which states that whenever the cumulative global output of a technology increases, its cost will decline. Figure VI.2 shows evidence of this in the costs of solar and wind energy, batteries and electrolyzers, whose prices have fallen with global production (Way and others, 2022). For example, the price of solar photovoltaic panels has fallen by 99.6% since 1976; and their cost is estimated to fall by 28% every time global production doubles, and for wind the cost decreases by 15% (Sharpe, 2023). It is estimated that every doubling of production reduces the cost of electrolyzers by between 9% and 13%, and that of lithium batteries by 20%–30% (Usher, 2022).

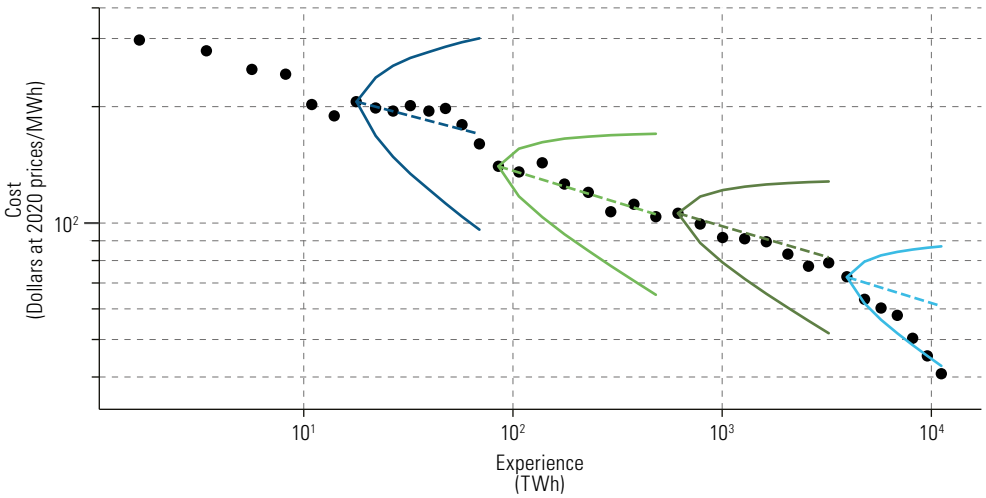
This phenomenon shows that technical progress advances through time, driven by multiple feedback effects: research and development, the learning curve, economies of scale and other factors (Sharpe, 2023). Wider dissemination of these effects at the country level requires technical, operational, political and prospective (TOPP) capabilities in the institutions needed to drive the transformations (Salazar-Xirinachs, 2023). Thus, an increase in investment levels in transformative sectors can promote growth, not only through increased demand (Keynesian multipliers) but also by fostering innovation, which drives productivity in the economy (Zenghelis and others, 2024).

Figure VI.2
Relation between cost and global production of energy, estimated experience curve, historical levels

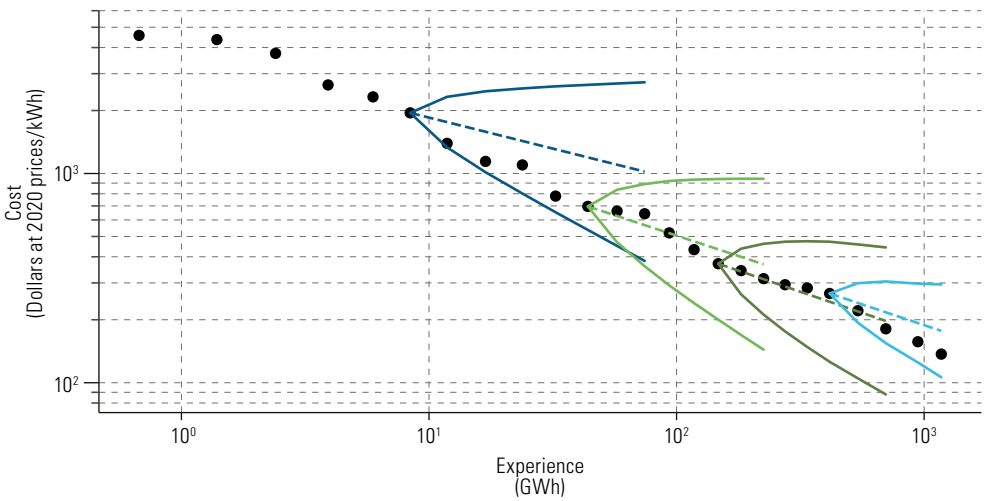
A. Solar, 1976–2020



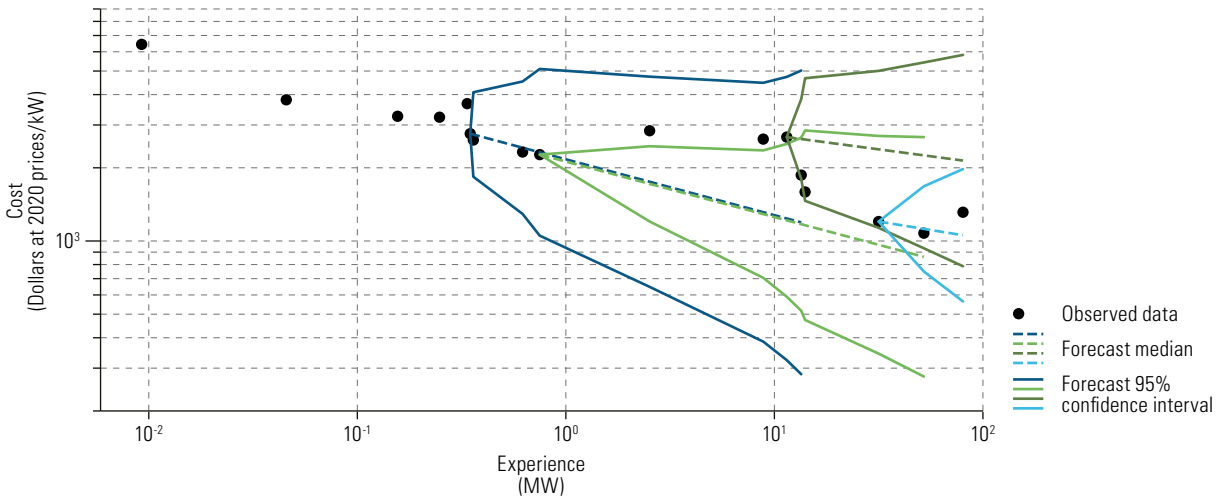
B. Wind, 1984–2020



C. Batteries, 1996–2020



D. P2X electrolyzers, 2004–2020

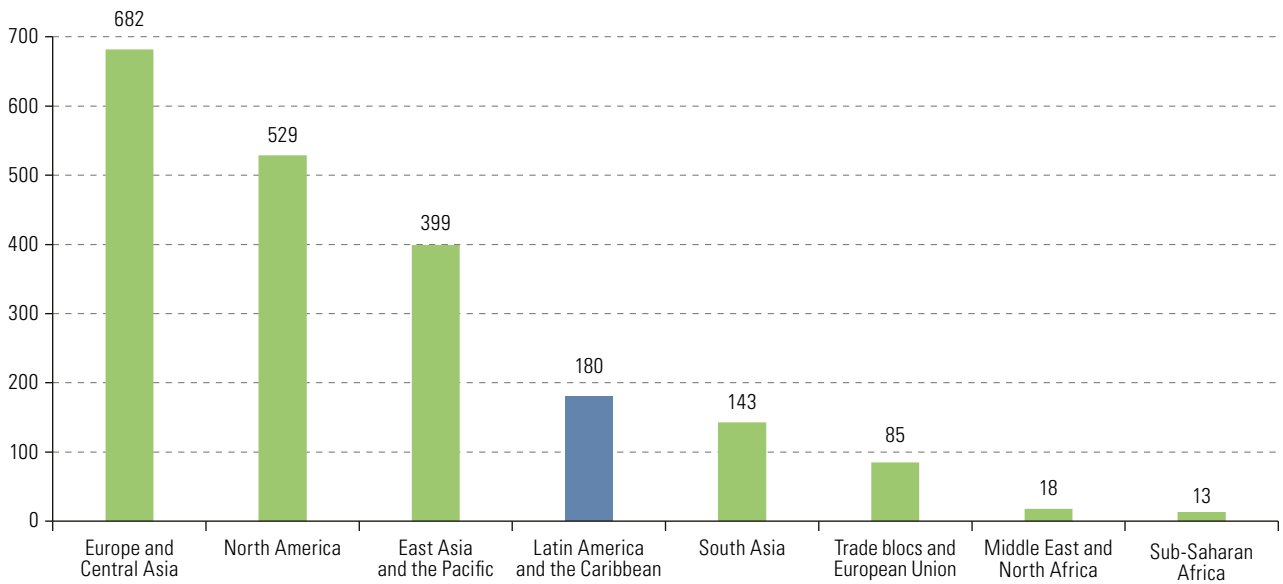


Source: R. Way and others, "Empirically grounded technology forecasts and the energy transition", *Joule*, vol. 6, No. 9, 21 September 2022.

Similarly, but with less technological intensity, the sectors that are most vulnerable to the physical impacts of climate change must identify, assess, measure and manage the financial risks associated with the impact of extreme weather phenomena —both chronic, such as droughts or glacier melt, and acute, such as tropical storms, floods or heat waves. The valuation of the material significance of these risks will influence business strategies and how activity is organized in firms engaged in water supply, food production, tourism in vulnerable areas (such as beach tourism) and urban planning itself. These will generate other types of investments with their corresponding positive economic impact, by avoiding damages and creating or reinforcing new activities, such as the bioeconomy and sustainable tourism.

Lastly, investments in manufacturing sectors, within a productive development policy, improve the international engagement of the region's economies. This is particularly important given the steps being taken by various economies worldwide. The repository of new industrial policies, Global Trade Alert (GTA),[1] recorded more than 2,500 measures in 2023, of which 2,050 have the potential to distort international trade. The majority were announced by the economies of Europe, North America and Asia and the Pacific (79%). In Latin America and the Caribbean, 180 measures were identified, 86% of which aim to improve strategic competitiveness, while 10% are related to climate change mitigation (mainly goods, software and technology, followed by low-carbon technologies), and the remaining 4% correspond to issues related to the security of (non-food) supply (see figure VI.3).

Figure VI.3
New distorting industrial policies, 2023
(Numbers)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from Global Trade Alert (GTA) [online] https://data.globaltradealert.org/.

The most widely used policy instruments have been subsidies to local producers, although in North America, location policies have also played a key role (see table VI.2). Policies that do not require direct public budget expenditures may be used more frequently in countries that have limited fiscal headroom. In terms of climate concerns, while domestic subsidies remain the instrument of choice, location policies were used as a second option.

[1] See [online] https://data.globaltradealert.org/.

Table VI.2
Distorting industrial policy instruments, by policy instrument and region, 2023
(Number of instruments)

Region	Subsidy[a]	Import policy[b]	Location policy	Export subsidy[c]	Export policy[d]	FDI policy[e]	Public procurement policy[f]	Other
Latin America and Caribbean	84	62	14	11	4	3		2
East Asia and Pacific	203	61	16	64	29	5	2	19
Europe and Central Asia	494	35	8	59	41	15	10	20
Middle East and North Africa	12	1		4	1			
North America	276	27	112	30	23		23	38
South Asia	32	63	31	6	10		1	
Sub-Saharan Africa	7	2		2	2			

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from Global Trade Alert (GTA) [online] https://data.globaltradealert.org/.
Note: The greener the colour of the cells, the larger the number of instruments.
[a] Includes capital contributions and equity shares, financial subsidies, import incentives, subsidies in kind, interest subsidies, price stabilization, production subsidies, State aid, State loans, unspecified State aid and tax or social security relief.
[b] Includes antidumping, import bans, import controls, import licensing requirements, import quotas, import tariffs, import tariff quotas, domestic taxation of imports, import-related non-tariff measures and safeguards.
[c] Includes export subsidies, financial assistance in the foreign market, other export incentives, tax-based export incentives and trade finance.
[d] Includes export bans, export licensing requirements, export quotas, export tariff quotas, export taxes, local supply requirements for exports and export-related non-tariff measures.
[e] Includes foreign direct investment (FDI): rules on entry and ownership, financial incentives.
[f] Includes changes in procurement legislation or practice.

In this global scenario, the region has the opportunity to prioritize growth-driving sectors and their value chains where it has certain comparative advantages, establishing policies and institutional capabilities in line with the new vision of productive development policies explained in chapter IV. The sectors in question are analysed below.

B. Energy transition

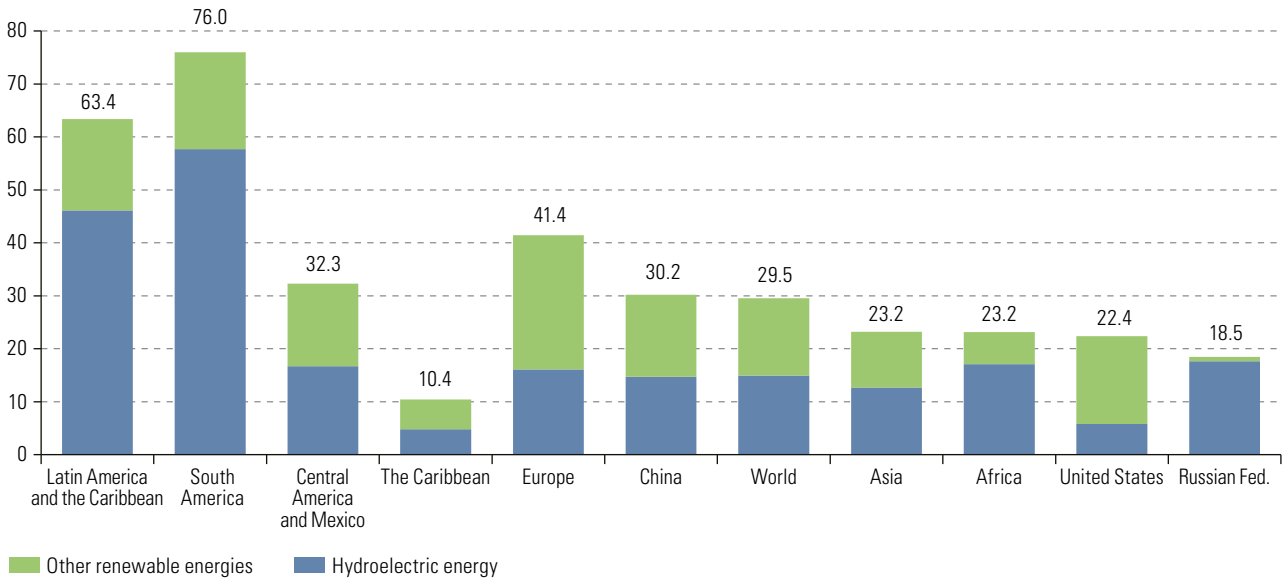
1. The potential of renewable energies

Latin America and the Caribbean is already the region of the world with the largest renewable share of electric power generation. At 63.4% (OLADE, 2024), this is well over double the global average of 29.5% (IRENA, n.d.) (see figure VI.4). In the last 10 years, the region has seen rapid growth in its installed renewable energy capacity, especially solar and wind power, in response to new growth opportunities, technological innovations and significant cost reductions. In the coming decades, the region will continue on its energy transition path, increasing the renewable share of total energy supply (and of electric power generation in particular), in accordance with the countries' energy planning. The energy transition reaches beyond the sector itself, by contributing to the creation of new industrial sectors.

Nonetheless, challenges persist in terms of insufficient and obsolescent transmission grids, and a reliance on hydroelectric power (around 73% of renewable generation) which is threatened by climate change. Up to 70% of the region's hydroelectric plants are likely to be affected by droughts and drier climates in the next 15 to 30 years (IEA, 2023c).

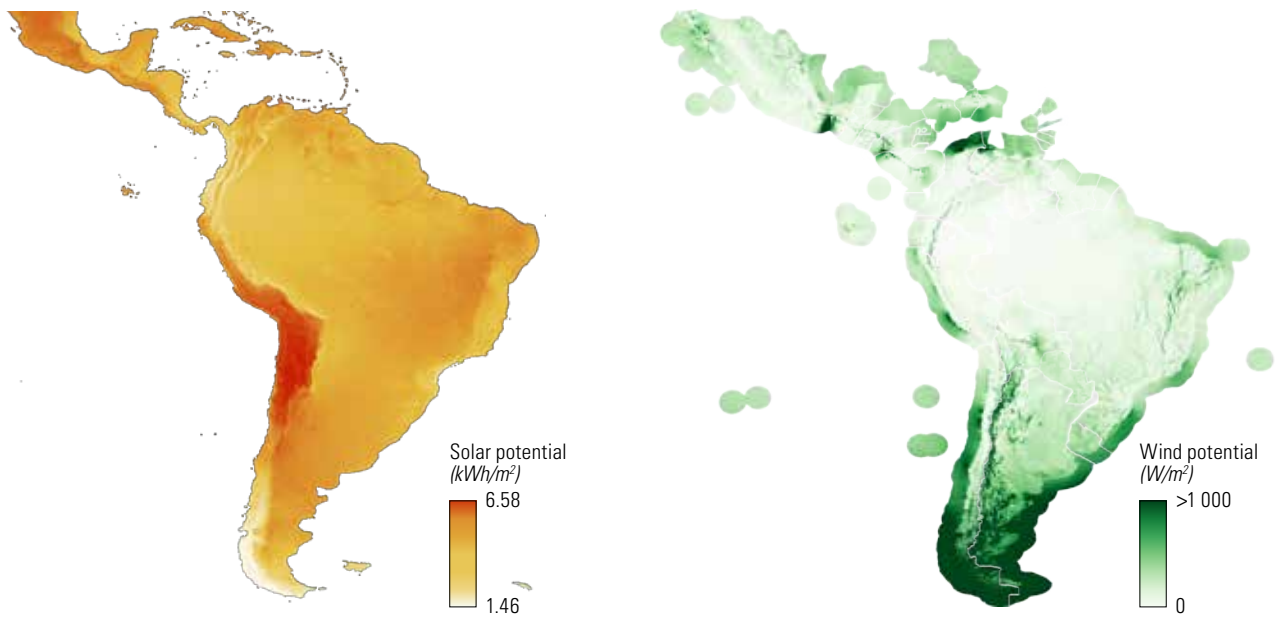
Although the region possesses huge potential for renewable energy generation, only 30% of its hydroelectric potential is currently being harnessed (10% in the case of wind energy and just 1% in the case of solar energy) (OLADE, 2023a), and its distribution varies greatly. While northern Chile and southern Peru have high solar radiation indices, wind has the greatest renewable potential in Brazil and Mexico, which are regional leaders in installed wind power capacity (see map VI.1). Brazil is also the world's second largest producer of hydroelectric energy, behind China, and one of the largest producers of bioethanol.

Figure VI.4
Latin America and the Caribbean and other selected economies: renewable share of electric power generation, latest available year
(Percentages of total power generation)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Renewable Energy Agency (IRENA), "Regional trends", n.d. [online] https://www.irena.org/Data/View-data-by-topic/Capacity-and-Generation/Regional-Trends (for 2021 data), and Latin American Energy Organization (OLADE), Energy Information System of Latin America and the Caribbean [online] https://sielac.olade.org/default.aspx (for 2022 data).

Map VI.1
Latin America and the Caribbean: solar and wind energy generation potential
(KWh/m² and W/m²)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank/International Finance Corporation (IFC)/Solargis, Global Solar Atlas 2.0 [online] https://globalsolaratlas.info and Technical University of Denmark/World Bank/ International Finance Corporation (IFC), Global Wind Atlas 3.3 [online] https://globalwindatlas.info/en.

2. Green hydrogen: status and prospects

Sectors that have high potential for productive transformation and for business models that contribute to the energy transition also include green hydrogen and derivatives, such as methanol, ammonia and synthetic fuels. The large renewable share of the region's electricity matrix, and its great potential for the untapped renewable sources, mentioned above, position the region competitively in the emerging green hydrogen market —with potential applications in energy-dense sectors such as transportation and manufacturing, or in other carbon-intensive industries. Hydrogen carriers and derivatives electrolyzed with renewables also provide major opportunities, as well as direct use in fuel cells in mobility, thermal and building applications. Since 2020, the H2LAC collaborative platform,[2] has sought to boost the development of green hydrogen and its derivatives in Latin America and the Caribbean, with a view to promoting their production and use.

Latin America and the Caribbean has experience in hydrogen production. In 2022, it produced approximately 4% of the world's hydrogen (95 Mt^2 /year), mostly from natural gas (62%) and coal (21%); and it was used as feedstock in the ammonia (34%), methanol (27%), refineries (31%) and steel (8%) industries (IEA, 2023c). Ninety percent of the region's demand is supplied by Argentina, Brazil, Chile, Colombia, Mexico and, mainly, Trinidad and Tobago.

The nascent green hydrogen industry is in the process of development, with projects in initial and pilot stages; and the pace has increased very sharply in the last five years, led by Brazil, Chile, Colombia and Uruguay. These countries have moved ahead with roadmaps, national strategies and policies for development of the green hydrogen market and industry. At least 16 of the region's countries have a public policy on green hydrogen development, or else a national mechanism for its development; and they are also receiving support from international cooperation in this domain. In 2022, there were 23 green hydrogen projects in operation in the region and more than 1,000 at different stages of development.

Green hydrogen is expected to grow vigorously in the future, with the demand for electricity to produce it forecast to represent 4% of the total in South America by 2050. In this context, the development of value chains around the hydrogen industry presents an opportunity for the region.

Nonetheless, multiple challenges persist. These include green hydrogen production costs with insufficient fiscal incentives (Ummelas, 2023), global inflation in the costs of the technologies and capital financing (Martin and others, 2024), limited global electrolyzer production capacity, transportation costs and distance to major consumer markets in Europe and Asia (IRENA, n.d.), as well as the need to expand water desalination and port infrastructure (IEA, 2023c).

For green hydrogen to serve as a vector of the region's energy transition, a common effort is needed to coordinate actors and resources, to enable long-term strategic planning, reduce investment risks, develop regulations that respond to the characteristics of the industry, and build the infrastructure needed to produce, transport, store and export the product. It will also be necessary to induce domestic demand to achieve the necessary scales of production and reduce uncertainty; and thus gain access to competitive capital and financing that will enable the market to develop and foster international cooperation to obtain certification and mutual recognition of this product.

3. Energy integration: security and sustainability

Increasing regional energy interconnection and integration is also essential for speeding up the energy transition, while also strengthening security and resilience to climate shocks. According to the International Energy Agency (IEA, 2023c) and the Latin American Energy Agency (OLADE, 2023b), electricity integration in Latin America and the Caribbean has made insufficient progress and at different scales. Despite the existence of the Electricity Interconnection System for the Countries of Central America (SIEPAC) and a number of successful binational relations, such as Itaipu (binational agreement between Brazil and Paraguay), in South America, cross-border

[2] ECLAC is a founding member, along with Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), the World Bank and the EUROCLIMA programme.

trade in electricity is meagre compared to other regions of the world (IEA, 2023c). The World Bank estimated that 20 of the region's countries could save nearly US$ 2 billion per year if there were unlimited cross-border trade between their electricity systems, given their current power plants and demand patterns (Timilsina, Deluque Curiel and Chattopadhyay, 2021).

Although the region has immense potential for energy integration, which could multiply transmission capacity sixfold by 2050 and facilitate the spread of renewable energies, announcements of new projects under study or under way are not very encouraging. Active public policies are needed to facilitate energy exchange, such as investment incentives, infrastructure development, institutional strengthening, clear regulatory frameworks and cooperation.

4. Outlook for electricity transition in Latin America: trends and investment needs

Going forward, electricity demand is projected to continue to grow and be met by a pronounced expansion of the renewable portion. According to IEA (2023c), demand is expected to double between 2021 and 2050 in net-zero emission scenarios.

To analyse the growing demand for electricity and the resulting opportunities, the PLEXOS simulation tool was used to analyse the national energy plans of 21 Latin American countries, along with price and cost projections for different fuels and generation technologies. The study aimed to optimize the expansion of installed capacity, the adoption of renewables and the use of cross-border interconnections to meet future electricity demand in five scenarios.

Five simulation scenarios are defined:

(i) Constant scenario (CONST), in which the share of the different energy generation sources remains constant until 2050;

(ii) Base scenario (BASE), in which the proportion of renewable energies in the electricity matrix is based on the countries' current policies and energy expansion plans, and takes account of existing international interconnections and those that form part of national plans;

(iii) Base scenario with greater electricity integration (BASE+I), which assumes the same policies and expansion plans as the base scenario, but with a higher degree of interconnection between countries in the region (incorporating possible interconnection projects between countries);

(iv) Scenario with more renewables (RE) that maintains the same interconnections as the base scenario and establishes a target for renewable generation of 87% by 2030 and close to zero net emissions by 2050[3] in South and Central America. In the case of Mexico, a target for the incorporation of renewables by 2050 is set in line with its nationally determined contributions;

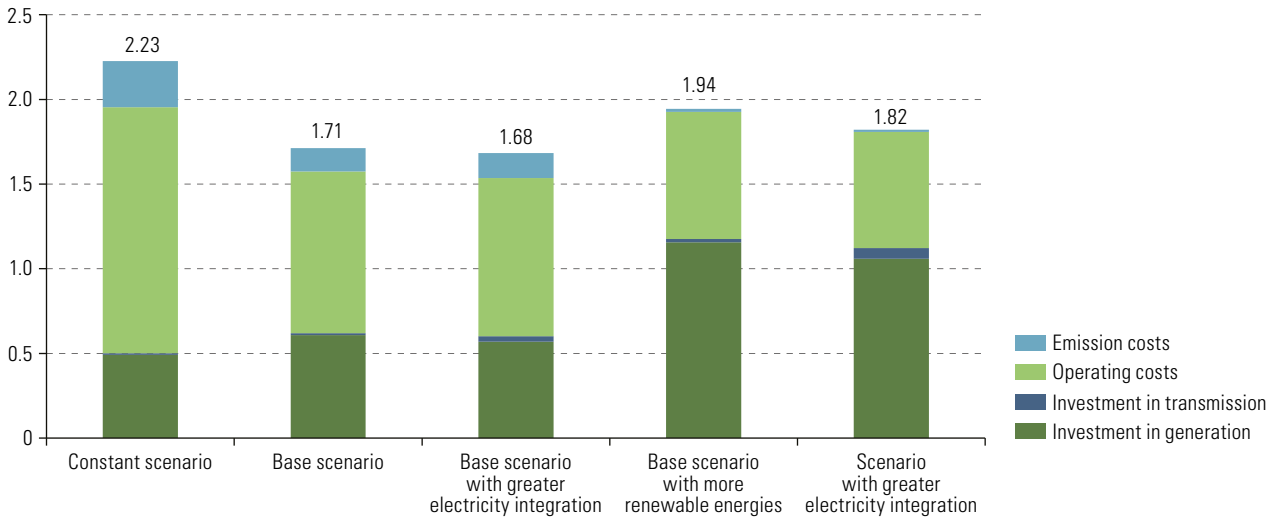
(v) Scenario (RE+I) with greater electricity integration and the same percentages of renewables as the previous case, but including the potential for electricity integration.

The modelling took account of international trends and price projections for the different fuels (gasoline, natural gas, coal and others), along with investment costs in renewable technologies (solar, wind, and biomass). Furthermore, the growth of electricity demand is expected to incorporate vectors such as electromobility, the electrification of other sectors and energy processes, the expansion of distributed generation capacity, distributed storage, and the production of green hydrogen through electrolysis, in accordance with the countries' expansion plans. In addition, a valuation was made of carbon dioxide emissions for each scenario, using a cost of US$ 5 per ton of CO_2 until 2025, rising to US$ 15 per ton by 2039, and then to US$ 32.5 per ton by 2050, based on the experiences of CO_2 emission taxes in the region.

[3] Net zero emissions between 2060 and 2100.

In the case of South America, the preliminary results of the electric power outlook for the different scenarios show that the annual investment required (including capital, operating and CO_2 emission costs) to achieve the plans for satisfying demand in 2025–2050, including generation and transmission, is equivalent to 2.23% of the region's annual GDP in the constant scenario, and 1.71% in the BASE scenario (see figure VI.5). This shows that the countries' energy expansion policies and plans that already aim to increase the share of renewables in the energy matrix, make it possible not only to cut greenhouse gas emissions but also to reduce the total costs and investments needed in generation and transmission infrastructure, than in the case of maintaining its current share in regional generation (CONST scenario). However, further accelerating the penetration of renewables raises investment requirements to 1.94% per year. Compared to the CONST scenario, the BASE scenario affords an annual saving of 0.51% of the region's annual GDP, while the RE scenario puts this saving at 0.28% per year. The difference between the two amounts could be included as an additional contribution in the new nationally determined contributions to climate change, conditional on financing.

Figure VI.5
South America: investment needs and associated costs, annualized data, 2025–2050
(Percentages of GDP)



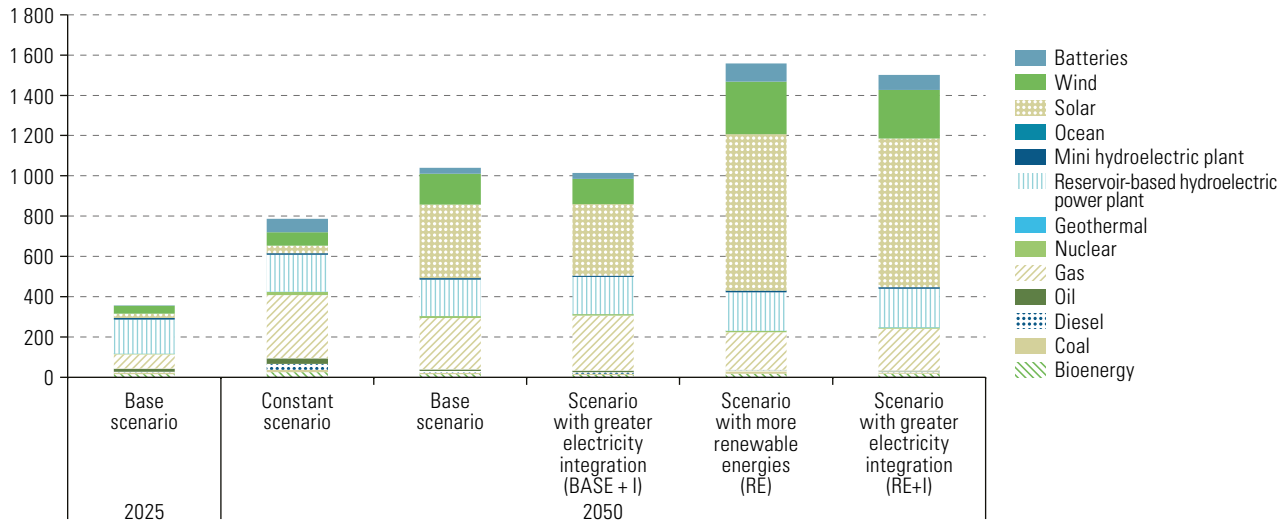
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The different scenarios modelled show that energy integration produces significant efficiencies in system operation and reduces investment and operating costs. Compared to the constant scenario, if the BASE scenario incorporates the region's electricity integration potential (BASE+I), it produces a saving equivalent to 0.54% of the region's annual GDP (cost reduction of 0.03% per year relative to the BASE scenario), while the RE plus integration scenario (RE+I) produces a saving of 0.41% per year (cost reduction of 0.13% per year relative to the RE scenario).

The constant CONST scenario maintains the current shares of generation technologies in the energy matrix, so that the share of solar and wind energy is limited to the percentages that will be installed in 2025. This scenario entails higher operating costs, since generation is done mainly by thermal power plants in which the variable costs, based on fuel prices, make the system more expensive to operate than in scenarios that make greater use of renewable energies. It also generates greater greenhouse gas emissions.

The RE scenario, which implies moving towards net zero emissions, requires over 770 GW of additional installed capacity to be built, compared to the constant CONST scenario by 2050, which would provide nearly 2.5 times more total renewable capacity. By boosting solar and wind power plants, the RE scenario represents almost 10 times more installed capacity in these technologies compared to the constant CONST scenario, because their plant factor and the need for investment in energy storage systems are much smaller (see figure VI.6).

Figure VI.6
South America: installed capacity outlook for 2025
(Gigawatts)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

In terms of the differences between the fossil fuel costs reported by the countries in their expansion plans, especially for the producer countries, it can be assumed that if these were to take account of the international costs borne by the importing countries, then the installed capacity of renewable power plants would have to increase by even more owing to the change in relative prices. This implies an increase in the required annual investment of 0.08% of South America's GDP, compared to the best scenario.

Although investment in renewables has been growing in recent years and has surpassed investment in non-renewables, it is still insufficient. For example, investment announcements in renewables in the region averaged US$ 11 billion in the last 15 years, representing just 0.23% of regional GDP. These investments are clearly insufficient, as can be seen in figure VI.5, with previous available studies estimating the investment needed at 0.8% of GDP just to universalize access, and well above 1% for all renewability scenarios (OLADE, 2023a; IEA, 2023c; Brichetti and others, 2021).

In the case of the subregion consisting of Central America and Mexico, the preliminary results of the electric power outlook are similar. Maintaining the existing share of generation technologies in the energy matrix (constant CONST scenario) has higher costs than incorporating renewable energies according to the countries' policies and expansion plans (BASE scenario). In the first case, annual investment needs would represent about 2% of the subregion's GDP from 2025 to 2050, but in the second case these would drop to 1.4%, which emphasizes the importance of implementing these plans.

Accelerating the incorporation of renewables (RE scenario) further would raise investment needs to more than 1.7% of GDP per year until 2050. This would enable the countries of this subregion to reduce greenhouse gas emissions by more, as a result of increasing the renewable energy share, if they receive international support to finance the differential relative to the BASE scenario.

In Central America and Mexico, the projected effect of integration (BASE+I and RE+I scenarios) provides smaller efficiency gains and therefore has marginal positive effects in reducing investment needs, unlike in South America. This is explained by the fact that the subregion already has relatively high-capacity interconnections that are underutilized; so no significant new transmission infrastructure investments are projected. At the same time, the territorial characteristics of Central America and Mexico result in a primarily north–south linear interconnection.[4]

[4] These preliminary scenarios have operated separately in South America and in the subregion comprising Central America and Mexico.

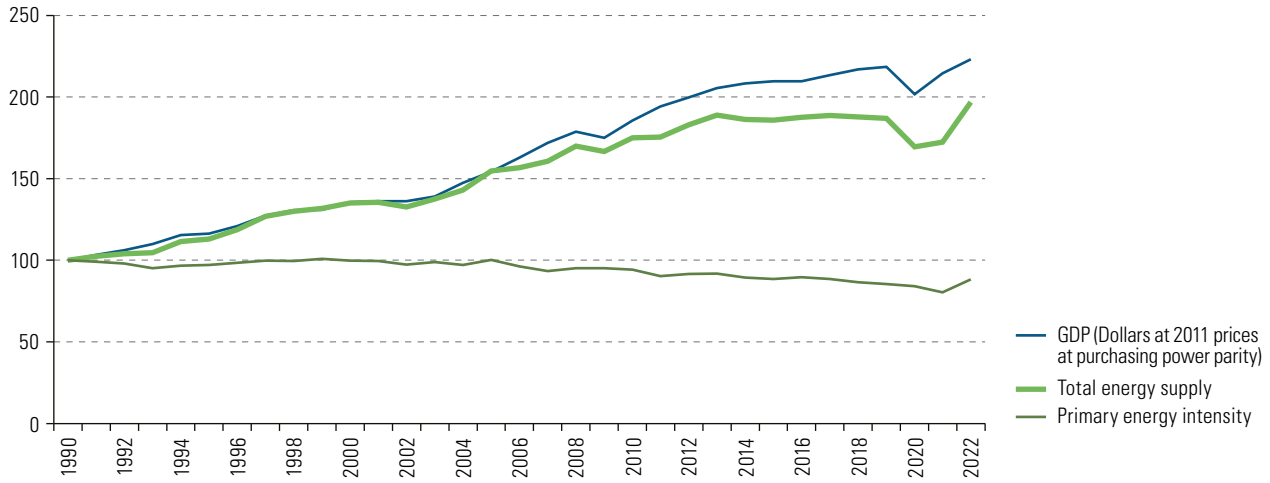
5. Opportunities to enhance energy efficiency

Along with the opportunity presented by renewables and energy integration, energy efficiency has the potential to reduce systemic vulnerability and dependency on imported fossil fuels and derivatives, make energy services more affordable, postpone investments in energy infrastructure, mitigate adverse local environmental impacts, and reduce emissions levels (C2E2, 2015).

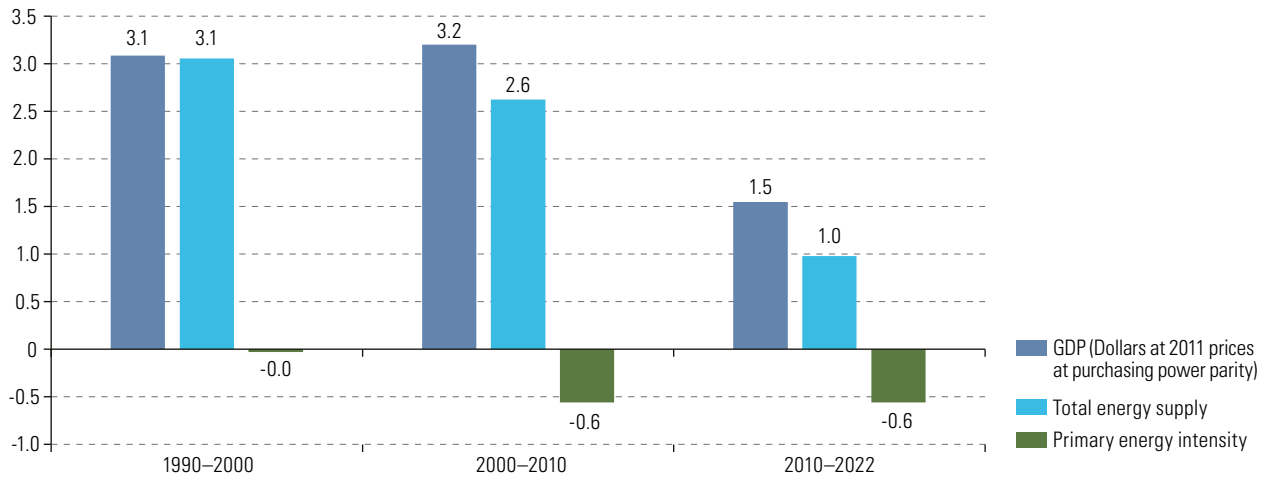
The region's energy intensity has fallen slightly, with the amount of energy needed to produce one unit of GDP decreasing between the decade of 2000 and 2022, thus revealing a decoupling of GDP growth from energy consumption (see figure VI.7). Nonetheless, these decreases in the region are below the global average reductions, which almost doubled from -0.9% between 2001 and 2010 to -1.7% between 2011 and 2020 (IEA, 2023b). The behaviour of the different sectors of production varies, both across activities and between countries.

Figure VI.7
Latin America and the Caribbean: evolution and variation in energy intensity of GDP, 1990–2022

A. Evolution of energy intensity of GDP
(Index: 1990 = 100)



B. Variation in energy intensity of GDP
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis Latin American Energy Organization (OLADE), Energy Information System of Latin America and the Caribbean [online] https://sielac.olade.org/default.aspx.

To promote efficiency, progress needs to be made in four major groups of public policies: (i) laws and regulations, such as codes and standards; (ii) economic instruments, such as incentives; (iii) governance and institutional mechanisms; and (iv) financing and investment schemes. These groups of policies should be implemented in combination, according to the national context. Examples of these initiatives include the Regulation on Energy Management of Large Consumers in Chile, the Official Standards for Non-residential buildings in Mexico, the Support Programme for MSMEs for Energy Efficiency Measures in Uruguay, and the National Energy Efficiency Programme in Brazil. Despite these advances, there is still great potential to optimize the effectiveness of these policies and achieve a significant deployment of energy efficiency programmes in the region.

6. Public policies to speed up the energy transition

Achieving a just energy transition requires simultaneous measures based on five mutually reinforcing pillars (ECLAC, 2022; 2023a; 2024a and 2024b):

(i) Universalization of the coverage of affordable electricity to the entire population, including rural, remote and isolated areas.

(ii) Robust increase of renewable energy in the energy matrix and progressive electrification of highly carbon-intensive sectors of production, such as transportation and industries.

(iii) Increased energy efficiency in all sectors of production and in the residential and building sectors.

(iv) Greater energy interconnection and integration between countries in the region.

(v) Greater resilience and energy security in the face of external shocks.

These measures focus on the following medium- and long-term public policy areas:

(i) Creation and strengthening of the ecosystems of governance, institutions, regulatory frameworks and public-private participation and cooperation.

(ii) Increased investment in access, transmission, distribution and interconnection infrastructure, innovation and new technologies.

(iii) Coordination of energy and productive development policies to promote value chains associated with the new industries of the energy transition.

(iv) Strengthening of energy planning.

The technical, operational, political and prospective (TOPP) capabilities of the participating institutions are decisive enablers for the results of public policies (see table VI.3).

Table VI.3
Technical, operational, political and prospective (TOPP) capabilities of institutions for managing the energy transition

Capabilities	Characteristics
Technical	– Formulation, design and evaluation of effective public policies for electricity access, reduction of energy poverty, decarbonization of the energy matrix, energy efficiency, integration and security, and associated productive development. – Modernization and adaptation of energy policy and regulatory frameworks to incorporate social innovations (new service demands, electrification of energy end uses) and technological innovations (green hydrogen, storage, electromobility). – Innovation of instruments and incentives to mobilize financing and investments and create new business models that make the development of energy transition infrastructure and technology viable.
Operational	– Incorporation of specialized technological tools for long-term energy monitoring, forecasting and planning to support informed decision making. – Effective implementation of plans, strategies and budgets to meet the targets and objectives of the energy transition. – Use of evaluation systems for programmes, projects and public policies that allow for the necessary adjustments or the replicability and scalability of successful cases.

Capabilities	Characteristics
Political	– Leadership of processes of institutional, normative or regulatory transformations that achieve political consensus and social legitimacy among the different stakeholders, to ensure the continuity of public energy policies beyond political cycles. – Creation of multi-stakeholder and multilevel dialogue spaces for formulating and designing public policies and for implementing infrastructure projects, within the framework of energy transition strategies. – Promotion of collaboration platforms and policy harmonization among the various actors. – Provision of resources to implement regulations, plans and policies more effectively, to achieve energy integration between countries.
Prospective	– Incorporation of institutional areas specialized in energy foresight and analysis of global and regional strategic information for the energy industry. – Strengthening of national and regional long-term energy planning, based on foresight, to manage energy and electricity supply and demand more efficiently, as well as investment needs and their optimal location, using participatory and collaborative mechanisms for the construction of energy foresight scenarios. – Design of action plans or protocols to mitigate risks and deal with potential crises, thus contributing to energy security and resilience in the face of external shocks and extreme phenomena.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

In short, a just and sustainable energy transition requires planning processes, an active role played by each State, with support from different international organizations and agencies, and the multilevel participation of different private actors: firms, civil society and the academic sector. Effective implementation and continuous monitoring and evaluation are essential to ensure that these policies achieve their intended objectives. Effective governance of the energy transition requires the creation or strengthening of processes of democratic participation by citizens in public policy decision-making, since it involves changes in the ways energy is produced and consumed.

C. Electromobility as a system and the energizing potential of sustainable urban mobility

The fifth session of the Conference of the Parties to the Paris Agreement (COP28) proposed accelerating the reduction of emissions from various forms of road transport, through infrastructure development and the rapid deployment of zero- and low-emission vehicles. Globally, the use of electric vehicles was equivalent to the consumption of 700,000 barrels of oil in 2022. The International Energy Agency (IEA) estimates that fuel demand for road transport will peak in 2025, while the amount of oil displaced by the use of electric vehicles will exceed 5 million barrels per day by 2030 (IEA, 2023a).

Mobility is fundamental for productivity, equity and sustainability in cities. In Latin America and the Caribbean, which is a highly urbanized region, it is one of the activities that generates greenhouse gas emissions. For this reason, transportation has been a pillar of mitigation strategies and is usually included in city climate action plans and national plans, including nationally determined contributions. These include strategies such as promoting electric vehicles, replacing private and public fleets, and improving public transportation systems (ECLAC, 2024c; Rondón Toro, Reyes Pontet and Herrera Jiménez, 2022; Samaniego and others, 2022a). In this context, there are ambitious goals, which afford a glimpse of a panorama of significant change (see table VI.4).

However, the major financing requirement, both to purchase new vehicles and to subsidize the operation, poses challenges for the pace of implementing electromobility targets, especially in the short term. In the city of São Paulo, for example, in March 2024 the electric vehicle fleet had only attained one tenth of the target set in the plans for that year (Bazani, 2024). Weak governance and business models that are inadequate for the new realities exemplify some of the difficulties in progressing towards the planned targets (Mobility Portal Latinoamérica, 2023).

Table VI.4
Electromobility targets in selected cities

Colombia	Bogotá As from 2022, no new diesel buses can be incorporated into the public transport fleet. All vehicles to be electric or have net zero emissions by 2040
Argentina	Buenos Aires 10% of buses to be electric in 2030 and 30% in 2050
Mexico	Mexico City 20% of the vehicle fleet to be electric by 2030
Brazil	São Paulo 20% of the vehicle fleet to be electric by 2024

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of E. Sandoval, "Situación financiera de la movilidad urbana en Bogotá", *Project Documents* (LC/TS.2022/151), Santiago, ECLAC, 2022; C. Goytia, "Situación financiera de la movilidad urbana en Buenos Aires, 2015-2021", *Project Documents* (LC/TS.2022/160), Santiago, ECLAC, 2022; A. Marín, "Situación financiera de la movilidad urbana en Ciudad de México", *Project Documents* (LC/TS.2022/212), Santiago, ECLAC, 2022; and F. R. Ramos, "Situación financiera de la movilidad urbana en São Paulo", *Project Documents* (LC/TS.2022/209), Santiago, ECLAC, 2022.

1. Evolution of the electric vehicle market

Although the transition to low-carbon economies depends on cutting back on the use of fossil fuels, the combustion of which is also highly correlated with the emission of other pollutants that affect air quality in the region's cities, an exclusively environmental consideration of the transition to electromobility misses multiple opportunities. The current trend towards electromobility raises the question of whether the region's countries will merely be consumers, or whether there is potential for them to participate significantly in the production of vehicles and their value chain.

The region's electric vehicle fleet has grown substantially: between 2018 and 2023, the number of electric buses increased fivefold to more than 4,000 units (E-Bus Radar, n.d.). Electric cars display a similar trend, with sales reaching 90,000 units in 2023 (Mobility Portal Latinoamérica, 2024). Although the growth rates are encouraging, electric vehicles still account for a very small share of the total: in Mexico, for example, they accounted for just 5.2% of total light vehicle sales in 2023, while in Brazil the equivalent figure is 3% (Mobility Portal Latinoamérica, 2024).

The global situation is more positive: IEA estimates that 14 million electric vehicles will have been sold by 2023, 35% more than in 2022 and representing 18% of global sales. China clearly accounts for a large share, with 60% of new electric vehicle registrations in 2022 (IEA, 2023a). Although the pace of electric vehicle sales had been growing steadily from very low levels, various factors have slowed the expansion in recent times (see box VI.1).

Box VI.1
What has happened to electric vehicle sales recently?

The rate of growth of electric vehicle sales slowed or even stalled in some countries in 2023 and early 2024. Compared to December 2023, sales in China fell by 26% before the Chinese New Year, and were down by 32% in Europe and by 14% in Canada and the United States. This slump in sales has forced vehicle manufacturers to postpone plans to expand the production of electric models and even to increase the output of internal combustion vehicles. Nonetheless, sales of plug-in hybrid vehicles have grown significantly.

The causes of the drop in sales include the following:

- Electric vehicle prices are still higher than those of similar internal combustion vehicles. Although lifetime maintenance and operating costs are lower, the difference in initial outlay is still large.
- Many countries (including China, France, Germany, Norway, Sweden and the United Kingdom) have eliminated or restricted assistance to buyers, in terms of both subsidies and tax breaks. Norway is an exemplary case for the market penetration of electric vehicles. The European Union has also announced tariffs on imports of this type of vehicle from China.

- The initial buyers of electric vehicles either belong to higher-income groups or else are persons who are more willing to adopt innovations. Penetration in lower income segments with more traditional behaviour will be more complex, especially following the reduction in subsidies. The trend of gasoline prices is another factor that detracts from electric vehicle sales.
- The slow deployment of charging infrastructure in some countries.

Despite this slowdown, the deadlines proposed by the European Union for banning the production of internal combustion engine vehicles in 2035 are not being questioned for the time being; and the market is expected to regain its growth path given the continuing fall in the price of batteries, which are an important component in the formation of the final price of these vehicles.

Source:Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of N. Carey, "Global EV sales up 69% y/y in Jan, down 26% vs Dec - Rho Motion", Reuters, 14 February 2024 [online] https://www.reuters.com/business/autos-transportation/global-ev-sales-up-69-yy-jan-down-26-vs-dec-rho-motion-2024-02-14/; Autobild, "Volkswagen también pega un volantazo en su estrategia eléctrica e invertirá 60.000 millones de euros en motores de combustión", 12 June 2024 [online] https://www.autobild.es/reportajes/volkswagen-tambien-pega-volantazo-estrategia-electrica-invertira-60000-millones-euros-motores-combustion-1390721; The Economist, "Is America's EV revolution stalling?", 27 November 2023 [online] https://www.economist.com/business/2023/11/27/is-americas-ev-revolution-stalling; O. Ummelas, "Norway risks missing 2025 EV sales goal, Federation says", Bloomberg, 1 November 2023 [online] https://www.bloomberg.com/news/articles/2023-11-01/norway-risks-missing-2025-ev-sales-goal-federation-says; B. Vindry, "Sales of electric vehicles in Europe in the first quarter of 2024", Electromaps, 7 May 2024 [online] https://www.electromaps.com/en/blog/sales-of-electric-vehicles-in-europe-in-the-first-quarter-of-2024; B. Yu, "Life after subsidies for China's EVs", Dialogue Earth, 30 November 2023 [online] https://dialogue.earth/en/business/life-after-subsidies-for-chinas-evs/; A. González, "UK's EV purchase incentives lag behind European counterparts: study", Leasing Life, 11 March 2024 [online] https://www.leasinglife.com/features/uks-ev-purchase-incentives-lag-behind-european-counterparts-study/?cf-view&cf-closed; C. Domonoske, "EVs won over early adopters, but mainstream buyers aren't along for the ride yet", NPR, 7 February 2024 [online] https://www.npr.org/2024/02/07/1227707306/ev-electric-vehicles-sales-2024; and P. Krizansky, "EV charging deployment: what are the next priorities?", Economist Impact [online] https://impact.economist.com/sustainability/project/the-rev-index/ev-charging-deployment/?utm_medium=cpc.adword.pd&utm_source=google&ppccampaignID=19495686130&ppcadID=&utm_campaign=a.22brand_pmax&utm_content=conversion.direct-response.anonymous&gad_sourc.

The urban mobility sector can leverage economic activity and employment and thus demonstrate that it is possible to reconcile the expansion of production with sustainability. It also provides an opportunity to redesign both mobility systems and cities, since incorporating these new technologies will require structural changes in these systems, involving greater integration between urban and mobility planning.

By 2030, the year specified for achieving the Sustainable Development Goals, 83.6% of the population of Latin America and the Caribbean will be living in urban zones. Currently, there are 74 cities with more than 1 million inhabitants, which accommodate about half of the total urban population and are natural candidates to incorporate electrically powered public vehicle fleets (United Nations, 2019). The demand for public mobility could therefore encourage the industry to produce vehicles in the region, instead of adding to the external deficit by importing them.

2. Towards an integrated vision of mobility: the collateral opportunities generated by technological changes

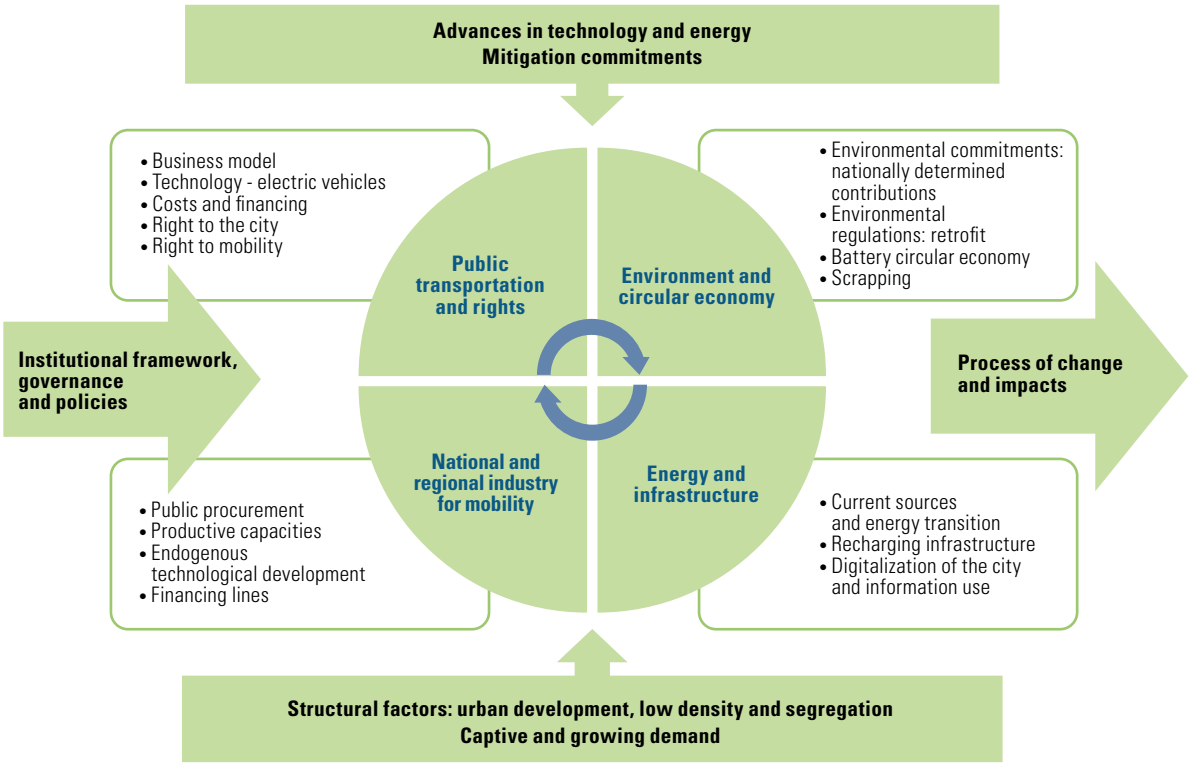
The emission reduction targets expressed in the nationally determined contributions, or even in climate action plans or local urban mobility plans, often do not coincide with the strategies and premises outlined in land use plans and urban planning as a whole. Enhancing the impact of electric mobility involves integrating it with guidelines for urban consolidation, seeking to achieve compact cities. It would be inconsistent if the result of public policy were to maintain the growth of the vehicle fleet —regardless of technology— and continue fomenting the urban sprawl, with the economic costs that this generates.

Action on mobility must incorporate technological change and exploit possibilities for interlinking this service in a complex governance environment. While abandoning fossil fuels would improve the quality of life for urban residents, the disorganized supply of public mobility services, the weak institutional framework and, above all, the uncertain financial sustainability of the systems cast doubt on the effectiveness of the investments planned

to remodel the vehicle fleet beyond reducing emissions. A systemic approach to electromobility entails acting on its elements, in order to enhance the impact of the investments needed for electric vehicle purchase, the generation and transmission of renewable energy, and the provision of recharging points.

The elements involved in extending the presence of low-emission vehicles, particularly electric vehicles, should thus consider various dimensions, in which climate commitments and the urban environment act as constraints on change processes that are driven by public policies, within a national or local institutional framework and articulation (see diagram VI.2).

Diagram VI.2
Latin America and the Caribbean: urban mobility system



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of M. Castillo, "Revisión de materiales desarrollados en el marco del proyecto Ciudades Inclusivas, Sostenibles e Inteligentes (CISI), elaboración de casos de estudio con un análisis sobre el estado de situación de la movilidad urbana en Bogotá, Buenos Aires, Ciudad de México, Sao Paulo y San José de Costa Rica", Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), May 2023; and Steer, *Green your Bus Ride: Clean Buses in Latin America. Summary report*, World Bank, 2019.

Ultimately, it is a matter of coordinating strategies, incentives, regulations and investments, to leverage the impacts of action fostering the generalized presence of electric vehicles. It is necessary to avoid the paradox that would result from expanding the vehicle fleet —with clean technology but identical impact on congestion and use of public space— to solve the problem caused originally by excessive growth in the number of vehicles. Persevering with a model in which the private automobile predominates, which requires more investments in roads and generates further urban sprawl, cannot be the solution.

Public services, such as mobility, are also fundamental for connecting people to opportunities, whether employment, education, care or leisure. If public mobility systems are more efficient and cover larger areas of the city, productivity and inclusion will improve. It should be borne in mind that journeys are a demand derived from the need to move from one place to another, so demand management policies should support the shift to clean technology. If the city is more compact, the need to use transport services decreases and the shorter distance can be covered by active mobility modes. Accordingly, policies and investments need

to be retargeted towards active mobility and better public systems. If the efficiency, quality, frequency and coverage of public mobility are neglected, the end result will be no more than emission gains at the cost of longer travel times and lower city productivity, notwithstanding the proliferation of electric cars.

3. Sustainable mobility: challenges, opportunities and institutional capacities

The work of ECLAC on electromobility has focused on the analysis of public vehicle fleets, prioritizing their role and importance in the service provided to citizens, while also recognizing that their behaviour directly reflects government action and can exert a major "demonstration effect". This poses several challenges, the first of which is financial.

The electrification of public vehicle fleets requires investments to purchase the vehicles, which are more expensive than their diesel or gasoline counterparts but have lower operating costs. However, this larger initial investment poses a direct problem: in systems that are currently loss-making, higher initial costs can only be funded from spending cuts and thus a lower-quality or less frequent service, or else through changes to the current operating model that could involve fare hikes or higher subsidies.

In Chile and Colombia, which have progressed furthest in implementing electromobility in urban bus fleets in the region, there has been a greater need to finance the system through public subsidies in the last few years, owing to persistent deficits generated during the COVID-19 pandemic and a social context that is more resistant to fare hikes. In Chile, subsidies exceeded US$ 1.7 billion in 2023, while, in Bogota, the Tariff Stabilization Fund grew from providing less than a quarter of system financing in 2016–2019 to approximately two-thirds in 2020–2021 (Sandoval, 2022; Ministry of Finance of Chile, 2023).

Secondly, the new business models need to fit into the current organization of the system. Technological transformations in favour of electromobility in buses must be matched by institutional and organizational changes that include the existing actors (public authorities, private operators, regulators), make the public transport system more efficient, and improve the organization of supply and thus make technological change feasible. For example, making the entire system electric, rather than units scattered throughout the city, affords economies of scale in the service provided. Moreover, these innovations cannot be resolved by a fare policy that requires the systems to be self-financing. The implementation of electric bus operations entails economic, social and environmental benefits that are perceived not only by transport users themselves but by society at large. This reality needs to be made transparent, and resources for the financing and renewal of public fleets must be increased. Failure to do so would imply a huge subsidy from public transport users to society as a whole, which would be highly inequitable since it is the lower-income sectors that use public transport the most and, therefore, would be the antithesis of a supposedly just transition (Figueroa, 2024).

Thirdly, operating electromobility also requires resources to be allocated for investment in electric power generation and distribution, and in recharging stations. It would not make sense to reduce emissions from vehicles while keeping fossil fuels as their energy source. For example, Costa Rica defined a national decarbonization target of 30% of the fleet of private and institutional light vehicles being electric powered by 2035, and 95% of the fleet being zero-emission by 2050. Achieving this objective would require an annual investment averaging 0.45% of GDP until 2030 and 0.23% until 2050, to cover energy generation and transmission together with vehicle purchase (Krieger Merico, 2024). It will also be necessary to define the nature of the recharging stations: whether they should be considered a public good or be installed by the private sector, or both. In addition, there is the complexity and cost of obtaining the land to install them in central or high-density sectors (World Bank, 2022).

Another issue is the economic potential of electromobility. Better organization could reduce average commuting times on public transport, which, in the case of Buenos Aires, for example, are twice those of private motor vehicles, at 76 and 39 minutes, respectively. Less congestion would benefit the city's productivity and enhance the social inclusion of its inhabitants (see chapter V).

Moreover, the key input for delivery of the service, the electric bus, can be manufactured in the countries of the region. As with any industrial effort, this requires active productive and demand development policies, in public procurement schemes, for example. It is also necessary to consider the productivity gain that could be obtained by organizing the sector around productive clusters.

In the last two decades, the bus and minibus fleet has grown by around 4% per year in much of the region; and future demand makes it possible to envisage a scenario involving a dozen manufacturing plants, considering the scale at which they currently operate (Biderman and others, 2023). Argentina, Brazil and Colombia are designing or deepening specific industrial strategies in this regard. The world's largest electric car manufacturer, BYD, started to build an electric car factory in Brazil in March 2024, with an investment of US$ 600 million, using facilities occupied previously by Ford.

The recent decision by the United States Government to restrict tax benefits for buyers of automobiles that contain battery components or critical minerals made by "foreign entities of concern", and announcements of new tariffs on Chinese-made batteries and electric vehicles, of 25% and 100% respectively, (White House, 2024), are likely to be accompanied by strict rules of origin. Europe is also preparing measures to restrict imports from China. This will have an impact on the speed at which electric vehicles are adopted in these areas, but also on the potential for Latin America and the Caribbean to leverage their competitive advantages with all of their potential trading partners. These measures could represent an opportunity for the region, based on nearshoring strategies that could create a positive environment for strengthening the automotive and components industrial base, especially in Central America and Mexico.

Lastly, a circular economy approach opens up the opportunity to carry out vehicle conversions (*retrofitting*), thus taking advantage of the bodywork and residual value of the units, and reducing transition costs. Further electrification also requires a decision on the fate of the new batteries, which are a major component of the cost of these vehicles (Zagorodny, 2023; Jones Acuña and Rodríguez, 2021a).

In short, a paradigm shift is needed that transcends the sectoral vision of transportation and fosters a comprehensive strategy for sustainable mobility, rights-based and with a gender perspective, which includes institutional capabilities (technical, operational, political and prospective) and governance considerations (see table VI.5).

Table VI.5
Technical, operational, political and prospective (TOPP) capabilities of institutions to manage the transition to sustainable mobility

Capabilities	Characteristics
Technical	– Promotion of an integrated, territorially defined, public policy on electromobility, which brings together different sectors and incorporates social, economic, productive and environmental dimensions. – Evaluation of the impact of investments made in electromobility programmes, beyond the number of buses incorporated into public fleets, in order to adjust future strategies. – Generation of information on the interrelationships and cross-cutting impacts of electromobility projects. – Promotion of coordination between actors that demand equipment, regulators, financiers and manufacturing companies, taking advantage of the productive development opportunities arising from investment in public transport improvements. – Implementation of mechanisms to evaluate the (non-financial) economic productivity of the provision of public electric mobility systems. – Promotion of the design and implementation of business models that hasten the incorporation of electric buses without losing sight of the social importance of public transport fares.
Operational	– Strengthening of the capacities of entities responsible for the design and implementation of electromobility programmes. – Use of technology and big data to encourage the use of public transportation, taking into consideration the role of mobility in caregiving tasks, which are mainly performed by women. – Strengthening of public-private coordination, incorporating other actors that have been absent from past discussions on public transportation. – Guaranteed access to timely, long-term financing on preferential terms for value chain participants.

Capabilities	Characteristics
Political	– Promotion of collaboration between national and local levels, in order to align climate action plans with the investments foreseen in mobility plans and to articulate electromobility strategies with urban planning. – Raising of stakeholder awareness of the co-benefits and opportunities provided by adopting a systemic approach to electromobility. – Support for public leadership that promotes a comprehensive vision of electromobility, builds trust and fosters cooperation. – Creation of the mechanisms required by local authorities that are knowledgeable about the territory, and their incorporation into policy formulation and design. – Promotion of articulation and coordination among sectoral entities in actions that are traditionally the responsibility of individual entities. – Pursuit of agreements between national and local governments, transport companies, individual entrepreneurs, civil society and public and private financing entities.
Prospective	– Formulation of scenarios that include multiple strategies aimed at sustainability, taking into account the availability and penetration of different energy sources (ethanol, biogas, electricity, hydrogen), technologies and mobility modes and uses. – Collective construction of future scenarios, for sustainable mobility in general and electromobility in particular, distinguishing clearly between desirable and feasible scenarios, and fostering stakeholder ownership. – Identification of trends in the demand for the public electromobility service, particularly those that modify the need for and generation of journeys. – Analysis of the impacts of the international environment, specifically constraints in international of vehicle and battery trade, on the possibility of deepening the electric bus manufacturing processes in the region.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

It is also essential to have fluid communication and joint planning between national government institutions, and between these and the local authorities that understand trends and opportunities in the cities. Governance also entails developing clear and formal links with the private sector and civil society under public leadership that take advantage of the window of opportunity provided by electromobility. Understanding electromobility as a system will make it possible to exploit to the full the impact that massive investments in the renewal of public (and private) vehicle fleets —and the associated investments and expenditures— could have on cities.

The technical, operational, political and prospective (TOPP) capabilities of the institutions involved are decisive enablers for the results of public policies (table VI.5).

The challenge is to overcome inertia and the traditional practice that has fostered compartmentalized visions of the sectors, neglecting synergies and opportunities to move towards sustainable, productive and inclusive urban development, in which electric mobility plays an important role.

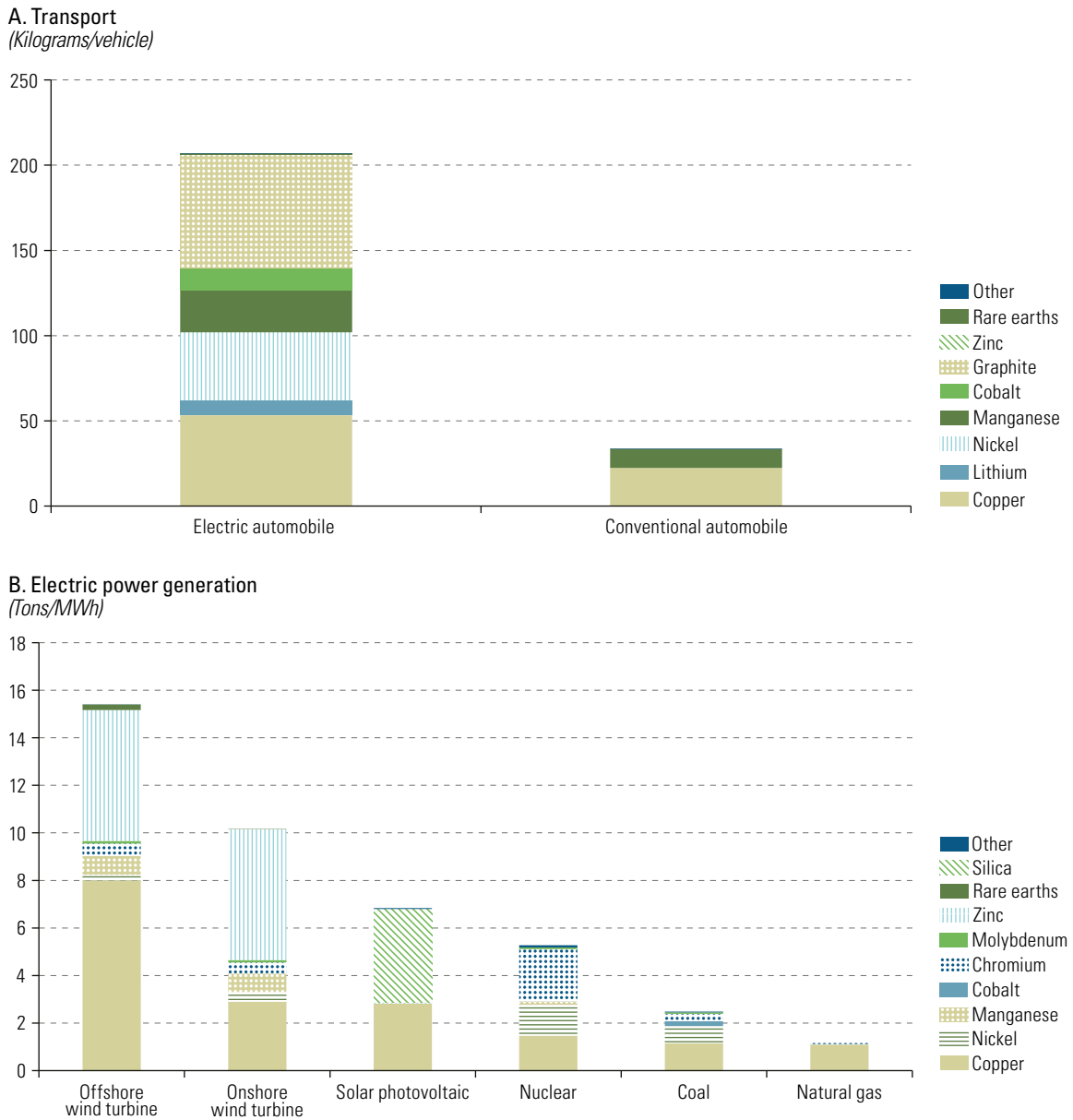
D. Critical minerals for the energy transition and electromobility

1. Demand and availability in Latin America and the Caribbean

The transition towards renewable energy sources and the spread of electromobility are fuelling burgeoning demand for key minerals such as lithium, copper, cobalt, graphite and nickel. These are essential for the manufacture of wind turbines, solar panels, and high-capacity batteries that are used in electric vehicles, energy storage systems, and other items.

These technologies make much more intensive use of certain minerals than conventional fossil fuel-based technologies. According to IEA (2021), electric vehicles consume six times more in critical minerals than fossil fuel vehicles (see figure VI.8A). Wind and solar energy also require more minerals per megawatt hour (MWh) of capacity, than that obtained from burning coal or gas (see figure VI.8B).

Figure VI.8
Minerals used in selected clean energy technologies



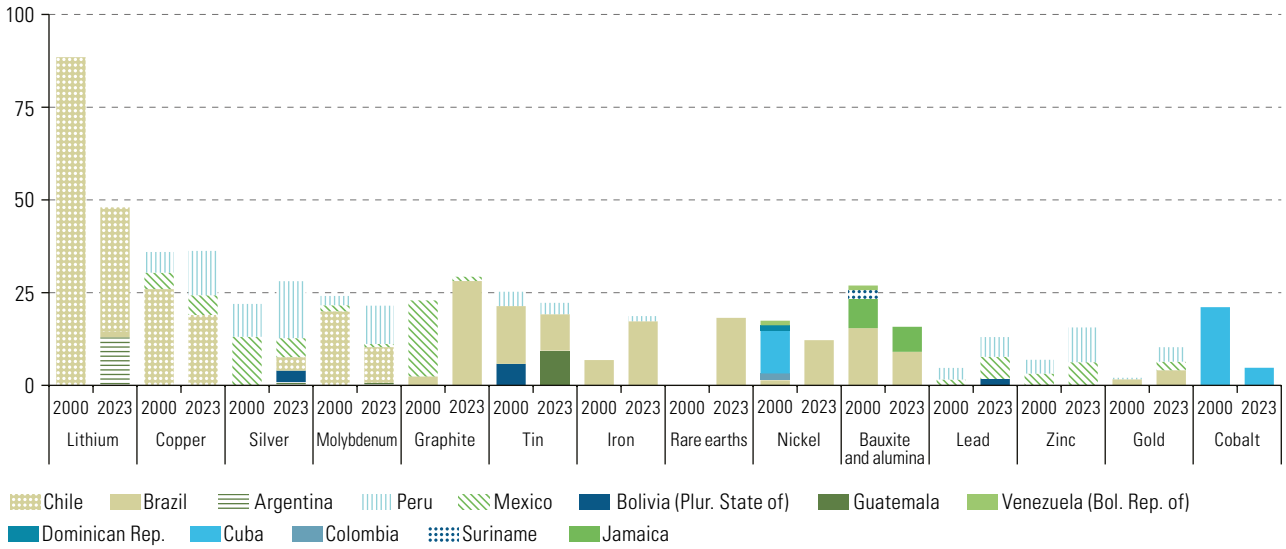
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Energy Agency (IEA), *The Role of Critical Minerals in Clean Energy Transitions*, Paris, 2021.

The global demand for lithium could thus grow by more than tenfold by 2050, and demand for cobalt could triple; there could also be very significant increases in demand for the remaining minerals in an IEA net-zero emissions scenario. Demand growth depends on the speed with which countries adopt renewable energy and electromobility technologies. Nonetheless, the demand for many minerals will continue to be driven also by other technologies.

Latin America and the Caribbean has the mining potential to contribute to the global supply of several of these critical minerals, because it has large reserves of lithium, copper, silver, tin, molybdenum, graphite, and other minerals (see figure VI.9). Several countries also have abundant resources; for example, the Plurinational State of Bolivia has 22% of the world's lithium resources and may add to the reserves in the near future if

conditions are right. The region is expected to increase its lithium carbonate equivalent production capacity by 2.7 times over the next 10 years, based on projects in the probable pipeline, and by five times if projects in the possible and speculative pipelines are also included (Jones, Acuña and Rodríguez, 2021b).

Figure VI.9
Latin America and the Caribbean (13 countries): share of selected world mineral reserves, 2000 and 2003
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United States Geological Survey (USGS), *Mineral Commodity Summaries 2024*, Reston, 2024.

Raising current production levels to meet this increased demand requires huge investments and an expansion of the mining frontier into territories that have unexploited resources, which poses challenges in terms of production and sustainability.

2. Opportunities and challenges: responsible management, supply chains and productive development

Responsible management of the mineral supply chain is a crucial part of ensuring a just, effective, inclusive and sustainable energy transition. In particular, mineral production and refining poses significant socioenvironmental challenges, such as water consumption in areas that are subject to high water stress, the impact on ecosystems, and potential pressures on the traditional economic activities of social groups living in the surrounding areas. At a time when mining is increasing, it is important to reach broad national agreements on this activity, and to foster appropriate management of socioenvironmental conflicts with greater transparency and citizen participation. To meet these challenges, the mining industry will require stricter regulations and standards to make the activity more sustainable.

Better management of tax revenues and expenditures arising from the exploitation of mineral resources can support productive diversification and value added. More progressive, efficient and equitable taxation is needed to increase the economic rent obtained from minerals, and to distribute and use it more effectively.

The region also has productive development opportunities along the value chains of critical minerals and energy-transition technologies. Mineral-supplying countries should not remain trapped in the initial segments of these chains. The opportunities in question range from the refining of the minerals through to their industrial processing into intermediate or final products, as exemplified by copper and lithium. Refined copper is used to produce alloys and intermediate products such as wires and tubes; it is also used to produce cables and valves that can serve as components or parts of other products such as electric vehicles, solar panels and wind

turbines. As described in box VI.2, countries producing minerals such as lithium can increase their participation in the production chains of lithium-ion batteries, and their precursors and refined minerals (ECLAC, 2023b). However, investment announcements in the metals and minerals sector in the region over the last 20 years have focused on extraction.

Box VI.2
Chile: value added initiatives in the lithium industry

Chile's Production Development Corporation (CORFO), which is responsible for the country's lithium exploitation contracts, applies an instrument for promoting value added initiatives. This operates by reserving a quota of lithium carbonate and hydroxide production at preferential prices, based on a clause in the contracts that it manages with SQM and Albemarle, which are the firms responsible for the two lithium extraction and refining projects in Salar de Atacama. This preferential price quota is awarded, through a bidding process, to firms interested in developing higher value added lithium projects.

Recently, CORFO awarded lithium carbonate quotas at preferential prices to two Chinese firms, BYD and Yongqing Technology Co. The former has plans to set up a factory to produce up to 50,000 tons per year of lithium ferro-phosphate-type cathode material ($LiFePO_4$ for LFP type batteries), with an estimated investment of US$ 290 million and the creation of 500 jobs by the end of 2025. Yongqing Technology Co plans to operate a LFP-type ($LiFePO_4$) cathode material plant with a capacity of 120,000 tons per year for the same period, with an estimated investment of US$ 233 million and the creation of 668 jobs. Both initiatives have plans to train local personnel to operate the specialized factories.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of press releases from Production Development Corporation (CORFO) of Chile.

The creation of technical and productive capacities and infrastructures for value added, the generation of productive linkages and scaling up in global value chains are all essential, as are research and development initiatives to provide the necessary knowledge in an industry subject to constant innovation.

Lastly, the production agenda for minerals that are critical for the energy transition also confronts an international context in which the large economic blocs are promoting various productive development initiatives, aimed particularly at expanding national capacity to manufacture technologies that are needed for the transition to low-carbon economies. Global competition sees countries responding through policy strategies such as subsidies, tariffs and other instruments that foster the development of national or regional supply chains, such as nearshoring or friendshoring, with allied countries. Thus, the United States, the European Union, China and Japan have prioritized the location of investments and their supply of transition-critical minerals (see table VI.6).

Table VI.6
Initiatives in support of productive and industrial development related to supply of critical minerals

	China: Made in China 2025 and five-year plans	United States: Inflation Reduction Act	European Union: Industrial Plan of the European Green Deal and European Critical Raw Materials Act	Japan: Green Transformation Act
Investment location and critical mineral sourcing provisions	Increase the domestic content of key components and materials to 40% by 2020 and 70% by 2025, as well as domestic sourcing of electric cars. The initiative does not set specific targets for minerals, but has contributed to China's dominance in the production of minerals and related technologies (it accounts for more than 80% of global production of solar panels, 50% of battery production, and is the main producer of refined products of most minerals).	Minerals and materials for batteries and electric vehicles must be produced or recycled in the United States or in countries with which it has free trade agreements (incremental targets are set of 50% in 2024 and 80% in 2027).	By 2030, in European Union consumption, at least 10% of minerals, 40% of components and 15% of recycled materials must be produced or processed within the bloc. No third country will be able to supply more than 65% of the annual consumption of any raw material.	The initiative does not specify location requirements and allows subsidies for international suppliers of critical minerals.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of M. Castillo, I. Garcés and R. Furtado Messias, "Perspectivas de desarrollo de las cadenas de valor relacionadas con el litio en Chile y América del Sur", *Natural Resources and Development series*, No. 223 (LC/TS.2024/38), Santiago, ECLAC, 2024, and news and press releases on the respective policies.

The need to secure the supply of strategic minerals for the energy transition in industrialized countries is an opportunity for the region —for example, to expand its smelting and refining capacities, exploiting the transfer of cutting-edge technology that meets high environmental standards and provides competitive advantages, and the potential of production chains and associated industrial clusters. One point in favour of the region boosting its smelting and refining capacity is that the transportation of concentrates has a carbon footprint that is approximately 45% larger than cathode production, and that electric power systems already have a lower carbon footprint than in Asian countries. Also, in the future, with the foreseeable expansion of renewables and green hydrogen, there could be an advantage in accessing more environmentally demanding markets.

3. Governance and technical, operational, political and prospective (TOPP) capabilities for the sector of minerals that are critical for the energy transition

To take advantage of these opportunities and rise to the challenges described above, a new model of governance is needed for natural resources in the region, which will contribute to making these resources a pathway for the major productive transformation needed for the transition to a productive, inclusive and sustainable development model. This new governance must be multilevel, transparent, democratic and effective; it must incorporate the life cycle approach to natural resources, and the territorial approach (ECLAC, 2024a). It is also necessary to strengthen a series of institutional capacities (see table VI.7) that contribute to this governance and allow the countries of the region to develop a strategic vision, adequate regulation and greater coordination.

Table VI.7
Technical, operational, political and prospective (TOPP) capabilities of institutions to manage the productive, responsible and sustainable exploitation of critical minerals

Capabilities	Characteristics
Technical	– Training of human resources in mining ministries and other related public institutions, to formulate and implement policies that promote more sustainable extraction of critical minerals and boost both upstream and downstream value added. – Capacity building in ministries and other public agencies related to mining (geological services, environment, production, energy and so forth) on the relationship between critical minerals, the energy transition and electromobility. – Development of institutional capacities for the environmental impact assessment of projects that promote citizen participation. – Strengthening of the link between mining ministries and the academic sector to generate technical knowledge on critical minerals and promote a network of national and regional technology centres for critical minerals.
Operational	– Development of greater transparency and capacity in productive, fiscal, social and environmental information related to the mining sector. – Investment in the use of information and communication technologies (ICT) and geographic information systems (GIS) to generate real-time information on indicators of the productive, social and environmental performance of mining projects in the territories. – Use of available technology and information for reducing disaster risk (and other risks such as climate change) and to generate early warnings for mining operations and associated infrastructure. – Support to engage neighbouring communities in monitoring and controlling mining operations in the territory, and to identify shortcomings in the implementation of related strategies and policies.
Political	– Creation or strengthening of mechanisms or instances of participation by key actors from civil society, communities, the private sector and the academic sector, for the planning and coordination of policies related to the responsible and sustainable exploitation of critical minerals. – Establishment of regulations and methodologies to obtain participation and free and informed consultation of communities and indigenous peoples. – Promotion of national and regional consensus-based strategies to develop productive linkages in the value chains of minerals that are critical for the energy transition. – Formulation and implementation of coordinated and consensus-based sectoral research, development and innovation policies in the value chains of critical minerals.
Prospective	– Technological surveillance of developments in mineral extraction, renewable energies and electromobility. – Production of market intelligence for critical minerals. – Development of climate change scenarios to reduce uncertainty and incorporate climate change risk criteria in the regulation, planning, operation, closure and post-closure of critical mineral exploitation projects.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

E. Water and climate change: challenges and opportunities

Extreme events associated with climate change and deforestation strongly affect the hydrological cycle, disrupting not only human access to safe water and sanitation but also productive activities, including food and energy security, while worsening socioeconomic inequalities and exacerbating migration. Latin America and the Caribbean is the world's second most disaster-prone region. In the last three decades, disasters related to water and climate change have accounted for 88% of the total number, 77% of the reported economic cost and 89% of the people affected in the region (ECLAC, 2024c), and their frequency and severity have been increasing. In addition, the availability of water has been affected by a decline in its quality, partly because of increased pollution, affecting both human and ecosystem health. Investment in improved water management can potentially be a tool to change this situation and drive sustainable and inclusive development in the region.

1. The effects of climate change and pollution on water resources

Extreme events such as droughts, storms, hurricanes and floods have a major socioeconomic and environmental impact and cause loss of life.

Droughts lead to crop loss or damage, decreases in food stocks, drinking water shortages and forced migration as a result of severe food insecurity and lack of economic opportunities. They also reduce hydropower generation, increase the risk of forest fires and even affect international trade.

According to data from the Centre for Research on the Epidemiology of Disasters (CRED, 2023), droughts in Latin America and the Caribbean have affected more than 53 million people and caused more than US$ 22 billion in total damages (OCHA/UNDRR, 2023). In Argentina, for example, the 2022–2023 drought caused losses equivalent to 3% of GDP (Rosario Stock Exchange, 2023), and in Central and South America the 2021 drought caused a 50% drop in hydroelectricity generation (IEA, 2024).

Long-standing water deficits in Latin American cities affect production, workers' incomes and tax revenues. These deficits have caused, for example, income losses estimated at US$ 40 per worker per month[5] (Damania and others, 2017), equivalent to 10% of the average monthly income in rural areas (Núñez Cobo and Verbist, 2018). In cities, workers in formal sectors can also lose up to 7% of their income during episodes of prolonged water shortages, while informal and own-account workers or those in small businesses can lose up to 11% of their income (Núñez Cobo and Verbist, 2018). This is due to an increase in power cuts during droughts, sometimes of up to 33%, and the deterioration of workers' health, as they are affected by increased contamination of water sources and epidemic diseases.[6]

The socioeconomic impacts mentioned above also result from high temperatures and lack of rainfall, on which ecosystem services depend. Since the 1980s, there has been a decrease of 30% to 50% in glacier area in the Andes (Dussaillant and others, 2019). This has effects on the availability of water for human consumption in cities that depend on glacier melt (IPCC, 2022). Another consequence of prolonged droughts and high temperatures is wildfires, which threaten lives, livelihoods, critical infrastructure, water stocks and biodiversity. Since 2000, 10.6 million people and 33 million hectares of land have been affected by wildfires across the region, with damages worth US$ 1.3 billion (OCHA/UNDRR, 2023). During the same period, there have been 1.47 million fires in Latin America (OCHA/UNDRR, 2023).

5 Estimated value based on data for 13 million people living in 78 major metropolitan areas in 10 countries (Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Mexico, Paraguay, Peru and Uruguay) between 1990 and 2013 (Damania and others, 2017).

6 In Brazil, the number of hospital admissions in municipalities experiencing drought or high temperatures increases by 3.8% compared to a month of normal or near-normal weather, and by as much as 4.8% when mostly urban municipalities are singled out. The number of diarrhoea cases also increases compared to a year in which the climate is within normal ranges: by 5.2% in an average municipality and 5.9% in a mostly urban municipality (Desbureaux and Rodella, 2019).

International and intraregional trade can also be affected by droughts. An example of this is the impact of the phenomenon on the Panama Canal, through which 14% of world trade passes. The depth of Gatun Lake, the canal's main source of water, has dropped to record lows over the past seven years, and 2023 coincided with very low rainfall associated with El Niño. This has forced vessels to reduce cargoes and has increased waiting times and prices for using the canal. Similarly, weather anomalies reduced transport capacity on the River Amazon by up to 50% during the driest months of 2023 (Trompowsky, n.d.). As a consequence, the cost of water freight increased by between 25% and 50% (CIEAM, 2023).

Floods and storms, meanwhile, accounted for 80% of climate change-related disasters in Latin America and the Caribbean during the period 1990–2023. The two phenomena resulted in 1,384 disasters between them, with a reported loss of almost 80,000 lives and more than 116 million people affected (ECLAC, 2024c). Major storms paralyse the region's economies. The cost of the disasters caused by Tropical Storm Eta and Hurricane Iota in Honduras in 2020 was estimated at some US$ 2 billion. In 2022, Hurricane Ian affected coastal communities in Jamaica, where it caused flooding, and devastated more than 20,000 hectares of agricultural land when it emerged in the Gulf of Mexico after crossing Cuba. In the same year, Hurricane Bonnie advanced over Central America (Costa Rica, El Salvador and Nicaragua), where it brought heavy rains and significantly affected different means of subsistence (staple crops, vegetables and livestock) and infrastructure. More than 10,000 people were left without electricity in Nicaragua (WMO, 2023). Tourism is another of the sectors that are severely affected by weather phenomena of this kind (IDB/ECLAC, 2021).

Water pollution remains a problem in the region. The proportion of safely treated wastewater does not exceed 45% (United Nations, 2024). Water quality is also suffering from the negative effects of rising temperatures, lower amounts of dissolved oxygen and, consequently, reduced self-purification capacity in freshwater reservoirs (UNESCO/UN-Water, 2020). At the same time, flooding is a major threat to sanitation and hygiene infrastructure and poses a serious health and cross-contamination risk. Vector-borne diseases such as malaria, yellow fever, leptospirosis and others are often observed after flood events (UNESCO/UN-Water, 2020).

According to the World Health Organization (WHO, 2023), diseases related to lack of access to safe drinking water, hygiene and safely managed sanitation were responsible for more than 40,000 deaths and 2 million years of life lost in Latin America and the Caribbean in 2019. Of the deaths, 6,000 were among children under 5 years of age. On top of these numbers, it is estimated that almost a quarter of river stretches are affected by severe pathogenic contamination, with a substantial increase of almost two thirds in monthly concentrations of faecal coliform bacteria (more than 1,000 units of these bacteria per 100 ml) between 1990 and 2010, as a result of wastewater entering from sewers (Saravia Matus and others, 2022). Lastly, the problem of saline intrusion has also become significant in the region, where it has reached critical levels in many coastal aquifers, posing serious difficulties, since salt water is unsuitable for many production processes, crop irrigation and human consumption. The situation represents a particularly serious challenge for coastal communities that depend on these fresh groundwater sources for their livelihoods, especially considering that 27% of the region's population live in coastal areas (ECLAC, 2021).

2. Water management as an engine of sustainable and inclusive development: what can be done and how

In 2022, only 75% of the population in Latin America and the Caribbean had access to safely managed drinking water, with lower coverage levels in rural areas (53%) than in urban areas (80%). As regards safely managed sanitation, regional coverage was below 50% (JMP, 2023). This is consistent with the low levels of sectoral investment in the region between 2015 and 2019, amounting to 0.16% of regional GDP (Lentini, 2022).

It is crucial for investment in the countries of the region to be substantially increased. The investment required to close these gaps and ensure universal access to clean water and safe sanitation free of faecal and chemical contaminants within households, with guaranteed supply, is estimated at the equivalent of 1.38% of regional GDP over 10 years (Saravia Matus and others, 2023). This implies that the average regional investment

effort in the sector needs to be increased more than eightfold. Table VI.8 shows the annual investment needed to close gaps in access to drinking water and sanitation, along with the employment and value added that would be generated by these investments in selected Latin American and Caribbean countries. In addition to the benefits in the form of employment and increased value added, universal access to water and safely managed sanitation would translate into improvements in the health and productivity of the population in proportions similar to the impacts described above.

Table VI.8
Latin America and the Caribbean (selected countries): annual investment needed to close gaps in access to drinking water and sanitation, and creation of employment and value added
(Percentages and numbers of people)

	Honduras	El Salvador	Colombia	Peru	Mexico	Chile	Argentina	Costa Rica	Brasil	Dominican Republic
Annual investment *(Percentages of GDP)*	4.44	2.46	1.89	1.81	1.56	0.46	1.113	1.05	1.28	1.37
Annual employment growth *(Number of people)*	14 018	85 118	431 053	457 642	855 462	45 127	239 379	34 263	1 411 509	130 014
Increase in value added *(Percentages)*	5.35	3.14	2.55	2.45	1.78	0.59	1.07	1.53	1.37	2.41

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of S. Saravia Matus and others, "Necesidades de inversión en agua potable y saneamiento en América Latina y el Caribe: efectos en el empleo verde y el valor agregado bruto", *Natural Resources and Development series*, No. 218 (LC/TS.2023/101), Santiago, ECLAC, 2023.

For integrated water management, it is critical to improve the resilience of water infrastructure and better adapt it to climate change. To carry out the necessary water-related adaptation measures by 2030, a total of 1.1% of the region's annual GDP should be invested, breaking down as 0.7% to enhance existing water and sanitation infrastructure, 0.3% to improve riverine and coastal flood control and 0.1% for anti-flooding measures and protection of irrigation infrastructure (ECLAC, 2023c). In the region, 31 countries have included water as a priority sector in the climate change adaptation measures of their nationally determined contributions (ECLAC, 2023c).

Adaptation measures include reforestation of river basins, expansion of green infrastructure and sustainable urban drainage systems for rainwater management, flood protection mechanisms and efficient irrigation systems, along with the adoption of circular water management in the drinking water and sanitation sector. Implementing these would reduce the amount of water needed for agriculture, protect cities from extreme weather events that might lead to flooding, safeguard coastal aquifers against phenomena such as saline intrusion, and improve water storage and conservation capacity (Quirós, 2021).

Circular water management entails the recovery of wastewater as a valuable resource from which water can be extracted for reuse, energy and nutrients. This practice mitigates the negative externalities associated with water scarcity or poor water quality, which increase in times of drought. Municipal wastewater is 99.8% water (López Hernández and others, 2017), which means that, once treated, it can be used for residential and agricultural irrigation, industrial processes and groundwater replenishment. Considering that methane is a potent greenhouse gas with a warming power more than 80 times that of carbon dioxide, it is important to reduce methane emissions associated with the water and sanitation sector, as wastewater treatment plants are estimated to be responsible for 5% of these emissions (Aguilar-Benítez and Blanco, 2018). In the region, there are concrete options for investment in circular technologies to harness methane and generate electricity with positive environmental effects in a way that is financially viable for operators of drinking water and sanitation systems. For example, wastewater treatment plants with a capacity of between 500 l/s and 4,000 l/s can be converted and use methane to generate electricity, with an average cost-benefit ratio of 1.36 and a reduction of 0.72 kg of CO_2 equivalent per cubic metre of wastewater treated (Saravia Matus and others, 2022). This approach becomes more viable in plants using anaerobic wastewater treatment technologies (with returns of US$ 5.5 for every dollar invested) than in those using aerobic technologies (US$ 1.01 for every dollar invested).

Although resources from public budgets will continue to be essential to meet safe drinking water and sanitation targets, users need to contribute through their bills to operating costs and, so far as they are able, to investment in renewed and expanded infrastructure. In the vast majority of the region's countries, payments by users do not exceed the threshold of 3% of their income, which is below the 5% identified as a globally agreed ceiling (Fernández, Saravia Matus and Gil, 2021). An appropriate pricing policy is necessary not only to discourage waste and cover the costs of the service, but also to secure access to the service for low-income households.

In short, progress along the path of water transition in the region needs to be pursued through a combination of measures across four pillars: (i) universalization of access; (ii) reduction of water poverty; (iii) containment of negative externalities (which requires measures to adapt to climate change); and (iv) introduction of new technologies and approaches such as the circular economy. These efforts will also contribute to proper management and appreciation of the value of water (ECLAC, 2024a). Within this framework, various solutions can be implemented to optimize water management that are financially attractive and technically conducive to the reduction of greenhouse gases, the generation of green jobs and an increase in the availability of fresh water in the face of climate change.

Given the investment effort required, it is essential for regulatory frameworks to be adjusted so as to attract new investors, which also requires innovative financing instruments and systems. As a starting point, it is necessary to consider the limitations of the current context, where State resources are the main or practically only source of investment in the sector. These limited resources have been further reduced in the current conditions of fiscal constraint, where the drinking water and sanitation sector must compete with other sectors that have even less revenue-generating capacity. Another limitation is that there are many medium-sized providers in the region facing financial problems because of the inadequacy of State resources, the difficulty of covering costs with tariffs and thus a reluctance in the traditional financial sector to lend to municipalities or small and medium-sized public service providers. This is due to the sector's need for financing periods matching the lifespan of investments, which, at an average of between 20 and 30 years, exceeds the periods for which commercial banks are willing to lend. These factors have led to a chronic financing gap in the sector. There is a similar situation as regards the inadequacy of resources to maintain and expand infrastructure for protection against floods, saline intrusion in aquifers, for example, for which mechanisms that facilitate financing and maintenance need to be designed. Consideration also needs to be given to financing for the protection of green infrastructure, river basins and forests, all of which helps to secure the drinking water supply.

Given what has been said, it is important to implement new forms of financing, such as thematic bond issues. In Latin America and the Caribbean, at least 14 large water and sanitation utilities can be identified as having issued green and sustainable bonds (Grez, Vogt and Cantú, 2023). For smaller providers, a more feasible option is the creation of revolving investment funds, set up with State resources earmarked for the sector. Experience with this type of mechanism in countries as diverse as the Philippines and the United States (OECD, 2021) shows its great potential benefits for the drinking water and sanitation sector in a context of significant budget constraints, given the medium and small scale of providers left out by traditional financing services. The resources for these funds come from both government contributions and credits obtained on the national or international financial market, as well as payments from municipalities and local water and sanitation service providers, which receive partially repayable credits that can be invested both in improving drinking water and sanitation coverage and in building adaptive water infrastructure. In addition, by providing technical assistance to beneficiaries and establishing a system of credits that increase as management performance improves, the mechanism encourages continuous improvement and efficiency in water resources management. These funds can also support agricultural extension activities to introduce efficient irrigation methods, including in turn the reuse of treated water for irrigation purposes.

Strengthening water governance and the technical, operational, political and prospective (TOPP) capabilities of water sector institutions is essential to improve water management in the countries of the region, with elements such as those described in table VI.9.

Table VI.9
Technical, operational, political and prospective (TOPP) capabilities of institutions for efficient, accountable and sustainable water management

Capabilities	Characteristics
Technical	– Promotion of improved and systematic monitoring of the availability and use of surface and groundwater resources and the state of the water infrastructure so that water can be used in a sustainable and less polluting way. – Construction of water indicator systems that report on water stocks, abstraction, uses and quality so that problems of overexploitation and pollution can be identified at an early stage. – Establishment of technical parameters that incorporate climatic conditions, both for new infrastructure and for the adaptation of existing infrastructure. – Analyses of technological transformation in the different sectors that strategically depend on water so that resilience, circularity, efficiency and water-saving solutions can be pursued at an early stage. – Implementation of registries and assessments of water concessions or water usage rights in different productive and human consumption sectors and mechanisms for speedy, transparent conflict resolution. – Establishment of a transparent pricing system for raw water use focused on ensuring responsible and sustainable water use in the different productive sectors. – Establishment of the human right to safe drinking water and sanitation at the highest (constitutional) level. – Continuous support for and reinforcement of the functioning of water allocation systems and the rules for granting and revoking usage rights.
Operational	– Regulation so that holders of water concessions or rights pay the financial charges corresponding to these and fines if they cause environmental damage, with the funds thus collected being used to strengthen the operation of water institutions. – Design of progressive and inclusive pricing structures that reflect the ability to pay, promoting efficient and sustainable water consumption, while easing the burden on lower-income households and thereby ensuring access to safe water and sanitation. – Adoption of innovative investment mechanisms (e.g. bonds and revolving funds) to extend sources of finance from the public to the private or community level, exploring climate finance options. – Development and implementation of incentives that support principles of increased productivity, resilience and circularity in the water demand management of each user sector on the basis of integrated water resources management approaches, to ensure that human and ecosystem requirements are met. – Effective communication linked to the premise that water security is a national security matter. – Establishment of mechanisms to foment the training of professionals specializing in water resources, with the aim of continuously updating the skills of technicians and public managers and promoting innovation in the sector.
Political	– Creation or reinforcement of a water authority, which could be of ministerial level, to set policies in a way that takes account of relationships with the various sectors and users in order to put an end to the severe institutional fragmentation that limits stable financing for investments aimed at sustainable and efficient water management and to strengthen regulatory bodies and ensure the financial sustainability of service providers and the maintenance of water infrastructure. – Creation of arrangements for coordination between the different water users via practices such as a water cabinet to speed up decision-making with backing from the highest national authorities. – Encouragement of basin organizations as valid coordination and participation options to ensure proper linkage between the local and national scales. – Establishment of a culture of appreciation for the value of water in which all actors are committed to responsible production and consumption.
Prospective	– Knowledge and systematic assessment of data related to the evolution and future of water resource use, the integrity of river basins and relevant ecosystems (water scenarios) and progressive measures to ensure the resilience of water infrastructure and service provision in the long term. – Establishment of intersectoral analysis groups to assess future impacts on water security alongside other potential crises such as pandemics, conflicts and recessions.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

F. Sustainable tourism

1. The contribution of tourism

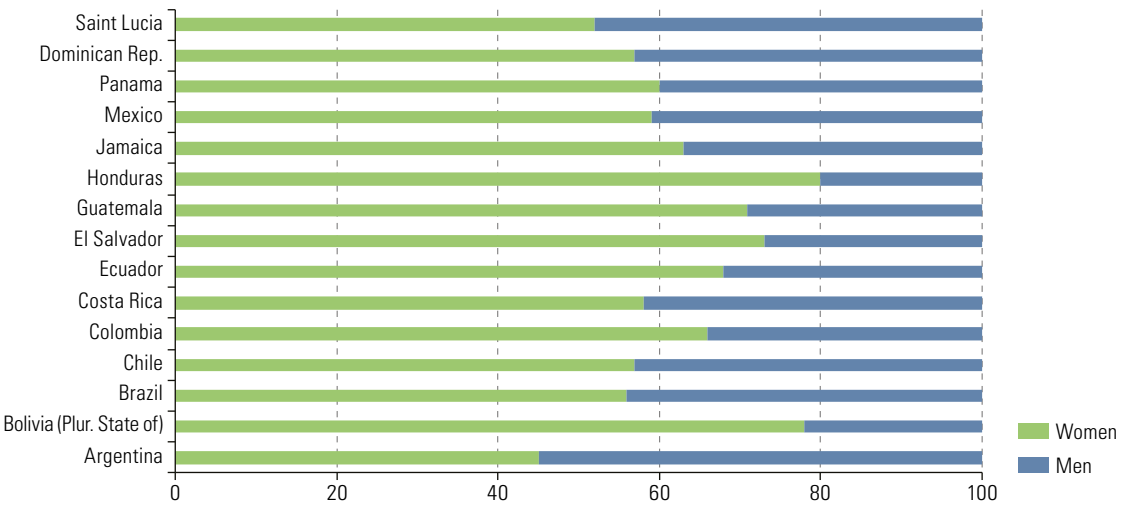
Latin America and the Caribbean received 76 million tourists in 2023. Mexico was the country that received the greatest number in the region, at some 42 million, followed by the Dominican Republic at 8 million and Argentina at 7 million. In 2023, the level of international tourist arrivals in the Americas recovered to 90% of pre-pandemic levels, while levels in Central America (+5%) and the Caribbean (+1%) were higher than in 2019.

The growth in the continent was mainly due to intraregional tourism from North America to the Caribbean and Central America (UN Tourism, 2024). The Caribbean and Central America rely on foreign tourist visits, while in Mexico domestic visitors account for three quarters of the total. In some South American countries such as Argentina, Brazil, Chile and Peru, the contribution of domestic tourism is as high as 50% (ECLAC, 2020).

In 2023, the region received tourism revenues of US$ 118 billion. The Caribbean received 33% of this, Mexico 26%, South America 27% and Central America 14%. Tourism's contribution to GDP is about 2.5% in South America and about 5% in Central America and Mexico (United Nations, 2024). The contribution of tourism to GDP in the Caribbean averages about 20%, but with large variations between countries: less than 10% in Cuba, the Dominican Republic, Haiti and Trinidad and Tobago, an average of 18% in the Bahamas, Belize, Grenada and Jamaica, and between 48% and 61% in Antigua and Barbuda and Saint Lucia (UNCTAD, 2016).

It is also estimated that tourism accounts for 10% of employment in Latin America and 35% in the Caribbean. Despite its importance in employment, about 52% of those working in the sector are informally employed. Women hold about 58% of accommodation and catering jobs (see figure VI.10), while youth up to 24 years of age hold 21% of jobs (ECLAC, 2020). Tourism employment is also characterized by short hours and low pay. Women tend to fill the lowest-paid and lowest-skilled jobs, especially in cleaning and customer service, with less involvement in management and technology positions. Women are also underrepresented in public decision-making positions: 73% of tourism ministries in ECLAC member States are headed by men and 27% by women.

Figure VI.10
Latin America and the Caribbean (selected countries): shares of women and men in employment in accommodation and catering, 2022–2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Labour Organization (ILO), ILOSTAT [online database] https://rshiny.ilo.org/dataexplorer4/?lang=en&id=EMP_TEMP_SEX_ECO_NB_A.

The sector is exposed to numerous direct and indirect impacts from climate change. Rising sea levels and ocean acidity will threaten coastal tourism infrastructure and natural attractions, with changes in biodiversity impacting ecotourism. This phenomenon can already be seen to be affecting one of the tourist attractions in the Caribbean, which has 10% of the world's coral reefs and 60% of the region's, but has seen a 60% decline in live coral cover over the last 20 years because of climate change and a variety of other factors (IKI, 2023). As well as being a tourist attraction, coral reefs generate other ecosystem benefits, such as increased coastal protection against storms, flooding and erosion (ECLAC, 2018). Sea level rise, coastal erosion, coastal regression and inundation, and saline intrusion will have profound and multiple impacts on coastal tourism by degrading and affecting tourist infrastructure and attractions such as beaches (ECLAC/Environmental Hydraulics

Institute, 2015). Another problem linked to the climate change-related warming of the sea, among other factors, that is affecting tourism, fishing and biodiversity (by causing coral death) is the presence of sargasso in much higher quantities than normal on the Caribbean coasts, requiring clean-ups that have significant costs for the tourism sector.

Natural resources are a central element of the tourism that the region attracts, making their conservation and sustainable management essential. However, it is a sector that also suffers from environmental impacts and contributes to greenhouse gas emissions. Tourism transport alone is estimated to account for 22% of overall greenhouse gas emissions from the transport sector and 5% of total emissions (UN Tourism/ITF, 2019). As regards water, it is estimated that tourism consumes 1% of the world's drinking water (UN Tourism, 2013). Although consumption is low in comparison to other productive activities, it presents major challenges at the local level, as does the management of the waste it generates. In general, there is little linkage between territorial development plans, ecosystem capacities and tourism planning.

2. The sustainable transformation of tourism

Sustainable tourism comprises four key elements: (i) optimal use of natural resources to maintain essential ecological processes and conserve biodiversity and ecosystems; (ii) respect for cultural authenticity, preservation of cultural heritage and traditions, and support for interculturality, diversity and tolerance; (iii) viable economic operations that provide socioeconomic benefits to participants; and (iv) the capacity to plan, lead and manage tourism development with multilevel and inclusive governance (UN Tourism/UNEP, 2005; GSTC, 2019; Bonilla and others, 2024).

The literature that has studied the relationship between tourism and economic growth is quite extensive and might be summarized as being divided into two opposing positions. On the one hand, there is the "beach disease" hypothesis, according to which a high degree of specialization in the tourism sector may harm economic growth in the long run. The argument is that since tourism is a labour-intensive sector, its development may draw resources away from other more productive sectors, reducing the accumulation of human capital (Boto García, 2023). On the other hand, there is support for the "tourism-led growth" hypothesis, whereby the revenues generated by international tourism are a form of trade in services that contributes to growth through the expansion of aggregate demand.

For example, Bronzini, Ciani and Montaruli (2021), using data for Italian provinces, find that tourism expenditure has positive, albeit modest, effects on economic growth. They estimate that, for every euro per capita that a foreign visitor spends, value added grows over the next decade by between 0.8 and 2.1 euros. They also show that tourism, although it increases employment, has no effect on labour productivity. Arriaga and González (2019) analyse the importance of tourism activity in Mexico by identifying the inter-industry relationships produced by the sector and find that for every million pesos of final demand in the tourism sector, 2.5 jobs are created directly and 1.7 indirectly. Marquina (2014) observes that the Mexican productive system depends on tourism demand, with a strong interconnection between the tourism sector and the rest of the economic structure. The author finds that, without this sector, total gross value added in the Mexican productive system would be 8.2% lower as a direct result, with an induced indirect effect of 15.7% of total gross value added on top of this.

Despite its economic momentum, tourism's contribution to countries' development, especially local development, has been mixed, albeit with wide variations in specific experiences. While it contributes to exports, is a source of investment and employment, and commonly features strong participation by micro-, small and medium-sized enterprises (MSMEs), the sector's development also often presents shortcomings. These include challenges such as the casualization and feminization of jobs, greenhouse gas emissions, conflicts over the use of local water resources, lack of innovation in the tourism experience, and conflicts over land tenure in rural areas or access to housing in cities, among others. During the pandemic, the dependence of local communities on tourism, the weakness of territorial management, the absence of emergency networks

or funds and the relative lack of measures in the sector to deal with the seasonality characterizing it all became apparent. Rural areas are also affected by large deficiencies in the quality of and access to services and public infrastructure that impact the quality of tourism offerings and opportunities for professionalization and innovation. In general, tourism in the region faces four main challenges: the quality of jobs, innovation in tourism services and products, sustainable management of the natural and cultural heritage, and management of tourism destinations (Bonilla and others, 2024). These challenges are also strategic areas that could drive a transformation of the sector, increasing its productivity.

Tourism employment has low barriers to entry and is highly seasonal, attracting youth, migrants and women seeking to balance paid and unpaid work. However, there are cases where competitiveness is based on the casualization of working conditions rather than on professionalization and improvement of service quality. Similarly, there is often little innovation in tourism experiences, partly because of the paucity of linkages between tourism and the digital, creative and environmental industries and a lack of planning to take advantage of the link between tourism and the agricultural and cultural sectors. This is partly due to the limited business capabilities of tourism MSMEs, which account for some 95% of tourism establishments. While much of the region's tourism depends on the natural and cultural heritage, there are staffing and budgetary constraints on the development and management of sites, while linkages between tourism development needs and environmental and cultural agendas are poorly structured. These challenges are exacerbated by dispersed governance, which hampers the management of destinations at the territorial level and means that little advantage is taken of social and business dynamics there.

As with other sectors, capacity-building in tourism is essential to improve the sector's productivity and competitiveness through innovation in its business models, services and products and the quality of employment.

Given how much interest there is in the region's immense natural and cultural heritage, high-quality, innovative tourism offerings could help to improve jobs and conditions for local communities, add value to the tourism experience and drive innovation in other industries. Cultural and biodiversity attractions can serve to turn these resources to account and develop market niches that generate higher revenue per tourist, supported by trends such as local and sustainable experiences, women travelling alone, travel out of season or off the beaten track, and the quest for physical and mental well-being. There is also great potential for linkages with the agriculture and fisheries, culture, and environmental conservation sectors and with the digital and creative industries. As well as improving tourism provision and contributing to the development of new tourism products, these linkages can have additional effects, instilling a new appreciation of local practices and traditions, for example, or raising environmental awareness. They could also lead to the transformation of the region's tourism knowledge into disruptive innovations in tourism or other industries.

The culture sector and leisure industries can be major producers of intellectual property that draw out the value of local cultural heritage and strengthen social cohesion and community self-esteem. Links with the agricultural and fisheries sector help to improve the sustainability of gastronomic offerings, showcase local diets and agricultural landscapes, and promote agrotourism. Digital and creative industries could facilitate the use of data intelligence and other tools of the digital revolution, improve promotion and marketing strategies and transform the region's experience and challenges into digital and technological applications. There are also great opportunities to link the country or destination's environmental priorities to its tourism development strategy, for example through scientific or conservation tourism, which not only contributes to economic activity, but could support efforts to conserve and monitor protected areas and develop new green materials and businesses.

The potential to use tourism for local sustainable development largely depends on the implementation and leadership capabilities of the public sector. The complexity of the sector means that different sectors need to interact under the leadership of national tourism authorities. While local and national tourism actors are active, they are also diverse and divided into numerous groupings, which makes it difficult to coordinate efforts and direct them towards common objectives. It is important to enhance the ability of national governments to empower local communities so that they can take ownership of tourism strategies and coordinate their implementation with subnational governments. It is also necessary to have tourism planning and decision-making arrangements that include communities, and strategies for communicating information of relevance to communities and businesses. This involves establishing coordination mechanisms and improving

public and private data availability and sharing. Social dialogue and strengthened governance are crucial to achieve these goals. It is essential, for example, to take account of the capacity of national governments to effectively empower local communities in the planning and implementation of tourism strategies. There is also a need for inclusive planning and decision-making arrangements that are not only participated in by the authorities, but that actively involve local communities and businesses.

Table VI.10 lists the TOPP capabilities of the institutions responsible for promoting the tourism sector that are considered to have an important contribution to make to progress in the directions suggested.

Table VI.10
Technical, operational, political and prospective (TOPP) capabilities of institutions for fostering sustainable tourism

Capabilities	Characteristics
Technical	– Capacity-building among national and subnational tourism personnel in the areas of territorial management and sustainability, with an approach that encompasses social, environmental, cultural, economic and governance criteria for the planning and management of tourism destinations. – Development of the skills and conditions required for joint efforts by intersectoral and inter-institutional teams to manage tourism destinations by training national and subnational tourism personnel in sustainability topics, promoting research in public institutions, fostering collaboration between institutions and carrying out fieldwork at destinations. – Development of capabilities and functions centred on the creation, sharing and use of technology and public and private data in the planning and management of tourism destinations. – Incorporation of the agricultural, cultural and environmental sectors in national and destination-level tourism planning and development. – Development of strategies for securely and transparently sharing public data and linking information relevant to destination planning and management with the private sector and other providers.
Operational	– Creation of inter-institutional working groups to generate and share information for the implementation of a tourism sustainability measurement system, based on the statistical framework for measuring the sustainability of tourism of the World Tourism Organization (UN Tourism). – Establishment of joint national and subnational government coordination and monitoring mechanisms, and strengthening of subnational governments' ability to implement the national tourism policy. – Establishment or development of arrangements for working with national and local tourism associations to improve the availability of data about tourism businesses, expand the scope of promotion and communication programmes and tailor support to the situations and needs of businesses and destinations. – Coordination with the private, academic and educational sectors to renew or create technical and professional academic offerings with a focus on sustainability, innovation and quality. – Development of green and innovation financing access mechanisms for micro-, small and medium-sized tourism enterprises, rural businesses and businesses owned or run by women. – Development of promotion, support and incentive programmes for the transition towards a form of tourism based on the principles of the circular bioeconomy and the effort to develop sustainable and innovative products, services and business models. – Identification and establishment of the conditions necessary to transform tourism in accordance with the principles of the care society.
Political	– Creation of spaces for dialogue to develop a vision of sustainable tourism that is widely shared with national and subnational public and non-public stakeholders, and incorporation of the tourism development strategy into the investment attraction, business development, public infrastructure, employment, disaster risk reduction and technical and vocational education agendas. – Creation or strengthening of mechanisms for coordination with the institutions responsible for the social and occupational security of people working in tourism to address issues related to social security, work, migration, youth, children and women. – Fostering of collaboration with strategic sectors such as culture and creativity, agriculture, livestock and fisheries, environment, digital services and technology, and the circular bioeconomy with a view to sophisticating and diversifying tourism offerings. – Creation of tourism development coordination and planning mechanisms that include subnational governments, local tourism associations, businesses, communities and other relevant stakeholders at destinations.
Prospective	– Coordination for the design of a vision of the future to guide long-term sustainable tourism development, considering the impact of the digital revolution on jobs and consumption, changes in consumption due to population ageing in countries of origin, emigration and immigration from and to destinations, and the impact of climate change and biodiversity loss on the attractiveness of destinations and on tourist preferences. – Capacity-building and working groups for the study of alternative scenarios and future trends and of emerging risks and opportunities in the regional and global tourism context. – Use of analytical methodologies to explore alternative scenarios, assess potential impacts and formulate proactive strategies to adapt and prepare for future changes in regional and global tourism.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

G. The bioeconomy: a driver of sustainable productive transformation

The bioeconomy is much more than a production sector. It is a set of activities encompassing: (i) primary sectors that produce different types of biomass (agriculture, livestock, forestry, fisheries and aquaculture); (ii) manufacturing sectors that use this biomass to produce, among other things, foodstuffs, feed, bioenergy,

fibres and clothing, building materials, and biochemicals; (iii) waste biomass and by-products derived from the production and processing of primary biomass and from the consumption of the products made from it; (iv) ecosystem services, biodiversity and its elements, genetic resources, and applications derived from knowledge of biological systems, processes and principles (e.g. in biodiagnostics, biomonitoring, biodesign, bioremediation, and research and development (R&D)); and (v) applications of technologies stemming from the biological and life sciences revolution (e.g. biotechnologies, omics, gene editing) and their convergence with technologies in the field of material sciences (e.g. nanotechnology) and digital sciences (e.g. bioinformatics, artificial intelligence, data analytics).

1. The transformative power of the bioeconomy

ECLAC (2024a) has highlighted the disruptive power of the bioeconomy to address global problems such as climate change, improve environmental management in agriculture, respond to changes in consumption habits, and diversify and sophisticate production structures and increase value added.

The bioeconomy is an opportunity both to mitigate the effects of climate change and to adapt to this in agriculture, while enhancing synergies. For example, environmental problems arising from the use of synthetic nitrogen fertilizers and increased nitrous oxide (N_2O) emissions offer opportunities for the local development of biofertilizers and other inputs based on biological resources, which in turn will help reduce dependence on imports of synthetic fertilizers. Another example concerns N_2O and methane (CH_4) emissions from livestock, which offer opportunities to improve the digestibility of pasture and forage and to introduce genetic advances aimed at improving methanogenesis in cattle. As regards adaptation, modern biotechnologies can be applied to design crop varieties that are better adapted to conditions of water, heat and salinity stress, thus contributing to increased resilience. Negative externalities associated with the generation of agricultural waste (including manure) can be turned into opportunities to produce bioenergy, biomaterials and other high value added bioproducts. Through the development of new bio-based inputs and the production of bioenergy, the bioeconomy contributes to the reduction of greenhouse gas emissions. In addition, changes in consumption habits are creating opportunities to diversify production and develop high value added products such as new proteins and foods with improved nutritional qualities, taste and texture (ECLAC, 2024a).

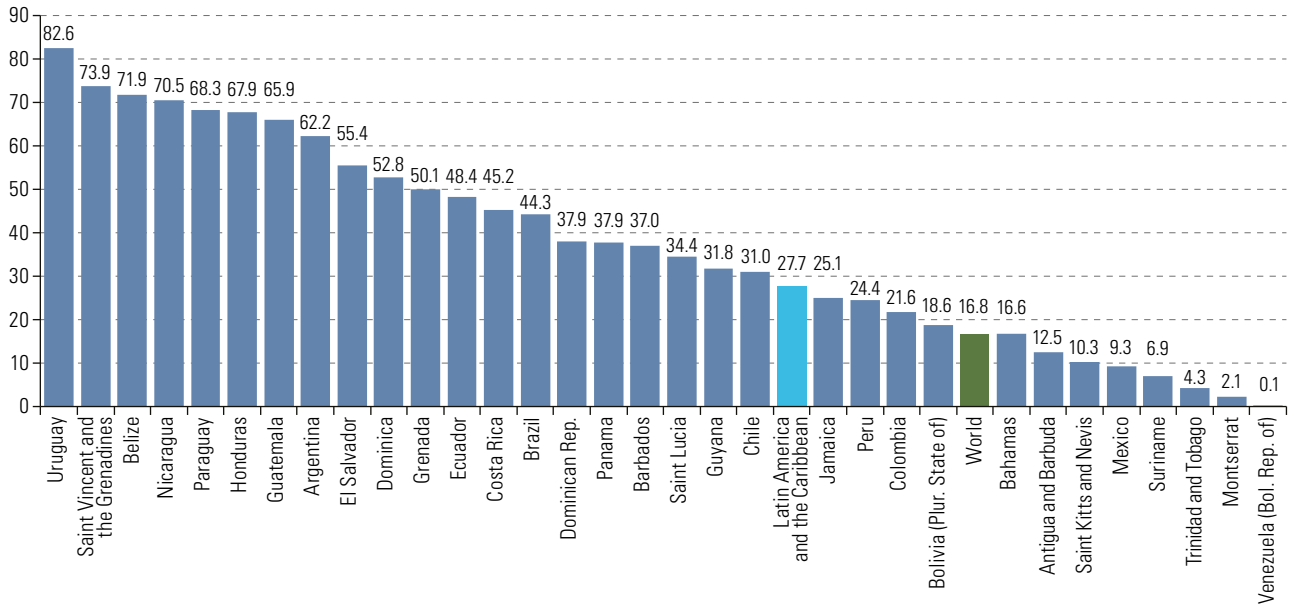
ECLAC (2024a) also stresses that the bioeconomy can be considered a new technological paradigm, in the sense proposed by Dosi (1982), since it offers solutions to selected technological problems (such as the reduction of greenhouse gas emissions and adaptation to climate change) on the basis of principles derived from the natural sciences (biological principles, processes, systems and resources) and selected material technologies (such as biotechnology, nanotechnology, digital technology, artificial intelligence and the convergence of these).

2. The economic contribution of the bioeconomy in Latin America and the Caribbean

If the productive activities that make up the bioeconomy are linked to standardized international classifications of economic activities (the International Standard Industrial Classification of All Economic Activities (ISIC)) and products (the Central Product Classification (CPC)), measures to estimate the economic contribution of the bioeconomy can be developed by creating bioeconomy satellite accounts (Vargas and others, 2022; Vargas, Mondaini and Rodríguez, 2023). Taking an average for 13 countries (Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Peru), characteristic bioeconomy products (those whose content derives entirely from biological resources) account for 17.2% of gross production by value, 12.5% of imports, 24.5% of product taxes, 18.6% of intermediate consumption, 28.6% of exports and 24.9% of final consumption. If products with extended characteristics are included, i.e. those whose biological and non-biological content cannot be separated a priori, the potential contribution of the bioeconomy increases in all cases by more than 10 percentage points.

Exports provide a complementary way of determining the economic importance of the bioeconomy. Using the biotrade database developed by the United Nations Conference on Trade and Development (UNCTAD) and Harmonized Commodity Description and Coding System (HS) codes, figure VI.11 gives the percentage share of exports of products of biological origin in the region's total exports (27.7%), and shows that the figure is more than 10 percentage points higher than the world average (16.8%). Their importance is particularly great in South America (40.2%), where it is attributable to the presence of major agro-exporting countries such as Uruguay (82.6%), Paraguay (68.3%), Argentina (62.2%) and Brazil (44.3%).

Figure VI.11
Latin America and the Caribbean: biotrade as a share of total trade (exports), 2010–2022 averages
(Percentages)



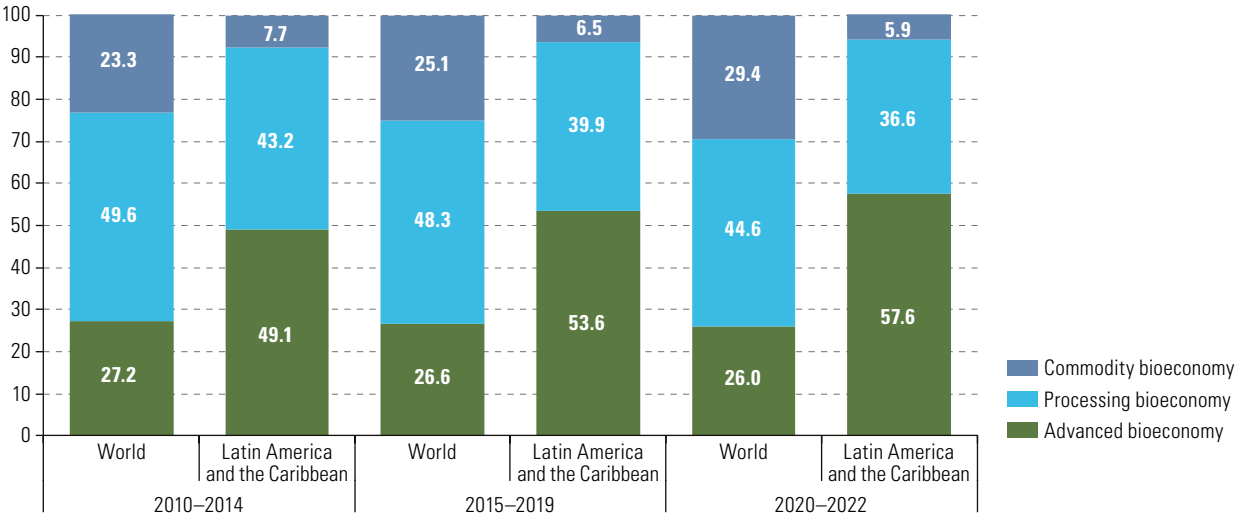
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), "Trade in biodiversity-based products" [online] https://unctadstat.unctad.org/en/Biotrade.html#.

3. The bioeconomy: diversifying, sophisticating and adding value

Despite the economic importance of the bioeconomy in Latin America and the Caribbean, its production structure is not very diversified. ECLAC (2022) proposes three categories of bioeconomy: (i) the commodity bioeconomy, which includes the production and use of different types of biomass for the production of raw materials (e.g. crop and livestock farming, forestry, aquaculture and agro-industry); (ii) the processing bioeconomy, encompassing manufacturing sectors where products originating in the commodity bioeconomy are processed (e.g. the wood, pulp and paper, animal feed, human food, and textile and clothing industries); and (iii) the advanced (or high value added) bioeconomy, which emphasizes the application of modern knowledge and technologies (sometimes leveraging traditional knowledge) to develop new products (or substitutes for fossil-based products) and high value added chains (e.g. sustainable use of biodiversity and its elements, utilization of non-conventional primary biomass and microorganisms, recovery of secondary biomass via biorefining, and the application of knowledge about biological principles and processes).

Figure VI.12 highlights not only how heavily dominated the region's bioeconomy exports are by commodities, especially agricultural products, compared with world averages, but also how much this concentration has increased, from 49.1% (44.6% for agricultural products) of the total in the period 2010–2014 to 57.6% (53.0% for agricultural products) in 2020–2022. At the other extreme, the export share of the advanced bioeconomy is low and falling, having declined from 7.7% in 2010–2014 to 5.9% in 2020–2022.

Figure VI.12
Latin America and the Caribbean and world: structure of international trade in bioeconomy products, by bioeconomy type, 2010–2014, 2015–2019 and 2020–2022 averages
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), "Trade in biodiversity-based products" [online] https://unctadstat.unctad.org/en/Biotrade.html#.

The average positive balance in the region's commodity bioeconomy goods trade (exports minus imports) increased from US$ 90.5 million in 2010–2014 to US$ 129.7 million in 2020–2022. In the same periods, the region ran a surplus of about US$ 37 million for processing bioeconomy products, while a negative balance of US$ -27 million for advanced bioeconomy products in the first period worsened to US$ -38.4 million in the second (UNCTAD, n.d.).

4. The bioeconomy: productive development and the sociobioeconomy

Two recent developments in policies to promote the bioeconomy are its incorporation into productive development strategies and the formulation of the concept of the sociobioeconomy.

(a) The bioeconomy and productive development

The bioeconomy has been incorporated into recently implemented productive development strategies in countries of the region such as Brazil and Colombia. In Brazil, one of the six missions of the Action Plan for Neoindustrialization 2024–2026 concerns the bioeconomy, decarbonization, the energy transition and energy security (Ministry of Development, Industry, Trade and Services/CNDI, 2024). The goals of this mission that relate directly to the bioeconomy include: strengthening production chains based on the circular economy and the sustainable and innovative use of biodiversity; developing bioeconomy industries; promoting an appreciation of the value of forests in sustainable forest management; and developing strategic technologies for decarbonization, the energy transition and the bioeconomy. In Colombia, the bioeconomy is included in the agro-industry and food sovereignty strategic area of the National Reindustrialization Policy (CONPES, 2023). This includes development of the bioeconomy for sustainable and regenerative agricultural and livestock production; encouragement for local industrialization and marketing of bioinputs and bioproducts derived from biotechnology; the use of new technologies and access to capital goods to optimize agricultural production (precision agriculture) and ecological restoration; and the pursuit of modernization and productive inclusion

in the agricultural sector. Elements that are important for the bioeconomy are also included in the strategic areas of energy transition (e.g. decarbonization and reduction of economic dependence on fossil and mineral resources) and reindustrialization in the health-care sector (e.g. biotech medicines).

(b) The sociobioeconomy approach

Another important innovation in bioeconomy promotion policies has been the formulation of the concept of the sociobioeconomy, associated mainly with the development of the bioeconomy in biodiversity-rich environments. There is no single established concept of a sociobioeconomy. According to Costa (2023), for example, the concept stresses the pursuit of synergies between the social, biological and economic spheres to achieve a more prosperous, equitable and sustainable future. Voss and Rodrigues Maciel (2023) state that the concept recognizes the links between biodiversity and sociocultural systems, advocating sustainable production chains, protecting genetic heritage, valuing communities' traditional knowledge, stimulating job creation and income generation, and positioning itself as a climate change adaptation strategy. Frazao (2023) writes that the concept embodies the relationship between biological diversity, traditional agricultural systems (agrobiodiversity) and the use and management of these resources together with the knowledge and culture of indigenous peoples, traditional populations and family farmers.

The sociobioeconomy concept has been promoted in the context of proposals for the development of an Amazonian bioeconomy, particularly in Brazil. An important forerunner was the creation of the Bioeconomy Brazil - Sociobiodiversity programme. Launched in 2019 and run by the Ministry of Agriculture, Livestock and Food Supply, the programme aims to organize production systems based on the use of biodiversity products and the selective extraction of non-timber forestry products.

5. The bioeconomy: linking institutional approaches and capabilities

Three bioeconomy development models can be identified in Latin America and the Caribbean. Two are associated with the major sources of biological resources identified in the region: (i) the circular bioeconomy model, which is based on making complete use of biomass, and (ii) the sociobioeconomy model, mentioned above. A third, the "technobioeconomy" model, is based on knowledge of biological systems, processes and principles and the application of advanced technologies such as "omics" (genomics, transcriptomics, proteomics, metabolomics, metagenomics and phenomics), gene editing and synthetic biology.

These models can be used to identify scenarios for the development of strategies and initiatives aimed at promoting the bioeconomy in the region. They are complementary models, with the linking elements being the role of science, technology and innovation, the objectives of equity and sustainability, and the value chain and territorial production cluster approaches.

The four national bioeconomy strategies in the region have elements of all three models, especially the circular bioeconomy and sociobioeconomy models. These are the National Bioeconomy Strategy: Costa Rica 2020–2030 (Government of Costa Rica, 2020); the Bioeconomy Strategy for Colombia as a Living and Diverse Power: Towards a Knowledge-Driven Society (Government of Colombia, 2020); the Sustainable Bioeconomy Strategy of Uruguay (in preparation); and the National Bioeconomy Strategy of Brazil (Government of Brazil, 2024). These strategies seek convergence between productive development and sustainability objectives and highlight the potential of the bioeconomy for diversifying production and adding value. All four strategies promote the recovery of waste biomass, the promotion of activities geared towards adding value to agriculture and food production, the conservation and sustainable use of biodiversity, and the push to develop advanced bioeconomy activities.

More specialized strategies have recently begun to emerge at the sectoral and subnational levels. A leading example is the proposed Agricultural Bioeconomy Sectoral Strategy for Mexico (ESBAM) (Government of Mexico, 2023). In Argentina, stress is placed on the potential for using biomass in various sectors, including biomaterials and high value added products (Romano, 2019), and in regional productive development (O'Farrell and others, 2023). An example in the field of biodiversity, meanwhile, is the State Bioeconomy Plan of the State of Pará in Brazil (Government of the State of Pará, 2022).

Lastly, the role of the bioeconomy in the creation of innovation clusters should be mentioned. The development of the bioeconomy requires a strong and integrated network of related industries that support each other right along the value chain. Clusters are shaped by close interaction between research organizations, start-ups and established firms with greater capacity to engage in product development and access large markets (Birner, 2018). Examples of bioeconomy innovation clusters in Germany can be found on the website of the BioEconomyCluster initiative[7] and examples of agriculture- and food-related industry clusters on the European Cluster Collaboration Platform.[8] The European Commission's initiative to foster the transition to the bioeconomy at the subnational level in the regions of the European Union, called BIO2REG,[9] should also be noted. Bioeconomy innovation clusters already exist in Latin America and the Caribbean, including HubBio[10] in the province of Santa Fe (Argentina) and the Costa Rican biotechnology and medical devices cluster, CR Biomed.[11]

Whatever the model (or combination of models) taken for the bioeconomy, it will be necessary to strengthen a number of institutional capabilities that could help facilitate the transformations needed to exploit its potential in Latin America and the Caribbean (see table VI.11).

Table VI.11
Technical, operational, political and prospective (TOPP) capabilities of institutions for fostering the bioeconomy

Capabilities	Characteristics
Technical	– Development of bioeconomy strategies that foster synergies with other sectors driving a great productive transformation and that particularly contribute to systemic transformations for the attainment of the Sustainable Development Goals. – Design of action plans for the implementation of bioeconomy strategies in which specificities and possible local sources of biological resources for the development of the bioeconomy are identified and enhanced with a territorial development and production cluster approach. – Capacity-building for the design of bioeconomy strategies that incorporate national policy frameworks and relevant international commitments (e.g. climate change and biodiversity). – Incorporation of measures to promote the bioeconomy in productive development strategies, pursuing convergence between its goals and those of environmental policies. – Design of financial and non-financial instruments to support the development of new enterprises and inclusive business models that encourage the participation of youth and women. – Capacity-building for the management of intellectual property produced by bioeconomy innovations. – Generation of information on the availability of biological resources (e.g. types, volumes and distribution) and on the technical, professional and research talent gaps that need to be filled if they are to be used sustainably.
Operational	– Establishment of consultation mechanisms to coordinate the implementation of national bioeconomy strategies and the development of subnational action plans that take territorial specificities into account. – Strengthening of mechanisms for coordination between sectoral institutions responsible for the implementation of bioeconomy development strategies and action plans (e.g. ministries of economic affairs and industry, agriculture, environment, energy, and science, technology and innovation). – Creation of technical working groups in areas of strategic interest for the development of the bioeconomy, including the participation of representatives of public institutions, the private sector, civil society and the academic and research community. – Development and application of mechanisms to measure the economic contribution of the bioeconomy and its linkages, and indicators to determine its sustainability. – Identification and application of best practices and lessons learned regarding the promotion of bioeconomy initiatives with a territorial development and production cluster approach.

7 See [online] https://www.bioeconomy.de/en/.
8 See [online] https://clustercollaboration.eu/in-focus/industrial-ecosystems/agri-food.
9 See [online] https://bio2reg.eu/.
10 See [online] https://hubbiosantafe.ar/.
11 See [online] https://crbiomed.org/.

Capabilities	Characteristics
Political	– Promotion of mechanisms for communication, coordination and political dialogue with the different actors involved in the development of the bioeconomy. – Promotion of multilateral dialogue and collaboration in areas of common interest across countries to foster the development of the bioeconomy (e.g. research and development programmes, requirements and criteria for registering biomolecules, development of human talent). – Creation and implementation of multisectoral and multi-stakeholder dialogue mechanisms to harmonize visions around the establishment of regulatory frameworks and incentives that foster the development of the bioeconomy. – Communication to society of the potential of the bioeconomy and its economic, social and environmental benefits as an innovative and transformative option for tackling major global challenges.
Prospective	– Capacity-building and development for the monitoring of technological advances (e.g. patents) and changes in consumption patterns that are important for the future development of the bioeconomy. – Capacity-building for the identification and surmounting of new trade and regulatory barriers that may limit the development of the bioeconomy. – Capacity-building for the identification and application of the best available scientific information and data on the economic, social and environmental benefits of the bioeconomy, as well as its potential risks. – Mainstreaming of the bioeconomy in the agendas of research programmes, forums and bodies carrying out foresight activities (e.g. parliamentary foresight committees).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

H. The circular economy: efficiency and productive transformation

The circular economy applies a new logic of production and consumption involving the optimization and permanence of the use and value of resources in the economy, based on technological innovation and the development of new business models. In this logic, the circular economy is a system in which materials do not become waste and nature is regenerated. Materials are kept in circulation through processes that start with the eco-design of products and prioritize maintenance, repair, reuse, remanufacturing, recycling and composting, seeking to decouple the consumption of natural resources from economic activity. Eliminating waste and pollution, circulating products and materials, and regenerating nature are the three globally adopted principles of the circular economy (Ellen MacArthur Foundation, n.d.; ECLAC, 2022 and 2023a). Moving towards the circular economy entails a great transformation in production and consumption systems, involving investment, the incorporation of new technologies, demand for new talent and skills, and the creation of new jobs. Accordingly, this is a productive transformation that contributes to more productive, inclusive and sustainable development models.

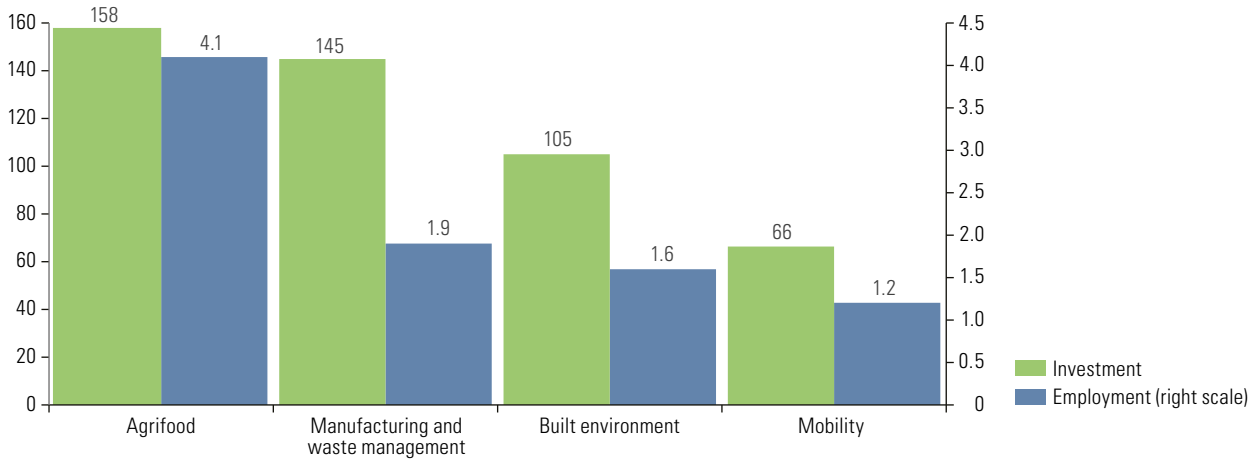
1. Potential benefits of progressing towards a circular economy

As a resource-rich region, Latin America and the Caribbean plays a key role in the global extraction and supply of materials; despite representing 8.3% of the world's population, it provides more than 11% of the world's raw materials by weight. It is largely self-sufficient in raw materials and contains many countries with a moderate material footprint. However, the region's economy is largely linear, with minimal secondary materials consumption of less than 1%[12] (Circle Economy, 2023a), well below the global average of 7% (Circle Economy, 2023b). About 40% of the 10.7 billion tonnes of material resources extracted in the region were exported in 2018 to meet global materials demand. The rapid increase in this demand has become a major driver of environmental degradation in the region and has led to an increase in the national extraction footprint (mainly biomass and minerals) per capita.

[12] This is a rough estimate owing to the lack of reliable and comparable data in the region and the high level of informality.

The Circularity Gap Report: Latin America and the Caribbean (Circle Economy, 2023a) establishes that the implementation of circular economy strategies could reduce materials use and the carbon footprint by approximately 30% apiece. At the same time, the cost of the policies and investments required for this transformation is estimated at some US$ 474 billion over the next few years in four key sectors: agrifood, manufacturing and waste management, the built environment, and mobility. This amount would be available if the tax burden in the countries of the region were to rise to the Organisation for Economic Co-operation and Development (OECD) average, and up to 8.8 million formal jobs could be generated (see figure VI.13) (Circle Economy, 2023a). The report also estimates that certain interventions in the agrifood and manufacturing sectors would reduce the region's environmental footprint by two thirds, without considering additional positive and potentially synergistic effects in the areas of housing, renewable energy and mobility, among others. However, the raw material exporting profile of the Latin America and Caribbean countries means that policies adopted in other parts of the world are of great importance.

Figure VI.13
Latin America and the Caribbean: estimated gains in formal employment following adoption of circularity policies and associated investments
(Billions of dollars and millions of jobs)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Circle Economy, "The Circularity GAP Report 2023: we live in the overshoot era", 2023 [online] https://www.circularity-gap.world/2023.

On conservative estimates for four countries of the region (Chile, Colombia, Mexico and Peru), an 8% decrease by 2030 in the use of plastics, whose progressive reduction is being negotiated internationally, and a 5% decrease in the use of some raw materials (fossil fuels, metallic materials and construction materials) would raise GDP by between 0.9% and 2.2% and employment by between 1.2% and 2.1% because of efficiencies in production and consumption processes associated with the circular economy (ECLAC, 2022; Rodríguez and others, 2023). Greenhouse gas emissions would also fall. The circular economy is thus emerging as a promising way to achieve higher growth while contributing to environmental stewardship, if the economic environment, regulatory framework and infrastructure needed to scale up circular practices are in place (Rataj and Türkeli, 2024), particularly if market failures are dealt with (Fullerton and others, 2022).

The challenge is to strive to incorporate circular practices throughout all priority sectors on the basis of national strategies and public policies that are aligned with a transition towards circularity.

2. The future is circular: recommendations and institutional capabilities

Moving towards a circular economy in Latin America and the Caribbean requires not only technical solutions, but also suitable governance based on collaboration between actors, the construction of metrics, national strategies and road maps, and the design of economic, financial and regulatory instruments, among other

things. Given the complexities of a transition towards circularity, it is essential to have a theory of change that serves to arrive at a shared systemic vision, harmonize concepts, identify gaps and opportunities, design policies, and plan, communicate and follow up this approach (see diagram VI.3). The shared vision can provide direction, enabling stakeholders to navigate the complexities of the circular transition with greater clarity, unity and purpose.

Diagram VI.3
Theory of change approach for dealing with transition to circular economy

Context	Action	Indicators	Results	
Why is a transition to a circular economy needed in Latin America and the Caribbean?	What steps are needed to achieve the goals?	What are the measurable effects?	What are the short-run results of pursuing a transition to a circular economy in Latin America and the Caribbean?	What are the structural long-run results for the countries of Latin America and the Caribbean?
• Low economic growth and low productivity. • The region is heavily dependent on natural resource extraction. • Environmental crisis (loss of biodiversity, changes in land use, pollution). • High vulnerability and low resilience to climate change impacts. • Volatile commodity prices. • Low participation by the countries in global value chains. • Exports based on natural resources with little value added. • Informal employment, high levels of inequality and poverty and large gender gaps. • Low levels of investment. • Little investment in innovation.	• Identification and transformation to circularity of priority sectors in the countries of the region. • Public policies, strategies, standards and governance for the transition. • Development of financing instruments for the transition. • Ongoing investigation into methodologies for evaluating the impacts of the circular economy at the regional and national levels, and into the economic, social and environmental aspects (co-benefits). • Participation of different stakeholders (national governments, other international bodies, academia, firms, non-governmental organizations, consumers) and recognition of the issues they face. • Creation of ongoing political dialogue. • Identification of indicators and metrics for monitoring progress towards the transition.	• Strengthening and development of policy instruments for the transition to the circular economy. • Optimization of resource use over the product and service life cycle in priority sectors. • Measures to overcome barriers to the progress of the strategies. • Effective participation by priority sectors and stakeholders in action to change production and consumption patterns. • Contribution to changes in social variables. • Strengthening of databases that facilitate the construction of indicators and measurement of the circular economy. • Financing and resources allocated or redirected to the circular economy.	• Contribution to the attainment of the Sustainable Development Goals and Paris Agreement. • Efficient use of resources and increase in circularity. • Development and implementation of policy instruments and strategies for the circular economy. • Reduction in greenhouse gas emissions and climate change adaptation and resilience in priority sectors. • Improved conservation of the region's natural heritage. • Job creation in the circular economy sector (cross-cutting). • Increased circular economy research, development and innovation. • Availability of information and data for measuring and managing circularity. • Availability of finance and resources for implementing circular economy actions.	• Changes in production and consumption patterns and in the way services are generated. • Changes in the dynamics of employment because of new activities, start-ups or technological innovation. • Sustainable growth in sectors that interact with the circular economy (cross-cutting). • Efficient use of finite natural resources and their natural renewal times. • Contribution to the preservation of the natural heritage and ecosystemic services in the region for current and future generations. • Contribution to the reduction of greenhouse gas emissions globally. • Improved quality of life for the region's population. • Countries and cities free of pollution and waste. • Development model with more efficient and productive economies.
Key assumptions				
• Economic inefficiencies. • Increase in global demand for resources. • Extractivism and pressures on the physical basis of the economy in Latin America and the Caribbean. • Decline in ecosystemic services. • Current and projected environmental, economic and social impacts of climate change.	• Decoupling of economic activity from the use of finite resources and generation of waste. • Identification of gaps and opportunities for the transformation of production and consumption patterns.	• Transformation of production and consumption patterns in the region in the context of more efficient and productive economies. • Optimum use of resources and materials available in the economy. • Political commitment by the countries.		

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Samaniego and others, "Panorama de las hojas de ruta de economía circular en América Latina y el Caribe", *Project Documents* (LC/TS.2022/235), Santiago, ECLAC, 2022; C. de Miguel and others, "Economía circular en América Latina y el Caribe: oportunidad para una recuperación transformadora", *Project Documents* (LC/TS.2021/120), Santiago, ECLAC, 2021; P. Schroeder, K. Anggraeni and U. Weber, "The relevance of circular economy practices to the Sustainable Development Goals", *Journal of Industrial Ecology*, vol. 23, No. 1, February 2019.

Throughout the region, countries are progressively implementing national strategies, general legislation, action plans, road maps, white papers and circular economy guides with strong governmental leadership. The recommendations below reflect the work done in these processes, which will provide a faster transition towards a circular future (Jurado, Cabrera and del Castillo, 2023; Government of Uruguay, 2024):

- Boost investment in circular infrastructure to minimize waste generation and emissions, while facilitating the use of secondary materials.
- Strengthen regulatory instruments (such as product eco-design requirements with an emphasis on durability and ease of repair and recycling, and extended producer responsibility systems) that contribute to the establishment and expansion of circular business models.
- Align economic and financial instruments through tax restructuring, subsidies and other fiscal instruments, public procurement and other initiatives, to redirect investments towards circularity.
- Produce and disseminate high-quality statistics on the flow of materials, waste and emissions throughout the economy, tackling major gaps in data on industrial and construction and demolition waste streams. Standardized waste reporting protocols for municipalities and businesses can help ensure consistent and thorough data collection.
- Develop strong governance with collaborative platforms where academia, industry and policymakers can pool their efforts to accelerate a flow of knowledge and resources that stimulates circular production processes and innovative circular solutions.

On the basis of these areas of opportunity and challenges, table VI.12 itemizes some institutional capabilities that could drive the transformation towards the circular economy.

Table VI.12
Technical, operational, political and prospective (TOPP) capabilities of institutions for progress towards a circular economy

Capabilities	Characteristics
Technical	– Design, harmonization and implementation of policies, regulations and incentives that favour circular business models (e.g. eco-design measures, extended producer responsibility, product and process certification and eco-labelling, and recycling). – Incorporation of circularity indicators in the design of development policies and strategies to enable continuous evaluation of their impact. – Awareness-raising and strengthening of knowledge and skills of importance to the circular economy in the public and private sectors. – Development of training programmes to strengthen the human talent and social capital needed to drive the circular economy ecosystem.
Operational	– Implementation of enabling measures for circular production and consumption by updating regulations, financing and information. – Public capacity-building for mapping and monitoring material, water and energy flows to identify efficiency and productivity measures and make them publicly available. – Use of information technologies for the dissemination of circular habits, technologies, good practices and consumption. – Incorporation of circular economy criteria or indicators in public procurement to boost the domestic market for recirculated materials. – Use of information technologies and geographical information systems to improve the traceability of materials, by-products and waste in all value chains where there are business opportunities.
Political	– Organization of collaboration between different government bodies and other stakeholders in the different value chains to jointly implement the transition to a circular economy with a systemic vision. – Promotion and dissemination of collaboration platforms in production clusters for the participatory design of circular economy strategies, with a view to increasing the exchange and use of by-products and waste at the intra- and intersectoral level. – Support and recognition for and empowerment of private leaderships that promote replicable circular practices and activities. – Collaboration and coordination between different levels of government to efficiently manage solid waste with a view to increasing recycling rates.
Prospective	– Support for the development of public and private platforms to publicize scenarios and identify barriers and opportunities in the adoption of circular economy practices. – Promotion of technological research, development and innovation to facilitate the expansion of the circular economy. – Support for monitoring and analysis of international developments in policies, regulations and technologies relating to scenarios for materials use, assisting the authorities and businesses in their efforts to assimilate them and turn them into opportunities for improvement.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2023.

I. Summary

This chapter has discussed the integral importance of the environmental dimension to the proposed new growth strategy, which seeks to broaden the scope of productive development policies by focusing on a number of dynamic sectors and providing options for development within the framework of what ECLAC has called "the big push for sustainability". This means that policies, tools and measures to promote sustainability and tackle climate change are part of the toolkit for achieving the great productive transformation that is proposed and that was discussed in chapter IV. The drive for sustainability thus presents similar challenges of governance, TOPP capacity-building in institutions and social dialogue.

The chapter has elaborated on the challenges of pursuing responsible and sustainable productive transformation in a number of specific areas and sectors: the energy transition (renewable energies, green hydrogen and associated mining resources, such as lithium); electromobility and its potential to boost sustainable urban mobility; minerals critical to the energy transition and electromobility; water management; sustainable tourism; the bioeconomy; and the circular economy. The argument is that these driving sectors, which will vary by country, have the capacity to bring about productive transformations with greater inclusiveness and environmental sustainability, as well as generating synergies and feedback effects that reinforce the region's growth. Each section of this chapter has presented a brief characterization of these areas. As discussed, each has specific challenges in terms of governance and institutional capabilities for managing the necessary transformations.

Broadly speaking, the countries of the region are characterized by heterogeneous national governance frameworks and face the challenge of strengthening and adapting these to facilitate the development of driving sectors with environmentally friendly production and consumption patterns.

Much like the previous two chapters, this one has emphasized the "hows". Better environmental governance and TOPP capabilities are needed, not only to resolve challenging situations such as the region's high level of socioenvironmental conflict, but precisely to develop collaborative institutional mechanisms that will remain stable over time and facilitate the achievement of lasting socioeconomic transformations. Each section closes with a table summarizing the TOPP capabilities that could be developed in each area to advance towards a sustainable productive transformation.

Also of great importance are efforts to strengthen regional initiatives, such as the Regional Agreement on Access to Information, Public Participation and Justice in Environmental Matters in Latin America and the Caribbean (Escazú Agreement),[13] and to enable as many actors as possible to participate in regional debates in order to broaden the agreements necessary for the proposed transitions (De Miguel and Sánchez, 2023).

For this reason, ECLAC is committed to a comprehensive approach which recognizes the connecting links between the generation and absorption of technological solutions and growth, environmental performance and the institutional and social context required if the necessary transformations in development models are to be managed.

[13] The Escazú Agreement, which entered into force on 22 April 2021 and has 16 States parties and 24 signatory countries, aims to ensure the full and effective implementation in Latin America and the Caribbean of the rights of access to environmental information, public participation in environmental decision-making and access to justice in environmental matters, as well as the creation and strengthening of capacities and cooperation, contributing to the protection of the right of everyone in the present and future generations to a healthy environment and to sustainable development (see [online] https://www.cepal.org/en/escazuagreement).

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CHAPTER

VII

How can domestic and international financing for development be mobilized?

Introduction

According to several estimates (OECD, 2022; UNCTAD, 2023; Bhattacharya and others (2022); Songwe, Stern and Bhattacharya, 2022), the annual gap in the financing and investment required worldwide to achieve the Sustainable Development Goals (SDGs) of the 2030 Agenda for Sustainable Development is between US$ 2.5 and US$ 4 trillion, meaning that approximately US$ 30 trillion must be mobilized between 2023 and 2030. These estimates are based on the combined funding needs of sectors that are key for the SDGs, such as energy, water and sanitation, infrastructure, food and agriculture, biodiversity, health and education. The Inter-American Development Bank (IDB) (Bendersky, 2019) estimates the development financing gap in the countries of Latin America and the Caribbean at around US$ 650 billion per year. Financing the necessary investments requires a massive effort, both domestically and internationally, to mobilize public and private resources.

This section analyses the main challenges for development financing in Latin America and the Caribbean, focusing on the following areas:

(i) Domestic public finance, including government resources, the role of monetary policy, and development banks;

(ii) Domestic private finance, in particular the role of the private financial sector;

(iii) International private finance, including foreign direct investment (FDI), family remittances and the international financial architecture.

A. Macroeconomic conditions constrain resource mobilization

1. The international context

Slow economic growth in Latin America and the Caribbean in recent decades has affected countries' capacity both to accumulate sufficient savings and to mobilize additional financing. Compounding domestic issues are high interest rates on global markets, volatile international financing flows and the region's vulnerability to external shocks, three factors that significantly increase the cost of financing. Forecasts of subdued global growth and sluggish international trade, along with high indebtedness and fragmented global governance —which limits the access of developing countries to some sources of financing— are squeezing the availability of resources.

In response to global inflation, developed countries have repeatedly raised their policy rates since 2022, triggering rises in the cost of financing across the board for the countries of the region, along with significant capital outflows.

Rising global interest rates and the attendant increases in financing costs are also driven by heightened uncertainty, largely fuelled by the conflicts in Ukraine and the Middle East. The possible repercussions of escalation on the oil supply, coupled with additional disruptions to global production chains, represent latent pressures on inflation which are likely to keep the rates high. Rising numbers of conflicts and military costs are also constraining the availability of resources flowing to the region from official development assistance (ODA).

While the integration of the region's countries into the global economy has enhanced trade and financial openness and boosted trade and investment, it has also deepened economies' exposure to external volatility and uncertainty (BIS, 2021). The reasons for this include a stronger link between short-term macroeconomic trends and external shocks that affect the balance of payments (Ocampo, 2021), the influence of the global financial cycle (Miranda-Agrippino and Rey, 2022), fluctuations in the dollar as an anchor currency (Obstfeld and Zhou, 2023) and sudden shifts in global commodity prices (Eberhardt and Presbitero, 2021).

Exposure has also been heightened by factors that are specific to the region's economies, including limited financial development, dollarized debt (currency mismatches) and a greater reliance on short-term external financing sources.

Higher financial costs have squeezed fiscal space and curbed the capacity to mobilize resources, resulting in a meagre outlook for development financing. Like fiscal policy, monetary policy tends to be procyclical, as domestic interest rates are often driven by international rates (Ocampo, 2020; Rey, 2013; Miranda-Agrippino and Rey, 2022). This tendency is heightened when monetary policymaking relies on a single instrument, such as the short-term interest rate in inflation-targeting regimes. As discussed below, a broader range of policy instruments can mitigate this pressure.

Subdued external demand amid the current conditions of slow growth in the global economy and international trade volumes represents a further dampener on the resources available to the countries of the region. Sluggish international trade reduces the incentives for the region's businesses to seek investment to expand operations. Slacker global economic growth also curtails the flow of remittances, which account for over 20% of GDP in some of the region's countries.

2. Domestic public resource mobilization

Limited capacity to mobilize public resources domestically has tilted the fiscal balance towards deficit, exerting constant pressure on public debt (ECLAC, 2021b). This has been exacerbated by steeply declining tax revenue since the global financial crisis of 2008, which contrasts with buoyant pre-crisis collections (see figure VII.1, panel A). Stagnating tax revenue is the result of the region's slow economic growth, which is analysed in chapters II and IV. The tax gap between the countries of the region and those of the Organisation for Economic Co-operation and Development (OECD) has thus remained relatively constant since the crisis. In 2022, general government tax revenue represented 21.5% of GDP in Latin America and the Caribbean on average, compared with 34.0% for OECD countries (see figure VII.1, panel B). In several of the region's countries, the tax take is below that of other countries at a similar level of development (OECD and others, 2023). However, the situation varies widely from country to country. While in some the tax burden is comparable to the OECD average, in others it is well below the regional average, which shows that there is ample room to mobilize additional resources.

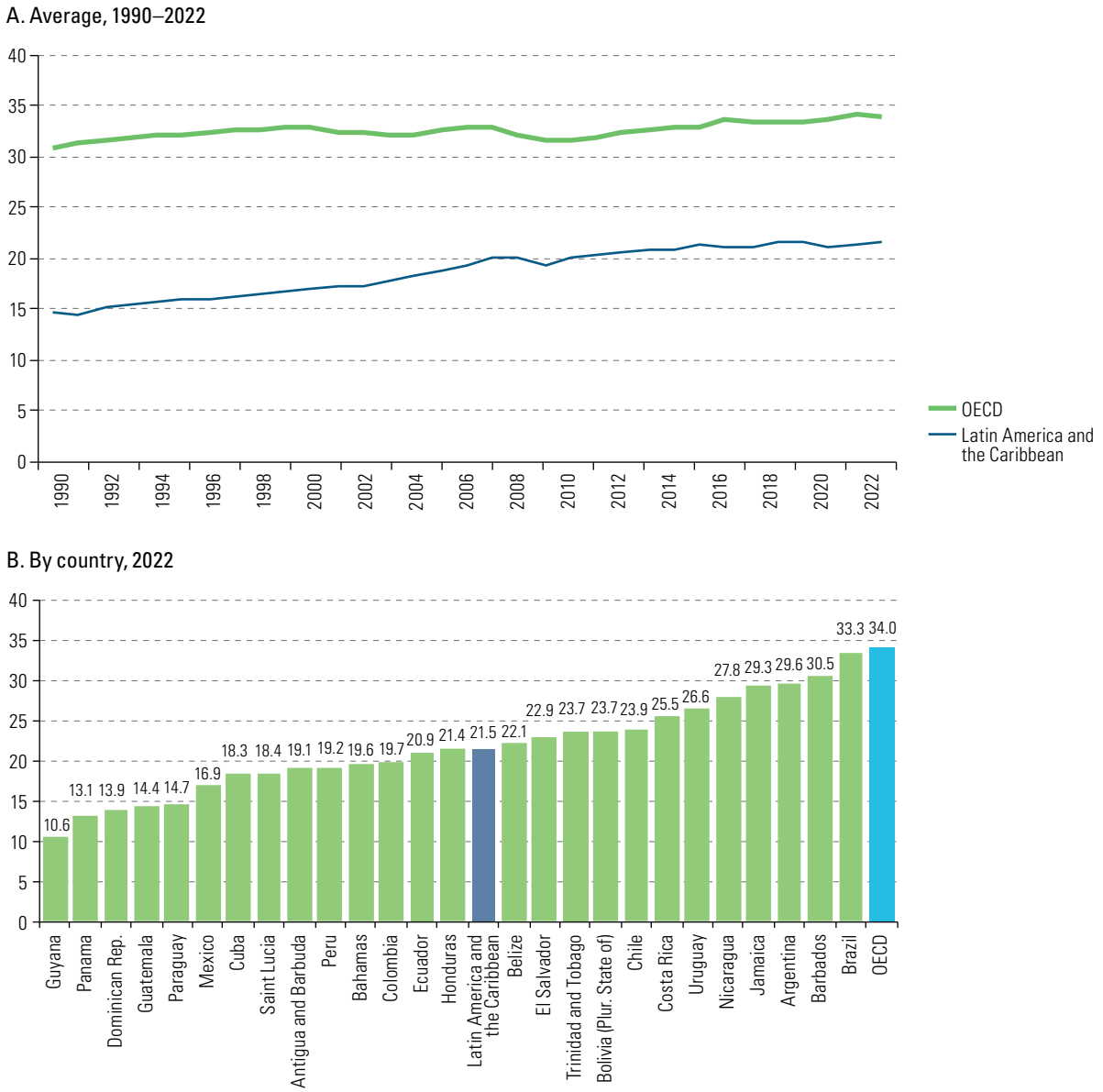
The region's tax structure is biased towards indirect taxes. Goods and services taxes, including value added tax (VAT), account for 46.5% of the region's tax burden, while 29.8% of the tax take comes from income tax and 16.7% from social contributions. In contrast, the tax structure in OECD countries is relatively evenly balanced between direct taxes on income (34.2%), indirect taxes on consumption (31.9%) and social contributions (25.6%) (see section V.B).

To mobilize additional resources to finance more productive, inclusive and sustainable development, the countries of the region must take steps to strengthen direct taxation. For example, strengthening personal income tax would result in significant additional benefits, such as increasing the redistributive impact of the tax system and strengthening automatic stabilizers (ECLAC, 2023d).

Tax evasion and avoidance also remain a major obstacle to the mobilization of domestic resources for financing development. The most recent estimates by the Economic Commission for Latin America and the Caribbean (ECLAC, 2024c) indicate that losses from evasion and avoidance of income tax and VAT came to 6.7% of GDP in 2023, the equivalent of US$ 433 billion. To contextualize this figure, the total capital expenditures —and thus public investment— of Latin American central governments amounted to approximately US$ 152 billion that year.

Income tax non-compliance (personal and corporate) is a particularly serious problem in the region. However, the situation varies considerably across countries (ECLAC, 2020b). Evasion and avoidance of corporate income tax, the main component of the region's income tax revenue, ranges from 31.6% in Colombia in 2019 to 84.3% in Panama in 2021 (DIAN, 2021; DGI, 2021). In several countries, such as Costa Rica, Ecuador, Guatemala, Panama and Peru, tax systems collect less than 50% of potential income tax.

Figure VII.1
Latin America and the Caribbean and Organisation for Economic Co-operation and Development: general government tax revenues, 1990–2022 and 2022
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD), OECD.Stat [online] https://stats.oecd.org.

Compared to income tax non-compliance, VAT non-compliance is lower, both in absolute and theoretical terms. The VAT situation is also very uneven from one country to another (ECLAC, 2020b), however. In Argentina, Chile, Mexico and Uruguay, the non-compliance rate is 20% or less. By contrast, in Panama and the Dominican Republic, VAT evasion is 40% or more of the potential tax take. The revenue lost from VAT non-compliance is above the regional average in Brazil, the Dominican Republic, Ecuador, El Salvador, Guatemala, Nicaragua and Peru.

The need to mobilize tax revenue has grown in a context of higher indebtedness. Gross central government public debt in Latin America rose from 29.4% of GDP in 2008 to 55.0% of GDP in 2023 (ECLAC, 2024c).

As a result, following a succession of severe economic and financial crises in the region, public debt in Latin America has risen to heights not seen since the early 2000s, which may be attributed to persistent and high fiscal deficits (ECLAC, 2021b). In the Caribbean, public debt has remained high and was equivalent to 70.3% of GDP in 2023 (ECLAC, 2024c). In this context, several countries in the region are under pressure to contain public spending increases in order to reduce primary deficits or generate surpluses to safeguard public debt sustainability.

This situation is compounded by the interest rates at which debt is issued by the countries of Latin America and the Caribbean. Rates on dollar-denominated sovereign issues on international markets fell steadily until 2021, when the average coupon reached 3.6% (ECLAC, 2023e). Since then, however, there have been successive increases. This adverse scenario also has a greater impact on countries with worse credit performance, as reflected in the ratings awarded by specialized agencies. Investor-grade countries account for 72% of total sovereign issues in the region, and their average coupon as of September 2023 was 6.4%. In contrast, non-investor-grade countries, which account for the remaining 28%, paid an average coupon rate of 7.8% (see figure VII.1).

Table VII.1
Latin America and the Caribbean (selected countries): sovereign debt issuance, January–September 2023

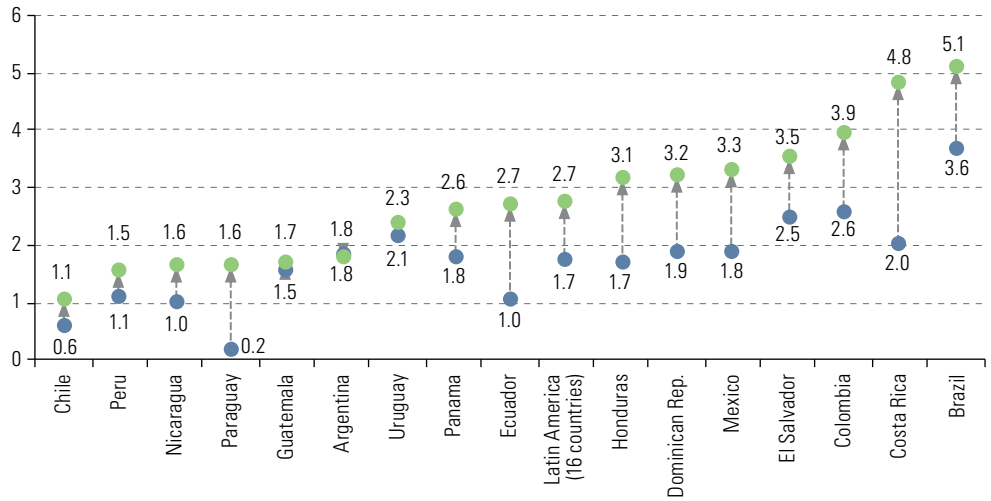
Date	Country	Sovereign credit rating in foreign currency (Moody's/S&P/Fitch)	Amount *(Millions of dollars)*	Interest rate *(Percentages)*
Jan 2023	Mexico[a]	Baa2/BBB/BBB-	4 000	6.05
Jan 2023	Colombia	Baa2/BB+/BB+	2 200	7.60
Feb 2023	Dominican Republic	Ba3/BB/BB-	700	7.05
Mar 2023	Panama[a]	Baa3/BBB/BBB-	1 800	6.65
Mar 2023	Costa Rica	B1/BB-/BB-	1 500	6.55
Apr 2023	Brazil	Ba2/BB-/BB-	2 250	6.15
Apr 2023	Mexico[a]	Baa2/BBB/BBB-	2 941	6.34
May 2023	Ecuador	Caa3/B-/CCC+	656	5.65
Jun 2023	Chile[a b]	A2/A/A-	2 250	5.14
Jun 2023	Guatemala	Ba1/BB/BB	1 000	6.60
Jun 2023	Paraguay	Ba1/BB/BB+	500	5.85
Jul 2023	Panama[a]	Baa3/BBB/BBB-	700	6.38
Sep 2023	Guatemala	Ba1/BB/BB	565	7.05
Sept 2023	Panama[a b]	Baa3/BBB/BBB-	1 400	6.87
Sep 2023	Trinidad and Tobago[a c]	Ba2/BBB-/Unrated	560	5.95

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Dealogic, LatinFinance, Cbonds, Bloomberg, Fitch, Moody's, S&P Global Ratings and official figures.
Note: All issues were in dollars, unless otherwise indicated.
[a] The credit rating of sovereign debt denominated in foreign currency implies investment grade.
[b] Issued in several tranches.
[c] Moody's credit rating of sovereign debt denominated in foreign currency does not imply investment grade.

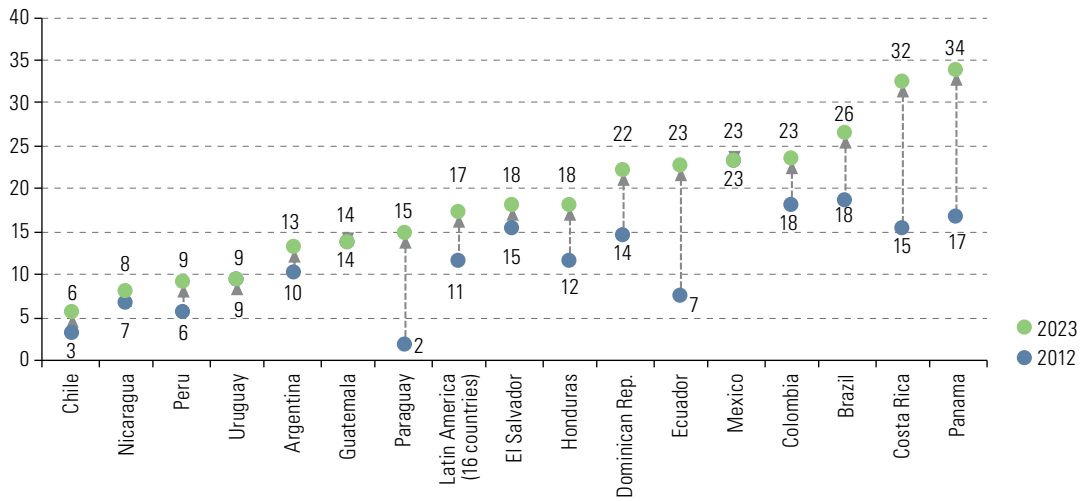
Increased public indebtedness and rising financial costs have significantly increased interest payments in the region. As illustrated in figure VII.2, the interest payments of the central governments of Latin America reached 2.7% of GDP in 2023, up 1 GDP point from the 2012 figure of 1.7%. In several cases, however, larger increases were recorded. The tightening of monetary policy in 2022 and 2023 —on both international and domestic fronts— intensified the upward trajectory of interest payments in the region (ECLAC, 2023a and 2024c). Countries have therefore had to allocate an increasing share of their tax revenues to debt servicing. In 2012, 11% of central government tax revenues in Latin America went to interest payments, rising to 17% by 2023. However, the year-on-year increases were greater in certain countries, with interest payments coming to account for as much as 30% of the tax take in some.

Figure VII.2
Latin America (selected countries): central government interest payments, 2012 and 2023
(Percentages of GDP and percentages of tax revenues)

A. Percentages of GDP



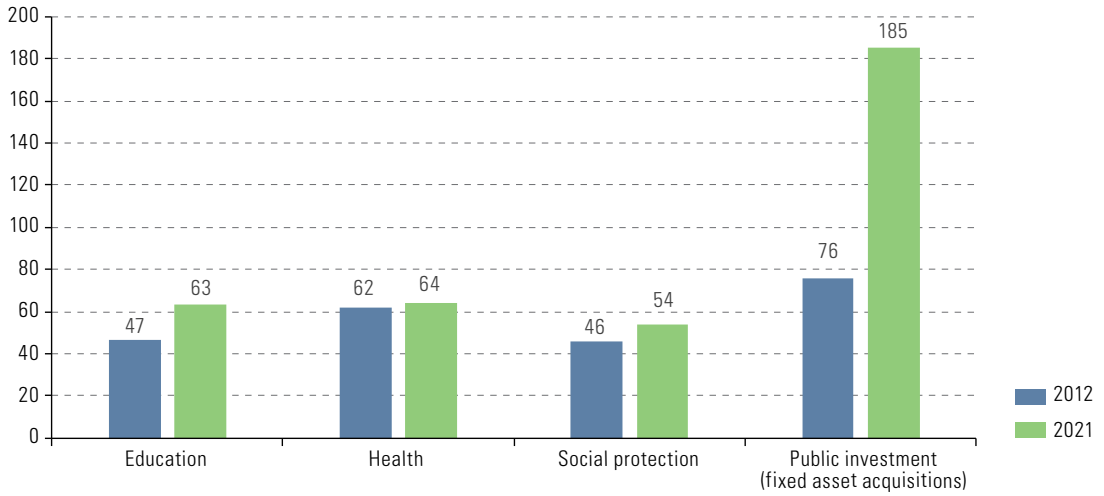
B. Percentages of tax revenues



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
Note: For Argentina, Mexico and Peru, the figures refer to the national public administration, federal public sector and general government, respectively.

The reallocation of public resources to service the growing burden of interest payments has triggered development distress in Latin America and the Caribbean (ECLAC, 2023b). As illustrated in figure VII.3, interest payments in 2012 were equal to approximately half of education and social protection disbursements and more than 60% of health spending. However, the rise in interest payments in 2021 was greater than the growth in public social spending, significantly increasing the ratio between the two, despite significantly higher health and social protection spending in 2020 and 2021 to respond to the coronavirus (COVID-19) pandemic. Also of concern is the inverse variation between interest payments and public investment. The ratio between interest payments and fixed asset acquisitions surged over the decade, reaching 185% in 2021, compared with 76% in 2012. This is partly because capital expenditure was the main fiscal adjustment variable at a time when countries were adopting fiscal consolidation measures to protect public debt sustainability.

Figure VII.3
Latin America and the Caribbean (21 countries):[a] central government interest payments relative to spending on education, health, social protection and public investment, 2012 and 2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Public debt and development distress in Latin America and the Caribbean* (LC/TS.2023/20), Santiago, 2023.

Note: Figures are medians. Figures for Brazil, Colombia, Costa Rica, Guatemala, Paraguay and Peru refer to general government. Figures for Argentina, El Salvador and Mexico refer to the non-financial public sector. Public investment is measured through fixed asset acquisitions. Figures for fixed asset acquisitions as part of interest payments are for central governments in all cases.

[a] Argentina, Bahamas, Barbados, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago and Uruguay.

Gross fixed capital formation by the region's public sector is well below that of other regions. Measured as a weighted average, it reached 2.8% of GDP in Latin America and the Caribbean in 2019, which contrasts with the values in advanced economies (3.5% of GDP) and in particular with emerging and developing Asia (11.7% of GDP). Public investment varies widely within Latin America and the Caribbean. Some countries, such as Ecuador and the Plurinational State of Bolivia, invest more than 6% of GDP, while others, such as Argentina, the Dominican Republic and Guatemala, invest less than 2% (ECLAC, 2022a).

Like total investment, public investment behaviour in Latin America over the past three decades has been linked to the commodity price supercycle and flows of fiscal revenue from non-renewable natural resources. Calculated as a simple average, public investment in the region accounted for 4.3% of GDP between 1990 and 2004. Between 2005 and 2014, it reached an average of 5.5% of GDP thanks to an increase in fiscal revenues from non-renewable natural resources, but then reverted to pre-2005 lows beginning roughly in 2014, in a period of steady falling international prices for metals, minerals and crude oil (ECLAC, 2022a).

Flagging investment affects economic infrastructure projects and the acquisition of fixed assets for social services, taking an economic and social toll that makes it harder to achieve sustainable development and further complicates efforts to close structural development gaps. In Latin America, cuts to capital expenditure on economic services, in particular transportation projects, account for nearly two thirds of the total contraction in central government capital expenditure after 2014 (ECLAC, 2020a).

3. Tight monetary policy

In line with similar policies in developed countries, the countries of the region began raising domestic interest rates in mid-2021 to counter inflationary pressures, hindering efforts to mobilize resources for development financing. A tighter monetary stance, with higher interest rates and lower money supply, increases the cost of debt for companies and individuals alike. Higher borrowing costs and lower liquidity have made investment

less attractive. Firms have deferred investments or scaled back their scope, slowing capital formation and weakening productivity (ECLAC, 2023b and 2023e). The higher cost of debt curbs household spending, dampening aggregate demand even further and compounding the decline in investment (Kaplan, Moll and Violante, 2018).

Projects with longer gestation periods or steeper start-up capital requirements are especially susceptible to the adverse effects of high debt costs (Lorenzoni and Werning, 2023). Renewable energy and infrastructure projects, along with innovation-driven enterprises, often depend on patient investors and supportive financial conditions to thrive. However, high interest rates dissuade investors from committing to such projects, which holds back progress in achieving environmental sustainability, upgrading infrastructure and spurring technological innovation.

A tight monetary policy stance also affects the behaviour of the banking sector, through the credit channel. This could entail financial risk and affect aggregate demand components such as consumption and investment. Since the credit cycle closely tracks the global financial cycle, the risk of exchange-rate volatility and sudden cross-border capital movements leaves various economic sectors exposed to external financial conditions. Abrupt changes in global financial conditions or investor sentiment can trigger capital flight, exchange-rate fluctuations and economic instability, further complicating efforts to mobilize financial resources for development.

In principle, in small, open economies with floating exchange rates, such as those of the Latin American and Caribbean countries that have inflation-targeting regimes, a narrower spread between the domestic reference rate and international rates can spur net capital outflows, placing downward pressure on the nominal exchange rate (Miranda Agrippino and Rey, 2022). By increasing the cost of imported goods, depreciation influences inflation expectations, which are often a key driver of inflation in the region.

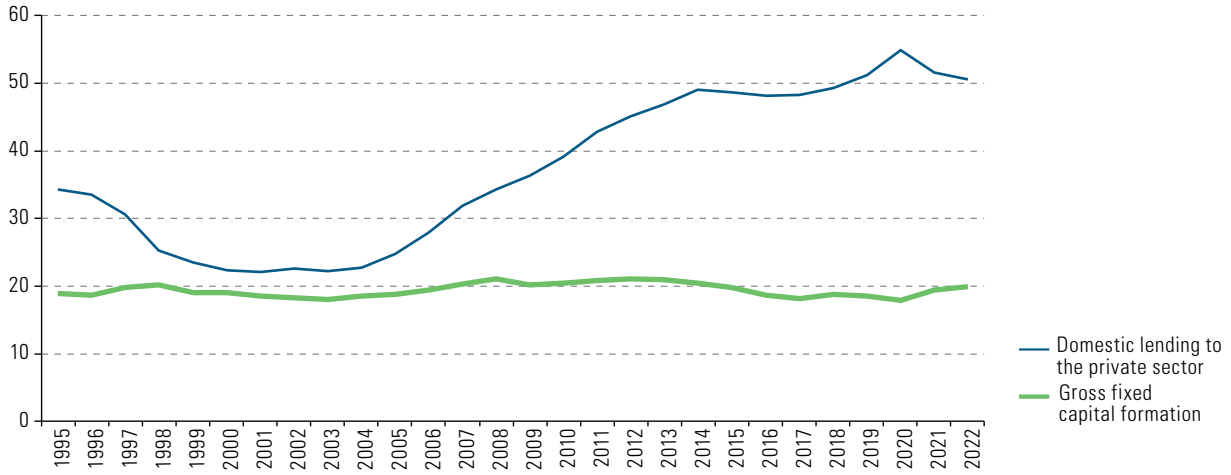
This illustrates that the effects of the monetary policy stance are asymmetrical across the business cycle. During contractionary phases, central banks prioritize inflation control by hiking interest rates, which dampens investment. However, alongside the fact that rate cuts tend to be modest and gradual during periods of monetary policy easing, economic recovery and the revitalization of lending for productive activities remain misaligned in Latin America and the Caribbean, depressing key real variables such as productivity and investment and ultimately leading to weaker growth and a truncated expansion phase (Titelman and Pérez Caldentey, 2015).

4. Financial system decoupling from the real economy and poor financial inclusion

Over the past three decades, the financial sector in the countries of the region, as in the rest of the world, has grown significantly in volume, participants, instruments and products. However, for the region, the deepening of financial systems —measured by domestic lending as a percentage of GDP— has taken a different path from investment as a percentage of GDP, as illustrated in figure VII.4. While financial deepening increased from nearly 30% of GDP in 2006 to over 50% in 2022, investment as a share of GDP remained at around 20% throughout that period (Titelman, 2023). This phenomenon reflects the decoupling of financial savings and productive investment.

Closing the gap between financial savings and the financing of production requires a financial system that is capable of incentivizing and efficiently channelling savings to finance investment and technological innovation and facilitate access to financing by production agents, especially small and medium-sized enterprises (SMEs). From this perspective, financial inclusion is a productive integration policy. It means using the financial system as an instrument to enhance the ability to save and consume, support the growth of business talent and leverage investment opportunities. Financial inclusion thus enables the financial system to meet the differing financing needs of firms at different phases of productive and technological processes.

Figure VII.4
Latin America and the Caribbean: financial deepening and investment, 1995–2022
(Percentages of GDP)

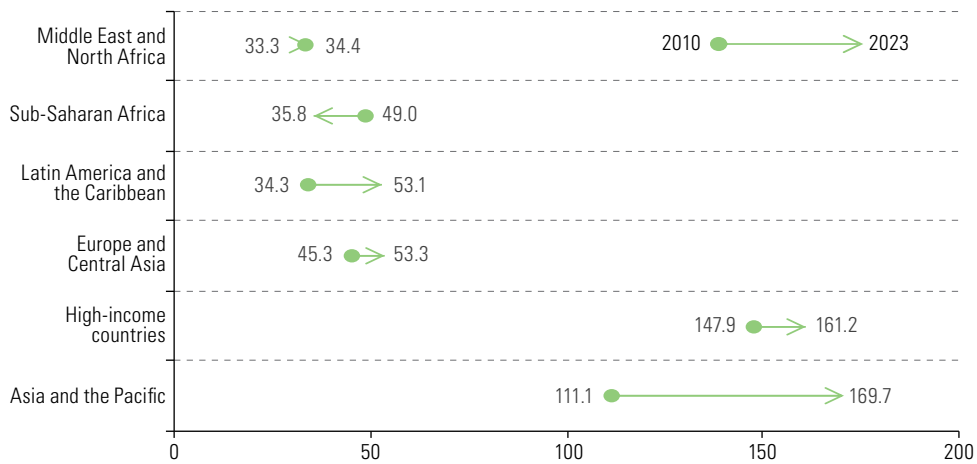


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "World Development Indicators" [online database] https://databank.worldbank.org/source/world-development-indicators.

Latin America and the Caribbean is one of the regions with the lowest financial inclusion, relatively speaking. Within the productive sector, the access barriers of the formal financial system are substantially higher for SMEs than for larger firms. According to the findings of Pérez Caldentey and Titelman (2018), on average, just 45% of small businesses in Latin America and the Caribbean are able to obtain loans from formal financial institutions. SMEs mainly use the financial system for deposits and payments, and use credit products far less. On average, 93.6% of the products they use are current accounts, while credit lines account for 36.9% and term loans for 23.4%. This hinders their capacity to expand and their future growth.

Figure VII.5 presents financial system lending to the private sector as a share of GDP across different global regions, illustrating that in 2010, the share in Latin America and the Caribbean (34.3%) was nearly on par with the Middle East and North Africa (33.3%), and below the developing countries of Europe and Central Asia (45.3%) and Sub-Saharan Africa (49%).

Figure VII.5
Groups of countries: average financial system lending to the private sector, 2010–2023[a]
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "World Development Indicators" [online database] https://databank.worldbank.org/source/world-development-indicators.
Note: Unless otherwise specified, regional groupings do not include high-income countries.
[a] Figures for the Middle East, North Africa, Europe, Central Asia and high-income countries are for 2020.

However, the financial system developed in the countries of Latin America and the Caribbean in the decade following the financial crisis. This enabled the growth of private sector lending, which rose to 53.1% of GDP in 2023, a level comparable with the developing countries in Europe and Central Asia (53.3%). This is well above the Middle East and North Africa, where it has remained relatively constant at around a third of GDP, and Sub-Saharan Africa, where it contracted to around 35.8% of GDP. Despite this significant increase in the region, private sector lending as a share of GDP remains well below that of developed countries (161.2%) and the developing countries of the Asia-Pacific region (169.7%).

To advance financial inclusion, the public and private sectors must work to improve financial and legal institutional frameworks, strengthen economic stability, and support the establishment of new instruments for managing economic and financial risk. A new approach to financial inclusion is also needed to channel resources towards the productive sector and development targets. Development banks play an important role in spurring innovation in financing, both directly and in coordination with other banks.

Development bank innovation may relate to products, processes or institutional frameworks. Product innovation includes both instruments to facilitate access to the financial system and to manage risk. Innovation also means extending the financial network and exercising flexibility in evaluating individuals' and companies' ability to pay. Innovation in public banking also extends to the institutional dimension, where it involves enhancing the complementarity of development and commercial banks and striking an appropriate balance between innovation and regulation.

5. Limitations on national development banking

In a region that invests little and is suffering significantly from the negative impact of climate change, improving the capacity to mobilize financing for the investment and productive sectors is key. Despite the potential of the region's extensive network of national development banks to complement commercial banks in financing productive sectors, significant barriers exist, notably limited resources and technical capacity constraints.

There are more than 100 national development banks in Latin America and the Caribbean, of which 73% operate as first-tier banks and 27% as second-tier banks. Analysis shows no predetermined development banking model; rather, different institutional and financial models coexist, which generates significant potential for cooperation and coordination among these domestic financial institutions.

Among the main barriers they face in expanding domestic financing for productive development are limited access to low-cost financing and insufficient long-term capital. This limits the capacity to fund transformative investment projects, which can require long lead times, substantial up-front capital investment and significant long-term financing.

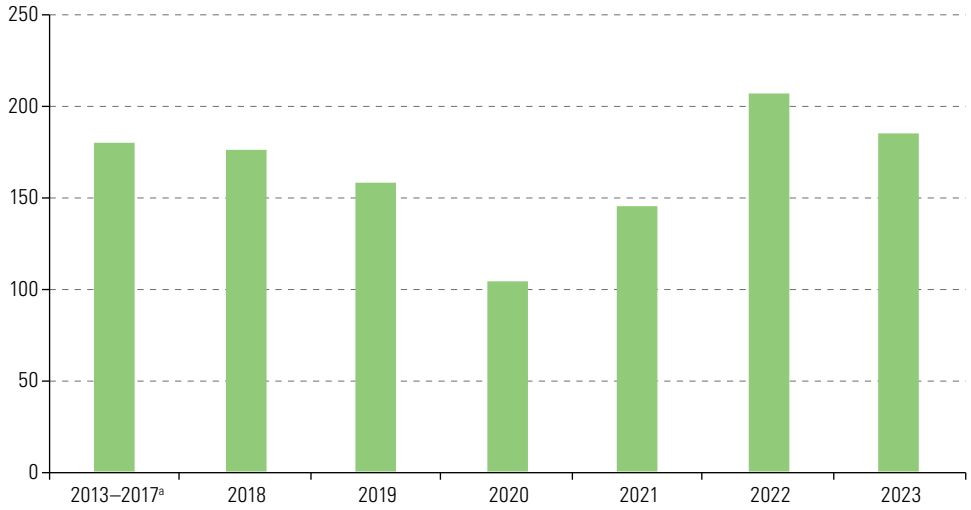
According to a World Bank survey (De Luna Martínez and others, 2017) of the member institutions of the World Federation of Development Financing Institutions (WFDFI), domestic development banks face significant technical capacity constraints, including lack of capacity to identify and rank relevant projects, which is more severe in the case of green projects; difficulty in assessing the financial and technological risks of climate projects; and lack of knowledge and experience in climate finance and the use of innovative financing products.

6. Foreign direct investment

FDI, the main external source of private financing, is showing a widespread drop in flows to emerging countries and regions.

Amid high interest rates, ongoing geopolitical conflicts and increasing global economic fragmentation, global FDI flows fell in 2023 for the second consecutive year. In Latin America and the Caribbean, FDI inflows reached US$ 184.2 billion in 2023, 9.9% lower than in 2022. Although after excluding 2021–2022, average FDI inflows to the region in 2023 are even higher than in the previous decade, they are trending downward from the highs of the early 2010s (see figure VII.6).

Figure VII.6
Latin America and the Caribbean: FDI inflows, 2013–2023
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Annual average for 2013–2017.

As explained in ECLAC (2024d), FDI in the region is largely concentrated in sectors and countries with abundant natural resources and relatively cheap labour, although skill levels also play a key role, especially in high-tech sectors. FDI is generally more stable than portfolio or other types of investment, in particular during periods of global economic uncertainty. However, it is not immune to fluctuations, especially in economies closely linked to commodity sectors, as it tends to mirror commodity price trends.

Against this backdrop, the challenge of attracting and retaining FDI that contributes to sustainable and inclusive development in the region remains as relevant as ever, and countries must make efforts to enact the right kind of policies if they are to attract FDI that supports their development process and the realization of investment potential to build capacities, create quality jobs, transfer technology and enhance the diversification and sophistication of the production mix (ECLAC, 2023c).

In the productive development policy space, the challenge is to leverage existing advantages to spur transformation of the productive structure by strengthening interlinkages to address the structural challenge of stagnation (Salazar-Xirinachs and Llinás, 2023).

In Latin America as in the rest of the world, policy instruments have progressively become more diversified. However, the main incentives for attracting investment are still grounded in tax-related measures. Although tax incentives can influence investment decisions to some degree, they are not enough to attract investment, which requires a diverse mix of factors, including infrastructure, productive capacity, a skilled workforce and a set of complementary activities along the value chain, meaning that efforts to attract FDI must be coordinated with measures usually taken under productive development policies and agendas (ECLAC, 2023c).

However, Latin American and Caribbean countries have only relatively recent experience in policies to attract investment, and policy design must be improved and institutional capacity strengthened in this area. It will be essential to better coordinate efforts to attract FDI with strategies to develop production and to begin using FDI in a more targeted manner as a strategic tool to further sustainable development processes.

The data demonstrate that integrated policies that incorporate FDI attraction into a long-term strategy —focused on both efficient resource allocation and effective coordination, while also maintaining alignment with long-term productive development targets— are more successful at fostering well-being than policies based solely on incentives such as subsidies or tax breaks. From this perspective, policies aimed at investment in productive development should focus on building the coordination capacity of stakeholders and creating mechanisms for multilevel government coordination.

A review of the specialized literature, case studies and interviews with investment promotion agencies conducted by ECLAC (2024d) revealed the importance of aligning FDI attraction strategies with long-term productive development policies, designed collaboratively by actors from the public and private sectors, academia and civil society.

7. Role and potential of remittances

The substantial volume of remittances received in the region underscores their importance and potential to finance sustainable development in Latin America and the Caribbean. In the receiving countries, remittances are already playing a key role in counterbalancing some of the negative repercussions of outmigration and as a source of income for groups at the lower end of the income distribution curve (Maldonado and J. Harris, 2023). Remittances differ from other flows in that they are highly disaggregated, as migrants themselves transfer the funds to their countries of origin. Remittances are also used for a variety of purposes. Fajnzylber and López (2008) argue that they support growth and poverty reduction in destination countries by providing more funds for private households to invest in their communities. They also increase bank deposits, which can boost commercial lending.

Remittances have the potential to meet development needs that other types of financial flows are less effective at addressing, including by reducing volatility for low-income earners and providing a minimum income, which supports poverty reduction (Beaton and others, 2017). They can also be an important source of financing for micro-, small and medium-sized enterprises (MSMEs) (Catrinescu and others, 2009), although information on this particular aspect remains scarce in the region. As a direct and secure channel for cross-border financing, remittances provide households with funds that would be difficult to obtain through financial institutions, complementing other flows to reduce poverty and support consistent consumption over time.

However, economies can reap even greater benefits from remittances if they have suitable institutional structures and policies in place. Specific policies are required to leverage the potential of remittances to fill development gaps. As an example, lowering transaction costs could further incentivize the flow of remittances to the countries of the region.[1] Reducing these costs by increasing digitalization and through other means could boost financial flows. Low-income households' access to digital banking could also be improved for receiving remittances, since they are still mainly sent using cash transactions (Beaton and others, 2017). Finally, the benefits of remittances are largely determined by the regulatory environment (Padilla Pérez, Stezano and Villarreal, 2020). Financial regulations could also further evolve to recognize remittances as collateral for small business loans (CABEI, 2021).

8. International financial architecture falls short in supporting Sustainable Development Goals and climate action

Disbursements from multilateral financial institutions have been too slow to close the development financing gap, and transfers to developing countries are too low (Summers and others, 2023). For 2023, global and regional multilateral development banks committed an estimated US$ 41 billion to Latin America and the Caribbean, compared to an annual funding gap estimated by IDB at US$ 650 billion (Bendersky, 2019).

One of the main challenges is that most of the countries of Latin America and the Caribbean are classified as middle-income countries, which limits the allocation of concessional funding for development by multilateral financial institutions. The use of per capita income as an indicator for resource allocation is underpinned by two broadly controversial considerations: per capita income is assumed to faithfully reflect countries' economic and social development, and higher per capita income is assumed to equate to greater capacity to mobilize domestic and external resources and thus to finance economic and social development. By this logic, upper-middle-income and high-income countries should replace preferential and concessional sources of financing with greater domestic resource mobilization efforts and access to private markets under reasonable financial conditions.

[1] Transaction costs in Latin America and the Caribbean are higher than in East Asia and the Pacific, Central Asia, the Middle East and North Africa. In Latin America and the Caribbean, sending US$ 200 costs an average of 6.1%, compared to 4.3% in South Asia (Ratha and others, 2023). The United Nations has made lowering transaction costs below 3% and the elimination of remittance corridors with costs above 5% by 2030 a priority under SDG target 10.c (United Nations, 2015).

In 2022, only eight of the countries in Latin America and the Caribbean received concessional financing from the World Bank through the International Development Association (IDA), accounting for 14% of the total received by the region. Likewise, with concessional lending reserved for low-income countries or vulnerable middle-income countries, IDB provides concessional loans to only four of the region's economies.

International capital market fluctuations often amplify changing external conditions. Financing conditions on international capital markets are very sensitive to the global context and to the risk perceptions of issuing countries, which makes them highly volatile. Not all middle-income countries have access to capital markets and not all those that do enjoy the same conditions. The largest economies in Latin America and the Caribbean are the main users of capital markets for bond issuance. Smaller economies, particularly in the Caribbean, have made scant use of this market. Investments in these economies are considered high-risk, which raises the cost of sovereign debt issues.

As noted earlier, rising debt levels, slow growth and tighter international conditions are significantly squeezing fiscal space in the countries of the region. Their debt vulnerabilities have grown and their sovereign credit quality has worsened, which is seriously hampering their capacity to accelerate the achievement of the SDGs.

Debt relief and restructuring initiatives thus play an important role in supporting resource mobilization capabilities. However, existing international processes for restructuring sovereign debt have proven insufficient to significantly reduce debt levels and the burden of debt servicing, and are further hindered by prolonged, cumbersome negotiations, while most do not apply to middle-income countries.

The Debt Service Suspension Initiative of the Group of 20 (G20) granted a mere US$ 13 billion of debt relief (2.7% of the total) to 48 countries, whose total debt stock was approximately US$ 477 billion. Meanwhile, most middle-income countries are excluded from both the Debt Service Suspension Initiative and the Common Framework for Debt Treatments. The middle-income countries able to take advantage of such initiatives are vulnerable countries that belong to IDA, the concessional lending window of the World Bank that provides assistance to the poorest countries in the world.[2]

One of the main shortcomings of debt restructuring proposals is the lack of an inclusive approach to debt settlement addressing the needs of both debtors and creditors. Proposals have also failed to provide differentiated solutions, tailored to the variety of debt profiles and debt vulnerability in the region. On the creditor side, the biggest challenge has been uptake from the private sector and international financial institutions. On the debtor side, these initiatives create uncertainty about repayment obligations and can be perceived as tantamount to default, leading to downgrades by credit rating agencies. The possibility of weaker solvency also affects the involvement of international financial institutions such as the World Bank, which argue that debt suspension would affect their own credit ratings and financing costs, unless it is counterbalanced by increased capital contributions from shareholder countries.

Lastly, existing debt restructuring initiatives fail to consider the shifting financial and global panorama of the past two decades, with major changes such as the growing importance of non-bank financial intermediation and the increase in bilateral lenders outside the Paris Club, including the Kingdom of Saudi Arabia and South Africa, but mainly China. These changes have resulted in a more diversified and fragmented creditor base, a broader debtor base with uneven debt profiles, and more complex legal structures and debt instruments. This increases information asymmetry problems, the likelihood of coordination failures and the opacity of developing countries' debt situation.

B. Policy strategies to boost financing

This section considers three public policy strategies to mobilize resources for development financing: strengthening public finance, the comprehensive use of macroeconomic stabilization tools and reform of the international financial architecture.

[2] The Latin American and Caribbean countries in this category are Dominica, Grenada, Guyana, Haiti, Honduras, Nicaragua, Saint Lucia and Saint Vincent and the Grenadines. These countries are also members of IDA, and therefore qualify for concessional loans from the World Bank. Guyana, Honduras and Nicaragua receive IDB concessional loans and Haiti receives IDB grants.

1. Strengthening public finance

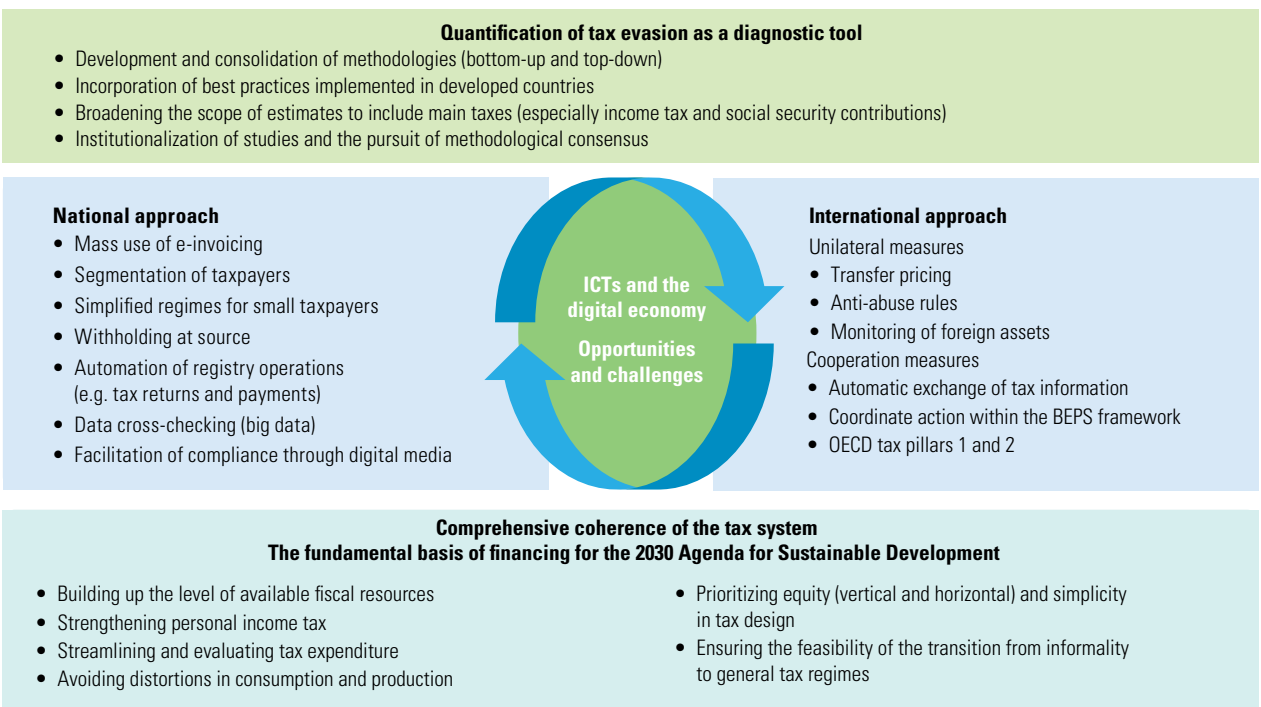
(a) Tax policy

Fiscal revenue is one of the main sources of funding for the great transformations required for sustainable development in the countries of the region analysed in chapter II, and for progress towards the SDGs. Fiscal space must be expanded, both by increasing the resources available and by optimizing their use. Achieving this will require a larger tax take and improvements in spending efficiency, progressivity and equity impact. In that regard, ECLAC has identified the elements of an integrated strategy for tax, financial and public spending policies to mobilize and channel resources towards productively, socially and environmentally high-performing driving sectors.

One of the main obstacles for domestic resource mobilization has been tax evasion and avoidance. In 2023, tax non-compliance in Latin America stood at US$ 433 billion, or 6.7% of regional GDP (ECLAC, 2024c). Countries have implemented a range of administrative measures to reduce tax evasion, including advances in electronic invoicing, the monitoring and detection of anomalies using information and communications technologies (ICTs) and steps to strengthen analysis and control for specific taxes and sectors (ECLAC, 2020b and 2024c).

Tax evasion is more than a public resources problem. It undermines the very foundations of the tax system's legitimacy because it erodes the efficiency and the equity that should prevail among taxpayers. The strategy for addressing tax evasion, encompassing both tax policy measures and administrative reform, is therefore particularly important for the countries of the region. Diagram VII.1 summarizes the main components of the road map proposed by ECLAC (2020b) based on the measures used in the region.

Diagram VII.1
Latin America and the Caribbean: strategy to address tax evasion



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Fiscal Panorama of Latin America and the Caribbean, 2020* (LC/PUB.2020/6-P), Santiago.

Improving tax management begins with improving how evasion is measured. Understanding its scope, causes and determinants is critical for tax policy design and to anticipate its potential effects on different groups of taxpayers. Rather than focusing on specific data points from particular years, multi-year trends should be

assessed through time. Periodically estimating the tax gap is useful for society as it enables taxpayers to evaluate the efforts made by tax administration authorities to encourage voluntary compliance. Institutionalizing the processes by which tax evasion is gauged and disseminating them as a good practice helps to strengthen domestic and regional fiscal governance.

The experience of the region's countries in tackling high levels of evasion of the main taxes illustrates the need for progress on two fronts. One is a domestic approach tailored to the circumstances of each country. It must also align with contemporary international trends in tax reform and administrative measures. Mass implementation of mandatory electronic invoicing is a significant step forward for the region's economies in the oversight and inspection of all taxpayers, irrespective of size. Voluntary compliance can also be facilitated through a series of instruments, including different modes of electronic payment, the development of applications and the establishment of multiple taxpayer communication channels to reduce compliance time and costs. Lastly, automatic withholding in financial transactions has proven indispensable for ensuring tax compliance.

As the digital economy has advanced worldwide, in recent years several Latin American countries have joined the trend of protecting VAT collection by incorporating digital services into the taxable base. The experience so far shows that the impact on the tax take has been satisfactory, indicating that the region could adopt that model if better solutions do not emerge internationally.

On the international front, the strategy is twofold. First is a series of unilateral measures focused on updating and strengthening the legal frameworks on transfer pricing, thin capitalization and intercompany payments, as well as new definitions of the concept of permanent establishment and standards to prevent the abuse of bilateral agreements, among others. The region's countries must also leverage international cooperation synergies for taxation. This will involve actively participating in international initiatives that encourage the requisite automatic information exchange between jurisdictions.

Reviewing tax expenditure also offers a significant opportunity to strengthen public revenues in the near term.[3] In 2021, tax expenditure in Latin America averaged 3.7% of GDP, representing 19% of central government budget spending (ECLAC, 2023a). In terms of tax expenditure, examining tax incentives is key, as they accounted for tax collection losses equivalent to between 0.6% and 2.5% of GDP around 2019. Although tax incentives can be a useful tool for boosting investment in the SDGs, their cost efficiency ratio has been called into question in the literature (ECLAC/Oxfam International, 2019).

Not all tax incentives are equal in their capacity to encourage investment. This means that countries should prioritize the ones that are most effective —because their design influences investment size— and that reduce the cost of capital, such as deductions, tax credits and accelerated depreciation schemes. However, their effectiveness should be determined on a case-by-case basis, through cost-benefit analysis. Tax incentives unrelated to firms' investment costs, such as the tax holidays, permanent exemptions and reduced rates that are common in the region, are better avoided or limited.

Beyond the effectiveness or otherwise of tax incentives for promoting investment, growth and employment, they are simply one element among many that can shape FDI flows and investment rates, given that factors outside the tax system have proven more important for attracting investors.

Cost-benefit analysis is important not only for determining whether to maintain, limit or end a tax expenditure but also for strengthening policy transparency and the efficiency and equity of tax systems. For this, countries require stronger institutional frameworks to publish periodic, timely and detailed updates on the costs, expected benefits, main beneficiaries and purposes of tax expenditure.

In addition to systematic cost-benefit analyses, having control and accountability mechanisms in place is important, as is ensuring greater public participation and coordination between the various government bodies involved. Tax expenditure should undergo legislative process, and its reports be included in annual budget discussions, presented in a manner that enables comparison with other budget spending.

[3] Tax expenditure is the revenue foregone owing to special tax regimes that favour certain sectors, activities, regions or economic agents.

Coordination should go beyond the national sphere and progressively move towards enhanced international cooperation. The countries of the region should join forces to advance towards the adoption of compacts on the use and transparency of tax incentives, strengthen regional fiscal cooperation and avoid harmful tax competition, which decreases tax revenues and limits domestic resource mobilization for the achievement of the SDGs (ECLAC, 2019b).

Likewise, achieving productive, inclusive and sustainable development requires a sustained public spending effort. The viability of this active fiscal policy agenda hinges on steadily increasing tax collection. The main challenge for the region is strengthening personal income tax, as its low tax take in that area is the largest gap vis-à-vis OECD countries and weakens the redistributive capacity of the tax system. Reforms of this key tax to be discussed include reviewing marginal rates, tax bases and the treatment of various types of income (ECLAC, 2023d), along with other tax instruments such as wealth and property taxes (ECLAC, 2021b).

Many studies have shown that income and wealth distribution is highly unequal in the region and has become more concentrated in recent decades. They also show that income tax is regressive at the top, with the wealthiest 1% paying a lower average tax rate than the middle class, which means that it fails to alleviate wealth and income concentration (ECLAC, 2021b).

One of the instruments being considered is a net worth tax, which falls under property tax. This type of tax is usually collected on a yearly basis, and the taxable base is defined as the difference between the total value of all property and rights owned by the individual (assets) and the value of their debts (liabilities). Given that this is a direct tax, it is both feasible and standard practice to structure it progressively, with an exemption up to a certain wealth threshold and incrementally higher marginal rates thereafter.

Net worth tax is currently little used in the region (ECLAC, 2021b). The countries that do use it are Argentina, the Bolivarian Republic of Venezuela, Colombia, the Plurinational State of Bolivia and Uruguay. Many factors must be considered in designing and implementing net worth tax to make it effective, including vertical equity and redistribution, horizontal equity, savings and investment, tax compliance and tax administration challenges.

Countries should also consider environmental and corrective taxes. In addition to mobilizing resources, they incentivize consumption and production patterns that align with the SDGs (ECLAC, 2019b). There is a growing interest in carbon taxes in the region and ECLAC estimates that they could raise significant resources, given a high enough carbon price (ECLAC, 2024c). It is important to consider the impact of carbon tax on the population and how to use the resources mobilized to address any potential regressive impact and facilitate private climate investment. Countries could also consider new taxes related to public health, including on sugar-sweetened drinks and other unhealthy foods.

Another extremely important topic for the region is taxing the extractive sector. Recent international fluctuations in the prices of non-renewable natural resources and the associated profits have once again brought to the fore the importance of fiscal frameworks that enable States to collect a fair share of the economic rent from extractive activities. ECLAC estimates have found some countries to have regressive tax structures, such that the State's share of economic rent falls as prices rise (ECLAC, 2022b). Important taxes to consider in this scenario include progressive royalties or taxes on economic rents.

(b) Thematic bonds and other innovative financial instruments

Other than through tax policy, additional funding can be obtained from financial markets through innovative financial instruments (ECLAC, 2023e). Thematic bond issues have increased considerably in the region since 2020. However, only a few countries are active in those markets, which points to the importance of establishing the required institutional frameworks, including by adopting internationally recognized sustainable financing frameworks. Countries could also consider taking steps to attract private investment from global sustainable investment funds for catalytic projects with high economic and social returns.

(c) International tax reform

Another important area for improving resource mobilization is international tax reform, which is needed to mobilize global liquidity towards developing regions, including Latin America and the Caribbean, and can complement the design of national tax systems, in particular with regard to income tax. Improving personal income tax progressivity will require mechanisms for sharing tax information so that national tax authorities can identify the transactions of high-net-worth and highly mobile taxpayers, who could elude or evade domestic tax legislation. For corporate income tax, stronger domestic taxation would be supported by international architecture that made it possible to adequately tax the operations of multinational corporations in the place of origin of their economic activity.

In terms of taxing high-net-worth individuals and preventing the abuse of offshore financial centres, tax amnesties in the region have revealed vast undeclared assets. In some cases, these assets represented up to 21% of GDP, and 80% were located abroad (ECLAC, 2017b).

Taxing the wealthiest people using an approach that complements individual income tax would be an efficient way to make tax systems more progressive and generate significant resources to finance the SDGs (Zucman, 2024). According to estimates from the *Global Tax Evasion Report* 2024 (Alstadsæter and others, 2023), a 2% minimum tax on the world's multimillionaires could raise up to US$ 250 billion per year. Although there would be technical challenges in implementing it, international cooperation would pay a key role in reducing the risk of tax evasion. Sharing fiscal and financial data based on current models such as the Foreign Account Tax Compliance Act, used in the United States, or the Standard for Automatic Exchange of Financial Account Information in Tax Matters, used by many other countries, could be a way of boosting international tax cooperation. Notably, in the G20 ministerial declaration on international tax cooperation, countries agreed to continue exploring mechanisms for applying such a tax (G20, 2024).

Global action to reduce cross-border tax evasion and avoidance include the Base Erosion and Profit Shifting Project, introduced by OECD and the G20 countries in 2013. This initiative consists of a 15-point action plan, primarily seeking to tax profits at the origin of the economic substance where revenue is earned and value is created. By establishing a single set of international tax rules, it has supported and guided many legal framework reforms around the world. In 2016, OECD and the G20 countries also established the Inclusive Framework on Base Erosion and Profit Shifting so that interested countries could participate in coordinating and developing standards on topics related to base erosion and address the tax challenges arising from the digitalization of the economy.

Under the Inclusive Framework on Base Erosion and Profit Shifting, it was agreed to streamline and accelerate the implementation of the arm's length principle for business and distribution activity in the base country, focusing in particular on the needs of jurisdictions with limited capacity. The initiative consists of two pillars. There are two measures under pillar 1: regulations to allocate a portion of the excess profits of multinational corporations to the market jurisdiction, and a methodology to determine the prices of marketing and distribution activities in the market jurisdiction, focusing on jurisdictions with limited capacity. Pillar 2 includes interlinked domestic standards, through which a new global minimum tax of 15% is applied to multinational enterprises with annual turnover of 750 million euros or more and reestablishes the tax rights of source countries under the treaty on payments subject to a nominal corporate income tax rate below 9%.

The Organisation for Economic Co-operation and Development estimates that in 2021, the first measure of pillar 1 allocated tax rights to market jurisdictions on approximately US$ 204.6 billion in profits. This is expected to lead to annual global fiscal gains of between US$ 17.4 billion and US$ 31.7 billion (O'Reilly and others, 2023). Meanwhile, the global minimum tax proposed under pillar 2 is expected to increase corporate tax revenues by an annual average of between US$ 155 billion and US$ 192 billion, which is between 6.5% and 8.1% of global tax revenue (OECD, 2024).

The Regional Platform for Tax Cooperation in Latin America and the Caribbean (PTLAC) is another important initiative that provides a venue for the region's ministries of the interior, economy and finance to generate knowledge and share experiences on tax policy challenges. Its purpose is to generate studies, foster sharing

and provide technical guidance to support the design of tax policies that promote the sustainability, equity and growth of member countries, based on international experiences and the needs of the region and each country.[4]

Such regional initiatives, based on tangible objectives, afford the countries of Latin America and the Caribbean greater impact in international discussions on taxation. The Regional Platform for Tax Cooperation also provides an opportunity for member States to jointly explore tax topics of common interest as well as policy options to address them. The members of the Regional Platform for Tax Cooperation are currently working on progressive taxation, tax expenditure and environmental taxation. This work is an example of how regional and international tax cooperation and reforms to the international tax architecture can complement national efforts to increase tax revenues. The Regional Platform will also play an important role in identifying technical assistance needs. Developing countries could benefit from additional support from regional and international bodies to strengthen their taxation capacity, in terms of both financial and human resources.

This should be complemented by a strategy to strengthen fiscal institutions to better manage the economic cycle and strategically allocate public resources to boost economic growth in a sustained and sustainable manner. Fiscal policy can therefore play an active role in driving the major development model transformations that will enable the region to build a more productive, inclusive and sustainable future.

2. The role of macroprudential policy

Broadly speaking, macroprudential policy in the region has been countercyclical, mainly focused on cushioning credit cycles by deploying instruments aimed at addressing sectoral exposure to external conditions —especially exchange-rate volatility— along with capital controls in response to the growing impact of sudden capital movements.

The experience of the countries in this regard points to three mechanisms by which macroprudential regulation can support the mobilization of additional resources to finance development: increasing financial sector resilience to shocks, strengthening credit cycle monitoring complementing other macroeconomic policies.[5]

The macroprudential policy framework provides scope for countercyclical instruments aimed at mitigating macroeconomic volatility in order to support steady long-term growth. This is illustrated by countries' experiences with managing legal reserve requirements to cushion the effects of the credit cycle, which can be organized in different ways, around rates, types of deposits and currencies. Another, more recent example is the use of capital conservation buffers to preserve credit flows during the pandemic or the activation of countercyclical capital buffers in situations of inflationary pressure and heightened financial risk. That policy option has been consolidated by countries' experiences and the wide range of instruments available (ECLAC, 2020a), which enabled their flexible use during the COVID-19 crisis.

Because macroprudential policy acts directly on financial institutions, it can influence the credit supply as well as borrowing costs. Instruments such as maximum loan-to-value ratios affect credit demand through the channel of banking sector assets, while legal reserve requirements affect lending and investment through the liabilities channel. Other instruments, such as capital requirements, target the assets of financial institutions. By operating on banks' financing costs, they influence lending rates, which affects lending volume and, in turn, shapes aggregate demand and output trends.

The menu of macroprudential instruments serves to address the growing vulnerability of the region's economies to external shocks stemming from increased financial and trade integration. Specifically, the macroprudential approach deploys capital control provisions in response to closely intertwined credit and global financial cycles driven by fluctuating capital flows and exchange rates. At the regional level, capital controls

[4] The concept for the Regional Platform for Tax Cooperation in Latin America and the Caribbean was proposed by Colombia, Chile and Brazil at the thirty-fifth Regional Seminar on Fiscal Policy of ECLAC, in May 2023. It was formally established at the First Latin America and Caribbean Summit for Global, Inclusive, Sustainable and Equitable Taxation, held in Cartagena de Indias (Colombia) in July 2023.

[5] For a review of the macroeconomic impacts of macroprudential policy, see Kim and Mehrotra (2022) as well as Boar and others (2017). In the specific case of Latin America and the Caribbean, see de Oliveira and Vasconcelos (2023).

concern international capital flows and treat commercial and financial lending as asset categories. Additional measures include provisions to address liquidity risk, including exchange-rate risk. From this perspective, greater international reserve accumulation is also being used as a macroprudential instrument for active foreign-exchange intervention.[6]

In addition to providing macrofinancial stabilization, macroprudential instruments can be targeted to sector-specific risks and vulnerabilities. They can act on both the composition of aggregate demand and the sectors that are most vulnerable to the credit cycle. For example, during the 2020 crisis several monetary authorities established specific provisions to support MSMEs or to support specific productive sectors, such as agriculture.

The empirical data suggest that the impact of macroprudential measures varies based on the components of aggregate demand. Specifically, macroprudential measures curtail household consumption in the short and long terms, while boosting long-term business investment (Teixeira and Venter, 2023), which speaks to the potential of macroprudential policy to sustain the expansionary phase of output in the region. Better targeting of macroprudential instruments can also counter the decoupling of higher lending from long-term productive investment.

Coordination of macroprudential and monetary policies is essential to maintain macrofinancial stability. Credit is the main channel through which macroprudential and monetary policies interact. Several macroprudential instruments, including capital adequacy requirements, have an impact similar to that of the monetary policy rate (Cecchetti and Kohler, 2014). Similarly, some instruments traditionally seen as part of the monetary policy toolkit are now viewed as macroprudential. Legal reserve requirements fall into this category, as do some banking sector liquidity provisions. By affecting lending conditions, macroprudential policy can also influence interest rates, indirectly shaping the monetary policy stance. In turn, monetary policy can place pressure on financial stability. Expansionary monetary policy can cause financial risks to accumulate through the risk-taking channel of monetary policy, as in the 2009 financial crisis. High reference rates, on the other hand, increase borrowing costs for households and businesses as well as the likelihood of default. They can also spur sudden inflows of foreign capital, leading to a build-up of financial risks that would justify a tightening of macroprudential policy and capital controls.

Macroprudential policy action can therefore be used to compensate for the limits of monetary policy. The global financial panorama has placed greater pressure on the conduct of monetary policy in the region, in particular with regard to the use of countercyclical instruments. This limits the effectiveness of monetary policy transmission to the real sector (De Leo, Gopinath and Kalemli-Ozcan, 2024), which in the context of inflation targeting, privileges the use of the short-term reference rate as the single instrument of macrofinancial stabilization (Korinek and Stiglitz, 2022). Policy responses during the COVID-19 pandemic illustrate how macroprudential policy can compensate for limited monetary policy space. It can also help to stabilize output and prices in general, through the credit channel and money market rates, and create more space for countercyclical monetary policy (Bussière and others, 2021). In the current economic conditions, complementary macroprudential and monetary policies can temper excessive or repeated adjustments to the monetary policy rate that have high social costs and take a heavy toll on output and investment.

3. Reform of the international financial architecture

Although much progress has been made since the adoption of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, significant gaps remain in its implementation. Following four years of compounding shocks that include the COVID-19 pandemic, geopolitical conflicts and economic instability, the financing gap for the achievement of the SDGs has widened, reaching US$ 4 trillion per year for developing countries and revealing other deficiencies in the international financial architecture that must be addressed to achieve the SDGs. The inability of the international financial architecture to mobilize sufficient,

[6] A good illustration is the use of currency swaps by the Central Bank of Brazil.

stable, long-term funding to address current needs, including the climate crisis and the SDGs, has turned a spotlight on its structural defects and added urgency to calls for reform.

Against this backdrop, the Member States of the United Nations decided to convene the fourth International Conference on Financing for Development, from 30 June to 3 July 2025, in Spain. The mandate of the Conference is to assess the progress made in financing for development, address new and emerging issues, and support reform of the international financial architecture.

Potential ways to achieve these objectives have already been put forward. The Secretary-General produced a policy brief on reform of the international financial architecture in the framework of the recommendations made in preparation for the Summit of the Future, to be held in September 2024 in the context of the seventy-ninth session of the General Assembly of the United Nations.

Beyond the United Nations, significant work is being done by international financial institutions, informal groups of countries such as the G20 and Group of Seven (G7), and initiatives led by individual Member States, such as the Bridgetown Initiative for the Reform of the Global Financial Architecture and the Paris Pact for People and the Planet, to step up support for developing countries and preserve the hope of achieving the SDGs.

The main elements of the proposal of the Secretary-General for the reform of the international financial architecture are set out below.

(a) Modernization of global economic governance

The proposal is premised on the notion that the global governance system, established after the Second World War, is no longer fit for purpose. With that in mind, two recommendations have been made to ensure that global financial governance better reflects the contemporary global reality and to increase its capacity to tackle current and future challenges. The first seeks to transform the governance of international financial institutions, boosting the representation of developing countries in keeping with their greater participation in the global economy and society. The second proposes the creation of a representative apex body to systematically enhance the coherence of the international system.

To transform the governance of international financial institutions, the following measures are proposed: (i) update the quota formulas of the International Monetary Fund to reflect the changing global landscape, incorporating a component to reflect the population of member countries; (ii) reform voting rights and decision-making rules to make them more democratic, for example through a double majority rule, with a majority of both voting rights and member countries; (iii) delink access to International Monetary Fund resources from quotas, with access instead determined by both income and vulnerabilities, for example through a multi-vulnerability index; and (iv) boost the voice and representation of developing countries on boards, striving for gender-balanced representation in all the governance structures of international financial institutions, in particular at the leadership level.

With regard to enhancing the coherence of the international system, the proposal urges Member States to use the opportunity presented by the Summit of the Future to agree on a global coordinating body on economic decisions in the form of a biennial summit, at the level of heads of State and government, between members of G20 and of the Economic and Social Council, the Secretary-General and the heads of international financial institutions.

(b) Sovereign debt resolution mechanisms

The United Nations Secretary-General's *Our Common Agenda Policy Brief*, No. 6 (United Nations, 2023a) outlines a clear path forward to reduce sovereign borrowing costs and create a durable solution for countries facing debt distress, structured around two main areas: (i) de-risking sovereign debt instruments and improving sovereign debt markets to support the SDGs; and (ii) improving sovereign debt resolution mechanisms by

expanding the coverage of the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative in the short term and creating a multilateral sovereign debt resolution authority in the medium term.

Sovereign debt risks can be reduced by updating responsible borrowing and lending principles to incorporate the SDGs. Debt management capacity and transparency must also be improved, which requires the establishment of an accessible public registry of sovereign debt contracts and the financing conditions provided to countries. In addition, sovereign debt sustainability analyses should be refined in order to distinguish between liquidity crises and solvency crises, and to allow more fiscal space for investment in climate change and the SDGs. Such efforts can be complemented by reforms to risk assessment and credit rating by private credit rating agencies, including the incorporation of longer-term assessments into the analysis and more transparent credit rating methodologies. Lastly, debt contracts should be updated to include contingency clauses to protect debtors from potential insolvency caused by exogenous shocks, such as natural disasters.

In the short term, reforms to enhance debt crisis resolution should focus on expanding participation in the G20 Common Framework for Debt Treatments to include middle-income countries. Its operation should be streamlined, and countries should be treated equally. In the medium term, the creation of a multilateral debt restructuring mechanism is needed to ensure equal conditions between private creditors and sovereign debtors. This mechanism would serve as a broker in negotiations between creditors and debtors. Among other tasks, it would negotiate debt treatment based on a set of common principles to try to level the playing field between private and public creditors.

(c) Increased multilateral bank lending capacity

The lending capacity of multilateral development banks can be enhanced via three different but complementary means: (i) increased capitalization, (ii) more efficient use of capital, and (iii) more flexible lending criteria.

Major development banks have proposed capital increases as a necessary means to raise lending capacity in order to meet the growing financing needs of developing countries. At the regional level, in March 2024, IDB approved a capital increase for IDB Invest, which will increase its financing capacity by US$ 15 billion to US$ 17 billion by mobilizing resources from private investors. In 2020, the Central American Bank for Economic Integration (CABEI) increased its authorized capital for the eighth time, and for the second time in less than 10 years. The rise, from US$ 5 billion to US$ 7 billion, represented a 40% increase in the Bank's capital base. According to CABEI, the increase will boost institutional lending capacity by about 45%, which translates into an increase in loan approvals of approximately US$ 1 billion per year. In December 2021, the Development Bank of Latin America and the Caribbean (CAF) approved its largest ever capital increase, by US$ 7 billion in paid-in capital, which will allow it to double its loan portfolio by 2030. At the global level, in 2023, the World Bank announced plans to raise its capital, which would expand its lending capacity by between US$ 100 billion and US$ 125 billion over the next decade.

Other initiatives to increase development bank lending capacity include the modification of capital adequacy frameworks. According to a G20 study, this could raise the global investment capacity of multilateral banks by between US$ 500 billion and US$ 1 trillion without compromising their credit rating (Léautier and others, 2022; G20, 2023). The World Bank is also considering increasing guarantee amounts and hybrid capital, including by recycling special drawing rights (SDRs), making more efficient use of callable capital and expanding concessional financing. As a result, for every US$ 1 of additional capital, US$ 6 of additional financing could be generated over the span of a decade.

Given the importance of leveraging private resources to finance development, multilateral development banks can also explore alternative financing mechanisms such as social and sustainable bonds. Globally, there has been solid growth in green, social and sustainable bonds since 2013. Data available for Latin America and the Caribbean show that the international issuance of green, social and sustainable bonds —including sovereign and corporate issuance— in the period 2014–2022 represents a cumulative total of US$ 81.2 billion (Climate Bonds Initiative, 2024).

The international financial architecture should also provide higher levels of concessionality in international financing. Concessionality should not depend solely on a country's income level. New metrics need to be developed and the focus of the model needs to shift from "graduation" to "gradation". While the graduation mechanism is based on countries becoming ineligible for official development assistance once they reach a certain level of income, the gradation mechanism "adopts a gradual, phased approach that flexibly combines public and private financing instruments for all countries on the basis of their ability to mobilize domestic and external resources, their willingness and capacity to contribute to regional and global public goods, and a common, prioritized diagnosis of the problems that need addressing" (ECLAC, 2021a).

Based on this multidimensional perspective, cooperation governance and financing must play a facilitating role and be multilevel in nature, taking into account South-South cooperation, triangular cooperation and horizontal cooperation, both among the different levels of government and between government and private and civil society organizations. In addition to new metrics, new development cooperation tools are needed at the operational level to adapt cooperation to evolving global and regional contexts, while building on the effectiveness of existing tools.

Development banks can enhance their lending capacity to the productive sector by cooperating with commercial banks through guarantee systems, by addressing information asymmetry thorough the promotion of financial education and incorporation of demand-side factors in their analyses, and by strengthening cooperation between national and multilateral banks. Guarantee systems have two important advantages. The first is that they can increase the financial system's supply of credit to firms that lack sufficient collateral and cover the credit needs of start-ups and new and less experienced businesses. Second, guarantees improve credit conditions. The interest rates, amounts and terms of loans can be improved by the risk mitigation provided by a guarantee mechanism.

Funds financed by developed countries are a complementary policy option to expand the provision of finance from developed countries to developing countries. Recently, in November 2023, at the twenty-eighth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, developed countries approved the operation of the loss and damage fund, an issue that had been on the development agenda for the past three decades. The fund seeks to ensure that developed countries and major emitters of pollutants compensate those experiencing the most devastating effects of climate change.[7]

(d) Special drawing rights

Another tool to increase liquidity is the recycling of SDRs from developed to developing countries. The August 2021 SDR allocation, equivalent to US$ 650 billion, helped overcome some of the gaps in the international financial safety net. However, the mechanism of allocating SDRs in proportion to countries' IMF quotas meant that developing countries received only about one third of the 2021 allocation, while the most vulnerable countries received much less.

To date, the most advanced countries have committed the equivalent of US$ 107.7 billion, mainly through the IMF Poverty Reduction and Growth Trust and Resilience and Sustainability Trust. The IDB and the African Development Bank are developing a proposal wherein developed country SDRs would be used to purchase hybrid capital instruments issued by development financing entities that are classified as prescribed SDR holders. Such capital would be used to leverage private financing and expand the lending capabilities of regional development banks.

[7] Under the agreement reached at the twenty-eighth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP28), the loss and damage fund will be the operating entity of the Financial Mechanism of the Convention, also serving the Paris Agreement. To this end, the fund will have an independent secretariat, which will be hosted ad interim by the World Bank and whose operation will be governed and supervised by a board based in the Philippines. During the first board meeting in May 2024, it was agreed that the board would be headed by France and South Africa. In 2024, the board will develop modes of access, financial instruments, modalities and facilities, all of which must be approved at the twenty-ninth session of the Conference of the Parties, to be held in November 2029. According to information received from the COP28 president, as of April 2024, the fund had received pledges equivalent to US$ 662 million.

A complementary proposal, contained in the United Nations Secretary General's policy brief, is to restructure the role and use of SDRs, including automated issuance of SDRs on a countercyclical basis or in response to shocks. Under this proposal, to combat future crises effectively, SDRs should be issued quickly at the start of a financial crises or other shocks (United Nations, 2023a). In 2008–2009, it took 11 months after the onset of full-scale financial crisis to agree on SDR issuance, while in 2020–2021, it took 17 months. The issuance of SDRs should be subject to mechanisms that automatically generate a recommendation for issuance when pre-established conditions are met, in order to avoid political delays. A new allocation formula would allow SDR issuance to target countries in most need of liquidity, for instance, those facing disasters or other shocks. While there is relatively broad support for the idea that IMF should be able to systematically issue SDRs in cases of urgent global liquidity needs, this possibility is complicated by the current governance structure of the Fund (Coulibaly, 2024; Jacobs, 2024).

4. Institutional capabilities and governance to implement the strategies analysed

Mobilizing financing for development requires stronger coherence among financing policies, both between sectors and funding sources, and between funding sources and sustainable development priorities. Improving this alignment depends on the institutions and processes through which development financing policies are designed, implemented and managed, in other words, effective governance.

Effective governance makes it possible to establish and maintain the political leadership necessary for the implementation of comprehensive development financing policies; ensure national ownership and enable national governments to take the lead in developing and implementing financing policies; reinforce collaboration between different central government agencies, as well as between different levels of government; facilitate the participation and engagement of all relevant stakeholders, both State and non-State, ensuring their participation throughout the process of policy design, implementation and management; strengthen coordination with development partners on funding priorities; better integrate policies to mobilize financing from different sources, whether public or private, domestic or external; and end compartmentalized approaches to estimating financing needs, identifying financing opportunities and challenges, and designing and implementing resource mobilization policies.

International experience points to three determinants of effective governance of financing for development: commitment and leadership, access to knowledge and perspectives, and coordination.

First, there is a need for strong high-level political and technical commitment and leadership to provide the overall vision and the general objective with which development financing policies should be aligned, thus ensuring the ownership, commitment and participation of different stakeholders in development financing strategies beyond electoral cycles.

The governance of a sound fiscal sustainability framework can be organized around fiscal rules with clearly defined objectives, ensuring consistency with principles such as debt sustainability, macroeconomic stability, inclusive growth and intergenerational equity (ECLAC, 2022b).

In addition, fiscal rules should take into account the fiscal rigidities specific to each national context and be consistent with the management of sovereign wealth funds and other stabilization mechanisms, thus ensuring a comprehensive fiscal policy. Fiscal rules must also be coordinated with medium-term programming to ensure long-term fiscal sustainability and stability. The transition to and implementation of new fiscal rules must be backed by a broad political consensus to ensure their acceptance and effectiveness.

Building stronger fiscal institutions also requires normative and regulatory frameworks that support economic stability and predictability. This is essential to attract domestic and foreign investment and to maintain confidence in financial markets. The strengthening of fiscal capacities must be accompanied by public policies that promote sustainable economic growth and the reduction of public debt, which in some countries has reached worrying levels.

Second, better governance of development financing needs to include the knowledge and perspectives of relevant stakeholders in decision-making, so that policymakers can integrate a broad set of needs, priorities and interests into the design and implementation of a comprehensive approach to financing for development. This facilitates access to relevant information for decision-making as well as finance providers' accountability.

Where a fiscal sustainability framework is developed as the backbone of a comprehensive development financing strategy, it is essential to establish and strengthen independent fiscal councils to ensure that fiscal rules are credible and effective.

Lastly, coordination among relevant actors —both within the government and between the government, the private sector, academia and civil society— can leverage synergies in the design and implementation of financing policies in different areas and at different levels, minimizing risks and effectively managing the contradictions and trade-offs inherent in different policy mixes.

In this regard, a key area of effort is to strengthen coordination mechanisms among macroeconomic policies in order to maintain coherence and consistency in the design and implementation of fiscal, monetary, exchange-rate and prudential policies within the respective authorities' mandates. Such coordination mechanisms include the regular publication of the economic policy criteria underpinning the preparation of draft budgets, as well as the participation of finance ministries in the meetings of central banks' monetary policy councils.

Considering the institutional arrangements in place in a growing number of countries, where monetary authorities have been given operational autonomy under inflation-targeting regimes, one alternative to enhance macroeconomic policy coherence and consistency is to make existing monetary regimes more flexible. The objective is to use a broader set of instruments in the context of an integrated policy framework to respond to external shocks, with macroprudential measures playing a key role both in targeting the effects of monetary policy and in managing capital inflows and outflows with a view to preserving macrofinancial stability.

In addition to the foregoing, it is essential for the region to adopt a common position on the reform of the international financial architecture in order for the countries of Latin America and the Caribbean to influence the design of a fairer and more efficient global financial system. Critical junctures in the discussion on international financial reform include the Summit of the Future to be held in September 2024, the preparatory meetings for the Fourth International Conference on Financing for Development scheduled for mid-2025, the discussions of the G20 International Financial Architecture Working Group, as well as the spring and annual meetings of IMF and the World Bank.

A unified regional position can strengthen the region's voice in international forums, thus facilitating reforms that improve access to financing and conditions for investment and development. The Regional Platform for Tax Cooperation is a concrete example of a coordination mechanism aimed at improving institutional capabilities and sharing good practices among the countries of the region.

The Platform's objective is to generate a mechanism through which Latin American and Caribbean countries can establish regional positions on key cross-border tax issues and provide an arena for technical exchanges on common tax issues, leading to potential solutions.

Regional positions that are coordinated at the multilateral level and draw on concrete policy objectives will help create the conditions for tax systems capable of financing countries' development requirements. Central to this effort will be the creation of spaces for the exchange of experiences, the generation of customized policy and macroeconomic analysis, and the provision of technical assistance to ensure that countries derive the greatest benefit from stronger international fiscal cooperation. A key point in this is that ministries of finance and ministries of foreign affairs must collaborate closely at the national level to support the establishment of regional positions.

Operating together, the three above-mentioned functions can support more coherent governance of strategies to mobilize financing for development, thereby making resources available to achieve national sustainable development goals and promote inclusiveness, sustainability and resilience (INFF Facility, 2024).

(a) Critical capabilities for stronger governance of development finance mobilization

All potential sources of funding need to be considered in mobilizing financing for development. Effective governance must therefore harness and coordinate the efforts of existing institutions and processes that govern the national budget and broader public financial management, such as budget preparation, procurement and public investment; alignment of private financing and investment, for example, through public-private dialogue platforms; development cooperation; and broader economic governance arrangements.

Financing national development priorities must bring together the capacities of various stakeholders, both inside and outside government, and be realized through various processes that can guide policy design and implementation in different areas and facilitate information exchange and coordination among different stakeholders.

Important institutions for this in the governmental sphere include the office of the president, ministries of planning, finance and foreign affairs, as well as sectoral ministries, the central bank, development banks, local governments, parliaments, supreme audit institutions, national statistical offices and national disaster prevention offices. Beyond the government itself, key institutions include public and private donors, multilateral development finance institutions, companies, national and international commercial banks and investors, academia and civil society.

Processes relevant to the governance of development financing include national and local development planning, annual budgeting, public financial management reforms, as well as the design and approval of public investment projects, the design of development cooperation strategies and the design of private sector development and investment promotion strategies.

Different countries have differing priorities and needs, political and administrative systems and institutional structures. However, it is possible to identify certain characteristics relating to institutions' technical, operational, political and prospective capabilities that are relevant for improving the governance of development finance mobilization (see table VII.2).

Table VII.2
Technical, operational, political and prospective (TOPP) capabilities of institutions for mobilizing development financing

Capabilities	Characteristics
Technical	– Design, implementation and evaluation of comprehensive public policies for mobilizing public and private financial resources, both nationally and internationally, with cross-cutting approaches in key development areas. – Innovation in instruments and incentives to scale up the financing granted and mobilized by development banks. – Capacity-building to access innovative financing instruments.
Operational	– Use of modern public management tools for budgeting, planning, performance management and evaluation, and accountability procedures. – Development, implementation and management of comprehensive information systems to link the use of available financing with policies in key development areas. – Promotion of effective collaboration and coordination between different levels of government in order to avoid policy compartmentalization, improve joint planning, reduce duplication of efforts, increase efficiency, improve risk management, and address inconsistencies in the design and implementation of policies to finance development in different areas.
Political	– Fostering strong, high-level political leadership to facilitate the incorporation of development financing issues in existing spaces for social dialogue among various development stakeholders for public policy design and implementation. – Promotion of dialogue and coordination mechanisms between different levels of government, including those responsible for macroeconomic policy, as well as between ministries of finance and ministries of foreign affairs, in preparation for international meetings on reform of the international financial architecture. – Creation of international cooperation platforms to establish common positions on international financial reform.
Prospective	– Formulation of future scenarios that contemplate different combinations of sources of development financing and potential trends regarding their availability. – Facilitation of public policy design and implementation processes by developing alternative futures to anticipate future needs and priorities, strengthening efficiency in resource allocation and ensuring that financing is directed to key areas of development. – Analysis of the impact of the international environment on the availability and composition of sources of financing for development.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. M. Salazar-Xirinachs, "Rethinking, reimagining and transforming: the 'whats' and the 'hows' for moving towards a more productive, inclusive and sustainable development model", *CEPAL Review*, No. 141 (LC/PUB.2023/29-P), Santiago, ECLAC, 2024.

C. Summary

As discussed in chapter II, Latin American and Caribbean countries face a development crisis characterized by three traps (Salazar-Xirinachs, 2023): low growth, high inequality, and weak institutional capacities and ineffective governance. These traps are rooted in a set of structural gaps, hallmarks of the region's development models, that often feed into one another. To close the structural gaps identified, some major transformations are proposed to create a more productive, inclusive and sustainable future.

As mentioned, the design and implementation of policies to facilitate these transformations requires significant investment, which in turn calls for the mobilization of public and private resources at both the national and international levels. From this perspective, resource mobilization to finance development has the transformative potential to create a more productive, inclusive and sustainable future in the region.

The main obstacles to resource mobilization include low economic growth, limited public policy space and high financing costs. A set of strategies organized around three key areas is proposed to address these obstacles and boost financing for key sectors, including energy, water and sanitation, infrastructure, food and agriculture, biodiversity, health, education and other sectors that drive and stimulate growth.

First, public finances must be strengthened by increasing resource mobilization capacity through improved tax collection. This entails reinforcing direct taxation, especially personal income tax, and combating tax evasion and avoidance that result in significant tax revenue losses. In addition, there is a need to build a sustainable framework for public finances that enables efficient public debt management, reduces fiscal deficits and ensures macroeconomic stability.

Another essential strategy is the comprehensive use of macroeconomic stabilization tools. The implementation of macroprudential policies can make the financial sector more resilient and mitigate macroeconomic volatility, complementing other economic policies to improve business cycle management. Monetary and fiscal policies need to be adjusted to support investment and growth, avoiding procyclical policies that exacerbate economic fluctuations.

In addition, the international financial architecture needs to be reformed, structured around four pillars: (i) strengthening global economic governance by involving developing countries more in decision-making by international financial institutions; (ii) improving international mechanisms for sovereign debt relief and restructuring in order to boost developing countries' capacities to manage their obligations in a sustainable manner and avoid debt crises; (iii) significantly scaling up the availability of financing for development by strengthening development banking institutions to enable them to mobilize more resources for the productive sector, including by creating new mechanisms to facilitate investment and long-term financing; and (iv) providing more equitable access to the global financial safety net, primarily by restructuring the role and use of SDRs.

To develop and pursue such strategies, countries must strengthen their existing institutional capabilities, especially operational capabilities and those for policy design, execution and monitoring. Work on strengthening fiscal institutions can thus be structured around the adoption of fiscal rules consistent with debt sustainability and macroeconomic stability, supported by independent fiscal councils and a broad political consensus. Likewise, the development of mechanisms to facilitate the adoption of common regional-level positions concerning the reform of the international financial architecture can improve the prospects for development financing. The Regional Platform for Tax Cooperation in Latin America and the Caribbean is a useful mechanism to coordinate efforts and share good tax practices, thereby creating conditions for efficient tax systems that finance development and reduce dependence on external funding. As mentioned above, national-level coordination between ministries of finance and ministries of foreign affairs is also crucial for establishing common positions.

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Final remarks

In a changing and particularly unstable global economic and political context, the countries of Latin America and the Caribbean are facing a development crisis.

Globalization is being redefined:

- Global goods trade and investment flows are growing more slowly than in the pre-pandemic years, and their structure in terms of origin and destination is changing; meanwhile, trade in services is growing rapidly.
- The geography of global value chains has also changed, with nearshoring cropping up in both the United States and Europe.
- Industrial policy based on large-scale subsidies, which has regained favour in western developed economies and is a central component of China's economic policy, is increasingly accompanied by technology trade policies among the major trading powers.
- Mounting technological and industrial rivalry between the world's major economies is no longer viewed exclusively as a matter of economic policy but as a matter of national security as well.
- Reforming the international financial architecture has become a prominent topic on global agendas.
- Changes to international tax laws are limiting some traditional public policy areas, such as tax incentives to promote and attract foreign direct investment (FDI).
- The economic and social costs and consequences of climate change continue to grow, in particular for developing countries, which have fewer resources and lower capacity to address these effects.

This constellation of transformations poses challenges but also offers significant opportunities for the development of Latin American and Caribbean countries. However, these opportunities will not come to fruition alone; they will require proactive productive development policies, many of which have already returned to the arena of global economic policy.

The development crisis that is facing the region is reflected in negative trends and insufficient growth across a range of economic and social indicators and also manifests itself in the form of development traps, defined as vicious circles that limit countries' ability to achieve development objectives. This report has addressed the three traps that the Economic Commission for Latin America and the Caribbean (ECLAC) considers most consequential for the region: a low capacity for growth; high inequality and low social mobility and cohesion; and weak institutional capacities and ineffective governance. These traps are compounded by the challenges of addressing climate change and fostering environmentally sustainable development.

This report has presented an analysis of how to manage the three great transformations that are considered regional priorities:

(i) A great productive transformation to achieve stronger, sustained, inclusive and sustainable growth.

(ii) A great transformation to reduce inequality and foster inclusion and social mobility.

(iii) A great transformation to advance sustainability and combat climate change.

The analysis also takes into account two cross-cutting issues:

(i) The challenge of improving institutional capacities and social dialogue processes to manage the three transformations.

(ii) The challenge of mobilizing financing, both for these specific transformations and for development in general.

A major productive transformation to achieve stronger, sustained, inclusive and sustainable growth

The region can escape the low-growth trap only by embarking upon a major productive transformation. This can be achieved only if the economic policy toolkit is expanded to include productive development policies that are substantially more ambitious and broader in scope. The productive development policy vision that ECLAC has proposed for the region emphasizes the role of governance and public-private collaboration and recognizes the need to increase resources and enhance existing productive development policies in the countries and territories, in addition to improving policy management.

Sector prioritization is crucial and should be determined by the specific conditions of each country. It is equally important to realize the potential for cooperation among public, private, academic and civil society stakeholders at all levels of government.

Pursuing productive development policy requires an institutional framework that is capable of effective leadership in the design, administration, monitoring and evaluation processes within each institution's respective area of authority and that has sufficient technical, operational, policy and prospective capabilities. Technical capabilities include the ability to collectively build and implement productive development policies in strategic synergy with all other dimensions of development, which should all be aligned within a comprehensive development planning framework. Operational capabilities include having mechanisms and systems in place to facilitate the alignment and coordination of efforts. Political capabilities include strengths in establishing and maintaining relationships and interactions among the various relevant stakeholders and managing coalitions in order to recalibrate policy configurations that are holding back productivity improvements. Prospective capabilities include understanding technological and market variations and trends, building future scenarios and designing road maps to realize them, and being able to change course and react to evolving conditions, including disruptions.

ECLAC also envisages an enhanced territorial approach, including the adoption of cluster initiatives or other measures to coordinate territorial production. The report also analyses and proposes the adoption of an experimentalist approach to governance and the design of mechanisms that ensure policies' long-term continuity.

A major transformation to reduce inequality and foster inclusion and social mobility

Breaking free of the trap of high inequality and low social mobility and cohesion calls for an integrated approach that addresses the root causes discussed in this document simultaneously. Six causes of this development trap were identified.

First, inequality is rooted in the region's low growth and productive heterogeneity, which is linked to a weak labour market with high levels of informality and significant variation in productivity across sectors, hence the importance of productive development policies for reducing inequality and fostering social mobility.

Second, tax systems need to be made more progressive and generate additional resources to fund transformations, by means of strengthening direct taxes on income, property and wealth; this would both increase revenue and leverage the redistributive potential of the tax system. The successful design and implementation of reforms to improve tax collection and progressivity depends largely on strengthening the technical, operational, political and prospective capabilities of finance ministries and tax administrations. In addition, social dialogue is a prerequisite for lasting fiscal compacts. It is indispensable when it comes to garnering the broad consensus needed for reforms to be politically and socially viable and establishing governance mechanisms to support implementation and follow-up.

Third, social protection systems are a key arena for reducing inequality and increasing social mobility and cohesion. Often, these systems are interconnected with various instruments and institutions, which amplifies the impact of their technical, operational, political and prospective capabilities. The analysis presented in this report has considered active labour market policies, contributory and non-contributory pension systems and structural deficiencies in health-care systems. Social institutions must be strengthened in these and other areas.

Amid multiple simultaneous transformations, there is a growing need to coordinate between sectors and levels of government and to strengthen the planning function in the design of strategic policies. With regard to technical capabilities, planning measures must be strengthened to strategically guide the implementation of the policies that collectively form the social protection system; this includes, for example, strengthening comprehensive information systems and social registers of potential recipients. Operational capabilities include human resources with the training, skills and commitment necessary to confront the multiple challenges and requirements of social protection policies, as well as mechanisms like single windows that facilitate citizens' access to a range of social protection programmes and entitlements through a single channel. Political capabilities are key for advancing social protection polices through the broad agreements these require. Prospective capabilities are essential for anticipating the implications of a changing social risk structure in the context of demographic, epidemiological and nutritional transitions, the increased frequency of disasters and the effects of climate change, as well as technological and labour transformations.

Fourth, realizing the potential of education to serve as a conduit for social mobility, requires higher enrolment rates and improved learning quality. The coverage of both vocational and professional postsecondary education should be expanded and complemented by minimum quality standards that encourage the development of cognitive, socio-emotional and digital skills, with a view to designing more productive and higher-income careers. A lifelong learning approach to education and professional training is also important. This approach should span the entire life cycle, from childhood to adulthood, with a focus on developing the necessary skills and knowledge to thrive in a labour market increasingly characterized by uncertainty and change. Thus, to make education a true engine for upward social mobility, education ministries must strengthen their technical, operational, political and prospective capabilities. The ministries responsible for education policy need vision and leadership to create a broad coalition of public and private stakeholders with a view to achieving political, social and fiscal consensus that recognizes and strengthens the role of education in inclusive social development.

Fifth, the transformative proposal for a care society is essential to reducing inequality and fostering social inclusion. The care society is based on a development model that prioritizes people and the planet in a gender-responsive manner and within the framework of human rights. It is a vital alternative to the current development model, which perpetuates gender, socioeconomic, ethnic and racial, and spatial inequalities. It requires strong States with robust capacities. The proposal for a structural transformation towards a development model that is built on care and the sustainability of life is the product of analysis, information-gathering and systematization of years of research on gender and women's autonomy, all indicating a need to strengthen technical capacities. A strengthened care society also requires the development of operational capabilities, including management tools; georeferenced information on available care services; and the systematization of the sociospatial aspects of demand for care using digital platforms that facilitate decision-making on the implementation of care policies. The development of political capacities is also key in driving and effectively managing transformations towards the care society. This includes fortifying democratic governance, fostering social dialogue and building consensus. Prospective capabilities, meanwhile, are relevant in terms of the projection of demographic trends and changes, the capacity of the care society to create jobs and the costs of building care networks, among other aspects.

Sixth, Latin American and Caribbean cities tend to be breeding grounds for inequality, with high levels of informal occupancy and non-compliance with building regulations, spatial segregation with high transport costs for poor segments of the population, residential overcrowding and poor access to basic services, such as water, sanitation and electricity. Taken together, these conditions produce high levels of social exclusion. Thus, moving towards inclusive cities is a critical component of the agenda to reduce inequalities in the region, which calls for a participatory scenario-building process that goes beyond the extrapolation of current trends. A new narrative is needed, taking into account the multidimensional nature of urban development, recognizing the

existence of institutional paths and incorporating scenario-building of potential futures from a political economy perspective. This narrative, too, must be complemented by technical, operational, political and prospective capabilities. Technical capabilities include integrating the various dimensions of urban, economic, social and environmental policy. Operational capabilities include broadening urban planning capacities and using technology and big data to optimize the provision of public services. Political capabilities include leadership in developing a comprehensive vision and leveraging public consultation and participation mechanisms in planning processes. Prospective capabilities include identifying trends in the demand for urban services based on sociodemographic shifts, and updating urban architecture and design to meet the needs of the twenty-first century.

As discussed in this report, working on one or two of these causes of high inequality and low social mobility and cohesion is not enough to move the needle; overcoming this development trap will require a comprehensive approach to address all six causes simultaneously.

A great transformation to advance sustainability and combat climate change

The third great transformation proposed by ECLAC pertains to sustainability and climate change. It requires an approach that is both cross-cutting and sector-specific. This report has presented an analysis of the energy transition and e-mobility, together with the minerals critical to both; the circular economy; sustainable water management; sustainable tourism; and the bioeconomy. A modern approach to productive development policy is needed to manage the transformation of these and other sectors.

As with the other two transformations, the sustainability transition presents challenges related to governance, strengthening institutions' technical, operational, political and prospective capabilities, and social dialogue. For example, to achieve a just and sustainable energy transition, planning processes must be in place, and the State must take an active role with the support of various international organizations and bodies and the multilevel participation of private sector stakeholders, including firms, civil society and academia. Effective implementation and continuous monitoring and evaluation of policies are crucial for achieving planned objectives. The energy transition will entail profound changes, including in how energy is produced and consumed. Given the scale of these changes, democratic processes for citizen participation in policymaking must be established or strengthened to ensure effective governance of the energy transition.

E-mobility will also require a paradigm shift, moving beyond the sectoral approach to transport and adopting a comprehensive strategy for sustainable mobility. This has important implications for the technical, operational, political and prospective capabilities of institutions and for governance. Technical capabilities include pursuing integrated public policy on e-mobility and generating data on the interlinkages and cross-media effects across economic, social and environmental dimensions. Operational capabilities include deploying technology and big data to incentivize the use of public transport, taking into account the role of mobility in care tasks. Political capacities include pursuing a comprehensive approach to e-mobility that builds trust among all key stakeholders and fosters cooperation. Prospective capabilities include technological foresight to predict the availability and penetration of different energy sources (ethanol, biogas, electric, hydrogen), as well as identifying trends in the demand for public e-mobility services. Fluid communication and planning is essential, both among State institutions at the national level and between national institutions and local authorities, who are more familiarized with trends and opportunities in their cities. Governance includes clear and formal relationships with the private sector and civil society, led by the public sector, to take advantage of the window of opportunity for e-mobility. Understanding e-mobility as a system will enable precision leveraging of massive investments in renewing public (and private) automobile fleets and their potential impact on cities.

A key component of the big push for sustainability is the responsible management of the mineral supply chain, which is critical to ensuring a just, effective, inclusive and sustainable energy transition. Mineral production and refining present significant socioenvironmental challenges, which must be well managed. Additional challenges include better managing tax revenues and expenditures associated with the mining sector, including manufacturing

and value added. Productive development policies for critical minerals are essential to prevent countries from limiting themselves to the extractive phase of the process. In the future, with the likely expansion of renewable energy and green hydrogen, countries with critical mineral reserves and new renewable energy resources will have a growing advantage in terms of accessing markets that are expected to have stricter environmental requirements. Progress in that regard will require a new model of governance for natural resources in the region, which should be multilevel, transparent, democratic and effective, and must incorporate the life-cycle approach to natural resources and a territorial perspective. This new model of governance, which will include strengthened technical, operational, political and prospective capabilities, will enable countries of the region to develop a long-term strategic vision, with appropriate regulations and improved coordination.

Advancing the water transition in the region requires action across four pillars: achieving universal access; reducing water poverty; containing negative externalities (including climate change adaptation measures); and introducing new technologies and approaches, such as the circular economy. In addition, regulatory frameworks must be modified in order to attract new investors, which in turn requires innovative financial instruments and systems. Strengthening water governance and the technical, operational, political and prospective capabilities of institutions in this sector is fundamental to improving water management in the countries of the region.

In light of the strength and significant impact of the tourism sector on the development of many of the countries and territories of Latin America and the Caribbean, its sustainability is central to their inclusive and sustainable development. Sustainable tourism comprises four key elements: (i) optimal use of natural resources to safeguard essential ecological processes and conserve biodiversity and ecosystems; (ii) respect for cultural authenticity, the conservation of cultural heritage and traditions, and the contribution of intercultural perspectives, diversity and tolerance; (iii) operations that are economically viable and offer socioeconomic benefits to participants; and (iv) the capacity to plan, lead and manage the development of tourism with multilevel and inclusive governance. The sector's complexity demands coordination between different sectors under the leadership of national tourism authorities. National government capacities are needed to empower local communities to take ownership of tourism strategies and coordinate their implementation with subnational governments. There is also a place for planning and decision-making forums on the future of tourism that engage communities, and for communications strategies and relevant information for communities and firms. To that end, mechanisms should be set up for coordination and data access and exchange between the public and private sectors. Social dialogue and stronger governance are crucial for all these.

Another fundamental component of sustainable development is fostering the bioeconomy as an engine for productive transformation. The bioeconomy represents opportunities for climate change mitigation and adaptation in agriculture and for leveraging synergies between the two. To harness the transformative potential of the bioeconomy, governments must be able to pursue more robust strategies to foster its synergies with other driving sectors of major productive transformation. They also need strengthened mechanisms for coordination among the sectoral institutions responsible for implementing strategies and action plans. Mechanisms for multisectoral and multi-stakeholder dialogue must be created and implemented to reconcile different visions for the design of regulatory and incentive frameworks, and capacities developed and strengthened to keep abreast of technological developments and changes in consumption patterns that might affect the future development of the bioeconomy.

Lastly, the report's analysis looked at ways of stimulating the circular economy —another essential component of sustainable development. Moving towards a circular economy entails a major transformation of production and consumption systems, with implications for investment, the adoption of new technologies, demand for new skills and abilities, and the creation of new jobs. This productive transformation contributes to the realization of more productive, inclusive and sustainable development models. In addition to technical solutions, stimulating the circular economy will require adequate governance based on collaboration among stakeholders, the development of metrics, long-term road maps and national strategies, and the creation of economic, financial and regulatory instruments, among other aspects. It also requires strengthening regulatory instruments that contribute to the establishment or expansion of circular business models; aligning economic and financial instruments to redirect investments towards the circular economy; and building solid governance with collaborative platforms that enable the academic, private and public sectors to coordinate their efforts to devise innovative circular solutions.

For the transformations proposed by ECLAC in this report, substantial progress will depend on the mobilization of financial resources at the national and international levels. As discussed in chapter VII, it is essential to strengthen public finances by increasing resource mobilization capacity through improved tax collection, but it is equally essential to have in place a sustainable framework for public finances that facilitates efficient management of public debt, thereby reducing fiscal deficits and ensuring macroeconomic stability. Another essential strategy is the use of macroeconomic stabilization tools, as macroprudential policies can boost financial sector resilience and ease macroeconomic volatility, complementing other economic policies for better management of the economic cycle. Monetary and fiscal policies must be adjusted to support investment and growth, avoiding procyclical measures that exacerbate economic fluctuations. The scope of action should extend beyond the region, with the aim of influencing reforms to the international financial architecture to facilitate access to resources for development. When it comes to private international resources, comprehensive strategies should be designed to attract FDI and link it to the rest of the national productive structure, and to increase the productive use of family remittances.

Development financing needs not only stronger technical, operational, political and prospective capabilities, but also better governance, including local and national planning for development, designing and approving public investment projects, and strategies for development cooperation, private sector development and investment promotion.

Contribution of ECLAC

ECLAC provides knowledge and capacities to support the countries of the region in their national and regional processes, as they manage the transformations needed to escape development traps. In accordance with its mandates, ECLAC will continue to analyse the challenges and opportunities involved in moving towards a more productive, inclusive and sustainable development in the region and will accordingly continue to generate technical information for public policy formulation and monitoring. It will also continue to provide the countries with spaces for technical collaboration to strengthen the technical, operational, political and prospective capabilities of institutions through, for example, the development of innovative technical tools to inform the design and evaluation of public policies; the delivery of courses, workshops and seminars to enhance the knowledge and capacities of public officials; the development of methodologies for public planning and policies; the dissemination of international best practices; and support for collaborative processes on joint development initiatives by the public sector, private sector, academic sector and civil society.

Latin America and the Caribbean is facing a number of development traps that pose significant obstacles to a more productive, inclusive and sustainable future. This development crisis coincides with an international context that has changed considerably in the last decade —both on the geo-economic and geopolitical fronts— and which is shifting towards a new set of rules for trade and investment.

For its fortieth session, the Economic Commission for Latin America and the Caribbean (ECLAC) is putting forward a new proposal analysing three transformations that are vital for moving towards a new development model: (i) a productive transformation for higher, sustained, inclusive and sustainable growth; (ii) a transformation to reduce inequality and foster inclusion and social mobility; and (iii) a transformation to boost sustainability and combat climate change. This document includes various proposals for carrying out these transformations, with a focus on how to manage them so as to overcome the development traps in the region. Managing these transformations requires improved governance; strengthening of the technical, operational, political and prospective capabilities of institutions; and the promotion of social dialogue.

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