



## Overview

# Investing in sustainable development

Latin America and the Caribbean (LAC) needs an ambitious and comprehensive investment agenda to embark on a stronger and more sustainable development trajectory. To close existing investment gaps and overcome the region's structural challenges, it is essential to scale up domestic and foreign investment. These investments should be a catalyst for better quality jobs and an upgraded production structure, harnessing the potential of LAC's endowments and of the green and digital transitions. Strong public institutions are fundamental to promoting effective and efficient public and private investments and aligning them with national development strategies and social priorities. Moreover, innovative financing mechanisms, a renewed role for development finance institutions and reinvigorated international partnerships are key aspects to make this new investment agenda an instrument that sets the region on a path towards greater well-being for Latin Americans.

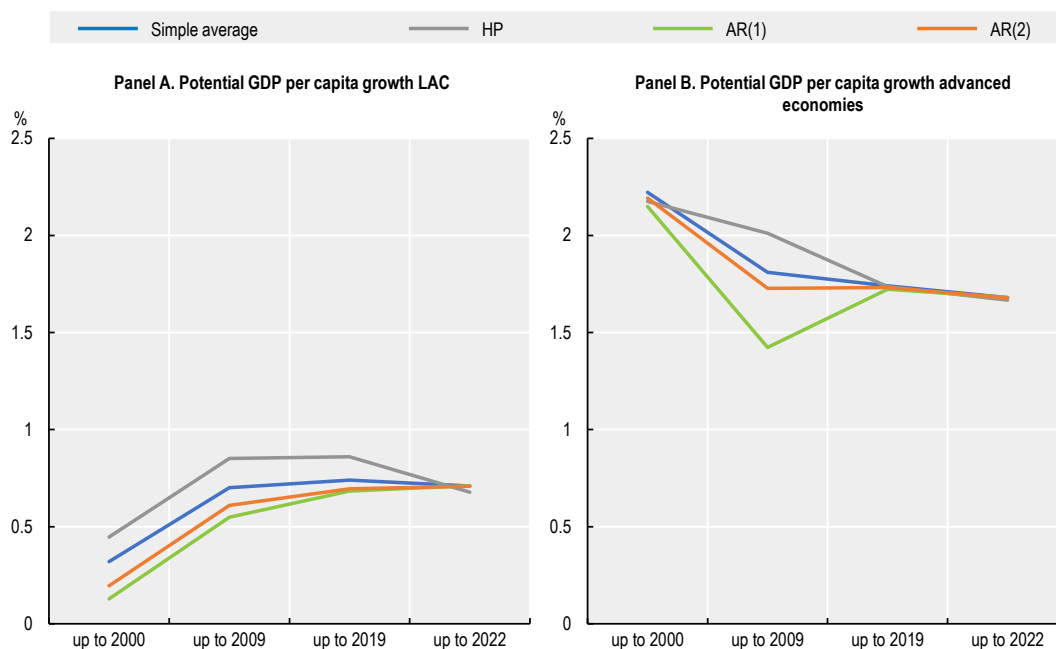
## LAC needs to improve potential growth and social conditions in a challenging context

Economic activity in Latin America and the Caribbean (LAC) has slowed in 2023. Following the contraction caused by the COVID-19 pandemic, gross domestic product (GDP) growth in the region had rebounded to above 6% in 2021. This expansion was mainly due to fiscal and monetary stimuli, improved external conditions and base effects. In 2022, external conditions became less favourable, public transfers were reduced, monetary policy tightened and the effects of reopening economies dissipated. GDP grew by almost 4% on average in LAC in 2022, with most countries in the region regaining pre-pandemic GDP levels. Nevertheless, the deceleration of economic activity in 2023 suggests that the region is returning to the low levels of growth seen in the years before the pandemic.

This decline reflects enduring structural weaknesses that limit the region’s growth potential, compounded by the impact of an unfavourable global context. Potential GDP per capita growth has been below 1% since 1980, although it increased slightly following the commodity boom between 2003 and 2013. Since then, potential per capita output growth has stagnated at around 0.7%. It has remained consistently below the average rate in advanced economies, which is close to 1 percentage point higher, thus hindering convergence (Figure 1). Global conditions are also denting growth in LAC countries. The global economic outlook remains weak, with tight monetary and fiscal conditions across major economies, including a weaker recovery in the People’s Republic of China (hereafter “China”) than expected (ECLAC, 2023<sup>[1]</sup>; OECD, 2023<sup>[2]</sup>).

Figure 1. Potential GDP per capita growth in LAC and advanced economies

Estimated under different methods since 1980

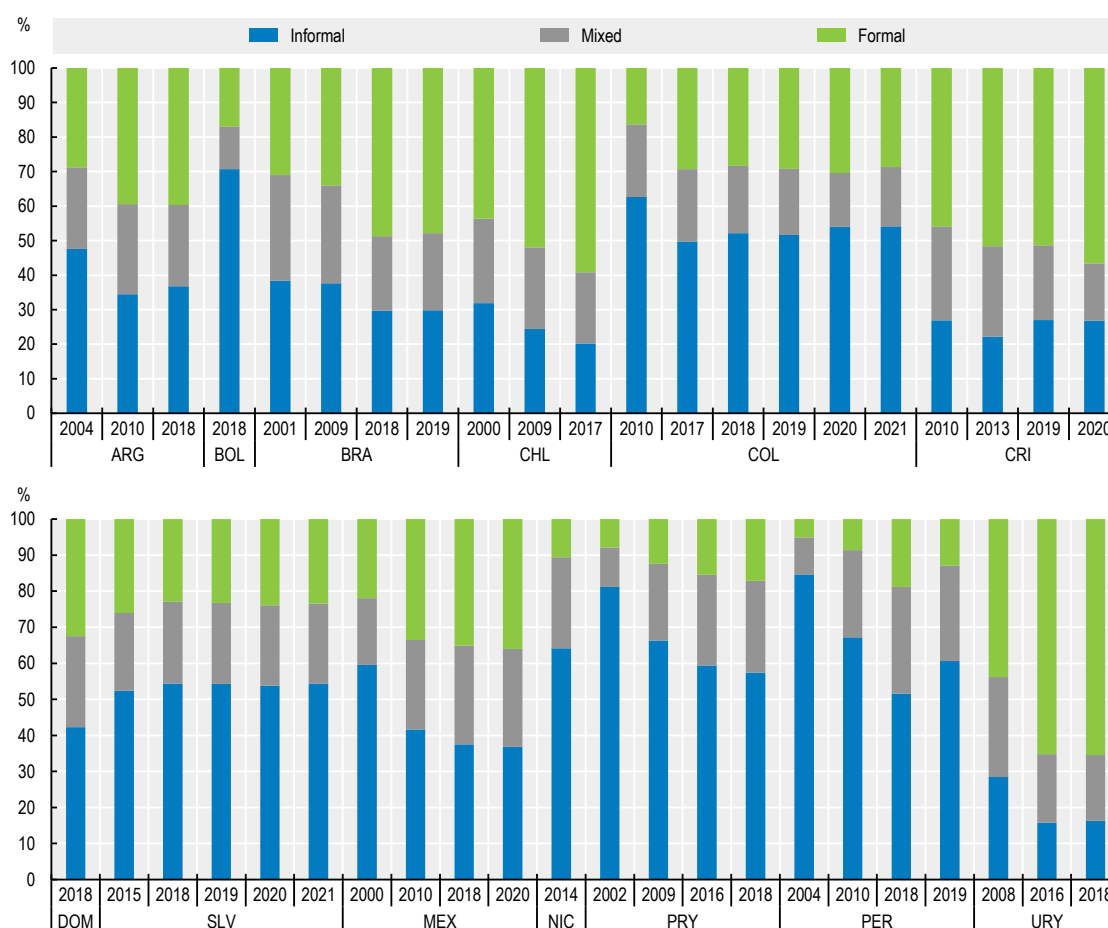


Note: Average growth is a simple average over the period analysed. HP = the Hodrick-Prescott filter, which was used as an alternative model due to its resilience to short-term shocks to create a smoothed curve (lambda 100). AR = autoregressive model, which uses GDP per capita growth data. The number of lags (1 and 2) was determined by analysing the autocorrelation function and choosing the model that maximised the log-likelihood. The LAC and advanced economies series refers to countries covered by the IMF’s World Economic Outlook database, April 2023. Source: Authors’ calculations based on (IMF, 2023<sup>[3]</sup>).

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Socio-economic conditions remain challenging in LAC, with poverty and extreme poverty above pre-pandemic levels in more than half of LAC countries. In 2022, 29% of the LAC population was in poverty and 11.2% in extreme poverty. One of the main challenges for addressing this situation is the persistence of high levels of labour informality, entailing lower wages and lack of access to social protection. On average, the informal employment rate in LAC was 48.7% in 2022 (ECLAC/ILO, 2023<sup>[4]</sup>). Before the pandemic, 42.8% of the region’s population lived in a household that depended entirely on informal employment, and 21.8% lived in mixed households, i.e. households with both formal and informal workers. This implies that two-thirds of the region’s population depended totally or partially on informal employment, though with important variations between countries (Figure 2).

Figure 2. Distribution of informal workers at the household level, selected LAC economies



Note: The selected economies are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Mexico, Nicaragua, Paraguay, Peru and Uruguay.  
 Source: Authors' elaboration based on (OECD, 2021<sup>[5]</sup>).

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Increased inflation eroded purchasing power in LAC, with a more severe impact on the most vulnerable populations. In the first half of 2023, the detrimental effect of inflation was considerably higher for households in extreme poverty. Compared to average households, households in extreme poverty faced an average price increase that was 4.1 percentage points higher. From a sample of LAC economies, the highest difference between the

impact of inflation on the average population and on extremely poor households was observed in Argentina (11.6 percentage points) and Peru (7.0 percentage points).

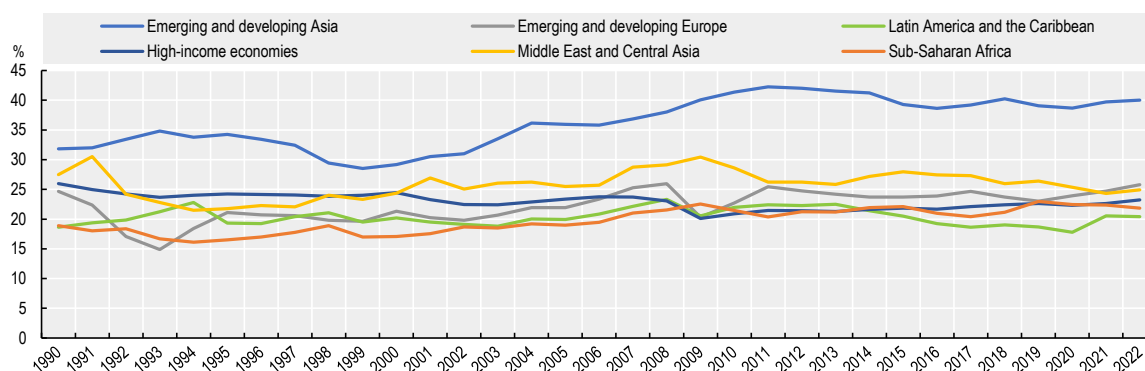
## Investment can drive sustainable development in the region

More and better investments are needed to expand potential growth and create more formal jobs; to drive production transformation and leverage the opportunities of LAC's unique advantages; and to harness the potential of profound global transformations, notably the green and digital transitions.

### The public and private sectors should mobilise further and better investments

The LAC region exhibits one of the lowest levels of total investment across all regions globally – only 20% of GDP – although with important divergencies across countries in the region (Figure 3). After reaching 23.3% in 2008, investment levels as a share of GDP have been relatively low, particularly between 2016 and 2020, when they were below 20% of GDP, only to recover slightly in 2021 and 2022. Within the region, investment as a percentage of GDP varies significantly. The only countries that achieved a steady increase in investment levels from 2014 to 2022 were Antigua and Barbuda, the Dominican Republic, Grenada, St. Vincent and the Grenadines, El Salvador and Paraguay.

Figure 3. Total investment as a percentage of GDP in LAC and selected regions, 1990-2022



Note: As in the IMF database, data for each region corresponds to weighted averages. Investment, defined as gross capital formation, is measured by the total value of gross fixed capital formation and changes in inventories and acquisitions less disposals of valuables for a unit or sector [SNA 1993]. Investment is expressed as a ratio of total investment in current local currency and GDP in local currency.

Source: (IMF, 2023<sup>[6]</sup>).

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Investment levels vary considerably across economic sectors. Almost half of the total investment in LAC from 1990 to 2018 was received by manufacturing (22.7%) and general services (21.1%). Commerce received 13.7%, mining 12.4%, agriculture 9.4% and transportation 10.9%. Essential services including electricity, gas and water accounted for 7.2% of total investment in the same period (ECLAC, 2022<sup>[7]</sup>).

Low levels of investment in LAC can be partly explained by the region's low levels of national savings. On average, for every percentage point of GDP increase in national savings, domestic investment increases by 0.39 percentage point, although with strong heterogeneity in the region (Cavallo and Pedemonte, 2015<sup>[8]</sup>). Despite those wide variations across countries, the region has consistently presented low levels of gross domestic savings, accounting on average for around 20% of GDP since 2000. This is considerably lower than the 35% of GDP saved by East Asia and Pacific economies.

The private sector is the largest source of investment in almost every LAC country, but this investment remains concentrated in large enterprises. The private sector accounted for 78% of total investment in 2019, below the OECD average of 84%. Private investment in LAC is highly concentrated, with 1%, 5% and 10% of the region's top companies being responsible, on average, for 25%, 55% and 69% of long-term investment.

The public sector has a crucial role to play in fostering sustainable development, notably by investing in strategic public infrastructure. However, public investment in infrastructure has remained low in the last decades, particularly since 2008, and stood at a level of 1.6% of GDP in 2021 (Infralatam, 2022<sup>[9]</sup>). Key sectors where investments in public infrastructure are needed are clean energy, sustainable transport, telecommunications and water. Investment in telecommunications and transport infrastructure can act as a catalyst for further growth and connectivity, at national and subnational levels, by allowing national and international firms to connect with other regions and integrate with national, regional and global markets. Similarly, quality infrastructure in energy, telecommunications and water can provide better equipment to ensure that both the digital and green transitions benefit all citizens in the LAC region.

In 2021, the largest public investments in LAC were in the transport sector (0.8% of GDP), followed by energy (0.3%), telecommunications (0.25%) and water (0.2%). Most public investment in infrastructure in LAC is directed towards the roads subsector; further efforts are needed in other modalities to make transportation sustainable. The strategic nature of infrastructure in energy, telecommunications and water underscores the importance of increasing public investment efforts in these areas.

Public sector investment can attract more and better private investment through various frameworks and tools. LAC governments can promote the development of innovative environments to attract higher levels of investment, for example by updating regulatory investment frameworks to set clear and transparent conditions for investors. Moreover, public-private partnerships (PPPs) can accelerate the development of strategic sectors and advance a more sustainable production matrix. PPPs require effective regulatory and institutional frameworks to avoid unexpected fiscal costs due to renegotiation of concession contracts. Even if as a share of GDP PPPs for public infrastructure in the region remains modest (0.46%), in 2021 LAC was above other developing regions like Sub-Saharan Africa (0.31%), South Asia (0.26%), East Asia and the Pacific (0.16%), the Middle East and North Africa (0.05%), and below Europe and Central Asia (0.47%) (World Bank, 2023<sup>[10]</sup>).

Overall, to achieve the Sustainable Development Goals (SDGs) by 2030, LAC countries need a substantial increase in both the levels and quality of investment. To close the gap between current investment levels and those necessary to achieve the SDGs, the LAC region will need an estimated investment of nearly USD 2.22 trillion in public infrastructure – the equivalent of USD 282 per capita per year by 2030 (IDB, 2021<sup>[11]</sup>). Low levels of domestic savings mean that LAC countries must borrow abroad to finance their investments, although this can sometimes be more costly and increases exposure to fluctuating external conditions.

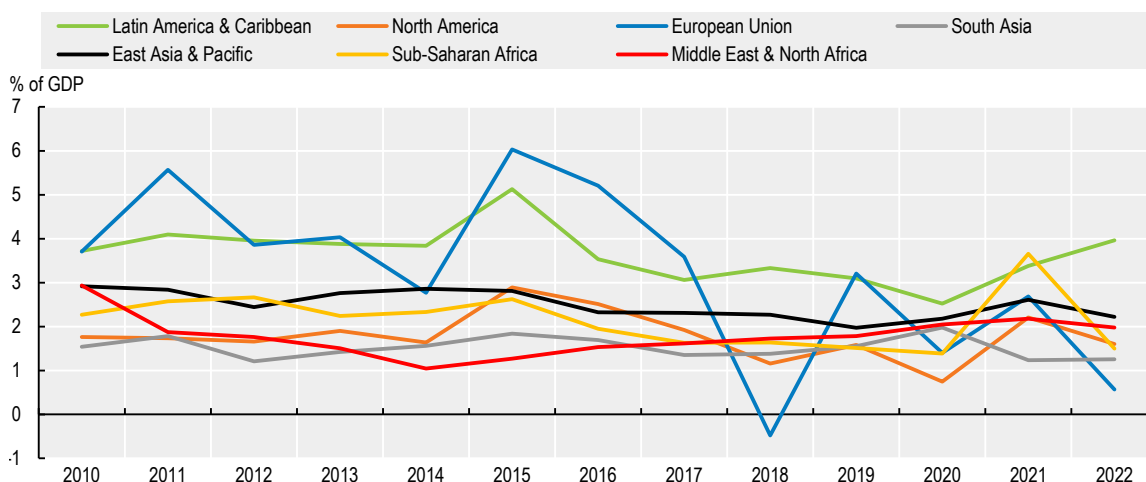
### **While domestic investment has been low, the region has been successful in attracting FDI**

While investment levels are low in the region, LAC has attracted relatively high levels of foreign direct investment (FDI) compared to other emerging economies. In 2022, it was the region that received the largest FDI flows globally relative to GDP, a position it has also held between 2018 and 2020 on average. FDI inflows were equivalent to 4% of the region's GDP in 2022 (Figure 4). Although global FDI decreased by 24% in 2022, FDI inflows increased by 55% in LAC, reaching almost USD 225 billion. To put these FDI inflows into perspective, for the periods 2017-19 and 2020-22 FDI represented the equivalent to



290% (USD 464 billion) and 278% (USD 445 billion), respectively, of the financial resources provided by the Marshall Plan to promote Europe's recovery after World War II (USD 13 billion in 1948 equivalent to USD 160 billion in 2022). Similarly, while the Marshall Plan amounted to around 2% of the combined national incomes of the recipient countries between 1948 and 1951 (Eichengreen, 2010<sup>[12]</sup>), FDI in LAC surpassed 3% of GDP in the periods 2017-19 and 2020-22, reaching 4% of GDP in 2022.

Figure 4. FDI inflows as a share of GDP, by region, 2010-22



Note: As in (World Bank, 2023<sup>[13]</sup>), data for each region corresponds to weighted averages. For the LAC region, 37 countries were taken into account with available data for 2022: Antigua and Barbuda, Argentina, Aruba, Bahamas, Barbados, Belize, Bolivia, Brazil, Cayman Islands, Chile, Colombia, Costa Rica, Curacao, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Saint Maarten, Suriname, Trinidad and Tobago, Turks and Caicos, Uruguay and Venezuela. The latest data available for Aruba, Curacao and the Cayman Islands corresponds to 2021, while for Venezuela it corresponds to 2014.

Source: Authors' elaboration based on (World Bank, 2023<sup>[13]</sup>).

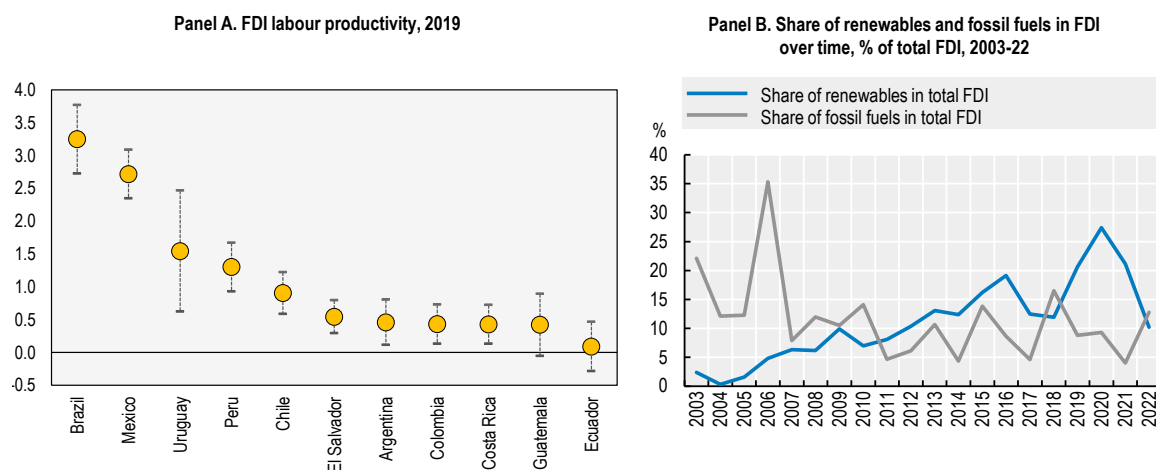
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Wide heterogeneity in FDI inflows is evident across LAC countries, both in terms of their origin and destination. More than half of FDI inflows to the LAC region in 2022 were directed to Brazil and Mexico, while Central America saw a decline of 11.9% that year. In terms of origin, and based on project announcements, the European Union (EU) and the United States have consistently accounted for more than half of the region's FDI inflows. About 8% of FDI in the region originated from LAC countries, followed by China (4%), the United Kingdom (4%) and Canada (2%) (fDi Markets, 2023<sup>[18]</sup>).

FDI represents an opportunity to boost productivity, innovation and the development of strategic sectors such as renewable energy. The OECD FDI Qualities Indicators, which seek to measure the impact of international investment on sustainable development, show that foreign investors are more productive than domestic firms across most LAC countries (Figure 5, Panel A), or more likely to introduce product innovation or invest in research and development (R&D). This productivity and innovation gap suggests that there is potential for knowledge and technology spillovers from foreign to domestic firms. In addition, regarding the development of strategic sectors, greenfield FDI in renewable energy has surpassed greenfield FDI in fossil fuels almost steadily since 2011 (Figure 5, Panel B), particularly in countries like Paraguay, Brazil, Uruguay, Dominican Republic, Honduras and Chile, where renewable energy FDI has dominated the energy sector and attracted a sizable share of total greenfield FDI over the 2003-22 period.

Figure 5. FDI Qualities Indicator for productivity and evolution of greenfield FDI by energy type

Selected LAC countries



Note: In Panel A, the orange dots depict the estimation of the indicator while the dashed lines represent the corresponding confidence interval. If the value is  $>0$ , foreign firms perform better than domestic firms. Based on 2019 data or the latest data available. For methodological details, see [www.oecd.org/fr/investissement/fdi-qualities-indicators.htm](http://www.oecd.org/fr/investissement/fdi-qualities-indicators.htm). Panel B shows the share of all opened and announced greenfield FDI projects in renewables and fossil fuels as a share of total greenfield FDI in LAC over time. In Panel B, LAC comprises Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Paraguay, Peru and Uruguay.

Source: Based on (OECD et al., 2021<sup>[14]</sup>), (OECD, forthcoming<sup>[15]</sup>) and (OECD, 2019<sup>[16]</sup>).

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## Investment can be a catalyst for job creation and improved labour market conditions

Investments can create new formal jobs in the LAC region. However, the potential for investments to yield favourable effects on labour market outcomes will very much depend on the type of investments, the sectors where they take place and the policies surrounding those investments, including social protection, education and skills policies.

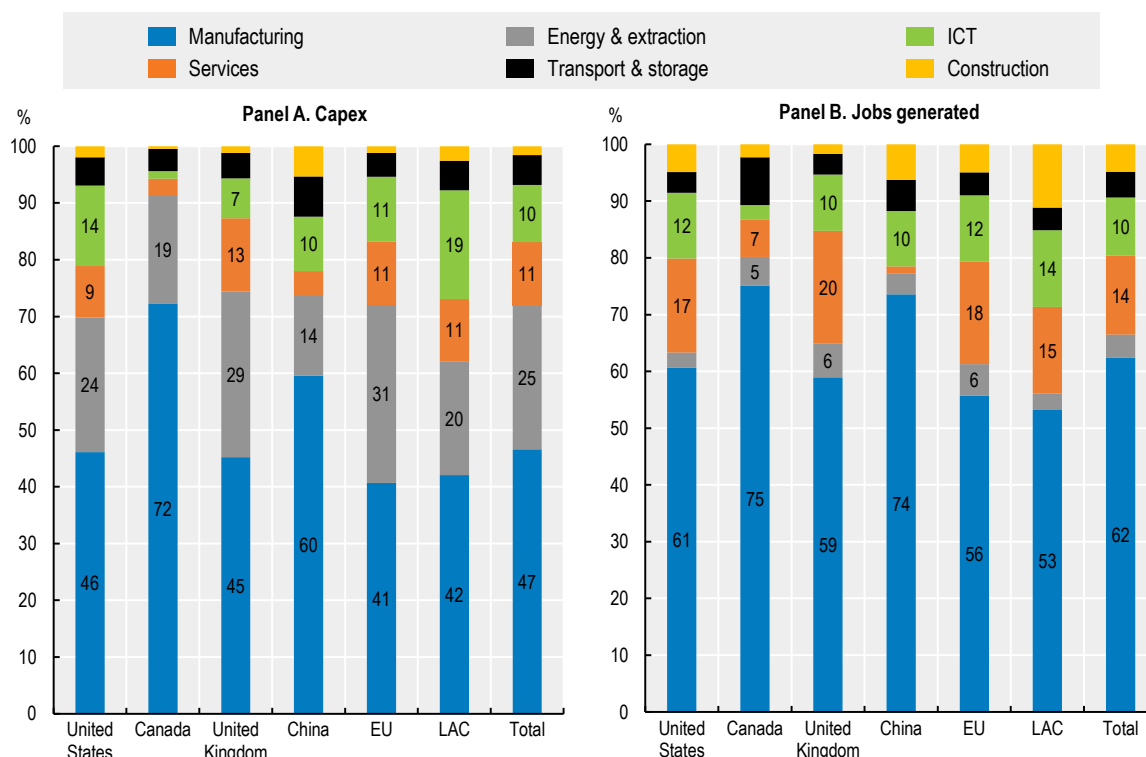
FDI has a particularly relevant impact on labour market conditions. Foreign firms in LAC tend to offer higher average wages and employ a higher proportion of unskilled workers than domestic firms do, and are also more likely to offer training opportunities (OECD, 2022<sup>[17]</sup>). Thus, foreign investors are an important source of employment for low-skilled workers in LAC and can make a significant contribution to upgrading their skills and increasing their employability.

The impact of FDI in terms of job creation varies significantly depending on the country of origin and the sector receiving the investment. FDI from the EU and the United States has had a particularly positive impact on the creation of jobs. However, results vary largely across economic activities, as seen in the manufacturing and the energy and extraction sectors, the main receivers of total FDI. In particular, 56% of jobs created in the region by FDI from the EU were in the manufacturing sector, which received 41% of the invested capital coming from the EU. Similarly, 61% of all jobs created in the region by FDI from the United States were in the manufacturing sector, which received 46% of total FDI from the United States. Conversely, 31% of the capital from the EU is invested in energy and extraction, but this created only 6% of new jobs. In the same vein, 24% of the region's FDI from the United States targeted the energy and extraction sector, but this only created 3% of jobs (Figure 6). Finally, FDI in renewables creates more jobs than it does in fossil

fuels in LAC. For example, USD 1 billion invested in fossil fuels creates on average about 500 new jobs, while 800 jobs are being created with USD 1 billion worth of investment in renewables.

Figure 6. Capital expenditure and formal jobs created by FDI in LAC, January 2003-May 2023

By sector and countries of origin



Note: ICT = information and telecommunication technologies. Capex = capital expenditures. Data covers January 2003 to May 2023. Energy and extraction includes: coal, oil and gas; minerals; and renewable energy. Services include: business services, financial services, health care, hotels and tourism, and leisure and entertainment. Construction includes: real estate. ICT includes: communications and software, and IT services. The LAC country group includes 27 countries: Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Lucia, Trinidad and Tobago, Uruguay and Venezuela.

Source: Authors' elaboration based on (FDI Markets, 2023<sub>[18]</sub>).

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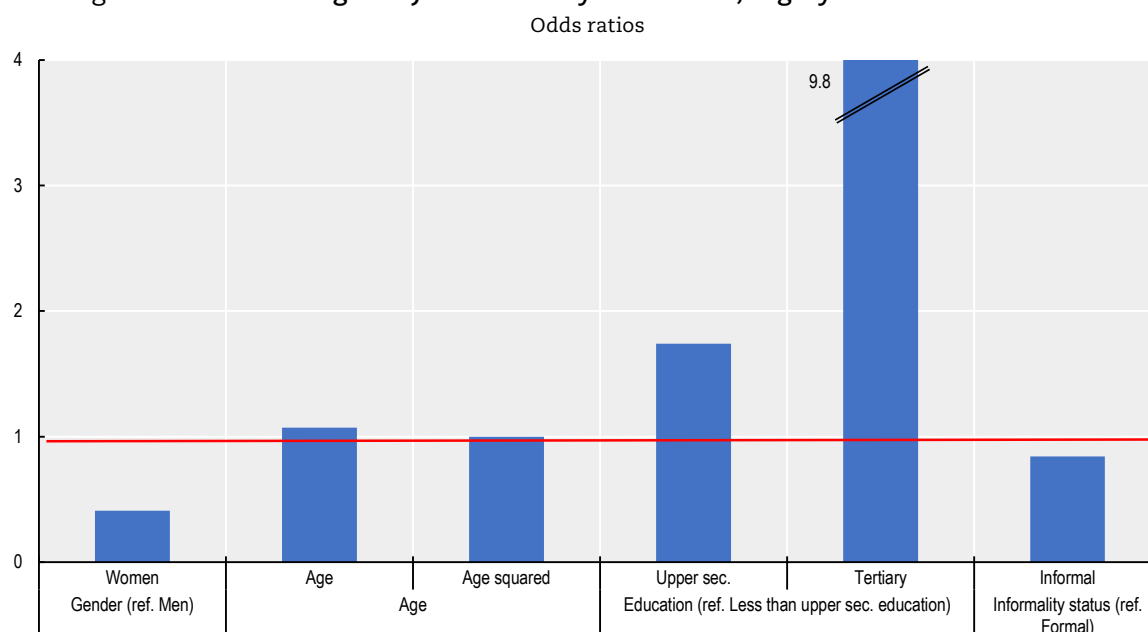
Emerging sectors offer important opportunities for job creation. In a scenario where investments in green sectors increase by 3 percentage points annually, additional net job creation could reach 10.5% by 2030 (OECD et al., 2022<sub>[19]</sub>). In particular in terms of green job creation, several activities show high potential: sustainable food manufacturing (+18.8% green jobs by 2030) is related to more sustainable production models in agriculture, food and beverages, and sustainable intermediate products; public administration (+14.6%) includes activities related to the planning and implementation of sustainable policies (from general administration to sustainable local development or energy market policies). It also comprises supervision and administration of social and economic life such as public activities related to the care economy. Sustainable construction (+14.3%) is mainly linked to new sustainable building construction, installations and completions that should improve buildings' energy efficiency thanks to the use of new technologies. This also includes repair, additions and alterations to improve existing constructions from an environmental perspective; sustainable transport (+14.1%) reflects the need for more



sustainable passenger and freight transportation systems, and to support sustainable transport activities, including the ones linked to digital transformation through telecommunications; finally, sustainable commerce (14.1%) represents the growing new business models of selling goods and services, and to repair goods that should contribute to developing the circular economy.

The development of green sectors requires well-targeted investments in human capital in order to leave no one behind. As new green occupations are mostly related to advanced scientific knowledge and skills, they are more likely to be assigned to highly educated men and tend to be formal jobs (Figure 7). This means that there is an important potential contribution of green jobs to increasing formalisation in LAC, particularly if paired with active labour policies to eradicate gender bias.

Figure 7. Workers in green jobs are likely to be male, highly educated and formal



Note: An odds ratio greater than 1 indicates that the condition or event is more likely to occur in the first group. An odds ratio less than 1 indicates that the condition or event is less likely to occur in the first group. In the chart the odds of holding a green job for women is 0.4 times the odds for men, meaning that women are less likely than men to be employed in a green occupation. The data refer to a pooled sample of workers in Argentina, Bolivia, Brazil, Colombia, Ecuador, Guatemala, Mexico, Paraguay and Uruguay, in 2021. Green tasks are identified using the methodology of (Vona et al., 2018<sub>[20]</sub>).

Source: Authors' calculations based on national labour-force surveys.

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### Investment is key to transforming production and tapping into emerging sectors

The production structure in LAC is characterised by low productivity levels. Productivity in LAC economies has been low for decades, and the gap relative to advanced economies has been widening. In 2023, labour productivity in LAC relative to the United States was around 27%, down from around 40% in the early 1980s.

Significant productivity differentials exist both between and within sectors: very dynamic and high-productivity sectors that are generally export-oriented coexist with less dynamic sectors and with high rates of informality. This heterogeneity is also observed at the level of production units. The region's many informal, low-productivity micro, small and medium-sized enterprises (MSMEs) coexist with technology-based and fast-growing start-ups.

By transforming the production structure, LAC countries will be able to raise productivity, increase potential growth and create better job opportunities. Investments in physical capital, knowledge and innovation, both from domestic and foreign sources, will be a fundamental driver of this production transformation. Similarly, investment in strategic sectors will allow the region to harness untapped opportunities, notably those associated with the green transition and digital transformation. It will also help the region to increase dynamism through technological upgrading, diversification towards more knowledge-intensive activities across all economic sectors and higher-quality jobs.

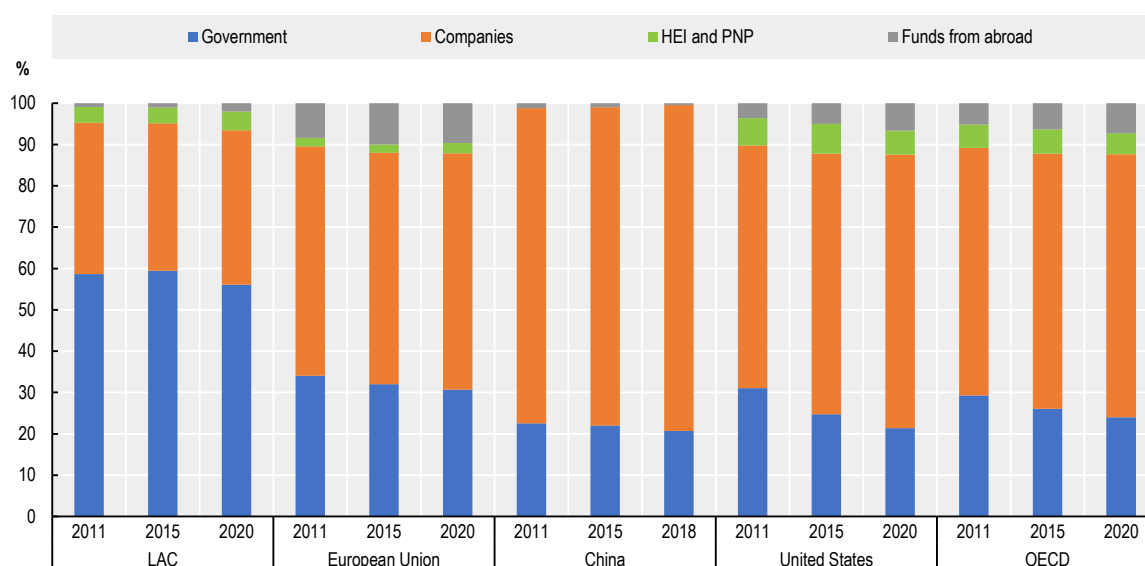
**Investment in R&D is needed for the transformation of LAC’s production structure**

Innovation is crucial for sustainable development and the transformation of the production structure in LAC as it is capable of spurring and prolonging long-term growth. Nevertheless, total investment in research and development in LAC has remained low for the past two decades, at around 0.65% of GDP between 2017 and 2020, or only 2.3% of total world investment, and well below the OECD average of around 2.7% of GDP in 2022 (RICYT, 2022<sup>[21]</sup>).

Significant heterogeneity in R&D expenditures is evident across LAC countries. In absolute terms, Argentina, Brazil and Mexico accounted for 86% of the region’s R&D expenditures in 2020. Brazil, which alone accounted for 65%, invests the highest proportion of its GDP (nearly 1.2% in 2020), followed by Argentina and Cuba (0.52%). In contrast, R&D investment levels in Guatemala and Trinidad and Tobago are close to 0.05% (RICYT, 2022<sup>[21]</sup>). As capacities vary a lot across LAC countries, some of them face specific policy challenges in terms of improving their technological sophistication and the innovative potential of their structures of production.

Governments in LAC remain the main funding source of R&D investment, contributing nearly 60%<sup>1</sup> (Figure 8). This highlights the need to increase private investment in R&D. Private investment in R&D has been constantly growing in developed economies and currently exceeds 60% in the United States, the European Union and OECD member countries, and stands at nearly 80% in China.

**Figure 8. Share of R&D investments by funding source in LAC and other territories, 2011-20**



Note: HEI refers to higher education institutions. PNP refers to private non-profit organisations.

Source: Authors’ elaboration based on (RICYT, 2020<sup>[22]</sup>) for LAC and OECD’s STI Scoreboard for the other territories.

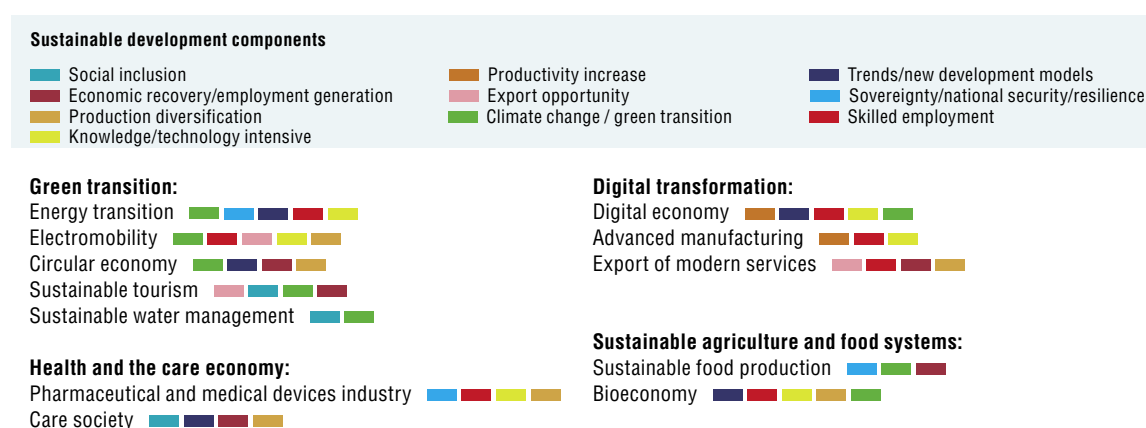
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Most sectors in LAC invest a medium to medium-low percentage of value added in R&D, while patent applications have been dominated by non-resident applicants in recent years (87%) (WIPO, 2023<sup>[23]</sup>). This contrasts with what is seen in more developed countries, where firms invest a higher percentage of value added in R&D and most patent applications are submitted by residents.

### Investment should target strategic sectors such as the green and digital transitions

The sectors with the greatest potential for increasing productivity, creating better jobs and developing sustainable and inclusive value chains may be grouped into four broad areas, which are interlinked among them and where significant transformations are taking place, opening up new opportunities for investment and job creation: i) the green transition; ii) the digital transformation; iii) health and the care economy; and iv) sustainable agriculture and food systems (Figure 9).

Figure 9. Sectors with high potential to drive sustainable development



Source: Authors' elaboration based on (ECLAC, 2023<sup>[24]</sup>; OECD et al., 2022<sup>[19]</sup>).

The green transition requires substantial investment in new technologies and human talent, and it will involve a large reallocation of workers from brown to green sectors. In recent decades, green sectors in LAC have shown more dynamic growth (3.3% per year) than the total economy (2.8%). The development of the green hydrogen industry and the addition of local value to critical raw materials are two areas of particular potential in the region.

Digital transformation can help improve productivity and competitiveness and be a way to take advantage of technological progress. Health and the care economy can help to increase resilience and preparedness for future health crises by developing stronger and self-sufficient local industries, strengthening the region's scientific, technological and production capacities. This can contribute to building more inclusive societies by promoting affordable and quality care services. Advancing towards more sustainable agriculture and food systems is key to ensuring food security both in the region and in the rest of the world, as LAC has the world's largest reserve of land with agricultural potential.

### Boosting investment requires mobilising innovative sources of finance

The LAC region needs to mobilise private and public sources on a large scale to finance the investments it needs. Tight fiscal space in many LAC countries limits the scope for public investment, which is already constrained by low levels of tax revenues. While the public sector can play an important role, particularly by investing in quality infrastructure, an ambitious and comprehensive investment agenda also requires much

higher levels of private investment, which has been traditionally constrained by low levels of savings and high interest rates. To stimulate it, development finance institutions (DFIs) can support access to finance and drive investments in key sectors while leveraging the potential of private finance; and innovative financing instruments may be developed, including Green, Social, Sustainability and Sustainability-linked (GSSS) bonds.

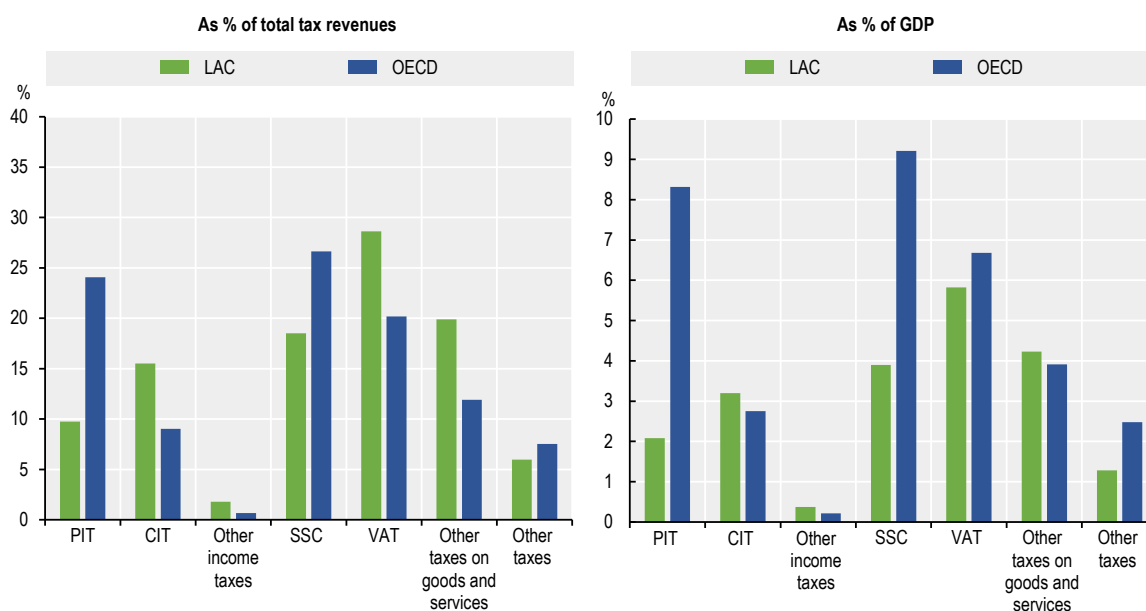
### Greater efficiency in taxation and spending can expand the scope for public investment

Expanding public investment will require mobilising resources from various sources of funding, yet most countries in the LAC region are constrained by limited fiscal space. This highlights the importance of advancing towards more effective and progressive tax systems, more efficient and effective public spending and debt management, and stronger and more sustainable fiscal frameworks (ECLAC, 2022<sup>[7]</sup>; OECD et al., 2022<sup>[19]</sup>; OECD et al., 2023<sup>[25]</sup>).

Regarding tax revenues, the average tax-to-GDP ratio in the LAC region in 2021 was 21.7%, considerably lower than the average of 34.1% in OECD economies. These revenues varied widely across LAC countries, from 12.7% of GDP in Panama to 33.5% in Brazil. LAC tax structures rely on indirect taxes more than direct taxes (Figure 10). In 2020, taxes on income and profits accounted for 25.2% of tax revenues in LAC on average, relative to 33.1% on average in the OECD.

Relatively high corporate income taxes (CIT) may hinder investment and entrepreneurship. Within income taxes, CIT accounted for 15.5% of total tax revenues in LAC, while personal income taxes (PIT) represented only 9.7%. In OECD economies, PIT account for a larger share of tax revenues (24.1%) than CIT (9.0%) (OECD et al., 2023<sup>[25]</sup>). Furthermore, effective corporate tax rates – i.e. the actual tax liabilities faced by companies after taking into account existing tax provisions – tend to be high due to relatively high statutory rates and tax provisions that are less generous than those observed in other jurisdictions.

Figure 10. Average tax structure in the LAC region and the OECD, 2020



Note: PIT is personal income tax, CIT is corporate income tax, SSC is social security contributions and VAT is value-added tax. Source: Authors' calculations based on (OECD et al., 2023<sup>[25]</sup>).

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On the expenditure side, more effective and efficient spending could be achieved through effective focalisation of public expenditures (including social spending and subsidies). Regarding public debt, it is above pre-pandemic levels and interest payments represent a larger fraction of spending, reducing the scope for countercyclical policies and investment.

Better debt management and economic growth are required for debt to stabilise or decrease, and investments are crucial for this. Capital investments are essential for the production transformation and can help to offset the contractionary effects of fiscal adjustment in the short term. Fiscal policy must therefore protect public investment with adequate fiscal frameworks, including fiscal rules that are flexible enough to accommodate exogenous shocks. This can be accomplished by including cyclically adjusted fiscal targets, setting well-defined escape clauses and practising differential treatment of investment expenditures.

### **DFIs can bolster access to finance for MSMEs and investments in strategic sectors**

The potential of national and subnational public development finance institutions (DFIs) is often underutilised in LAC countries. With their diverse and innovative financial instruments, DFIs can play a crucial role in addressing the lack of depth in LAC's financial markets by redistributing risks and making markets more inclusive. In turn, DFIs also have the potential to bridge financing gaps faced by enterprises and to help expand the market.

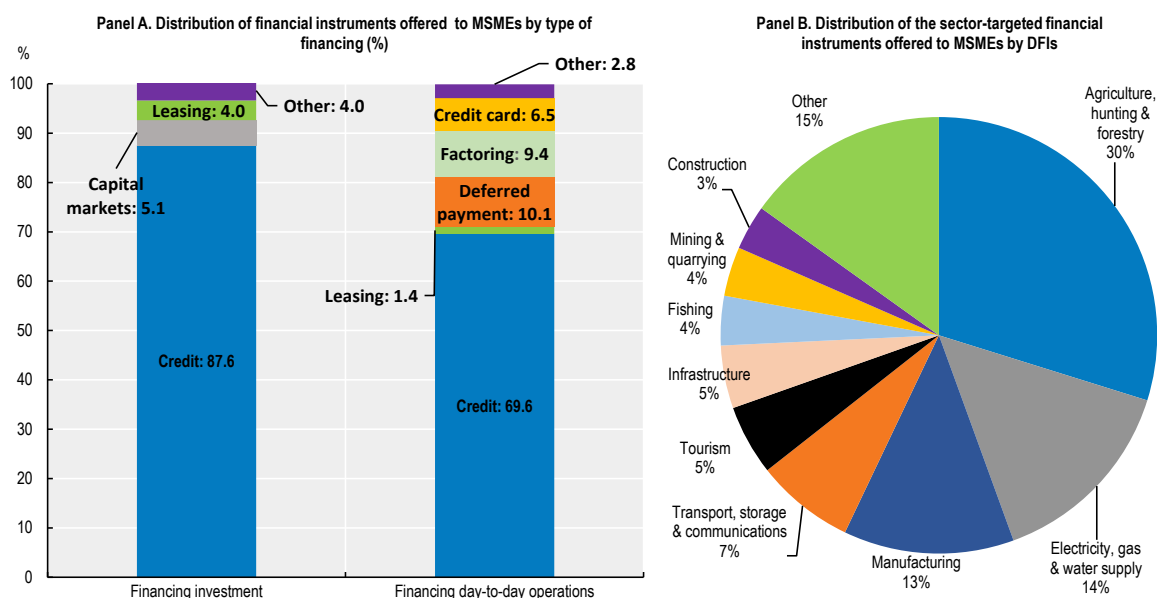
As much as 75% of the financing needs of MSMEs in LAC remain unfunded, and DFIs can play a pivotal role in contributing to filling this gap. Public DFIs in LAC are already focused on MSMEs, as shown by an analysis in 2023 of 38 national and subnational public DFIs across 13 LAC countries. Of all instruments used by these DFIs, 42% target both MSMEs and large companies, 39% target only MSMEs, 7% target public institutions and 4% are directed only to large companies. Financing offered to MSMEs mainly targets investment (45%) and day-to-day operations (34%). This shows the commitment of DFIs to guaranteeing the working capital, liquidity and long-term investment needs of these firms.

DFIs offer MSMEs in LAC a variety of tailored financial instruments that cater to their financial needs at every stage of their development. Credits are the most common instrument offered to finance investment projects (87.6%) and to finance day-to-day expenses (69.6%), but other instruments are also used, including factoring, leasing, guarantees and mechanisms to access capital markets (Figure 11, Panel A).

DFIs can also promote innovation and long-term investments in strategic sectors, aligned with national development priorities. This will contribute to public-sector efforts for production transformation at the national, subnational and local levels. DFIs also support private-sector investments in key sectors. Of the total financial instruments offered to MSMEs with a sectoral perspective, 30% target agriculture, hunting and forestry; 14% target electricity, gas and water supply; 13% target manufacturing; and 7% target transport, storage and communications (Figure 11, Panel B).



Figure 11. Financial instruments offered to MSMEs by DFIs in LAC, by type of financing and sector, 2023



Note: The database covers 38 national and subnational public DFIs in 13 LAC countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Mexico, Paraguay, Panama, Peru and Uruguay. Panel A: The category “Other” includes the following financial instruments: non-reimbursable financial support; credit fund; guarantee; trusts; and cancellation of liabilities. Panel B: The category “Other” includes the following sectors: wholesale and retail trade; financial intermediation; real estate, renting and business activities; public administration and defence; education; health and social work; other community, social and personal service activities; ICT; and creative industries.

Source: Authors’ elaboration based on public data (annual and sustainability reports) accessed in 2023 from 38 public DFIs in 13 LAC countries.

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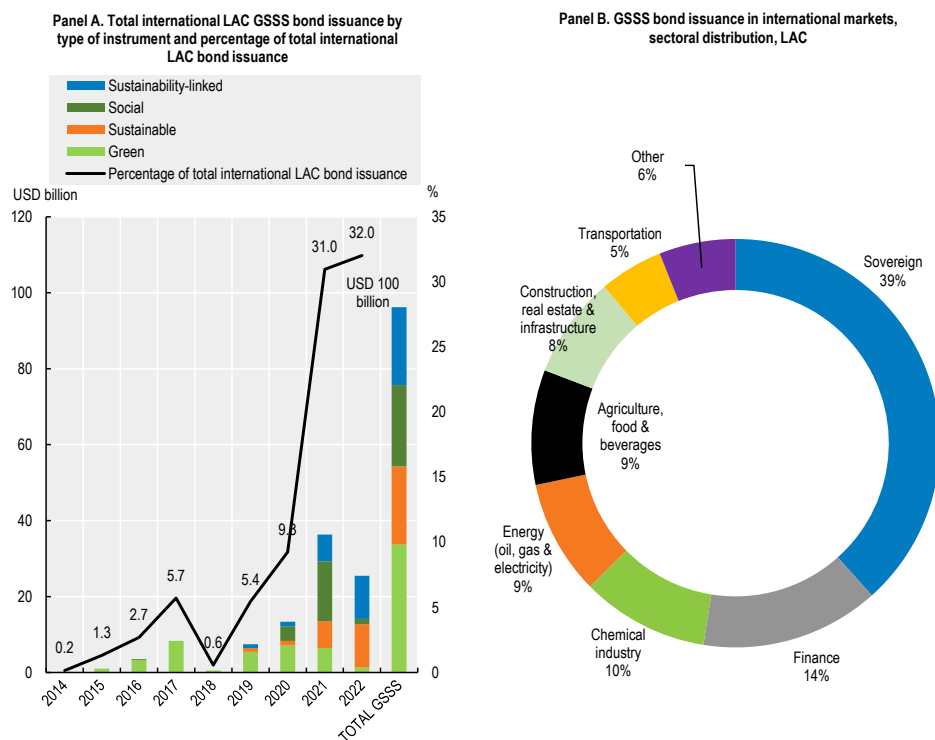
## Scaling up innovative debt instruments can boost private and public investment in LAC

Developing sustainable debt market instruments can help mobilise resources where needs are greatest. While the GSSS bond market represents only 1% of total assets outstanding and around 2% of new issuances globally, it constitutes a promising avenue forward (OECD, 2022<sup>[26]</sup>). In the LAC region, even with tight financial markets, GSSS bonds are an attractive financing mechanism, representing 32% of total international LAC bond issuance. Between 2014 and 2022, the GSSS bond market reached a cumulative value of close to USD 100 billion, of which green bond issuance alone accounted for USD 33.4 billion, followed by bonds linked to sustainability criteria (USD 24.4 billion) (Figure 12, Panel A).

Sovereign GSSS issuance has been gaining prominence in recent years as a share of total GSSS bond issuance in LAC. In 2022, sovereign GSSS bond issuance in international markets in the region accounted for 35.7% of the total sovereign issuance of all types of bonds in international markets. During the first six months of 2023, this figure increased to 43.5%. Until June 2019, all GSSS bond issuances in LAC originated in the corporate sector. In 2022, sovereigns led, with a 57% share of total GSSS bond issuance in LAC, followed by corporates (23%) and supranational and quasi-sovereign issuers (20%).

GSSS bonds have also emerged as attractive instruments for specific sectors to raise capital and address the region’s pressing sectoral challenges. Between 2014 and April 2022, the main sectors that issued GSSS bonds, after sovereign (39%), were finance (14%), the chemical industry (10%) and energy (9%) (Figure 12, Panel B).

Figure 12. International GSSS bond issuance in LAC by type, as percentage of total and by sector, 2014-22



Note: GSSS refers to Green, Social, Sustainability and Sustainability-linked bonds. Total sustainable bonds for 2022 include two blue bonds issued by the Bahamas. Panel B: The category “Other” includes the following sectors: telecommunications; forestry & paper; and retail & consumer products.

Source: (Núñez, Velloso and Da Silva, 2022<sup>[27]</sup>; OECD et al., 2022<sup>[19]</sup>)

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Countries in LAC are focusing on expanding, improving and harmonising sustainable finance frameworks, which are essential to regulating, monitoring and verifying the issuance of GSSS bonds and other instruments. More consolidated frameworks have the potential to reduce transaction costs for investors, making capital markets in the region more attractive. Green and sustainable taxonomies have been developed in the region. They have been implemented in Mexico and Colombia, while they are under development in countries such as Brazil, Chile, Dominican Republic, Peru and subregions such as Central America. In June 2023, the United Nations system in LAC launched the first Common Framework of Sustainable Finance Taxonomies. This regional framework is intended as a voluntary guidance document for actors in the region who are in the process of developing or intend to develop taxonomies. The framework also provides guidance for the interoperability of taxonomies within LAC and globally (UNEP, 2023<sup>[28]</sup>). To maintain market transparency and avoid greenwashing/SDG-washing, it is also crucial to consolidate reliable monitoring and verification systems. LAC’s GSSS bond market has made progress from self-labelling to becoming an externally reviewed market, yet there is still a long way to go. External reviews, i.e. pre-issuance and/or post-issuance reviews, must be installed and enhanced.

## Strong public institutions should link investments with national and citizens’ priorities

Better public institutions are fundamental to ensuring that investment and production transformation efforts address the priorities of citizens and are well connected with the

broader development strategies in LAC countries. Similarly, by enhancing the rule of law, transparency and integrity, public institutions can create a conducive environment for investment, help build trust and reduce risk aversion.

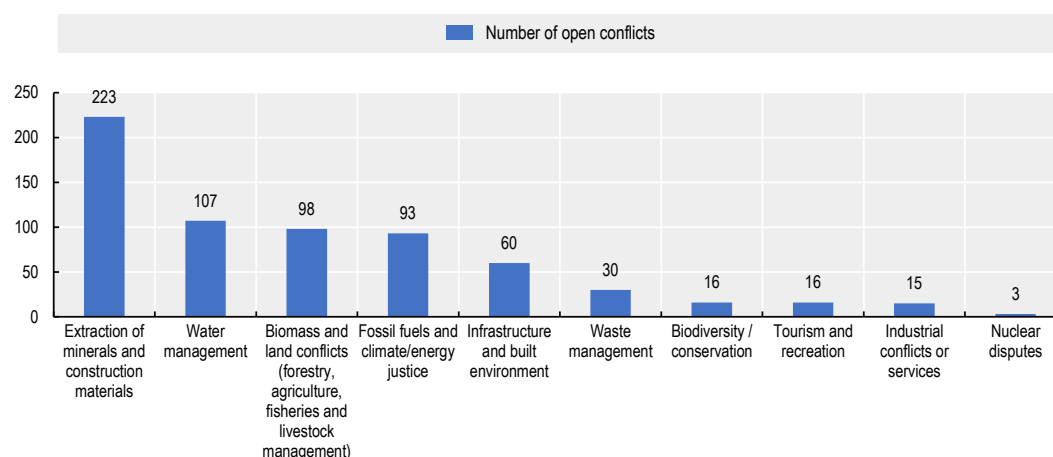
### Favouring dialogue around the investment agenda to strengthen the social contract

An ambitious investment agenda can have a significant impact on living standards across socio-economic groups in LAC. Engaging stakeholders to agree on the strategies for production transformation and investment will be crucial to making these efforts possible and to avoiding potential conflict. This involves understanding and incorporating stakeholders’ priorities throughout the policy-making process, which increases the legitimacy of investment strategies, thus strengthening the social contract.

As enterprises are central to production transformation and a main source of investment, citizens’ perceptions of their role are crucial. However, LAC citizens currently have low trust in national and international companies. In 2020, LAC citizens had either no trust at all (20.3% and 24.4%) or little confidence (35% and 34.2%) in national and international companies, respectively (Latinobarómetro, 2020<sub>[29]</sub>). In other words, lack of trust was expressed by more than half of those polled. In contrast, perceptions that FDI has positive impacts on economic development remain relatively high in LAC, though there has been slippage recently. FDI was seen as beneficial by 53.6% of the population surveyed in 2020, down from 70.7% in 2016 and the lowest level to date.

Inclusive dialogue throughout the investment cycle is particularly relevant to avoid conflict derived from the potential economic, social and environmental impacts of some investments on specific groups. Many social conflicts around environmental issues have erupted in the LAC region. Of 742 social conflicts that occurred in LAC from 2000 to 2022, 661 were still unresolved by the end of 2022. About one-third of the conflicts still open in 2022 concentrated on mining (33.7%), followed by water management (16.2%), biomass and land conflicts (14.8%), and fossil fuels and climate/energy justice (14.1%) (Figure 13).

Figure 13. Number of open social conflicts in LAC linked to environment, by category, 2022



Note: These conflicts are defined as mobilisations by local communities and social movements, which might also include support of national or international networks against particular economic activities, such as infrastructure construction or waste disposal/pollution, whereby environmental impacts are a key element of the grievances. The figure shows unresolved conflicts that started in the period 2020-22.

Source: (Environmental Justice Atlas, 2023<sub>[30]</sub>).

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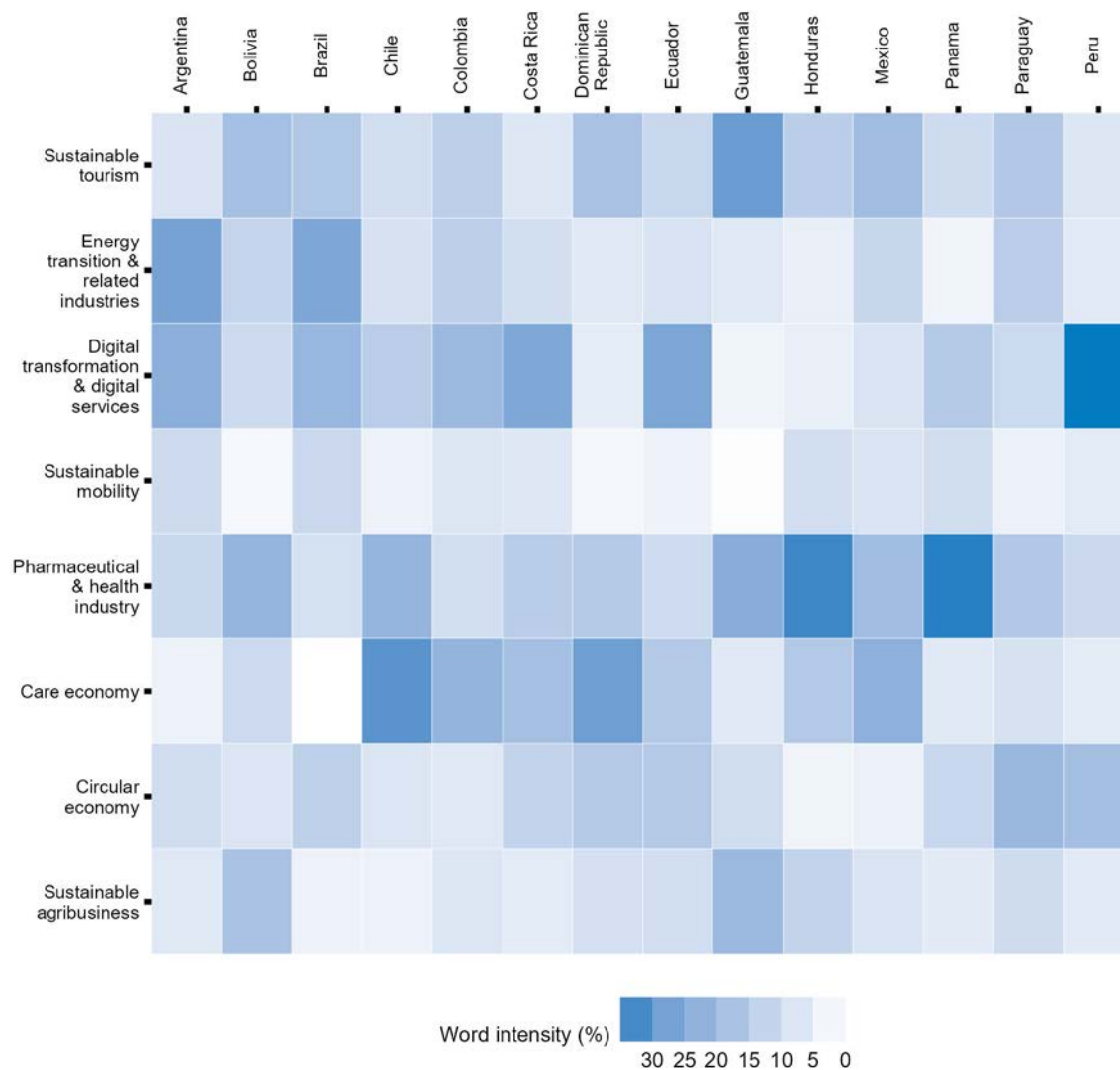
To build support for the investment and production transformation agenda, while preventing and/or handling potential social conflicts and corruption, governments must establish mechanisms to ensure effective citizen participation, rigorous and standard environmental and social impact assessments, and more equitable distribution of the benefits of investment projects. Public consultations, access to information and data, participatory budgeting and representative deliberative processes are useful practices for engaging citizens in the process. Local governments have a vital role in promoting citizen participation, as investment projects often have direct impacts on specific communities and territories.

### **Aligning the investment agenda with national development strategies**

National development plans (NDPs) can provide the well co-ordinated, long-term and comprehensive policy frameworks needed to advance coherent investment and production transformation strategies. The LAC region has frequently grappled with fragmented policies and political uncertainty, which discourage the domestic and foreign investments that are essential for production transformation. However, in most LAC countries, NDPs have emerged as a powerful instrument to provide strategic direction, enhance investor confidence and reinforce social contracts. The process of elaborating an NDP often includes mechanisms to incorporate civic participation and foster the inclusion of a diversity of views. NDPs can also contribute to adopting a whole-of-government strategy, which aligns public policies both horizontally (across sectors) and vertically (between government levels), facilitating efficient resource utilisation and investment planning.

NDPs can also act as a catalyst to attract private investment by enhancing policy predictability and transparency, and can include policy guidelines associated with strategic sectors with high development potential in the region. An analysis of the NDPs of 14 LAC countries indicates that agendas like digital transformation appear rather prominently, with greater relative relevance in countries such as Costa Rica, Ecuador and Peru. The pharmaceutical and health care industry receives significant attention in most countries, with Guatemala, Honduras and Panama addressing this agenda in particular. The energy transition is also addressed in most (but not all) NDPs, and is particularly emphasised in Argentina and Brazil. Interest surrounding the care economy also varies among countries, with nations like Chile, Colombia and the Dominican Republic leading in addressing this agenda. The approach to sustainable tourism is balanced across all countries, with Guatemala giving greater relative importance to this area. Sustainable agribusiness is addressed in all countries, although it receives slightly less relative attention than other topics, with countries such as Bolivia and Guatemala giving it greater relative importance. The circular economy is addressed in a balanced way in most NDPs, although in most countries it is not among the sectors receiving the most attention. Lastly, across countries, NDPs give low emphasis to sustainable mobility (Figure 14). It is worth mentioning that some countries may have specific sectoral strategies for certain sectors that are not particularly prominent in the NDPs. Sectoral development plans, often formulated in consultation with diverse stakeholders, provide additional, specialised frameworks for stimulating growth and development in key economic sectors. These planning tools are particularly important for aligning investments with broader socio-economic goals and for specifying implementation measures.

Figure 14. Prioritisation of strategic economic sectors in LAC national development plans, 2023



Note: Word intensity refers to the frequency with which a specific set of words associated with a strategic sector appears in each NDP. The idea is that the more frequently a set of words appears, the more “intense” or important they might be in the context of the text being analysed. This intensity, measured by frequency, can be indicative of the prominence or significance of a particular topic within the text. As a colour darkens, the frequency of references to a given strategic sector within the plan increases. The sum of the relative frequencies across all economic sectors in a country’s national development plan is 100. Each country’s text data comes from the latest development plan (or its equivalent), published by October 2023.

Source: Authors’ elaboration using the national development plans of 14 LAC countries.

StatLink <https://stat.link/i79mst>

Other institutional arrangements offer additional co-ordination mechanisms. National public investment systems are pivotal in guiding public investment processes, offering an institutional framework that assures fiscal sustainability and enhances the economic and social impact of public spending. Effective multi-level governance (MLG) is crucial for aligning national policy objectives with local needs in investment and production transformation. Tools for MLG can operate both vertically and horizontally, involving various governmental tiers and stakeholders. Contracts specifying roles and co-financing clauses can enhance compliance and efficiency. Local governments play a pivotal role in attracting FDI and providing essential services, further supported by spatial planning policies.

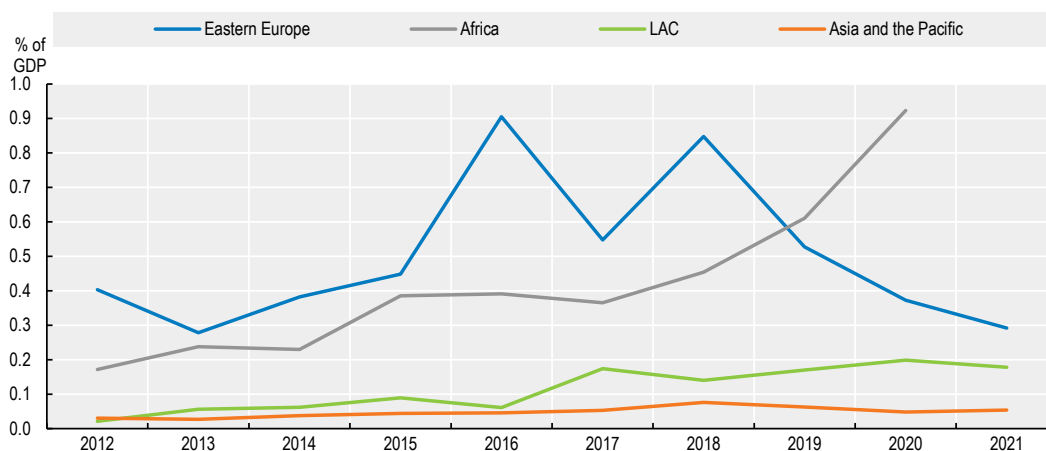


## International partnerships can help attract investments and enhance their development impact

To attract investments that are conducive to LAC's production transformation, international partnerships can create synergies between international organisations, governments, experts, development agencies and private-sector institutions. The nature of these partnerships is being reshaped by evolving global dynamics and trends, with a noticeable shift in development finance towards recognising the potential of the private sector to bridge the global investment gap.

International co-operation should contribute to attracting private investments that finance LAC's development and economic transformation. The region's heterogeneous economies and rich environmental resources can attract more FDI, impact investments and other international financial flows. Moreover, even if the region shows little and decreasing reliance on concessional sources of financing, such as official development assistance (when measured as a share of gross national income), development co-operation is still essential for LAC to further mobilise international financial flows through innovative mechanisms. For instance, blended finance can mobilise additional finance towards sustainable development projects. During the last decade, LAC has experienced an increase in the share of mobilised private finance by official development intervention as a percentage of GDP, from 0.06% (USD 3 billion) in 2016 to 0.18% (USD 9 billion) in 2021 (Figure 15). Most of the financing for banking and financial services came from guarantees, credit lines and syndicated loans, instruments that are generally used for supporting the development of MSMEs and financial inclusion (OECD, 2023<sup>[31]</sup>).

Figure 15. Amounts mobilised from the private sector by official development finance interventions, 2012-21



Note: Countries included in Eastern Europe: Albania, Belarus, Bosnia and Herzegovina, Kosovo\*, Moldova, Montenegro, North Macedonia, Serbia, Türkiye and Ukraine. Countries included in Asia and the Pacific: Afghanistan, Armenia, Azerbaijan, Bangladesh, Bhutan, Cambodia, China, Fiji, Georgia, India, Indonesia, Iran, Iraq, Jordan, Kazakhstan, Kiribati, Kyrgyzstan, Lao PDR, Lebanon, Malaysia, Maldives, Micronesia, Mongolia, Myanmar, Nepal, Niue, Palau, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Syrian Arab Republic, Tajikistan, Thailand, Timor-Leste, Tonga, Turkmenistan, Tuvalu, Uzbekistan, Vanuatu, Viet Nam, West Bank and Gaza Strip, and Yemen. Countries included in LAC: Antigua and Barbuda, Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Uruguay, Venezuela. Africa includes all African countries. Data for 2021 are being reviewed.

\* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Source: Authors' calculations based on (OECD.Stat, 2023<sup>[32]</sup> and IMF, 2023<sup>[6]</sup>).

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Beyond the opportunities presented by international financial flows, international partnerships play a crucial role not only in mobilising greater resources but also in ensuring that investments yield a greater socio-economic impact. Three main objectives can help international partnerships to ensure that they mobilise more and better investments. First, these partnerships can strive to create an enabling environment that attracts and facilitates investments that are conducive to the region's production transformation. This includes tools like international standards, frameworks and investment treaties, or capacity building and technology transfers, which improve the level playing field of countries in the region. Second, they can foster alignment and collaboration among investment-related actors, such as multilateral development banks (MDBs) and DFIs, export credit agencies (ECAs), investment promotion agencies (IPAs) and the private sector, to enhance co-ordination and effectiveness through specific platforms. Third, they can boost local development by implementing measures like local content requirements that strengthen local economies and value chains, and by aligning support with national development strategies (Table 1).

**Table 1. International mechanisms to promote better investments**

Objective	Existing or potential instrument
Create an enabling environment	International standards and frameworks
	International investment treaties
	Capacity building and technology transfer
Foster alignment between institutions	Co-ordination platforms among investment related actors with development and commercial purposes
Boost local development	Platforms for aligning investments with national priorities
	Local content requirements

Source: Authors' elaboration.

It is important to acknowledge that policies designed to attract FDI must be accompanied by measures to bolster the local capacity to absorb investments. This synergy is essential for FDI to serve effectively as a mechanism for knowledge and technology transfer. The measures include investing in education, strengthening institutional frameworks and developing physical, scientific and technological infrastructure. It is crucial to establish a comprehensive framework that combines efforts to attract FDI with production development policies. Development partners can support efforts to upgrade productive development policies via international partnerships and co-operation.

Deepening regional integration in LAC can be a source of mobilisation of better and stronger investments. For LAC countries to take advantage of regional and subregional integration opportunities, public policies geared to regional production integration, productive development and trade, international dialogue and co-operation among integration mechanisms are essential. LAC has made progress in regional integration – for instance, the region has significantly reduced tariff barriers, making entry to the regional market more attractive for FDI. As of 2019, the average tariff imposed on trade within the region was merely 2% (ECLAC, 2021<sup>[33]</sup>). Subregional trade blocs have contributed to this achievement and have also worked towards harmonising regulations and standards across member countries. Aligning regulations related to customs, taxation, investment procedures and business practices helps to reduce barriers for investors. Such alignment can also enhance transparency and predictability, making it easier for businesses to operate and invest across borders. To attract additional investment, further regional productive and commercial integration, economically viable regional production chains and a stable market that combines efficient scale with minimising transaction costs must be prioritised.

### A new EU-LAC investment agenda

Strengthening partnerships and co-operation with the European Union can improve the development impact of investments in LAC countries. The European Union is not only

the region's third-largest trading partner and the leading contributor to development co-operation, it is also one of the top investors in LAC. With a new impetus in EU-LAC relations, LAC is placed at the top of EU priorities for investment, especially with the launch of the EU-LAC Global Gateway Investment Agenda (European Commission, 2023<sup>[34]</sup>). The agenda identifies investment opportunities in LAC that will benefit the region's production transformation in sectors such as climate and energy, critical raw materials, infrastructure, SME development, electromobility and sustainable tourism, among others (Figure 16). This tool, accompanied by political and policy dialogue, can be supportive of LAC's production transformation by leveraging on a balanced mix of trade, investment and co-operation. Renewed mechanisms of dialogue and co-ordination among the investment, trade, and development communities, might be useful to accompany further LAC's reindustrialisation efforts aligning with national priorities, and ensure investment flows follow a shared criteria on quality, sustainability, and inclusiveness.

Figure 16. Global Gateway Investment Agenda, number of projects by country and sector, 2023

	Climate and energy	Digital	Education and research	Health	Transport
<b>Country</b>					
Argentina	7	4			
Barbados	2			2	
Belize	2	2			
Bolivia	2				
Brazil	4	2			2
Chile	2		2		
Colombia	2	2			2
Costa Rica	2	2		2	2
Cuba	2			2	
Dominican Republic	2	2			2
Ecuador	7			2	2
El Salvador		2			2
Guatemala	2	2		2	
Guyana	2			2	
Haiti	2		2		
Honduras	2	2		2	
Jamaica	2	2			2
Mexico	2			2	
Panama	4	2	2	2	
Paraguay	2			2	
Peru	7			2	2
Suriname	2				2
Bahamas	2				
Trinidad and Tobago	2	2		2	
Uruguay	2				2
Venezuela	2				
<b>Regional and sub-regional</b>					
Amazon Basin	2				
Caribbean	2				2
Central America and Mexico	4				
Eastern Caribbean	2				
LAC	4	2	2	2	2

Note: The figure shows the total number of projects by country published by the European Commission. Darker blue shows a higher number of projects (lightest blue = 1 project; darkest blue = 7 projects). In addition to the number of projects shown at country level, the number of projects at the regional and subregional level is also included in the Amazon Basin, Caribbean, Central America and Mexico, Eastern Caribbean and LAC regions.

Source: (European Commission, 2023<sup>[34]</sup>).

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## Notes

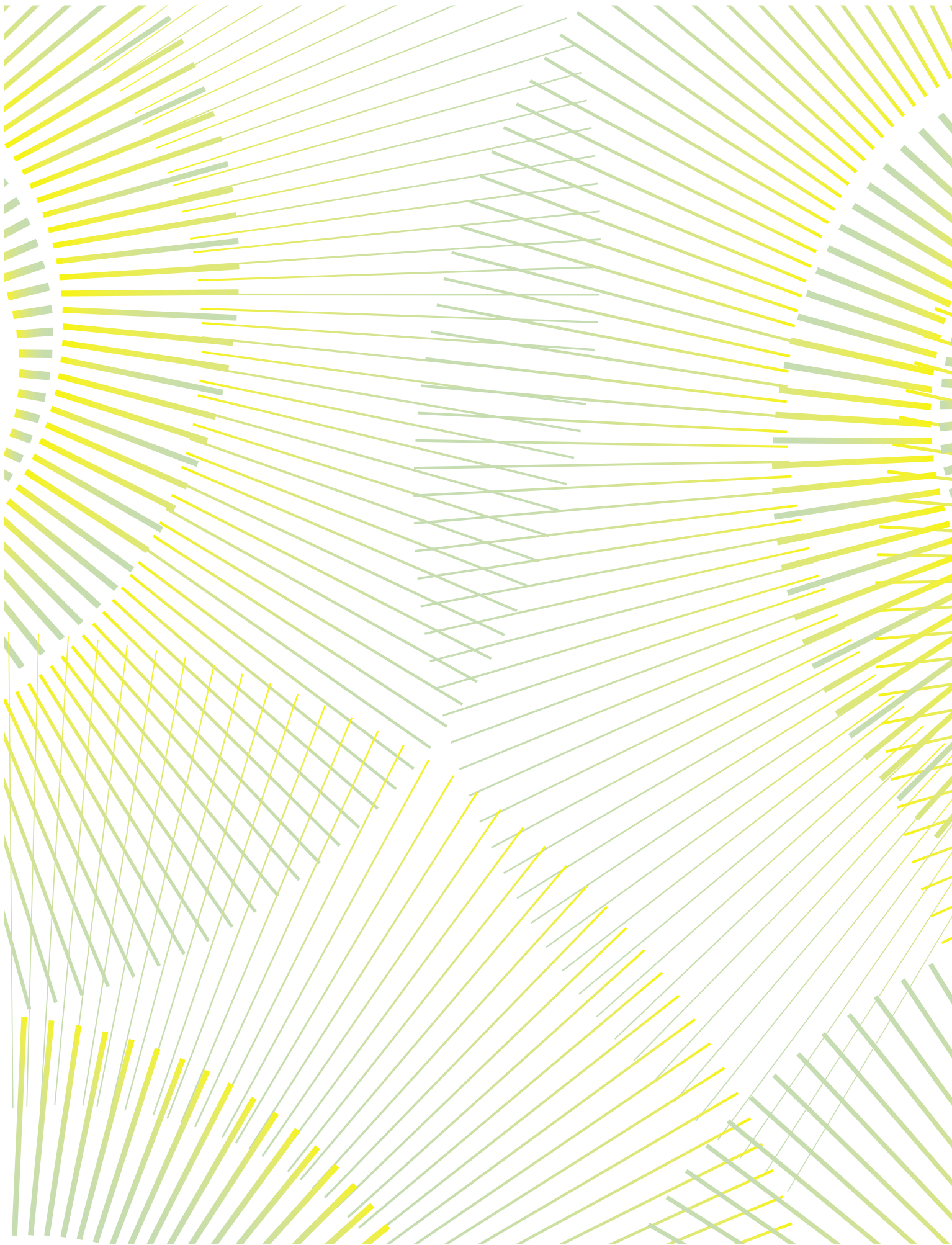
1. This figure should be higher given that data on business investment includes investments made by state-owned enterprises.

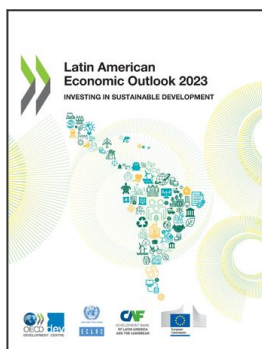
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**From:**  
**Latin American Economic Outlook 2023**  
Investing in Sustainable Development

**Access the complete publication at:**

<https://doi.org/10.1787/8c93ff6e-en>

**Please cite this chapter as:**

OECD, *et al.* (2023), "Overview: Investing in sustainable development", in *Latin American Economic Outlook 2023: Investing in Sustainable Development*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/6f230210-en>

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