SPECIAL REPORT

Latin America: structural reforms in the face of a business change of cycle

Madrid, April 2015

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1. INTRODUCTION

"The party of high oil prices and low interest rates is over. We are entering a storm from an economic point of view...Besides the fall in oil prices, the United States will soon increase their interest rates. In this context, all currencies, included those of the developed countries, are depreciating against the US dollar...There is no doubt: hard times are coming, times of great volatility and tough adjustments where emerging economies will have to make a difference from one another in order to get out as soon as possible and dented as little as possible from the international turbulence".

This text, written by Leo Zuckermann, analyst of the Mexican newspaper Excelsior, only confirms a feeling that is being gradually extended through Latin America. We are witnessing a cycle change, an end of an era in front of which the Latin American countries must react in order to adapt their economies to the new global and regional scenario. The slowdown and downturn signs are very obvious, caused by lower commodities prices, mainly set off by the economic downturn in China, the increase in external financing costs and prospects of fewer capital inflows. This, added to the own structural problems of the Latin American economies and to the global change that is taking place regarding the transfer of wealth from the Atlantic to the Pacific Ocean, forces the countries of this region to undertake far-reaching reforms in order not to fall behind in relation to the emergence of other regions such as sub-Saharan Africa and many Asian countries, nor lose ground in the reduction of poverty and inequality.

In fact, Latin America is not going through an unknown phase but through an experience which, with its nuances and specific features, had already occurred. Historically, the rise in international prices of commodities the region exports used to create a "virtuous circle" where income increased and trade deficit decreased becoming surpluses. This way, states received greater financial means thanks to those new revenues and expanded the public spending. Along this line, the Argentine economist, Ricardo Arriazu, points out that this initiates "a second stage in which demand (and production) increase in other sectors than automotive and agricultural machinery producers in Argentina's case), and since production rises, employment and wages grow; at this stage the public sector benefits from a new increase in tax collection and imports start to grow. At the third stage, the process is accentuated due to the capital inflow, attracted by the greater economic growth and the improvement in the fiscal and external accounts. At this stage, public spending expands rapidly because governments feel confident due to the improvements in tax collection and some countries let their currencies appreciate due to the great increase in their reserves. "The boom ends when international prices start to fall and the increase in public and private spending results in

a deterioration of the internal fiscal accounts and the external balances and all added to a fall in the foreign investment.

Latin America's history is indeed a succession of serious crises, followed by major adjustments that precede booms linked to the high prices in commodities, accompanied by speculative "bubbles" that end up exploding in the midst of scandals of corruption and delegitimization of the State. After the traumatic beginning of the 19th century (1810-1850) Latin American States gradually settled in and the economy developed based on the growth of international trade and on the links with a Western Europe that demanded Latin American export products for their increasing industrial production and the population growth. The 1929 crash forced the region to reinvent itself for the first time and to promote import substitution industrialization, which was accompanied by a whole academic production giving it intellectual support (Raúl Prebisch's ECLAC school of thought).

The new system was supported thanks to the boom of the global postwar period and to the abundance of petrodollars in the 1970s. But the excessive indebtedness, the fall in oil prices and the regional economies' structural shortcomings (huge deficits and inflation) plunged the region into another serious crisis, the "Lost Decade" of the 1980s, as a result of which Latin America had to reinvent itself again. The commitment to neo-liberal reforms (the Washington Consensus), to external openness, the reduction of tariffs, the stimulus to trade, the reduction of inflation and deficits (by reducing the size of the State through privatization) allowed the region to be ready (with its "homework done") to be able to benefit from and strengthen during the boom of the "Golden Decade" (2003-2013). First of all, during a virtuous six-year period (2003-2008) followed by, after the fall in 2009, a new growth period despite the international turbulences (2010-2013). As Rebeca Grynspan, current Ibero-American Secretary General, states, "in the last 10 years more than 50 million people escaped from poverty. The majority benefited from the labor market dynamism –in particular men's remunerations, from 25 to 49 years old, in urban areas, in the region's services sector– and to a lesser extent through social transfers and the demographic dividend". In these years, a series of solid economic and financial policies, together with the tailwind of the commodities "super cycle", enabled Latin America to grow at an average rate of 4,2% since 2003.

However, since 2014, the tailwind does not blow with such strength and the development accumulated in the boom years has peaked since the region's challenges are different, more focused on avoiding the "middle-income countries' traps". The 2003-2013 boom prevented the region's structural problems from

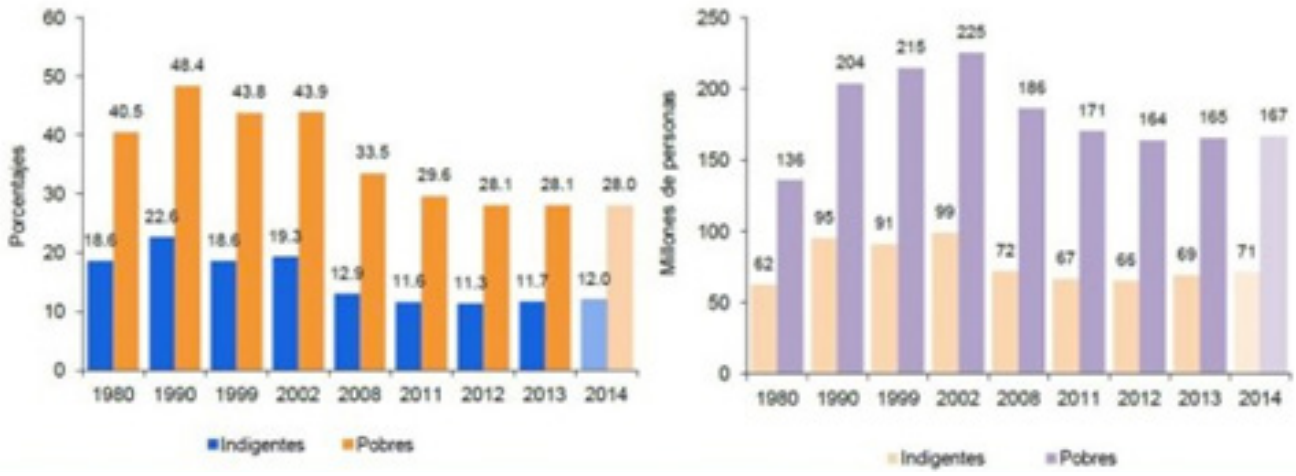
being seen more clearly, unlike what happened in the 1980s and 1990s, Latin America failed to do their homework believing that the growth would fix them itself and in this second half of the present decade it is time to build more diversified, competitive and productive economies, that back innovation and investment in human and physical capital in order to make further progress on reducing poverty, destitution and inequality.

2. SIGNS OF A E CHANGE OF CYCLE

Latin America is currently going through much more than a change of cycle is experiencing a change of era. The "Golden Decade" (2003-2013) brought a time of exports boom for the region based on orthodox approaches in terms of macroeconomy and on previous reforms, carried out in the 1980s and 1990s, that granted economic rationality to the region as regards inflation control, decrease in the tax and trade deficits as well as the resizing of the State apparatus. That era is history and now new challenges arrive for the Latin American economies that must face a new time of structural reforms in order to adapt to a more competitive world with lower and more volatile levels of growth where commodities are not going to be the only nor the main locomotive for growth.

There is no doubt that Latin America emerged strengthened from the boom years, what is also true, however, is that the whole momentum for reform that existed in the 1980s and 1990s was lost in the last fifteen years. It is also true that Latin America is facing this new change of cycle in a much stronger way than in the 1980s because from the "Lost Decade" (1982-1989) to the present time, the region managed to reduce its

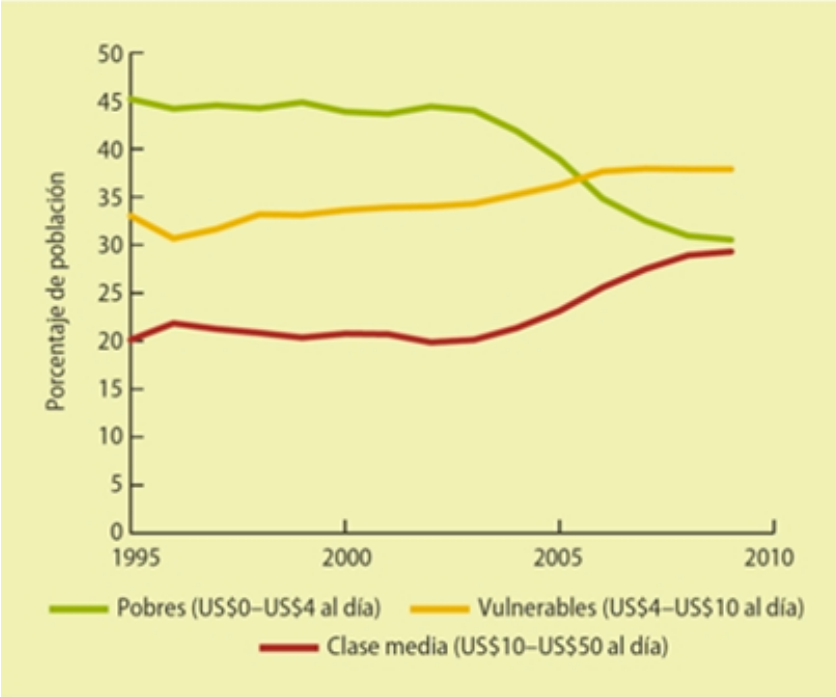
Latin America: evolution of poverty and destitution, 1980-2014 (as a percentage and in million people)



Source: El País newspaper

indebtedness, strengthened the financial system capitalization and made progress in reducing poverty and to a lesser extent, inequality. This nearly uninterrupted growth in the last years (except in 2009) was accompanied by a profound social change: Latin America greatly reduced its levels of poverty (from 225 million of poor people in 1990 to 164 million of poor people in 2013), enabling the emergence of a new and heterogeneous middle class. Inequality, measured by the Gini coefficient, was also reduced, but in a less pronounced way.

Graphic 1: Trends within middle classes, vulnerability and poverty in Latin America and the Caribbean, 1995-2009



Fuente: Banco Mundial, basado en datos de SEDLAC (Socio-Economic Database for Latin America and the Caribbean).
Nota: Los países incluidos son: Argentina, Bolivia, Brasil, Chile, Colombia, Costa Rica, República Dominicana, El Salvador, Ecuador, Guatemala, Honduras, México, Nicaragua, Panamá, Paraguay, Perú, Uruguay y República Bolivariana de Venezuela. Los umbrales de pobreza y los ingresos están expresados en US$ por día del año 2005 al tipo de cambio PPA (Paridad del Poder Adquisitivo).

Source: World Bank

The social structure in Latin America is now much more different from how it was fifteen years ago. The region's economic growth has led those 60 million people to get out of poverty and join an emerging and heterogeneous middle class. Although poverty reduction is still making progress in most of the countries, a significant part of these new middle classes are very vulnerable to an economic downturn and run the risk of falling back into poverty. After all, as stated by Alicia Bárcena, Secretary General of ECLAC: "It is true that millions of people have escaped poverty, but they do not belong to the middle class for their spare capacity, but for their borrowing capacity when buying imported goods".

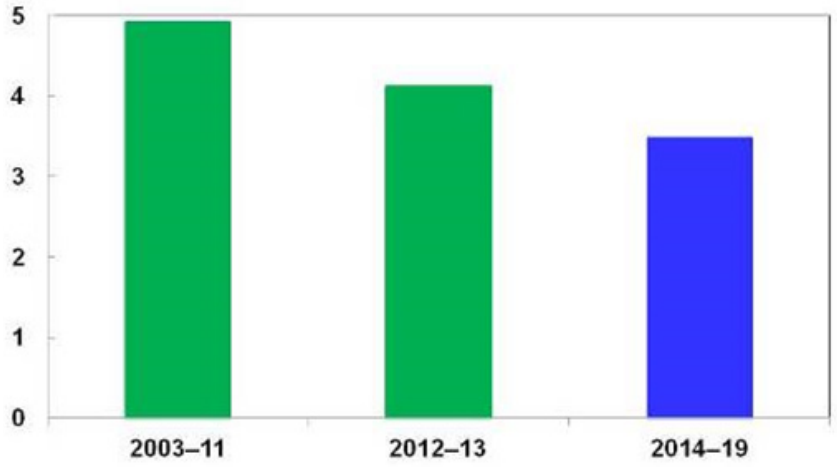
Since the crisis of 2009, the region is facing a new economic cycle marked by slowdown. Latin America thought that the boom was going to be indefinite because China and the rest of Asia would grow at 8-10% rates for decades, which has finally not happened. The region has not saved in the way that had been expected and has backed a social spending of clientelist nature and current expenditure rather than boosting infrastructure, education or healthcare, which explains the ongoing protests that are taking place in Brazil, Chile, Peru or Colombia. Since

2010, growth levels over 5% have never been restored and in fact, rates have decreased from 4.5% in 2011 to the 2.2% forecast for 2015. After growing at an average rate of 4.3% in the period 2004-2011, the economies of the region have barely expanded at an average annual growth rate of 2.1% since 2012.

Another sign of this change of cycle is that poverty reduction has stopped and has even worsened. During the last three years, the poverty rate has remained at around 28% of the population, according to the household surveys of the Economic Commission for Latin America and the Caribbean (ECLAC) in 2014. The ratio of extremely poor people (with a daily income of less than US$ 2.50) has risen up to the 12%.

Graphic 2: Average projected GDP growth 2014-2019[1]

(Annual average percentage change)



Fuente: Cálculos del personal técnico del FMI.

[1]Proyecciones condicionadas en base a un modelo GVAR, asumiendo que los precios de las materias primas se mantienen constantes en los niveles promedio de 2013. Promedio simple de Argentina, Bolivia, Brasil, Chile, Colombia, Ecuador, Honduras, Perú, Paraguay, Uruguay, y Venezuela.

Source: IMF (downloaded from http://blog-dialogoafondo.org/?p=3991)

As stated by Alejandro Werner, IMF director for the region, in an interview for the newspaper *El País:* "Latin America is starting in 2015 a period of a change of cycle . Very possibly a change of political cycle, but certainly a change of a new economic cycle. The growth rate of 1.3% is rather low. We came from levels of 4%. It is the reflection of Latin America's adjustments to the fall in the prices of commodities, minerals and agricultural products, after a period of sustained growth; the negative effect of the fall in oil prices; and the end of the momentum for reform carried out in the 1990s. This momentum has not been sustained and its effect is running out. We must anticipate the difficulties on the side of international economy in the commodities environment, accelerate the structural reform in education, continue with the important agenda on infrastructure that has been implemented and continue developing the commodities sector".

The tailwind that marked the Golden Decade (2003-2013) is therefore finished and the signs of transformation within the international economic context that were clear by 2014 are very obvious in 2015.

LOW ECONOMIC GROWTH

Latin America is going to have a low growth in 2015 that will

not exceed the 2.5% rate, clearly insufficient to confront the social challenges of the region. According to ECLAC, while the economy of Latin America and the Caribbean will recover in 2015, it will do it below its needs since the Gross Domestic Product (GDP) will reach an average growth of 2.2%, whereas in 2014 it reached a 1.1% rate, the lowest since 2009.

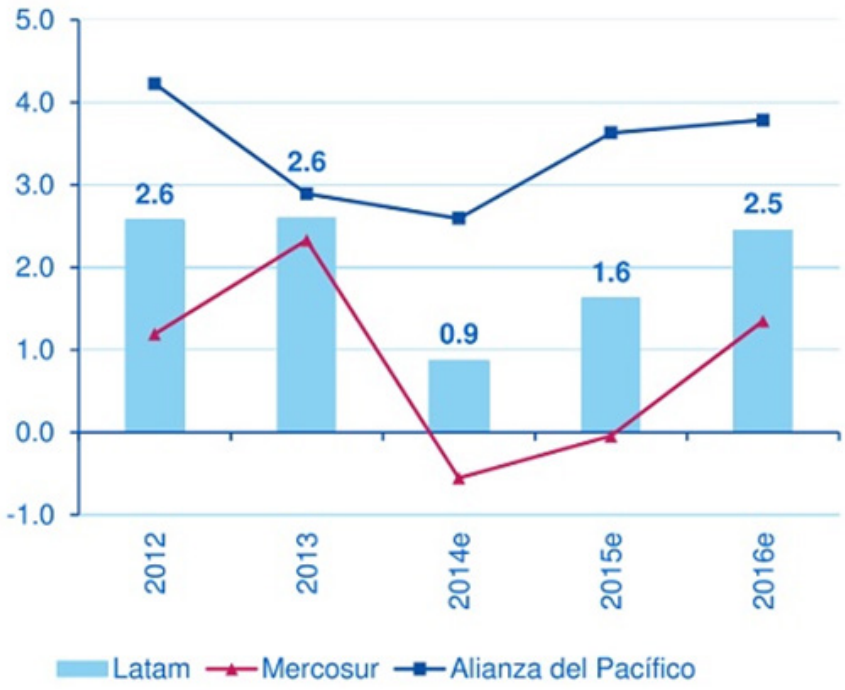
Likewise, the Development Center of the Organisation for Economic Co-operation and Development (OECD) and the Development Bank of Latin America foresee that the region will continue in 2015 at growth figures far below the 5% rate, and therefore will continue facing a slowdown at its pace of economic expansion. The growth forecast is within a range between 1% and 1.5% for 2014 as against the 2.5% and the 2.9% respectively recorded in 2013 and 2012. "Latin America is slowing down more rapidly than most of the emerging world", says the World Bank's Chief Economist for the region, Augusto de la Torre.

HETEROGENEITY IN THE REGIONAL SITUATION

Again, as has been happening in the last years, the region will grow, or slow down, at different paces. Latin America will grow by 1.5% in 2015 and by 2.4% in 2016 but the Pacific Alliance countries (Chile, Peru, Colombia and Mexico) will do it faster, at a 3.6% rate in 2015, than the Mercosur countries which will collapse into stagnation or even into crisis, especially Brazil, Argentina and Venezuela. At this new juncture, the lower Chinese growth strikes the South American countries while Mexico and Central America could benefit from the economic upturn in the United States (although, at the same time, in Mexico's case the fall in oil prices and the rise in interest rates in the United States will affect its growth).

"A stronger slowdown in China is still a key risk for the commodities exporting countries in Latin America and the Caribbean –assures the Director of IMF's Western Hemisphere Department, Alejandro Werner–. The good thing is that Mexico, Central America and some parts of the Caribbean will benefit from a United States' more vigorous recovery".

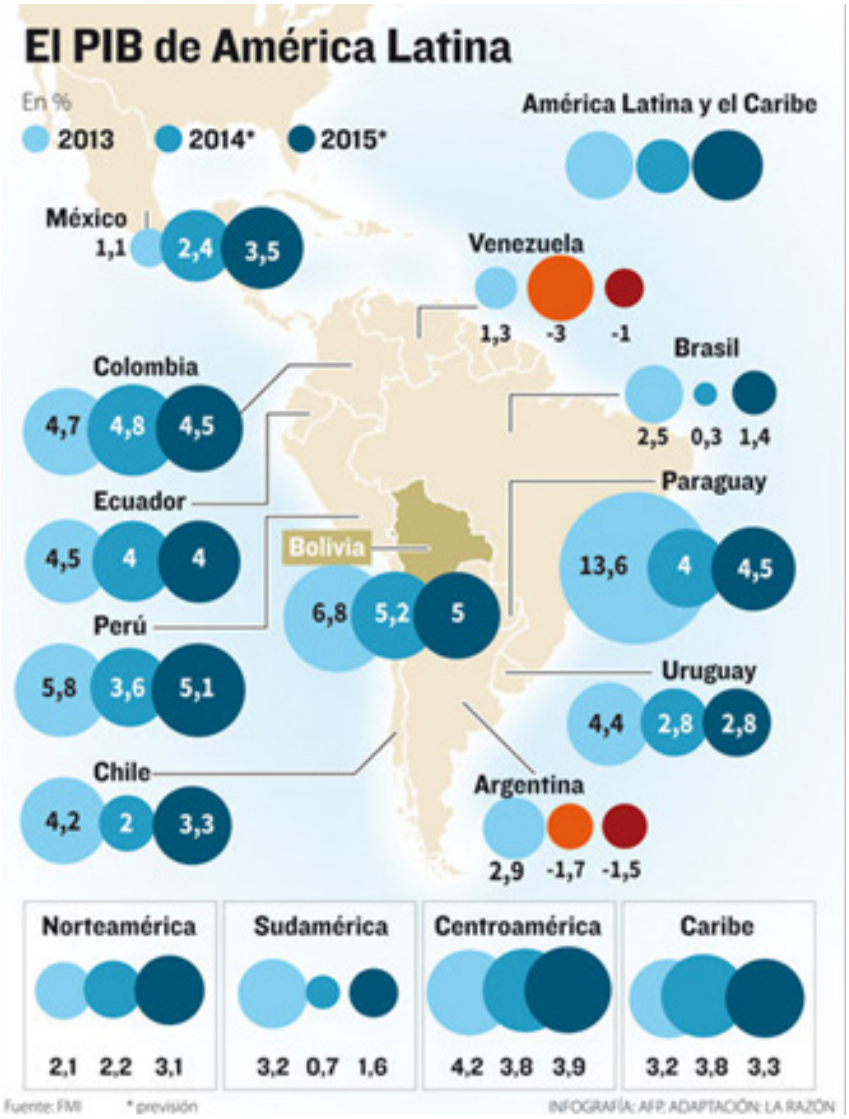
Latin America: GDP growth (%)



Source: BBVA

Thus, two countries are on the verge of, or are already facing, an economic crisis: Venezuela and Argentina (in Brazil the forecasts show a situation of economic stagnation). Another group of countries will have a moderate growth: Chile, Colombia, Mexico, Peru and Uruguay will grow by 2.7% in 2014 and 3.5% in 2015. Central America would grow at a 3.5% rate. For its part, Bolivia, Ecuador and Paraguay will be leading the region's growth at a 4-5% rate.

GDP in Latin America



Source: La Razón newspaper

FALL IN COMMODITIES PRICES

The model of growth in Latin America has been based since 2003 on commodities exports at historically high prices. However, since October 2014, the international oil price (main export of Mexico, Venezuela and Ecuador) has fallen from 90 to 54 dollars a barrel. In the case of soya, the price is around 250 dollars per ton, far from the 600 dollars per ton it reached in 2008 and which explained the economic boom in the Kirchnerist Argentina. Copper, main export of Chile and Peru, is now 2.89 dollars per pound and is recorded at its lowest value since 1 July 2010.

The IMF ensures that the high commodities prices are already history for the next 2 or 3 years, which has serious consequences for Latin American countries and their tax revenue. The hydrocarbons expert, Carlos Miranda Pacheco, in Bolivia's case, expressed it very clearly in the newspaper *Página Siete:* "Oil at half of its previous price means that in 2015 we will receive as well half the gas exports earnings of this year, it will only be 3.2 billion dollars instead of 6.5 billion dollars".

"The economic upswing brought prosperity and social improvements"

DEVALUATION OF LATIN AMERICAN CURRENCIES

The main currencies have lost their value against the dollar and as a whole, Latin American currencies have depreciated sharply. In particular, the Brazilian case stands out: the real has lost until March around 18% of its value against the dollar this year, and is the worst-performing among the major currencies. The dollar, which has become an investment shelter in times of volatility, has also benefited from the recovery in the United States as well as from the forecast that the US Federal Reserve will raise the short-term interest rates.

These four features described indicate a change of a cycle that follows a boom period in which the region stopped doing its homework, in contrast to what happened in the 1990s.

Generally, it can be stated that in these years there has been an excess of complacency among the Latin American leaders about the economic situation of their countries. The economic upswing brought prosperity and social improvements, but the traditional and historical problems Latin America is carrying (its economic vulnerability, lack of innovation, poor competitiveness and productivity, the existence of important bottlenecks –low investment in human and physical capital– or lack of their production and markets diversification) have been far from being overcome or solved. The region has lived on income (on the homework done in the 1990s) and on an inertia supported by the good global economic context that favored its exports and discouraged the implementation of structural reforms. José Juan Ruiz, economist of the Inter-American Development Bank, states that "in the last 50 years, Latin America has not been able to converge in terms of welfare with the most developed countries. Although in relation to 1960 the per capita income in Latin America in constant dollars has increased 4.5 times, with respect to the U.S. citizen, today the welfare gap is 8% bigger than the one suffered by their parents or grandparents. Meanwhile, the Asian emerging countries turned the last decades into the platform for their take-off to development. Singapore, which in 1960 had a per capita income equivalent to the one Ecuador had, has already converged with the American one. Korea, in the 1960s as prosperous as Brazil, has a 66% of the US income today and has exceeded the standard of living of the Spanish citizen. China, with an income below the twentieth part of the American one, has reached 10,000 dollars in two decades".

Despite the confirmation of this historical backwardness, the complacency and excess of satisfaction invaded the region and became a serious obstacle and a disincentive to undertake

"Latin America did not take sufficient advantage of the boom period"

reforms during the prosperity years. Enrique V. Iglesias, former Ibero-American Secretary General, warned in 2012 that "Latin America is changing, but we must be careful; we went too far with complacency; the global crisis is striking us; we are better prepared than ever, but it is striking us and we must think that Latin America must react in order to overcome the vulnerability that we will inevitably have –and we have– in the world we live in. There was much talk of why we opted for commodities. Well, to have commodities is a Providence's blessing. It is not a curse. It can become a curse is if we go back to the 19th century's business relations. It is important to emphasize that we have to exploit with great efficiency and sustain our commodities, which also develop the new forms of trade such as value chains. There is no need to export whole cars, we can export car batteries".

Indeed, the great sin of the Golden Decade was complacency. Several examples are very illustrative of how regional leaders "got a big head" about prosperity:

- In 2011 Sebastián Piñera assured that "this 21st century was going to be the century of Latin America and the Caribbean and we are the ones destined to run and lead with one single aim and one single mission: to improve the life, the quality of life of our peoples".
- In the same vein, although slightly more moderate, Felipe Calderón spoke of this being "the Decade of Latin America".
- And they were not only politicians but also experts like Luis Alberto Moreno, president of the IADB, who did not hesitate to state in the newspaper El País in 2010 that "beyond the conjuncture, we are going to have a decade of good growth, and as long as there is a good growth there will be a natural attraction of private and foreign investment in Latin America".

Undoubtedly, as stated by the Executive Secretary of ECLAC, Alicia Bárcena, the region erred in this excess of complacency: "Latin America did not take sufficient advantage of the boom period, this is the truth. I think Latin America could have done much more in order to invest, in order to turn this variable, investment, into the main bridge between the short and the medium term".

3. A NEW REFORMING CYCLE

Augusto de la Torre (World Bank's Chief Economist for Latin America):"Latin America can no longer rely on foreign countries to grow, and lacks alternative tools. The economic slowdown will continue if reforms are not carried out".

In 2014-2015 this euphoria, excessive sometimes, of the

"It is about reforms aimed at making the economies of these countries more competitive and innovative"

last 10 years has led to the fear that the current slowdown results in a more profound economic crisis. Furthermore, the change of the international context (slow growth in the United States, crisis in the EU, slower growth in China and the emergence of other more competitive economic areas like Africa or some Asian countries) shows that it is necessary to change the form of Latin American inclusion in the world. As experts point out, "the party is over and the tailwinds have become headwinds" (José Juan Ruiz, chief economist of the Inter-American Development Bank (IADB)) and now it is time to boost a "painful process of reforms" but necessary (Alejandro Werner, Director of IMF's Western Hemisphere Department). "With the reduction of the tailwinds that favored Latin American and the Caribbean during the last years, the region will have to resort to its own resources to stimulate growth. And these resources are in fact only one: productivity" concludes the recent report by the World Bank *"Latin America Entrepreneurs: many firms but little innovation"*, drawn up by Daniel Lederman, Julian Messina, Samuel Pienknagura and Jamele Rigolini.

The new cycle of reforms to which the region is faced up is characterized by its comprehensive and global nature. They are not only reforms or paper over the cracks but a bid to change the region's economic model. First of all, it must come from a broad consensus and political commitment (reach an agreement so that these reforms have a State policy nature with continuity over time). Secondly, it is about a change of mind and therefore hard. It is about reforms aimed at making the economies of these countries more competitive and innovative by boosting productivity. And for that, investment in human capital (in education) and in infrastructure is essential.

That is why they must have their origin in a clear political will because not only difficult challenges will have to be addressed but also considerable resistance in order to change the entrenched bad habits.

In short, it is about unlocking the bottlenecks in the region that hamper or slow down its development: at the institutional level, modernizing public and administration services; boosting the competitiveness, the productivity and the innovation of the regional economies; increasing the investment in terms of infrastructure (the region only allocates 3% of its wealth to the building of roads, subway, logistics, drinking water supply, electricity and telecommunications networks) and of education; strengthening the financial sector where companies have a poor access to financing, which prevents them from taking advantage of the investment opportunities. As pointed out by the IADB: "in Latin America and the Caribbean credit is scarce, volatile and

"There is not one single problem in the Latin American public administration"

expensive. The average credit to the private sector, nearly 40% of the Gross Domestic Product (GDP), is much lower".

In order to adapt to this new and changing world there are seven areas on which the region's countries must emphasize and implement this second reforming cycle:

DEEPENING INSTITUTIONALISM

The reforms package the region needs in terms of productivity, competitiveness, investment in human and physical capital and commitment to innovation and diversification must be carried out under the protection of a strong institutional framework. Institutionalism is a historical deficit Latin America is carrying. The region was born in the 19th century devoid of institutions which took almost half a century to be created and consolidated (1810-1850). This state, fragile at first and then gradually stronger but small (1859-1929), became a progressively bigger state until it was oversized (1945-1980). The strong reduction in the size of the state after the "Golden Decade" (1982-1989), with privatizations and the state downsizing since 1989, has resulted in an administration with serious shortcomings when it is time to promote public policies. A state that does not offer security to the citizens, that fails to provide good services in such areas as education, healthcare and transports and that is burdened by a lack of legitimacy among the population due to its low effectiveness and efficiency and its high levels of corruption.

In any case, there is not one single problem in the Latin American public administration but a range of problems and shortcomings since it is a multidimensional issue.

First of all, there exists a drawback in the scarcity of resources, in short, a fiscal problem. There is a very heterogeneous situation in the region: tax collection in Brazil represents 37.5% of its GDP, the greatest of the region, followed by Argentina, with 31.2%. On the contrary, in Guatemala is only 14%. However, there is a common feature either excessive or inadequate: the fiscal problem is caused by the low tax collection level (Guatemala or Mexico) or by the spending inefficiency despite the high tax revenue (Brazil and Argentina). Latin American and Caribbean tax systems are on average the ones that collect the least tax revenues in the world: in 2013 tax revenue reached the 21.3%. It is true that the tax burden has been increased in the last years: ECLAC recognizes the significant increase during the period 1990-2013 when tax burden grew by seven percentage points in 23 years, from 14.4 to 21.3% which is currently recorded. However, it is still 13 percentage points below the OECD countries average, 34.1%.

In the words of José Antonio Alonso, professor of Applied Economics at the Complutense University, "the institutional

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weakness is reflected in the fragility of the fiscal covenant on which the State is based. If citizens question the legitimacy of public institutions is difficult for them to feel encouraged to contribute with taxes to its maintenance. As a consequence, the tax burden is generally low; the evasion levels, high, and public spending is often regressive. This does nothing but to accentuate, in a sort of a vicious circle, the lack of legitimacy of the institutions, making it impossible for the State to fulfil the tasks entrusted to it as a provider of public goods to society. The tax reforms promoted in the region over the 1990s did not solve the problem, since by putting tax systems to rest on tax figures related to spending (instead of to income) they dissolved the most direct contractual relationship between citizens and State".

When tax reforms are raised (to increase the tax collection base as well as the tax burden) it should also be taken into account that it is not only about a greater collection but also about a better management. The great challenge for Latin American countries is to build an administrative apparatus and a fiscally sustainable and technically competent public service. As pointed out by Carlos Santiso, Head of the Institutional Capacity of the State Division of the IADB, state apparatuses must have three fundamental features to gain legitimacy among the citizens: they must be more effective, more efficient and more transparent.

- **More effective states:** Since the 1990s, the different governments of the region have developed several initiatives in order to boost the professionalization of the administrative systems and the civil service. Despite the progress achieved, there is still a strong backwardness in three areas: regarding the adaptation of the legal and administrative systems, the one related to its modernization in order to reach international standards and on the effectiveness of the public policies promoted from the State.

According to Carlos Santiso "countries must forge effective governments. An effective government is the one that achieves results that meet its citizens' needs. It manages according to the results and takes evidence-based decisions. Where to start? First, putting statistics at the forefront of policies design to base them on greater and better evidence. Government statistics are not sufficiently used as information base in the development of policies and government programs are rarely accurately evaluated. Second, an effective State requires a strong strategic focus –not a strong State–. The roles of president and prime minister, even though they are strong, are often technically weak. Chile, Paraguay and Uruguay have made

"Where to start? Two main areas: the professionalization of the civil service and the reduction of bureaucracy"

significant steps in order to reinvent their "centers of government", which improve the coordination and monitoring of the government programs".

- **A more efficient administration:** Latin American countries have not managed to fully implement genuine systems of professionalized civil service. Although it is true that most of them have legislated in this regard and have laws on civil service in accordance with the latest developments on this subject, the implementation leaves much to be desired and is far from what the regulation says.

  Santiso suggests in this regard that "countries have to promote efficient governments. An efficient government is the one that reduces the citizens' costs in its interactions with the public sector and provides services of a certain quality at less cost. Efficient governments require the extension of solutions based on e-governments promoting the use of information technologies in an increasingly young and connected society. This also involves improving the quality of regulations and simplifying the administrative bureaucracy. Promoting a fiscally sustainable and technically competent public service is one of the major challenges. Where to start? Two main areas: the professionalization of the civil service and the reduction of bureaucracy. The reduction of bureaucracy and the simplification of procedures play a major role for people when they need to turn to governmental entities to obtain a service or exercise a right. In this regard, governments are using technological innovations in order to improve the management of information and streamline the administrative processes, for example, by means of service portals and shared services.

- **Greater transparency in light of a more empowered society:** The current corruption cases that are striking Latin America in 2015 have highlighted the serious transparency problems affecting the institutions of the region and which are behind the citizens' disaffection towards parties and the administration in general.

  Institutional weakness is still, together with inequality and corruption, one of the main Achilles' heel that prevents the region from having a better quality democracy. According to the Latinobarómetro, trust in the main institutions of the representative democracy (parliaments with only 29% and parties with 24%)

"This low productivity takes place essentially in smaller companies"

continues to show low levels of support, a true reflection of the serious crisis of representation that is currently affecting a high number of countries in the region.

Therefore, Carlos Santiso stresses that "the countries must promote open governments. An open government is the one that is transparent, acts with integrity and prevents corruption. The relationship between State and citizens is being radically changed by technological innovation, whose speed often exceeds the governments' capacity to adapt to it. Open governments actively support a greater access to information and promote its effective use to prevent corruption and improve management. Where to start? There are two priorities: to strengthen accountability and integrity systems and improve specific transparency policies. To strengthen and modernize the control and audit institutions is a defining challenge for the region and is at the same time a key mechanism for governments to give account of the results they achieve, thereby improving the quality of public management".

INCREASE IN PRODUCTIVITY

José Juan Ruiz (chief economist of the IADB): "If Latin American countries implement reforms that raise its productivity in the next 10 years, each country will increase its annual growth by almost 2 points. The growth rate would accelerate by 1.8 points and instead of growing at an annual 3% rate, we will come back to growing at a 4.8% rate during the next 10 years".

Another of Latin America's Achilles' heel is its low productivity as compared with the one of the developed countries. In other words, its inability to raise productivity by finding more efficient ways to use labor improving not only their physical but also their human capital. This low productivity takes place essentially in smaller companies and affects, particularly, the service sector, where the majority of the population works. As the Inter-American Development Bank points out "low productivity is often the unintended result of a great number of market and state failures that distort investment incentives, prevent the efficient companies' expansion and promote the survival and growth of inefficient companies. These market and state failures are more pronounced in low income economies –and Latin America is no exception– and they are an important factor that explains their relatively low levels of productivity".

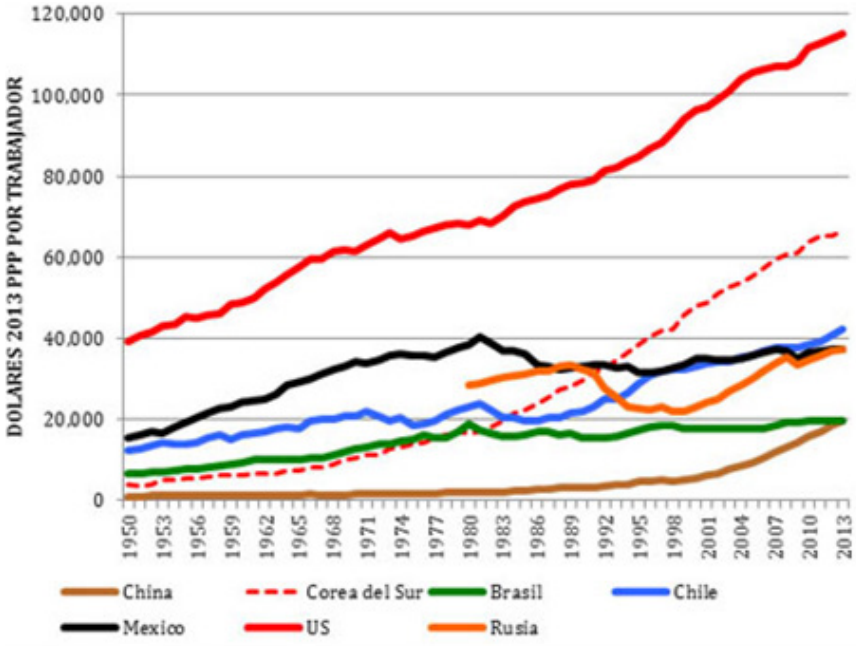
As shown in the following chart, the productivity rates not only have not improved in the last three decades but they have stagnated (Brazil), have

decreased (Mexico) and only in exceptional cases (Chile) have increased.

The Inter-American Development Bank points out that "over the last 50 years the growth of the working population and of the region's capital stock has been higher than the one, for example, in the United States, and the levels of education have also improved. But the steady increase of the relative productivity gap has led the current Latin American and Caribbean citizens to have, as compared with the United States, a lower relative per capita income level than the one experienced by the generation of their parents and grandparents. Therefore, to create conditions in order to improve productivity growth rates is a primary objective of the region's strategy for sustainable development".

In fact, as we see in the following chart, the so-called Asian tigers, from 1978 onwards, have been able to better close the productivity gap with respect to the United States. In this regard, Latin America has been left behind since it has not boosted the necessary structural reforms to reduce the difference with the US economy.

Indeed, the economic boom of the "Golden Decade" was not accompanied by an improvement of productivity by means of investment in R&D&I (research, development and innovation). The region's countries, in the vast majority middle-income countries, can no longer compete with emerging economies through a decrease in wages but through the improvement of productivity. As pointed out by Mario Pezzini, Director of the OECD Development Center, "new actors have emerged, who have some technological capacity and also a large population in rural areas available for work for a low wage. Productivity and low wages, with this, those countries gained competitiveness and are a tough competition for others who do not have these conditions. The solution left is to increase the capacity for innovation. In Latin America there are countries that are implementing policies in this regard. There are examples of this in Argentina, Colombia, Mexico, Chile, and Dominican Republic. There is greater



Source: América Economía

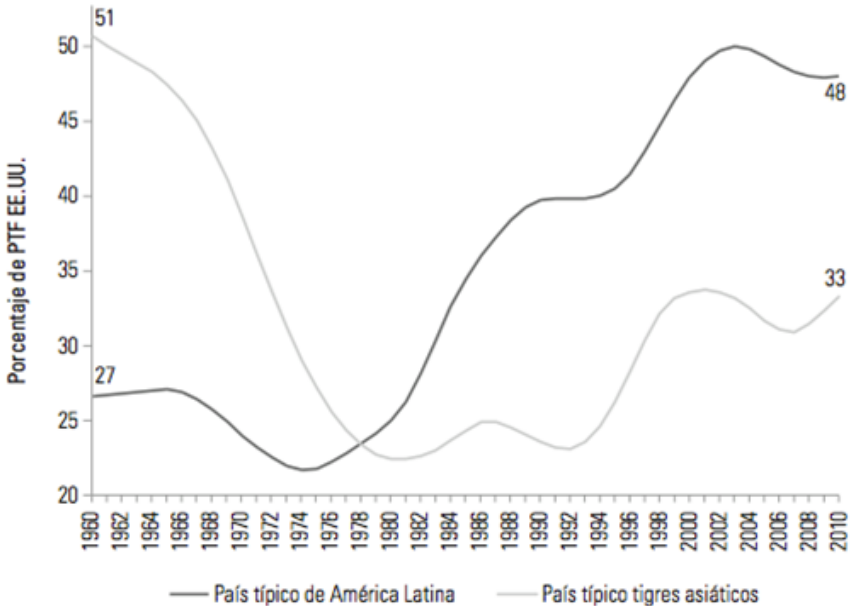
attention to this subject and investment is starting but there is a lack of exchange of information, of knowing what to do and what not to do in order to progress on solid bases".

There are several factors that affect this low productivity although the IADB suggests that "the main cause of the region's disappointing performance, and the fundamental factor on which policies need to be focused, is the low productivity with which production factors are used". Improving the productivity and reaching a faster growth involves, among other things, creating a better environment that establishes the appropriate conditions to improve productivity, making a better use of the existing production factors, promoting public policies offering better incentives, combating the informal economy characterized by its low productivity or improving the general quality of the education system.

Latin America, if it does not want to be surpassed by other regions, must focus on a high value-added production not only based on commodities exports and the cost-price being its only comparative advantage. Increasing productivity requires improving the logistics system and boosting an appropriate infrastructure for the global market. In fact, the region will have to find its own engines for growth, increasing productivity in economic sectors other than commodities.

As recalled by José Juan Ruiz, Eduardo Fernández-Arias and Ernesto Stein, economists of the Research Department of the IADB, in the book "Rethinking Productive Development", "Latin America had less physical and human capital than the developed countries. Less machinery, less years of schooling. Although this explanation was correct, was partial: over the last 50 years the region has accumulated physical capital, created employment and improved its human capital quicker than the United States. If the convergence only depended on the accumulation of factors, Latin American citizen would have closed their welfare gap

Graphic 1.3: Productivity gap with respect to the United States



Source: IADB

"The increase in productivity in Latin America requires structural measures and reforms in the medium and long term"

by 25% with respect to their American neighbor. But quite the opposite happened. Therefore, the inference must be that the main problem is the efficiency with which the production factors are combined; what we economists call the total factor productivity. In that area, the region's achievements were more than disappointing: while Asia reduced by two thirds its relative productivity gap regarding the United States, Latin America doubled it, turning the convergence of the accumulation of factors into net welfare divergence. The levels of inequality, the informality in the labor market –more than half of the Latin American workforce works in the informal economy–, the size of companies, the shortcomings in education and health, the lack of infrastructure, the public safety, the institutional weakness, the corruption are, among others, relevant factors that contribute to the fact that the continent is not growing further".

Thus the increase in productivity in Latin America requires structural measures and reforms in the medium and long term and it is associated with an increase in the investment in physical and human capital, in particular in three areas: infrastructure, technology and education. Productivity is the first step in order to be more competitive and this depends on the labor quality (education and training), the infrastructure (modernizing infrastructure, transport and communications) and the technology (promoting innovation).

MORE COMPETITIVE IN A GLOBAL WORLD

This low productivity is intrinsically linked to the region's low levels of competitiveness. A competitiveness that has worsened over the "Golden Decade" because the economic boom and the emergence of middle classes have led in many countries of the region to the real exchange rates appreciation, the increase in wages, the rise in the level of taxation, factors that have led to a loss of competitiveness in the economies of the region.

The Global Competitiveness Report 2013-2014 of the World Economic Forum (WEF) precisely indicated a general stagnation of the competitiveness in the region: Chile (34th) remained leader in the regional ranking, above Panama (40th), Costa Rica (54th) and Mexico (55th). The worsening of Brazil stands out, which has lost eight ranks (56th). Likewise, it also stands out how Venezuela also drops eight positions and is the worst positioned country of the area, at 134th place, due to its high inflation and public deficit rates. Peru (61st) and Colombia (69th) remain stable thanks to the solid macroeconomic indicators, while Ecuador (71st) climbs fifteen places, as a result of the improvements in infrastructure, education quality and innovation.

Uruguay (85th) and Argentina (104th) represent the sharpest drops in the competitiveness ranking, they drop eleven and ten positions, respectively, due to the deterioration of their macroeconomic prospects, which affect, above all, the access to foreign financing.

The lack of Latin American competitiveness stems from a weak functioning of the institutions, insufficient infrastructure and inefficiency in the allocation of production factors. These shortcomings, which all the Latin American economies show, are the result of insufficient competition and a gap in training, technology and innovation, "that prevents many companies and nations from moving towards higher value-added activities". Even Chile, leader in terms of competitiveness at Latin American level, which has strong institutions, low levels of corruption, an efficient government and macroeconomic stability, has a series of handicaps such as the weakness of the education system, which does not provide companies with a workforce with the necessary training.

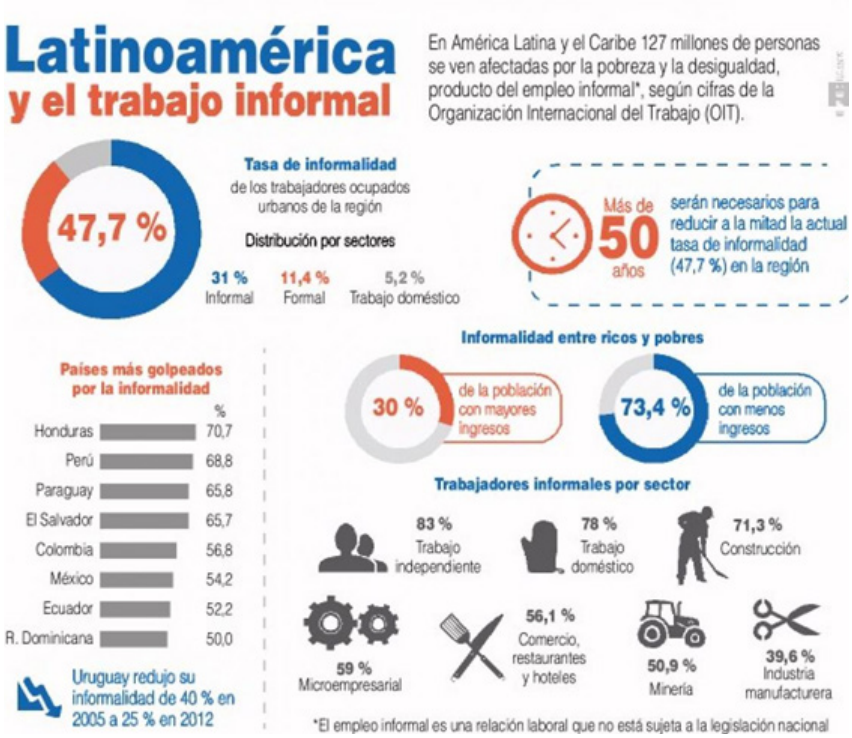
Source: La Razón

So what Latin America needs to do in order to integrate into this emerging and global world that is now arising is to increase the levels of productivity and competitiveness. To that end, public institutions, in strong public-private partnerships, must create an enabling environment for innovation and business venture, must invest in physical and human capital and support the exports and markets diversification.

To ensure that Latin America is more productive and competitive it is necessary to reduce one of the main obstacles in the regional economy, informality. An informal sector which is around 50% of the working population and restricts the quality and effectiveness of the State and hinders its capacity for tax collection and its actual presence in the region. It also affects the effectiveness of macroeconomic policies and hampers the growth of small businesses, most of which have low productivity and are linked to a low level of education in employment and a poor access to financing.

Figures speak for themselves in this regard: more than 127

million people (47% of the Latin American workforce) in the region have an informal job, which means that they fall outside the labor legislation, do not pay social security contributions and do not pay taxes. Informality affects some sectors more than others and has an impact especially on areas such as the construction industry, agriculture and domestic workers. The reduction of the informal sector in these years has been significant but it is still insufficient and runs the risk of increasing in view of the current slowdown: the informal sector dropped from 65% in 2000 to 47.7% in this decade. The countries with the highest rates are, according to the ILO, Guatemala, 77.7%, El Salvador, 72.2%, and Honduras 74.9%.



Source: América Economía with data by ILO

Whereas in Mexico the figure is 58%, in Brazil the informality rate is 37.8% and in Uruguay, 32.5%.

Elisabeth Tinoco, Regional Director of the International Labour Office of the ILO, points out that "the economic growth rate of 3-4% from the year 2000 onwards had a recent impact on the creation of formal employment. But now, with a slowdown that could be intuited from long time ago, the informal sector is back. People manage to eat by doing the most unusual jobs. It is the need for survival. The policies governments have promoted in order to generate formal employment are threatened by the economic downturn. That is the great fear".

In this regard, Latin American countries must start taking steps to reduce the informal sector along the lines that the IADB has suggested: by means of an emphasis on institutional policies that create incentives to work or employ in the formal sector, designing a tax system that generates a "tax discrimination" and favors the formal sector with a lower burden. And also social security programs that benefit the workers paying taxes and carry out an improvement in access to credit.

HIGH INCREASE OF THE INVESTMENT IN PHYSICAL CAPITAL

José Antonio Llorente (Founding Partner and Chairman of LLORENTE & CUENCA): "The future growth and economic

"A better infrastructure raises the quality of life of the population"

development of Latin American countries is to be found in the investment in infrastructure. Investing in infrastructure is investing in a country's development, especially if we are talking about Latin America... it is essential to understand that the region not only must increase its investment in infrastructure, but must do it in a more efficient way".

There is a widespread consensus in the academic literature referred to the fact that investment in education and infrastructure is essential to achieving improved levels of competitiveness and productivity. In this regard, the promotion of investment in infrastructure becomes a crucial factor to make this necessary qualitative leap the countries of the region require in order to be successfully linked with an increasingly more competitive world. Ensuring the region's current and future economic growth depends, largely, on the decisions taken within the field of infrastructure.

As the Development Bank of Latin America (CAF) points out, generally, a better infrastructure raises the quality of life of the population, increases the economic growth, facilitates the regional integration and diversifies the production system. To which the Inter-American Development Bank adds that the rapid growth in the region's economy and in foreign trade in the last ten years has shown the serious shortcomings of the region in terms of electricity, transportation infrastructure (roads, railways and ports), etc. This deficit is due to the insufficient investment effort, over all these years, both with regard to the public and private sector.

As the following chart shows, the majority of Latin American countries are below the global average regarding infrastructure: only Panama (30th place), Chile (45), Mexico (66) and Guatemala are on the top of the ranking:

In the 1980s, the region's investment in infrastructure was more than 3% of the GDP and this amount was mainly funded by the State (these were the days of interventionist states and the import substitution industrialization). This trend changed in the 1990s, following the wave of neo-liberal reforms, and dropped to 2%, with the private sector leading this kind of investments. Already in the first decade of the 21st century investment was reduced to 1% and since 2007 has risen over 2% and is again around 3% with a similar involvement between the State and the private sector.

But the amount invested in infrastructure, which already was insufficient to provide a sustainable basis to the boom the region has been experiencing during the "Golden Decade (2003-2013)", is still very low to make the qualitative leap Latin America needs in order to raise its competitiveness and

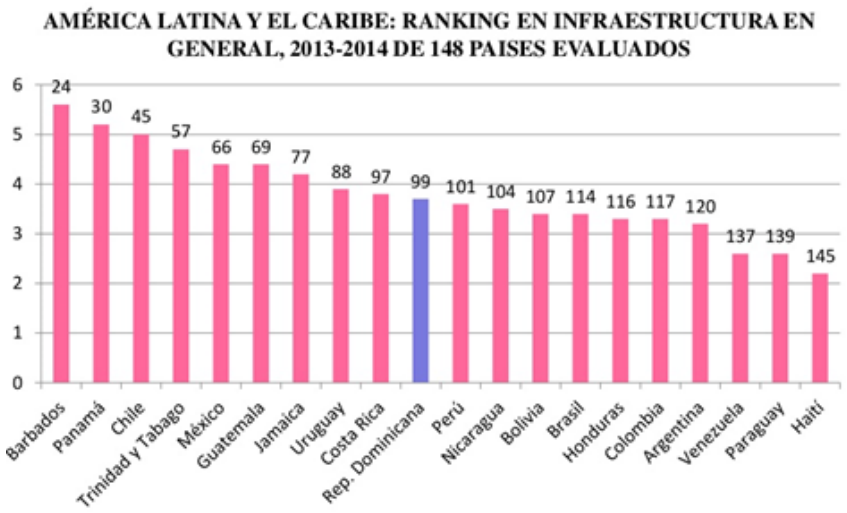
productivity. In this regard, the Uruguayan economist Ernesto Talvi stresses that "governments should try to internally generate a boost to their economies stimulating those sectors in which there is a deficiency in the region, such as infrastructure and energy...we will have to get to work and do our homework properly".

Along these lines, Juan Sosa, Vice-President for Infrastructure of the Development Bank of Latin America (CAF), points out that the region only allocates 3% of its GDP to the building of roads, subway networks, to the promotion of logistics, of drinking water supply, electricity or telecommunications networks: "Latin America is now facing a unique chance to develop and make a qualitative leap in the next decades. Without infrastructure, quality of life cannot be improved, since it supports the economic growth and business competitiveness. If there is no competitiveness, growth will not be sustainable over time".

One of the keys to increasing productivity and competitiveness in global markets involves promoting the appropriate infrastructures enabling access to any attractive market, whatever it is and wherever it is located, from an advantageous position. Sustainable development and Latin American countries' progress is intrinsically linked to infrastructure development because this investment not only brings social improvements (regarding the quality of life of the population), but also generates business and trade opportunities for companies. The main deficiencies the region shows concern roads, railways, water and sanitation networks, followed by ports and airports as well as the energy and telecommunications sectors. "There is a lack of rails, airports, ports, buses and subway stations, energy plants that need to be developed. Governments are starting to realize that if they want their economies to continue growing they need to support the sector and this is a huge opportunity", says Lawrence Lam, director of Samcorp.

To sum up, in order to reduce the gap in the area of infrastructures (both in new investments and maintenance expenses thereof) two actions need to be

The lack of infrastructure in Latin America affects commercial development



Source: World Bank (2014), Global Competitiveness Report, 2013-2014

"The State must increase its investments"

promoted, which, according to the Executive President of the Development Bank of Latin America (CAF), Enrique García, would be related to:

- Doubling investment from the current 3% of the GDP (Latin American average) up to at least 6%, following the example of Asian countries, whose current average capital in infrastructure is 10% of GDP.

  A recent report by the World Economic Forum gave Latin American countries an average mark of 3.6 points out of 10 in infrastructure compared with the 5.4 points average of the OECD countries, where the roads and railway sectors are the weakest together with the electric power sector. Therefore, ECLAC has also estimated that the investment level required by Latin America to reduce the infrastructure gaps regarding the emerging countries from East Asia is equivalent to an investment of 7.9% of the annual GDP at least until 2020. This amount is equal to US$ 286.3 billion a year.

- Creating partnerships with the private sector, which is essential when facing the infrastructure challenge because the Latin American states lack the necessary resources, and sometimes sufficient knowledge, and therefore the promotion of "strategic partnerships" between the private and public sector is decisive".

  In this regard, as held by the CAF, the State must increase its investments and also deploy a group of public policies aimed at better targeting of subsidies, allocating greater resources to the maintenance of infrastructures, framing the sector's policies in "an integrated sustainable development paradigm", as well as strengthening public institutions.

INCREASE OF THE INVESTMENT IN HUMAN CAPITAL

Jorge Familiar (Vice President of the World Bank): "In a region where the access to education up to secondary level is almost universal, the main challenge is quality. And in order to raise quality, what happens in the classrooms or, more specifically, the skills of the people responsible for teaching is what is essential".

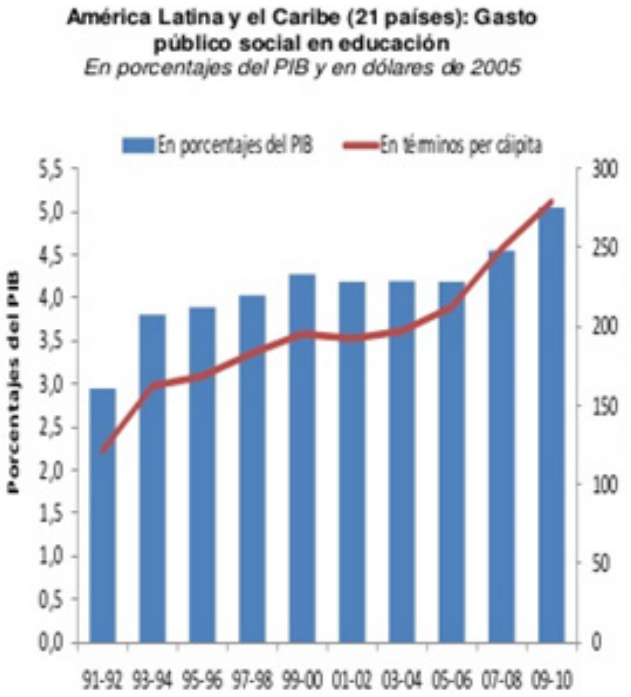
Besides physical capital, investment in human capital (quality education) is equally decisive to achieve a productive development and to build a globally competitive economy based on innovation. Academic research, especially the one carried out by the IADB, concludes that education, when aimed at the student for him or her to acquire, throughout their academic and even working life,

skills and capacities applicable to their work environment, increases workers' productivity, raises their income level, contributes to the general well-being of society and encourages the introduction of innovation and new technologies.

Education not only has this economic component but another of a clear social aspect. Investing in quality education contributes to encouraging equal opportunities and social cohesion by means of an inclusive economic development. In fact, the major problem of education in Latin America is inequality since deep inequalities persist regarding coverage, quality and access (rural vs. urban areas), between more or less developed departments and between different social strata. To take only one example, in Colombia a study by the Fundación para la Educación Superior y el Desarrollo, Fedesarrollo, concludes that "education in Colombia, apart from having on average a poor quality, perpetuates inequalities and does not allow education to fulfil its fundamental role of being one of the important factors of social mobility".

Since the 1980s, Latin America has made significant progress

Public spending on education and health had a significant increase. How are results assured?



Source: ECLAC

"The main problem of education in Latin America is not only a matter of quantity but of quality"

in education coverage with a public investment that doubled in real terms. In 2010, according to ECLAC, the total spending on education was 5.3% of the GDP in Uruguay, while in countries like Mexico, Chile and Argentina it was above 6%. The result of allocating around 4.7% to education has been a great increase in coverage: the enrolment rate in primary and basic education is almost 100% and the youth and adult literacy rate is 90%.

In any case, public investment in education in Latin America is behind the one of developing countries in other regions and behind the one of the OECD countries, which is around 12% of the GDP. Besides, those unquestionable advances in Latin America in the area on education regarding coverage have been insufficient in pre-primary education, to which only 62% have access, in secondary education (between the ages of 12 and 15 years), to which only 70% have access, and middle school, between 15 and 17 years, to which only 40% have access.

Anyway, the main problem of education in Latin America is not only a matter of quantity but of quality. In this regard, ECLAC holds that what is important is not just spending more but doing it better, more effectively and efficiently.
At a regional level there are many examples. One of them is Uruguay, the country that invests the most in education. The Instituto Nacional de Evaluación Educativa (INEEd) of this country emphasizes that the higher budget on education in the last decade has not resulted in an improved quality of education. Although investment has grown from 4.5% of the GDP in 2004 to 6.2% in 2012, the problem of education in Uruguay remains unsolved: "In the next decade –says the report by the INEEd– the country must continue to increase the investment in education, but should do it in an increasingly more efficient way, carefully analyzing the allocation of resources among different education policy alternatives. Likewise, it should link a sustained effort of improved wages to reforms in the approach and conditions of the teaching work".

Another spotlight in order to improve education quality in Latin America is the quality of the teachers. Mariano Jabonero Blanco, director for Education of the Fundación Santillana, points out that "the quality of the education system is never better than the quality of its teachers... attracting the best teachers to the profession and ensuring them an excellent and appropriate training, rigorously evaluating the teaching staff in exercise of their duties, holding them accountable for their performance, and lastly motivating and paying them consequently, is the model that has been successfully implemented for many years in the countries that are global

"Democratizing education, requires in Latin America profound changes"

leaders in education, as proved by their excellent results in PISA tests and similar ones. Conditions that are not fulfilled in almost no country of Latin America, which explains such negative consequences as the ones described in the mentioned report, like, for example, the loss of teaching time observed in the daily activities in classrooms: due to a lack of pedagogical and educational skills, the average of the teachers of the visited schools use less than 65% of their time in teaching and learning activities, spending the rest of the time in roll calling, bringing order, administrative tasks or simply wasting it".

Improving the quality of the education teachers give involves irretrievably clashing with the strong interests created and the established corporate powers (teacher unions that, like the Mexican ones, refuse to change). The educational reform promoted by Enrique Peña Nieto in Mexico has clashed precisely with particularly radicalized unions, capable of mobilizing hundreds of thousands of teachers and of paralyzing a country and even prevent these reforms from being implemented in areas like Oaxaca and Guerrero.

"To ensure, says Jabonero, more and better learning for everybody, in other words truly democratizing education, requires in Latin America profound changes in the processes of selection, training, evaluation and payment of teachers, as well as carrying out external standardized evaluation tests and widely disseminate its results. A process to which the need to redefine the relationships with teacher unions is not indifferent, unions, possibly the most powerful in the world until now, that have coexisted with such unfair and inefficient systems, and that have often clashed with educational transformation and improvement policies. The recent experiences in Mexico, Peru or Ecuador to modify the balance of power relationships between teacher unions and democratic governments, show that changes are possible".

Additionally, the commitment to quality education involves increasing the number of school hours reducing half days and promoting full working days (eight hours), improving infrastructure (classrooms, work material...) and turning education into a big national project with the agreement of all actors around a State policy, protected against the ups and downs of politics and clientelism, with the aim of improving the quality and relevance of education.

In this regard, and following the IADB, the successful models, the ones that should be an inspiration for Latin America, are those which:

- **Promote continued training:** *"Countries have also understood that the education process does not end with a*

"Education and work training have followed separate paths in Latin America and the Caribbean"

secondary school diploma, not even with a university degree. It just never ends. Education systems in the labor market promote lifelong learning, thus ensuring an encouragement for production. In these systems, workers are permanently moving between the labor market and the education or training system throughout their working life cycle".

- **Associate knowledge and skills acquisition with the labor market needs:** *"Latin America and the Caribbean have made no progress towards continued training nor have they paid enough attention to the school and training integration in the labor systems. Initiatives have disproportionally focused on expanding education systems and creating isolated work training niches with a limited coverage, leaving little room to review and improve their quality assurance mechanisms and the relevance of the skills taught, to better meet the production sector's demands. Latin American countries seem to have simply assumed that a population with a higher number of years of study is a synonym for a better trained population. Education and work training have followed separate paths in Latin America and the Caribbean".*

In conclusion, if Latin America wants to take the train of progress must promote the investment in education like South Korea or New Zealand did, which has turned them not only into developed countries but also ones with high levels of social cohesion. This guarantees governability and the social and economic stability of a country. As Alieto Aldo Guadagni, former secretary of Industry and Commerce of Argentina, points out, "chronic poverty cannot be reduced without education that prevents the transmission of poverty from generation to generation. Economic growth in the 21st century does not depend on the abundance of natural resources, but on the quality of human capital accumulated by education and also by child health policies. In our country we are walking for a long time now through the path of social inequality, strengthening the intergenerational reproduction of poverty and annulling our former rising social mobility. Our education system does not only not promote and ensure equal opportunities, foundation of social justice, but it can neither contribute to a booming economic growth due to its poor quality".

INNOVATION DEFICIT

Competitiveness and Innovation Division of the IADB: "The region resigned itself to exporting

its native wealth without transforming it, and nor was it concerned about creating another kind of innovative products for export. This is its greatest risk".

Deficit in productivity and competitiveness the region faces runs in parallel with the deficit in innovation Latin America is suffering. Although it is true that the spending on research and development (R&D) has increased in the last fifteen years (the region is, after Asia, the world's second with the highest growth in investment in R&D) it is also true that it is still far away from the OECD and Asia countries.

In Latin America investment in R&D is around 0.8% of the GDP (according to 2011 data from the IADB), which is an advance with regard to the 0.48% of 1990 and the 0.57% of 2000. However, there is still a long way to go in Latin America to reach, or at least to show similar figures, the 2.8% in the United States, the 3.7% in South Korea, the 3.9% in Finland or the 4.3% in Israel.

Alongside undeniable progress there are as well undeniable shortcomings. In these years the region has made progress in sectors like biotechnology and value-added production of certain commodities. This is Chile's case, which has developed technology based on these exports (wine, salmon, etc.), cold exports, commodities packaging and has even developed a technological leadership in copper mining. But there are more cases since innovation has arrived in Latin America along very different paths. From traditional sectors (wine, nuclear technology and aeronautics industry) to undertakings with a shorter history (fine fruits, software, electronics, salmon and caviar).

But all this progress is, for now, exceptional because there is no comprehensive policy of support and investment in R&D. As the president of the IADB, the Colombian Luis Alberto Moreno, points out, "there is a huge shortfall in innovation in Latin America. There is no doubt that winds have changed, we had tailwinds with a very important consumption from China, good prices and low interest rates. All this is changing and this means that we have to do greater internal

Innovation is an engine for economic growth, and Latin America has not yet assimilated the idea

Los gastos en I + D en América Latina son sistemáticamente inferiores a los de los países desarrollados y los de mejor desempeño en el mundo (Israel, Finlandia y Corea del Sur) son precisamente aquellos países que han logrado alcanzar a otros países desarrollados en los últimos 30 años.

Source: Instituto Mexicano de la Competitividad

efforts, we have to row more on our own and innovation is one of the ways to better row".

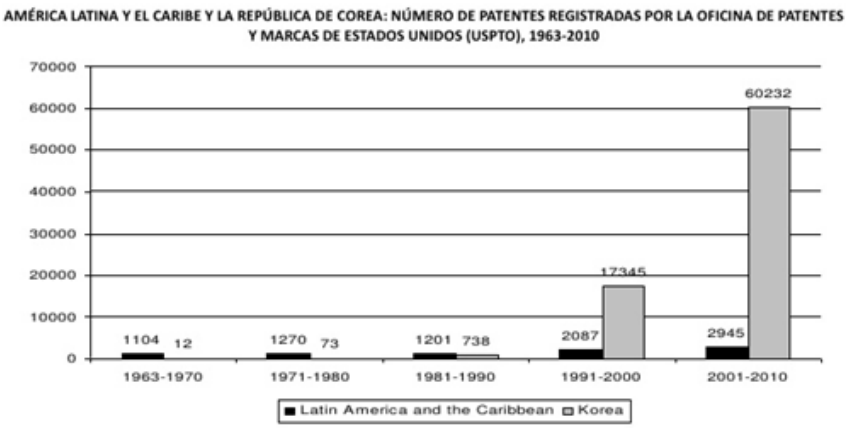
Besides the insufficient spending on innovation, this kind of investment is very focused on a handful of countries. Brazil, Mexico and Argentina account for more than 90% of Latin American investment in research and development according to the report "El Estado de la Ciencia 2013" (The State of Science 2013), published by Red de Indicadores de Ciencia y Tecnología (RICYT). Brazil is the regional leader investing 1.2% of its GDP in R&D, while Argentina reaches 0.64% and Mexico, 0.45%. As compared with these figures, El Salvador and Guatemala are the countries with the lowest investment in R&D, in the range of 0.03 and 0.04%. This report indicates that in 2011, Latin America and the Caribbean invested US$ 44 billion in R&D, 3.2% of global spending. This means that, for instance, the region's companies are the ones that introduce the least new products in international markets or that no country, nor the region as a whole, approaches the more developed countries in terms of the number of patents. The example of Latin America and South Korea only in the last decade is quite clear: Latin America did not reach three thousand patents and South Korea exceeded sixty thousand.

As shown in the following chart prepared by ECLAC, countries like Singapore or the one from the example, South Korea, register twenty times more patents than Latin America:

Thus, the region is facing a chronic lack of innovation that goes hand in hand with the failures regarding improvement in physical and human capital. A higher investment in innovation would result in a better design of science, technology and innovation policies for them to have a greater impact on economic and social development processes. In addition, investing in innovation would contribute to giving support to a sector in which Latin America is certainly leader, the entrepreneurship sector. Finally, this lack of innovation hinders competitiveness and growth and has an impact on the creation of quality jobs.

The studies by the IADB have shown that the investment in R&D in Latin America and the

Patents in the Republic of Korea and Latin America and the Caribbean

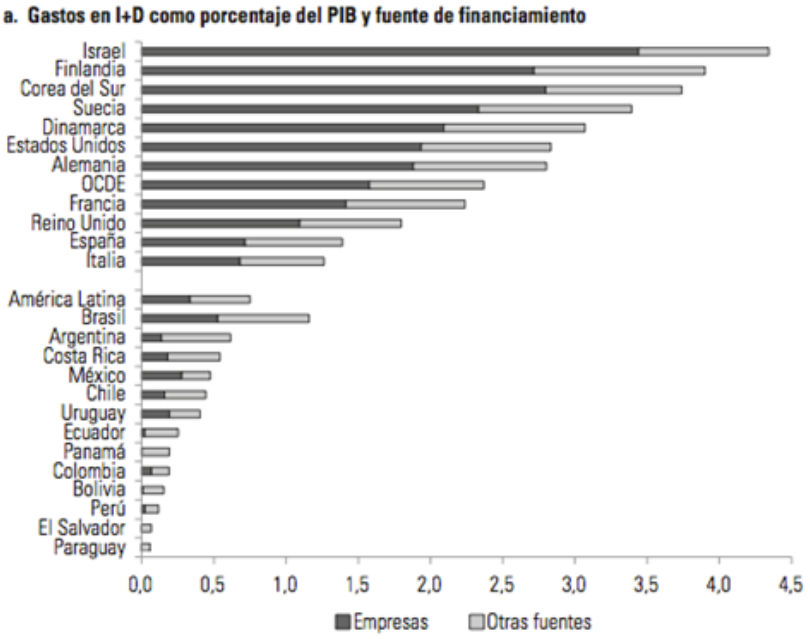


Source: ECLAC

Caribbean is systematically lower than the one of the developed countries and that the nations that have managed to converge with developed countries in the last 20 or 30 years are the ones that make a greater investment effort in innovation both from the public and the private sector. The IADB recalls that "the private sector finances a significant part of the effort in R&D. While business investment in R&D in the developed countries accounts for more than 60% of national investment, in Latin America and the Caribbean this figure is lower than 35%. These data suggest an important deficit in investment in R&D in the region, especially in the private sector".

The IADB concludes that "evidence suggests that Latin America and the Caribbean under-invest in innovation...It is clear that the business sector in Latin America and the Caribbean suffers a lack of investment in innovation beyond what could be expected given the region's financial development and accumulation of human capital".

Graphic 3.1: Innovation landscape in Latin America and the Caribbean



Source: RICYT

The region's commitment must focus on giving a strong boost to innovation not only as a public policy but also coordinated with the private sector. As Gabriel Sánchez Zinny points out (president of Kuepa, initiative to introduce new technologies in Latin American education) there is a need to promote "innovation and entrepreneurship by creating government agencies or public-private institutions that give venture capital to new projects. This is the case of Inadem in Mexico, Start-Up in Chile, based in Santiago, Innpulsa in Colombia. Public-private partnerships are fundamental in this area and will be the ones that eventually allow the much-needed boost to innovation so that Latin America progress towards its next stage of development".

DIVERSIFICATION OF EXPORTS AND MARKETS

The lack of diversification of the exported products as well as of the markets to which Latin America exports, is one of the historical problems of the region. An example case regarding the high concentration of export market is Mexico: 78% of its exports

go to the United States. An example case regarding the concentration of exported products is Venezuela (95% of its income comes from oil export). Even in Chile, country in which the share of products other than copper in exports increased between 1985 and 1997, since 1997, however, copper started to increase its weight due to the boom in the metal price (more than 40% of Chilean exports are linked to mining products). In 2003, exports based on natural resources accounted for 49% of the export basket of the region while a decade later the rate rises up to 60%.

Besides, exports to Asia account for almost 50% of the total while at the beginning of the last decade it amounted to barely 34%.

Regarding the export markets, China's emergence as the place towards which to direct exports, seemed to be in the last decade a solution for the diversification of the region in contrast to the traditional Latin American exports connection towards the United States. In ten years, trade between Latin America and China increased from US$ 15 billion to US$ 241.5 billion, with an average growth of 30%. Furthermore, Latin American exports to China are concentrated in a few products. Thus, soya represents around 53% of Argentine sales and 45% of the Uruguayan ones, according to ECLAC data. In Brazil, the concentration in iron reaches 45% of its sales and soya, 24%. Oil represents 94% of Ecuador's exports, 78% in Venezuela and 53.8% in Colombia. In Peru, the concentration in copper accounts for 38% of its exports and in Cuba, nickel represents the 71%. In total, 14 countries of the region target 75% of their total exports to China.

The map of Chilean exports

Source: Government of Chile

"It is time to seek product diversification, we cannot depend only on commodities"

This has therefore been another of the unfinished issues of the Golden Decade. The IADB points out that "in a ten-year perspective, the export basket of Latin America and the Caribbean is more concentrated on primary commodities and its derivates and therefore is more vulnerable to the weakening of those markets: in 2003, the exports of these products covered on average the 49% of the export basket of the region, while in 2013 the rate reached the 60%". Reports by ECLAC point out that export growth in Latin America has occurred in an intensive way but not in an extensive way and has therefore obtained meager results from its strategy of diversification of the exports on the basis of the free trade agreements. From 1990, all countries, except for Venezuela and Uruguay, at least doubled the actual value of their exports, at a 7% or higher rate.

Alicia Bárcena, Secretary General of ECLAC, indicates that "the key product diversification for closing wider gaps within society is still pending. If a wave of better prices arises, we must enable these profits to be invested in other forms of capital and not to be spent only in current expenditure. It is time to seek product diversification, we cannot depend only on commodities. The time has come to take this issue very seriously in order to reduce structural gaps; we must focus on investment".

4. CONCLUSIONS

Latin America is the region of the opportunities and the missed opportunities. A region that although it has progressed politically, economically and socially since its independence 200 years ago has not been able to reach the locomotive of development and modernization. It is a region where political democracy and freedoms prevail almost fully, but with signs of an institutional weakness in many countries. It is an area of the world where the economy has been strengthened since the 1990s and where there is a more balanced society thanks to the emergence of numerous and heterogeneous middle classes. But it is also a society and an economy which are still vulnerable to the changes in the international environment: the falls in the prices of commodities bring to light the weak spots of its economic structure and entail that wide social sectors might fall back into poverty. A reflection by João Pedro Brügger Martins, economist of the investment fund Leme, about Brazil sheds some light on the matter at a regional level: "there is the feeling that, once again, we missed the opportunities and did not take advantage of them, neither with the boom in the commodities prices nor with the World Cup, and the situation is not expected to change with the Olympic Games in Rio next year".

In the current juncture of change and volatility in the international

"Reforms that, to be effective, have to start from a broad political consensus"

economic environment, the region cannot miss a boat on which, for now, it has not even jumped. A boat that leads to the economic and social modernization and that, in order to get on board, requires facing important challenges which stem from the historical problems the region suffers, in the words of the OECD, and which it has not managed to solve neither in the good nor in the bad times: low productivity, "black beast" in words of Ángel Gurría, Secretary-General of the OECD (in two decades it only registered an increase of 1.6% as compared with the 3% of countries like South Korea); inequality, informal employment, which affects 47% of the workers; the low tax collection weakening the State and its institutions; and the lack of investment in infrastructure (2.5% of the GDP as against the 6% of Asian countries) which greatly increases export costs.

The effort that is now required involves boosting an ambitious comprehensive reform. A change that affects institutionalism, politics, society and economy. Reforms that, to be effective, have to start from a broad political consensus between all or the majority of political and social forces. This is essential for its success because it gives the reformist strategy stability and continuity and because it protects them in the face of a possible resistance that might arise to those changes. A resistance that is going to be very high due to the entrenchment of some social practices that are fomented by corruption and clientelism (an example for this is the protests and mobilizations against the educational reform promoted by Enrique Peña Nieto in Mexico).

From this basis, the basis of political-social consensus is from which profound and long-term reforms can be undertaken in order to improve institutional quality (a stronger State, not bigger, based on a suitable tax pressure for the public services citizens demand). Changes emphasizing on the diversification of their production structures and boosting innovation and knowledge, in order to try to be less dependent on commodities exports. Structural reforms that promote productivity and competitiveness since Latin American countries are playing in an increasingly competitive global market. Combating the current exports stagnation requires diversifying not only the local economy, but the markets to which products are sent in order to avoid possible shocks in sectors like the one oil is suffering now. The commitment must be to increasing the participation in global value chains in order to access to international flows of knowledge and technology. Furthermore, the diversification of export markets is very important: join traditional ones (U.S.A. and EU), not only emerging markets (Asia), and also promote interregional trade, which only represents 19% of the total trade. And

"Future is built from the present"

to achieve this it is crucial to invest in infrastructure and the construction industry, sectors which not only generate employment, but also create production chains.

Future is built from the present. Latin America is stronger politically, economically, socially and financially than 35 years ago. Besides, it has the capacity to jump on the bandwagon of modernity. Now we just need to have political will, strength and value to undertake the tough reforms needed to avoid the current stagnation. And in addition to all this, to square a very complex circle: "to do more with less" to have a more efficient spending.

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