LATIN AMERICA:
AN AGENDA FOR RECOVERY
The COVID-19 pandemic is having unprecedented economic and social consequences across the world. Latin America is one of the regions that is suffering the most from this crisis and forecasts estimate that recovery will be slow and fragile. The elements of structural vulnerability that Latin American economies were already suffering from before the outbreak of the pandemic pose an added risk and limit the capacity of economic policies to deal successfully with the pandemic crisis. This report provides an in-depth examination of these and other related issues and makes recommendations on which policy objectives should be pursued in this context.

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1. INTRODUCTION

a. Short-term economic impact of the pandemic in Latin America

The global COVID-19 pandemic is having enormous human, social and economic costs in developed, emerging and developing countries alike.

The COVID-19 pandemic has resulted in incalculable loss of life and is having an unprecedented economic impact. According to the latest forecasts, global GDP could fall by more than 5% by 2020, and for Latin American countries as a whole this figure could rise to 9%. This slump in economic activity and the expected slow and fragile recovery jeopardise the progress made in the Latin American region over the last twenty years in terms of poverty reduction and improvements in income distribution and the functioning of institutions.

According to recent data from the OECD and CAF, poverty will rise by 4.4% this year in Latin America. Losses in terms of per capita income will be such that they will return to the levels of a decade ago. The impact of both phenomena is expected to be uneven, with a much greater impact on the 40% of workers who do not have access to social protection or to the assistance put in place in most economies to contain the impact of the pandemic crisis.

In addition, an estimated 2.7 million businesses, most of them small, are already at risk of closure, which could result in the loss of more than 8.5 million jobs.
The region’s governments are using up, if they have not already done so, the limited fiscal space available to them in the investments needed to safeguard the productive fabric, jobs and the welfare of families, especially the most vulnerable ones. The packages of fiscal measures put in place for this purpose, which on average represent close to 4% of the region’s GDP, and the lower levels of tax collection resulting from the crisis have significantly increased the primary deficits of Latin American economies (by around 5% on average). In turn, these deficits are being financed by higher levels of debt, which is expected to increase, on average, by around 10 GDP points by the end of this year.

On the other hand, Latin American countries are exposed to market swings and uncertainty when accessing financing. If interest rates rise, adding the effect of exchange rate volatility to the cost of debt service, as already occurred in March and April, debt levels could become unsustainable (above 80% of GDP) in a large part of the region’s economies. The expectation that this will happen is already leading to widespread cuts in the credit ratings, including changes to negative outlook, of economies such as Chile, Colombia, Mexico, Costa Rica and Trinidad and Tobago.
The channels of transmission of the economic impact of the health crisis are well known, however they have rarely manifested themselves all at the same time and throughout the region:

- **Falling exports and commodity prices.** According to ECLAC, the value of Latin America's exports will fall by 15% by 2020.

- **Capital flight.** The IMF estimates that between January and March 2020 there were capital outflows of more than 30 billion dollars, which has had a significant impact on some of the most representative currencies. For 2020 as a whole, foreign direct investment is expected to fall by 50%.

- **Tourism plummets.** The fall in visitors and revenues will be generalised, although it will affect the Caribbean and Central American countries to a greater extent, where tourism accounts for more than 10% of GDP in many of their economies.

- **Fall in migrant remittances.** These remittances are highly dependent on the economic situation in the United States and Europe, where the largest number of Latin American emigrants are concentrated and where the economic impact of the pandemic crisis is very high. For 2020 as a whole, remittances are expected to fall by 30% compared to 2019.

- **Short-term financing problems.** The situation of the main Latin American economies had not been particularly buoyant in 2019, with Argentina and, to a lesser extent, Ecuador probably being the most dramatic cases due to their difficulties in meeting their debt commitments. The dismal growth prospects, the difficulties to increase tax revenues and the size of the credit stock in the regional economies make investors fear a possible credit crunch in some of the countries in the region.
Compared to other regions of the world, the expected impact of the crisis in Latin America will be much more severe and the recovery much slower. In addition, GDP per capita levels have been languishing since 2015 and are not expected to recover until 2025. In this context, it seems clear that Latin America is on the verge of another 'lost decade'.

The future does not look bright, and in order to weather this crisis, Latin America must face the short term with determination and the long term with far-sightedness.

Addressing the health crisis remains the top priority to avoid further loss of life and a greater short-term impact on the real economy. The existence of significant vulnerabilities in many of the region's health systems only reinforces this need.

Furthermore, this crisis has revealed the importance and the need to address the region's structural deficits (health, savings,
pensions, social protection, labour market, etc.), which have now worsened.

Just as the previous health of patients affects their ability to recover from the coronavirus, so too the macroeconomic health of countries is a determining factor in their chances of post-crisis regeneration. This paper argues for a recovery based on structural reforms of the region’s economies aimed at strengthening their efficiency, competitiveness, resilience and sustainability.

**b. Economic policy objectives and the need for international cooperation**

Latin American economies face the COVID-19 pandemic with elements of additional structural vulnerability that limit the effectiveness of national economic policies to counteract the most pernicious effects of the crisis in the medium term.

The fundamental objective of economic policy must be to engage citizens in building a more productive, greener and more caring society, while respecting and strengthening macroeconomic stability. In this sense, a recovery programme for Latin America needs to consider the following aspects:

- **On the side of the real economy,** the programme must address the vulnerable citizens most affected by the COVID-19 crisis and contribute to the recovery of lost demand and productive capital through structural reforms that allow for increased productivity. This objective has time as its main operational constraint: the longer the temporary shock lasts, the more the productive fabric will suffer and the more previously viable economic relationships will break. All this will have a direct impact on the future growth potential of regional economies.

- **On the financial side,** the priority is to prevent the current crisis from evolving into a financial crisis. Historical experience, also in Latin America, shows that financial crises are more persistent
and end up damaging the real growth potential of the economy, with all that this implies for the generation of employment and opportunities for the population as a whole, in general, and for the most vulnerable, in particular.

Unfortunately, the room for manoeuvre of local monetary policies to meet these needs is limited by the lack of anchoring of inflation expectations in some economies, the limited development of local currency financial markets, the currency mismatch in corporate indebtedness, tensions in foreign exchange markets and capital outflows in an environment of loss of confidence in international markets.

All this shapes a scenario in which market solutions alone will not be able to solve the challenge of financing the high deficits and debts that will emerge as a result of the crisis. Nor will regional cooperation be sufficient, so it is necessary to articulate internationally coordinated measures to try to fully insert the countries of the region into the environment of extraordinary liquidity and financial support that most advanced countries are developing for their economies and which, in this context, can generate positive external effects for those economies that cannot replicate these same conditions domestically.

This is not a request for solidarity with the region, but rather a question of health and economic efficiency. The Ibero-American Community, with four countries participating in the G20, is embedded in the global agenda. The globalisation of value chains, migratory movements, capital invested in the region and its structural vulnerabilities make it a major global player whose stability and prosperity are in everyone’s interest.
c. Liquidity and the need to create fiscal spaces

A necessary condition for meeting the above objectives is the availability of instruments to meet the growing liquidity needs of the most vulnerable households and businesses. Ideally, these needs should be met by the local banking system. Liquidity is clearly the region's most immediate problem.

The region has internal levers that need to be activated, but they will certainly be insufficient given the depth of the economic crisis that the pandemic is causing which, at the time of writing, is still escalating in much of the region. This insufficiency requires coordinated international action in order to be eliminated.

The generation of fiscal space is another necessary condition to tackle the public spending programmes that will have to be used to promote reconstruction and the subsequent economic and social recovery. The large current expenditure involved in managing the health crisis will impose a severe budgetary constraint on the countries of the region during 2021 and 2022, limiting their capacity to invest in recovery.

Increased investment in economic or social infrastructure is not only relevant to stimulate aggregate demand, but also to generate beneficial impacts on productivity, long-term growth and social inclusion. In this regard, public funds are also needed to further strengthen guarantee systems as a way to promote firms’ access to credit, which is a prerequisite for them to expand employment and production.

Fiscal packages to contain the COVID-19 crisis in Latin America represent around 4% of GDP. This contrasts with the situation in Europe and North America, where fiscal packages average around 15% of GDP. The financing of the deficits resulting from the implementation of these measures in these large economic blocs is being partly facilitated by the significant capital flight from emerging countries that occurred at the onset of the crisis. The placement of debt in secondary markets to finance these
imbalances is also being facilitated by the very aggressive quantitative easing policies that the American and European central banks have put in place. While these policies will not prevent significant declines in economic activity this year, they will hopefully facilitate a rapid recovery once the pandemic is contained and supply constraints are lifted.

Rising fiscal deficits and debt levels in North America and Europe will continue for several years, but unlike Latin America, these regions will be able to continue to finance their imbalances thanks to the low interest rates driven by their central banks' Quantitative Easing policies. The private sector is also benefiting from the expansionary nature of these policies put in place by the American and European central banks. Quantitative Easing measures aimed at facilitating access to credit and guarantee programmes are helping to sustain the private sector.

In short, Latin America is facing a very complicated situation marked by the fiscal and debt problems resulting from the COVID-19 crisis and the need to rebuild its economy. Moreover, it is facing this situation at a clear disadvantage compared to more advanced countries which have a greater capacity to introduce expansionary fiscal and monetary policies to aid recovery.

Given the historic ties between these regions and the interdependence of their economies through migration, trade and investment flows, there is a mutual interest in strengthening international cooperation in order to overcome the unprecedented development challenges posed by the COVID-19 crisis.
2. THE IBERO-AMERICAN COMMUNITY AND THE GLOBAL AGENDA OF THE G-20

Despite the region's enormous heterogeneities of all kinds and the constant attempts to fragment the region, the dream of a Latin America that uses its full potential in an intelligent and integrated manner persists. Only from the communion of interests and the strength that comes from integration will Latin America be able to consolidate and increase its space in the global agenda. In this sense, the four Ibero-American countries participating in the G-20 are invited to act in a coordinated manner in this forum, exercising the leadership required for the defence of regional interests.

As has already been made clear, this crisis is extraordinary for many reasons, one of the most obvious being the immediate impact on the countries' social structures, which makes subsidy mechanisms and/or cancellation of obligations necessary to provide liquidity directly to those most affected by the pandemic.

International financial cooperation is essential for the provision of liquidity and the generation of sufficient fiscal space to address the most immediate challenges facing the region. In our opinion, a coordinated action between the world’s major economies and those of the region should be considered in order to propose schemes that would temporarily alleviate the debt burden of the most affected countries, conditional on the release of funds to counteract the effects of the pandemic. It is clear that any such scheme should in any case preserve the interests of investors and avoid complicating market access for issuing countries. On the contrary, this proposal should be designed to help maintain the sovereign bond ratings of the region's countries.
There are several options for channelling international financial cooperation to allow for a sustained recovery in Latin America. The following are different possibilities, some of which are more feasible in the short term and others more oriented towards the medium term, but which need to be implemented immediately in order to be operational as soon as possible.

a. Safety nets against Latin America's financial vulnerability: The role of the IMF and Multilateral Banks in the aftermath of COVID-19

The IMF has acted swiftly since the beginning of this crisis and in our view should consider making full use of its $1 trillion lending capacity to help the economies most affected by the pandemic.

So far, the IMF has approved requests for emergency financing totalling $25 billion. This includes $5.5 billion for 17 countries in the Caribbean, Central and South America. New Flexible Credit Lines have been approved for Chile and Peru, and Colombia's line has been renewed, increasing precautionary lending to the region to $107 billion.

We join the voices that defend that the IMF should expand its extraordinary lines and assume an additional issuance of up to 1 trillion of Special Drawing Rights (SDR), so that the exceptional conditions of access to liquidity created by the Quantitative Easing policies in the central countries can be extended as long as necessary also to all emerging economies, and in particular to Latin America.

Finally, even though its effect is more long-term, an IMF capital increase should be considered as a shield against the prolongation of the crisis and to be more responsive to future pandemics or any other circumstance with a global impact.

The IMF should also be closely involved in economic policy advice. Latin American governments must begin to develop ambitious
plans for the time of recovery and can benefit greatly from the global experience that the IMF can provide.

Such cooperation can also be channelled through multilateral lending institutions, such as the IDB or the CAF, which have played and will continue to play an important role during the crisis and in the coming years by choosing sensitive projects for the region and providing the necessary credit and guarantees.

However, these institutions are also facing limits that inhibit them from taking more aggressive positions, given their capital constraints and the fact that they are subject to market rules, which prevent them from being more proactive without damaging their financial sustainability and credit rating.

In part, this could be solved by increasing their own funds with contributions from central countries. It is clear that this is a measure that takes time and that, based on past evidence, would not be operational for several years, but it is considered necessary in order to play a significant role in the region's recovery agenda.

In this way, for very limited amounts compared to the enormous total increase in public spending that is taking place, a lasting capacity to support recovery will be available in existing institutions, with decades of proven experience in evaluating and financing high quality projects, perfectly aligned with the objectives of the global agenda and with high levels of internal governance.

For all these reasons, we propose to undertake without delay a capital increase in all multilateral banks operating in Latin America.

One possibility that could be explored would be the creation of a Special Purpose Vehicle (SPV) to which multilateral banks and countries that so decide, particularly those most interested in the region (basically the United States, the European Union and China), would provide the initial capital. This capital would be leveraged in the global capital markets by issuing AAA bonds that could be
subscribed by central banks or international funds. A permanent secretariat constituted by the partners would be responsible for selecting projects that could be financed in the region.

The advantage of this type of structure is that it takes very little time to set up and it optimises the experience in the region and the analysis and management capacity of institutions such as the IDB or the CAF, which, by keeping this financing off their balance sheets, would not see their ratings threatened.

Finally, joint financing lines between multilateral banks could be considered, such as the one structured by the IDB and the EIB a few years ago to support investments by medium-sized European companies in Latin America and vice versa.

b. The role of central banks

Recognising the heterogeneity of the possibilities of central banks in the region — as the institutional development of Latin American countries varies greatly — it is recommended, within the real possibilities of each country, to implement extraordinary liquidity provision mechanisms linked to the granting of credit to the productive sector in order to sustain economic activity at reasonable interest rates and, with it, to stop the rampant destruction of employment.

At the same time, a sound prudential regulation needs to be maintained in the region. This is the time when such schemes become essential for society, as they prevent the materialisation of the negative externalities caused by the problems of the financial institutions.

It would be desirable that, given the exceptional nature of the crisis, and recognising that it is not part of their mandates, the enormous power of the Fed, the ECB and other central banks in providing adequate financing conditions could reach the battered economies of the region, which could benefit from the conditions
at which companies and households in the world's most advanced economies are accessing financing.

The quickest way to achieve this is by extending the swap and repo network to the region's central banks, this way they would have access to foreign currency funding on preferential terms and they would be able to pass it on to the productive economy. However, many countries with shallow financial markets would not qualify for currency swaps, nor do they have large reserves to use in a repo programme. Here, the role of the IFIs or indicators of financial integration is key, and the IMF (with increased capacity) should be considered to channel foreign exchange liquidity lines to countries.
3. THE PILLARS OF AN AGENDA FOR RECOVERY

a. Regional integration of Latin American markets

'Trade between us [Latin America] is scarce. We are more integrated with the outside than with the countries of the region themselves. Regional trade relations, especially regional value chains, are essential to foster dynamic productivity growth'

(A. Gurría, Secretary-General of the OECD)

Recent data show that only 15% of Latin American and Caribbean imports correspond to intra-regional trade, while in other regional blocs in Asia and Europe this figure rises to 60-70%.

The lack of trade integration is a key obstacle to economic and productive growth in the region, therefore addressing a regional initiative to boost intra-regional trade is essential. It seems clear that one of the consequences of the pandemic crisis will be the shortening and regionalisation of value chains.

There is no doubt that significant progress has been made in the last two decades and the ground has been prepared for stronger and more inclusive growth. This is evident from the data on the value of exports from Latin America to other countries. However, these data also convey an instability that distances the region from a true consolidation of trade integration.
The contraction of international trade seems to be an inevitable consequence of the COVID-19 crisis, which is likely to accelerate the shortening of value chains and the relocation of certain links that had already been observed before the outbreak of the pandemic.

It is worth remembering that the region is coming from a bad 2019 in terms of the behaviour of export prices. Goods exports from Latin America and the Caribbean entered a contractionary phase in 2019, after two years of expansion. The region’s total external sales are estimated to have fallen by 2.4% that year, after growing by 8.7 % in 2018 and 12.2% in 2017.

Exports from Latin America and the Caribbean lost momentum in 2018. In 2019, this downward trend deepened into contractionary territory. Behind this behaviour was the evolution — also negative — of prices.
Compared to other regions, the pandemic crisis is having a much greater impact on Latin America’s intra-regional trade compared to its trade with rest of the world. Estimates for the first quarter of 2020 show intra-regional flows falling by 7.9%, more than double the contraction of their extra-regional sales (-2.1%). In the European Union and the North American Free Trade Agreement countries, the reduction in intra- and extra-regional trade is similar, although intra-European trade appears to be slightly more resilient.
All these trends suggest that strengthening intra-regional trade will be key to post-crisis economic recovery and revival.

Latin America exists. It exists as its own continent, as an economic area, as a region crisscrossed by countless common historical, cultural and other ties. The dream of a Latin America that uses its full potential in an intelligent and integrated way persists.

In the absence of a political-economic structure such as the EU, Latin America’s development as a market with potential is held back by fragmentation, which manifests itself in a lack of connectivity.

This is not only a question of infrastructure, which is surely a necessary condition, but also of economic regulation, barriers to intra-zone trade, capital and labour mobility, lack of connectivity in education and in the recognition of qualifications, etc.

Source: Own compilation based on official sources.
Note: *EU data refer to the first two months.
For all of the above reasons, greater economic and trade integration is the best start to leverage sustained growth over time and to take advantage of and optimise the region’s real weight on the global agenda.

Some specific recommendations:

- Implementing strategic cross-border infrastructure projects that multiply transaction capacity.

- Simplifying and harmonising rules of origin as a means of facilitating the region's internal trade.

- Investing in advanced logistics systems to enable the expansion of digitalisation and e-commerce.

- Ensuring mutual recognition of professional certifications and validations in order to promote geographical mobility within the region and encourage intra-regional exchanges.

**b. The financing of future investments in reduced fiscal spaces. The role of Public-Private Partnerships (PPPs) in post-pandemic recovery**

Numerous studies indicate that Latin America has great potential to develop PPP projects to help solve its infrastructure deficit. According to recent studies, in the coming decades Latin America should invest between an additional 2.5% and 5% of its GDP to close the infrastructure stock gap with other regions of the world.

In Latin America, there is a significant lack of rail infrastructure throughout the region, which hampers passenger transport, competitiveness and freight transit. At the same time, the composition of the road network, the paved network or asphalt roads, is comparatively poor.

Bearing in mind that world trade moves largely by sea, having
competitive port infrastructures is key for any economy, especially those that need to strengthen their exports. In this sense, with the sole exception of Panama, the network of port infrastructures in Latin America has ample room for improvement.

With respect to energy investments, the development of alternative energies, mainly clean energies such as solar and wind power, is an opportunity to promote greener and more sustainable growth.

In the telecommunications sector, broadband is also an important opportunity, insofar as its deployment in some countries in the region is low compared to the standards of advanced economies, which are using digitalisation as a lever for economic growth.

In any case, it would be more than desirable that all the investment programmes that are launched serve to reactivate the necessary recovery of economic growth and, simultaneously, collaborate in the fulfilment of at least one of the 17 Sustainable Development Goals established by the United Nations and to be achieved by 2030.

In this context, and taking into account the budgetary constraints that the crisis caused by the pandemic is certain to bring, PPPs — as an instrument enabling a reduction of the burden of infrastructure on public coffers — appear to be the only way to achieve the objectives of a solid recovery of the economy.

The fundamental objective of a PPP is to achieve greater efficiency and easier access to capital in order to share the risks. A PPP should always be a mutually beneficial partnership between the public sector and the private sector.

PPPs have been promoted globally as a very useful tool for States to meet their infrastructure and public service needs with the participation of the private sector. Latin America has been no stranger to the implementation of this scheme, becoming in recent years a leader in PPPs with respect to the rest of the developing regions.
Although they have not always worked well, PPPs have proven to be a good tool for maintaining the pace of investment during periods of modest economic performance. The case of Latin America is a good example: the high growth rates in the first decade of this century (around 6% on average) gave way to a sharp slowdown that limited the investment capacity of national and local governments to implement infrastructure and social initiatives.

This scenario led to PPPs gaining prominence while helping to preserve some of the social gains made during the boom years, as well as facilitating the flow of capital needed to carry out development initiatives. Chile, the most advanced country in the region in this type of partnership, combined public capital and national private funds to boost road infrastructure, achieving very good results in the development and maintenance of its road network. Similarly, Brazil, Mexico, Colombia and Peru have had extensive experience in infrastructure development through the PPP model for more than two decades.

The region as a whole must address its pending challenges and improve its policy and regulatory frameworks, institutional
governance, investment climate and new financing formulas, since the development of the PPP scheme imposes conditions that cannot be avoided.

In this sense, the countries with the longest tradition in PPPs have made progress in improving and developing both their regulatory and institutional frameworks based on previous experiences. However, one of the region’s greatest challenges in this area is to obtain sufficient resources to finance infrastructure. The proper development of PPPs requires the existence of sufficiently mature financial markets in local currency, otherwise the financial costs rise to the point of discouraging operations.

Countries such as Colombia, Brazil, Mexico, Chile and Peru have sufficiently developed financial markets to reasonably take on PPP programmes in local currency. The possibility of obtaining low-cost financing in local currency has important advantages. On the one hand, it allows countries to be free from the restrictions imposed by foreign financing and, on the other hand, it avoids exchange rate risk and the costs associated with it.

But the arrival of COVID-19 has changed the situation and social spending has reached the main items of public spending in the States with increasing tensions in their financing, jeopardising their already narrow fiscal margin to invest in infrastructure. On the other hand, COVID-19 has brought the financial markets to a standstill in the face of the uncertainty of the new reality.

This new situation demands substantial efforts to sustain and deepen a new agenda that places infrastructure as an engine of growth and its multiplier effect on the economy (20% return, according to estimates by McKinsey Global Institute). The challenge is not only to close a quantitative gap, but also to improve the productivity of these investments, and this requires additional efforts to incorporate functionality, sustainability and better evaluation and design of these interventions.

Everything suggests that the markets that finance infrastructure in Latin America could change and that we will face a lower supply
due to higher country risk. If the financial sector becomes less liquid, solutions will be needed to attract financial resources in the short and medium term. The budgetary situation in some countries is very complicated and part of these public resources may end up compensating the private sector for many of the projects already underway. A clear example of this is Colombia and its fourth generation of highways programme (4G), where there is a minimum guaranteed income in all its projects and the government will have to transfer this income to the private sector through its Contingency Fund.

In this sense, after the pandemic, the strategic approach to infrastructure investment, and especially to the use of PPPs, should consider a few points:

- The governance of PPP projects needs to be improved and harmonised, taking into account that:
  
  a. Current dispute resolution mechanisms are generally lengthy and inefficient, therefore options such as the use of arbitration should be considered. A maximum time limit for dispute resolution of no more than six months should be established.

  b. Compensation instruments in the event of termination should be articulated. The grounds for termination of contracts and instruments and, where appropriate, amounts of compensation should be clearly defined.

  c. External and independent evaluation should play a key role in analysing the financial viability of projects, appropriate risk transfer and compensation instruments.

- It will be of great importance to develop methodologies, as harmonised as possible, to help improve decision-making (project evaluation and design) and thus investment efficiency.

- An essential objective must be to consolidate a Latin American infrastructure financing market with high levels of standardisation,
depth and efficiency that will improve financing conditions by making infrastructure investment a specific asset recognised by the market.

Well executed public investment continues to be a key factor in economic confidence. In this sense, the proper planning of infrastructure investment programmes by Latin American governments, in close collaboration with regional multilateral banks, and the use of PPP mechanisms could become a key pillar to emerge from this adverse economic period, generating employment and laying the foundations for the future development of the region, bringing its countries closer to OECD standards.

c. Digitalisation to break the loop between informality and labour rigidities

According to recent reports, the extraordinary liquidity measures and other public programmes have mainly reached formal companies and the middle classes. This is due to the low financial inclusion in the region, where just over 50% of the population has a bank account, and labour informality, which is concentrated in the lower income strata.

With percentages of informal workers ranging from 25% in Uruguay or 30% in Chile to 70% in Peru and Bolivia, protection measures aimed at situations of extreme poverty and vulnerability have come up against the obstacle of the need for physical distribution, as the degree of digitalisation — already relatively low in the region — is very low in these population strata. The visible consequence has been the proliferation of crowds of people to collect payments and food, or the displacement to their places of origin when they lose their livelihoods in large cities, which has aggravated the health emergency (ECLAC, 2020).
Figure 7. Informality rates in Latin America

Notes: Legal definition of informality: informality is defined as workers without the right to a pension, health insurance, social protection, work contracts and the general entitlements of the formal sectors.
Statlink 12 http://dx.doi.org/10.1787/888933649962

Source: OECD, CAF and ECLAC

Informality is highest in sectors such as agriculture and construction, where more than 60% of workers are informal. However, other sectors that have a high weight in employment, such as services or manufacturing, also suffer from high informality. In the latter, for example, 35% of wage earners are informal.

Informality is also more prevalent among young people and those with lower levels of education and income. The average informality rate for workers aged 15-24 is 60% in Latin America as a whole, and is above 80% in countries such as Bolivia, Guatemala, Honduras and Paraguay. For wage earners with incomplete secondary education, the average in the region is 59% and it exceeds 75% in at least 7 countries. Informality in the lowest income quintile reaches 86% of workers.

It is clear that informality is a well-known structural challenge in the region and has several causes:
1. The high costs of formal employment (mainly bureaucracy, rigidity and minimum wages that are not linked to productivity) and taxation, which encourage informality as the only way to obtain short-term profitability.

2. Weak labour and tax control, which reduces the likelihood that offenders will be detected and sanctioned.

3. The perception that the benefits of being a formal worker are not sufficiently attractive.

4. The low average productivity of informal work (around a quarter of that of formal work in Peru, for example, according to BBVA Research), which is related to the comparatively low educational level of informal workers.

5. A civic spirit that does not sufficiently condemn dishonesty or lack of transparency or promote a spirit of compliance with the law.

On the other hand, where informality dominates, there is exclusion. Exclusion from unemployment, health and welfare benefits. Financial exclusion, which stifles access to credit and limits both investment and insurance against income fluctuations. Tax exclusion, with its negative effects on the provision of public services that overburden the formal sector. In addition, structural informality distorts the allocation of resources (e.g., difficulty in hiring employees in the formal sector) and entrenches the scourge of low productivity.

It is not possible to think of an equitable recovery that fosters productivity and resilience without tackling the causes of informality. There are no simple recipes that save labour, tax and government reforms. Likewise, digital technologies are also a way to make policies addressed at reducing informality more effective, as enablers. It is no coincidence that the digitisation index of Latin American countries (for example, BBVA Research’s multidimensional DiGiX index) correlates closely and positively with per capita income and negatively with the weight of informality.
Digitalisation — i.e. good landline and mobile broadband infrastructure, accessibility, use by individuals, businesses and governments, and supported by appropriate regulation that promotes digital technologies and facilitates and protects digital identity — entails three advantages:

1. It empowers citizens by providing them with an easy, cheap and remote access to public services and transfer programmes. The resulting improved perception of public goods and services would reinforce the willingness to comply with rules, starting with registration for labour, social and tax purposes.

2. Digitalisation also empowers authorities by enabling them to reach the most vulnerable, to be more efficient and less bureaucratic, to collect taxes less expensively and more conveniently, and to be more effective in detecting and deterring irregular behaviour.

3. The incorporation of digital skills in the education system and job training processes improves human capital and wages and allows companies to have a better access to the financial system, public procurement and markets, both traditional and new. It also allows for improved procurement, production, distribution and sales processes.

A successful policy for the digitalisation of society, economy and the government require combining a series of 'small victories' or quick successes with a solid and multiannual strategy. Short-term measures (e.g., the promotion of digital identity associated with particularly popular services, tax benefits, or public procurement only for professionals or formal companies) are highly idiosyncratic and depend very much on the situation each country has as starting-point.

The medium- and long-term digitalisation strategy must be underpinned by a virtuous triangle of e-inclusion with three vertices:
1. Digital development, which includes both supply-side factors — investment in infrastructure, i.e., reliable and secure landline and mobile networks, with sufficient bandwidth and secure internet servers, as well as reduced costs — and demand-side factors — ambitious uptake in public services, as well as by businesses and individual users. Areas such as education, health, employment and unemployment, public services for businesses and citizens, and labour, tax and pension administrations should be priorities.

2. Digital regulation aimed at facilitating digitalisation (onboarding) with simple and secure digital identity systems and guaranteeing data protection with international standards of accessibility and cybersecurity. An essential part of this is the promotion of mobile solutions, with particular attention on the payment system to bring the use of cash to reasonable levels. Regulation should stimulate innovation and ensure a level playing field between new players (start-ups) and traditional companies. A minimally harmonised regulation in the region would be highly desirable, as it would act as a lever for further integration, minimise arbitrage and enable the full use of economies of scale.

3. Digital education through public campaigns and incentives from the earliest stages of training — with the help of mobile training solutions and gamification — and on a cross-sectoral basis. The benefits of digitalisation rest on prudent identity and data management.

In short, any inclusive recovery strategy in the region requires an investment in creating and strengthening digital ecosystems. This is the only way to bridge the digital divide, while bringing the majority of Latin America’s citizens into the world of economic and social inclusion, a precondition for resilience and progress.

In the face of the unprecedented disruptions generated by the pandemic, digital connectivity has proven to be a lifeline for those who have had the knowledge, access and means to move part of
the activities to the digital dimension. Thanks to telework, e-commerce, online education, e-health and e-government, the most prepared — countries like Chile, Uruguay or Costa Rica, or workers in formal sectors and the business classes in all countries — have been able to cope better with the impact of the crisis.

Digitalisation, however, must be accompanied by other measures to promote formality in employment, such as:

- Reducing the costs associated with hiring. In Colombia, a fiscally neutral reform that reduced payroll contributions and corporate profit taxes reduced the informality rate by 5 percentage points.

- Tax simplification for small businesses and the self-employed to facilitate compliance and avoid barriers to growth.

- Improving benefits linked to formal employment for workers (pensions or unemployment insurance). In this line, a reform in Uruguay that extended health benefits to formal workers and their dependents generated an increase in the formality rate of about 2 percentage points.

- Strengthening enforcement capacities.

- Improving the employability of the labour force through investment in education and training. In Brazil, increased schooling has been identified as one of the main determinants of the fall in labour informality in recent decades.

- Programmes based on cash transfers or other non-contributory social benefits should be designed with caution because they alter incentives in the labour market, causing a reallocation of employment from the formal to the informal sector.

d. An adequate legal framework for the 'second chance'

As we have seen, the macroeconomic impact posed by COVID-19 is paramount and will have — although its full effects may come with
some delay — very important consequences for business solvency. Many companies that were perfectly viable in February 2020 will find it very difficult to survive the losses caused by the interruption of their commercial life due to the lock-down.

This could lead to a wave of business crises that would threaten the survival of a significant part of the business fabric, especially many SMEs with less financial capacity. Faced with this situation, the different national legislators are responding with a series of legal reforms, including, first and foremost, bankruptcy legislation.

Although bankruptcy legislation varies greatly among the different countries of the Ibero-American Community (several countries have recently undertaken major reforms of their national legislation), this problem has common features, and therefore, in view of this situation, we will propose below some recommendations that may be of common interest:

- We propose the advisability of temporarily suspending the legal duty to request bankruptcy proceedings in those Latin American countries where such proceedings exist. The aim of this measure is to prevent a company that was solvent before the pandemic from being forced to file for bankruptcy.

- In countries where there is no specific insolvency regime for SMEs or micro-enterprises, as in the case of Spain, the implementation — at least temporarily — of specific rules for the rapid and simplified treatment of insolvency proceedings is recommended. In those Latin American countries where a simplified framework for small businesses does exist, its extension to medium-sized companies is also recommended, at least during the period of the pandemic’s greatest economic impact.

- Creditor applications for bankruptcy proceedings against affected debtors in companies that were solvent before the outbreak of the

crisis should be suspended or restricted during the pandemic period.

- In countries where there is a rule to ‘recapitalise or liquidate’ companies whose net worth is reduced to a certain percentage of share capital, as is the case in Spain and other Latin American countries, it is also recommended that this rule be temporarily suspended. This is intended to prevent solvent companies that are temporarily in losses due to COVID-19 from being forced to disappear if their shareholders do not have sufficient assets to recapitalise the entity.

- For those regulations that require the debts of directors or certain shareholders to be subordinated in insolvency proceedings, as is the case in Spain and several Latin American countries, such subordination should be temporarily suspended. Otherwise, financing companies during the crisis will become even more complicated.

- Finally, it is recommended that insolvency courts be provided with adequate material and human resources. We must avoid at all costs a recurrence of courts collapsing similar to what happened in hospitals and health-care facilities in the areas hardest hit by the coronavirus.

e. Promoting greater private social investment for a more inclusive and sustainable recovery

The pandemic is causing serious damage to the social fabric of Latin America and reversing the gains made in the fight against poverty in recent decades, with the serious risk that vulnerable segments of the population will fall back into poverty. A truly sustainable recovery will require the promotion of more inclusive economic development models that reduce the great inequality affecting the region.
The measures detailed in previous sections will help lay the foundations for Latin America’s recovery, but repairing the region’s social fabric will also require greater investment focused on social impact projects. Public investment (state or multilateral) will have to take the lead in this area, but the private sector must also assume part of the responsibility as a driver of social investment projects that facilitate an inclusive and sustainable recovery and at the same time contribute to the achievement of the Sustainable Development Goals. In this context, several axes to work on are proposed:

1. **Promoting impact investing in the region.**

Impact investing is investment that seeks social and/or environmental returns in addition to financial profit. This practice was born a decade ago, but is growing strongly (it currently has, globally, around 715 billion dollars in assets under management). In Latin America there is an incipient but very dynamic impact investment ecosystem, especially in countries such as Brazil, Mexico, Chile, Argentina and Colombia, which must be expanded and strengthened through the following measures:

1. Creating new and larger impact investment funds. Development banking, both national and multilateral, plays an important role here as a catalyst for new impact investment funds and facilitator of the development of the ecosystem.

   Increasingly more Latin American private investors and corporations are making impact investments. We call on all capital providers in the region to join this movement.

2. Promoting wholesale public impact instruments that catalyse private impact investing. Some European governments have taken up the establishment of public funds to stimulate and support the creation of private impact funds. Examples such as Innovaçao Social in Portugal or Big Society Capital in the United Kingdom.

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Kingdom are noteworthy, and could be good references for setting up similar initiatives in Latin America.

3. Promoting Payment by Results (PbR) Contracts, these are innovative social financing mechanisms in which payers by results (generally governments) agree with private investors on certain social results to be achieved and the payment of financial returns in the event that such results are achieved in an objectively measurable and verifiable way. Since the first successful PbR in the UK 10 years ago, nearly 140 PbRs have been structured worldwide, having proved effective in addressing issues as diverse as access to and quality of education, criminal recidivism, and the health and employment of vulnerable populations. Latin America has been a pioneer in conducting PbRs in emerging countries, successfully developing them in Colombia to stimulate employment. In addition, the PbR of the City of Buenos Aires is starting its last year of implementation with excellent results in youth employability. Also noteworthy are the first PbR and a Payment by Results Fund conceived in Chile. We call on all national and local governments in the region to consider PbRs as a useful tool to attract private investment to solve complex social problems.

4. Promoting the adoption of international standards for impact measurement and management by investors, such as the metrics proposed by the organisations participating in the Impact Management Project (IMP)³

2. **Promoting the development of more strategic philanthropy and a less risk-averse social investing:**

Not all social challenges in the region can be solved through profitable business models. Moreover, the vast majority of social entrepreneurs have difficulties in accessing funding because they work on complex issues or through models that have not yet been tested and do not meet the risk/return ratios demanded by investors. It is therefore necessary to:

³. [https://impactmanagementproject.com/](https://impactmanagementproject.com/)
1. Promote a greater mobilisation of ‘Venture Philanthropy’. That is, investment by willing providers of capital in exchange for the achievement of greater social impact. These include purely philanthropic actors as well as social or corporate investors who prioritise impact over financial return.4

There is a great opportunity and need for philanthropists and foundations in the region to adopt more innovative and risk-prone models of philanthropy in order to: 1) provide early-stage support to high-potential social purpose organisations to help them reach a stage of development that makes them amenable to traditional investments, thus filling the gap in the Venture Capital ecosystem for social enterprises (hence the term ‘Venture Philanthropy’) and 2) catalyse solutions with potential systemic transformative capacity.

2. Promote greater and more effective corporate philanthropy or social investment. Companies are the primary impact-creating agent, with a unique capacity to innovate, mobilise resources and scale solutions. For a deeper and more sustainable recovery, companies need to go beyond traditional Corporate Social Responsibility practices, adopting a variety of social investment strategies and instruments, whether from corporate foundations or corporate social investment funds, or corporate social venturing through corporate incubators and accelerators. International experience shows that companies can be very effective transformation agents through a variety of strategies aligning their social investments with their business (i.e. whether their social investments are in areas unrelated to their business or whether they are closely linked to it). Their ability to increase their impact will be greater insofar as their strategy and business model inherently generate social solutions that

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4. According to Latimpacto, the Latin American network of social investors, the most effective venture philanthropy is characterised by: 1) the deployment of tailor-made capital instruments (from grants, to loans, to equity, to hybrid financial instruments) that fit the needs of the social purpose organisations they support; 2) non-financial support aimed at strengthening them institutionally; and 3) active impact measurement and managem.

benefit the communities in which they operate, according to the concept of ‘Shared Value’\(^6\)

3. Developing ecosystems, public policies and legal frameworks that facilitate social investment.

Unlike traditional markets that operate in highly developed ecosystems, with financial intermediaries, professional services (legal, strategic, talent development) and developed regulatory frameworks, social entrepreneurs and investors in the region operate almost without support. It is essential that public and private actors in Latin America join forces to support the development of ecosystems that enable social investment through:

1. The development of regulatory frameworks and public policies that facilitate different forms of social investment (making it easier for foundations to make investments aligned with their mission; facilitating Results Contracts; establishing frameworks that recognise the hybrid nature of social enterprises allowing them to receive hybrid forms of financing, etc.). In this field, the work of the Global Steering Group for Impact Investment (GSG) and its National Advisory Boards (NABs) in Mexico, Brazil, Chile, Colombia and Central America should be highlighted.

2. The development of ecosystems to support social enterprises, through incubators and accelerators that help to train them and financial intermediaries that structure financing. In this area, the initiative Emprendedores frente al Covid-19\(^7\) stands out, which brings together the largest network of organisations supporting social entrepreneurs in Latin America with the aim of facilitating collaboration between them for reconstruction. Also noteworthy is the work of Sistema B\(^8\), which works to strengthen the movement of companies that promote market solutions to social and environmental problems.

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8. https://sistemab.org/
3. The development of the strategic philanthropy/venture philanthropy ecosystem in the region, supporting greater and more effective deployment of capital through the dissemination of best practices, training in venture philanthropy methodologies, and the facilitation of partnerships and co-investments in order to join forces for greater impact. This is the important role of Latimpacto⁹ the recently formed Latin American network of social investors.

4. Decalogue of proposals

The document ‘LATIN AMERICA: AN AGENDA FOR RECOVERY’ aims to provide an independent, multidisciplinary and expert view on the aspects that should be present in the region's economic recovery strategy after the crisis caused by COVID-19. The main recommendations to the authorities are summarised below.

1. **Strengthening the influence of the Ibero-American Community in the Global Agenda**, calling for greater coordination of the four countries of the Community participating in the G-20.

2. **Making full use of the IMF's lending capacity** and issuing an additional SDR 1 trillion so that the liquidity created by the Quantitative Easing policies in the core countries is also extended to all emerging economies and in particular to Latin America.

3. Undertaking without delay a **capital increase in all the multilateral banks operating in Latin America**, in particular the IDB and the CAF.

4. Using **quantitative easing** measures by national central banks that have the capacity to do so as a response to the fall in demand caused by the health crisis, conditional on the creation of corporate credit.

⁹. https://latimpacto.org/
5. Extending the network of **swaps and repos** of the ECB and the Fed to the central banks of the region, using the intermediation of the IMF so that they have access to foreign currency financing on preferential terms and can pass it on to the productive economy. It is also recommended that other ways to contribute to the stabilisation of the area be considered.

6. Moving decisively towards greater **economic and trade integration** as the best way to leverage sustained growth over time and to take advantage of and optimise the region’s real weight on the global agenda.

7. Addressing pending challenges and improving policy and regulatory frameworks, institutional governance, investment climate and new financing formulas to enhance and generalise the **development of PPPs**, thus facilitating the transition towards a **green economy**.

8. Investing in creating and strengthening **digital ecosystems**. This is the only way to bridge the digital divide, while bringing the majority of Latin America’s citizens into the world of economic and social inclusion, a precondition for resilience and progress.

9. Undertaking a reform of the entrepreneurial ‘second chance’. The **temporary suspension of the legal duty to apply for bankruptcy proceedings** in those Latin American countries where such proceedings exist, and implementing — at least temporarily — **specific rules for a quick and simplified treatment of bankruptcies** in those countries where they do not yet exist.

10. Promoting **social investment and the impact economy**, social entrepreneurship and corporate social responsibility to try to mitigate the effects of the pandemic on inequality, equal opportunities and poverty.
5. Bibliographic references

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