

Chapter 1

Structural macro perspective and the role of the digital transformation to overcome development challenges


The coronavirus (Covid-19) crisis has been an exceptional, unexpected and exogenous shock to Latin America and the Caribbean, where most of the countries were already suffering from anaemic or zero growth. The region confronts the crisis with structural challenges, including a vulnerable middle class, persistent inequalities, laggard productivity and constrained fiscal space. The persistence of structural bottlenecks caps the space for rapid recovery. In some countries, inequality reduction has stalled in the most unequal region in the world, and increases in poverty and indigence are expected in the context of the coronavirus (Covid-19) crisis. Against this scenario, innovative and effective actions have been implemented to contain the damage, but further efforts will be needed at the national and international level for a sustainable recovery. Digital transformation proved to be a useful tool during the pandemic, but only for some firms and citizens. If gaps in coverage, access and use are properly addressed, digital transformation will play an essential role in the economic recovery and holds the potential to help overcome the persistent challenges and spur more sustainable and inclusive development.

LAC faces the Covid-19 crisis with low productivity growth, a vulnerable middle class, an increase in poverty and persistent inequalities

The social consequences of the crisis are uneven, and affect mainly the most vulnerable groups

In 2020, extreme poverty is likely to increase by 4.5 percentage points, which means

28.5 million additional people

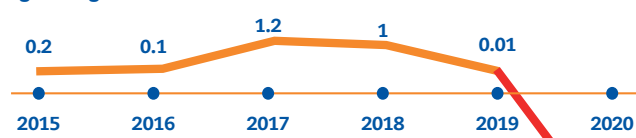


and a total of **96.2 million people living in extreme poverty**

Slow growth in recent years and the sharp decline in GDP growth projections limit the space for a rapid recovery

LAC is facing an unprecedented economic crisis


Average GDP growth in LAC




Year	Average GDP growth in LAC (%)
2015	0.2
2016	0.1
2017	1.2
2018	1
2019	0.01
2020	-0.1

The drop in GDP per capita will bring LAC back to levels similar to those of 2009


2.7 million companies are likely to close, causing the loss of 8.5 million jobs



The Covid-19 crisis is reinforcing the structural development traps that prevent a more inclusive and sustainable growth




Digital transformation is a key global trend



Digital transformation can help overcome these traps: enhance productivity, promote inclusiveness, strengthen institutions and chart a sustainable development path

Digital transformation comes with various challenges and opportunities, and can help overcoming Latin America's development traps



Introduction

Latin America and the Caribbean (LAC) is navigating challenging and historic times, as the world confronts the worst peace-time recession in a century (OECD, 2020a; IMF, 2020). The pandemic has not only cost the lives of countless Latin-Americans, but it has considerably affected socio-economic conditions, with domestic lockdown measures to contain the spread of the virus causing an immediate drop in economic activity, coupled with an unfavourable external context, including strong declines in global demand, global trade, tourism, commodity prices and a surge in financial volatility. With output projected to fall by more than 9% in 2020 (ECLAC, 2020a; CAF, 2020a), LAC is the region experiencing the biggest contraction in the emerging markets and developing economies (IMF, 2020). LAC entered the crisis following a wave of mass protests in some countries driven by deep social discontent. This was partly due to a poor economic performance, which hindered advances in social progress. Between 2014 and 2019, LAC experienced the weakest period of growth since 1950 and exhibited lower growth than the Organisation for Economic Cooperation and Development (OECD) average, with almost no expansion of the economy in 2019. This suggests that potential growth in most LAC countries was already low.

Most LAC countries responded to address the socio-economic consequences of the coronavirus (Covid-19) crisis with supportive monetary and fiscal measures from the beginning of lockdown measures. Fiscal policy is playing an essential role in mitigating negative economic and social effects and will continue to be pivotal in the subsequent recovery. Countries' ability to react to the pandemic with fiscal policy depends on their fiscal space and their access to international financial markets. Efforts to mitigate the effects of the pandemic have mainly focused on counter-cyclical measures to support vulnerable firms and households. Some central banks have eased monetary conditions by lowering interest rates and adopting liquidity measures, including non-conventional monetary measures, to promote domestic demand and facilitate business activity. Supervisory authorities also eased prudential regulations to prevent credit bottlenecks that might be caused by binding regulatory requirements amid the crisis.

Owing to the sharp reduction in economic growth, prospects for socio-economic progress have dimmed, with reduction of poverty and inequality on hold and possibly reversing in 2020. Under a scenario of a 9% contraction in GDP in 2020, poverty in LAC may rise by 6.9 percentage points (45.4 million more people), compared with the prior year, affecting a total of 230.9 million people (37.3% of the LAC population). Extreme poverty is likely to increase by 4.5 percentage points (28.5 million more people), affecting a total of 96.2 million people (ECLAC, 2020a). Similarly, after strong decreases in inequality during the commodity boom, inequality has stagnated since 2014 in the most unequal region in the world (OECD et al., 2019). Inequality is a historical and structural characteristic of LAC societies and has been maintained and reproduced over years. It is an obstacle to the eradication of poverty, to sustainable development and to the protection of people's rights and a more sustainable development model. The present crisis risks making high and persistent inequality worse. Urgent policy action, on several fronts, is needed to address its root causes and drivers (ECLAC, 2018a; OECD et al., 2019).

Socio-economic progress after the crisis will also be feeble due to the regions structural challenges that are being aggravated by the coronavirus (Covid-19) crisis. Low potential growth, low and stagnant productivity growth, a vulnerable middle class and persistent inequality are just a few symptoms of structural challenges that stand in the way of further inclusive and sustainable development and of convergence with advanced economies. The 2019 *Latin American Economic Outlook (LEO)* identified four development traps: low productivity, social vulnerability, institutional weaknesses and environmental risks (OECD et al., 2019). The mass protests of 2019 in some countries revealed the

urgency to regain citizens' trust and rebuild the social contract. The current crisis may present an opportunity to create consensus among citizens around major pending reforms. These reforms need to take into account how the pandemic is exacerbating existing development traps (OECD et al., 2019): elements to consider include the need to improve the quality and universality of health care, social protection, strengthen *ex ante* crisis response mechanisms (e.g. automatic stabilisers) and implement fiscal reforms of both income and expenditures, and clear development strategies to boost productivity, promote job formalisation and reduce dependence on fossil fuels and transition to a low-carbon development model.

The digital transformation can play an important role in tackling the health crisis, mitigating its socio-economic consequences and promoting a recovery that delivers more sustainable and inclusive development. The digital transformation refers to the economic and societal effects of digitisation and digitalisation. The digital revolution entails disruptions that are triggering innovations in business and consumption models, transforming production systems and value chains, reorganising economic sectors, generating new dynamics in the world of work, creating smart goods and services and introducing new conditions of competitiveness. It has consequences on citizens' lives, in the manner they learn, work, consume, interact with each other and with their institutions. This revolution is a result of the combined adoption of technologies, such as broadband high-speed networks, smart devices, cloud computing, the Internet of Things (IoT), Blockchain, Big Data analytics, artificial intelligence (AI), robotics, additive manufacturing (3D printing) and virtual and augmented reality. The availability of such technologies facilitates the emergence and provision of new solutions in the economic, social, institutional and environmental fields. These new tools are already helping mitigate the effects of the pandemic, either by allowing, to some extent, business continuity, teleworking and home schooling or by tracking quarantined citizens. The realisation of these opportunities is not automatic. In many LAC countries, poverty, inequalities, and precarious and informal labour markets hamper access to and use of these digital solutions.

The speed of change due to the exponential nature of technological advances, the great utility of digital technologies in all sectors and industries, and their profound capacity to transform entire systems of production, management and governance bring opportunities but also complexity and uncertainties to the dynamics of development (ECLAC, 2018b; OECD, 2019a, 2019b).

To ensure that policies harness the benefits of the digital transformation while mitigating the challenges, LAC policy makers need to be more proactive in “going digital” and step up their engagement with citizens, businesses, unions and academics to adapt policies to the new context. Policy makers must provide the conducive environment for innovation and digital technology adoption (Andrews, Nicoletti and Timiliotis, 2018). The adoption of new technologies can create polarisation between productive and less productive firms, concentrate market power and stymie competition and firms' entry, change the structure of the labour market and potentially increase existing inequalities, aggravating the digital divide at home, school and work. These and the employment precariousness associated and the gaps in social protection coverage can worsen social vulnerability. These challenges existed before Covid-19. The pandemic – and the measures implemented to contain its spread – have made them even more urgent.

This chapter first presents the external context LAC faces in this coronavirus (Covid-19) crisis. Second, it shows the economic impact on the region and the policy responses needed at the national and international level. Third, it shows that the crisis asymmetrically affects citizens and firms, insisting in particular that the greatest impact is on the most vulnerable groups. The last section identifies how the digital transformation can help overcome the region's structural challenges.

External and domestic impacts of the coronavirus (Covid-19) crisis on economic performance

A challenging international context

As a result of coronavirus (Covid-19) and the associated containment measures, global activity is contracting dramatically in 2020. The pandemic forced governments to focus on health measures as the primary concern. Confinement and isolation led to the temporary and sometimes permanent shutdown of businesses, widespread mobility and travel restrictions, financial market turmoil, erosion of confidence and heightened uncertainty; these, together with depressed incomes due to rising unemployment, strongly lowered demand (OECD, 2020a). In a rapidly changing environment, it is difficult to quantify the magnitude of the measures' impact on gross domestic product (GDP) growth, but it is clear that they imply sharp historical contractions in output, household spending, corporate investment and international trade. The latest estimates suggest that annual GDP growth of the world economy for 2020 will range between -4.5% and -5.0% (IMF 2020; OECD, 2020a). Without the prompt and effective policy support introduced in all economies, the contraction in output would have been substantially larger (OECD, 2020a).

The outbreak of the coronavirus (Covid-19) has added to the complicated economic, financial, commercial and technological scenario experienced in the last years. In 2019, advanced and emerging economies lost momentum. Weaker demand and escalating trade tensions debilitated global trade, increasing uncertainty about the economic outlook and dampening business confidence and thus investment.

The slowdown in trade flows is intensifying in 2020. Global trade collapsed, declining by over 15% in the first half of 2020 (OECD, 2020a). Confinement measures caused a collapse in demand and a disruption of global value chains. Disruption of production in countries that participate in global value chains (GVCs) will be a crucial factor in the deterioration of trade in intermediate goods, compounded by a widespread weakening of demand for consumer and investment goods as a result of confinement and the economic crisis (ECLAC, 2020b).

Despite heterogeneity across countries, growth in the United States, Europe and the People's Republic of China (hereafter "China"), key partners of LAC, are being hit before a rebound in 2021. The coronavirus (Covid-19) outbreak will bring the US economic expansion to a halt, with strong negative economic growth in 2020. The US GDP contracted by 32.9% in the first quarter at an annualised rate (BEA, 2020). There is uncertainty about the evolution of the pandemic. GDP is projected to decline by -3.8% this year, with a 4.0% rebound in 2021. Massive monetary and fiscal responses sustained US households and businesses, but continued policy support will be needed to boost the economic recovery and avoid protracted high unemployment (OECD, 2020a). Lockdowns in European economies will also lead to a major recession. The fall is estimated to be around -7.9% in 2020, with double-digit unemployment and strong increases in public debt. Fiscal and monetary policies will remain supportive, to boost the subsequent economic recovery, which is estimated at around 5.1% in 2021. In China, GDP will slow down to 1.8% in 2020. The pandemic triggered an increase in precautionary saving and eroded consumer confidence. In 2021, the economy is expected to grow by 8.0% annually (OECD, 2020a).

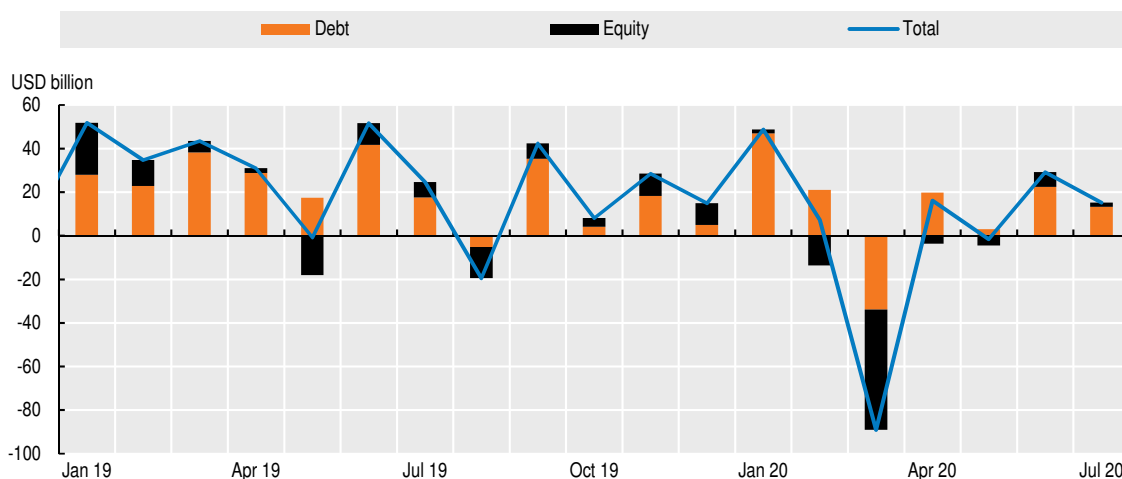
Financial volatility in emerging markets

While the coronavirus (Covid-19) crisis has been an exceptional, unexpected and exogenous shock to the world economy, abundant liquidity remains in international capital markets, making this crisis different from past global crises. Following the sudden

stop in March 2020, and the largest ever capital outflows from emerging markets (IIF, 2020), global liquidity and the appetite for emerging markets have increased, thanks to the Federal Reserve expansive monetary policy. Net capital inflows have returned to emerging markets, particularly debt flows have returned to emerging markets in April 2020, although they have not yet fully recovered. As of August 2020, emerging economies as a whole accumulated net capital outflows close to USD 25 billion. China represented the bulk of these movements, while the rest of emerging economies registered net inflows, although below the levels accumulated in the same period of the previous year (Figure 1.1).

Despite large international liquidity and expansionary policies in the OECD area to respond to the crisis, uncertainty arising from the trade collapse and deteriorating economic outlook has increased volatility in financial markets, with greater risk aversion and worsening global financial conditions. These led to higher demand for safe assets (rates of return on US securities have reached historically low levels, for instance), lower demand for LAC financial assets and significant currency depreciations in some countries (ECLAC, 2020c; OECD, 2020b).

Figure 1.1. Financial conditions, net capital flows to emerging markets (3 months rolling sum)



Sources: Based on Capital flows tracker, IIF (August 2020) and Bloomberg. StatLink <https://doi.org/10.1787/888934171343>

Sharp decline in commodity prices

The coronavirus (Covid-19) crisis caused a sharp fall in commodity prices (Figure 1.2) that is having a strong negative impact on the income levels of several LAC economies. The contraction in global demand, particularly from China, Europe and the United States, is playing a major role in commodity price dynamics. A geopolitical crisis in the oil market led to a 24% reduction in prices in less than a week in early March 2020 (ECLAC, 2020c), aggravated by physical constraints to inventory accumulation, particularly in the United States.

The price of base metals decreased dramatically in 2020 because of the contraction of industrial production. In the case of agricultural commodities, soybeans, sugar and coffee prices have also sharply declined (OECD, 2020a). Prices are expected to remain relatively low over the next two years.

Figure 1.2. Commodity prices, 2005-2020 (2005 = 100)



Source: Bloomberg data. Own calculations based on GVAR model.
 StatLink <https://doi.org/10.1787/888934171362>

Disappointing performance in Latin America and the Caribbean

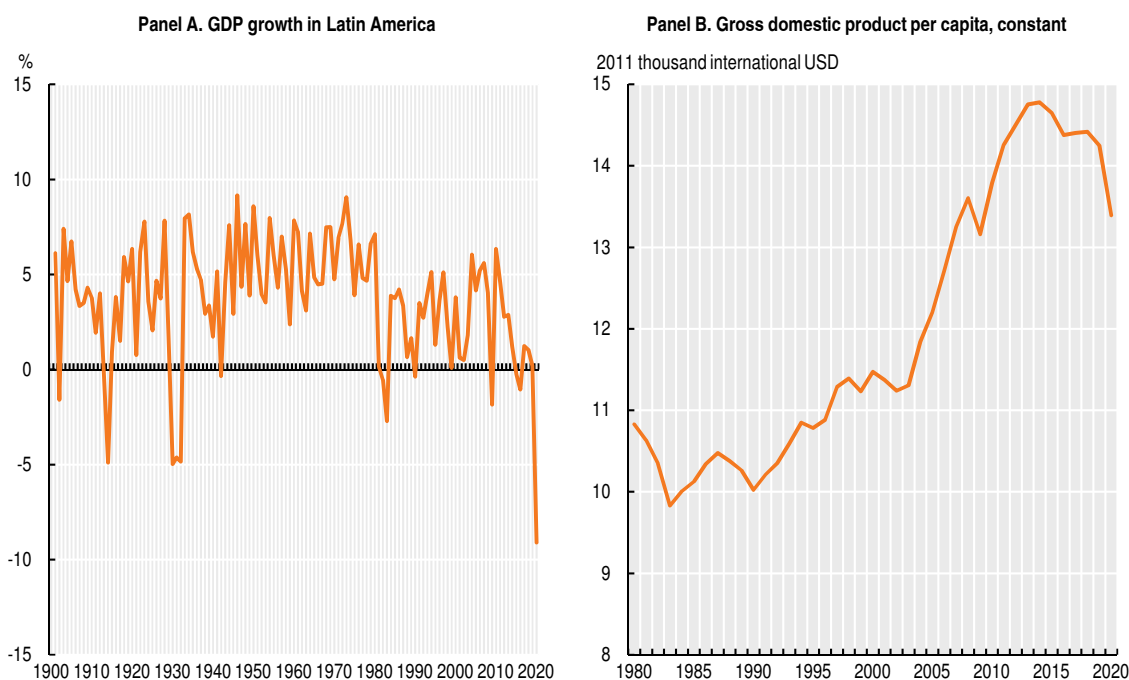
The coronavirus (Covid-19) pandemic will have large and lasting socio-economic consequences in LAC, aggravating the region’s already complex situation. The recovery of Latin American economies following the recession of 2015-16 proved fragile. Between 2014 and 2019, the region experienced the weakest period of growth since the 1950s, consistently recording lower growth rates than the OECD average. Activity growth lost momentum in 2018 and subsided even more in 2019. In 2019, with heterogeneity in the region, the combination of a less favourable external environment and idiosyncratic negative shocks in several countries pushed average growth in the region close to 0%. The pandemic is bringing both external and internal shocks that accentuate the region’s vulnerability and unsolved structural challenges.


The impact of this crisis on economic activity and social conditions is particularly severe for the region in the absence of appropriate automatic stabilisers, such as unemployment insurance, in most countries of the region (OECD, 2020b). Since the majority of firms finance investment mainly with retained earnings, gross capital formation is bound to be negatively affected. The downside multiplier effects felt at sector and economy levels will be significant and compounded by uncertainty regarding the duration of the pandemic. Several international organisations estimate annual GDP growth in 2020 at below -9% for LAC (CAF, 2020a; ECLAC, 2020a; IMF, 2020). This supposes a historical decrease in economic growth for the region (Figure 1.3, Panel A). The majority of LAC countries will exhibit negative growth in 2020 (CAF, 2020a; ECLAC, 2020a; OECD, 2020a). The magnitude of the economic contraction will vary across countries and depend on several factors, including: the depth and length of confinements, size and effectiveness of additional measures adopted both within and outside the region during and after the lockdown,

sectoral composition of the economy, openness to the world economy and the global economy in the aftermath of the crisis (OECD, 2020b).

In 2020 the average GDP per capita for the region is estimated to go back to its 2009 level (Figure 1.3, Panel B). Consumer and investor confidence will remain subdued as long as the pandemic is not under control. This will not only weigh on investment and aggregate demand in the short term, but further cap potential growth in the medium term by reducing capital accumulation. In addition, a slow recovery of employment may increase informality and poverty and compromise human capital accumulation (see the section below on the social effects of the coronavirus [Covid-19] crisis). Finally, in the absence of reforms to boost formalisation, competition and facilitate resource reallocation, productivity gains will stall. Output losses could be permanent, risking another lost decade in terms of per capita income advances.

Figure 1.3. Annual GDP growth rate and GDP per capita in Latin America and the Caribbean



Source: Own calculations based on ECLAC (2020a), “Addressing the growing impact of COVID-19 with a view to reactivation with equality: New projections”, *Special Report COVID-19 No. 5*; CAF (2020a), “Economic Perspective for the Second Quarter”; and IMF (2020), “A crisis like no other, an uncertain recovery”, *World Economic Outlook Update*, June.
 StatLink  <https://doi.org/10.1787/888934171381>

Coronavirus (Covid-19) and its economic transmission channels

Beyond the direct health impact of the coronavirus (Covid-19), the socio-economic impact in LAC occurs – and will continue to occur – through a variety of transmission channels.

First, confinement measures induce a large immediate drop in economic activity. The health measures imply the significant slowdown and, in some cases, outright stoppage of production and distribution of goods and services. As workers are prevented from going to work, the consequent rise in unemployment and decline in working hours, accompanied by the fall in the wage bill and incomes, trigger a reduction in aggregate demand for

goods and services, and business profits. The prevailing structure of production, large informality, limited infrastructure and insufficient digital skills limit the share of workers who could potentially work from home. A significant fraction of GDP and employment in LAC is therefore affected by the confinement measures.¹ Faced with a contraction in consumption, uncertainty and mounting debt, firms are also cutting back on investment.

Second, containment measures, restrictions on border crossing and social anxiety affect key sectors, such as tourism and international travel. Incidence is particularly strong in countries where tourism is a major driver of economic activity, such as Caribbean economies. In these countries, tourism services accounted for 13.9% of GDP and 15.2% of total employment in 2019 (see Chapter 6), and could fall by around 25% (ECLAC, 2020c). In the first four months of 2020, international tourist arrivals declined by 39% in the Caribbean, 35% in Central America and 35% in South America, compared with the previous year (ECLAC, 2020c). Other sectors, such as retail trade, wholesale trade and manufacturing, are also being heavily affected.

Third, the global slowdown (OECD, 2020a) and the disruption of global and regional value chains generate a sharp decline in LAC exports and potentially disrupt domestic production in sectors highly vulnerable to disruptions in global value chains.

Fourth, the decline in commodity prices, the economic slowdown and the fiscal response affects both the trade and fiscal balances of several LAC countries.

Fifth, higher volatility in financial markets brings high uncertainty in LAC debt, equity and currency markets, affecting the solvency of large companies exposed to commodity markets or that have no other form of insurance against currency fluctuations. Part of this has reversed since April, following expansionary policies in developed markets and the sharp reduction of interest rates. However, the cost of credit remains high for some countries and companies owing to risk premiums.

In contrast to these negative effects, the adoption of digital technologies and the spread of the Internet have been critical to sustain a certain continuity in business, jobs and study from home, although the digital divide, notably lack of high-speed broadband Internet and lack of appropriate digital skills, has prevented benefit to all. Digital technologies play an important role with respect to the pandemic.

A strong setback in external accounts

The sharp decline in global and regional economic activity in 2020 will have an impact on LAC's external accounts. Deficits in current account balances reduced slightly in 2019, following the slowdown in international trade and the correction in commodity prices. With few exceptions, current account deficits were financed by foreign direct investment (FDI) (Figure 1.5, Panel A).

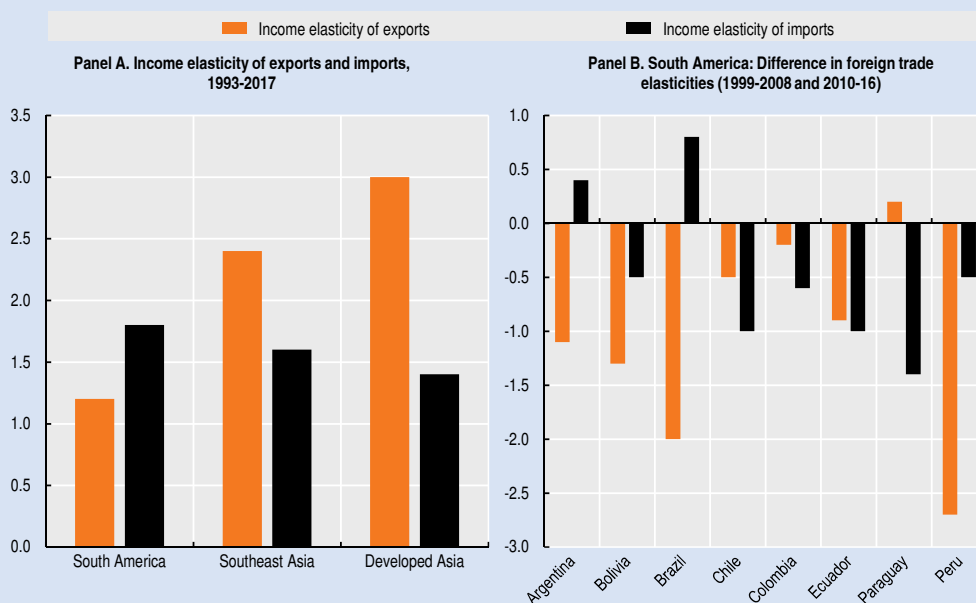
The overall impact of the crisis on the external account will depend on the combined behaviour of its various components and on the income elasticity of exports and imports (Box 1.1). While the sharp reduction in imports should alleviate the trade balance, the contraction in global demand and commodity prices should have a negative impact on the more outward-oriented LAC economies dependent on commodity revenue. Similarly, countries dependent on tourism, such as Caribbean countries, should have a negative impact on the services component of the trade balance. First estimates suggest that, for 2020, the fall in imports will be more significant than in the region's exports, producing a small improvement in the current account balance (ECLAC, 2020b). While the transfer balance in the current account will deteriorate owing to lower remittances, the income account will likely improve because of lower profit repatriations.

Box 1.1. Income elasticity of exports and imports in Latin America and the Caribbean

LAC countries need to change their patterns of insertion into the global economy to achieve higher GDP growth rates without suffering external imbalances. The relationship between export and import income elasticities allows estimating the growth ceiling with external equilibrium. For instance, in the case of South America, the relationship between the income elasticity of exports and imports is approximately 0.8, which implies that, if the world's GDP grew to 2% in the next few years, South America could grow to 1.4% without suffering from increasing external indebtedness (Figure 1.4, Panel A) (Abeles and Cherkasky, 2020). The ratio for Mexico is 1.2, which establishes an external restriction ceiling of 2.2%. These values are much lower than those estimated for Asian economies, which reach close to 4.0%, accounting for the much greater space to grow without colliding with the external restriction. Import elasticities are similar among various regions, so it is the low export elasticities that define the reduced ceiling for growth with external equilibrium in LAC, with a tendency to the fall of the income elasticity of exports (Figure 1.4, Panel B).

Exports in the region show low diversification and thus are much less sensitive to global demand growth than in other regions, which have recorded much higher and sustained GDP growth rates for several decades. Countries with a higher content of industrial exports, and especially those of high technological content tend to have greater export elasticities, in contrast to countries that exports raw materials. Export elasticities tended to worsen in recent years more than the pace of world product growth. With the exception of Paraguay, export elasticities fell in the last decade, amid the boom in international commodity prices, compared with the previous decade.

Figure 1.4. Income elasticity of exports and imports, selected regions



Source: Abeles and Cherkasky, (2020), "Revisiting Balance of Payments Constrained Growth 70 years after ECALC's Manifesto, the Case of South America", *Revista de Economia Contemporânea*, 24(1), and CEPALSTAT (database), <https://data.worldbank.org/products/ids>
 StatLink <https://doi.org/10.1787/888934171400>

The sharp decline in global demand is affecting export volumes and prices, with a deterioration of terms of trade of several countries in the region due to decreases in commodity prices. The value of the region's exports could fall by as much as 23%, with an 11% drop in prices and a 12% decline in volume, essentially owing to a sharper contraction in global demand (ECLAC, 2020b). In particular, as of early April 2020, oil prices had fallen by 60% since the beginning of the year; copper, iron, sugar and coffee prices had also sharply declined. While the collapse in oil prices can be a relief to the oil-importing Caribbean and Central American economies, it affects the fiscal and external accounts of several South American countries and other economies of the region, including Mexico and Trinidad and Tobago. The drop in metal prices is also negatively affecting countries; Chile and Peru, for instance, are suffering from the decline in copper prices.

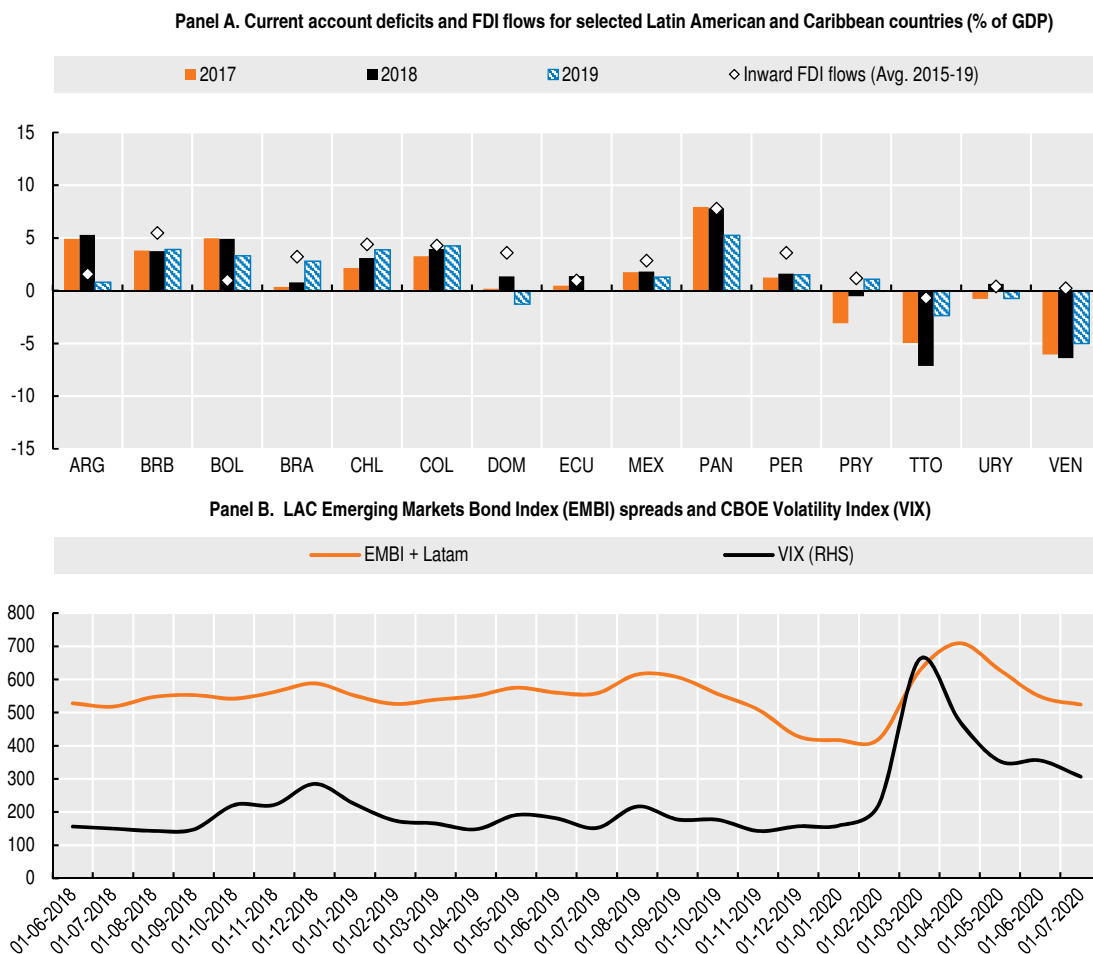
FDI will deteriorate dramatically, reducing the financing quality of the current account deficit and curbing improvements in productivity. On a global scale, FDI is expected to fall between 30% to 40%, decreasing the most in economies most severely hit by the pandemic (UNCTAD, 2020). The sharp fall in remittances (World Bank, 2020a) will further weaken current account balances, with a likely stronger impact on Central America and Mexico. Conservative estimates show that remittances originating from the United States will fall by at least 3% in 2020 (Inter-American Dialogue, 2020); this could decrease further owing to border-crossing restrictions that will sharply cut migration flows, such as seasonal workers moving to the United States.

The slowdown in LAC main trading partners, notably China and the United States, is a significant factor affecting the outlook of the region. China has become the main trading partner for many South American economies (OECD/CAF/UN ECLAC, 2015). China is not only a major importer of raw materials but also a direct investor and credit provider to LAC economies, mainly Argentina, Brazil, Ecuador and Venezuela (Inter-American Dialogue, 2020). Contraction in the United States mainly affects Mexico, Central America, Colombia and the Caribbean.

Between February and May 2020, LAC experienced substantial capital outflows (especially portfolio investment), surpassing levels reached in the aftermath of the 2008 financial crisis (IDB, 2020; IIF, 2020). Although LAC Emerging Markets Bond Index (EMBI) spreads remain lower than in the 2008 financial crisis, they are above levels observed in the past five years (Nieto-Parra and Orozco, 2020). The evolution of sovereign bond spreads in some countries of the region, in particular those without solvency difficulties, has been highly correlated with the volatility conditions of international markets. For instance, similar to international markets' expectation of volatility, measured by the Chicago Board Options Exchange's Volatility Index (VIX), LAC EMBI considerably increased in March 2020 and then relatively receded (Figure 1.5, Panel B).

Since April 2020, governments and companies in the region (e.g. Chile, Colombia, Guatemala, Mexico, Paraguay, Peru, Uruguay) have been able to issue bonds in international markets at relatively low costs, although variations across countries remain, even among investment-grade countries. Similarly, concerning exchange rate markets, currencies have depreciated differently, even among these countries. Compared with the 2015-19 year averages, between January and May 2020, the average exchange rate in Peru depreciated by 4%, in Colombia and Mexico by around 15% and in Brazil by around 33%. Strong currency depreciations will pose an additional concern to governments and companies highly indebted in foreign currency and that have not hedged their foreign currency exposure (OECD, 2020b).

Figure 1.5. External accounts and financial conditions in selected LAC countries



Sources: Based on official data, IMF and Bloomberg.
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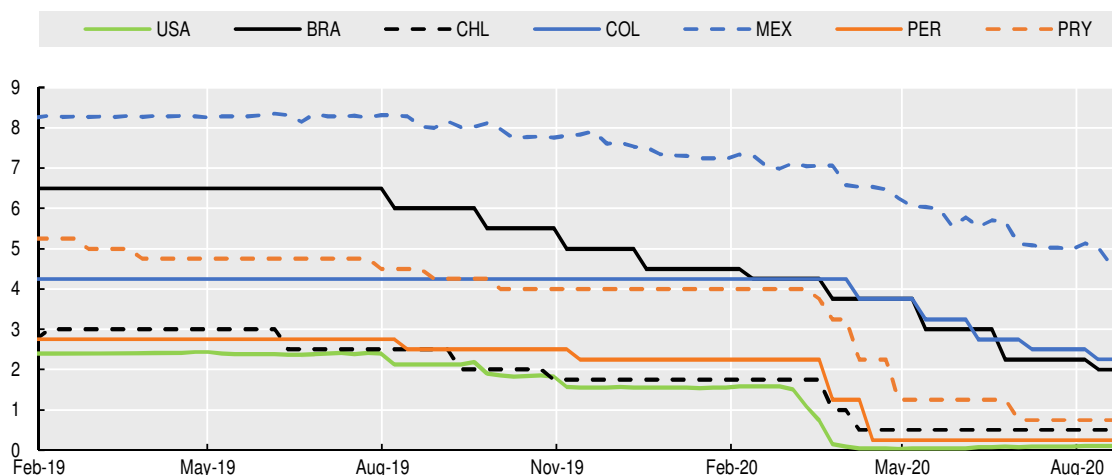
Monetary policy and financial conditions to respond to the crisis

Central banks have played an active role in the response to the coronavirus (Covid-19) crisis. Most central banks in the region started to ease monetary conditions at the beginning of lockdown measures (Figure 1.6). Monetary actions were timely, and more than ten countries decreased the policy interest rate and intervened in the foreign exchange market. Some countries provided liquidity in dollars through swap lines and purchased public or private securities. In particular, the central banks of Brazil, Chile, Colombia and, to some extent, Peru have purchased private and government securities in domestic financial markets. Credit regulations have also been eased to allow commercial banks to renegotiate loans with households and firms without affecting their credit ratings.

With the considerable decrease in domestic demand, inflation remains contained in most Latin American countries. Despite heterogeneity across countries, moderate increases in prices may be expected in the short term because of currency depreciation and supply shocks. However, given the absence of significant pressures on prices and a considerable slack in some economies, central banks in Latin America have continued to lower interest rates to shore up activity. Economic uncertainty about the duration of the coronavirus

(Covid-19) crisis and, therefore, lockdown measures in the region will affect monetary conditions.

Figure 1.6. Monetary policy interest rates for selected countries (%)



Source: Based on official data and Bloomberg.
 StatLink <https://doi.org/10.1787/888934171438>

Local financial systems were relatively well prepared to face the economic shock, with high solvency and liquidity ratios before the crisis. Even so, demand for liquidity is projected to increase as firms and households may seek additional credit or use existing lines to mitigate the negative effects of lockdown measures on economic activity. Prompt actions by central banks have largely reduced the risks of liquidity shortfalls in financial systems. Non-performing loans may also grow, particularly once renegotiated loans mature. Evidence suggests that banks behave pro-cyclically during crises and may restrict credit to preserve their balance sheets, but countries in the region have already adopted measures to prevent the situation spiralling down. More than 15 countries have imposed a moratorium on loan repayment, opened preferential lines to provide credit or liquidity to small and medium-sized enterprises (SMEs) and reduced liquidity and reserve requirements to support credit (Nuguer and Powell, 2020).

Fiscal policy to mitigate the crisis and ignite the recovery

Fiscal policy is playing an essential role in mitigating the negative economic and social effects of the pandemic and will continue to be pivotal in the recovery. With fragile or non-existent unemployment insurance, high informality and low tax revenues in the region, weak automatic stabilisers (Espino and González Rozada, 2012) make discretionary fiscal responses to the crisis even more urgent.

Most LAC economies have implemented fiscal measures (OECD, 2020c). Over 20 countries have put in place transfers to households and opened credit lines to firms. More than 15 countries have also introduced reductions or deferrals of labour taxes and social security contributions, and debt service deferrals and salary compensation for workers. Measures aiming to mitigate the effects of the coronavirus (Covid-19) crisis should be designed as temporary so as not to compromise future fiscal stability (ECLAC, 2020c; Izquierdo and Ardanaz, 2020).

On average, fiscal support in some countries of the region has been modest compared with the size of the shock and with advanced and other emerging economies. Fiscal support varies considerably across countries and it has been relatively large in some economies,

including Brazil, Chile and Peru. However, the final value of these measures remains uncertain given the final execution of these announcements as well as the possibility to expand the duration or coverage of these temporary actions or the announcement of new policy actions in the upcoming months. Moreover, informality and limited access to bank accounts complicate the logistics, focalisation and effectiveness of transfers to firms and vulnerable households. However, some countries have implemented innovative policies in that respect (see the section below on the social effects of the coronavirus [Covid-19] crisis).

Macroeconomic policies in response to the coronavirus (Covid-19) crisis, including fiscal, should distinguish short- and medium-term objectives and instruments. The short term refers to policies aimed at confronting immediate effects. The medium term refers to a context of a flattening contagion curve and progressive lifting of lockdown measures. Co-ordination among monetary, fiscal and capital account regulation policies is essential in the short, medium and long term.

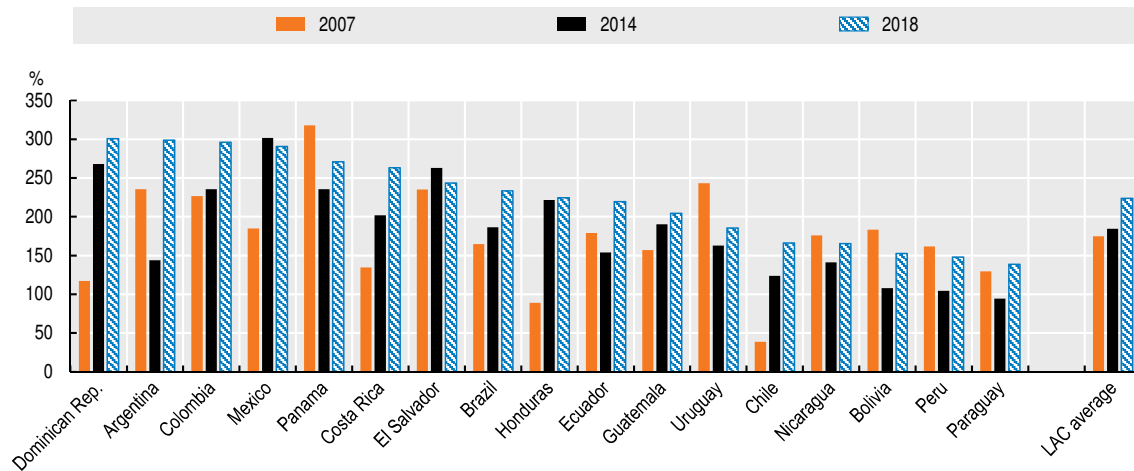
Short-term fiscal policy should strengthen health systems, provide liquidity to firms to preserve employment and help them survive, and buffer household income losses, particularly those more vulnerable. Some countries with high informality or underdeveloped social safety nets have resorted to implementing or expanding existing social transfer programmes and guaranteed to facilitate loans to SMEs.

In the medium term, transfers and guarantees must give way to increased capital expenditures and investment in education and skills as key to ignite and sustain recovery efforts. After the health emergency, fiscal policy should increase demand, while focusing on investing in infrastructure and human capital to increase medium-term productivity. Public capital expenditures are set to have high multiplier effects in the economy and provide the expectation of profitability for crowding in private-sector investment, especially if pursued in close co-ordination with policies that allow formalisation and reallocation to more productive firms. Not all fiscal measures are alike and governments should strive to design stimulus packages that deliver large economic multipliers reasonably quickly and also set the economy on a path towards low-carbon development (Hepburn et al., 2020).²

LAC countries' ability to react to the pandemic with fiscal policy will depend on their starting fiscal position and their access to international markets. Before the crisis, with strong heterogeneity among countries, fiscal space in the majority of countries was limited, as many economies were undergoing fiscal adjustments. Fiscal deficits are the norm in most countries in the region. Despite high heterogeneity, tax revenues remain scarce at close to 23.1% of GDP, more than ten percentage points lower than the OECD average (OECD et al., 2020). Moreover, fiscal policy has not been sufficiently effective in reducing inequalities, informality and promoting entrepreneurship. The relatively low tax revenue also implies the need for improving the design, targeting and execution of public expenditures (Izquierdo, Pessino and Vuletin, 2018; OECD et al., 2019).

Debt levels have increased in almost all countries since 2014. Public debt-to-tax ratios, a proxy indicator of countries' financial capacity to pay the public debt, increased in most countries, leaving them in a weaker position to face the coronavirus (Covid-19) crisis than they were in 2007, before the 2008 financial crisis (Figure 1.7). Going forward, fiscal measures to address the crisis and the consecutive economic slowdown are likely to take a toll on tax revenues. Given the increasingly limited fiscal space and the increasing revenues needed to address the heterogeneous challenges, global co-ordination of public debt management should be the priority.

Figure 1.7. Debt-to-tax ratio (gross public debt) in selected Latin American countries, 2007, 2014 and 2018



Sources: Based on official data (2019) and OECD et al. (2020), Revenue Statistics in Latin America and the Caribbean 2020. StatLink <https://doi.org/10.1787/888934171457>

Global co-ordination of public debt management

Coronavirus (Covid-19) fiscal needs call for globally co-ordinated debt management. Issuer or creditor inaction can lead to debt defaults and, therefore, debt crises, adding to an already complicated scenario. There is no unique solution to managing public debt in the region owing to country differences in initial fiscal conditions, type of foreign creditors and financial capacity to tap into capital markets.

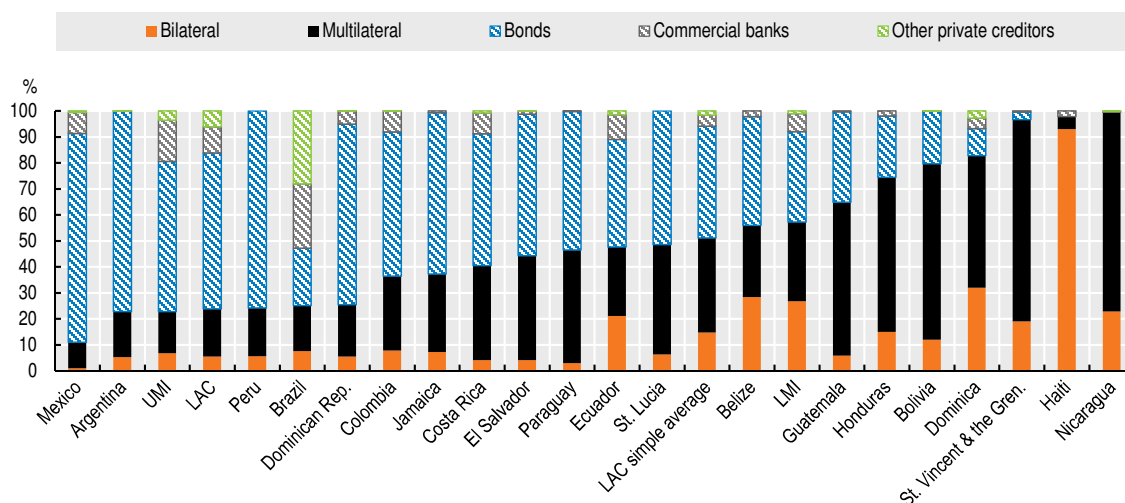
Some countries had challenging financial situations before the pandemic. In countries including Argentina and Ecuador, international discussions on outstanding public debt obligations started before the crisis; Ecuador reached the majority needed to restructure bonds with private creditors in August 2020. Capital markets actors had already put a price on the cost of restructuring before the crisis (Nieto-Parra and Orozco, 2020). Similarly, Argentina reached an agreement to restructure almost 100% of its external public debt on 31 August 2020. Caribbean countries are highly indebted and may face borrowing constraints. In 2018, 3 of the 25 most indebted countries in the world (measured by gross general government debt levels relative to GDP) were in the Caribbean: Antigua and Barbuda, Barbados and Jamaica (IMF, 2019; OECD et al., 2019).

How countries raise resources varies across the region. Some Central American countries (e.g. Guatemala, Honduras, Nicaragua), Caribbean economies (e.g. Haiti, Saint Vincent and the Grenadines, Dominica) and a few South American economies (e.g. Bolivia, Ecuador) have traditionally issued debt through bilateral creditors or multilateral banks. On the other hand, Mexico and most South American economies have traditionally had access to capital markets to raise funds (Figure 1.8), and about half their debt is in domestic currency. Brazil issues debt mostly in domestic currency. High local currency debt issuance reduces the debt sustainability risks in the face of large exchange rate depreciations.

Debt ratios are expected to increase in the next two years. As long as interest rates would be below growth rates, debt ratios should stabilise in the medium term, but at higher levels. Debt should eventually be brought back to more sustainable levels and fiscal space regained, but the process must be gradual to prevent stalling growth and social progress. With abundant liquidity, international capital markets seem more willing

to admit larger debt ratios at this point, and there is still access to capital flows. However, financial conditions to tap into capital markets vary across countries, and pricing varies considerably according to countries' debt sustainability. Conditions may also change rapidly in the medium term if monetary policy normalises in advanced economies.

Figure 1.8. External public debt stock by creditor (public and private) in selected Latin American and Caribbean countries, 2018



Notes: LAC simple average gives equal weight to all countries on their distribution of credit holders; LAC takes into consideration the amount issued by each LAC country. LMI and UMI are all lower middle-income and upper middle-income countries in the world.

Source: OECD Development Centre calculations based on World Bank (2020b), *International Debt Statistics* (database), <https://data.worldbank.org/products/ids> (accessed May 2020).

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High heterogeneity in public debt levels and financial conditions across LAC countries highlights several policy actions that can be crucial in response to the coronavirus (Covid-19) crisis, depending on the case:

- There needs to be co-ordinated action among bond holders and capital markets actors in restructuring debt issued by countries already facing financial difficulties. This is crucial to minimise reputational risk (i.e. future access to capital markets) and provide countries with some fiscal space to respond. Collective Action Clauses can help facilitate renegotiation with bond holders.

Previous debt relief or restructuring mechanisms provide useful lessons learned. In particular, creditors and debtors should share the burden. Debt relief or restructuring initiatives should be led by official creditors, then crowd in private creditors (Bolton et al., 2020). Governments should focus on an effective economic policy communication strategy and the objectives regarding expected achievements from debt relief or restructuring. Effective data and information sharing with creditors is key. Last, governments should include appropriate contingency clauses in the agreement.

- Official support should prioritise economies that have little or no access to capital markets.
- Countries that already enjoyed ample fiscal sustainability must retain access to capital markets with low risk premiums that allow them to raise funds needed to respond to the crisis.
- Another group of countries might have access to capital markets but face high debt cost due to the deterioration in perceptions of debt sustainability among markets

participants. The deterioration includes current and potential downgrades in credit ratings or expectations of low future growth and public revenues. There are several policy options, including debt standstill or moratorium, debt relief, creation of a special vehicle to finance the crisis or pay the debt, and greater use of Special Drawing Rights. All require international co-operation, involving multilateral banks, developed countries or private creditors (Nieto-Parra and Orozco, 2020; Bolton et al., 2020).

Historical examples provide lessons for facing today's public finance challenges, for instance, the outcome of the long 1980 debt crisis resolution process in the region. Policy support and co-operation among countries in the early 1990s (e.g. by converting bank loans to bonds [Brady Plan]) were vital in reducing socio-economic costs. Involving private creditors helped lower uncertainty surrounding access to capital markets and allowed economies to access financial markets and borrow additional resources (Eichengreen, 2020). Rapid policy response is essential to avoid high socio-economic costs (Flores Zendejas, 2020).

Increased productivity to promote growth

Low productivity growth has long been a drag on potential growth. One of the most relevant challenges for LAC countries is related to their low levels of productivity (see Chapter 2). LAC countries base their competitiveness, to a large extent, on the advantages of natural resources or the abundance of low-skilled labour. This type of comparative advantage can sustain periods of rapid growth, such as during the commodity boom, but not long-term convergence with advanced countries.

The type of competitiveness necessary to achieve sustained economic growth is based on incorporation of technology and productive diversification towards dynamic sectors, both in technology and in terms of international demand (ECLAC, 2012) (see Chapter 2). The importance of technology is visible in the ability to respond to the crisis. Countries with a more developed communications infrastructure and that are more advanced in their adoption of digital technologies are better placed to preserve certain economic activities and save jobs in the region. However, significant gaps remain in many countries in terms of digital and technology assimilation (CAF, 2020b).

In the medium term, public capital expenditure can play a role to ignite recovery efforts and boost productivity growth. Under the expected circumstances, capital expenditures are bound to have a high multiplier effect on employment and promote productivity. They can act as a vehicle for crowding in private-sector investment, especially if pursued in close co-ordination with production transformation policies, and with improvements in private-sector policies and the business climate. Indeed, close co-ordination between public investment and production transformation (e.g. via public procurement policies) may maximise the multiplier effects of the former.

The outcomes of a lengthy wave of contagions, mobility restrictions and moderate policy support in most LAC countries may well be destruction of some capital (i.e. firm bankruptcies) and high unemployment and informality. Policy efforts should be directed to facilitate mobility and efficient reallocation of resources to more productive firms and sectors. There is space to promote competition, innovation and entrepreneurship; simplify tax systems to encourage firm expansion and formalisation, and to make fiscal policy more progressive; and improve state capacities to provide better goods and services to citizens to rebuild trust in governments (OECD et al., 2019). More efficient and better-funded governments will be better equipped to meet the challenges of promoting sustainable growth and developing adequate systems of social protection and safety nets.

Social effects of the coronavirus (Covid-19) crisis

The fight against poverty and inequality, and the realisation of more just and inclusive societies with higher levels of well-being for all, as stipulated in the UN 2030 Agenda for Sustainable Development, is an objective at the highest level in LAC political agendas. Although countries have made significant progress in reducing poverty and inequality over the last decades, there are still significant challenges and structural gaps to act upon, which the present crisis is magnifying.

Inequality in LAC is the result of a complex matrix of determinants and has its roots in the economic structure and institutional settings. Income group or class is one of the structural axes of social inequality, along with gender, age (life cycle), ethnicity, race and territory. Individual socio-economic status reflects and explains many of the dimensions in which inequality is expressed: employment and work, access to productive resources and income, education, health, basic services, housing, food, security, social protection, opportunities to live free of violence, technology and participation, among others (ECLAC, 2018a, 2016).

LAC societies are characterised by structural inequality, which has been maintained and reproduced even in periods of economic growth and prosperity. This inequality constitutes an insurmountable obstacle to the eradication of poverty, to sustainable development and to the guarantee of people's rights. High levels of income inequality can have negative effects on economic growth and create political instability (Milanovic, 2020). Inequality is based on an economic structure that is concentrated in a few sectors. It is characterised by a complex framework, in which socio-economic inequalities intersect with gender, territorial, ethnic, racial and generational inequalities (ECLAC, 2016).

The social consequences of the coronavirus (Covid-19) crisis are asymmetrical and mainly affect the most vulnerable groups, aggravating the region's already complicated social scenario (see Chapter 3 for the role of the digital transformation for these groups).

Regarding the production structure, the economic downturn will mostly affect workers from sectors like tourism, commerce and transport, particularly micro, small and medium-sized enterprises and own-account workers, most of whom are informal. The crisis will be particularly difficult for micro and small firms, which have no capacity to absorb the shock. Around 2.7 million – or 19% of all firms – mostly micro companies are likely to close (Figure 1.9, Panel A), entailing the loss of 8.5 million jobs and affecting the livelihoods of many more households that depend on those jobs for their household income (ECLAC, 2020d).

Extending support to firms is difficult, as many are informal and often fall outside the scope of programmes aimed at the productive sector. Direct transfers, credit guarantees and moratoria on the payment of taxes, utilities or social security contributions usually require formal status. As support to informal activities is mainly targeting the self-employed, informal SMEs are falling through the cracks. Some countries are encouraging firms to formalise, at least to some degree: in exchange for signing up on registries, they become eligible for support (Basto-Aguirre, Nieto-Parra and Vázquez-Zamora, 2020).

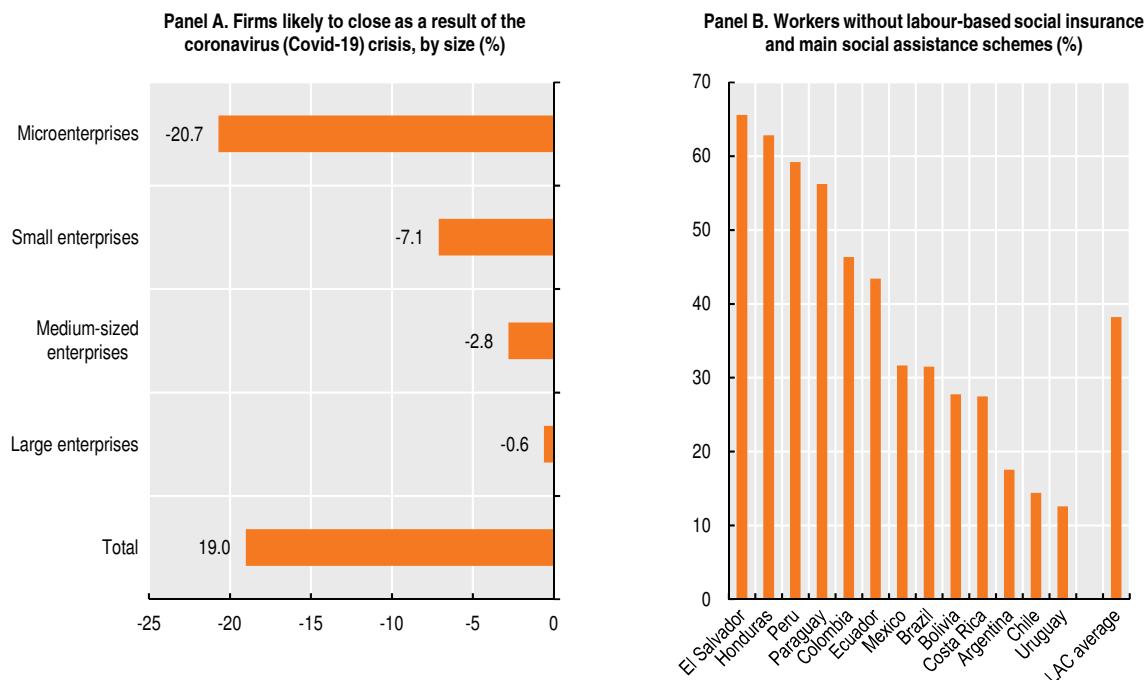
The income shock generated by the coronavirus (Covid-19) crisis is having a negative effect on social conditions in LAC, especially for the most vulnerable. The shock hurts disproportionately the poorest and most economically vulnerable households in a region where 25% of the population is poor and 37% is vulnerable to falling into poverty. Most workers in these income groups are caught in the social vulnerability trap: in informal jobs that limit their access to social protection (including health services), unemployment insurance, income stability and savings as a safety net.

On average, close to 60% of workers in the region are considered informal, with particular incidence across the most disadvantaged socio-economic groups (OECD,

2020b). Some 58% of informal workers live either in economic vulnerability (USD 5.5-13.0 per day) or in poverty (less than USD 5.5 per day).

Social assistance programmes in the region cover a significant portion of poor households, but many remain exposed. Close to 40% of workers are not protected by any safety net (Figure 1.9, Panel B); this reaches a level of 65% across informal workers (Basto-Aguirre, Nieto-Parra and Vázquez-Zamora, 2020). These workers can hardly face any increases in health expenditures or income loss due to quarantine measures. Containing the increase in poverty requires new forms of social protection that reach vulnerable groups during this crisis or the provision of emergency basic income so that no citizen lives under the national poverty line (ECLAC, 2019).

Figure 1.9. Workers without a safety net and firms likely to close owing to the coronavirus (Covid-19) crisis in selected Latin American countries



Source: ECLAC (2020d), “Sectors and businesses facing COVID-19: Emergency and reactivation”, Special Report COVID-19 No.4 and Basto-Aguirre, Nieto-Parra and Vázquez-Zamora (2020), *Informality in Latin America in the post COVID-19 era: Towards a more formal “new normal”?*, Vox Lacea.

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Governments have made significant efforts to reach informal workers and households by expanding non-conditional cash transfers. Argentina’s *Ingreso Familiar de Emergencia* explicitly aims to reach households that subsist from informal activities, self-employment or domestic work. In Brazil, informal workers and the unemployed earning less than half the minimum wage and not covered by social benefits except *Bolsa Família* received a temporary new benefit. In Chile, *Ingreso Familiar de Emergencia* reaches informal workers and vulnerable households. In Colombia, *Ingreso Solidario* aims to reach 3 million vulnerable informal or self-employed households not covered by social benefits. Dominican Republic put in place the *Quédate en Casa* and *Pa’ Ti* programmes. Ecuador’s *Bono de Protección Familiar* was expanded to reach informal households not receiving other social transfers. Peru also expanded *Bono Familiar Universal* during the crisis to reach 2.3 million households without a formal dependence labour relationship (OECD, 2020b). While the coronavirus (Covid-19) crisis is a major challenge for the region, it is also an opportunity

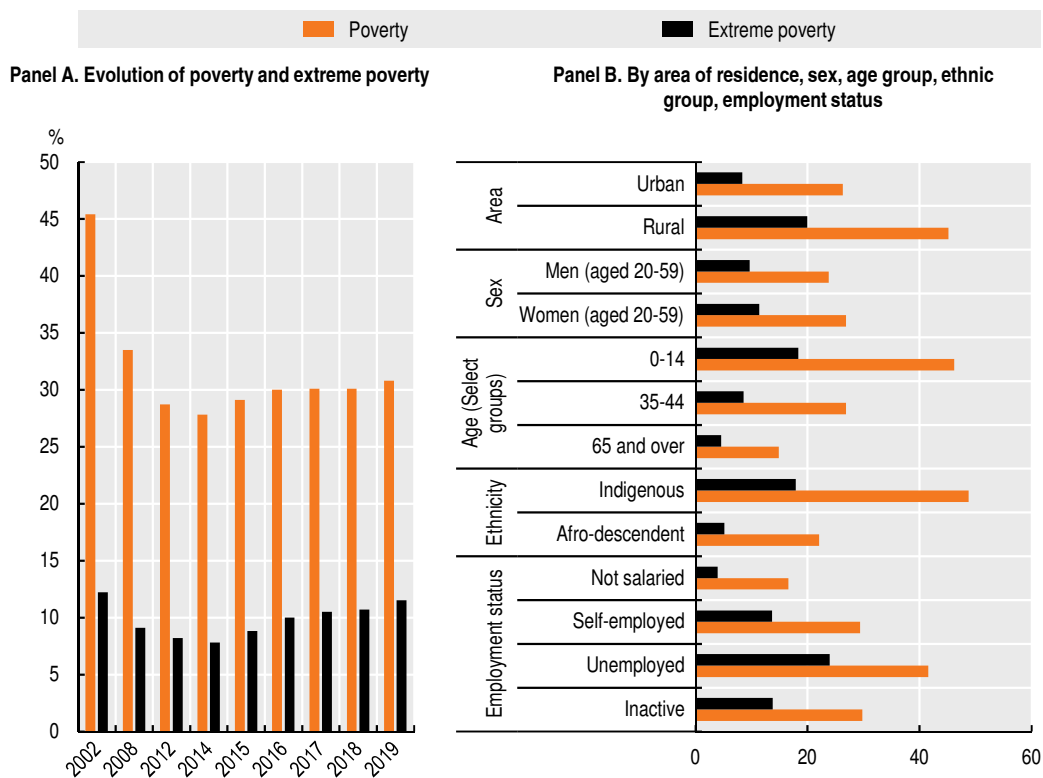
to rethink social protection and move towards more inclusive systems (Basto-Aguirre, Nieto-Parra and Vázquez-Zamora, 2020).

The poverty dimension

Between 2002 and 2014, the region made great strides in reducing the poverty rate (from 45.4% to 27.2%) and extreme poverty rate (from 12.2% to 7.8%). The end of the commodity export boom and the consequent economic slowdown reversed the trend from 2015 onwards and the number and rate of poor people started to increase again. In 2019, the number of people living in poverty and extreme poverty reached 191 million and 72 million, or 30.8% and 11.5% of the LAC population, respectively (Figure 1.10, Panel A) (ECLAC, 2019). The commodity price fall was intensified by the reduction in fiscal space and adjustment policies that affected coverage and continuity of anti-poverty and social and labour inclusion policies (Abramo, Cecchini and Morales, 2019). Labour market indicators deteriorated: unemployment rose and the trend towards greater formalisation was curbed. The increase in poverty varies across LAC countries, and the impact is greater among those in rural areas, women, children (and Afro-descendants and indigenous people (Figure 1.10, Panel B).

In the absence of a strong response, the coronavirus (Covid-19) pandemic could increase poverty and extreme poverty. An additional 45.4 million people could become poor, reaching a total of 230.9 million people (37.3% of the LAC population). Extreme poverty is likely to increase by 4.5%, 28.5 million more people, affecting a total of 96.2 million people (ECLAC, 2020a).

Figure 1.10. Evolution of poverty and extreme poverty in Latin American and Caribbean, by socio-economic characteristics, 2002-19



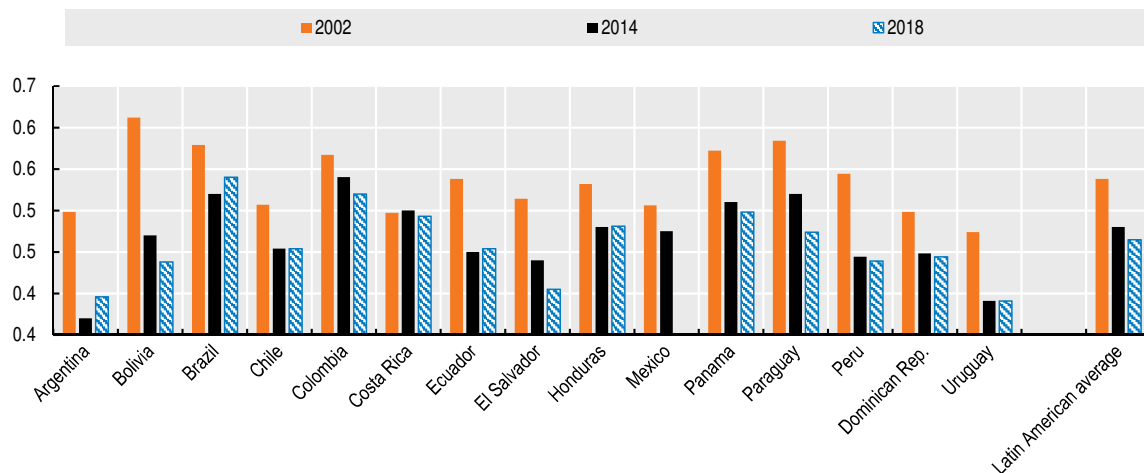
Source: Own elaboration based on ECLAC (2019), Panorama Social de América Latina. StatLink <https://doi.org/10.1787/888934171514>

The inequality dimension

Despite significant progress in the last 15 years, inequality remains high in LAC. It is the most unequal region in the world, with an average Gini Index almost one-third higher than Europe. The average LAC Gini Index fell from 0.54 in 2002 to 0.47 in 2014 and 0.46 in 2018 – a decrease of 13.6% in 16 years or 0.9% per year, on average. The pace of decrease slowed over the period: the average between 2014 and 2018 was 0.6% per year, compared with 1.0% per year between 2002 and 2014. However, these averages mask very uneven patterns across LAC countries in relation both to inequality and to the intensity and direction of changes over the periods. In 2018, Argentina, El Salvador and Uruguay recorded the lowest levels (below 0.40); Brazil and Colombia recorded levels higher than 0.52 (ECLAC, 2019) (Figure 1.11).

The coronavirus (Covid-19) crisis will exacerbate already existing inequalities because of the higher incidence in most vulnerable segments of the population. In this respect, the digital divide in the region has become an even greater concern as it can further enhance inequalities. Digital solutions have been developed to mitigate the consequences of the lockdowns. Still, 32% of the LAC population has no Internet access, which has proven essential to confront the impacts of the pandemic (CAF, 2020b). Education is a case in point: not all students, nor all schools are equally equipped or have access to the necessary equipment and pedagogical tools for remote schooling. Students from more disadvantaged backgrounds or from schools in disadvantaged areas suffer the most from school closures in terms of learning outcomes, with possible lasting consequences (OECD, 2020b) (Chapter 3). In fact, the impact on inequality can well go beyond this crisis. Education is case in point. Not all students, nor all schools are equally equipped or have access to the necessary communication infrastructure or pedagogical tools to deliver remote schooling successfully. Students from more disadvantaged backgrounds or from schools in disadvantaged areas suffer the most from school closures. Higher dropouts from school and lower learning outcomes will likely have lasting consequences on their human capital formation, job opportunities and future earnings (OECD, 2020b) (Chapter 3). Moreover, girls are at a greater risk of not returning once schools reopen, deepening gender gaps and reducing girl empowerment.³

Figure 1.11. Inequality in selected Latin American countries (Gini Index), 2002, 2014 and 2018



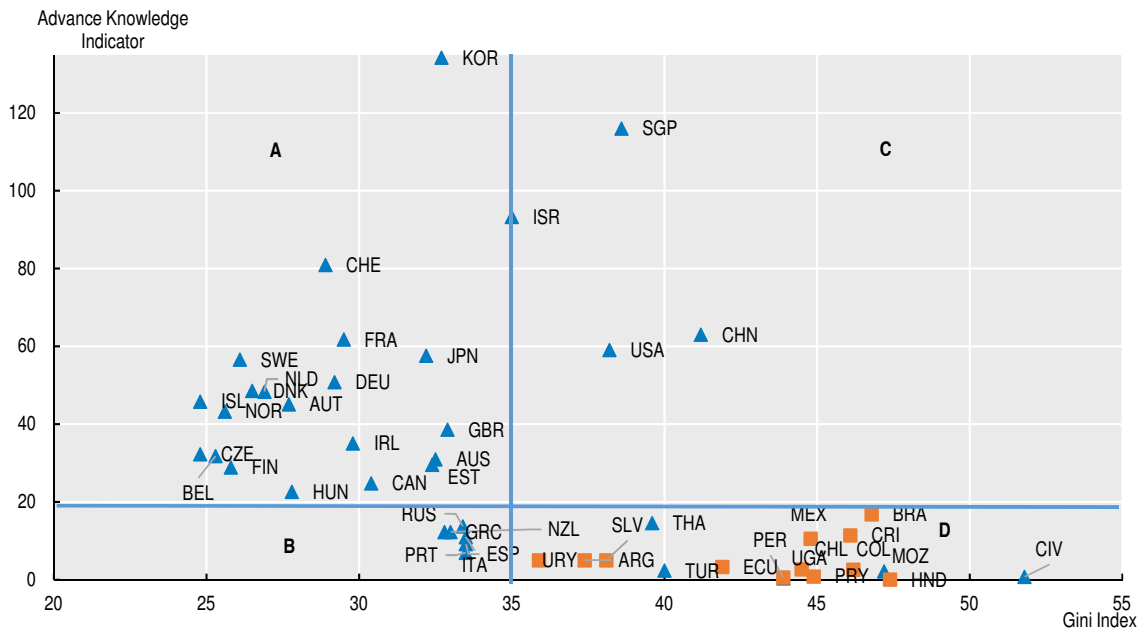
Source: ECLAC (2019), *Panorama Social de América Latina*.
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Socio-economic challenges and the productive structure

Poverty, inequalities and social vulnerabilities are strongly related to the productive structure and how countries are inserted in the knowledge economy. This can be illustrated by analysing the relationship between inequality and the Advanced knowledge indicator, a proxy of the productive structure. The indicator combines a country’s specialisation in the production and export of high-tech goods with research and development (R&D) efforts, considering the productive and technological capabilities and generation and dissemination of knowledge (Rovira, forthcoming). By relating this indicator to an income inequality index (Gini Index), four possible groups are identified, with respect to the world average.

Latin America is in the group with high inequalities and low technology adoption, although with variation across countries. Countries in the first group (quadrant A, Figure 1.12) have a high advanced knowledge indicator value (economies that export high-tech goods and incorporate R&D as a main element in their development strategies) and low income inequality. Those in the second group (quadrant B) do not have a very high degree of sophistication but have low income inequality, thanks to social welfare. Those in the third group (quadrant C) have diversified productive structures and a knowledge-based economy but high income inequality. Those in the fourth group (quadrant D) have high income inequality and poor capacity to generate and incorporate technologies into their productive structure. Some African countries, Turkey, Thailand and all Latin American countries are part of this quadrant, although with very strong heterogeneity among them. Countries with lower relative levels of income inequality, such as Argentina and Uruguay, contrast with countries like Brazil, Colombia and Honduras.

Figure 1.12. Advance knowledge indicator and the Gini Index



Note: The Gini coefficient uses income after taxes and transfers. The “Advance Knowledge” indicator is calculated as the multiplication between the averages (2014-17) of the variables i) high technology exports as a percentage of manufacturing exports and ii) R&D expenditure as a percentage of GDP. Due to the availability of information, for the average of the R&D expenditure variable as a percentage of GDP, in the case of India, Mozambique, New Zealand and Senegal, only the year 2015 was taken; In the case of Mexico, the years 2014, 2015 and 2016 were taken and, in the case of Ivory Coast, the year 2016. For the average of the variable of high technology exports as a percentage of exports in manufacturing, in the In the case of Mozambique, only the years 2014, 2016 and 2017 were taken.

Source: Rovira (forthcoming), *Deconstruyendo el proceso de desarrollo de ALC: entre la heterogeneidad productiva, la escasa complejidad tecnológica y la concentración del ingreso*.

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The coronavirus (Covid-19) crisis is an opportunity to implement pending structural reforms in the region and lay the foundations of a new social contract. The crisis comes at a time of growing discontent between citizens and states – as highlighted by the protests in late-2019 – and unmet aspirations for better-quality public services and well-being (OECD et al., 2020). While the crisis may deepen social discontent, it could also create momentum to rethink the social contract, address structural vulnerabilities – the region’s productivity, social vulnerability, institutional and environmental development traps – and thereby respond to rising aspirations. In evolving a new social contract, dialogue among all actors, including civil society, policy makers, academics, unions and the private sector, is essential to build consensus, address existing issues and guarantee a sustainable pact.

Such a process should take several dimensions into consideration. First, stronger social protection systems could play a central role in future public policies. Second, more resources will be necessary to build resilience and finance inclusive development, including through reformed progressive tax systems and more efficient public expenditure. Third, successful sustainable development strategies should support effective co-ordination to boost formal employment, productivity growth and the transition to more inclusive and low-carbon development models. The participation of a broad range of actors throughout the policy-making process is necessary to draw upon a variety of knowledge and viewpoints. For this reason, international and regional co-operation will also be important sources of knowledge, financing and co-ordinated action both in the immediate response to the crisis and to sustain the future reforms and a sustainable recovery in the region (OECD et al., 2020).

Digital transformation in the time of coronavirus (Covid-19)

The coronavirus (Covid-19) and its containment have corroborated the increasing role of new technologies and a transition towards a digital economy and society. The exponential increase in Internet traffic, the growing importance of teleworking and teleconferencing, and the maintenance of distribution and supply value chains are just a few indicators of this acceleration (CAF, 2020b). Technology has become particularly useful to help contain the pandemic, with some economies using digital tools to communicate test results and track quarantined citizens (Kim, 2020) (see Chapter 4). Digital technologies have allowed parts of the population to keep working or studying from home while in quarantine, allowing access to updated information, public services and education programmes while complying with social distancing measures (see Chapter 3).

The Internet, digital platforms and e-commerce contributed to a few sectors maintaining partial activities. They facilitated commercial transactions (e.g. Amazon, Mercado Libre, Rappi), financial services (e.g. Ant Financial, Avant, Mercado Pago, Nubank), communication services and social networks (e.g. Facebook, Skype, WhatsApp, Zoom), tourism and hosting services (e.g. Takeoff, Booking, Airbnb), app development (e.g. Apple iOS, Google Android) and job matching (e.g. Laborum, LinkedIn, Workana, Freelancer). Digital technologies can play an important role in the region’s recovery as well, while addressing the persistent challenge of low productivity. They can spur new connections between supply and demand, facilitate commercial transactions and job matching, and create or modernise industries, for instance, into agriculture (Agrotech), banking and finance (Fintech) or automotive (Autotech) (see Chapter 2). Analysis of Big Data captured by digital payments is allowing governments to track the recovery and facilitating research on policy effectiveness more promptly.

The different impacts of containment measures across sectors and socio-economic groups is a stark reminder of why addressing digital gaps, promoting inclusiveness and

making technologies work for all should be a main policy goal. Only workers, students, citizens and consumers with adequate infrastructure and skills can benefit from the advantages of technological tools to continue working, studying and accessing goods and services. Urgent additional efforts are necessary in the region to deploy communication infrastructure (CAF, 2020b), improve regulatory frameworks and enhance access to the internet and digital services. In parallel, education and training systems must be better equipped to deliver digital skills (OECD, 2020d) and transversal skills (IDB, 2019). These skills are necessary for people to benefit from the digital transformation and adapt to changing circumstances through their life. For instance, gender disparities start early in school and affect future professional development. In both LAC and the OECD, boys are four percentage points more likely to start using digital devices before age 4 and five percentage points more likely to start between ages 4 and 6 (see Chapter 3). An increasing role for international co-operation is needed to co-ordinate and intensify such efforts (see Chapter 5).

Digital transformation as a catalyst for inclusive and sustainable development

Low economic growth, a vulnerable middle class and persistent inequalities are symptoms of the region's four development traps. Their circular, self-reinforcing dynamics limit countries' capacities for further inclusive and sustainable growth. These traps are the result of longstanding weaknesses and new challenges arising from progress towards higher income status (OECD et al., 2019). The digital transformation brings new tools and opportunities, but also challenges. If properly adapted, digital tools can help the region to cope with the current crisis and existing structural challenges. Technological progress has accelerated, and major shifts are radically transforming economies and societies.

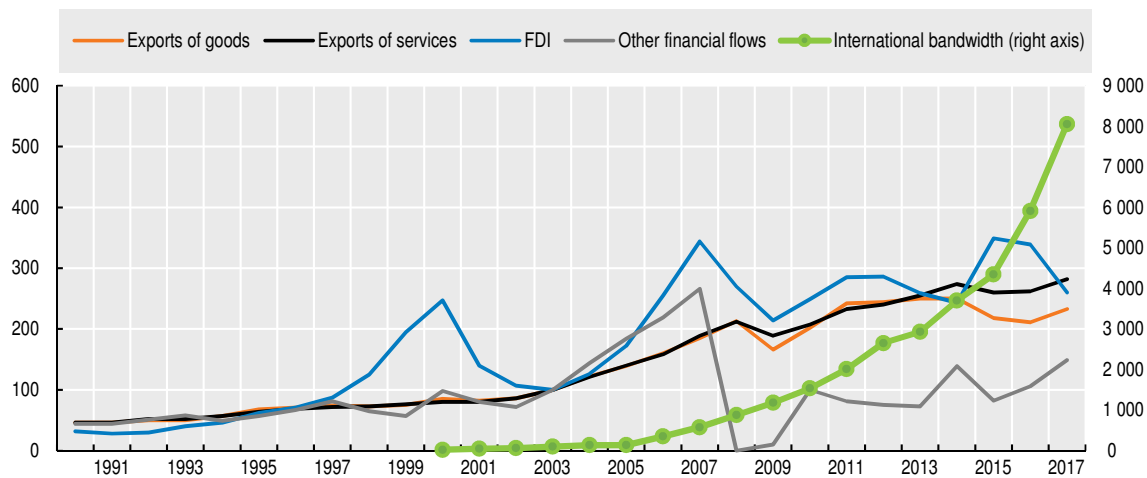
The digital transformation is still at an early stage in LAC, and the major transformational impact of changes is yet to be seen. AI, Big Data, Blockchain, the IoT, drones, 3D printing, computing power, cloud computing and 5G networks are prominent examples making up the so-called fourth industrial revolution or next production revolution (OECD, 2017a, 2017b). The dynamism of digitalisation is evidenced by the fast growth of international bandwidth capacity⁴ since 2007, despite volatility in international markets and a global financial crisis. Worldwide data flows increased about 130-fold between 2002 and 2017, while commercial and financial flows only tripled. Three phases can be singled out. The first phase of growth, from 2000 to 2010, shows the beginning of the digital transformation and associated data flows. The second, between 2010 and 2015, shows an acceleration of these flows, mainly driven by the development of broadband networks. The third, from 2015 onwards, shows greater acceleration in data flows, driven by greater combined adoption of digital technologies (Figure 1.13).

The digital transformation can help address the region's development traps. It can support a more inclusive and productive society (see Chapters 2 and 3), help diversify the LAC economies (OECD, forthcoming), help improve governance, enhance access to public services (see Chapter 4), expand the way people collaborate and create content, and enable them to benefit from access to global markets and greater product diversity and choice. The United Nations (UN) Sustainable Development Goals (SDGs) identify access to information and communications technologies (ICT) and universal and affordable access to the Internet as a key target (target 9c). Digital tools can promote the achievement of many SDGs (OECD et al., 2019).

Policy makers in the LAC region need to be more pro-active in "going digital" and step up their engagement with citizens, businesses and unions to adapt policies to the new context. Efforts are underway but there are still strong lags (OECD, 2020e), and seizing the opportunities will also require new policy approaches that take into account how the transformation affects all aspects of the economy and society in complex and interrelated

ways, challenging existing policies in many areas and cutting across sectoral policy silos. Stronger domestic (including across levels of government) and international co-operation and collaboration, and rethinking how policies are developed and implemented, will be critical. The OECD Going Digital project identifies seven key areas of action to make the digital transformation benefit growth and well-being: 1) enhance access to digital technologies; 2) strengthen their effective use; 3) enable digital innovation; 4) ensure quality jobs for all; 5) promote an inclusive digital society; 6) strengthen trust; and 7) foster open markets (OECD, 2019a). Action in these areas can provide Latin American governments with a useful framework to overcome LAC's development traps.

Figure 1.13. Commercial flows of goods and services, foreign direct investment, other financial flows and international Internet traffic capacity, 1990-2017 (Index 2003 = 100)



Source: ECLAC (2018b), *State of Broadband in Latin America and the Caribbean 2017*.
 StatLink <https://doi.org/10.1787/888934171571>

If digitalisation is to be a driver of sustainable development, the design and implementation of digital transformation strategies should be coherent and aligned with a country's sustainable development strategy. In this respect, it is important to highlight how digital transformation can help address spatial disparities and move towards a low-carbon development model. The regional (sub-national) dimension should not be overlooked. The considerable heterogeneity in digital transformation across regions within countries must be addressed to boost productivity, competitiveness and inclusion in co-ordination with national policies (Box 1.2).

Box 1.2. Regional gaps in digital transformation: the case of Colombia

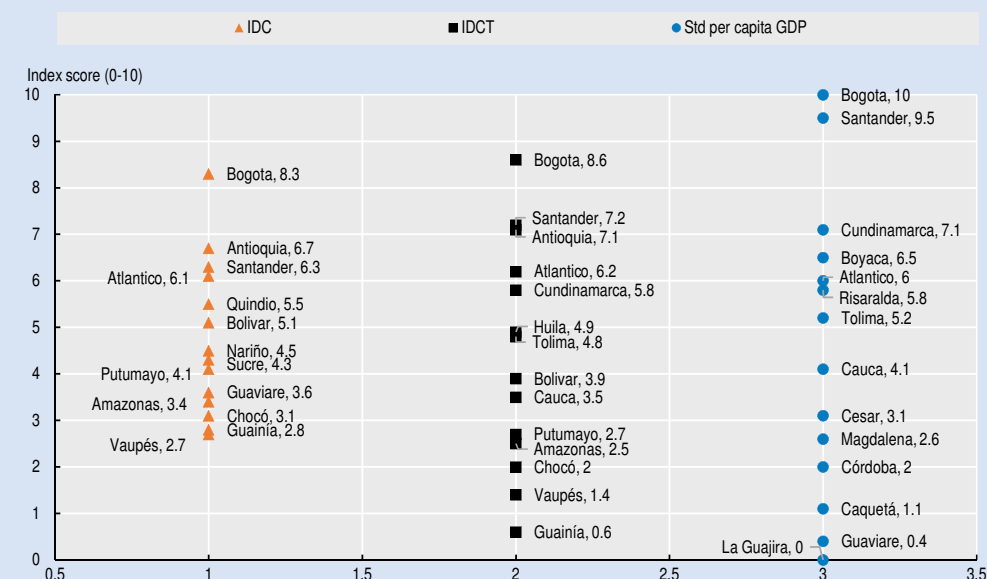
For the past seven years, the Private Competitiveness Council and the Universidad del Rosario have produced and published the Departmental Competitiveness Index (IDC), a multi-dimensional diagnosis of the economic development of Colombia's regions based on the methodology of the World Economic Forum (WEF) Global Index of Competitiveness. The IDC is constructed from 104 hard indicators – which do not correspond to results of perception surveys – grouped into 13 pillars and 4 competitiveness factors. The final result is a normalised score from 0 to 10 for Colombia's 32 departments and Bogotá.

The indicator has been used as a diagnostic and follow-up tool for local development plans. It was recognised by the WEF in 2017 for its ability to measure regional competitive

performance and has generated numerous discussion spaces throughout the country as a key input into public policy analysis for the regions (Consejo Privado de Competitividad/ Universidad del Rosario, 2016; WEF, 2017).

In 2019, the IDC highlighted the importance of digital transformation by including an ICT adoption pillar. This served as the basis for the Departmental Technology Connectivity Index (IDCT), which was inspired by the Global Competitiveness Index ICT adoption pillar and the OECD Going Digital conceptual framework. The IDCT evaluates the departments' performance in five areas: 1) public appropriation of ICT; 2) ICT infrastructure in the territories; 3) household access; 4) ICT entrepreneurship; and 5) human capital formation. The IDCT reveals large gaps in the area of insertion and mass adoption of ICT at the regional level: a gap between departments of 5.6 points in the IDC ranking and 8.0 points in the IDCT. Classification in the IDCT coincides, in part, with per capita income of the departments (Figure 1.14).

Figure 1.14. Dispersion of scores in the Departmental Competitiveness Index, Departmental Index of Technological Connectivity and GDP per capita in Colombia, 2019



Notes: GDP per capita excludes mining-energy activities. To perform normalisation, a maximum-minimum transformation was used that assigns a value between 0 and 10.

Source: Consejo Privado de Competitividad (2019).

StatLink <https://doi.org/10.1787/888934171590>

Illuminating Colombia's enormous digital transformation disparities is the first step. These indexes should be used to inform public policy actions. For instance, given that the greatest gaps in digital transformation are found in departments with high rurality rates, public-private partnerships could provide the necessary communication infrastructure for regional connectivity, so that it does not fall completely to the public sector (Consejo Privado de Competitividad, 2019).

As a result of the dematerialisation of the economy, the digital transformation can help achieve a "fair" transition to sustainable low carbon growth by producing clean energy (e.g. electrifying industry, transport and household consumption; regenerating natural

carbon sinks) and improving resource use efficiency (e.g. reducing waste, minimising the carbon intensity of construction) (IDB /DDPLAC, 2019). In all cases, supply of digital goods and provision of digitally deliverable services reduces the need for physical movement, reducing emissions. Similarly, both can increase efficiency in energy production and consumption. The digital transformation and the transition to a low-carbon economy can have strong social and civic inclusion spillover effects. It can help bring health benefits and quality jobs. Transition to a low carbon economy must be fair in the sense that efforts to preserve the planet must go hand-in-hand with social justice. There are risks associated with high levels of digital energy consumption: polluting production processes and, in the case of hardware devices, significant e-waste. In 2017, digital technology and storage of generated data accounted for almost 7% of worldwide electricity consumption. With more citizens and devices connecting to the Internet, the figure is expected to rise, putting further pressure on the environment (Greenpeace, 2017).

Measurement plays a key role in the design and evaluation of policies and to ensure the effectiveness and accountability that are needed to rebuild trust between citizens and states, but existing tools and metrics struggle to keep up with the digital transformation and its possible impacts (Box 1.3) (OECD, 2019c). In the short term, priority should be given to improving the international comparability of current indicators and making statistical systems more flexible to the introduction of new concepts related to the digital transformation. In the longer term, the statistical community will have to design new and interdisciplinary approaches to data collection and exploit the information captured by digital technologies. Partnerships with the private sector will be especially important in bringing new data and insights into the policy-making process to achieve these objectives (OECD, 2019c).

Box 1.3. Measuring the digital transformation: A roadmap for the future

The OECD articulated nine actions that would improve countries' capacity to monitor and measure the digital transformation and its impacts. The first four aim to equip governments with better data and indicators for dealing with the challenges. The remaining five target areas for priority attention. The goal is to advance the measurement agenda and elaborate key indicators for dimensions of the OECD Going Digital integrated policy framework, along with additional indicators providing more detail and nuance (OECD, 2019c).

Action 1. Make the digital economy visible in economic statistics.

Action 2. Understand the economic impacts of digital transformation.

Action 3. Encourage measurement of the digital transformation's impacts on social goals and people's well-being.

Action 4. Design new and interdisciplinary approaches to data collection.

Action 5. Monitor technologies underpinning the digital transformation, notably the Internet of Things, AI and Blockchain.

Action 6. Improve the measurement of data and data flows.

Action 7. Define and measure skills needs for the digital transformation.

Action 8. Measure trust in online environments.

Action 9. Establish an impact assessment framework for digital governments.

The ambitious transformation envisioned by the UN 2030 Agenda for Sustainable Development implies a change in the development paradigm that must be conceived in consideration of the new industrial era driven by the digital revolution. The digital transformation results in changes in consumption and production models that can offer both opportunities and risks to the environment. The response to the coronavirus (Covid-19) crisis affords an opportunity to tackle both issues at once: recovery policies should direct economic stimulus towards building a development model grounded in environmental sustainability (OECD, 2020b).

Conclusion

LAC entered the coronavirus (Covid-19) crisis with existing development traps and a deep social discontent, illustrated by a wave of mass protests in late 2019. It was also undergoing its weakest period of growth since 1950. The crisis has exacerbated deep, structural challenges in LAC countries.

Containment measures brought an immediate and sharp drop in economic activity, while global lockdowns created an unfavourable external context, with a strong decline in global demand, trade, tourism and commodity prices and increased financial volatility, as witnessed by record-high capital outflows in the first quarter of 2020 and exchange rate depreciations.

Sharply reduced economic growth has dimmed prospects for socio-economic progress in LAC. The social consequences of the crisis have been asymmetrical, mainly affecting the most vulnerable. A large number of mostly micro firms will likely close, entailing considerable job losses and affecting household income. The income shock will most hurt the poorest and economically vulnerable households, and significant increases in poverty and extreme poverty are expected. Most workers in these more exposed income groups are caught in a social vulnerability trap: they are in informal jobs that limit their access to social protection, unemployment insurance, income stability and savings as a safety net. Informal sector workers are also particularly vulnerable to sanitary challenges brought by the pandemic and lack necessary working conditions that would reduce health risks.

Most countries have responded with timely monetary and fiscal measures to mitigate the socio-economic impacts of the crisis. Some central banks have eased monetary conditions by lowering interest rates and adopting liquidity measures, to promote expansion of domestic demand and facilitate business activity. Fiscal policy has played a strong role in the short term and will be pivotal for the recovery and addressing structural challenges, such as sluggish productivity growth, in the medium term. Countries' ability to deploy fiscal policy depends on their starting fiscal space and their access to international markets. Given the limited space and heterogeneous challenges, global co-ordination of macroeconomic policies and of public debt management is a priority.

Digital technologies have been essential in confronting the pandemic and its socio-economic consequences. They helped maintain some business continuity and allowed part of the population to telework and continue education remotely. However, few in LAC have the infrastructure and skills to benefit fully from these technologies; the pandemic confirms the high potential of the digital transformation but highlights the urgent need to close the digital divide.

The usefulness of digital technologies during the pandemic illustrates the importance of the digital transformation in overcoming the LAC region's structural challenges and development traps identified in LEO 2019. The traps themselves result from longstanding structural gaps reinforcing development challenges. In this sense, as countries advance in their respective development pathways, structural gaps in key development dimensions,

such as productivity, social inclusion and poverty, have generated vicious dynamics leading to development lock-in. The pandemic has revealed that the structural problems that the region faces limit the development and adoption of digital technologies and solutions. The scarce percentage of the population that has been able to access digital solutions, for example teleworking, and the small number of companies that were digitally prepared to face the coronavirus crisis should be a wake-up call.

The digital revolution presents multiple opportunities that can allow to overcome the structural gaps that the region is facing. Properly adopting new technologies can ignite new engines of growth and support productivity growth and diversification (see Chapter 2). Digital tools can improve well-being by creating new jobs, improving human capital and fostering better work-life balance (see Chapter 3). They can strengthen public governance by facilitating more credible, effective, inclusive and innovative institutions, and better equip them to address citizens' demands and rising social discontent (see Chapter 4). They can also help achieve a fair transition to sustainable green growth and a low-carbon development model, with the dematerialisation of the economy. Many challenges of the digital transformation transcend borders, requiring international efforts and development partnerships. LAC can draw on lessons from abroad to make better use of technologies to ensure that the digital transformation benefits all (see Chapter 5).

Notes

1. The International Labour Organization estimates that 23% of workers in Latin America are in occupations that allow home-based work, as opposed to 30% in North America and Europe, 12% in Asia-Pacific and 7% in Africa (ILO, 2020).
2. Hepburn et al. (2020) survey of several senior officials and other economic experts from G20 countries on the relative performance of 25 major fiscal recovery “archetype” fiscal packages across four dimensions: speed of implementation, economic multiplier, climate impact potential, and overall desirability. They identify five policies with high potential on both economic multiplier and climate impact metrics: clean physical infrastructure, building efficiency retrofits, investment in education and training, natural capital investment, and clean R&D.
3. Burzynskaa and Contrerasa (2020) highlight two main reasons girls have a higher risk of not returning to schools: a higher risk of sexual exploitation, pregnancy, and (forced) marriage during lockdowns; and a disproportionate increase in unpaid household work, resulting in girls spending more time helping out at home instead of studying.
4. International bandwidth is the maximum amount of data transmission from one country to the rest of the world.

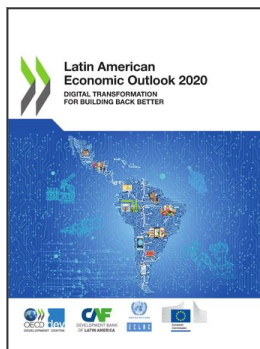
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