Fiscal Panorama of Latin America and the Caribbean 2021

Fiscal policy challenges for transformative recovery post-COVID-19

Alicia Bárcena
Executive Secretary
Economic Commission for Latin America and the Caribbean (ECLAC)
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UNITED NATIONS
ECLAC

COVID-19 RESPONSE

A COMPLEX CONTEXT

- Growth in 2021 will not offset the contraction seen in 2020 be heavily influenced by uncertainty related to unequal access to vaccines and uneven vaccination roll-out.
- Governments made fiscal efforts **(4.6% of GDP)** to mitigate social and economic effects.
- Given the persistence of the pandemic and the fragility of the economic recovery process, an expansionary fiscal policy must be maintained in 2021 although the capacity to sustain expansionary fiscal and monetary policies varies greatly.
- Growth expected to be sluggish in the coming years, making it difficult to restore employment levels, address informality and reverse increases in poverty and extreme poverty.
- Widening inequalities: technologically-intensive sectors will tend to recover faster in a region characterized by low productivity and fragmented social protection and health systems.
- Women will bear the brunt of the impact, with labour market participation set back by 10 years.

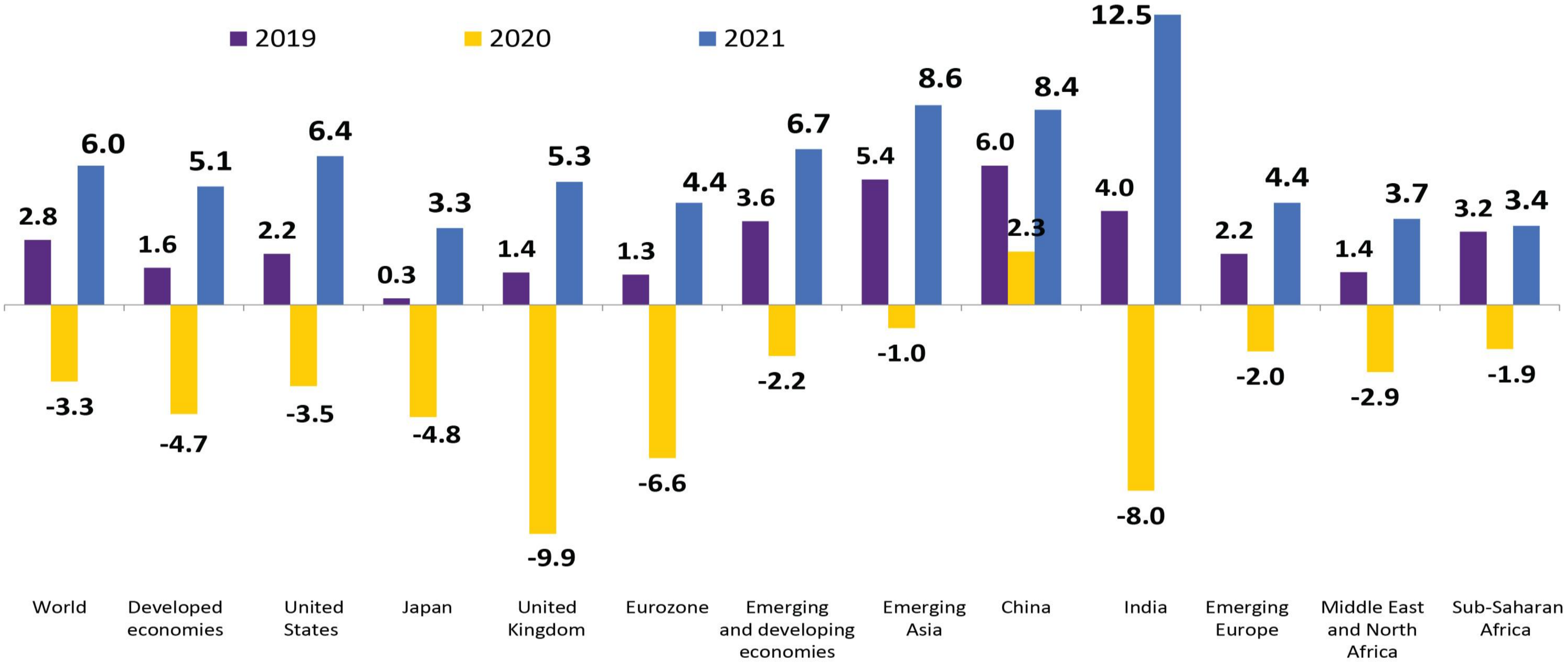
RECOVERY AT RISK

- Uneven, inconsistent and asynchronous economic recovery
- Uncertainties about vaccine efficacy
- High levels of global debt, particularly in middle-income countries (96% of GDP except in China and India).
- More than half of the region's economies are rated as high risk; coupled with increases in long-term rates, this could increase volatility in financial flows to the region
- Global debt relief initiatives currently exclude middle-income countries

GLOBAL ECONOMIC GROWTH FOR 2021 FORECAST AT AROUND 6%, WITH SIGNIFICANT DISPARITIES BETWEEN COUNTRIES

SELECTED REGIONS AND COUNTRIES: GDP GROWTH RATES FOR 2019, 2020 AND PROJECTIONS FOR 2021

(*Percentages*)

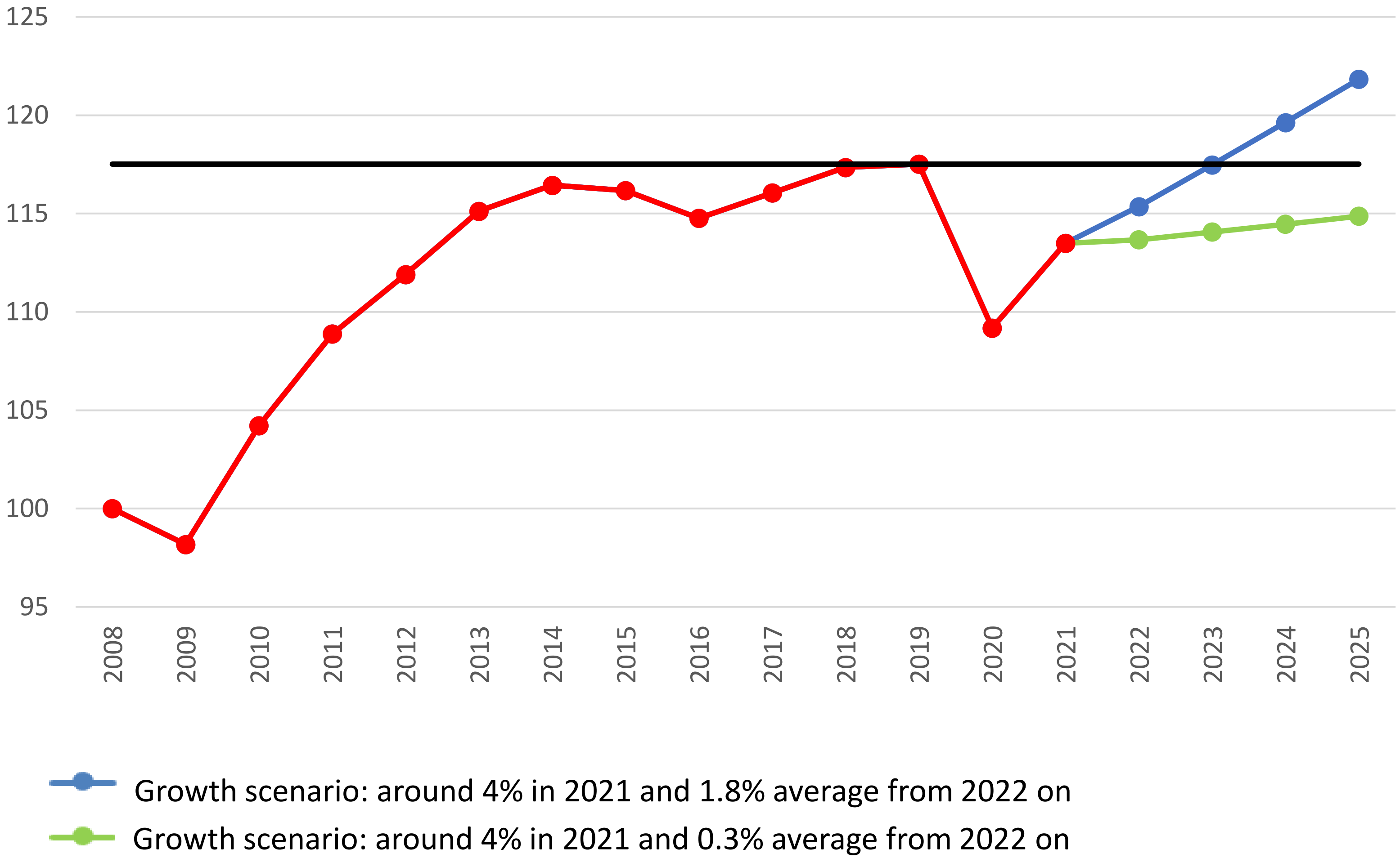


Source: ECLAC, on the basis of WEO, IMF (April 2021) and official sources.

POSITIVE GROWTH PROJECTED FOR THE REGION IN 2021, WITH A SLOW RETURN TO PRE-PANDEMIC LEVELS OF ECONOMIC ACTIVITY (2019)

LATIN AMERICA AND THE CARIBBEAN: GDP LEVEL IN REAL TERMS

(Base year 2008=100)



After a 7.1% contraction in 2020 and projected growth of around 4% in 2021, with growth in line with the preceding decade (1.8%) the pre-pandemic level would be regained **in 2023**

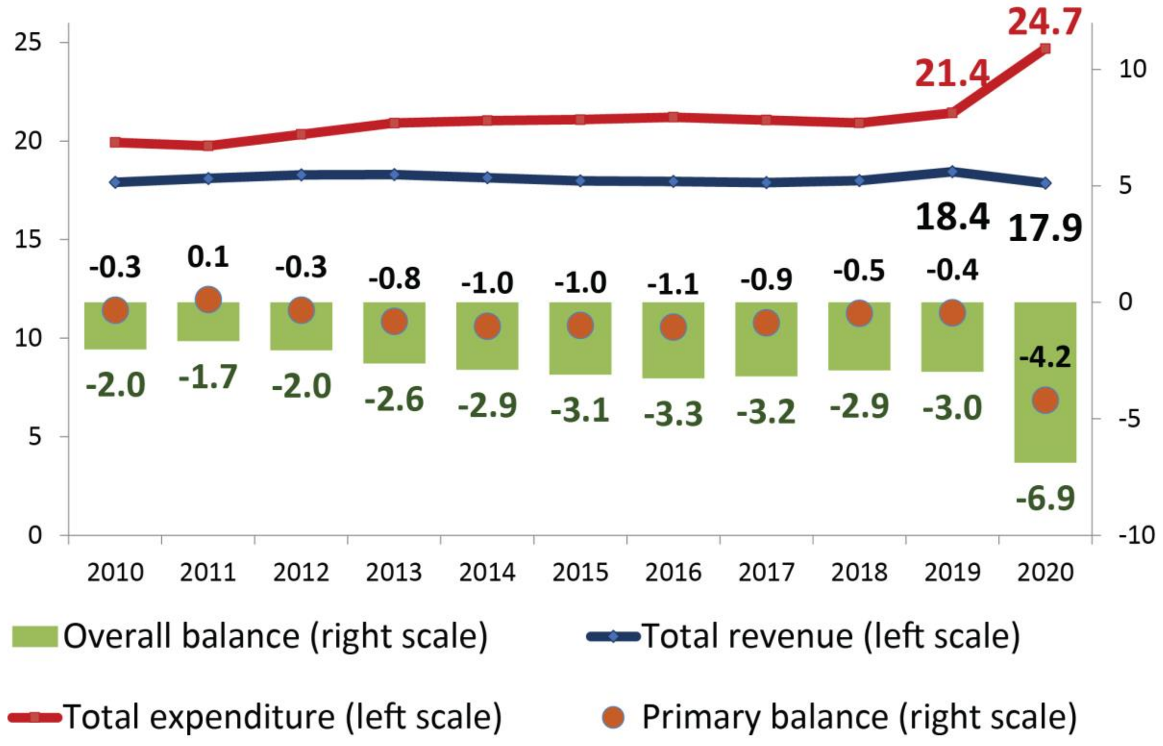
However, with growth in line with the past 6 years (0.3%) it would take more than a decade

Source: ECLAC, on the basis of official figures.

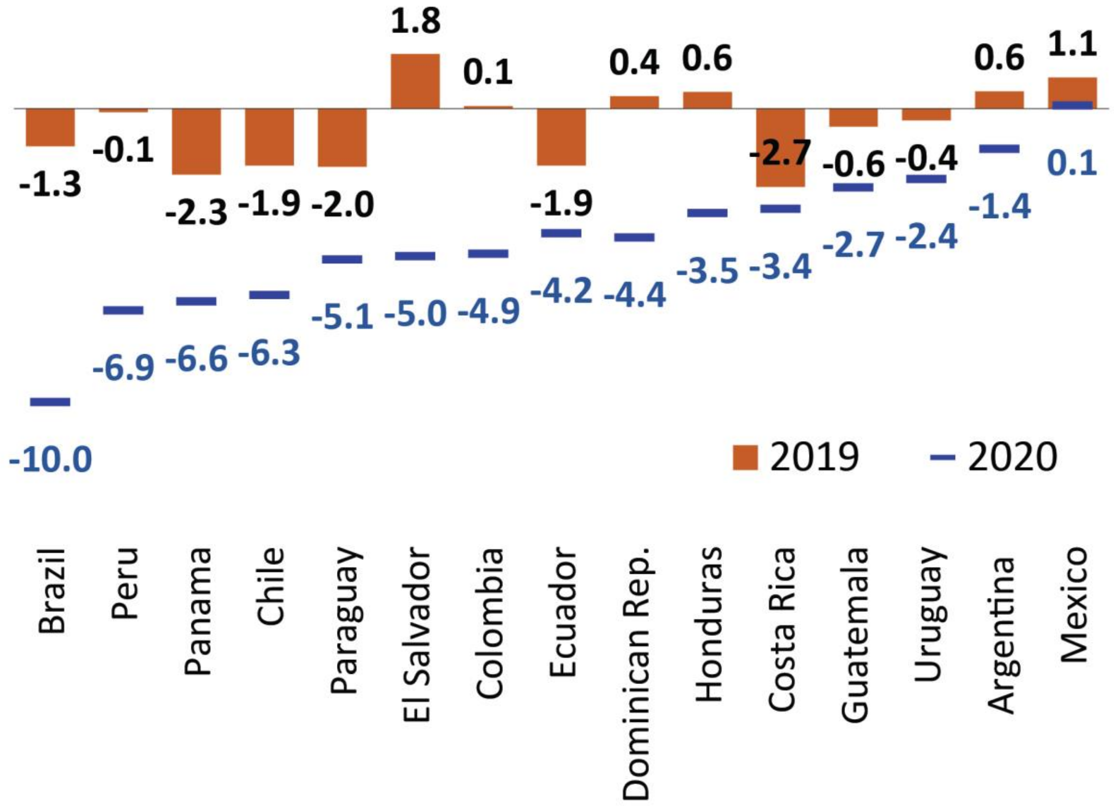
Fiscal policy in 2020

FISCAL DEFICITS WIDENED OWING TO THE DECLINE IN PUBLIC REVENUES AND THE INCREASE IN PUBLIC SPENDING

LATIN AMERICA (16 COUNTRIES): CENTRAL GOVERNMENT FISCAL INDICATORS, 2019–2020
(Percentages of GDP)



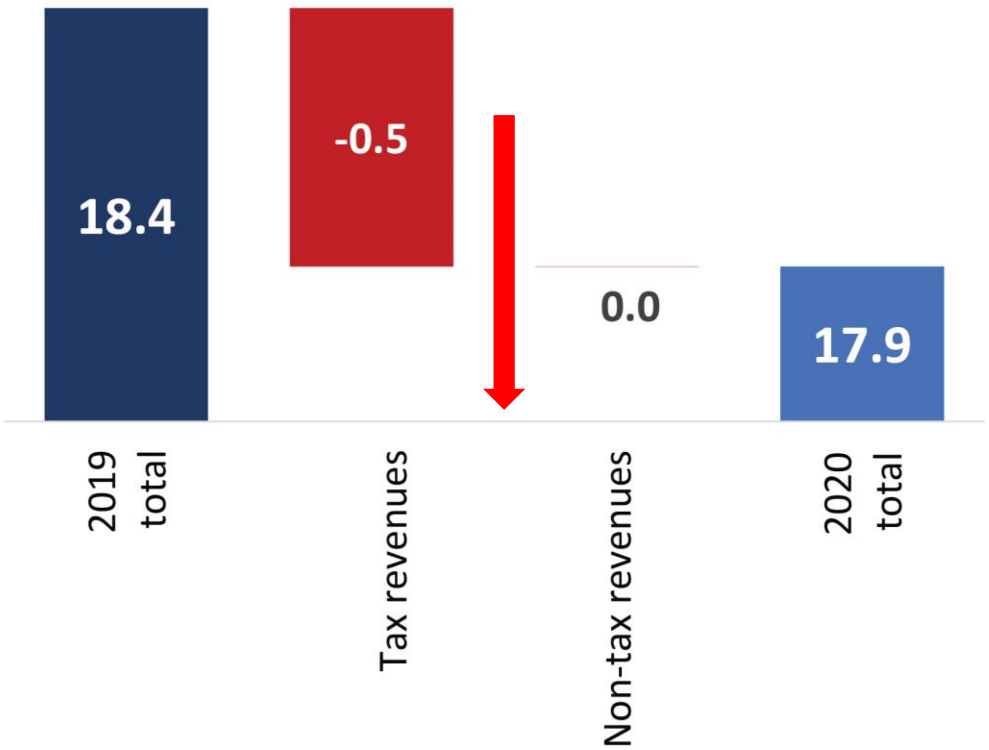
LATIN AMERICA (15 COUNTRIES): CENTRAL GOVERNMENT PRIMARY BALANCE, 2019–2020
(Percentages of GDP)



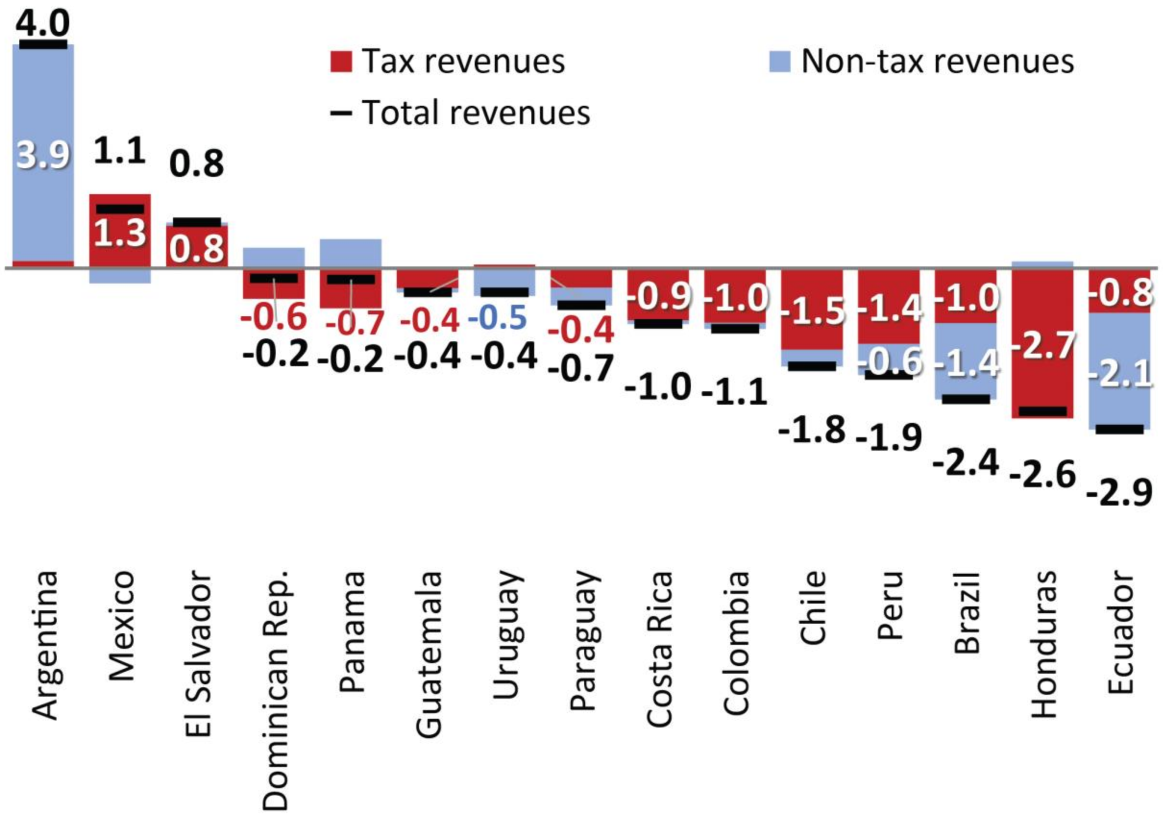
Source: ECLAC, on the basis of official figures.

THE DECLINE IN TAX REVENUES WAS THE MAIN FACTOR BEHIND THE CONTRACTION IN GOVERNMENT REVENUES

LATIN AMERICA: TOTAL CENTRAL GOVERNMENT REVENUES, BY COMPONENT, 2019–2020
(Percentages of GDP)



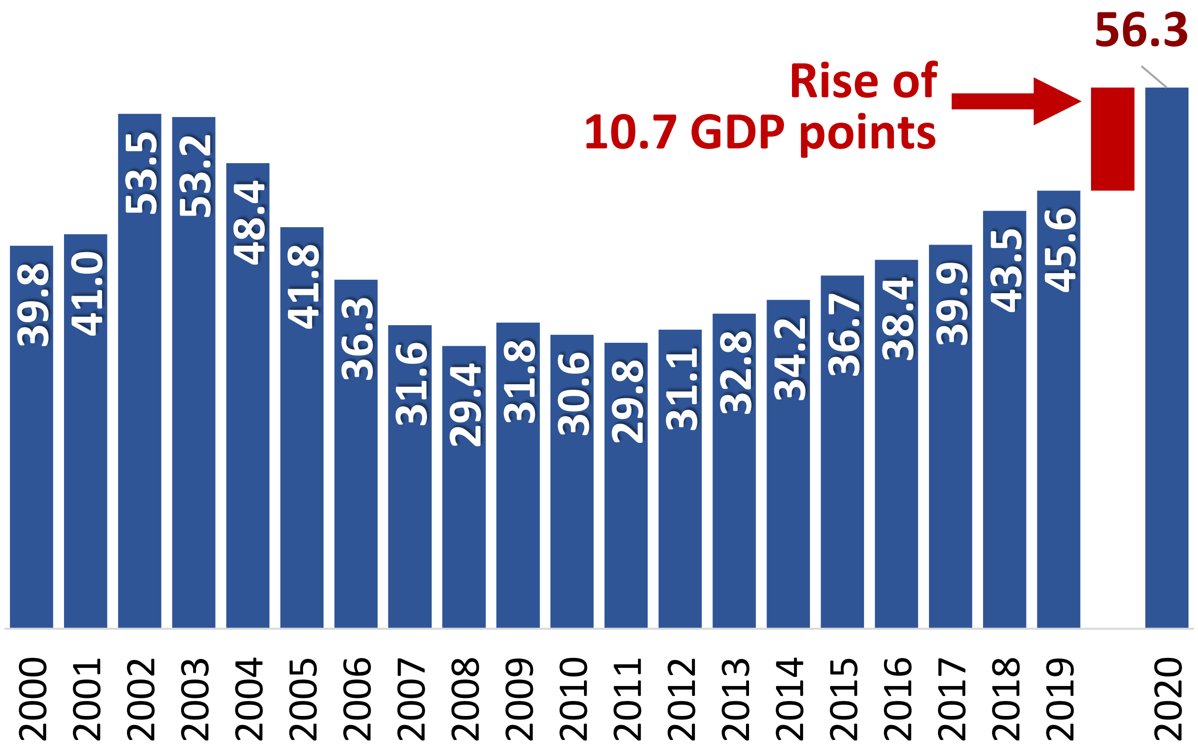
LATIN AMERICA (15 COUNTRIES): TOTAL CENTRAL GOVERNMENT REVENUES, 2019–2020
(Percentage points of GDP)



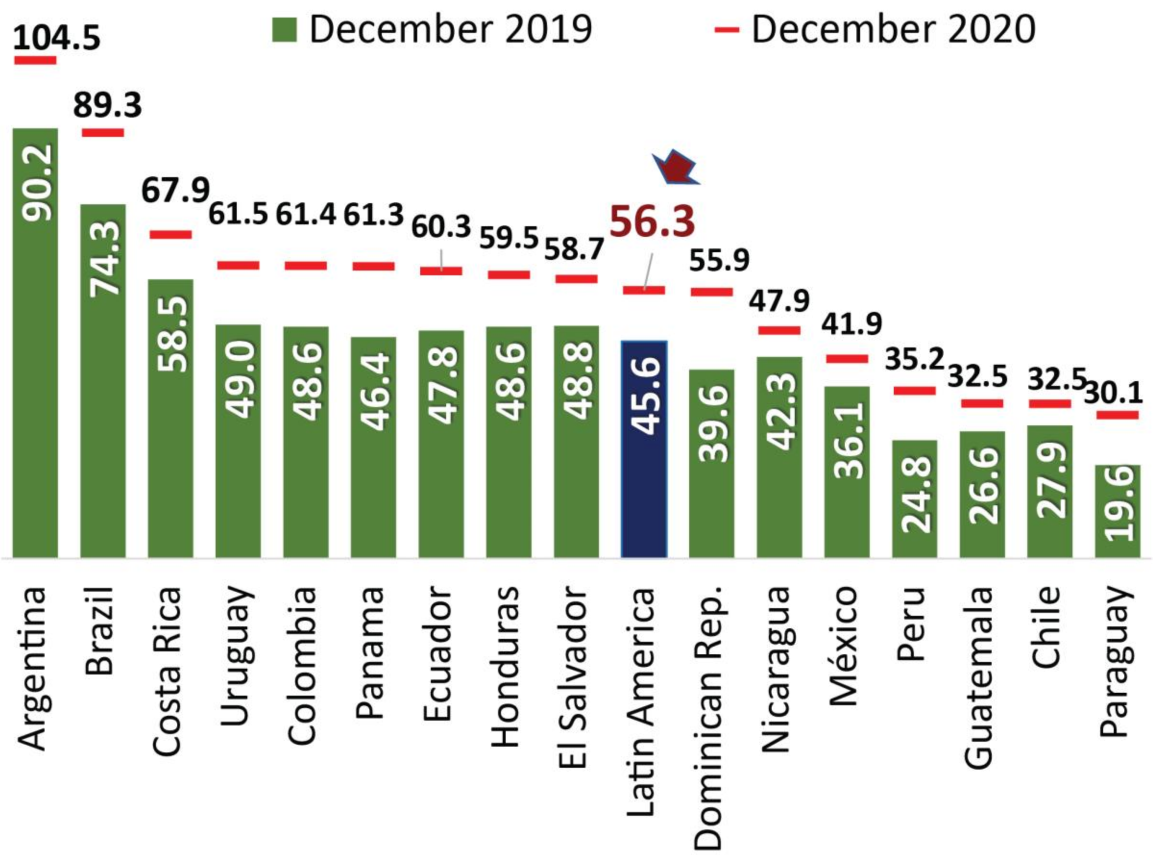
Source: ECLAC, on the basis of official figures.

THE RATIO OF PUBLIC DEBT TO GDP ROSE ACROSS THE BOARD, REFLECTING RISES IN DEBT AND FALLS IN GDP

LATIN AMERICA (16 COUNTRIES): GROSS CENTRAL GOVERNMENT PUBLIC DEBT, 2000–2020
(Percentages of GDP)



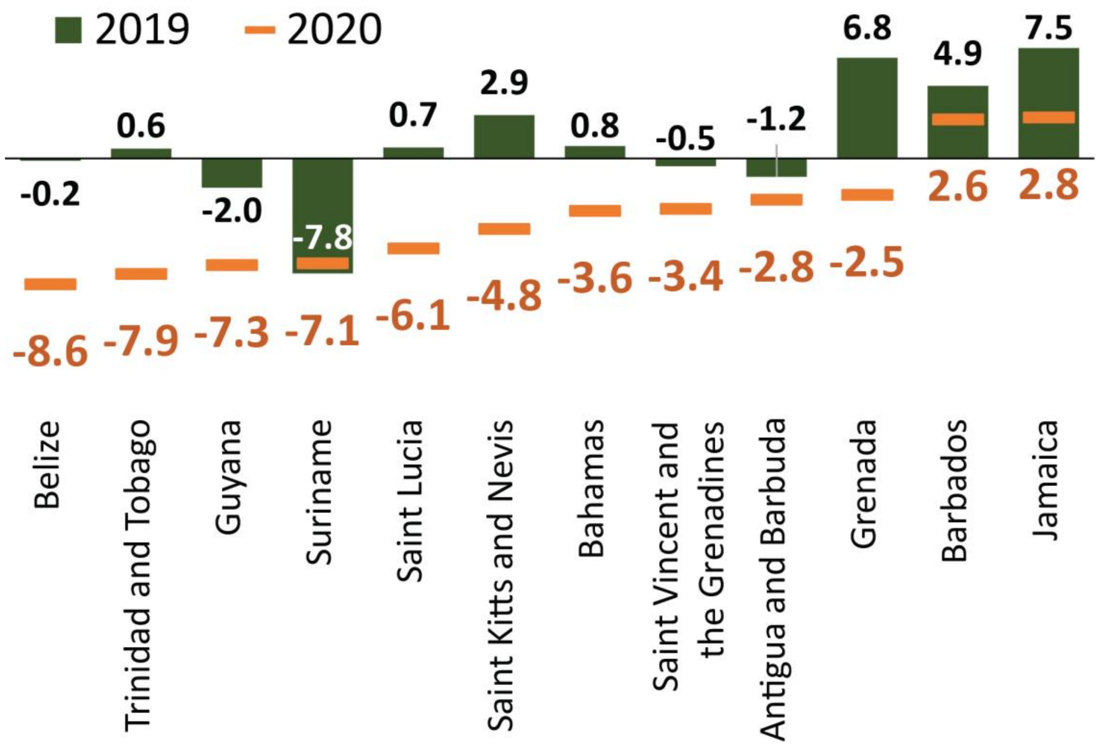
LATIN AMERICA (16 COUNTRIES): GROSS CENTRAL GOVERNMENT PUBLIC DEBT, 2019–2020
(Percentages of GDP)



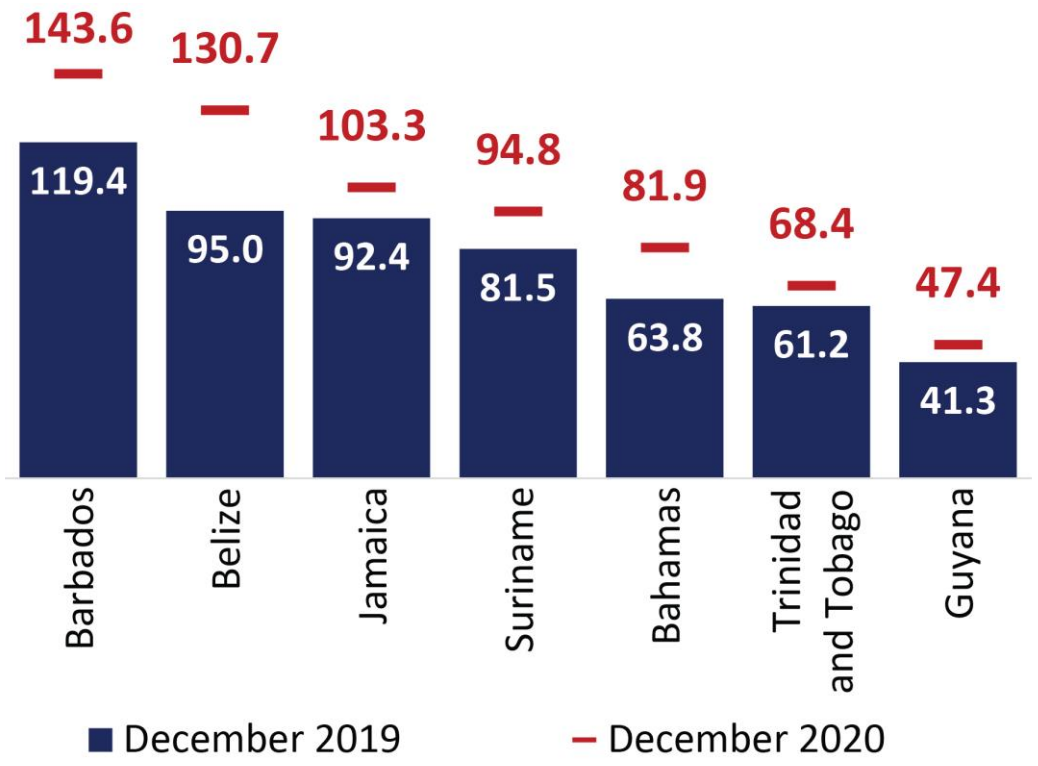
Source: ECLAC, on the basis of official figures.

THE PANDEMIC PUSHED PUBLIC DEBT ABOVE 100% OF GDP IN SOME CARIBBEAN COUNTRIES

THE CARIBBEAN (12 COUNTRIES): CENTRAL GOVERNMENT PRIMARY BALANCE, 2019–2020[a]
(Percentages of GDP)



THE CARIBBEAN (7 COUNTRIES): CENTRAL GOVERNMENT GROSS PUBLIC DEBT, 2019–2020
(Percentages of GDP)

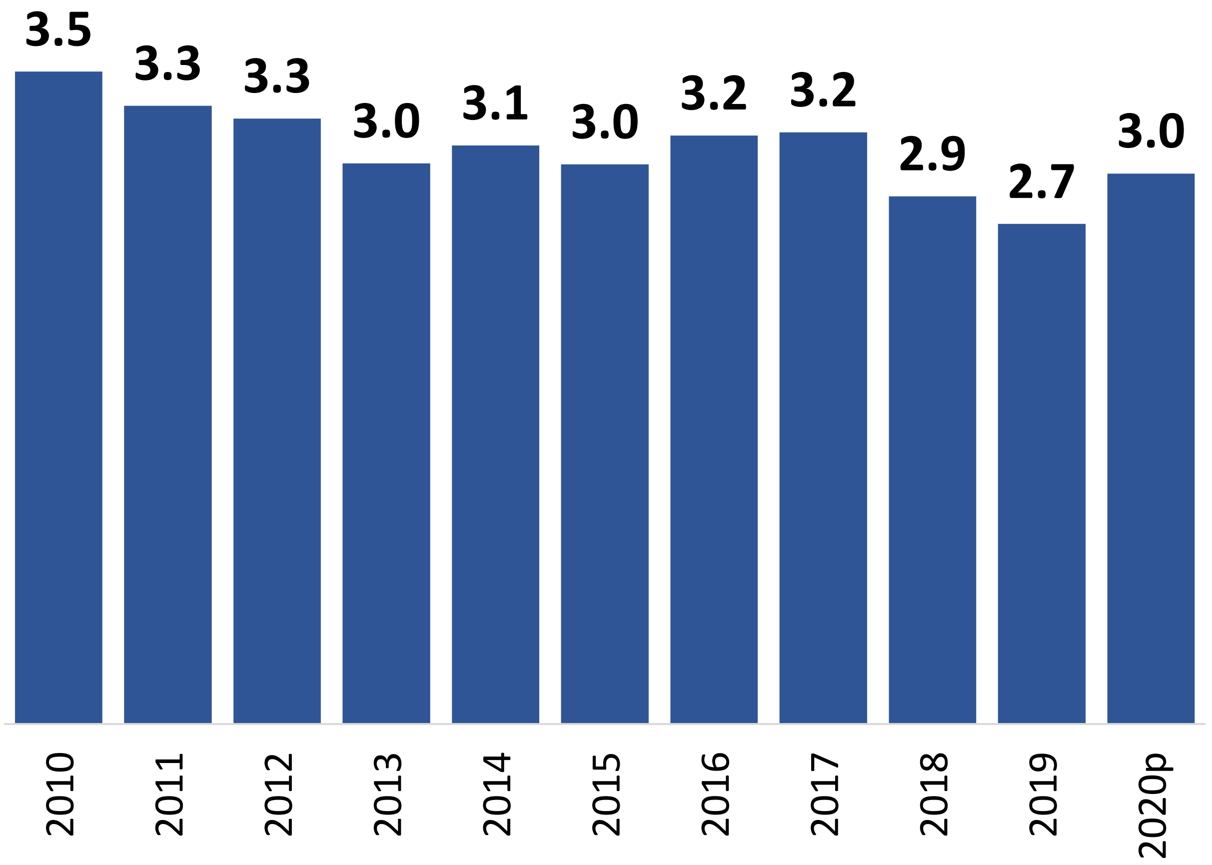


Source: ECLAC, on the basis of official figures.

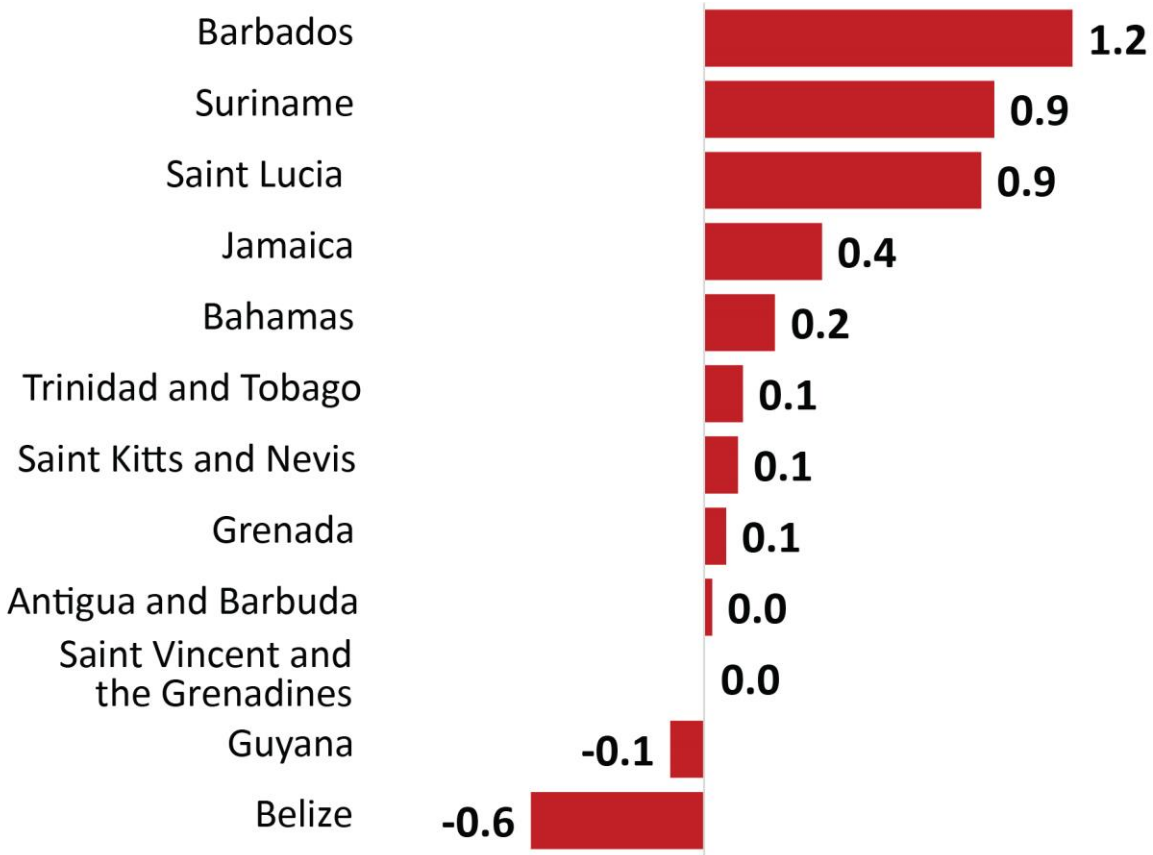
[a] The figures for Suriname are for January–September 2020; those for Barbados are for April–December 2020; and for Belize and Jamaica, for January–December 2020.

THE RATIO OF INTEREST PAYMENTS TO GDP ALSO INCREASED IN THE CARIBBEAN

THE CARIBBEAN (12 COUNTRIES): CENTRAL GOVERNMENT INTEREST PAYMENTS, 2010–2020
(Percentages of GDP)



THE CARIBBEAN (12 COUNTRIES): YEAR-ON-YEAR VARIATION OF CENTRAL GOVERNMENT INTEREST PAYMENTS, 2019–2020
(Percentage points of GDP)

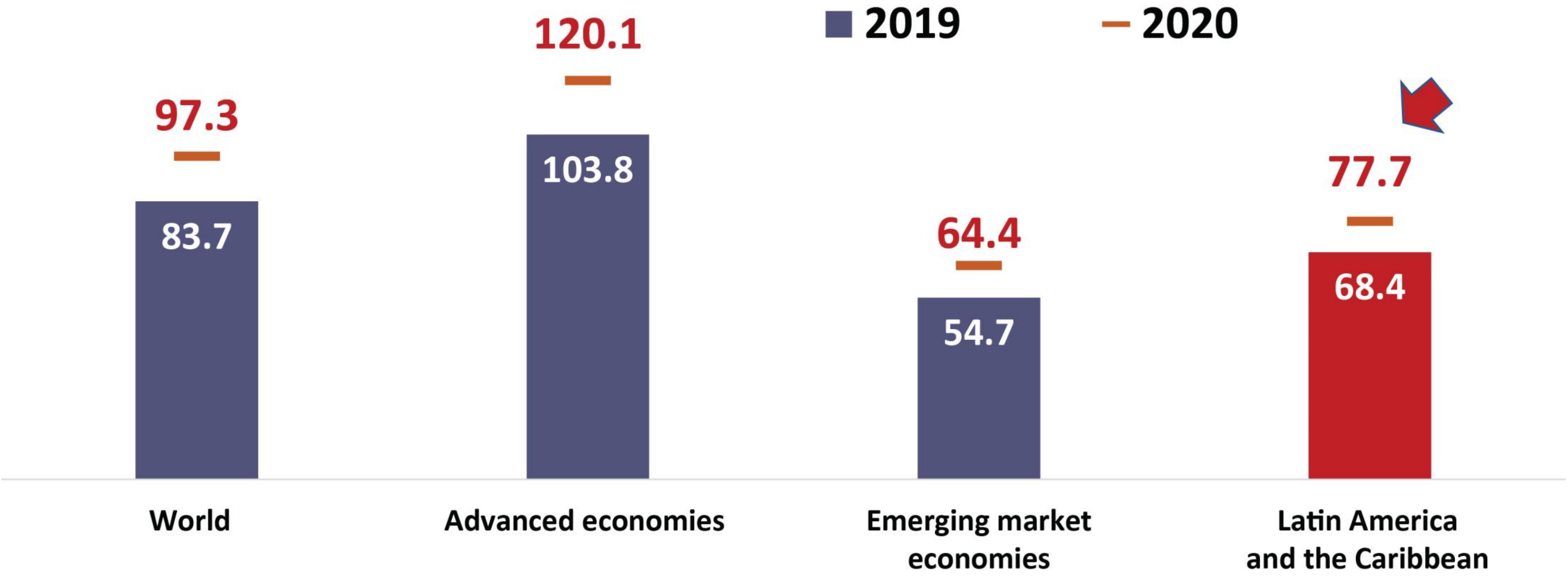


Source: ECLAC, on the basis of official figures.

THE REGION HAS HIGHER DEBT LEVELS THAN DEVELOPING ECONOMIES, BUT LOWER LEVELS THAN DEVELOPED ECONOMIES

SELECTED REGIONS: CENTRAL GOVERNMENT GROSS PUBLIC DEBT, 2019 AND 2020

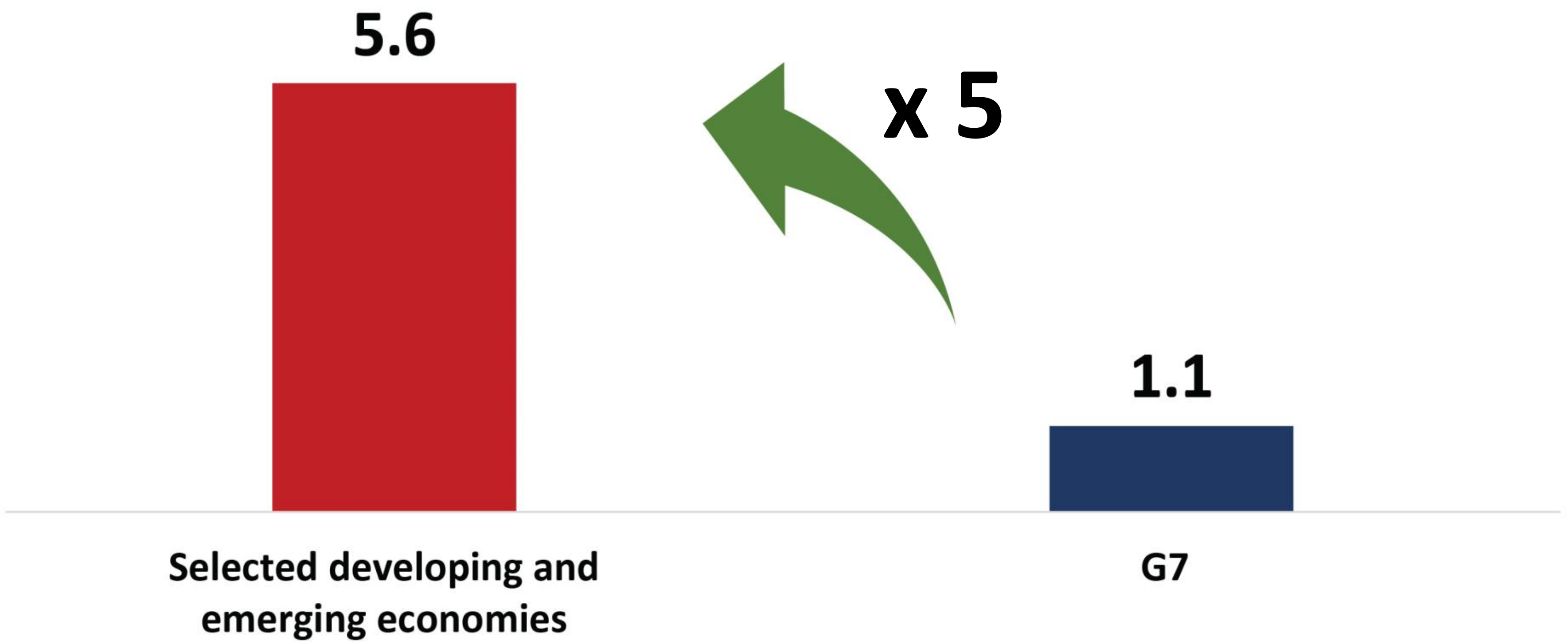
(Percentages of GDP)



Note: The figures for overall balance and gross public debt are weighted averages of the figures from *Fiscal Monitor*, April 2021, IMF.
Source: ECLAC, on the basis of International Monetary Fund (IMF), "Fiscal Monitor Update", Washington D.C., April 2021.

BUT DEBT SERVICE IS FIVE TIMES HIGHER IN DEVELOPING ECONOMIES

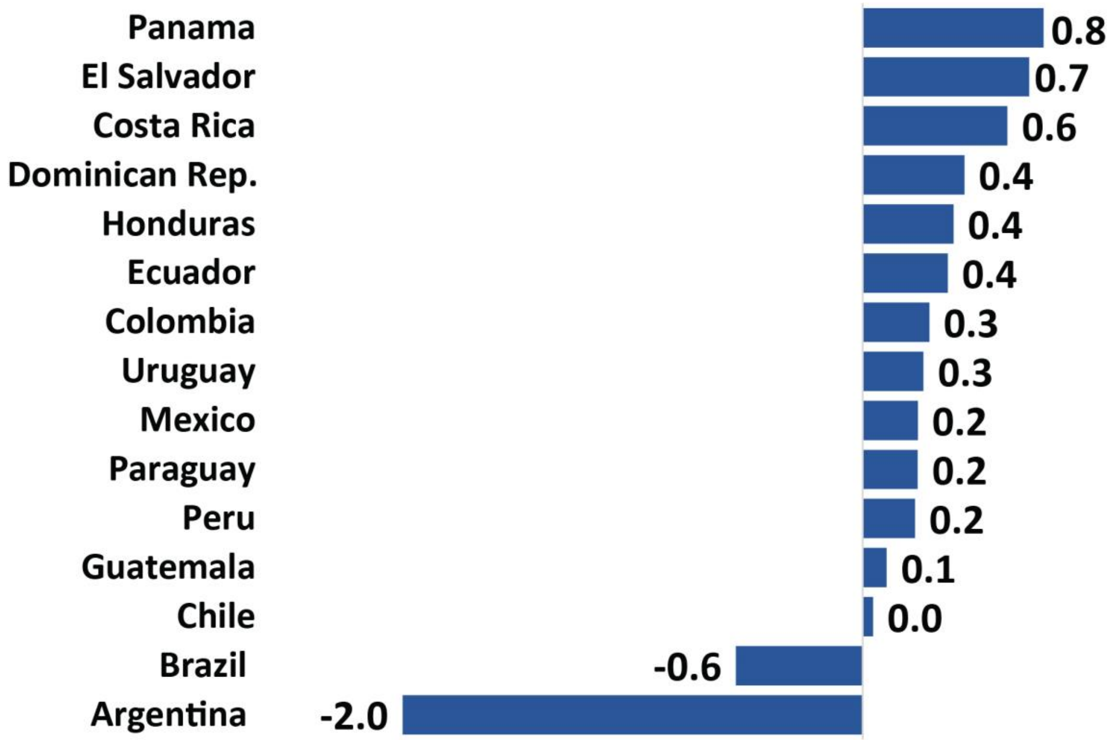
TOTAL DEBT SERVICE AS A PERCENTAGE OF TOTAL DEBT, DEVELOPING AND EMERGING ECONOMIES AND G7



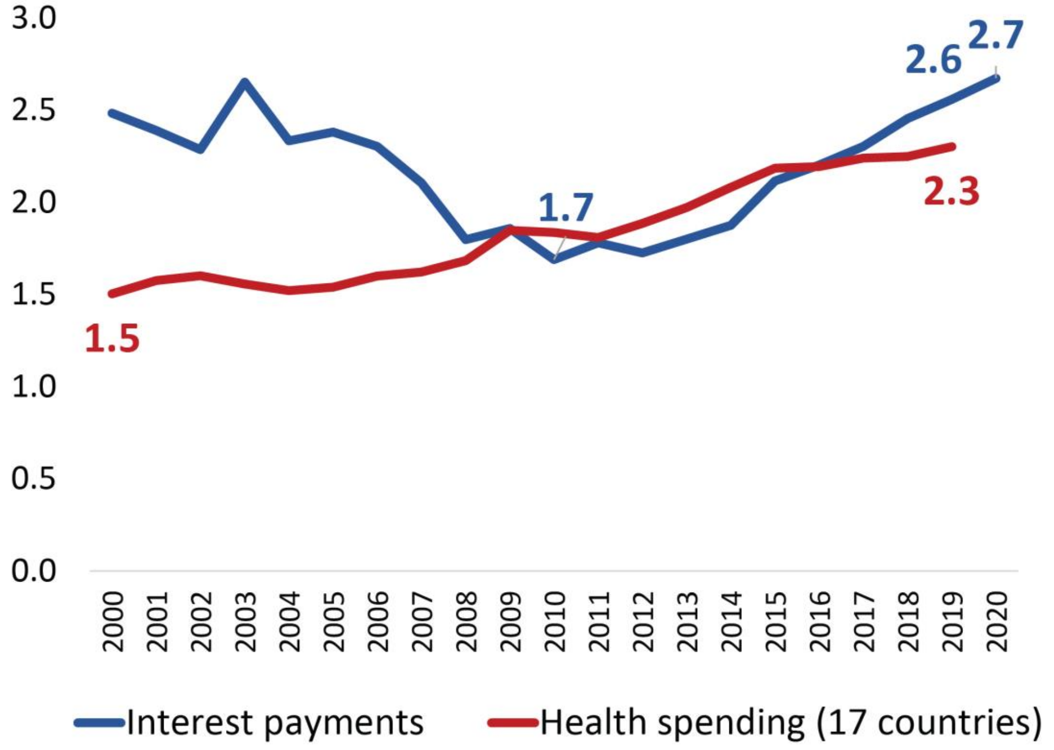
Note: Debt service includes domestic and external debt. Developing and emerging economies include Brazil, India, Indonesia, Mexico and South Africa. G7 includes Italia, Japan, France and the United States.
Source: Bloomberg (2021).

THE BURDEN OF INTEREST PAYMENTS GREW IN MOST COUNTRIES, LIMITING THE ROOM FOR OTHER PRIORITY SPENDING

LATIN AMERICA (15 COUNTRIES): YEAR-ON-YEAR VARIATION IN INTEREST PAYMENTS BY THE CENTRAL GOVERNMENT, 2019–2020
(Percentage points of GDP)



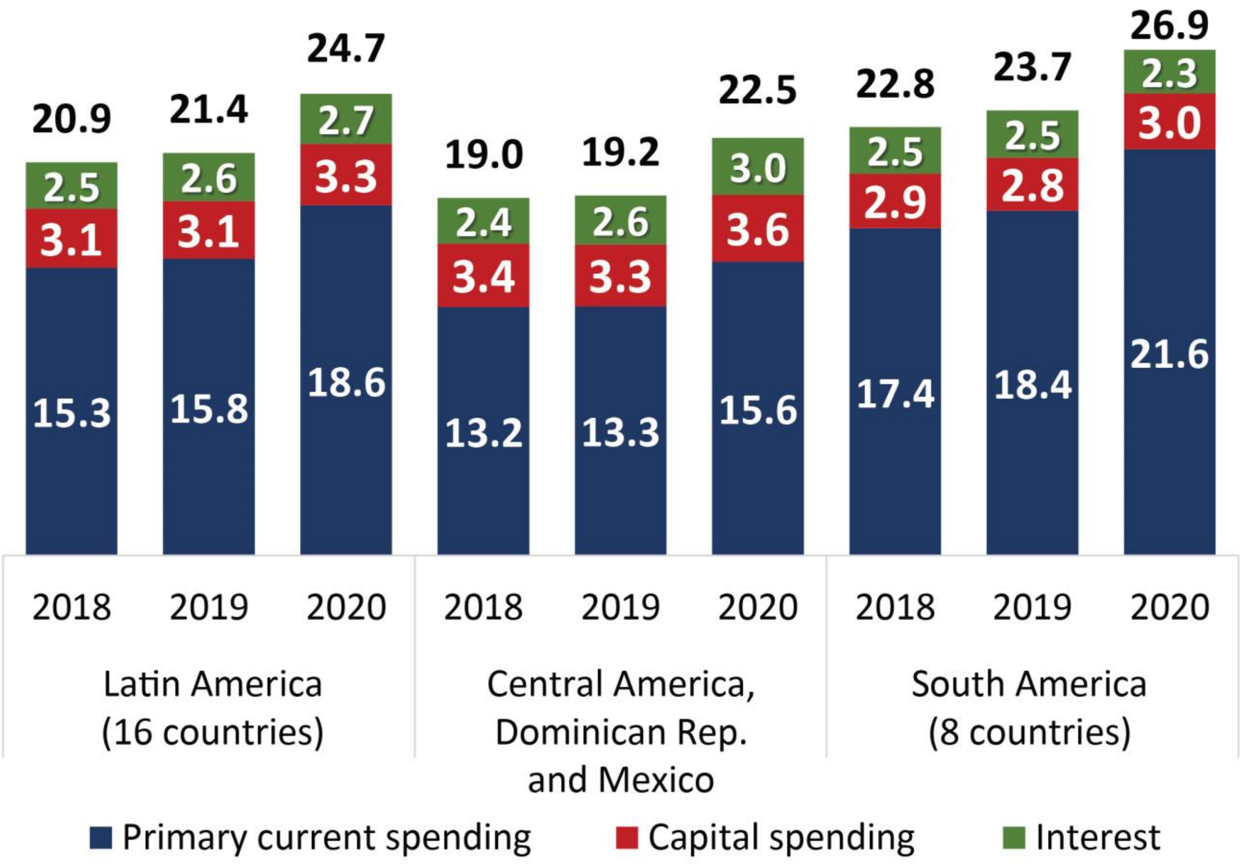
LATIN AMERICA (17 COUNTRIES): INTEREST PAYMENTS AND HEALTH EXPENDITURE BY THE CENTRAL GOVERNMENT, 2000–2020
(Percentages of GDP)



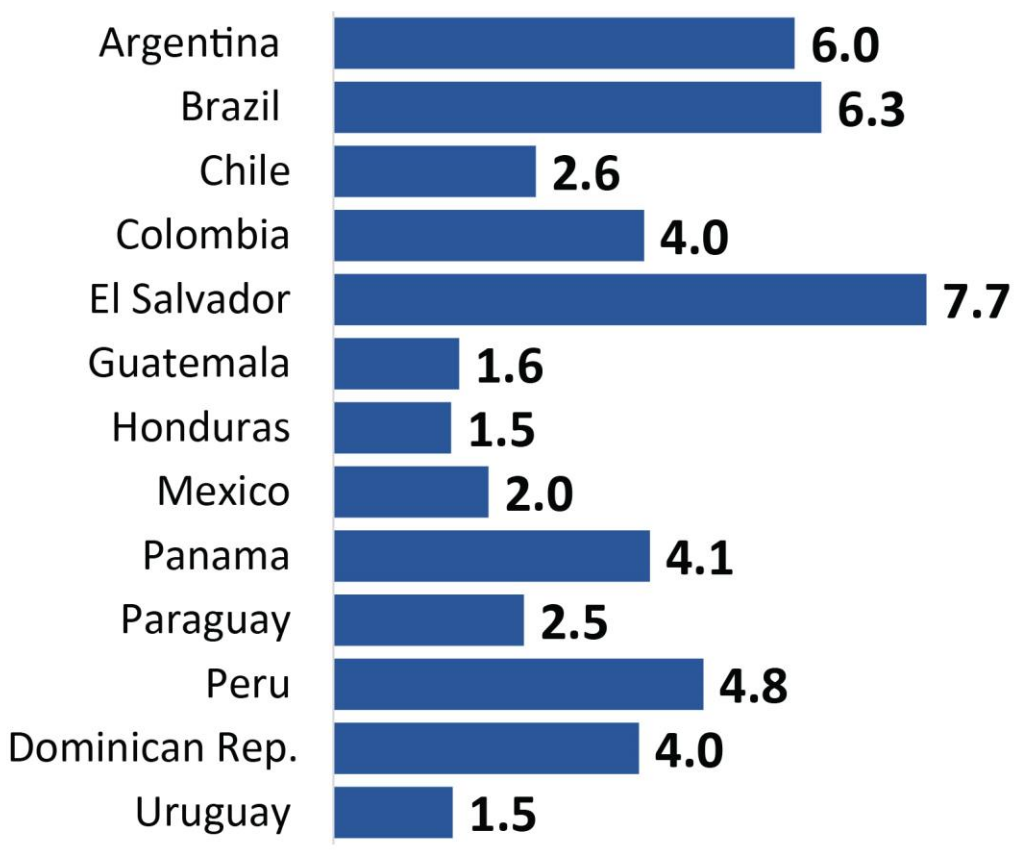
Source: ECLAC, on the basis of official figures.

EVEN SO, HIGHER PUBLIC SPENDING WAS THE MAIN INSTRUMENT USED TO MITIGATE THE SOCIAL AND ECONOMIC EFFECTS OF THE PANDEMIC

LATIN AMERICA: COMPOSITION OF TOTAL CENTRAL GOVERNMENT SPENDING, 2018–2020
(Percentages of GDP)



LATIN AMERICA (SELECTED COUNTRIES): YEAR-ON-YEAR VARIATION IN CENTRAL GOVERNMENT PRIMARY SPENDING, 2019–2020
(Percentage points of GDP)



Source: ECLAC, on the basis of official figures.

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IN 2020, FISCAL POLICY WAS KEY IN MITIGATING THE SOCIAL AND ECONOMIC EFFECTS OF THE PANDEMIC

2020: 4.6% of GDP on average on announced emergency plans

2.5% of PIB on average on announced State credit guarantees

2021: January–April: 1.2% of GDP on average on announced emergency plans

Targets:

Health, household income, production capacity

Mechanisms:

- Tax relief
- Public spending
- Government-backed liquidity instruments

Country-specific efforts based on:

- Structure of the economy
- Fiscal space available
- Capacity to mobilize additional financing
- Capacity of health and social protection systems to cope
- Spread of the disease

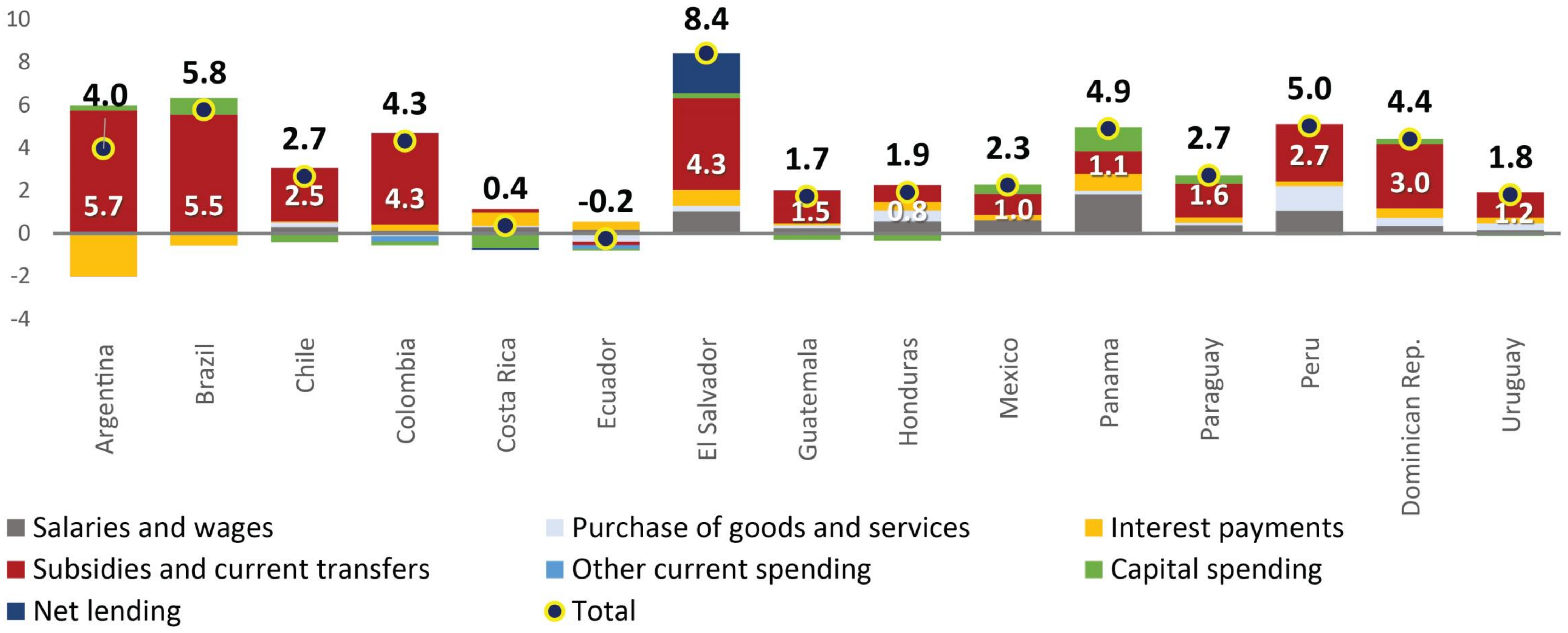
Countries with **wider coverage of social protection systems** were able to **respond rapidly** to contain and mitigate the effects of the pandemic.

Some have announced the extension of fiscal measures in 2021.

LARGEST INCREASES IN SPENDING IN SUBSIDIES AND CURRENT TRANSFERS TO HOUSEHOLDS AND PRODUCTION SECTOR

LATIN AMERICA (15 COUNTRIES): YEAR-ON-YEAR VARIATION IN THE COMPONENTS OF TOTAL CENTRAL GOVERNMENT SPENDING, 2019–2020

(Percentage points of GDP)

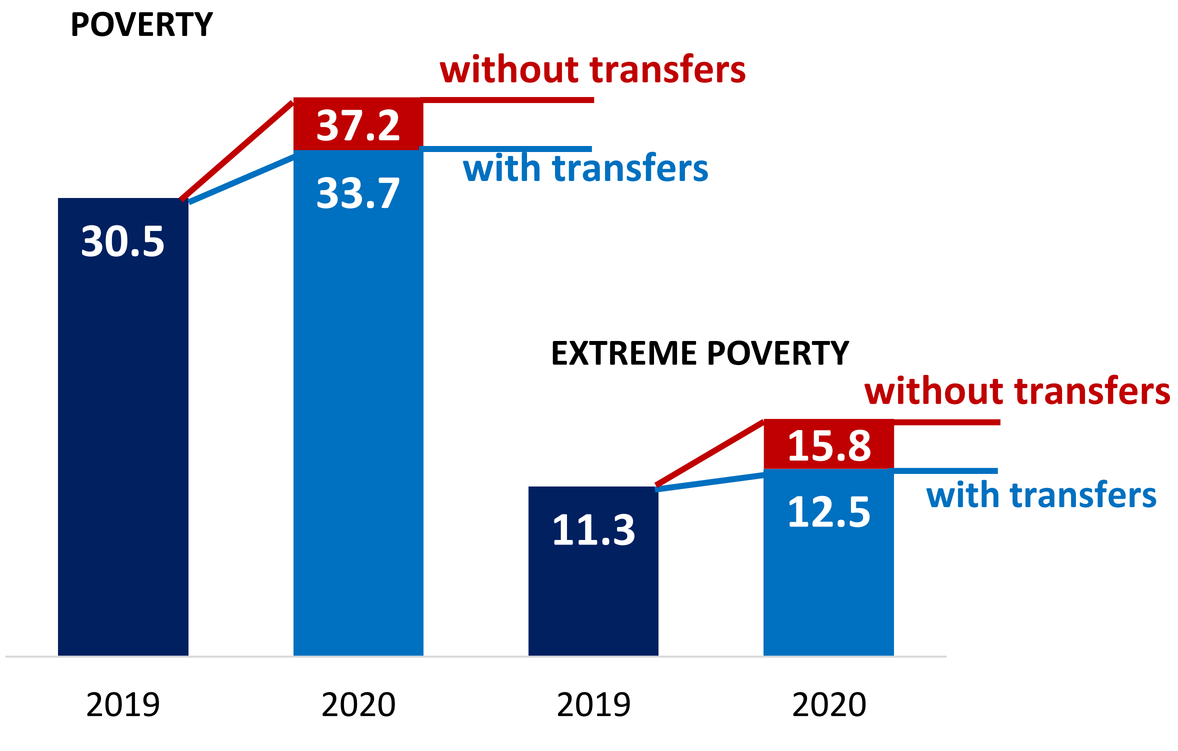


Source: ECLAC, on the basis of official figures.

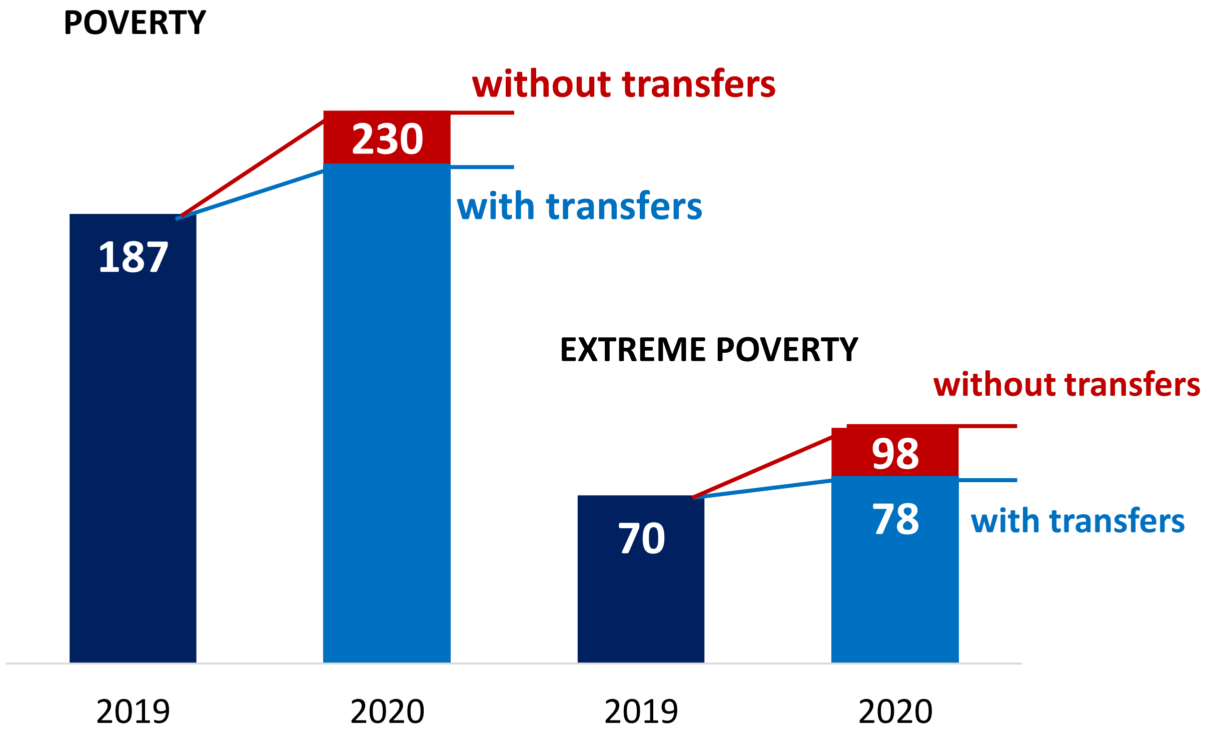
CENTRAL ROLE OF PUBLIC SPENDING ON EMERGENCY CASH TRANSFERS TO MITIGATE THE RISE IN POVERTY

LATIN AMERICA: POVERTY AND EXTREME POVERTY, WITH AND WITHOUT CASH TRANSFERS, 2019 AND 2020

PERCENTAGES



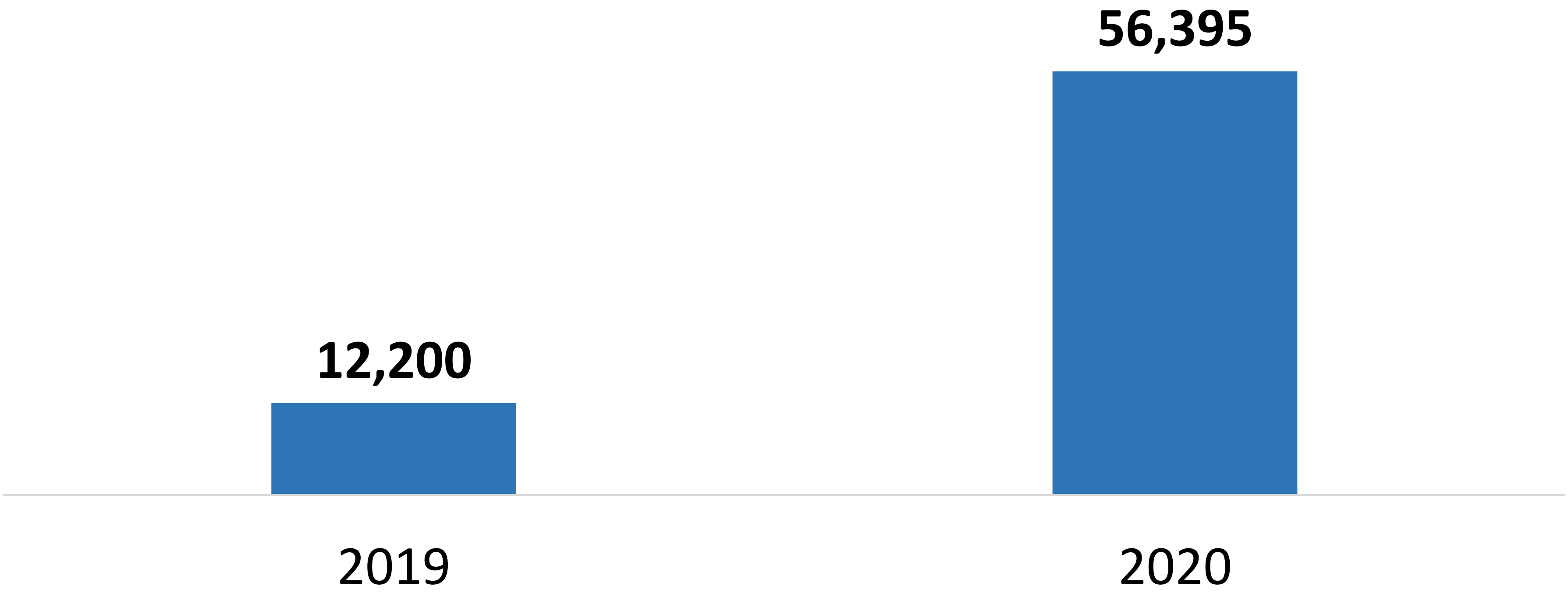
MILLIONS OF PERSONS



Source: Social Panorama of Latin America, 2020, ECLAC, on the basis of Household Survey Data Bank (BADEHOG). [a] Weighted average of the following countries: Argentina, Bolivia (Plurinational State of), Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela (Bolivarian Republic of). The simulation does not take into account changes in remittances to households.

EFFORTS HAVE ALSO FOCUSED ON SUPPORTING PRODUCTIVE ACTIVITY BY PROVIDING GUARANTEES THROUGH DEVELOPMENT FINANCING INSTITUTIONS

GUARANTEES EXTENDED IN 2019 AND COVID-19 PROGRAMMES
(Millions of dollars)



Note: 2020 includes the first three quarters of the year. Includes data for Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru and Uruguay.
Source: On the basis of World Bank (2020) second survey of performance of credit guarantee schemes in Latin America during the COVID-19 pandemic. 30 September, 2020.

A strategic approach to public spending

CHALLENGES OF EXPANDING FISCAL SPACE AND MAINTAINING EXPANSIONARY FISCAL POLICY IN THE PANDEMIC

STRENGTHENING PUBLIC REVENUES

- Eliminate tax evasion
- Reduce tax expenditures
- Access to international financing
- Increase tax collection, consolidate income tax, expand the scope of property, capital and environmental taxes
- Improve income distribution

RETHINKING PUBLIC SPENDING

- As an instrument of development
- Tie in emergency with a transformative recovery
- Support domestic demand
- Support supply: MSMEs
- Prioritize employment-intensive investment (for women and young people) in more productive sectors

Fiscal covenants and political/social compacts to close gaps in equality, climate action, universal access to health and social protection

THE REGION NEEDS TO TARGET SPENDING WITH A STRATEGIC FOCUS, AS THE BASIS FOR TRANSFORMATIVE RECOVERY

Challenges:

- **Linking short-term demands with long-term investment.**
- **Pro-employment growth in response to rapid technological change**
- **Urgent need to invest in environmental protection and social inclusion**

The proposal is to focus public spending on:

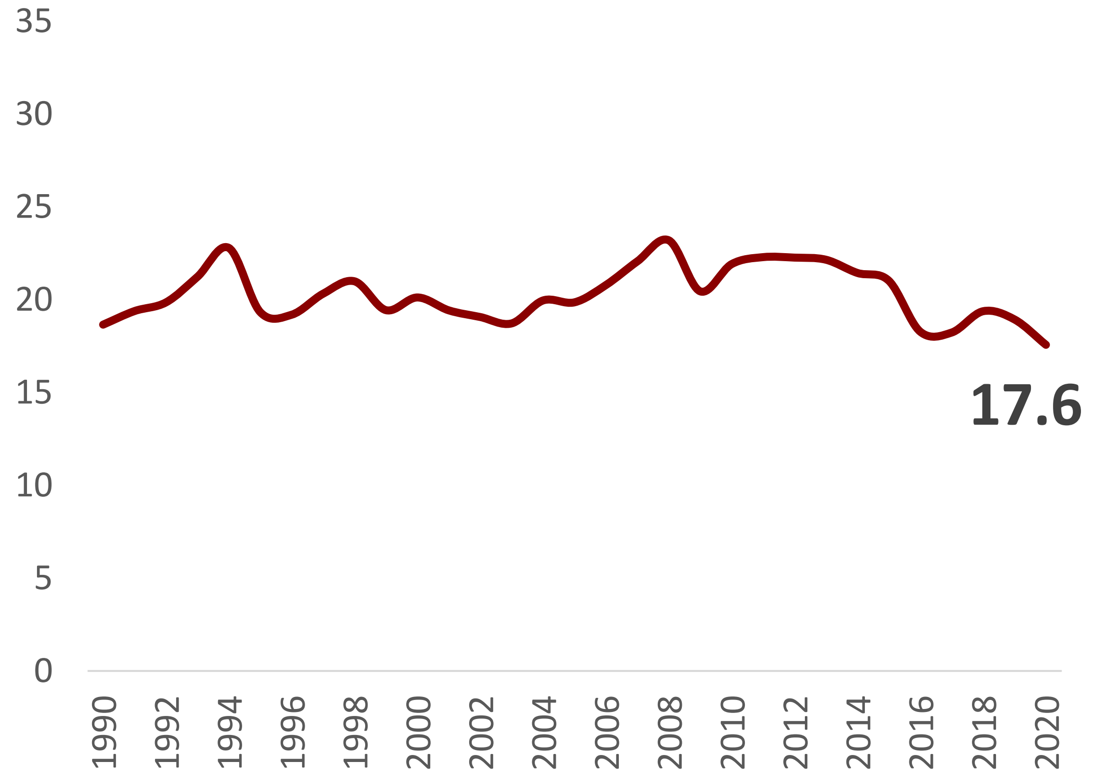
- Maintaining emergency transfers (emergency basic income) in 2021.
- Supporting MSMEs.
- Investment that is intensive in decent work in strategic sectors, with gender equality.
- Incentives for productive development, with a view to the digital revolution, sustainability and climate action, with clean technology.
- Universalizing social protection systems, health care, care and education, which will require increases in public spending over time.

IT IS VITAL TO REVERSE THE DECLINE IN INVESTMENT: THE RATIO OF INVESTMENT TO GDP IS THE LOWEST IN THE WORLD

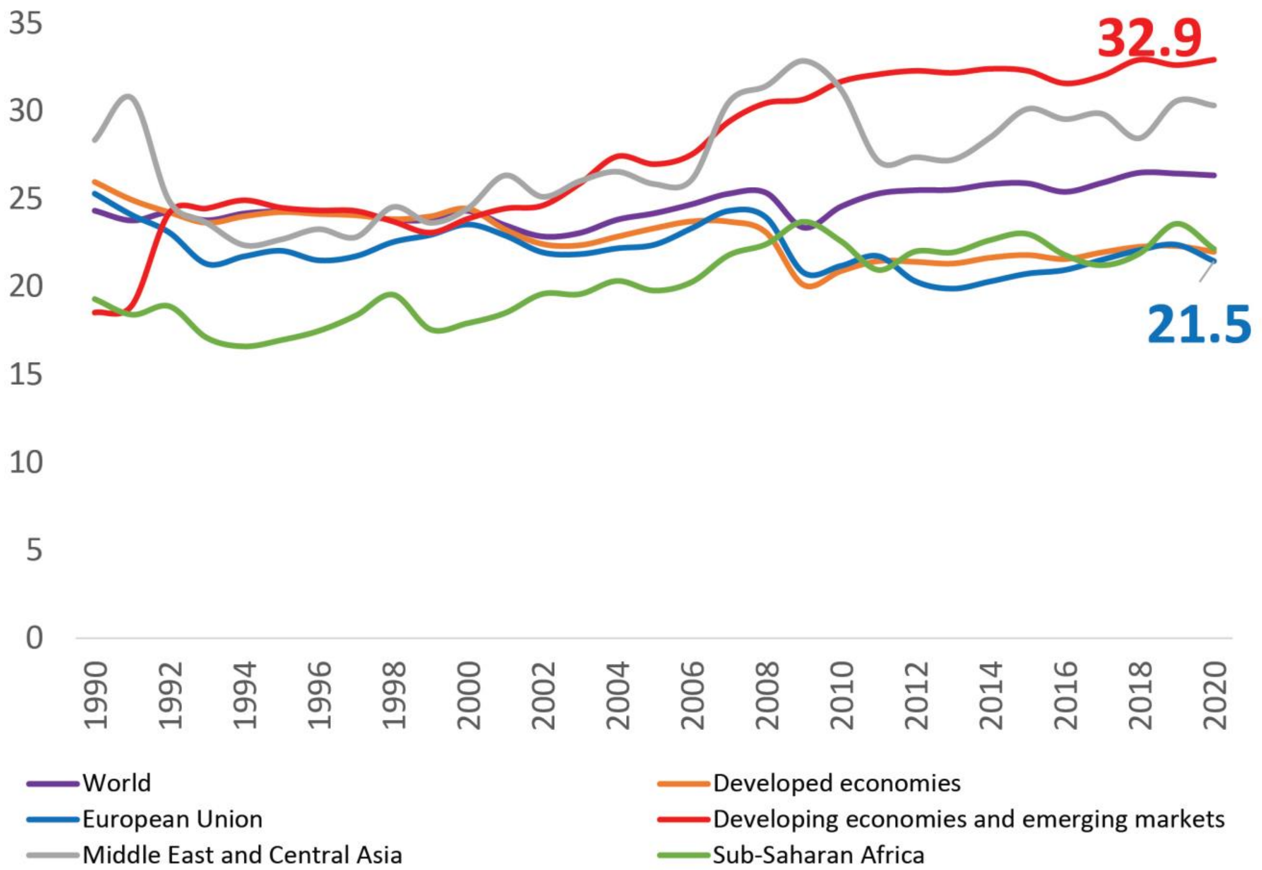
RATIO OF INVESTMENT TO GDP

(Ratios on the basis of current dollars, percentages)

LATIN AMERICA AND THE CARIBBEAN



WORLD AND OTHER REGIONS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and International Monetary Fund (WEO, April 2021).

A STRATEGIC APPROACH TO INVESTMENT

- Beneficial interactions among the construction of welfare states with production transformation, with technological change, formal employment and endogenous capacity-building.
- ECLAC has identified eight sectors to drive the new pattern of development, to boost competitiveness and employment, and reduce environmental footprints and socioeconomic and gender inequality.

A STRATEGIC APPROACH TO PUBLIC SPENDING MUST MAINSTREAM GENDER TO REDUCE INEQUALITY

Earmark spending for policies to reduce gender inequality in the response to the crisis and the long term

- Analyse gender distribution effects of fiscal policies (income, spending and investment) and mainstream gender throughout the budget cycle.
- Assign sufficient resources for key policies and services for women (comprehensive care systems, universal access to emergency basic income and social protection).
- Ensure that budget reallocations or cuts do not affect financing for gender equality policies.

Pursue fiscal measures to protect the income and employment of women who have been affected by the crisis, and their participation in the recovery

- Invest in the care economy and measure multiplier effects on labour force participation of women, redistribution of time and income.
- Prioritize sectors which have been affected by the crisis and are intensive in innovation and technology, with a high proportion of women.
- Public procurement that prioritizes SMEs in which women participate.
- Financial inclusion for women’s companies.
- Fiscal investment for digital inclusion of women.

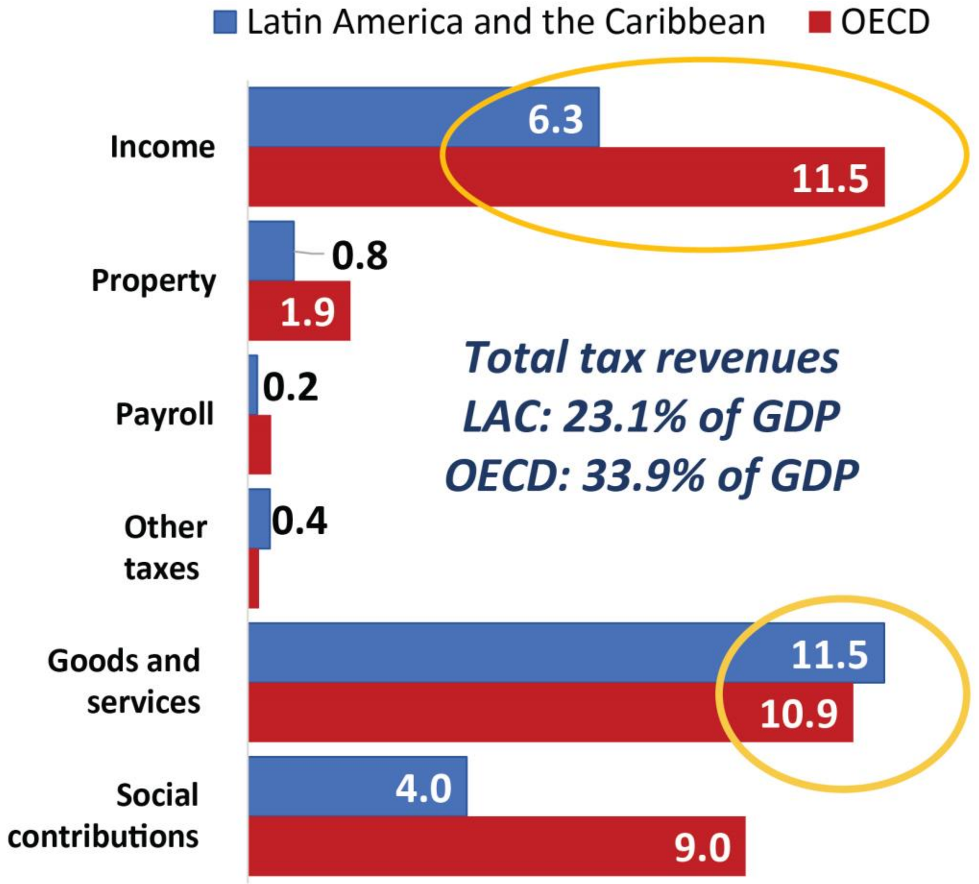
Tax policies to increase fiscal space, improve income distribution and maintain the sustainability of spending trajectories

ALTERNATIVES TO IMPROVE THE TRAJECTORY OF PUBLIC REVENUES AND THE REDISTRIBUTIVE CAPACITY OF TAX POLICY

- **Eliminate spaces for tax evasion:**
  - *Tax non-compliance 2018: US$ 325 billion, 6.1% of GDP*
  - *Reduce avoidance and evasion by multinationals and individuals through tax havens and profit shifting*
  - *Multilateral agreements to reduce tax evasion and illicit financial flows*
- **Multilateral agreements to set a worldwide minimum rate for corporate income tax**
- **Solidarity or wealth tax, on substantial gains during the pandemic, to finance the response to the emergency**
- **Assess tax expenditure (3.7% of GDP) and refocus it on the Sustainable Development Goals**
- **Consolidate personal and corporate income tax**
- **Extend the scope of taxes on wealth and property**
- **Taxes on the digital economy, environmental taxes and taxes relating to public health issues**
- **Revise and update royalties for extractive industries**

LATIN AMERICA AND THE CARIBBEAN (25 COUNTRIES) AND OECD COUNTRIES: GENERAL GOVERNMENT TAX STRUCTURES, 2018

(Percentages of GDP)



IN THIS CONTEXT, WEALTH TAX IS AGAIN BEING DISCUSSED AT THE GLOBAL AND REGIONAL LEVELS

- **Wealth tax** is a form of tax on property. It is generally applied to net wealth —the difference between the value of all the possessions and rights of a person (assets) and the value of their debts (liabilities)— but in some cases also to gross wealth (without deducting debts).
- **United States:** proposed annual tax of 2% on net wealth of between US$ 50 million and US$ 1 billion, with an additional 1 percentage point (total rate of 3%) for wealth exceeding US$ 1 billion.
- **Latin America: three countries already applied wealth tax before the pandemic:** Argentina (gross), Colombia (net) and Uruguay (net).
- **Argentina: Special wealth tax** to finance the cost of the pandemic, on the wealth of persons with assets worth more than approximately US$ 2.4 million.
- **Bolivia: Recurring tax on large fortunes** applicable to individuals whose wealth exceeds approximately US$ 4.4 million.
- **Chile: Planned one-off tax on wealth** exceeding US$ 22 million to finance the costs of the pandemic.

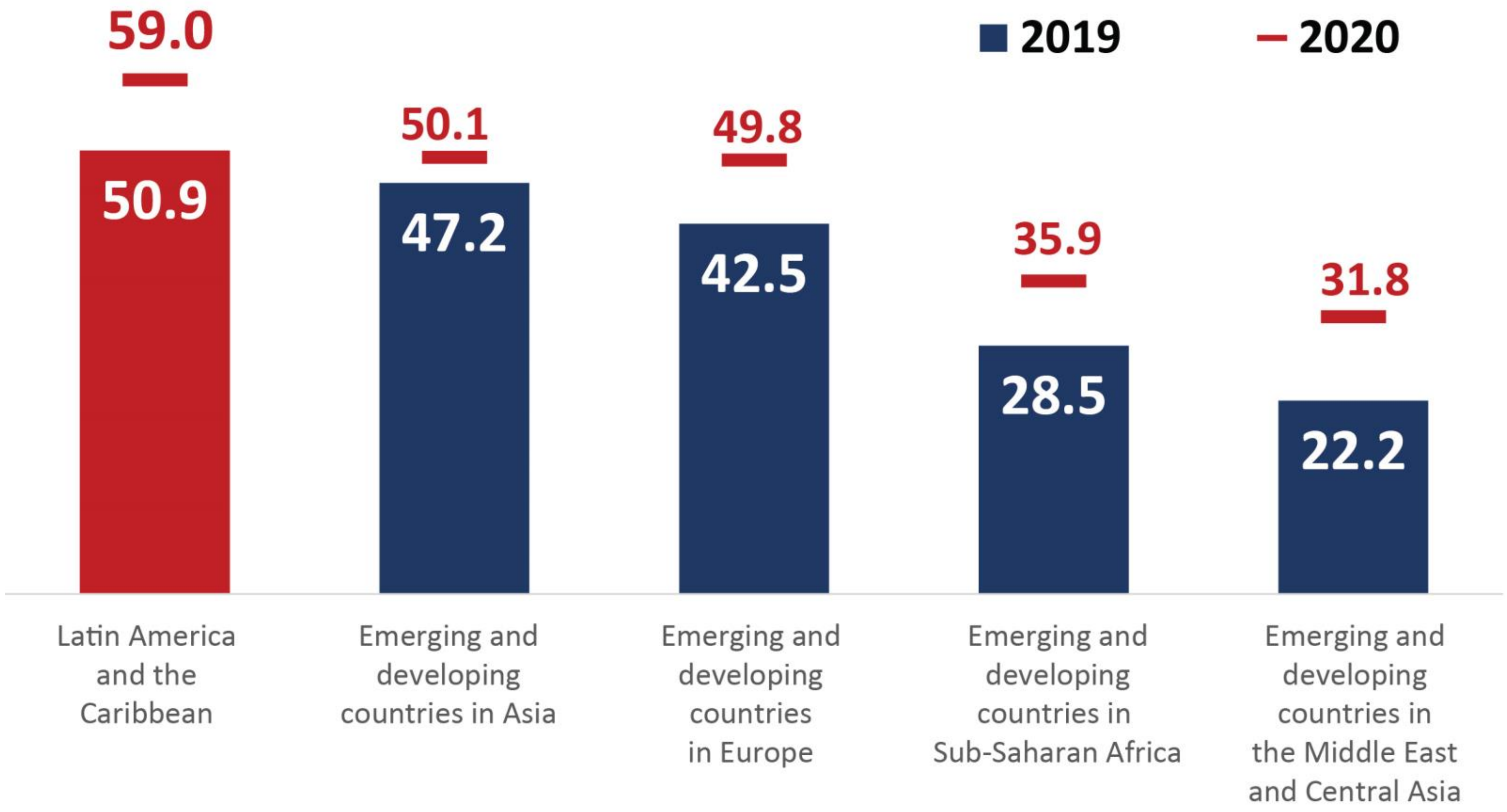
Assess the scope of taxes on property and wealth in a context of low tax revenues, tax structures that are progressive to a limited extent, growing inequality and a need to cover the cost of the pandemic

Financing for development

THE REGION OF THE DEVELOPING WORLD WITH THE HIGHEST LEVEL OF EXTERNAL DEBT SERVICE IN RELATION TO EXPORTS OF GOODS AND SERVICES

EXTERNAL DEBT SERVICE FOR REGIONS OF THE DEVELOPING WORLD, 2019 AND 2020

(Percentages of exports of goods and services)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of IMF 2021, *World Economic Outlook, April 2021*.

- Latin America and the Caribbean spends **an equivalent of more than half of its exports of goods and services** on external debt service.
- Debt service is particularly high for the smallest economies:

  In the **Caribbean**, on average, debt service is equivalent to **30% of government revenues.**

INCREASING FISCAL SPACE REQUIRES EXPANDING AND REDISTRIBUTING LIQUIDITY FROM DEVELOPED COUNTRIES TO DEVELOPING COUNTRIES

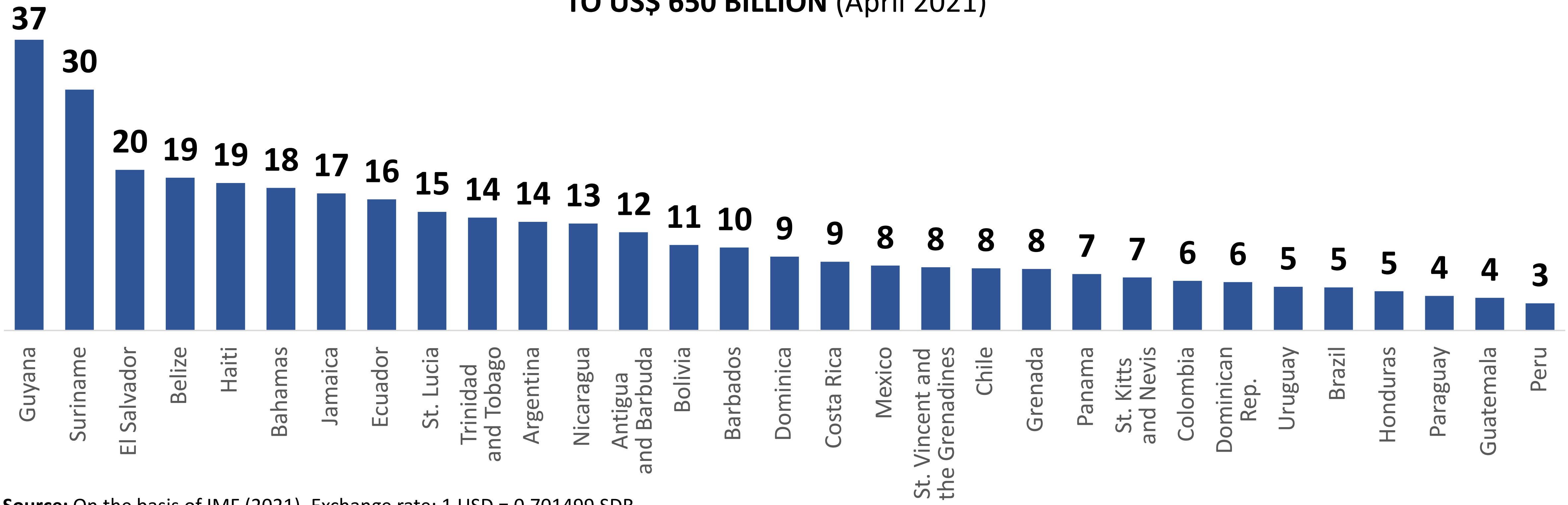
- Massive issuance of special drawing rights (SDRs) and voluntary reallocation of unused SDRs but through new mechanisms and criteria, for example the creation of a new trust fund.
- SDRs present a number of advantages compared to other IMF credit facilities and lines of financing:

SDRs are **imprescriptible and automatic** rights of all IMF member countries (up to 100% of their quota)	»	Other IMF programmes depend on macroeconomic conditions (e.g. flexible credit lines) or countries' level of income (e.g. Poverty Reduction and Growth Trust Fund).
SDRs are not loans (**do not create debt**)	»	The financing facilities (including lines of emergency financing to address the pandemic, such as the Rapid Credit Facility and the Rapid Financing Instrument) involve the creation of debt.
SDRs **do not involve conditionalities**	»	All IMF programmes not associated with the pandemic or low-income countries involve conditionalities with significant social costs.
The use of SDRs **implies the application of an interest rate (0.05%) which is much lower than that of the market** and does not involve surcharges associated with the duration or the amount	»	Traditional IMF programmes such as the Extended Fund Facility involve significant surcharges depending on the duration or amount of the loan. Surcharges affect 30% of countries (including Argentina) involved in IMF programmes and are the largest source of IMF financing. They generate more than 50% of total IMF financing.

NEW SDRs CAN STRENGTHEN THE EXTERNAL POSITION OF THE REGION'S COUNTRIES, REDUCE RISK AND FREE UP RESOURCES TO ACHIEVE SDGs

- The countries do not incur the costs of accumulating international reserves, which are the main mechanism to address external shocks.
- New SDRs would benefit small and highly indebted economies.

TOTAL SDRs AS A PERCENTAGE OF RESERVE ASSETS FOLLOWING ISSUANCE OF SDRs EQUIVALENT TO US$ 650 BILLION (April 2021)



Source: On the basis of IMF (2021). Exchange rate: 1 USD = 0.701499 SDR.

NEW SDRs SHOULD BE COMPLEMENTED WITH MECHANISMS TO REDISTRIBUTE LIQUIDITY FROM DEVELOPED COUNTRIES TO DEVELOPING COUNTRIES

- At the regional level, consideration should be given to the creation of a new trust fund through which countries with unused SDRs (recently issued and older) could voluntarily or temporarily use some of them to strengthen the financial capacity of regional financial agreements and other financial institutions in the region (regional development banks).
- Multilateral and subregional development banks could participate in this initiative and benefit from the reallocation of SDRs.
- SDRs could increase the capacity to leverage resources.
- Development banks could issue bonds that IMF could exchange for SDRs and banks could use the SDRs to provide concessional loans.

INSTRUMENTS TO COMPLEMENT INCREASED LIQUIDITY WITH COMPREHENSIVE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

Complementing liquidity *from SDRs through the creation of multilateral funds and greater regional cooperation*

- **Fund to Alleviate COVID-19 Economics**. US$ 516 billion (3% of GDP of developing countries) for concessional loans free of conditionalities.
- Strengthening of regional cooperation by improving the **lending and response capacity** of regional, subregional and national financial institutions, and strengthening their linkages.

Institutional reform *of the multilateral debt architecture with a multilateral debt restructuring mechanism involving private investors*

- Would include **collective action clauses** to facilitate and expedite debt negotiation processes
- Would incorporate the **support** of multilateral financial institutions
- Would avoid **fragmentation and differing solutions** and the creation of more uncertainty
- Credit rating agencies

Innovative instruments *to improve debt repayment capacity and avoid debt distress*

- **Innovative instruments** that link countries' repayment capacity to:
  - Their exposure and vulnerability to natural disasters (e.g. in the case of **hurricane clauses**)
  - Ups and downs of the economic cycle (e.g. in the case of **bonds linked to national income**)
- **SDG** bonds

ISSUANCE OF SOCIAL, GREEN AND SUSTAINABLE DEVELOPMENT SOVEREIGN BONDS IN 2020

- **Ecuador:** US$ 400 million social sovereign bond to finance the “Casa para Todos” government programme.
- **Guatemala:** Eurobonds equivalent to US$ 1.2 billion, of which the first tranche of US$ 500 million was structured as a social bond targeting projects to address the effects of COVID-19 in the country.
- **Chile:** green sovereign bonds amounting to US$ 1.650 billion and operations in euros amounting to the equivalent of US$ 2.180 billion. In addition, social bonds denominated in Chilean pesos equivalent to US$ 2.111 billion for projects to support households, education, health and programmes to address the effects of the crisis.
- **Mexico:** sustainable sovereign bond linked to SDGs equivalent to 750 million euros (US$ 890 million) to finance projects in education, health services, water, energy and social infrastructure in the most underdeveloped areas.

SUMMARY: FIVE MESSAGES

1. **Public spending as a development instrument** requires the linkage of the emergency with a transformative recovery: in the short term, with emergency transfers and income and Support for productive sectors, and, in the medium term, with efforts focused on the universalization of social protection.
2. **Multilateral debt renegotiation mechanisms** for middle-income countries and the complementing of liquidity with innovative initiatives and instruments.
3. **Solidarity or wealth taxes** on those who generated substantial gains during the pandemic to finance the emergency.
4. **Sustainable public spending** with tax policies aimed at eliminating evasion, re-examining tax expenditure, consolidating direct taxes on property and wealth, green taxes and the digital economy.
5. **Fiscal covenants/policies** that enable a synergetic economic recovery with investments targeting climate action with decent work, that allocates resources to the care economy and gender inclusion.

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