



Some reflections on the main fiscal policy challenges posed by the Covid19 pandemic for Latin America and the Caribbean (LAC)

Remarks by Teresa Ter-Minassian at the VIII Encontro Ibero-americano de Coordenação Orçamentária e Fiscal Intergovernamental

Belo Horizonte, November, 18, 2020



Outline

- ▶ I am in general agreement with the key messages of Alain's, Noel's, and Cristina's thoughtful and informative presentations
- ▶ Therefore, I will use the time allotted to me to briefly outline my thoughts on three issues of special interest
 - ▶ Why is the LAC region faring worse on average than other regions in the Covid19 pandemic?
 - ▶ What more can fiscal policy do to mitigate the economic and social cost of the pandemic, and to support a sustainable recovery post-pandemic in the region?
 - ▶ Which are the main challenges facing subnational governments (SNGs) in coping with the pandemic, and the policy and institutional reforms needed to better meet these challenges?



Why is LAC faring worse on average than other regions in the Covid19 pandemic? (I)

- ▶ In the latest IMF World Economic Outlook, **real GDP is projected to decline by over 8 percent in LAC this year**, compared with 4.4 percent in the global economy as a whole
- ▶ Worse yet, **real GDP is only expected to recover by 3.6 percent next year**, compared with 5.2 percent on average in other regions of the world. This would leave it in 2021 below its 2019 level, which itself had capped several years of near-stagnation
- ▶ The IMF's projections are more optimistic than earlier ones by other international institutions, partly reflecting a better than initially expected performance in the third quarter of this year
- ▶ But they are subject to **serious downside risks**, connected in particular with foreseeable adverse spillovers on the region from the ongoing strong second wave of the pandemic in the US and Europe
- ▶ To be sure, **the picture is not homogeneous within the region**. The decline is projected to be lowest in Guatemala, Paraguay and Uruguay. In contrast, Argentina, Ecuador, Mexico, Peru, and most Caribbean countries are experiencing worse than average falls in output



Why is LAC faring worse on average than other regions in the Covid19 pandemic? (II)

- ▶ **The relatively poor performance of LAC reflects**, in addition to well-known and long-standing structural problems, **policy and institutional weaknesses that have become more damaging in the pandemic context.**
- ▶ These include:
 - ▶ **Serious deficiencies in health care systems** in many countries of the region
 - ▶ **Logistical difficulties in providing adequate income support to households** impacted by Covid19-required restrictions to mobility and activity, in an environment of high labor informality
 - ▶ **A social and political context characterized by sharper than usual tensions**, and even turmoil, in a number of countries in the region
- ▶ As highlighted in Noel's presentation, **the social cost of the pandemic is staggering**, and threatens to undo much of the progress in reducing poverty in recent decades



What more can fiscal policy do to mitigate the economic and social cost of the pandemic, and to support a sustainable recovery post-pandemic in LAC? (I)

- ▶ **The policy response** to mitigate the economic and social impact of the pandemic **in LAC has been substantial on average so far**, albeit with significant differences across countries
- ▶ **Monetary policy has been eased in most countries**, mainly through reductions in interest rates. **Flexibility in exchange rates** has helped support exports and avoid external crises
- ▶ But, **fiscal policy has done the heavy lifting in most countries**. The IMF estimates that fiscal support measures (including discretionary budgetary and off-budget measures, and guarantees) have totaled some 8 percent of the region's GDP, and have played a key role in avoiding an even worse downturn in the region
- ▶ **The extent and composition of the stimulus have varied across countries**. It has been above average in Peru, Brazil, Bolivia and Chile, and well below average in Mexico, most of Central America, and the Caribbean.



What more can fiscal policy do to mitigate the economic and social cost of the pandemic, and to support a sustainable recovery post-pandemic in LAC? (II)

- ▶ The job is far from finished. **An abrupt withdrawal of fiscal stimulus in 2021 should be avoided to the extent possible**, because it might jeopardize the incipient economic recovery and plunge more households into poverty
- ▶ **At the same time, however, most (albeit not all) countries face tight constraints on their fiscal space, due to, among other factors:**
 - ▶ **Relatively high levels of the gross public debt** (estimated by the IMF to average more than 80 percent of GDP for the region as a whole, compared with a 62 percent average for emerging and middle income countries)
 - ▶ **A positive differential between real interest rates and GDP growth rates** (a key determinant of adverse public debt dynamics)
 - ▶ **Deficit financing possibilities** limited by non-investment grade ratings and by shallow domestic capital markets



What more can fiscal policy do to mitigate the economic and social cost of the pandemic, and to support a sustainable recovery post-pandemic in LAC? (III)

- ▶ Against this background, **creating fiscal space** for tapering the fiscal stimulus only gradually, and for supporting a lasting recovery over the medium-term, **is likely to require a multi-pronged effort:**
 - ▶ **A credible commitment to sustained fiscal consolidation over the medium term.** Gaining such credibility will not be easy, given the long history of policy volatility in most countries of the region. An early approval of the structural fiscal reforms most needed in each country to reduce deficits over the medium term would be important in this respect
 - ▶ **Tax policy and administration reforms** of the types discussed in Noel's and Cristina's presentation, that would generate additional revenues in an efficiency- and equity-friendly manner
 - ▶ **Policy and institutional reforms on the spending side** that would reduce rigidities, facilitate reallocation of budgetary resources to needed investments in human capital and infrastructures, and exploit the substantial existing scope for efficiency gains
- ▶ The specific menu of reforms should reflect the economic, institutional and socio-political context of individual countries



Main challenges facing SNGs in coping with the pandemic and its aftermath (I)

- ▶ Unfortunately, cross-country information on recent and prospective developments in subnational finances in LAC and in other regions remains spotty
- ▶ The limited information available so far suggests that the impact of the pandemic on subnational finances has varied significantly both across and within countries, reflecting differences in:
 - ▶ The sensitivity of subnational own revenues to the economic downturn
 - ▶ The extent of responsibilities in the areas of health care, education, and social assistance assigned to SNGs
 - ▶ Subnational institutional capacities to meet these responsibilities
 - ▶ The degree of support to SNGs by the central government through increased transfers, loans and guarantees; and through effective policy and administrative coordination; and
 - ▶ The scope for deficit financing. Fiscal rules constraining such scope have been suspended in many countries, but SNGS' market access has become more difficult in most cases



Main challenges facing SNGs in coping with the pandemic and its aftermath (II)

- ▶ **In many countries, central governments have taken the brunt of the fiscal impact of the pandemic to date.** They also have put in place reasonably **effective mechanisms of coordination with SNGs**. This conference offers an opportunity to learn from successful cases in this area
- ▶ **Going forward, however, tighter fiscal constraints on central governments will likely require increased efforts by SNGs to create their own fiscal space** for much needed public investments in social and productive infrastructures of their responsibility, including essential investments in digital technologies
- ▶ As Noel's and Cristina's presentations have emphasized, **there is significant scope in LAC countries to:**
 - ▶ Strengthen subnational own revenues
 - ▶ Streamline and reform intergovernmental transfers, to make them more equitable and incentives-compatible
 - ▶ Increase flexibility and efficiency of subnational spending; and
 - ▶ Improve SNGs' access to sustainable financing of investments, through better-designed and enforced subnational fiscal rules



Muito obrigada!