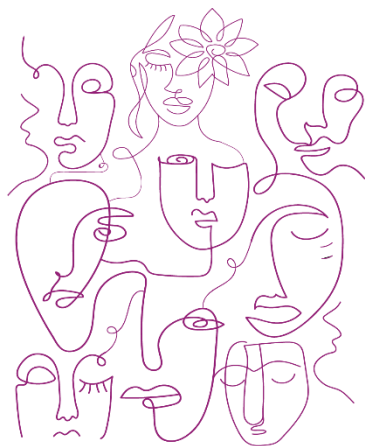


KEY ISSUES PAPER

02.10.2024



Latin America and the Caribbean
**3rd OECD MINISTERIAL
SUMMIT ON
SOCIAL INCLUSION**
Bogotá - Colombia 2024

Productive Inclusion Revisited

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Background paper: *Forthcoming*

Key issues

Latin America and the Caribbean (LAC) is a region of enormous contrasts, where wealth and prosperity coexist with pockets of extreme poverty and vulnerability. LAC countries have lifted millions out of poverty in recent decades, but progress towards combating inequality has been less successful. In the two decades running up to the COVID-19 pandemic, most countries in the region made significant progress in reducing income inequality. However, these modest gains have fallen short in addressing the region's vast inequality challenges, and progress has stalled in recent years. As a result, LAC still remains one of the most unequal regions in the world by international comparisons.

Economic inequality frequently acts as a catalyst for social disparities, as income gaps impede access to essential resources and services. Consistent with this, inequality in LAC is characterised by the lack of social and economic cohesion among population groups. Additionally, the LAC region not only has the world's highest levels of income inequality, but also provides very unequal opportunities to move up the social ladder. Households in the middle of the income distribution have limited access to educational services, both in terms of quantity and quality, compared to their middle-income counterparts in OECD countries and affluent households within the region. These limited opportunities for access to quality education, based on socio-economic background, perpetuate existing inequalities in the region, hindering individuals from achieving social mobility—whether by improving their socio-economic status within their own lifetime (intra-generational) or in comparison to their parents (intergenerational). Consequently, many individuals from low socio-economic backgrounds are unable to acquire the necessary skills to successfully integrate into the workforce.

Although educational attainment has improved considerably in Latin America and the Caribbean, particularly at the primary level where coverage is almost universal (97.1%, similar to that of 98.9% for OECD member countries), significant challenges in access still persist at the secondary and tertiary levels. Education completion rates and academic achievement levels remain low for children in LAC countries, especially those from lower socio-economic backgrounds.

School dropout is a major issue in the region, disproportionately affecting students nearing the end of their schooling and those at the lower end of the income distribution. On average, 35% of young people between 21 and 23 years old have not completed secondary school. Additionally, in Latin America and the Caribbean, the gross tertiary completion rate is only 25.1%, placing the region 15 p.p. below the OECD average (40%), and below the global average (30.8%). The region's low completion rates at this level contribute to a general shortage of high-skilled workers, which hampers enterprises and overall productivity. On an individual level, this leads to a significant income disparity between those with and without tertiary education, restricting the latter group to lower-quality and lower-paying jobs.

Beyond educational attainment, the region's youth also have low levels of foundational learning: in reading and science, more than half of the region's 15-year-olds do not meet the minimum level of competencies (level 2), and for mathematics, the percentage rises to 75% (PISA 2022). Further, PISA highlighted significant socio-economic disparities within countries in Latin America and the Caribbean, exceeding the OECD average. Despite these disparities and their impact on performance, the average scores of socio-economically advantaged students in the region remain below those in the OECD, and even fall short compared to socio-economically disadvantaged students in OECD countries. These findings may reflect a broader issue of insufficient quality in the region's education system, undermining its potential to drive productivity and social mobility.

Poor educational attainment and learning outcomes frequently result in significant challenges and disadvantages for individuals as they transition into adulthood, impacting their opportunities, job prospects, and socio-economic status. The OECD's Survey of Adult Skills (PIAAC) evaluates individuals' proficiency in literacy, numeracy, and problem-solving to assess their capabilities beyond formal education and their readiness for the workforce and societal participation. In its first cycle, the survey included Chile, Ecuador, Mexico, and Peru, revealing several important trends for the region. A higher percentage of adults in these countries scored at the lowest performance levels compared to the OECD average, demonstrating the need to improve student competencies in the educational system to perform adequately in adult life.

Additionally, in LAC, the level of skills is more closely related to the quality of jobs people have rather than the number of jobs available. This underscores the intergenerational transmission of educational and socio-economic status, where socially advantaged individuals are more likely to attain higher education, gain better skills, and secure superior jobs. In contrast, those with lower educational attainment and skills often face low-quality, informal sector jobs, affecting two-thirds of households in the region. This situation increases their risk of poverty and income shocks, hindering their ability to advance educationally and improve their socio-economic status.

To address these issues, the region could increase its investment in education, as all the countries assessed have cumulative spending levels below \$75,000—the threshold where higher PISA performance correlates with increased spending. Additionally, some countries at similar spending levels significantly outperform Latin America and the Caribbean, suggesting that reallocating existing educational resources could also be beneficial.

A high-quality education system that nurtures and promotes skills and a highly adaptable workforce is pivotal for Latin America and the Caribbean's inclusive growth and development. Currently, the region's workers and students underperform in terms of skills and proficiency when compared to OECD countries, limiting its potential growth. In this regard, other countries' experiences, such as Korea and Singapore, become extremely relevant. In the second half of last century, these countries' governments invested heavily in education, promoting inclusive growth by equipping younger generations with the necessary skills to enhance their socio-economic status and, at the aggregate level, transform their economies.

In summary, as both PISA and PIAAC reveal that Latin America and the Caribbean's education systems are not successfully providing the necessary skills for today's fast paced economy, policies that transform the current education landscape are required. To be effective in increasing upward social mobility, education policies must build equity considerations into their design from the outset. To adapt the current and future workforce, it is crucial to increase and improve spending on high-quality, accessible education for all socio-economic backgrounds. This approach will help boost productivity, expand the pool of skilled workers, alleviate constraints on enterprises, transform the economy, and achieve inclusive growth.

Questions for discussion

- Social mobility in Latin America and the Caribbean (LAC) is low, and social inequalities remain high. Education is key in addressing these issues, but the quality of education in the region is lacking. This is reflected in poor PISA results, high school dropout rates, and low participation in tertiary education compared to OECD countries: ***How can policymakers enhance education quality and reduce dropout rates through targeted reforms that address the underlying causes of these challenges?***
- The [Survey of Adult Skills \(PIAAC\)](#) provides information on the key skills and competencies of adults (aged 16 to 65) across different countries, with the goal of understanding how these skills impact individuals' ability to participate in society and succeed in the labor market. ***How could Latin***

American countries benefit from having information on the skills of their youth and adult populations? Would the region benefit from a regional skills survey in collaboration with international organizations and various stakeholders?

- Skills development through vocational education, adult training, and on-the-job training can help a diverse group of young and adult learners in Latin America enhance their skills and fully capitalize on job market opportunities. ***What types of regional collaboration and knowledge exchange currently occur between Latin American countries in the area of skills development? What would be the main benefits of increasing collaboration, and how could countries benefit from a unified regional skills strategy***
- Career choices and educational pathways of young Latin Americans are heavily influenced by their socioeconomic status and gender. Women, in particular, tend to choose traditionally feminine careers and often avoid STEM fields (science, technology, engineering, and mathematics), which are typically higher-paying: ***What types of interventions do you think would be most effective in supporting both low-income students and young women in pursuing careers that foster their professional development?***

Background paper: *Forthcoming*

Key issues

Social and productive inclusion implies that all types of people and firms have access to economic opportunities and a better quality of life in all places. However, in Latin America and the Caribbean, divides between urban and rural areas are particularly stark compared to the OECD overall, and disparities within large metropolitan areas are also high. For example, in Chile and Mexico, the gap between the region with the highest and lowest poverty rate was over 50 percentage points, compared to an OECD average inter-regional gap of 18. These comparisons are also mirrored in the very high levels of informal activity in Latin America and the Caribbean, which are significantly above the OECD average, and which weigh down on the public and private investment that can boost productivity and social inclusion. Countries in the region are therefore looking at new approaches to tackle these inequalities, and in particular the role that actors in the social and solidarity economy can play, especially concerning informality.

Across the globe, the social and solidarity economy is increasingly recognised as a tool for job creation, labour-market inclusion, and people-centred local development. It includes co-operatives, associations, mutual societies, social enterprises, and other forms of solidarity and self-help groupings, and shares similarities with concepts widely used in Latin America and the Caribbean, such as the “popular”, “grassroots” or “solidarity” economy. In many countries it plays a significant role. For instance, in Colombia, the solidarity economy directly contributes approximately 4% to GDP, while in Mexico, the social economy accounts for 3.2% of overall employment. By design, the target actions for the social and solidarity economy typically focus on groups and regions that are most vulnerable and/or most likely to be excluded from the labour market and have difficulties accessing essential services. These typically include women, youth and migrants, whether that be in rural remote areas or major cities.

While agricultural co-operatives have existed for many years, new innovative models of the social economy such as platform co-operatives and social enterprises have arisen. They help address new social and environmental challenges, including around informality, where many vulnerable groups engage by necessity rather than choice. But most countries are not tapping into the full potential of these actors, including as pioneers of innovations on sustainability, inclusivity, and social impact, in line with a broader trend towards responsible business practices.

Many countries in the region have started to put in place public bodies, laws or strategies to support the social and solidarity economy. In some cases this is done in conjunction with the “grassroots” economy, as many of their activities also involve mutual aid and community engagement. In Brazil, there is the National Secretariat for the Popular and Solidarity Economy (*Secretaria Nacional de Economia Popular e Solidária* – SENAES/MTE) within the Ministry of Labour and Employment. The 2022-2026 National Development Plan in Colombia recognizes the significant role of the social and solidarity economy in local development and the opportunities of working with popular economy organisations and initiatives. Many countries have given legal recognition to the sector’s different forms, such as Uruguay’s Law on the Social and Solidarity Economy. Many countries also have institutes for promoting it, such as the National Institute for Associativism and the Social Economy (*Instituto Nacional de Asociativismo y Economía Social* – INAES) in Argentina, the National Institute for Associativism and Cooperativism (*Instituto Nacional de Asociatividad y Cooperativismo* – INAC) in Chile, the National Institute for the Popular and Solidarity Economy (*Instituto Nacional de Economía Popular y Solidaria* – IEPS) in Ecuador, and the National Institute for the Social Economy (*Instituto Nacional de la Economía Social* – INAES) in Mexico, among others.

However, the social and solidarity economy, or its constituents, are not always recognised within countries, which can hold them back, including on accessing finance. There are opportunities for governments at national, regional and local level to do more. Legal recognition is one such area, and there are many others. For example, the social and solidarity economy can be a partner to public employment services, not just as an employer, but also in providing training, advice and support to disadvantaged groups and firms (informal and formal). It can also support transitions from informal to formal jobs, including through collective entrepreneurship. Tax incentives to promote formalisation of micro and small business, if not coupled with business development services, are less likely to achieve sustainable formalisation. There is also an opportunity for them to be a partner in local development and promote social innovation, which can be in public services but also the sustainable use of land and public space, transport, natural resources, and other local amenities.

A number of different framework conditions and policy actions can be used to promote and strengthen the social and solidarity economy and its capacity to partner directly with the public and private sector. These framework conditions and policy actions are outlined in the [OECD Recommendation on the Social and Solidarity Economy and Social Innovation](#), which covers public awareness and data on these entities, institutional recognition, legal and regulatory frameworks, access to finance and procurement, skills and business support, and impact measurement, for example.

Questions for discussion

- *One of the challenges for working with the social and solidarity economy or “grassroots” economy is the fact that these entities may not have a formal legal status or a status that is not well understood by the public sector or the general public. Recognising this economy opens new opportunities to support the populations that work in grassroots entities in many of the region’s peripheral urban and rural areas. **What are your country’s strategies to formally recognise the social and solidarity economy and/or “grassroots” economy?***
- *The public sector can partner with the social and solidarity economy in many ways, from helping to implement employment services to addressing physical infrastructure gaps in disadvantaged communities. **What are the ways your country is partnering with the social and solidarity economy and/or “grassroots” economy to address social inclusion in policy areas such as employment, environment and access to local services?***
- *The social and solidarity economy is reaching far beyond the traditional agricultural co-operatives to promote innovative new business models (such as platform co-operatives), contribute to a circular economy, or boost productivity through collective entrepreneurship. **What opportunities is your country seizing with the social and solidarity and/or “grassroots” economy to promote a fairer digital and green transition in all communities?***
- *The [OECD Recommendation on the Social and Solidarity Economy and Social Innovation](#) outlines a range of framework conditions to develop the social and solidarity economy from awareness raising and data to legal frameworks and access to finance. It also highlights the importance of these entities for social innovation. **In what areas would future OECD guidance for the Recommendation be the most helpful for Latin America and the Caribbean?***

INVESTING IN SOCIAL PROTECTION: ENHANCING FORMALISATION AND ACHIEVING UNIVERSAL COVERAGE

Background paper: [Towards better social protection for more workers in Latin America : Challenges and policy considerations](#)

Key issues

Informality is long-standing structural challenge of Latin American labour markets and remains part of the daily lives of many workers in the LAC region. Almost half of people in the region live in a household that depends solely on informal employment. Informality is often both the cause and consequence of low income levels.

As social protection benefits are often tied to paying contributions and being in formal-sector employment, vulnerable households with informal labour incomes often have little or no social protection mechanism to fall on. The conditions associated with informal work leave informal workers, which typically have lower incomes than formal workers, highly vulnerable to monetary poverty in the face of unemployment or old age, often imply a lack of health care coverage, and the lack of workplace regulations leaves them at higher risk of occupational and safety hazards. Recently, the COVID-19 crisis has further highlighted the great and long-standing vulnerability of informal workers. The need to reform social protection systems across Latin America to make them more effective and fiscally sustainable has become more salient following the COVID pandemic.

Besides its social consequences, widespread informal employment also implies that many firms remain entirely in the informal sector, which in turn has implications for productivity. Productivity levels of informal economic units, often of small size, are a major concern in the region. Firms employing informal workers often stay small as they try to remain below the radar of tax authorities to avoid taxes, including the higher cost of formal labour, but also regulations. A generalised lack of access to credit for informal activities further diminishes their growth prospects. Informal firms typically underinvest into the skills of their workers, given that they are often on less stable contracts and suffer high job turnover.

Labour informality has many roots and causes, including low access to high-quality education and training, low levels of productivity, and a weak institutional framework and enforcement. But beyond these, the design of the social protection system is also a key factor, and one that may deserve more attention than it has received. Labour informality and social protection coverage may be interlinked, as high social contributions can be a key barrier to formal job creation in the region. Redesigning social protection in a way that takes full account of the incentives generated by social contributions has the potential for much more visible progress in formalization, given that these contributions are a core element of the cost differential between creating a formal job and an informal job.

One policy option with significant potential to reduce labour informality, raise productivity, and decrease poverty and inequality, would be to reform social protection systems to ensure some basic social protection coverage for all, regardless of whether they work in the formal or informal sector, while simultaneously reducing the cost of formal employment. This could be achieved through a stronger focus on non-contributory social protection benefits, which should be fully integrated into the main social protection system, and constitute one of their main pillars, to overcome the current fragmentation of social protection in the region. Labour informality is so widespread in Latin America that continuing to tie transfer benefits to formal labour market participation, the salient characteristic of most social protection benefits across Latin America, may risk leaving behind too many of those in need. At the same time, history has shown that countries will not simply grow their way out of informality, which can be part of a vicious circle. Even those Latin American countries with a strong growth trajectory or those with higher per-capita incomes still have significant levels of informality.

Finding the necessary political consensus for a significant redesign of social protection in the region will face challenges, and these will differ from country to country. One of these relates to the tax system. With few exceptions, Latin American economies are characterised by comparatively low tax revenues, potentially imposing limits on the financing of social protection unless new revenue sources can be mobilised. Implementing this approach would imply that a part of basic social protection would need to be financed by general tax revenues, rather than by social security contributions.

Existing contributory social protection schemes could complement this basic pillar for those with a stronger capacity to contribute. Such a two-pillar setup would imply a significant re-design of social protection systems in many countries in the region, although some countries have significantly strengthened the role of non-contributory benefits in the recent past. The success of such strategies will hinge on countries' capacity to identify fiscal space for enhancing non-contributory benefits, either by raising additional tax revenues or reducing expenditures in other areas, including those with regressive distributional impacts. Reforming social protection systems will not be easy, but these reforms can provide the basis for both stronger and more inclusive growth in Latin America.

Questions for discussion

- *Informality is a complex issue that has many causes. Despite a broad and interesting literature on the issue, our understanding of this widespread social phenomenon remains imperfectly understood. **What are the main drivers of large informal sectors in LAC economies?***
- *Many Latin American countries have high social security contributions, which add to the costs of creating formal jobs. At the same time, many workers have low skills levels, and the capacity of their employers to pay contributions is limited, particularly when they are small enterprises with low productivity levels. **How strong is the link between high non-wage labour costs and informal work?***
- *Many countries have recognised the limits of tying social security benefits to participation in the formal labour market, which is often out of reach for many workers. Non-contributory social protection schemes have become more widespread in the region, but they often remain a parallel and separate benefit system that is not integrated with contributory social security schemes. **Has your country implemented reforms or innovative strategies to increase access to social protection for vulnerable population beyond labour formalisation schemes?***
- *Fiscal space is often limited in the region, and efforts to mobilise additional tax resources have proven difficult. Yet, reducing labour tax wedge by lowering social security contributions for formal workers will require financing a larger part of social protection through general tax revenues. **What are the prospects for identifying fiscal space for enhancing the role of non-contributory benefits in basic social protection for low-wage earners?***