

# **Policy responses to COVID-19 in Latin America: Big steps in a small space**

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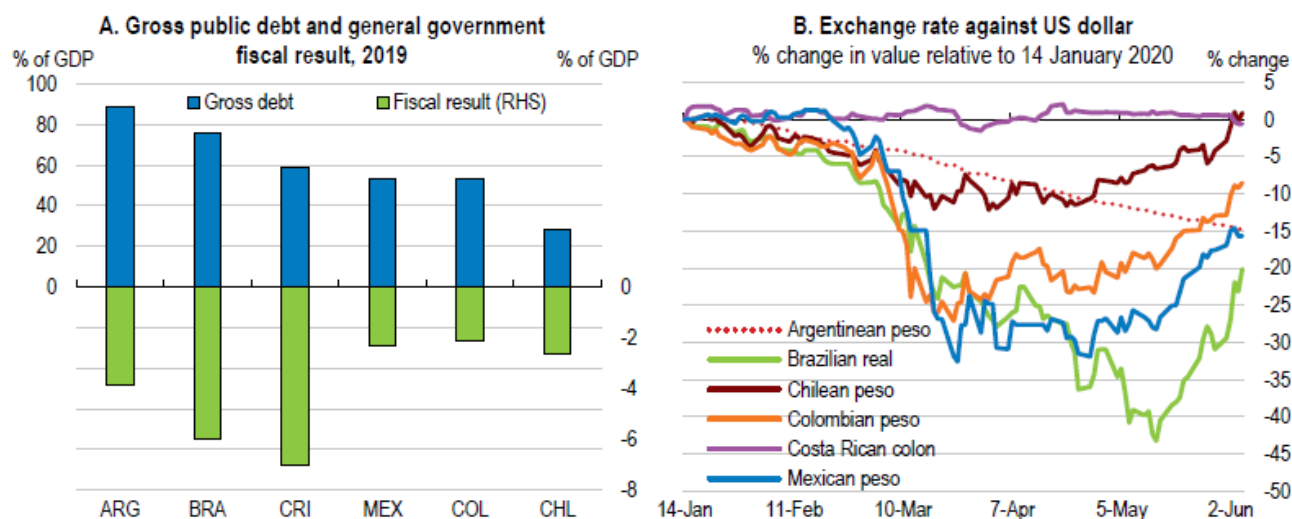
**Latin American economies are facing important challenges in the face of the COVID-19 pandemic. The outbreak will exacerbate the region's deep inequalities along many dimensions, which calls for a strong policy reaction to protect vulnerable households and firms. Still, the need for big steps contrasts with the severely limited fiscal space that most economies in the region have. Squaring this circle is not trivial, but well-designed temporary policies can go a long way to save livelihoods and prevent permanent scars, especially for disadvantaged groups.**

**Fighting poverty and inequality is now more important than ever before.** The epidemic risks inflicting greater health risks and greater economic costs on the economically disadvantaged. Distancing measures will imply income losses for those whose jobs do not allow teleworking, and these workers are on average less-educated, with limited access to health insurance, in unstable and low-wage jobs. Often without formal employment, many workers are not covered by social safety nets. Women may also bear a particularly high burden as additional childcare duties resulting from school closures may disproportionately fall on them. School closures have suspended meal provision to children, risking malnutrition with long-lasting adverse effects for some, and an increase in inequalities, as disadvantaged households have lower access to digital learning possibilities. Many low-income households will also be particularly hit by the fall in remittances, which can reach 20%, as economic activity shuts down in host

countries . Even before the pandemic, the region has seen significant episodes of social unrest, with large-scale uprisings and demonstrations taking place in Chile and Colombia.

**Fiscal space available for the policy response is severely limited across the region.** Only few countries have been able to build up fiscal buffers, for example Chile. More commonly, countries in the region face challenges related to high public debt, including Argentina, Brazil and Costa Rica (Figure 1, Panel A). Rising sovereign spreads and exchange rate depreciations have reflected the volatility of investor confidence and in some cases raised the cost of servicing foreign-currency debt (Figure 1, Panel B). Countries in the region are potentially vulnerable to sudden stops in light of external debt and current account deficits, including those that have enjoyed easy access to external financing in the past.

**Figure 1. Fiscal space is limited in major Latin American economies and currencies have lost value**

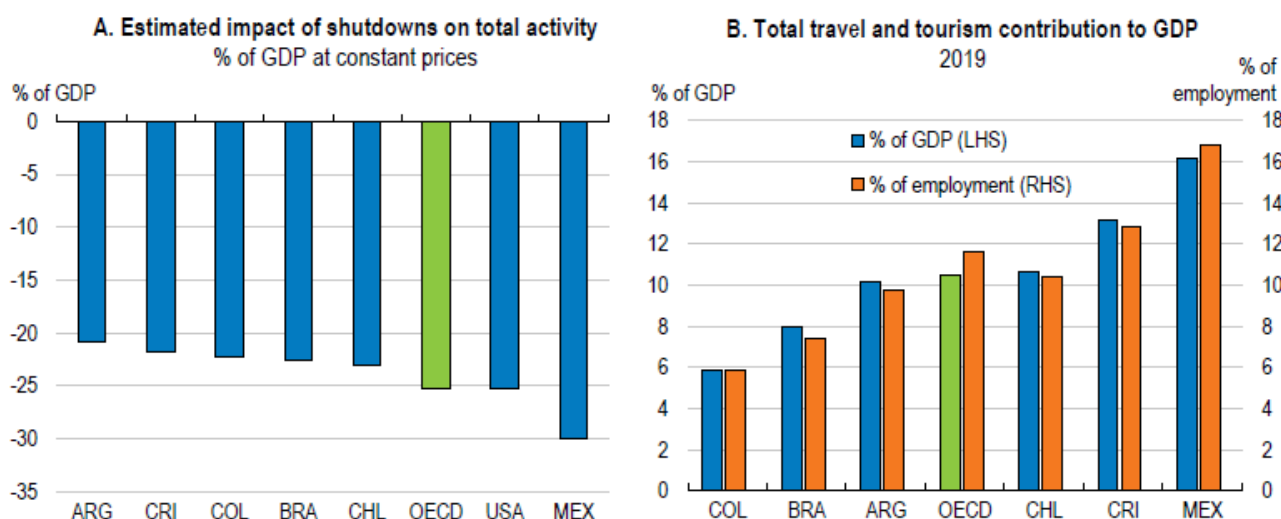


Source: IMF; National Treasury of Brazil; Thomson Reuters.

**Economic challenges associated with COVID-19 are enormous.** Domestic activity has been hit hard by the necessary confinement measures imposed in almost all Latin American countries (Figure 2, Panel A). Relatively more open economies, like Mexico, Chile and Costa Rica, also suffer from deep recessions in their trading partners. The tourism sector,

crucial for Mexico, Costa Rica and Chile, is facing a contraction with effects that are likely to persevere (Figure 2, Panel B). Remittance inflows, exceeding 2 and 3% of GDP in Colombia and Mexico, respectively, are expected to fall significantly. The sharp decline in the oil price has eroded fiscal revenues in Colombia and Mexico.

**Figure 2. A deep recession is on the horizon**



Note: In Panels A and B, OECD refers to the unweighted average of its 37 member countries. In Panel B, data are estimates.

Source: OECD policy note on initial impact of COVID-19 containment measures on economic activity; World Travel & Tourism Council.

## Policy support is crucial to save livelihoods

**Despite all these challenges, policies can provide significant relief for disadvantaged groups.** Emergency relief need not be at odds with efforts to improve fiscal sustainability, provided that the fiscal responses to COVID-19 are temporary, just like the pandemic itself. Temporary income support payments or short-time work compensation schemes can go a long way to keep families from falling into poverty or mitigate possible permanent effects on jobs. By contrast, expenditure items that are typically hard to reverse, such as new public hiring or subsidies without explicit sunset clauses should be avoided.

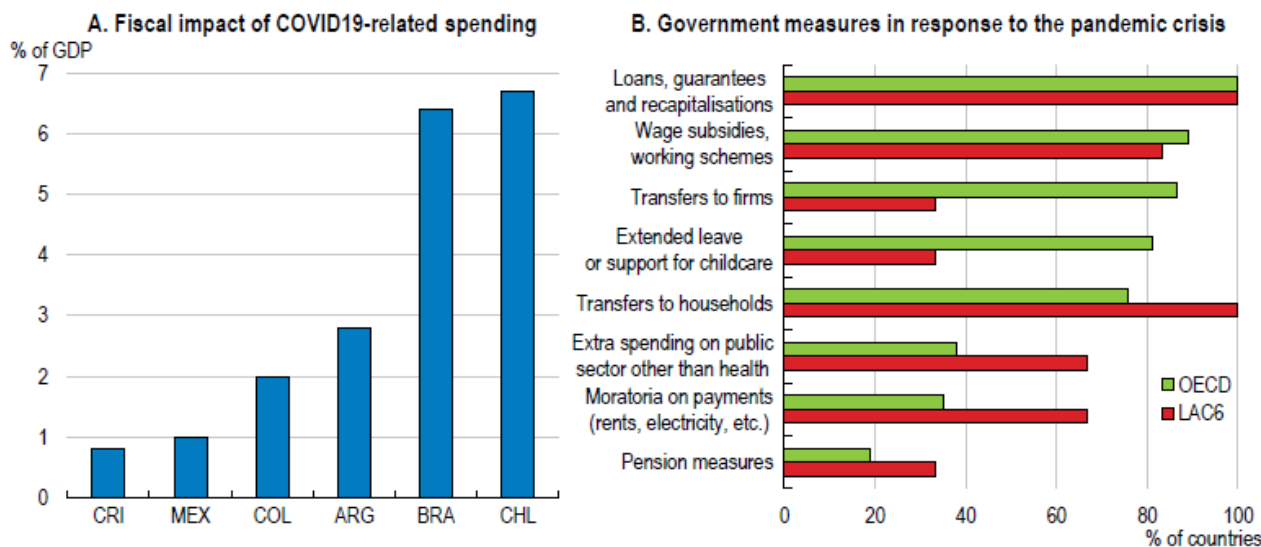
**Governments in Latin America have acted appropriately to alleviate the economic effects of the pandemic.** Pandemic-related additional public spending ranges from around 1% of

GDP to around 7% of GDP (Figure 3, Panel A). This is in addition to tax deferrals or anticipated benefit disbursements, most of which will not be visible in fiscal accounts. Spending measures have focused on strengthening health systems, but also include income support for formal and informal workers and support for SMEs, including for wage bills and loan instalments, and public credit guarantees (Figure 3, Panel B). In the short term, public deficits and debt will rise across Latin America.

**Fiscal and monetary frameworks have been strengthened over time and now is the moment to put them to work.** Fiscal rules should remain the main instrument to maintain sustainable debt paths over the medium-term, even if escape clauses may be used in the short-term. Beyond that, combining higher spending now with effective policy signals to bolster the credibility of fiscal adjustment in the future may be a good way to avoid a deterioration of financial conditions, especially as markets may become more demanding. Some countries have developed a culture of continuous policy evaluation, which should be rigorously applied to COVID-19 policy responses.

**Identifying fiscal space is challenging but possible.** Almost all countries in the region have room to focus spending more on those in need and to phase out tax loopholes that benefit more affluent taxpayers. Identifying this fiscal room may be more important now than ever, but often requires strong political leadership. Possible examples could include systematic evaluations of subsidies, tax exemptions, special tax regimes, public employment or the targeting of social transfers.

Figure 3. Policy responses and fiscal space differ widely across Latin America



Note: LAC6 refers to the following countries: Argentina, Brazil, Chile, Colombia, Costa Rica and Mexico.  
 Source: OECD Country Policy Tracker.

### Preparing for the recovery

**Now is also the time to think about policies for the post-pandemic recovery.** After the storm has passed, legitimate demands will once again need to be balanced against limited means. Strengthening social safety nets and reducing income and opportunity inequalities are long-standing challenges for Latin America. Making tax and benefit systems more progressive and effective, raising spending efficiency, reducing informality, and providing workers with the skills needed for today and tomorrow’s labour market are further key structural policy recommendations that the OECD has made to a number of Latin American countries.