POLICY NOTE
ON LATIN AMERICA

INVESTMENT AND CONFIDENCE THROUGH STRONGER INSTITUTIONS

EMnet Latin America Meeting:
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Investment and Confidence through Stronger Institutions

Growth is back in the Latin American and the Caribbean (LAC) region after years of remaining subdued. Lack of trust in public institutions however weighs down on opportunities for further growth and investment. Political transitions across the region can provide an opportunity to enact reforms that strengthen institutions and underpin economic development. This note provides insights and suggests recommendations from the private sector on how to restore business confidence and support investments in Latin America. The analysis builds on discussions held during the business meetings of the OECD Emerging Markets Network (EMnet) held in Paris, France, on 28 May 2018 and in Antigua, Guatemala on 14 November 2018, in addition to desk research and bilateral discussions with EMnet members and other private sector representatives.

Key messages include:

- Despite the improved economic climate, regional growth prospects are burdened by a lack of confidence, low levels of investment, low productivity, weak labour market conditions and a challenging business environment.
- LAC governments should implement structural reforms that can restore business confidence and support investment. Countries should particularly capitalise on the opportunities offered by regional and global free trade initiatives to this end.
- Creating a supportive business environment by improving macroeconomic management and tackling insecurity issues can be key in generating business opportunities. Also helpful are enhanced regulatory and fiscal policies that improve the investment climate and streamline industry-specific taxes.
- More public-private collaboration can provide LAC governments with the tools to address evolving citizen demands and to build more robust institutions. Public-private partnerships (PPPs) can prove to be an efficient solution to public service provision and contribute to strengthening institutions.
- The evolving needs of both individuals and businesses require a rethinking of labour market regulations and educational systems, which can support firm-level productivity.

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EMnet brings together private sector executives (CEOs, CFOs, chief economists and heads of strategy), high-level policy makers (government ministers and heads of state) and OECD experts to debate issues.

Events are closed to the public and media and operate under the Chatham House Rule to encourage open and dynamic discussions on doing business in Africa, Asia and Latin America.

To learn more about EMnet, please see http://www.oecd.org/dev/oecdemnet.htm.

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ABBREVIATIONS AND ACRONYMS

BoP	Bottom of the pyramid
CAF	Corporación Andina de Fomento (Development Bank of Latin America)
CAFTA-DR	Dominican Republic-Central America Free Trade Agreement
CESC	Contribución Especial para la Seguridad Ciudadana y Convivencia
CIT	Corporate income tax
CUSMA	Canada-United States-Mexico Agreement
ECLAC	Economic Commission for Latin America and the Caribbean
ETI	Enabling Trade Index
FDI	Foreign direct investment
FOB	Free on board
FTA	Free trade agreement
FTZ	Free trade zone
GDP	Gross domestic product
LAC	Latin America and the Caribbean
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PACI	Partnering Against Corruption Initiative
PIT	Personal income tax
PPP	Public-private partnerships
SME	Small and medium-sized enterprise
TFA	Trade Facilitation Agreement
VAT	Value Added Tax
VET	Vocational education and training
WEF	World Economic Forum

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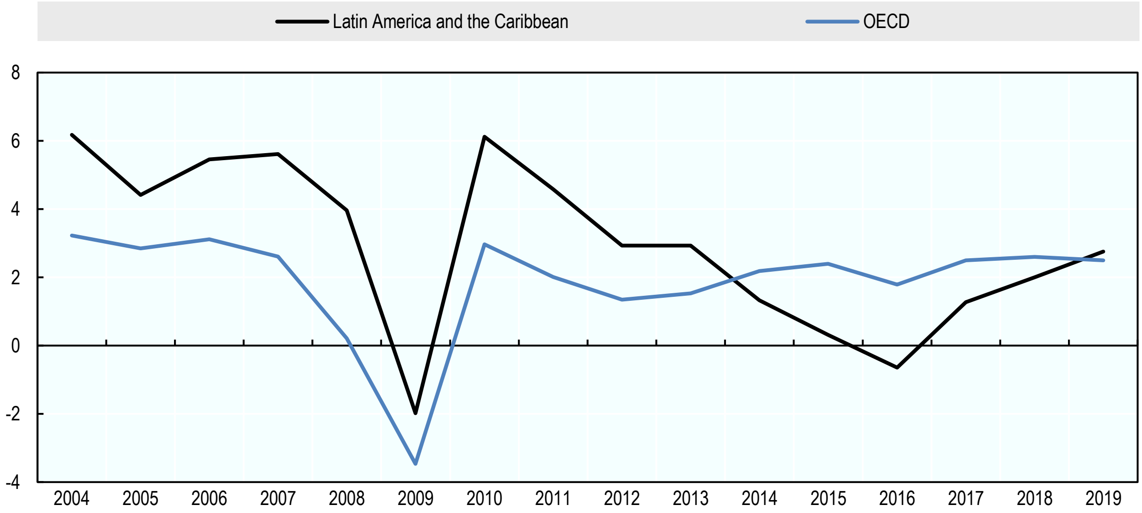
LATIN AMERICA'S ECONOMIC AND BUSINESS OVERVIEW

After five years of economic slowdown, Latin America is on a path of frail economic recovery

After a five-year slowdown, the region's gross domestic product (GDP) began contracting in 2015 due to weak external demand and declining commodity prices, along with domestic, social and political turmoil (IMF, 2016a). Large economies such as Argentina and Brazil entered recessions, with output decreasing by 2.2% for Argentina and 3.6% for Brazil in 2016 (World Bank, 2018a). After regional growth reached 1.3% on average in 2017, GDP was projected to increase by around 2% in 2018 (versus an OECD average of 2.4%), and between 2.5% and 3% in 2019 (2.1% in the OECD) (Figure 1). This range masks a wide heterogeneity, with countries in Central America outperforming Mexico, South America and the Caribbean (OECD/CAF/ECLAC, 2018; IMF, 2018). The ongoing recovery is mostly the result of a more positive global economic outlook, but also of improvements in domestic conditions. Nevertheless, the current performance remains less favourable than the one experienced during the growth cycle of the 2000s. Between 2000 and 2010, growth rates averaged 3.3% per year (World Bank, 2018a).

Figure 1. **GDP growth in Latin America and the OECD (annual %)**



Note: Growth projections from the IMF for OECD countries and from ECLAC for Latin America.

Source: OECD calculations (2018), based on IMF (2018) and ECLAC (2018).

Investment in the region is insufficient to support long-term growth

After dropping in response to falling commodity prices and political uncertainty, domestic investment is expected to pick up. However, evidence shows that LAC economies invest less than most regions of the world, with only sub-Saharan Africa trailing behind in terms of share of GDP (IDB, 2018a). Total investment rates vary from country to country. Panama leads the region, with total investments representing 47% of GDP (IMF, 2017a). Many of these are associated with large-scale projects such as the expansion of the Panama Canal and an extensive pipeline of other ongoing and planned investment projects (IMF, 2017b). Venezuela, on the other hand, invests the least, with a total investment rate of 8.8% in 2017 (IMF, 2017a).

Rapid technological advances and a shift in perceptions of globalisation have redirected foreign investment to advanced economies, which captured a larger share of global inflows (IMF, 2017a). Thus, foreign direct investment (FDI) in the LAC region is also suffering. Latin America saw an average decrease in FDI inflows of 7.8% in 2016 (ECLAC, 2017a). This was largely due to a significant loss of economic momentum, stemming in part from the fall in commodity prices, as well as increased political risk in certain countries.

FDI trends varied widely. The largest economies remain the most attractive, with Brazil (41% of regional inflows), Mexico (19%) and Colombia (9.5%) leading the region in FDI performance (UNCTAD, 2017a). South America was particularly affected by weak commodity prices, which had an effect on investment in natural resources. While FDI inflow to South American economies fell 14.2% to USD 101 billion, Colombia saw an increase of 15.9% and Paraguay 5.1% (UNCTAD, 2017b). Central America also experienced a drop in FDI inflows as trade headwinds formed. Only Panama saw a rise in FDI inflows (+16%), propelled by a rebound in equity investments, which had dipped in 2015. The Caribbean also experienced lower FDI, with strong variations across this sub-region.

Regional trade performance is facing challenges

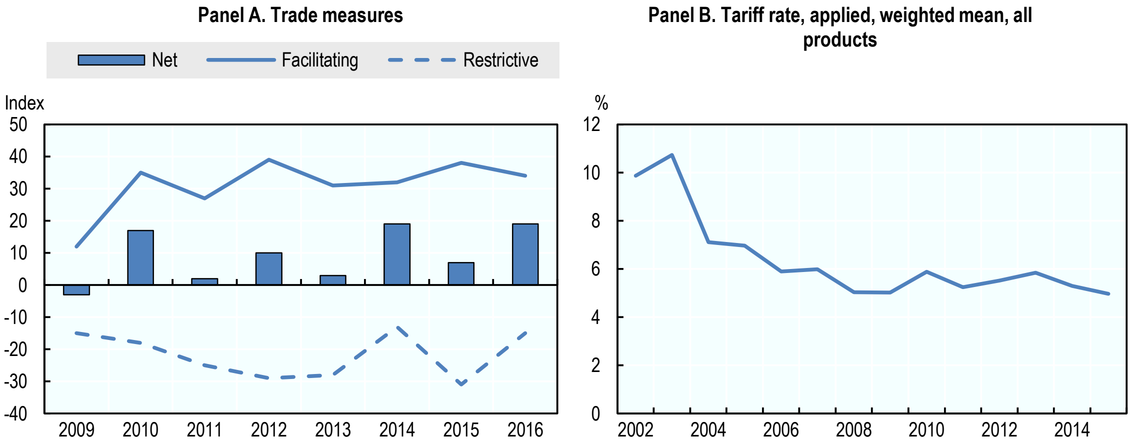
Global trade is picking up, yet LAC economies have failed to reap the full benefits of this recovery. In fact, trade in the region has contracted over the past three years (IMF, 2017c). LAC exports decreased by 6.1% in 2016, while imports dropped by 12.5% (WITS, 2018). This downward trend proceeded from the decline in international commodity prices and the global economic slowdown. An economic deceleration in China (OECD, 2018a), a key regional partner, has also contributed to diminished trade prospects for the region.

Similarly, Latin America's participation in global value chains is lower than for other emerging markets (Cadestin et al., 2016). Indeed, only 13% of the value exported by Argentina, Brazil, Chile, Colombia, Costa Rica and Peru was generated in other economies. This is below figures for North American Free Trade Agreement (NAFTA) countries (19%), the European Union and Southeast Asia (both at 30%).

Growing global protectionist sentiments have also fuelled uncertainty and worsened trade prospects for the region. This presents a potential barrier to business growth. Central American economies are particularly dependent on exports to the United States and are thus significantly exposed to changes in US trade policy. The renegotiated NAFTA (CUSMA) should help reduce fears that the United States will terminate the agreement. Lingering uncertainties from these negotiations and delays in ratification, however, could pose a significant risk to a number of industries throughout the LAC region. Other trade agreements, such as the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR), to which the United States is party, could be seen as additionally risky.

The recent uncertainty surrounding trade prospects for Latin American economies has already hampered investment in the region (*The Economist*, 2017). Nevertheless, some countries have been making progress in opening their economies to trade by liberalising tariffs and other such measures (Figure 2).

Figure 2. **Trade facilitation and trade restrictive measures and tariff rates, Latin America vs. world economies**



Note: Panel A estimated as the sum of trade facilitation and trade restrictive measures for Argentina, Brazil and Mexico. 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.

Source: WTO/OECD/UNCTAD (2017) and World Bank (2017b), *World Development Indicators.*

The LAC region also lags behind in terms of intra-regional trade. Approximately 15% of total exports are destined for markets within the region. This figure reaches 50% in developed economies in Asia and Europe. Furthermore, although other regions have made progress in this regard, LAC regional integration has remained relatively stable since 1990 (IMF, 2017d).

In this context, increasing regional integration will be important for Latin American economies if they are to return to the path of long-term inclusive growth. The OECD has recommended taking advantage of regional trade agreements such as the Pacific Alliance and Mercosur[1] in responding to an increasingly complex trade scenario (OECD/CAF/ECLAC, 2018).

Low levels of productivity continue to hamper business activity in the region

The region has suffered from low productivity growth over the decade prior to 2018. Labour productivity has weakened, as GDP per person employed decreased by 1.5% since 2015 (OECD, 2018b). In fact, low labour productivity explains 70% of the gap in GDP per capita between the LAC region and the upper half of OECD economies (OECD, 2018b). Productivity is closely tied to firm-level competitiveness and business growth (Porter, 1990). The OECD has called for comprehensive structural reforms and stronger institutional support for pro-productivity policy frameworks to unleash private sector productivity and to close persisting productivity gaps (OECD, 2016a). The OECD estimates that the potential for inclusive productivity gains through policy reforms is strongest among Latin American small and medium-sized enterprises (SMEs). SMEs currently represent 70% of Latin American employment, while generating only 30% of regional GDP, or half the OECD average (OECD, 2016a).

Labour markets continue to show vulnerabilities despite signs of improvement

The performance of the labour market in Latin America and the Caribbean was mixed in 2017. After significant deterioration resulting from the 2011-15 economic slowdown and the economic contraction in 2016, unemployment in the LAC region rose from 7.9% in 2016 to 8.4% by the end of 2017 (ILO, 2017a). This trend is weighted principally by Brazil (40% of the regional labour force), which saw its unemployment rate rise to 13.1%. Without Brazil, the average unemployment rate for the LAC region fell from 6.1% in the third quarter of 2016 to 5.8% in the equivalent quarter of 2017. Central America and the Caribbean both experienced a decline in the unemployment rate, to 5.3% (-0.6%) in the case of Central America and 7.4% (-0.4%) for the Caribbean (ILO, 2017a).

Latin American youth (i.e. individuals aged 15 to 24 years) were particularly affected by the region's economic slowdown. For the first time in more than a decade, the youth unemployment rate reached nearly 20%, approximately triple the rate for adults (ILO, 2017a). Youth account for roughly 40% of the region's total unemployed population, with Guatemala (55%), Honduras (53%), Belize (50%) and Paraguay (49%) faring worst in this regard (ILO, 2017a).

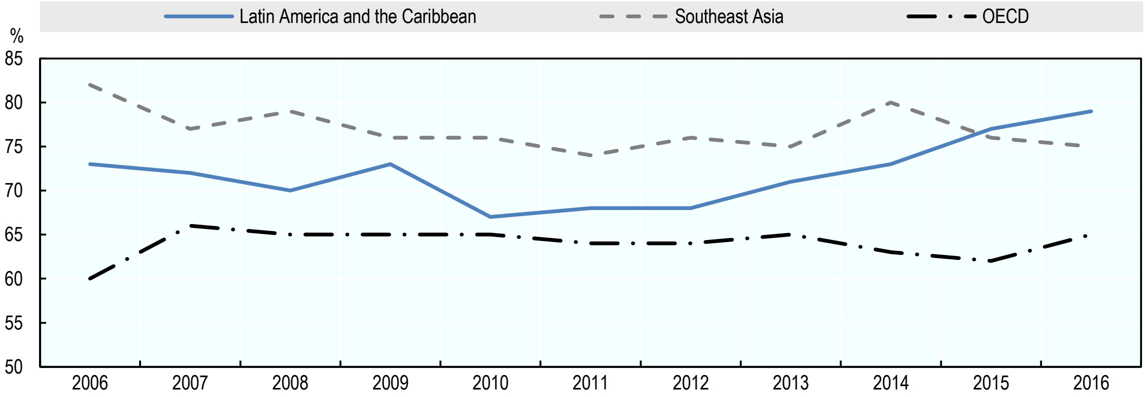
The composition of employment in the LAC region is shifting away from wage employment to non-wage employment. The regional share of urban employment for own-account[2] workers has continued to rise, from 21.6% in 2013 to 23.6% in 2016, while the proportion of employees dropped from 64.6% to 63.4% over the same period (ILO, 2017a). Informality continues to affect the region, with 55% of the working population – about 140 million individuals – working in the informal sector (OECD/CIAT/IDB, 2016).

BUSINESS CONFIDENCE IN LATIN AMERICA

The erosion of public trust poses a risk to the region

The share of the Latin American population having little or no trust in government has risen 20 percentage points since 2006, reaching 75% in 2017 (OECD/CAF/ECLAC, 2018). Although the whole region has observed this downward trend, it varies among countries. In Argentina and Uruguay, for example, the share of citizens expressing confidence in their governments is above 40%. On the other hand, the figure drops below 30% for countries such as Brazil, Colombia, Mexico and Peru (OECD/CAF/ECLAC, 2018). Recent incidents of corruption that have affected the region further exacerbate Latin Americans' poor perception of their governments. In 2016, 80% of the LAC population perceived corruption to be widespread in government institutions, up from 65% in 2010 (Figure 3).

Figure 3. **Perception of corruption in government in Latin America, Southeast Asia and OECD**



Source: OECD/ECLAC/CAF (2018), *Latin American Economic Outlook 2018: Rethinking Institutions for Development,* based on Gallup (2017), World Poll, http://www.gallup.com/services/170945/world-poll.aspx.

Lack of trust in government can cause citizens and businesses to disengage from the state. This can in turn lead to informal employment practices, avoidance of public services, resistance to paying taxes and reduced compliance with civic obligations – or even to social uprisings. Lack of trust in government can further hamper economic development by weighing down on investment and consumption (OECD, 2017a). For instance, OECD research has shown a positive relationship between inward FDI and the quality of a country's governance (OECD, 2006). Institutional credibility is therefore key in supporting investment.

Low public trust in government can push Latin Americans towards informal employment

Incentives to participate in the formal economy are lower if trust in the capacity of the state to provide quality public goods and services has been eroded. As such, poor perceptions of public institutions can give rise to a culture of informality. Fifty-five percent of workers in the region did not contribute to pension or healthcare programmes (EPRS, 2016). These levels of informality can be detrimental to the establishment of a competitive business climate. Informal employment leads to reduced productivity and lower skill levels, both key concerns to firms throughout the region (OECD, 2016b).

Dissatisfaction has led to public service avoidance

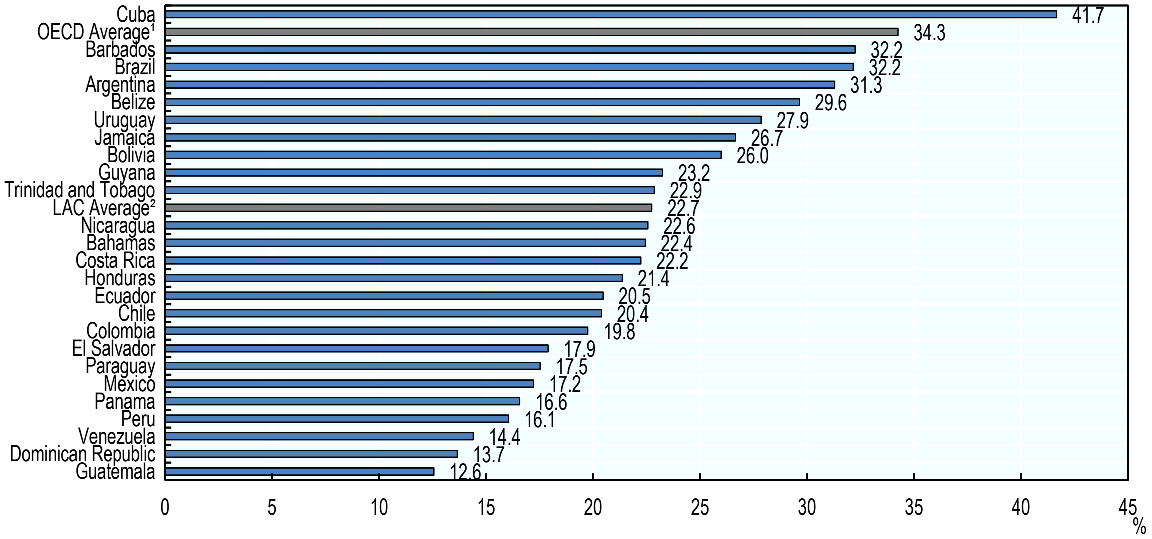
Discontent with public services in Latin America is generalised across income groups. The share of the population satisfied with the quality of healthcare services fell from 57% to 41% between 2006 and 2016 (OECD/CAF/ECLAC, 2018). Other public services display a similar trend. High levels of dissatisfaction have led individuals with sufficient resources to opt out of public services. For instance, enrolment in private schools in LAC for the first income quintile is 6.1%, versus 48.8% for the fifth quintile (OECD/CAF/ECLAC, 2018). Citizens opting out of public services further erodes the social contract. Moreover, it raises questions as to how the private sector can play a role in addressing this issue.

Tax evasion adds to fiscal pressures

In 2015, Value Added Tax (VAT) evasion and income tax evasion in LAC totalled USD 340 billion, representing 6.7% of regional GDP (ECLAC, 2018). In addition, tax morale (i.e. the willingness of citizens to pay taxes) has decreased in recent years: in 2015, 52% of the population justified not paying taxes if possible, relative to 46% in 2011. This is particularly' relevant in a region where the average tax-to-GDP ratio stood at 22.7% in 2016, well below the OECD average of 34.3% (OECD et al., 2018). In fact, all LAC countries except Cuba have tax-to-GDP ratios below the OECD average (Figure 4). This creates additional fiscal pressure on LAC governments. As a result, Brazil, Argentina and Costa Rica, which hold the highest public debt levels (at 74.0% for Brazil, 53.7% for Argentina and 48.8% for Costa Rica) (ECLAC, 2018), risk a further deterioration of their fiscal profiles (Moody's Investors Service, 2018). The reduced fiscal space that many Latin American countries face can be exacerbated further by the normalisation of monetary policy and an increase in interest rates in developed countries (Moody's Investors Service, 2018). In a context of low taxation rates and anticipated decreases in public revenues due to lower commodity prices, tax evasion is an additional risk for the solvency of certain governments in the region. Improvements in fiscal structures that enhance effective tax collection capabilities can help LAC countries regain fiscal space (ECLAC, 2018).

Figure 4. **Tax-to-GDP ratios in LAC countries, 2016**

(total tax revenue as % of GDP)



Source: OECD et al. (2018), *Revenue Statistics in Latin America and the Caribbean*, https://www.oecd-ilibrary.org/taxation/revenue-statistics-in-latin-america-and-the-caribbean_24104736.

In collaboration with the Inter-American Center of Tax Administrations (CIAT), the IDB and member countries, the OECD is working to combat tax evasion in the region by supporting local tax authorities in the application of the OECD Transfer Pricing Guidelines, promoting the exchange of information (OECD, n.d.).

Lingering fiscal imbalances in the region can be of particular significance for businesses, as governments may opt to increase the fiscal space by implementing corporate tax increases. This, however, can negatively affect investment prospects as businesses grow weary of potential tax raises.

Civic disengagement and social uprisings are weighing down on certain Latin American countries' growth prospects

The growing disconnect between Latin American states and their citizens, illustrated by the erosion of trust and satisfaction levels described above, has fuelled civic disengagement. Instances of social uprising in Venezuela, Mexico, or Brazil highlight deepening social fractures and rising anti-government sentiments facing the region (Dumitru, 2017). Weakened democratic robustness creates uncertainty for business. It is happening as Latin America faces one of the most important electoral marathons in recent decades, with 12 presidential elections taking place in 2018 and 2019. Although this provides the region with a unique window of opportunity for much-needed reforms, such a period of transition can also generate uncertainty for business decision-makers and thus potentially delay new investment plans (Zovatto, 2017).

The business climate in the region remains challenging

Although the region has made progress implementing structural reforms supportive of a healthy and stable business climate, improvements are still required. Firm competitiveness remains a central challenge to Latin American economies. In fact, large gaps in all analysed areas of competitiveness persist, notably as they relate to institutions, infrastructure, labour market efficiency and innovation (WEF, 2018a). The World Economic Forum's Executive Opinion Survey, which gathers insights from business leaders across the world, ranks the types of risks that are of concern to business leaders. In Latin America, national governance failure ranks highest among risks, followed by high unemployment and social instability (Marsh & McLennan Companies/WEF, 2017). Issues of corruption in Brazil, corporate governance in Mexico and the breakdown of national governance in Venezuela all are sources of uncertainty that pose significant business risk. Consequently, the Latin American landscape remains a comparatively challenging environment for companies to navigate. The potential to gain from improvements in key areas, such as regulation, transparency and public services, is significant. Public institutions can play a crucial role in supporting a business climate that underpins a virtuous cycle of business opportunity, investment and growth.

Weakness in regulatory systems is a significant hurdle for businesses

Regulation is one of the more important levers by which governments can support efforts to enhance competitiveness, raise productivity and reduce the administrative burden on business. The World Bank, in its annual *Doing Business* report, assesses the quality of business regulations in countries around the world by reference to best practices. The World Bank found that the LAC region scored lower than OECD countries, Europe and Central Asia. It also underperformed East Asia and the Pacific in terms of ease of doing business (World Bank, 2018b). Similarly, the OECD indicator of product market regulation (PMR) shows that business regulations are significantly more restrictive in the LAC region than in OECD countries (World Bank, 2018b).

Pro-competitiveness reforms can encourage companies to be more innovative, to invest more and thereby lift productivity (OECD/IDB, 2016). To this effect, the OECD promotes the systematic employment of stakeholder engagement, cost-benefit analyses and ex-post evaluations throughout the design and implementation phases (OECD, 2017a). OECD estimations show that efficient pro-competitive product market reforms could raise GDP in Argentina, Mexico, Chile and Brazil by more than 20% by 2060 (OECD, 2015a).

With this in mind, LAC countries have worked towards increasing the quality of their regulatory systems. This is, for example, the case for Mexico, which initiated a broad competition policy reform programme in 2013. The programme aims to enhance the ability of firms to compete effectively in markets. It also supports innovation, efficiency and productivity in the telecommunications sector (OECD, 2017b). Despite these efforts, LAC has shown the least convergence with best practices in terms of regulatory factors when compared with East Asia and the Pacific and with sub-Saharan Africa (World Bank, 2018b).

Corruption and a lack of compliance with the rule of law continue to present a risk for businesses

Corruption continues to make headlines in Latin America. In 2015, only 15% of the Latin American population did not believe that extensive corruption was present in their own governments (Latinobarómetro, 2015). The situation has recently deteriorated, with perceptions of corruption across Latin America rising: more than 60% of the region's population thought that corruption increased from 2015 to 2016, with that figure reaching 87% in Venezuela, 80% in Chile and 79% in Peru (Transparency International, 2017).

Similarly, analysis shows that compliance with the rule of law is low in LAC countries. Indeed, the regional average on the World Justice Project's Rule of Law Index, measuring rule of law adherence in 113 countries and ranging from 0 (low) to 1 (high), stands at 0.58. This is way below the OECD average of 0.74 (OECD, 2018c). Weak legal enforcement can increase risks of corruption and lead to an even more complex business landscape.

These issues come at an economic and social cost. Estimates show that the annual cost of corruption amounts to 5% of global GDP or USD 2.6 trillion. Corruption also increases the cost of doing business by up to 10% on average (OECD, 2014a). Not only does corruption create an additional direct cost for business as represented by bribes, it also brings risk in the form of potential prosecution, penalties, blacklisting and reputational damage (OECD, 2014a). Ultimately, corruption and a weakened rule of law act as a tax on corporate activity and, in the LAC context, have the effect of discouraging private investment (IMF, 2016b). At a broader level, lack of transparency creates market distortions through an erosion of fair competition, which stifles future business opportunities (OECD, 2014a).

The persisting skills mismatch remains a barrier to business growth

Human capital and skills are essential to the advancement of social cohesion, boosting aggregate labour productivity and improving companies' capacity to seize market opportunities. Globally, Latin America remains the region with the largest skills gap (IDB, 2017a). More than 50% of firms in the region continue to experience difficulty filling jobs, a rate that is far above the OECD average (36%) (ManpowerGroup, 2015). Despite improvements in educational outcomes, Latin American countries rank at the bottom of the OECD's Programme for International Student Assessment's (PISA) proficiency distribution (OECD, 2018d). Furthermore, technological progress is rapidly transforming the nature of jobs, with low-skilled workers and youth being among those most at risk (OECD, 2018e). This also shifts the demand for skills, requiring workers and companies to adjust (ManpowerGroup, 2016). Technological change can further exacerbate the lingering educational shortcomings of LAC countries. This risks increasing the divide between labour market needs (particularly for businesses) and the pool of available skills (IDB, 2017a). Without an adequate policy response, the region's persisting skills mismatch can become a barrier to job opportunity for LAC citizens, as well as an obstacle to firms' overall productivity (IDB, 2017a).

The emergence of the middle class: challenges and opportunities

In the 15 years following the turn of the century, LAC economies have known an extended period of socio-economic progress. The share of the population living in poverty dropped from 43% to 24% between 2000 and 2015. In addition, measurements of well-being beyond income, such as health, education and equality issues, have significantly improved (UNDP, 2016). The percentage of the population earning USD 10-50 per day (2005 purchasing power parity), considered a benchmark for the middle class, rose from 21% in 2000 to 35% in 2015 (OECD/CAF/ECLAC, 2018). As such, the rise of the middle class in the LAC region has been one of the major positive socio-economic transformations of recent times. This has given way to a new consumer class with more sophisticated needs and greater expectations in terms of goods and services. It has also brought new challenges and opportunities to the region's public and private sectors.

The growing middle class presents new market opportunities for businesses

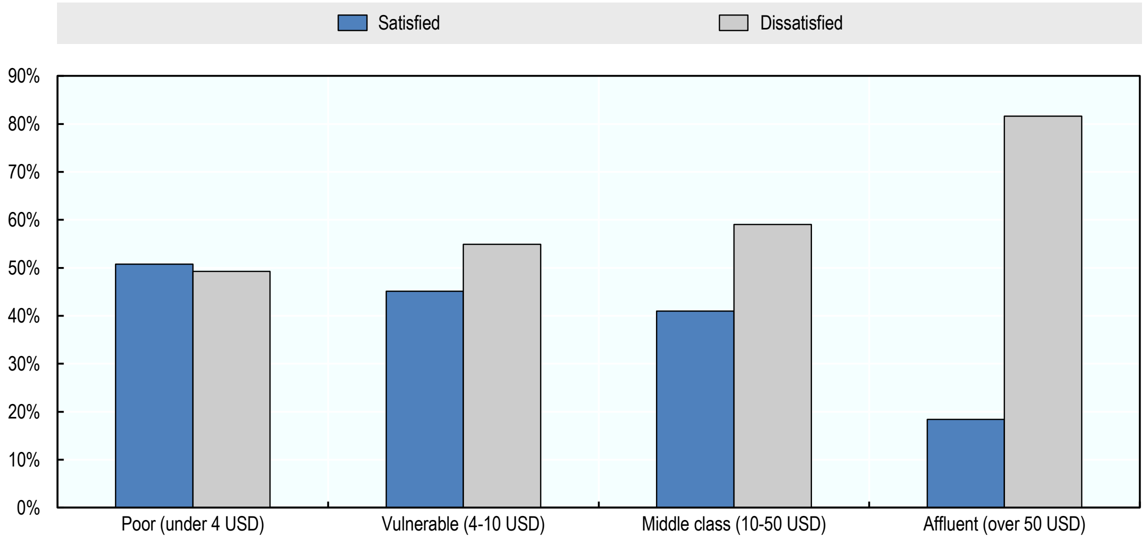
The emergence of a new middle class has brought new opportunities for businesses operating in the region. Economic growth since the turn of the century, coupled with an increase in average earnings and a decrease in poverty levels in nearly every country, has propelled domestic incomes upwards, supporting domestic demand (ECLAC, 2017b). These trends present lucrative opportunities for many businesses, as this category of consumer represents a major evolving market, consuming close to USD 500 billion per year (Price, 2016). Together with the growing demand, the region has experienced a shift in focus for business models. Traditional bottom of the pyramid (BoP) models of low price, low margin and high volume, which can be difficult to implement (Simanis and Duke, 2014), have been replaced by a strategic targeting of middle-income consumer groups (Euromonitor International, 2014). This segment has sufficient spending power to consume non-essential goods (Euromonitor International, 2014). Thus, this emerging consumer class can respond to more sophisticated, higher-margin products and services, which present significant opportunities for the private sector (Euromonitor International, 2014). Companies are increasingly required to offer a broad range of goods and services tailored to local tastes, and to provide good customer service and consistent quality standards in response to the new demand (Euromonitor International, 2014). It is therefore important for governments to recognise their evolving domestic markets and to adequately adjust policies for companies to properly respond to this new demand.

Rising aspirations increase pressure on governments to deliver public goods and services

With rising living standards, LAC's middle-class citizens have become more demanding of their governments to deliver on public goods. LAC governments continue to struggle in catering to the needs of their citizens, leading to growing public frustration. Perceptions of public services have deteriorated. Dissatisfaction with public education was reported by 47% and public health services by 56% of the LAC population, as compared with figures of 46% and 52% for 2012 (USAID/LAPOP, 2017). This is well above levels in OECD countries (stable at around 30% for both education and health) (OECD, 2017a).

Discontent with public services is widespread throughout Latin American societies and this discontent increases with income. While 55% of the vulnerable middle classes have expressed dissatisfaction with health services, this figure exceeds 80% for the affluent classes (Figure 5). These high levels of dissatisfaction have led large numbers of Latin Americans to opt out of public services completely. (OECD/CAF/ECLAC, 2018).

Figure 5. **Satisfaction with public health services by socio-economic group, 2015**



Note: Percentage of responses to the question: "*Are you very satisfied, satisfied, dissatisfied, or very dissatisfied with the quality of public medical and health services?*" Satisfied represents the sum of those who answered to be "very satisfied" and "satisfied" with the public medical and health services, while dissatisfied is the sum of the "dissatisfied" and "very dissatisfied", categorised based on daily per capita income (USD).

Source: OECD/CAF/ECLAC (2018), *Latin American Economic Outlook 2018: Rethinking Institutions for Development*, OECD Publishing, Paris, http://dx.doi.org/10.1787/leo-2018-en.

Providing public goods and services is an essential component of government action. Improving the quality, access and responsiveness of public services can be a key lever to restore trust in government (OECD, 2017c). In response to surging demand for better public goods, and given the private sector's know how, partnerships between the public and private sectors can become an attractive option in improving services. PPPs, which have traditionally focused on transportation, telecommunications and energy, have now started to include social infrastructure sectors such as healthcare (PwC/UCSF, 2015), educational and prison facilities and e-governance (AKE, 2017). New partnerships can facilitate the mobilisation of previously untapped resources and develop more innovative solutions. PPPs, when properly implemented, can therefore be effective solutions for governments responding to rising and more sophisticated demand from citizens in a context of increased fiscal constraints.

Public institutions can play a crucial role in restoring business confidence and reviving investment

Strengthening institutions in the region can restore business confidence and support investment. In order to promote investment more effectively, LAC governments will need to adopt predictable and transparent processes, increase accountability, and provide a framework that allows stakeholders to participate in policy development (UNCTAD, 2004).

As described above, firms operating in the LAC region are facing a number of challenges. A subdued growth outlook, low levels of trust and a challenging business climate all contribute to hampering business confidence and investment. Latin American governments can play a critical role in providing the policy frameworks to open up new business opportunities. Strengthening institutional governance will therefore be essential in supporting business growth throughout the region (Bayar, 2016).

Business regulations have a key role to play in unlocking investment. By promoting open and competitive markets and creating level playing fields, governments throughout the region can incentivise investment and reduce business risk. Measures such as establishing independent competition authorities, reducing state intervention and abolishing overly restrictive competition policies all contribute to more competitive markets. Not only can this revive investment but it can also boost productivity and encourage innovation (OECD, 2016b).

Recent episodes of corruption and low levels of compliance with the rule of law, both of which generate uncertainty, also burden the investment climate. Governments throughout the region can tackle these issues by strengthening public institutions and by promoting accountability and a coherent integrity system and strong, independent judicial institutions. All of these factors will contribute to broader compliance with the rule of law.

Institutions also have a role to play in addressing the region’s low levels of productivity. Enhancing integration through regional trade agreements and trade facilitation measures will help counteract the negative impacts of an increasingly complex global trade landscape. At the same time, an adequate supply of skilled workers will have a direct impact on firm productivity. This will require a revision of education systems such as to better adapt to rapid technological changes and evolving labour market requirements. Public-private collaboration in the design of vocational education training programmes and use of labour market information can provide a solid framework for skills development. It will be essential also for governments to address productivity challenges in collaboration with the private sector if competitiveness and investment are to be advanced.

PRIVATE SECTOR INSIGHTS ON INSTITUTIONAL STRENGTHENING, BUSINESS CONFIDENCE AND INVESTMENT

This section includes insights and recommendations from the private sector drawn from the EMnet meeting on Latin America on 28 May 2018 in Paris, in addition to desk research and bilateral discussions with EMnet members and other private sector representatives. Participants at the meeting highlighted the critical role that public institutions play in establishing conditions propitious to investment. In particular, companies highlighted the need for institutions to provide a supportive business environment. Public-private collaboration was an important component in this process, as was the need to address evolving labour market requirements. Both were seen as critical in the bid to attract investment to the region.

Creating a supportive business environment

Latin America is undergoing a modest recovery after a two-year recession. However, persistent macroeconomic volatility, security issues and regulatory barriers can hinder the development of a favourable investment climate. Public institutions can play a crucial role in enhancing the level of business confidence that underpins a virtuous cycle of investment, growth and opportunity, particularly during times of transition (OECD/CAF/ECLAC, 2018).

Macroeconomic stability as a key factor in attracting investment

Participants in the EMnet meeting emphasised the need for public institutions to ensure the macroeconomic stability of their economies. Indeed, sound macroeconomic policies that sponsor growth and provide a more stable environment can play a pivotal role in defining companies' investment plans. Economic volatility depresses the overall investment climate, especially in developing countries (Pindyck and Solimano, 1993). Companies highlighted macroeconomic indicators such as inflation rates, public debt levels, GDP growth rates and currency exchange rates as factors influencing their investment decisions.

Latin American economies continue to face a number of macroeconomic issues that pose risk to investors. As a result, several LAC countries have seen their sovereign credit ratings lowered, including Brazil[3] (Reuters, 2018) and even Chile[4], the region's highest-rated sovereign debt holder (Slattery, 2017). These credit rating downgrades reflect in part macroeconomic instability, thus highlighting the need for LAC governments to prioritise the macroeconomic management of their economies.

In the past, some of the region's countries have faced challenges in trying to mobilise fiscal policy as a tool for macroeconomic stabilisation. LAC countries have typically employed pro-cyclical fiscal policy elements, increasing the risk of overheating during boom times and creating the conditions for consequent deep recessions (World Bank, 2017a). Such fiscal policies not only deteriorate a country's fiscal status, they can also amplify the volatility of the business cycle, which continues to present a source of concern for the private sector. Indeed, 28 out of 32 countries in the region showed a negative overall fiscal balance in 2017, with a median fiscal deficit of 3.1% of GDP (World Bank, 2017b). As such, fiscal crises rank as one of the top five risks in doing business in the LAC region, according to the World Economic Forum's Executive Opinion Survey (Marsh & McLennan Companies/WEF, 2017).

Participants affirmed that exchange rate volatility and high inflation can adversely affect investor confidence. For instance, in response to a sharp fall in the peso in Argentina, which reached an all-time low of 26 pesos to the dollar in June 2018 (Trading Economics, 2018), the central bank hiked interest rates by more than 600 basis points to establish a benchmark rate of 40%, the highest in the world at that point (BloombergMartinez and Gilbert, 2018). This in turn has had a significant impact in terms of investor confidence and as a consequence, on the country's attractiveness as an investment destination (Rapoza, 2018). Participants agreed that the decline in business confidence in LAC institutions' ability to manage their economies, compounded by financial instability, was weighing on consumer spending, increasing uncertainty and deterring corporate investment (Ciżkowicz and Rzońca, 2013).

Policy makers that can establish a track record of sound macroeconomic policy can generate business confidence, which will in turn support investment (IMF/World Bank, 2001). With the improving global and regional outlooks, LAC governments are being given an opportunity to improve the macroeconomic management of their economies. Space for monetary policy is opening up, with lower inflation rates in certain economies, while limitations remain with regard to fiscal policy (OECD/CAF/ECLAC, 2018). Efficient fiscal and monetary policies, as well as stronger institutions, in particular central banks, can be fundamental in ensuring economic stability and thus generating investor trust in the region.

Resolving insecurity issues

The LAC region continues to suffer from issues related to insecurity and violence. It remains the most violent region in the world, with 24 homicides per 100 000 inhabitants – more than four times the global average (IDB, 2017b). Although only 8% of the world's population lives in Latin America, 33% of total homicides in the world occurred in the LAC region in 2015 (Muggah and Tobón, 2018). This not only has social implications, as citizens in Latin America rank security as the most pressing problem (Latinobarómetro, 2016), but has economic consequences also. The total cost of crime in the LAC region is estimated conservatively at 3% of regional GDP. This represents a total cost of USD 236 billion (IDB, 2017b).

Participants concurred that this economic cost is often borne by the private sector. They stressed the need to place security at the centre of economic policy priorities. Crime, violence and a lack of security affect businesses through direct loss (from theft or fraud, for instance) or through expenses related to private security. Insecurity can have a corrosive effect on competitiveness and act as a deterrent for firms looking to invest in the region. According to the World Bank Enterprise Survey, businesses in the LAC region reported losing 3.6% of annual sales due to crime (IDB, 2017b). Over and above economic loss, crime and violence further erode trust in public institutions (OECD/CAF/ECLAC, 2018). The OECD has underlined that low levels of public governance, such as poor human resource management of security services, have caused security initiatives to fail in the region. Security service employees, for instance, tended to be less educated than the rest of the public sector (OECD/CAF/ECLAC, 2018).

Although security-related public spending in LAC is similar to levels in the United States and the United Kingdom (1.45% of GDP), average private spending on security was estimated at between 0.81% and 1.37% of GDP in 2014 – double the rate for the US and the UK (IDB, 2017b: 23). In addition to costs incurred to ensure the security of their assets and employees, companies are sometimes required to face public safety challenges incurring a different type of cost. A case in point, for example, is the telecommunications sector, where a number of Latin American countries have imposed network service restrictions or signal inhibitors to prevent communications in prisons or other prohibited areas. In Guatemala, mobile operators are required to implement technical solutions that interrupt mobile telecommunications in and around prison facilities (GSMA, 2014). The use of such devices causes extensive network disruption, affects service quality, and can put public safety at risk if emergency services cannot function properly (GSMA, 2014). Other measures that LAC governments have implemented to tackle these issues – thereby raising concern for businesses and acting as a deterrent to investment – include sector-specific taxes described as contributing to the cost of public security. In Honduras, the 2011 Law on Citizen Security established a Special Contribution from the Mining Sector, levied at 2% of the free on board (FOB) value of mineral exports to finance citizen security (IDB, 2013). Similar to spending on security services, these indirect costs can weigh on investments and create a barrier to growth in the affected business sector.

Participants in the EMnet meeting emphasised the need for governments to find more effective solutions to tackle insecurity and violence. More specifically, policies should avoid creating asymmetries if they are to allow for better functioning markets. Research by the IDB has shown that earmarked taxes[5] are more sustainable the more moderate the rate and the broader the base (IDB, 2013). Meanwhile, the public security objectives of LAC governments can be more easily achieved through greater spending efficiencies and more targeted levies. Latin American security policies should be comprehensive, be subject to rigorous performance evaluation, and be the result of multi-year planning strategies (IDB, 2013). Businesses agreed that the private sector had a valuable contribution to make in supporting these efforts. A joint approach to finding solutions was preferable in addressing the complexities of the issue and would promote confidence and create investment opportunities.

Companies noted that it was important not to impose additional burdens on the private sector, citing as examples the mobile restrictions enforced in Guatemala and special mining sector levies in Honduras as part of those countries' attempts to deal with crime and insecurity.

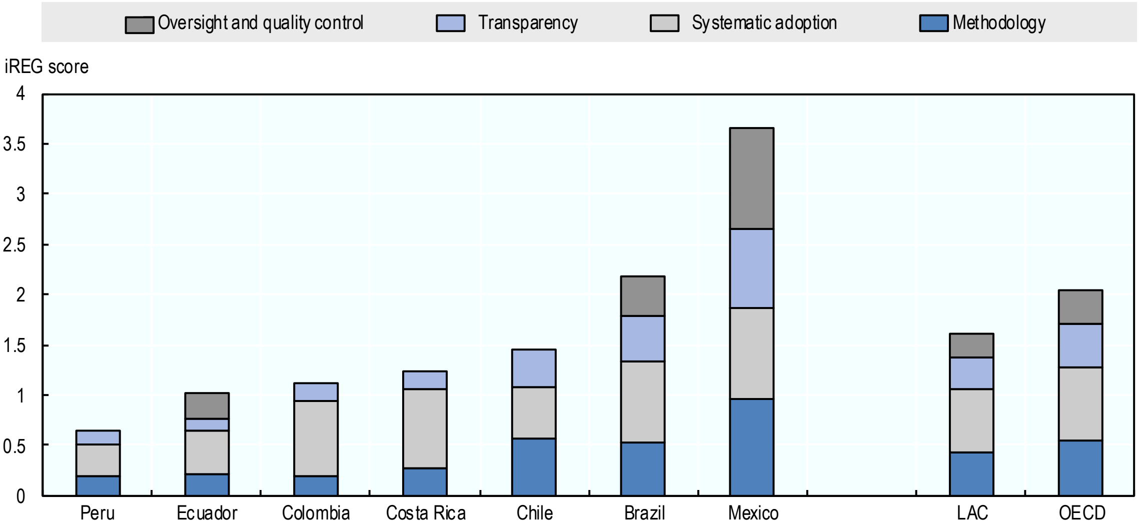
Implementing effective business regulations

Strengthening regulatory policy can give rise to considerable economic gains. Not only do adequate regulatory reforms increase firm competitiveness and productivity, they can also benefit end consumers by achieving lower prices (OECD, 2016b). Participants pointed to the example of Mexico, where reforms in the telecommunications sector led to enhanced competition and a reduction in consumer prices of more than 25%, benefiting both consumers and businesses (OECD, 2017b).

In particular, participants emphasised the need to establish a field that reduces distortions in Latin American markets as a way to rebuild business confidence. New digital technologies and more sophisticated consumer demand are generating disruptive innovations and pushing companies to develop new business models (OECD, 2016c). In this context, firms recommended that public regulators take note of business models involving new industry actors and new technologies. A case in point was the taxi industry, with Uber showing penetration into several Latin American markets (OECD, 2016c). Similar disruptions are creating change in the financial services sector, with the rise of mobile payment systems now competing with more traditional banking services (OECD, 2016c). These market disruptions have the potential to generate significant economic gains and enhance productivity (WEF, 2016). However, competition authorities must be able to provide the appropriate regulatory framework to allow LAC economies to reap the benefits fully (OECD, 2016c). EMnet members participating in the meeting advocated a flexible approach to regulatory policy. They also recommended the development of early-stage efforts to identify competition issues related to market disruptions, in line with OECD perspectives (OECD, 2016c). To this effect, the OECD is currently working with Chile, Colombia, Costa Rica, Mexico, Panama and Peru to assist these countries in undertaking market studies which will help competition authorities analyse and respond more effectively to market distortions and new developments (OECD, 2015b).

Companies also stressed the necessity of including the private sector, among other actors, more systematically in the design and permit-issuing stages of regulatory policy in order to ensure coherence and transparency. Stakeholder engagement is fundamental to the development of sound regulatory policies because it enhances the quality of regulations by gathering feedback from parties interested in and affected by them. It also increases compliance levels (Querbach and Arndt, 2017). Countries in Latin America differ in the adoption of good practices in this area. While Mexico and Brazil have adopted effective consultation systems on a par with, or even arguably better than, the OECD average, other countries, such as Peru and Ecuador, continue to lag behind (Figure 6).

Figure 6. **Composite indicator: stakeholder engagement in developing subordinate regulations in selected LAC countries**



Note: The figure displays the total aggregate score across the four separate categories of the composite indicator. The maximum score for each category is one and the maximum score for the aggregate indicator is four. The more regulatory practices as advocated in the 2012 OECD Recommendation on Regulatory Policy and Governance a country has implemented, the higher its indicator score. The data on LAC countries reflect the situation as of 31 December 2015. Data on OECD countries cover 34 OECD countries and reflect the situation as of 31 December 2014.

Source: Indicators of Regulatory Policy and Governance (iREG) for Latin America 2016. Indicators of Regulatory Policy and Governance (iREG) 2015. http://www.oecd.org/gov/regulatory-policy/indicators-regulatory-policy-and-governance.htm.

Addressing Latin America's tax landscape

Companies pointed to the taxation regime as a significant hurdle to doing business in the LAC region. More precisely, participants highlighted the prevalence of discriminatory taxation, which not only adversely affects business growth where taxes cut into profits, but can also come at a cost to the end consumer in the form of higher prices.

Throughout the region, sector-specific fiscal pressures weigh down on certain industries, and companies see this as setting up asymmetric market conditions. Excise and other indirect taxes applied to a narrow set of goods and services at increasingly higher rates are gaining in popularity in Latin America (EY, 2017a).

The case of El Salvador was highlighted in a reference to taxation of the telecommunications sector. The country implemented a special tax in 2015, the Contribución Especial para la Seguridad Ciudadana y Convivencia (CESC), which is levied at a rate of 5% on the pre-tax value of telecommunication services and equipment (determined according to the law). The tax was intended to address insecurity issues in the country (GSMA/Deloitte, 2017). As a result, in addition to several other taxes and regulatory fees – including, for example, payments linked to spectrum assignment, renewal and rights of use, which were discussed by participants – the mobile sector's contribution to government tax revenue was 1.7 times higher than the market's size[6] (GSMA/Deloitte, 2017). Indeed, the telecommunications sector contributed around 4.5% of GDP in taxes and regulatory fees, despite accounting for just 2.7% of GDP in sales (GSMA/Deloitte, 2017). Similar excise duties on telecommunications exist in other LAC countries, such as Panama (5%), Colombia (5%), Argentina (4%) and Mexico (3%) (GSMA/Deloitte, 2017).

EMnet participants stressed that such sector-specific taxes may cause inefficiencies in LAC economies and discourage investment. This argument has also been supported by recent OECD work, which highlights the pervasiveness of special provisions and differentiated tax regimes as a barrier to the efficient allocation of investments (OECD/CAF/ECLAC, 2018). Some participants also stressed the need for authorities to avoid tax discrimination based on product origin. Participants argued that new regional industry players, even if not physically located in Latin America, should be subject to the same fiscal obligations as their more established counterparts with local footprints.

Business participants highlighted examples in the alcohol beverage industry, where specific tax discriminations against foreign products have been resolved through international policy dialogue. An example was Colombia's introduction of non-discriminatory tax reforms for distilled spirits, following recommendations linked more specifically to the OECD in this regard (OECD, 2014b). Participants, encouraged by these efforts, proposed that they continue across the region.

Companies also discussed the relevance of having a local presence, in light of new trends brought on by digital technologies. They noted a perceived lack of consensus regarding a geographic link between value creation and tax liabilities that fits traditional fiscal models. The OECD recognises a number of these challenges, including more specifically the appropriate allocation between countries of taxes derived from cross-border digital activities (OECD, 2018h). The work of the Task Force on the Digital Economy (TFDE), which includes all OECD and G20 member countries, has presented options which can help individual countries address some of the challenges arising from digitalisation. These options include, for example, creating a new nexus rule in the form of a "significant economic presence" test (OECD, 2018h).

Further to this work, recent evidence suggests that some multinational enterprises engaged in digital business have already begun to align corporate structures more closely with economic activity. Nevertheless, it is recognised that challenges remain, and that there is indeed no consensus around the need to enhance OECD/G20 BEPS (Base Erosion and Profit Shifting) recommendations so that they more broadly address some of the tax liability challenges (e.g. double non-taxation) posed by digitalisation (OECD, 2018h).

In line with OECD recommendations (OECD/CAF/ECLAC, 2018), companies also expressed support for tax policy reforms that broaden the tax base. In 2015, 57% of income tax was collected as corporate income tax (CIT) while that figure reaches 32% for the revenue generated by personal income tax (PIT). This contrasts heavily with OECD countries, where 72% of income tax originated from PIT and 26% from CIT (OECD et al., 2018). With the exception of Mexico, workers in LAC countries do not pay any personal income tax at the average wage level (OECD/CIAT/IDB, 2016), highlighting potential room for reform in the tax structure and tax collection system.

Generating business confidence through trade integration

Business confidence[7] reflects firms' assessment of current and future opportunities. Participants noted that opening up trade through trade facilitation measures and free trade agreements (FTAs) can be effective at generating market opportunities and increasing levels of business confidence.

These trade liberalisation and facilitation measures provide businesses operating in the region with an institutional framework propitious to doing business on a larger scale – both regionally and internationally. However, non-tariff barriers have been proliferating, while domestic factors such as quality of infrastructure and logistics services, as well as efficiency of customs management, continue to constrain trade integration (IMF, 2017c).

Some LAC countries have made significant strides in this regard. Argentina, for instance, has implemented a number of trade facilitation measures, removing export restrictions on several products. Indeed, the country completed its ratification process for the Trade Facilitation Agreement (TFA) in January 2018, with the objective of eliminating bureaucratic delays and reducing red tape (WTO, 2018). Similarly, Mexico has made notable progress in opening up to trade. The country has signed agreements with 46 countries, while barriers to services trade have been reduced in key sectors, such as media and telecommunications (OECD, 2017b). Another example of successful trade policy can be found in Costa Rica, which has introduced a free trade zone (FTZ) regime in order to boost exports (OECD, 2016d. These FTZs, supported by Costa Rica's three trade promotion agencies (COMEX, CINDE and PROCOMER), have made an important contribution to exports. Indeed, between the mid-1990s and 2014, the share of goods exported by firms located in the FTZs rose from 12% to more than half of the total value of goods exported, which more than tripled over the same period (OECD, 2016d).

Throughout the region, Latin American countries are progressing towards greater trade integration by establishing trade platforms. Among these, the most notable are the Mercosur and the Pacific Alliance. Combined, these trade platforms represented more than 80% of the region's foreign trade and more than 90% of regional GDP and FDI flows in 2014 (ECLAC, 2014). The Pacific Alliance trade pact removed tariffs on 92% of commercial products between Chile, Colombia, Mexico and Peru, with the intent to remove the remaining 8% in less than seven years (EY, 2017b). These two trade blocs (Box 1) are meeting regularly to discuss ways in which they can deepen economic ties and explore possibilities for co-operation (OECD/CAF/ECLAC, 2018).

Participants emphasised that these efforts to boost both intra- and extra-regional trade can generate business confidence and support private investment. They also emphasised that promoting trade openness is essential in responding to evolving consumer demands, as Latin Americans increasingly look for premium products. While the total Latin American consumer market grew by 7.5%, the premium brand market grew by 9.2% in 2016 (Nielsen, 2017). Similarly, more than 50% of the so-called Millennials and Generation X in the region are more open to innovative products that their markets cannot provide (Nielsen, 2017).

Box 1. Latin America's largest trade platforms: Mercosur and the Pacific Alliance

- **Mercosur**
  Mercosur was founded in 1991 by Argentina, Brazil, Paraguay and Uruguay, which remain permanent members, while Venezuela's membership has been suspended since 2016, after being approved in 2012. Bolivia, Chile, Colombia, Ecuador and Peru are associate members. Mercosur acts as a customs union and a free trade bloc. It allows free trade (except on the automobile industry and sugar). The group accounts for 295 million people and USD 3.5 trillion in GDP.

- **Pacific Alliance**
  The Pacific Alliance was founded in 2011 by Chile, Colombia, Mexico and Peru. The group accounts for approximately 37% of Latin America's GDP and 50% of exports. It is a trade bloc that pursues commercial, economic and political integration among member countries. It is based on a liberalisation agenda in the areas of trade in goods and services, investment and capital markets.

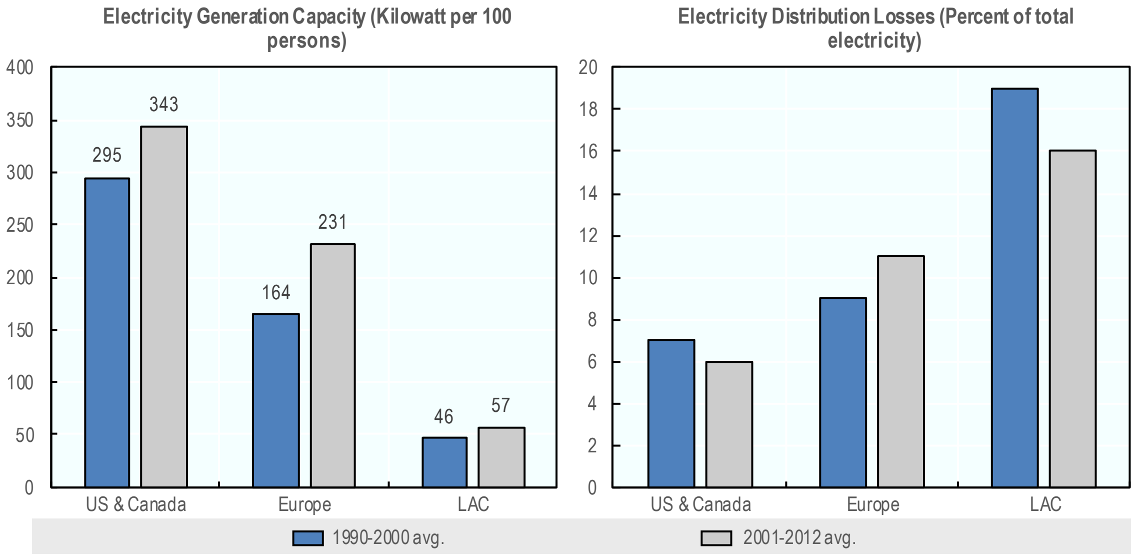
Sources: OECD/CAF/ECLAC (2018), *Latin American Economic Outlook 2018: Rethinking Institutions for Development*; Keller (2016), "Explainer: What is Mercosur?", 6 December, Americas Society/Council of the Americas website, http://www.as-coa.org/articles/explainer-what-mercosur-0; Etoniru (2015), "What is the Pacific Alliance?", 20 July, Americas Society/Council of the Americas website, *https://www.as-coa.org/articles/explainer-what-pacific-alliance*.

The private sector can act as a key partner for LAC governments in restoring confidence and reviving investment

Participants emphasised that improvements in the provision of public goods and services, as well as a reduction in the region's infrastructure gap, are necessary not only to respond to the LAC population's growing and evolving needs but also to restore business confidence and revive investment.

Latin American governments face a dual problem: the higher aspirations of the emerging middle class are increasing the pressure for states to deliver better public goods and services, while many LAC countries' ability to provide them are constrained by reduced fiscal space. Furthermore, the region continues to lag behind advanced economies in terms of infrastructure (IMF, 2016a). This is particularly salient with respect to electricity generation, in which both infrastructure stock and quality fall short when compared with the figures for developed countries (Figure 7).

Figure 7. **World electricity infrastructure indicators**



Source: IMF (2016a), *Regional Economic Outlook: Western Hemisphere*, http://www.imf.org/en/Publications/REO/WH/Issues/2017/01/07/Regional-Economic-Outlook-Western-Hemisphere12.

In sectors such as insurance services for example, there is a perception expressed by businesses of an evolution in the demands of the middle class in Latin America since the 1990s. In urban centres across the region, businesses see demand for services that are similar to what would be expected in OECD jurisdictions. This level of demand sophistication however is not widespread and less complex insurance products still need to be adapted and proposed outside of this framework.

In responding to this demand, the sector is looking for policy makers in Latin America to guarantee a certain level of macroeconomic stability. This is particularly relevant with regards to managing inflation and price stability, which is a key priority in order to be better able to manage the long-term investments that underscore the effective operations of this sector. While expectations for inflation across the region at the end of 2019 are anticipated at 3.5%, there is wide variability between countries like Mexico (3.3%) and Argentina (27.5%) (Fundación MAPFRE, 2018). Businesses also see a need to enhance general saving levels, which can facilitate investment in projects that can broadly benefit the middle class such as targeted infrastructure initiatives or strengthening pensions.

PPPs as sponsors of investment and public service improvement

Companies highlighted how PPPs can be effective in sponsoring investment. PPPs can channel new funds into public infrastructure projects, thus freeing up fiscal resources, which can be allocated towards other priority projects (World Bank, 2017c). As well as expanding the fiscal space, PPPs offer the possibility of significantly increasing efficiencies. Collaborating with the private sector on infrastructure projects can also increase visibility on a project's completion time and budget (World Bank, 2016). The presence of multiple stakeholders, who assume different risks in line with their capacity to manage or diversify them, allows for more effective pricing and risk allocation. This can in turn lead to more efficient outcomes (World Bank, 2017c). PPPs also present an opportunity to benefit from the private sector's expertise, from its innovative capacities and project management competencies, facilitating a transfer of skills to governments or state-owned enterprises (World Bank, 2016).

Previous EMnet discussions have highlighted how PPPs can facilitate the implementation of large infrastructure projects and reduce the cost of such investments. However, if adequate institutional and human capacities are not in place, PPPs can have the inverse effect of propelling such costs upwards (OECD, 2017d).

Countries throughout the region have been using PPPs since the late 1980s with varying degrees of success (World Bank, 2017c). PPPs in LAC countries have traditionally focused on information and communications technology (ICT), energy and transportation. It is noteworthy that one-third of regional investments in infrastructure come from the private sector (OECD/CAF/ECLAC, 2018). Chile leads the region in this development, with 197 projects awarded from 1990 to 2016 worth USD 69.4 billion, ranging from water and sanitation facilities to roads and ports (AKE, 2017).

Participants highlighted the need for LAC governments to provide a clear, predictable and legitimate institutional framework that is supportive of PPPs. The public sector needs to present itself as a solid partner for PPPs and to build institutional capacity accordingly (OECD/CAF/ECLAC, 2018). Companies stressed that key roles and responsibilities should be determined and maintained throughout the project's lifespan, while regulations should be clear, transparent and promote a more competitive landscape. The OECD provides a number of recommendations to this effect, in line with EMnet participants' views, through its Principles for Public Governance of Public-Private Partnerships (OECD, 2012). These recommendations serve as a guideline to allow governments to ensure that "PPPs are met by strong institutions, are affordable, represent value for money and are transparently treated within the national budget process" (OECD, 2012).

Latin American governments are working towards strengthening their PPP regulatory and institutional environments. The Infrascope Index, which measures a country's capacity to implement sustainable and efficient PPPs in infrastructure on a scale of 0 to 100 (with 100 being the highest), ranks Chile and Colombia as the regional leaders, with both countries scoring 74 (The Economist Intelligence Unit, 2017). Argentina (48/100) stands among the lowest-ranked LAC countries, along with Panama (51/100), the Dominican Republic (49/100), Ecuador (44/100) and Venezuela (8/100) (The Economist Intelligence Unit, 2017). Furthermore, nine LAC countries already have units dedicated to managing PPPs (World Bank, 2018d) and most have taken steps to improve their PPP legal and policy frameworks. Peru, for instance, has enhanced its PPP legal and institutional frameworks by strengthening the independence of the Proinversion agency that promotes private investment in public services and infrastructure through PPPs (Astesiano, 2017). Argentina also implemented a new PPP law in 2016, which regulates aspects of PPP projects in order to stimulate private investments in areas such as infrastructure, housing and services, among others (Herbert Smith Freehills, 2016).

Fighting corruption and strengthening the rule of law through public-private collaboration

The private sector plays a pivotal role in the fight for greater transparency. As a key actor and a central stakeholder, affecting and affected by this challenge, business will be key in promoting accountability, integrity and supporting a broader culture of transparency. Companies affirmed that the private sector can be instrumental in reinforcing compliance and promoting transparency in Latin America.

Business stakeholders are increasingly playing a role in anti-corruption efforts by making voluntary commitments above and beyond the legal requirements for anti-bribery compliance. For instance, Walmart, the US retailer, has invested more than USD 141 million in its global ethics and compliance systems since 2013. Moreover, it has been pursuing certification under programmes such as the ISO 37001 anti-corruption norm (Krolicki and Bose, 2017).

Companies present at the EMnet meeting stressed that only through public-private collaboration can effective measures be identified and the appropriate steps taken to support a more open and competitive business environment. Multinational corporations, through their day-to-day operations, come into contact with multiple governments and have first-hand experience engaging with a variety of public institutions. As such, the private sector is a pool of knowledge on government processes that can be tapped into and used by governments looking to strengthen the rule of law and to fight corruption in their countries. EMnet participants emphasised that more collaboration and knowledge sharing between the public and private sectors can be key to addressing compliance and transparency issues. An example that was brought forward during the discussions was the World Economic Forum’s Partnering Against Corruption Initiative (PACI), a CEO-led platform with approximately 90 global cross-industry signatories that works to bolster trust, integrity and transparency through public-private collaboration (WEF, 2018b).

Meanwhile, participants discussed how institutions must design and enforce rules and regulations that adequately promote more robust anti-corruption behaviour, level the playing field for all stakeholders, and set the highest standards of ethics and good practice. A prime example of institutional efforts to promote transparency can be found in Peru. Following OECD recommendations on Public Integrity and Transparency, Peru created a National Authority for Transparency and Access to Information in 2017. The government created this entity to promote and supervise compliance with the rules of transparency and access to public information (El Peruano, 2017). The OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which establishes legal standards criminalising bribery, has six Latin American signatory countries – Argentina, Brazil, Chile, Colombia, Costa Rica and Mexico (OECD, 2017e). Following recent high-profile corruption scandals, which have had an impact on a number of governments across the region, as well as legal obligations under the OECD Convention, a number of LAC countries have undertaken further legislative reforms. For example, Argentina's new 2017 Law on Corporate Criminal Liability expands corporate liability to include national and transnational bribery activity. It goes even further, creating potential successor liability in mergers and acquisition transactions (Goldaracena and Caniza, 2018). Companies recommended that countries continue emphasising this type of effort and work with entities such as the OECD to ensure alignment with best practices. Also in alignment with these recommendations, the OECD launched the *Integrity for Good Governance in Latin America and the Caribbean Action Plan* in Lima, Peru, in 2018. The plan seeks to provide guidance on the introduction of specific policy actions to enhance anti-corruption and integrity frameworks for public governance across the region (OECD, 2018i).

Addressing evolving labour market requirements will be key in enhancing business productivity

Despite opportunities for improvement, labour market inefficiencies weigh down on business growth

Labour markets in Latin America continue to suffer from significant inefficiencies with regard to skills and qualifications. While over half of firms struggle to find adequately skilled workers, the region has the highest skills shortage in the formal economy (Melguizo and Pages-Serra, 2017). The region also suffers from occupational mismatch. A study by the International Labour Organisation of youth in the LAC region found that for 36% of surveyed young workers their studies did not apply to their line of work. Moreover, 39% said that their jobs demanded fewer years of study than they had completed (ILO, 2017b).

Labour market failures have been found to negatively affect businesses due to lower labour productivity and less efficient allocation of resources (Adalet McGowan and Andrews, 2015). Furthermore, a more skilled workforce is linked to higher market value (Abowd et al., 2005). To this effect, businesses pointed to the prevalence of these labour market inefficiencies as both a cause of social and developmental challenges and a barrier to business growth.

At the same time, participants evoked Latin America's particular demographic advantage: a relatively young population. Indeed, one-quarter of the Latin American population is aged between 15 and 29 (OECD/CAF/ECLAC, 2016). Most countries in the region benefit from this demographic dividend today, which offers LAC governments the possibility of achieving development and firm productivity gains (OECD/CAF/ECLAC, 2016). However, many of these young individuals are confronted with a lack of labour market opportunities, as companies cannot offer jobs that match their needs (Herranz, 2016).

As the demographic window of opportunity is closing, with decreasing fertility rates and rising life expectancy, it is ever more important for LAC governments that they address inefficiencies in their labour markets. Participants stressed that, by doing so, a significant step will be taken towards rebuilding trust in institutions among both citizens and firms.

Adapting policy to the region's evolving labour market dynamics

The needs of the region's population are changing, in terms of labour market outcomes. New forms of work are emerging on a global scale with, increasingly, more workers engaged in temporary, part-time, own-account or triangular employment[8] (ILO, 2017b). An International Labour Organisation survey of Latin American youth found that 69% of respondents would prefer to work in their own companies in the future, while 40% expect to work from home and 59% anticipate flexible work schedules (ILO, 2017b). These perspectives on future employment contrast strongly with the current labour market situation. Indeed, only 10% of youth surveyed currently work in their own enterprise, while fewer than 30% work flexible hours and fewer than 20% work from home (ILO, 2017b).

Firms operating in the region that will be able to provide workers with better-adapted contracts can take advantage of these emerging preferences to benefit their activities. Offering more flexible solutions can help businesses attract and retain talent (ManpowerGroup, 2017). A ManpowerGroup survey of 14 000 global candidates aged 18 to 65 found that 38% of respondents place schedule flexibility among the top three factors they consider when making career decisions, a 20-30% increase since 2016. This figure is even higher in LAC countries such as Colombia (39%), Peru (41%), Costa Rica (45%) and Argentina (45%) (ManpowerGroup, 2017). Flexibility also allows firms to adapt to fluctuations in the business cycle and withstand economic shocks (ILO, 2016).

Labour market policies and regulations have a strong role to play in this regard, not only in supporting flexibility for businesses and workers but also in ensuring that non-standard jobs are of better quality and are better able to meet expectations. Labour market reforms in LAC countries explain in part the heterogeneity of the evolution of temporary and part-time work across the region (ILO, 2016). Argentina, for instance, has a relatively low incidence of temporary employment, due in part to more rigid labour market regulations (ILO, 2016). Research points to high termination costs, complex procedures for collective dismissals and restrictions on the use of temporary contracts as impeding the good functioning of the Argentinian labour market (OECD, 2017f). Participants noted in particular that labour market reforms should provide firms with the flexibility they need to properly recruit human capital, while ensuring that the quality of temporary and part-time jobs is preserved. This can prove to be an effective tool for fighting informality in Latin America, as more flexible employment can provide a stepping stone for youth to enter the labour market (OECD, 2014c).

During the EMnet meeting *Public-private collaboration towards institutional openness* in Guatemala, businesses highlighted in particular the role that multinational companies can play in addressing the informality challenge. This included how, under their obligations to comply with international standards on anti-corruption, a number of multinationals work closely throughout their supply chains in the region, including through small and medium-sized producers, to ensure that formal processes are in place to guarantee compliance. This creates an incentive that drives local suppliers towards formality in order to be better able to integrate their products into these value chains and facilitate access to markets.

Rethinking education systems to close the skills gap

Companies affirmed that a key lever in unlocking firm productivity and preparing future generations of workers for the fast-changing world lies in skills development. Education systems were discussed as a fundamental area needing improvement in Latin America. In order to provide Latin Americans with the skills that companies are looking for, businesses stressed the need to rethink education systems to provide more adequate training that better matches labour market requirements.

Demand for specific skills is shifting in Latin America. As technology advances, the nature of jobs will be transformed (ManpowerGroup, 2016). Although this provides LAC economies with potential growth engines, it also increases the complexity of skills required by today's labour markets (Melguizo and Perea, 2016). As such, skills related to creativity, cognitive ability and emotional intelligence will be in increasing demand (ManpowerGroup, 2016).

In order to build effective educational programmes, companies recommend revising traditional educational models by sponsoring more public-private co-operation. Collaboration between the private sector and educational institutions can help bridge the gaps that separate students and the unemployed from acquiring the skills they need to access labour markets (WEF, 2015). Vocational education and training (VET) programmes can provide a solid framework to help students gain the skills currently sought by employers but can also better adapt training programmes to future labour market requirements. Companies acknowledged that VET programmes and on-the-job experience are still lacking across the region. In countries such as Chile and Ecuador, for instance, fewer than half of secondary students do internships (UNESCO, 2016). Increased public-private collaboration, with flexible roles and responsibilities, will be a necessary step to allow educational and vocational training systems to adapt to changing demands for skills (OECD/CAF/ECLAC, 2018). An example of this is the Cibertec Institute in Peru, which offers technical-vocational training to more than 14 000 students in collaboration with companies such as Cisco Systems, Microsoft or Oracle, to ensure that its students obtain marketable skills (IFC, n.d.)

At the same time, companies across the region, along with other stakeholders, are increasingly contributing to enhancing the skills of the workforce. Companies emphasised that with first-hand knowledge of the skills required by employers, the private sector can offer education solutions to the region's workforce that are better adapted to labour market requirements. IBM, for instance, through its IBM Skills Gateway offers online as well as in-person training courses specifically designed to develop the skills that businesses need.[9] Furthermore, the P-TECH programme, which the company has also pioneered, offers an example of a collaborative model, where a partnership is established between high schools, community colleges and local business partners to provide STEM (science, technology, engineering and mathematics) training to underserved youth. The goal is to facilitate the obtaining of high school diplomas, free associate's degrees and first-in-line job interview opportunities based on the skill requirements of the various industry partners (IBM Corporation, 2018). Similarly, Google's Activate initiative provides free online and offline training in the digital skills space to unemployed individuals. The pilot initiative has trained 170 000 students and awarded 30 000 certifications worldwide and is present in several Latin American countries, such as Argentina, Chile, Colombia, the Dominican Republic and Ecuador. (WEF, n.d.).

CONCLUSION

Despite improved economic prospects, the LAC region's growth outlook remains below the global average, as well as below that for other emerging regions, such as Asia or Africa. Latin American economies continue to face a number of challenges related to low levels of productivity, investment and trust. At the same time, LAC countries are experiencing a number of transitions. Indeed, political, social and demographic shifts are occurring throughout the region that present both risks and opportunities.

LAC governments will play a pivotal role in addressing these issues. By sponsoring a healthy business environment, institutions play a key role in introducing virtuous cycles of trust, investment and growth. This provides businesses with opportunities to grow, while consolidating partnerships and upholding the highest ethical and best practice standards. The private sector can also be a key player in efforts to address these issues. Through collaboration with the public sector, businesses can help respond to growing pressure from citizens for better public services and at the same time assist governments in strengthening their institutions.

Business representatives agreed that strong institutions and mutual trust are the pillars fundamental to the revival of investment. Addressing productivity issues will require efficient regulatory policies, a revision of labour markets and education systems. Macroeconomic instability, insecurity and market distortions all weigh heavily on investment decisions and will require a strong institutional response.

Providing companies with market opportunities and reducing barriers to the expansion of their activities should be at the centre of policy decision-making. Business and inclusive growth are not antithetical, and carefully designed and implemented policies can benefit Latin American economies significantly. Trade integration and promotion of PPPs are just two examples of measures that, if implemented correctly, can generate growth and investment opportunities.

Overall, participants stressed the need to sponsor more dialogue between the public and private sectors, emphasising that building confidence is a difficult process and requires time. Only through repeated and systematic consultation between both sectors, and successfully designed policies that take this dialogue into consideration, can the LAC region truly benefit from the improved global outlook and close the income gap.

Notes

[1] Members of the Pacific Alliance include: Chile, Colombia, Mexico and Peru. Mercosur members include: Argentina, Brazil, Paraguay and Uruguay.

[2] The International Labour Organization defines own-account workers as "workers who hold self-employment jobs and do not engage 'employees' on a continuous basis". See ILO website: http://www.ilo.org/global/statistics-and-databases/statistics-overview-and-topics/status-in-employment/current-guidelines/lang--en/index.htm.

[3] S&P cut Brazil's credit rating to BB- (three notches below investment grade) in January 2018 as doubts grew about the government's ability to close the fiscal deficit.

[4] S&P downgraded Chile's sovereign debt rating to A+ from AA- in July 2017 due to weak business confidence and low commodity prices, which led to reduced fiscal revenues.

[5] Earmarked taxes are taxes whose revenues are reserved solely for a specific group or usage.

[6] A value greater than 1 indicates that the sector over-contributes to tax revenue relative to the size of the sector in the economy.

[7] See OECD "Business confidence index": https://data.oecd.org/leadind/business-confidence-index-bci.htm.

[8] Triangular employment refers to an employment relationship involving three actors: an employee, an agency and a client (employer).

[9] See IBM Skills Gateway webpage: https://www-03.ibm.com/services/learning/ites.wss/zz-en?pageType=page&c=a0011023.

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