Chapter 4

Institutions to embrace a future of better jobs and greater well-being in Latin America and the Caribbean

This chapter argues that discussion around rethinking institutions for development in the LAC region should be forward-looking. To feed this discussion, the first part focuses on the potential impact of technological change on the world of work and on economic activity. It also reflects on the institutional challenges to guarantee good quality jobs and economic opportunities in the context of the "fourth industrial revolution". A forward-looking approach to policy making also demands a sustainable fiscal framework. This is the subject of the second part of the chapter, which analyses how to improve taxation to raise more revenues, how to improve spending and how to ensure the long-term sustainability of public finances.

Institutions to embrace a future of better jobs and greater well-being

Institutions must be forward-looking and adapt to technological change and its impact in the nature of work

Promote productive development policies

To create **good quality jobs**

Promote education and skills policies

To favour **employability** and the **match** between **demand** and **supply skills**

Support new labour market institutions

To guarantee **good job** conditions (for example, for the growing **gig economy)**

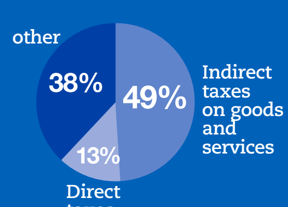
Efficient and effective public finance management enhances the use of public resources to finance better public services

Taxing better:

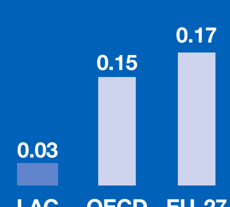
Total **tax revenues** in LAC are low and concentrated on **goods and services...**

... while the **redistributive capacity** of the tax system is low

LAC total tax revenues, 2015



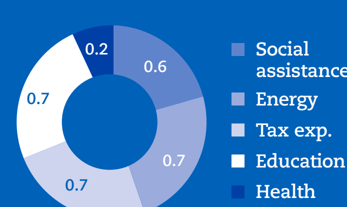
Reduction in Gini points



Investing more:

Improving efficiency of **government expenditures** could produce **3% of GDP** to increase investments

Potential savings of efficient spending



A rapidly changing global context is fuelling an increasing disconnection between citizens and public institutions in Latin America and the Caribbean (LAC), bringing new socio-economic challenges and the need to rethink institutions to embrace emerging opportunities. Various megatrends are shaping an era of uncertainty where citizens perceive new challenges and risks that demand new policy responses, while new opportunities emerge from which they have the ambition to benefit. Climate change, an ageing population and technological progress are three main global trends that could largely transform societies across the globe. Institutions need to be rethought to adapt to these new realities, and to guarantee well-being and socio-economic progress.

This chapter argues that discussion around rethinking institutions for development in the LAC region should be forward-looking. Institutions today must be designed in a way to respond to the evolving aspirations of society, as well as being flexible and adaptive to rapidly changing realities. To feed this discussion, the first part of this chapter focuses on the potential impact of technological change on the world of work and on economic activity. It also reflects on the institutional challenges to guarantee good quality jobs and economic opportunities in the context of the "fourth industrial revolution". Institutions must be rethought to support the expansion of good-quality-job-creating sectors. They should favour employability through more and better education and skills. And they should guarantee good working conditions through standards for all emerging varieties of working arrangements and through stronger social protection systems.

A forward-looking approach to policy making also demands a sustainable fiscal framework. Such a framework must guarantee the capacity of financing more and better public goods and services to respond to citizens' rising and evolving demands. This is the subject of the second part of the chapter, which analyses how to improve taxation to raise more revenues, how to improve spending and how to ensure the long-term sustainability of public finances.

Providing better jobs and socio-economic opportunities in a changing global context

Technological change will transform the nature of work in the LAC region

Technological change has reached an unprecedented pace in recent years, giving way to a new production revolution. In this context, the possibilities of production are continuously expanding, with technologies complementing and amplifying each other's potential (OECD, 2017a). Information and communication technologies (ICTs), artificial intelligence, big data, the expanding power of computing and the Internet of Things (IoT) are some notable examples of this recent trend, which many have called the "fourth industrial revolution" (OECD/CAF/ECLAC, 2016).

This trend is expected to profoundly transform economies, the world of work and the nature of jobs. Rapid innovation and technological progress will lead to deep transformations of economic structures, disrupting some industries that will be challenged as new technologies redefine the terms of competitive success (OECD, 2017a). As a consequence, some sectors may experience a significant decline in their relative share of the total economy and of total employment creation. Others, however, may undergo a steep rise in their value added, in their capacity to create jobs and in their potential for growth. These changes will largely transform economic structures, with large implications for the institutional framework that countries put in place to support sectors with good prospects for future expansion and for job creation.

Technological change in the LAC region will change the nature of jobs as the main tasks performed by humans will be strongly transformed. Technology and machines will have a much deeper presence in production processes, while workers will increasingly perform those tasks more genuinely associated with humans (i.e. non-routine, problem-solving tasks). This will have a direct impact on the kind of skills demanded for jobs and thus require a rethinking of institutions in the field of education and training. In addition, job arrangements and the organisation of work will be deeply transformed. Social and labour protection will face new challenges, including the costs of job destruction associated with more technological, innovation-led economies. This will also require a rethinking of labour institutions to guarantee good working conditions and standards of living, as well as to manage adjustments in employment associated with economic disruption.

The region must adapt its institutional framework to respond to new challenges and embrace emerging opportunities, and to provide citizens with better jobs, prospects of employability and progress and decent standards of living (OECD Ministerial Declaration, 2016). For this, it is critical to focus on productive development policies (to create good quality jobs), education and skills policies (to favour employability), and labour market institutional arrangements (to guarantee good job conditions).

Productive development policies to create good quality jobs

Technological change will transform the nature and structure of LAC economies. New sectors will be created and others destroyed with a significant shift of employment across them. The institutional response of countries to these structural transformations will largely determine their capacity to embrace emerging opportunities. It will also remain critical to align the development model with the Sustainable Development Goals (SDGs), namely with Goal 8 that focuses on promoting sustained, inclusive and sustainable economic growth, full and productive employment, and decent work.

The impact of rapid technological progress on economic structures is particularly visible in the changing role of manufacturing. Manufacturing has always played a central role in driving economic prosperity as an engine of innovation, research, job creation and productivity. But the global manufacturing structure has changed dramatically. Industrial jobs have declined in traditional industrialised countries and increased in newly industrialised countries. In the emerging scenario, industry cannot be viewed as an independent sector of the economy, but rather as the centre of a complex integrated ecosystem. Readiness to play a role in the new ecosystem is a fundamental driver of either countries' success or failure. The role of manufacturing will be critical not only as a source of quality jobs (productivity and high wages), but also as an engine of technological dynamism and an interplay between goods production and digital technologies.

The production revolution is not only transforming economic structures but also business models. In the advanced manufacturing of the 21st century, the digital and physical worlds are converging: advanced hardware is combined with advanced software, sensors and big data analytics. This results in smart products and processes, with greater interaction between consumers, suppliers and manufacturers (ECLAC, 2016). The most significant change in the economy is occurring in business models based on the connectivity of objects or the Internet of Things. In this context, the greatest advances are emerging in health (monitoring applications, medication dispensers and tele-medicine) and in manufacturing (robotisation, advanced manufacturing and the development of next-generation machine-to-machine (M2M) services), as well as in areas such as energy, transport, natural resources and smart electricity grids.

A shared vision of governments and policy makers is needed to build the preconditions for advanced manufacturing in terms of institutions, policies, infrastructures, advanced skills and technological readiness. Policy makers must understand advanced manufacturing, giving priority to all instruments needed for its development. This vision would help identify the main factors crucial for boosting productivity and development in industrialised countries, which are related to sophistication, technological development and innovation, infrastructure and education, and training (WEF, 2016). These results indicate the relevance of industrial and technological policies, as well as the importance of institutional development to foster growth and productivity. This is particularly important to set the conditions for the "fourth industrial revolution". Transformation is not defined by any particular set of emerging technologies, but rather by the transition to new interconnected systems that are being built on the infrastructure of the digital revolution.

In this context, productive development policies (PDPs) will be critical to embrace the opportunities of technological change and move towards a knowledge-based, innovation-led economy. PDPs, and the corresponding institutions and instruments, are critical tools to influence the rhythm and pattern of growth. They can have a central role in supporting the transition to a new development model (IDB, 2015; Salazar-Xirinachs et al., 2014). The institutional design of PDPs will strongly determine the capacity of countries to embrace change and favour the expansion of new, job-creating sectors. This, in turn, will provide good prospects for growth and productivity gains, as well as the diversification of the productive structure and a more sustained, inclusive and sustainable pattern of growth with more and better jobs.

This productive transformation entails expanding high-value added activities, creating value chains and removing obstacles to competitiveness (ECLAC, 2012). In this respect, the *OECD Productive Transformation framework* provides guidance to promote structural change. Under this framework, and in a context of uncertainty and complexity, more sophisticated policy approaches are needed to favour five main capacities of the institutional system that have been identified as critical to support productive transformation, namely: the capacity to be forward-looking; the capacity to be flexible and react to changing circumstances; the capacity to activate learning dynamics and engender self-discovery processes; the capacity to deal with increasingly complex networks; and the capacity to create resilient linkages and create and retain value (OECD, 2017b).

A strong institutional framework is critical to support PDPs, which have often done harm in the LAC region. In many cases, PDPs in the region have not focused on countries' latent comparative advantages or have been guided by subjective and arbitrary motivations, stemming from a rent-seeking culture and leading to economic inefficiencies. The region must avoid misguided policies, improving their impact as components of a broader development strategy.

The scepticism about PDPs in the region derives from doubts about state capacities, as well as from suspicion that these policies could be used to transfer rents to powerful groups. In this respect, three institutional capabilities appear as critical to support the effective design, implementation and evaluation of PDPs. First, technical capabilities can successfully overcome the technical challenges associated with complex policies. Second, organisational capabilities are needed to foster effective management of policy efforts and to favour policy co-ordination across sectors and with the private sector. Third, political capabilities can guarantee long-term support of strategic priorities and protect the policy process from deviations towards the private interest (IDB, 2015).

PDPs should be inserted into a broader agenda to promote inclusive growth in LAC. An "entrepreneurial" state should take a rigorous, active and forward-looking approach to assess the potential for growth of different sectors and put in place policies to support innovation-led growth. In seeking this, both the public and the private sector play relevant roles. In particular, the role of the state can go well beyond levelling the playing field for private sector initiatives. Rather, it can take certain risks that the private sector is not willing to take, as well as reaping benefits from that risk-taking to favour future investments. In this sense, innovation is not only an outcome of spending on research and development. It is more directly related to the set of institutions that allow new knowledge to diffuse throughout the economy (Mazzucato, 2013).

All in all, the advent of the production revolution represents a critical opportunity in the region to transform economies and exploit new sources of productivity and growth. Extraordinary growth in the past 15 years in LAC has mainly come from labour accumulation, as well as external tailwinds; in fact, LAC has one of the weakest productivity performances of any region in the world (MGI, 2017). But the current scenario challenges traditional sources of growth and opens up new opportunities for drivers of inclusive development. To make the most of this potential, policies must expand high-value added activities, exploiting key value chains, removing obstacles to competitiveness and fostering adoption of digital and automation activities (MGI, 2017). In this sense, policies must provide more and better education and skills for all and strengthening the link with changing labour market demands must be a core strategic priority.

Education and skills to favour employability in a new world of work

Technological progress, which is expected to largely transform the nature of jobs, will lead to a global shift in the demand for skills which is expected to also have an impact in the LAC region.

The net impact of technological change and automation on creating and destroying jobs is difficult to anticipate. It will largely depend on the capacity of countries to adopt institutional responses to the changes on the demand of skills that this will bring about. Jobs will increasingly incorporate technology, and thus humans and machines will have to interact more prominently.

The main tasks performed by workers will significantly change as demand shifts towards skills related to cognitive ability, systems and complex-problem solving. Machines will increasingly be able to replace humans in performing routine and non-routine manual tasks and routine cognitive tasks. Thus, the demand for skills will move towards capacities more specific and exclusive to humans and a rise of the demand for cognitive abilities, systems skills and complex problem-solving skills could be expected in the future (OECD/CAF/ECLAC, 2016).

These emerging challenges could be aggravated in LAC by the large educational gaps that still remain in the region. Although years of schooling have increased, international measurements show large gaps in LAC in terms of formal education in basic competencies of math, reading and science (OECD/CAF/ECLAC, 2014). There are also significant gaps in terms of vocational training and around 50% of formal firms in the region do not find the workforce with the skills they need (OECD/CAF/ECLAC, 2016). Training at the workplace is also poor: while one out of nine workers in the region receives some type of training in a year, the average for the OECD member countries is more than one out of five (IDB, 2015).

The world of education and vocational training is thus confronting one of the most profound changes in its history. To respond to emerging challenges and embrace upcoming opportunities, 21st century jobs demand skills and competencies of a more complex nature (technical, digital, socio-emotional). This implies that curricula, as well as teaching and learning methods, should be adapted so that they effectively train citizens in skills that are useful to improve their employability prospects.

These transformations also challenge educational and vocational training systems to be up to date, anticipating new requirements and offering lifelong education and training. Anticipation of skills is of particular relevance in such context. This can help address large skills' mismatches in the LAC region and prepare for future skills needs, guiding policy actions in the fields of education, labour and migration (OECD, 2016a). The use of information on skills needs, inferred from labour market information or vacancy surveys, is critical to develop occupational forecasts, to update occupational standards and to design apprenticeships and on-the-job- training programmes, as well to inform curriculum development and set the number of student places at all levels and fields of education. This information can be used more effectively when there is good co-ordination across ministries and strong engagement of stakeholders. In this respect, sector skills councils and independent bodies such as national skills advisory groups are good practices that can largely improve co-ordination (OECD, 2016a).

Governance of the education system is also critical to face a world of increasing complexity and where new challenges will test the capacity to provide the right skills and guarantee coherence and co-ordination among all stakeholders (Box 4.1). Education systems are in fact complex systems, characterised as networks of interdependent actors whose actions affect many other actors, and which evolve, adapt, and re-organise themselves (Snyder, 2013).

Box 4.1. **Governing education in a complex world**

Over the past years many OECD and LAC countries have decentralised the control of their education systems, providing schools and local authorities with greater autonomy over responding to the needs and demands of their communities. As information about school and student accomplishments are now more readily available, parents, but also teachers, students and labour unions, have become more vocal and more involved in education policy on various levels. The greater availability of information, increasingly dynamic relationships in governance arrangements and greater number of stakeholders together call for new approaches to governance (Burns and Köster, 2016).

Understanding education systems as complex means acknowledging that traditional linear governance patterns have limited applicability. Taking the example of decentralisation, devolving power to local authorities will not improve the functioning of the system unless it is accompanied by attention to the connections and interactivity present and by adequate processes supporting the realisation. If the legacies of the system as well as its ambitions for its future are not considered in policies, they are likely to backfire.

The decentralisation of decision-making powers in education to the municipal level may not always have the desired effects of greater local responsiveness. Rather, municipalities lacking adequate capacities and the culture to take responsibility for local education, may fail to implement adequate processes for peer learning and accountability within the municipal hierarchy, resulting in fragmented approaches and shutting the door on co-operation and peer learning. While decentralisation indeed can lead to greater responsiveness to local needs, it needs to be adapted to system history and culture as well as respective processes supporting the transition in place. Although it might be tempting to look for proven recipes for success, policy requires responses adapted to context and considering links between system components and culture of interaction.

Box 4.1. **Governing education in a complex world** *(cont.)*

Five elements of modern governance for complex systems

Governance must be able to integrate the dynamism and complexity of today's education systems at the same time as it steers a clear course towards established goals, all the while financial constraints dictate efficiency. Five elements are crucial to govern complexity in education:

- Focus on effective processes, not on structures. The success of governance structures depends on the underlying processes and right conditions. The number of levels, and the power at each level, is not what makes or breaks a good system. Rather, it is the alignment of policies and practices, the involvement of actors, and the processes underlying governance and reform.
- Be flexible and adaptive to change and uncertainty. Strengthening a system's ability to learn from feedback is crucial for flexibility and adaptiveness as well as for quality assurance and accountability.
- Build capacity, engage in open dialogue and involve stakeholders. While working to include a wide range of perspectives and knowledge, governance in complexity is not rudderless: productive integration of stakeholders only works with a strategic vision and set of processes to harness diverse ideas and input.
- Pursue a whole-of-system approach. Effective governance aligns policies, roles and responsibilities to improve efficiency and reduce potential overlap and conflict across the system and across policies.
- Integrate evidence, knowledge, and the use of data to improve policy making and implementation. A strong knowledge system combines descriptive data, expert practitioner knowledge and research findings – the key is to know what to use, when, why and how.

In the race between education and technology, technology is permanently challenging educational and training systems to keep pace. The structure of demand for competencies is changing fast, which challenges educational and vocational training systems to reform them to improve quality and pertinence. This is partly due to processes of productive transformation, and partly to impacts of the technological revolutions. In the traditional model, specialised institutions outside of enterprises had responsibility for vocational training. With the need to detect skills requirements of enterprises in real time, vocational training must become a public-private partnership with flexible roles and responsibilities. This would give the system the speed and pertinence required by the development process.

The region needs to rethink labour market institutions to guarantee good job conditions

Technological progress will also have an impact on the organisation of work and the nature of working arrangements in the LAC region. This will call for a rethinking of labour market institutions to guarantee decent labour conditions and good quality jobs.

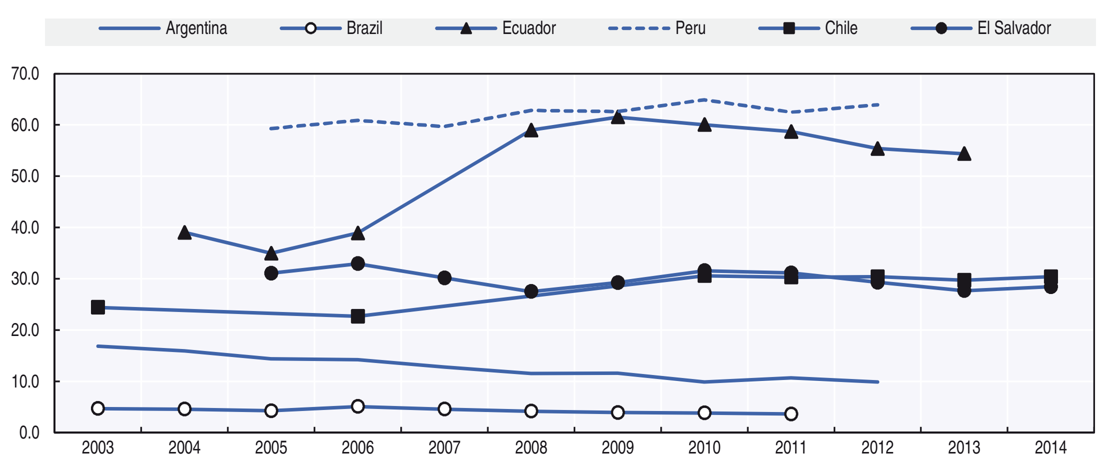
The growing diversification in working arrangements, particularly a rise in non-standard employment (NSE), has been a distinguishing feature of recent years in the world of work (ILO, 2016). This diversification reflects transformations in production from globalisation and technological advances, including digitalisation, that have helped create and disperse production networks across the globe. These transformations, coupled with the rise of artificial intelligence and robotics, the growth of the "platform economy" and the trend towards casual labour, have raised questions about the future of work. Social protection systems, including social insurance and tax-financed mechanisms, must find ways to adapt to these changes.

Types of employment have diversified. "Standard employment" has been understood as work that is full time, of indefinite length and part of a subordinate relationship between an employee and an employer. The rise of "non-standard employment" provides opportunities and challenges for the future world of work in general, and social protection in particular. Non-standard forms of employment include temporary employment; part-time work; temporary agency work and other multi-party employment relationships; disguised employment relationships; and dependent self-employment.

This diversification has brought challenges for attaining decent work, given that many labour laws and social security policies depend largely on the standard employment relationship. Even in LAC, where waged employment is more limited and often takes the form of casual work, the regulation of the employment relationship is similar to that in developed countries. Many of the concerns about the effects of NSE on workers, businesses and the labour market are as applicable. While some NSE such as casual employment have been a regular feature of labour markets in many developing countries, other forms, such as temporary agency work, have only appeared in the past few decades. The challenge is therefore to adapt labour and social protection policies to foster an inclusive labour market for the future.

Trends in NSE have not been uniform across the world or LAC, reflecting both different levels of economic development and regulatory policies. Some forms of NSE have grown as a result of changes in the law that have purposely or unwittingly created incentives for their use by enterprises. This can be seen when comparing the differences in the incidence and evolution of temporary employment in six LAC countries between 2003 and 2014 (Figure 4.1). In some countries, such as Argentina and Brazil, the use of temporary employment is limited. In contrast, in Chile and El Salvador around 30% of employees are on temporary contracts, despite differences in the economic structure of the two countries. The incidence of NSE is highest in Ecuador and Peru.

Figure 4.1. **Temporary workers, as a percentage of wage employees (selected Latin American countries, 2003-14)**



Note: Data for Peru are based on written contracts only. Data for Argentina and Brazil are based on Q4 of each year. For Ecuador 2007/08, there is a break in the series.

Source: ILO (2016) based on Argentina: EPH (Q4 of each year); Brazil: PME (IBGE) (Q4); Chile: CASEN; Peru: ENAHO; and El Salvador: EHPM.

StatLink http://dx.doi.org/10.1787/888933651083

Non-standard forms of employment have a variety of effects on working conditions, including employment security, wages and remuneration, working time, occupational safety and health conditions, access to social security, work-life balance and opportunities for training. Whether these effects are positive or negative largely reflects workers' reasons for entering non-standard employment, and the legal mechanisms in place controlling working conditions in non-standard employment. In general, non-standard employment can bring benefits for workers when engagement reflects both a voluntary choice on the part of the worker and where the contract provides equal treatment compared to "standard" work.

An important concern with respect to NSE is its implications on workers' representation and other fundamental rights at work. Workers in NSE may lack access to freedom of association and collective bargaining rights, either for legal reasons or because of their more tenuous attachment to the workplace. They may also face other violations of their fundamental rights at work, including discrimination. This, in turn, can have implications on working conditions, as collective bargaining is an important regulatory tool.

NSE can also have important implications for working conditions, including on earnings, on occupational safety and health (OSH) and on training. Workers in NSE often earn less than workers in "standard" jobs, even if they have similar backgrounds and characteristics and are doing the same work (ILO, 2016). Labour market studies throughout the world show that a temporary or temporary agency worker can be penalised by up to 30%. There are significant OSH risks owing to a combination of poor induction, training and supervision, communication breakdowns (especially in multi-party employment arrangements) and fractured or disputed legal obligations. Injury rates are higher among workers in NSE. Finally, workers in NSE are less likely to receive on-the-job training, which can have negative repercussions on career development, especially for young workers. This is particularly problematic for LAC, as training rates in the region are low overall.

NSE has important implications for LAC firms as well. NSE may generate short-term financial gains especially if arrangements are exempt from social security contributions and other employee benefits. However, such cost savings are associated with a lack of protection for workers (with negative implications for labour productivity, e.g. in the case of ill health) and are not sustainable if the workforce (standard and non-standard alike) is not well managed. This is particularly true if NSE use is intensive. Indeed, firms that rely heavily on temporary and other forms of NSE risk a gradual erosion of firm-specific skills in the organisation, limiting the firm's ability to respond to changing market demands. As a result, the short-term cost and flexibility gains may be outweighed by longer-term productivity losses. These "intensive-using" firms (in developing and transition countries) tend to be more labour-intensive, invest less in the training of temporary workers and are usually older and less productive (Aleksynska and Berg, 2016).

In this context, there is a need to adapt and strengthen labour market institutions to guarantee good quality jobs in a new world of work. There is also a need to re-assess regulation to ensure decent working conditions, as well as to make efforts – as part of strengthening the social compact – in ensuring compliance with regulations. These measures include: *i) addressing employment misclassification*: recognition of an employment relationship is the precondition for application of labour legislation; *ii) ensuring equal treatment for workers:* legislation can adopt ILO standards that incorporate the principle of equal treatment for part-time workers, fixed-term workers and temporary agency workers; *iii) implementing minimum hours and other safeguards:* these can be useful for addressing some forms of very short hours and on-call arrangements, and improve income security; *iv) assigning obligations and liabilities in multi-party arrangements:* in such arrangements, workers may find it difficult to clearly identify the respective responsibilities of each party. The ILO's Private Employment Agencies Convention, 1997 (No. 181), requires the determination and allocation of the respective responsibilities of private employment agencies and of user enterprises in relation to labour rights; *v) restricting the use of non-standard employment:* in certain instances, restrictions are needed in the use of NSE to prevent abuses. The EU Directive on Fixed-Term Work requires the adoption of measures to prevent abuse arising from the use of successive fixed-term employment contracts or relationships; and *vi) promoting collective responses and collective agreements:* collective bargaining is another important regulatory tool for addressing potential decent-work deficits for workers in NSE (ILO, 2016).

Improving women's labour market integration

In the LAC region, where labour institutions have been traditionally biased towards men, the production revolution and the transformation of the economy and the world of work open a great opportunity to improve women's participation in labour markets. Historically, conceptions of work have assumed a male breadwinner with a wife and dependants at home – "the industrial man". These views shaped the employment and social security laws that still exist today. They have also shaped how labour markets function, and the position and progress of different groups in the labour market. Moreover, some original laws and standards were designed to limit women's working hours. Female-dominated industries set minimum wages below those of comparable men's wages, in effect legislating their secondary role in the home and the labour market (Vosko, 2010). Social security systems also commonly penalised secondary earners.

The "standard employment relationship" is not a legal concept. However, the consideration of full-time, open-ended and subordinate employment as "standard" employment and the development of labour protections tied to this notion has meant that workers who could not perform work with these characteristics have been unduly penalised. This affected both access to jobs, and also the pay, benefits and conditions of the jobs they were in. In particular, lack of recognition of unpaid reproductive work has perpetuated gender biases in the labour market, with women often relegated to the "margins of paid work" (Vosko, 2010). Because of care responsibilities, women were presumed not to be able to dedicate themselves to full-time work, and these obligations also kept them from doing so (Sirianni and Negrey, 2000).

As a result, when women do participate in the labour market, especially in LAC, they are more likely to be in informal work or not in employment, education or training (NEET); this gives them greater control over their working hours to balance work with domestic and family responsibilities. This is particularly true among young women in the region where 30% aged 15-29 are NEET, relative to 11% of young men (OECD/CAF/ECLAC, 2016). This over-representation in informal work and inactivity also reflects women's greater difficulties in entering and remaining in the formal labour market, which is a consequence of the unequal distribution of unpaid work. On average, women carry out at least two-and-a-half times more unpaid household and care work than men. This inequality affects women's ability to obtain and remain in formal jobs – given the hours and availability that some formal jobs require – as well as the reservation of some employers in hiring women because of other demands on them outside of work.

Women's labour market experience also depends on public policies, which can either reinforce gender stereotyping – and its subsequent ramifications in the labour market – or remedy it. Indeed, differences in labour force participation rates frequently reflect prevailing social welfare policies, tax policies and the provision of public services (Grimshaw, 2011). But policies can be adapted. For example, policies in Sweden in the

1950s and 1960s centred on the notion of the male breadwinner. However, beginning in the 1970s the country began transforming its welfare state on the assumption that all fit adults should be in employment. The social security system changed from one of "derived entitlements" to "individual rights", and paid work was accommodated through the provision of high-quality, public care services, as well as flexible paid leave policies (Bosch, 2004). Moreover, parental leave policies could be shared between mother and father; fathers were given incentives to take parental leave. Other European countries have followed Sweden's example, instituting policies to increase overall labour force participation of women. Key policies included supporting childcare services and paid parental leave policies, and facilitating and promoting good quality, part-time work (Blau and Kahn, 1996).

In a context of rapid technological change, new risks are emerging. The proliferation of NSE may appear more attractive for women, for example, because they facilitate the reconciliation of work and family tasks, but this can also be a source of perpetuation of certain family roles, and these types of jobs generally entail more vulnerable working conditions. Thus, they need to be coupled with a rethinking of labour market institutions. Conversely, some opportunities will arise associated with new technological possibilities that will support work-life balance, as well as the expansion of new sectors that can open opportunities to support the integration of women into the labour market.

Achieving social protection for all

In LAC, there is a need to strengthen and expand social protection systems so that all workers benefit from adequate coverage. This is especially true since technological progress may encourage the proliferation of NSE, as well as profound transformations leading to the destruction of a substantial amount of jobs. In some instances, it may require adapting existing social security systems. Eliminating or lowering thresholds on minimum hours, earnings or duration of employment, for example, can help ensure NSE workers are not excluded from coverage. In other instances, it will require implementing and extending non-contributory social assistance systems so that informally employed workers and those out of the labour market can have coverage.

A combination of contributory and non-contributory forms of social protection can ensure at least a basic level of social security for all. It can also respond to the social protection needs of the majority of the population, including the middle classes, based on equitable and sustainable financing mechanisms.

In addition, this approach allows for the design of national social protection systems that combine different mechanisms that are linked to employment or residence in an equitable and sustainable way, with appropriate financing available through taxes or contributions. As a general rule, combining different types of protection usually gives workers a better level of protection. Four main policies are needed to improve social protection coverage, including responding to the challenges of the future world of work (ILO, 2016).

Ensuring non-discrimination and equal treatment among different contractual arrangements

The social security system may exclude NSE workers either because of short hours or limited contribution period. This policy area is addressed by the ILO Part-Time Work Convention, 1994 (No.175), which states that the minimum number of working hours or earnings need to be lowered so as to avoid the exclusion of an "unduly large percentage of part-time workers". More specifically, social insurance systems can count each hour of work towards social security contributions.

Social insurance coverage for temporary workers can be improved in two ways. First, thresholds set out in the legislation regarding the minimum duration of employment could be lowered. Second, enhanced coverage could ensure greater parity and equality of treatment between workers in different forms of employment. Thus, access to benefits can be improved by allowing greater flexibility with regard to interrupted contribution periods. For example, the period to consider contributions to social insurance could be extended.

Such policies can be complemented by measures to recognise care work (e.g. child rearing) as contribution periods counting towards social security entitlements. As is the case in Chile, this policy can facilitate the access of women to social security benefits and reduce gender inequalities in social insurance systems (Fultz, 2011).

Adapting social insurance schemes to extend coverage to previously excluded categories of workers

In many LAC countries, substantial coverage gaps continue to exist. This is particularly the case for informally employed workers, including casual workers and own-account workers. Social security systems can be made more inclusive by specifically addressing these gaps. Such measures would not only enhance social protection coverage, but also enable workers to move more freely between different sectors and occupations.

Overall coverage rates for some categories of *self-employed workers* remain low in the region. However, many countries elsewhere have begun to include some categories of self-employed workers in social insurance systems. This includes Canada, which provides social insurance cover for self-employed workers in the event of unemployment (OECD, 2015a). Such coverage is especially relevant given the growth of self-employment and of the gig economy.

Some countries have developed innovative mechanisms to cover categories of workers in ways adapted to their specific characteristics and needs. India's construction sector, for example, has a high incidence of sub-contracting and casual work. In response, Worker Welfare Funds cover all those involved in a construction project, including casual and sub-contracted workers. The main contractor contributes 1% of the total value of every construction project (Newitt, Alastair and McLeish, 2014).

Improving the working of social security systems

LAC could enact several measures to improve social security systems. These could simplify administrative procedures for registration and contribution payments, and enhance access to information about individual entitlements. Further, they could help make entitlements portable between different social security schemes and employment statuses. For example, several countries (Argentina, Brazil, Chile) have simplified tax and contribution payments to help certain categories of self-employed (owners of micro-enterprises and their employees) gain access to social security.

Complementing social insurance with non-contributory mechanisms to provide a social protection floor

Mechanisms are needed in LAC to ensure social security coverage for workers in non-standard employment arrangements. These include extension of contributory or non-contributory (tax-financed) social security schemes. Without such mechanisms, workers are likely to have inadequate coverage or no coverage at all. As a result, they will be more exposed to social risks with regard to income security and effective access to health care.

Tax-financed protection plays a key role in filling the gaps and ensuring at least a basic level of coverage, thereby guaranteeing a floor of social protection for everyone. Such non-contributory schemes play an important role, especially for those who are not covered or are insufficiently covered by contributory mechanisms. Tax-financed benefits may also close coverage gaps for NSE workers for child and family benefits (e.g. Argentina), unemployment protection and social assistance (e.g. France, Germany). In the area of health protection, tax financing is essential for national health services and for subsidising health insurance contributions for low-income workers, including many NSE workers who may not be sufficiently covered otherwise.

The combination of contributory and non-contributory elements is key to building a comprehensive social security system with a strong floor of social protection. Different financing sources aid in ensuring the financial, fiscal and economic sustainability of national social security systems, and in achieving universal social protection.

Enhancing the efficiency and effectiveness of public finance to foster inclusive growth

Investing and mobilising resources for sustainable development in an effective and efficient manner is still one of the region's pressing issues. Fiscal indicators show the region lags behind in crucial areas. Per capita government spending among LAC countries was 35% that of OECD economies (USD in PPP 16 876 in 2015), while total tax revenues are 21.7% of gross domestic product (GDP) relative to 34.3% in the OECD. LAC remains the most unequal region in the world with an average Gini coefficient of 0.49 after taxes and transfers, compared with 0.29 in OECD member countries. This highlights the meagre redistributive power of LAC's fiscal system (OECD, 2016b; OECD/CIAT/ECLAC/IDB, 2017).

The state's core functions of raising revenue and allocating public resources and ensuring their sustainability in the long-term are all indispensable to delivering inclusive growth. Yet public support for reform is limited because of the erosion of the fiscal pact and low levels of tax morale (see Chapter 2). In this context, bolstering the state's fiscal capacities requires spending better, improving tax collection, strengthening regional and local governments' capacities, and focusing on public finance's sustainability. In some cases, spending better will not be enough to bridge the existing gaps in infrastructure and social public spending; countries will also need to raise more revenue to invest more. Furthermore, the limited fiscal space due to the upsurge of primary and overall deficits starting in 2011 (Figure 4.2) is exerting some pressure to increase the level of public resources at all levels of government.

Improving the provision of public goods in LAC through decentralisation efforts requires addressing weak institutional fiscal capacities of local and regional governments. Many central governments have transferred the responsibility for public goods and services to regional and local governments to satisfy local needs in a better way. However, these sub-national jurisdictions cannot always mobilise more revenues to cover these additional tasks, resulting in fiscal imbalances. Consequently, they depend on transfers from central governments to make up the difference. Furthermore, a large number of sub-national governments lack institutional capacities to execute transferred funds and deliver adequate public services.

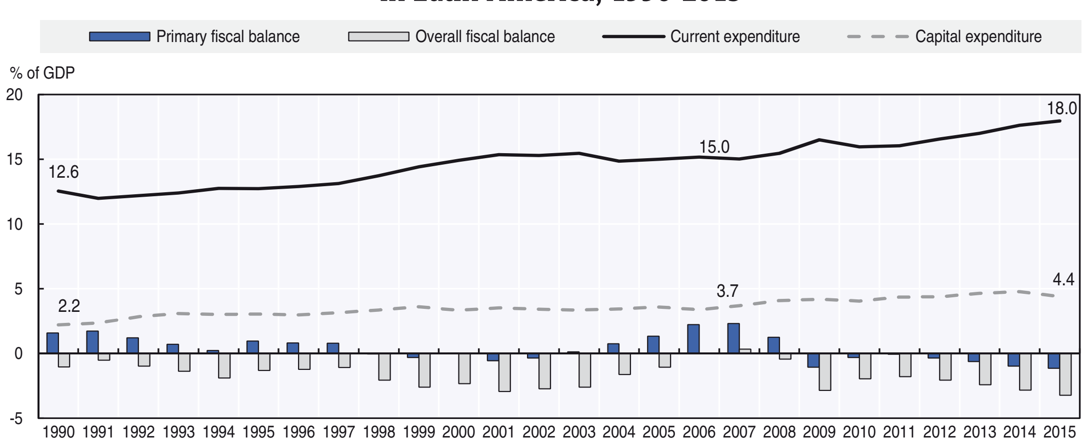
Better spending: Investing for development

Improving the effectiveness and efficiency of spending in LAC are the first steps towards a renewed fiscal pact, economic growth and development. Governments' spending levels and composition are critical as they directly allocate public funds towards the provision of collective and individual public goods. Since 2007, spurred by the favourable macroeconomic conditions, LAC increased spending by 4.2 percentage points. Despite this expansion, general government spending in LAC countries was 8.4 percentage points less than in OECD member countries in 2014 (OECD, 2016b). This is a wide gap, given the existing differences in the provision of public goods and services between both regions.

Composition of government expenditures is as important as spending levels. In 2014, and as a share of total government expenditures, LAC economies spent the most on compensation to government employees (an average of 29.1%); OECD member countries spent 23.1% of their budgets on this item. The second largest expenditure for LAC countries was on intermediate consumption goods (14.6%), a percentage slightly higher than in the OECD (14.3%). Finally, LAC countries invested 0.4 percentage points less than OECD economies, 7.3% and 7.7% respectively, in 2014 (OECD, 2016b).

Despite efforts in LAC to rein in expenses of central government on employee wages and the government consumption of goods (current expenditures), these budget items continue to grow more rapidly than investments or capital expenditures. In 2015, current expenditures represented 80% of total central government spending, with capital expenditures taking up the remainder. Since 2007, current expenditures have increased by 2.9 percentage points of GDP, a greater rate of increase than capital expenditures, which increased by 0.7 percentage points. Furthermore, overall increases in their spending have required central governments to incur in debt or seek other financing mechanisms to finance the budget.

Figure 4.2. **Central government expenditures, primary and overall fiscal results in Latin America, 1990-2015**



Note: Non weighted average includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, the Dominican Republic, Uruguay and Venezuela.

Source: OECD/CAF/ECLAC based on CEPALSTAT (2017) public finance statistics.

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Current expenditure levels and their growth crowd out public investing in several Latin American countries. Government spending on employees' wages and other essential consumption goods are inelastic and harder to adjust in the short term compared to capital expenditures. This makes them less sensitive to fluctuations of the economic cycle. Consequently, available funds are allocated towards financing current expenditures. At the same time, the investment gaps in infrastructure, health, education and other capital goods to improve the provision of public goods and services continue to widen.

Effective public investment at the national and sub-national levels in LAC can be a powerful tool to boost growth and development, reduce territorial disparities and leverage private investment. In contrast, poor or badly managed investment waste resources, erode public trust and may hamper growth (OECD, 2014a). When compared with the OECD average, investment gaps in LAC countries – particularly at the sub-national level – can be significant. For example, sub-national public investment as a percentage of total public investment in OECD member countries averages almost 60%, rendering sub-national governments important players in the investment arena. However, in most Latin American countries this percentage does not reach 50%. Indeed, in Paraguay, Chile and Costa Rica, it is under 14%. While the amount of investment is certainly important, effective public investment requires substantial co-ordination across levels of government to bridge gaps, as well as governance capacities to design and implement public investment projects. Thus, the impact of public investment depends to a significant degree on *how* governments manage the responsibility across levels of government – an area on which the OECD has issued recommendations (Box 4.2).

Box 4.2. **OECD Recommendation on Effective Public Investment across Levels of Government**

In 2014, the OECD adopted a Recommendation on Effective Public Investment across Levels of Government. This Recommendation outlines a series of 12 principles to help governments assess the strengths and weaknesses of their public investment capacity at national and sub-national levels and to help set priorities for improvement. The principles address cross-cutting challenges in public investment relating to co-ordination, capacity and issues arising from framework conditions. Countries adhering to the Recommendation take steps to ensure that national and sub-national levels of government use resources dedicated to public investment for territorial development effectively, in accordance with the principles set out below:

Pillar 1: Co-ordinate public investment across levels of government and policies

- Invest using an integrated strategy tailored to different places.
- Adopt effective co-ordination instruments across national and sub-national governments.
- Co-ordinate among sub-national governments to invest at the relevant scale.

Pillar 2: Strengthen capacities for public investment and promote policy learning across levels of government

- Assess up-front long-term impacts and risks of public investment.
- Encourage stakeholder involvement throughout the investment cycle.
- Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.
- Reinforce the expertise of public officials and institutions throughout the investment cycle.
- Focus on results and promote learning.

Pillar 3: Ensure sound framework conditions for public investment at all levels of government

- Develop a fiscal framework adapted to the investment objectives pursued.
- Require sound, transparent financial management.
- Promote transparency and strategic use of public procurement at all levels of government.
- Strive for quality and consistency in regulatory systems across levels of government.

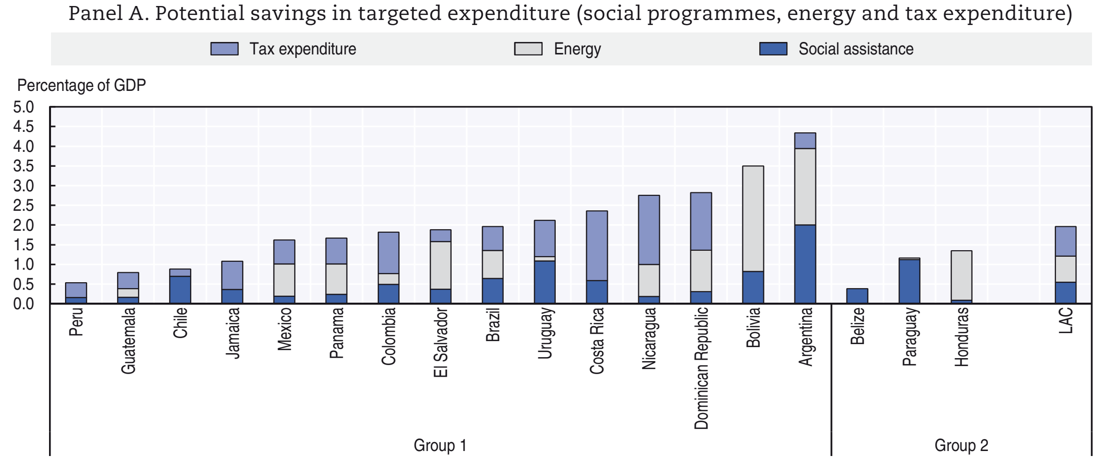
Source: OECD (2014b), Recommendation of the Council on Effective Public Investment across Levels of Government.

Latin American and Caribbean countries require infrastructure investments of 5% of GDP per year for several years to catch up with advanced economies (Serebrisky et al., 2015). Currently, LAC economies invest half of this threshold. The result is a region poorly connected in roads and ports, reduced coverage of basic services such as water and sewerage, and underdeveloped power grids and telecommunication infrastructure. Adequate funding to reduce the infrastructure gap involves spending better, investing more and increasing total investment levels by involving the private sector.

Improving efficiency of government expenditures could produce 3% of GDP in savings to reduce the infrastructure gap in the region. Improving the targeting of energy subsidies, tax expenditures and to a lesser extent social programmes can produce average total savings of 2% of GDP for the region (Figure 4.3, Panel A), while reducing inefficiencies in education and health spending, potentially saves an additional 1% of GDP (Figure 4.3, Panel B) (IDB, 2016). This process entails a detailed review of the budget by sectors to ensure that public servants' wages are consistent with international standards and are in line with achieved outcomes. In addition, it requires a thorough revision of the mechanisms through which subsidies and social programmes provide benefits.

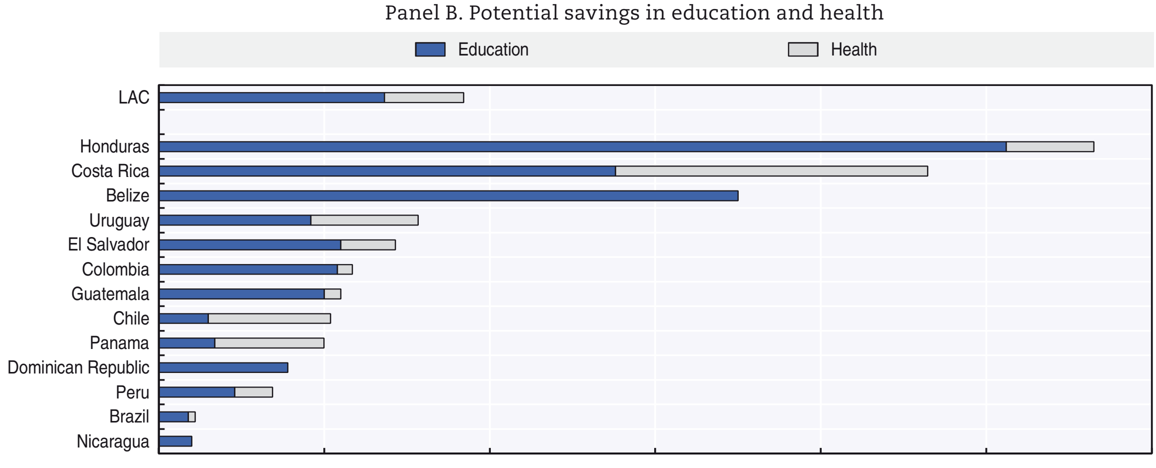
Figure 4.3. **Potential savings through efficient spending in Latin America**

Panel A. Potential savings in targeted expenditure (social programmes, energy and tax expenditure)



Note: For comparison purposes, countries have been split into two groups. Group 1 contains estimates of leakages for countries with data on all three sectors. Group 2 only includes leakage estimates on energy and social assistance.

Panel B. Potential savings in education and health



Note: There are no health filtration estimates for Belize.

Source: IDB (2016), *Saving for Development*, idb/Savings_for_Development.

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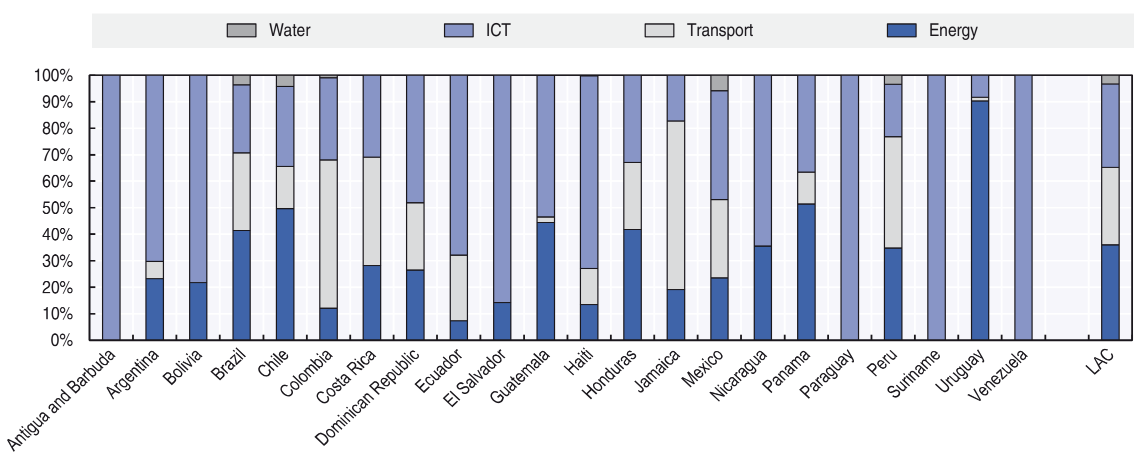
Public-private partnerships (PPPs) can be an effective way to increase total investments in LAC countries, but require greater regulatory clarity and greater institutional capacity. Engaging in PPP processes entails defining clear frameworks and ensuring that government has appropriate capacity to initiate and manage them. As the public sector needs to be a credible partner with appropriate regulations and oversight, enabling the ideal environment for PPPs demands high levels of public governance and co-ordination (Box 4.3). This condition is particularly important as decentralised authorities or local governments which must deal with major private sector actors often manage PPPs (OECD, 2008).

PPPs in LAC countries have focused on ICT, energy and transportation. Despite high heterogeneity across countries in the region, a third of investments in infrastructure come from the private sector. PPPs in ICTs, energy and transport have dominated the total market share, representing more than 90% of PPPs in the region in the last decade (Figure 4.4). In OECD member countries, PPPs have gone beyond these specific sectors and invest in infrastructure, coverage of basic services such as drinking water, and sanitation. In so doing, they address inadequacies in electric networks, energy supply and telecommunications, among others (Sanchez, 2016).

In the region, PPP projects have been traditionally inefficient and have led to increases in their total cost. The performance of concessions is determined by the contract, and by regulatory and institutional design. Flaws in the design of concession contracts have caused excessive costs in Latin America (OECD/ECLAC, 2012). For instance, in Chile, Colombia and Peru, 50 of 61 road contracts were modified at least once between 1993 and 2010, resulting in more than 540 renegotiations. All modified contracts were changed for the first time less than three years after the initial signing of the concession (Bitran, Nieto-Parra and Robledo, 2013).

Figure 4.4. **Public-private partnership investments by sector in Latin America (2006-16)**



Source: OECD/ECLAC/CAF based on World Bank (2017a), *Private Participation in Infrastructure* database, https://ppi.worldbank.org/.

StatLink http://dx.doi.org/10.1787/888933651159

Box 4.3. **Improving the efficiency of public-private partnerships**

Sound regulatory and institutional frameworks are fundamental to increase the effectiveness of public-private partnerships (PPPs) in some countries in the region where weaknesses in prioritisation and planning phases cause inefficiencies in these projects. Empirical analysis in Latin American economies, such as Chile, Colombia and Peru, suggests that state-led renegotiations, which were more common than those

Box 4.3. **Improving the efficiency of public-private partnerships** *(cont.)*

led by firms, were motivated by the opportunistic behaviour of governments. State-led renegotiations that added new stretches of roads and that included additional complementary works during governments' last year in office were costlier than other renegotiations (Bitran, Nieto-Parra and Robledo, 2013). Furthermore, delays and inefficiencies in environmental and land licensing, as well as from consultation with local actors, have affected the timing and certainty of concession contracts in the region. Finally, most of the concession schemes at national level do not apply to regional and municipal governments, affecting the capacity to undertake effective PPPs at local level. *Ex-ante* feasibility studies and the institutional framework supporting value-for-money evaluations could help solve difficulties at the stages highlighted above.

Following a social feasibility analysis, policy makers can use value-for-money evaluations to assess whether a concession model is preferable to direct public sector provision. While most OECD economies do a cost-benefit analysis or use a public-sector comparator, Latin American countries usually limit their analysis to a comparison of tendering results. This creates uncertainty as to whether the private sector can generate value for money. Furthermore, authorities must not heavily discount future payments of concessions or favour concessions over public procurement to meet short- and medium-term fiscal targets. Institutional capacity is therefore necessary to manage and oversee PPP programmes effectively (Reyes-Tagle and Garbacik, 2016). Only nine OECD member countries accounted for concessions as contingent liabilities in government accounts in late 2007 or early 2008 (Araújo and Sutherland, 2010). A change in fiscal accounting can improve concession selection, avoiding reckless investments and the transfer of fiscal commitments to the future. The state controls economic results of the concession through regulations and also receives the work at the end of the contract. Consequently, it could consider concessions as public projects to increase the transparency of public accounts. The OECD 2012 Council Recommendation on PPPs provides guidelines as to when concessions are worth pursuing and addresses their budgetary consequences (OECD, 2012). Reliance on international experiences for improving and making better use of cost-benefit analysis is valuable to the region. The recent French appraisal system and the United Kingdom's project valuation framework are useful examples that emphasise multi-criteria analysis rather than a unique objective (OECD/ITF, 2011).

Some countries in the region have improved the regulatory and institutional framework in the past five years to achieve more effective private participation in infrastructure. Since 2012, for instance, the contract term and resources committed to it in Colombia cannot be increased by more than 20%. The new framework also requires value-for-money analysis to justify executing projects through a PPP instead of through regular public procurement. Further, a new National Infrastructure Agency was created with greater administrative capacity and technical expertise in the design, structuring, tendering and monitoring of contracts. In Honduras, a new independent Fiscal Contingency Unit within the Ministry of Finance has the explicit purpose of approving PPP projects and conducting oversight. All quantifiable firm and contingent commitments by the non-financial public sector in PPP contracts, calculated at present value, may not exceed a limit equivalent to 5% of GDP (Reyes-Tagle and Tejada, 2015). In Peru, recent efforts to increase efficiencies in environmental and land licensing should improve the timing and certainty of concession contracts (OECD, 2016c).

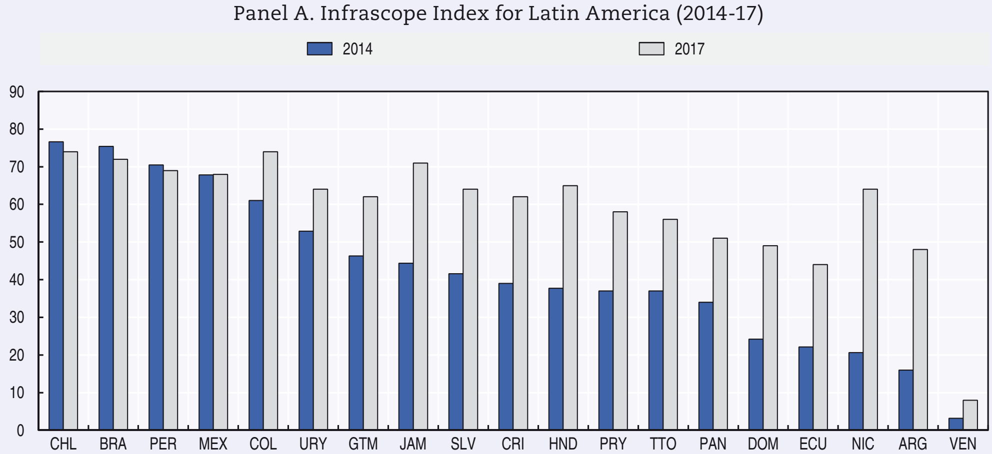
Despite this progress on PPPs, Latin America still faces challenges concerning its readiness for an efficient institutional environment. The Infrascope Index measures the environment of 19 Latin American and Caribbean countries for implementing PPPs

Box 4.3. **Improving the efficiency of public-private partnerships** *(cont.)*

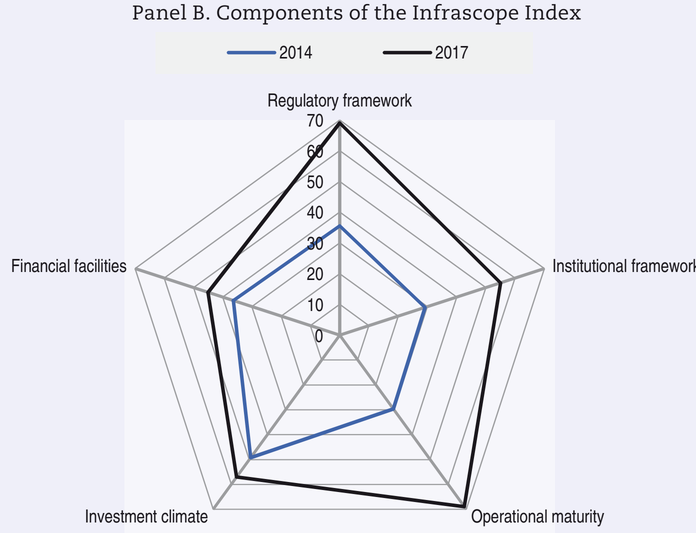
effectively, particularly in infrastructure. The measure takes into account the legal and regulatory framework, the institutional framework, operational maturity, investment climate, financial facilities and sub-national adjustment (EIU, 2014). Since the first Infrascope benchmarking study in 2009, the scores for most countries have increased in each subsequent edition. The average overall score for the region improved by nearly 10 points between 2009 and 2014 (from 32.9 to 42.5). Moreover, the regulatory and institutional framework categories have had the most significant improvement as many countries have updated their PPP and concession laws and set up new PPP agencies or specialised units within existing institutions. However, Latin American and Caribbean countries still face great challenges in this respect (Figure 4.5). In 2014, financial facilities demonstrated the least rate of progress.

Figure 4.5. **Environment for effectively implementing PPPs**

Panel A. Infrascope Index for Latin America (2014-17)



Panel B. Components of the Infrascope Index



Note: The Infrascope Index is measured on a scale from 0 to 100. Countries with a score between 0 and 29.9 are qualified as nascent, 30 to 59.9 as emerging, 60 to 79.9 as developed and 80 to 100 as mature.
Source: EIU (2017), *Economist Intelligence Unit Database for Latin America and the Caribbean* (2017).
StatLink http://dx.doi.org/10.1787/888933651178

Beyond traditional investment schemes: Social Impact Bonds

Social Impact Bonds (SIBs) are a relatively new and innovative instrument to finance social interventions. Although SIBs have been mostly implemented in developed countries, they are rapidly spreading among middle-income countries.

Traditionally, governments award contracts and grants and link their funding to the completion of a set of activities. The public sector's need for more innovation has led some developed economies to engage in SIBs, which are associated with outcomes-based agreements. Tools like SIBs are implemented as contracts or grants between a funder, an investor and a service provider where payment and financial rewards are contingent upon the achievement of agreed and measurable outcomes (Beeck Center, 2014).

As a financing mechanism for social policies, SIBs could mitigate the public sector's investment risk, increase effectiveness and pay for services now, while requiring public contributions later (Ramsden et al., 2016). SIBs involve three main stakeholders: governments, non-governmental organisations (NGOs) and investors. Governments need to improve social/living conditions and the welfare of people within the constraints of a public budget. NGOs have the field expertise, knowledge and skills to work with the population in need. Investors have private resources and are willing to take risks to receive a return. Each part has different motivations and interests and stands to benefit by working together through the payment-for-results approach.

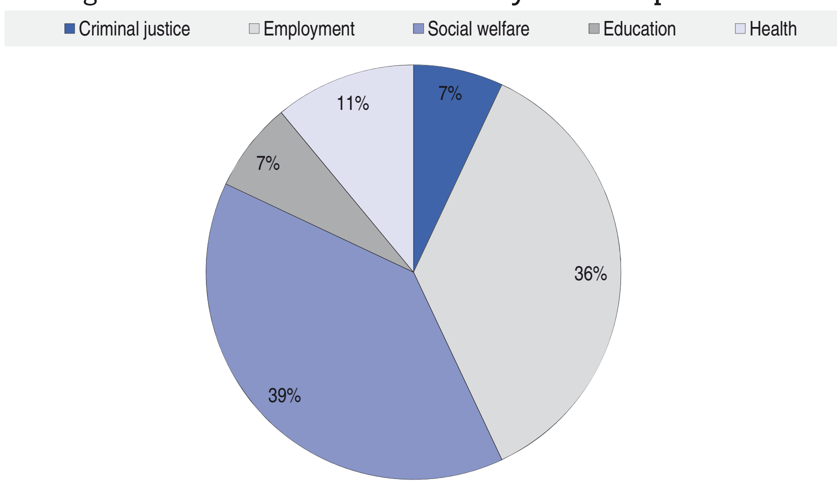
In the payment-for-results model, the public sector aims to pay only for interventions once the agreed outcomes are achieved. The risk of an unsuccessful service is thus transferred to the investor rather than the delivery organisation (Centre for Public Impact, 2017). This mechanism combines some components of results or performance-based financing and PPPs (Gustaffson-Wright et al., 2015). Usually, SIBs are seen as the next generation of PPPs, as they move away from infrastructure services towards social services touching upon education, health and many more. The idea is to bring together the socially motivated private sector, social organisations and governments to deliver targeted services. SIBs aim to improve outcomes through collaboration between service providers and investors. Because the payment is based on results rather than processes, there is more room for innovation and greater freedom to test new solutions.

SIBs offer governments a tool to overcome typical public sector barriers. It is a leadership tool that helps address the lack of performance assessment, under-investment in prevention and inability to collaborate effectively with service providers around improving systems (Harvard, 2016). By tackling these issues it can speed up progress in addressing challenging social problems, while making states more efficient in the way they spend public resources.

SIBs are a growing global phenomenon. Initiated in the United Kingdom, all 61 SIBs currently in place are in OECD member countries (32 in the United Kingdom, 10 in the United States and 19 in other countries including Austria, Australia, Belgium, Canada, Finland, Germany, Ireland, Israel, the Netherlands, Portugal, South Africa, South Korea and Switzerland) (Centre for Public Impact, 2017). This tool is currently funding activities in the categories of criminal justice, employment, social welfare, education and health (Figure 4.6).

Increasing expectations and demands in Latin America call for higher result levels and therefore more effective service delivery. In response to these growing needs, SIBs are an interesting tool to shift the way governments finance and deliver public services. The first SIB in the region, launched in Colombia as a joint-initiative of the Colombian Department for Social Prosperity, IDB Multilateral investment fund, Swiss State Secretariat for Economic affairs (SECO) and private sector foundations engaged in social inclusion projects, targets vulnerable populations – mostly poor, unemployed and victims of violence in three cities (Box 4.4).

Figure 4.6. **Main activities funded by Social Impact Bonds**



Note: Criminal justice includes tackling recidivism. Employment includes reducing NEETs, improving employability and tackling unemployment. Social welfare includes homelessness and child welfare. The education component includes early year education, reducing school dropout and universities. Health includes preventative interventions.

Source: Centre for Public Impact (2017).

StatLink http://dx.doi.org/10.1787/888933651197

It is too early to draw conclusions on the success of this initiative and on its potential for the region. However, this experiment in Colombia will be an interesting test for institutional capacities in this country and can provide lessons applicable to other Latin American countries. Indeed, Social Impact Bonds not only require political will and the securing of important funds, but also strong co-ordination between different stakeholders and among different levels of government. Most importantly, given the result-oriented nature of the instrument, SIBs require strong monitoring and assessment capacities to measure the impacts (Peña, 2014).

Box 4.4. **Social Impact Bond in Colombia**

In 2017, Colombia launched the first Social Impact Bond (SIB) ever in Latin America. It resulted from an agreement between NGOs, and private and public sector entities with support from international organisations. This new financing mechanism is a first test of the Colombian government to examine the payment-for-results approach.

Among many stakeholders for the SIB, the Colombian Department for Social Prosperity, the Inter-American Development Bank and the Swiss State Secretariat for Economic Affairs, committed to pay a maximum of USD 750 000 to investors based on agreed outcomes and conditions. Socially motivated investors execute the initial budget by investing in a social intervention implemented by one – or more – NGOs.

The project attempts to identify vulnerable populations through several database systems, and make them more employable. Service providers are selected in the

Box 4.4. **Social Impact Bond in Colombia** *(cont.)*

market. NGOs with expertise in a particular area handle services related to such areas as registration and counselling; pre-training and post-training assessment; specific skills training and socio-emotional skills; psychosocial support; job intermediation; job placement and accompaniment. Following the payment-for-results approach, services providers have autonomy to carry out the intervention and focus on intended results, which are mainly about the number of people employed and length of time they retain the job.

The amount of the government's payment is based on a differentiated unit price. This price gathers the costs of the intervention and a percentage of return for investors. The total amount paid will depend mainly on the number of employed individuals; the price will vary depending on the length of time that the person had been retained in the job (from three to six months). For the maximum amount, an external evaluation should demonstrate that participants were employed and lasted in the job for at least six months.

The autonomy of the service providers, as well as the risk tolerance that characterises private investors, allows and even incentivises innovation in the field of the intervention. Indeed, as the payment-for-results approach does not make payment conditional on certain activities or methods, NGOs can decide for themselves how to obtain better results.

Raising tax revenue for development and inclusive growth

Tax systems in Latin America and the Caribbean yield insufficient levels of tax revenues to fund development goals. Strengthening the state's ability to sustain public finance stability and fund development efforts entails a thorough process of tax reform. Tax policy reform should focus on progressivity, achieve a simpler and broader tax base, improve environmental outcomes through pricing mechanisms and improve taxing capacities of local and regional governments.

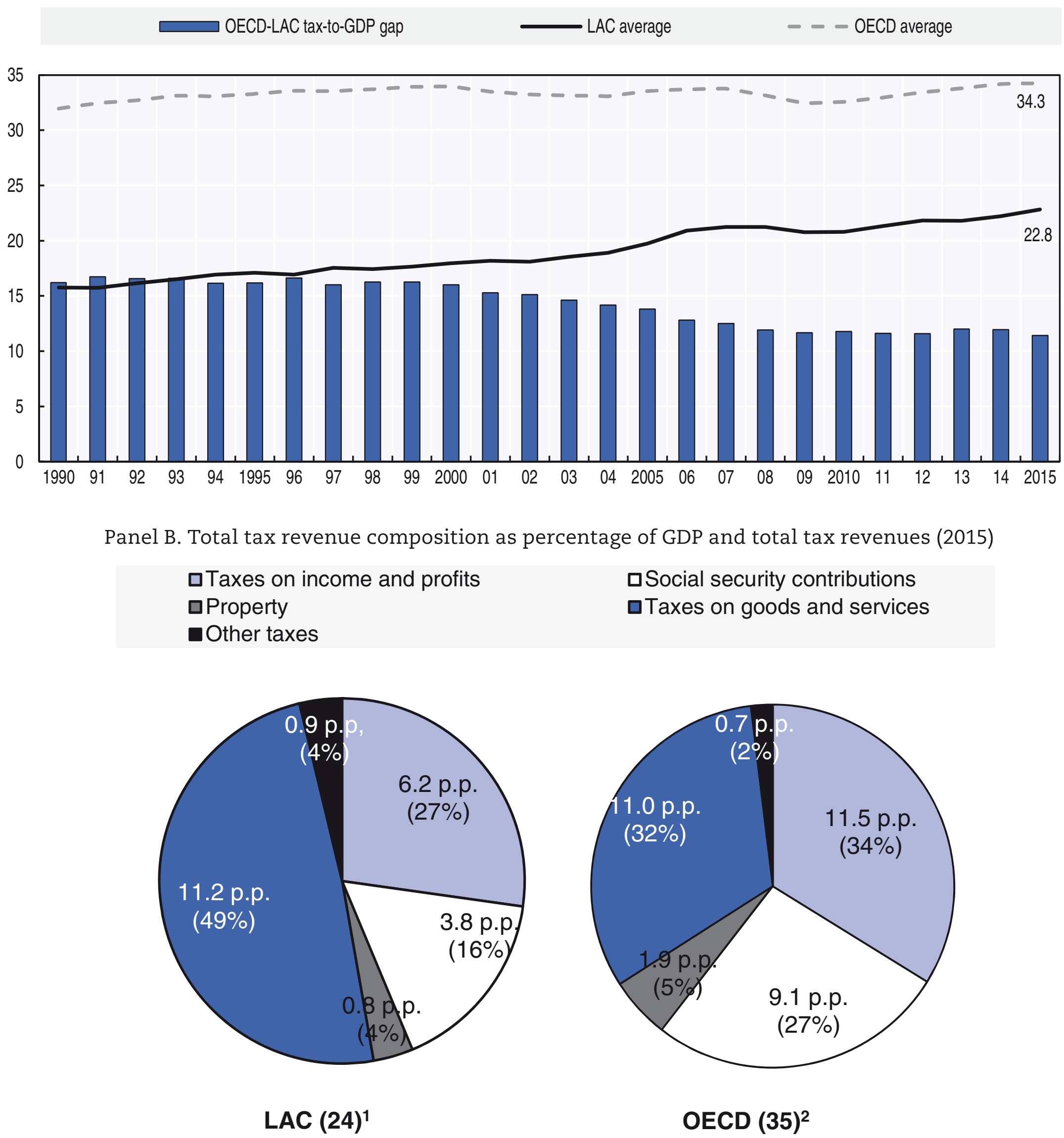
Improving revenues through efficient and progressive taxes is crucial to ensure sustainable economic development. This guarantees sufficient financing to cover government functions and, more importantly, to replace and enable capital formation within countries and improve equality. Tax revenues have increased by 7.1 percentage points during the last two and a half decades, rising constantly with the exception of a minor decline experienced in 2008 and 2009 (Figure 4.7, Panel A).

Despite these improvements, total tax revenues in Latin America and the Caribbean remain 11.5 percentage points of GDP lower than in OECD member countries. Moreover, tax revenues continue heavily skewed towards indirect taxes on goods and services (49% of total tax revenues). Direct taxes for their part continue to be weak, given the low in-take of personal income tax and property taxes (13% of total tax revenues). For its part, the corporate income tax (CIT) represents 16% of total tax revenues. However, the pervasiveness of special provisions and differentiated tax treatments to economic sectors distort efficient allocation of investments. As a result, direct taxation depends mainly on social security contributions, which are normally earmarked to finance current and future benefits of ageing populations.

Figure 4.7. **Tax revenue in LAC and OECD: levels and composition**

Panel A. Tax-to-GDP ratios, 1990-2015

Panel B. Total tax revenue composition as percentage of GDP and total tax revenues (2015)



Note: Other taxes includes un-allocable tax revenues on income, profits and capital gains and other taxes that cannot be classified according to the OECD Interpretative Guide available in OECD (2016b), *Revenue Statistics 2016*.
1. Represents a group of 24 Latin American and Caribbean countries. Chile and Mexico are also part of the OECD (35) group.
2. Represents the unweighted average for OECD member countries.

Source: OECD/CIAT/ECLAC/IDB (2017), *Revenue Statistics in Latin America and the Caribbean 1990-2015*.
StatLink http://dx.doi.org/10.1787/888933651216

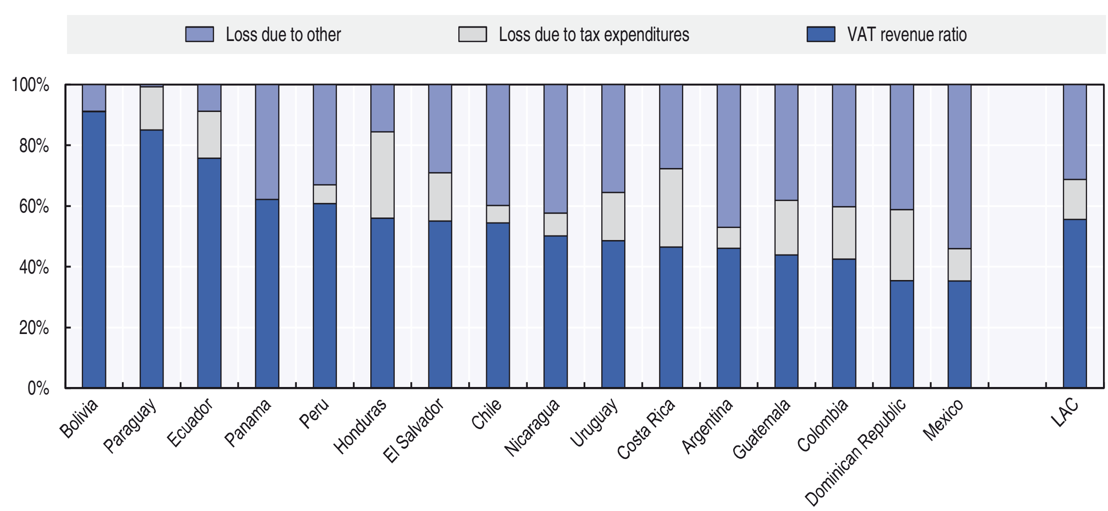
The value added tax (VAT) is the pillar of most tax systems in Latin American and Caribbean countries. Since 1990, VAT revenue has increased by 3.7 percentage points of GDP, outgrowing any other tax. It yielded an average of 6.0% of GDP in 2015. These levels were below VAT-to-GDP revenues in OECD member countries (6.8%), a difference of 0.8 percentage points. Notwithstanding, the importance of the VAT in LAC becomes more apparent in the context of how much it represents of total tax collection. Indeed, the VAT represents 26.3% of total tax revenue in LAC, 6.5 percentage points higher than in OECD member countries (19.8%).

The VAT would benefit from greater simplification and better control in the region. An analysis of the VAT revenue ratio (VRR), a measure of actual revenue relative to potential revenue and of the ratio of tax expenditures to the potential VAT revenue suggests that in 2015 for every 100 currency units of potential VAT revenue, 56 units were collected by the tax administration; 13 were forgone revenue owing to exemptions, reduced rates or other benefits dictated by tax policy; and 31 were lost owing to other factors that cannot be explained by the previous two. These might include measurement errors, fraud, evasion, elusion or aggressive tax planning (Figure 4.8).

This analysis suggests there is space to improve the VAT's revenue collection through the rationalisation of fiscal benefits. A proper year-by-year evaluation of the intended and actual benefits and the recipients of these benefits would help ensure that revenues are not forgone without a justifiable cause. On the other hand, actions to strengthen the tax administration to curb evasion and to achieve higher levels of compliance are the best strategies to help the VAT reach its total potential. The use of ICTs to simplify the VAT's filing process, electronic invoicing (Box 4.5) and the use of big data for data cross-referencing are all tools that can help exert a better control of the tax.

Figure 4.8. **Decomposition of the VAT's potential revenue**

As a percentage of potential VAT revenue



Note: The figure decomposes the potential revenue of the VAT into three categories: i) VAT revenue ratio (VRR) is the proportion of the potential VAT actually collected by the tax administration; ii) tax expenditures is the proportion of the potential VAT that is not collected owing to reduced rates, exemptions, zero rates and other fiscal benefits or reliefs; and iii) other is the rest of the potential revenue VAT base that cannot be explained through tax expenditures, that is, it groups measurement errors, evasion, elusion, fraud or aggressive tax planning to avoid paying the tax. The potential VAT revenue is calculated by levying the generalised VAT rate on final consumption expenditure (the sum of private consumption and general government final consumption expenditure).

Source: OECD/CAF/ECLAC based on data from OECD/ECLAC/CIAT/IDB (2017), *Revenue Statistics in Latin America and the Caribbean*; World Bank (2017b), *World Development Indicators database*; National Ministries of Finance and National Tax Administrations.

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Box 4.5. **Beyond control and compliance: The externalities of electronic invoicing**

Electronic billing is gaining ground in Latin American countries as a means to modernise the tax administration and tackle evasion. Argentina, Brazil, Chile, Colombia, Ecuador, Guatemala, Mexico, Peru and Uruguay have all introduced e-invoicing schemes, while countries including Costa Rica, El Salvador, Nicaragua and Panama are all developing frameworks to enforce these mechanisms. The electronic invoice (e-bill or e-invoice) is a digital file that contains information pertaining to the sale of goods and services. The merchant transmits this e-invoice directly to the tax authority once the transaction has transpired. This enables the tax administration to exert better fiscal control in real time and at a lower administrative cost.

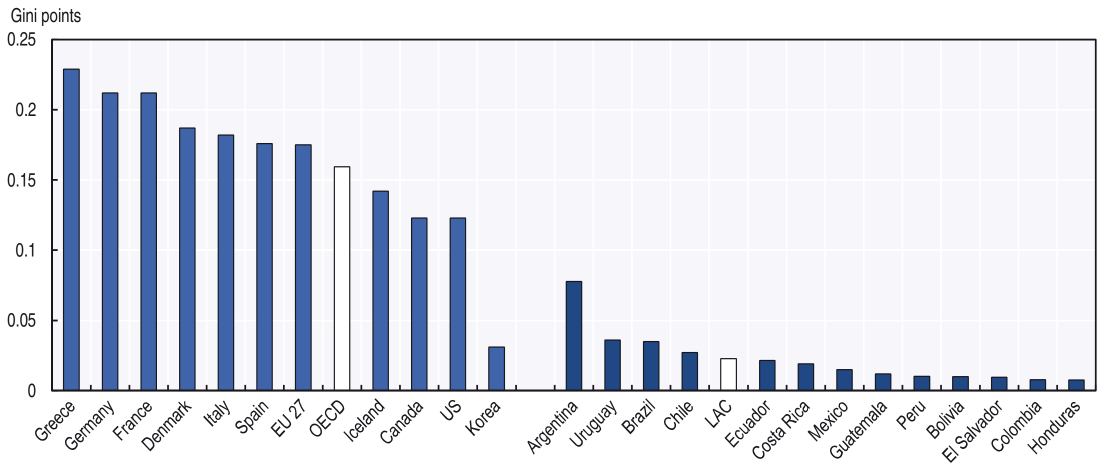
Electronic invoicing encourages job and firm formality, reduces compliance costs, increases tax collection and creates positive externalities. First, the e-bill increases the perception of auditing among informal firms that conduct business with formal firms. In so doing, it encourages informal firms to formalise as it becomes a requirement of their clients/suppliers to conduct business within an integrated system. For instance, in Brazil e-invoicing helped reduce informal employment from 55% to 40% in the last decade (MGI and IDV, 2014). Second, an e-billing system reduces human errors, eases access to taxing files, improves the tax administration's response times and simplifies VAT filing and reporting. The net effect is an increase in tax revenues. In Brazil, the first country in LAC to implement such an e-billing scheme, tax evasion dropped from 32% to 25% (Munoz, MacDowell and Goes, 2017), and profits reported by firms increased by 22% over four years (Naritomi, 2015). Enhanced fiscal control from these measures increased revenues. In Uruguay, the application of the electronic bill raised VAT revenues by 5.3% (Barreix and Zambrano, forthcoming). In Mexico, e-billing increased the amounts of VAT declared to the authorities by 2.2%, 3.2% and 7.1% in 2011, 2012 and 2013, respectively (Fuentes Castro, 2016).

The returns to investments on e-invoicing schemes outweigh the costs to both the public and private sectors. From a public perspective, enforcing an e-billing programme requires a strong and modern tax administration, with solid departments in charge of collection, auditing and ICTs and well-developed taxpayer registries. Following this initial investment, modernisation produces many benefits: increasing tax collection through reduction of evasion, improving efficiency of the tax administration and fostering voluntary tax compliance. From the private perspective, this process requires merchants to invest in training and specialised software and equipment; in exchange, merchants gain from reducing the costs of filing for VAT payments and curbing unfair competition from informal firms.

Current taxation systems in LAC have a small redistributive capacity because of the limited participation of direct taxes. In OECD economies, taxes and transfers contribute to the reduction of the Gini coefficient by up to approximately 15 percentage points. In most Latin American economies, however, that reduction is below 3 percentage points (Figure 4.9). The state's capacity to ensure reasonable redistribution is key to strengthening the fiscal pact, and the social contract between governments and their citizens. Countries with lower income inequality are associated with greater capacity to raise taxes (Cárdenas and Tuzemen, 2010).

Figure 4.9. **Impact of taxes and transfers on income distribution in Latin America and selected OECD economies**

2012 for OECD economies and circa 2011 for Latin America



Note: The redistributive capacity is the difference between the Gini coefficient of the market income and the Gini coefficient after taxes and transfers.

Source: Data for Latin American economies is obtained from Lustig (2016). For OECD economies, the data is from the *OECD Income Distribution Database (IDD)*.

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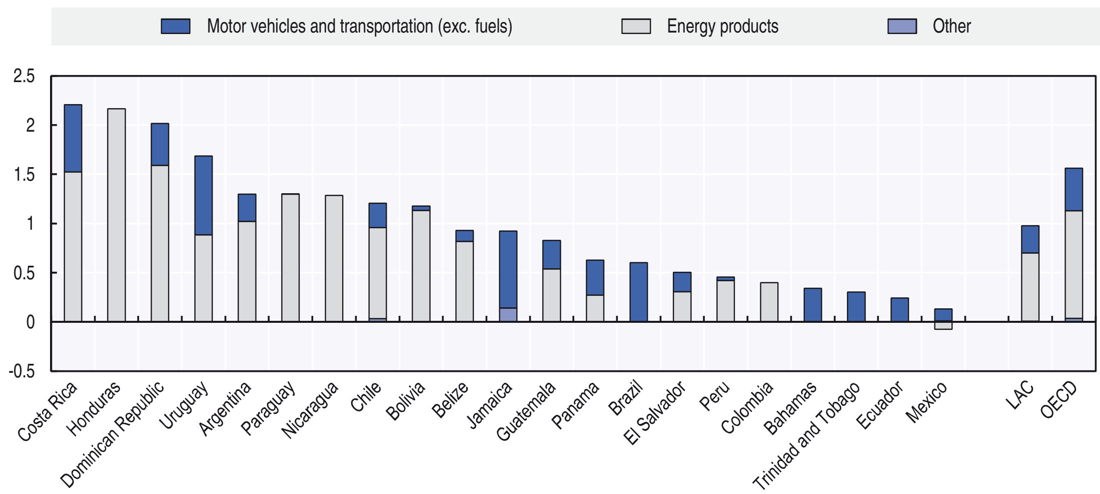
Improving the personal income tax (PIT) system can enhance revenues and have a positive impact on income redistribution in the region. Collection of personal income tax in Latin America is approximately 2.1% of GDP, which is relatively low compared with the OECD average of 8.4% (Figure 4.7, Panel B). The PIT's revenue-raising capacity is constrained owing to an over-emphasis on progressivity. On average, only individuals in the richest 10% of the population are liable for the tax. A myriad of exemptions, deductions and standard tax allowances diminish the tax base. As a result, on average, only 38% of the taxable base is subject to the tax in the tenth decile. These factors limit the revenue raised by the tax, all of which paradoxically erodes the tax's redistributive power. Improving the revenue collected by the PIT requires revising the tax allowances granted by the tax and updating the tax schedule (Barreix, Benítez and Pecho, 2017).

LAC countries can improve both tax revenues and the efficiency of the corporate income tax (CIT) by rationalising incentives and eliminating distortions to the allocation of investments. CIT revenues were favoured by the increases in prices of commodities during the last decade. Since 2003 and throughout the super commodity cycle, CIT revenues went from 2.3% to 3.7% of GDP. Tax reforms were successful in expanding the tax base by including passive foreign income, which also contributed to a small increase in revenue from the CIT. Notwithstanding, fiscal incentives to attract foreign investments in special economic sectors, especially in Central America, are granted at an average fiscal cost of approximately 0.9% of GDP (IDB, 2013a). The largest incentives are given to free trade zones, local development and tourism. Many of these provisions have not been appropriately assessed to measure their effectiveness.

Taxing externalities can increase available fiscal resources and contribute to improving environmental outcomes in the LAC region. Taxation is an important asset within the policy toolset to drive resource efficiency, reduce waste and move towards a sustainable economy (OECD, 2015b). In LAC, externalities imposed on the environment are rarely corrected through taxes. Some environmentally related taxes do exist, such as excises on gasolines and diesels, and taxes on permits for motor vehicles. However, these are levied to increase revenue rather than to improve upon environmental outcomes (Lorenzo, 2016). In LAC countries, revenue from environmentally related taxes tallied 0.98% of GDP in 2014, most of which is collected through levies on fuels (0.69% of GDP). The other large component is derived from revenues raised on motor vehicles and transportation (0.28% of GDP).

Figure 4.10. **Environmentally related tax revenues (2014)**

As percentage of GDP



Source: OECD (2017c), *Environmental Taxation* database; OECD/ECLAC/CIAT/IDB (2017), http://www.oecd.org/env/tools-evaluation/environmentaltaxation.htm; OECD/CIAT/ECLAC/IDB (2017), *Revenue Statistics in Latin America and the Caribbean 2017*, http://dx.doi.org/10.1787/rev_lat_car-2017-en-fr.

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Finally, strengthening the tax administration's capacities is a critical part of a broader tax reform strategy that aims at increasing revenues, improving efficiency and reducing inequality. Strengthening the international tax rules through the implementation of the recommendations of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project helps create a more even playing field, which increases overall socio-economic development in the region. Furthermore, moving towards Automatic Exchange of Information for Tax Purposes should help fight tax evasion and give countries greater scope to tax both domestic and foreign-source income earned by tax-resident businesses and households. Twelve Latin American and Caribbean countries – Argentina, Brazil, Chile, Colombia, Costa Rica, Haiti, Jamaica, Mexico, Panama, Paraguay, Peru and Uruguay – are among the 94 countries that have joined the inclusive framework on BEPS.

Governments are decentralising to connect more closely with citizens

Governments in the LAC region are pursuing fiscal and political decentralisation to connect more closely with citizens. The processes of decision making and budgetary powers have been widely acknowledged as important tools to stimulate more efficient provision of public goods and improve preference-matching, thus enhancing democratic participation and accountability (Brosio and Jimenez, 2012). The premise is that decentralisation could also allow for more targeted delivery of public services based on the demands and necessities of the local population that these local institutions directly represent.

Strong and connected federal, regional and local levels of public institutions are necessary to capitalise on the full potential of multi-level governance (Chapter 3). In practice, both fiscal and political decentralisation in most Latin American countries faces significant challenges. On the one hand, several responsibilities have been transferred to regional and local governments during the last decade and a half, despite the existence of an inadequate revenue base to finance these additional responsibilities. Instead, sub-national governments have relied highly on transfers from central governments that often undermine their incentives to raise more tax revenues and improve on the delivery of services.

Despite these moves, LAC countries tend to be, on average, more fiscally centralised than OECD member countries: sub-national government expenditure is three times lower in the LAC region than the OECD average. Sub-national expenditure represents 6.5% of GDP and 20.9% of public expenditure, compared with 16.6% and 40.2% respectively in OECD countries – and 9% and 23.9% worldwide (OECD/UCLG, 2016). Sub-national investment in many LAC countries is also highly centralised and below the OECD average. For example, in Paraguay, Chile and Costa Rica, sub-national governments are responsible for less than 14% of public investments compared with an average of almost 60% in the OECD.

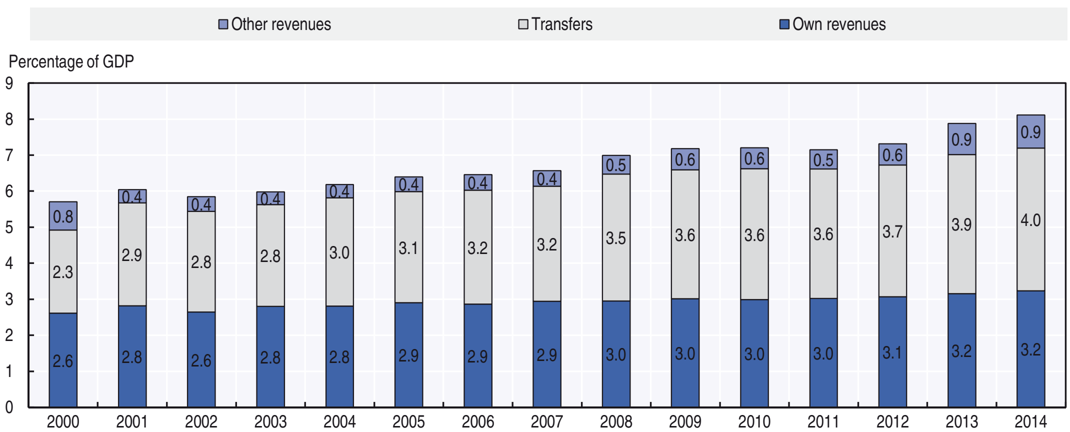
Further, despite significant increases in total fiscal revenue at the sub-national levels due to transfers, taxing powers remain extremely low in most Latin American countries. By failing to take advantage of their taxing potential, sub-national authorities undermine their abilities to provide more targeted and effective service delivery to the population that they directly serve. This can affect the generation of own-source revenue by local authorities. This, in turn, limits their ability to pursue development policies, programmes and investments that are locally generated and thus potentially more reflective of their needs and those of their citizens.

While there are important differences across countries, total fiscal revenue of sub-national governments in Latin America has significantly increased during the last 15 years. On average, total fiscal revenue increased from 5.7% of GDP to 8.1% (Figure 4.11). There are multiple ways in which sub-national governments may increase their revenues: i) generation of own resources; ii) inter-governmental transfers; and iii) through debt iv) a combination of the three alternatives.

Despite these options, the increase in total fiscal revenues can be attributed to greater dependence on transfers from central governments (with the exception of Costa Rica, Chile, Brazil and Uruguay). On average, total transfers increased from 2.3% of GDP to 3.2% of GDP. In countries such as Argentina and Mexico, central governments contribute more than 8% of GDP to transfers directed to their sub-national governments. The central governments of Colombia and Ecuador contribute 5.0% and 3.6% respectively, while the central government of Brazil contributes 3.7% of GDP. At the other end of the spectrum, countries such as Peru and Uruguay only contribute 2.6% and 1.1% of GDP, respectively (OECD/CIAT/ECLAC/IDB, 2017).

The decentralisation of tax powers has been relatively weak in most countries of the region. Most sub-national governments contribute very little to the total revenue of Latin American countries (Figures 4.11 and 4.12). On average, sub-national authorities collect 2-5% of their country's total tax revenues. While this lower performance seems to apply to most Latin American countries, the exception of Brazil is worth noting. The sub-national governments of Brazil – which include both states and municipalities – collect more than 30% of total revenue. Therefore, in LAC there is a significant degree of centralisation of tax powers at these levels of government (OECD/ECLAC/CIAT/IDB, 2017).

Figure 4.11. **Evolution of the total revenue structure in sub-national governments, Latin America average, 2000-14**



Note: The concept of sub-national governments will refer to the provinces in the case of Argentina; prefectures and municipalities in Bolivia; states and municipalities in Brazil; municipalities in Chile; departments and municipalities in Colombia; local governments (cantons) in Costa Rica; provincial councils and municipalities in Ecuador; states and municipalities in Mexico.

Source: OECD/CIAT/ECLAC/IDB (2017).

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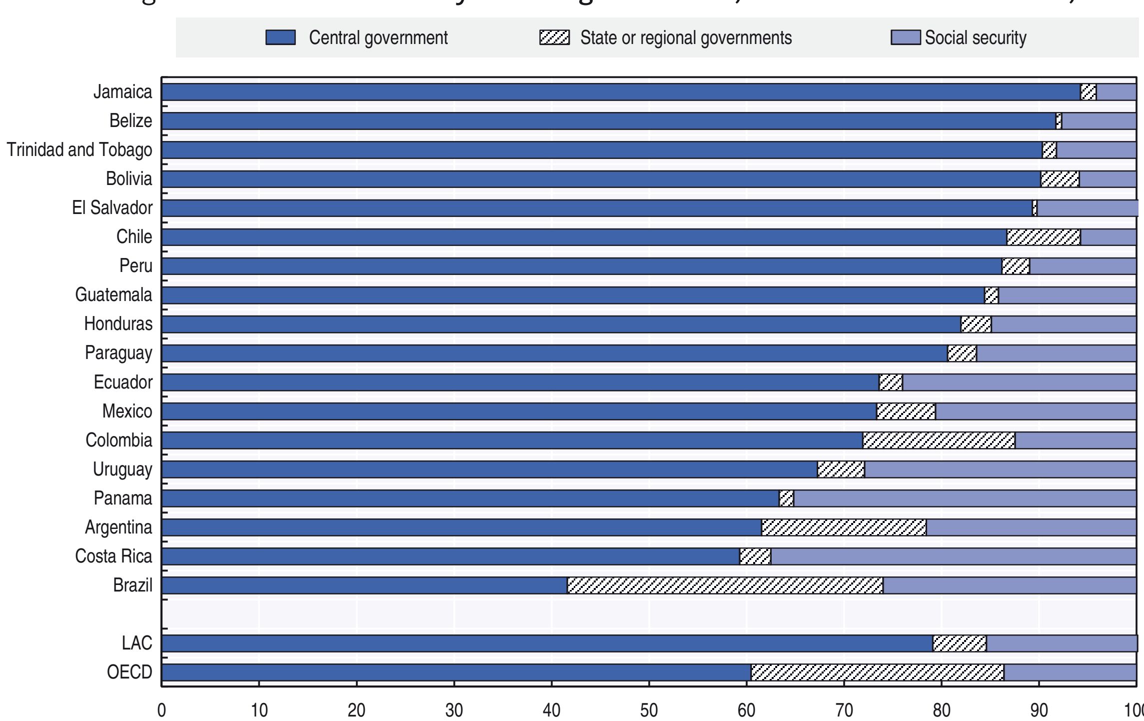
Figure 4.12. **Tax revenue by level of government, Latin America and OECD, 2014**



Source: OECD/CIAT/ECLAC/IDB (2017).

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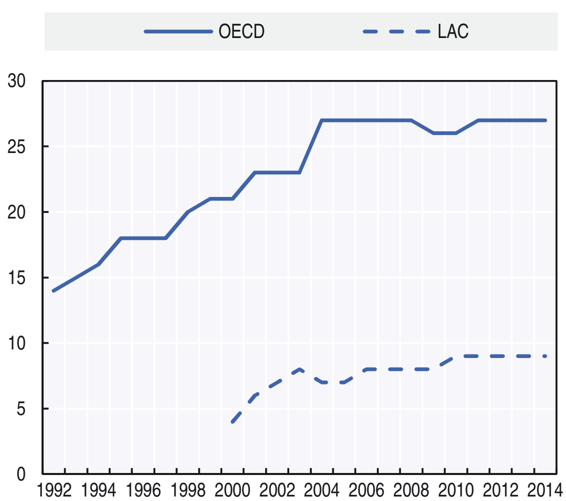
Fiscal rules can strengthen macroeconomic management

Macroeconomic management has improved considerably in the region in the last two decades, based on sounder monetary and fiscal frameworks. Since the early 2000s, a particular case for fiscal rules has spread (Figure 4.13). Nine countries in the region are implementing a fiscal rule (albeit different types): Brazil, Chile, Colombia, Costa Rica, Ecuador, Jamaica, Mexico, Panama and Peru (IMF, 2017).

Fiscal rules can contribute to long-term sustainability of public finances, while ensuring adequate funding for investments. They improve management processes and yield stable and predictable fiscal horizons in which actions can be planned with a degree of trust and certainty. These rules have usually followed three main objectives: ensuring debt sustainability; strengthening stability; and improving the expenditure composition (investment).

Figure 4.13. **Number of countries using fiscal rules in Latin America and OECD**



Fiscal rule / Country	Expenditure rule	Revenue rule	Budget balance rule	Debt rule
Argentina	2000-08		2000-08	
Brazil	2000-14			2000-14
Chile			2001-14	
Colombia	2000-14		2011-14	
Costa Rica			2001-14	
Ecuador	2010-14		2003-09	2003-09
Jamaica			2010-14	2010-14
Mexico	2013-14		2006-14	
Panama			2002-03, 2009-14	2002-03, 2009-14
Peru	2000-14		2000-14	

Source: Alberola et al. (2016), "Fiscal policy and the cycle in Latin America", *BIS Working Paper No. 543*, http://www.bis.org/publ/work543.pdf.

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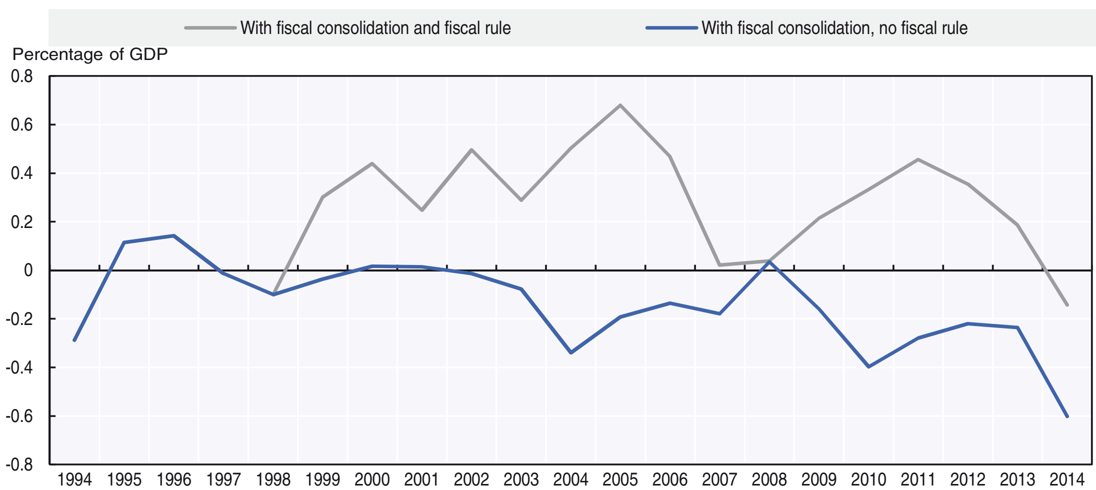
The economies from the region that have applied these rules have largely preferred those that entail budget balance. In most cases, they have complemented them with a second rule, normally an expenditure or a debt rule (Figure 4.13). A particular case is Ecuador, which has used three different fiscal rules in the last 20 years; currently, it is using only the expenditure rule. Along with Ecuador, Chile uses a single rule, in its case for budget balance. Most cases have clear mechanisms to deal with non-compliance with the rule. For example, if Chile, Colombia or Peru fail to follow the budget balance rule, they must present a proposal to the legislative power with corrective measures (OECD/IDB, 2014). If the expenditure rule is not followed in Brazil or Colombia, it is up to the authorities to undertake measures.

Fiscal policy in Latin America has been traditionally pro-cyclical; fiscal rules play a role to reverse this characteristic. Countries in the region, as in other emerging areas, tended to spend too much in good times and were forced to save during economic downfalls. These policies exacerbate the economic cycle. Latin American dependence on external financing and the recurrence of sudden stops may have made the region more prone to this behaviour. Nevertheless, things may be changing since the 2009 financial crisis. Fiscal policy has become less pro-cyclical as the relevance of financial restrictions has diminished; economies with fiscal rules have shown a more countercyclical behaviour (Alberola et al., 2016).

Countries under a fiscal rule are less pro-cyclical than those without such a rule (Figure 4.14). The former even display episodes of countercyclical fiscal policy, a result traditionally reserved for developed economies. Nevertheless, despite sounder fiscal frameworks, fiscal balances are weaker now than before the financial crisis, raising doubts of resilience in case the slowdown becomes long term or deepens. In response to the crisis, some countries in the region approved fiscal stimulus, but expenditure packages, mostly current spending, are not flexible in the recovery (see Celasun et al., 2015; and Powell, 2015). In other words, few economies have applied an exit strategy from the stimulus and the region is far from the levels of fiscal space seen before the crisis.

Figure 4.14. **Fiscal stance in selected economies in Latin America**



Source: Alberola et al. (2016), "Fiscal policy and the cycle in Latin America", BIS Working Paper No. 543, http://www.bis.org/publ/work543.pdf.

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Fiscal rules also aim to improve expenditure composition. A well-documented bias in budgeting results in a volatile and low public investment, notably in infrastructure in most emerging regions. Latin America is no exception, exhibiting investment rates (both public and private) far below the rates observed in emerging Asia or those needed to close the gaps with more developed regions.

In this respect, exit strategies should not only reconstruct fiscal space, but also develop fiscal frameworks more favourable to public infrastructure (see Carranza, Daude and Melguizo, 2014, for an analysis for Latin America). Peru had the good practice of combining a deficit ceiling for the non-financial sector and a cap in the growth rate of current expenditures. This allows for a significant increase in public investment.

Conclusions

In a rapidly changing global context, citizens perceive the rise of new challenges and demand institutions that are ready to respond to them. At the same time, they embrace opportunities brought about by ongoing global transformations. Institutions must be rethought to respond to these demands and support a stronger connection with citizens. To that end, they must be transformed by being flexible, innovative and proactive.

A particular trend that directly affects citizens' lives and well-being is related to technological change, which is having an impact on economies and on growth prospects, as well as on the nature of jobs. The institutional response must favour the creation of more good quality jobs, fostering the employability of citizens by providing better education and skills, and guaranteeing good working conditions. Institutions need to address the challenge of promoting economic growth and the expansion of sectors with the capacity to create jobs.

In this respect, productive development policies (PDPs) must play a critical role, and be supported by greater technical, organisational and political capabilities to be successful. This must be coupled with ambitious education and skills policies to foster employability in a context of changing demands for skills and a changing set of tasks performed by humans.

Quality of education must be strengthened alongside pertinence to improve the connection with labour market demands, which need to be more effectively anticipated. Also, the institutional framework must be redesigned to stand ready to provide training all through the working life, and train in skills that will be in higher demand.

Finally, technological progress has led to the proliferation of new forms of labour arrangements, with negative consequences in terms of social protection and overall working conditions. Labour market institutions need to be rethought to guarantee good quality working conditions. Strategies include ensuring the non-discrimination and equal treatment among different contractual arrangements, adapting social insurance schemes to extend coverage to previously excluded categories of workers, improving the overall working of social security systems, or complementing social insurance with non-contributory mechanisms, among others.

A forward-looking approach to policy making also demands a sustainable fiscal framework. It must be able to guarantee the capacity of financing more and better public goods and services to respond to rising and evolving citizens' demands. To this end, countries will have to ensure proper funding through effective and efficient spending, better taxation and proper rules to ensure long-term sustainability.

There are several steps to this process. First, subsidies, government programmes and tax expenditures should be continually appraised to guarantee they reach their intended goals and recipients. Public-private partnerships and Social Impact Bonds offer interesting ways to improve spending and maximise public outcomes. Second, taxation should focus on eliminating unnecessary distortions, while pursuing a more progressive tax system that diminishes inequality and improves environmental outcomes. Decentralisation efforts should be wary of undermining sub-national governments' capacity. Finally, fiscal rules yield stable and predictable fiscal horizons, allowing actions to be planned with a degree of trust and certainty. This helps ensure fiscal space to generate the kind of economic and productive investments the region needs and to prepare future generations with the kinds of skills future markets will demand.

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