

Editorial

The Latin America and the Caribbean (LAC) region has been experiencing a growing disconnect between citizens and public institutions in recent years. Indeed, the latest *Latinobarómetro* survey shows that 75% of Latin Americans showed little or no confidence in national governments in 2017, up from around 55% in 2010. Trust in other institutions like the judicial system or elections also deteriorated as dissatisfaction with the quality of public services grew.

This growing disconnect is not specific to Latin America, as it is also gaining ground in other regions of the world, and stems from several factors, some of them particular to Latin American countries. On the positive side, a more demanding society calls for more and better public services, notably in health and education. It also asks for more efficient, trustworthy, open and innovative public institutions. This shift has been largely driven by the expansion of the middle class, one of the greatest socio-economic transformations in the region, which represents today more than a third of LAC's population. For the first time in decades, the middle class is more numerous than the population living in poverty. The implications are significant for public policies and for the functioning of democracy itself.

The *Latin American Economic Outlook 2018 (LEO 2018): Rethinking Institutions for Development* argues that reconnecting public institutions with citizens and better responding to their demands is critical for well-being and the sustainable development of the region. Indeed, it is a vital step to guarantee a new period of economic growth, social progress, political stability and greater well-being for all in LAC. The policy debate, therefore, must devote greater focus to rethinking institutions.

But the growing divide between citizens and institutions reflects some persistent socio-economic challenges, documented in previous editions of the *Latin American Economic Outlook* – including for example the persistence of large inequalities related to socio-economic background, gender, or geographical location, low access to education and skills, and the predominance of low quality, informal jobs. In addition, emerging concerns related to the international trade system and the possible implications of technological progress on the future of work also increase uncertainty. On the domestic front, low levels of productivity and the stagnation of incomes at middle-income levels – what is often called “the *middle-income trap*” – remain critical challenges for greater well-being in LAC. Despite progress, 25% of Latin Americans still live in poverty, while around 40% have escaped poverty during the last 15 years, but only to join a vast and vulnerable social group of mostly informal workers that could easily fall back into poverty. This means that close to 65% of Latin Americans still live in poverty or vulnerability.

The disconnect between society and institutions in LAC thus derives from a combination of rising aspirations and unmet demands as well as persistent and emerging socio-economic challenges that erode trust and the foundations of the social contract. Trust is a cornerstone of public governance, and critical for the success of public policy. Without trust, citizens disengage from their civic duties and find few incentives to participate in politics and to pay taxes. Eventually, this damages the legitimacy of governments and their capacity to finance and deliver good quality public services resulting in a negative spiral that further erodes the social contract.

These economic, social and political challenges are being confronted with a macroeconomic performance that is improving, but not good enough. After five years of economic slowdown and a two-year recession in 2015-16, a modest recovery is now

underway. Gross domestic product grew at a rate of 1.3% in 2017, and is projected to grow between 2-2.5% in 2018. The macroeconomic outlook still points to different “Americas Latinas”, with significant heterogeneity across countries. A stronger recovery is expected in the Southern cone than in the Andean countries and Mexico, with a more mixed outlook for Central America. Increased global trade, a moderate recovery in commodity prices and the gradual monetary normalisation in advanced economies – still supportive of financial flows – underpin the cyclical recovery in the region. Short-term risks look more balanced, but increased uncertainty about the progress of globalisation may dampen trade and foreign direct investment flows. In addition, a series of global megatrends, affecting Latin America and many other economies, is intensifying. These include weaker productivity, technological change, an ageing population, urbanisation and climate change. All of them challenge the status quo, and require more courageous and innovative policy action to embrace and deliver a future of greater well-being.

LEO 2018 highlights two areas of policy recommendations. *First*, institutions must be rethought to boost inclusive growth. The objective of achieving strong growth should go hand-in-hand with the provision of better job opportunities, greater macroeconomic stability and better prospects of socio-economic progress for citizens. Here the specific focus is on the institutional transformations needed to achieve greater levels of trade, trade integration, production diversification and value-addition. LAC needs to shift towards further regional and global integration; to that effect, persistent barriers, mainly non-tariff, need to be removed. This must be accompanied by policies to support investments in skills, technology and R&D. At the same time, the region should progress towards a stronger negotiating position in the international arena. *Second*, institutions must be rethought to build states that deliver and respond to citizens’ demands. They need to be more reliable, building a culture of integrity and transparency that leads to regaining citizens’ trust; they need to be more efficient and effective, to improve the delivery of services to citizens and make better use of existing resources; and they need to be more forward-looking, to anticipate change, adapt to emerging challenges and demands, and find innovative responses to them. Corruption, weak state capacities and lack of effective interaction channels with society all contribute to push public administrations away from citizens’ demands.

LEO 2018 presents a comprehensive analysis on the drivers of these issues in LAC and provides policy recommendations and examples of best practices that can illustrate ways forward. These practices include spreading a culture of integrity and trust across the public administration, and improving state capacities by increasing fiscal resources and administrative capabilities. They also include adopting technologies to embrace change, innovate in policy making and create spaces for citizen engagement and participation. These are all critical elements of the agenda for the coming years in the region.

We hope this joint effort by the Development Bank of Latin America (CAF), the Economic Commission for Latin America and the Caribbean (ECLAC), the European Commission and the Development Centre of the Organisation for Economic Co-operation and Development (OECD) will contribute to policy discussions on these issues. We aim to stimulate the debate to rethink institutions in LAC and adapt them to the new challenges of a rapidly changing world. Our citizens demand this, and for good reasons.

Alicia Bárcena
Executive
Secretary
ECLAC

Luis Carranza
Executive Chairman
CAF – Development
Bank of Latin America

Angel Gurría
Secretary-General
OECD

Neven Mimica
European Commissioner
for International
Cooperation and
Development



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