

## Chapter 4

# **Making states more capable: Building and implementing national strategies**

This chapter stresses the need to continue enhancing domestic capacities to overcome development traps and therefore improve citizens' well-being. A key starting point is National Development Plans (NDPs), which prioritise policies and adopt a well organised and comprehensive approach. Although these plans are country-specific, they have common targets and challenges in design and implementation. The chapter highlights the importance of improving and increasing public spending for successful implementation of such plans. It insists NDPs should navigate effectively in the political economy. Finally, the chapter focuses on the need to increase domestic resources for development to finance sustainable development, considering the role of taxes, financial markets, national development banks and public-private partnerships.

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# Latin America needs better institutional capacities to achieve sustainable development



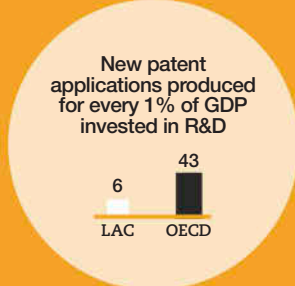
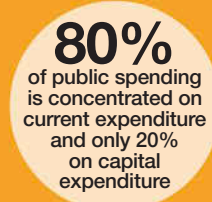
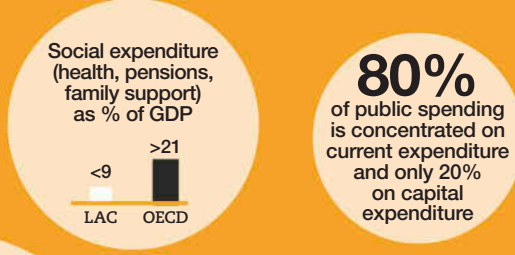
## Better planning for development

National Development Plans (NDPs) are a critical tool for development planning, enabling shared development objectives and a common long-term vision



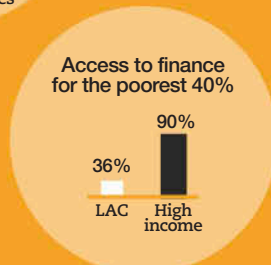
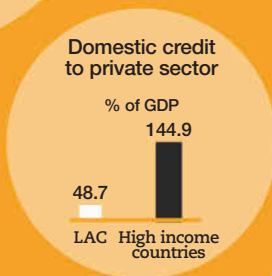
## Better spending for development

Planning and evaluation of expenditures are fundamental to make sure spending is based on value for money and not on past spending



## Better financing for development

Taxes, national development banks, public-private partnerships and financial markets are key domestic resources for development



## Introduction

The *development in transition* approach argues that Latin America and the Caribbean (LAC) faces “new” development traps that are holding back its potential for further progress. The productivity trap, the social vulnerability trap, the environmental trap and the institutional trap confront the region with new and increasingly complex development challenges. The *development in transition* approach further suggests the need for stronger domestic capacities coupled with renewed international co-operation to overcome these traps effectively and to boost sustainable and inclusive development. Thanks to these actions, the region will be moving from current challenges to new opportunities for all citizens. Therefore, moving towards higher stages of development will require ambitious policy reforms and stronger domestic institutions. These demand innovative and more sophisticated domestic policy responses than those that brought LAC to the upper middle-income range.

Stronger domestic capacities are also needed to adapt to, and embrace, the opportunities of a rapidly changing external environment. Achieving the Sustainable Development Goals (SDGs) is an ambitious endeavour that demands stronger institutions. Furthermore, major tectonic shifts are at play, including protectionism, technological progress, climate change, migration and population ageing. These shifts are rapidly transforming economies and societies, rendering institutions obsolete. They demand new responses and capacities to embrace emerging opportunities.

Increasing state capacities is indeed a key policy area to overcome LAC’s development traps. This approach remains critical to favour effective and more targeted impact of productive, social and inclusion policies. State capacities are also crucial to advance towards greener production and consumption patterns. They are also at the heart of the increasing levels of citizen dissatisfaction and mistrust (OECD/CAF/ECLAC, 2018). In this sense, it is critical to further develop capacities within national institutions in LAC countries.

In the past decade, most LAC countries have been improving their institutional capacities in different dimensions. For instance, first, the NDPs have taken into consideration the multidimensionality of development and have included policy actions to tackle development traps. In addition, most of them are aligned with the Agenda 2030 and use the SDGs as monitoring indicators. Second, the regulatory and institutional frameworks to include the private sector in the policy-making have improved, in particular regarding public procurement and public-private partnerships. Third, anti-corruption measures have been strengthened and transparency and open government policies are being implemented to improve trust and better involve citizens in decision-making (OECD/CAF/ECLAC, 2018). Finally, to finance development, although the level of taxes remains low compared to OECD countries (22.7% vs. 34% of GDP in 2016), they have increased by more than 1.8 percentage points between 2010-2016, and most countries are actively attempting to decrease tax avoidance and evasion at the local and international levels (OECD/ECLAC/CIAT/IDB, 2018).

Even though LAC has advanced in many areas during the last decades, evidence suggests that institutions have evolved at a slower pace than society’s aspirations (OECD/CAF/ECLAC, 2018). Limited state capacities are common – and have experienced little progress over time – across developing economies. Often developing countries have copied best practices from their more developed counterparts that make them look more capable even if they are generally not so (the “isomorphic mimicry”, as put by Andrews, Woolcock and Pritchett, 2017).

This chapter focuses on strengthening domestic capacities in three main areas to address development traps and foster a multidimensional approach to sustainable development in LAC. First, better capacities are needed to improve the *planning and policy-making process for development*. This includes issues related to building technical capacity to design, implement and monitor long-term, strategic National Development Plans (NDPs). In addition, it includes how NDPs are linked to the international development agenda of the SDGs and the global context. Finally, it examines how to create the political consensus and citizen support to overcome the complexities of the political economy of reforms in LAC. Second, better capacities are needed to improve *spending for development*. This will enable countries to do more with less and have mechanisms to make a more efficient and impactful use of public resources. Third, better capacities are needed to improve *financing for development*. This refers to mobilisation of sustainable domestic financing for development, both public and private, to invest in structural policies and support the sustainable development agenda. In all three areas, the digital transformation plays a critical role, providing new tools and opportunities to deliver better public goods and services. Hence, the chapter highlights some relevant examples where digitalisation can improve institutional capacities.

The three areas are cross-cutting, affecting all public policies for all sectors and levels of government. Previous editions of the *Latin American Economic Outlook* (LEO) focused on various public policy issues that are crucial for sustainable and inclusive development in the region. These include fiscal policy; migration; small and medium-sized enterprises; infrastructure and logistics; education and skills; trade integration and the relationship with China; youth, skills and entrepreneurship; and the relevance of rethinking institutions to support greater development. These editions analysed horizontal issues across all LEOs, such as low productivity, labour markets and the persistence of informality, and the socio-economic implications of an expanding middle class. The three areas in this chapter are fundamental steps to improve and strengthen topics covered in previous LEO editions.

### Improving state capacities for planning and policy making in Latin America

Development planning has experienced a significant evolution in recent years in LAC, mainly through the adoption of NDPs. Contemporary planning strategies in LAC foster a multidimensional view of development with a strong focus on reducing poverty and inequality, and encouraging productivity. It also promotes participation of a broader group of public and private actors in design and implementation. Additionally, planning strategies in LAC favour adoption of policies to mitigate market failures and provide public goods. This occurs often throughout regulation, public investment and, in some cases, the organisation of public-private partnerships.

NDPs represent a critical tool for development planning, enabling countries to move towards shared development objectives with a common and long-term vision. In this respect, NDPs can be essential to co-ordinating public policies so that LAC economies can overcome development traps. Likewise, it is critical to link the NDPs to the 2030 Agenda for Sustainable Development (the 2030 Agenda), in particular to those SDGs where global public goods are crucial.

To adopt NDPs, some countries must navigate in multi-annual and complex policy reforms. In that setting, NDPs emerge from country-specific policy-making processes (PMPs). These PMPs, in turn, result from a particular political economy equilibrium, characterised by a complex interaction between public and private actors in a specific institutional setting. In this light, the NDPs in LAC are beset by notorious shortcomings,

particularly in the design and implementation phases. These shortcomings, in turn, emerge from the lack of technical capacity in the design of planned reforms and programmes; insufficient continuity in implementation processes due to frequent government turnover; and inadequate connection between plan design and the budgetary process.

International co-operation can provide valuable support in the design and implementation of NDPs. By providing technical support, contributing to build local capabilities and sharing successful reform experiences, international co-operation can help address some weaknesses of planning strategies (Chapter 5).

Digital technologies can be useful to develop more effective NDPs in LAC. These technologies are a powerful tool to improve citizens' participation and empowerment in the design phase of planning strategies. They also facilitate the impact evaluation of government programmes and projects in connection to the SDGs. Finally, digital technologies enhance state capabilities to develop more accurate and rigorous long-term macroeconomic scenarios that are essential in setting up consistent and sustainable development strategies.

### **Development planning in Latin America: The role of National Development Plans**

Development planning is a political and social process that seeks to co-ordinate different actors, sectors and levels of government for comprehensive actions to achieve development objectives (ECLAC, 2018a). These planning processes have acquired various levels of complexity and scale that demand a systemic approach. Under such an approach, planning must be understood as a set of norms, institutions, instruments and processes that interact according to the objective of sustainable development.

NDPs represent a critical planning tool to move towards shared development objectives with a common and long-term vision. These planning tools usually identify responsibilities and relevant actors for its fulfilment. As such, they can be an effective instrument to articulate a cohesive and rational approach to the process of public management, setting up a link between the country's development challenges and goals. This type of tool guides investments in major issues such as education, health, infrastructure and security, among others. These are needed to achieve development, provide equal opportunities and create better conditions to enhance quality of life. Plans are based on the general situation of the nation, its environment and its medium- and long-term priorities. Clear objectives and challenges help a country visualise and establish the actions necessary for each social actor to promote development (ECLAC, 2017).

#### **National Development Plans in Latin America**

As many as 18 LAC countries have at least one national instrument for development, while Cuba and Uruguay are formulating an NDP or strategy with a long-term vision. Several countries in the region have built NDPs on a long-term basis. These include Dominican Republic, Guatemala, Haiti, Honduras, Jamaica, Paraguay and Peru. The scope of these instruments is quite diverse. They range from development plans or strategies to meet objectives during a specific government term to national strategies that extend beyond the duration of a certain administration (see Annex 4.A1 for the NDPs included in this analysis and Chapter 6 for Caribbean small states).

Citizens' participation in planning is one key aspect of the national development strategy. Within the LAC region, this participation ranges from simply receiving information on a specific topic to jointly formulating, implementing and following up the plan. Seven countries in LAC have long-term plans and strategies formulated through political consensus and participatory processes with broad representation of actors of the society.

Implementation of the plans requires co-ordination of public institutions for joint work with different actors or different levels of citizen participation. In this environment, the national planning authority is a key actor. In LAC, this authority has diverse configurations with respect to administration, dependence, hierarchy and responsibilities. While some authorities operate as a government minister with exclusive mandates, others function within different ministries or are autonomous agencies. On the other hand, some countries do not have a centralised planning authority. Instead, they link planning instruments to the government budget with a decentralised assignment of responsibilities.

LAC has several models of frameworks that regulate planning instruments. In some cases, countries grant constitutional status to the planning exercise. Others have laws that dictate planning processes that a government must follow. Still others give the status of law to an NDP or strategy. As many as 10 countries in LAC have given constitutional status to planning, 11 have a specific law about planning instruments and 4 gave legal status to an NDP.

The link between the development plan and the budget is fundamental to implementing the strategy and achieving objectives. In this regard, 14 LAC countries have established a legal framework for the link between the development plan and the budget. Five countries have specific guidelines in the plan to co-ordinate both the plan and the budget. Four other countries have a mechanism that includes estimates or projections about the budget needed to implement the proposed actions in the plan.

A mechanism for the follow-up of NDPs is key for their success. In LAC, 13 countries have a monitoring and evaluation system in place. Five countries have not yet defined a mechanism, while one is building it. In addition, 12 countries have a legal framework related to monitoring and evaluating the development plan; the planning authority is responsible for this process.

The fulfilment of each stage of the plan – participation, implementation, and monitoring and evaluation – is critical for achieving goals. The authorities that carry out this task design and co-ordinate a complex system of policies, programmes and projects with different institutions, government levels and time-frames. In addition, national priorities need to be articulated with the 2030 Agenda and the SDGs. This requires renewed efforts of co-ordination, political will and leadership for plans, strategies and programmes to embrace global, national, regional and local levels. Finally, these plans should consider the international context and global public goods as crucial elements in the design and implementation of domestic strategies (Chapter 5).

Furthermore, countries must review their co-operation mechanisms to support the implementation of development plans. This includes integrating new perspectives and modalities to support the transition to sustainable development and design of public policies crucial to managing globalisation. This, in turn, should recognise that priorities and choices of allocation may change from one country to the next, and that non-financial co-operation is a crucial contribution to global governance (Chapter 5).

#### **National development plans as a critical tool to address the “new” development traps**

The visions embodied in the development plans or strategies describe expected achievements. Based on a review of development plans in the region, the main ideas in these visions were summarised as follows: *A society centred on people, inclusive, empowered, egalitarian, with quality education and respectful of diversity; a country without extreme poverty, in solidarity, in peace and tranquillity, with quality of life and in harmony with the environment, which*

*guarantees the well-being of present and future generations; a solid, prosperous, dynamic, diversified and sustainable economy with quality jobs; a democratic, participatory, transparent, effective system that promotes equal opportunities.*

This summary highlights the economic, social, institutional and environmental dimensions that are part of the different development visions. Based on these visions, countries detail the strategic objectives that constitute the country's medium- and long-term development guidelines, which are materialised in the short term through action lines. This strategic framework determines a set of national, sectoral and cross-cutting policies that are translated into programmes and projects that seek to achieve national goals.

Based on the strategic objectives in development plans in the region, priorities have been grouped into four major traps that economies face in their transition to development: *productivity, institutional, environmental and social vulnerability*. On average, countries' most pressing policy issues relate to institutional strengthening, including reforms for modernisation of public services, citizen security, justice and international co-operation. The second major issue is productivity, including macroeconomic stability, growth and employment, infrastructure development and investments in science and technology. Social vulnerability comes in third place and includes social and human development, inclusion and social cohesion, equity, quality of education and access to basic services. The less-mentioned topics are those related to the environment and the adaptation and mitigation of climate change (Figure 4.1).

Figure 4.1. Latin America (16 countries): Intensity of specific topics in development plans

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

Note: Each strategic objective of the national development plans for every country was classified according to a broad thematic area. Subsequently, strategic objectives were grouped according to their thematic link with the four development traps. Next, a relative indicator was calculated by country, giving the maximum value to the country that covers all topics in every category in its strategic objectives.

The colours indicate the intensity of the topics included in the strategic objectives according to the challenges of the development in transition. As a colour darkens, its priority within the plan increases. The figure is based on the latest development plan (or its equivalent) approved by the end of 2018. See Annex 4.A1 for the NDPs included in this analysis and Chapter 6 for Caribbean small states.

Source: Own elaboration based on the information contained in development plans.

The previous analysis indicates some trends on policy priorities, which are also related to the institution in charge of preparing the scope and objectives of these NDPs. Likewise, some programmatic differences can be observed between development planning instruments in the region. Institutional strengthening and macroeconomic stability, growth and employment are the strategic objectives most mentioned in revised plans. Even though environmental issues are relatively less present as strategic objectives in development plans in Latin America, Caribbean countries have recognised these areas as critical for planning. This difference can be explained in part by their exposure to recent extreme climate events (see Chapter 6 on Caribbean small states).

#### **National development plans and the link with the SDGs in Latin America**

The United Nations' SDG agenda – known as the Agenda 2030 – is a tool for planning, monitoring and evaluating the development agendas of countries. The Agenda 2030, considered as a civilising and universal instrument, establishes people as its main focus. It emphasises rights and a commitment to global sustainable development in which all countries participate equally (ECLAC, 2016a). In this respect, it integrates three pillars of sustainable development: economic, social and environmental.

Since 2015, LAC countries have articulated their NDPs in light of the Agenda 2030. Indeed, the integration of both the national and global development agendas is an opportunity for LAC countries (Chapter 5). The alignment process identifies links between the national agenda and the SDGs. In this way, the articulation of NDPs can favour compliance with the SDGs.

Argentina, Guatemala and Paraguay are some of the countries in making the articulation of their NDPs in line with the SDGs. Argentina appointed the National Council for the Co-ordination of Social Policies (CNCPS) in 2016. As the presidential body that co-ordinates adaptation and implementation of the 2030 Agenda, the CNCPS oversees technical assistance in each stage of the NDP process (CNCPS, 2017; CNCPS, n.d).

The Forum of Latin American and Caribbean Countries on Sustainable Development is the mechanism to monitor and review the implementation of the Agenda 2030 and the SDGs in the region. The Economic Commission for Latin America and the Caribbean (ECLAC) accompanies and supports countries of the region in implementation through evaluation of their capacities and resources of all kinds, developing new strategies and designing institutions in the national, regional and global levels through the forum (ECLAC, 2018a).

Four main priorities support implementation and follow-up of the Agenda 2030. The first priority relates to strengthening regional institutional architecture through (i) forming and consolidating a solid base for a follow-up and collaborative analysis of the SDGs; (ii) strengthening capacities of the countries; and (iii) identifying regional trends and gaps in the implementation of the Agenda. This priority, as a guideline at the regional level, promotes a transparent, co-ordinated and integrated relationship. The national, regional and global levels have clear reporting mechanisms, hierarchy and mandates. The forum and each ECLAC body provide a platform that bridges the domestic sphere and the larger system. This allows consolidation of policy dialogue between multiple actors with the idea of sharing good practices, emerging challenges and joint goals (ECLAC, 2018a).

The second priority relates to strengthening analysis of capacities for implementation of the Agenda 2030 at the regional level. This includes analytical and technical support, as



well as policy advice to countries. The regional analysis, led by ECLAC, subsidiary bodies and intergovernmental bodies, also involves other actors such as the academic sector, the private sector and civil society. Together, they exchange knowledge, experiences and proposals that solve problems exposed in the Agenda 2030 (ECLAC, 2018a).

The third priority relates to integration of the SDGs into NDPs and national budgets. This recognises planning as a means of implementing the international Agenda. The work plan of each country must recognise in its planning process the actions that contribute to the fulfilment of each objective. ECLAC identifies four key actions for national planning. The first supports creation of national architecture to foster both dialogue among countries for co-operation and mutual learning of experiences and good practices. The second promotes incorporation of the SDGs into national and territorial planning systems through medium and/or long-term development strategies. The third strengthens capacities of planning, monitoring, evaluation and public management of all actors to identify and promote the application of strategic tools that consolidate development objectives in institutions, public policies and NDPs. The fourth is to develop a regional observatory of planning for sustainable development that serves as a support platform for all actors and a space for dialogue between nations. The platform allows access to information and different instruments that help in the implementation and follow-up of the Agenda 2030 (ECLAC, 2018a).

The fourth priority is the integration of measurement processes needed to produce SDG indicators in national and regional statistical development strategies, as well as the consolidation of national statistical systems and the leading role of national statistical offices. It aims to enhance capacity of national statistical systems by responding to the needs of the Agenda 2030 (ECLAC, 2018a).

#### **Using multidimensional measures to define and monitor the development agenda**

As challenges and opportunities can diverge from one economy to another, there is no single path to development. Countries in transition, moving from one level of income to the next, show signs of strong economic growth, while still facing different development vulnerabilities (Chapter 2).

Multidimensional measures are essential to capture the complexities of development and to gain a more precise picture of people's living conditions. Income indicators are easy to understand and communicate. They are also relatively easy to calculate and allow comparisons across countries and over time. Yet, for policy making and analysis, they might not provide a clear picture of needs and achievements across the spectrum.

Several methodologies have been developed to measure development. For instance, many developing countries already apply the United Nations Human Development Index (UNDP, 2018) or the Multidimensional Poverty Index (Angulo, 2016; Alkire, 2018). Two complementary multidimensional measures of development could guide policy makers in their planning agenda: the OECD How's Life framework and ECLAC's structural gap approach (Box 4.1). The OECD framework measures development outcomes to reflect the realities of citizens. For its part, the ECLAC's structural gap approach identifies long-term objectives to tackle obstacles to inclusive growth.

#### Box 4.1. Well-being indicators and structural gap approach: Two complementary methodologies for informing policy makers in the region

Several new approaches aim to measure development beyond income and can inform policy makers and compare with other countries. First, use of well-being indicators can improve design and delivery of development plans at different stages of implementation. Second, the structural gap approach (SGA) can identify financial needs and their allocation required to overcome key long-term obstacles.

The well-being approach, as exemplified by the OECD *How's Life?* framework (OECD, 2017), can inform policy makers in several ways (Durand, 2018). At the agenda-setting stage, regional well-being indicators can become a diagnostic tool to identify priority issues and comparative evidence across countries. Additionally, policy formulation would help spell out in detail how the proposed policy will improve each of these identified priorities. It would also help clarify *ex ante* a range of well-being benefits and costs. Robust methodologies, for example, would allow for comparison between policy options and alternative programmes. Moreover, comparing multiple well-being outcomes across and within countries permits identification of issues shared by more than one country. Finally, the well-being approach can be used to monitor and evaluate the effectiveness of development plans.

The second methodology, the SGA, is a strategic framework for identifying financial needs and for allocation of resources required to overcome key long-term obstacles (ECLAC, 2012). The SGA is thus an alternative methodology that can assess the most important needs of countries in transition. By focusing on a common diagnosis and prioritisation of challenges, it can help formulate national development strategies and inform the new development agenda. Closing development gaps requires mobilisation of both traditional and emerging resources. Tailor-made instruments are key to identifying a country's ability to mobilise domestic and external resources and their willingness and capacity to contribute to global and regional public goods.

#### From planning to action: The policy-making process in Latin America

This section examines the political economy of designing, adopting and implementing development plans in LAC. First, it reviews some trends in policy priorities in development plans and analyses the role of planning in policy making and the “life cycle” of reforms in the region. Second, it briefly describes the peculiar features of the political economy of planning in LAC. It ends by discussing the importance of communication for successfully passing reforms and, particularly, in adopting and implementing national development strategies.

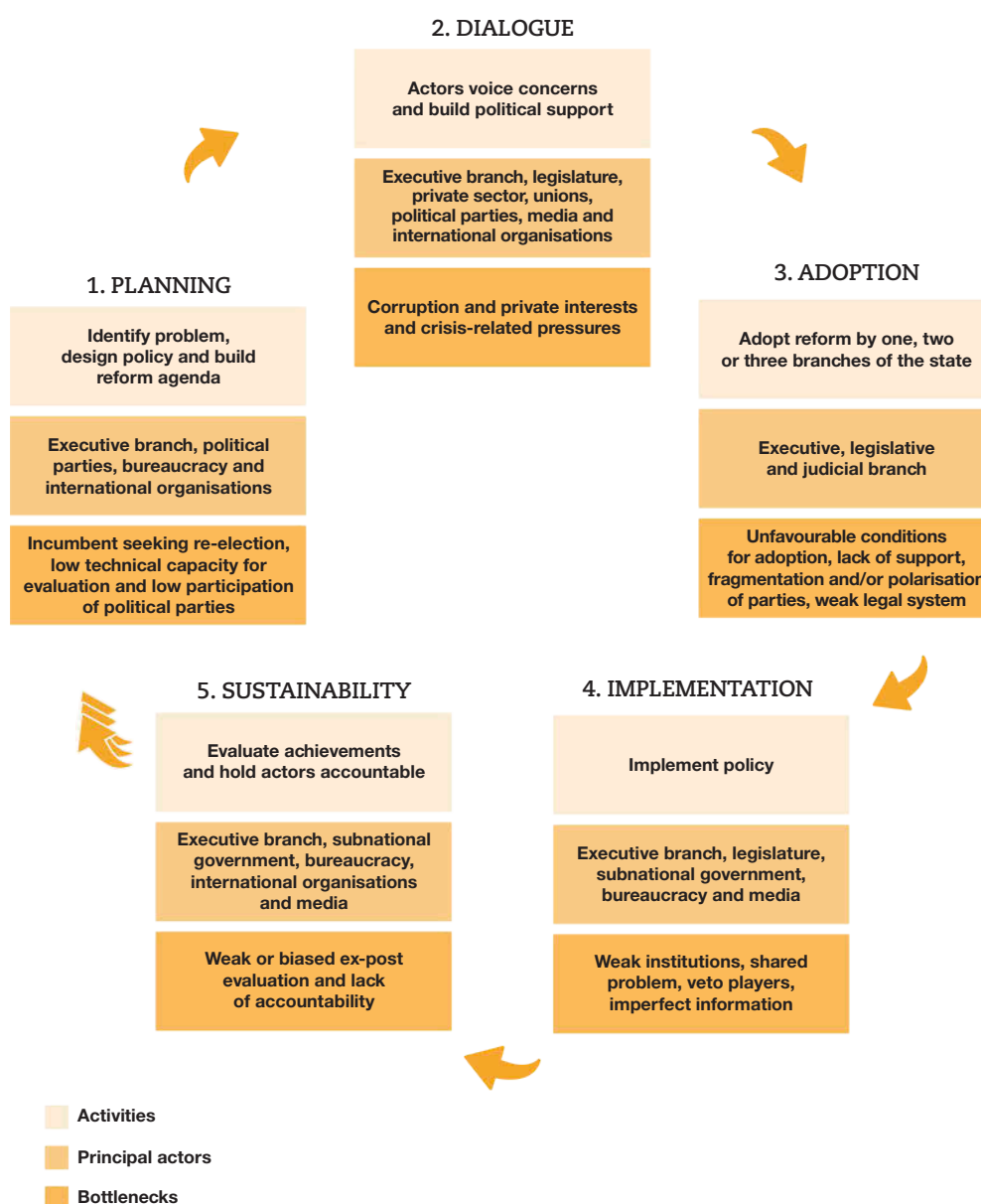
The design, adoption and implementation of national development strategies is eminently a “political action” (Mattár and Cuervo, 2017). Planning involves the definition of a long-term vision of the evolution of a country's economic and social structure, the arrangement of complex long-term policy objectives and the resulting allocation of scarce fiscal and political resources to particular government agencies, programmes and projects (Bertola and Ocampo, 2013; ECLAC, 2017).

To achieve their goals, NDPs usually comprise adoption and implementation of policy reforms over a prolonged period. In this view, planning is the first of five critical stages of the life cycle of reform; the others are dialogue, adoption, implementation and sustainability (Dayton-Johnson, Londoño and Nieto Parra, 2011). The planning

stage involves identification of the problem, design of the policy and agenda setting for reform (Figure 4.2).

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

Figure 4.2. The stylised reform cycle: Activities, principal actors and bottlenecks



Source: Dayton-Johnson, Londoño and Nieto Parra (2011).

Partially owing to the presence of a strong tradition of presidentialism, the executive branch and its cabinet play a significant role in setting the agenda for development planning, and more generally, in managing the entire PMP in LAC. As a result, ministries, and particularly ministries of planning and/or economy and finance, are often key players in designing and implementing NDPs (Stein et al., 2005; ILPES-ECLAC, 2017a; Mattár and Cuervo, 2017).

Conversely, and despite some differences across countries, legislatures usually play a limited role in the formulation and adoption of development strategies in the region. Similarly, the participation of civil society organisations in the definition of goals and policy guidelines in the development strategies remains limited (ECLAC, 2018a; Mattár and Cuervo, 2017).

In most LAC countries, business groups have been influential in the PMP. These groups influence the design and implementation of NDPs through formal or informal associations, bargaining, lobbying, government appointments, political financing and, in some cases, corruption (Schneider, 2010). Both technical staff and effective interest intermediation may serve to impede rent seeking. If business association members meet regularly to reconcile differences, they are more likely to be attentive, and resistant, to rent seeking by other members. At first glance, well-organised associations seem a prerequisite for effective business-government collaboration (Schneider, 2015). However, different capture mechanisms, including financing and media campaigns, lobbying and a “revolving door” between private and public positions, negatively affect the effectiveness of reforms in LAC countries (OXFAM, 2018).

Besides the specific features of the PMP, there are some additional weaknesses in planning processes in LAC: (i) difficulties in implementation; (ii) lack of long-term planning; (iii) lack of intersectoral co-ordination; (iv) insufficient budget allocations for implementing plans; (v) limited co-ordination between plan design and budget; (vi) political interests that outweigh technical recommendations; (vii) frequent government turnover, with no continuity in implementation processes; (viii) lack of political will to implement plans; (ix) complexity of institutional architecture and excessive bureaucracy; and (x) insufficient attention to planning as an instrument for effecting change or anticipating unfavourable results (ILPES-ECLAC, 2017b).

Digital technologies can help address some of the planning weaknesses in LAC. Social media and digital platforms are a key tool to improve citizens’ participation and empowerment in the design phase of NDPs, as well as to enhance the transparency of its adoption and implementation stages. Additionally, the adoption of digital technologies along the entire policy cycle can play a crucial role to improve links between development goals set by the NDPs and national budgetary systems, and therefore, to concretise government programmes and projects. Hence, these technologies could help LAC governments to monitor policy compliance with the development traps more effectively and to evaluate more rigorously those policies’ alignment with, and their impact on, the SDGs. Finally, applying recent advances in artificial intelligence technologies to the large datasets of administrative data available in the region to the state agencies can have a positive impact. Specifically, it can improve LAC governments’ ability to design and implement sound development strategies based on more solid and accurate macroeconomic forecasting and scenario-building exercises (Estevadeordal et al., 2018).

Communication plays a crucial role for effective adoption and implementation of development strategies. In particular, the success of the dialogue, adoption and implementation phases hinges on convincing multiple public actors of the potential long-term benefits of proposed policy changes and reforms (Lora and Olivera, 2004; Lora, 2007; Dayton-Johnson, Londoño and Nieto Parra, 2011).

Recent evidence from the behavioural economics literature suggests that people respond to perceived changes in regulations and other policies rather than to actual changes. Government can go a long way towards producing changes in behaviour by modifying the way policy reforms are actually framed and presented to the public (Castro and Scartascini, 2015).

Tax compliance is a promising area for improving the effectiveness of public policies through the adoption of communication interventions or “nudges”. Recent evidence from randomised control trials (RCTs) in the region singles out the large and positive role of “information” on raising tax revenues. This is particularly true in relation to penalties and the probability of detection in the case of tax evasion. More generally, evidence from the RCTs indicates the use of clear, concise and salient messages, and direct communication methods, offer an effective value-for-money when promoting, and finally passing, tax reforms (Castro and Scartascini, 2015; Carrillo, Pomeranz and Singhal, 2017).

Finally, the adoption of communication interventions or informational nudges can play a relevant role in development plans. For instance, several NDPs in LAC have recently introduced ambitious multi-annual reforms in the energy sector (ILPES-ECLAC, 2017a; 2017b). Energy reforms are notoriously difficult to carry out as they frequently entail unpopular increases in tariffs and prices. Additionally, tariff schemes in the energy sector are usually extremely complex to understand. Therefore, economic agents, and particularly households, have a limited understanding of the social and economic implications of modifying energy tariffs (Bastos et al., 2014). In that setting, conveying effectively the benefits of policy changes, and carefully explaining how mitigating measures such as subsidised tariffs could help low-income households, might help build and sustain support for energy reforms (Castro and Barafini, 2015).

## **Towards more and better spending for development in LAC countries**

NDPs in LAC countries identify the need to spend more and better in key areas affecting development. In particular, most NDPs insist on the need to enhance and to improve public investment through, for example, improved connectivity. In addition, NDPs address the need to spend better on certain inputs to achieve better outcomes for citizens. Better incentives to teachers, for example, increase education performance. Finally, NDPs play a role in the design of Centre of Government policy objectives; a key area is the co-ordination across several authorities to spend more effectively. This is the case, for instance, between transport roads and schools’ infrastructure at subnational level.

This section presents two domains regarding spending for development in LAC countries. First, it insists on the need to improve the effectiveness and efficiency of public expenditures. Second, it highlights that in some areas spending remains too low in LAC to close the gap with other countries in social and competitiveness domains. Drawing on these two dimensions, this section shows that the levels and quality of spending in the region are insufficient to overcome development traps and accomplish the Agenda 2030.

### **More efficient and effective public spending as a driver of development**

Analysis of government spending in LAC reveals widespread waste and inefficiencies that could be as large as 4.4% of the region’s gross domestic product (GDP). This indicates ample room to improve basic services without necessarily spending more resources (Izquierdo, Pessino and Vuletin, 2018).

Using existing public resources, LAC countries can achieve better social and economic outcomes. In several areas, including education, health services, public safety and infrastructure, the region could improve public services using current levels of spending. At the very least, it could provide current levels of services using fewer public resources.

With respect to the quality of secondary education, some actions that are not necessarily resource-intensive could improve Latin America's system. According to the Programme for International Student Assessment (PISA), intangible variables and variables related to soft skills interact most with teaching performance in both Latin America and the OECD. These include teachers' expectations of their students' futures, and to a lesser extent the type and level of teacher certification (Avendano et al., 2016). These factors may require less spending than certain "traditional" policies such as higher teacher-student ratios, better physical infrastructure and more qualified teachers (OECD/CAF/ECLAC, 2014).

Regarding infrastructure, increased investments are less important than better connectivity through more efficient spending and complementary services. Strategies for improved efficiency in spending include stronger planning and improved budgeting that allows for evaluating projects over several years. Similarly, at a post-construction stage, proper maintenance and strong regulations are needed to guarantee the quality of existing infrastructure (World Bank, 2018). Infrastructure projects require time and resources for their planning and execution; sufficient funds are not always available.

Much can be done to improve transport of goods and services using existing infrastructure and adopting cost-effective policies. These "soft" solutions can include developing integrated logistics policies supported by the necessary governance and institutions; providing modern storage facilities and efficient customs and certification procedures; making better use of information and communication technologies; and promoting competition in transport (OECD/CAF/ECLAC, 2013; World Bank, 2016).

At the sub-national level, there is a need to improve the allocation of commodity-based transfers to regions. Despite improvements in the past years, most countries of Latin America need still to improve the allocation of these revenues according to level of development of the regions and, for instance, to finance education and skills, infrastructure and research and innovation policies to promote economic diversification. Prioritising and planning these investments should be carried out with a dialogue between national and sub-national governments and private actors, civil society and academia. To improve the management of these revenues, support for governance capacity at the sub-national level is also needed (OECD, 2013; OECD, 2016a).

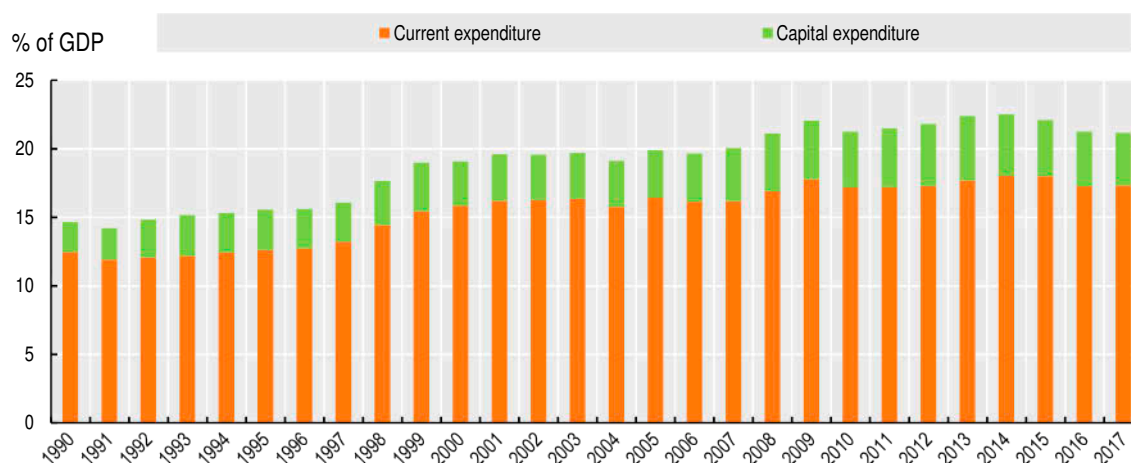
Another important component to spend more effectively and efficiently is the allocation across different types of spending. Public spending is typically allocated according to historical standards rather than value-for-money. In the health sector, more resources have traditionally gone towards curative care rather than prevention. In education, more attention has been given to post-secondary degrees rather than early childhood development (Izquierdo, Pessino and Vuletin, 2018). However, greater attention on education in the early years can be cost-effective. For example, it can save on future investments by increasing individuals' performance at later stages, enhancing economic productivity (OECD/CAF/ECLAC, 2014; Izquierdo, Pessino and Vuletin, 2018).

A temporal bias means that LAC countries prioritise short-term rather than long-term spending. Since 1990, more than 80% of primary central government expenditure has been allocated towards current expenditure, which tends to be more short term. Conversely, capital expenditure has been almost consistently below 21%. After reaching its peak in 2012, it decreased to 18% in 2017 (Figure 4.3). Latin American economies tend to reduce capital expenditure in hard times, despite its long-term effect and higher fiscal

multipliers; they increase current expenditure in good times (OECD/CAF/ECLAC, 2018). This result is exacerbated under broad weak institutions (Ardanaz and Izquierdo, 2018).

Figure 4.3. **Central government current and capital expenditure in Latin America and the Caribbean**

(percentage of GDP)



Source: Own calculations based on CEPALSTAT.  
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### Closing the spending gap

The region lags behind in key public investments such as infrastructure or research and development (R&D), as well as social expenditures. These are essential to overcome the development traps and achieve the Agenda 2030.

Low capital expenditure translates into low infrastructure investment in a region where it is of key importance. In 2014, Latin America invested around 2.8% of GDP in infrastructure, although with strong variations across countries. This rate is second-lowest among emerging economies, surpassing only sub-Saharan Africa (1.9% of GDP). Investment rates of other regions for the same year are 7.7% for East Asia and the Pacific, 6.9% for the Middle East and North Africa, 5.0% for South Asia and 4.0% for Central Asia. Consequently, in terms of availability and quality of infrastructure, the region underperforms more than other emerging regions (World Bank, 2018a). This is a concern, as Latin America's production structure is especially time-sensitive. Low-quality infrastructure investment entails high costs and a time-consuming process for exports (OECD/CAF/ECLAC, 2013; World Bank, 2016).

In addition, R&D expenditure in the region lags behind, holding back productivity gains. To overcome the productivity trap, LAC economies must find new engines of sustainable development that will depend on favourable investment rates and a developed system of national innovation. The region has a relatively low investment in R&D as a percentage of GDP, with an average of 0.7% between 2000-14. In contrast, in East Asia and the Pacific and in the OECD average, the rate is above 2.0% of GDP. On average, the public sector is responsible for about 60% of the region's total R&D expenditure, compared to less than 40% by the business sector. In contrast, economies such as the United States, Spain or Portugal mainly finance their R&D through private investments (RICYT, 2016).

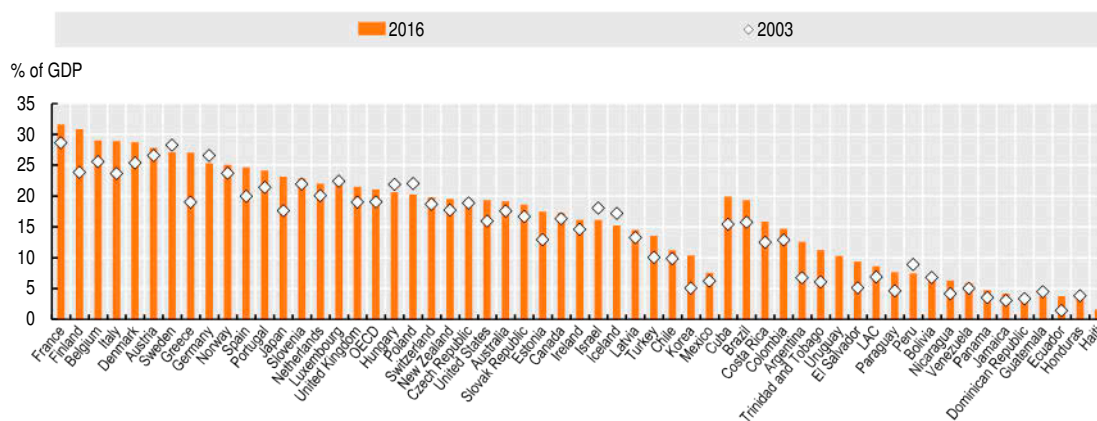
Inefficient and insufficient investment in R&D translates into slow production of original knowledge, as measured by patent applications. Expenditure in R&D in Latin America is inefficient. On average, each percentage point of GDP invested in R&D produces six new patent applications via the Patent Co-operation Treaty. In contrast, OECD member

countries produce on average 43 patent applications per each point of GDP invested in R&D. The mix of inefficient and low spending results in low production of original knowledge. In 2015, the region applied for two patents per million habitants in 2015. This is relatively low compared to the 110 patent applications per million habitants in the OECD in 2015. That same year, patent applications varied strongly in Latin America from around 8.2 in Chile to less than 0.2 in El Salvador. However, they were consistently below the OECD level.

Efforts to increase quality spending in social protection across the LAC are also needed to overcome vulnerability and institutional traps. Improving the quality and coverage of key public services is a priority, especially those affecting individuals of low socio-economic background, such as education and skills (OECD/CAF/ECLAC, 2016, 2014). In LAC economies, current levels of investment in key socio-economic areas for development are consistently well below those of OECD economies (Figure 4.4). Social expenditures in health, pensions, family support and other social services were around 8.6% of GDP in 2016, well below spending in OECD countries (21.2% of GDP) (OECD, 2016b). At 4.3% of GDP in 2015, investment in education in the region also lags behind the close to 5.5% of GDP that OECD member countries invest in education.

In sum, the region needs to increase and improve spending on social components, including health and education. It also needs to boost investment in R&D and other innovation policies to strengthen competitiveness. More and better spending is crucial to overcome the aforementioned traps (Chapter 3).

Figure 4.4. Public social expenditure in OECD and LAC countries



Note: For OECD member countries, instead of 2016, data for Mexico refer to 2012 and 2013 for Japan, 2014 for Turkey and 2015 for Canada, Chile and New Zealand. For Latin American countries (right panel) data are not fully comparable with OECD member countries, 2015, except for Panama 2014 and Venezuela 2009. Instead of 2003, data refer to 2009 for Colombia.

Source: OECD Social Expenditure Database (2016b); ECLAC (2016b), Base de Datos de Inversión Social. StatLink <https://doi.org/10.1787/888933936995>

## Domestic financing for development: The role of public and private sectors to raise funds for development

Responding to the Agenda 2030 and the development traps requires mobilising vast resources to finance long-term policy reforms (see discussion above). The post-2015 development agenda brings a profound transformation in sustainable development that requires a huge mobilisation of resources. Worldwide, finance needs of the Agenda are estimated at USD 3-14 trillion. This will entail a change in funding, organisation and allocation (ECLAC, 2017). Therefore, the financing for development angle is fundamental to achieve the SDGs and to help countries in transition overcome their development traps.



Sufficient domestic resources for development are needed to enable both the public and private sectors to drive national development. Domestic resources for development can come from public and private sectors in key domains such as taxes, national development banks, financial markets and public-private partnerships. This section argues these different sources of financing for development are important and can be enhanced in the region.

### **More and better public resources are needed to fund development**

LAC economies need to mobilise further domestic resources to overcome development traps and achieve the Agenda 2030. In 2016, the average tax-to-GDP in the LAC region was 22.7% of GDP, compared to 34.0% of GDP in OECD member countries (OECD, 2018a; OECD/ECLAC/CIAT/IDB, 2018). Tax-to-GDP ratios varied widely between countries, ranging from 12.6% in Guatemala to 41.7% in Cuba. Roughly half of the countries in Latin America and the Caribbean have tax-to-GDP ratios between 17% and 26%. How tax revenues are collected is as important as how much is collected.

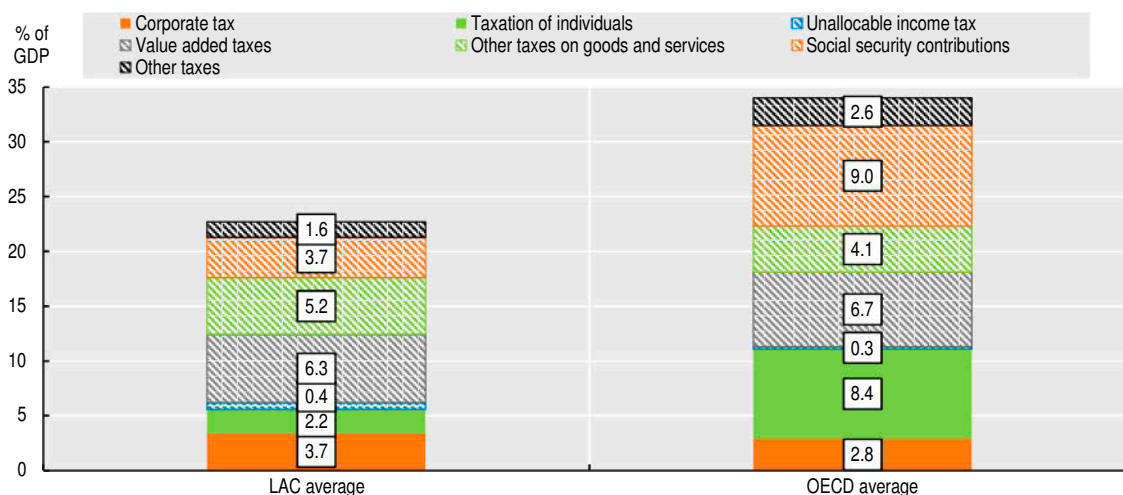
Taxation is necessary to mobilise revenues and finance public goods and services, and should also help reduce inequality and poverty. Taxes are one of the key tools available to government to reduce inequality and to support measures to reduce poverty, including both the financing of social expenditure and the provision of direct support through the tax and benefit system. Both the level and structure of taxation is relevant to the role of taxes in encouraging more inclusive growth: direct taxes such as personal income taxes, which should be progressive, and social security contributions, which may directly support social expenditure, are particularly important in this regard.

In contrast to most OECD economies, tax structures in Latin America and the Caribbean depend most on indirect taxes, rather than direct taxes which tend to be more redistributive (Figure 4.5). The main difference between the OECD and LAC is the contribution of social security contributions (SSC) and the personal income tax revenues (PIT) to total tax revenues. In 2016, on average the PIT and SSC represented only 9.7% and 15.9% of total tax revenues, respectively. In the OECD, the corresponding figures were 33.6% and 26.2% of total tax revenues, respectively. On the other hand, consumption taxes (mainly valued-added taxes, or VAT, and sales taxes) accounted for 50.5% of tax revenues in LAC countries in 2016 compared with 32.7% in OECD member countries. Several factors in Latin America reduce tax revenues, including a narrow tax base due to the proliferation of exemptions and deductions, simplified tax regimes, high minimum non-taxable levels, low willingness to pay taxes (i.e. tax morale), high levels of informality and tax evasion and avoidance (OECD, 2018a; OECD/ECLAC/CIAT/IDB, 2018).

Tax expenditures tend to be high in the region and further assessment is needed to determine their socio-economic costs and benefits. Tax expenditures are “provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax” (OECD, 2010). A systematic inventory analysis of tax expenditure data will provide a more accurate depiction of foregone revenues in the region. Estimates show that in 2016 (or latest data available), tax expenditures amounted to 3.5% of GDP in Latin America. In Costa Rica, Nicaragua, Dominican Republic and Uruguay, tax expenditures exceed 5.0% of GDP. Most tax expenditures come from general taxes on consumption (2.0% of GDP) and to a lesser extent from direct taxes on corporate income (0.7% of GDP) and on personal income (0.6% of GDP) (Pelaez Longinotti, 2017). A crucial issue lies in clearly identifying the objectives of tax exemptions and in quantifying their costs and benefits. Tax exemptions may aim at economic, social and environmental policy goals that include creating more and better jobs, boosting innovation and competitiveness, and improving social conditions.

Yet, it is necessary to quantify these tax expenditures to appraise their effectiveness and efficiency in achieving their intended goals. This is particularly important since tax expenditures are automatically enforced year after year (Redonda, 2016; OECD, 2018c).

Figure 4.5. Tax structure (as percentage of GDP) in the LAC and OECD regions, 2016



Source: OECD/ECLAC/CIAT/IDB (2018) and OECD (2018a).  
StatLink <https://doi.org/10.1787/888933937014>

Tax evasion and tax avoidance in Latin America strongly reduce available resources for development. In 2014, the region is estimated to have lost USD 340 billion through tax evasion – two thirds of this from personal income taxes alone – which amounts to 6.7% of GDP (4.3% of GDP from PIT and 2.4% of GDP from VAT) (ECLAC, 2016c). Most tax avoidance stemmed from direct taxes (4.3% of GDP), which tend to be more redistributive (Brys et al., 2016; Barreix, Benítez and Pecho, 2017; ECLAC, 2018, 2016c; OECD/CAF/ECLAC, 2018; OECD/ECLAC/CIAT/IDB, 2018).

Tax avoidance and tax evasion through tax planning and misinvoicing should be tackled at international level. Regarding tax avoidance, profit shifting and aggressive tax planning are a source of lost tax revenue. Multinational enterprises, for example, might manipulate transfer prices from economies with high tax levels towards jurisdictions that apply low or zero taxation. Similarly, in their trade practices, some international firms use misinvoicing – falsifying the value of a transaction – to evade paying tax. In 2013, Latin America lost approximately USD 31 billion in tax revenue (0.5% of GDP) due to trade misinvoicing. Estimated losses vary greatly, but are particularly large in Brazil, Costa Rica and Mexico. The size of tax revenue lost and the many ways in which some multinational enterprises operate highlight the need for a co-ordinated response (ECLAC, 2016c).

A deeper integration into global markets must be accompanied by corresponding tax regulation to avoid tax base erosion and profit shifting from multinational enterprises (MNEs). Tax planning that aims to exploit gaps and mismatches in rules by artificially shifting profits to low- or non-tax jurisdictions refers to tax avoidance strategies and is reducing the tax contribution of MNEs in LAC and worldwide. Strengthening the international tax rules of LAC countries, including through implementing recommendations of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, will help create a more level playing field. This, in turn, will increase tax revenues and overall economic productivity.

Evasion from international transactions must be addressed with a co-ordinated effort in order to increase tax revenues. The Global Forum on Transparency and Exchange of

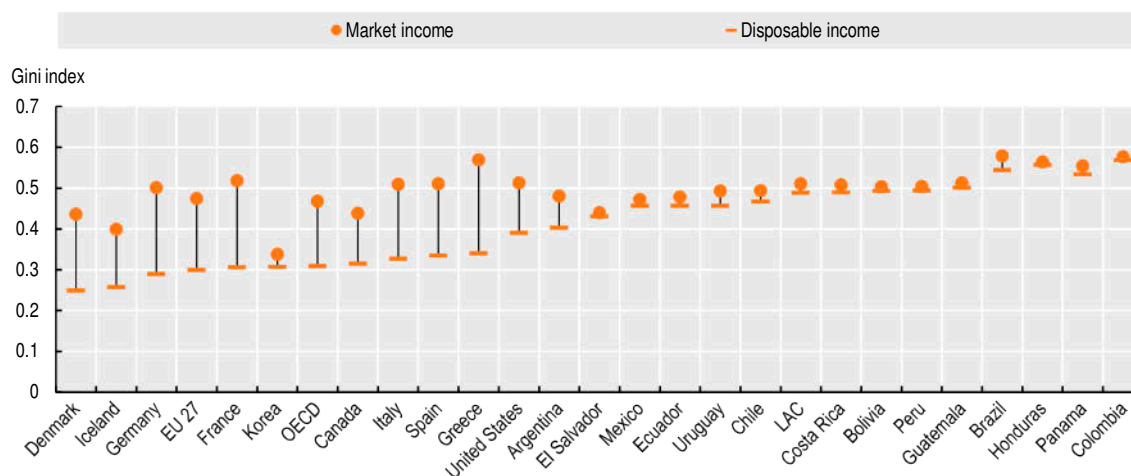
Information for Tax Purposes plays an important role in this context. In November 2018, Argentina, Panama, Paraguay and Uruguay established a Latin American initiative to maximise the effective use of the information exchanged under the international tax transparency standards to tackle tax evasion, corruption and other financial crimes and improve international tax co-operation to counter practices contributing to all forms of financial crimes (Punta del Este Declaration, 2018). A move towards Automatic Exchange of Information for Tax Purposes will help fight tax evasion and give countries greater scope to tax both domestic and foreign-source income earned by tax-resident businesses and households.

New technologies can also help reduce tax evasion and increase revenues. Technology facilitates access to information and allows authorities to cross-reference tax filings more easily. Similarly, it allows users to experience a more simplified tax payment process. New technologies have already had positive effects on tax revenues in Latin America. In 2013, for example, Chile became the first country in the region to adopt E-invoicing, which allows recording of commercial transactions in electronic format. Since then, Argentina, Brazil, Colombia, Ecuador, Mexico, Peru and Uruguay have adopted E-invoicing; countries such as Costa Rica, Guatemala, Panama and Paraguay are looking to implement it. Recording commercial transactions in electronic format helps diminish tax evasion, makes taxes more transparent and contributes to the digitalisation of tax administrations. Other forms of digitalisation such as the application of block-chain technology or the use of big data are still in the experimental stage. Eventually, they could simplify the tax process and reduce evasion. However, they must be accompanied by corresponding institutional reforms and keep in mind the effects of the new technology on the international tax system (Barreix and Zambrano, 2018; KPMG, 2018; OECD, 2018b).

#### Improving both taxation and social transfer systems should help reduce income inequalities

The combination of inefficient spending and insufficiently progressive taxation in LAC do little to reduce inequalities. In OECD economies, taxes and transfers contribute to the reduction of the Gini coefficient by approximately 16 percentage points. In LAC, the comparable reduction is 2.2 percentage points on average (Figure 4.6; Lustig, 2017; OECD/CAF/ECLAC, 2018).

Figure 4.6. Impact of taxes and transfers on income distribution in Latin America, the European Union and selected OECD economies



Source: INEC (2016); Lustig (2017); OECD/CAF/ECLAC (2018); and Commitment to Equity (CEQ) Institute at Tulane University, New Orleans.

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Moreover, LAC faces key challenges to increasing revenues in a more redistributive manner that go beyond increasing tax rates. These challenges include a narrow tax base due to the proliferation of regressive tax expenditures and deductions, simplified tax regimes, high minimum non-taxable levels and low willingness to pay taxes (OECD/CAF/ECLAC, 2018). In Latin America, the income level at which personal income tax (PIT) begins to be paid is higher than in the OECD. This is true whether measured in terms of GDP per capita (Jiménez and Podestá, 2016; ECLAC, 2017) or with reference to average salaries (OECD/CIAT/IDB, 2016). As a result, a high proportion of individuals is exempt, which weakens the redistributive potential of the PIT. Because of high informality rates in the region, policy solutions for PIT, in aspects such as higher progressivity and increases in the tax base, require more analysis of impact on total cost (for workers and employers) of employing formal workers at different income deciles (OECD/CIAT/IDB, 2016).

### **The political economy to raise public resources for development**

LAC countries have attempted several times to improve their tax systems, but the political economy of reforms makes it difficult to approve and implement proposed changes. Previous experiences in the region show policy makers attempting tax reforms particularly disturbed by different capture mechanisms, including financing campaigns and lobbying. Media campaigns and the “revolving door” of high-level officials between public and private jobs have been common during periods of fiscal reforms in the region (OXFAM, 2018). Granting tax expenditures to corporates, preferential rates on CIT or PIT, as well as tax evasion and avoidance mechanisms to the private sector undermines the effectiveness of tax reforms. These aspects contribute to rent-seeking activities, diminish competitiveness and contribute to inequalities in the region, items directly linked to the productivity and social vulnerability traps.

To achieve necessary comprehensive tax reforms, the policy making process should consider communication strategies alongside improvements in the quality of spending. First, governments should communicate clearly to their citizens the benefits of proposed reforms to tackle development traps and improve well-being. Second, they should complement such reforms with more effective, efficient and transparent public spending. If taken hand-in-hand, such actions can improve citizen perceptions of comprehensive fiscal reforms and help build political support.

The sequencing of different reforms could jeopardise overall tax reform. In recent decades, scholars have studied whether political leaders should push as many reforms as possible at once (i.e. big bang approach) or introduce them one after the other (i.e. unbundling strategy) (OECD, 2010; Dayton-Johnson, Londoño and Nieto Parra, 2011). There are arguments for “bundling” reforms into a comprehensive package to build fiscal legitimacy in the region. Bundling reduces political constraints, facilitates political support for fundamental reforms, and addresses distributional issues easier (OECD, 2010). This is because structural reforms to improve citizens’ well-being may gain larger support from the population, and gains from one reform can more than compensate for losses by others. Thus, reforms should be implemented simultaneously and swiftly to avoid costly inefficiencies.

### **Private domestic resources for development: The role of financial markets**

Well-developed and well-functioning financial markets are fundamental to promote sustainable and inclusive growth and therefore advance in the different dimensions of development. Access to finance, through different modalities, such as the banking system, fixed income and stock markets, is key to closing development traps. Strong

financial systems contribute to a country's economic development and technological innovation (King and Levine, 1993; Jayaratne and Strahan, 1996; Rajan and Zingales, 1998; Levine, 2018, 2005). Overall, the development of financial markets seems a policy priority for most countries in the region (Izquierdo et al., 2016; Melguizo et al., 2017).

While well-regulated and supervised banking systems in the region are fundamental to guarantee financial stability, further efforts are needed to increase financial inclusion. Thanks to adoption of macro-prudential regulation and improvements in the supervision of financial markets in most countries in the region, the banking system is more solvent than at the end of the 1990s. This has contributed to the resilience of local financial markets to the 2008 global financial crisis, in particular compared to previous external shocks. However, even with solvent banks, the region's financial system could contribute more to sustainable development. High capital adequacy ratios in the region are associated with low loan-to-GDP ratios, suggesting sub-optimal levels of financial intermediation. Most countries in the region have adopted capital adequacy regulations (following Basel II standards). Solvency ratios are also well above those required by their supervisors. However, financial depth remains poor.

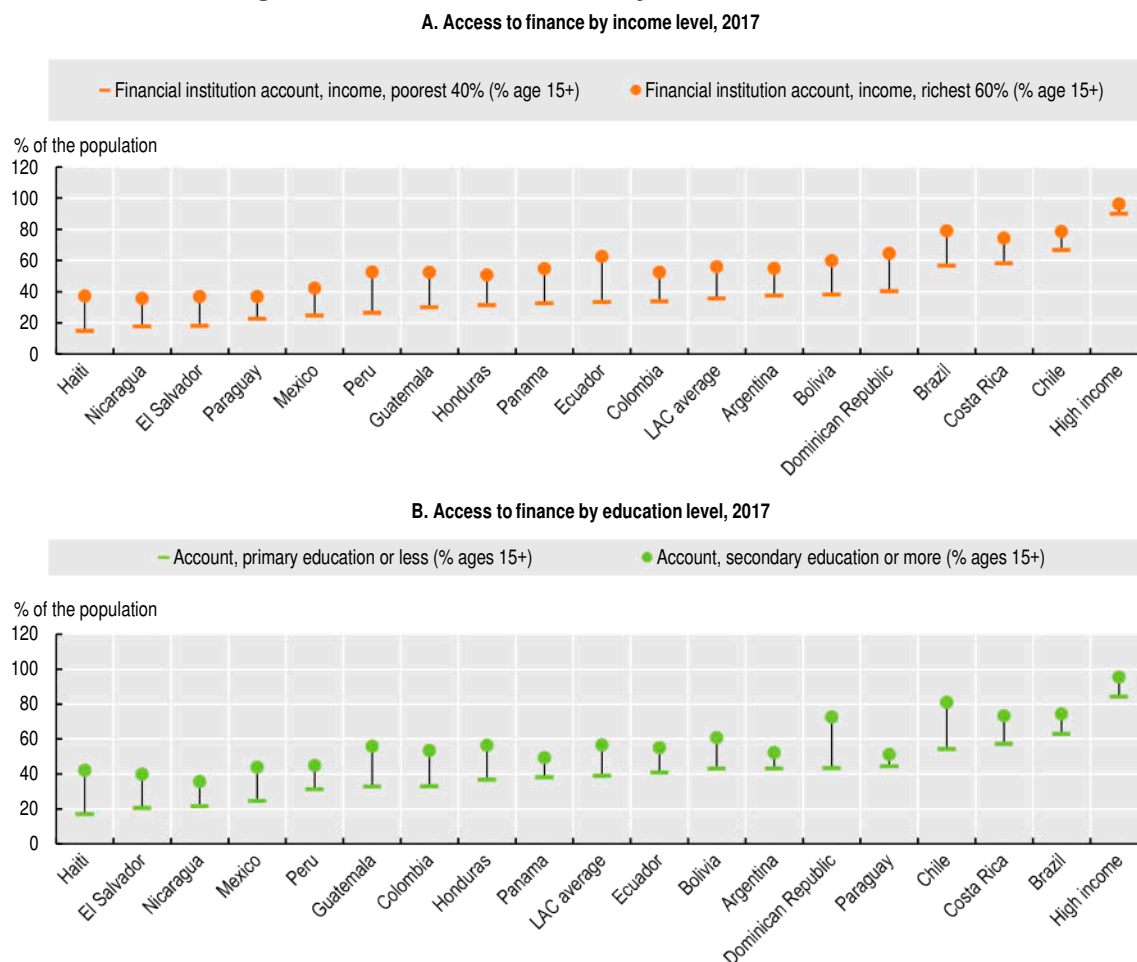
While financial depth has improved in the 21st century, credit provided to the private sector remains low. Between 2000-17, domestic credit provided to the private sector as a percentage of GDP increased from 25.2% to 49.2%. However, it remains around 95 percentage points below the OECD average (World Bank, 2018a). At the same time, greater access to the banking system should be treated cautiously. Financial deepening may increase macroeconomic volatility (Minsky, 1977; Kindleberger, 1978). Furthermore, the correlation between financial access and economic growth becomes negative when credit to the private sector is close to 100% of GDP (Arcand et al., 2015; Cavallo, Eichengreen & Panizza, 2018). Still, with the exception of Chile, current levels of financial access remain well below 100% of GDP.

Further financial inclusion remains a key challenge in the region. In 2017, only 54% of the population aged 15 and above had access to an account in a financial institution compared to more than 94% at the OECD (World Bank, 2018b). Despite improvements in the past years, financial inclusion gaps by income and education levels are high in Latin America compared to OECD member countries. This is particularly the case of Dominican Republic, Ecuador and Peru regarding income levels, and of Chile, Dominican Republic, Guatemala and Haiti regarding education levels (Figure 4.7). Finally, more than 27% of LAC manufacturing firms report access to finance as a major constraint for their operations. In countries such as Brazil, Costa Rica, Honduras and Jamaica, this ratio exceeds 40%.<sup>1</sup>


Capital markets are a key element to ensure finance for firms, in particular for medium and large firms. In light of experiences in the OECD, higher liquidity in capital markets is fundamental to heighten sustainability of income status in the region (Melguizo et al., 2017). Capital markets can be seen as an alternative for external finance for large and medium firms as funding through equity may be costly for younger and smaller firms (Agénor and Canuto, 2017). The use of capital markets by these firms could avoid crowding out effects as it will allow the banking sector to focus on micro and small enterprises. To exploit capital markets for private entrepreneurship and innovation, crowding out effects of the public debt market should be avoided. In the context of limited savings rates, relatively high levels of public debt should affect the total value of private assets in capital markets. This is relevant in some countries in the region such as Brazil, Colombia and Peru.

Market capitalisation in Latin America is below that of the OECD, but capital markets particularly need to improve in terms of quality and inclusion. On average, market capitalisation in the region is around 42% of GDP, more than 84 percentage points below the OECD average of 127% of GDP. The LAC average hides strong disparities. Economies such as Chile surpass 100% of GDP and economies such as Argentina and Panama are below 25% of GDP.

Figure 4.7. Financial inclusion by income and education levels

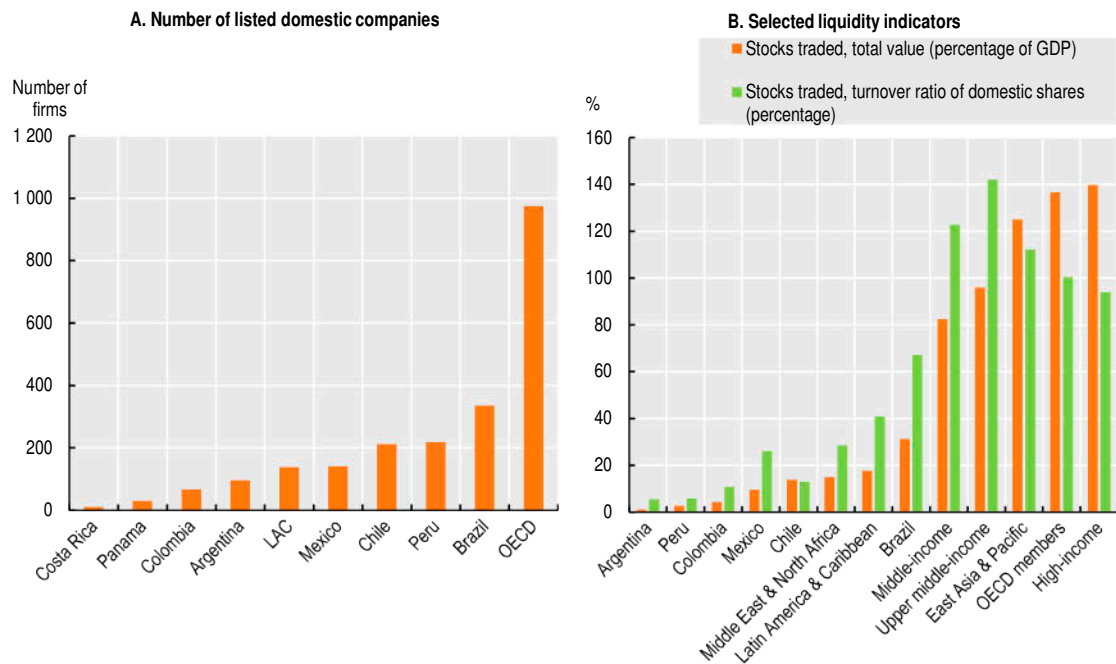


Source: World Bank (2018b).


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Capital markets in Latin America should be more inclusive as the number of participating companies is relatively low. The number of issuers can be a relatively good measure of the inclusiveness of capital markets. In Latin America, on average, about 138 companies per country participate in capital markets with wide variations in the region. This participation is considerably low if compared to the OECD average of 974 (Figure 4.8, Panel A). Similarly, there is still space to improve the quality of capital markets in terms of liquidity levels, which remain low in the region. This indicator was signalled as a key policy area to overcome the productivity trap (Figure 4.8, Panel B; Melguizo et al., 2017; Arellano et al., 2018).

Figure 4.8. Capital markets in Latin America compared to OECD countries, 2017



Note: Panel B: The value of stocks traded is the total number of shares traded multiplied by their respective matching prices. Figures are single counted (only one side of the transaction is considered). Companies admitted to listing and admitted to trading are included in the data. Data are end-of-year values. Turnover ratio is the value of domestic shares traded divided by their market capitalisation.

Source: World Bank (2018b), World Development Indicators (WDI) and Global Financial Development Databases. StatLink  <https://doi.org/10.1787/888933937071>

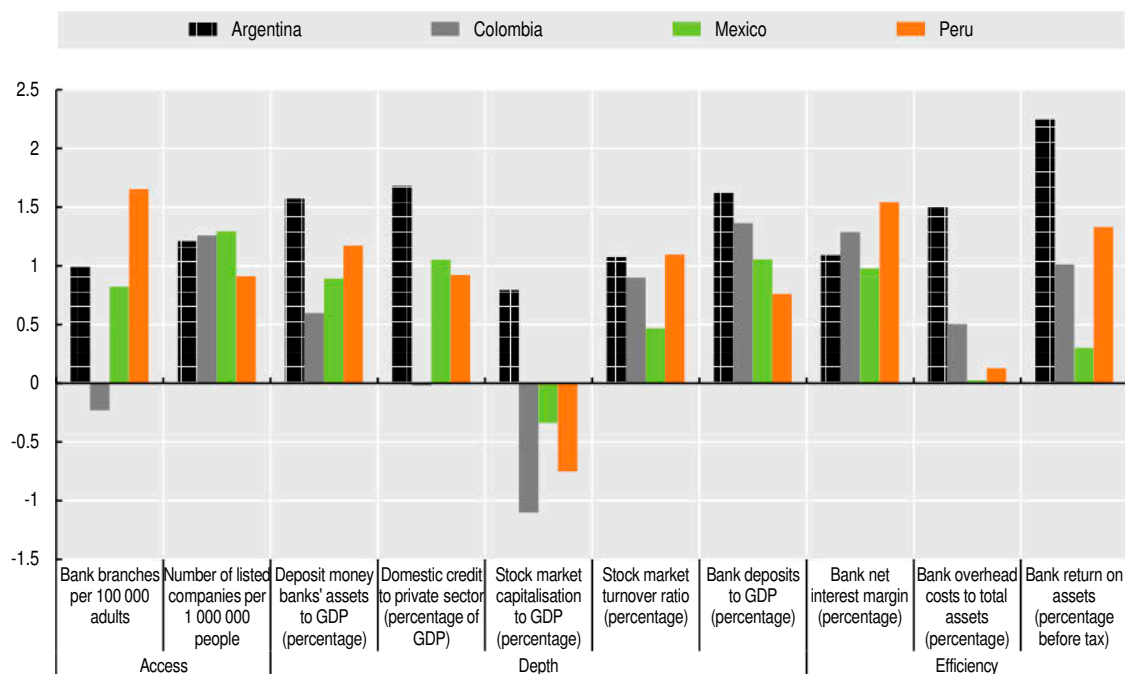
Although policy priorities differ across countries in the region to improve financial development, some common challenges remain. For example, based on experiences of Asian and OECD member countries, further inclusive access, depth and efficiency remain a concern for banking systems in Argentina, Colombia, Mexico and Peru. There are some exceptions such as access to bank branches in Colombia. Capital markets also need strengthening. Stock market capitalisation to GDP is relatively high compared to other countries (apart from Argentina). However, inclusive access (number of listed companies) and further depth in terms of liquidity in these markets (stock market turnover) is needed (Figure 4.9).

### Technology disruption and new spaces for financing development

The development of financial technologies (Fintech) brings new opportunities to increase financial depth and inclusion. Fintech consists of applying technology to improve financial activities (Schueffel, 2017). It implies the provision of financial services as an end-to-end online process through development of new applications, processes, products or business models. This makes it possible to make financial services more accessible to more households at lower cost and at a faster rate. These services include national and international electronic payments, loans through collective financing, financial advice, enterprise financial management and insurance. Fintech is already driving change in the financial sector as the boundaries between different types of service providers are blurring; entry barriers are changing and payment services improving.


Figure 4.9. Policy gaps to financial development in selected LAC countries

Standard deviation, five-year comparison before passing from middle to high income on a sustainable basis.



Note: Gaps are standardised. If a gap is positive, LAC economies must undertake improvements to move on a sustainable basis from middle income to high income.

Source: Arellano et al. (2018).

StatLink  <https://doi.org/10.1787/888933937090>

Multiple forces are driving the growth of Fintech. First, access to credit through traditional services, especially for small and medium-sized enterprises (SMEs), used to be costly. Fintech can help reduce related compliance costs. In addition, high penetration of mobile services and devices promote financial inclusion and digital payments characterised by transaction speed, low cost and high security. Meanwhile, benefits for loans are time savings, flexibility and less bureaucracy.

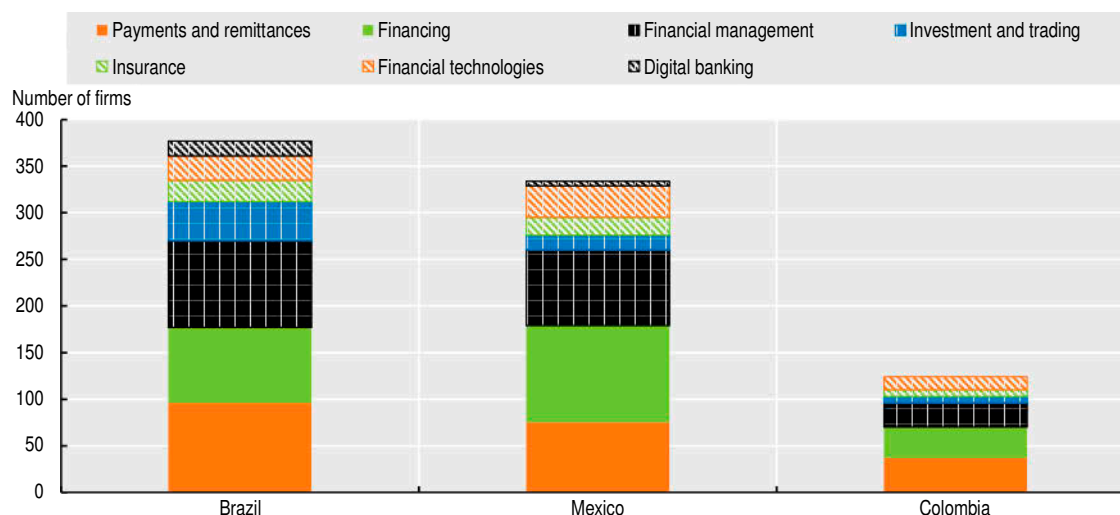
Fintech advances globally and Latin America is not far behind. Global Fintech transaction value was USD 3 590.6 billion in 2017, of which 80% corresponded to digital payments. Furthermore, according to the Fintech Adoption Index 2017, two of the ten countries with the highest rate of Fintech adoption by their population are from Latin America. More than 35% of populations in Brazil and Mexico were digitally active consumers using Fintech services. However, this result remains relatively low compared to China (69%), India (52%) or the United Kingdom (42%) (EY, 2016). Brazil offers the biggest ecosystem in the region for Fintech with 377 companies in 2017, followed by Mexico (more than 330 Fintech companies) and Colombia (more than 120 companies). The three LAC countries share the same main Fintech segments: payments and remittances, lending and enterprise financial management (Figure 4.10).

Fintech needs more investment in infrastructure and proper regulatory models to continue developing and providing services. The regulatory model must be adjusted to balance efficiency with stability. Given the transactional nature of these technologies, it is essential to work in a framework of international co-operation (IMF, 2017). In the case



of infrastructure, access to a simple mobile phone or the Internet can potentially open access to mobile money accounts and other financial services. But digital technology alone is not enough to increase financial inclusion. A well-developed payments system (public and private), good physical infrastructure, appropriate financial regulations and consumer protection are all essential for people to benefit from the potential of Fintech. Solutions also need to be tailored to the users, individuals or small businesses operating predominantly in the informal economy (World Bank, 2018b).

Figure 4.10. Numbers of Fintech start-ups per segment (to August 2017)



Source: ECLAC based on Finnovista (2018).  
StatLink  <https://doi.org/10.1787/888933936957>

### National development banks, a complement to financial markets

National Development Banks (NDBs) play a crucial role in financing for development as a complement to traditional private banking. Private financial markets are essential to help drive development, but can generate inefficiencies. NDBs can correct these inefficiencies in several ways. First, NDBs help counteract the pro-cyclical behaviour of private financing. Second, they help promote innovation and structural transformation, a key challenge in LAC. Third, they can enhance financial inclusion by providing financial services to SMEs. They are also essential in the financing of strategic infrastructure investment and supporting provision of public goods (Griffith-Jones and Ocampo, 2018).

Since 2000, NDBs have become increasingly relevant in the Latin American financial system. Between 2000 and 2011, net loans grew at a rate of 18% per year to reach close to USD 750 billion in 2011, more than three times the totals of 2001 (USD 192 billion). In Costa Rica, Uruguay and to a lesser extent Argentina, Brazil and Dominican Republic, this sector plays an important role in the total credit of the financial system (ECLAC, 2018b). In 2012, the private sector in Latin America received 22% of its total credit from NDBs.

NDBs in the region have recently played a central role in the financing of micro-enterprises and SMEs (MSMEs). NDBs in LAC provide about 59% of their loans to MSMEs. The access of MSMEs to credit is affected by information asymmetries and high financial costs, as well as characteristics of the Latin American financial system noted earlier (ECLAC, 2018b).

NDBs play an important role in promoting innovation for financing, both directly and indirectly. Regional and sub-regional development banks complement their national

counterparts thanks to common objectives and instruments. However, there is also room for developing greater synergies with the private banking sector that could lead to mutually beneficial innovations. New instruments can arise and could contribute, for instance, to the inclusion of SMEs and to strengthening complementarity between public and private financial intermediaries (ECLAC, 2018b).

There is no “one size fits all” model for development banking. In Latin America, the approximately 100 financial development institutions are diverse in terms of mandates, modalities, functions and organisation (Box 4.2). Mexico, for example, has six main development banks specialised in different areas, including infrastructure, international trade, housing and MSMEs. In this sense, the structure of development banking is segmented without explicit institutional co-ordination, which can duplicate functions and limit their scope and impact of development banking. Conversely, in Brazil, a single large development bank, the BNDES, finances a wide range of activities (Box 4.2) (ECLAC, 2018b).

#### Box 4.2. Selected national development banks in Latin America

Brazil’s National Economic and Social Development Bank (BNDES). Founded in 1952, the BNDES has had a central role in promoting transformational investments in different phases of the country’s socio-economic development. Low public and private investment levels have led to a sizable overall infrastructure gap in Brazil. From 2002-15, the bank offered more support for key infrastructure and logistics projects, and its lending level increased exponentially. The BNDES could, and should, play a critical role in developing infrastructure and logistics for investment financing. It can do this through fostering project development capacities, and financing, leveraging and crowding-in private resources for the sector.

Mexico’s Nacional Financiera (NAFINSA). NAFINSA, one of Mexico’s NDBs, contributes to economic development through facilitating access to financial resources to MSMEs and priority investment projects. It also provides services to finance business development, contributes to the formation of financial markets, and acts as trustee and financial agent of the federal government. Based on credit directly granted as a first-tier or second-tier financial intermediary, NAFINSA is second in importance after Banco Nacional de Obras (BANOBRA). NAFINSA’s share in the aggregate flow of credit to the private sector is less than 4% of the total. All NDBs represent close to 16% of the overall credit to the private sector.

Chile’s Corporación de Fomento de la Producción or Production Development Corporation (CORFO). In 2015, CORFO had total assets of USD 6 272 million. This represented 2.6% of the country’s GDP, which was relatively small compared to other NDBs in the region. CORFO’s main financial support to the private sector in recent years has been through loan guarantees to financial institutions rather than loans themselves. In terms of activity, CORFO has three focal areas: productive diversification, support to innovation and entrepreneurship, and foreign and national investment promotion. In recent years, CORFO has developed several innovative instruments. These include the Start-Up Chile programme, which has received international recognition and been emulated by other Latin American countries.

Colombia’s system of NDBs. Colombia’s NDBs constitute a system of multiple and specialised institutions, including FINAGRO, BANCOLDEX, FINDETER and FDN. These banks have been active in infrastructure development (and associated long-term lending), financial inclusion and entrepreneurial growth. Except for FDN, which has minority strategic partners who chair the board and have control over critical decisions, the other institutions are controlled by the national government (though with minority private ownership in the case of FINAGRO).

Source: Based on Griffith-Jones and Ocampo (2018).

International experiences on development banks are useful for the region. For instance, the role of the European Investment Bank and other European national banks, such as the Banque Publique d'Investissement (BPI) in France and KfW in Germany, provide insights in terms of lending and advising activities to promote entrepreneurship, local development and innovation in the region.

### **The role of public-private partnerships to finance development**

Public-private partnerships can be another source of financing for development and help the state finance the provision of public goods. Addressing traditional social gaps and emerging development challenges increasingly means that public and private actors must seek greater efficiency, quality and sustainability in the delivery of public goods and services.

In the past decade, private investment in infrastructure over GDP has remained stable and below 1.5% of GDP in Latin America almost every year (Infralatam, 2018). Public-private partnerships could be a much-needed tool to promote more effective, long-term investment in infrastructure.

Yet, public-private partnership arrangements are not without risk: some transport projects in LAC with private and public partners have been inefficient, increasing total costs. Flaws in contract design for concession contracts have caused excessive costs in Latin America (Bitran, Nieto-Parra and Robledo, 2013). Over the past 40 years, deficient planning, reduced access to resources, lack of community benefits and lack of adequate consultation were the most prominent drivers of conflict in public-private partnerships projects within the region (Watkins et al., 2017).

Using public-private partnerships to increase fiscal space can end up costing future governments. Several criteria determine whether a government should opt for a public-private partnership or another modality to finance infrastructure projects. These include the availability of risk management expertise among the partners for the specific steps of an infrastructure project.

Concessions should be chosen based on value-for-money. Cost-benefit analyses identify which infrastructure projects help determine the most appropriate mode of financing. The OECD 2012 Council Recommendation on PPPs provides guidelines as to when concessions are worth pursuing and addresses their budgetary consequences (OECD, 2012).

Some countries in the region have improved regulatory and institutional frameworks for public-private partnerships. For instance, in the past five years, Colombia, Honduras and Peru have achieved more effective private participation in infrastructure through enhanced regulations (OECD/CAF/ECLAC, 2018).

Exploiting the benefits of concessions requires strong capacity for evaluating, tendering and managing contracts. Following a social feasibility analysis, value-for-money assessments can be used to decide whether a concession contract would be more appropriate than publicly funded work. Additionally, mechanisms are needed to limit the possibility of projects running behind schedule or over budget. Most countries in the region have room to improve in that area.

Finally, better fiscal-accounting procedures in the region could improve selection of contractors. This would prevent use of public-private partnerships solely to preserve fiscal space.

## Conclusions

This chapter stressed the need to continue enhancing domestic capacities to overcome development traps. NDPs are a key starting point to prioritise policies and adopt a well-organised and comprehensive approach to move from vicious circles to virtuous circles of development. The design and implementation of these plans presuppose that country strategies should go beyond GDP and become the basis of the development agenda. Such an agenda should consider the importance of global public goods, as well as the international context, where interlinkages with domestic challenges have been increasingly important.

Although specific plans vary across countries, they have common targets and challenges in design and implementation. Most plans focus on key issues to tackle the institutional trap, followed by measures to address the productivity and social vulnerability traps. In addition, most countries have articulated their NDPs in light of the Agenda 2030. Main constraints against achievement of the plans include lack of technical capacity for design, insufficient continuity in implementation and disconnection between design and budget.

Successful implementation of NDPs depends on spending “more and better” in several policy areas that affect development traps. The impact of the rising middle class, along with new challenges, requires increasing effectiveness of expenditures. To achieve the SDGs and promote further sustainable development, governments need to invest more resources through NDPs.

Navigating the political economy of NDPs is as important as defining their priorities. Adoption and implementation of these plans have been affected by the policy-making process. In some cases, the involvement of several actors has undermined implementation. With some exceptions, business groups have influenced the policy and direction of the NDPs. The region needs to continue increasing transparency and implementing measures to avoid capture mechanisms.

Domestic financing for development is fundamental for implementation of NDPs. Some key areas of action include improved a taxation structure, further inclusion in financial markets, an active role for NDBs and well-regulated public-private partnerships. Regarding public resources for development, recent experiences stressed the importance of considering citizen demands. Government also needs to define the sequence of policy changes needed to navigate the political economy of tax reforms more effectively. This would require better communication and interaction with the expenditure side.

Political will is needed to ensure that the design, adoption and implementation of NDPs are strictly linked to effectiveness of public spending and resources of financing for development. To enhance sustainable development, well co-ordinated work with international co-operation as a facilitator in the region is fundamental (Chapter 5).

## Annex 4.A1. National Development Plans in Latin America covered in the analysis

As many as 18 Latin American countries have at least one national instrument for development. Cuba and Uruguay are formulating a National Development Plan or equivalent with a long-term vision (see Chapter 6 for Caribbean small states).

Country	National Development Plan or equivalent	Authority in charge of planning
Argentina	Objetivos de Gobierno de Argentina 2015-2019 [OBJECTIVES OF THE GOVERNMENT OF ARGENTINA 2015-2019]	Ministerio del Interior, Obras Públicas y Vivienda [MINISTRY OF THE INTERIOR, PUBLIC WORKS AND HOUSING]
Bolivia	Agenda Patriótica 2025 [PATRIOTIC AGENDA 2025] Plan de Desarrollo General Económico y Social para el Vivir Bien [PLAN FOR GENERAL ECONOMIC AND SOCIAL DEVELOPMENT AND WELL-BEING] Plan de Desarrollo Económico y Social en el marco del Desarrollo Integral para Vivir Bien 2016-2020 [PLAN FOR ECONOMIC AND SOCIAL DEVELOPMENT WITHIN THE FRAMEWORK OF THE GENERAL DEVELOPMENT FOR WELL-BEING 2016-2020]	Ministerio de Planificación del Desarrollo (MPD) [MINISTRY OF PLANNING AND DEVELOPMENT]
Brazil	Plan Plurianual 2016-2019 [PLURIANNUAL PLAN 2016-2019]	Ministério do Planejamento, Desenvolvimento e Gestão [MINISTRY OF PLANNING, DEVELOPMENT AND MANAGEMENT]
Chile	Programa de Gobierno 2014-2018 [GOVERNMENT PLAN 2014-2018]	Presidencia de la República [PRESIDENCY OF THE REPUBLIC]
Colombia	Plan Nacional de Desarrollo 2014 - 2018 "Todos por un nuevo país" [NATIONAL DEVELOPMENT PLAN 2014-2018 "ALL FOR A NEW COUNTRY"]	Departamento Nacional de Planeación (DNP) [NATIONAL PLANNING DEPARTMENT]
Costa Rica	Plan Nacional de Desarrollo 2015-2018 "Alberto Cañas Escalante" [NATIONAL DEVELOPMENT PLAN 2015-2018 "Alberto Cañas Escalante"]	Ministerio de Planificación y Política Económica (MIDEPLAN) [MINISTRY OF PLANNING AND ECONOMIC POLICY]
Dominican Republic	Estrategia Nacional de Desarrollo 2010-2030. "Un viaje de transformación hacia un país mejor" [NATIONAL DEVELOPMENT STRATEGY 2010-2030. "A TRANSFORMATIONAL PATH TOWARDS A BETTER COUNTRY"]	Ministerio de Economía, Planificación y Desarrollo (MEPyD) [MINISTRY OF ECONOMY, PLANNING AND DEVELOPMENT]
Ecuador	Plan Nacional para el Buen Vivir 2017-2021 [NATIONAL PLAN FOR WELL-BEING 2017-2021]	Secretaría Nacional de Planificación y Desarrollo (SENPLADES) [NATIONAL SECRETARIAT FOR PLANNING AND DEVELOPMENT]
El Salvador	Plan Quinquenal de Desarrollo 2014-2019 "El Salvador productivo, educado y seguro". [FIVE-YEAR DEVELOPMENT PLAN 2014-2019 "EL SALVADOR PRODUCTIVE, EDUCATED AND SAFE"]	Secretaría Técnica y de Planificación (SETEPLAN) [TECHNICAL SECRETARIAT FOR PLANNING]
Guatemala	Plan Nacional de Desarrollo: K'atun Nuestra Guatemala 2032 [NATIONAL DEVELOPMENT PLAN: K'ATUN NUESTRA GUATEMALA 2032]	Secretaría de Planificación y Programación de la Presidencia (SEGEPLÁN) [SECRETARIAT FOR PLANNING AND PROGRAMMING OF THE PRESIDENCY]
Honduras	Visión de País 2010-2038 [COUNTRY VISION 2010-2038] Plan de Nación 2010-2022 [NATION PLAN 2010-2022]	Secretaría de Coordinación General de Gobierno [SECRETARIAT FOR GENERAL GOVERNMENT CO-ORDINATION]
Mexico	Plan Nacional de Desarrollo 2013-2018 [NATIONAL DEVELOPMENT PLAN 2013-2018]	Presidencia de los Estados Unidos Mexicanos [PRESIDENCY OF THE UNITED STATES OF MEXICO]
Nicaragua	Plan Nacional de Desarrollo Humano 2012-2016 "A seguir transformando Nicaragua" [NATIONAL PLAN FOR HUMAN DEVELOPMENT 2012-2016 "FOLLOWING THROUGH ON THE TRANSFORMATION OF NICARAGUA"]	Consejo Nacional de Planificación Económica y Social (CONPES) [NATIONAL COUNCIL FOR ECONOMIC AND SOCIAL PLANNING]
Panama	Plan Estratégico Nacional con Visión de Estado Panamá 2030 [NATIONAL STRATEGIC PLAN WITH VISION OF THE STATE OF PANAMA 2030] Plan Estratégico de Gobierno 2015-2019 [STRATEGIC PLAN OF THE GOVERNMENT 2015-2019]	Ministerio de Economía y Finanzas (MEF) [MINISTRY OF ECONOMY AND FINANCE]
Paraguay	Plan Nacional de Desarrollo: Paraguay 2030 [NATIONAL DEVELOPMENT PLAN: PARAGUAY 2030]	Secretaría Técnica de Planificación del Desarrollo Económico y Social (STP) [TECHNICAL SECRETARIAT FOR ECONOMIC AND SOCIAL DEVELOPMENT PLANNING]
Peru	Plan Bicentenario: El Perú hacia el 2021 [BICENTENARY PLAN: PERU TOWARDS 2021]	Centro Nacional de Planeamiento Estratégico (CEPLAN) [NATIONAL CENTRE FOR STRATEGIC PLANNING]

## Note

1. Regional average is computed by taking a simple average of country-level point estimates. For each economy, only the latest available year of enterprise survey data is used in this computation. Only surveys, posted during the years 2010-17 are used to compute regional average. Based on Enterprise Surveys (<http://www.enterprisesurveys.org>), World Bank.

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