Chapter 4

Unleashing LAC's production potential: The role of public institutions and financing

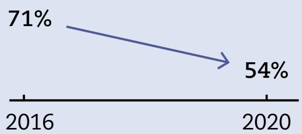
This chapter examines key elements necessary to mobilise investment and drive a production transformation that brings greater well-being for all citizens in Latin America and the Caribbean (LAC). It emphasises the vital role of public institutions, which are key to creating the conditions conducive to investment and to making the production transformation more connected to the demands of citizens and the broader development strategies of LAC countries. The chapter also explores financing mechanisms that can help to unlock the region's financial markets. Public development finance institutions (DFIs) and innovative debt instruments such as green, social and sustainability-linked (GSSS) bonds can be used to boost private and public investment. The chapter concludes with key policy messages.

Towards better institutions and financing to boost investment

The involvement of citizens and other stakeholders is key to enhancing the impact of investments on well-being and strengthening the social contract

Perception of investments' impact

Positive citizen perceptions of FDI in LAC



Trust in companies

55%
of LAC citizens had little to no trust in national and international companies in 2020

Social conflict

Almost **90%** of all social conflicts related to the environment that arose in LAC from 2000-22 were still unresolved by the end of 2022

Promoting investment: what are the priorities in LAC countries?

Our analysis of National Development Plans in 14 countries reveals the following strategic sectors:

Energy transition and related industries

Digital transformation

Care economy, pharmaceutical and health industry

Sustainable agribusiness

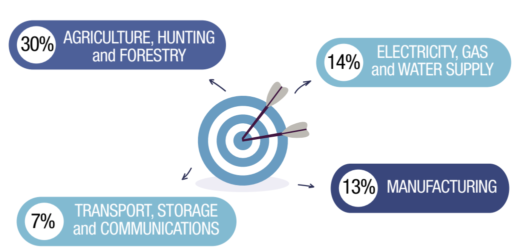
Sustainable tourism

Circular economy

Development finance institutions (DFIs): a key for smaller firms to invest in strategic sectors

Access finance through different mechanisms: credits, factoring, leasing, guarantees, etc.

National and subnational DFIs can help MSMEs:



Contribute to investments in strategic sectors

Contribute to green, digital and gender goals

Introduction

The role of investment is paramount in driving production transformation, which in turn is essential for achieving greater well-being in Latin America and the Caribbean (LAC). A structural transformation of the economy involves diversifying and upgrading the production apparatus across all LAC countries. This can lead to stronger economic growth and productivity, more quality jobs, and enhanced economic resilience – essential elements for closing inequality gaps and improving living standards (ECLAC, 2022[1]).

Two dimensions are vital to turn investment and production transformation strategies into key drivers of inclusive and sustainable development in the region: public institutions and financing.[1]

First, public institutions can ensure that production transformation strategies are built on inclusive dialogue among all stakeholders, thus enhancing linkages between investment efforts and social priorities, and strengthening the social contract within the region. Public institutions can also improve the investment climate, creating more conducive and predictable conditions by strengthening the rule of law and backing it up with quality regulation, transparency, openness and integrity (OECD, 2015[2]) (Chapter 2). These are fundamental ingredients for building trust, which facilitates investment by boosting compliance and investor confidence. Finally, public institutions can also establish a strategic approach to investment and production transformation, ensuring that these efforts are coherent with broader national development and productive development strategies, and that an integrated and co-ordinated approach is adopted across institutions, levels of government and stakeholders. In this sense, public institutions can take the lead in establishing an approach that is centred on citizen well-being (OECD, 2021[3]), that maintains alignment with the UN Sustainable Development Goals (SDGs), and that commits to contributing to equitable and sustainable development (OECD et al., 2019[4]).

Financing is the second major dimension. Mobilising massive financial resources from public and private sources will be required to finance investment gaps in crucial sectors in LAC, such as quality infrastructure. To stimulate this, the region will need to unlock the potential of its financial markets, with a crucial role for development finance institutions (DFIs) in supporting access to finance and in driving investments in strategic sectors. There is increasing potential in the region for innovative financial tools, such as Green, Social, Sustainability and Sustainability-linked (GSSS) bonds, which can promote public and private investment with the support of more consolidated and harmonised sustainable finance frameworks.

This chapter addresses the question of how to unleash LAC's production potential and make it a catalyst for better development. The chapter begins by analysing how public institutions can help to foster investments and production transformation, and to focus their impact on well-being. The chapter then explores how to improve access to the necessary financing. It emphasises the role of DFIs, the potential of innovative debt instruments such as GSSS bonds and the need to strengthen sustainable finance frameworks. The chapter concludes with key policy messages.

Public institutions are vital to making the production transformation a driver of well-being and central to a new social contract

Production transformation – and the investments needed to make it happen – can have a significant impact on living standards across socio-economic groups in LAC. Engaging strategic stakeholders to agree on the strategies for production transformation and investment will be crucial, both to make the strategies and investments possible and to avoid potential conflict. This involves understanding stakeholders' priorities and incorporating them throughout the policy-making process. Ensuring that efforts to attract and mobilise investment are human-centred will strengthen the social contract.

Such renewed social contract will only endure and bear long-term effects if positions the priorities of main stakeholders around a strategic vision. In other words, investment and production strategies should derive from a whole-of-government approach and be directly linked to national development strategies to guarantee policy coherence, long-term planning and co-ordination across levels of government and key stakeholders. These points will each be addressed below.

Confidence in the impact of investments on well-being remains low in the region

The pursuit of new and more diversified sources of investment and more sustainable forms of production will have multidimensional impacts on citizens' lives in LAC and could thus lay the foundations for a new social contract. A social contract is understood as an intangible but shared acceptance of what society needs and how to achieve these needs through a series of rules and institutions (ECLAC/OECD, 2018[5]).

To ensure the impacts of changes leading to a new social contract meet the expectations and desires of citizens, their opinions must be heard and considered. The only way to guarantee the production transformation is truly sustainable and inclusive is by involving citizens in its design, implementation and evaluation phases. Achieving a broad consensus around the priorities of the production transformation will also prove crucial to efforts to achieve the SDG goals by 2030 and beyond.

Understanding citizens' perceptions about how investments will impact their lives, and on the roles of key stakeholders within the production transformation, will be crucial to building social support, tightening links among stakeholders and, ultimately, strengthening the social contract.

LAC citizens have generally low levels of trust in their national governments and weak levels of satisfaction with their democratic systems. Only around half (48%) of the population surveyed in 2023 preferred democracy over other systems (Latinobarómetro, 2023[6]). Trust in governments stood at just 27% in 2020 (Latinobarómetro, 2020[7]), well below the 41% average in OECD countries (OECD, 2022[8]).

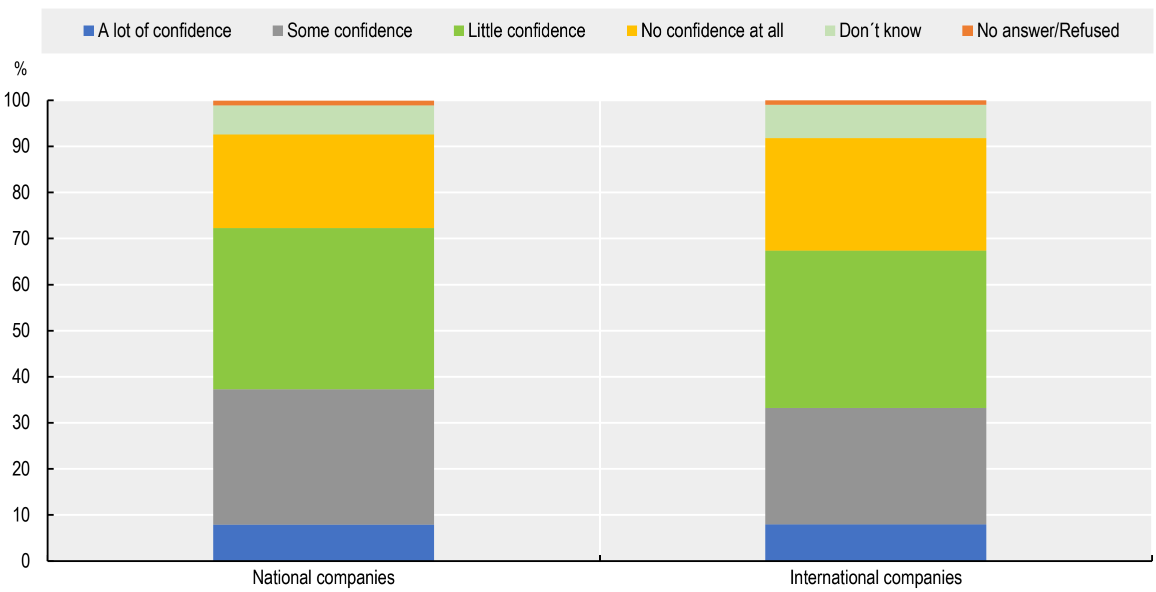
Securing trust in public institutions is essential. A stable institutional environment is crucial for attracting investments and creating for stakeholders a predictable horizon of the production transformation. In fact, low confidence levels may signal that the public sector lacks sufficient capacities to guide a successful production transformation strategy.

Trust in public institutions is particularly relevant in a context of increasing political polarisation observed both in LAC and globally. Low levels of trust may become a significant barrier to investment in LAC, as a heightened political divide often introduces uncertainty into the investment climate (Azzimonti, 2011[9]). This uncertainty arises from the possibility of unexpected policy changes, especially concerning taxation, regulations, foreign trade and the potential nationalisation of industries (Biglaiser and Staats, 2010[10]). Political instability can also lead to social unrest, disrupting business operations and discouraging investment. Additionally, deeply polarised environments sometimes struggle with issues such as governmental gridlock and corruption, which also have negative impacts on investment.

As enterprises are central to production transformation and a main source of investment, citizens' perceptions of their role is crucial. At present, however, LAC citizens have low trust in national and international companies. Asked in 2020 about their views of national and international companies, LAC citizens polled had either no trust at all (20.3% and 24.4%) or little confidence (35% and 34.2%) – adding up to a slight majority overall (Figure 4.1) (Latinobarómetro, 2020[7]). This could be partially explained by a lack of information and low visibility of the roles played by firms. But it also suggests that citizens see strong potential for improving the impacts – social, economic and environmental – of private-sector activities. Governments from the region could promote a more active role for the private sector through a more ambitious adoption of the *OECD Responsible Business Conduct Guidelines* (see below on stakeholder participation), among other efforts.

Figure 4.1. **Most LAC citizens have little trust in national and international companies**

Level of confidence among LAC citizens in national and/or international companies, 2020



Note: Question: "Please look at this card and tell me how much trust you have in each of the following groups/institutions. Would you say you have a lot, some, a little or no trust in?"

Source: (Latinobarómetro, 2020[11]).

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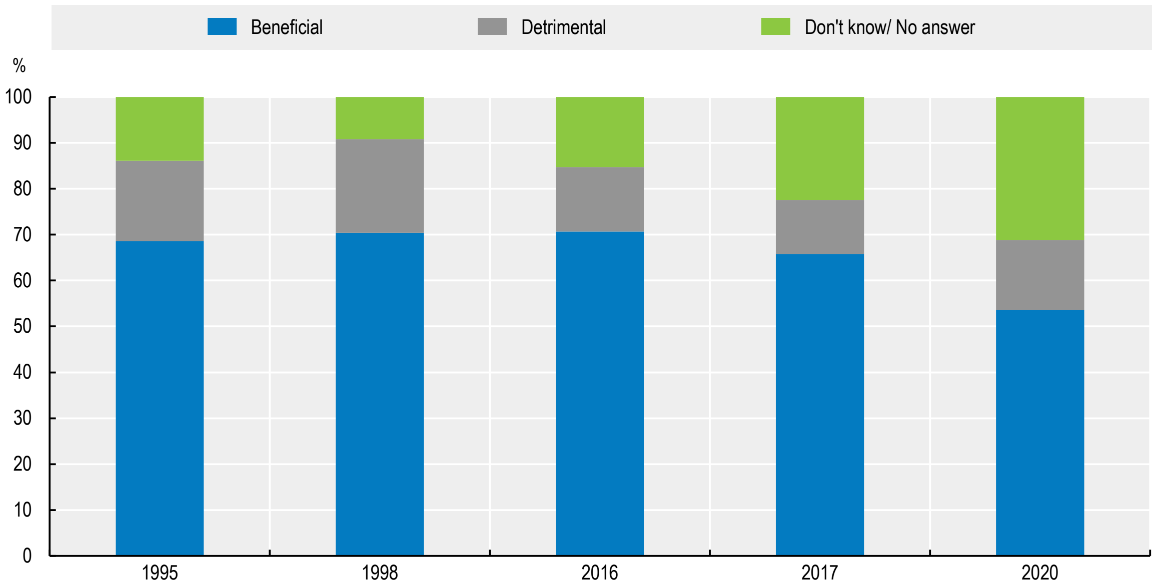
While perceptions that foreign direct investment (FDI) has positive impacts on economic development remain relatively high in LAC, they have been dropped substantially in recent years. FDI was seen as beneficial by 53.6% of the population surveyed in 2020, down from 70.7% in 2016 and the lowest level to date (Figure 4.2). This decline coincides with an increasing lack of awareness about FDI among LAC citizens: in 2020, 28.8% of respondents said they did not know enough to answer whether the effects of FDI were beneficial or detrimental to the economic development of their country (10 percentage points more than in 2017). Citizens' perceptions of FDI vary depending on the type of investment concerned. The purchase of national companies by foreign investors is seen by 40% of citizens as positive for their country, while 72% think the building of factories by foreign companies is a good thing for their country (Pew Research Center, 2020[12]). These trends underscore the importance of raising awareness of the positive impacts that FDI can have (Chapter 2), and of developing mechanisms to make FDI more connected to the development priorities of countries, sub-national regions, and citizens.

Figure 4.2. **Positive perceptions of FDI have declined among LAC citizens**

Share who consider that FDI is beneficial or detrimental for their country's economic development, 1995-2020



Note: Question: "Is foreign investment beneficial or harmful for the economic development of the country or do you not know enough to say?"

Source: (Latinobarómetro, 2020[11]).

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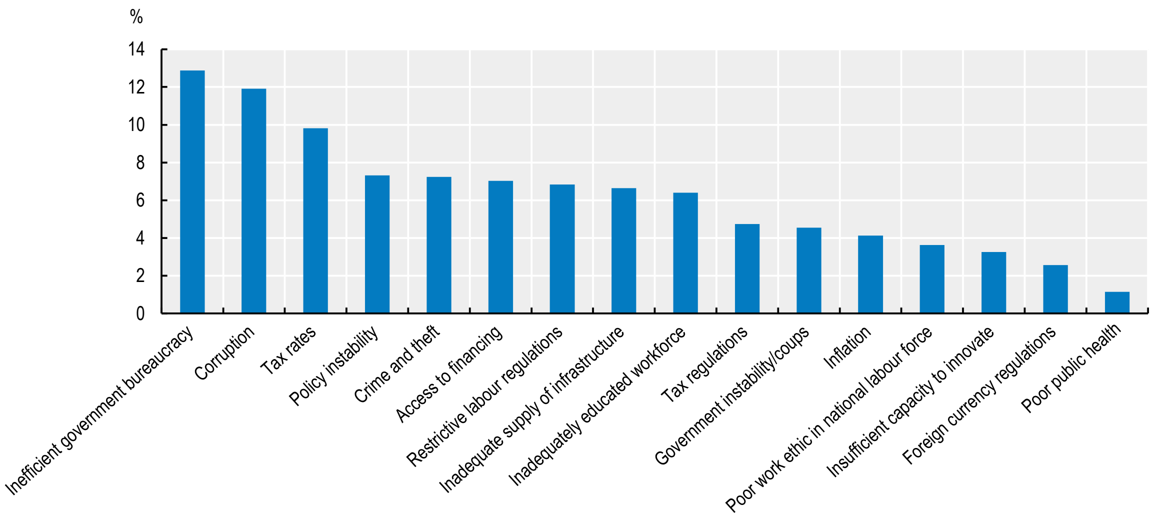
In designing policies to mobilise investment and improve the investment climate, understanding the opinions of private-sector representatives can be crucial. The most problematic factors for doing business in the LAC region have been identified by business leaders as inefficient government bureaucracy (12.9%), corruption (11.9%) and high tax rates (9.8%) (Figure 4.3). In the 2020 Doing Business Survey, enterprise owners in the LAC region expressed a significantly higher number of concerns regarding bureaucratic obstacles and the costs associated with formal market operations. The LAC region is ranked 119th out of 190, a position considerably lower than the 56th ranking occupied by the OECD countries. Regarding tax rates, business leaders signalled the pressure of the high contribution rate, particularly during the second year of operation (47.03%), which is well above the averages for the OECD (39.86%), other developing regions such as the Middle East (32.48%), and East Europe and Central Asia (32.10%) (World Bank, 2020[13]). Working more closely with the private sector will help LAC governments better understand the wide range of factors that influence how companies allocate investment.

Figure 4.3. **Business leaders' perceptions of the most problematic factors for doing business in LAC**

Ranking of the most problematic factors for doing business in LAC according to business executives, 2017



Note: Question: "Select the five most problematic factors for doing business in your country and rank them between 1 (most problematic) and 5." For the LAC region, the simple average of 20 countries was calculated: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

Source: (World Economic Forum, 2018[14]).

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Low levels of confidence in the capacity of both public institutions and national and international firms to improve well-being reveal the need to better connect investment and production transformation strategies with development outcomes. To achieve this, it is important that LAC governments reinforce mechanisms for dialogue across stakeholders, so that production transformation is built upon agreement and considers its diverse impacts. Similarly, investment and production transformation efforts should be aligned with broader development strategies and should result from a co-ordinated effort across policies and sectors.

Improving the impact of investments on overall well-being requires that public institutions foster and ensure inclusive dialogues among stakeholders

By creating the conditions for active stakeholder participation, public institutions can play a pivotal role in ensuring that the production transformation is truly inclusive and brings well-being to all. This is crucial to ensure human-centred investments. A diversity of views from the actors involved in investments and production transformation efforts will not only legitimise the process and reduce trade-offs; it can also contribute to the success of such efforts by bringing in new visions and experiences.

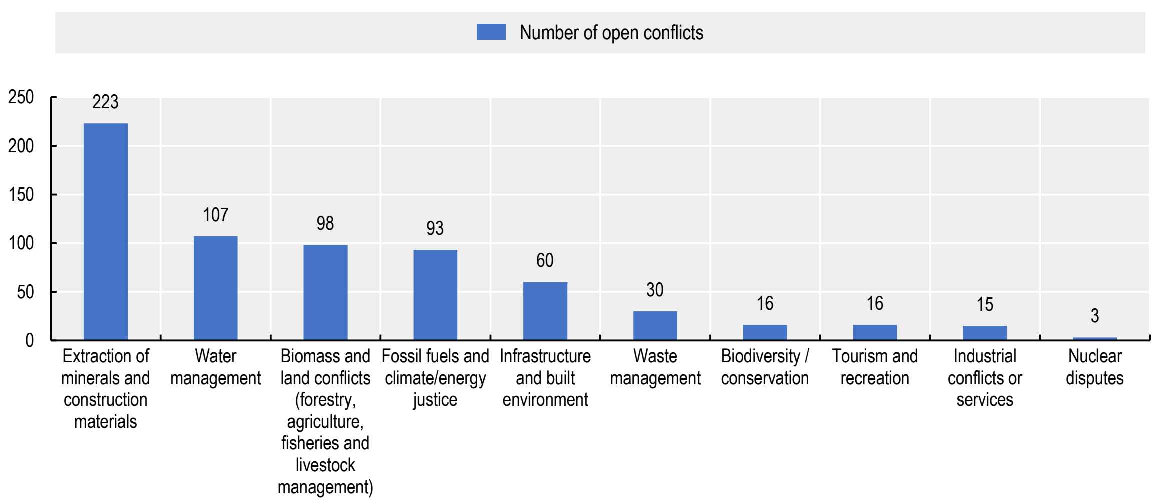
Dialogue with society to foster inclusion and manage potential social conflict

Citizen involvement throughout the investment cycle results in projects that are more effective, sustainable and equitable. Input from citizens can help to meet their needs and improve trust in government; it can also prevent the capture of projects by special interest groups (OECD, 2014[15]).

Inclusive dialogue is particularly relevant because of the risk that production transformation can lead to social conflict due to the potential detrimental impacts of some investments on specific groups, territories or communities. These conflicts emerge due to various economic, social and environmental factors. For instance, when undertaken without appropriate consultation or compensation, land acquisition for projects can result in the displacement of local communities, triggering social tensions. Economic disparities resulting from unequal distribution of project benefits can also exacerbate conflicts. Opposition may arise as well over the environmental consequences of large-scale projects that are potentially detrimental to biodiversity and local livelihoods, especially mining projects (Bebbington and Bury, 2013[16]). These considerations are of particular relevance in a context in which the LAC region holds a significant share of critical minerals for advancing the green transition globally, or a need exists for immense investments in various areas that can potentially create tensions across socio-economic groups and territories (OECD et al., 2022[17]).

Many social conflicts around environmental issues have erupted in the LAC region in recent years. Of 742 social conflicts that arose 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 4.4) (CALAS, 2019[18]; Environmental Justice Atlas, 2023[19]; Latin American Observatory of Environmental Conflicts, 2023[20]). In mining in particular, the number of conflicts shot up by 236% from 2010 to 2023, affecting more than 300 local communities (OCMAL, 2023[21]).

Figure 4.4. **Number of open social conflicts in LAC linked to environmental issues, 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 started in the period 2020-2022.

Source: (Environmental Justice Atlas, 2023[19]).

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In order to build support for the production transformation while preventing and/or handling potential social conflicts and corruption, it is vital that governments 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 (OECD/CAF/ECLAC, 2018[22]).

Regarding citizen participation, several tools can help governments to promote bottom-up collaboration and engage citizens throughout decision making for investment and production transformation policies. The *OECD Guidelines for Citizen Participation* present a ten-step path for planning and implementing a citizen participation process, including:

identifying the problem to solve and the moment for participation; defining the expected results; identifying the relevant group of people; choosing the participation method; choosing the right digital tools; communicating about the process; implementing the participation process; using citizen input; evaluating the process; and fostering a culture of participation (OECD, 2022[23]). These guidelines also present eight different methods that can be effective in involving citizens in decision-making processes, notably: access to information and data; open meetings; public consultations; open innovation; citizen science; civic monitoring; participatory budgeting; and representative deliberative processes.

Several projects in the LAC region have already incorporated citizen participation throughout the development stages. For instance, Chile co-ordinated a participatory process across 15 regions when developing its Energy Route 2018-22: Leading Modernisation with a Citizen Seal, an initiative of the Ministry of Energy aiming to gather citizen input ahead of energy modernisation efforts (Ministerio de Energía, 2017[24]). In Costa Rica, residents were involved throughout the design of the National Development and Public Investment Plan (Reyes and Ríos, 2016[25]; ECLAC, 2021[26]). Examples of civic monitoring include the Marea Digital civic technology platform in Buenaventura in Colombia, which allows citizens to identify and report local issues affecting the community, and the Promise Tracker in Brazil, a collaborative data collection platform that allows citizens to define an issue they would like to tackle and then collect data about it to be shared with decision makers (OECD/WB, 2022[27]). Another good example of multi-actor engagement within a local productive transformation agenda is the Smart Specialisation Strategy of Bogota-Cundinamarca, implemented in Colombia between 2016 and 2020 (Llinás, 2021[28]).

Local governments have a vital role in promoting citizen participation. Given that investment projects often have direct impacts on specific communities and territories, local governments must enable citizen participation from the very beginning of projects. Participatory tools should ensure the widest access for all citizens, and especially for the most vulnerable groups, which in LAC includes women, people with disabilities, Afro-descendants and indigenous peoples. Early citizen participation is crucial in decisions such as the location of facilities or the terms of an environmental impact assessment. Among other useful practices, neighbourhood assemblies and visits to the facilities can allow broad consultations with enterprises and government representatives. Temporary co-ordination committees can prove useful to create smaller opportunities to gather representatives of companies, civil associations, neighbourhood groups and local government representatives to supervise the progress of projects. In turn, collaboration with local universities or non-governmental organisations (NGOs) can be useful for providing technical assistance, especially at key moments such as pre-feasibility studies or environmental or social impact assessments.

Citizen oversight committees, or *veedurías ciudadanas*, are an interesting example of monitoring mechanisms being applied in several LAC countries. These committees empower citizens to monitor public administration activities, including the execution of public contracts and public service management. These watchdog groups ensure transparency, efficiency and legality by vigilantly tracking the performance of public officials and institutions. They report irregularities to the appropriate authorities and play a pivotal role in preventing corruption and mismanagement. In the context of large public infrastructure projects, *veedurías* contribute significantly to ensuring that project implementation goes as planned and that funds are used appropriately, thereby effectively addressing community concerns.

Other examples of good practices in the region include guides from Chile's Environmental Assessment Service on in-person activities and early community participation (SEA, 2013[29]; SEA, 2017[30]), and a guide to citizen participation from the Colombian Foreign Ministry (Ministerio de Relaciones Exteriores de Colombia, 2016[31]).

NGOs also play a critical role in promoting citizen participation in decision making on investment projects. One example in LAC is the Propaz Foundation in Guatemala, which trains and educates citizens on alternative methods of conflict resolution, constructive communication, social leadership, consensus building and do-no-harm methodology. In Argentina, the Democratic Change Foundation provides technical support for indigenous communities, while the Environment and Natural Resources Foundation aims for collective construction of democratic and participatory citizenship in areas linked to environmental sustainability. At the international level, the Extractive Industries Transparency Initiative is an international standard that promotes transparency in payments made by extractive companies to governments and vice versa. This includes dialogue and consultation with civil society and involves civil society organisations (CSOs) in data collection and analysis.

Social and environmental impact assessments are essential tools for measuring and understanding the effects that projects, policies or activities may have on society and the environment. These assessments are fundamental for informed decision making; protection of the environment and communities; transparency and citizen participation; regulatory compliance; and long-term sustainability. Social and environmental impact assessments encourage dialogue among different stakeholders, such as local communities, businesses, government and NGOs. This dialogue facilitates understanding of the concerns and expectations of each stakeholder and seeks consensual solutions to achieve sustainable development.

Several institutions in LAC aim to manage social and environmental impact assessments. In Chile, for instance, Law 20.417 established the Environmental Impact Assessment System (SEIA), which requires public participation as part of the environmental assessment process for large projects. In December 2021, the bodies in charge of the environmental impact assessment systems of Argentina, Chile, Colombia, Costa Rica and Peru signed the statutes of the Latin American Network of Environmental Impact Assessment Systems (REDLASEIA), which was created in October of the same year to strengthen impact assessments in the region and to exchange best practices and lessons learned (MSGP, 2010[32]; SEA, 2021[33]).

Transparent and clear redistributive measures can also help to reduce tensions arising from investment projects. For example, to manage potential conflict emerging from activities with potential environmental impact, it is important to emphasise the development of sustainable alternative activities, such as allocating part of the benefits obtained into human development, education and the health of local communities, and into research, development and innovation (Box 4.1) (IDB, 2021[34]).

Box 4.1. **Costa Rica grants access to natural resources in exchange for benefit sharing**

Costa Rica has implemented a mechanism to ensure that local communities receive a direct benefit from private research and development (R&D) based on their surrounding biodiversity (or access and benefit sharing, ABS).

The National Commission for Biodiversity Management (CONAGEBIO) grants multi-year access contracts for private enterprises to research Costa Rica's biodiversity and genetic resources for commercialisation. This procedure requires prior informed consent and mutually agreed conditions with local producers. Since 2016, Costa Rica has already granted permits to seven enterprises.

Following this initiative, Costa Rica also created the *Distintivo ABS*, the first label in LAC that certifies the compliance of products with the ABS regulations and good practices.

Source: (OECD, 2023[35]).

Engaging with the private sector to improve its beneficial impact on development

Making the production transformation a driver of well-being also involves incentivising enterprises to evolve into purpose-driven organisations (Schoenmaker, 2020[36]). Powerful tools for moving in this direction are the *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct* (RBC) and the associated *OECD Due Diligence Guidance for RBC* (OECD, 2018[37]). As of 2023, eight LAC countries had adhered to these guidelines: Argentina, Brazil, Chile, Costa Rica, Colombia, Mexico, Peru and Uruguay.

National contact points (NCPs) for responsible business conduct can prove useful as alternative mechanisms for mediating and resolving conflicts that may arise between private sector companies, civil society and governments. In 2019, Chile's NCP helped resolve a conflict between trade unions and a private enterprise in the manufacturing industry that had been accused of not respecting workers' human rights. Similarly, Brazil's NCP mediated a conflict between a corporate group accused of not respecting the areas bordering the installation of its mines and a neighbouring association (OECD, 2020[38]). Regardless of the policy mix used to promote a bottom-up approach, it will be essential for governments to seek a balance of stakeholders, views and interests to avoid policy capture – i.e. situations in which public decisions over policies are consistently or repeatedly directed away from the public interest towards a specific interest (OECD, 2017[39]).

A wide array of additional actions exists to further engage the private sector to improve its beneficial impacts on development. Clear regulations to promote the use of public-private partnerships (PPPs) can help the private sector to better identify priority sectors in each country and its territories, and to incentivise investments in strategic projects with social impacts (Chapter 2). Promoting strategic activities based on moderate capital inputs can also help – by avoiding market concentration and democratising market access to small and medium-sized enterprises (SMEs) with higher impact in local communities (Chapter 3). To promote further and better investment, governments could also guarantee fair and depoliticised resource allocation to increase trust within the private sector. For example, for infrastructure projects, governments could implement a transparent system of project selection, based on solid cost-benefit analysis, with co-designed guidelines for prioritising projects and improved environmental, social and governance (ESG) assessments (KPMG, 2021[40]). Finally, the private sector can actively help to address multidimensional inequalities. For example, private enterprises can address the gender gap in certain industries that are key for the production transformation by providing training and skills development. Companies can also address gender-biased inequalities by closing the gender pay gap (Atlantic Council, 2023[41]) or by identifying the additional burden women face at home, such as caregiving or unpaid domestic work, and providing incentives such as flexible hours.

Open government as a crucial dimension of promoting stakeholder engagement

Open government policies are fundamental for building trust, enhancing transparency and promoting stakeholder engagement. Ensuring readily available and comprehensible information on governmental actions, economic performance, business regulations and investment opportunities reduces investment risks and fosters informed decision making. Governments in the LAC region have shown progress in adopting open government principles in recent years. As of 2022, 16 LAC countries were members of the Open Government Partnership. Additionally, at least 67 Plans of Action for Open Government were implemented in LAC between 2011 and 2022.

Centres of government (CoGs) can play a fundamental role in promoting open government. They can have significant impacts by providing more transparency at every stage of the investment process, including: i) clear information about how to register a foreign enterprise; ii) access to amendments and draft bills; iii) consistency of investment regulations and mechanisms to signal incongruencies; iv) interactive platforms showing the prioritisation of projects with private investment and the budget of each project; and v) information about the origin of private funds assigned to projects with direct impacts on citizens' well-being. LAC governments should seize the opportunities provided by the digital transition and make all of these tools available in digital formats, multiplying the range of stakeholders able to access the information. At present, CoGs in LAC countries are involved in fewer stages of the transparency policy process than those of OECD countries. LAC's CoGs tend to focus on the design, communication and monitoring stages, and to leave the implementation, co-ordination and evaluation stages to ministries or agencies in charge of the policy (OECD, 2020[42]).

Envisioning whole-of-government, long-term strategies for production transformation

Production transformation entails gradual and lengthy structural changes that require policy coherence, a whole-of-government approach and long-term policy planning. Co-ordinated public policies, both horizontally (across sectors) and vertically (across government levels), optimise resource utilisation and enhance the impact of investments. Aligning policy objectives across various sectors and government levels steers investments efficiently towards strategic sectors for production transformation, while avoiding potential policy conflicts and addressing trade-offs. Such coherence significantly mitigates uncertainty for investors. Similarly, policy planning makes it possible to identify investment priorities (Chapter 3), align policy objectives, and facilitate coherent and co-ordinated actions beyond political cycles (OECD, 2018[43]).

The absence of political consensus on state policies has been a common challenge in LAC countries, harming both investment levels and production transformation. Uncertainty stemming from inconsistent policies dissuades investment due to higher perceptions of risk, while the fluctuations of policy cycles disrupt long-term investment plans. Since inconsistent policies convey a lack of effective governance, investor confidence diminishes, inhibiting domestic and foreign investments. Furthermore, fragmented policies impede the formulation of coherent industrial strategies, while the absence of long-term planning hinders sustainable development efforts. Production transformation requires the establishment of stable and comprehensive policies that garner wide-ranging political support.

National development plans can be a powerful tool in production transformation efforts

Most LAC countries have a national development plan (NDP), or national development strategy, that serves as the country's main strategic policy roadmap and can act as a first guide to policy efforts linked to investment and production transformation. NDPs establish long-term policy directions. If agreed upon by most key stakeholders, they can contribute to reinforcing the social contract in the region. The process of elaborating an NDP often includes mechanisms to incorporate civic participation and foster the inclusion of a diversity of views. Critically, some NDPs go beyond the policy cycle or include specific protocols to prevent changes in government from affecting the continuity of policy priorities (OECD, 2021[3]). In addition to NDPs, many countries have production development policies that aim to upgrade and diversify the economy as a vehicle for increasing productivity. To achieve this, these policies generally include both horizontal and vertical instruments and programmes that prioritise the strategic sectors on which many production development efforts and resources are focused.

Typically, NDPs outline strategic development guidelines that serve as orientation tools for both public and private investments. National investment plans need to be connected to policy guidelines outlined in NDPs. Similarly, NDPs can significantly influence private investment decisions by offering a strategic roadmap for future growth and stability, a key dimension for investor confidence. NDPs provide predictability, and thus incentivise private capital flows towards certain strategic sectors in which private investors foresee potential growth. By outlining infrastructure development, capacity-building initiatives or possible economic incentives, NDPs outline new market opportunities, enhancing the country's attractiveness to investors.

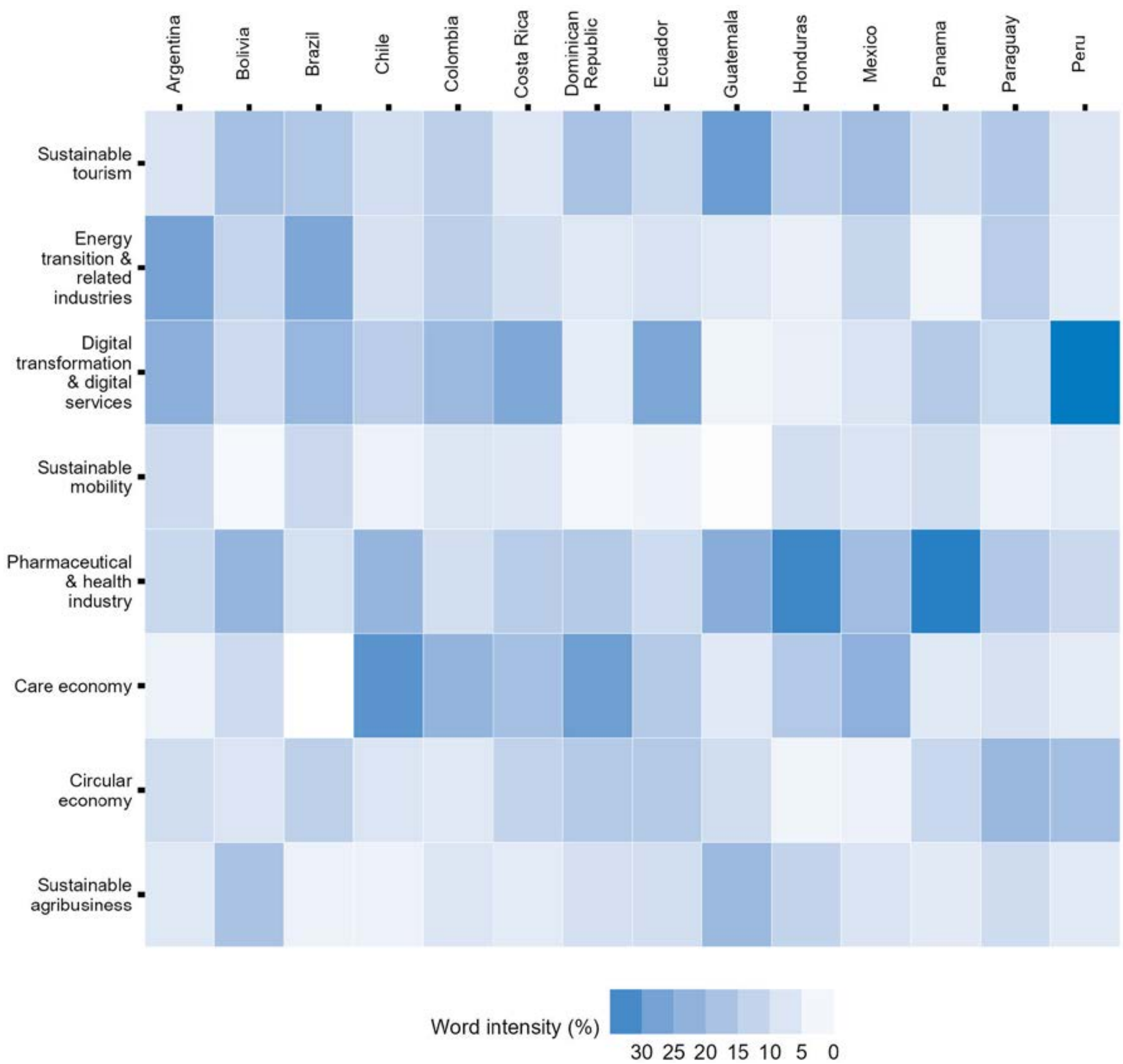
To ensure effective implementation, NDPs should define the budget allocation for each priority or provide links to specific sources of financing; for instance, dedicated funds or resources from specific sectors, such as the extractive industries. Additional specific measures that can contribute to operationalising priority objectives are: i) including a sectoral and territorial approach to create a national productive map; ii) increasing the availability of land for productive strategic sectors; iii) mapping main stakeholders from the public and private sectors and assigning specific responsibilities over the long term; and iv) specifying concrete tools for horizontal (sectoral) and vertical (subnational) co-ordination. Finally, it will be crucial to specify how, when and with which funds monitoring and evaluation will take place.

NDPs are typically designed to capitalise on a country's strengths, resources and potential areas for growth, such as natural resources, industry strengths, workforce skills and geographical advantages. They provide a roadmap to guide public and private investment towards sectors in which the country has or seeks to develop competitive advantages.

Most NDPs in LAC countries include public policy guidelines associated with strategic sectors with high potential to drive sustainable development. Chapter 3 provides a list of strategic sectors that have potential to enhance productivity, foster social inclusion and promote sustainability in the LAC region. These sectors present appealing prospects for investment, and they include: sustainable agribusiness; the circular economy and sustainable water management; the care economy; sustainable mobility; the pharmaceutical and healthcare industry; digital transformation and digital services; energy transition and related industries; and sustainable tourism (ECLAC, 2023[44]; ECLAC, 2023[45]).

An analysis of the NDPs from 14 LAC countries indicates that among these strategic areas, there are agendas like digital transformation which appear rather prominently in most LAC NDPs, with countries such as Costa Rica, Ecuador, and Peru showing greater relative relevance. The pharmaceutical and healthcare industry receives significant attention in most countries, with Guatemala, Honduras, and Panama addressing this agenda more notably relative to other strategic sectors. Energy transition is also addressed in most NDPs, though not all, and it is dealt with particular emphasis in Argentina and Brazil. Interest surrounding the care economy is also variable 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. Although it receives slightly less relative attention, sustainable agribusiness is addressed in all countries, with some 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 is not one of the sectors receiving most attention. Lastly, sustainable mobility appears with low emphasis in all the NDPs. (Figure 4.5).

Figure 4.5. **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 to 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. Darker colours indicate higher frequency of references to a given strategic sector within the plan. The sum of the relative frequencies across all economic sectors in a country's NDP is 100. Each country's text data come from the latest development plan (or its equivalent), published by October 2023.

Source: Authors' elaboration using the National Development Plans of 14 LAC countries: Argentina (MECON, 2023[46]); Bolivia (MPDB, 2021[47]); Brazil (MEB, 2020[48]); Chile (Government of Chile, 2022[49]); Colombia (DNP, 2023[50]); Costa Rica (MIDEPLAN, 2022[51]); Dominican Republic (MEPyD, 2012[52]); Ecuador (SNPE, 2021[53]); Guatemala (SPPPG, 2014[54]); Honduras (Government of Honduras, 2022[55]); Mexico (PREUM, 2019[56]); Panama (Government of Panama, 2019[57]); Paraguay (STPP, 2021[58]); and Peru (CEPLAN, 2022[59]).

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It is important to note that the level of coverage and depth of NDPs varies significantly across countries, which can have impacts on the intensity with which specific policy areas appear. Similarly, some countries have specific sectoral strategies for certain sectors that are not particularly prominent in the NDPs. While there may be country-specific explanations as to why some sectors appear more prominently than others, some general conclusions can be drawn. First, some sectors may appear less prominently not because they are less relevant for development in the country, but because other bodies or institutions take a strong role in defining the strategic orientation in that specific sector (e.g. financial issues are usually led by the Ministry of Finance or financial regulatory and supervisory bodies). Second, NDPs sometimes focus on new and emerging areas rather than on policy areas that are well-developed or have a more consolidated policy framework.

Box 4.2. **Colombia's strategic roadmap for public investment**

In Colombia, the national government formulates a strategic mid-term roadmap for public investment every four years. This is accomplished through a series of processes, bodies, and instances governed by Colombia's National Planning System. After each new administration takes office, the National Planning Department (DNP) prepares a National Development Plan (NDP) based on the elected government's proposals. This initial draft undergoes a review by three separate bodies to ensure various criteria are met: civil society participation (via the National Planning Council [CNP]), technical and economic feasibility (through the National Council of Economic and Social Policy [CONPES]), and legal compliance (assessed by the National Congress).

Each NDP is accompanied by a budgeting component known as the Multi-year Investment Plan approved by Congress. In this plan, the national government estimates its medium-term capacity to achieve its public investment objectives while adhering to the Medium-Term Fiscal Framework set by the Ministry of Finance. The 2022-26 NDP "Colombia, a Global Power of Life" identifies five key areas essential for the implementation of the government's agenda; the Multi-year Investment Plan and their corresponding legislation, Law 2294 of 2023, set a strategic and detailed distribution across these five key policy areas. These are human security and social justice (64.4% of total public investment for the period 2023-26); regional convergence (12%); production transformation, internationalisation, and climate action (9.9%); human right to food (4%); and territorial planning around water and environmental justice (2.5%). The remaining is allocated to macroeconomic stability (7.2%), which is defined as a cross-cutting element in the NDP. Additionally, the National Public Investment Plan outlines a multi-year cross-sectoral investment plan to allocate supplementary budgeting for the Peace Process programmes.

Source: DNP (2023[50]); Congress of Colombia (2023[60]); DNP (2023[61]); Montoya and Nieto-Parra (forthcoming[62]).

National public investment systems help connect investments with specific objectives

National public investment systems (NPISs) play a key role in development strategies. They encompass the set of state institutions that govern a country's public investment process, and employ methodologies, standards and procedures to guide the formulation, execution and evaluation of investment projects. NPISs are key to enhancing the economic and social impact of public investment by improving the quality and efficiency of public spending (ECLAC, 2023[63]). They facilitate strategic decision making on infrastructure and social investments, aligning them with development goals, fostering economic growth and enhancing competitiveness.

NPISs can also serve as catalysts to attract private investment, acting as a guarantee of project continuity and minimising risk for investors. Enhancing the role of NPISs to stimulate private-sector participation could be achieved by improving the credibility, transparency and predictability of public policies. These improvements could attract more FDI and drive a significant transformation of the production base, in turn stimulating innovation, upgrading value chains and creating high-quality jobs.

Several critical elements underpin successful NPISs. First and foremost, strategic alignment with a country's NDP ensures that investment initiatives contribute to wider socio-economic objectives. A robust institutional framework, characterised by clearly defined roles and responsibilities, facilitates efficient co-ordination and decision making. Transparent and efficient procedures are necessary for prioritising, implementing and evaluating impactful projects. Fiscal sustainability is a key consideration in all investment decisions, as is the active participation of stakeholders, which enhances investment quality and public support. A well-structured regulatory framework safeguards the interests of all involved parties, promoting an environment conducive to investment. Lastly, integration of public investments with annual and medium-term budgeting processes assures financial viability (ECLAC, 2023[63]).

Sectoral development plans are strategic roadmaps that provide a framework for promoting growth and development in specific economic sectors. These plans are typically produced by governments, often in consultation with stakeholders from the private sector, academia and civil society. They identify key goals, targets and strategies for developing different sectors, and may also outline specific policies or initiatives to be implemented. For example, Chile has a Green Hydrogen National Strategy (ME, 2020[64]); Costa Rica has a National Energy Plan 2015-30 (MINAE, 2015[65]) and a National Tourism Plan 2022-27 (ICTCR, 2022[66]); Colombia has a National Energy Plan 2020-50 (UPME, 2021[67]) and a Tourism Sector Plan 2022-26 (MCIT, 2022[68]), and is currently putting in place a new Reindustrialisation Policy that prioritises five strategic sectors; Peru has a National Infrastructure Plan for Competitiveness (MEF Peru, 2022[69]); and the Dominican Republic has a National Infrastructure Plan 2020-30 (MEPyD, 2020[70]).

Beyond fostering policy co-ordination and private-sector collaboration, these plans can attract domestic and foreign investment to support transformation efforts. By enhancing sectoral competitiveness, they can stimulate innovation, skills development, infrastructure upgrades and regulatory advancements. For example, Ecuador's National High-Yield Seed Plan was a successful multi-stakeholder plan for boosting the productivity of small farmers, with public and private actors and financing (Box 4.3).

Box 4.3. **A successful initiative in Ecuador to boost the productivity of small farmers**

Ecuador's National High-Yield Seed Plan was initiated in 2013 by the Ministry of Agriculture and Livestock and involved multiple stakeholders. The plan primarily focused on delivering technological packages to small corn producers to enhance their overall productivity. Instrumental to its success was a network involving national government, local governments, private companies and banks.

The Ministry of Agriculture and Livestock led and co-ordinated the project, while local governments played a key role in formalising small farmers. Private companies were vital anchors for corn purchases, while private suppliers facilitated necessary resources for the technological packages. Financial support was made available by private banks and development banks. The Development Bank of Latin America and the Caribbean (CAF) provided funding to improve the capacity of companies to purchase corn produced under the programme. Ecuador's Internal Revenue Service created a simplified tax regime.

Developing such multi-stakeholder strategies for increasing sectoral productivity can boost the impact of investment resources. This initiative more than doubled average corn yields, from 3.8 tonnes to 7.66 tonnes per hectare, while the net profit of the beneficiaries ranged from USD 890 to USD 1 292 per hectare in 2017 – compared to just USD 102 per hectare for non-beneficiary producers.

Source: CAF (2019[71]).

Multi-level governance can foster the potential of investments

The multiplicity of policies and actors involved in investment and production transformation efforts demands a high degree of co-ordination. Effective multi-level governance (MLG) is needed to co-ordinate national policy objectives with institutions and actors at the subnational and local level. The implementation of MLG tools for production transformation can take place vertically or horizontally, involving national, subnational and local governments as well as key stakeholders such as the private sector and neighbourhood associations.

Certain MLG tools can serve as a model, although each country will need to adjust them to its specificities (Allain-Dupré, 2020[72]). Creating a map of the main stakeholders and their channels of communication can help to identify potential gaps and understand the distribution of responsibilities in terms of sectors and functions (OECD, 2017[73]). Contracts, which are widely used tools in OECD countries, allow the responsibilities of all actors to be established in advance: the national government, which decides on the prioritisation and awarding of projects; the investors, which must comply with social and environmental standards; and local governments, which must provide certain goods and services (Charbit, 2020[74]). In other MLG schemes, the strategic priorities are defined at the subnational level. This was the case with the Research and Innovation Smart Specialisation Strategies implemented in the European Union in the last decade (Foray, David and Hall, 2009[75]). Adding co-financing clauses to these contracts can help ensure that all parties comply with their responsibilities. Cross-jurisdictional co-operation involving more than one municipality in the production of a particular good or service can foster local value chains. This type of MLG process could prove particularly useful for co-ordinated investment strategies or rural-urban partnerships, generating positive spillovers, increasing efficiency through economies of scale, and enhancing synergies among the policies of neighbouring municipalities (OECD, 2019[76]).

Local governments have a central role in production transformation efforts – and in connecting investments with the needs and potential of specific territories and communities. For instance, local governments can attract FDI by facilitating information and access to local suppliers for investors and by connecting them with local firms (OECD, 2015[2]). Similarly, local governments have the responsibility to provide goods and services that have direct impacts on development of local communities and their production activities and on attracting investments (OECD, 2015[2]). The OECD has developed a framework with key policy dimensions to improve attractiveness in specific regions of three South American countries: Argentina (Misiones), Chile (Valparaiso and Magallanes), and Colombia (Cordoba and Pacífico) (OECD, 2023[77]).

Spatial planning policies and land-use allocation are intimately related to the type of activities that can be developed at the local level. Currently all 33 LAC countries have a land-use planning law, policy and/or plan; however, only 19 have co-ordination mechanisms between sectoral and territorial planning (ECLAC, 2023[78]). This responsibility of local governments is particularly important as clear information about land tenure can encourage new investments (OECD, 2015[2]). Also, the different uses that municipalities grant for each parcel of land will directly determine what type of investors can locate in the area. The allocation of land for future investments should have a high degree of citizen participation (see above on stakeholder participation). Spatial planning and cadastral management are essential for investment and territorial development, but they also serve to improve fiscal management and support the integration of all legal, property and physical information (OECD, 2023[77]).

Alternative institutional arrangements, such as cluster initiatives, have potential to enhance co-ordination among the private sector, public sector, academia and civil society. These collaborative frameworks aim to address strategic priorities collectively, fostering the development of prioritised sectors in production strategies. Such initiatives offer a conduit for bridging national and local development endeavours, thereby serving as an MLG tool. Use of cluster initiatives has garnered significant traction across the LAC region, with notable experiences in Argentina, Colombia, Costa Rica, Mexico and the Caribbean. Their implementation could be improved, however, particularly regarding the need for increased financial allocation. Comprehensive efforts should be directed towards harmonising the quality and depth of cluster agendas, and a more seamless integration with overarching national strategies and local production development policies must be ensured (Salazar-Xirinachs, 2020[79]; Salazar-Xirinachs, 2020[80]; Llinás, 2021[28]). A better and more widespread use of cluster initiatives in implementing productive development policies in LAC could prove key in upgrading and diversifying the region's economies.

Financing the investments needed for the development agenda

LAC will require a vast mobilisation of public and private resources to finance the investments needed in the region. Two policy areas stand out for their ability to channel investments directly towards strategic development objectives. The first is linked to public development finance institutions (DFIs), the role of which can be strengthened in the region. The second is the development of innovative financing instruments, including green, social, sustainability and sustainability-linked (GSSS) bonds.

DFIs, mostly represented by national and subnational public development banks, play a crucial role in providing innovative financial services, technical and digital support, and expanded access for firms to financial markets.[2] They are well positioned to offer affordable access to financing to the micro-, small- and medium-sized enterprises (MSMEs) that drive employment. Public DFIs can offer unique opportunities to finance all stages of growth, especially for MSMEs, covering most of their working capital and investment needs. They can also facilitate MSMEs' access to capital markets, which is crucial for raising long-term funds, and can align investments to the country's economic priorities. These investments can be used to improve vital infrastructure, key economic sectors, R&D initiatives, and projects that promote gender equality, digital transformation and the green transition. By offering tailored financial and non-financial services to municipalities, local public institutions and national governments, DFIs can also boost public investment in key economic sectors, such as infrastructure and health.

Economic, social and governance (ESG) debt instruments, are key to mobilising and leveraging finance where needs are greatest for both public and private sector issuers. GSSS bonds, as a key asset class within the wider universe of ESG assets, represent a unique opportunity for the LAC region to link its debt requirements to sustainability criteria. To enhance GSSS bond financing, it is necessary to expand and harmonise sustainable finance frameworks, including principles, standards and taxonomies (OECD, 2023[81]). It is also important to consolidate reliable monitoring and verification systems to maintain market transparency and to avoid green/SDG-washing, or efforts by businesses to promote their positive contributions to some SDGs while not mentioning their negative impacts on others.

This section addresses how leveraging the financial and technical services of public DFIs can help MSMEs to make key investments that can drive the production transformation and address cross-cutting challenges. It explains how DFIs support governments, municipalities and public institutions in advancing investment in key sectors. It then focuses on GSSS bonds and how they can promote public and private investments with the support of more consolidated and harmonised sustainable finance frameworks.

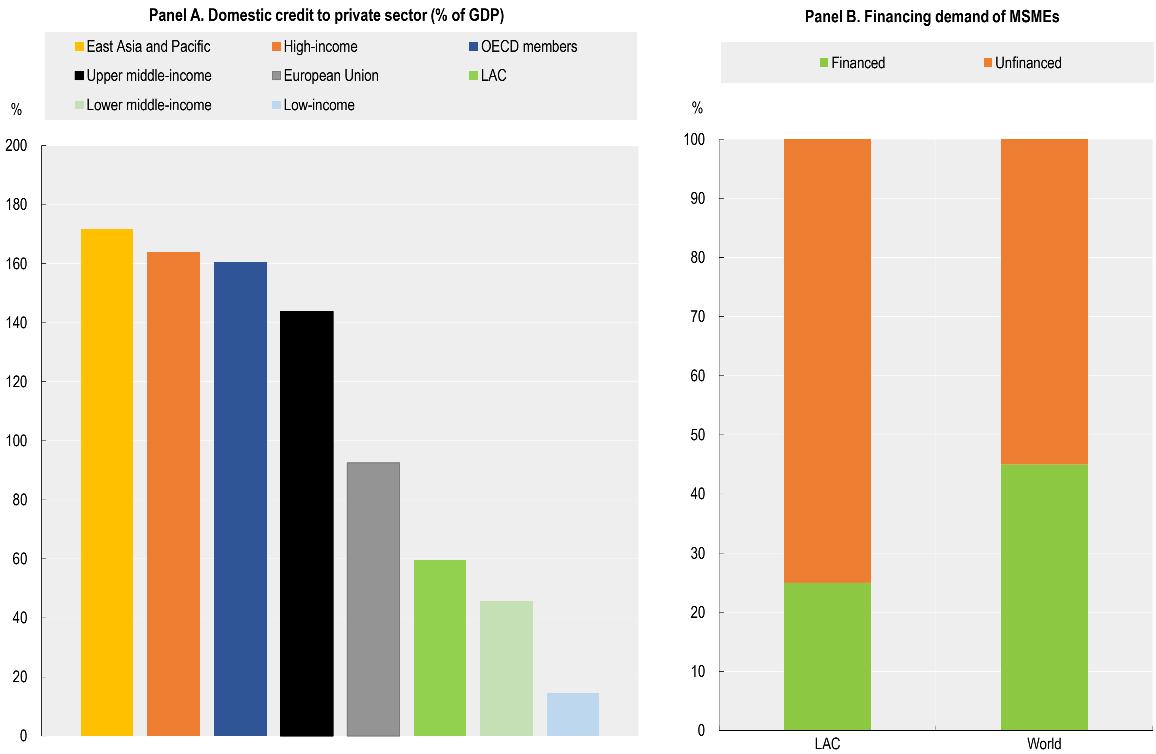
DFIs can be crucial facilitators of private and public investments

National and subnational DFIs are uniquely positioned to mobilise essential resources to achieve the SDGs and guide a production transformation in an equitable and sustainable manner (ALIDE, 2023[82]). DFIs have a mandate to promote economic development and employment, and to facilitate investment and projects that align with the country's development objectives. Public DFIs include mostly national development banks (NDBs) and subnational development banks (SDBs). They also include specialised financial institutions and funds at the national and local levels. In the LAC region, the asset average of DFIs corresponds to 9.4% of GDP in Costa Rica, followed by Uruguay (7.9%), Panama (7.9%) and Chile (7.4%) (ALIDE, 2020[83]).

Public DFIs possess unparalleled knowledge of local markets and have long-standing relationships with local private and public sector actors. This advantageous positioning enables them to assess risks, develop project pipelines, generate investment prospects, and facilitate the flow of domestic and international capital between the public and private sectors (Feyertag, Attridge and Kumar, 2022[84]). Public DFIs can also play a catalytic role by using blended finance mechanisms to create more favourable risk-adjusted returns for international private investors (Chapter 5). Given the heterogeneity of capacities and skills among different DFIs, some are better equipped than others to support the LAC region's green, digital and social transitions. Not all DFIs have the same lending capacity or access to the same financing conditions. Constraints affecting some institutions, particularly domestic banks, include poor access to low-cost, long-term capital. Another major associated challenge is lending to entities that do not have a clear guarantee from their government. This issue is especially important when it comes to financing projects for highly indebted municipal entities and local governments.

The potential of DFIs is often underutilised in LAC countries, especially at national and subnational levels (Feyertag, Attridge and Kumar, 2022[84]; Smits and Rodríguez, 2022[85]). 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 potential to bridge financing gaps faced by enterprises and help expand the market. Although substantial heterogeneity exists across LAC countries, financial systems in the region remain underdeveloped relative to the economic level of most countries. In domestic credit to the private sector as a percentage of GDP, at 59.5% the LAC region is far below levels of 171.5% in East Asia and the Pacific, and 160.7% in OECD countries (Figure 4.6, Panel A). As a result, 75% of the financing needs of LAC MSMEs remain unfunded (Figure 4.6, Panel B).

Figure 4.6. **Depth of LAC's financial markets**



Source: (World Bank, 2023[86]); (SME Finance Forum, 2017[87]).

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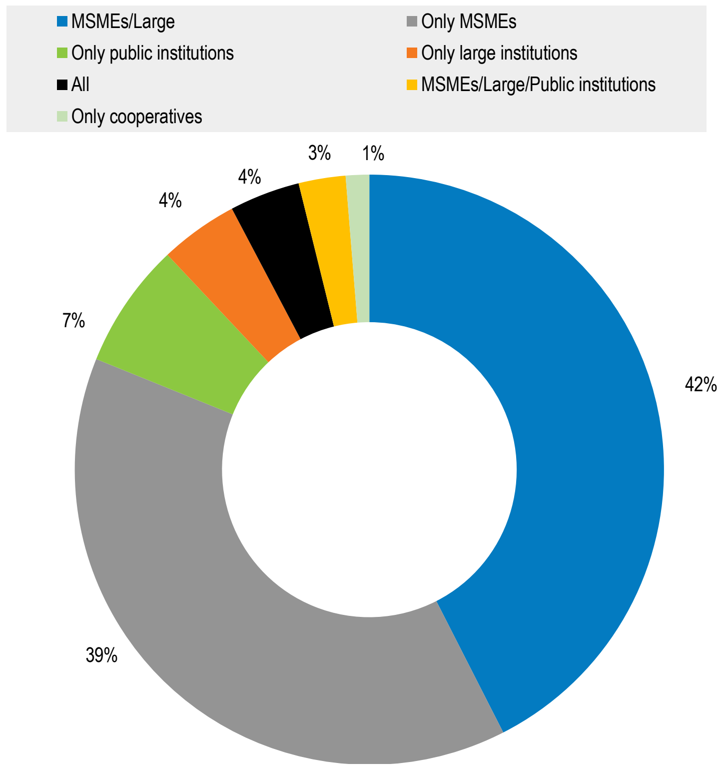
MSMEs account for 99% of formal enterprises and 66% of formal employment in LAC (Dini and Stumpo, 2020[88]). While MSMEs contribute 20% of GDP in Europe, in LAC they contribute only 3.2%. This difference is due, in part, to the current financing gap, and to limited efforts by MSMEs in LAC to adopt technologies and improvements in production processes (Oliveira de Paiva, 2020[89]) (Chapter 3). Since MSMEs can represent a significant segment for sustained economic recovery and job creation, it is crucial to address one of the main structural barriers they face: the financing gap (López-Calva, 2021[90]).

An analysis in 2023 of financial instruments used by 38 national and subnational public DFIs[3] across 13 LAC countries highlights the crucial role of DFIs in financing MSMEs in the region (Figure 4.7). Of 473 financial instruments mapped, 42% target both MSMEs and large companies, 39% target only MSMEs, 7% target public institutions including national governments and municipalities, and 4% are directed only to large companies.

Figure 4.7. **Targets of financial instruments in selected DFIs in LAC, 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.
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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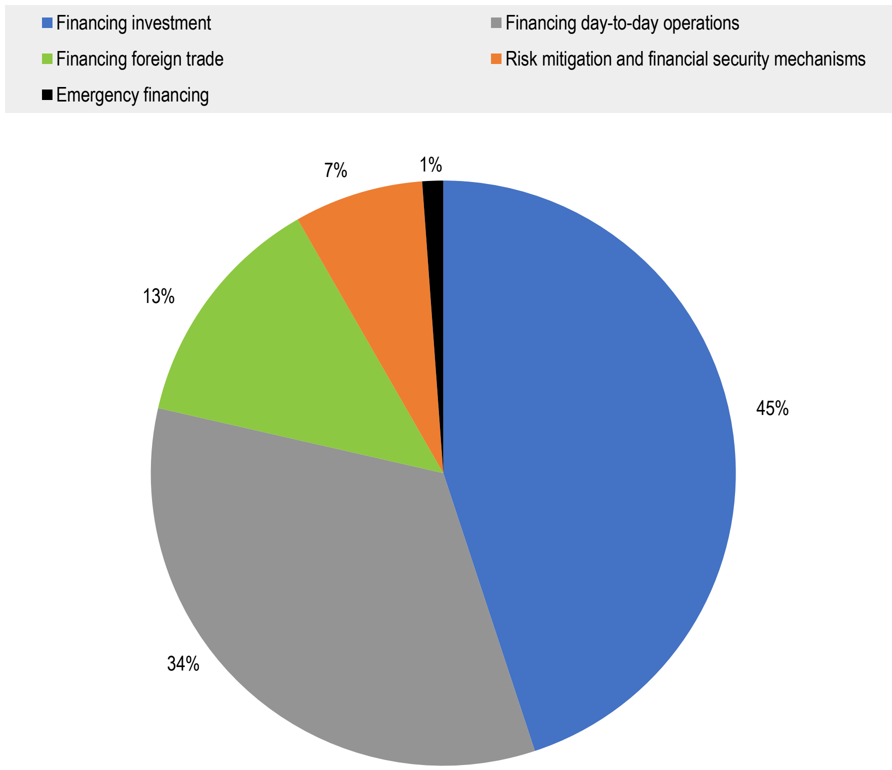
DFIs offer MSMEs a diverse pool of instruments and services

DFIs offer MSMEs in LAC a variety of tailored financial instruments that cater to financial needs at every stage of development. These instruments can be grouped into five types of financing: i) financing day-to-day operations (working capital, payroll, inventory, rent); ii) financing investment; iii) financing foreign trade; iv) emergency financing; and vi) risk mitigation and security instruments. The main types of financing offered through the 38 DFIs under discussion are financing investment (45%) and financing day-to-day operations (34%). This shows the commitment of DFIs to guaranteeing the working capital, liquidity and long-term investment needs of MSMEs. Other types of financing are less common and are primarily intended to enhance the financial inclusion and competitiveness of MSMEs (Figure 4.8).

Figure 4.8. **Distribution of financing types offered to MSMEs by public DFIs in LAC, 2023**



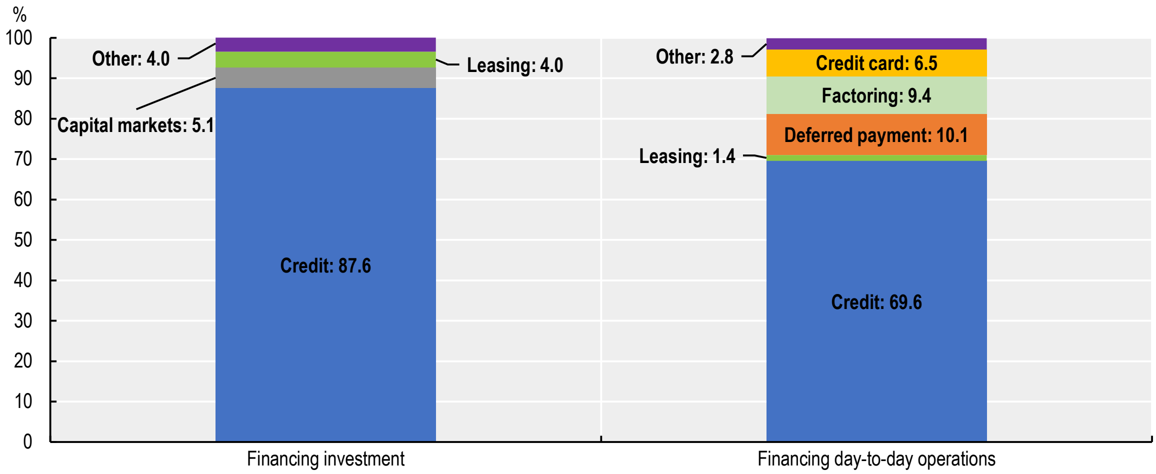
Note: The database covers 38 national and subnational public DFIs in 13 LAC countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Mexico, Paraguay, Panama, Peru and Uruguay.
Source: Authors' elaboration based on public data (annual and sustainability reports) accessed in 2023 from 38 public DFIs in 13 LAC countries.

StatLink *https://stat.link/vkundc*

Multiple tools exist to support MSMEs in financing their investment needs. These investments are essential for MSMEs to undertake renovations or expansions, acquire new capital goods, and launch projects that foster innovation. Credits are the most common instrument offered to finance investment projects (87.6%). Although other types of financing are utilised less, they can also be useful for developing MSMEs. Financing mechanisms offered to grant MSMEs access to capital markets (5.1%) can allow them to participate in crucial investment portfolios. Leasing (4.0%) is offered as an innovative instrument that can allow MSMEs to finance long-term productive investment. This is done through a subsidised rate to foster the acquisition of capital goods aimed at increasing productivity in key sectors of the economy. Guarantees and credit funds are other financial instruments used by DFIs to help boost investment (Figure 4.9).

DFIs can also finance the day-to-day expenses of MSMEs, including working capital, inventory, payroll and rent. Credits are again the most common instrument (69.6%) and have the objective of maintaining and/or generating jobs and the acquisition of machinery. Long-term credits can allow MSMEs to purchase inputs, raw material or fuel so that they can focus on maintaining their production activity and improving their competitiveness. Deferred payment mechanisms (10.1%) are used to help with commercial development, while factoring (9.4%) is offered to MSMEs to boost their competitiveness and increase liquidity for day-to-day operations. Other financial instruments used to help boost liquidity and access to working capital include credit cards, leasing or leaseback, trusts, guarantees credit funds and cancellation of liabilities (Figure 4.9).

Figure 4.9. **Distribution of financial instruments offered to MSMEs by type of financing (%), 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. The category "Other" includes the following financial instruments: Non-reimbursable financial support; Credit fund; Guarantee; Trusts; and cancellation of liabilities.

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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Some DFIs have developed significant expertise in financing the foreign trade needs of MSMEs. This is done through mechanisms that provide guarantees and/or funding for pre-export and post-export financing operations of goods and services. To help MSMEs protect themselves against natural hazards and disasters, public DFIs in the LAC region also offer emergency financing (credit) lines, which can finance the acquisition of new capital goods and/or the construction of facilities.

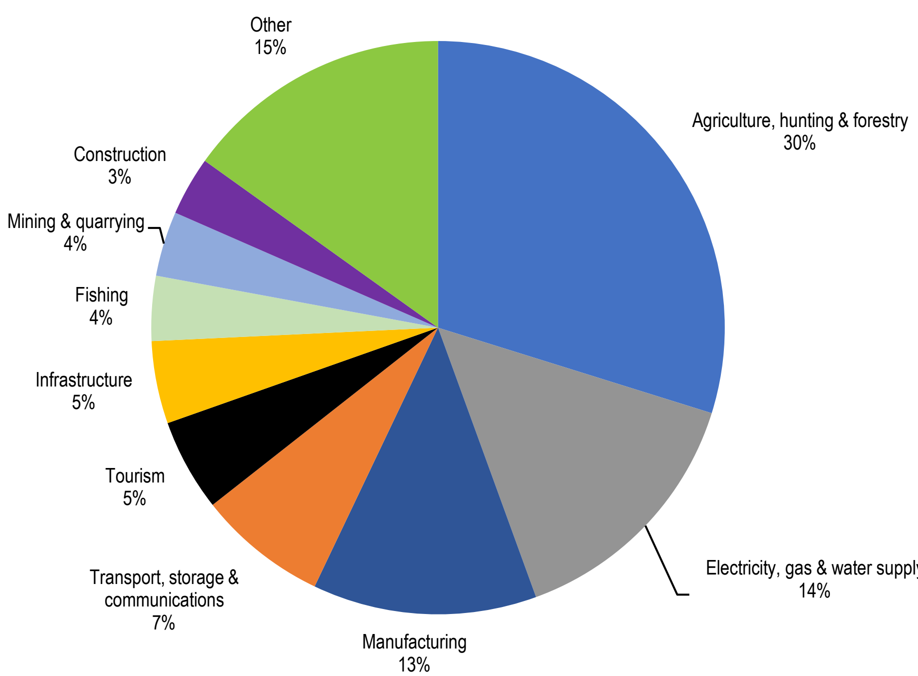
Trust funds and guarantees are also important risk mitigation and security instruments offered by public DFIs seeking to help MSMEs access project financing in strategic sectors. Trust funds offered to MSMEs mainly support economic and/or social development programmes aligned with national priorities that aim to foster job creation and promote environmental sustainability. Guarantees can also enhance financial inclusion by reducing credit risk and providing security to lenders. This is particularly relevant for MSMEs with limited assets or credit histories. Well-evaluated public DFIs allow MSMEs to acquire financing under better conditions, for example with longer terms, lower entry requirements and lower interest rates. MSMEs in the LAC region mostly use loans and credit lines in climate-related finance, highlighting the need to scale up guarantees that can help reduce risks and attract new investment. Ensuring that credit-guarantee schemes preserve market discipline in credit allocation is a key issue (Blancher et al., 2019[91]).

As key public entities, DFIs have potential to increase the supply and quality of financial instruments. Such instruments can encourage innovative and long-term investment and employment by the private sector, especially MSMEs. Increasing the capacity and accessibility to innovative financial instruments by MSMEs in LAC is fundamental to combatting the current limitations of the region's financial systems (Coalición Regional, 2016[92]). Multilateral Development Banks (MDBs), such as CAF or the Inter-American Development Bank (IDB), can play a key role in providing technical support and transferring strategic know-how to DFIs. MDBs can help build institutional capacity in financial instruments related to capital markets development and the issuance of GSSS bonds. This role can be instrumental in mainstreaming climate- and social-related debt instruments and advancing the sustainable agenda within the region's capital markets (see section on GSSS bonds). It is also necessary to consolidate monitoring and follow-up systems for each financial instrument to better understand their impact and fine-tune them according to companies' needs. The diversity of tools that DFIs offer to key economic sectors, accompanied by the necessary technical and digital support, can help consolidate LAC's production transformation and prepare for and play an active role in shaping a new international financial architecture.

DFIs can boost key production sectors

National and subnational DFIs can play a significant role in promoting investments in key production sectors. They have potential to increase companies' access to finance, thereby boosting development and job creation (ALIDE, 2022[93]). Customised financial instruments can address sector-specific challenges and align sectors with national goals. Of 38 national and subnational DFIs mapped, 87% have one or more financial instruments that target specific sectors. Of 473 financial instruments identified, 41% have a sectoral perspective. One instrument can target several sectors in parallel. Of the total financial instruments with a sectoral perspective, 30% target the agriculture, hunting and forestry sector; 14% the electricity, gas and water supply sector; 13% the manufacturing sector; and 7% the transport, storage and communications sector (Figure 4.10).

Figure 4.10. **Distribution of the sector-targeted financial instruments offered to MSMEs by DFIs, 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. 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; Information and Communication Technology (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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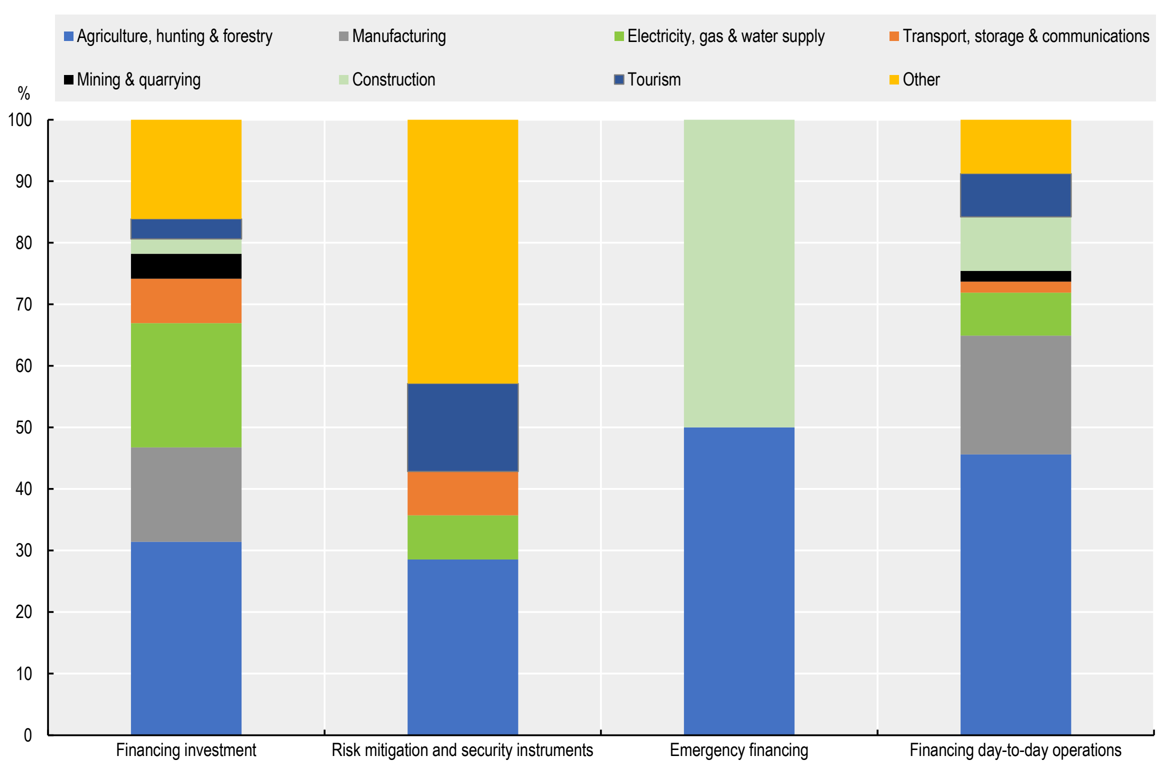
The agricultural, hunting and forestry sector is the most targeted by all types of financing instruments that are provided by public DFIs in LAC to MSMEs (Figure 4.11). Among these instruments, those financing investment help to support various sectors (such as agri-food or bioeconomy) by providing resources for diverse activities (such as vegetable growing, cattle milk production, poultry farming, beekeeping and meat-processing plants). In this way, they contribute to diversifying a country's production structure. Instruments financing day-to-day operations can also contribute to diversification by helping MSMEs to stabilise and thus become better equipped to focus on long-term planning and on exploring new investment opportunities.

The electricity, gas and water supply sector is targeted through instruments for financing investment, financing day-to-day operations, and supporting risk mitigation and security. Financing investment often includes incentives to improve energy-environmental efficiency and production certification.

The manufacturing sector is often targeted by DFIs, especially through financing of investment and day-to-day operations. Instruments for financing investment for this sector focus on the acquisition of projects with industrial units already built or under construction (Figure 4.11).

Figure 4.11. **Sectoral distribution of financing instruments provided by DFIs to MSMEs in LAC, 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. The category "Other" includes the following sectors: Fishing; 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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For DFIs to help effectively drive the LAC region's production transformation, it is important that they function within the framework of well-defined national development strategies. These strategies should allocate DFIs a distinct and strategic mandate, particularly in relation to their role in promoting key production transformation sectors. DFIs must also advance in their efforts to develop instruments that respond to the specific needs and singularities of each production sector. In order to offer the right kind of instruments, DFIs need to develop capabilities and skills within their country's sectoral priorities.

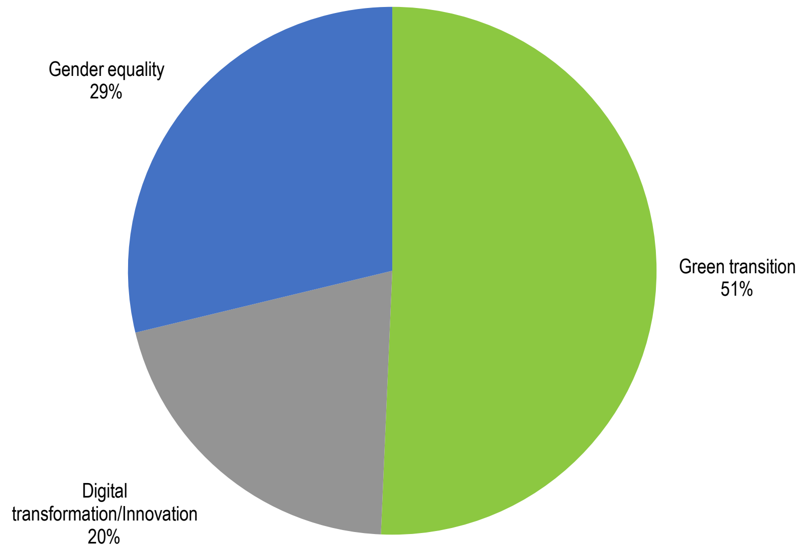
Niche sectors within the larger sector categories are also relevant when developing targeted financial instruments. Green hydrogen, for instance, is a growing niche sector in different LAC countries and requires that DFIs address its emerging needs. This includes financing human capital development in the industry or technologies required, and providing support for products that utilise green hydrogen. Establishing closer contact with companies and getting to know their aspirations and installed capabilities at the sector level can facilitate development of better targeted instruments. Fine tuning these processes requires that DFIs expand their technical knowledge on specific sectors and invest in capacity-building strategies. The Latin American Association of Development Financing Institutions (ALIDE) can become a crucial platform for national and subnational public DFIs to access sectoral information. By bringing together the experience and knowledge of financial experts from across the region, ALIDE could take the lead in improving the design of sector-specific financial services.

DFIs can help MSMEs contribute to green, digital and gender goals

The commitment of national and subnational DFIs to the SDGs could work in favour of developing financial instruments for MSMEs that have sustainable, gender-sensitive and digital objectives. This can help channel private investments towards achieving key development goals. At present, however, of 473 financial instruments for MSMEs offered by public DFIs in the LAC region, only 19% address at least one of the three cross-cutting challenges. Of the financial instruments that address at least one cross-cutting challenge, 51% target the green transition in some dimension, 29% target gender equality, and 20% target digital and innovation challenges (Figure 4.12).

Figure 4.12. **Distribution of financial instruments targeting green, digital and gender dimensions, 2023**

Instruments offered by DFIs to MSMEs in LAC



Note: Distribution shows cross-cutting challenges only for those DFIs that had one or more services targeting a green, digital or gender dimension. The following DFIs offered financial instruments targeting at least one cross-cutting challenge: Banco de Inversión y Comercio Exterior S.A. (BICE); Banco de La Pampa, Banco de la Provincia de Buenos Aires (BAPRO); Banco de la Nación Argentina; Banco de Desenvolvimento de Minas Gerais S.A. (BDMG); Banco do Nordeste do Brasil S.A. (BNB); Banco Nacional de Desenvolvimento Econômico e Social (BNDES); Banco Regional de Desenvolvimento do Extremo Sul (BRDE); Desenvolve SP – Agência de Fomento do Estado de São Paulo S.A.; Fondo para el Financiamiento del Sector Agropecuario (FINAGRO); Banco Nacional de Costa Rica; Banco Popular y de Desarrollo Comunal; Instituto Nacional de Desarrollo Agropecuario (INDAP); Banco Nacional de las Exportaciones (BANDEX); Corporación Nacional de Finanzas Populares y Solidarias (CONAFIPS); Banco de Desarrollo Rural S.A. (BANRURAL); Banco de Desarrollo de El Salvador (BANDESAL); Nacional Financiera S.N.C. (NAFIN); Banco Nacional de Comercio Exterior S.N.C. (BANCOMEXT); Fideicomisos Instituidos en Relación con la Agricultura (FIRA); Banco de México; Banco Nacional de Fomento (BNF); Agencia Financiera de Desarrollo; Corporación Financiera de Desarrollo S.A. (COFIDE).
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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To increase green investments, DFIs in LAC offer financial services to MSMEs to support projects related to renewable energy (energy generation and efficiency), and to mitigate crises related to natural disasters. To accelerate the green transition, it is essential for DFIs to provide financing mechanisms that target the most critical sectors. This will support countries in achieving their climate-change mitigation and adaptation objectives. Among the financial services targeting the green transition with a sectoral perspective, 33% focus on the electricity, gas and water supply sector; 17% on the agriculture, forestry and fishing sector; and 10% on the transport, storage and communications sector. Other less-targeted sectors include mining and quarrying, as well as manufacturing, with each accounting for 6.8%. Despite being less targeted, these sectors play crucial roles in achieving countries' mitigation and adaptation goals (UNEP, 2023[94]). Therefore, it is necessary for public DFIs to expand their financial services and offer more targeted support to these sectors with high greenhouse gas (GHG) emissions.

DFIs have also developed financial frameworks to facilitate women-led investments. Financial support for women includes, for example, investment loans for MSMEs that are 51% owned by women or those with women ownership of at least 25% that have at least one woman on their board of directors or in their senior management. However, much room for improvement still exists. The proportion of disbursements to women-led MSMEs is still very small compared to the total. More opportunities should be generated, not only to increase the supply of financial services to women but also to stimulate demand, for instance through gender-focused financial education programmes.

DFIs can also help to increase digital, research, innovation and technology-oriented investments. DFIs offer trusts to stimulate the information and communications technology sector, loans to foster innovation and financial support for developing new products, processes or services. Public DFIs are also innovating in the financial technology (fintech) sector by offering MSMEs financing platforms to promote financial inclusion. In parallel, public DFIs are increasing focus on their own digital transformation, including by integrating applications and automating operations through digital channels.

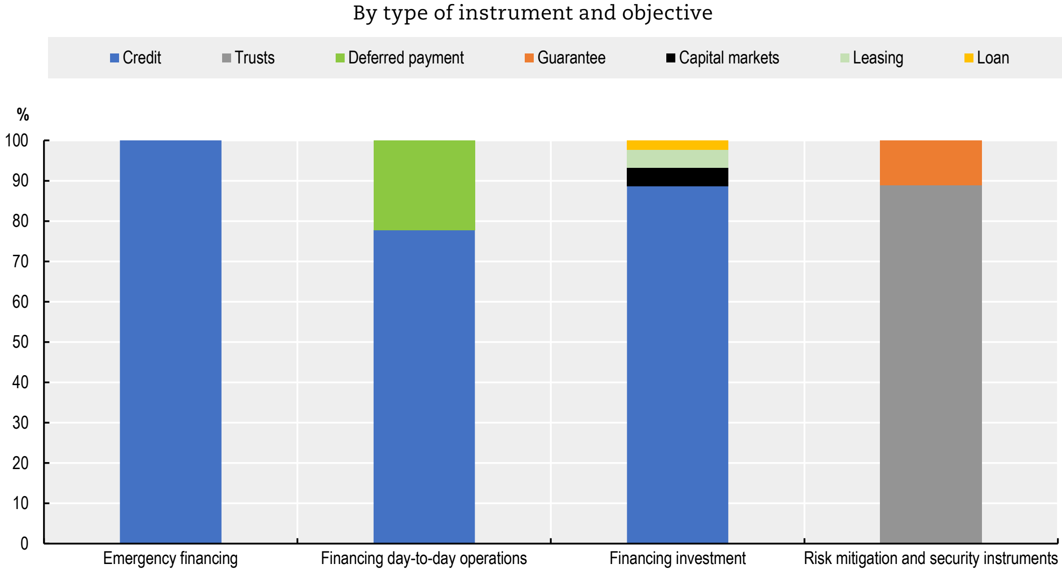
To boost investment in these dimensions, DFIs can establish specific programmes for: i) project preparation; and ii) technical support during project implementation. It is important for DFIs to engage actively in policy dialogues concerning the green transition, digital transformation and gender equality (Smits and Rodríguez, 2022[85]). This should include offering insights into the constraints and catalysts they have identified. Lastly, DFIs need to develop the capacity to articulate and measure the impact of their financial instruments on work towards the SDGs and climate-related objectives.

DFIs can support investments by local governments in targeted sectors

National and subnational DFIs in LAC have an important role in financing public investments, for example by providing national or local governments with permanent financing lines such as credits, capital market access mechanisms, guarantees, leasing, deferred payment and trusts (Figure 4.13). Credits often target improvements in infrastructure and public services at the local level. Some investment credits focus on municipal projects that target SDGs in areas including energy efficiency, smart cities, renewable and clean energy, water supply and sewage treatment, among others. To finance investment, DFIs also support public institutions in accessing capital markets. Leasing is emerging as a novel instrument enabling government institutions to access new equipment and technologies for investments. It allows regular equipment renewal at low credit costs, improving the investment capacity of local governments and enhancing public services for the population (Jouglard, 2019[95]).

Figure 4.13. **Distribution of financial instruments offered to the public sector by public DFIs in LAC, 2023**

By type of instrument and objective



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.
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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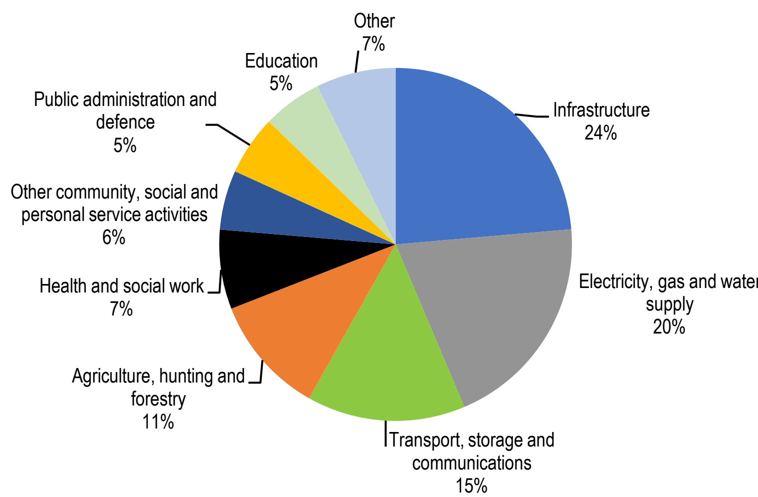
DFIs in LAC also offer targeted financial instruments to public institutions to facilitate mobilising resources to key sectors. Of the total instruments offered, 24% target the infrastructure sector; 20% the electricity, gas and water supply sector; 15% the transport, storage and communications sector; and 11% the agriculture, hunting and forestry sector (Figure 4.14). Most of the credits offered to public institutions focus on developing urban infrastructure and public services. These credits allow the financing of roads and bridges, as well as infrastructure projects in the energy, tourism, culture and sports sectors.

Figure 4.14. **Sectoral distribution of financial instruments offered to the public sector by public DFIs, 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. The category "Other" includes the following sectors: Fishing; Mining and quarrying; Wholesale and retail trade; Repair of motor vehicles, motorcycles and personal and household goods; and ICT.

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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DFIs can also provide technical and digital support to public entities. They can offer the public sector specialised and advisory services as well as technical assistance by creating partnerships with state secretariats, ministries and municipalities. In May 2023, the state of Pernambuco in Brazil sought technical assistance from the Brazilian Development Bank (BNDES) to expand its sanitation infrastructure. BNDES will oversee specialised consultants conducting preliminary studies, including a sector diagnosis, investment estimates, an assessment of financing options and economic viability studies (BNDES, 2023[96]). Some DFIs also offer training on digital platforms for efficient credit access and assist in disseminating information on available credit lines.

DFIs in LAC still have a long way to go in providing and expanding some of these instruments to the public sector. Access to these instruments and services must be increasingly improved through digital innovations that streamline the application and procurement processes for the different lines of financing. Some misunderstanding still exists, especially in small public entities, of how these new types of financial products and services work. It is thus necessary that public DFIs increase technical and digital services to support municipalities and also help to "professionalise" the public sphere by progressively aligning its practices with those of the private sector (Jouglard, 2019[95]).

Innovative financial tools, such as GSSS bonds, can help to finance investments

Capital markets serve as a vital component of the LAC region's financial system, and their potential can be strengthened. Capital markets can help to mobilise financing for strategic sectors such as infrastructure and housing, facilitate funding for SMEs, and foster innovation (World Bank, 2022[97]). By functioning as a hub for investors and issuers, capital markets in LAC facilitate economic growth and enable companies and governments to access necessary funds for expansion and development.

In addition to traditional instruments (such as equities, fixed-income assets and derivatives in the foreign-exchange market) in LAC capital markets, new instruments have been developed. Equity instruments such as venture capital funds are gaining importance and showing growth in the region. These funds aim to increase financing for early-stage and high-growth companies (Box 4.4). There has also been significant growth in the issuance of GSSS bonds, reflecting rising investor interest in ESG-themed products (ECLAC, 2022[98]).

Box 4.4. **Unleashing the potential of venture capital funds to finance start-ups in the LAC region**

Venture capital plays a crucial role in supporting start-ups and companies at different stages of growth, from initial development to expansion and acquisition activities (OECD, 2015[99]). Venture capital funds can be classified into three main types: early-stage financing, expansion financing and acquisition/buyout financing. Early-stage financing encompasses seed financing, start-up financing and first stage financing, providing capital for start-ups to qualify for loans, complete product development and initiate full-scale business activities. Expansion financing supports growing companies and includes second-stage financing, bridge financing and third-stage financing. This type of financing enables companies to pursue growth opportunities and utilise initial public offerings (IPOs) as a strategic business approach. In IPOS, shares of a private company are offered to the public for the first time, raising additional funds and providing access to public markets. Acquisition financing involves financing to purchase other companies or parts of them, while leveraged buyout financing facilitates the acquisition of specific products (Nayak, 2018[100]).

Many medium-sized companies face challenges when seeking conventional financing due to the inherent risks involved in their ventures (Rudolph, Faruk and Gonzalez-Uribe, 2023[101]). Venture capitalists bridge this funding gap by offering capital, expertise and networks. Their involvement supports the growth of promising start-ups and contributes to developing entrepreneurial ecosystems in the region. Through their support, they facilitate connections for start-ups with mentors, industry experts and potential collaborators, fostering knowledge sharing.

The venture capital landscape in LAC has experienced remarkable growth in recent years, with venture capital investments surging from around USD 1 million in 2015 to nearly USD 20 billion in 2021 (Rudolph, Faruk and Gonzalez-Uribe, 2023[101]). This surge surpassed corporate debt financing and approached the levels of equity financing raised through IPOs in the region's primary markets. It can be attributed to the entrance of deep-pocketed venture capital investors actively pursuing both early-stage and late-stage deals. These opportunities, predominantly facilitated by non-domestic investors in the LAC venture capital market, have played a significant and instrumental role in driving overall investment value and participation in deals, further fuelling growth and development of the LAC venture capital ecosystem.

Box 4.4. **Unleashing the potential of venture capital funds to finance start-ups in the LAC region** *(cont.)*

In 2021, LAC's venture capital investment as a percentage of GDP reached a rate of 0.38%, surpassing Southeast Asia's rate of 0.27% but below the global average of 0.57% (Endeavor Intelligence & Glisco Partners, 2022[102]). Notably, Colombia and Brazil have emerged as frontrunners with investment rates of 0.52% of GDP within the same year, showcasing their strength in attracting venture capital. Despite facing a decline in FDI, in 2021 Mexico achieved a record level of venture capital investment with USD 3.7 billion (0.29% of GDP). These figures demonstrate the increasing prominence and attractiveness of venture capital opportunities in the region, and indicate the potential for further expansion and innovation in the coming years.

Sustainable debt market instruments are key to addressing development challenges

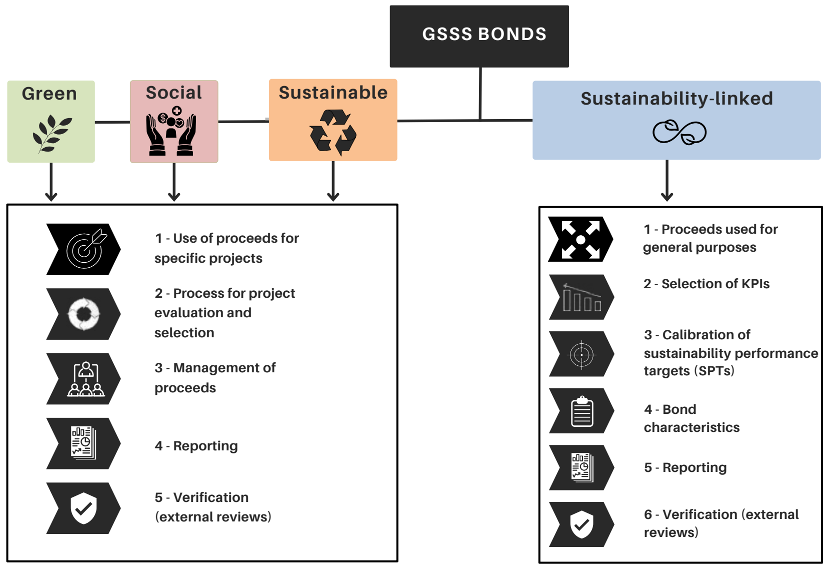
Developing sustainable debt market instruments can help mobilise resources where needs are greatest. Increasing demand for ESG-linked assets, and especially for GSSS bonds, has contributed to raising public and private funds for crucial projects.

For sovereigns in the LAC region, raising funds through these assets has become an attractive option to increase the return on liquid global capital, diversify the investor base, mobilise direct capital into sustainable activities, and acquire financial support for creating sustainable capital markets. In the aftermath of the COVID-19 pandemic, impact investing through bonds has become increasingly important, especially since European funds are willing to take a longer-term view of risk (Gavin, 2022[103]). For sovereigns in LAC, bond proceeds can fund sustainable public expenditure and infrastructure, as well as sustainable policies and national commitments, such as the Nationally Determined Contributions (NDC) set under the Paris Agreement on climate change (Frisari, Carlino and Palacios, 2022[104]).

For corporates in LAC, issuing debt in international markets is attractive as it often offers lower interest rates and greater potential for capital gains. Bond proceeds can also benefit sectoral investments in LAC, such as the agricultural sector (agribusiness, food and beverages, forestry), the financial sector (commercial banks, financial services companies, finance development banks/multilateral agencies), and the energy sector (utilities, oil, gas, power) (ECLAC, 2023[105]).

There are two types of structures in the sustainability debt market: green, social and sustainable (GSS) bonds which are "use-of-proceeds" bonds designed to finance sustainable projects, and sustainability-linked bonds which are "target-linked" bonds tied to specific sustainability targets (Figure 4.15). As defined by the International Capital Market Association (ICMA), use-of-proceeds bonds (also called GSS bonds) are fixed-income instruments, the proceeds of which are exclusively applied to finance or refinance green, social and sustainable projects, either entirely or partially. With target-linked bonds (also called sustainability-linked bonds [SLBs]), the proceeds are used for general purposes. The issuers choose the associated targets they want to achieve through the issuance of the bond; ultimately, they accrue additional payments to bondholders if the predetermined targets are not met. These bonds are generally tracked by assessing key performance indicators (KPI) and sustainability performance targets (SPTs) (OECD et al., 2022[17]; Núñez, Velloso and Da Silva, 2022[106]).

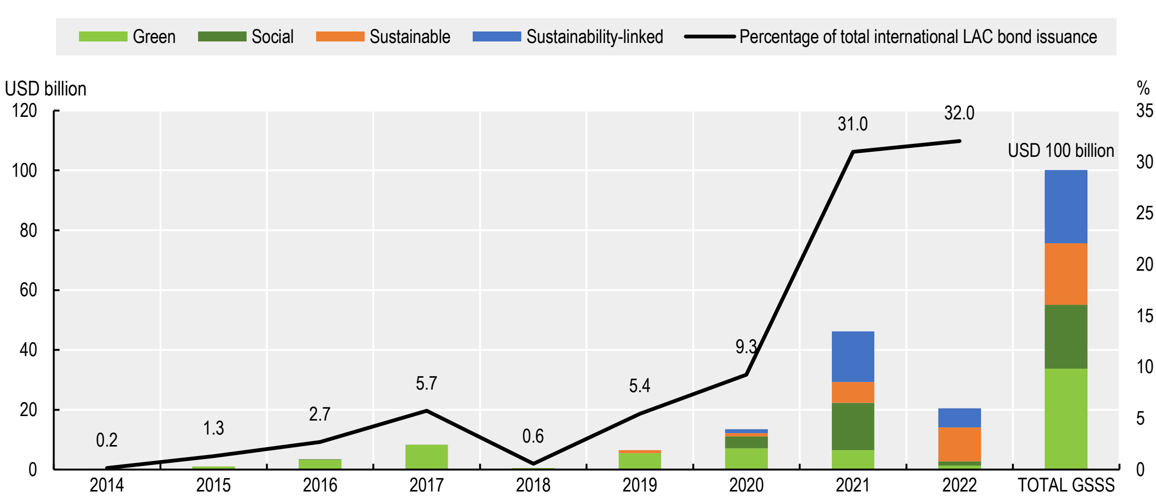
Figure 4.15. **Types of structure in the sustainability debt market**



Source: Authors' elaboration based on ICMA Principles.

To date, the GSSS bond market represents only a small fraction of the global bond market. It is still considered a niche sector, representing only 1% of total assets outstanding and around 2% of new issuances globally (OECD, 2022[107]). In the LAC region, however, even with tight financial markets, GSSS bonds continue to be an attractive financing mechanism, representing 32% of total international LAC bond issuance. The region issued USD 20.1 billion of international GSSS bonds in 2022, down 56% from 2021 but still the second-highest year recorded. Between 2014 and 2022, the GSSS international 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 4.16).

Figure 4.16. **International bond issuance in LAC: GSSS by type and as percentage of total, 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.

Source: (Núñez, Velloso and Da Silva, 2022[106]; ECLAC, 2023[105]).

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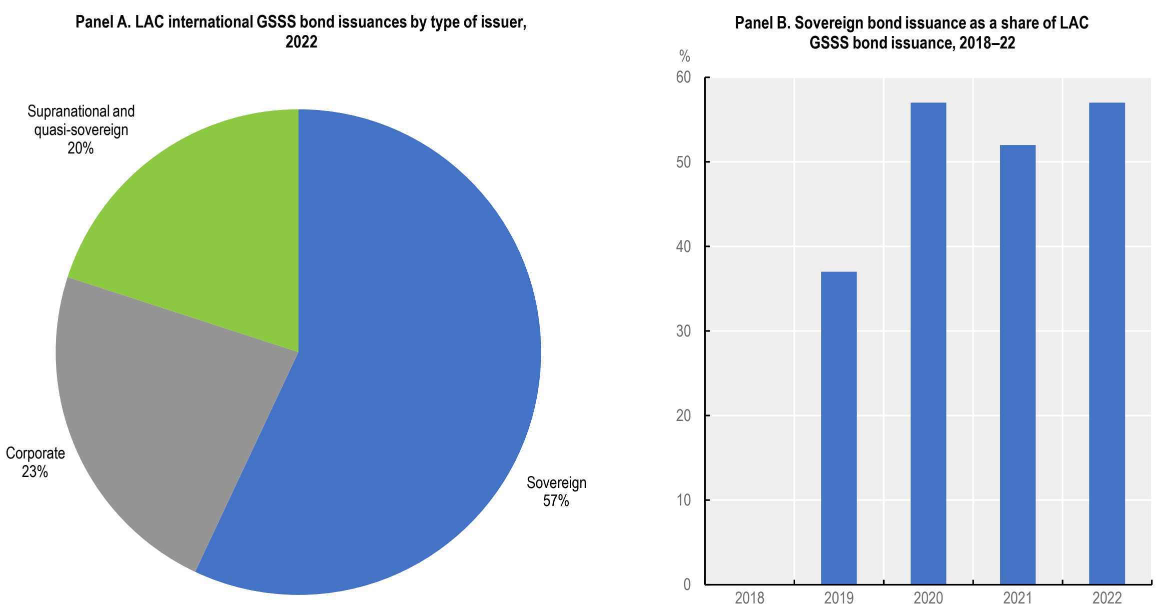
Sovereign GSSS issuance has been growing as a share of total GSSS bond issuance in LAC. In 2022, sovereign GSSS bond issuance in international markets in the region accounted for 35.7% of the total sovereign issuance of all types of bonds in international markets. During the first six months of 2023 this figure increased to 43.5%. Until June 2019, all LAC GSSS bond issuances originated in the corporate sector, and corporates continued to lead total GSSS bond volumes in 2019 with a 44% share of the total, while sovereign issuances represented 37%, and supranational issuers 19%. Sovereign issuances have since been rising. 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%) (ECLAC, 2023[105]) (Figure 4.17, Panel A). In June 2019, Chile issued the region's first green sovereign bond in international markets. By 2022, seven countries had followed (Ecuador, Guatemala, Mexico, Peru, Bahamas and Uruguay [in order of appearance]) by issuing green (or blue), social, sustainability and sustainability-linked bonds in international markets (Figure 4.17, Panel B) (ECLAC, 2023[105]). Regarding sovereign issuances in the domestic market, in 2021 Colombia became the first emerging economy worldwide to issue a sovereign green bond in local currency (TES Verdes) (OECD et al., 2022[17]).

Figure 4.17. **GSSS sovereign bond issuance in international markets**



Note: Quasi-sovereign issuers are defined as companies with full or partial government ownership or control. Supranational issuers are defined as entities formed by two or more central governments to promote economic development for the member countries.

Source: (ECLAC, 2023[105]).

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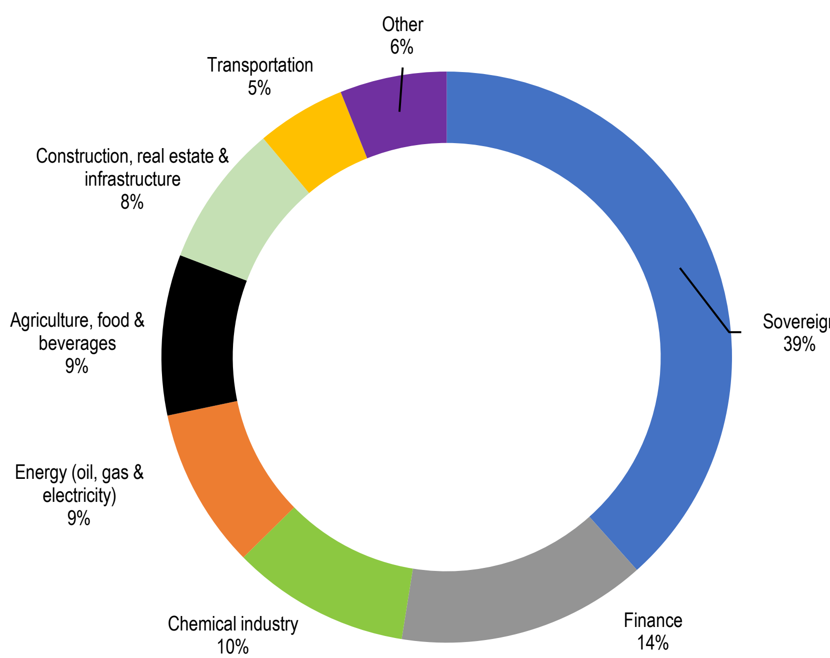
The share of SLBs in total GSSS bond issuance fell to 31% in 2022, from 37% in 2021. These bonds can be prone to greenwashing. Since issuers self-impose KPIs and SPTs that can be very difficult to verify externally, increased market scrutiny and fear of greenwashing may slow the growth of this type of bond in the short term. Nonetheless, SLBs offer issuers the opportunity to redirect capital flows to achieve multiple sustainable objectives at the same time. Two LAC countries, Chile and Uruguay, became pioneers in 2022 as the world's first nations to issue sovereign sustainability-linked bonds; as of mid-2023, they remained the sole issuers in the LAC region (OECD, 2023[81]). In March 2022, Chile issued a USD 2 billion sovereign bond tied to two key performance indicators: reducing GHG emissions and boosting energy production. With the issuance, Chile became the first government to link its official NDC commitment on climate change to a bond issuance. In November 2022, Uruguay issued its first bond indexed to indicators of climate change (BIICC).

GSSS bonds have emerged as attractive instruments for specific sectors to raise capital and address the LAC 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 4.18). Diversification across sectors in the GSSS market in LAC has increased since 2019 (Núñez, Velloso and Da Silva, 2022[106]). Until 2018, the only sectors issuing GSSS bonds were pulp and paper, food and beverage, and energy. Since 2019, new sectors have accessed the sustainable market, including auto and related activities, technology, chemicals, telecommunications, consumer products, real estate, transportation, and sugar and ethanol (Núñez, Velloso and Da Silva, 2022[106]). Sectoral distribution indicates that these bonds have potential to increase finance investment in projects in key sectors with sustainability impacts.

Figure 4.18. **GSSS bond issuance in international markets, sectoral distribution, LAC**

December 2014 to April 2022



Note: The category "Other" includes the following sectors: Telecommunications; Forestry & paper; and retail & consumer products.
Source: (OECD et al., 2022[17]; Núñez, Velloso and Da Silva, 2022[106]).

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GSSS bonds can unlock key investments to address gender equality and digital inclusion

The LAC region has become a leader in gender bond issuance, with a total of ten issuances between 2016 and 2022 from sovereign, corporate and supranational issuers (Sacristán, 2022[108]). Gender bonds are a type of social, sustainable or sustainability-linked bond that aims to raise capital earmarked for new or existing projects that support the advancement, empowerment and equality of women. For instance, Ecuador's Banco Pichincha issued two gender bonds in 2022. The first funded loans to women-led small businesses. Half of the bond sale was subscribed to IDB Invest and the other half to the

International Finance Corporation (IFC).The second gender bond was a private placement, backed by diversified payment rights (DPR) to fund loans for MSMEs owned by women (ECLAC, 2022[109]; OECD et al., 2022[17]).

Regarding digital inclusion, GSSS bonds are being used globally to address the digital divide. By issuing GSSS bonds with a digital inclusion component, companies, governments and multilateral organisations in LAC can raise funds to support the region's digital transformation efforts (Norton and Horton, 2021[110]). Digital inclusion bond financing enables commitments to digital inclusion projects and KPIs that may relate to investing in broadband infrastructure, digital skills training, financial inclusion, and access to quality health care and education, among other priorities (Norton and Horton, 2021[110]). In LAC, in 2022 IDB Invest issued its first silver economy social bond to support seniors' financial inclusion, including through digital solutions. The proceeds will be directed to fund social projects with a focus on alleviating poverty and reducing inequalities that affect senior citizens and retirees in LAC (IDB Invest, 2022[111]).

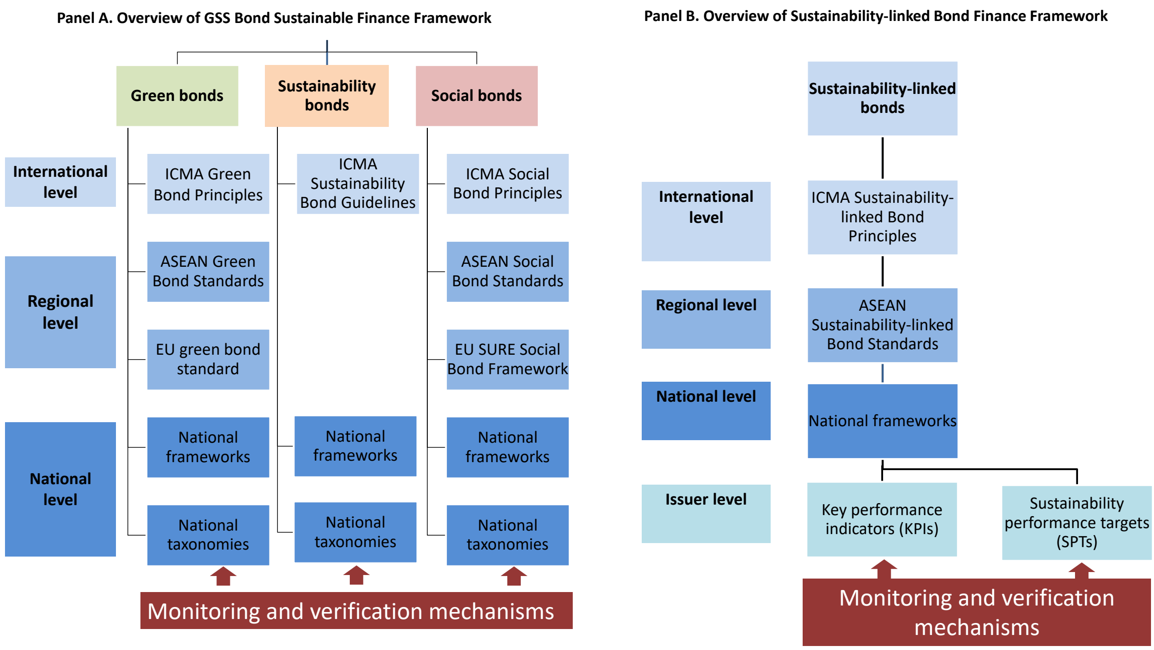
GSSS bonds in LAC would benefit from harmonised regulation and monitoring

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. Frameworks that are more consolidated have potential to reduce transaction costs for investors, making capital markets in the region more attractive (Salazar-Xirinachs, 2023[112]). Such frameworks may include principles, standards and/or taxonomies that serve two main purposes: i) reducing and managing the ESG risks of financial activities; and ii) encouraging the flow of capital to assets, projects, sectors and companies that have environmental, climate and social benefits.

Sustainable finance frameworks guide the issuance of GSSS bonds at international, regional and national levels. The ICMA principles and the Helsinki Principles[4] are often used as overarching guiding frameworks for the issuance of GSSS bonds at the regional and national levels (Figure 4.19). The ICMA principles, for instance, provide a set of specific procedural guidelines for each type of bond issuance. This benefits investors, as it allows them to make better-informed decisions on their investments. ICMA's suite of instruments – i.e. Green Bond Principles (GBP), Social Bond Principles (SBP), Sustainability Bond Guidelines (SBG) and Sustainability-Linked Bond Principles (SLBP) – have become increasingly important in international markets. Several countries and corporates around the world now use them as reference to develop their own frameworks for the issuance of GSSS bonds (Núñez, Velloso and Da Silva, 2022[106]) (ICMA, 2023[113]).

The framework for GSS bonds is different from that of SLBs. For use-of-proceeds or GSS bonds, standards and taxonomies have been developed to guide issuance, certification and verification (Figure 4.19, Panel A). For target-linked bonds or SLBs, standards have also been developed to guide issuance, certification and verification, except the final step involves evaluating issuer level "self-imposed" KPIs and SPTs (Figure 4.19, Panel B).

Figure 4.19. **Overview of sustainable finance frameworks for GSSS bonds**



Source: Authors' elaboration.

In both cases, overarching principles and guidelines serve only to advise issuers under a general framework. It is therefore important that issuers at the regional and national levels develop clearer and more binding standards and taxonomies, rather than relying solely on the market to self-regulate through principles. Chile presents a good example of how standards have been gradually developed for all types of GSSS bond issuances. In 2019, Chile's Ministry of Finance published a Sovereign Green Bond Framework in collaboration with the Ministry of Environment. In 2020, it published a Sustainable Bond Framework that set standards for the issuance of not only green bonds, but also social and sustainable bonds. In 2022, the Ministry of Finance developed a Sustainability-Linked Bond Framework prior to issuing (March 2022) its first sovereign sustainability-linked bond (OECD et al., 2022[17]).

Green and sustainable taxonomies have been developed in the LAC region. As of mid-2023, they have been implemented in Mexico and Colombia, and are under development in countries such as Brazil, Chile, Dominican Republic, and Peru and in sub-regions such as Central America (UNEP, 2023[94]). These are tools to manage financial risks related to environmental and social issues and to avoid greenwashing. Taxonomies can also be used as industrial policy tools. Creating technical assessment criteria for defining a green activity allows financial and environmental authorities, along with industry stakeholders, to engage in comprehensive sustainability discussions. Such dialogue is essential for a well-informed green transition in the region. In April 2022, the Colombian government published the region's first green taxonomy, which seeks to help identify projects with environmental objectives, develop capital markets, and promote effective mobilisation of private and public resources (OECD et al., 2022[17]). In June 2023, the UN system in LAC also launched the first Common Framework of Sustainable Finance Taxonomies through the Working Group on Taxonomies of Sustainable Finance in Latin America and the Caribbean.[5] This regional framework is intended as a voluntary guidance document for actors in the region that are in the process of developing or intend to develop taxonomies.

The framework also provides guidance for interoperability of taxonomies within LAC and globally (UNEP, 2023[94]). Harmonising the methodologies behind the different taxonomies will increase trust among investors and reduce transaction costs.

To maintain market transparency and avoid greenwashing/SDG-washing, it is 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 still has a long way to go (EU-LAC Foundation, 2020[114]; Núñez, Velloso and Da Silva, 2022[106]). External reviews, i.e. pre-issuance reviews and/or post-issuance reviews, must be installed and enhanced (Table 4.1). To date, the absence of internationally recognised credit ratings attached to emerging market green bonds has limited investment opportunities. The challenge pertains to assessing the creditworthiness of bond issuers in the region. However, since 2021, a growing proportion of issuers from emerging economies have secured credit ratings from at least one major credit rating agency. In 2021, of all the green bonds issued by emerging economies worldwide, 14% received an investment-grade rating, while another 9% were rated as non-investment grade. The remaining bonds were not rated at all, and a minor percentage were withdrawn. The lower percentage of internationally rated bonds in 2021 compared with 2020 is a result of the overall higher issuance in the People's Republic of China (hereafter "China"), where many issuers have relied on local credit ratings (Amundi and IFC, 2021[115]).

With green, social and sustainable projects, issuers should develop an initial methodological framework that establishes clear and measurable objectives for external verification and monitoring. In the case of SLBs, KPIs and SPTs should be public, clear and measurable from the beginning and include signals for improved performance. The benefit of developing and strengthening these mechanisms is twofold. First, greater transparency avoids green-/SDG-washing. Greenwashing can occur, for instance, when the definition of a green bond implies that resources are somehow linked to an investment in sustainability projects (water, electricity, solar panels, etc.) but the yield on the bond is not linked to indicators that effectively measure improvements in the issuer's environmental impacts. Second, reinforcement of verification and monitoring promotes the harmonisation of taxonomies and impact reporting practices.

Table 4.1. **External reviews for GSSS bond issuance**

	Mechanism
Pre-issuance reviews	Second-party opinion (SOP): An institution with environmental, social, or sustainability expertise that is independent of the issuer and provides an opinion about the framework. Verification: An issuer can obtain independent verification against a designated set of criteria. Certification: An issuer can have its GSSS framework certified against a recognised external GSSS standard or label. GSSS scoring/rating: An issuer can have its GSSS bond framework evaluated or assessed by third parties, such as specialised research providers of rating agencies, according to an established scoring/rating methodology (ICMA, 2021[116]).
Post-issuance reviews	Second- or third-party assurance report: This provides assurance of the allocation of proceeds to eligible GSSS projects. Impact reporting: This seeks to quantify numerically the environmental, social or sustainable impacts of a project/asset. With GSS bonds, the impact report can detail whether the proceeds are being used effectively to meet the GSS objectives set out at the start of the project. With SLBs, the report can measure performance against KPIs and STIs set at the time of issuance.

Source: Authors' elaboration based on (CBI, 2023[117]).

Key policy messages

Public institutions play a fundamental role in enhancing the impacts of investments on the well-being of LAC citizens. This involves creating attractive and predictable conditions for investments to flow (Chapter 2). It also involves developing investment and production transformation strategies that reflect broad agreement among stakeholders, are connected to the broader development strategy of each country, and are ultimately an essential part of a renewed social contract in the region.

The investments required for the region's development agenda will need to come from both public and private sources. In addition to improvements in fiscal frameworks (Chapter 1), two areas are particularly promising. First, strengthening national and subnational DFIs can support access to finance, particularly for MSMEs, and drive investments in key sectors. Second, the development of capital markets in the region is essential. Potential is increasing for innovative financial tools such as GSSS bonds, which can promote public and private investment with the support of more consolidated and harmonised sustainable finance frameworks. Box 4.5 presents the key policy messages for achieving the objectives described throughout this chapter.

Box 4.5. **Key policy messages**

Towards inclusive dialogue to build consensus around investment and production transformation strategies

- Promote spaces for citizen participation, following the OECD Guidelines for Citizen Participation Processes. Public consultations, participatory budgeting and representative deliberative processes are relevant methods to foster citizen participation.
- Strengthen the social and environmental impact assessments of investment projects with relevant citizen participation.
- Develop transparent and clear redistributive measures to support socio-economic groups, territories and communities that may be negatively affected by investment projects.
- Support the adoption of the OECD Responsible Business Conduct Guidelines, strengthening the role of National Contact Points as relevant instances to mediate and resolve conflicts that may arise among private-sector companies, civil society and governments.
- Empower local governments to boost inclusive citizen participation in investment and production decisions, involving vulnerable groups, collaborating with local institutions and using tools to foster innovation, prevent conflicts and ensure sustainable investments.
- Enhance open government policies and strengthen the role of Centres of Government to provide transparency at every stage of the investment process, including transparency tools (e.g. clear registration information; access to amendments; consistent regulations; interactive project platforms; and disclosure of the origins of private funds).

Towards whole-of-government investment and production transformation efforts

- Ensure effective implementation of national development plans (NDPs), deepening the focus on long-term strategic planning and ensuring policy continuity beyond political cycles. Sector-specific strategies should be well connected to broader development strategies.
- Define the budget allocation for each priority in NDPs to ensure effective implementation.

Box 4.5. **Key policy messages** *(cont.)*

- Strengthen national public investment systems via greater aligment with NDPs; mechanisms for efficient co-ordination and decision making across stakeholders; transparent procedures for prioritisation, implementation and evaluation of impactful projects; and clear linkages with annual and medium-term budgeting processes to ensure financial viability.
- Enhance policy co-ordination and multi-level governance and create a map of main stakeholders in the investment arena and their channels of communication to help identify potential gaps and improve the distribution of responsibilities.

Towards financing the production transformation and mobilising investments for strategic sectors

- To increase private investment, especially by MSMEs, public DFIs in the region can:
  - Expand and evaluate further the supply of financial instruments that incentivise innovative and long-term investment by the private sector. These instruments are aimed at financing key aspects including working capital, sustainable investment, foreign trade, and climate emergencies.
  - Advance efforts to develop instruments that answer the specific needs and singularities of key production sectors within the framework of a well-defined national development strategy.
  - Invest in capacity building in niche sectors to provide improved sector-specific financial, digital and technical services, enabling MSMEs to meet their financial requirements.
- To address the finance gap faced by MSMEs by scaling up financial instruments that have sustainable, gender-sensitive and digital objectives, DFIs can establish specific programmes for project preparation and for technical support during project implementation.
- To boost public investment, DFIs can increase their offer in technical and digital services by creating partnerships with state secretariats, ministries and municipalities, and improve capacity-building for these entities.
- To promote capital market instruments that support investments in key development areas, countries in the region can:
  - Support the expansion and attractiveness of venture capital funds to finance start-ups. Continue efforts to create a more favourable business growth environment (e.g. by crafting legal frameworks that enhance investment in technology-based businesses).
  - Support the expansion and adjustment of SLBs, redirecting capital flows towards projects that promote climate-change mitigation and adaptation while strengthening the social and sustainable dimensions.
  - Enhance sustainable financing frameworks for GSSS bonds and foster co-ordination and harmonisation across countries. It is crucial to consolidate reliable monitoring and verification systems to maintain market transparency and avoid green-/SDG-washing. Pre- and post-issuance external reviews must be established and enhanced.

Notes

1. The word "institutions" in this chapter refers to government agencies or public agencies.
2. "DFIs" in this document will always refer only to national and subnational public development finance institutions.
3. The 38 national and subnational DFIs are the following. From Argentina: Banco de Inversión y Comercio Exterior S.A. (BICE); Banco de La Pampa; Banco de la Provincia de Buenos Aires

(BAPRO); Banco de la Nación Argentina; Fondo de Garantías Buenos Aires – FOGABA. From Brazil: Banco de Desenvolvimento de Minas Gerais S.A. (BDMG); Banco do Nordeste do Brasil S.A. (BNB); Banco Nacional de Desenvolvimento Econômico e Social (BNDES); Banco Regional de Desenvolvimento do Extremo Sul (BRDE); Agência de Fomento do Estado de São Paulo S.A. (Desenvolve SP). From Chile: Instituto Nacional de Desarrollo Agropecuario (INDAP); Corporación de Fomento de la Producción (CORFO). From Colombia: Fondo para el Financiamiento del Sector Agropecuario (FINAGRO); Banco de Comercio Exterior de Colombia (Bancoldex); Instituto Financiero para el Desarrollo del Valle del Cauca (Infivalle); Instituto para el Desarrollo de Antioquía (IDEA). From Costa Rica: Banco Nacional de Costa Rica; Banco Popular y de Desarrollo Comunal. From the Dominican Republic: Banco Nacional de las Exportaciones (BANDEX); Banco de Reservas de la República Dominicana (BR). From Ecuador: Banco de Desarrollo del Ecuador B.P. (BdE); BanEcuador B.P.; Corporación Financiera Nacional B.P. (CFN); Corporación Nacional de Finanzas Populares y Solidarias (CONAFIPS). From El Salvador: Banco de Desarrollo de El Salvador (BANDESAL); Federación de Cajas de Crédito y de Bancos de los Trabajadores (FEDECRÉDITO); Banco de Fomento Agropecuario (BFA). From Guatemala: Banco de Desarrollo Rural S.A. (BANRURAL). From Mexico: Banco del Bienestar; Banco Nacional de Obras y Servicios Públicos S.N.C. (BANOBRAS); Sociedad Hipotecaria Federal S.N.C. (SHF); Fideicomisos Instituidos en Relación con la Agricultura (FIRA) – Banco de México; Nacional Financiera S.N.C. (NAFIN); Banco Nacional de Comercio Exterior S.N.C. (BANCOMEXT). From Panama: Caja de Ahorros. From Paraguay: Agencia Financiera de Desarrollo; Banco Nacional de Fomento (BNF); Crédito Agrícola de Habilitación (CAH). From Peru: Corporación Financiera de Desarrollo S.A. (COFIDE); Banco de la Nación, Banco Agropecuario – Agrobanco. From Uruguay: Banco de la República Oriental del Uruguay (BROU).

4. The Helsinki Principles (agreed upon in 2019) are the shared principles of the Coalition of Finance Ministers for Climate Action, which is comprised of members from more than 80 governments and is supported by 25 institutional partners. These principles are aspirational and serve to give a common purpose to member countries, which are committed to taking collective and domestic action on climate change and achieving the Paris Agreement's objectives.
5. The Working Group on Sustainable Finance Taxonomies in Latin America and the Caribbean is comprised of the United Nations Environment Programme (UNEP), the World Bank Group, the United Nations Development Programme (UNDP), the Economic Commission for Latin America and the Caribbean (ECLAC), the Inter-American Development Bank (IDB), the Development Bank of Latin America (CAF), and the Food and Agriculture Organization of the United Nations (FAO).

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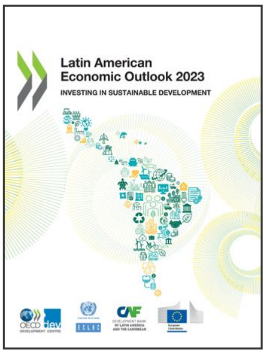

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