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TACKLING CORONAVIRUS (COVID-19)
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COVID-19 in Latin America and the Caribbean: Regional socio-economic implications and policy priorities

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This policy note is an updated version of the note published end April 2020. It updates indicators and the main socio-economic consequences of the COVID-19 crisis in Latin America and the Caribbean (LAC) and presents the main policy priorities to be achieved, taking into consideration the most recent evolution of the crisis. In 2020 LAC will be the most affected emerging and developing region in the world in terms of GDP growth and this crisis is hitting particularly the most vulnerable groups. Policy reactions have been bold, but further measures are needed. In the immediate, the priority must be to prevent further contagion by strengthening testing, tracking and tracing strategies, and to continue supporting most vulnerable families, workers and firms. In addition, investment efforts to promote activity are fundamental to spur a swift economic recovery. In the medium term, the aftermath of the crisis must be turned into an opportunity to redefine the social contract, putting well-being and sustainability at the centre, based on stronger social protection systems, innovative productive development strategies, and more robust and inclusive public finances. Co-ordinating a global response to address the impact of – and the recovery from – the COVID-19 crisis in the region remains vital, including to tackle the challenge of financing development and of dealing with increasing debt levels.

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KEY MESSAGES

1. Latin America and the Caribbean (LAC) is navigating challenging and exceptional times, and in 2020 will be the most affected emerging and developing region in the world in terms of GDP growth contraction. The impact of this crisis will leave the large majority of LAC countries with negative growth and GDP per capita will bring LAC back to levels similar to those of 2009.
2. The economic impact of the COVID-19 crisis is manifold: a domestic lockdown driving an immediate fall in economic activity; a slowdown in global demand affecting in particular exports, tourism and FDI to the region.
3. Lockdowns and containment measures to mitigate the pandemic have hit particularly hard low-paid and informal workers. As many as 38% of total workers (and 61% of vulnerable informal workers) do not have access to any kind of social protection. The absence of safety nets puts them at greater risk.
4. The COVID-19 crisis is particularly difficult for micro and small firms that lack the resources to absorb this shock. As many as 2.7 million LAC companies are likely to close, most of them micro-enterprises, which would entail the loss of 8.5 million jobs (OECD et al., 2020[1]).
5. The spread of the Internet and the adoption of digital technologies have been critical to sustaining certain continuity in business, working or studying from home during the crisis. However, the digital divide, notably the lack of high-speed broadband Internet and appropriate digital skills, have prevented many, especially the most vulnerable, from reaping the benefits of these solutions.
6. Women have been disproportionally affected by the crisis, which has magnified existing vulnerabilities and disparities. Women's incomes are, on average, lower than men's, their poverty rates are higher and they are more likely to be exposed to health-related sectors. School closures and confinement measures have increased risks of school dropout and domestic violence.
7. Most LAC governments have reacted swiftly and efficiently to this crisis, targeting policy actions to most vulnerable groups. Fiscal and monetary policies are playing an essential role in mitigating the negative economic and social effects of the pandemic and will continue to be pivotal in the recovery. However, the space to manoeuvre remains limited for the majority of countries as public revenues have contracted and fiscal space remains limited.
8. In the immediate, the priority must be to curb contagion and to support the most vulnerable households, workers and firms.
9. As contagion rates are brought under control and containment measures are phased out, policies should stimulate aggregate demand, supporting the most affected sectors and fostering investment to bring the economy back to full activity.
10. In the medium-term, this crisis should bring an opportunity to lay the foundations of a new social contract, moving towards stronger social protection systems, a well-defined productive strategy, low carbon development and achieving a sustainable fiscal pact.
11. The role of international co-operation and the multilateral system is key: to co-ordinate the response to the health emergency and access to vaccines; to mobilise adequate financial resources to provide financial relief to countries most in need; to ensure functioning and rule-based trade and investment systems. Given the increasing financial resources needed to address the recovery, global co-ordination of public debt management should be a priority.

Since the onset of the COVID-19 pandemic, Latin America and the Caribbean (LAC) countries have implemented social distancing and other mitigation measures to reduce the spread of the virus, starting with El Salvador's lockdown and travel ban on 11 March. Total and partial lockdowns have included measures such as shutting down borders, prohibiting transit for non-essential reasons, cancelling events, closing non-essential business, and stopping or virtualising the classes in schools and universities, among others.

The socio-economic impact of the COVID-19 crisis has been greater in Latin America and the Caribbean than any other emerging or developed region (IMF, 2020[2]). Moreover, the impact has been asymmetric, particularly affecting the most vulnerable groups. The high level of labour informality, close to 60%, and the almost 40% of workers not covered by any protection or social assistance regime, makes the social impact dramatic in the region (Basto-Aguirre, N., S. Nieto-Parra and J. Vázquez-Zamora, 2020[3]; OECD et al., 2020[1]).

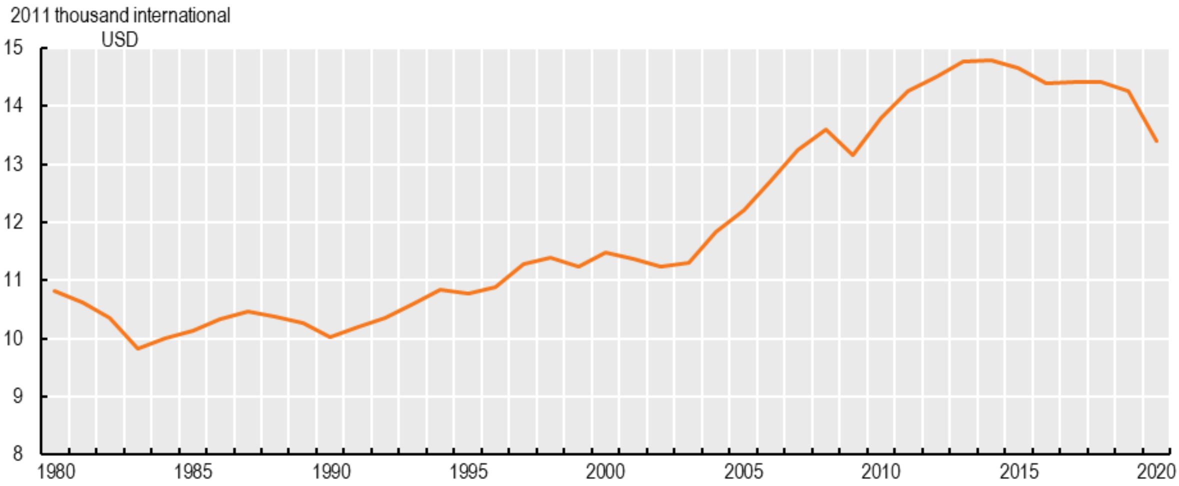
This policy note is an updated version of the note published end April 2020. It updates indicators and the main socio-economic consequences of the COVID-19 crisis in Latin America and the Caribbean (LAC) and presents the main policy priorities to be achieved, taking into account the most recent evolution of the crisis. In particular, this policy note includes most recent data on main macroeconomic trends and on the projected impact of the crisis on key socioeconomic indicators. It also includes additional detail on where the focus of policy priorities should be placed. The note is structured in five sections. First, it presents the impact of the COVID-19 crisis on growth and well-being. Second, it analyses the pandemic impact on key aspects concerning households and firms. Third, it presents the policy responses and implications at the monetary and fiscal front. Fourth, it shows the economic impact of the crisis on the region's external accounts. Finally, the note provides policy guidance identifying policy priorities from the immediate response to the crisis to the broader rethinking of the social contract.

The COVID-19 crisis impact on economic growth and well-being

The COVID-19 pandemic is having strong socio-economic consequences, accentuating the already complex scenario faced by LAC, characterised by significant structural *development traps* (OECD et al., 2019[4]). The region entered the COVID-19 crisis with the majority of countries presenting low potential growth and increasing social discontent. Between 2014 and 2019 the region experienced the weakest period of growth since the 1950s, consistently recording lower growth rates than the OECD average. In 2019, growth was practically nil and protests erupted in some countries, confirming that despite past improvements in reducing income poverty, vulnerability and exclusion remain a major concern in the region. In the COVID-19 context, governments need to respond more effectively to the growing aspirations of a rising but vulnerable "middle-class" that is at risk of slipping into poverty as a consequence of the crisis, and to urgently include segments of the population that are left behind and could fall into extreme poverty.

The impact of the crisis on economic activity and social conditions is particularly severe with a historical decrease in economic growth in 2020, leading to a strong setback in terms of GDP per capita. Several international organisations have estimated annual GDP growth for 2020 in LAC to be negative falling between 7% and 9% (IMF, 2020[5]; ECLAC, 2020[6]). The decrease in economic activity in LAC is the steepest if compared with other emerging or developed regions and it is the worse economic performance recorded since 1900. The consequent drop in GDP per capita will bring LAC back to levels similar to those of 2009 (Figure 1). While LAC economies would achieve positive growth in 2021, but still insufficient to reach pre-pandemic levels (OECD, 2020[7]) (ECLAC, 2020[6]), mostly explained by a base effect, actions are needed to safeguard and improve their productive capacity, which has been affected during the crisis. Uncertainty remains extremely high, and the size of the economic contraction will vary considerably across countries and will depend on (i) the depth and length of the confinements, and the potential impact of a second wave of contagion in the region, (ii) the additional measures adopted by countries during and after the lockdown, both within and outside the region, (iii) the evolution of national economies in the region, including debt management, (iv) the path of the global economy in the aftermath of the crisis, considering the second wave of infections already hitting some northern hemisphere economies, possibly with renewed lockdowns before the end of 2020.

Figure 1. Evolution of GDP per capita in Latin America and the Caribbean (1980-2020)



Source: (OECD et al., 2020[1]) based on (ECLAC, 2020[8]), "Addressing the growing impact of COVID-19 with a view to reactivation with equality: New projections", Special Report COVID-19 No. 5; (CAF, 2020[9]), "Economic Perspective for the Second Quarter"; and (IMF, 2020[10]), "A crisis like no other, an uncertain recovery", *World Economic Outlook Update*, June.

Beyond the direct effect of COVID-19 on human health, the socio-economic impact of the pandemic in LAC is – and will continue to occur – through different channels. First, the confinement measures adopted by governments induced a large immediate drop in economic activity, as most workers were prevented to go to work and remained locked down at home. Households have been also cutting sharply their consumption on most goods and services during confinement and it remains at low levels after containment measures have been gradually phased out. Second, containment measures, restrictions to border crossing, and social anxiety affect key sectors such as tourism and international travel. They are having a particular incidence in highly dependent countries as some Caribbean economies, where the tourism economy accounted for more than 25% of GDP, on average, in 2019. The total GDP is expected to fall by 7.9% in 2020 in the Caribbean (excluding Guyana) (ECLAC, 2020[8]). Other sectors such as retail trade, wholesale trade and manufacturing sectors are also being heavily affected. Third, the global slowdown (OECD, 2020[11]) and the disruption of global and regional value chains generated a decline in LAC exports. Fourth, while the fall in oil prices can be a relief to the oil-importing Caribbean and Central American economies, it affects fiscal and external accounts of several South American countries, as well as Mexico and Trinidad and Tobago.

In contrast to these negative effects, the adoption of digital technologies and the spread of the Internet have been critical to sustaining certain continuity in some business, jobs or studying from home, although the digital divide, notably the lack of high-speed broadband Internet and digital skills, has prevented from reaping the benefits to all (OECD et al., 2020[1]).

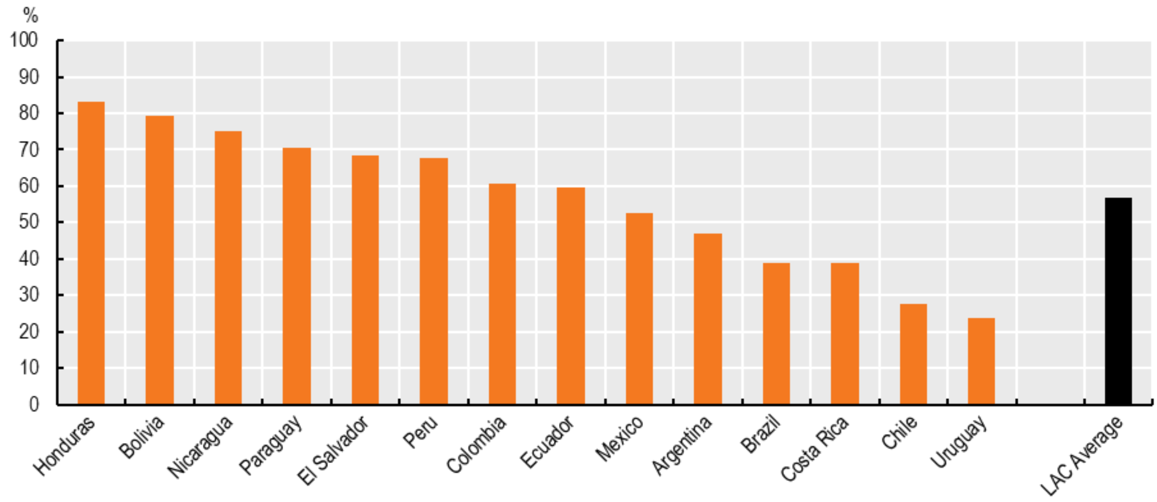
The economic slowdown of previous years coupled with the drop in activity caused by the pandemic is having negative effects on living standards and well-being in LAC. The pandemic has touched every aspect of people's lives. Several dimensions of people's current well-being, such as health, income and wealth, and job quality, are receiving a direct and strong impact. Other dimensions have an indirect but still important impact, including knowledge and skills, subjective well-being, social relations and housing. In particular, regarding education, while schools remained closed, home schooling may have different long-term impacts on children and youth, depending on their socio-economic background (OECD, 2020[12]). In addition to increasing deprivations, this crisis is widening socio-economic inequalities and gaps between certain groups (e.g. in terms of gender and territory, rural/urban). Moreover, current circumstances also threaten the well-being of future generations, since the accumulation of economic, social and human capital is also being affected.

Impacts on households and firms

The socio-economic impact of the COVID-19 crisis is being severe across individuals, households and firms even though different public policy responses have been in place. Social conditions are worsening as a result of the economic slowdown and the impact is being harder for the most vulnerable groups. By the end of 2020, the pandemic could leave 45 million more Latin Americans in poverty reaching 231 million or 37.3% of the total population, going back to levels registered in 2005. In the case of extreme poverty, it could increase by 28.5 million, reaching 96.2 million or 15.5% of the total population (OECD et al., 2020[1]). (ECLAC, 2020[8]) For the first time since 2010, the average person in LAC will be poor as opposed to middle class. The crisis is showing that the region's medium-term challenge of consolidating a larger middle class will first and foremost need to address growing poverty levels in the context of the pandemic.

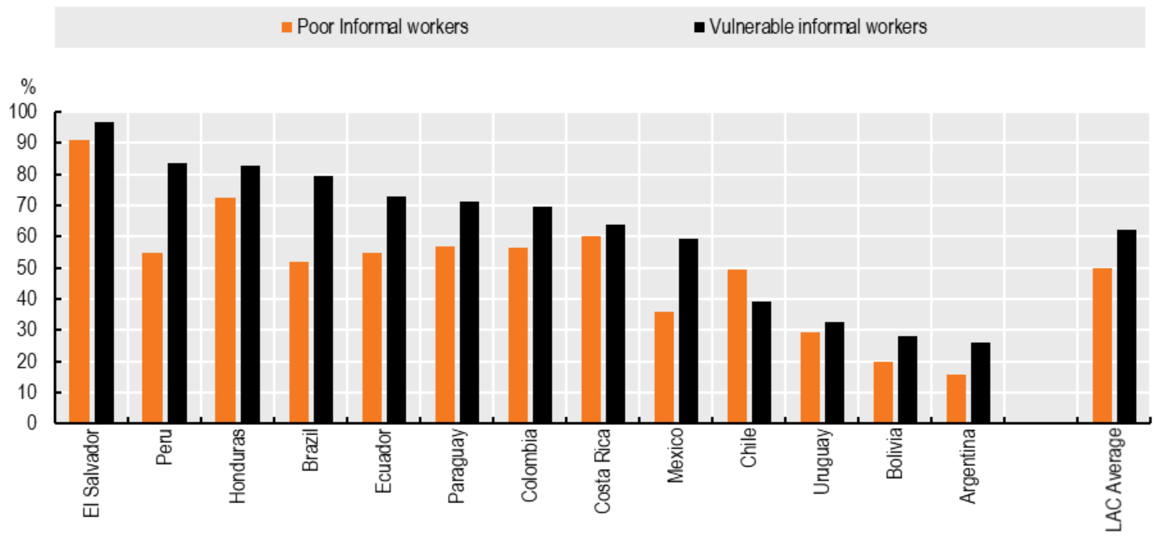
The COVID-19 crisis is likely to increase informal employment, which already accounts for close to 60% of workers in Latin America (Figure 2). The social impact of the pandemic is being particularly difficult for the close to 40% of workers – and their families - who are not protected by any safety net. This situation affects even harder the 61% of vulnerable informal workers who are not part of a household covered by a major social assistance programme (either direct transfers from the largest transfer programmes or non-contributory pensions) (Figure 3). Many of them are own-account workers in the subsistence economy. They live day-by-day and cannot work remotely. Their risk of slipping back into poverty is considerable. Protecting this group of informal vulnerable workers with no access to social protection and avoiding a widespread expansion of poverty, which already affects 25% of the population, is one of the main challenges of this crisis. Containing the increase in poverty requires new forms of social protection that reach vulnerable groups during this crisis (ECLAC, 2019[13]).

Figure 2. Percentage of informal employment in selected Latin American countries, 2018 or latest available year



Note: Regional average is an unweighted average. Informality refers to i) contributing family workers; ii) employees not covered by social security contributions of the employer and/or not entitled to paid sick leave and/or paid annual leave; iii) own-account workers and employers where their economic units are not legally recognised and/or are non-compliant with fiscal and social security obligations. Due to the systematic approach to produce international comparable data and given that the use of household surveys differs from labour force surveys, informality estimates may differ from the estimates presented in other sources including national statistics. These figures are subject to updates.
Source: OECD Development Centre calculations based on household surveys, 2018 or latest available year. Informality definition is based on ILO and data construction is based on the systematic approach proposed in "The Key Indicators of Informality based on Individuals and their Households" (KIIbIH) database (OECD/ILO, 2019[14])(OECD/ILO, 2019). Due to the release of public microdata for updated household surveys and increasing efforts to raise international comparability, figures are subject to updates.

Figure 3. Poor and vulnerable informal workers not covered by a major social assistance programmes (cash-conditional transfers and social pensions), selected LAC countries, 2018 or latest year available



Note: Regional average is an unweighted average. Informality definition for employees implies lack of access to employment-based insurance. For independent workers, it implies that their economic units are not legally recognised and/or are non-compliant with fiscal and social security obligations. Economic vulnerability refers to per capita income (PPP) between USD5.5-13 a day. Poverty refers to per capita income (PPP) lower than USD5.5 a day. These estimations are an effort to increase cross-country comparability. However, differences in the underlying household surveys may result in non-comparable data that the harmonisation process cannot fully solve. Due to the systematic approach to produce international comparable data and the use of household surveys different from labour force surveys, informality estimates may differ from the estimates presented in other sources including national statistics. These figures are subject to be updated.
Source: OECD Development Centre calculations based on Household Surveys. Argentina - EPH 2018, Bolivia - Encuesta de hogares 2018, Brazil - PNAD 2015, Chile - Casen 2017, Colombia - ENCV 2017, Costa Rica - ENH 2018, El Salvador - EHPM 2017, Honduras EPHPM 2014, Mexico - ENH 2018, Paraguay - EPH 2018, Peru - ENH 2018, Uruguay - ECH 2018, Ecuador - ENEMDU 2018. Informality definition is based on (ILO, 2018), *Women and Men in the informal Economy*, and data construction is based on the systematic approach proposed in “The Key Indicators of Informality based on Individuals and their Households” (KIIbIH) database (OECD/ILO, 2019).

The COVID-19 is further amplifying existing inequalities in access to and quality of education. As schools closed in almost all LAC countries, online learning became suddenly critical for the education of 154 million students (around 95% of all students in LAC) (UNICEF, 2020[15]). Yet, education systems in LAC are not sufficiently prepared for the world of digital learning. In fact, 51% of the region’s 15-year-old students in advantaged schools have access to an effective online learning support platform, while only 21% of the students in disadvantaged schools do so. Additionally, 88% of the region’s 15-year-old students from advantaged schools have access to a computer to work at home, while only 45% of students in disadvantaged schools do. Technology is only as good as its use. PISA 2018 asked school principals about schools’ capacity to enhance teaching and learning using digital devices. On average across LAC countries, 58% of 15-year-olds are enrolled in schools whose school principal considers that their teachers have the necessary technical and pedagogical skills to integrate digital devices in instruction. This highlights the enormous training needs that lie ahead for educators to catch up with technology opportunities (OECD et al., 2020[1]). Again, this contrasts significantly between socio-economically advantaged and disadvantaged. In Colombia, for example, this percentage is 73% in advantaged schools but just 50% in disadvantaged schools. These numbers signal that schools may reinforce rather than moderate the disadvantage that comes from individual home backgrounds (OECD, 2020[16]).

With the COVID-19 crisis, the digital divide has become an ever greater concern as it is amplifying existing inequalities (Basto-Aguirre, Cerutti and Nieto-Parra, 2020[17]). Only workers, students or consumers with the proper infrastructure and skills are benefiting from the advantages of technological tools. Although access to ICTs has significantly improved, gaps persist and new ones may emerge (OECD et al., 2020[1]). Only 34% of primary, 41% of secondary and 68% of tertiary education students have access to an Internet-connected computer at home. Studying online is particularly difficult for students from poor and vulnerable households. For instance, less than 14% of poor students in primary education have a computer connected to the Internet at home vs. more than 80% of affluent students (Basto-Aguirre, Cerutti and Nieto-Parra, 2020[17]). In addition, more than 6 in 10 households with per capita income in the lower quintile of the income distribution do not have access to high-speed fixed broadband connection needed to support working and studying, whereas nearly 8 in 10 households with per capita income in the highest quintile of the income distribution do so. A striking gap also remains in the way people with low and high levels of education use the Internet, with over 20 percentage points’ difference in the case of on-line banking (OECD et al., 2020[1]; Basto-Aguirre, Cerutti and Nieto-Parra, 2020[17]).

The COVID-19 crisis is deepening the disparities between regions and cities within LAC countries. Measures as basic as washing hands or avoiding physical contact are difficult to follow for 21% of the LAC urban population living in slums, informal settlements or inadequate housing where basic services are not affordable. Many houses do not have access to safe water and, on average, up to 3 people share each room (Oxfam, 2020[18]). In these areas, the potential positive impact of containment measures has been more limited. Territorial differences are important also when considering health and social conditions, which could lead to a heterogeneous impact of the pandemic. For instance, in Colombia, the infant mortality – regarded as a sensitive (proxy) measure of population health – of Vichada is almost three times that of

Antioquia; and in Peru the infant mortality of Tumbes is over three times higher than that observed in Puno (OECD et al., 2019[4]).

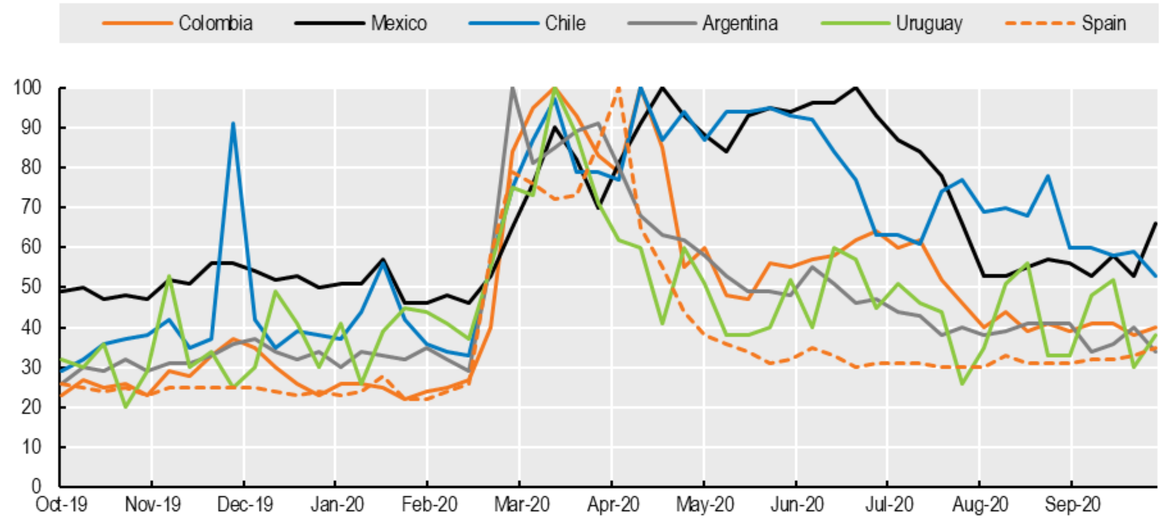
Women are being disproportionally affected by the COVID-19 crisis. First, given the traditional and gendered division of roles in LAC, women are bearing a higher physical and emotional burden than men during the pandemic. Women are the primary care providers and the daily time they dedicate to unpaid domestic and care work is on average three times higher than men in LAC (OECD, 2019[19]). Secondly, in some countries women are being particularly affected by the reduction in economic activity as they are more likely to hold informal jobs. For example, in Mexico 58% of women are part of informal employment against 50% of men, and in Costa Rica 39% of women are informal compared with 35.5% of men in 2018. Finally, women are more likely to be exposed to domestic violence as a result of quarantine and lockdown measures. For instance, in Argentina emergency calls for domestic violence cases have increased by 25% in the two months following the beginning of the lockdown, on March 2020. A fall in their income may further create barriers for them to leave a violent domestic situation (UN Women, 2020[20]).

The immediate effects of an economic downturn are being felt also by migrants living in LAC countries and their households, as many have irregular migrant statuses or work informally. More than 11 million migrants reside in LAC countries. Figures have dramatically increased since 2015 with the humanitarian and economic crisis in Venezuela pushing around 4.9 million people to leave the country, with close to 4 million who have settled in countries of the region. Migrants in LAC are overrepresented among the poorest segments of the population. Less than 15% of households in the lowest income quintile have savings to cover emergency expenses (Busso and Messina, 2020[21]).

A total of 2.7 million of companies are projected to go bankrupt by the end of 2020 (ECLAC, 2020[22]), particularly micro, small and medium enterprises (MSMEs) that represent 99% of all companies in the region and generate more than half of jobs (ILO, 2015[23]; Dini and Stumpo, 2019[24]; OECD et al., 2020[1]). MSMEs, especially those relying on self-employment and microenterprises, are being largely affected by the economic consequences of containment measures as they have less liquidity and buffers. Furthermore, SMEs employ 76.5% of workers in the trade sector and 86.1% in hotels and restaurants (OECD/CAF, 2019[25]). Both sectors are highly affected by this crisis. Indeed, by end March 2020, mobility trends for places like restaurants, cafes, or shopping centres fell by more than 80% compared to normal periods in countries like Colombia, the Dominican Republic, Ecuador, El Salvador, Panama and Peru (Google, 2020[26]). Finally, the productivity gap of LAC MSMEs makes them particularly vulnerable to demand shocks. Microenterprise productivity reaches only 6% of the productivity of large firms (vs. 42% for European Union firms) (Dini and Stumpo, 2019[24]). With lower productivity and potentially facing rigid cost structures, MSMEs are more likely to face bankruptcy or losses.

In contrast to the crisis negative effects, the pandemic and subsequent containment measures have shown the increasing importance of new technologies for consumers and firms. The online interest for delivery services has increased since the beginning of the confinement measures in Latin American countries showing a potential consumption habit shift towards e-commerce after the crisis (Figure 4). Moreover, digital technologies can play an important role in the region's recovery addressing the persistent challenge of low productivity. In a region where productivity disparities are considerable according to the size of the firm, the digital transformation brings an opportunity but also a risk of reinforcing these differences (OECD et al., 2020[1]). With appropriate policies, digital technologies could help close the productivity gap between MSMEs and bigger firms. They can spur new connections between supply and demand, facilitate commercial transactions and job matching, and create or modernise industries, for instance, agriculture (Aggrotech), banking and finance (Fintech), automotive (Autotech) or transportation. Rapid growth in e-commerce could lead to increases in freight volumes of between 2% and 11%, depending on the transport mode (ITF, 2019[27]). The potential of digital technologies in the region is a positive lesson from the crisis although there is still a need to expand digital inclusion to ensure that all benefit from the digital transformation.

Figure 4. Popularity of "delivery" searches on Google, selected LAC countries vs. Spain (0-100)



Note: Rolling seven-day averages. Y axis represents search interest for the term “delivery” (or equivalent in each country) for a given date and country, relative to the highest search interest for the term “delivery” (value of 100) observed in the considered period and country. For Colombia, Mexico, Chile and Spain, we used the series of searches for “domicilio”, while in Argentina we used “delivery”. One of the limitations when analysing Google Trends series is the non-comparability on the scale of two series that were downloaded separately. To minimise this, we have downloaded each variable simultaneously with a chosen series in common (migraña [headache]). To choose it, we considered a list of series that had a stable popularity throughout the year (non-seasonal) and the period analysed (stationary).
Source: OECD Development Centre calculations based on Google Trends data.

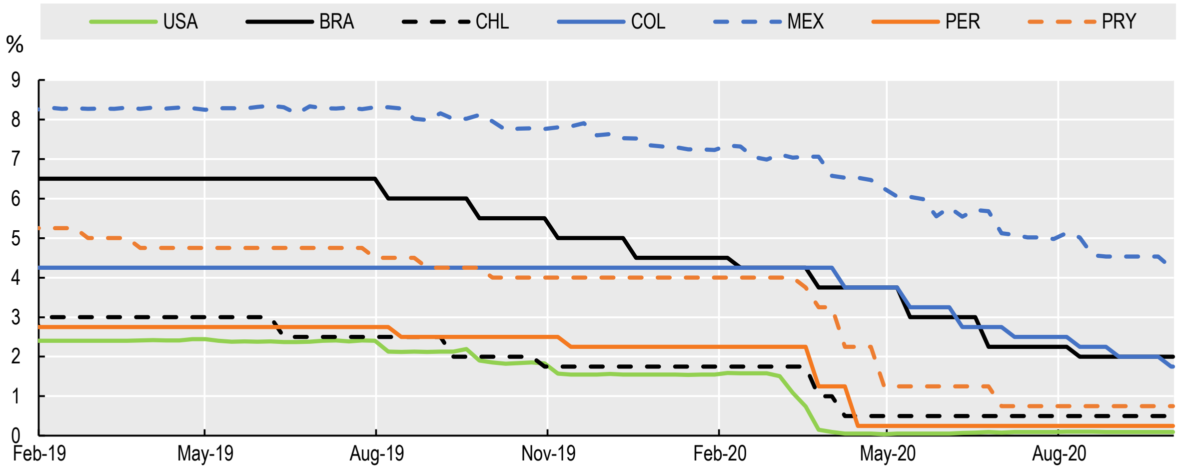
Policy responses and implications at the monetary and fiscal fronts

Monetary policy

In response to the COVID-19 crisis, many central banks have played an active role. They started to ease monetary conditions at the beginning of lockdown measures (Figure 5). Since then, and given the fall in economic activity that eases pressure on prices, inflation has remained contained in most Latin American countries giving central banks the necessary space to continue lowering their interest rates to support economic activity (OECD et al., 2020[1]).

Monetary actions were timely, and more than ten countries decreased the policy interest rate and intervened in the foreign exchange market. Local financial systems were relatively well prepared to face the economic shock, with high solvency and liquidity ratios before the crisis. Some countries provided liquidity in dollars through swap lines and purchased public or private securities. In particular, the central banks of Brazil, Chile, Colombia and, to some extent, Peru have purchased private and government securities in domestic financial markets. Credit regulations have also been eased to allow commercial banks to renegotiate loans with households and firms without affecting their credit ratings (OECD et al., 2020[1]).

Figure 5. Monetary policy interest rates for selected countries



Source: Based on official data and Bloomberg.

This crisis highlighted the importance of an independent central bank and inflation targeting regimes to undergo counter-cyclical policies. Similarly, economies with sound financial and macroprudential regulations that support healthy local financial markets were able to face the economic shock with high solvency and liquidity ratios in their financial systems.

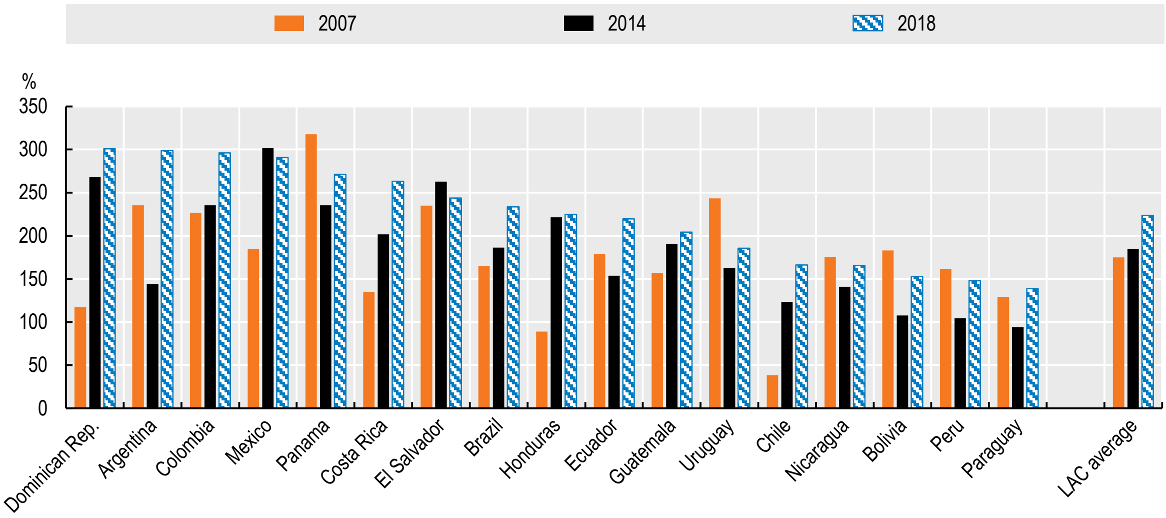
Fiscal policy

Fiscal policy is playing an essential role in mitigating the negative economic and social effects of the pandemic, and will continue to be pivotal for the recovery. Weak automatic stabilisers in the region (Espino and González Rozada, 2012[28]), with fragile or non-existent unemployment insurance, high levels of informality and low tax revenues, make discretionary fiscal responses to the crisis even more urgent than in European countries, for instance. At first, fiscal policy has aimed to stop the spread of the virus, through support for preventive programmes, detection and treatments, and to support businesses continuity and protect jobs. Most economies of the region have implemented such programmes.

Countries' ability to react with fiscal policy to the pandemic has been influenced by the starting fiscal position and their access to international markets. Before the COVID-19 crisis, fiscal space in the majority of countries in the region was already limited as many economies were undergoing fiscal adjustments. Despite high heterogeneity, tax revenues remain scarce at 23.1% of GDP in 2018, more than 10 percentage points lower than the OECD average (OECD et al., 2020[29]). Moreover, fiscal policy has not been sufficiently effective in reducing inequalities and promoting entrepreneurship (OECD et al., 2019[4]) (Izquierdo, Pessino and Buletin, 2018[30]).

Debt levels have been on the rise since 2014 in almost all countries. Public debt-to-tax ratios increased in most countries, leaving them in a weaker position to face the COVID-19 crisis than in 2007, before the 2008 financial crisis (Figure 6). Caribbean countries are highly indebted and may face further constraints to borrow. In 2018, 3 out of the 25 most highly indebted countries in the world (measured by gross general government debt levels relative to GDP) were in the Caribbean: Antigua and Barbuda, Barbados and Jamaica (IMF, 2020[2]) (OECD et al., 2019[4]). Going forward, tax measures to address the COVID-19 crisis and the consequent economic slowdown are taking a toll on tax revenues. Given the increasingly limited fiscal space and the increasing revenues needed to address the heterogeneous challenges, global co-ordination of public debt management should be the priority.

Figure 6. Debt-to-tax ratio (gross public debt) in Latin American countries, 2007, 2014 and 2018

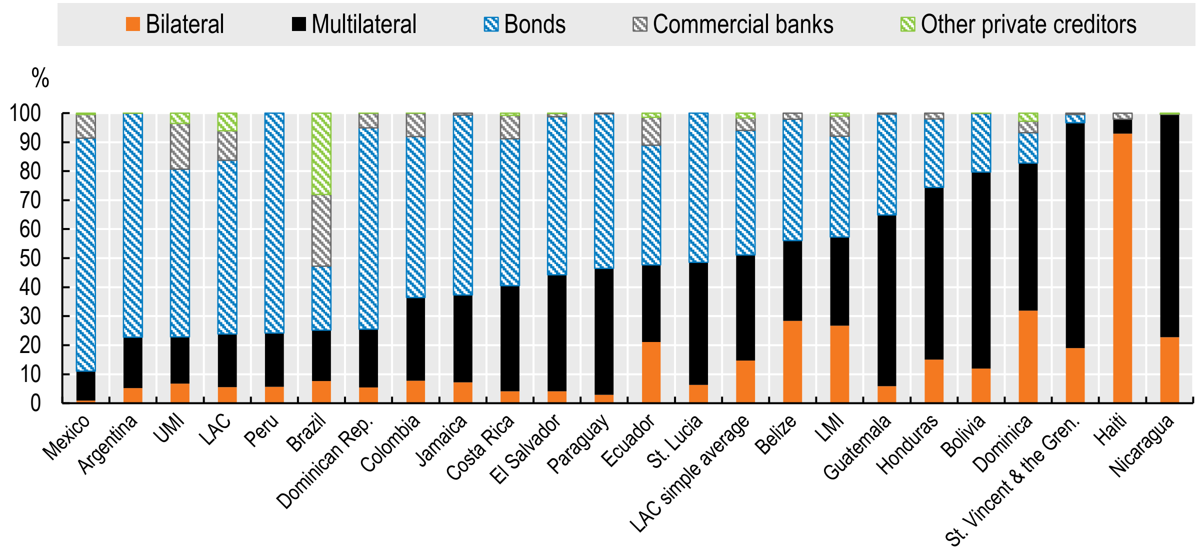


Note: Simple average of the countries included in the figure.
Source: (OECD et al., 2020[29]), *Revenue Statistics in Latin America and the Caribbean 2020* and CEPALSTAT.

The pressure that the COVID-19) crisis places on fiscal accounts and debt levels call for globally co-ordinated debt management. Issuer or creditor inaction can lead to debt defaults and, therefore, debt crises, adding to an already complicated scenario. There is no unique solution to managing public debt in the region owing to country differences in initial fiscal conditions, type of foreign creditors and financial capacity to tap into capital markets. Some countries had challenging financial situations before the pandemic. For instance, in countries including Argentina and Ecuador, international discussions on outstanding public debt obligations started before the crisis; Ecuador reached a successful agreement with its private creditors to restructure its external public debt in August 2020 (OECD, 2020[31]). Capital markets actors had already put a price on the cost of restructuring before the crisis. Similarly, Argentina reached an agreement to restructure almost 100% of its external public debt on 31 August 2020 (OECD et al., 2020[1]) (Nieto-Parra and Orozco, 2020[32]).

How countries raise resources varies across the region. Some Central American countries (e.g. Guatemala, Honduras, Nicaragua), Caribbean economies (e.g. Haiti, Saint Vincent and the Grenadines, Dominica) and a few South American economies (e.g. Bolivia, Ecuador) have traditionally issued debt through bilateral creditors or multilateral banks. On the other hand, Mexico and most South American economies have traditionally had access to capital markets to raise funds (Figure 7), and about half their debt is in domestic currency. Brazil issues debt mostly in domestic currency. High local currency debt issuance reduces the debt sustainability risks in the face of a large exchange rate depreciation (Nieto-Parra and Orozco, 2020[32]) (OECD et al., 2020[1]). As debt ratios are expected to increase in the next two years the need for a globally co-ordinated debt management is more present than ever in order to stabilise debt ratios in the medium term, before bringing them back to more sustainable levels and recover fiscal space (see the section on policy priorities).

Figure 7. External public debt stock by creditor (public and private) in selected Latin American and Caribbean countries, 2018

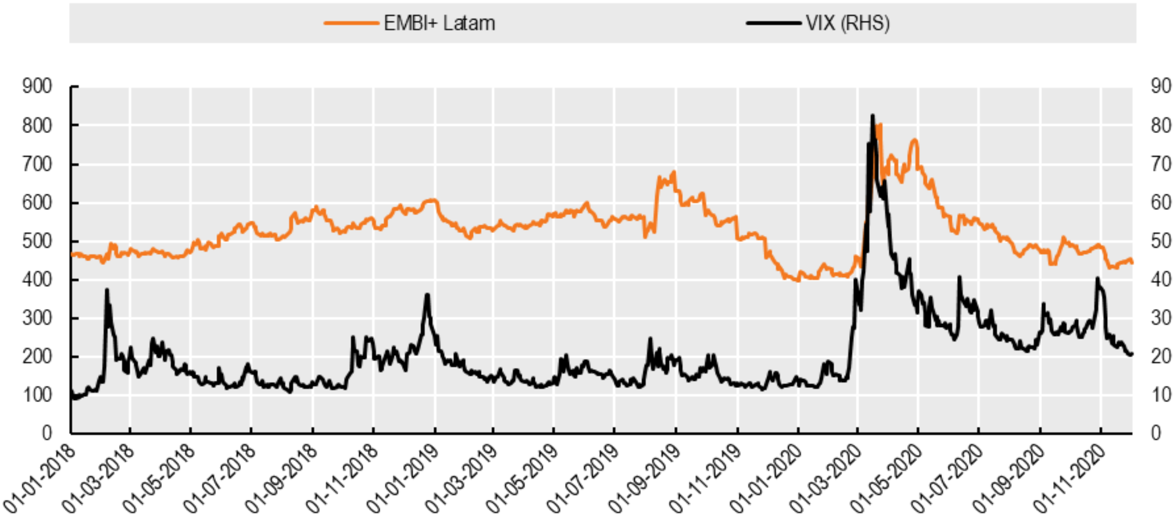


Note: LAC simple average gives equal weight to all countries on their distribution of credit holders; LAC takes into consideration the amount issued by each LAC country. LMI and UMI are all lower middle-income and upper middle-income countries in the world.
Source: (OECD et al., 2020[1]) (Nieto-Parra and Orozco, 2020[32]).

Balance of payments and global integration

The sharp decline in global and regional economic activity in 2020 is having an impact on LAC's external accounts. Global activity is contracting dramatically in 2020. The latest estimates suggest that annual GDP growth of the world economy for 2020 will fall by -4.2%. Similarly, global trade collapsed, declining by over 10% in 2020 (OECD, 2020[11]). The majority of countries in the region entered the COVID-19 crisis with current account deficits, but with few exceptions, these deficits were financed by foreign direct investment (FDI). The economic slowdown in global and regional economies caused by the COVID-19 crisis is changing these dynamics. FDI inflows fell by 25% in LAC in the first half of 2020 compared to 2019 (UNCTAD, 2020[33]). By the end of 2020, FDI is expected to fall by around 40% worldwide, with a decline of between 45% and 55% in LAC. Falls in FDI in 2020, accounting until the second or third quarter of the year depending on the country, vary strongly among LAC economies. Peru has experienced the hardest fall (-72%), followed by Colombia (-50%), Brazil (-45%), Argentina (-35%) and Chile (-33%), with Mexico (-6%) suffering the lowest fall (ECLAC, 2020[34]). While the sharp reduction in imports should alleviate the trade balance, the contraction in global demand should have a negative impact on exports. First estimates suggest that, for 2020, the fall in imports will be more significant than in the region's exports, producing a small improvement in the current account balance. However, countries dependent on tourism, such as Caribbean countries, should have a negative impact on the services component of the trade balance. While the transfer balance in the current account should deteriorate owing to lower remittances, the income account will likely improve because of lower profit repatriations (ECLAC, 2020[35]; OECD et al., 2020[1]; World Bank, 2020[36])

Figure 8. Latin American sovereign bond market and international volatility



Note: The EMBI is a benchmark index for measuring the total return performance of international bonds issued by emerging market economies. EMBI LATAM measures the average spread that is defined as the differentials between the performance of sovereign bonds denominated in US dollars and US Treasury bonds, as calculated by JP Morgan Chase. International markets' expectation of volatility is measured by the Chicago Board Options Exchange's Volatility Index (VIX).
Source: (OECD et al., 2020[1]) based on Thomson Reuters, Datastream.

Although volatility persists, high levels of international liquidity have contributed to reducing sovereign bond spreads from May 2020. The evolution of LAC Emerging Markets Bond Index (EMBI) spreads has been highly correlated with the volatility conditions of international markets. For instance, similar to international markets' expectation of volatility, measured by the Chicago Board Options Exchange's Volatility Index (VIX), LAC EMBI considerably increased in March 2020 and then relatively receded (Figure 8). On the contrary, stock markets and exchange rates have not fully recovered. The main equity markets in Latin America have fallen by more than 15% since the beginning of the year and exchange rates have depreciated year to date by almost 10% in Mexico and Peru, by more than 15% in Colombia and close to 30% in Brazil.

Policy priorities: From the immediate response to the broader rethinking of the social contract

Profound uncertainties remain around the evolution of the crisis for Latin America and the Caribbean, making the policy response more complex to design. The sequencing of policy priorities will be critical and should be structured to address different policy objectives in the immediate, short and medium-term.

In the immediate, preventing the contagion and continue supporting the most vulnerable

To contain the spread of COVID-19, many LAC countries reacted swiftly by adopting social distancing and lockdown measures. As these measures have a strong socio-economic impact, several countries in the region have adopted fiscal and monetary policies to protect the most vulnerable and to preserve human, productive and financial capacities to help reduce the negative impact of the crisis (for more details of these policy measures see the OECD Country Policy Tracker at http://oecd.org/coronavirus/en/#country-policy-tracker).

On the monetary front, some central banks, under their inflation targeting regimes, lowered interest rates, but also announced a reduction of reserve requirements and an injection of liquidity into the economy.

In addition to this, specific measures have been adopted to shield the most vulnerable families, workers and MSMEs:

- Financial intermediaries, including national development banks, have adopted facility conditions on loan repayments (e.g. mortgages or consumption credits) to households and have promoted guarantees for new credits or deferral on loan repayments to vulnerable firms.
- Government measures in support to the most vulnerable families include non-conditional cash transfers, tax deferrals and reductions, food baskets or suspension of payments of basic utilities. Similarly, measures to support workers include exemptions from social security contributions, right to withdraw funds from individual saving accounts (i.e., unemployment, pensions), direct cash transfers to self-employed and subsidies to temporary employment. Finally, to minimise bankruptcies, tax deferrals have been allowed for firms as well as payroll support or deferral on payment of utilities (OECD et al., 2020[1]).

It is essential to constantly evaluate the implementation and effectiveness of these measures and to re-adjust them if necessary, especially those aimed at the poorest and vulnerable population. This is, in particular, relevant to support informal vulnerable workers who are not covered by any form of social assistance programme and women who are disproportionally affected by the crisis.

The phasing out of the containment and lockdown measures should be accompanied by testing more people and tracking the infected population, and to consider a strategic distribution of vaccines. Testing more people to identify who is infected, tracking them to make sure they do not spread the disease further, and tracing who they have been in contact with, will be essential to suppress the resurgence of local outbreaks and avoid further contagion in LAC countries. As vaccines become available, access to them should prioritise people with very high risk of exposure to COVID-19 including the elderly and most vulnerable population.

In the short term, adopting bold measures to spur a swift economic recovery

On the economic front, while the previous measures aimed to avoid further increases in poverty or in firms' bankruptcy, this stage must be aimed at bringing the economy back to its full activity. The main measures must support effective demand stimulus, in particular from the consumption side. Specific support measures for most affected sectors and investment plans should also contribute to reactivate the economy.

Social policies will need to continue to support those affected by the inevitable impact of the crisis, particularly the most vulnerable and those who have fallen into poverty during the pandemic.

These actions involve the mobilisation of vast financial and human resources. Domestically, it is leading to higher public deficits and rising levels of public debt, which in countries with a weaker fiscal position represents a challenge. More than ever improvements in the effectiveness and efficiency of public expenditures are crucial. At the international level, co-ordinated support from the international community will be vital given the magnitude of the effort and the difficulties that some LAC countries will face to finance themselves in international markets.

In the medium term, laying the foundations of a new social contract

This crisis has impacted LAC at a time when levels of trust and citizen satisfaction are particularly low (OECD et al., 2019[4]). A wave of protests in late-2019 highlighted the rise in social discontent and growing aspirations for better quality public services, and greater well-being for all. While the COVID-19 crisis may further deepen social discontent, it may also present an opportunity to create consensus among citizens around major pending reforms, and to recover common values around the importance of having strong public services and the relevance of belonging to the formal sector.

The COVID-19 crisis may trigger pending structural reforms in the region, particularly in a context where 8 presidential elections will take place in Latin America between January 2021 and October 2022. Following the lessons learned from past reforms adopted in crises periods, there are various possible mechanisms through which this crisis may favour reforms. For instance, this crisis may increase further the costs (for example at the fiscal or social fronts) of delaying reform. In this sense, a crisis may result in a "window of opportunity" that enables to undergo reforms that seemed hitherto impossible (Tommasi and Velasco, 1995[37]) (Dayton-Johnson, Londoño and Nieto-Parra, 2011[38]). Therefore, moving forward, in the context of the COVID-19 crisis, governments must use the momentum to rethink the social contract, addressing structural vulnerabilities – the development traps of low productivity, social vulnerability, institutional weaknesses and environmental sustainability – and responding to citizens' rising aspirations. This would mean moving from today's fragmented status quo to a new equilibrium grounded on equality of opportunities in the longer term, which is the basis of a social pact (Larrain, 2020[39]).

More than ever the COVID-19 crisis highlights the need for co-ordination and coherence across different actors, to deliver the most effective responses, and to build consensus across citizens in a sustainable pact. Furthermore, LAC countries need strategies that empower citizens at all stages of the policy-making process. In addition to an effective participatory process involving different actors, three dimensions should be considered to re-design the social contract in the region:

- **Putting well-being at the centre of public policies and moving towards stronger social protection systems**. This crisis exposes underlying vulnerabilities that simple income metrics, while important, fail to identify and address. Citizens' frustrations with the quality of public services and the multi-dimensional aspects of poverty reinforce the idea that development is beyond income. Governments in the region have taken important steps to mainstream well-being in public policies, with a stronger alignment of National Development Strategies to the SDGs. These efforts should not be reversed by the response to the COVID-19 crisis. Furthermore, the crisis has revealed that current mechanisms for social protection may be insufficient; many citizens are left outside the existing channels. The response to the crisis should promote innovative options to reduce social coverage gaps, protect the most vulnerable population, promote quality jobs, foster gender equality, improve the quality and universality of social protection systems, and design crisis response mechanisms in the absence of strong automatic stabilisers.
- **Defining a sustainable productive strategy**. National strategies should involve a broad range of actors and draw on a variety of knowledge and viewpoints to define policies towards higher levels of productivity and formal job creation in the region. The response to the crisis is an opportunity to

transform the development model of LAC and direct the economic stimulus towards building a model grounded on environmental sustainability. In addition, digital transformation can play a major role to drive productivity growth and increase competitiveness, in particular for companies that are lagging behind. Digital transformation has proven to be a tool to preserve certain economic activities and to save jobs in the region throughout this crisis. Policies to boost productivity must place a strong focus in matching market needs and in ensuring a smooth transition from obsolete to new jobs (OECD et al., 2020[1]).

- **Mobilising resources to build resilience and finance inclusive development**: The crisis highlights the need for more financing for public services, social protection and competitiveness. Tax and expenditure systems need to be reformed alongside improvements in the tax administration. In terms of taxes, options include increasing direct personal income taxes, property taxes, environment-related taxes, eliminating inefficient tax expenditures and reducing tax avoidance. These measures should contribute to increasing progressivity and tax collection, while also contributing to the imperative transition to a low-carbon economy. In terms of expenditures, governments should support income security for the most vulnerable, enabling them to plan, cope with risks and transition to the formal economy, and to improve the effectiveness of public expenditures. They should also strengthen investment to promote financially and environmentally sustainable MSMEs with better insertion in local and global value chains to overcome the regional productivity trap.

The role of international co-operation

The COVID-19 crisis urges for a New Deal for development in which the international community needs to provide an ambitious response to the crisis. The relevance of co-ordinating a global response to address the immediate, short and medium-term impacts of the COVID-19 crisis cannot be overemphasised. There are at least four critical areas for co-ordinated action at the international level:

- **A globally co-ordinated debt management** requires several policy actions that can be crucial in response to the coronavirus (COVID-19) crisis. In particular, international co-ordinated action should be independent of the level of income, contribute to solve debt sustainability problems and respond to the impact of the crisis. There is no unique solution to managing public debt in the LAC region due to discrepancies across countries. First, there needs to be co-ordinated action among bond holders and capital markets actors in restructuring debt issued by countries already facing financial difficulties. Second, official support should prioritise economies that have little or no access to capital markets. Third, countries that already enjoyed ample fiscal sustainability must retain access to capital markets. Finally, countries that might have access to capital markets but face high debt cost and/or debt sustainability risks can use several policy options that require international co-operation such as debt standstill or moratorium, debt relief, creation of a special vehicle to finance the crisis or pay the debt, and greater use of Special Drawing Rights.
- **International co-operation is critical, and the role of the G20 must be central to co-ordinate the response to the health emergency**, making vaccines available, accessible and affordable for all. International co-operation is also critical for the mobilisation of financial resources at a global level. Beyond this, mechanisms for knowledge-sharing, policy dialogues and technological transfers are needed to spur a lasting, sustainable recovery and a reinvigorated multilateral system where the region should play an active role.
- **Regional co-operation and integration** appear as pending, yet highly desirable objectives, both to address the urgent consequences of the crisis and also to drive the recovery and prepare for future setbacks. Regional integration can play a key role for the recovery by promoting further regional value chains across countries in LAC.

- **As brought to light by the COVID-19 crisis, international co-operation is essential to overcome challenges that transcend borders, such as the taxation issues brought on by the digitalisation of the economy.** On an equal footing basis, LAC countries should greatly benefit from further co-operation with other economies, and the LAC region has also an important role to play in reaching consensus solutions through effective multilateral co-operation. Examples concern the OECD standards on effective collection of VAT on online trade, and the OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS) to address the corporate income tax challenges arising from the digitalisation of the economy.

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