OVERVIEW

Latin American Economic Outlook 2012

Transforming the State for Development

ECLAC

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The Economic Commission for Latin America and the Caribbean

ECLAC is one of the five regional commissions of the United Nations. ECLAC was founded in 1948 for the purpose of contributing to the economic development of Latin America and the Caribbean, coordinating actions to promote that development and reinforcing economic ties among the region's countries and with other nations of the world.

Over the years, the institution's in-depth analysis of the region has taken the form of two main lines of action: economic and social research and the provision of technical cooperation to Governments. The Commission's ongoing concern for growth, technical progress, social justice and democracy has characterized the integral approach towards development that now forms part of the legacy of its rich intellectual tradition.

The 33 countries of Latin America and the Caribbean are member States of ECLAC, together with the United States, Canada, and several European and Asian countries that have historical, economic or cultural ties with the region. The Commission thus has a total of 44 member States. In addition, nine non-independent Caribbean territories hold the status of associate members.

Foreword

The current international and national contexts of Latin America and the Caribbean open a window of opportunity for countries in the region to design long-term development strategies. In addition to the gradual consolidation and strengthening of its democratic systems, most of the region has resisted the economic and financial crisis well thanks to responsible macroeconomic management and structural reform over the last years.

The state can and must play a fundamental role in building on these advantages and in confronting the many challenges that still remain, in particular with regard to improving the quality of life and reducing poverty and inequality.This can be achieved by: creating quality jobs; consolidating fiscal systems that are solid, transparent and fair; investing in education and training; increasing the efficiency of infrastructure investment; and supporting innovation and productive development.

This publication is the product of a joint effort by the Development Centre of the Organisation for Economic Cooperation and Development (OECD) and the Economic Commission for Latin America and the Caribbean (ECLAC), undertaken in order to analyse the role of the State in the economic growth and development of Latin American and Caribbean countries. We ask: What should be the main elements of the reform of the State in Latin America and the Caribbean? What lessons can be drawn from reform efforts in the region and beyond?

The main message of our work is that the social policies of the last years alone are not enough to create more equitable and inclusive societies. The State must strengthen the quality and effectiveness of fiscal and monetary policy, as well as actively promote education, investment and productive development.

The Latin American Economic Outlook 2012 tackles these questions in light of best practices in public policy, within Latin America the Caribbean and outside the region. We hope that these insights will contribute to the the efforts of Heads of State and Government at the XXI Ibero-American Summit, working toward strengthened capacity of States to promote economic development for better opportunities and a better quality of life for the region's citizens.

Alicia Bárcena Iglesias
Executive Secretary
ECLAC

Angel Gurría
Secretary General
OECD

Overview

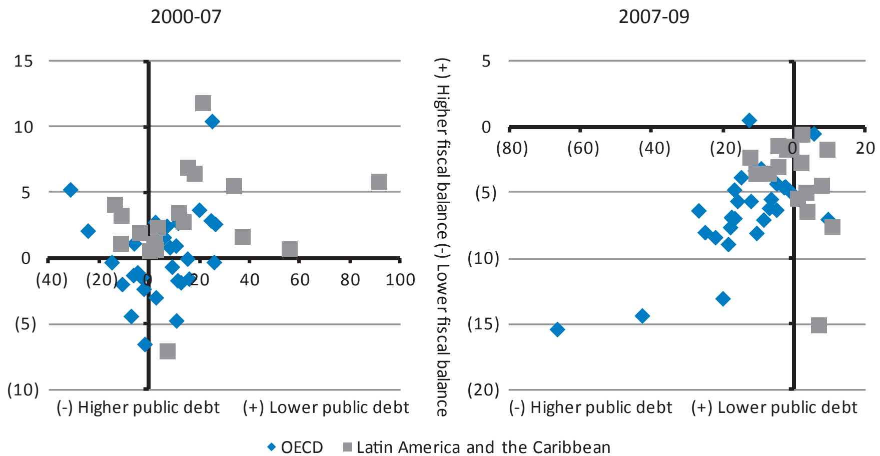
Latin America's solid economic performance since 2003 has created the possibility for transforming the state, enabling the adoption of ambitious public policies that lock in the prospect of long-term development and mitigate short-term risks. Despite important differences in current economic conditions within the region (with South America outperforming Central America, Mexico and the Caribbean) strong external demand (especially from emerging economies like China), in combination with vigorous internal demand, resulted in an average annual GDP growth rate of almost 5% during 2003-08.[1] Part of this performance was also due to good macroeconomic management that created sufficient fiscal space to manage the effects of the global financial crisis without jeopardising fiscal sustainability (Figure 1). Between 2000 and 2007, public debt in the region shrank on average by 15 percentage points of GDP, while fiscal balances moved from an overall deficit of 2.4% of GDP to a surplus of 0.4% of GDP. Macroeconomic policies and higher primary export prices strengthened macroeconomic stability and provided resources for implementing anti-poverty programmes and increasing access to basic public services. This led to less pronounced recessions and swift recoveries compared to OECD economies. While real GDP growth in the advanced economies is expected to remain sluggish,[2] Latin America is expected to grow 4.4% in 2011 and 4.1% in 2012.[3] In this context, Latin American countries have the opportunity to design and implement public policies with long-term development goals and also reduce some medium and short-term risks.

The region should strengthen its macroeconomic policy space to guard against uncertainties in the global economic outlook and volatility in international capital markets. The global economy continues to be the main source of uncertainty for Latin America and the Caribbean. Large capital inflows, due to significant interest rate differentials between the region and the developed economies, and the subsequent exchange rate and inflationary pressures were defining features of the first semester of 2011 and still deserve special attention. Fiscal problems in the euro zone could have serious repercussions in international financial markets, including emerging markets, where capital flow reversals could trigger large swings in the real exchange rate with disruptive effects on economic activity. Trade with China – which more than tripled during the 2000s – was one of the factors that facilitated the region's quick recovery. Nevertheless, today this

1 ECLAC (2010a) discusses the relative importance of both factors.
2 OECD (2011a).
3 ECLAC (2011).

makes the region more exposed to a potential growth slowdown in China, which would affect it through lower export demand and commodity prices. Both would have a strong impact on fiscal accounts in many countries of the region. As a result of significant national fiscal and monetary stimuli, several countries are currently in an expansionary phase of the business cycle, in which a countercyclical fiscal policy helps strengthen the response capacity and mitigates against the risks associated with a reversal in the business cycle. Instruments such as stabilisation funds and credible fiscal rules (sufficiently flexible to adapt to extraordinary economic circumstances) can be effective tools for rebuilding fiscal space.

Figure 1. Latin America's economies gained fiscal space, used to confront the financial crisis and reduce poverty, but they are still vulnerable to new shocks.



Source: ECLACSTAT Statistics on public finances for Latin America and the Caribbean and OECD (2011a) for the other countries.

Note: Each point represents one country. The panels include OECD countries and 19 countries from Latin America and the Caribbean.

Macroeconomic policies should also be consistent with long-term requirements linked to economic and current demographic changes. Although the main objective in the short-run is to rebuild fiscal space diminished by the policy response to the crisis, governments should at the same time address macroeconomic and structural restrictions and problems that limit the region's opportunities to achieve its development goals. In this sense, while larger inflows of foreign investment are in principle good news for the Latin American economies, they come with several challenges: greater exchange-rate volatility, "Dutch disease" (an appreciation of the national currency that harms the international competitiveness of exports, except commodities), and potentially unsustainable credit expansions. Governments should use available instruments to contain excessive volatility,

inflation and appreciation pressures on the exchange rate which are not the result of economic fundamentals. Under extraordinary circumstances, capital controls and taxes on short-term financial transactions can be an effective tool to contain currency appreciations, especially when prudential financial regulations are not sufficient to guarantee financial stability. These measures do not just reduce the volatility of economic fluctuations, but also remove obstacles to economic diversification and provide predictability to foster investment in new technologies and stability in public finances, which enable the adoption of long-term policies for more and better growth. This occurs in a context in which demographic growth and other structural changes – such as the aspirations of the incipient middle classes – mean that countries in Latin America will require more fiscal room for manoeuvre in order to provide required services.

Latin American countries should take advantage of current opportunities to remove development barriers and take a quantitative and qualitative leap ahead in the provision of public services. Despite important progress in reducing poverty during the boom – from 44% of the population in 2002 to 33% in 2008 – and to a lesser extent in decreasing inequality, there are still important gaps to be closed and challenges to be faced. In particular, the region must increase its efforts to reduce social inequalities. One in three Latin Americans (180 million people) still lives below the poverty line and 10 Latin American economies rank among the 15 most unequal economies in the world. Conditional cash transfer programmes have been successful in reducing poverty, but the lack of broader social safety nets is a severe problem for the majority of Latin America's citizens. Another key challenge is creating mechanisms and incentives for a knowledge- and innovation-based economy that would achieve higher productivity levels and a more diversified economy, in an environment where incentives and signals – like the exchange rate – often strengthen profitability and the expansion of natural resource–based sectors. Latin American countries should create the bases for development to be sustainable even when external conditions are less favourable. In this sense, governments in the region's resource-rich economies should consider using part of the windfall rents of higher commodity prices to promote diversification and competitiveness in the rest of the economy by investing in education, infrastructure and innovation. If governments do not act now, exports will continue to be concentrated in low-added-value primary products with oligopolistic markets that hinder the entry of new firms and do not facilitate income redistribution and social inclusion. In such a situation, more households would be vulnerable to adverse shocks like illness or natural disasters, including those that are not living in poverty (e.g. the nascent middle classes).[4] The stakes are high in the policy debate about transforming the state for development, because insufficient development results could exacerbate social conflicts and weaken institutions.

4 OECD (2010a).

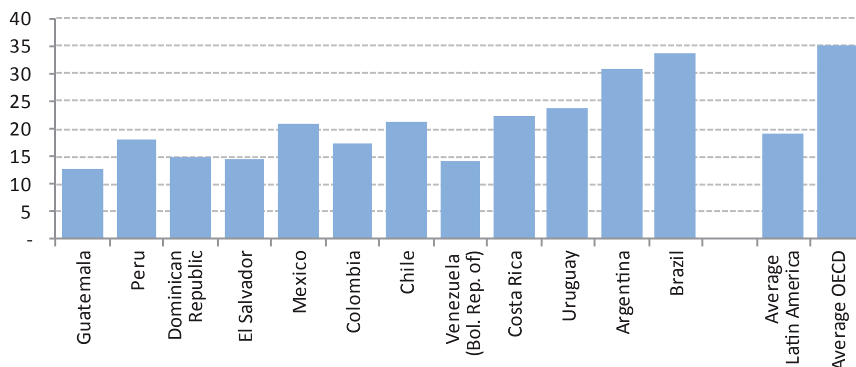
Fiscal reforms would increase the financial resources available to the State

Fiscal reforms to reduce the enormous gap between the requirements and the available resources are needed to build states that are able to respond to the development challenges. In the last two decades, including the recent crisis, the strength of public finances in the region has been remarkable. Debt levels have been reduced (from around 80% of GDP at the beginning of the 1990s to around 30% today) in part thanks to an increase in fiscal revenues. Furthermore, public expenditure has become more effective at promoting growth, reducing poverty and redistributing income, through increased social expenditures and public investment. In addition, budget rigidities have been reduced and fiscal space increased. However, the majority of Latin American countries have fewer resources per capita to fulfil the expectations of their citizens than developed and even many emerging economies. This is the true constraint facing countries in the region that are striving to meet the demands of their societies.

Not only is fiscal revenue in Latin America low, but tax bases tend to be narrow and are biased towards non-progressive taxes. With the exception of some countries in the Southern Cone, like Argentina, Brazil and Uruguay, which have revenues similar to the OECD average at around 30% of GDP, overall fiscal revenue in the region is low (Figure 2). In addition, personal income tax levels are lower, there are more deductions and exemptions than in other countries, and tax structures are concentrated in indirect taxes. The low fiscal revenue is due to high levels of tax fraud and avoidance, high degrees of informality and the limited capacity of the tax administration. Therefore, tax administrations' institutional capacity should be strengthened, income tax bases should be broadened, and other types of taxes should be explored. These reforms should be accompanied by efforts to raise the quality of public services and initiatives to educate citizens about fiscal matters to increase tax morale. Low levels of fiscal revenues in Latin America impede states from making the necessary investment in education, infrastructure and productive development, which together with health and social protection, are key levers to increase productivity, competitiveness and social inclusion.

Tax bases are also limited by the extensive use of tax expenditures: deductions and exemptions. Governments should consider eliminating several of these types of tax expenditure, particularly those that are most regressive and distortionary. They should also provide more information, be more transparent and carry out studies on the effects of their tax expenditure. In particular, based on technical evaluations on the effectiveness of the items of tax expenditure currently in place, governments should consider transforming those items of expenditure with redistributive and social objectives into more transparent transfers and expenditure policies. When evaluating the effectiveness of different instruments (tax expenditures versus direct subsidies) the relative institutional capacity of tax administrations in comparison to the capacity of agencies responsible for expenditure must be considered.

Figure 2. Tax revenues in Latin America are low.
(Public tax revenues as percentage of GDP, 2008)



Source: Based on data from ECLACSTAT and Revenue Statistics in Latin America, CEPAL-CIAT-OCDE.

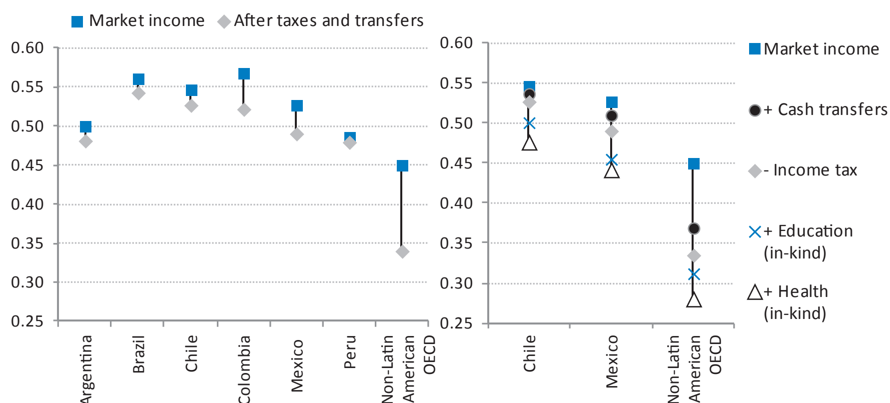
Note:

a) The statistics refer to the non-financial public sector in Argentina, Colombia, Costa Rica, El Salvador, Mexico and Venezuela (Bolivarian Rep. of); government in general in Brazil, Chile and Peru; and central government in Guatemala, Dominican Republic and Uruguay;

b) tax revenues in Mexico include a certain portion of the income from oil production.

Fiscal policy does little to reduce inequality in Latin America, due to low levels of direct personal taxes and public social expenditures, as well as inadequate targeting of expenditure. This explains the significant differences in the effectiveness of fiscal policy at reducing inequalities compared with in OECD economies (Figure 3). These differences are most significant for cash transfers, rather than for in-kind transfers such as expenditure on education and health. To revert this situation, governments must reinforce income transfer programmes for low-income households and the solidarity pillars of social protection systems, in particular the pension system, while taking care not to create incentives that would favour the informal economy or encourage people not to work. The large differences in the level of social expenditure between countries in the region (ranging from 7% of GDP in Guatemala to around 25% of GDP in Brazil) reflect major differences in the design of social protection systems, especially in pensions and healthcare, as well as in the proportion of the population covered by health, education and unemployment benefits.

Figure 3. Fiscal policy does little to reduce inequality in Latin America. Income inequality and fiscal redistributional effects of different policy instruments.
(Gini Indices)



Source: OECD (2008*a*) for non-latinamerican OECD countries, OECD (2008*b*) for Argentina, Brazil Colombia and Peru and estimations based on National Household Survey for Chile and Mexico.

Resources need to be used effectively, efficiently and transparently

Therefore, the creation of a fiscal pact that reinforces the social contract between the citizens and the state can be fundamental.[5] The success of fiscal reforms depends on there being a link between taxes and expenditure and people realising that taxes enable the provision of public services from which they can benefit. Fiscal reforms move forward when: (i) they are solidly backed by previous analyses and ex-post evaluations, which are transparent and take all relevant factors into account; (ii) they have been adapted to the country, in particular regarding transition periods needed for their implementation; (iii) there is clear leadership and support by large sectors of the population. Fiscal pacts – agreements between the relevant social, economic and political actors – can be general or focused on a particular sector such as education, employment, social protection or infrastructure, or they can be structured around a common principle like equality, public security or the fight against poverty. The legislature has a key role in building such agreements, supporting them within the budget and negotiating the reforms needed to improve the tax system.

5 ECLAC (1998) was the first to consider the need for a new agreement regarding taxes and expenditure.

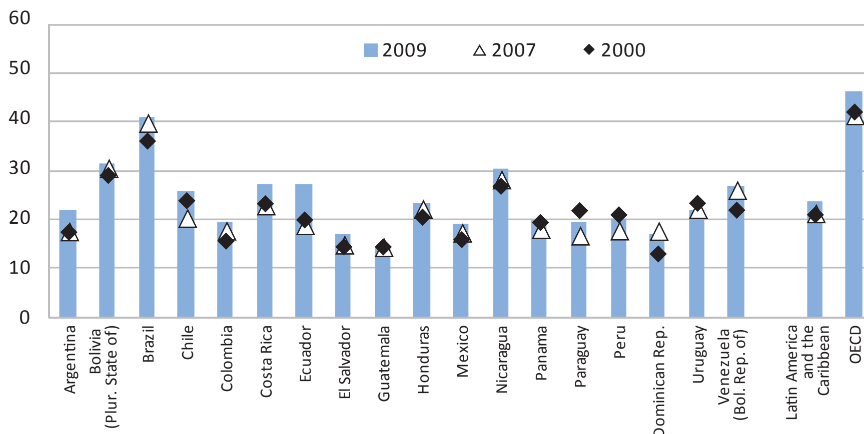
Beyond more financial resources, the state should also transform itself to respond better to the needs of its citizens and manage resources in a more effective, efficient and transparent way. The state is a fundamental actor in modern society and Latin America is not an exception. Democratic consolidation, economic growth, the development of social protection systems, urbanisation and globalisation have led to a constant expansion in the functions of the state and the resources needed to sustain them. Despite recent increases in public expenditure as a percentage of GDP – an indicator of the size of the state – in some countries of the region it is still significantly lower than in the OECD (Figure 4). Many Latin American governments do not have the necessary tools to identify development opportunities and implement policies.

States should therefore increase their management capacities and strengthen their human resources. The professionalisation of public services is one of the main challenges for reforming public sector management in Latin America. At the same time, states need effective tools for planning and coordinating policies, programmes and projects to fulfil their transformational role. Institutions such as fiscal rules and medium-term fiscal frameworks should be strengthened. More transparency and accountability should be introduced in the budgetary process. States should also introduce evaluation mechanisms for policies and programmes, as well as national public investment systems.

Efficiency and effectiveness are crucial to meeting the development challenges. Doing more with the same resources, or using fewer resources to do the same, would free up resources that could be allocated to other priorities. Improved efficiency would also help gain public support for the necessary reforms: when citizens see that the state is using its resources efficiently and that they benefit from the services it provides, the state gains legitimacy and citizens become more willing to pay taxes. The public sector can achieve greater effectiveness through the definition of planning instruments by policy makers, along with an effective coordination of policies, programmes and projects.

Finally, more transparency in public management reinforces the efficiency and effectiveness of public interventions. Policies and actions to reduce corruption should be based on greater access to information and civic participation in public policies. New technologies (e.g. the use of the Internet for e-government or the more recent development of open government) can help, but public sector institutions have to change the way they operate and adapt to fully take advantage of the potential opportunities.

Figure 4. Public expenditure is lower in Latin America than in the OECD.
(Public expenditure as percentage of GDP)



Source: Based on data from CEPALSTAT and OCDE Government at a Glance (OECD, 2011a).

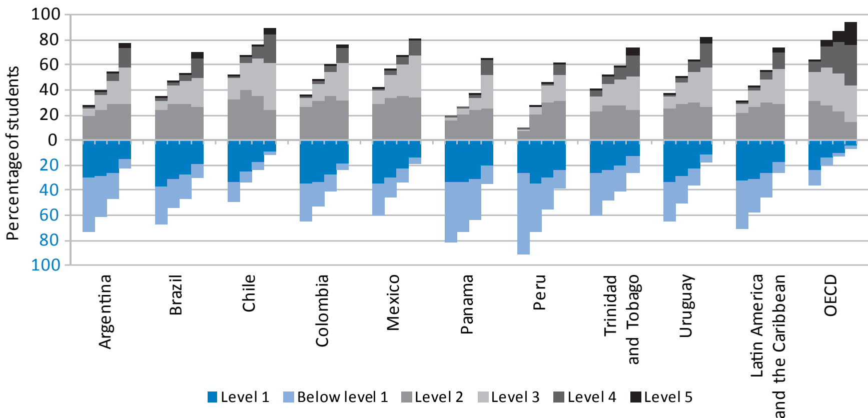
Note: The statistics refer to general government in the case of Bolivia (Plurinational State of), Brazil, Chile, Costa Rica, Nicaragua and Peru and the central government in Argentina, Colombia, Ecuador, El Salvador, Guatemala, Honduras, Mexico Panama, Paraguay, Dominican Republic, Uruguay and Venezuela (Bolivarian Rep. of).

Sustainable and inclusive growth requires involvement in education, infrastructure and innovation

Beyond improving the delivery and transparency of policies and programmes, the transformation of the state should also help identify new strategies to define and achieve its primary development objectives. Sustainable and inclusive growth can be supported by three key areas: education, infrastructure, and productive development and innovation. To overcome the structural barriers to the region's development and achieve equitable development, states must identify strategies. Governments must use more resources, greater effectiveness and greater transparency in the use of public resources and efficiency in the implementation of policies. But these measures are not sufficient: they must also identify priority areas for action and create the necessary governance structures to carry out the different programmes. Broadening the coverage and quality of the education system, increasing the density of and access to infrastructure, and increasing investment in productive development and innovation are crucial to the transformation and diversification of the region's productive structures. This will boost the technological content of the region's exports and improve its standing in global value chains. All these elements will be crucial to increase the region's productivity, generate good-quality jobs and develop more equitable economic systems.

The coverage of and spending on the region's education systems has improved consistently over the last few decades. However, the quality of education remains low and access is unequal. In primary education, countries in the region have reached levels of coverage comparable to those of OECD economies, but the coverage of secondary and tertiary education are lagging behind: 82% compared to 99% for secondary education, and 43% compared to 76% for tertiary education, respectively. While the quality of education has improved, significant gaps remain. Internationally comparable evidence on the quality of schooling, such as the OECD's PISA study, shows that Latin American students perform worse than their counterparts in OECD economies. For example, in reading tests, almost 50% of Latin American students fail to reach the minimum acceptable level; in OECD economies this figure is less than 20% on average. At the same time, differences in performance by geographic area (urban vs. rural), by gender, by type of school (public vs. private) and by socio-economic status remain high and have even increased (Figure 5). For example, in Argentina, Mexico and Panama the performance gap between urban and rural schools is more than 45 points, after correcting for socio-economic status. This means that rural students are effectively lagging more than a school year behind their urban counterparts.

Figure 5. 15-years-old Latin Americans score below their OECD peers in reading tests; socioeconomic differences are more important in explaining performance among students in Latin America.
(Distribution of test score in PISA reading tests, according to socioeconomic and cultural household background quartiles, 2009)



Source: Based on data from PISA 2009.

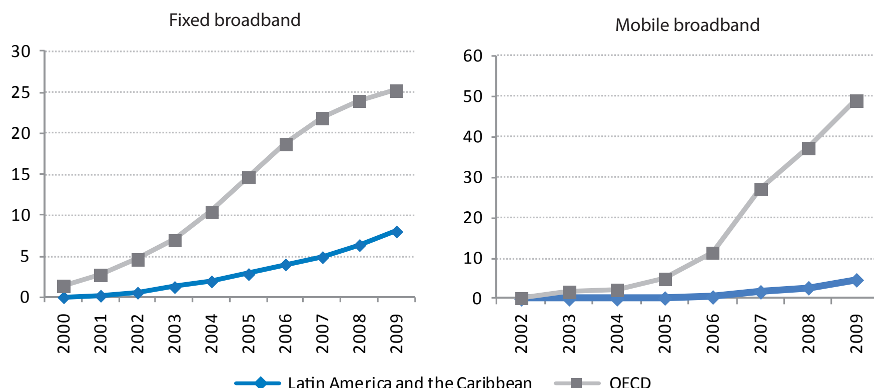
Note: The distribution by performance levels in Latin America and OECD refers to the simple mean of attainment level weighted at the national level for participating countries in PISA 2009.

There are two main trends in the management of education services: increasing decentralisation in its provision and higher private-sector provision of tertiary education. Although responsibilities have been transferred to regional, state and municipal levels, in many countries this process has not been accompanied by adequate investment in capacity-building for different levels of government, or by adequate funding. In tertiary education – which has experienced the highest increase in demand due to demographic transition – more than 50% of students are enrolled in private institutions. This explains the increase in private spending in education, which has more than doubled between 2003 and 2009 from 1% to 2% of GDP.

Lack of infrastructure is a significant bottleneck for the sustainability of growth, competitiveness and even equity in Latin America. The region has large infrastructure gaps (some of which have increased over the past years, such as broadband Internet access) when compared to the OECD economies and emerging economies in Asia and other regions of the world. These gaps can be closed through more and better investment in infrastructure. In the first semester of 2000, Latin America showed a deficit in transport infrastructure (kilometres of paved road per square kilometre) of 85% when compared with South-East Asia, and a gap of almost 60% in the energy sector (megawatts per 1 000 inhabitants). In the telecommunications sector, while there have been important advances, the gap in access to broadband Internet services has increased considerably, due to a lower rate of growth in the number of subscribers in Latin America compared to in OECD economies. The gap in access to fixed broadband between Latin American and the OECD economies rose from 1% in 2000 to 17% in 2009, and from 5% in 2005 to 44% in 2009 for mobile broadband (Figure 6).

Latin America needs an improved framework with long-term vision that can strengthen the processes of planning and managing investment in infrastructure. In the transport sector, prioritisation and project planning must maximise social returns based on an appropriate pre-feasibility process, which requires a balance between new projects and the maintenance of existing ones. Public action in the transport sector should be guided by the principle of co-modality – that is the use of one mode or an inter-modal combination for a journey or a series of journeys of persons or merchandise, maximising the efficiency of the overall journey. In the telecommunications sector, the regulatory framework needs to be adapted to accommodate convergence to common technological platforms. Regulation should be oriented towards improving the management of state-controlled resources, such as the electromagnetic spectrum, domain names and numbering.

Figure 6. The broadband gap in Latin America is large and increasing.
(Percentage of broadband subscribers in the total population)



Source: Regional Broadband Observatory (ORBA) in the ITU database.

Note: The regional average is a simple average.

Moreover, the incentives and norms that regulate private-sector participation in infrastructure investment, management and provision need to be improved. In the transport sector, it is especially important to establish and follow an appropriate selection process for deciding on private participation. Additionally, well-designed contracts minimise renegotiations of concessions, considerably reducing contingent fiscal liabilities. In Peru, Colombia and Chile, 50 out of 60 road concessions signed up to 2010 were renegotiated, generating costs of USD 7 billion. In the telecommunications sector, especially for broadband Internet access, governments must establish mechanisms and incentives to encourage investment (whether public or private) in socially desirable infrastructure to serve communities in regions which are not profitable for the private sector. For these measures to take effect, the role of the regulatory agencies and of consultation mechanisms between decision-making bodies are fundamental.

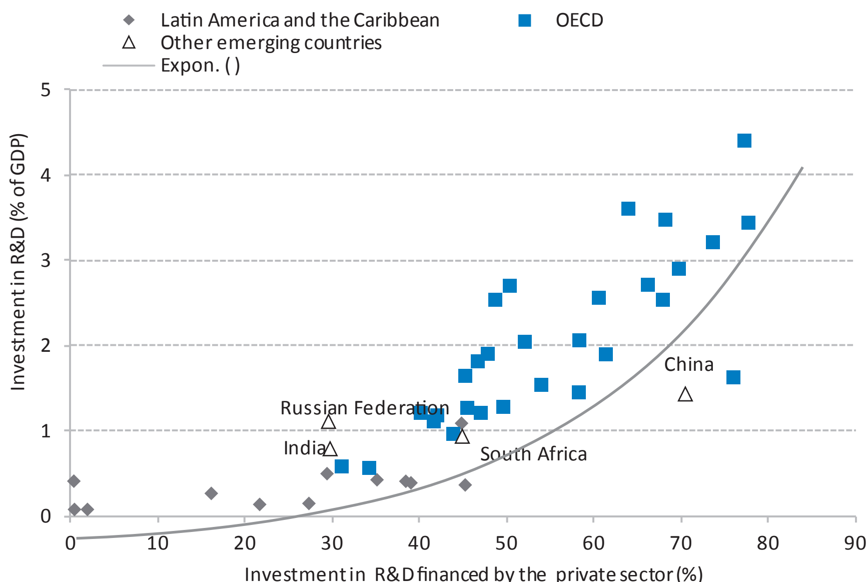
The productivity gap is a persistent problem for Latin America and the Caribbean. This reflects the limited diversification of the region's economies, their specialisation in non-technology-intensive sectors, and scant investment in research and development (R&D) and in innovation. The labour productivity gap between Latin America and the United States persists and has even increased in certain sectors. Labour productivity in technology-intensive sectors in Latin America was just 18% of the productivity in the same sectors in the United States in 1990, and 12% in 2007, reflecting little structural change in the region.[6] Natural resource–intensive sectors still make up 60% of manufacturing value-added in Latin America, whereas in the United States 60% of manufacturing

6 ECLAC (2010*b*).

value-added is concentrated in knowledge-intensive sectors. At the same time, primary goods and manufactures based on natural resources represent up to 50% of Latin America's exports. As a result, the region invests few resources in R&D; the level of investment in R&D with respect to GDP rose from 0.5% in 2004 to 0.6% in 2008, while in the OECD economies the figures were 2.2% to 2.3% for the same period. Contrary to the experience of developed countries, Latin America's private sector invests little in R&D and the scientific and technological activities of its firms are concentrated in the acquisition of machinery and equipment (Figure 7).

In the past decade, institutions responsible for designing innovation policy have been strengthened, but the region still lacks policies focused on national innovation systems and adequate financial support for implementing innovation strategies. The creation of ministries and agencies dedicated to innovation strategies illustrates the growing interest for this area in several countries. For example, Argentina created the Ministry of Science, Technology and Productive Innovation in 2007; Chile established the National Innovation Council for Competitiveness (2005) and the Governmental (ministerial) Committee for Innovation for Competitiveness (2007). Since 2008, Brazil has implemented a productive development policy with strong participation from the Brazilian Development Bank (BNDES) (this strategy was updated in August 2011). Nonetheless, it remains necessary to synchronise productive development strategy and innovation policy (for example through sectoral funds, as in Argentina, Brazil and Mexico), improve planning capacity and overcome the tendency of assigning resources based on short-term assessments, and design results-oriented policies (more exporting firms, more PhD graduates employed in the production sector, new productive processes and/or market services, etc.) rather than input-oriented policies (R&D spending, enrolment in PhD courses, etc.).

Figure 7. The challenge in Latin America: mobilise private sector R&D
(R&D Investment as percentage of GDP)



Source: Based on data from the United Nations Educational, Scientific and Cultural Organization (UNESCO), see [http://www.uis.unesco.org/pages/default.aspx] Ibero-American/Inter-American Network of Science and Technology Indicators (RICYT), see [http://ricyt.org] and Main Science and Technology Indicators (MSTI) Database of the Organization of Economic Cooperation and Development (OECD).

Note: Figures correspond to the year 2002 for Plurinational State of Bolivia; 2004 for Switzerland; 2005 for Panama and Paraguay and 2006 for Australia, China, Israel and South Africa.

Modernise public policy management systems

Education, infrastructure and productive development and innovation are three crucial areas for achieving competitiveness, economic development and social inclusion in a given economy. Each of these policy areas requires active public policies, strategic planning and more efficient and effective management by the state. The fiscal pact, designed to meet specific development goals, must be complemented by the modernisation of public policy management systems in five priority areas, bearing in mind that the region has institutional models of varying complexity and different frequencies of interaction between the relevant actors:

1. **Adopt management systems and results-oriented planning mechanisms.** Institutional capacity for the management of resources needs to be increased and multi-year planning for better resource efficiency should be adopted to facilitate investment in medium- and long-term projects. It is also important to

seek synergies with the private sector to boost the viability and implementation of national development strategies. Designing policies based on long-term vision and prioritising between the various reforms are fundamental in this effort. For example, it is important to balance the objectives of coverage of schooling (for instance, through investment in infrastructure) with the objectives of quality and inclusion (for instance, the capacity of the education system to reduce disparities between rural and urban regions) and the objectives of competitiveness (for instance, supporting the professional insertion of qualified human resources). An approach that focuses on *results* rather than on *inputs* also facilitates the evaluation of policies, making it possible to learn lessons from the implementation of those policies and consequently adjust them to make them more effective and efficient.

2. **Create incentives and mechanisms for vertical and horizontal coordination between different levels of government and between the public and private sectors.** This requires investment in strategic intelligence – specialised and trained human resources – in public administration and dialogue mechanisms to boost confidence between the public and private sectors. Likewise, state capacity for control and regulation needs to be increased. For example, the lack of coordination between different actors is the principal weakness of infrastructure policy in Latin America and undermines productivity, competitiveness and access. The main obstacles to effective coordination are the lack of institutional incentives for co-operation and the absence of appropriate institutional architecture. Incentives need to be designed that favour coordination between agencies at the same level of government, between agencies at different levels of government, and between public and private actors. The designation of responsibilities between different levels of government is also fundamental. In the area of education, for example, central governments must retain the power to set standards, design the basic curriculum and control the teaching statutes that define the employment conditions and professional development of teachers. Meanwhile, the professionalisation of teaching careers, linking it more closely to performance and better training facilities within schools, should involve school heads and various levels of public administration. In other policy areas, it is essential to develop hiring schemes that foster professionalisation, specialisation and the development of a civil career that is not connected to the political cycle and is capable of using advanced planning, monitoring and evaluation tools.

3. **Establish clear standards and regulation mechanisms that enable the implementation of the agreements reached.** A clear regulatory framework that facilitates the relationship between public and private sectors is essential for investment in both infrastructure and innovation. For example, in the telecommunications sector, the legal regimes in most of the region's countries are still oriented towards a service-based regulation, which is not in line with technological convergence. The regulation of telecommunications services must be reformed to avoid segmented measures which create asymmetries and regulatory distortions that are detrimental to the end consumer. Tertiary education needs to operate within a regulatory framework that includes clear evaluation and accreditation mechanisms which guarantee and improve standards.

4. **Invest in institutional strengthening and training for public management.** Devolving responsibilities to regions, states and municipalities must be accompanied by adequate fiscal resources and management capacities at the local level. The provision of education services and transport infrastructure requires precise linkages between different levels of government, making it essential to invest in training for sub-national public-policy managers. Likewise, while new instruments and criteria are defined for budgetary allocations, governments need to provide training to public managers and direct funds to facilitate local, national and regional co-operation.

5. **Generate information, indicators and institutions for public policy decision-making.** Information systems should be designed and created to provide tools with which to evaluate government action. Many countries have invested in units dedicated to the compilation and circulation of indicators in the fields of education and innovation. Much effort has gone into modernising computer systems in ministries and public agencies, increasing transparency and access to data, as seen in larger economies such as Argentina and Brazil and smaller ones like Costa Rica and Panama. At the same time, incentives to use this data in the evaluation and re-design of policy must be put in place. Unlike OECD economies, Latin America is still in the early stages of creating national institutions that analyse policy. In the area of innovation, Brazil is the most advanced country, where the Institute for Applied Economic Research (IPEA), affiliated to the Secretariat of Strategic Affairs of the Presidency of the Republic, as well as the Centre for Management of Strategic Studies (CGEE), affiliated to the Ministry of Science and Technology, carry out impact evaluation and feedback on public policies.

Summing up, despite the global financial crisis, the situation of Latin American economies has improved substantially in recent years. The governments of the region should take advantage of this opportunity to design and implement better public policies that take a more inclusive and sustainable long-term development path. While the main objective in the short-run is to rebuild fiscal space – diminished due to the policy response to the crisis – at the same time, governments should also address macroeconomic and structural obstacles that limit the region's chances of achieving its longer-term development goals. The most relevant objectives are to reduce inequality in income distribution, improve the provision of public services, create more opportunities and promote economic diversification. More efficient public management is crucial, as it would free up resources for additional development policies and increase public support for managing and implementing the required reforms. But efficiency alone is not enough: states also have to become more effective in achieving their objectives. This can only be accomplished by implementing a fiscal reform that raises the required resources to meet the development goals. Many governments in the region have identified three priority areas for investment, given their potential contribution to increasing competitiveness and social inclusion: education, infrastructure and innovation. In each one of them, a more efficient management and more effective strategic action by the state is needed.

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Latin American Economic Outlook 2012

TRANSFORMING THE STATE FOR DEVELOPMENT

Even in the midst of a global financial crisis, Latin American and Caribbean economies find themselves in better conditionto confront new challenges. Latin America must seize this opportunity to design and implementbetter public policies for economic and social development. The greatest of the long-term objectives of Latin American states remains development: economic growth and structural change that is rapid, sustainable and inclusive. In particular, governments must reduce inequalities in income, public-service delivery and opportunities, as well as promote the diversification of economies, often concentrated on a few primary-product exports.

Improved efficiency of public administration is crucial to address both the short-term and long-term dimensions of these challenges. The real change, however, will come if Latin American and Caribbean states carry out meaningful fiscal reforms, making them not only more efficient but also more effective. The increased effectiveness of fiscal policy holds the promise to provide resources needed to address the key challenges of economic development. Three key priority areas for investing additional resources have been highlighted by many governments in the region for their potential to raise competitiveness and social inclusion: education, infrastructure and innovation. In each of these areas, more efficient administration and more effective strategic action is needed from states.

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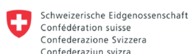

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