2010

Chapter VII

State, political action, fiscal policy and social covenants: an equation in the making

A. Where we are coming from

It has been said with some justification that the end of the twentieth century came not in 2000 but in 1989, with the fall of the Berlin wall. This is partially true if we think of the profound change in political parameters which led to this historic milestone and which redesigned the political and economic architecture of the planet. These changes occurred in the context of consolidation of a new production paradigm, based on the acceleration of scientific and technological knowledge and the increasing globalization of markets and communications, as well as the intensification of competition.

At the time, Kenichi Ohmae (1995), one of the business strategy gurus of the contemporary world, prophesied the end of the Nation State and foresaw that this category would be relegated to the museum of history and be replaced by four irresistible forces: capital, corporations, consumers and communication. He also anticipated that, at the international economic level, "business units" or "region States", meaning globalized economic zones in various parts of the planet, would replace States as such. In addition to this academic vision, the Washington Consensus on "reform and modernization of States" defined concepts setting limits on State action in the economic and social sphere (Bárcena, 2009b).

In Latin America and the Caribbean, the early 1980s were marked by the debt crisis, which coincided with the above-mentioned reorientation of politics and the economy, the new model of globalization and the predominant social model based on self-regulated market mechanisms and predominance of private agents. In the diagnosis of the reasons for the Latin American crisis given at that time, particular blame was assigned to the excessive growth of government in the preceding decades and to the inability to control the public deficit and the wage demands of the public and private sectors. This criticism coincided with economic globalization, or the “wave of openness”, the trend towards deregulation of global trade, both financial and commercial, and offshoring for cost reasons. In this context, two main types of measures were promoted in the region: measures designed to promote stability through public policies dictated by market mechanisms and measures aimed at reducing the size of government and the extent of its intervention in the economy.

The policy package put in place in almost all countries in Latin America and the Caribbean reflected this vision of development and included resizing the public sector, reducing the para-State sector and eliminating expenditure and transfers not considered to be priority or strategic (which unfortunately included some in the social sector). Admittedly, during this period significant progress was also made as regards macroeconomic institutional policy and adoption of measures to achieve greater fiscal prudence. In the process, however, institutions were dismantled that were essential to the development of sectors such as agriculture or industry and that played an important role in long-term policymaking and productive development.

Today the States in the region are facing a considerable deficit. This is also a reflection of our contradictions, of structural heterogeneity, of our history of inequalities and inequities, of a chequered political path on which progress is still needed towards better-quality democracy, and of our unfinished fiscal reform. Our States have not achieved sufficient credibility as providers of public goods, raisers of fiscal revenue, guarantors of social well-being or promoters of productivity and employment. However, there is growing consensus about the fundamental role played by the State and the inability of markets to perform these tasks. In addition, the current financial crisis, considered to be the worst since the Great Depression, marks the end of a cycle of growth and prosperity and an opportunity to chart a new course for development. Over the past two decades, the globalization of markets and the accompanying dominant ideology projected a one-sided and partial image of progress. Now this image is being questioned in the light of the profound instability revealed by the crisis, the uncertainty about future growth and the exacerbation of social vulnerability.

The market/State/society equation prevailing for the past three decades has proved incapable of responding to the global challenges of today and tomorrow. The goal is therefore to make sure that the State is in the right place to face the future.

B. Where we want to go: recreating the link between the State and society

The political democratization of Latin America and the Caribbean unified the ethical principles of liberty and equality. Nowadays, both these principles are essential: one cannot take priority over or be sacrificed to the other. However, while balance and mutual reinforcement between these principles has been achieved at the level of values and norms, in practice political democratization seems to have progressed much further than social democratization, although not all the problems of the former have been solved. In addition, it must be acknowledged that the flourishing of the liberal and individualist tenets essential to legitimize political democracy does not necessarily create a climate conducive to the principles and mechanisms of equality.

Today, both nationally and regionally, we see the tentative emergence of a new "polis", of a process of reconstruction of the relationship between State and society. Renewal of the Nation State model assumes that an ethical, political and socio-economic community is to be reconstituted. This too means putting the issue of equality at the heart of the agenda.

In this approach to development, societies must refocus on the following three essential values.

First, the general good and the provision of public goods, involving the creation and provision by the State of goods that benefit the whole of society. These require considerable investments, which may not show results for some time. Public goods can be found in areas as diverse as education and health, production infrastructure, transportation, communications, energy, the environment, investment in science and technology, social peace at home and abroad, administration of justice, democratic elections and public security. Macroeconomic equilibrium – in its broad sense of price stability, employment, work and instrumental capital and macro-prices such as the exchange rate – is also a public good which can be shared simultaneously by the various economic agents. As well as providing public goods, States will have to be able to participate responsibly in the international arena in order to provide global goods such as financial stability, pandemic control and climate security. In this connection, a new State architecture is needed so that the State can play a more significant role in ensuring general well-being and spearheading our countries' development strategy, over and above the functions defined by the subordinate State paradigm.

Second, the value of the concerted strategic vision. Societies have memory and build a future. In order to think and act on development, one must learn from past experience and approach development from a strategic viewpoint. Like the life of people, the future of societies is created over time: a society that does not educate itself, that does not invest in social cohesion, that does not innovate, that does not build consensus and that does not have solid and stable institutions has little chance of thriving. In this connection, the State must be able to provide strategic management with a long-term vision, to play a prophetic role and to intervene in the design of policies geared to national development. Here it is important to remember that the State acts in a context of shared power, so that the negotiation and creation of strategic national consensuses are both the means and the end. For this reason, the State must be able to promote a dialogue giving it greater legitimacy to reconcile the various interests with clear socio-economic goals through regulation, which implies a need to improve its own regulatory abilities.

Third, enhancing the previous two, is the value of political action. The model focusing on market self-regulation placed too much emphasis on the consumer, to the detriment of the citizen, as well as on the political neutrality of technical criteria. But consumers are not all equal before the market and they therefore have unequal access and power. On the other hand, in a democratic society citizens have the same rights and duties and voting does not depend on consumption capacity. Ultimately, democracy is the way citizens decide which public goods should be guaranteed to the entire population and to what extent they should be provided. This civic will is expressed through the democratic institutions and must be constructed and preserved as a common good by the State entities. The public domain must revert to the community and be accessible to all citizens and not only to the Government or the State.

These three values require a new role for the State and full enjoyment of democracy. It is only on the basis of civic democracy that the State can refocus on the concept of general interest, rethink the meaning of the common good, invest in the production and provision of public goods and again become involved in building the future.

C. Towards a new State architecture: the main approaches for closing gaps and opening trails

A new State architecture must be created that will allow the State to play its rightful role as leader of our countries' development strategies. By casting a critical eye on its historical performance, we should be able to define that role, give the State the proper tools and determine its precise place in conjunction with the market and the citizens, achieving an optimum balance of this trilogy in the development dynamic.

In order to do this, we must abandon assumptions now disproved by historical evidence, which at the time alternated between condemnation of the market and condemnation of the State. The excellence and efficiency of our markets will depend to a large extent on the quality and probity of States to regulate them with appropriate oversight mechanisms, incentives and guidance. Above all, it is clear that there are functions for which responsibility lies with the State, working for the common good and social cohesion.

The market alone does not produce equality or public goods; nor is it concerned with the situation in the long term. This is not to deny the usefulness of market mechanisms or of a suitable public-private mix for resource allocation and provision of services. In this connection, advocacy of greater State involvement does not minimize the importance of market functions.

Previous chapters described major challenges as regards State policies for boosting growth, promoting productivity, encouraging greater territorial coordination, achieving better employment conditions and better labour policy and providing public goods and social protection with a clear universalist and redistributive focus. These are complex tasks, in which there can be no overnight success. They require arduous technical work, the creation of social covenants and development financing. They respond to a threefold challenge: to boost the economies of the region in order to achieve development, to deal with the crisis and its antecedents using new policy instruments, and to eliminate the region's long-standing legacy of inequality and social exclusion. This in turn means that it is now urgently necessary to reform the tax and transfer system with a view to generating more revenue-raising power and —in contrast with the individualist market model— to making social solidarity the focus of collective life. It will then be possible to move towards real equality of rights and opportunities, recognizing growth as a prerequisite for development, for which purpose it must be accompanied by decent work, social cohesion and environmental sustainability.

Earlier chapters described the central functions of a new State in order to revitalize the strategic vision of development, closing gaps and opening avenues, with the maxim of equality for growth and growth for equality. To sum up, these are the main proposals made in each of the earlier chapters.

1. The macroeconomic environment

The macroeconomic environment has repercussions for both growth and equity, since it affects the investment rate and its impact on future development trends, the value added content of exports and how they tie in with the rest of domestic production (GDP), innovation, development of small and medium-sized enterprises (SMEs) and the formality or precariousness of the labour market. The greater the macroeconomic instability, the more adverse will be its effects on GDP, productivity, the investment rate and employment formality. Macroeconomic-policymaking style therefore has clear implications for all these variables.

Macroeconomic strategies must be designed to bring economies closer to their potential frontier, to protect them from external volatility and to make them stronger by proactive use of the available instruments (in the areas of finance, taxation and foreign exchange). As a corollary, it is argued that the design and alternative implementation of such instruments affect the various firms and workers in different ways, with substantive consequences for the degree of inequality. Gradual and comprehensive application of macroeconomic policy can and must contribute to the creation of decent employment and to the necessary progress towards production convergence and productive development.

The earlier analyses provide a set of guidelines. First, in order to achieve less volatile economies, closer to their growth potential, oversight of the capital account must be improved. This is not the same as adopting generic protectionist measures or blocking transnational financial flows. The instruments may include measures ranging from regulation of its size to a mix of incentives and disincentives to localization and mobility of foreign capital depending on types, cycles and size of flows. Second, the necessary soundness and technical autonomy of central banks must be ensured through clear forms of macroeconomic coordination by Governments and an institutional structure that is responsive to indicators from the non-financial economy. In recent history, among the mechanisms and goals of central banks, inflation is usually considered to be the most important parameter compared with others such as growth, employment and productive investment. The type of investment is important, since the central bank and economic entities must contribute to the creation of a production structure that gradually creates a more equitable market, so that productivity and earning gaps between firms of different sizes and workers of different social origins can be gradually narrowed. More significant and ongoing liaison between central banks and ministries of planning, finance, industry and agriculture, forestry and livestock farming is not only desirable but essential in a productive development project.

Third, fiscal equilibrium and countercyclicality require a strong determination to expand countries' fiscal capacity, which in most cases means increasing the tax burden. In a recent study, Woo (2009) shows that inequality measured by income and educational capital is strongly linked to three key variables: fiscal volatility, fiscal procyclicality and low economic growth. To unravel this nexus requires clear and countercyclical fiscal rules aimed at reducing added volatility and expanding the fiscal base in order to increase spending and egalitarian social investment. Monetary and exchange policy should reflect these general objectives, promoting macro prices that will encourage agents to invest in activities that help to reduce structural heterogeneity.

There will be no significant and sustained improvement in poverty and income distribution in Latin America and the Caribbean unless active fiscal policies are adopted to influence the efficiency and distributive potential of markets. In other cases, the priority might instead be to improve the quality of spending, as regards resource allocation as well as efficiency and effectiveness, in order to achieve a sustained reduction in inequality in the social and economic structure.

The design and construction of an inclusive financial system aimed at productive financing require expansion and development of the instruments available for managing risk, diversifying access and extending relevant deadlines. This involves a considerable increase in SME financing and expansion of the role of microfinance, with varying coverage and institutional arrangements. The incomplete state of existing capital markets has been an insurmountable barrier preventing many SMEs from making development strides, which are an essential ingredient for achieving growth with equality. Reform of the capital market along these lines requires strengthening of public banking and especially of development banking, as an instrument to facilitate and democratize access to credit, particularly long-term credit for investment financing.

In short, a reform of the Washington Consensus reforms should promote linkage of the financial system to the process of domestic investment and thus to the domestic economy rather than to foreign financial markets. It must also contribute to greater economic stability, avoiding dissociation of the exchange rate from real interest rates in order to reduce the frequency and severity of cyclical fluctuations and to prevent real interest rates from being consistently negative or too high. Lastly, the aim should be to deconcentrate economic power through inclusive financing mechanisms facilitating SME access. Avoidance of an accumulation of imbalances in aggregate demand, the current account or the exchange rate by timely application of countercyclical policies requires continuous mini-adjustments of macroeconomic variables. There will then be no need for traumatic major modifications, which usually involve over-adjustments of macro prices and recessions that exacerbate inequality.

In turn, foreign capital can play a useful role by supplementing national savings. The composition and stability of flows are important, and it is essential to distinguish between foreign investment creating new productive capacity and financial flows which are purely speculative and highly procyclical. Indiscriminate financial liberalization proved ineffective in achieving productive development and real macroeconomic stability, and prejudicial to the goal of reducing inequality. The global crisis, an example of the risks of unregulated financierism, has created space for the application of more pragmatic policies for countercyclical regulation of the capital account in the countries of the region.

Development sustainability requires public policies compatible with social inclusion, with countries participating in the international economy in a manner that is increasingly integrated domestically and socially. How to tackle the reform of national capital markets and their link with international financial markets is a crucial challenge to be met in order to achieve a macroeconomy that underpins sustained economic and social development.

2. Production convergence

The State must play a very active role in the sphere of productivity. This is necessary, on the one hand, to draw closer to the international production frontier and craft a more dynamic structure that can drive growth and learning. On the other hand, an active State role is needed to close the domestic productivity gaps that perpetuate inequalities through structural heterogeneity. In this connection, this document has emphasized the need for public policies on industrial development, technological innovation, financing for less productive sectors, and promotion of SMEs, as well as enhanced coordination between the State and production agents to close the energy gap and achieve more sustainable and lower-carbon production and consumption.

In this context, the production structure should be transformed on the basis of three integrated policy axes: (i) industrial, with a focus on innovation-intensive sectors (closing the gaps between sectors); (ii) technological, involving strengthening of supply and linkage of supply with demand in order to create and disseminate knowledge (closing the gap with regard to the international frontier), and (iii) support for SMEs, recognizing asymmetries between enterprises in responding to price signals (closing gaps between agents).

In order to give priority to the development of knowledge-intensive sectors and break the vicious cycle of factor endowment related to natural resources, States must create new institutional policy, fiscal policy and strategy for the production framework and its agents.

As stated above, sound development banking, with long-term financing and planning capacity, can achieve a sustained increase in investment in knowledge-intensive sectors and encourage innovation. It also promotes a substantial increase in investment in SMEs to increase their productivity and linkages to larger enterprises and bigger markets. Lastly, efforts should be made to finance innovative projects linking academia and business in long-term commitments.

Support for the development, stability, productivity and profitability of SMEs requires institutional change, to which greater fiscal priority should be given. SMEs are not a foot-note in the strategy of development with equality but one of its cornerstones. As part of this institutional reform, the State should be given instruments to enable it to eliminate asymmetries between agents as regards access to information, credit and technology.

Numerous instruments exist for moving the production frontier of Latin American and Caribbean societies: sectoral technology funds, systems of public ownership or revenue for mining activities involving strategic resources and a mix of trade-related and fiscal instruments such as tariffs, selective tax waivers and taxes, designed to support key export sectors or those which are linked into transnational platforms.

Lastly, there must be a strong medium- and long-term commitment to significantly increase public investment in research and development and infrastructure creation. Without production capacity linked to output and without logistics to convert opportunities into real platforms for generation of wealth and communications, growth bottlenecks cannot be eliminated. It will not be possible to leverage the growth cycles stemming from changes in the structure of relative international prices into qualitative leaps in output and productivity.

Of course, what is proposed here involves creating and allocating revenue on the basis of government decisions and requires a fiscal and institutional commitment that is difficult to maintain in the long term. Regarding the first point, when the State provides revenue to the private sector, it must do so solely on the understanding that the return in public value from the use of the aid will be greater than the initial cost of providing it. It is never easy to discipline the recipients of government revenue, but the twentieth century provides no examples of strong growth in which real strides were made without instruments of this type. Covenants between public and private agents are crucial in this area, as will be seen at the end of this chapter. As regards fiscal sustainability, it must be understood that institutional and fiscal capacity-building for States specifically means increasing their capacity to play a leading role in the network of private agents which development requires.

3. Territorial convergence

Because of the diversity of institutions and actors influencing territorial development, it is essential to build territorial cohesion covenants allowing top-down and bottom-up coordination of efforts to promote regional and local development. In order to reverse territorial inequality, it is also necessary to resolve general inequality, initially by linking the most marginalized spaces with hubs of natural-resource-based exports. Hence the importance of public policies backed by covenants between stakeholders in the various territorial subdivisions, designed to promote greater equality in this sphere.

The State must play a central role, if the strategic focus of improved territorial equality is to be the creation of territorial cohesion funds, which here serve at least three purposes. First, they transfer funds from the central level to the subnational levels, with a commitment to use them for the creation of synergies between spheres of production, for capacity-building and for correcting basic lacks. The second purpose is redistributive, taking the form of transfers or cross-subsidies, in the same way as income tax is used to transfer resources or provide services to those who are unable to pay for them. Redistribution to achieve greater equality of opportunities and rights is part of the role of the State advocated in this document. Third, a territorial cohesion fund serves as an instrument for coordinating sectoral and spatial policies, in order to avoid duplication and promote more integrated forms of participation. It is thus a mechanism of intersectoral planning applicable to areas in which sectoral decentralization usually leaves many gaps.

Intergovernmental transfers can play an important role in the correction of territorial disparities, in conjunction with regional development policies established at the national level, operating in both a top-down and a bottom-up manner with local or provincial authorities. The financing of territorial development and the resulting elimination of disparities must be based on the fiscal efforts of the subnational levels themselves —such as better tax collection— and on transfer systems applied in the context of carefully coordinated development programmes.

The provision of basic services in segregated cities, with municipal financing arrangements based on territorial taxes, is very unequal and exacerbates disparities. The State is in a position to break this vicious cycle by pursuing direct policies such as territorial tax redistribution funds, extra resources, zoned allocations and special programmes in vulnerable districts.

4. More and better employment

We are proposing active State policies geared to improving the quality of employment and the capacity of the labour force, such as minimum wage policies, production support and protection of the economically active population (EAP) in the informal sector, assistance to population groups with major labour-market-integration problems and coordination between labour policy and social protection. A more active role is advocated for the State in promoting labour negotiation forums, both in order to improve income distribution through negotiated wage increases and in order to facilitate sustainable agreements linking increased productivity to improvement of working conditions.

Labour policy must serve a dual purpose: to promote the efficient functioning of the labour market and to protect its weaker stakeholders. The central problem of labour market rigidities and their impact on formality does not lie with hiring and firing costs. The real reason for lack of formalization is the cost of social security contributions. Disincentives to firing and incentives for retaining and training workers are positive, inasmuch as they are reflected in higher productivity and greater capacity-building for workers. Programmes are also needed to evaluate exemption or subsidy systems for contributions by SMEs and individual entrepreneurs in order to achieve a better balance and avoid informality as an extreme form of flexibilization. In a broader context, it is essential for labour policy to be linked to a long-term development strategy.

In addition, it is important for the State —in partnership with representatives of business and academia— to promote the creation of a national training system. This is doubly important, because it will provide a dynamic response taking into account demand characteristics and the people’s needs and aspirations.

A minimum wage policy is advisable. The lowest price of labour should not be set by the market. It could be slightly above the price that the market might naturally set. Be that as it may, minimum-wage-setting must be a long-term policy, with a gradual increase in the minimum wage, which must be compatible with production and credit policies.

There is also a need to broaden the base for funding unemployment insurance (ranging from contributions to general revenue) and its eligibility criteria (ranging from formal workers with considerable seniority to the most precarious and temporary forms). A countercyclical unemployment fund is also necessary for times of recession and crisis, with eligibility further broadened to include unemployed workers in the informal sector. In these phases of the cycle, these strategies should be accompanied by active employment policies such as direct job creation by the State. This should be supplemented by more permanent training policies and linkage of labour supply and demand.

There should also be movement towards basic minimum health and income protection that is not solely contingent on belonging to the formal sector and making the relevant contributions. The transition from social protection with an eligibility criterion based on formal employment to an approach based on rights and citizenship also requires a shift in social protection financing, with less emphasis on payroll funding and more importance given to the universal and progressive tax bases providing general revenue.

The following measures should also be adopted: (i) arrangements to protect and promote labour market integration, particularly for the weakest, including standards on the length of the workday and occupational health or programmes to promote labour integration for groups facing special obstacles; (ii) enactment of anti-discrimination legislation, if it does not already exist; (iii) promotion of social-labour dialogue to improve labour policy; (iv) development of a strategy to gradually increase the coverage of labour policy; (v) organization of a modern and efficient labour inspection system, and (vi) creation of efficient and expeditious labour courts.

5. Closing social gaps

In the social area, emphasis has been placed on the central role played by the State in providing the equality agenda with its pillars of social protection and promotion. This is of fundamental importance, because here the market, left to its own self-regulation mechanisms, has widened quality and achievement gaps instead of closing them. For this reason, progress is needed in charting a new course for the State as regards social issues, towards a more active role in well-being with a sustained increase in social spending, capacity-building in social institutions in order to improve public management and income transfer systems with a clear distributive impact. In other words, programmes should be designed around an integrated social protection system, with strong non-contributory solidary pillars and a clear universalist approach, compatible with the principle of equal rights. In the area of education, where inequalities of origin have long been perpetuated instead of being reversed, the State should play a strong role in promoting greater access to pre-primary education, especially in groups that cannot pay the costs out of pocket. It is also necessary to extend the school day in public schools, to enable lower-income groups to move towards completion of secondary education and to ensure that quality and learning gaps within public supply and between public and private education are gradually closed.

The design of a basic universal social protection system —income security and health— inevitably involves upgrading non-contributory social protection solidarity mechanisms, expanding assistance programmes, balancing paid and unpaid work and facilitating women's entry in the labour market. Otherwise the demographic window of opportunity will be wasted or missed.

Public social spending must be increased and its countercyclical bias enhanced.[1] However, it is not enough simply to spend more. A new expenditure architecture is needed that is more egalitarian, suited to existing risk structures and geared to enhancing countries' production capacity.

This requires, first of all, a system of targeted or universal income transfers based on a minimum general income for older persons, with limitation or abolition of pension subsidies and large pensions. There is a great need for complementary systems of guaranteed income that are not dependent on the labour market and which are flexible and expandable at times of recession. Particular attention should be paid to the creation or expansion of non-contributory income transfers (basic supplement) to vulnerable families with children, as well as subsidies to vulnerable households which lose contributory coverage in a crisis.

Of course, the State cannot and should not do everything itself, even as regards assistance and redistribution. Hence the need to enhance social networks providing various services, benefits and support programmes, linking public and private agents with social stakeholders.

However, while transfers to equalize, protect and stabilize the well-being of households are necessary and positive, they do not suffice to create more egalitarian and productive societies. The region is faced with productivity and equality bottlenecks caused by both demand and supply problems. Many counties have not succeeded in pushing back their well-being frontiers even when demand-side economic opportunities have arisen. This is because the production framework creates opportunities but is not fully able to take advantage of them. For this reason, it is crucial to invest in actions that promote the activation and accumulation of capacity and know-how. Social spending should increasingly become social investment. In this connection, promoting universal preschool education would serve the threefold purpose of equalizing opportunities, increasing the productivity of future workers and freeing up the female workforce, whose participation in the labour market is limited by caregiving responsibilities. Something similar occurs when daycare coverage is expanded and the school day is extended.

Lastly —although it has been said before, it is no less true now— a key challenge in the short and medium terms is to invest in primary education quality and expand secondary education coverage and access, improving teachers' skills and knowledge. This is the only way for societies to expand frontiers and close gaps at the same time. Today these education strategies have both an ally and a challenge in the expansion of the use of information and communication technologies (ICT) in the public education system.

---

[1] Given their GDP levels, most Latin American countries' social spending could be far higher. As will be seen below, this because they also have a much lower tax burden as a percentage of GDP. In a recent financial year, Sabaini identified a gap of almost 3% of GDP between the actual and the potential tax burden in the region. In the most extreme case, the gap was as much as 14% of GDP. Even without reaching these levels, the large majority of the countries of the region clearly can and should increase the tax burden, preferably using progressive instruments.

This raises the question of the amount of resources available to government authorities. The level of public spending depends on countries' revenue-raising ability. Here, taxation is the means by which the State's financial capacity can be increased so that it can play its proactive role in the promotion of development and social equality.

Finally, in the political sphere the State plays a leading role which it cannot abdicate. The goal here is to ensure more democracy and more equality, which are two sides of the same coin. As regards democracy, the State must strive to improve the quality of political action in its procedures, through a strategic agenda reflecting the deliberations of a broad spectrum of stakeholders and through popular will expressed in covenants that provide political legitimacy and ensure the application of medium- and long-term policies. As regards equality, the State must focus on increasing the participation of the excluded and vulnerable sectors in the fruits of growth. For this purpose, equality of citizenship —of rights, of voice representation, of full subjects of law— is the link between political action and social equality.

Although it has been mentioned, the topic of climate change has not been addressed in-depth here. Climate change will undoubtedly occupy an increasingly important place on the international agenda and among countries' responsibilities. This agenda requires us to change how we produce, consume, generate and use energy, making the carbon footprint one of the main variables of competitiveness. Climate change also has an ethical dimension, one of intergenerational solidarity, in view of the looming threats to the planet unless appropriate action is taken today. Adaptation and mitigation policies involve long-term planning, particularly as regards infrastructure, transport, land use and energy production. What is required here is strong and decisive action by the State, long-term investments and incentives to change cultural habits and daily life.

D. Taxation as the key to linking the State with equality

1. The place of public spending in development

As documented in chapters I and II, the region's fiscal spaces have benefited from the steep debt reduction achieved by Governments during the boom period. Of course, in the next few years, the difficulty of obtaining resources in a context of slow growth (see chapter I) and considerable expenditure needs will again put pressure on public finances. The discussion of expenditure efficiency and revenue-raising ability is even more relevant if equality becomes a priority goal of development strategy.

On the expenditure side, it is worth recalling the three traditional functions of fiscal policy (Musgrave, 1959 and 1998): allocation of public goods (that is, by encouraging the political process by which they become available); redistribution of income; and promotion of macroeconomic stabilization. Although the region has unfinished business in all these areas (chapter II deals with the countercyclical role of fiscal policy), the functions of public goods allocation and income redistribution certainly deserve special attention.

The dilemma of the dichotomy between growth and equality, always latent, becomes less relevant when priority is given to spending that has positive effects on economic growth, formal employment and access to public goods. Empirical evidence shows that the repercussions of public spending on growth vary depending on its composition. What is important is to adopt a comprehensive and strategic approach, which considers effects both on well-being and on production convergence, in order to choose the right level and structure of spending in the light of the equality and productivity goals proposed in this document.

The non-linear relationship between public spending and growth varies depending on the type of expenditure (European Commission, 2008). First, it is important to distinguish between public spending and public investment and, to the extent possible, to emphasize the latter. Second, a distinction must be drawn between various types of disbursement. For example, interest payments will always be negative for growth and employment, inasmuch as they are resources that could have been used for productive purposes. In countries with large financing needs, multiple financing sources must be considered, including borrowing, in order to build physical and human capital. However, public spending financed at high interest rates in a context of low growth is to be avoided or treated as a last resort. For this reason, in order to achieve fiscal balance with appropriate public debt levels, numerous variables must be considered on the basis of fiscal sustainability criteria.

Government consumption, wages and salaries and pensions to a certain extent represent efficient expenditure, but their excessive growth may negatively affect savings and investment. Transfers to deal with social exclusion and unemployment, housing, and the family and children increase macroeconomic efficiency to the extent that they promote women's participation, labour integration of excluded persons and private consumption. This confirms one of the main messages of this work: pro-welfare social spending must be seen as a social investment that helps to reduce structural heterogeneity and to encourage production convergence.

Spending on education, active labour market policies, health, research and development, and gross fixed capital formation is strongly pro-growth. Thus the production of public goods has the dual advantage of creating conditions propitious to growth and creating employment in the formal sectors of the economy, guaranteeing both equality of access and equality of opportunity.

The non-linear macroeconomic effect of public spending must be emphasized. This is not to say that it is inefficient to increase public spending, but it cannot be relied upon as the sole engine of development either. In the vast majority of the countries of the region, the level of spending on public goods is still far from optimal, even if the goal were solely economic growth. This potential for increased public spending is accompanied by a need to improve its productivity. The two are not mutually exclusive but complementary.

Thus improvement of public spending quality in Latin America and the Caribbean requires sustained investment in physical and human capital and innovation. In some countries of the region, the effort to carve out the fiscal space for reducing poverty and inequality would benefit much from a better quality of public spending, in the form of increased investment in education and knowledge and expedited spending on physical investment, innovation and knowledge. At the same time, as seen in chapter VI, efforts must continue to be made to universalize rights and emphasize the most progressive categories of social spending.

In many countries, this need for quality is accompanied by a need for increased coverage, since the provision of essential public goods is insufficient. The poverty reduction strategy of the most vulnerable countries of the region has focused too much on welfare spending and has not sufficiently emphasized other aspects inherent in a broader strategy, such as public investment in infrastructure, in order to stimulate growth by reducing poverty and inequality.

Reorienting public spending and increasing programme coverage are long-range tasks. In fact, government plans and national development strategies are increasingly including fiscal goals that are beyond the time frame of a single administration and therefore constitute State policies. As discussed below, the work of enhancing the foundations of the State's financial administration is an integral part of a broad fiscal covenant.

Use of explicit comprehensive planning instruments and of a medium-term public spending framework can facilitate the necessary reassignment between functional categories. The key to a successful multi-year framework is institutional mechanisms that allow decision-makers to balance total available resources with country priorities. For example, multi-year budgeting —the financial expression of the development plan in terms of economic and functional classifications— is a powerful programming tool and illustrates the ability to set public priorities in a democratic system.

2. The progressive effects of income and expenditure

In Latin America and the Caribbean, fiscal policy does not have the same progressive impact on equality as in the countries of the Organisation for Economic Co-operation and Development (OECD), which partly explains the great inequity in the region in terms of income distribution and quality of public goods. As regards both income and public spending, the redistributive function of the State is a work in progress.

The effects of fiscal policies may be direct or indirect. On the spending side, measures to increase income in the lower deciles have a direct impact on poverty and probably also on income distribution. Mechanisms such as conditional cash transfers are also used to improve the social inclusion of the most vulnerable sectors. Large enough spending of this kind is an important factor in explaining Gini index variations. There are also indirect and longer-term effects when resources are invested in public goods, since public policies affecting the productivity of the poorest pay back in the form of growth and equity. There is no doubt that public spending on justice, public safety, infrastructure and public transport, health, training, social inclusion and many other areas benefits the poor most, by improving the conditions under which they are integrated into the labour force.

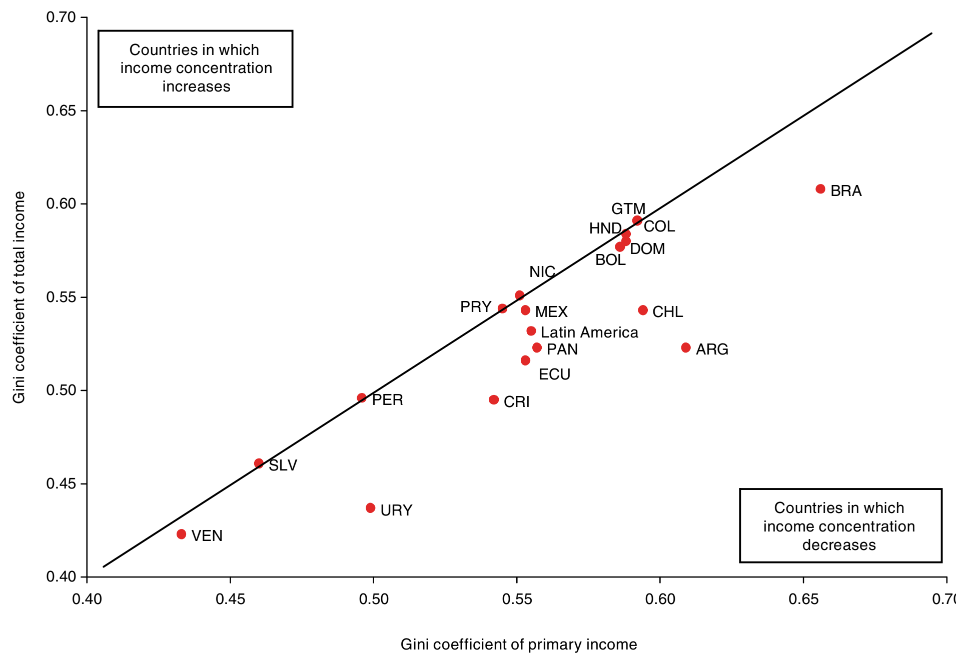
With regard to revenue-raising, the level and progressiveness of taxes directly affect income distribution. The ability of the tax system to correct unequal distribution will depend on the volume of resources raised and how the rates are structured by income level, and also on income tax evasion and the number of exemptions. In the medium term, the tax system can also influence labour supply (for example, if employers bear a heavy burden), individual effort and family size, all of which affect income distribution trends.

Thus direct State intervention through cash transfers and tax level and structure can be said to have a significant impact on poverty and income distribution. For example, in OECD the estimated Gini coefficient before taxes and transfers is 0.45, dropping to 0.31 following direct redistributive action by the State, including the progressive component of the tax system which accounts for one third of the impact, and cash transfers to lower-income groups, especially those over 65 years of age (OCDE, 2009d).[2] As can be seen in figure VII.1, in some Latin American countries the respective Gini variation is much smaller.

[2] The impact on poverty is also direct and striking: in the OECD countries, before taxes and transfers relative poverty was 50%, whereas after fiscal measures it was only 15%.

Figure VII.1

LATIN AMERICA (18 COUNTRIES): GINI COEFFICIENT FOR PRIMARY PER CAPITA INCOME AND TOTAL PER CAPITA INCOME OF HOUSEHOLDS, AROUND 2008 [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys conducted in the relevant countries.

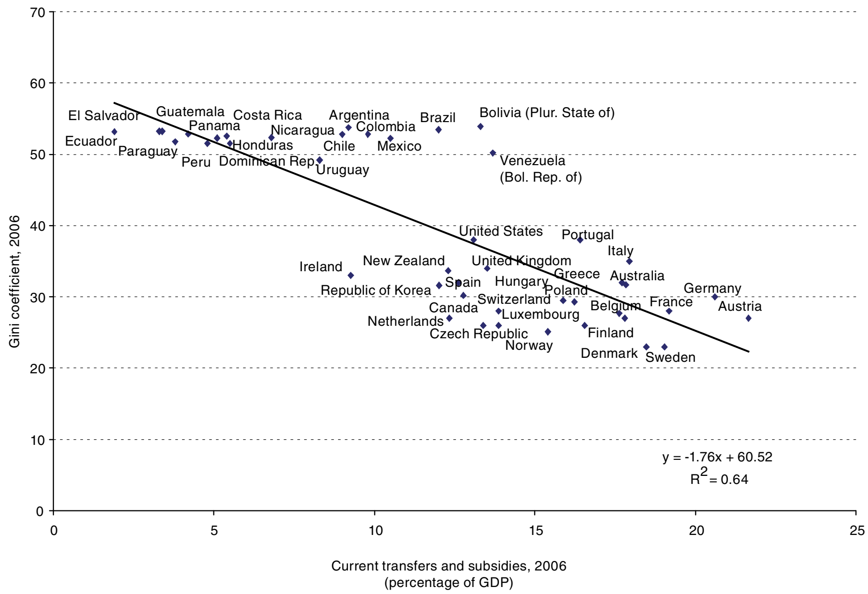
[a] Refers to primary income, after taxes and social security contributions.

Another way to illustrate this distributive effect is to estimate directly the impact of the variables which significantly affect the Gini coefficient, including social spending and tax composition (see Afonso, Schuknecht and Tanzi (2008) for the OECD countries). Application of this methodology to the countries of Latin America gives very similar results (Gonzalez and Martner, 2010) (see figures VII.2 and VII.3).

Figures VII.2 and VII.3 eloquently demonstrate, first, a marked synchronicity between the more egalitarian countries where transfers and subsidies account for a much larger percentage of GDP and, second, a definite link between equality and higher income tax. This does not mean that that there is a one-way causal relationship between these variables. As has been seen in earlier chapters, other factors have a considerable effect on equality, such as greater productive and territorial convergence and "historical accumulation" of capacity and knowledge, culture and provision of public goods.

Figure VII.2

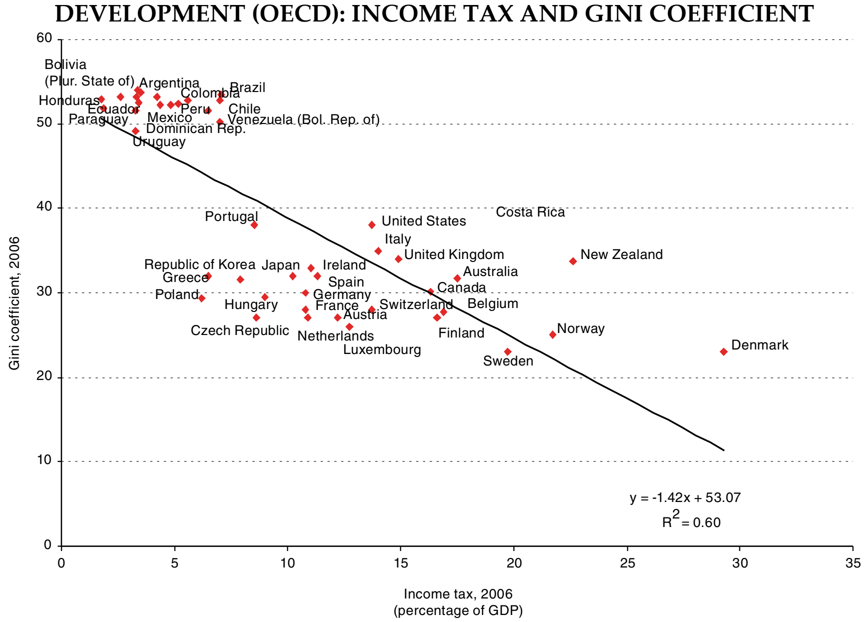
LATIN AMERICA AND THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD): PUBLIC TRANSFERS AND GINI COEFFICIENT



Source: Ivonne González and Ricardo Martner, "Del síndrome del casillero vacío al desarrollo inclusivo: buscando los determinantes de la distribución del ingreso en América Latina", document presented at the twenty-second Regional Seminar on Fiscal Policy, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 26-29 January 2010.

Figure VII.3

LATIN AMERICA AND THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD): INCOME TAX AND GINI COEFFICIENT



Source: Ivonne González and Ricardo Martner, "Del síndrome del casillero vacío al desarrollo inclusivo: buscando los determinantes de la distribución del ingreso en América Latina", document presented at the twenty-second Regional Seminar on Fiscal Policy, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 26-29 January 2010.

3. A progressive and efficient tax structure

Three factors affect fiscal revenue-raising capacity and how these resources are distributed throughout society: tax burden, tax structure and measures to combat tax evasion.

The average tax ratio in Latin America is about 18% of GDP. This is very low, in view of the region's relative level of development and, above all, of the resource requirements implicit in the public policy demands facing the Latin American States, to which reference has been made in previous chapters. That said, the tax burden in the region, including social security, increased on average from 12.8% in 1990 to 18.4% in 2008 (see table VII.1.A). In addition, fiscal resources from the exploitation of natural resources surged in some countries, including the Bolivarian Republic of Venezuela, Chile, Ecuador, Mexico and the Plurinational State of Bolivia. Although revenue from this source is rather more volatile than other revenues, it increased the region's total average tax receipts to about 23.5% of GDP in 2008. In the Caribbean countries, tax receipts average 26.3% of GDP, as shown in table VII.1.B, which is significantly higher than the figure for Latin America.

One way of judging whether tax receipts and the tax structure are "right" is to compare the ratio of taxes to GDP in a number of countries. The situation of Latin America and the Caribbean compared with other regions of the world is very revealing. In 2007, the tax burden of OECD was almost twice that of Latin America as a percentage of GDP. In addition, various studies on the subject show that potential tax receipts in the countries of the region are much higher than the actual level. On the basis of a recent work by Gómez Sabaini, Jiménez and Podestá (2009), figure VII.4 shows that only Argentina, Brazil, Nicaragua and the Plurinational State of Bolivia have a high tax ratio in relation to per capita GDP, whereas in Uruguay and Costa Rica the tax ratio seems compatible with their level of development (see figure VII.4). In the other countries of the region, the tax ratio is clearly lower than it should be in view of their level of development. This means that there is scope for increasing public revenue and therefore the redistributive capacity of the State through the provision of more resources.

However, the Latin American and Caribbean region not only fails to collect enough; it also collects poorly. Less than one third of tax revenues come from direct taxes, while the bulk comes from excise tax and other indirect levies.[3] Accordingly, it is not surprising that the distribution of income after tax is even more inequitable than primary distribution. The tax ratio difference between the OECD countries and the Latin American countries can be explained mainly by the low burden of tax on income and net worth in the region, since the level of excise taxes is quite similar. Although corporate income tax is quite similar in the two groups (just over 3% of GDP in OECD), there are significant differences in income tax (0.9% of GDP in Latin America, compared with almost 9% of GDP in OECD). Since personal income tax is the most progressive kind of tax, this would indicate that the Latin American countries' tax structure is more regressive than that of the developed economies, which adversely affects income distribution and is one of the reasons why the Latin American and Caribbean region is among the most unequal on the planet.

[3] Although in the Caribbean indirect taxes also account for most of the total, resources from foreign trade duties are more important.

Table VII.1

LATIN AMERICA: TAX REVENUE OF CENTRAL GOVERNMENT, INCLUDING SOCIAL SECURITY CONTRIBUTIONS

(Percentages of GDP)

	1990	2000	2008
Argentina [a]	16.0	21.5	30.6
Bolivia (Plurinational State of) [a]	9.3	17.9	21.7
Brazil [a]	26.4	30.4	35.5
Chile [a]	15.5	18.9	20.9
Colombia [a b]	9.5	14.9	18.4
Costa Rica [a]	16.9	18.9	23.1
Cuba	…	27.5	25.2
Ecuador	10.1	11.6	16.5
El Salvador	10.5	12.4	14.6
Guatemala	7.6	10.9	11.6
Haiti	7.3	7.9	9.5
Honduras	12.9	14.3	15.9
Mexico	11.4	11.0	9.4
Nicaragua	9.0	17.5	21.7
Panama	14.7	16.0	16.5
Paraguay	9.9	12.0	13.7
Peru	11.7	14.1	17.4
Dominican Republic	7.1	11.3	15.0
Uruguay	21.2	22.5	23.3
Venezuela (Bolivarian Republic of)	18.7	13.6	14.2
Average for Latin America (excluding Cuba)	12.9	15.7	18.4
Average for Latin America	12.9	16.3	18.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] General government.

[b] The 2008 figure corresponds to 2007.

Table VII.2

THE CARIBBEAN: TAX REVENUE OF CENTRAL GOVERNMENT, EXCLUDING SOCIAL SECURITY CONTRIBUTIONS [a]

(Percentages of GDP)

	1990	2000	2008
Antigua and Barbuda	18.4	15.8	21.3
Bahamas [b]	15.7	15.5	15.5
Barbados [b c]	28.2	31.1	34.1
Belize [b]	…	23.9	21.2
Dominica [b]	22.9	24.9	28.9
Grenada	22.3	22.7	23.7
Guyana	27.6	29.1	32.0
Jamaica	20.7	22.6	26.5
Saint Kitts and Nevis	19.9	21.2	27.0
Saint Vincent and the Grenadines	24.0	24.0	28.1
Saint Lucia	26.0	22.5	27.1
Suriname [b]	…	34.1	22.8
Trinidad and Tobago [b]	22.4	25.3	33.8
Average for the Caribbean	22.6	24.0	26.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Fiscal years. Excluding social security contributions.

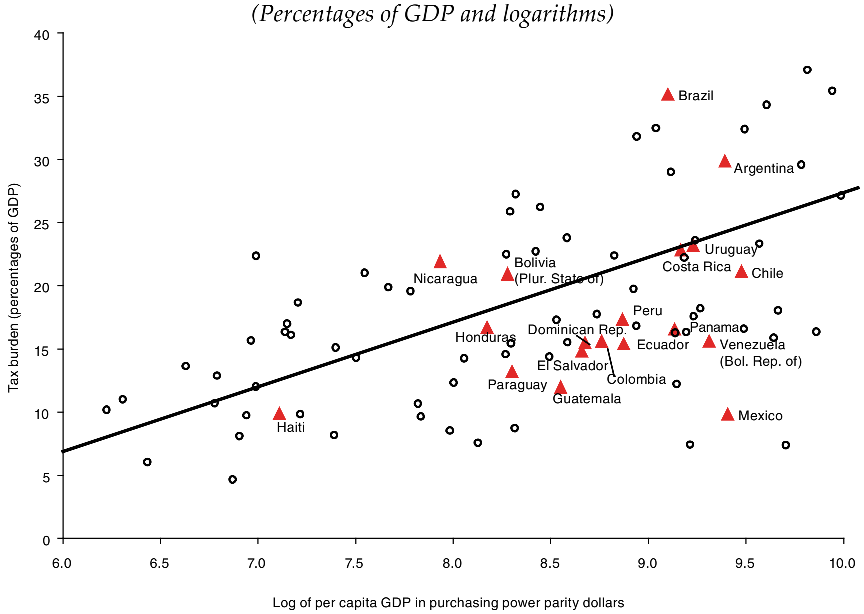
[b] The 1990 figures in the case of the Bahamas and Barbados refer to 1995, in the case of Dominica to 1993 and in the case of Trinidad and Tobago to 1999. The 2000 figures for Belize and Suriname correspond to 2001.

[c] Non-financial public sector.

Figure VII.4

GLOBAL COMPARISON OF TAX BURDEN AND PER CAPITA GDP IN PURCHASING POWER PARITY

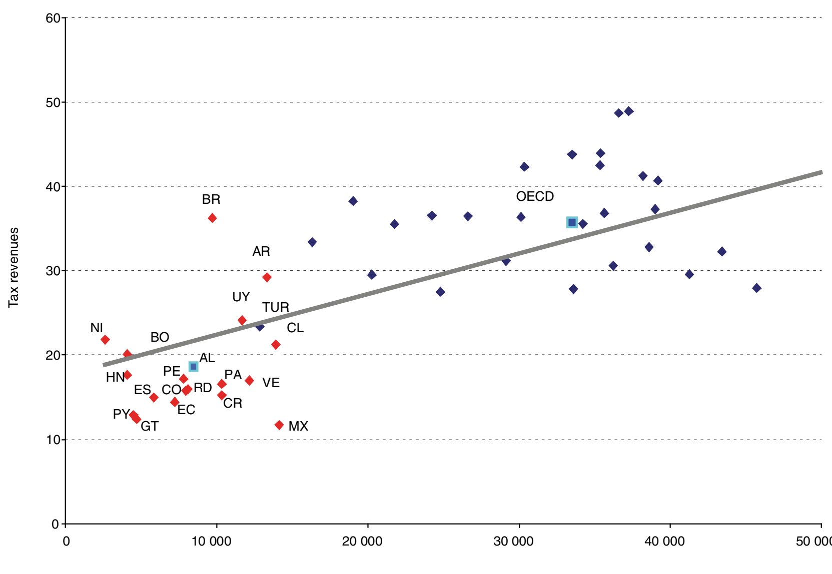
(Percentages of GDP and logarithms)



Source: J.C. Gómez Sabaini, J.P. Jiménez and A. Podestá, "Tributación, evasión y equidad en América Latina", *Evasión y equidad en América Latina*, Project document Nº 309 (LC/W.309), J.C. Gómez Sabaini, J.P. Jiménez and A. Podestá (comps.), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2010.

Figure VII.5

LATIN AMERICA AND THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD): TAX REVENUE AND PER CAPITA GDP, 2007 [a b]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

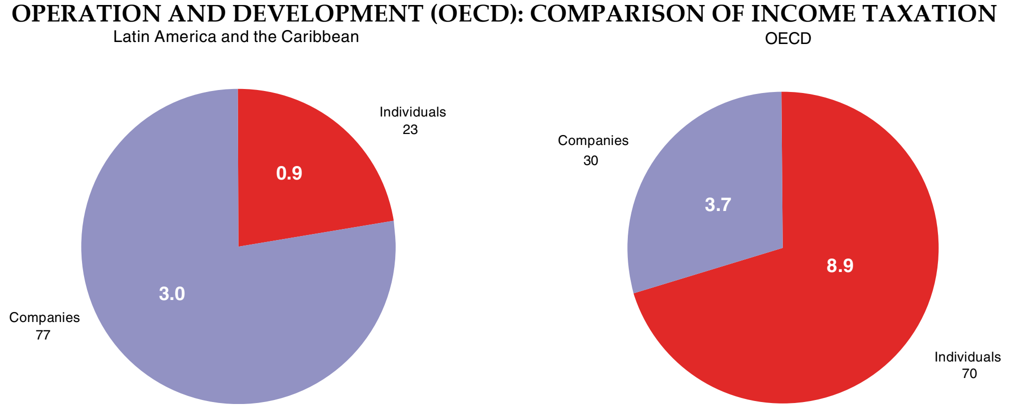
[a] GDP is expressed at 2000 constant prices.

[b] Tax revenue data include social security contributions and cover general government in Argentina, Brazil, Chile, Costa Rica, the Plurinational State of Bolivia and Uruguay.

However, the Latin American and Caribbean region not only fails to collect enough; it also collects poorly. Less than one third of tax revenues come from direct taxes, while the bulk comes from excise tax and other indirect levies.[4] Accordingly, it is not surprising that the distribution of income after tax is even more inequitable than primary distribution. The tax ratio difference between the OECD countries and the Latin American countries can be explained mainly by the low burden of tax on income and net worth in the region, since the level of excise taxes is quite similar. Although corporate income tax is quite similar in the two groups (just over 3% of GDP in OECD), there are significant differences in income tax (0.9% of GDP in Latin America, compared with almost 9% of GDP in OECD). Since personal income tax is the most progressive kind of tax, this would indicate that the Latin American countries' tax structure is more regressive than that of the developed economies, which adversely affects income distribution and is one of the reasons why the Latin American and Caribbean region is among the most unequal on the planet.

Figure VII.6

LATIN AMERICA AND THE CARIBBEAN AND THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD): COMPARISON OF INCOME TAXATION



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures for Latin American and Caribbean countries: Organisation for Economic Co-operation and Development (OECD), *Revenue Statistics 1965-2007*, Paris, 2008 and International Monetary Fund (IMF) *World Economic Outlook* (WEO), October 2008 for OECD countries.

The weakness of direct tax collection in Latin America and the Caribbean is basically due to two factors: the narrow tax base and high non-compliance levels. Both of these are also the result of the preferential treatment and tax loopholes that characterize the region's tax systems, resulting in considerable forgone revenue. As regards income tax, most of the countries afford preferential treatment to capital income through a series of exemptions or special incentives for financial placements, interest on government securities, mutual fund earnings, capital gains from immovable property and shares. Favourable treatment is also often given to reinvested profits. This forgone revenue reduces the tax base and increases the complexity of tax systems.[5] This not only violates the basic requirements of equity, which are that persons with equal capacity to pay

4 Although in the Caribbean indirect taxes also account for most of the total, resources from foreign trade duties are more important.

5 For more details about regional experience with the use of tax exemptions and incentives, see Jiménez and Podestá (2009).

should pay the same amount in taxes (horizontal equity) and that those with greater capacity should pay a proportionally larger amount (vertical equity) but also creates economic distortions in resource allocation which undermine the global efficiency of the economy and make countries less competitive internationally.

In the Caribbean, tax incentives also result in efficiency losses through preferential tax treatment, costs of forgone fiscal revenue and the cost of revenue mobilization resulting from the abuse of concessions. Nassar (2008) shows that, although in the Caribbean corporate income taxes have tended to converge, in the larger economies they have declined more significantly than in the smaller ones, suggesting a certain amount of tax competition. A decrease in corporate tax, combined with generous concessions, makes it difficult to increase revenue by expanding the tax base. Analysing the effects of the tax burden on investment in the zone of the Organization of Eastern Caribbean States (OECS), Nassar (2008) showed that marginal effective tax rates are substantially lower in the case of firms granted tax incentives than for other firms. Tax exemptions wiped out the tax effect on capital and, in some cases, turned into subsidies. To the extent that in some cases tax incentives are granted with a considerable degree of discretion, this impact may imply a misallocation of resources. Accordingly, the productivity of certain investment projects is distorted by the number and type of incentives.[6]

In Latin America and the Caribbean, the most progressive tax —personal income tax— has too small a share in total taxes to offset the regressive force of the remaining taxes. By contrast, in the industrialized countries fiscal policy has been instrumental in redistributing market rents to benefit the lowest-income groups, especially through the significant equalizing function performed by transfers and social spending. As can be seen in table VII.3, this redistributive effect is much stronger in Europe than in Latin America. In the former, States succeed in substantially altering income concentration indices by means of tax policies and transfers (public spending).

Finally, in addition to the regressive structure of the tax burden, the region has serious tax evasion problems. According to various ECLAC studies,[7] income tax evasion is very common and ranges from 40% to 65% approximately, representing a shortfall of 4.6% of GDP on average. These high levels of evasion undermine the redistributive effect of income tax. On the one hand, as noted by Jorratt (2009), evasion affects horizontal equity, since evaders end up paying less than tax-payers with the same capacity to pay who choose to fulfill their tax obligations. On the other hand, it may also reduce vertical equity, especially in progressive income taxes: the higher the taxes, the greater the incentive to evade them. In addition, people with more resources have easier access to professional advisers, who often promote tax avoidance strategies or reduce the risks of non-compliance. Monitoring of evasion and avoidance is therefore essential in order to improve the distributive effects of tax systems in the region.

---

[6] In Jamaica, which is perhaps typical of many Caribbean counttries, the forgone revenue represented by tax holidays, tax incentives and other exemptions was as much as 60% of total tax revenue in the fiscal year 2002-2003. Tax incentives represented 24% of revenue from corporate income tax and 56% of the taxes on international trade. In the OECS countries which depend on import duties, the fiscal revenue lost because of tax holidays was estimated at 4.3% of GDP in Dominica and 12% in Saint Kitts and Nevis. It is calculated that the annual loss of revenue for the whole subregion is between 9.5% and 16% of GDP.

[7] See Álvarez Estrada (2009), Arias Minaya (2009), Cabrera (2009), Cabrera and Guzmán (2009), Cetrángolo and Gómez Sabaini (2009), Jorratt De Luis (2009) and Roca (2009).

Table VII.3
LATIN AMERICA AND EUROPE (SELECTED COUNTRIES): INCOME INEQUALITY BEFORE AND AFTER TAXES AND TRANSFERS, 2008
(Percentage variation of Gini coefficient)

Latin America	
Argentina	-2.0
Brazil	-3.6
Chile	-4.2
Colombia	-7.0
Mexico	-3.8
Peru	-2.0
Latin America and the Caribbean (6 countries)	-3.8
Europe	
Austria	-34.2
Belgium	-36.2
Denmark	-40.8
Finland	-34.7
France	-24.4
Germany	-34.9
Greece	-25.0
Ireland	-35.8
Italy	-22.9
Luxembourg	-41.5
Netherlands	-33.3
Portugal	-24.0
Spain	-25.5
Sweden	-35.6
United Kingdom	-34.6
Europe (15 countries)	-32.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of E. Goñi, J.H. López and L. Servén, "Fiscal redistribution and income inequality in Latin America", *Policy Research Working Paper*, No. 4487, Washington, D.C., World Bank, January 2008.

To sum up, the region's existing fiscal systems have three common features: (i) low tax ratios, (ii) regressive taxation, and (iii) poorly allocated public spending. Although some progress has been made with respect to these limitations, the tax structure remains highly concentrated in consumption taxes and revenues suffer as a result of high levels of evasion and avoidance, poor collection of direct taxes such as income tax (especially personal income tax) compared with the developed countries, and little or no taxation of capital assets. Instead of being a mechanism promoting more equitable income distribution, the region's taxation and public spending systems are thus producing greater inequality.

4. The fiscal covenant for distributive equity

The evidence given above confirms the need for a fiscal covenant that affords the State greater power to redistribute resources and to play a more active role in the promotion of equality. As regards both social spending and the collection of resources to finance it (especially the tax structure), there is significant scope for progress and enhancement of the redistributive role of the State.

This is the framework in which, for over a decade, ECLAC has been emphasizing the importance of the fiscal covenant (ECLAC, 1998b). Five main tasks or principles have been identified, which today are still fully relevant: continue or complete the task of consolidation of public accounts, improve the productivity (quality) of public expenditure, create increasingly transparent public management machineries, and promote more distributive equity, all within a democratic and participatory environment.

Since a fiscal covenant of this nature has political implications far beyond those which would result from conventional fiscal or budgetary reform, the concept of the role of the State and the strategies which the authorities are trying to promote must be made explicit. For example, the idea of a fiscal covenant is something akin to vindicating the notion of development planning, which in turn reflects the desire for a comprehensive design of public policies. These policies may be conceived as mechanisms intended to promote "continents" rather than "islands" of equity. The general goal of equality presupposes substantial improvements in many sectors. The quality and universalization of education, the amount and coverage of social benefits and the capacity of measures to help the poorest will be crucial issues for the achievement of lasting progress in income distribution.

Today the idea of a fiscal covenant is finding favour in the region. The concept has been gaining support in international organizations and in national political dialogue, at the sectoral level or overall. There are at least two reasons for this greater willingness to embrace fiscal covenants. First, the evidence that public spending is a powerful instrument for containing the most corrosive effects of external volatility (decline in employment, income and consumption). Second, the recognition that good fiscal policy, backed by sound institutions and adequate public management capacity, makes an additional contribution to social equity and cohesion and to productive development.

Insofar as it requires agreements between the various public and private agents, the fiscal covenant must include at least the following components:

- A commitment to gradually increase the tax burden, so as to balance improved fiscal policy with adequate incentives for productive investment.
- A clear determination on the part of the State to improve revenue collection, including gradual reduction and control of evasion and progressive abolition of exemptions from direct taxes, for the sake of greater equity and efficiency.
- A reform of the tax structure in agreed phases, especially increasing income tax.
- A shared platform on which variations in the tax burden and structure are consistent with the larger role of fiscal policy within overall public policies.
- A clear and agreed public agenda for improving the transparency of public expenditure, the public institutions responsible for it and spending efficiency and effectiveness.
- A programme of gradual reprogramming of social spending in which the reallocation within and between sectors will, according to available evidence, show a greater redistributive impact and greater externalities in terms of equity and productivity.
- A tax structure and expenditure policy that take into account territorial inequalities and actively attempt to eliminate them. For example, territorial cohesion funds or mechanisms designed to introduce a progressive tax burden following a territorial approach.

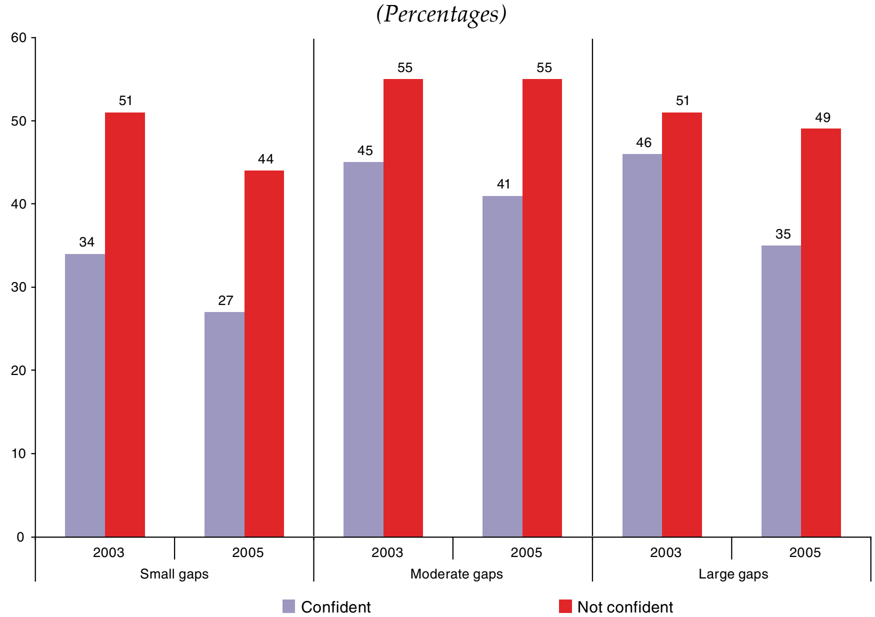
The social consensus and the legitimacy of the Government are based on the beliefs of individuals and their perceptions of State action. Citizens understand that they must pay taxes, provided that these ensure the provision of public goods and services by the State. Consequently, the way in which the Government spends public resources will largely determine its degree of legitimacy and its right to demand more revenue from tax-payers.

Lastly, if the fiscal covenant is based on the need to finance public policies by increasing the tax burden, it will be important to increase public confidence that these resources are being well used. In this connection, the most recent data from the Latinobarómetro survey show that the mix of confidence in spending and willingness to pay more taxes is not particularly widespread in society (see figure VII.7). This "tax hostility" is a problem that must be tackled precisely by greater transparency in the use of tax resources, as well as tangible impacts on well-being as a result of their use. The vicious cycle of low tax collection and limited tax legitimacy must be broken and replaced with a virtuous cycle of higher tax collection and greater consensus regarding tax reforms.

Figure VII.7

LATIN AMERICA (18 COUNTRIES): PEOPLE WHO BELIEVE THAT THE TAX BURDEN IS VERY HEAVY, BY DEGREE OF CONFIDENCE IN TAX SPENDING AND SOCIAL GAPS IN COUNTRIES, 2003 AND 2005 [a]

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Latin America in the Mirror: Objective and Subjective Dimensions of Social Inequity and Well Being in the Region* (LC/G.2419-P), Santiago, Chile, 2009, forthcoming.

[a] The questions used in the Latinobarómetro survey were: All things considered, do you think that taxation levels in [country] are very high, high, low, very low or just right? Are you confident that tax money will be well spent by the State? Countries are divided into three groups according to size of the social gap.

The regional agenda should be subjected to the scrutiny of the majority of citizens. Decision-making processes must be based on an agenda of probity, in which the various interests are transparently identified and dialogue, negotiation and consensus are basic decision-making tools. A public agenda must be constructed which includes a strong private sector and a solid citizenry with rights and real opportunities to exercise them.

E. The importance of social covenants for equality and strategic development

The fiscal covenant mentioned harks back to the importance of building social covenants in order to promote the new State/society/market equation proposed in this document. Without the legitimacy and political solidity of agreements between the various stakeholders, the proposed reforms could well remain in the realm of wishful thinking and good intentions.

Social covenants are explicit agreements between social and political stakeholders on a certain general or specific social order. Being explicit, they are different from the various types of mutual accommodation that occurs between the various sectors over time without the involvement of any stakeholder-defined institutional structure or forum. They are also different from what in Latin America was called a "compromise state", consisting of a series of unstable arrangements between the various sectors concerned: middle class, organized working class and upper class (bourgeoisie and oligarchy).

With covenants, the three basic issues are content (what they are about), stakeholders (between whom they are concluded) and methodology (how they are reached).

The content of covenants depends on their historical context. They may be creative (establishing a new social order of a general nature or within a specific sector), operational or instrumental or simply institutional civic agreements renewed or amended in the electoral context. Their coverage also varies. They may be pacts of national unity and forward-lookingness, as in the case of South Africa at the end of apartheid or accords concluded at the end of civil wars; they may be political, relating to the type of State organization (federalism, centralism and other forms) or to the political regime, such as the Punto Fijo Pact in Venezuela or the Naval Club Pact in Uruguay; they may refer to the socio-economic model, including fiscal, productive and labour covenants; they have to do with the model of international integration, forms of participation of civil society or a specific sector such as education, health or communications. In general, covenants tend to combine various aspects. The best known examples of social covenants are those forged between workers, management and the State (with a strong role for the State) that gave rise to the European welfare State, the New Deal in the United States and the Moncloa Pacts during the Spanish transition.

The stakeholders (who participates and how) depend on content and bargaining power. In covenants on the economic and social order, the main stakeholders have traditionally been the social classes represented by their organizations, mediated by the State. The best example is that of tripartite agreements between the State, trade unions and employers' associations, which may be conducted through consensus or by means of institutionalized arrangements such as economic and social councils. If the covenant concerns the political order, the main stakeholders are political parties and usually also the parliament. In the aftermath of civil war or the establishment of a new regime, peace commissions are sometimes placed over the stakeholders in a mediatory function, or may be composed wholly or partially of the stakeholders. In societies in which class distinctions are tending to become blurred, where there are numerous stakeholders whose social class is not clear, and in which political parties have lost legitimacy, national councils or commissions emerge such as the Equity Council in Chile, consisting of representatives of civil society and of the State, experts, mediation bodies and political parties. Agreements of this type are generally difficult to implement because they are not institutionalized, but they play an important role by defining expectations and historical perspectives on the sort of covenant that may later emerge in other specific spheres.

As regards methodology, bodies such as constituent assemblies are the most common type of mechanism when a new national system is put in place. In other cases, however, there may be an institution such as an economic and social council, laws and formal written or oral agreements or simply mere understandings which take shape in practice. This raises the problem of how to deal with free riders or of who is the guarantor of the covenant.

The content, stakeholders and methodology can be determined only with respect to specific situations. Here, a society's history and political culture are decisive, since their spaces, stakeholders and legitimacies are different from those of other societies. The political regime is also important; in a democracy, it is assumed that there will be some type of bargaining process that is compatible with the rights of the citizens and stakeholders involved, and that the covenant will have a general soundness conferred by the inclusion of all citizens in the legitimate interplay between majorities and minorities.

1. Social covenants and equality

Equality of rights provides the normative framework and the basis for social covenants creating more opportunities for those who have less. The equality agenda requires that covenants should be rethought in order to create institutional policy consolidating a democratic and participatory order with a development approach that expresses the will of the majority and allows all stakeholders to participate. This agenda includes the construction of a far-reaching economic and social agreement whose ultimate expression is the fiscal covenant. As stated in the previous section, this requires a tax structure and a tax burden that strengthen the redistributive role of the State and of public policy in order to guarantee thresholds of well-being. Labour institutions that protect employment security are also part of the equality agenda. Another pillar of that agenda will be an array of production, labour, territorial and social policies that seek not only equality of opportunity but also to narrow gaps in outcomes.

(a) Content

In this connection, ECLAC has stressed the importance of covenants for social cohesion (ECLAC, 2008b). Such covenants seek to consolidate social protection systems on the basis of the principles of universality, solidarity and efficiency, with clear and sustainable rules, effective management, linkage of different institutions, participation and enjoyment of rights by the population, decentralized operations and public-private engagement. Substantively, social cohesion covenants have broad coverage and include generation of public revenue, more productive fiscal expenditure, transparency of public spending, protection of equity, strengthening of democratic institutions, creation of employment, social protection and education and training.

A covenant for equality is basically a covenant designed to redistribute income and other assets,[8] and to correct tremendous structural heterogeneity. While greater production convergence is the foundation for achieving greater social equality in a sustainable manner, the most

[8] In addition to the usual assets of physical, human and social capital, ECLAC advocates inclusion of the time variable. For example, the considerable gender-based differences between available time and time devoted to unpaid work. Another aspect is the importance of understanding time as a generation sequence. In this sense, the distributive mechanisms of the State affect the way in which generations will pay for and benefit from growth. This is connected with the demographic window which is currently positive in the region. Environmental sustainability is also part of this equation.

immediate and available redistributive mechanisms of the State are still tax reform, the taxation system and the allocation of social spending. The State is a key player, not only because it must equalize opportunities but also because it must reduce inequality of outcomes over the life cycle, within and between generations. In other words, the participation of the State means the difference between the "equity effect" and the "equality effect".

Redistribution faces two challenges. First, nowadays it is inconceivable outside of democratic mechanisms: it cannot be achieved by physical coercion and must be based on consensus-building around the agenda of the covenant in question. Second, there is no democratic political force without the creation of large majorities to achieve national political agreements that are in the nature of State policy rather than government policy. Agreements of this type are reached in the midst of conflicts of interest, so that the role of the political system is precisely to mediate between various interests in order to build consensus.

(b) Stakeholders

An initial important factor –albeit one with uncertain implications– is public opinion regarding the fairness of existing distribution. On the one hand, the greater the perception of unfairness, the greater may be the willingness to conclude social and fiscal covenants with a redistributive agenda. On the other hand, the opposite may be true: a society perceiving fairer distribution is also a society that is more demanding about the role to be played by the State in guaranteeing equality. According to figure VII.8, there tends to be less confidence in political institutions when there is a greater perception of distributive unfairness. The State and the political system will have to deal with this vicious cycle in order to enhance public confidence in the redistributive capacity of the State (ECLAC, 2009j).

In order to reverse this vicious cycle, the support of the political and social stakeholders must be enlisted. This requires the creation –albeit in virtual or symbolic terms– of a cultural climate favourable to a redistributive coalition, so as to weaken the force of stakeholders opposed to any redistributive covenant adversely affecting their interests. In this connection, what is important is not only the legitimacy of the State but also the inclusion in this coalition of stakeholders that have great symbolic prestige in society and are supportive of equality, such as grassroots religious associations, philanthropic organizations, social communicators, solidary foundations, and trade unions.[9]

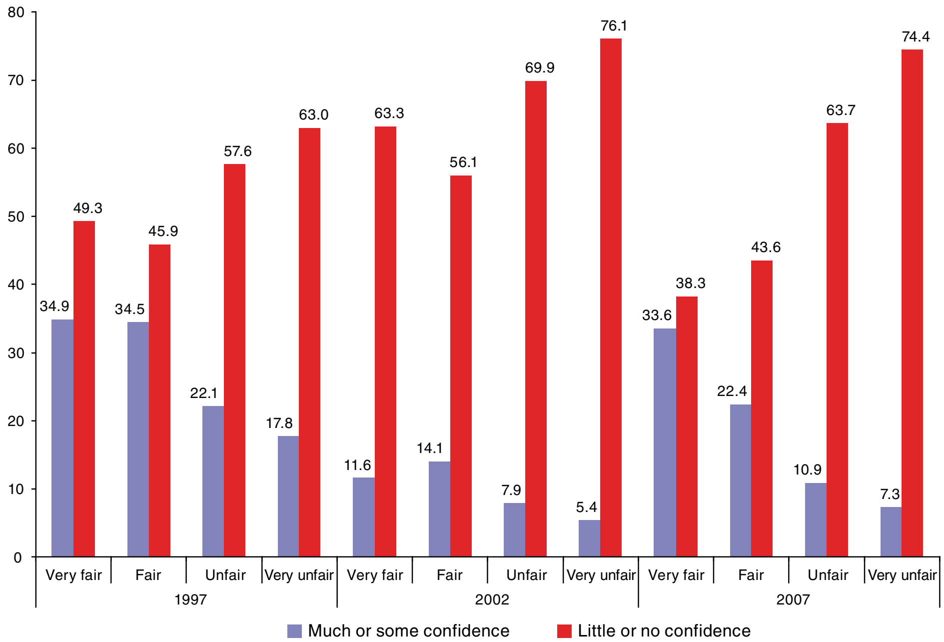
Unlike national foundational covenants, in which all sectors participate equally and equally willingly, an equality covenant involves all affected sectors, even if they are relatively disfavoured. This is possible only when they feel that they have more to lose if they do not participate in the covenant than if they do, when the legitimacy of the redistributive coalition is such that they have no alternative but to join it, or when they perceive that the "systemic effect" of the covenant will give them more benefits in the long term than the lack of one.

[9] A very interesting example is found in Chile, where the Equity Commission was created at the initiative of the Catholic Church and some of its spokespersons advocated a maximum ethical wage to balance the minimum legal wage.

Figure VII.8

LATIN AMERICA (18 COUNTRIES)[a]: CONFIDENCE IN POLITICAL INSTITUTIONS[b] BY PERCEPTION OF FAIRNESS AS REGARDS INCOME DISTRIBUTION, 1997-2007

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from the Latinobarómetro database, 1997, 2000 and 2007.

[a] The data available for the Dominican Republic are only for 2007.

[b] The index of confidence in political institutions was constructed on the basis of the following questions: Please look at this card and tell me, for each of the groups, institutions or persons listed, how much confidence you have in them: much, some, little or none? Political parties and Parliament or Congress. The replies were divided into three groups: (i) much or some confidence in Congress or Parliament and the political parties; (ii) little or no confidence in both institutions; and (iii) a group in between, with much or some confidence in one of them.

Among social and political stakeholders, special consideration must be given to the State, which as a stakeholder is both a space for others and an agent organizing and intervening in society. In order to design and implement an equality agenda, the institutional structure of the State must therefore be capable of bringing into play two aspects of its personality: the State as a space in which the various stakeholders meet and negotiate and the State in its capacity to intervene, set goals and evaluate outcomes in the area of equality. This means that the equality covenant must be considered to be a policy of State, not only of government.

The State must be rethought and reconnected with the ability to steer development and real capacity to assign resources and perform regulatory functions, in the context of new relations with society, the system of representation and the basis for the creation of social stakeholders – in other words, civil society.

In this context, three models pose different types of problem for the construction of social covenants. In more societal models, stakeholders and grassroots social movements have a major presence, but the State and the political parties do not. In this case, however powerful it may be, in the absence of an authority to which demands can be addressed and of parties representing it, civil society is still on its own and at the mercy of self-appointed powers which are precisely the ones that tend to oppose redistribution and equality. In party-based models, on the other hand, the parties can build redistributive coalition agreements and proposals on the subject. However, the weakness of the social stakeholders detracts from the legitimacy of the agreements and means that they have little real basis beyond political calculation. In the more autocratic models, the leader has greater capacity to spearhead a redistributive proposal but less possibility of concluding agreements involving productive and political sectors which are not part of the governing group. Lastly, technocratic models tend to give priority to equilibrium and economic growth and are less supportive of redistributive policies.

It is difficult to imagine an equality covenant under democratic regimes that does not include mediation by the parties and parliament. The parties can represent the various sectors not convened by civil society organizations and, in addition, are ideal forums for the formulation and negotiation of proposals both with the electorate and with specialized bodies such as parliament. There are three problems here, which affect countries in different ways. The first is the absence, in some cases, of a full range of parties. The second is the difficulty currently experienced by parties in transcending opportunistic proposals made during election campaigns and projecting themselves into an ideal of social organization such as equality, with its correlatives – production models and development. This involves reaching basic consensuses on production and social issues, independently of the political situation. Consequently, the third issue that the parties must be the political expression of the redistributive coalition between different interest groups that will make this development ideal a reality. Since these are policies of the State, this may require consensus-building and partnership efforts that may conflict with electoral requirements and with a fragmented political map preventing the achievement of agreements or covenants with greater social import and political continuity. There does not have to be unanimity, but there is a need to construct stable projects with the support of the majority and egalitarian goals. This requires party review and reform, which in turn necessarily implies political reform.

(c) Modalities

This brings us to the third aspect of the social covenant: the methodology for reaching it. The goal here is not to propose institutional engineering, since this necessarily varies from case to case depending on the national context. But it is important to consider the social and political mix on the various stages where a social equality covenant plays a role: Parliament, local and regional stages and new negotiating scenarios.

The first task will probably be to carry forward a national debate on the subject. Its forms may vary. It must include a forum for drafting content, which may be similar to the methodology of the constituent assembly or national council or commission, in which State agencies, experts, social stakeholders and religious institutions participate in formulating agendas and overarching goals overall and for each sector. In addition, equality agreements should be endowed with a certain degree of solemnity, with the creation of technical commissions to draft legislation for discussion in parliament.

A social equality covenant should engage civil society and the parties (in the style of a national equality council), at least in an advisory capacity, across all the areas of competence of traditional institutions (ministries and the Executive Branch, evaluation and advisory bodies). The local and regional levels are extremely important for the administration, coordination and participation of grassroots stakeholders.

2. Labour covenants

Separate mention must be made of labour covenants, for at least three reasons. The first is that labour negotiations have a long history and there are international standards on tripartite negotiations that clearly identify the participants: workers, management and the State. Second, labour agreements are vital for reconciling the goals of labour protection and decent employment with the productivity agenda of firms. Third, they are a component of social equality –given the influence of employment earnings– and of social cohesion.

The goal of a labour agreement is to improve labour institutions so that they are better able to perform their dual function of imparting economic dynamism and protecting labour. In view of the goal of greater equality, special efforts must be made to expand the coverage of labour institutions to an increasing proportion of the working age population, a large percentage of which is still excluded.

Social dialogue is the mechanism by which the content of labour covenants must be defined, and it must examine the specific bottlenecks that prevent labour institutions from performing better in a particular country. There are forums for developing solutions that promote both economic growth and worker protection in the existing context. However, this combination is not always possible, so that it is essential to identify the forums for and the validity of mutual concessions between governments, employers' organizations and trade unions.

International labour standards can be a valuable reference for the social dialogue. In view of their tripartite origin in the deliberations of the International Labour Organization (ILO), these standards already represent the outcome of social dialogue and they generally offer enough scope to be converted, through national debate, into relevant and legitimate rules in each country. The same is true of the focus on "decent work", which has become widely accepted internationally and among social stakeholders.

There is also a need for more resources to redesign labour institutions. In order to avoid substantially increasing labour costs, which could hurt demand for labour, these resources should be provided from fiscal revenue. Thus the debate on labour covenants cannot be dissociated from the context of the general fiscal covenant.

A gradual approach is also important. Although it may seem tempting to negotiate a unified package of reforms in all relevant areas, which could facilitate the practice of mutual concessions, in many countries this is not feasible because there is no climate of confidence between the parties. A confidence-building process is therefore required, which could consist of gradual steps in the right direction to enlarge the openings for embarking on new agreements.

It is also recommended that labour agreements should be part of a long-term development strategy. The strategy and its relevant goals will define some of the key requirements for labour institutions and link them to non-labour aspects, such as education and technological progress. The next section describes some successful cases of agreements between various participants in the framework of long-term development strategies.

In view of the weakness of protection systems, it is essential to concentrate on the design or improvement of a system to provide protection against unemployment and act as a disincentive to excessive staff turnover. The features of the scheme will depend on the specific situation of each country and on the way in which the social covenant can bring about consensus in the light of the complex variables of financing, coverage, entitlements, obligations and complementary services, among others.

As noted in chapter V, active labour market policies play a central role in improving equality in the labour market, for example by enhancing training with a view to greater production convergence in the economies. In addition, these policies facilitate confidence-building and learning processes. Although there are of course differences of opinion regarding programme financing, management and oversight, concurrence on the basic interests of the main stakeholders facilitates the conclusion of agreements on specific instruments. In view of the great unmet challenges –for example, as regards training– a broad dialogue on the enhancement of active labour market policies could have a favourable outcome, opening up space for debate in other areas.

3. Covenants and learning: a look at the positive experience of alliance-building between agents

Some countries quickly adopted a development strategy and agenda following a common practice: adoption of a medium- and long-term strategic vision, an action plan for achieving goals and objectives and a public-private alliance supporting institutional policy for the definition and implementation of strategies, programmes and policies. According to some ECLAC studies on which this section is based (ECLAC, 2008b; Devlin and Moguillansky, 2009), concerning the experience of 10 countries,[10] the combination of strategic approaches and construction of alliances between agents is crucial to understanding these countries' recent development successes. This success is exemplified in productive transformation, export expansion and diversification, addition of value and know-how in exports, reduction of the income gap with rich countries and enhancement of equality.

The strategies include goals such as more and better employment, better education and reduction of inequity, which are closely linked to the strategy of productive transformation, enhancement of international integration and innovation. This approach adopted in covenants forged in countries with successful development experiences coincides with the recommendation in this document that advances in the area of social equality should be dynamically linked to advances in productive capacity, employment and economic growth, in a strategic approach to development.

One example is Ireland, which during the 1970s and 1980s pursued a policy of indiscriminately seeking direct foreign investment and in the 1990s specialized in four areas, pharmaceuticals, chemicals, ICT and medical equipment. The goal of this reorientation was to preserve the policy of high wages, which rose rapidly in line with productivity, and to reduce the income gap within the country in order to remain competitive. In addition, today Ireland has a National Economic and Social Council (NESC), which is one of the most inclusive institutions as regards the variety of stakeholders and consensual dialogue. In fact, over time NESC developed a discussion methodology designed to facilitate consensus. NESC prepares a triennial report that provides strategic input in the negotiation of the national social agreement between Government, business and the trade unions and has for some time been very influential in the formulation of the Government's national plan.

Another example is the Operational Programme Enterprise and Innovation (OPEI) of the Czech Republic, which is part of that country's Economic Growth Strategy[11] In addition, it benefits from the Structural Funds and the Cohesion Fund of the European Union, designed to achieve convergence with the richest countries in the Union. OPEI was planned as a renewable

[10] The countries covered in the study by Devlin and Moguillansky (2009) on which this section is based were: Australia, Czech Republic, Finland, Ireland, Malaysia, New Zealand, Republic of Korea, Singapore, Spain and Sweden.

[11] See [on line] http://home.cerge-ei.cz/munich/TEXTY/2005_09_06_SHR_final_eng.pdf.

programme, from 2004 to 2006 and from 2007 to 2013 (Ministry of Industry and Trade of the Czech Republic, 2007), so that it has long-term financing and can achieve successes over a period of time. It focuses on SMEs and mixes public and private resources to stimulate entrepreneurship, innovation, internationalization of firms, business support services, and improvements in institutional quality and the business environment.

Reference should also be made to the experience of the Moncloa Pacts, in Spain. In 1977, the country was experiencing severe economic and social difficulties under the Suárez presidency. There was a call for a major national agreement with the support of all political parties, as well as of general and business unions and a series of economic, social and political agreements were signed allowing planning for the future and gigantic development strides. This strategic agreement also allowed Spain to increase the tax rate by one percentage point each year over ten years to provide responsible financing for development efforts.

Following the global financial crisis, the new Government of Australia quickly devised a plan to combine short-term policies with long-term strategy in order to meet future challenges. It implemented the Nation Building – Economic Stimulus Plan, designed to create and support employment and to attract long-term investment. This initiative was, in turn, part of a proposal for meeting the strategic challenges created by the international crisis, climate change, population ageing and long-term food and water supply issues. To this end, the Government is spearheading a revolution in the areas of education, investment in infrastructure and innovation, health and environmental reforms, and a new and more participatory form of government inaugurated during what was known as the Australia 2020 Summit.

In addition to the formal and structured alliances in countries such as Ireland and Finland, there are other forms of association: informal and tacit (not institutionalized) as in Spain and Sweden; formal but ad hoc as in Australia, in which Governments convene them for a specified period of time, engaging special stakeholders; or hybrid as in the Czech Republic, New Zealand and the Republic of Korea, where various types of alliance coexist. However, the coalitions that in practice prove most effective, facilitate transparency and prevent State capture by economic stakeholders are the ones that are formal and structured.

The formation of this type of alliance is a gradual social process with much institutional learning, in which each country has to find the solutions best suited to its cultural, historical, political and economic reality. However, there are certain requirements. First, the State must have the necessary qualities to be a credible partner of the private sector: professionalism, honesty and technical know-how, combined with fiscal soundness to finance programmes and incentives. The purpose of these schemes is, on the one hand, to help firms seeking to enter new markets and upgrade their products, processes and technologies and, on the other, to give workers better-quality employment and higher wages. Second, the State has to find ways of interacting strategically with the private sector (in the broad sense of business, academia, workers and NGOs) to ensure that it is not captured by special interests and that the alliance preserves its character of public good. Third, the State must improve its ability to manage and coordinate incentive and cooperation programmes with the private sector, implementing them transparently and with permanent performance-based accountability.

The private sector also has new responsibilities. In order to take advantage of the opportunities of the post-crisis era, it must adopt a medium- and long-term vision, aiming to steadily scale up its activities by means of investment and innovation. It must also be prepared to proactively support formation of an alliance with the public sector which would be in the nature of a public good. This will enable the State to expand its resources and capacity in order, among other things, to: (i) become a credible partner, mobilizing the country's best talents; (ii) pursue policies that help to reduce poverty and inequity; (iii) provide infrastructure, logistics and connectivity; (iv) support learning through more and better education in key areas for competitiveness, training and investment in additional incentives to encourage innovation; and (v) promote the internationalization of SMEs.

Latin America also has experience with alliances.[12] Among the formal and structured ones, with stakeholder participation similar to that of Ireland's NESC, mention may be made of Brazil's Council for Economic and Social Development (CDES), which was created in 2003 as an advisory body to the Office of the President and has influenced policies and parliamentary reforms. Peru also has a body providing broad-ranging advice to the Government on medium-term and long-term topics: the National Agreement, created in 2002. However, the power and capacity of this forum to influence policy have been declining because it did not succeed in gaining the full attention of the leaders of the existing Government and did not have sufficient interaction with the public.

In Chile, on the other hand, alliances have mainly been ad hoc, convened by the Government to work on specific topics such as education reform, inequality, financial reform, negotiation of free trade agreements and the Pro-Growth Agenda formulated by the Confederation of Production and Commerce (CPC). One of the main differences from alliances in countries outside the region is that the dialogues are topic-based and do not take place in the framework of an agreed vision of the future, so that it is difficult to achieve cohesive agreements under a common umbrella. In addition, there have been forums for dialogue and commissions whose agreements were not binding or which did not link up with defined government responsibilities.

Colombia is one of the countries in which the public-private alliance is most deeply rooted in the State, having been developed in the early 1990s. Currently the most broadly accepted alliance is the National Competitiveness Commission, a public-private body linking relevant stakeholders and institutions at the national and regional levels. As established by law, this Commission represents a meeting-place for the various economic representatives, where productivity and competitiveness policy is outlined, in accordance with the country's development plans and programmes. However, as noted by Gómez Restrepo, Botiva and Guerra (2007), the persistent lack of institutional linkage results in duplication between and within the various bodies and confusion about the role played by the various agents in the development of the national competitiveness policy.

In general, a review of the experiences of nine countries in the region studied by Devlin and Moguillansky (2009) and their comparison with successful cases outside the region lead to the following conclusions: (i) Even if alliances have formal support at the highest level of government, their legitimacy and future relevance are affected by changes of government; (ii) There are rarely any legal or informal ties by which these alliances can influence the decisions of the public authorities, so agreements are often not forwarded to executing agencies and are not allowed for in the budget, which discourages the economic and social stakeholders involved; (iii) In some countries, the councils have an unmanageable number of participants, making them unwieldy;

[12] For a detailed analysis of the features of public-private alliances, their composition and their linkage to various levels of public administration, see Devlin and Moguillansky (2009).

(iv) These bodies have no budget to employ a technical secretariat and conduct the necessary studies to enable them to base their discussions on solid arguments, especially for the long term; (v) There are no proper procedures for preventing State capture. In view of these problems, in Latin America and the Caribbean public-private alliances rarely influence strategies or, more importantly, political decisions.

If the agreements constructed are to prosper, they must be truly long-term, have precise and agreed goals and be based on efficient, effective, transparent and properly financed public policies. It is not enough to conclude agreements relating solely to the objective sought; it is also necessary to define methods and time frames for implementing them, institutional arrangements to make them sustainable over time and, of course, the resources to finance them.

4. By way of conclusion

A social covenant requires and promotes changes in political action. It results in a more proactive State, stronger mechanisms of legitimacy and representativeness, stronger engagement on the part of economic agents, and the participation of various social stakeholders, together with the creation of appropriate forums. The covenant is a process rather than a result. It involves discussions and agreements on long-term coexistence projects, sacrifice of immediate interests for the sake of the common good and the development dynamic, and a general commitment to a better society and better-quality political action. It is an attempt to relegitimize politics on the basis of both inward democracy and outward integration into an increasingly globalized order.

This is clearly a far-reaching and long-range task, requiring the strategic vision advocated here. But a start must be made at once. It is important to have social covenants so that policies are not dependent on election timing and changes of government. It is important to adopt an approach to fiscal viability that is centred on civic rights, particularly social rights. It is important to direct growth towards more and better employment. It is important to reflect gender and generation changes in a new architecture that makes the care economy compatible with labour market participation, takes advantage of the windows of opportunity presented by the demographic transition and averts the risks arising from this transition.

Development, as we experience it, envisage it or have suffered it, has reached a turning in the road today. The financial crisis and its social impacts, as well as the threat of climate change, have placed a large question mark over the scope of the production and economic paradigms prevailing in earlier decades. In this situation, citizens are now seeking refuge and guidance from their Governments and their States and a fairer international order with a greater variety of voices. Without a new State architecture reflecting the new context, the new realities emerging from the crisis, the requirements of the equal rights agenda and the challenges of climate change, there will be no future.