

# The macroeconomic challenges facing post-pandemic Latin America

*Latin American countries have struggled during the pandemic and did not take full advantage of the credit lines available to them. **Andrés Velasco (LSE)** looks at the challenges facing their economies as they start to recover.*

The public health performance of Latin American and Caribbean nations during the pandemic was dismal. Six of the 20 countries with the [highest per capita deaths](#) in the world are in Latin America. Peru heads the list and Brazil is 8th. While poverty, pre-existing health conditions, weak health infrastructure, and insufficient enforcement and respect for health directives played a role, those factors alone cannot explain why the region did so badly. Many countries in Asia and Africa suffer from the same problems and yet had fewer deaths per capita. Even countries which vaccinated people early, like Chile — and which, like Uruguay, were looking fairly good at the beginning of the pandemic cycle — ended up as mediocre performers. Uruguay and Chile did better than average for the region, but compared with other middle-income countries around the world, their performance is unimpressive.

From a macroeconomic point of view, there was some progress compared to earlier times when the region suffered powerful external shocks. Only Chile was in a position to carry out strong counter-cyclical fiscal and monetary policy when the global financial crisis erupted 12 years ago. This time around, in addition to Chile, Peru, Brazil, and to some extent Colombia did. There was more fiscal room to manoeuvre and more credibility on the monetary front, which made an aggressive response feasible. And, as Andrew Powell of the Inter-American Development Bank has said, this was the first big crisis to have hit Latin America that does not trigger a financial crisis in the region. Countries that enjoyed market access retained it, and so far, we have not seen defaults, runs on banks, or wild gyrations in asset prices.

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But there are many caveats to this rosy assessment. To start with, only a handful of countries had scope to carry out very aggressive counter-cyclical measures. Peru and Chile went into the crisis with low debt-to-GDP ratios. Brazil entered it with high debt-to-GDP ratios, but was blessed with a huge domestic financial market and consequently was able to borrow. Mexico, meanwhile, which has a left-wing president who has a reputation for being allergic to the idea of credit, could have done a lot more but chose not to.

These conditions did not apply in the rest of the region. Mauricio Cárdenas, the former finance minister of Colombia, has said that rich countries did whatever it takes and developing countries did whatever they could afford. Brazil, Peru and Chile did whatever it takes because they had the fiscal space. Many others did not.

It is puzzling that since countries did not lose access to the world capital market and enjoyed the ability to borrow from the International Monetary Fund, the World Bank and the Inter-American Development Bank, current account deficits narrowed as much as they did. The standard model suggests that if countries suffer a transitory shock, so that their income is low countries had to adjust by contracting demand and imports, so that their external deficits narrowed. This time around, they did have a choice. Yet the deficit still narrowed.

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Is the explanation that countries did not have as much room to borrow as some of the numbers suggested? Or is it that they could have, but that going to the IMF is still associated with a lot of stigma? The IMF developed new facilities and advertised its willingness to lend during the pandemic, but the overall amounts committed were puny. The IMF argues that the supply of loans was there, but the demand was not. That can't be quite right. If I'm running an ice cream shop with only three flavours, and no one wants to buy my ice cream, that's my problem: it's not the consumer's problem. Perhaps we should conclude that the IMF needs to develop a different kind of ice cream.

In Latin America, the pandemic crisis is ending, but the spectre of a debt crisis remains. Over the short run, most economies are recovering quickly and benefitting from high commodity prices. But over the medium term, the combination of much higher public and private debt, shortening debt maturities, and rising world interest rates is not auspicious. Countries with debts amounting to a higher percentage of GDP will of course be at greater risk, and that ratio varies a great deal across Latin America. But there are several nations — Brazil and Argentina among them — where debt ratios are already in the worrying zone. If rising interest rates cause a shortening of maturities, as governments refuse to lock in the higher rates, the stage could be set for the kinds of debt runs the region has witnessed far too often in the recent past.

The focus on productivity and long-term growth in the [IDB's report](#) is very welcome. Latin America as a whole tends to perform badly in both dimensions. Chile used to be the poster child in these areas, but today suffers from stagnating productivity and plummeting growth capacity.



COVID testing in Lima, January 2021. Photo: [Municipalidad de Lima](#) via a [CC BY NC SA 2.0 licence](#)

Today no one in the region enjoys rising and sustainable growth trends. Nor will there be a one-size-fits-all solution to the productivity problem in the region. South America, Central America and the Caribbean, and Mexico have very different export opportunities. While Central America and Mexico are integrated into the North American value chain, South America is not. Indeed, it is the only major region of the world, along with Africa, that has no substantial participation in any value chain. This is a huge hindrance to diversifying exports and to growth.

Green infrastructure investment could help. Multilateral lenders will look to finance new investment in infrastructure. The region should take full advantage of this opportunity. The trick will be to increase green infrastructure while adding as little as possible to the region's debt burden. In low-income countries grants should play the central role. And for middle income emerging nations in the region, equity inflows, private-public partnership and other kinds of innovative financing arrangements need to take centre stage.

The [IDB's report](#) argues room for new green spending could be found if Latin America restructured public spending and reduced inefficient or regressive expenditures. That is right, but easier said than done. The political economy of making those changes can be very difficult. It would be pleasant to think that every year governments start from a blank slate and can get rid of undesirable expenditure. The truth is, of course, that a great deal of it has powerful defenders. Regressive and eco-unfriendly energy subsidies are an obvious example. Argentina and Ecuador have struggled to get rid of them.

Earned income tax credits would make a considerable difference to poverty and exclusion in Latin America

If countries are going to spend more to fight poverty and inequality, they should prefer earned income tax credits (EITC) over a universal basic income. Too much has been done to boost social welfare for citizens in stable work at the expense of those left out of the formal labour market, who often have very little access to welfare benefits. EITCs are expensive, but can be targeted — towards women or the young, for example. They would make a considerable difference to poverty and exclusion in Latin America.

The political climate, unfortunately, is not receptive to these kinds of policy discussions. In my 30 years working in the region, I have never seen a political environment that is so focused on the short term and so inclined towards demagoguery and populism. In the next 12 months, Chile, Brazil and Colombia will have presidential elections that are looking more and more like choices between the extreme right and the extreme left. But populist cycles do eventually come to an end. When that happens, the region would be wise to pay attention to the wise policy counsel the IDB provides in this report.

*This post represents the views of the author and not those of the COVID-19 blog, nor LSE. It is based on Andrés Velasco's contribution to [Opportunities for Stronger and Sustainable Post-Pandemic Growth in Latin America and the Caribbean](#), an LSE event which discussed the Intra-American Development Bank's [2021 Latin American and Caribbean Macroeconomic Report](#).*