



# *New institutions for development* A view on Latin America

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*Rethinking Development in a world in Transitions*

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## *Institutions and development in transition*

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- Despite strong income growth, reduction of extreme poverty and achievement of middle or high-income status, many developing countries still face major challenges in terms of development outcomes (vulnerability, inequalities across people and places, environment)
- GDP alone fails to capture “development” and correlation between income level and people’s well-being outcomes is not univocal. Transitioning to higher income status does not necessarily means achieving lasting development.
- Domestic capacities & institutions (including design, implementation and evaluation of public policies) underpin many of the structural gaps and development traps developing countries face. Better revenue collection and public expenditure is key.
- International cooperation and global governance (multilateralism) can help address those shortcoming
- Both domestic institutions and international cooperation (and the economic analysis underpinning them) need to be adjusted/rethought, also in light of evolving nature of globalization, technological change, climate change and demography.



# Regional Y disparities (forthcoming LEO19)

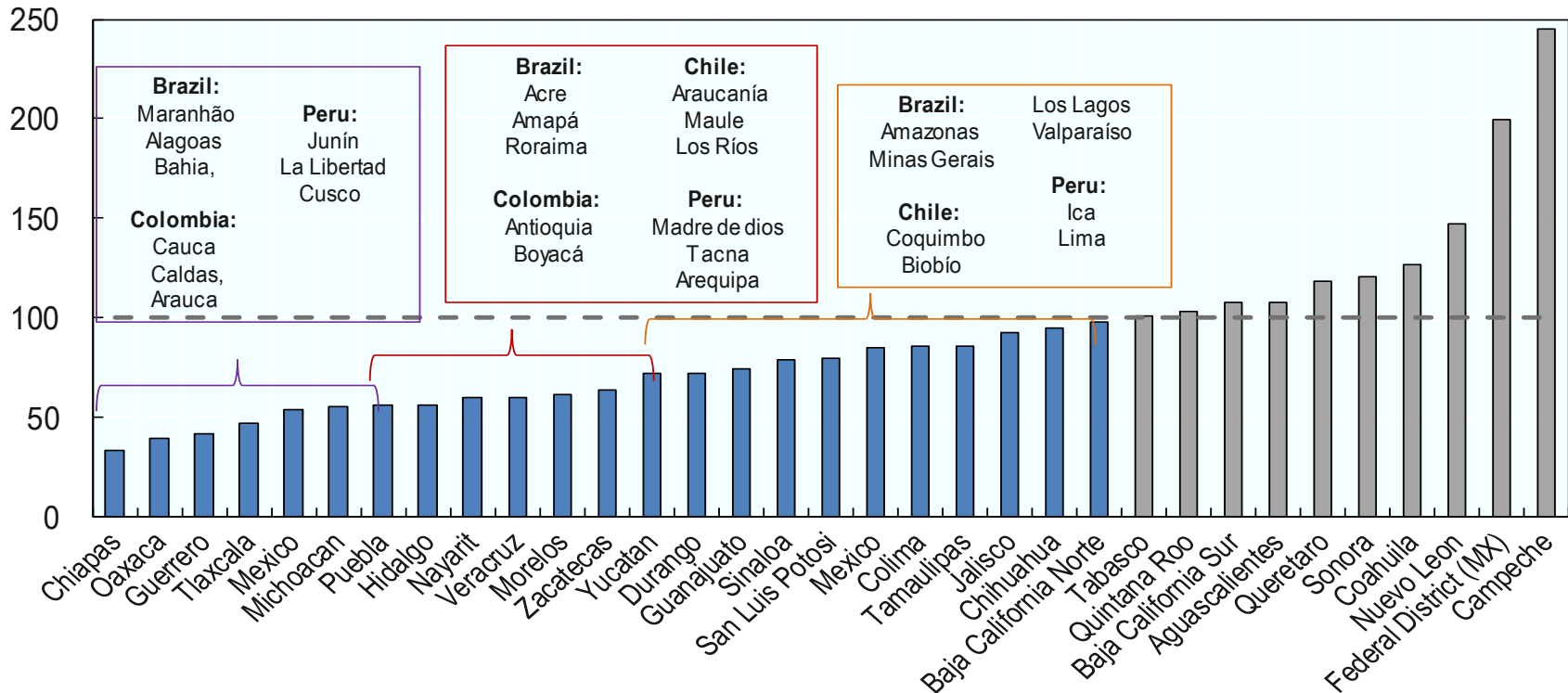


- Mexico will be a high income country in 2030;
- Chiapas will be in 2060 and CDMX did so 13 years ago

Standardized per capita GNI of provinces in Mexico, 2016

100 = high income

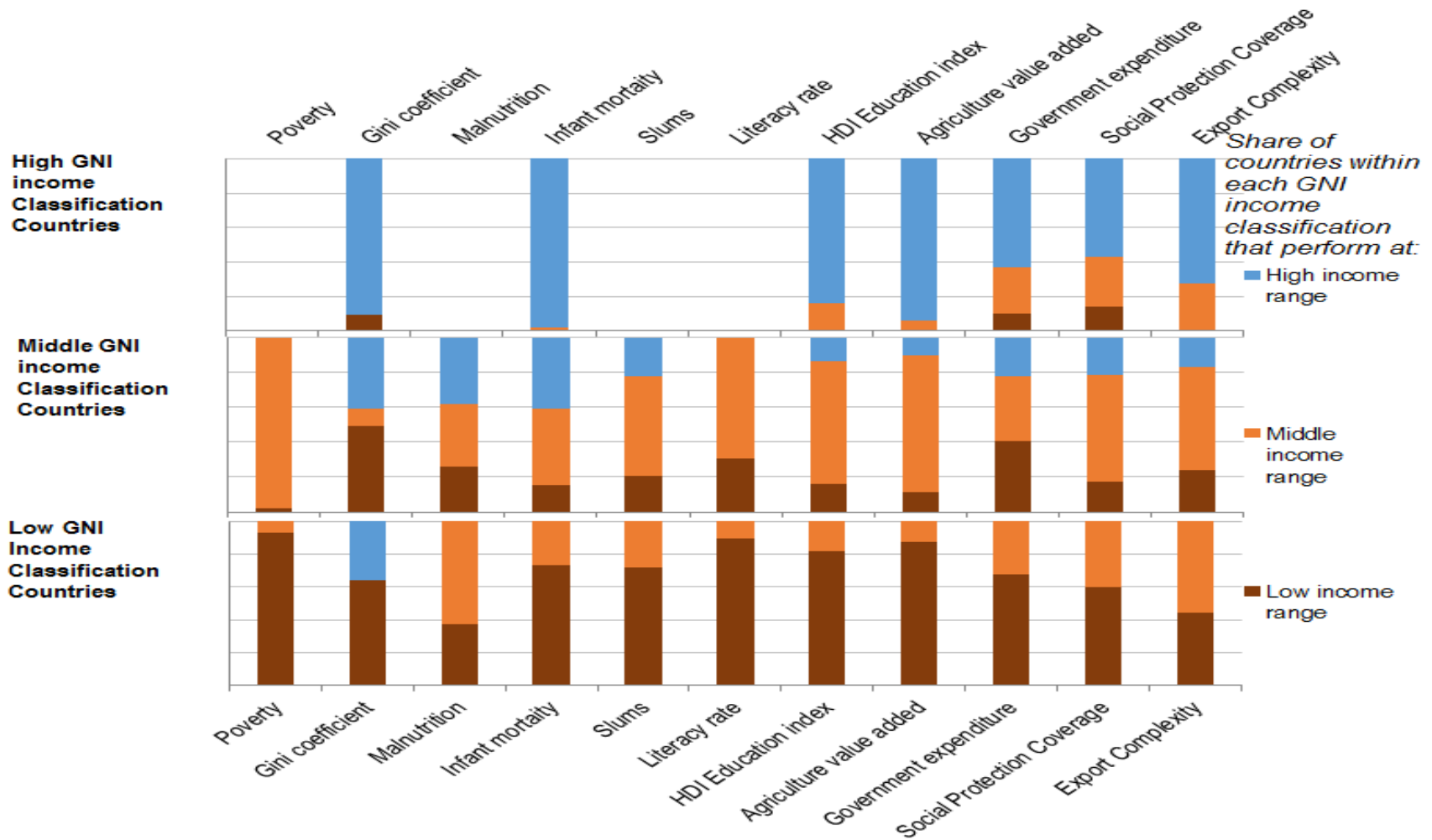
Paraguay/ Namibia ----- Malaysia/ Romania ----- Portugal /Korea



Source: OECD (forthcoming).



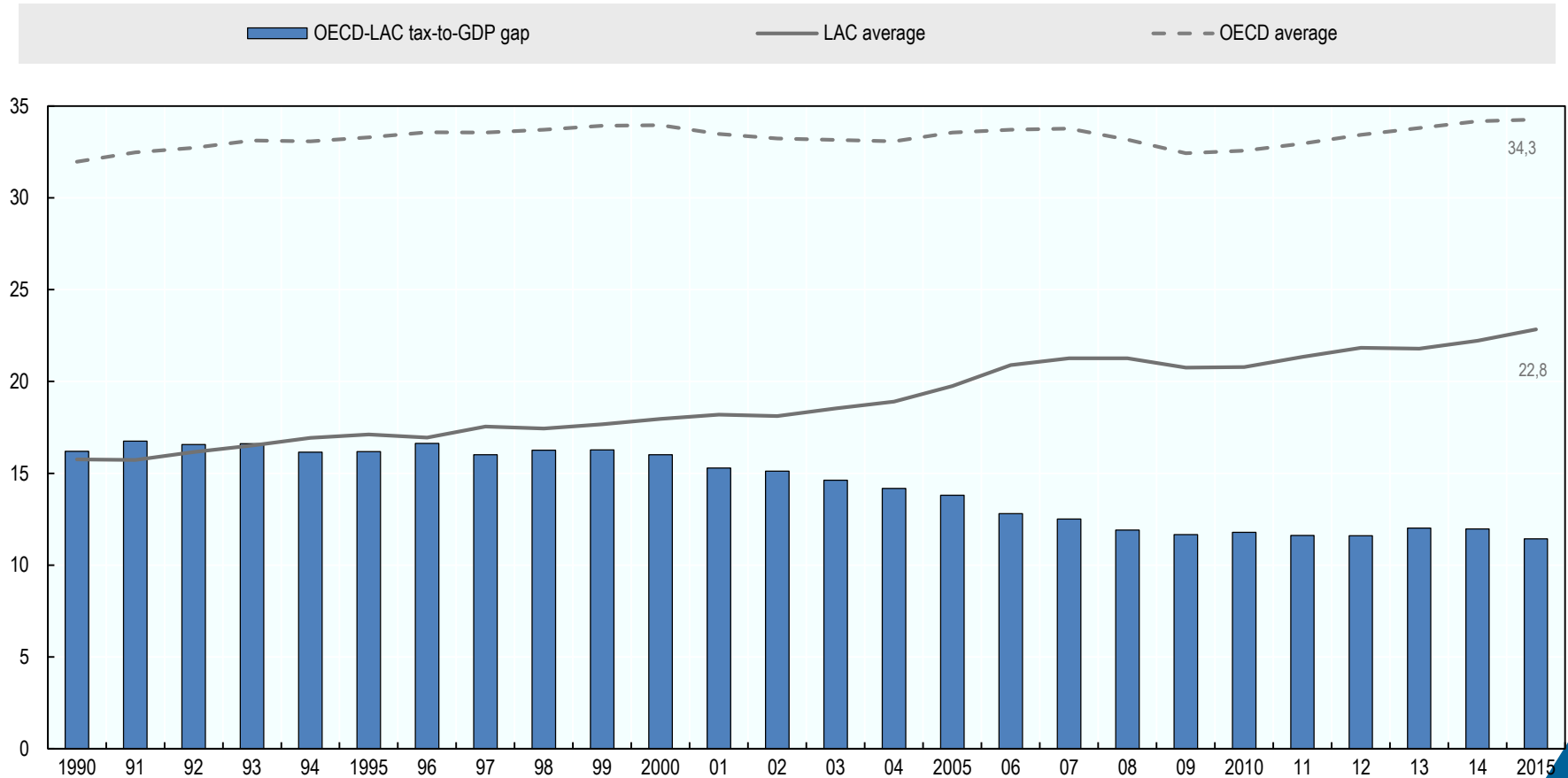
# Countries across income groups share development challenges





# Enabling states: efficient and effective states require strengthening capacities

## Tax revenue in LAC (% GDP)



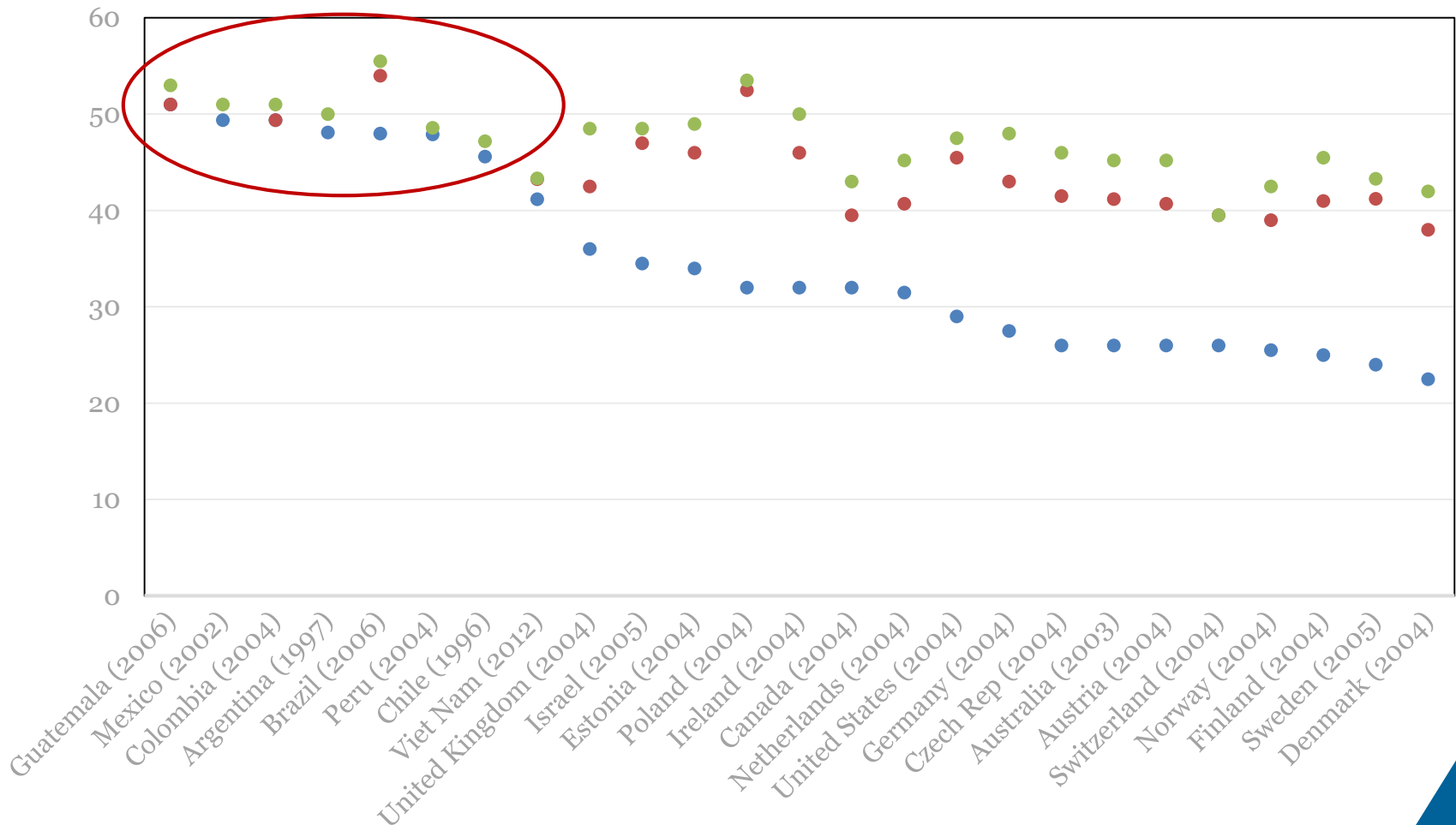
Source: OECD/ECLAC/CIAT/IDB (2017), Revenue Statistics in Latin America and the Caribbean



# Income inequality before and after taxes

Measuring income inequality before and after taxes and public transfers is a simple way to assess the extent to which fiscal policy play a redistributive role and can reduce income inequality.

● Inequality after taxes and transfers ● Inequality after taxes (and before transfers) ● Inequality before taxes and transfers





# *Institutions and development: Definitions & theory*

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Douglass North:

- Institutions are made up of formal rules, informal norms and the enforcement characteristics of both and it is the admixture of rules, norms, and enforcement characteristics that determines economic performance.
- While the formal rules can be changed overnight, the informal norms change only gradually.
- Institutions are formed to reduce uncertainty in human exchange. They provide the “rules of the game”. They shape incentives in political, social, economic human exchange.
- In a world of instrumental rationality institutions are unnecessary.

*“If we accept values as given and constant, if we postulate an objective description of the world as it really is, and if we assume that the decision maker's computational powers are unlimited then two important consequences follow. First we do not need to distinguish between the real world and the decision maker's perception of it: he or she perceives the world as it really is. Second we can predict the choices that will be made by a rational decision maker entirely from our knowledge of the real world and without a knowledge of the decision maker's perceptions or modes of calculation (we do, of course, have to know his or her utility function)” -- Herbert Simon (1986)*

- But we live in a world of incomplete information and limited mental capacity



## *Institutions and development: Definitions & theory*

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- Large literature on the role of **institutions and governance** for growth and development outcomes (Kaufmann et al.; Acemoglu et al).
- Empirically tricky to **ascertain whether institutions drive development** or whether more developed countries can afford better institutions or whether other factors (geography?) explain both.
- Evidence suggests governance problems are widespread: rule of law; state capture; corruption; policy design, implementation, evaluation.
- Policy prescription: better governance / institutions needed for development. (e.g. early 2000s: good governance needed to make aid work)
- But what are «good institutions»? And can they be transferred?
  - One size fits all? Normatively weak but functionally strong institutions (e.g. Ang)
  - Isomorphic mimicry: building institutions and processes in weak states that look like those found in functional states (Pritchett et al.)





## *Our view on institutions in Latin America: facing the development traps*

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- A common feature across Latin America and the Caribbean (LAC) in recent years is the **growing disconnect between society and public institutions**
- The growing dissatisfaction has been largely driven by the rise of the **middle class**, which has boosted aspirations
- The disconnect between society and institutions is also driven by persistent **low growth and high inequality**, and by the uncertain domestic and global context (new challenges).
- The **social contract** is weakening in LAC owing to the decline of trust in public institutions and the rising dissatisfaction with public services
- LAC can largely benefit from rethinking its institutions, building a **renewed state-citizens-markets nexus** to achieve stronger & more inclusive growth, develop links with society and meet citizens' aspirations.



# *Rethinking institutions in Latin America*

## *(Based on LEO 2018)*

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- **Why?** Deteriorating the social contract and well-being; emerging challenges from technological change and new globalisation (impact on jobs); combined could fuel rise of populism and further worsen citizens' prospects.
- **Focus (formal institutions):**
  - **Policies** (plans or actions to achieve an objective)
  - **Organisations** (structures where people implement those actions)
  - [High level rules and frameworks (rules/norms that govern adoption or change of policies and organisations)]
- **New institutions for what?** Take advantage of new opportunities; protect vs emerging risks; build a new model that delivers more inclusive growth and sustainable development.
- **Citizens' view:** jobs & income; quality of public goods & services; integrity & corruption.



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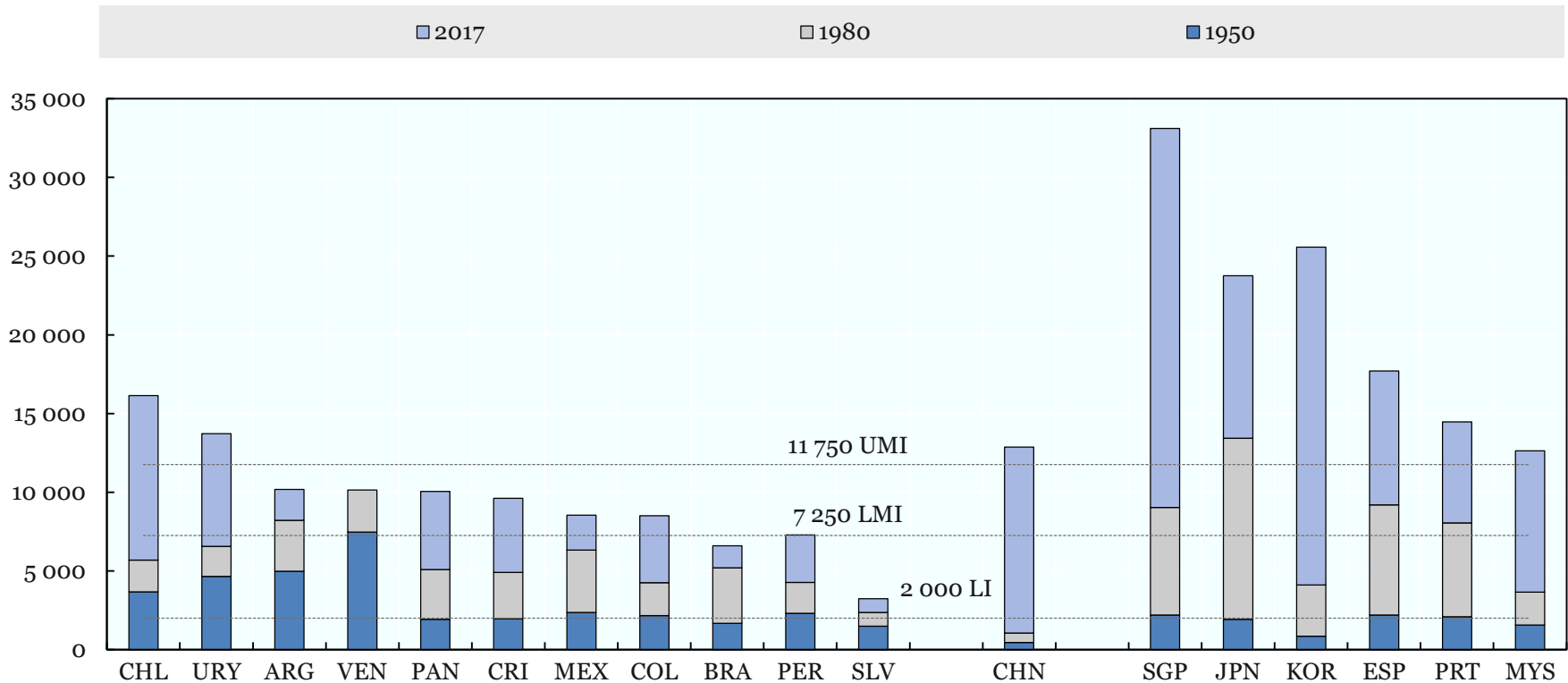


- **The role of institutions for inclusive growth in LAC**
- Institutions and outcomes in LAC
- Rethinking institutions in a *development in transition* LAC



# Latin America is facing the so-called *middle-income trap*, due to low productivity growth / lack of structural change

GDP per capita in Latin America, selected OECD economies and Asia  
(USD PPP 1990)



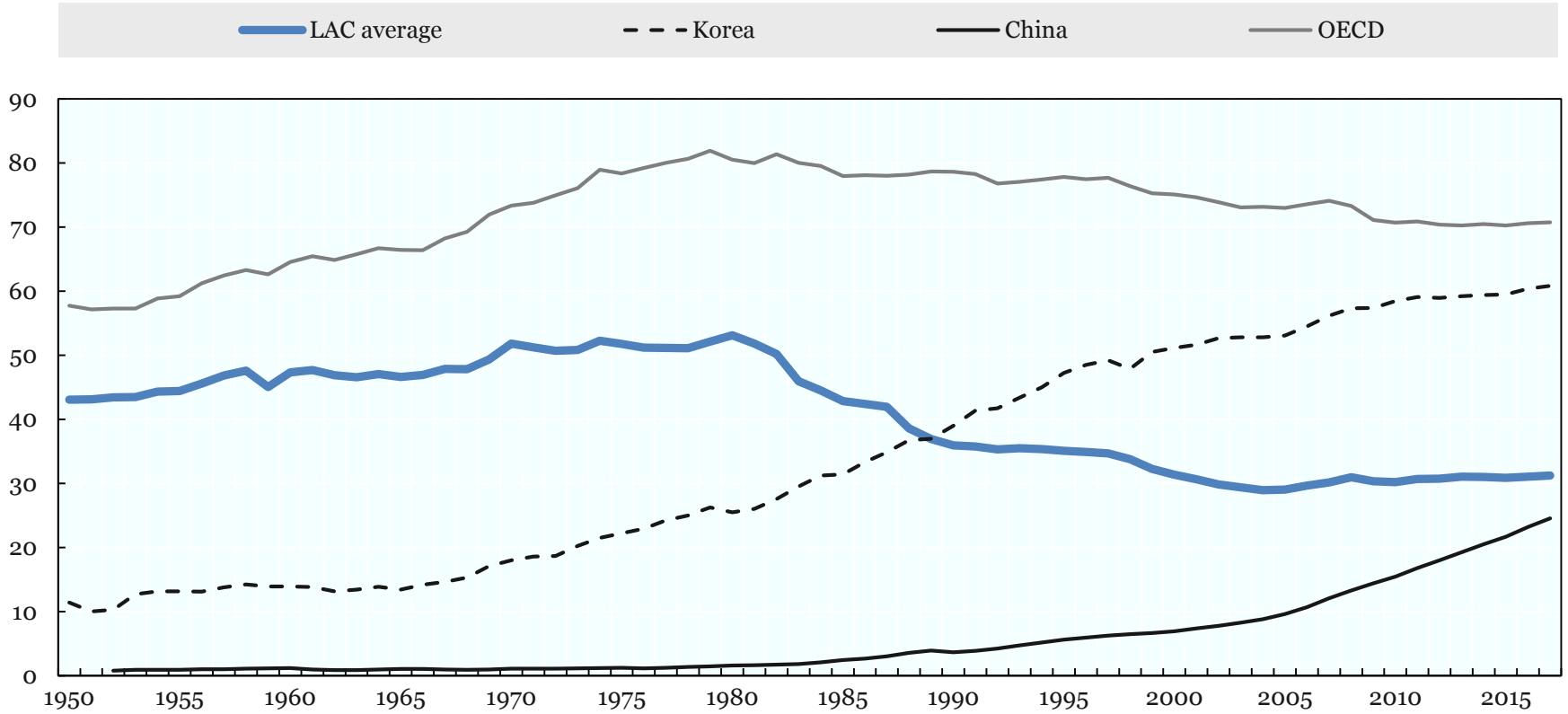
**Note:** UMI = upper-middle income; LMI = lower-middle income; LI = low income.

**Source:** Melguizo, A. S. Nieto-Parra, J.R. Perea and J.A. Perez (2017), "No sympathy for the devil! Policy priorities to overcome the middle-income trap in Latin America", OECD Development Centre Working Paper, No. 340.



# Productivity is (almost) everything

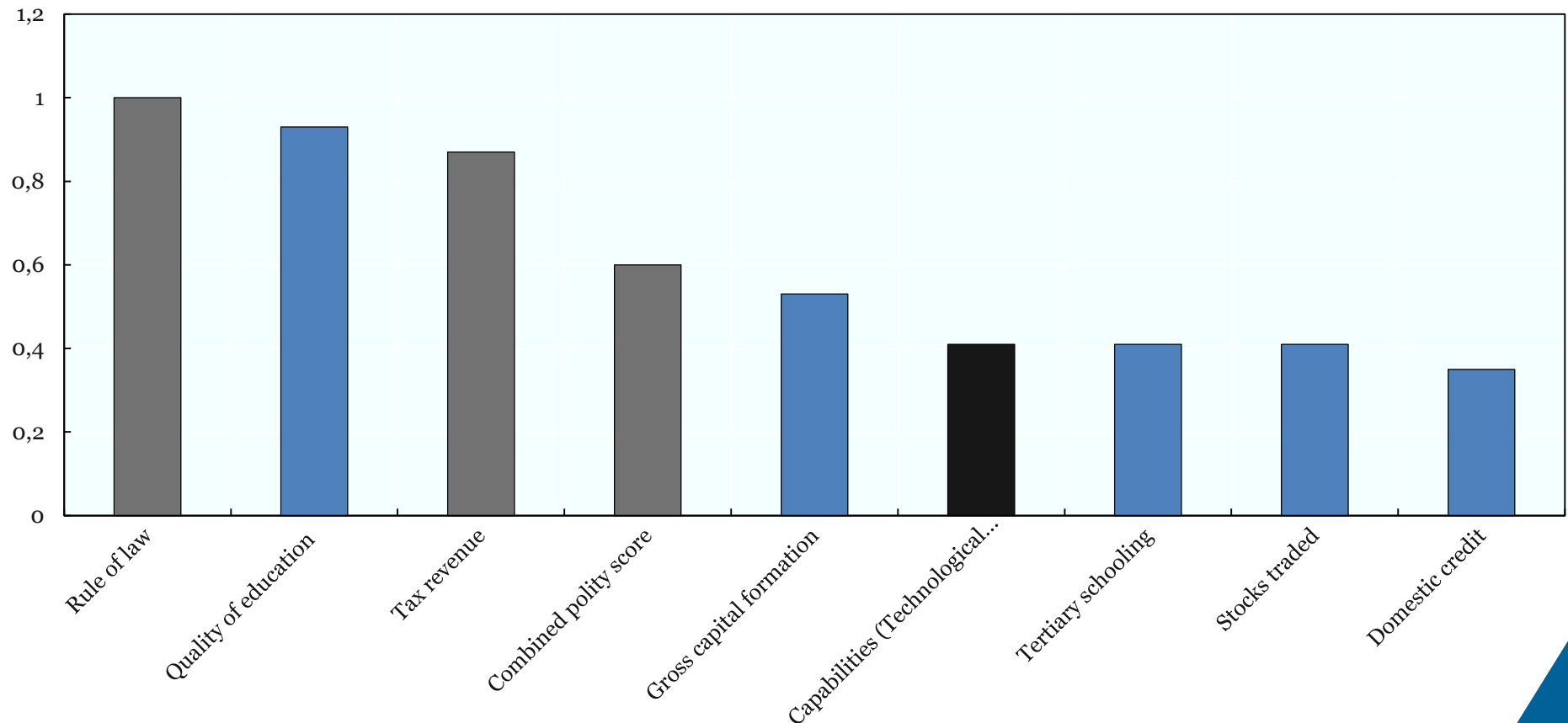
Labour productivity in Latin America, OECD, South Korea and China (as a % of US productivity)





# Strong institutions and trade openness – in addition to education and finance – are key to overcome the M.I.T.

**Policy priorities to evade the middle-income trap**  
(Discriminant analysis evaders vs. trapped, average loading)



**Note:** Ranking of importance from left to right. Average loading.

**Source:** Melguizo, A. S. Nieto-Parra, J.R. Perea and J.A. Perez (2017), "No sympathy for the devil! Policy priorities to overcome the middle-income trap in Latin America", OECD Development Centre Working Paper, No. 340.



## Outline

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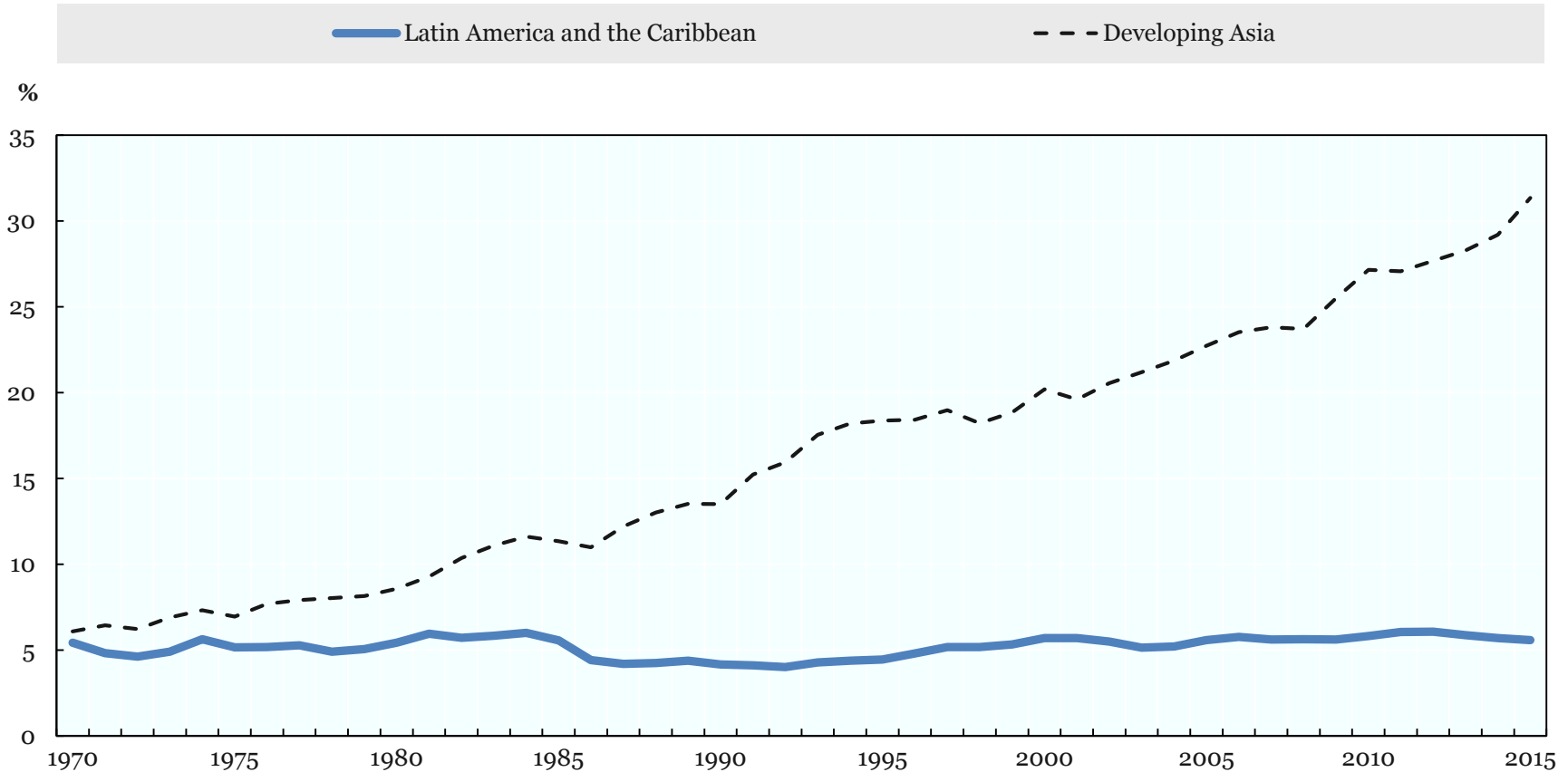
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# Latin American integration into the world economy has stagnated. Share in X of manufacturing & services with higher technological content declined

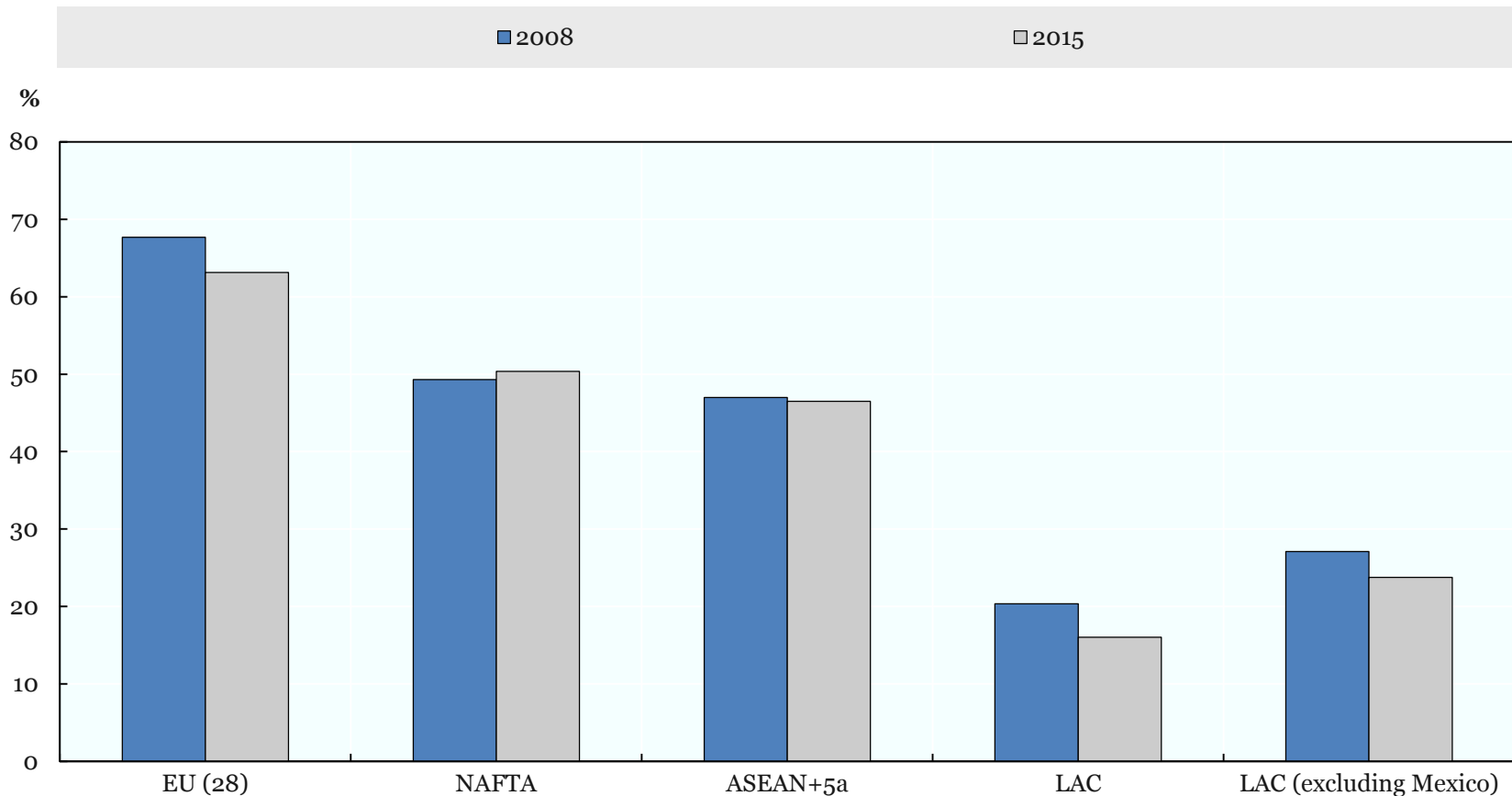
## LAC and developing Asia exports of goods (% world exports)





# ... while regional economic integration remains low

Share of intra-group exports in total exports (%)



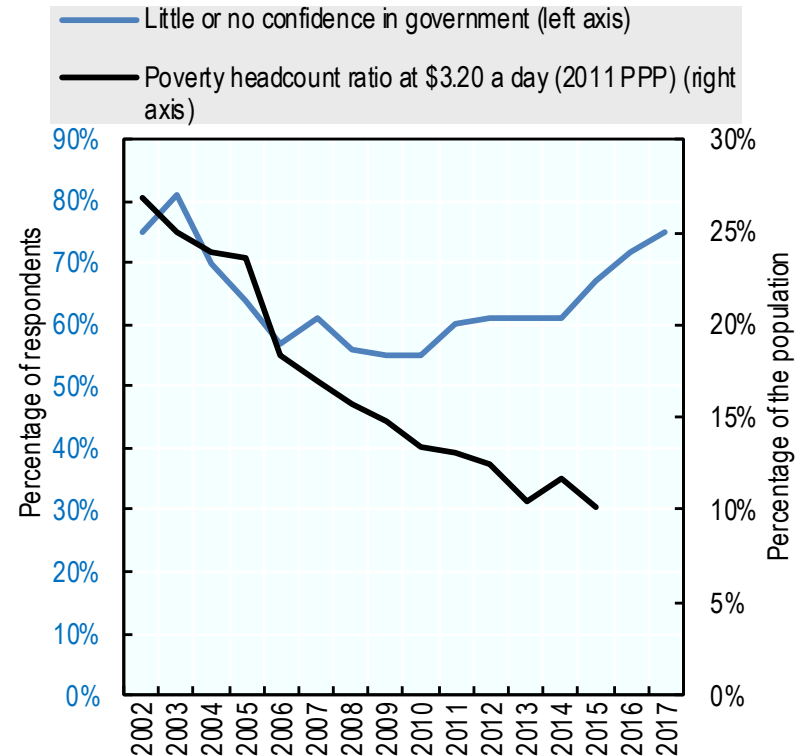
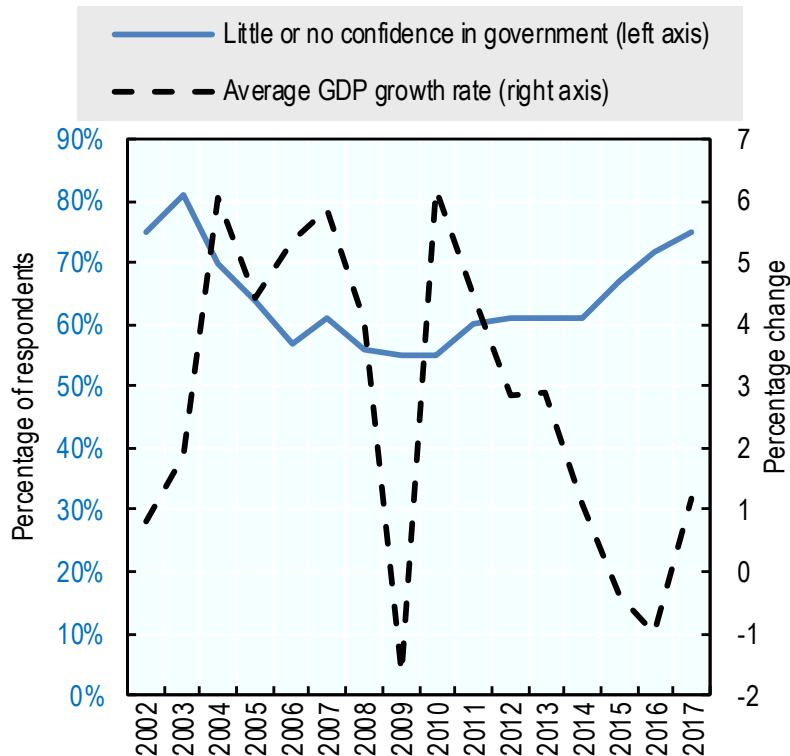
**Note:** ASEAN + 5 includes China, Japan, Korea, Chinese Province of Taiwan, Hong Kong (SAR China) and the 10 members of ASEAN.

**Source:** OECD/ECLAC/CAF, based on data from COMTRADE.



# Trust in public institutions has deteriorated, in line with the economic slowdown...

## Trust in governments and socio-economic indicators in Latin America



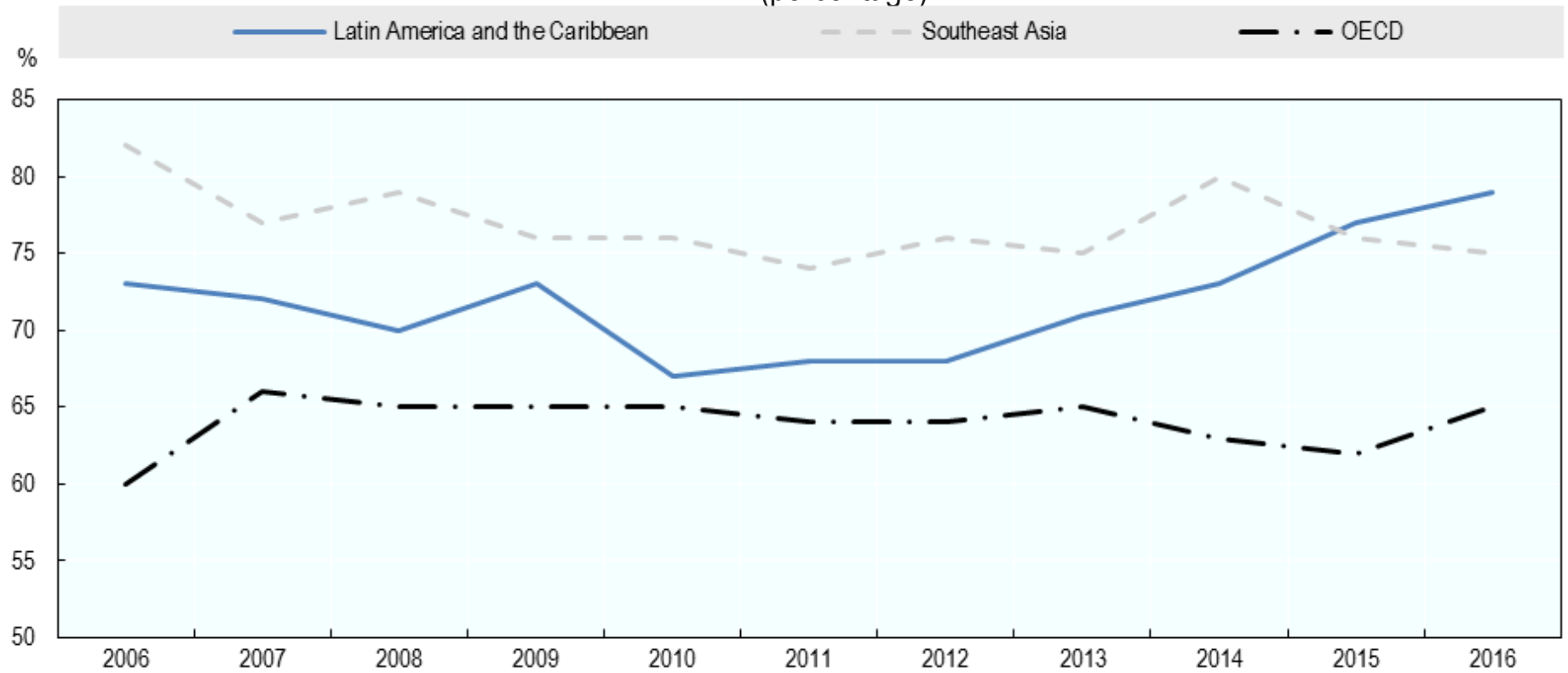
**Note:** Unweighted averages for all variables for a sample of countries comprised by: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela

**Source:** OECD/ECLAC/CAF based on data from IMF World Economic Outlook (2017), World Bank Development Indicators (2017) and Latinobarometro (2017). Growth figures are based on based on data from CEPALSTAT (2017).



# ... and a perception of corruption on the rise

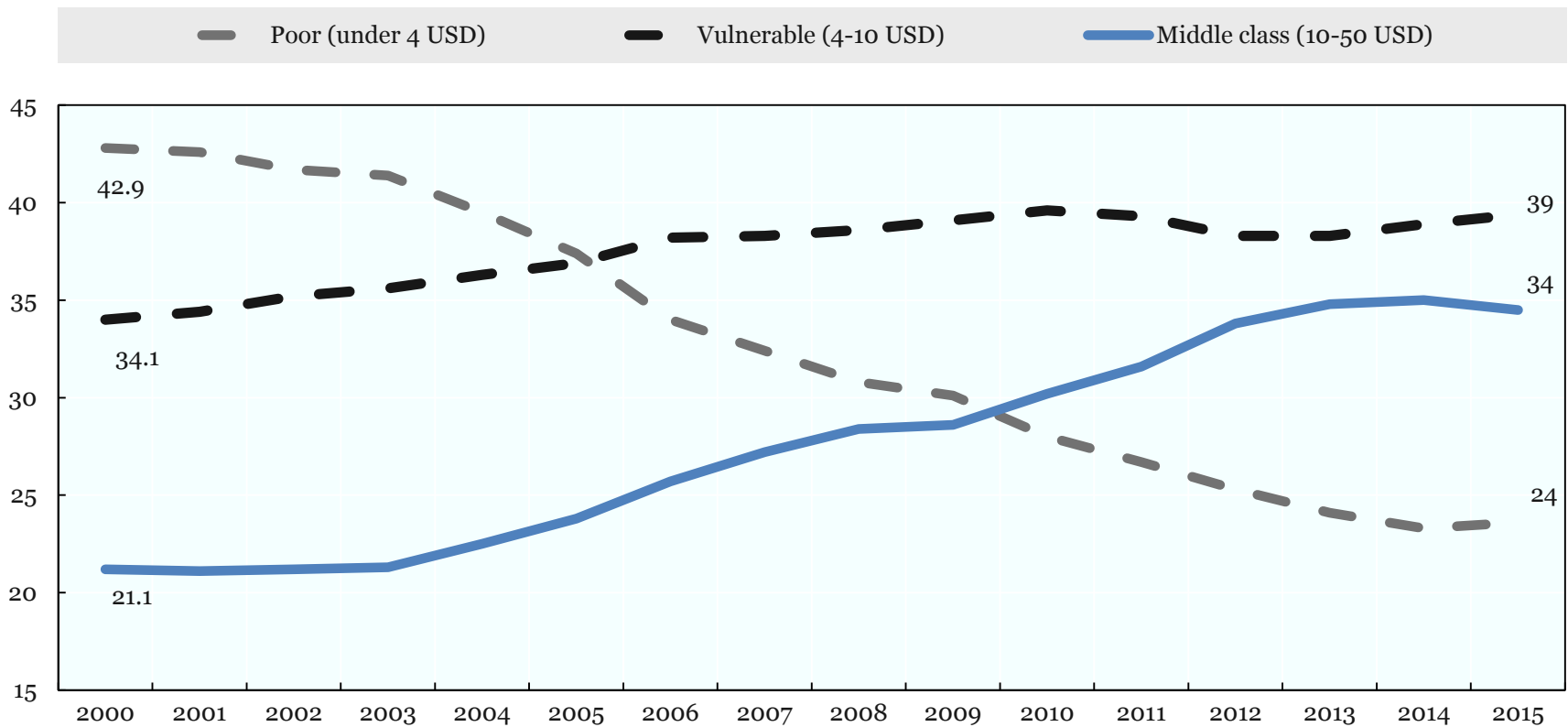
Perception of corruption in government in Latin America, Southeast Asia and OECD  
(percentage)





# A larger middle-class is driving up aspirations and demands *(for good)*...

Latin American population by socio-economic groups  
(% population)



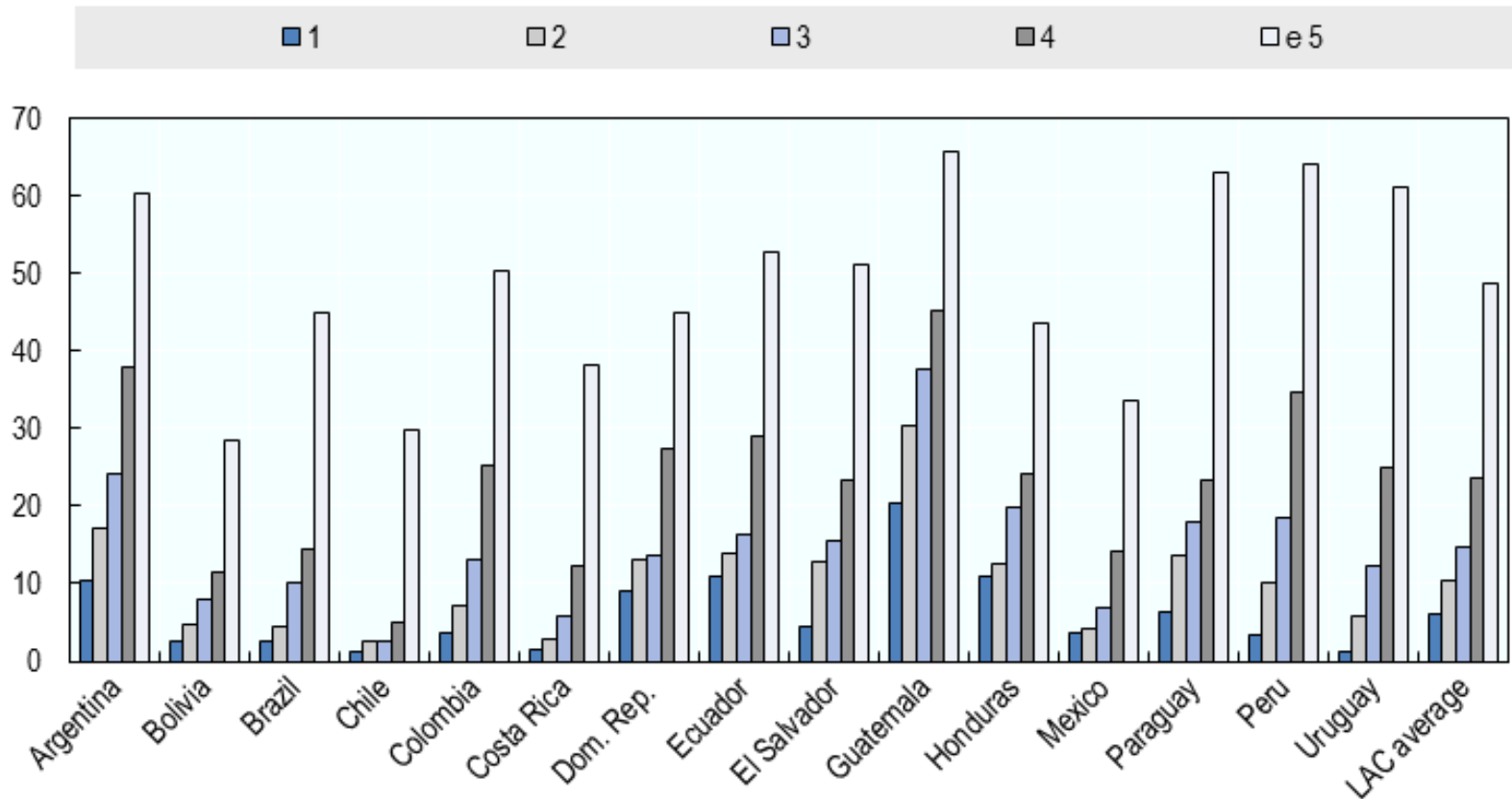
**Note:** The affluent, those that earn over 50 USD per day are not included.

**Source:** OECD/ECLAC/CAF based on LAC Equity Lab tabulations of SEDLAC (CEDLAS and the World Bank, 2017).



# ... unmet for the time being, so wealthier individuals *opt out* of public services

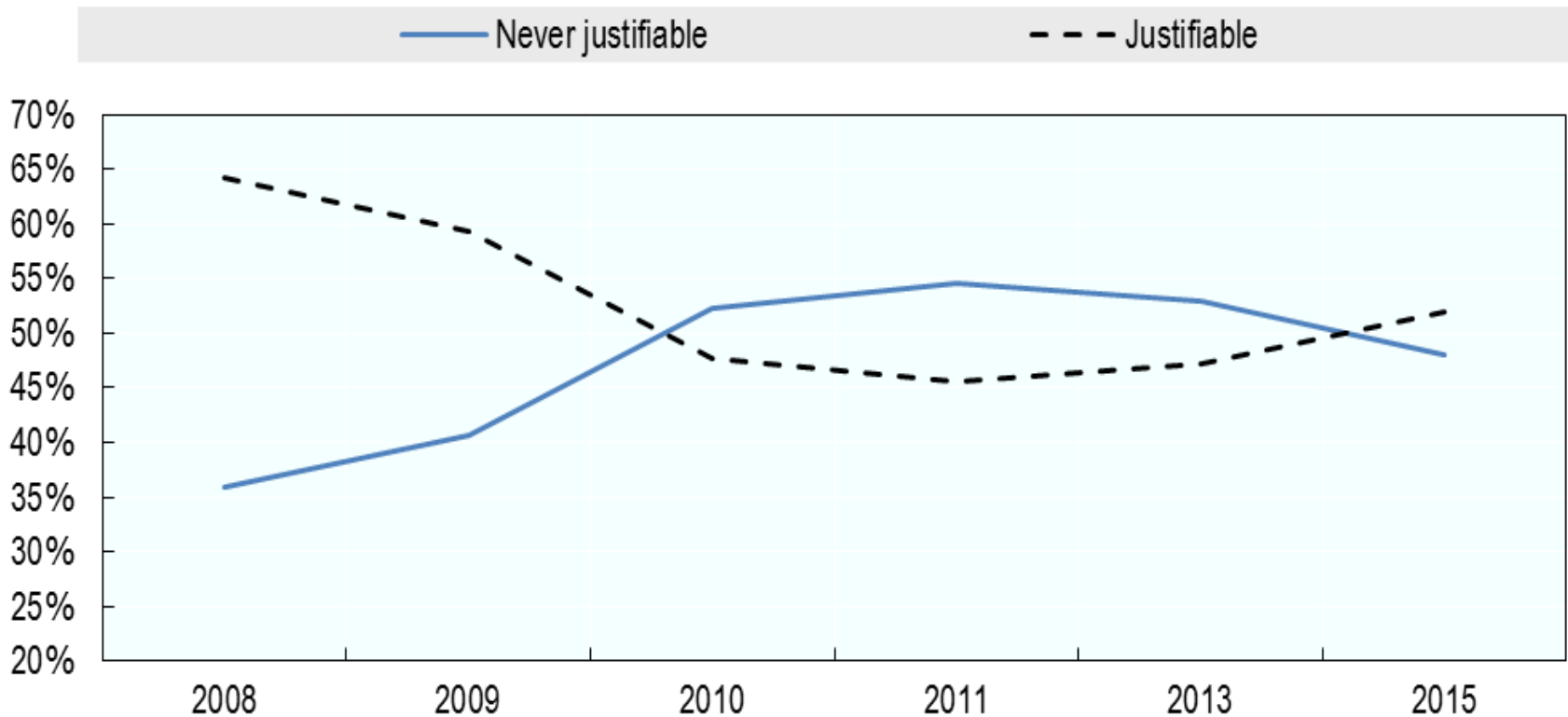
**Enrolment in private schools in Latin America, 2014**  
(% secondary students in private schools, by income quintile)





# The *disconnect* translates into a low willingness to pay taxes

**Tax morale in Latin America**  
(Do you find it justifiable not to pay taxes?, % population)





## Outline

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- The role of institutions for inclusive growth in LAC
- Institutions and outcomes in LAC
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# Rethinking institutions in a development in transition LAC

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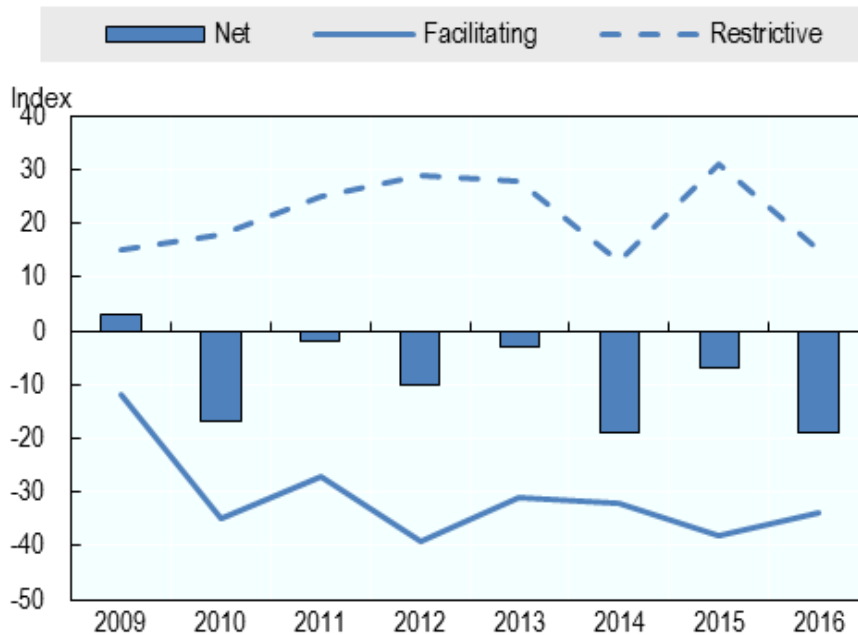
- Institutions to promote inclusive growth: focus on trade integration and structural transformation / productivity growth
- Institutions to enhance the facilitating role of the state and citizens' empowerment: focus on trust, efficiency of P.A., open government.
- Institutions that can anticipate and adapt to a changing economy and society: focus on production transformation, education & skills, labour markets.



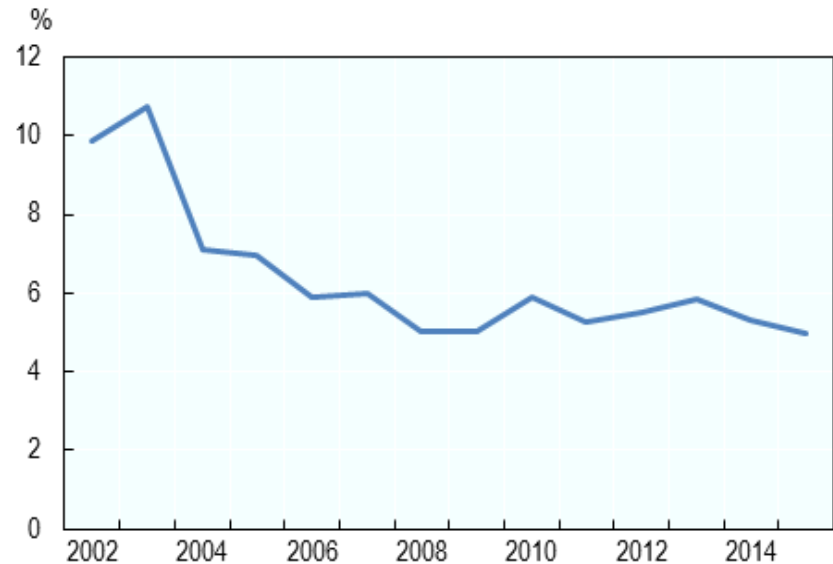
# Latin America should continue opening up, focusing on non-tariff measures and regional integration (Pacific Alliance-Mercosur)

## Trade facilitating and restricting measures and tariff rates, Latin America vs world economies

Panel A. Trade measures



Panel B. Tariff rate, applied, weighted mean, all products

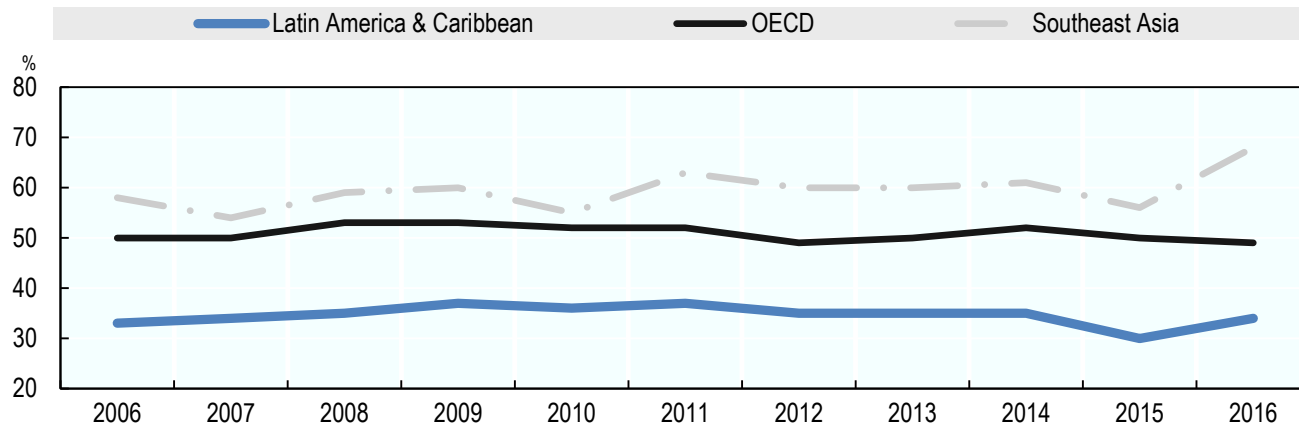


**Note:** Note: Panel A estimated as the sum of trade facilitating and trade restrictive measures for Argentina, Brazil and Mexico VS World economies . Panel B estimated as the simple mean of applied tariff rates (weighted by product) for Argentina, Brazil, Chile, Colombia, the Dominican Republic, Mexico, Peru and Uruguay in 2015. For Colombia, Mexico and Peru, 2014 data are used.  
**Source:** WTO/OECD/UNCTAD (2017) and World Bank (2017b), World Development Indicators.



# Enabling states: credibility - strengthening the rule of law and regulatory systems

Trust in the judicial system in Latin America, OECD, and Southeast Asia



Source: OECD/CAF/ECLAC based on Gallup World Monitor (2017)

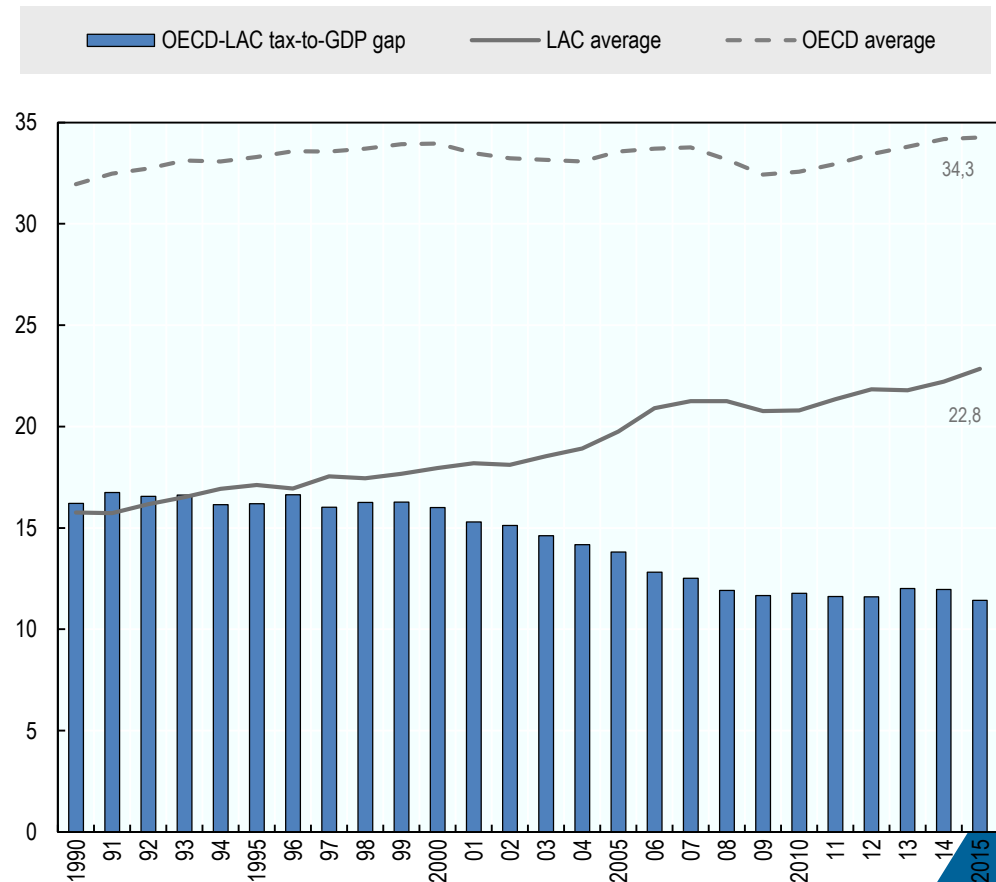
- **Independent and effective legal institutions** to avoid crime, corruption and policy capture. *OECD Recommendation on Public Integrity (e.g. Lava Jato)*
- **ITs (open governments, big data)** to limit corruption, and build accountable and transparent states (e.g Panama Papers, Paradise Papers)
- **Effective regulatory frameworks** to promote fair competition and limit harmful practices. *OECD Recommendation on Public Procurement (Chile Compra, Colombia Compra Eficiente)*



# Enabling states: efficient and effective states require strengthening capacities

- Raising more and better **tax revenues**, and spending better (fiscal reforms in COL, CHI, MEX)
- Stronger **Centres of Government**: leadership, coordination and policy coherence (ARG, PER)
- **Merit-based civil service recruitment systems** – impartiality and state capabilities
- Improve **management cycles**, inc. monitoring and evaluation - better service delivery (Sinergia, Colombia; MIDE and EVALUA in Jalisco, Mexico)

Tax revenue in LAC (% GDP)



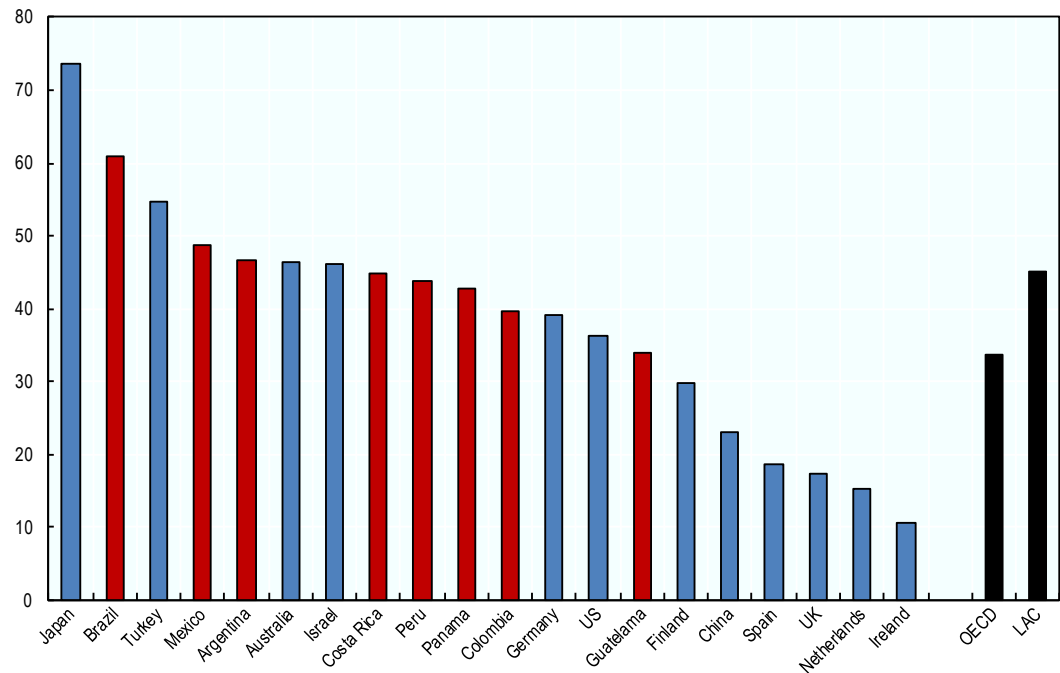
Source: OECD/ECLAC/CIAT/IDB (2017), Revenue Statistics in Latin America and the Caribbean



# Enabling states: openness, transparency and forward-looking vision

- **Open governments** - culture of transparency, accountability and access to information
- **Innovation labs** - collaboration and citizen engagement within public institutions to design cost-effective, risk-taking small pilot projects (Mi Quito, Mi Medellín, Ágora Río, Bogotá Abierta)
- Use of **big data** - detailed information to guide public policy action (e.g. Dengue in Brazil)
- **New institutions** to anticipate change and adapt: skills, productive development, innovative labour regulations

Skills gap in LAC (% firms)



Source: ManpowerGroup Talent surveys



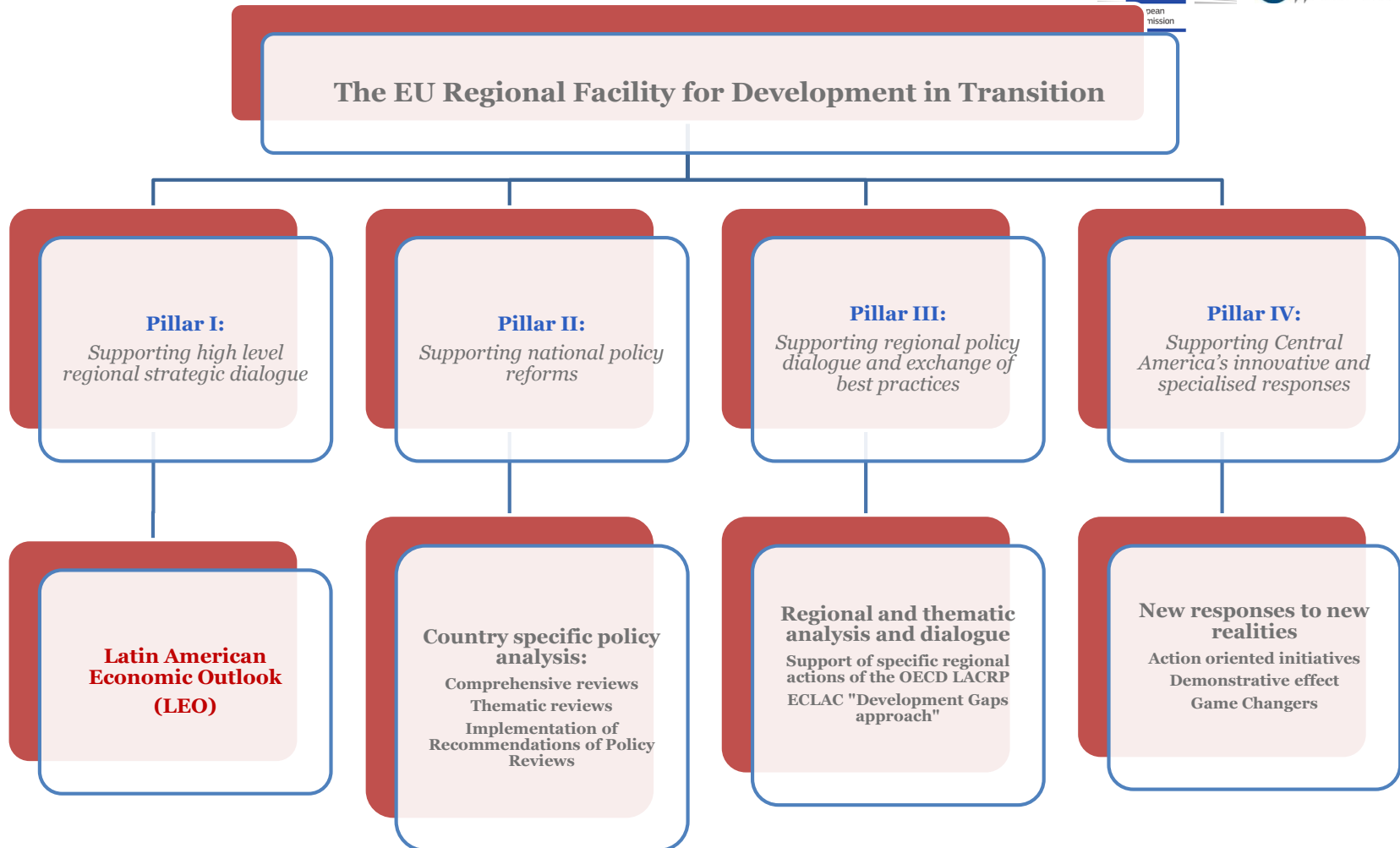
## *Now's the time to rethink institutions...*

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- Support **trade integration** and raise productivity
- Build **enabling states**:
  - **More reliable**: Moving towards **trustworthy** states requires strengthening the rule of law, and regulatory systems
  - **More capable**: Building more **efficient and effective** states requires strengthening their capacities
  - **More open and innovative**: Fostering **open, participatory, and innovative** states is necessary to build a new connection with citizens
- Adopt a **forward-looking perspective**, so that institutions are flexible and embrace the future
- The **economic recovery** and the **electoral cycle** opens a **window of opportunity**

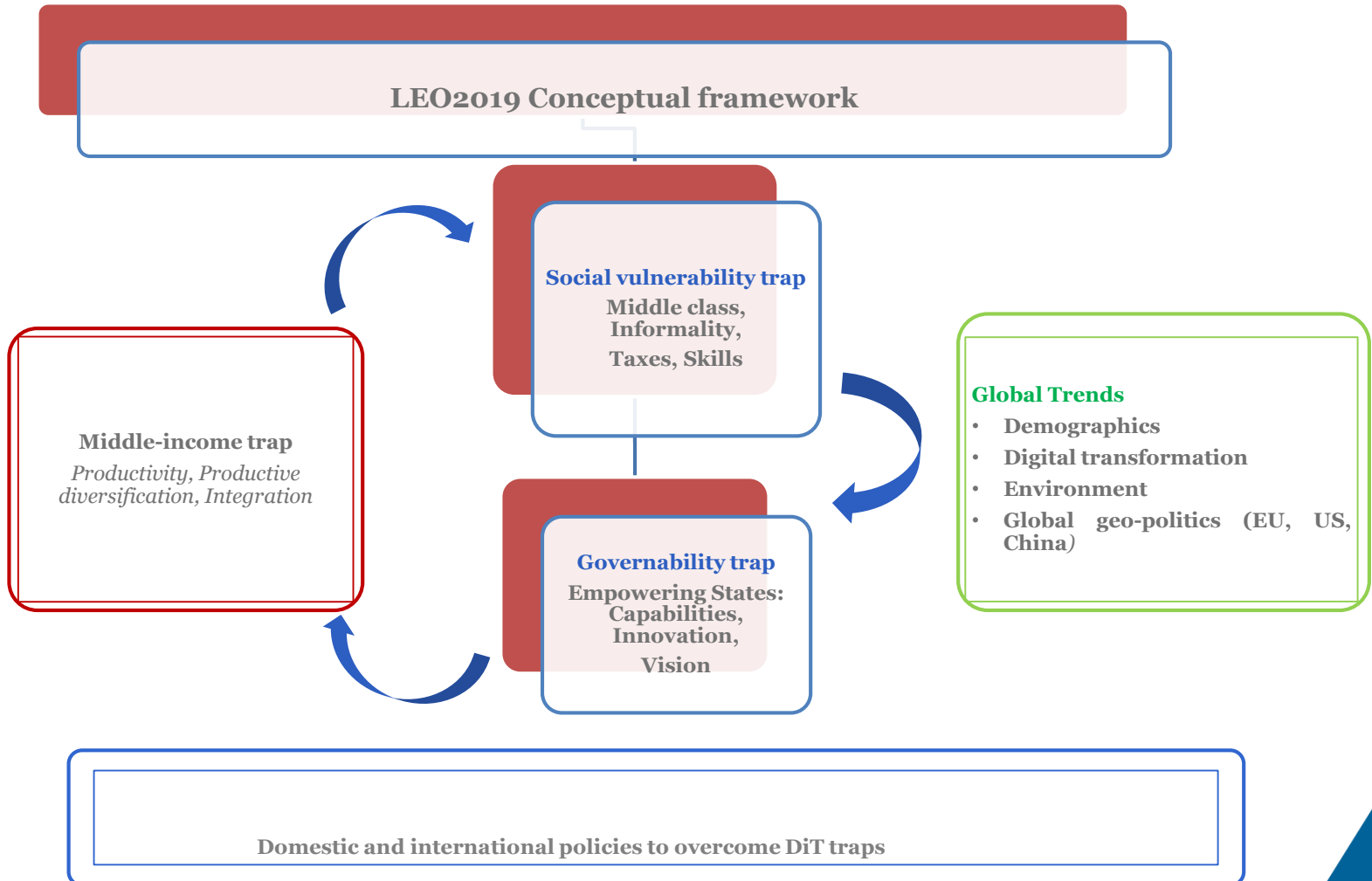


# ... and to renew economic relations





# Latin American Economic Outlook 2019







*Stay tuned!*

[www.oecd.org/dev/development-in-transition.htm](http://www.oecd.org/dev/development-in-transition.htm)

[www.latameconomy.org](http://www.latameconomy.org)