



# **SUSTAINING DEVELOPMENT FOR ALL:**

**Expanding Access to  
Economic Activity and  
Social Services**

**Inter-American Development Bank**



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## ■ WHY THIS PUBLICATION?

**H**umanly, ethically and politically exclusion, conscious or unconscious, is unacceptable. From a moral point of view, it is not possible to live placidly alongside the suffering that lack of basic necessities causes. Politically, failure to meet the needs of large parts of the population threatens basic democratic principles, and is in itself undemocratic. While the poverty reduction agenda of multilateral organizations may seem a lofty goal, this is really a primary responsibility for all members of society. While it may seem that for some economic actors, such as the private sector and civil society, other goals like profit maximization or general service to the public are principal to their functioning, their purpose can and should be aligned with the overarching goal of ending poverty. Even the private sector is waking up to the fact that the poor make good consumers, strong citizens and worthwhile stakeholders.

Ending poverty is a difficult task, even in cases where there is a consensus about what needs to be done: not only is poverty a relative concept, but often there is no consensus on what needs to be done even when the target population is identified. Multilateral development institutions, like the Inter-American Development Bank, have declared poverty reduction a primary and overarching goal, but activities targeted to achieve such goals can be dispersed and ineffective: such is the lesson of forty years of lending. In the case of the IDB, we have come to the realization that pursuing economic growth, growth that is environmentally and socially sustainable, is key to achieving the goal of reducing poverty. Sustaining Development for All is more than a slogan: it is a mandate to act.

There are many recipes for achieving development for all. One factor that is often contentious, and more so in Latin America than in other part of the world, is the degree of reliance on well functioning private markets: the legacy of the Washington Consensus is that there is no consensus at all. The liberal school of thought still proposes faith in the machinery of private markets, considering that somehow benefits from commerce and trade, and increases in economic activity will spread throughout society, trickling down to the less well-off. The past few decades have shown that, indeed, improvements in the functioning of private markets have increased economic activity, but the benefits have been very slow in reaching the poor, and reducing inequality has been elusive. In fact, inequality has increased, becoming one of the distinguishing factors of the region compared to other continents.

There are limitations to the well functioning of private markets and to the capture of benefits by the poor. While markets are a necessary condition, they are not a sufficient one. This is particularly true in developing countries, where institutional capacity is a real limitation and large portions of the population are not even included in “the market.”

There is a need to enhance the system of transmission of benefits and the capacity of excluded populations to participate and capture the benefits of growth. We need sustainable development for



all, not just for those able to participate, be they a majority or a minority, or at the top or the base of the pyramid. Granted, our efforts must concentrate on the inclusion of excluded persons, but this must be accomplished without disturbing the important contribution of those who are already included.

Benevolence need not be the primary motivation for inclusion: as recent literature demonstrates, there are market opportunities for private firms in serving the poor. While the poor may have limited purchasing power, they are, unfortunately, also numerous. By paying attention to this potential new market and designing products and services that serve their specific needs, the private sector would not be doing charitable work: it would be serving the same profit principles applied to other segments of their customer base. It is no longer simply laudable to give access to the poor to products and services that otherwise they would not have, it may also be a good profit maximization strategy. Therefore, it is myopic from the point of view of development to ignore this reality, and not to try to harness the forces of public and private interests to converge on a common goal. In order to sustain development, the less well-off not only need products and services that meet their needs, but also the ability to buy them. They need access to jobs and social services. They need to be included. We prefer to say that there is a wealth of opportunities at the bottom of the pyramid, opportunities to support the disadvantaged, rather than for making a fortune selling them goods and services.

The new “private sector oriented” approach is often seen as a critique of the “old development” approach, which is considered to have failed. The public sector oriented approaches of the past (with their emphasis on assistance) have been shown to only mitigate the problem without solving it. They represented a “give them fish” rather than a “teach them how to fish” philosophy. What we need today is not a further polarization of the issues, but a comprehensive approach that does not consider problems in a piecemeal fashion, but that involves all actors in an integrated manner. All levels of government need to be included in the debate, since they are often responsible for including or representing the disenfranchised. The private sector needs to be included because bringing together profit objectives and social goals has shown to be an effective way of addressing these issues. Civil society is the major stakeholder and should have a say in identifying the problems that need to be resolved, as well as the solution it is willing to accept. The multilateral development institutions, as honest brokers and lenders of needed financial resources, can play active roles too in supporting sustainable solutions.

This publication takes a comprehensive view of all the action areas that need to be addressed in a coordinated and integrated manner to achieve sustainable development for all. The articles included herein deal with how to enhance the quality of life of the poor, how to enable all members of society to become productive economic agents, and how to include them in a more democratic society. The introductory article presents an overview of the current situation of poverty and inequality in Latin America and the Caribbean, and discusses ways in which the market can help reduce them.

Part I, Access to Markets and Buying Power, presents a collection of articles that explain how to align the objectives of the private sector with those of development; how socially responsible firms can enhance the well-being of all; how developing entrepreneurship and providing support to micro, small and medium enterprises can contribute to the creation of jobs; how to make financial markets work for all; how to design infrastructure that can support the marginalized and the poor; how to utilize ecosystems in a responsible fashion; and, finally, how to utilize the rural potential and the potential inherent in the cultural richness and natural resources of indigenous populations to enhance access for those who have been neglected.



Part II, Access to Services, discusses what is actually required to help provide access to markets and enhance the buying power of the poor. The articles in this section touch upon issues such as the role of local governments in reaching and empowering the poor; the need for education and training services to allow productive participation and access to jobs; the measures required to take advantage of the vast potential of women; and overcoming the obstacles posed by violence and crime that tend to affect the disadvantaged most, and is a particular problem for Latin America and the Caribbean. This section of the book also looks at issues such as providing accessible housing solutions, making jobs more available to the urban poor and, creating the health services needed for a decent living.

Part III looks at actual measures to enhance the process of access to markets and services through better use of social capital. These are issues such as solidarity, trust, civic and ethical values, and their connection to information and communications technologies.

This publication was written to facilitate access to the ideas promoted to as large an audience as possible: inclusiveness starts at home. It has been written as a team effort by the staff of the Sustainable Development Department to contribute to the public and internal debate on how to focus and enhance the impact of the IDB and, most importantly, the institution's impact on the poverty agenda mandate. It is our hope that this publication will serve the purpose of promoting sustainable, rather than polarized, solutions and truly inclusive development.

*Antonio Vives*

Manager a.i.

Sustainable Development Department



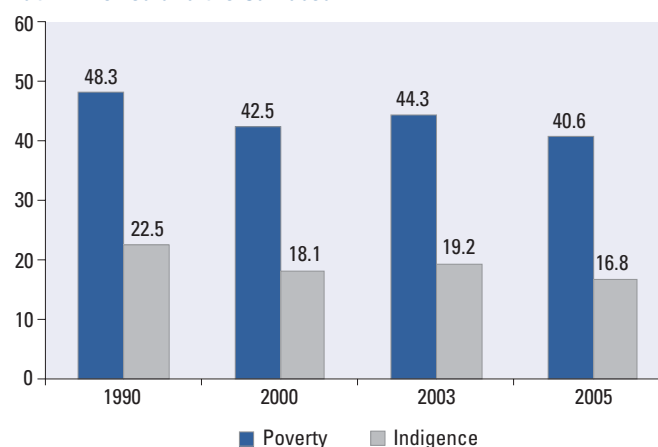
## ■ POVERTY ERADICATION THROUGH ACCESS TO SOCIAL SERVICES, MARKETS AND BUYING POWER

Poverty has been decreasing in Latin America and the Caribbean, but at a speed that is insufficient to reach the first Millennium Development Goal of reducing extreme poverty by half between 1990 and 2015. As noted by the Economic Commission for Latin America and the Caribbean,<sup>1</sup> the region is experiencing a period of renewed growth following the stagnation that began in 2000. Average per capita GDP growth increased from –0.2 percent between 2000 and 2003 to 3.5 percent between 2004 and 2005. It is expected that these improvements in overall economic growth will translate into reductions in poverty rates. Figure 1 shows that both poverty and indigence declined in the region between 1990 and 2000, and projected figures for 2003 and 2005 show a further decline after the setback of the early 2000s. These improvements amount to an advance of 51 percent in the achievement of the first MDG, which is encouraging but still short of the 60 percent improvement needed to achieve the goal by 2015. Efforts to sustain and increase the rates of inclusive economic growth in the region are needed to accelerate poverty reduction and promote increases in well-being for the population as a whole.

Part of the slow progress in reducing poverty in the region is explained by the high level of inequality that prevails (see figure 2). As a result, poverty rates

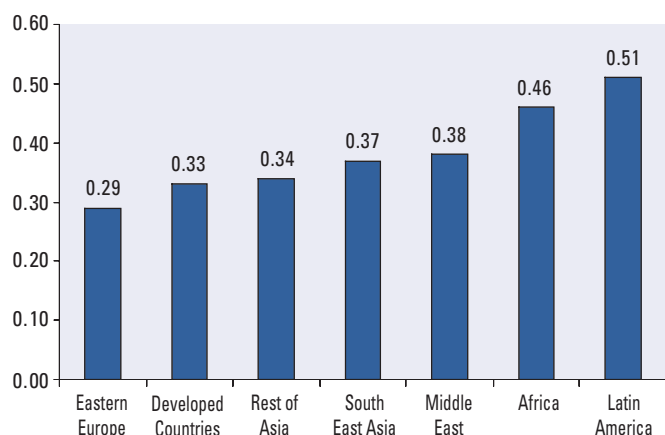
<sup>1</sup> Economic Commission for Latin America and the Caribbean. 2005. *Balance preliminar de las economías de América Latina y el Caribe*. Santiago de Chile.

**FIGURE 1**  
**Evolution of Poverty and Indigence Rates in Latin America and the Caribbean**



Source: ECLAC, 2005. Figures for 2003 and 2005 are projected by ECLAC based on GDP growth estimates and are dependent upon assumptions about how growth is distributed among the population.

**FIGURE 2**  
**Comparison of Inequality Rates Across World Regions (Gini)**



Source: Calculations based on the World Development Indicators Database, World Bank.

are disproportionately high given average income levels in the region. Countries with high income inequality require higher GDP growth rates to reduce poverty than those with relatively lower inequality. Recent studies of the distribution of the benefits of growth across income groups (pro-poor growth) in the region highlight the low impact of GDP growth on poverty reduction. This is a serious policy concern for the countries of the region.<sup>2</sup>

## Poverty Eradication: A Multi-sector Policy Perspective

Poverty is a multidimensional phenomenon closely related with the low accumulation of human capital and scant economic opportunities for the poor.

Although sustainable economic growth, macroeco-

nomic stability and governance are essential ingredients for poverty reduction, they are not sufficient. Promoting inclusive growth with the aim of reducing poverty requires efforts in two fronts: enhancing the productive capacity of the poor (enhancing human capital) and developing pro-poor access to markets by expanding employment and business opportunities for poor people. The scaling up of specific actions to boost capacity (assets) and opportunities for the poorest and most excluded groups are required to promote greater equity and increase the impact of growth on poverty.

Enhancing the productive capacity of the poor requires:

- Policies that promote equitable access to education and health to increase the skills of the poor and decrease their vulnerability; and equitable access to basic infrastructure services, especially water and sanitation, and housing and urban upgrading. These services complement human capital and are instrumental in its accumulation.
- Policies to develop pro-poor access to markets that enhance employment and business opportunities and take advantage of value-chain opportunities that integrate poor rural producers and small urban entrepreneurs into dynamic sectors of the economy that are linked to domestic or international markets. In addition, it requires support for microfinance and microenterprise development and stimulating the private sector in general, including improving business climate indicators. Also important are policies to protect the interests of employees and poor entrepreneurs.
- Two key complementary policy areas are: ensuring an adequate environment (governance, corporate social responsibility, public and private sector trust) to increase the capacity and op-

<sup>2</sup> See for instance, World Bank, 2005, *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*, Washington, D.C.

portunities of the poor; and fostering institutions to monitor inclusive and shared growth and, facilitating and promoting evidence-based policymaking.

## Increasing the Productive Capacity of the Poor

Given that labor is the main productive factor of the poor, a critical element in the fight against poverty and inequality is strengthening investments in human capital, from early childhood through adulthood. Access to quality education and health services should be a chief priority of social policy and reform agendas. It is essential that social policies and programs *go beyond average indicators* of access to services, and monitor to what extent the poor are reaching those education and health goals. This approach will mean scaling up comprehensive programs to improve the coverage and quality of the supply of education and health services for the poor; implementing policies and systems designed to improve equity, efficiency and effectiveness in social spending; and scaling up programs to promote demand and investment in these services on the part of the poor.

There is solid empirical evidence indicating that education is a key area where public policy has the most potential to play a significant role in reducing poverty and inequality.<sup>3</sup> Human potential and skills are developed largely in early childhood and are significantly affected by the learning environment at home, at school and in the local community. The ability of the poor to invest in education is limited because of insufficient and inadequate supply, insufficient savings, child labor and/or because of credit market constraints. Returns to education in the region have been increasing greatly, reflecting the stronger demand for workers with post secondary schooling. This has worsened inequality in labor income and has strengthened the need to have access to post secondary schooling to overcome poverty.

Even though the region has recorded significant progress toward achieving universal primary education enrollment, progress in completing five years of primary education has been slower, and few countries can boast universal net enrollment for the entire primary cycle. By 2001, only 12 out of 29 countries in the region had rates of fifth grade completion higher than 90 percent, and 10 had rates below 80 percent.<sup>4</sup> In many countries, only a third or less of children of secondary school age actually enroll in secondary school. Levels fall precipitously in rural areas, rarely exceeding 10 percent. Despite steady increases in academic achievement, a third or less of the urban workforce has completed the 12 years of schooling deemed necessary to guarantee a decent standard of living and keep pace with the demands and challenges of an increasingly global economy. It is important to note also that national averages hide drastic disparities among the poor and nonpoor. The IDB's EQxIS system of social indicators, which provides estimates based on recent household survey data (circa 2004), shows that the

<sup>3</sup> See Bourignon, François, Francisco Ferreira and Nora Lustig, 2005, *The Microeconomics of Income Distribution Dynamics in East Asia and Latin America*, World Bank, Washington, D.C.; and Inter-American Development Bank, 1998, *Facing Up to Inequality in Latin America: Economic and Social Progress in Latin America 1998–1999 Report*, IDB, Washington, D.C.

<sup>4</sup> Economic Commission for Latin America and the Caribbean. 2005. *Objetivos de Desarrollo del Milenio: una mirada desde América Latina y el Caribe*. Santiago de Chile.

**TABLE 1**  
**Selected Social Indicators (circa 2004)**  
**Latin America and the Caribbean <sup>1</sup>**

SECTOR / Indicators	Average <sup>2</sup>	Population quintiles <sup>3</sup>	
		Poorest 20%	Richest 20%
EDUCATION			
Net attendance ratio in primary education (%)	91.2	88.8	93.0
Net attendance ratio in secondary education (%)	68.5	52.4	86.0
Literacy rate of 15–24-year-olds (%) <sup>4</sup>	88.4	75.4	97.4
HOUSING			
% of population using solid fuels	16.5	41.7	2.2
% of pop. with sustainable access to an improved water source	92.5	83.3	98.3
% of population with access to improved sanitation facilities	71.7	46.1	92.3
% of population with access to secure tenure	65.7	39.7	87.8
EMPLOYMENT			
Unemployment rate of 15–24-year-olds (%)	17.4	25.6	10.7
Share of women in wage employ. in the nonagric. sector (%) <sup>5</sup>	38.0	28.0	45.6
INFORMATION AND COMMUNICATION			
Personal computers in use per 100 population	15.0	1.6	44.4
Internet users per 100 population	8.2	0.6	28.9
Telephone lines and cellular subscribers per 100 population	56.7	24.1	88.0

<sup>(1)</sup> Includes: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela, representing approximately 97% of the total population of Latin America and the Caribbean.

<sup>(2)</sup> Average weighted by population.

<sup>(3)</sup> Average of national quintiles weighted by population.

<sup>(4)</sup> 5 or more years of schooling completed.

<sup>(5)</sup> Excludes domestic workers.

Source: IDB, EQxIS, System of Information of Social Indicators and Equity. Poverty and Inequality Unit. MECOVI. Accessed from [www.iadb.org/xindicadores](http://www.iadb.org/xindicadores) on February 1, 2006.

illiteracy rate of the 15 to 24-year-old population, considering a functional definition of this indicator (whether a person has completed 5 or more years of schooling), is nearly 12 percent. However, there is a marked difference in this indicator between the poorest (25 percent illiteracy) and richest (3 percent illiteracy) quintiles of the population.<sup>5</sup> Likewise, while the net attendance ratio for secondary education is estimated at 69 percent, the figure among the poorest quintile is 52 percent, compared to 86 percent for the richest quintile (table 1).

<sup>5</sup> EQxIS is the *System of Information of Social Indicators and Equity*, accessible from [www.iadb.org/xindicadores](http://www.iadb.org/xindicadores).

The equity gaps in education go beyond access. Poor children have weaker academic performance and lower skills because of the inferior quality of the education they receive at school and the low educational background of their parents, which affects what they learn at home. Indicators on repetition rates for the poor are substantially worse than for the population average. Thus, students from poor families have a harder time finishing primary school, and their learning levels put them at a clear disadvantage to access and complete secondary school or go on to higher education. The inadequate quality of instruction, its limited relevance to the work place, and its unsuitability to a culturally diverse population become core obstacles that prevent the poor from accruing any of the high returns of quality education or better employment opportunities, severely limiting the potential contribution of education to social mobility in many of the region's countries.

Good health and nutrition also yield important benefits and are instrumental to enhance the productive capacity of the poor. A healthy workforce is a more productive one because fewer days are lost to illness. Thus, good health contributes to a higher standard of living. The region as a whole has made progress in reducing malnutrition. According to ECLAC, the percentage of Latin American and Caribbean children under 5 years of age who are underweight declined from 10.3 to 7.2 percent between 1990 and 2002. This rate of improvement surpassed the progress required to achieve the Millennium Development Goal of reducing this indicator to 5.2 percent by 2015. However, these aggregate figures hide the region's heterogeneity. The undernourished population ranges from around 2 percent in Argentina to almost 50 percent in Haiti. Poor nutrition during the fetal stage retards growth and increases infant mortality. Since catch-up potential after age 2 is limited, malnourished children have weaker cognitive skills that, in turn, minimize their prospects for human capital accumulation and their productivity as adults.

Health indicators for the countries of Latin America and the Caribbean remain at critical levels, especially those that can be improved or controlled through public health measures, such as efforts to reduce infant mortality among the poor and indigenous children living in rural areas, as well as efforts to reduce maternal mortality and transmissible diseases. Even though most countries in the region have made substantial progress in reducing infant mortality, high heterogeneity persists across them and across subnational regions and income and ethnic groups. While countries like Uruguay and Costa Rica achieved infant mortality rates below 15 deaths per 1,000 live births, Haiti and Bolivia have rates above 50 per 1,000 live births.<sup>6</sup> Infants born in the poorest families, those born in rural areas and those from indigenous descent also show mortality rates significantly higher than nonpoor infants and those born in urban areas or who are of nonindigenous descent. For example, mortality rates for infants born in the poorest income quintile of Bolivia are more than four times those of infants born in the richest quintile; mortality rates for infants born in rural Peru are twice as high as those for infants born in urban areas; and mortality rates for indigenous infants born in rural Bolivia are twice those of nonindigenous babies born in urban areas.<sup>7</sup>

<sup>6</sup> Pan American Health Organization. 2005. *Health Situation in the Americas: Basic Indicators 2005*. Washington, D.C.

<sup>7</sup> Economic Commission for Latin America and the Caribbean. 2005. *Objetivos de Desarrollo del Milenio: una mirada desde América Latina y el Caribe*. Santiago de Chile.



The most recent data<sup>8</sup> on maternal mortality rates show an average mortality rate of approximately 95 deaths per 100,000 live births in the region. This rate is considered high given the average per capita income levels of the region's countries. Rates vary substantially, from less than 15 deaths per 100,000 births in Chile to more than 200 in Bolivia and Haiti. With respect to transmissible diseases, the incidence of AIDS is increasing in the region (UNAIDS estimates that approximately 2.4 million people were infected with the disease in 2004 and 5 countries show prevalence rates above 2 percent). The incidence of malaria in Latin America and the Caribbean is low compared with other world regions. PAHO data show that in 2004 there were 872,000 new cases, most of them in Brazil and the Andean region. The highest rate of prevalence in risk areas (more than 200 cases per 1,000 inhabitants) was in Guyana and Suriname. In the case of tuberculosis, PAHO data for 2003 show an average incidence rate for the region of 38.7 cases per 100,000 inhabitants. But incidence rates vary substantially from less than 20 cases per 100,000 inhabitants in countries like Chile, Costa Rica, Mexico or Uruguay, to more than 100 cases per 100,000 inhabitants in Bolivia, Haiti and Peru.

It is important to note also that, in most countries, mortality from external causes is higher than in other countries with a comparable income level because of precarious living and working conditions, violence and lack of safety in road transport. Adjusted PAHO data for 2000-2005 show that mortality rates due to external causes were 123 per 100,000 for men and 26 per 100,000 for women in Latin America and the Caribbean.

The greatest challenge to health in Latin America continues to be inequality. Although health reform has made more services available to the very poor in some countries (Chile, Colombia and Brazil), there is still considerable inequality between high- and low-income groups in the coverage and quality of service. These inequalities are serious contributors to the vicious circle of poverty and lack of social mobility in the region. Poor households in which the mother or father dies, or family members are stricken with serious diseases are devastated by the loss of income and the high cost of medical care and can fall into poverty traps. Public interventions have been ineffective in addressing these inequalities. In many countries, public health spending is regressive with a disproportionate share of the total going to the highest income groups. In addition, groups excluded by race, ethnic origin, gender and other factors account for the greatest proportion of unmet health needs because of problems with access and a service delivery infrastructure that is inadequate for the sociocultural profile of the excluded population.

Enhancing the productive capacity of the poor also requires policies that promote equitable access to basic services, especially water, sanitation, housing and urban upgrading. These services complement human capital and are instrumental in its accumulation. As reported by ECLAC and the United Nations, around 80 million Latin Americans (5 percent of the urban and 31 percent of the rural population) do not have access to clean water. Sixty percent of urban and rural dwellings with water hookups do not have continuous water service. More than 100 million people do not have access to sanitation services. This represents 16 percent of the urban and 56 percent of the rural population. The IDB's EQxIS estimates show that access gaps to these services between the poorest and richest

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<sup>8</sup> Pan American Health Organization. 2005. *Health Situation in the Americas: Basic Indicators* 2005. Washington, D.C.

quintiles of the population are still high in many countries of the region. For instance, less than half of the population in the poorest quintile have access to improved sanitation facilities and secure tenure, whereas for the richest quintile these indicators are close to 90 percent (see table 1, page 4).

Inadequate access to water and sanitation services affect the productive capabilities of the poor through its impact on educational attainment (due to stunting from diarrhea-caused malnutrition, and reduced school attendance and performance due to water- and sanitation-related illnesses and time spent collecting water), earnings potential (loss of labor due to water- and sanitation-related illnesses and time spent collecting water, lack of opportunity for businesses requiring water inputs, and asset degradation through soil pollution due to inadequate disposal), and on reduced savings for investment (high proportion of household budget used to buy water). In most cases, the deficiencies in access to water in the region can be traced to lack of an adequate legal, institutional and regulatory framework; gross price distortions; and subsidized services that benefit the better-off to the detriment of the poor. Reform in these areas should become a priority in order to improve access to water for the poor.

Efforts are also needed to improve housing conditions for the poor. Even though the proportion of the urban population living in shantytowns decreased between 1990 and the early 2000s (from 35.4 percent to 31.9 percent), the number of persons living in shantytowns increased with urban population growth (from 111 million to 127 million). Available information for 15 countries in the region also shows that 24 percent of dwellings in the region have been built with inadequate materials.<sup>9</sup> There is increased evidence that poor housing conditions relate and contribute to social disadvantage and vulnerability. Housing situations are not simply products of poverty but also contribute to the difficulties facing households and affect the social integration of those who dwell in them. Poor social integration in marginalized neighborhoods affects human capital accumulation, increases vulnerability to crime and violence and reduces labor market participation. Urban segregation is also related to poor quality schooling and social problems. Lack of adequate housing is closely related to lack of water and sanitation services and leads to precarious living conditions that contribute to increased vulnerability to natural disasters. Public-private partnerships are key to ensuring adequate housing for the poorest. Public priorities to enable private investment in housing and urban upgrading for low-income groups include improving the regulatory environment for the building industry, developing efficient land market regulations and improving the transparency of land markets.

## Promoting Pro-poor Access to Markets

A comprehensive approach to poverty reduction should not only increase the productive capacity of the poor but also give them the means to turn that capacity into an improved standard of living. Providing the poor with access to markets (goods and services, financial and labor markets) plays a key role in enabling them to share the benefits of growth and to protect themselves from falling into pov-

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<sup>9</sup> Economic Commission for Latin America and the Caribbean. 2005. *Objetivos de Desarrollo del Milenio: una mirada desde América Latina y el Caribe*. Santiago de Chile.

erty traps during recessions. A broad set of policies is required to enhance employment and business opportunities for the poor. These include support to microfinance and microenterprise development, private sector incentives, and the efficient provision of infrastructure services such as energy, roads, ports and airports. In addition, access to markets for the poor should take advantage of value-chain opportunities that integrate poor rural producers and small urban entrepreneurs into domestic or international markets.

Seventy percent of poor earners in Latin America and the Caribbean either own a microenterprise or are employed in one. Thus, the well-being of the poor is very closely associated with the success (or failure) of these business initiatives. After a decade of reforms, most of which included the deep liberalization of financial markets, the region still must find a way to give small businesses and the poor better access to saving and credit markets. Access to financial services (credit, savings or micro-insurance) for the poor has proven to be essential for productive investments—including the increasing flow of remittances—that help them escape poverty and provides them with a low cost risk management tool to cope with negative economic shocks. While there have been significant advances in increasing access to financial services to low-income populations, aggregate figures show that there is still a long way to go.

Large deficits in access to these services are evident, especially in rural areas where transaction costs are higher. In recent years there have been increased efforts to measure the depth of financial services provided to the poor and the impact of programs to support the creation of microenterprises. Recent estimates for ten countries of the region show that only 20 percent of households have savings in the formal sector (8.9 percent of poor households) compared to almost 90 percent in developed countries.<sup>10</sup> While microfinance and microenterprise activities have made great advances in the region, enhancing the impact of these activities on reducing poverty requires greater efforts to promote them, especially regarding regulation.

Access to markets is a necessary condition to ensure that the poor benefit from economic growth (pro-poor growth), especially those living in rural areas. The adequate provision of infrastructure is essential for pro-poor access to markets and for promoting stronger ties between the productive activities of the poor and the dynamic sectors of the economy. One of the priority areas for investment is rural infrastructure to lower transportation costs to and from remote or largely inaccessible areas. Only 27 percent of roads in the region have asphalt surfaces compared with 94.8 percent in high-income countries and 54 percent in middle-income ones.<sup>11</sup> Promoting investment to improve access to electricity and basic productive infrastructure (such as irrigation canals) is also essential to improve the economic opportunities of the poor. Although electricity coverage exceeds 86 percent in the region, it is still below the average for middle-income countries (90.4 percent) and it is not uniform across countries. While in some it exceeds 95 percent, it fails to reach 70 percent in at least 6 countries.<sup>12</sup>

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<sup>10</sup> Tejerina, Luis and Glenn Westley. 2006. Poor households and the financial sector: Identifying the gaps in borrowing and saving. IDB. Washington, D.C. Forthcoming.

<sup>11</sup> World Bank. 2005. *World Development Indicators* 2005. Washington, D.C.

<sup>12</sup> Ibid.

There are still substantial gaps in access to infrastructure between poor and nonpoor populations in the region. In addition, investment is needed to improve access to marketing networks, new telecommunications and Internet technologies where gaps in access are more pronounced. For example, there are four times more telephone and cellular subscribers in the richest than in the poorest quintile of the population. Gaps in access to a personal computer and the Internet are even wider. Only around 1 percent of the population in the poorest quintile have access to these services (compared to 44 and 29 percent, respectively, for those in the richest quintile, see table 1, page 4).

International trade integration should bring about opportunities and direct net benefits to the population living in poverty. To make sure that this is the case, the increase in access to world markets and foreign investment should take into account the abundant factors in the region (labor) and should be accompanied with measures to strengthen the cooperative and export capacity of micro and small enterprises and rural producers, as well as provide support to the vulnerable population temporarily affected by job losses.

Eradicating poverty should involve everyone, not only the public sector. Socially responsible corporations can play a key role in the fight against poverty by becoming effective providers of goods and services, creating job opportunities and working in partnership with national and local governments and communities in the socially and environmentally responsible use and management of the natural resource base. In the process of operating profit-making firms, private industries can contribute to overall economic development, and often do so in harmony with the goals of multilateral development institutions and the public sector. In particular, private enterprises can produce goods and services that are needed to enhance the quality of life of the population, such as public services, housing and the like.

While social policies that increase the human capital of the poor are an essential pillar of the effort to reduce poverty, recent studies show that interventions that only improve the supply side of labor markets may be insufficient to increase the earnings of the poor. Labor market demand policies are needed in order to provide quality jobs. Since the private sector provides more than 90 percent of jobs in the region it is crucial to promote an investment climate that is conducive to private sector growth and increasing the quantity and quality of jobs available.

International comparisons of business climate indicators suggest some priority areas for policy actions in order to promote private sector activity in the region. While the region's income level is relatively high compared to other developing areas, business-related indicators are the worst in several areas, such as anti-competitive practices, policy uncertainty, macroeconomic instability, access to and cost of financing, taxation and the legal system (see chapter 1 on private sector development).

## **Ensuring an Adequate Environment to Increase the Capacity and Opportunities of the Poor**

To ensure the success of policies to expand the productive capacity and economic opportunities of the poor, key complementary policies should be implemented to foster the availability of (i) national and local governance for all (property rights, violence prevention, legal services for the poor); (ii) re-

sponsible management of environmental assets (ecosystems, etc.); (iii) opportunities to adopt new technologies and (iv) social capital (trust in public and private institutions).

In the area of governance, the workings of national and local governments need to be revamped so public agencies can better ensure access to basic services and an equal footing for small businesses and producers, protect poor consumers and small businesses, and ensure more transparency and accountability. There is also a pressing need to make the region's legal and justice systems more accessible to the poor. Poor people are more likely to be victims of certain crimes and human rights violations, but have virtually no legal recourse. A restructuring of judicial processes with an eye to assisting the poor should be on State reform agendas throughout the region. These improvements of the judicial systems should be complemented with preventive measures to reduce the incidence of crime, violence and other social ills on low-income groups by improving access to legal identity and law enforcement, information, counseling, programs for at-risk children and youth, and policies fostering peaceable coexistence and integration on a local, national and regional scale.

In many countries of the region the move toward an economy in which market forces play a more central role has not been sufficiently accompanied by the development of effective regulatory capabilities that promote competition and protect the interests of poor consumers, ensure property rights (especially for homeowners and small businesses), reduce rent-seeking and protect the common good.

Environmental conditions have major effects on the health (through its influence on human exposure to harmful biological agents and chemical agents), opportunity (access and sustainability of the natural resource base) and security (through its influence on vulnerability to natural disasters) of poor people. Environmental policies need to include specific measures to alleviate the harm that environmental degradation does to vulnerable communities and to promote environmentally sustainable productive practices, including recovery and use of the traditional knowledge and practices of indigenous populations. To that end, there is a need to promote innovative approaches to the sustainable management of ecosystems that are the site of economic activity and home to poor populations such as indigenous communities and other marginalized ethnic groups.

The capacity of small businesses and poor producers to assimilate new technologies is also essential for reducing poverty and promoting sustainable and inclusive economic growth. In today's global knowledge economy, technological capacity and innovation are recognized as significant determinants of productivity and competitiveness. An educated and skilled workforce (with critical masses of scientists, engineers and other highly qualified and credentialed technicians) combined with legal systems that promote and enforce intellectual property rights and a favorable environment for science and technology institutions is the basis of technological innovation. For small businesses and poor producers the assimilation and creation of technology and knowledge depends, additionally, on access to information technologies, training and extension services, and technical assistance. In Latin America and the Caribbean there are 106 Internet users per 1,000 people compared to 377 in developed countries.<sup>13</sup> Policies to promote the assimilation of technology by small business and poor

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<sup>13</sup> Ibid.

producers should also promote the formation of value chains and facilitate the development and dissemination of technical and quality standards for products and processes.

Finally, building social trust can be instrumental in fully incorporating the poor and their interests into market economies. In many countries, there is an absence of broadly inclusive social partnerships, regulation and accountability mechanisms to ensure that the interests of the poorest and most vulnerable groups, and those positively or adversely affected by reforms are taken into account. Social capital, both at the local and national levels, can also play a catalytic role in helping the poor take full advantage of public policies aimed at increasing their productive capacity and market opportunities.

## **Monitoring Inclusive Growth and Promoting Evidence-based Policy-making**

As established at the 2002 Conference on Financing for Development in Monterrey, Mexico, measurement and monitoring of the effectiveness of actions to support development requires special attention. To that end, mechanisms need to be established to monitor progress in implementing policies to increase the capacity and opportunity of poor populations. Indicators and monitoring and evaluation systems should be developed to assist with tracking the impact of development policies, programs and targeting efforts. Support to develop monitoring and evaluation capacity, with participatory elements, is crucial to improving, adjusting and adapting poverty reduction policies based on the lessons learned.

Knowing the facts should improve the effectiveness of public policies in achieving development objectives. The capacity to monitor, evaluate and improve public policies is directly related to the availability of statistical data to inform the process. Credible, timely and good quality data are essential for a transparent and evidence-based policy-making, and consistent accountability in a democratic process. Hence, the relevance of fostering the development of the agencies in charge of generating information and statistical indicators, mainly the national statistical offices (NSOs), but also the sector-specific agencies that produce administrative records. Despite the progress achieved in the last decade, some NSOs in the region remain institutionally weak, face serious budgetary problems, have outdated legal frameworks, and lack true autonomy, which is essential if the data are to be credible. The road to high-quality indicators starts with high-quality data and necessarily goes through stronger and more independent statistical agencies. Another important element in the improvement of statistics is the standardization of methodologies, definitions and variables across countries to ensure comparability.

The use of information as a tool to inform policy decisions and a democratic and inclusive policy debate does not come automatically with the availability of data; access to statistical data is a necessary but not a sufficient condition. Efforts are also needed to enhance management by results by governments, nongovernment organizations and bilateral and multilateral donors. These efforts have to be complemented with actions that ensure open access and the broad dissemination of information to foster a statistical culture that uses data to inform decision-making and as a tool to promote transparency and accountability. To facilitate this exercise, it is essential to encourage an open dia-

logue between data producers and data users so that the supply of and demand for information are synchronized. It is also necessary to strengthen the capacity of NSOs to disseminate data and to make it easily available to users.

## **Concluding Remarks**

In summary, in order to accelerate poverty reduction and achieve the Millennium Development Goals by 2015, the region must pick up and sustain the rate of inclusive economic growth and promote the well-being of the population as a whole. Hence, poverty eradication in Latin America and the Caribbean requires not only a multidimensional poverty perspective but also a multi-sector policy approach to attack two fronts: the low accumulation of human assets and scant economic opportunities for the poor. These policies require crucial complementary support in two other policy areas: promoting an institutional environment (both in public and private sector governance) that is conducive to the expansion of the capacities and opportunities of the poor, and fostering a monitoring system to promote more transparent and evidence-based policies within our democratic political institutions.



## **PART I**

# **■ ACCESS TO MARKETS AND BUYING POWER**



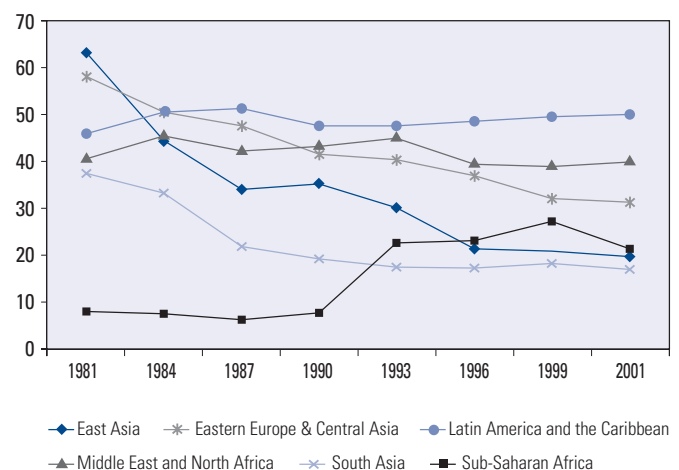
## ■ PRIVATE SECTOR DEVELOPMENT AS A TOOL FOR REDUCING POVERTY

Poverty remains endemic in Latin America and the Caribbean. Overall, 36 percent of the population lives in poverty and roughly one quarter lives in extreme poverty (defined as less than US\$2 per day).<sup>1</sup> In some countries the situation is even more severe (70 percent of Ecuadorians are considered poor) and in others the situation is worsening (poverty rates in Venezuela increased from 43 percent in 1998 to 55 percent in 2003). Despite increased economic growth in the 1990s (albeit at reduced rates compared to the 1980s), there remains a high degree of disparity and inequality, which, according to recent evidence, has played a role in the persistence of poverty in the region.<sup>2</sup> Disparity may have slowed growth in even the most thriving countries, fueling a vicious circle of lagging economic expansion, disparity and poverty that has contributed to the region's lag in competitiveness and wealth creation. During the past forty years, the East Asian countries increased their per capita income tenfold and reduced poverty by half, while Latin America's per capita income has only tripled and poverty remains largely the same as in the seventies. While other regions in the world have managed to significantly decrease poverty, in Latin America and the Caribbean poverty has remained nearly unchanged. Currently, only Sub-Saharan Africa has higher levels of relative poverty.

<sup>1</sup> De Ferranti, D., G. Perry, F. Ferreira and M. Walton. 2004. *Inequality in Latin America and the Caribbean: Breaking with History?* Washington, D.C.: The World Bank.

<sup>2</sup> Perry, G., O. Arias, H. Lopez, W. Maloney and L. Servén. 2006. *Poverty Reduction and Growth: Virtuous and Vicious Circles.* Washington, D.C.: The World Bank.

**FIGURE 1**  
**Percentage of People Living in Relative Poverty**



Single factor explanations of the principal trends (such as macroeconomic volatility, slow financial liberalization, lack of technological innovation, weather patterns and natural wealth endowments, or even demographic movements) fail to provide a convincing or useful explanation for the region's persistent poverty.<sup>3</sup> Data comparisons over a very long period of time indicate that the current development gap in the region dates from the middle of the twentieth century and stems from the ability of other regions to take advantage of the rapid pace of global expansion, while Latin America and the Caribbean has failed to mobilize resources to compete in a global market.

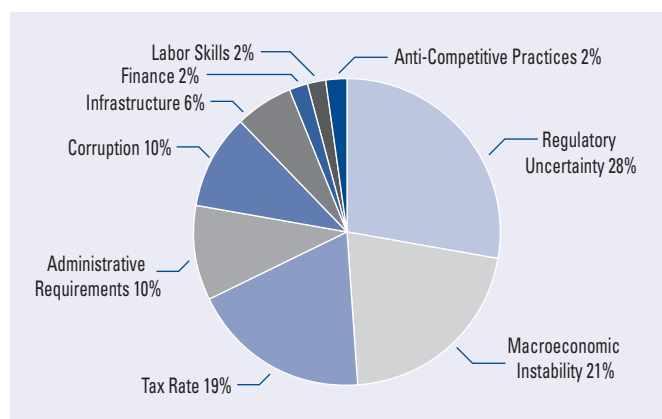
## Constraints to Private Sector Development

Prominent among the failures that gave rise to the widening poverty gap are issues relating to the lack of support for private sector development in the region, such as lagging investment in basic infrastructure, inadequate institutions and a business climate that favors informality and creates high administrative and economic burdens for the private sector. Crippling bureaucracies, widespread corruption and an ineffective judiciary clearly hamper the functioning of the private sector, while inadequacies in the secured transaction frameworks, insufficient fiscal policies and weak infrastructure create further obstacles for investors. Managers polled by the World Bank's Investment Climate Surveys identify that policy uncertainty and red tape are the key constraints that they face when conducting business activity in the region.

Latin American businesses are hampered by some of the lowest levels of access to capital, the

most rigid labor laws, the highest taxes and the most burdensome rules to register or dissolve companies. The countries of Latin America stand out among all those surveyed by the World Bank's Investment Climate Surveys for reporting higher levels of policy uncertainty than any other region in the world. For example, nearly 90 percent of Guatemalan firms report that regulations are not interpreted consistently. The comparable figures for Peru and Brazil are 79 and 66 percent, respectively. However, in South Asia, only 2 percent of firms report policy uncertainty as a problem. Furthermore, in a world-wide comparison of the costs that entrepreneurs have to assume to produce their goods or provide their services, businesses in the region clearly have a competitive disadvantage because of the multitude of charges and costs that stem from regulatory and infrastructure inadequacies (see figure 3).

**FIGURE 2**  
**Leading Constraints Identified by the Private Sector**



Source: World Bank Investment Climate Survey data

<sup>3</sup> Ibid.

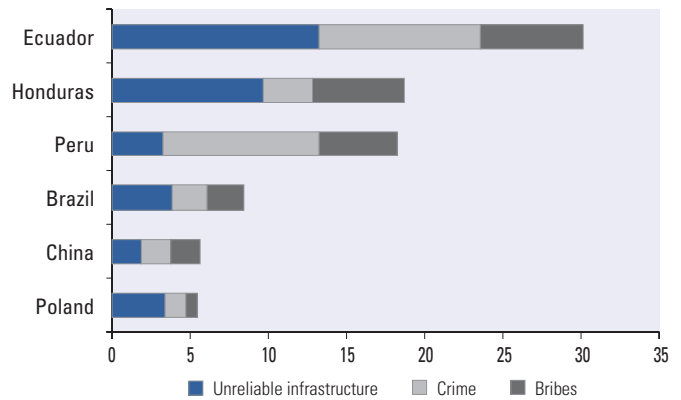
It is clear that private sector development cannot take place unless serious work is done to remove these obstacles. According to Miller et al., in countries where the economy grew and poverty fell, most of the decline in poverty took place in rural areas, where the majority of poor households tend to live.<sup>4</sup> However, Latin America (more specifically Bolivia, Brazil and El Salvador) was the exception.<sup>5</sup> There, a greater proportion of the poor live in urban areas, and nonfarm rural income grew as a result of self-employment and increases in manufacturing output.

## Job Creation and Informality

The private sector<sup>6</sup> accounts for the vast majority of jobs in Latin America and the Caribbean. Although there are differences among countries, the services sector is dominant in the region, accounting for 61 percent of total private production. Manufacturing accounts for roughly 31 percent of total private output and agriculture makes up the remainder.<sup>7</sup> The region's private sector is dominated by microenterprises, which make up about 90 percent of all private firms. Small and medium enterprises (SMEs) account for 8 percent of all private firms, and large firms make up 2 percent of the total. Thus, the entrepreneurial structure in the countries of the region is severely polarized. The small number of large national or multinational private companies that operate in the region are integrated into international markets and can attract the human capital and financial resources necessary to generate the productivity improvements that lead to greater competitiveness. But, small enterprises, microenterprises and small rural producers have limited access to financial markets, skilled labor and technology, and thus face serious productivity constraints.

Because of the way in which local specific factors effect the opportunities and incentives for firms to invest and create jobs, problems affecting private sector performance have a disproportionate im-

**FIGURE 3**  
**Costs Resulting from Business Climate Failures**  
**as a Percentage of Sales**



Source: World Bank ICS data.

<sup>4</sup> Miller, E., S. Noorani, C. Penn and A. Lipszyc. 2005. Pro-poor Growth in the 1990s: Lessons and Insights from 14 Countries. Washington, D.C.: The World Bank.

<sup>5</sup> Ibid.

<sup>6</sup> The private sector is defined as all economic activities, profit and nonprofit, that do not involve production by the public sector. This definition includes all for-profit firms regardless of size, activity (goods, services or financial), or location (urban or rural). It also includes institutions specifically established to serve the private sector such as industry associations.

<sup>7</sup> IDB, 2003.

impact on microenterprises and SMEs (known as MSMEs), which lack the means to overcome unjustified costs, risks and barriers to competition. For instance, inadequate infrastructure tends to have a much larger impact on MSMEs than on large companies because smaller firms tend to rely more on public services and are less able to absorb the costs imposed by market inefficiencies. A study by the World Bank estimates that the costs faced by smaller firms are a third higher than those encountered by their larger counterparts.<sup>8</sup> The study's findings also support the conclusion that generally smaller companies have less access to financing, experience higher unpredictability in the application of regulations and find government services less efficient.

Many firms and workers in Latin America and the Caribbean have no choice but to operate in the informal sector because of the very high costs involved in complying with laws and regulations. It could be argued, therefore, that policymakers can easily overcome the lost potential for growth and job creation by addressing the causes of informality, that is, lowering high fiscal and regulatory burdens. This would guarantee that the benefits of operating in the formal sector would far outweigh the costs and put an end to informality.

Informality, however, is not only caused by governmental failures like bureaucratic burdens and a detrimental business climate. It is not exclusively the lack of formal registration. It is also a choice made by entrepreneurs to operate partially or totally outside the law, underreporting employment, avoiding taxes, ignoring quality standards, infringing copyrights and breaching safety regulations.<sup>9</sup> Informality can itself be the result of the poverty that drives people to self-employment, the pervasive lack of confidence in the State by people who have lived the vicissitudes of volatile political systems and discrimination (against women and minorities) that is deeply ingrained in the social fabric. Because informality is often viewed as a social phenomenon whereby unskilled workers find employment, policymakers tend to consider it as a way to reduce social tension without regard for the consequences of such complacency.

This has resulted in some of the highest levels of informality observed in any region of the world, as well as productivity losses that have a severe impact on the competitiveness of the productive sector. Several recent studies have highlighted how better educated entrepreneurs would weigh the costs of remaining in the informal sector (such as inferior access to capital and export outlets) against the costs of joining the formal sector (including high entry costs, taxation, fees and higher exposure to corruption and bureaucratic harassment).<sup>10</sup> Informal companies that operate fully or partially outside the formal fiscal and legal environment distort competition by providing substandard products and

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<sup>8</sup> Hallward-Driemeier, M. and D. Stewart. 2004. *How do Investment Climate Conditions Vary Across Countries, Regions and Types of Firms?* Washington, D.C.: The World Bank.

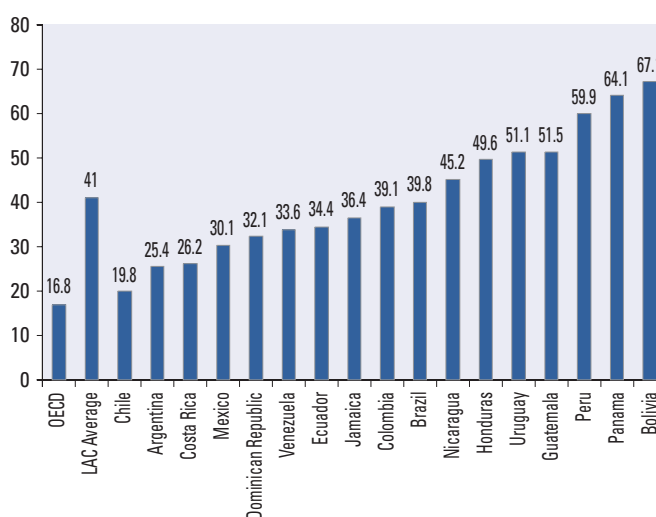
<sup>9</sup> For an exhaustive discussion of what constitutes informality see Friedrich Schneider, *Size and Measure of the Informal Economy in 110 Countries*. Canberra, Australia, July 2002.

<sup>10</sup> See: Schneider, F. 2002. *Size and Measurement of the Informal Economy in 100 Countries Around the World*. Washington, D.C.: The World Bank; International Monetary Fund. 2004. *Strengthening the Foundations for Growth and Private Sector Development: Investment Climate and Infrastructure Development*. Washington, D.C.; and Mesnard, A. and M. Ravallion. 2002. *Wealth Distribution and Self-Employment in a Developing Economy*. Washington, D.C.: The World Bank.

services, underinvesting in labor skills and undermining productive factors. For the countries in Latin America and the Caribbean where the informal economy outweighs the formal one, this means a vicious cycle that increases, rather than reduces, poverty, one that destroys, rather than creates, wealth. Studies conducted since 1990 by the McKinsey Global Institute put the cost of informality to emerging economies at 1 to 2 percent of GDP.

More importantly, the effects of informality are reflected in how the economy as a whole performs, and especially in the stagnation of productivity and wages. Farrel notes that “by avoiding taxes and regulatory obligations, informal companies gain a substantial cost advantage that allows them to stay in business despite their small scale and low productivity and prevents more productive, formal companies from gaining market share.”<sup>11</sup> The result is slower economic growth and inferior job creation, which is true for the region. Per capita income increased at an annual rate of only 1.6 percent during the 1990s, while total factor productivity decreased at an annual rate of 0.62 percent. Informality suppresses investment and undermines overall competitiveness because it traps enterprises in a low productivity environment that shuts companies out of markets, financing, technology and innovation. The critical role of productivity in generating economic growth has been widely documented in studies that compare growth performance across countries over long periods of time, and the findings indicate that most of the difference in growth between countries is explained not by physical capital accumulation or the development of human capital, but by differences in total factor productivity in which technology plays an important role.<sup>12</sup> Differences in conditions that improve efficiency and innovation, such as measures to improve the business climate, also explain differences in growth among countries.

**FIGURE 4**  
**The Informal Sector as a Percentage of GDP**



Source: Schneider, F. 2002. Size and Measurement of the Informal Economy in 100 Countries Around the World. Washington, D.C.: The World Bank.

## Productivity and Economic Growth

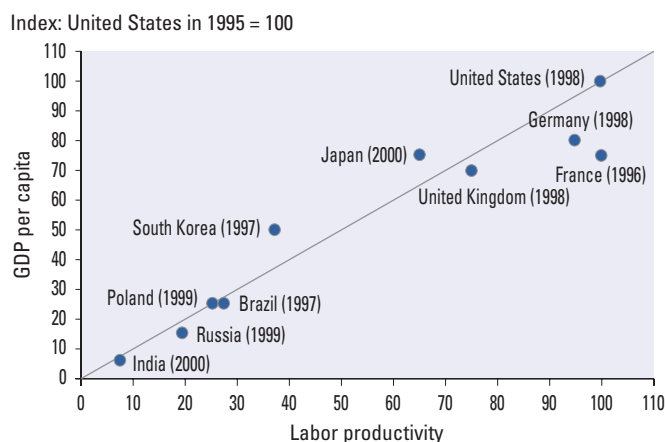
The policy implications of such findings are becoming clearer. According to Lewis (2004) undistorted competition that helps companies become more productive and efficient has been shown to

<sup>11</sup> Farrel, D. 2004. The Hidden Dangers of the Informal Economy. *McKinsey Quarterly* No. 3.

<sup>12</sup> World Development Report, 2005. The World Bank. Washington, D.C.



**FIGURE 5**  
**Impact of Productivity on Economic Growth**



Source: Economist Intelligence Unit; Organization for Economic Cooperation and Development (OECD); McKinsey analysis

**TABLE 1**  
**Competitiveness Rankings**

Country	2005	2004
Chile	23	22
Uruguay	54	55
Mexico	55	48
El Salvador	56	53
Colombia	57	64
Trinidad and Tobago	60	51
Costa Rica	64	50
Brazil	65	57
Jamaica	70	65
Argentina	72	77
Panama	73	58
Guatemala	97	80
Bolivia	101	98
Dominican Republic	102	72
Ecuador	103	90
Paraguay	113	100

Source: World Economic Forum, 2005.

be the single factor that has the greatest influence on economic growth. Creating a level playing field that allows the private sector to function without interference or unnecessary hurdles has produced the highest living standards experienced by any economy.

The wave of reforms in the 1980s and 1990s that aimed to improve the efficiency of markets by opening economies to international competition through lower trade barriers, expanding access to international capital, shifting ownership of assets to the private sector and stabilizing the economy was not entirely effective. Numerous SMEs exited the markets following structural changes like trade liberalization, in part, owing to poor access to factor markets, an absence of long-term capital or the inability to acquire new technologies needed to develop competitive advantages. Many of these firms were concentrated in labor-intensive industries like footwear, furniture and clothing. Some countries, such as Argentina, Colombia, Mexico and Brazil, have been relatively more successful in raising productivity, but others, like Jamaica, Peru and Uruguay, have fallen further behind. According to the World Economic Forum, the evidence suggests that past reforms were not sufficient to close the productivity gap with developed economies and, with the exception of Colombia, the competitiveness ranking of most countries in Latin America and the Caribbean has continued to decline.<sup>13</sup>

The important lesson yielded by the accumulated experiences and data presented above is that while investment is important, ensuring that investments can be productive is an equally significant factor. Two examples stand out clearly from recent experiences. Both India and China have been able to greatly reduce poverty by making reform efforts that favor private sector participation in the economy,

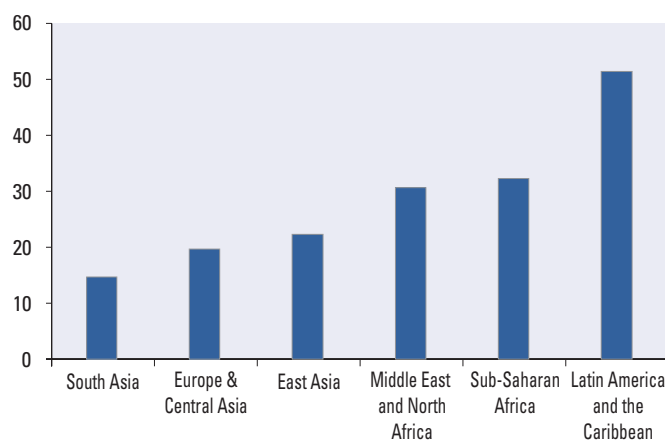
<sup>13</sup> World Economic Forum, 2005.

thus improving not only the share of private investment in GDP, but also their competitive standing in the global economy. In the last 25 years, both countries have experienced a near doubling of private investment as a share of GDP, and a nearly tenfold increase in per capita GDP. In addition, their standing in competitiveness rankings has been improving very rapidly (they rank respectively 49 and 50 in the 2005 Global Competitiveness Report).

*“Growth with a poor investment climate is possible, but unlikely to be sustained.”* This is one of the conclusions of the 2005 World Development Report, indicating how Brazil experienced sustained growth in the 1960s and 1970s in spite of its isolationist policies. Nonetheless, since private companies lacked incentives to invest and improve productivity, they were not able to deal with the retrenchment in public spending that followed ballooning public debt and macroeconomic shocks. A comparison of investment climate and total factor productivity between Brazil and China clearly indicates that policies designed to facilitate the functioning of the private sector have significant effects on total factor productivity and that private companies, especially those in highly competitive sectors, tend to be far more productive and successful in the global economy.<sup>14</sup> These findings support the hypothesis that improving market access, strengthening the infrastructure network, lowering transaction costs, strengthening property rights and improving the overall investment climate are some of the most effective measures for promoting job creation and economic growth. Further evidence comes from a study of the Indian automotive industry during the 1990s. Once barriers to foreign direct investment were removed and the sector was liberalized, labor productivity more than tripled, and output nearly quadrupled.<sup>15</sup> This also indicates that microeconomic policy issues affecting competition and access are the most significant impediments to faster economic growth. The countries of Latin America and the Caribbean are still lagging in most of these areas. Companies in the region report far higher complaints about anti-competitive practices than in any other part of the world.

Whether formal or informal, large or small, firms face similar constraints in terms of insecure property rights, corruption, policy unpredictability, limited access to finance and an overburdening bureaucracy. Less developed countries have historically adopted more market-distorting measures than their developed counterparts, and they also tend to have

**FIGURE 6**  
**Perception of Anti-Competitive Practices (% of firms)**



Source: World Bank ICS data

<sup>14</sup> Subramanian, U., W. P. Anderson and K. Lee. 2005. Measuring the Impact of the Investment Climate in Total Factor Productivity: The Cases of China and Brazil. Working Paper No. 3792. The World Bank. Washington, D.C.

<sup>15</sup> Palmade, V. 2005. Industry Level Analysis: The Way to Identify the Binding Constraints to Economic Growth. Working Paper No. 3551. The World Bank. Washington, D.C.

more restrictive regulations that end up protecting vested interests rather than the job creation potential that they are designed to safeguard. Relieving these constraints would not only increase income for entrepreneurs and lead them to expand their activities, but it would also lower the barriers to entry that encourage informality. Evidence indicates that red tape accounts for between 10 and 20 percent of the productivity gap observed in a number of US and Argentine industries, and that burdensome bureaucracies foster noncompliance and evasion, and ultimately facilitate fragmentation and inefficiencies in entire economic sectors.<sup>16</sup> A good business climate encourages a more competitive environment where firms have the incentives to increase investments. It also removes unjustified costs, increases productivity and fosters the competitive environment that has led once poor countries to economic success.

## Public Policy and Private Sector Development

Public policy toward the private sector plays a fundamental role in defining the mix of government intervention and the market. Addressing institutional weaknesses, the related high costs of doing business, and improving the coordination of public-private interactions, make up the major part of a second generation reform agenda. In particular, weak public institutions remain a significant hindrance to private sector development. Unfortunately, institutional underdevelopment undermines the effectiveness of the very real progress that has been made during the first generation of reforms (macroeconomic stability, trade reform and privatization) and has even called into question the validity of reform programs. Little is accomplished, by national or subnational policies or by external financing, if institutional capacity is not commensurate with the tasks at hand. This puts the onus on institutional strength, understood as solid regulatory capacity, reliable information systems, technical know-how, participatory policy planning and effective implementation, monitoring and evaluation. The countries of Latin America and the Caribbean are lagging in too many of the reform and regulatory actions that have enabled historically poorer regions, such as East Asia, to make significant inroads and overcome obstacles to economic growth. In nearly every area polled by the World Bank's Enterprise Surveys, East Asian entrepreneurs seem to have fewer problems operating than their Latin American counterparts.

Significant factors that explain the difference between the experiences of the countries of Latin America and the Caribbean compared to those of East Asia include the ability of the East Asian countries to create institutions that support the private sector. By adopting long-term development strategies and forming strong public-private partnerships that underpin government actions, East Asian nations have fostered a strong and vibrant private sector that helped create competitive advantages in the global economy. In a recent study conducted by Invest Korea, foreign investors named a well-educated work force, effective infrastructure and a favorable investment climate as reason for investing more than US\$3 billion in the first quarter of 2005.<sup>17</sup> That is in sharp contrast to the 1960s, when Korea restricted foreign direct investment flows and capital repatriation.

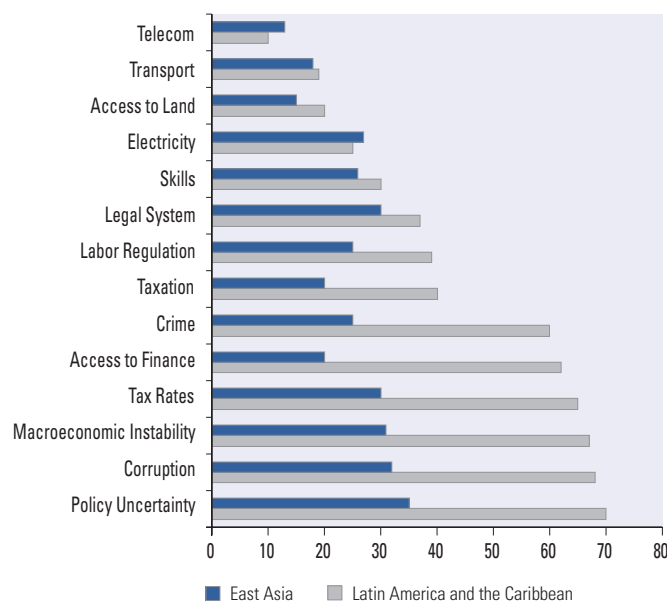
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<sup>16</sup> Elstrodt, H.-P., P. Ordorica Lanero and E. Urdapilleta. Micro Lessons for Argentina. McKinsey Quarterly No. 2.

<sup>17</sup> Invest Korea. 2005. Why Korea: Ten Reasons for Investments in Korea. Seoul.

Intelligent oversight of the private sector is the mark of a modern and successful State. Korea, Singapore, India and China are only some of the latest examples of countries that have managed to rapidly change the dynamics of their economies by making sure that their policies support, rather than hinder, private sector development. Even if opinion surveys of entrepreneurs provide imperfect data (open to the criticism that some opinions may not be unbiased or objective), the marked disparity shown in figure 7 should provide a wake-up call for governments throughout Latin America and the Caribbean about the importance of modifying, improving or creating the necessary institutions to support private sector activity, improve competitiveness and the business climate, and strive to reduce informality. Competitiveness depends on a healthy process of innovation and dynamic improvement (e.g., new products, new processes, and new ideas) that drives the growth in productivity, and it is only through strengthening of the private sector that such innovation takes place.

**FIGURE 7**  
**Perception of Main Constraints by Entrepreneurs**



Source: World Bank ICS data.

## Concluding Remarks

While the private sector is the engine of growth, it is the State that provides the enabling environment for enterprises to thrive. Therefore, it is important that governments in the region take the appropriate steps to modify, improve or create the necessary institutions and regulations to support private sector activities. The region's greatest challenge to overcoming widespread poverty and lackluster economic growth lies in the establishment of a healthier business climate and a marked decrease in the importance of the informal economy. Overcoming this challenge will take a mixture of macro- and microeconomic policy reforms, strengthening of institutions and policies that, combined with cultural and attitude changes, will provide the enabling environment that the private sector needs to grow.



# ■ Making Financial Markets Inclusive<sup>1</sup>

## The Role of Financial Markets in Development

Well-functioning financial markets are an essential component of the development equation. They make possible the exchange of goods and services, credit and investment flows, savings and the conduct of business. There is a robust link between deficient financial services and shallow markets, and lackluster economic growth, inequality and poverty.

A significantly large group of people in Latin America and the Caribbean has limited or no access to affordable and adequate financial services. This includes large numbers of businesses and households, particularly the poor and those that are socioeconomically and politically marginalized, such as microenterprises, small and medium enterprises (SMEs) and rural producers. Measuring financial access is inherently challenging because many businesses operate informally and do not appear in records and databases. Also, financial institutions and regulators do not classify loans by income group. Thus, one of the major sources of information about them comes from household surveys, rather than from the formal financial system. Based on these surveys, the IDB estimates that there are approximately 60 million microenterprises in Latin America, of which only 6.5 percent (or about 4 million) have obtained loans from financial institutions, and only 18 percent have access to deposit services. In rural areas, where over 50 percent of the poor live, only 4 percent of households have access to credit from a financial institution.

Key financial services such as bank and savings accounts, credit and insurance often cost more for low-income businesses and households, making them unattractive. In 2003, the region's intermediation margins were over 900 basis points, compared with 600 worldwide. The interest rates paid by microenterprises and SMEs are often 2000 to 3000 basis points (20 to 30 percentage points) or more above the country's inflation or deposit rates. Despite these high interest rates, microfinance

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<sup>1</sup> Making financial markets inclusive is a cornerstone of the IDB's draft Financial Markets Strategy.

programs in the region continue to grow rapidly, as service is extended to new areas and thousands of additional clients sign up for loans each year.

Why do financial markets need to be more inclusive? First, microenterprises, SMEs and potential entrepreneurs are vital to the economies of the region. The IDB estimates that they comprise over 90 percent of firms, employ about 70 percent of the labor force and account for anywhere from 22 to 66 percent of GDP, despite the fact that they lack adequate access to an important factor of production, i.e., finance. Second, exclusion leads to high borrowing costs that can make businesses unprofitable and lock these borrowers into a cycle of poverty and exclusion from which it is difficult to emerge. Third, microenterprises and SMEs are socially important. For instance, IDB analysis of household surveys from 18 countries showed that 70 percent of poor earners are either employers or employees of microenterprises. This suggests that there is a large untapped capacity to reduce poverty in the region by making financial services more inclusive.

## **What Prevents Financial Markets From Being Inclusive?**

Lack of retail capacity and appropriate products, as well as a variety of legal and regulatory roadblocks, combine to prevent financial markets in the region from being inclusive. Latin America's financial markets have developed over several centuries, evolving from the need to provide banking services to large commodity exporting companies to financial systems that deliver global banking products, reinsurance, mutual fund services and pension fund management. Over the past decade and a half the region has undertaken far-reaching first generation structural reforms that liberalized capital accounts trade, and financial and capital markets, privatized enterprises, diversified exports and promoted investment. The reforms included strengthening regulation and supervision, reducing market distortions (such as interest rate ceilings), credit coefficients, excessive reserve requirements and public interventions in the markets, as well as the creation of private pension funds.

The decade also witnessed an increase in the range of personal financial options and sophisticated technological improvements that have permitted an even greater focus on market segmentation and concentration on clients perceived to be more lucrative—large blue-chip businesses and wealthier individuals. At the same time, competition has increased; squeezing bank profit margins. Consequently, some formal financial institutions have reached out to SMEs and microenterprises with loan and savings services. This has been accompanied by an expansion of the frontier of microfinance products to include credit and debit cards, micro-mortgages, small farmer loans, low balance savings accounts, micro-insurance and remittances. It has also resulted in the development of many informal financial mechanisms to assist low-income groups. Thus, the first generation of financial reforms have provided net overall welfare gains, dramatically increasing the size and efficiency of domestic financial systems, making them more stable and allowing them to branch into new areas of business and become more competitive.

However, the expanded range of personal financial options and sophisticated technological improvements that assist customers have been aimed primarily at upper- and middle-income groups. So, despite the advances and market deepening, the gap between those who are being served by financial markets and those who are not remains. Moreover, despite the gains, lending in the region



has declined from 59 percent of GDP in 1990 to 45 percent in 2003. This is bound to affect the poor since they have limited access to other financial options. Exacerbating this dilemma is the region's growing informality, which is spurred by unemployment and by burdensome tax systems that carry high costs for compliance with laws and regulations. In some countries, 60 to 70 percent of the labor force is estimated to be informal. This has many disadvantages for low-income groups: it is more difficult to access credit from formal financial institutions, buy insurance and use the court systems (see chapter 5).

## Unlocking Credit

Why is it so difficult for the poor to obtain credit through the banking system? One of the reasons is the lack of retail capacity for serving the poor with appropriately designed products. This is especially true for microfinance, a lending area that has evolved over the past forty years offering small, short-term loans and liquid deposit accounts with low minimum balances. Most of this coverage has been attained through donor or government support of NGOs that serve low-income communities. Over time, many NGOs have evolved into regulated microfinance institutions (like Banco Sol, for example). Although the number of microfinance institutions has grown rapidly, coverage is far from adequate and is particularly sparse in rural areas. Credit unions and cooperatives serve both urban and rural areas, but fall far short of filling the gap in financial services; moreover, they are often inefficient, understaffed and inadequately funded. An additional complication is that many microfinance institutions, credit unions and cooperatives are not properly regulated. This undermines the soundness of these systems and also permits practices that are unfavorable to the poor, including placing limits on unsecured lending, excessive provisioning, extensive and unnecessary loan documentation and financial reporting requirements, and minimum branch operating hours. Community partnerships with a financial institution or local business can be a good source of credit for the poor. For example, providers of equipment, fertilizer, seed and other productive inputs may offer supplier credits to small producers, or an agro-processor may use his accounts receivables or inventory to secure a bank loan, and then on-lend these funds to small farmers as production or investment credit.

The lack of retail capacity also extends to the formal banking sector. Banks throughout the region may intermittently serve the poor, but many are not interested in establishing branches or working in areas where these clients are located, particularly when they live in remote rural regions that lack the potential for high lending volumes, adequate critical mass and the wealth to make lending profitable. Bankers argue that the cost of processing information from smaller borrowers without records or audited statements is high because they must spend more time evaluating the potential borrower's

### Credit through Partnerships

Companies such as Vodacom and Coca-Cola are reaching out through special lending programs to assist entrepreneurs in poor areas to purchase a franchise or become a vendor for their products. Other companies, such as Dupont, are providing credit and technical assistance to rural producers. Groups such as the World Business Council are becoming catalysts for greater corporate awareness of market opportunities and how to work in poor areas to foster sustainable development and the role of business in development.

### Alternatives to Credit

Many micro and small enterprises, with limited collateral, have found other ways to obtain credit, for instance through venture capital, angel financing and financial leasing. Financial leasing focuses on the client's ability to repay rather than on collateral, and the asset involved is the leased asset (generally equipment), which can be repossessed in the event of default. The lessor has a stronger legal position with respect to this equipment that enables leasing companies to lower rates and down payments and lengthen tenors. Financial leasing, as opposed to operational leasing, is a good means to acquire equipment since the client may own it at the end of the payment stream without having to provide additional collateral. Unfortunately, there are regulatory restrictions in many countries that prevent financial institutions from offering financial leases.

creditworthiness than they do for larger borrowers. Nonetheless, in other regions, bankers have developed simplified lending applications for small, low-income clients and trained their lending officers in how to quickly establish the cash flow of a transaction without annual audited statements. Another hurdle is the reluctance to visit small clients at their place of business, a *sine qua non* in countries that have flourishing SME markets. Many banks have adopted a *laissez-faire* attitude toward expanding credit, which has been fueled by the availability of high-yield government instruments as an alternative to credit and deposit expansion. Furthermore, some banks clearly prefer to focus their efforts on the large corporate market niche.

The absence of an adequate secured transaction framework inhibits the extension of credit. The secured transaction framework is important because

lenders look for asset security or collateral that guarantees the loan in the event that the client is unable to pay. The assets pledged as collateral are essential because they reduce losses for lenders. However, in most countries in the region, collection processes in the event of borrower default are time-consuming and costly, laws do not protect creditors and the judiciary process is unreasonably lengthy.

When compared to other regions, the use of collateral in Latin America and the Caribbean is extremely costly and inefficient. IDB studies and a widely used creditor rights' protection index show that the region is doing poorly in protecting creditor rights through bankruptcy laws and enforcement. On average, it takes twice as long to resolve credit disputes in Latin America and the Caribbean compared with developed countries, and nearly a third longer than in Southeast Asia. While this affects all credit transactions, it is particularly onerous for SMEs because it causes banks to require security of 100 to 200 percent of the credit, whereas they may require no security from a large corporate client. Transparent property registries that provide accurate information on assets offered as collateral, improved land and property titling, and the upgrading of credit bureaus that provide client loan history information to lenders could help offset the deficiencies in the secured transaction framework. Unfortunately, more often than not, these institutions are encumbered with numerous restrictions.

### Creating a Savings Environment

Another financial option that is not readily available to the poor is savings instruments. Savings are especially important for the poor because they have limited access to credit and insurance markets that could provide them the security needed to weather unforeseen circumstances such as natural disasters, economic recessions, illness and theft. Savings are also important to finance future entrepreneurial activities and education. However, banks are disinterested in offering small savings accounts. As a result, the poor are often forced to save by accumulating consumption goods (food), semi-du-

rables (livestock and clothing) and durables (equipment and jewelry), as well as cash, real estate and contributions to informal institutions such as rotating savings and credit associations (ROSCAs). These forms of savings are inefficient and have serious disadvantages, including depreciation, the possibility of theft, the high transactions costs that typically accompany the conversion of illiquid assets into cash and problems of indivisibility.

Because the main purpose of assets is to provide a store of value, the savings instruments must provide adequate returns and not depreciate in value. This is problematical because the region has suffered periodic bouts of inflation, devaluation and high reserve requirements. Real estate, small shops and housing are often the largest store of value and sometimes the only asset held by low-income households. Many micro, small and medium entrepreneurs work from their homes so that home improvements, such as adding a workspace, are also income-generating investments. Yet, housing markets are extremely illiquid and under these conditions it is difficult for smaller borrowers to obtain mortgages or home improvement loans.

Interestingly, an important potential source of savings for low-income households is remittances. Last year, the flow of remittances to Latin American and the Caribbean was more than US\$40 billion, exceeding total official aid. Research has shown that microfinance institutions, banks and other intermediaries that become reception points for remittances also experience an increase in deposits and lending, and that remittances are increasingly funding savings and loan repayments.

Improving the availability of appropriately designed financial savings products through greater outreach by banks and other financial institutions is an important priority. In cases where there is imperfect knowledge about the savings products demanded by the poor, underwriting market research might also be needed.

## **Making Insurance Policies Accessible**

Like credit and savings, insurance products in the region have not been structured for the poor and yet they are the most vulnerable to risks. Casualty, death or disability can mean loss of an important and sometimes sole source of income. Also, funeral and burial costs can place a major strain on the finances of low-income households. While the region's insurance industry has grown during the last decade, much of this growth has been generated by car and casualty insurance targeted to middle- and upper-income groups. In fact, a recent survey in Peru showed that insurance products are available to a limited segment of businesses. Insurance companies have yet to recognize the potential profits of serving millions of low-income families and have yet to design products that are relevant to them. Many low-income families are not aware that insurance products could help them.

The virtual absence of agricultural insurance in rural areas inhibits the modernization of agriculture and investment in higher yielding, more remuner-

### **Strategic Partnerships between Financial Service Providers**

A few programs that provide life and disability insurance are emerging from strategic alliances between banks and insurance companies. One insurer, Zurich Boliviana, has partnered with a microfinance institution, Banco Sol. The policies issued to Banco Sol's clients combine savings and life insurance. Other strategic partnerships offer programs providing property insurance for microentrepreneurs, which is especially valuable when the home is used as the place of business.

ative but riskier crops and livestock. In most Latin American countries, less than 2 percent of the cultivated area is insured. Poor farmers have little capacity to pay high premiums and there is a lack of reliable information on risk factors that would permit sound underwriting. In addition, there is a moral hazard arising from the difficulty of creating insurance contracts that leave intact farmers' incentives to do all they can to avoid losses. Insurers look for uncorrelated risks, but the risks in the agricultural sector are often highly correlated, especially within a given region. International reinsurers are unwilling to enter small country markets due to the high concentration of risk.

There is some evidence that new technologies (including parametric or weather index insurance products) and strategic alliances between insurance companies and microfinance institutions can be fruitful and overcome typical market impediments associated with crop insurance products. Microfinance institutions have an in-depth knowledge of low-income communities so that the costs of marketing and servicing the insurance policies are reduced.

## Expanding Access to Pension Systems

Pension systems are another financial service that does not reach many low-income groups. Many countries in the region have undertaken structural reforms of their pension systems that have profoundly affected middle-income wage earners and capital markets. Nonetheless, pension coverage remains low, reaching only about 25 percent of the wage earners that at some point have contributed to either social security or a private pension plan. The private pension systems were not designed with lower-income wage earners in mind, who in most instances are unable to afford the regular salary deductions for contributions. Oftentimes, no pension systems are available at all for microentrepreneurs and those who are employed in the informal sector. Moreover, there has been little research into alternatives for low-income groups. Possible products could include long-term savings instruments, such as those pioneered by the Grameen Bank, and private micro-pension systems. The problem of economies of scale and attracting fund management could be resolved by partnering micro-assets with larger pension systems. Many countries have social safety nets or assistance pensions for the

poor, but they are often inadequate to provide viable old age security. Thus, while considerable work has been done on pension systems in the past decade, more is needed to make coverage more inclusive for lower-income groups through both private and public systems.

### A Source of Finance for Low-Income Housing

Outside the region, capital markets are instrumental in providing affordable finance for housing, especially low-income housing, on a large scale. One of the main reasons that this has yet to become a reality in Latin America and the Caribbean is the absence of an adequate secured transactions frameworks, including property rights in housing and land. This impedes the expansion of low-income housing markets because it is costly and time consuming for the lender to take possession of a house in the event of default. This, in turn, limits the securitization of housing assets, which has greatly expanded housing and mortgage markets elsewhere.

## Whither Capital Markets?

In many countries, the capital market is an important source of funding for SMEs, as well as a savings option for small investors. The potential for capital markets in Latin America and the Caribbean to fulfill this important role has yet to be realized. The market is plagued with many structural problems, including

inadequate corporate governance, complicated disclosure requirements, high costs and the lack of transparency of financial and audited accounts. Until these are resolved, SMEs will not be able to use the markets as a funding source.

## Making Financial Markets Inclusive: The Challenge Ahead

Policies with well-structured incentives will need to be developed to overcome these barriers and make financial services more inclusive for the majority of Latin Americans and Caribbeans. There are numerous institutions, programs and products with demonstrated track records in providing financial access to the poor. Based on these, four areas that require particular attention have been identified: strengthening the institutional and fiscal framework, customizing products to meet demand, improving the legal and regulatory environment, and education and training.

### Strengthen the Institutional and Fiscal Framework

1. *Expand and strengthen institutions that can unlock credit.* There is a need for well-managed, formal financial institutions that provide factoring, leasing, low-income housing finance and other financial products specifically designed for the poor.
2. *Build capacity to serve low-income groups and underserved areas.* Equally important is the need to create new institutions or help existing ones, including commercial banks, to expand in rural and low-income areas and in some areas such as the Caribbean where microfinance has grown more slowly. Partnerships between financial services, corporations and the community can increase financing and help build capacity in low-income areas.
3. *Establish pension systems and social safety nets to insure old age coverage.* There need to be more options for pension coverage for low-income groups, including long-term savings instruments, micro-pension systems that work with a larger fund, and carefully crafted social safety nets and minimum pensions for those who are not able to contribute financially. This area will require considerable research and development efforts.
4. *Introduce measures, including fair tax systems, that encourage formality.* It is necessary to establish tax structures that are fairer to micro and small enterprises and that encourage formality so that there is greater access to financial services.
5. *Support actions that will attract small investors and SMEs to capital markets.* This will require, among other things, improving corporate governance, accounting and auditing standards, and listing requirements, as well as reducing costs, possibly through bundling of SME issues. This is an endeavor for the long term.

### Customize Products to Meet Demand

6. *Promote programs and products that are tailored to low-income groups.* Develop deposit and insurance products for the poor and underwrite market research on the characteristics of the products needed by them. Encourage partnerships between insurance companies and microfinance institutions to

deliver life, disability, casualty and other insurance products. Promote the development and use of a new generation of crop insurance products, combined savings accounts and life insurance policies, and health insurance and special savings instruments that do not depreciate in value.

7. *Support community partnerships that provide alternative finance.* Partnerships that unite community development initiatives with financial institutions or corporations that can provide financial services to underserved markets should be explored and supported. It will be important for policy-makers to be aware of and nurture partnerships involving corporations.

## **Improve the Legal and Regulatory Environment**

8. *Establish secured transaction frameworks.* This requires legislative and regulatory changes that make it possible to use a wide range of assets as collateral and perfecting and enforcing security interests in it. This should be accompanied by the creation of transparent property registries, improved land and property titling and upgrading credit bureaus. In order to speed up the processing of claims, changes in the judiciary and possibly the creation of special tribunals will also be needed.
9. *Provide regulation and supervision for financial institutions that service lower-income groups.* Regulation and supervision needs to be expanded in a cost effective manner to cover institutions that serve low-income groups, such as credit unions and microfinance institutions. In cases where this regulation is already in place, it will require continued improvements to avoid inappropriate practices.
10. *Continue first generation financial reforms.* The reemergence of loan rate ceilings and credit coefficients in the region threatens to reverse gains that have been made over the past decade in the size, efficiency and inclusiveness of financial systems. Interest rate ceilings can have particularly damaging effects because microfinance institutions require high interest rates to recover the costs of making these small loans. Interest rate ceilings prevent microfinance institutions and banks from making profits on their loans, curtailing the supply of credit to these vulnerable clients.

## **Education and Training**

11. *Support financial literacy programs.* Programs that provide education for low-income groups are needed to help them become informed consumers. Curricula could include items such as opening and using bank accounts; how remittances work; death, disability and casualty insurance; and mortgage applications.
12. *Training programs for financial service providers.* Support the development of training programs for intermediaries interested in lending to microenterprises and SMEs, including topics such as how to conduct relevant cash flow analyses and make client visits.

The future growth and development of Latin America and the Caribbean will depend, to a large degree, on its ability to make a number of key services more inclusive. This is especially true of access to financial services because those to be included represent a large untapped resource pool in terms of GDP and employment growth.

### ■ Infrastructure and the Poor

Lack of basic infrastructure has long been seen as a defining characteristic of poverty. Throughout Latin America and the Caribbean, 125 million people lack access to safe water, 200 million people are without adequate sanitation and about 70 million people do not have reliable rights to electricity.<sup>1</sup> Compared to other regions of the world, Latin America and the Caribbean has one of the most stubborn rates of poverty (the only exception is Sub-Saharan Africa).

Undoubtedly, reducing poverty in the region cannot be considered only an issue of infrastructure, but recent debate on how to reach the Millennium Development Goals (MDGs) and reduce poverty has paid only limited attention to the issue of access to services. Yet, the role of infrastructure in promoting economic growth, reducing the vulnerability of the poor and underpinning livelihood improvements is undisputed, and both macroeconomic and microeconomic transmission mechanisms through which investment in infrastructure reduces poverty are well documented.

Participatory assessments carried out by multilateral<sup>2</sup> and bilateral<sup>3</sup> organizations have repeatedly underscored the importance that poor people themselves give to the impact of lack of infrastructure on their quality of life: regardless of continent and background, the world's poor value the services and institutions that give them an opportunity to access markets and education, as well as improve their basic quality of life.<sup>4</sup>

Regardless of their urban or rural situation, poor people place great importance on their ability to access infrastructure services and consider it a priority. Some of the reasons that they give for this are:

#### Voices of the Poor

*"If we get a road, we would get everything else: community center, employment, post office, water, telephone."*

*"Because of the bad road, no outside buyers come here. I borrow money and plant the ground and can't sell because of this."*

<sup>1</sup> Source: World Bank data.

<sup>2</sup> Narayan, D., and P. Petesch. 2002. *Voices of the Poor*. Washington, D.C.: The World Bank.

<sup>3</sup> DFID, Making Connections, Infrastructure and Poverty Reduction. London, 2002.

<sup>4</sup> Narayan and Patesch, 2002.



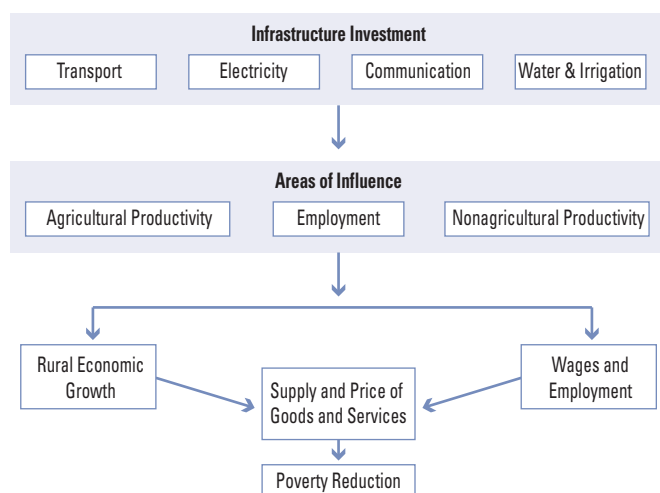
- creating spatial integration by improving access (mainly through transport or communication infrastructure) to more and larger markets for goods and services;
- enabling economic actors to respond to new types of demand in different places;
- lowering the cost of inputs used in the production of goods and services;
- reducing transaction costs and facilitating trade flows within and across borders;
- opening new opportunities for entrepreneurs or making existing businesses more profitable;
- creating employment, not only directly in public works, but also indirectly by allowing access to markets and other sources of jobs;
- enhancing human capital, by improving access to school and health services (direct improvement of health due to water and sanitation); and
- improving environmental conditions, which are linked to improved livelihoods, better health and reduced vulnerability.

This inventory of justifications points to both direct and indirect areas of influence. Direct influences result, for instance, from the impact of irrigation and road density through subsequent productivity improvements in crops and sales, as well as indirect progress due to time savings from not having to gather fuel and water, health externalities of access to potable water and sanitation, improved security, or the benefits of better access to information for economic activity. Figure 1 attempts to summarize those direct and indirect effects of infrastructure provision:

The impact of such effects appears to be significant: every 1 percent increase in road kilometers per capita is correlated to an increase in household consumption of 0.08 percent.<sup>5</sup> Research on Vietnam reveals that rural communities with paved roads have a 67 percent higher probability of

escaping poverty than communities without paved roads.<sup>6</sup> Even more dramatic results are observed when considering the incidence of access to potable water: child mortality (which is considered a mark of social welfare) and diseases caused by contaminated water or inadequate sanitation dropped by 26 percent in Argentine municipalities with high poverty levels<sup>7</sup> when service was extended, and bet-

**Figure 1**  
**Infrastructure and Poverty Reduction**



Source: Adapted from Ali, I., and E Pernia. 2003. Infrastructure and Poverty Reduction – What is the Connection? Asian Development Bank, Manila.

<sup>5</sup> Jalilian, H., and J. Weiss. 2004. Infrastructure, Growth and Poverty: Some Cross-country Evidence. Asian Development Bank Institute. Tokyo

<sup>6</sup> Glewwe, P., M. Gragnolati and H. Zaman. 2000. Who Gained from Vietnam's Boom in the 1990s? An Analysis of Poverty and Inequality Trends. Working Paper 2275. The World Bank, Washington, D. C.

<sup>7</sup> Galiani, S., P. Gertler and E. Schargrodsky. 2005. Water for Life: The Impact of Privatization of Water Services on Child Mortality. *Journal of Political Economy*, Vol. 113.



ter results were observed when the service was provided by private operators who were focused on extending access.

Such results are not surprising: the poor typically use fewer infrastructure services than the nonpoor, not only because of their lower income, but because of the very low level of access they enjoy. Therefore, improving access for such large segments of the population has striking results. Based on empirical data collected worldwide in the Living Standard Measurement Studies,<sup>8</sup> over 65 percent of households have electricity, 38 percent have in-house water, 36 percent have sewer connections, and 24 percent have telephones. Such utility connections are highly correlated with income proxies,<sup>9</sup> and rural residents are shown to suffer disproportionately from lack of access. Yet, the countries of Latin America and the Caribbean have now fallen behind China and most middle-income countries in terms of overall access to infrastructure (with the exception of cellular phones and water and sanitation), even though in terms of per capita income the region is still wealthier than its comparators.

**TABLE 1**  
**Comparison of Infrastructure Coverage**

	<b>Electricity (% connected)</b>	<b>Roads (km/km<sup>2</sup>)</b>	<b>Mainlines (x 1000 people)</b>	<b>Cellular Phones (x 1000 people)</b>	<b>Water (% connected)</b>	<b>Sanitation (% connected)</b>
Latin America and the Caribbean	87	0.008	170	246	89	74
China	99	0.19	209	215	77	44
Middle-income Countries	90	0.06	178	225	83	61
Year	2000	2002	2003	2003	2002	2002

Source: Fay, M., and M. Morrison. 2005. *Infrastructure in Latin America and the Caribbean: Recent Developments and Key Challenges*. The World Bank, Washington, D. C.

Both cross-country and in-country regional differences are to be observed among these averages: in Costa Rica, 98 percent of households have electricity, while in Peru only 69 percent do. Furthermore, coverage disparities between urban and nonurban areas are even more striking: rural access to water in Brazil and Chile is 58 percent and 59 percent respectively, even lower than that in poorer countries

<sup>8</sup> Komives, K., D. Whittington, and X. Wu. 2001. *Infrastructure Coverage and the Poor: A Global Perspective*. University of North Carolina, Chapel Hill.

<sup>9</sup> Monthly aggregate household consumption data.

such as Burundi (78 percent) and Zimbabwe (74 percent).<sup>10</sup> In Colombia, a third of the rural population does not have access to the road network.

**TABLE 2**  
**Household Access to Infrastructure in Some Countries of the Region**

Country	Year	GDP/ capita (US\$)	% access to electricity		% access to piped water		% access to telephone		% access to flush toilet	
			Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Haiti	1994	270	76.7	3.9	30.1	1.8	—	—	11.6	0.1
Nicaragua	1998	370	92.4	37.6	90.3	25.1	16.5	1.1	41.7	2.8
Bolivia	1998	1,010	96.2	29.0	88.3	31.0	36.2	0.6	45.1	2.4
Dominican Republic	1996	1,550	—	—	58.2	43.6	40.8	4.1	64.8	9.4
Guatemala	1998	1,650	91.4	54.0	59.5	51.2	27.1	6.1	71.4	24.2
Colombia	2000	2,080	99.5	83.9	98.1	50.7	66.7	10.3	96.3	58.2
Peru	1996	2,250	92.1	17.8	78.4	29.6	27.7	0.3	70.9	4.2
Brazil	1996	4,320	99.0	72.4	85.4	27.2	—	—	55.7	16.2

Source: Clarke and Wallsten. 2003. Access is defined by the existence of a connection. — : no information.

The effects of such low levels of access to infrastructure in rural areas has significant spillovers for the economy as a whole: “while rural natural resource activities only account for 12 percent of regional GDP, their effect on national growth and poverty reduction is nearly twice as large due to the forward linkages to other economic activities and their high contribution to exports. For instance, for each 1 percent growth of the rural natural resource sector, there is a 0.22 percent increase in national GDP and a 0.28 percent increase in the income of the poorest families. This represents more than twice the expected 0.12 percent increase corresponding to the sector’s share of GDP.”<sup>11</sup>

Based on a study carried out by the Asian Development Bank Institute,<sup>12</sup> a 1 percent increase in infrastructure stock per capita is associated with a 0.35 percent reduction in poverty ratios when pov-

<sup>10</sup> Source: Fay et al., 2006.

<sup>11</sup> Perry, G., O. Arias, H. Lopez, W. Maloney and L. Serven. 2006. *Poverty Reduction and Growth: Virtuous and Vicious Circles*. Washington, D.C.: The World Bank.

<sup>12</sup> Jalilian, et al. 2004.

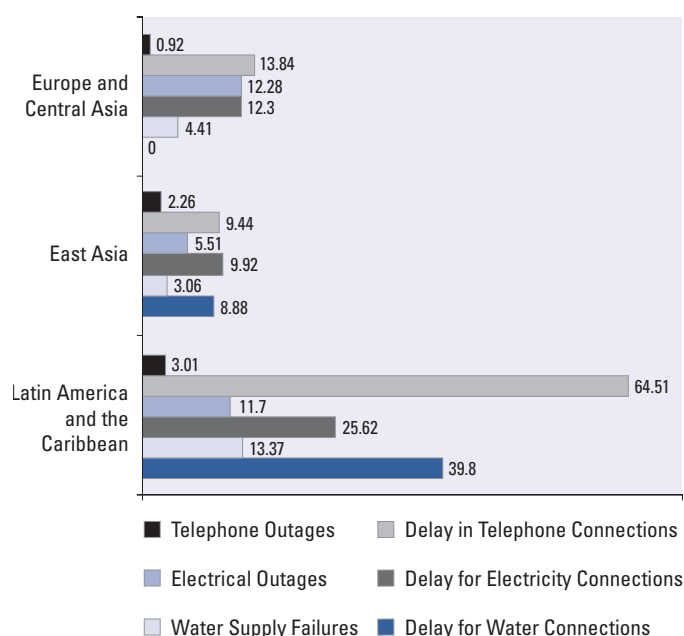
erty is defined as US\$1 per day, and a 0.52 percent decline when poverty is defined as US\$2 per day. Evidence from Latin America concludes that a 1 percent increase in infrastructure stocks reduces the number of people living in poverty by half a percentage point.<sup>13</sup>

Yet, the region as a whole is trailing significantly other parts of the world in providing access on a timely basis: in a cross-regional comparison, the regional average for connection delays in nearly all types of services is significantly greater than its comparators. Not only is there a lower density of investment than in other regions, but the rate at which services are increased is also slower than in other parts of the world. Furthermore, as indicated by the failure of such services as measured by outages, the quality itself of the infrastructure is lagging.

## Infrastructure and Economic Growth

It has long been documented that an adequate supply of infrastructure is an essential ingredient in productivity and growth,<sup>14</sup> but a vigorous debate has been ongoing regarding the specific mechanisms through which infrastructure contributes to economic growth. As several authors have pointed out,<sup>15</sup> not only underinvestment, but also the misallocation of investment, leads to failures in output growth and a negative social surplus. In the past, investments in infrastructure did not always deliver the expected benefits because the lack of strong systems or procedures to scrutinize them meant that investment choices were distorted by political and personal interests. Often, there was a big bias toward large-scale capital intensive projects, and neglect for institutional issues and maintenance. The contribution to growth of such large-scale investments was at times less evident than the damage to the

**FIGURE 2**  
Connection Delays and Outages by Type of Service  
(number of days)



Source: World Bank Enterprise Survey.

<sup>13</sup> Estache, A., V. Foster and Q. Wodon. 2001. Making Infrastructure Reform Work for the Poor: Policy Options Based on Latin American Experience. World Bank, Washington, D.C.

<sup>14</sup> World Bank, World Development Report, 1994; Easterly W., and L. Serven, The Limits of Stabilization Infrastructure, Public Deficits and Growth in Latin America and the Caribbean. The World Bank, Washington, D.C., 2003; Calderon, C., and L. Serven, 2004. The Effects of Infrastructure Development on Growth and Income Distribution. The World Bank, Washington, D.C.; DFID, 2002; ADB. 2004. ERD Policy Brief Series No 13. Infrastructure and Poverty Reduction: What is the Connection? Manila.

<sup>15</sup> Robinson, J., and R. Torvik. 2004. White Elephants. *Journal of Public Economics* 89.

environment and to vulnerable people who were displaced from homes and livelihood as a result. It is clear that weak governance and inadequate institutions distorted public investment choices, thereby lowering the potential economic benefits of such investments and, at times, even diverting benefits that were intended for the poor.

Furthermore, if the relationship between growth and infrastructure is difficult to detect it is because this type of capital comes in discrete lumps responding to investment cycles. In addition, construction times are often divorced from existing business opportunities. In relation to macroeconomic shocks, infrastructure has a contingent use because of its high specificity and irreversibility. Additionally, a reverse causality can also be argued: sometimes growth explains increments in infrastructure instead of the other way around. The experience of the United States suggests that, initially, investment in roads had a significant impact on national economic growth, but in the end this relation saturates and may become a luxury good. In cases where the main source of wealth depends on State control, infrastructure projects will emerge erratically and will be only marginally productive.

Infrastructure also has different spatial effects: energy and drinking water can increase local production and have direct local impacts, while transport and communication have spillover effects for other regions. While infrastructure effects can reach quite distant places, international connectivity can have ambiguous effects on poverty because firms tend to concentrate in high activity hubs. Regions that enter the globalization game with a rudimentary stock of infrastructure and a poor location can end up worse than before.

Efficiency of allocation has a significant impact on the returns created by investment in infrastructure: when overall economic policy conditions are poor, the returns on investment decline and, in some cases, become even negative. Poor policies and inefficient provision absorb scarce financial resources and damage macroeconomic stability. Public failures raise private costs, and chronically unreliable services directly increase production costs: recent analysis in Colombia shows that infrastructure services account for about 16 percent of overall production costs. In turn, increases in the cost of conducting a business is a clear deterrent to further investment, with the result that fewer jobs are created and a vicious cycle of localized poverty sets in.

The output contribution of infrastructure—especially that of telecommunication, transport and electricity—is linked not only to higher costs, but also to lower productivity, as disruptions in the supply of electricity, or delays in getting products to markets result in lower production. The delays and outages documented in figure 2 have very real and significant impacts on the costs of production that companies in the region have to absorb, and that affects their ability to bring to market services and goods that are competitive in the global economy. A comparative survey of firms in China and Brazil<sup>16</sup> reveals that interruptions in utility services have significant negative effects on total factor productivity by causing idle labor and wasted capital inputs, and that especially outages in electricity saddle Brazilian companies more than Chinese ones. Losses from electrical outages can surpass 10 percent of sales, rapidly eroding already low margins. When added together, problems with electricity,

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<sup>16</sup> Subramanian, U., W.P. Anderson and K. Lee. 2005. Measuring the Impact of the Investment Climate on Total Factor Productivity: The Cases of China and Brazil. Working Paper 3792. The World Bank, Washington, D.C.

telecommunication and transport are reported as constraints by over 60 percent of firms operating in the region.<sup>17</sup>

A similar assessment of delays affecting international trade<sup>18</sup> puts companies in Latin America and the Caribbean at a significant disadvantage compared to their competitors in terms of access to international markets, because logistic costs exceed international norms by wide margins (as indicated by the time cost of trade). The time cost of trade reduces trade by 1 percent for every day of delay, and by 7 percent for time-sensitive agricultural products. The countries of Latin America and the Caribbean require, on average, 29 days to export, while developed countries require, on average, 12 days and East Asian countries, 23 days. Logistics costs on a per-country basis average as low as 15 percent of total product cost in Chile and range as high as 34 percent in Peru. The average for the OECD countries is 10 percent. Thus, poor infrastructure not only affects a firm's ability to export, but also a country's ability to attract foreign direct investment.

Comparing the growth rate for infrastructure density in Asia and Latin America, it is apparent that during the 1980–1997 period the number of telephone lines per worker increased 64 percent more in Asia than in Latin America, the stock of electricity generation assets increased by over 100 percent more, and the road network by 43 percent more. This infrastructure gap is estimated to have accounted for 25 percent of the GDP disparity between the two regions during that period, a gap that has been widening over time. Furthermore, over the past forty years, the countries of East Asia have managed to multiply their per capita income tenfold and reduce poverty by half, while Latin America's per capita income has only tripled and poverty levels remain largely the same. It is thus not surprising that in international comparisons of competitiveness and the business climate the region not only performs behind its comparators, but has been slipping from the rankings during the past few years (see chapter 1).

## Polarization is Ineffective

The decline in infrastructure investment in Latin America and the Caribbean dates from the early 1980s. Budget constraints account for the decreased government ability to invest in upkeep and expansion of infrastructure, and while private participation increased substantially, it failed to maintain the high levels experienced in the mid-1990s or to keep pace with expanding needs. Looking at individual countries, only Chile and Colombia have managed to increase investment volumes in this sector, while almost all other countries in the region have seen contractions. Most of the increases are in the telecommunication sector, where private participation has been rising, while nearly all other sectors (transport, power, water and sanitation), which are still dominated by public investment, have experienced investment contractions.

<sup>17</sup> Hallward-Driemeier, M., and D. Stewart. 2004. How do Investment Climate Conditions Vary Across Countries, Regions and Types of Firms? The World Bank, Washington, D.C.

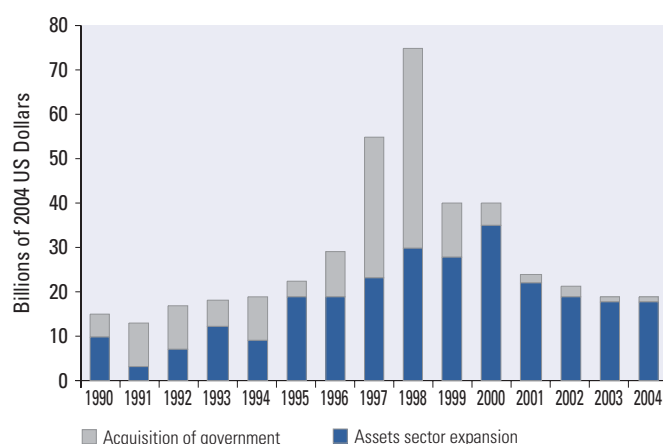
<sup>18</sup> Djankov, S., C. Freund, and C. S. Pham. 2006. Trading on Time. The World Bank, Washington, D.C.

Even as private participation in infrastructure made significant inroads during the past ten years, public opinion backlashes have slowed down the rate at which the private sector continues to invest. Between 1990 and 2003 the private sector in the region increased its market share to 86 percent of telecom subscriptions, 60 percent of electricity provision and 11 percent of water connections, and while privatization of services has resulted in improved efficiency and increased coverage and quality of service, data show that 74 percent of transport concessions and 55 percent of water concessions were renegotiated, and about 2 percent of all concessions were cancelled. At close look, all these failures indicate that the local political and financial realities were not taken into account in the arrangements.

Indicate that the local political and financial realities were not taken into account in the arrangements.

In the past, divestment decisions by governments were guided by deficient sector performance and/or a need for increasing public spending on social sectors such as health and education. Thus, the decision to involve the private sector was not based on considerations regarding what alternative would be most feasible for the service being considered, but rather on how appealing the proposition could be made to attract the private sector and raise funds. This led to unsustainable financial structures and unreasonable expectations that have fueled public discontent and brought about numerous renegotiations and the pullout of most recent investors. What has become clear from an analysis of the past fifteen years of infrastructure financing in Latin America and the Caribbean is that neither the public nor the private sectors alone will provide comprehensive solutions that are acceptable and sustainable over the long term, and polarized solutions create more

**FIGURE 3**  
**Evolution of Private Sector Participation in Latin America and the Caribbean**



Source: World Bank, PPI Project Database.

problems than they solve. A recent study shows that 40 percent of a sample of 796 infrastructure concessions was renegotiated, and the average time to renegotiate was 2.2 years. The most critical sectors in that regard have been transport and water, in which 74 and 55 percent of the concessions were renegotiated, respectively. At close look, all these failures indicate that the local political and financial realities were not taken into account in the arrangements. A large volume of those disputes can be attributed to poorly designed contractual arrangements, opportunistic behavior on the part of governments, the private sector's overestimations of demand and the political economy of user tariffs. The tariff setting model that does not allow cost recovery has shown to be difficult to change: oftentimes prices have been set at "social levels" that compromise the utility or service sustainability.

Encouraging private sector participation in infrastructure has proven to be an effective way of increasing efficiency and performance in the sector: numerous studies show how increased competition, for instance in telecom or transportation, has improved access, lowered unit prices and increased productivity to a level where efficiency gains have freed up capital for investment, as well as attracted new operators and investors.

Nonetheless, governments remain at the heart of infrastructure service delivery through regulation and the provision of institutions that ensure that those markets will function well. To achieve their goals for economic growth, improved competitiveness and poverty reduction, they need to leverage better their investment capability and attract as much complementary financing as possible. Only through partnering with the private sector can a meaningful scaling up of investment in infrastructure be achieved, but history shows that merely scaling up investments will not resolve the issues inherent in infrastructure.

While the private sector is the engine of growth, it is the State that provides the enabling environment for enterprises to thrive, and therefore it is important that governments in the region take the appropriate steps to modify, improve or create the necessary institutions and regulations to support private sector activities. Little is accomplished, by national or subnational policies or by external financing, if institutional capacity is not commensurate with the tasks at hand. This puts an onus on institutional strength, understood as solid regulatory capacity, reliable information systems, technical know-how, participatory policy planning, effective implementation, monitoring and evaluation, and intelligent oversight. Most of all, making rational investment choices where resources are limited by hard budget constraints is of primary importance, as economic growth follows efficient allocation of resources, not indiscriminate spending. Therefore, close identification of priority investments that sustain competitiveness needs to precede any discussion of how the transaction should be structured and who should own the assets.

## **Concluding Remarks and Recommendations for a Way Forward**

A study on the effects of having access to water, electricity, telephone and sanitation in Peru shows that households receiving all services show a 37 percent increase in consumption, or a significantly higher rate of growth than comparable households with no access to services or even only partial services.<sup>19</sup> Such results have been validated by numerous in-country studies performed since, reaffirming the fact that the availability of rural water, electricity, communication infrastructure and road access enhances the opportunities for the rural poor to generate income and gain access to markets and education, thus improving their chances of avoiding poverty. Such results are also valid for the urban poor, who generally have even better chances of getting access to services.

High levels of corruption, political instability, inefficient bureaucracies and judicial insecurity have certainly contributed to the dampening of competitiveness in Latin America and the Caribbean, and part of the setback is attributable to problems in the business climate, which failed to sustain and promote efficient infrastructure investments. Nonetheless, it is also true that retrenchment from both public and private investments in infrastructure have affected the competitiveness of the region:

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<sup>19</sup> Chong, A., and C. Calderon. 2001. Volume and Quality of Infrastructure and the Distribution of Income: An Empirical Investigation. Inter-American Development Bank, Washington D.C.

55 percent of private sector entrepreneurs in Latin America complain about the inadequacy of the infrastructure, while 18 percent of entrepreneurs in East Asia identify this as a problem. Regionally, both public and private investment in infrastructure fell from 3 percent of GDP in 1988 to 1.6 percent in 1998.

Infrastructure is instrumental in enabling access to jobs, markets and services.

The payoff from better infrastructure services goes beyond reducing technical inefficiencies and financial losses: improvements in productivity and pricing permit a more efficient delivery of services in response to demand, and also enhance economic growth and competitiveness. Efficiency

improvements would allow a greater mobilization of resources for needed new investments by generating higher revenues and encouraging a policy environment conducive to new inflows of investment. Undeniably, reliable, efficient and extensive infrastructure is crucial to the economic and social development that promotes pro-poor growth.

Since the alternatives for financing infrastructure cannot be reduced to the *private vs. public* dichotomy, and the “one-formula-fits-all” approach is not viable, understanding the relative strengths and roles that public and private sector partners can fulfill may lead to a better origination of projects that enhance both growth and access. Engaging along the whole spectrum of public-private solutions, and taking into account local realities, project structures can be devised that leverage existing strengths and limit constraints in ways that provide effective and affordable services. Factors such as the business environment, the preparedness of existing institutions and the political economy of envisaged reforms need to be taken into account to ensure that first-rate, sustainable projects are implemented that attain the goals they are set to achieve.

In terms of implementing a pro-poor agenda of infrastructure investments, it is also important to keep in mind that interventions should be targeted to areas where a large number of poor live, and this is often the rural areas that are not well served, if at all. Encouraging the involvement of these communities in the planning of technologically appropriate and commercially viable options is key to scaling up investments that are tailored to the areas’ long-term service needs, and support innovative solutions that make services affordable and sustainable in the long term. The availability of such services ultimately promotes employment creation and the kind of virtuous cycle observed in many areas across the world.



# ■ Developing Entrepreneurship

A significant number of people in Latin America and the Caribbean earn their living through self-employment by creating new enterprises and businesses, rather than working for an employer. Numerous studies have highlighted the contribution of these new enterprises to economic development, detailing their positive impacts on job creation, productivity, economic growth and poverty, as well as their effect on society as a whole by reinvigorating social and productive processes. The impact on job creation is particularly important because it generates work opportunities for younger people, minorities and immigrants, who are generally the most affected by unemployment and poverty.

This chapter analyzes the challenges facing the countries of the region in their efforts to boost economic growth and reduce poverty by ensuring that more people can channel their energies and expertise into the creation of new enterprises. It briefly discusses the impact of entrepreneurial activity on growth, employment and poverty reduction and presents a brief overview of the factors that are limiting entrepreneurial activity in the region. Among these factors are the lack of access to financing, business opportunities and support networks; the failure of the education system to motivate students and provide them with the skills needed to become entrepreneurs; cultural biases against entrepreneurship, and regulatory barriers. Policy recommendations for addressing these issues are set forth in the final section.

## The Contribution of New Enterprises to Development

The creation of new enterprises leads to increased growth and employment and, hence, helps reduce poverty. The creation of new enterprises affects economic growth through two mechanisms. First, there is the direct impact on the economy's productive capacity resulting from the entry of new companies into the market. This is partially offset by the losses of companies that are completely or partially displaced as a result of the added competition; however, the net impact should be positive given that the new entrants often bring with them new and innovative products/services and ways of doing business. These indirect effects, whose role is fundamental to raising the economy's competitiveness and overall growth, can be summarized as: greater efficiency, structural change, innovation and greater product variety.

- *Greater efficiency.* The creation of new companies, and even the threat of that taking place, leads to a change in the behavior of existing companies and prompts them to improve their efficiency.
- *Structural change.* The entry of new companies with more modern and efficient practices gradually replaces existing businesses and favors the process of structural change.
- *Innovation.* New businesses are known to introduce radical innovations, creating new markets in the process. The reasons that some of these far-reaching changes do not usually take place in established businesses may lie in the fact that they tend to be more focused on profiting from the products that they already have on the market rather than on seeking new opportunities. Another reason may be that by establishing a new business, an individual can better use his/her expertise or put into practice notions that did not find footing in other existing businesses.
- *Greater product variety.* The creation of businesses increases the variety of goods and services, thereby leading to a greater number of possible solutions to existing technological problems, as well as a better fit between consumer demand and the supply of goods and services. Greater variety may also contribute to greater productive specialization and to the use of more efficient technologies.

The relationship between entrepreneurial activity and growth has been studied empirically. During the 1990s, the OECD countries that had higher rates of business creation also posted higher rates of economic growth. Furthermore, a positive association has been found between high rates of economic growth and high rates of participation of adults in the creation of new businesses. This relationship becomes even stronger when there is a two-year lag on the dependent variable. In other words, strong rates of new business creation have the strongest impact on economic growth two years later. The contribution of entrepreneurial activity to regional and local economic growth has also been studied and the research shows that differences in rates of entrepreneurial activity explain differences in economic performances between regions.

As can be expected, the creation of new businesses has a significant impact on the creation of jobs. It has been shown that high rates of growth in the number of businesses created precede a net increase in the number of jobs in an economy. Additionally, it has been noted that differences in the rate of creation of new businesses in Europe and the United States explain differences in private sector job creation between them during the 1990s. More recent studies, however, find that the impact of entrepreneurial activity on employment has lags that may be up to ten years long.

New enterprises also contribute to reducing poverty, and they do so in two ways. The first relates to high-growth new enterprises that generate jobs and inclusion opportunities, even for low-income population groups. The second are subsistence and self-employment businesses that allow people to earn a living through businesses in which entry barriers, whether of knowledge or capital, are very low (see table 1). Sometimes, when these self-employment businesses succeed in joining the formal sector as suppliers to regional or national value chains, entrepreneurial activity becomes an effective route to social mobility. It should be noted, however, that these processes do not take place overnight. In fact, the process of creation and early development of a business that reaches a minimum level of dynamism takes at least three years.

This discussion leads to several considerations for policy design. First, it shows that while entrepreneurial activity has a positive impact on growth and employment, that impact may not be felt

for a considerable period of time. Accordingly, promoting entrepreneurial activity is not a short-term solution. On the contrary, policies pursuing this objective should be conceived with medium or long-range time horizons. Second, to make a real contribution to economic growth, the new businesses must foster change in existing production structures through greater efficiency or innovation. In this regard, if the aim is to accelerate growth, the businesses promoted should be limited to those that are capable of establishing differentiated or innovative business models. Finally, if what is being sought is to incorporate a greater portion of the population into business activities and promote self-employment as a poverty-combating strategy, policies must go beyond generating a subsistence income. The aim should be that self-employed endeavors evolve to become small businesses that are less vulnerable to episodes of unemployment.

**TABLE 1**  
**Dynamic and Subsistence Enterprises in Latin America and the Caribbean**

	<b>High-growth Enterprises</b>	<b>Subsistence Enterprises</b>
Economic and Social Impact	Mainly economic growth, employment and innovation.	Mainly poverty reduction, employment and social inclusion.
Business Performance	High growth in sales and employment Over a million dollars in sales and over 15 employees after three years of operations.	Employment and income for the entrepreneur and, in some cases, for family members. Generally fewer than 5 people employed.
Leadership	Team of entrepreneurs with previous work experience and university education.	Independent entrepreneur who, in some cases, has been pushed out of the labor market.
Product/Service	Based on differentiation from one already existing in the economy. In certain cases innovative in nature.	Based on imitation and on costs. Sectors with very low entry barriers and a high degree of informality.
Initial Investment	Between US\$10,000 and \$100,000.	Less than US\$5,000.

## **Main Challenges Facing New Entrepreneurs**

The process of business emergence and development is complex and multidimensional. Being able to understand it adequately and identify the barriers that affect it requires a systemic approach, one that takes into account all the factors that contribute to forming entrepreneurs, as well as the elements of the context or environment in which enterprises develop, including economic, institutional, social and cultural aspects. Along these lines, the discussion that follows explains the factors limiting entrepreneurial activity in the region, including access to financing, access to opportunities and networks, access to education, culture and role models, and regulations and policies.

## Access to Financing

Access to financing and capital is particularly important for launching an enterprise and during the first phases of growth. When starting a business, entrepreneurs typically invest their own funds and obtain loans from family and friends, relying on outside sources of financing to a lesser extent. In Latin America and the Caribbean it is more difficult than elsewhere in the world to gain access to outside sources of financing, such as loans from private banks, guarantees and subsidies from government institutions, venture capital or angel investors. As a consequence, slightly more than two-thirds of Latin American entrepreneurs are negatively affected by the conditions under which they begin their entrepreneurial activity. Their scale of operations and/or technological level are lower than would be desirable in order to be competitive, or they must wait to start operations later than planned.

The problem of access to financing is even more acute in the first years of the business when personal savings and support from relatives and friends are no longer sufficient to sustain growth. Although entrepreneurs now tend to use more bank loans during this phase, they still lack the same access to capital available to entrepreneurs elsewhere in the world. In East Asia, for example, the proportion of firms that use outside financing sources during their early years of life is practically double that in the start-up phase, whereas in Latin America it rises only slightly. This picture is completed by the fact that access to corporate venture capital is certain in Asia, while its presence in Latin America is only marginal.

The lack of access to financing also affects the newly self-employed and entrepreneurs who create subsistence microbusinesses. Despite the great expansion of microfinancing institutions in the region, most of them still do not serve businesses that are less than one or two years old. This situation, combined with the fact that the self-employed generally have little personal and family savings, considerably limits the development of the new subsistence businesses. A more detailed exploration of the financing issue can be found in chapter 2.

## Access to Opportunities and Networks

New enterprises are generally developed to serve the needs of existing businesses. Thus, existing businesses and institutions play a fundamental role as generators of opportunities for new businesses, as well as in the formation of entrepreneurial skills and relationship networks among workers. SMEs, for example, are customarily regarded as good “pools” of entrepreneurs, because in them their workers can develop a better, more comprehensive understanding of the entrepreneurial function than in large corporations. However, in many countries of the region, particularly those that are relatively less developed, the number of SMEs is limited. This, in turn, seriously limits the demand for new enterprises and the supply of entrepreneurs. Inadequate local markets also restrict the opportunities for apprenticeships that new businesses generally need in order to gain access to international markets.

Access to social (friends, family), institutional (support agencies and programs, business associations, institutions of higher learning, etc.) and commercial (suppliers, customers) networks may foster the entrepreneurial process by (for example) facilitating access to the resources needed for starting a business, support for problem-solving, and information on business opportunities. The importance of networks for entrepreneurial development is recognized in various studies that highlight

its role at different phases in the entrepreneurial process. In the region, social networks seem to play a more important role than commercial and institutional networks. The fragility of production networks in some countries, and the reluctance of businesspeople to cooperate and break up business processes, limit the development of business networks. With regard to institutional networks, it is clear that very few institutions in the region provide business services suited to the needs of new entrepreneurs. Public and private SME support programs are generally conceived to provide answers to the problems of mature businesses. Indeed, most of these initiatives rule out new businesses as their potential beneficiaries. In addition, employment and professional training programs are designed to make apprentices and unemployed workers more employable, not to help them with the start-up and early development of an independent enterprise.

## **Access to Education**

The education system can provide motivation and impart the skills needed for individuals to consider the option of starting their own business. For that to happen, the education system must have adequate teaching methods, trained teachers and professors, committed leaders and internship programs that expose students to business settings. Unfortunately, this is not happening in the region. That is why very few successful entrepreneurs indicate that formal education was important in shaping their entrepreneurial skills. They acknowledge that university education played a relatively significant role in providing them with the needed technical knowledge. However, there is a change underway in this regard in many countries. It is led primarily by universities and, to a lesser extent, by professional training schools and institutes. As part of this shift, many universities now teach courses on entrepreneurship and the development of business plans in all curricula, ranging from economics and engineering to medicine and the humanities. Furthermore, institutions of higher learning have opened specialized centers and incubators for supporting students, graduates and teachers who wish to start an enterprise.

## **Culture and Role Models**

Culture is a society's set of norms and values. Different cultural aspects such as social appreciation for entrepreneurs, attitudes toward risk-taking and the presence of exemplary entrepreneurial models are cultural factors that affect the emergence of entrepreneurial callings. In societies with cultures that favor entrepreneurship, people are more likely to want to start a business in order to gain social recognition, to be independent, or to follow in the footsteps of other entrepreneurs whom they admire. However, in Latin America and the Caribbean models of exemplary entrepreneurs do not seem to play the motivating role that they have elsewhere in the world. Asian entrepreneurs, for example, give greater recognition to the motivating influence of other entrepreneurs whom they admire and whom they wish to emulate. The presence of these role models has a positive impact on the likelihood that people will want to become entrepreneurs. In the countries of East Asia, the mass media play an important role in publicizing these model entrepreneurs. This different presence of role models in the two regions should not be attributed solely to the media, however. It also may be that the different degree of success attained in economic and social development by the two groups in the past has

helped shape very different perceptions regarding the social role of leading entrepreneurs, certainly those most widely known through the media.

## **Regulations and Policies**

This category includes the set of regulations, bureaucratic procedures, and policies that have an impact on business creation, such as taxes, the bureaucratic procedures required to formally establish a new firm and initiatives and programs for fostering entrepreneurial activity. All these affect, for example, business opportunities and access to them, the emergence of callings and the acquisitions of skills, as well as entry into the marketplace. In Latin America and the Caribbean, new enterprises do not generally receive preferential tax treatment. In terms of the paperwork for formally establishing a new company, available data and studies indicate that the time and cost entailed in registering a company in the region are much higher than in developed countries. It should be pointed out, however, that programs for simplifying paperwork are now being implemented in many Latin American countries and, in some cases, they are yielding excellent results. Some progress is also being made in the area of policy to foster entrepreneurship. As mentioned above, many universities have created specialized centers and business incubators to support students and professors who wish to create businesses. Several nongovernment organizations and business groups in the region have also been offering innovative services for entrepreneurs. The public sector, meanwhile, is where the least progress has been made in programs and initiatives to encourage the entrepreneurial spirit, although there are some exceptions, such as Chile, where the government is promoting a very innovative program of financing and subsidies for entrepreneurs.

## **Policy Recommendations**

In Latin America and the Caribbean a significant proportion of the population invests its energies, knowledge and savings in developing new enterprises. Nevertheless, as a result of the limitations and challenges of the business climate—including financial, educational, cultural, regulatory and development policy issues—not all this entrepreneurial energy is transformed into high rates of economic growth, low unemployment and lower levels of poverty. The progress achieved in the 1990s in terms of economic stability no doubt represents something fundamental and positive for entrepreneurs. However, in order to improve the number, quality and sustainability of the businesses that are entering the markets of the region, progress must be made in reforms and policies, on matters of financing, education, networks, culture and pro-entrepreneurial regulations.

The development of financial products that serve the needs of entrepreneurs during the very early stages of business gestation and entrepreneurial activity are needed. The main issues that must be solved in the region in order for venture capital and angel investment to develop are the following: cost-effective mechanisms for generating project flows, lack of human resources specialized in assessing and monitoring new enterprises, and legal issues (for example, those associated with the rights of minority shareholders). But financial innovations should not be conceived solely for high-growth businesses. Products of a massive scope should also be created for new subsistence enterprises. For

example, thorough improvements in microfinancing lending technologies and innovative guarantees schemes would make it possible to meet the needs of new subsistence-type businesses, thereby increasing their chances of evolving into small businesses. Box 1 details a project to improve access to finance for Honduran youth.

There are opportunities in the region for introducing educational reforms to improve the effectiveness of the education system in shaping entrepreneurial motivation and skills. Such reforms should foster the development of modern teaching programs that, by combining theory and practice, can prepare students to face the challenges of creating and managing a new enterprise. Teachers and professors also need to be trained in those areas. Student exposure to the new content should be intensified as they go through the different stages of the education system, from elementary to secondary to higher education. However, inasmuch as many young people in the region do not go to college, secondary and technical schools should provide them with the necessary tools so that those who decide to go into business will succeed. Training institutions that operate outside the education system should also incorporate entrepreneurial content to serve those who did not receive a formal education. The content typically associated with this type of training should include courses on drawing up a business plan, teamwork and human resource management, product differentiation and marketing, and so forth.

The promotion of networks is also of fundamental importance for encouraging entrepreneurial activity in the region. Through networks, particularly commercial and institutional networks, entrepreneurs can increase their chances of gaining access to business opportunities, technology, financing and information. Networks can be developed through different mechanisms. Examples of the development of networks include through teamwork, during the different stages of the education system, by forming clubs, forums and associations of entrepreneurs, and through programs for transferring knowledge from already established entrepreneurs to those who wish to start, or are already in the process of starting their businesses, and so forth. Best practices for promoting networks based on international experience are discussed in box 2.

### **Box 1: Improving Access to Finance by Honduran Youth**

Since 1998, the Banhcafe Foundation, a Honduran NGO, has been developing activities to support young entrepreneurs. In 2005, with IDB support, Banhcafe created a guarantee fund to reduce the risk faced by financial institutions when providing loans to young low-income entrepreneurs who are in the process of starting new businesses. The fund was designed according to the best international practices. Its main characteristics are the following: (i) it offers a guarantee that will be paid when the financial institution begins delinquency collection proceedings; (ii) it is selective in that it will offer guarantees to young people with good business plans; (iii) it shares risks given that the guarantee will cover 50 percent of the value of the loan balance while the other 50 percent will be assumed by the financial institutions; and (iv) private sector businesses participate by contributing cash and acting as mentors for the young entrepreneurs.



## Box 2: Best Practices for Network Promotion

- *High Visibility Leadership:* The power of a visionary leader who can mobilize people around an idea or a project should not be underestimated. Many activities need a “champion” with the passion and intellectual credibility to move them ahead successfully.
- *Relationships, Not Contacts:* Developing networks does not mean establishing mere contacts between persons, but rather fostering relationships; that is, creating areas of trust for exchanging information and developing leadership capabilities.
- *Small Groups:* Networks with many participants are easier to create than those with few people. However, the latter are more effective for generating information exchanges and group learning. Initially the effort must focus on identifying the right people rather than on generating many groups.
- *Long-Term Commitment:* Programs for developing networks must be developed for the medium and long term. As a rule, achieving results with such initiatives requires at least three or four years.
- *Facilitate, Don’t Intervene:* The role of officials of a networking program must be to “be there, but not stand out,” to provide administrative support for the network, but avoid being involved in directing activities.
- *Connect People, Not Businesses:* People can relate, businesses cannot. Hence networking development programs should not build alliances between business, but ties between people who want to share ideas and learn from one another.

Creating a culture more favorable to entrepreneurship is another of the great challenges in the region. Although this task is extremely complex, some countries are working in this area with rather encouraging results. Information and advertising campaigns have been the strategy most commonly used by development agencies to stimulate people’s entrepreneurial spirit. Such campaigns encompass a wide range of means and activities, including developing television programs, specialized journals, case studies of successful entrepreneurs, competitions to select business plans, as well as model entrepreneurs, seminars and workshops. In Latin America and the Caribbean, various media, including business newspapers and magazines, have carried out such activities successfully. The task ahead is to evaluate the results of these experiences and, on the basis of what has been learned, try to publicize and replicate them throughout the region.

A final issue on which governments and chambers of commerce should continue working is that of simplifying procedures and paperwork for registering businesses. Although statistics show improvements in this regard, much more remains to be done for Latin American entrepreneurs to be able to register their businesses within the same time periods and at the same costs as in developed countries. Progress in this area, in addition to helping make the entrepreneurial sector more a part of the formal economy, will also enable countries to have more reliable data on the income and expenditure flows of businesses in their economies, data that will be crucial for de-

signing better policies and programs for fostering entrepreneurial activity.

The public and private sectors should work together to develop these policies and reforms. A strong involvement by the private sector—and by civil society in general—is needed if the intention is to change existing conditions. Hence, it is crucial that actions be taken to obtain the private sector’s commitment from the strategy design phase onward. This commitment is very important for several reasons. For one thing, some activities achieve better results when they are set up from the private sector. Moreover, the tasks of publicizing exemplary entrepreneurial models, or of mentoring require very active participation by the private sector, from which they must be nourished. In addition, the resources available for carrying out the strategies must be leveraged through direct support by the private sector.



## Concluding Remarks

This discussion suggests that societies seeking to pursue job creation, improved growth and competitiveness, and poverty alleviation need to give entrepreneurship policy a high priority. Entrepreneurs and new enterprises, both high-growth and subsistence enterprises, have the potential to make a significant direct contribution to these three main policy goals. In Latin America and the Caribbean, the main challenges that entrepreneurship policies should address are related to financing, education, networks, culture and pro-entrepreneurial regulations. To be successful, these policies should be designed and implemented by public-private partnerships and be entrepreneurial both in the way they promote the mobilization of the institutions of civil society and in the way they work with the entrepreneurs. It is also crucial that local capabilities are awakened and that work be done in a decentralized manner under oversight systems that assure that efforts are coordinated and rationalized. Finally, entrepreneurship promotion should be conceived as a long-term strategy. Indeed, the maturation of an entrepreneurial project from the beginning of the motivational process until the business is created takes several years. Broadening the base of dynamic entrepreneurs in a society is as important as having roads or bridges. Entrepreneurs must be socially valued as “strategic human resources.” Hence, fostering the emergence of entrepreneurs ought to be regarded as a long-term social investment.



# ■ FOSTERING MARKET ACCESS FOR MICRO, SMALL AND MEDIUM ENTERPRISES

This chapter analyzes the competitive challenges of smaller scale firms in a global economy and the importance of becoming a part of global value chains through commercial linkages with larger enterprises. It reviews the obstacles that small business face to engage in commercial relationships with large corporations, as well as good practices for overcoming those obstacles. The chapter draws policy recommendations for supporting the inclusion of micro, small and medium enterprises into the mainstream of current global business.

## Market Size and Enterprise Size

Micro, small and medium enterprises<sup>1</sup> make up the vast majority of businesses in all the countries of the region, representing over 99 percent of formal businesses. The weight of these businesses is evident in the fact that they account for 65 to 90 percent of total employment and for 35 to 55 percent of gross domestic product. If, in addition, we take into account the informal economy, which is extremely important in the region, microentrepreneurs and their dependents make up a significant portion of the population earning a living through business activity in a market economy.

Despite their variety, it can be demonstrated that most small enterprises sell their goods or provide services on purely local markets. Due to their limited scale, these firms (especially microbusinesses or small farm producers) sell solely in the territory immediately surrounding them; sometimes they are limited to their municipality or even the neighborhood in which they work. Often, their size keeps them from systematically approaching district or national markets, which are reserved for small or medium businesses with a higher degree of operating capacity. Only in exceptional cases do some advanced and well-capitalized SMEs manage to reach export markets.

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<sup>1</sup> The expression “small business” is used indistinctly for micro, small and medium enterprises. However, SME will be used when referring only to small and medium enterprises.

The causes of these limitations are to be found in the scant development of the markets themselves, the small size of the businesses, and their limited managerial and operational capabilities. The fact that most of the countries in the region had closed markets for a good portion of the recent decades has led to a fragmentation of markets in the region, made competition difficult, and contributed to keeping markets small and their level of development very low.

Consequently, we find that, in much of the region, productive specialization is low and firms act in isolation and with few linkages. That is, companies depend on a small number of inputs whose level of transformation and value added are low, they process and transform them with their own limited technical capabilities, and sell them in local final markets where, until recently, there was little competition. The upshot of this is a vicious circle in which the level of development of local markets is much lower than that of international markets.

In addition, the poor, who make up the majority of the region's population, are not well served with products suited to their purchasing power. This is an important potential market in the region.

In this setting, the economies of the region are opening to trade and tending inexorably toward globalization. Indeed, the entry of international competitors into local markets is a direct threat to small producers with inefficient operations for whom it is very difficult to face the foreign competition. Likewise, their chances of gaining access to international markets are limited by the same problems of scale, lack of specialization and intense competition from other international producers.

This is a highly vulnerable situation for small businesses accustomed to acting primarily on their own, that is, with few production and commercial links to other businesses and with production highly integrated within each firm. There are two types of response to this situation. One is to stay in their local markets and compete using pricing strategies to defend themselves against outside competition. Another response is to shift to a more aggressive strategy, seeking to incorporate more value into their products through greater specialization and higher productivity. The second strategy is followed in an attempt to not only maintain their presence in local markets, but also to reach larger national or international markets.

## **Improved Ties Between Businesses and Greater Access To Markets**

The process of globalization and liberalization directly causes markets to grow in size and become more sophisticated. The reason for this is the competition of more providers from other markets with a higher level of product development. In order to serve larger and more complex markets, small businesses must find a way to overcome their competitiveness shortcomings, which largely result from their small size. A small business cannot afford to have its own marketing department providing it with expertise and access to market information, nor internal quality control services, a sales force, and other similar services that would be needed to enter primary markets. Only a small portion of SMEs can assemble the combination of factors needed to grow in order to serve larger markets and be able to export directly.

A way to successfully overcome the problems of access to larger markets is by linking with other businesses (small or large) and specializing in one or more partial phases or aspects of the production

process. This strategy allows small firms to gain access to markets for parts, components, or services that are integrated into other products. As a result, the businesses that compete in final markets are increasingly less individual businesses and more business groups (providers and clients).

There are two major ways of designating these groups of businesses: national or global value chains and clusters. Neither term is in any way exclusive. Rather, each simply places the emphasis on a different aspect. Thus, the concept of *value chains* relates more to “chained” relations of suppliers and customers: from raw materials and supplies, through their manufacture and transformation, commercialization, packing, distribution and final sale. Value chains may be more or less long and complex, national or global, and may also be vertical or horizontal in nature. In *vertical chains*, the position of each business with respect to the market largely determines the relations of governability and hierarchy vis-à-vis other businesses in the chain, and it also conditions the flow of information among them. Thus, for example, in the handcraft export chain, it is the business that is actually selling in the primary markets that knows most about and monitors most closely what the market is demanding. This means that it is the firm transmitting information on what the market is seeking and, consequently, it ranks and organizes the value chain, transferring orders and requests to each of the stages in the production chain until it reaches the small producer or artisan. *Horizontal chains* are a means for small business to resolve the problem of scale by cooperating among each other, either to market their products or for any of the other essential functions that allows them to find a place in international markets. In either case, vertical or horizontal chains, there are two concepts that are crucial to the competitiveness of the businesses involved, and hence to their ability to gain access to markets, namely transaction costs and the relationships of trust between businesses.

The concept of *cluster* places greater emphasis on the set of linkages established between enterprises and institutions related to the same business in a particular territory. The idea of “business” could be associated with that of value chain because, ultimately, every business has suppliers and customers. However, normally this concept relates to a multiplicity of firms, which, even while competing in very similar markets could have the same suppliers, and hence, hierarchical relationships are more diluted. For example, metalworking shops in a wine-growing area, which sell most of their production to the various wineries, are, in effect, in the wine business and the fate of their market will depend on the wine market. The same is true of bottlers and manufacturers of labels or packaging for wine. Clusters bring together the converging interests of companies of very different sizes that enter international markets thanks to the competitive environment created through the interaction of different players within a particular territory. Also included in the concept of cluster are the government or private institutions that accompany and support businesses. They may differ very much in nature, and range from professional training agencies to technological development and quality control entities. In clusters, as in value chains, lowering transaction costs is crucial to competitiveness. And perhaps more than in vertical value chains, the relationships of trust between businesses, and between them and the agencies that support them, are vitally important. A more advanced expression of such trust between companies is found in the well-known case of the Italian industrial districts. The Italian experience is a successful example of how local SMEs achieve a high level of specialization and cooperation, enabling them to compete successfully in international markets. Even though it might be difficult to replicate this experience in Latin America, it has helped inspire and refine the concept of cluster in the region.

## The Challenge of Change for Small Businesses

The changes in the rules of the game resulting from trade liberalization and the globalization of markets entails a fundamental challenge for micro, small and medium entrepreneurs who, in response, must change the way they do business. A good portion of the challenge for gaining access to national and international markets lies within the businesses themselves, while another portion lies in the business environment.

The problems that manifest themselves within businesses have to do with the educational level of small entrepreneurs, their individualistic mindset, the lack of a culture of collaborating with other businesses and the difficulties encountered when doing business with large companies, among others.

The low level of education of the smaller entrepreneurs makes it extremely difficult for them to understand how the rules of the game have changed and to accept them as something necessary for the country's economic growth even when the new rules may involve serious disruptions for them. The natural tendency to keep doing things "as they've always been done" can lead to protectionist tendencies in internal markets, which would only delay even further the modernization of the region's productive capacity.

The individualistic mindset of small entrepreneurs makes them resistant to relinquishing some responsibilities to other levels of the (vertical or horizontal) value chain or of the business cluster. Entrepreneurs who are accustomed to acting independently fear losing autonomy. Likewise, the lack of a culture of collaborating with other businesses means an initial degree of mistrust that must be overcome. It is difficult for small business owners to reach the point of placing their trust in other business people who may be their competitors, suppliers or customers. Mistrust is greater in countries where compliance with the law is not guaranteed, institutions do not operate predictably, or the level of informality is very high.

The difficulties faced by small businesses in doing business with large companies deserve special mention. One of these is informality. Many micro and small businesses operate in the informal sector. However, large companies that have to observe national and often international regulations are not very likely to be willing to do business with suppliers who do not meet minimal formality requirements. In addition, informal businesses compete unfairly with formal businesses. Hence, the problem must be dealt with in a comprehensive manner. Simply facilitating the formalization of business transactions between small and large businesses is not enough.

Another problem faced by small businesses when doing business with large companies is the difference in productivity between the two, and the difficulties that small businesses face in complying with quality certifications and regulations as well as meeting delivery deadlines and other contract conditions (which are often unfamiliar to small businesses). Large purchasing companies often assist their suppliers by providing information about market requirements. They sometimes go so far as to provide the infrastructure (such as, for example, plant health quality control) needed by the suppliers so that they can more easily meet market requirements.

Training employees and assisting them to adapt to the new requirements are also difficult for micro and small businesses and can become barriers to entering certain markets. The production processes required by large purchasers very often entail changes in installations and more sophisticated equipment, which in turn demands more highly trained operators.

Adapting to larger markets requires adequate financing, affecting working capital needs as well as, in some cases, entailing investments in new equipment and installations. This can also create a stumbling block for micro and small businesses. Large scale firms can also come to the aid of their suppliers by financing these expenditures or by providing advances.

Entering a production chain requires a complete change in management style for the micro or small business. From setting medium- and long-range strategic objectives to organizing human, technical, financial and other resources, the process of changing management style leads to improved competitiveness (upgrading), which provides sustainable access to markets.

Shortcomings in the *business environment* can also hinder access to markets for small businesses. For example, smaller businesses may find it too burdensome to comply with regulations such as obtaining licenses, clearing customs, and plant health and environmental requirements. These can become insurmountable barriers for small businesses. Weaknesses in the operations of institutions charged with enforcing laws and resolving business disputes can also have a relatively large impact on the operations of small businesses. Finally, lack of access to adequate financing and business development services can thwart the efforts of these businesses to enter the market.

## Ways in Which Small Businesses Can Reach Markets

This section provides an overview of good practices to illustrate the process of competitive upgrading of small business that allows them to reach larger markets.

The great variety of micro and SMEs and the differences between countries and the type of markets being accessed would suggest the need for a case study of the different types of experiences (including agricultural, artisan, or manufacturing micro and small enterprises with very low income and little value added); of SMEs in agroindustry and manufacturing that are expanding their markets to the national level; and of advanced small business with greater value added that are able to reach export markets. For each group it would be possible to ascertain the degree of vertical or horizontal cooperation or cluster-type activity taking place. This section looks at programs intended for agricultural microenterprises, artisans and new exporters.

### Small Agricultural Producers and Large Buyers

Supermarkets and large retail chains are transforming the way food is distributed. Distribution techniques applied in more developed countries are also coming to prevail in the region's metropolitan areas and cities. Large food distribution chains, often operating across national borders (such as Costa Rica's Hortifruti which operates in several countries in Central America) have experienced significant growth by relying on distribution methods suited to serving a middle-class urban market that demands ever-higher health standards. Hortifruti (which initially received USAID support) established commercial relationships with small farmers, many of whom operate at a subsistence level, in the countries where it was located. The operation consisted of providing training and technical assistance so that the small producers could standardize the quality of their product, as well as know-how regarding adequate hygiene and plant health treatments that would enable them to pass the inspections

required by the market. Hortifruti also set up small warehouse plants where small producers could consolidate their production and sale. It likewise provided producers with a letter of guarantee enabling them to have access to financing at microfinancing institutions or specialized NGOs. Hortifruti was able to do this by offsetting its risk via international aid, but it also had its own business reasons. By diversifying its supply sources to several small farmers, rather than a few large suppliers, it was able to make its purchasing structure more flexible. As a result, almost 2000 small farmers were able to upgrade their operations and gain access to quality markets. Some even managed to become exporters because Hortifruti manages its surpluses from one or more countries in Central America depending on demand conditions and supply availability.

Other instances of one large buyer and many very small producers can also be found. In El Salvador's beekeeping industry, for example, a large company introduced technological changes in the development of new products from honey, thereby fostering access to international markets to a large group of small beekeepers.

A variant of this formula is found in the cooperative organization of small grape growers, who, with the help of the Carvajal Foundation, achieved a substantial improvement in productivity and in the quality of the grapes. A corporation of producers (Corpoginebra) was created to gain access to new markets in a sustainable manner (Uva Isabella).

## Exports of Handicrafts

The experience of an IDB Innovation Project has given rise to a new program (that is currently being implemented) that is yielding an interesting operating model. According to this arrangement, three Central American exporters of furniture and home decoration items have launched a strategy for gaining access to global markets with handcrafted products that compete with Chinese exports. To compete effectively, they rely on the high quality and innovative design of their products, and their flexibility in adapting very quickly to new market trends. They do so through agreements with large global buyers (Pier 1 and others) by which the latter, or rather their professional designers, provide sketches of products so that the export companies can send them price quotes and samples or prototypes. Once these have been accepted by the global buyers, the export companies entrust their production to a network of local craftspeople with whom they have had previous commercial relationships and with whose capabilities they are already familiar. The supervising companies oversee production, choose raw materials, colors, textures and other details and carry out final quality control of each product to assure that it meets the requirements of the global buyers. The distribution of revenues generated for each link in the chain (retail sellers, global buyers, export companies and artisans) has to be sufficient for each of them to remain competitive (see figure 1).

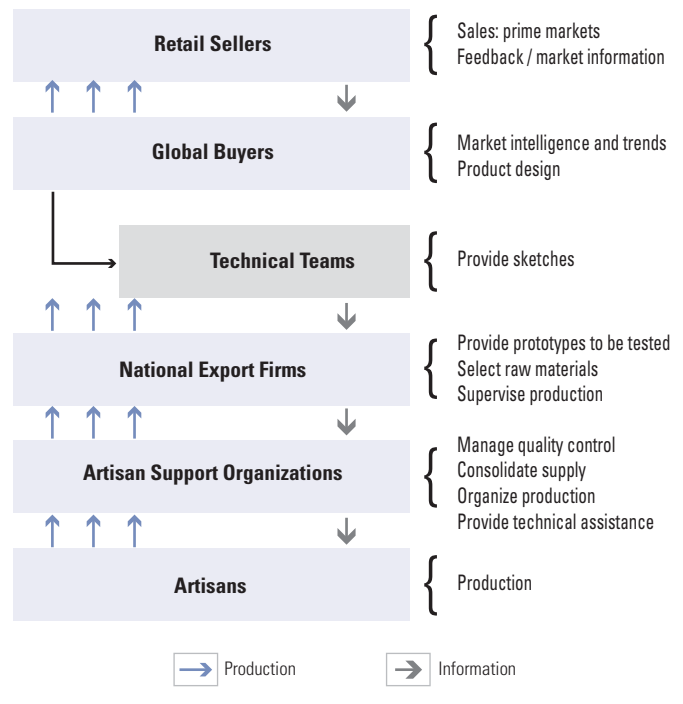
Thus, the artisans must be paid enough so that they will not shift their production to other distributors or to local tourism. The result has been that over 1000 low-income artisans have been able to reach international markets after going through an upgrading process when they joined the value chain. The value chain is sustainable because all the private companies comprising it benefit from it. The program's aid is focused on strengthening the organizations of artisans and on upgrading their capacities, and also on fostering their relationships with the rest of the value chain.



## Promoting New Exporters

The purpose of the New Exporters of Uruguay program is to create export capabilities in small businesses that have the potential, conviction and commitment to penetrate export markets. The program trains several advisors in three stages, providing them with expertise in international marketing and teaching them how to apply their skills to the eligible businesses. The first stage involves a diagnosis of the company's competitive strengths and weaknesses. The second stage involves the development of a complete export plan, and the third, deals with launching the plan. It should be noted that according to this methodology, the advisors prepare the export plans by working inside the companies, and the companies pay at least 50 percent of their fees. The third phase is optional and is financed by the businesses using the aid that was available for other programs. The program was completed successfully and received a positive evaluation from 90 percent of the participating companies.<sup>2</sup>

Figure 1



## Lessons and Policy Recommendations

The best practices presented above are a partial sample of the feasibility of designing and implementing effective programs to achieve greater access by micro and small enterprises to national and international markets in an open economy setting. The kinds of programs presented are based on market dynamics and led by private businesses. These interventions are focused on creating capacity among micro and small businesspeople and on strengthening their organizations. The distortions generated by the interventions are temporary. These and other programs that support the expansion of access to markets through a process of upgrading toward greater linkage with other companies offer a series of lessons and recommendations.

It should be emphasized that the most efficient programs are those led by the businesses themselves, and that the task of the public sector, while still important, is limited to some support activities and ensuring that there is a favorable business environment.

<sup>2</sup> Casos exitosos de desarrollo empresarial en Uruguay [Successful Cases of Entrepreneurial Development in Uruguay]. Inter-American Development Bank. Montevideo. April 2004.

The following recommendations should be borne in mind when providing *support for private businesses*, whether they are individual business or part of value chains or clusters.

- Start from an already existing business situation. Do not attempt to create a whole complex of relationships between businesses that are inexperienced or have never had any links.
- The business project must be demonstrably feasible, whether as an individual business or as a value chain.
- Put priority on eliminating obstacles so that businesses can negotiate the financing of their business operations.
- Focus on creating capacities in businesses or in consortia of businesses.
- Have an adequate incentive scheme.
- As much as possible, keep in mind the distribution of earnings along the value chain or cluster and make sure that the smallest entrepreneurs also benefit from the program.
- The financial sustainability of the activity should be a *sine qua non* condition of the intervention.

The *support that can be provided by the public sector* for fostering market access by small businesses must emphasize its function as catalyst rather than as operator. Some recommendations along these lines include the following:

- Promote free trade agreements and the elimination of nontariff barriers, and avoid establishing conditions that may create biases against smaller businesses.
- Encourage foreign direct investment and the formalization of business cooperation agreements between local businesses and international companies.
- Preference for actions on the environment affecting all businesses over actions that support a limited number of businesses.
- Open and foster small business access to the government procurement market at the national, subnational and municipal levels.
- Use of publicly available promotion tools, such as basic information on trade agreements, basic market intelligence data, and so forth.
- Design of export promotion programs and those that foster the internationalization of national businesses on the basis of instruments such as development of advisory services on foreign trade, the identification of possible trading partners outside the country, help with international trade fairs, formation of export consortia, and so forth. These efforts should always take place on the principle of sharing risks with private businesses or their organizations.

## Concluding Remarks

In conclusion, the increased access of micro, small and medium enterprises to (national and international) global markets is very important for economic development and for improving the employment and living conditions of people in the region. For the most part, micro and small businesses can par-

ticipate in the economy only by gaining access and adapting to global markets. This adaptation, in turn, requires a major change in the way business is done and greater connections between smaller businesses and larger ones through value chains and clusters. This will help the weaker companies to better deal with the problems of scale that they face. Various experiences show that it is possible to design programs that will encourage the participation of smaller businesses in global markets. Operational recommendations are drawn from these experiences, emphasizing the need to allow the private sector to take the lead, reserving a facilitating role for the public sector, and providing support for the actions of businesses. Spreading these successful experiences and expanding the base of micro and small entrepreneurs are challenges facing the Bank and the international community.



# ■ Corporate Social Responsibility to Enhance Access to Economic Activity

**T**his chapter explores how socially responsible corporate practices can provide sustainable solutions to the socioeconomic problems that affect the poor. It discusses initiatives that are being implemented to facilitate access to better economic opportunities and suggests ways to support and implement these socially responsible business practices.

## The Contribution of Responsible Practices to Economic Development

Considered a pillar of development, the private sector plays a key role in economic growth and wealth creation and contributes to development by conducting business in an ethical and responsible manner. Companies that implement corporate social and environmental responsibility (CSR) practices as part of their business strategy have a long-term, sustainable and positive impact on growth, development and poverty reduction. CSR is understood here as the corporate practices that complement and support main business activities and explicitly seek to avoid damage and promote the well-being of stakeholders, such as clients, suppliers, employees, financial resource providers, surrounding communities, governments and the environment.

If well implemented, CSR practices can help to enhance access to goods and services, economic activity, quality jobs, responsible supply chains and other positive outcomes. In other words, CSR practices can provide sustainable solutions to the socioeconomic problems that affect the poor, hence contributing to reducing poverty. Engaging with stakeholders inside and outside the company can also help to leverage business resources, skills, competencies, technology and networks, and increase the contributions that the private sector makes to improve the standard of living of many people.

While the private sector cannot solve all social and economic problems, it can have a positive impact on prosperity while at the same time increasing its profitability. Good corporate citizenship and corporate social responsibility involve doing business in an ethical manner, going beyond the simple compliance with the law, and taking into consideration the expectations of the society in which

a company operates. Thus, the private sector's social and environmental responsibilities include expanding the opportunities available to the poor as well as their participation in the market.

Empowering low-income populations by providing access to jobs, credit, training, products and business opportunities is essential for building prosperity and promoting economic growth and development. When everyone has a stake in economic development, societies tend to be more socially and politically stable.

Financial aid from international donors can be helpful, but alone is neither enough nor sustainable. Trade, commerce and market-based initiatives are the most effective tools for helping people get out of poverty. Companies investing in new business ideas that provide products and services, create jobs and develop skills in the least favored communities act as powerful drivers for market-based development. Providing affordable quality products and services empowers people to improve their own lives. Creating more economic opportunities for the traditionally excluded, and contributing to improve their employability and entrepreneurial skills has a direct and sustainable impact on the generation of income streams for poor families. In addition, companies involved in providing access to essential services such as energy and clean water, contribute to improving the living conditions of poor and excluded communities. All these market-based initiatives benefit and mobilize the local community, boosting income levels, reducing local dependency on aid and donations and strengthening the socioeconomic fabric.

However, this is not merely an altruistic option. It also makes sense for companies to provide opportunities to traditionally excluded sectors of the population because this can lead to the development of new markets of untapped customers, build future workforces and ensure the presence of productive and reliable suppliers and distributors with valuable skills and knowledge about their own communities and neighbors. This requires innovative business models that focus on developing the potential and skills of the disadvantaged segments of the market in order to turn them into business partners.

Profitability can go hand in hand with efforts to achieve the common good and improve living standards for poor communities. Some companies are already doing business with low-income populations in a sustainable manner and within a win-win framework of corporate citizenship. There are successful cases that illustrate creative solutions that the private sector is implementing to improve the living conditions of disadvantaged communities while expanding markets and increasing profitability (see Box 1).

The creation of employment and the social integration of otherwise marginalized communities are highly favorable consequences of undertakings carried out by firms that seek the commercial inclusion of low-income sectors. New local businesses might also be created as a result of a company's presence, to supply it with raw materials, workforce and other resources needed. This aspect is especially relevant as small and medium enterprises (SMEs), as well as microenterprises, play an important role in creating jobs and reducing poverty.

## **Small and Medium Enterprises**

Empirical studies show a prevalence of SMEs at lower-income level communities, making them the major drivers of innovation, entrepreneurship and local job creation and of the equitable creation of

### Box 1: Creative Private Sector Solutions to Improve Living Conditions

Many companies operating in Latin America and the Caribbean conduct their businesses in a socially responsible way, but they also set precedents in doing profitable business while providing or expanding economic opportunities for low-income groups linked to their supply chain.

**Pão de Açúcar**, a Brazilian retail chain, created an organization called Caras do Brasil whose suppliers are micro-enterprises. The 250 different types of products are sold in 25 Pão de Açúcar shops in Rio de Janeiro and São Paulo. Caras do Brasil provides a viable solution for small producers that otherwise would have no access to marketing or distribution channels. This initiative also helps develop new markets for small producers, contributing to local community development. Caras do Brasil allows the participating shops to widen their product line, differentiate from competitors and improve their reputations. However, the eligibility requirements for a microentrepreneur to become a supplier are demanding. These requirements encourage businesses to join the formal sector and small producers to legalize their activities by complying with existing regulations. They also encourage small businesses and producers to join the formal banking system by, for example, opening savings accounts.

**Helados Bon** is a successful ice cream company in the Dominican Republic whose management is interested in supporting entrepreneurship among the company's employees and helping develop local communities. The company believes that its business cannot prosper in an unstable and poor society. Helados Bon has outsourced 80 percent of the retail sales, distribution and other services to former employees, providing them with better financing conditions than would otherwise be available to them to start up their small businesses.

Helados Bon also launched an organic macadamia ice cream and topping. The company decided to combine the marketing of macadamia nuts with the conservation of natural resources. To do so, it established an agreement with Plan Sierra. The aim of this agreement is to help local farmers to grow macadamia trees, which, in turn, implies the reforestation of 140,000 hectares. Participating farmers have benefited from the introduction of sound agricultural management and access to new sourcing and marketing methods.

**Unión Fenosa** entered the Colombian energy market in 2000, a market characterized by scarce formal access to electricity in many areas and socioeconomic factors that contributed to fraud and waste. About two million people had illegal access to electricity, which also caused safety problems. The company learned that living conditions and income patterns of these users were not the same as in the regular electricity market and that they generated lower revenues for the company and high energy losses. Energía Social was created in 2004 to address a basic need for safe and legal access to electricity on a sustainable and cost-effective basis, for those communities that had been traditionally excluded and were considered not profitable by utilities providers. The company developed an innovative method of collecting revenue through the creation of small enterprises in the communities to read meters, collect payments and provide customer and repair services. Unión Fenosa also established a collective billing system. The company worked closely with central and local authorities to develop an appropriate tariff and billing structure and raise awareness of the need for reform of the legal framework of Colombia's energy market. The company has contributed to the "normalization" of 12,000 families living in the Colombian coast. Providing these communities with regular access to electricity resulted in an improvement in the basic infrastructure for local small businesses, schools and safe wiring systems.

wealth. SMEs operating in rural areas and small communities play a crucial role in contributing to the generation of economic opportunities and the social development of those mostly poor and disadvantaged segments.

While responsible practices in SMEs are less widely known, this does not mean that they are inexistent or exclusive to large companies. An IDB study of CSR practices in Latin American SMEs published in 2005 shows that the majority of SMEs in the region employ some sort of responsible practices with their clients, suppliers, subcontractors and the community where they operate, but only a few of them are capable of supervising and monitoring down the supply chain. These socially and environmentally responsible business SME practices have an important impact in expanding economic opportunities for low-income segments and contribute to improving the well-being of their communities, but they are seldom called CSR.

## Challenges

Although they have a long tradition in Latin America, philanthropy efforts have not achieved their fullest potential impact on improving people's livelihoods in a sustainable manner. Moreover, they have a rather paternalistic view of their role in society. These efforts have focused primarily on supporting education, health and cultural activities; while leaving behind the most important contribution in which they have comparative knowledge and advantage; namely, making market opportunities available to low-income groups. Progress needs to be made in this front for Latin American companies to be able to adopt practices that are socially and environmentally responsible and can generate economic opportunities for the poorest segments of the population.

The impediments that the public sector faces in its efforts to meet social and environmental needs heighten the importance of encouraging the private sector to assume its social and environmental responsibility. However, even though the business sector can contribute to improving social well-being and access to goods and services for those traditionally excluded, it is also true that it should not replace the State in the provision of basic public goods.

Responsible practices are having a positive social and economic impact on improving living standards in local communities while contributing to companies' bottom lines and reputations. These activities can also help improve corporate relations with governments and communities, making it easier to obtain the license to operate.

Despite the successful cases mentioned in box 1, several obstacles and challenges still remain. Companies are recognizing that, in order to do business in low-income market segments, they will need first to understand the differences in societal structures and address deficiencies in infrastructure, skills or financial capacity. In order to overcome these obstacles, companies need to look for strategic alliances with partners that already have the know-how to work with these groups. Some studies find that the same issues that slow overall social and economic development and the creation of strong private and public sectors are hindering the development of these CSR initiatives to help the poor. These factors include the lack of institutional capacity and a relatively less favorable business climate.

Companies need to develop sustainable relationships with low-income consumers, social organizations and local governments to fulfill their commitment to social responsibility. Understanding



the complexity of these networks, as well as the real concerns and needs of this population group, is of critical importance. Once this confidence is established, patterns of communication arise in both directions making it easier to identify and meet new needs while generating benefits to the company at the same time.

The cases presented in box 1 prove that profitability can go hand in hand with efforts to achieve the common good and improve living standards for all. The success of these initiatives refutes the notion that corporate involvement in poverty relief invariably has a negative impact on the bottom line. It also highlights the connection between the business mission of generating profits and corporate social and environmental responsibility. In these cases the companies helped the communities by creating jobs and generating more stable income streams and providing access to services. The initiatives also proved to be profitable.

As already mentioned, a number of companies, rather than focusing on selling to the poor, are including smaller companies from poor communities in their supply chains. Creating stronger links between SMEs, local communities and microentrepreneurs is critical for the success of business-led development. The main challenge is to provide micro and small enterprises with the necessary skills to become reliable business partners. Access to finance is critical to ensure affordability and enable people to buy goods and services that improve their lives as customers as well as suppliers, but financial assistance alone is not enough. Larger companies must help their smaller partners meet minimum requirements with respect to the quality of the goods and services they supply, as well as provide training and advise on best practices and efficient processes. In return, these smaller local businesses will provide valuable local knowledge, networks and understanding of local market conditions.

## **Recommendations to Foster Socially Responsible Behavior**

Responsible companies can make a significant, if not critical, difference in the social and economic development of Latin America. The region needs a responsible private sector to achieve sustainable, equitable and inclusive economic growth. Companies in all sectors, as well as governments, and civil society and multilateral organizations are responsible for encouraging a socially and environmentally responsible private sector. Effective poverty reduction through socially and environmentally sound business practices requires multifaceted and multi-stakeholder approaches.

CSR and access to economic opportunities are all-inclusive: all stakeholders are part of it and each one of them has a role to play. Further efforts to increase awareness of the social and economic benefits of CSR practices together with a set of the right incentives are needed.

Central and local governments should create the necessary legal framework and infrastructure to foster responsible corporate behavior. Little can be achieved when individuals and economies lack basic infrastructure, water, energy, health and education.

There needs to be a conducive policy environment and a legal framework that is not an obstacle for responsible company behavior and is supportive of these activities. A policy that includes the right incentives would be a powerful driver for firms to behave in a responsible manner and to actively be involved in expanding economic opportunities for the benefit of the majority. At the same time, a legal framework that allows creativity and innovation to implement business initiatives is also required.

Governments should also support the strengthening of institutions (such as business associations, networks and service providers as well as other civil society institutions and the media) so that they can play appropriate roles in society. This will require the adoption of a more participatory view of the roles of government, the private sector and civil society. Knowledgeable stakeholders will reward responsible firms contributing to better societies or will place the irresponsible ones in the spotlight.

The role of *civil society organizations* is relevant for two reasons. On the one hand, these organizations should be the voices that express society's concerns and expectations. We are all aware of the relevance of a well-informed citizenship on CSR issues. Citizens can demand basic rights as consumers and influence companies to be more responsible through their purchasing patterns. On the other hand, NGOs and other types of civil society organizations are closer to and have better knowledge of the capacity of low-income groups, as well as of the technical and financial skills they need to effectively become part of the value chain of socially responsible companies that can open up market opportunities for them. In that regard, companies should foster multi-stakeholder partnerships with civil society and the government in order to develop initiatives that allow low-income groups to become integrated into the market.

The role of *the media* is crucial to communicate and spread the CSR agenda. Their influence and power are immense both in portraying reality as well as in shaping public opinion. They should contribute to a better informed society and to advance toward a more responsible private sector. The media should focus on exposing bad corporate behavior and highlighting cases where the private sector is taking a positive leadership role in providing economic opportunities for the disadvantaged.

Because of their important impact on business competitiveness, *financial markets* can have a strong influence on corporate behavior by exercising a monitoring role or through more direct actions. Financial incentives to firms that, as part of their corporate social responsibility, are interested in providing economic opportunities to low-income communities (some of which might need technical assistance to be able to sell their products or services) would also be very helpful in fostering responsible behavior. These could be provided by multilateral financial institutions, government agencies or the private financial sector itself.

*International donors and multilateral development institutions* can play a powerful role in fostering CSR practices and synergies among corporations, civil society and governments. International financial institutions could use their resources to finance projects that promote CSR practices that expand economic opportunities for low-income groups, build the capacity of institutions that foster CSR, and educate all stakeholders to demand responsible business practices and responsible behavior from their private sector clients, which would enhance credibility and reduce risks. Development institutions could act as independent bodies to develop compliance, reporting and accountability principles and guidelines to be used in monitoring progress.

## Concluding Remarks

Problems affecting the most disadvantaged require new approaches and innovative solutions. With a quarter of the population of Latin America and the Caribbean living on less than two dollars a day, the urgency of the matter is clear. Businesses can enhance their contributions to addressing this situation

by creating wealth and opportunities. Providing access to the goods and services that help the poor earn a living fosters their development and makes it easier for them to become self-reliant.

The implementation of development models that combine good public and private governance, social entrepreneurship and corporate social and environmental responsibility with private sector resources and innovation is one of the most effective ways to promote sustainable development.

Providing access to economic opportunities yields benefits that are central to the concerns of many Latin American governments (such as preserving the environment, creating jobs and promoting social values). Often, the private sector is better able to achieve these goals with less effort and increased sustainability. The private sector can improve living standards by bringing the most disadvantaged into mainstream economic activities, thus increasing prosperity for all. It is a win-win equation that all stakeholders, including governments, should foster.



## ■ The Role of Ecosystems in Enhancing Economic Growth and Social Development

Ecosystems provide the basic flow of environmental services that make human life and economic activity possible. Recently, the most comprehensive scientific assessment of ecosystems worldwide, the Millennium Ecosystem Assessment<sup>1</sup> commissioned by the United Nations, revealed that 60 percent of ecosystem services are being damaged or used unsustainably. The services that are more degraded or at risk are: fisheries, genetic resources, fresh water, and regulation of air quality, erosion and natural hazards. The scientific rigor of the Millennium Ecosystem Assessment and the important social and economic implications of its findings are a clear wake-up call to the development community, highlighting the importance of conserving and managing the goods and services from ecosystems that are vital to human well-being, social development and economic growth. This chapter asserts that the conservation and sustainable management of ecosystems makes good economic sense. Business opportunities and markets can be tapped and stimulated to increase the value of goods and services derived from ecosystems, and major benefits can be obtained from sustainable food supplies, increased well-being of the poor, gains in productivity, better health and reduced threats of natural disasters. Government policies, multilateral development financing and private sector initiatives can significantly contribute to controlling and reverting ecosystem deterioration.

While it can be argued that the conversion of natural ecosystems has been carried out for the sake of economic development, its costs are evidenced by the depletion and deterioration of ecological services that are putting pressure on the sustainability of economic activities, such as tourism, agriculture, forestry and fisheries. Threats

This chapter asserts that the conservation and sustainable management of ecosystems makes good economic sense.

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<sup>1</sup> The Millennium Ecosystem Assessment was the largest study on ecosystem health ever carried out on the planet. The study took 5 years to complete and required the participation of 1,360 experts from 95 countries in all continents.

to the health of ecosystems are quite evident throughout the region. Fish catches are reported to have decreased in the Caribbean and along the Central American coast; significant bleaching and decay of coral reefs are reported in the Caribbean and Pacific regions; 332 animal and plant species are threatened with imminent extinction throughout the region, increasing the loss of biodiversity; sources of fresh water are diminishing and becoming increasingly polluted; Andean glaciers have retreated significantly from historical levels (for example, the Ruiz and Huila volcanoes in Colombia); soil erosion and desertification patterns are on the rise; and the vulnerability to natural disasters has increased, particularly in lowlands and coastal areas.

In addition, the poor are seeing their situation worsen. For example, small producers in rural communities and coastal zones are losing sources of income that depend directly on the goods and services that local ecosystems provide. Moreover, because they lack the means to protect themselves from illnesses and to gain access to public health services, they are disproportionately affected by polluted ecosystems. If all of these costs are internalized in national income accounts, they could add up to a significant percentage of gross domestic product. For instance, Mexico has reported environmental costs as high as 10 percent of GDP.

## **Addressing Key Linkages and Policy Options**

In the last two decades, policymakers have gained awareness about the supporting (e.g. nutrient cycling and primary production), provisioning (e.g., medicines and fresh water), regulating (e.g., carbon sequestration and flood regulation) and cultural (e.g., spiritual and recreational) services of healthy ecosystems. The linkages between these ecosystem benefits and social and economic well-being are well established. Forests not only save lives by controlling landslides and floods, but are also the source of numerous medicines and other nontimber forest products that are finding markets worldwide and improving the livelihoods of local communities. Coastal and marine ecosystems also minimize hurricane and storm surges and provide food and recreational opportunities. These and other ecosystems are the source of multiple combinations of services that deliver basic materials, health, security, good social relations and the opportunity to be able to achieve what an individual values doing and being. Access to fresh water, food, medicines, clean air and climate regulation, among other benefits, are derived from and depend upon the functioning of ecosystems.

While all ecosystems experience the indirect effects associated with demographic changes and growing per capita consumption, five major drivers have been identified to cause the greatest impact on ecosystems, particularly upon biodiversity and human health. These drivers (which have local, national and global implications) include the overexploitation of natural resources, habitat transformation, the introduction of invasive alien species, increased pollution and climate change. The impact of these drivers on ecosystems is increasing and, in the case of pollution and climate change, the changes are happening at an increasing rate. In the not-too-distant future, the social and economic cost of not taking appropriate actions may become too high; therefore, it is important to address and manage the challenges associated with these drivers that promote the deterioration of ecosystems.

Economic processes and policies that affect decisions on the use of natural resources need to internalize long-term environmental sustainability outcomes. For example, policies that lead to the uncontrolled conversion of land to extensive agriculture place significant pressures on water, soil and forest resources. In eastern Bolivia, the market-driven agricultural sector has led to an expansion of the agricultural frontier, which, in turn, has become an increasingly important driver of land-use change. The rapid expansion of soybean production in the Bolivian and the Brazilian Amazon, or the expansion of farm land into marginal hillsides in Central America, comes at the expense of fragile resources and, often, at the expense of local communities and small-scale farming.

Five major drivers have been identified to cause the greatest impact on ecosystems, particularly upon biodiversity and human health.

As suggested above, the cultivation of soybean has been one of the most significant market phenomena of the last decade. It is driven in part by a growing demand from China and other Asian countries, which has led not only to rapid growth in mechanized agriculture in Brazil and Bolivia, but also to increasing deforestation rates. Similarly, since the mid-1990s China has tripled its imports of timber from countries such as Peru and Bolivia. Policymakers must be aware of the long-term social and environmental impacts of these market forces and design timely and appropriate mitigation measures.

Globally, stocks of large fish such as grouper, cod, swordfish and tuna have declined by 90 percent in the last 50 years. In many areas of the Caribbean and the Pacific, numerous spawning aggregations of key species such as grouper (*Epinephelus striatus*) have been fished to extinction. Both scientists and fisherman have seen a dramatic decline in fish stocks due to overfishing, pollution and habitat destruction. Recent reviews have concluded that fisheries are the most important cause of coastal and marine biodiversity loss. The US National Research Council assessed the impact of fishing and concluded that the fishing sector is responsible for major impacts such as habitat destruction and changes in genetics, demography and food webs. National marine parks and reserves have been established to help troubled fisheries in countries such as Belize and The Bahamas. The Exuma Cays Land and Sea Park, which was established in The Bahamas more than 40 years ago, has become a model of success and inspired other marine parks around the world.

Development projects and programs that result in major physical modification of land spaces, rivers and water bodies cause significant habitat transformation. Urbanization, which in Latin America is characterized by urban sprawl and unplanned settlements, has altered the ecosystems upon which these cities depend. Poorly designed roads and infrastructure can cause similar effects in terms of expanding the agricultural frontier, promoting fires, facilitating the extraction of native species and fragmenting vital ecosystems. Development planners and policymakers need to ensure that careful social and environmental considerations and project alternatives are evaluated to minimize and mitigate damages. Mitigating damages and enhancing environmentally sustainable outcomes maximize development benefits for all.

Ecosystems are highly sensitive to the introduction of invasive alien species. Invasive alien species can alter ecological balances and native populations of species, and result in significant losses to local economies. An illustration is the disappearance of hundreds of fish species in Lake Titicaca in Peru and Bolivia as a result of the commercial introduction of the trout, which has disrupted the diet, food supply and economy of native communities.

Pollution is another driver that significantly affects the health and sustainability of ecosystems. In particular, the greatest effects are often associated with nutrient loadings (such as nitrogen, phosphorus and sulfur) into fresh water and coastal ecosystems. Lake Yojoa in Honduras, Lake Managua in Nicaragua and most rivers in the region present worrisome levels of pollution and nutrient loads with severe effects on human health and on the sustainability of living conditions in those waters. Adequate government investments and policy options designed to effectively and efficiently curb pollution are required to revert or control ecosystem degradation.

Climate change has significant direct effects on ecosystems, and those impacts have local, regional and global consequences. Rising temperatures are affecting not only the earth's ice sheets, but also glaciers throughout the Andean region. Rising sea levels are threatening widespread flooding and severe storm damage in the low-lying areas of the Caribbean. The effects of climate change have also altered the health of coral reefs, the distribution of species and migration patterns, and disease outbreaks throughout Latin America. For instance, a recent study in Costa Rica suggests that the high mortality rate of a number of unique frogs is due to a sudden increase in water temperature. These amphibians do not have the ability to protect themselves from viruses and diseases that thrive in warmer water temperatures. Climate change is also affecting productive sectors such as agriculture and fisheries, and increasing the vulnerability of many areas in the region.

Deforestation is also altering the climate of key ecosystems such as the Amazon. Scientists have found that deforestation directly affects global biochemical processes by contributing between 10 to 25 percent of the total amount of greenhouse gases generated by humans. The increasing interest in biofuels (e.g., ethanol) needs to be carefully assessed and managed so that it does not turn into another driver of deforestation that puts additional pressure upon tropical ecosystems, especially if these initiatives are based on species that prosper in tropical climates and soils, such as palm oil, sugar cane and elephant grass.

## **Tapping Benefits for All Through Market Opportunities**

It has been demonstrated that small farmers and rural communities increase their levels of income and their food security, as well as their health and overall livelihood, through activities that protect their ecosystems. Also, the business community can make long-term gains through practices that increase the value and market opportunities of goods and services, and through savings obtained from environmentally sound production processes.

### **Emerging Markets**

Awareness about the increasing negative impacts of unsustainable development activities on the world's ecosystems is also drawing attention to the need for a development paradigm that promotes healthy ecosystems and sustainable incomes. As human demands grow and environmental goods and services become more scarce and fragile, those who bear the costs of degradation are exploring innovative initiatives to reduce those risks and costs by financing environmentally sound development opportunities. Low-income producers, peasants and indigenous communities are seeking compensa-



tion for the costs of maintaining healthy ecosystems. The common goal of promoting conservation, increasing incomes and reducing costs is calling for the creation of ecosystem markets in many countries in Latin America and the Caribbean. Clear opportunities are apparent in the creation of markets for biodiversity, carbon, water and ecotourism.

## Biodiversity Markets

About 1.8 million species have been described so far and scientists estimate that we share this planet with approximately 12.5 million species. This means that experts still have to describe about 86 percent of these species, most of which are found in the tropical countries of Latin America and the Caribbean. The region includes six of the so-called megadiversity countries (Brazil, Colombia, Ecuador, Mexico, Peru and Venezuela) and harbors over 40 percent of the world's biological diversity. Therefore, it is not surprising that biodiversity has been at the forefront of policy discussions and concerns among stakeholders in the region since the late 1980s.

Biodiversity offers great potential for the establishment of markets for food (e.g., crops, aquaculture and wild foods), fiber (e.g., timber and cotton), genetic resources, biochemicals, natural medicines and pharmaceuticals, among others. The combined global market for these resources is well over US\$350 billion per year. The challenge is to harvest and use them in a sustainable manner. Some markets acknowledge this goal by assigning a premium to those goods that are produced according to certain standards. Organic products that are certified as pesticide free are frequently more expensive than those grown following nonorganic methods. Consumers that care about the rainforest usually seek brazil nuts, shade-grown coffee and nontimber forest products (e.g., oils and hearts of palm) that are also sold at a premium, usually in international markets.

Brazil nut (*Bertholletia excelsa*) is the most environmentally sound and profitable nontimber forest product harvested in the Amazon regions of Bolivia, Brazil, Colombia, Ecuador, Peru and Venezuela. The brazil nut tree is a good example of the complex and common relationships found in the Amazon rainforest where plants and animals are inextricably intertwined. This tree is so specialized that its pollination (and hence, fruit production) requires one particular insect species (the Euglossine orchid bee). Moreover, only one species of animal is capable of chewing through the extremely tough fruit pod to disburse the seeds for new tree growth. The brazil nut tree is also a sustainable source of income for local communities. This extractive activity represents more than half the yearly income for thousands of families in these areas, and serves as the political justification for the protection of the areas where the brazil nut grows. Brazil nut trees occur in natural dense stands, which make the *castaños* economically attractive. These areas, of several hundred to a few thousand hectares, are given in concession to local families and/or to larger landholders, for the extraction of nuts. A mature tree can produce between 250 and 500 pounds of brazil nuts per year. Bolivia, for example, exports about US\$38 million every year, which is equivalent to 50 percent of the global production of brazil nuts.

The combined global market for these resources is well over US\$350 billion per year.

The importance of shade coffee to biodiversity is a function of the size, location and composition of the farms that grow it. Shade coffee farms incorporate a wide variety of plant and animal species,

including trees that fix nitrogen, bear fruit and provide fuelwood and timber, as well as other food crops such as beans and bananas. Shade coffee farms are frequently located adjacent to biologically important protected areas. They are an important source of income for local communities living in protected areas such as the El Triunfo Ecological Reserve in Chiapas, Mexico. Sustainable coffee farms in and around these protected areas buffer them from destructive economic activities, and function as biodiversity corridors connecting the protected areas and expanding their effective size. However, the conservation benefit of shade coffee farms is being eroded in many areas as farmers shift from a biodiverse shade-based growing system to an approach that involves clearing other vegetation and growing high yielding coffee plants in full sun with chemical fertilizers and irrigation. The impact of this shift on biodiversity is apparent in the drop-off in bird populations. For example, while shade coffee farms in Chiapas (Mexico) provide a habitat for up to 140 bird species, farms that grow coffee in full sun are typically home to fewer than 20.

Other productive and commercial activities, such as fishing, are major sources of income for local communities in Latin America. In 2004, for example, commercial fishing contributed US\$95.3 million to the economy of The Bahamas. Similarly, in 2001 the fishing industry was estimated to produce at least US\$100 million and more than 20,000 direct jobs in the Brazilian Amazon. Cultivation of herbivorous fish such as the tambaqui (*Colossoma macropomum*) can reach mean annual yields close to 4,500 kg/ha in tropical regions under ideal conditions. Small-scale aquaculture has been a profitable and ecologically sustainable practice for small family farms in the Andes and Amazon regions of South America.

Capturing the benefits of the sustainable production of goods also involves defining what is sold and creating the appropriate regulatory framework. This process is relatively simple for some goods such as crops and timber, but more complicated for less tangible resources such as genes and

biomolecules that are often regarded as information. Since the Convention on Biological Diversity came into force in 1993, some countries in Central and South America (e.g., Costa Rica, Colombia, Peru, Ecuador, Bolivia and Venezuela) have adopted access and benefit-sharing policies that clarify rights over genetic and biochemical resources and pro-

The fishing industry was estimated to produce at least US\$100 million and more than 20,000 direct jobs in the Brazilian Amazon.

pose contracts as the main mechanism to negotiate access and benefit-sharing issues among users and providers of these resources. While Costa Rica's legislation has allowed the creation of a market for genetic and biochemical resources, other nations are still struggling with technical and political concerns that have prevented the flow of benefits derived from these resources. The Costa Rican experience shows that bioprospecting by itself is not likely to generate significant investments to ensure the conservation of rainforests. However, this initiative has provided other benefits that include training, the construction of labs and the possibility to add scientific value to products. Examples of industries with potential to generate these and other benefits from genetic and biochemical resources include the pharmaceutical, botanical medicine, seed, crop protection and biotechnology industries.

Land-dwelling organisms, particularly plants and microorganisms, have been the basis of the early development of pharmaceutical and biotechnology products and continue to be the source of new products, albeit with declining rates of success. Consequently, many scientists have turned their

attention to the potential offered by marine organisms and microorganisms, including the so-called extremophiles that are found in extreme habitats where nothing else is able to survive. In the last few years, scientists have accumulated enough evidence to demonstrate that terrestrial and marine organisms that were thought to be the source of active compounds are just the hosts of other microorganisms that are the true producers of these compounds. This finding has interesting implications for the sustainable supply of compounds needed for clinical trials and the development of end pharmaceutical products. Marine organisms also have great potential as a source of compounds for other industries such as the cosmetics, agribusiness and orthopedic industries. Pseudopterosins, for example, are a group of anti-inflammatory and analgesic compounds isolated from the Bahamian soft coral (*Pseudopterogorgia elizabethae*) that have cosmetic applications. A few years ago, the company Estee Lauder brought one of the pseudopterosins to market in record time as an additive in the cosmetic line Resilience. However, it should be noted that since The Bahamas lacks a national access and benefit-sharing policy, it has been unable to capture the benefits derived from this species of soft coral.

## Carbon Markets

Just over three decades ago, the link between deforestation and the greenhouse effect had not yet been made. Today, while there are still a few nonbelievers, the international community of countries is convinced about the need for quick action to minimize the global impact of the greenhouse effect. The Kyoto Protocol of the United Nations Framework Convention on Climate Change provides a mechanism for selling carbon sequestration services. Clearly, storing carbon in forests is an attractive, cost-effective, and environmentally sensitive solution to the climate change problem. Carbon sequestration is achieved by absorbing and storing carbon through activities such as reforestation (Nicaragua), agroforestry (Colombia) and reduced-impact forest management (Dominican Republic). Since carbon in the atmosphere is a global issue, it makes no difference where carbon sequestration benefits are generated.

Creating a market for carbon sequestration also requires great technical, legal and commercial efforts. These include: (i) developing carbon models in order to quantify the service, (ii) creating a national carbon registry and (iii) developing a carbon ownership legislation to clarify property rights to the resources. Such efforts are already being made in the countries mentioned above and other Central and South American nations.

## Water Markets

Ecosystems provide valuable hydrological services. Forests, for example, not only provide clean water but also reduce sediment loads in waterways, which, in turn, reduce the sedimentation of reservoirs and the associated production and maintenance costs for irrigation systems. They also regulate the timing of water flows and reduce flood risks during the wet season. Taking into account these and other benefits, countries such as Ecuador, Costa Rica and Colombia have designed systems of payments that compensate land users for preserving watersheds under forest cover. Designing and implementing this system involves the following key steps: (i) identifying and quantifying water services, (ii) identifying key beneficiaries and charging them for water services, (iii) developing market and payment

systems that work and (iv) addressing institutional and political issues. It is important to keep in mind that water benefits are easier to capture when users are already organized (e.g., a municipal water supply or irrigation systems) and when payment mechanisms are already in place. If this is the case, then payment for water services can be added to existing channels and domestic users can be charged an additional fee for conservation.

## **Ecotourism and Nature-based Tourism**

The global market value of ecotourism and nature-based tourism reaches between US\$200 and US\$260 billion annually. This market generates direct local and national benefits. It is a source of income for small and medium enterprises that generate employment for both skilled and unskilled labor in critical areas of marine and terrestrial ecosystems. In Costa Rica, ecotourism generates about US\$360 million a year. Ecotourism lodges in Peru, Bolivia and Ecuador provide examples of this trend throughout the region. Their main contribution to conservation is the creation of local jobs that, in turn, generate a vested interest in the conservation of ecosystems and the services and goods they provide.

## **Priority Actions for Governments and the IDB**

Governments, as well as IDB financing and technical support, can play a significant role in addressing the problems facing the ecosystems of the region. To ensure that ecosystem goods and services are provided and maintained in a sustainable manner, and to foster emerging markets, as discussed in the previous section, key areas for government and Bank support include changing and improving the policy framework, enhancing governance, supporting scientific knowledge and its dissemination, investing in public goods, working with businesses and the private sector and mainstreaming the environment across sectors.

### **Changing or Improving the Policy Framework**

Economic, trade and sector policies have the greatest impact in terms of human behavior and the allocation and utilization of resources. The value of environmental goods and services should be measured in economic terms and incorporated into cost-benefit analyses in policy decision-making processes. It is in this regard that conservation efforts will be meaningful and appealing, not only to planners and policymakers, but to producers and consumers as well. The Bank is well positioned to bring together cross-sectoral interests through policy dialogues, and help create public-private partnerships to mainstream concerns about the health of ecosystems into country development objectives.

### **Enhancing Governance**

Good governance is at the heart of the rational management of resources and the resolution of conflicts. Governments and the IDB can greatly improve governance by strengthening national and local

institutions, regulatory frameworks and the rule of law. Another ingredient of good governance is supporting greater civil society participation and empowering local communities so that they are able to participate in decision-making processes that affect their livelihoods.

## **Supporting Scientific Knowledge and Dissemination**

The lack of scientific knowledge about ecosystem services and the poor dissemination of that knowledge, contribute to maintaining a state of ignorance that perpetuates the misuse and overexploitation of ecosystems. This is an important area for governments and the IDB to support, in partnership with the scientific community, specialized NGOs, and local and indigenous communities who have unique traditional knowledge about the use and benefits of their natural resources.

## **Investing in Public Goods**

For the most part, many goods and services provided by ecosystems are public in nature, from fresh water to biodiversity resources. Therefore, their management and conservation require specific and targeted public investments. Recognizing the importance of public goods in a regional context, the Bank has developed a Fund for Regional Public Goods, which is an innovative tool to finance, among others projects, the protection and management of regional biological corridors, information sharing, and regional coordination and capacity building.

## **Working with Businesses and the Private Sector**

As stated above, it is increasingly recognized that there are significant business opportunities associated with the conservation and management of ecosystems. The concept of payments for environmental services is a key approach, which is beginning to take hold as an instrument for sustainability, and one that allows the generation of markets that benefit both users and producers/owners. Carbon credits, ecotourism, water markets and tradable permits have shown that they can produce positive environmental and financial outcomes. In addition, industries are increasingly recognizing that it is good business to adopt social and environmental corporate responsibility principles and cleaner production processes that save resources, reduce waste and protect the environment at the same time. The IDB has the tools and financial means to support these private sector initiatives. Governments should provide an adequate incentive framework to encourage corporate environmental responsibility.

## **Mainstreaming the Environment Across Sectors**

A significant contribution to ecosystems health is possible when environmental issues are mainstreamed across economic sectors such as agriculture, tourism, transportation and energy. If environmental sustainability criteria are strategically incorporated into development plans for these sectors, the impact of those plans on ecosystems will also be positive. Given that governments and the IDB invest significantly in these sectors, ensuring adequate environmental consideration early-on will go a long way toward contributing to the sustainability of ecosystems in the region.

## Concluding Remarks

Healthy ecosystems are essential for our well-being and sustainable development. They can no longer be taken for granted or be used as free and open-access resources for extracting services and goods, or as recipients of discharge and waste generated by human activity. Healthy ecosystems provide a vital function to society. They are the source of significant economic, environmental, social and cultural benefits.

Ecosystems in Latin America and the Caribbean are deteriorating rapidly. Those who have the most to lose in this situation are the poorest groups in society. Governments, multilateral development organizations, civil society and the business community must take a proactive stance and build a society that prospers in harmony with healthy ecosystems. It is important to assume these responsibilities sooner rather than later for the sake of present economic development and the well-being of future generations.

The IDB, through its new Environment and Safeguards Compliance Policy, and by embracing principles of corporate social responsibility is signaling a commitment to do no harm and to enhance the value and opportunities derived from ecosystem goods and services. Maintaining and ensuring the long-term sustainability of healthy ecosystems is not only economically wise but a moral responsibility.

# ■ Mobilizing the Rural Potential

**T**he development of rural areas is critical to the improvement of national well-being in most countries. In Latin America and the Caribbean, however, the record of achievement in rural development is relatively poor. Most governments and development agencies de-emphasized rural development in the past twenty years, and rural poverty remains pervasive despite the high rates of rural-to-urban migration.

With the adoption of the Millennium Development Goals (MDGs), rural development is making its way back onto the development agenda. Specialists working in this field argue that policies and programs today should differ from the top-down integrated approach of the past. The recommended territorial or area approach combines efforts related to the provision of public goods, the promotion of productive activities, and capacity building at the national and local levels. This chapter sets out the potential merits of this new approach and makes the case for rural development as part of a strategy for poverty reduction and growth.

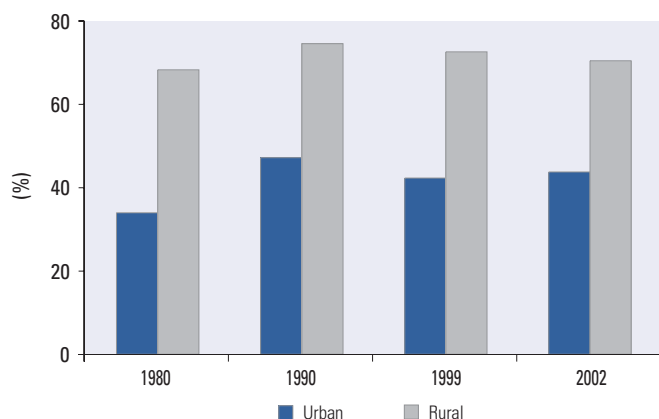
## The Need for Poverty Alleviation in Rural Areas

In many of the region's countries, poverty is synonymous with rurality. Chronic poverty rates in Latin America in 2002 were nearly three times higher in rural households than in urban ones. Almost two thirds of rural dwellers were living in poverty, compared to 38 percent of their urban counterparts. Only a few countries were able to reduce rural poverty, and in most cases that decline was the result of migration from rural to urban areas. Rapid urbanization in the region means that, today, only one fifth of the population lives in rural areas compared to 35 percent in 1980. Despite these changes, the region's absolute rural population has remained unchanged since 1970.

Nevertheless, overall progress has been made in the social sectors and in establishing social infrastructure. Latin America is narrowing its urban-rural education gap; school dropout rates are declining more quickly in rural areas than in cities; and progress has been made in terms of the quantity and quality of rural roads, electricity and telephone services, as well as in access to mass media.

But progress in the rural economy was selective and much less effective. The reforms of the 1990s created an enabling environment for increasing private investment, and helped to boost nontraditional agricultural exports, thereby promoting the productive restructuring of commercial agriculture.

**FIGURE 1**  
**Rural and Urban Poverty in Latin America**



Source: Dirven, M. 2003. Alcanzando las metas del milenio: una mirada hacia la pobreza rural y agrícola. Santiago, Chile: ECLAC.

The disengagement of the public sector, and insufficient involvement of the private sector in financial and productive services, have caused major gaps to appear, which have made agriculture less competitive, particularly in traditional sectors.

The structure of rural employment has changed substantially. In 2000, less than 24 percent of the economically active population worked in agriculture, a considerable decline from the 42 percent registered in the 1970s. Some 44 million people make up the region's agricultural workforce. Roughly 20 million rural dwellers (close to 40 percent of the total rural labor force) now work off the farm. In the last few decades the relative weight of nonfarm rural pursuits in the employment of rural households has climbed by over 4 percent each year, on average, whereas the on-farm employment share dropped by 0.4 percent annually.

In the second half of the 1990s, rural earnings from nonagricultural employment accounted for an average of 47 percent of aggregate rural income. However, there is an increasing interdependence between modern agriculture and nonfarm employment as most rural nonfarm employment opportunities are concentrated in the fast growing agricultural areas. As a result, agricultural development is critical to capturing the potential of rural areas and people.

Improved awareness of the importance of environmental issues has led to an increased recognition of the contributions of rural areas to economic and environmental sustainability. The growing demand for healthy food, clean water and biofuels, as well as new environmental services like carbon fixation or the provision of recreational services, present new investment and income opportunities for the rural population.

To take full advantage of the rural potential, and to reach the poverty reduction objectives of the MDGs, the development agenda needs to pay adequate attention to rural development and address the main structural problem facing the rural population; namely, access to services and markets.

## Rural Development and Poverty: Lessons Learned

Faced with the lack of effectiveness of past rural development efforts, bilateral and multilateral agencies reduced their budgets for rural development and agricultural programs. However, the adoption of the MDGs has at least indirectly placed rural development back on the agenda: it is difficult to argue that the poverty reduction objective of the MDG can be achieved without a greater reduction in rural poverty. To improve the effectiveness of this effort, national governments and development agencies must rely on and share the wealth of experience amassed during the last few decades.

In general, past rural strategies pursued two separate focuses that were not knitted into a strategy to build a modern, more equitable society. The first focus was on modernizing agricultural



production, so that it could become an engine for economic growth. The second focus was to pursue rural development through an assortment of programs and projects to combat the social and economic exclusion of the rural poor. Unfortunately, these isolated measures were never integrated into stable policies.

Rural development strategies need to look more to poverty reduction options that are based on the heterogeneity of the regions and their populations. Not all rural areas have the potential to support a sustainable economic development process. Therefore, development programs should include options to address issues such as migration and explicit social interventions to promote changes in assets. Other options include efforts to reduce vulnerability, to empower the local population by building the human and social capital needed for democratic institutions to operate, and to strengthen the participation of rural organizations in decision-making processes. The approach chosen should emphasize sociocultural inclusion and be based on in-depth knowledge of the local situation in the territory.

While agriculture is important, the productive transformation of rural areas encompasses more than agriculture. The concept of rurality that has reigned in Latin America and the Caribbean is now obsolete. Reliance on that notion has affected the quality of the design and implementation of development strategies, policies and programs. The shortcomings of the preexisting concept of rurality included an underestimate of the weight of the rural sector, confusing “rural” with “agricultural,” and did not recognize the existence of interactions between rural and urban areas.

Policy reforms have curtailed public action in the rural sector. The structural reforms enacted in the last decades eliminated many of the sector-oriented public policy instruments of the past, such as subsidies, differentiated exchange rates, exemptions, the purchasing power of State enterprises and commodity price fixing. While public sector support for agricultural development activities shrunk to an average of under 5 percent of total public spending, the private sector failed to fill the gap in the provision of services, despite the fact that the reforms created an enabling environment for increasing private investment. As a result, the reforms helped boost nontraditional agricultural exports, thereby promoting the productive restructuring of commercial agriculture. The disengagement of the public sector, and insufficient involvement of the private sector in agricultural services (such as credit, research, technical assistance and plant and animal health) created major gaps, which have made traditional agriculture less competitive.

Public rural expenditures are mainly allocated toward “private” goods. Around 50 percent of public rural expenditures in most Latin American countries are spent for private (nonsocial) goods that mainly benefit specific producer groups. Insofar as expenditures in this area are limited, expenditures on private goods diminish the provision of public goods such as rural education, rural roads, health and research. The poor allocation of rural expenditures leads to slower growth in agriculture and rural activities, and has a particularly negative impact on small rural producers.

Institutional weakness poses a serious hindrance to rural development. As the countries of Latin America and the Caribbean tackle the imperative of expanding rural agricultural and nonagricultural activities and manage demands for improvements in rural competitiveness in a global economy, it is becoming clear that some major institutional shortcomings need to be addressed in order to launch a sustainable rural development process in the region. In general, the region needs effective and dynamic public and private institutions to serve the demands of the rural sector.

Few government organizations have the structure needed to tackle the multisector, multidimensional nature of rural development, especially with respect to creating incentives for cooperation, redressing asymmetries and guaranteeing the enforcement of contracts. Their work is fragmented by sector, it lacks effective coordination mechanisms and they frequently have trouble improving on the status quo or overcoming the inertia of traditional practices. In many instances, nongovernment organizations have successfully overcome some of these constraints, although their focus is issue-specific and local. Given that the role of the State changed in the 1990s and fiscal constraints are now more pressing, there is a greater need to forge partnerships with the private sector and to use fiscal resources efficiently.

Institutional development needs to emphasize participation and consensus building. Renewed emphasis is needed on institutional development and the modernization of State policies and institutions dealing with the rural sector. In addition, new public policies should be established to promote private sector activity, as well as civil society and local government actions. The full engagement of local stakeholders in the conceptualization, design and implementation of rural initiatives will empower the local society, and ensure the sustainability of those initiatives and the creation of a dialogue between the public and private sectors.

Attention to the environmental, social and cultural dimensions is crucial in geographically-targeted projects. Environmental problems in the rural sector arise, among other reasons, from market failures and governance shortcomings. Simply enacting laws and creating institutions or financing mitigation or remediation measures will not fix problems that stem from the unsustainable management of rural natural resources. Economic policies and incentives also shape the way in which individuals, producers, firms and institutions use natural resources.

The lessons learned from past experiences need to be incorporated into the design of new rural development policies and programs to avoid the errors of previous integrated rural development programs and harness the potential of rural areas. The modernization of national policies and of the way services are provided in rural areas should go hand in hand with support for local institutions to enable their participation. This includes empowering local institutions and building and strengthening their operational capacity, as well as efforts to bring the public and private sectors together to formulate a joint agenda for specific rural areas. Linking national and local development processes is critical for realizing the full potential of rural areas.

## **Empowering the Poor to Play a Role in the Economic Transformation of Rural Areas**

Rural territorial development is understood as the simultaneous process of productive, institutional and social transformation in a given rural area. Productive transformation focuses on activities that promote sustainable economic growth. Institutional and social transformations concentrate on creating stronger and more able institutions and investment incentives and on improving the well-being of the rural population to reduce poverty and promote equity. These objectives should be developed simultaneously, in order to generate employment and earnings required to reduce poverty, and to ensure that this new approach will be comprehensive and sustainable, rather than the scattered efforts

of the past. Actions at the national and local level are necessary to promote the new territorial rural development approach.

## **At the National Level**

Differentiated territorial approaches and interventions are necessary to stimulate the different economic potentials of rural areas. In the past, rural development challenges were not tackled with comprehensive approaches or an adequate allocation of resources. Rural development, broadly defined, should be conceived as part of a national development vision. This does not mean a return to integrated rural development programs, which failed because of their rigid top-down approaches and lack of participation and of local community empowerment.

Rural development strategies and policies must be consistent with macroeconomic policies and encompass the entire rural environment, as well as rural-urban relations. They must also address the multifaceted nature of the livelihood strategies employed by rural families and map out options for on-farm and nonagricultural employment, employment in more than one sector and migration. To that end, strategies and policies will need to be socially and territorially differentiated. From their earliest stages, programs and projects should be designed with an eye to their potential for replication and prospects for scaling up successful small projects into farther-reaching programs with larger impacts. There is a need to develop mechanisms to monitor the impact of national policies at the local level and to provide feedback for their improvement.

Integration into local and/or international markets is a must for a successful productive transformation process. Development approaches posited upon self-sufficient poor households may, in the best of cases, help stabilize poverty, but they are highly unlikely to reduce the ranks of the poor. Policymakers must keep the rural sector in mind when designing strategies to open up regional and world markets for agricultural and agroindustrial products and ascertain the impacts of those policies on the rural poor. In addition, the capacity of rural residents to participate in regional and global markets with higher quality products needs to be consolidated. This entails shifting from the supply-driven strategy that characterizes many projects to a strategy driven by external demand, be it from domestic or international markets.

The productive transformation process needs to be supported by a consolidation of public policy reform programs. This is aimed at reducing market distortions; facilitating temporary adjustments to compensate low-income producers and consumers for the impacts of reform policies; and developing new instruments to support the private sector, especially to strengthen the capacity of small and medium businesses and producer organizations.

Special attention needs to be given to the modernization of productive services for the private sector. This includes strengthening systems that provide information about markets, promote exports, and are involved in agricultural health and food safety as well as quality certification for agricultural products. In addition, it also involves research, the development and transfer of technology, business and professional training and strengthening intellectual property rights. The challenges posed by free markets require demand-driven, flexible and high quality services. Finally, innovative implementation instruments should be developed to tackle the problem of transaction costs in rural areas.

### **Demand-driven Productive Services**

In Bolivia, the Instituto Nacional de Tecnologías Agropecuarias (IBTA) was no exception to the rule of inefficient national agricultural research and extension services. Technology transfer services did not meet the needs of small and medium farmers. When IBTA was closed in 1998, the Bolivian government (with the support of international development organizations) set up a new technology transfer service, the Sistema Boliviano de Tecnología Agropecuaria (SIBTA). The system created four private foundations with government participation that would work with four major agricultural areas. The principal objective of the foundations is to act as brokers between the needs of farmers and the technical assistance provided by private for-profit or nonprofit organizations. First, the foundations identify the most important value chains for their regions. Second, they meet with the farmers associations of the value chains to identify, in a participatory process, bottlenecks in the chain. Once they are identified, the foundation assists the farmers in the development of project profiles. Based on the profiles, farmers associations, together with service suppliers, create project proposals. Finally, the best projects are selected for financing. The most important innovation is the flexibility of the system to respond to the demand of the farmers association and, at the same time, play an active role in promoting the system and its use among farmers. This innovative process enables farmers to express their concerns about the system, giving them, for the first time, access to the technological services they really need.

Lowering transaction costs through innovative strategies is also important for the development of rural financial markets and to facilitate the investment that is essential to help producers diversify and modernize. The State must play an active role in the establishment and/or consolidation of these financial services, but should not be directly involved in their delivery. Some of the changes needed to improve access to credit by small producers and expand rural financial services involve reforms of the legal framework to make it easier to pledge assets such as inventories, livestock and accounts receivable as security for loans. Also needed are reforms that would allow intermediaries to use portfolio securitization and to establish venture capital funds, trusts and agricultural commodities exchanges. Value chain financing should be promoted so that the most bankable actors in the chain are able to access formal credit markets and, in turn, indirectly finance smaller, less creditworthy partners.

Finally, access to land and water needs to be improved, particularly for farmers whose natural resource base is insufficient, since lack of resources aggravates poverty and contributes to the degradation of natural resources in marginal rural areas.

### **At the Local Level**

A decision needs to be made about whether to emphasize a more productive or a more social agenda. This depends on the economic potential of the targeted region and on its economic and social ex-

posure to external markets. As financial resources are limited, it is recommended that this approach focus on the productive transformation of rural areas with sufficient potential for a sustainable integration into markets outside of the targeted area.

Rural institutional development requires revised and specific activities, including: (i) modernizing rural development agencies; (ii) implementing coordination and checks and balances processes between national, provincial and local government; (iii) promoting networking and other forms of association between local governments to create regionwide organizations; (iv) strengthening the management capacity of local authorities; (v) assigning greater powers and capacities to local governments on political, administrative and financial issues; and (vi) helping secure the citizenship rights of the rural poor.

Improving the management capacity of local institutions is crucial for the implementation of the new approach. Experience has shown that national or regional coordination committees are not the answer. Territorial development contracts, consensus building forums, local rural development councils, and other institutional arrangements are formulas for overcoming constraints, particularly if in addition to offering spaces for dialogue, they have the authority to decide how financing resources are used.

Building public-private partnerships is another key element of the new approach. Promoting development is not the work of the public sector alone, as was previously thought. The private sector should play a key role in developing the rural economy. Small and medium enterprises, conglomerates and supply chains are key to the diversification of rural economic activities. Part of the new approach should be to support these private businesses and associations to improve their access to low-cost, long-term financial services as well as business development services and technologies. Rural development programs must, therefore, place particular emphasis on promoting partnerships between the public and private sectors, in order to share risks, maximize synergies, promote investment and ensure that the benefits of development are equitably distributed.

### Value Chain Financing

Ecologic Finance is a nonprofit NGO based in the United States that specializes in financing rural community-based groups involved in productive activities in environmentally sensitive areas of Latin America and Africa. Founded in 1999, Ecologic Finance has increased its portfolio to US\$18.5 million and has made over 125 loans to cooperatives and rural producer associations in Mexico, Guatemala, Belize, Honduras, Nicaragua, Costa Rica, Peru, Bolivia, Ecuador, Brazil, Kenya, Rwanda and Uganda. What is different and innovative about this NGO is that it works with groups that have hitherto lacked access to traditional credit markets to secure marketing contracts for profitable commodities, to improve financial management skills, to secure necessary extension services, and to size loans according to investment needs. Ecologic Finance has emerged as a “trusted broker” between end users such as Starbucks, Green Mountain Coffee, and a host of fair trade organizations and very isolated, poor communities producing commodities such as coffee, cocoa, honey, tea, spices, certified wood, wild-harvested rainforest products and fish, and engaged in ecotourism. Ecologic Finance lowers transaction costs by working in alliances, using “conservation” as a selling point to obtain “green” pricing premiums for producers and service providers, and by aggressively raising low-cost capital. The organization was recognized by the Yale University School of Management in June 2005 for its business model and innovation.

## Linking the National and Local Levels

In order for the new approach to rural economic development to work, joint efforts are needed at the local and national levels. In order for the productive transformation process to be successful and inclusive, national policies as well as financial and productive services must focus on the provision of public goods in the rural areas. Similarly, an empowering process should take place at the local level in order to improve participation and the quality of local demand. Creating this link between the national and local levels, as well as feedback mechanisms between the two is crucial to realize the latent economic potential of the rural sector and to contribute to the attainment of MDG poverty goals.

### Empowering People in their Territory

The EXPIDER project (Pilot Experiences in Territorial Rural Development in Latin America) was conceived as a laboratory to generate empirical knowledge that could contribute to the design, execution and evaluation of future territorial development operations. EXPIDER was executed in three rural areas of Bolivia, Ecuador and Honduras. The lessons learned are related to the criteria to delineate the rural territories for intervention; the mechanisms to improve vertical and horizontal coordination among various rural development institutions; the creation of public-private partnerships; the composition, function, representativeness and financing of Local Organizations for Rural Development (LRD); the process of participative strategic planning; the role of the Rural Development Plan (RDP); and the spatial and temporal relation between the processes to create an LRD and the preparation of an RDP. One particular point of interest was EXPIDER's association with national rural investment programs financed by development agencies. This experience demonstrated that such an association is of great value and constitutes a model to follow. In effect, EXPIDER supported the national rural program by providing knowledge and experience that allowed the program to improve its effectiveness, while the national program helped EXPIDER with financial resources and the possibility of scaling up its local findings, having a multiplying effect that reduced the risk of isolation and limited impact. EXPIDER improved the capacity of LRDs to formulate and implement a joint public-private development agenda for their region and linked this effort to national investment programs. EXPIDER showed that linking local and national levels in a joint agenda makes rural territorial development possible.

## Concluding Remarks

The relative inability of past rural development policies, programs and projects to have a significant impact on rural income and employment and reduce rural poverty, together with the new trends and conditions prevailing in the rural economy and society at large, as well as the lessons learned by governments and development agencies, lead to a new rural development strategy with a territorial, multisector and participatory approach. This new rural territorial strategy reflects a simultaneous effort of investment in the provision of public goods and capacity building at the national and local levels. This strategy to reach the rural poor and mobilize the rural potential, seeks to empower people to participate in political decisions, to bring private and public sector together and to improve the institutional and human capacity to identify and develop the economic potentials of rural areas, and thus to contribute to reducing poverty and promoting growth in rural areas.

### ■ **Development with Identity: Mobilizing the Potential of Indigenous Peoples' Natural Resources and Cultural Heritage**

**T**he more than 400 indigenous peoples of Latin America and the Caribbean are culturally and linguistically heterogeneous and have very different economic systems, ways of interacting with their physical environment and patterns of integration into national society. Most sources agree that there are 40 to 50 million indigenous people in Latin America and the Caribbean (accounting for approximately 8 percent to 10 percent of the region's population) with higher than average rates of population growth. In countries such as Bolivia, Guatemala and Peru, indigenous people account for at least half of the total population.

Indigenous peoples tend to be poor in absolute terms as well as relative to the rest of the population. Indeed, according to poverty profiles from several countries and to the World Development Indicators, the majority of indigenous peoples fall within the poorest strata based on standard definitions of poverty (figure 1). It is estimated that indigenous people account for 20 percent to 25 percent of the regional population living below the poverty line. The depth of the poverty that these groups face, and their specific needs and demands mean that they may be left behind in efforts to reach national poverty reduction goals.

This chapter addresses three aspects of concern: the role of indigenous assets in overcoming material poverty and exclusion; the lessons learned from poverty reduction efforts and the expansion of social services for the benefit of indigenous people; and the ways and means to mobilize the potential of these groups for what we will call “development with identity.”

#### **The Role of Indigenous Assets in Overcoming Material Poverty and Exclusion**

Indigenous peoples have made great strides in the past decade, particularly in national and international legal and regulatory frameworks, in terms of recognition of their specific rights and the increased participation of their political organizations and movements. Yet this progress has failed to reverse or



check the decline in many indigenous peoples' living conditions. They remain subject to dispossession from their ancestral lands and territories where environmental conditions continue to deteriorate, resulting in accelerated migration to poor urban areas and abroad. Despite increased migration, an estimated 60 to 70 percent of indigenous people live in rural areas and account for between 45 to 50 percent of the rural poor.

The indigenous peoples of Latin America and the Caribbean are heirs to vast territories, natural resources and cultural heritage that have been eroded by policies of exclusion or assimilation, which determined government actions until the 1960s and beyond. Processes that rejected native cultures and forced integration into Western society brought on poverty and the destruction of indigenous peoples' heritage, dignity and self-esteem. They also gave rise to conflicts within and among these and other sectors of society, as well as to migration from rural to urban settings, the loss of ancestral knowledge and practices, and the exclusion of indigenous peoples from political participation in the nation-states of which they are part. Nonetheless, despite their heterogeneity and different levels of interaction with the dominant societies, strong indigenous organizations have emerged over the past three decades to demand the right to their identity as indigenous peoples and revalue their heritage as the foundation for their identity and as a resource for the economic and social development of their own peoples and of society in general.

## **Lands, Territories, and Natural Resources**

Population growth, advancing agricultural frontiers, hydrocarbon extraction, forestry and mining, as well as mass tourism and the development of national and transnational infrastructure, have exerted pressure on indigenous territories and economies, both peasant and tribal, and resulted in a deterioration of the quality of life and of previously sustainable economic and environmental conditions. In some cases, the creation of protected areas or natural parks has imposed limits on indigenous communities' access to their own natural resources, and even led to their resettlement. Despite these processes of dispossession and the degradation of their ancestral lands, there continues to be a strong association between the location of indigenous territories and the areas with the highest biodiversity and natural resource conservation. In recent years, significant progress has been made in most countries in developing legal and institutional frameworks to recognize, safeguard, and regularize the collective rights of indigenous peoples over their territories and resources. Nevertheless, enforcement of these norms continues to be lax, and processes of demarcation, titling and governance are occurring at a slow pace. Faced with growing pressures on lands and territories, these measures become necessary as a way to maintain or recover traditional ancestral territorial sustainability and, as a result, prevent indigenous societies and economies from becoming unviable.

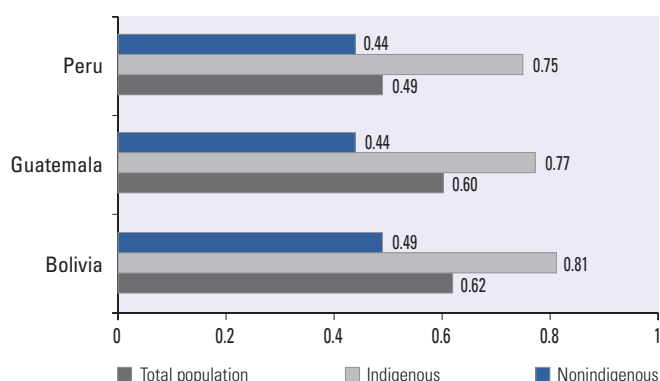
## **Economic Opportunities**

Indigenous peoples whose economy is based primarily on subsistence and reciprocity in their ancestral territories, as well as those who are more integrated into the national economy, are at a disadvantage in terms of access to technical and financial services and regulated labor markets. Many



communities continue to have limited access and control over their own lands and resources, which in turn place important limitations upon their economic opportunities. Even for those communities that have obtained legal protection for their collective lands and territories, the absence in those territories of public and private investment in accordance with principles of comanagement and the equitable sharing of benefits, coupled with the limited entrepreneurial and administrative capacity of indigenous organizations, continues to pose significant challenges in terms of improving their living conditions. Accordingly, indigenous peoples are seeking greater access to conventional financial, business and professional training services, as well as the strengthening or recovery of ancestral mechanisms for financial or in-kind services (such as internal land use distribution systems, bartering and exchange of products across vertical ecosystems, storage and inventory of products known as *qollqas*). They are also seeking to be governed by their own regulatory systems and requesting training for the economic governance of their territorial and cultural heritage and their natural resources.

**FIGURE 1**  
**Poverty Rates (Percentage of the population with incomes of less than US\$2/day)**



Source: Dureya S. and Genoni, M.E. 2004. Ethnicity, Race and Gender in Latin American Labor Markets. IDB. Based on household surveys from 1998 and 1999.

## Some Lessons from Poverty Reduction Programs and the Expansion of Social Services for the Benefit of the Indigenous Poor

As measured by conventional indicators, indigenous peoples' poverty has persisted during past decades. However, studies have shown that indigenous peoples are less vulnerable to crises. It is likely that the reason for this is that many of their economies are based primarily on subsistence, and are not highly monetized. Indigenous peoples have criticized conventional short-term poverty alleviation programs because they cause distortions in their own economies and create dependencies on government handouts. For many years, government policies (as well as those of international cooperation agencies) toward indigenous peoples were exclusionary or geared toward integration and assimilation, based on the perception that indigenous peoples' sociocultural characteristics were impediments to development. The lack of success of these programs led indigenous peoples and others to focus on a development vision rooted in indigenous peoples' own worldview and culture.

In addition, the mechanisms of reciprocity, redistribution and exchange prevalent in many indigenous economies account for the resilience of indigenous peoples in the face of extreme material poverty. Indigenous peoples often question the relevance of conventional poverty indicators and insist on the need to complement them with others that take into account their own concepts

of development and well-being, including legal protection of their territories, access to natural resources, cultural heritage and values, and social capital within their communities and organizations.

## **Access to and Quality of Services**

Despite some improvements, a significant gap continues to exist between indigenous and nonindigenous populations in terms of access to social services, as demonstrated by education and health indicators. Such gaps are evident in primary and secondary education, particularly for indigenous women, who exhibit the highest rates of illiteracy and the lowest enrollment rates. In spite of progress in intercultural bilingual education, problems of high repeater and dropout rates, poorly qualified teachers, poor educational quality, and returns on education below those experienced by the nonindigenous population persist. Furthermore, indigenous people remain at a serious disadvantage in terms of access to higher education as compared to nonindigenous people, leading to occupational segregation. At the same time, indigenous peoples' access to health care services is even more restricted as demonstrated by morbidity and mortality rates that are far higher than those of the nonindigenous population, particularly among mothers and children.

Efforts at decentralization have kept short of articulating indigenous governance systems with decentralized public entities; decentralized government spending has not reached remote indigenous communities. Despite the growing political participation of indigenous leaders at the national level, the capacity of local communities to express their demands and participate in decision-making processes at the local and subnational levels remains weak.

## **Limits of Programs Targeted to Indigenous Peoples**

Project reviews by the IDB and other institutions found that initiatives aimed at improving indigenous peoples' living conditions only reach this goal if specific measures exist to improve targeting, bring down barriers to access, adapt services to the sociocultural and linguistic characteristics of indigenous peoples, and enable their active participation in the identification, planning, development and evaluation of project activities. Thus, while significant progress has been made in the number of projects that specifically include indigenous peoples, a large percentage of projects that implicitly include indigenous peoples among their beneficiaries lack distinct ethno-specific or socioculturally appropriate designs and methodologies and, in practice, rarely manage to benefit the indigenous segment of the target population.

The quality of projects designed with the participation of the indigenous target population and including sociocultural assessments has shown improvements, particularly when experts on indigenous issues took part in project development and efforts to target beneficiaries. Limitations on these efforts include the lack of baselines or information systems broken down by ethnic group, making monitoring and evaluation difficult, as well as the governments' limited institutional capacity, among many other factors. These findings are consistent with portfolio analyses and evaluation studies conducted by other donor institutions and by some indigenous organizations.

## Mobilizing the Potential of Indigenous Peoples for “Development with Identity”

Indigenous peoples have important assets in terms of land and natural resources, cultural heritage and social capital, but lack institutional capacity and access to appropriate training, financial services and information technology, which are needed to develop the potential of these assets. In many cases, urban and foreign migration has not resulted in assimilation and loss of identity; in fact strong linkages to communities of origin provide unique channels for exchange of goods and services. Indigenous peoples’ demands for the legal security of their territory and natural resources as well as a large degree of autonomy in managing their internal affairs, has awakened a keen interest in the concept of development with identity: improving economic conditions by developing the potential of their resources and thereby protecting and strengthening these resources in the context of economic and cultural globalization processes.

*Development with identity* refers to a process that involves indigenous peoples in harmony and sustained interaction with their environment and cultural assets. It also includes the sound management of natural resources and territories, the creation and exercise of authority, and respect for the cultural, economic, social, legal and institutional rights and values of indigenous peoples in accordance with their own worldview and governance. Development with identity seeks to consolidate the conditions in which indigenous peoples can thrive and grow in harmony with their surroundings by capitalizing on the potential of their cultural, natural and social assets. To adopt different concepts of indigenous development entails an acceptance of these communities’ economic objectives, which are not necessarily aimed at maximizing the profitability of resources in the short or medium term. Rather, priority is often given to sufficient well-being of the community, in balance with the environment and the conservation of resources for future generations.

Traditionally, indigenous economies are based on the worldview that the accumulation of wealth through production surpluses, particularly at the individual level or among elite groups, does not contribute to societies’ well-being or security. Contact with Western society, market pressures and migration are causing gradual changes in these concepts, but with mixed results. The challenge lies in supporting development initiatives and organizational systems that are unique to indigenous peoples in order to improve their living conditions through their own leadership and in a manner consistent with each community’s specific sociocultural situation and vision. This means greater access, with gender equality, to socioeconomic development opportunities that strengthen identity, culture, territorial integrity, natural resources and social organization, and reduce material poverty and marginalization. Such actions should be guided by the premise that sustainable development requires the initiative and empowerment of indigenous beneficiaries, control over the course of their own economic, social and cultural development, internal management of their territories and effective governance and participation in political processes, so that they can fully exercise their rights and responsibilities as indigenous peoples and as citizens of the nation-states of which they are a part.

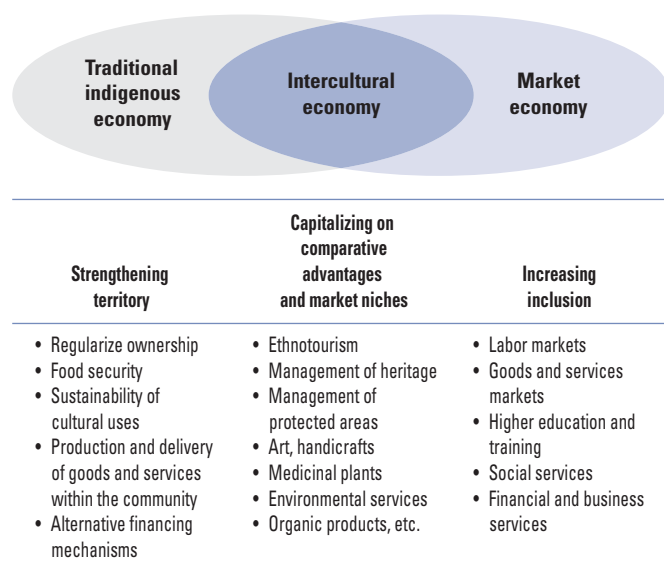
In order to support development with identity, the Bank’s recently adopted strategy on indigenous development promotes action in three areas, taking into account the different needs and priorities as defined by indigenous peoples themselves:

- *Strengthening lands, territory and governance* of traditional indigenous societies and economies in their territories and rural communities of origin, in a manner that is consistent with applicable legal norms and indigenous organizational structures, as the basis for ethnic and cultural identity and food security, as well as a safety net during crises.
- *Reducing marginalization and exclusion* in national society, including urban areas, to facilitate greater access and improve the quality and sociocultural relevance of social and financial services, labor markets and educational opportunities.
- *Mobilizing the potential of indigenous peoples' natural, cultural and social assets* to develop entrepreneurial initiatives and provide services in market niches where they have comparative advantages. Mobilizing the potential for development with identity by capitalizing on their assets provides opportunities to improve the quality of life of their communities, taking into account those national and global market niches where there is an increased demand for indigenous goods and services. This would improve the living conditions and reduce poverty in their communities, while at the same time strengthening and preserving indigenous assets and reinforcing cultural identity. Examples of such initiatives include the development of ethnotourism, arts and crafts, organic and forest products, ethnobotanical products and medicinal plants, environmental services, management of protected areas and cultural heritage sites.

Figure 2 illustrates this concept of development with identity in the economic realm and reflects the dynamic relationship between the traditional indigenous way of life, the local external context, and the challenges and opportunities for indigenous development that exist in each area. The Bank's strategy for indigenous economic development aims to support indigenous peoples' self-development so that they may meet their own goals within

traditional, intercultural spaces or the market economy, and develop their communities, organizations and management capacity. Development in such spaces helps to reaffirm the key importance of the sociocultural values of indigenous communities, which in turn strengthens their capacity to exercise autonomy and manage their intercultural relations with society and the state.

**FIGURE 2**  
**Strategy for Indigenous Economic Development**



## Rural-urban Links

This development with identity approach also draws on the potential of the unique relationships of urban and rural indigenous people. Far from submitting to or assimilating into the dominant culture, many urban indigenous people maintain strong economic, social and cultural ties with their communities of origin, in some cases reversing assimilation processes

observed over previous decades and rebuilding or reinterpreting their cultural traditions and social networks in urban centers, as illustrated by indigenous settlements or neighborhoods in cities such as Santiago, El Alto, Mexico City, Quito, and others. Such links between urban indigenous peoples and their communities of origin are translating into new opportunities for revitalizing rural indigenous economies and creating urban indigenous businesses. They make it possible to capitalize on the comparative advantages of the original communities' natural, cultural and social resources and support the gradual linkage between traditional and modern practices. Nonetheless, capitalizing on these opportunities requires new institutional models, strategic partnerships, innovative approaches and training. Without new approaches, the concentration of indigenous people living in poor conditions in big cities may increase; the rural economies of their communities of origin might become unviable, and, possibly, destroy the economic, social and cultural base of indigenous peoples, resulting in their fragmentation, and in extreme cases, in their extinction.

The Bank's new strategy calls for actions to strengthen the legal security of indigenous territories and resources; facilitate their access to culturally appropriate education, capacity building, institutional strengthening, and financial services; and identify and support initiatives to mobilize the comparative advantages of indigenous peoples in terms of natural, cultural and social capital, while articulating indigenous economic systems with the market economy. The strategy also supports the scaling up of interesting pilot initiatives in revitalizing indigenous knowledge, products and services; traditional practices in land use management; economic systems of reciprocity, redistribution and exchange; rental land markets; and the participation in management and benefit sharing of indigenous peoples in forestry, mining and hydrocarbon extraction. These are potential models for economic development that strengthen cultural identity. In addition, areas in which indigenous peoples have a comparative advantage need to be identified, including cultural and ecotourism, the management of environmental conservation areas, the production and commercialization of medicinal plants and other products developed by indigenous communities, the management of archeological heritage sites, and the promotion of indigenous arts and crafts. This requires support for the development of normative frameworks for the protection of indigenous intellectual property rights. In terms of indigenous governance structures, the strategy calls for supporting articulation between indigenous governance structures and decentralized government entities, and facilitates the participation of indigenous peoples in local, subnational and national democratic processes. Finally, the strategy supports integrated and participatory community development programs, the nature of which is closer to indigenous peoples' holistic worldviews and social organization and aspirations for a more empowered participation in the management and development of their territories.

These emerging approaches, while already being addressed in some of the Bank's more recent projects targeted at or including indigenous peoples, provide both challenges and opportunities, not in the least regarding the institutional framework and the articulation between indigenous authorities and municipalities and decentralized government agencies. Further research and evaluation is needed to confirm the effectiveness and viability of these initiatives. However, as some Bank-supported projects are already demonstrating, this new generation of projects is helping to reverse the decline in indigenous people's economic conditions, enabling them to contribute to overall economic growth while strengthening their unique natural resources and cultural heritage.

## Concluding Remarks

The emerging concept within indigenous communities and organizations of development with identity as a strategy for improving economic conditions while preserving natural and cultural assets, is gaining ground. Now that many countries have adopted legal frameworks to protect the individual and collective rights of indigenous peoples to their territories, natural resources and cultural heritage, indigenous peoples are increasingly concerned about the viability of their societies and economies in the face of growing pressures from global integration processes that may jeopardize their unique identity and culture. Unlike other vulnerable population groups, indigenous peoples have distinctive comparative advantages in terms of their assets, which they could further mobilize for reversing material poverty and increasing the viability of their communities and cultures, thereby making important contributions to overall economic growth. The Bank is in an exceptional position to support these efforts, given its vast experience and expertise in entrepreneurial development and its mandates for poverty reduction, social equity and inclusion.

## **PART II**

### **■ ACCESS TO SERVICES**





# ■ The Role of Local Governments in Reaching and Empowering the Poor

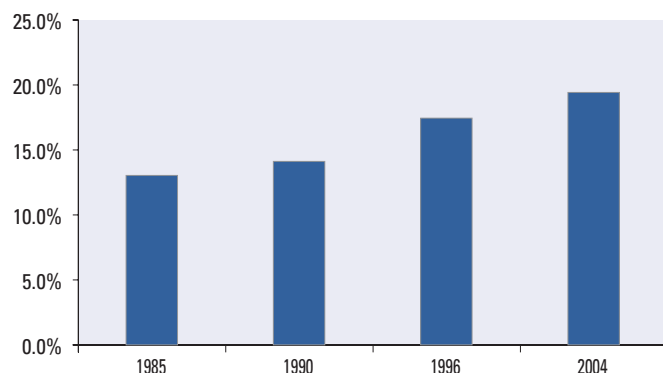
While “good policies” and economic growth are important elements in reducing poverty, they are not necessarily sufficient. The role that effective democratic governance plays in creating the conditions for alleviating poverty has been highlighted on many occasions in recent years. Local governments (the role of which is becoming stronger in the context of the trend toward decentralization) are particularly well placed to assist. Poverty and social exclusion are more effectively addressed at the local level, where they are easier to identify and target. Citizens can participate in and monitor the decisions that affect them. The proximity of local governments to their public service recipients, in turn, allows them to tailor basic services to the needs of particular groups. This chapter addresses these issues by looking at how local governments can contribute to reaching and empowering the poor.

## The Comparative Advantage of Local Governments in Reducing Poverty and Inequality

In the last twenty years, Latin America has undergone a process in which power and resources have been increasingly transferred to subnational levels. Most of the countries have committed themselves broadly and deeply to a model of decentralized governance in the political and fiscal policymaking arenas. Representative democracies are present at the local level in the majority of countries. As a result, local governments are now being held directly accountable to their constituencies rather than just to the central government. Hand in hand with the latter, local governments have also been given greater responsibility and resources to meet the demands and preferences of the residents of their jurisdictions. This is evident from the increase in the share of subnational expenditures which, as a percentage of total governmental expenditures grew from 13 percent in 1985 to 19 percent in 2004 (see figure 1), moving closer to the level found in the more developed OECD countries (29 percent).

These changes have important implications for poverty alleviation. Given that local governments constitute the closest and most direct link between citizens and the State and are, therefore, more knowledgeable of their needs and preferences, they have a comparative advantage in providing cli-

**FIGURE 1**  
**Subnational Spending as a Share of Total Government Expenditure (LAC Averages)**



Source: Robert Daughters and Leslie Harper. 2006. Fiscal and Political Decentralization in Latin America. Inter-American Development Bank.

ent-oriented services, such as potable water, waste disposal, transport infrastructure, power, shelter and land tenure, primary education and health services. The central responsibility of local governments over these service areas makes them key players in the battle to meet the basic needs of the poor. Local governments know better than central government authorities the level of services that already exist, the priorities and preferences of different segments of the population as well as particular geographic, economic and social characteristics of their communities that might affect the suitability of given policies and their implementation.

In short, therefore, local governments can understand specific needs, target responses accordingly and have greater flexibility in tailoring those services to the preferences of their constituents. Local government's capacity for responsiveness also

should make them most effective at addressing exclusion. The link to poverty is fairly straightforward. Poverty is a multidimensional phenomenon that can be understood as exclusion from economic, political and social resources. The excluded are more likely to be poor, and those excluded from political processes are not heard and find little response from the State.

Local governments are not the only actors with a role in reaching the people. They cannot substitute for functions better delivered by other levels of government, nor do they have a comparative advantage in every policy sector that affects their constituents. However, when they effectively complement and are complemented by other tiers of the system, they can play a pivotal role.

## **Risk and Success Factors for Effective Local Government Support**

Although local governments have certain comparative advantages with regard to poverty reduction, it is important to note that these advantages are not realized automatically. Certain conditions have to be in place for local governments to fulfill their potential in this regard. Where subnational governments have structural weaknesses, such as inadequate institutional capacity or fiscal resources, a handover of greater responsibility can actually contribute to a deterioration, rather than an improvement, in the quality of services and, concomitantly, a reduced efficiency in addressing the needs of the poor.

The need for adequate institutional capacity is especially important given that decentralization entails an increasing role for subnational governments in terms of both the scope and complexity of their responsibilities. For example, in some countries complex sectors, such as education and health, have been partially decentralized to the local level. Given the high levels of technical skill required

for effective delivery in both of these sectors, and given the need to ensure national standards across jurisdictions, local governments may be heavily burdened in trying to ensure adequate technical and institutional capacity. This makes it imperative for other actors (central or regional governments, civil society and others) to step in as well with quality enhancement and control.

Insufficient financial resources at the local level constitute another important area of risk. Ideally, local governments would be able to generate their own revenues through local taxes, thus providing a direct link between those who supply and consume the services and those who pay for them. The problem is that the local jurisdictions with the weakest economic bases, by definition, are also the ones with the largest proportion of poor and the least capacity to generate revenue.

To deal with the regional inequalities or horizontal imbalances generated by this type of situation, in the majority of the countries of the region, subnational governments now receive most of their income through compensatory transfers from the center. However, this type of arrangement can be suboptimal, since it may obscure the accountability link and reduce the incentives of citizens to monitor and penalize public officials for unwise expenditures and poor services. In addition, since transfers are often linked to sectoral spending quotas prescribed by the central government, local governments are hindered in their ability to allocate resources in line with their supposedly more accurate knowledge of the community's specific needs.

Particularly in small rural municipalities, human resources are often deficient as well. Qualified professionals tend to migrate to more competitive job markets in the regional capital cities. Local governments may then be left with an excess of unskilled staff, hampered by outdated administrative procedures and limited capacity to manage basic public finance and accounting functions, such as budgeting, procurement, tax administration, auditing, evaluation, reporting and personnel management. These weaknesses can contribute to problems such as corruption and mismanagement.

The latter, in turn, can result in public resources being diverted away from purposes that might serve the poor. More specifically, elite capture and/or cronyism may ensue, both undermining the efficiency advantage of local governments in service provision and leading to higher costs, lack of responsiveness and poor targeting of resources.

While both capture and cronyism can and do occur at the national level, there is some debate as to whether or not local governments are more vulnerable. Although some recent research argues against this hypothesis, deficiencies in respect to the intensity of political competition and the strength of institutional checks and balances at the local level in some country contexts contribute to the emergence of such distortions.

Despite these risks, it should be emphasized that local governments continue to have an important role to play in fighting poverty. In order to minimize the risks and maximize effectiveness,

### Summary of the Comparative Advantages of Local Governments

- Responsiveness of local governments ensures more effective delivery of basic social services and infrastructure (sanitation, education, health, transport, housing, citizen security, basic infrastructure, management of public spaces).
- Ability to better target government response to special needs of the poor.
- Proximity between government and citizens improves prospects for political inclusion and accountability.

local governments need to develop strong institutional environments and standards of governance. Some of the key factors of success are public management efficiency in the delivery of services, effective cooperation with other government and nongovernment stakeholders, political inclusiveness and participation, a commitment to mobilize local resources, and transparency and accountability. These factors are briefly discussed below.

### **Achieve Public Management Efficiency in the Delivery of Services**

Local governments need to build up managerial and technical expertise and a competent bureaucracy that can attract and retain professional staff. Civil service reforms that include strengthening of the administrative capacity, hiring and promotion on the basis of merit, training programs tailored to workplace needs, and adequate remuneration and working conditions are needed in many instances. Structuring the public administration around merit-based criteria can help ensure autonomy and protect civil servants from arbitrariness, politization and rent-seeking.

### **Ensure Effective Cooperation with Other Government and Nongovernment Stakeholders**

For local governments to provide effective services, they need to cooperate with other levels of government, civil society and the private sector. This is particularly true with regard to sectors such as social welfare, health and education in which different actors are complementing each other.

Effective intergovernmental working relations require a clear delegation and assignment of functions for each level of government, accompanied by financial resources that are compatible with the delegated functions. For instance, in relation to education and health it has been common for the central governments in the region to transfer responsibilities to subnational governments without the resources to cover their true costs (unfunded mandates).

Partnering with NGOs and community-based organizations can also be critical since these organizations have the most direct and immediate connection with specific citizen groups. Furthermore, the degree of specialization that NGOs can develop in certain areas of poverty alleviation cannot be easily matched by most local governments. Civil society actors can play a critical role as partners, by linking up with special target groups or vulnerable populations such as the elderly, adolescents, single parent households, minority ethnic communities, and so on. Local governments cannot access many of these disadvantaged groups if they do not have local NGOs as agents of contact or intermediaries.

### **Promote Political Inclusiveness and Participation**

One major area of exclusion is in the political arena. When citizens do not vote, politicians have no incentive to respond to their needs nor are they necessarily aware of them. For local governments to be able to take action aimed at reducing poverty, they have to be aware of the needs of the different sectors of the population and design public policies accordingly. Enhanced political participation and representation (i.e. more inclusive politics) should lead to policy priorities that take into account the

needs of the various community sectors in terms of inclusion through better access to productive assets and such services as housing, health care, and formal and technical education.

Participation and representation both presuppose the existence of functioning formal and informal mechanisms starting with democratic elections. Both the quantity and quality dimensions of electoral processes are important when it comes to evaluating the degree of participation and inclusiveness of the political system. The quantity aspect has to do with the level of electoral participation, particularly in countries without compulsory voting and automatic registering of voters. High levels of absenteeism can be indicators of failures in the representative system, reflecting a lack of citizen interest in politics, dissatisfaction with or disaffection from the political process, lack of institutional credibility and legitimacy, or a combination of the above. The quality dimension, in turn, has to do with the extent to which such mechanisms permit citizens to effectively signal their preferences and hold public officials accountable.

As a consequence of the first wave of decentralization reforms that took place during the 1980s, in a majority of the countries of the region, mayors are today elected (in most cases through a direct popular vote). However, a more inclusive democracy goes beyond the purely electoral aspects. Democratic inclusiveness hinges on the ability of political actors to build consensus around priorities. For local government actors to make the most of this ability and their comparative advantages, they have to be able to create the spaces that will ensure an effective exchange of interests and needs between the different members of the community.

## **Mobilize Local Resources**

While it is broadly accepted that central governments have a strong comparative advantage in mobilizing fiscal resources, it is also true that local governments can compensate for this by developing potential local sources of revenue. Just as importantly, they can compensate by mobilizing local human resources for the delivery of services, for example, through self help or community help mechanisms.

Own-source revenue generation at the local level is important, since when there is a clear link between services and those who pay for them, the services tend to be held in higher esteem and local providers are more likely to be held accountable. Thus, incentives should be developed for local governments to maximize the generation of own-source revenue in classic areas of local taxation such as property, betterment and sales taxes, or the disciplined application of user charges for services. However, given the perceived political cost of trying to generate many of these revenues, and the ca-

### **Mobilizing Nongovernment Stakeholders While Increasing Political Inclusiveness**

The Local Development Program II – FISDL (ES0120) supported by the IDB and being implemented in El Salvador is a good example of how local governments can partner up with nongovernment stakeholders in order to improve the effective delivery of services and increase political inclusion.

FISDL is a national social investment program that works through a partnership of local governments and NGOs in the undertaking of social service investments. FISDL works with a consultative group including the municipal association (COMURES), NGOs and the private sector. The program promotes civil society participation in local development through a participatory planning methodology, which involves communities in the identification of priority social infrastructure investment projects.

capacity required to administer them, local politicians often tend to avoid taking steps to collect these revenues. A complementary option to taxation is to explore fundraising with stakeholders, such as private entrepreneurs.

This option is real in the context of projects that involve neighborhood upgrading, recreational facilities, public open spaces and road improvement. The potential benefits at the local level in this kind of instance is less dependent on a national decentralization plan than on the community's capacity for taking an active role. Ex-post analyses have shown that spontaneous local initiatives developed in different countries while implementing certain programs are highly efficient in benefiting disadvantaged groups. These results have, a posteriori, motivated support for community participation in the design and implementation of projects through specific strategies like community-based development and community-driven development.

## **Be Transparent and Accountable**

The transparency and accountability of local governments to their inhabitants can have a significant impact on efforts to reduce poverty. A central problem in the region is that governments do not have sufficient resources and the resources that they have are inefficiently used. This is frequently expressed in the problems of elite capture and cronyism mentioned above. Increasing transparency is a major tool to counter these types of distortions in political representation. Transparency facilitates the ability of citizens to hold public officials accountable for their actions or inactions.

In order for citizens and civil society to exercise effective oversight and participate in policy-making, governments and policymakers must provide sufficient and effective information. This, in turn, requires transparency in the identification of government priorities, decision-making and execution of policies. Elections are the ultimate democratic mechanism for ensuring accountability. As discussed above, if this mechanism functions properly, competition for public office results in an effective delegation of authority by citizens to representatives such that they are held accountable for their performance and adhere to their policy promises.

Transparency is also key to the efficient delivery of basic services to the poor and the rest of the community. For local governments to provide better services, they must be accountable for the money they receive, either from the central government or directly from the taxpayers, and for the use of this money. If they are not accountable, they are not likely to be efficient. In that sense, local government service provision provides the potential for better oversight by civil society organizations since, on a small scale and closer to the action, they can obtain access to better information and monitor processes more effectively. More intensive and effective monitoring by civil society should increase the quality of services administered by local governments.

For accountability to work there is a need for voice and restraint instruments such as effective political parties and organized groups—either community wide, as in the media, or special interest groups, such as community or neighborhood organizations. Transparency in public affairs is also key in obtaining reliable and timely information on financial management. There is also a need for channels of influence, formal redress procedures, open meetings and councils. With some of these mechanisms in place, more participation can lead to greater demands for disclosure. Reliable mechanisms for the accountability of elected representatives such as counter-corruption programs, third party audits

and monitoring systems can also help in improving these processes.

## Concluding Remarks

For local governments to become catalysts for poverty alleviation and bring tangible results to their populations, it is critical that they fulfill the elements of good governance spelled out in this chapter. Emphasis should be placed on giving local governments the tools they need to carry out their functions in a way that is not just an ad hoc reaction to day to day challenges, but that can involve long-term planning to ensure that problems of future generations will be addressed and thus help break the vicious cycle of poverty.

This requires local governments with strong public administrations, sufficient resources and mechanisms that enable citizens to have a say in their communities' development. It also entails effective partnerships with other levels of government and civil society. How they relate to other actors is critical in order to bring about a mutually reinforcing system, with each playing the role to which they are best suited and complementing the efforts of the others. More targeted and sustainable service delivery will have an effect on the degree of legitimacy and stability of the system. Local governments will have to be held accountable for the outcomes and should be able to bring tangible results to their communities, for it is the poor who will pay the highest costs otherwise.

### Corruption and Interest Group Capture at the Local Level

Local governments are not necessarily more prone to cronyism and corruption practices than central governments. However the public perception often points in that direction. The reasons behind it are that:

- Local governments tend to lack institutional capacity: The weaker the institutional setting, the less checks and balances between government branches, and the higher the risk of corruption and cronyism.
- Local governments are closer to the people than central governments: For that reason, citizens can better understand the necessities, procedures, and availability of resources, and more easily supervise service delivery. An increased capacity to monitor the performance of local authorities increases the ability of citizens to censure their elected representatives.

The following good governance practices can serve as an antidote to the risk of corruption:

- Promoting a merit-based civil service.
- Developing finance systems: effective management, information and reporting.
- Developing impact indicators to measure effectiveness.
- Strengthening oversight institutions
- Strengthening civil society monitoring capacities: training local communities in social auditing.





## ■ Improving the Access to and Quality of Education Services: The Challenge of Unequal Opportunity

Education bears a close relation to competitiveness, growth and the range and quality of opportunities people encounter throughout their lives. The private benefits and powerful public externalities it conveys have been widely documented. Education has a positive impact on labor productivity, earnings, poverty reduction and social mobility. It affects the capacity to innovate and enhances the nature and scope of social achievements, including the quality of civic interactions and democratic governance. Yet, this picture changes when education is not equally distributed within a given society. When the range of educational opportunities becomes available only to certain sectors of the population, educational outcomes tend to be strikingly uneven. In consequence, the effect of hard work, talent and motivation gets diluted, and a further tilting of the scale in favor of those in privileged positions from the start takes place. As a result, larger externalities arising from having a generally educated population fail to materialize, and competitiveness and growth suffer.

This chapter focuses on the relationship between poverty and education. It briefly summarizes some of the main trends and lingering challenges facing education systems across Latin America and the Caribbean, recognizing the progress that has been made and highlighting main areas of concern. Foremost among these is the powerful effect that poverty wields on education. Even if it can be reasonably assumed that talent is randomly distributed within any given society, achievement is not. It tracks, almost perfectly, prevailing socioeconomic fault lines. This section offers some insight into how poverty interacts with education and why poor children tend to have poor educational performance. Analyses included here touch on issues ranging from social exclusion to gaps in coverage and access, to differences in learning. Finally, it provides a taxonomy of policy options. Based on projects supported by the Inter-American Development Bank, it examines concrete experiences that have led to real progress in improving the equity of education throughout the region.

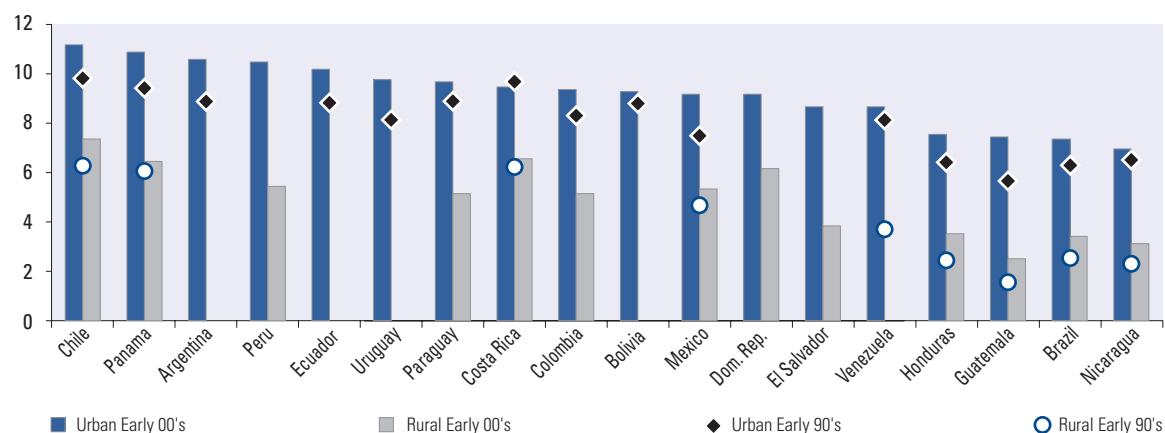
## Education Outcomes and the Poor

Educational trends throughout Latin America and the Caribbean are promising. More children are in school now than at any other time in the past. More importantly, these children represent all sectors of society, including the poor and racial, ethnic and linguistic minorities. They enter school earlier, attend school for longer periods of time and complete ever-higher levels of education. The schools they attend are better than at any time in the past. There are more of them at all levels, the teachers that teach in them are better trained, and the textbooks they use are widely and more equitably distributed, with better quality in content and pedagogy. Average years of education in some countries of the region have more than doubled (for the 15+ cohort) between 1960 and the present, and the region remains on track in its progress toward meeting the Millennium Development Goal (MDG) of universal completion of the primary level by the year 2015. Girls in particular have made notable progress, by-passing boys in terms of enrollments at all levels and moving Latin America and the Caribbean beyond the MDG for gender parity in education and closer toward trends observed throughout the OECD (see figures 1 and 2).

Economic, social and political forces affect the supply of and the demand for schooling, as well as the benefits that individuals can extract and expect from the education they receive. This makes education particularly difficult from a policy point of view. Many of the forces that bear a direct impact on the equity and quality with which education is delivered remain beyond the immediate control of policymakers. In fact, of all the variables, students' family background accounts for the bulk of the variability in achievement. School and/or policy effects on learning tend to be smaller, albeit still significant, especially when targeted toward poorer students.

Latin America and the Caribbean suffers from the most severe income inequality of all the regions in the world. To an extreme uncommon elsewhere, socioeconomic status serves as a key determi-

**FIGURE 1**  
**Average Years of Education of the Economically Active Population**  
**(25-59 years) by Area (early 1990s and early 2000s)**



Source: ECLAC on the basis of national household surveys, "Panorama social de América Latina 2004."

nant of education outcomes throughout the region. Simply stated, poverty breeds poor educational performance. Poor children, regardless of their gender, race, ethnicity or place of residence, tend to begin school late, repeat their grade, drop out, and score poorly on tests. Serious implications follow, both for equity and competitiveness.

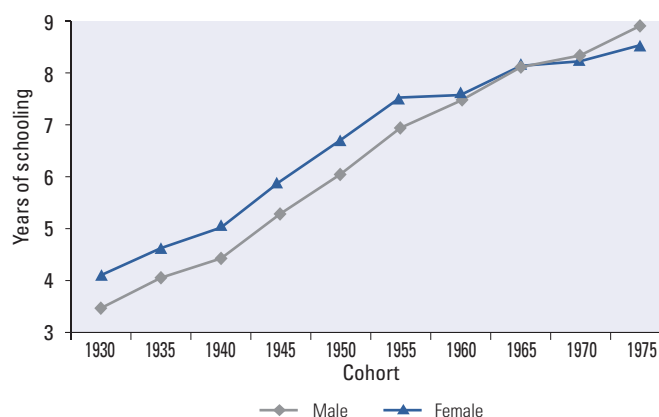
Inequalities of opportunity are visible early on, but tend to become much more accentuated with age (see figure 3). With some exceptions (e.g., Central America), poor children enroll in primary school with almost the same frequency as their richer counterparts. Indeed, average data from ECLAC for 17 countries (2003 or closest year) show a four percentage point enrollment gap between the poorest and richest cohort aged 7–12 in urban areas (95 percent versus 99 percent).<sup>1</sup> Yet this gap between children from low- and high-income families observed for the 7 to 12-year old cohort increases fourfold, to 16 percent, for the 13 to 19-year old cohort (71 percent versus 87 percent) and more than doubles again, to 36 percent, for the 20 to 24-year old cohort (21 percent versus 57 percent).

Gaps in achievement (measured by years of education) mirror these trends. Whereas this gap between the poorest and wealthiest quintiles remains below 10 percent in most countries for 6 to 11-years olds, it increases to an order of 20 to 30 percent for the 15 to 19-year old cohort. For 25 to 30-year olds across the region, an average of 5.5 years of schooling separates the highest from the lowest income quintile. The effect of these differences is not limited to the education sector. They are replicated in and by the labor market where, unsurprisingly, low levels of education command poorly compensated jobs and highest premium are paid to those with tertiary education.

## The Impact of Poverty on Education and Why Poor Children Perform Poorly

The reasons underpinning the inequitable distribution of education across Latin America and the Caribbean are many and varied. Poor children often do not enter school ready to learn. By some estimates, 6 year-olds from families in the upper income quintile enter school with a vocabulary of approximately 4,000 words; children from the poorest quintile enter with knowledge of merely 500

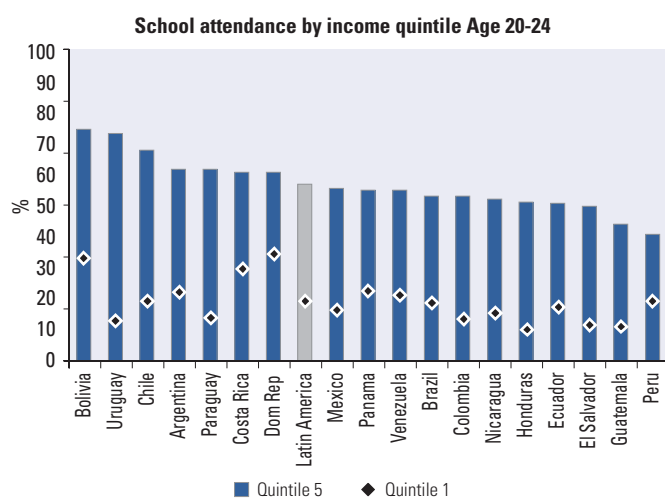
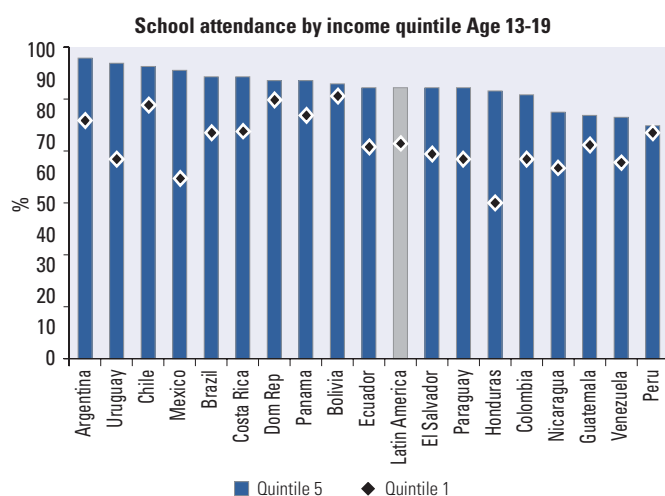
**FIGURE 2**  
**Latin America: Average Years of Schooling by Cohort and Gender (1930-1975)**



Source: IDB elaboration on the basis of household surveys.

<sup>1</sup> Given the fact that near-universal enrollment at the primary level across the region has reduced most all differences among socioeconomic strata, figure 3 omits data for the 7-12 cohort.

**FIGURE 3**  
**Urban School Attendance by Income Quintile and Age Group**  
**(circa 2003)**



Source: ECLAC, BADEINSO: Base de estadísticas e indicadores sociales.  
Note: The data for Latin America are a simple average of data available for the 18 countries included in this analysis.

words. Few catch up with their richer peers. Moreover, those that do manage to remain in school throughout the obligatory cycle often repeat a grade and learn less than children who benefited from the “privileges” of their class, including better teachers in better schools.

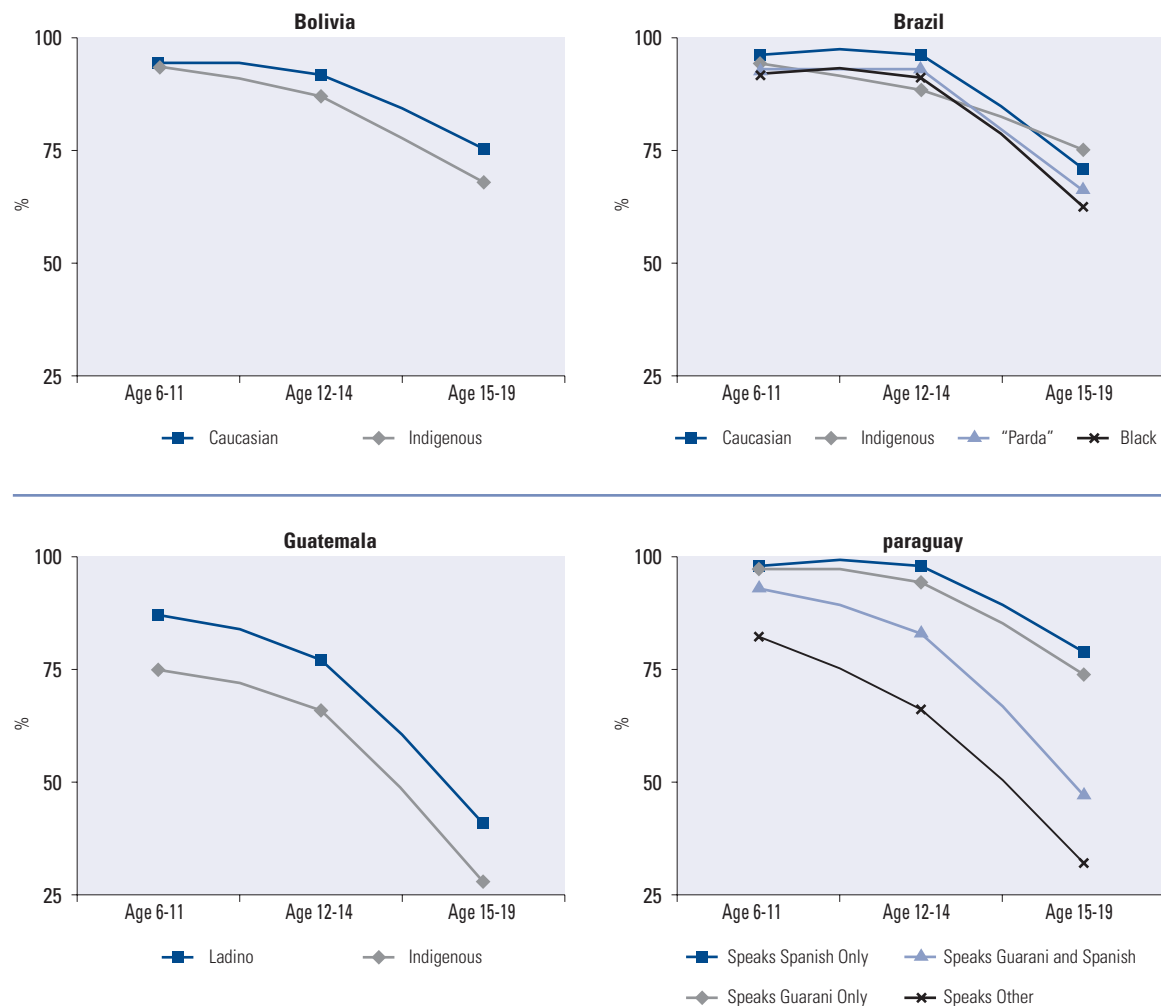
The region’s education systems generally have failed in compensating for learning deficiencies among their poorest students. Teachers tend to be ill prepared or absent, texts and materials are in short supply, and infrastructure is often inadequate to accommodate students’ needs. Issues of supply pose important considerations as well in that the majority of pre-primary, secondary and tertiary institutions tend to be concentrated in urban areas, while a large percentage of the poor reside in rural areas or the urban periphery.

## Poverty and Social Exclusion

Poverty remains largely concentrated in rural areas, the urban periphery and in marginalized (e.g., racial or ethnic) populations. Yet, in some instances, the exclusion of these groups from formal education systems is greater than what would otherwise be expected given their socioeconomic status. For example, in Guatemala, large marginal effects of race and ethnicity on the probability of being enrolled in school remain after controlling for gender, socioeconomic status and residence. On average, rural indigenous adolescents in Guatemala achieve just over 3 years of schooling by the time they are 15. Their nonindigenous rural peers achieve 4.5 years, while children living in urban areas reach 7 years of schooling. Insofar as few ethnic and racial minorities

attain basic education, few make the transition to secondary and tertiary level institutions (see figure 4).

The opportunity cost of education increases with age, particularly for poorer children and regardless of the years of education completed. As these children approach age 15, pressure to enter the labor market increases, often despite the fact that many may not have completed the primary level. These adolescents go to work at an early age, foregoing the reward of greater income in the long run that is linked to longer schooling. Entering the workforce ill prepared, they take low-paying, low-skill

**FIGURE 4****Social Exclusion in Education:****Current School Enrollment Rates by Group in Bolivia, Brazil, Guatemala and Paraguay, circa 2000**

Source: IDB, Marshall and Calderón (2006).

jobs with little opportunity for advancement. Those who study, or work and study, often fill the ranks of night or second-shift classes, which are generally taught by less qualified teachers than classes held during the daytime. As a result, these students are likely to lag academically and professionally relative to peers that enjoyed a better start and study full time or over longer periods of time (see box 1 for an innovative Bank project targeting these issues).

Opportunity costs are not the only explanation for low enrollment rates. Preliminary evidence points to the fact that perceptions regarding the quality of the education received and labor market outcomes also play a role. If the poor or socially excluded perceive that there will be little return to their investment of time and resources in education, then their resulting low levels of grade attain-

### Box 1: Improving Literacy in Nicaragua

Drop-out plagues education systems throughout Latin America and the Caribbean. In many instances, and particularly for children from poor families, children drop out of school prior to finishing the primary cycle. As a result, rates of literacy among this population are low and are associated with myriad problems of unemployability and marginality. To deal with these issues, the Multi-Phase Basic Education Project for Youth and Adults in Nicaragua seeks to lower illiteracy among 15- to 24-year olds from 19 percent (baseline) to 10 percent by 2105, and to increase net enrollment in basic education from 77 percent to 90 percent by 2015. The main objectives of the project include: (i) increasing the educational achievement of adults over 15 years of age who have never been enrolled in school or who dropped out of the formal education system before completing basic education; (ii) improving the income-generating capacity and employability of graduates from adult basic education; (iii) increasing the basic education graduation rate of youth aged 10 to 15; and (iv) enhancing the system for managing, monitoring and evaluating the impact of investments in basic education of youths and adults.

ment may be a rational response to the prevailing conditions. That is, although these populations may terminate their schooling before completing (for example) the primary level because of poverty or the need to work, they also may be leaving because they perceive few concrete benefits to staying in school, either because they are learning little in a low quality environment or see few or discriminatory prospects for gainful employment when they are older.

Indeed, there is some validation of this in today's labor market. Returns to tertiary education show a steady trend upwards. This reflects the impact of skill-based technological change on wages and captures the ever-greater market premium paid for jobs requiring nonroutine cognitive tasks, including analytical capabilities or intense interaction between people. As computers or other types of automation increasingly replace more routine tasks, workers with lower levels of education face falling wages. An interesting policy dilemma thus arises: if a poor child sees little chance of obtaining a tertiary degree and returns to secondary education are stagnant or decreasing, does it make sense to make the transition from primary to secondary education or to

move directly from primary education into the labor market?

### Gaps in Coverage

Issues surrounding preschool education deserve special comment. In study after study, interventions that are well structured and delivered have been shown to start children off on the right footing, boosting cognitive and socioemotional development, as well as having a positive influence on how well children perform and how much they achieve throughout their lives. These effects have been shown to be especially large when preschool and early childhood interventions are targeted toward children from poorer families. In practice, however, targeting and delivery have proved difficult. In most countries, private supply remains dominant and low-income families underserved. Several governments in the region, notably Mexico, Chile and El Salvador, have recently made strong commitments to make access to preschool universal.

Data also exist to suggest that the poor are disproportionately concentrated in technical tracks of the formal education system. But few of the region's technical education programs have proven capable of producing graduates that are academically and occupationally prepared to meet the challenges of an ever-changing labor market. Rather, technical education programs leave them with few

possibilities for further study at higher levels or other avenues for acquiring critical skills that command higher market premiums.

Serious equity issues plague the tertiary level as well. In many cases upper- and middle-class students, many of whom benefited from higher quality private education and expensive private courses to prepare them for entrance exams, attend free public universities and, upon exiting, reap the rewards of a market premium awarded to higher degrees. Poorer students, on the other hand, do not complete the secondary level at the same rate as richer students, thus truncating the demand for tertiary education. Among those that do make it to the tertiary level, many end up paying for their schooling in private institutions, few of which are renowned for high quality.

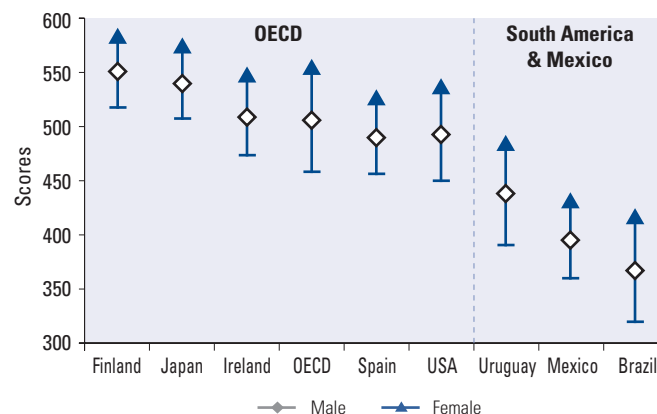
Training (nonformal sector) can be exclusionary as well. Most training opportunities require participants to be functionally literate, thus restricting entry to much of the “retooling” and upgrading necessary for a modern economy to specific portions of the population. This is no minor consideration. Even if the region were to achieve the education MDG by 2015, there would still remain 90 million adults who never finished primary education. Training will be key to increasing their employability and issues of how to best improve their basic skills while at the same time imparting job-ready skills will assume more urgency.

## Learning Lags Behind

Given the current state of education throughout Latin America and the Caribbean (progress punctuated by deficiencies in quality and equity), it comes as little surprise that learning has suffered. Again, strong differences by socioeconomic class appear. The Program for International Student Assessment (PISA, administered by the OECD) finds consistent and considerable income-related inequality in learning scores in the Latin American countries (see figure 5). In much the same vein, recent results from Chile’s SIMCE (*Sistema de Medición de la Calidad Educativa*) indicate that the greatest gains made between 2000 and 2004 were concentrated in the highest-income groups.

Notably, however, far from being confined to students from the lower end of socioeconomic scales, low performance afflicts schools and children at all income levels in Latin America. PISA results indicate that the best (and most affluent) Latin American performers participating in the 2000 and 2003 tests scored well below the best performers in other regions. For example, in Brazil and Mexico, more than 50 percent of students face difficulties in reading and in performing routine or obvious tasks; this figure increases to about 70 percent in the case of math. Comparable figures for the OECD are 20 percent for reading and 25 percent for math. In Uruguay, the region’s top performer, merely 15 percent

**FIGURE 5**  
**Average PISA Scores on the Mathematics Scale by Socioeconomic Quartile (2003)**



Source: OECD/PISA database, [www.pisa.oecd.org](http://www.pisa.oecd.org).

of students perform at internationally competitive levels in reading; only 10 percent do so in math. Percentages for the OECD are about double for reading and almost four times greater for math.<sup>2</sup>

## What to Do

Poverty and its pernicious interaction with social exclusion thus create roadblocks that compromise the equity and efficiency of education systems throughout the region. This, in turn, has negative impacts on labor productivity and overall competitiveness. Promising examples of efforts to improve equity in education systems exist in the region. Five approaches are summarized below. Each finds some reference in the Bank's portfolio of education projects and the results of all have been reviewed and evaluated. All five can be considered an example of what works to level the field of educational opportunity and yield educational outcomes that are less uneven.

### Increasing Access and Quality through Distance Modalities

Distance education has been shown to have an impact on increasing access to secondary and other levels of education, particularly for rural populations or in areas where supply is lacking. Initiatives such as Telesecundaria in Mexico (grades 7–9 and in operation for over 40 years) and Telecurso in Brazil (*supletivo* level, created by Fundação Roberto Marinho and funded by the Federation of Industries of the State of São Paulo) provide affordable alternatives when compared to constructing and staffing conventional schools, especially in larger countries. A particular strength of these programs is their ability to reach students living in isolated and rural areas at lower costs than would be possible through provision of a conventional school with trained teachers in a variety of subjects. These distance education programs rely heavily on highly structured and well-produced instructional materials, and help to resolve the fact that in poor and isolated areas teachers tend to be relatively less qualified and support materials (textbooks, maps and the like) are lacking. Once the initial costs of producing the materials is covered, marginal costs of vastly expanding these systems and even spreading them to additional regions or countries are low.

Results have been promising. Mexico's Telesecundaria enrolls one million secondary students and has been expanded to Central America. Learning results are equal to conventional instruction, after taking into account the weaker preparation of rural students. In much the same vein, Telecurso in Brazil reaches about 400,000 out-of-school youth. Pass rates on the Brazilian lower secondary school equivalency exam (*supletivo*) for Telecurso students are 60 percent or higher, with dropout rates falling below 20 percent. Increasingly, both public and private higher education institutions are offering distance learning programs with results that appear to be comparable to those of face-to-face instruction.

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<sup>2</sup> PISA tests 15 year olds, regardless of whether or not they are on grade. It thus captures the (under)performance of over-age repeaters (e.g., a 15 year old in grade 6), an issue of far more consequence in Latin America than in the OECD. See [www.pisa.oecd.org](http://www.pisa.oecd.org).



## Compensating At-risk Schools to Level the Playing Field

Compensatory programs for at-risk schools have produced noticeable results as well. In contrast to the conditional cash transfer programs or compensatory programs implemented elsewhere (e.g., the United States), which target poor children, these programs target at-risk schools and provide resources to help at-risk children in these schools increase academic achievement and reach the same performance standards that are expected of all children attending better-off schools. Criteria for selecting the schools include national assessment scores, the income level of the area's population and the grade level. The focus is often on lower grades and effectiveness appears to bear a direct relationship to the timely delivery of interventions. Available evaluation data also suggest that targeting is key to program success, as is strong project management.

Chile has been a pioneer in this field. Its P-900 program, first implemented in 1992, provides supplementary resources to 10 percent of schools (15 percent of national enrollment) in the lowest learning decile (measured by SIMCE exams). Following a comprehensive strategy that includes the provision of physical inputs, increased maintenance of school buildings, periodic technical assistance by field supervisors, teacher training and remedial tutoring provided by secondary school graduates from the community, learning in the P-900 program in language, mathematics and the natural and social sciences at grade 4 increased more than in the rest of the schools between 1992 and 2002.

Similar programs, such as Escuela Nueva in Colombia, also target schools with low-income children in rural settings. Based on a structured package that includes the use of study guides and training for teachers, self-study guides for students and community involvement, the Escuela Nueva approach allows the learning needs of diverse populations to be accommodated within a single school. It aims to provide a complete, quality cycle of primary education in areas where little or no educational opportunities existed before. The end result is that the children it serves have opportunities for gaining basic skills that were largely unavailable to their parents. Recent evaluations have found better learning results in Escuela Nueva schools than in traditional rural schools. The Escuela Nueva model has served as a source of inspiration for similar projects in Guatemala, El Salvador and Honduras, as well as for community-based education projects including the Consejo Nacional de Fomento Educativo (CONAFE) in Mexico and multi-grade schools in the Dominican Republic. Many of these initiatives have received Bank support. Paraguay (see box 2) and Uruguay have also pioneered an innovative approach of targeting early childhood and preschool programs to schools frequented by poorer children.

## Giving Out-of-school and Out-of-work Youth a Second Chance through Training

Training programs targeted to disadvantaged youth in Latin America and the Caribbean provide another line of activity for improving the skills of the poor. Based on concepts of efficiency, including the competitive contracting of training and demonstrations of demand for the skills trained (e.g., through the identification of jobs or internships as part of the training package provided), these projects target out-of-school and out-of-work youth and provide them with a series of basic and job-ready skills. A number of these programs have received Bank support, including Chile Joven and Proyecto Joven (Argentina) and similar interventions in Haiti and Peru. Relatively reliable data show that youths find jobs

## Box 2: Increasing the Equity of Preschool in Paraguay

The Primary and Preschool Education Program in Paraguay seeks to improve comprehensive education for children under 6 years of age by expanding coverage based on criteria of quality and equity, strengthening institutional management, and promoting household and community involvement. The Program's specific objectives are: (i) to achieve universal preschool educational coverage, measured by the gross enrollment rate, for all 5-year olds; (ii) to improve human resources development at the early education and preschool levels; (iii) to increase the quality of care for children from 0 to 4 years of age; (iv) to update and adjust standards and curricula for preschool and early education; and (v) to enhance the educational role played by the family and the community in the integral development of children under 6 years of age.

Based on the implementation of a standards-based instructional model to be introduced in all preschool classrooms (certified teachers, appropriate infrastructure, active learning pedagogies, appropriate and quality materials and curriculum, parental participation and assessment) to ensure the equitable distribution of quality preschool, the Program supports a mix of formal and nonformal delivery mechanisms. Its strategy for extending coverage and achieving universal preschool education is based on guidelines that prioritize and allow for the concentration of resources in schools deemed to be at greatest educational risk and in schools in the poorest districts. The distribution of infrastructure and quality enhancement provided through the Program was established on the basis of a four-variable weighted index: (i) deficit in preschool coverage (measured by the difference between the size of the population of 5-year olds and estimated preschool enrollment for a given year); (ii) deficit in quality of care (measured by the number of children in preschool classrooms that exceed the expected average number of children/classroom, which is 25 for urban areas and 20 for rural zones); (iii) educational risk (measured by the first-grade repeater rate); and (iv) socioeconomic departmental status (measured by the number of people living below the poverty line in each department).

in occupations that are sufficiently close to those for which they were trained, and that their rate of employment is considerably higher than that of control groups.

## Increasing the Demand for Education by Reducing the Opportunity Cost

Conditional cash transfers conceived primarily as poverty reduction programs, have been shown to also have a positive impact on education.<sup>3</sup> These programs, which provide families living in poor and/or rural municipalities with subsidies that are conditional on pre-established education, health and nutritional targets (e.g., enrollment in school), have been associated with increases in enrollment and retention rates in their respective target populations. In some notable instances (e.g., Progresa/Oportunidades), transfer mechanisms have been fine-tuned to allow for indexing by grade and gender (higher subsidies for higher grades and, at the secondary level, higher subsidies for girls than for boys). In the short term, more poor children enroll and stay longer in school. In the long run, as enrollment and completion rates among the poorest sectors of society increase, their probability of earning better wages and breaking vicious and inter-generational cycles of poverty increase as well.

## Equity-oriented Reforms in Education Financing

FUNDEF in Brazil provides an interesting example of the impact that changes in the rules dictating the al-

<sup>3</sup> Examples are: Progresa/Oportunidades in Mexico, the Family Assistance Program in Honduras, the Social Protection Network in Nicaragua and the Bolsa Escola program in Brazil, all programs that have received IDB support.

location of education financing can have on equity. Per student spending has long been recognized as a key variable affecting achievement gaps, particularly where spending is already very low. By applying a minimum spending floor per student and providing financing to schools in direct proportion to the number of students enrolled, independently of where the school is located, FUNDEF has made significant inroads in equalizing the playing field of educational opportunity. If a given jurisdiction fails to garner the resources necessary to meet this minimum, FUNDEF closes the financing gap. Public financing (federal level) thus becomes a tool for compensating for structural (e.g., across state or municipalities) inequalities. FUNDEF-induced changes have had a noticeable impact on education throughout Brazil. It effectively redistributed resources away from relatively wealthy state schools toward chronically underfinanced municipal schools (which tend to accommodate a large number of poorer students). By 1999, the share of enrollments in municipal schools was on a par with that of state schools and per student spending at the municipal level had increased by about 49 percent. And, as overall enrollments and completion of the primary cycle increased, more students found their way into the secondary level. Indeed, there was a notable expansion in secondary education (57 percent) between 1994 and 1999.

## Concluding Remarks

Latin America and the Caribbean has made great strides in expanding access to primary education. Most of the countries in the region are within a stone's throw of the Millennium Development Goal of universal completion of primary education. Most remarkably, and unique around the world, girls of recent cohorts have been incorporated into the region's education systems on an equal footing with boys which, in practice, means that another education-related MDG (gender parity in education) has been achieved. Preschool education has also expanded and, in some countries, coverage currently rivals levels found in developed economies. Secondary education has expanded rapidly and overall levels of education in the labor force have increased to an average of 6 years.

This success story, however, coexists with several fundamental flaws. Exhibiting the largest income inequalities in the world, the countries of the region have not been able to create equal educational opportunities for all or to use educational policy as a means for offsetting existing income and social inequalities. Even if most children enter school, many leave prematurely or learn little; this is particularly the case of the children of low-income families. Social exclusion creates additional obstacles. Children from indigenous populations share less in the general progress made in primary enrollment. Performance, measured by the results attained by Latin American countries participating in comparative learning assessments such as OECD's PISA, remains consistently poor. This not only puts the region at a disadvantage in a globally integrated economy, but also provides a strong indication that its competitiveness is driven less by human and knowledge capital than what it could and should, judging from the experience of other developing regions of the world.

This is a mixed picture of progress: of inclusion mixed with remaining pockets of exclusion, of schools where everybody reports for first grade but many never learn what they should and need to learn. The scenario it paints leads to the simple conclusion that education is one of the most important developmental challenges the region faces in the immediate future. The promise of more social

and economic opportunities for all in the region is closely related to how strong, how effective and how sustained the efforts to improve education will be in the next decade. A major focus of such efforts must be, by necessity, the improvement of access and quality of education for the poor.

## ■ **Leveling the Playing Field: Women's Participation and Contribution to Development and Economic Growth**

Women are a formidable economic force everywhere in Latin America and the Caribbean. In 2004, between 30 and 46 percent of the labor force was comprised of women who, in Mexico, were estimated to produce 30 percent of GDP. If nonmarket work, including household work, is taken into account, women's contribution to GDP rises by up to 17 percent. At the household level, women are key contributors, bringing in one-third of the income from remunerated labor.

Women's economic participation also has favorable implications for the development of the human resources of the future, boosting their children's prospects and the chance of curtailing the intergenerational transmission of poverty. In 13 out of 15 countries in Latin America for which this has been studied, a mother's participation in the labor force increases her children's probability of staying in school and improves their educational attainment by 5 percent.

However, women's economic contributions could be reinforced, with concurrent benefits in terms of empowerment, inclusion, gender equality and growth. In the last four years, the World Economic Forum included gender equality indicators in its survey of world competitiveness on the premise that women's progress is critical to development and growth. The five Latin American countries listed among the 58 countries ranked for gender equality did not fare very well. The exception was Costa Rica, which placed in the top third. As a group, Latin American countries ranked ahead of Asian, Middle Eastern and African countries in terms of economic opportunity, political empowerment and educational attainment, but they ranked last in measurements of economic participation and some indicators of health. The World Economic Forum notes that there is a "clear economic incentive behind empowering women: countries that do not fully take advantage of one half of the talent in their population are misallocating their human resources and thus undermining their competitive potential."

Against this background, this chapter identifies the obstacles to enhancing female economic participation and explores the implications for action. Governments in Latin America and the Caribbean, on the lookout for sources of productivity gains and growth, increasingly share the perspective espoused in this chapter that investing in women's potential makes sense for the benefit of national economies,

families, women and men alike. For instance, Chile's newly elected president, Michelle Bachelet, has made women and youth a focus of her labor reform program. Women's labor force participation rate in Chile has grown steadily over time, but at 37 percent it is still low by the standards of the developed world and even those of some Latin American countries. How to respond is the subject of this chapter.

## Women's Labor Market Participation

Both personal and household characteristics need to be examined to shed light on the question of women's participation in the labor force. To begin with, household data indicate that the poor participate less in the labor force than the better-off in all countries, the difference being overwhelmingly explained by female participation, which rises with income. On average, according to IDB research, 84 percent of men participate in the labor force, with little variation across the income spectrum. Yet, while over 60 percent of the women in the top income decile perform remunerated work, only 37 percent do so in the three lowest deciles.

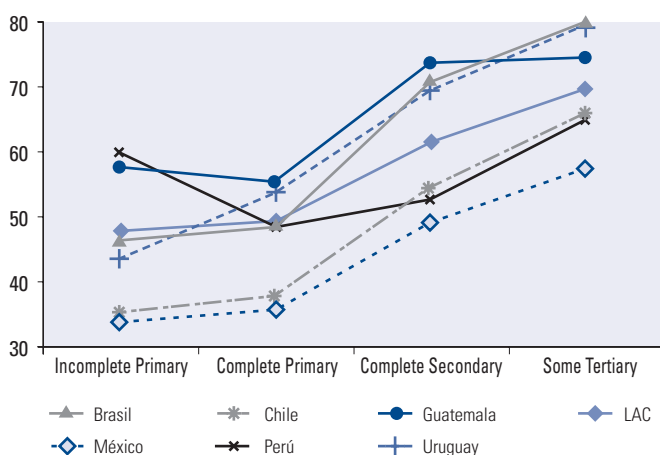
A woman's participation in the labor market can be explained by her earning potential, which in turn is positively related to her education and negatively related to fertility. Child rearing requires resources that have an opportunity cost associated to the value of the woman's work in the marketplace. The higher the educational level, the more income a woman forgoes taking care of her children and domestic tasks. The higher this opportunity cost, the lower the number of children and the higher women's participation in the labor force. The link between education and labor force participation is documented in figure 1 for selected countries. Another relationship, not shown in the figure, is that women's participation in formal sector jobs rises with their educational achievement.

Despite significant advances in recent decades, female participation rates remain significantly

below male rates throughout the region, and although educated women have higher labor market opportunity costs, there are still important untapped resources among their ranks. As table 1 shows, the pool of the highly skilled not currently working is mostly female, accounting for 70 to 80 percent of the inactive population older than 25 years of age that have completed tertiary education. This seldom acknowledged, unused pool of trained human resources, which is available now, should attract the attention of the private operators and governments that are intent on raising the productivity and competitiveness of the business sector and the economy more broadly.

To achieve more competitive economies and fuel economic growth, and to effectively reduce poverty, governments need to address the needs of women at both extremes of the social spectrum.

**FIGURE 1**  
**Female Labor Force Participation by Education Attainment**



Source: Good Jobs Wanted, Statistical Appendix, IDB, 2004.

TABLE 1

**Percentage of Women in the Inactive Population by Level of Education Completed**

Age Group	Less than Secondary	Secondary Complete	Tertiary Incomplete	Tertiary Complete	Total
26–40	0.88	0.92	0.77	0.79	0.87
41–65	0.81	0.76	0.79	0.69	0.80

Source: IDB Research Department, from household surveys.

## Challenges Women Face

### Balancing Work and Home Life

Why are educated women not participating in the labor force more fully? The reason for this does not seem to be associated with the need to carry out household chores or care for children and other dependents, because middle- and upper-class households have access to abundant and affordable domestic services to cover that need. Rather, the preference or need of women to be at home, especially during the childbearing years and when caring for other members of the family, including aging parents, seems to come into play. This situation could change if women had access to flexible working arrangements. In a survey in Chile almost 50 percent of upper income women answered that flexible hours would facilitate their employment. Formal labor market conditions usually demand a working day of 8 hours, five days a week, year-round. There is little room for flexibility, not only because of employers' preferences, but also, in some cases, because of rigid labor legislation provisions. The demographic transition toward an older population is likely to impose further demands on unpaid care services within the household.

Why are less educated women not participating in the labor force? And when they do, why are they overrepresented in the informal sector? Motherhood and the need to care for family members represent an obvious constraint on low-skilled women's labor market options and mobility. Under heavy time constraints, due to gender imbalances in time allocation within the household and time burdens for single mothers, low-skilled women might be marking a preference for informal sector jobs or occupations that make balancing their responsibilities at home feasible. Informal sector activities may allow them to work at home or near their homes, oversee their children, or work part time. However, these accommodations are usually costly for women, who pay a price in terms of lower wages and no social security protection.<sup>1</sup> Low-income women usually cite the need to care for their children or other members of the family as reasons for not participating in the labor force. The Chilean survey finds that low-income women refer to the availability of childcare services as the second most impor-

<sup>1</sup> Informal sector jobs tend to pay less and offer fewer benefits than formal sector jobs. The gap between formal and informal wages is larger for women than it is for men of similar age and education.

tant factor that would facilitate their employment (the first one is a good education). Day care options for pre-K children from low-income families are rare, often costly and of bad quality. Day care options for dependent adults are almost nonexistent.

The uneven distribution of domestic responsibilities between men and women, as well as boys and girls, remains at the root of women's labor market participation. Time use data for Mexico shows that working women with husbands/partners spend on average 37 hours a week doing paid work and 78 hours in household activities including cooking, cleaning, shopping for the home, administrating the household, repairing things and taking care of children or other dependents. Meanwhile, men with working wives/partners, spend on average 52 hours a week in paid work and 40 hours a week in household activities. As a result, wives have 13 hours less a week than their husbands to dedicate to personal activities such as sleeping, eating, grooming and recreation, or to other activities such as studying. Women who engage in paid employment do not diminish their participation in household activities significantly compared to women that are not in paid work.

## **A Safe Environment**

Social and domestic violence also affects women's economic participation. Increasingly, the physical care of the home and valuables is a reason to stay home or remain nearby. Also, security in the streets imposes conditions to the physical mobility of women around cities, limiting their labor market options to days, hours and areas easily accessible through transportation systems that offer some degree of safety. The worrisome femicides in Mexico and Guatemala, linked to the economic participation of large groups of young women in areas where maquila industries are concentrated, call for urgent attention from local and national authorities.

Domestic violence poses a challenge to women's economic empowerment. It not only causes physical and mental suffering to the victims, but it exacts heavy costs on their labor market participation and productivity. Domestic violence in Colombia increases the probability of female unemployment by 6.4 percent and reduces women's incomes by 40 percent compared to the incomes of women who do not suffer violence. Overall, the burden on economic performance can be high, according to some sources reaching around 4.2 percent of GDP in direct and indirect costs associated with domestic violence. A study of low-income women in Lima found that mothers' fear that relatives might sexually abuse their young children is a consideration driving them to stay at home.

## **Limited Capabilities**

Despite significant achievements in the education of girls in Latin America and the Caribbean, important challenges still exist to achieving gender equality in the acquisition of capabilities.

High levels of gender segregation exist in vocational education and training. Although there has been a trend toward the diversification of female enrollment, women are still concentrated in a few sectors of the economy. According to data from a survey of 16 major national training institutes in the region, conducted by ILO's CINTERFOR in 1999, ten sectors with the highest number of female students concentrated 77 percent of female enrollment, while the same parameter in the case of men only included 51 percent of male enrollment. Gender segregation in training interacts with, and is rein-



forced by, stereotyping in the education system and labor markets, affecting the employment prospects of women and men alike.

Information and communication technology (ICT) is at the heart of a global economy based on knowledge. Expanding ICT creates opportunities for both men and women. However, figure 2 shows that there already are significant gender gaps in the region with regard to access to the Internet and use patterns (which has become a crucial skill for participating in remunerated economic activity). Low-income women also lag behind men in terms of financial literacy. This constitutes a significant barrier to their economic participation as entrepreneurs.

## Discriminatory Labor Markets

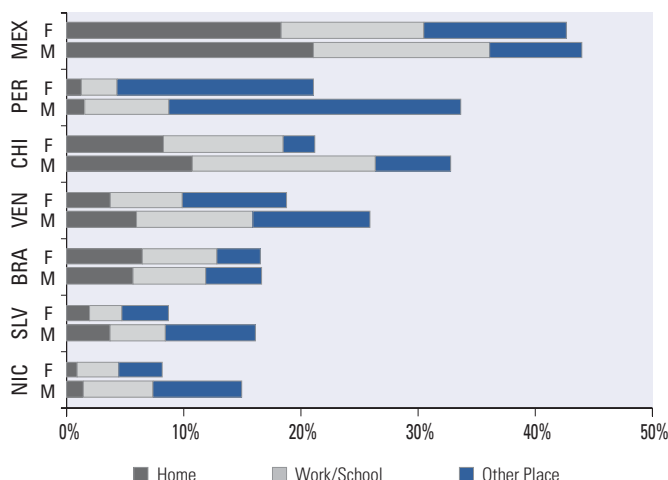
Labor market conditions may represent important incentives or hindrances to women's participation. Unexplained wage gaps between men and women, discrimination practices in hiring and promotions, lack of social protection and benefits, and high levels of horizontal and vertical segregation by gender are all decisive factors that affect women's economic participation.

Despite the fact that women in the labor force are, on average, one year more educated than men, unemployment rates are greater for women than for men. Data from 16 countries reveal that unemployment rates during the last few years were 40 percent higher for females than males, and groups with lower levels of education had significantly higher rates. The gender gap in wages remains, although it is narrowing: circa 2002, the ratio of female to male hourly wages in urban areas was 0.83 across 15 countries. However, while female wages were exceptionally low in Chile, working women earned almost the same per hour as men in Costa Rica and Colombia.

In most of the countries of the region, women are overrepresented in the informal sector. This means that there is a large and growing majority of working women who are not covered by labor laws and are working under the constant risks posed by unexpected illness, job loss or poverty in old age. Studies done by the IDB show that in 12 out of 16 countries of the region women have higher probabilities than men of earning "poverty wages," defined as those where a worker is paid one PPP-adjusted US dollar per hour or less.

Labor markets in Latin America continue to be highly segregated by gender. To restrict a significant proportion of workers from a majority of occupations carries heavy costs for the region's economies in terms of flexibility, efficiency and equity. A study of Costa Rica, Ecuador and Uruguay found that occupational segregation did not decrease during the 1989-1997 period in any of the three countries, despite important shifts in occupational structure and macroeconomic circumstances. A second important finding—robust across all three countries—is that occupational segregation is more severe

**FIGURE 2**  
**Internet Access by Gender and Location**



Source: Author's calculations based on Latinobarómetro 2003.

among the less educated. As in many other policy areas, women with less education are more limited in their options than their more educated counterparts.

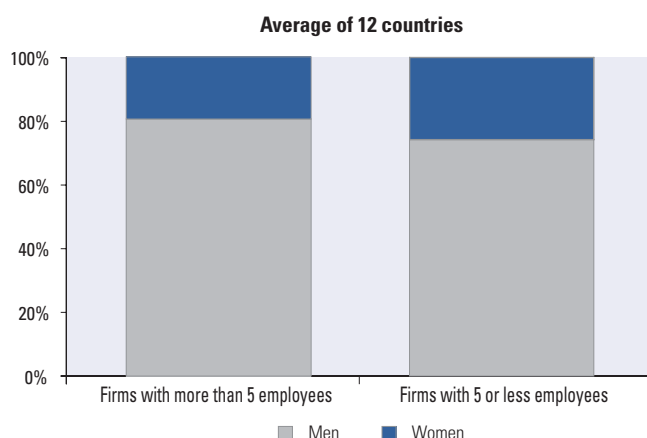
## Inequality in Access and Control of Assets

Land and home ownership is not only valuable to women because of their direct use. Studies show that it also protects women against domestic violence and increases household expenditures on children's well-being. Furthermore, women's control of assets increases their access to credit, which is restricted by their lack of collateral. The gender distribution of land ownership in Latin America is extremely unequal: less than a quarter of landowners are women. An evaluation of a land-titling program in Peru shows that redistributing property toward women by including their names in property titles is an effective mechanism to increase their access to credit.

Data on access to credit and other financial instruments show significant gaps between women and men. The difference is more pronounced among the poor. In Guatemala, 8.2 percent of male applicants obtained a loan according to one source, while only 2.6 percent of applying women did. When limiting the analysis to formal financial institutions, men's access was four times larger than women's. Among the poor, men's access was 22 times larger than women's. Women are in the majority among the users of informal and semi-formal sources of credit, but they draw significantly smaller total sums than men.

Information on the overall needs and challenges of women entrepreneurs in the region is very scarce. However, available evidence from household surveys points to a significant gender gap for the participation of women and men as employers (see figure 3). A study done by the Bank concludes that access to capital, technology and technical assistance were all more problematic for women outside the major metropolitan areas. In Argentina women business owners (39 percent) are more likely than men (31 percent) to indicate that business management training is an important issue, and that training sessions would help their business growth.

**FIGURE 3**  
**Employers by Gender and Size of the Firm\***



\* Does not include the self-employed.

Source: IDB calculations based on household surveys.

## Measures to Enhance Women's Economic Participation

Increasing the economic participation of Latin American women requires a multisectoral approach to address the different life issues that go into the decision and the practical effects of the labor market participation of different groups of women. A cultural change in favor of gender equality in general is an important component of this approach. This section draws attention to the range of policies and services that governments can put in place to enable women to increase their productive roles. Some of these are

areas where the IDB has accumulated significant experience, some are fields where more can and should be done, and some represent new areas and new approaches.

## **Timesaving Infrastructure and Policies**

Household services such as piped water and sanitation, gas and electricity, telephone lines and/or cellular communication are critical timesaving investments. Water and sanitation programs, especially when paired with basic health care training, not only save the time otherwise invested in carrying water from public pipes or wells, but they contribute to improvements in the health status of households, which in turn, reduces illnesses and the time spent (mostly by women) caring for the sick. The Bank has valuable experience in designing programs that improve sanitary conditions.

Household electricity increases the productivity of domestic work and expands the day for work, study or leisure purposes. Telephone lines or cellular phones are cutting the time required for communications and gaining access to information, usually reducing the amount of time involved in staying in touch with family and the workplace and exchanging information.

Investments in rural and urban transportation are also critical because they can improve the quality of roads, reorganize transport systems and increase the safety of passengers. Transportation networks that connect low-income neighborhoods with places of work are particularly important. The recent subway connection between the Puente Alto and La Florida neighborhoods in Santiago, Chile, and the upper-income areas of Las Condes and Providencia has reduced the traveling time of service providers by an average of 2 hours a day.

Bank programs that extend urban and rural transportation and social services to homes are helping to improve the allocation of time and to reduce the burden of going to work and the time it gets to get there. Consultations during project design and implementation should ensure the participation of women to obtain their ideas and preferences with respect to institutional arrangements such as the scheduling of the services or the establishment of transport routes.

## **Citizen Security and Domestic Violence Policies**

The high personal and economic costs associated with social and domestic violence require public attention. Safety is a consideration for women's economic participation, as noted above. Efforts to curtail the social violence epidemic are underway in many cities of the region, often with Bank support.<sup>2</sup> Reducing domestic violence is important per se, but also because there is sound evidence of the causal relationship between domestic violence and youth involvement in crime. The issue of domestic violence deserves prominent attention, funding, surveillance and legislation. The Bank has played an important role in this area by calling the attention of governments to the urgency of acting on this issue; providing seed money to test promising approaches; creating synergies between national and subnational governments; and providing lending for programs designed to curve the prevalence of domestic violence. The strategy of mainstreaming domestic violence projects into lending for citizen security programs

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<sup>2</sup> See chapter 13 on crime and violence.

has allowed channeling important resources to prevention and treatment. However, the Bank should remain vigilant to ensure that this important component of the cycle of violence continues to get the attention it deserves and that improvements in the legal framework are adequately funded.

## **Day Care Services**

Social services that support the caring needs of children, adolescents, the sick and the elderly are very scarce in the region, and are an area where additional investments are needed. Good quality services that are affordable, conveniently located and operate on a schedule that is compatible with working hours could make a big difference in the employment prospects of poor women.

Governments need to increase investments to expand access and improve the quality of services for early childhood development as well as day care centers. Governments could also provide incentives for private sector involvement in service delivery. Comprehensive approaches to early childhood programs yield very high economic returns, given their proven positive effects on children and their parents. Programs have to set quality standards measured by results, adapt initiatives according to a country's resources and give priority to lower-income families. The region has been slowly moving in this direction, often with Bank support, and some of its experiences provide valuable lessons for future action.

After-school programs for children and adolescent have multiple benefits for the children, their families and the community. Structured and supervised activities, such as tutoring with homework assignments and to compensate for any deficiencies from previous schooling, and engaging in recreational, artistic, cultural and scientific activities provide alternatives that occupy their free time and improve their school performance. They also allow women to search for income-generating opportunities and contribute to reductions in crime and violence. The Bank's valuable experience in designing programs that address the needs of children and adolescents in poor neighborhoods can be replicated in the region.

More attention needs to be paid to the increasing needs of the elderly. As the Latin American public becomes more aware of the economic, financial and social implications of the rapid demographic transition, there is increased pressure to reform the network of social services that provide support to seniors. It is well documented that women assume a greater burden of care-giving activities for the elderly than males do, and that they often have to choose between paid work and caring for their dependents at home. More private and government expenditure could provide more options in this area as well.

## **Education and Training**

Improving the education of low-income women is of particular importance to more fully utilize human resources and fuel economic growth. To reach this goal, governments need to improve the access of women to educational opportunities, as well as the quality and labor market relevance of their education and training. Poor girls, particularly those from indigenous groups, still lag behind boys in educational attainment. The challenge is to design projects that address the barriers that they face and create incentives for families to invest in girls' education. The Bank has experience working with

conditional cash transfer programs, like the Oportunidades program in Mexico, which has been able to raise girls' enrollment in secondary school by providing different scholarship amounts according to the child's gender.

Education plays a key role in building social norms. The Bank needs to make additional efforts to assure that gender roles in the curriculum, textbooks and teacher practices are not reinforcing stereotypes that limit the capabilities and opportunities of girls and boys. At the secondary and post-secondary levels, governments should try to promote the participation of young women in non-traditional areas of study.

Training programs can increase the human resources capabilities and its pertinence to the needs of labor markets. These programs can also enable men and women to cross gender frontiers. An effort to train women in nontraditional sectors and to work with employers to offer on-the-job training and practicum experience could enhance the already good Bank record on equal opportunity labor training. The Bank also has a long-standing tradition of supporting the development of microcredit in the region. However, more could be done to improve poor women's financial literacy, which is a major constraint to their development as small entrepreneurs.

## Labor Policies

The Bank has been an important supporter of reforms and improvements in the management of labor market policies and programs that are underway in the region. However, active measures could increase women's participation and the degree to which they benefit from these programs. Governments need to increase opportunities for training, skills certification and intermediation services for the low-income population, paying special attention to the participation of women in these services. In particular, efforts must be made to combat gender segregation. In order to increase the impact of these interventions, programs need to be linked and adapted to rural and informal workplaces.

Governments need to establish effective anti-discrimination instruments that can assure women that they will be able to compete fairly in the labor market. Enforcement of current legislation regarding nondiscrimination, maternity protection, day care services, and leave to take care of sick children is overdue. In order to avoid that well-intended protections backfire against women, these regulations need to apply to mothers and fathers alike. Some examples of these measures are promoting family leave, day care, after-school programs, flexible work schemes and day care for dependent adults. These should be made available to both men and women. There is also a need to create special training programs that can help women to reenter the labor market after periods of absence from economic participation associated with childbirth and childrearing.

A crucial area with the potential to boost women's employment and improve their quality of life are policies and programs to foster work and family compatibility. Some of these practices are part-time work; job sharing; working from home by relying on electronic technology; temporary work; maternity, family and sick leave to cover giving birth and taking care of children and dependent adults. A public-private sector agreement needs to be reached to put measures such as these into place. Regulations are also needed to allow flexible work conditions. However, making work more flexible should not mean a deterioration of working conditions. To that end, workers organizations need to negotiate the specific details of these agreements, by sector, or enterprise by enterprise, or through

collective bargaining. The Bank has been actively involved with the private and public sectors in the region in promoting corporate social responsibility practices, but could do more, in particular, with regard to fair labor practices for gender equality.

## **Property Rights Policies**

The experience with inheritance laws and practice, discriminatory land markets, and gender-neutral land reforms demonstrates that explicit and enforced public policies are needed to strengthen women's access to economic assets. Housing, urban improvement, land titling and programs to legalize informal settlements need to incorporate specific actions to address the gender gaps in assets in urban and rural areas. While some countries have enacted new legislation, information and education campaigns targeted at women are still needed to make them aware of their rights and the relevant laws. The Bank has invested important resources providing support to governments to regularize and strengthen property rights. One element to pay attention to is the lack of identity documents among women in the region. This largely feminine problem impedes women's ability to register their names in property titles.

The Bank plays an important role in supporting the productive use of financial resources sent to the region by the increasing numbers of migrant workers. Remittances could be a powerful mechanism to increase poor women's formal access to housing and land. Given the significant role of women as receptors of remittances, programs that link remittance flows to the development of housing markets are a unique opportunity to raise poor women's access to economic assets.

## **Developing Entrepreneurship**

Poor women and those from the most excluded groups need significantly increased access to credit in order to have the opportunity to become small entrepreneurs and homeowners. To accomplish this, affirmative action policies may be required to raise women's participation in business services such as training, technical assistance and counseling related to business development. The development of entrepreneurship also entails assistance with linking women into support networks.

The most successful programs fostering the development of women's enterprises are collaborative initiatives, often involving women's business organizations, nongovernment organizations and government agencies. IDB programs and initiatives can act as catalysts for bringing together women's business groups and government agencies.

## **Roles of Government and the Private Sector**

Governments and the private sector must play a part in order to increase the participation of women in the labor force. Governments must commit public resources and encourage private sector involvement, to increase poor women's capabilities, invest in time-saving infrastructure and provide social services that allow poor women to reconcile their productive and reproductive roles. It must also enforce equal opportunities and antidiscrimination legislation, and promote poor women's participation in labor market programs and business development services. Firms must also comply with equal op-

portunities and antidiscrimination laws. To attract educated women into the labor force, flexible work arrangements need to be put into place. These require the development and enactment of appropriate norms and regulations. Flexible working arrangements can represent win-win situations. Workers that are more committed and satisfied with their jobs are more productive employees. Firms and employers may find that taking into account the family needs of their workers allows them to tap into human resources that were not available before.

## Concluding Remarks

The economies and households of Latin America and the Caribbean need the input of working women. There is substantial room for improving, supporting and enhancing women's participation in the workforce, with concomitant contributions to the productivity and competitiveness of the region's economies and the impact on reducing poverty. What is required is an overall cultural change to foster equality between women and men such that gender would cease being the determinant that it currently is of women's economic rights and opportunities in life.

The goal of gender equality cannot be achieved without greater access to education on the part of low-income women and changes in the shares of household work undertaken by women and men. As discussed in this chapter, investments in infrastructure can improve domestic productivity and free up time for women to work outside the home; quality and affordable care services can have the same effect while expanding the market for social services; social and domestic violence prevention and reduction programs act to increase safety and self-esteem, both of which are associated with increased workforce participation, productivity and income. Enforceable labor market policies that combat discrimination, foster equal opportunities, provide access to productive resources and training, and make work and family life more compatible are also required. More information and analysis of the macro and micro determinants of women's economic participation is critical to policy formulation, and partnerships between the State, the private sector and civil society are essential. In a sense, a systematic approach to gender mainstreaming is what the challenge is all about.





## ■ Violence and Crime as Impediments to the Poor's Access to the Economic Mainstream

Violence and crime are pervasive problems in Latin America and the Caribbean, affecting the business climate, growth prospects, and the scope to reduce poverty and inequality alike. Homicide rates have grown to more than 19 per 100,000 inhabitants compared to the global average of about 9 in 2000. The trend has been upward in the region, making violence and crime an issue that governments cannot ignore.

Homicide rates and other indicators of the spread of violence and crime vary substantially between countries, regions within countries, and cities and neighborhoods. What does not vary, in general, is that the poor are bearing the brunt of the consequences in the form of social disruption, heavy human costs, and foregone employment and access to services. Arguably, the reduction of violence and crime is a necessary element of a strategy to “reach the people” and foster participation on equitable terms.

This section views violence as a multicausal, preventable problem that calls for action ranging from the local to the global sphere. It analyzes risk factors and some of the consequences of violence and crime and introduces an agenda for redress. The focus is on prevention at the local and municipal level, with the cost-effectiveness of the interventions a concern.

### A Burden on Development

High rates of violence and crime shape peoples’ outlook and sense of well-being, as well as many of their investment and consumption decisions. In Latin America, violence and crime rank prominently among citizens’ concerns. According to opinion polls (table 1), violence and crime were the fourth or fifth main concern in the region in recent years, becoming the second most important problem that people worried about in 2005, as reported by *Latinobarómetro*.

The literature on the cost of violence and crime is sobering, with one study tentatively placing the annual cost to the region’s economies at 14 percent of GDP. The costs are of different types. *Direct*

TABLE 1.  
Ranking of Citizen Concerns in Latin America, in percentage points (2000–2005)

2000		2001		2002		2003		2004		2005	
Problem	%	Problem	%	Problem	%	Problem	%	Problem	%	Problem	%
Unemployment	21.28	Unemployment	22.42	Unemployment	25.25	Unemployment	28.37	Unemployment	29.04	Unemployment	29.91
Education	21.18	Corruption	10.12	Low salaries	11.78	Low salaries	10.73	Inflation/ Economic Crises	14.66	Crime and Violence	14.01
Corruption	9.1	Poverty	9.39	Corruption	11.37	Corruption	10.45	Poverty	10.74	Political Problems	8.76
Crime and Violence	7.96	Crime and Violence	8.97	Poverty	10.34	Poverty	9.74	Crime and Violence	9.39	Inflation/Increase in prices	8.71
Poverty	7.18	Employment instability	8.92	Crime and Violence	7.41	Crime and Violence	8.29	Corruption	7.99	Poverty	6.53
Low Salaries	6.97	Low salaries	8.5	Employment Instability	6.31	Employment Instability	5.54	Other	4.67	Corruption	6.12

Source: Own calculations based on data from Latinobarómetro.

costs measure the health costs, the morbidity and mortality consequences, the costs of reduced labor productivity, absenteeism and decreased participation in the labor market, and the value of all goods and services used in responding to and controlling violence and crime, including the treatment of victims and perpetrators and the costs of public security, law enforcement, police, the justice and penitentiary systems, and other needs. *Indirect costs*, in turn, include the effects of violence and crime on the investment climate and wealth-creating activities foregone. Emotional pain, the erosion of the social fabric, the effects of violence and crime on the quality of life, and the transmission of violent behavior to subsequent generations are important elements of cost, even if they elude quantification.

There is no convincing single explanation as to why the levels of violence and crime in Latin America and the Caribbean are as high as they are and why violence is on the rise. Professional research publications, as well as the press, have documented the rise of illicit activities in the region and the world in recent times. The region is part of the global market for activities and services of this sort, a market that like that for licit activities has become deeper and more fluid in the wake of the opening of borders, technological advances, and the “death of distance” that characterize our times.

Closer to home, the factors that contribute or deter violence and crime can be classified into three main groups: (i) individual, (ii) domestic/household and (iii) community/society level factors.

Factors at the level of the individual can explain why some people are victimized or act as perpetrators more often than others. These factors are related to gender, age, other biological and demographic characteristics, educational and socioeconomic achievements, employment status, whether an agent of crime has been a victim or witnessed violence within the household, and the propensity to engage in risky behavior, including alcohol and drug abuse.

Factors at the household level refer to such aspects as living conditions and social relations, including income, parenting skills, overcrowding, the ability to supervise children and youngsters, conflict management skills, and the presence or absence of a history of violence in the family.

Finally, community factors are related to the social and economic environment in which individuals and households live. Income inequality, the extent of unemployment, the availability and functioning of public services, social capital, access to justice, and the community's relationship with law enforcement agents and the police are some of the determinants in point. The three groups of factors that foster or can help deter violence and crime are interrelated and often mutually reinforcing. In particular, high levels of income inequality and the social exclusion of specific groups have been found to be factors in the spread of violence and crime, often to the detriment of the very groups to which the perpetrators belong.

Women, children and young males are the most affected and victimized by violence and crime. Up to half the population of women in Latin America and the Caribbean have been estimated to suffer psychological abuse by their partners, while more than one third are victims of physical violence. Studies have documented the resulting negative effects in terms of the productivity of female labor, absenteeism and incomes earned, not to mention the effects on the family as the basic cell of social reproduction and cohesion.

Children living in violent conditions are affected in terms of their happiness, health, learning ability, school achievement and social skills, and they are likely, at an older age, to reproduce the aggressive behavior that they witnessed. A vicious cycle is at work as violence begets violence, spilling from the household into the street.

Youths—especially young males—are the cohort most at risk of being both victims and perpetrators of violence in Latin America and the Caribbean. Depending on the country, the male cohort in the 15 to 24-year age bracket represents between 20 and 40 percent of all deaths, the rate of homicide deaths of males is nine times that of females. These are staggering statistics that, in and of themselves, should be enough to motivate a public and community-driven response. The case is strengthened if one thinks of the human, social and civic costs in addition to the economic losses of violence and crime to which reference was made above.

## Preventing Violence and Crime

Increasing citizen security and preventing violence and crime is a medium- to longer-term process that requires the commitment of government, opinion leaders, politicians, the media, civil society and private actors as well as an ability to prioritize and adequately design a course of action over time. The transformation of the city of Medellín, Colombia, in recent years, under the municipal authorities' motto *del miedo a la esperanza* comes to mind as a process that has produced significant benefits and deserves to be studied with a view to extracting lessons that might be applied elsewhere.

Traditionally, the approach to fighting violence and crime in Latin America and the Caribbean has been through law enforcement or what may be called reactive measures engaging the police and justice systems. The results have been limited at best and cannot be called cost-effective. The examples of Medellín and a number of cities in the region that have been the target of projects supported by the IDB suggest that a broader approach is needed. Communities need to be mobilized, public perceptions of violence and crime and of the institutions in charge need to be shaped, city infrastructure needs to be built to reduce the opportunities for crime (this includes the lighting of public venues such as parks and sports facilities, for example), law enforcement and the police may need to be reformed, alternative conflict resolution mechanisms may need to be introduced, youth programs need to be put in place, employment must be created, and the factors that shape the quality of children's development and family life must be taken into account and influenced in serviceable and conducive ways. The forces and actors with a bearing on the nature and the incidence of violence and crime are complex, dynamic and diverse. The response must be commensurate, and (as the experience suggests) it should be homegrown, adapted to the local circumstances and community owned.

Interventions that focus on improving family management, parenting and early childhood development have been found to be particularly cost-effective in preventing violence and crime. Working with parents to help them model positive patterns of behavior in the way they handle stress and anger can have a high pay-off in terms of the prevention of violence against women and children in the household which, as mentioned earlier, is often reproduced in the form of criminal behavior later on.

Local governments such as municipalities are the natural locus for much of the task of preventing and controlling violence and crime. They should take the lead in coordinating initiatives involving the relevant range of actors such as community dwellers, civil society organizations, the private for-profit sector and the central government. The task is to design and implement interventions that fit the community's needs. For continued community ownership, under conditions in which the going can get tough, experience suggests that it is important to design interventions that can be evaluated;

that is, with clear indicators of success, quantitative targets, and a monitoring system that allows tracking progress and the achievement of milestones so that they can be publicly discussed. This has been done in the case of Medellín, as well as other cases supported by the IDB, for example, the city of Bogotá.

In recent years, the government of Bogotá undertook a groundbreaking program to reduce violence and promote citizen security, with impressive results. The homicide rate was reduced by 66 percent between 1994 and 2003 to 23.4 per 100,000 inhabitants. Thousands of firearms were collected and thousands of people convened in town halls and meetings to discuss actions aimed at reducing violence and crime. The strategies implemented included: campaigns to control the circulation of firearms and promote disarmament; restrictions on alcohol sales; interventions to recuperate decayed urban spaces that were hot spots for violence and crime; implementation of neighborhood crime-monitoring committees to encourage collaborative relationships between communities and the police; creation of family police stations to provide services to victims of family violence; and, broadly, the professionalization of the police. The experience of Bogotá demonstrates the importance of a broad-based and adequately resourced approach as well as the political commitment that needs to be sustained across successive administrations.

Although the initiatives implemented in Bogotá have had a significant impact in terms of reducing violent crime, it is important to recognize that such efforts are difficult to carry out without the presence of effective institutions. Therefore, increasing the capacity of the institutions in charge of formulating and executing violence prevention policies is central to these efforts. With the appropriate capacity installed, these institutions will be able to gather more and precise information, target their interventions better, and increase the delivery of social and financial services to those most at risk. Equally important, because violence and crime are multicausal and complex phenomena, strong and effective institutions are needed for the tasks of coordination among different actors and the implementation of complementary interventions such as social protection and public works programs that can affect the problem of insecurity in positive ways.

## Concluding Remarks

Violence and crime are an important development challenge and a source of continued dysfunction and exclusion in Latin America and the Caribbean. Governments need to take note, formulating and implementing strategies of prevention and control. Policies and programs aimed at preventing violence and crime should be seen as indispensable elements of broader strategies to foster growth, the reduction of poverty and the participation of poor people in the economic mainstream. The factors at the level of the individual, household and community that give rise to violence and crime are increasingly understood, and there exists a body of experience and evolving practice from which one can learn about what works in terms of the response of local governments. The task ahead remains huge, but the problem of violence and crime is amenable to correction if it is appropriately and comprehensively addressed.



## ■ Housing Sector Reform as a Means for Reaching the Poor

**T**he development of housing solutions is one of the most cost-effective ways of expanding the asset base of low-income households and enhancing both equity and growth. In many Latin American countries public policy on housing has shifted from supply-side subsidies for finished homes for low-income households (a well-intentioned, but unsustainable approach), to policies that seek to enable housing markets. Thus, policies now focus on financing mechanisms, land markets and real estate development, among other aspects, with a view to mobilizing production capacity and private solutions to expand housing. However, markets alone cannot solve the problem because low-income households usually cannot afford formal housing. Supplementary solutions are needed to support these households' access to housing, including progressive building and the improvement of homes through self or community help.

### The Housing Challenge

Conservative estimates indicate that by the year 2000 more than 17 million households in Latin America and the Caribbean were sharing dwellings with others and 21 million families lived in inadequate homes. The supply of affordable homes each year lags significantly behind the growth in demand from newly formed households. The structural problems underlying these statistics include the region's slow economic growth that does not generate adequate employment and income for all, the escalating cost of urban land, the relative underdevelopment of the region's housing finance systems, and the misguided housing policies of the past that devoted most public resources to programs that did not reach the majority in need.

The experience shows that government programs centered on the construction and distribution of finished houses for low-income households cannot solve the housing problem because they supply a limited number of quality homes to a few lucky families, while leaving many needy households unassisted. Houses financed with public funds are unaffordable to the intended beneficiaries (even with access to subsidized loans) and are eventually acquired by households in other income brackets. Subsidized lending erodes the capital of the government-owned housing finance institutions, preventing housing provision and financing mechanisms from being replicated. Low-

standard site-and-services programs (created to expand the scope of government-backed programs) have also proven incapable of reaching all the families in need, while government-sponsored housing finance mechanisms, which operate with resources from labor taxes to subsidize loans, are unsustainable.

The housing finance systems in Latin America are underdeveloped. In spite of the significant contribution of the housing sector to wealth accumulation, the use of mortgage financing is low. This situation originates from the risks involved in lending for housing: credit, collateral recovery, and interest rate and term mismatch risk. *Credit risk* results from the low income of a large proportion of the population. Nearly half the population of the region lives on less than two dollars per day, and their sources of income (mostly from informal activities) are sporadic and difficult to document. The difficulties that lenders encounter in executing the guarantees generate *collateral recovery risk*. The causes of this risk include the legal protection offered to homeowners in cases of default, complex repossession procedures, and the inefficiencies of the judiciary, which make the recuperation of collateral a lengthy undertaking. *Interest risk* is caused by macroeconomic instability in Latin America. Volatility also discourages saving, forcing lenders to fund long-term loans with short-term deposits, which leads to *term mismatch risk*. In the face of these realities, the expansion of private lending for housing in Latin America has been difficult.

Many urban sites, another key ingredient in the housing equation, are characterized by price escalation. The best land in terms of location and environmental endowments is actively sought by the wealthier households and investors intent on generating returns. Poor households and less productive economic activities are relegated to the less suitable locations when they can be accessed legally or are pushed to public lands or environmentally unsuitable parcels that can be invaded. Informal access to land is the most common strategy for low-income families to initiate the phased construction of their houses through self-help. Most poor families live in self-built, often substandard houses in formal or informal settlements, frequently without access to basic services.

Complex and varied rental housing markets contribute significantly to the provision of shelter and have vast social, economic and urban impacts, while also playing a critical role in facilitating household mobility, particularly as families transition through their life cycle. The rental market in Latin America requires further development following years of ill-conceived rent control policies. Renting space in informal settlements and house sharing are common among low-income families. Renting and subletting deteriorated inner-city dwellings are costly solutions for poor families that at the same time contribute to the loss of heritage and underutilization of urban assets.

The role of local governments in housing has increased, as have their responsibilities for key determinants of land availability for residential uses: the provision of trunk infrastructure (roads, water, sewerage and drainage) and the regulation of land uses. Additionally, local governments often play a role in supplying residential land for the poor, while in the more decentralized countries, the provinces, states and municipalities often exercise significant fiscal authority, mostly in land taxes and service charges, which affects the operation of housing markets. Frequently, larger Latin American states, provinces and municipalities allocate significant resources to implement subsidized social housing programs; some even experiment with rental housing for the poor. Yet, when misguided, the valuable resources and efforts of local governments do not yield the desired results, facing similar difficulties as those described for national housing policies.



## The Enabling Markets Approach to Housing

Numerous governments, realizing their inability to provide adequate shelter for all needy households through traditional policies and programs, recognize the importance of mobilizing the resources and resourcefulness of the private sector (including household savings and sweat equity). Their goal is to induce private entrepreneurs and civil society organizations to handle housing production and financing for all segments of the population. Under the *enabling markets approach* governments direct their efforts to improving relevant market operations and preventing market failures through effective regulations and taxes, the provision of infrastructure and services, and targeted subsidies. The payoff to unleashing the potential of individuals, communities, developers, investors and entrepreneurs to finance, build, sell and improve affordable houses, is significant. For instance, in Panama, a country with low inflation, low interest rates and a strong financial sector, 70 percent of households (those earning a minimum salary equivalent to approximately US\$250 per month) have access to formal sector loans and low-cost homes developed by the private sector.

The approach pioneered by Chile and Costa Rica, and later adopted by other countries (Colombia, Ecuador, Guatemala, Peru and Panama), involves the restructuring of traditional relations between the State, the private sector and the community with respect to housing. Under the enabling approach, the key task for the public sector is to create the conditions that improve private sector performance through the elimination of unnecessary regulations and by withdrawing the government from the direct production and financing of low-cost houses. Other necessary requirements include improvements of the land titling and registration regime, the elimination of obstacles for executing guarantees and the removal of rental regulations.

For example, the revision of land subdivision regulations facilitates the private supply of reasonably priced, upgradeable land for residential uses. If these interventions prove to be insufficient, the government can intervene by facilitating the development of mortgage and microfinancing for home construction and improvement, as well as by issuing one-off capital subsidies to low-income families, enabling them to purchase homes constructed by private entrepreneurs. These measures mitigate some of the risks that impede the development of mortgage financing. Direct one-off subsidies decrease credit risk by reducing the financing to affordable amounts for families in different income brackets. Improved title and registration regimes partially reduce the risks confronted by lenders in executing the guarantees. Success in implementing this approach does not depend solely on housing policies and related reforms; rather it depends on macroeconomic stability (which is essential to reducing interest rate and term mismatch risk) and the availability of long-term financing in local currency.

Although the enabling markets approach has prompted significant changes in government policies and programs, the repertoire of instruments used still falls short of fulfilling the complex needs of the region's housing sector. In particular, it has been difficult to reach households in the first two quintiles of the income distribution structure. By focusing primarily on the formal portion of housing production, enabling markets programs do not sufficiently address critical housing processes that provide shelter to households through the informal acquisition of land and the phased, and mostly self-financed, construction of the shelter, that, in some cities, account for 65 percent of the housing stock. Moreover, policies rarely focus on rental markets (which play a significant role in well-function-

ing housing markets) and land market issues, often critical to facilitate housing access to low-income households.

## IDB Support for Housing Sector Reform

Bank support for housing followed the evolution in policy referred to at the outset of this chapter. After financing public programs for finished houses and, later, sites and services projects, the Bank is currently actively supporting the efforts of Latin American countries to move away from the direct production and financing of affordable houses, toward the adoption of a market-facilitating role. Between 1993 and 2005, the Bank approved 29 housing loans, totaling US\$2.6 billion, to assist countries in the design and implementation of housing sector reforms. The three principal investment components in the Bank's housing portfolio include:

- Upgrading and titling of urban settlements;
- Development of long-term mortgage credit, including loans for second-tier finance institutions and mortgage insurance; and
- Up front, one-off, demand-side subsidies to individual households, used in conjunction with savings and commercial loans in financing new homes and home improvements.

Bank operations in support of the enabling approach are more complex than previous housing loans, which focused on the production of finished houses or sites and services for low-income households. Contemporary programs, which consist of multiple components requiring a closely intertwined implementation process, involve a variety of executing agencies and regulators, requiring more time to generate results. Therefore, they require strong, long-term political support both for the reforms and to replace the old policies and programs.

These programs generate two lessons: that the enabling approach to housing reform yields better results, and that a two-pronged strategy for improving the flow and stock of housing is effective.

*The enabling approach to housing reform yields better results.* This is demonstrated by the successes of early reformers, such as Chile and Costa Rica, and the progress made by countries that received Bank support in the 1990s. However, tangible results occur only after several years of sustained efforts, spanning several administrations, underscoring the need for a long-term perspective and political commitment when attempting housing sector reform. Additional resources may not be necessary in this commitment, as data proves that countries attaining positive results have devoted a similar per-

centage of GNP to housing (around 2 percent) as have poorly performing countries lagging behind in the reforms.

*A two-pronged strategy for improving both the flow and the stock of houses is effective.* A critical task is to expand and diversify the flow of new housing solutions by improving the performance of housing finance and urban land markets. Encouraging private suppliers of

The enabling approach to housing markets yields better results than the direct construction and financing of houses by the public sector, as demonstrated by the successes of early reformers, such as Chile and Costa Rica, and the progress made by countries that received Bank support in the 1990s.

houses and financing in moving down market is critical, as this expands the reach of formal housing markets and frees up public resources to cater to the needs of poorest households.

In most countries, improving the private supply of affordable urban land is the key element in any housing policy benefiting low-income households. Reforms to regulations governing land use planning, subdivision and servicing of residential land and land titling are cost effective methods, but must be based on well-conceived pro-poor regulatory audits. Well-designed systems of land taxation also encourage more efficient land markets, particularly by discouraging the speculative retention of land outside the market. Innovative forms of collective land ownership play a significant role in securing land tenure in communities where individual titles do not concur with communal customs and values.

The maintenance and upgrading of the existing stock of housing is the second prong of the strategy. Bank experience demonstrates that urban upgrading programs must be an integral part of housing policies. Key areas of intervention with direct and indirect impacts on housing conditions are improvements to physical infrastructure, the regularization of land tenure and the provision of neighborhood social services. These programs help encourage higher levels of investments in the homes and open up the potential use of home equity collateral to access credit markets, yet they are often difficult to execute because they require the coordinated intervention of several agencies. The Bank has documented positive results when municipal governments execute these programs. However, the multiple deficits of informal settlements may lead to overspending of public resources. By enforcing caps on individual household investments based on solid estimates of the economic benefits of the interventions, governments can control this propensity, while allowing flexibility in the choice of intervention.

## **Priority Areas for Intervention to Extend Housing for the Poor**

To expand the housing sector's capacity to reach the poor, interventions are required to increase the flow of affordable housing solutions, improve the quality and utilization of the existing housing stock and promote more efficient use of public resources that assist the poor in accessing decent housing.

### **Expansion of the Housing Stock**

*Strengthening urban land markets* is critical to improving housing sector operations and must be prioritized along with other sector reforms. Land prices should be compatible with market conditions, but within the reach of low-income households. Facilitating the production and sale of affordable urban land requires interventions on several fronts including investing in urban infrastructure to expand the supply of serviced land, introducing mechanisms to discourage speculative retention of land and capturing appreciation in order to reinvest in infrastructure and urban services. Other key intervention tools include establishing public-private partnerships for land development, promoting the rehabilitation of deteriorated urban areas and the recycling of vacant or underutilized urban land, and endorsing greater transparency of land markets. A pro-poor regulatory audit can reveal the need for reforms in

areas of government policy such as public investment in infrastructure, land taxation, land use and subdivision standards.

*Promote private sector involvement in housing production and financing for all income groups* by pulling the government out of the direct production and financing of houses, and thus opening up opportunities for private producers and lenders to supply the market. The availability of affordable and accessible mortgage loans is crucial because it helps expand the supply of low-cost houses. Traditional mortgage finance mechanisms in Latin America and the Caribbean typically reach a small share of the population (middle class and above) offering only one product, a loan for the purchase of a developer-built new home. This does not suit the needs of the low/moderate-income groups, who in general are unable to afford high-cost finished housing solutions or lack the formal employment and other requisites necessary to qualify for loans. Thus, it is important to persuade mortgage issuers to go down market, diversify the products they offer and develop second-tier mechanisms to increase available funds.

The rapid expansion of new home production may lead to substandard construction. It is difficult for consumers to protect themselves against such risks, as houses are complex products with potentially concealed defects at the time of purchase. Local governments should carefully supervise and approve new housing developments to ensure quality and protect consumers, although most municipalities will need support in discharging these responsibilities.

*Support for phased housing construction* is critical as most households build their homes in stages. The continuous process of home expansion and improvement can be made more effective through targeted interventions that promote better quality and accelerate the construction process. In addition to facilitating access to serviced residential land, key interventions include the provision of technical assistance to do-it-yourself builders, the development of new building materials and the promotion of microfinance (small short-term loans) for low-cost housing solutions, such as phased home construction, house improvements and the construction of a new unit on a family-owned lot.

## Improvement of the Existing Housing Stock

*Upgrading low-income, informal settlements* is essential in solving the problems of the existing stock of housing. Successful interventions range from the simple improvement of basic infrastructure and the provision of secure tenure, to more complex integrated interventions. When the sponsoring institution has sufficient financial and institutional resources, it can adopt a more comprehensive approach with a variety of interventions, such as infrastructure improvements, environmental hazard mitigation, the provision of social services, tenure regularization and technical and financial support for home enhancements. These programs are often the only viable government housing solutions in the absence of a stable macroeconomic environment and efficient financial markets, and in countries facing significant distortions in land markets. However,

to prevent governments from condoning informal housing solutions, while encouraging them to allocate funds to formal housing solutions in a reformed housing sector, settlement-upgrading programs must always be integrated with efforts to expand new housing production.

Low-income households can only access housing gradually, building their homes as resources become available. Public support can help create a more efficient process; however, it involves interventions in new areas.

*Cost-effective house improvements are essential.* A portion of the housing stock in formal settlements is usually in different stages of disrepair or lacks basic facilities. Thus, the promotion of cost-effective house improvement programs is imperative in improving the overall housing conditions of the population. Most countries in the region have low housing mobility, with many families staying in the same house for most of the family life cycle. This often leads to informal, precarious home improvements and expansions undertaken by the families themselves. The availability of credit lines and technical support for these families, as well as training and technical support for micro and small construction enterprises would support a more efficient process.

## **Institutional Developments for More Efficient Housing Policies**

*The efficient use of public funds to support the housing sector is essential.* The public sector must help markets achieve greater efficiency, while the private sector takes on the responsibility of producing and financing houses. Public funds should only be used for subsidies as a last resort, after other means of facilitating housing access to low-income households have been explored and proven unfeasible or insufficient. A vast body of literature and evaluation of programs indicate that subsidies should always be one-off, up-front, transparent, budgeted and targeted to households in need. Public funds can find more effective uses improving the regulatory environment for the real estate and building industries, developing efficient land market regulations, and improving transparency in land markets. Yet, when subsidies are the tool of choice, targeting techniques, such as social surveys (either designed specifically for housing programs or part of a more general system of targeting social expenditures) are essential in identifying and assisting all families in need. Local governments play a key role in administering these surveys as they are in close contact with the targeted populations. Establishing national lists of beneficiaries also helps targeting, reducing the risk that some families receive more than one subsidy for the same purpose.

*Effective urban development and environmental planning,* such as the enforcement of land use and subdivision regulations, helps prevent or mitigate environmental risks in urban settlements. However, these regulations are often ineffective because they are systematically bypassed when governments are incapable of ensuring compliance and the low-income population cannot afford them. Alternatively, it is important to develop low-cost approaches that focus on reasonable and enforceable rules and identify and reduce vulnerability to environmental hazards, while at the same time avoiding the worst ills of informal settlements (lack of critical basic services, overcrowding, poor accessibility and lack of light and ventilation in the dwellings). Supporting effective risk management involves disseminating simple disaster-resistant building codes and encouraging housing agencies to work with those organizations responsible for hazard mapping and municipalities in improving land use planning.

*Performance indicators.* To evaluate and improve reforms it is necessary to produce, maintain and disseminate performance indicators that accurately portray the state of the sector and its evolution toward greater efficiency and equity. Given that scarce data availability limits the variety and scope of the potential indicators, it is essential to promote data collection and analysis through population and housing census and household surveys. Improvements in housing conditions take time; therefore, performance indicators should be tailored to measure progress in different periods, ranging from yearly assessments of government programs to measurements of progress in the aggregate housing

situation through censuses taken every decade, including regular studies that provide insight into advances in key indicators of a well-functioning housing sector.

## Urban Infrastructure and Services

As the quality of housing is closely linked to its neighborhood, housing policies must concentrate on the adequate provision of basic urban services and infrastructure. Although these components usually fall outside the housing sector, they provide essential services to households. Municipalities play a key role in the provision of well-located, basic urban services, such as health, education, and recreational facilities, and trunk infrastructure, such as of roads, potable water, and sewerage, all essential to the wellbeing of the population. Housing programs must support the development of proper institutional and financial mechanisms that ensure the sustainable provision of these services.

## Concluding Remarks

Housing production and consumption affects socioeconomic development by promoting economic growth through the expansion of the construction industry and, when operating efficiently, by expanding the asset base of low-income households. Although the enabling approach to housing markets yields better results than traditional direct construction and financing of affordable houses by public institutions, these results are based on several conditions. Tangible outcomes occur after several years of sustained efforts, thus requiring a long-term perspective and political commitment. To be effective, interventions should focus on both expanding new housing production and improving the quality of the existing housing stock. The development of financial markets and sustained investment in trunk infrastructure are also imperative to the success of the approach.

Under any circumstance, reaching the poor to help them attain good housing conditions is difficult given the high cost of the required assistance and the diversity of initial housing situations. Settlement upgrading programs produce strong results in improving the quality of the housing stock. However, expanding the flow of new housing solutions is a challenge that needs to be addressed more systematically. Low-income households can only access housing gradually, building their homes as resources become available. Public support can help create a more efficient process; however, it involves interventions in areas that the public sector in Latin America is usually reluctant to take on. Key issues involve improving the operation of land markets, the expansion of microcredit for phased housing construction and the provision of technical assistance for quality housing construction. There are successful cases in which public support was offered in phased housing construction, although they are mostly pilot projects of limited reach. Mainstreaming interventions in support of progressive housing

construction is a significant challenge for the future. Central or regional governments command the resources to finance the initiatives involving transfers to the poor; however, local governments are better positioned to deliver the services required in reaching the poor. Programs to facilitate access to serviced

Reaching the poor to improve their housing conditions is a collaborative enterprise requiring the active participation of all levels of government, private companies, banks and NGOs.

residential land can be most efficiently developed by municipalities that usually have control over land subdivision regulations, a major source of escalations in land costs. In addition, municipalities are in a better position to deliver or contract the delivery of technical assistance to do-it-yourself builders. Banks, NGOs and foundations are providing microcredit for housing in many localities, while expanding their capacity to reach the majority on a sustained basis is the public policy challenge.

Reaching the poor to improve their housing conditions is thus a collaborative enterprise requiring the active participation of all levels of government, private companies, banks and NGOs. This is the challenge and it can be overcome, as proven by successful programs around the region.





## ■ Enhancing Access to Urban Jobs and Services

**L**ow-income households face obstacles in achieving access to urban services and opportunities for formal employment. Although poverty is generally defined as a condition that differentiates citizens by their economic status, in practice it also translates into reduced access to basic urban infrastructure and social services. The poor tend to live in segregated neighborhoods lacking minimum services. Efforts to reduce poverty, therefore, involve increasing access to urban human and social services for the poor, including transportation to good jobs.

Although the region's rapidly growing urban areas are engines of economic growth, they are also the locus of deep-seated poverty that needs to be confronted. As in the case of rural development (see chapter 8) territorial or spatial approaches have been found to be promising in bringing about improvements in urban living standards in the short run.

This chapter identifies strategies to implement spatially-focused interventions that translate into improved basic services and transportation to employment centers. As argued here, urban interventions targeted to specific geographic areas and employing a combination of infrastructure and social investments can be highly effective in fostering social integration and reducing poverty. Better access to transportation, particularly in underprivileged urban areas, can enhance the competitiveness and productivity of the city as a whole and of the residents of those areas in particular. The pursuit of social integration and investment goals requires greater private sector involvement in the financing of urban development.

### **Jobs, Services and Local Development**

Over 75 percent of Latin America's 523 million inhabitants currently live in cities. The region has experienced a remarkably radical and rapid transformation from rural-based to urban economies. In 1900, only one of four people lived in urban areas (defined as settlements of 2,000 or more inhabitants), whereas by 2000, three-quarters of the population lived in cities. Four of the region's cities are listed among the world's megacities (that is, cities with more than 10 million residents). These four megacities are Mexico City (with 16.6 million inhabitants), São Paulo (16.5 million), Buenos Aires (11.6 million) and Rio de Janeiro (10.2 million). Three other cities (Bogotá, Lima and Santiago de Chile) have

populations of over 5 million. The process of rapid urbanization is expected to continue, with up to 85 percent of Latin America's population living in cities by 2025.

The role of cities in economic development is unquestionably important. HABITAT, in its Global Report on Human Settlements 2001, estimates that urban areas account for over half of the region's GDP, while the World Bank and other agencies estimate that 80 percent of future GDP growth will be generated in cities. However, most urban areas in developing countries lack the capacity to create good quality jobs in tandem with their rapid population growth. This mismatch has been exacerbated in recent years by the shift in the mix of labor skills required by economies undergoing transformation. The increased demand for skilled labor has not been matched by improvements in education, resulting in mismatches between supply and demand. This leaves a considerable proportion of urban workers without access to formal jobs, contributing to unemployment and the growth of low-productivity informal sector activities.

A combination of residential and economic informality defines the "dual" cities that prevail in the region. The poor, who live in informal housing and largely work in informal sector jobs, in some cases make up the majority of the population. Informal employment and irregular neighborhoods are the means by which the poor are able to survive in the urban environment.

Despite the fact that poverty is highly concentrated in urban areas, cities still offer the best opportunities for economic advancement and can play a key role in reducing the gap between rich and poor, integrating the poor into mainstream societies and providing access to educational and economic opportunities. This is due both to the fact that economic activities and jobs are more abundant in dynamic urban centers, and because the provision of education, health, sanitation and other services is made easier by the economies of agglomeration of densely populated urban areas.

Increasing the access of the poor to jobs and urban services contributes to both economic and social improvements. Enhancing the urban communication and transportation infrastructure improves the competitiveness of cities vis-à-vis other centers by enabling them to offer better conditions for the establishment of employment-generating activities while improving labor productivity. Similarly, improved access to basic urban infrastructure in poor areas has a favorable impact on the quality of life, fostering social integration and reducing poverty.

## Policy Challenges

It is largely the task of urban governments to put into place comprehensive poverty reduction strategies based on spatial approaches, and to promote the physical integration of residential and employment zones within cities. To understand the challenges that this entails, it is necessary to look at the constraints that municipal governments face in terms of competing for employment-generating economic activities and mobilizing resources for strategic investments in depressed urban areas.

## Increasing the Competitiveness of Cities

Modern cities increasingly compete with each other to attract capital to their jurisdictions. This is achieved by offering a combination of fiscal, physical and environmental incentives, including the

quality and availability of the labor force. That is, cities that possess superior transportation and communication infrastructure, as well as adequate levels of urban services, enjoy advantages over others not blessed with comparable amenities. Cities that invest in making transportation accessible reduce the amount of time that workers spend in commuting and, as a result, become more productive and competitive. The impact is enhanced when sufficient attention is given to improving access from poor residential areas to employment centers, giving more residents access to job opportunities.

The key factors that differentiate cities in the global competition for capital are related to the quality of life and of infrastructure, particularly urban transportation systems, energy, telecommunications and sanitation. Urban areas in developing countries tend to be severely constrained in their capacity to expand and modernize this infrastructure. Their urban layout also tends to be more inefficient. In general, they have well-endowed, modern residential areas with acceptable levels of services, interspersed with large swaths of space where these infrastructure services are mediocre. The usual pattern is one of urban sprawl with the outlying areas being the newest and poorer ones. This means that the residents who most need jobs tend to live the farthest away from the areas in which the jobs are located.

One of the problems that arises relates to diseconomies of agglomeration, meaning that beyond a certain scale and without the proper infrastructure and adequate urban planning, urban growth leads to increases in the marginal costs of providing services, as well as the costs associated with pollution and congestion. These increased costs can easily discourage new activities and promote the flight of existing ones, leaving behind a reduced fiscal base, reduced government revenues and weaker economies.

Therefore, to realize their potential as centers of growth and to maintain their competitiveness, cities require strategic investments based on consistent urban development plans. Their social integration role depends on the ability to maximize workers' access to employment centers, which, in turn, depends on their ability to put into place low-cost public transportation systems. The planning and financing of these priorities are key challenges for urban governments.

## **Improving Local Government Capacity**

The challenges of competitiveness, urban management and social development require that local governments become efficient, democratic institutions, capable of mobilizing the institutional and financial resources needed to discharge their expanding responsibilities. Urban governments must shoulder a significant portion of the investments in services and infrastructure required to expand access. Local governments also face the challenge of delivering employment support activities and human and social services in depressed areas, as well as for addressing the cultural values that often marginalize the poor from mainstream society. Delivering these services requires specialized skills and hard-to-find community development practices, which have to be addressed by harnessing the support of nongovernment organizations and the private sector. Most often, local governments face considerable capacity limitations for long-term urban planning, the implementation of coherent investment programs and the delivery of social services tailored to the poorest and most vulnerable segments of society.

Additionally, urban governments must provide services to a growing number of people who cannot fully afford them. Further to the mounting demands for public health services and education,

cities are faced with the need to continually expand the variety and scope of issues they address, such as homelessness, drug trafficking and related violence. Often, the imperfect distribution of responsibilities among different levels of government and the lack of adequate compensation for revenue shortfalls, as well as unfunded mandates resulting from national priorities, means that these services are provided in an inefficient manner.

Local governments need to be able to mobilize their own financial and institutional resources and manage them efficiently. In addition to the often limited management capacity of local governments, institutional constraints and other conditions typical of subnational governments also affect their ability to mobilize resources and discharge their functions. The IDB's Subnational Development Strategy highlights the importance of focusing attention on the system of incentives that condition local government performance, which includes the structure of intergovernmental relations, the system of governance adopted locally, the institutional capacity of local governments and the mechanisms for financing local entities.

## **Proposed Strategies**

Based on lessons from the IDB's experience in the urban, social and transportation sectors, a number of priorities emerge to address the issue of expanding the access of the poor to urban services and employment centers. The key lies in working through local governments to develop integrated programs that are based on a territorial approach, which are also coordinated with citywide public transport initiatives. This section discusses how to address these goals, the required institutional environment and the complementary resources needed.

### **Spatial Approaches for Delivering Targeted Services to the Poor**

Integrated interventions based on a territorial or spatial approach consist of a package of investments and services delivered to targeted poor neighborhoods, which are designed and implemented in close sequential coordination. These territorial interventions have gained credibility and legitimacy throughout the region because of their ability to deliver a combination of effectively targeted services under controlled cost conditions. The resurgent interest in integrated programs (particularly among local governments, which are more directly involved with the problems that result from urbanization) is largely driven by the need to find ways to effectively deal with the multidimensional problems of poverty and social exclusion. Moreover, this approach also enhances the synergies among different interventions and maximizes impacts among the beneficiaries.

Targeting a specific territory is a trend derived from a generation of integrated interventions in areas such as early childhood development, violence reduction, social protection, neighborhood upgrading, integrated watershed management and community development projects. The trend involves defining the specific geographic area of operation of the social programs in order to facilitate coordination and enhance targeting. This makes it possible to better reach areas where hard-core poverty and exclusion are concentrated. Merging urban infrastructure and social services creates synergies

that maximize and mutually reinforce the impact of both forms of interventions (for example, improving sanitation in the homes and targeting complementary schooling services to needy children serves the goal of improving health and educational indicators).

The delivery of social and urban services to poor neighborhoods requires an emphasis on inter-agency and intergovernmental coordination both within local governments and among different levels of government. Experience acquired through many urban interventions has shown that the most effective coordination occurs at the local level, where services can be programmed in closer contact with the beneficiaries. This implies establishing coordination mechanisms for implementing integrated programs, which should involve key players and empower beneficiaries who are able to play a role in the decision-making process for allocating resources. Successful multisector project implementation also requires the simplification of implementation arrangements and on-site project management schemes.

The key lessons that emerge from the Bank's accumulated experience in this area imply that the emphasis of integrated programs should be on: (i) investing in multiple sectors, including basic infrastructure and social services and offering a menu of services that can be tailored to the needs and aspirations of individual communities; (ii) empowering beneficiary communities, through their active participation in decision-making regarding project design, as well as in implementation and supervision; (iii) undertaking appropriate sociocultural assessments of potential beneficiaries to identify the different stakeholder groups, including the more invisible ones; and (v) maximizing effective inter-agency coordination, striving for simplicity by reducing the number of collaborating agencies, using multiphase operations, and dividing the responsibility for implementation phases among agencies.

### **Public Transportation Focused on the Accessibility of Poor Areas**

Investing in public transportation makes better use of resources, reduces pollution and better serves the low-income population, which tend to be its most frequent users. Yet, public transportation is usually poorly maintained, unsafe, highly polluting and often uncomfortable; in addition, coverage is often limited. Key objectives in this regard are to support the planning and financing of urban transportation systems and infrastructure, seeking to expand service coverage and effectiveness and to increase access for low-income people. Emphasis should be placed on the rationalization and appropriate maintenance of existing systems and on encouraging the participation of the private sector in financing and operating the systems. Alternatives are to support a variety of interventions, including rationalization, construction, remodeling, rehabilitation, expansion and maintenance of streets and urban transportation, as well as terminals or stations for passengers and freight, and complementary equipment.

Improving mass transit and trunk infrastructure that affects urban growth patterns are endeavors that are not limited to the transportation sector. They need to be coordinated with urban planning strategies that regulate density, facilitate access to land by the poor, and organize the location of different activities in the cities. In addition, accessibility for the poor in densely populated urban areas is a major social policy issue. Providing better means of public transportation for residents of poor neighborhoods is a form of "transportation equity" (a concept explored by Margareth Pugh in *Barriers to*

*Work: The Spatial Divide Between Jobs and Welfare Recipients in Metropolitan Areas*), which should be an integral part of welfare programs if they are to be successful.

The Bank has financed urban transportation projects ranging from the expansion and improvement of commuter trains in São Paulo and Buenos Aires to a national urban transportation program in Venezuela, as well as a traffic management project in Bridgetown, Barbados. Bank financing is prominent in the expansion of a bus-based system in Curitiba, Brazil, which includes significant private participation. The improvement and expansion of highways and roads also form part of Bank-sponsored urban transportation projects. Through its private sector window, the IDB provided a loan to the consortium that constructed and is operating the Via Amarela toll road in Rio de Janeiro and a debt guarantee issued by the consortium that is building and operating the Costanera Norte toll road in Santiago, Chile. Other urban projects, particularly municipal development loans, often support investments in roads, streets and sidewalks and in transportation terminals and modal interchange facilities. The challenge ahead is a much closer coordination of urban development and transportation programs, providing access for poor areas in the forefront of priorities. Working directly with local governments should facilitate this approach.

## **Involving the Private Sector in Urban and Social Development**

The demands of urban growth on government resources far outpace their financial capacity to deal with them. Additional income sources, beyond the resources of local governments, are needed to achieve the desired levels of services demanded by expanding urban populations. This is even more urgent in regards to the urban poor, a segment that is growing faster than the remainder of the population and faces higher service deficits. Current trends in privatization and service concessions have demonstrated the feasibility of sharing responsibilities with the private sector in areas previously thought to be the exclusive realm of governments. The most common example is that of concessions for water distribution, although the record of achievement is heterogeneous across Latin American cities.

These and other forms of public-private cooperation should be explored in the areas of urban infrastructure and local public services, both in traditional revenue-generating services and in services directed to poor areas or consumers, which demand public subsidies or alternative financial arrangements. For instance, the development of urban infrastructure in low-income neighborhoods can be transformed into an attractive investment opportunity for private developers, provided that local governments can compensate the investor with development rights in other areas of the city or with other forms of incentives. A similar approach can be applied to other urban functions such as urban transportation, expansion of street and roads networks, solid waste management, downtown revitalization and social housing. These functions require the use of incentives that can be channeled through different instruments, including public-private partnerships, service concessions, demand-side subsidies, regulatory exemptions and sale of development rights.

The IDB has promoted a number of collaborations between the public and private sectors for poverty related functions and services. This includes, for example, the downtown revitalization of Quito, Ecuador, which also preserved housing and jobs for the poor, as well as demand subsidies for privately provided low-cost housing in Chile and other countries. The challenge is to increase these operations in particularly complex areas such as settlement upgrading and low-cost urbanizations,

which have a significant impact on poverty alleviation. It is in the best interest of the countries, and of city governments in particular, to pursue these partnerships and joint ventures between the public and private sectors. The IDB is increasingly emphasizing this approach in its operations as a way of introducing new practices for reaching urban and social development goals. The goals here are to develop feasible proposals and operating models, grounded in case studies of successful experiences in different sectors, promote seminars to combine the skills of urban experts and private sector specialists and develop demonstration projects that can be replicated throughout the region.

## Concluding Remarks

Providing the poor with better access to urban jobs as well as improving services in their residential neighborhoods has been presented as a challenge for urban or city governments. Cities in Latin America are both the engines of growth and the locus of concentration of poverty. The cities need to improve their conditions for competing in the modern world through, among other factors, improved transportation and communication structures that should be produced with special attention to connecting the poorest areas to employment centers. Strategies for dealing with accessibility issues have to address the resources and technical capacity limitations faced by local governments. Recent experiences with spatially focused approaches provide good examples of urban interventions that can be comprehensive in scope—involving a multiplicity of sectors—while still being well targeted to specific populations.

Thus, we conclude that: (i) increasing accessibility by the poor to jobs and services is a deserving social goal that also has positive economic implications for the urban economy; (ii) the best way to address this issue is by combining access to transportation with territorial approaches targeted to high poverty areas; (iii) city governments are the main protagonist of these efforts, requiring appropriate technical and financial support, but also the right incentives for mobilizing local resources and behaving in a fiscally responsive manner; and (iv) involving the private sector in financing pro-poor urban interventions is feasible, with new approaches to be explored. The IDB has an important role to play in promoting and supporting these public-private collaboration initiatives.





## ■ Market Solutions for Improving the Health of the Poor

**M**arkets in health are by definition imperfect. Their main imperfections<sup>1</sup> are associated with the sector's intrinsic characteristics and the information asymmetries between producers and consumers of health services. In view of the frail state that consumers find themselves in when they are in need of health services, and given the power wielded by suppliers (doctors and hospitals) by virtue of the knowledge that they have, consumers frequently have no option but to accept the treatment, medication and advice offered by service providers.

For these reasons, historically, the health sector has been one in which the structure of supply prevails over demand. The information asymmetry between suppliers and consumers is even more marked for socially deprived groups who lack the education and resources with which to make informed decisions. They lack information both on how to look after their health properly and on how to gain access to health services. They also lack a network of contacts that could provide them a second opinion on diagnoses or alternatives to the solutions prescribed by suppliers, even if they had the means to pay for these services.

Although from earliest times the health market has been predominantly private, growing public intervention in regulating, financing and providing health services over the course of the twentieth century has increasingly changed its nature. From an economic point of view, these interventions are justified in areas such as the provision of public and mixed (public-private) goods in health (sanitary and epidemiological oversight, vaccination, etc.), in covering the financial risk of cost-effective services for the poor, in covering catastrophic health risks for all, in regulating the quality and efficiency of services, and in matters relating to public and collective health.<sup>2</sup>

In welfare economies like those of Europe, and even in other developed countries like the United States, Canada and Japan, public financing of health services, and often their actual provision, cover a

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<sup>1</sup> Arrow, K.J. 1963. Uncertainty and the Welfare Economics of Medical Care. *American Economic Review* 53(5): 941–73, December.

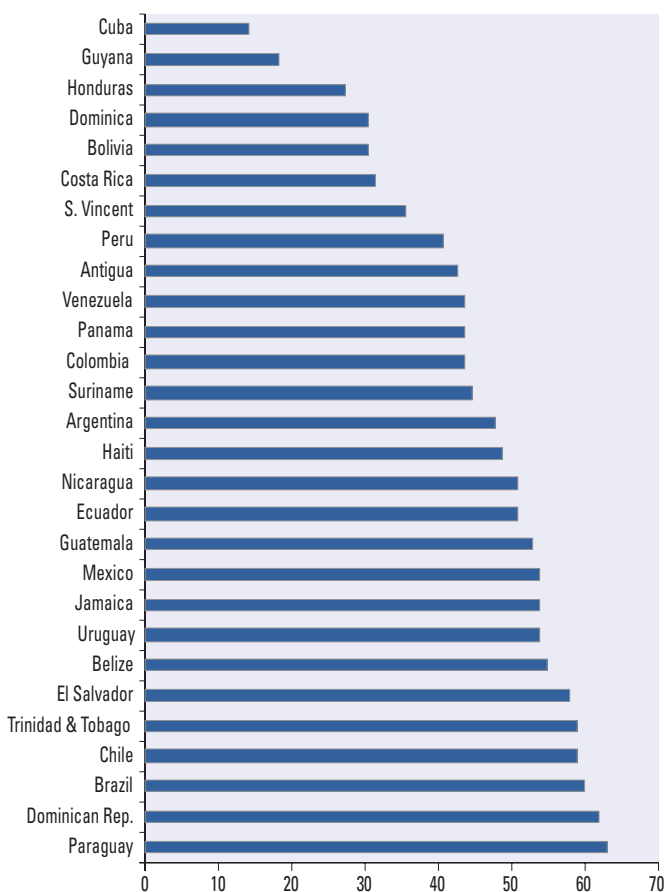
<sup>2</sup> Musgrove, P. 1996. Public and Private Roles in Health: Theory and Financing Patterns. World Bank Discussion Paper No. 339. Washington, D.C.: The World Bank.

large segment of the health market. In some instances, this has led to extremely high costs (particularly in proportion to the results achieved in terms of health service coverage and quality) because of inefficiency in the provision of services and high transaction costs, gaps in coverage (especially among the poor), and defective evaluation and oversight systems, among other failures. Throughout the world, governments have attempted to minimize these shortcomings by relying on private health insurance, and outsourcing public services to private suppliers and nongovernment organizations.

## The Private Dimension of Health Spending in Latin America

In Latin America and the Caribbean, private sector spending accounts, on average, for more than half of spending on health. Figure 1 shows that in 23 out of the 28 countries, private health spending is above 40 percent of total health spending.

**FIGURE 1**  
**Private Health Spending as a Proportion of Total Spending on Health in Latin America and the Caribbean (2001)**



Private health spending can be evaluated according to its two components: spending on private health insurance and direct out-of-pocket spending. The former represents a more rational method of organizing health spending, since it allows for economies of scale in the purchase of collective health services and, in addition, provides the means to protect families against unplanned financial health risks, averting catastrophic costs that could lead to vulnerability and indigence.

Out-of-pocket spending, in turn, is an inefficient method of private spending on health, since families generally lack the information required to manage their health spending properly and to use it in such a way as to meet the criteria of rationalization that the use of private insurance facilitates. In the structure of health insurance, out-of-pocket spending may be used to complement the purchase of drugs and direct payment for consultations, hospitalization and medical examinations. Generally, co-payments may help provide a more rational structure in the use of out-of-pocket spending when linked to properly designed health insurance schemes, but these are frequently exposed to unplanned spending in cases of catastrophic illnesses. In these cases, the design of such financial protection mechanisms as stop-loss insurance may minimize the negative effects.

Figure 2 shows health insurance spending as a percentage of total health spending and its distribution by type (public or private). The figure shows that the country with the highest share of insurance in health spending (Uruguay) has a high rate of private insurance participation. The second country in terms of the importance of insurance in health spending (Costa Rica) has a high rate of public sector participation in the provision of health insurance.

There is no public insurance in countries where the health system is public and universal (Trinidad and Tobago, Jamaica and Brazil). In countries with higher average incomes, such as Chile, Argentina and Colombia (with the exception of Mexico), private insurance plays a strong part in financing health insurance.

In Mexico and in countries with lower average incomes, like those of Central America and some of the Andean countries, the share of private insurance in total health spending is minimal. These are countries in which the share of out-of-pocket spending is high (see figure 3). Consequently, they represent fertile ground for expanding methods of insurance (public or private), following the example of Mexico's experience with the Popular Health Insurance program (Seguro Popular de Salud).

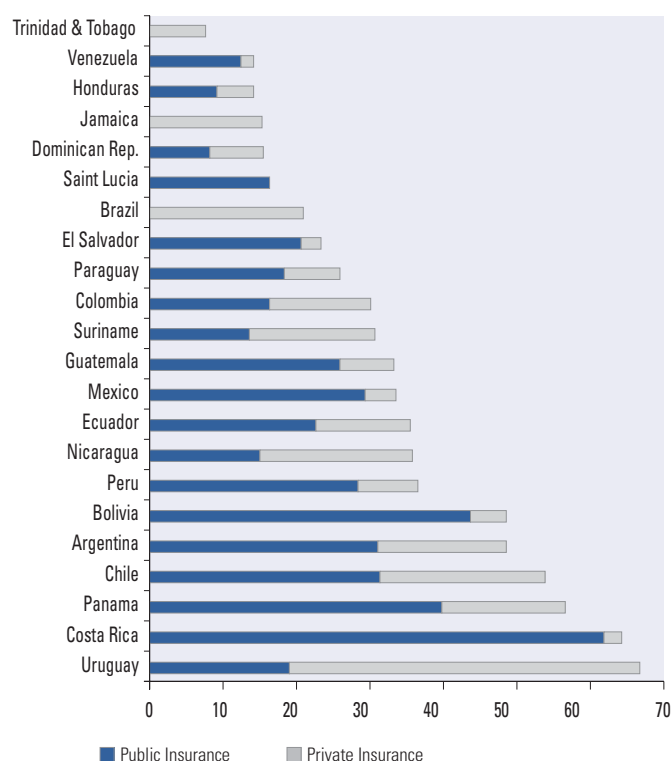
Direct out-of-pocket spending by families constitutes an important part of private health spending. Figure 3 shows direct out-of-pocket spending as a proportion of total health spending in different countries in Latin America and the Caribbean. Such spending constitutes a high proportion of family budgets, ranging from 11 percent (in Cuba) to 57 percent (in Belize). In the largest countries, Brazil and Mexico (where more than half of the region's population is concentrated), out-of-pocket spending represents 37 percent and 51 percent of health spending, respectively. The poor countries of Central America as well as the countries of the Caribbean also have high percentages of direct spending in the composition of total health spending.

Health spending involves a heavy budgetary burden in the population quintiles with the lowest levels of income. Studies based on household expenditure surveys in Brazil show that lower-income families spend a higher share of total family outlays on health than do higher-income families. This is the exact opposite of what occurs in educational spending, where rich people spend proportionately more.

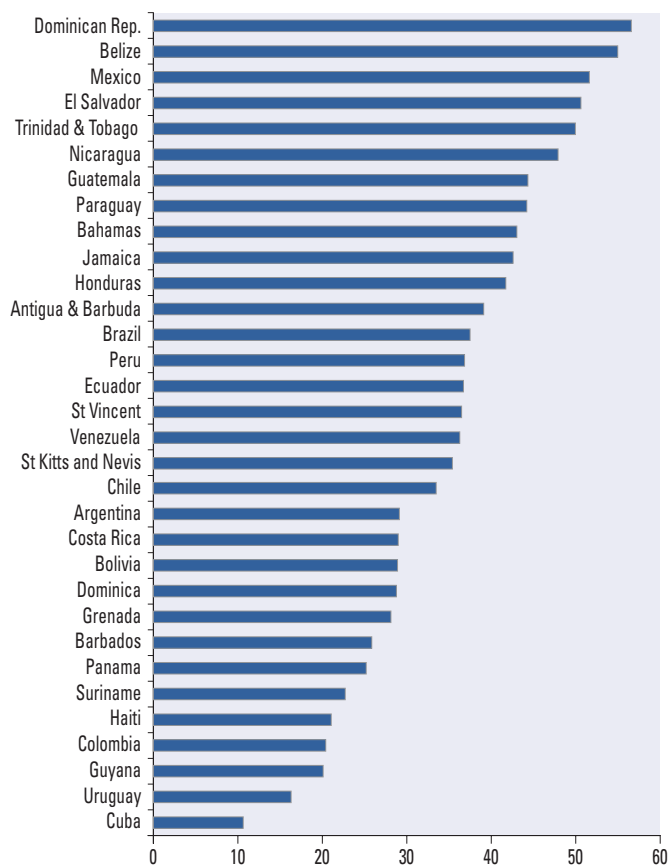
Moreover, unable to benefit from health insurance mechanisms, families end up spending these resources on health goods and services inefficiently. For example, the share of spending on health among poor families is higher for items like drugs, which can account for as much as 70 percent

**FIGURE 2**

**Spending on Health Insurance (Public and Private) as a Percentage of Health Spending in Latin America and the Caribbean (2001)**



**FIGURE 3**  
**Direct Spending (out-of-pocket) of Families as a Percentage of Health Spending in Latin America and the Caribbean, (2001)**



of family budgets in the lowest income deciles in countries like Brazil. Similarly, spending on direct costs for consultations, hospitalization, medical examinations and other procedures reach very high levels among the poor. This justifies providing these services in ways that bring efficiency, economies of scale and lower costs.

## Inequalities in Financing and Coverage

Over recent years, there has been much discussion about equality in health. Some argue that direct public spending is more effective in promoting equality, since everyone, even the poorest, in theory, gets medical attention on the basis of their needs. Others argue that equality can be achieved through public regulation and the use of proper economic incentives, and that some market solutions (such as the use of the proper economies of scale, competitive pricing, well-targeted subsidies and the use of suppliers with a reputation for quality) are indispensable in promoting equality.

It is difficult to establish which one of these views is the correct one. Doing so involves bringing in other variables, such as the efficiency of procedures, control and the degree to which there is

transparency or social participation to monitor results. In some instances, these variables are impossible to measure, or are taken into account only after the fact in the evaluation of experiences.

Partial information for Latin America and the Caribbean in the 1990s (table 1) shows that while public spending reached all income quintiles, some governments at particular points during the decade spent health resources in a more equitable manner than others.

For example, in 1991, the distribution of public health spending in Argentina favored the first and third quintiles, public health spending in Guatemala in 1999 and in Ecuador in 1995 favored the wealthiest quintiles. In most cases, this was not intentional, but resulted from policy focus and the implementation of health policies, in the search for greater transparency, oversight and the proper means of evaluation.

For instance, it is possible that the population in the richest quintile in Guatemala consumes more health services for treating chronic ailments because of longer life expectancy, whereas people in lower income quintiles consume less expensive primary medical services. However, it may be the case that in poor countries with fiscal constraints, public health spending directed toward the wealthier

TABLE 1

**Percentage Distribution of Public Spending on Health by Income Quintile in Selected Latin American and Caribbean Countries (1990s)**

Countries	Income quintiles				
	Poorest	Second	Third	Fourth	Richest
Argentina (1991)	38.7	16.6	25.5	14.8	4.4
Bolivia (1990)	31.5	26.5	19.5	14.2	8.3
Chile (1996)	30.9	23.2	22.2	16.5	7.2
Colombia (1997)	17.5	19.7	22.2	20.7	19.9
Costa Rica (1996)	27.7	23.6	24.1	13.9	10.7
Ecuador (1995)	12.5	15.0	19.4	22.5	30.6
Guatemala (1999)	12.8	12.7	16.9	26.3	31.3
Jamaica (1996)	25.3	23.9	19.4	16.2	15.2
Peru (1996)	20.1	20.7	21.0	20.7	17.5
Uruguay (1993)	34.9	19.9	22.1	13.2	10.0

Sources: ECLAC (2002). *Una década de desarrollo social en América Latina (1990–2002)*. Santiago; and PAHO. 2001. *Investing in Health: Social and Economic Returns*. Scientific and Technical Publication No. 582. Washington, D.C.

sectors ends up reducing expenditures on the poor. Once again, asymmetries of information and the distribution of social capital (this time between the poor and the rich) mean that, where there are no proper policies for targeting expenditures, the relatively more well-off have the knowledge, information and lobbying capacity to garner relatively larger shares of health spending.

As we pursue this theme of health coverage, a different sort of picture begins to emerge. Table 2 shows that the highest levels of service coverage in the first quintile were achieved by two countries that undertook reforms: Brazil and Colombia. In Brazil, reform was driven by a sharp expansion in the public supply of services. Colombia undertook pluralist reforms, with a mix of public finance and private service provision.

Similarly, as table 2 shows, countries like Guatemala demonstrate a striking inequality in coverage as well as in the use of public spending. In addition, the proportion of out-of-pocket spending to overall health spending is high.

It is true that inequality in the distribution of private spending tends to be higher than in that of public spending, since out-of-pocket spending is the most inequitable form of health spending. Still, the question that needs to be asked is: how to encourage the proper use of the market to promote solutions that increase coverage and equity in health, in a context where the large ratio of out-of-pocket spending is both a challenge and a window of opportunity for rationalizing the use of scarce family resources in poor countries.

TABLE 2

**Health Services Coverage Rates by Income Quintile in Selected Latin American and Caribbean Countries (2000)**

Countries	Rate of coverage	Poorest quintile	Second quintile	Third quintile	Fourth quintile	Richest quintile
Bolivia	56.7	19.8	44.8	67.7	87.9	97.9
Brazil	87.7	71.6	88.7	95.7	97.7	98.6
Colombia	84.5	60.6	85.2	92.8	98.9	98.1
Guatemala	34.8	9.3	16.1	31.1	62.8	91.5
Haiti	46.3	24.0	37.3	47.4	60.7	78.2
Nicaragua	64.6	32.9	58.8	79.8	86.0	92.3
Paraguay	66.0	41.2	49.9	69.0	87.9	98.1
Peru	56.4	14.3	49.6	75.4	87.2	96.7

Source: IDB, MECOVI, Household Surveys in Latin America and the Caribbean.

## Market Solutions to Improve the Health of the Poor

The coverage and quality of health services for low-income populations need to be reviewed by analyzing the interrelation between financial mechanisms and service provision. Using this sort of approach, we can study both conventional mechanisms and nonconventional market ones that integrate public and private provision. Table 3 shows four options.

*Public financing of public provision* is the conventional way of organizing the delivery of services to the poor. The public sector finances public health services at different levels of government. Traditional budgetary arrangements are used to fund health establishments, pay salaries and evaluate health services through processes rather than results. A number of studies have shown that such solutions have not had a beneficial effect on health services.

*Public funding of private provision* enables innovative market solutions that increase the capacity of health services to respond to the needs of the poorest. In Latin America and the Caribbean, when contracts are transparent and results are monitored, outsourcing (such as the purchase of private supply services on the basis of health objectives or basic health packages) has proven to be efficient. According to research by the World Bank, this has been the case of such experiences as IGUALAS in the Dominican Republic. Other instances judged to have had positive effects include the schemes for basic health insurance for mothers and infants (SUMI) in Bolivia, whereby the public sector finances or subsidizes coverage of essential services to poor population groups. The Popular Health Insurance scheme in Mexico also stands out as an innovative experience in subsidized coverage of basic health insurance for groups with few means. It enables the supply and quality of services to be rationalized and expanded on the basis of the scant resources of groups that cannot afford to pay.

TABLE 3

**Options to Finance and Provide Health Services for the Poor by Means of a Public and Private Mix**

Financing of services	Service provision	
	Public	Private
Public	Public health networks of federal, regional and municipal governments.	Outsourcing of services, management contracts, contracting professionals or medical firms for training; subsidies to nongovernment organizations for coverage of populations unable to pay, or to popular health plans.
Private	Purchase of high technology services (university hospitals) or unused capacity in public hospitals.	Plans and mechanisms for health insurance; financing from multilateral or bilateral donors to cover populations unable to pay.

*Private finance for the provision of public services* is not very common, but can occur in instances where the expansion of private service comes up against capacity constraints and where spare capacity can be bought in the public sector. There have been examples of this in Latin America with the expansion of service provision by the ISAPRES in Chile during the 1990s. Similarly in Brazil, companies that organized health plans, such as AMIL and Golden Cross, bought specialized health services from public university hospitals. These experiences are not geared toward improving the health of the poor, but rather to consolidating markets for services aimed at middle-class users. Yet, following this modality, we can also find firms that take advantage of tax concessions, such as income tax rebates, to finance the activities of underfunded hospitals and public services for the poorest in such areas as maternity care. What is crucial here is to guarantee that new private resources are not used to fund more of the same, but to improve and innovate management and to build greater efficiency and quality in service provision.

*Private funding for the private provision of services* is where we find the widest range of innovative experiences in health for the benefit of the poorest. An important experience in this area is that of PROSALUD in Bolivia. This is an NGO funded through resources donated by international agencies, like USAID, and by the sale of high-quality services, such as maternity care (including for the public sector). Income from subsidies is combined with selling services to higher-income groups in order to provide services to the poorest. Such experiences have been common among philanthropic groups, in the social work of religious organizations, and in many other ways in which tax incentives are used by medium and large private companies.

Although there may be limitations in developing market solutions in the four instances listed above, it would seem that public funding of private provision and private funding of private provision provide the most potential for development. However, there are two essential preconditions for their success. Firstly, they must ensure flexibility in the management of human, financial and material resources, so that these are freed from the bureaucratic constraints that have impeded progress in organizing health services in many Latin American and Caribbean countries. Secondly, use should be

made of available dispersed financial resources in poor communities so as to ensure greater efficiency in the ways these are used to generate concrete results, minimizing financial risk and maximizing coverage and quality of service provisions to these communities.

The countries of Latin America and the Caribbean have been prodigal in producing innovative experiences in the private management of health services. Many of them, starting with the generation of risk pooling, such as the recent experience in popular health insurance in Mexico, have contributed to increasing levels of social health protection vis-à-vis the catastrophic costs that can decimate family budgets. However, very few of these experiences have been properly evaluated so that lessons can be learned and replicated elsewhere, both within the region and beyond.

International organizations need to promote efforts to assess such experiences and view them as market-based solutions, which—if properly evaluated, systematized and regulated—will be able to contribute to resolving problems of equity and health coverage in the region.

## Concluding Remarks

Even considering the imperfect competition conditions faced by the health sector, with appropriate regulations, market solutions can be used to address health needs, including those of the poor. While 7.3 percent of regional GDP was spent on health in 2001, the region also displays high levels of private participation in health markets by international standards. Yet, 39 percent of private health spending is represented by out-of-pocket spending, which has negative effects on the equity and efficiency of the allocation of health resources.

But in spite of the large share of out-of-pocket spending, there was a slight increase in the use of insurance mechanisms (particularly private insurance). This creates a window of opportunity to improve the efficiency and quality of health markets. Between 1980 and 2000, public and private health insurance increased from 19 to 29 percent of total health spending in the region.

During the last twenty years, many countries experimented with market solutions to improve the health of the poor. However, the region still faces challenges in improving the way in which out-of-pocket health resources are spent and in managing better the expenditures of the public sector. International organizations need to promote efforts to assess these experiences and market-based solutions, which—if properly evaluated, systematized and regulated—can help resolve problems of equity and health coverage in the region.



## **PART III**

# **ENHANCING THE PROCESS**



## ■ Encouraging Inclusion through Social Capital

### Social Capital, the Key to Development

The notion of social capital has been widely written about and discussed in recent years. Concrete applications of this concept have been made in the areas of development policy and projects. A number of countries have introduced the concept in the design of public policy as a means to maximize the generation of social capital. Civil society organizations have adopted it as a key way in identifying and measuring their contributions to the economy. The development of social capital is a central strategy of more advanced social policy, which relies on it to foster social inclusion and give impoverished communities access to productive sectors. Indeed, organizations like the World Bank, the IDB, the United Nations, the World Health Organization and the Pan-American Health Organization are actively integrating social capital into their operational planning.

Measurements of the relevance of social capital are becoming ever more important. In their now classic research, Knack and Keefer<sup>1</sup> have shown that there is a robust correlation between such attributes of social capital as confidence and civic cooperation, and national economic growth. La Porta, López de Silanes, Shleifer and Vishny<sup>2</sup> found strong correlations between the degree of confidence in a society and such aspects as judicial efficiency, the absence of corruption, the quality of the bureaucracy and honoring tax obligations. A Johns Hopkins University study has calculated that civil society organizations, a key component of social capital, generate more than 5 percent of annual GDP in 35 countries. If these were added up, the contribution of social capital would make it equivalent to the seventh largest economy in the world.<sup>3</sup>

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<sup>1</sup> Knack, Stephan and Philip Keefer. 1997. Does Social Capital Have an Economic Payoff? A Cross-country Investigation. *Quarterly Journal of Economics*. Vol. 112. No. 4, pp. 1251-1288. November.

<sup>2</sup> La Porta, R., A. López de Silanes, A. Shleifer and R. Vishny. 1997. Trust in Large Organizations. *American Economic Association Papers and Proceedings*. May, pp. 333-338.

<sup>3</sup> Salamon, Lester M., S. Wojciech Sokolowski and R. List. 2003. *Global Civil Society. An Overview*. The Johns Hopkins University Center for Civil Society Studies. Baltimore.

Similarly, social capital underpins successful targeted experiences that can be considered best practices. These include New York City's Friends of Parks programs; Brazil's Self-management in Public Sanitation program; South Africa's Reducing Crime in Schools program; The Philippines' disaster management program; Porto Alegre's Participatory Municipal Budgets program; and Rosario's A More Human City program.

Social capital places the emphasis on the centrality of human relationships in the market, in production, in society and in life. There are at least four aspects of these relationships that are highly significant to economic activity, production and development. These are: (i) the degree of confidence that people have in each other; (ii) the capacity for entering into associations; (iii) the civic culture and (iv) ethical values. Where the degree of confidence among people is high, the market is more likely to reach its potential and the number of transactions and agreements multiply; this does not occur if confidence is low, which leads to higher costs arising from disputes. If the capacity for association is high, cooperation becomes much more possible. If there exists a civic culture, people are more willing to participate in issues of collective interest, from taking care of parks to paying their taxes. Finally, the ethical values that predominate in a society (such as social responsibility, solidarity, transparency and honesty) are key to economic and social performance.

Today, we can measure these items, as well as the key role that they play. Thus, we can show that where there is little social capital or where the social capital is negative (as in the case of mafias), productivity, the business climate and, ultimately, the overall economy, suffer. Where social capital is high, it can set in motion virtuous circles, as the more successful economies have shown in recent decades.

There are four basic forms of capital: natural capital, which constitutes the natural resource endowment of a society; the constructed capital of a society, which includes financial and commercial capital, goods, infrastructure, and technology, for example; human capital, which has to do with the population's health, culture and education; and social capital. Social capital cannot take the place of other forms of capital; rather, research shows that it makes other forms of capital more productive and dynamic.

As will be shown, one of the strategic functions of social capital is its potential to encourage social inclusion by strengthening, sustaining and empowering the poor.

## **Mobilizing Social Capital for Inclusion: Some Success Stories**

Bangladesh's Grameen Bank (or village bank), which reached 36,000 villages in that country, has become a key international reference point because of its success in lending to the poorest and improving their access to productive sectors and the market. As a result of its activities, a third of the 12 million people who received microloans were able to escape poverty. The bank had an exceptional recovery rate on its loans of 98 percent. The village bank model has been copied in 60 countries, including the United States, France and Norway. One of the root causes of its success is the fact that it mobilized the social capital of the poor, especially women who made up 94 percent of its creditors. The bank lends to individuals who are members of a mutual support group of five persons. The group as a whole is

responsible for the loan and its members must cooperate among themselves. Using this methodology, the Grameen Bank built conditions that helped generate confidence, a culture of association, civic consciousness and positive ethical values, empowering millions of excluded women. According to its founder, Muhamad Yanus, “The first thing we discovered was that forming groups was essential to the success of our enterprise. Individually, the poor feel exposed to all sorts of dangers. Belonging to a group gives them a kind of security. On their own, individuals tend to be unpredictable and insecure. In a group, he benefits from the support and emulation of all the others, and his behavior becomes more regular and creditworthy.” In many instances, groups were made up of people from the immediate circle of friends of the women who were members. Members of the group felt obligated to pay because they did not wish to lose the esteem of their peers. The “real collateral” resided in feelings of belonging, emulation and the esteem of others.

The municipality of Villa El Salvador, in Peru, is 34 years old. It was built by its 400,000 poor residents who constructed an entire city in the desert dunes, 19 km. to the south of Lima. Two decades after it was founded, Villa El Salvador had 50,000 houses, 38,000 of which were constructed by the residents themselves, 68 percent with rudimentary materials. Local residents have installed 2.8 million square meters of paved roads (which were built mainly with community labor), and built 60 community centers, 64 schools and 32 libraries. In addition, they constructed 41 multipurpose health, education and nutritional centers, health clinics, a network of pharmacies and roads, and planted half a million trees. Enrollment in the municipality’s primary schools is 98 percent, while in secondary schools it reaches 90 percent. They also created an industrial park for microenterprises. Today, the municipality has one of Peru’s main furniture making industries; birth certificates can be obtained in ten minutes, and permits to set up businesses are granted within 24 hours. Villa El Salvador is turning itself into a productive city and setting up a technological university.

The underpinning for these achievements was the tight-knit culture of the Peruvian Andes. Natural norms of solidarity, reciprocity, civic culture and responsibility enabled the development of social capital. People in Villa El Salvador erected an extensive participatory organizational structure in which nearly 50 percent of all persons over 18 years of age occupied some position of responsibility. For example, school children currently elect school prefects and mayors, and decide how to manage the investment budget at their disposal. This teaches them how to sustain the ethos of productive association that has enabled Villa El Salvador to make such strides. The municipality received the Prince of Asturias Prize. It has also been designated as a UN City Bringing the Message of Peace by UNESCO because it represents one of the most challenging experiences in popular education. Finally, it was awarded the Peruvian National Prize for Architecture and Urban Development because of its humane design.

The ABC region of the state of São Paulo has 2.5 million residents. An intergovernmental council was created to address problems of industrial exodus and obsolescence, and concomitant increases in unemployment. The council includes the seven municipalities of the region, the state government and leaders of the Citizens’ Forum of the Greater ABC, which brings together more than 100 entities, representing employers, workers and other sectors of civil society. While public officials take part in the council, they do not have final say. Agreements are reached only after all members commit themselves to carrying out the plans. The council deals with issues, such as increasing the competitiveness of productive chains, professional training, monitoring of employment, macro drainage plans, plans

for improving the system of roads, regional collective transport, regional health planning, and others. Its principles embody key elements of social capital, such as confidence building, private-public collaboration and encouraging civic commitment. It has achieved significant results with respect to boosting social inclusion.

The agency for economic development of Córdoba, one of Argentina's largest cities, promotes the economic and social development of the Greater Córdoba region, linking the activities of the private sector with those of the public sector. Among other things, it develops an array of activities to strengthen micro, small and medium enterprises. The agency includes 16 business chambers as well as the municipality of Córdoba. Its more specific aims include "contributing on an ongoing basis to the formation of social capital." One of its core programs is Entra 21, a joint business and municipal effort to widen the scope of social capital and encourage social inclusion. Entra 21 enables unemployed youth to join the workforce by developing a strategic alliance among firms, NGOs with experience in working with young people and local universities. The agency has also created a program for the development of productive chains that seeks to boost the competitiveness of small businesses in Córdoba by supporting the formation of groups that build linkages between firms. Another program provides specialized microfinancial services for micro and small companies. There is also a project to generate employment and labor inclusion by promoting microenterprises in vulnerable sectors, and transferring methodologies, and promoting participatory planning and joint management projects for NGOs and those involved in grassroots activities to assist unemployed persons covered by national social programs

## Lessons Learned

We have briefly reviewed four examples of how mobilizing social capital can promote inclusion. Two of these, the Grameen Bank and Villa El Salvador, emerged from civil society; the other two, in São Paulo and Córdoba, involved alliances between the public sector and civil society. All of them, to different degrees, have been successful in encouraging inclusion and access to productive sectors; all are regarded as points of reference, nationally and internationally. They form part of a much more extensive set of experiences in the region that have achieved similar results in a variety of fields. Among these are the EDUCO schools in El Salvador, based on rural school management by poor peasant communities; the Glass of Milk program in Peru, managed by mothers; parent participation in school management in Minas Gerais, and the healthy municipalities (*municipios saludables*) programs in many countries, which are supported by the Pan-American Health Organization.

All of these experiences have elements in common. Firstly, people believed in the benefits of social capital and sought to develop it in systematic ways. Their aim was to raise levels of confidence among the various actors and stimulate the capacity for joint action. In addition, they promoted civic responsibility and paid particular attention to the general welfare. Secondly, all opted for nontraditional methods of organization in ways that were highly innovative: in the Grameen Bank, the groups and the direct face-to-face contact between the bank and the people; in Villa El Salvador, decentralized self-management on the basis of direct participation by the great majority of residents; in the ABC council, joint action through a horizontal relationship between government and civil society;

and in Córdoba, the involvement of the organized business sector and the municipal government for the development of innovative projects to encourage inclusion and productive participation. Thirdly, projects have been guided by firm and clear ethical values. The aims are to create opportunities, transparency, efficiency of execution, on-going accountability and the firm commitment of participants. All the experiences evince a strong belief in solidarity.

A key lesson of these experiences is that they gain legitimacy by means of the contributions that they make to the lives of numerous families and people involved. However, they also highlight the need for systematic policies to widen the scope of what has been done so far.

## **Policies to Help Mobilize Social Capital for Productive Inclusion**

How do we build social capital so as to promote productive inclusion? The routes that each country or region should follow to build social capital must reflect their specific characteristics and situations. However, in general terms, there is a key role for public policy, private enterprise, and volunteer organizations and those of the poor. These entities should join in strategic alliances to make the best possible use of resources and maximize their impact.

One of the explicit objectives of public policy should be to strengthen the social capital of disadvantaged communities. Governments should design indicators to measure progress, and monitor and evaluate the extent to which objectives are being met or whether new incentives are necessary. Social capital has to move from being an “expression of good intentions” to measurable indicators.

Policies of this sort exist in other areas in the region, particularly in the social sector. For example, improving social capital is one of the central aims of Mexico’s largest social program, Oportunidades, which reaches 5 million families. The objectives of Oportunidades state: “Social cohesion, based on processes of individual and community participation, the workings of civil and social organizations, and the existence of networks and solidarity within communities, enables the development and construction of the social capital of individuals, families and communities.” Strengthening social capital, it points out, “contributes to improved efficacy and transparency in social programs.”

Argentina’s new social policy establishes the need to develop social capital and suggests that this should be done on the basis of the family unit. Among its management strategies it points specifically to “the family as the nexus for social inclusion,” indicating that “the family is the engine of social integration, and the approach to social policy should stem from the family unit. Individuals are not the ones affected by the conditions that generate poverty; rather it is the family that suffers the consequences of an unfavorable social situation.”

The Government of Chile has developed new institutions to drive community participation and to empower disadvantaged communities. An objective of the “Chile Solidario” program is the empowerment of the family, which is considered the center of social capital. The program establishes innovative mechanisms to accomplish this, including providing personalized support and entering into contracts with each family.

In all these cases, public policy systematically establishes the need to develop social capital as a lever for social inclusion. Yet, there is a great deal that still needs to be done in Latin America. Pri-

vate firms can contribute significantly to encouraging the creation of social capital. Programs that can strengthen the organization and training of disadvantaged persons can improve conditions for them to join productive enterprises. This increases their social capital, raising the collective self-esteem and reinforcing incentives.

Volunteer organizations can also add important elements to the efforts of public policy and private firms to build social capital. Examples, such as the success of the informatics schools established in the slums of Brazil are indicative of the potential of these efforts.<sup>4</sup> The role of volunteer organizations in Latin America in helping to construct social capital to foster social inclusion can continue to grow, particularly because of the shifts now taking place in this area. The idea that is gaining strength involves replacing the typical volunteer model based on providing assistance with one that focuses on creating a relationship between volunteers and the community in order to build a relationship as equals involving methodologies that strengthen the social capital of the recipient communities.

Finally, the disadvantaged communities themselves are the key protagonists in the construction of social capital for inclusion. Their linkages, growing participation, generation of representative leadership, development of productive projects on the basis of their own values and culture, may unleash multiplier effects.

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<sup>4</sup> This involved a program to rehabilitate a large number of centers for young people and create the conditions for social inclusion.



## ■ Information and Communication Technology and Development

**T**he rapid advances and pervasive diffusion of information and communication technology (ICT), combined with the growth of the Internet and other global networks have led to deep transformations in economic, social and institutional structures. ICT applications affect the performance of businesses and the efficiency of markets, foster the empowerment of citizens and communities as well as their access to knowledge, and contribute to strengthening and redefining governance processes at all institutional levels.

As all major and wide-ranging technological advances, the ICT revolution is at the same time creating enormous opportunities and posing daunting challenges. On one hand, it has the potential to increase productivity and wealth, generate new activities, products and services, and improve the well-being of the population, notably in regard to education and health levels. On the other hand, the uneven distribution of such opportunities can lead to further alienation of marginalized communities and an exacerbation of existing socioeconomic inequalities. A balanced access and effective use of ICT tools and networks in the new global economy, along with an integrated process of technological innovation are critical for reducing poverty, increasing social inclusion and improving living conditions for all.

Numerous studies have focused on the direct contribution of ICT to socioeconomic development and, while their findings and conclusions vary according to the context and application, there is an overall agreement that access to information can transform production processes, increase income potential and improve the living conditions of the poor. Indeed, ICT is an effective tool that, when supplemented by investments in connectivity and other factors such as innovation, education, health and infrastructure, increases competitiveness and contributes to economic growth, social development and poverty reduction.<sup>1</sup>

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<sup>1</sup> Dissemination of Information and Communication Technologies for Development: A Framework for Action – Draft Profile. Inter-American Development Bank. November 2005.

## ICT, Digital Opportunities and Social Development

The “digital divide” (a phrase coined in the 1990s) described the perceived growing gap between those who have access to and the skills to use information and communication technologies and those who, for socioeconomic and/or geographical reasons, have limited or no access. In particular, it is used to raise the concern that the emergence of ICT could exacerbate existing inequalities in the access to information and that, thereby, certain groups could face additional disadvantages because of their geographic location, age, gender, culture and socioeconomic status, among others. Moreover, the phrase reflects the prevalence of socioeconomic and structural inequalities at the regional, national and local levels, which are characterized by insufficient infrastructure, relatively high access costs, inappropriate or weak policy regimes, inefficiencies in the provision of telecommunication networks and services, lack of local content and uneven ability to derive economic and social benefits from information-intensive activities.

The United Nations Millennium Declaration notes that efforts to make access available to all and harness the power of ICT can contribute toward the achievement of the Millennium Development Goals (MDGs) by 2015, thereby creating “digital opportunities” in development. Directly, by expanding the reach, scope and impact of social development programs, health services and education and training programs, and providing opportunities for improving gender equality and citizen participation. Indirectly, by creating new economic opportunities and/or extending them to lift individuals, communities and nations out of poverty.

This section analyzes the challenges faced by lower-income populations in their efforts to participate in and benefit from the growth of the knowledge economy. It highlights how the effective deployment of ICT can create or expand economic and social opportunities for a growing share of the population in the Latin American and Caribbean. It also presents concrete examples and best practices in the deployment of ICT in various areas and discusses their impact on the poorer fraction of the population, with an emphasis on demonstrative and replicable experiences. Finally, it reviews policy and investment actions that can be taken by various stakeholders and sectors that are aimed at facilitating access to emerging technologies, connectivity and high-impact ICT solutions in the context of sustainable economic growth and poverty reduction objectives.

### Benefiting the Poor through ICT: Lessons Learned and Best Practices

Untapped opportunities exist to replicate, multiply and scale up successful pilot projects and approaches in the deployment of ICT as a means to reduce poverty and promote social development. Of particular interest are those opportunities that further the potential of ICT for sharing knowledge, generating synergies and economies of scale and adapting to local conditions. Indeed, scaling up poverty reduction efforts through ICT requires extensive outreach and capabilities for deepening its impact.<sup>2</sup>

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<sup>2</sup> Richard Gerster and Sonja Zimmermann. 2005. Upscaling Pro-Poor ICT Policies and Practices. Creating and Enabling Environment: Toward the Millennium Development Goals.

Undoubtedly, a multi-stakeholder partnership approach is crucial for the effective development of an inclusive information society and the creation of digital opportunities, as well as for undertaking a wide range of ICT promotion and investment actions in priority social sectors. Such a partnership is also important for the implementation of successful interventions to reduce poverty that can be replicated and scaled up from pilot or demonstration projects. A multi-stakeholder approach should clearly define the concrete responsibilities of all stakeholders and promote the active participation of governments, the private sector and civil society.

## ICT in Education

Inequalities in access to education (especially high-quality education that prepares young people for employment opportunities in an inclusive information society and to become active citizens in complex, market-driven, democratic societies) are a critical barrier to reducing poverty and increasing economic growth. Near-universal access to the Internet via low-cost networks enables teacher training, enhances student access to traditional teaching materials via Internet distribution, and allows the introduction and use of new and advanced multimedia resources and learning tools. The young generation takes readily to computers and such resources, and there is evidence that classroom access to ICT tools can improve learning and help motivate students to stay in school.

Outside the classroom, affordable and near-universal access to information (via government or commercial voice-driven systems and the Internet) enables life-long learning and encourages the habit of searching for information to support personal and family decision-making. For many adults, voice-driven information sources and services in local languages that are accessible via telephones are important means for improving their access to information. At the same time, there is evidence that informal learning outside the classroom is strongly enhanced by affordable access to the Internet. This informal learning is driven, in part, by the growing availability of information on the Internet and the increasing organization of such information by search engines, but also by the growing use of interactive systems—from “chat” systems to e-mail and text-messaging to web logs and other interactive web-based systems.

Best practices for ICT-enhanced classroom education have been slow to emerge, in part because of the high cost of providing computers, appropriate curricula and adequate teacher training. Nevertheless, there are a number of concrete examples that show the effectiveness of widespread, small-scale experimentation and pilot projects which, coupled with careful evaluation, provide best

### Box 1: National University Network in Chile

The Red Universitaria Nacional (REUNA) project in Chile uses point-to-point and point-to-multi-point wireless services to provide network access to 25 suburban and rural colleges from two urban universities. The system took advantage of existing fiber and cable backhaul infrastructure available in Valparaíso and Temuco, providing access to neighboring colleges using wireless technologies. Because distances between points varied, the network “topology” presented different features. Also, a local cloud of connectivity was provided using WiFi technologies. Through a community choice system, where students decided the order and content of class “programming,” students at the receiving colleges used videoconferencing to customize their curricula, choosing from among a large selection of classes. Additionally, project participants point to the spontaneous creation of self-managing communities and research networks as a result of the project. The resulting economies of scale and decline in the price of wireless components allowed for a considerable reduction (40 percent) in equipment costs for access and remote points. <http://www.reuna.cl/>

## Box 2: Committee to Democratize Information and Communication Technology

The *Comitê para Democratização da Informática* (CDI) works to create opportunities for young people to free themselves from poverty and social exclusion through the implementation of community Computer Science and Citizenship Schools (EICs). The CDI views computer literacy as a vehicle for creating employment opportunities and promoting civic participation, formal education, literacy, concern for the ecology, health, human rights and nonviolence. CDI invests in the community's capacity to organize its own educational programs. Since its inception in Rio de Janeiro in 1995, CDI has provided support to 130 communities in the establishment of autonomous and financially self-sustaining EICs. There are currently 965 EICs using the methodology and model developed by CDI. In a recent evaluation, carried out by an external consulting group, 86 percent of the students stated that CDI schools had a positive impact on their lives (such as going back to regular schools, making new friends and staying away from drugs). The experience has been replicated throughout the world and, today, CDIs operate in Argentina, Chile, Colombia, Guatemala, Honduras, Mexico and Uruguay as well as in Angola, Japan and South Africa. <http://www.cdi.org.br/>

practice ICT applications for formal and informal education.

An example of a best practice in informal education is the *Comitê para Democratização da Informática* (CDI), a nongovernment, nonprofit organization in Brazil that fosters the social inclusion of less-privileged social groups through the use of ICT as a tool to encourage education and active citizenship. The CDI also uses ICT to benefit low-income communities and institutions by assisting individuals with special needs (including the physically and mentally disabled, the visually impaired, homeless children, prisoners, and indigenous populations). In order to promote digital inclusion, CDI enters into partnerships with national and international philanthropic organizations, companies, government agencies and individual donors.

## ICT and Health

The improvement in the delivery of health care services in geographically remote and rural areas is one of the most promising and clearly demonstrated applications of ICT in social development. Evidence suggests that improved health outcomes have been achieved through various applications of ICT solu-

tions. In particular, ICT is being used in many developing countries and communities to facilitate: (i) remote consultation, diagnosis and treatment through the use of digital cameras to download images onto a computer and transfer them to doctors in nearby towns; (ii) collaboration and information exchange among physicians; (iii) ICT-based medical research through the use a network of satellites and ground stations to submit data for clinical trials; (iv) medical training through ICT-enabled delivery mechanisms; and (v) access to centralized data repositories connected to ICT networks that enable remote healthcare professionals to keep abreast of medical knowledge.

Moreover, ICT provides considerable benefits and capabilities when applied to disease prevention and response efforts during epidemics. The Internet is an effective means to disseminate public health messages and disease prevention techniques in developing countries. It also enables better monitoring and response mechanisms. Also, ICT is helping improve the efficiency of public health systems and medical facilities by, for example, streamlining medical procurement or creating and managing patient records.

Real-time reporting of disease outbreaks as well as ordering medicines and supplies via software such as the VOXIVA toolset pioneered in Peru (which is now used worldwide) has dramatically increased the efficiency of health services delivery. Such solutions combined with handheld devices assist frontline

health workers in efficiently collecting and reporting patient data, and contain digital diagnostic and treatment guides for a wide variety of conditions.

## ICT and Financial Services

ICT tools can drive down transactions costs for financial services such as microfinance and a widening range of banking, insurance and other services for low-income groups, particularly as their delivery expands beyond nonprofit groups and becomes more widespread. For example, the expanded use of ICT and the Internet can reduce the transaction costs of remittances in a way that brings higher social benefits for all parties involved in these transactions. Under the Bank's leadership, the region has been a leader in both these areas, with many innovative financial companies serving low-income communities and providing the lowest-cost remittance services in the world. Nonetheless, there is still much to do. Transaction systems adapted to serve low-income communities via text messaging over mobile phones have been successful in Asia and Africa, and may prove useful in Latin America and the Caribbean as well. ICT technology offers several approaches to expanding access to electronic transactions and banking services via remote transaction devices for microfinance that work over mobile phone networks; smart cards that can store account balances, transaction histories, and positive IDs such as a fingerprints. The next generation of mobile phones may be capable of conducting transactions automatically via very short-range radio, potentially turning phones into electronic wallets.

Among the potential benefits of expanding ICT-based financial services and electronic commerce to low-income communities are: market access, economic value added, improved household security, the ability to grow microenterprises, reduced vulnerability to theft and greater participation in the formal economy.

## Wireless Technologies and Community-based Communication Services

Largely for reasons of cost, most rural communities and many low-income urban communities lack effective and affordable local phone systems. These communities usually rely on a few pay phones

### Box 3: Alerta DISAMAR: An Innovative Disease Surveillance System

Alerta DISAMAR is a pilot disease surveillance program implemented in 2002 by the Peruvian Navy, which relies on novel technology from VOXIVA Inc. Alerta DISAMAR allows users to collect, store, disseminate and analyze data on diseases under surveillance, reported through any type of telephone or the Internet. Designated users receive automatic notification of selected reports via e-mail, voice mail, or SMS message. Health officials can communicate with remote health professionals using voice mail as if they were e-mails to individuals or to predetermined groups of users. The system sends timely automatic reports on the number of cases of eight of the most reported diseases compared to the previous three weeks and a monitoring of cases that do not have yet a final diagnosis. Alerta DISAMAR shows a sustained improvement in coverage, data quality, baseline incidence rates, and outbreak detection capability. Alerta is a flexible and stable program with minimal recurring costs. It is a prime example of sustainable technology transfer for improving public health in a country with limited resources. More than 18,042 health events have been reported so far using this program. In addition, 18 outbreaks have been detected that have led to recommendations for improving vector control and food procurement processes. <http://www.voxiva.net/news/121603.asp>

#### **Box 4: PRODEM FFP's Multilingual Smart ATMs for Microfinance, Bolivia**

PRODEM Private Financial Fund (PRODEM FFP) offers low-income communities and micro, small and medium enterprises a wide range of savings, credit and money transfer services. Its 65-branch network is the largest in the country and spans both urban and rural areas. To expand its market, improve its services in even the most remote areas and help overcome barriers such as illiteracy, the company has developed and deployed a new technology-based solution that employs smart cards, digital fingerprint recognition technology, and Smart ATMs, as well as stand-alone, voice-driven Smart ATMs in local languages with color-coded touch screens. <http://www.digitaldividend.org/case/case.htm>

or shared mobile phones (which are used sparingly) and most calls are made to numbers outside the community. Yet historically, where affordable local phone systems exist, typically 60 percent of all phone traffic is within the community. A low-cost local phone system can make universal access a reality in many communities of Latin America and the Caribbean.<sup>3</sup>

The technological potential to do so has now emerged, via local Wireless Fidelity Networks (WiFi) and Voice-Over-Internet (VOIP) telephony using peer-to-peer systems.<sup>4</sup> In addition to making a wide range of voice-driven e-government and commercial services accessible and affordable, low-cost wireless networks, VOIP and high-capacity broadband networks, enable access to a great variety of Internet services and information via a computer or other converged device.

One of the benefits of voice-driven or voice-accessible services (especially if also made available in indigenous languages) is overcoming literacy and computer skill barriers. Other benefits also include ending rural isolation, enhanced family solidarity, increased access to information and services, improved ability to find employment and, at a community level, higher economic capacity and productivity and wider citizen participation in democratic processes. The experience shows that this can be achieved with affordable computers and Internet access, especially if these services are delivered through local entrepreneurs or community access facilities (such as telecenters) that can assist in computer and Internet usage.

Nevertheless, it is important to note that only a few countries in Latin America and the Caribbean have made VOIP legal or removed restrictions to its use. Likewise, few countries have made frequencies available for unrestricted WiFi use, permitted open competition for telecom and Internet services, or allowed community-based systems exemption from legal/natural monopolies. Beyond regulatory restrictions, the business environment in many countries still poses barriers to entrepreneurs and the creation of small businesses. There have been few pilot projects that promote best practices with rapidly emerging ICT technologies such as those cited. As a result, the region still lags behind many Asian, and even some African countries in realizing the potential development benefits from widespread ICT access and emerging wireless and nonconventional communication technologies.

<sup>3</sup> Allen Hammond. World Resources Institute. 2005.

<sup>4</sup> This technology is already having a global impact on long distance calling through services such as Skype.



## Helping the Poor Profitably: A Case for Access to ICT and Wireless Technologies

The example in box 6 illustrates what Professor C. K. Prahalad of the Michigan Business School poses in his book *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*, which highlights the collective purchasing power potential of the world's 4 to 5 billion poorest people. He urges efforts to promote an enabling business climate that go beyond the promotion of social corporate responsibility as means to foster local well-being, while generating a strong revenue and profit potential base in the long term. Moreover, a recent study by the London Business School found that, in a typical developing country, an increase of ten mobile phones per 100 people boosts GDP growth by 0.6 percentage points. The study concludes that wireless solutions are concrete examples of "technologies that help people help themselves."<sup>5</sup>

It becomes clear that the poor can benefit from the effective deployment of ICT and the development of the new economy when such interventions match the local conditions and meet the following four requirements. First, promote a multi-stakeholder partnership framework delineating the effective participation of the public sector and civil society, while creating the incentives for socially responsible private investment. Second, strengthen the provision of ICT-based public social services and promote social inclusion, while maintaining the role of the private sector as the main source of innovation. Third, stimulate macroeconomic growth by facilitating access to knowledge and information through increased connectivity and appropriate ICT solutions for marginalized and lower-income populations, thereby tapping a strong market potential. And fourth, design and adopt long-term ICT investment frameworks in human development (i.e. education, health and environment), along with the design and implementation of cost-effective technologies aimed at increasing the market access, efficiency and competitiveness of the poor (connectivity, knowledge centers, etc.).

### Box 5: Communications and Social Services in the Amazon

The Amazon Association, a Brazilian NGO, and the Solar Electric Light Fund, a nonprofit organization based in Washington, D.C., teamed up to provide basic services and economic opportunities to the Caboclo indians by means of broadband wireless Internet. Many members of this indigenous community lack basic health care, education and economic opportunities. In the absence of phones, electricity or Internet infrastructure, solar panels are being used to power a permanent satellite uplink to a local telecenter, which was built in four days and is expected to be self-sustainable in four years. In addition, it is expected that connectivity will be extended to other communities along the Jauaperí River in a cost effective manner by using WiFi technologies and sharing costs. According to the Wireless Internet Institute, "communicating on a regular basis with the outside world has provided a tremendous psychological lift to the community." The Amazon Association is able to stay in contact with community members through the use of e-mail, report on problems at the reserve, participate in decision-making and request supplies and medicines. Wireless technologies are an important means for outreach, empowering a community and promoting civic involvement. The project has become a source of income for local craftswomen, who can now sell their wares through the Amazon Association. [http://www.self.org/Brazil\\_Press\\_Release.asp](http://www.self.org/Brazil_Press_Release.asp)

<sup>5</sup> Calling an End to Poverty. *The Economist*. July 7, 2005.

### **Box 6: Vodacom's Community Cell Phones in South Africa**

Vodacom Community Services started operating under a 1994 government mandate to provide telecommunications services in disadvantaged communities in South Africa. Vodacom developed an innovative way to meet this mandate, via entrepreneur-owned and operated phone shops. These have provided affordable communication services to millions of South Africans, and empowered thousands of previously disadvantaged individuals with income-generating opportunities and lasting business skills. The Community Services program now provides over 23,000 cellular lines at over 4,400 locations throughout South Africa. By investing so extensively in disadvantaged communities, Vodacom is also investing in its own future by creating a distribution channel for its services, in addition to a well-recognized brand name. Though full returns will materialize in the future, the company is confident that its investments will pay off directly through increased sales and indirectly through a stronger, better-connected South African economy. <http://www.digitaldividend.org/case/case.htm>

By removing barriers to the entry of new and lower-cost technologies (such as fixed wireless) and of new communication and ICT-based services (such as Voice-Over-Internet phone service), and ensuring open competition, it will be possible to increase entrepreneurial activity and expand private sector investment. Nevertheless, the direct involvement of the public sector continues to be fundamental in sharing and expanding service into remote areas and to serve as a catalyst for the effective delivery of social services. This also reduces risk for private enterprises and helps comply with commitments to serve certain regions, communities and marginalized or disadvantaged groups, while also allowing market forces to trigger actions and operate effectively.

### **Digital Opportunities For All: An Action-oriented Framework for Latin America and the Caribbean**

Contributing to development through ICT requires an environment that facilitates the dissemination

and use of ICT in various institutional, business and social settings and, in particular, the promotion and creation of the necessary conditions to facilitate investment in technological infrastructure, promote price declines to facilitate access and foster digital education.

Specifically, an effective environment conducive to the dissemination and use of ICT requires a number of concrete actions under a multisector approach. This includes, for example, the creation or strengthening of institutional capacity with the participation of the public, private and civil society sectors, in order to promote and foster the dissemination and use of ICT through programs and initiatives that build an inclusive information and knowledge society. Bank-led National Programs for the Information Society have been successful in raising awareness, creating the necessary institutional and organizational conditions and allowing for the identification of concrete and comprehensive national ICT investment plans.

Another action relates to supporting the implementation or strengthening of national and regional regulatory frameworks, which is necessary for the development of the information society and knowledge economy, promote competition and loosen restrictions on the telecommunications market. The establishment of a normative environment to foster media convergence and enhance the deployment of various ICT-based platforms is also important. Moreover, such regulatory frameworks must promote and facilitate research, technological innovation and the deployment of ICT for governance, expansion of the business sector, poverty reduction and social and economic development.



Such measures should facilitate the extension of broadband connectivity services, bringing rates into line with purchasing power, while placing priority on semi-urban, rural and remote areas. They should also provide citizens and firms with access to ICT through initiatives that combine training, connectivity and infrastructure at affordable prices.

Experience shows that ICT-based programs aimed at enhancing the reach and impact of social development and poverty reduction programs not only strengthen the capacity of the public sector (at the national and local levels) to deliver public services, but also contribute to building public trust while enhancing citizen participation. According to evidence derived from lessons learned and best practices, and based on the social development needs and opportunities in Latin America and the Caribbean, ICT is a proven instrument that, when effectively deployed, facilitates the provision of access to formal and informal education, the delivery of health services, the creation of new financial services and, overall, the implementation of targeted poverty reduction programs in priority remote and marginalized areas.

Nevertheless, the desired impact can only be achieved if such actions are accompanied by institution building and strengthening of the organizations responsible for social development and, furthermore, by developing ICT-based systems that help to improve the management, delivery and impact of social and poverty-targeted programs. Moreover, adequate organizational arrangements must be in place to promote the implementation of community-based development programs and to facilitate investments in broadband connectivity, the deployment of wireless and other solutions in health care facilities, schools, and neighborhoods, and the development of local content.

All such actions undoubtedly require not only a concrete delineation of the responsibilities that the public sector, private sector and civil society should assume, but also the promotion and establishment of partnerships based on their mandates, responsibilities, purpose and competitive advantages. The consolidation of an information society leading to the effective deployment of ICT requires an action-oriented multi-stakeholder approach. Indeed, experience shows that these partnerships allow for addressing multiple issues that cannot be resolved without the concerted efforts of diverse constituents, while also allowing for synergies, coordination and sharing of priority investments, ultimately leading to a more efficient and sustainable process of economic and social development and poverty reduction through the deployment of appropriate and innovative technologies.<sup>6</sup>

Within such context, the active participation of the technology-based private sector in the development of the region represents a pivotal source of innovation for promoting social development, and creating local jobs, income opportunities and wealth. This can be achieved through the effective implementation of market, regulatory and institutional conditions to create the incentives necessary to balance social responsibility with profit motives. A course of action is promoting the participation of the private sector through ICT and connectivity investments and technical assistance in priority social sectors while, at the same time, creating value-added opportunities and the expansion of ICT-based social and financial services to underserved communities; and tapping the profit potential that

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<sup>6</sup> “Digital Reach”. International Telecommunications Union. “Multi-stakeholder Partnerships for Tackling the Digital Divide”.

can be realized from efforts aimed at improving the social and economic conditions of the poor (i.e. under a “blended strategy”).<sup>7</sup>

The governments of the region, for their part, must continue to support investments in connectivity and ICT-based services through e-government programs aimed at enhancing the capacity of national and local administrations in the delivery of education, health, environment and sanitation services, and through the deployment of ICT as a regional public good. They must also continue to extend the reach, scope and impact of such efforts to traditionally disadvantaged and marginalized groups. Equally important are sustained efforts to establish an enabling environment for the private sector to continue investing and innovating in ICT.

## Concluding Remarks

In recent years, the Latin American and Caribbean countries have experienced significant progress in the penetration of ICT, exceeding the growth achieved in the sector by other regions in the world. Nevertheless, the current levels continue to fall short of those in industrialized nations with respect to overall connectivity and widespread access, in addition to the adoption of ICT products and services by the private sector (especially by small and medium enterprises), as a means to improve productivity, market access and overall competitiveness. Another factor that has not reached optimal levels yet is the deployment of ICT by the public sector, as most administrations in the region, particularly at the local/municipal level, still show an incipient use of ICT in actions to modernize administrative processes and improve the delivery of public social services. The level of access to and deployment of ICT varies among countries, but the situation reveals the need for concerted actions to create the conditions that will enable its promotion and dissemination.

In this context, the Bank is aware that it must continuously update its financial and technical assistance instruments to effectively adapt to the demand of its borrowing member countries. The IDB will continue to support activities to provide and facilitate access to efficient ICT tools for the exchange of information, ideas and knowledge, and the deployment of ICT to promote more inclusive socioeconomic development that extends benefits to the poor. This will be further accomplished through partnerships with various sectors and stakeholders and by capitalizing from concrete experiences, lessons learned and best practices.

The countries of the region will continue to benefit from the mainstreaming of ICT and connectivity initiatives in their social and economic development agenda, especially when integrated in national “e-strategies” that are centered on the expansion of ICT-based services and solutions at the local level. The challenge still persists as to how to appropriately adapt such technologies to improve

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<sup>7</sup> Promoting social corporate responsibility under a “blended strategy” framework is based on the principle that the enhancement of the productive and economic capacity of the poor (under a long-term profit motive) through the provision and deployment of adequate technologies has a direct impact on their access to information and sources of financing, their ability to enter formal labor markets, their purchasing power and, thereby, the economic growth of the region.

the livelihood of poor families and communities, and increase their income-generating opportunities. The Bank remains committed to continue supporting its borrowing member countries in the implementation of action plans to provide access to ICT infrastructure and solutions and services with a high social impact. To this end, the Bank will help in delineating the road for investments by a socially responsible private sector, while modernizing and strengthening the capacity of local and national public administrations to use and allocate their financial and technical resources in an effective and efficient manner.



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