PROMOTING PRODUCTIVITY FOR INCLUSIVE GROWTH IN LATIN AMERICA
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation’s statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

"Better Policies" Series

The Organisation for Economic Co-operation and Development (OECD) aims to promote better policies for better lives by providing a forum in which governments gather to share experiences and seek solutions to common problems. We work with our 34 members, key partners and over 100 countries to better understand what drives economic, social and environmental change in order to foster the well-being of people around the world. The OECD Better Policies Series provides an overview of the key challenges faced by individual countries and our main policy recommendations to address them. Drawing on the OECD’s expertise in comparing country experiences and identifying best practices, the Better Policies Series tailor the OECD’s policy advice to the specific and timely priorities of member and partner countries, focusing on how governments can make reform happen.

Photo credits: © Shutterstock.com
Foreword

The 21st century has so far seen Latin America make great strides in terms of social and economic development. Even after the global financial crisis struck, growth in the region held up rather well. The combination of relatively strong GDP growth and policy innovations to tackle poverty and inequality have delivered broad-based improvements in living standards.

Notwithstanding recent improvements, Latin America is still the region with the highest income inequality in the world. While unemployment in the region is relatively low – and its workers put in long hours – there is a very high incidence of informality, and the productivity gap with respect to more advanced economies is daunting. Even in Chile and Argentina, the best performing countries in the region, labour productivity is around one-third less than the OECD average. And as the external economic environment has recently become more challenging, underlying structural weaknesses in many of the region’s economies have become more visible, with some countries having experienced very low or even negative real GDP growth.

These twin challenges – large productivity and inclusion gaps – underline the imperative for urgent action. The challenge for governments in the region is to put their economies back on a stronger, fairer and more sustainable growth trajectory by undertaking the comprehensive structural reforms needed to accelerate productivity growth while improving social cohesion. The OECD has prepared this brochure to identify reform priorities in five policy areas key to addressing these twin challenges: human capital, labour market, business environment, innovation, and infrastructure. Focusing mainly on the more advanced countries in the region, it draws on successful initiatives and best practices from across the region and beyond.

Investing in education, skills and life-long learning will be key to both improving labour productivity and spreading economic opportunities. Bringing more firms and workers into the formal economy can improve pay and working conditions while helping to close the huge productivity gaps between SMEs and larger firms. Ensuring an open, competitive business climate will encourage trade and investment while supporting the efficient allocation of resources. Improving innovation frameworks can encourage the development and diffusion of new technologies. Likewise, investing in domestic and intra-regional transport and communication networks can help firms seize the opportunities of trade and technological change while improving social connectivity.

The OECD stands ready to work with the governments in Latin America to design, develop and deliver better policies for better lives across the region. We have just launched – in December 2015 – a new OECD Global Forum on Productivity to help countries work together more closely to formulate policies to boost productivity and share experiences. Mexico and Chile are already OECD members. Colombia and Costa Rica are engaged in the accession process, while Peru participates in an OECD country programme. Brazil is a Key Partner of the OECD, and we launched our first ever joint programme of work in 2015. In June 2016, we will further enhance our engagement with the region with the launch of our Latin America and Caribbean Regional Programme.

Angel Gurría
Secretary-General, OECD
Contents

Introduction ................................................................................................................................................... 1
Improving the human capital base ................................................................................................................ 5
Promoting high-quality jobs .......................................................................................................................... 7
Putting in place sound, open and competitive business environments ....................................................... 9
Strengthening innovation frameworks ....................................................................................................... 12
Connecting people and firms through better investment in infrastructure .............................................. 15
Bibliography ................................................................................................................................................. 18
1 Introduction

After a period of relatively robust growth that has allowed tens of millions of poorer households to join the global middle class, growth in Latin America has slowed recently, partly as a result of external factors. To close the still large gaps in living standards in relation to advanced economies, the region needs to significantly raise productivity growth while making sure that everybody has the opportunity to benefit from it. This will require comprehensive structural reforms, supported by a pro-productivity policy framework that incorporates social inclusion considerations from the outset.

Between 2000 and 2014, average GDP growth in Latin America and the Caribbean amounted to over 3% per year. Bucking global trends, income inequality also declined in many countries in the region during this period (Figure 1.1, Panel A), not least due to policy innovations like Brazil’s Bolsa Familia. The same applies to poverty. Extreme poverty fell from 29% to 16% in 2013, and moderate poverty from 17% to 14% over the same period. However, income inequality in the region (as measured by the Gini coefficient) remains 65% higher than in high-income countries, 36% higher than in East Asian countries, and 18% higher than in sub-Saharan Africa (UNDP, 2010).

More recently, the region as a whole has faced a barrage of external challenges as the commodity super-cycle ebbs, Chinese growth slows, and US monetary policy approaches normalisation. Notwithstanding intra-regional heterogeneity, convergence in living standards towards those in advanced countries has therefore slowed, or even gone into reverse in some countries. The region as a whole grew by only 1% in 2014, well below the 5% growth rates seen in the mid-2000s. It is expected to have contracted slightly in 2015 before expanding modestly in 2016, albeit at a rate below the OECD average. Moreover, the previously benign external environment had in many cases shielded countries from pressures to introduce the structural reforms, and make the investments necessary, as the bedrock of sustainable and inclusive prosperity. To cite just one example, individuals with fewer skills are often confined to operate in low-productivity, precarious jobs, frequently in the informal economy (Figure 1.1, Panel B).

Figure 1.1. Inequalities remain high in most Latin American countries

A. Gini coefficient from 0 (perfect equality) to 1 (perfect inequality)

B. Share of informal workers

Note: Gini coefficients refer to equivalised household disposable income, except for Argentina (per-capita income). Data for Costa Rica are preliminary. Informal workers are defined as workers not contributing to a mandatory pension scheme. Data refer to around 2013.

Sources: OECD/IDD, except for Brazil, Peru, Uruguay and Panama (LIS) and Argentina (SED/LAC (CEDLAS and The World Bank)); IDB Labour Markets and Social Security Information System (SIMS) based on household surveys.
In Latin America, as in most emerging-market economies, raising productivity growth is key to closing the large gap in living standards in relation to advanced economies, and thereby escaping the middle-income trap. Official statistics suggest that, on average, Latin Americans spend more time in work activities than the OECD average, but that this comparatively high contribution of labour resource utilisation to GDP per capita is more than offset by the huge gap in productivity levels (Figure 1.2, Panel A). A look at the average labour productivity performance over the past decade shows that in most cases, productivity has barely grown fast enough to keep pace with advanced economies, let alone to significantly close the gap (Figure 1.2, Panel B).

These twin challenges – of closing the inclusivity and productivity gaps – underscore the challenges that governments now face in addressing deep structural weaknesses that recent external headwinds have laid bare. When promoting productivity growth, policy makers need to embrace policies that focus on a more inclusive concept of productivity growth, one that enables all people and firms to fulfil and raise their productive potential so as to yield improved aggregate productivity growth as well as a more equitable share of the proceeds. This can set in motion a virtuous circle. The past has shown that technological advances, and the related innovations in processes and business models, do not automatically diffuse throughout an economy to yield broad-based and sustainable economic growth, nor will gains in well-being necessarily be broadly shared across regions, firms, and the population. Enhancing productivity for inclusive growth requires a more holistic approach that considers the interactions between well-being, inequalities and productivity.

A better use of existing skills among the population will help to increase efficiency and productivity in the near term, but a higher rate of productivity growth will prove difficult to sustain in the longer run without a massive improvement in educational attainments to raise skills levels (Section 2). Inequalities in access to quality education and opportunities to develop skills result in a massive waste of potential talent and contribute to the region’s very high degree of income inequality. This problem is reinforced by a low degree of income redistribution, which further entrenches inequalities. While taxes and transfers reduce inequality by 19 Gini points in Europe, for example, the difference is less than two Gini points in Latin America.

The potential for inclusive productivity gains associated with policy reforms may be largest among Latin America’s SMEs. Accounting for some 70% of employment in the region, SMEs generate only 30% of GDP, which is approximately half the OECD average. This reflects particularly large productivity gaps between large and small
enterprises. The share of exporting SMEs is also only half of that recorded in Eastern Europe, and one-third lower than in East Asia, suggesting significant scope for gains for SMEs from integrating into regional and global value chains. Yet, SMEs face some specific challenges regarding their ability to participate in international activities, especially in the areas of innovation, compliance with standards, skills and resources, or information gaps. SMEs are also more likely to operate in the informal sector. This is partly a result of regulatory and administrative burdens as well as, in some cases, heavy tax burdens. Informality perpetuates inefficiencies, as companies remain small to avoid these burdens (Section 3). It also breeds inequalities, as employees in the informal sector do not benefit from social security coverage.

Another factor contributing to poor productivity performance is the misallocation of resources – the trapping of labour and capital resources in low-productivity firms and sectors as well as the slow process of reallocation towards more dynamic ones. This prevents the most innovative and productive firms from reaching the necessary scale to operate in global markets and fulfilling the high growth potential that comes with the commercialisation of successful ideas. Symptoms of widespread resource misallocation in the region include the large size of the informal economy and the challenge firms face to recruit staff with the necessary skills as well as striking gender inequalities (Figure 1.3). Improving the efficiency of resource allocation will require lowering the barriers to market entry, firm growth and job creation in the formal economy. Boosting formal employment will also contribute to higher job quality, as formal jobs tend to be characterised by higher pay, lower job insecurity and better working conditions than jobs in the informal economy. Increasing job quality in the region is therefore an important objective, not only to increase workers’ well-being, but also to enhance their productivity (Section 3).

Productivity can also be enhanced by strong connections to external knowledge and technologies via trade, foreign direct investment (FDI), and participation in regional and global value chains (GVCs) as well as the international mobility of skilled labour. For instance, openness to trade and strong participation in GVCs has helped countries from Central and Eastern Europe to maintain high productivity growth and a steady pace of catch-up growth.

**Figure 1.3. Latin American Countries Suffer from an Inefficient Allocation of Resources**

A. Ratio of female to male labour-force participation rate

B. Share of firms identifying an inadequately educated workforce as a major constraint

Note: Data on the share of firms identifying an inadequately educated workforce as a major constraint refer to 2014 or the latest year available. LAC refers to Latin America and the Caribbean, MENA to Middle East and North Africa, EAP to East Asia and Pacific, SSA to Sub-Saharan Africa, SA to South Asia and EECA to Eastern Europe and Central Asia.

In the case of Latin America, the picture is more mixed, with Mexico and Chile being relatively well integrated into GVCs, while Argentina, Brazil and Colombia lag behind (Figure 1.4). Geographic factors such as the distance to large markets and the reliance on natural resource exports explain part of cross-country differences in trade intensity and GVC participation, but the latter are also influenced by regulatory barriers to foreign trade and investment, including in services, which tend to be relatively high in most Latin American countries. There is particular scope to boost intra-regional trade and value chains (Section 4).

To a large extent, the disappointing productivity performance of Latin America results from a poor return on investment in physical capital as well as under-investment in intangible assets (Daude and Fernández-Arias, 2010), in particular knowledge-based capital (KBC). One important element for boosting productivity is for national firms to vastly improve their ability to harness the forces of knowledge diffusion from firms operating at the frontier, essentially large multinationals. For this to happen, complementary investments in R&D, skills, organisational know-how (i.e. managerial quality) and other forms of KBC are needed (OECD, 2015a). Available data indicate that Latin American countries typically trail other emerging economies in R&D spending and other innovation-related investments, contributing to relatively weak innovation ecosystems. Strengthening the region’s innovation performance will require mobilising all actors and paying particular attention to SMEs (Section 5).

Insufficient transport and digital infrastructure also hamper the region’s integration into global value chains as well as broader social and economic development (Section 6). Transport and logistics costs remain high, with the strong preference for road transport preventing countries from exploiting the comparative advantages of different modes of transport. And measures of digital infrastructure development, such as broadband penetration, put the region well behind OECD countries and emerging economies in Asia. Not only do infrastructure gaps hold back potential growth, but they can also undermine social cohesion by restricting the dividends people can draw from their skills, efforts and experience. Investments are needed to improve intra-regional connectivity. Moreover, all countries could benefit from further improvements in their underlying governance framework for the planning, financing and operation of infrastructure projects.
Improving the human capital base

Broad access to quality education and training is essential for increasing social cohesion and boosting aggregate labor productivity. Developing the skills of young people and adults and preparing them for lifelong learning must therefore be a priority. While Latin American countries have made important progress over the past decade in improving the quality of skills, there is still significant room to do better. In all three subjects tested in the OECD’s Programme for International Student Assessment (PISA), the participating countries from Latin America rank in the bottom third of all countries. In addition, the region needs to reduce the wide disparities in people’s access to good-quality education and skills. National success requires that everyone has the potential to fully participate in society and share in prosperity.

Despite improvements in education outcomes, Latin American countries lag behind the OECD average. School enrolment remains low, both in secondary education (74%, 17 percentage points below the OECD average) and tertiary education (42%, 29 percentage points below the OECD average). The average school performance of 15-year-olds in Latin American countries is well below the OECD average, with a gap that is equivalent to almost two years of education. More than half of 15-year-old Latin American students do not acquire the basic level of competencies to perform well in the labour market, and less than 2% of them are “top performers” in mathematics, compared to the average of 13% in OECD countries. This skills gap remains a binding constraint for businesses in Latin America.

Average skills outcomes hide large dispersions within Latin American countries, where many people suffer from unequal access to good-quality education and skills. Student outcomes in Latin America are more dependent on socio-economic background than the average in OECD countries (Figure 2.1). In Brazil and Costa Rica, for example, children who belong to the bottom income quintile have almost 50% less likelihood to access secondary education than those from the uppermost quintile. Gender and spatial inequalities in the provision of and access to education also pose major challenges.

Latin American countries thus need to build stronger and more suitable skills through the education system and lifelong learning, especially for children and youth in lower-income households. Skills policies also need to focus on demand-side issues, strengthening the linkages between education and the labor market.
between education and the labour market, bolstering technical training programmes and providing guidance on skills needed in the labour market. A particularly important role is played here by the vocational education and training (VET) system, which should provide good foundation skills, be responsive to the needs of the labour market and have strong elements of work-based learning. Where possible, the social partners should be actively involved in developing VET programmes to make sure they are relevant to current labour market requirements. Countries also need to properly assess and anticipate skills needs, ensuring that this information feeds effectively into policies to reduce skills mismatch and shortage.

A number of initiatives have been launched in Latin American countries in recent years that go in the right direction. In Brazil, the Bolsa Escola school-allowance programme and the National Partnership to Strengthen Secondary Education (Pacto Nacional pelo Fortalecimento do Ensino Médio) aim at reducing regional inequalities in access and performance. In Colombia, conditional cash transfer programmes such as Familias en Acción and Estrategia de Cero a Siempre seek to improve the quality of early childhood programmes. In Mexico, Oportunidades, the cash transfer programme that began in 2002, has already helped to decrease poverty, encourage educational attainment and cushion income. Going forward, it is taking a positive step by completing the conditional transfers with a new programme, Prospera, which promotes active labour market policies to improve beneficiaries’ productive potential, through tools such as scholarships for college or technical college, priority listing in the National Employment Service for job-seekers and access to financial education, savings, insurance and credit.

Teachers’ policies have also been intensified as a key ingredient to boost performance. Brazil has implemented various training programmes for education staff, including the Profucionario programme, and the Peruvian government has recently introduced an incentive mechanism to recognise teachers’ performance. The improvement of assessment frameworks has also been a priority for some countries. One example is the 2012 Pact for Mexico (Pacto por México), which has promoted the independence of the National Evaluation Body (Instituto Nacional para la Evaluación de la Educación).

**Key recommendations**

- Build stronger and more suitable skills through the education system and adult training, with specific attention to lower income households.
- Increase investment in education to improve school infrastructure and the quality of instructional time.
- Promote stringent, transparent recruitment and evaluation procedures for teachers, along with attractive career paths and mobility mechanisms.
- Adopt cost-effective educational measures in the classroom and better feedback from the school principal to teachers.
- Strengthen the linkages between education, training and the labour market.
- Properly assess and anticipate skills needs, ensuring that this information feeds effectively into policies that reduce skills mismatch and shortage.
3 Promoting high-quality jobs

Good jobs are not only important for people’s well-being, they can also raise their productivity. Despite improvements over the past decades, many jobs in Latin American countries are still characterised by low pay, strenuous or hazardous working conditions and long working hours. This is particularly true for the large share of the labour force employed in the informal economy, outside the reach of regulation and without access to social protection.

Focusing exclusively on how many jobs an economy generates delivers a very partial picture of the situation, since workers’ well-being also depends crucially on the quality of their jobs. Moreover, through better access to opportunities for skills development, better health outcomes and higher workers’ commitment, better quality jobs can also contribute to higher productivity. This observation appears all the more important in the context of emerging markets, where the main issue is not the lack of jobs as such, but the shortage of quality jobs.

The quality of people’s jobs hinges to a large extent on their skill levels. Low-skilled workers are typically in jobs with lower earnings, longer hours, higher insecurity, poorer working conditions and poorer access to training. Data for six Latin American countries show that, on average, low-skilled workers earn one-third of what high-skilled workers do per hour of work, and face combined risks of job loss and extreme low pay that are almost four times higher. Workers in informal jobs — many of whom are low skilled — are particularly affected by poor job-quality (Figure 3.1). In these six Latin American countries, workers in informal jobs — who account on average for more than 1 in 3 workers — lack access to social protection and earn less than two-thirds of what workers in formal occupations earn. They also face a risk of extremely low pay that is nearly eight times higher than for formal workers.

To help workers get on a good career path early on, policy makers should consider making use of the range of available active labour market programmes, including training schemes and entrepreneurship incentives. Among the structural measures proposed, strengthening the education system, including vocational education and training, should be a priority (Section 2). Apprenticeships can also give workers a better start in their careers. The limited evidence available highlights the positive experience of some Latin American countries in this domain, notably Argentina and Mexico, where apprenticeship completion rates reach about 80%. The engagement of employers has also proved a crucial element for the success of apprenticeship schemes. In Brazil, Aprendiz Legal, an apprenticeship programme based on a legal requirement for firms to hire apprentices, has been successful in expanding the number of apprenticeships.

![Figure 3.1. Informal workers in Latin America have lower quality jobs](chart)

**Figure 3.1. Informal workers in Latin America have lower quality jobs**

OECD Job Quality Indicators, 2013

<table>
<thead>
<tr>
<th></th>
<th>Formal workers</th>
<th>Informal workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings quality</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insecurity from low-pay</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incidence of long working hours</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Earnings quality is a combination of average earnings and earnings inequality and insecurity from low pay is the probability of falling below a threshold of extreme low pay (see OECD Employment Outlook 2015, Chapter 5 for details). Figures represent country averages across six emerging economies in Latin America (Argentina, Brazil, Chile, Colombia, Costa Rica and Mexico). Figures represent 2013 values, except for Chile (2011) and Mexico (2012).

Source: OECD calculations based on national household and labour force surveys.

More generally, training schemes, job subsidies, entrepreneurship incentives, but also public work programmes, can promote job quality and productivity. In Latin America, specific work
schemes and training programmes exist that can complement apprenticeships. They include the BECATE programme in Mexico and the Joven programmes in Chile, Argentina and Colombia, which combine education, job training and internships. These programmes have generally been shown to have a positive impact on labour market formality.

In promoting access to quality jobs across socio-demographic groups, policy makers in Latin America should also place priority on measures that protect workers against the main labour-market risks they face and increase the quality of their working environment. These include improving social protection schemes and expanding their coverage, as well as enhancing safety standards and labour regulations. The key challenge is to strike the right balance between protection and work incentives. The introduction of a system of unemployment benefits based on individual savings accounts in Chile is a good example of reforms that aim to strengthen the link between benefits and individual incentives.

To promote productivity and improve the quality of jobs in the region, countries can provide better incentives for formal employment. To this end, governments should improve the quality of the public services they deliver. There is also a need to strengthen the link between contributions and benefits in social protection schemes, while ensuring adequate safety nets. Fiscal incentives may also play an important role in promoting formalisation. Simplified tax and administrative systems, streamlined registration processes and a reduction in red tape are important steps to lower the costs of formality for employers and the self-employed. Mexico’s new Regimen de Incorporation Fiscal includes incentives to join the formal sector, such as reduced personal, social security, value added and excise tax obligations in the initial decade of operation (Dougherty, 2015). Brazil also adopted a number of policy measures to reduce the costs of formality, such as the Simples Nacional that introduced a more progressive tax structure and simplified the collection of taxes and social security contributions. It is estimated that these measures contributed to the formalisation of 500 000 microenterprises accounting for 2 million jobs from 2000 to 2005 (Delgado et al., 2007). Finally, Colombia’s 2012 tax reform that reduced taxes and contributions (Parafiscales) on labour has had a positive impact on formal job creation.

Policy makers also need to enhance the effectiveness of labour laws (including health and safety rules) and working-time regulations, converging to international labour standards. Very often, employment protection legislation in emerging economies is strict in a legal sense, but poor enforcement renders the legislation ineffective. In many Latin American countries, the failure of employers to make legally mandated severance payments, for example, is an important issue. Moreover, labour inspection systems should be given sufficient resources to carry out their work effectively. The number of workers per labour inspector remains very high in countries like Colombia and Mexico (28 000 in Colombia and about 192 000 in Mexico) (OECD, 2015b). In Mexico, the 2012 labour law reform strengthened inspections and increased penalties for non-compliance. It also established mechanisms to expedite justice in labour disputes, and modernised the labour court system. Improved co-ordination among different government agencies is another necessary ingredient for success.

**Key recommendations**

- Expand access to and make greater use of active labour-market programmes and strengthen the education system.
- Provide incentives, which could include legal requirements, for firms’ engagement in active labour-market programmes.
- Increase workers’ job security and the quality of their working environment through better social protection schemes and enhanced safety standards and labour regulations.
- Improve the quality of public services and strengthen the link between contributions and benefits in social protection schemes.
- Simplify tax and administrative systems.
- Improve the enforcement of labour laws and regulations, including by equipping labour inspection systems with adequate resources.
Putting in place sound, open and competitive business environments

Making Latin America’s institutional framework and business climate more conducive to competition, trade and investment can help bridge the large gap in productivity levels in relation to the advanced economies. This could also help boost participation in regional and global value chains, allowing for more economic actors, and SMEs in particular, to share in the gains from trade. There is also scope for well-designed pro-competition product market reforms to improve social inclusion, directly by reducing the prices poorer people pay for basic goods, as well as indirectly through stronger economic growth that boosts the incomes of all households.

Global value chains (GVCs) have created opportunities to participate in international commerce without having to develop a complete product or value chain and to draw on knowledge of firms operating at the technological frontier, thereby learning by doing. Latin America has failed to fully seize these opportunities, however, with limited participation in GVCs. Intra-regional supply chain links are particularly weak with only 9% of foreign value added used for exports on average sourced from within the region, as compared to 49% for the European Union and 40% for Southeast Asia.

There are large differences in economic and geographic circumstances across the region, and individual Latin American countries play complementary roles in regional and global supply chains. Mexico and Costa Rica, and, in general, other Central American nations located in greater proximity to North American manufacturing hubs rely more extensively on foreign inputs coming predominantly from North America and increasingly from Asia, and specialise in processing them for further exports, mostly to North America. Importing for processing is less prevalent in Chile and much less in Argentina, Brazil and Colombia. These countries, along with others in South America, tend to specialise more strongly in exporting natural resource-based intermediates which are processed abroad, increasingly in Asia. In fact, the share of foreign inputs from China used in Latin American value chains increased by a factor of ten times between 2000 and 2011, while the share of Latin American inputs into Chinese value chains increased three times, demonstrating the dynamic growth in extra-regional value chains.
Maximising opportunities for productivity-enhancing growth through better linking into GVCs requires an enabling business and regulatory environment, access to high-quality manufacturing and service sector inputs, as well as adequate human capital and infrastructure (Sections 2 and 6). This complementarity and the fact that regional trade tends to be more diversified and settled, suggest that further regional integration holds promise. For example, there are already 68 preferential trade agreements (PTAs) involving at least one Latin American country, while 32 of these are intra-regional. This complicated regional web of PTAs could be usefully consolidated and harmonised in order to reduce overlap, duplication and conflicts of different rules and technical standards. The Pacific Alliance is a notable initiative in this regard. The OECD’s Services Trade Restrictive Index (STRI) – which covers Brazil, Chile, Colombia, and Mexico – suggests that some countries in the region would benefit from converging towards best practice by further liberalising their services sectors, and by prioritising those sectors like transport, telecommunications and courier services which are crucial to participation in GVCs. Already, Colombia is among the best performers in this regard, having the least restrictions in 5 of the 18 sectors measured, and below average in 17.

Reducing barriers to international trade would contribute to stronger productivity because competition with foreign suppliers would encourage firms to become more efficient. Improvements in the areas of trade facilitation and logistics performance, the quality of infrastructure and institutions, intellectual property protection, workforce development and the creation of an efficient services sector and innovation-friendly business environment would also support GVC integration.

Foreign direct investment is another important dimension of GVC integration. Overall, Latin America has enjoyed high levels of FDI growth, but it has been highly concentrated in natural resource sectors and is therefore sensitive to commodity cycles. The steep decline in commodity prices has significantly affected investments into many resource-rich countries: after years of sustained growth, FDI flows to Latin America contracted by 16% in 2014, greater than the 7% global contraction. The diversification and sophistication of FDI is thus a pressing priority in the region. FDI could also have a significant developmental component to the extent that it supports the integration of SMEs into GVCs and establishes R&D facilities. Although Latin American countries are generally open to FDI, the OECD FDI Regulatory Restrictiveness Index suggests that there is also scope for liberalising policies further in some markets, such as Mexico and Brazil, particularly in services sectors like transport. Some countries, such as Chile, are also developing investment promotion strategies. These can help attract FDI, but they require policy coherence, transparency and rigorous programme evaluation.

Strengthening the competition framework can drive productivity while supporting social inclusion by reducing the price of basic goods for households. Fostering competition in product markets such as telecommunications, food and the retail sectors will boost productivity by improving the efficiency of resource allocation. Pro-competition reforms may include, for instance, removing or redesigning regulations or other forms of state intervention unnecessarily restricting competition, especially those that make things harder for new market entrants. Such product market regulations tend to be more restrictive in Latin America than is typically
the case in OECD countries (Figure 4.1). Insofar as it is mainly young firms that bring growth in jobs and employment, regulatory and other forms of obstacles to new firm entry are particularly damaging to growth prospects. Furthermore, by limiting product market competition, high barriers to entry also weaken incentives among incumbents to invest in innovative products and services. There are signs of progress, however, and countries such as Mexico are opening up some of their network industries to FDI so as to boost productivity and lower prices. The scope for such competition-enhancing measures to improve social inclusion outcomes is illustrated, for example, by an OECD study on Mexico that shows the relative negative effect of monopoly power is greatest among poor households (Urzúa, 2013).

Vested interests in the status quo can unduly influence or capture policy making in order to oppose these reforms to maintain their rents. Indeed, some of costs can be the result of a conscious design to create rents by capturing regulations and policies. The problem is compounded by the historically high inequality and concentration of political and economic power in Latin American countries. In comparison to OECD economies, firms in Latin America disproportionately consider corruption and the court system as a major constraint in doing business (Dougherty, 2014). In turn, real or perceived corruption has, among others, measurable effects on productivity, international trade and FDI (Lambsdorff, 2006). This underlines the urgent need for action to improve public sector integrity and minimise corruption risks.

Key recommendations

- Consolidate and harmonise intra-regional preferential trade agreements (PTAs) and support global initiatives for trade liberalisation.
- Prioritise the further liberalisation of FDI in sectors – notably services sectors like transport – crucial to participation in GVCs.
- Consider coherent and transparent investment promotion strategies that aim to attract high-quality and diversified foreign investment.
- Reduce barriers to entrepreneurship, trade and investment to foster competition.
- Take action to strengthen the rule of law and to stamp out public and private sector corruption.
Strengthening innovation frameworks

Latin American countries lag behind in terms of their innovation performance, not only in relation to OECD countries, but also in relation to emerging countries in other regions. Making progress will require improvements in the framework conditions and more effective research and innovation policies, including stronger co-operation between business and research institutions, a comprehensive digital agenda to seize the potential benefits of technology, strengthening the necessary skills for innovation, and better co-ordinated governance.

Latin America invests less in research and development (R&D) and other forms of innovation than OECD countries. Brazil is the only Latin American country that spends more than 1% of GDP on R&D (Figure 5.1), with about half of that coming from the business sector. In addition, patent registrations are relatively low in the region. On average, OECD countries registered 50 patents per year per million inhabitants in the early 1990s and by the early 2010s this number had risen to 132. In contrast, in Latin American countries, patents per year per million inhabitants were only 0.3 in the early 1990s and 0.9 by the early 2010s.

Strengthening the region’s innovation performance will require a co-ordinated and inclusive approach that mobilises all actors and pays particular attention to the creation of new firms and the needs of SMEs, whose productivity and innovation gaps with regard to large firms are larger on average than in OECD countries. Support for business innovation should be well balanced and not rely only on tax incentives. Well-designed, competitive grants need to complement tax incentives and are better suited to the needs of young innovative firms. Strong commitment and sufficient capacities to monitor and evaluate policies to foster innovation will also be crucial, together with appropriate structures to ensure that the lessons learned from experience translate into more efficient government actions.

Well-designed programmes that upgrade productivity in traditional sectors have been found to be particularly useful to support innovation. Examples include virtual training programmes, innovation and training subsidies, digitalisation and e-commerce programmes, rapid enterprise diagnostic assessments which analyse strengths and weaknesses through online self-assessment tools or face-to-face interviews with business support managers, and programmes specifically conceived for informal enterprises. In Chile, the PROFO (Proyectos Asociativos de Fomento) programme aims to improve the technical, financial, and managerial capabilities of SMEs. Several programme evaluations have shown a positive impact in terms of adding value to products and growth in the productivity of participating SMEs (Cortes-Lobos, 2013).

Examples include virtual training programmes, innovation and training subsidies, digitalisation and e-commerce programmes, rapid enterprise diagnostic assessments which analyse strengths and weaknesses through online self-assessment tools or face-to-face interviews with business support managers, and programmes specifically conceived for informal enterprises. In Chile, the PROFO (Proyectos Asociativos de Fomento) programme aims to improve the technical, financial, and managerial capabilities of SMEs. Several programme evaluations have shown a positive impact in terms of adding value to products and growth in the productivity of participating SMEs (Cortes-Lobos, 2013).
Measures to boost SMEs’ participation in innovation also include enhancing access to financial resources for innovation-oriented SMEs, facilitating knowledge and technology flows between research institutions and small entrepreneurs, investing in knowledge and technology infrastructure for SMEs (Sections 2 and 6), and fostering the use of public research outcomes among small businesses. In Chile, the National Corporation for Industrial Development (CORFO) has improved technology transfer programmes for SMEs by identifying international best practices in technology adoption, fostering partnerships with research institutes and SMEs, and promoting technology adoption in SMEs. In Colombia, through the Fund for the modernisation and innovation of micro, small and medium-sized enterprises (MSMEs) (*INnpulsa Mipymes*), the government supports small businesses in meeting supply chain requirements and developing innovative products and services to enter new markets.

Inclusive innovation policies can also support lower-income and excluded groups by meeting their needs at an affordable cost and by providing new education and work opportunities. Argentina offers up to 30 000 scholarships a year for tertiary education for low-income students through its two programmes (*Becas Bicentenario* and *Becas TICs*), which aim to increase participation in scientific studies. Colombia has recently launched a similar programme (*Ser Pilo Paga*) offering 10 000 scholarships for low-income students to pursue undergraduate studies. In Panama, the National Secretary for Science, Technology and Innovation (SENACYT) manages *Infoplazas*. These are structured as community centres, and provide public access to the Internet and to e-learning platforms, as well as training in information and communication technologies. *Infoplazas* also help to reduce the digital gap and to address social exclusion and territorial inequality (OECD, 2015c).

Several Latin American countries already use innovation policy to leverage innovation in
support of inclusive growth. For example, Colombia’s National Development Plan for 2010-14 emphasised the role of innovation as a tool to “align its economic development to its social development”, notably by providing incentives for and removing barriers to inclusive innovation (OECD, 2015d). One such initiative is Ideas para el Cambio, an open call for ideas issued to the scientific innovation community to solve priority challenges faced by disadvantaged communities. Chile has also developed a cross-cutting initiative to encourage policy discussion around the subject and provides funding for inclusive innovations. The National Institute for Entrepreneurs in Mexico (INADEM) is promoting women’s entrepreneurship and financial inclusion for start-ups and MSMEs. Efforts to strengthen participation in innovative activities by a wide range of economic actors are also crucial at the regional level. One example of such policies is the use of intellectual property to support the innovation capabilities of lagging sectors of the economy, such as traditional and informal sectors (OECD, 2014a).

A more inclusive approach to innovation that can help empower SMEs and lagging regions will also require good governance to align the various policies that are needed for innovation (OECD, 2013b; OECD, 2015e). While in most of the region progress has been made in institution building and in co-ordination among agencies, a long road still lies ahead to consolidate that progress (OECD/CAF/ECLAC, 2014). Promoting innovation requires co-ordination of different actors at national, regional and local levels, as well as across different ministries and agencies, especially between agencies in charge of innovation and those in charge of industrial and production development policies. In addition, consultations with the private sector are needed to facilitate implementation. Many countries in Latin America have started to create competitiveness or innovation councils where different actors convey their priorities so as to shape a shared agenda, such as in Colombia, Costa Rica, and more recently Chile, with the National Productivity Commission that was founded last year (Banks, 2015). It is also crucial to work towards a clear agenda for implementation, starting for example by addressing a specific challenge and working out a plan and the associated resources. A good example is Costa Rica’s Presidential Council for Competitiveness and Innovation as well as the country’s skills upgrading agenda.

Key recommendations

- Encourage business investment in R&D and other knowledge assets through a balanced and well-designed mix of direct and indirect support measures that do not disadvantage young, innovative firms.
- Increase the effectiveness of public investment in research and innovation by enhancing knowledge flows between research institutions and firms.
- Improve the framework conditions for innovation and entrepreneurship, in co-ordination with programmes to sustain upgrading in domestic manufacturing and service delivery.
- Design programmes that have sufficiently broad reach and low per-enterprise cost to enhance productivity in SMEs in traditional sectors.
- Further consider the development of more inclusive innovation policies that would enable women, small entrepreneurs, poorer households and indigenous populations to seize the opportunities of new technologies.
Connecting people and firms through better investment in infrastructure

High-quality infrastructure is key to both raising productivity levels and improving social inclusion. Physical and digital connectivity facilitates social interactions and labour mobility, allowing people to draw higher dividends from their skills, efforts and experiences. Such connectivity, as well as improved logistics performance, are also critical to underpin trade in goods and services across value chains, and thereby to spread economic benefits from trade. Despite significant progress in recent decades, the quantity and quality of infrastructure in Latin American countries is still a barrier to inclusive growth.

Latin America has made great strides in providing basic access to services in some dimensions, such as water supply and electricity. However, the region ranks relatively low in several international infrastructure indicators, such as the Global Competitiveness rankings (WEF, 2015). The perceived quality of overall infrastructure ranks Latin America for the period 2015-16 at 3.3 points on a scale of 1-7 (where a higher score means better quality of infrastructure). That is well below the OECD average (5.3 points) and average for emerging Asian economies (4.7 points).

Weak transport links in particular are an impediment to productivity growth and social inclusion in the region (OECD/CAF/ECLAC, 2013). The quality of road transport lags behind the standards of typical middle-income countries. Moreover, the strong preference for road transport over other modes (the concentration of road transport in Latin America is 15 times greater than in the United States, for example), prevents the region’s move to a greener growth model, and increases logistics costs by hampering the development of co-modal transport options. This reduces countries’ competitiveness and their participation in national, regional and global value chains. Logistics costs in the region represent 18-35% of a product’s value, compared to around 8% in OECD countries.

The quality of ports is low in Latin America and their size small, while the absence of exclusive freight carriers often creates logistical difficulties and impedes the exports of perishable goods. Moreover, rail transport is concentrated exclusively on bulk trade. Addressing these “behind-the-border” constraints thus requires the same or greater policy attention as the free-trade agreements that many countries in the region have been pursuing. Over the 2012-14 period, the ratio of freight costs to tariffs was approximately 9, compared to an average ratio of less than 3 in the OECD (OECD/CAF/ECLAC, 2015).
Similarly, to take advantage of some recent regional integration initiatives, such as the Pacific Alliance, there is a need to increase connectivity among Latin American economies. At the same time, investing in public transport systems could help reduce urban congestion and greenhouse gas emissions while increasing rural connectivity, thereby improving well-being and contributing to a reduction in spatial inequalities. By improving access to labour markets and to opportunities for education and training, better public transport could also have a positive twin impact on both labour productivity and social inclusion.

But gaps in digital infrastructure are also striking. In 2013, the average penetration in Latin America was 35% for mobile and 9% for fixed broadband, compared to the OECD average of 72% for mobile and 28% for fixed broadband (Figure 6.1). Having sufficient quantity and quality of digital infrastructure – such as broadband, Internet addresses and data – is key to integrating into global value chains and to harnessing the next production revolution. Moreover, advances in connectivity and telecommunications infrastructure also help improve social inclusion. Social media, for example, allows governments to communicate more effectively with citizens and, at the same time, digital tools (e.g. online petitions, mobile applications) allow citizens to participate more actively in government. Digital technologies have also encouraged the development of massive open online courses, which provide enhanced access to educational and training opportunities. Colombia has defined the development of domestic content and applications serving the need of low-income groups in its Vive Digital Strategy 2014-18 and Bolivia has incorporated the promotion of local content development as a key objective of its national telecommunication programme for social inclusion.

Latin America’s infrastructure gaps can be closed through more and better investment. Total infrastructure investment in the region amounts to less than 3.5% of GDP. To meet medium-term infrastructure needs, this would need to be increased to about 6.2%, and achieving an infrastructure stock of Asian countries like Korea and Malaysia would require significantly more (Perrotti and Sánchez, 2011; ECLAC, 2014). This will require greater public-sector investment, potentially backed by initiatives such as earmarking royalties from commodity production, as in Colombia (OECD, 2013c), or designing fiscal rules so as to shift the balance of the government budget towards investment, as in Peru (Carranza, Daude and Melguizo, 2013). Private sector investment, both domestic and foreign, also has a key role to play. Chinese financing has already become an important source of infrastructure financing in some countries of the region, and is expected to play a bigger role in the coming decades (OECD/CAF/ECLAC, 2015).

There are also governance challenges around infrastructure investment. First, aligning infrastructure investments requires a more cross-
sectoral and strategic approach to planning investment. Governments in Latin America have trouble putting together well-integrated strategies to guide investment because of sectoral silos and poor co-ordination across levels of government. Second, delivering projects on time and on budget requires increased government capacity at all stages, from project design and approval to execution. Strengthened frameworks to ensure good corporate governance of state-owned enterprises, which play a key role in sectors such as energy and transport in most Latin American countries, are also needed. Further efforts are needed to improve the policy framework for infrastructure investment, such as improvements in value-for-money analysis, in the preliminary phases of concession contracts, and in designing the fiscal accounting system so that it does not inappropriately favour concessions over public projects (OECD, 2015f). More should be done to avoid unexpected fiscal costs of Public-Private Partnerships (PPPs). Of the 61 highway concessions signed up to 2010 in Colombia, Chile and Peru for example, 50 have been renegotiated at least once, resulting in more than 540 renegotiations in total (Bitran, Nieto-Parra and Robledo, 2013). Some countries in the region have already updated their PPP and concession laws and set up new PPP agencies or specialised units within existing institutions (e.g. Chile, Colombia, El Salvador, Mexico and Peru). This should help better mobilise private sector investment.

Other policy initiatives that could reduce transport costs by making the most of existing infrastructure include introducing an integrated logistics policy, providing modern storage facilities, making customs and certification procedures more efficient, using ICT for logistics, and promoting competition in the transport sector (OECD/CAF/ECLAC, 2013).

Key recommendations

- Increase investment in transport infrastructure to improve connectivity, giving priority to co-modal transport options.
- Prioritise investment in digital infrastructure, especially broadband and data, and promote data sharing and reuse.
- Strengthen governance mechanisms in integrated infrastructure investment planning, co-ordination across sectors and levels of government, identification of realistic delivery modalities and timeframes.
- Strengthen the transparency and integrity of frameworks for infrastructure investment.
- Increase the efficiency and effectiveness of the preliminary phases of PPP contracts through value-for-money analysis and the streamlining of the grant process for land, environmental and social licenses.
Bibliography


LIS (Luxembourg Income Study Database), www.lisdatacenter.org/our-data/lis-database/.


SEDAC (Socio-Economic Database for Latin America and the Caribbean [CEDLAS and The World Bank]), http://sedlac.econo.unlp.edu.ar/eng/.


PROMOTING PRODUCTIVITY FOR INCLUSIVE GROWTH IN LATIN AMERICA