APRIL 2026

Latin America & the Caribbean Economic Update

Revisiting Industrial Policy: Strategic Options for Today

The Office of the Chief Economist of the Latin America and the Caribbean Region

WORLD BANK GROUP

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The cutoff date for the growth projections for the LAC region and its countries used in this report is April 6, 2026.

Executive Summary

Revisiting Industrial Policy: Strategic Options for Today

Latin America and the Caribbean (LAC) enters 2026 with growth still constrained by long-standing structural challenges. Regional GDP growth is projected to reach 2.1 percent in 2026—slightly below the 2.4 percent recorded in 2025—leaving LAC once again one of the slowest-growing regions in the world, with GDP per capita barely growing. The lack of improvement comes with downward revisions in some country projections and reflects a familiar mix of demand: private consumption remains the main driver, while investment stays subdued amid elevated global and domestic uncertainty and still-restrictive real (inflation-adjusted) financing conditions. Progress against inflation continues, albeit more slowly than expected.

The changing global environment presents new risks and opportunities. Though uncertainty surrounds the rules of the international trade order, tariffs on the region have risen less than expected, the potential remains for alignment with hemispheric production hubs, and the energy transition amplifies the region's potential role in clean-technology value chains, given LAC's comparatively clean power mix and deep endowments of critical minerals. Realizing these upside opportunities requires complementary domestic reforms that reduce policy uncertainty, close gaps in infrastructure and human capital, and strengthen institutions so that private capital can respond when global uncertainty recedes. These upside prospects coexist with downside risks, notably from renewed conflict in the Middle East, where energy-price volatility could delay disinflation and weigh on growth.

Chapter 1 reviews the region's recent macroeconomic and social evolution and the near-term challenges it faces as inflation approaches its "last mile," growth remains subdued, and fiscal space stays tight under high interest bills. Chapter 2 examines the reemergence of industrial policies that countries are experimenting with to instill more dynamism in their economies and create better jobs.

Chapter 1. The State of the LAC Region

Growth Remains Subdued, while Country Paths Diverge

LAC's growth outlook for 2026 remains constrained despite slightly easier global financing conditions and still supportive commodity prices. The lack of improvement over 2025 conceals weaker prospects for many economies and implies essentially flat income gains per person. Consumption continues to lead, but its impulse is modest as real incomes recover gradually and real borrowing costs stay elevated. The binding constraint is investment, which remains subdued as firms wait for clearer signals on the external environment and domestic policy frameworks. Argentina has emerged as the main upside exception, as stabilization and reforms have improved expectations and financial conditions.

Beyond Argentina, pockets of dynamism persist among smaller LAC economies. Paraguay continues to outperform the regional average, supported by strong agricultural exports, expanding electricity generation, and a stable macro framework.

In Central America, countries such as Costa Rica, El Salvador, Guatemala, and Honduras maintain comparatively robust growth, underpinned by flows of remittances, exports of services, and deeper integration into regional value chains. In El Salvador, improvements in the security environment have coincided with stronger activity in tourism, retail, and investment in tradable sectors, as well as robust remittance inflows that have boosted domestic liquidity, easing some long-standing constraints on economic activity.

By contrast, Brazil and Mexico face slower momentum amid tight domestic financial conditions, limited fiscal space, and trade policy uncertainty. Chile and Peru show more moderate growth, supported by investment in mining and infrastructure, alongside gradually improving domestic conditions. In the Caribbean, the oil-driven expansion of Guyana—and soon Suriname, and to a lesser degree Trinidad and Tobago—is widening divergence relative to economies that depend heavily on tourism. Jamaica is recovering from a devastating hurricane, while Haiti's prospects depend critically on the success of new security initiatives.

External Headwinds Were Moderating, Amid Rising Uncertainty

Global conditions were becoming somewhat more supportive than in mid-2025, but global uncertainty is again increasing. The U.S. Federal Reserve initiated easing in late 2025 and then paused at 3.50 percent–3.75 percent in January 2026, while other major central banks have moved cautiously, leaving global rates higher for longer than previously anticipated. In addition, heightened energy-price volatility linked to the conflict in the Middle East could delay disinflation and weigh on growth.

Growth in advanced economies is subdued, China's expansion is moderating, and the baseline is for broad moderation in non-energy commodity prices through 2026, with oil & gas unpredictable at this point. News-based measures of trade policy uncertainty have declined from their April 2025 spike but remain above the levels that prevailed before 2024. LAC export volumes have shown resilience, reflecting both lower effective tariffs after exceptions, and higher tariffs on Asian competitors. However, firms continue to approach cross-border investment and supply chain commitments cautiously in the face of policy uncertainty and weaker external demand in some markets.

Inflation Moderated, but Central Banks Remain Cautious

After a forceful disinflation episode that began in 2022, the pace of inflation reduction has slowed as core inflation—especially in services—has proved persistent. Most LAC economies are expected to bring inflation back within, or close to, targets by 2026–27, but the "last mile" has become harder as wage-price dynamics and indexation keep services inflation sticky. External conditions are mixed: a softer U.S. dollar has eased exchange rate pass-through somewhat, but global monetary policy easing has progressed gradually and risk appetite has remained selective, leaving real financing conditions still tight. Against this backdrop, most central banks are easing only cautiously, while Colombia's central bank had to make an upward adjustment. More recently, conflict in the Middle East has heightened energy-price volatility, with prices moving up. While the inflationary impact has so far been contained, pressures on energy and transport costs add risks to the disinflation path—particularly for services prices and fuel-importing economies.

High Rates, Tight Space: Can Fiscal Policy Rise to the Challenge?

Fiscal deficits remain stubborn across much of the region, even where primary balances have improved, because high interest payments continue to weigh on overall outcomes and compress space for priority spending. Public debt ratios have stabilized after the run-up following the COVID-19 pandemic but remain high by historical standards, and a return to the lower levels prevailing before 2020 is unlikely without stronger potential growth and additional fiscal consolidation. The composition of spending is a central constraint: rigid current expenditures tend to crowd out public investment during downturns and periods of tighter financing, undermining long-term growth. On the revenue

side, the case for a tax mix that is more compatible with growth remains strong. With borrowing costs still elevated and widely dispersed across countries, credible fiscal frameworks—including well-designed fiscal rules with clear debt anchors, escape clauses, and independent oversight—can help improve debt market pricing and protect investment.

Labor Markets, Informality, Poverty, and Inequality

Labor market dynamics play a central role in shaping social outcomes in LAC. Persistent informality—closely associated with low education, self-employment, and microenterprise activity—continues to limit workers' access to sustained productivity gains and formal wage growth, reinforcing the sensitivity of poverty reduction to economic slowdowns. Importantly, high levels of informality reflect not only regulatory and institutional constraints but also the weak returns to formal salaried employment many low-skilled workers face.

At the same time, widespread informality and income volatility complicate the measurement of inequality: income-based indicators tend to overstate long-term disparities in welfare relative to consumption-based measures. Together, these features highlight how labor market structure, limited opportunities for productive formal employment, and measurement challenges interact to constrain social mobility and slow progress on poverty and inequality—underscoring the importance of productivity-enhancing growth, better jobs, and stronger institutions for achieving durable social gains.

Trade Agreements, Market Access, and Diversification: Lessons for LAC

International trade remains a key channel through which LAC economies can expand market access, reduce concentration risks, and support diversification. Evidence in chapter 1 shows that countries' trade outcomes differ not only in how open they are but in how they integrate: the breadth of markets they can access, the purchasing power of their partners, and the degree to which their export structures align with global value chains. These differences are closely linked to the architecture of trade agreement frameworks, which shape both the depth of integration within blocs and the flexibility countries retain to reach outward.

More centralized frameworks—such as customs unions—can foster deep internal integration, production linkages, and policy coordination, while involving trade-offs in members' flexibility to pursue preferential agreements beyond the bloc. By contrast, more flexible arrangements allow countries to build broader and more diversified networks of partners, facilitating access to large, high-income markets—and, in some cases, stronger participation in global value chains. In an environment of elevated trade policy uncertainty, the credibility of these frameworks matters for investment decisions: pathways that expand or clarify market access—such as the EU–MERCOSUR Partnership Agreement—or reduce uncertainty around key relationships play an increasingly important role in shaping firms' expectations.

For LAC, the payoff from trade agreements depends less on their sheer number than on how effectively they expand access to large, complementary markets and are translated into actual use by firms. Market access alone is not sufficient: gains hinge on reducing barriers behind the border and strengthening domestic enabling conditions—such as infrastructure, regulatory certainty, and skills—that allow firms to scale, diversify, and upgrade. Importantly, the appropriate trade policy strategy is shaped by institutional constraints: different agreement architectures imply different degrees of autonomy and coordination, and thus different pathways to deeper integration. In this sense, trade policy remains a critical lever for improving resilience and long-term growth prospects, even as near-term global conditions remain challenging.

Chapter 2. Revisiting Industrial Policy: Strategic Options for Today

Stagnation in economic growth and persistent difficulties in creating high-quality jobs have moved industrial policy—the range of policies expected to increase a strategic business activity—back to the center of the policy debate in much of the developing world. In LAC, growth policy has tended toward being noninterventionist for the last 50 years—and with good reason. The protectionist policies of the import substitution industrialization (ISI) era led to nondynamic industries and macroeconomic instability. These disappointing outcomes, together with a growing appreciation of more market-friendly economic theory throughout the region, and the generally superior performance of more market-friendly policies, led to a discrediting of industrial policy, and a general feeling that government failure would be worse than the market failures that industrial policy was meant to redress.

Renewed Global Interest in Industrial Policies

However, industrial policy is being reconsidered worldwide. Frustration with low growth rates in LAC and many other developing countries has led to a questioning of the minimalist role of the state in growth policy. Further, there is concern about how to prepare to best leverage the new opportunities raised by the energy transition and shifts in the global economic order.

An emerging academic literature has provided some solidly grounded evidence of the success of government interventions targeted at specific sectors in the Asian miracle economies, while successive administrations in the free market bellwether economy, the United States, have engaged in large-scale infant industry interventions in green energy and chip making and more recently in protective tariff policy. Over the last 15 years, Argentina and Brazil have engaged in substantial efforts to promote certain industries, while Colombia and Mexico have been augmenting the number of trade-related protective measures.

To offer a fresh look at the tools governments might deploy to increase growth and create jobs, the World Bank recently published *Industrial Policy for Development: Approaches in the 21st Century.* Acknowledging that each intervention carries risk as well as rewards, and that success is highly dependent on the capacity of the state, its fiscal space, and market size, the volume offers guidance to countries on what interventions might be worth embarking on, whether temporarily targeting specific sectors or supporting more horizontal policies, such as education, infrastructure, and marketing networks.

Some proponents of industrial policy have argued that it is limiting to demand that market failures be identified to justify state intervention—essentially asking why, if a particular outcome is so valuable, the market is not generating it. However, the volume follows the general consensus that identifying instances in which market allocation is inefficient—in terms of coordination failures, missing public goods, excessive market power, incomplete markets and knowledge and network externalities pertaining to particular goods, among other shortcomings—provides discipline to the discussion and helps prevent interventions that are likely to be costly failures. The report also acknowledges the risks arising from uncertainty around these failures and government's capacity to remedy them and hence argues that countries need to weigh the degree of risk they are willing to assume in pursuing particular industrial policy tools.

Industrial Policy as Learning Policy

However, LAC's history urges particular care in reapproaching industrial policies. As a recent World Bank report, *Reclaiming the Lost Century of Growth: Building Learning Economies in Latin America and the Caribbean*, argues, whatever growth-promoting qualities a good or economic structure may possess on average, its development impact in a particular context depends on a set of complementary agendas. It is precisely in these areas that LAC still lags.

This year's co-winner of the Nobel Prize in economics, Peter Howitt, has shown that similar economies can have very different high-growth or low-growth equilibria, depending on their capabilities to adopt and exploit new technologies.

LAC's history is filled with examples of low-growth equilibria. The region lost control of the historically central mining industry across the continent because of the inability to adopt the new technologies of the Second Industrial Revolution to foreigners who could. Meanwhile, Japan and the United States leveraged mining to generate diverse and dynamic industrial sectors. Further, there was clearly nothing automatic about learning by doing. In neither mining nor in the emerging industrial sectors across the twentieth century did the region develop the capabilities or institutions to assimilate emerging technologies. This remains the case today and across many sectors. Asia's manufacturing sectors continue to gain productivity and expand employment while the reverse is true in LAC. Fundamentally, *how* goods are produced matters as much as *what* is produced.

Further, LAC's overall performance has been disappointing across both interventionist and noninterventionist models. Chapter 2 decomposes growth across three eras—the ISI period, the liberal market period, and the new period of experimentation in industrial policy—and shows that in all cases, compared with the Asian economies, growth has been lower and productivity growth often minimal or negative.

Hence, while retaining an openness to the lessons emerging from Asia and academia about targeting particular sectors, chapter 2 argues that a necessary complement to any growth strategy is developing the capacity to place bets (informed but uncertain investments) across a range of new products, processes, technologies, and markets that will enhance productivity growth across the sectors the region is engaged in, identify new areas of comparative advantage, and learn from that experimentation to manage progressively more complex investments. This in turn suggests four ingredients for a successful growth strategy: (1) developing the capabilities across the spectrum of human capital and knowledge-related institutions to assimilate new technologies and identify new opportunities; (2) facilitating experimentation by firms and diffusion of risk in well-developed financial markets; (3) maximizing the benefits of integration with the global economy; and, as a prerequisite to the first three, (4) strengthening the state.

Building Capabilities

As chapter 2 shows, LAC historically has lacked critical capabilities for identifying and taking advantage of new technologies. Public primary and secondary education are below global standards. This results in a poorly trained workforce, and a much-reduced pipeline of potential entrepreneurs and technical people. Universities still graduate relatively few students in science, technology, engineering, and mathematics (STEM). LAC universities rank low globally, with few in the top 1000, and they have limited interactions with the private sector.

Further, LAC firms are not at the global frontier, and the role of the state in helping them get there is not straightforward. Whether they invest in the skills or what is termed entrepreneurial capital or technological capabilities is dependent on their incentives to do so, the cost of accumulating these capabilities, and their distance from the frontier. No protection at all may imply insufficient room to learn by doing and reach the frontier, but too much protection too long can obviate the need to learn at all. Lowering the cost of accumulating human capital—by ensuring quality basic education, providing managerial extension services, creating high-quality collaborative universities and research think tanks that support the private sector—reduces the need for sectoral incentives—and may determine whether reaching the frontier is feasible at all. Through this lens, the Asian industrial policy model offered modest short-term protection with incentives to export combined with massive state efforts to facilitate learning. By contrast, LAC's ISI period combined high and sustained protection with weak efforts on the human capital front.

Facilitating Risk Taking

Development is fundamentally a process of placing informed bets—whether adopting a new process or product will increase profits, whether investing in research and development (R&D) will make a firm or country more competitive, whether expanding into a new market will buy resilience. Engaging in any of these activities increases risks that firms face. Firms in LAC place fewer bets and hence reap fewer upside payoffs that would translate into increased aggregate growth. This partly depends on management quality;

innovation requires a multiyear horizon and the ability to manage risk. Studies of managers in Colombia, for instance, have found that, as in the United States and China, improved management practices contribute to increasingly sophisticated exports and access to advanced markets. Furthermore, in a virtuous cycle, such practices foster greater innovation within Colombia. But entrepreneurs also need access to markets to diffuse risk. Shallow markets, which still characterize the region, are correlated with lower risk taking.

Maximizing the Benefits of Openness

Integration in the global economy is critical. First, trade permits firms and countries to take advantage of scale economies. Second, trade, foreign direct investment (FDI), study abroad, and university exchanges offer means to reach the knowledge frontier most rapidly. If in the 1950s it was imagined that LAC could invent the necessary technologies on its own, today that notion is fanciful.

Finally, openness facilitates a necessary contestability and discipline that can weed out low-performers and encourage new entrants and more productive firms to thrive. Once again, in this area, the link to productivity growth is intermediated by firm capabilities. That an absence of competition stifles innovation is generally accepted, although Philippe Aghion, co-winner of the 2025 Nobel Prize in economics, argues that the impact of increasing competition on innovation is not necessarily increasing: it depends critically on how close firms are to the technological and managerial frontier.

While strengthening competition agencies and intensifying domestic competition raises productivity, innovation, and employment, as the World Bank report *Competition and Productivity Growth In Latin America and the Caribbean* shows, competing globally can be less growth promoting. While in the United Kingdom and France, 50 percent of firms innovate when confronted with more global competition, in Chile the share is much lower—only 7 percent. These different experiences demonstrate that building capabilities does not happen automatically and is a necessary complement to more competition. Recent studies show that improving firm capabilities increases exports, expands the number and sophistication of markets, and increases the quality of exported goods.

ISI failed arguably because extreme protectionism led to limited contestability, little contact with the technological frontier, and little incentive to "learn how to learn" to reach it. The reform period redressed these failures but arguably did not embrace the complementary capabilities agenda. As chapter 2 documents, LAC continues to lag across all dimensions of human capital and knowledge-related institutions.

Strengthening the State in LAC to Support Industrial Policy

All three areas involve resolving market failures. Basic education generates externalities in many directions. Worker training may wind up benefiting other firms if trained workers leave. One firm's investment in R&D can be appropriated by others. Gaps in information or understanding about how well firms actually perform lead firms to underinvest in managerial and technological upgrading. Dominant firms prevent more dynamic firms from entering. Financial markets are too thin for entrepreneurs to diversify the risk of experimentation. Entering new international markets benefits more than just the firm that acts as the first mover. Poor regulation, including bankruptcy and conflict resolution, prevents capital markets from deepening.

Redressing these market failures requires state interventions. Effective state interventions, in turn, require a capable state. This includes issues of state autonomy—insulation from rent-seeking lobbying, sufficient bandwidth, and the ability to process information to identify the most productive areas of investment, as well as the capabilities for evaluation and execution. It also includes the capability to terminate experiments going badly. Subnational governments might be able to better recognize and solve these failures, but the variability of their capabilities can undermine decentralization efforts.

Improving the capabilities of the region's governments is precisely the logic behind the World Bank's Government Analytics program, which seeks to disseminate what has been learned about measuring government performance, and

how to improve it. *Data for Better Governance: Building Government Analytics Ecosystems in Latin America and the Caribbean*, in particular, shows how countries can use existing sources of data to diagnose and improve LAC governance, while the *World Bank's CLIAR Dashboard* can be used to identify agency-level strengths and weaknesses. In addition, the report *Public Workforce Performance and Prosperity* provides guidelines on how to attract and remunerate more effective public officials.

Generating Faster Growth and Better Jobs in LAC: Learning to Place Better Bets

Development is a process of placing informed bets. The private sector needs to weigh the risks and returns of initiatives to invest and innovate; governments make the same calculations when attempting to resolve market failures that are imperfectly understood and measured. The contribution of World Bank's new report on industrial policy is precisely to lay out the new evidence, particularly from East Asia, on the tradeoffs they face when choosing to embark on their policies. LAC's experience suggests that whatever decisions developing countries make to shift the composition of *what* is produced, the complementary, more cross-cutting horizontal agenda is critical to ensure that *how* it is produced helps developing countries learn to better identify and exploit the new technologies of the twenty-first century—technologies that are essential to generating the high-quality jobs LAC and other developing regions need.

Growth Outlook for the Region

Real GDP Growth Rates

	2022	2023	2024	2025e	2026f	2027f
Argentina	6.0	-1.9	-1.3	4.4	3.6	3.7
Bahamas	10.9	3.0	3.4	2.8	2.2	1.9
Barbados	15.9	1.8	3.4	2.7	2.7	3.0
Belize	9.3	0.5	3.5	1.5	2.4	2.2
Bolivia	3.7	2.5	-1.1	-2.1	-3.2	4.0
Brazil	3.0	3.2	3.4	2.3	1.6	1.8
Chile	2.1	0.7	2.8	2.5	2.4	2.3
Colombia	7.3	0.8	1.5	2.6	2.2	2.4
Costa Rica	5.5	4.8	4.1	4.6	3.6	3.7
Dominica	10.4	3.7	2.1	3.1	2.8	2.9
Dominican Republic	5.2	2.2	5.0	2.1	3.6	4.4
Ecuador	5.9	2.0	-2.0	3.7	2.5	2.5
El Salvador	2.9	3.5	2.6	3.9	3.2	3.0
Grenada	7.3	4.5	3.3	4.5	3.1	3.0
Guatemala	4.2	3.5	3.7	4.2	3.7	3.8
Guyana	63.3	33.8	43.8	15.4	16.3	23.5
Haiti	-1.7	-1.9	-4.2	-2.7	0.6	1.9
Honduras	4.1	3.6	3.6	3.8	3.4	3.7
Jamaica	6.4	2.7	-0.5	-0.4	-1.0	3.2
Mexico	3.7	3.1	1.4	0.6	1.3	1.7
Nicaragua	3.6	4.4	3.6	4.9	3.4	3.4
Panama	10.8	7.4	2.9	4.4	3.9	4.1
Paraguay	0.0	5.3	4.7	6.6	4.4	4.2
Peru	2.8	-0.4	3.5	3.4	2.7	2.8
St. Lucia	20.6	3.3	4.7	1.3	1.9	1.8
St. Vincent & the Grenadines	3.1	5.3	4.1	3.6	3.0	3.1
Suriname	2.4	2.4	1.7	1.8	4.0	4.5
Trinidad and Tobago	0.9	1.5	2.5	0.8	0.7	3.2
Uruguay	4.6	0.8	3.3	1.8	1.6	1.9

Source: World Bank staff calculations.
Note: The cut-off date for the data is April 6, 2026. “e” stands for estimate; “f” for forecast.

CHAPTER 1

The State of the LAC Region

Chapter 1. The State of the LAC Region

Economic activity: Growth remains subdued, while country paths diverge

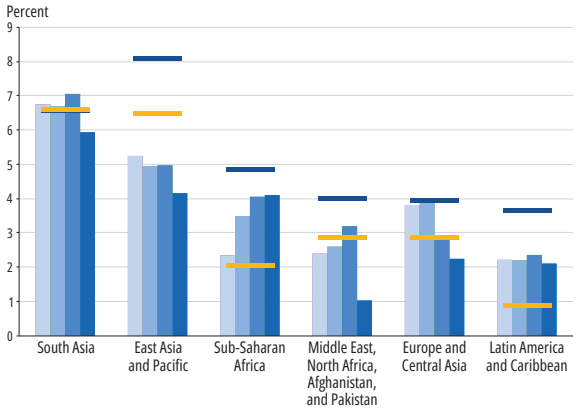
The regional GDP growth rate for Latin America and the Caribbean (LAC) is expected to reach 2.1 percent in 2026—slightly below the 2.4 percent recorded in 2025. This static performance conceals downward revisions in growth projections for many economies across the region (refer to figure 1.1, panels A and B). Long-standing structural challenges still frame the region's growth outlook. Moreover, LAC is once again projected to be one of the slowest-growing regions in the world in 2026, underscoring the region's persistent structural weaknesses and its continued lag behind other emerging regions. In addition, GDP per capita in LAC is projected to barely grow in 2026, reinforcing the stubborn pattern that the region's already weak aggregate performance translates into no meaningful income gains for the average resident. While the combination of easier global financing conditions and still-high commodity prices provided some support in early 2026, their effect is offset by elevated global uncertainty and domestic headwinds, including restricted fiscal space and subdued private demand. These challenges are compounded by downside risks—notably from renewed conflict in the Middle East—where energy-price volatility could delay disinflation and weigh on growth.

Advances in Argentina

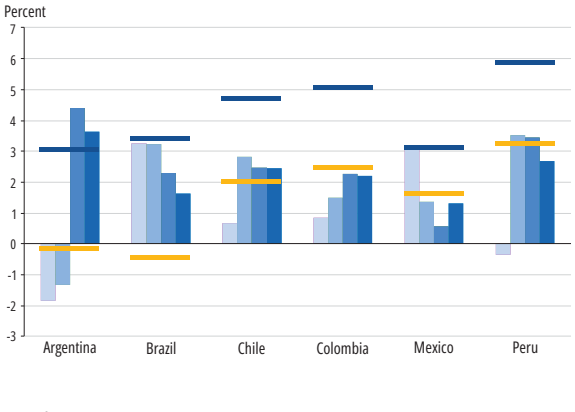
Argentina stands out against this backdrop. A decisive fiscal-led adjustment—moving from a large deficit in 2023 to primary and overall surpluses through expenditure rationalization, cuts to waste and administrative inefficiencies, and the retargeting of price-based energy subsidies away from higher-income households—has helped anchor inflation expectations and compress sovereign risk. As figure 1.2 shows, for Argentina, the EMBIG spread fell sharply, averaging about 2,200 basis points in 2022–23, declining to about 1,400 basis points in 2024, and then reaching about 750 basis points in 2025 (with a median near 700 basis points). The spread spiked temporarily in September–November 2025 around the legislative elections; by March 2026, on average, it tightened to less than 600 basis points (refer to figure 1.2, panel A).

FIGURE 1.1 Real GDP growth by region and LAC-6 country

A. Real GDP growth by region



B. Real GDP growth in the LAC-6



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

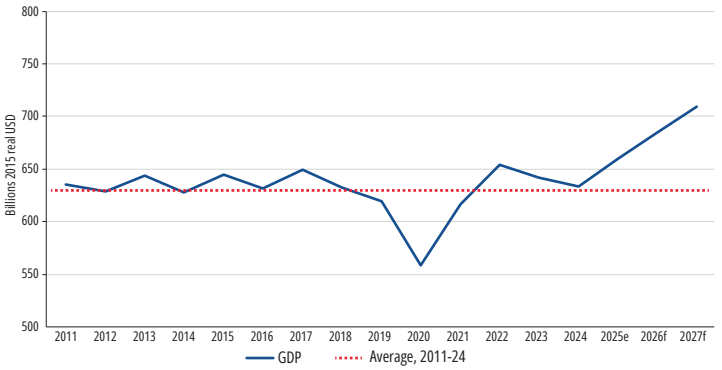
Note: The values for 2026 are based on projections (as of April 6, 2026). In panel B, the LAC-6 includes Argentina, Brazil, Chile, Colombia, Mexico, and Peru. e = estimate; f = forecast; GDP = gross domestic product; LAC = Latin America and the Caribbean.

FIGURE 1.2 Argentina: Evolution of EMBIG spread and real GDP

A. Evolution of EMBIG spread, 2022–26

Source: JP Morgan.

B. Real GDP, 2011–27 (forecast)



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

Note: The values for 2026 and 2027 are based on projections (as of March 27, 2026). Aggregates are simple averages. In panel A, the Emerging Markets Bond Index (EMBIG) spread reflects the difference between the yield on Argentine instruments and the yield on U.S. Treasury bonds of comparable maturity. e = estimate; f = forecast; GDP = gross domestic product; USD = US dollar.

Building on those fiscal gains—because sustainable growth and multiyear investment are not plausible under near-hyperinflation and crisis-level sovereign risk—the government has advanced a pro-growth agenda that includes tax reform. Most notably, the Large Investment Incentive Regime (RIGI) (Law 27.742; Decree 749/2024) targets large projects in energy, oil & gas, mining, technology, steel, infrastructure, tourism, and forestry, offering a cut in the corporate income tax rate from 35 percent to 25 percent, accelerated depreciation, indefinite loss carry-forward with transferability from year 5, a dividend withholding that falls to 3.5 percent after year 7, mechanisms for a value added tax (VAT) credit, full crediting of the bank debits/credits tax, extensive customs exemptions, phased relief from export duties, gradually expanding foreign exchange flexibility on export proceeds, and 30-year legal stability via single-purpose vehicles—changes that are directionally consistent with the prior World Bank finding that statutory corporate tax burdens in LAC are high by standards in emerging markets and developing economies (EMDEs), implying room to improve the tax mix while reducing distortions (Vuletin 2025).

Complementary external anchors are also emerging. On February 5, 2026, the United States and Argentina launched a strategic framework to strengthen supply chains for critical minerals, explicitly linking US financing tools and demand with Argentina's RIGI. In parallel, the EU-MERCOSUR Partnership Agreement—ratified by Argentina's Congress—would, once fully operative, broaden market access and reduce policy uncertainty for tradables and large projects. Domestically, the approval of labor-market reforms by Congress and ongoing efforts to improve the business and regulatory environment further support the investment outlook.

Together with a strong agricultural harvest that is supporting near-term activity, these measures have shifted expectations meaningfully: cumulative growth moved from –0.4 percent in 2011–24 to an expected 12.2 percent in 2024–27 (refer to figure 1.2, panel B). At the same time, downside risks remain significant, particularly given Argentina's sizable external financing needs in a context of negative net international reserves and still-limited access to international debt markets. Overall, greater clarity around the fiscal anchor and reform agenda has helped anchor expectations, improve financial conditions, and support a recovery in private consumption and investment.

Pockets of dynamism in Central America and other LAC economies

Beyond Argentina, a number of smaller LAC economies—particularly in Central America and parts of the Southern Cone—are showing comparatively stronger momentum. Paraguay continues to outperform the regional average, extending its recent robust growth trend, supported by solid agricultural exports, expanding electricity generation, and a stable

macro framework that has underpinned investment and consumption. In Central America, growth remains robust in countries such as Costa Rica, El Salvador, Guatemala, and Honduras, reflecting a combination of remittances, services exports, and growing integration into regional value chains. Costa Rica, in particular, continues to benefit from high-value services, medical devices, and nearshoring-related investment. El Salvador has sustained growth amid improvements in security conditions, formalization, and a more predictable macro environment, reflected in stronger tourism, retail activity, and investment in tradable sectors, supported by robust remittance inflows that have boosted domestic liquidity and eased long-standing growth constraints.

In the Southern Cone and Andean belt, Chile's growth is stabilizing at about 2.5 percent as domestic demand steadies and mining exports underpin the external position and policy rates gradually normalize toward neutral. Peru, following the 2023 trough, has maintained solid growth of around 3.1 percent, supported by copper exports and infrastructure investment. However, medium-term gains will depend on sustaining the mining pipeline and addressing long-standing structural bottlenecks that constrain potential growth and private consumption.

These experiences highlight that, even within a generally subdued regional outlook, credible policy frameworks, openness to trade, and sector-specific strengths can still deliver above-average growth outcomes.

A dual-track outlook in the Caribbean

In the Caribbean, Guyana's oil-driven surge continues to lift the subregional average in 2026. Trinidad and Tobago—another hydrocarbon producer—benefits intermittently from gas-related activity, but with a more mature production profile and without the scale of expansion seen in Guyana. Suriname, while not yet experiencing an oil-led surge, is beginning to see growth supported by investment and expectations linked to recent offshore discoveries. By contrast, growth in the rest of the Caribbean has been moderating as tourism-dependent economies face softer external demand, high import and energy costs, and climate-related vulnerabilities. The result is an increasingly dual-track outlook within the subregion. This widening contrast underscores the growing divergence between resource-rich producers and the remainder of the Caribbean.

Slow growth elsewhere

Without a broader reduction in uncertainty and real financing costs, and against a near-term global backdrop shaped by developments in the Middle East, the region's acceleration is likely to remain measured rather than broad-based.

Beyond these pockets of strength, most of the region has continued to grow only slowly in 2026. The combination of easier financing conditions in early 2026 and favorable commodity prices remains insufficient to overcome the drag from persistent trade tensions, policy uncertainty, limited fiscal buffers, and weak private demand. Within this environment, Brazil is expected to cool further relative to 2025, as tight financial conditions—policy rates remained restrictive through early 2026—and a soft external environment weigh on credit, investment, and trade. A more discernible improvement will be likely only if monetary conditions normalize and global pressures ease. Mexico's low growth from 2024 is also likely to persist into 2026, as the fading impact from large public infrastructure projects coincides with ongoing uncertainty about trade policy. While the monetary policy easing cycle should lend some support to domestic demand, it will probably only partially offset external headwinds, particularly with reviews related to the United States-Mexico-Canada Agreement (USMCA) affecting the planning horizons of firms.

A changing risk–opportunity profile amid heightened global uncertainty

Despite persistent structural headwinds and currently subdued growth expectations, LAC enters 2026 with a distinct and evolving risk–opportunity profile. The region remains far from active theaters of interstate conflict, providing a comparatively stable external security backdrop—even as violence linked to organized crime continues to pose challenges in several countries.

In a global landscape undergoing realignment, LAC's strategic economic relevance is gradually rising. Firms are increasingly diversifying supply chains and exploring production locations that are geographically closer or geopolitically more aligned. These shifts—reinforced by the global energy transition, as the region combines a comparatively clean power mix with large shares of key critical minerals—open space for LAC to capture additional trade and investment over time, although the scale and persistence of the gains will depend crucially on domestic policy frameworks, institutional quality, and implementation capacity. Ongoing changes in global trade policy also offer selective opportunities: the recently signed EU–MERCOSUR Partnership Agreement signals renewed interest in cross-regional economic ties and could, once fully implemented, expand market access and diversification options for both sides.

More recently, the conflict in the Middle East has added a new layer of uncertainty to the global outlook, reflected primarily in heightened volatility and upward pressure in energy prices. This has introduced both risks and selective opportunities for commodity-exporting economies. For LAC, the macroeconomic implications of this environment are heterogeneous and hinge importantly on countries' energy positions and policy buffers. Higher energy prices tend to weigh on net energy-importing economies through inflationary pressures and weaker external balances, while providing a short-term advantage for energy and selected commodity exporters via stronger fiscal and external positions. Whether these tailwinds translate into durable gains, however, depends on resilience across the external, monetary, and fiscal fronts, and on the ability to manage volatility and avoid procyclical responses.

Overall, the global environment presents both opportunities and risks relative to the low-growth baseline. While nearshoring, renewables, and critical-mineral value chains offer upside potential, geopolitical tensions also introduce downside risks. Translating temporary tailwinds into durable gains will require stronger institutions, lower policy uncertainty, and progress on infrastructure and human capital (refer to Beylis and Lozano Gracia 2025).

A consumption-led upswing with subdued investment

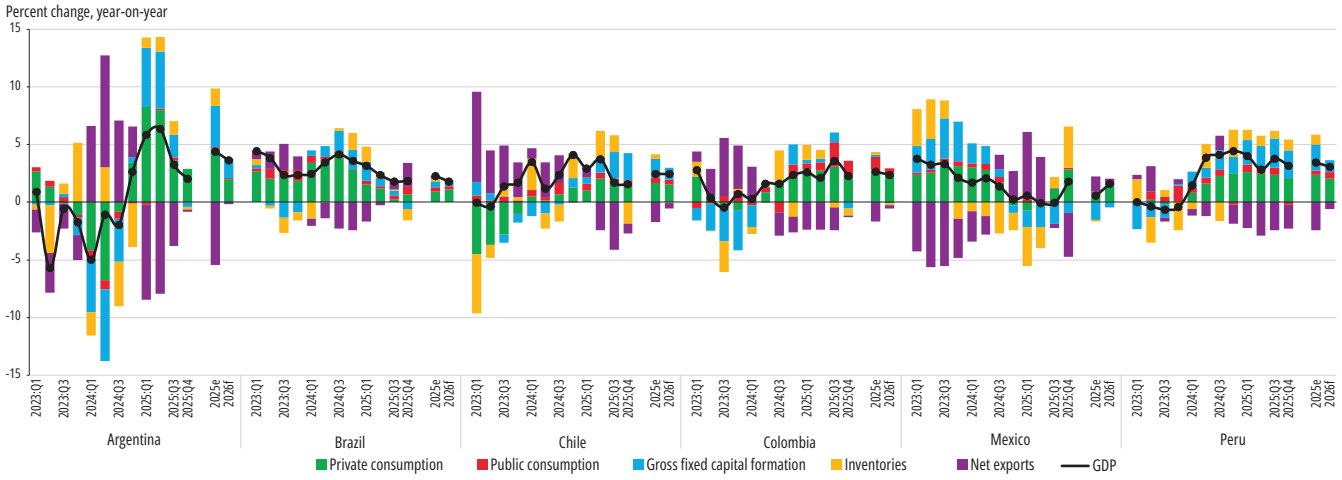
Private consumption is set to remain the main driver of demand across LAC in 2026, but its impact is modest, as real (inflation-adjusted) incomes recover only gradually and real borrowing costs stay elevated in several large markets. Meanwhile, investment remains subdued, with easing cycles proceeding unevenly and uncertainty—both global and domestic—still weighing on decisions about capital expenditure (refer to figure 1.3).

Among the large South American economies, domestic demand has been softening where monetary conditions remain tight and fiscal space limited—notably in Brazil, where high real rates continue to restrain credit, investment, and discretionary spending. In Mexico, the overall demand impact is muted as earlier public investment support fades and uncertainty about trade policy persists; monetary easing offers some relief, but external headwinds linked to tariff dynamics keep the near-term outlook cautious. By contrast, a small group of economies show measured firming of domestic components. Argentina's composition is shifting toward a more balanced mix as private spending and investment stabilize alongside improved policy credibility. In Chile, consumption is edging up as rates move toward neutral and mining continues to anchor exports. Peru is benefiting from investment in copper and infrastructure, with consumption improving but still temperate compared to trends before the COVID-19 pandemic. Overall, the demand mix in 2026 leans on consumption, but the binding constraint is investment. Without a broader reduction in uncertainty and real financing costs, and against a near-term global backdrop shaped by developments in the Middle East, the region's acceleration is likely to remain measured rather than broad-based.

External balances under pressure

Fiscal deficits persist in several LAC economies, and the softness in domestic demand—alongside only gradual disinflation—has not produced a broad rebuilding of private savings. In a number of countries, household and corporate buffers have

FIGURE 1.3 Contributions to real GDP growth



Sources: Haver Analytics; Banco Central de Chile; World Bank Macro Poverty Outlook (Spring Meetings 2026); World Bank staff calculations.

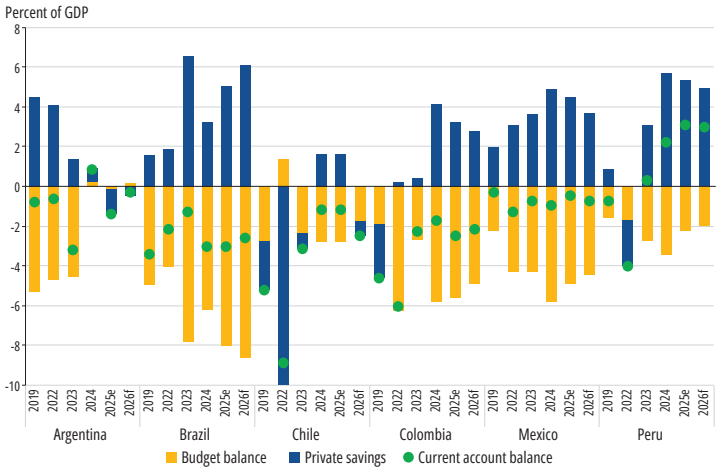
Note: The values for 2026 are based on projections (as of March 27, 2026). Inventories include statistical discrepancies. e=estimate; f = forecast; GDP = gross domestic product; LAC = Latin America and the Caribbean.

stalled or edged lower; together with the 2025 episode of appreciation of real exchange rates, import volumes firmed up where demand stabilized, and external financial conditions eased. These forces are narrowing current account balances in 2026. As a result, earlier gains in the external balance are partly reversing, leaving external accounts more sensitive to shifts in global risk sentiment and terms-of-trade conditions, including the recent rise in energy-price volatility (refer to figure 1.4).

Household sentiment stabilizes, while firms remain cautious

Consumer confidence has been edging up across several LAC economies since mid-2025 and, as of February 2026, remains broadly aligned with the global improvement in sentiment, supported by easing inflation and relatively resilient labor markets (refer to figure 1.5, panel A). However, readings are near historical averages rather than decisively above them, suggesting only gradual support to private consumption. An exception is Mexico, where consumer confidence was on a downward trend from late-2024 highs through much of 2025; the index registered several consecutive monthly declines before and after a modest rebound in mid-2025. By contrast, business confidence shows a cautious uptick at best and remains close to, or slightly

FIGURE 1.4 Decomposition of current account balances



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

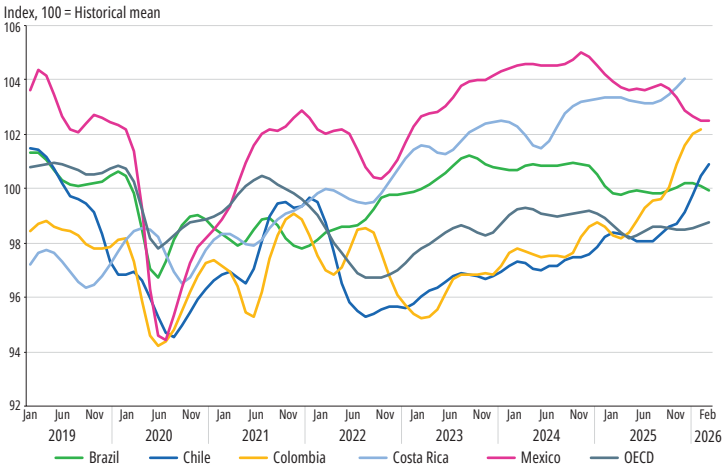
Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast; GDP = gross domestic product.

below, long-term norms across many economies—consistent with subdued investment and firms' continued caution amid elevated policy uncertainty and real financing conditions that are tighter than before the pandemic (refer to figure 1.5, panel B).

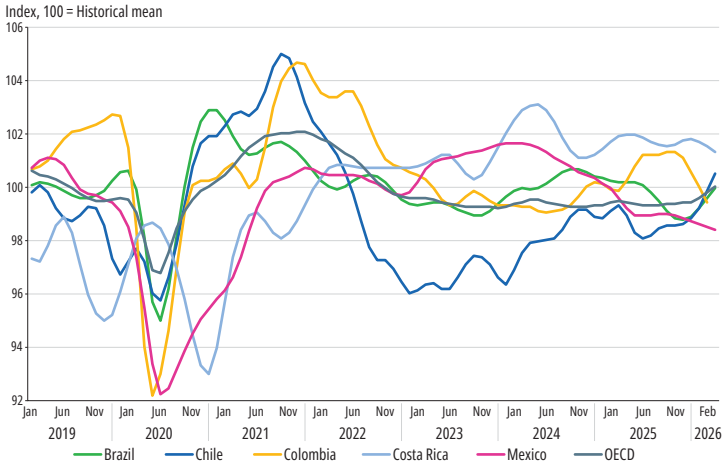
This divergence—households stabilizing faster than firms—mirrors the region's macro narrative: domestic demand is still led by consumption, while capital expenditure lags as companies wait for clearer signals on the external environment and country-specific

FIGURE 1.5 Evolution of confidence indicators

A. Consumer confidence index



B. Business confidence index



Sources: For panel A, OECD (Consumer Confidence Index, CCI) (indicator) (doi: 10.1787/46434d78-en). For panel B, OECD Business Confidence Index (BCI) (indicator) (doi: 10.1787/3092dc4f-en).
Note: OECD = Organisation for Economic Co-operation and Development.

policy frameworks. Global trackers likewise point to a modest improvement in sentiment by February 2026, but without a broad-based inflection in investment intentions.

External environment: External headwinds were moderating, amid rising uncertainty

After initiating easing with a 25 basis point cut on September 17, 2025, the U.S. Federal Reserve kept the federal funds rate unchanged at 3.50 percent–3.75 percent as of March 2026, framing the pause as a data-dependent balance between still-elevated inflation and a softer—but stabilizing—labor market (refer to figure 1.6, panel A). In parallel, the European Central Bank (ECB) ended 2025 and the first quarter of 2026 on hold, while the Bank of England delivered a cut to 3.75 percent on December 18, 2025 and maintained it unchanged as of March 2026, signaled that any additional easing in 2026 would be gradual. Since the onset of the conflict in the Middle East, higher and more volatile energy prices have added risks to the inflation outlook, primarily through energy and transportation costs, potentially slowing the pace of disinflation. While historical experience suggests that energy-price spikes linked to geopolitical tensions often tend to fade in the absence of major supply disruptions, central banks continue to view the current shock as largely supply-driven. Even so, a period of elevated volatility and prices could complicate the calibration of monetary policy, reinforcing a more cautious stance in global financial conditions over the short term.

For LAC, easier global financial conditions provide some relief; however, local authorities remain cautious in lowering policy rates further given sensitivities around capital flows and the need to keep inflation expectations anchored. In practice, cutting rates too quickly can narrow interest-rate differentials with advanced economies and raise risk premiums, prompting volatile portfolio flows and exchange-rate pressures that could reignite inflation through import prices. Recent developments in the Middle East add to this cautious backdrop by increasing uncertainty around the near-term inflation outlook, particularly through higher and more volatile energy prices. This is why guidance, smaller moves, and clear sequencing matter: they allow real interest rates to ease over time without weakening currency anchors or destabilizing capital flows.

The global growth outlook was revised downward through the first half of 2025 as trade tensions intensified and policy uncertainty peaked, before stabilizing in the second half of the year amid a gradual de-escalation of trade-related risks. By early-2026, projections were stable but subdued, with easier financial conditions partly offset by lingering trade frictions, geopolitical tensions, and uneven disinflation. Major advanced economies—especially

the G-7—enter 2026 with softer-than-anticipated momentum relative to mid-2025 expectations (refer to figure 1.6, panel B). For the United States, 2025 growth reached 2.1 percent, followed by a projected 2.2 percent in 2026. In the euro area, the outlook remains modest, with growth of 1.4 percent in 2025 (up from 0.9 percent in 2024) and projected to be 0.7 percent in 2026 amid weak manufacturing, structural headwinds, and only gradual policy easing.

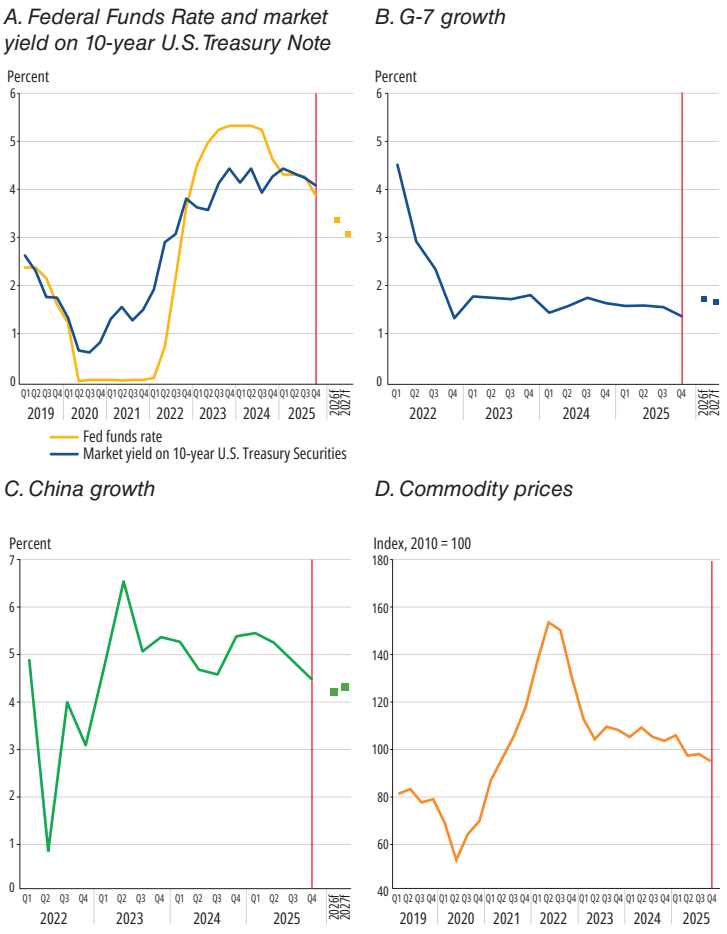
China's outlook has also been revised down compared to assumptions in early 2025. After an expansion of 5.0 percent in 2025, growth is projected to moderate to 4.2 percent in 2026 as strains in the property sector, softer private investment, and weaker external demand weigh on activity (refer to figure 1.6, panel C).

Commodity prices were moderating during 2025 (refer to figure 1.6, panel D). However, renewed conflict in the Middle East has heightened uncertainty, contributing to higher and more volatile energy prices, alongside rising fertilizer costs.

An additional source of uncertainty comes from climate dynamics. After a period of weakening La Niña conditions, climate forecasters assign a rising probability to the emergence of El Niño later in 2026, although uncertainty remains high at this horizon. Historically, El Niño episodes have been associated with increased volatility in agricultural and energy markets through their effects on weather patterns, logistics, and yields, with heterogeneous implications across regions. For LAC, these risks are asymmetric: some economies may benefit temporarily from higher prices for selected commodities, while others—particularly those exposed to climate-sensitive agriculture or energy imports—may face heightened risks to inflation, growth, and external balances.

News-based measures of trade policy uncertainty, after spiking in April 2025, have declined but remain elevated relative to levels that prevailed before 2024 (refer to figure 1.7). Recent assessments also indicate that tariffs, export controls, and related trade instruments continue to be used in ways that intersect with broader geoeconomic and geopolitical considerations, keeping the trade outlook subject to episodic flare-ups even as near-term uncertainty

FIGURE 1.6 Evolution of the Federal Funds rate, G-7 growth, China growth, and commodity prices



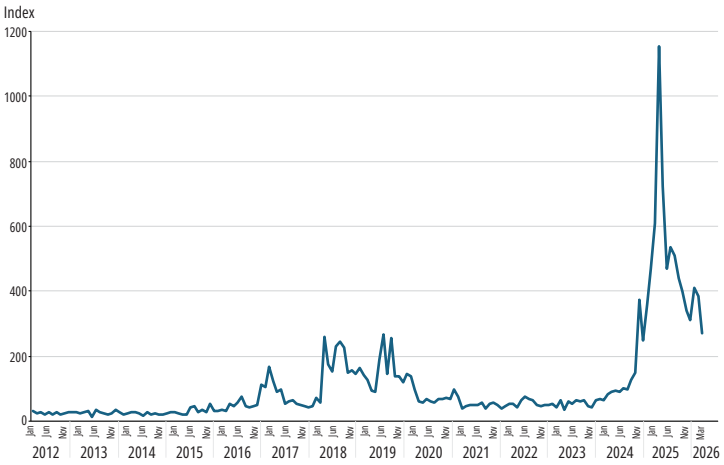
Sources: For panel A, U.S. Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis, and U.S. Federal Open Market Committee; for panel B, Organisation for Economic Co-operation and Development (OECD) Quarterly GDP (indicator) (doi: 10.1787/b86d1fc8-en) and Consensus Forecasts; for panel C, National Bureau of Statistics of China and World Bank; for panel D, World Bank Commodity Prices (Pink Sheets) (https://www.worldbank.org/en/research/commodity-markets).

Note: f = forecast; G-7 = Group of Seven; LAC = Latin America and the Caribbean.

measures have eased. Against this backdrop, LAC export volumes have shown resilience, but firms still report a more cautious approach to cross-border investment and supply chain commitments in the presence of policy uncertainty and weaker external demand in some markets (refer to figure 1.8).

For LAC economies, the policy environment remains challenging. Even as global financial conditions have eased compared to mid-2025, external demand is subdued, commodity prices are stabilizing—with heterogeneous dynamics across energy and other commodities—, and trade policy uncertainty—though below its April-2025 spike—remains above historical norms.

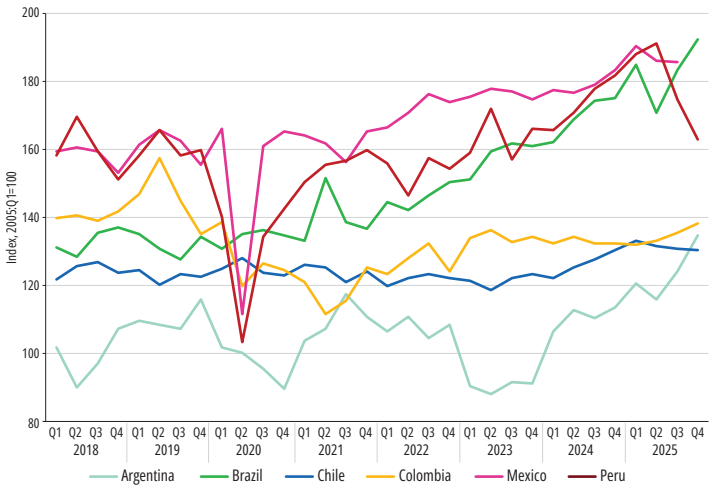
FIGURE 1.7 Trade Policy Uncertainty Index



Source: Caldara et al. 2020.

Note: The index represents the proportion of news articles that contain references to trade policy uncertainty (TPU). A value of 100 in the index corresponds to 1 percent of articles mentioning trade policy uncertainty.

FIGURE 1.8 Export of Goods Volume Index in the LAC-6



Source: United Nations Conference on Trade and Development (UNCTAD).

Note: The values are seasonally adjusted. LAC = Latin America and the Caribbean.

Inflation has moderated but central banks remain cautious

Following an early and forceful policy response and the easing of global supply bottlenecks, inflation in LAC has fallen markedly from its 2022 peak. Yet the pace of disinflation slowed through 2024 as core inflation proved persistent—especially in services—reflecting elevated labor costs, indexation practices, and intermittent pressures from international food markets (refer to figure 1.9).

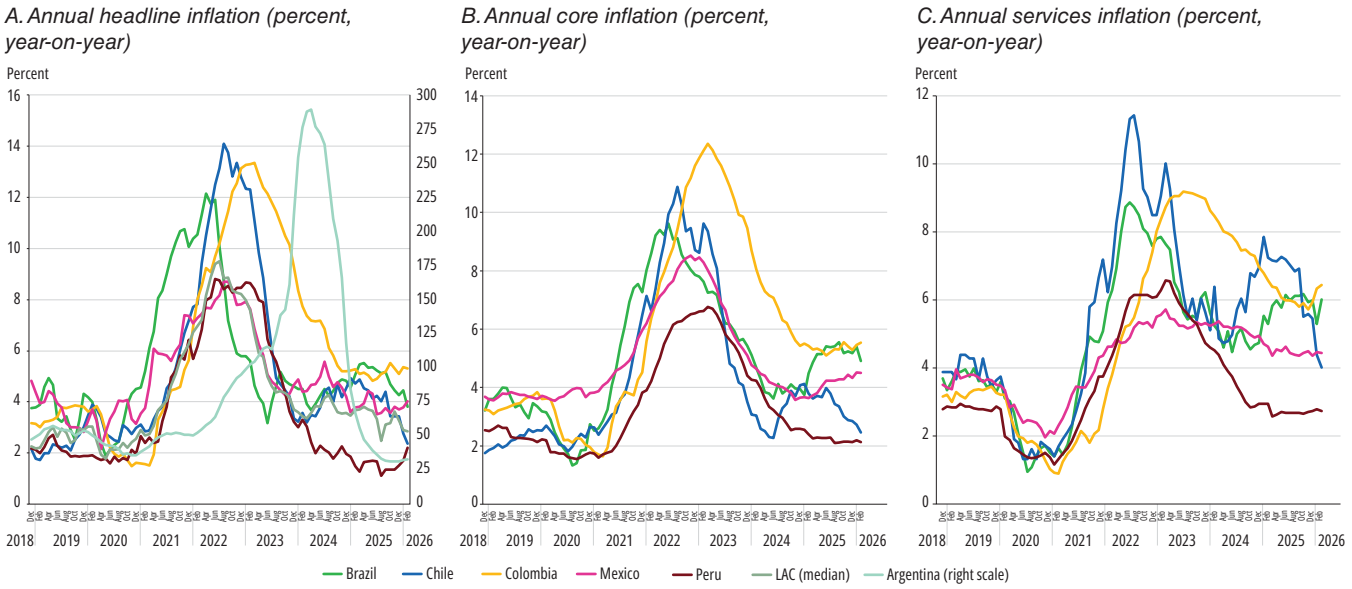
Since early 2025, this "last mile" has become more challenging in the region, with some LAC economies registering brief upticks in inflation, keeping central banks on a cautious footing. Headline inflation generally has continued to edge down, but at a slower clip, while services inflation has stayed sticky—mirroring tightness in segments of labor markets and the lagged pass-through of earlier wage increases. These dynamics align with regional assessments pointing to convergence to targets that has been slower than initially expected in a subset of countries, despite credible policy frameworks and anchored expectations in many others.

The conflict in the Middle East has triggered higher and more volatile energy prices—alongside higher fertilizer costs—and added upside risks to the inflation outlook, operating first through goods (energy, transport, and food-related inputs) and potentially spilling over to services at the margin. This matters because even a transitory increase in energy prices can slow headline disinflation and complicate inflation expectations, reinforcing central banks' preference for caution.

On balance, most LAC economies are projected to bring inflation back within—or close to—their target ranges by 2026–27. The main exception is Colombia, with inflation expected to remain persistently above the central bank's target over the projection horizon (refer to figure 1.10). These developments have shaped monetary policy dynamics in LAC, leading some central banks to slow the pace of monetary easing or even to raise their policy rates, as in Brazil and Colombia (refer to figure 1.11).

A notable shift was the softer US dollar in 2025, which modestly eased external headwinds by tempering exchange rate pass-through and imported inflation. The US dollar's weakening relative to 2024 reduced the need for procyclical tightening to defend currencies in several economies, even as risk appetite remained constrained by global trade frictions and uneven growth. The modest easing from a softer US dollar did not translate into a broad improvement in external financing conditions. Global policy rates declined more slowly than expected and risk appetite remained subdued amid heightened trade tensions, keeping sovereign and corporate borrowing costs

FIGURE 1.9 Inflation rates: Headline, core, and services



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

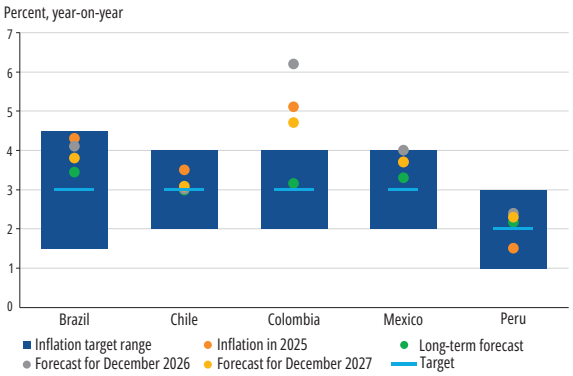
Note: LAC (median) includes Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, and Uruguay. LAC = Latin America and the Caribbean.

elevated. As a result, capital inflows strengthened only in a handful of economies with stronger fundamentals, making the improvement more selective than in previous easing cycles.

Exchange rate developments have mirrored this evolution in two stages. In 2024, LAC currencies generally weakened against a strong US dollar amid narrowing interest rate differentials as early domestic easing began (refer to figure 1.12). In 2025, the configuration shifted: the US dollar softened, but the slower-than-expected decline in global policy rates and higher uncertainty led LAC central banks to pause or recalibrate their easing cycles to safeguard credibility, contain pass-through, and manage capital flow risks. Interest rate differentials are above historical norms for some countries (such as Brazil and Colombia) but compressed for others (such as Chile, Mexico, and Peru), limiting room for maneuver and reinforcing a data-dependent stance.

Policy implications for April 2026 are nuanced rather than binary. With the US dollar no longer exerting the one-way pressure seen in 2024, central banks can maintain or judiciously resume normalization without unduly jeopardizing currency stability—conditional on continued progress in bringing down underlying inflation and continuing to anchor expectations. However, the balance of risks—stemming from trade frictions, geopolitical tensions, uneven global growth, and only gradual easing of global financial conditions—warrants incrementalism: allowing time for past tightening to transmit, preserving gains in credibility, and leveraging the modest external tailwind from a softer dollar, while recognizing that completing disinflation increasingly hinges on domestic drivers in services and labor markets.

FIGURE 1.10 Inflation forecasts and central bank targets

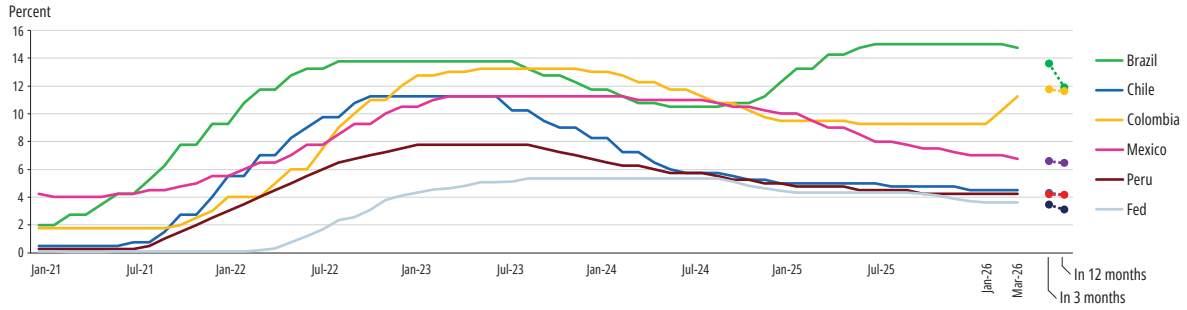


Source: Consensus Forecasts.

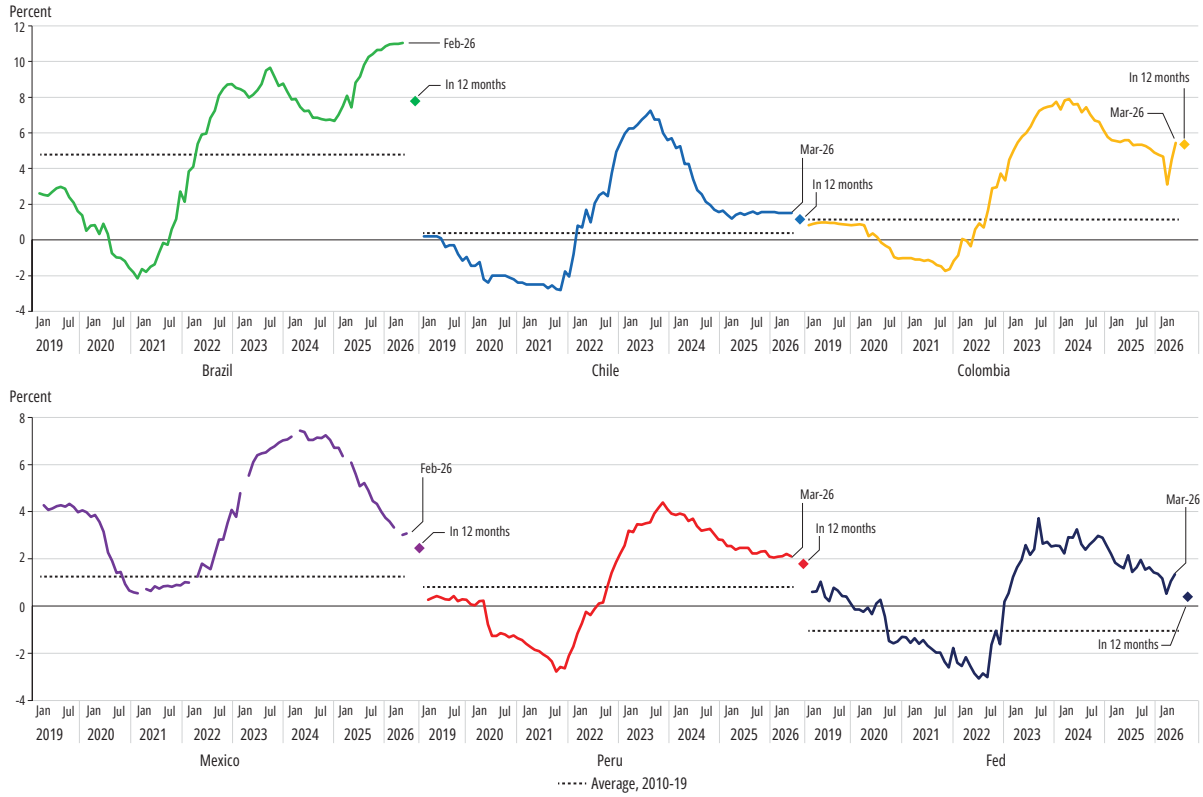
Note: The survey date was March 2026 for the December 2026 and December 2027 forecasts, and January 2026 for the long-term forecasts. Long-term forecasts are period averages at the 6- to 10-year horizon.

FIGURE 1.11 Monetary policy rates and real policy rates

A. Monetary policy rates, January 2021 to March 2026, and projected



B. Real policy rates, January 2019 to March 2026, and projected



Sources: World Bank Macro Poverty Outlook (Spring Meetings 2026); Consensus Forecasts; central banks databases.

Note: For panel B, real interest rates are calculated as the difference between the nominal monetary policy rate and the expected inflation rate for the next 12 months, based on data from central banks. For forecasted values, the same calculation is applied, using national central bank forecasts for the nominal policy rate. For inflation rates, the 12-month forecast uses expected inflation for 2026 from Consensus Forecasts. The series for Mexico contains breaks due to the unavailability of inflation expectations data in December of each year since 2020, based on data from Bank of Mexico. LAC-5 includes Brazil, Chile, Colombia, Mexico, and Peru. Fed = U.S. Federal Reserve.

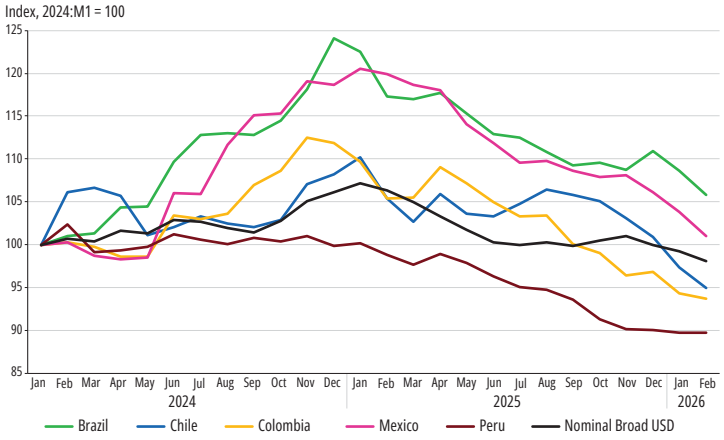
Can fiscal policy rise to the challenge of high interest rates and tight space?

High interest costs continue to weigh on overall outcomes and slow the transition to overall fiscal balances. Thus fiscal deficits remain stubborn across much of the region, even as several economies have improved primary balances. Debt service is absorbing a substantial share of total expenditure among large borrowers, compressing space for capital spending and limiting room for priority social programs. This composition effect has persisted into the 2025–26 horizon and is observable in the latest cross-country projections for the LAC-6 (refer to figures 1.13 and 1.14).

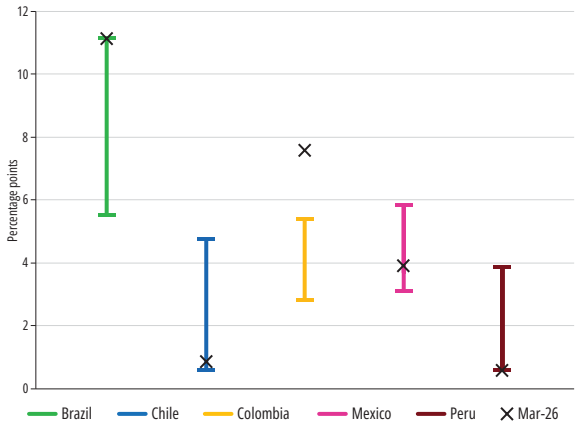
Public debt ratios have stabilized after the run-up following the pandemic but remain high by historical

FIGURE 1.12 Exchange rates and interest rate differentials

A. Exchange rates, January 2024–February 2026, local currency per US dollar



B. Interest rates differentials, January 2010–March 2026



Sources: World Bank staff calculations based on Haver Analytics and U.S. Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis.

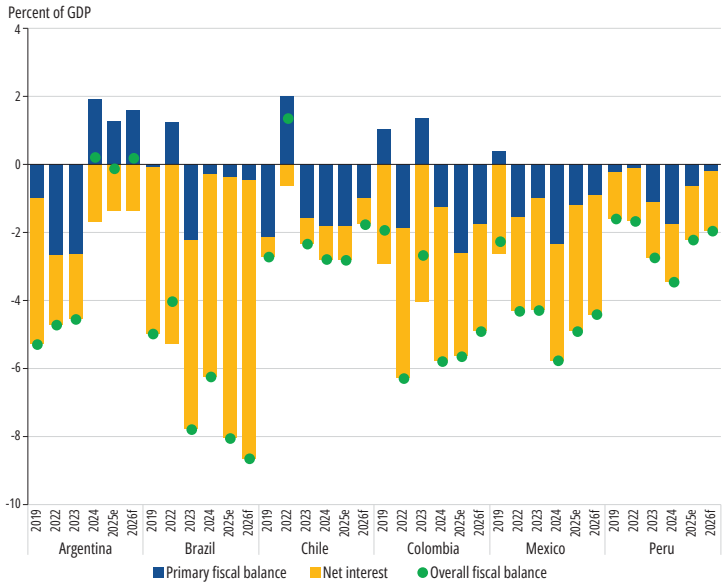
Note: For panel A, the nominal broad USD (US dollar) index measures the value of the US dollar against a trade-weighted basket of foreign currencies. For panel B, each box plot provides a summary of the distribution of the interest rate differentials (the difference between the monetary policy rate and the Federal Funds Rate) for the 2010–26 period. The lines span from the first quartile (Q1, 25th percentile) to the third quartile (Q3, 75th percentile), while the black crosses represent the latest datapoint available.

standards. Given modest growth and an external environment marked by policy uncertainty and episodic risk repricing, a return to the lower debt levels that prevailed before 2020 is unlikely without additional fiscal consolidation and stronger potential growth (refer to figure 1.15).

Argentina stands out as a partial exception: despite starting from very high debt levels, the authorities have achieved a significant reduction in public debt, reflecting a front-loaded, expenditure-led fiscal adjustment, with limited reliance on revenue-raising measures. It recorded a front-loaded improvement in the primary balance alongside broader stabilization measures, with inflation and sovereign spreads declining over the period.

Ecuador advanced a multiyear consolidation centered on revenue measures, fuel subsidy reform, and rebuilding liquidity buffers, accompanied by steady progress against program milestones and a narrowing of sovereign spreads. Next steps—already under way—to embed fiscal sustainability and safeguard financing conditions focus on further strengthening non-oil revenues and liquidity buffers, continued high-quality expenditure measures, and additional progress on governance and private investment reforms under the authorities' program.

FIGURE 1.13 Decomposition of overall fiscal balance

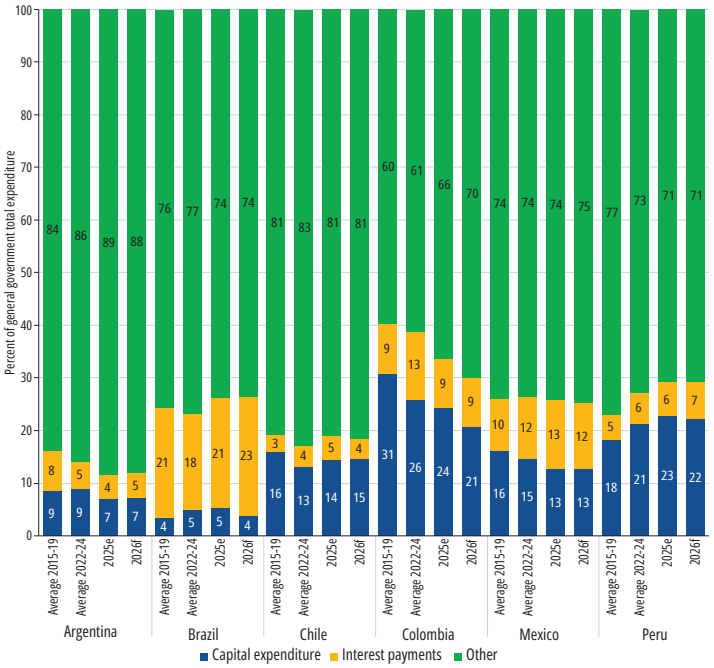


Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast; GDP = gross domestic product.

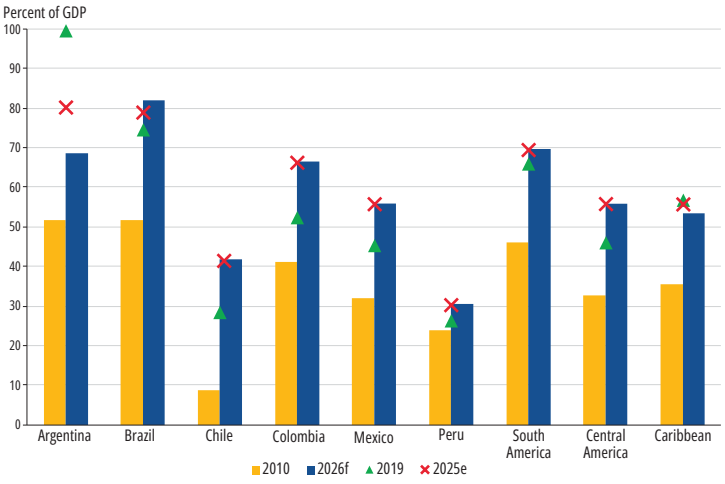
Overall in LAC, the composition of spending remains a central constraint. As *Public Spending Policies in Latin America and the Caribbean: When Cyclicality Meets Rigidities* (Riera-Crichton and Vuletin 2024) shows, current expenditures expand

FIGURE 1.14 Decomposition of general government total expenditure



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).
Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast; GDP = gross domestic product.

FIGURE 1.15 General government debt stock



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).
Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast; GDP = gross domestic product.

during upswings and are downward-rigid during downturns, which forces adjustment onto public investment when financing tightens—precisely the pattern that undermines long-term growth and resilience and that has reappeared in the current cycle of higher interest rates. The analysis underscores the case for expenditure rules that preserve investment and reduce procyclicality, complemented by efficiency improvements and better-calibrated indexation. On the revenue side, as *Rethinking Taxation for Growth in Latin America and the Caribbean* (Vuletin 2025) argues, broader, more neutral tax bases—calibrating value added taxes in tandem with targeted cash transfers to meet equity goals, moderating statutory corporate rates where they deter investment, and elevating property taxation as administrative feasibility improves—would help shift the revenue mix toward forms of taxation that are more compatible with growth and macro stability.

Borrowing costs remain higher than in the 2010s, with wider dispersion across countries. Regional EMBI spreads remain far apart, and—even with some easing in the second half of 2025—the decline in external policy rates has been slower than anticipated amid elevated uncertainty about trade and other policies (refer to figure 1.16, panel A). As a result, many sovereigns still finance at levels well above last decade's troughs, with cross-country gaps that track market perceptions of policy credibility and medium-term fiscal anchors (refer to figure 1.16, panel B).

In this environment, credible fiscal frameworks can materially improve debt pricing. Well-designed fiscal rules—especially expenditure rules paired with explicit debt anchors, time-consistent convergence paths, well-specified escape clauses, and independent oversight—are associated with lower risk premiums and better protection of public investment. Box 1.1 sets out the evidence and documents how these frameworks have evolved globally and within LAC.

In short, fiscal and monetary settings are closely intertwined. Elevated interest bills and still-high external rates keep risk premiums sticky, so central banks must factor tighter financing conditions into "last-mile" disinflation while services inflation

persists, amid renewed inflation risks from recent increases and volatility in energy prices. A softer US dollar in 2025 offered only limited relief, as capital flows concentrated in a handful of stronger sovereign borrowers rather than easing financing conditions more broadly across emerging markets.

Financial sector: Non-performing loans remain contained, and financial deepening remains uneven

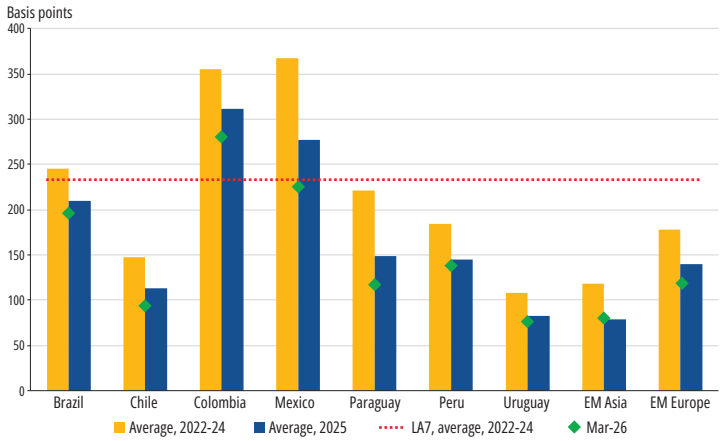
The monetary tightening cycle that began in 2022 raised borrowing costs across LAC, contributing to a moderate increase in non-performing loans (NPLs). While several central banks have started easing policy, the global financial environment remains restrictive, limiting the pace of domestic rate cuts. Overall, recent data point to contained credit quality risks, with no signs of systemic stress across the region. At the same time, subdued credit growth under tighter lending conditions may have mechanically affected NPL ratios—both through portfolio-composition effects and denominator effects—suggesting that part of the observed stability or increase in NPL ratios reflect weaker credit expansion rather than a worsening in underlying borrower risk.

Brazil is the main exception. NPLs have ticked upward gradually, reflecting the lagged effects of high real interest rates and weaker conditions for more vulnerable borrowers. Nonetheless, NPL levels remain moderate by historical standards. Strong bank capitalization and provisioning suggest that current developments call for continued vigilance rather than concern. In contrast, NPL ratios have remained stable or declined in other major LAC economies (including Colombia, Mexico, Peru, and Chile), supported by prudent lending standards and, in some cases, firmer growth dynamics (refer to figure 1.17).

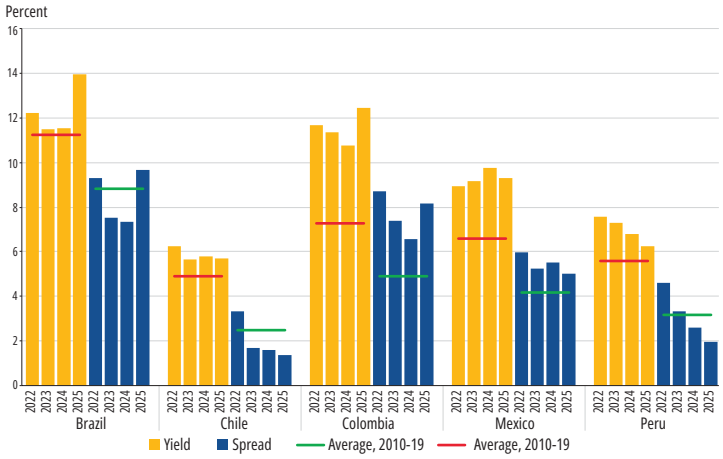
Structural differences are more pronounced in the depth of private credit markets. Private credit depth matters for growth by shaping investment, firm dynamics, and productivity, while shallow credit constrains entrepreneurship and sustained private-sector-led growth. Private credit levels range from about 40 percent–60 percent of GDP in Brazil, Colombia, Mexico, and Peru, broadly in line with the global average for middle-income economies. Chile stands out, with private credit near 125 percent of GDP, reflecting a deep and sophisticated financial system; its credit depth is closer to that of dynamic economies in Asia—where private credit frequently

FIGURE 1.16 Borrowing costs: EMBIG spread and 10-year long-term government bond

A. EMBI Global Diversified Subindexes, strip spread, regions



B. Long-term government bond: 10-year, LAC-5



Sources: For panel A, World Bank staff calculations based on J.P. Morgan; for panel B, World Bank staff calculations based on Haver Analytics, Central Bank of Peru, and U.S. Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis.

Note: EM = emerging market; LA = Latin America; LAC = Latin America and the Caribbean.

A. The J.P. Morgan EMBI Global Diversified Index (EMBIGD) tracks liquid, US dollar-denominated emerging market fixed, and floating-rate debt instruments issued by sovereign and quasi-sovereign entities. The Emerging Markets Bond Index (EMBI) spread reflects the difference between the yield on these instruments and the yield on U.S. Treasury bonds of comparable maturity. Aggregates are simple averages. EM Asia includes India, Indonesia, Malaysia, and the Philippines. EM Europe includes Bulgaria, Hungary, Poland, Romania, and Serbia. LA7 includes Brazil, Chile, Colombia, Mexico, Paraguay, Peru, and Uruguay. B. The spread shown in the figure represents the difference between the 10-year government bond yields of LAC-5 countries (Brazil, Chile, Colombia, Mexico, Peru) and the yield on the 10-year U.S. Treasury bond.

BOX 1.1 Adoption, Design, and Effectiveness of Fiscal Rules

After decades of fiscal strain, Latin American and Caribbean (LAC) countries have made tangible progress in strengthening their fiscal stance. Once emblematic of procyclical policy—tightening in downturns and spending in booms, thereby amplifying business cycles (Gavin and Perotti 1997; Kaminsky et al. 2004)—the region has become noticeably less procyclical in more recent years (Frankel et al. 2013). In a number of cases, fiscal policy has even begun to lean against the cycle, taking on a more stabilizing role (Céspedes and Velasco 2014). Primary balances have improved since the mid-2010s, and the consolidation of the large deficits that were incurred during the COVID-19 recession has been comparatively swift.

But the region's fiscal fragilities have not vanished. Many LAC economies still carry elevated debt burdens accumulated through successive shocks. And since the global financial crisis, debt service has become a heavier drag on budgets: interest payments have risen sharply as a share of public revenues, especially among the region's largest borrowers. These pressures steadily erode fiscal space, crowding out discretionary spending and narrowing governments' ability to smooth fluctuations or respond decisively when new shocks hit. Building fiscal resilience, therefore, remains a core policy priority.

Against this backdrop, many LAC countries have increasingly turned to fiscal rules to strengthen fiscal frameworks. By placing numerical limits on key fiscal aggregates—such as deficits, expenditure, or public debt—fiscal rules aim to promote fiscal discipline and anchor expectations. Once largely the domain of advanced economies, these frameworks have spread widely across emerging market and developing economies (EMDEs) in recent years (refer to figure B1.1.1, panel A). In LAC, early adopters included Brazil (1988), followed by countries such as Colombia (2000), Argentina (2000), and Chile (2001). Adoption has continued steadily, and by 2024, 25 of 43 LAC countries (58 percent) had at least one fiscal rule in place.

Fiscal rules alone, however, are no panacea for sustainability. Evidence on the dynamic effects of adoption suggests that primary balances often strengthen in the years that follow, but the payoff is neither automatic nor durable. After accounting for cyclical effects, primary balances across EMDEs typically improve by about 1.4 percentage points (as a share of trend GDP) over the first five years after adoption (refer to figure B1.1.1 panel B). Thereafter, these gains often fade as discipline weakens and earlier progress unwinds. A key reason is that rules operate through institutions and governance structures: credibility, monitoring, and enforcement capacity shape whether constraints bind in practice and whether effects persist. Where institutions are strong, rules can anchor expectations and sustain adjustment beyond the initial momentum; where they are weaker, rules are more easily bypassed, amended, or suspended as time passes.

Institutional and governance challenges in EMDEs—including across LAC—are well known, but they are not the whole story behind the success or lack of success of adopting fiscal rules. Rules are introduced in diverse economic, fiscal, and political settings that shape both the incentives to adopt and shape early outcomes. These contexts also influence how credibility is built. Rule credibility is not automatically conferred at the moment a fiscal rule is adopted; it is often earned through repeated demonstrations that the rule will be respected in practice and that policy making is becoming more transparent and disciplined.

Crucially, the conditions surrounding adoption do not remain fixed. Macroeconomic pressures can intensify or ease, political coalitions can fragment or consolidate, and competing priorities can shift. As these forces evolve, governments' willingness to uphold the spirit of the rule can strengthen or weaken. The adoption environment therefore leaves a lasting imprint: it shapes early credibility and the breadth of political ownership, influencing whether the rule becomes an embedded constraint or merely a temporary signal. In that sense, the motivations and circumstances surrounding adoption can help explain why rules deliver durable gains in some cases but lose traction in others.

Among these factors, the economic environment at adoption appears to play a central role (refer to figure B1.1.1, panel C). Fiscal rules introduced in

BOX 1.1 Adoption, Design, and Effectiveness of Fiscal Rules *(continued)*

good times are more likely to produce improvements that endure. With fewer immediate fiscal pressures, adoption tends to be proactive—a deliberate effort to lock in prudence rather than a crisis response—and governments have space to demonstrate follow-through and implement complementary reforms. By contrast, rules adopted in weak conditions often struggle to gain traction. Introduced under pressure to signal resolve and expected to deliver rapid results, they can quickly lose credibility when improvements fail to materialize. While strong institutions and sound rule design may help, they rarely offset these macro headwinds (Fatás et al. 2026).

These insights carry clear policy implications. Successful fiscal rule adoption is not only about strong institutions or sound design; it requires actively investing in credibility and building broad political consensus to sustain commitment over time. Early buy-in is decisive: without a broad coalition behind the rule, frameworks can become brittle—easily diluted, reinterpreted, or reversed when pressures mount. Favorable economic conditions can make implementation easier and are more likely to reflect a long-term commitment to fiscal discipline, but political settings that force negotiation and coalition-building can be just as valuable. Introducing rules in more polarized or adverse political environments can make sustaining commitment far more difficult.

But even when adoption starts well, fiscal stability is never guaranteed. Deficits can re-emerge and debt can rise, particularly after large shocks such as the global financial crisis or the COVID-19 pandemic. Maintaining sustainability therefore requires continued vigilance: fiscal frameworks must be reinforced over time, and periodic adjustments may still be necessary to keep public finances on a sustainable path.

While successful adoption is shaped primarily by context and commitment, the ability to implement fiscal adjustments later depends on sound rule design and institutional support. Broad public sector coverage limits opportunities to shift deficits across levels of government, while deficit rules provide a clear anchor that can sharpen the link between day-to-day decisions and long-term sustainability (World Bank 2026a). Design features that specify enforcement actions when limits are approached or breached can strengthen commitment to adjustment—often by prioritizing expenditure restraint. Complementary fiscal institutions and frameworks further enhance effectiveness by improving monitoring, strengthening budget assumptions, and supporting operational implementation.

This is where many EMDEs—including those in LAC—still have ground to cover. Although the region generally aligns more closely with international practices than the average EMDE, only about 80 percent of LAC countries have explicit enforcement mechanisms, and about two-thirds ensure broad public sector coverage (refer to figure B1.1.1, panel D). Only 72 percent include escape clauses—critical during large shocks—and even fewer specify targets in cyclically adjusted terms, which help restrain spending in good times while preserving flexibility in downturns. Institutional support is also uneven: only one-third embed rules in a medium-term expenditure framework, independent fiscal institutions remain limited, and just over half operate sovereign wealth funds to help smooth revenue volatility.

Chile illustrates how strong design and institutions reinforce each other. Its structural balance rule, introduced in 2001, rests on transparent methodologies and committees of independent experts that estimate potential GDP and long-term copper prices. This institutional backbone has given the rule credibility and ensured that fiscal policy operates countercyclically rather than procyclically (Barreix and Corrales 2019). During the 2000s commodity boom, Chile saved windfall revenues and built substantial buffers; when copper prices collapsed in 2008, it deployed those buffers to support activity without undermining sustainability (Céspedes et al. 2014). The result was stronger fiscal balances, reduced output volatility, and durable credibility. Chile's fiscal rules and prudent fiscal policy management also enabled the government to provide fiscal stimulus during the pandemic without undermining fiscal sustainability (Lam et al. 2023).

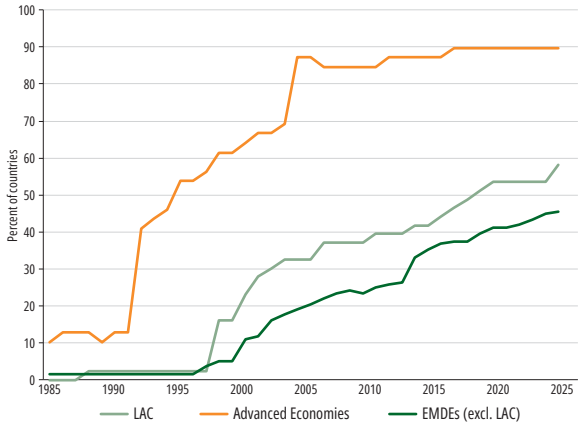
Effective frameworks, however, do not mechanically replicate international templates. They are tailored to

BOX 1.1 Adoption, Design, and Effectiveness of Fiscal Rules *(continued)*

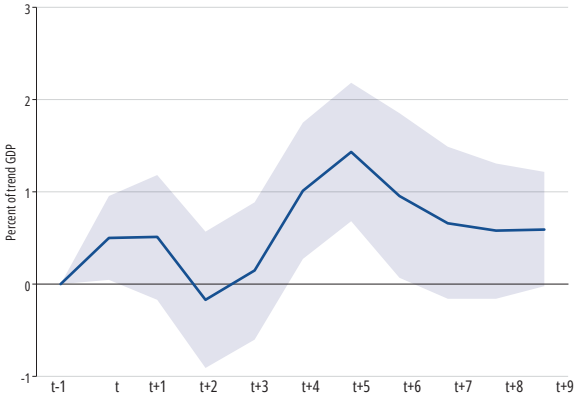
domestic challenges and anchored in clear objectives. Striking the right balance between enforceability and flexibility—while preserving simplicity—is essential. In this process, administrative and statistical capacity sets practical limits: not all countries can implement sophisticated designs or manage multiple overlapping rules. Simpler rules can nonetheless remain powerful because they provide a transparent benchmark. Such frameworks have proven effective in supporting fiscal adjustments (World Bank 2026a).

FIGURE B1.1.1 Fiscal rules adoption, performance, and design

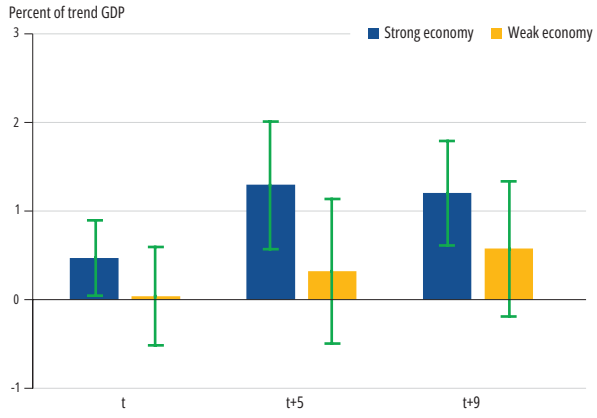
A. Fiscal rule adoption



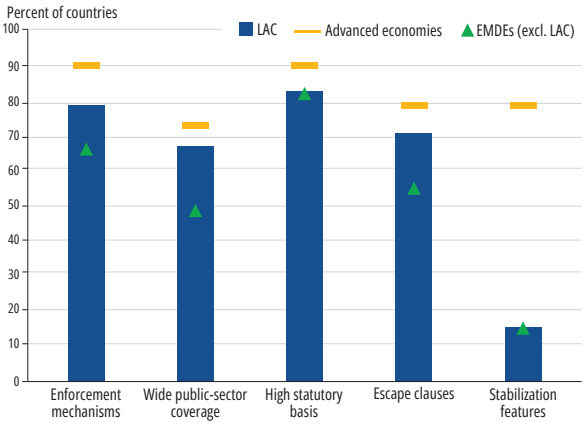
B. Cumulative change in the primary balance after rule adoption in EMDEs



C. Cumulative change in the primary balance after rule adoption, by state of the economy



D. Design of fiscal rules in 2024



Sources: International Monetary Fund; World Bank.

Note: Results are from LP-AIPW regressions. Technical details are provided in World Bank Global Economic Prospects (January 2026). EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean.

A. Lines show the percent of countries that had at least one fiscal rule in place.

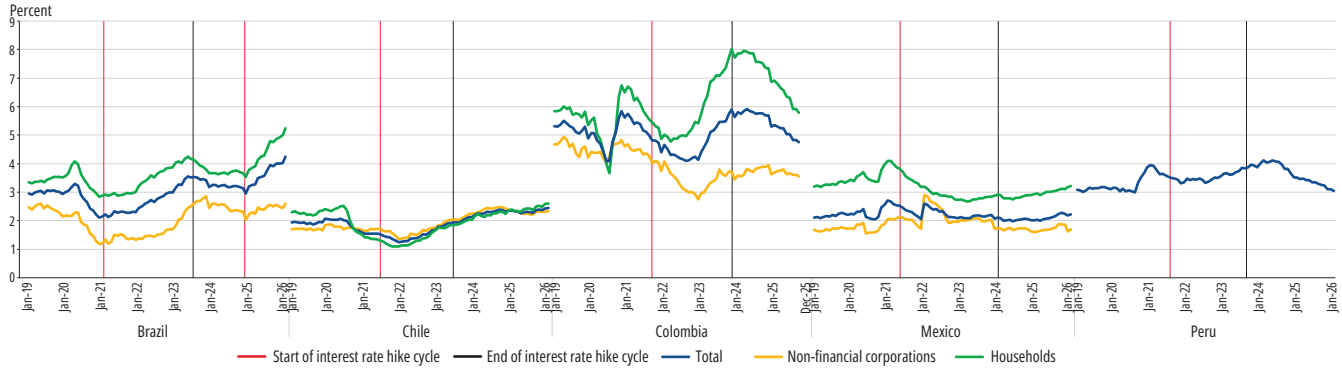
B–C. Line (bars) show the cumulative change in the cyclically adjusted primary balances as percent of GDP in the years around fiscal rule adoption, compared to a counterfactual scenario of no rule adoption in year t. Shaded area (vertical lines) show 90 percent confidence intervals.

B. Results are based on a sample of 116 countries (83 EMDEs and 33 advanced economies) with 58 cases of fiscal rule adoption (33 in EMDEs and 25 in advanced economies) between 1984 and 2015.

C. The state of the economy is defined using a weighing function based on a country-normalized, 3-year average of lagged real GDP growth relative to its long-term average. Sample includes 116 economies (83 EMDEs and 33 advanced economies), with 57 cases of fiscal rule adoption (33 in EMDEs and 24 in advanced economies) between 1984 and 2015.

D. Sample includes 25 LAC economies, 35 advanced economies, and 62 EMDEs outside of LAC. Bars show the percentage of countries (with rules) that include certain rule design or have complementary fiscal institutions in place.

FIGURE 1.17 Share of non-performing loans to total gross loans in the LAC-5

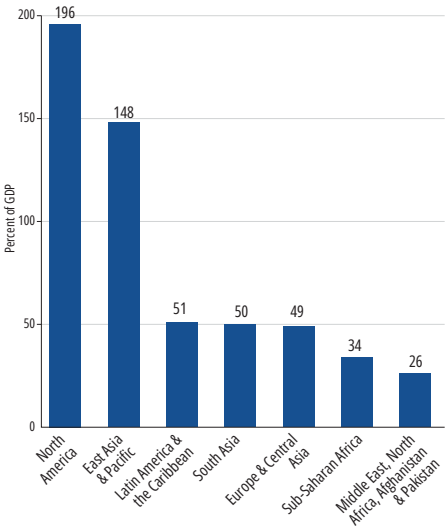


Source: World Bank staff calculations based on national statistics.

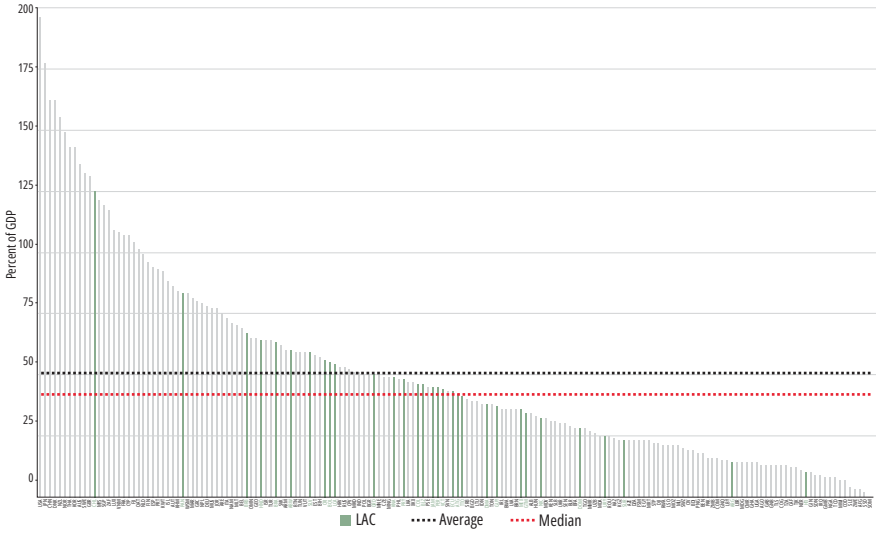
Note: Household debt is composed of mortgages and consumption loans. Non-performing loans are loans for which the contractual payments are delinquent, defined as being overdue for more than 90 days in the case of Brazil, Chile, Mexico, and Peru, and 30 days in the case of Colombia. LAC = Latin America and the Caribbean.

FIGURE 1.18 Domestic credit to the private sector by region and country

A. Domestic credit to private sector, 2019, by region



B. Domestic credit to private sector, 2019, by country



Source: World Development Indicators (WDI), World Bank.

Note: LAC = Latin America and the Caribbean.

A. Regional aggregates include only countries that are members of the World Bank Group's International Development Association (IDA) and/or International Bank of Reconstruction and Development (IBRD).

B. The panel presents data for 170 countries.

exceeds 120 percent–150 percent of GDP (such as the Republic of Korea and Singapore, with the percentage even higher in Japan and China)—than to the typical range in LAC. At the other extreme, Argentina's private credit remains exceptionally low, at about 15 percent of GDP, reflecting long-standing macroeconomic instability and public sector crowding out. Recent fiscal consolidation following the change in administration may help free financial resources for the private sector, though a sustained recovery in credit will depend on continued macroeconomic stabilization (refer to figure 1.18).

Caribbean and Central America

Some Caribbean and Central American economies outperformed Latin American countries in 2024, although performance continued to vary markedly between tourism-dependent countries and commodity exporters (refer to table 1.1). Tourism-based economies have broadly recovered the levels of GDP that prevailed before the COVID-19 pandemic, supported by the strong rebound in tourist arrivals, even as growth in the services sector is expected to moderate. Among commodity exporters, Trinidad and Tobago and Suriname experienced sharp output contractions during the pandemic following declines in international commodity prices, but activity has rebounded alongside the recovery in prices. Guyana stands out within the region, having recorded exceptionally rapid and sustained GDP growth since 2020, driven by the scaling-up of offshore oil production. This expansion has been accompanied by rising fiscal revenues, improved external balances, and a declining public debt-to-GDP ratio, although the pace of growth also underscores the importance of strengthening public investment management, building institutional capacity, and ensuring that oil wealth translates into broad-based and inclusive development. Beyond near-term macroeconomic dynamics, longer-term challenges remain across the region, particularly related to productivity and labor mobility. These longer-term constraints are particularly acute in Haiti, where repeated shocks have severely eroded household welfare and access to basic services. Box 1.2 takes a closer look at recent evidence from high-frequency phone surveys, documenting how food insecurity, declining incomes, and service gaps have compounded development challenges in Haiti.

TABLE 1.1 Real GDP growth prospects in the Caribbean and Central America

Country	2024	2025e	2026f
Commodity exporters			
Trinidad and Tobago	2.5	0.8	0.7
Suriname	1.7	1.8	4.0
Guyana	43.8	15.4	16.3
Tourism-dependent			
St. Vincent and the Grenadines	4.1	3.6	3.0
St. Lucia	4.7	1.3	1.9
Jamaica	-0.5	-0.4	-1.0
Grenada	3.3	4.5	3.1
Dominica	2.1	3.1	2.8
Belize	3.5	1.5	2.4
Barbados	3.4	2.7	2.7
Other			
Haiti	-4.2	-2.7	0.6

Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).
Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast.

Public debt dynamics remain heterogeneous across the Caribbean and Central America. Several countries have reduced debt-to-GDP ratios through a combination of economic growth and fiscal consolidation. Relative to benchmarks before and during the pandemic, Belize, Costa Rica, Jamaica, St. Lucia, Barbados, and Suriname show substantial progress in lowering debt burdens (refer to figure 1.19). Jamaica strengthened its fiscal governance framework in 2025 by making the Independent Fiscal Commission (IFC) fully operational, building on the foundations established by the Economic Programme Oversight Committee (EPOC). The IFC's early independent assessments of budget credibility and fiscal performance have reinforced steps toward transparency and policy credibility, supporting Jamaica's transition to a durable, rules-based fiscal framework. In Costa Rica, declining debt ratios reflect a more gradual, rules-based consolidation anchored in the fiscal rule and expenditure controls, supported by sustained primary surpluses and improved market confidence. This framework has helped stabilize public finances following the pandemic-related increase in debt and strengthen fiscal credibility. Barbados and Belize reduced debt through decisive policy choices rather than gradual adjustment alone. Barbados combined fiscal reform with a comprehensive debt restructuring that lowered interest costs, while Belize cut external debt through a debt-for-nature swap tied to marine conservation. In both cases, visible actions helped lock in credibility and support the recovery.

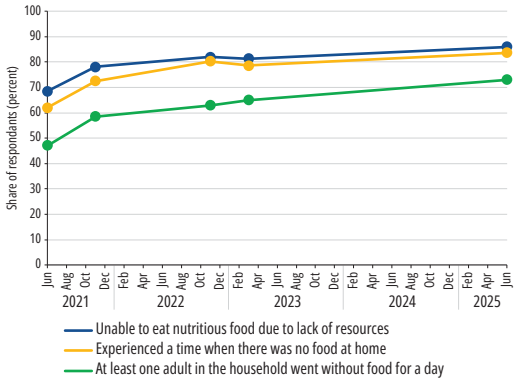
BOX 1.2 Haiti's Development Challenges in Focus: Building New Evidence through Phone Surveys

Compounding shocks—health crises, natural disasters, and insecurity—have continued to weaken Haitians' well-being over the last five years, with food insecurity rising. While conflict and social unrest have impeded to collect household-level data through traditional face-to-face methods, six rounds of phone survey data collected between 2021 and 2025 make it possible to track Haitians' living standards, jobs, and access to services. Food security has worsened, even as the COVID-19 crisis has abated: for example, about three-quarters of Haitians live in a household where at least one adult went without food for a day in the previous month in 2025, up from about half in 2021 (refer to figure B1.2.1). Over the same period, the share of Haitians reporting that they were able to meet their basic food and non-food needs more than halved, while many households also shed their assets—behavior that typically only happens during deep and persistent crises—weakening their long-term financial resilience.

Incomes are declining and in-work poverty is proliferating in Haiti, even as broad employment patterns remain stable. Between 2021 and 2025, the share of phone survey respondents who were employed and working hovered around 4 in 10. Among those who were working, the share engaged in self-employment remained around 6 in 10 and the share in services stayed around 7 in 10. Yet labor incomes have dropped. For people living in households with wage income, non-farm self-employment income, and agricultural income in the previous year, more than 7 in 10 saw incomes from each source fall or be eliminated by the time they were interviewed in 2025. With non-labor incomes—including remittances—suffering a similar decline, Haitians' options for building economic security appear increasingly limited.

Large gaps in basic services expose Haitians to non-monetary poverty (refer to figure B1.2.2). In 2025, only 65 percent of Haitians had improved sanitation and just 30 percent had electricity access from any source in their household. While access to improved drinking water was more widespread, just over half of Haitians relied on

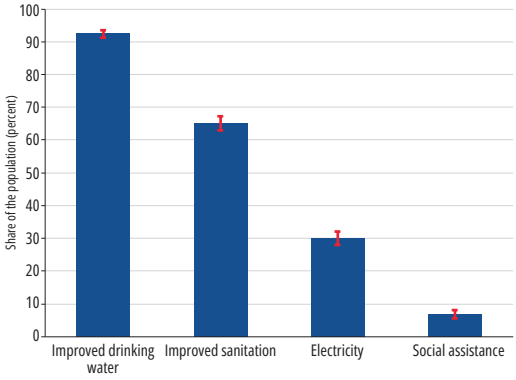
FIGURE B1.2.1 Food security in Haiti, 2021–25



Source: Haiti High Frequency Phone Survey Waves 1-5.

Note: Indicators ask whether each food insecurity situation was encountered in the household in the 30 days before the interview. Individual-level weights have been applied, so the sum of the weights is the number of 18+ year olds in households with a mobile phone.

FIGURE B1.2.2 Access to basic services in Haiti, 2025



Source: Haiti High Frequency Phone Survey Wave 5.

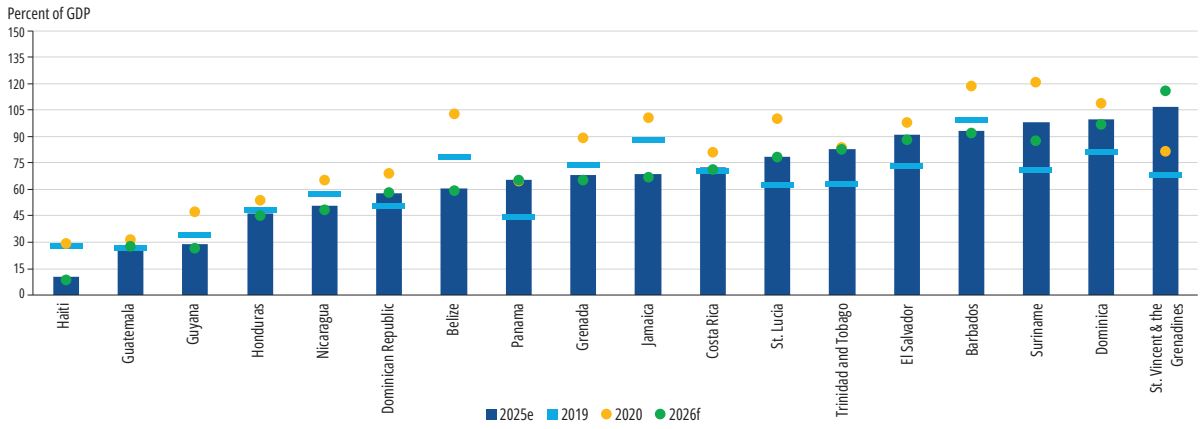
Note: Improved water and sanitation standards follow Joint Monitoring Programme for Water Supply, Sanitation and Hygiene (JMP) standards. Social assistance includes cash, food, and in-kind transfers from the government, nongovernmental organizations, international organizations, or religious bodies. Individual-level weights have been applied, so the sum of the weights is the number of 18+ year olds in households with a mobile phone. Error bars represent 95 percent confidence intervals.

BOX 1.2. Haiti's Development Challenges in Focus: Building New Evidence through Phone Surveys *(continued)*

bottled or tanker water—distribution mechanisms that could be disrupted by insecurity. Social assistance coverage was dwarfed by the extent of shocks and food insecurity: only 6.9 percent of the population lived in a household that received any form of social assistance from any source in the previous year.

Addressing gaps in services and infrastructure could support productive jobs and poverty reduction. Expanding social assistance and access to services can improve Haitians' well-being in the short term, protecting against severe food insecurity. Yet investing in infrastructure can have longer-term effects too. For example, electricity can connect households to input and output markets and enable productivity-enhancing equipment for priority sectors, including agro-industry, textiles, and digital finance. Therefore, expanding coverage to key services could provide the foundations for more productive employment, human capital development, and pathways out of poverty.

FIGURE 1.19 General government debt stock across the Caribbean and Central America



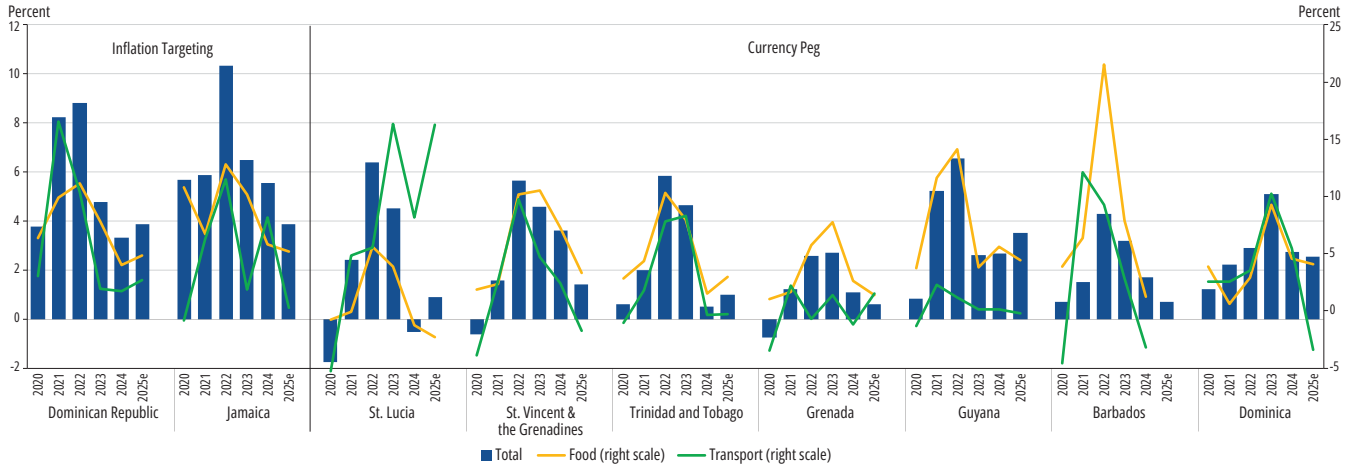
Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).
Note: The values for 2026 are based on projections (as of March 27, 2026). e = estimate; f = forecast; GDP = gross domestic product.

At the same time, some highly indebted Caribbean economies continue to face challenges in achieving durable debt sustainability, while oil-producing countries such as Guyana confront the parallel task of managing revenue volatility and avoiding procyclicality as public finances expand rapidly.

Inflation rose sharply across the Caribbean in 2022, driven by higher global food and fuel prices, although countries with exchange rate pegs were better able to cushion these shocks than those operating under inflation-targeting regimes. Since 2023, the normalization of international prices has contributed to a broad easing of inflationary pressures across the region (refer to figure 1.20).

Against this backdrop, recent developments related to the conflict in the Middle East introduce additional uncertainty for Caribbean and Central American economies through several distinct channels. Exposure differs across countries depending on their position in energy and food markets. At the same time, for economies whose growth models rely heavily on services—particularly tourism—shifts in global demand, air-travel costs, and a more cautious short-term global environment represent an additional source of vulnerability. Where these channels intersect, external shocks may compound, underscoring the sensitivity of growth prospects to global developments and reinforcing the importance of resilience-building policies, diversification, and adequate buffers.

FIGURE 1.20 Inflation in the Caribbean and Central America



Sources: World Bank Macro Poverty Outlook (Spring Meetings 2026); Eastern Caribbean Central Bank; Guyana's Bureau of Statistics; Barbados Statistical Service; International Monetary Fund (IMF); and World Bank staff calculations.

Note: e = estimate.

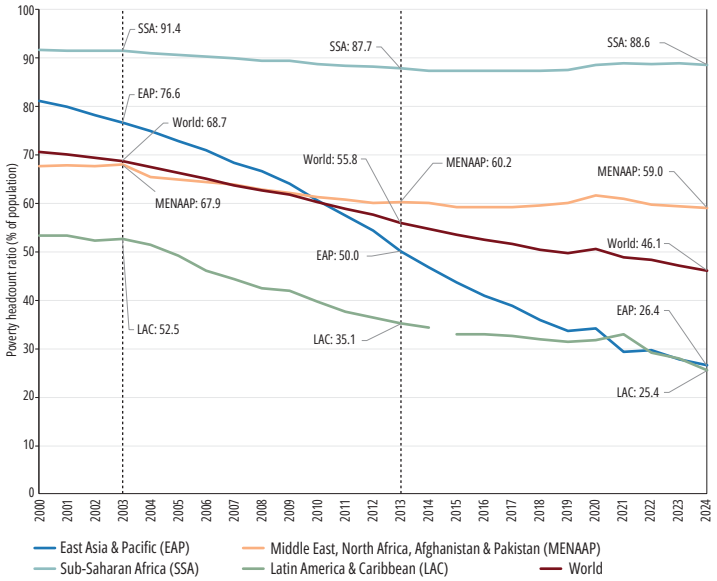
Labor markets, informality, poverty, and inequality

Economic slowdown constricts the decline in poverty

Social progress in key indicators—most notably monetary poverty—has historically moved closely with economic performance across emerging regions. In LAC, the poverty rate fell sharply during the 2003–13 "Golden Decade" of high commodity prices and strong growth, declining by 17.4 percentage points. About one-third of this reduction reflected redistribution, while two-thirds was driven by economic growth (World Bank 2019). Importantly, within the growth component, only about one-third (around 20 percent of the total poverty reduction) was associated with trend-based, more permanent income gains, while the remaining two-thirds (approximately 45 percent of the total reduction) came from cyclical, transitory improvements. This composition highlights the fragility of past social gains and the sensitivity of poverty outcomes to short-term fluctuations in economic activity.

As the externally driven boom faded and growth slowed after 2013, the pace of poverty reduction decelerated markedly, with poverty declining by a more modest 9.7 percentage points between 2013 and 2024 (refer to figure 1.21). By contrast, regions

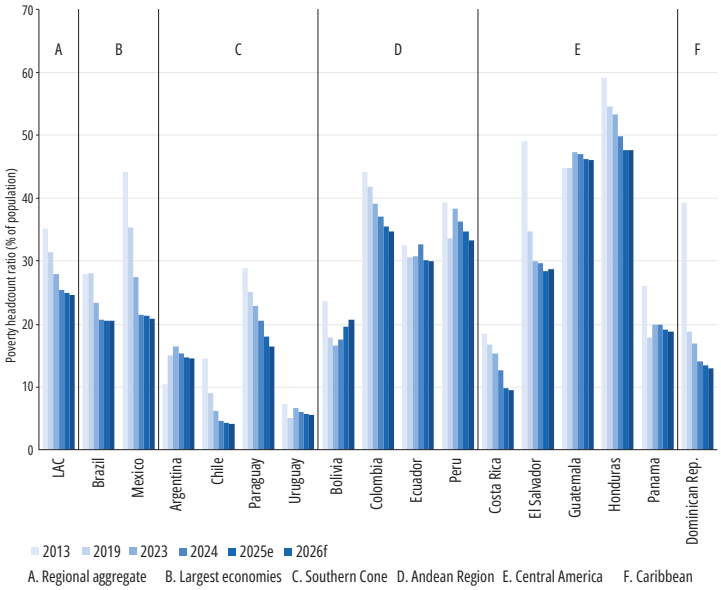
FIGURE 1.21 Regional poverty rate dynamics



Sources: World Bank staff calculations based on Regional Poverty and Inequality Update, Latin America and the Caribbean (October 2025). Data for the LAC region are drawn from the World Bank Group LAC Equity Lab, while data for other regions are sourced from the World Bank Group Poverty and Inequality Platform (PIP). Last updated on March 27, 2026.

Note: The figure uses a poverty line for upper-middle-income countries of US$8.30/day in 2021 purchasing power parity (PPP) terms. Dashed vertical lines mark the "Golden Decade" of poverty reduction for LAC. The LAC regional aggregate is based on 18 countries in the region for which microdata were available at national level. In cases where data were unavailable, values have been estimated using a combination of methods, including microsimulations, and then pooled to create regional estimates. Due to substantial methodological revisions in Mexico's official household survey in 2016, which resulted in a discontinuity in the poverty series, a break has been introduced in the LAC-18 series from 2015 onward.

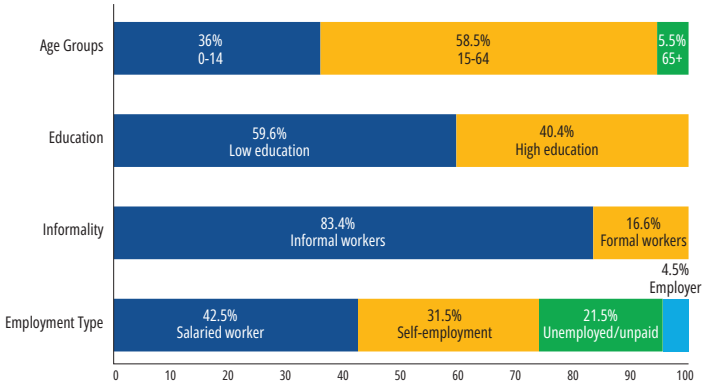
FIGURE 1.22 Poverty rates in LAC economies



Source: World Bank Macro Poverty Outlook (Spring Meetings 2026).

Note: The figure uses a poverty line for upper-middle-income countries of US$8.30/day in 2021 purchasing power parity (PPP) terms. For Argentina, data have only urban coverage. For the Dominican Republic, Mexico, Paraguay, Uruguay, and the LAC aggregate, due to survey and methodological changes, the 2013 value is not entirely comparable with the rest of the series. For Paraguay, and Uruguay, due to survey and methodological changes, values from 2023 onward are not entirely comparable with the rest of the series. For Chile, the 2017 value is used for 2019 and the 2022 value for 2023. For Guatemala, the 2014 value is used for 2013 and 2019. For Mexico, the 2012 value is used for 2013, the 2018 value for 2019, and the 2022 value for 2023. The LAC regional aggregate is based on 18 countries in the region for which microdata were available at national level. In cases where data were unavailable, values have been estimated using a combination of methods, including microsimulations, and then pooled to create regional estimates. Updated March 27, 2026. e = estimate. f = forecast. LAC = Latin America and the Caribbean.

FIGURE 1.23 Composition of the poor population in LAC



Sources: World Bank staff calculations based on Regional Poverty and Inequality Update, Latin America and the Caribbean (October 2025). Data for the LAC region are drawn from SEDLAC (CEDLAS and World Bank).

Note: The LAC regional aggregate is based on 18 countries in the region for which microdata were available. In cases where data were unavailable, values have been estimated using a combination of methods, including microsimulations, and then pooled to create regional estimates. Education levels are defined as follows: low education includes individuals with no formal education or who completed primary education, and high education includes those who completed secondary or tertiary education. Informality is measured among working individuals ages 15–64 and refers to workers without work-related pension insurance, with country-specific definitions applied as needed. In Argentina, informal workers include salaried workers without pension insurance and unpaid workers without complete tertiary education. In Mexico, workers without work-related health insurance benefits are classified as informal. In Honduras, informal workers include unpaid workers without tertiary education or, if they have tertiary education, those employed by small private firms, as well as salaried workers with limited education who work in small private firms.

that sustained stronger and more consistent growth in GDP and labor productivity—notably East Asia and Pacific—continued to reduce poverty rapidly over both periods. Largely propelled by China's robust performance, East Asia and Pacific has since converged with LAC in terms of its poverty rate, underscoring the central role of sustained growth in driving durable social progress.

Looking ahead, recent downward revisions to growth forecasts across LAC are expected to further weaken the pace of poverty reduction (refer to figure 1.22). Slower economic growth implies that the main engine of past social progress will operate with less force in the coming years. Compounding this challenge, limited fiscal space in many countries constrains the scope for offsetting weaker growth through higher social transfers. Elevated public debt levels and persistent fiscal deficits restrict governments' ability to expand existing programs or introduce new ones, leaving fewer buffers to cushion the impact of slower growth on vulnerable households.

These constraints are particularly binding in a region where poverty remains pervasive among workers with low levels of education and weak attachment to the formal labor market (refer to figure 1.23). Poor households in LAC are disproportionately concentrated among low-educated individuals, informal workers, and those engaged in self-employment or unstable forms of work. This labor market profile limits exposure to sustained productivity gains and formal wage growth, reinforcing the sensitivity of poverty outcomes to economic slowdowns and constraining the pace of further social progress.

Understanding why poverty remains persistent among low-educated and informal workers requires looking beyond aggregate growth outcomes to the structure of labor markets and how welfare is measured. Box 1.3 explores why labor informality—particularly self-employment in micro firms—remains widespread in LAC, emphasizing the role of job amenities, worker preferences, and limited returns to formal employment. The complementary discussion in box 1.4 revisits how inequality is assessed in highly informal economies, showing that income-based measures may overstate underlying

BOX 1.3 Why Informality Persists. The Lure of Self-Employment

The share of workers considered "informal" in Latin America and the Caribbean (LAC)—both entrepreneurs and informal salaried workers—remains stubbornly high, totaling 55 percent to 60 percent of the workforce. The causes and implications for this high level of informality remain widely debated: Why is it so persistent? How bad is it for workers? How responsible is it for LAC's stagnant growth? The forthcoming World Bank report, *Why Labor Informality Persists: Self-Employment and Job Quality in LAC,* explores these questions (Beylis, Maloney, et al. forthcoming).

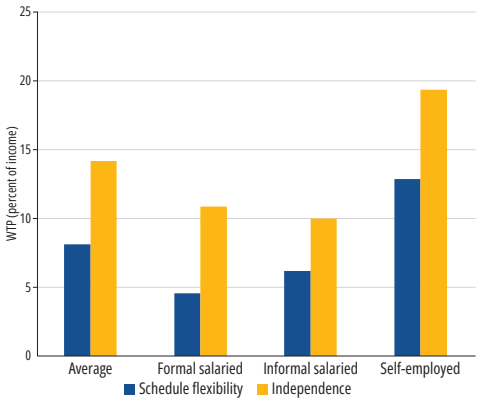
Self-employment in firms with up to 5 workers (so-called micro firms) is the epicenter of activity in the informal sector. The vast majority of informal workers are found in such firms, and the share of their workforce mirrors the share of workers in micro firms. Understanding the persistence of informality in LAC requires understanding the persistence of the informal micro firm.

This, in turn, requires understanding why workers select into microentrepreneurship—which inevitably requires lifting the hood on what workers consider a good job. While job quality is often associated with access to state labor social protections, this definition has long been seen as inadequate in the advanced economies and is equally so in developing countries. In a canonical work, Rosen (1983) stressed that the labor market clears on both earnings and job amenities, which include formal labor market protections as well as such characteristics as agency (being one's own boss) and flexibility. In fact, the 2025 American Job Quality Study identifies these amenities as two of five characteristics of quality employment (Gallup et al. 2025).

The self-employed workers of LAC register the same high amenity value of agency (being your own boss) and autonomy found in the advanced economies. Surveys show that 80 percent of *salaried* workers in Mexico and the Dominican Republic say they would prefer to be self-employed, substantially above the very high level of 50 percent prevailing in the member-countries of the Organisation for Economic Co-operation and Development (OECD). Similar results are being found for household enterprises in Africa as well (Cerkez et al. 2024; Falco et al. 2015), and Asia and Eastern Europe, suggesting that the lure of self-employment is not a phenomenon confined to LAC.

Using state-of-the-art methods based on discrete choice experiments, Beylis, Garin, et al. (forthcoming) estimate the willingness to pay for different job amenities and benefits in seven Latin American countries (Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru), using nationally representative panels of workers. The authors find sizable valuations for both flexibility (8.1 percent of earnings) and independence (14.2 percent). Another important finding of the analysis—consistent with the literature on advanced economies—is that workers appear to sort into jobs that fit with their preferences. That is, workers who value these attributes the most are found in jobs that offer these amenities (refer

FIGURE B1.3.1 Willingness to pay for job amenities



Source: Beylis, Garin, et al. forthcoming.

Note: Simple average for seven Latin American countries: Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru. WTP= willingness to pay.

BOX 1.3 Why Informality Persists. The Lure of Self-Employment *(continued)*

to figure B1.3.1). For example, workers who are currently self-employed value schedule flexibility more than twice as much as salaried workers (12.9 percent versus 5.4 percent) and independence almost twice as much as salaried workers (19.3 percent versus 10.3 percent).

The resulting concentration of workers in informality, then, is the result of workers maximizing welfare, not productivity. Emphatically, saying that these workers choose informal jobs does not imply that they are well-off or even happy—only that they would not be better off in the formal salaried jobs for which they are qualified, given their poor human capital and the low productivity in the formal sector.

Is LAC, then, condemned to a bloated informal sector and stagnant growth? Not necessarily. Both across countries and within countries, the share of workers in self-employment declines in a linear fashion with development. This pattern is consistent with the increase in the opportunity cost of the amenities of self-employment as the productivity of formal salaried jobs increases.

Hence, *policies that shift the cost-benefit calculus toward formal employment will lead to a rise in productivity*. A gap between contributions and benefits may occur for many reasons related to the design and efficacy of social protection systems, creating an incentive to enter self-employment. Because workers optimize at the family level and not the individual level, if one member pays contributions for health benefits that cover a whole family, a second contribution is pure tax. Similarly, low-education workers frequently switch from one type of work to another; thus despite contributing to a pension while working in a formal job, they may never qualify for a pension (Maloney 1999). Meanwhile, frequently raided pension funds reduce the expected return. Expanding universal pension and health insurance programs reduces the relative value of formal benefits (Bosch and Campos-Vazquez 2014; Levy 2008). The World Bank publication, *(In)Formalizing Work: Taxes, Benefits and Incentives in Latin America and the Caribbean* (Fietz et al. 2025), estimates the implicit tax on formal workers in the extreme case where social security contributions are not valued at all and the likely impact on sectoral allocation and shows it to be potentially very large.

Similarly, *policies supporting the best firms* so they can *reach their full potential—dictated by their entrepreneurial skill level—further contribute to creating formal jobs and reducing informal ones*. Relaxing credit constraints for formal firms allows the most productive firms to expand significantly, attracting workers with better wages, and pushing out the least productive entrepreneurs (Beylis et al. 2026).

Enhancing worker and entrepreneurial skills significantly boosts productivity, particularly of the largest firms, increasing the demand for workers and their wages (Beylis et al. 2026). As formal wages increase, informal entrepreneurs abandon their micro firms and engage in formal salaried work, as higher wages in the formal sector more than compensate for the value of foregone job amenities.

Policies anchored to the size of a firm (size-dependent policies) should be reformed. As Eslava and Melendez (forthcoming) have documented for a large set of LAC countries, there are still many size-dependent policies that interfere with the natural growth trajectories of productive firms because firms face large discrete jumps in taxes, contributions, and mandates as they expand.

Tax wealth, not firms. High corporate income tax (CIT) rates in LAC, coupled with a challenging business environment, incentivize evasion and discourage investment. Vuletin (2025) advocates for reducing CIT rates to align with other emerging markets, improving enforcement, engage in public-private partnerships for tax collection, and shifting focus to property taxes as a more viable form of wealth taxation.

BOX 1.4 Rethinking Inequality Measurement in EMDEs: The Role of Consumption

A long-standing concern in the analysis of inequality in emerging market and developing economies (EMDEs), including those in Latin America and the Caribbean (LAC), is that these economies appear substantially more unequal than advanced economies. Comparative evidence consistently shows that income-based inequality measures in EMDEs—particularly in LAC—are markedly higher than those observed in advanced economies in the Organisation for Economic Co-operation and Development (OECD).

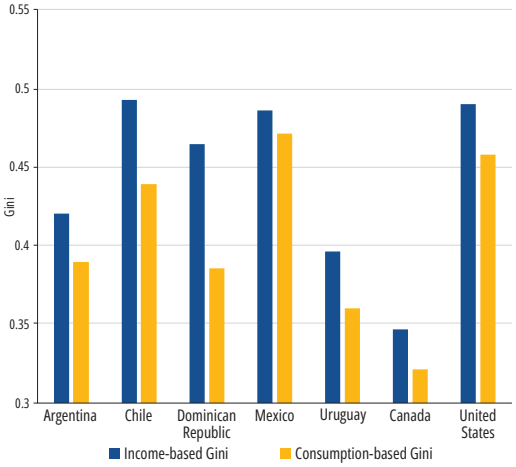
Cross-country evidence also suggests that inequality tends to decline as GDP per capita rises. This pattern is broadly consistent with the Kuznets hypothesis, whereby inequality initially increases during early stages of structural transformation and later falls as economies reach higher income levels. However, a growing body of research has emphasized that income is often imperfectly measured in EMDEs, complicating cross-country comparisons of inequality.

High levels of labor informality are a central source of this mismeasurement. Informal earnings are frequently underreported or incompletely captured in household surveys, and are often volatile due to exposure to temporary shocks. In many EMDEs, informality accounts for more than half of total employment and a sizeable share of output, making point-in-time income a noisy proxy for underlying welfare. As a result, income-based inequality measures may overstate persistent disparities, particularly at the lower end of the distribution.

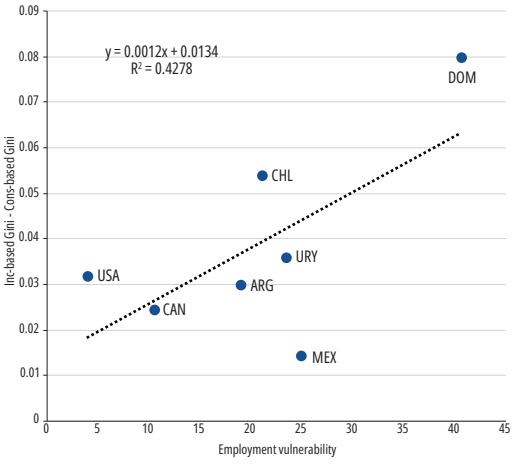
Because of these challenges, an expanding literature argues that consumption should be used alongside income when assessing inequality, especially in economies with large informal

FIGURE B1.4.1 Income versus consumption inequality measures

A. Income-based and consumption-based Gini using spending surveys



B. Relationship between income-based and consumption-based gap and employment vulnerability



Sources: World Bank staff calculations based on household expenditure surveys from the selected countries: Argentina – Encuesta Nacional de Gastos de los Hogares (ENGHO 2017/18); Bolivia – Encuesta de Presupuestos Familiares (EPF 2016); Canada – Survey of Household Spending (SHS 2019); Chile – Encuesta de Presupuestos Familiares (EPF 2017); Dominican Republic – Encuesta Nacional de Ingresos y Gastos de los Hogares (ENIH 2018); Mexico – Encuesta Nacional de Ingresos y Gastos de los Hogares (ENIGH 2018); Uruguay – Encuesta Nacional de Gastos e Ingresos de los Hogares (ENIGH 2016); United States – Consumer Expenditure Survey (CES 2021).

Notes: Vulnerable employment refers to contributing family workers and own-account workers expressed as a percentage of total employment.

BOX 1.4 Rethinking Inequality Measurement in EMDEs: The Role of Consumption *(continued)*

sectors. Consumption is more closely related to permanent income—a central insight of the Permanent Income Hypothesis—and is less sensitive to short-term income fluctuations. Consistent with this view, consumption-based inequality is typically found to be lower than income-based inequality.

This box provides empirical evidence along two dimensions. First, across a set of countries including Argentina, Chile, the Dominican Republic, Mexico, Uruguay, Canada, and the United States, consumption-based Gini coefficients are uniformly lower than income-based Gini coefficients (refer to figure B1.4.1, panel A). This pattern holds not only in EMDEs but also in advanced economies, though the gap is markedly larger in the former, suggesting that income mismeasurement is more pronounced where informality and income volatility are higher.

Second, the difference between income-based and consumption-based inequality is systematically related to labor market structure. Figure B1.4.1, panel B, shows a strong positive association between the gap (income Gini minus consumption Gini) and employment vulnerability, defined as the share of own-account and contributing family workers in total employment. Countries with higher employment vulnerability—an indicator of informality and income instability—exhibit a larger divergence between income-based and consumption-based inequality. This relationship is consistent with consumption- smoothing behavior and with the notion that income measures in highly informal economies tend to overstate underlying welfare inequality.

These findings have important implications for the interpretation of inequality in EMDEs, particularly in LAC. When inequality is measured using income, EMDEs appear to be about twice as unequal as advanced economies. When measured using consumption, however, this gap is substantially smaller. This does not imply that inequality in EMDEs is low or unimportant. Rather, it highlights that measurement matters: in contexts characterized by high informality and income volatility, income-based inequality measures can exaggerate disparities in long-term living standards.

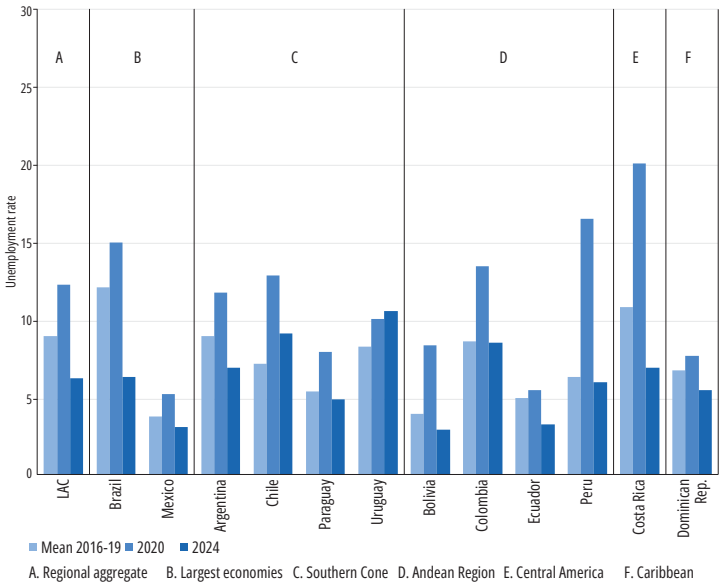
More broadly, the results underscore the value of relying on complementary welfare indicators, rather than income alone, when assessing inequality in EMDEs. Improvements in household survey design, better integration of administrative data, and sustained reductions in labor informality are essential not only for reducing inequality itself, but also for improving how it is measured. Doing so provides a more accurate picture of welfare differences and a firmer basis for policy design.

welfare disparities and that consumption-based indicators provide a more informative picture in contexts characterized by income volatility and informality. Together, these perspectives help clarify the structural channels through which slow growth translates into persistent poverty and limited social mobility.

Similarly, the unemployment rate masks important dynamics related to informality, poverty, and productivity. The unemployment rate in LAC has remained relatively contained. By 2024, unemployment was generally below its pandemic peak and, in several countries, close to pre-pandemic levels, suggesting a degree of resilience in labor market participation despite the recent growth slowdown (refer to figure 1.24). At the same time, the unemployment rate is a narrow indicator that does not differentiate between formal and informal employment, nor does it capture changes in job quality, earnings, or employment stability. In economies with high informality, labor market

adjustment during periods of weak growth tends to occur through shifts toward self-employment and informal activities rather than through higher unemployment rates. As a result, relatively stable unemployment rates may coexist with subdued productivity growth, weaker real income dynamics, and slower poverty reduction—highlighting the distinction between employment quantity and employment quality that characterizes labor markets in the region.

FIGURE 1.24 Unemployment rates in LAC economies



Source: LAC Equity Lab tabulations of LABLAC (CEDLAS and the World Bank), https://www.worldbank.org/en/topic/poverty/lac-equity-lab1/labor-markets/main-labor-market-indicators.

Note: The labor force includes both employed individuals and those actively seeking work (that is, the unemployed). The unemployment rate reflects the proportion of the labor force that is unemployed. In this plot, most data points are based on information from the third quarter of each year. Exceptions include Colombia, Costa Rica, and Ecuador, where data are drawn from the fourth quarter; and Bolivia, Uruguay, and the regional aggregate for LAC, where data correspond to the second quarter. From 2021 onward, due to methodological changes, reported values for Colombia and Ecuador are not fully comparable with previous years. For Paraguay, values from 2022 onward are also not fully comparable with earlier periods. For Uruguay, values for 2016–19, 2020, and 2024 are not fully comparable with one another due to methodological changes and should be considered indicative. LAC = Latin America and the Caribbean.

Trade agreements, market access, and diversification: Lessons for LAC

International trade as a development tool

International trade remains a foundational driver of long-term economic development. A robust body of empirical literature demonstrates that more open economies—particularly EMDEs—tend to grow faster by facilitating access to larger markets, imported technologies, and the competitive pressures necessary for productivity gains (Wacziarg and Welch 2008; World Bank 2020). These benefits, rooted in classical mechanisms such as specialization, scale effects, and knowledge diffusion, are especially critical for smaller economies where domestic markets lack the depth to support diversified industrial bases. The dividends of openness are further amplified when a country's export basket closely matches the import demand of its trading partners. In such cases, integration does more than expand market size: it embeds domestic firms into production networks where demand, specialization, and scale are jointly determined, strengthening productivity gains through value chain linkages rather than arms-length trade alone.

Realizing these gains from trade depends not only on openness per se, but also on how countries integrate into global markets and through which policy instruments. In practice, this integration increasingly takes place through networks of preferential trade agreements (PTAs). PTAs are treaties between two or more countries under which members grant each other more favorable trade conditions than those applied to nonmembers. While traditionally focused on tariff reductions, modern PTAs increasingly extend to non-tariff measures and behind-the-border policies—such as customs procedures, investment rules, standards, competition policy, and intellectual property—making them a central vehicle for trade liberalization as progress at the multilateral level has slowed. By lowering tariffs and trade costs among members, PTAs expand the share of global GDP that domestic firms can access on preferential terms and shape not only the volume but also the nature of integration.

To capture these dimensions systematically, figure 1.25 reports three complementary indicators: the share of global GDP accessible through PTAs (refer to panel A), the average GDP per capita of PTA partners (refer to panel B), and the average Trade Complementarity Index (TCI) with PTA partners (refer to panel C). The TCI measures how well a country's export profile matches its partners' import

demand at the goods level, capturing alignment with partners' production structures. Therefore, it could be interpreted as indicative of the scope for deeper value-chain linkages and specialization patterns across PTA partners.

Together, these measures proxy access to global demand, exposure to high-purchasing-power markets, and alignment with partners' production structures and the presence of deeper value-chain linkages. The figures highlight pronounced heterogeneity within Latin America and the Caribbean. In panel A, countries such as Chile and Peru appear among the most globally integrated economies—comparable to Singapore or Republic of Korea—with preferential access to close to 90 percent of global GDP, followed by Mexico, Colombia, and Panama in the 60 percent–70 percent range, while larger South American economies such as Argentina and Brazil remain weakly integrated, with coverage closer to 20 percent, though the recently concluded EU-MERCOSUR agreement could improve this picture in the coming years. Panel B reveals a similar, though less stark, pattern in terms of partner income levels. Panel C shows even greater dispersion: Mexico exhibits one of the highest levels of trade complementarity with its PTA partners, reflecting the close alignment between its manufacturing-intensive export basket and the import demand of North American value chains, whereas Chile ranks among the lowest, consistent with an export structure dominated by primary commodities whose demand is broad but less partner-specific—implying that Chile's integration is breadth-oriented rather than value-chain-oriented, whereas Mexico's PTA network is characterized by deep, production-stage complementarity.

How trade agreement frameworks shape the trade-off between autonomy and integration

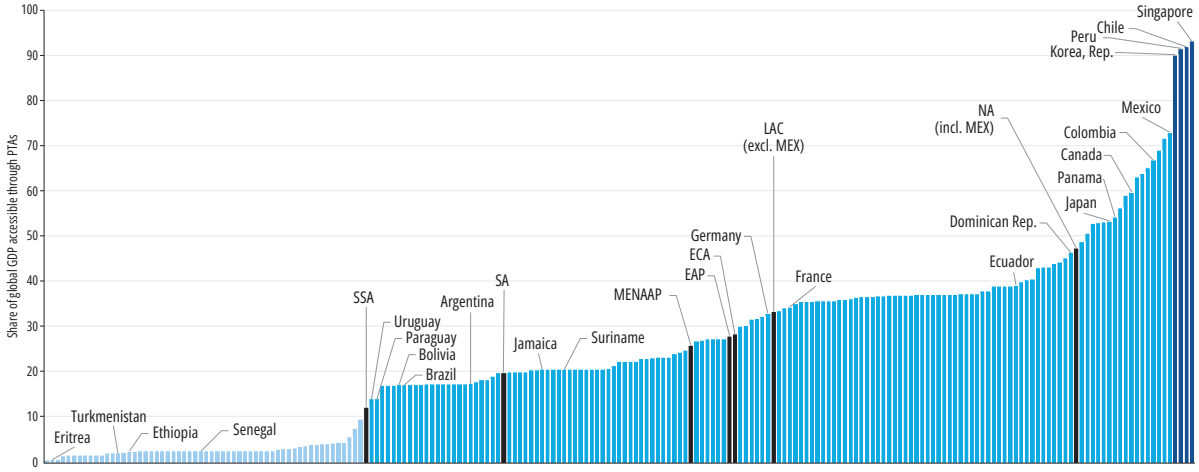
The PTA patterns documented in figure 1.25 (panels A–C)—coverage of global GDP, the income level of PTA partners, and trade complementarity—are not merely the result of countries "having more agreements." They also reflect the institutional architecture through which countries integrate. Trade agreement frameworks shape both the depth of integration within the bloc—through common rules, external tariffs, and internal market discipline—and the degree of external policy autonomy that members retain. These design features jointly influence how countries access scale and specialization gains internally, while also determining how easily they can expand market access beyond their bloc, connect to partners with high purchasing power, and align with global value chains. Put differently, the same PTA network measures can be read as revealed outcomes of how different frameworks balance internal integration against external flexibility.

At a broad level, three stylized frameworks illustrate the trade-off between autonomy and integration. Customs unions—such as the EU, MERCOSUR, and (in intent) the Caribbean Single Market and Economy (CSME)—adopt a common external tariff (CET) and a shared external trade policy. This model can deliver deep internal integration but typically limits members' ability to pursue independent tariff-liberalizing agreements with third parties. In return, it enables freer and more efficient intra-bloc trade—by eliminating rules of origin—supports deeper production integration and bloc value-chain formation, and strengthens collective bargaining power vis-à-vis external partners. Mega Free Trade Agreements (FTAs)—such as the Pacific Alliance and the CAFTA-DR (Dominican Republic–Central America–United States Free Trade Agreement) — occupy an intermediate position because they liberalize trade within the bloc while preserving members' formal authority over external tariffs and third-party negotiations. In practice, however, coordination requirements, complex rules of origin, and bloc embedded supply chains can still constrain autonomy. Stand-alone FTAs, exemplified by Chile's sequential approach, preserve the greatest formal autonomy and flexibility. Retaining control over tariffs and negotiating priorities facilitates diversified integration across partners, helping explain broader diversification rather than bloc-centric concentration.

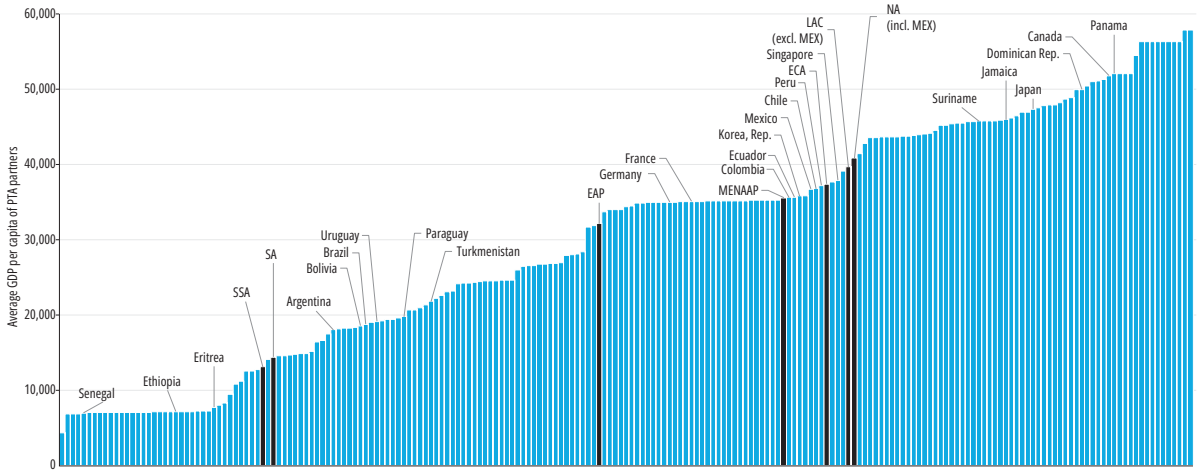
Figure 1.25 (panels D–F) further examines these distinctions by decomposing PTA relationships into within-bloc versus outside-bloc components. Panel D separates the share of global GDP accessible through PTAs into access generated

FIGURE 1.25 Coverage of Preferential Trade Agreements (PTAs)

A. Share of global GDP accessible through PTAs, by country and region



B. Average GDP per capita of PTA partners, by country and region



C. Average Trade Complementarity Index (TCI) with PTA partners, by country and region

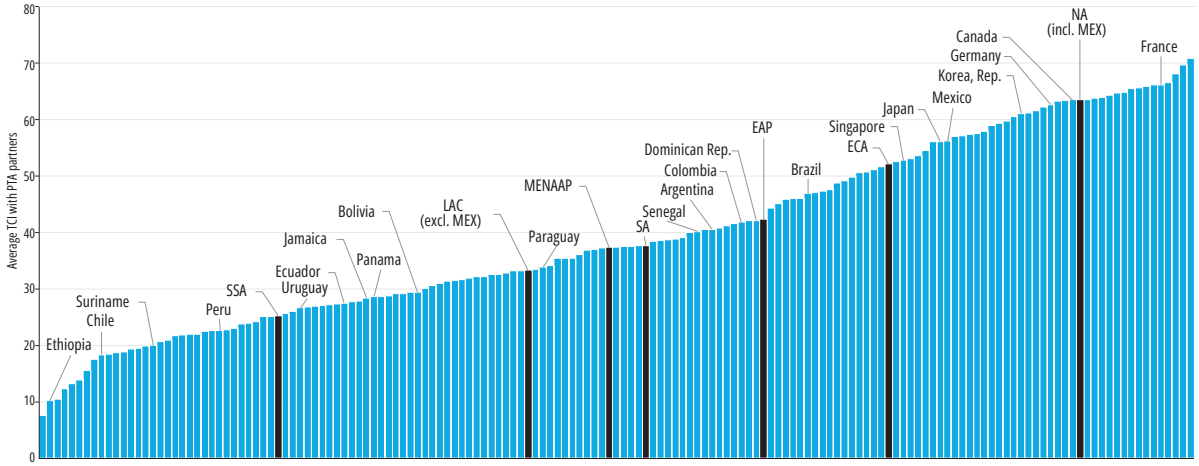
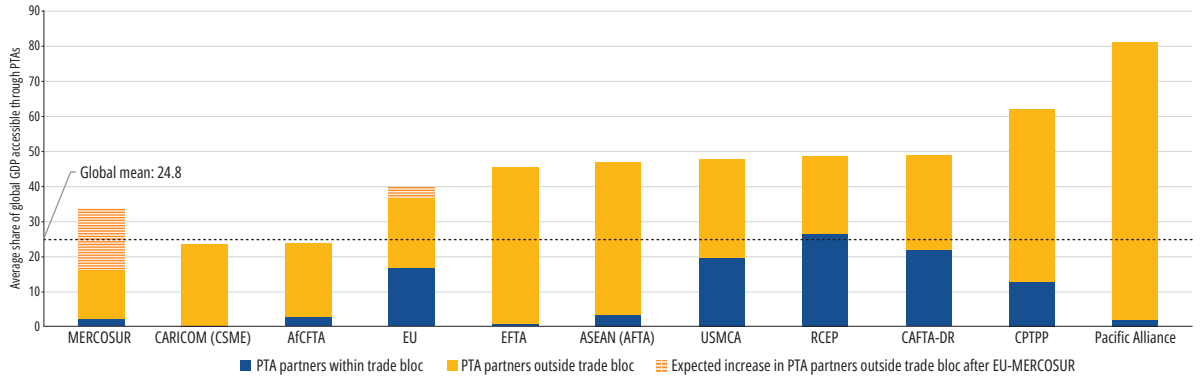
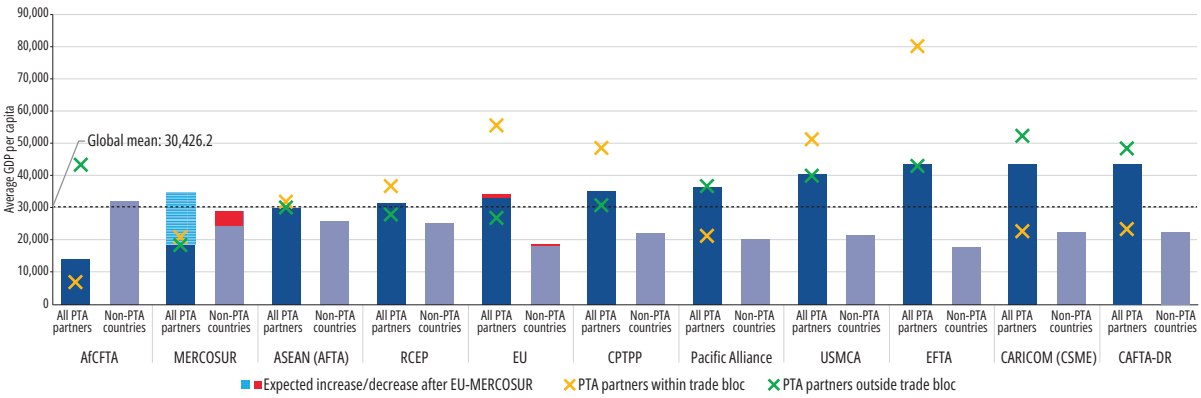


FIGURE 1.25 Coverage of Preferential Trade Agreements (PTAs) *(continued)*

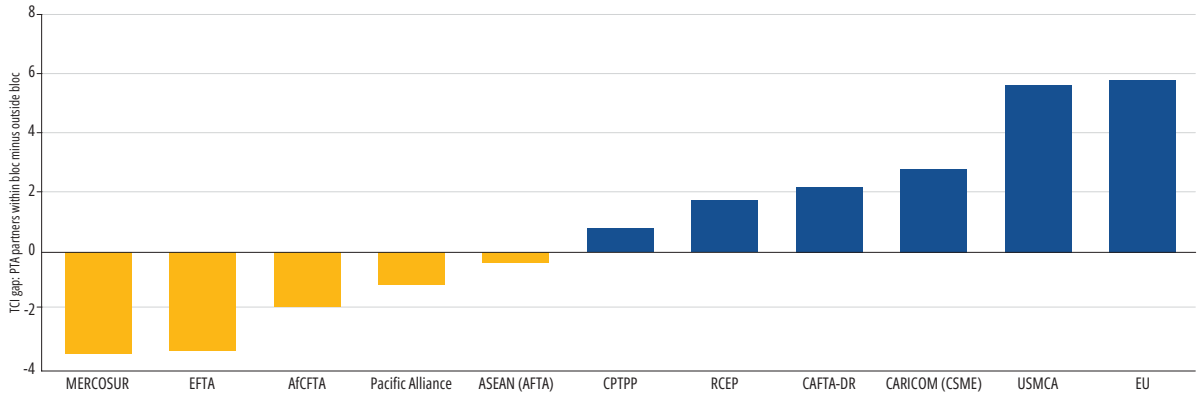
D. Average share of global GDP accessible through PTAs, by trade bloc



E. Average GDP per capita of PTA partners and non-PTA countries, by trade bloc



F. Trade Complementary Index gap: PTA partners within trade bloc minus outside trade bloc



Sources: World Bank staff calculations based on World Bank Deep Trade Agreements Database, World Bank Trade Complementarity Index, and World Development Indicators.

Note: The share of global GDP accessible through PTAs is defined as the sum of GDP (current US$) of all economies with which a given country maintained an active PTA at the end of 2023, expressed as a percentage of world GDP. The average GDP per capita of PTA partners is the average of partner GDP per capita (PPP, constant 2021 international $) of all economies with which a given country maintained an active PTA at the end of 2023. The Trade Complementarity Index (TCI) measures the extent to which one economy's export profile matches another's import profile, ranging from 0 (no overlap) to 100 (perfect match). For each economy, the average TCI with PTA partners is computed across all economies with which it maintained an active PTA at the end of 2023. The TCI gap in panel F is computed as the difference between the average TCI of PTA partners within the same trade bloc and the average TCI of PTA partners outside the bloc; positive values indicate that intra-bloc PTA partners are more trade-complementary than extra-bloc PTA partners. PPP = purchasing power parity.

A–C. EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC (excl. Mex.) = Latin America and the Caribbean excluding Mexico; MENAAP = Middle East, North Africa, Afghanistan, and Pakistan; NA (incl. Mex.) = North America including Mexico; SA = South Asia; SSA = Sub-Saharan Africa.

D–F. AFTA = ASEAN Free Trade Area; AfCFTA = African Continental Free Trade Area; ASEAN = Association of Southeast Asian Nations; CAFTA-DR = Dominican Republic–Central America Free Trade Agreement; CARICOM = Caribbean Community and Common Market; CSME = Caribbean Single Market and Economy; CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership; EFTA = European Free Trade Association; EU = European Union; MERCOSUR = Southern Common Market (South America); RCEP = Regional Comprehensive Economic Partnership (Asia-Pacific); USMCA = United States-Mexico-Canada Agreement.

within the framework and access generated through PTAs with partners outside the framework. This decomposition provides a direct window into flexibility: frameworks that leave members greater scope to negotiate externally tend to display a larger "outside-bloc" component, whereas more centralized customs union architectures tend to result in a smaller one. In this sense, panel D links the autonomy concept directly to the market access measure in panel A: autonomy shows up empirically as the ability to convert legal flexibility into broader PTA-based coverage of world demand. Countries embedded in more flexible frameworks—including mega-FTAs such as the Pacific Alliance, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), CAFTA-DR, ASEAN, and, to some extent, the USMCA and Regional Comprehensive Economic Partnership (RCEP) (Asia-Pacific)—enjoy larger global GDP access precisely because they can extend PTA links beyond the bloc. By contrast, more rigid frameworks such as customs unions—notably, the EU and MERCOSUR—exhibit more limited PTA-based access outside the bloc. This pattern is particularly visible for MERCOSUR, as shown by the limited share of global GDP accessible through PTAs with countries outside the bloc.

Panel E performs a parallel decomposition for partner income, distinguishing the average GDP per capita of PTA partners within the bloc from that of PTA partners outside the bloc, and comparing both to non-PTA countries. This distinction helps separate two channels that can appear similar in aggregate. Some frameworks "inherit" high-income partners because they include large, rich members internally, while others rely more heavily on external PTAs to connect members to high-income markets. Panel E therefore clarifies partner quality (illustrated in panel B) as a joint outcome of bloc composition and members' freedom to reach outward. The EU, European Free Trade Association (EFTA), CAFTA-DR, CSME, the Pacific Alliance, and USMCA all use PTAs to access high purchasing power, but through different channels: predominantly within-bloc in the EU and USMCA, and more through extra-bloc agreements in CSME, CAFTA-DR, and the Pacific Alliance. Notably, AfCFTA and MERCOSUR stand out as the only frameworks where PTA partners are, on average, lower income than potential partners outside the PTA network—highlighting missed opportunities in terms of access to markets with higher purchasing power.

Panel F summarizes the structure of integration by reporting the TCI gap—the difference between average trade complementarity with PTA partners within the bloc and PTA partners outside the bloc. A positive TCI gap is naturally interpreted as indicating that PTA partners within the bloc are more complementary than partners outside the bloc—consistent with deeper value chain linkages and specialization patterns that are systematically reinforced inside the framework. This is the intuition behind well-functioning arrangements oriented toward production networks, where internal integration is not only deep legally but also strongly aligned with trade structure and input-output linkages. Conversely, a negative TCI gap suggests that partners within the bloc are less complementary than PTA partners outside the bloc—consistent with a framework whose internal composition or integration dynamics do not generate strong alignment of value chains, even when a common external policy exists. This value is negative for MERCOSUR, suggesting that within-bloc countries are less linked through value chains than those in frameworks like the EU, USMCA, CSME, or CAFTA-DR.

The practical diagnosis for MERCOSUR involves its limited reach outside the PTA bloc (refer to panel D), relatively low access to purchasing power through existing PTA partners with higher-income opportunities outside (refer to panel E), and a negative within-minus-outside TCI gap (refer to panel F). Read jointly, this highlights that when outward PTA expansion is hard and complementarity is stronger outside than within the bloc, the highest-return paths to greater market access and diversification come from bloc-level external openings or institutional pathways that make outward engagement more feasible within the framework's rules. For CSME and CAFTA-DR, this same decomposition shows that outward PTAs can help smaller blocs reach high-income markets (refer to panel E), while a positive TCI gap is consistent with more internal complementarity (refer to panel F).

Key options to deepen trade integration in LAC

Different options exist for different types of countries and markets. For the many LAC economies that are not bound by a customs union, the policy implication is straightforward: use full autonomy over external tariffs and negotiations to expand deep agreements with large, complementary markets. Chile is the clearest demonstration of this "autonomy leads to diversification" model: it has negotiated a very large set of trade agreements spanning a wide set of partner economies and a large share of world GDP, illustrating how a small economy can "buy" market size through sequential, high-quality agreements. A similar outward strategy is being deployed in Peru, Colombia, and Costa Rica, which have built broad networks covering major global partners to secure predictable access and rules. The actionable message for this group is to prioritize agreements that materially expand exposure to large markets where complementarity is high, and pair them with trade facilitation and services/investment disciplines that improve utilization.

For LAC economies bound by customs union rules—most prominently MERCOSUR—the feasible path to deeper integration is necessarily more institutional. One route is the bloc-level "big bet": negotiate and implement a deep agreement at the customs union level with a major partner. The EU-MERCOSUR process exemplifies this approach: negotiations reached political agreement on the trade pillar in late 2024 and have moved into a ratification pathway. Such an agreement would be consequential precisely because it would combine a step-increase in GDP coverage—given the EU's weight in global output—with preferential access to some of the markets with the highest purchasing power in the world (refer to the shaded areas in figure 1.25, panels D and E). A second route—often more tractable in the short term—is to pursue targeted, functionally deep cooperation that reduces non-tariff barriers and improves certainty with key partners. Recent initiatives between the United States and Argentina illustrate this template, focusing on market access, standards, and barrier reduction through bilateral frameworks. This channel is particularly relevant in settings where tariffs are already constrained or adjustment through tariffs is limited, and where non-tariff and regulatory barriers tend to be the binding margins for trade. These options matter because MERCOSUR's internal trade intensity is relatively low—about 10 percent of total trade—making external deals and mechanisms to reduce barriers particularly valuable.

Finally, there is an additional tailwind for renewed optimism: LAC's strategic value in critical minerals is rising. Current estimates suggest that the LAC region concentrates around 50 percent of global lithium resources. This concentration of resources strengthens the economic logic for deepening market access and rules-based partnerships—not only on what LAC exports today but also on the region's growing role in inputs critical to the global energy transition. All these routes promise additional trade opportunities, providing the region with a pathway toward more robust and diversified integration into the global economy.

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CHAPTER 2

Revisiting Industrial Policy: Strategic Options for Today

Chapter 2: Revisiting Industrial Policy: Strategic Options for Today

Renewed Global Interest in Industrial Policies

Stagnation in economic growth and persistent difficulties in creating high-quality jobs have moved industrial policy—the range of policies expected to increase a strategic business activity —back to the center of the policy debate in much of the developing world. In Latin America and the Caribbean (LAC), the growth strategy has tended toward being noninterventionist for the last 50 years—with good reason. The protectionist policies of the import substitution industrialization (ISI) era led to nondynamic industries and macroeconomic instability. The weakness of governments to resist lobbying led to the persistence of some of the most distortionary trade policies in the world (Balassa 1971). These factors, together with a growing appreciation of more market-friendly economic theory throughout the region, led to a discrediting of industrial policy, including in the multilateral organizations, and a generally skeptical assessment that government failure would be worse than the market failures that industrial policy was meant to redress.

However, industrial policy is being reconsidered worldwide. In academia, careful studies of the Republic of Korea, Japan, and elsewhere have suggested that, in Asia, active investment in horizontal policies not tied to any specific sector—such as investments in education, infrastructure, and marketing networks—combined with well-designed, temporary targeting of specific sectors contributed importantly to their rapid catchup (Juhász et al. 2024). New research on Korea's drive to promote the Heavy and Chemical Industry (HCI) has updated earlier, pessimistic perceptions of this push (Lee 1996; Yoo 1997) and found positive and persistent impacts on productivity (Choi and Levchenko 2022; Lane 2025; Lee 2022). Though measuring externalities and spillovers remains fiendishly difficult, some analysts have produced estimates on, for instance, scale economies across sectors (Bartelme et al. 2025), while others have identified sectors offering higher risk-return combinations than traditional sectors (Krishna et al. 2023).

Most importantly, however, the market-driven model that minimizes the role of the state is seen in many quarters as being insufficient to generate the needed growth to generate quality jobs and reduce poverty. LAC has had the slowest growth rates of any region since the COVID-19 pandemic, and even the best exemplars of the mainstream model, such as Chile, are experiencing limited productivity growth. Despite the fact that market-friendly policies have led to better performance than earlier interventionist models of the past (Easterly 2019), the region and the world are searching for ways to boost growth and job creation. Further, there is a desire, particularly in LAC, to leverage more from the critical minerals sector than in the past and to leverage the possibilities in green energy. The recent Bank report *From Resource-Rich to Resource-Smart* (Beylis and Lozano 2025) lays out the investments, innovations, and institutional reforms needed to do this.

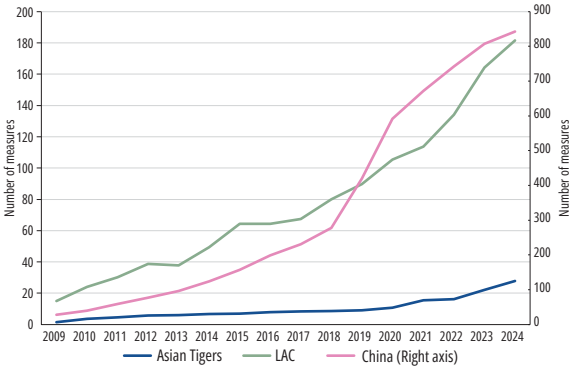
In practice, industrial policies are already being employed to greater extent in the developing world. The Asian Tigers, LAC, and China from 2009 onward have increasingly implemented interventionist measures (refer to figure 2.1, panel a). Within LAC, Brazil and Argentina are the most relevant users of trade interventions, with Colombia and Mexico also intervening more. Chile and Peru have continued to abstain (refer to figure 2.1, panel b). The trade tools employed are familiar. Import barriers and export subsidies are used the most, while location policies, and promotion of foreign direct investment (FDI) are among the least utilized (refer to figure 2.2).[1]

[1] Export barriers correspond to policies that restrict exports from the home country to the rest of the world. Import barriers include measures such as tariffs and quotas that restrict competition from foreign products in the home country. Domestic subsidies and export subsidies entail the domestic provision of credit for national production or exporting and include subsidies from state-owned banks and development banks. Foreign direct investment (FDI) includes all measures that aim to attract or facilitate direct investment by foreigners. Procurement and location correspond to measures that force governments to buy from national suppliers and firms and to build plants in a specific location.

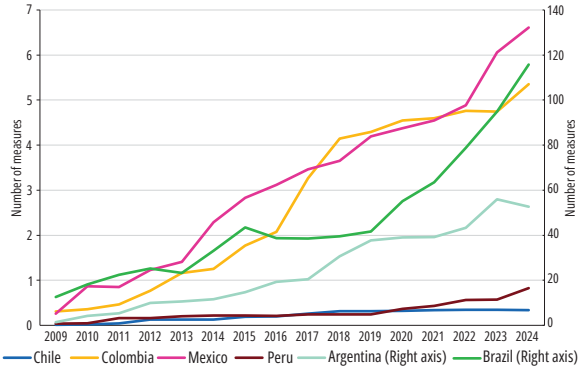
FIGURE 2.1 Trade interventions, Asian Tigers, China, and LAC, 2009–24

Net Trade Interventions Alerts (thousands)

A. Asian Tigers, LAC, and China



B. Select LAC countries



Source: Global Trade Alert 2025.

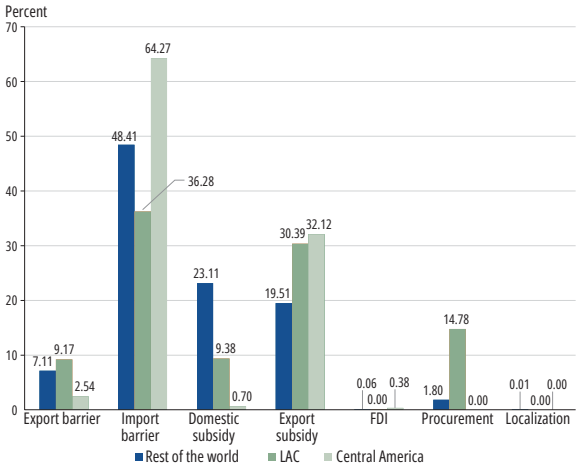
Note: Number of measures in thousands. Net Trade Alerts are defined as new trade policy measures introduced during the period minus measures that expired or were removed. A positive value indicates a net increase in trade restrictions or interventions. LAC = Latin America and Caribbean. Asian Tigers = Hong Kong, Korea, Rep, Singapore.

Moreover, these patterns understate the true extent of industrial policy, as governments are increasingly relying on public financing to support strategic sectors.[2] A prominent example is Brazil's Nova Indústria Brasil program, which channels substantial funding through BNDES, a national development bank, toward green industry, health technologies, agribusiness, and defense. In fiscally constrained countries, where interventions may crowd out public investment and capital costs are high, the bar for justifying industrial policy should be significantly higher.

To offer a fresh look at the tools governments might deploy to increase growth and create jobs, the World Bank recently published *Industrial Policy for Development: Approaches in the 21st Century* (Fernandes and Reed 2026). Acknowledging that each intervention carries risk as well as rewards, and that success is highly conditioned by the capacity of the state, its fiscal space and market size, the volume offers guidance to countries on what interventions might be worth pursuing, whether sector-specific or more horizontal.

Some proponents of industrial policy have argued that it is limiting to demand that market failures be identified to justify state intervention—essentially asking why the market is not generating a particular outcome if it is so valuable (Mazzucato 2013). However, the volume follows the general consensus that doing so provides discipline to the policy discussion and helps prevent interventions that are likely to be costly failures.[3] More boldly, the report summarizes recent work attempting

FIGURE 2.2 Industrial policy tools by type, LAC and rest of world



Source: Global Trade Alert 2025.

Note: Categories match definitions of industrial policy types in Maloney, Cirera and Ferreyra (2025). All averages are relative to the region's total. Foreign direct investment (FDI) measures exclude restrictions related to the outbreak of the Covid-19 pandemic. All measures exclude industrial policy measures for national security. LAC = Latin America and Caribbean.

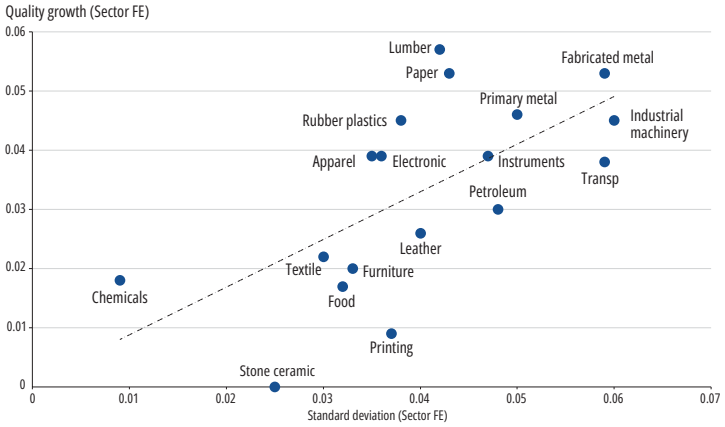
[2] For a discussion on different ways to measure industrial policies, refer to Box 2.1 in Fernandes and Reed (2026).

[3] For the consensus view, refer to Harrison (2024); Lederman and Maloney (2012); Cherif and Hasanov (2020); and Rodrik (2004), for instance.

to identify benefits of targeting individual goods and sectors whose full growth benefits the market may not recognize and makes recommendations of how countries might engage in doing so.

This chapter does not attempt a comprehensive review of Industrial Policy for Development or the emerging literature. It does attempt to center the discussion in the context and history of LAC. Specifically, it focuses on a particular set of market failures around how firms and countries learn to identify and use new technologies, and argues that addressing these failures is an essential complement to any growth strategy.

FIGURE 2.3 Growth potential of manufacturing sectors based on their risk and return



Source: Krishna et al. 2023.

Note: The figure shows sector fixed effects (FE) after regressing the mean and standard deviation of unit values of exports with respect to country and sector fixed effects. The analysis covers countries in Latin America and the Caribbean, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, North America, South Asia, and Sub-Saharan Africa. The analysis uses data from disaggregated (HS10) bilateral exports to the United States from 1989 to 2001.

Industrial policy for development

As is well known in the neoclassical economics literature, several impediments to the efficient allocation of resources across the economy through markets may coexist, resulting in welfare losses (Pigou 1920; Samuelson 1954; Coase 1960; Akerlof 1970). These market failures include coordination failures, knowledge and network externalities, insufficient provision of public goods, market power, incomplete markets, and asymmetric information.

Ideally, industrial policy—or what some have called productivity policies (Crespi et al. 2014, CEPAL 2025)—can help redress these market failures by facilitating collaboration between firms and sector(s) in a variety of ways: through industrial parks or sectoral road mapping exercises; providing public inputs in such areas as education, infrastructure, research and development (R&D), or market access support; offering subsidies; establishing intellectual property rights to promote R&D and innovation; energizing pro-competitive institutions to work against collusion and predatory behavior; facilitating information flows; supplying credit guarantees for risky investments; and certifying products to make them visible to consumers (Fernandes and Reed 2026).

In practice, governments face constraints in resources and administrative capacity, or bandwidth. They effectively must make policy "bets" under conditions of uncertainty about both the magnitude of market failures and the state capacity to redress them (refer to Juhász et al. 2024; Maloney and Nayyar 2018). While steps such as providing public education or establishing patenting systems have widespread support, the most contentious bets have been incentives to particular sectors that are perceived to be intrinsically better able to promote economic growth. In the past, measuring these properties, particularly knowledge spillovers, was elusive and numerous analytical short cuts have been used with mixed results.[4] Recently, however, Bartelme et al. (2025) have successfully measured scale economies pertaining to individual sectors. Krishna et al. (2023), noting that product quality is a component of productivity, demonstrate that improvements in the quality of a country's export basket, as measured by the growth of unit value, are related to the variance of that growth—there is a relationship between risk and return and certain sectors offer more upside possibilities of growth than others.[5] As figure 2.3 shows, manufacturing sectors with high growth

[4] For a review, refer to Lederman and Maloney (2012).

[5] The literature on quality (Hallak and Schott 2011; Khandelwahl 2010; Krishna et al. 2023) shows that within very finely disaggregated products, there are huge variations in quality measured by the unit values of exports. The premium that Don Melchor at $150 a bottle (or Chateau Lafite Rothchilde at $3,500) has over $10 bottles is the result of experimentation and technology transfer. This higher quality leads to higher value added, and a higher price, and hence is key to growth.

TABLE 2.1 First-choice and second-choice industrial policy tools based on the need to be addressed and country characteristics

Minimum country requirements for each industrial policy tool

Market failure	No.	Industrial policy tool	Rank	Minimum country requirements		
				Government bandwidth	Local size market	Fiscal space
	Public inputs tailored to needs of activity					
Coordination failure	1	Industrial parks	1st choice			
Underinvestment in training	2	Skills development	1st choice	Large		
Asymmetric information	3	Market access assistance	1st choice	Large		
	4	Quality infrastructure	1st choice	Large		
Positive spillovers, including learning-by-doing with advanced products and processes, plus external benefits including foreign exchange, job creation, pollution reduction, and resilience	Market interventions incentivizing a narrow activity					
	5	Production subsidies	1st choice	Large		Large
	6	Innovation subsidies	1st choice	Large		Large
	7	Commodity export bans	2nd choice			
	8	Government procurement rules	2nd choice	Large		
	9	Import tariffs or quotas	2nd choice		Large	
	10	Export subsidies	2nd choice			Large
	11	Technology transfer quid pro quo	2nd choice	Large	Large	
	12	Local content requirements	2nd choice	Large	Large	
	13	Consumer demand subsidies	2nd choice	Large	Large	Large
	Macroeconomic interventions incentivizing a broad activity					
	14	Strategic exchange rate devaluation	2nd choice			
	15	Research and development tax credit	2nd choice			Large

Source: Fernandes and Reed 2026.

potential (ones with both high average risk and high return) include fabricated metal products, industrial and commercial machinery and computers, and lumber and paper products, while sectors offering lower potential growth include stone and ceramics, printing, textiles, food products, and furniture.

Overall, the uncertainty around the benefits of policies directed at particular sectors and concern about government capabilities, resources, and insulation from political interference, as well as considerations about the size of domestic markets, leads countries to choose among a portfolio of possible tools/interventions with differing risk-return combinations. These combinations are shown in table 2.1. Countries with capable governments, ample fiscal resources, and large markets can implement the widest range of policies.

Besides advocating that governments provide strong fundamentals via horizontal policies that improve human capital, infrastructure, effective market regulation, and macroeconomic stability, Industrial Policy for Development takes an open stance to policies that target specific sectors. Risk-averse governments can support activities that remain close to revealed comparative advantage within existing sectors—for example, minerals and energy in LAC. This medium-risk approach leverages existing knowledge and infrastructure while expanding into similar markets with higher growth potential. Governments that are more comfortable with risk can target activities completely unrelated to revealed comparative advantages, particularly in sectors that have high growth potential and expanding global markets, such as Korea did with the heavy industries program.

First-choice policies focus on the provision of public inputs addressing market failures directly by subsidizing the activities that are underprovided. Second-choice policies shape industry outcomes by intervening indirectly in adjacent markets. They thus lead to a trade-off between promoting development objectives and generating welfare losses to consumers in the form of higher domestic prices. While the risk of failure is considerable, the rewards of successful bets can be great, yielding substantial gains to productivity and positioning countries in dynamic industries.

Industrial Policy for Development argues that industrial policy must be transparent and efficient. Support should be time-bound and based on specific measurable objectives, and outcomes should be closely monitored. Periodic evaluations should be conducted to offer insight into the effectiveness of the tools implemented. Traditional metrics of effectiveness often include production targets such as quantities produced and job creation. These can be complemented by more dynamic metrics—such as labor productivity dynamics, investment, and share in the global market—because static targets are prone to manipulation and collusion between the government and the private sector. Periodic evaluations also enable governments to implement incentives (encouraging investment in new areas) and disincentives (sunset clauses) to enhance the performance of industrial policies and prevent the provision of perpetual subsidies to unproductive enterprises, as has happened in Tierra del Fuego, Argentina (refer to box 2.1). The evaluation should also be dynamic, with objectives regularly updated as goals are attained. Ideally, failed ventures provide information on where to go and highlight mistakes in the design of policies. Market information generated from the process of experimentation serves as a roadmap for the next generation of entrepreneurs as they venture into up-and-coming sectors in the local and global economies.

The synthesis offered by Industrial Policy for Development is an invaluable input in LAC's policy debates. This said, while policy makers should maintain an openness to the lessons emerging from Asia and academia about targeting particular sectors, LAC's history is one of disappointing growth across sectors and, indeed, to some degree, economic models. The ISI experience of industrial targeting highlights the downside risks, but all periods suggest four basics that should be part of any industrial or productivity policy:

1. Building capabilities across the human capital spectrum and knowledge-related institutions that facilitate learning—enhancing the ability to identify new technologies, products, and processes.

2. Facilitating risk taking in financial markets and with management practices that help manage the necessary attendant risks of experimentation, improving the ability to place better bets.

3. Maximizing the benefits of the global economy that offers scale, access to technology, and a disciplining device.

Each of these three basics focuses on market failures that need to be redressed, and all point to the fourth basic area:

4. Strengthening the state: a strong state insulated from undue political influences that permits market failures to be corrected. The strength of the state importantly determines the latitude countries have in designing their industrial/productivity policies (Fernandes and Reed 2026).

BOX 2.1 Political Interference Undermines Industrial Policies

Industrial policies often require long-term governmental commitment, both because of the time needed for workers, managers, firms, and industries to accumulate capabilities and because the outcomes of these policies are inherently uncertain. However, unlimited support with no procedure and timetable to wind down assistance (sunset clauses) can provide perverse incentives, undermining the initial objective. The package of special incentives for the string of islands on Argentina's southern tip, the Tierra del Fuego regime, is widely regarded as a case of failed industrial policy, marred by political interference and fundamental design flaws that have persisted for decades (Fernandes and Reed 2026).

Created in 1972, the regime sought to leverage the region's strategic location by stimulating population growth and employment through an expansive package of tax exemptions and trade benefits for goods manufactured on the archipelago. However, its poorly conceived incentive structure has generated substantial fiscal cost for the Argentine government—estimated to reach US$1.07 billion annually—without achieving meaningful technological upgrading or productivity gains. Although dismantling or restructuring the regime has been a central topic of public discussion, there have been no concrete proposals to do so. Instead, benefits have been repeatedly extended, most recently in 2021, prolonging the regime until 2038 without establishing clear conditions for participants' performance or a transition plan (Hallak et al. 2024).

The design flaws stem from the interaction of the regime's core incentives. First, tariff exemptions on imports into the archipelago give participating firms a cost advantage over producers in continental Argentina. Second, the application of a credit on the value added tax (VAT) on turnover value is intended to reward domestic value creation in Tierra del Fuego, but fails to encourage innovation in practice because local firms generate little to no actual value added. The combination of these incentives encourages firms to import large volumes of inputs duty free and resell them to the mainland at higher prices while claiming the associated tax benefits. This structure not only induces market distortions but also entrenches a growing fiscal burden on the government.

As a result, the Tierra del Fuego regime represents a case of persistent policy flaws, sustained less by economic rationale than by political considerations. The activity it supports is not self-sustaining; the firms involved remain viable primarily because of substantial fiscal transfers rather than increases in their productivity or technological capability. This dynamic reinforces dependence on government support and increases the long-term economic costs of maintaining the regime, highlighting the challenges of reversing entrenched but ineffective industrial policies.

The elusive pursuit of productivity growth in LAC

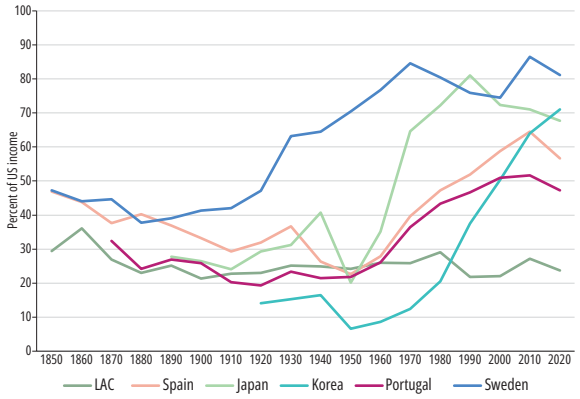
As the recent World Bank report *Reclaiming the Lost Century of Growth: Developing Learning Economies in Latin America and the Caribbean* (Maloney, Cirera and Ferreyra 2025) discusses in detail, LAC has struggled with growth since the mid-nineteenth century, when countries such as Finland, Sweden, Japan, Korea, Portugal, and Spain that had levels of income comparable to LAC took off and converged toward levels in the United States. Meanwhile, for the next century, LAC stagnated at a relatively constant 30 percent of US income. In 1950, Jamaica had twice the level of income of Republic of Korea. More depressingly, LAC superstars such as Argentina, Uruguay, and to a lesser extent Chile, which had incomes at the same level as France or Germany in the mid-1800s, lost ground over the next century and converged to the rest of the LAC region (refer to figure 2.4).

The problem of low growth and its drivers can be more clearly understood and decomposed with more reliable data that has become available starting with the 1960s. The subperiods since then can be crudely divided by the prevalence of interventionist measures. The import substitution industrialization

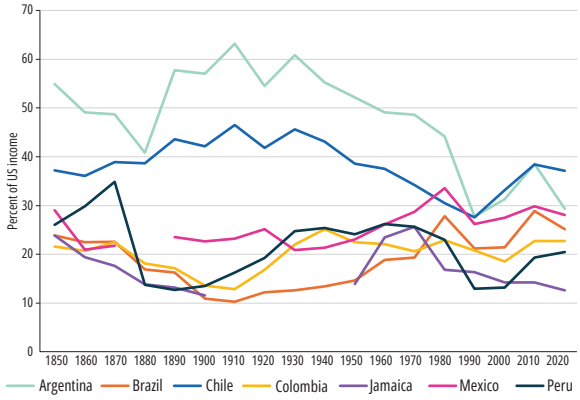
FIGURE 2.4 Underperformance of LAC relative to other regions in the world

PPP GDP per capita as a percentage of US GDP per capita

A. European and Asian comparators



B. Select LAC countries

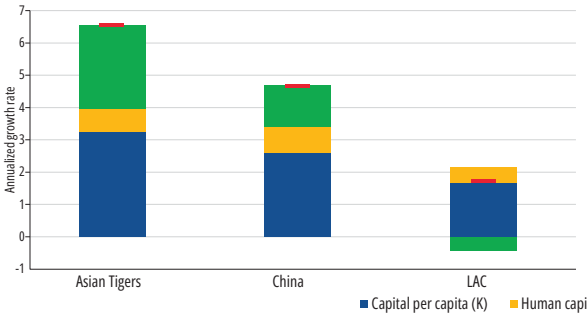


Source: Maloney, Cirera and Ferreyra 2025.

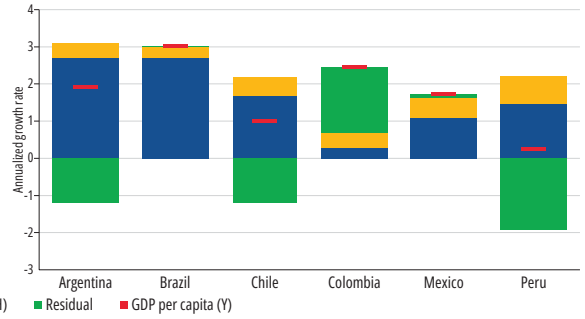
Note: Korea refers to the historical Korea until 1949, and the Republic of Korea thereafter. GDP= gross domestic product; LAC = Latin America and the Caribbean; PPP = purchasing power parity.

FIGURE 2.5 Growth decomposition analysis comparing Asian Tigers, China, and LAC during LAC's import substitution industrialization era, 1965–89

A. Asian Tigers, China, and LAC



B. Select LAC countries



Source: World Bank staff calculations based on World Bank data (GDP per capita, constant 2021 PPP) and Penn World Table 11 (Stock of capital, constant 2021chained dollars; Population, and Human Capital Index).

Note: The figure covers the period from 1965 to 1989 during LAC's import substitution industrialization era. Regional aggregates are weighted by GDP per capita (base year 1965). Asian Tigers = Hong Kong SAR, Korea, Rep., Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru. GDP = gross domestic product; LAC = Latin America and Caribbean; PPP = purchasing power parity.

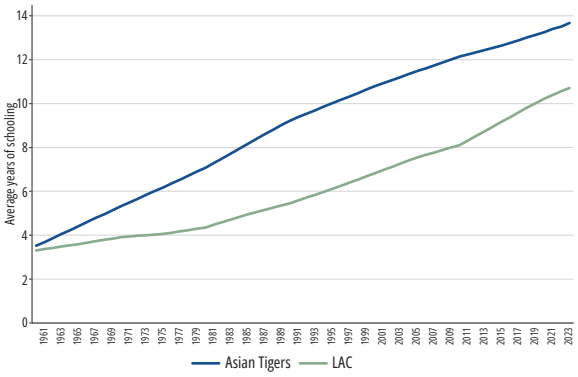
period extended from 1965 to 1989, ending with the advent of Washington Consensus, which advanced freer trade. A market friendly reform period proceeded from 1990 to 2008, ending with the global financial crisis. This was followed by a period from 2009 to 2023 when countries began experimenting again with interventionist measures. While LAC's performance was better during the second period, what is striking is that under every policy regime, the region performed substantially worse than Asia, and productivity growth has always remained poor.

Import substitution industrialization was characterized by globally high tariffs and quotas, overvalued exchange rates, and other measures with the goal of displacing imports of manufactures with local production (Balassa 1971). They clearly reveal that while both regions industrialized, the Asian Tigers grew at 3 times the rate of LAC (refer to figure 2.5). While productivity growth contributed between 30 percent and 40 percent of overall economic growth in Asia, productivity actually declined, and depressed overall growth, in LAC due to the emergence of extreme misallocation and

inefficient industries misaligned with LAC countries' comparative advantages. China, which had still not fully entered its reform period, did better, enjoying brisk factor accumulation, most notably in human capital, and modest growth. Asia's outward-oriented stance linked to export performance, as well as temporary protective measures to permit room to reach the technological frontier,[6] were paired with a dramatic increase in human capital. By contrast, LAC did not see protection as temporary and did not build human capital (broadly considered) (refer to figure 2.6). Nor did it prioritize learning how to learn about new technologies and exploit them to raise productivity, or to create industries that eventually compete internationally.

The liberalizing reforms that followed in LAC redressed many of the issues of contestability and incentives by moving to more market-centered strategies and dismantling many institutions of the ISI era (such as national development banks and state-owned enterprises).[7] Since the 1990s, LAC has complemented its integration into the global economy with horizontal reforms aimed at reducing state intervention in the economy, liberalizing capital markets, and achieving macroeconomic stability. During this period of liberalization, it could more easily access physical capital, and there were large gains from reallocation that led to high productivity in some, but not all, countries. However, overall growth, while higher, still lagged that of Asia, particularly in liberalizing China, and productivity, even in Chile, has slowed dramatically (refer to figure 2.7).[8]

FIGURE 2.6 Average years of schooling as a proxy for human capital accumulation, Asian Tigers and LAC, 1960–2023



Source: World Bank staff calculations based on average years of schooling for individuals at least 25 years old (Penn World Table 11).

Note: Regional aggregates are weighted by population. Asian Tigers = Hong Kong SAR, Korea, Rep., Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru. LAC = Latin America and the Caribbean.

The global financial crisis of 2008–09, the subsequent decline in commodity prices, and continuing growth rates around 2.5 percent have shifted policy discussions again to how the market-driven model might be complemented with more strategic industrial interventions aimed at fostering innovation, strengthening value chains, and addressing persistent productivity gaps. Developed countries have implemented a range of industrial policies that developing economies, due to fiscal limitations and government capacities, find challenging to replicate (World Bank 2025b). Although most LAC countries managed the immediate shock better than in previous crises, the slowdown exposed the region's limited progress in diversifying production and upgrading technology (CEPAL 2025; World Bank 2023). Since 2009, per capita income growth has slowed in the Asian countries and LAC (refer to figure 2.8). However, while China maintained comparatively stronger growth through sustained accumulation of physical capital, productivity growth declined in LAC.

Most countries in LAC have lost dynamism, mostly because of losses in productivity. Human capital is still contributing modestly to aggregate growth, which continues to be explained mostly by accumulation of physical capital.

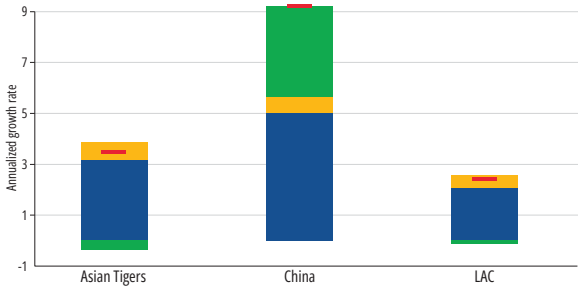
[6] Those that did not, such as the VHS industry in Taiwan, China, were closed down.

[7] This evolution in Latin America reflected a broader global trend toward economic openness. Beginning in the 1980s, most regions experienced a significant wave of trade liberalization, as evidenced by the steady rise and convergence of trade-to-GDP ratios on a global scale. However, this convergence in openness obscured disparate outcomes. While East Asian economies have translated their integration into export-oriented industrial strategies since the early 1960s and technological upgrading since the 1980s, Latin America's insertion into global markets remained primarily resource-based and imports-intensive, thereby limiting the potential for productivity gains and structural transformation (Bulmer-Thomas 2017; Ocampo 2012).

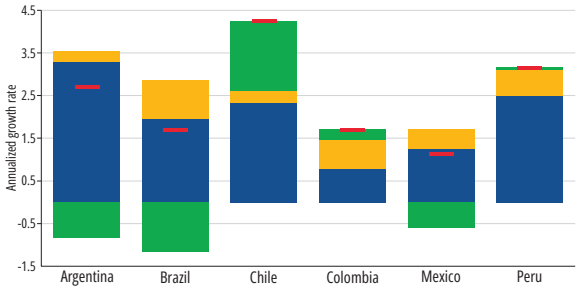
[8] Some caution is advised in interpreting the productivity changes. Total factor productivity (TFP) includes whatever markups may be caused by protection. Eliminating these rents may increase efficiency but also decrease prices, which as a result looks like a fall in productivity.

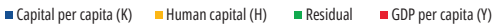
FIGURE 2.7 Growth decomposition analysis comparing Asian Tigers, China, and LAC during LAC's era of liberalizing reforms, 1990–2008

A. Asian Tigers, China, and LAC



B. Select LAC countries



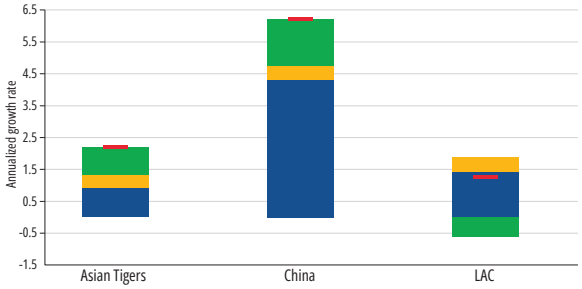


Source: World Bank staff calculations based on World Bank data (GDP per capita, constant 2021 PPP) and Penn World Table 11 (Stock of capital, constant 2021chained dollars; Population, and Human Capital Index).

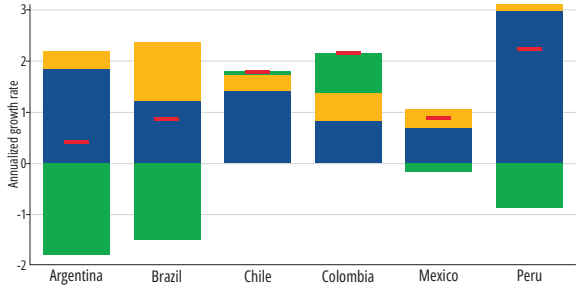
Note: The figure covers the period from 1990 to 2008 when LAC economies were liberalizing. Regional aggregates are weighted by GDP per capita (base year 1965). Asian Tigers = Hong Kong SAR, Korea, Rep., Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru. GDP = gross domestic product; PPP = purchasing power parity.

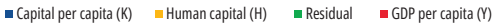
FIGURE 2.8 Growth decomposition analysis comparing Asian Tigers, China, and LAC, 2009–23

A. Asian Tigers, China, and LAC



B. Select LAC countries





Source: World Bank staff calculations based on World Bank data (GDP per capita, constant 2021 PPP) and Penn World Table 11 (Stock of Capital, constant 2021chained dollars; Population, and Human Capital Index).

Note: The figure covers the period from 2009 to 2023, when a rebirth of industrial policy occurred. Regional aggregates are weighted by GDP per capita (base year 1965). Asian Tigers = Hong Kong SAR, Korea, Rep., Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru. GDP = gross domestic product; LAC = Latin America and the Caribbean; PPP = purchasing power parity.

Industrial policy as learning policy

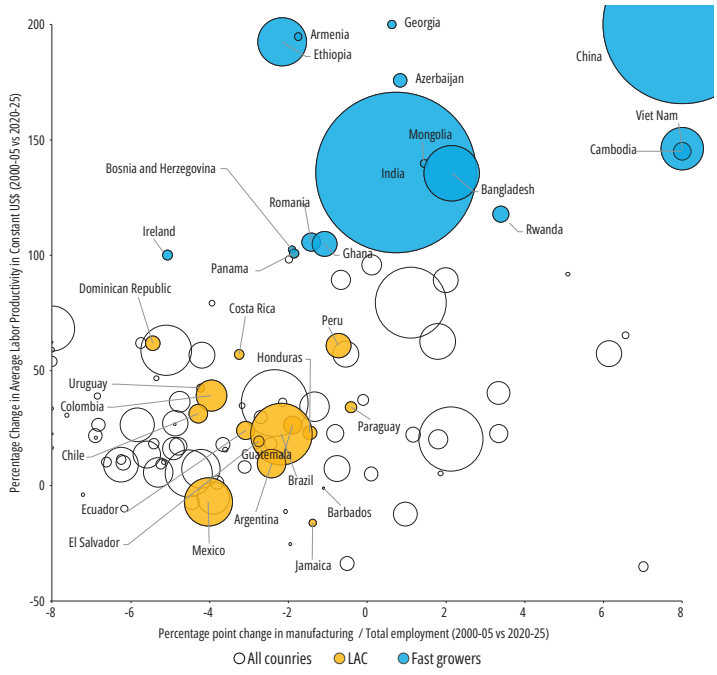
One hypothesis to explain continued sluggish growth is that despite reduced tariffs and market-friendly reforms, domestic markets in LAC remained shielded from international competition by other barriers that have hindered productivity gains (Kee et al. 2009), and many other reforms remain limited. Other observers argue that the region has been unable to diversify away from the commodities that are thought to lack the possibilities for growth (Ocampo 2012).

However, *Reclaiming the Lost Century of Growth in Latin America and the Caribbean* (Maloney, Cirera and Ferreyra 2025) makes the case that the region has long needed to resolve a set of market failures that allow countries to learn—that is, to become better at identifying and then implementing the new technologies that arrive. As Stiglitz and Greenwald (2014) argue, nations need to "learn to learn." Such a "learning"-oriented industrial policy is essential both to more noninterventionist models and a critical complement to any sectoral approaches.

Similar economies can have very different growth equilibria, depending on their capabilities to adopt and exploit new technologies (refer to Howitt 2000; Acemoglu et al. 2026). The challenge is not ensuring the flow of information but rather developing the

FIGURE 2.9 Contrasting experiences in manufacturing in Asia and LAC

Percentage change in average labor productivity (2000–05 versus 2020–25) versus percentage change in manufacturing employment as a share of total employment (2000–05 versus 2020–25)



Source: World Bank staff calculations based on data from International Labour Organization (ILO).

Note: Bubble size indicates population. LAC (in yellow) = Argentina, Barbados, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay. Fast growers (in blue) = Armenia, Azerbaijan, Bangladesh, Bosnia and Herzegovina, Cambodia, China, Ethiopia, Georgia, Ghana, India, Ireland, Mongolia, Romania, Rwanda, Viet Nam. LAC = Latin America and the Caribbean.

ability to assimilate these technologies in a productive way, as Kenneth Arrow (1962) noted long ago. This line of analysis also suggests that whatever growth-promoting qualities a particular product or economic structure may possess on average, its development impact in a particular context depends on the capability of a country to bring the latest production technologies to bear in production.

This entails a process of experimentation—of placing informed bets that a given investment will pay off—and learning from success and failure. This, in turn, requires a set of capabilities across the spectrum of human capital—in worker skills, managerial practices, and technological abilities. It also requires a set of enabling institutions that facilitate the identification and adoption of new technological and market opportunities, and that helps entrepreneurs manage the risk attending the experimentation that is necessary to take advantage of them.

History suggests that these are the areas in which LAC has faltered. LAC's growth stagnation starting in the mid-nineteenth century dates precisely from the time when adopting the new technologies of the Second Industrial Revolution required more organized and developed scientific capabilities—and that institutions in the region did not have, measured either as literacy, technological capabilities, or innovation-related institutions. Micro evidence abounds supporting this hypothesis. The region lost competitiveness and then ownership in mining, as well as in nascent steel and textile industries, precisely because of an inability to identify and adopt the new technologies emerging; indeed, many extractive industries passed in total to foreigners who had these abilities (Beatty 2015; Birchal 1999). Copper, for instance, had radically different development implications in different time periods in Chile—the sector was presumed dead by 1900, but then revived when US firms transferred technology—and across countries, where the United States and Japan leveraged the same mineral under the ground to lay the foundation for dynamic and diversified economies (Maloney and Valencia Caicedo 2022). Comparing Argentina's retrogression to the growth of similarly resource-rich Australia, Canada, and the United States, di Tella (1985) argues that those countries were able to shift from expanding the frontier to reaping the benefits of innovation where Argentina could not. The bottom line is that Latin America's superstars stagnated not because of what sectors they were in but because they were unable to apply new technologies to build upon them.

This experience suggests that there is clearly nothing automatic about learning by doing. In neither the region's 400-year experience in mining nor in the emerging industrial sectors across the twentieth century did LAC achieve the competitiveness necessary to compete internationally. This remains the case today—and across many sectors. Agriculture is strong and globally very competitive in many LAC countries. However, while in Asia, manufacturing sectors in China, Cambodia, and Viet Nam continue to gain productivity and expand employment, the reverse is true in LAC (refer to figure 2.9). This pattern corresponds with findings from the firm-level Firm Adoption of Technologies Survey that firms in LAC adopt new technologies more slowly than firms in Asia and Eastern Europe (Cirera et al. forthcoming).

Insights into the underlying mechanism distinguishing these differing productivity trajectories can be gained at looking at how LAC seems to be missing the capability to "place the bets" required to incorporate new practices in technology to lift export quality. While it is true, as shown in figure 2.3, that some manufacturing sectors do offer higher risk-return opportunities, figure 2.10 shows that, controlling for export sectors, LAC places less risky bets than the advanced economies. This behavior accounts for more than half of the lower regional growth rate in export quality—and probably more, because even within sectors with potentially high pay-offs, LAC countries place less risky bets.

Moreover, the phenomena of premature deindustrialization—where economies begin to lose manufacturing jobs before reaching high income levels—and the rapid advance of automation now raise important doubts about whether the East Asian, export-led manufacturing model can be widely replicated elsewhere. The report *At Your Service? The Promise of Services-Led Development* argues that services, although diverse and often presenting trade-offs between productivity gains and job creation, have the potential to support development. If the evolution of digital technologies, business services, and creative industries can reduce these trade-offs then services-led growth could become a viable path for countries like those in LAC.

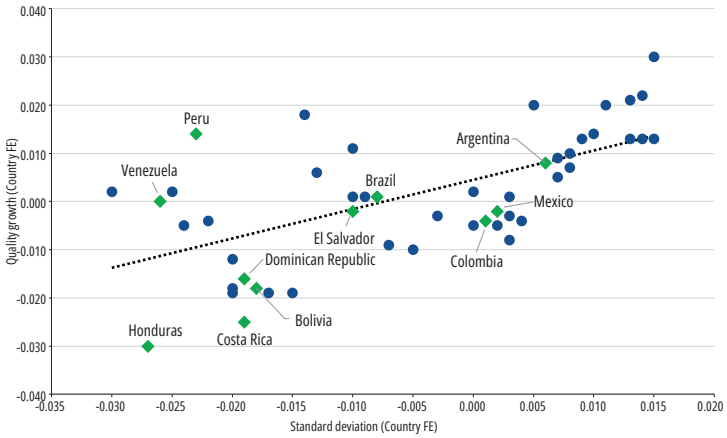
The bottom line is that how goods are produced matters as much as what is produced. Producing them in a growth-enhancing way is precisely guaranteeing a process where entrepreneurs are able to experiment; to place the bets in new technologies, products, or markets; and to learn from the process so as to handle more sophisticated challenges in the future. Hence, while policy makers need to remain open to new evidence on sectoral targeting, industrial or productivity policies need to focus on the four basic areas identified earlier in this chapter.

1. Building capabilities

Industrial policy needs to be construed as a means of creating the capabilities and markets to make such experimentation possible. Policy needs to be designed so that any incentives that seek to support industries are combined with those that seek to support building capabilities and efforts to improve the necessary financial markets. This interaction is not straightforward. One approach suggests that whether firms invest in skills, entrepreneurial capital, or technological capabilities is a function of production incentives, the cost of accumulating these capabilities, and distance from the technological frontier (Maloney and Zambrano 2021). No protection at all may leave firms without the necessary support to learn by doing and reach the frontier, (this is the justification for infant industry arguments and policies); but too much protection too long can obviate the need to learn at all.

Lowering the cost of accumulating human capital—by ensuring quality basic education, providing managerial extension services, creating collaborative universities and research think tanks that support the private sector, among others—reduces the need for direct infant industry support at the sectoral level—and, in fact, may determine whether reaching the frontier is feasible at all. Through this lens, the Asian Industrial Policy model offered modest short-term protection with incentives to export that rewarded learning, combined with massive state support to facilitate learning. By contrast, LAC's ISI period exhibited high and sustained protection with weak effort on the learning front.

FIGURE 2.10 Contrasting experiences placing risky bets within manufacturing sectors, LAC versus select economies

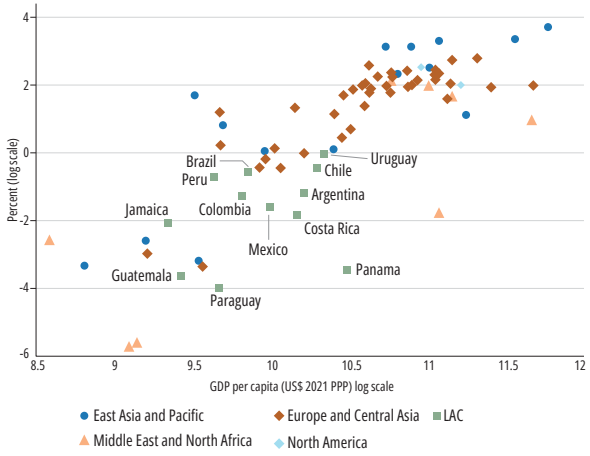


Source: Krishna et al. 2023.

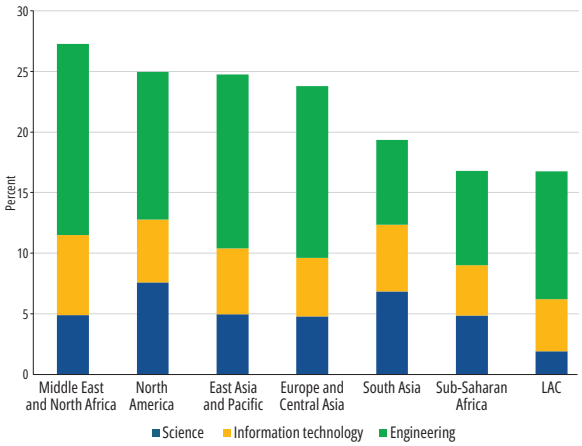
Note: The figure shows country fixed effects (FE) after regressing the mean and standard deviation of unit values of exports with respect to country and sector fixed effects. The analysis covers countries in Latin America and the Caribbean, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, North America, South Asia, and Sub-Saharan Africa. The analysis uses data from disaggregated (HS10) bilateral exports to the United States from 1989 to 2001. Venezuela = Venezuela, RB.

FIGURE 2.11 Regional comparisons of different dimensions of capabilities to manage and adopt new technologies

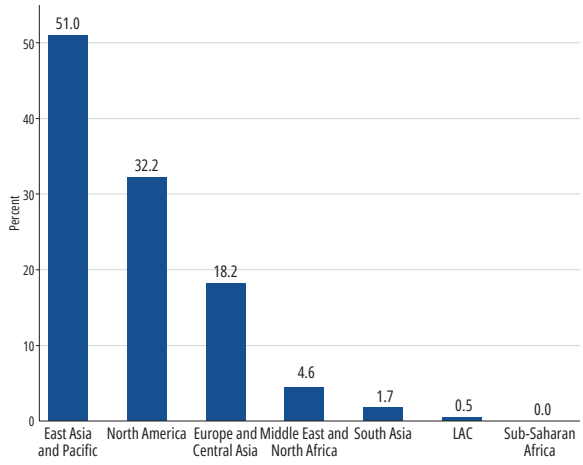
A. Mathematical literacy



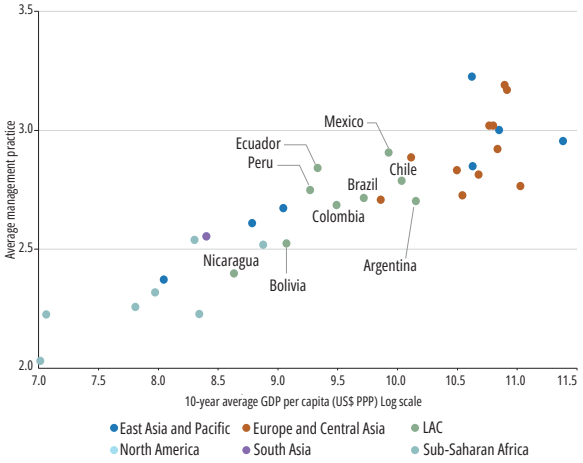
B. Share of graduates of university and short-cycle program in STEM fields



C. Innovativeness of the region's universities



D. Management capabilities



Sources: (A) : Original figure based on OECD PISA 2022 Database (https://www.oecd.org/en/data/datasets/pisa-2022 -database.html) , (B) Original figure based on UNESCO Institute of Statistics (http://data.uis.unesco.org), (C) Original figure based on SCImago Innovation Ranking data (https://www.scimagoir.com /rankings.php?ranking=Innovation), and (D) Original figure modified from Bloom et al. 2014 based on World Management Survey data (https://worldmanagementsurvey.org/) and World Bank World Development Indicators (https://databank.worldbank.org/source/world-development-indicators) in Maloney, Cirera and Ferreyra (2025).

Note: GDP = gross domestic product; LAC = Latin America and the Caribbean; PPP = purchasing power parity.

A. Percentage of 15-year-old students who meet the highest proficiency levels (levels 5 and 6) in the PISA mathematics assessment. Data labels use International Organization for Standardization (ISO) country codes.

B. Percentage of higher education graduates in STEM fields (information for last year available 2000-10) by region. STEM stands for science, technology, engineering, and mathematics. Data grouped natural sciences, mathematics, and statistics in the category "Science".

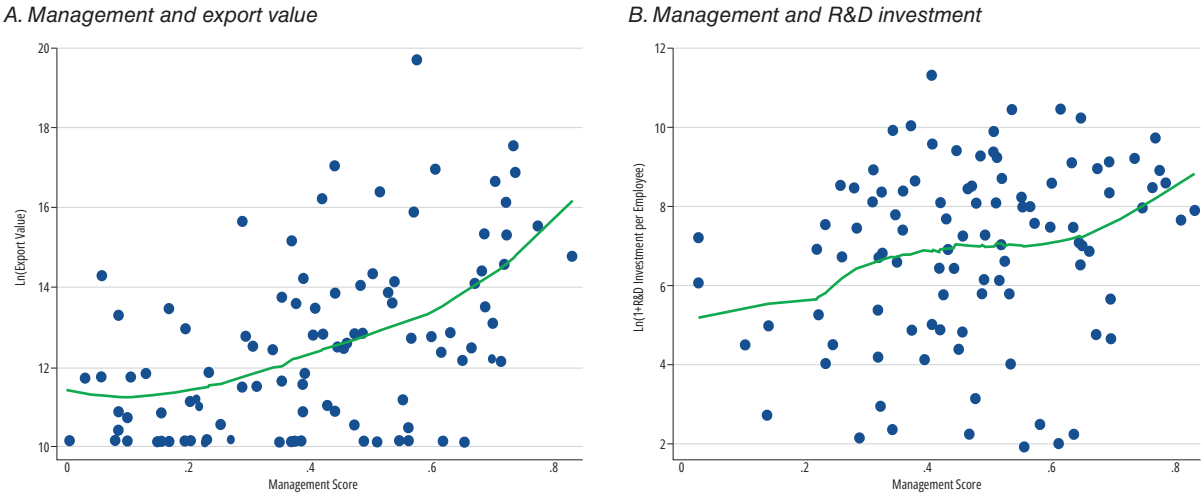
C. Share of institutions by region in the top 1,000 universities according to the SCImago Institutions Rankings for innovation 2024.

D. Country-level average management score over manufacturing firms. Each dot is an average score computed over multiple management practices for each firm for the period 2004–22.

ISI failed arguably because extreme protectionism led to limited contestability, little contact with the technological frontier, and little incentive to "learn how to learn" to reach it. The region began disadvantaged with a weak inheritance in education and vocational training. The countries that took off at the end of the nineteenth century had nearly complete literacy. By contrast, the superstars in LAC had at most half. Literacy is critical not only because it powers the supply of talented workers but it is also the foundation for higher technical skills. The superstars in LAC—Argentina, Uruguay, and to a lesser extent, Chile—had 20 percent of the per capita number of engineers as Sweden or Denmark when they took off from the same level of income.

The reform period made huge progress in establishing macro stability and vastly reducing distortions and

FIGURE 2.12 The relationship between management quality, export value, and innovation



Source: Fernandez et al. 2026, using management scores from the World Management Survey.
Note: Sample of 100 firms (2020) in Colombia. Blue dots indicate individual observations. Non-linear fit.

misallocation, but arguably did not embrace the complementary capabilities agenda, where LAC continues to lag. Figure 2.11 presents select measures of capabilities to manage and adapt new technologies. The region has expanded access to basic education, but the quality remains low. In LAC, 25 percent to 35 percent of firms report they cannot expand for lack of qualified labor, compared to 7 percent in Asia (Maloney, Vuletin et al. 2025). That is, there are high-quality jobs waiting to be created if only the education and training system produced the corresponding workers. Further, the region lags in high-quality entrepreneurs—the individuals who actually take ideas to market—not because LAC college graduates are less entrepreneurial but because there are fewer of them. The region graduates the lowest share of science, technology, engineering, and mathematics (STEM) graduates in its universities, and those universities rank low on research quality. East Asia boasts 50 percent of the universities in the top 100, while LAC's share is 0.5 percent (Maloney, Cirera and Ferreyra 2025).

Education at all levels in LAC suffers from a failure to provide public goods, but demand and supply coordination failures may also be at work at multiple levels. It is not unusual to find engineers in Latin America unable to find jobs in their field. Meanwhile, Brazil's attempt to launch an oil tanker and platform sector failed for a lack of engineers and designers (Alves et al. 2021)—and this is not an isolated case.

Finally, LAC is tied with Sub-Saharan Africa for the lowest level of collaboration in the world between universities and the private sector. Offsetting the market failures in innovation, particularly in basic research, has frequently led to nonmarket institutions whose coordination needs to be guided by others. There are success stories. Brazil's agricultural research institute, EMBRAPA, has been where previously not possible. Chile's alliances with external think tanks in California and Europe have been key to its dynamic fruit and wine sectors. Further, while the cost-benefit analysis is difficult to calculate, Brazil's success in airplane manufacture illustrates the successful development of capabilities accompanying sectoral policies (refer to box 2.2).

Finally, LAC lags in management capabilities, which play a critical role in identifying promising projects, encouraging calculated risk-taking, and motivating employees to achieve higher productivity. The following subsection further examines the implications of these deficiencies.

2. Facilitating risk taking

Placing bets to increase productivity requires more than technical capability. It requires managers who are capable of moving beyond managing the day-to-day operations of firms to being able

BOX 2.2 Capability Building for Sustainable Industrial Policy: Evidence from Brazil

Industrial policy aims to shape a country's economic development by guiding and supporting strategic industries, but its long-term success depends on more than government backing or financial incentives. Effective industrial policy must prioritize capability building by strengthening technological know-how, institutional capacity, and human capital to ensure that firms and sectors can sustain progress once state support is scaled back or withdrawn. Brazil offers a valuable set of contrasts for LAC; it has implemented industrial policies that range from highly successful to deeply problematic, providing rich lessons on what enables self-sustaining development and what leads to dependence or failure. To illustrate this spectrum, this analysis examines three key cases: the Brazilian Agricultural Research Corporation (Embrapa), the Brazilian Aeronautics Company (Embraer), and Brazil's shipbuilding industry.

Embrapa's trajectory illustrates how a well-designed industrial policy centered on knowledge creation can transform an entire sector by overcoming entrenched market failures in research and development (R&D). Created in 1973 to address Brazil's chronic underinvestment in agricultural R&D driven by appropriability problems and coordination failures, Embrapa built the scientific and human capital base needed to make vast regions with acidic, nutrient-poor soils agriculturally viable. Through training researchers abroad, cultivating domestic scientific expertise, and establishing a decentralized network of research centers tailored to Brazil's diverse ecological zones, the institution generated innovations that unlocked the productivity potential of previously underutilized lands. This geographically diversified research model proved decisive: empirical estimates indicate that agricultural productivity would have risen by only about 47 percent had Embrapa centralized its activities, compared with the 110 percent increase achieved under its dispersed structure (Akerman et al. 2025).

In contrast to Embrapa's clear success in building self-sustaining capabilities, Embraer presents a more complex and ambiguous outcome. Founded in 1969, it relied extensively in its early stages on government aid such as guaranteed demand, tax incentives, and large public R&D subsidies. The 1980s fiscal crisis exposed the firm fragility, leaving it heavily indebted and ultimately forcing its privatization in 1994 despite major rescue efforts. International collaborations such as the AM-X program helped Embraer build engineering capabilities applied in later projects (like the KC-390). Embraer reinforced this progress through human capital investments, most notably its master's program in aeronautical engineering. Yet the scale of state support still raises questions about whether these gains justified the fiscal costs. Ultimately, while Embraer gained engineering capabilities, its pre-privatization dependence on extensive state support and its near-failure in the early 1990s show that its overall trajectory remains far from a clear success (Francelino et al. 2019; Frischtak 1992, Lourencao et al. 2019).

Although Embraer's experience is marked by ambiguity, Brazil's shipbuilding industry offers a clearer example of industrial policy failure when capabilities fail to develop. Revived in the 1950s and boosted by strong foreign direct investment (FDI) in the 1970s, the industry experienced its first major collapse in the early 1990s after subsidies were withdrawn, leading to disinvestment, delays, cost overruns, and technological stagnation. The sector regained attention in the 2000s following major offshore oil discoveries, which sharply increased the demand of the majority state-owned oil company, Petrobas, for rigs, tankers, and support vessels. Long wait times for imported equipment created incentives to reactivate domestic production through public bids, but many contracts went to civil engineering firms that specialized in land-based construction rather than maritime or offshore technologies, resulting in a significant skill mismatch. Although the government attempted to compensate through technological partnerships with experienced international shipbuilders, domestic firms lacked the absorptive capacity to internalize and apply the transferred knowledge. Ultimately, the industry failed to catch up with international competitors, with domestic production costs remaining well above those of imported vessels (Alves et al. 2021).

The Brazilian experience underscores that capability building (not subsidization alone) is the decisive ingredient for durable industrialization. Embrapa stands out precisely because it embedded scientific learning, decentralized experimentation, and human capital development at the core of its strategy, enabling productivity gains that persisted beyond direct state support.

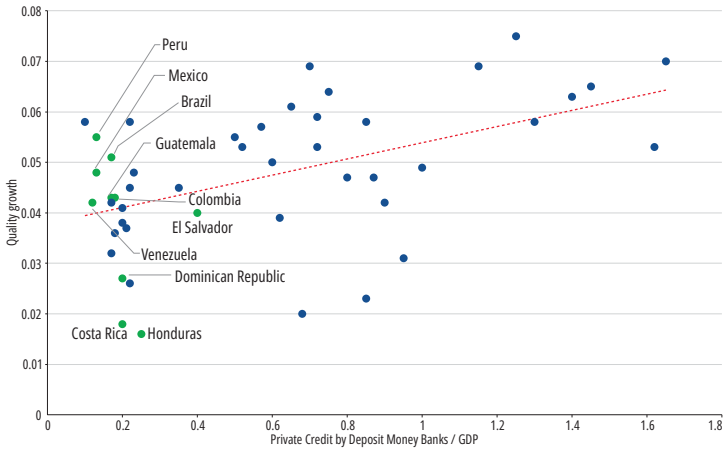
to take a long-term view of necessary innovation and investment. The relationship between basic managerial practices and firm's export values and investment in R&D are presented in figure 2.12, as captured by the scores from the World Management Survey. This measure and that of the US Census Bureau Management and Organizational Practices Survey (MOPS) are highly correlated with innovation in R&D and patenting (Cirera et al. forthcoming), as well as new products and processes and the entrance into more demanding sectors in Colombia (Fernandez et al. 2026).

Managerial and entrepreneurial capital are essential. A Deloitte report on LAC's skills deficit reveals that only 17 percent of Latin American companies rate the maturity of their cost management as "high"—well below the United States and global average. The report cites lack of strategic planning, weak liquidity management, and insufficient internal controls as primary drivers of this deficit in LAC (Deloitte 2020).

This management gap reflects multiple reinforcing factors: inadequate business education, limited exposure to international best practices, weak competitive pressures that would otherwise force management improvements, and insufficient knowledge transfer from multinational corporations. In particular, there are severe information asymmetries. Though LAC managers rank themselves modestly in the quality of their practices, they believe they are close to the frontier. The new Firm Adoption of Technologies Survey shows the same to be true in adopting technologies. The firms farthest from the frontier are most likely to believe they are there. This provides strong support for subsidized managerial extension services that provide subsidized benchmarking, and then help in improving practices, as well as identifying possible high-growth firms.

However, it is also necessary for these managers to diffuse risk in well-developed financial sectors. Engaging in R&D roughly doubles the degree of uncertainty in the evolution of a producer's productivity level (Doraszelski and Jaumandreu 2013) and financial constraints have been shown to reduce the incentive for firms to innovate

FIGURE 2.13 The worldwide relationship between the growth of quality in products and financial depth



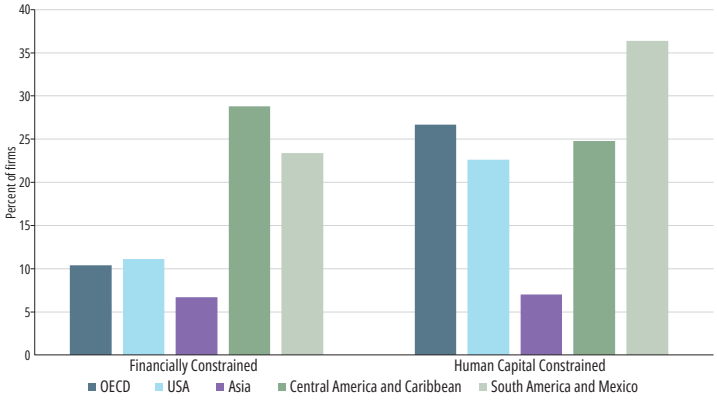
Source: Krishna et al. 2023.

Note: This figure plots and mean quality growth against financial development for countries that export at least 50 products at the HS10 level to the United States. Slope = 0.02 (t-stat = 5.35). HS 10 products are products with a 10-digit code under the Harmonized System (HS) of import and export classifications. GDP = gross domestic product.

(Gorodnichenko and Schnitzer 2013). Foster and Rosenzweig (2010) argue, in the context of small-scale agriculture, that "the incompleteness of insurance and credit availability play an important role in delaying the adoption of profitable new technologies." Krishna et al. (2023) show that quality growth is correlated with financial depth (refer to figure 2.13), and establish causality by showing that the establishment of stock markets increased the growth and dispersion of quality in products, while the financial contraction during the Asian financial crisis decreased them.

Managers in LAC report being financially constrained more than twice as often as managers in developed countries (refer to figure 2.14). Understanding why LAC's financial markets remain so shallow and addressing shortcomings are thus critical tasks for successful industrial policies in the region. Relevant considerations include the time required to resolve bankruptcy or other contract disputes. In the United States, this process often takes about three months, whereas in LAC it can take about two years. Firms will be reluctant to lend to risky projects if they know they are unlikely to recover something from unsuccessful ventures quickly.

FIGURE 2.14 Share of US, OECD, and LAC firms that face financial and human capital constraints



Source: World Bank Enterprise Survey, last available year for each country.

Note: OECD's average excludes members from LAC. South America & Mexico, and Central American & Caribbean include all countries considered in the World Bank Enterprise Survey database, except Haiti. Asia includes mainland China, Hong Kong. LAC = Latin America and the Caribbean; OECD = Organization for Economic Co-operation and Development; USA = United States of America.

3. Maximizing the benefits of openness

Integration in the global economy is critical. First, trade permits firms and industries to exploit scale economies. Second, trade, FDI, study abroad, and university exchanges offer means to reach the knowledge frontier most rapidly (Akcigit and Melitz 2025). If in the 1950s it was imagined that LAC could invent the necessary technologies on its own, today that notion is fanciful.

Yet LAC undertrades, given its position and free trade agreements, gravity models suggest (refer to figure 2.15). Protectionism abounds. While some sectors have been brutally exposed to competition from China, others remain protected by varying tariff and non-tariff measures (refer to figure 2.16). The case for reaping the benefits of greater integration and participation in global value chains, and specific steps needed to achieve the border reforms required (such as trade facilitation and regulatory cooperation), are discussed in *Deep Trade Agreements: Anchoring Global Value Chains in Latin America and the Caribbean* (Rocha and Ruta 2022).

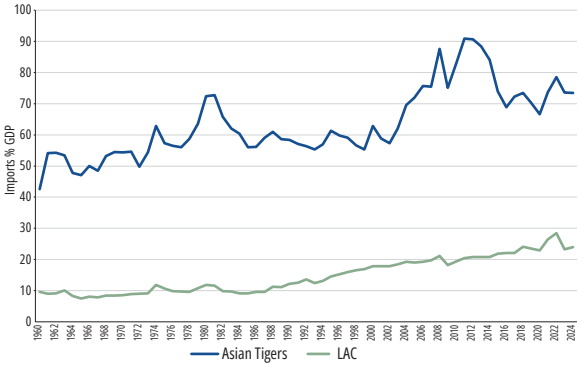
FDI is another missed opportunity. Despite talk of friendshoring or nearshoring, FDI has not increased significantly in LAC—partly due to the unavailability of skilled labor, poor infrastructure, high corporate taxation, thin financial markets, and insecurity. These shortfalls affect the emergence of new domestic industries, as well. The region also has not approached FDI in a way that would encourage learning. While countries such as China and Norway have used FDI as an instrument to get to the technological frontier, LAC has tended to see it more as a source of jobs and taxes. The leverage that countries have to negotiate technology transfer depends on potential market size (China) or resources (Norway) but also on whether the home firm perceives benefits in terms of developing local suppliers/partners.[9] This, in turn, depends on the quality of firms and the business climate. Costa Rica's policy of facilitating FDI while building capabilities to leverage it for broader development offers an example of a better integrated approach (refer to box 2.3).

Finally, openness facilitates the necessary contestability and discipline that can weed out low-performers and encourage new entrants and more productive firms to thrive. Once again, in this area, the link to productivity growth is intermediated by firm capabilities. That an absence of competition stifles innovation is generally accepted, although Philippe Aghion, co-winner of the 2025 Nobel Prize in economics, argues that the impact of increasing competition on innovation is not straightforward: it depends critically on how close firms are to the technological and managerial frontier (Aghion et al. 2005; Aghion et al. 2009). While intensifying domestic competition and strengthening competition agencies increase productivity, innovation, and employment, as the World Bank report *Competition and Productivity Growth In Latin America and the Caribbean* (Vostroknutova et al. 2025) shows, competing globally can be less growth promoting for LAC. While in the United Kingdom and France, for instance, 50 percent of firms innovate when confronted with more global competition, according to Maloney and Zambrano (2021), in Chile the share is much lower—only 7 percent, Cusolito et al. (2023) find.

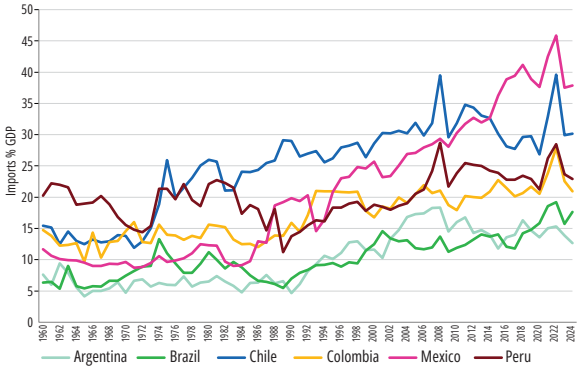
[9] The principles of practice of this technology transfer quid pro quo are highlighted in Fernandes and Reed (2026).

FIGURE 2.15 Relative openness to trade, Asian Tigers versus LAC

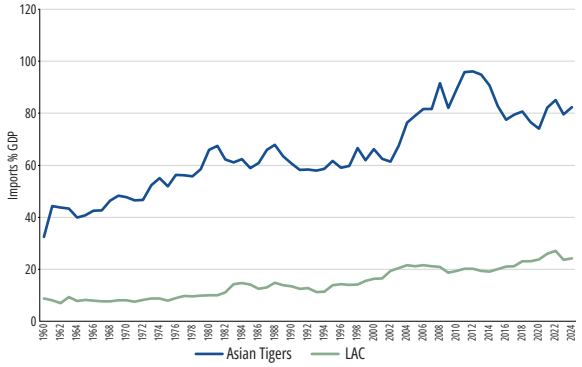
A. Imports in goods and services as a percentage of GDP in LAC and the Asian tigers



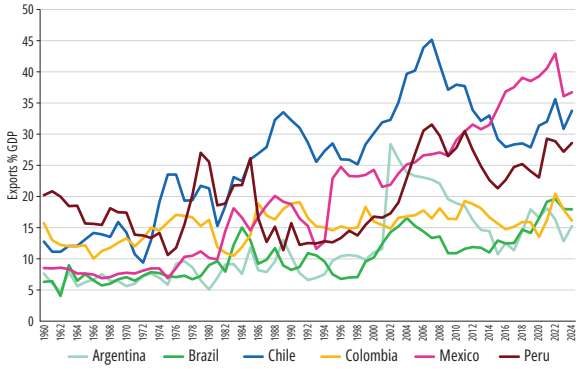
B. Imports in goods and services as a percentage of GDP in LAC countries



C. Exports in goods and services as a percentage of GDP in LAC and the Asian tigers



D. Exports in goods and services as a percentage of GDP in LAC countries

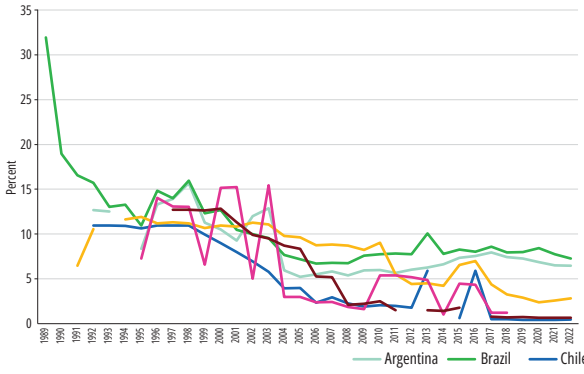


Source: World Bank staff calculations based on imports of goods and services as a percentage of GDP (World Development Indicators database).

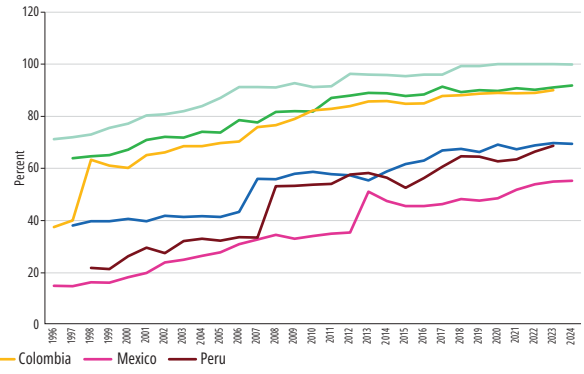
Note: Regional aggregates are weighted by GDP. Asian Tigers = Hong Kong SAR, Korea, Rep., Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru. LAC = Latin America and the Caribbean; GDP = gross domestic product.

FIGURE 2.16 Shifting patterns of protectionism in LAC: Liberalizing tariffs and intensifying regulatory measures

A. Applied weighted tariff rates in Latin America



B. Non-tariff measures (NTM) as share of total import value



Source: World Development Indicators (WDI). Data compiled from UNCTAD TRAINS, WTO IDB/CTS, and UN Comtrade.

Note: Tariffs measured as the import-weighted average of effectively applied tariff rates across all merchandise products for each country and year. Weighting uses each product's share in total imports, based on data from UN Comtrade, ensuring that goods with greater import importance carry more influence in the final rate. When an effectively applied tariff is unavailable, the most favored nation rate is substituted to maintain complete coverage. Non-tariff measures are represented as the share of a country's total import value that is subject to at least one NTM. This captures the extent to which imported goods face regulatory requirements such as technical barriers, sanitary and phytosanitary measures, licensing rules, quantity controls, or other policy instruments beyond tariffs. The measure is calculated by identifying all product lines covered by at least one NTM and summing the corresponding import values. These import values are then expressed as a share of the country's total imports, weighting each product by its importance in the import basket.

BOX 2.3 Building Capabilities to Leverage FDI in Costa Rica

Costa Rica's transformation into a high-value destination for foreign direct investment (FDI) was rooted in institutional developments that long preceded the arrival of multinational firms. During the 1950s to1970s, the country pursued an import substitution strategy while simultaneously investing in foundational human capital and training institutions. A cornerstone of this effort was the establishment in 1965 of the National Institute for Learning (INA), which provided technical training aimed at supporting early industrialization. This institutional base proved critical when the macroeconomic crisis of the 1980s struck the region. Unlike many Latin American and Caribbean (LAC) countries that experienced a "lost decade," Costa Rica embarked on a distinct path by combining stabilization policies with an outward-oriented development strategy centered on attracting FDI (OECD 2012).

A key turning point in Costa Rica's development strategy came with the creation of the Costa Rican Investment Promotion Agency (CINDE) in 1982, formalized as a private nonprofit organization of public interest in 1984. As LAC's first dedicated investment promotion agency, CINDE helped reposition the country in global value chains by branding it as a stable, reliable, and skill-rich location for multinational firms. Working alongside the Free Trade Zone (FTZ) regime and export incentives, CINDE's investor-oriented services attracted major companies in the services, medical devices and electronics sectors, among them Baxter, Abbot (now Hospira), and eventually Intel (Bamber and Gereffi 2013; World Bank 2025a).[10]

Costa Rica improved its human capital to attract FDI and continued to actively respond to the skill demands created by multinational firms, most notably Intel. While the country already had a strong education base, the arrival of high-tech FDI induced reforms in tertiary and technical education, expansion of English-language and engineering training, and close coordination between firms, universities, and training institutions. Intensive firm-level training and labor mobility generated economywide skill spillovers, enabling Costa Rica to upgrade from assembly toward more knowledge-intensive activities. This process illustrates that FDI can accelerate human capital accumulation only when complemented by deliberate public policy and institutional coordination (Rodríguez-Clare 2001; World Bank 2006).

[10]In May 2023, the Ministry of Foreign Trade withdrew funding from CINDE, cutting its government budget by 73% and transferring its functions to PROCOMER, the state export promotion entity.

Hence, again, capability building does not happen automatically and is a necessary complement to more competition. Recent studies in the United States and China (Bloom and Van Reenen 2007), as well as Colombia (Fernandez et al. 2026; Iacovone et al. 2026), show that improving firm capabilities increases exports, expands the number and sophistication of markets, and increases the quality of exported goods.

4. Strengthening the state

Advancing these agendas requires redressing associated market failures and this, in turn, requires strengthening the state. Thus, an increasing body of work is examining the political economy of industrial policy (refer, for example, to Juhász and Lane 2024). Political economy includes not only issues of state autonomy and insulation from rent-seeking lobbying, bandwidth (Reed 2024), and the ability to process information to identify the most productive areas of investment (Liu 2019; Maloney

and Nayyar 2018), but also government's capability for execution.

Industrial policies are fundamentally decisions taken under uncertainty. Governments must in effect make a risk-return calculation as to which interventions are likely to yield significant impacts and how successful implementation is likely to be. Policy makers must have confidence in the magnitude of those assessments. Such calculations are not trivial even in straightforward cases, such as simply facilitating information flows. Microeconometric studies of the Japanese textile miracle show that state agencies frequently disseminated outdated technologies; the driving force of the country's surge in textiles was actually one or two dynamic entrepreneurs working at the technological frontier (Braguinsky et al. 2015). The government misjudged the situation. Hence, continued improvements in the quality of governance and the government's ability to make good bets are an essential part of any growth policy and in particular in more active industrial policies.

Subnational governments might be able to better recognize the outcomes of such bets. Because local authorities are often more attuned to the unique economic, social, and institutional circumstances within their jurisdictions, they can observe and assess the impact of industrial policy interventions more closely than national bodies. This proximity allows them to identify both successes and failures faster, enabling timely adjustments to strategies and resource allocation. Furthermore, subnational governments may leverage local partnerships and stakeholder engagement to facilitate feedback loops, ensuring that policy decisions reflect actual market dynamics and community needs. However, the effectiveness of this approach depends on the capacity of subnational institutions, as variations in local capabilities can either support or hinder the realization of intended outcomes. By fostering a decentralized system where capable regional actors play an active role in monitoring and adapting industrial policies, countries can create a more responsive and targeted development environment that maximizes the learning from each policy experiment.

However, LAC has not been making progress in this area over the last 30 years. World Bank Governance Indicators suggest that in Government Effectiveness, Regulatory Quality, Rule of Law, or Corruption, the region arguably has less bandwidth, less capacity for effective implementation, and less insulation from lobbying and vested interests than it did a generation ago, even as the Asian miracles and China continue to improve in most dimensions (refer to figure 2.17).

Improving the capabilities of the region's governments is precisely the logic behind the Bank's Government Analytics program, which seeks to disseminate what has been learned about measuring government performance, and how to improve it. In particular, *Data for Better Governance: Building Government Analytics Ecosystems in Latin America and the Caribbean* (Santini et al. 2024) shows how countries can use existing sources of data to diagnose and improve LAC governance, while the *World Bank's CLIAR dashboard* can be used to identify agency-level strengths and weaknesses. On the other hand, the *Public Workforce and Prosperity Report* (World Bank 2026) provides guidelines on how to attract and remunerate more effective public officials.

Industrial policy is the outcome of a political equilibrium that creates winners and losers (Acemoglu and Robinson 2013), leading to political bargaining, and outcomes that may be "second best"—at best (Dixit 2009; Rodrik 2008). In practice, complex political economy dynamics must be addressed even for government interventions that are typically accepted. This point is emphasized in a new framework, the so-called London Consensus (Besley et al. 2025), which underscores the significance of state capacity in achieving growth.

Notably, the quality of public education in LAC remains poor despite 50 years of documentation, both of the returns to schooling and that the region lags badly. The construction of basic infrastructure, whose returns are also well documented, is often impeded by corruption that raises costs, lowers quality, and delays completion. These are relatively "sure" bets that the region has trouble placing. Putting further demands on the state to undertake riskier bets—such as choosing high-growth sectors, executing support policies well, and withdrawing support for "bad bets"—may still be ambitious. Combined with the

FIGURE 2.17 Government capabilities in the Asian Tigers, China, and LAC

Source: World Bank Governance Indicators.

Note: Regional values are weighed by the total population (World Bank). Values are relative to the world average. Asian Tigers = Hong Kong SAR, China; Korea, Rep. Singapore; China. LAC = Argentina, Brazil, Chile, Colombia, Mexico, Peru.

limited fiscal space documented in chapter 1, a more conservative stance toward industrial policy would be justified, as laid out in the new World Bank typology (refer to table 2.1).

Learning to place better bets to promote faster growth and job creation

Development is fundamentally about placing bets. The private sector needs to weigh the risks and returns of investment and initiatives to adopt technology. Governments make the same calculations when attempting to resolve market failures that are imperfectly understood, measured, and redressed. The contribution of the World Bank's new report on industrial policy is precisely to lay out the new evidence— particularly from East Asia—on the trade-offs countries face when designing their growth strategy.

LAC's experience suggests that whatever decisions are made about attempts to shift the sectoral composition of what countries produce, there is a complementary, more horizontal industrial policy agenda: to ensure that whatever commodities, products, or services are produced is done so in a way that firms and countries can learn to better identify and exploit the new technologies of the twenty-first century that are essential to generating the high-quality jobs and growth the region needs.

Much of this agenda is a continuation of the ongoing efforts at reform in the region. Facilitating trade and FDI, improving bankruptcy procedures, and improving digital literacy remain basic and necessary policies that should not be hard to resolve. For some

other "horizontal" policies—such as ensuring quality primary and secondary education or investing in better infrastructure—despite well-established rates of return, LAC has often been unable to follow the Asian miracles. Box 2.4 highlights successful efforts in the region in building human capital, and the World Bank's support to produce the skills required for firms to expand.

The resistance to improvement, often due to difficult political economy issues, reveals the continued weakness of the state that need to be kept in mind as industrial policies with less certain returns are contemplated. Remaining challenges, rather than targeting particular sectors, are often horizonal: tackling cross-cutting areas such as increasing human capital, improving infrastructure, implementing effective market regulation, and ensuring macroeconomic stability. An important challenge is constructing innovation systems that drive increases in innovation and R&D: specifically, by ensuring quality universities and research institutes work closely with a private sector to meet the needs for increasing managerial capabilities.

The evidence collected by Industrial Policy for Development around sectoral policies is an invaluable resource for policy makers seeking faster growth and better jobs for their citizens. LAC's experience suggests, however, that placing these riskier bets requires progress on the basic reforms and advancement on the national learning agendas, as well as strengthening Latin America's public institutions. Box 2.5 provides a pathway to exploit mining opportunities in the region under the proposed framework.

BOX 2.4 Building Human Capital for Industrial Policy in LAC

Industrial policy in Latin America and the Caribbean (LAC) depends critically on whether workers with the right skills are available when and where investment takes place. When human capital is misaligned with firm demand, industrial policy packages can be subject to delays, low take-up, and weak spillovers. Addressing this constraint is not primarily a matter of expanding the supply of trainers and training programs, but of building a skills-for-work ecosystem that continuously links private sector labor demand to worker preparation, with hiring and sustained employment as the objective. Such an ecosystem operates as a recurring cycle in which labor demand is identified, translated into credible signals for workers and training providers, and supported by matching and placement mechanisms that reduce information frictions and hiring risk. While these processes are often coordinated at the national level to exploit scale and consistency, they must be complemented by local, firm-level information and iterative interaction among employers, training institutions, and public agencies.

Argentina's experience in the mining sector illustrates how this logic can be applied through responses by sectors at the local level aligned with priority investments. As lithium and other mineral projects expand, the World Bank Group, in partnership with mining firms and Universidad Siglo 21, has supported the identification of priority occupations and skill profiles associated with new investments. These profiles are translated into concrete training pathways that update technical and academic programs and are explicitly linked to hiring pipelines. The approach emphasizes speed and specificity, ensuring that local labor markets can respond to investment timelines while building domestic capabilities alongside project development.

In the Dominican Republic, skills development has been embedded directly into the expansion of special economic zones linked to logistics, manufacturing, and nearshoring. Firms operating in these zones identify occupational needs associated with new investments, while training institutions adapt short-cycle training and certification programs in coordination with the national training institute, INFOTEP. Placement is facilitated through firm-based training and coordinated recruitment within the zones, reducing matching frictions at scale. This integration of identification of demand, adaptation of training, and timely placement has allowed the skills system to respond rapidly to investment needs while maintaining credibility with employers.

Chile provides an example of building a nationwide system that supports sectoral and territorial responses. Through investments by the Ministry of Education and the Ministry of Labor, including the national training and employment service, SENCE, the country has developed labor observatories, competency frameworks, and governance mechanisms that channel employer input into skills development schemes. These national tools provide a common methodological backbone that can be applied across sectors and regions, reducing duplication and transaction costs while allowing local initiatives to adapt occupational profiles and training content to specific technological and production contexts.

Brazil illustrates how system integration at the national level can strengthen matching and placement at scale. Building on the existing Emprega Brasil platform, the government is developing an integrated employment and skills system that combines posting of job vacancies and matching of job candidates, worker profiling, digital job search, public employment services, unemployment insurance, digital work records, and referrals to training opportunities. By fully integrating labor intermediation, skills development, and administrative data, the platform aims to improve coordination across sectors and regions and to institutionalize learning from global experiences, progressively strengthening the performance of the national skills system.

BOX 2.5 Mining the Energy Transition: Opportunities for LAC

The transition to a lower carbon global economy opens a window of opportunity for dynamic growth and job creation in LAC. For example, new technologies depend heavily on mineral resources, such as lithium and copper, which the region has in abundance. But such bountiful natural wealth is no silver bullet for development. To capitalize on the region's competitive advantages, its governments must develop a comprehensive set of policies that transform the region's legacy resource driven model into one driven by resource and environmental efficiency and greater productive and innovative capabilities.

Rising global demand for energy transition minerals presents opportunities for Latin America and the Caribbean (LAC) to add value and expand into downstream products like batteries. Yet, mining emissions, environmental impacts, and social risks remain high. Innovation is needed to make mining more sustainable, increase clean energy use, and limit water consumption. Achieving this requires well-connected innovation ecosystems involving mining firms, suppliers, government, academia, and industry associations (Bryant 2015; Deloitte 2016; Upstill and Hall 2006).

LAC suppliers face disadvantages due to limited research, education, and training centers, and weak coordination with mining companies. A lack of pilot and testing facilities hinders technology development and scaling. Most local innovations are isolated, lacking formal links and collaboration with large mining firms, who usually rely on foreign suppliers (Molina 2018; Stubrin 2017). Moreover, there is limited communication between suppliers and mining companies, which is generally more transactional than collaborative (Figueiredo and Piana 2018; Molina 2018; Pietrobelli, Marin, and Olivari 2018). One exception is the development of the World Class Supplier Program in Chile, led by BHP Billiton and Codelco, the state mining company. The program aimed to communicate the operational problems of mining firms so local suppliers could build their organizational and technological capabilities to provide solutions. Impact reviews suggest that the program has improved innovation efforts, although it has yet to deliver large-scale solutions or generating exports of services from local suppliers (Navarro 2017).

All of these issues point toward a weak innovation system in mining, which can be addressed with the right incentives and policy design. In Australia, the United States, and Canada, where most successful supplier firms originate, a broad ecosystem for innovation exists. There are coordinating agencies, research centers, and industrial organizations that support innovation by creating spaces for communication, addressing common problems, and sharing the risk and cost for innovators (Bryant 2015; Deloitte 2016).

When designing institutions and policies to incentivize innovation, there are two important lessons to keep in mind (Cirera and Maloney 2017). First, technology extension centers and business associations are more effective when they are the result of public-private partnerships. This ensures communication and helps address coordination issues while keeping services aligned with business needs. Second, successful institutions tend to be subnational and close to specific sector clusters. Local knowledge and proximity facilitate effective and frequent interaction with local firms.

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Growth and quality job creation in Latin America and the Caribbean (LAC) remain subdued amid a challenging global environment. Inflation continues to decline, but monetary easing has proceeded more slowly than anticipated, non-energy commodity prices are softening, and persistent fiscal deficits continue to constrain needed investment. In addition, the rapid evolution of the global trade regime, together with heightened volatility in energy markets linked to the recent conflict in the Middle East, creates high levels of uncertainty around investment, inflation, and monetary policy undermining medium-term growth prospects. Frustration with a lack of progress on the longer-term growth and jobs agenda, combined with the emergence of new academic studies on the Asian Miracles has moved Industrial Policy back to the center of the policy debate in much of the developing world. While policy makers need to remain open to the emerging lessons, LAC's historical experience—from import substitution industrialization, through market-oriented reforms, to the recent return of industrial policy—shows that across sectors and policy regimes, weak productivity growth persisted, importantly because the region lacked the capability to identify and exploit new technologies, processes, products, and markets. Hence, industrial policy needs to be thought of importantly as "learning policy," with four agendas: building capabilities across the human capital spectrum; facilitating experimentation and risk-taking; exploiting openness productively; and, to redress the market failures attending each agenda, strengthening the state.

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