

Chapter 1

The social contract in Latin America and the Caribbean: Situation and policy challenges

This chapter illustrates the weakening of the social contract in the region, and aims to better understand its intricacies and the policy challenges and areas that are crucial for its strengthening. First, it presents evidence that suggests the growing disconnection between citizens and public institutions in Latin America and the Caribbean (LAC), which in turn is a sign of a weaker contract. This section argues that two factors could explain this growing disconnection: the rising aspirations of a middle class that has significantly expanded in the last decade, and the difficulties of public institutions to respond to new socio-economic challenges and guarantee greater well-being. The strength of the social contract is also assessed by exploring tax morale – i.e. the willingness to pay taxes – in the region. Second, it looks at how well-being has diminished recently in LAC, and suggests the need to rethink institutions to provide better opportunities and public goods and services and respond to citizens' evolving demands, thus improving their well-being.

The social contract in Latin America and the Caribbean: situation and policy challenges

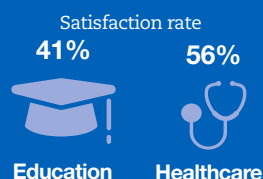
Latin America and the Caribbean witness a growing disconnection between citizens and the state

Lower trust in government



Trust in government has fallen from a level of **45%** in 2010 to around **25%** in 2017

Low satisfaction with public services



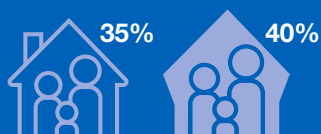
Over 2006-16, the share of people **satisfied with the quality of public services** also fell

Lower tax morale



More than half of Latin-Americans were willing to **evade paying taxes** in 2015

The unmet aspirations of a larger *middle class* are a key driver of the current social dissatisfaction



In 2015, around **35%** of LAC population could be **considered consolidated middle class** (21% in 2001), but around **40%** remains **vulnerable**



Dissatisfaction with public services brings **upper- and middle-class households** to move towards **better quality private services...**



... while **vulnerable middle class and poor households** remain using **low quality public services**, thus perpetuating social divides

In recent years, the Latin America and Caribbean (LAC) region has witnessed a growing disconnection between citizens and the state. This is illustrated mainly by a decline of trust in public institutions and an increase of citizen dissatisfaction with public services. The rising aspirations of a larger middle class, coupled with the difficulties of public institutions to respond to persistent and new socio-economic challenges emerging from both the domestic and the global context, explain to a large extent this disconnection.

These developments suggest a weakening of the social contract in LAC, with significant implications for people's perception of well-being. The social contract can be broadly understood as a tacit pact between the state and citizens. On the one hand, the state enables people to make the most of their lives (through guaranteeing fundamental rights and ensuring a certain standard of material conditions and quality of life through the provision of public goods and services). On the other, citizens fulfil certain duties and obligations (such as voting and paying taxes) that underpin the effective functioning of democratic societies.

Rebuilding the social contract is vital to foster higher well-being for all in LAC. To do so requires a rethinking of institutions to better respond to citizens' demands and to bridge the gap with them. In LAC, declining levels of trust and satisfaction with public services suggest that citizens no longer believe that public institutions can respond to their demands. As a result, they do not perceive sufficient benefits linked to the fulfilment of their duties as citizens, but rather see fewer incentives to engage in the obligations associated with the social contract. This, in turn, undermines the capacity of the state to provide quality public goods and services effectively. This leads to a negative impact on citizens' perception of well-being, which further fuels their disengagement from public institutions in a downward spiral.

This chapter illustrates the weakening of the social contract in the region, and aims to better understand its intricacies and the policy challenges and areas that are crucial for its strengthening. First, it presents evidence on the growing disconnection between citizens and public institutions in LAC. The strength of the social contract is also assessed by exploring tax morale – i.e. the willingness to pay taxes – in the region. Second, it analyses how a stronger social contract is critical to achieve greater well-being, and argues that a rethinking of institutions is needed in the LAC region in order to achieve this goal by better responding to citizens' demands and providing better public goods and services.

The social contract has weakened in LAC owing to the difficulties of institutions to respond to the rising and evolving aspirations of society

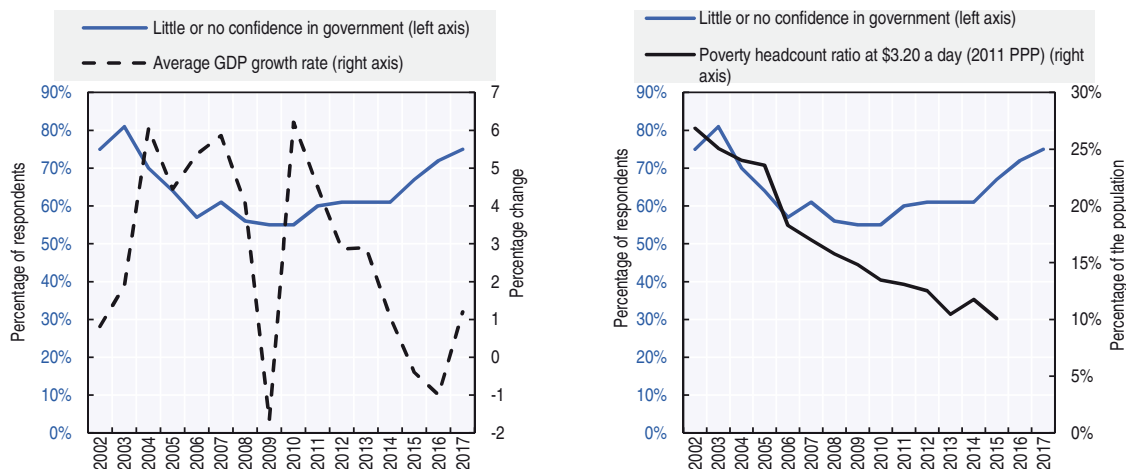
The widening gap between aspirations and perceptions suggests that the social contract has been weakening in LAC. The notion of the social contract is broad, although its strength can be measured through different indicators that help understand the vigour of the relationship between the state and society. Social contracts are generally characterised by a number of explicit and implicit agreements that determine what each socio-economic group gives to the state and what it receives back (Estefania and Martinez-Lillo, 2016). Citizens will only engage firmly in these agreements under three conditions. They must believe they are reliable (i.e. they trust state institutions), they must perceive these agreements are beneficial (i.e. they are satisfied with what they receive by engaging in them) and they must perceive the pact as fair (i.e. no one is favoured over others or benefits at their expense). Looking at the gap between social aspirations (what people would like to receive or what they demand from the state) and perceptions (what they feel they receive from engaging with the state) could reveal insights into the strength of the social contract. In LAC, both the indicators about perceptions and aspirations point to a weakening of the social contract in recent years.

Low trust and dissatisfaction illustrate the erosion of the social contract in LAC

Trust in institutions is low in LAC and has deteriorated in recent years. On average in the last decade, 62% of the Latin American population had little or no trust at all in governments. Lack of trust in governments has deepened since the global financial crisis, reaching levels of around 75% in 2017, up from a level of 54% in 2010 (Figure 1.1, Panel A). Trust has decreased even in a context of a large decline of poverty rates in the LAC region (Figure 1.1., Panel B).

Trust is usually understood as “holding a positive perception about the actions of an individual or an organisation” (OECD, 2017a). It is thus interpreted as having confidence that the actions of others will follow what is expected. In this respect, trust is a fundamental element for the success of public policies. Many such policies depend on co-operation and compliance of citizens, while many others assume the public will behave in a way that transforms these policies into successful action. There are different categories of trust: trust of citizens in governments; trust of governments in citizens; and trust among citizens. While the three are relevant for a solid social contract, the chapter focuses on trust of citizens in governments and in public institutions. Without trust, citizens do not perceive value in engaging in an agreement that may not be respected.

Figure 1.1. Trust in governments vs. growth and poverty rates in Latin America



Note: Unweighted averages for all variables for a sample of countries comprising: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

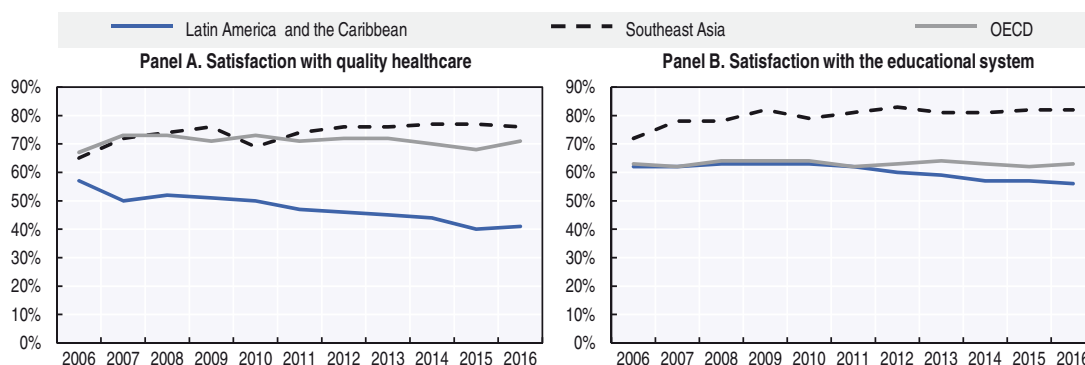
Source: OECD/CAF/ECLAC based on data from IMF (2016), *World Economic Outlook*; World Bank (2017a), *World Development Indicators*; and Latinobarometro (2017).

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Other indicators also suggest that citizens in the LAC region are losing trust in institutions. Overall in 2016, only 23% of Latin Americans said they were confident in the honesty of elections (compared with 46% in the OECD). In addition, only 15% said they did not believe that corruption was widespread in government (compared with 28% in the OECD). Further, 34% had confidence in the national judicial system (compared with 49% in the OECD) (Gallup, 2017).

Overall satisfaction with public services has also diminished in the region. Over 2006-16, the share of people satisfied with the quality of healthcare fell from 57% to 41%. This remains well below satisfaction levels in OECD member countries (around 70%), which have remained stable (Figure 1.2, Panel A). Likewise, satisfaction with the quality of the education system fell from 63% to 56% over the same period (around 63% for OECD members in 2016) (Figure 1.2, Panel B).

Figure 1.2. Satisfaction with main public services in Latin America, OECD and Southeast Asia (percentage of total population)



Source: OECD/ECLAC/CAF based on Gallup 2017.

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Multiple factors drive citizen dissatisfaction in LAC. What seems to matter the most for citizens are economic problems (jobs and income), the quality of goods and services (especially to combat crime and violence, and provide health and education), and political issues (notably corruption), according to Latinobarometro (2017). An additional source of information to understand citizens' perceptions are internet searches, which in addition provide higher anonymity, sincerity and frequency than traditional surveys. These searches suggest that citizens' perceptions about economic problems, public insecurity, corruption or public services are directly linked to presidential approval rates in LAC – used as a proxy of citizens' overall satisfaction and potentially of their willingness to engage firmly in the social contract (Montoya, Nieto-Parra, Orozco and Vazquez, forthcoming) (Box 1.1).

Box 1.1. Big data is a relevant source information to understand the main drivers of citizens' discontent

Today, an increasing number of people from all over the world turn to the internet in search of information on politics, economics and jobs. Each minute, searches of people living in different countries generate large amounts of georeferenced data, reflecting concerns, opinions, preferences and needs. The absolute anonymity of these searches, and therefore the sincerity in their content, make the generated data more likely than traditional surveys to be objective (Stephens-Davidowitz, 2013). These reasons mostly explain why social scientists are increasingly using this massive amount of data with the aim of knowing more about people's behaviours. Likewise, this new source of information also has the potential to inform policy makers and governments on various aspects of citizens and public opinion (Reimbsbach-Kounatze, 2015).

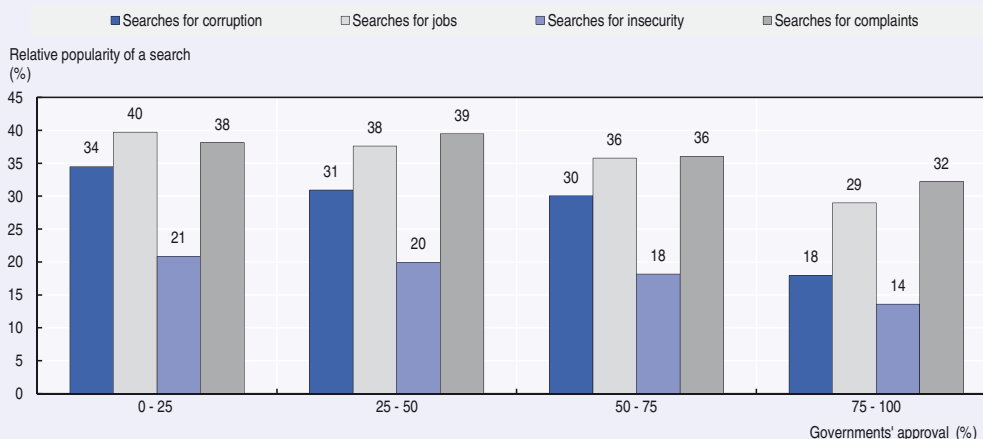
Recent empirical evidence shows that data obtained from internet search engines (in particular google data) is a useful source of information about citizens' main socio-economic concerns (Montoya, Nieto-Parra, Orozco and Vazquez, forthcoming). This analysis examines whether citizens' perceptions of the region's most important problems, measured using their searches on the internet, can explain executive approval rates, on the belief that the latter is a good proxy of the satisfaction of citizens with their government and thus their willingness to engage in the social contract. The analysis includes 18 LAC countries between January 2006 and December 2015, employs

Box 1.1. Big data is a relevant source information to understand the main drivers of citizens' discontent (cont.)

monthly panel data, and combines variables gathered from standard national statistics data and variables constructed from the results of internet searches done by citizens. The latter is included precisely with the goal of approaching citizens' perceptions and concerns (Montoya, Nieto-Parra, Orozco and Vazquez, forthcoming).

Stylised facts from Montoya et al. show a negative relationship between governments' approval and the volume of internet searches for corruption, jobs, insecurity, and consumer complaints in the region (Figure 1.3). This negative relationship suggests that the volume of searches for these issues, which mostly coincide with the main sources of concern of society according to Latinobarometro (Latinobarometro, 2017), is lower when executive approval rates are higher. In this respect, internet searches appear to be informative about citizens' sources of discontent with governments.

Figure 1.3. Internet searches on economic, political, and social issues in Latin America, within different levels of executive approval



Note: This graph displays the average popularity of internet searches within each quartile of government's approval data. It employs monthly observations between January 2006 and December 2015 of 18 LAC countries, including Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

Source: OECD/ECLAC/CAF using data from Google trends and the Executive Approval Database (Carlin et al., 2016).

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The econometric analysis performed by Montoya et al. confirms that citizens' perceptions of corruption and insecurity – proxied using internet search query data – have a negative and statistically significant influence on the rates of approval of the incumbent government. Nevertheless and surprisingly, the unemployment variable, constructed with internet searches for terms related to the search of a job by citizens, does not seem to have an effect on governments' approval in the LAC region. The large presence of labour informality in LAC, which may well distort the dynamics of job searches – many don't need to look for a job as they already have one in the informal sector or only look for jobs through informal channels – may be one of the explanations behind this counterintuitive result. Other variables non-related to internet searches, such as the level of inflation, economic growth rates, and the international economic environment, are also strong determinants of executive approval rates.

Box 1.1. Big data is a relevant source information to understand the main drivers of citizens' discontent (cont.)

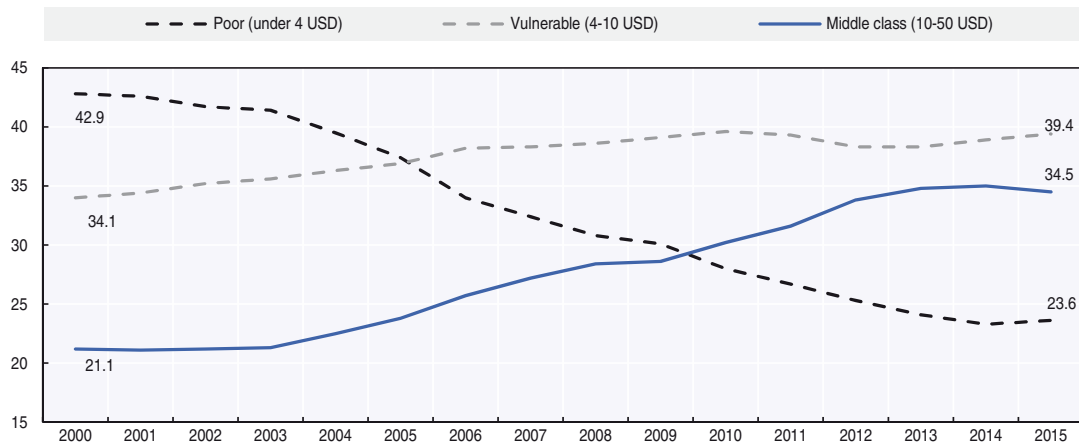
This analysis displays the potential that big data has to inform governments about citizens' concerns, opinions, preferences and needs with higher anonymity, sincerity and frequency than traditional surveys. Nonetheless, using information from internet search engines presents some limitations. First, the sample is unlikely to be representative, considering that internet access is constrained for certain segments of the population. This applies particularly to Latin America and the Caribbean (LAC), given the low levels of internet penetration in the region despite its progress over the last decade [54.5 internet users per 100 inhabitants in 2015 (World Bank, 2017a)]. This may limit the sample of people performing internet searches to mainly middle and high-income inhabitants from LAC. In order to test differences in the results depending on the evolution of internet access, Montoya et al. integrate different time-specifications according to the number of internet users per 100 inhabitants of each country. The second main caveat is the latent risk of capturing searches that are not of our interest. To limit biases generated by unrelated topics captured in the searches, Montoya et al. refine results from internet searches by excluding potential misleading words.

The rise of aspirations and the unmet demands of society are one of the main explanations to why discontent in LAC is growing even after unprecedented socio-economic progress. It is somewhat paradoxical that trust and citizen satisfaction have deteriorated even after an economic boom in LAC; poverty rates have declined sharply, inequalities have narrowed and overall living standards have significantly improved. Various explanations may lie behind this phenomenon. First, the recent economic slowdown could be creating a feeling across many segments of society that the previous socio-economic gains could be at risk. At least, people might believe it will be difficult to continue with a similar pace of progress. Second, increasing interconnectedness favoured by technological advances may have created new paradigms of social progress. It is easier to compare progress in LAC against societies of higher levels of development, thus inflating aspirations among younger generations. Third, a number of global trends such as rapid technological change, an ageing population, migration and climate change are perceived as challenges beyond the powers of the nation state, thus creating a sense of uncertainty and risk among citizens. Finally, the expansion of the middle class has been accompanied by higher aspirations and demands. This is particularly true in LAC, with one out of four citizens aged between 15 and 29 years old. It also has the first generation born and raised in democracy, and one that is highly urbanised, with almost 90% of its population living in cities: these factors also contribute to the evolving demands from society (OECD/CAF/ECLAC, 2016). The shifting aspirations of a larger middle class stand out as a major transformation in LAC's society and deserve special attention.

The rising and evolving aspirations of a larger middle class

The expansion of the middle class has been one of the major socio-economic transformations of recent times in LAC. In 2015, around 35% of the population could be considered consolidated middle class (earning USD 10-50 [2005 PPP] a day), up from 21% in 2000. Almost 40% of the population could be considered vulnerable middle class (living with USD 4-10 [2005 PPP] a day) (Figure 1.4). For the first time in history, the poor are the smallest socio-economic group in LAC, comprising near 24% of the population – individuals living on less than USD 4 (2005 PPP) a day (OECD/CAF/ECLAC, 2016).

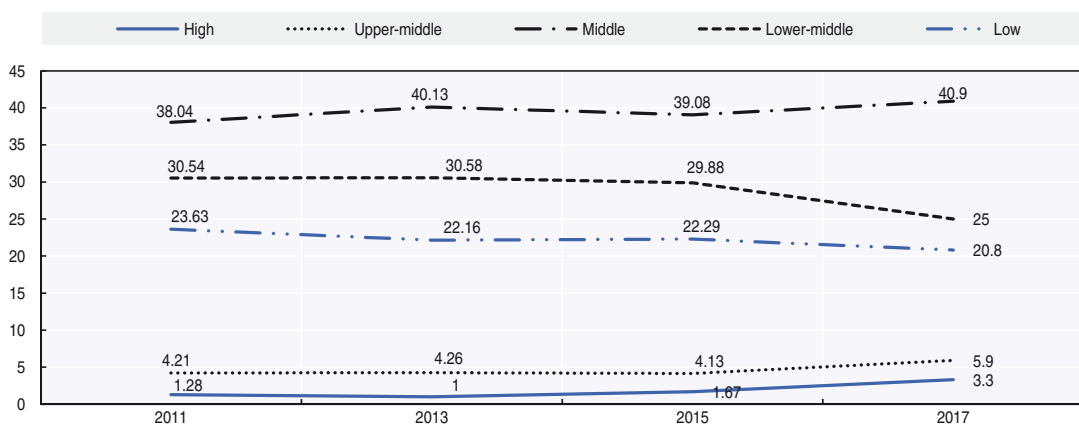
Figure 1.4. Latin American population by socio-economic groups
Percentage of total population



Source: OECD/ECLAC/CAF based on LAC Equity Lab tabulations of SEDLAC (CEDLAS and the World Bank, 2016).
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Moreover, a majority of LAC’s citizens perceive themselves as being part of the middle class. *Being middle class* is not the same as *feeling part of the middle class*. Subjective measures of social class suggest that the middle class in LAC is even larger than that shown by income measures. Further, it suggests the middle class is aspirational in the region (i.e. people have middle-class aspirations even when their levels of income are not necessarily those attributed to middle-class groups). Almost 40% of citizens perceive themselves as middle class according to some results (Figure 1.5). Other analysis puts the share at 53% (Penfold and Rodriguez, 2014). In terms of aspirations, expectations and social demands, then, as well as the role played by this socio-economic group in shaping and strengthening the social contract, the relevance of the middle class may be even larger than suggested by income measures.

Figure 1.5. Latin American population by subjective socio-economic groups
Percentage of total population according to the socio-economic group to which they believe they belong



Note: The question asked in the survey is: “Which social class would you describe yourself as belonging to? High, upper-middle, middle, lower-middle or low.”

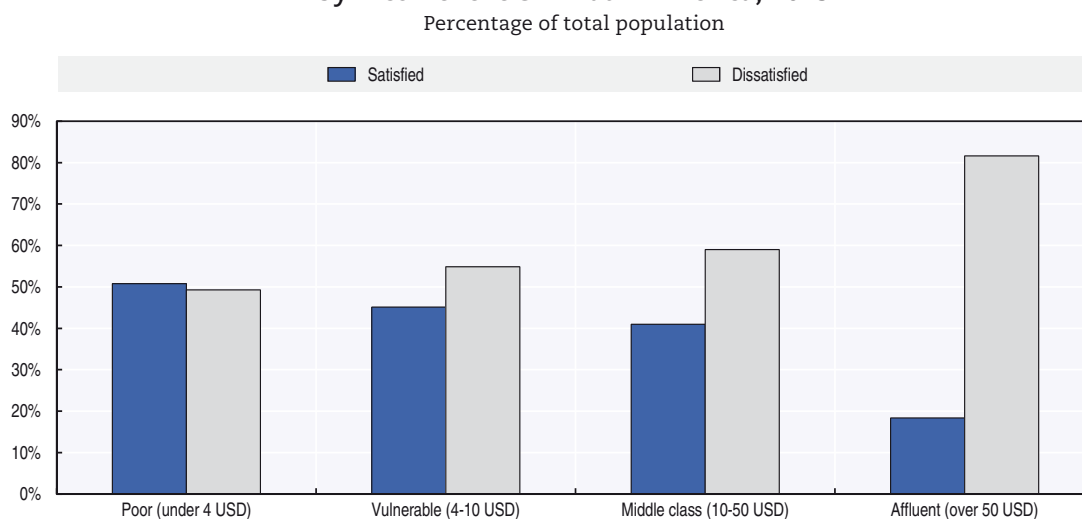
Source: OECD/ECLAC/CAF based on Latinobarometro, 2017, 2015, 2013, 2011.
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The enlargement of the middle class has brought with it a change in aspirations, expectations and demands, which significantly explains the current social dissatisfaction in LAC. Belonging to the middle class is usually associated with a certain set of

aspirations and demands. Middle-class citizens are strong supporters of democracy, but at the same time are critical of its functioning (OECD, 2010). In fact, when the middle class reaches at least 30% of the population, its members attain a collective power to demand better public goods and services more effectively (Birdsall, 2016). In this sense, an increase in the size of the middle class makes social policy on health and education more active, decreases official corruption levels and improves the quality of governance regarding democratic participation (Loayza, Rigolini, Llorente, 2012). In LAC, the large expansion of the consolidated middle class is presumed to have changed substantially the expectations of a large segment of society (Penfold and Rodriguez, 2014). Likewise, the members of the large vulnerable middle class live with the uncertainty that they could fall back into poverty in the advent of a negative shock. Indeed, in 2015 around 7 million people did fall back into poverty in the region (ECLAC, 2016). Altogether, increased expectations of the consolidated middle class and the sense of instability of the vulnerable middle class can largely explain the upsurge of social dissatisfaction witnessed in LAC in recent years.


Discontent with public health services is generalised across Latin American society, but seems to rise with income. As much as 55% of the vulnerable middle classes report dissatisfaction with these services, while almost 60% in the consolidated middle class do. Similarly, more than 80% in the high income group also report dissatisfaction with public health services (Figure 1.6). Dissatisfaction with public education, water and sanitation, and public security follow similar trends (LAPOP, 2016).

Figure 1.6. Satisfaction with public medical and health services by income levels in Latin America, 2015



Note: "Poor" refers to individuals whose daily per capita income is below 4 USD; "vulnerable" have a daily per capita income of USD 4-10; "middle class" have income between USD 10-50; "affluent" have an income above USD 50. 2005 USD PPP per day. PPP = purchasing power parity.

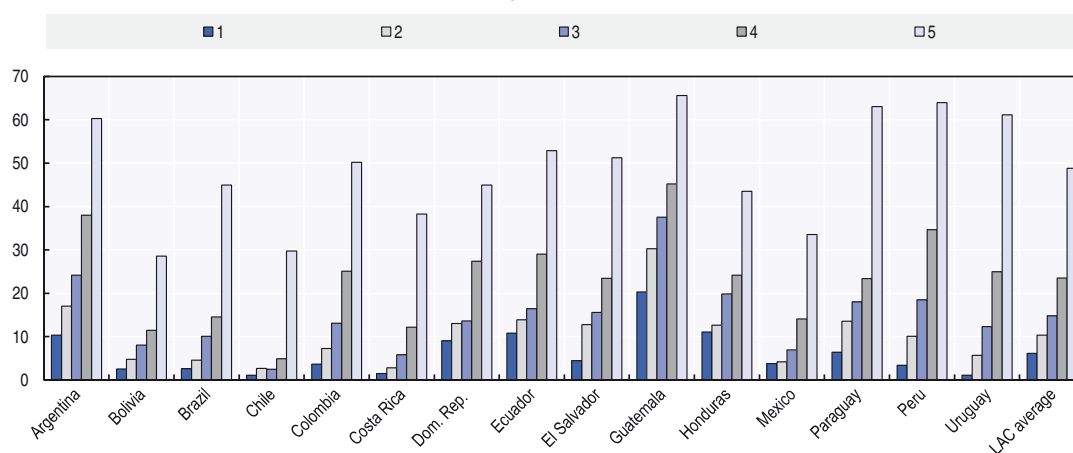
Source: OECD/ECLAC/CAF based on The Americas-Barometer by the Latin American Public Opinion Project (LAPOP), www.LapopSurveys.org.

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High levels of dissatisfaction with public goods may explain why a large share of Latin Americans with sufficient income chose private services over universal public services (such as education or health). For instance, the share of secondary students enrolled in private schools is strongly linked to household income, with a drastic increase for the fourth and fifth quintile (Figure 1.7).

Dissatisfaction with public services, and the subsequent opting out of those with sufficient resources, weaken the social contract. The welfare state remains highly fragmented, providing differentiated services to various population groups (Ribe, Robalino and Walker, 2010). On the one hand, individuals from upper- and middle-class households usually channel their dissatisfaction with public services by opting out; they move towards better quality private services they can afford. On the other hand, individuals from the *vulnerable middle class* and poor households are also dissatisfied with the quality of public services, but do not have the necessary income to opt out of them; they remain using low quality public services. This creates a fracture. Consolidated middle classes pay both for the cost of public services that they finance but do not use, and for the cost of private services that they eventually use. And vulnerable middle classes use public services, but are dissatisfied with them and are not able to afford higher quality options. In this context, these groups, which together represent around 75% of the population, are dissatisfied for different reasons, and they may find few incentives to engage firmly in a solid social contract.

Figure 1.7. Enrolment in private schools by income quintiles in Latin America, 2014
Share of secondary students in private schools



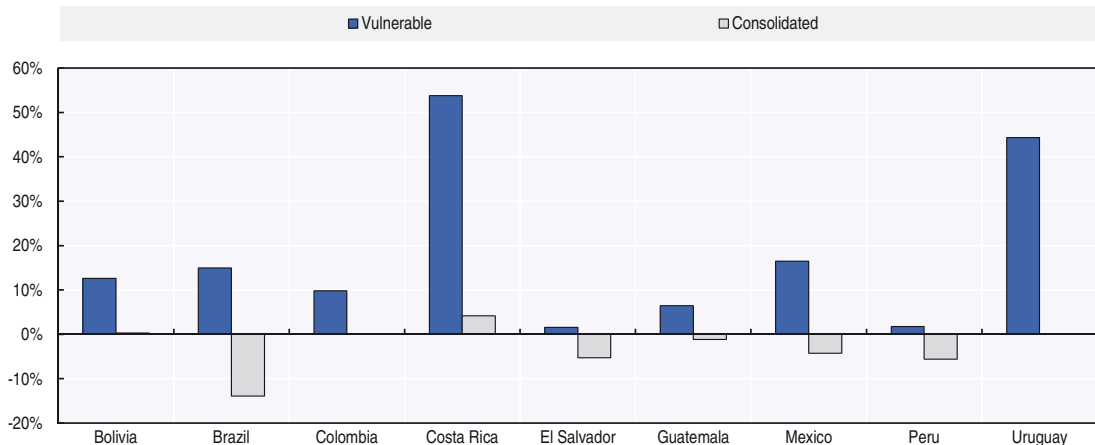
Source: OECD/CAF/ECLAC, based on CEDLAS and the World Bank (2016).
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After accounting for the effect of taxes, transfers and public services, individuals from the consolidated middle class are net payers, while those from the vulnerable middle class are net receivers. As the consolidated middle class pay more in taxes than the monetary value of what they receive in transfers, (direct, indirect and in-kind transfers), they are net payers. Conversely, individuals from vulnerable households are net receivers, as the monetary value of the transfers and services they receive is larger than the taxes they pay (Figure 1.8). In fact, when the monetary value of education and health is not considered, the vulnerable in all LAC countries included in the Commitment to Equity Institute (Box 1.2) analysis, except for Ecuador, become net payers. This implies that the bulk of redistributive policies rests upon public services, which most often have poor quality (OECD, 2010; Daude, Lustig, Melguizo and Perea, 2017; Lustig, 2017a).

Although the middle class bears most of the cost of welfare policies, indirect taxes put more pressure on the poor and the vulnerable class. Indirect taxation, particularly value added taxes (VAT) and other excise taxes on inelastic products passed on to consumers via higher prices, affect middle-class and low-earning individuals the most. In the case of Brazil, Colombia, Costa Rica and Uruguay, the share of taxes as a percentage of market

income is higher for the vulnerable class than for the consolidated middle class. In the case of El Salvador, Guatemala and Peru, the share is relatively equal for both cohorts of the middle class.

Figure 1.8. Net fiscal position of the middle class, circa 2010
Change in final income with respect to market income, percentage



Notes: “Vulnerable” have a daily per capita income of USD 4-10; “middle class” have income between USD 10-50; 2005 USD PPP per day. PPP = purchasing power parity.

Source: OECD/ECLAC/CAF based on Daude, Lustig, Melguizo and Perea (2017), “Fiscal policy and the emerging middle class in Latin America, an analysis based on the Commitment to Equity”.

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Box 1.2. The Commitment to Equity

The Commitment to Equity (CEQ) Institute at Tulane analyses the impact of taxation and social spending on inequality and poverty in individual countries, and provides a roadmap for governments, multilateral institutions and non-governmental organisations (NGOs) to build more equitable societies (Lustig, 2017b).

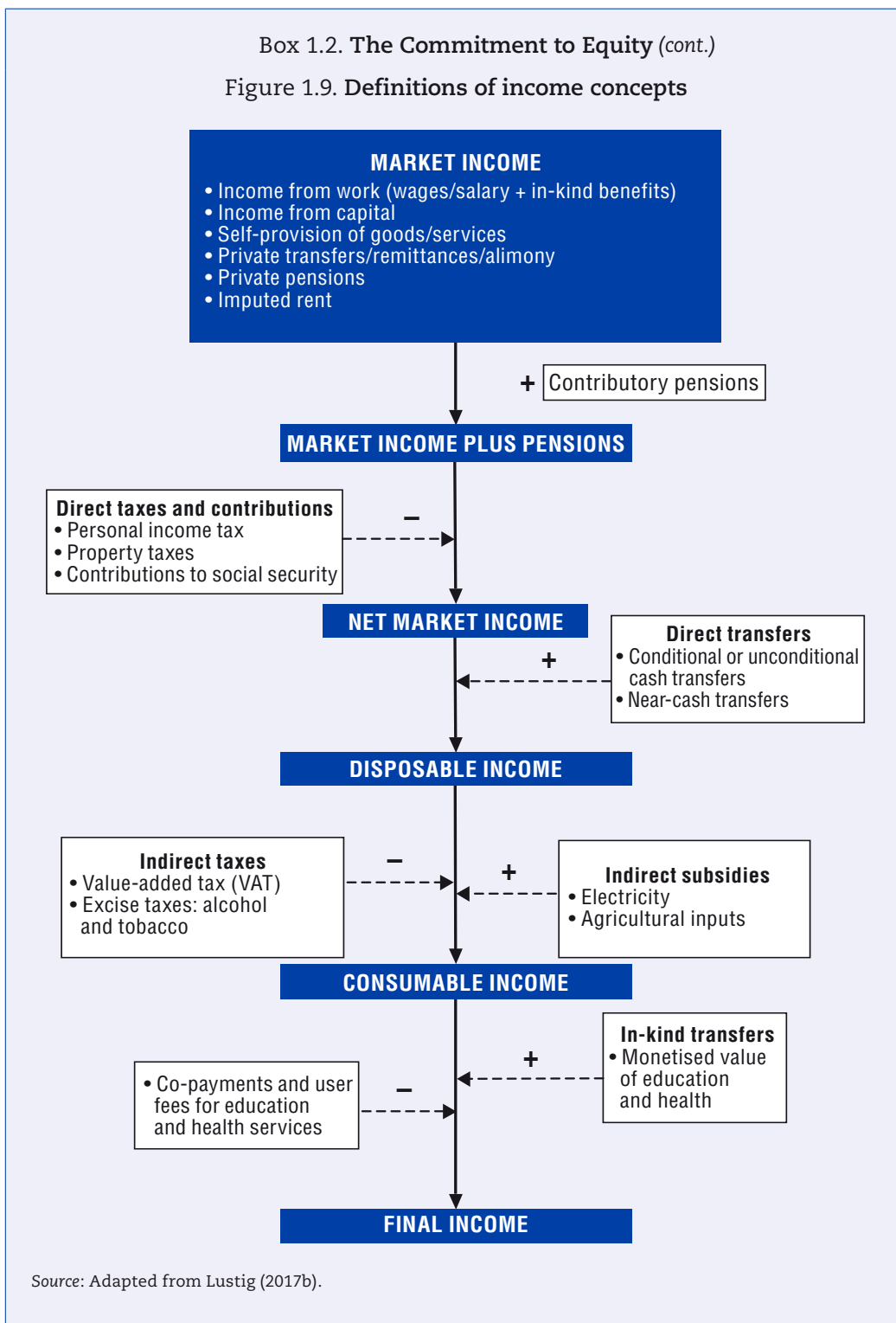
The CEQ produces tax and benefit incidence studies that aim to answer the following four questions:

1. How much income redistribution and poverty reduction are being accomplished through fiscal policy?
2. How equalising and pro-poor are specific taxes and government spending?
3. How effective are taxes and government spending in reducing inequality and poverty?
4. What is the impact of fiscal reforms that change the size and/or progressivity of a particular tax or benefit?

To address these questions and to measure the redistributive effect and poverty impact of taxes and benefits, CEQ produces a fiscal incidence analysis. This consists of allocating taxes (personal income tax and consumption taxes, in particular) and public spending (social spending and consumption subsidies, in particular) to households or individuals. This enables comparison of incomes before taxes and transfers with incomes after taxes and transfers (Lustig, 2017b). Figure 1.9 summarises the construction of these income concepts.

Box 1.2. The Commitment to Equity (cont.)

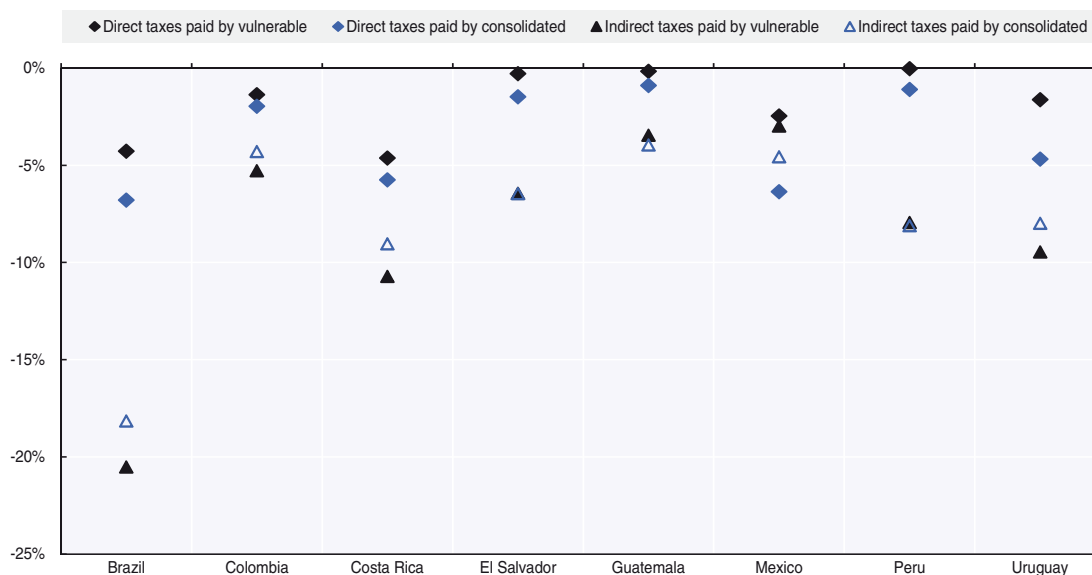
Figure 1.9. Definitions of income concepts



The consolidated middle class and the rich largely bear the weight of direct taxes, as personal income taxes are focused only on very high-earning individuals (Barreix, Benitez and Pecho, 2017). This is especially the case in Brazil, Costa Rica and Mexico,

where direct taxes as a share of market income are higher for the consolidated middle class than for the vulnerable. Similarly, this is the case in El Salvador, Guatemala and Peru where the vulnerable do not pay direct taxes (Figure 1.10).

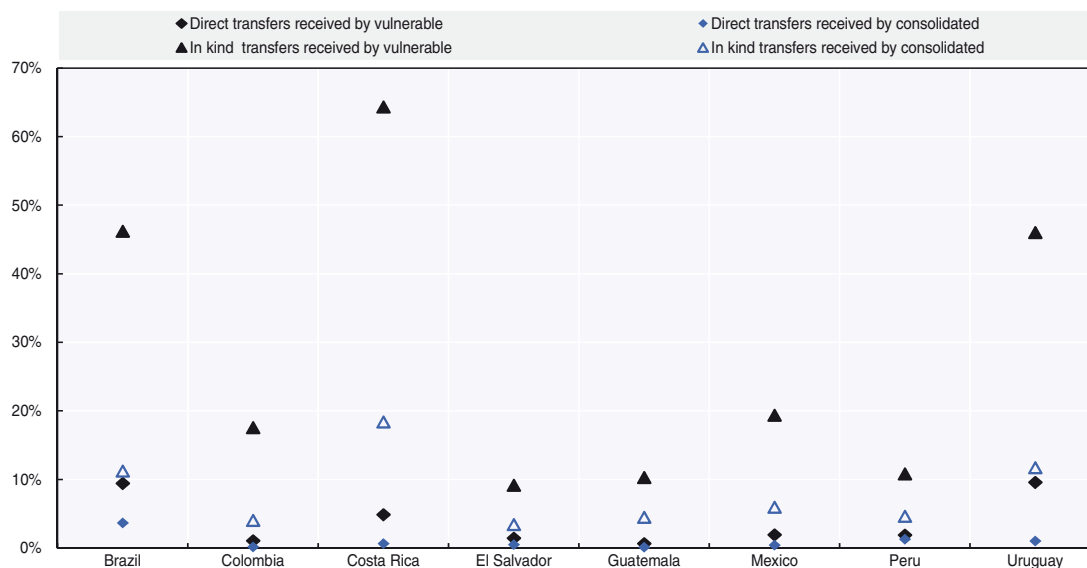
Figure 1.10. Ratio of taxes paid to market income for the middle class (vulnerable and consolidated) by country in Latin America, circa 2010



Source: OECD/ECLAC/CAF based on Daude, Lustig, Melguizo and Perea (2017).

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Figure 1.11. Ratio of transfers received to market income for the middle class (vulnerable and consolidated) by country in Latin America, circa 2009



Source: OECD/ECLAC/CAF from Daude, Lustig, Melguizo and Perea (2017).

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The majority of transfers (direct and in-kind) benefit the vulnerable middle class on a larger scale compared with the consolidated middle class (Figure 1.11). Such transfers include education and health services as a percentage of their market income. This

probably occurs because the consolidated middle class can opt out of low-quality public services, especially in education and health, in favour of private services. Similarly, and because of the nature of their design, direct transfers (conditional and unconditional cash transfers, school feeding programmes, free food transfers, etc.) tend to be progressive in absolute terms (Daude, Lustig, Melguizo and Perea, 2017). This benefits the vulnerable middle class (as a percentage of their market income) rather than the consolidated middle class. In fact, in economies such as Colombia, Guatemala, El Salvador and Mexico, the impact of direct transfers on the consolidated middle class is rather small.

Assessing the strength of the social contract in LAC: A fiscal perspective using tax morale

One of the main components of the social contract is the fiscal pact. This can be defined as the agreement that citizens pay taxes to the state in exchange for certain public services and goods. The strength of the fiscal pact can be a good measure of the strength of the social contract in a broader sense.

The degree of involvement of LAC citizens in the fiscal pact is strongly determined by the perception about the net results of their participation in it (Avanzini, 2012). The engagement of Latin Americans in the fiscal pact depends on their trust in institutions, satisfaction with public services and the overall benefit they believe to have obtained by participating or fulfilling their obligations with the state. If Latin Americans are dissatisfied with their government and the services it provides, they are more likely to justify cheating on taxes and to potentially avoid paying them. They may also opt out of the use of public services, effectively undermining the social contract. Measuring tax morale, or willingness to pay taxes (Box 1.3) is thus a way to understand the degree of engagement of citizens in the fiscal pact. It ultimately indicates their trust and satisfaction with public institutions and services.

Box 1.3. Measuring tax morale

There exist different ways to measure tax morale based on household surveys. Both the World Value Survey (WVS) and the Latinobarometro ask whether “cheating or evading taxes can be justified”, although the WVS adds, “If you have the chance”. These results are not totally comparable with other regional surveys for other emerging regions. The Afrobarometro, for example, asks whether “not to pay taxes on income was wrong and punishable, or wrong but understandable, or not wrong at all”. The Asiabarometer asks the question indirectly: “Would you like to see more or less government spending in each area?”, with a reminder that more expenditure may require a tax increase. In both the Latinobarometro and the WVS, respondents are asked to rank from 1 to 10 their justification of tax morale (with 1 being never justifiable and 10 being always justifiable). For this chapter, “10” represents people who would never justify avoiding taxes, while “1” would be for those who would always justify cheating on taxes.

Results from Latinobarometro and WVS differ as the sample of countries and the period are not the same. For WVS, it consists of nationally representative surveys in almost 100 countries through waves of amplitude of five years (wave). In this chapter, results and analysis from the WVS are from wave 6, which consists of the years 2010-15. It features 58 countries, including Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Trinidad and Tobago, and Uruguay.

In the case of the Latinobarometro, it undertakes a yearly nationally representative survey (latest data available are 2015), which includes 18 Latin American countries: Argentina, the Plurinational State of Bolivia (hereafter “Bolivia”), Brazil, Chile, Colombia,

Box 1.3. Measuring tax morale (cont.)

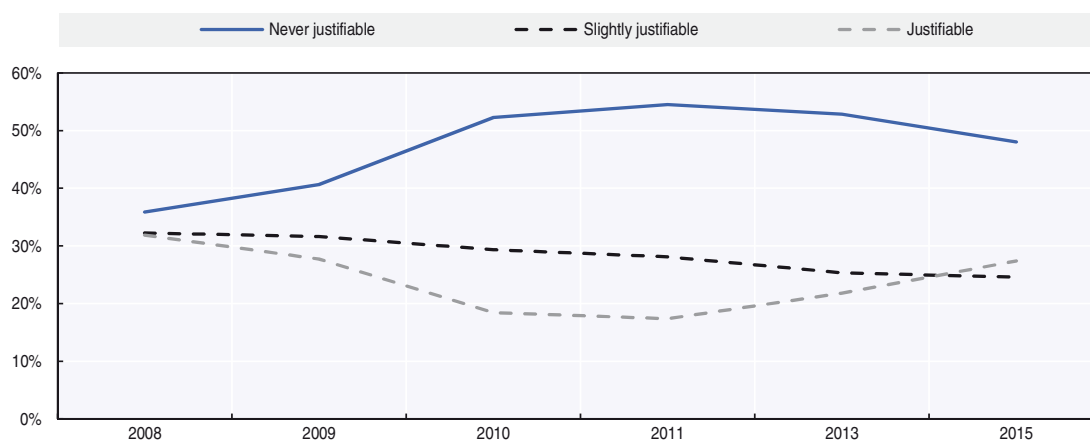
Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and the Bolivarian Republic of Venezuela (hereafter “Venezuela”).

Independently of the source, there are some challenges in the measurement of tax morale. For instance, given the data are based on self-reports, in which subjects may tend to overstate their degree of compliance, the results or analysis might be biased (Andreoni, Erard, and Feinstein 1998). Similarly, using the question “cheating or evading taxes can be justified” ignores the fact that cheating is a “no-option,” or at least much more limited in some developed countries, thanks to better enforcement mechanisms (Daude, Gutierrez and Melguizo, 2013). Nevertheless, and despite the possible weaknesses in the data, there does not appear to be a better substitute or database to Latinobarometro or WVS to measure tax morale.

The engagement of citizens in the fiscal pact, measured through tax morale, is relatively low in LAC and has been deteriorating since 2011. More than half of Latin Americans were willing to evade paying taxes if possible in 2015. Two groups can be observed among those willing to evade taxes: those who would strongly justify evading taxes and those who slightly justify evading them, representing 27% and 25% of Latin Americans in 2015, respectively (Figure 1.12). In the same year, those who believe that evading taxes cannot be justified by any means accounted for 48% of the population (Latinobarometro, 2015). Tax morale has deteriorated since 2011, when 54% of Latin Americans were unwilling to justify evading taxes (6 percentage points higher than in 2015). This deterioration comes after significant improvement of tax morale in the region, suggesting a reversal in the drivers of the willingness to pay taxes. In fact, there appears to be a correlation between this declining trend and those observed in indicators of trust in institutions and satisfaction with public services, among other self-reported measures on citizens’ perception of states.


Figure 1.12. Tax morale in Latin America

Percentage of total population



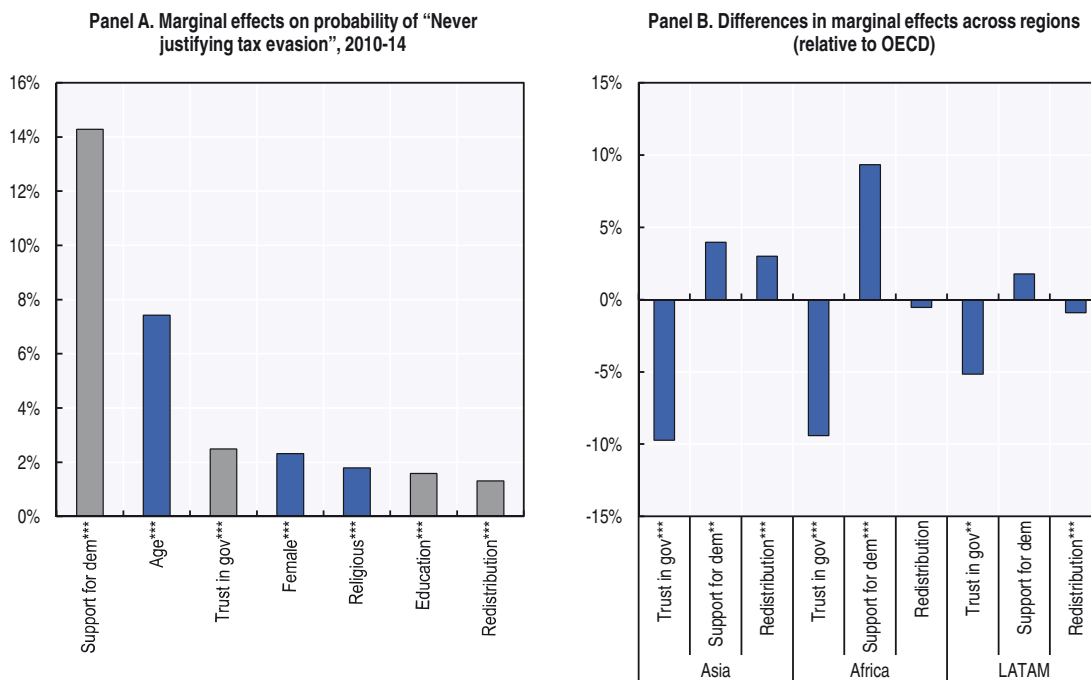
Notes: Average for all available observations for Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela. The specific question asked is: “Please tell me for each of the following statements whether you think it can always be justified to cheat on taxes, never be justified, or something in between”. For practical purposes, we classify those as “never justifiable” to the share of respondents that answered 10 (the highest note); “slightly justifiable” is the fraction of respondents who answered between 9 and 6; and “justifiable” is the fraction of answers between 1 (the minimum possible) and 5.

Source: OECD/ECLAC/CAF based on Latinobarometro 2015.

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The degree of support for democracy, the redistributive capacity of the fiscal system, and the levels of trust in governments and of satisfaction with public services are critical determinants of tax morale. People who agree with being governed under a democracy are about 14 percentage points more likely to never justify cheating on taxes than those who do not agree (Figure 1.13, Panel A). Similarly, people with greater trust in government and who believe that redistribution is an essential characteristic of democracy are more likely to have higher tax morale (2% and 1% higher, respectively). Other determinants of tax morale are individual characteristics such as gender, age or religion, though to a lesser degree. However, these appear in different magnitudes and, with the exception of age, are rather small. Similarly, socio-economic characteristics such as the perceived economic situation, labour status or educational attainment all play a role in the willingness to pay (or avoid) taxes. For instance, a higher level of education would entail a higher willingness to comply with tax payments (2%) (Box 1.4). This highlights the need to invest in skills and the positive reinforcement mechanism that it can provide for economic development, decreasing inequalities and increasing tax morale (Torgler, 2005; Daude and Melguizo, 2010; Daude, Gutierrez and Melguizo, 2013; Melguizo, Olate and Orozco, forthcoming).

Figure 1.13. Determinants of tax morale: Marginal effects on probability of “never justifying tax evasion”, 2010-14



Notes: Marginal effects, based on the coefficient in column 5, Table 1.1 described in Box 1.4. Robust standard errors ***,** denote significance at 10%, 5% and 1%, respectively. For female and religious, it reflects the change in the dummy variable (being female or religious equals 1); for support for democracy and trust in government, it reflects the difference between the maximum support and the minimum possible; age takes into account the difference between a 25-year-old and a 65-year-old person; educational attainment accounts for the difference between completed tertiary education versus completed primary education.

Source: OECD/ECLAC/CAF based on Melguizo, Olate and Orozco (forthcoming), “Revisiting the determinants of tax morale”, forthcoming based on World Value Surveys (Wave 6, data for 2010-14).

StatLink <http://dx.doi.org/10.1787/888933649867>

At the same levels of trust in government and same vision of redistribution, citizens in LAC are less likely to report high tax morale than in the OECD. Analysing regional differences can show how additional changes in the institutional characteristics can affect the probability of reporting tax morale. For instance, improved trust in government would have a lower effect (still positive) on the probability to report high tax morale in LAC (5% lower) than in the OECD (Figure 1.13, Panel B). This characteristic is shared with economies from Africa and Asia, although in this case the probability is more accentuated (9% and 10% lower, respectively). Similarly, an increase of support for redistribution would improve tax morale in LAC by 1% less than in OECD economies. This result is similar to that of African economies, but contrary to Asian economies where the probability is actually higher. Conversely, those citizens from LAC with the same level of support for democracy have a higher probability (2%) than OECD citizens of having high tax morale, although it is not significant. These results suggest the importance of rebuilding trust, as the marginal gains in tax morale would be larger than in other emerging regions.

Box 1.4. Revisiting the determinants of tax morale

The drivers of tax morale can be better understood through a micro-econometric analysis, as shown by Melguizo, Olate and Orozco (forthcoming). Specifically, it uses a Probit model on an individual basis, following Daude, Gutierrez and Melguizo (2013). This analysis uses the World Values Survey database, with data for 2010-14 and 58 countries, where 9 are Latin American (Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Trinidad and Tobago, and Uruguay). For this analysis, the dependent variable is tax morale. This is a dummy that equals unity if the person rates 10 (cheating on taxes is never justifiable), and 0 from the answers ranging between 1 and 6 (with 1 being cheating on taxes is always justifiable).

Explanatory variables cover socio-economic dimensions and institutions. The socio-economic variables included are marital status, religion, gender, educational attainment, employment status, economic status and economic problems. The institutional variables include support for democracy – how individuals value having a democratic political system and the importance of redistribution as a characteristic of democracy.

The variables are defined as following: Marital status (married/living together; divorced/separated; widowed/single), religion (a binary variable taking the value of 1 if respondents consider themselves religious and zero otherwise), gender (a binary variable taking the value 1 if the respondent is a female and 0 otherwise), educational attainment (from no formal education to university level), employment status (divided in eight binary variables covering part- or full-time employment, self-employment, unemployment, students, housewives, retirees and other status).

The variables that deal more directly with general aspects of government in general are constructed such that a higher number indicates a stronger preference (“more is better”). These comprise “support for democracy”: how individuals value having a democratic political system (from 1: very bad to 4: very good), “trust in government”: the confidence of household in national government (from 1: none at all, to 4: a great deal) and “Preferences for redistribution”: whether taxing the rich and subsidising the poor are an essential characteristic of democracies (from 1: not essential to 10: essential). The main results of these analyses are presented in Table 1.1 and Figure 1.13.

Box 1.4. Revisiting the determinants of tax morale (cont.)

Table 1.1. Probit regressions explaining tax morale

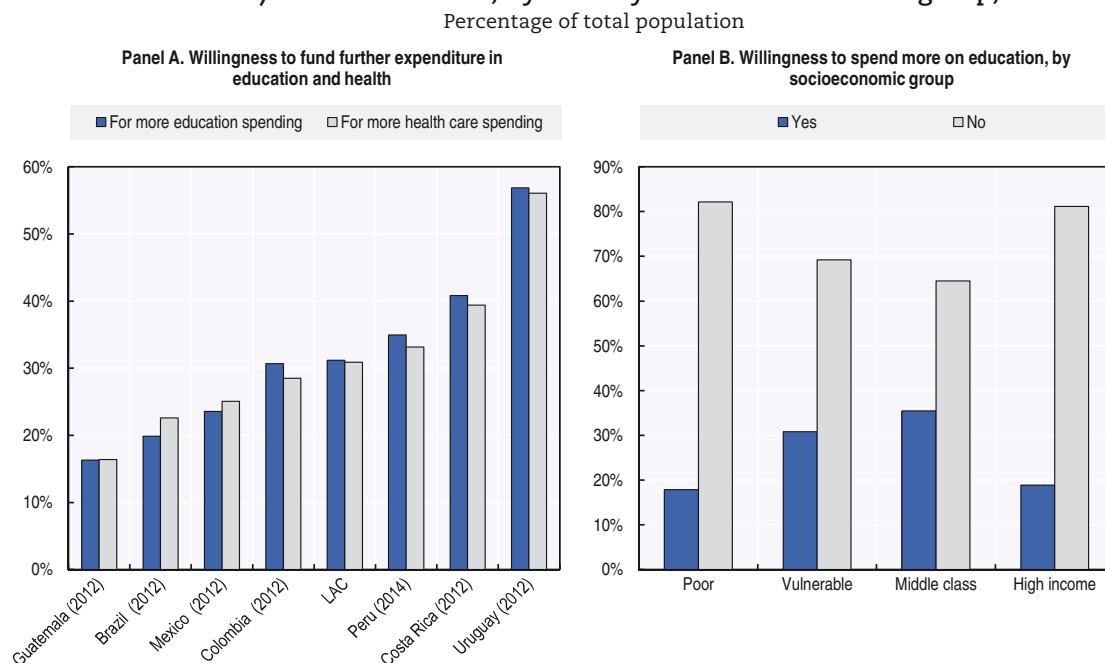
	(1)	(2)	(3)	(4)	(5)	(6)
Religious	0.02 (0.004)***	0.02 (0.004)***	0.018 (0.004)***	0.019 (0.004)***	0.018 (0.004)***	0.019 (0.004)***
Female	0.027 (0.003)***	0.024 (0.003)***	0.025 (0.003)***	0.026 (0.003)***	0.023 (0.004)***	0.023 (0.003)***
Age	0.002 (0.000)***	0.002 (0.000)***	0.002 (0.000)***	0.002 (0.000)***	0.002 (0.000)***	0.002 (0.000)***
Educational attainment	0.003 (0.001)***	0.003 (0.001)***	0.002 (0.001)***	0.004 (0.001)***	0.003 (0.001)***	0.002 (0.001)***
Part-time	-0.019 (0.006)***	-0.019 (0.006)***	-0.019 (0.006)***	-0.021 (0.006)***	-0.021 (0.006)***	-0.019 (0.006)***
Self-employed	0 (0.005)	-0.001 (0.005)	-0.003 (0.005)	0 (0.005)	-0.003 (0.006)	-0.003 (0.005)
Retired	0.011 (0.006)*	0.012 (0.007)*	0.012 (0.007)*	0.01 (0.007)	0.011 (0.007)*	0.012 (0.007)*
Housewife	-0.005 (0.005)	-0.004 (0.005)	-0.004 (0.005)	-0.007 (0.005)	-0.006 (0.006)	-0.005 (0.006)
Student	0.013 (0.007)**	0.012 (0.007)*	0.009 (0.007)	0.012 (0.007)*	0.009 (0.007)	0.009 (0.007)
Trust in government		0.012 (0.002)***			0.008 (0.002)***	0.008 (0.002)***
Support for democracy			0.05 (0.002)***		0.048 (0.002)***	0.048 (0.002)***
Redistributive democracies				0.005 (0.001)***	0.004 (0.001)***	
Observations	58.478	56.691	55.323	56.432	52.954	54.078

Notes: Marginal effects. Robust standard errors in parenthesis. *, **, *** denote significance at 10%, 5% and 1% respectively. Regressions include country and marital status dummies not reported here. The dummy for full-time employment is omitted in the regressions.

Source: Melguizo, Olate and Orozco (forthcoming), "Revisiting the determinants of tax morale", OECD Development Centre.

Latin Americans have low willingness to increase their tax contributions even if it is for universal public services such as education or health, with heterogeneity amongst socio-economic groups. Low willingness to pay further taxes (even for universal public services) could indicate the low trust of Latin Americans in government institutions and the aspirations of citizens to use private services instead of public services. Only one-third of Latin Americans would be willing to pay more taxes for education and health, although with heterogeneity among countries. For instance, in Uruguay or Costa Rica, the willingness to pay taxes for education or health is higher than in economies such as Guatemala or Brazil (Figure 1.14, Panel A). Although generally low, the willingness to increase tax contributions for public services also varies through socio-economic groups. The vulnerable and consolidated middle class, for example, present the highest willingness to increase their contributions for public education (Figure 1.14, Panel B). The vulnerable group relies most on these public services, but is dissatisfied with their provision and quality. The consolidated middle class is similarly dissatisfied, but has the resources to opt out to the private sector.

Figure 1.14. Willingness to pay higher taxes for public services (education and health) in Latin America, by country and socio-economic group, 2015

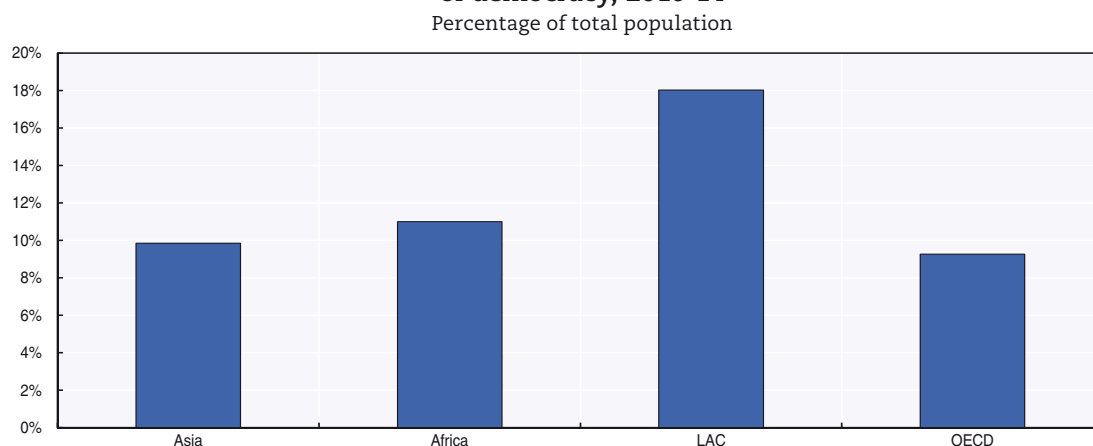


Notes: Poor refers to individuals whose daily per capita income is under 4 USD; “vulnerable” have a daily per capita income of USD 4-10; and “middle class” have an income of USD 10-50. The “affluent” have an income above USD 50. 2005 USD PPP per day. PPP = purchasing power parity. The question asked in the surveys is: “Would you be willing to pay more taxes than you currently pay, so that the government can spend more on primary and secondary education and on the public health service? Yes or no.”

Source: OECD/ECLAC/CAF based on LAPOP (2015), The Americas-Barometer by the Latin American Public Opinion Project, www.LapopSurveys.org.

StatLink <http://dx.doi.org/10.1787/888933649886>

Figure 1.15. Citizens agreeing that redistribution is not an essential characteristic of democracy, 2010-14



Notes: The question asked in the survey is: “How essential do you think is the characteristic ‘Governments tax the rich and subsidises the poor’ in a democracy?” Respondents are asked to rank from 1 to 10, with 1 being “not an essential characteristic of democracy” and 10 “an essential characteristic of democracy”. The figure shows the percentage of respondents who do not consider redistribution as an essential characteristic of democracy.

Source: OECD/ECLAC/CAF based on World Values Survey database (wave 6, 2010-14).

StatLink <http://dx.doi.org/10.1787/888933649905>

The redistributive function of fiscal policy appears to be less clear for Latin Americans than for citizens in other regions, effectively undermining the fiscal pact and

decreasing tax morale. In LAC, almost 20% of the population believe that taxing the rich and subsidising the poor is not an essential characteristic of democracy (Figure 1.15). This result is much higher than in Africa (11%), Asia (10%) or OECD economies (9%). This may be a source of weakness of the fiscal pact in LAC. If a sizeable share of Latin Americans do not clearly perceive the main objective and destination of their taxes, then they may find more reasons to justify cheating on taxes when possible. This may jeopardise their overall engagement with the fiscal pact.

All in all, governance and institutions play a large role to increase tax morale. Latin Americans' low trust in government and democracy, their dissatisfaction with public services and the high levels of corruption leave citizens with little desire to engage with the state, pay taxes or generally participate in the social contract. Therefore, governments and institutions must attempt to regain the trust from citizens by becoming more transparent, providing more and better public services (with more efficient spending and more progressive taxation), guaranteeing participation schemes and implementing innovative policies.

A stronger social contract in LAC entails rethinking institutions to overcome persistent socio-economic challenges and promote greater well-being

One of the main reasons for the disconnection between citizens and the state is the inability of public institutions to satisfy the evolving and rising demands of society. Indeed, a number of socio-economic challenges persist in the region, while others are emerging. This section explores the recent evolution of some of the main, persistent socio-economic challenges in the region that hold back people's perception of well-being. It argues that to strengthen the social contract institutions need to be rethought to respond to the demands of society and promote greater well-being.

Recent erosion of the perception of well-being weakens the social contract in LAC

A strong social contract is critical to support greater well-being for all in LAC. At the same time, greater well-being supports a strong social contract. When citizens' perceive that public institutions are unable to respond to their demands, as seems to be the case in LAC, they find few incentives to fulfil their obligations in the social contract. This, in turn, undermines the state's capacity to effectively provide quality public goods and services, which has a negative impact on citizens' well-being. This creates a downward spiral that further fuels citizen disengagement from public institutions.

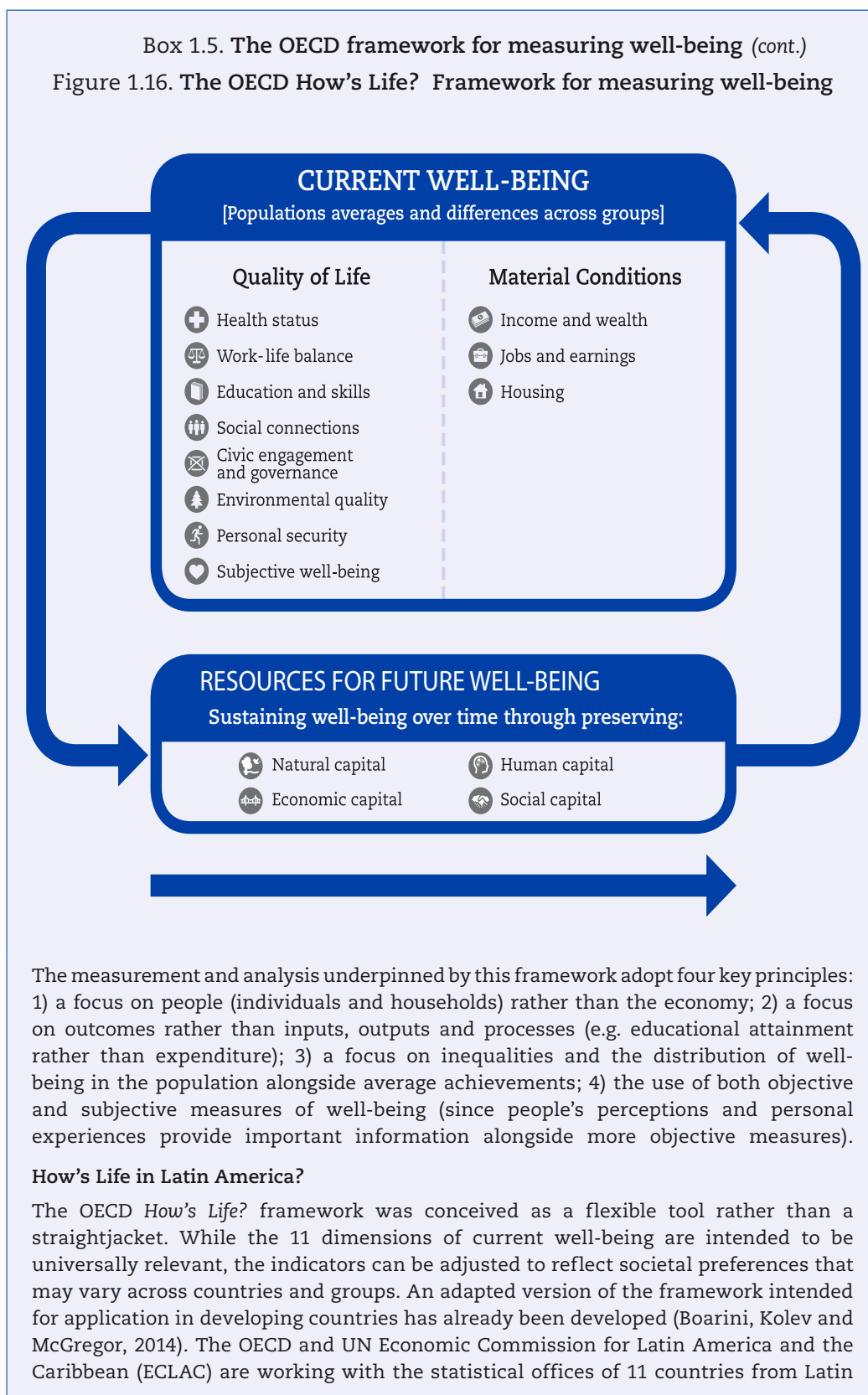
Indicators on people's perceptions of well-being show a deterioration in LAC in recent years (OECD/CAF/ECLAC, 2016). Following the structure of the OECD How's Life? Framework, well-being can be measured from a perspective of governance and civic engagement (OECD, 2017b; OECD, 2011; Boarini et al., 2014) (Box 1.5).

Box 1.5. The OECD framework for measuring well-being

The core mission of the OECD is to support countries in making "better policies for better lives". To understand people's life conditions, and to inform policies that aim to achieve inclusive and sustainable well-being, the OECD developed the *How's Life?* framework in 2011 (OECD, 2011) (Figure 1.16). The framework measures individual well-being outcomes in two broad pillars: material conditions (comprising income and wealth, jobs and earnings, and housing conditions) and quality of life (including health status, education and skills, work-life balance, social connections, civic engagement and governance, personal security, environmental quality and subjective well-being). In addition, the framework also encompasses resources for the sustainability of well-being over time in terms of natural, human, economic and social capital.

Box 1.5. The OECD framework for measuring well-being (cont.)

Figure 1.16. The OECD How's Life? Framework for measuring well-being



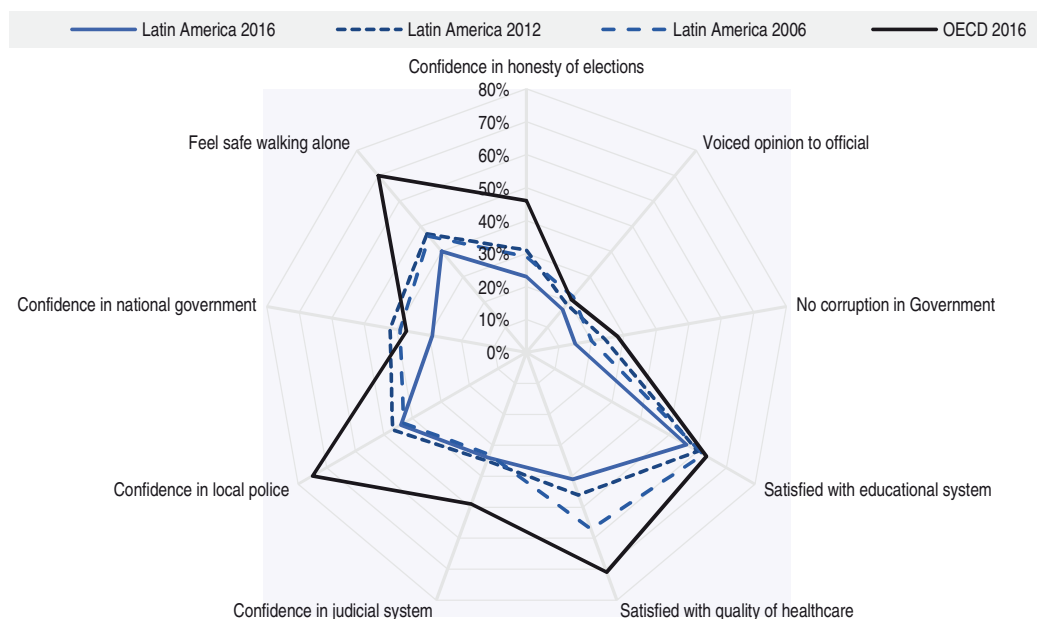
Box 1.5. The OECD framework for measuring well-being (cont.)

America and the Caribbean to identify concepts and indicators that are especially relevant for the region. A consultation carried out with participating agencies in 2016 highlighted a number of important issues for the region that are not emphasised in the original framework. These include food security, child labour, gender-based or intra-family violence, environmental rights, social protection, unpaid work and inclusiveness of institutions. Work is ongoing to identify the most appropriate comparable indicators to measure these aspects of well-being in the region.

Selected indicators related to governance show a deterioration of the perception of well-being in LAC (OECD, 2017b). These include people’s satisfaction with democracy (confidence in the honesty of elections), political engagement (having voiced an opinion to an official), corruption in public services (perceptions of widespread corruption in government and business), satisfaction with services (such as education and healthcare), and trust in public institutions (confidence in the national government, the judicial system and local police). Across all these indicators, positive responses are low in LAC, especially when compared with the OECD average. In almost all cases, the share of people replying positively decreased over the decade 2006-2016, and notably since 2012 (Figure 1.17).

Figure 1.17. Selected indicators of governance and well-being in Latin America and OECD

Percentage of respondents replying positively to each question



Source: OECD/ECLAC/CAF based on Gallup World Poll 2017.
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Rethinking institutions for greater well-being: Towards a new state-citizens-market nexus

Rising aspirations and evolving demands, together with the uncertainties created by domestic structural weaknesses and a challenging global scenario, are weakening the social contract in LAC. What is at stake is people's current and future well-being. In this context, LAC can largely benefit from rethinking its institutions, which can be understood as policies, organisations, and laws and regulations (Box 1.6). This is necessary to embrace upcoming opportunities, shield against emerging risks, and build the pillars of sustained social and economic progress where citizens' demands are met.

Box 1.6. Defining institutions: The LEO 2018's conceptual framework

The *Latin American Economic Outlook 2018* (LEO 2018) aims at rethinking institutions and their role in supporting inclusive development through a better state-citizens-market nexus. The notion of institutions is broad, encompassing a wide-ranging set of issues. In fact, unanimity on this concept does not exist (Hodgson, 2006).

Institutions as the “rules of the game” in a society

The influential work by Douglas North laid the foundations of what has since been a fertile ground for economic literature and analysis: the role of institutions for economic development. He defines institutions as “humanly devised constraints that structure political, economic and social interactions” (North, 1991). These are devised as formal rules (constitutions, laws, property rights) and informal restraints (sanctions, taboos, customs, traditions, codes of conduct), which usually help perpetuate order and safety within a market or society.

North's contributions allow us to make categories that are relevant for the LEO 2018: formal institutions vs. informal institutions. The former are created by societies. The scope is broader to affect, influence and transform their nature through policy action than with informal institutions, which are conventions or codes of behaviour that evolve over time. The LEO will focus more on formal institutions, although informal institutions will be discussed when useful to complement the analysis or to illustrate the nuances of a particular institutional challenge.

Another contribution of North's approach is its understanding of institutions as “the rules of the game” in society. This approach has been developed by later authors. Hodgson, for example, sees institutions as “durable systems of established and embedded rules that structure social interactions” (Hodgson, 2006).

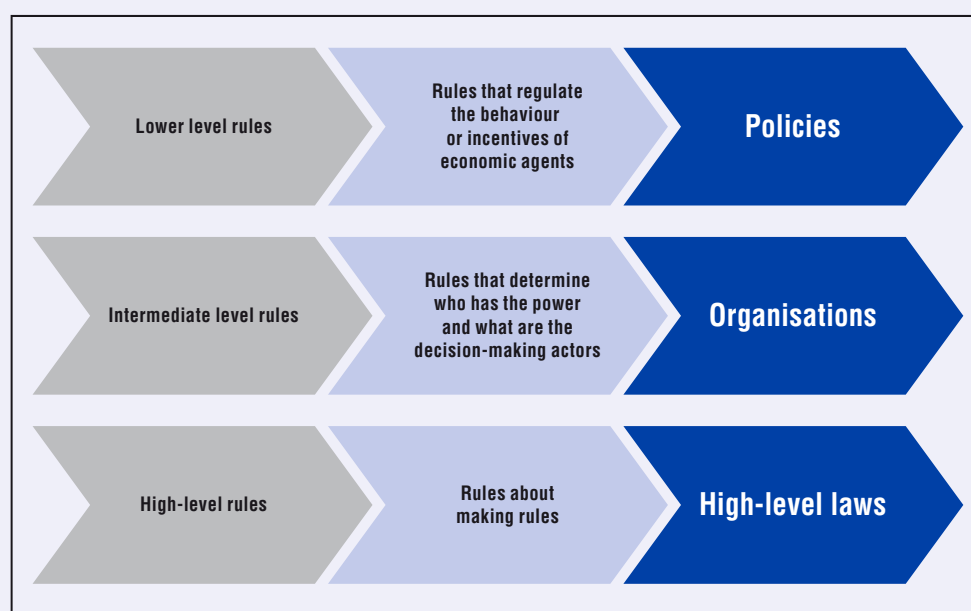
Different types of rules of the game: policies, organisations, and regulations and laws

The literature on institutions in LAC develops this rules-based approach. Acuña and Tommasi (1999) build on North's ideas and consider institutions “as sets of rules that structure interactions in particular ways” and establish a hierarchy of rules, as Tommasi (2004) further developed. This categorisation broadly suggests the existence of three levels of rules: 1) lower-level rules that regulate the behaviour of economic agents; 2) intermediate-level rules that determine who has the power and/or the distribution of competences; and 3) higher-level rules to govern how other rules are determined and define the actual working of the policy making system. This framework is also used in the 2017 *World Development Report* (World Bank, 2017b), where lower-level rules are associated with specific policies; intermediate-level rules refer to organisational forms; and higher-level rules relate to “rules about changing rules” (e.g. constitutions).

Box 1.6. Defining institutions: The LEO 2018's conceptual framework (cont.)

LEO 2018 uses its own taxonomy of rules, adapting it from the work of North, the World Bank, and Acuña and Tommasi. The broad concept of institutions is broken down in three different categories: 1) *policies*, which refer to concrete plans and/or sets of actions directed towards achieving a specific social, economic or political outcome; 2) *organisations* understood as the bodies or structures within which some people act, or are designated to act, towards some purpose; and 3) *high-level laws*, which usually take a legal or normative form, and can be understood as formal rules that enable the adoption of organisational or policy changes (Figure 1.18). Throughout the LEO 2018, the notion of institutions will be broad, with a focus on the former two, policies and organisations. They will all be considered as critical pillars of the institutional framework, determining social, political and economic outcomes.

Figure 1.18. Taxonomy of rules (institutions) for the LEO 2018



Source: OECD/CAF/ECLAC, based on Acuña and Tommasi (1999) and World Bank (2017).

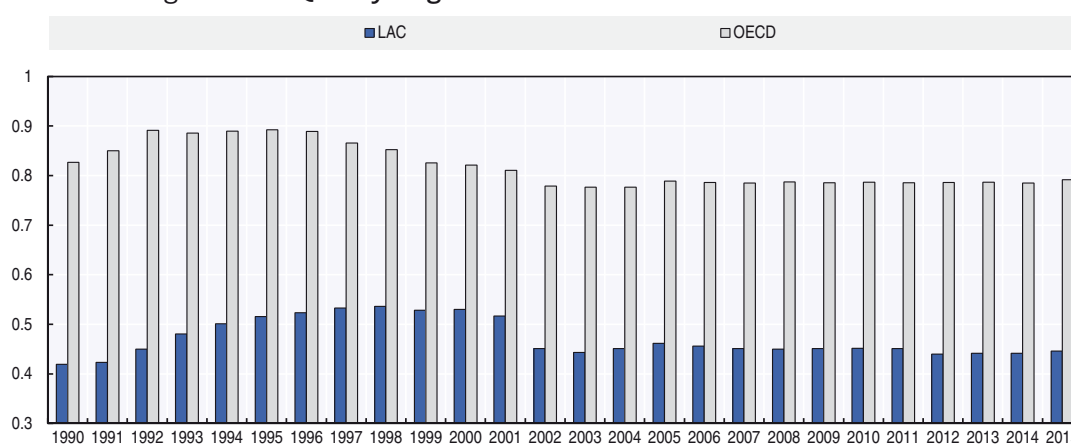
Institutions must be rethought in a way that build and reinforce a new *state-citizens-market nexus*, creating and exploring interactions among its three core parts, promoting synergies, and placing citizens' demands and well-being at the centre. To support a *state-citizens-market nexus* that puts society's demands at the centre, reforms should focus on institutions linked to the main sources of discontent of citizens: the *market* and the *state*. Citizens expect an economy – *the market* – to provide increasing income and job opportunities. Similarly, they expect public institutions – *the state* – to provide good services and deliver their functions in an efficient, reliable and innovative manner. While these issues are the focus of Chapters 2, 3 and 4, the remainder of this chapter focuses on analysing the main challenges related to the state capacities in the region, as well as the situation regarding economic opportunities and provision of main public services.

State capacities remain limited in the LAC region

State capacities in most Latin American economies face some limits. LAC countries are at an earlier stage of institutional development with fewer available resources and weaker governmental capacity. Consequently, they perform fewer tasks and provide fewer services than OECD member countries, as reflected by an aggregate Quality of Government (QoG) indicator (OECD/IDB, 2014).

Moreover, compared with LAC, many OECD countries have accumulated greater stocks of institutional capacities, more developed legal and oversight levers, a better trained bureaucracy and higher flows of financial resources. Accordingly, the average in the QoG index, which ranges from 0 to 1, is in LAC countries systematically below that of OECD countries by 0.35 points for 1990-2015 (Figure 1.19).

Figure 1.19. Quality of government in Latin America and the OECD



Note: The quality of government indicator is a composite average that captures measures of corruption, law and order, and bureaucracy quality. Higher values indicate higher quality of governments, and it ranges from 0 to 1. Unweighted averages for OECD, Latin American and Caribbean economies.

Source: OECD/ECLAC/CAF based on Dahlberg et al. (2017), *The Quality of Government Institute Dataset*, version January 2017.

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Nonetheless, both regions share a similar trend in time. For both regions, the QoG indicator declines at the beginning of the 2000s decade and remains steady throughout the rest of the period. The rise of the middle class may have important effects given that more affluent societies favour the creation and consolidation of democracies and influence the quality of governance (Ferreira et al., 2013). This will exert pressure on LAC countries to enhance governance capacities and effectiveness in the public sector.

In a context of decreasing levels of trust and rising social aspirations, the state and its institutions in the LAC region need to evolve accordingly to meet growing demands and expectations. The role of the state within market economies has historically evolved with social preferences and demands from society. The ongoing theoretical discussions regarding the optimal level of state intervention is far from settled. Indeed, the state has played different roles during the last century. However, the existence of market failures has been the guiding principle that has justified interventions during the last 60 years (Tanzi, 2011). Notwithstanding their allotted roles, states have not always successfully addressed market failures. In many cases, these issues were too complex given their weak institutional capacities.

Institutions need to be strengthened to improve the state's capacity to respond to citizens' demands. State capacities or government quality are associated with the institutions' ability to function effectively and efficiently, deliver outputs and remain insulated from political micromanagement (Fukuyama, 2013; Manning and Holt, 2014). State capacity is usually linked to issues such as the professionalisation of the state

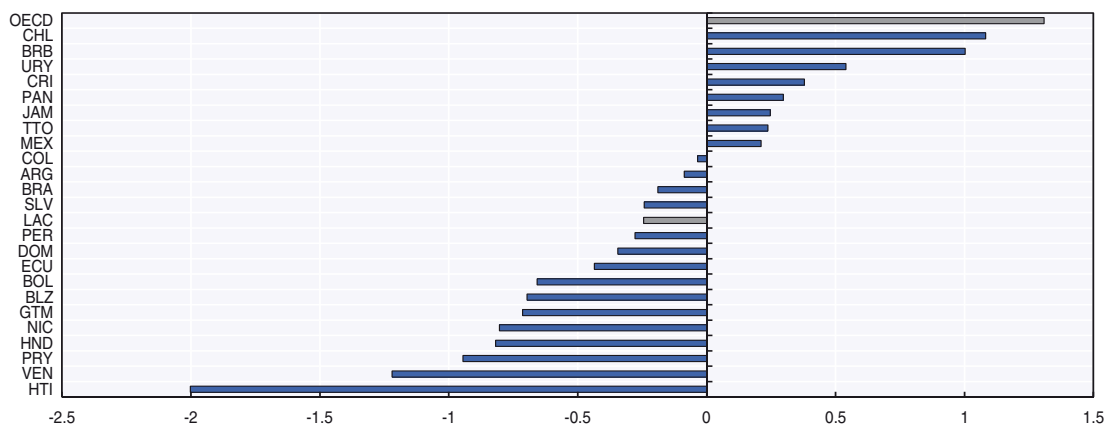
bureaucracy, as well as to the ability to protect property rights, credibly commit to private investors and raise revenues from society (Rauch and Evans, 2000; Soifer and Vom Hau, 2008; Cárdenas and Tuzemen, 2011; Savoia and Sen, 2012; CAF, 2016).

The predominant view is that high-quality governments and institutions will perform quality functions and deliver better services that will lead to improved outcomes. At the same time, they will use resources more efficiently, which will be conducive to inclusive economic growth. There is a lot to gain from having more efficient and effective states and governments: if all governments improved their productivity to be on a par with the rates of the top-performing nations in their peer group, the world could potentially save as much as USD 3.5 trillion a year by 2021. This is equivalent to reducing global government budgets by 9% without compromising outcomes (McKinsey, 2017).

Institutional abilities and outcomes are difficult to gauge as many underlying factors can influence their results. Numerous scholars and international organisations have attempted to quantify the states' capacity with respect to outputs or services delivered. For instance, the QoG dataset studies how high quality institutions can be achieved and the effects of QoG in different policy areas (Dahlberg, et al. 2017). Similarly, the Bertelsmann Stiftung's Transformation Index (BTI) "analyses and evaluates the quality of democracy, a market economy and political management" (BTI, 2016). For its part, the World Bank's Worldwide Governance Indicators measure government effectiveness, regulatory quality, political stability, control of corruption and violence (World Bank, 2017a). Despite the limitations and caveats, these datasets remain the most comprehensive compilation of quantitative and qualitative measures of the state and the different institutions that encompass it.


LAC's average citizen perceives its government as ineffective. The ability of governments to operate effectively relies highly on the management of policies and practices. Assessing citizens' perceptions of the overall functioning of institutions is crucial to understand the extent of their satisfaction with delivery of public services. This, in turn, allows the establishment of a baseline to measure progress. The average LAC citizen perceives that government effectiveness in the region lags behind that of OECD economies (Figure 1.20). Heterogeneities on how different socio-economic groups "experience the state" also emerge within countries (see Box 1.7).

Figure 1.20. Government effectiveness perception index in Latin American countries and the OECD, 2015



Note: The figure plots the Government effectiveness perception index for available countries and available years. Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Higher values indicate higher quality of governments from -2.5 up to 2.5.

Source: OECD/ECLAC/CAF based on World Bank (2016b), *Worldwide Governance Indicators*.

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Within the region, perceptions of government effectiveness are quite heterogeneous. Countries like Chile and Barbados have the highest perception of effective governments throughout LAC countries, yet the level remains below the OECD average. Moreover, countries with positive perceptions of government effectiveness have experienced a deterioration in these perceptions over the last decade. In the best cases, they have remained relatively constant, a salient feature also reflected by the QoG trend.

State capacities vary across the different functions and levels of government (Fukuyama, 2013). All of the different functions that governments perform require continuous review and upgrading. In particular, however, the legal, fiscal and bureaucratic functions of the state can boost the effectiveness of policy implementation. Additionally, since the division of responsibilities between levels of government strongly influences public sector efficiency, the capacity to achieve efficient multi-level governance at all of these levels becomes crucial.

Box 1.7. Exit, voice and compliance: How people “experience the state” in Latin America

In 1742, political philosopher David Hume wrote that “nothing appears more surprising to those who consider human affairs with a philosophical eye, than the easiness with which the many are governed by the few”. Indeed, throughout history, effective states rely on the citizen’s willingness to pay taxes, to co-operate and not free-ride on others, to save and invest and, in summary, to be part of the social contract. The “state” is, in the end, the manifestation of a collective decision to live together. But why would people voluntarily comply and co-operate? This is a central question to understand the enormous heterogeneity we see in terms of state effectiveness across the world (World Bank, 2017b). Institutions, like rules that involve agreements among actors, are not effective if they do not induce compliance. Many countries are known for having the best “laws on paper”, but a very uneven implementation of such a legal structure.

One central aspect, sometimes neglected, is the idea of how citizens “experience the state”. This experience is shaped through their interactions with public officials over provision of public goods and services, as well as with different levels of authority. The percentage of people who report abuse by the police is an example of an experience with the state that shapes citizens’ willingness to comply with rules and may also induce exit. In the same way, positive experiences, such as receiving social programmes or public services, shape the way in which people engage politically and their willingness to be part of the social contract (Estevez, Diaz-Cayeros and Magaloni, 2016).

Concrete experiences such as registering a child for school, seeking help from the police, attending a public hospital, requesting official documentation or applying for social assistance benefits may greatly influence how people perceive the state. Differential barriers to such services can render such experiences exclusionary and ineffective. Barriers such as lack of information, cost of access, administrative complexity, and discrimination or social/physiological barriers weaken an important source of “process legitimacy”. People in marginalised neighbourhoods, for example, may experience the police as a source of violence and coercion rather than protection. Indigenous families may refuse needed healthcare because they have been previously stigmatised in a public hospital where doctors and nurses do not speak their language. As a final example, citizens who must travel long or costly distances to register for services to which they are entitled may perceive the state less favourably than those with accessible services in their community.

Box 1.7. Exit, voice and compliance: How people “experience the state” in Latin America (cont.)

Trust and legitimacy are foundational pillars for achieving co-operation among members of a society and ensuring the sustainability of the social contract (World Bank, 2017b). Citizens may choose to “exit” rather than co-operate by choosing informal or privately provided services. They may even withdraw from services all together, weakening incentives to contribute through tax compliance. Exit behaviour can lead to fragmented social contracts (Ferreira et al., 2012). Conversely, positive experiences in the provision of goods and services can shift perceptions of the state and its role in people’s lives. Cortés et al. (2006), for example, reported how a rural family in Mexico changed its view of the state after their children benefited from the *Oportunidades* Conditional Cash Transfer programme.

In designing and assessing the provision of public services and the implementation of public programmes, it is fundamental to have a broader perspective. This should aim for effectiveness, but also provide people with an experience that triggers a sense of belonging to a social contract. This, in turn, will strengthen incentives to comply as an essential dimension of citizenship.

Source: Lopez-Calva and Bolch, based on *World Development Report 2017: Governance and the Law*, World Bank.

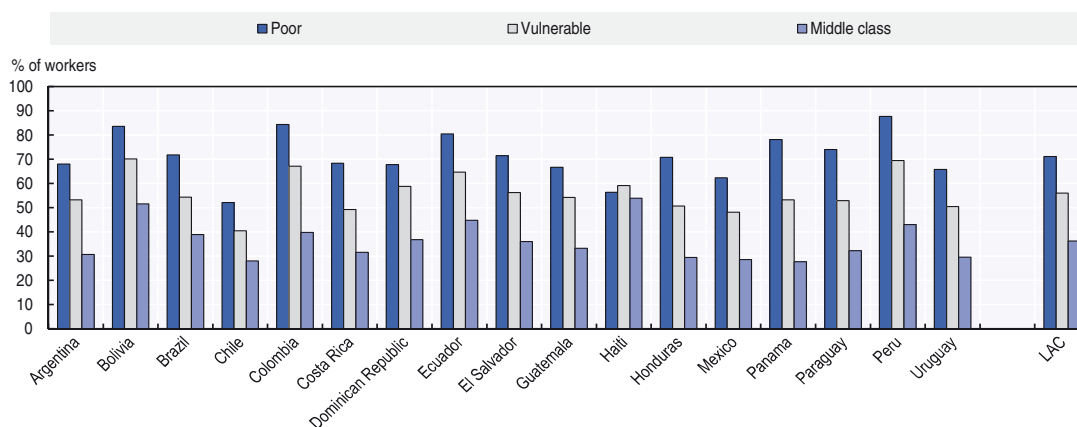
Better economic opportunities and stable prospects

The LAC region is undermined by the large presence of labour informality, which is both a cause and a consequence of a weak social contract. Providing better economic opportunities, mainly through more and better jobs, is a critical aspect of a strong social contract. Citizens must feel they have a stable socio-economic status and good prospects for future progress. More and better jobs are critical to satisfy this aspiration, but high levels of labour informality remain a critical constraint.

The high levels of informality in LAC have negative consequences in terms of low social protection and widening inequalities, which in turn erode the social contract. Most businesses, especially small and medium-sized enterprises, are informal. Two out of five workers in the region hold non-registered jobs (CEDLAS and the World Bank, 2016). Informality is a key obstacle to making earnings more equal and societies more inclusive, and is more pervasive among poor and vulnerable (Figure 1.21). Additionally, informal work, by definition, leaves workers without the right to a pension, health insurance and the general entitlements of the formal sectors.

Informality is also a consequence of a weak social contract. In a context of low trust and dissatisfaction with public services, business and workers find incentives to remain informal. Such incentives could include low tax morale, dissatisfaction with public services, low trust in governments, high formality costs and benefits not anchored to contributions. These incentives are especially true for the consolidated middle class, which has the means to pay for private services. Social security contributions and other non-wage costs (e.g. regulations) can be too costly relative to informal workers’ income and productivity. These factors, in combination with weak enforcement, can doom poor and vulnerable workers to informality (OECD/CIAT/IDB, 2016). As such, they are left out of the scope of the states’ responsibilities. This widens inequalities, creating higher distrust of the state. This, in turn, further disconnects citizens with governments and powers the vicious circle of tax evasion and poor or no access to quality public services.

Figure 1.21. Labour informality in Latin America by socio-economic group
Percentage of workers that hold non-registered jobs, 2014

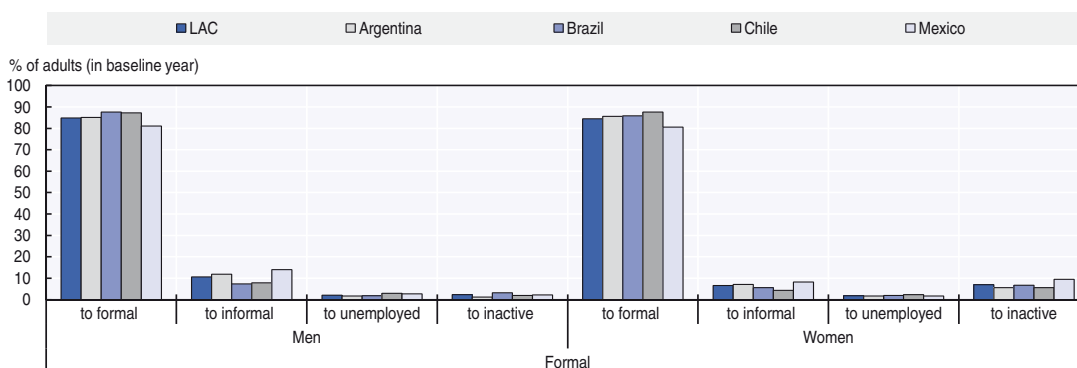


Notes: Legal definition of informality: informality is defined as workers without the right to a pension, health insurance, social protection, work contracts and the general entitlements of the formal sectors.

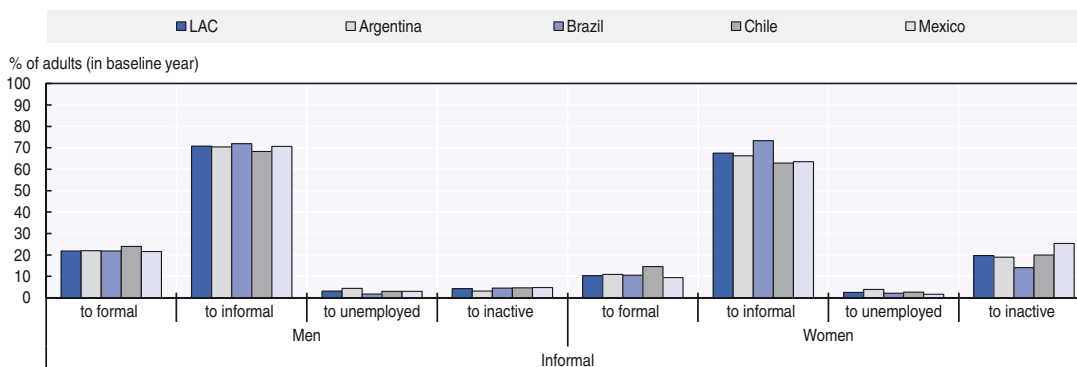
Source: OECD/CAF/ECLAC based on OECD World Bank tabulations of SEDLAC (CEDLAS and the World Bank, 2016).
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Figure 1.22. Latin American labour market transitions

Panel A. Yearly transition rates from formality, men and women
Adults (aged 30-55), 2005-15



Panel B. Yearly transition rates from informality, men and women
Adults (aged 30-55), 2005-15



Note: Results show yearly transition rates out of formal and informal jobs for the pooled period 2005-15. Transitions rates are calculated as the ratio between flow of people moving that transitioned from Condition 1 to Condition 2 between time 0 and time 1, over the total stock of people in the population in Condition 1 in time 0 (i.e. informal employment to formal employment). The transitions are year to year (from year t to year t+1). This analysis is limited to urban populations due to data limitations. Data for Argentina are representative of urban centres of more than 100 000 inhabitants.

Source: OECD/CAF/ECLAC based on OECD and World Bank tabulations of LABLAC (CEDLAS and the World Bank).
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Most labour markets in LAC are far from being segmented and exhibit sizeable transitions between formality and informality (Bosch, Melguizo and Pagés, 2013). Flows out of informal jobs are more common than those out of formal jobs. Still, a considerable share of informal workers make the transition into formal jobs every year. In Argentina, Brazil, Chile and Mexico an average of 33% of female workers and 29% of male workers currently in the informal sector will not remain there for more than a year (Figure 1.22). Almost 10% of informal female workers will move into formal jobs, and 22% of their male counterparts will do so. Flows out of the formal sector and into the informal sector are also sizeable, stressing the need to place better incentives in the former. On average, 16% of women workers currently in the formal sector and 15% of their male counterparts will leave within a year. More than 9% of all formal workers will be informal a year later (71% of males who exit formal wage work and 43% of the women), compared with 2% who will be unemployed. Frequent flows of workers both ways between the formal and informal sector suggest that policies to promote formal, good quality jobs should focus on strengthening the incentives to become formal.

This pattern of entering and leaving the formal sector suggests that informal jobs are more unstable owing to higher risk of job loss. Informal jobs appear to be associated with a higher probability of making the transition into inactivity, particularly among women: 60% of those women make the transition out of informality compared with 15% for men. Certainly, this can also result from personal choice. Women who are planning to leave the labour force soon for family reasons, for example, may be more likely to look for more flexible work, and thus self-select into informal work (OECD/CAF/ECLAC, 2016).

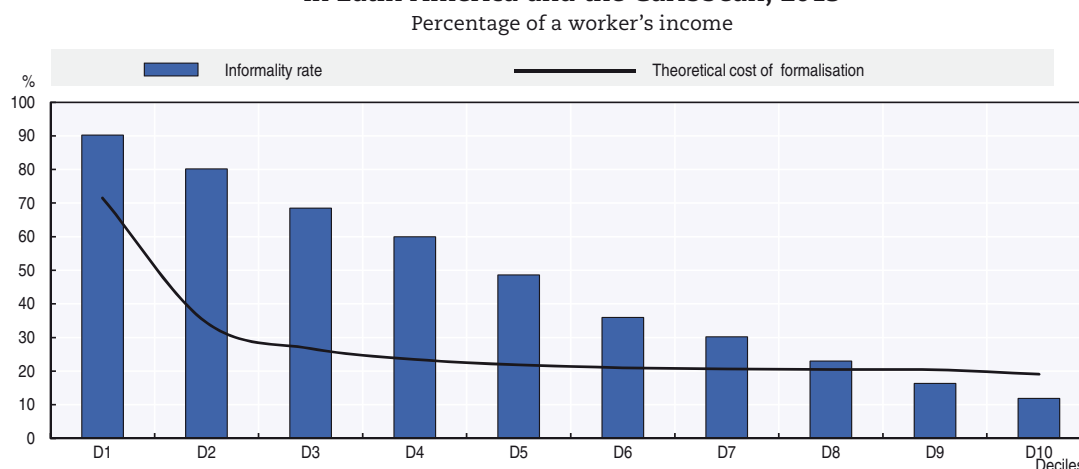
Yet informal jobs seem to be a trap for some groups, particularly youth, women and low-skilled workers, and have long-term adverse effects on equity. While an informal job might be a “springboard” for some, it can have scarring effects for workers’ employment prospects and future wages. Bosch and Maloney (2010) and Cunningham and Bustos (2011) found that informal salaried work in Argentina may act as a preliminary step towards the formal sector. In fact, it might be a regular step towards formal work, especially for younger workers, which provides training time that does not necessarily harm an individual’s career path. However, Cruces, Ham and Viollaz (2012) found strong and significant scarring effects: people exposed to higher levels of unemployment and informality in their youth fare systematically worse in labour markets as adults (OECD/CAF/ECLAC, 2016).

Labour market institutions can help provide better quality, formal jobs and strengthen the social contract. First, and from the demand side, more incentives are needed in the formal sector to benefit from the relatively easy transitions from informality to formality. Introducing progressivity into social security contributions can incentivise both workers and businesses to register workers. Lowering these same contributions temporarily for low-paid workers whose jobs are brought into the formal sector can also work as incentives for the transition from the informal sector. It is also important to simplify companies’ and workers’ registration in the formal sector. Enforcement of stricter and more frequent workplace controls are also key since most informal workers are employed by informal firms. Second, institutional responses such as investments in skills to support workers’ productivity and matching with formal jobs can help create formal jobs from the supply side. Additionally, the creation of good quality jobs demands strong and innovative productive development policies. This is particularly the case in the context of the fourth industrial revolution, where new opportunities and sectors are emerging and where the nature of jobs is expected to change profoundly.

Social security contributions tend to be regressive in the LAC region. In some countries, regulatory frameworks render these too high for low-paid workers to join the formal sector. Social security contributions are low in most LAC countries. In Argentina, Brazil, Uruguay, Colombia and Costa Rica, conversely, social security contributions are similar to

those of OECD member countries (OECD/IDB/CIAT, 2016). Nonetheless, contributions to social security programmes are too costly relative to informal workers' income, especially for those at the lower end of the income distribution (Figure 1.23). Breaking these vicious circles can be challenging. In Colombia, for example, when employers reduced payroll contributions by 13.5 percentage points in 2013, they created about 213 000 formal jobs (Bernal, Eslava and Meléndez, 2015; Medina and Morales, 2016). Their actions also reduced informality by between 1.2 and 2.2 percentage points (Fernández and Villar, 2016).

Figure 1.23. Informality and formalisation costs by income deciles in Latin America and the Caribbean, 2013



Note: LAC is the simple average of Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela.

Source: OECD/CIAT/IDB (2016), *Taxing Wages in Latin America and the Caribbean*, <http://dx.doi.org/10.1787/9789264262607-en>.

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In many LAC countries, registration of businesses and workers in the formal sector can be burdensome and costly, while workplace controls are weak and infrequent. In Peru, for example, informality is partially explained as a by-product of excessive regulations and barriers to entry into the formal sector. This is especially true for SMEs that are affected by the overlap of several tax regimes targeted at a similar base (OECD, 2016a). At the same time, in Panama, higher informality rates among wage earners do not correlate with higher formalisation costs (OECD/CIAT/IDB, 2016); poor controls and enforcement are much more relevant here. Usually informal workers have low skills and poor upgrade opportunities. This makes it hard to escape the low productivity trap and find jobs that are a good fit for their capabilities. Getting a formal job is difficult for people with low skills. Almost three-quarters of the informal workers in LAC have not completed secondary education, compared with one-third of those holding formal jobs (OECD and World Bank tabulations of SEDLAC, 2016). Additionally, informal firms generally provide workers with fewer opportunities to accumulate human capital and are less productive (La Porta and Schleifer, 2014). All of this might thus pose an additional burden to the most vulnerable earnings and to career advancement (OECD/CAF/ECLAC, 2016). Low productivity sometimes translates into workers not being sufficiently productive to offset the costs of formalisation (IDB, 2015).

Creating formal, good quality jobs entails policy action on the supply side too. This occurs mainly by providing more and better skills for workers, and through productive development policies to support sectors with potential for the creation of formal jobs. Upgrading the skills of informal workers requires expanding training programmes. Alternative skills certifications that describe capacities developed during informal jobs could increase prospects for formality. In several OECD member countries, training,

employment, counselling services and incentives to develop small business have helped improve the employability of job seekers in a cost-effective manner (OECD, 2015). Providing better active labour market policies (ALMPs) can also raise productivity and the likelihood of getting a formal job. As education expands for new generations, ALMPs should focus on all individuals who face skills challenges on the labour market, not only on youth and high-school dropouts from poor households as most programmes in Latin America do.

Moving towards stronger and innovative productive development policies will also be crucial to create good jobs and socio-economic opportunities, particularly in the context of the fourth industrial revolution, which brings new challenges.

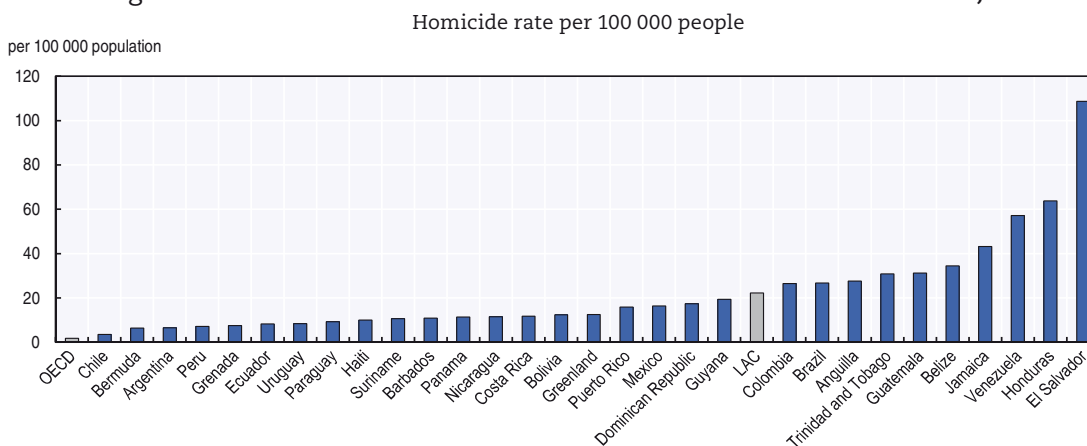
Equality of opportunity must be improved through better public services for increased well-being: Education, health, transport and basic services

Strong social contracts need to be fair so that citizens perceive they have access to good quality goods and services, and equal opportunities for all members of society. Given that rising aspirations of the middle class for better quality services have not yet been fulfilled, persistent inequalities in LAC may be one reason why citizens seem increasingly dissatisfied. Citizen security, education and health, and transport and other basic services are key dimensions of citizens' demands for better services and equality of opportunities.

Crime and violence erode the social contract and hinder well-being

Individuals' security, an essential determinant of well-being, has become a major concern for citizens in the region. LAC is one of the most violent regions in the world: while it is home to 9% of the global population, it has 33% of world homicides. This represents a homicide rate above 22 per 100 000 (Figure 1.24) (Jaitman et al., 2015). The growth of crime and violence during the past decades has entailed high economic and social costs to the region since it constrains investment decisions of firms and disproportionately affects the poor. At the same time, it has compromised governance and the legitimacy of the state by undermining the confidence of citizens in authorities and institutions, and among themselves (CAF, 2014).

Figure 1.24. Crime and violence in Latin America and the Caribbean, 2015



Note: "Intentional Homicide" means unlawful death purposely inflicted on a person by another person. Data on intentional homicide should also include serious assault leading to death and death as a result of a terrorist attack. It should exclude attempted homicide, manslaughter, death due to legal intervention, justifiable homicide in self-defence and death due to armed conflict. Data are for assault at the national level, number of police-recorded offences. Data for Chile are for 2014, Ecuador and Guatemala are for 2013, and Bolivia, Haiti and Nicaragua are for 2012. LAC average includes: Anguilla, Argentina, Barbados, Belize, Bermuda, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Greenland, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Puerto Rico, Suriname, Trinidad and Tobago, Uruguay and Venezuela. Source: UNODC (database), <https://data.unodc.org/> (2017), *Statistics on Drugs, Crime and Criminal Justice at the International Level* <https://data.unodc.org/> StatLink <http://dx.doi.org/10.1787/888933650019>

Most security initiatives in the region fail because of low levels of governance. In particular, human resources are poor, budgets are small and incentives are not properly aligned with intended results. In fact, workers in the criminal justice system often have a lower educational level than the rest of the public sector. Resources allocated vary widely between countries – from 2% to 10% of the total public budget. Finally, the incentive structure that rises from the form of compensation, promotion and control of the rules governing certain functions may limit or enhance the capacity of the public sector to implement security policies (CAF, 2014).

Inequalities in education remain a crucial challenge in the region

Education in Latin America is subject to strong access and quality disparities among students of different household income, territories, ethnicity and gender. The socio-economic background, ethnicity and gender of students, as well as the geographical location of schools, have a marked influence on access to education, performance and completion.

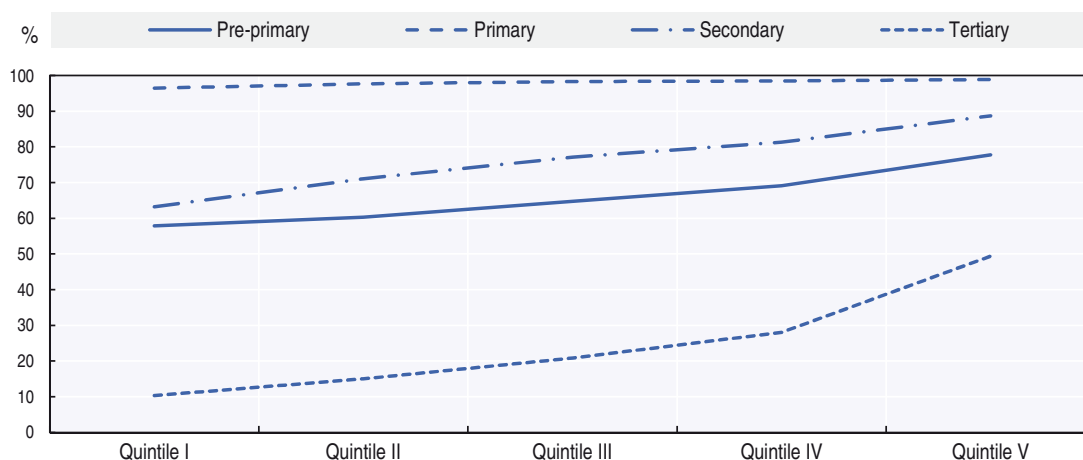
Inequities in education start early and increase along students' educational path. More than three-quarters (78%) of three- to five-year-old children from households in the highest quintile of income distribution attend pre-primary school. However, only 58% of those from the lowest quintile do so. This is particularly relevant as secondary-school performance improves by the equivalent of almost a full school year among those who had pre-primary education (OECD/CAF/ECLAC, 2014).

Access to secondary and tertiary education is also strongly linked to socio-economic background and geographical location. Among the lowest income quintile, 63% attend secondary school compared with 89% of the highest quintile; only 10% of the lowest group graduate and continue into tertiary education compared with 49% of the highest group (CEDLAS and the World Bank, 2016). Likewise, only 62% of young Latin Americans are enrolled in secondary education in rural areas compared with 80% in urban areas (CEDLAS and the World Bank, 2016).

Half of the students from the richest households opt out of public education. At primary level, in which the region is close to universal coverage, only 49% of students from the highest quintile of income distribution attend a public institution. The figures are similar for secondary education. Thus, when they have the means, Latin Americans are likely to choose private education. This is especially the case in countries such as Argentina (70% of the students in the upper quintile of the income distribution attend private institutions), Colombia (64%), Paraguay (65%), Peru (63%) and Uruguay (75%) (CEDLAS and the World Bank, 2016).

Despite some improvement in recent years, education quality and learning outcomes in the region are poor. Performance in successive rounds of the global education survey known as PISA shows a moderate improvement over time in students' learning outcomes. Still, results from Latin American countries participating in PISA (Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Mexico, Peru and Uruguay) are telling. Fifteen-year-olds from these countries performed 92 points lower than OECD students in mathematics, 69 points lower in reading and 78 points lower in science (Figure 1.26) (OECD, 2016b). This is equivalent to approximately two years of schooling, two-and-a-half years of schooling and three years of schooling, respectively.

Figure 1.25. Education enrolment by levels of education and income quintiles in Latin America and the Caribbean



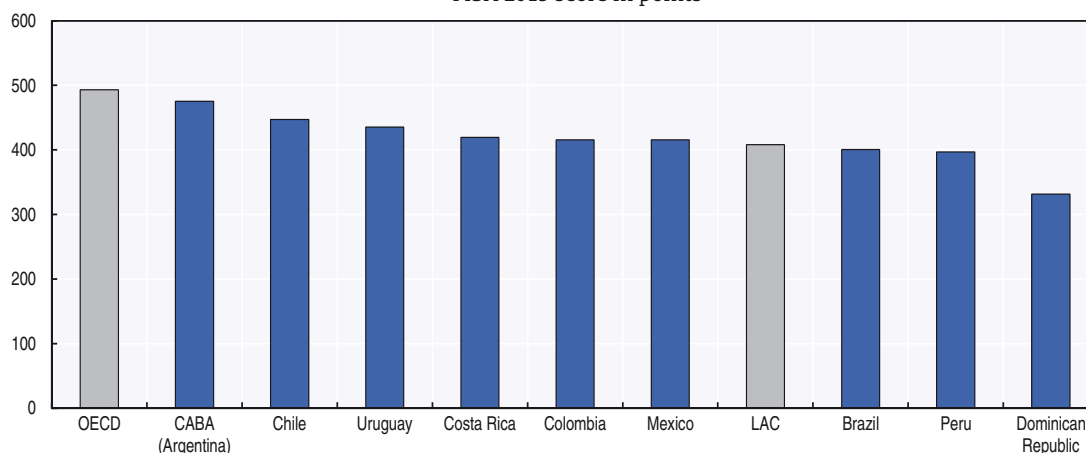
Note: LAC average includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay .

Source: Own calculations based on CEDLAS and the World Bank (2016).

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Figure 1.26. Latin American learning outcomes in PISA, 2015

PISA 2015 score in points



Note: Argentina results only reflect results for the City of Buenos Aires. LAC simple average includes the economies from the region that participated in the 2015 PISA test.

Source: OECD/CAF/ECLAC based OECD, PISA 2016 (database).

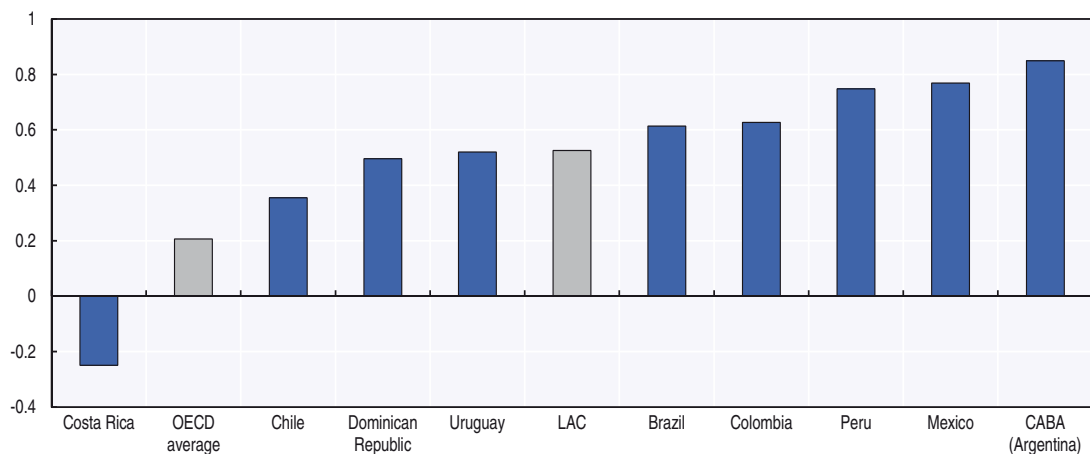
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The socio-economic status of students and schools has a powerful influence on learning outcomes of students in Latin America. Indeed, this status can explain 17% of the performance variation in Latin America compared with 13% for OECD economies in PISA 2015 (OECD, 2016b). The strength of the socio-economic gradient refers to how well socio-economic status predicts performance and indicates the extent to which education policies should target socio-economically disadvantaged students. Advantaged students generally perform better than disadvantaged students. On average, a one-unit increase in the PISA index of economic, social and cultural status of the student is associated with an increase of 28 score points in the science assessment in Latin America. This represents about one year of schooling. Moreover, students with low socio-economic

status are at greater risk of not attaining the baseline level of skills in science, the focus of the PISA 2015 test. Latin American students from disadvantaged socio-economic backgrounds are almost four times more likely than more advantaged students not to attain the baseline level of proficiency in science (OECD, 2016b). Similar results are obtained when looking at mathematics and reading performance.


Similar to the large differences in performance among different groups, the distribution of educational resources appears to be linked to the socio-economic background of students and schools. High-performing countries, such as Finland, Germany and Korea, tend to allocate resources more equitably across socio-economically advantaged and disadvantaged schools. This is not the case in Latin American countries where principals of disadvantaged schools are more likely to report more shortage or inadequacy of educational resources than counterparts in advantaged schools (OECD, 2016c). In fact, the correlation between a school's mean socio-economic background and the index of educational resources (including the books, instructional material and laboratories) in LAC (0.53 in 2015) is considerably higher than in OECD economies (0.21 in 2015) (Figure 1.27). Moreover, principals of rural schools report more shortages or inadequacy than do those in towns (OECD, 2016c). In the long run, improving the distribution of educational resources is an important challenge to improve both performance and equity in Latin America's educational systems. In the short run, educational resources need to target students from poorer socio-economic backgrounds to reduce inequalities.

Figure 1.27. Education resource allocation and socio-economic status in Latin America and the OECD, 2015



Note: LAC average includes Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Mexico, Peru and Uruguay. Argentina only reflects results for the City of Buenos Aires. Schools' educational resources refers to aspects such as physical infrastructure, e.g. school buildings, heating and cooling systems and instructional space; and educational material, such as textbooks, laboratory equipment, instructional materials and computers. This figure uses a shortage of educational resources index based on school principals' perception of the extent to which shortage of educational resources hindered the school's capacity to provide instruction.

Source: OECD/CAF/ECLAC based on OECD (2016b); PISA Products (database), www.oecd.org/pisa/pisaproducts/

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Infrastructure and services are still a source of inequity

Citizens in the region need reliable and accessible transport to reduce transport costs and ultimately improve quality of life. Improving transport connectivity goes beyond questions of infrastructure. It also recognises the need for policies and strategies

that increase efficiency and reduce transport costs, including time, financial cost, and negative environmental and social impacts.

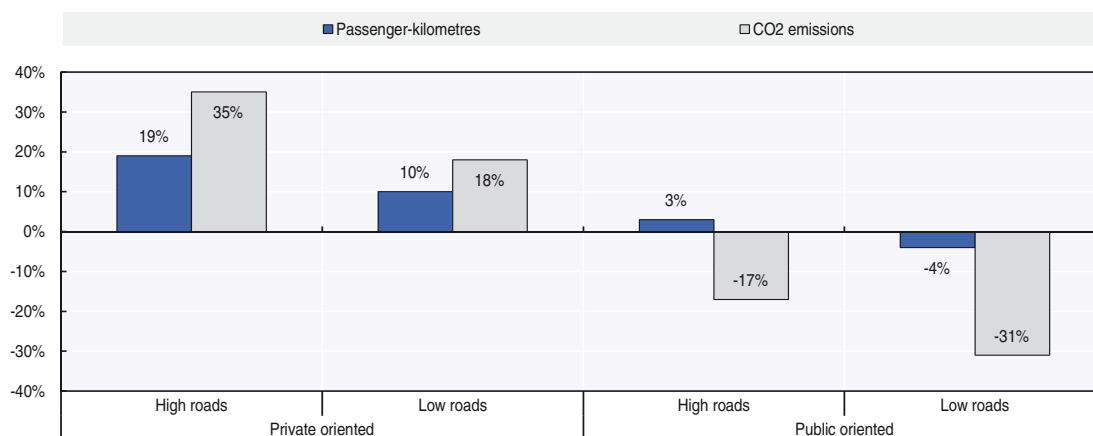
The development of a strategy for improving connectivity is particularly relevant in the region, where transport costs are high, compared with OECD member countries. Further, transport is considered one of the main bottlenecks to development. Better logistics in transport and adopting a multi-modal approach that shifts focus from roads (e.g. developing railways, ports and waterways) are central to this strategy. Also key are improving the design and implementation of transport policies at national and sub-national levels.

Citizens, particularly in urban areas, require better public services to reduce congestion and, to a lesser extent, environmental costs. The urban population perceives increased congestion as a major problem. The accelerated growth of the vehicle fleet is a major challenge, especially in a context of limited traffic management capacity. Whether urban transport policies favour public transport or private vehicles and the development of roads over the next decades will determine vehicle fleet growth in Latin America. This, in turn, will affect both congestion and CO₂ emissions (Figure 1.28).

Urban transport policies favouring public transport, co-modality and other modes of transportation beyond roads (e.g. cycling, intra-city trains, metro) would bring significant benefits to the region. They could both enhance CO₂ mitigation potential and improve mobility (compared with a business-as-usual scenario or one in which urbanisation increasingly supports private vehicle use). This highlights the importance to support, at a national level, sustainable urban transport policies as a common objective for the country.

Figure 1.28. Mobility and CO₂ emissions in Latin American cities, compared with baseline scenario (2010-50)

Alternative road and public/private scenarios



Note: Baseline: Per capita road infrastructure expands at a rate that corresponds to the evolution of urban density under the *baseline sprawl* scenario. It follows the negative relation between urban density and road intensity observed in historical data. *High roads*: Urban roads expand at higher rates than urban population, following the highest trend observed in the country or region. *Low roads*: Urban road infrastructure per capita grows following the *low sprawl* evolution of urban density, following the lowest trend observed in the country or region.

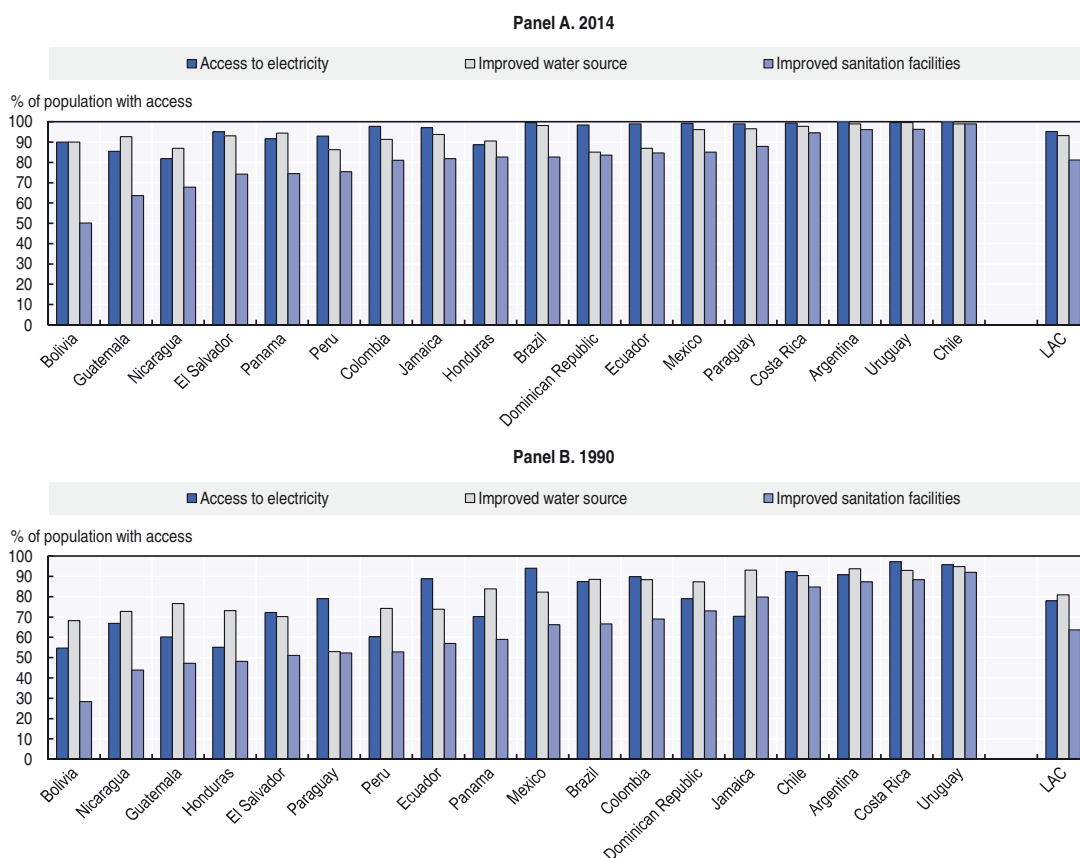
Source: ITF (2015), *ITF Transport Outlook 2015*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789282107782-en>.
StatLink <http://dx.doi.org/10.1787/888933650095>

In terms of water and electricity, and to a lesser extent sanitation, the region has advanced in the past decades, achieving high levels of coverage at national level (Figure 1.29). Electricity access has improved the most, covering 99% of those living in urban areas. Still, 12% of those living in rural areas remain uncovered. Similarly, although 93% of the Latin American population at national level has access to safe water,

the share drops to about 84% of the rural population. This leaves more than 20 million people uncovered (World Bank, 2017a). In terms of sanitation, about 81 million people (36% of the rural total) have access to improved services. The remaining 46 million people use unimproved systems. This contrasts with urban coverage levels, where 97% of the urban population has access to safe water and 88% to improved sanitation.


Inequalities persist beyond rural and urban borders and expand to sub-national regions. Access to water, sanitation and electricity infrastructure is unequal across territories, especially in Bolivia, Ecuador, Guatemala, Honduras and Peru (Figure 1.30). Most disparities can be observed in sanitation services, partially because it lags behind in terms of coverage. On average, there is a 40 percentage point difference within sub-national regions between the largest and lowest coverage of sanitation infrastructure. In Argentina, El Salvador, Guatemala, Honduras and Paraguay, the gap is as large as 50 percentage points.

Figure 1.29. Water, sanitation and electricity access in Latin America and the Caribbean



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

Source: World Bank (2017a), *World Development Indicators*.

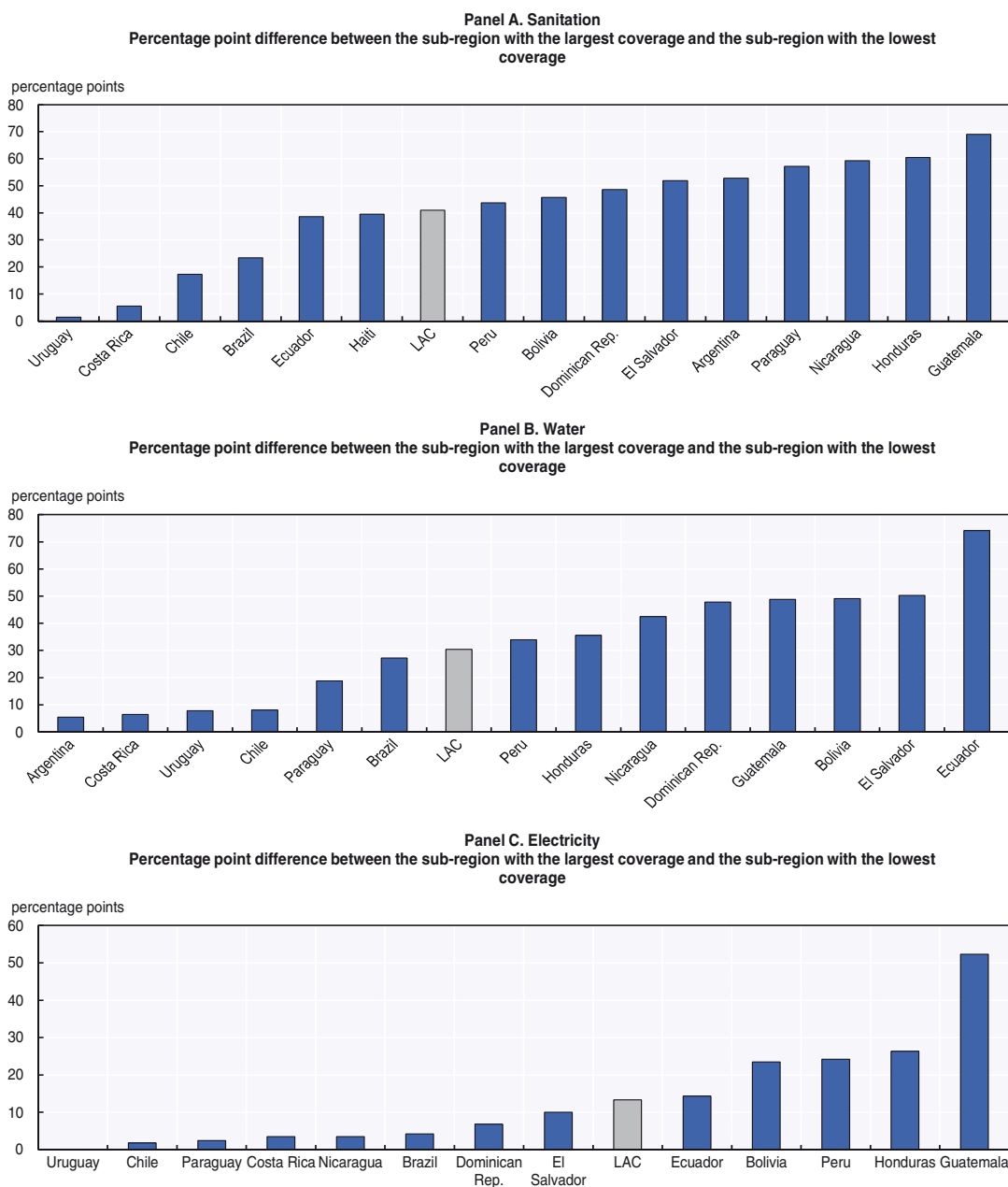
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Access to good quality health remains largely unequal

Most countries in the region still fall short on achieving universal health coverage despite having taken different paths towards this goal. In the past decade, the region has especially advanced in terms of population coverage and access to basic health services (i.e. immunisation, family planning, antenatal care, skilled attendance at birth, improved water and sanitation) (Figure 1.31, Panel A). However, population coverage

remains insufficient, public spending on health is low and out-of-pocket payments are high. As a result, Latin Americans, especially those in the poorest sectors, find it difficult to receive needed health services without facing financial hardship (World Bank, 2015).

Figure 1.30. Access to water, sanitation and electricity by countries and territories in Latin America and the Caribbean, 2014



Note: Territories covered in each country vary due to data availability. Data for Argentina and Uruguay are only representative of urban areas. LAC average includes countries in each figure.

Source: Own calculations based on CEDLAS and the World Bank (Equity Lab tabulations) (2016).

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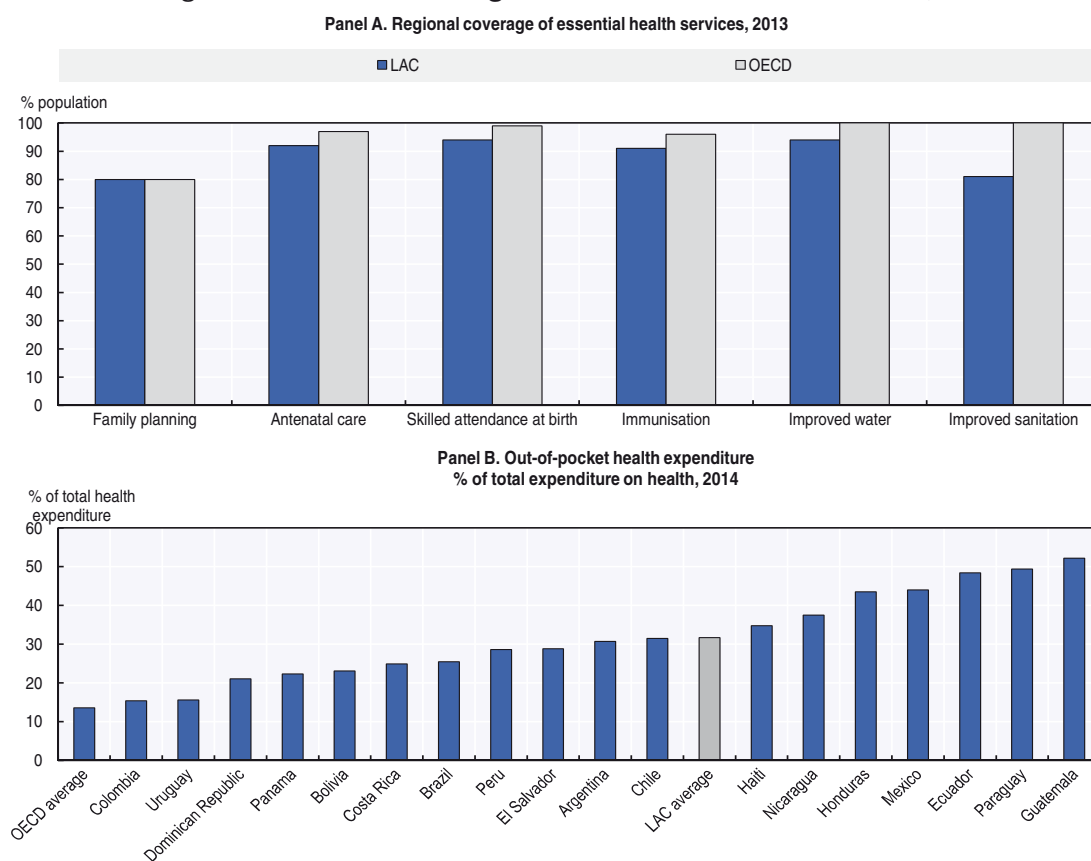
Individuals are responsible for a relatively large share of total health expenditures in LAC. Across the region, individuals paid 31.7% of health expenditures out of their own pockets in 2015 (Figure 1.31, Panel B). This was significantly above the 20% recommended

by the World Health Report and above the 13.6% prevalent in OECD member countries (World Bank/WHO, 2017). Lower out-of-pocket expenditure is associated with low risks of catastrophic or impoverishing health spending. Similarly, higher public spending on health is associated with higher financial protection (WHO, 2017a; 2016). Thus this indicator reflects the extent to which public health systems offer protection to citizens. High out-of-pocket payments are of great concern as they may force low-income households to cut back in relevant areas such as food and education, or fall into deeper poverty levels when faced with large exogenous health shocks (WHO, 2017a).

Access to health service in LAC has been linked to the different insurance schemes offered in the region. On the one hand, beneficiaries of contributory schemes can access both private and public providers. Beneficiaries of subsidised regimes have only access to public health providers. There are large disparities in terms of quality across public and private providers. These create differences in access across types of regimes that have significant implications for equity (World Bank, 2015). In this context, the structure of the different insurance schemes predominant in the region perpetuates inequities within countries.

Inequalities in access to health services among and within LAC countries persist; ensuring equity in both access and quality of services remains a key challenge. In the five LAC countries for which recent data were available, the average difference in immunisation rates between the highest and lowest income quintiles is approximately 13.9 percentage points (Figure 1.32, Panel A). At the same time, the average difference in the mortality rate in children under five between the two quintiles is 50 deaths per 1 000 live births (WHO, 2017b) (Figure 1.32, Panel B).

Figure 1.31. Health coverage in Latin America and the OECD, 2013



Source: World Bank Databank, 2017.


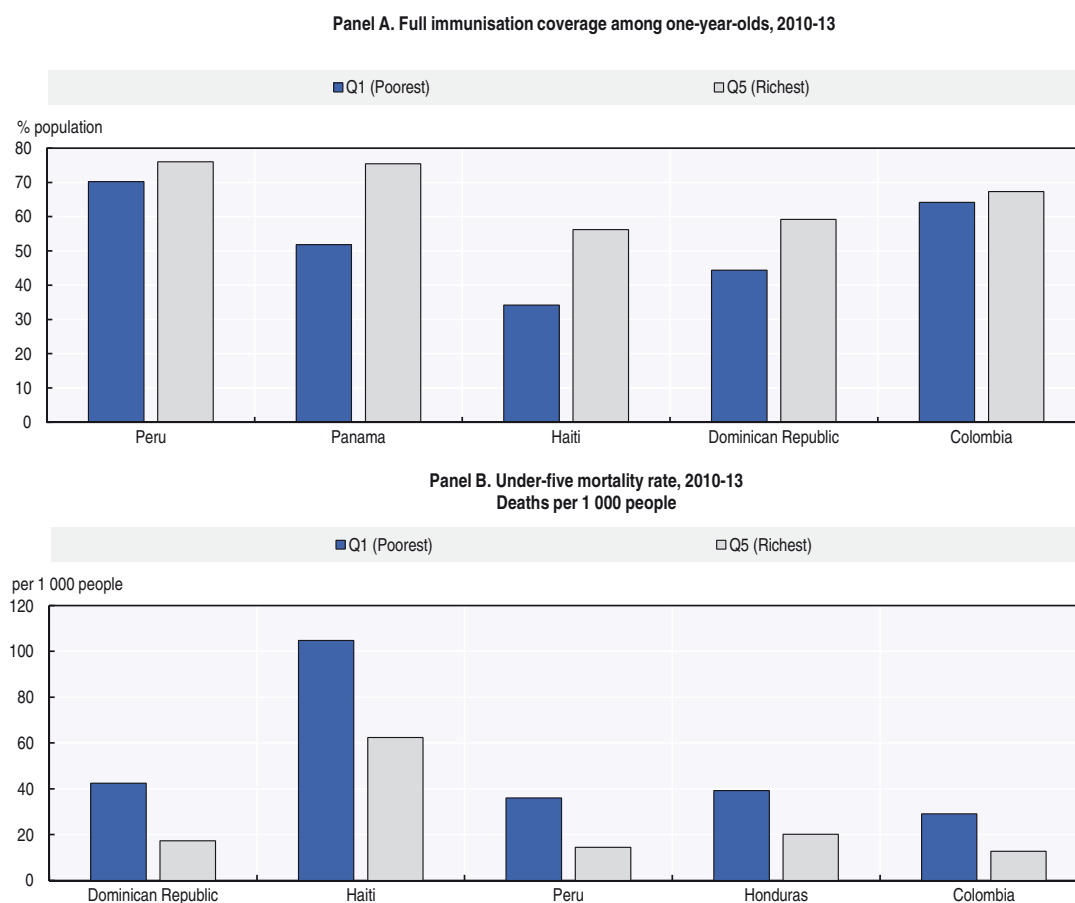

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Figure 1.32. Inequity in access and quality of health services within LAC countries by socioeconomic group, 2010-13



Source: OECD/CAF/ECLAC based on WHO (2017).
 StatLink  <http://dx.doi.org/10.1787/888933650171>

Additionally, large differences persist in the quality of services provided across the region's systems and subsystems. One common way to assess the quality of these services is to analyse the extent to which health services translate into improved health outcomes. Trends in amenable mortality serve as an indicator for a combination of access and quality of health services. It is estimated that almost 14% of all deaths in the region are attributed to communicable diseases; this number is twice as large as the OECD average (World Bank/WHO, 2017).

Conclusions

The social contract in LAC has weakened in recent years, as illustrated by the decline of trust in public institutions and the increasing dissatisfaction with public services. There is a growing disconnect between citizens and institutions that results from both the rising aspirations of a larger middle class (which reached a level of 34.5% in 2015) and the limitations faced by public institutions to respond to current and emerging challenges, particularly in a rapidly changing global context.

These developments suggest that citizens increasingly believe that public institutions are not ready to respond to their demands and rising aspirations. As a result, citizens do

not perceive sufficient benefits linked to the fulfilment of their duties as such, but rather see fewer incentives to engage in the obligations associated with the social contract. In fact, the willingness of citizens to pay taxes (tax morale) has declined in recent years in LAC, thus undermining the capacity of the state to provide quality public goods and services effectively. This leads to a negative impact on citizens' perception of well-being, which further fuels their disengagement from public institutions in a downward spiral.

There is a need to rethink institutions in LAC to bridge the gap between society and institutions and support greater well-being for all. Institutions must be rethought in a way that build and reinforce a new *state-citizens-market nexus*, placing citizens' demands at the centre. For this, reforms should focus on institutions linked to the main sources of discontent of citizens: the *market* and the *state*. Citizens expect an economy – *the market* – to provide increasing income and job opportunities. Large rates of informality in the region need to be overcome to support better quality jobs. Similarly, citizens demand public institutions – *the state* – that provide good services and deliver their functions in an efficient, reliable and innovative manner. Rethinking institutions to support state capacities as well as to improve public services will also be critical in a region where the quality of government and education, health, transport and other basic services are still far from OECD standards.

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