

# Compacts for Equality

Towards a Sustainable Future



**2014**

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Thirty-fifth  
session of  
ECLAC

Lima, 5-9 May

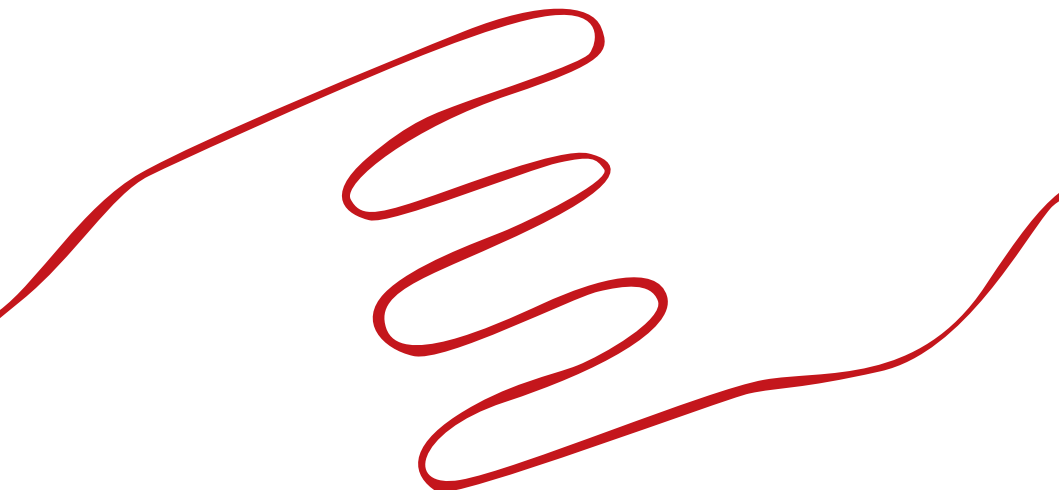


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# I. Introduction

## A. The ECLAC approach: the equality trilogy

Throughout its history, one of the Commission's ongoing concerns has been to propose a model for sustainable development for the medium and long terms. This conviction has gained fresh impetus over the past five years and has given rise to what we have called the "trilogy of equality", consisting of the position papers presented at the last two sessions of the Commission (Brasilia, 2010, and San Salvador, 2012)<sup>1</sup> and the document that has been prepared for the thirty-fifth session, to be held in Lima in April 2014.<sup>2</sup> The present document summarizes the Lima position paper and examines the two main development challenges facing Latin America and the Caribbean today: how to achieve greater equality, and how to make development sustainable for the benefit of future generations at the current development crossroads.

The first document of the trilogy, entitled *Time for Equality: Closing Gaps, Opening Trails*, was published in 2010, on the occasion of the Commission's thirty-third session. The form of development proposed therein revolved around the value of equality, taking a rights-based approach, with the maxim of equality for growth and growth for equality summing up the spirit of this proposal. It emphasized the role of the State

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<sup>1</sup> See ECLAC, *Time for Equality: Closing Gaps, Opening Trails* (LC/G.2432(SES.33/3)), Santiago, Chile, 2010; and *Structural Change for Equality: An Integrated Approach to Development* (LC/G.2524(SES.3/3)), Santiago, Chile, 2012.

<sup>2</sup> ECLAC, *Compacts for Equality: Towards a Sustainable Future* (LC/G.2586(SES.35/3)), Santiago, Chile, April 2014.

in light of the subprime mortgage crisis, which called into question the self-regulated market, and highlighted the need to ensure the same rights for all in the pursuit of development.

In macroeconomic terms, *Time for Equality* proposed stabilizing exchange rates and resisting currency appreciation. It underscored the importance of a proactive fiscal system designed for reconciling macroeconomic equilibria with promotion of robust economic growth and reducing the volatility of production activity by keeping capacity utilization high. Accordingly, capital controls were advocated to regulate inflows and outflows of resources. These proposals diverged from the orthodox principles of the 1980s and 1990s, on the basis that these had forced the region's production capacity into a sort of straitjacket. The more heterodox proposals formulated by ECLAC were in keeping with the new times. Not by chance were they echoed in the renewed public agendas and in documents put forth by the International Monetary Fund, the World Bank and other multilateral agencies. No longer is it anathema to discuss equality, progressive fiscal reform and more active State policies and take a long-term perspective on economic and production matters: on the contrary, these notions now form part of the accepted lexicon and of a shared vision.

Next, *Time for Equality* drew attention to the urgent need for structural change geared towards closing both internal and external gaps, so as to forge a less heterogeneous production structure. The macroeconomy, it was emphasized, should perform to the tune of structural change, promoting investment through active industrial policies, with special emphasis on closing innovation and infrastructure gaps, supporting small and medium-sized enterprises (SMEs) and encouraging research and development.

*Time for Equality* reviewed three fundamental aspects of equality and inclusion, namely, the territorial dimension, employment and social protection. These aspects are not unrelated to the production sphere: as ECLAC has been maintaining, social issues are not played out in the social sphere alone. Territory, employment and social protection are intimately bound up with a production pattern that fosters territorial inclusion, generates productive employment and, hence, provides a more robust fiscal and contributory system to underpin social protection and capacity-building.

Social protection and investment must act as a lynchpin for growth in both equality and production. Protection against external shocks through basic income transfers, investment in early childhood care, the creation of care systems that support that investment and enable women to become fully integrated into the workforce: these are all part of structural change. They all help to build human capabilities, equalize opportunities and outcomes, make society more cohesive and tackle the intergenerational reproduction of exclusion at its roots.

The pillars of development proposed in *Time for Equality* were explored in greater depth in the position paper of the thirty-fourth session of ECLAC, entitled *Structural Change for Equality: An Integrated Approach to Development*. The structural change approach calls for management of the business cycle so as to leverage installed capacity utilization throughout the cycle. At the same time, innovation and investment must be promoted through industrial policymaking, in order to increasingly embed knowledge and build endogenous capacities in technological and production spheres, thereby generating dynamic comparative advantages. This does not mean turning aside from the potential benefits of commodity booms, but it does mean being aware that these upcycles are not sufficient for laying solid and sustainable foundations for growth and acting accordingly.

Retrospectively, it is clear that in the Latin American and Caribbean region expansionary cycles have been accompanied by real currency appreciation and, hence, balance-of-payments vulnerabilities. At the time of *Structural Change for Equality*, the 2003-2011 cycle appeared on the surface to have skirted this problem unscathed. Nevertheless, the strategic view taken in the document warned of this risk, which today has indeed materialized in a mounting current account deficit.

Underlying the link between boom and currency appreciation—which fetters sustained and sustainable development—are a number of factors: the cyclical surge in capital flows and terms-of-trade variations, the region's dependence on commodity exports, the absence of industrial and technology policies to leverage these cycles for structural change, a narrow view of the cycle in terms of nominal stability without regard for other targets such as employment and distribution, and a reluctance to regulate and manage international capital flows.



In *Structural Change for Equality*, ECLAC proposed a set of initiatives for transforming vicious cycles of unsustainability into virtuous circles for sustainable development. The thrust was that qualitative transformation of the production structure should drive and strengthen sectors and activities that are more knowledge-intensive and that generate faster-growing demand, while also creating more and better employment, which is the key to equality. This calls for a systemic approach that dovetails macroeconomic and fiscal policies with industrial and social policies.

## **B. A turning point and a crossroads**

The crisis that broke out in 2008 tested the ability of States to mitigate the impacts of a severe external shock and preserve equilibria. By mobilizing a range of political and financial resources and taking countercyclical action, governments were able to mitigate the social costs of the crisis—which during previous crises had been frankly brutal. The countries marshalled a timely response to the crisis, reconciling the need for urgent social action with economic caution. The test showed that public action and political will in the region had acquired a surprising maturity. It was evident that orthodox formulas no longer ruled, the political margin for manoeuvre had widened, and policymaking had gained much from the deepening of democracy. The region had succeeded in expanding both its toolkit and its policy objectives.

Significant strides have been made in reducing poverty and unemployment, and steps have been taken to improve income distribution, albeit with varying rates of progress from one country to another, reflecting their marked heterogeneity. Democratic systems have become consolidated in countries which, until a few years ago, had been devastated by civil war or in the grip of dictatorial regimes. Greater macroeconomic stability has been achieved, the public debt has been reduced and countercyclical policies have been deployed to mitigate the impact of external crises, both enrolment in and progression through education have risen, health-care services have improved and access to social safety nets has broadened.

The Latin American and Caribbean region has come to a crossroads. Difficulties have been encountered in sustaining the advances made or

pursuing them beyond certain limits. Major challenges hamper both progress along the path towards equality based on full exercise of rights and its broadening to the various spheres in which equality is at stake. Moreover, economic sustainability challenges abound as the business cycle enters a slower phase, with gaping lags remaining in production patterns. As regards environmental sustainability, the global challenges of climate change, coupled with the dynamics of consumption and urban concentration, pose serious negative environmental externalities that undermine the economy and the well-being of the population.

In Latin America and the Caribbean, the limits are drawn by a combination of external constraints and endogenous features. External constraints include slowing international trade, fluctuating commodity prices, volatile financial signals and the reordering of production into transnational value chains in which the countries of the region run the risk, once more, of missing an opportunity to gain a less asymmetric position. Among the endogenous problems are the region's disjointed and outmoded production structure, the low levels of investment with little embedded technological progress, the high degree of informality in the labour market, welfare and capacity gaps, weak natural resource governance, consumption patterns that reflect large shortfalls in public services, serious environmental and energy pressures and persistent institutional shortcomings in terms of regulation and the ability to capture revenues and allocate resources. Notwithstanding the differences between subregions, the region must address the challenge of closing the gaps posed by stark inequality, structural heterogeneity and external vulnerability.

The commodity price boom and its macroeconomic impacts increased the region's bias towards natural resource specialization. Public investment has not regained its role as a catalyst for growth, despite the shortfalls in infrastructure, nor has it leveraged the private sector's engagement in the delivery of essential services, such as education and health, while the undersupply of quality public services by the State has worsened. The more private consumption gains ground as a growth driver, the more difficult it becomes to forge social contracts for the provision of quality public services across different socioeconomic groups. Amid weak labour institutionalality, informal employment and occupations and low productivity levels remain pervasive.

Growth rates are still positive, but they have tailed off since 2011. The downturn in the natural resources cycle, along with the expected reduction in capital flows, tighter liquidity situation and possible rise in interest rates, leaves the region less favourably placed for the future. The reduction of poverty and inequality shows signs of losing momentum and the indigence rate has not come down at all. Furthermore, the emerging middle classes and vulnerable sectors that have only recently left poverty behind are placing greater demands on the State for sufficient good quality public and collective services, in such areas as public safety, transport, education and health.

The foregoing raises enormous challenges to efforts to move towards greater equality. The complexity of the present juncture and of the outlook for the short and medium terms calls for a progressive public policy and fiscal effort to increase equality. Thus, as proposed in the closing pages of this document, the balance between State, society and market must be redesigned in order to build compacts with support from stakeholders that can guarantee far-reaching political agreements. Only through compacts will it be possible to develop the institutional framework and the collective will to open up this policy space; and only through compacts will society be able to take ownership of the sense and content of such policies.

Economic, social and environmental sustainability must therefore be harmonized, based on a strategic view of the development process in which equality is the goal, structural change is the path, and the art of politics and policymaking is the instrument by which it can be achieved. For this to occur, priority must be accorded to boosting investment and instilling a virtuous relationship between growth, productivity and environmental sustainability by embedding knowledge in production and generating high value added. The world of work must be endowed with greater inclusive potential and fiscal policy made to converge with social policies in order to reduce the multiple social gaps revealed by a multidimensional look at inequalities in the region. Consumption growth must be channelled so as to harmonize the timely provision of public services with consumption of private services, in the interests of social inclusion and environmental sustainability. Lastly, policies must be geared to making resolute progress towards better and stronger governance and developing the natural resource endowment so as to build a more

diversified, environmentally sustainable economy with synergies in employment and well-being.

The region must combine dynamic development that is sustainable over the medium and long terms with a systematic effort to attain higher levels of equality. Such equality is not understood only as equality of resources, that is, as better income distribution. It is understood, too, as greater equality of capabilities and agency, equality in the full exercise of citizenship and in dignity and reciprocal recognition among stakeholders. Recognizing individuals as equal and interdependent means that policies must be applied to promote their autonomy and mitigate their vulnerabilities. Incorporating the contributions of the gender, ethnic and environmental perspectives calls for policies on equality in the distribution of roles (in the family, at work and in politics), in the relationship between present and future generations and in the visibility and affirmation of collective identities.

At its heart, a scheme for equality and future development such as that proposed by ECLAC in the documents cited and herein requires a virtuous interaction between institutions and structures: industrial policies capable of calling upon public and private agents to raise investment and shift sector composition to boost productivity; governance and use of the region's comparative advantages in natural resources to build a diversified, knowledge-intensive economy with high value added and make the sphere of work more inclusive; a better balance between public service delivery and private consumption, consistent with environmental sustainability; and construction of a sustainable taxation and social welfare system in order to achieve a high redistributive impact and expand capacity-building for society as a whole. Only through a virtuous dialectic between institutional change and structural change will it be possible to boost development in the strategic direction set forth in the following pages.

A virtuous circle of better institutions and structures more suited to sustainable development and social equality undoubtedly requires collective accords or social compacts in various spheres. Only policies enshrined in such compacts can provide a robust framework for medium and longterm lines of action: a compact for investment and structural change; a fiscal compact for striking a better balance between private goods and public services in the architecture of well-being; a compact

for natural resource governance and environmental preservation, with an emphasis on solidarity with future generations and a more diversified, “green” production matrix; and a social and labour compact to build the State’s redistributive capacity in different areas of inequality and ensure that labour institutions keep pace with structural change in order to close gaps in relation to gender, output, quality employment and the division of benefits between capital and labour.

## **II. Shaping the future of equality and sustainability in Latin America and the Caribbean**

In Latin America and the Caribbean, the combination of poorly diversified structures, with few knowledge-intensive activities, and inefficient institutions that are often controlled by powerful economic and political interests leads to a primary —i.e. market-driven— distribution of resources that is highly unequal and, in turn, only marginally corrected by fiscal and social policies. The result (with considerable variation between countries) is highly segmented low-productivity economies, as well as societies with large divides in terms of income, capacities, relational networks and recognition of rights entitlements.

### **A. Structure and institutions: a model in the making**

#### **1. Production structure and inequality**

A production structure becomes more complex thanks to diversification and greater participation in knowledge-intensive activities. This fosters equality in at least three ways. First, the economy is able to boost productivity and competitiveness and thus sustain growth and expand high-quality employment. Second, a more complex economy generates intermediate levels of productivity that are not present in simpler economies, in which employment tends to be concentrated in very low-productivity —and often informal— sectors, which is not

conducive to equality. Lastly, inequality is linked to the distribution of education and capacities among economic agents. This distribution does not occur in a vacuum, but in the context of certain production processes. More complex structures require more skilled workers, failing which supply would outstrip demand and there would soon be little reason to pursue education.

## **2. Inequality and institutions**

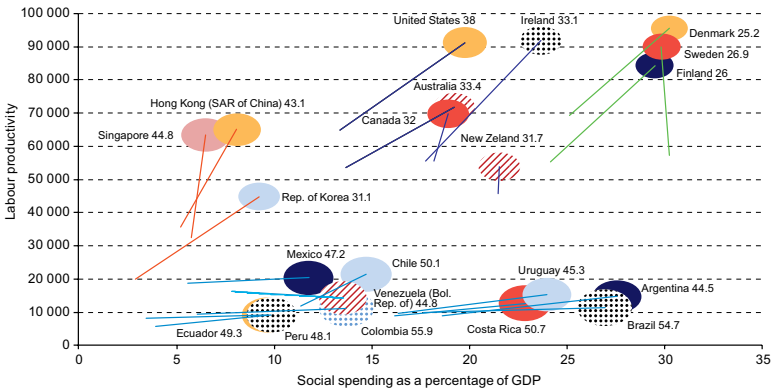
Institutions act upon social structures, and specifically on equality, in various ways. First, the income distribution that emerges from the market is already affected by State intervention (or lack thereof): the setting of minimum wages, employer-worker bargaining, and regulation of the degree of monopoly in the goods and services markets, among other factors, all have direct consequences on primary income inequality. Second, action by the State reshapes market-driven income distribution through instruments such as tax and transfers. These are mechanisms that directly affect the distribution of disposable household income. Lastly, a very significant part of the State's redistributive action takes place through mechanisms that may be considered indirect, such as public spending on education and health, which do not affect actual disposable household income but do have a very important —albeit time-lagged— impact, inasmuch as they promote human capacities and improve future positioning in the job market.

Whereas the OECD member countries achieve a 35% reduction on average in the Gini index of household income distribution through taxes and transfers, in Latin America and the Caribbean the average reduction is 6%. Many of the region's economies produce levels of market income inequality similar to those seen in several more developed countries (among them Ireland, Israel, Italy, France, Greece, Portugal, Spain, the United Kingdom and the United States), but these asymmetries are not corrected, with the result that inequality is much sharper in Latin America and the Caribbean than elsewhere. To a large extent, this is because the region's labour markets have a high rate of informality, which in the long run translates into very limited access to pensions. The redistributive capacity of other direct transfers in the region is also diminished because the amounts involved are small.

### 3. Sustainable dynamics between productivity and equality

Production structures and institutions that foster equality may be combined in various ways and may generate different dynamics. In figure 1, labour productivity is plotted along the y-axis as a proxy for the knowledge-intensiveness of the production structure, since productivity is an outgrowth of the technological capacities disseminated across the production fabric. Plotted along the x-axis is public social spending as a percentage of GDP, which is a proxy for the effort made by institutions to correct inequalities and protect vulnerable sectors. Inequality is represented by the size of the circles, which correspond to Gini indices (the larger the circle, the more inequality). This gives rise to the following conclusions.

**Figure 1**  
**Labour productivity and social spending as a percentage of GDP,**  
**around 1990 and 2010, and inequality around 2010<sup>a</sup>**  
*(Dollars at constant 2005 prices and percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Standardized World Income Inequality Database, version 4.0, September 2013 [online] <http://myweb.uiowa.edu/fsolt/swiid/swiid.html>; and Organization for Economic Cooperation and Development (OECD), STAN Structural Analysis Database [online] <http://www.oecd.org/industry/ind/stanstructuralanalysisdatabase.htm>; and World Bank, *World Development Indicators*.

<sup>a</sup> The lines indicate trends in labour productivity and social expenditure between the two years under consideration (around 1990 and 2010). Inequality is represented by the size of the circles, which correspond to Gini indices (the larger the circle, the more inequality).

*First, there is no need to sacrifice equality for the sake of efficiency.*

The most egalitarian countries are those with the highest productivity and those that invest the most in correcting the inequalities arising



from the competitive process (as reflected in social spending as a percentage of GDP). Their core (upper part of the northeast quadrant) comprises primarily the Scandinavian countries, which combine complex production structures with an institutional framework that limits the concentrating effects of the market and strongly redefines its outcomes.

*Second, institutions play a key role in distribution.* In one group of countries (Australia, Canada, Ireland and the United States), production structures are as complex as in the Scandinavian countries, but equality outcomes have not been as good. The difference lies in the higher rate of social spending in the Scandinavian countries. The institutional framework and society's decisions about how much inequality it is willing to tolerate matter—and leave a clear mark on the patterns of inequality, even for similar levels of production structure complexity. This also applies to countries in Asia. Many of them achieved swift reductions in inequality by means of structural change and the continuous creation—over several decades— of higher-productivity jobs. But neither employment nor productivity alone have been enough to move these countries into the northeast quadrant of figure 1; they need to boost their social spending, as well. In many of these countries, this issue is already high on the political agenda.

*Third, social spending alone will not bring greater equality.* Productivity policies must go hand in hand with distribution policies. In the first decade of the 2000s, many Latin American countries managed to reduce inequality through increased social spending, despite shortcomings in its composition. But further gains in equality will require structural change and a smaller informal sector, otherwise imbalances will emerge that limit job creation. These imbalances may appear in the current account (a surge in imports that outstrips exports), in the fiscal arena (public deficit), or in price trends (inflationary pressures). A contributing factor is that productivity gains in Latin America and the Caribbean have been much smaller than in other regions. In figure 1, the lines corresponding to productivity trends in the region between 1990 and 2010 are almost horizontal, while those relating to the other countries in the sample are clearly positive.

## **B. Threats to the sustainability of development with equality**

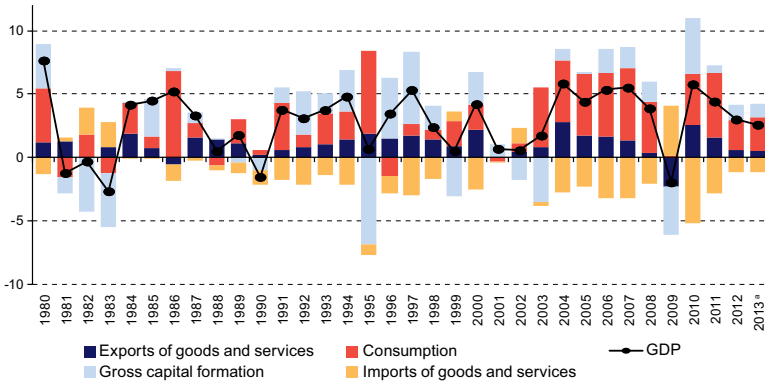
Over the past decade, regional poverty, unemployment and income inequality have eased significantly, educational and social protection coverage has broadened, democracy has taken deeper root and economic stability has become more consolidated. However, as noted earlier, these advances have brought the region to a crossroads in terms of its ability to consolidate the progress made thus far and build on it moving forward. To what extent, in the framework of the current pattern of development and the existing relationships between structures and institutions, can the region make real strides towards deeper and broader equality, in its various dimensions? The question of the future of development is also a question about the sustainability of development in various areas: economic sustainability, sustainability of social progress and environmental sustainability.

### **1. Economic sustainability: macroeconomic imbalances and structural change**

Following a two-year period (2010-2011) of robust economic growth and rising employment following the shock of the 2008-2009 international crisis, the recovery lost momentum and the region's economies slowed in 2012-2013. Although the risk of a serious crisis on the order of those of the 1980s and the late 1990s and early 2000s may be ruled out, the slowdown augurs lower growth in the future. This means that the labour market will also be weaker and could lose its ability to reduce inequality. The downtrend in unemployment, which had been observed since late 2010, slowed in 2013.

Sluggish global growth could worsen the economies' vulnerability to current account imbalances. Indeed, current accounts in the region are tending to move into deficit and many of the economies are already running twin deficits (on both the fiscal and current accounts). Adjustments will be needed in the future, which could result in lower rates of growth and employment. The weakness of investment also makes the region vulnerable and has serious implications for the sustainability of growth, which has been driven by consumption in recent years (see figure 2).

**Figure 2**  
**Latin America: GDP variation and contribution to growth of aggregate demand components, 1980-2013**  
*(Percentages of GDP)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Estimates.

Unless investment gains momentum, it will not be possible to boost the rate of technical progress or create infrastructure that will help close the productivity gap with the advanced economies. Hence, for example, productivity in most of the countries of the region has fallen steadily in comparison with that of the United States. In a world where the technological frontier is moving at high speed, this drop in investment will bring more acute problems of competitiveness and growth in the future.

## 2. Equality and sustainability in the social sphere

In most of the Latin American and Caribbean countries, the gains made in reducing poverty and inequality in recent years are attributable to favourable labour market conditions. The region's indicators for employment, unemployment and labour market participation are at a 20-year high and employment growth has also produced a relative improvement in job quality, as wage employment has risen as a proportion of total employment. In addition, during the past decade, employment in low-productivity sectors diminished somewhat, alongside real wage gains and increases in the minimum wage. Minimum wage changes have, in some countries, been an important driver of poverty and inequality

reduction. Nevertheless, the current risk of a slowdown in growth could undermine this positive trend, especially where the production structure has not diversified or become sufficiently complex to withstand shocks more robustly.

The direct corollary of rising employment and earnings in the region has been declining poverty, which fell to 27.9% of the population in Latin America in 2013, while the indigence rate dropped to 11.5%. Thus, the poverty rate has fallen by 16 percentage points since 2002, and the extreme poverty rate by 8 percentage points.

This picture of the glass half-full contrasts with one that is half empty. Much of the population earns income near the poverty line, and thus remains vulnerable. Poverty rates are highest among women and children. In capacity development, although real progress has been logged in terms of coverage, access and advancement through the various educational cycles, learning and achievement within education systems is highly stratified. In the structure of social spending, public investment in childhood is very low. This has a negative impact on the development of capacities among new generations, which is not promising considering the greater productivity demands and the demographic shift towards societies with higher dependency rates due to population ageing.

### **3. Environmental sustainability**

The style of development of the region's countries has relied on a production structure of static comparative advantages, based on abundance and exploitation of natural resources. Generally speaking, investment, innovation and technological development have been geared towards this traditional structure, and the bias has been supported by incentives such as relative prices, spending structures, subsidies, fiscal provision of infrastructure and access to financing, among other elements. This pattern has driven the expansion of the agricultural frontier, escalated the extraction of mineral, forest and fishery resources, and heightened pollutant emissions, with negative environmental externalities.

The pressures on the environment have been exacerbated by the effects of the region's production specialization, the pattern of —and increase in— consumption, and the increasing concentration of the population in megacities. Latin America and the Caribbean is the most

urbanized region in the world, with eight in ten people living in cities. The repercussions are manifold: worsening water, air and soil pollution and ecosystem degradation, with the attendant negative impacts on productivity, human health and quality of life, and the socioenvironmental conflicts that arise as a consequence, along with other aspects. All of this poses a threat to an extremely important endowment that sets this region apart: its biodiversity and its abundance of natural resources.

Given the unequivocal evidence regarding the consequences of environmental degradation, both locally and globally, environmental sustainability must be made a priority as countries transform their production matrix and consumption profile. In other words, what ECLAC has been calling “structural change” requires finding synergies, without delay, between productivity gains, social inclusion and the green economy at the local and global levels.

### **III. Equality and inequality in Latin America and the Caribbean**

Given the overarching aim of development sustainability as set forth in the preceding pages, ECLAC has argued that equality must be both the core value and the ultimate purpose in shifting the direction of development. This, the third document of the ECLAC trilogy of equality, restates the importance of equality of means and opportunities, but also considers equality in relation to the development of capacities, interaction in networks, and the recognition of individuals and peoples as full bearers of rights. This means considering equality in a “relational” context of socialization, autonomy and recognition, which includes people’s perceptions of levels of equality and inequality.

As ECLAC aims to illustrate below, this complex vision of equality calls for a multidimensional approach, which will in turn have to be translated into an integrated policy approach that can enhance synergies and break vicious cycles between the different dimensions of inequality.

## A. Equality of means: income and wages

At the beginning of the last decade, the trend towards growing inequality was reversed in the countries of Latin America,<sup>3</sup> thanks mainly to trends in per capita income, and specifically in earnings, and Gini index values have accordingly declined. Nevertheless, Latin America remains the most unequal region in the world.

The narrowing wage gap between skilled and low-skilled workers over the past decade may be interpreted in various ways. One reason could be growth in the supply of skilled workers. Another, however, could be slowing relative demand for skilled labour during the period, as the commodity price surge may have boosted the demand for unskilled workers and driven down the education wage premium.

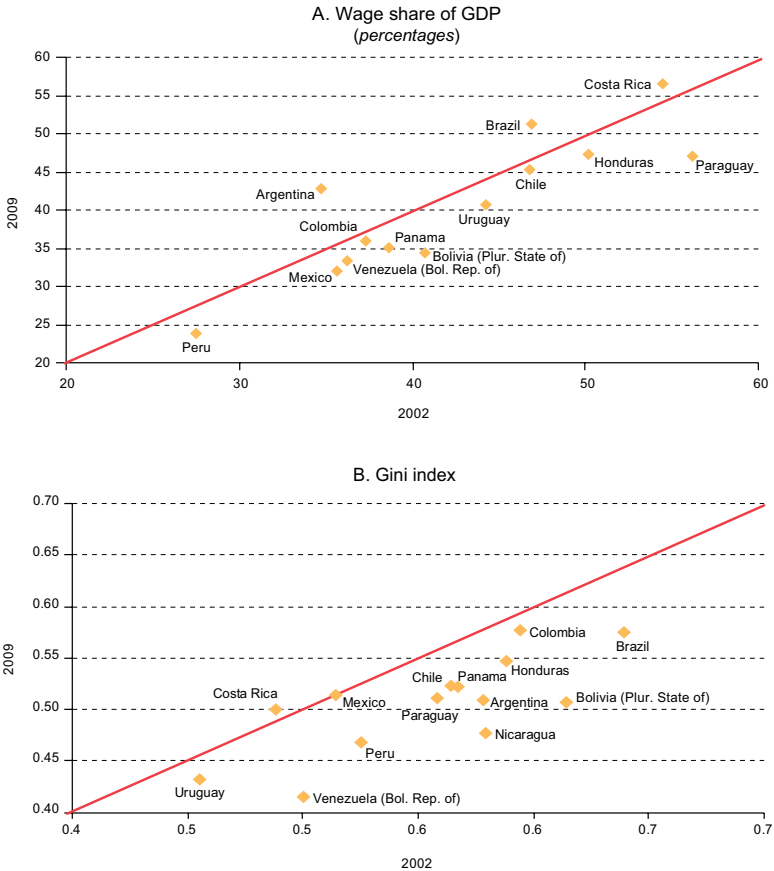
If the latter explanation is the truer, sectoral composition, heavily influenced as it is by natural-resource-centred economies, could be increasing relative demand for low-skilled workers, thereby narrowing the gap in returns on education. But rather than a sign of development converging with equality, this would be a warning that the combination of stagnating productivity and the region's prevailing specialization pattern are discouraging educational progression and capability development. The evidence is not yet conclusive; the debate is still open, and it is crucial to understanding distributive dynamics.

At the same time, although income inequality began to fall from 2002-2003 onwards, wages did not rise noticeably in relation to total GDP (see figure 3). Distributive improvements at the household level have not, broadly speaking, been reflected in a more egalitarian share-out between capital and labour. Thus, the way the fruits of growth and productivity gains are appropriated by the different production agents is not helping to narrow the gaps —this is a structural component of inequality and it poses substantial policy challenges.

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<sup>3</sup> The Caribbean is not included because there were insufficient comparable data.

**Figure 3**  
**Latin America (13 countries): wages as a share of GDP**  
**and Gini index, 2002-2009<sup>a</sup>**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from CEPALSTAT, the National Institute of Statistics and Censuses (INDEC) of Argentina, and the central banks of Costa Rica, Guatemala and Uruguay.

<sup>a</sup> Guatemala is not included because the latest Gini index reading available is for 2006.

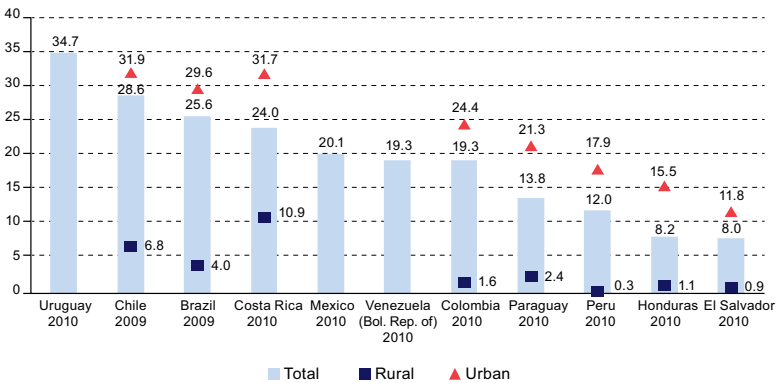


## B. Equality of capacities and in quality of life

The average number of years of education completed by the adult population (between the ages of 25 and 65) has increased across all quintiles in all the region's countries over the past decade. However, there are still marked disparities between countries and socioeconomic groups. These gaps shifted in various ways between 2002 and 2011. On analysing the distribution of years of education, irrespective of income, the countries with the highest average educational attainments are also those with the least inequality, a connection also evident in other regions.

With regard to Internet connectivity, a vitally important aspect of capacity development in today's world, the region's countries have made remarkable progress in coverage, but very large gaps persist between socioeconomic groups in terms of access and use. In the nine countries for which information was available, the usage rate for high-income segments is 64.9% on average, compared with 24.6% in the low-income segments. The household Internet access divide by geographical area is also very significant, with rural households worse off.

**Figure 4**  
**Latin America (11 countries): households with Internet access**  
**in urban and rural areas and nationwide, around 2010**  
*(Percentages)*



**Source:** Observatory for the Information Society in Latin America and the Caribbean (OSILAC), on the basis of information from household surveys and the national statistical offices of the respective countries.

Nutrition is another fundamental aspect of quality of life and capacity development. In recent years both acute and chronic undernutrition have declined in the countries analysed<sup>4</sup> and gaps have become smaller in most countries, except in Peru and the Plurinational State of Bolivia. However, obesity levels and the associated problems are on the rise in almost all countries. Overcrowding and access to durable goods—two important variables for households' material well-being—have shown improvements on average. They have also (broadly speaking, and with some exceptions) become more egalitarian in terms of distribution. The region has, then, moved towards greater equality in living conditions and access to durable goods.

### **C. Reproductive inequalities**

The number of children per woman in the region has fallen sharply throughout society, narrowing social divides in fertility levels. However, the reproductive timetable, particularly for the first child, is still fairly early, particularly among adolescents in sectors with lower incomes and less education. This is disturbing because of the disadvantages entailed by having children during adolescence, all the more so considering that a large percentage of these pregnancies are unplanned. The likelihood of becoming a mother in adolescence, measured by the percentage of women aged 19 to 20 years who are mothers, varies considerably by quintile. By way of example, the rate in the first quintile in rural areas is about 70% in the Dominican Republic and 60% in the Bolivarian Republic of Venezuela, whereas in the top quintile it is 15.7% and 10.8%, respectively, in urban areas. The likelihood of adolescent motherhood fell overall in both quintiles in the intercensal period (with just a few exceptions), but the gap between them widened in most of the countries.

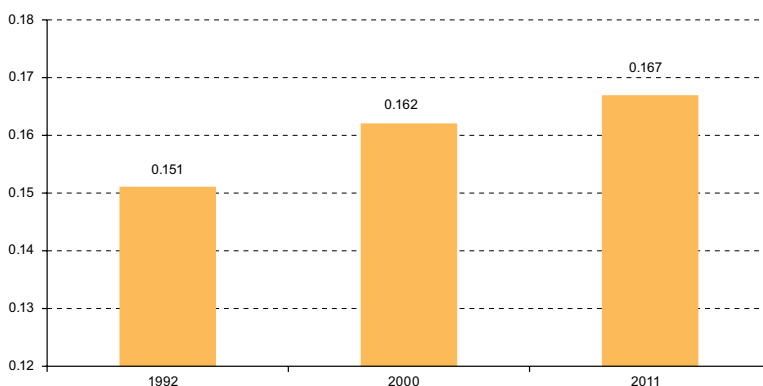
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<sup>4</sup> The analysis is based on demographic and health surveys (DHS) from Brazil (1996 and 2006), Colombia (2005 and 2010), the Dominican Republic (2002 and 2007), Haiti (2006 and 2012), Honduras (2005 and 2011), Peru (2007 and 2012) and the Plurinational State of Bolivia (2003 and 2008).

## D. Relational aspects of equality

The results in this area of equality are not auspicious. For example, school segregation in the primary and secondary system in Latin America increased, on average, in the past two decades. Figure 5 shows the average value (not weighted by population) for the index of dissimilarity,<sup>5</sup> taking the poorest quintile of the population as the potentially segregated minority. A higher index signifies a greater degree of segregation. This school segregation index rose from an average of 0.151 in the early 1990s to 0.162 at the turn of the century and 0.167 at the start of the 2010s. Of the 14 countries included in the sample, the index of dissimilarity (i.e. the educational segregation experienced by the low-income sectors) rose in 10.

**Figure 5**  
**Latin America (14 countries): segregation between public and private school networks, average values for the index of dissimilarity, 1992, 2000 and 2011**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household survey microdata.

No country shows significant reductions in the school segregation indicators analysed for the 2000s, when all the countries saw inequality decline in respect of incomes and other dimensions of well-being. This asymmetry has troubling implications for the dynamics of distribution

<sup>5</sup> The index of dissimilarity or Duncan index reflects the proportion of students from the minority group (first, or poorest, quintile) who would have to change schools in order to be distributed evenly across the different educational establishments. Values range from 0 to 1, with 0 representing nil segregation and 1 maximum segregation.

and social inclusion in the future. School segregation produces a twofold or two-stage stratification. First, during the education process because of peer socialization, differences in the quality of provision and an educational climate that varies from school to school and area to area. Second, segregation leads to later discrimination in opportunities to use educational accomplishments to participate in the world of work, both because of divides in networks of relationships built up in the school community and the extension of these to families and because of differentiation in symbolic recognition and prestige gaps depending on where a person was educated.

Residential segregation means that the different socioeconomic groups in a city or metropolis live separately, with little or no sharing of residential space. The results bear out the previous findings, namely: (i) the index of dissimilarity is lower for the poorest decile than for the richest decile, although the difference narrowed in the reference period;<sup>6</sup> (ii) the index of dissimilarity fell for both groups, and the geographical distribution within the city of both the poorest and richest deciles was closer to that of the other deciles in 2010 than in 2000; (iii) the fall in the dissimilarity index in the first and tenth deciles is primarily attributable to a sharper-than-average fall during the intercensal period in Brazil, which accounts for a relatively large proportion of both the region's total urban population and of the cities included in the measurement; and (iv) generally speaking, the index tended to fall in the other countries analysed too, particularly for the highest socioeconomic decile, since for the lowest socioeconomic decile a number of cities recorded an increase in segregation.

## **E. Equality and mutual recognition: gender gaps in autonomy**

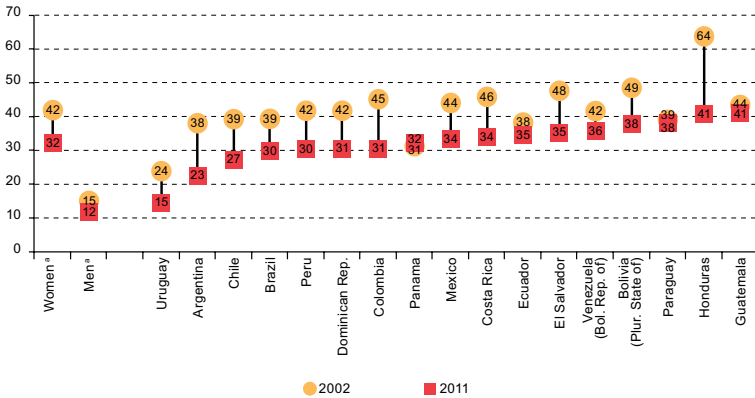
The indicator for the proportions of the two sexes lacking incomes of their own illustrates, from a gender perspective, women's significant lack of economic autonomy in Latin America. The proportion of women without incomes of their own in the region dropped from 42% in 2002 to 32% in 2011, while the proportion of men in the same position dropped from

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<sup>6</sup> This means that the richest (tenth) decile lives in more of a "bubble" than the poorest (first) decile. In other words, this group has less contact with members of other social groups in its area of residence. However, this has much to do with self-segregation by wealthy groups.

15% to 13% in that period (see figure 6).<sup>7</sup> Nonetheless, a third of women aged 15 and over and not in education are still unable generate income and are economically dependent, which severely affects their economic autonomy and so their ability to overcome poverty. The proportion of women without incomes of their own has fallen in 10 countries: Argentina, Brazil, Chile, Colombia, the Dominican Republic, El Salvador, Honduras, Mexico, Panama and Uruguay. In the other countries, the decline in the indicator is explained solely by the rise in the number of women aged 15 and over who are not in education. Structural barriers, in particular the absence of comprehensive care systems, prevent women from entering the job market.

**Figure 6**  
**Latin America (16 countries): women aged 15 or over not in education and without incomes of their own, by area of residence, 2011**  
*(Percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys.

<sup>a</sup> Refers to 2002.

<sup>b</sup> Refers to 2011.

<sup>7</sup> The indicator is defined as the proportion of the female (male) population aged 15 or over who do not receive individual monetary incomes and are not studying (depending on their activity status) relative to the total female (male) population aged 15 or over who are not studying. The result is expressed in percentages.

## **F. The subjective dimension: perceptions of inequality and conflict**

Demoscopic surveys illustrate the critical perceptions of Latin Americans concerning equality, trust and conflict.<sup>8</sup> In 2011, 79% of Latin Americans taking part in the survey considered income distribution unfair or very unfair, while 77% expressed mistrust towards others. In addition, almost 80% of respondents said that the level of social conflict was high or very high. These figures should be a spur to further efforts to create spaces of social communication and cohesion. Educational and territorial segregation, and the persistence of large divides in a number of dimensions, probably do little to build trust among citizens or improve perceptions of distributive dynamics.

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<sup>8</sup> These figures are based on the 2011 Latinobarómetro survey of the population aged 18 years and over in 18 Latin American countries.



## **IV. The world of work: the master key for equality**

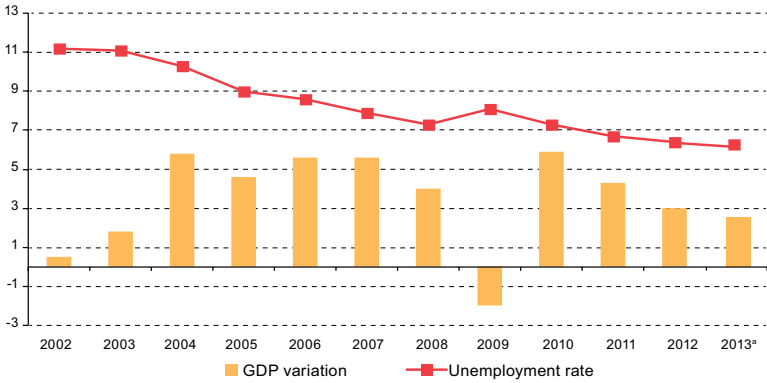
The world of work is the most influential sphere of society in terms of creating, exacerbating or mitigating inequalities. Work provides the largest share of household income in the region and is the source of income distribution inequalities. But it is also at the root of other, equally important inequalities that have to do with participation and access to occupations and jobs, where gender and ethnicity gaps are substantial. The world of work is also a cornerstone of the ECLAC view of equality, in which social relations and mutual recognition are paramount.

### **A. The half-full glass**

The past decade in Latin America and the Caribbean has (except for 2009) been marked by sustained per capita GDP growth, as seen in highly favourable trends across key labour market indicators. The unemployment rate in the countries of the region fell from 11.2% to 6.3% between 2002 and 2013 (see figure 7); the overall employment rate went from 52% to 57% during the period. Growth in employment in the region has increased the proportion of wage workers and employers in total employment, and lowered the percentages of own-account workers.



**Figure 7**  
**Latin America and the Caribbean: unemployment and GDP, 2002-2013**  
*(Percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT database.

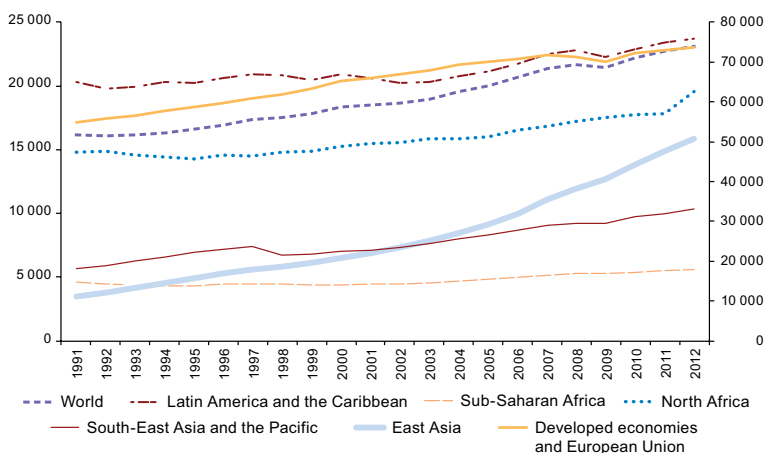
<sup>a</sup> Preliminary data.

Apparent labour productivity (GDP per person employed) for the region also performed positively, since it rose by 1.6% per year between 2002 and 2012, improving on the figure for 1990-2002 (when it slid by 0.1% per year). But gains regionwide over the past decade were smaller than in the Asian countries in particular (see figure 8). And the gap with North America (Canada and the United States) did not narrow, meaning that the region’s relative labour productivity slipped in comparison with the world average.

The region’s productivity is strongly differentiated by activity sector, but there has also been a trend towards sectoral convergence over the past decade. Output per person employed in the high-productivity segment in 2002 was 6.4 times the figure for the low-productivity segment, but by 2011 the gap had narrowed to 5.8 times. The ratio between output per person in the high-productivity and the medium-productivity segments went from 2.8 to 3.1 between 2002 and 2011. In 2011, output per worker in the medium-productivity segment was around twice the figure for the low-productivity sectors (compared with a ratio of 2.3 in 2002).<sup>9</sup>

<sup>9</sup> The low-productivity sector groups agriculture, commerce and services; the medium-productivity sector covers construction, manufacturing and transport; and the high-productivity sector includes finance, electricity and mining.

**Figure 8**  
**Latin America and the Caribbean and other regions: GDP per person**  
**employed by region, 1991-2012<sup>a</sup>**  
*(Dollars at constant 2000 prices)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the World Bank and International Labour Organization (ILO), Key Indicators of the Labour Market (KILM).

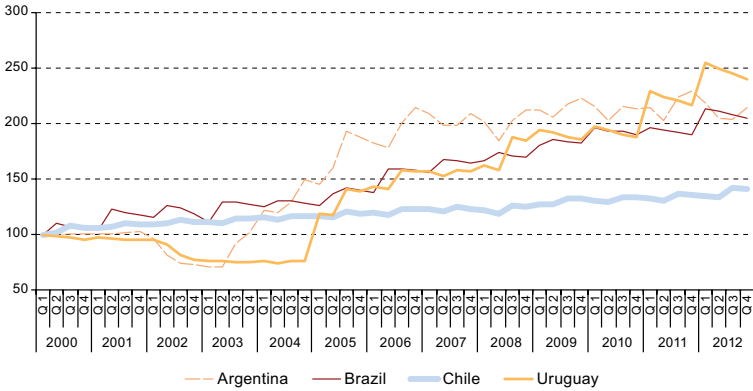
<sup>a</sup> The right scale applies to the developed economies and the European Union, and the left applies to all the others.

In terms of GDP and employment generation, in 2002 the low-productivity segment accounted for 40% of GDP and 69% of employment. In 2011 its share of GDP and employment stood at 41% and 65%, respectively. This split is very similar to the one seen in 2002. At the other extreme, the high-productivity segment generates 28% of GDP and only 7% of employment. Despite the slight decline in differences in productivity between activity sectors, heterogeneity in the economy is still high at the end of the period.

Labour market growth over the past decade took place in conjunction with a trend towards income equalization, which contributed a good deal to the decline in household income inequality. In some countries in the region, the minimum wage appears to have influenced this fall in inequality. The real value of the minimum wage has risen significantly in several countries, turning it once again into an important labour market tool. Specifically, in Argentina, Brazil and Uruguay, the minimum wage has risen substantially, while growth has been less striking in Chile (see figure 9).<sup>10</sup>

<sup>10</sup> Real variation is calculated by weighting the price indices for the provinces.

**Figure 9**  
**Latin America (selected countries): change in the real minimum wage, 2000-2012**  
*(Local currencies, current prices at latest observation)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC) and International Labour Organization (ILO), on the basis of official data for the minimum wage and consumer price index (CPI) from countries.

In these four countries, the increase in the minimum wage drove the average wage up by between 1% and 4%, depending on the country. There is also evidence that the minimum wage has an equalizing impact in these countries, although not a significant one in the case of Chile. In Argentina, Brazil and Uruguay the drop in inequality is primarily explained by compression at the lower end of the distribution, which can be attributed to the rise in the minimum wage. In Chile, the slight decreases in all of these indicators were statistically insignificant, suggesting that the minimum wage has not had an equalizing impact on labour income.

Recent explanations for declining inequality in the region have focused on factors driving supply and demand for workers at different qualification levels. These findings suggest the importance of considering, in addition, the role of labour institutions in the distributive improvements in some countries of the region. Narrowing wage differentials could indeed be the result, in turn, of stronger minimum wages and other tools, such as collective bargaining. It should be noted that the minimum wage hikes in the cases under review took place during a period of employment growth, particularly in Argentina, Brazil and Uruguay, amid a strong drive for labour market formalization.

## **B. The half-empty glass: gender inequalities in the workplace**

The gender differences observed in the workplace range from labour market participation decisions to occupation, unemployment and social security contribution profiles. Although female participation rates have increased steadily over the past few decades, they are, in all of the countries of the region, significantly lower than the rates for men. Nevertheless, the rate of labour market participation for men fell in 19 of the 27 countries while the rate for women rose in 22. This differential trend has narrowed gender gaps in most of the countries, and female participation rates in 2011 were closer to those for men than they were in 2002. The widest gaps are in the countries of Central America. The employment rate rose much faster for women than for men, reflecting a narrowing gender gap with regard to this indicator.

In terms of occupational segregation by sex, patterns also differ from country to country, but there was no general downtrend in the indicator. Men's monthly income is 28% more than women's (simple average for all of the countries in 2011, based on monthly income). Comparing 2002 with 2011 shows that the average labour income gap between men and women has narrowed in most of the countries. The differences are smaller if hourly income is compared instead of monthly income because, on average, women work fewer hours than men.

The time spent on unpaid work by men and women differs considerably, resulting in women shouldering a greater proportion of the total workload. The time women spend on unpaid work varies by occupational category (own-account workers spend twice as much time on unpaid work as employers), marital status (married and divorced women spend more time on unpaid work than widows or unmarried women), and age group and educational level (the higher a women's level of educational attainment, the less time she dedicates to unpaid work). In the case of men, none of these categories seems to influence the time they spend on unpaid work.

While most countries report a higher contribution rate among male wage workers than among female ones, the countries with the largest differences in the employment rate (i.e. where a much higher proportion of wage workers are men) show smaller differences in the contribution rate, or even a higher contribution rate among women. This suggests that women who manage to enter the labour market in countries where

female employment is much lower than male employment are highly likely to be contributors, which is indicative of a labour market selection process. Since the female labour market participation rate is lower in those countries, the women who tend to participate most in the labour market are those who are highly educated, and for that reason are more likely to be social security contributors.

Although contribution gaps between male and female wage workers have narrowed in most Latin American countries over the past decade, large differences by sex persist among those aged 65 and over in receipt of a pension. In the 16 countries for which information is available, between 2002 and 2011 the percentage of the population aged 65 and over receiving a pension rose from 42.4% to 46.2% among men, and from 32.4% to 38.1% among women. However, pension amounts are consistently higher among men, since women's contribution histories are much more likely to have been interrupted owing to motherhood, caregiving activities and a more precarious employment situation.

These gender differences in the labour market and in the care economy represent large potential losses of productivity and income for households. However, it is not just a matter of reducing household income gaps by increasing women's pay. It is also very important to close the employment gaps so as to advance equality in other areas, such as the full exercise of autonomy, the development of individual capacities and potential, access to contributory social protection and participation in society beyond the household.

The situation of indigenous peoples and Afro-descendent populations is especially worrisome, since these groups are the most severely affected by inequalities in the world of work, and women even more so, as they suffer the double discrimination of gender and ethnicity. This is where the mutually reinforcing inequalities of means, capacities and recognition intersect.

### **C. Recent improvements and future uncertainties**

The information available once again paints a picture of a glass half full or half empty. On the one hand, it highlights the positive trend in key labour market indicators over the past decade: increased employment, a falling unemployment rate and higher labour productivity and formalization.

At the same time, worker income rose, and income dispersion declined; at least in some of the countries of the region this was linked to a stronger minimum wage. From a gender perspective, the participation rate gap between women and men narrowed, as did the gap in terms of employment and access to social security.

However, the latest available data show slowing labour market indicators, bringing into question the sustainability of recent progress and the potential for building on it, in particular taking into consideration that the more structural characteristics of the region's labour markets have remained essentially unchanged. Production heterogeneity is still high and this combines with weak labour institutions to produce marked wage dispersion. Gender gaps are still wide and there has been no substantial change in gendered occupational segregation, and there is no sign of progress regarding the particularly disadvantageous labour market situation of indigenous peoples and Afro-descendent populations.

This context of overlapping labour market inequalities calls for robust State intervention in the areas of production, labour regulation and institutions, labour market policy and redistribution of care. It is necessary to bolster labour institutions to make progress on formalizing employment, closing the gaps in labour law implementation, achieving a fairer distribution in the appropriation of gains and enhancing autonomy in the organization of work. We must aim for a different production structure that is intensive in activities that build capacities in the world of work and narrow productivity gaps. Through cross-cutting policies ranging from legislation to oversight and the mass media, gender and ethnic discrimination in access paths, pay and role-setting must be reversed. Those are all long-range challenges, but change in all these areas cannot be deferred if the goal is to build more equal societies progressing towards equality in a sustainable manner. The goal is to move both structure and institutions in a coordinated manner to establish virtuous circles that can underpin greater equality and sustainability. To this end, society must agree to boost capacity-building, learning and knowledge, and to increase investment in production.



## V. Consumption patterns and development style

If the world of work is decisive in the creation or narrowing of income gaps, such gaps are reflected in the world of consumption, in unequal access to well-being and quality of life. What is more, if work is key to equality, consumption is key to sustainability. In Latin America and the Caribbean, and at ECLAC, concerns over emulative and shop-window consumption have been present for several decades. Those concerns relate to economic sustainability, given the link between the production pattern (and production investment), the export pattern and the expansion of consumption, in particular of imported goods and services. These are also linked to equality, in terms of fairer distribution of access to the means to achieve well-being; and to environmental sustainability vis-à-vis future generations, given the negative impacts that consumption dynamics can have on pollution, energy use and the accumulation of waste.

Consumption has risen strongly in recent years. Per capita private consumption, in dollars at constant 2005 prices, rose by a cumulative annual rate of 2.4% between 1990 and 2012 in Latin America, on average. This figure is higher than per capita GDP growth for the same period (see table 1). In the past few years, consumption has in fact been one of the strongest drivers of aggregate demand, although its growth has slowed somewhat recently.<sup>11</sup> Generally speaking, average private consumption rates in the region are almost three times as high as in middle-income countries, but less than a fifth of the average in OECD countries.

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<sup>11</sup> In the first quarter of 2013 private consumption growth was down on the year-earlier period.



**Table 1**  
**Latin America: cumulative annual growth in per capita GDP**  
**and per capita private consumption, averages, 1990-2012**  
*(Percentages, in dollars at constant 2005 prices)*

	1990-2012	1990-2000	2000-2012
Average per capita GDP	2.0	1.5	2.5
Average per capita private consumption	2.4	1.9	2.6

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT database.

**Table 2**  
**Latin America, OECD countries and middle-income countries:**  
**average per capita private consumption, 1990-2012**  
*(Dollars at constant 2005 prices)*

	1990-2012	1990-1995	1995-2000	2000-2005	2005-2012
Latin America	3 003	2 519	2 788	2 972	3 595
OECD countries	16 853	14 404	16 117	17 941	19 009
Middle-income countries	987	748	862	986	1 281

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

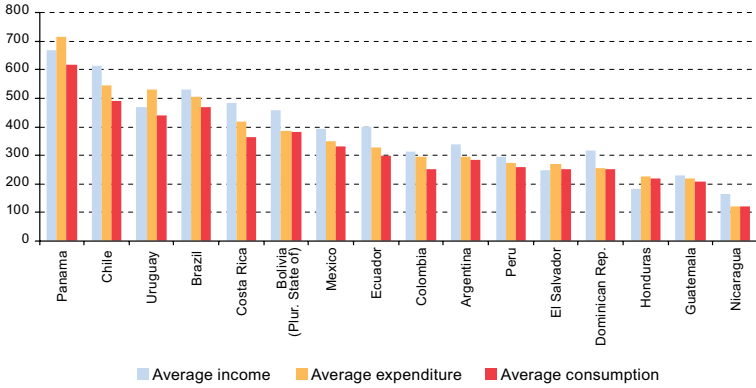
Disparities in expenditure and per capita consumption are very large in the region: the highest consumption levels are seen in Panama, Chile and Brazil, while the lowest levels of spending are observed in Honduras, Guatemala and Nicaragua (see figure 10). The ratio between the countries with the highest per capita spending (Panama) and the lowest (Nicaragua) is 5.8; the equivalent ratio for consumption is 5.0 and for income, 4.0.

This brings positive effects, because part of the rise in consumption is associated with increased well-being in sectors that were deprived in the past, contributing to better living standards, which, in turn, enable better use of time and more opportunities for capacity-building. This occurs, for example, with the spread of access to household appliances and personal computers, to education and health services, and, where public transport is inadequate, to automobiles.

Despite the expansion of private consumption, food continues to represent a major item of expenditure (40% of total spending on average in the region's countries, compared with 25% in the European Union). The region's sharp income inequality is also reflected in its expenditure.

Distribution of per capita household expenditure by income quintile reveals striking disparities: the richest quintile spends four to eight times more than the poorest quintile. Yet, the gap in income is wider than the gap in spending and consumption.

**Figure 10**  
**Latin America (16 countries): household income, expenditure**  
**and per capita consumption, averages, around 2006**  
*(PPP dollars at constant 2005 prices)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of processing of data from household income and expenditure surveys conducted in the respective countries.

Although the situation today is different from the historical context in which ECLAC first put forward its reflections on consumption in past decades, there are recurrent risks that cannot be ignored. The composition of regional demand is one cause for concern: private consumption is a major component and accounts for a much larger share than in the OECD countries on average. Moreover, in several countries in Latin America and the Caribbean consumption is more volatile than GDP. Consumption is extremely procyclical in the region, which exposes the economies to vulnerability issues (with a corresponding negative impact on well-being) that can be precipitated in recession, in the event of a fall in the prices of natural resources (in South America) or in remittances (in Central America), or when overly simple production structures lose economic vigour.

The strong link between expanding consumption with a large imported component and the flow of resources from the export of commodities represents an equation whose sustainability is at best uncertain. Although in recent years the countries have been able to stabilize their consumption trajectories and lessen output volatility, the relative volatility between the two aggregates is still a hallmark of the region. This raises uncertainties over the future sustainability of rising consumption, because the combination of high volatility and preponderantly private consumption worsens vulnerability to a range of external shocks.

With regard to access to financing for consumption, credit growth is positive inasmuch as it affords households opportunities for intertemporal reallocation of consumption to meet their needs. However, consumers are prone to falling into debt traps, and high rates of credit penetration can magnify the impacts of shocks. This points to a problem of sustainability in credit expansion, with greater exposure of the indebted population with fewer assets; and in terms of equality, information asymmetries and access to credit in general make borrowing costs higher for lower-income sectors. In addition, credit use is unequally distributed by decile, even relative to the expenditure or income of each stratum, but tends to be minimal in the lowest deciles and highest in the upper third of the distribution.

Another source of concern is that the upper income levels, favoured by wealth concentration, tend to show a pattern of consumption very intensive in high-cost private services and luxury goods, with a heavy imported content. This erodes the “quality of society” by confining group relations to their differentiated consumption levels. It worsens well-being gaps between consumers of high-end private goods and services and consumers of lower-quality public services. The data show that spending by the upper income deciles is proportionally higher in categories such as transport, education and health care —precisely those in which there is a clear shortfall in public service delivery (see table 3).

**Table 3**  
**Latin America (17 countries): ratio between the proportion of expenditure**  
**by item in the tenth and first deciles, around 2006**

Country	Food	Housing	Health care	Clothing and footwear	Transport	Household equipment and maintenance	Education	Other	Acquisition of assets and financial expenditure
Argentina	0.5	0.8	2.9	1.0	2.2	1.7	2.2	1.8	26.0
Bolivia (Plurinational State of)	0.5	1.7	1.5	0.8	2.1	1.0	13.0	1.8	8.5
Brazil	0.4	0.8	1.4	0.6	2.3	0.5	2.6	1.5	12.6
Chile	0.4	0.7	3.4	0.9	1.0	1.6	2.3	1.8	9.8
Colombia	0.3	1.1	0.8	0.9	2.4	0.9	4.0	1.5	12.8
Costa Rica	0.3	0.9	4.0	1.0	1.9	2.3	6.0	1.6	8.0
Dominican Republic	0.6	2.8	0.8	1.7	3.3	1.4	2.6	1.5	2.0
Ecuador	0.4	1.1	1.3	1.0	1.9	0.9	4.0	1.5	7.4
El Salvador	0.4	0.8	2.5	1.3	2.9	0.7	10.6	1.3	14.2
Guatemala	0.5	1.3	1.4	0.7	5.6	1.5	5.0	2.3	9.1
Honduras	0.6	4.1	3.1	1.1	6.9	1.1	5.5	3.2	<sup>a</sup>
Mexico	0.4	1.3	1.2	0.8	1.3	1.1	1.8	1.7	17.1
Nicaragua	0.6	1.2	1.3	0.5	3.4	1.8	7.3	3.0	2.5
Panama	0.4	1.3	2.6	0.7	1.4	0.9	1.1	1.7	5.2
Peru	0.5	2.0	1.3	0.7	3.6	0.7	10.2	2.2	2.6
Uruguay	0.4	0.8	3.0	0.6	2.0	0.6	3.6	1.4	2.1
Venezuela (Bolivarian Republic of)	0.6	1.7	2.2	0.9	1.1	1.3	5.5	1.2	25.7
Average	0.5	1.4	2.0	0.9	2.7	1.3	5.1	1.8	10.0

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of processing of data from household income and expenditure surveys conducted in the respective countries.

<sup>a</sup> The value for the first decile is zero.

Although growing consumption should to some extent be understood as a way to increase well-being, the strong emphasis on private consumption of imported goods, which use large amounts of energy and pollute the air, raises several red flags. The first is that the bias towards private consumption, which is more stratified by income, works to the detriment of quality service provision by the public sector. This does nothing to increase equality, which, as a shared value, is more strongly reflected when the well-being of society is addressed as a whole in fiscal compacts that are then translated into the delivery of public services and goods that everybody uses and consumes. The “flight” to private consumption, especially in sectors such as transportation, health and education, does not pave the way either for social cohesion or for a fiscal covenant with a redistributive slant. In contrast, when the State can provide good services with universal coverage in health, education, transport, security, utilities and the environment, social cohesion and well-being will boost willingness to engage in reciprocal commitments and lessen the tendency to retract from them.

The second red flag has to do with economic sustainability and transformation of the production sector, insofar as patterns of commodity-intensive production and import-intensive consumption are becoming entrenched. This is not new in the region, but it has taken on a new intensity.

The third red flag is the impact on the environment. In contrast with the bias towards private consumption, a consensus-driven public solution emphasizing shared alternatives would cut greenhouse gas emissions and use less non-renewable energy, as well as encouraging societal stakeholders to form collective accords around energy matrixes that are more environmentally friendly and sustainable.

Redirecting the dynamics of consumption in order to achieve greater equality and sustainability (economic, social and environmental) requires progress in several areas. The first is a twofold fiscal compact, namely, tax reform and the delivery of strongly welfare-linked public services. More resources need to be captured through taxation in order to improve service provision, and taxes have to be progressive if this equation is to increase equality. At the same time, access to services needs to be extended to the sectors most deprived of them. A social compact that

encompasses these two sides of the same coin is at once the means to and the purpose of greater social cohesion, or, it could be said, of a “better quality of society”.

A second area for shifting the dynamics of consumption towards greater equality concerns strategic guidelines for calibrating the expansion of consumption with investment in the production sector. A high-consumption society that has undiversified production and is heavily dependent on the value of its raw materials is not a sustainable society. Financing consumption through the commodities boom has its limits. An agreement is needed to pair the expansion of consumption for greater well-being with investment to achieve a production structure that increases social inclusion through employment, and builds resilience to external shocks through diversification. The balance between consumption and production, and the dynamics of both, are also crucial for maintaining the long-term equilibrium of the current account.

In other words, changes in consumption patterns need to be combined with efforts to raise rates of investment and change its composition. It is very difficult to change patterns of demand without change in patterns of supply. Low rates of investment going to non-tradable sectors or to natural resources that are hostage to the commodity lottery, do little to reduce the volatility of consumption or to shift it towards less polluting products and processes. A broader supply, at lower prices, of environmentally friendly goods and services needs to be paired with efforts to educate consumers and reduce inequalities. In this regard, generating key industrial policy incentives to raise investment in new sectors is a *sine qua non* for transforming consumption modalities.

A third area has to do with the environmental and energy-related externalities of the consumption pattern. Taxing pollution and excessive energy consumption is necessary to promote greater solidarity with future generations. It is evident today that shop-window consumption, the increase in the vehicle fleet, the expansion of energy spending at above rates of per capita GDP growth, and the waste produced by the planned obsolescence market pose serious problems of air pollution, urban congestion, accumulation of non-degradable waste and heavy pressures on the energy matrix, which will be discussed below. Thus, consumption and its implications for future generations should be

the subject of a social compact that links all the stakeholders in a solidary manner and conditions consumption standards to a vision of a sustainable future. “Environmental citizenship” involves rights and obligations in this regard.

We are all consumers and we are all citizens. But consumption must not become a substitute for citizenship. We cannot be consumers at the cost of our sense of citizenship and that is why it is important to strike a better balance between private consumption and public services, and between quality of life today and tomorrow. Consumption must be grounded in a sense of citizenship, and so must be thought out collectively on the basis of a rationale of well-being and sustainability.

## **VI. Development style and environmental sustainability**

The prevailing style of development in the region is one of inertia, or an “equilibrium” that erodes the basis of its own sustainability. The consumption patterns described above have negative environmental externalities such as waste generation, air pollution, the destruction of biodiversity, environmental degradation, and greater exploitation of renewable and non-renewable natural resources. The long-run growth trend in income means that the relative importance of food as an item of expenditure will decline over time, creating opportunities for the consumption of other goods and services. These new consumption opportunities will be decisive when it comes to defining sustainable consumption options.

The region’s production structure, infrastructure profile, prevailing technological paradigm with little production innovation, political economy with misguided economic incentives and subsidies, and private and public goods consumption matrix yield an equilibrium with very little environmental sustainability. From an intergenerational and intertemporal perspective of equality, it is vital to pay particular attention to how existing patterns of production and consumption could affect quality of life in the future.

The dominant pattern of economic growth in Latin America and the Caribbean is expected to drive a sustained rise in the consumption of energy and fossil fuels and their derivatives, such as gasoline, which will



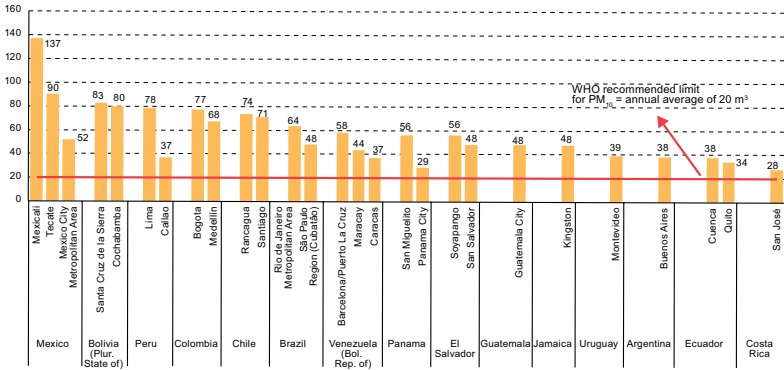
be hard to control with price mechanisms. This has negative implications for air pollution and health in urban areas and will contribute to the carbon dioxide emissions that lead to climate change. Against this backdrop, the regulatory role of the State is fundamental, and efforts must be made to find alternatives to the existing consumption patterns and modalities of supply of public goods and services.

Special attention must be paid to air pollution, which eloquently illustrates the link between consumption patterns, the energy matrix, environmental externalities and the direct impact on people's health and quality of life. Air pollution is generated primarily in urban settings as a result of the rising number of automobiles (mobile sources) and industrial activities (fixed sources). In Latin America, which is highly urbanized, this is a critical issue. Urban growth styles and a shortage of infrastructure for public, pedestrian and non-motorized transport could drive a trend towards greater motorization density in Latin America similar to the levels in countries at the upper frontier such as Australia, Spain and the United States. Furthermore, the low price-elasticity of demand for gasoline points to a dearth of suitable alternatives to private transport.

Out of total household spending in the countries of the region under review, spending on gasoline, diesel and biodiesel ranges from less than 1% for the first quintile to 9% for the fifth quintile. The high concentration of spending on gasoline in the upper quintile clearly flags the segmentation of transport modes across the population. The lack of modern, safe and good-quality public transport leads to high spending on private transport in the upper income quintiles. This consumption structure often has a heavy environmental impact, mainly in urban areas where air quality falls short of international health standards. This configuration is not unrelated to political-economic factors that make it difficult to eliminate subsidies such as those for fossil fuels.

Rising demand for durable goods also has a direct negative impact on the environment and the population, notwithstanding their benefits in terms of increasing material well-being. They generate solid waste and hazardous waste, and they increase energy consumption. In Latin America and the Caribbean, energy consumption, like gasoline consumption, is highly income-elastic and fairly price-inelastic compared with other regions. They thus cannot be controlled by pricing mechanisms alone.

**Figure 11**  
**Latin America and the Caribbean (selected cities) annual**  
**average PM<sub>10</sub> 2008-2009**  
*(Micrograms per cubic metre)*



**Source:** World Health Organization (WHO), "Global Health Observatory Data Repository" [online] <http://apps.who.int/gho/data/node.main.156?lang=en>.

**Table 4**  
**The World and Latin America and the Caribbean: income- and**  
**price-elasticity of demand for energy**

	<b>Latin America and the Caribbean</b>	<b>World</b>
Income elasticity	0.9	0.7
Price elasticity	-0.01	-0.2

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

Moving towards sustainable development requires recognizing the risks as well as the benefits of consumption and taking government action as necessary to mitigate or minimize those risks. A strategy for taxing fossil fuels can, besides slowing the growth of demand, help to generate additional fiscal resources that can be used to build new urban infrastructure or to build up intergenerational solidarity funds. This means not only taxing negative externalities caused by fossil fuel use in an adequate manner, but also assessing the design of policies targeting low-income brackets that could be impacted by direct price increases for fuels or spillover effects on the price of food or public transport.

Measures must also be sought to increase the rate of solid waste disposal in landfills and to find alternatives for using and treating solid waste before final disposal. Here too, economic incentives may be useful to increase recycling, heat treatment and the use of waste for power

generation, among other possibilities. But when key goods are price-inelastic, tax measures and changes in relative pricing are not enough. The supply of clean energy needs to be increased in order to replace the most polluting ones. And standards and restrictions need to be put in place to limit the inefficient use of natural resources, together with policies to support the changeover.

The management and use of water resources is increasingly a matter of priority. While, in general, the primary use in the region overall is irrigation, this has become an issue of growing concern, in particular for small-scale farm production, owing to increased demand from and use by large agricultural and mining companies, overexploitation of aquifers and unsustainable irrigation practices that deplete or pollute the available water or increase the cost of irrigation, with effects on land degradation, declines in productivity and increased loss of arable land.

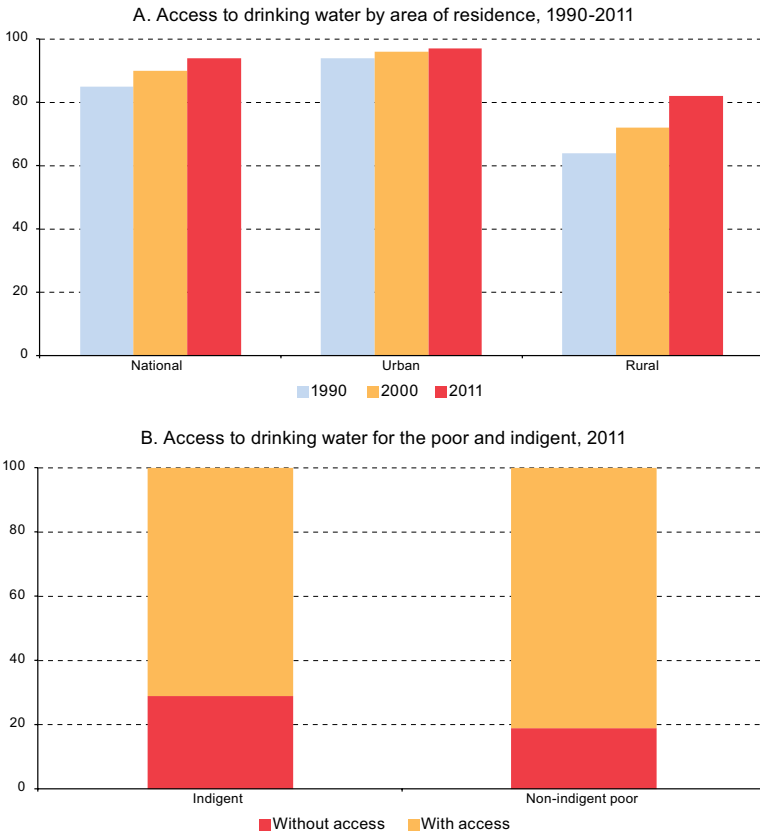
Access to water is sharply unequal in the region, both between and within countries. Supply coverage in rural areas is 82% compared with 97% in urban areas (see figure 12). The proportion of indigent persons with access to safe drinking water is 71%; the figure is 81% among the non-indigent poor. Sanitation infrastructure is the least available service for these groups: only 47% of the indigent population and 61% of the population living in poverty have access to it. As for drinking water for human consumption, supply coverage in the region surged in recent decades, from 85% in 1990 to 94% in 2011.<sup>12</sup>

Growing awareness and mobilization of citizens concerning their right to water, market failures and the important economic, social and environmental aspects of water call for urgent action to improve water management and use to meet the growing demand that sets users and consumers in competition with one another. But the countries of the region still lack an institutional framework for comprehensive water resource management. Instead, through inertia, a sector-based approach still predominates, leaving water still under the purview of the various actors and entities depending on use (domestic, agricultural and industrial).

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<sup>12</sup> The data were obtained from the social statistics and indicators database CEPALSTAT. They refer to the proportion of the population using an improved drinking water source.

**Figure 12**  
**Latin America and the Caribbean: access to drinking water, 1990-2011**  
*(Percentages)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT database.

The region is highly vulnerable to climate change because of factors that include geography, population and infrastructure distribution, dependence on natural resources and significant agricultural activities, as well as vast forests and biodiversity, low capacity for allocating additional resources to adaptation and other social and demographic characteristics that lead to a large proportion of the population being social vulnerable.

Climate change could become a new constraint for economic growth. Or, if addressed in a timely, comprehensive manner, it can open opportunities to renew and improve infrastructure and urbanization, upgrade production processes and industrialization, create more efficient transport methods with lower emissions and gradually move towards a lower-carbon development pattern. Such a change can make a meaningful contribution to increasing equality and driving production convergence as long as it improves the quality of public services for the well-being of the disadvantaged.

Latin America and the Caribbean has a rich natural heritage, with 20% of the world's forest area and six megadiverse countries. A third of the world's potential crop land and freshwater reserves also lie in the region and, thanks to Brazil, it represents 31% of global production of biofuels. Latin America and the Caribbean accounts for 13% of global oil production, 47% of worldwide copper production and 48% of the global production of soybean. In other words, the region is rich in natural resources and very successful in the export of raw materials. But do we know how to manage them? Have we been able to add value to them or industrialize our economies beyond the maquila sector? Do we know how to capitalize on productivity gains (especially in view of high international prices) in order to redistribute them in our society? Do we have common criteria for royalties and for regulating foreign investment in a coordinated manner?

Shifting towards greener growth paths is an increasingly urgent challenge. The adverse effects of climate change weigh heavily on the economies of the region, whose production structures are highly dependent on the environment (agriculture, livestock and tourism); they disproportionately affect the poorest people, who are the most vulnerable. The Latin American and Caribbean region is also constantly exposed to extreme climate events that have significant economic, social and environmental consequences. This is particularly the case in Central America and the Caribbean. Natural disasters have serious social repercussions, expressed in various dimensions of human development and poverty. The countries of the region must bring risk management into national policies within the framework of a sustainable development strategy and improve social and economic resilience in the face of these events. Furthermore, global markets are likely to shift to accommodate

more stringent environmental standards, which could make the region less competitive. This makes it all the more urgent to embrace the green technology revolution creatively.

Green industrial policy should be based on bringing new clean technologies increasingly into production processes, with a large and growing role for local capacities, reducing dependence on imports for obtaining less polluting goods and processes. Existing industries should be restructured, and new activities with positive environmental impacts created (such as the production of clean energies like biodiesel, and the recycling and reuse of materials). These new activities can generate complex production linkages and drive high local innovativeness.

Lastly, high export yield based on raw materials is of little use if the profits are not distributed throughout society, if the high prices are not leveraged for investing in innovation and diversifying the production structure or if those resources are exploited without safeguarding the environment and preserving strategic resources. It is quite a challenge to reverse the trend towards reprimarization of our economies, especially in South America. To do so, we must better manage the financial resources gained, so as to invest in the creation of other forms of physical, human and technological capital. And we must achieve all this with the full inclusion of workers, promoting new skills and knowledge.



## **VII. Natural resource governance for structural change with equality**

Both economic and environmental sustainability are strongly determined by the production structure. The importance of natural resources in the production structure for much of the region is clear. The boom in international demand for primary goods (minerals, hydrocarbons, soybeans and other agricultural commodities) has undoubtedly been instrumental in strengthening the macroeconomic performance and fiscal position of the region's exporting countries since 2003. The region cannot ignore its wealth of natural resources but it must be alert to the risks and problems associated with natural-resource-intensive production. These risks include local currency appreciation, which lowers the price of imported goods (Dutch disease) to the detriment of national industry; the temptation of a rentier approach, which discourages the implementation of industrial policies to expand the country's production and technological base; and the risks associated with managing considerable government revenues under weak institutional conditions with little transparency and social oversight.

Case analysis shows that numerous challenges remain, including achieving efficient organization and establishing the institutional framework needed to leverage these sectors' contribution to development. Capitalizing on this set of factors must be combined with progress towards a production structure that is more diversified and more intensive in technology and innovation, all the while maintaining the ultimate objective of greater equality in the region. Key to this is natural resource governance, comprising a set of sovereign policies that determine how



ownership of resources—and control and distribution of the rents from exploiting them—is managed, in order to maximize their contribution to sustainable development. It includes the resolution of social and environmental conflicts that may arise from the exploitation of these natural resources. Governance along these lines is key to ensuring that the exploitation of natural resources is tied in with economic development, with the kind of supply chains that are created or encouraged, with the infrastructure that is put in place, and with the effort expended on protecting the environment and the rights of peoples and communities.

Natural resource exploitation poses challenges in two distinct spheres of structural change. One is the production matrix around natural resource exploitation, and efforts to introduce, from the developing sector, greater density in capacities, technological innovation, production linkages and synergies with other sectors. Investment in infrastructure for exploiting and transporting natural resources should also generate the broadest possible benefits for other production sectors and for society as a whole. The other sphere relates to government appropriation of natural resource rents and the good use of the associated tax revenues for building human capacities (through investment in education and training) and in other production sectors with high value added content (through industrial policies).

Structural change in these two spheres can, in turn, enhance equality to the extent that investment in infrastructure is used to expand educational attainment, develop production capacities, contribute to greater social inclusion by creating more productive jobs, promote greater access to services and linkages through better infrastructure, and build up the public purse for better and expanded coverage of social protection systems.

## **A. Natural resources and development dynamics**

Any development process must increase the share of higher knowledge-content activities within the production structure. The role of natural resources in this process should therefore be assessed in terms of their contribution to structural change. As shown in table 5, many countries specializing in natural resource exportation are making considerable efforts in the areas of learning and technology absorption (as evidenced by the data on patents and R&D) or are moving towards a more knowledge-intensive structure (as suggested by the technology complexity indicator).

**Table 5**  
**Selected regions and countries: indicators of technology effort in the production structure, 2010**

	High-and-medium-tech exports, $X_{HMT}/X^c$ (percentages)	Engineering-sector share of manufactures, $IPR^b$	Sophistication of exports, $EXPY^c$	Concentration in export goods, $IHH^d$	Patents <sup>e</sup>	Spending on R&D in relation to GDP <sup>f</sup> (percentages)
Argentina	22.0	0.4	1.04	0.14	1.0	0.5
Brazil	32.0	0.7	1.14	0.11	0.5	1.0
Mexico <sup>g</sup>	60.5	0.6	1.32	0.15	0.6	0.4
Developing Asia <sup>h</sup>	64.3	0.9	1.46	0.19	17.2	1.3
South America	18.5	0.2	0.91	0.33	0.4	0.4
Central America	34.2	0.2	1.12	0.20	0.3	0.2
Mature natural-resource-intensive economies <sup>i</sup>	32.4	0.8	1.41	0.21	55.2	2.0
Mature economies <sup>j</sup>	64.6	1.1	1.51	0.09	126.1	2.4

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

<sup>a</sup> Percentage of total exports consisting of medium- and high-technology manufactures.

<sup>b</sup> Share of high-tech sectors in total manufactures, compared with technological intensity in the United States.

<sup>c</sup> Indicator of export sophistication.

<sup>d</sup> Herfindahl-Hirschman index of concentration in export goods.

<sup>e</sup> Number of patents issued by the United States Patent and Trademark Office per million inhabitants, average for the period 1990-2010.

<sup>f</sup> Expenditure on research and development (R&D) as a percentage of GDP, average for 1998-2010. The averages are computed on the basis of the available data for each country in each year.

<sup>g</sup> Mexico and some Central American economies tend to show high values for high-tech exports as a percentage of total exports. The value added of these exports, however, is very low and consists mainly of wages for unskilled labour because the production process is segmented into value chains. That is why the HMT indicator should be viewed in the light of the other indicators of technology intensity (such as R&D and number of patents), which clearly show that these countries lag far behind.

<sup>h</sup> Includes Hong Kong (Special Administrative Region of China), Indonesia, Malaysia, the Philippines, the Republic of Korea, Singapore and Thailand.

<sup>i</sup> Denotes a group of countries with high per capita GDP in which natural-resource-intensive exports account for over 30% of total exports: Australia, Denmark, Finland, Ireland, New Zealand and Norway.

<sup>j</sup> France, Germany Italy, Japan, Sweden, the United Kingdom and the United States.

In South America, natural resources and natural-resource-based exports represent over 70% of total exports, a far larger share than in developing Asian countries. Asia and the advanced economies, meanwhile, score higher than Latin America and the Caribbean on various indicators of value added (see table 5). This is also true of the advanced economies that export natural-resource-intensive goods, which managed to overcome the so-called natural resource curse by implementing appropriate policies. This “curse” is not so much a set of factors as the result of a certain type of political economy that does not encourage the kind of industrial and technology policies that drive structural change with equality.

One of the variables through which a natural resource boom influences the production structure is the real exchange rate. Improving terms of trade and faster growth can put downward pressure on the nominal exchange rate and upward pressure on nominal domestic prices, both for tradable goods (imported inflation) and non-tradables (rising aggregate demand effect). Both movements make a country less competitive and can push certain activities to extinction (especially in manufacturing). These activities lose ground not because companies lag behind technologically or in relative productivity, but rather because of real currency appreciation. This is compounded by the impact of differential yields on resource allocation, inasmuch as an export boom can draw scarce resources away from the non-tradable sector.

Natural resource rents may be captured by a small national or transnational group or put to non-production uses, which undermines the political economy of development. On the one hand, if their use reinforces patterns of inequality and social segregation, this may discourage educational attainment and investment in capacity-building. On the other hand, if the State captures most of the rents and uses them to encourage investment in education or to boost social cohesion through sustainable redistribution mechanisms, this can simultaneously foster productivity and equality. In this case, natural resources, structural change and equality would not be mutually exclusive options, but rather form a virtuous circle.

Investment in infrastructure for developing natural resources should also have positive systemic impacts by, for example, improving access and connecting geographical areas, expanding services to cover excluded

groups, and laying the logistical groundwork for greater diversification of activities. But the privatization of mining and the industrialization of agricultural production (wheat and soybean farming, for example) have not, so far, generated positive linkages with infrastructure, denying other sectors the opportunity to take advantage of infrastructure improvements. Despite economic growth in recent decades, the countries of the region have not managed to close the longstanding infrastructure gap.

## **B. Ownership and appropriation of natural resource rents**

A strategically important part of natural resource governance has to do with the legal frameworks, tools and definitions by which States govern ownership and appropriation of the rents of those resources. Sovereignty to regulate ownership of assets defined as being in the “public domain” is crucial for ensuring that the processes for developing them and the associated rents endogenize the benefits (capacities, technology and fiscal resources for social and economic investment) and mitigate negative externalities, such as environmental impacts and depletion of non-renewable resources.

The constitutions of the countries in the region tend to agree that natural resources (renewable and non-renewable) are State-owned and in the public domain. Their use should not be divorced from the national interest and the common good. Therefore, the State should have full sovereignty over natural resources and set the terms for exploiting them. On these grounds, the State grants rights (of usage, in the case of renewable resources like water) or a concession (in the case of non-renewable natural resources) to a holder who has a right to the concession or to the use of the resource, but not to the resource itself.

Changing scopes and definitions of resource ownership and exploitation thereof by the public sector or the private sector are a source of tension that is specific to each type of exploitation. One of them is the potential contradiction between encouraging investment and ensuring that the participation of the State in economic rents is progressive, that is, that the State’s participation becomes proportionately greater during price boom cycles that generate windfall earnings. How progressive

State participation is depends on regulation and tax schemes, which vary widely across the region. So, the State's share of economic rents also varies widely.

Progressiveness is, then, a principle that should guide the design of taxes on the exploitation of natural resources. Although there are difficulties in operationalizing the concept of extraordinary rents, they may be understood as cumulative gains that clearly exceed the rate of return that, in international practice, the industry usually requires in order to invest in development projects in these sectors. At such rates of return, States have justification for taxing these extraordinary rents without impacting the investment dynamic or the usual return on capital investments for extractive operations.

Given the magnitude of the price boom and indicators of extraordinary mining profits during 2003-2012, governments should strengthen their capacity to audit the mining sector and have independent profit indicators to ensure that tax collections are in line with existing legal frameworks. The countries should move towards greater integration and coordination of actions for making progressive adjustments to the tax regime and harmonizing the terms for mining investments. In particular, perverse fiscal competition should be avoided as it is counterproductive to maintain regimes that are looser than the international average, have already served their purpose and are unsuited to the sector's new regional environment.

Despite the heterogeneity of national experiences, six overall tendencies can be identified with regard to the use of extractive rents appropriated by the State. The first is that producing regions or locations have priority over non-producing ones in the allocation of resources to subnational governments, although in several countries there are also mechanisms for allocating resources to non-producing regions. The second general tendency is towards current expenditure of resources, with weak commitment to their financial management through saving or stabilization or intergenerational equity funds. The third tendency identified is that when central governments allocate a portion of extractive rents to subnational governments, they tend to distribute part of the royalties, rather than the tax proceeds from extractive sectors. A fourth tendency is that legislation generally restricts the use of revenues

distributed to subnational governments to capital expenditures rather than current expenditures. In almost all the countries, existing legislation specifically provides that revenue passed to subnational governments be used for investment expenditures and bars their use for current expenditure. The fifth tendency is a growing direct allocation of some of the revenue from extractive rents to vulnerable populations (the poor, indigenous peoples, older adults, school-age children and others). Lastly, the sixth tendency identified is that none of the countries have legislation in place to assess the impact of the revenues distributed to subnational governments or put to specific uses.

### **C. Where governance is needed**

The region has not capitalized on high international prices for its natural resources to invest in physical and social infrastructure and in capacity-building, production diversification through technological innovation, and social well-being. Its comparative advantage in natural resources has spurred economic growth and the availability of financial resources, but the potential for structural change has not been seized nor has it been prioritized on public agendas. Instead, the natural resource price boom has primarily contributed to a surge in consumption (in particular of imported goods and services), with negative environmental impacts and no consideration for long-term economic or environmental sustainability. In a future scenario of flat or falling global commodity demand and raw material prices, such an equation could trigger serious trade imbalances, among other undesirable outcomes.

Coordination through policies and State institutions is essential for generating virtuous circles linking the exploitation of natural resources to structural change. This has, in fact, been achieved in industrialized countries with large natural resource endowments. Natural resource governance also fosters resolution of the conflicts that arise between the different actors in areas where extraction takes place. Mechanisms for regulation, negotiation, benefit-sharing and receiving loss compensation must be firmly established in areas where natural resource development harms the groups living there. This is particularly true because some of the investments aimed at new or expanded extraction projects have been very controversial. Flashpoints have included water, soil and air

pollution, territorial issues and lack of prior informed consent from the affected communities. Such conflicts also embody the different dimensions of equality raised here: intergenerational equality, insofar as natural resource exploitation affects the environment and the availability of these resources for future generations; equality as mutual recognition, inasmuch as it affects the lands and resources of indigenous peoples claiming their collective rights over ancestral heritage and the use of its resources; and equality in terms of ownership of rents, given the high concentration of these rents and their limited distribution in the social setting where extraction takes place.

Changing the current paradigm for exploiting natural resources through governance that is compatible with sustainability and equality calls for a road map to be agreed upon that will ensure the State collects a more progressive share of the rents generated from natural resource development, particularly during lengthy price booms such as the present one. This may require updating the tax system and greater coordination between the region's countries on how investment in these sectors is handled to prevent tax competition that is ultimately detrimental to proper governance.

Not only must States capture the necessary rents; governance also requires that institutions use these resources efficiently, channelling them into specific investments in human capital (education and health), infrastructure and technological innovation and development. Moreover, as public investment and social spending become more transparent and efficient in terms of generating capacities, providing well-being and encouraging technical progress, more cohesion can be built around a system of natural resource ownership and rents that offers States greater fiscal robustness.

## **VIII. Compacts for equality, sustainability and structural change**

Today, the region is at a crossroads, at which it must deal with both external constraints and endogenous factors that could curb its future development. The external constraints that it must learn to cope with include slowing international trade, stagnating global demand, increased uncertainty about the signals coming from financial markets and about access to financing, and the region's lack of sufficient linkages with today's shifting global value chains. The region's internal problems include an outmoded, disjointed production structure, labour markets with large informal sectors, low investment and a failure to incorporate technical progress, welfare gaps, gaps in capacity, poor natural resource governance, consumption patterns that reflect shortfalls in public services and that put a great deal of pressure on the environment and the energy supply, and institutional shortcomings in terms of the ability to capture, regulate and allocate resources.

In order to turn this situation around, ECLAC is proposing an approach for transforming the region's development process in which equality is the core element, structural change is the way forward and politics and policymaking offer the means to that end. At this stage, policies need to be redirected towards sharply boosting investment in order to create a virtuous cycle among growth, productivity and environmental sustainability by incorporating knowledge into production and generating a high level of value added; by making the labour market more inclusive and promoting greater convergence between tax reforms and social policies with a clearly redistributive bias in order to reduce



the various types of inequalities troubling the region; by balancing the growth of private consumption with a regular supply of high-quality public services in order to pave the way for greater social cohesion and environmental sustainability; and by instituting an appropriate system of natural resource governance as a basis for further diversifying environmentally sustainable forms of production that will have positive impacts on employment and the level of well-being.

Notwithstanding the worth of majority agreements and consensuses, such proposals really need —if they are to come to fruition— medium- and long-term social compacts involving a wide range of actors and State policies of undisputed legitimacy. The specific nature of these social compacts will vary depending on the conditions existing in each country. These conditions include the level of institutional development, the nature of the production matrix, the tax system, the political model and political culture of the country, social conditions, available capacities and various other factors.

In this framework, an overview of a number of principles and major objectives that could serve as a substantive platform for compacts of this type is offered below. This platform could be used as a basis for defining specific procedures and the specific content of each compact, which will depend on the conditions in each country. The agreements to be negotiated regarding what principles are to serve as a foundation or platform for these collective accords may not provide enough of a basis for defining their specific content or the associated legislation, but they can contribute to an initial convergence of positions or at least to progress towards a meeting of minds. Subsequent negotiations can then be pursued with a view to agreeing on procedures, programmatic agendas and commitments.

## **A. A fiscal compact for equality**

Fiscal policy should be used to generate countercyclical effects that will help to stabilize the macroeconomy and to support growth and income redistribution. One of its core functions is to provide the financing needed to honour the commitments assumed as part of the agenda for equality and sustainable development. The fiscal compact or covenant is therefore not just another agreement; it is the mechanism that makes

other collective accords financially viable. The fiscal compact is also one of the crucial elements in building a more robust public institutional structure that will be more effective in reshaping society's social and production structures.

The fiscal compact applies to both facets of fiscal policy, i.e. taxation and social spending. In most of the countries, there is room for improvement in both of these areas: room for making spending more efficient and for leveraging its redistributive impact.

The fiscal compact should enshrine tax reforms that will provide the increased revenues needed to finance changes in public administration. Both in order to generate greater political support for tax reforms and in order to ensure that those reforms will create virtuous circles that will drive structural change and contribute to greater equality, institutional reforms must be introduced to increase accountability and put public finances on a better footing in general. Just as compacts make political institutions sturdier, sturdy institutions lay the groundwork for the formation of compacts and the translation of those agreements into appropriate policies.

## **B. A compact for investment, industrial policy and inclusive financing**

Productivity gains, the absorption of technical progress and the diversification of increasingly knowledge-intensive production activities all require markedly higher investment rates. This greater flow of investment must also be directed towards sectors and activities that will spur medium- and long-term growth and equality. This is why the region needs to use industrial policies, in conjunction with other macroeconomic, environmental and social policies, to create incentives that will steer investment towards sectors and activities embodying more dynamic and sustainable growth trajectories. These policies should include sectoral and horizontal incentives that will lead the way to certain types of technological and learning paths. Given the wide range of stakeholders and sectors involved, compacts that are very large in scope will be needed to pursue the shared objective of transforming the production matrix while bringing about structural change. Infrastructure gaps must also be closed in a strategic manner to support the change in production patterns.

In moving this new development-oriented investment agenda forward, the financial system has a key role to play in mobilizing savings and channelling them efficiently towards investment and technological innovation and towards the various agents of production, including households, businesses and, particularly, SMEs. The idea of inclusive financing must be built into the compact, to ensure small businesses and low-income people are able to gain access to financial services.

The financial system is a key player in an investment policy focusing on an integrative approach to production. The development banking system can play a vital role in this area within the framework of a compact for financial inclusion by promoting and linking up cooperative public-private ventures. The backdrop for all this is the densification of the financial system.

### **C. A compact for equality in employment**

Since the labour market is so segmented and so heavily influenced by the prevailing patterns of structural heterogeneity, the compact to be reached in this connection should link structural changes with institutional and convergent productivity inroads. A compact in this area should encompass a strategic vision and a broad-based support programme focused on narrowing gaps in productivity, labour income and employment quality and on striking a balance (in terms of time and gender and the provision of care networks) between paid and unpaid work.

Stronger labour institutions can help to formalize employment. They will also help to enforce labour laws, distribute the benefits of labour more fairly and strengthen mutual recognition between the various actors in the world of work. Institutional reform will generate synergies in terms of equality and inclusiveness that will play a vital role in backstopping changes in the production structure. Institutional changes will be needed to afford the labour factor—versus the capital factor—a more equitable share of productivity gains.

A comprehensive labour policy should coordinate macroeconomic and sectoral policies in order to ensure that the priority objective of providing people with productive, decent forms of employment is incorporated into macroeconomic policy; that job losses are kept to an absolute minimum and that the unemployed are protected during

the low points of the business cycle and during the transitional stages of the production matrix; and that a production structure is fostered that will narrow internal and external productivity gaps and promote skill-building.

#### **D. A compact for social welfare and public services**

The first document<sup>13</sup> of the ECLAC trilogy on equality established the need for the State to play a leading role in building more inclusive social protection networks with fewer coverage gaps and in undertaking sweeping reforms in the education system. The thrust was to reduce the differentials in capacity-building between different groups in society and to gear the learning process towards meeting the challenges posed by structural change, cultural change and the need for the citizenry to play a full-fledged role in building a democratic society. This, the third document in the trilogy, also highlights that gender mainstreaming in public policy and in the labour market, as well as the specificity of the issues and challenges associated with the rights of indigenous peoples, call for government coordination and regulation in order to reconcile the vector of equality of means with the vectors of equality of mutual recognition and autonomy.

The social compact must also endow public policymakers with the recognition and management capacity needed to convince a large majority of the population to make use of a more ready supply of higher-quality public services and public goods. A collective accord must also provide some kind of link between consumption patterns (or patterns in the way higher income and more readily available financing are used) and more equal access to well-being. It is not a question of using coercive policies to block people's legitimate aspirations in terms of consumption, but rather of shaping incentives, disincentives and trade-offs that will foster a better balance between private expenditure and the supply of public services and public goods.

The agenda for social institutions should include the delivery of fundamental public goods and services. Regulatory frameworks, tax systems and urban investment arrangements should limit upper-middle-income and upper-income sectors' options for avoiding "public bads" (by

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<sup>13</sup> *Time for Equality: Closing Gaps, Opening Trails* (LC/G.2423(SES.33/3)), 2010.

choosing to live in gated communities, hiring private security services, using private means of transport, etc.) and promote the use of collective systems (public transport, the public commons, high-quality waste management systems). Basic health and education systems should be of a high enough quality to attract middle-income sectors.

The idea is, on the one hand, to reverse the vicious cycle whereby public-private segmentation in the provision of the means to attain a given level of well-being is linked to difficulties in concluding social compacts and, on the other hand, to help cultivate virtuous cycles entailing greater cohesiveness, a greater willingness to enter into collective agreements and a shared use of better-quality public services. The social compact should thus aim towards universal coverage in the provision of these goods and services, avoiding the segmentation often found in targeted welfare policies, in exclusively contributory insurance systems and in market solutions.

## **E. A compact for environmental sustainability**

Environmental sustainability poses enormous challenges in terms of intergenerational solidarity and recognition of the wide range of groups that are adversely affected by environmental degradation and by the exhaustion of non-renewable resources. These compacts must be both national and global in scope and they must engage civil society very actively, on both of these scales.

The Latin American and Caribbean region must meld its responses to environmental challenges with structural change that will boost productivity and close the gaps between different groups in order to move towards greater equality. The compact must therefore provide for a transition to a green economy and include policy tools for reshaping consumption patterns in ways that will result in less pollution, less waste and a better balance between private consumption and the supply of public goods and services.

There is a need to show greater solidarity with future generations, and one of the ways of doing this is to tax or penalize polluters and those who waste energy. Serious environmental problems that affect the entire population are being generated by high levels of consumption of waste-producing, planned-obsolescence goods, the steadily growing number

of vehicles and their contribution to pollution and congestion, and the fact that the increase in energy consumption is outdistancing per capita GDP growth and putting mounting pressure on the energy matrix. By the same token, this strong link between consumption and the environment needs to be taken into account in a social compact in which stakeholders work together in solidarity with one another to regulate consumption with a view to its long-term sustainability.

The compact should also block the negative environmental externalities of consumption with the help of taxes on fossil fuels. This will not only curb demand, but will also generate fiscal revenues that can be used to develop new types of urban infrastructure or to establish intergenerational solidarity funds. In addition to this taxation tool, the compact should also provide for compensatory policies to assist low-income groups that may have to bear the brunt of higher fuel prices or the second-order effects of those price hikes on food and public transport costs.

## **F. A compact for natural resource governance**

Governing the region's natural resources means addressing, from a medium- to long-term perspective, the system of ownership, appropriation and use of rents and the system for settling disputes arising from resource development. A proper institutional and regulatory framework must be in place if the region is to prevent the high international prices for its natural resources from generating Dutch-disease distortions, and if it is to stop its ample natural resource endowment from triggering various forms of rent-seeking behaviour. The region must make use of that endowment to shape a more technology-intensive and more diversified production structure in which economic rents are used to pursue the ultimate aim of promoting greater equality in access to well-being, capacity-building and mutual recognition among the actors involved.

This type of governance is the institutional counterpart of the effort to deepen structural change, which ensures that the region's natural resources are harvested in a way that will give rise to development with virtuous-circle production linkages, infrastructure that will help to create synergies between production and social uses, environmental sustainability and full respect for the rights of peoples and communities.

The compact should seek to ensure that the State collects a more progressive share of natural resource rents, particularly during lengthy price booms such as the present one, whether through taxation or State ownership of resources. This objective may be achieved by updating the tax system in these sectors to make it more progressive and by means of closer coordination among the countries of the region in dealing with investment in these sectors; this kind of coordination could help governments avoid the sort of fiscal competition that reduces their ability to capture a greater share of the wealth generated by natural resource development projects. Natural resource governance compacts should provide for the creation of institutional mechanisms —such as stabilization funds or oil wealth trust funds— to ensure that the economic rents derived from natural resources are channelled into sustainable investments rather than private consumption.

These rents should be efficiently invested in education and health, infrastructure, innovation and the development of technology in order to lay a solid foundation for well-being, capacity-building and innovation over the long term. This, in turn, will call for a skillful handling of the difficult political economy choices involved in the public investment of natural resource rents and their distribution among different groups in society and different levels of government.

## **G. A compact among the international community for development and cooperation beyond 2015**

The international community closed out the 1990s with the Millennium Declaration, a development milestone that opened the way for the Millennium Development Goals. One of the stellar achievements of the Millennium Development Goals agenda has been the worldwide acceptance of the Goals and their effectiveness in mobilizing resources and focusing the political debate on the struggle to end poverty.

Looking ahead, this global compact should target an economic structure capable of attaining threshold levels of environmental sustainability and social well-being for the majority of the population. Its scope should go beyond the satisfaction of basic needs to encompass reduction of the deep-seated inequalities and asymmetries within and between societies. This involves leaving behind the traditional

premise of development assistance, whereby the rich countries help out developing countries and prescribe the kinds of action they should take in order to combat poverty. The idea is to form a global compact that expresses solidarity with coming generations who will be living in a world marked by greater uncertainty and more severe shortages of natural resources. It will also involve advocating the conclusion of international trade, environmental and social agreements that will respect the principle of shared but differentiated responsibilities in the interest of addressing asymmetries at the global level, and that will not shift the heaviest costs onto the shoulders of the poorest or the most vulnerable countries. The goal is shared prosperity and more inclusive societies.

In order to accomplish this, representative, politically legitimized leaders will be needed to strengthen multilateral frameworks and improve the governance of development. A universal, inclusive form of global governance is needed that will reflect the interests, needs and aims of the international community. The provisions of the different international treaties and agreements that are already in existence need to be harmonized, as do the negotiations undertaken and the commitments assumed in the various international trade, climate, environmental, social and financial forums. The region needs to develop a new approach for agreeing on these types of changes more quickly, for establishing more clearly defined goals and for introducing inclusive, efficient mechanisms to ensure accountability.

## **H. The importance of compacts**

The earlier documents in the trilogy have already underscored the importance of entering into such compacts in order to forge a new type of relationship among the State, the market and society. In *Time for Equality: Closing Gaps, Opening Trails* (ECLAC, 2010), the Commission advocated the creation of social and fiscal accords that could have a greater redistributive effect and could strengthen the role of the State and public policy in the transition to an institutional structure that is more effective in upholding labour and social rights. Two years on, in *Structural Change for Equality: An Integrated Approach to Development* (ECLAC, 2012), the Commission again highlighted the importance of policy tools in



bringing the joint efforts of the State, the market and civil society to bear in the implementation of a strategy for structural change with equality. It also emphasized the integration of macroeconomic, industrial and social policies, with a single aim: virtuous structural change, coupled with equality and environmental sustainability.

As set out in the present document, which completes the trilogy, a social compact is especially important now because the region is at a crossroads, and slowing growth in trade and consumption could call for bold decisions regarding social protection, investment and fiscal policy. The region must urgently revisit the way in which its institutions and structures are linked to one another so that it can tackle long-standing problems of unsustainability and inequality and build its capacity for dealing with a global situation that is placing greater constraints on growth.

The shared long-term vision and reciprocal commitments assumed as part of the process of developing a compact help to ensure that political and social stakeholders' expectations will tend to converge and that they will have greater ownership of proposals for change, which will provide the basis for policies and institutions that are more robust and more legitimate. Compacts can combine a long-term intertemporal interrelationship with a broad-based participatory process, and this kind of combination can be essential in high-uncertainty situations.

Today, more than ever, the Latin American and Caribbean democracies need compacts that cement a new institutional framework and allow demands for equality in the broadest sense to be heard —encompassing fair distribution, rights and intergenerational opportunities— and the economy must respond to these expectations. The “indignant” protesters in Brazil, the Chilean students who took to the streets, the various civic, environmentalist and grassroots movements and the shifts in electoral choices and leaderships may appear to be separate phenomena. But they can all be traced to a common cause: the difficulty in moving towards a style of development that will govern natural resources intelligently, combine greater well-being with better public services for all, substantially reduce wealth concentration and even out the unequal appropriation of the fruits of economic growth by the different agents of production.

How and to what extent the response to these challenges can be resolved through policies will be determined by the collective decisions which are today—and must still be tomorrow— part of the public and democratic debate in the region. In this, the State is called upon to play a fundamental role. Democracy gives policies legitimacy through agreements and compacts forged with a strategic objective. It also helps to identify the type of development we want without sacrificing sovereign options or ignoring the constraints and possibilities presented at this historic turning point.





2014

Since its inception, the Commission has been committed to devising a model for sustainable development over the medium and long terms. Recently, the basic tenets of the development model have been revisited in light of the current challenges of equality and sustainability, as set forth in the position papers presented at the last two sessions of the Commission.

*Time for Equality: Closing Gaps, Opening Trails* (Brasilia, 2010) proposed equality as the guiding principle and ultimate objective of development in Latin America and the Caribbean. Moving in that direction required placing the macroeconomy at the service of social well-being, as well as changes in the production structure, greater territorial inclusion, expanded social protection and a social and fiscal compact that included universal coverage.

These development pillars were further explored in *Structural Change for Equality: An Integrated Approach to Development* (San Salvador, 2012). Here, the emphasis was on the need to link efforts towards a more equal form of development with inclusive structural change that would promote knowledge-intensive sectors and reduce internal and external gaps in income and productivity, consistently with the principle of rights equality.

*Compacts for Equality: Towards a Sustainable Future*, presented by ECLAC to the States members at the thirty-fifth session of the Commission (Lima, 5-9 May 2014), completes the trilogy. In this third volume, the aim of equality dovetails with development that is more economically, socially and environmentally sustainable in the medium and long terms in Latin America and the Caribbean.

This new proposal firmly embraces the gender perspective, natural resource governance and the dynamics of labour and consumption, and advocates medium- and long-term social covenants, engaging a broad range of actors in the exercise of citizenship, as a condition for successful development.

