Chapter VI

Policies for an integrated approach to development

Structural change for equality is a long-term vision, where the role of policy is to prioritize, direct and create consensus, and where the development of efficient and democratic institutions forms a bridge between the vision and its effective implementation. It is a truly forward-looking approach intended to ensure that future generations are fully able to realize their rights and potential. No single model embodies this approach: it will take different forms in different countries, depending on specific national requirements.

The 2008-2009 crisis marked a turning point because it opened up spaces for reflection and discussion that had been unthinkable under the prevailing development model, especially with regard to acceptance of industrial policies, of orienting macroeconomic policies towards growth rather than towards nominal stability, and of rights-based pro-equality policies.

The current technology revolution is accelerating and opening up new paths for harmonizing growth with environmental sustainability, thanks to savings in materials, energy and movements of people and goods brought about by growing virtualization. Technological change can therefore be oriented to reconcile productivity gains with environmental criteria.

In demographic terms, societies in the region will age and rely increasingly on the productivity of the working generation. In the current demographic-dividend phase, where the number of children is falling while the working-age population is increasing, it is worthwhile investing in the skills of future generations. This makes it imperative to seize the opportunities and anticipate the risks of changes in the age pyramid.

These forces provide a close connection between this proposal and the younger generation. Today it is young people who are mobilized —with their greater versatility embodied by social networks and their aspirations of inclusiveness— to ensure more equal rights, timelier access to skills development and more informed advocacy of environmental sustainability.

This chapter prioritizes three key areas: industrial policy for structural change; macroeconomic policy for generating an environment conducive to growth, investment and real and nominal stability; and social and employment policies for fostering income distribution and equality.

This document has shown that structural change is the cornerstone of a long-term process of growth with employment and equality. Such change cannot occur spontaneously: all successful development experiences have been the result of active policies to stimulate high-productivity, more knowledge-intensive sectors (Schumpeterian efficiency) in which internal and external demand grows fast (Keynesian efficiency).

Section one of this chapter discusses the evolution of industrial policies in the region and emphasizes the need for a policy that defines precisely where a sustained effort of structural change should be invested, respecting the differing production, scale and institutional requirements of countries in the region. Having an industrial policy entails choosing which sectors should drive this process. This would be a futile exercise unless it was accompanied by institution-building to ensure that policies are implemented effectively, including building social consensus on this goal, both of which are areas where the region has been ineffective.

It is also shown that the process of structural change is not independent from the business cycle and that cycle duration, the intensity of the expansion and contraction phases, and the scale and composition of investment affect the production structure and help to define its trajectory over time. For this reason, section two of this chapter addresses macroeconomic policy from a different perspective, emphasizing its structural and long-term impact. Special attention is given to two aspects. First, macroeconomic policies must sustain aggregate demand, use of installed capacity and employment, i.e. Keynesian efficiency. Second, they must prevent the volatility and structure of macroprices from undermining efforts to diversify production. Macroeconomic policies that support structural change are based on a broad notion of stabilization which, while not disregarding the evolution of nominal variables, incorporates growth and employment objectives. In particular, they must sustain boom periods, preventing them from being disrupted early as a result of imbalances and crises that undermine investment and jeopardize the production of non-traditional tradable goods. An important task of macroeconomics geared to the long term is to expand the space of fiscal and monetary policies. This could include macroprudential policies and policies to control short-term capital flows to overcome the constraints imposed by the trilemma discussed in chapter IV.[1]

Lastly, it is shown that sustained employment growth and improved functional and personal distribution of income over the long term stem from diversification of production. To redress inequality, short-term social measures are required urgently, including income transfer policies. Such policies are consistent with efforts to maintain Keynesian efficiency and aggregate demand. They must be supplemented by policies for improving the operation of the labour

[1] Chapter IV states that it is impossible to have an independent monetary policy, an exchange-rate target and a fully open financial account simultaneously.

market and increasing the number of workers in formal jobs covered by social protection. Education and training are therefore strategic variables that contribute simultaneously to improving income distribution and building the capacity required for an intensive process of structural change with equality.

A. Industrial policy

Latin America and the Caribbean has had experience in a variety of industrial policies, stemming from each country's specific objectives, experience and economic and institutional capacity. Measures have ranged from the implementation of sectoral policies to the development of horizontal (cross-sector) policies, and included support for clusters or production chains. Moreover, there is growing acceptance of the need to develop horizontal policies, which until recently were fiercely resisted in many countries. As a result, there has been gradual recognition that industrial policies should be at the core of strategies for production structure diversification and structural change.

1. Evolution of industrial policy

Policies to create new sectors were the centrepiece of industrial policy until 1980.[2] Their goal, which is still valid today, was to create a denser production structure in the countries. At that time, they sought to achieve this goal taking advantage of growth in domestic demand, particularly investment, which would otherwise have led to higher imports, with all the external constraints these imply. Over the course of the 1950s and 1960s, the region's largest economies made progress with building a mass consumer goods industry and that of high-value durables, like cars. In the 1970s, there was a growing perception that the effects of investment could be divided into two types: first, the installation of productive capacity, with positive effects on aggregate supply; and second, the concomitant demand for capital goods which, for lack of the right kind of domestic supply, increased import demand, and therefore negated the beneficial spillover effects for the rest of the production structure. At that time, the concepts of industrial policy, policy for the manufacturing sector and incentive policies for capital goods production were closely linked.

Industrial policies were used to organize domestic supply growth and provide a focus for planning or programming in relation to the production structure.[3] Three interrelated factors strengthened this organizing role: public-sector support mechanisms were organized at sectoral or even subsectoral level;[4] private-sector interests were also organized in sectoral chambers or associations, which were the main defenders of the trade protection system; and international trade negotiations yielded negative or positive lists of sectoral preferences. Industrial policies concentrated on the agricultural and manufacturing sectors, although the preponderance of the latter was such that the concepts of industrial policy and policy for the manufacturing sector tended to be conflated.

[2] Most of the region's economies were closed in financial and commercial markets, and there were even markets that only local producers could supply.

[3] The leading examples in the 1970s, prior to the rupture produced by the external debt crisis, were Brazil's second National Development Plan and Mexico's National Industrial Development Programme 1979-1982, which was in operation during the boom that accompanied the growth of the country's oil export platform.

[4] For example, ministries of industry, agriculture, mining and others and, within these, departments for food, metallurgy, chemicals, capital goods, etc.

After playing this central role, industrial policies gradually lost legitimacy over the course of the 1980s, to the extent that they were virtually absent from the new economic model ushered in by structural reforms, at least in its strictest version. Industrial polices lost credibility for a number of reasons. The main ones were: the privatization or closure of public-sector enterprises that invested directly in new sectors because the new vision prevailing at the time gave the State only a subsidiary role in the economic dynamic; the need to balance public finances by doing away with subsidies, particularly those of a fiscal nature and the subsidy components of lending operations; and the perception that many investments had involved poor planning, faulty project management and corruption, and indeed that some projects were no more than pointless “white elephants”. This loss of legitimacy did not occur everywhere in the world. In a number of East and South-East Asian countries, active policies targeted at individual sectors or even companies remained in force well into the 1990s, when they became less common as, albeit at different paces, these countries gradually entered the free market mainstream and the new international trading regime.[5]

Whatever the merits of the economic arguments against industrial policy, the policy debate was polarized into the “developmentalists versus neoliberals” stereotype. Leaders of pro-market reforms blamed industrial policies for distorting the allocation of resources and creating the fiscal imbalances that underlay inflation. A growing number of governments in the region gradually came to share this stance.[6] This extreme position was not always matched by the reality, however; even some staunchly pro-market governments kept some sectoral policies, particularly for the automotive industry.

(a) Industrial policy following the economic reforms

As chapter II has shown, financial and trade liberalization, and privatization, had a major impact on the industrial structure, leading to structural change that in turn altered not only the ownership structure, employment and business dynamics, but also the organization of major markets for goods and services. Following the reforms, much of what the region was doing in terms of industrial policy was encompassed within the concept of “competitiveness policies”.[7] After an initial period extending until the mid-1990s, when burgeoning economic reforms led to industrial policies being all but excluded from the public agenda, there was a resurgence of interest in competitiveness, understood as the ability to increase presence in international markets.

In this new context, three approaches to competitiveness policy were shaped. Some countries, chiefly Brazil, Mexico and some in the English-speaking Caribbean (including Jamaica, with its 1996 National Industrial Policy, and Trinidad and Tobago, with its Industrial Policy 1996-2000), produced policy documents targeted specifically at the manufacturing sector and its linkages with technological development and international trade. These policy documents were not so much industrial plans or programmes, strictly speaking, as shared working agendas for government and the private sector, and this led their critics to accuse them of being “programmes without goals” and even “without resources”.

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5 The literature on industrial policies in East Asia is very extensive. For a review of such policies, see, for example, Devlin and Moguillansky (2010, annex to chapter II) and Peres and Primi (2009).

6 In the early 1990s, it was common to hear from top macroeconomic policy officials Gary Becker’s dictum (1985) that “the best industrial policy is none at all”. Simple as it was, this maxim summed up their attitude quite well.

7 It is useful to maintain the distinction between industrial and competitiveness policies to highlight the need for policies to create new sectors in the strict sense. Competitiveness policies alone are not enough to change the production structure because not all sectors have the potential to benefit equally from increased efficiency. Naturally, creating new sectors requires the development of appropriate economic agents and institutions.

Second, in Andean and Central American countries, the main thrust of policy was to raise the competitiveness of the economy as a whole without giving any particular priority to the manufacturing sector. National competitiveness strategies were based on the cluster analysis methodology, and clusters were referred to in Spanish under a variety of names, including *"agrupaciones"*, *"aglomeraciones industriales"*, *"arreglos productivos"* and *"conglomerados productivos"*.[8] In practice, these approaches led to the negotiation and implementation of sectoral agreements, generally spanning value chains, between private-sector actors and the government, with the latter acting as catalyst or facilitator.

Policies to support clusters spread rapidly. In some countries, they became the centrepiece of national competitiveness strategies, as in Colombia, where cluster-based policies have been in place since the early 1990s,[9] or in El Salvador, a country that has an active policy of supporting clusters and micro and small enterprises. In other, generally larger countries, vigorous measures have been taken to encourage these clusters at the subnational level. This is illustrated, in the case of Mexico, by the support formerly given to the footwear sector in Guanajuato and the electronics sector in Jalisco (Unger, 2003; Dussel Peters, 1999), and in the case of Brazil by the actions of the Brazilian Micro and Small Business Support Service (SEBRAE) throughout the country as part of the Project to develop "local production arrangements" (in Portuguese, *arranjos produtivos locais* (APL)). This type of policy still enjoys great legitimacy, even among international financial organizations, which has made it more acceptable to governments and even led to some measures being described as "support for clusters".

Finally, Argentina, Chile and Uruguay did not work on the basis of industrial policies or national competitiveness strategies. Preference was given instead to what are known as horizontal policies,[10] which were supposed to be non-discriminating between sectors and to be implemented by means of incentives to company demand, by contrast with the supply subsidies that characterized the earlier industrial policy model of import substitution. When sector-wide problems arose, horizontal policy instruments would be brought to bear on solving them, without these policies being deemed to have lost their essentially neutral character. It was in Chile that this type of intervention was conceptualized and implemented most forcefully, although the country long continued to provide direct subsidies to the forestry and mining sectors, and to export activities (Moguillansky, 2000).[11]

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8 This approach was based on Porter (1990) and culminated in the work of the Monitor Company in Andean countries in the early 1990s and in the project Central America in the 21st century: an agenda for competitiveness and sustainable development, coordinated by the Latin American Centre for Competitiveness and Sustainable Development (CLACDS) of the Central American Business Administration Institute (INCAE) in the mid-1990s.

9 In 2006, the Colombian government set up an institution called National Competitiveness System (SNC) to take charge of activities to develop, implement and monitor policies for building the capacity of companies in domestic and foreign markets. Colombia's National Policy on Competitiveness and Productivity (PNCP) included a vision to 2032 and focused on five strategies: development of world-class sectors or clusters; leap forward in productivity and employment; formalization of business and employment; promotion of science, technology and innovation; and cross-sector strategies to promote competition and investment. In June 2008, this strategy culminated in 15 action plans (Gómez Restrepo, 2009). This vision, which combines cross-sector and sectoral policies, was reformulated in Colombia's Productive Development Policy introduced in 2011 (Díaz Granados and Pinto, 2011).

10 The expression "neutral or horizontal", in widespread use across the region, conceals the fact that any policy will ultimately favour certain sectors over others. This happens because these policies seek to raise the efficiency of production factor markets, which are used in different proportions by the different sectors or products. In some cases, policies that are presented as neutral to give them greater legitimacy are oriented from the outset towards specific sectors. This is usually the case with technological development policies.

11 As discussed below, between 2007 and 2010, Chile's experience began to take on different characteristics. In 2011, Argentina and Uruguay implemented policies targeted at production chains.

(b) Competitiveness policies

As the specialized literature has often pointed out (IDB, 2001; Melo, 2001; Peres, 1997), competitiveness policies in the region, even those that are fundamentally sectoral in scope, have focused far more on increasing the efficiency of existing sectors than on creating new ones, something that is consistent with a quest for greater international market share relying chiefly on static comparative advantages (natural resources and unskilled labour). This has happened both in countries with a diversified production structure (Brazil and Mexico, among others), and in countries with more specialized structures. Of the former it might be said that only a very few sectors are wholly absent from their economies and that sectoral policies should be detected at the individual product level. While this is true, the evidence suggests that in Brazil, particularly prior to its 2008 Productive Development Policy, and in Mexico generally, sectoral-type measures have focused on strengthening and expanding established sectors, the most noteworthy example being the automotive industry, as indicated earlier.

The creation of new activities comes up sporadically as a policy objective. In this case, two main lines of action have been followed: international trade negotiations to secure market access, chiefly through bilateral or multilateral free trade agreements, and efforts to attract foreign direct investment (FDI) to develop export platforms, including free trade zone and maquila activities.

Attracting FDI has been the main mechanism used to create new sectors in most of the region's countries. Measures of this kind include the deepening of the Mexican export platform as part of the North American Free Trade Agreement (cars and car parts, electronics and clothing), more elementary assembly activities in export processing zones in some Central American and Caribbean countries,[12] and investments in privatized service and commodity sectors in South American countries (Mortimore, 2000; Peres and Reinhardt, 2000). The activities leading to the diversification of production structures have largely been determined by the different strategy combinations of investing multinationals (discussed in chapter III) and government sectoral policies, albeit with the limitations deriving from low value-added (owing to the preponderance of assembly activities) and a lack of linkages with the rest of the national economy concerned (ECLAC, 2011a).

The instruments that have been used to attract foreign investment can be classified into three major groups: (i) incentives, chiefly in the form of free trade zones and fiscal benefits; (ii) standards to create an efficient business environment (rule of law, transparency, assured access to international markets, good infrastructure, etc.); and (iii) specialized factors of production, particularly skilled labour. The countries of the region have applied these three types of instruments to differing degrees; with few exceptions, however, it is the first two that predominate (Mortimore and Peres, 1998).

Besides specific instruments to attract foreign investment, countries have used two other types that apply to any kind of investment (domestic or foreign). These are financial and fiscal incentives and a large group of measures used by governments to create competitive environments for companies to perform (pro-competition measures and regulation of monopoly sectors), bring down transaction costs (reducing administrative controls, among other things) or enable companies to act collectively to take advantage of economies of scale (sectoral agreements spanning production chains,[13] support for partnerships between companies, etc.).

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[12] In the 1980s, these activities were promoted by the Caribbean Basin Initiative (CBI) and, in latter years, by the Central America-Dominican Republic Free Trade Agreement (DR-CAFTA).

[13] In small economies typical of the region, policies to support production chains inevitably consisted of promoting the integration of local firms into global value chains. Such policies require lines of action to reduce firms' transaction costs, which can be particularly burdensome for smaller firms.

The region's competitiveness policies can be grouped as follows, in accordance with the degree of acceptance they have attained (although this classification bears no relation to their efficiency): policies with strong legitimacy, policies with weak legitimacy and emerging policies. Policies with strong legitimacy are those that have been generally accepted by governments. In addition to the above-mentioned policies for export promotion (trade promotion) and inward FDI, this group includes policies to promote scientific and technological development and innovation (see box VI.1); human resources development, including business training; support for micro and small enterprises (see box VI.2),[14] and productive development at the local or subnational level, these two last being very closely intertwined. These policies have proved so acceptable because of their perceived sectoral neutrality, as they operate on markets for production factors (technology and training) or because of their perceived positive impact on job creation, especially at the subnational or local level.[15]

Box VI.1

SCIENCE, TECHNOLOGY AND INNOVATION POLICIES IN LATIN AMERICA AND THE CARIBBEAN

While there was no explicit science, technology and innovation (STI) policy in the region until the early 1980s, the public sector played a role in laying the foundations for scientific and technological development and put in place the institutional infrastructure for the future management of STI policies. Governments adopted linear, selective supply policies, i.e. policies based on unidirectional causality from the creation of knowledge to its technological application. As a result of these policies, which sought to expand endogenous technological capability, 80% of research and development (R&D) spending was publicly funded and most of these activities were carried out by State corporations in strategic sectors like energy and telecommunications. In addition, research institutes and scientific councils were established to support capability-building and national development strategies.

Following the economic reforms, this model was replaced by a demand-oriented model, based on the same linear view of knowledge. Government policies played a marginal role. The main instruments were incentives for the implementation of horizontal policies, in which priority was given to incentives for demand from the production system, and State intervention was consented only to correct market failures and stimulate the private sector. As a result, STI policies became subject to market behaviour and the trend towards importing knowledge and technology was reinforced, with foreign direct investment being favoured as a source of technology, while at the same time the rules on intellectual property were amended (ECLAC, 2004). Simultaneously, the institutional infrastructure and organizational routines of development institutions were streamlined and modernized, a number of research institutes were shut down and management criteria closer to private models were introduced, favouring a service delivery rationale.

In recent years, countries in the region have afforded increasing importance to STI policies and, with varying speed and success, have gained experience in designing and implementing them. The main advance has been to incorporate the concept of "national innovation system", where innovation is seen as a complex, non-linear, systemic phenomenon that depends not on the efforts of individual companies or research centres, but on interaction between actors responding to market incentives (companies) or non-market incentives (some universities and research centres), as well as on public institutions establishing incentives and regulatory systems (ECLAC/OECD, 2011). This cemented the idea that knowledge creation and innovation calls for interaction between supply policies (public resources and support for specific sectors and technologies) and policies to encourage and subsidize demand from the production sector (ECLAC, 2010a; Cimoli, Ferraz and Primi, 2005).

[14] A possibly unique case is the Plurinational State of Bolivia, where article 318.II of its 2008 Constitution states that the State recognizes and will prioritize support for the organization of clusters of urban and rural micro, small and medium-sized manufacturing enterprises. Furthermore, article 334 states that the State will protect and promote micro and small enterprises, as well as rural economic organizations and small producer organizations or associations, which will be given preference in government procurement. See also Bolivia's Ministry of Productive Development and Plural Economy (Ministry of Productive Development and Plural Economy, 2009).

[15] These competitiveness policies are not the only public measures to affect an economy's competitiveness: there are also macroeconomic policies (discussed in the next section), as well as infrastructure development and other policies.

Box VI.1 (concluded)

Some governments in the region have only recently incorporated this “systemic” concept of innovation into their intervention rationale and the design of their institutional structure and management, and have prioritized reforms for the modernization of STI policy management agencies (Calza, Cimoli and Laplane, 2009). Five countries have a ministry of innovation (Argentina, Bolivarian Republic of Venezuela, Brazil, Costa Rica and Cuba). Others use different models: national innovation councils reporting to the office of the president (Chile and Nicaragua) or to ministries of industry or education (e.g. Mexico). Brazil has the most developed system in the region, where a large number of agencies are responsible for programme decision-making, implementation and financing, and the ratio of R&D expenditure to gross domestic product (GDP) is the highest in the region (1.2%). In terms of new instruments, Brazil has introduced sectoral funds to support innovation, which combine supply mechanisms with demand incentives (Pacheco, 2003).

Learning how to design and implement STI policies has generally been slow in the region and been accompanied by weak instruments, for a number of reasons. First, even though strong financial support is required to implement policies, STI expenditure in the region is still low and the private sector contributes very little. Second, STI policy remains reliant on other economic policies – a reliance based on the erroneous idea that when macroeconomic signals are correct, production and technology will adopt a virtuous growth path. However, the implementation of STI policies necessitates an institutional architecture that removes them from this subsidiary position. Finally, there is no coordination between STI policy and a strategy of structural change. As a result, STI policies are still limited by a production structure with little complexity or diversification, poor endogenous technological capabilities and weak demand from the private sector, which has no incentives to prioritize knowledge creation and innovation in the production sector.

Any government policy to boost investment in research, development and innovation must encourage private sector participation, considering the bottlenecks it faces when deciding on investments (great uncertainty associated with R&D investments, high interest rates, high operating costs, limited access to the credit market, especially for smaller firms, and limited opportunities for linkages with other firms, universities, research centres, or others).

The role of the State, in particular its development banks, in financing innovation is key to reducing uncertainty and increasing private return on investment, internalizing the externalities typically associated with technological activity (ECLAC, 2010a). The policy model should include incentives for collaboration between the public and private sectors, in terms of both strategy and finance, based on common spaces for discussion where divergent interests can be reconciled (e.g. those of the business world, STI institutions and civil society).

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

Box VI.2

POLICIES TO SUPPORT SMALL AND MEDIUM-SIZED ENTERPRISES: PROGRESS IN POLICYMAKING AND FAILURES OF IMPLEMENTATION

Policies to support small and medium-sized enterprises (SMEs)[a] are on the agenda of the region’s governments, in institutional contexts where efforts have varied in terms of effectiveness, coverage and continuity. In the past decade, there has been progress in reorganizing support institutions. Innovative and fairly widely disseminated instruments have been put into operation, including productive linkages, partnership programmes and productive networks and clusters, and access has been provided to non-financial support services. Some countries have also made it easier for SMEs to access financing by improving institutional management and creating new financial instruments (ECLAC/IDB/OAS, 2011).

While the introduction of instruments such as leasing, factoring, guarantee schemes or venture capital are a move in the right direction, they have not been sufficient to remove the bias against smaller companies. To move forward in building an inclusive financial system that provides a strong impetus to SMEs, public development banks need to be strengthened to counter the biases of private banking (Ferraro and Goldstein, 2011). The provision of capital resources to medium-sized enterprises and innovative firms makes it necessary to tackle key problems of moral hazard and asymmetric information between investors (or venture capitalists) and company managements. Development banks can play a key role in this market segment, both by channeling funds through intermediary companies in the case of venture capital, or by taking a direct share in the company’s ownership as a minority shareholder.

The incorporation of microenterprises into SME policy has increased the number of beneficiaries and compounded the complexity of an already broad and heterogeneous universe of firms (ECLAC, 2010a). This has called for targeted policies to be developed and implemented as part of a systemic approach, in particular policies oriented towards sectors where SMEs have a strong presence.

Box VI.2 (concluded)

Despite progress, the results of SME support policies have been unsatisfactory because there is still a wide gap between efforts and results, as well as between policymaking and implementation. Many countries have announced, developed and adopted policies that they did not actually put into operation owing to inconsistency between objectives, instruments and budget allocations. Brazil is the only country in the region with a budget to support SMEs, amounting to around 0.1% of GDP. Further problems include the weakness of institutions responsible for policy implementation and a limited conceptual framework that takes policy measures only to solve market failures (Goldstein and Kulfas, 2011). In addition to implementation failures, policy evaluation processes are weak and little is known about the effectiveness of programmes and instruments, results obtained, levels of coverage and assistance to businesses, or impact of the instruments on company performance.

Following the reforms, in most cases economic intervention by governments is considered only when markets fail to operate efficiently, and actions must cut across all sectors, which excludes targeted SME support policies and sectoral policies. However, according to a structuralist approach, the SME support policy should be part of an industrial policy designed to foster changes in the production structure. This conflict between the two approaches is embodied by the contradiction between individual assistance policies and system-wide interventions. With individual policies, actions tend to be ad hoc and aimed at reducing or eliminating distortions in the functioning of markets, while the system-wide approach seeks to implement integrated support strategies.

As any approach that uses policies only to correct market failures will result in interventions aimed solely at resolving ad hoc problems, an SME support policy designed from this perspective will produce a mixture of uncoordinated, incomplete measures that fail to recognize production sectors as key components of economic development or to provide an option for targeting growth-boosting measures on the most dynamic SMEs. Some countries in the region aim to implement more targeted policies by distinguishing groups of SMEs according to their degree of development and sectoral location, and to implement instruments customized to each group's needs. While this process is still incipient, it indicates progress towards more targeted policies.

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

[a] ECLAC analysed the role of SME-support policies in promoting innovation, weathering crises and improving access to financing in the framework of the cooperation programme "Policies and instruments for promoting growth in Latin America and the Caribbean", implemented during 2009-2010 with the support of the Spanish Agency for International Development Cooperation (AECID).

Policies with weak legitimacy, meanwhile, are those that are more clearly in contradiction with the current development model, particularly the open economy model and balanced public finances. They include direct fiscal subsidies, non-targeted tax exemptions, directed credit and the use of subsidized interest rates, tariffs on foreign trade and the use of the State's purchasing power. Concerning this instrument, the situation varies from one country to another. While some use it at the national or subnational level,[16] others regard it as being outside the range of applicable policies because it would go against objectives of spending efficiency and transparency.

Emerging policies, in particular pro-competition measures, regulation of infrastructure sectors whose markets do not operate efficiently and environmental policies, are acquiring growing legitimacy, but are still maturing and are at very different stages of development in the region's countries (see box VI.3).[17] Some have modern legislation and fairly solid institutions with which to implement these policies, while in others they are still at the stage of debate and decision-making, or are not a major item on the public agenda.

[16] A noteworthy example, discussed later in this chapter, is Brazil's *Plano Brasil Maior*, launched in August 2011.

[17] Other important policies include improving corporate governance regimes and corporate social responsibility.

Box VI.3

PRO-COMPETITION MEASURES AND CREATION OF ENVIRONMENTALLY SUSTAINABLE SECTORS

Pro-competition measures

Anti-competitive practices are common in the region owing to the small scale and high concentration of most national markets. In many countries there are companies that, despite being inefficient, enjoy great market power. Therefore, not only can regulatory and pro-competition policies reduce consumer prices, they can also foster innovation and increase efficiency and productivity.

The regulations in this area must: (i) distinguish the type of concentration that meets the need to increase plant scale in order to reduce costs from the type that seeks only to increase market power; (ii) differentiate the type of concentration derived from anti-competitive practices from the type that is normal in small economies, where it is common for a few firms to dominate a sector; and (iii) decide whether it is appropriate to discipline local businesses, which are usually far from the technological and productivity frontier, by means of greater foreign competition, or whether to allow them to conclude agreements to take advantage of economies of scale and learning.

The special characteristics of small economies underscore how important it is for competition rules to be specific to each country. In some cases, the best pro-competition measure may be prohibition of cartels, whereas in others it may be prohibition of abuse of dominant position, merger regulation or surveillance of exclusive agreements (Stewart, 2006). Given the asymmetry of power between multinationals and small-country governments, regional agreements on competition need to be developed or strengthened, introducing regional methods for gathering evidence or measuring market power, rather than just national ones.

Environmental policies

Achieving a sustainable pattern of development entails implementing strategies that address economic, social and environmental issues simultaneously. These strategies must define a new set of economic incentives, as well as new regulatory and institutional frameworks. This makes it necessary to do the following.

Modify the vector of relative prices in a direction consistent with the sustainable use of natural resources and the environment. This means internalizing negative externalities (many environmental) associated with the production, distribution and consumption of goods and services, and recognizing the need for economic instruments, such as taxes, fiscal incentives or tradable permits, to help reduce their worst impacts.

Implement regulations consistent with economic incentives. Evidence in the region points to persistent market failures, in conjunction with low response sensitivity of agents to economic incentives because of weak price signals and poor long-term returns, coupled with lack of substitute goods and services for such items as private transport or fossil fuels. Relative price policies must be accompanied by regulations in areas where these signals are insufficient and there is a risk of irreversible losses, for instance in biodiversity or forest cover.

Move forward with a more environmentally sustainable technological paradigm. This entails building knowledge, developing infrastructure, establishing economic incentives and boosting spending on technological research and development. All this must form part of industrial policies aimed at creating new knowledge-intensive, environmentally sustainable sectors. Ultimately, this means selecting and developing long-term technological trajectories.

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

The content of the region’s most recent policy documents has displayed a high degree of convergence, except as regards acceptance of sectoral policies. National differences notwithstanding, this convergence has focused on six basic elements:

(i) an emphasis on raising competitiveness in the global market;

(ii) horizontal or neutral instruments, whose legitimacy has become firmly established even though, as noted earlier, their effects in practice are far from neutral;

(iii) support for micro and small enterprises, basically because of their capacity to create jobs;

(iv) growth in programmes to support clusters;

(v) strengthening of science, technology and innovation policies and, more recently, policies for the widespread use of broadband internet;

(vi) targeting of subnational or local economic areas.

The fact that the above six elements have remained a fairly constant feature of competitiveness policies would suggest that a certain amount of policymaking skills and experience have been gained, which could serve as a basis for designing and implementing new industrial policies.

2. Urgent return of sectoral policies

The pattern of productive specialization in Latin America and the Caribbean has led to the closure or lock-in of a production structure centred on environmentally inefficient and non-knowledge-intensive activities. The activities typical of the current technological revolution have little impact on this production structure, with the resulting adverse effect on the productivity gap in terms of the technology frontier (see chapter I). To overcome this lock-in, relative sector profitability needs to be re-geared in favour of knowledge-intensive sectors, which can only be achieved by means of policies for progressive structural change, i.e. industrial policies aimed at creating new manufacturing, primary and service sectors. Such policies are critical to a development path that incorporates and transcends competitiveness policies designed to improve the efficiency of existing sectors. It is essential to transcend existing sectors in order to generate sectors that make more efficient use of materials and energy, and to promote activities with higher knowledge content.

In the early 2010s, by contrast with what has been happening in other development policy areas, there is still no convergence in the positions of Latin American and Caribbean countries where sectoral policies are concerned. While in a decreasing number of countries the official stance is strongly against these policies (although sectoral support is provided ad hoc), in others they are recognized as a valid way of raising the competitiveness of activities that have the potential to penetrate external markets or that face stiff competition from imports. There are some double standards with these policies: countries that deny their utility, particularly when it comes to support for manufacturing, use them openly and without any need for justification in numerous areas of agriculture and services (tourism, for example).

Sectoral policies have been making a slow comeback in Latin America and the Caribbean. After the crisis of the early 2000s, Argentina selected nine production chains to receive support under its Programme of National Forums for Industrial Competitiveness and Production Chains. Shortly afterwards, Mexico chose 12 priority production branches to benefit from sectoral programmes under its 2002 Economic Policy for Competitiveness. More recently, the Mexican government defined Ten guidelines for increasing competitiveness, 2008-2012, which includes actions with a sectoral content: promoting scaling-up to high value-added activities; speeding up the restructuring of traditional industries; and the use of pioneering technologies. In 2005, Peru produced its National Competitiveness Plan focusing on six areas, including areas that determine measures for competitive chains, innovation and competitiveness.[18]

Meanwhile, between 2007 and 2010, Chile moved from a position of having only horizontal policies to a policy of innovation and competitiveness based on a selected set of "priority clusters".[19] Chile's 2007 National Strategy of Innovation for Competitiveness demonstrated a shift

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18 Similar efforts to position knowledge and innovation as engines of growth also featured in Costa Rica's National Development Plan 2006-2010 and the National Strategic Plan of Barbados 2005-2025 (see Devlin and Moguillansky, 2010).

19 The clusters are in the areas of aquaculture, fruit growing, pig and poultry farming, functional foods, mining, special interest tourism, logistics and transport, financial services, outsourcing and construction, i.e. all primary or service sectors where the country has shown comparative advantage, with manufacturing activities virtually absent (National Council for

in emphasis, with some progress towards actions focused on these priority clusters (Agosín, Larraín and Grau, 2009). In early 2010, this strategy was clarified in Chile's Agenda for Innovation and Competitiveness 2010-2020, which defined priorities for clusters and horizontal platforms for competitiveness (National Council for Competitiveness Innovation, 2010). A debate on whether to continue this strategy has been in progress since the Government changed in March 2010.

In other countries, promotional measures have been targeted more closely, to the extent that support has been given to the individual projects of particular companies. Some examples are the incentives for investment in megaprojects in the Peruvian mining sector, the measures taken by the government of Costa Rica so that Intel Corporation would establish an operation in the country (Alonso, 2003), and tax exemptions to support projects declared to be of national interest in Uruguay. Brazil is the clearest example of this comeback of sectoral policies. The country's three experiences, outlined in box VI.4, have characteristics in common: continuity of priorities, in particular innovation and competitiveness; flexibility to take into account unforeseen problems; a growing concern to set explicit goals, mobilize instruments and establish effective interaction with the private sector; and integration with other development policies, such as education and science and technology (Ferraz, 2012).

Box VI.4

BRAZIL'S EXPERIENCE WITH INDUSTRIAL POLICY IN THE 2000s

In November 2003, the Brazilian Government announced its Industrial, Technological and Foreign Trade Policy (PITCE) guidelines, which set out its sectoral strategic options in four knowledge-intensive productive activities: semiconductors; software; drugs and medicines; and capital goods. It also established the Brazilian Agency for Industrial Development (ABDI) to coordinate implementation of the PITCE policy.[a] Suzigan and Furtado (2006) pointed out in their evaluation of this policy that, in spite of positive aspects like the emphasis on innovation, clear goals and a new institutional organization, it had weaknesses, such as incompatibility with macroeconomic policy, inconsistencies between instruments, poor infrastructure, deficiencies in the science, technology and innovation system, and lack of coordination.

In May 2008, Brazil launched its Productive Development Policy (PDP), a new industrial policy with a greater sectoral emphasis. In addition to horizontal, mainly fiscal and credit, measures and six strategic technology programmes coordinated by the Ministry of Science and Technology (MCT), this policy includes seven programmes coordinated by Brazil's National Bank for Economic and Social Development (BNDES) targeted at leading sectors (aerospace; oil; natural gas and petrochemicals; bioethanol; mining; pulp and paper; and beef), coupled with 12 competitiveness programmes coordinated by the Ministry of Development, Industry and Foreign Trade (MDIC) in the automotive, capital goods, textiles and clothing, wood and furniture, cosmetics, civil engineering, services, shipbuilding, leather and footwear, biodiesel, plastics and other industries (Government of Brazil, 2008; Ferraz, Nassif and Oliva, 2009).

To implement the PDP, a structure was designed in which the Ministry of Development, Industry and Foreign Trade was in charge of overall coordination, under the strategic guidance of the National Industrial Development Council (CNDI),[b] supported by a *sui generis* institution: an executive secretariat comprising representatives from Brazil's National Bank for Economic and Social Development, Ministry of Finance, Brazilian Agency for Industrial Development and the Ministry of Science and Technology. The secretariat was established in order to overcome institutional bottlenecks that could hamper the operation of the PDP, particularly when it is run by ministries with less *de facto* power than the institutions responsible for implementing the funding, a problem already identified by Suzigan and Furtado (2006).

Although the PDP is the region's most advanced and ambitious industrial policy effort to date, it had to overcome a severe implementation problem only a few months after it was launched. When the international financial crisis erupted in the second half of 2008, it changed many of the parameters on which the policy was based. Since then, its goal has been much more to prevent a sharp decline in the economy, through credit and fiscal measures to reduce the cost of capital, than to promote structural change and growth.

Competitiveness Innovation, 2007 and 2008). Later, broadband Internet access was added to the list (National Council for Competitiveness Innovation, 2010). The latter document was prepared shortly before the Government changed in March 2010.

Box VI.4 (concluded)

Brazil's rapid recovery in 2009 and strong growth in 2010 provided renewed opportunities for industrial policy. In August 2011, the new Government that had come into office in January of that year implemented *Plano Brasil Maior*, which accords greater importance to sectoral development schemes, particularly in labour- and technology-intensive sectors. The new plan, covering the period 2011-2014, is wider in scope than the PDP and, in addition to policies to boost innovation, investment and foreign trade, it contains measures for protecting the domestic market and local manufacturing output, including use of the State's purchasing power. This defensive approach was particularly important in a context where strong appreciation of the local currency increased the pressure of imports on domestic production, with the resulting fall in the latter's domestic content.[c] In April 2012, the Brazilian Government announced a set of accompanying measures for the plan, including the prevention of customs offences and stricter compliance with technical standards as defensive measures, in aid of strengthening land borders (*Fronteira Blindada*), textile and clothing imports (*Panos Quentes*) and footwear imports (*Passos Largos*).[d]

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

[a] The PITCE states that these sectors were selected because they: (i) have shown fast and sustained growth; (ii) account for a significant share of international investment in research and development; (iii) open up new business opportunities; (iv) relate directly to innovation in processes, products and uses; (v) increase the density of the productive fabric; and (vi) are important for Brazil's future and have potential for developing dynamic comparative advantage (Ministry of Development, Industry and Commerce, 2003, p. 16).

[b] The CNDI was established in 2004 as an advisory body responsible for identifying key policy priorities. It is chaired by the MDIC and comprises 13 line ministries, the BNDES president and 14 representatives of business associations, key industry sectors and unions.

[c] See www.brasilmaior.mdic.gov.br/oplano/brasilmaior.

[d] See Federal Government, *Novas medidas do Plano Brasil Maior*, Brasilia, 3 April 2012.

The renewed emphasis on sectoral policies in Brazil's strategies has heightened the region's interest in such policies, particularly in the Southern Common Market (MERCOSUR) where, in 2011, Argentina launched its Industrial Strategic Plan 2020, which includes measures to boost 11 industry chains, while in 2010 Uruguay embarked on a similar effort for 15 value chains (Torres, 2010).

However, the slow comeback of sectoral policies in the region is out of step with the urgent need for countries to progress with structural change to unlock their production structures. The idea of reinstating the role of industrial policies in creating new sectors, rather than just increasing competitiveness, should be given greater legitimacy and placed at the centre of the policy agenda, helping to move towards an environmentally sustainable technological paradigm. These policies are crucial in enabling the region to participate fully in the current technological revolution, promoting environmentally sustainable paths in nanotechnology, biotechnology and information technology, and communications, with the ensuing generation of new energy sources and substantial improvements in urban services. However, first this entails resolving the failures of implementation discussed below.

3. Key role of implementation and evaluation

(a) Implementation failures and lack of impact assessments

With some exceptions, the degree of policy implementation in Latin America and the Caribbean has traditionally been low, as indicated in Peres (1997 and 2009). Particularly clear analyses are provided by Alonso (2003) concerning the situation of the five Central American countries and Fairbanks and Lindsay (1997) concerning the Andean countries that designed competitiveness strategies around the concept of clusters. According to these studies, the causes behind widespread policy implementation failures (i.e. "government failures"), and the resultant gap between what is decided and what is actually done, fall into a number of categories, as shown below.

(i) Non-operational or unattainable objectives

The inclusion of non-operational or unattainable objectives in policymaking transfers real implementation decisions to the budgetary allocation stage. The problem in these cases is that because of shortcomings in their formulation, policies tend to be more akin to declarations of intent than to resource allocation instruments.[20] Evaluation of the 41 sectoral agreements in Colombia to determine the factors conducive to success shows that: (i) agreements containing well-structured, quantifiable and time-limited commitments are easier to follow and implement; (ii) agreements comprising just a few simple commitments achieve greater results; (iii) the leadership and decision-making capabilities of the people behind the agreements are fundamental; and (iv) production chains that had been supported since before the agreements achieved better results (Velasco, 2003). The practice followed in the region does not usually take these success factors into account. Thus, policy documents tend to end up as long “shopping lists” of needs and objectives. While the multiplicity of objectives may be due to the action of numerous agents in complex societies, it also reflects an inability to set priorities and build consensus around a few that can realistically be achieved.

(ii) Shortages of human and financial resources

The implementation of these policies requires major human and financial resources. Shortages of these resources needed for policy implementation, especially serious in smaller and poorer countries, often means reliance on external resources (lending or aid) to make policy and, especially, to enforce it. When donor priorities change and they withdraw support for a policy, it usually vanishes. Furthermore, when policies are rolled out they do not tend to be accompanied by an implementation programme, nor are the cost and the financing required for full policy implementation and evaluation usually considered, the approach being once again to “decide first and then see what can be done and how it can be afforded”. This is compounded by the fact that direct fiscal subsidies, and directed credit with subsidized interest rates, are policies with weak legitimacy. It calls for a macroeconomic policy whose rules recognize the need to use these instruments.

(iii) Lack of institutional capabilities

Almost all the countries in the region are deficient in the institutional capabilities needed to implement policies, even some quite straightforward ones. The difficulties increase when countries try to introduce policies that are more a reflection of “international best practice” than of their own actual needs and specific characteristics. This results in policy formulations that are detached from reality and, worse still, are often sponsored by State agencies with little weight in the government power structure or by business associations that are unrepresentative and have little economic or political influence. The problem is compounded by the fact that policymaking and implementation authorities in the region are usually separate. Although countries can increase their institutional capacity over time, and some in the region have done so, institutional creativity and innovation require stability of objectives over longer periods than the four- to six-year terms that are the norm for governments in Latin America and the Caribbean, together with financial resources to make action possible. The great disparity in tax burdens between the various countries in the region, ranging from under 10% to over 30% of GDP, means there are structural differences in the potential for progress in this area (see chapter IV).

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[20] While data exists concerning the financial resources that were allocated to some policies, there is not enough information to assess whether the policies were actually implemented.

Despite these problems, in the 2000s significant advances were made in building an institutional framework for policymaking and implementation, ranging from the establishment of agencies such as Colombia's National Competition Commission (CNC) or Chile's National Innovation Council for Competitiveness (CNIC), to more complex developments such as the institutional structure of Brazil's 2008 Productive Development Policy (PDP).

(iv) Weakness of public-private agreements

Policy implementation agreements between government and the private sector are unreliable, as transpires when the time comes for the public sector to release funds or for the private sector to make matching investment and spending commitments. Furthermore, there is a proliferation of plans and programmes that are only produced in reaction to political pressure from economic actors, or as a means of soliciting international financing, or to comply with legal or constitutional provisions. Businesses, which vigorously defended protection policies until the late 1970s, are not showing the same robust commitment to policies for diversifying and improving productive specialization in the region's countries (ECLAC, 2008a).[21]

(v) Weakness of economic signals

Implementation problems are compounded, in the case of industrial policies, by the weak and ambiguous economic signals sent out by programmes. What businesses are now offered, at best, is a set of signals that are difficult to interpret and translate into concrete measures, and whose implications for profitability are uncertain. No matter how well formulated a policy may be, unless it is accompanied by clear signals of profitability, it will be hard for it to achieve its objectives.

Implementation failures and the perception that "policies don't work" affect the legitimacy of industrial policies and the interest they may arouse among businesses, their main beneficiaries. This leads to a paradoxical situation: businesses consider that the resources available for policy implementation are inadequate and high-risk, and yet they do not make full use of them.

Overcoming these five causes of implementation failure and making policies work is one of the main challenges for development strategies.

Efforts to evaluate the implementation and effects of industrial policies are constrained not only by the information available, but also by the fact that, until very recently, these policies rarely specified which criteria and mechanisms should be used for evaluating them. The problem is compounded by the technical complexities involved in evaluating policies that have multiple objectives and lines of action, often without establishing verifiable quantitative targets.

The steps taken to evaluate the effects of industrial policies have been even more limited and unsatisfactory than the efforts to evaluate their implementation. In the region there have been evaluations of only a few specific programmes, such as small business support or technological innovation programmes, plus general evaluations of what has happened after policies have been applied, but without any effort being made to show a clear causal link between policy measures and observed outcomes.

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21 Furthermore, even though disagreements between the government and the private sector have diminished, they are far from over.

(b) How to remedy the shortcomings

What can be done to close the gap between what is decided and announced, and what is actually done and evaluated? Three lines of action, which are not mutually exclusive, look promising.

First, policymaking should be accompanied by explicit considerations as to which institutions are responsible for implementation. This means that those involved with industrial policy will have to venture into matters of State structural reform. The aim is to transform the structure of State, strengthening implementing agencies by endowing them with political power, effective budgetary instruments and technical capacity, to ensure that the structure works for the policies designed. This is particularly important when it comes to implementing system-wide or transversal policies which, by definition, will cover more than one sector or more than one implementing agency.

Given the shortage of qualified human resources in those areas of the State that are involved in policy implementation, a second line of action would be to transfer to these areas highly qualified staff with an executive profile who are currently engaged in policymaking. In the short term this will necessitate the reallocation of human resources, which must be accompanied by appropriate incentives.

A third line of action is to develop and strengthen policy operators, i.e. institutions and individuals who will ensure policy implementation by using a combination of policymaking, action and funding capabilities. This can be done by identifying and building the capacity of public or private institutions to lead and ensure policy implementation.

The region's experience shows that long-term institutional development within the State is possible, as evidenced by ministries responsible for macroeconomic policy and central banks. In the agricultural and extractive sectors, too, many countries in the region have created and maintained vigorous institutions, examples being the Brazilian Agricultural Research Corporation (EMBRAPA) and the oil institutes of Mexico and Bolivarian Republic of Venezuela. This experience can be emulated in areas linked to the development of other production sectors. This requires leadership, resources and continuity.

Private-sector policy leadership has been efficient in some cases (in the formation of certain clusters at the local level, for example), and needs to be employed whenever possible, but such leadership has proved difficult to systematize in the region and remains concentrated in relatively strong sectors. Thus, economically weak sectors, which need major efforts from policy operators, tend to be weak in leadership as well.

Strengthening intermediate-level implementation bodies has been a successful strategy in countries such as Chile, where the PROFO programme has been used to support clusters of micro, small and medium-sized enterprises (SMEs), although the predictable problems of adverse selection and moral hazard have not gone away.

None of these measures is a panacea, nor will implementation be easy. They do open up new options, however, and deserve to be considered from perspectives that combine the economic, institutional and administrative dimensions.

4. The way forward

With industrial policy strategies there are five major aspects to be considered: the criteria for deciding which sectors to support; the policy instruments available; the constraints imposed by the size of national markets and the accumulated capabilities in the different countries in the region; the spaces for action to facilitate multilateral and bilateral trade agreements; and the political will to take measures of this type.

The choice of sectors must set out from the recognition that there are no universal criteria for deciding which activities ought to be promoted. However, a large body of international experience has shown that, in practice, countries have chosen and continue to choose sectors in accordance with a few more or less precise criteria. Chief among these criteria are the knowledge content of the activities concerned, dynamism in the international market because of a high level of elasticity in relation to world income and especially the income of developed countries, and the potential for productivity growth. Another consideration is the strategic character of certain activities, essentially because they account for a large share of total output, exports or employment, usually at the national level but sometimes at the local or subnational level as well. A review of policies provides a good illustration of how these criteria are used, not always explicitly, in the countries of the region.

The technology dimension has been increasingly important for determining the scope of industrial policies. Although the term “sector” has traditionally been applied to groups of activities whose common feature is the production of goods or services with a high cross-elasticity of demand, it can also be used for activities that have a common technological development path (Robinson, 1953): thus, we speak of the aerospace sector, the biotechnology sector and the information and communication technology sector. When it comes to encouraging activities that share a particular technology, the focus has sometimes been on horizontal policies, while at other times intervention has been focused directly on particular companies, market segments or knowledge networks.

Ultimately, the criteria for choosing sectors are based on differing views of the role of the market and the importance of efficiency based on Ricardian comparative advantage for the allocation of productive resources. For instance, some point to the market’s limitations in allocating productive resources efficiently, in the belief that capacity-building occurs on paths far removed from static comparative advantage (Cimoli, Dosi and Stiglitz, 2009; Chang, 1994 and 2002), which tends to be concentrated in industrial sectors because of increasing returns, technology spillovers and innovation (Greenwald and Stiglitz, 2006). By contrast, others are more favourable to market efficiency and, while recognizing the need to diversify the economy, stress that the economy should move close to static comparative advantage (Lin, 2011; Hausmann and Klinger, 2006; Hausmann and Rodrik, 2003).

Moreover, as policies become systemic in scope, special attention needs to be paid to their impact on the conditions for competitiveness in the economy as a whole. The extra costs associated with the early phases of learning curves must not be so great that they jeopardize the competitiveness of the businesses using the new goods or services, especially if these businesses are strongly oriented towards external trade. It is not easy to strike the right balance between supporting diversification of the nation’s productive apparatus and taking advantage of opportunities to import cheaper or technologically superior capital goods and inputs; thus balance can only be sought through experimentation and trial and error, i.e. through policies of a pragmatic rather than doctrinaire cast. As pragmatic policies tend to be reactive, a major challenge for the region is to combine pragmatism with much more proactive policies.

The programmes of the above-mentioned countries of the region already use many of the instruments available for implementing industrial policies. They consist mainly of combining competitiveness policy instruments with public-sector direct financing instruments, particularly national development banks, tax incentives and public investment, as well as use of the purchasing power of the State and State-owned enterprises. The idea behind these policies is to provide temporary conditions conducive to profitable new activities and technological trajectories, such as the widespread introduction of broadband internet access as a platform for cloud computing.

The concentration of instruments on support for new sectors has much in common with the “infant industry” concept, extended by Greenwald and Stiglitz (2006) to include “infant economies”. By contrast with the former situation in the region and elsewhere, however, economies are now open and it is not possible to use permanent, across-the-board trade protection instruments. This constraint weakens the economic signal (expected returns) sent out to potential investors in the new activities and means that a significant part of the cost and risk of the promotional measures has to be met by the State. This creates problems both for the selection of budget priorities and for the stability of budgetary allocations at times of fiscal tightening. Sustaining development mechanisms over the long run so that they outlast individual terms of government is a challenge that the countries of the region have yet to address successfully.

Another powerful instrument of sectoral policy is direct State investment, possibly implemented via State-owned enterprises, which are very important in key sectors in a number of countries in the region. Even though there is a great deal of room for manoeuvre in this area, as a number of cases show, particularly at the local or subnational level, they are little used in the region. The experience suggests that while the cumulative effects of the policy combinations applied so far have yet to be evaluated, the inducements they create have not been strong enough.

It has been argued that small countries with more limited institutional capacity cannot and should not introduce policies that are sectoral in scope. While it is certainly important that the domestic market could be used to achieve economies of scale and learning, it cannot be denied that this is less of an issue in open economies or economies with potential for regional or subregional integration, as shown by the experience of numerous small countries that operate as highly competitive export platforms. That institutional capacity is a significant requirement is not in doubt, particularly in the short term, but the fact of its being limited does not mean that sector-wide activities need be ruled out, but rather that they should be focused on subsectors, segments or even products for which existing capacities suffice. The region’s experience with cluster policies reveals that even small countries have succeeded in creating policies to improve their pattern of specialization.

With regard to the spaces for action to allow international trade agreements, Ul-Haque (2007) points out that, at present, the scope of industrial policy is limited by the growing interference of World Trade Organization (WTO) rules in areas previously considered as being within the purview of national domestic policies. In addition to reducing trade barriers overall, WTO rules prohibit export subsidies and quantitative restrictions on trade, except in the least developed countries. The rules also include trade-related foreign investment measures (TRIMs) (under which local content or export performance requirements are not permissible) and intellectual property measures (TRIPS) (the rules on the subject must meet certain minimum standards). However, as Rodrik (2004) states, the importance of these constraints should not be exaggerated because the biggest obstacle to the development of industrial policies is not the ability of governments to implement them but rather their willingness to do so, as the cases of Republic of Korea, Singapore and others have demonstrated.

There is no consistent political will to implement sectoral initiatives in the region. Even in countries that do not regard sectoral policies as legitimate, they are still practiced in an ad hoc way, and specific support measures are often applied to crisis-hit sectors. Given that these policies are necessary for development in the region, the question is what has to be done to increase their legitimacy.

Two lines of action are paramount. First, there is a need to improve implementation capacity to narrow the gap between the policies formulated and the ability of institutions to implement them; the persistence of this gap damages the credibility of policymakers and, hence of the policies themselves. Second, considerable progress is needed in the task of assessing the impact of policies in relation to their ultimate objectives: economic growth, technological progress, higher productivity. Given the scarcity of public resources, only robust evaluations can create the scope for reallocating resources from other policy areas to these, backing up the argument that it is just as important to use fiscal resources for these policies as it is to invest in education, or public health or safety.

Despite significant progress since the days when the belief was that “the best industrial policy is none at all”, from a broader perspective a crucial question remains open. Apart from improving policy implementation and evaluation to diversify the production structure, it is necessary to bolster social agents interested in seeing these policies applied on a wide scale in the region’s countries, i.e. agents that would pledge their economic and political resources to initiatives of this type. Industrial policies have made a slow comeback in Latin America and have been able to operate, albeit on a small scale, in most countries with open economies and macroeconomic policies favouring nominal stability above that of real variables, despite the prior belief that such macroeconomic policies would be incompatible with the use of industrial policies. For these policies to have more than a marginal impact, social actors, including the State, will have to commit themselves to them and back them up with their authority and resources, linking them with the macroeconomic, social and environmental policies that drive productive development.

B. Macroeconomic policies

A macroeconomic policy for development faces a number of challenges: real and nominal stabilization of the economy; transformation of the production structure; and progressive income redistribution for equality. Without overlooking the region’s positive performance in terms of nominal stabilization (by preventing inflationary pressures and insurmountable strains on the balance of payments and public finance), the goal is to achieve and sustain a high growth rate in productive activity. This growth should be able to generate the number of jobs needed to absorb the growing labour force and maintain full utilization of installed capacity, stimulating investment and structural change.

This document proposes that special importance should be accorded to the way in which macroeconomic policy impacts on income distribution. In addition to the known effects of inflation on the poorest sectors of the population, there is the impact of the real exchange rate on real wages and the composition of employment between tradable and non-tradable sectors, coupled with the impact of public spending and the tax structure on the income of the various economic strata.

Macroeconomic policy encompasses fiscal, monetary, exchange-rate and financial policy (including macroprudential regulatory measures), as well as incomes policies. There is no ideal recipe for combining policies and instruments that can be replicated in all countries of the region irrespective of their structural characteristics. Moreover, as this proposal suggests, broadening policy objectives beyond nominal stability alone, the repertoire of policy instruments needs to be revised and expanded.

This section discusses, first, the role of fiscal policy; second, the role and linkages between monetary and exchange-rate policies; third, macroprudential regulation; and fourth, the regulation of cross-border capital flows.[22]

1. Fiscal policy

(a) Countercyclical fiscal policy

As mentioned in chapter IV, fiscal policy is one of the most effective instruments in countercyclical macroeconomic policy. This requires it to play a complementary role to that traditionally played by monetary policy in managing aggregate demand and controlling inflation. Implementing a countercyclical policy entails: timely identification of the start, end and intensity of each phase of the cycle; appropriate institutions to monitor macroeconomic variables and estimate the impact of shocks; and enough fiscal space to allow the necessary public spending to offset the weakening of aggregate demand during the downturn, without jeopardizing the sustainability of public finance and the balance of payments.

(i) Broader fiscal policy

The importance of expanding the fiscal space during boom periods is evident given the costs of making drastic adjustments during downturns. Such adjustments would further reduce disposable income and tax revenues, increase debt in terms of GDP and exacerbate inequality.[23] The fact that most countries in the region (except for Brazil, Argentina and a few others) have a small tax burden and a lower share of direct taxation than other countries justifies increasing the tax burden as a means of expanding the fiscal space during the upswing phase, especially personal income tax. Advantage could be taken of the favourable circumstances associated with cyclical upswings to abolish, or at least limit, personal income tax exemptions (referred to as “tax expenditures”). The same rationale could also be applied, during periods of rising international prices, to tax on revenue from the exploitation of natural resources. For countries where natural resources are a not major source of budget revenue, public debt levels are higher or tax revenues are more modest, including several in Central America and the Caribbean, the challenges for expanding their fiscal space will be greater and their options more limited.

(ii) Automatic fiscal stabilizers

Automatic fiscal stabilizers can be applied to both revenue and expenditure. Countercyclical behaviour of tax revenues can be promoted by combining progressive taxation (i.e. tax rates rising in step with real income) with a broad tax base. This would lead to a relative

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22 Incomes policy is discussed in section VI.C.

23 Apart from helping to manage demand by taking a countercyclical approach, expanding the fiscal space is also warranted in order to maintain fiscal surpluses for resolving tensions in the financial system, which can increase during downturns (Hannoun, 2010).

reduction in tax revenue during downturns and a relative increase during upswings, inducing a countercyclical dynamic of disposable income and spending.

The tax that best meets these requirements is income tax. However, as mentioned in chapter IV, this is precisely the tax with which most Latin American and Caribbean countries have the biggest problem, owing to narrow tax bases, high levels of evasion and avoidance, and preferential treatment or hefty exemptions (Gómez Sabaini, Jiménez and Podestá, 2010). Expanding the tax base, reducing exemptions, strengthening tax control, ensuring tax progression and simplifying taxation (along the lines of the dual systems in Scandinavia, Spain or Uruguay, for example) would reinforce it as a countercyclical instrument and allow a better relationship to be established between taxation and equality. Sales tax or value added tax (VAT) also play a stabilizing role by virtue of their countercyclical behavior, but have potentially regressive distributive effects.

On the public spending side, while some Latin American and Caribbean countries use countercyclical mechanisms, they are too small-scale to rely on exclusively. Only seven countries in the region have unemployment benefit or insurance schemes (Argentina, Barbados, Bolivarian Republic of Venezuela, Brazil, Chile, Ecuador and Uruguay) and, even there, the coverage of such schemes is insufficient given the high level of informal employment and failure to register a significant percentage of the employed. Accordingly, it has been suggested that, under certain conditions associated with downturns, the region's legislatures could authorize the executive branch to automatically implement emergency investment programmes that are both directly and indirectly labour-intensive (ECLAC 2010a). Furthermore, consideration could be given to temporary conditional cash transfer programmes targeted at vulnerable groups and to training programmes for the unemployed, as a number of countries have done. In an especially severe economic recession, the executive would have prior approval from the legislature to extend the programmes automatically. Such authorization would need to be for a limited period to ensure that interventions are temporary and consistent with the intended countercyclical impact.

(iii) Fiscal rules

The aim of fiscal rules is to make macroeconomic policy credible by minimizing the possibility of discretionary intervention by the authorities.[24] The first fiscal rules to be introduced in the region were associated with stabilization programmes funded by multilateral lending agencies. This first generation of rules was based on quantitative targets for public sector financial performance, such as fiscal balance or a maximum level of deficit, which ultimately contained a bias that was just as procyclical as the bias they sought to avoid, if not more so.[25] Three factors drove proposals to reduce the discretionary power of the region's governments: (i) the weakness of automatic stabilizers, (ii) the procyclical bias of public finances; and (iii) the opposition to State economic intervention that had prevailed since the mid-1980s.[26]

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[24] There are different types of fiscal rules. While Australia, Canada, New Zealand and the United Kingdom prioritize transparency and accountability in the management of public finances, in continental Europe and some emerging economies, including a number in Latin America, fiscal rules rely more on numerical reference values (targets or limits) relating to the performance of certain fiscal indicators than on procedural matters (Kopits, 2001).

[25] The problems the euro zone is experiencing support this view.

[26] In general, the argument for the usefulness of fiscal rules has drawn on what has been dubbed the "new political economy" that, in democratic societies, fiscal rules are necessary to limit the power of rulers, who are prone to adopting discretionary measures with a deficit or procyclical bias when faced with an electorate that may be unable to understand the adverse consequences of such discretionary action, or is indifferent to the intertemporal budget constraint of the public sector (Buchanan and Wagner, 1977).

Countercyclical policy calls for the maintenance of a cyclically adjusted fiscal balance that forces governments to save resources during boom periods (generating a fiscal surplus) and allows them to spend resources during downturns (when there is a temporary deficit).[27] Working with a cyclically adjusted fiscal balance makes it possible to stabilize expenditure, by mitigating or removing the procyclical bias of a policy aimed at achieving an annual fiscal balance or a specific target of overall balance. Table VI.1 lists the main features of the fiscal rules adopted in the region between 2000 and 2010, some of which had a procyclical orientation and others a countercyclical or acyclical orientation, as in the case of Chile and Colombia.

Table VI.1
LATIN AMERICA: MAIN FEATURES OF FISCAL RULES

Country	Rules	Type	Coverage	Period of adjustment	Status	Year of entry into force
Argentina	Nominal growth in primary expenditure must not exceed nominal GDP growth.	Rule on spending	General government	Yearly	Law	2004
	Jurisdictions must maintain financial equilibrium in executing their budgets.	Current-account rule	General government	Yearly	Law	2004
	In each fiscal year, debt servicing must not exceed 15% of net revenue-sharing transfers to municipalities.	Rule on debt	Subnational governments	Yearly	Law	2004
Brazil	Spending target set by the government	Rule on spending	General government	Yearly	Law	2000
	Budget target set by the government.	Current-account rule	General government	Yearly	Law	2000
	Debt target and ceilings set by the government.	Rule on debt	General government	Yearly	Law	2001
Chile	Non-financial public sector (NFPS) primary surplus target set by the government and adjusted on the basis of the business cycle.	Current-account rule	Central government	Cyclical	Political commitment	2000
Colombia	The operating costs of subnational territorial entities must be financed from their current revenue.	Current-account rule	General government	Yearly	Law	2003
	Public expenditure is budgeted on the basis of structural revenue obtainable in various medium-term scenarios net of cyclical components (structural balance).	Current-account rule	Subnational governments	Yearly	Law	2001
Ecuador	Central government current expenditure must not increase by more than 3.5% in real terms.	Rule on spending	Central government	Yearly	Law	2003
	Non-financial public sector (NFPS) current operating expenditure must not increase by more than 2.5% in real terms.	Rule on spending	General government	Yearly	Law	2003
	The non-petroleum deficit must be reduced by 0.2% of GDP per year (until it reaches zero).	Current-account rule	General government	Yearly	Law	2003

27 That is to say, excluding from the estimate any variations arising from specific booms, slowdowns or even contractions in economic activity.

Table VI.1 (concluded)

Country	Rules	Type	Coverage	Period of adjustment	Status	Year of entry into force
Mexico	Any proposal for new or higher expenditure must correspond to a (non-borrowing) revenue initiative or must be offset against reductions in other spending items (balanced budget).	Rule on revenue	General government	Multi-year with a budget ceiling	Law	2006
	Surplus income (above the budgeted figure) must be used to offset rises in unbudgeted spending. Any remaining funds must be credited to four different funds in the proportions specified by law.	Rule on revenue	General government	Multi-year with a budget ceiling	Law	2006
Panama	Non-financial public sector (NFPS) deficit of between 2% and 2.5% of GDP.	Current-account rule	General government	Yearly	Law	2002
	Reduce public debt to under 40% of GDP by 2017.	Rule on debt	General government	Yearly	Law	2002
Peru	Current expenditure growth must not exceed 3% in real terms.	Rule on spending	General government	Yearly	Law	2000
	Non-financial public sector (NFPS) deficit equivalent to 1% of GDP.	Current-account rule	General government	Yearly	Law	2000
Venezuela (Bolivarian Republic of)	Current account targeting.	Current-account rule	General government	Yearly	Law	2000

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean 2010-2011* (LC/G.2506-P), Santiago, Chile. United Nations publication, Sales No. E.1.1.II.G.3.

The adoption of a structural balance rule poses methodological problems in calculating parameters, particularly the long-term trend growth rate of potential GDP. The rule could create a situation where underestimation of the sustainable growth rate of potential GDP results in an effective growth rate lower than would otherwise have been feasible. Indeed, the definition of cyclically adjusted tax revenue depends on this fundamental parameter. The lower the expected growth in taxes, the less public spending needs to grow to maintain the fiscal balance, so reducing effective growth. Thus, underestimation of the potential growth rate reduces growth, leading to a "self-fulfilling prophecy" of low growth. The design and analysis of structural balance rules must take into account the impact exerted on long-term GDP growth by policies on income, spending and fiscal financing. The rules must also consider the quality or composition of public spending, recognizing that the proportion of investment in spending is likely to affect the long-term growth rate of the economy.

Owing to its institutional implications, the establishment of a fiscal rule (should this option be chosen) should be part of every country's gradual learning process. Such a rule could be part of a fiscal covenant, which, by embodying political consensus, confers greater institutional strength. Having built this consensus, it would be possible to define further components of the rule, such as the simultaneous removal of budget rigidities and the methodology for measuring the cyclically adjusted deficit, as well as the escape clauses and institutional arrangements for ensuring proper control and accountability. Provided that the necessary agreements are reached, it is possible to resort to temporary discretionary measures to deal with cyclical swings, while remaining wary of any temporary inconsistencies these may cause.

(iv) Discretionary policies

An important point in the discussion about the appropriateness of introducing fiscal rules is their credibility. Given that, in practice, this is achieved over time and not merely by announcing a rule, in principle there is nothing to prevent governments from adopting consistent fiscal behaviour, supported by restricted discretionary measures. The benefits in terms of credibility would be the same as from compliance with a fiscal rule, without losing room for manoeuvre or the ability to exercise discretion, especially in extreme circumstances (see, for example, Leith and Wren-Lewis, 2005). Many countries in the region adopted restricted discretionary measures of a countercyclical nature during the 2008-2009 crisis, which included a temporary increase in public investment and current expenditure, especially transfers to vulnerable groups, and lower taxes (ECLAC, 2009).

There are a number of practical problems with discretionary interventions, especially during cyclical downturns. First, political and administrative decisions can delay spending or tax changes and prevent timely intervention.[28] To avoid this type of problem, an investment programme covering a long period of time, associated with industrial policy priorities, should form part of a restricted discretionary approach. Second, it is not always clear when the contraction (or expansionary) phase of the cycle has ended, or how quickly public spending can be implemented. Accordingly, the precise time to switch from an expansionary fiscal policy to one of reversing stimulus packages is debatable. There are two risks: ceasing stimulus measures too soon, as has happened in some developed countries as a result of a political focus on fiscal austerity not necessarily consistent with technical criteria (Romer, 2011); or retaining stimulus measures even though they are no longer warranted, as occurred in some countries in the region following the 2008-2009 crisis. [29] One way to avoid such risks is to establish or strengthen automatic stabilizers.

It is important for countercyclical fiscal policy to be tied closely to industrial policy, as regards both the destination of spending and tax collection. The use of fiscal space resources should be defined in the light of the objectives not only of stability and smoothing the business cycle, but also of structural change and equality. Countercyclical fiscal policies define amounts of resources and the best time for spending and investment based on cyclical dynamics. However, the sectors to which resources are allocated (the qualitative dimension of spending) must be defined taking into account development goals. Only by sustaining investment, especially in fast-growing sectors, will it be possible to keep up output and productivity growth, averting a sharp recession and the resulting widening of the technology gap.

It matters from which sectors taxes are raised. The choice of sectors and actors for funding the increased fiscal space has implications not only on distribution but also on industrial policy. Environmental taxation is one way of combining the qualitative dimension of tax collection with a policy of structural change, as discussed below.

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28 This problem may also affect schemes governed by fiscal rules that fail to specify in advance what type of spending can be undertaking during the contraction phase of the cycle.

29 This type of problem can also arise under a fiscal rule, given the difficulties with calibration, or when an unusually favorable or adverse external shock occurs.

(v) Other instruments

Fiscal revenue stabilization funds, using revenues from taxation or the exploitation of natural resources, can help to stabilize current expenditure and add countercyclical financing. They can also help to stabilize the foreign exchange market by regulating the supply of foreign exchange, which makes it essential to maintain close coordination between tax and foreign exchange authorities usually located in different institutions.[30] Examples in some countries in the region may provide a basis for designing such funds (see box VI.5).

Box VI.5

TRINIDAD AND TOBAGO'S HERITAGE AND STABILIZATION FUND

Trinidad and Tobago's Heritage and Stabilization Fund (HSF) was established with the passing of HSF Act. No. 6 in March 2007. This fund was previously known as the Interim Revenue Stabilization Fund (IRSF), which came into existence in 2000. All proceeds from the IRSF were transferred into the HSF, and the fund is denominated in United States dollars. The HSF Act incorporates several of the "best practices" identified in literature pertaining to such commodity funds. It also outlines details on the establishment and management of the fund, including operational guidelines, resources of the fund and governance arrangements. The purpose of the fund is to save and invest surplus revenues derived from petroleum production in order to:

- cushion the impact on, or sustain, public expenditure capacity during periods of revenue downturn, caused by a fall in prices of either crude oil or natural gas;
- generate an alternative stream of income so as to support public expenditure capacity as a result of revenue downturn caused by the depletion of non-renewable petroleum resources;
- provide a heritage for future generations of Trinidad and Tobago, from savings and investment income derived from excess revenues.

Source: Ministry of Finance and the Economy, Government of the Republic of Trinidad and Tobago [online] www.finance.gov.tt/legislation.php?mid=20

In the 2008-2009 crisis, multilateral lending agencies played an important countercyclical role by granting loans that were extended considerably at that time.[31] Even though it is not an automatic stabilizer, this form of quick access to credit could be put in place systematically and, in particular, lending agencies could facilitate the development and speedy implementation of bilateral or subregional investment programmes, in such areas as infrastructure, during downturns. The regional financial architecture could be strengthened in support of economic integration objectives and contribute to the countercyclical policy, particularly in small open economies.

The consolidation of expanded subregional or regional markets could broaden the geographic scope of individual national countercyclical measures. This could be achieved, as Central America is currently attempting and the European Union has already done, by establishing a single market with

[30] For a description of these stabilization funds in the region, see ECLAC (2011b), Ffrench-Davis (2010b) and Martner and Tromben (2004).

[31] Several Latin American and Caribbean countries were given access to new facilities implemented by the International Monetary Fund (IMF), such as the Flexible Credit Line (FCL), "precautionary" standby arrangements and quick access to short-term loans under the Exogenous Shocks Facility (ESF). The 11 agreements signed in 2009 were under these new arrangements. Costa Rica, the Dominican Republic, El Salvador and Guatemala signed precautionary standby agreements; Mexico (US$ 47 billion) and Colombia (US$ 10.5 billion) accessed the FCL. Dominica, Saint Lucia and Saint Vincent and the Grenadines received ESF credits, and Belize and Saint Kitts and Nevis accessed the Emergency Natural Disaster Assistance (ENDA) facility. In the first half of 2010, El Salvador and Jamaica signed non-precautionary standby agreements, Grenada increased its Poverty Reduction and Growth Facility (PRGF) arrangement and Mexico extended the FCL it received in 2009. See Jiménez and Lorenzo (2010) and ECLAC (2010a).

free movement of goods. Agreements are needed to avoid the collection of sales tax (VAT and excise taxes) at borders,[32] as well as transport and infrastructure improvements and logistical arrangements at customs to reduce transaction costs between countries (Funes, 2011). Valuable experiences already exist that should be developed further, such as the Initiative for the Integration of Regional Infrastructure in South America (IIRSA) by the South American Infrastructure and Planning Council (COSIPLAN) of the Union of South American Nations (UNASUR), or the Mesoamerican Integration and Development Project (Project Mesoamerica or Puebla-Panama Plan (PPP)).

(b) Taxation and structural change

Fiscal policy must go beyond quantitative aspects and numerical rules on public debt, deficits or spending. It must take into account the impact of public finances on development goals, long-term growth and income distribution. It is not only public spending that matters but also the quality of such spending, as it has a decisive impact on the long-term trajectory of the economy (Stiglitz, 2002). Two of the most important public spending components are social spending and public investment in infrastructure, health and education, as discussed in the next section. Spending on public investment can offset the decline in private spending in downswings. It also lays the foundations for higher long-term growth because it increases capital stock and may shift the production structure. It is therefore necessary to avoid social spending and public investment being used as adjustment variables during downturns, as often happens in the region, although this was not the case in the 2008-2009 crisis (see chapter III).

Discussed below are two areas with the potential to combine increased fiscal resources with strategies and lines of action to advance environmentally sustainable structural change. They could have a powerful impact as they change profitability incentives across sectors, internalizing negative externalities and reducing the depletion rate of non-renewable resources. There are externalities to be corrected in both production and consumption, in what chapter II described as “showcase modernity”.

The first potential area is environmental tax reform. The abolition of fossil fuel consumption subsidies and well-designed environmental taxes are crucial to align relative prices and internalize negative externalities (Ekins and Speck, 2011; Kreiser and others, 2011; Cnossen, 2005). This would help to generate the resources needed for a structural change towards knowledge-intensive, low-pollution sectors. Environmental tax reform must be accompanied by a set of regulations to support these changes with the right economic incentives and price signals, and an appropriate institutional framework. In the region, such a reform would expand the fiscal space and narrow gaps in income distribution because the environmental costs are borne primarily by the poor.

There is scope to reduce fossil fuel consumption subsidies, especially petrol, paying attention to and implementing compensatory mechanisms for low-income sectors and bearing in mind that some countries in early stages of development consider such subsidies to be an effective tool for promoting their industrialization. The trade-off is not easy and achieving a suitable compromise means stepping up efforts to develop new technologies, for example for the production of substitute goods and services, such as new forms of public transport. Meanwhile, increasing environmental taxes has great revenue potential, not least because of strong growth in the region’s vehicle fleet. Data for member countries of the Organization for Economic Cooperation and Development (OECD) show that taxes on energy and motor vehicles account for between 1.5% and 2% of GDP (see OECD, 2010).

[32] To prevent governments from losing tax revenue, other tax collection mechanisms can be used to offset losses.

Environmental tax reform, appropriate regulation, green public procurement, mainstreaming environmental criteria into investment projects, credit support and aligned sectoral policies are some of the ways to create the right framework for environmentally sustainable structural change.

The second potential area is good governance of natural resources. On the back of a rise in commodity prices, between 2004 and 2010 revenue from the region's mining sector as a percentage of GDP nearly quadrupled, while that from the hydrocarbon sector doubled compared with the average for 1990-2003.[33] The State collects taxes, royalties and other duties on this revenue.

Good governance of natural resources refers to the policy framework regarding the ownership of those resources and the appropriation and distribution of rents therefrom to maximize their contribution to development. A combination of the following objectives is therefore crucial.

- Increase revenue collection from the extractive sector through schemes to increase progressiveness during cycles of rising prices, without impairing investment growth.
- Channel these funds into long-term investments, such as education and training, innovation and technological development, and infrastructure. Efficient investment of rents from non-renewable resources is a basic criterion of long-term sustainability, known as Hartwick's rule.[34]
- Institutionalize proper macroeconomic management of such rents, while preventing them from having a negative impact on the exchange rate and the production system.

Increasing rent collection during cycles of rising prices necessitates adjustments to the regulatory framework and tax treatment. In contrast to the hydrocarbon sector, where such instruments as production-sharing contracts and windfall taxes are in common use, tax regimes in the mining sector have been slower to incorporate progressive instruments to tax windfall profits, once the projects have recovered their sunk costs for exploration and capital investment, and attain or exceed rising thresholds in their rates of return.[35]

Latin American and Caribbean countries have struggled to translate boom periods for exporting their natural resources into development processes. Challenges with organizational efficiency and the establishment of institutions remain, which are of special importance in the current price cycle. To address them it is necessary to build political consensus on improving institutions, regulatory frameworks and policy instruments governing the exploitation of non-renewable resources.

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33 See ECLAC (2012a). This document examines the share of States in the economic rent from the mining and hydrocarbon sectors over the past decade. For example, the estimated revenue from the region's mining sector rose from an average of 0.54% of GDP over the 1990-2003 period to an average of 2.08% of GDP over the 2004-2010 period (World Development Indicators, Database 2011).

34 Hartwick's rule defines the amount of investment in capital stock (buildings, roads, knowledge stocks, etc.) that is needed to exactly offset declining stocks of natural resources. This investment is undertaken so that the standard of living does not fall as society moves into the indefinite future (Hartwick, 1977).

35 The main exception in the region's mining sector is the contract for the Pueblo Viejo project, concluded between the Government of the Dominican Republic and Barrick Gold Corporation. This contract includes the condition that, once the project has reached a 10% internal rate of return, the State will take a 28.75% share of net profits. In combination with 3.2% royalties and 25% income tax, this instrument would give the Dominican State close to a 50% share in the project's net flows. For examples of progressive instruments in the hydrocarbon sector, see IMF (2010).

2. Monetary and exchange-rate policies

(a) Degrees of freedom in monetary policy

Some of the objectives of monetary policy are to achieve low and stable inflation, moderate cyclical fluctuations in real variables and help to set the main macroprices for promoting development. As monetary policy is also closely linked with the stability and solvency of the financial sector, it needs to be coordinated with macroprudential policy and policy to control cross-border capital flows. Monetary policy should also be coordinated with fiscal, industrial, incomes and other policies. Which strategy a country's monetary authority chooses to adopt will depend largely on the structural characteristics of the country's economy and the external environment (including changes in terms of trade, exposure to international liquidity shocks and changes in expected external demand).

The effectiveness of monetary policy is conditioned by the response of capital flows to interest rate changes in economies that have liberalized their financial account – the "trilemma" described in chapter IV.[36] This document has shown how strategically important the level, variance and dynamics of the real exchange rate are in the medium and long terms. The deepening financial globalization following the fall of the Bretton Woods regime of fixed exchange rates, particularly over the past two decades, has highlighted the constraints that monetary authorities face in practising an independent monetary policy, while at the same time maintaining some control over the exchange-rate path, especially in countries most deeply integrated into international financial markets (Eatwell and Taylor, 2000). As discussed in chapter IV, these constraints are reflected in the importance of the exchange-rate channel in the region.

A countercyclical monetary policy that raises the interest rate during the boom phase may be at odds with the procyclical effect of the capital inflows it encourages, which promotes exchange-rate appreciation. Even though appreciation can help to keep inflation under control during the expansionary phase, by stimulating imports and penalizing exports it increases the external deficit and discourages investment and employment in the production of tradable goods and services. In many cases, the price of tradable goods falls relative to non-tradable goods, which is an unsustainable trend in the context of a growing current account imbalance. The perception of vulnerability can then disrupt capital inflows. Conversely, during a downturn the process may be reversed: reducing the interest rate causes an outflow of capital that contributes to exchange-rate depreciation. This stimulates inflation, to which the response is an interest rate increase, which then exacerbates the recession.

The use of monetary policy to sustain a competitive exchange rate also has its problems, such as increased inflationary pressure. This may make it necessary to slow the expansion of aggregate demand using non-interest rate mechanisms, such as fiscal policy, which conflicts with using it for achieving other policy objectives, in particular development goals. There are a number of complementary lines of response to challenges such as this.

A first line of response is to alter the starting conditions of the trilemma, limiting the free entry and exit of short-term capital. By restricting such movements, interest rate changes will fail to generate the arbitrage opportunities that attract foreign capital, limiting their impact on the

[36] The trilemma states that it is impossible for an economy to have all three of the following at the same time: (i) free entry and exit of foreign capital; (ii) an independent monetary policy; and (iii) a fixed exchange rate.

foreign exchange market. The regulation of short-term capital flows affords greater latitude in the exercise of monetary policy, making it possible to contain the expansion of aggregate demand when it accelerates too fast, while avoiding the risk of causing an untenable situation in the external sector. In turn, by reducing the need for intervention in the foreign exchange market in times of high capital inflows, this type of regulation reduces the quasi-fiscal cost associated with such interventions. In order to provide an exchange-rate policy with greater latitude, a number of countries in the region have introduced measures to reduce the potential for high short-term profits using interest rate arbitrage (carry trade).[37]

The following section discusses in more detail the different types of control on international capital flows and their main effects. A complementary policy for regulating the financial account is macroprudential regulation of domestic financial systems, which is also analysed in the following section. By restricting the rate at which domestic credit expands during the upward phase of the cycle, macroprudential regulation can, in addition to its original goal of mitigating the systemic risk of domestic financial systems, play a countercyclical role complementary to that of monetary policy.

A second line of response is to give fiscal policy a more influential role in managing aggregate demand. The less independent the monetary policy is (a more open financial account), the greater this role will be. It is therefore necessary to evaluate the trade-offs between using fiscal policy as an anti-inflationary tool or as an engine of long-term economic growth.

When the trigger of inflation is exogenous (typically a rise in the price of a basic input or food), international experience shows that there are other policy instruments (such as taxes or variable tariffs applied to domestic consumption or foreign trade) that can help to contain inflation, reducing the need for a contractionary monetary or fiscal policy (Jones and Kwiecinski, 2010).

For this reason, any short-term analysis of the relationship between monetary and exchange-rate policy, on the one hand, and inflation and growth, on the other, will need to distinguish between pressures of supply and pressures of demand. If rising inflation has been caused by international price shocks, stabilization instruments will be needed to reduce price volatility, preventing upward pressure on inflation expectations.

Such economic policy dilemmas are not easy to resolve in practice. If monetary policy relegates its traditional anti-inflationary role, even partially, in pursuit of an exchange-rate target (or, more generally, to preserve the external equilibrium), and transfers to fiscal policy the role of containing any increases in inflation, this may excessively restrict the scope of public investment policies. There should therefore be more tolerance of short-term inflation stemming from large demand-generating investment packages before deciding to increase productive capacity, which would avoid disrupting the investment process early. For this and other reasons, coordination between monetary and fiscal policies is essential to moderate business cycles and resolve any conflict between growth and price stability objectives.[38]

[37] Examples include Chile in the early 1990s, Colombia between the early 1990s and now, Argentina following its debt restructuring in early 2005 and, more recently, Brazil and Peru.

[38] One institutional mechanism to facilitate such coordination might be an economic policy committee or office tasked with reconciling macroeconomic and financial objectives with productive and social objectives.

A third line of response refers to incomes policies, specifically the coordination of price and wage increases between trade unions and employers. The aim is to reduce the rate of price and wage rises through agreements in order to avoid recessionary measures. This is only feasible where workers' and employers' organizations are strong and representative, and are able to reach a credible and verifiable commitment.[39]

(b) Exchange-rate policy: effects on the diversification of production and distribution

The region's experience in recent decades suggests that it is necessary to avoid using the exchange rate as the only variable of adjustment to external imbalances. Stabilizing macroeconomic policies should, especially if a boom in capital inflows is in the offing or in progress, consider policies that avoid excessive short-term exchange-rate fluctuations with a permanent negative effect on resource allocation. This requires a managed float exchange rate, which has advantages over rigid fixed exchange-rate regimes.

One means for achieving a stable competitive exchange rate is an international reserve management policy. The costs and benefits of accumulating reserves should be considered when implementing such a policy. Benefits include discouraging speculative short-term capital movements and guarding against sudden capital outflows. A comfortable stock of international reserves would make it possible to avoid making sudden adjustments in the balance of payments, especially during downturns when there is more danger of a sudden or sharp devaluation. Costs include a lower return on short-term investment of international reserves than could be achieved by other means. Where there is no sterilization of foreign-exchange-market interventions carried out to build reserves, an additional cost is incurred in terms of inflationary pressures. By contrast, where the policy is accompanied by sterilization measures, the quasi-fiscal cost must be taken into account.[40]

Policies for increasing productivity, thereby increasing competitiveness for a given nominal exchange rate, also help to reduce pressure on the exchange rate. Greater diversification of the economy by enhancing the quality of the basket of goods creates non-price competition and provides return on investment with a degree of independence from the real exchange rate.[41]

Furthermore, to support the efforts of governments seeking to avoid exchange-rate overkill, the international financial architecture (both global and regional) should put in place timely and sufficient compensatory financing schemes under conditions that foster development.

In the relationship between exchange-rate policy and income distribution, it is necessary to consider the negative impact of exchange-rate depreciation on real wages (Díaz-Alejandro, 1963; Krugman and Taylor, 1978). All else being equal, real wages increase or decrease as the exchange rate appreciates or depreciates. The positive relationship between real wages and exchange-rate appreciation has led some analysts to describe prolonged episodes of ultimately unsustainable exchange-rate appreciation as "exchange-rate populism" (Dornbusch and Edwards, 1991; Bresser-Pereira, 2010, chapter 4). As discussed earlier, this is when real wages are raised artificially, while at the same time the current account balance deteriorates and job creation contracts owing to the negative impact of the appreciation on the production of tradable sectors. However, maintaining

[39] For a discussion of the role of incomes policies in managing the business cycle, see Abeles, Gerstenfeld and Vega, 2011).

[40] For an analysis of the quasi-fiscal impact and sustainability of a sterilization policy associated with a policy to prevent currency appreciation, see Frenkel (2007).

[41] There is considerable literature stressing the importance of the exchange rate as an instrument for productive development and real macroeconomic stability (Ffrench-Davis, 2010a; Rodrik, 2011).

competitive real exchange rates can generate sustainable paths of real wage growth over time, as they provide greater access to global markets, economies of scale and rapid output, productivity and employment growth.[42]

Like incomes policies, pro-competition policy plays an important role. It prevents firms with great market power from passing on costs to prices disproportionately, while incomes policies moderate the intensity of the distributive struggle in the process of price and wage formation.

In short, it is necessary to ensure that wage growth does not lag behind nominal GDP growth. This means that the "price effect" (falling real wages in response to a depreciating short-term nominal exchange rate) should be more than offset by the "employment effect" (growth in jobs linked to improved profitability of the tradable sector, higher investment and more demand for labour in the long term), plus the "productivity effect" (stemming from faster growth and access to the economies of scale in the international market (Kaldor-Verdoorn's law)).

3. Macroprudential policy

The aim of macroprudential regulation is to preserve the stability of the financial system by minimizing systemic risk (Correia, Jiménez and Manuelito, 2009).[43] This helps to prevent the excessive contraction (or expansion) of the balance sheets of financial institutions that tends to accompany the recessionary (or expansionary) phase of the business cycle, as well as to control their economic and social costs (Hanson, Kashyap and Stein, 2011).

To date, macroprudential countercyclical measures in the region have been limited to dynamic provisioning for credit losses, as in Colombia, Peru and the Plurinational State of Bolivia.[44] As regards countercyclical capital requirements for financial institutions, the proposals are more diverse.

To minimize the procyclicality of the current capital standards (the ratio between capital and risk-weighted assets), it has been proposed to supplement it with a limit on leverage based on the ratio between the core capital or Tier 1 capital (Financial Services Authority, 2009) and gross assets (i.e. credits, but this time non-risk-weighted).[45] It is argued that not only is this is a more robust measure of a financial institution's solvency, it is also less procyclical than the current criterion. A second proposal is for dynamic capital requirements, which would be increased in credit expansion phases and lowered in declining phases, lessening the procyclicality of credit because the cost (the need to raise new capital) would rise during upswings.

[42] It is necessary to take into account the extent and speed with which changes in the nominal exchange rate are transferred to prices (pass-through), affecting the inflation rate. If this effect is strong, a devaluation will result in a significant increase in domestic prices, without the real exchange rate being affected substantially.

[43] This has been defined as "a risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy". There are two major dimensions to systemic risk: one is temporal, relating to how risk in the financial system evolves over time, how it accumulates and how it links in with the real business cycle; the other is cross-sectional, relating to how risk is distributed in the financial system at a given point in time and what interconnections and common exposures may exist between its agents (IMF, 2010). See Kaufman and Scott (2003).

[44] In Colombia, for example, banks reached an agreement with the regulator for part of their profits to be deposited in a reserve fund for emergencies. In Brazil, cyclically adjusted capital reserves are used (*de facto*, not *de jure*).

[45] The core capital or Tier 1 capital refers to the portion of regulatory capital that is provided directly by shareholders. While definitions vary from case to case, this is akin to effective net worth, excluding subordinated bonds.

As regards liquidity, the debate has only just begun and regulation of this aspect is expected to become even more important than that of capital, requiring the adoption of measures to restrict maturity transformation and so ensure a closer match between the maturity structure of assets and liabilities. While this carries a cost in terms of the ability to support long-term ventures, it has the benefit of promoting a stable financial system, with positive implications for long-term growth.

The primary aim of domestic macroprudential regulatory instruments is to prevent financial instability and fragility. However, in practice, they can produce effects similar to those of a countercyclical monetary policy, inducing changes in aggregate demand but without the strict need to modify the policy interest rate, with the result that there are fewer side effects in the foreign exchange market. Indeed, during the expansionary (or contraction) phase of the business cycle, macroprudential policy tends to mitigate (or stimulate) growth in domestic credit, which is generally used to increase private consumption, preventing the burden of adjustment (stimulus) in aggregate demand from being placed entirely on monetary and fiscal policies. Thus, macroprudential regulation can help to distribute the burden of countercyclical measures across a wider range of instruments, improving the chances of success and curbing unwanted side effects caused by implementing each instrument separately.

From the macroprudential standpoint, financial account regulation is key to mitigating the local impact of more volatile international financial flows. Furthermore, it can effectively influence the behaviour of local financial institutions and the portfolio decisions of external agents, influencing the financial account balance. Given the difficulties in enforcing financial account controls, some authors suggest that efforts should focus on macroprudential regulation (Calvo, 2010).

Moreover, financial account regulation is a necessary complement of managed float exchange-rate policies, as it makes monetary policy decisions more independent from the dynamics of foreign exchange markets. If the financial account is unregulated, opting for a managed float regime would mean relinquishing virtually any chance of pursuing an independent monetary policy.

4. Financial account regulation

Liberalization of the financial account following the reforms of the late 1980s and the 1990s was based on the assumption that free international capital movements would stimulate growth. The theory was that incomplete openness to cross-border capital flows would undermine global risk diversification and decrease investment in developing countries, diminishing their long-term growth.[46]

However, volatility and abrupt reversal of capital flows has been a factor in the spread of financial crises, exacerbating macroeconomic volatility, with adverse consequences on growth, employment and income distribution (Akyuz, 2012; Easterly, 2001). The increased macroeconomic instability associated with volatile cross-border flows amplifies the procyclical tendencies of some government policies, narrowing the scope for governments to use countercyclical measures (Kaminsky, Reinhart and Végh, 2005). As a result, the administration of cross-border financial flows has become a prerequisite for progress towards a macroeconomic policy more consistent with industrial policy objectives (Ffrench-Davis, 2005; Ocampo, 2009 and 2011).

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[46] Indeed, during the 1990s, the International Monetary Fund discussed the possibility of amending Article VI of its Articles of Agreement authorizing member countries to use controls on the entry and exit of foreign capital. In the end the plan was thwarted by the Asian financial crisis of 1997.

There are two types of instrument for regulating the financial account (Epstein, Grabel and Jomo, 2003). Direct instruments are associated with administrative measures such as bans or quantitative limits on capital flows. Indirect, or price-based instruments, are normally associated with measures to increase the cost of capital flows, such as explicit taxes or unremunerated reserve requirements on flows. Explicit taxes are based on a percentage fee, usually imposed on the gross amount of foreign capital. Unremunerated reserve requirements are an obligation on potential foreign investors to deposit in the central bank a fraction of the capital entering the country, without receiving interest payments. In practice it acts as a tax.[47]

The region has had mixed experience with financial account regulation. Chile's, in the first half of the 1990s, was successful.[48] More recently, countries like Argentina, Brazil, Colombia and Peru have attempted regulation to avoid excessive appreciation of the exchange rate (ECLAC, 2009 and 2010a, cap. II).[49] In addition, several countries have increased the number of instruments for regulating cross-border capital flows. Costa Rica (2012), El Salvador and Peru (2010-2011) have implemented unremunerated reserve requirements on short-term liabilities payable to foreign banks in order to skew foreign bank lending to the longer term. Chile and El Salvador have reserve requirements on foreign loans to banks of less than a certain term, and Costa Rica is seeking to implement such requirements in 2012. Peru has made ample use of such instruments in recent years in order to skew foreign bank lending to the longer term. In 2007, in a scenario of capital inflows, Peru exempted long-term foreign loans from the 30% reserve requirement then in place for foreign debt. It reduced the cost of this form of funding and improved the profile of bank liabilities, making banks less vulnerable to changes in external financing conditions. Although reserve requirements were abolished in 2008, in response to prevailing liquidity constraints, in early 2010 renewed capital inflows led to their being re-imposed on foreign loans to banks for a term of less than two years (Terrier and others, 2011).

There is some debate in the region about the effectiveness of this form of regulation because of economic agents' ability to circumvent or evade regulatory schemes by creating new financial instruments not covered by the original regulation. According to authors such as Stiglitz and others (2006), interventions do not need to be fully effective to justify being implemented. The purpose of regulations on capital inflows is to reduce the amount of short-term inflows by turning them into long-term investment projects, penalizing their "premature" withdrawal and making monetary and exchange-rate policies more independent. They also make it easier to manage the exchange-rate policy in times of speculative capital outflows (flight to quality), reducing the financial and external vulnerabilities associated with sudden stops (Magud and Reinhart, 2006).

[47] For a calculation of the tax rate implicit in reserve requirements, see De Gregorio, Edwards and Valdés (2000), and Ocampo and Tovar (2003).

[48] In that period, Chile faced a significant supply of external financing, which led the authorities to regulate the amount and composition of capital inflows, making short-term flows more expensive by imposing an unremunerated reserve requirement deposited with the central bank. This gave the authorities breathing space to implement simultaneous countercyclical monetary and exchange rate policies (Magud and Reinhart, 2006; Edwards and Rigobon, 2009). In the latter half of the 1990s, Chile's policy changed and, in 2001, it curtailed the regulatory power of the reserve requirement to liberate the capital account (Ffrench-Davis, 2010b, chapter IX; Le Fort and Lehmann, 2003).

[49] For example, Brazil has an explicit tax on capital inflows (financial transactions tax (IOF)). The IOF was abolished in October 2008, after the fall of Lehman Brothers, in a context of severe external illiquidity. However, in late 2009 the IOF was reinstated, this time leaving out foreign direct investment (FDI) and foreign loans to banks and businesses with a term of more than three years, in a scenario of strong capital inflows into Brazil and pressure towards currency appreciation.

Without effective regulation of short-term capital flows, instability in international financial markets has negative implications for income distribution. The poorest sectors of the population tend to be hardest hit by exchange-rate and financial crises, in the form of rising unemployment and falling real wages. In developing countries, weak social safety nets exacerbate the negative effects of a crisis. Moreover, the asymmetry in international mobility of factors of production (labour immobility versus capital mobility) results in capital acquiring more bargaining power than workers (especially unskilled workers), which also has distributional impacts.

5. Final comments

The analysis in this section reveals a need to expand macroeconomic policy objectives and instruments and enhance coordination between authorities in charge of the various macroeconomic policy areas, as well as between them and authorities responsible for industrial and social policies. It also highlights the importance of building up fiscal space to allow the implementation of countercyclical policies and of tying the structure of taxation and quality of spending to development goals.

The instruments are already in place and there have been successful experiences of using them. By far the greatest challenge lies not in choosing which instruments to use or discussing their usefulness but in having (or building) the institutional basis and political backing needed to implement and operate them effectively.

The proposed instruments relating to cross-border capital movements and financial system regulation call for complex negotiation with a highly concentrated and organized economic sector with strong international connections, this being a classic problem of collective action. Other instruments influence the real exchange rate, with a heavy impact on the purchasing power of workers and the middle classes. It is no wonder that “exchange-rate populism” has been so widespread in the region, as it offers immediate political benefits and deferred costs, by creating a perception of purchasing power, which is in fact inconsistent with real levels of productivity and competitiveness.

Since the 2008-2009 crisis, civil society has lobbied increasingly for tighter regulation of the financial system, in response to the enormous economic, social and political costs incurred by unsustainable financial and real estate booms. This problem is compounded when financial sector imbalances are “socialized”, i.e. when governments end up taking over these liabilities and transfer the risk and costs onto sovereign debt and society as a whole. The difficulties currently facing Europe, as well as those experienced by the United States not long ago (which it has not completely overcome), and those suffered by Japan in the 1990s (whose effects continue to this day), are examples of such costs and of how difficult it is to recover afterwards.

Similarly, experience in recent decades has made the costs of excessive appreciation of the real exchange rate only too apparent. Such currency appreciations have been behind the powerful external shocks to have struck the region since the 1970s, and often overlap with and compound domestic financial crises. Avoiding excessive appreciation is central to economic stability and growth; international consensus has shifted in favour of stricter regulation of short-term capital movements.

A further point is that, in the short term, a higher real exchange rate has a negative impact on real wages. This will be acceptable only where the trade-off is higher employment (to avoid reducing the wage share of GDP), accompanied by faster productivity rises, with real wages growing at the same rate. Over time, this can offset initial losses.

Substantial institution-building is needed to build consensus among key stakeholders (government, business and workers) on the distribution of costs and benefits and to secure viable compensation commitments.

C. Social policies

The previous sections have shown that macroeconomic policy and industrial policy must be coordinated and not left to go their separate ways. This is in the interests of establishing synergies between the long and the short term, where exchange rate, fiscal and financial policies influence not only the duration and amplitude of cycles and their costs and benefits, but may also create incentives or disincentives to investment, diversification of the production structure and, more specifically, greater convergence or divergence in productivity levels throughout the economy. Conversely, greater diversification of production, with significant absorption of technical progress and narrower productivity gaps, is key to cushioning the effect of cycles and building endogenous capacity to sustain competitiveness and move forward with structural change.

The relationship between macroeconomic policy and industrial policy is the prelude to a set of dynamics that occur in the sphere of employment and distribution of productivity gains.

Productivity gaps lead to gaps in the quality of employment, which in turn segments access to social protection. The ultimate challenge remains to move towards universal social protection, which calls for: (i) closing historical gaps in the area of social protection, stemming largely from gaps in the coverage of the contributory system and incomplete coverage by general government revenues, depriving many people of timely access to safety nets; (ii) to mitigate the impact of vulnerability caused by fluctuating growth and economic crises; and (iii) as mentioned in chapter V, to protect those temporarily affected by changes in the world of work from the planned structural changes.

In the sphere of workers' social security, a long-term scenario under which the proportion of high-productivity activities grows would bring about significant improvements. However, during the transition to this scenario, redistributive instruments should be established and strengthened to provide specific guarantees of protection. Such instruments must address the specific characteristics and requirements of each society and the various population groups within it.

Under the broad umbrella of social protection, more traditional redistributive policies (transfers and taxation) are an important feature in the region, as are labour policies. They include risk protection policies (mainly unemployment insurance) and labour market stimulus policies (training, labour market intermediation and job creation), both of which are crucial in supporting and enhancing the process of structural change. Finally, the process of transformation to a more homogeneous production structure dominated by high-productivity sectors necessitates deep-seated changes in the labour market, which must take place within a framework of reinforced labour market institutions, where the minimum wage and wage negotiations play a key role.

This document argues that a virtuous process of structural change would create the necessary conditions for quality employment with rights. However, it is not enough on its own. Labour market institutions must be designed in such a way as to create and enhance virtuous circles between productivity gains, higher wages and quality job creation (Weller and Roethlisberger, 2011). This entails, first, passing on more of the productivity gains to working conditions (in the form of higher wages and other monetary and non-monetary aspects of job quality) and, second, enhancing objective and subjective facets of job quality that increase productivity. Legal regulations and regulation through collective bargaining are means for furthering these goals.

Moreover, growth and development strategies that focus on higher productivity and the increasing incorporation of knowledge and technology require a leap forward in human capacity and more equal opportunities for building it. It is difficult to use new investment efficiently and realize potential productivity gains without a workforce with growing skills and knowledge. In addition, narrowing skills gaps enables new investment in the production structure to be capitalized, ensuring that employment leads not only to higher productivity but also to narrower wage disparities.

Below are a number of proposals in different labour and social policy areas that are relevant to the changes advocated in this document.

1. Countercyclical employment and income policies

Wages, coupled with productivity, affect the competitiveness of businesses and economies, as well as household consumption and hence domestic demand. Skewing policies in favor of only one of these aspects has negative distributional implications. Accordingly, policies that overemphasize the wage aspect as a production cost tend to result in greater inequality. Continuing such policies over the long term in regions with severe inequalities like Latin America and the Caribbean is not only ethically questionable, it also jeopardizes the social sustainability of prevailing patterns of economic growth.[50] In turn, policies aimed at stimulating domestic demand by means of large wage increases unrelated to productivity may accelerate inflation,[51] creating external imbalances and endangering the competitiveness of many businesses, in addition to posing a risk of destroying lower productivity jobs. Incomes policies should therefore seek a sustainable balance between wages and productivity, in terms of both their long-term objectives and their management over the cycle.

Quality job creation is key to reducing poverty, as well as a means for increasing long-term growth capacity. In past crises that have struck the region's economies, formal employment was typically an adjustment variable. While not all countries suffered to the same degree, invariably this led to higher unemployment and informal employment, with different weightings between the two mechanisms.[52]

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50 It has been argued that great inequality impacts negatively on economic growth, in terms of the rate of growth as well as the sustainability of growth periods (Bourguignon, Ferreira and Walton, 2005; Berg and Ostry, 2011). One factor at the root of the financial crisis that erupted in United States in 2007 was the move by low-income households to offset increased income inequality and the resulting impact on their purchasing power by increasing debt (credit cards, mortgages) (ILO-IILS, 2011).

51 Where productivity gains outstrip real wage increases, as has been the case in the region at certain times, it is feasible and desirable for real wages to rise above productivity for a given period.

52 As pointed out by Ros (2006), wages were not an alternative adjustment variable. Although historically real wages in the region have been more flexible than, say, in the United States (González Anaya, 1999), falling real wages had little impact on retaining formal employment during crises. Instead, formal employment and wage purchasing power were lost simultaneously because falling output was often accompanied by high inflation.

Falling real wages owing to shrinking labour demand, combined with bouts of high inflation tend to have a long-term impact. For example, it was not until 2005 that real wages in Mexico's formal sector returned to their level prior to the 1994-1995 crisis. Similarly, real wages in Uruguay took until 2010 to return to 1999 levels.[53]

In turn, the variability of growth also has an adverse impact on employment in the long run because not all the job losses suffered during recessions are offset by the gains during recoveries. So, between the mid-1990s and 2002, when there was a string of recessions followed by brief periods of recovery, the unemployment rate of many countries in the region see-sawed, with a general upward trend.[54]

During the recent crisis of 2008-2009, two aspects differentiated labour market performance compared with previous crises. Both relate to government policies implemented during the crisis, which provide a number of lessons for the implementation of countercyclical employment and income policies (see ECLAC/ILO, 2011).

First, contrary to what happened in previous crises, real wages did not fall in 2009. In 2008, nominal wages rose sharply in response to stagnant or lower wage purchasing power caused by a surge in inflation (especially in the price of food). The subsequent fall in inflation from 8.2% in 2008 to 4.7% in 2009 on a weighted average of the region, mainly on the back of falling international food and oil prices, allowed a significant percentage of the nominal wage increases to be translated into real gains. In addition, countries pursued minimum-wage policies, which resulted in a median 3.6% increase in real minimum wages across 16 countries. Thus, the evolution of real wages, both as an average and in the lowest echelons, helped to stabilize the purchasing power of wage-earners' households.

Second, a number of countries made efforts to safeguard employment by means of social protection. In spite of the contraction in regional GDP in 2009, formal employment grew slightly. This was aided by the optimism of many businesses that the crisis would be temporary, coupled with a strong and rapid recovery in the region's economic activity. A number of labour market policies already in force, or introduced during the crisis, also helped to increase formal employment (ECLAC, 2009).[55]

In addition to policies for safeguarding employment covered by social protection, the region has used other labour instruments that can be implemented effectively during the contraction phase of the cycle and could be developed further. They include unemployment insurance schemes, which are automatic stabilizers par excellence and played a key role in some countries during the crisis. Further development of existing unemployment insurance schemes and the creation of new schemes in other countries are key tasks for any labour policy seeking to combine business cycle management with protection of workers' incomes in the event of job loss.

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[53] Workers who experience periods of unemployment often have to contend with poorer quality employment and lower wages later in their careers (Bucheli and Furtado, 2002; Herrera and Hidalgo, 2003).

[54] In a panel study, Navarro (2009) found that the elasticity of employment to economic growth is much higher in recessionary phases than in upswings.

[55] A number of countries have continued to implement policies for formalizing businesses and labour relations, which have resulted in a large increase in the number of jobs covered by social protection, in excess of the job creation rate. This has been facilitated by enhanced labour inspection, following a period where it had become weakened, as was typical of the 1990s (Bensusán, 2009). In turn, several countries helped to provide training to workers threatened with dismissal owing to the difficult economic context.

Countries in the region have extensive experience with emergency public employment programmes, which are designed to stabilize household income in the contraction phase of the cycle. Emergency programmes focus primarily on people who do not have a formal job and are therefore unaffiliated to a contributory unemployment insurance scheme. The advantage with emergency programmes is that, provided they have been properly designed in advance, they can be implemented and extended rapidly in a shock situation. On the other hand, they pose a challenge of how to manage them throughout the cycle because there tends to be resistance to their removal during the expansionary phase. Finally, to supplement labour policies, the targeted social programmes already in operation could be extended quickly to stabilize the incomes of the neediest households.

One instrument that is little used in Latin America and the Caribbean but has proved effective in other regions is negotiated, partially subsidized short-time work (IMF, 2010). It combines lower costs for firms during a crisis with a proportionally smaller pay cut for workers than their reduction in working hours (while providing more time off). This averts total loss of employment.

Over the past decade, many countries have strengthened their labour market institutions, which helped to enhance implementation of the policies mentioned (Weller, 2009). However, the fact is that the resources available for such policies tend to be meagre, making it difficult to speed up the processes of decentralization and modernization needed to expand their coverage and efficiency.

In short, minimum wage policies, unemployment insurance, emergency employment schemes, transfers and social programmes for the poorest and most vulnerable sectors of the population can help to maintain or increase aggregate demand and shorten the duration of the contraction phase, producing a countercyclical effect on employment and incomes.

2. Employment policies and care networks

Labour policies are instrumental in supporting and driving the process of structural change. Unemployment insurance to provide income to unemployed workers is one of the most important policies because of its stabilizing effect. Apart from being a countercyclical instrument, unemployment insurance, together with training programmes, can serve as a compensatory mechanism in processes of structural change that will alter the sectoral composition of demand for skilled labour.

As noted above, few countries in the region have unemployment insurance, and even in those that do, it is limited in scope owing to the large proportion of jobs without social protection. Structural change would lead to growth in employment covered by social protection and, hence, to a higher percentage of social security affiliates, with positive effects in terms of revenue for the system. Accordingly, closer productive convergence, the formalization of businesses and growth in medium- and high-productivity firms would serve to broaden unemployment insurance coverage. However, it is also necessary to progress with implementing unemployment insurance programmes in countries where none yet exist. Specific aspects of the design of new programmes (eligibility requirements, replacement rate, financing) call for detailed preparatory studies and consideration of the lessons learned from countries in the region with experience of such programmes.

Until insurance coverage is expanded, a section of workers will continue to be unprotected and it will be necessary to guarantee their coverage by funding alternative non-contributory schemes.

A major shortcoming of existing unemployment insurance schemes in the region is their weak linkage with policies for improving the functioning of labour markets and the quality of labour supply. This group of policies usually includes labour market intermediation services, training policies and job creation policies (direct employment programmes or employment subsidies for firms hiring staff). This may require public employment systems to be established or strengthened, integrating support for job-seekers with training and unemployment insurance. Information and communication technologies (ICTs) are a key tool in the labour market intermediation process, as they can help to match workers more closely with firms, an area that has not yet been fully exploited in the region.

Public employment systems have a further role to play in including the groups least integrated into the labour market. In particular, they can provide access to a first job by introducing incentives targeted at increasing youth employment, for instance. The increased public investment in infrastructure required by structural change will boost job creation. Public employment programmes can also be used to offset the recomposition of labour demand stemming from structural change, which must be coordinated with training and support for job-seekers.

Within a context of promoting high-productivity activities, it is vital to ensure that the workforce matches labour demand requirements. Learning must be geared to each country's future needs in line with its productive development. Strengthening the linkage between the technical training system and the world of work is an unfinished agenda in countries of the region. This would be aided by increasing labour market transparency by supplying information on employment conditions for various professions and trades, employment/unemployment, wages, and other aspects. Such information should be provided by the labour market observatories established in several countries in the region. Labour market intermediation systems must be given access to this information, and should be informed of the specific needs of businesses and the existing knowledge and skills of job-seekers in order to achieve good job placement outcomes, not only in terms of quantity (high recruitment rate) but also in terms of quality (matching worker skills closely with employer requirements). Public employment systems need to be developed and made sustainable, to enable them to coordinate the various interventions involved.

A number of challenges may be identified in relation to vocational education and training. First, it is necessary to ensure that a growing proportion of young people without a university degree enter the workforce with a qualification as a non-university technician or skilled worker, steadily expanding the proportion of workers with intermediate-level training. Non-university technical training is still weak in many countries of the region (Jacinto, 2010). Second, the technological and organizational changes so typical of today's labour market call for workers to acquire new knowledge and skills as part of a lifelong learning process.

Special consideration should be given to care networks, where labour policies tie in with social protection systems. Up to now, the social organization of care has tended to place the burden of caring for children and sick or elderly relatives on women. Market solutions, namely paying for care out of pocket, primarily benefits higher-income households and women, which is another form of inequality among women themselves. This requires a decisive move towards networks of care where the State plays a more prominent role in the provision of services, ranging from workplace crèches and nurseries, schools and community centres to care centres and home support workers for disabled or elderly adults unable to take care of themselves. Very few countries in the region today have a clear agenda for integrating into their social protection policies care services that ensure a more equal distribution of the care burden among the four stakeholders involved: families, communities, the State and the market.

There are clear synergies to be derived from integrated care networks (where labour and social protection policies overlap). Releasing some of the time women spend on this unpaid and thankless care task contributes to the path of egalitarian structural change. Including women in quality employment is synergistic with productivity gains. Women's higher average level of formal education compared with men in the region is an asset that should be tapped to boost this female labour supply and to facilitate their employment in more knowledge-intensive sectors by means of policies to prevent labour market discrimination against women.

Precisely because they reach the most vulnerable families, social care networks support households that cannot afford care: those with the largest number of young children and single-parent households headed by women. The lower labour force participation of women in low-income households creates a vicious cycle of inequality and poverty, as it is those very households that face the highest ratio of dependents to income contributors. So, to facilitate higher labour force participation among women in these groups, it is necessary to increase the incomes of the neediest households.

Finally, incorporating the organization of care into integrated social protection systems expands the life choices of many women who shoulder the largest burden of care in family arrangements. This would contribute to gender equality by providing opportunities for personal development and participation in society.

3. Labour market institutions

Over the past decade, many countries in the region have improved their labour market indicators while at the same time strengthening their labour market institutions, in stark contrast to previous trends (Weller, 2009). However, there are still severe shortcomings in labour market institutions and unfinished business in the area of labour market regulation. There are marked age and gender biases, and large swathes of the working population are not covered by core labour standards. The "dual" model that exists in the region is one of the main obstacles to the transferral of productivity gains to low-income workers and to breaking down the barrier between "insiders" (formal workers) and "outsiders" (informal workers), which is then transposed to social protection.

To facilitate the structural change scenario, labour market institutions must be designed in such a way as to create and enhance virtuous circles between productivity gains and quality employment.

Productivity gains must be used to improve to working conditions, in both monetary and non-monetary terms and with an emphasis on training. This will help to create a virtuous cycle including greater job satisfaction and worker commitment. A strengthened framework of labour institutions will help to bring about these changes.

The region needs to push forward with legal regulations that establish minimum labour rights regarding working hours and social benefits, as well as such rights as paid leave and a year-end bonus (13th month salary). Although countries in the region have introduced a statutory minimum wage, its real coverage is limited because of the high proportion of jobs without social protection.[56] Again, expanding protected employment as part of a productivity-increasing process would help to broaden the scope of the minimum wage, augmenting the positive impact of this instrument on poverty and inequality. In recent years, countries in the region have upgraded their minimum wage, improving the lives of low-income workers. They should pursue this policy direction, while recognizing that increases must be consistent with economic development, to avoid falling into default (Marinakis, 2008).

Employee profit-sharing should be considered an integral part of collective bargaining, based on the premise that the active involvement of workers in an organization is crucial to enabling it to optimize gains (Durán, 2011). Legal regulations must ensure another fundamental right to avoid excluding workers from quality employment and ensure that productivity gains are transferred to them: unionization and collective bargaining. Following a marked decline in unionization in the region over the past decade, trade union organization has increased in a number of countries. In some cases, legal changes facilitated collective bargaining, for example for subcontracted workers and female domestic workers. This raises a need to move towards the formalization of social dialogue by embedding it in government agencies, in the form of social dialogue councils, which are already operating in some countries in the region. New dimensions could be incorporated into spaces for negotiation, or even escalation clauses in an economic crisis to address the different phases in the cycle, moderating adjustment costs during downswings and boosting growth phases, while giving a central role to the relationship between productivity gains and wage increases (Marinakis, 2008).

4. Redistributive policies

While ECLAC has argued that employment is the main route to social inclusion, it also recognizes that, in the short and medium term, the very segmentation of access to quality jobs will prevent the region from achieving the levels of welfare to which it aspires (ECLAC, 2006). The classical contribution equation between employment and social protection does not close because the large proportion of informal employment sets a “ceiling” on possibilities for increasing productivity and contributory social protection for much of the working population. It also determines the type of employment open to those who are outside the labour market or unemployed.

Immediate action is needed to remedy this structural conditioning and achieve long-term results. In most countries only a portion of the population is employed in medium- and high-productivity sectors and is affiliated to social security. Employment in low-productivity sectors and unemployment are typically associated with larger, lower-income households, young mothers with small children, and sectors that are the least educated, poorest or most vulnerable to poverty (ECLAC, 2012b).

As a result, the non-contributory solidarity pillar of social protection, which in developed countries was intended to cover a residual sector of the population, has come to occupy a central role in Latin America and the Caribbean. The demands on this pillar are great, primarily because a large section of the population is still excluded from the contribution equation. While only a small percentage of households receive public transfers, they are relatively significant among poor

[56] Some countries in the region have a nationwide minimum wage (Argentina, Brazil, Chile, Peru and Uruguay), while others set wage levels by occupational category (Costa Rica, Guatemala, Honduras and Paraguay) or by region (Mexico). Uruguay has a national minimum wage in general application throughout the country, which is combined with a specific minimum wage for each activity and occupation set by wage boards (Marinakis, 2008).

households, with those in the first decile receiving double the average. Despite persistent limitations in terms of coverage, there is a highly progressive distribution of public transfers and they play a major redistributive role in the region (ECLAC, 2010b).

Cash transfers have the advantage of tackling people's risks head on, as they target households with children, teenagers and young adults, prioritizing coverage of poor households headed by women and focusing effectively on the non-working and unemployed sectors (ECLAC, 2011b). Some countries use cash transfers to help the neediest sectors of the population to procure social services. However, cash transfer programmes are not a replacement for the functions of other instruments, and their effectiveness largely depends on the presence of well-established universal health and education systems (Cecchini and Madariaga, 2011). Boosting the supply of such services remains a priority in the region.

Even in countries with more developed social protection systems, non-contributory programmes, including non-contributory pensions, continue to be critical to people's social protection, especially where there are high levels of informal employment. In terms of both coverage and spending, the non-contributory pillar is still a long way from catering to all those experiencing acute vulnerabilities. The expansion and consolidation of this pillar remains a priority objective and, to that end, it is important to enhance institutional and financial stability in order to turn the non-contributory pillar into State policy.

The process of structural change should consider including a further means for achieving equality, apart from reducing wage gaps and ensuring a fairer distribution of productivity gains and other factors. The State could appropriate some of the productivity gains, through taxation, to boost funding for social policies targeted at sectors of the population that are experiencing the greatest difficulties or need more time to secure better-paid, quality jobs. As discussed in the following section, while non-contributory transfers clearly have the greatest redistributive bias, they cost very little in monetary terms and, as a whole, account for a tiny percentage of social spending and GDP. So, capitalizing on leaps in productivity to continue building more robust and inclusive social protection systems is part of any agenda for combining structural change with equality.

As mentioned earlier, segments of the economically active population and their families may face periods of adjustment to changing production patterns, with job losses and problems in regaining decent employment. This makes investment in unemployment insurance and job training a crucial part of any development agenda seeking to promote inclusive social protection linked with capacity-building and a more productive return to the labour market. Using the dynamics of production itself to fund a resource buffer for these ends will, in the long term, result in more cohesive societies with a shared development strategy and, when structural change is complete, in a less segmented labour force.

As already mentioned, tax policies are a key component of structural change with equality. Not only do they further change by generating revenue to finance public spending (including transfers), they also impose progressive taxes, the burden of which increases in step with taxpayers' rising levels of income or wealth. As the region's tax structures rely mainly on indirect taxation on goods and services (chiefly value added tax), the potential redistributive effects of taxation are greatly weakened by inadequate income taxation, including a narrow tax base, high degree of evasion and targeting mainly of corporate and non-personal income (see chapter IV).

Overall, taxation on capital is low (differential treatment and exemptions persist) and wealth tax represents a very small portion of tax revenues. Even though the total tax burden has increased in recent decades, it is lower than in other countries with similar levels of development. The scale of indirect taxation undermines the redistributive effects of the fiscal system, even making it regressive in some countries.

Levels of income inequality prior to State intervention are much the same in Latin America as in developed countries. However, the redistributive capacity of national tax systems in the region is, at best, poor or non-existent compared with developed countries. As a result, the region's levels of income inequality after State intervention are considerably greater than in developed countries. This means that there is room for making the tax system more progressive, which should be done by improving the design of income and wealth tax and increasing revenues from it. This is no easy road, as there are strong structural constraints, including a large informal sector, low average income levels and weak tax administrations, as well as the resistance that direct taxation often triggers. Increasing the progressivity of tax systems is therefore one of the fundamental means to increase income equality.

5. Social spending in the transition towards structural change with equality

In the past two decades, countries in the region have made great efforts to increase the resources available for social policy. Encouragingly, public social spending in the region has shown steady growth. While in 1990-1991 it accounted for 45% of total public expenditure, by the start of the third millennium it had risen to 58% and, in 2006-2007, it reached 63%. Social spending in 21 Latin American and Caribbean countries increased from 11.3% of GDP in 1990-1991 to 17.9% in 2008-2009.

With regard to sectoral trends in social spending, all the major items have increased, albeit unevenly. Welfare and social security was the fastest-growing item, rising to more than three percentage points of GDP between the periods 1990-1991 and 2008-2009 and accounting for more than half the entire public social spending increase. The second item was education, with an increase of 1.85% of GDP over the same period.

How is this dual component of social protection —welfare and social security— distributed across society? The two types of spending have a very different distributional bias. While welfare transfers, both public and private, benefit mainly those in the first deciles, retirement benefits (given that they are contributory or fully funded by individual savings accounts) benefit the wealthiest deciles. Pensions are more evenly distributed on account of their strong non-contributory component (ECLAC, 2010b).

As a result of high labour market segmentation, the preponderance of the contributory pillar in social security leads to retirement benefits being paid mainly to those in the highest income deciles. Increasing the number of jobs covered by social protection in a context of higher productivity, as part of a process of structural change, would lead to a more even distribution of retirement benefits in the long run.

However, as noted, non-contributory transfers are a critical resource to protect those most at risk during the early stages of structural change. Combined with appropriate capacity-building, they generate the necessary synergies to ensure that change is socially inclusive and that it taps into a wider pool of skilled workers to meet the new production requirements. Moreover, the composition of social spending is likely to be reformed and funding may well increase (as a result of changes in the appropriation of surpluses from productivity gains). This would promote a pro-equality distributional bias as the solidarity pillars of social protection gradually carve out a gateway to a universal system of incremental minimum thresholds of welfare. For this to happen, it is crucial to increase substantially the items corresponding to non-contributory transfers, in order to continue moving from a welfare bias to integrated and inclusive social protection systems.

It is important to consider how approaches to social protection have changed: there has been a gradual shift of emphasis towards protection to alleviate collapse of income, exposing people to situations of vulnerability and social risk. Such approaches break with the targeting rationale and call into question the benefits of individual capitalization models in social protection systems. They also seek to combine the poverty reduction component with that of fighting inequality, by linking together and implementing a variety of social programmes integrating the provision of traditional social security, social services and non-contributory transfers.

Finally, investment in education is crucial to both promoting structural change and progressing towards more egalitarian societies. There is abundant and conclusive literature to confirm this. While it is not within the scope of this document to propose education sector reforms, it is within its scope to stress the key role of capacity-building in structural change. Educational systems play a pivotal role in matching labour supply to demand. While recognizing the importance of education as an end in itself, the magnitude of this matching task should not be underestimated, especially at a time when production and work organization models are changing in response to vigorous absorption of technical progress.

Most countries in the region have tested a wide range of education system reforms and have injected an increasing share of their total social expenditure into the sector. While it is true that the upcoming generation will enjoy more years of formal education than its predecessors, neither the increased resources nor the direction of reforms have succeeded in narrowing educational attainment gaps between different social groups, nor have they led to clear improvements in the quality of education, measured as relevant learning throughout the formal education cycle.

Experience shows that some policies do help to narrow gaps in educational paths and to improve learning. They include: universal free public education at pre-school level; widespread introduction of ICTs into public schools and their use in the classroom; increased investment in support of learning and in timely school progression throughout secondary education; teacher training geared to the new methods of knowledge production and transmission; and the consolidation of technical and vocational education systems to provide many young people with options to join the labour market and take part in the dynamics of productive change.

All this calls for additional resources for the education sector. As current expenditure swallows up almost 90% of total spending, it is essential for there to be higher financing margins to undertake systemic reforms in the field of capacity-building. As has been stated on many occasions, social spending on education is much more than spending – it is social investment in human capacity.

6. Key role of the State in charting a new social policy course towards structural change with equality

For the adoption of social and labour policies with a clear redistributive effect, as proposed in this section, it must be recognized that the State has a key role to play in harmonizing structural change with equality. On the one hand, the State must ensure that labour market institutions promote a fairer appropriation of productivity gains between the various actors in the productive world. On the other hand, it must promote an integrated social protection system, based on progressive social spending, which would address the risks and vulnerabilities that occur in the workplace and in workers' families as a result of the dynamics of transformation inherent in structural change. Finally, given the lags and gaps in human capacity, and the mismatch between the requirements of labour demand and characteristics of labour supply, the State must meet all the challenges posed by the knowledge society in this area, to ensure a more educated society where the development of relevant skills for the new world of production and communication is a universal right, coupled with an integrated system of job training that includes technical and vocational skills training components, and that provides employment opportunities commensurate with the structural change.

This is the basis of the social agenda for structural change with equality. As stated two years ago in the ECLAC document *Time for equality: closing gaps, opening trails*, this key role for the State also calls for a fiscal covenant. First, it must be a fiscal covenant where the redistributive impact of government policy is underpinned by tax reform to increase the share of direct taxation, especially personal income tax, in the total tax burden and to reduce tax evasion and exemptions. Second, the fiscal covenant should place at the heart of the public and policy debate an agenda of restructured social spending that strikes a better balance between contributory and non-contributory components, and where access to good education, health and care services does not depend on out-of pocket spending.

The State needs to be afforded a more active role in the provision of public goods and promotion of well-being, with a sustained increase in social spending, capacity-building in social and labour institutions to improve public management and remedy asymmetries in the world of work, income transfer systems with a clear redistributive impact, and integrated social protection systems with non-contributory solidarity pillars and a clear universalist approach, compatible with the principle of equal rights.