Chapter VII

Concluding remarks: The State and policy in the integrated approach to development

A. Policy and the State in an integrated approach to development

The proposals put forth herein seek to continue further with the ideas set out in *Time for equality: closing gaps, opening trails,*[1] building on an integrated vision that combines the economic, social and environmental dimensions of development. What is proposed is to advance, in an integrated, systematic fashion, towards the strategic horizon of structural change with equality, in the spheres of industrial, macroeconomic, labour, social and environmental policy. But the focus is, first and foremost, on the interlocking nature of and synergies among these spheres of intervention.

The integrated approach emerging from these long-range proposals calls for coordinated action by involved, committed stakeholders. It also calls for robust, efficient institutions that can regulate, guide, target and even fund many of the actions needed to advance towards this vision over time.

Politics and the State therefore have critical roles to play. Politics, because the combination of stakeholders for transforming the production pattern and deciding which sectors to target requires political covenants to ensure support for this approach and for its continuity over time. The relationship between structural change with equality and political legitimacy is a two-way street. Because a development strategy such as the one proposed here has such a long-term horizon, coordination among political institutions, government agencies, the business community, workers and other civil society stakeholders is paramount.

[1] LC/G.2432(SES.33/3), 2010.

There is a bicausal link between the quality of a democracy and the continuity of development policies geared towards structural change with equality. Sounder, more transparent political democracy institutions make for stakeholders who are more inclined to rally around a shared strategy. When deliberative spaces, channels of participation and mechanisms for political representation and policymaking operate smoothly, the wheels of the systemic adjustment proposed herein will run more smoothly, too.

Political will and policy quality are, therefore, conditions —or achievements— that should be the foundation of profound change that requires agreements and a shared ethic for reaching compromises among the actors involved in structural change.

But this also calls for a different kind of State. First comes a State whose political legitimacy is grounded in its ability to set the course for future development towards horizons such as those spelled out by ECLAC in *Time for equality* and herein. It is not enough for a State to exhibit administrative probity and efficient use of resources (although these are essential if society is to trust in its government). The State must be able to substantively mobilize and communicate its citizens' aspirations for well-being and progress by means of messages that link the present and the future, mapping out the route from one generation to the next and winning support and commitment (which does not at all mean uniformity of opinion or of vision).

Second comes a State with a clear ability to rally stakeholders around far-reaching projects. In Latin America and the Caribbean there is no other actor that could shoulder this role of coordinator in the face of such a complex industrial, macroeconomic, labour and social policy scenario. Experience shows that self-regulating markets do not optimize factor allocation, foster synergies, achieve social integration or set or hold the best sustainable course towards development. In this second decade of the twenty-first century, there is evidence at the national, regional and global levels that coordination and regulation are essential in a wide range of spheres (finance, trade, production, environment and migration, among others). It is the State that can regulate, oversee, target and coordinate at the national level, both inwards and outwards, from a vantage point that encompasses all facets of development. Economic strategy in the region has largely been lacking in this active role of the State in coordinating decision-making by the actors involved.

Last, what is needed is a State with clear goals to drive many of the processes proposed under the aegis of structural change with equality and environmental sustainability. This calls for appropriate incentives and robust investments that, at the same time, target knowledge-intensive sectors, activities that create quality jobs and are competitive internationally, and a technology paradigm that ensures lower carbon intensity and high energy and environmental efficiency. It is equally essential to invest in human capacities for structural change and greater equality in the generational changeover. Policies must be devised and funded to provide a shield against the risks of income loss and to guarantee minimum levels of well-being during the transition towards a new production and information paradigm. All of this also calls for new fiscal covenants and arrangements that enable the State to capture more resources for promoting economic growth in the context of an improved, more progressive tax strategy.

The central role of the State in the policy areas proposed herein is examined in more detail below.

B. Central role of the State in policies geared towards structural change with equality

1. Industrial policy: Institutions to be built

This document highlights the central role that industrial policy has to play in structural change with equality. It acknowledges that the road to a new paradigm consistent with greater environmental sustainability and energy efficiency will only be possible if there is a move towards profound change in production structures to respond to the pressing need for a leap in technology. But the region lacks industrial policy and, above all, consistent public institutions that can move these policies forward, keep them targeted and funded and ensure that they are in line with current challenges in the spheres of technology, production, the environment and global integration.

For this same reason, institution-building is priority number one. Just as in the 1980s and 1990s, when highly professionalized central banks and ministries of finance were consolidated and conferred with decision-making power and the autonomy needed to be consistent over time and beyond electoral swings, what is needed today is a similar consolidation and empowerment of development banks and ministries of industry or production. Such institutions promote and marshal the interests of all stakeholders around structural change and provide a framework of institutional legitimacy and technical competence for making decisions that are not easy: which sectors should be targeted for change, how to disseminate technological capacities, how to coordinate industrial policy with macroeconomic management, where to invest fiscal resources to enhance the scope and speed of structural change and how to bring into the transformation process sectors where investments and jobs might be threatened by accelerating technological progress. Without adequate institutions there is no viable governance capacity or political will to move forward consistently, with a targeted, long-term vision, along the lines laid out here in terms of industrial policy. We are facing a potential third industrial revolution that may be similar in scope to previous ones. This calls for more urgent, active action by the State in the face of global vulnerability and uncertainty.

Under the industrial policy approach laid out herein, the State should act in complementary directions, i.e., build the capacities and competitiveness of existing sectors with clear potential for specialization and for incorporating technological progress, and diversify the production structure by creating or consolidating new high-productivity, more environmentally efficient sectors. This is on top of the pressing need to promote higher efficiency among small and medium-sized enterprises and microenterprises, especially because of their capacity to generate jobs and become disseminators of knowledge and of technology appropriation. This shift in modes of production requires scientific and technological knowledge and synergies in order to marshal advances in biotechnology, nanotechnology and digital technology so as to leap forward in reducing the use of materials, in recycling waste and in harnessing new knowledge emerging from biodiversity.

Among the actors, only the State, by means of adequate institutions and techno-political capacity, can coordinate the various components of structural change to promote synergies across the economy, with backward and forward linkages, including support for intermediate productivity sectors to link more dynamically with larger companies or sectors at the leading edge of productivity. And State institutions with suitable technical capacity can evaluate policy impacts in terms of the end goals: economic growth, innovation and technological progress, higher productivity and enhanced capacities. The sustainability of this approach to development depends on maintaining the integrity of the material base of the economy: water, energy, air and biodiversity in the context of growing urbanization. These issues, while not addressed in detail in the preceding chapters, are at the core of this proposal for structural change with equality. Because public resources are scarce, only appropriate assessments will enable the State to reallocate resources and use fiscal space in areas as diverse as production promotion and investment, education, public health, environmental protection and citizen safety.

The central role of the State also has to do with the funding of industrial policy. In open economies, where blanket, permanent trade protection is not desirable, the economic signal (expected profitability) sent to potential investors in new activities is weakened. By the same token, much of the cost and risk of promotion falls to the State. Here, robust and relatively autonomous institutions are important, because industrial policy should stand on its priorities and budgets, even during times of fiscal constraint. In other words, sustaining promotion mechanisms over the long haul requires policies that outlast a given administration. This has yet to be accomplished in Latin America.

In addition to State funding for promotion policies, direct State investment is important, too. There is ample scope for action here, albeit with marked differences among regions and subregions. These differences do not mean that smaller countries or those with less developed institutions should relinquish sector-wide policymaking. There is always room for targeting sector-based action at the level of subsectors, segments or even products within the scope of existing capacities. In this sense, the region’s experience with policies promoting production clusters shows that even the smaller countries have been able to design policies for improving their pattern of specialization. Here, again, the State should promote and invest in the development of sectors and subsectors with the greatest potential and synergy. Nor should it be forgotten that the role of the State is not just to offer incentives to those who are willing to invest in structural change, but also to penalize those who have benefited from such incentives without making investments. One of the main differences between successful industrial policies in Asia and the less successful ones implemented in Latin America in the past lies, for our region, in the lack of oversight and in granting permanent benefits to firms that are not performing well in either technology or exports.

National funding to support industrial policy can now find specific international counterparties in order to, for example, speed the transition to lower-carbon economies. Between 2006 and 2011, the region captured US$ 90 billion in clean-energy investment, 80% of which went to Brazil.[2] However, the region would be able to access additional investments that are better distributed geographically if it had active industrial policies ensuring production practices that are less carbon-emission-intensive.[3]

---

[2] Bloomberg and Multilateral Investment Fund (MIF), Climatescope 2012 [online] http://www5.iadb.org/mif/climatescope/2012/overview.html.

[3] In 2011, new investments in clean energy totaled US$ 280 billion but went mainly to Europe, the United States and China. The region attracted less than 5% of the total.

2. The State and macroeconomic policy: Multiple goals and necessary agreements

The macroeconomic policy role of the State is indisputable and has grown in the region over the past two decades, both technically and institutionally. This is clear to see in the higher profile of central banks and finance ministries. One field where there has been unquestionable progress in State and government policy is in the sphere of macroeconomics. In this regard, it is important to take State institutions as a reference point for consolidating more robust and consistent industrial and social policies over time.

However, as stressed herein, macroeconomic policy goals need to be broadened. The instruments exist, and they have been used successfully. The challenge lies less in choosing what instruments to use or debating their usefulness, and more in having (or building) the institutional base and political support needed for them to be implemented and work well. Many of the instruments proposed concern cross-border movements of capital and credit control, which requires that the State conduct complex negotiations with a sector that is very concentrated and organized and has strong external connections.

Both the State and civil society have come to see greater regulation of the financial system in a more favourable light in view of the enormous economic, social and political cost of crises sparked by bubbles, liquidity cycles, crises and unsustainable financial and real estate market booms. Experience over the past few decades has very clearly shown the costs and benefits of real exchange-rate appreciation. Avoiding excessive appreciation is one of the keys for stability and growth, and the international consensus has shifted in favour of stricter regulation of short-term capital movements. But it should not be forgotten that a higher real exchange rate has a negative short-term impact on real wages. This would be acceptable only if the trade-off were a higher employment rate (to keep from lowering the wage bill as a percentage of GDP) along with faster rates of increase in productivity matched by real wage growth. This, over time, would offset the initial loss.

For the same reason, the State should push for covenants whereby stakeholders accept the distribution of costs and benefits over time. Reaching an agreement on the exchange rate and wages, along with credible compensatory commitments among the main actors (Government, companies and workers), requires intense institution-building and policy coordination by the State.

3. Central social and labour policy role of the State with a view to structural change with equality

Adopting social and labour policies with a clear redistributive impact as proposed herein entails acknowledging the central role of the State in reconciling structural change with equality. On the one hand, the State must ensure that labour institutions work towards fairer appropriation of productivity gains among the various stakeholders in the world of production. It should, on the other hand, promote an integrated social protection system based on progressive social expenditure that covers the risks and vulnerabilities for workers and their families triggered by the transformation dynamics of structural change.

Last, given the lags and gaps in human capacities and the mismatch between labour demand requirements and the characteristics of the labour supply, the State should take on all of the challenges posed by the knowledge society in this sphere: a more educated society where everyone is entitled to developing capacities in keeping with the new world of production and communication, and an integrated job training system that includes technical education and occupational training components and provides job opportunities in accordance with that structural change.

That is the foundation of the social agenda for structural change with equality. As posited in 2010 in *Time for equality*, this central role of the State also entails a fiscal covenant. What is needed is, on the one hand, a fiscal covenant where the redistributive impact of public policy is fed by tax reform that increases the relative weight of direct taxes (especially, personal income tax) and the total tax burden while reducing tax evasion and exemptions. On the other hand, the fiscal covenant should inject into the public and policy discussion an agenda for reshaping social spending with greater balance between contributory and non-contributory components, where access to a good education, health and care services does not depend exclusively on spending by individuals.

As noted in *Time for equality*, the idea is to advance towards a social turning point where the State has a more active role to play in the provision of public services and the promotion of well-being, with a sustained increase in social spending, progress in building social and labour institutions that improve governance and reverse the asymmetries in the world of work, income transfer systems that yield a clear redistributive impact, and integrated social protection systems with strong non-contributory solidarity-based pillars.

4. Global governance, national States and regional integration

Last, from an international perspective, the early twenty-first century made very clear the pressing need for greater coordination among countries and national States to address changes that take place at the global level and affect the paths to economic, social and environmental development. These include the growing weight of emerging economies and South-South relationships in the world economy; the urgent need to mitigate the impact of climate change, foster standards for environmental sustainability and lower-carbon-content economies; and the need for stricter regulation of the global financial system and for innovative mechanisms for funding development. Redefining and enhancing global governance institutions remains an unfinished task, both to reflect new world balances and to strengthen multilateralism when facing these challenges. Such governance calls for active participation by national States, as well as regional integration in which those States play a key role.

The countries of Latin America and the Caribbean are seeking to play a more active role in these global debates by means of a more coordinated presence in interregional and global forums. New integration schemes that go beyond trade are paving the way to enhanced regional and subregional cooperation. Examples of this are the recently created Community of Latin American and Caribbean States (CELAC) and Union of South American Nations (UNASUR). They complement existing integration mechanisms and expand the space for political dialogue. Increasing policy coordination at the regional and subregional level, in areas such as infrastructure, telecommunications, transport and energy, is appropriate and necessary for creating conditions conducive to the structural change with equality envisioned herein.

C. Integrated policies and synergies

The potential synergies between macroeconomics and the production structure and between business cycles and short- and long-term growth trends pose the challenge of how to achieve the most virtuous possible combination of macroeconomic policy and industrial policies based on a new technology paradigm that is more knowledge-intensive and environmentally efficient and also enhances the conditions for social inclusion and equality. Macroeconomics for development cannot dissociate cycle management and (real and nominal) stability from structural change and a higher rate of long-term growth. This coordination must be part of an integrated approach where production change and a levelling up of capacities and social opportunities are explicit priorities. This process should be accompanied by social policy (especially during temporary stages of structural change when production is still not the universal prime route to inclusion with well-being. Achieving equality does not necessarily run counter to investing in and protecting the environment (the raw material for development). The idea is to achieve virtuous linkages between the economic, social and environmental spheres by means of renewed industrialization.

The preceding chapter looked at policy direction on several fronts (industrial, macroeconomic and social), geared towards promoting the central dimensions of development addressed herein: structural change, technology and income convergence with the developed world and correction of the high levels of inequality that have characterized Latin America and the Caribbean. In the face of these challenges, what are the potential synergies and contradictions between these policies? The synergies do tend to outweigh the contradictions, opening up the possibility of harnessing development policy complementarities. But it should not be forgotten that synergies operate in both directions, creating virtuous circles and vicious ones. When policies are correct and work with each other, they can have more impact than a single policy on its own. However, when policies point in opposite directions or are applied without considering the integral goals of development, their negative impacts tend to reinforce each other and can give rise to vicious circles which lead economies to fall behind.

There are many spaces for inter-policy synergies. Some —but not all— of them are examined below.

Strong complementarity is the one between industrial policy and the need for countercyclical and income-distribution policies. Industrial policy requires sustaining public investment during the down phase of a cycle and keeping private investment from plummeting in a set of strategic sectors and activities (because of their Keynesian and Schumpeterian efficiency). A sustained investment programme that ties in with industrial policy has a built-in strongly countercyclical component because it lessens the investment elasticity of the cycle. And the investment timeline can be adjusted, to the extent possible, to expand investment in recessionary phases and slow it during upswings.

Behind a programme of this type is the perception that some State policies go beyond political and business cycles and reflect a stable consensus in society as to the goal of development. Industrial policy should define the qualitative or long-range dimension (expenditure composition) of countercyclical or short-range policy (expand fiscal space on the upswing, narrow it during the recessionary phase). Maintaining the (public and private) investment programme over time will keep the technology lag from increasing during periods of slower growth; this, in turn, will contribute to post-crisis recovery (another factor that helps smooth the cycle). Environmental efficiency and natural heritage stewardship are essential for defining the qualitative dimension of investment and industrial policy.

Another powerful synergy is between industrial policy and short-term capital controls to prevent unsustainable currency appreciation, which could drive investment away from industrial policy priority sectors. As pointed out above, what industrial policy does is to adjust incentives in order to channel investment towards where the long-term benefits are strongest (the cost of environmental externalities should be figured into these benefits). If the relative price structure works strongly against tradable goods, it will be very difficult to reverse the market signals. Conversely, policies to avoid currency appreciation will yield the same stimulation impact on tradables output with much less fiscal effort.

An examination of incentives also reveals the fundamental role of macroprudential policies. When speculative bubbles form, especially in the real estate sector, investing in producing tradable goods becomes less attractive because the expected return will be unable to compete with the promise held by soaring markets. When the bubble bursts, there is a general pull-back of credit that also hits fixed capital formation very hard. Both the public sector and the private sector have recently been caught up in Ponzi processes of financial fragility; these are very costly to pull out of. The literature often flags crowding-out issues between public and private investment, but crowding out between different kinds of investment may be a more serious problem, especially between investments seeking to profit from existing assets and asset-creating investments. An unsustainable investment in the first kind of assets can set back investment in new assets for very long periods. This is true for the public sector and the private sector alike. Investments in very high-yield government bonds successfully compete with investments in the real sector, whose rates of return (corrected for financial risk and for not internalizing environmental vulnerabilty)[4] are lower.

Another major synergy is the one between labour-market policies, stabilization policy and industrial policy. Industrial policy should, over the long run, seek for competiveness to be based more on knowledge than on abundant natural resources or low wages. Social and training policies should support this transition in two ways: help lessen wage demand during the initial phase, compensating workers by, for example, expanding education and health service coverage (which also has positive impacts on their productivity); and ensure the supply of skilled labour in line with industrial policy priorities. Industrial policy, in turn, by promoting productivity gains, brings costs down and pushes real wages up without triggering inflationary pressures. By fostering more constant investment rates it reduces the pressure of unemployment on social spending and frees up fiscal space for other purposes. It is important to recover the idea that real wages should not be allowed to lag behind productivity. It has already been seen that the functional distribution of income worsened in the region over the past decade. This helped curb inflation, but historical experience suggests that when productivity gains are not transferred to real wages for a long time, tensions accumulate and wind up feeding wage-price spirals.

Harnessing these synergies to the fullest requires a renewed institutional environment allowing for interaction between policymakers in different spheres. It is no exaggeration to say that ministries currently work in considerable isolation from each other. At times, having each of these authorities autonomous from its peers (where each one keeps to its own affairs and is held

---

4 Environmental vulnerability includes the growing economic and social cost of extreme weather events. In 2010 the region was hit by more than 98 extreme events at a cost of approximately US$ 50 billion, almost seven times more than the previous decade.

accountable only by its own indicators) and from the government is seen as more efficient than coordination. But policy management is subject to the same issues as other areas exposed to externalities. A decision taken by a particular actor may impose costs on other actors which are not internalized by the decision-maker. Accordingly, mechanisms for dialogue, coordination and evaluation must be established. This takes us back once more to the subject of social consensuses and State policymaking with an integrated, long-term vision that extends beyond any individual ministry or cabinet of ministers or even any single administration.

D. A future with greater well-being

The approach proposed herein seeks to infuse politics and policies with a vision of the future. The idea is to look at structural change through the prism of progressive equality and to consider a production dynamic in constant renewal that meets the challenges of globalization in a knowledge society that addresses the aspirations of sustainable development and has a growing impact on social inclusion through the world of work. The foregoing chapters have set out the main challenges and obstacles on the way to this future horizon, in such diverse spheres as industrial, macroeconomic, employment and social policy. They have offered a critical assessment, a hopeful look, lessons learned from successes and failures and, on that basis, a road map that links the short run and the long haul moving forward.

We have stressed that structural change for equality that also fully embraces environmental sustainability is a long-term proposition entailing profound transformations where policy returns to the centre in its irreplaceable role in prioritizing, guiding and reconciling. ECLAC believes that the time has come to recast policymaking, not only to advance democracy in the region but also because now that there is no single model there is more freedom to reinvent the future. We welcome that freedom and see it as a platform for dialogue.

In the opening pages we also said that the proposed approach focuses on the leading role to be played by coming generations in the full exercise of their rights and their potential. It will fall to these new generations to fully develop the capacities required by intense changes in productivity, knowledge and technological progress, in citizen involvement, in a deliberative culture and in environmental stewardship. These are the generations who will have to promote new ways of producing, organizing and communicating. They are also the ones who will be tasked with preserving and promoting the well-being of all in societies under increasing pressure from population ageing, growing urbanization and scarcer global public resources. And these generations are the ones who will have to live with the effects of several centuries of predatory natural resource use and the diminished capacity of those resources to sustain high rates of growth.

That is exactly why there is no time to lose. Now more than ever, we must push for change to achieve greater productivity and greater equality. There is room in the political imaginary, which is no longer haunted by the spectre of single models and has more space, for each country to map its future in keeping with its own realities and goals. In some spheres, the pace is being set by the speed of the technology revolution, production paradigm shifts, the demographic transition, the financial crisis and environmental disasters. Experience has shown what works and what does not. Looming threats to political stability and citizen safety need to be addressed by bringing the future closer to the present and stepping up public and policy action for development and social inclusion.

The countries of Latin America and the Caribbean are not all striding towards the future at the same pace. They differ in stages of development, production strengths and weaknesses, population and domestic market size, degree of institutional and fiscal consolidation, capacities and culture. But diversity is not an obstacle to reflecting on what the region's hallmark should be, adjusting the details to individual realities: dynamic combination and coordination of macroeconomics, structural change, environmental sustainability, employment with rights and a net of social protection in the face of risks. It is not by chance that throughout this document we have returned again and again to intraregional heterogeneity to weigh policies and strategies that set the same course, albeit at different speeds.

We would once more like to conclude by stressing the importance of covenants between stakeholders to make that shared course possible. *Time for equality* highlighted the key role of fiscal and social covenants in bringing about change with political viability, citizen support and sustainability over time. Any strategy involving radical changes, conflicting interests, resource investment alternatives and tensions between short- and long-term impacts will require covenants.

It is above all the capacity of policies and of the State that should be maximized to move such covenants forward. These covenants are lessons in formal and substantive democracy, and they are key for legitimizing strategies that go beyond election cycles. They represent legal and political achievements that encompass the direction and depth of change, the body of laws and the citizens' imaginary. They go beyond agreement to bind and rally society's stakeholders around a shared vision of development.