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RESILIENCE IN ACTION: SOCIAL POLICIES TO NAVIGATE UNCERTAINTY IN LATIN AMERICA AND THE CARIBBEAN

Thematic Table 4:

Financing Resilience in Uncertain Times: Linking Fiscal Systems with the Sustainable Development Goals

Technical Note

1. Introduction

Latin America and the Caribbean (LAC) countries are experiencing an unprecedented combination of challenges. The COVID-19 pandemic has exacerbated the region's already fragile socio-economic conditions, highlighting deep structural inequalities and fiscal vulnerabilities. Public finances in the region, which were already constrained by limited tax revenues and high levels of debt, have come under immense pressure as governments responded to the health crisis with increased spending on emergency services and social protection programs. As a result, fiscal deficits have ballooned, with debt-to-GDP ratios rising sharply across the region. In many countries public debt has surged to unsustainable levels, reducing fiscal space for future development investments and complicating economic recovery efforts.

The pandemic's impact has exposed limitations of existing fiscal systems, emphasizing the need for a comprehensive approach that aligns fiscal policies with development objectives. To build resilience and achieve sustainable growth, LAC countries might want to rethink fiscal policies to focus on long-term investments in human capital, environmental sustainability, and social inclusion. This requires a fundamental shift in the way governments generate and allocate public resources, ensuring that fiscal systems are not only responsive to immediate crises but also support the region's broader development goals.

The economic fallout from the pandemic was profound, with the region experiencing its sharpest economic contraction in decades. According to the International Monetary Fund (IMF), LAC's economy shrank by 7.4% in 2020, marking one of the steepest declines globally. The pandemic pushed millions of people into poverty, with the Economic Commission for Latin America and the Caribbean (ECLAC) estimating that an additional 22 million people in the region fell into extreme poverty, reversing years of progress in poverty reduction. The crisis has disproportionately affected vulnerable groups, including women, informal workers, and Indigenous communities, further entrenching existing inequalities. Women, in particular, have been disproportionately impacted by job losses, as they are overrepresented in sectors hardest hit by the pandemic, such as tourism, retail, and informal work. At the same time, climate change continues to pose a significant threat to the region's development prospects. LAC is one of the most vulnerable regions to climate-related risks, with the Caribbean facing increasingly frequent hurricanes, while South American countries endure severe droughts and floods.

Addressing these interconnected challenges requires a comprehensive and integrated approach to fiscal policy that aligns with development objectives. To achieve this, governments in LAC could develop fiscal systems that prioritize sustainability, resilience, and inclusivity. This means rethinking tax policies, public spending, and debt management strategies to ensure they contribute to long-term development goals. For example, governments could explore ways to broaden tax bases and reduce tax evasion, which remains a significant issue across the region.

In addition to improving tax collection, fiscal policies should integrate climate resilience and environmental sustainability. The region has made some progress in this area, with countries like Chile and Colombia issuing green bonds to finance renewable energy and sustainable infrastructure projects. However, these efforts need to be scaled up across the region, with greater focus on leveraging innovative financial

instruments, such as sustainability-linked loans and state-contingent debt instruments, which can provide automatic debt relief in the event of major economic shocks or disasters.

The private sector also plays a crucial role in financing sustainable development in LAC. With public finances under strain, attracting private investment through public-private partnerships (PPPs) and blended finance is essential to funding critical development projects. PPPs have been successfully used in countries like Brazil, Chile, Colombia, Mexico and Peru to finance large-scale infrastructure projects, such as roads, water systems, and energy facilities, which are vital for economic recovery and long-term growth. According to the IDB, PPPs in LAC have the potential to mobilize over USD 200 billion in investments by 2030, provided that governments create enabling environments through robust regulatory frameworks and fiscal incentives that encourage private sector participation in sustainable development.

This technical note aims to explore how LAC countries can align their fiscal systems with their development priorities in order to build resilience and promote sustainable development in the region. It will review key challenges faced by governments in financing recovery efforts, including constrained public finances, rising debt levels, and increasing vulnerability to climate-related disasters. The note will also examine the role of innovative financial instruments and mechanisms, such as green bonds, blended finance, and state-contingent debt, in supporting sustainable investments. Finally, the document will provide recommendations on how governments can leverage private sector involvement to bridge financing gaps and achieve the SDGs by 2030.

2. Context of Fiscal Challenges in LAC

The economic landscape in LAC has been significantly affected by the COVID-19 pandemic, resulting in severe contractions in output, increased public debt, and fiscal imbalances. In 2020, the global economy experienced a contraction of approximately 4.3% of GDP due to the pandemic, with LAC seeing some of the sharpest declines among emerging markets. The region's GDP fell by 7.4%, marking the steepest recession in over a century.

Public finances across LAC were deeply strained as governments scrambled to respond to the health emergency, allocate funds for social protection, and provide economic stimulus packages. This significant increase in public spending resulted in ballooning fiscal deficits. Data from the IMF show that between 2019 and 2021, fiscal deficits in the region grew by an average of six percentage points, with several countries experiencing much sharper rises.

Debt levels across the region have become a growing concern, with LAC's overall debt burden now exceeding 75% of GDP in many cases, with some countries in the region showing their debt-to-GDP ratios soar past 90% during this period. This dramatic rise in debt was accompanied by increasing vulnerability to external shocks, such as global interest rate hikes and commodity price volatility. These vulnerabilities have placed further pressure on LAC economies, particularly those reliant on external financing and the export of raw materials.

The pandemic has underscored the need for LAC countries to adopt more sustainable fiscal policies that balance short-term recovery needs with long-term development goals. According to the IDB, the region's recovery could take longer than in other parts of the world, particularly if fiscal imbalances are not

addressed. The focus must shift towards strengthening domestic resource mobilization, improving tax collection, and implementing fiscal reforms that reduce reliance on external borrowing.

2.1 Impact of the Pandemic on Fiscal Deficits and Public Debt

The region's reliance on external borrowing, coupled with limited fiscal space prior to the pandemic, compounded the economic fallout. According to the World Bank, LAC's debt burden is projected to remain elevated for the near future, with several countries already struggling to manage rising debt service costs.

The IMF has warned that without substantial reforms aimed at improving fiscal sustainability, LAC countries will face growing risks of debt distress. This is particularly concerning given the region's exposure to global financial markets, where tighter monetary conditions in advanced economies could lead to higher borrowing costs and capital outflows. As global interest rates continue to rise, countries with large debt burdens are especially vulnerable to fiscal shocks. Without substantial reforms to stabilize public finances, these countries face elevated risks of debt distress, especially as they continue to grapple with the impacts of the pandemic and external economic shocks like inflation and geopolitical tensions.

2.2 Inequality and Vulnerability to External Shocks

The pandemic also highlighted and exacerbated long-standing inequalities in the region. LAC is known for its high levels of income inequality, with significant disparities in access to healthcare, education, and social protection. The economic shock caused by COVID-19 further widened these gaps, pushing millions into poverty. According to ECLAC, extreme poverty in LAC surged to 13.8% in 2020, reversing years of progress in poverty reduction. The pandemic's impact on informal workers, who account for nearly 50% of the region's labor force, was particularly severe, as many lacked access to formal social protection systems.

In addition to social vulnerabilities, the region remains highly susceptible to climate-related risks. LAC is one of the most disaster-prone regions in the world, facing frequent hurricanes, floods, and droughts, which place additional strain on fiscal resources. The economic costs of climate-related disasters in the region are substantial: according to the IDB, by 2050, climate change damages could cost USD 100 billion annually to the region. These risks further limit the fiscal space available for critical investments in infrastructure and climate resilience, which are essential for achieving the development goals.

2.3 Fiscal Gaps in LAC

Even before the pandemic, many LAC countries faced significant fiscal gaps due to limitations in tax collection systems, high levels of tax evasion, and inefficient public spending. Tax evasion and avoidance in LAC amounted to 6.7% of regional GDP (USD 433 billion) in 2023, representing a significant loss of public revenue that could be redirected toward development investments. Additionally, a large informal sector—representing nearly 50% of the workforce in some countries—reduces the taxable base significantly, as informal workers and businesses often operate outside the formal tax and regulatory framework, leading to lower tax revenues for governments.

Reliance on external borrowing to finance fiscal deficits has led to increasing debt levels, particularly in countries some countries. However, borrowing to fill fiscal gaps often comes at the cost of long-term fiscal sustainability, as the debt service burden constrains future spending and investment capabilities. The World Bank notes that even when interest rates are favorable, the increase in government debt, exacerbated by the pandemic, has led to significant fiscal pressures. This situation limits the fiscal room for maneuvering and constrains future investments, making it difficult for countries to finance long-term development projects.

The COVID-19 pandemic drastically widened fiscal gaps in the region. Governments were forced to significantly increase public spending to address the health crisis and provide economic relief. This was compounded by falling revenues due to the economic contraction. Between 2019 and 2020, fiscal deficits in LAC countries increased by an average of 6% (Latin America's combined fiscal deficit expanded from 3.8% of GDP in 2019 to 8.3% in 2020). In some of the worst-hit economies, such as Argentina and Peru, deficits surged by over 10%, driven by emergency expenditures and declining revenues during the economic downturn.

3. Linking Fiscal Systems to Development Objectives

Achieving the SDGs by 2030 requires a transformative shift in how governments across LAC finance their development priorities. Aligning fiscal systems with the SDGs is an important mechanism for public expenditures, taxation policies, and debt management strategies to contribute directly to sustainable development outcomes, including poverty reduction, environmental sustainability, and inclusive growth. However, many LAC countries face challenges in mobilizing adequate domestic resources and structuring public spending in ways that are consistent with the SDGs.

3.1. Integrating the SDGs into National Budgets

One of the key strategies for linking fiscal systems to the SDGs is through the integration of SDG priorities into national budgets and fiscal frameworks. This process involves aligning national spending plans with the 17 SDGs, ensuring that public funds are directed toward critical sectors such as health, education, climate action, and social protection. Countries like Mexico and Costa Rica have made significant strides in incorporating the SDGs into their budgetary processes, using SDG-aligned performance indicators to track the effectiveness of public expenditures.

In Costa Rica, the Ministry of Finance has developed a methodology for assessing how national budget allocations contribute to each SDG by incorporating these goals into the National Development and Public Investment Plan (PNDIP) and other strategic financial frameworks, allowing policymakers to better understand the impact of their fiscal decisions. The country's approach focuses on integrating sustainable development objectives into public finance management, with a particular emphasis on social inclusion and gender equality in public sector budgeting. This alignment supports a more efficient allocation of resources toward priority sectors like education, health, and sustainable development initiatives.

In turn, Mexico has implemented a robust framework that integrates SDGs into its budgetary process through a collaboration between the Ministry of Finance and UNDP. The process involves linking the National Development Plan with budget allocations, using performance evaluation systems to monitor the

alignment with SDG targets, and employing a results-based management approach to ensure that public spending contributes directly to the SDGs. Mexico's effort to incorporate SDGs into its budgetary planning has resulted in the integration of most of its development programs with the SDG framework, enhancing the transparency and accountability of public expenditures.

3.2. Strengthening Revenue Mobilization for Sustainable Development

For LAC countries to finance the SDGs effectively, improving domestic resource mobilization is essential. Many countries in the region suffer from low tax revenues due to weak tax systems, high levels of tax evasion, and a large informal economy. According to the OECD, tax revenues in LAC account for only 22.9% of GDP on average, compared to 34.1% in OECD countries. Closing this gap is critical for generating the funds necessary to invest in SDG-related projects.

In recent years, several countries in LAC have introduced progressive tax reforms aimed at increasing revenue collection and reducing inequality. In December 2020, Argentina passed a one-time wealth tax called the "Extraordinary Solidarity Contribution," aimed at individuals with assets worth at least AR$ 200 million (approximately USD 2.4 million). The tax rates ranged from 2% to 5.25% on both domestic and overseas assets. The revenues from this tax were intended to support pandemic-related expenses, including healthcare supplies, aid for small businesses, and financial support for vulnerable communities impacted by COVID-19.

Additionally, tax reform efforts in countries like Chile and Colombia have focused on broadening the tax base and reducing regressive taxation practices, which disproportionately impact low-income households. Colombia's flagship tax reform, implemented in 2022, focused on making the tax system more progressive by increasing taxes on higher incomes and reducing tax benefits for certain industries. The aim was to ensure that the wealthiest sectors of society contribute a fairer share to national revenue, directly addressing income inequality. Similarly, Chile has taken steps to adjust its tax policies to better distribute the fiscal burden and improve social equity. These reforms include measures to limit tax exemptions, increase taxes on higher-income earners, and introduce a more progressive structure to the taxation system.

Beyond tax reforms, LAC countries should also focus on improving tax administration and reducing tax evasion, which costs the region billions of dollars each year, as previously discussed.

3.3. Promoting Green and Sustainable Financing Instruments

To bridge the financing gap for the development priorities, LAC governments are increasingly turning to innovative financing instruments that align with environmental and social goals. Green financing mechanisms, such as green bonds and sustainability-linked loans, offer a promising avenue for mobilizing resources towards climate resilience and sustainable development projects.

Countries like Chile and Colombia have already pioneered the issuance of green bonds, raising billions of dollars to finance renewable energy and sustainable infrastructure initiatives. Specifically, Chile's green bond issuances were particularly successful: Chile was the first sovereign issuer in LAC to sell green bonds, starting in 2019, and has since issued a total of USD 25.9 billion in environmental, social, and governance

(ESG) bonds, including USD 7.7 billion in green bonds. Colombia also recently issued its first green bond in the local market, raising USD 197 million, with a significant portion directed towards financing water projects, transport, environmental protection, and renewable energy. Scaling up such initiatives across the region will be critical for closing the financing gap needed to achieve the SDGs.

Moreover, sustainability-linked loans, which tie borrowing terms to the achievement of specific sustainability targets, are gaining traction in the region. These instruments provide financial incentives for both governments and private companies to invest in projects that contribute to climate action, clean energy, and social inclusion. Uruguay has been active in the sustainability-linked loan market. It became the first country to secure a USD 350 million sustainability-linked loan from the World Bank, which links financing conditions to specific environmental targets, such as reducing methane emissions from its livestock sector. This innovative loan allows Uruguay to benefit from reduced interest rates if it meets these predefined sustainability goals.

3.4. Gender-Responsive and Inclusive Fiscal Policies

In addition to green financing, gender-responsive budgeting (GRB) is a powerful tool for aligning fiscal systems to development objectives. GRB involves incorporating gender equality considerations into the planning and execution of national budgets to ensure that public spending promotes the empowerment of women and reduces gender disparities.

Countries such as Mexico and Argentina have been at the forefront of implementing GRB frameworks, using gender-focused audits and assessments to determine the impact of fiscal policies on women and marginalized groups. Mexico has established one of the most comprehensive GRB systems globally, with mechanisms to tag and track budgetary allocations aimed at promoting gender equality. This system, known as Annex 13, "Expenditures for the Equality between Women and Men," specifically earmarks funds to narrow gender gaps through various public programs and initiatives.

Argentina has also made significant progress by integrating gender considerations into its national budget. The country's budget now includes a gender perspective, with specific allocations for programs aimed at closing gender gaps and promoting women's autonomy in areas such as economic participation and decision-making.

These measures are reinforced by civil society organizations, which conduct gender audits and advocate for transparent implementation of these policies to hold the governments accountable. These efforts have not only contributed to greater gender equality but also improved the overall effectiveness of public spending by ensuring that resources are allocated in ways that benefit all segments of society.

3.5. Ensuring Fiscal Transparency and Accountability

Finally, fiscal transparency and accountability are critical components of development-aligned fiscal systems. Ensuring that public spending is transparent and subject to scrutiny helps to build trust in government institutions and ensures that resources are used effectively. In this regard, digital tools and open data platforms can play a crucial role in enhancing the transparency of public expenditures and improving citizen engagement in the budget process.

Countries like Uruguay and Costa Rica have introduced open budget initiatives, which allow citizens to track how public funds are being spent and assess the alignment of government spending with SDG targets. In Uruguay, the government has established mechanisms through its Office of Planning and Budget (OPP) and the National Institute of Statistics (INE) to ensure that national policies and budgets are closely aligned with SDG objectives. This system allows for transparent monitoring of public funds and the progress of SDG targets, fostering accountability and public engagement in the decision-making process.

Costa Rica has also taken significant steps towards implementing open budget initiatives, focusing on transparency and the efficient allocation of resources toward SDG-related projects. The country uses digital platforms to disclose budgetary information, which encourages citizen participation and oversight in public spending decisions.

These initiatives not only promote accountability but also empower citizens to participate in the decision-making process, ensuring that fiscal policies reflect the needs and priorities of the population.

4. The Role of the Private Sector

The private sector plays a critical role in financing and achieving the SDGs in LAC. Public resources alone are insufficient to meet the financing gap that the region faces to reach the SDGs by 2030. Leveraging private capital through innovative financial instruments and partnerships is essential for bridging this gap and ensuring that investments are directed toward inclusive and sustainable growth.

4.1 Public-Private Partnerships (PPPs) and Blended Finance

Public-Private Partnerships (PPPs) and blended finance mechanisms offer effective tools for leveraging private capital to finance critical public infrastructure and services that support SDG achievement. These instruments allow governments to pool public resources with private investment, sharing both risks and returns to fund large-scale projects in sectors such as transportation, energy, healthcare, and education.

For example, Peru has been a leader in using PPPs to finance infrastructure projects. Through the "Lima Metro Line 2" PPP project, the Peruvian government partnered with private sector companies to build a USD 5.6 billion metro system aimed at reducing traffic congestion, improving public transportation, and lowering carbon emissions in the capital.

Blended finance, which combines public development funds with private capital to reduce investment risks, is another growing mechanism in the region. In Mexico, the Climate Investment Funds (CIF) blended public and private financing to support geothermal energy development. For example, the IDB has approved a loan modification of approximately USD 108.6 million to promote private investments in geothermal electricity generation. This program aims to finance up to 300 MW of geothermal capacity and is expected to leverage an additional estimated USD 4.2 billion in public and private investments. By de-risking private investments, the CIF's financing attracted private sector participation, resulting in substantial investment in clean energy projects.

4.2 Mobilizing Private Capital for Sustainable Development

Private sector engagement is vital for financing large-scale investments in infrastructure, renewable energy, healthcare, and education, all of which are critical for achieving the SDGs. Green bonds, sustainability-linked loans, and social impact bonds are innovative financial instruments that allow governments and companies to raise capital for SDG-aligned projects.

As already mentioned, Chile has been at the forefront of green bond issuance, raising over USD 5 billion since 2019 to finance projects focused on renewable energy, clean transportation, and climate resilience. These bonds attract international investors seeking to finance projects that align with environmental, social, and governance (ESG) principles. Additionally, Brazil has utilized sustainability-linked loans that tie borrowing terms to specific sustainability targets, encouraging companies to improve their environmental and social impact while accessing favorable financing.

4.3 Innovation and Sustainable Business Models

Private companies are increasingly adopting sustainable business models that contribute to the SDGs. The rise of impact investing, where financial returns are coupled with measurable social and environmental outcomes, is transforming how the private sector supports development goals. For instance, Colombian agribusiness companies have pioneered the use of impact investments to develop sustainable agricultural practices, improve food security, and reduce environmental degradation, while also creating environmentally sustainable business practices. One prominent initiative is the collaboration with cocoa producers in Orinoquia, where efforts are made to establish more efficient and sustainable supply chains. This involves rehabilitating previously cleared lands and increasing the income of local farmers by enabling them to cultivate cocoa sustainably. Furthermore, the integration of climate-smart practices within these agricultural sectors is seen as essential for fostering resilience and improving livelihoods, especially in regions affected by conflict.

Moreover, shared value creation, a strategy where businesses align their profitability goals with societal needs, is gaining traction in the region. Companies in sectors such as agribusiness, technology, and finance are developing products and services that address SDG-related challenges while generating financial returns. This model helps businesses build resilience, foster innovation, and support inclusive growth while contributing to long-term development. For instance, the International Finance Corporation (IFC) has been active in financing agribusiness projects through initiatives like the USD 80 million green loan to the Latin American Agribusiness Development Corporation (LAAD). This investment aims to support small and medium enterprises (SMEs) in adopting sustainable practices and enhancing water use efficiency. Such financing is crucial for improving access to capital for agribusinesses, which often struggle to secure funding due to their size and perceived risks.

Additionally, impact investing in LAC has been growing, with a notable increase in ventures focusing on agricultural development, renewable energy, and financial inclusion. A significant portion of impact investments targets agriculture and rural development.

4.4 Enhancing Financial Inclusion and Innovation

The private sector is also playing a crucial role in promoting financial inclusion, particularly through the use of digital technologies. Fintech innovations across LAC are expanding access to financial services for previously underserved populations, helping address inequality and poverty. The region has seen a rapid emergence of fintech companies, with about 40% of these startups focusing on small and medium-sized enterprises (SMEs) that traditionally have limited access to banking services. This growth is particularly important in the context of financial inclusion, as many fintechs leverage technology to create user-friendly solutions that meet the unique needs of these populations.

Brazil's Nubank, a digital bank, has transformed the banking landscape by providing financial services to millions of unbanked individuals, including low-income and rural populations. Nubank's business model not only fosters financial inclusion but also supports entrepreneurship and economic empowerment, particularly for women and marginalized communities.

4.5 Challenges and Opportunities for Private Sector Engagement

Despite the significant contributions of the private sector to SDG financing, several challenges remain. Regulatory barriers, lack of clear incentives for sustainable investments, and political instability in some LAC countries continue to hinder private sector engagement. Additionally, aligning private sector investments with long-term development goals requires stronger partnerships between governments, businesses, and civil society.

However, the opportunities for private sector engagement are vast. By fostering a supportive regulatory environment, offering fiscal incentives for sustainable investment, and encouraging innovation, LAC governments can further catalyze private sector contributions to the SDGs. With the right policy frameworks in place, the private sector can play an even larger role in financing sustainable development and building resilience against future crises.

5. Risk-Informed Finance: Building Resilience

As LAC countries strive to recover from the economic impacts of COVID-19 and build back stronger, risk-informed finance has become a crucial strategy for ensuring long-term resilience. Risk-informed finance refers to financial policies and frameworks that incorporate an understanding of various risks—such as climate change, natural disasters, and global economic fluctuations—into public investment decisions, fiscal management, and economic planning. In the context of the SDGs, adopting a risk-informed approach is vital to ensuring that investments are not only efficient but also resilient to future crises.

5.1 Understanding Risk in Fiscal Policies

The region's exposure to climate change-related risks, natural disasters, and external economic shocks makes risk-informed finance essential for sustainable development. As already mentioned, the LAC region is one of the most vulnerable to climate-related events, with countries such as the Caribbean island states

frequently facing hurricanes, while South American nations experience floods, droughts, and landslides. These natural disasters cost the region billions of dollars each year and severely disrupt economic activity.

Additionally, the region is highly sensitive to external economic shocks, including fluctuations in commodity prices and global interest rate hikes, which can destabilize fiscal systems. This level of risk exposure underscores the need for governments to integrate climate and disaster risk assessments into their fiscal policies and public investment decisions.

5.2 State-Contingent Debt Instruments (SCDIs)

One promising approach to managing these risks is the use of state-contingent debt instruments (SCDIs). These financial instruments provide automatic debt relief in the event of a crisis, such as a natural disaster or a severe economic downturn, helping countries maintain fiscal stability in the face of shocks. SCDIs link a country's debt repayments to specific conditions, such as GDP growth or climate-related events, allowing for flexibility in debt servicing when crises strike.

Several LAC countries have experimented with SCDIs. For example, in 2019, Barbados undertook a significant restructuring of its sovereign debt, which included an innovative provision linking repayments to climate-related disasters. This restructuring allowed the country to pause debt repayments in the event of a major natural disaster, ensuring that necessary resources could be redirected toward immediate recovery efforts. The restructuring was part of a broader economic reform program known as the Barbados Economic Recovery and Transformation (BERT) plan. It aimed to stabilize the economy and improve the country's debt sustainability. This model could be scaled up across the region, providing a financial safety net for countries highly vulnerable to natural disasters and economic shocks.

5.3 Integrated National Financing Frameworks (INFFs)

Another key tool for building fiscal resilience is the implementation of Integrated National Financing Frameworks (INFFs). INFFs provide a strategic framework for aligning public and private financing with national development priorities and the SDGs, taking into account various risks and ensuring that resources are allocated effectively.

Several LAC countries are in the process of developing and implementing INFFs, which can help to coordinate financing from multiple sources—including public budgets, private investments, and international development assistance—while incorporating risk assessments into financial planning. For example, Ecuador is actively working on its INFF to better align its financing strategies with sustainable development goals and enhance investment in climate resilience and adaptation measures. Other LAC countries which have implemented INFFs or are developing them are Barbados, Colombia, Cuba, Guatemala, Haiti, Jamaica, Mexico, Suriname and Uruguay.

INFFs also enhance transparency and accountability in public spending, as they provide a clear roadmap for how resources are mobilized and allocated to achieve national development goals. By embedding risk-informed strategies into these frameworks, governments can ensure that their fiscal systems are better equipped to handle future shocks.

5.4 Resilience Bonds and Catastrophe Bonds

Innovative financial instruments such as resilience bonds and catastrophe bonds are also gaining traction as mechanisms for financing risk-informed investments. Resilience bonds are designed to finance projects that reduce vulnerability to natural disasters, such as flood barriers, climate-resilient infrastructure, and coastal protection. These bonds offer investors the opportunity to fund resilience projects, with the potential for financial returns tied to the achievement of risk-reduction outcomes.

Catastrophe bonds, or "cat bonds," transfer the risk of natural disasters from governments to the financial markets. In exchange for regular coupon payments, investors agree to bear the financial losses associated with a predefined catastrophe, such as a hurricane or earthquake. If the disaster does not occur, the investors receive their full capital and interest payments; if it does, the government is released from repaying part of the debt, which can then be used to finance recovery efforts.

Caribbean countries have been leaders in using catastrophe bonds through the Caribbean Catastrophe Risk Insurance Facility (CCRIF), which provides insurance coverage against extreme weather events and earthquakes. The CCRIF has helped countries like Grenada and Dominica access immediate liquidity following hurricanes, enabling them to respond quickly to disasters and finance recovery efforts (after Hurricane Maria in 2017, Dominica received a payout of approximately USD 19 million, while Grenada was set to receive over USD 44 million to address the extensive damage caused by Hurricane Beryl in 2024).

6. Policy Recommendations

Given the fiscal challenges and opportunities for aligning fiscal systems with the SDGs in LAC, a set of robust, forward-looking policy recommendations is crucial for addressing long-term sustainability and resilience needs. The following policy actions are proposed:

6.1 Align Fiscal Systems with development priorities

LAC countries would benefit from systematically aligning their fiscal policies and budgets with their development priorities. Some LAC countries have already adopted SDG budgeting frameworks that prioritize public spending in critical areas such as poverty reduction, climate action, and social protection. Expanding these efforts by developing detailed performance indicators that track fiscal contributions toward development achievements would be beneficial. Moreover, integrating development priorities into tax policies can also ensure that fiscal revenues are derived in ways that are equitable and environmentally sustainable.

6.2 Enhance Domestic Resource Mobilization

To close the significant SDG financing gap, LAC countries could strengthen their domestic resource mobilization. Tax reforms should be geared toward broadening the tax base, reducing informal economic activity, and tackling tax evasion. The region loses billions of dollars each year to tax avoidance and evasion, and closing these loopholes is essential for increasing available resources for SDG-related investments.

Furthermore, tax reforms should aim at increasing progressivity, ensuring that higher-income groups contribute their fair share.

Investments in digital technologies can also improve tax collection efficiency. The adoption of e-taxation systems across the region could reduce administrative costs and increase tax compliance. Some countries in the region have made significant progress in this area, modernizing their tax collection infrastructure and improving compliance.

6.3 Leverage Innovative Financing Instruments

Scaling up the use of innovative financing instruments is essential for bridging the financing gap for development-related projects. Green bonds, social impact bonds, and sustainability-linked loans offer promising avenues for attracting private capital into sustainable development. Some LAC countries have already issued green bonds, raising billions of dollars to finance climate resilience and renewable energy projects. Expanding these initiatives across the region and ensuring that governments create a supportive regulatory framework for green finance will be crucial for their success.

Moreover, blending public and private capital through instruments like blended finance can mitigate investment risks and attract more private sector participation in areas such as infrastructure, healthcare, and education. Governments should partner with international organizations and development banks to expand the use of blended finance for SDG-related investments, especially in areas with high upfront costs like renewable energy and sustainable infrastructure.

6.4 Strengthen Risk-Informed Fiscal Policies

LAC countries might want to consider adopting fiscal policies that are resilient to external shocks, such as climate change, natural disasters, and global economic fluctuations. Risk-informed finance is critical for ensuring that public investments are sustainable and can withstand future crises. Instruments like state-contingent debt instruments (SCDIs), which adjust debt payments based on economic conditions or natural disasters, offer an innovative way to manage fiscal risks.

INFFs could also be scaled up to ensure that public and private financing aligns with national development priorities and accounts for future risks. These frameworks help coordinate financing from multiple sources and ensure that investments in critical infrastructure, social protection, and climate resilience are well-managed.

6.5 Foster Public-Private Partnerships (PPPs)

PPPs are a vital tool for mobilizing private capital to finance large-scale SDG-related projects. Governments should foster a supportive regulatory environment for PPPs, encouraging private sector participation in sectors such as renewable energy, healthcare, transportation, and education. By sharing both risks and rewards, PPPs can unlock significant private sector investment while ensuring that projects are aligned with public development goals. Expanding successful initiatives in the region to other countries will help address the region's infrastructure gaps while supporting SDG targets.

6.6 Promote Transparency and Accountability

Transparency and accountability are key to ensuring that fiscal policies are effective in achieving the SDGs. Governments should invest in digital tools and open data platforms that track public expenditures, enabling citizens to see how their tax dollars are being used. By promoting open budgeting practices and citizen engagement, countries like Costa Rica and Uruguay have improved public trust and ensured that fiscal policies are aligned with the needs of the population.

7. Conclusion

This technical note has explored the complex fiscal challenges facing LAC as the region seeks to recover from the COVID-19 pandemic and make progress towards its development objectives. The region's fiscal systems are under strain, with rising debt levels, widened fiscal deficits, and significant resource gaps that should be addressed to finance long-term development. However, by adopting risk-informed fiscal strategies, mobilizing domestic resources, and leveraging private capital through innovative financing instruments, LAC countries can build resilience and accelerate progress toward sustainable development.

The key to success lies in aligning fiscal systems with SDG priorities, strengthening domestic resource mobilization through progressive tax reforms, and expanding the use of green and blended finance. PPPs and private sector engagement will be essential in bridging the SDG financing gap, while risk-informed policies and instruments like state-contingent debt can help countries navigate future crises more effectively.

Ultimately, a combination of these strategies will allow LAC governments to achieve long-term sustainability, reduce inequality, and promote inclusive economic growth, ensuring that no one is left behind in the pursuit of the 2030 Agenda.