Executive summary

For the last five years the economic performance of Latin America and the Caribbean has been disappointing, with growth rates being barely positive on average. Supporting the trends in social spending made possible by unusually high commodity prices was becoming increasingly difficult, which confronted many countries with painful adjustments. Over 2019, social unrest erupted across the region, reflecting a widening gap between popular expectations and economic and social realities. And then, in early 2020, international oil prices collapsed. This is also when the Covid-19 outbreak unfolded.

Countries in Latin America and the Caribbean have a rich history of severe adverse shocks, including precipitous falls in commodity prices, dramatic tightening of financial conditions, and major natural disasters. The current external environment of the region bears similarities with this history, which implies that previous experience will be very valuable. But the Covid-19 epidemic brings in a new dimension, as the measures needed to contain the outbreak of the epidemic also result in a major supply shock.

The channels through which the adverse external shocks will affect domestic economies vary from country to country. Demand from China and G7 countries will fall dramatically, but potentially to different extents, with diverse implications for commodity exporters in South America and for exporters of manufactured goods and services in Central America and the Caribbean. The decline of oil prices will have deleterious consequences for countries whose exports earnings and budget resources critically depend on oil, but it will bring relief to net oil importers. Air traffic has fallen to a trickle as flights have been massively cancelled to prevent the spread of the virus. The resulting collapse in tourism will severely impact countries in the Caribbean basin, but others less so.

As for the supply shock, Latin America and the Caribbean is only in the initial stages of epidemic. While all the G7 economies saw their first cases by the end of January 2020, the first deaths in the region happened almost two months later, in mid-March. The onset of a pandemic is characterized by deep uncertainty, especially as the virus is new and its contagiousness and lethality are not well known. Because of this uncertainty, most governments have sensibly chosen to err in the direction of saving lives, “at any cost” if needed. But several months after the outbreak of the epidemic, the growing availability of epidemiological and economic data allows assessing the impact of the measures adopted. For latecomers to the epidemic, this time lag provides an opportunity to adjust the policy response.

Countries across the region have been trying to manage the tradeoff between health costs and economic costs. Getting that balance “right” requires assessing both the health impact and the economic impact of the measures that may be adopted to contain the spread of the epidemic. These measures range from national-level quarantines and population lockdowns to social distancing initiatives targeted at vulnerable population groups, such as the elderly, or to specific locations.

An estimation of the impact of general and targeted measures on the number of Covid-19 cases was conducted for this report, building on daily data from 25 countries. The results show that general containment measures always result in fewer Covid-19 cases over time than targeted measures. But both are considerably
more effective if they are implemented shortly after the first case is registered. For example, targeted contain-
ment measures adopted 15 days after the outbreak of the epidemic do more to slow down its progress than
general measures adopted after 30 days.

Assessing the economic cost of containment measures on economic activity requires high-frequency data on
economic activity. Examples include nighttime light data from satellite imageries, electricity consumption,
or the number of daily commutes as assessed by shared ridership applications. For this report, the selected
high-frequency indicator was the volume of nitrogen dioxide, as measured through satellite imageries. These
emissions are highly correlated with active combustion by vehicles and other machinery. The results confirm
that general measures to contain the Covid-19 epidemic led to dramatic declines in economic activity.

In responding to the crisis, countries in Latin America and the Caribbean do not have the fiscal space enjoyed
by advanced countries. Some were facing crises even before the Covid-19 outbreak. Economies in the region
are also characterized by higher levels of informality, which makes many of their firms and households much
more difficult to reach through instruments such as tax deferrals and wage subsidies. With limited resources
and constrained instruments, a proper design of the policy response becomes crucially important.

The hardship from the crisis will be enormous for large segments of the population. Many households live
from hand to mouth and they do not have the resources to cope with the lockdowns and quarantines need-
ed to contain the spread of the epidemic. Many workers are self-employed, and informality is common even
among wage earners. Reaching these workers through transfers is more challenging than in formalized econ-
omies. Many households also depend on remittances, which are collapsing as activity shuts down in host
countries, with migrant workers among the most affected.

The policy response needs to squarely tackle this social dimension of the crisis. The first line of response in-
cludes existing social protection and social assistance programs that can rapidly be scaled up and whose cov-
erage can be extended. Such programs might be supplemented though mobile or digital payment channels.
Food distribution programs may be considered while strong social distancing measures are in place.

The standard advice in the presence of adverse shocks is to protect workers, not jobs. This advice is predicat-
ed on the grounds that most shocks affect specific firms, sectors, or locations, and allowing sectoral or spatial
restructuring is bound to increase efficiency. However, the standard advice does not hold when an economic
shock affects the entire economy. Employer-employee matches that took a long time to build and would re-
main profitable when the economy goes back to normal may be permanently dissolved due to this temporary
shock. Job-specific human capital may be lost and ramping up production later may become more difficult.

A dual approach to protecting jobs is worth considering. Strategically important firms and sectors may get
explicit support, in exchange to a commitment to keeping their workers. Smaller firms can be reached and
triaged by banks or other intermediaries. These financial institutions may be incentivized through risk shar-
ing and guarantees, so that they ensure the availability of liquidity in a context of mounting working capital
needs.

In past crises, when the financial sector experienced solvency problems, job losses were much more import-
ant, and the subsequent recovery was severely hampered. Unfortunately, the risk of a financial crisis cannot
be ruled out in the current context. The financial sector is generally in a relatively strong position. But the
magnitude of the shocks is extraordinary. At the international level, the region is seeing larger portfolio out-
flows than at the time of the Global Financial Crisis. At the domestic level, many debtors will be unable to
service their obligations and call for renegotiations, or simply default.

Protecting payment systems is essential in this context. But even with a well-functioning market infrastruc-
ture, governments have an important role to play as coordinators. Upfront blanket guarantees for bank
deposits may help maintain the confidence of the public. Out-of-court debt restructuring may need to be
simplified, guidance on regulatory relief measures be provided, and bank resolution be strengthened. More
radical coordination measures, such as moratoria or payment deferral schedules, may be considered as well,
depending on the severity of the crisis.
A key question is who in the end should bear the losses. From an economic point of view, the answer is simple: the losses should be centralized with the government to the extent possible. Confronted with an uninsurable shock like the Covid-19 epidemic, only governments can serve as an insurer of last resort. But given the resource constraint, it is important to clearly communicate how the losses will be managed. A statement of this sort would coordinate expectations and help economic agents adjust to the new environment, serving as a social compact on how to manage the crisis. But the statement should also be realistic on what is feasible, spelling out clear priorities.

To support jobs and firms, governments may need to take ownership stakes in strategically important firms. To avert a financial crisis, they may need to recapitalize banks and absorb non-performing assets. If not adequately managed, these moves could open the door to rent seeking and political patronage. The process of acquiring and managing assets needs to be perceived as transparent and professional to maintain confidence in the government. This may also allow decision makers to take urgently needed measures without fearing prosecution in the future.

Strong arrangements need to be put in place to ensure that the acquisition and management of assets is conducted at arms’ length from politicians, building on the best examples of sovereign wealth funds and asset management companies in countries at similar development levels.

A forward-looking response to the crisis should ideally go beyond addressing immediate needs and draw out the path towards a vigorous and sustainable recovery. Well-designed emergency measures are a step in that direction. Protecting strategic sources of employment, avoiding a financial crisis and managing assets professionally will help kickstart the economy. However, despite the urgent challenges, a long-term vision is needed. Countries should seek to reclaim their long-term development agenda, with jobs and economic transformation at the center of it.