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REVIEW

ECONOMIC  
COMMISSION FOR  
LATIN AMERICA AND  
THE CARIBBEAN



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COVID-19  
RESPONSE

# CEPAL REVIEW

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THE CARIBBEAN

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The *CEPAL Review* was founded in 1976, along with the corresponding Spanish version, *Revista CEPAL*, and it is published three times a year by the Economic Commission for Latin America and the Caribbean (ECLAC), which has its headquarters in Santiago. The *Review* has full editorial independence and follows the usual academic procedures and criteria, including the review of articles by independent external referees. The purpose of the *Review* is to contribute to the discussion of socioeconomic development issues in the region by offering analytical and policy approaches and articles by economists and other social scientists working both within and outside the United Nations. The *Review* is distributed to universities, research institutes and other international organizations, as well as to individual subscribers.

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*This publication, entitled CEPAL Review, is covered in the  
Social Sciences Citation Index (SSCI), published by Thomson Reuters,  
and in the Journal of Economic Literature (JEL),  
published by the American Economic Association*

United Nations publication  
ISSN: 0251-2920  
LC/PUB.2021/4-P  
Sales No.: E.21.II.G.7  
Distribution: G  
Copyright © United Nations, 2021  
All rights reserved  
Printed at United Nations, Santiago  
S.20-00628

This publication should be cited as: Economic Commission for Latin America and the Caribbean (ECLAC), *CEPAL Review*, No. 132 (LC/PUB.2021/4-P), Santiago, 2021.

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#### Explanatory notes

- Three dots (...) indicate that data are not available or are not separately reported.
- A dash (-) indicates that the amount is nil or negligible.
- A full stop (.) is used to indicate decimals.
- The word "dollars" refers to United States dollars, unless otherwise specified.
- A slash (/) between years (e.g. 2013/2014) indicates a 12-month period falling between the two years.
- Individual figures and percentages in tables may not always add up to the corresponding total because of rounding.

# Editorial note

As the first year of the third decade of the twenty-first century draws to a close, it is certain to go down in the annals of world history as the year of the health emergency caused by the coronavirus disease (COVID-19) pandemic. During these past 12 months, the world has faced moments of tremendous uncertainty and pain as a result of the lethal disease caused by this virus, which, after emerging in the Chinese city of Wuhan in January, quickly developed into a global pandemic. At the time of writing, world health agencies estimate the number of cases of coronavirus infection to be in excess of 60 million people worldwide, and that nearly 1.4 million human beings have died from the disease. As a result of the human progress achieved over the past century, thanks to scientific advances and the steady, albeit unequal, progress in humankind's material conditions, together with the improvement and universalization of health systems, the world had become unaccustomed to pandemic crises of such huge proportions as it faces today. The most recent forebear of the coronavirus crisis occurred a century ago, in 1918, when "Spanish flu" engulfed the world, claiming between 20 million and 40 million lives, according to historical estimates.

Predictably, the COVID-19 pandemic soon triggered a global economic and social crisis. Owing to health lockdown measures of varying degrees of stringency, such as physical distancing, the closure of production units, the collapse of world trade and the lack of a safe and effective vaccine to neutralize the infections (notwithstanding strenuous efforts by the scientific communities and global pharmaceutical industries), the world's economies are experiencing a brutal contraction in output, surging unemployment, lost incomes and, hence, rising poverty levels and major setbacks in terms of income distribution. In this regard, the pandemic has merely deepened the recessionary gaps that have persisted in the global economy since the economic crisis of 2008 and 2009. Set against the cyclical economic crises that have afflicted capitalism throughout its history, this one is the most severe since the Great Depression of the 1930s.

In this sombre scenario, international health statistics show Latin America and the Caribbean to be the region of the world hardest hit by the scourge of coronavirus. Over 11 million people infected and close to half a million deaths are the sad figures that we have to lament thus far. Our region has also been the hardest hit in economic and social terms. Various studies by the Economic Commission for Latin America and the Caribbean (ECLAC) show that, by the year's end, the crisis will have caused a GDP contraction on the order of 9.1%, the closure of 2.7 million firms, 44.1 million people unemployed and 231 million in poverty, of whom 96 million in extreme poverty. The fact that it will also have fuelled significant increases in the Gini coefficient reflects how the scourge of coronavirus is aggravating regional inequality, which was already structurally high before the crisis. The greater virulence with which the pandemic and the economic crisis have affected Latin America and the Caribbean is explained by our region's lacklustre growth since 2014, and the structural features of production and distribution that have historically characterized its dysfunctional pattern of economic, social, political and environmental development.

As a contribution to broadening and deepening discussions on the global crisis and its effects and on the prospects for recovery in Latin America and the Caribbean, this special edition of *CEPAL Review* presents a special issue on the COVID-19 pandemic — guest edited by Alicia Bárcena, Executive Secretary of ECLAC, and Mario Cimoli, Deputy Executive Secretary of ECLAC. Our guest



editors have prepared an introduction, which analyses and reviews the 15 articles written for this special issue by regionally and internationally renowned personalities from the field of social sciences. With this edition, *CEPAL Review* adds to the intellectual output that this United Nations regional commission has produced since the onset of the health emergency in early 2020. It seeks to contribute, from the domain of ideas, to overcoming the crisis and to making real and effective progress towards a new development model, based on production transformation, social inclusion and environmental sustainability — the permanent guiding themes of ECLAC thinking.

Miguel Torres  
Editor of *CEPAL Review*  
December 2020

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# Introduction

## The global economy and development in times of pandemic: the challenges for Latin America and the Caribbean

Alicia Bárcena and Mario Cimoli  
Guest editors

### I. A special edition for complex times

This special edition of *CEPAL Review* has been prepared in the context of the health crisis caused by the global spread of coronavirus disease (COVID-19) in 2020. The pandemic has been accompanied by the most acute economic crisis for global capitalism since the Great Depression of the 1930s. More broadly, it has brought a severe humanitarian crisis in which millions of human lives have been cut short by the virus, while the loss of production and employment has translated into worsening conditions of material well-being for vast segments of the world's population (especially in respect of health, education and nutrition) and hence severe reversals on poverty and income distribution. In this sombre global landscape, Latin America has proved to be one of the regions most affected by the pandemic. This is no accident, given the internal and external asymmetries that characterize its dysfunctional development style, a pattern described by numerous publications in the structuralist and neostructuralist literature analysing the socioeconomic and environmental dynamics of the region at different stages in its history.<sup>1</sup>

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<sup>1</sup> See Prebisch (1962), Bielschowsky (1998), Ffrench-Davis and Torres (2021) and ECLAC (2020), to mention just a few.

In the context of global health history, the pandemic is an ongoing phenomenon whose effects are difficult to determine and measure qualitatively and quantitatively. Prior to this health crisis, other pandemic diseases had resulted in high levels of mortality year after year in recent decades (Žižek, 2020). The question then arises as to what differentiates this pandemic from similar scourges. A plausible answer may be found in the speed of transmission and the mortality that this virus has caused in its first year of circulation. Because of this, the pandemic had an immediate effect on the labour force and thus on effective demand, production and trade. It has also shown that inequality within developing countries is a significant obstacle to the deployment of containment policies.

A variety of analysts have set out to study the impact of this global health phenomenon and offer different perspectives on the future of the economy in the aftermath of the pandemic. One example is the thinking of Chena and Pérez Caldentey (2020), who raise the question of whether the pandemic will reinforce prevailing trends in the organization and coordination of global production and finance or whether, conversely, it will be a factor for disruption and creative destruction. While this question may elicit different answers, it is clear that the health crisis will have ineluctable effects on the region's productive structure and on the prospects of advancing a process of structural and distributional change. Mitigating its negative short-term impacts with urgent measures that also take account of the long term is the way to ensure that these effects contribute to a resolution of the structural problems facing the region, particularly its technological and productive shortcomings and its high level of inequality.

## II. The contents of this edition

With these considerations in mind, this special edition of *CEPAL Review* offers different perspectives on the effects of COVID-19 in the region and puts forward a variety of policy proposals aimed at dealing with the health, social and economic crisis caused by the spread of the virus, in accordance with each author's particular approach.

The material presented here can be classified by the different analytical perspectives in the 14 articles the issue contains. First, there are articles that address the subject of COVID-19 from a global standpoint. These include the pieces by Ha-Joon Chang, Giovanni Dosi, Maria Savona, and Nora Lustig and Mariano Tommasi. This special edition includes another set of articles exploring the effects of the pandemic from a regional perspective, comprising essays by Alicia Bárcena and Mario Cimoli; José Antonio Ocampo; Martín Abeles, Esteban Pérez Caldentey and Gabriel Porcile; Nicole Bidegain, Lucía Scuro and Iliana Vaca Trigo; and Juan Carlos Moreno Brid and Rodrigo Morales. This group of essays is complemented by a pair of articles that analyse pandemic-related topics from a combination of global, regional and national perspectives. In this category are the essays by Benedicte Bull and Francisco Robles and by José Gabriel Palma, which also highlight the political economy challenges posed by the pandemic. The collection of articles in this edition is completed by three papers analysing the situations of individual countries, with Leonardo Lomelí writing on Mexico, Luiz Carlos Bresser-Pereira on Brazil, and Ramón López and Gino Sturla on Chile.

Of the articles with a global perspective, Chang's addresses a central and recurring theme in development debates: multilateralism. The author analyses the factors leading to the deterioration of the world trading system in the context of the neoliberal economic order that has held sway in the governance of the global economy since the 1980s. He argues that this deterioration may be opening the way to a "new" new international economic order, stemming not only from the collapse of world trade and the ongoing effects of the 2008 economic crisis, but also from changes in the global economy and in prevailing ideas, as well as other factors such as the emergence of China as a global economic power, climate change and the health crisis caused by the spread of COVID-19.

Dosi's article analyses some trends in global capitalism prior to the pandemic and certain aspects of the latter that would seem to require a choice to be made between maintaining countries' current mode of governance (characterized by what the author calls techno-authoritarianism) or moving towards new forms of social organization. The author further argues that the health crisis has occurred in a context of increasing technologization and socioeconomic fragility. In this context, there have been very clear trends involving the worsening of functional income distribution to the detriment of wages, the widening of gaps between productivity and wages, and the explosive growth of profits (financial and non-financial).

In a similar vein, Savona examines the effects of COVID-19 in the context of the current digital transformations and employment structures in the global economy, describing some of the new policy challenges posed by the pandemic. In her analysis, she argues that the "new normal" that will emerge must recognize a "new essential" in relation to the world of work and sectors of economic activity. The set of essays with a global perspective is completed by Lustig and Tommasi's study, in which these authors analyse the link between the effects of COVID-19 and the social protection required by the most vulnerable sections of the population.

Regarding the articles with a regional perspective, this issue offers readers a variety of approaches, data and policy implications serving to provide a broader understanding of this health phenomenon in our region. The essay by Bárcena and Cimoli, setting out from the observation that Latin America and the Caribbean has been one of the regions most affected by the pandemic, analyses structural asymmetries prior to the health crisis, which revealed the dysfunctionality of the growth process in the region's countries, and argues for the need to move towards a new pattern of development.

In a similar line of analysis, Abeles, Pérez Caldentey and Porcile examine the effects of COVID-19 in the region, arguing that recovery will require large-scale fiscal policies designed to stimulate effective demand. The composition of these fiscal efforts should, according to the authors, be heavily weighted towards investment aimed at generating technological capabilities, economic diversification and increased linkages in the productive matrix.

Ocampo's essay offers a historical analysis of the impacts of COVID-19, comparing the current health crisis with the Great Depression of the 1930s, the Asian crisis of 1997 and the crisis of 2008–2009, which he calls the North Atlantic crisis. The author notes that all shocks associated with external financing, terms of trade, trade volumes and remittance levels have had less severe impacts than the current health contingency. Ocampo identifies insufficient international financial cooperation as being at the heart of these findings. From this perspective, he argues that the pandemic has hit Latin America and the Caribbean so hard mainly because of the internal structural factors that caused the economic stagnation observed in the region before the crisis, in line with the analyses in the articles by Bárcena and Cimoli and by Abeles, Pérez Caldentey and Porcile.

The set of essays written from a regional standpoint is completed with the study by Bidegain, Scuro and Vaca Trigo, who analyse the impact of the pandemic from a gender perspective, highlighting the way it has affected the economic autonomy of women in the region, and the article by Moreno Brid and Morales, who offer a subregional perspective on the effects of COVID-19 in Central America.

Turning to the articles that combine different perspectives, mention may first be made of Bull and Robles, who conduct a thorough literature review in order to explore how pandemics affect inequality in income distribution. The authors argue that the economic literature provides significant evidence that pandemics increase distributional inequality, while historiographical and political science studies suggest that they can lead to institutional crises which, in a context of mutations within elites and pressure from popular demands, can result in inequality levels being maintained. After contrasting these theoretical theses with a set of empirical data presented for the region, the authors suggest that in the COVID-19 pandemic, although there have been income transfers to the wealthier sectors

and some changes in the composition of elites, there is little evidence that the region is witnessing an institutional crisis, given that it is these elites that have provided the political leadership during the health emergency.

In a similar line of analysis, Palma addresses the issues surrounding inequality in the region, emphasizing the case of Chile. Drawing on the theory of political economy of David Ricardo, income distribution is understood as the materialization of a conflict in which multiple stakeholders are engaged in a struggle over different interests that takes place within a particular historical, political and institutional setting as relevant as the purely economic “fundamentals”. Starting from this analytical framework, Palma argues that, regardless of events over the region’s history, the rich in Latin America have remained rich by virtue of the iron law of oligarchies, i.e. through a mechanism whereby dysfunctional institutions rebuild to ensure a distributive pattern that benefits the oligarchic sectors of society.

Lastly, the special issue is rounded off with three articles exploring the effects of the COVID-19 pandemic on specific countries. Lomelí offers an analysis of the health-care economy in Mexico, Bresser-Pereira examines the impact of the pandemic on the Brazilian economy, and López and Sturla present an essay on the taxation of large fortunes, focusing their analysis on Chile.

### III. Reflections arising from these essays

The articles in this special edition address issues that go beyond the health emergency caused by COVID-19. While dealing with the effects of the pandemic, as outlined in the previous section, they also address global and regional structural aspects that predate the crisis. Thus, the health crisis is highlighting certain questions about the world economy that have arisen every time it has been faced with global shocks of a similar magnitude.

Over the last four decades, as the globalization of technology, finance and trade has intensified, the global economy has been repeatedly struck by economic crises that have exacerbated gaps between developed and developing countries, inequality within and between countries, political tensions and the real threats of environmental destruction.

These occurrences, accentuated particularly by the 2008 economic crisis, have highlighted the multiple failures of globalization in terms of its governance and the dysfunctional patterns of development that it has generated within countries. Rodrik (2011) has addressed these issues, analysing the tensions between globalization, democratic progress and national development policies. In this context, the role played by institutions is crucial in striking a proper balance between the three variables involved, something that is inherently complex, given the diversity and heterogeneity of the arrangements arrived at by different countries in accordance with their social peculiarities and preferences. Often these national arrangements diverge from the institutional forms of regulation, stability and legitimization that markets require. The deregulation of financial markets has led the global economy into sharper cycles of boom and bust and, ultimately, into new financial crises, which have worsened socioeconomic conditions within countries while fuelling anti-globalization social movements.

Where centre-periphery relations are concerned, the supremacy of deregulated financial markets over the real sectors of the world economy has had profound effects on the capability of countries, especially developing ones, to implement productive and trade policies that might enable them to close the internal and external gaps affecting them. The problems of global financial governance are paralleled in the way the multilateral trading system is organized, with restrictions that undermine the capabilities of the global South to implement national industrial policies of a developmentalist cast (Chang, 2002).

In the face of these recurrent economic crises stemming from a globalization that has been dysfunctional in its governance and effects, a year after Rodrik published *The Globalization Paradox*, Paul Krugman released a manifesto whose central demand was to “end this depression now!”. In this work, he argues that the recessionary bias present in global capitalism since 2008, which has now become not only an economic crisis but a humanitarian one in the fullest sense as a consequence of COVID-19, is rooted in the persistence of the austerity policies adopted by technocracies, which inhibit the fiscal and monetary stimuli necessary, in the opinion of Krugman and other Keynesian economists, to boost the drivers of aggregate demand that are required to reactivate global aggregate demand (Krugman, 2012). Various studies published over the past 10 years by the Economic Commission for Latin America and the Caribbean (ECLAC) have addressed the recessionary bias prior to the pandemic, one of whose fundamental determinants is the inadequacy of effective demand both globally and regionally. ECLAC (2016) is an example, with its idea of promoting Keynesian efficiency within the context of the multilateral system.

During these years in which the contradictions evinced by the current global economic system grew more acute, ECLAC refined its proposals for economic, social and environmental progress through a development strategy grounded in a rights-based approach. *Time for Equality: Closing Gaps, Opening Trails* (ECLAC, 2010) laid down the foundations for this strategy, in many instances anticipating criticisms of the world’s current globalization model by globally prominent heterodox economists.

On the basis of the positions set out in that document, the contents of this strategy for development and the pursuit of equality were expanded and detailed in areas that have been a permanent part of the Commission’s developmentalist messages: structural change for inclusive development (ECLAC, 2012) and the need for wide-ranging development compacts relating to taxation, production policy, the advancement of women, social cohesion and environmentally sustainable development, among other things (ECLAC, 2014). This strategy links strongly with the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (ECLAC, 2016) and with the documents *The Inefficiency of Inequality* (ECLAC, 2018), which makes a solid case for the invalidity of the “big trade-off” between equality and efficiency posited by Okun (1975), and *Building a New Future: Transformative Recovery with Equality and Sustainability* (ECLAC, 2020), which presents the Commission’s most recent proposal, one that, in the context of the pandemic, engages with the economic, social and environmental gaps that affect the region to produce a set of policy guidelines designed to create the conditions for a recovery accompanied by structural change and social inclusion.

Thus, while ECLAC has offered these perspectives, which address the key structural asymmetries holding back development in the region, including the technological and production gaps that limit its growth and the culture of privilege (an original take on the political economy puzzle explaining why it is impossible to reduce inequality in a broad sense and apply a progressive tax policy), other voices in the world have drawn attention to the harmful effects of the current pattern of globalization. They include the extensive output of Thomas Piketty and his interpretation of capitalism in the twenty-first century, drawing attention to data on the long-standing concentration of wealth in the developed economies and bringing the analysis of income distribution in the highest percentiles, particularly the top 1% (Piketty, 2014), into the debate and into the realm of economic research. Milanovic (2016) introduced the concept of global inequality, i.e. the average income differential between the world’s inhabitants, into the discussion on distribution. According to Milanovic, inequality in global terms follows the Kuznets cycles of distributional dynamics within countries and income convergence between them. Although this is a contribution to research on the subject, Milanovic’s theses have generated some controversy among analysts, some of whom argue that the way institutions are constructed and the pro-elite asymmetrical distribution of power within societies play a stronger role than the factors posited by Milanovic. The papers by Palma and by Bull and Robles included in this issue offer a view along these lines.

In addition to the new debates on distribution presented in this special issue, the articles included here also open up a reflection on other crucial topics. One is the need for the State to recover its development policy role, given that markets alone, when left to their own devices in the spirit of the liberal philosophy of *laissez-faire*, have not succeeded in operating effectively to meet the requirements of vigorous growth with an appropriate distribution of its benefits among the different social actors, especially in the developing world. ECLAC (2020) addresses the role the State should play as an agent that generates compacts for the implementation of macroeconomic, industrial, social and environmental policies that can support sustainable structural change and social inclusion.

In line with these ideas, a number of economists have argued for the need to expand the role of the State in economic and development policies. Very notably, Mariana Mazzucato has advocated for the entrepreneurial role of the public sector in these policies. Specifically, she has pointed out that the State has been a key actor in investment and that its role in this has been obscured by the high-technology private sector, a segment that has been the subject of myth-making which overshadows the role of the public sector (Mazzucato, 2013). Setting out from this premise, she has linked the role of the State to the importance of technological innovation, revisiting a central aspect of classical political economy: the theory of value. Mazzucato's (2018) central question here is what wealth is and where value comes from. Moreover, she rightly asks what value really is and how much of what is presented as such is not rather appropriation or extraction of existing value. These questions are very important for the development prospects of the region, since the extractivist nature of its economies' productive matrices often concentrates value and does not necessarily create or increase wealth.

Consequently, the need to advance with the creation of new sectors or industries that generate genuine value gives the State a preponderant role in this objective, on the understanding that industrial policy and structural change are *missions* whose purpose is to meet strategic needs for societies (Mazzucato, 2021), such as food and health security, and other essential sectors. These approaches are certainly convergent with what ECLAC (2020) has proposed in relation to productive sectors with strong potential for the deployment of a new development strategy (renewable energies, sustainable mobility and urban spaces, health-care manufacturing and the bioeconomy, among others). The papers by Dosi and Savona included in this edition provide material for reflection on these topics.

Returning to the question of what will become of the world economy after the pandemic, there are various reflections on the subject, many of them just preceding the outbreak of the pandemic, which highlight the malaise being caused by the dynamics of global capitalism. Several of these have been alluded to in this section, and 2019 was a very prolific year for writing on the subject. First, mention may be made of *Capital and Ideology* by Thomas Piketty, who argues that the real essence of inequality is not purely economic or technological, but political and ideological. In an approach closer to Gramsci's than to Marx's, he argues that the driving force of history is not the class struggle, but hegemonic disputes over ideology. An important reflection of Piketty's is that it is possible to move on from capitalism to fairer societies in systems of participatory socialism or social federalism (Piketty, 2020).

On the other hand, the perspectives of Milanovic (2019) and Stiglitz (2019) are more oriented towards correcting the asymmetries of the current pattern of capitalism, i.e. moving beyond neoliberalism. Milanovic argues that capitalism, the one system prevailing in the world economy since the 1990s, has major flaws, such as inequality and corruption, but also advantages in terms of satisfying the autonomy of individuals, although he warns that it carries the moral cost of "material success" being exalted as their ultimate goal (individualism). Nonetheless, he is optimistic about the future of this system and argues that there are ways to reduce its excesses and inequities, something akin to what Stiglitz (2019) conceptualizes as a "progressive capitalism" that can emerge following the correction of aspects such as global corporate concentration, the failures of the financial industry, the



capture of nation-States by business groups and the concentration of data arising from the activities of the new digital technology conglomerates. Action in these areas, Stiglitz believes, can help rebuild the foundations of a fairer and more inclusive capitalism.

A point of view that is more nuanced and perhaps more pessimistic than those of Piketty, Stiglitz and Milanovic is that expressed by Rodrik in 2020, at the height of the pandemic. He succeeds in interweaving his critique of the handling of the health crisis with the problems already affecting the world economy, systematized in his globalization-democracy-State triad, within the framework of neoliberal hegemony. Rodrik argues:

In short, COVID-19 may well not alter – much less reverse – tendencies evident before the crisis. Neoliberalism will continue its slow death. Populist autocrats will become even more authoritarian. Hyper-globalization will remain on the defensive as nation-states reclaim policy space. China and the US will continue on their collision course. And the battle within nation-states among oligarchs, authoritarian populists, and liberal internationalists will intensify, while the left struggles to devise a program that appeals to a majority of voters (Rodrik, 2020).

In these sentences, Rodrik evidently reaffirms the decline of the neoliberal phase of capitalism, but realistically points out that the recessionary biases which it generated over the past decade and which the pandemic exacerbated will continue to operate in the years to come and will persist strongly. Notwithstanding Rodrik's points, what is clear is the growing need to persevere with the idea of putting all intellectual, political and civic efforts at the service of a more balanced, fair and inclusive globalization, while putting those same efforts into a region, Latin America and the Caribbean, that is making progress in overcoming its structural obstacles to development and equality.

Seen in that light, the articles presented in this special edition of *CEPAL Review* bring readers a wealth of perspectives and reflections that we hope will enable them to broaden their understanding of the global and regional phenomena which will need addressing as a result of the new global shock brought by COVID-19.

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# Structural asymmetries and the health crisis: the imperative of a transformative recovery for the advancement of sustainable development in Latin America and the Caribbean<sup>1</sup>

Alicia Bárcena and Mario Cimoli

## Abstract

This article underscores the pressing need to transition to a new development model in Latin America and the Caribbean as the region strives to cope with the current health emergency. Statistics show that the Latin American and Caribbean region has been hit harder by the pandemic than any other and that it has also sustained the most damage in economic and social terms. This is attributable to long-standing structural factors that set the stage for the emergence of its present dysfunctional development pattern. The region grew by a scant 0.4% per year between 2014 and 2019 against the backdrop of a widening external productivity gap, deepening structural heterogeneity, low-productivity development paths and a declining share of wages in GDP. All this has eroded its social and economic development process. The economic reactivation effort must therefore be based on a package of coordinated, ambitious structural reforms in the areas of production, fiscal policy and institutional affairs in order to forge an inclusive and sustainable development style.

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## Keywords

COVID-19, virus, epidemics, economic aspects, economic crisis, health, poverty, unemployment, economic growth, gross domestic product, income distribution

## JEL classification

O54, D30, G01, I14

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<sup>1</sup> The authors are grateful to Gabriel Porcile, Vianka Aliaga and Cecilia Vera for their comments and contributions and to Claudio Aravena, Pablo Carvalho, Ernesto Espíndola, Nicole Favreau and Fernando Sosso for quantitative inputs that have helped to substantiate the lines of reasoning developed here.

## I. Introduction

The spread of the coronavirus disease (COVID-19) in Latin America and the Caribbean since March 2020 has not only triggered an extremely serious health emergency that has taken a heavy toll in human lives and has had serious economic and social repercussions. These effects have, in turn, deepened the recessionary bias that the region's economies were displaying even before the outbreak of the health crisis. This bias translates into slow growth, sluggish exports, lower levels of productive investment and higher employment and has, in a number of cases, led to economic stagnation and concomitant setbacks in social areas that are reflected in rising poverty and worsening patterns of factor and personal income distribution. In some countries, the social and economic crises associated with this dynamic have engendered severe political crises that pose a threat to democracy and to the broad social inclusion that is a necessary condition for any virtuous development process.

In response to the outbreak of COVID-19 and the impacts that it has had and is still having, since March 2020 the Economic Commission for Latin America and the Caribbean (ECLAC) has been deploying a major analytical effort to explore the health, social and economic implications of this crisis and to offer policy proposals to its member countries that will help them to reboot the region's economy and set out on a new sustainable development and growth path.

In this article we will analyse the structural factors that explain why this pandemic has had a greater health-related and socioeconomic impact in Latin America and the Caribbean than it has in other regions of the world and will review the studies on this health crisis that have been conducted by ECLAC. We will argue that, because of these structural factors, the region's pre-pandemic development style was unsustainable from a social (inequality), economic (persistent productive and technological asymmetries between the region and more advanced countries) and environmental (use of natural resources and the biosphere in excess of planetary boundaries) standpoint. An integrated approach needs to be taken to the examination of these three factors in order to encompass their multiple interactions. This approach is based on the analytical model of these three (economic, social and environmental) gaps which was proposed by ECLAC at its thirty-eighth session (ECLAC 2020i). This model describes the region's existing growth pattern and its prospects for moving towards a more virtuous growth path.

This article is divided into six sections. Section II offers an analysis of the global scope of the pandemic in terms of its health and economic impacts. Section III delves into the stylized facts associated with the economic dynamics of the region prior to the outbreak of the present health emergency. Section IV presents the three-gap model along with a discussion of the challenges involved in narrowing those gaps under differing sets of political conditions. Section V surveys the social and economic fallout from the crisis, while section VI concludes the analysis with a series of macro-, meso- and microeconomic policy proposals for finding a viable way forward that will set the region on a new development path: a path that will entail changing production patterns and greater social inclusion and environmental sustainability as the region leaves its current dysfunctional development model behind.

## II. The global scope of the pandemic

### 1. Health impacts

With the rapid spread of COVID-19 around the globe, today our civilization finds itself confronted with a health, social and economic crisis of staggering proportions (ECLAC, 2020a). While the world and the region were able to cope with the outbreaks of human avian influenza ("bird flu") in 2003 and of swine flu in 2009 (transmitted by the H5N1 and H1N1 viruses, respectively), the COVID-19 health emergency

has necessitated much greater containment efforts and has resulted in more cases and more deaths than any other epidemic since the Spanish flu did a century ago. Data compiled by the World Health Organization (WHO) for the period up to 25 February 2021 indicate that COVID-19 has killed 2,486,679 persons.<sup>2</sup> By comparison, historical estimates presented by Murillo (2011) indicate that the Spanish flu claimed between 20 million and 40 million lives, while the Hong Kong flu (1968) caused slightly fewer deaths than COVID-19 had up to the cut-off date for this analysis (see table 1).

**Table 1**  
Worldwide deaths caused by flu pandemics in the twentieth and twenty-first centuries  
(Number of persons)

Years	Disease	Deaths	Virus
1918–1919	Spanish flu	20 000 000 – 40 000 000	H1N1
1957–1959	Asian flu	2 000 000	H2N2
1968	Hong Kong flu	1 000 000	H3N2
2003 <sup>a</sup>	Bird flu	455	H5N1
2009 <sup>b</sup>	Swine flu	18 449	H1N1
2019 –	Coronavirus disease	2 486 679	SARS-CoV2

**Source:** G. Murillo, “Recordando la gripe española”, *Medicina Interna de México*, vol. 27, No. 5, Mexico City, 2011 and World Health Organization (WHO).

<sup>a</sup> Figures up to 10 July 2020.

<sup>b</sup> Figures up to 1 August 2010.

Table 2 provides data on the global impact of COVID-19. These figures indicate that, with over 111 million cases on record to date in the world, the regions where the incidence of the disease has been the lowest are Oceania, with somewhat more than 58,000 cases (0.1% of the world total), Africa, with 3,697,776 cases (3.3%), and the Middle East, with 5,523,592 cases (4.9%), while the regions where the pandemic has hit the hardest are Europe, with 36,794,659 cases (32.9%), North America, with 28,807,637 cases (25.7%), Latin America and the Caribbean, with 21,066,155 cases (18.8%), and Asia, with 16,051,119 (14.3%). The trends in the number of deaths more or less mirror the trends in the number of cases, as, here too, Oceania, Africa and the Middle East have registered the fewest COVID-19 deaths, with 0.05%, 3.7% and 4.5% of the world total, respectively (columns 1 through 4).

**Table 2**  
World regions: COVID-19 cases and deaths as of 25 February 2021  
(Numbers of persons and percentages)

Region	Cases (number) (1)	Deaths (number) (2)	Cases (percentages of the total) (3)	Deaths (percentages of the total) (4)	Cases (per million persons) (5)	Deaths (per million persons) (6)	Deaths as a percentage of all cases (7) = (6)/(5)*100
Africa	3 697 776	91 928	3.3	3.7	3 056	76	2.5
North America	28 807 637	520 779	25.7	20.9	78 734	1 423	1.8
Latin America and the Caribbean	21 066 155	667 308	18.8	26.8	32 453	1 028	3.2
Asia	16 051 119	254 807	14.3	10.2	3 842	61	1.6
Europe	36 794 659	837 638	32.9	33.7	43 399	988	2.3
Middle East	5 523 592	112 987	4.9	4.5	15 668	320	2.0
Oceania	58 271	1 219	0.1	0.0	1 382	29	2.1
World	111 999 954	2 486 679	100	100	14 649	325	2.2

**Source:** Prepared by the authors, on the basis of figures provided by the World Health Organization (WHO) [online] <https://worldhealthorg.shinyapps.io/covid/> and World Bank.

<sup>2</sup> Data on the pandemic are updated regularly on the WHO website ([online] <https://worldhealthorg.shinyapps.io/covid/>) but, for the purposes of this article, 25 February 2021 is used as a cut-off date. The data compiled by the Coronavirus Resource Center of John Hopkins University ([online] <https://coronavirus.jhu.edu/map.html>) exhibit similar trends to those reflected by the WHO figures.

While Asia has one of the highest incidence rates, its COVID-19 death toll (10.2% of the world total) is lower than those of other hard-hit regions owing in part to its sound health policies. In North America, with 520,779 deaths (20.9% of the world total), the United States outpaces Canada in percentage terms in both the number of cases and the number of deaths. Europe, with 837,638 COVID-19 deaths, or 32.9% of the total, is one of the first regions where the virus began to spread on a large scale after it was detected in China in early 2020 and where it has been the most lethal. Italy and Spain saw the largest number of cases and deaths in the early months of the outbreak while, towards the end of 2020, the Russian Federation, France and the United Kingdom were experiencing high case rates. Although the European countries initially managed to curb the crisis with the help of large-scale health and fiscal support measures and were thus able to relax their lockdowns and travel restrictions, many of these countries have since been hit by further waves that have obliged them to reintroduce the types of measures used during the initial outbreak.

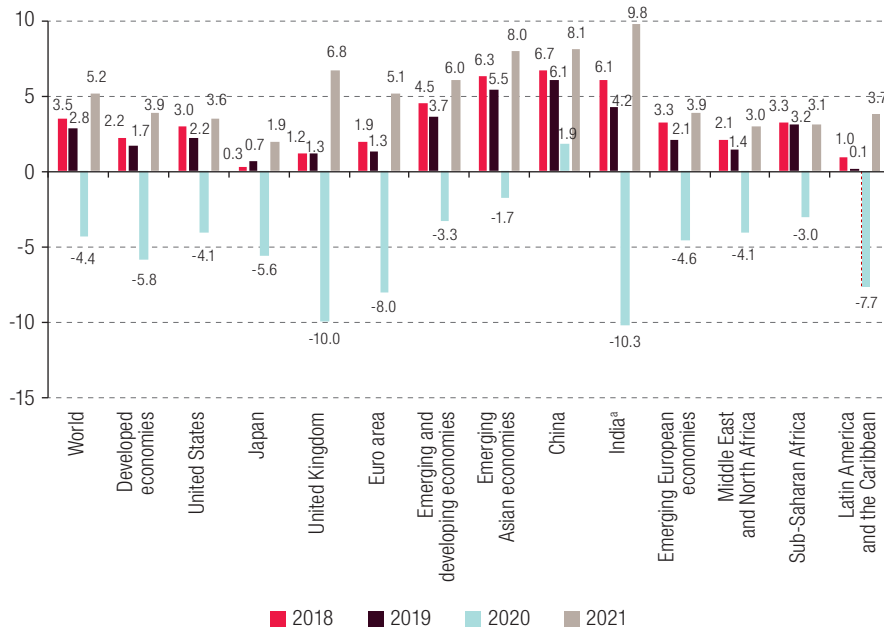
The Latin American and Caribbean region is not only one of the world regions with the most COVID-19 cases, after Europe and North America, but it also has the second-highest COVID-19 death rate in the world, with 667,308 deaths, or 26.8% of the world total. Columns 5 and 6 of table 2 show the numbers of cases and deaths per million inhabitants in each region. The regions with the most cases per million persons are North America and Europe, followed by Latin America and the Caribbean. In terms of the number of deaths, the order changes, however. North America still heads up the list, with 1,423 deaths per million population, but it is followed by Latin America and the Caribbean (1,028) and then by Europe (988). Above and beyond these differences in adjusted regional totals, however, as may be seen in column 7 of table 2, which shows the number of deaths as a percentage of the total number of cases, the rate for Latin America and the Caribbean, at 3.2%, is the highest of any world region. This more informative measurement of the spread and impact of the virus reflects the greater fragility of the region's health-care systems owing to their fragmentation and insufficient coverage as compared to those of the world's more developed regions.

## 2. Economic impacts

The outbreak of coronavirus disease in the Chinese city of Wuhan in January 2020 soon spread to the rest of the world, reaching pandemic proportions. Governments around the world were forced to order lockdowns and impose social distancing measures in an effort to curb the spread of the virus (ECLAC, 2020a and 2020h). These measures, many of which are still in place, have nearly paralysed the global economy. The lockdown introduced early on in China sent shockwaves through many economies that rely on trade with that country, including those whose pattern of specialization rests on commodities, since both the demand for these products and their prices have fallen, although they were expected to rebound towards the end of the year in some cases. In addition, because of China's dominant position in global value chains, production patterns have undergone changes that have swiftly propagated and affected all the countries involved in those chains (ECLAC, 2020a).

The health crisis has thus turned into an economic crisis of an enormous magnitude, one that is comparable to the severe cyclical crises that overtook capitalism in the twentieth century. As noted by ECLAC in its *Economic Survey of Latin America and the Caribbean, 2020*, "the COVID-19 pandemic has pushed the global economy into the worst recession since the Second World War" (ECLAC, 2020h, p. 16). In fact, ECLAC (2020j) projects that the global economy will have contracted by 4.4% in 2020. This trend is illustrated in figure 1, which tracks GDP growth in the major regions and in certain countries that have a strong influence on the world economy. GDP growth in the developed economies, which had already been slowing since 2018, is expected to have plunged by 5.8% in 2020. Within this group, even steeper drops of 8.0% in the euro area economies and of 10.0% in the United Kingdom are projected, while the United States and Japan are expected to see their GDP shrink by 4.1% and 5.6%, respectively.

**Figure 1**  
Selected regions and countries: GDP growth rates in 2018 and 2019  
and projections for 2020 and 2021  
(Percentages)



**Source:** Prepared by the authors on the basis of figures from Economic Commission for Latin America and the Caribbean (ECLAC); World Bank, Global Economic Monitor (GEM) [online database] <https://datacatalog.worldbank.org/dataset/global-economic-monitor> [accessed on: June 2020]; Organization for Economic Cooperation and Development (OECD), OECD Economic Outlook, Paris, OECD Publishing, June 2020; European Central Bank (ECB), "Eurosysteem staff macroeconomic projections", June 2020 [online] <https://www.ecb.europa.eu/pub/projections/html/index.en.html>; and United Nations, World Economic Situation and Prospects as of mid-2020, New York, 2020.

<sup>a</sup> The figures for India are for the fiscal year, which begins in April and ends in March of the following calendar year.

Emerging and developing economies are expected to register a smaller contraction (of around -3.3%), but this will stand in sharp contrast to the growth trend observed in 2018 and 2019. Within this group, the economies of East Asia and the Pacific are estimated to have grown by 1.7%. China's economy will continue to expand, but at a projected rate of only 1.9%, after having buoyed world economic growth in 2018 and 2019 with rates of 6.7% and 6.1%, respectively. India, meanwhile, is likely to see a contraction of 10.3%, and the economies of the Middle East and North Africa are expected to experience a sizeable drop (-4.1%) in their GDP as well.

Among the developing economies, those of Latin America and the Caribbean have not only been the most severely affected in terms of the health of the population (see table 2) but have also been the hit the hardest in economic terms (see figure 1), with their GDP plummeting by around -7.7%. This nosedive in regional production, as will be explained below, is being brought about on the one hand, by the collapse of world trade and weakening international prices for the region's export products and, on the other, by the slump in demand within the economies of the region, which has, in conjunction with widespread lockdowns, driven up unemployment levels and caused many production units to close their doors. As will be discussed later on in this article, these developments are also having a strong impact on society in terms of poverty, extreme poverty and inequality.

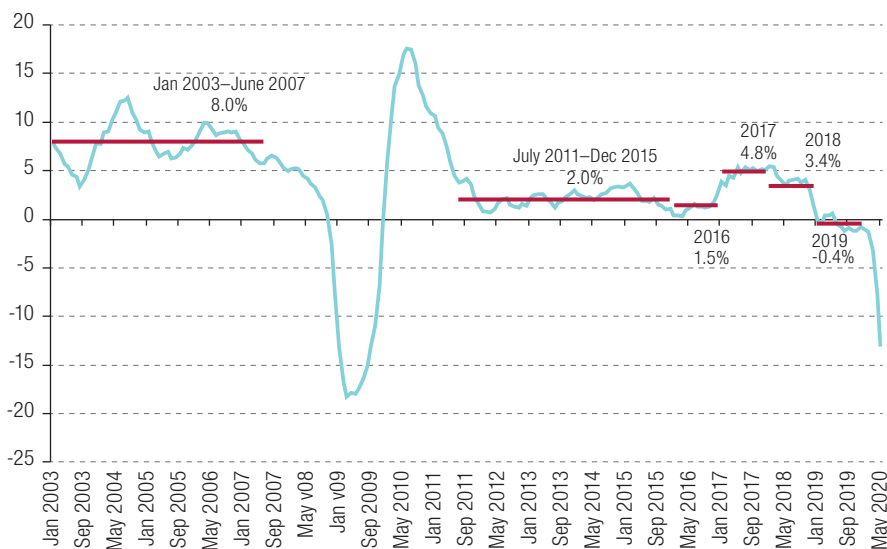
Recent ECLAC projections (2020) point to a resumption of growth both in the world as a whole and in all the regions and countries for which trends have been analysed, however. Nevertheless, a recovery clearly hinges on more effective efforts to contain the pandemic and particularly on the advancement of the national inoculation strategies made possible by international laboratories' swift development of

COVID-19 vaccines. The prompt roll-out of these strategies could do a great deal to reduce worldwide levels of uncertainty and thus re-energize the production sector, spur economic growth, revive trade and contribute to the recovery of employment levels and capital formation.

World trade has collapsed during the pandemic. The World Trade Organization (WTO) has projected a drop of between 13% and 32% in world trade in goods (based on data up to May) (see figure 2). According to figures compiled by ECLAC (2020h), unlike what has occurred in earlier crises, trade in services has been hurt even more than trade in goods. Transport services, in particular, have been badly hurt by the sharp downturn in merchandise trade. In addition, health-related restrictions on international passenger travel have had a massive impact on tourism. Based on data compiled by WTO, ECLAC (2020h) has calculated that activity in the tourism industry plunged by 56% between January and May 2020, and it is projecting a contraction of between 60% and 80% in this sector for the year as a whole.

**Figure 2**

Year-on-year variations in the volume of world trade in goods, January 2003 to May 2020  
(Percentages based on a seasonally adjusted index)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Netherlands Bureau of Economic Policy Analysis (CPB), World Trade Monitor [online database] <https://www.cpb.nl/en/worldtrademonitor>; World Trade Organization (WTO), "Trade forecast press conference", 8 April 2020 [online] [https://www.wto.org/english/news\\_e/spra\\_e/spra303\\_e.htm](https://www.wto.org/english/news_e/spra_e/spra303_e.htm).

With global export demand shrinking, according to initial projections for 2020, it was estimated that commodity prices would be sharply lower than they had been in 2019. This would have a negative impact on the terms of trade for commodity-exporting countries. Oil prices were expected to slump by 36% in 2020. The prices of agricultural products, on the other hand, were forecast to be hurt much less by the crisis, for falling almost 2%. Metal and mineral prices were projected to have dropped by a scant 0.1% overall, but with sharply differing price trends for individual metals and minerals. Thus, the prices of industrial metals, including copper, were estimated to fall by 5%, but this would be almost completely offset by the rise in the prices of precious metals such as gold, which, at least as of 24 July 2020, had jumped by 28% (see table 3).

**Table 3**  
Year-on-year variations in annual average commodity prices, 2016–2020  
(Percentages)

	2016	2017	2018	2019	2020 <sup>a</sup>
Agricultural products	4.9	0.5	0.5	-3.0	-1.7
Food, tropical beverages and oilseeds	6.8	-0.6	-2.8	-3.7	-1.5
Food	11.5	-0.2	-4.3	-0.6	-2.5
Tropical beverages	0.6	-1.7	-10.1	-5.0	6.5
Oilseeds and oils	2.4	-1.0	1.4	-7.7	-2.0
Forestry and agricultural raw materials	-2.3	4.9	13.4	-0.7	-2.4
Minerals and metals	-0.8	23.3	4.2	-1.0	-0.1
Energy <sup>b</sup>	-16.3	23.5	25.6	-9.1	-29.6
Crude petroleum	-15.7	14.5	29.4	-10.2	-35.6
Commodities – total	-4.0	14.5	9.8	-4.6	-10.9
Commodities other than energy – total	2.3	10.8	2.3	-2.0	-0.9

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "World Bank Commodities Price Data (The Pink Sheet)", 2 June 2020 [online] <http://pubdocs.worldbank.org/en/774651591120179792/CMO-Pink-Sheet-June-2020.pdf>; United States Energy Information Administration (EIA), *Short Term Energy Outlook*, 7 July 2020, and data from Bloomberg and Capital Economics.

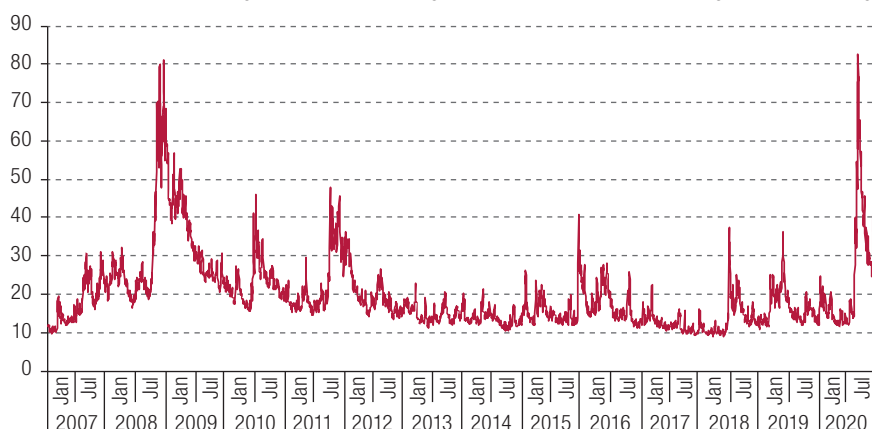
<sup>a</sup> The figures for 2020 are projections.

<sup>b</sup> This category includes petroleum, natural gas and coal.

Governments have adopted a variety of special macroeconomic policy measures, including downward revisions of central bank interest rates, in both developed and emerging economies. The authorities in both of these types of economies have also deployed fiscal stimulus packages of various sizes in an effort to soften the blow for employment and household income. These packages have included, for example, transfer payments to households and businesses, extended grace periods for the payment of taxes and other levies, payroll subsidies, tax cuts and government guarantees for loans and other types of credit.

While conditions have not deteriorated in the financial sector, the level of uncertainty about the health-related, social and economic knock-on effects of the pandemic remains high, and that uncertainty is reflected in the financial market volatility illustrated in figure 3. As measured by the VIX index, market volatility reached an all-time high in mid-March 2020, triggering massive capital outflows from emerging markets and driving up sovereign risk ratings, particularly in emerging markets. Most currencies have depreciated sharply against the United States dollar, given the globally countercyclical nature of that currency, as it tends to strengthen during recessions and to weaken in the face of expectations of reactivations and boom times (see figure 4).

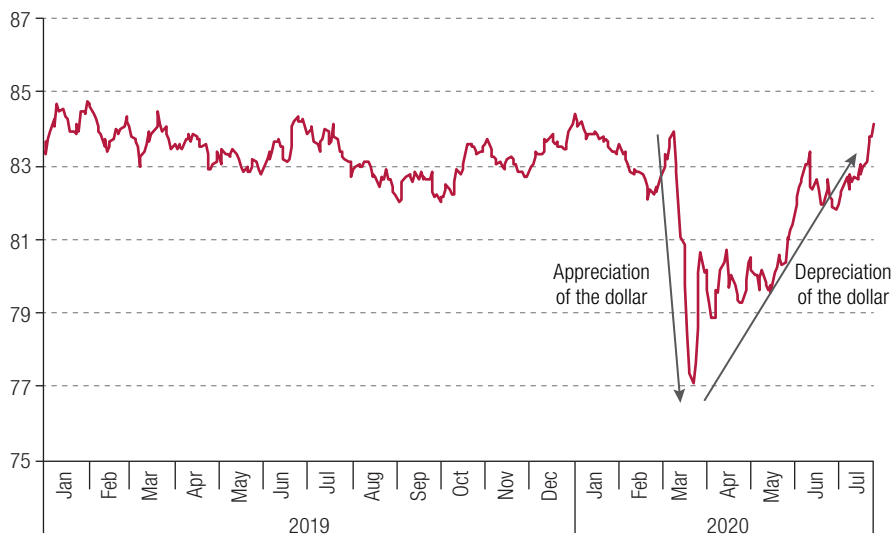
**Figure 3**  
Financial market volatility as measured by the VIX index, 1 January 2007–24 July 2020



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg.



**Figure 4**  
Dollar exchange rate for major currencies, 1 January 2019–16 July 2020  
(DXY index; January 2013 = 100)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg.

**Note:** The Bloomberg Dollar Spot Index (DXY) tracks the trend in the value of the United States dollar against a basket of 10 leading global currencies.

### III. Latin America and the Caribbean and the health crisis

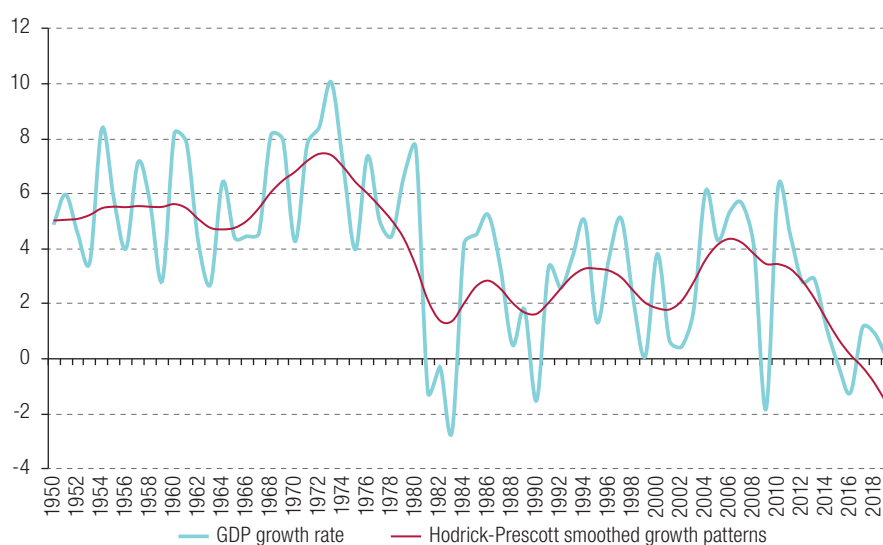
Information was provided in section II which indicates that the pandemic has had a greater health-related and economic impact on Latin America and the Caribbean than on any other world region. In this section, we will show how these impacts are the consequence of recessionary factors that were already in evidence in 2014–2019, when the region's average annual growth rate was a paltry 0.4%. Those six years were marked by the continued impact of the recessionary shocks experienced by the world economy as a result of the 2008–2009 global financial crash (what Ocampo (2020) refers to as the “North Atlantic crisis”) and the euro area crisis of 2011, the elevated level of financial volatility in global markets, the end of the commodity boom, and recent geopolitical and economic developments such as the worsening trade tensions between China and the United States.

This external environment has exacerbated persistent structural factors that are characteristic of the economies of the region, such as structural heterogeneity or domestic production gaps; balance-of-payments growth constraints; the contraction of effective demand, especially in relation to productive investment; the shift in the composition of the export basket back towards commodities and the lack of complexity in the sectoral production matrix in terms of knowledge, innovation, and research and development (R&D); limited fiscal space for social and production policies; the deterioration of employment conditions as the informal sector once again expands; and the long-standing shift in factor income distribution away from wages. Even before the crisis, all these elements were translating into social reversals in terms of poverty, extreme poverty and personal (and household) income distribution (see ECLAC, 2020a, 2020b and 2020i, and, in this special edition, Abeles, Pérez Caldentey and Porcile, 2020). A number of stylized facts will be examined in the following discussion that illustrate the internal and external structural features of regional economic dynamics that predate the crisis occasioned by the pandemic.

## 1. Unstable, volatile growth

Over the long term, GDP growth rates in Latin America and the Caribbean have been lower than those of developed economies and of other peripheral and emerging regions. An even more characteristic feature of the region's lagging development in relative terms is the difficulty it has had in sustaining strong growth rates during economic booms and the relative persistence of slack growth during recessions and reactivations, which signals the presence of real volatility. Figure 5 depicts growth trends in Latin America from 1950 to 2019. A cursory look at the figure shows up two things very clearly: (i) the highest rates registered by the region occurred between 1950 and 1980, which was a period marked by developmentalist policies and State-guided industrialization; and (ii) following the Latin American external debt crisis, which the region began to recover from in 1983, its growth rates regained positive territory and then remained there except in 1990, 2009, 2016 and, as noted in the preceding section, 2020.

**Figure 5**  
Latin America: real GDP growth rates, 1950–2019  
(Percentages)

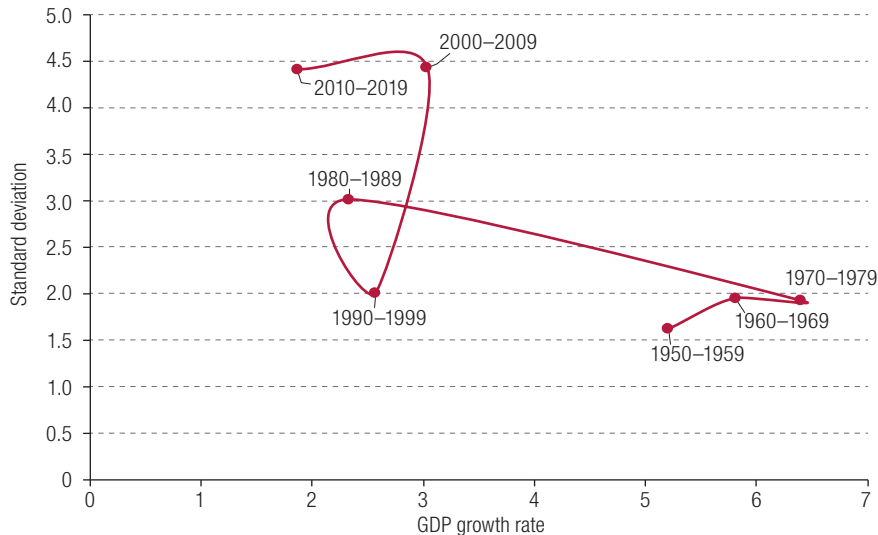


**Source:** Prepared by the authors, on the basis of figures provided by the Economic Commission for Latin America and the Caribbean (ECLAC).

In the years from 1983 to 2020, the region reverted to a production pattern based on static comparative advantages against the backdrop of a hyperglobalization of the world economy, and growth was slower than in the years leading up to that period. When the Hodrick-Prescott filter is applied to the data on this trend, the persistent variability affecting the region's economies becomes evident, along with the downward trend in growth from the 1980s onward.

A more direct measurement of the volatility of the region's economic growth pattern is presented in figure 6, which plots average effective GDP growth rates in different periods (horizontal axis) and shows their corresponding standard deviations (vertical axis). As the reader will see, the region's growth rates were higher and less volatile in 1950–1979, while they were lower and more volatile in 1980–2020. A reduction in external vulnerability and an increase in the accumulation of domestic production capacities associated with the production policies characteristic of the period of developmentalism may be at the root of the explanation for this turnaround in the region's historical growth patterns.

**Figure 6**  
Latin America: volatility of growth, 1950–2019  
(Percentages and standard deviations)



**Source:** Prepared by the authors, on the basis of figures provided by the Economic Commission for Latin America and the Caribbean (ECLAC).

## 2. Growth under external constraints

Externally constrained growth is one of the most typical stylized facts associated with the region's dysfunctional development pattern. The core component of this concept has to do with peripheral economies' inability to grow at a pace that will allow them to absorb the entire workforce. This gives rise to the high levels of underemployment in low-productivity occupations that is characteristic of development dynamics on the periphery (structural heterogeneity) owing to these economies' very limited potential for generating foreign exchange. Raúl Prebisch's analysis of this issue led him to argue that its cause lay in the fact that the periphery's commodity exports are less income-elastic than are imports of the manufactures produced by the world's central economies are (Prebisch, 1962). Over the long term, this results in a divergence of these two types of economies' growth patterns owing to their productive and technological asymmetries and the external debt pressure exerted on the periphery due to its structural foreign exchange shortages. Prebisch (1963) expanded upon these ideas in developing the concept of external constraint, which he described as a succession of balance-of-payments disequilibria of such a magnitude that shortages of foreign exchange first hindered and later blocked the process of import substitution (Rodríguez, 2006, p. 143).

Seers (1962) and Rodríguez (1977) devised similar approaches to the issue of external constraints, but it was Thirlwall (1979) who formalized the concept of growth rates that were compatible with external equilibrium. In a global economy composed of two regions — a centre and a periphery — that rate is expressed as:  $y^E = \frac{\epsilon}{\pi} y^C$ , where  $y^E$  and  $y^C$  represent, respectively, the periphery's and the centre's growth rates;  $\epsilon$  stands for the income elasticity of world demand for exports from the periphery and  $\pi$  denotes the income elasticity of imports coming from the centre. These elasticities are determined, in turn, by the ratio between the periphery's and the centre's technological capacities because these are what determine the nature of a country's participation in the markets where domestic and external demand are growing the fastest. The periphery will grow more slowly than the centre and their growth rates will diverge whenever  $\frac{\epsilon}{\pi}$  is less than 1. This divergence will continue as long as peripheral economies are not able to modify that variable by introducing industrial, production and technology policies to increase it and thus diminish the external constraint.

The relationship between growth and the external sector is illustrated in figure 7, which plots the trade balance as a percentage of GDP (horizontal axis) and GDP growth (vertical axis). Periods during which the economies grew rapidly while registering a trade deficit are followed by periods of low growth in which the region's economies have had to grow and invest less in order to generate surpluses that would allow them to pay their countries' debts. They managed to grow while maintaining a trade surplus only during the years of rapid industrialization in the 1970s and during the commodities boom, although, in this latter case, growth was slower. The situation that began to take shape at the start of the 2020s, with the outbreak of the pandemic, is an extremely complex one, however.

**Figure 7**  
Latin America: the trade balance as a percentage of GDP and GDP growth rates, 1950–2019  
(Percentages)



**Source:** Prepared by the authors, on the basis of figures provided by the Economic Commission for Latin America and the Caribbean (ECLAC).

### 3. Low labour productivity as an underlying factor of spurious competitiveness

In the mid-1980s, Fernando Fajnzylber developed two opposing concepts to characterize the region's competitiveness and development patterns. He described the form of competitiveness based on prices, overvalued exchange rates, depressed wages and static comparative advantages supported by the extraction of natural resources as "spurious competitiveness" and differentiated it from competitiveness based on the incorporation of technical progress into the production process and increasing training-induced labour productivity, which he called "authentic competitiveness" (Fajnzylber, 1990).

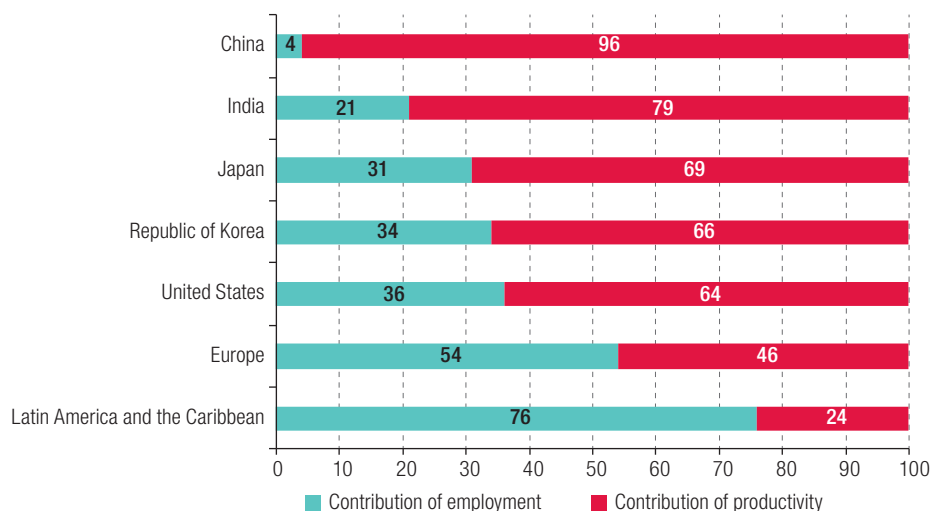
Figure 8 provides a breakdown of GDP growth rates for the countries of Latin America and the Caribbean along with other countries and regions in 2000–2019 based on the contributions of employment and labour productivity to GDP growth.<sup>3</sup> The figure shows that, on average, 76% of the region's growth over the last two decades has been powered by employment and 24% by gains in

<sup>3</sup> This is calculated using the following procedure: If  $Y$  represents the level of GDP and  $E$  the level of employment, then mean labour productivity is defined by  $P_E \equiv \frac{Y}{E}$ . Using these definitions, it becomes trivial to express GDP as  $Y = P_E \cdot E$ . By converting this equation into a logarithm and then taking the total differential for time, we have  $\dot{Y} = \dot{P}_E + \dot{E}$ , where  $\dot{Y}$  represents the GDP growth rate,  $\dot{P}_E$  the increase in mean labour productivity and  $\dot{E}$  the growth of employment. Normalizing the equation by the GDP growth rate, we then find that the contribution of mean labour productivity is  $\frac{\dot{P}_E}{\dot{Y}}$  and that of employment is  $\frac{\dot{E}}{\dot{Y}}$ .

labour productivity. This pattern differs sharply from the pattern exhibited by the Asian economies, as productivity accounted for 96% of GDP growth and employment for just 4% in China, while the contributions of these two factors amounted to 80% and 20%, respectively, in India, 70% and 30% in Japan, and 66% and 34% in the Republic of Korea. The differentials between these two factors are smaller in Europe and the United States but in both of those cases the contribution made by labour productivity is greater than it is in the region (46% and 64%, respectively).

**Figure 8**

The Latin American and Caribbean region and other regions and countries: the contribution of employment and labour productivity to GDP growth, 2000–2019 averages (Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), *Building a New Future: Transformative Recovery with Equality and Sustainability* (LC/SES.38/3-P/Rev.1), Santiago, 2020.

These results can be accounted for by the differing intensity of the technological effort made in these individual economies, and this is reflected with particular clarity in the trend in the ratio of R&D to GDP. The reversion to a more commodity-based export mix in Latin America and the Caribbean during the commodity boom phase of the business cycle, combined with the weakness of the institutional framework for industrial policy in the region, has clearly militated against the development of a process of structural change that would increase the contribution of labour productivity to economic growth by improving the conditions for authentic competitiveness in the region's economies.

#### 4. Learning patterns in the presence of backward paths and hysteresis

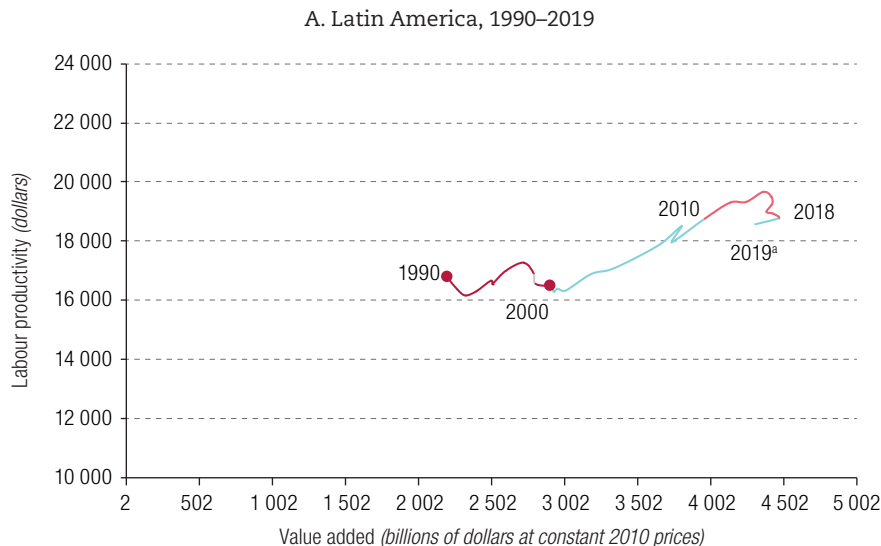
In their theoretical and empirical analysis of the persistently high unemployment levels found in the economies of Western Europe starting in the 1980s, Blanchard and Summers (1986) characterized this situation as the outcome of a process of “unemployment hysteresis” whereby a short-term increase in unemployment rates brought about by a recessionary shock may then be prolonged and eventually turn into a structural form of unemployment. According to Setterfield (2009), hysteresis is a special kind of path dependency in which the effects of a past shock on a variable  $\mu$  —for example, the rate of unemployment in a given economy— may influence the present value of that variable; put another

way:  $\mu_t = f(\mu_{t-1})$  and  $f'(\mu_{t-1}) > 0$ , that is, that the present rate of unemployment depends on its previous values and that an increase in those values generates an increase in their present value.<sup>4</sup>

A pivotal factor in this analysis is the determination of whether or not, in the aftermath of a past unemployment shock (as a consequence of a global economic crisis, for instance), unemployment then follows a process akin to a random walk (the dynamic exhibits a unit root). This is tantamount to maintaining that the unemployment shock is permanent or extremely long-lasting, or that it is stationary with drift. Not all of the econometric evidence for the world at large or for the region in particular points in the same direction, but it is clear that, in the wake of the North Atlantic crisis of 2008–2011, unemployment trends in some developed economies and in Latin America suggest that a process of hysteresis is at work.

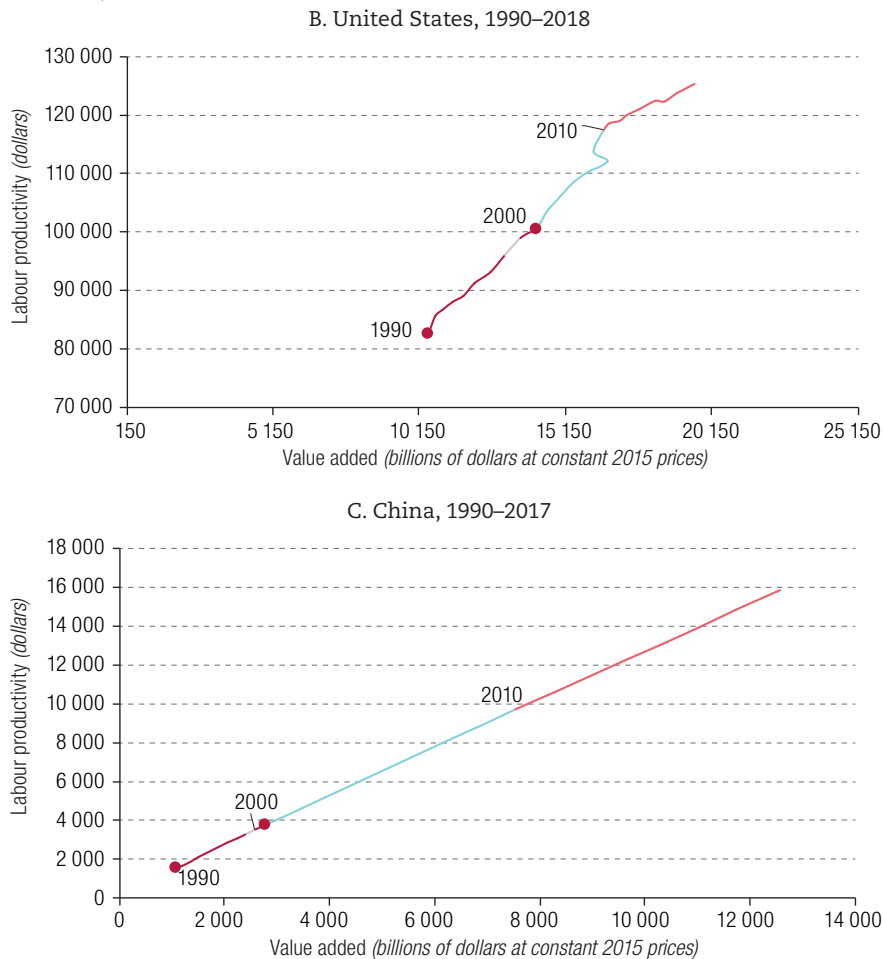
Figure 9 provides a comparison of the creation of value added and labour productivity in China, the United States and Latin America. The curves for the Chinese and United States economies indicate that when increases in value added are coupled with increases in labour productivity, employment levels also rise. Especially in China's case, the confluence of steady increases in productivity and in employment has driven up GDP. In Latin America, this interaction has been much weaker. After 2009, GDP climbed while productivity slipped (suggesting that output was raised by increasing lower-productivity forms of employment) and, starting in 2014, both productivity and employment – and, along with them, GDP – began to fall.

**Figure 9**  
Latin America, United States and China: labour productivity and value added  
(Dollars and billions of dollars)



<sup>4</sup> The concept of hysteresis describes a situation in which an economy's parameters are altered by a shock in such a way that the economy cannot revert to its original state even after the shock wanes. Consequently, periods in which a currency appreciates sharply or unemployment rises steeply may have a long-lasting effect rather than simply generating short-run fluctuations.

Figure 9 (concluded)



**Source:** Prepared by the author on the basis of statistics provided by Economic Commission for Latin America and the Caribbean (ECLAC); System of National Accounts of the United Nations; ECLAC/ International Labour Organization (ILO), "Work in times of pandemic: the challenges of the coronavirus disease (COVID-19)", *Employment Situation in Latin America and the Caribbean*, No. 22 (LC/TS.2020/46), Santiago, July 2020.

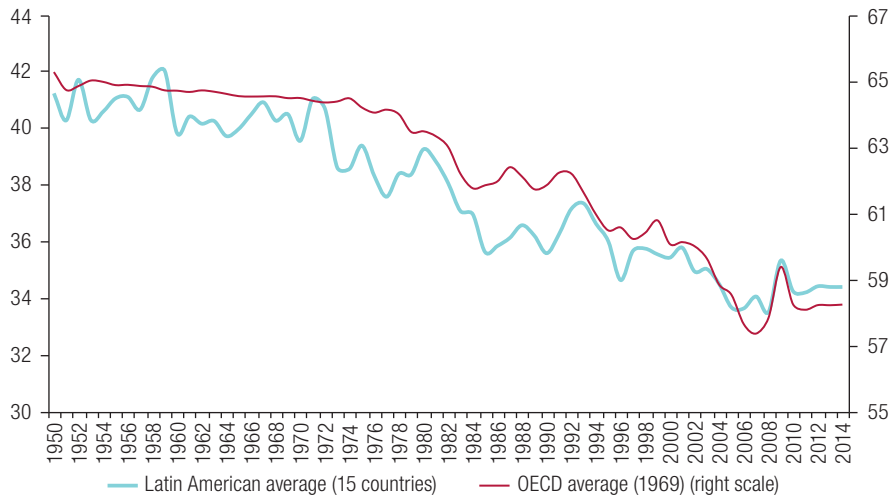
<sup>a</sup> Figures for 2019 are estimates.

## 5. Secular deterioration in factor income distribution

A stylized fact of global capitalism over the last 70 years is that factor income distribution has been deteriorating in a way that works to the detriment of labour (Torres, 2019). This has been a cross-cutting trend encompassing both developed countries and developing economies. Since the 1950s —when developmentalism was in full swing— and until the recent period of hyperglobalization, the share of wages in GDP has been steadily shrinking in the Latin America economies and in those of the member States of the Organization for Economic Cooperation and Development (OECD). In Latin America, the share of wages slipped from 41% in 1950 to 35% in 2014, while in the OECD countries it fell from 65% to less than 59% during that same period (see figure 10). As of 2014 —the most recent year for which information is available— this long-standing decline in the share of wages was the net effect of some sharply contrasting shifts in both the OECD and the Latin American economies, however.<sup>5</sup>

<sup>5</sup> For an analysis of the cases of 15 Latin American countries, see Alarco (2014) and, for information on the member States of the Organization for Economic Cooperation and Development (OECD), see the Penn World Table database [online] at: <https://www.rug.nl/ggdc/productivity/pwt/>.

**Figure 10**  
Latin America and the Organization for Economic Cooperation and Development (OECD):  
trends in the share of wages in GDP, 1950–2014  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), “Wage share and economic growth in Latin America, 1950–2011”, *CEPAL Review*, No. 113 (LC/G.2614-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2014 and University of Groningen, Penn World Table [online database] <https://www.rug.nl/ggdc/productivity/pwt/>.

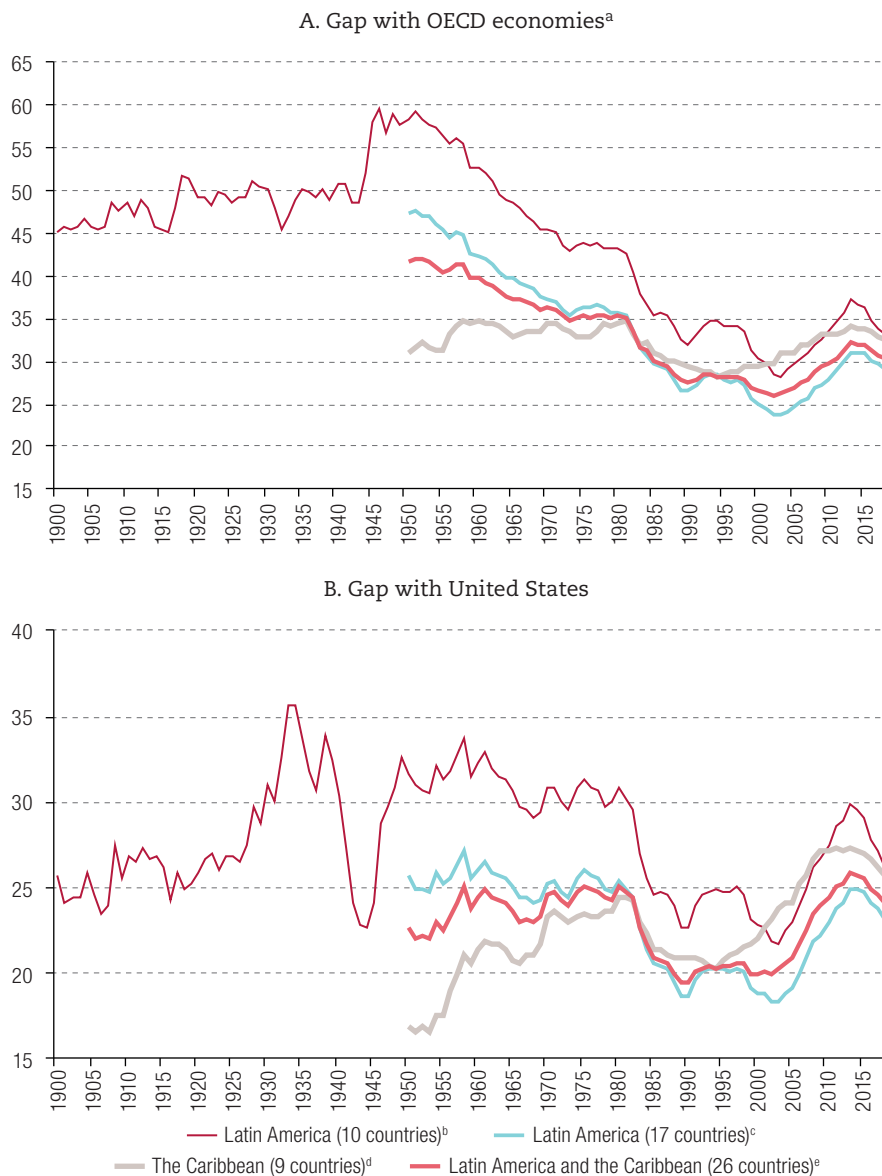
For example, the share of wages in countries such as Belgium, Canada, Denmark, Finland and France is over 60%, whereas, in the economies in which the share of wages in GDP is the smallest (Italy, Japan and the United Kingdom), the figure ranges from 43% to 48%. In Latin America, Costa Rica is the country where wages account for the largest share, at 50%, followed by Brazil and Honduras, where the corresponding figure is around 45%. In contrast, the share of wages in GDP in the Bolivarian Republic of Venezuela, Peru and Mexico is between 20% and 29%. To some extent, the values of this indicator in Latin America are reflecting structural problems in the region’s labour markets, such as a lack of labour flexibility, domestic production gaps, the nature of the production sector’s patterns of specialization and the workforce’s weakened ability to unionize, to say nothing of these economies’ high levels of informality. The asymmetrical nature of factor income distribution is a fundamental factor in the regressive nature of personal income distribution. Furthermore, it is reasonable to assume that, given the economic stagnation seen in 2014–2019 and the serious setbacks in terms of employment and wages caused by the health crisis, both of these distributions will deteriorate further in the future.

## 6. A widening external gap

Given this state of affairs, the Latin American and Caribbean region is not narrowing the external productivity gap separating it from the developed world. Figure 11 illustrates how, even though per capita GDP in both Latin America and the Caribbean has been on the rise relative to that of the OECD countries and the United States since 1990 (after the “lost decade” of the 1980s), it has not regained the levels of the period 1950–1989. And, in line with points made in the first part of this section, the gap in this indicator between the region and developed economies began to widen again in the 2010s.



**Figure 11**  
Latin America and the Caribbean: divergence in production expressed as per capita GDP of the region as a percentage of per capita GDP of the Organization for Economic Cooperation and Development (OECD) and the United States, 1900–2018



**Source:** University of Groningen, Penn World Table [online database] <https://www.rug.nl/ggdc/productivity/pwt/>.

<sup>a</sup> The gap with OECD was calculated using data for 20 countries for the period 1900–1949 and using data for 24 countries (member countries up to 1973) from 1950 on.

<sup>b</sup> Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Plurinational State of Bolivia and Uruguay.

<sup>c</sup> Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

<sup>d</sup> Barbados, Cuba, Dominica, Dominican Republic, Haiti, Jamaica, Puerto Rico, Saint Lucia, and Trinidad and Tobago.

<sup>e</sup> Argentina, Barbados, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia, Puerto Rico, Saint Lucia, Trinidad and Tobago and Uruguay.

## IV. The three gaps

As discussed in the previous section, the pandemic's impact on the region is framed by three structural crises: a social crisis that is reflected in high levels of inequality; an economic crisis that is reflected in low growth and a technological lag relative to advanced countries and (increasingly) some Asian economies; and an environmental crisis that is reflected in the loss of biodiversity, forests and water resources and in an upward trend in greenhouse gas emissions. As these three crises and the policies required to overcome them all interact with one another, an effort to change the region's development style will have to be based on a coordinated approach to all three of them. ECLAC (2020i) has proposed an integrated three-gap model for addressing the interactions among the relevant variables and the corresponding policy tools. This model is constructed on the basis of the three different growth rates that will be outlined here.

### 1. A growth rate consistent with the maintenance of external equilibrium ( $y^E$ )

The first of these rates is a growth rate that is compatible with a basic component of the balance of payments (current account plus long-term capital movements) that is in equilibrium. For the sake of simplicity, the equation for a balanced trade growth model known as Thirlwall's law, as discussed in the second part of section III, can be used to describe this type of externally constrained growth:

$$y^E = \frac{\varepsilon y^C}{\pi} \quad (1)$$

In this expression,  $y^E$  is the growth rate of the periphery for which the net trade balance is zero.<sup>6</sup> Equation (1) defines the external equilibrium curve *EE* (shown in diagram 1), which represents all combinations of  $y^E$  and  $y^C$  that satisfy balanced trade.

### 2. The minimum rate required to reduce inequality ( $y^S$ )

This is the rate required, on the one hand, to reduce structural heterogeneity by placing unemployed and underemployed workers in formal sector jobs in which productivity is on the rise and, on the other, to finance social policies and policies for transferring income from the highest-income deciles to the lowest-income deciles. While a great deal of the necessary reduction in inequality can be achieved by means of purely redistributive policies, formal sector job creation —made possible by growth and by the diversification of production— is a necessary complement to those policies.

### 3. The maximum rate compatible with environmental constraints ( $y^A$ )

This is the highest rate that is compatible with respect for the Earth and the protection of our planet for the enjoyment of future generations. From an operational standpoint, it can be measured in terms of greenhouse gas reduction targets, although conceptually it should be consistent with the necessary limitation of a variety of the environmental impacts of human activity, rather than solely climate change. This rate falls as the centre grows because that growth leaves less room for emissions from the periphery, since the total carbon budget must be shared by the two types of regions. The centre-periphery environmental frontier represents all possible combinations of growth in the periphery and the centre

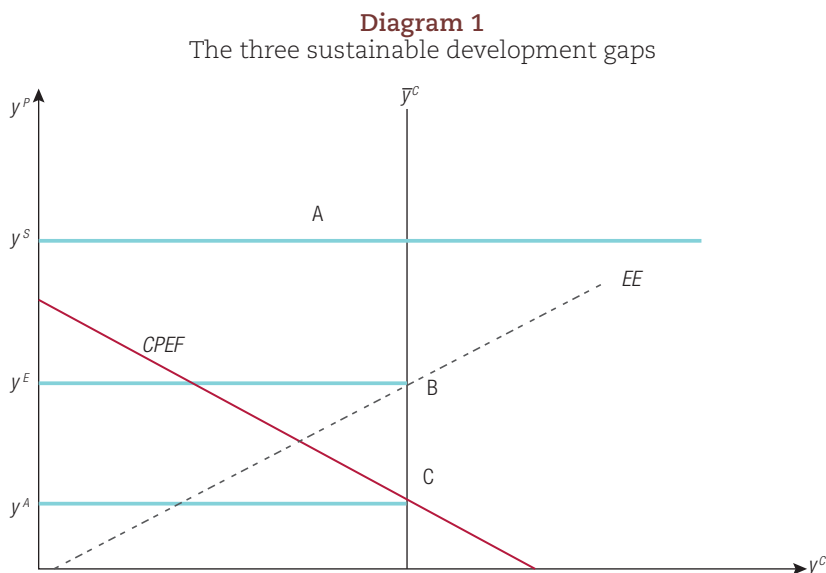
<sup>6</sup> For further information, see Blecker and Setterfield (2019), chapter 9.

that are compatible with the existing carbon budget given the decarbonization rate associated with environmental innovations and their diffusion in the global economic system. Technical progress towards the decarbonization of production will reduce emissions per unit of GDP and boost  $y^A$  relative to each increment of the centre's growth rate. As cleaner energy sources are used and as energy efficiency increases, the same carbon budget will become compatible with more growth.

## 4. The interaction of the three rates

The  $y^A$  rate is the point at the crossover of two dimensions of inequality: (i) intergenerational inequality, based on the idea that future generations have the right to have access to the same environmental services for their development as current generations do; and (ii) intragenerational inequality, based on the idea that the poorer countries (and the poorest people in each country) have the right to raise their levels of income and well-being more quickly than the richer countries (and the richest people in each country) do.

Diagram 2 plots the following three gaps based on the assumption that the centre's growth rate is exogenous  $\bar{y}^C$ : the social gap, which is the difference between the growth rate required to support equality and the rate that is compatible with an external equilibrium (the difference between  $y^S$  and  $y^E$ , segment A–B); the environmental gap, which is the difference between the external equilibrium rate and the sustainability frontier (the difference between  $y^E$  and  $y^A$ , segment B–C); and the sustainability gap, which is the difference between the equality growth rate and the environmental balance rate (the difference between  $y^S$  and  $y^E$ , segment A–C).



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

**Note:**

$y^P$ : growth rate of the periphery.

$y^C$ : growth rate of the centre (exogenous and equal to  $\bar{y}^C$ ).

$y^E$ : growth rate of the periphery that is compatible with the external constraint, which increases as the growth (and demand for imports) of the centre does and as the periphery's technological capacities do (authentic competitiveness).

$y^S$ : minimum growth rate for equality; the greater the initial level of inequality and the less of a redistributive effort that the country makes, the higher this rate will be.

$y^A$ : maximum growth rate for the periphery that is compatible with a global environmental balance, which falls as the centre grows and climbs with an increase in technical progress, particularly progress in the innovation and diffusion of environmental technologies.

Social gap: the distance between points A and B.

Environmental gap: the distance between points B and C.

Sustainability gap (three dimensions): the distance between points A and C.

*EE*: growth rate of the periphery that is compatible with external equilibrium.

*CPEF*: centre-periphery environmental frontier.

Sustainable development, broadly defined, is achieved only when  $y^E = y^S = y^A$ , that is, when all three (social, economic and environmental) dimensions of the required sustainability conditions are fulfilled. ECLAC estimates (2020) for Latin America and the Caribbean indicate that:  $y^S > y^E > y^A$ .

Of the three rates, the one that tends to prevail in an open economy is the growth rate that is compatible with external equilibrium, as growth in excess of that rate requires taking on debt, and there is a limit to how much borrowing a country can finance on international markets. As a function of external pressures, the economy will move towards  $y^E$ . To achieve a sustainable form of development, a policy package is needed that will set the stage for the convergence of these rates. This kind of package can act as a driver of sustainability by raising investment levels in the various sectors of the economy on a coordinated basis so that sweeping social, productive and technological changes will reinforce one another. The rate on which the economy needs to converge is the equality growth rate, which is the highest of the three; thus, social, technological and environmental policies need to merge at level  $y^S$ .

On the one hand, social policies can lower the minimum rate required to support equality. This rate will be lower if the initial degree of inequality is low and if redistributive policies are ambitious ones. Growth and an increase in formal sector employment will invariably be essential mechanisms for reducing inequality, but they will be relatively less important (at least in the short run) in a welfare state.

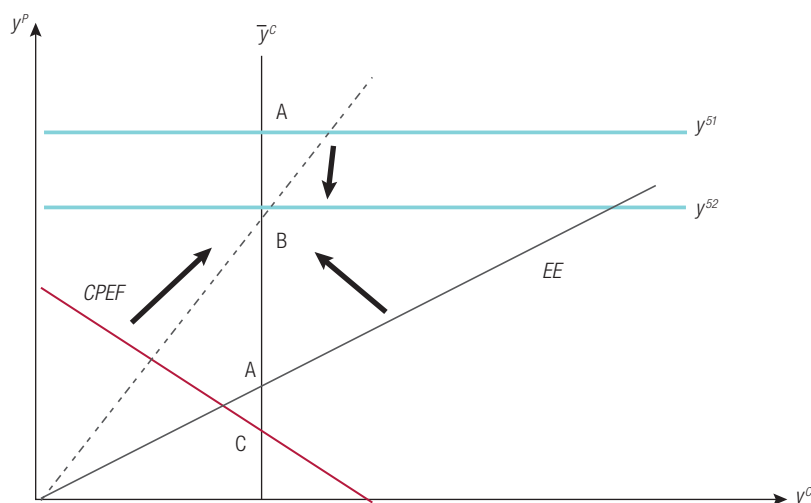
On the other hand, industrial and technological policies can further the diffusion of technology and structural change in the periphery that will promote authentic competitiveness (and, along with it, the  $\varepsilon/\pi$  ratio and external equilibrium growth rate,  $y^E$ ,) (see Cimoli and Porcile, 2014; Cimoli, Pereima and Porcile, 2019).

Finally, in order for  $y^E$  and  $y^A$  to converge, technical progress must move in certain prescribed directions, i.e. towards raising the efficiency of energy use, reducing greenhouse gas emissions and promoting sustainable forms of production. Innovation and technology diffusion policies should not only bolster authentic competitiveness but also steer the economy towards low-carbon development paths based on the use of renewable energy.

In order for this approach to be viable, cross-policy complementarities need to be explored. Policies for promoting investment in renewable energy sources can lower the cost of energy and, in so doing, support international competitiveness; policies for supporting education and encouraging people to adopt sustainable consumption patterns will help to ensure that environmental innovations are also supportive of competitiveness (since the goods being offered will fit in with emerging demand patterns); industrial policies that spur the domestic production of electric vehicles or vehicle parts will reduce external deficits and emissions; social policies aimed at achieving universal health care and education will contribute not only to equality but also to productivity, technological learning and competitiveness. Diagram 2 provides an overview of cross-policy complementarities and illustrates the need for their coordination in order to build momentum for a major effort in this regard.

The minimum growth rate for equality could be lowered from  $y^{S1}$  to  $y^{S2}$  (from point A to point B) by means of more extensive social and welfare policies. At the same time, industrial and technology policies could be pushing up the centre-periphery environmental frontier and the rate that would be compatible with protection of the environment (from point C to point B) by, among other things, promoting investment in renewable energy or sustainable forms of farming and tourism. Technological and structural changes can alter curve EE (whose slope is given by  $\varepsilon/\pi$ ), shifting the external equilibrium growth rate from point A (initial position) to point B (following a change in the pattern of specialization). It is essential for these policy tools to be brought to bear on these three curves in a carefully coordinated manner.

**Diagram 2**  
Policies that promote both equality and technical progress



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC).

**Note:**

$y^P$ : growth rate of the periphery.

$y^C$ : growth rate of the centre (exogenous and equal to  $\bar{y}^C$ ).

$y^S$ : minimum growth rate for equality; the greater the initial level of inequality and the less of a redistributive effort that the country makes, the higher this rate will be.

Social gap: the distance between points A and B.

Environmental gap: the distance between points B and C.

Sustainability gap (three dimensions): the distance between points A and C.

*EE*: growth rate of the periphery that is compatible with external equilibrium.

*CPEF*: centre-periphery environmental frontier.

## V. Economic and social impacts during the pandemic

The pandemic has had a huge impact on aggregate supply and demand in the region. The intensity and persistence of these effects will be directly related to the conditions existing within each economy, as well as global trade dynamics, the duration of the health crisis, and the health, economic and social policies adopted to mitigate those effects.

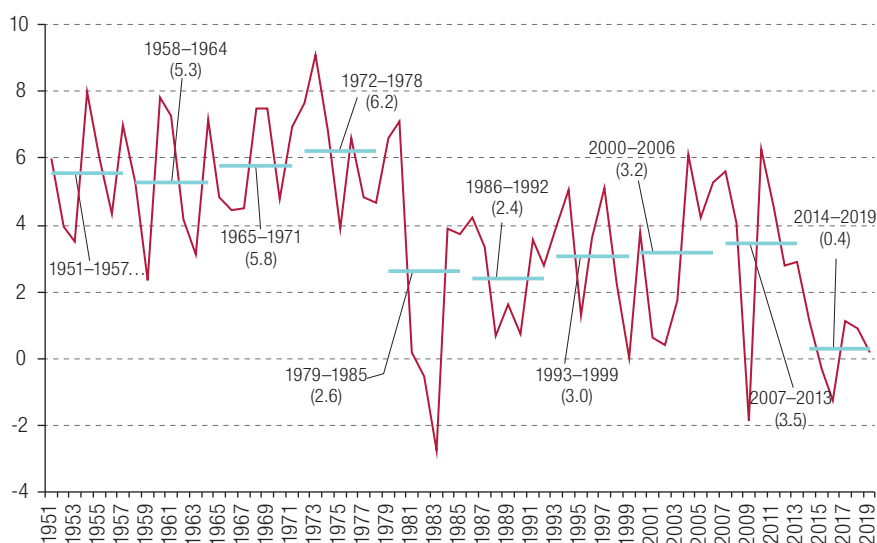
ECLAC (2020a) has classified the costs of the pandemic according to its direct effects on the region's health-care systems and its indirect effects on production and consumption. The direct effects include the greater pressure being exerted on the region's highly fragmented health-care facilities, which will heighten the pre-existing inequality in access to health-care services for people of different income levels and areas of residence. The indirect effects on aggregate supply and demand stem from the fact that lockdowns and social distancing requirements have led to the suspension of production activities in the areas of education, commerce, tourism, transport and natural resource development.

## 1. Economic impacts<sup>7</sup>

### (a) The macroeconomic scale of the crisis

In the short run, the crisis is expected to lead to higher unemployment, lower wages and income levels, and increased poverty, extreme poverty and inequality. In the medium and long terms, its greatest repercussions are likely to be the bankruptcy of numerous businesses, a downturn in private investment, a decline in growth rates, a reduction in the degree of integration of global value chains and a deterioration in production capacity and human capital. ECLAC has argued that the reactivation of the region's economy calls for an appropriate contextualization and understanding of the true proportions of these effects. In fact, when the crisis triggered by the COVID-19 pandemic is viewed within its historical context, it becomes clear, as ECLAC (2020b and 2020h) has pointed out, that this is the most severe crisis to be experienced since the years following the Second World War (see figure 12).

**Figure 12**  
Latin America and the Caribbean: real GDP growth rates, 1951–2019  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

ECLAC has calculated that the region's per capita GDP will shrink by 8.5%, thus falling back to around 2010 levels. This means that the end result of the pandemic and the recessionary period that preceded it will be another “lost decade”.

As this stark retrogression takes hold, the productive fabric will thin out and the region's already problematic structural heterogeneity will be amplified. In more concrete terms, it is estimated that the pandemic will force the closure of some 2.7 million formal sector businesses in the region (ECLAC, 2020d) and that 44 million people will be unemployed, or 18 million more than in 2019. This will be the biggest jump in joblessness since the global financial crisis, when the unemployment rate climbed from 6.7% in 2008 to 7.3% in 2009. According to the indicators shown in table 4, the year-on-year unemployment rate will reach 13.5% of the economically active population (EAP) (ECLAC, 2020e and 2020h).

<sup>7</sup> For a complementary analysis of this topic, see Bárcena (2020).

**Table 4**  
Latin America and the Caribbean: employment indicators, 2020<sup>a</sup>  
(Millions of persons and percentages)

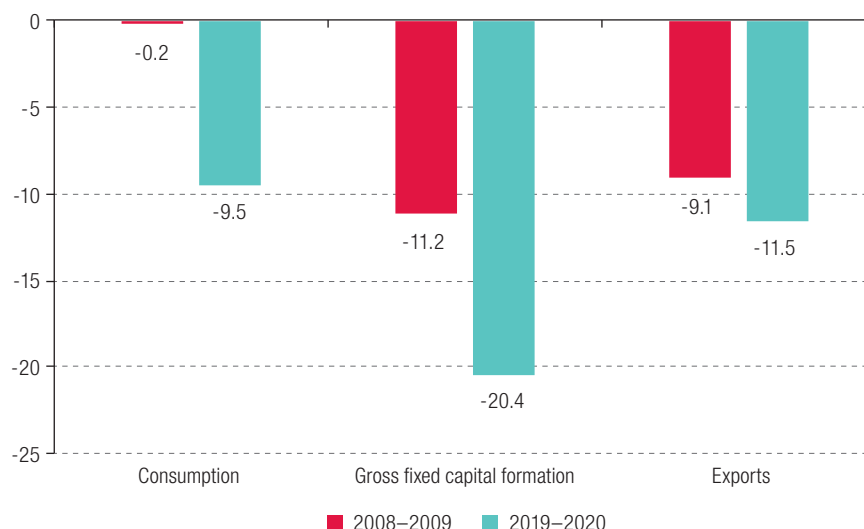
Indicator	2020
Economically active population (EAP)	326.9
Number of unemployed	44.1
Change in number of unemployed	18.0
Unemployment rate (percentage)	13.5

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Projections.

As for the adverse effects of the crisis on aggregate demand, ECLAC (2020h) projects that the contractions in all of the main components (investment, consumption and exports) will overshadow those observed during the international financial crisis of 2008 and 2009. While real investment fell by 11.2% in 2009, it is estimated that it will have plunged by 20.4% in 2020. Projections also indicate that consumption will have diminished by 9.5% in 2020 (compared to a contraction of just 0.2% during the earlier crisis) and that exports will be down by 11.5% (compared to a drop of 9.1% in 2008–2009) (see figure 13).

**Figure 13**  
Latin America and the Caribbean: year-on-year variation in the components of aggregate demand, 2008–2009 and 2019–2020<sup>a</sup>  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Projections.

## (b) Impact of the crisis on regional trade

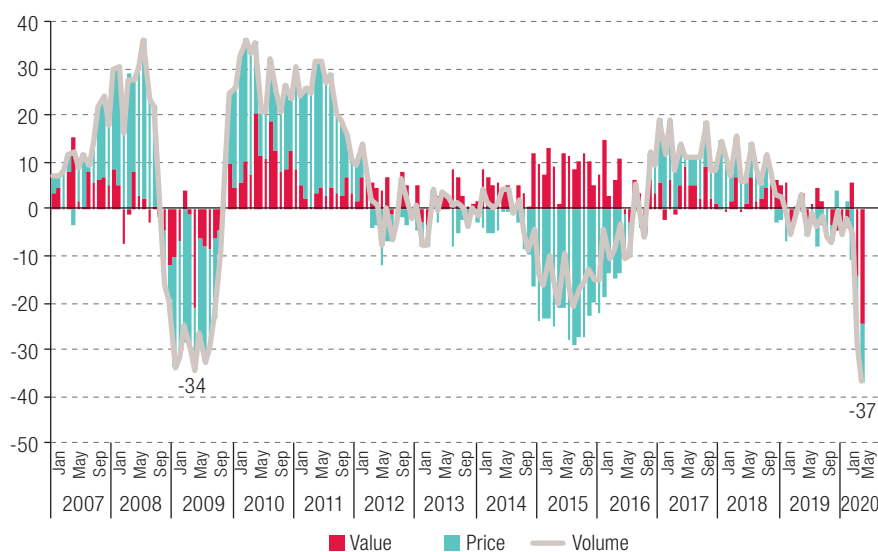
As noted earlier, the contraction of the region's GDP is associated with the external effects of the pandemic on international trade and the widespread decline in the prices of the region's commodity exports. As ECLAC (2020f) has observed, "The COVID-19 outbreak occurred in a context of sluggish global trade that has been dragging on since the 2008–2009 financial crisis". ECLAC estimates that, between January and May 2020, the value of the region's exports and imports of goods was down by 17% from its level during the same period in 2019. Both exports and imports plummeted towards the end of this five-month period, registering year-on-year drops of 37% in May.

The year-on-year reduction in the volume of trade in April–May 2020 (a drop of 20% for exports and one of 25% for imports) was much sharper than it had been in the corresponding period of 2009 (see figure 14). The downturn in exports is attributable to both the supply shock generated by the partial shutdown of production activities and the demand shock sparked by the economic downswing in the main markets for the region's exports. In the case of imports, the contraction is mainly a result of the deep recession that has overtaken the region, where output is expected to shrink by 9.1% (ECLAC, 2020e).

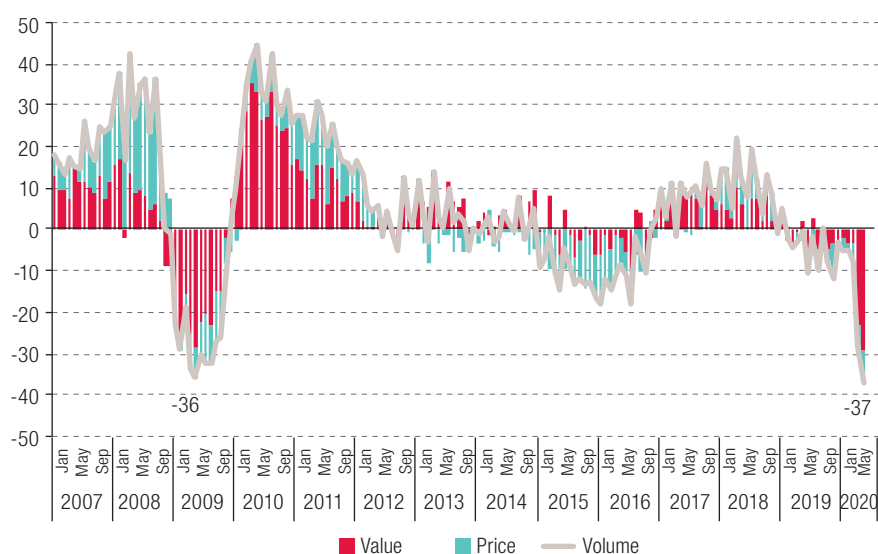
**Figure 14**

Latin America and the Caribbean: year-on-year variation in exports and imports of goods, by volume, price and value, January 2007 to May 2020  
(Percentages)

**A. Exports**



**B. Imports**



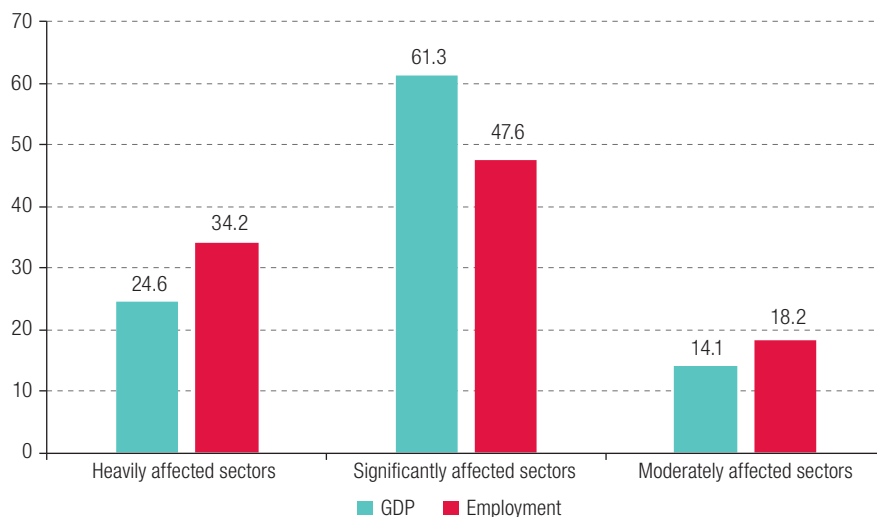
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the countries' central banks, customs services and statistical offices.



### (c) Effects of the crisis on productive development and entrepreneurship

ECLAC (2020d) has classified the different branches of production activity, based on the strength of the crisis' impact on output and employment, as follows: (i) heavily affected sectors: tourism; traditional cultural industries; repair services; hotels and restaurants; transport; fashion; and motor vehicles; (ii) significantly affected sectors: mining; electricity, gas and water; construction and building materials; business services; financial activities; beverages; furniture and lumber; chemicals; and electronics, machinery and equipment; and (iii) moderately affected sectors: crop farming, stock raising and fisheries; food production for the domestic market; medical inputs and equipment; medicines; telecommunications; and packaging. On the basis of this classification, it is estimated that 34.2% of formal sector employment and 24.6% of the region's GDP correspond to sectors that are being heavily affected by the crisis; less than 20% of formal sector employment and GDP is being generated in moderately affected sectors, and 61.3% of GDP and 47.6% of formal sector employment are generated in sectors that are being affected to a significant extent (see figure 15).

**Figure 15**  
Latin America and the Caribbean (27 countries): GDP and employment in different sectors, by strength of the expected impact of the crisis, 2020  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Out of all the businesses that will close their doors, the greatest impact is likely to be felt by micro-, small and medium-sized enterprises (MSMEs), given the share of production and employment that they account for. Studies conducted by various chambers of commerce in the region estimate that 2,650,528 microenterprises will go out of business because of the health crisis (20.7% of the total), along with 98,708 small enterprises (7.1%), 5,943 medium-sized business ventures (2.8%) and 406 large companies (0.6%) (ECLAC, 2020d). The job losses that will be caused by these closures are estimated at 6,383,958 jobs (21.5% of the total) in microenterprises, 1,512,655 jobs (7.3%) in small businesses, 390,155 jobs (2.7%) in medium-sized ones and 231,724 jobs (0.6%) in large companies.

Finally, as observed in an earlier study by ECLAC (2020g), the digital economy has partially offset the adverse effects seen in brick-and-mortar production and financial sectors. In fact, the solutions provided in the areas of health, education, commerce and employment by remote communications applications have played a pivotal role in the struggle to curb the health and economic impacts of the

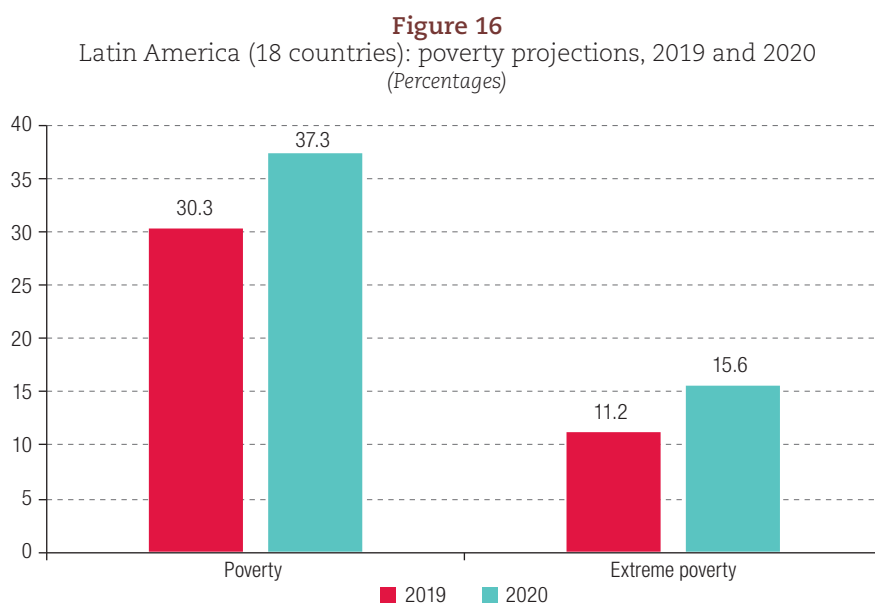
pandemic. That same study also sounds a warning, however, about the potential widening of the digital divide as the demand for broadband connections swells, since the social sectors that have the least access to these connections are lower-income groups, older age cohorts and residents of rural areas.

## 2. Social effects

The economic effects analysed in the preceding section will have social repercussions. The region is expected to lose some of the ground gained in the 2000s and 2010s in its bid to reduce poverty and inequality.

### (a) Poverty and extreme poverty

As a consequence of the pandemic, poverty rates in the region will climb back to the levels seen some 15 years ago. ECLAC estimates based on the results of household surveys indicate that the size of the poor population in Latin America will be the same in 2020 as it was in 2005 (231 million people), and 96 million people will be below the extreme poverty line, which is comparable to the figure for 1990. In percentage terms, the poverty rate will climb by 7.0 percentage points relative to the 2019 rate, while the extreme poverty rate will be 4.4 percentage points higher (see figure 16).



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Household Survey Data Bank (BADEHOG).

### (b) Effects on income distribution

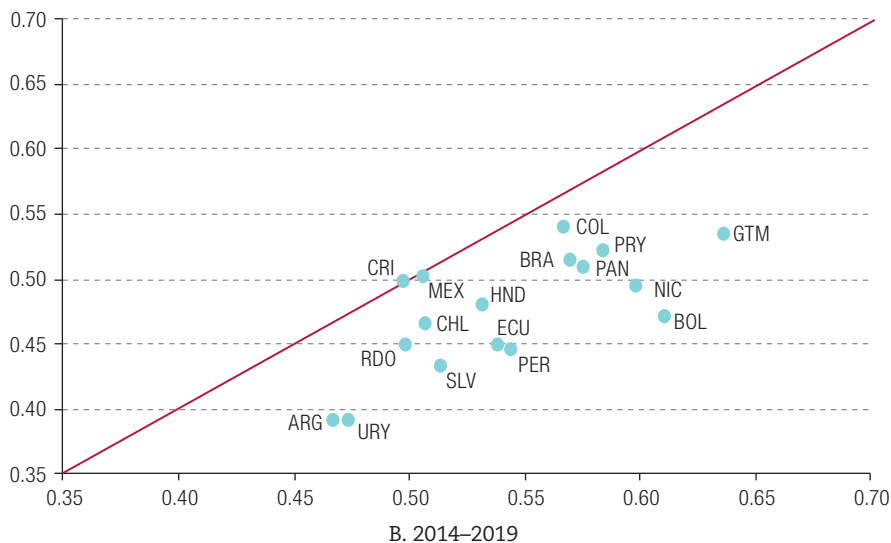
ECLAC (2020c) has projected that the job losses and wage cuts occasioned by the pandemic will lead to a reversal in all the countries of Latin America of some of the progress made in improving income distribution. Figure 17 illustrates the deterioration in income distribution in the region in 2014–2019 as compared to the situation during the commodity price boom of 2003–2014. During that boom period, rapid economic growth (especially in South America) enabled governments to boost social spending aimed at reducing poverty at the same time that companies were hiring more workers. The resulting shrinkage of the informal sector and increase in labour income translated into improvements in distribution

which, although they were just a first step, nonetheless represented a significant advance for many countries. The end of the commodity boom in 2014 triggered an about-face in all these social and economic trends as the demand for raw materials waned and the production matrix rapidly reverted to an emphasis on primary sector activities. This had the effect of exacerbating the region's structural heterogeneity and rolling back distributive gains.

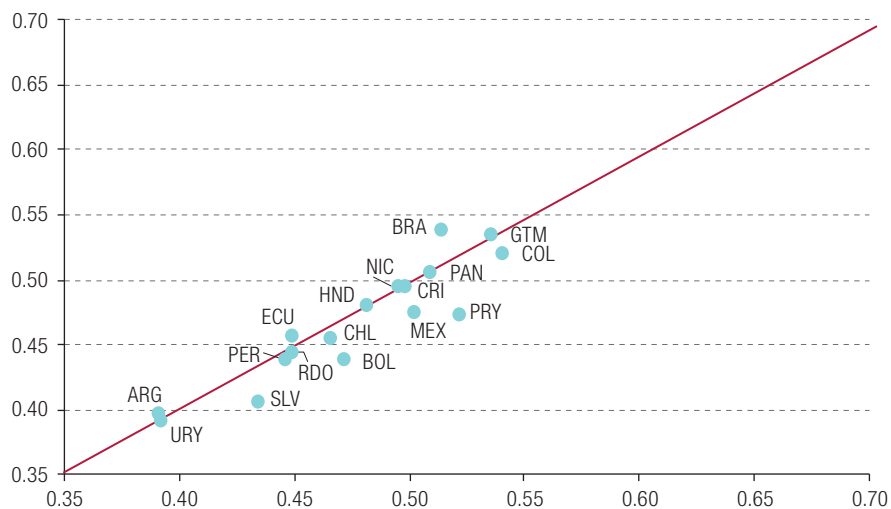
**Figure 17**

Latin America (17 countries): personal income distribution, 2003–2014 and 2014–2019  
(Gini coefficient on a scale from 0 to 1)

A. 2003–2014



B. 2014–2019



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Household Survey Data Bank (BADEHOG).

Table 5 shows the projected increases in the Gini coefficient for 2020, classified by percentage ranges. These increases, as observed earlier, will be widespread and will vary markedly from one country to another. Guatemala, Nicaragua and Paraguay will see their coefficients rise by between 1.0% and 2.9%, while countries such as the Plurinational State of Bolivia, Costa Rica, Panama and the Dominican Republic will have increases of between 3.0% and 4.9%. Most of the countries of the region, including Brazil,

Chile, Colombia, El Salvador, Mexico and Uruguay, will experience even greater setbacks in income distribution, with their Gini coefficients jumping by between 5.0% and 6.9%. Argentina, Ecuador and Peru will lose the most ground of all in terms of distribution as their Gini coefficients will be over 7.0% higher.

**Table 5**  
Latin America (17 countries): projected increases in the Gini coefficient in 2020  
(Percentage ranges relative to 2019)

1.0%–2.9%	3.0%–4.9%	5.0%–6.9%	Over 7.0%
Guatemala	Costa Rica	Brazil	Argentina
Honduras	Dominican Republic	Chile	Ecuador
Nicaragua	Panama	Colombia	Peru
Paraguay	Plurinational State of Bolivia	El Salvador	
		Mexico	
		Uruguay	

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Household Survey Data Bank (BADEHOG).

It is important to remember that the impacts of the health crisis will not be spread evenly over the various segments of the population. As pointed out by ECLAC: “The different socioeconomic impacts reflect the social inequality matrix in the region, which is built around the axes of socioeconomic stratum or social class, gender, life-cycle stage, ethnicity or race and territory, along with other factors such as disability, migratory status and homelessness. These inequalities accumulate, strengthen and interact, causing multiple forms of discrimination that lead to differences in the exercise of rights” (2020c, p. 5).

## VI. Concluding observations: from the crisis to a new development pattern

In this article we have analysed the situation in Latin America and the Caribbean in the light of the COVID-19 health crisis and have shown that it is the region in which the health and socioeconomic impacts of the pandemic have been the most severe. We have also shown that this outcome is directly related to the pre-pandemic situation in the region. The structural asymmetries that account for the intensity of the crisis in this region include its pattern of specialization, divergent trends in productivity and employment, and the deterioration in its functional distribution of income in conjunction with a range of more far-reaching inequalities.

This analysis of the pandemic’s economic and social effects in the region underscores the enormous challenge to be met by the region if it is to deploy the macroeconomic, social and production policies needed to reactivate the economy once the crisis has passed. ECLAC contends that this recovery must go hand in hand with a structural transformation that will narrow and then close the three gaps associated with the region’s dysfunctional economic model. ECLAC has referred to this strategy as a transformative recovery for advancing towards a sustainable form of development because it combines economic recovery with an effort to supersede the region’s current development style (ECLAC, 2020i).

ECLAC has proposed four lines of action for addressing the most pressing impacts of the pandemic. The first is the provision of a basic income as an emergency social protection measure. The second is the distribution of an anti-hunger grant. The third is a policy package designed to support business networks and segments of the workforce that are at risk of swelling the ranks of the unemployed. The fourth is a set of measures to strengthen the role of international financial institutions in helping to meet global borrowing requirements.

From a medium- and long-term standpoint, ECLAC has espoused the view that a socially, economically and environmentally sustainable development process is not something that unregulated markets can achieve on their own. Public policies need to be introduced in a range of different areas at the same time in order to advance innovation in the region and bring its technology up to date, help to shape a welfare state that will support learning and equality, redesign economic incentives to underpin environmental protection, and apply macroprudential policies to provide stability and promote competitiveness, progressive fiscal policies that will promote equality while providing financing for public investments and sectoral policies that will help the sectors that are the main drivers of sustainability to grow. These policies need to be interconnected and based on complementarities and synergies that will leverage what ECLAC has described as a “big push for sustainability”.

The sectoral dimension of these policies is of crucial importance. The transition towards sustainable development will call for efforts to enable strategic sectors to make a greater contribution to GDP while strongly discouraging others, whether for environmental reasons, considerations of equality or on technological grounds.

ECLAC has identified seven sectors that are of strategic importance for the transition to sustainable development because of their attributes in the areas of competitiveness, employment, equality, decarbonization and/or environmental sustainability:

- A transition to non-conventional renewable energy sources in order to establish a sustainable energy matrix
- Sustainable mobility in urban areas
- An inclusive and innovative digital economy as a driver of growth and sustainability
- The health-care manufacturing industry
- The bioeconomy for sustainable development based on biological resources and natural ecosystems
- A circular economy to promote recycling
- Sustainable tourism

These activities should be the focus of industrial and technology policies. Policy incentives should be configured to promote these sectors, and public investment should play an important role in attracting private investment and supporting effective demand during the crisis.

Finally, this transformative transition will call for political compacts that provide for expansionary, progressive, effective and efficient fiscal policies. Leadership cadres are needed that will provide greater certainty, that know how to build partnerships, reshape politics and promote well-being, foster solidarity among nations, strengthen regional integration, fulfil international agendas (including the 2030 Agenda for Sustainable Development) and transmute emergency measures into drivers of the recovery.

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# The COVID-19 crisis in Latin America in historical perspective<sup>1</sup>

José Antonio Ocampo

## Abstract

This essay compares the COVID-19 crisis in Latin America with two long-lasting crises (the Great Depression and the debt crisis) and two more recent and shorter ones (the 1997 Asian crisis and the 2008–2009 North Atlantic crisis). The analysis indicates that almost all external shocks, whether associated with external financing, the terms of trade, trade volumes or remittances, have been weaker during the current crisis. What has mainly been lacking is international financial cooperation. The severity of the crisis has therefore been due more to domestic factors: the fact that the region was the global epicentre of the pandemic for several months and that the crisis has come on top of five years of poor economic performance and three decades of slow growth. For this reason, the region needs to change its development patterns on top of implementing policies to overcome the crisis.

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## Keywords

COVID-19, economic crisis, international cooperation, economic growth, poverty, Latin America

## JEL classification

E60, F34, F55, O19

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<sup>1</sup> This essay is partly based on the book on Latin American economic history written by the author jointly with Luis Bértola (Bértola and Ocampo, 2012) and on a recent paper on international financial cooperation with Latin America prepared for the United Nations Development Programme (UNDP) and published in CEPAL Review (Ocampo, 2020a). The author would like to thank Daniel Titelman and the staff of the Economic Development Division of ECLAC for the data provided to assist in the preparation of this essay. References to events during the current crisis draw on information available as of early November 2020.



## I. Introduction

The COVID-19 crisis will go down as the worst in Latin American economic history. Besides the drastic contraction of production activity, it will represent a setback of at least a decade in the fight against poverty and inequality. Since it was also preceded by one of the region's worst ever half-decades for economic growth and the prospects for recovery are beset with uncertainties, 2015–2024 will turn out to be another lost decade, one that may actually be worse and slightly more prolonged than the debt crisis of the 1980s.<sup>2</sup>

In this essay, I compare the current crisis with earlier episodes in Latin American history. I analyse both the evolution of production activity and the impacts of the external context —foreign trade, external financing and international economic cooperation. I also discuss some of the policies adopted to deal with the crisis. Given the length of the essay, I only include aggregate indicators for the region, although I do touch on the experiences of some individual countries in the body of the text.

The essay is divided into six sections. Following this introduction, section II reviews the evolution of Latin America's gross domestic product (GDP) since the beginning of the twentieth century in order to identify the crises that are analysed in the following sections. Section III examines the long-term evolution of commodity prices and the terms of trade in the region, one of the key determinants of the regional booms and busts discussed in section IV. Section V looks in detail at the crisis caused by the COVID-19 epidemic. Section VI concludes by summarizing its determinants from a historical perspective.

## II. The main crises in Latin American economic history

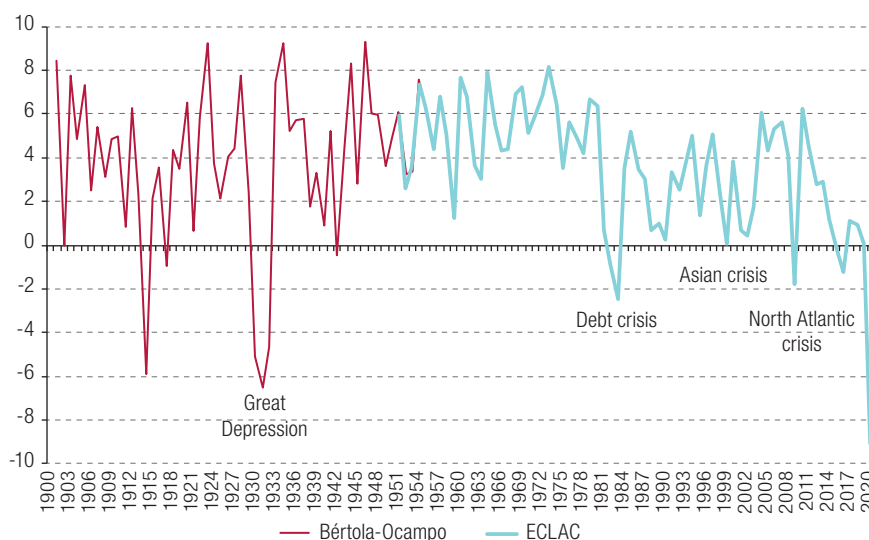
Figure 1 provides an overview of economic growth in Latin America since the early twentieth century. As can be seen, there are five episodes during which Latin American GDP has fallen substantially: in 1914, 1930–1932, 1982–1983, 2009 and 2020. If half-decades of low growth are included, two additional episodes can be identified: the one that followed the Asian crisis of 1997, with growth of only 1.3% per year between 1999 and 2003, and the five-year period before the current crisis, 2015–2019, during which the Latin American economy grew at a rate of only 0.1% per year, with slightly negative figures in 2015 and 2016.

These crises have differed in their intensity and duration and the degree to which they have spread through the region, and in the international context in which they took place. The first crisis, that of 1914, was very much centred on the Southern Cone, especially Argentina, which only regained its 1913 level of GDP in 1922, while Chile and Uruguay did so much faster. The combination of external financing and the outbreak of the First World War explains this outcome. Mexico's economy was already relatively stagnant as a result of its revolution. Other countries were partially affected in 1914, but generally continued to grow, albeit very unevenly in the cases of Cuba and Venezuela.<sup>3</sup> Because it was so concentrated in a particular subregion, this crisis will not be analysed in this essay.

<sup>2</sup> The decades referred to throughout the essay correspond to the decades of the twentieth century.

<sup>3</sup> The name "Venezuela" was changed to "Bolivarian Republic of Venezuela" on 15 December 1999, and this essay accordingly uses one or the other form depending on the year.

**Figure 1**  
Latin America: gross domestic product (GDP) growth, 1900–2020<sup>a</sup>  
(Percentages)



**Source:** Prepared by the author, on the basis of L. Bértola and J. A. Ocampo, *The Economic Development of Latin America since Independence*, Oxford, Oxford University Press, 2012 (for the period 1900–1949), and data from the Economic Commission for Latin America and the Caribbean (ECLAC) (for the period 1950–2020).

<sup>a</sup> Data for 1900–1949 refer to Latin America as a whole and those for 1950–2020 to a group of 10 Latin American economies: Argentina, the Bolivarian Republic of Venezuela, Brazil, Colombia, Cuba, Chile, Ecuador, Mexico, Peru and Uruguay.

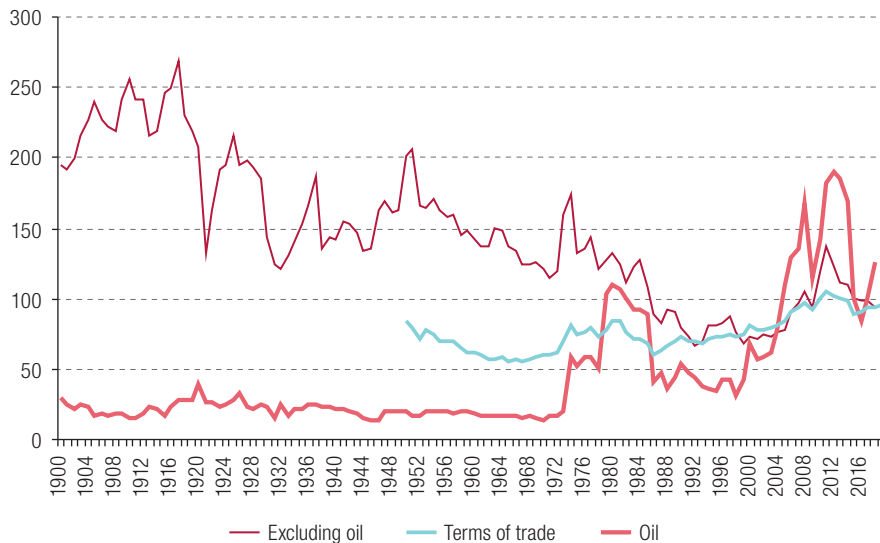
The other crises spread to a larger set of countries in the region. Two of them were long-lasting: the one caused by the Great Depression of the 1930s and the Latin American debt crisis and the lost decade to which it gave rise. The most recent ones, namely those following the Asian crisis of 1997 and the North Atlantic crisis of 2008–2009, were shorter-lived.<sup>4</sup> All of them generated external shocks related to international trade and the availability and cost of external finance, with flows of remittances from Latin American migrants also involved in the more recent ones. With the exception of the debt crisis, whose epicentre was in the region, they all derived from episodes of external origin.

Shocks associated with capital flows have been present in all the crises, albeit with different characteristics and support mechanisms to deal with them. For example, the interruption in external financing was more prolonged during the long-lasting crises than in the more recent ones, but action was also taken to reduce the amount of external debt in the former. Declines in international trade have actually occurred in certain crises but not in all of them. In particular, trade experienced a prolonged crisis during the Great Depression and short but sharp interruptions in the North Atlantic and current crises, but did not do so during the Latin American debt crisis. These issues should therefore be analysed on a case by case basis.

The evolution of commodity prices and their effects on the region's terms of trade do admit of a long-run analysis. Figure 2 shows the evolution of non-oil commodity prices and oil prices since 1900, both deflated by an index of manufacturing prices in international trade. From 1950, the Latin American goods and services terms of trade series is also presented.

<sup>4</sup> I use this term rather than “global economic crisis” because, although its effects were global, its epicentre was in the United States and Western Europe.

**Figure 2**  
Real commodity prices (index 2015=100) and Latin American terms of trade (index 2010=100), 1900–2019



**Source:** Prepared by the author, on the basis of B. Erten and J. A. Ocampo, “Super cycles of commodity prices since the mid-nineteenth century”, *World Development*, vol. 44, Amsterdam, Elsevier, 2013 (for commodity prices updated and deflated by the Manufacturing Unit Value Index (MUV)) and data from the Economic Commission for Latin America and the Caribbean (ECLAC) (for terms of trade for goods and services since 1950).

The evolution of the series shows that these prices experienced a deep deterioration during the two long-lasting crises. In the Great Depression, in fact, this deterioration followed on from the major collapse in commodity prices that had taken place in 1920–1921 and not been completely reversed during the international boom of the 1920s. Non-oil commodity prices fell to less than half their level prior to the collapse of 1920–1921, although oil prices fell by less than 10%. The first of these declines was far greater than that which took place during the debt crisis, when non-oil commodity prices fell by 38% between 1980 and 1987; oil fell by much more, but remained well above its levels of before the first oil shock in 1973. The terms of trade fell by slightly less, but the decline was still 28% between 1980 and 1986.

It is interesting to note that there was another sharp fall in commodity prices and Latin America’s terms of trade in the 1960s and 1970s, exceeding that seen during the debt crisis, albeit more gradual, but its effects on economic activity were limited because of ongoing industrialization, a topic to which I will return in the next section. Lastly, the combination of the three declines referred to explains the strong long-term downward trend in commodity prices between the 1920s and the late 20th century, which corroborated Prebisch’s (1973) thesis. However, this trend did not occur in the nineteenth and early twentieth centuries, nor has it recurred (so far) in the twenty-first.<sup>5</sup>

By contrast with the long-lasting crises, the shorter ones were not characterized by such adverse commodity price or terms of trade dynamics and, most importantly, these indicators recovered rapidly. During the North Atlantic crisis, moreover, there was only a temporary interruption to an upward commodity price cycle that had begun in 2003–2004 and would last until 2012–2013.

<sup>5</sup> It is interesting to note that it was World Bank researchers (Grilli and Yang, 1988) who revived the thesis of commodity price decline in the twentieth century. See Erten and Ocampo (2013) on long-term commodity price dynamics and cycles.

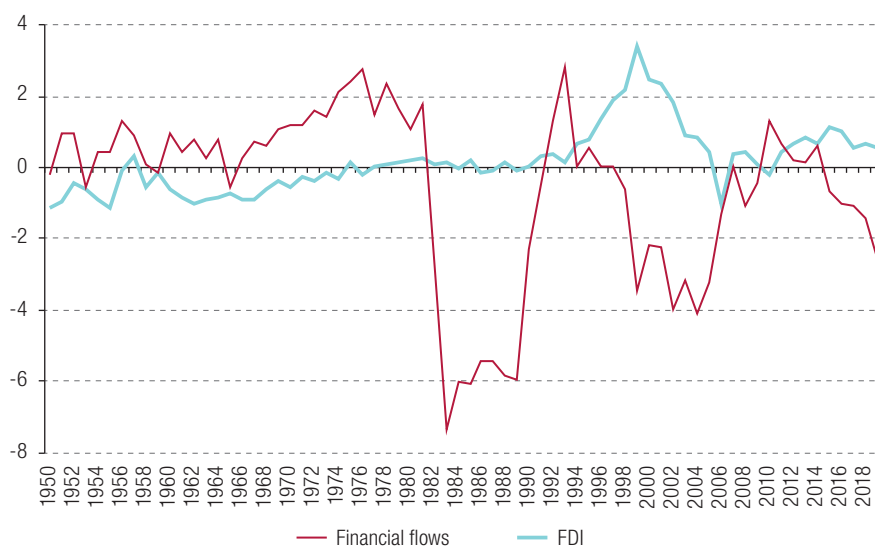
### III. The long-lasting crises

As this analysis indicates, collapsing commodity prices were a common element in the long-lasting crises, but there was a fundamental difference: the Great Depression was a global crisis, while Latin America was the epicentre of the 1980s crisis. A comparison of the evolution of international trade and financial markets reflects these differences.

The system of world trade collapsed during the Great Depression, not only because of the direct effects of the decline in economic activity, but also because of the extensive use of protection as an adjustment mechanism. The trading system would be rebuilt gradually after the Second World War (a stage I shall refer to simply as “postwar” in the rest of this essay), using as a framework the General Agreement on Tariffs and Trade (GATT), signed in 1947, but centring initially on trade between developed countries. It should be added that the European economies had been unable to recover their economic dynamism after the First World War, and this affected the exports of the countries most dependent on them, especially Argentina. By contrast with these trends, exports supported the recovery during the debt crisis.

As is well known, the event that triggered the Great Depression was the collapse of the New York financial market, which had been at the centre of the financial boom of the 1920s and from which a number of Latin American countries had benefited. The reconstruction of an international private sector capital market would begin with the development of the so-called Eurodollar market in London in the late 1950s and would expand strongly in the 1970s thanks to the entry of more international banks into this business and to the financial surpluses of the oil-exporting countries. As figure 3 shows, the net transfer of resources to Latin America through the capital account only began to be significant in the late 1960s and peaked at about 2% of GDP in the 1970s.

**Figure 3**  
Net transfers of resources to Latin America through the financial account, 1950–2019<sup>a</sup>  
(Percentages of GDP)



**Source:** Prepared by the author, on the basis of data from the Economic Commission for Latin America and the Caribbean (ECLAC).

<sup>a</sup> Net transfers are estimated as the net balance of financial income minus the net balance of financial services.

The collapse that took place, especially after the Mexican moratorium of August 1982, and that led to the debt crisis, was monumental, representing a transfer of resources abroad of some 6% of GDP between 1983 and 1989. This means that the reversal of capital flows acted as a massive shock, equivalent to 8% of regional GDP. In contrast to the Great Depression, however, the capital outflow was specific to the region and not a global phenomenon.

One point of great interest is that in both cases measures were taken to reduce external debt. During the Great Depression, the suspension of debt service by Latin American countries was part of an international process, supported even by successive United States governments. A total or partial moratorium for Latin America began in 1931 and covered all countries except Argentina, which had to agree to continue paying its debt to British creditors as part of its trade commitments to the United Kingdom, and Venezuela, which had paid off all its external debt by the early 1930s (Bértola and Ocampo, 2012, chapter IV).<sup>6</sup>

For its part, as one element of the policies adopted to secure the support of the Latin American countries for the allies during the Second World War, the United States Government pursued what proved to be a generous foreign debt renegotiation. The best settlement was that of Mexico in 1941, when it obtained a 90% reduction in the value of its debt, including that resulting from the nationalization of American investments in oil and railways. The debts owed by the other countries were not reduced, but interest payments were, and unpaid interest was not capitalized. Eichengreen and Portes (1989, table 2.1) have estimated that the region ultimately paid an effective interest rate of just over 3% on debts taken out in the 1920s, between 4 and 5 percentage points lower than the terms under which they were contracted. This meant that, as a region, they had the best outcome of all countries that had had capital market access in the 1920s.<sup>7</sup>

Measures were also taken to assist Latin American countries during the debt crisis of the 1980s, but they were modest and belated, basically because of the risk of bankruptcy for international banks, and especially those of the United States.<sup>8</sup> There were, of course, many “silent moratoriums” in the form of temporary arrears on commercial and bilateral debt service payments, but strong pressure from the industrialized countries and multilateral agencies led Latin American countries to renegotiated agreements favourable to commercial banks (Altimir and Devlin, 1994; Devlin, 1989). At the same time, the United States and other industrialized countries put pressure on the International Monetary Fund (IMF) and the multilateral development banks to provide more financing. This was particularly important in the Baker plans of 1985 and 1987, but the amounts they provided were modest compared to the massive reversal of private capital flows and came with unprecedented “structural” conditionality (market reforms and fiscal adjustments that were often draconian).<sup>9</sup> The final phase came in March 1989 (i.e., almost seven years after the start of the crisis) with the Brady Plan, which included a modest reduction in debt balances, and whose main effect was to renew access to private external financing (see figure 3).

The combined impact of the collapse of international trade and commodity prices and the reversal of capital flows was devastating in terms of access to foreign exchange during the 1930s. Despite the export revival which began in 1933 (although it was curbed by the macroeconomic adjustment measures adopted by the United States in 1937), the purchasing power of exports and imports was still between 30% and 40% below 1929 levels when the decade ended, and more than 20% below that level at the

<sup>6</sup> By 1935, 97.7% of all dollar bonds issued by Latin America were in default, if Argentina's are excluded. Even by 1945, when some countries had renegotiated their obligations, 65.0% of non-Argentine debt remained in that situation (United Nations, 1955, table XII).

<sup>7</sup> See also the estimates by Jorgensen and Sachs (1989) for the reduction in the present value of external debt as a result of these renegotiations.

<sup>8</sup> At the beginning of the crisis, Latin American debt was equivalent to 180% of the capital of the nine largest United States banks.

<sup>9</sup> In addition to increased funding, the second Baker Plan included a policy of debt buybacks and swaps, as well as exit bonds with low interest rates.

end of the Second World War. In contrast, the purchasing power of exports did not decrease during the 1980s and in fact started to increase in the second half of the decade. The greatest adverse effect was the need to generate large and persistent trade surpluses to repay external debt, in accordance with the programmes agreed with the commercial banks (Bértola and Ocampo, 2012, figures 4.1 and 5.5).

Even more importantly, the combination of macroeconomic policy measures and structural reforms was much more favourable in the 1930s.<sup>10</sup> The definitive abandonment of the gold standard in the region and worldwide made it possible to adopt expansionary fiscal and monetary policies in the 1930s, after an initial period of firm adjustment under the rules associated with the maintenance of parity between national currencies and gold. In contrast, the fiscal adjustment to deal with the large deficits that had built up before the debt crisis, the explosion of inflation in many countries because of currency depreciation and the adjustment programmes agreed with the IMF led rather to the adoption of austerity policies during the debt crisis.

From a structural point of view, the Latin American countries were forced to refocus on their domestic markets during the 1930s, carrying out both manufacturing and agricultural import substitution. This reorientation towards domestic markets resulted in a strong economic recovery from 1933 onward that was partly arrested at the end of the decade and in the early years of the Second World War but accelerated again at the end of the War and in the early postwar years, now supported by a commodity price boom (see figures 1 and 2). Although economic growth was not very rapid during the 1930s (2.2% per annum in 1929–1939), it was among the best in the world.<sup>11</sup> If the Second World War years are included, Brazil, Colombia, Mexico and Venezuela had the best growth performance.

Industrialization, which had already taken off in some countries in the late nineteenth and early twentieth centuries, put down deep roots, now with firm support from the State, and led after the Second World War to average annual growth of 5.6% in the period 1945–1980, the highest and most stable in Latin American history. Not all countries benefited alike; in particular, those of the Southern Cone lagged behind the other countries of the region.<sup>12</sup>

The debt crisis led to a very different pattern of development, characterized by economic liberalization and more vigorous integration into the world economy. Average growth between 1980 and 1990 was just 1.4% a year, much lower than in the 1930s. Colombia, which entered the crisis with low levels of foreign debt, was the best performer, along with Chile in the second half of the decade, after its severe contraction at the start of the crisis. Some countries, including Argentina and Peru, actually ended the decade with a lower level of economic activity than in 1980.

Although export performance was generally good, economic growth in 1990–2019 averaged just 2.6% a year, i.e., a little under half that achieved during the era of State-led industrialization. It was also the worst performance of any developing region (excluding the Caribbean).<sup>13</sup> Only a handful of Latin American countries have grown more since 1990 than during the previous period, essentially those that performed most poorly during the industrialization era (Bolivia,<sup>14</sup> Chile and Uruguay, with Argentina performing slightly less well in the recent period than it did historically). Brazil and Mexico experienced a sharp slowdown from one period to the next, even though their policies for integration into the world economy differed.

<sup>10</sup> On the 1930s and 1980s, see the study edited by Thorp (1988) and ECLAC (1996), as well as Bértola and Ocampo (2012, chaps. IV and V).

<sup>11</sup> As a reference, according to Maddison's (2010) historical data, Western Europe grew by 1.5% per year on average in 1929–1940 and the United States by 0.9%.

<sup>12</sup> See the study edited by Cárdenas, Ocampo and Thorp (2000).

<sup>13</sup> According to United Nations data, excluding the Caribbean, which grew by 2.1% per year, the only other region to perform so poorly was sub-Saharan Africa, which grew at 2.8% per year.

<sup>14</sup> The name "Bolivia" changed to "Plurinational State of Bolivia" on 7 February 2009, so this essay uses one or the other form depending on the year.

One of the basic reasons for the weaker performance was the “premature deindustrialization” of the region’s countries, as this began at a much lower level of per capita income than in the industrialized countries when they entered a similar process (Palma, 2005). Another factor has undoubtedly been greater susceptibility to economic crises, reflected in the volatility of economic growth over recent decades, which has been higher than it was during the industrialization period and even somewhat higher than was typical in the early decades of the twentieth century.<sup>15</sup> We shall turn our attention to recent crises in the following sections.

## IV. The two recent crises

The two recent crises had very different origins. The first was the result of the Asian crisis of 1997, which spread to other emerging economies following Russia’s moratorium on its foreign debt in August 1998. This crisis strongly affected Latin America and especially several South American countries. Mexico had already been affected by a homegrown crisis at the end of 1994, although this was short-lived thanks to direct support from the United States. The North Atlantic crisis had its epicentre in the United States and Western Europe, and resulted from the difficulties faced by several banking institutions, especially the investment bank Lehman Brothers, which went bankrupt in September 2008.

The international support provided to address the first crisis was of the traditional variety: financing for the affected countries through IMF and multilateral development banks. The intense controversy that arose around the IMF adjustment programmes led to a major reform of conditionality in 2002, centring it on macroeconomic variables (IMF, 2002). In addition, the Group of 20 (G20) was established so that finance ministers and central bank governors could cooperate to promote international financial stability. In 2001–2002, an attempt was made to negotiate the creation of a mechanism for renegotiating sovereign debts within IMF, but the process failed because of opposition from the United States (which had originally proposed the negotiations) and from Brazil and Mexico, among other debtor countries, because they considered that it could lead to an increase in the cost of external financing. What was agreed instead was the inclusion of collective action clauses in bond issues to facilitate debt renegotiations with private creditors.<sup>16</sup>

By contrast, the North Atlantic crisis gave rise to one of the most ambitious packages of international economic cooperation in history, adopted by the G20 now at the heads of State level. In particular, the G20 Global Plan for Recovery and Reform agreed by the G20 and adopted in London on 2 April 2009 (G20, 2009) led to the most significant reform of IMF credit lines in the organization’s history, to the largest ever issue of IMF special drawing rights (SDRs), to the capitalization of the multilateral development banks and a massive increase in their lending, to an ambitious reform of financial regulation and to a commitment not to use trade protectionism as an adjustment measure, in order to avoid the deepening of the crisis that had taken place during the Great Depression. More belatedly, the G20 also embarked on efforts to strengthen international tax cooperation (a task it entrusted to the Organization for Economic Cooperation and Development (OECD)), the adoption (in 2012) of the so-called IMF “institutional vision” regarding capital flows (IMF, 2012) and the expansion and redistribution of IMF quotas; this last unfortunately took five years owing to the delay by the United States Congress in approving the necessary resources.<sup>17</sup>

<sup>15</sup> In 1901–1929, average annual growth was 3.9%, the standard deviation was 3.2% and the coefficient of variation was 0.82. In 1945–1980, the first two figures were 5.6% and 1.8% and the coefficient of variation was 0.32. The equivalent estimates for 1990–2019 are growth of 2.6%, a standard deviation of 2.2% and a coefficient of variation of 0.87.

<sup>16</sup> In parallel, but not associated with the crisis, there were two initiatives for the reduction of poor countries’ debt: the 1996 Heavily Indebted Poor Countries Initiative and the 2005 Multilateral Debt Relief Initiative. Bolivia, Honduras and Nicaragua benefited from the latter (as did Haiti, which is not included in the analysis of this essay).

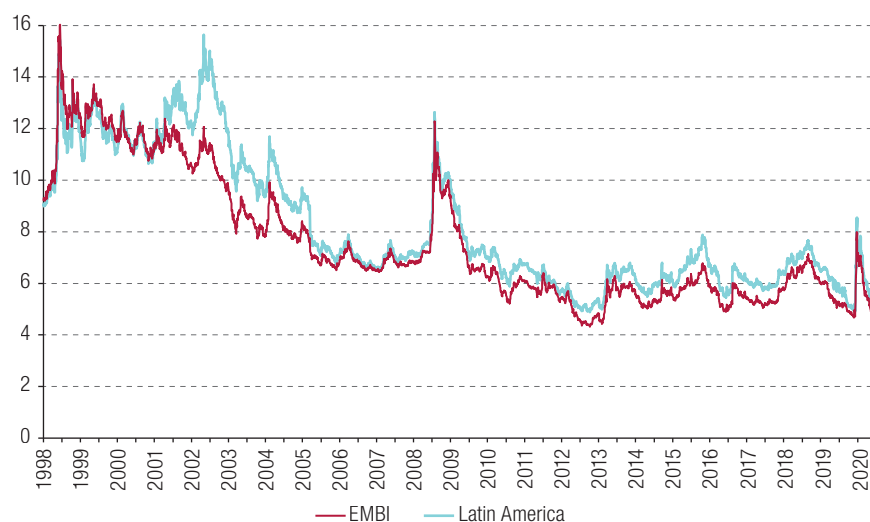
<sup>17</sup> See Ocampo (2017) for a detailed analysis of these topics.



The United States Federal Reserve also launched a currency swap programme, primarily with the central banks of other developed countries, but also including four emerging economies (Brazil, Mexico, the Republic of Korea and Singapore), although only temporarily. This was in addition to the expansionary monetary and fiscal policies adopted by developed countries and the very aggressive policies of China.

For Latin America, the successive Asian and Russian crises of 1997–1998 triggered a new wave of portfolio capital outflows that was almost as prolonged as the one that took place during the debt crisis, but somewhat less severe, with net resource transfers abroad that fluctuated between 2% and 4% of GDP, as compared to the 6% seen during the 1980s (see figure 3). This was partly offset by a boom in foreign direct investment in the region during the early years of the crisis, largely associated with privatization processes. At the same time, the cost of financing rose sharply, especially after the Russian moratorium of August 1998, reaching levels of 12% to 14% for about five years, as reflected in J.P. Morgan's Emerging Market Bond Index (EMBI), whose evolution since 1998 is shown in figure 4. Furthermore, the problems encountered by the adjustments in Argentina and Brazil meant that these costs remained high for a longer period than in other emerging economies.

**Figure 4**  
Yields of Latin America bonds compared with those of emerging economies, 1998–2020  
(Percentages)



**Source:** Prepared by the author, on the basis of data from J.P. Morgan.

**Note:** Daily data from 31 March 1998 to 9 November 2020.

Neither foreign trade nor the terms of trade were significantly affected during this crisis. The net result was five years of slow growth rather than a recession, with just one year of zero growth in 1999 (see figure 1). Argentina, the Bolivarian Republic of Venezuela and Uruguay did face a contraction during this five-year period, and a larger set of countries went into recession in 1999, including Colombia for the first time since the Second World War.

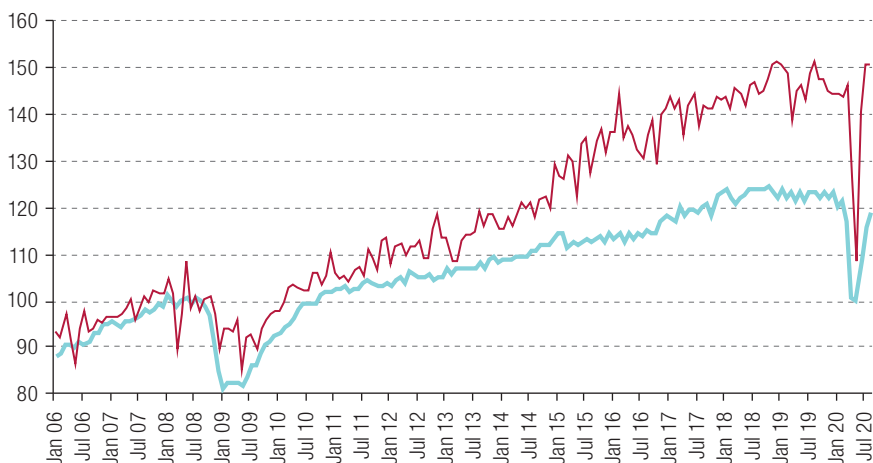
The North Atlantic crisis, like the long-lasting ones, did involve shocks in both financial and trade flows, combined with a sharp contraction in remittances from Latin American migrants. Thanks to the aggressive measures taken by the G20, however, the interruption to external financing was very moderate and short-lived for Latin America (see figure 3), and bond yields, which rose sharply after the collapse of Lehman Brothers as bond prices fell, had already normalized by the end of 2009. Moreover, the low interest rates that began to prevail in developed countries generated capital flows to emerging economies, including those of Latin America, especially between 2010 and 2014. Capital outflows from China interrupted this boom in 2015.



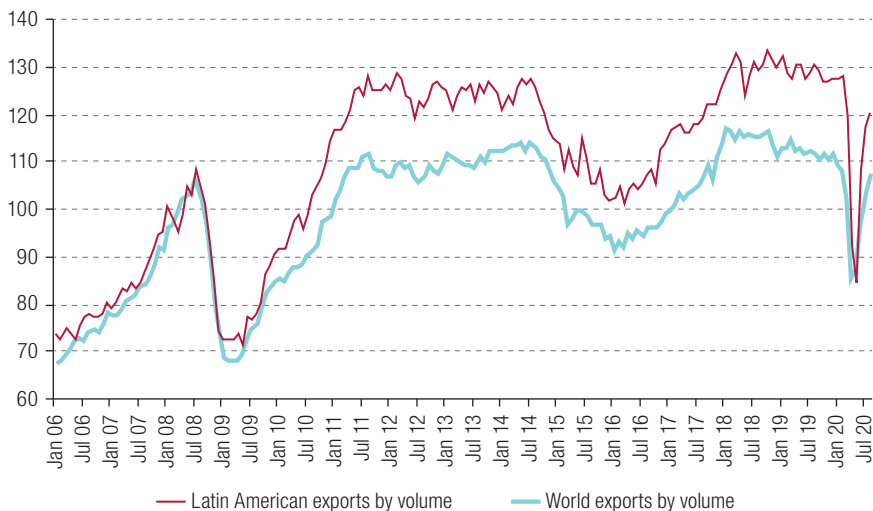
International trade initially underwent a sharp contraction during the North Atlantic crisis, in fact the worst of the postwar period, with world exports falling by nearly 20% in volume and 30% in value compared to the first half of 2008 (see figure 5). This contraction dragged down the corresponding indicators for Latin America, although with value falling by more than volume, owing to the drop in commodity prices. Once again, the G20 measures helped to bring about a rapid recovery and initiate a period of growth in international trade, albeit at the lowest rates since the end of the Second World War: 3.1% per annum in volume terms in 2007–2019, as compared to 7.3% in 1986–2007.<sup>18</sup> Latin America's export recovery was much stronger than the world average, supported by the renewal of the commodity price boom which, as seen at the end of section II, had begun in 2003–2004 and would last until 2012–2013, as well as by strong growth in sales of goods from several countries of the region to China.

**Gráfico 5**  
International trade indices  
(First half of 2008=100)

**A. Exports by volume**



**B. Exports by value**



**Source:** Prepared by the author, on the basis of Netherlands Bureau of Economic Policy Analysis (CPB), World Trade Monitor [online database] <https://www.cpb.nl/en/worldtrademonitor>.

<sup>18</sup> Estimates based on data from IMF and the United Nations, respectively.

Interestingly, the most lasting impact of this crisis was on the remittances of Latin American migrants. These stagnated in 2008 and fell by 14% in 2009, according to ECLAC data, and only in 2015 did they return to and slightly exceed the levels of 2007–2008.

The impact of this crisis on Latin America was significant in 2009, when GDP fell by 1.8%. Half the region's countries went into recession that year, with particularly severe downturns in the Bolivarian Republic of Venezuela and Mexico. However, recovery was rapid and strong, and in 2010 the region grew by 6.2%; only in the Bolivarian Republic of Venezuela did output continue to contract that year. However, the region's growth rate slowed substantially from 2011, even though external financing conditions and terms of trade became favourable. Moreover, as noted in section II, 2015 saw the start of one of the worst five-year periods in Latin American economic history.

## V. The COVID-19 crisis

The coronavirus (COVID-19) crisis is unique in history, because it combines the worst pandemic since the so-called Spanish flu of 1918 with a highly integrated world economy. Its direct effects have been a virtual shutdown worldwide of some economic activities (tourism, air passenger traffic, live cultural activities) and a sharp contraction in others (retail, restaurants and various other services) because of confinement measures and cautious behaviour adopted to avoid contracting the virus. These effects, which are impacting supply in a number of sectors, have also had repercussions on aggregate demand via reduced employment, lower household incomes and households' cautious approach to spending because of income uncertainty. While macroeconomic policies have been expansionary, especially in developed countries, the combination of these supply and demand effects in an integrated world has had dramatic consequences.

According to the latest projections available at the time of writing, IMF (2020c) estimates a decline in global GDP at market exchange rates of 4.7% in 2020.<sup>19</sup> The deep recession experienced by China in the first quarter of 2020 and the steeper recessions in a large set of countries in the second quarter reflect the devastating effects of confinement on economic activity.

The crisis is truly global and will be much severer than the North Atlantic crisis (a 2.0% contraction of the world economy in 2009 at market exchange rates, according to IMF), as the current one has affected all countries, while that of 2008–2009 did not have such a strong impact on a large group of emerging and developing economies. The contraction has been faster than during the Great Depression, but may be shallower and, above all, much less prolonged.<sup>20</sup> The baseline forecast by IMF is for 4.8% growth in 2021, but this would not fully compensate for the 2020 recession in most economies. This projection assumes, in any event, that the effects of the pandemic will gradually dissipate, but there is clearly uncertainty about the consequences of further outbreaks, which have already begun to occur in the European countries and the United States.

Given the magnitude of the crisis, developed countries have been adopting policies that include increasing public spending, reducing or postponing tax payments and providing businesses with liquidity, financing and credit guarantees. In both fiscal and monetary terms, IMF estimates that the policy packages are more aggressive than those adopted to deal with the North Atlantic crisis, although with differences between countries (IMF, 2020a, 2020b and 2020c). In contrast, China's reactivation measures have been less substantial than those adopted then, owing to the reduced fiscal leeway and higher levels of debt that it has today, two issues that affect many other emerging and developing economies. In the case of the Latin American economies, this is due both to the fiscal policies adopted

<sup>19</sup> The IMF estimates -4.4% at purchasing power parity, but this is not comparable with the estimates at market exchange rates of the United Nations, the World Bank and most private analysts.

<sup>20</sup> This is particularly true for the United States, where the economy contracted for three consecutive years during the Great Depression — with a cumulative fall of 27% according to historical figures presented by Maddison (2010)— and only returned to 1929 levels a decade later. In Western Europe, it took six years for GDP to return to 1929 levels.

to cope with the North Atlantic crisis and to the less restrictive attitudes in this respect since then and the effects of slow economic growth during the five years preceding the current crisis.

The international debate has highlighted the fact that, while the pandemic affected Western Europe and the United States early on and was slower to reach developing countries, the latter are more socially vulnerable. There are many reasons for this: health systems are of poorer quality and do not cover the entire population; informal working is rife and implies that confinement leaves a large group of workers without income; poor households live in small spaces and sometimes without proper access to water; and support mechanisms for the poor are non-existent or limited. On top of all this, there is less fiscal leeway and governments' access to credit is more restricted. For this reason, there is agreement on the need to adopt ambitious policies to support emerging and developing economies. The resource needs of these countries were estimated at US\$ 2.5 trillion at the beginning of the crisis by both IMF (2020d) and UNCTAD (2020a).

In view of the magnitude of the international crisis and the financial needs of emerging and developing economies, G20 leaders committed at the end of March to “do whatever it takes” and use all available policy tools to minimize the economic and social damage generated by the pandemic, restore global growth and maintain market stability (G20, 2020a). The finance ministers and central bank governors of the G20 member countries said much the same in their statement at the meetings of the Bretton Woods institutions (G20, 2020b). However, the international cooperation agreed so far has been very limited, in terms of both the measures taken and the resources to which emerging and developing economies will have access.

The contrast with the ambitious agenda agreed by the G20 in 2009, which was referred to in the previous section, is striking (Ocampo, 2020b). As regards IMF, resources have been secured through loans by countries to the Fund, but not through increased quotas; the expansion and reallocation of quotas was postponed in 2019 until 2023, and no decision has been made to accelerate the process. The United States vetoed the allocation of SDRs during the meetings of the Bretton Woods institutions. The only major reform of IMF has been the speeding up of approval for emergency loans to a wide range of countries, but for a small amount (about 80 countries and US\$ 30 billion), as the maximum authorized is the amount of each country's quota. It should be added that the Federal Reserve renewed its currency swap line, including the same emerging economies as had had access to it during the previous crisis, and added to this a repo mechanism allowing the Federal Reserve to buy any Treasury bonds that countries wish to sell it.

In contrast to 2009, there has been no call to capitalize the multilateral development banks. Fortunately, two of them, the World Bank and the African Development Bank (ADB), were capitalized in 2018 and 2019, respectively. Where debt is concerned, although there have been calls for far-reaching action,<sup>21</sup> the only significant measure has been the agreement to postpone poor countries' debt service payments until mid-2021,<sup>22</sup> so far without the participation of private creditors. There has also been a call to refrain from using trade protection as an adjustment mechanism, although the tensions of the so-called “trade war” between the United States and China continue.

It should be noted that cooperation measures have been particularly limited in relation to middle-income countries, a classification that includes almost all the Latin American countries. Financial cooperation with the countries of the region has indeed been very restricted (Ocampo, 2020a). On a positive note, Chile and Peru have been granted access to the IMF flexible credit line and Colombia's credit line has been renewed and increased (Mexico's was renewed at the end of 2019).<sup>23</sup> This contingency line is intended to supplement international reserves and not necessarily to be disbursed; Colombia was the

<sup>21</sup> For the proposals on debt, see in particular Bolton and others (2020), Reinhart and Rogoff (2020) and UNCTAD (2020b).

<sup>22</sup> This initially covered only 2020. In October, the G20 announced an extension until June 2021 and a programme that could reduce the debt of these countries, to be implemented on a case by case basis (G20, 2020c).

<sup>23</sup> With the increase in the line for Colombia, Chile has resources equivalent to 10 times its quota, Colombia and Peru 6 times and Mexico 5 times.

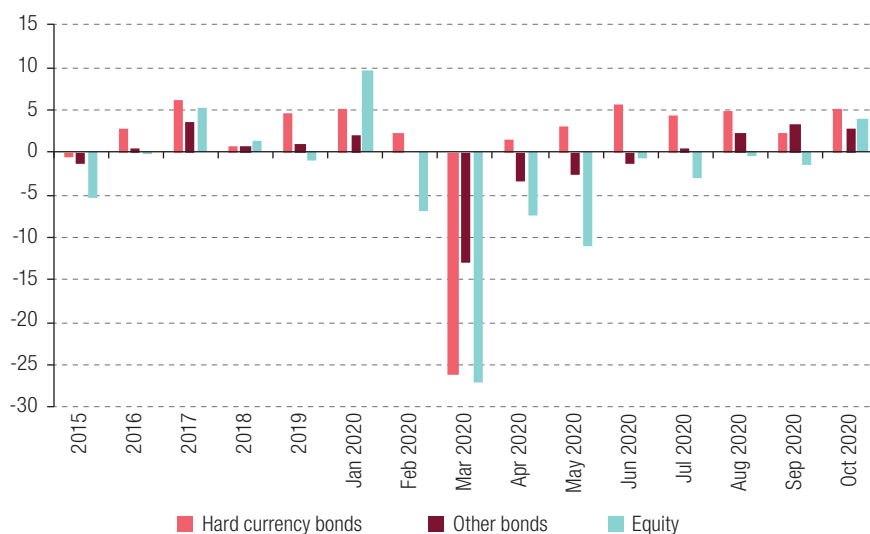
first country to announce the possibility of using some of these resources. Also worth noting are the successful renegotiations of Argentina and Ecuador's debts with implicit IMF support, the new credit granted to Ecuador, and the ongoing negotiations between Argentina and IMF to modify the country's financing line. It should be added that no resources have been requested from the Latin American Reserve Fund (FLAR, according to its Spanish acronym) and that its board opposes their use for fiscal purposes, something that is possible with IMF resources.

In addition, several Latin American economies have had access to IMF emergency lines, but for limited amounts. Lending by multilateral banks has increased, but the two that provide the most funding to countries in the region, the Inter-American Development Bank (IDB) and the Development Bank of Latin America (CAF), need to be capitalized to play as active a role as they did in the recovery from the North Atlantic crisis. The Central American Bank for Economic Integration (CABEI) was recently capitalized.

The limitations of international cooperation contrast with the ambitious domestic policies adopted by developed countries. This is particularly true of the United States, whose policies have been much more aggressive than those it adopted in response to the North Atlantic crisis. Its limited support for international cooperation also contrasts with the leadership it exercised then. European countries have also adopted markedly countercyclical policies, but have been more open to multilateral cooperation. The contrast between the aggressive domestic economic policies of the developed countries and limited international cooperation is undoubtedly the most striking feature of the current crisis (Ocampo, 2020b).

As in the previous crisis, the effects on financial markets were initially devastating. However, the magnitude of the intervention by developed country central banks, and especially the Federal Reserve, meant that the falls were not as severe as in 2008–2009 and that financial markets were able to recover from late March onward, albeit with high levels of volatility (IMF, 2020b). One of the initial effects was the worst outflow of portfolio capital from emerging economies in history, exceeding US\$ 100 billion (Brooks and Fortun, 2020; IMF, 2020b). However, as shown in figure 6, after the massive capital outflow during March, bond markets in hard currencies (particularly dollars) opened for emerging economies again in April 2020, especially from the middle of that month. As a result, 12 Latin American countries, a number of public companies and the multilateral banks based in the region have been able to access this market. Capital outflows from local currency bond markets also began to decline in April, and flows turned positive in June. The outflow of equity capital also began to decline in June, and the flow turned positive in October.

**Figure 6**  
Capital flows into emerging economies  
(Billions of dollars)



**Source:** Prepared by the author, on the basis of data from J.P. Morgan.

In addition, the collapse of emerging market bond prices in secondary markets drove yields sharply upward at the beginning of the crisis, but the growing demand for such securities caused yields to fall from the end of March 2020, so that by August they were back to levels similar to those prior to the crisis. This also meant that conditions for new issues were very favourable; indeed, several countries in the region have been able to issue bonds under the best conditions ever. The normalization of access to bond markets for Latin American countries has therefore been much faster than in previous crises: some 2 months, as compared to 12 months after the North Atlantic crisis and 5 and 8 years after the Asian and debt crises respectively.

The crisis also led to a sharp contraction in international trade, intensifying the fall in volume and value terms that had begun in late 2019 as a result of the “trade war” and expectations of a global economic slowdown.<sup>24</sup> The World Trade Organization (WTO, 2020) estimated in April that the fall in trade volumes would be between 13% in the baseline scenario and 32% in the worst case scenario. The fall in May was 18% in relation to the average volume for 2019, in the mid-range of the WTO estimates, but there has been a strong recovery, a much faster one indeed than was experienced after the North Atlantic crisis (see figure 5). In the case of Latin America, the initial fall was steeper, but the subsequent recovery has been too. In any case, the slowdown in trade growth since the North Atlantic crisis is likely to worsen. The main uncertainty relates to the destruction or contraction of international value chains. However, to the extent that the companies involved in such chains move closer to consumers, this trend could benefit Latin America.<sup>25</sup> As regards commodities, the crisis has led to a sharp reduction in the prices of oil and other energy products, an effect which, as we have seen, is detrimental to some Latin American countries but beneficial to others. There was also a decline in base metal prices in the early months, although this was less pronounced and was subsequently reversed, and a mixed trend in the case of agricultural commodities. Overall, then, the only commodity prices to have fallen substantially have been those of energy products.<sup>26</sup>

On top of these adverse shocks, a drop in remittances was initially expected. The available data indicate, however, that although there has been a decline for countries whose migrants are in South American countries, remittances received by the region as a whole were up by 9.6% in January–August 2020 compared to the same months in 2019.<sup>27</sup> This increase compares very favourably with the sharp fall they experienced during the North Atlantic crisis.

Projections by IMF (2020e) and ECLAC (2020b) indicate that the region will experience a severe recession in 2020; indeed, that it will be the worst among developing countries, along with India's, and one of the worst in the world along with that of Western Europe. The data in figure 1 suggest that this will be the worst recession in Latin America's history. All the projections also indicate that recovery in 2021 will be only partial. Brazil and Chile are expected to be the least affected of the medium-sized and large countries in the region, but several smaller economies are expected to experience more limited contractions in economic activity.

On the social front, the problems have been considerable (ECLAC, 2020a). Inadequate investment is reflected in weak and fragmented health-care systems that have not ensured universal access for the population in many countries. Because of the large digital divide, students from poor backgrounds cannot benefit from virtual education. Meanwhile, the prevalence of informal working has meant that a high proportion of households, especially those that are not poor but are vulnerable to falling into

<sup>24</sup> Data from the Netherlands Bureau for Economic Policy Analysis (CPB), on which figure 5 is based, indicate that growth in the 12-month moving average of the volume of global exports was negative from October 2019, while that of global export values has been negative since August 2019.

<sup>25</sup> See the analysis by The Economist Intelligence Unit (2020).

<sup>26</sup> See the data in International Monetary Fund (IMF), “IMF primary commodity prices”, undated [online] <https://www.imf.org/en/Research/commodity-prices>. World Bank (2020) projections for the whole year follow this pattern.

<sup>27</sup> The data refer to 13 Latin American countries for which ECLAC has information: Brazil, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru and the Plurinational State of Bolivia.

poverty, have been left without income and have not necessarily been reached by assistance in the form of conditional transfers. Some countries have introduced forms of limited support for these households. Many micro, small and medium-sized enterprises are failing, which is of great concern, as they generate a high proportion of employment in the region.

Overall, ECLAC estimates, as reported by the United Nations (2020), indicate that the poor population will increase by 45 million people, representing the loss of a decade and a half's progress in this area. This will coincide with likewise considerable increases in unemployment and informal jobs. These adverse trends are occurring, moreover, in a context where social conditions have been deteriorating since 2014 as a result of poor economic performance during the five years preceding the crisis.

It should be stressed that, in economic terms, the response of the countries of the region has been in line with international trends, but the scale of support has generally been much more modest than in developed countries. Central banks have provided liquidity (with obvious restrictions in countries that have dollarized economies). Governments have adopted fiscal programmes, most particularly to provide support to the health-care sector and to poor and vulnerable households, and measures to reduce or defer payment of some taxes, but the size of the packages has been variable. According to IDB estimates, the largest ones as a percentage of GDP have been those of Brazil, Chile, El Salvador and Peru (Pineda, Pessino and Rasteletti, 2020). Some countries have launched credit lines or credit guarantees on a large scale, most notably Chile, Colombia, Peru and Uruguay.

The greatest constraint has been the limited fiscal space available to the countries of the region. The contrast with their situation in the previous crisis is striking. On average, according to ECLAC data, countries had primary central government deficits of between 0.5% and 1% of GDP in the last five years compared to a surplus of more than 2% before the 2008 crisis, and national government debt of 46% of GDP compared to 29% in 2008. Differences in fiscal space have also been highlighted by several IDB analysts (see, for example, Izquierdo and Ardanaz, 2020).

## VI. In conclusion: the current crisis in perspective

The external shocks experienced by Latin America have been sharp and have taken place in a context of limited international financial cooperation, especially by comparison with the North Atlantic crisis. However, they have been less severe than in previous crises, particularly in the cases of private external sector financing and the terms of trade. In the latter case, the sharp fall in oil prices has obviously affected oil-exporting countries but has benefited a larger set of oil-importing countries. There was an initial contraction in the volume of international trade, although a less severe one than during the North Atlantic crisis (or the Great Depression, which is not an appropriate comparison in this case). It is possible that the limited trade dynamism which has characterized the world economy since then will be accentuated, but there could be opportunities for some countries in the region from the relocation of value chains. Remittances from migrant workers have also performed much better than during the North Atlantic crisis. On the whole, then, external shocks have been less adverse in the COVID-19 pandemic than during the two long-lasting crises and even than during the shorter ones.

This means that the severity of the crisis has been due more to internal factors in the Latin American countries. Among them should be included the fact that the region became the global epicentre of the pandemic between June and August (at the time of writing, the regional trend was favourable and the epicentre was shifting to other regions). Similarly, national policy constraints, characterised by inaction or limited action in some cases, and more generally by weaknesses in health-care systems and an inability to adopt more aggressive fiscal policies, also help explain the adverse outcome.



Even more important is the fact that, as seen in previous sections, the crisis hit the region after five years of poor performance. This helps explain why, instead of a two- or three-year crisis, the region will experience a new lost decade in 2015–2024. Moreover, the crisis closes three decades of slow economic growth, during which the region has been the worst-performing in the developing world.

This indicates that, looking beyond the current crisis, the region's development patterns need to be fundamentally changed, as has been pointed out by the United Nations (2020) on the basis of ECLAC contributions, and by the Latin American Consensus 2020 (Casilda Béjar and others, 2020). As these documents point out, the COVID-19 crisis should serve as a starting point for reformulating the region's development strategy, starting with seven basic objectives: (i) improve social policies and boost decent employment, with the aim of reducing high levels of inequality; (ii) to that end, increase public expenditure, financing this with more progressive tax structures; (iii) adopt more active production development policies underpinned by an aggressive research and development strategy; (iv) pursue stronger countercyclical policies that reduce the vulnerability of economies to crises; (v) implement a strategy of deep regional integration that can help diversify production activity in a context of slow growth in international trade; (vi) adopt an ambitious environmental policy conducive to compliance with international agreements on combating climate change and protecting diversity; and (vii) most importantly, firmly uphold democratic values and institutions.

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# Building pro-development multilateralism: towards a “New” New International Economic Order<sup>1</sup>

Ha-Joon Chang

## Abstract

This paper explains how a “New” New International Economic Order (NNIEO) may be emerging from the slowly crumbling neoliberal international economic order that came into being in the 1980s and 1990s. First, it examines how the neoliberal order has been fading and is being reshaped in the wake of the decline of the multilateral international trading system (embodied by the World Trade Organization (WTO)) and the 2008 global financial crisis. It then discusses how recent changes in the world economy and in prevailing ideas, together with a number of contingent factors – such as climate change, the rise of China and the coronavirus disease (COVID-19) crisis – are making the emergence of an NNIEO more likely, while recognizing that some factors may hinder progress towards it.

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## Keywords

Economic development, neoliberalism, multilateralism, international trade, WTO, economic systems, economic crisis, COVID-19, developing countries, China

## JEL classification

B27, F02, F55, F63

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<sup>1</sup> This article is based on the sixteenth Raúl Prebisch Lecture at the Economic Commission for Latin America and the Caribbean (ECLAC), delivered by the author on 21 August 2019. It was substantially updated and expanded in August 2020, in light of the coronavirus disease (COVID-19) pandemic and its consequences. The author would like to thank Alicia Bárcena, Executive Secretary of ECLAC, Mario Cimoli, Gabriel Porcile, Romain Zivy and Miguel Torres for their comments on the early version of the lecture.

## I. Introduction

The international economic order established after the Second World War, based on the so-called Bretton Woods institutions, unravelled in the 1970s. In the 1980s and the 1990s, following the end of developmentalism in the Third World through the structural adjustment programmes (SAPs) of the International Monetary Fund and World Bank and the collapse of the socialist bloc, a new, “neoliberal” international economic order came into being, based on exposure of the entire globe to unrestricted market forces. Many expected this new world order to last into the foreseeable future, if not forever, as summarized in the idea of “the end of history” coined by the (then) neoconservative American political scientist, Francis Fukuyama (1989).

However, the new world order started to unravel almost as soon as it was established. The euphoria about globalization following the replacement of the General Agreement on Tariffs and Trade (GATT) with the World Trade Organization (WTO) in 1995 was quickly dampened by discord between rich countries and developing countries in the subsequent Ministerial Conferences and by anti-globalization protests outside the conference venues, especially in Seattle (1999), Cancún (2003), and Hong Kong (2005). This was followed by the global financial crisis of 2008, which undermined confidence in the neoliberal system of open global financial markets. The rise of China, based on an economic order that is fundamentally different from neoliberalism, although not totally incompatible with it, has also posed a serious challenge to the neoliberal orthodoxy since the 2010s. The eruption of the coronavirus disease (COVID-19) crisis in 2020 has exposed yet more weaknesses of the neoliberal system, forcing many countries to rethink the way they organize their economies and societies.

This paper discusses whether the decline of the current neoliberal international economic order is creating the right conditions for the emergence of an alternative order, which I name a “New” New International Economic Order (NNIEO) after the New International Economic Order (NIEO), one of whose leading proponents was Raúl Prebisch. The paper is structured as follows. Section II describes the decline of the current multilateral order in international trade, represented by WTO. Section III traces this decline to the limitations of the WTO system itself. Section IV discusses the factors that militate against the emergence of an NNIEO as an alternative. While recognizing the importance of these factors, the subsequent sections of this paper argue that many other factors make the emergence of an NNIEO likely: changes in the structure of the world economy (see section V), changes in ideas (see section VI), and contingent factors, such as climate change, the rise of China and the COVID-19 crisis (see section VII). Section VIII provides some concluding remarks.

## II. The decline of the multilateral order in international trade

In the last few years, there has been particular concern over the future of the world trading system, given the aggressive trade policy of the Trump Administration in the United States. In the name of punishing what it sees as unfair competition from China, the Trump Administration has imposed extra tariffs on Chinese imports. In the same spirit, the United States has renegotiated in its favour both the North American Free Trade Agreement (NAFTA) and the free trade agreement with South Korea. It has even tried to use tariffs as a tool to reduce migration flows from Mexico.

Such a blatant rejection of multilateralism by the United States, especially in the context of growing racism and xenophobia in the rich world, has increased concern that the current world trading order based on multilateralism — the WTO system — is under serious threat.

This is particularly bad news for developing countries. It is abundantly clear that developing countries fare better under multilateralism, because individually they have weak bargaining power vis-à-vis the rich countries. The fact that multilateralism is the friend of the weak is reflected by rich countries' repeated attempts to undermine it whenever it does not work for them. The best example of this is the evolution of the WTO system itself.

When WTO was launched in 1995, the rich countries professed a firm commitment to multilateralism, going so far as to accept a “one country, one vote” system for the first time in any major international organization. In contrast, the five permanent members of the United Nations Security Council retain their veto powers, and decisions in the World Bank and the International Monetary Fund (IMF) are made essentially (although not entirely) according to the share capital held by each country. However, it became apparent that rich countries only supported the idea because they thought they could hold sway over developing countries by controlling the negotiation agenda and by coaxing or threatening individual developing countries through the strategic use of bilateral aid budgets, market access and foreign direct investments.

To their surprise, the rich countries soon found that they could not bully developing countries into agreeing to whatever they put on the table at WTO. During the Ministerial Conferences in Seattle in 1999 and Cancún in 2003, the prevalence of the so-called Green Room meetings (to which only the rich countries and a small number of developing countries that cannot be ignored were invited) made developing countries realize that the multilateralism promised by the rich countries was just lip service. As a result, developing countries have firmly resisted rich countries' subsequent unreasonable demands made through WTO, such as in the proposed Multilateral Agreement on Investment (MAI) or in non-agricultural market access (NAMA) negotiations.

When rich countries realized that they could not have their way within WTO, they started to shamelessly abandon their commitments to multilateralism. Even before President Trump took office, the United States had effectively disengaged from the WTO system and had been focusing on reaching bilateral and regional free trade agreements, such as the Trans-Pacific Partnership (TPP). The European Union may not have rejected multilateralism to the same extent as the United States, but it has actively engaged in “divide and rule” tactics in its trade negotiations with developing countries. In 1997, the WTO dispute settlement panel found that the preferential trade arrangement between the European Union and African, Caribbean and Pacific (ACP) countries (mostly former colonies of European Union member States) —known as the Lomé waiver— was inconsistent with GATT, so the European Union proposed replacing it with a trade-and-investment agreement, called the Economic Partnership Agreement (EPA). However, when negotiating EPA, the European Union deliberately divided the ACP countries into seven regional subgroups, instead of negotiating with all of them together, so that it could weaken their bargaining power.

In short, the multilateral trading system started to fall apart well before the advent of the Trump Administration in the United States and it is in the interest of developing countries to revive it. However, in doing so, it is not enough to return to the WTO system, which has inherent biases against developing countries and therefore needs radical reform if it is to be truly pro-development. In discussing what these biases are, how they may be countered and how a more equitable international economic order can be constructed, this paper draws on the ideas of Raúl Prebisch, which were embodied in the call for an NIEO, made by the United Nations in 1974.<sup>2</sup>

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<sup>2</sup> See United Nations (1974).

### III. The WTO system and its limitations

The WTO system is based on the principle that free trade is best for all countries under almost all circumstances. However, economic theories and historical records show that free trade between countries at different levels of economic development is harmful in the long run for economically less developed countries. In the short run, free trade is likely to (although not certain to) allow all trading partners to maximize their output and income, but in the long run it hampers the economic development of the less developed trading partners, by making it impossible for them to create high-productivity, high-technology industries, in the face of competition from superior producers based in economically more developed countries. This means that, unless the governments of economically less developed countries protect and nurture their nascent high-productivity industries through tariffs, subsidies and other supportive measures, they cannot cultivate such industries and thereby develop their economies.

This is of course the “infant industry” argument, which was first theorized by none other than the first United States Secretary of the Treasury, Alexander Hamilton, in his 1791 report to the United States Congress (Hamilton, 2001). This theory formed the basis of economic development policy in virtually all today’s rich countries, when they were developing countries themselves and trying to catch up with more economically advanced countries. As shown by Bairoch (1993), Chang (2002 and 2007) and Reinert (2007), all today’s rich countries, with the exception of the Netherlands and (up to the First World War) Switzerland, used protectionism during most of the period when they were trying to catch up with more advanced economies.

The United Kingdom and the United States, which are assumed to have invented free trade (or at least tell everyone that they did), were actually the most protectionist countries in their respective catch-up periods, protecting their industries from the superior producers based in the Low Countries (now Belgium and the Netherlands) in the case of the United Kingdom, and from the producers based in the United Kingdom, France and other European countries in the case of the United States. For most of these periods —from the mid-eighteenth to the mid-nineteenth century for the United Kingdom and from the mid-nineteenth century to the mid-twentieth century for the United States— their average industrial tariff rates were between 40% and 50% (see table 1).

Even when their average tariff rates were not so high, many of today’s rich countries provided high tariff protection, in addition to other supportive measures, to selected strategic industries. For example, Germany and Sweden may have had average industrial tariffs of between 15% and 20% in the very late nineteenth and early twentieth centuries, but they applied much higher tariffs for the emerging heavy and chemical industries, whose development allowed them to catch up with the United Kingdom. Another example is Belgium, which in the late nineteenth century had an average industrial tariff rate of just 10%, but applied tariffs of 30%–60% to textiles and of 85% to iron. Even in the period following the Second World War, protection was quite high until the 1960s. Only by the 1970s did today’s rich countries have average industrial tariffs that were lower than those applied by developing countries nowadays, which are around 10% (see table 2).

**Table 1**  
Selected rich countries: average tariff rates on manufactured products during  
their early stages of development  
(Weighted averages, in percentages of value)<sup>a</sup>

	1820 <sup>b</sup>	1875 <sup>b</sup>	1913	1925	1931	1950
Austria <sup>c</sup>	R	15–20	18	16	24	18
Belgium <sup>d</sup>	6–8	9–10	9	15	14	11
Canada	5	15	n/a	23	28	17
Denmark	25–35	15–20	14	10	n/a	3
France	R	12–15	20	21	30	18
Germany <sup>e</sup>	8–12	4–6	13	20	21	26

Table 1 (concluded)

	1820 <sup>b</sup>	1875 <sup>b</sup>	1913	1925	1931	1950
Italy	n/a	8–10	18	22	46	25
Japan <sup>f</sup>	R	5	30	n/a	n/a	n/a
Netherlands <sup>d</sup>	6–8	3–5	4	6	n/a	11
Russia	R	15–20	84	R	R	R
Spain	R	15–20	41	41	63	n/a
Sweden	R	3–5	20	16	21	9
Switzerland	8–12	4–6	9	14	19	n/a
United Kingdom	45–55	0	0	5	n/a	23
United States	35–45	40–50	44	37	48	14

**Source:** Prepared by the author, on the basis of H. J. Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective*, London, Anthem Press, 2002; P. Bairoch, *Economics and World History: Myths and Paradoxes*, Hemel Hempstead, Harvester Wheatsheaf, 1993, and K. Taylor, "Tariffs", *Encyclopedia of Canada, Vol. VI*, W. Stewart Wallace (ed.), Toronto, University Associates of Canada, 1948.

**Note:** R= Numerous and important restrictions on manufactured imports existed, therefore average tariff rates are not meaningful.

<sup>a</sup> World Bank, *World Development Report 1991: The Challenge of Development*, New York, Oxford University Press, 1991, p. 97, box 5.2, provides a similar table, partly drawing on Bairoch's studies that form the basis of the above table. However, the World Bank figures, although in most cases very similar to Bairoch's figures, are unweighted averages, which are obviously less preferable to the weighted average figures that Bairoch provides.

<sup>b</sup> These are very approximate rates, and give a range of averages, not extremes.

<sup>c</sup> Austria-Hungary before 1925.

<sup>d</sup> In 1820, Belgium and the Netherlands both formed part of the United Kingdom of the Netherlands.

<sup>e</sup> The 1820 figure is for the Kingdom of Prussia only.

<sup>f</sup> Before 1911, Japan was obliged to keep low tariff rates (up to 5%) through a series of "unequal treaties" with European countries and the United States. The box cited in note <sup>a</sup> above (World Bank, 1991) gives Japan's unweighted average tariff rates for all goods (and not just manufactured goods) for the years 1925, 1930, 1950 as 13%, 19% and 4%, respectively.

**Table 2**  
Selected rich countries: average tariff rates on manufactured products in the early post-Second World War period  
(Percentages)

	1950	1959	1962	1973	1979
Europe					
Belgium	11	14			
France	18	30			
West Germany	26	7			
Italy	25	18			
Netherlands	11	7			
European Economic Community (EEC) average <sup>a</sup>		15	13	8	6
Austria	18		20 <sup>b</sup>	11	8
Denmark	3				
Finland			>20 <sup>c</sup>	13	11
Sweden	9		8	6	5
Japan	n/a		18	10	6
United Kingdom	23		16		
United States	14		13	12	7

**Source:** Prepared by the author, on the basis of P. Bairoch, *Economics and World History: Myths and Paradoxes*, Hemel Hempstead, Harvester Wheatsheaf, 1993; H. Grubel and H. Johnson "Nominal tariffs, indirect taxes and effective rates of protection: the common market countries 1959", *The Economic Journal*, vol. 77, No. 308, 1967; B. Balassa, "Tariff protection in industrial countries: an evaluation", *Journal of Political Economy*, vol. 73, No. 6, 1965; P. Katzenstein, *Small States in World Markets: Industrial Policy in Europe*, Ithaca, Cornell University Press, 1985; D. Greenaway, *International Trade Policy: from Tariffs to the New Protectionism*, Basingstoke, Macmillan Press, 1983, and M. Panić, *National Management of the International Economy*, Basingstoke, Macmillan Press, 1988.

<sup>a</sup> EEC average after 1973 includes Denmark and the United Kingdom.

<sup>b</sup> Data for 1960.

<sup>c</sup> Estimate by the author. Data on Finland's tariff rates are not readily available, but, according to the data reported in table 8.2 of Panić (1988), in 1965 tariff revenue as a percentage of all imports in Finland was 9.97%, which was considerably higher than that of Japan (7.55%), which had an 18% average industrial tariff rate, or that of Austria (8.57%), which had a 20% average industrial tariff rate. Given these, it would not be unreasonable to estimate that Finland's average industrial tariff rate in the mid-1960s was well over 20%.

Last but not least, today's rich countries used numerous non-tariff barriers to trade, especially in the post-Second World War period, such as import bans, import quotas (including the notorious voluntary export restraints imposed on Japanese car manufacturers by the United States and European countries in the 1970s and the 1980s) and product standards (such as sanitary and phytosanitary standards for food items).

It is not just in trade policy that rich countries did all the things they now tell developing countries not to do under the WTO system. The same applies to areas such as subsidies, foreign direct investment (FDI) and intellectual property rights (IPR).

Through the Agreement on Subsidies and Countervailing Measures (SCM Agreement), the Agreement on Trade-Related Investment Measures (TRIMS Agreement), and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), WTO restricts what countries can do in terms of using subsidies, regulating FDI and reducing protection of IPRs, all of which are measures that developing countries need more than rich countries. However, when today's rich countries were trying to develop their own economies, they made aggressive use of industrial subsidies, heavily regulated FDI and deliberately did not protect foreigners' IPRs (for further details, see chapter 2 in Chang (2002) and Chang (2004)).

By showing that the history of development policy in today's rich countries contradicts WTO rules, I am not arguing that a pro-development international trading system necessarily needs to allow all the policy measures that were used by rich countries in the past. For example, in the nineteenth century, the United Kingdom, the Netherlands, the United States, France and Austria all allowed their citizens to register patents on inventions designed by foreigners. Such a practice would not only be unacceptable today, there are also better ways to help catching-up countries access advanced technologies, such as suspending selected patents for inventions that are essential for economic development, reducing licensing royalty rates for developing countries or applying active technology transfer policies.

What is important is not the particular policy measure but the principle behind such measures: that a truly pro-development multilateral system needs to be based on the principle of asymmetric protectionism. In such a system, economically weaker countries would be allowed to protect and regulate more than stronger countries, in the expectation that they would then gradually withdraw these extra policy measures as their economies develop and catch up with those of richer countries.

In response to this proposal, defenders of the WTO system say that there should be a level playing field in a multilateral system, otherwise it would be unfair. However, this is a misleading argument.

A level playing field is like, as Americans say, motherhood and apple pie: since it is good by definition it seems impossible to oppose it. However, it has to be disputed if we are to build an international economic order that is truly pro-development.

Needless to say, a level playing field is the right principle to adopt when the players are equal. For example, if the national football teams of Brazil and Argentina were to play each other in the World Cup, it would be entirely unfair if the Brazilian team were allowed to attack downhill and the Argentinians had to attack uphill.

However, when the players are unequal, a level playing field is the wrong principle to apply. If the Brazilian national team were to play a team of ten-year old girls, it would be only fair for the girls to attack downhill and for the Brazilians to do so uphill. Of course, in real life, football pitches are not tilted, precisely because we do not allow unequal players to compete against each other.

It is not just football. In all sports, competition between unequal players is structurally prohibited. In boxing, wrestling, taekwondo, weightlifting and many other sports, there are weight classes, which can be extremely narrow (the lighter weight classes of boxing have a range of just 3 lb (1.5 kg) or 4 lb (2 kg)).



In all sports, there are age classes: adult teams are not allowed to play against children or youth teams. In golf, there is even an explicit system of handicaps, which allows weaker players to compete with advantages in (inverse) proportion to their playing skills.

In response to these criticisms, defenders of the WTO system argue that there is already the provision for special and differential treatment (SDT) for developing countries in the system, so there is no need for further reform.

However, SDT makes only minimal allowances for developing countries. The least developed countries receive some extra provisions, such as the use of export subsidies, but they are very few. The only major provision for developing countries is that they have slightly longer to implement WTO rules (usually an extra five to eight years), but ultimately they still have to implement the rules in the same way as rich countries.

More importantly, I would argue that it is wrong to use the word “special” in SDT. Applying different rules to developing countries should not be considered special treatment. It is just differential treatment for different countries with diverse needs and capabilities, in the same way that ramps for wheelchair users or braille writing for the blind are not called special treatments.

In short, a truly pro-development multilateralism needs to create the maximum possible amount of policy space for countries to pursue policies according to their own capabilities and needs. In this sense, an updated version of the NIEO advocated by Raúl Prebisch is needed; one could call it a “New” New International Economic Order, or NNIEO.

## IV. Towards an NNIEO?

My call for an NNIEO will likely be dismissed as a doomed project, as the call for an NIEO was in the 1970s and the 1980s. Indeed, it may be argued that the prospects for reform of the international economic order are even bleaker today.

First, the postcolonial guilt felt by many people in rich countries in the 1970s, which gave the call for an NIEO some traction, has faded over the last half a century.

Second, there is no longer systemic competition between the Capitalist Bloc and the Socialist Bloc, which gave some bargaining power to developing countries that were able to play both sides off against each other, India being a notable example.

Third, the pushback against an NIEO in the neoliberal period has made some ideas contained in the proposal very difficult to implement. For example, the TRIMS Agreement has made it difficult to revive the idea of a code of conduct for transnational corporations (TNCs), which was an important part of the NIEO proposal.

Last but not least, the dominance assumed by neoliberal ideology in recent decades, despite being weakened by recent events such as the 2008 global financial crisis and the COVID-19 crisis, has made developing countries more accepting of the current neoliberal international economic order.

However, there are countervailing factors, which can be divided into three groups: changes in the structure of the world economy, changes in ideas and contingent factors. They are discussed in greater detail below.



## V. Changes in the world economy

First of all, developing countries now have much more weight in the global economic system than they did when the NIEO proposal was put forward, largely (although not exclusively) as a result of the rise of China. In 1974, rich countries accounted for nearly four fifths of the world economy (US\$ 4.189 trillion out of US\$ 5.312 trillion). By 2018, their share was less than two thirds (US\$ 54.108 trillion out of US\$ 85.791 trillion).

The COVID-19 crisis will likely accelerate this shift in the relative weights of rich and developing economies. According to IMF projections of late June 2020, advanced economies are set to contract by 8% in 2020, in contrast to a 3% contraction for emerging markets and developing economies (IMF, 2020a). Moreover, the latter are predicted to bounce back by 5.9% in 2021, whereas the projection for the former is for growth of just 4.8%. However, at the time of writing, less than two months after IMF published those projections, they are looking overly optimistic, especially for rich countries. Even if they remain unchanged, this would mean that, at the end of 2021, the output of the developing world would be 2.7% higher than in 2019, while that of the rich world would be 3.6% lower, implying a noticeable shift in their relative shares in the world economy. As the deeper recessions in the rich world are likely to have bigger hysteresis effects than those in the developing world, which are expected to be shallower, the relative growth performance of the rich countries is likely to be even worse in the coming years than it was before 2020.

Second, interactions among developing countries have become much more important than before. South-South trade has increased substantially, as it accounted for an average of 41.8% of world trade in the period 1995–1997) rising to an average of 57.4% for 2015–2017. Moreover, this was not entirely driven by the rise of China, as some might think. South-South trade excluding China rose from 34.8% of world trade in the period 1995–1997 to 42.1% for 2015–2017 (IMF, 2020b). Furthermore, China, India and other developing countries are emerging as important financial actors in the international economy, in terms of lending, foreign aid and FDI. More recently, Southern-led multilateral financial institutions have emerged, such as the New Development Bank and the Asian Infrastructure Investment Bank (AIIB). Consequently, developing countries are becoming less dependent on rich countries and can be more forceful in their demands for an NNIEO.

## VI. Changes in ideas

In addition to the changes in the global economy, there have been changes in ideas over the last half a century that will make realization of an NNIEO more likely. First of all, pro-development ideas that were considered too radical in the days of the NIEO have become acceptable, precisely because of the historical legacy of the NIEO, and have been realized, to a certain extent. For example, some economically advanced countries have already met and surpassed the official development assistance (ODA) target of 0.7% of GDP, which was considered very optimistic in 1970, when the commitment was enshrined in United Nations General Assembly resolution 2626(XXV). Another example is the forgiveness of developing countries' debts, which many thought unrealistic but has become a reality thanks to the enhanced Heavily Indebted Poor Countries Initiative of 2012. Most importantly, the adoption of a “one country, one vote” system by a multilateral institution, which was considered a pipe dream 50 years ago, has formed the basis for the WTO system, although it has not worked very well in practice, as previously discussed.

Second, the 2008 global financial crisis fundamentally eroded trust in the efficacy of open, deregulated financial markets, which is a lynchpin of the neoliberal international economic order. Even though neoliberal financial systems have not been subject to far-reaching reform since 2008 at national

or global levels, owing to strong resistance from the financial sector, the neoliberal ideas behind such systems are now much less widely accepted than they used to be. Moreover, since the crisis, rich countries have turned to monetary policies, such as extremely low interest rates and quantitative easing, that fundamentally contradict neoliberal principles. Given that the monetarist principles of tight monetary policy and high interest rates were seen as essential to providing the macroeconomic environment needed for efficient deregulated financial markets, the adoption of such policies has further undermined the theoretical justifications for the neoliberal financial system.

Last but not least, the COVID-19 crisis has invalidated much of the conventional neoliberal wisdom regarding the role of the government. Despite the neoliberal advice against government involvement in enterprise ownership and management, governments around the world have *de jure* and *de facto* nationalized some key private sector enterprises and are directly or indirectly subsidizing many more on a huge scale. In many rich countries, governments have been propping up employment during the lockdowns imposed to curb the COVID-19 pandemic by paying up to 80% of wages to keep workers on company books even though they are not working or are only working part-time. Many governments, even those that are ideologically opposed to public income support for the poor, such as the Trump Administration in the United States, have increased unemployment benefits and income subsidies, with various degrees of coverage. Governments around the world are running up huge budget deficits, abandoning the doctrine of balanced budgets that they had clung to —at least rhetorically if not in practice— since the 2008 financial crisis. One particularly prominent example is the Government of Germany, known for its fiscal conservatism, which abolished the law that put a ceiling on public debt, so that it could manage the COVID-19 crisis more effectively through budgetary means. Thus, just about every orthodoxy in the neoliberal playbook has been abandoned or turned on its head, opening the prospect of very different policy discourse in the coming years.

## VII. Contingent factors

The third element that is conducive to the emergence of an NNIEO is contingent factors that work in favour of developing countries, and by contingent I do not mean less important.

One factor is climate change, which is reaching a critical point. The urgency of the problem is making humanity realize that we are bound together by a single fate, thereby putting increasing pressure on rich countries to do more to help developing countries to tackle the crisis, especially through large-scale transfers of technology for climate change mitigation and adaptation. In particular, the sheer injustice of the fact that developing countries are more likely to suffer the worst consequences of climate change —such as more frequent storms and droughts and rising sea levels—, despite having barely contributed to the problem, means that adopting a more globally equitable approach to the matter is a moral obligation, and not simply a technical necessity.

Another factor is the economic rise of China when it is in the unprecedented position of being a major actor in the global economy while still being a developing country. This is going to affect the way the international economic order evolves. In 1974, the Chinese economy accounted for just 2.7% of the global economy (US\$ 144 billion out of US\$ 5.312 trillion), but by 2018 it accounted for 16.0% (US\$ 13.9 trillion out of US\$ 86.4 trillion).<sup>3</sup> Because the COVID-19 pandemic has affected the Chinese economy much less severely than rich economies, China will become even more important in the global economy.

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<sup>3</sup> Data from the World Bank.

Although China is not necessarily a champion of the collective interests of developing countries, and there is a degree of dependency between China, as a manufacturing nation, and other developing countries, as raw material exporters, it is undeniable that China's unique status —as a leading economy and a developing country— causes it to behave rather differently to other major economies, as can be seen in its approaches to aid, FDI and infrastructure development. Moreover, having China as a potential lender, investor and trading partner gives developing countries greater bargaining power when dealing with rich countries and the multilateral financial institutions they dominate.

Last but not least, two consequences of the COVID-19 crisis will affect how the global economy is organized and run in the years to come. First, the pandemic has heightened awareness of humanity's common fate, which as mentioned above has been made increasingly obvious by climate change, as we face the first genuinely global pandemic. Second, the COVID-19 crisis is changing how developing countries see rich countries.

At the time of writing, the governments of some of the richest countries in the world have mishandled the pandemic, resulting in hundreds of thousands of avoidable deaths, while some of the poorest societies, such as Viet Nam, Ethiopia, Rwanda and the Indian state of Kerala have managed it remarkably well, with minimal deaths, despite having meagre resources at their disposal. Meanwhile, the COVID-19 death rates in the United States, the United Kingdom and France —countries that prided themselves on being the guardians of civilization and that regularly lecture other countries on the importance of good governance, effective (if small) government and human rights— have run into the hundreds of thousands (and counting), owing to mismanagement, incompetence, social chaos and, above all, a flagrant disregard for human rights (especially those of poorer, older and minority population groups).

In light of this, many developing countries have begun to question their feeling of inferiority compared to rich countries, in particular the European countries or those of predominantly European extraction, accumulated over centuries characterized by colonialism, imperialism, economic domination and cultural indoctrination. Once this change in perspective takes hold, developing countries will no longer demur to rich countries in the same way they used to: with fear, awe and respect. This will change the international political dynamic, helping developing countries to be more assertive in their negotiations with rich countries.

## VIII. Concluding remarks

Developing countries must fight attempts by rich countries to undermine multilateralism. But they should not simply seek to restore the neoliberal version of multilateralism, as embodied in WTO. The international economic order needs to be reformed along more pro-development lines. In other words, an NNIEO is needed, based on recognition that the international economic system should maximize policy space so that different countries with diverse needs and capabilities can adopt the economic policies best suited to them.

Just as in the 1970s and 1980s when circumstances stymied the NIEO proposal, there are factors that will hinder progress towards an NNIEO, such as the fading of post-colonial guilt in rich countries, the disappearance of systemic competition between the capitalist bloc and the socialist bloc, the mechanisms put in place as part of the push-back against an NIEO in the neoliberal period and the dominance of the neoliberal ideology.

However, other factors could facilitate the emergence of an NNIEO. Firstly, there have been changes in the structure of the world economy that make the emergence of an NNIEO more likely, such as the growing importance of developing countries in the global economy and increased economic

interactions among developing countries. Secondly, there have been changes in ideas that favour an NNIEO, including increasingly widespread acceptance of some of the pro-development ideas expounded in the NIEO proposal (notably regarding foreign aid, debt forgiveness and the voting structure of global bodies); a rejection of the idea that deregulated and open financial markets are more efficient following the 2008 global financial crisis; and dismantling of the neoliberal orthodoxy on the role of the State in general, in light of the COVID-19 crisis. Last but not least, there are contingent factors that could facilitate the rise of an NNIEO, such as the growing awareness of humanity's common fate in view of climate change and the COVID-19 pandemic; the emergence of China as one of the world's leading economies while still a developing country; and the fact that developing countries are overcoming their inferiority complex vis-à-vis rich countries, particularly in light of the mismanagement of the COVID-19 crisis by many rich countries.

Of course, an NNIEO, if it ever emerges, will take time to become established. Therefore, in the meantime, developing countries must learn to navigate a biased system. Despite the popular perception, a lot can be done in this regard, but that is beyond the scope of this article (for further discussion, see chapter 5 in ECA (2016)).

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# COVID-19, elites and the future political economy of inequality reduction in Latin America

Benedicte Bull and Francisco Robles Rivera

## Abstract

The literature is divided on the impact of pandemics on income inequality. The economic literature points to an increase in inequality as a result of pandemics, whereas historical and political science literature argue that pandemics may create breakdowns of institutions, maintaining inequality due to elite shifts and pressure from below. We review current data on the impact of COVID-19 and find that there is evidence of an upward income transfer as well as some elite shifts in the region. However, elites have controlled the economic measures to alleviate and confront the crisis and there is little evidence of a resultant institutional breakdown.

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## Keywords

COVID-19, viruses, epidemics, economic aspects, income distribution, elite, wealth, poverty, economic policy, Latin America

## JEL classification

N46, P16, D36

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## I. Introduction

The debate on the effect of the coronavirus disease (COVID-19) on inequality has changed dramatically over the last months. While COVID-19 was portrayed as “the great equalizer” in the early stages of the spread of the infection and lockdown measures (Mein, 2020), evidence now abounds that the pandemic will increase poverty and inequality (Busso and Messina, 2020). The Economic Commission for Latin America and the Caribbean (ECLAC) reports that the pandemic could cause a variation in the Gini inequality index of more than 3 percentage points in some countries, while the number of people living in poverty will increase by 4.4 percentage points (28.7 million more people) to 34.7% of the region’s population (ECLAC, 2020a). This is a result of many factors, including the widespread loss of low-paying jobs and the fact that informal own-account workers have been prevented from conducting their regular economic activities. At the same time, recent evidence suggests that the income of the top earners has increased since March 2020 (Ruiz, 2020).

The literature on the impact of pandemics on inequality is inconclusive. Some studies show that pandemics disproportionately affect the poor and produce overall increases in income inequality (Cohn and Alfani, 2007; Karlsson, Nilsson and Pichler, 2014). Others show how pandemics and other crises have created disruptions, leading to a redistribution of assets as well as the institutional changes necessary for income redistribution (Piketty, 2017; Scheidel, 2018). This paper explores the argument that the long-term outcome depends on the extent to which crises change elites’<sup>1</sup> resources and their influence on institutions and policies (Solimano, 2014). If a crisis essentially transfers income upwards without provoking an elite change, a deepening of inequality can be expected. If, on the other hand, a crisis forces elites to be more attentive to the demands of non-privileged groups, it is possible that a restructuring of institutions that perpetuate the culture of privilege will be required and that inequality will be reduced in the long term. However, it is also conceivable that elite groups that are incurring losses as a result of the pandemic could seek to maintain privileges through tighter control of institutions and resistance to redistributive measures.

In this paper, we review the limited data available on income concentration among the top earners since the start of the COVID-19 pandemic, as well as information on the distribution of resources among different elite groups and the reactions of the elite to the measures implemented to control the pandemic. On this basis, we seek to determine whether COVID-19 could result in a disruption, with the potential for improved distribution of resources, or whether it will merely result in an upward transfer of resources with the maintenance of the status quo.

The article is divided into seven sections, including this introduction. Section II reviews the literature on the relationship between pandemics and inequality and section III presents a brief overview of economic inequality in Latin America. Section IV analyses the upward transfer of income during the COVID-19 pandemic and section V examines whether the crisis is creating a shift in elites. Section VI presents a discussion of elite influence on government measures to tackle the pandemic and section VII concludes.

## II. Pandemics, inequality and elites

There is conclusive evidence that inequality is a major determinant of the extent and impact of pandemics throughout history. During the 1918 Spanish flu pandemic, mortality rates varied considerably by income between and within countries, particularly in cities and towns with a high degree of social

<sup>1</sup> Elites are defined as groups of individuals whose control over natural, economic, political, coercive, social, organizational and/or symbolic (expertise or knowledge) resources give them a position of privilege to exert formal or informal influence on organizations and institutional practices (see Bull, 2014).

inequality (Mamelund, 2017). During the 2009 influenza A (H1N1) virus pandemic, the mortality rate was 20 times higher in some South American countries than in Europe and three times higher in the most socioeconomically deprived quintiles of England's population than the most affluent quintile (Rutter and others, 2012; Simonsen and others, 2013). In his analysis, Turchin (2018) found a strong statistical association between levels of inequality and global connectedness and the impact of pandemics. There is also an increasing body of evidence suggesting that COVID-19 infection rates and death rates are likely to be higher among poor and marginalized groups (Galasso, 2020). While the leading cause of higher infection and death rates among the poor during earlier pandemics was the deterioration of health, sanitary and housing conditions, current digital and labour inequalities also result in disparities in the ability to comply with physical distancing.

However, the evidence is less conclusive with regard to how pandemics in turn affect patterns of inequality. The economic strand of the literature concludes that pandemics and large epidemics have increased inequality. Focusing on five major events since 2000, Furceri and others (2020) find that pandemics lead to a persistent increase in inequality, measured by the Gini coefficient. Their model shows that five years after a pandemic, the Gini of market income and the Gini of net income increase by 0.75% and 1.25%, respectively. Pandemics also raised the income share of the upper deciles (Furceri and others, 2020). This is in line with other evidence that dramatic events such as wars or financial crises generally increase inequality (De Haan and Sturm, 2017). Among the reasons for this are that individuals with higher incomes are better able to adjust to changing labour markets and new business opportunities.

The historical and political science strands reach different conclusions. Pandemics have been among the great levellers of wealth and income through history, along with mass mobilization warfare, revolutions and State collapse (Scheidel, 2018). For example, the redistributive changes of the mid-twentieth century in Europe and the United States can be explained by a succession of global crises: the First World War, the Second World War and the Great Depression (Piketty, 2017; Starr, 2019). One of the reasons that pandemics have a positive effect on income distribution is that they hit the poor hardest, lead to labour scarcity and create the conditions for an increase in wages. During periods of stability and economic growth, elites focus on establishing laws and rules that allow for wealth concentration and the intergenerational transfer of wealth (Fukuyama, 2011; Scheidel, 2018). This is determined by their capacity to invest and generate employment (structural power) and their capacity to carry out political actions (instrumental power) (Fairfield, 2015). In Latin America, the “a culture of privilege” that developed over time is a system of values that perpetuates advantages to specific population groups based on their socioeconomic position, membership in political and cultural elites or ancestry (Bielschowsky and Torres, 2018). In contrast, in times of crisis, the focus is on short-term survival and overcoming threats. These are times when ideas of social equality gain acceptance, as elites are pressured to cooperate with and distribute income to lower classes, with a long-term impact on income distribution (Peacock and Wiseman, 1961; Starr, 2019).<sup>2</sup> While reductions in income inequality may also result from periods of stability and growth — as seen in Latin America between 2003 and 2014 — without a redistribution of assets and institutional change, such episodes may be short-lived (Rodríguez Weber, 2018).

However, the outcome of pandemics and other crises will not necessarily be homogenous. Collier and Collier (1991) show how the incorporation of labour into political institutions during the “critical junctures” of the 1930s shaped the paths to democracy and had very different outcomes in the years that followed. In the same way, the institutional handling of the COVID-19 crisis will affect both future inequality and democracy. The commonly held idea that inequality generally leads to the failure

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<sup>2</sup> This was the case with social conflicts of the 1930s in the Scandinavian countries, which saw the conclusion of agreements between workers and employers that led to a decline in income inequality over the following seven decades. See Bull (2019).



of democracy finds limited support in research.<sup>3</sup> However, high levels of income concentration affect the quality of democracy and, in particular, the degree to which democratic institutions are capable of enacting, implementing and sustaining distributive reforms, since powerful elites have more resources to oppose redistributive policies (Acemoglu and Robinson, 2019; Moene, 2015). This is partly because a higher concentration of wealth and resources weakens crucial democratic actors such as the media, social movements and unions (Durand, 2019).

The conclusions of both strands of literature with regard to the inequality effects of pandemics are not necessarily contradictory. The increase in inequality found in the economic literature, which focuses on a limited period of time, is based on the observations of the direct effects of pandemics and other crises. The conclusion from historical literature that the long-term outcome of a crisis is determined by changes in elites' sources of power and their support for institutions and redistributive measures means that an upward transfer of income without pressure for institutional disruption will deepen inequality. However, if the crisis generates redistribution of resources and creates pressure from below, elites are more likely to enter into new social contracts that could reduce inequality in the longterm. The persistence of the structural conditions that make Latin America the most unequal region in the world is often explained by elites' ability to maintain inequality-generating institutions even during democratic periods with large-scale social mobilization (Rovira-Kaltwasser, 2018).

### III. The starting point: wealth concentration and structural inertia in Latin America

The reduction in poverty and inequality in Latin America between 2003 and 2014 can be attributed to a combination of favourable global economic conditions, increases in education levels (leading to a lower skill premium) and social and labour market policy (Busso and Messina, 2020).<sup>4</sup>

However, falling inequality in Latin America had little effect on the incomes of the top earners. The limited data available indicate that the top 1% earn around 20% of total income, with few signs that this figure has declined (Alvaredo and others, 2018). New evidence in Morgan (2017) showed that in 2015 the richest 1% accounted for as much as 28.3% of the total income in Brazil and that the top 10% earned more than half (55.6%) of total income.<sup>5</sup> In the case of Chile, data for 2005–2010 show the top 1% earning around 30.5% of total income and the richest 0.01% earning 10.1% (López Vega, Figueroa and Gutiérrez, 2013). The World Bank (2018b) estimates that on average in the region, the top 10% hold one third of national income (see table 1).

In addition, there was no major redistribution of assets (Cornia, 2014). The Gini coefficient of wealth in Latin America is much higher than the average Gini of income, but comparable historical data are scarce (Amarante and Jiménez, 2015). Yet, there is little evidence of any major positive shift in asset inequality or any other major structural changes.

<sup>3</sup> There is little to support the claims that democracy leads to the equal distribution of wealth and that wealth inequality leads to democratic failure. The widespread assertion that Latin America has always been more unequal, and thus less democratic, than other regions has also been disproved on several counts. See Scheve and Stasavage (2017).

<sup>4</sup> The main exception to this trend was Costa Rica, where inequality increased (Trejos and Oviedo, 2012).

<sup>5</sup> Income here corresponds to pre-tax national income.

**Table 1**  
Latin America (17 countries): national income held by the richest 10%  
and Gini index, by country, 2008–2018  
(Percentages, average values for the period)

	Income held by the richest 10%	Gini index
Brazil	41.95	53.14
Colombia	41.45	52.30
Honduras	39.97	52.57
Panama	39.06	51.03
Paraguay	38.55	49.07
Guatemala	38.00	48.30
Mexico	37.98	47.70
Costa Rica	37.27	48.73
Chile	37.06	45.52
Dominican Republic	36.07	46.08
Nicaragua	35.70	45.05
Ecuador	35.50	46.52
Bolivia (Plurinational State of)	34.30	46.46
Peru	33.28	44.48
El Salvador	32.55	42.04
Uruguay	31.06	41.50
Argentina	30.58	42.53

**Source:** Prepared by the authors, on the basis of World Bank, “Gini Index (World Bank estimate)”, 2018 [online] <https://data.worldbank.org/indicator/SI.POV.GINI>, and “Income share held by highest 10%”, 2018 [online] <https://data.worldbank.org/indicator/SI.DST.10TH.10>.

**Note:** Data for Guatemala correspond to 2014. Data for Nicaragua are from 2009 and 2014.

In the absence of structural changes leading to a transformation in the distribution of assets and the elites controlling them, episodes of reduction of inequality may be short-lived. In Brazil, the pro-poor agenda and equality-driven growth adopted by Workers’ Party (PT) governments in lieu of profound redistribution arguably made the process unsustainable in the long term (Loureiro, 2020). In Colombia, two main factors have played a role in inhibiting better income distribution: first, landed elites that have historically shaped local policies and decision-making to their benefit (Faguet, Sánchez and Villaveces, 2020); and second, powerful business groups that influence tax policies and whose focus has been on indirect taxation and avoiding high income tax rates (Castañeda, 2018). The case of Honduras is a particular one, as democratic institutions are extremely weak and elite networks have relied on their control of money, power and the media, which, in turn, have further undermined any redistributive policy attempts (Euraque, 2019; Sosa Iglesias, 2017). In Panama, the new institutional framework created in 1999 provided incentives for business elites to promote and develop an advantageous liberal regime in the country (Kasahara, 2012; Pérez, 2011). Nevertheless, since 2009, infighting among elites over the control of government and corruption scandals have shown that a small but powerful faction of the business elite could wield considerable direct control of State administration to serve private interests (Cárdenas and Robles Rivera, 2020; Santos and Fraga, 2020). The main question now is how the balance of power between elite interests is affected by the COVID-19 crisis.

## IV. Upward income transfers amid the COVID-19 pandemic

Recent data suggest that the income and fortunes of the top earners and wealth holders have increased during the COVID-19 pandemic, contradicting early estimates. While we lack comparable data on the top 1% or the top 10% since the onset of the pandemic, we have used data on the income and wealth of the top earners based, inter alia, on the financial statements of major companies.<sup>6</sup>

Using these data, Gneiting, Luisani and Tamir (2020) find that, at a global level, excessive shareholder payouts prior to the onset of COVID-19 are a major reason for the financial trouble many large companies currently face. Between 2010 and 2019, the companies listed in the S&P 500 index spent US\$ 9.1 trillion on payouts to their wealthy shareholders, equalling over 90% of their profits over that same period. Since January 2020, many large companies have increased their payment to shareholders. For example, since January, according to company reports, Microsoft and Google have paid shareholders over US\$ 21 billion and US\$ 15 billion, respectively. This is not exclusive to technology companies. The world's six largest oil companies<sup>7</sup> had a combined net loss of US\$ 61.7 billion from January to July 2020 but managed to pay out US\$ 31 billion to shareholders during the same time period (Gneiting, Luisani and Tamir, 2020).

In an analysis of wealth trends in Latin America, calculated by comparing the net worth of the region's billionaires on 18 March 2020 and on 12 July 2020, Oxfam (2020) finds that during this period, the combined net worth of billionaires in Argentina increased from US\$ 8.8 billion to US\$ 11.2 billion; in Brazil from US\$ 123.1 billion to US\$ 157.1 billion; in Colombia from US\$ 13.7 billion to \$14.1 billion; in Chile from US\$ 21 billion to US\$ 26.7 billion; in Peru from US\$ 5.2 billion to US\$ 5.5 billion; and in the Bolivarian Republic of Venezuela from US\$ 3.4 billion to US\$ 3.5 billion.<sup>8</sup>

In total, the wealth of the 73 richest Latin Americans grew by US\$ 48.200 billion, or 17% since the beginning of the pandemic. Since the start of lockdown, the region has seen on average a new billionaire every two weeks (Ruiz, 2020). It is too early to say how the pandemic will affect the somewhat broader category referred to as high net-worth individuals (HNWI).<sup>9</sup> The World Wealth Report 2020 shows that while the growth of global wealth stalled in 2018–2019, the number of HNWIs increased by 8.6%. In the United States, the number of HNWIs shot up by a record 11%. The number of Latin American HNWIs also increased in this low-growth period, although by only 2.7%. The report notes that despite a dwindling global economy due to COVID-19, financial markets could prove resilient and boost the global outlook for HNWIs (Capgemini, 2020). Thus, although the recovery of Latin American stock markets has been slow and uneven since they plummeted in March–April 2020, the effect on the highest incomes may not be severe.

At the same time, according to International Labour Organization (ILO) figures for June 2020, unemployment had risen sharply due to COVID-19, leaving an unprecedented 41 million Latin Americans unemployed (ILO, 2020a). While unemployment during previous crises in Latin America has affected the middle classes, unemployment arising from COVID-19 has particularly harmed the poor owing to the nature of their work (Busso and Messina, 2020). Less than 10% of the poorest 40% of Latin Americans are able to work from home, either because they lack access to communication technologies or because their jobs require physical presence (Delaporte and Peña, 2020). Early research from Spain and the

<sup>6</sup> Gneiting, Luisani and Tamir (2020) draw on the S&P Capital IQ platform: an investor-grade financial analysis database, corroborated as necessary with a careful analysis of annual and quarterly financial reports of the companies.

<sup>7</sup> The companies are Exxon Mobil, Total, Shell, Petrobras, Chevron and BP. See Coffey and others (2020).

<sup>8</sup> See also Ruiz (2020).

<sup>9</sup> These are defined as individuals having investable assets of US\$ 1 million or more, excluding primary residence, collectibles, consumables and consumer durables.

United States that can be applied to Latin America shows two main trends (Aspachs and others, 2020; Béland, Brodeur and Wright, 2020). First, there was an increase in the unemployment rate and a decrease in working hours and labour force participation. Second, the negative impact was greater on younger workers, migrants and less educated workers. Both trends will heighten labour market inequalities (Béland, Brodeur and Wright, 2020). In Latin America and the Caribbean, ILO estimates that the loss of working hours in the third quarter of 2020, relative to the fourth quarter of 2019 is 25.6%. This is accompanied by a steep drop in labour income for the first three quarters of 2020, with a loss of 19.3% as a percentage of labour income and 10.1% as a percentage of gross domestic product (GDP) (ILO, 2020b).

COVID-19 has also had a deleterious effect on small and medium-sized enterprises (SMEs) and particularly microenterprises. Early data from ECLAC suggested that 7.1% of small businesses and 20.7% of microenterprises would close before the end of 2020 (ECLAC, 2020b). Later data from OECD suggest that the number will be much higher. While 38% of SMEs in Latin America were closed during the first half of 2020, 27% of these remained closed by end-June (OECD/Facebook, 2020).

In previous crises, the establishment of SMEs has been a “survival strategy” (Mungaray Lagarda and others, 2015). SMEs in Latin America are also considered to be particularly capable of adapting to adverse conditions, i.e. during crises (Bernal and Michel, 2016). However, strict lockdown measures and plummeting demand for goods and services have prevented SMEs from overcoming their main challenge in times of crisis, which is their generally low liquidity (OECD/Facebook, 2020).

While it is still too early to draw firm conclusions, the above data suggest that wealth is being transferred upwards, from lower income segments to high income groups, and particularly to the very top income earners and wealth holders. This will probably deepen inequality. However, it is also possible that wealth will shift from one elite group to another.

## V. Elite shifts as a result of COVID-19?

The upward transfer of wealth has not been even across sectors. The quarantining of millions of people across the region and closure of hundreds of shops have benefited digital platforms. In Argentina, two major companies —Mercado Libre and Globant— saw their stock prices increase. In the case of Mercado Libre, the stock price soared from US\$ 602 in August 2019 to US\$ 1,277 in August 2020 (see table 2) and its sales were up by 45% compared with 2019 (Ventrici, Kreпки and Palermo, 2020). Globant’s stock price, for its part, almost doubled year-on-year. Some of Brazil’s major online-based companies, such as PagSeguro Digital and StoneCo Ltd, also performed well, with share prices gaining in value since the beginning of the pandemic (Kitchener, 2020).

**Table 2**  
Argentina and Brazil: variation in digital platforms’ stock prices, 2019 and 2020  
(Dollars)

Company	Stock price on 26 August 2019	Stock price on 23 March 2020	Stock price on 27 August 2020
StoneCo Ltd (BRA)	30.51	19.89	50.56
PagSeguro Digital Ltd (BRA)	50.30	14.95	44.19
Mercado Libre (ARG)	602.62	457.65	1 201.40
Globant (ARG)	92.89 <sup>a</sup>	73.50	177.00

**Source:** Prepared by the authors, on the basis of National Association of Securities Dealers Automated Quotations (NASDAQ), “Stocks” [online] <https://www.nasdaq.com/market-activity/stocks>, and New York Stock Exchange (NYSE), “Listings Directory” [online] [https://www.nyse.com/listings\\_directory/stock](https://www.nyse.com/listings_directory/stock).

<sup>a</sup> This value corresponds to 28 August 2019.

The pandemic has also increased governments' dependence on —and thus the potential influence of— specific companies. From the outset, the Argentine Government worked hand in hand with Big Tech companies such as Amazon, Microsoft and Google, as well as Globant and Mercado Libre in order to use their data to try to control the nationwide spread of the virus (Ventrici, Krepki and Palermo, 2020). Two of these initiatives include a digital dashboard to track available beds and respirators in the country's hospitals and a mobile health application called *Cuidar* that allows users to carry out self-diagnosis, trace contacts and access movement permits. The dashboard was developed in record time by Globant and the North American company, Salesforce, while the application was developed through a multi-partner project led by the Secretariat of Public Innovation. However, the government is completely dependent on the partner companies for the continued operation of the application (Ventrici, Krepki and Palermo, 2020). Indeed, the increasing wealth of the tech companies, combined with government dependence on these platforms, will reduce the chances of implementing a digital tax as proposed by civil society and international organizations (ECLAC, 2019).

The digital economy is booming in the region on the back of the pandemic, with news reports projecting that it will represent 40% of the regional GDP by 2022 (Mari, 2019). However, by their very nature, these digital economies tend to concentrate resources in few companies. Early data show that economic winners of the pandemic are biotechnology, pharmaceutical, medical and Internet retail companies (Sokol and Pataccini, 2020).

On the other hand, economic shutdowns reduced exports, remittances and tourism —three key sources of income and wealth in the region. First, according to data from the first quarter of 2020, export values in Latin America fell by 3.2% as the economic contraction led to sharp declines in the prices of oil (-32.0%) and copper (-11.9%), with soybean and coffee prices also down by 2.2% and 4.4% respectively (Giordano, 2020). Second, there has been a decline in remittances. Preliminary data show that remittances were 17% lower in April 2020 than in the year-earlier period in countries that rely heavily on remittances, such as Colombia, the Dominican Republic, El Salvador, Guatemala, Honduras and Mexico (Noe-Bustamante, 2020). The impact on the relationship between elites could be severe in Honduras and El Salvador, for example, where remittances accounted for approximately 20% of GDP in 2019, and business groups have adapted their strategies to capture them (Bull, Castellacci and Kasahara, 2014; Rocha, 2008). Third, the collapse in tourism may cause total GDP growth in the Caribbean and Latin America to fall by 8 percentage points and 1 percentage point, respectively (ECLAC, 2020c). This will weaken elites in the service sector.

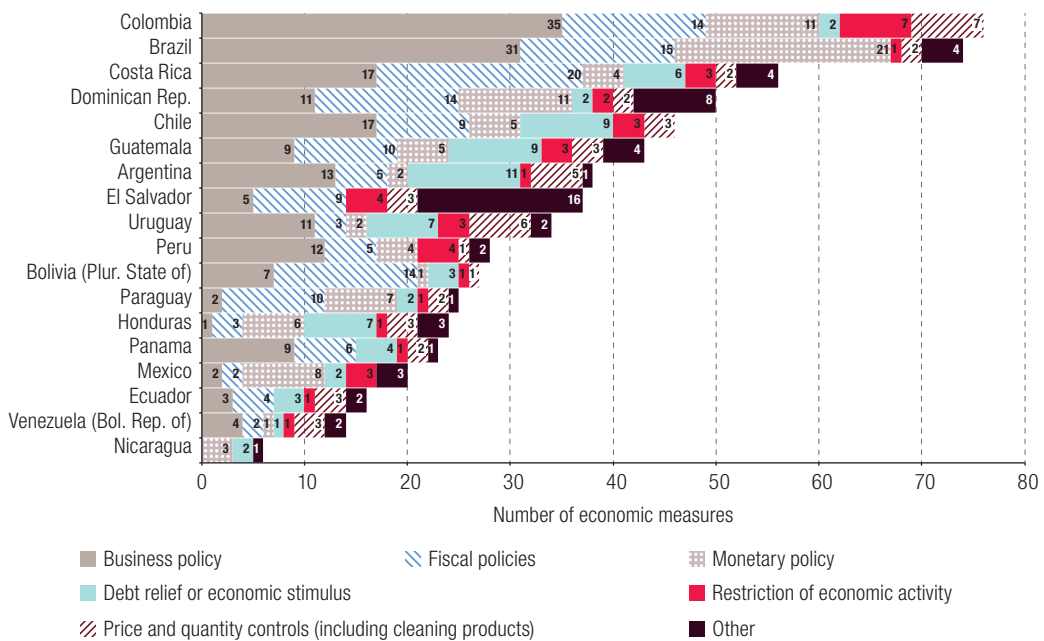
An elite shift of a completely different nature could result from the strengthening of military elites thanks to their role in maintaining control over the population during lockdown measures. Such a shift has occurred in countries like Nicaragua and El Salvador, as well as in Colombia, the Plurinational State of Bolivia, Chile and the Bolivarian Republic of Venezuela. In some cases, this may translate into increased military control over the economy. For example, there has been an increase in extortion in the Bolivarian Republic of Venezuela amid the COVID-19 pandemic (De Jesús, 2020). Acts of extortion, whether committed by gangs or groups with military connections, are known to have led to the takeover of small businesses by armed groups (Bull, 2020). Further strengthening of the economic role of military elites is therefore possible.

In sum, the pandemic may cause a shift in the control of resources. Elite groups in technology, the pharmaceutical and health care industries and the digital economy will gain, while those who own shopping centers or benefit from exports, remittances and tourism —who traditionally were at the top— may now need government support to keep their businesses in operation.

## VI. Elite and government reactions to redistribution during the COVID-19 pandemic

As mentioned above, the historical literature suggests that the nature of the pandemic, the type of institutions and income distribution determine whether elites accept or reject increased distribution of resources and the establishment of new institutions. It is too early to ascertain the willingness of elite groups to transform institutions amid the current pandemic. ECLAC data on the economic measures implemented by governments in response to COVID-19 as of September 2020 show that one third of these measures have been business-oriented policies (see figure 1). The emphasis on such policies is particularly strong in countries with pro-business governments, such as Brazil, Chile and Colombia.

**Figure 1**  
Latin America (18 countries): economic measures implemented to address the COVID-19 pandemic, by type of measure and country, March–September 2020  
(Numbers)



**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), “Follow up of the evolution of COVID-19 Measures”, 2020 [online] <https://cepalstat-prod.cepal.org/forms/covid-countrysheet/index.html>.

However, it is likely that the content of these policies or the extent to which they result from elite pressure, vary. In the following paragraphs, drawing on Bull and Aguilar-Støen (2019), Cárdenas, Robles Rivera and Martínez-Vallejo (2020), Robles Rivera (2014), Sánchez-Ancochea and Puig (2013) and Segovia (2005), we explore elite reactions during COVID-19, focusing on Central America, a region in which the elites have had recognized influence (see table 3). An early comparison of elite group’s responses to policies to address the pandemic suggests a high correlation between the responses and their access to government as well as ethnicity (Pérez-Sáinz, 2016; Sánchez-Ancochea and Martínez-Franzoni, 2020). In Guatemala and Honduras, elite networks and family-owned diversified business groups have played a crucial role shaping the political agenda (Bull, Castellacci and Kasahara, 2014). In these countries, elites have historically been severely opposed to tax reforms and any State expansion, despite recent recognition of the importance of State institutions (Bull and Aguilar-Støen, 2019). As a result, tax levels are still the lowest in Latin America (OECD and others, 2020). During the COVID-19



crisis, rather than promote institutional changes, governments have relied on corporate philanthropy to cope with the lack of medical supplies and food provision shortages (Cárdenas, Robles Rivera and Martínez-Vallejo, 2020). Examples include the opening in July of an early care and stabilization centre for COVID-19 patients by the Honduran Council of Private Enterprise (COHEP), in association with the Municipality of the Central District and the inauguration in September of the Hospital de Santa Lucía Cotzumalguapa in Guatemala, with donations in kind (construction site and medical equipment) from the Guatemalan Sugar Association (ASAZGUA) (Mutz, 2020). Similarly, in Mexico, business magnate Carlos Slim offered to fund the production of the vaccine under development by the University of Oxford and AstraZeneca for the Mexican market (El Heraldo de México, 2020). Instead of strengthening State capacities, these urgent and necessary actions have increased elites' bargaining power.

**Table 3**  
Central America (5 countries): proposals and actions adopted by elites in response to the COVID-19 pandemic

Country	Type of relationship with government	Key proposals and actions
El Salvador	Detachment	Corporate philanthropy Tax reductions Opposition to lockdown
Honduras	Capture	Corporate philanthropy Tax reductions Foreign funding
Costa Rica	Collaboration	Tax reductions Restructuring of public employment Reduction of social security contributions
Guatemala	Capture	Corporate philanthropy Tax reductions Foreign funding
Nicaragua	Detachment	Value added tax exemptions Foreign funding Humanitarian fund

**Source:** Prepared by the authors, on the basis of Cárdenas, Robles Rivera and Martínez-Vallejo, "Élites empresariales y desigualdad en tiempos de pandemia en América Latina", *Revista Española de Sociología*, vol. 29, No. 3, 2020.

In the neighbouring countries of El Salvador and Nicaragua, the pandemic may rather accelerate ongoing elite shifts whose outcomes remain highly uncertain. The co-government pact between the traditional Nicaraguan elite and the family of President Ortega (Spalding, 2017) was broken in 2018 when protests against a pension reform were met by mass repression and human rights violations. Nicaraguan elites have sought new channels of communication with the Ortega family, including during the pandemic, but without success. A similar scenario has shaped elite reactions to the pandemic in El Salvador. While, historically, Salvadoran elites played a crucial political role (Robles Rivera, 2017; Segovia, 2005), since the beginning of the crisis, President Nayib Bukele has publicly confronted the elites, leading to a public outcry of business associations against the lockdown measures implemented by the government (Cárdenas, Robles Rivera and Martínez-Vallejo, 2020).

In Costa Rica, elites' reactions have been shaped by their access to and collaboration with the government and a centre-right congress.<sup>10</sup> The Alvarado administration appointed prominent businesspeople to oversee the economic sector (Cárdenas, Robles Rivera and Martínez-Vallejo, 2020). From the very onset of the COVID-19 crisis, elites have actively promoted policies and change through the national business association, the Costa Rican Union of Chambers and Associations of Private Enterprise, and an influential philanthropic organization, Horizonte Positivo. They have sought agreements to ease business regulation procedures (*tramitología*) (Murillo, 2020), advocating austerity

<sup>10</sup> According to data from the Parliamentary Elites of Latin America Project (PELA, 2018), on average the political parties elected to congress in the period 2018–2022 can be described as "centre-right" based on their ideological self-placement and position.

measures and smaller government, while rejecting new taxes (UCCAEP, 2020). This suggests that in countries where elites are highly cohesive and have control over resources, they seek to supervise public authorities rather than challenge them.

## VII. Conclusions

It is now relatively clear that COVID-19 will be far from the “great equalizer” it was thought to be initially. The pandemic will increase poverty and will strike the lower-income strata more harshly than the middle classes owing to the different nature of their work. The big question now is how COVID-19 will affect wealth and income inequality in the future.

Latin America is characterized by high inequality of income as well as wealth. The period between 2003 and 2014 saw an improvement in income distribution, but no improvement in the distribution of wealth. The mechanisms that led to improvements in income distribution also proved unsustainable, partly for economic, but mainly for political reasons. The means introduced failed to produce positive feedback effects and long-term reforms and, in some cases, created strong opposition among elites (Chiasson-LeBel and Larrabure, 2019).

The historical literature suggests that pandemics can create the conditions for improved distribution if they serve as a “critical juncture” forcing elites to think about inclusion and distribution of resources. In this paper, we discussed the concentration of resources and elites’ reactions to different redistributive measures in response to the COVID-19 pandemic. Preliminary data suggest that there has indeed been a transfer of resources upwards during the pandemic. However, the various elite groups have not all benefited in the same way. The trend shows that COVID-19 has concentrated income in the hands of the super rich (billionaires) and particularly, but not exclusively, those in the technology sectors.

There is little evidence that the pandemic has made very wealthy individuals more inclined to support distributive reforms. Rather, their observed involvement in various forms of corporate philanthropy may, in the end, strengthen the status quo. The increase in robotization and other phenomena also reduce the likelihood that demands for higher salaries will resonate due to labour shortages, which historically come on the heels of pandemics.

The COVID-19 pandemic is far from over. It could still generate such an extreme rupture that it provokes more profound change in some countries, particularly where major upheavals were already under way, such as in Chile. Where such a major disruption occurs also depends on changes in the global context. It now seems clear that we will see a global concentration of resources in the hands of two sets of actors: major multinational companies (most of which are owned in the United States), and Chinese companies. How they form linkages with local elites in Latin America will be a significant factor deciding the future of elites, institutions and redistribution.

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# Why the rich always stay rich (no matter what, no matter the cost)

José Gabriel Palma

*To determine the laws which regulate [the distribution of the produce of the earth between rent, profit and wages] is the principal problem in Political Economy (David Ricardo)*

*Inequality is a choice [between perfectly feasible alternatives] (Joseph Stiglitz)*

*I am my choices (Jean-Paul Sartre)*

*The comfort of the rich depends upon an abundant supply of the poor (Voltaire)*

## Abstract

This article returns to the Ricardian tradition of understanding income distribution as the outcome of an “antagonistic” conflict with a multiplicity of actors and struggles, where history, politics and institutions matter as much as economic “fundamentals”. Because this relates to the political sphere, there are no purely logical solutions to the conflict, but rather options in a scenario of multiple equilibria. In deregulated markets, this conflict favours the supremacy of unproductive rent (especially those of “inefficiency”), to the detriment of operating profits, affecting investment and productivity growth. Moreover, dysfunctional institutions have the “ability to persist”, thus transforming the domination into a “stationary process”: the unbalancing impacts of shocks have only limited lifespans. When, in democracy, the Latin American oligarchy limits change and weakens the State through Buchanan-style constitutional straitjackets, they redesign their distributional strategies and absorb elements of opposing ideologies to keep their own hegemonic.

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## Keywords

Income distribution, inequality, Palma ratio, ideology, “reverse catching-up”, institutional persistence, neoliberalism, new left, poverty, Western Europe, emerging Asia, Latin America, Chile

## JEL classification

D31, E12, N36, P16

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## I. Introduction<sup>1</sup>

This article studies the complex and intriguing issue of why the rich tend to stay rich, no matter what the rest of society wishes. To do so, it returns to the Ricardian tradition of understanding the distribution of income as the outcome of the articulation of conflict between rentiers, capitalists and labour (and now bureaucracy as well), where history, politics and institutions matter as much as economic “fundamentals”. In other words, the article views income distribution as the articulation of a conflict with a multiplicity of actors and struggles. This conception of inequality is opposed to the neoclassical vision, with its rather mechanical interaction of pure fundamentals, and to that traditional left-wing vision of a single conflict (the class struggle) and only two parties (capital and labour), whereby the conflict takes place within a theological framework.

From our Ricardian perspective, the distributional conflict is naturally “antagonistic”, meaning that it essentially belongs to the political sphere, with no purely logical solutions (Laclau and Mouffe, 2011). It is a story of real alternatives in a scenario of multiple equilibria (Palma, 2019a). Furthermore, since in this Ricardian tradition the analytical cornerstone is the distinction between “rent” and “operating profits”, in an economy without a strong and intelligent State (in the sense of Mazzucato (2018)) and with deregulated markets, this conflict appears to favour the supremacy of easily obtained, unproductive rent (including those of “inefficiency”, which is to say those that hinder growth because they originate from market manipulation) to the detriment of operating profits, hampering investment and productivity growth. This is even more marked in economies with an abundance of natural resources and private appropriation of the rent, since the rent is obtained entirely at the initial extraction phase, meaning that deregulated markets (such as Chile’s) only encourage extraction and not diversification of production. This is the key lesson from the “Nordic model”: industrialization based on such resources requires a State that coordinates investments in this direction. Otherwise, the rent-seeking class have everything to win in the distributional conflict, and dysfunctional institutions have the “ability to persist”. This is particularly significant in analysis of Latin America since the neoliberal reforms and the slowdown in productivity gains —indeed the average for the region has been almost flat since 1980 (The Conference Board, 2020). This transfer of income within the capitalist elite to rentiers, away from entrepreneurs, appears to affect investment, absorption of technology and innovation.<sup>2</sup>

For Ricardo, the need to distinguish between the nature of rent and that of operating profits was fundamental to analysis of distribution and of growth. In fact, according to Ricardo (1817), “Adam Smith, and other able writers not having viewed correctly the principles of rent” had “overlooked many important truths, which can only be discovered after the subject of rent its thoroughly understood”. This also relates to the persistence of dysfunctional institutions in Latin America’s recent past, and particularly the “iron law of oligarchies”, whereby institutions that impede development tend to rebuild (with Chile as a case study).

In the United States, for example, as Acemoglu and Robinson (2006) describe, the traditional landed elites were able to sustain their political control of the South for another century after losing the Civil War by successfully blocking economic reforms that might have undermined their power, and by using their local political supremacy to disenfranchise African Americans and re-exert control over the labour force. In Latin America, likewise, dysfunctional oligarchies have been remarkably effective

<sup>1</sup> I am grateful to Alex Cobham and Andy Sumner for their valuable contributions to my work on inequality. I am also thankful to many friends and colleagues, in particular to Javier Núñez and the old gang of Cambridge PhD students for valuable contributions to my work on this subject. Contributions were also made, among others, by Mariana Chudnovsky, Camila Cociña, Jorge Fiori, Juliano Fiori, Daniel Hahn, José Antonio Ocampo, Cristóbal Palma, Carlota Pérez, Ignês Sodré, Lance Taylor, José Valenzuela and Robert Wade. Carlos Díaz Alejandro was a great mentor. This paper is dedicated to Diego Armando Maradona, “El Pelusa”, a symbol of our Latin American culture in all its glories and flaws —in its vitality and its self-destructiveness (the subject matter of this paper is no exception). The usual caveats apply.

<sup>2</sup> See Palma (2019b).

at rebuilding after successive political shocks. No matter what the rest of society has thrown at them, they have been able to reengineer something resembling a Southern-style political settlement, in the sense used by Khan (2018) and distributional outcome.

The case study for this analysis will be how the Chilean elite has been successful in transforming its “Southern-style” preferred scenario into something resembling a “stationary process”, in which the unbalancing impacts of shocks (such as, for example, the economic collapse of 1982, and the return to democracy in 1990) have had only limited life spans. Although Latin America’s history is rife with shocks, its oligarchies have been able to landscape the new scenarios in such a way that they have been able to continue achieving their fairly immutable rent-seeking goals.

In the case of Latin America, they have done so mainly through three channels: one is by forcing Buchanan-style straitjackets on new scenarios so as to restrict the scope of social change, like when they imposed a draconian constitution and a series of *leyes de amarre*, or “handcuff laws”, on Chile’s young democracy. Another is by having the flexibility to reengineer their distributional strategies so as to suit the new scenarios (the main subject matter of this article), while maintaining their collective action. And lastly, they have cleverly absorbed elements of opposing ideologies (such as the need to have effective social protection), so as to keep their ideology hegemonic in the new scenario, as any ideology aspiring to retain hegemony must do, according to Gramsci (1992). Their trump cards are their ruthlessness in the first channel, “fancy footwork”, or *jogo de cintura e jeitinho*, and ability to maintain collective action in the second, and ideological flexibility in “emergency” situations in the third.

From the perspective of flexibility in distributional strategies (“fancy footwork”), as the Chilean experience demonstrates, the Latin American capitalist elite has (so far) been able to successfully follow a complex distributional strategy which could be associated with what in game theory is known as a “Parrondo’s paradox”, or a winning sequence of strategies that are losing in isolation.<sup>3</sup> In its traditional formulation, this paradox consists of two games that are played alternately. An analysis of each game in isolation shows both to be losing games if played indefinitely (i.e. they have a negative expectation). However, when they are played alternately, the resulting compound game is, paradoxically, a winning game. In other words, it is possible —as in Chile— to construct a winning strategy by playing apparently losing distributional games alternately.

It remains to be seen whether in the near future the Chilean oligarchy will succeed in doing this again in the new scenario created by the social unrest of October 2019 and the COVID-19 pandemic. That is, whether this time they can successfully reengineer their distributional strategy (for the fourth time since ending the Popular Unity government in 1973): this time, by trying to rebuild their Southern-style rule with their newfound European “new” social democratic-style discourse.

Each of these distributional strategies, no matter how successful, had limited life-spans after which they became counterproductive; if they had continued to be implemented, they would have becoming losing strategies. The secret to the oligarchy’s long-term distributive success has been its ability to switch distributional strategy in time (maintaining internal cohesion), while conserving its hegemonic ideology.

If it succeeds once more, this will show how stationary this Southern-style rule is, in terms of its capacity to absorb changes and shocks without altering its fundamental structure, i.e. by making their impact temporary. If it does not, it would mean that the October 2019 social uprising would go down in the annals of Chilean history as the event that finally achieved a permanent effect on the concentrating and exclusionary structure of the Chilean oligarchical rule. That is, it would be the shock that could reshape the Chilean political settlement and distributional structure into something resembling a unit-root-style process: one in which the impact of shocks does not decay over time. Thus, the oligarchy would lose its considerable historical ability to revert change in its favour.

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<sup>3</sup> See Parrondo (1996).



As my analysis of inequality stems from the Ricardian tradition of understanding inequality as the outcome of political articulation of distributional conflict — in which it is history, politics and institutions that really matter — my analysis places the emphasis on Gramsci rather than Kuznets, on Hirschman rather than Solow, and on Mazzucato, Amsden or Pérez rather than on traditional understandings of the relationship between technology and inequality. The emphasis is on the specificities of endogenous processes rather than fundamental forces of the universe.

What matters most in this regard are issues such as what contributes to the formation of collective beliefs. How do consensus types of hegemony emerge? How can they be changed? Why are “antagonistic” conflicts related to the formation of firm political identities, into which so much libidinal energy is invested? In other words, my understanding of inequality is more about ideology than technology; agency than structure (provided that these agencies are able to understand structure); discursive articulation than economic determinism; choice than historical accidents (that Piketty describes<sup>4</sup>). In short, it is more about fighting artificially created “distributive failures” in the sphere of production (with Keynesian determination) than surrendering to market inequality in the style of the “new” Left in Europe and Latin America. As analysed in annex A2 (and in detail in Palma, 2019a), although in Europe governments at least make titanic redistributive efforts via taxes and transfers and public debt, they seem to have few qualms about letting major agents distort markets in their own favour, artificially creating a need for mammoth spending on social protection (equivalent to approximately a quarter of GDP if all components are included).

All these complexities make the analysis of inequality particularly difficult, as this phenomenon is intricate and surely overdetermined — making our modest understanding of its dynamics in the real world (despite recent progress) one of the most important analytical failings of current economic analysis.<sup>5</sup>

In fact, Krugman (2011) identified increasing inequality in developed countries and Latin America’s perennial economic underperformance as the two greatest analytical challenges today in economics. However, from my perspective, the real analytical challenge is understanding the interaction between the two phenomena in both mature and emerging economies, given that high-income economies of the Organization for Economic Cooperation and Development (OECD) are now determined to mimic Latin America’s relentless inequality and perennial underperformance. As previously mentioned, the analysis of Ricardo contributes to this task.

This process of “Latinamericanization” of OECD countries, which I analysed in Palma (2011 and 2016b) and later in Palma (2019a), resembles a reverse catching-up by high-income countries with those in the Tropics. The nature of economic activities may have changed since Ricardo’s analysis, but the sluggish economic performance (particularly in productivity) has not, driven by rising inequality with unproductive rent at the forefront (including those of inefficiency) as opposed to operating profit, which has not risen. Nor must it be forgotten that in Ricardo’s growth model, a steady state is one in which salaries are stagnant, capitalists do not obtain operating profits and rentiers take the lion’s share. The technological paradigm, the financial markets and institutions may have all changed, but the steady state seen in Latin America and the OECD built around this trinity is equally toxic, in terms of inequality, growth and democracy.

The specificity of Latin America’s political settlements and distributional structures is not just about artificially self-constructed inequalities that stifle growth, but also how the region’s capitalist elites (leaving the issue of whether they really are capitalists for later) have shown a remarkable “ability to persist” during all different forms of crisis, and even those that were directly related to their rent-seeking and inefficient accumulation methods.

<sup>4</sup> In Piketty’s original and highly influential work, there is no room for a natural tendency for inequality to decline even when a country reaches economic maturity. In his (by necessity mechanistic) neoclassical model, increasing inequality is supposed to be intrinsic to a capitalist economy irrespective of its political settlement and level of development (Piketty, 2014). For him, it took accidents such as two world wars and a massive depression to disrupt this supposed pattern (see Palma (2019a, appendix 2) for a discussion of this theme). However, in his next contribution (Piketty, 2020) he finally downplays the role of exogenous factors such as accidents, emphasising that of ideology.

<sup>5</sup> For some recent contributions, see Atkinson (2015); Bourguignon (2015); Galbraith (2016); Milanovic (2016 and 2019); Ocampo (2019); Palma (2011, 2016a and 2019a); Piketty (2014 and 2020); Scheidel (2017); and Taylor (2020).

So far, the pandemic has produced yet another example of this phenomenon: while economic activity and the living standards of many are decimated, most large fortunes (particularly financial ones) have continued to expand as in the best of times (Palma, 2020a).

Furthermore, with the pandemic this asymmetry between the oligarchy's capacity to always remain afloat regardless, no matter the cost, and the vulnerability of the rest of society has now undone much of what had been achieved in recent years in Latin America in terms of poverty reduction and minor improvements in inequality.

Latin America's fundamental political economy problem is that there are not many ways to reshape the structure of a system with so little entropy. It is hard to redesign the structure of our society and economy so that it can move forward in time, if the fundamentals of its status quo must remain unchanged, whereby those at the top can continue to appropriate such a huge share of national income doing the type of activities they favour. The main problem with such a system is that so much energy tends to be expended in trying to "stop" time that there is little left to move forward.

One key analytical hypothesis put forward here is that the experience of Latin America shows that rather than thinking in (neoclassical) terms on the possible concrete effects that well-known factors (such as technology or education) may have on inequality, it would be more illuminating to try to understand the concrete expressions that these factors have on inequality. Some of the pieces of the distributional puzzle may be the same in different experiences of inequality, but the way they fit together may differ —sometimes significantly.

That is, the specificity of Latin America's inequality stems from the particular ways in which its distributional struggles have manifested themselves, the different strategies that oligarchies have adopted to face and temporarily overcome these struggles (the main subject herein) and the further distributional challenges created by this process.

Some continue to blame Latin America's inequality on colonial institutions of half a millennium ago, such as *mita* (mandatory public service by the indigenous population) and the *encomienda* system (that rewarded conquerors with the labour of particular groups of conquered people).<sup>6</sup> Others, as in many neoclassical narratives analyse it in a way that somehow resembles Newtonian physics i.e. methodologies of mechanical determinism and simple causalities (in the style of nineteenth century physics, but with a dollar sign)—.<sup>7</sup> Others go as far as blaming the lack of major wars, as supposedly in OECD countries and in some of the emerging Asian economies of the first wave of industrialization it was possible to improve income distribution only in the aftermath of major conflicts (Scheidel, 2017; Piketty, 2014).

The monotonous insistence of many on blaming Latin America's huge inequality on exogenous or crude path-dependency factors is akin to using a pair of scissors to cut an analytical knot they are unable to untie.

In turn, it is unfortunate that Piketty (2014), in his first and most influential book, by unnecessarily relying on the neoclassical theory of growth (factor shares), led the debate over increased inequality in most OECD countries since Reagan and Thatcher, in the wrong analytical direction. Basically, in his neoclassical theory, too much of a good thing —in fact, in his analysis two good things: a great deal

<sup>6</sup> For Williamson (2009) —quite rightly— the supposed monotonous persistence of Latin America's inequality is just a myth.

<sup>7</sup> It should be no surprise that most neoclassical analyses of Latin America's inequality fail to explain why it is much higher than in many middle-income countries elsewhere, for example, in Asia, North Africa, the former Soviet Union and Eastern Europe (among others), even though some of the issues they highlight apparently point in the opposite direction. For example, almost all of these countries tend to have even more market failures and rigidities than Latin America; they have relative price structures, institutions and social capital that are even less 'right'; they have property rights over physical and intellectual assets that are less well-defined and less well-enforced; they have educational systems that are even more segmented, with the poor often getting an even more dismal deal; they discriminate on gender and race even more than in Latin America; they have even greater shortages of skilled labour; their democracies are even more 'low intensity', and with more problems of 'governance'; they have an even greater dependence on political connections, cronyism and corruption to achieve success in business. But, despite all of this, these countries are less unequal than Latin America (sometimes significantly so).

of investment and high elasticity of factor substitution (production flexibilities)— unfortunately ends up producing higher inequality. It is hard to imagine a construct that would idealize inequality more than this!<sup>8</sup>

Instead, as Stiglitz (2012) and I have argued (Palma 2011, 2016a and 2019a), inequality is a choice between perfectly feasible alternatives in a world of multiple equilibria. As Sartre (2004) argued, nothing reveals more transparently who we truly are than the choices we choose to make; this is certainly true for inequality. The bottom line, as the title of Palma (2016a) indicates, is that every country deserves the inequality it has.

It is just not credible to continue claiming that we are innocent bystanders of supposedly “exogenous” factors.<sup>9</sup> That is, one must always reject mechanical determinisms and simple causalities and insist on our ultimate freedom and responsibility. “I am my freedom”, says a character in one of Sartre’s plays (Sartre, 1946). Every act is a self-defining one, and no act of this kind can really be blamed on so-called exogenous factors. The all-time classic quotation on this matter is provided by Shakespeare, in a speech in *King Lear*:

This is the excellent foppery of the world, that, when we are sick in fortune, —often the surfeit of our own behaviour—, we make guilty of our disasters the sun, the moon, and the stars: as if we were villains by necessity; fools by heavenly compulsion; knaves, thieves, and treachers, by spherical predominance; drunkards, liars, and adulterers, by an enforced obedience of planetary influence; and all that we are evil in, by a divine thrusting on: an admirable evasion of whoremaster man, to lay his goatish disposition to the charge of a star! (Shakespeare, n/d)

At least it seems that it is finally becoming “common sense” (in Gramsci’s perspective) that the increasing market inequality that has characterized the global landscape since Reagan and Thatcher has been a self-constructed distributive failure. Warren Buffett explains this clearly and succinctly: “There’s class warfare, all right, but it’s my class, the rich class, that’s making war, and we’re winning” (see Stein, 2006). As for growing inequality, fundamentals? What fundamentals?

Essentially, if Adam Smith’s “invisible hand” (Smith, 1776) were to exist, and was what guided allocation of resources, this relentless increase in inequality, particularly in market inequality (see annex A2) could not have taken place, because market compulsions would have put a stop to it. Its foundations are artificially tailor-made. In fact, it feels almost tedious even having to state that increasing market inequality has been an artificially constructed distributive failure, a mere distortion of the market; it is as if somebody at the circus were to point out that when the magician saws a woman in half, “it’s only a trick!”.

## II. Some background issues

### 1. Ratchet effects, or the “support levels” of increases in inequality

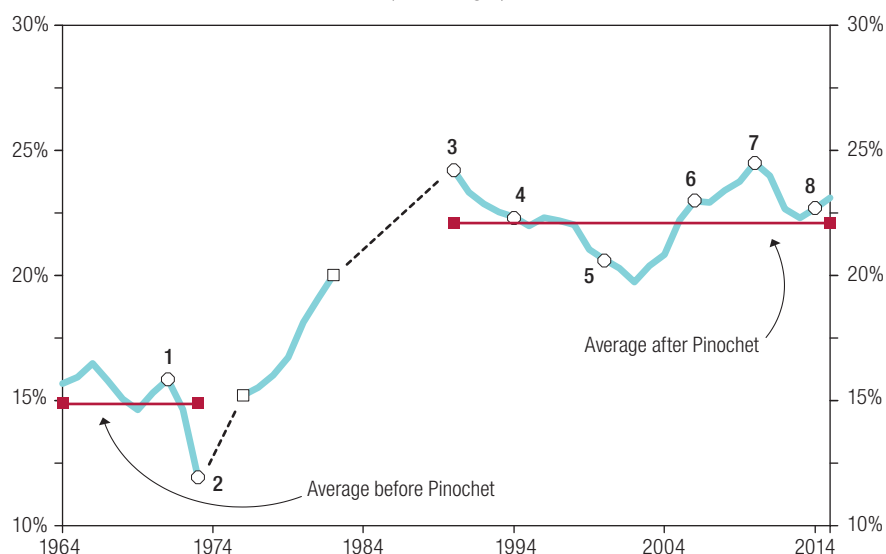
One of the issues I shall analyse in this article (hitherto rather disregarded in the literature), which has proved to be an important distributional stylized fact in post-war Latin America, is the distributional-ratchet effect resulting from the fact that improvements in inequality have tended to be temporary, while deteriorations

<sup>8</sup> For a critique of Piketty’s neoclassical analysis, see Rowthorn (2014); Taylor (2014 and 2020); Harcourt (2015); and Palma (2019a, especially appendix 2).

<sup>9</sup> Kaldor (1955) was the first to break the neoclassical mechanistic spell on the determinants of inequality in his analysis of the Harrod–Domar model, which elicited a strong reaction from Solow (1956). While Kaldor dealt with the Harrod–Domar instability issue by allowing for endogenous changes in the distribution of income between wages and profits, Solow argued that it was impossible to think of an efficient distribution of income that was not automatically determined by the value of marginal productivities.

have more permanent effects. That is, the well-known difficulties in reversing social dynamics seem to apply only to increases in inequality. Developments in Chile clearly illustrate this: the leap at the top end of the income structure has been difficult to revert (see figure 1).

**Figure 1**  
Chile: share of market (pre-tax) income of the wealthiest 1%,  
the distributional legacy of the dictatorship, 1964–2015  
(Percentages)



**Source:** World Inequality Lab, World Inequality Database, 2020 [online] <http://wid.world/>, on the basis of J. Atria and others, "Top incomes in Chile: a historical perspective of income inequality" (1964–2015)", *Working Paper Series*, No. 2018/11, World Inequality Lab, 2018.

**Note:** Dotted lines refer to years for which no data are available. For 1964–1981 "income" refers to fiscal income and from 1990 onward to pre-tax national income. Averages are harmonic means<sup>10</sup> (1957–1973 and 1990–2015). Three-year moving averages.

1. Election of Salvador Allende.
2. Pinochet seizes power in a coup d'état.
3. Pinochet is forced to hold a plebiscite on whether he should remain in power for another eight years, which gives rise to the first democratic government (centre-left coalition, the "Concertación") after Pinochet loses the plebiscite.
- 4, 5 and 6. Next three centre-left governments.
7. Election of a centre-right government.
8. The centre-left returns to government.

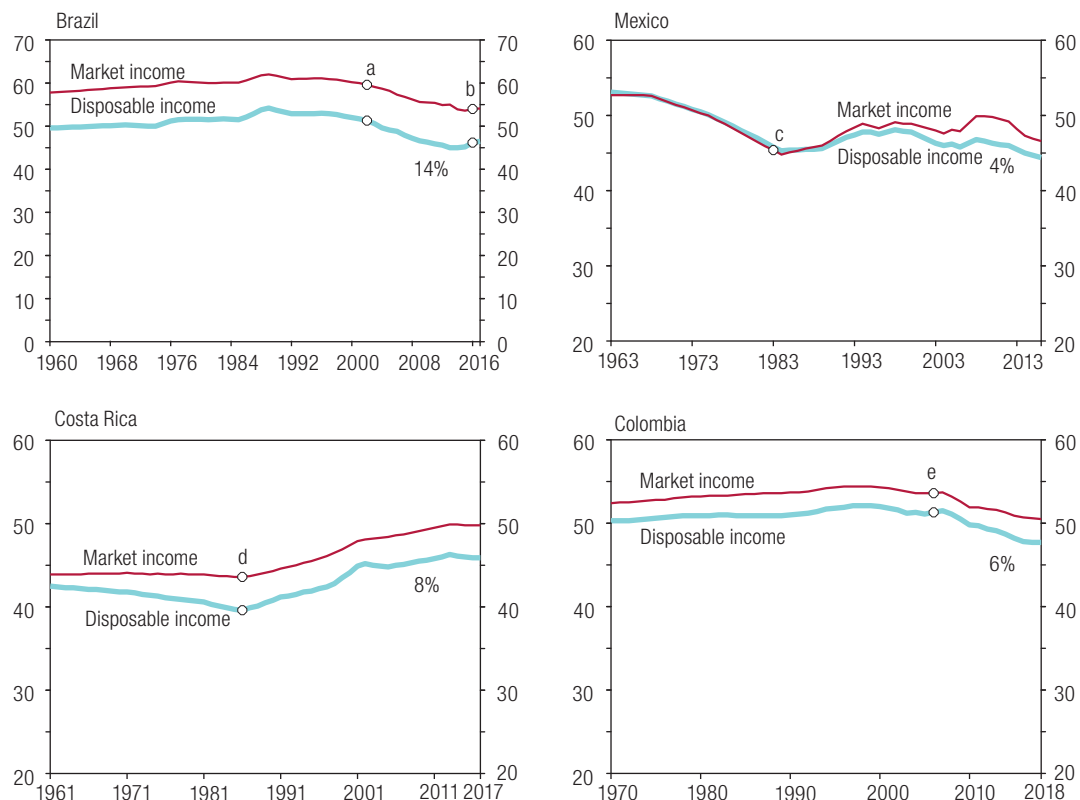
What is most striking is that this ratchet at the top occurred despite the fact that Pinochet lost the plebiscite by a wide margin, and that in period following the return to democracy there were four consecutive centre-left governments, all within a political coalition that included President Allende's Socialist Party. Moreover, this political coalition had the support of a clear majority in both presidential and parliamentary elections throughout, and one banner in their discourse and manifestos was to reduce inequality. Sections III to VII attempt to explain why they failed in this aim (at least in terms of being able to reduce the income share of the rich).

Standing out among other regional distributional ratchets is the case of Brazil. The Brazilian oligarchy was not only able to sustain the increase in inequality that followed the 1964 coup d'état, but also continued enjoying these gains long after the return to democracy —in fact, at least until the election of Luiz Inácio Lula da Silva (see figure 2).<sup>11</sup> This remarkable persistence of high inequality (with at best minor improvements) applies to other countries of the region as well.

<sup>10</sup> For the non-specialist, the harmonic mean is one of the three Pythagorean means. It is more appropriate for the average of ratios as it mitigates the impact of outliers; it also contains more information than the median. It is the reciprocal of the arithmetic mean of the reciprocals.

<sup>11</sup> See Fishlow (1972) for details on the rapid deterioration of inequality after the 1964 *coup*.

**Figure 2**  
Brazil, Mexico, Costa Rica and Colombia: market income  
and disposable income Gini indices, 1960–2018



**Source:** F. Solt, “Measuring income inequality across countries and over time: the Standardized World Income Inequality Database”, *Social Science Quarterly*, vol. 101, No. 3, SWIID version 9.0, October 2020 [online] <https://fsolt.org/swiid/>.

**Note:** Percentages shown in the panels indicate the relative reduction of the market income Gini index after taxes and transfers.

- a. Election of Luiz Inácio Lula da Silva.
- b. Parliamentary coup d'état against Dilma Rousseff.
- c. Election of Miguel de la Madrid.
- d. Election of Oscar Arias.
- e. Re-election of Álvaro Uribe.

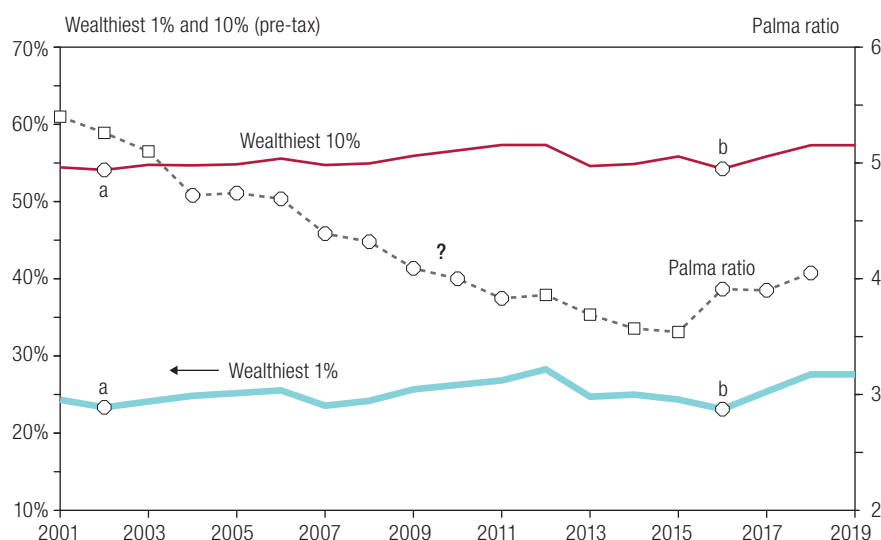
As figure 2 indicates, countries of the region hardly get into double figures when it comes to improving their market inequality via taxes and transfers. These efforts are minimal compared to those of European countries, which improve the Gini by up to 50% (see annex A2). They are even meagre compared to those of the United States under the administration of President Trump (25%). Why did Latin America achieve so little despite so much “progressive” talk?

Moreover, although Brazil's 14% reduction in its market Gini is the largest in the region —like South Africa's similar figure— it is a particularly modest effort since in both countries fiscal revenues are relatively similar to the OECD average (Di John, 2006; Lieberman, 2003; OECD, 2020a). The key difference between them is that South Africa, despite its relatively progressive taxation, fails to achieve more due to an ineffective system of transfers to the poor, whereas Brazil, although it has (or should I now say it had?) a more effective programme of transfers, falls down badly on its highly regressive tax structure.

Indeed, another source (World Inequality Lab, 2020) even questions Brazil's relatively small improvement in inequality in disposable income shown in household surveys during the four successive governments of the Workers' Party (PT). It is very likely that the Brazilian ratchet —which favours high-income groups, like its Chilean counterpart— has in fact remained in place, even during the terms of centre-left governments (see figure 3).

**Figure 3**

Brazil: share of national pre-tax income of the wealthiest 1% and wealthiest 10% and Palma ratio on inequality in disposable income (post-tax and transfers), 2001–2019  
(Percentages)



**Source:** World Inequality Lab, World Inequality Database, 2020 [online] <http://wid.world/>, on the basis of M. De Rosa, I. Flores and M. Morgan, "Inequality in Latin America revisited: insights from distributional national accounts", *Technical Note*, No. 2020/02, 2020 (for pre-tax income); and J. G. Palma, "Behind the seven veils of inequality: what if it's all about the struggle within just one half of the population over just one half of the national income?", *Development and Change*, vol. 50, No. 5, September 2019 (for the Palma ratio).

<sup>a</sup> Election of President Luiz Inácio Lula da Silva.

<sup>b</sup> Parliamentary coup d'état against President Dilma Rousseff.

There is little indication that the small decline that supposedly occurred in the income share of those at the top during the PT era, according to household budget surveys, is in fact real, given the new pre-tax evidence and the regressive tax policies of Brazil. In a similar fashion to Chile, as shown figure 9, the most likely scenario is that this is a result of the growing inability of budget surveys to reflect the income of the rich, in this increasingly financialized world (that is not short of tax havens). Even (successful) PT period policies to increase the income share of the poorest (such as those to reduce poverty, formalize labour contracts and increase the minimum wage) do not appear to be sufficient to support the supposed improvement in the Palma ratio (see the question mark in figure 3).

Furthermore, these policies, and policies to slow the destruction of the Amazon, are now at risk not just because of the economic impact of the pandemic, but also due to current government politics on the COVID-19 pandemic, misguided nationalism on the Amazon, and early Washington Consensus/Chicago-style neoliberalism in economic policies.<sup>12</sup>

The same scepticism is warranted by Chile's much-heralded minor improvements on inequality (see figures 1 above and 9 below). For those in Latin America wanting to improve inequality, it has proved much easier to "talk the talk" than to "walk the walk"!

<sup>12</sup> In view of the current pandemic, if we continue to destroy habitats and ruin ecosystems, other viruses are more likely to jump from animals to humans; in particular, the continued destruction of the Amazon could bring about the next health crisis. At the time of writing, even areas outside the Amazon, such as Pantanal, are now being burned to the ground —in fact, more than a quarter of its tropical wetland has already been destroyed. As Einstein is reported to have said, "Two things are infinite: the universe and human stupidity (and I'm not sure about the universe)."

## 2. Why dysfunctional institutions are so good at recreating themselves when shocked out of balance

As suggested above, all this brings us back to the complex issue of persistence in dysfunctional institutions, and in particular how they are so effective at recreating themselves —as the landed elite did in the South of the United States after losing the Civil War. The Chilean oligarchy was able to do the same, despite badly losing the 1988 plebiscite and four presidential and parliamentary elections thereafter. As times have changed, the oligarchy has found it more effective to co-opt its object of hate, than to lynch it. However, times have not changed that much: the oligarchy managed to impose on the majority a straitjacket Constitution, with many institutions above democratic control. In turn, thanks to the supramajorities required in Parliament for anything significant, and the “appointed” Senators (including Pinochet himself), those institutions above democratic control made it practically impossible to change the Constitution. It took a social explosion of the magnitude of that of October 2019 to shock Chile’s “Southern-style equilibrium” out of balance enough to force business leaders to convince the powers that be to start constitutional change. When the referendum on this possibility took place exactly a year after the social unrest (and 30 years after the return to democracy), it attracted an 80% positive response.

Regarding the role played by the “new” Left in all this (see annex A1), according to Gramsci (1992) any ideology aiming to remain hegemonic has to be able to absorb elements of opposing ideologies; but it has to do so in an imaginative way, articulating them with the essence of its own ideology. That is, for a consensus to remain hegemonic, dominant groups have to make ideological concessions to subordinate groups, but without endangering their domination. This was what business and right-wing political parties did so well in Chile after their defeat in the 1988 plebiscite; this helped them control the transition to democracy, whereby the elected centre-left authorities could run the government but the business elite retained de facto political power and the military (with Pinochet as Head of the Armed Forces for another eight years) retained its power through force.

The centre-left parties, instead, inspired by the “Third Way” of the Western European new social democracy, made that Gramscian ideological integrative effort of imagination in a timid, often opportunistic way, and with little creativity. As a result, they allowed the new neoliberal economic ideology to simply replace its previous social-democratic ideology.

Here the similarities with what happened in South Africa after the beginning of democracy in 1994 are also more than superficial: the Afrikaner political elite may have lost the major battle, but the white elite (partly helped by the co-option of a critical mass of the African National Congress (ANC) elite) is still appropriating the highest share of income of any elite in the world (Palma, 2011, appendix 3).

From this perspective, as Acemoglu and Robinson (2006) point out, one should never lose sight of the distinction between the two components of political power: de jure and de facto power. The political misfortune of Latin America is that the de facto political power of the oligarchy is such that, to date, these dysfunctional institutions have been able to survive all political and economic shocks fairly unscathed. The capture of the Latin American “new” left has proved to be just a chapter in that history (see annex A1).

## 3. Inequality as an anti-coordination game —as in a game of chicken (or “hawk-dove”)

In game theory, this type of game is a model of conflict associated with a diverse range of social conflicts. It is a question of which player yields first, as in the 1955 film *Rebel Without a Cause*; stolen cars are raced towards an abyss, and whoever jumps out first will be deemed a “chicken”. Bertrand Russell (1959) also famously used it as a metaphor for the game of nuclear brinkmanship, in which the final result could be one nobody wanted.



This is an “anti-coordination” game because the shared resource is rivalrous (although non-excludable). Namely, sharing comes at a cost, i.e. it is subject to a negative externality. This, of course, need not be the case in distributional games if the players are involved in a Marshallian efficiency wage scenario because of the likely positive feedback between wage growth and productivity growth. However, try explaining that to a short-sighted oligarchy that is convinced its income depends on not understanding.

The unstable state of affairs that characterizes a game of chicken leads to a situation in which there are only two possible (and opposite) Nash equilibria, corresponding to the preferred strategy of each player.<sup>13</sup> Anything in between is an unstable mixed outcome, always subject to being challenged. One that is the outcome of temporary and precarious arrangements of contingent practices, as in other antagonistic conflicts, is likely a result of practices that seek stability in a contingency. So, one effective tactic (that is particularly relevant here) would be for one party to signal his or her intentions convincingly enough. In other words, the game could easily become one of brinkmanship, designed to avert the possibility of the opponent switching to aggressive behaviour. This is one reason why in an antagonistic distributional conflict an “irrational” player can easily have the upper hand. And since credible threats —no matter how irrational— can be very effective, in terms of inequality the set of institutions and rules within which a distributional struggle is played out becomes crucial, as it can contribute to the credibility of one or another party.

In fact, one way of understanding the neoliberal transformations is in terms of the creation of a specific institutional scenario where the threats of the elite —irrational though they may be— should be taken extremely seriously by workers and the State. By now it seems clear that these reforms had little to do (in both mature and emerging economies) with increased economic efficiency, and a lot to do with helping capital to recover its power and regain the legitimacy lost through the crisis of the 1930s, the determination of President Franklin D. Roosevelt and his New Deal, the horror of war, the increasing organization of the working class, and the genius of Keynes. After the war, even in the United States, the income of the bottom 40% grew faster than that of the richest 1% during three consecutive decades (Palma, 2019a).

One of the aims of the 1980s reforms was to reverse this. From the perspective of Walter Benjamin (1968), all class society is in a permanent state of emergency because the ruling class is always under threat. The aim of neoliberalism, then, was to build a consensus and a praxis —and a “common sense”— that would help to create a class society in which the elite is not exposed to this threat, owing to their ability to debilitate the rest of society by imposing on them a continuously insecure life.<sup>14</sup> In this scenario, a mobile and malleable agent could achieve an unrivalled dominance. In this context, big capital (especially financial capital) rules and any alternative national development and autonomy strategy carries the risk of becoming a collective suicide pact.

This brings to mind Foucault’s (2008) proposition that neoliberalism is not really a set of economic policies but a new and very effective technology of power (Frangie, 2008; Palma, 2016b). So, workers are now back to old-fashioned precarious jobs; social security networks are being deliberately made increasingly porous; and easy access to persecutory debt is leading to what Krugman (2005) calls “the return to a debt-peonage society”. In turn, “subsidiary States” tightly limit the room for manoeuvre in terms of economic policy or agencies, other than those that are meant to keep capital sweet.

The uncertainties of a new technological paradigm do not help either, as although they give opportunities to financial capital and a few particular skills and innovations, they also bring further uncertainties to the majority of workers and the State (Pérez, 2002).

<sup>13</sup> In this game, the strategic space for both players would be “demand redistribution” and “do not demand redistribution” for the majority player, and “yield to redistribution” and “do not yield to redistribution” for the capitalist elite. This is a multiple equilibria story. In turn, the Nash equilibria would be “demand redistribution”, “yield to redistribution”, and “do not demand redistribution”, “do not yield to redistribution” for the majority player and elite player, respectively. In the first, the majority player has the upper hand, while in the second it the elite does.

<sup>14</sup> See Arantes (2007).



The bottom line for neoliberalism is how to reconstruct a scenario in which capital is known to have the power to pull the plug whenever it sees something it does not like. Under these circumstances, the ideological acceptance of the “preferred” (game) strategy of the elite could be considered smart, rather than chicken, making such an unfavourable position more bearable. Shared pain can even feel reassuring. After all, as Benjamin (1968) also reminds us, before all philosophy comes the struggle for subsistence.

In developing countries, the challenge for capital to develop more effective forms of legitimacy, and more sophisticated technologies of dispossession of value generated by others, has been even greater. In the new complexities of a post-Cold-War scenario, the existence of a dictator or two, such as in Chile’s military regime, is no longer enough.

The neoliberal discourse may have erupted onto the world stage during the thirst for new ideas in the 1970s, promising order, market efficiency, individual initiative, non-paternalism, sound macroeconomics and a new concept of the State, but what it ultimately offered to workers and the State was a life permanently on the edge and a high-risk and unstable order in which only capital, with its mobility and malleability, could really thrive, with the State mostly reduced to putting out fires, in a situation full of emergencies.

In a way, Keynes’ ideas were precisely about fighting these types of inefficient and old-fashioned “anti-coordination games”, searching for more efficient and stable *cooperative* outcomes. The mass production for mass consumption technological paradigm also helped this type of scenario, especially as it was in its “mature stage” (Mazzucato, 2013 and 2018; Pérez, 2002). However, if capital or labour pushed things towards brinkmanship scenarios, what was imperative for Keynes was to prevent a player prone to irrational behaviour — such as financial capital — from intimidating the other players in a game of chicken.

### III. The ability to persist of the Chilean capitalist elite

As already suggested, one possible explanation of Chile’s stubbornly stable marked inequality is that it has benefited from Parrondo’s paradox in the sense that the Chilean oligarchy seems to have successfully followed a complex distributional strategy which could be associated with that logic. In game theory, the secret to that paradox is to switch strategy when the game could become counterproductive (when it has passed its “sell-by” date).

There are many examples of these somewhat counter-intuitive scenarios; in financial markets, for example, there are strategies whereby a player could be guaranteed to lose all his money if they are played permanently, but which could generate a winning streak if played alternately.<sup>15</sup>

In the case of Chile, this scenario is rather transparent, although the oligarchy’s winning strategy has involved more than two games, so its mathematical solution would imply a more complex convex scenario than the usual linear combination of two games.<sup>16</sup>

The basic dilemma for any oligarchy determined to maintain such degrees of inequality is how to construct a winning strategy that is sustainable *when in a democracy*, given the fact that it is such a tiny minority, and that the distributional outcome that it seeks is so remarkably unequal.

What is needed to build a long-term winning strategy of this type is both the flexibility to switch between strategies as soon as they become counterproductive, the ability to maintain one’s hegemonic ideology, and the capacity to solve any internal “collective action” problem that may emerge along the way in order to ensure internal cohesion — so that members act together, even when individuals may

<sup>15</sup> See, for example, Blakeslee (2000).

<sup>16</sup> See Key, Klosek and Abbott (2006) for an example of a three-periodic game.

have incentives to free-ride. This phenomenon is sometimes linked to the concept of “elite closure”. According to Adam Smith (1776, volu. I, ch. 5), the elite’s greater capacity for “collective action” helps it enormously to take the lead in the distributional conflict.

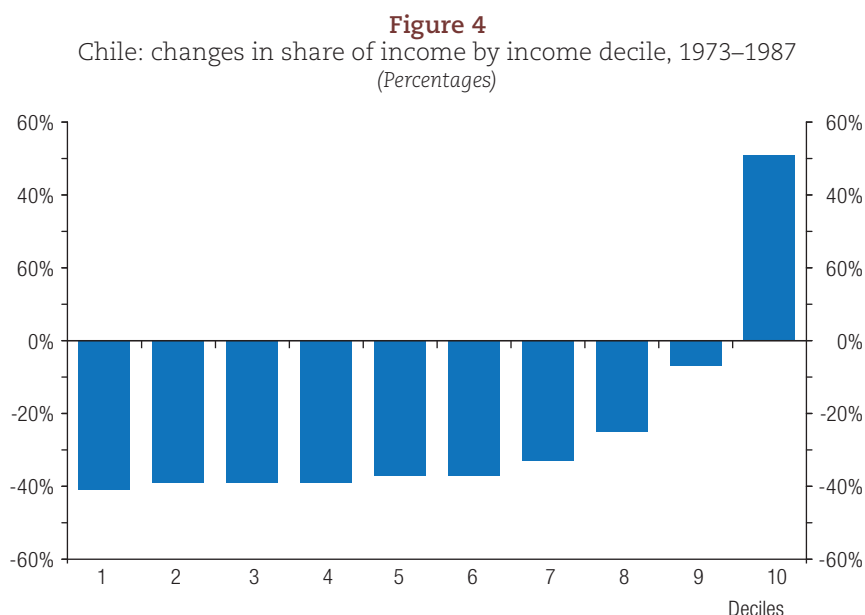
These are crucial components for the oligarchy’s ability to persist. From this perspective, North and others (2007) were right when they developed the “limited access order” hypothesis: how elites able to maintain cohesion can divide up the control of rents and block the access of others.

## IV. Strategy 1. How to convert the probabilistic outcome of a distributional game into a deterministic winner-takes-all scenario using terror

When Chile elected a left-wing government in 1970 —and that government (unusually enough) was prepared to implement the programme for which it had been democratically elected, including redistributive policies (see figure 1 above, and figures 5 and 6)— the Chilean oligarchy panicked, because those policies were going to tip the scales of the distributional game to the workers’ advantage, and chose the nuclear option of a coup d’état (in a country with a long democratic tradition).

In other words, the oligarchy chose to transform the distributional scenario from one in which the poor were getting the upper hand, to one in which it could implement its own “preferred” distributional strategy unimpeded —i.e. a winner-takes-all scenario. In this new Nash equilibrium, with its particularly asymmetric set of distributional strategies, and the corresponding payoffs, one player could convince the majority of the futility of challenging the situation while it had at its disposal the whole apparatus of State terror.

The outcome of this new “insatiable appetite” strategy —the oligarchy’s “strategy 1” in this narrative— is evident in figure 4.



**Source:** Prepared by P. Jervis and the author, on the basis of Centro de Microdatos (CMD), “Encuesta de Ocupación y Desocupación en el Gran Santiago 2019”, Faculty of Economics and Business, University of Chile, 2020 [online] <http://documentos.microdatos.cl/Encuestas/Ocupacion/OcupacionDesocupacion?C=T1>.

**Note:** Data refer to per capita household income in Greater Santiago (where about 40% of the population lives). It excludes from family incomes those of lodgers and domestic workers living in the house, those declared as “zero”, “does not know”, and “no response”.

In fact, in this survey the share of the tenth decile increased from 34% of national income to no less than 52% between 1973 and 1987 (the year of the plebiscite), taking even from the share of the ninth decile. This scenario resembles a postmodern Robin Hood who not only robs the poor to give to the rich, but also robs the rich to give to the even richer!

## V. Strategy 2. The return to democracy creates a new challenge for the elite: how to reconstruct its legitimacy via a more refined technology of power

No matter how much terror could be generated by the State's repressive apparatus in the dictatorship, the oligarchy could not play "strategy 1" indefinitely. Inevitably, towards the end of the 1980s, the distributional game began to move away from its determinist scenario, slowly returning to its normal probabilistic situation (with a more mixed and unstable distributional outcome) because of growing popular unrest. That is, the oligarchy's strategy 1 started to become counterproductive (i.e. a losing strategy) as the majority (especially new generations) began to lose their fear of challenging the oligarchy's preferred strategy. The emperor had no clothes (only a repressive apparatus).

As a way out of this conundrum, General Pinochet's government sought to legitimize its rule by calling a plebiscite in 1988, which was to allow him to remain as Head of State for another eight years. The government lost the vote, and by a wide margin, despite having tried to reverse some of the worse aspects of its distributional policy at the last minute (see movement from 3 to 4 in figure 7).<sup>17</sup>

In fact, in trying to improve his democratic credentials, Pinochet shot himself in the foot: just before the plebiscite, he signed the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment of Punishment. Ironically, the ratification of this Convention was what allowed Judge Garzón from Spain to ask the Government of the United Kingdom for Pinochet's extradition in 1998. This was the first time that a former head of government was arrested under the principle of universal jurisdiction. Also, and again for the first time, this enshrined in international law the principle that the immunity (current or former) Heads of State does not apply to crimes against humanity.

As Pinochet lost the plebiscite and his supporters lost the subsequent presidential and parliamentary elections by a wide margin, the elite had little choice but to switch to a more sophisticated distributional strategy. This they did rather effectively.

The key characteristic of strategy 2 is that it resembled the old Roman Catholic practice of indulgences, whereby sinners (in this case the sacrilegious oligarchy) could buy certificates that stated that through penitence their sins had been absolved.

The vital point for the oligarchy was recovering their democratic legitimacy; to achieve this, what could be better than supporting some distributional policies of the new centre-left government and a tax reform? However (with the help of the life senators appointed by Pinochet), they succeeded in imposing the condition that this would be a temporary measure. They also supported an increase in the minimum wage and other policies for poverty reduction, a mild reform of the labour legislation, and so on.

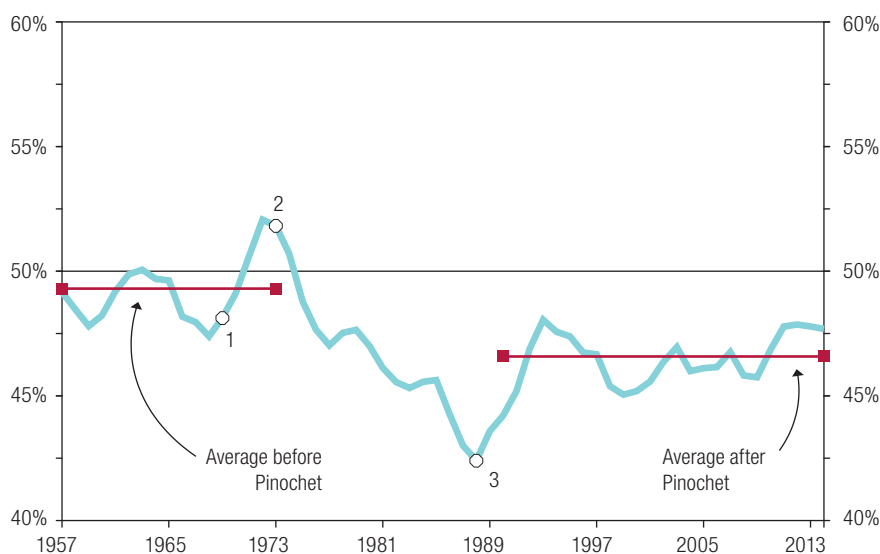
A crucial component of strategy 2 was the need for the oligarchy to rebuild its traditional distributional alliance with the middle and upper-middle strata since, as figures 4 and 5 indicate, they too had been squeezed during the winner-takes-all distributional strategy. Therefore, the oligarchy also supported (and pressured) the centre-left government towards different measures to benefit this

<sup>17</sup> In the other household survey (CASEN), this movement from point 3 to point 4 is less sharp.

sector. As a result, the share of income deciles 5 to 9 recovered some of the ground lost during the dictatorship, but it then stabilized at a level below 50% of the national income —a level that was well below what it had achieved during the presidency of Salvador Allende, reflecting how difficult it is to recover lost ground in a distributional game (see the ratchet effect in figure 5).

**Figure 5**

Chile: percentage of income of the middle and upper-middle strata (deciles 5–9), 1957–2014  
(Percentages)



**Source:** Prepared by P. Jervis and the author, on the basis of Centro de Microdatos (CMD), “Encuesta de Ocupación y Desocupación en el Gran Santiago 2019”, Faculty of Economics and Business, University of Chile, 2020 [online] <http://documentos.microdatos.cl/Encuestas/Ocupacion/OcupacionDesocupacion?C=T1>.

**Notes:** Averages are harmonic means (1957–1973, and 1990–2014). Three-year moving averages.

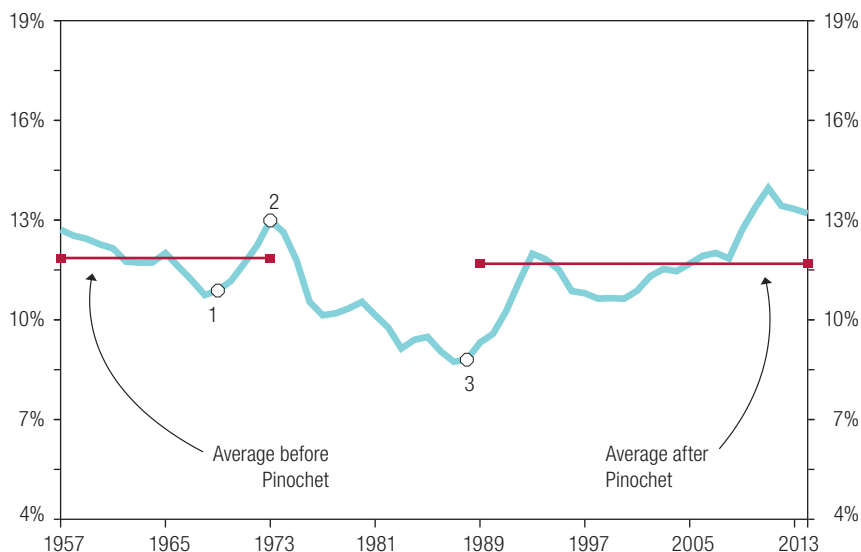
1. Election of Salvador Allende.
2. Pinochet seizes power in a coup d'état.
3. Election in 1989 of the first of four consecutive centre-left governments after Pinochet lost the 1988 plebiscite, followed by a right-wing government in 2010. In the CASEN survey, the cycles after point 3 are less pronounced.

The key message of this figure is that Chile is one of the very few countries in the world where deciles 5 to 9 are unable to defend their half of national income (Palma, 2019a). In addition, this image does not fit into a scenario where public choice theory applies, whereby agents make decisions according to their outcomes and those decisions are rational, favouring logic, objectivity and analysis over subjectivity and intuition. In Chile, in contrast, figure 5 shows that the middle strata (deciles 5 to 9) make decisions without considering outcomes (for example, majority opposition to Allende, mass support for Pinochet). Perhaps identity, subjectivity and intuition (we shall call this ideology for short) play a more important role in decision-making than Buchanan's primitive economism (he should have studied in Chicago!).

Figure 6 shows the changes in the income share of the poorest 40%.

As with the middle and upper-middle strata, the share of the bottom 40% did recover after the return to democracy. However, and as opposed to the downward ratchet of deciles 5 to 9 shown in figure 5, during the period covered by the oligarchy's strategy 2 this share did return to pre-1973 levels —thanks to distributional policies of the centre-left governments, which targeted the bottom of the income scale. In fact, when the centre-left lost on its fourth attempt at re-election in 2010 this income was trending upward.

**Figure 6**  
Chile: percentage of national income of the poorest 40%, 1957–2014  
(Percentages)



**Source:** Prepared by P. Jervis and the author, on the basis of Centro de Microdatos (CMD), “Encuesta de Ocupación y Desocupación en el Gran Santiago 2019”, Faculty of Economics and Business, University of Chile, 2020 [online] <http://documentos.microdatos.cl/Encuestas/Ocupacion/OcupacionDesocupacion?C=T1>.

**Note:** Averages are harmonic means (1957–1973, and 1990–2014). Three-year moving averages.

1. Election of Salvador Allende.
2. Pinochet seizes power in a coup d'état.
3. Election in 1989 of the first of four consecutive centre-left governments after Pinochet lost the 1988 plebiscite, followed by a right-wing government in 2010.

All in all, strategy 2 was a great success for the elite. Although it may well have lost some of its share in income, these elements of strategy 2 were like a sacrifice in a game of chess, where deliberately losing a piece could help win the game.

However, as the oligarchy clearly had no intentions of maintaining the pretence of its new progressive face indefinitely, as soon as it had succeeded in recovering a minimum of democratic legitimacy, it was able to move *credibly* to a new, more aggressive distribution strategy — strategy 3.

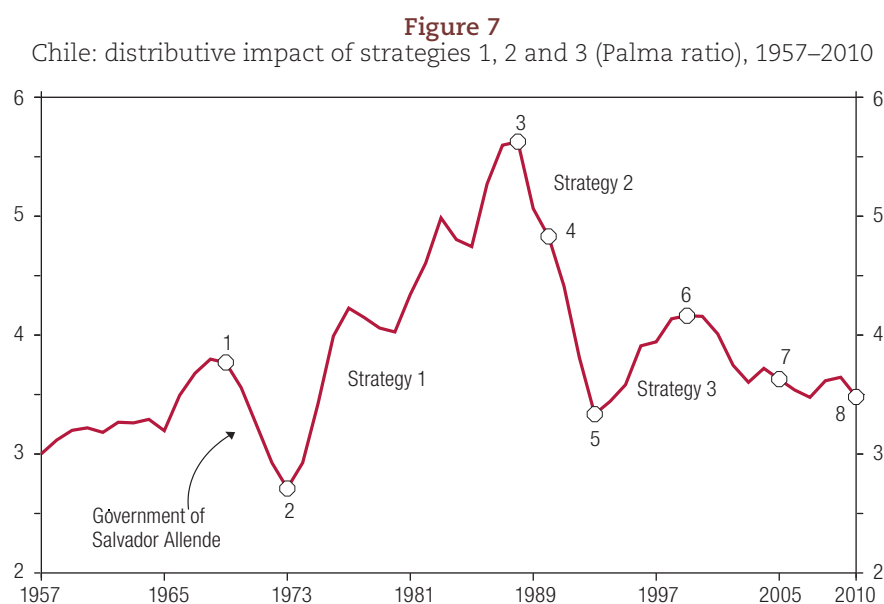
Therefore, despite the fact that it was a political minority (but greatly helped by the ability to leverage the tailor-made legal scenario built by Pinochet's Constitution and his “handcuff laws”), it began adopting a more aggressive strategy with actions such as defeating in Parliament (with the help of its appointed senators) a new labour reform, and reversing the tax reforms of the first democratic government.<sup>18</sup>

It is remarkable how the oligarchy, with the support of its military allies, managed to re-establish the legitimacy and hegemony of its ideology — but now in democracy. The key question is, how was that possible? How could they succeed in creating a hegemonic consensus around their discourse of deregulated market supremacy and trickle-down economics? And why was the “new” left not just ideologically neutralized, but also seduced into cheerleading this transformation? (If you can't beat them, join them, perhaps?).

<sup>18</sup> This is in a country where, even with these reforms, the tax take was about 20% of GDP (OECD, 2020b), and where the higher the income decile, the lower the proportion of income paid in taxes (see Engel, Galetovic and Raddatz, 1999; and López and Miller, 2008). Also, as in the rest of Latin America, income tax evasion was rampant — ECLAC (2016) calculated that tax evasion represented almost 7% of the regional GDP.

## VI. Strategy 3: how could something resembling a Nash equilibrium, built around the elite's preferred distribution strategy, with its extreme inequality and unilateral payoffs, emerge in a democracy?

The first key aim of strategy 3 was to stabilize the distributional outcome of strategy 2; its motto was “no more concessions!”. The second was to entrench the oligarchy's ideology as unrefutably hegemonic. When both objectives were achieved, which coincided with the early stages of the second presidency of the centre-left, the oligarchy could finally drop the façade and once more distort inequality in its favour (now in a democracy). Figure 7 summarizes the outcome of the oligarchy's three strategies: 1, higher inequality through terror, 2, the process of re-legitimizing capital, and 3, sustaining higher inequality through more refined technologies of power, based on more sophisticated forms of domination.<sup>19</sup>



**Source:** Prepared by P. Jenvis and the author, on the basis of Centro de Microdatos (CMD), “Encuesta de Ocupación y Desocupación en el Gran Santiago 2019”, Faculty of Economics and Business, University of Chile, 2020 [online] <http://documentos.microdatos.cl/Encuestas/Ocupacion/OcupacionDesocupacion?C=T1>.

**Note:**

1. Election of Salvador Allende.
2. Strategy 1 (following coup d'état).
3. Strategy 2 (from plebiscite of 1988 to start of second centre-left government).
4. First democratic government (centre-left coalition).
- 5, 6 and 7. Strategy 3 (consolidation of inequality during the following three centre-left administrations).
8. First democratic right-wing government in more than fifty years.

Triennial moving averages<sup>20</sup>

<sup>19</sup> See also figure 9.

<sup>20</sup> For a video that explains the nature of the Palma ratio as a new inequality index, originally published in the Washington Post, see Uncounted, “The Palma” [online] <http://uncounted.org/palma/>. See also [online] <https://www.youtube.com/watch?v=wY9XFQAMcA&feature=youtu.be>. The World Bank (2016) composed a related and similar statistic, the “Palma premium”, derived from the Palma ratio (since it primarily indicates the direction of the change in inequality).

The oligarchy's remarkable success during the first few years of strategy 3 tends to confirm my hypothesis that neoliberalism may well have become one of the most effective technologies of power ever. In Latin America, neoliberal ideology —with its extremely successful re-legitimization of capital— became shorthand for the art of getting what you want: legitimization of obscene and inefficient levels of inequality within a democracy. Or, in the language of game theory, it became a technology of power capable of transforming a particularly asymmetric set of distributive strategic choices and the corresponding unilateral payoffs into something resembling a Nash equilibrium in a democracy, albeit a low-intensity one. This was achieved by convincing the majority that it was futile to try to challenge this while the all-too-powerful top income players (who owned the playing field, had control of the ball and wrote the rules) kept their strategy unchanged.

It was futile to challenge this not just because the chances of success were minimal (given the distorted nature of the setting in which the game was being played), but also because a majority had to grasp that their meagre payoff was just their lot in life. In any case, under the prevailing international and domestic scenarios, this type of neoliberalism was the only workable option. Furthermore, as Adorno (1951) reminds us, domination is much more effective if the oligarchy can delegate the violence on which the domination is based to the (centre-left) dominated themselves.

As a result, the distributional game even ceased to be one of “chicken” and became one in which this Nash equilibrium around strategy 3 —so improbable in a democracy— was possible, mostly through ideological conviction. The fact that neoliberalism as a technology of power could do this without needing to employ crude old-fashioned forms of social conflict resolution was the most remarkable. In other words, the oligarchy was finally able to achieve in a democracy what was only possible in dictatorship previously.

This was an enormous achievement, while it lasted. When the major once again challenged this Nash equilibrium built around the elite's favourite strategy, in many countries the elite switched strategy and sought alliances with a range of parallel causes, such as cultural wars, racism, misogyny, nativism, xenophobia, nationalism, moralistic religious agendas and any populist cause. On occasion assistance even came from organized crime. The support of the corporate and financial elite for policies such as those of Trump and Bolsonaro is archetypal.

In Chile, however, these auxiliary causes gained little traction; moreover, a somewhat more politically sophisticated elite could still get its way with traditional forms of domination, such as the power to continue debilitating the rest of society by imposing an increasingly insecure life on workers and the State. These actions represented the stick, while the carrot was the promise that the payoff for the majority would eventually improve thanks to trickle-down effects. And they were told that they should be reasonable because there was no feasible better alternative for them.

Ultimately, the elite smartly chose not to oppose the new agenda of values of the centre-left administrations —which included the right to abortion and legal equality of homosexual persons— despite this going entirely against their moral values. In fact, the right much more vigorously opposed a minor tax reform pursued by the fourth centre-left government than the bill to legalize abortion at that time in three situations. The latter was mere lip service.

As a result, Chile was able to do away with the image of a banana republic in which the oligarchy needed nefarious individuals, in politics and in the management of the economy, to achieve its aims. In its new and more sophisticated domination model, military regimes —the traditional hedge against the threat from the majority— could become obsolete. Neoliberalism in its most sophisticated form.

The rapid economic growth during this period (that of strategy 2 and the start of strategy 3, see figure 8) gives support to Díaz Alejandro's (1983) anti-fundamentalism hypothesis, perhaps the greatest contribution of any Latin American to economic theory: that in terms of economic policy success, the nature of the policies is as important as the degree of support that they attract.



Meanwhile, most of my colleagues spend their lives discussing the absolute merits of their proposals, ignoring this simple truth. But when ideology alone is the leitmotiv of so many ideas...

From this perspective, the real challenge for the capitalist elite was that in order to sustain strategy 3 —and maintain that degree of support— it had to continue to deliver a high level of economic growth and trickle-down. That is, in order to continue to “manufacture consent” (Herman and Chomsky, 1988) this elite needed to show that its model could deliver sustainable progress and well-being.

However, reality inevitably caught up with strategy 3, as in a deregulated capitalist economy with such few compulsions (especially from the market), growth was bound to decelerate owing to the dominance of “easy” rent, and with it (in light of persistent inequality) so did the trickle-down effects.<sup>21</sup> Thus, GDP and productivity growth both slowed suddenly, particularly the latter, despite very favourable external conditions from 2002 onward (especially export prices and easily accessible cheap debt). In fact, productivity growth decelerated from 3.9% per year during the golden years of this model (between 1986 and 1998) to just 0.4% in the decade before the social unrest (see figure 8).

There is little doubt that in terms of the trickle-down effect and the well-being of the majority, strategy 3 failed miserably: in a country that had achieved a per capita GDP of US\$ 15,000 (US\$ 25,000 at purchasing power parity; World Bank, 2020) such a degree of inequality meant that in the final stages of strategy 3, the Chilean median net wage was not high enough to bring a family of four above the poverty line. And, as expected in this type of scenario, this median hides a huge gender gap: on average, women earned 28% less than men, meaning that in this case almost two thirds of these households would find themselves in such a situation.<sup>22</sup>

Bearing this in mind, a surprising aspect of this most unlikely of Nash equilibria achieved in strategy 3 —and in a democracy— is that while it was in effect, the majority could have quite feasibly improved its payoff if only it had agreed (while maintaining a minimum of collective action) on a different strategy. But, despite still having the support of half the population, the centre-left political parties were unable to rise to this challenge.

In fact, the idea that there was no alternative was deeply ingrained in the hegemonic consensus around strategy 3 and it synthesised the foundation of the Anglo-Iberian-style neoliberal discourse. This idea (which became taboo) had an amazing paralysing effect on the “new” left and on the majority of the population.

In Freudian parlance, the totem built around the supreme power of deregulated markets, giving them an almost supernatural significance —as a symbol erected as the emblem of the neoliberal tribe, which had been converted to a kind of animistic religion— coupled with the taboo against even imagining alternatives (after all, it was the end of history!) is one of the most effective ideological tricks ever.

Surely Gramsci must have felt vindicated. In a democracy, distributive struggles are chiefly won or lost at the level of ideology (supported by the power of social mobilization). Fundamentals? What fundamentals?

Also, as Albert Einstein emphasized (and Poulantzas (1975), following in the footsteps of Althusser, later theorized), even in natural sciences “Whether you can observe a thing or not depends on the theory which you use. It is the theory which decides what can be observed.”<sup>23</sup> And in economics this theory will also suggest the range of options for the econometric specification; and the circle can easily be closed, as in traditional econometric testing there is the problem of “too big to fail” —i.e. in very large samples, *p*-values decline quickly to zero. This can lead researchers to erroneously claim that the econometrics support hypotheses of no practical significance.

<sup>21</sup> On why capitalism needs markets that generate compulsions for its dynamic, see especially Wood (2002) and Khan (2005).

<sup>22</sup> See Durán and Kremerman (2020).

<sup>23</sup> Quoted in Heisenberg (1971, p. 63). Further “[...] as Einstein has emphasized, [...] deduction in [scientist’s] method runs not from facts to the assumptions of the theory but from the assumed theory to the facts and the [...] data. Consequently, theories have to be proposed speculatively and pursued deductively with respect to their many consequences so that they can be put to [...] tests. In short, any theory [...] makes more [...] philosophical assumptions than the facts alone give or imply (Northrop, 1958).



## VII. The strengths and weaknesses of strategy 3

One of the most significant questions concerning all of this is why strategy 3 could not be sustainable. Starting with its ideological aspects, the strengths and weaknesses of some of the ideas in the neoliberal discourse are nothing new. For example, they were already evident in an argument by Calicles (a character in Plato's dialogue *Gorgias*): "It is natural and just for the strong to dominate the weak, and ... it is unfair for the weak to resist such oppression by establishing laws to limit the power of the strong."<sup>24</sup>

In Calicles' opinion —as in the neoliberal critique of the post-war social democratic welfare state—, the problem (and what had to be reversed) had been that "the stronger, more aggressive and domineering by nature, had been defanged and domesticated by the new legal institutions of the weak *demos*."<sup>25</sup>

Calicles also tries to talk Socrates out of philosophizing:

For philosophy, Socrates, if pursued in moderation and at the proper age, is an elegant accomplishment, but too much philosophy is the ruin of human life. Take my advice, abandon argument. Learn the philosophy of business, and acquire the reputation of wisdom. ... Cease, then, emulating these paltry splitters of words, and emulate only the man of substance and honour, who is well to do.<sup>26</sup>

In sum —in the same way that the capitalist elite liked to preach to the "new" left during the transition to democracy— quit philosophizing, abandon argument, get real, do an MBA. It also helps if the rest of society can be convinced that the "dissident" camp was solely made up of pedantic doctrinaires.

The debilitating component of this discourse for the progressive forces vulnerable to the neoliberal pandemic is that abandoning philosophy and argument really meant ceasing to think critically.<sup>27</sup> The problem with critical thinking, of course, is that it is a distancing, even debilitating, activity. It distances us from conventions, from established assumptions and from settled beliefs. It takes what we know from familiar, unquestioned settings and makes it strange. And it does so not by just supplying new information, but by inviting and provoking a *new way of seeing*.

The risk is that once the familiar becomes strange, it is never quite the same again. However unsettling, there is no way back; it can never be un-thought or un-known. And as many of the left in Latin America know only too well, there are also huge risks involved, both political and personal. One way to avoid these risks (particularly after so many disappointments and so much terror) is through evasion: scepticism. Although, as Immanuel Kant (1998) reminds us, a period of scepticism can be a resting place to reflect upon previous dogmatic wanderings, to remain there is simply to give up on moral reflection.

The point here, of course, is that —despite the oligarchy's delusions of supremacy deriving from some moral right they convinced themselves they had— the stronger are not so because of nature but because of the environment. This is a core issue of the Darwinian insight into progress whereby a subset of members of a population may come to flourish relative to other members simply because they possess a feature, which others do not, that may render them better suited to some specific local environment. The question of the intrinsic worth of those who flourish most is part of this story (Lawson, 2003).

<sup>24</sup> See [online] <https://www.gutenberg.org/files/1672/1672-h/1672-h.htm>.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> See Palma (2016b).

This leads to a crucial component of my understanding of the deeper meaning of neoliberalism: a conscious and deliberate attempt to create a specific and artificially constructed economic environment that favours those features that capital possesses and others do not. An environment in which a mobile and malleable agent could achieve unassailable dominance, the success of which then also creates a seductive force that feeds this ideology.

Following on from the dilemma presented by Hirschman (1970) between exit, voice and loyalty, it could be argued that one reason for the capitalist elite's dominance is, in that scenario, they are the only ones with a credible exit strategy: easy access to mobile financial assets provides an feasible exit strategy. Hence, the threats they make in the distributional game are even more credible under that scenario. Here we can consider the metaphor of someone playing in a football match who tells the other players that either he will play the role of centre forward or he will go home and take his ball with him. Surely this is not the best scenario for building an effective team.

Another metaphor would be a puzzle in which a few large pieces can freely decide what shape they would like to take, while the rest would have to change their shape in order to fit. Or, according to the great Argentine cartoonist Quino, it is like a game of chess in which the oligarchy can checkmate its opponents whenever it likes, whatever its position on the board, which also would make the game rather boring —and the winner easy to predict.<sup>28</sup>

However, at least having an easy exit strategy is precisely what helps Latin American oligarchies to become more democratic —they can take the risk as in the new international order they no longer need to be geographically tied through fixed investments (such as land in the past).<sup>29</sup>

Although the core of their accumulation will always be their home country (such as the purely extractive side of commodities or domestic finance) —it being difficult to find other places that offer these levels of returns— they can now conveniently operate in a geographically diversified portfolio. Thus, the more money they have in tax havens, the nicer the mansions in Palm Beach (hopefully as close as possible to Mar-a-Lago) and the more investments they have in neighbouring countries, the more credible the threats in the national distribution game.

In Chile, for example, and according to balance-of-payments statistics, the assets of the international investment position of the financial and non-financial private sector (not counting private pension funds) reached US\$ 383 billion in 2018 —about a third larger than that year's GDP (Central Bank of Chile, 2020). The foreign currency component of overall debt of non-financial corporations reached one third of GDP (about US\$ 100 billion) —with the exception of China, the largest among all emerging economies (as a share of GDP) (Avdjiev, McGuire and von Peter, 2020). However, as opposed to China, there is little to show for it in terms of domestic investment, technological absorption, product diversification and productivity growth, because instead of investing at home, most of these funds were used to finance capital flight in the form of shifting productive capacities to neighbouring countries.

Hence the assets emerged abroad while the debts were kept at home, with, as they have learned from history, the implicit government guarantees to which they have become accustomed.

This “development” strategy may already be obsolete, and has been for some time, but until the social uprising in 2019 it was supported by an odd political settlement, characterized by the interaction among an insatiable capitalist elite —but one that was risk-adverse in production matters, or as Keynes would say, lacking in “animal spirits”— a captured progressive intelligentsia, passive citizens and a social imagination that had been paralysed by the absolute certainties of the new prevailing hegemonic ideology, the ghosts of the past and the disasters of alternative experiments in the region (Palma, 2016a).

<sup>28</sup> See (available in Spanish only) [online] <http://ajedrezzenlaunla.blogspot.com/2012/04/quino-y-el-ajedrez.html>.

<sup>29</sup> See Boix (2003) and Palma (2019a).

Another helpful component for domination by the oligarchy in all this is the fact that in the Ibero-American tradition, societies are often run by huge State apparatuses of faceless bureaucrats prepared to passively follow whatever ideology is the order of the day, no matter how economically inefficient these ideologies may be. The civil service in these countries is starkly different from Weberian ones, such as that seen in the Republic of Korea, Taiwan Province of China or Singapore (among other examples).

In fact, a paradigmatic example in Chile of this Ibero-American syndrome of faceless bureaucrats is the way in which the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (generally known as TPP-11) was negotiated by the relevant bureaucrats,<sup>30</sup> who seemed to be convinced that their professional role was merely to follow the commandments of the dominant ideology. As Primo Levi (1986) emphasises, the truly dangerous people are “the functionaries ready to believe and to act without asking questions”.

In short, in strategy 3 there could be only one distributional winner, a rapid rate of economic growth in the 1990s, the trickle-down gains from multiple financial bubbles (including residential real estate) and easy access to credit initially helped confirm the potential of strategy 3, and facilitated popular support for the discourse of deregulated market supremacy.

This support even continued after the economy slowed and the trickle-down dried up. So much so, that right-wing parties even won a presidential election for the first time in over half a century, after more than a decade of economic deceleration. It seems that the memories of successes last longer than those of failures, in the style of a system of adaptive expectations, whereby the former (successes) tend to create a longer-lasting memory.

## VIII. The limitations of rent-seeking capitalism: from strategy 3 to strategy 4

As I said in the dedication of this article to Maradona, and as Freud taught us, our life force mixes with our instinct for self-destruction. In Chile, as in the rest of the world that is captivated by the absolute certainties of neoliberal ideology, the paradise for the elite linked to strategy 3 was temporary (while episodes of hell seem to be slightly more resilient). Because of its very nature, the elite did not really have a high probability of winning indefinitely with this strategy.

In the words of Abraham Lincoln, the Achilles heel of strategy 3 was that “you can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time” that there is no alternative. The deceleration of growth and the trickle-down effect would ultimately play a crucial role in this. The social uprising in October 2019 finally sent strategy 3 to its resting place. It had achieved its goals for the elite, but had become counterproductive, and was finally drowned by a tsunami of discontent.

The key question is why the success of strategy 3 was also its worst enemy. In my opinion, the crucial point may be found in Ricardo's work: the natural limitation of this amenable rent-seeking capitalism (which, in Palma (2019b) I called “cosy-capitalism”) is that the capitalist elite starts taking cosiness for granted. The supremacy of “easy” rent (at the expense of operating profits for doing something that is of use to society) makes investment, product diversification, technological absorption, productivity growth and so on, become optional extras (see figure 8). For the elite, their huge share of national income becomes a source of enjoyment (including the financial casino and capital flight), rather than the fuel that powers new engines of productivity growth.

<sup>30</sup> See Palma (2018).

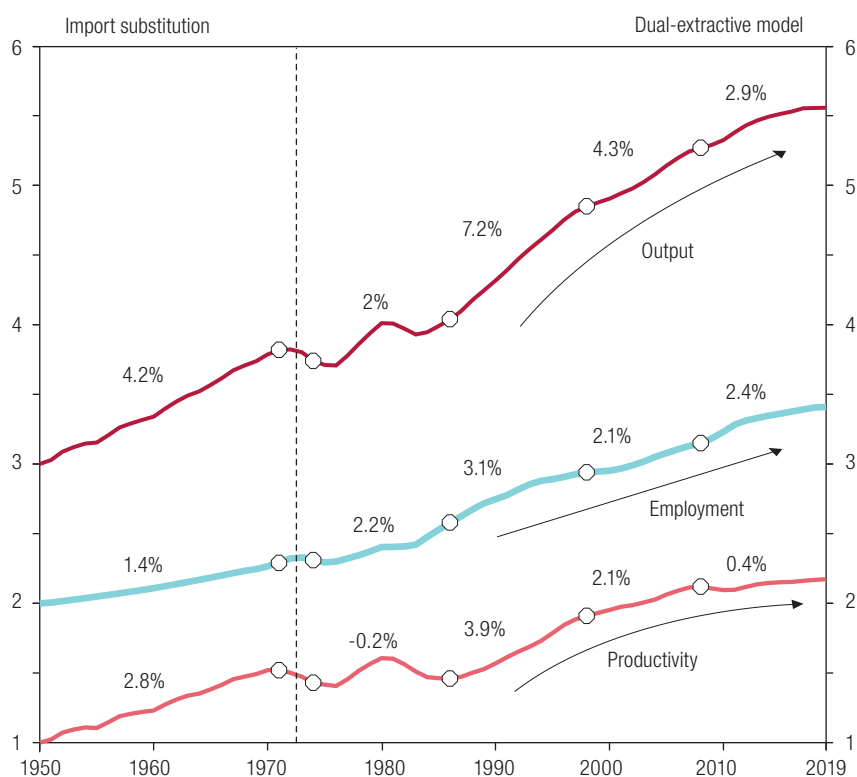
There also needs to be a continuing supply of poor (either nationals or imported as immigrants), because as the epigraph from Voltaire tells us, the comfort of the rich depends on an abundant supply of poor.

As Keynes (1920) said, when analysing the success of late-nineteenth century emerging economies, such as Germany and the United States “The new rich of the nineteenth century ... preferred the power which investment gave them to the pleasures of immediate consumption. ... Herein lay, in fact, the main justification of the Capitalist System. If the rich had spent their new wealth on their own enjoyments, the world would long ago have found such a regime intolerable”.

Intolerable indeed! That is exactly the greatest challenge that neoliberalism faces as a technology of power: it wants to achieve the opposite of all of that, but transforming that which is (inevitably) intolerable into something tolerable, and doing so within democracy.

Figures 1, 4 and 7 summarize the distributional outcome of strategy 3. Figure 8 shows their impacts on the real economy: in “cosy” and rent-seeking capitalism, cosiness for the elite and the challenges of dynamic markets do not mix well. Cronyism, or the ever closer and mutually advantageous relationships between business leaders and centre-left government officials, did not help either, as it enabled transformed strategy 3 into an extreme version of North’s “limited access order” capitalism.<sup>31</sup>

**Figure 8**  
Chile: GDP, employment and productivity, 1950–2019  
(Percentages)



**Source:** The Conference Board, “Total Economy Database: key findings”, 2020 [online] <https://www.conference-board.org/data/economydatabase/>.

**Note:** Each series is an index number (log scale), with base 1 in 1950 for productivity, base 2 in 1950 for employment and base 3 in 1950 for GDP. The dual-extractive model is the development strategy followed by Chile since its neoliberal economic reforms.<sup>32</sup> Productivity refers to output per worker. Three-year moving averages.

<sup>31</sup> North and others (2007).

<sup>32</sup> See Palma (2019b).

Figure 8 confirms the idea that although neoliberalism may well have become one of the most effective technologies of power ever, it had its Achilles' heels: its preference both for an economic scenario in which there were few market compulsions for big capital. The supremacy of inefficiency rent, such as that from market failures and distortions, also needed a "subsidiary" State, which instead of "disciplining" the capitalist elite (for example, to invest a large share of their income in activities with significant potential for long-term productivity growth), is instead disciplined by the elite. In other words, as a company manager might say, Chile become a market economy in name only (Lamarca, 2009). "Capitalism" of this kind (easy rent for the elite, capitalism for the rest) inevitably led to stagnant productivity growth. In the country, average annual productivity growth was just 0.4% over slightly more than a decade before the social unrest of 2019, in line with the average for the region since 1980. What sets Chile apart from the rest of the region is essentially that it had its golden extractivist age in the 1990s, but wasted that energy later.

If capitalism is what you want, as Keynes insisted, you must save it from this type of purely rent-seeking capitalists by implementing alternative strategies for national development and autonomy. To do this, a State is required that seeks to inject dynamism into an economy (Keynes, 1936, vol. I), and helps to coordinate investment (chapter 12). In other words, a disciplinary State, rather than a chastised State. This is the key to emerging Asia's success.<sup>33</sup> But in the Chile of strategy 3, with its chastised and subsidiary State, no such development agenda was in sight.

As figure 8 shows, GDP growth decelerated rapidly during the period of strategy 3, almost entirely due to the collapse of productivity growth (from an average of 3.9% per annum to just 0.4%); that is, to the point that creation of cheap jobs (mostly in traditional service sectors and construction, which accounted for 80% of the labour force, and with their traditionally low potential for long-term productivity growth) became the only driver of GDP growth for this capitalism that was increasingly "cosy" for the elite. The political and economic impact of this was overwhelming, proving Krugman (1994) right: "productivity [growth] isn't everything, but, in the long run, it is almost everything".

So much so that when the country inevitably ran out of cheap labour —as traditional services and construction had absorbed it at a rate between two to three times higher than the (low) population growth— the capitalist elite faced a historic crossroads. This was exactly the same crossroads as had been faced by every current developed country at a similar level of development. The crossroads offered two options. The first was to confront the lack of cheap labour, and the inevitable rises in wages, increasing productivity by updating the development strategy —in the case of Chile, by modernizing its dual-extractive model by searching for new engines of productivity growth, such as the industrialization of commodities or a green new deal. The second option was to simply opt for "more of the same" by filling the labour market with cheap labour through a new policy of mass immigration from neighbouring countries.

There are no prizes for guessing what happened to the cosy and amenable capitalism of strategy 3. Instead of accelerating productivity growth, they preferred "more of the same", with an abundance of cheap labour. The mass influx of immigrants that followed (so far equivalent to about 10% of the labour force) was generated by incentives from Chile, not by external factors (pull factors, not push factors). That is to say, it started with deliberate changes in immigration policy, not with political disturbances in neighbouring countries.

Most immigrants came legally, by plane into Santiago's main airport (often on special chartered flights). This phenomenon created a paradise for human trafficking gangs, which organized the logistics, transport and paperwork, then profited from the horrific conditions in which many of these immigrants ended up living in Chile. All immigrants needed to get a tourist visa when arriving in Chile was the return

<sup>33</sup> On how Republic of Korea did this during its process of industrialization, see Chang (1993); for Taiwan, Taiwan Province of China, see Wade (2003). For a summary, see Palma (2019a, figure 22).

plane ticket, an identity document, and a little cash (to prove that they were “tourists”) —all of which were often provided by the very same trafficking gangs. A labour contract —again, sometimes provided by the same gangs— would then suffice to swap a tourist visa for a work and residence permit.

Moreover, no one pushing for the new immigration policy seemed to have worried about the lack of housing or the limited availability of health services, education, transport, and all the basic services which would be desperately needed by these immigrants (Palma, 2019b).

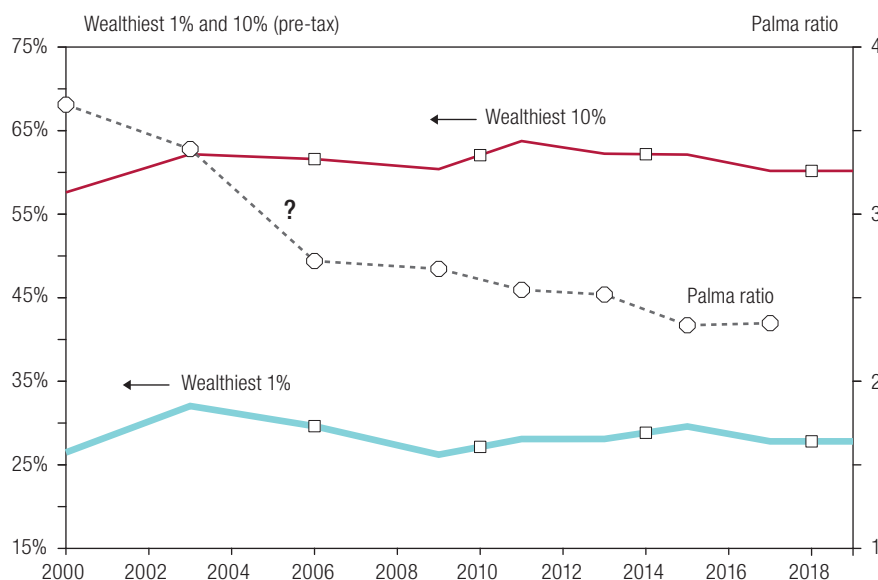
Hence, a growth model based on an abundance of cheap labour and no productivity growth (and continuous horizontal diversification abroad in production matters) could be maintained. Turning again to Voltaire, the comfort of the rich also depends upon an abundant supply of the poor in the production sphere.

It was precisely this “more of the same” that meant the neoliberal model was totally unable to update itself when its existing engines of growth (mere extraction of commodities and cheap services) had run their course. “Cosy-capitalism” —and its limited access order— had become self-destructive. The oligarchy has no one but itself to blame for strategy 3 having become contrary to their own long-term interests.

This inertia of insisting on “more of the same” —i.e. the resistance of the status quo to changes in its state of rest— and calm inaction reminds us of Conrad novels in which, as in so many sea stories, the main enemy of creativity is stasis. It is, in fact, the deadliest thing of all (Segal, 1997).

Finally, and as opposed to what household surveys indicate (figure 7 and Ministry of Social Development and Family Affairs, 2020), new tax data indicate that strategy 3 was far more distributionally successful for top earners than had been believed so far —casting further doubts on Chile’s supposed declining inequality (see figure 9).

**Figure 9**  
Chile: shares of pre-tax income of the wealthiest 1% and 10%, and post-tax and -transfers  
Palma ratio, 2000–2019



**Source:** World Inequality Lab, World Inequality Database, 2020 [online] <http://wid.world/>, on the basis of M. De Rosa, I. Flores and M. Morgan, “Inequality in Latin America revisited: insights from distributional national accounts”, *Technical Note*, No. 2020/02, 2020 (for pre-tax income); and J. G. Palma, “Behind the seven veils of inequality: what if it’s all about the struggle within just one half of the population over just one half of the national income?”, *Development and Change*, vol. 50, No. 5, September 2019 (for the Palma ratio).

**Note:** Circles indicate years that the main household survey (CASEN) was carried out; squares indicate presidential periods.

If the share of the wealthiest remained basically stable during this period, a drop in the Palma ratio of this nature (especially towards the end of the presidency of Ricardo Lagos, see the question mark in figure 9) would have needed an increase of the share of the bottom 40% of about twice the level reported in household budget surveys. It is difficult to believe that in a country with such a low and regressive system of taxation, the supposed post-tax drop of the income shares at the top, as reported in the surveys, is anything but the growing inability of these surveys to capture the income of the rich in this growingly financialized —and “tax-havened” world.

In sum, even though strategy 3 did become an abject failure in productivity matters, in the medium term it was remarkably successful for the rich in distributional ones —until an outburst of popular discontent put a sudden end to it with a display of social power not seen in Chile since defeat of Pinochet in his 1988 plebiscite. The power of the young (enraged by the hopeless future on offer under this strategy), and the feminist movement (which had had enough of gender abuse and discrimination at every level)<sup>34</sup> —not helped by violence from a large group of young people who have marginalized themselves, who neither study, nor work nor look for work— broke the neoliberal ideological spell: the emperor (who proclaimed “there are no other options”) had no clothes.

## **IX. Strategy 4: from the elite’s “preferred” distributional strategy (number 3) to a (somewhat desperate) search for peace in society through a substantial increase in social protection (towards the European “new social democracy”)**

Although this new distributional switch involves many issues, there can be little doubt that the key one is economic reality making it clear that in strategy 3 the supremacy of easy rent led to a lack of production growth. Also, new technologies of social communication have helped improve social cohesion among the majority and have amplified their “voice” (as referred to by Hirschman). Previously, the elite’s greater capacity for collective action due to its internal cohesion contributed to it having the upper hand in games of chicken; but new communications technologies have changed that. As the social unrest in Chile demonstrates, these new technologies have been a game changer.

The explosion of social unrest in October 2019 was quickly followed by the emergence of the pandemic, which provided a distraction from the social discontent for a while. However, as poverty and unemployment grew rapidly, while the centre-right government struggled to respond, this distraction was short-lived. The fact that almost all the great fortunes continued to expand as in the best of times (helped by the “perpetual mania” of the financial casino (Palma, 2020b)) became insulting to the majority of the population. When the plebiscite was finally held in October 2020 on whether to change Pinochet’s Constitution, it gained 80% support.

From the perspective of this work, one of the key impacts of the pandemic was to throw all kinds of inequalities into stark relief. For example, while in a middle-class neighbourhood (Ñuñoa), the two main reasons for requesting a permit to leave the house during lockdown were to go to the supermarket and to walk their (pedigree) dogs, in a working-class neighbourhood (La Pintana) these

<sup>34</sup> Its slogan, “El Estado opresor es un macho violador” (The oppressive state is a rapist macho) said it all (<https://www.youtube.com/watch?v=tB1cWh27rml>).



permits were mainly requested to attend funerals and visit relatives in penal institutions. In addition, low Internet coverage (13%) forced people from the neighbourhood to leave their homes even if they could work or study from home.

The combination of the explosion of discontent and the pandemic led to great anxiety — and in many cases outright panic — among the elite that Chile would once again be politically unmanageable as soon as there was some resemblance of normality. For a respected right-wing analyst, for example, the greatest fear was neither the coronavirus, which would pass although it would claim many lives, nor the imminent economic debacle, which would also ultimately end. His greatest fear was an unmanageable social group that had abandoned the basic rules of communal life.<sup>35</sup>

Faced with these uncertainties and challenges, some politicians and business leaders saw the discourse of European “new social democracy” as a way out of their strategic impasse, hoping that it could ensure a minimum of social protection and peace (strategy 4).

For example, the presidents of the main business associations, contradicting everything that they had preached for generations (especially since the neoliberal reforms), began to idealize a European-style new social democratic model.<sup>36</sup> Even some intellectuals from that political orientation began to publish social democratic manifestos to prevent future governments from moving from one social uprising to the next (Weissbluth, 2020). A former finance minister of Chile's current right-wing government, who is now a presidential candidate, expressed a similar opinion. Another candidate for the next presidential election (one of the “Chicago Boys” and a former favourite of Pinochet) also, for the first time, defined himself as a social democrat — and even said he was in favour of a stronger State capable of guaranteeing social rights (*El Mercurio*, 2020).

Not surprisingly, some on the “new” Left were furious, claiming that this was a serious infringement on their intellectual property rights!

Strangely, it is the inconsistencies between the economic and social agendas of the European new social democracy (see Palma, 2019a) that made strategy 4 so attractive to those who sought inertia in the status quo, but with peace in society (see annex A2). While the economic agenda is seemingly aimed at delivering more of the same, the new social agenda could give a new lease of life to their now fragile neoliberal model. Furthermore, they have an ace up their sleeve: in this financialized world, instead of having to pay for the extra social protection with new taxes, additional public sector borrowing can always save the day. Therefore, for the business community a switch to strategy 4 could be a win-win situation; it could re-establish the legitimacy of the neoliberal rentier model by making it a bit more civilized, and public bonds (instead of taxes) could finance the much-needed social peace, fighting poverty and providing a minimum degree of equity. How had this not occurred to them before?

Basically, it would be a way to square the circle: powerful agents could continue to manipulate the product and financial markets at their pleasure (including continuing to extend the market into hitherto unacceptable, even inconceivable, spheres of social life — those that have already generated some of the most inefficient activities in the economy), and deficit spending could facilitate the herd immunity necessary for social peace.

From this perspective, the new strategy makes complete sense, and the dwindling number of people within their group that still reject it are largely driven by the self-destructive power of fundamentalism. The most attractive element for the more enlightened right wing is that this new alternative, together with offering a minimum of social peace and some equality, allows them to maintain the Buchanian aspects of their model, of which Pinochet's Constitution and its “handcuff laws” (agreed with the centre-left during the transition to democracy; see annex A1) are a paradigmatic example. The bill currently in the Senate to support the aforementioned “TPP-11” agreement is another classic example (Palma, 2021).

<sup>35</sup> See [online] <https://www.latercera.com/opinion/noticia/el-miedo/SS57SUH65JGWXEE4VDXJD5N2W4/>.

<sup>36</sup> See, for example [online] <https://interferencia.cl/articulos/entrevista-juan-sutil-desde-el-punto-de-vista-social-probablemente-chile-tiene-que-avanzar>.

For Buchanan (1993), those who really needed social protection were big businesses and their property rights could only be guaranteed by imposing constitutional guarantees. Buchanan had a rather paranoid view of society, whereby there was an eternal conflict between “creators” (entrepreneurs) and “looters” (everyone else), who would constantly besiege the former. In his work he repeatedly warns of the danger of parasites and predators besieging innovators, who must therefore be given social protection through constitutional limits to change.

As in the rest of Latin America, in Chile this Buchanian influence has also permeated the ideology of the “new” left. Since the transition to democracy they have spared no effort in apologising for their “predatory” past (e.g. having been in favour of agrarian reforms, nationalization of natural resources, and so on). This has also occurred in Chile with the Christian Democratic Party. In the 1960s its first President, Eduardo Frei Montalva, had an economic agenda which was closely coordinated with the social agenda: agrarian reforms and the partial nationalisation of large copper mines went hand in hand with policies for social protection and social empowerment (the famous “Promoción Popular” policy). However, in the 1990s, during the presidency of his son Eduardo Frei Ruiz-Tagle, while the social agenda remained similar to that of Frei senior (although implemented in a more consultancy-intensive way), the economic agenda tried to build a future opposite to the past. And since these agendas pointed in opposite directions, they obstructed each other.

Moreover, the support from most of the centre-left for these constitutional barriers to defend the property rights of “creators” is provided despite the rather uncreative way in which so many of these supposed innovators acquired their assets: by pillaging public corporations and natural resources during the highly corrupt neoliberal reforms, with access to the plunder restricted to courtiers of the regime and relatives of the dictator.<sup>37</sup>

The question, of course, is whether in Latin America this new strategy 4 will achieve its goal of being an effective and sustainable mechanism to make a traditional neoliberal economic agenda compatible with a more civilized (social democratic) social agenda as it has been so far in Western Europe. Asymmetries of this kind are surely more fragile on the periphery than in the centre.

Also, strategy 4 may have arrived too late in Latin America, as did the aristocratic concessions in late eighteenth-century France. Latin American oligarchies will surely need “fancy footwork” and the appropriate collective action to make this new strategy work. It remains to be seen how all of this will play out.

## X. Conclusions

This paper tries to answer the question of why it is so easy for the rich to stay rich, no matter what the rest of society wants. In analytical terms, it contrasts the neoclassical vision, which stresses that the huge inequality in Latin America is a result of natural interactions between a number of “fundamentals” that are essentially economic and somewhat exogenous, and the Ricardian vision, in which the key lies in the structure of an antagonistic distribution conflict between rentiers, capitalists, bureaucrats and workers. This reflects both the particular interactions between power structures and market failures, and the capacity of a society to choose between alternatives in a world of multiple equilibria. In this, history, politics and institutions are equally as important as economic “fundamentals” or even more important.

Within this perspective, the analytical challenge is how to draw back the veils obscuring these interactions and distorting our vision of the self-constructed nature of its inequality.

Therefore, rather than thinking (as in most neoclassical narratives) about the possible concrete effects that known factors may have on inequality (e.g. technology, social mobility, education, and so on), it would be more illuminating to try to understand the concrete expressions that these factors may

<sup>37</sup> See, for example, Mönckeberg (2015), Gárate Chateau (2012) and Palma (2013).

find in actual situations of inequality, such as Chile's. In fact, some of the pieces of the distributional puzzle may well be the same in different circumstances, but the way they fit together may differ —sometimes significantly.

As I first discussed in Palma (1978) and later developed in (2016b), the analytical challenge in subjects such as inequality is not about building “mechanico-formal” theories that supposedly explain it all in a generic way. It is about developing methodologies for the analysis of concrete situations of phenomena such as inequality (the main aim of this study).

It is obvious that the capitalist economy tends towards a greater level of inequality and not just because of neoclassical issues such as Piketty's<sup>38</sup> “ $r > g$ ”, but because the elite, with its material power, ideological hegemony, strategic flexibility and internal cohesion, has the option to construct several routes to get the same advantages in the distributional struggle. It is also obvious that we are embarked on a process of growing internationalization and financialization, that societies are divided into key antagonistic groups, and that the particular is to a certain extent conditioned by the general. Essentially, the question we must ask ourselves is therefore why with these premises we have not gone beyond a partial —and therefore abstract— characterization of the phenomenon of inequality. The next step has yet to be taken: connecting the analysis to the specific, real-world situations of inequality.

A key lesson from the complex Chilean experience of distribution is the insight it provides into the fundamental problem with neoclassical thinking: it has never been able to break away from its original sin, of considering income distribution to be the natural (and somewhat mechanical) outcome of the relative value of marginal productivities (Solow, 1956). Furthermore, in that analysis, technology, preferences and factor endowments are assumed to be “givens” and history, institutions and politics are optional extras.

For example, although Chile has the same per capita GDP and the same average wage as Croatia (World Bank, 2020), it has a median wage that is only half Croatia's (Durán and Kremmerman, 2020). Surely this is not because some predetermined “fundamentals” have forced Chile to have such wage inequality. Here, the core issue is of choices between real alternative means of doing things. There has been enough assuming that we are innocent bystanders at the mercy of exogenous distributional forces.<sup>39</sup> And this choice, of course, is not taken in a vacuum, but within the parameters of the interaction between our history, politics and institutions with some of those fundamentals and market failures and distortions. As previously suggested, the critical factor is the agency, but for any agency to succeed, it must understand the structure.

Surely no predetermined force has compelled us in Chile (with its high middle-income level) to have a median net wage that is unable to bring a family of four above the poverty line. And all this in a country that likes to think of itself as *ad portas* to becoming a “developed” one —a good example of wishful thinking bordering on the delusional.

In other words, nothing reveals more transparently who we truly are in Chile as a society than the inequality we collectively choose to construct. The bottom line is that in Chile, as in most of the world, we deserve the inequality we have (Palma, 2016a). And this is as self-defining an act as it can be!

For example, Chile spends twice as much as Croatia on education and 50% more on health care, in terms of its percentage of public expenditure, and its tertiary enrolment is one third higher; it has a much higher rating in Moody's (A1 vs. Ba1), S&P (A+ vs. BBB-) and Fitch (A- vs. BBB-); it has a much lower level of corruption in traditional rankings; its State is less “fragile”; and it has a much better balance-of-payments position, and so on, but its Palma ratio is 2.8 (and Gini 48), while in Croatia the Palma ratio is just 1.1 (and Gini 31) (World Bank, 2020).

<sup>38</sup> Where “ $r$ ” is the rate of return on capital and “ $g$ ” is the growth rate of an economy.

<sup>39</sup> For a critique of neoclassical distributional models, and of their econometrics —especially on the use of the Gini index as a dependent variable, leading to misspecification and endogeneity— see Palma (2019a).

Perhaps the fact that its rate of homicides per 100,000 inhabitants (although very low by Latin American standards) is four times higher than Croatia's is a much more telling indicator of how inequality is self-constructed in Chile —and the way in which conflicts in general are articulated— than what rating agencies can tell us about both countries.

Another vital lesson from the Chilean experience is that in countries with artificially-constructed high levels of inequality, most of the routes available to the elite to get the upper hand are associated with an economic inefficiency. Markets are distorted to create excessive inequality and then (with the exception of very specific situations, such as that of Chile in the 1990s) the “excess” does not even return to the economy in the form of production (investment).

Mostly (but certainly not entirely) because of this, these routes or strategies become losing games if played indefinitely. Therefore, the secret for the elite is to be flexible and internally cohesive enough to play a sequence of losing strategies that wins —i.e. Parrondo's paradox. Perhaps Chile's greatest contribution to the analysis of inequality is that both phenomena —the relationship between self-constructed inequality and economic inefficiency, and the paradox— have taken place in a fairly transparent form.

And on the subject of OECD countries, no exogenous force has led them to “bananize” their market inequality (see annex A2, figure A2.1); the crucial issue is taking responsibility for our distributional choices. Germany's market inequality (and that of almost all high-income OECD countries) is not just “reverse-catching-up” with the tropics, but even surpassing almost all of Latin America. Clearly it was their choice, and one that self-defines their current political configuration.

So, life is no longer that easy in high-income OECD countries now, with not only a family to support, but also an oligarchy. It is all too tempting to say “Welcome to the Third World!”.

In turn, Latin America's Southern-style distributional situation has thus far proved to be something of a “stationary process”: their defensive “fancy footwork” against potential unbalancing events has been up to the task. Political shocks —such as the financial crisis of 1982 when Chile's GDP fell by 20%, unemployment surged to 30%, and half of the population fell below the poverty line, or the impact of the return to democracy— have therefore only had a short-lasting impact (the strength of which has waned rapidly).

Thus, in this “Gattopardian” stationary mode, in the event of destabilizing occurrences, almost everything has been allowed to change so that everything that matters to the elite can stay just as it was. The key question for Chile is whether the same will happen with the October 2019 social upheaval, which is now mixed with the pandemic and the new constitution. Or perhaps it will be the blow that finally has a more permanent effect on the process of accumulation and domination. In short, will these impacts transform everything into something of a “unit root” process, whereby such impacts do not decline in strength over time?

What is at stake is whether strategy 4, and the elite's new social agenda, will be able to repeat the “Gattopardian” trick. That is the “known unknown” of today's Chile and of other parts of the region.

Another mystery is how this oligarchy can be so flexible in its response to distributive impacts, and revise its strategy to revert them, while in economic matters it has been so rigid. Indeed, it is still stuck in a glaringly obsolete 1970s neoliberal model, based on the early, primitive version of the Washington Consensus. If in one sphere they are the masters of “political articulation”, in the other they have shown the manoeuvrability of an oil tanker.

The economic challenge that the countries of the region face is a titanic one: as discussed above, the fundamental problem with Latin America's current economic agenda is that it is very hard to reshape the component parts of the structure of an economic system with so little entropy; in other words, if there is a prerequisite that the fundamentals of the status quo cannot be changed, there are

very few ways to move forward. If those at the top want to continue taking the lion's share for seizing low-hanging fruit, they must expend a lot of energy to “freeze time”. As a result, little energy is left for moving towards more flexible structures in which these rigidities can be “disturbed”, seeking to rearrange the components into more imaginative (and efficient) structures.

On the subject of “disturbing” rigidities to rearrange components in more imaginative ways, the European new social democracy also faces a key challenge of this nature from its social protection system.

Furthermore, this time the help of the new left is not as useful as it was during strategies 2 and 3, as this group has lost most of its political clout. As already mentioned, for Adorno (1951), this is no minor point, as domination is so much more effective when the oligarchy “can delegate the ... violence on which it rests to the dominated”.

As analysed in Palma (2020a), Latin America is now trapped in what I call a “Gramscian Moment”, when the old fades, but the new fails to be born —i.e. when the elite and its “model” lose their legitimacy, but alternative discourses have so far been unable to gather sufficient credibility. In this interregnum, as Gramsci (1992) warns us —and as many in Latin America are experiencing first-hand, especially in Brazil— it is almost inevitable that a “a great variety of harmful symptoms” will appear. Part of the problem is that the region's neoliberal inertia has also stifled its social imagination (Palma, 2016b).

In sum, had the Latin American elite's plasticity in matters relating to its distributional strategy been replicated in the economic sphere, its economy (and more) would not be trapped ever deeper in the quicksand of inertia —my definition of a “middle-income trap”—, of which Chile is a paradigmatic case (Palma, 2019b).

The Freudian opposition between the instinct toward survival and the self-destructive drive seems to play out rather transparently in the spheres analysed in this article —particularly in the recurrent conflict between the Latin American elite's enormous “ability to persist” and its self-destructive rent-seeking drive.

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## Annex A1

### 1. The Latin American “new” left

In essence (for a more detailed analysis see Palma (2016b)) the key to the capitalist elite’s distributional success —aside from de facto political power, effective lobbying power, the ability to solve its own problems of collective action, and shrewd political alliances with the middle strata— has been a capacity to build hegemonic consensuses around its ideology and praxis. The “new” Left is just one of its casualties.

It is partly because of this that in Latin America and many other parts of the world the “new” left is characterized by having concluded (a little too eagerly) that, with current domestic and international parameters, it would not be possible to form alliances with enough support to implement progressive economic agendas.

The history of the South teaches us that such agendas require backing from a substantial majority (everything suggests that simple majorities are insufficient) to be able to take on all the international and domestic forces that are customarily compulsively opposed to them. This constituency is required, for example, for the State to be able to impose discipline on capitalist elites (and sometimes on workers) so as to be able to build an economic agenda that brings high levels of efficiency and low levels of inequality in the sphere of production (such as those found in the Republic of Korea and Taiwan Province of China (see figure A2.2)).

In some cases —such those led by Nelson Mandela in South Africa, Lula da Silva in Brazil, and Patricio Aylwin and Ricardo Lagos in Chile— centre-left coalitions in the South have had clear opportunities to build those alliances and garner that support. However, they forsook their progressive economic agendas too easily and abandoned the economy as the cornerstone of the economic debate. Ultimately, they conceded on almost all the points of the economic and distributional debates. In other words, because the “new” left believed it could not obtain enough power to implement its own economic agenda, it tried to gain power to implement someone else’s, but more efficiently and with a human face. It thus sought political power to implement what Francisco de Oliveira (2003) christened an “upside-down hegemony” or what Paulo Arantes (2007) called an “inverted utopia”.<sup>40</sup>

Throughout Latin America, but especially in Chile and Brazil (and also in South Africa) an “urgent needs” argument was used by the “new” left to justify abandoning its economic and redistributive agenda for “prudent” policies (i.e. policies that were acceptable to the dominant groups in the market).

Ultimately, according to Sartre’s (2004) concept of *mauvaise foi* (bad faith), this was an exercise to deceive others and themselves into believing that transformation of society had become the ultimate unacceptable risk. Thus, a key component of the “new-look” pragmatism was never to say or do anything that could wake the ghosts of the past (see Arantes, 2007).

Reportedly, when Margaret Thatcher was asked what her greatest political achievement was, her answer was clear-cut: transforming the Labour party into the ‘New’ Labour Party of Blair and Brown.<sup>41</sup> Pinochet (had it occurred to him) could have said the same about the “new” left in Chile. These are good examples of how neoliberals succeeded in “manufacturing consent” as Chomsky describes. The most telling sign of neoliberal success at this, particularly in the economic sphere, as Žižek (2008) reminds us, is when the “new” left started “telling stories of others as if they were one’s own”.

Part of this strategy was to relay this story, disguised as a “third way”, to their base, to the capitalist elite and to international financial markets. This also justified their initial reluctant acceptance of the neoliberal model. What was most amazing about this was how easily this narrative convinced the storytellers themselves.

<sup>40</sup> For more detail on how the Latin American “new” left has lost its ideological compass, see Palma (2016b).

<sup>41</sup> See [online] <https://www.independent.co.uk/news/uk/politics/margaret-thatcher-s-legacy-spilt-milk-new-labour-and-big-bang-she-changed-everything-8564541.html>.

## Annex A2

### 1. Post-war social democracy vs. the post-Thatcher and -Reagan “Third Way”

In post-war social democratic thinking, and even before the end of the war (such as in the meeting at Bretton Woods), there was one key idea: the only effective way out of the disaster was “to restructure to reactivate”. This same idea is the most relevant to Latin America’s current situation (Palma, 2020a). This notion called for new economic and social agendas that were closely interlinked and enhanced by interaction. This symmetry between the two agendas in the post-war period became the hallmark of this strategy, and one of its main strengths. Conversely, asymmetry between the two became the defining trait and greatest weakness of “version 2.0” of this strategy in post-1980s neoliberal Europe. The economic agenda would point in one direction, and the social agenda in the other.

### 2. The neoliberal crosscurrents of the 1970s

One way to visualize the resurgence of neoliberalism during the 1970s is that the stagflation post-1973 awakened the destructive power of fundamentalism; those who worshipped unfettered market forces had been dreaming of their chance to revenge the success of the Rooseveltian-Keynesian “heresy”. What neoliberals truly feared was that that success would destroy belief in free markets, threatening analytical chaos that would destroy understanding and eliminate meaning.

This fear brought destructive instincts into play, since the worst part of the Rooseveltian-Keynesian “heresy” and of structuralism in the periphery was its indisputable success in restructuring and reactivating the post-war world economy, both north and south of the Equator.

Therefore, the real challenge for neoliberals was not to creatively overcome Keynesianism, but to erase it from existence. When the main ideologue of the neoliberal reforms in Brazil was asked about their main aim, he replied that it was to undo 40 years of stupidity, and said that one was either a neoliberal or a “neoidiot” (*Revista Veja*, 15 April 1998). This idea of undoing stupidities — of multiplying everything by minus 1 — was what led these neoliberal reforms to become an exercise in non-creative destruction.

According to the psychoanalyst Ron Britton (1998), there is a direct relationship between expectation of understanding of reality and tolerance of dissent. The higher the expectations (as is often the case in natural sciences), the higher the tolerance of dissent; but if expectations are low, intolerance tends to be high. The post-neoliberal reform economic discipline a paradigmatic example of the latter.

Foucault’s (2008) conception of the relationship between power and knowledge, particularly the role of economic discipline in democracy — as a form of power that disciplines by imposing specific forms of knowledge — is helpful in understanding the role of “experts” in all this. In Chile, and around the world, many have become the praetorian guard of neoliberalism. In a recent debate in Chile on withdrawal of 10% of private pension funds to help households weather the decline in income caused by the pandemic the self-proclaimed “experts” competed among themselves for the most apocalyptic prediction of what would happen if this was passed by parliament. However, since they have been crying wolf for too long, nobody paid much attention.

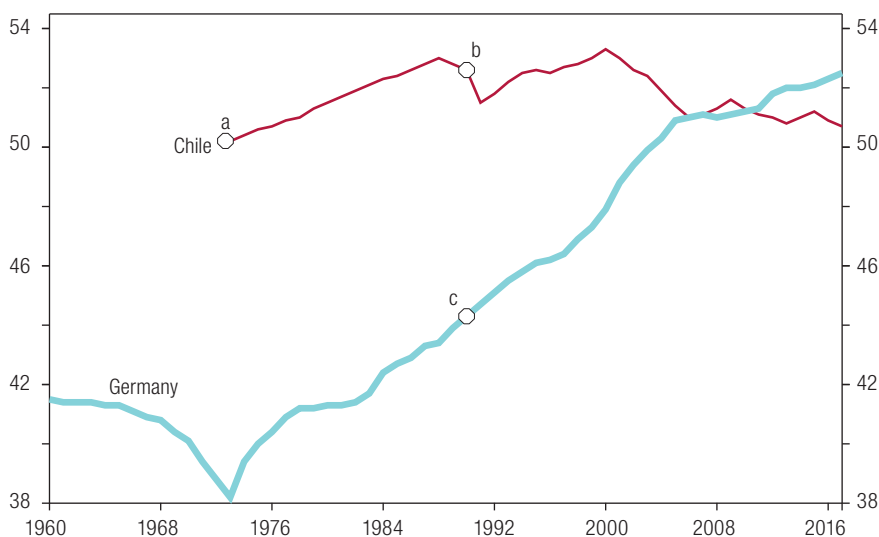
### 3. The growing asymmetry between the economic and the social agenda in European new social democracy

The fundamental problem of European new social democracy, unlike its post-war version, is that its new economic agenda has become entirely dissociated from its social agenda (which maintains its traditional format). Its economic agenda indiscriminately absorbed neoliberal economic discourse, while the latter was almost untouched.

In addition, as both agendas remain stuck in the past — one (the social agenda) trying to repeat it, the other (the economic agenda) attempting the opposite (building a future that is the opposite of that past)— they ignore how a new technological revolution and international economic order necessitate creative rethinking of everything. The epitome of this asymmetry is Germany, as clearly reflected in its market distribution.

**Figure A2.1**

Germany and Chile: market inequality as measured by the Gini index, 1960–2017



**Source:** Standardized World Income Inequality Database”, October 2020 [online] <https://fsolt.org/swiid/>.

**Note:** As the source does not provide information by deciles, it is not possible to perform analysis with the Palma ratio.

- Pinochet's coup d'état.
- Chile's return to democracy.
- German reunification.

It is remarkable how the election of Ronald Reagan and Margaret Thatcher and the fall of the Berlin Wall unleashed in OECD countries a “reverse catch-up” with the highly unequal middle-income countries, such as those in Latin America, “bananizing” their market inequality. The Washington Consensus promised convergence around the world, not just in income, but also in institutions and inequality. Although distributive (and other) convergence did occur, as shown in figure A2.1, it happened in the wrong direction!

The difference between the post-war social democratic economic agenda in Europe and the United States and the subsequent neoliberal one is that the former sought to generate economic dynamism by “disciplining” capital, while the latter ingrained in “common sense” (Gramsci's perspective) that the only way to generate economic growth was by keeping the rich happy. As shown in figure A2.1, this had an unimaginably harmful impact in terms of the inequality of distribution of (pre-tax and pre-transfer) market income.

Furthermore, while in Germany the market Gini index jumped by a third, investment fell by the same degree, from 30% of GDP to 20%, putting it close to the average for Latin America since 1980. This obsession with “Latinamericanizing” investment became widespread in OECD countries. Meanwhile, productivity growth in Germany also collapsed from about 4%–5% a year to almost zero, again similar to the Latin American average since 1980 (Palma, 2019a and 2020b).

Thus, in terms of inequality, the new iron law of oligarchy seems to be that with Latin American-style artificially inflated market-inequality, the larger the proportion of income appropriated by the top, the smaller the proportion of that income that is returned to the economy in a productive way. As suggested above, it is tempting to say, “Welcome to the Third World”.

The United States also became more unequal in its market distribution than its neighbour on the other side of the Rio Grande (Gini indices of 51 for the United States and 47 for Mexico in 2018). If the United States had its pre-pandemic income level, but the inequality of when Reagan was elected president, the top 1% would earn US\$ 2 trillion less than they did (more than Brazil’s GDP). Meanwhile, the average real hourly wage has been stagnant since the Reagan administration.

In turn, if the United States had the same income and inequality as in 2019, but its share of investment to GDP were as it was pre-Reagan, over US\$ 1 trillion more would be invested per year. Linking the two together (greater inequality with less investment and productivity growth), we find a clear tendency to “bananize”, or of “reverse catching up” in motion with countries on the other side of the Rio Grande.

It should be no surprise, then, that when Pope Francis referred to this type of capitalism and its unbridled greed, he said it was the “dung of the devil”, which creates a “subtle dictatorship”, and also plunders nature.<sup>42</sup> Also, when speaking about financial markets, he added that “A new, invisible and at times virtual, tyranny is established, one which unilaterally and irremediably imposes its own laws and rules.”<sup>43</sup>

My main criticism of the European “new” social democracy is not that it became neoliberal (there is no accounting for tastes); instead, it concerns its inability to absorb elements of economic neoliberalism *creatively*. As mentioned above, for Gramsci (1992) every hegemonic ideology, if it wishes to maintain its position, has to absorb elements of opposing ideologies, interlinking them with the essence of its own ideology. This means that for a consensus to remain hegemonic, dominant groups have to make ideological concessions to subordinate groups, but without endangering their domination. This is what Chile’s elite did so well after losing the 1988 plebiscite and the return to democracy, and is trying to do all over again in what this article calls strategy 4 by integrating aspects of the social agenda of the European “new” social democracy (such as the need for social protection) while maintaining its economic agenda of “more of the same” intact.

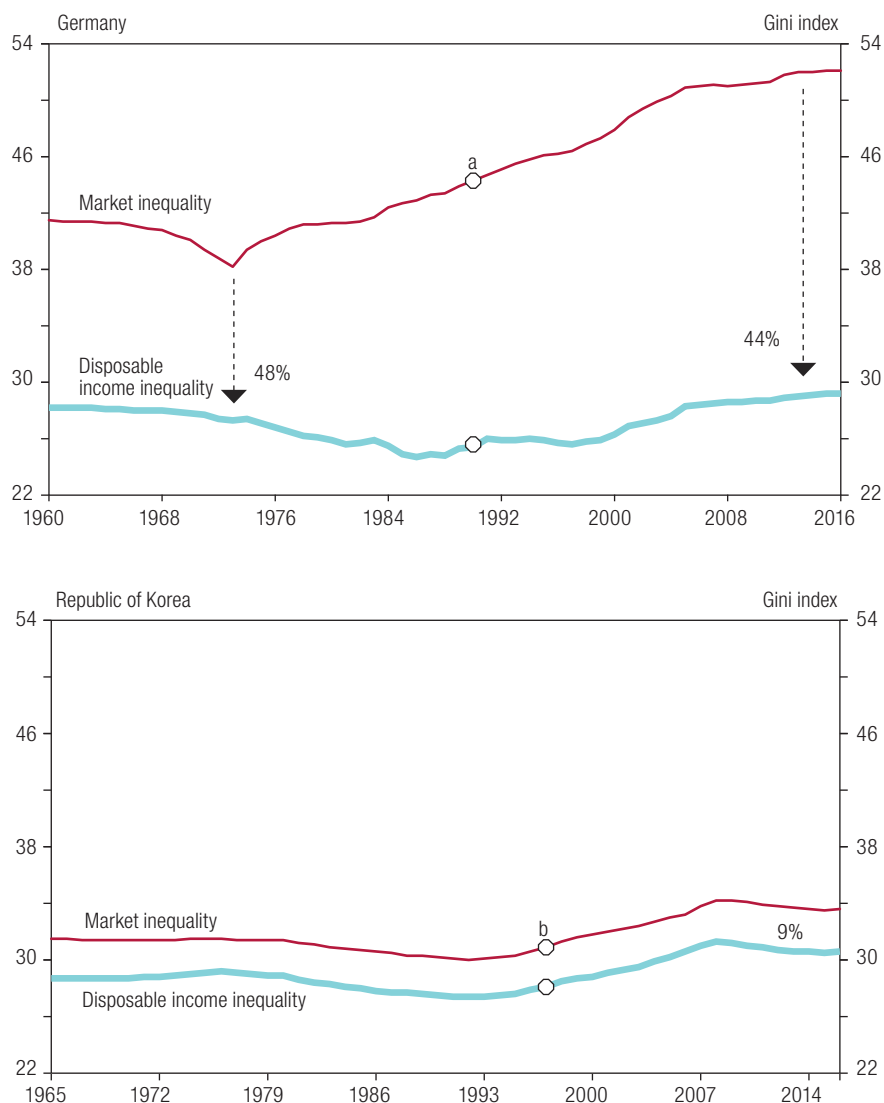
The most attractive feature of the European “new” social democracy for the elite was the effort to absorb elements of its opposing ideology unimaginatively and in a sometimes opportunistic way, letting the neoliberal economic ideology simply replace its own. The result was an insipid economic ideology, which was totally disjoined with its social agenda.

The crucial point is that Germany’s surprising deterioration of market inequality was far from inevitable (or that in the rest of Europe, Western and Eastern). Figure A2.2 compares Germany and the Republic of Korea.

<sup>42</sup> See [online] <https://edition.cnn.com/2015/07/07/world/pope-mass-ecuador-quito/index.html>; see also <https://www.theguardian.com/world/2015/jul/10/poor-must-change-new-colonialism-of-economic-order-says-pope-francis>.

<sup>43</sup> See [online] <https://uk.reuters.com/article/pope-economy/pope-rails-against-dictatorship-of-the-economy-urges-reform-idUSL6N0DX27N20130516>.

**Figure A2.2**  
Germany and Republic of Korea: market inequality and disposable  
income inequality, 1960–2016



**Source:** The Standardized World Income Inequality Database<sup>2</sup>, October 2020 [online] <https://solt.org/swiid/>.

**Note:** a. German reunification.  
b. Financial crisis.

As shown in figure A2.2, Germany and the Republic of Korea arrived at a similar distribution of disposable income (a Gini index of around 30, equivalent to a Palma ratio of about 1.2). However, the Republic of Korea almost achieves that low level of disposable income inequality already in the sphere of production. Germany, in contrast, *has chosen* to follow a tortuous path: while it let its market distribution worsen artificially by 14 percentage points on the Gini index scale between the mid-1970s and the mid-2010s, it then (and as opposed to the Latin American countries) implements a redistributive policy of pharaonic proportions so as to arrive at the same level of disposable income inequality as the Republic of Korea (a country that achieves that low-inequality level without much redistribution effort as it almost arrives there in the market).

This is what I call European new social democracy's “distributive failure” (Palma, 2019a). Letting things go in one direction in the market, and reverting them through taxes and transfers. This failure is different from a self-built increase in market inequality per se, which is a distributive failure in itself. This new distributive failure relates to the need to make an ever-greater effort to reduce the increasingly distorted market inequality, which absorbs more and more resources and is certainly unsustainable in the long run (Palma, 2019a).

The result of this distributive failure is that the direct requirements for social protection in the European Union already represented 40% of public spending before the pandemic, or an equivalent of 16% of GDP. If one adds public health and education, the three areas together accounted for two thirds of all public spending or an equivalent of 25% of GDP. As a result of the pandemic, as inequality and the need for social protection have increased, this cost has soared.<sup>44</sup> In the eurozone, for example, the budget deficit has grown almost tenfold to counter the pandemic (*Financial Times*, 2020b).

In sum, even before the pandemic, in Germany one out of every four euros of value added had to be allocated to the different areas of social protection, mostly to reverse a self-built, unnecessary, inefficient and gigantic market inequality, which was even of a Latin American-style.

Pope Francis hit the nail on the head when he addressed this subject: “Certain liberalism believes it is necessary to first produce wealth” for a given few “no matter how, to then promote some policy of redistribution by the State” (Libreria Editrice Vaticana, 2015). The key here is the “no matter how”: Europe has not only “latinamericanized” its market inequality, its increasingly financialized and rentier elite, in doing so, has done the same with investment and productivity growth levels.

The Republic of Korea, meanwhile, only needs to invest 11% of GDP in social protection to reach the same distribution of disposable income for which Germany has to spend more than double. That is why the Republic of Korea can afford two simultaneous luxuries: collecting 15 percentage points of GDP less in taxes than Germany, and having a level of public investment that is twice that of Germany (OECD, 2020a).

This is why the European new social democratic welfare state has ended up being a de facto subsidy for market inequality, since such high inequality would not be politically feasible without either a stratospheric level of social protection, requiring taxation in the region of 40% of GDP and an explosion in public debt. Social protection is supposedly a subsidy for the poorest, but in practice high-income groups are some of the greatest beneficiaries, as it allows them to maintain “more of the same”.

This is also reflected in the fact that after the 2008 global financial crisis, the United States and Europe spent US\$ 1 trillion on bank bailouts and injected US\$ 15 trillion via quantitative easing (QE), greatly and artificially increasing the net worth of a handful of individuals (Palma, 2020b). The result, as previously described, is that the welfare state has become a de facto post-modern Robin Hood, who “steals” from the rich to give to the even richer (Palma, 2020c).

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<sup>44</sup> See *Financial Times* (2020a) and Palma (2020b).



# Brazil: the effects of COVID-19 and recovery<sup>1</sup>

Luiz Carlos Bresser-Pereira

## Abstract

This article analyses the effects of coronavirus disease (COVID-19) on Brazil's population and economy, including its high mortality rate per 100,000 inhabitants and its slow stabilization. A brief comparison is made with what is happening in a similar Latin American country, Argentina, where the results in terms of mortality per 100,000 inhabitants have been better, and in France, where the recovery has been more robust. The article also assesses the efficiency of expenditures and notes that the comparison is also not favourable for Brazil. Lastly, it addresses the problem of financing and argues that only Argentina resorted to treasury bond purchases by the central bank, the policy adopted in most rich countries that have their own currency and central bank (which France does not have).

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## Keywords

COVID-19, virus, epidemics, economic aspects, demographic aspects, mortality, health, economic policy, health policy, public spending, financing, Brazil

## JEL classification

I18, O29, E5

## Author

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<sup>1</sup> The author would like to thank Tiago Porto, a PhD student at the Getúlio Vargas Foundation School of Business Administration (EAESP-FGV), for excellent assistance during the preparation of this article.

## I. Introduction

Between the 1930s and the 1980s, Brazil grew at a satisfactory pace and industrialized under a developmentalist economic policy framework. In the 1970s, it made the mistake of falling into debt; and in the following decade it was engulfed by the great external debt crisis, which was compounded by high inertial inflation. Weakened by the crisis and under pressure from the North, which in 1980 had turned towards economic liberalism, between 1990 and 1992 Brazil implemented a policy of trade and financial liberalization, embarked upon a process of premature deindustrialization, and returned to being merely a commodity exporter. Since then, it has experienced a process of quasi-stagnation that was only interrupted for a period, in the 2000 decade, by the commodity boom. Between 1950 and 1980, in the context of developmentalist nationalism, income per capita grew vigorously at a rate of 3.5% per year. Since 1980, income per capita has grown by just 0.8% per year, compared to 1.5% per year in rich countries and 3.0% per year in developing countries over the same period. In 2014, the country entered a deep recession, followed by a very unsatisfactory recovery that confirmed the overall picture of quasi-stagnation.

It was with this economic backdrop that Brazil, like all other nation States, confronted the coronavirus disease pandemic (COVID-19) in early 2020. Some countries did better than others in terms of the number of deaths, unemployment, the increase in poverty, the loss of gross domestic product (GDP), and public debt. While it is difficult to rank countries according to their success or failure on these five criteria, it is possible to assert with some confidence that Brazil and the United States performed worse than China and New Zealand. It is also known that better outcomes were achieved the quicker the problem was addressed in each country; the more effective were the isolation or physical distancing measures; the more tests were performed, and the more diligent the follow-up of those infected and the tracing of their contacts; the stronger and more accurate the guidance given to the population on these measures by government; the greater the solidarity shown by the inhabitants of each country in confronting the pandemic and their cooperation with the government in adopting behaviours aimed at slowing the spread of the disease; the better the public health system was at the outset, and the greater the budget support it received when the pandemic broke out; the more the government spent, and the more effectively, to reduce the number of deaths, limit the rise in unemployment and business failures and reduce demand. Lastly, it also depended on how the emergency expenditures were financed: whether by government borrowing from the private sector, thereby increasing public debt; or through monetary financing (central bank purchases of bonds issued by the Treasury for pandemic-related expenditures).

This essay considers the case of Brazil and analyses its bad outcomes in managing the pandemic. It investigates the relationship between the weak growth of the Brazilian economy since 1980 and the very high number of deaths from COVID-19. Although it is impossible to say with certainty that such a relationship exists, one thing is certain: for a nation State to develop and to face the new problems that are continually arising, it must be united. However, the cohesion of the Brazilian nation, which had strengthened considerably in the 1980s with the construction of a coalition of popular-democratic classes and the approval of a social and developmentalist constitution, failed to return the country to the growth path that was interrupted in 1980. With the large-scale popular demonstrations of June 2013, it became clear that this unity was a thing of the past. To assess whether Brazil really failed to confront COVID-19, this article makes a brief comparison with Argentina and France.

## II. Public policies

The public policies adopted by the countries to deal with the pandemic were of three types: (i) health, to reduce the number of people infected and the number of deaths; (ii) fiscal, to guarantee a minimum income to the population; and to reduce unemployment, business failures and the loss of GDP caused by the health measures; and (iii) financial, to fund COVID-19-related expenses.

The health policies recommended by infectious disease experts and international health institutions, which proved effective include: closing the country's borders; banning international flights; putting the affected cities or regions into lockdown; conducting mass testing, tracing and isolating the contacts of individuals who test positive; mandatory use of masks; setting up new hospitals or emergency beds; providing sufficient respirators, along with free testing and treatment; giving the population guidance on individual behaviour; and banning or strictly limiting redundancies. These are the measures that were adopted in two countries that were very successful in dealing with the pandemic: a very large country, China; and a very small one, New Zealand.

The appropriate fiscal policy consisted of increasing public spending significantly, while ignoring concerns about the sharp increase in the public deficit. This entailed increasing public expenditure on: (i) the health sector, by increasing the number of hospital beds and the availability of medical teams and the medicines needed to treat the disease; (ii) an expansion of unemployment assistance; (iii) a basic income policy for the poorest; (iv) a policy of discouraging businesses from making employees redundant; and (v) various policies to help businesses avoid bankruptcy. More generally, the aim was to adopt a countercyclical policy of expanding public investment. These were the policies adopted in the countries that have confronted the pandemic most effectively in the economic domain.

### III. Criteria and policies

Two countries were chosen for this comparison: Argentina, because it is a middle-income country like Brazil, and, despite the serious problems it faces, it managed to avoid a large number of deaths; and France, because it is interesting to include a wealthy country in the comparison. A small group of indicators were chosen as criteria of success or failure in dealing with COVID-19: the number of deaths per 100,000 inhabitants, the rise in the unemployment rate, the increase in poverty or inequality, the rate of decrease in GDP and the value of the additional public spending combined with the loss of government income. The data obtained is presented in table 1. While not entirely comparable, they give a good idea of each country's performance.

**Table 1**  
COVID-19 in Argentina, Brazil, and France

	Argentina	Brazil	France
Deaths per 100,000 inhabitants <sup>a</sup>	14.2	52.3	46.5
Rise in the unemployment rate ( <i>percentage points</i> )	1.5 <sup>b</sup>	2.3	-0.5
Increase in poverty or inequality	11.5%	-0.9%	0.0%
Rate of decline in gross domestic product (GDP)	-9.9%	-9.1%	-12.5%
Expenditure plus income loss ( <i>percentage of GDP</i> )	6.7%	11.8% <sup>c</sup>	6.9%

**Source:** Prepared by the author, on the basis of World Health Organization (WHO), "WHO Coronavirus Disease (COVID-19) Dashboard", 2020 [online database] <https://covid19.who.int/>; Worldometers.info, "World Population", 2020 [online database] <https://www.worldometers.info/>; Brazilian Independent Fiscal Institution, *Relatório de Acompanhamento Fiscal*, No. 43, 17 August 2020 [online] [https://www2.senado.leg.br/bdsf/bitstream/handle/id/575506/RAF43\\_AGO2020.pdf](https://www2.senado.leg.br/bdsf/bitstream/handle/id/575506/RAF43_AGO2020.pdf); National Institute of Statistics and Censuses (INDEC), "Mercado de trabajo: tasas e indicadores socioeconómicos (EPH)", *Trabajo e Ingresos*, vol. 4, No. 3, June 2020; Organization for Economic Cooperation and Development (OECD), "Unemployment rate", 2020 [online database] <https://data.oecd.org/unemp/unemployment-rate.htm>; J. Cuaresma and others, "Poverty headcount ratio at \$3.20/day", 2019 [online database] [https://dashboards.sdgindex.org/explorer/sdg1\\_320pov](https://dashboards.sdgindex.org/explorer/sdg1_320pov); International Monetary Fund (IMF), "World Economic Outlook Update, June 2020", 2020a [online] <https://www.imf.org/es/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020>; IMF, "Policy responses to Covid-19", 2020b [online] <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>.

**Note:** Unless otherwise indicated, the data refer to the first two quarters of 2020.

<sup>a</sup> After an equal number of days for the three countries (151 days from the first death).

<sup>b</sup> Change in the unemployment rate between the fourth quarter of 2019 and the first quarter of 2020.

<sup>c</sup> According to the Brazilian Independent Fiscal Institution (2020), the execution of federal government expenditures and credits disbursed was 50.6%.

## IV. Number of deaths per 100,000 population

The most important result is undoubtedly the number of deaths per 100,000 inhabitants. According to the official statistics that were used, the number of deaths in Brazil was higher than in France and much higher than in Argentina. However, the reported figure is definitely an underestimate. Paulo Lotufo, an epidemiologist from the University of São Paulo, has argued that deaths are being underestimated in every country. For example, *The New England Journal of Medicine* claims that the number of deaths caused by COVID-19 in Italy was 30% higher than the estimated figure, while in São Paulo, Brazil's most populous and wealthiest state, the number is likely to be 170% higher (Ruprecht, 2020). Calculations made by Imperial College London in June 2020, suggest that coronavirus deaths are three times higher than the reported statistics (Sousa Pinto, 2020).

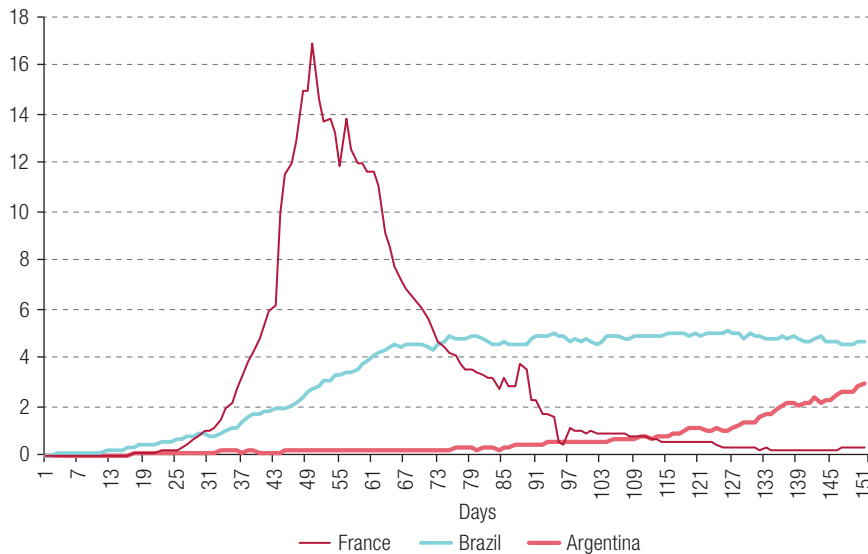
The COVID-19 mortality rate has certainly been lower, the stronger the governments were in establishing the lockdown and quarantine measures, the larger the number of tests that were conducted, and the more effective the tracing of those infected and of their contacts, and the medical and hospital care provided. In addition, the time elapsing between the first verified case of infection in the country and the start of the disease containment policy was also a crucial variable. The fewer the number of days between the two events, the smaller the initial spread of the disease and, hence, the fewer the number of people infected. The number of deaths in Argentina was far less than in France because the Argentine government reacted more quickly than the French government. According to Natanson (2020), despite concerns expressed by provincial governors and mayors about the social consequences of a rigorous and strict shutdown, President Alberto Fernandez acted decisively and chose the apparently less popular path of adopting a strict isolation and quarantine regime. In France, as in the other main European countries, there was a longer delay, which can be explained by the fact that it was affected by coronavirus before Brazil and Argentina. However, once the French government adopted the necessary measures, it did so competently; and the number of deaths declined. The case of Brazil was very different. According to the epidemiologist, Paulo Lotufo, two thirds of the country's COVID-19 deaths and half of its cases could have been avoided if social distancing had been adopted more effectively from the outset (UOL, 2020).

Figure 1 shows the number of daily deaths caused by COVID-19 in the 151 days since the first fatality in each country. The 151-day period was chosen because, at the time of writing, it was the period that had elapsed since the start of the pandemic in Argentina (the last of the three countries to be affected by the disease). The graph shows that the best performing country was Argentina, where the Government's speed of response was crucial. As in many countries where COVID-19 manifested itself early, the French authorities were slow to act, and the disease spread; but thereafter it acted decisively by adopting the necessary policies, and the number of deaths dropped significantly. Brazil failed totally; and the number of deaths reached a peak 75 days after the first fatality because, unlike in France, the government proved unable to adopt policies to flatten the infection curve.

It cannot be said that the Federal Government, which had prime responsibility for the policy to be implemented, was slow to take steps to combat the virus, because, in reality, it did practically nothing other than obstruct the actions of the country's Unified Health System (SUS), and those of the governors and mayors. In practice, there was no policy to contain the pandemic until civil servants attached to SUS, along with the state governors and mayors, decided to start the lockdown policy on their own. In doing so, they faced criticism from the President, who insisted that the problem was not serious; that there was no point in stopping businesses and schools; and that it was sufficient to supply hospitals and public outpatient clinics with two medicines used for malaria (chloroquine and hydroxychloroquine), whose effectiveness against COVID-19 has not been proven thus far, and which have significant side effects. Studies show that these medicines do not work even when they are administered in the initial phase of the disease, as the Ministry of Health started to recommend at the President's direction. In

the midst of this dramatic pandemic scenario, the country has already changed its Minister of Health three times; and, at the time of writing (early September), the Ministry is being led on an interim basis by General Eduardo Pazuello, who is not a physician and has not had any close relationship with health policies in his career. The governors and mayors, on the other hand, acted basically correctly, but without the support they needed from the Federal Government. At the start of the pandemic, there was open conflict between the President and the main governors; but after less than two months, some of them — particularly the Governor of São Paulo, who was implementing an appropriate lockdown policy — yielded to pressure from businesspeople in commerce and restaurants and relaxed the policy.

**Figure 1**  
Argentina, Brazil and France: mortality per million inhabitants  
since the first death from COVID-19, 2020  
(Number of persons)



**Source:** World Health Organization (WHO), "WHO Coronavirus Disease (COVID-19) Dashboard", 2020 [online database] <https://covid19.who.int/>.

**Note:** Seven-day moving average since the first fatality.

## V. Cost of health policies and economic protection

How much did the three countries studied spend on tackling the coronavirus, reducing the number of deaths, preventing hunger among the poorest, limiting the rise in unemployment and averting business failures? And how much did their tax revenues decline because of the lockdown and quarantine policies? How much did the countries invest in mitigating the effects of COVID-19, when increased spending and decreased revenues are added together? Surprisingly, table 1 shows that spending was highest in Brazil, where the Federal Government did not have a policy to contain the disease and support individuals and businesses. Brazil spent the equivalent of 11.8% of GDP, whereas Argentina spent 6.7% of GDP and France 6.9%. The explanation for this is simple: one month after the start of the pandemic, the Government proposed a monthly emergency assistance of R\$ 200, starting in April, for informal workers, individual microentrepreneurs, self-employed workers and the unemployed. However, the National Congress rejected tripled this proposal, without it being clear — either to the Ministry of the Economy or to the National Congress— how many beneficiaries there would be (it turned out to be roughly 60 million). The benefit was maintained at the same value from April to August, before being cut by half for the period September–December. In December, total spending should be R\$ 450 billion, which represents about 7% of GDP.

How efficient has that spending been? Although it is impossible to present a single measure of efficiency for each country, because the results are related not only to the drop in GDP, but also to the number of deaths, the rise in unemployment and the increase in inequality, it is not difficult to conclude that spending in Brazil was extremely inefficient. Although it was the country that spent the most, it also has the highest number of deaths per 100,000 inhabitants and the greatest increase in unemployment. Naturally, it performed better in relation to poverty, but this is explained by the size of the emergency aid that had not been planned by the government.

## VI. The financing problem

How will the large COVID-19-related expenditures be financed? Contrary to the practice in most rich countries that have their own currency and central bank (*The Economist*, 2020) and also to what was done in Argentina,<sup>2</sup> where a never-declared but large proportion of these expenses is being financed by printing money, the other two countries in this analysis resorted to orthodox financing by increasing their borrowing from the private sector. In the author's opinion, this is a mistake that Brazil could have avoided. At the outbreak of the pandemic, the Brazilian National Congress approved Constitutional Amendment 106 (known as the "War Budget"), which instituted an extraordinary fiscal, financial and procurement regime to meet needs arising from the state of public calamity. This authorized a relaxation of the Fiscal Responsibility Law (Complementary Law 101/2000) and non-compliance with the "golden rule" for the budget, which states that borrowing cannot be used to finance current expenses. The proposed amendment included permission, granted on an exceptional basis to the Central Bank of Brazil, to purchase newly issued securities from the National Treasury Secretariat to finance COVID-19 related expenses; but this was not supported by the Government and was rejected by members of the National Congress. In the author's opinion, this was a mistake; governments that did not issue new money to finance themselves lost autonomy over the amount of COVID-19-related expenditure, while borrowing from the private sector meant an increase in public debt.

An important explanatory variable for specifying the value of each country's expenditures in relation to COVID-19 was probably the mode of financing chosen (sale of bonds issued by the Treasury either to the private sector or to the central bank). Countries that adopted monetary financing felt free to spend more, because even though this decision could generate a large public deficit, measured gross, the net public debt (defined as the Treasury's debt minus its debts to the central bank) would have remained constant.

Prior to the global financial crisis of 2008, there was a taboo on the policy of monetary financing by the central bank. This was shared even by economists who, on the one hand, considered the money supply as endogenous, and, on the other, denied the monetarist thesis that an increase in the money supply would cause accelerating inflation. However, following the 2008 crisis, the central banks of the rich countries implemented a policy of "quantitative easing", which involved purchasing private sector securities and new bonds issued by the Treasury, which, in this latter case, is monetary financing. The aims were to increase the money supply or liquidity of the economic system, to lower interest rates and thus encourage firms to invest or consumers to spend. In the event, the increase in investment and consumption was not forthcoming, and the economies of the rich countries have virtually stalled since 2008. Nonetheless, there was a probably unintended consequence (except in the case of Japan, in the author's opinion): namely the large reduction in the public debt of countries that officially issued money. The reduction in the United States public debt was relatively small, about 12%; and that may be why economists in that country did not pay much attention to it. In the case of Japan, which had

<sup>2</sup> Argentina financed itself from profits received from the Central Bank. See Congressional Budget Office (2020, p.5).



an enormous debt, the increase in the money supply through quantitative easing was equally huge and reduced that debt by 77%. Reducing the public debt was not the aim of the measure; but in the case of Japan quantitative easing was so great that it is hard to believe that the Japanese government did not also consider this fact when implementing it. Monetary financing does not objectively imply an increase in public debt, but that is not what “official” public accounting says. The fact that the treasury and the central bank are part of the same state apparatus was not taken into account, because international rules of public accounting do not allow this. As can be seen, not only economists, but also public accountants enjoy a fiction; a fiction which, in this case, would discourage “irresponsible” public spending, even if it did not cause inflation.

Monetary issuance does not cause inflation, even according to the quantity theory of money, because the amount of money actually in circulation in an economy is endogenous. It does not depend on the amount of money issued by the State, but on how much the government, businesses and families spend, and how much they borrow to make that expenditure. There are two ways to finance COVID-19-related expenses: the Treasury can sell its debt securities either to the private sector or to the central bank. In both scenarios, the increase in the amount of money is the same. If the expenditure financed in either way does not cause aggregate demand to exceed aggregate supply, it does not cause inflation to accelerate. This is what happened with quantitative easing, and it is also happening now with COVID-19. In this case public expenditure increases; but it only partially compensates for the decline in private sector investment and consumption caused by the pandemic.

Moreover, the money supply is actually endogenous: the amount of money in circulation increases whenever there is an increase in spending, regardless of how it is financed; and an increase in the amount of money is not inflationary provided it does not bring the country close to full employment. However, there is longstanding fear among that monetary financing of the government will cause inflation. This probably originated long ago, when “inflation” did not mean “price increases” but “uncontrolled expansions in the amount of money in the economy.”<sup>3</sup> This myth was resurrected by monetarism. The basic argument of monetarism was that if central banks firmly controlled the money supply, inflation would be controlled. In the economic literature there is an identity, known as the equation of exchange ( $MV = Yp$ ), in which  $M$  is the amount of money,  $V$  is the velocity of circulation or the number of times a monetary unit circulates in a year,  $Y$  is national income, and  $p$  is inflation. It is an identity because it starts from the definition of the velocity of circulation of money ( $V = Yp / M$ ).

However, the monetarists transformed that identity into a theory (the quantity theory), by assuming that the velocity of money is constant and claiming that the increase in  $M$  causes an increase in inflation,  $p$ . Apparently, this theory is true because there is a close correlation between the money supply and inflation. However, firstly,  $V$  is not constant; the velocity of money is highly variable and changes with the business cycle.<sup>4</sup> Secondly, there is no reason to claim that an increase of  $M$  is the cause of an increase in  $p$ . It makes more sense to argue that it is an increase of inflation that requires the nominal money supply to increase, because the amount of money in an economy is endogenous (it is determined by the dynamics of the economic system itself). A functioning national economy needs a level of liquidity or quantity of money that is proportional to its GDP (to allow transactions to run smoothly).

When inflation increases or accelerates for some reason, the nominal money supply must increase to preserve the real amount of money or liquidity in the economy. To understand this, one can visualize the monetary liquidity needed by the system as the amount of lubricating oil that allows a machine to run smoothly, without friction. Thus, the nominal supply of money is endogenous and, given the real

<sup>3</sup> According to the Online Etymology Dictionary, the term “inflation” in the monetary sense of “enlargement of prices” (originally by an increase in the amount of money in circulation) was first recorded in 1838 in American English. See [online] [https://www.etymonline.com/word/inflation#etymonline\\_v\\_6450](https://www.etymonline.com/word/inflation#etymonline_v_6450).

<sup>4</sup> In the United States, the velocity of the M2 monetary aggregate during the Great Depression was 1.15 times. By 1964 it had risen to 1.67 and 1981 to 1.89. It peaked at 2.20 in 1997, before dropping to 1.25 in 2018 and 1.20 in 2020 (Federal Reserve Bank of St. Louis, 2020).



amount of money needed, it is inflation that requires it to increase and thus remain constant in real terms. While Keynes did not say this literally, he showed that the amount of money in an economy is endogenous. Here in Brazil, the author learned of the endogenous nature of money from Ignácio Rangel, who realized this by observing the Brazilian reality since the early 1960s.<sup>5</sup> Among Post-Keynesians, Basil Moore demonstrated the endogeneity of money theoretically in 1979.<sup>6</sup>

The theory of inertial inflation, as it developed in Brazil —the country that had the longest and most radical experience of this type of inflation— was definitively demonstrated and broadly defined in an article by Bresser-Pereira and Nakano (1984) on the accelerating, maintaining and sanctioning factors of inflation. An accelerating factor of inflation might be an episode of pressure from either supply or demand; but, in most cases, it is excess demand relative to supply. Formal and informal price indexation is the inertial or maintaining factor, which makes inflation resistant to the policies usually adopted to control it; and formal and informal indexation of the economy is the sanctioning factor, which keeps the real amount of money constant in an environment where inflation erodes the purchasing power of a given nominal amount of money.<sup>7</sup> As for the empirical rejection of monetarism, quantitative easing definitely showed that monetarism is meaningless. The central banks of the rich countries bought about US\$ 15 trillion directly from the Treasury and the private sector without stoking inflation.

Countries that issued money to finance their COVID-19 expenditure had more freedom to spend than countries that could not do so, such as those in the eurozone, which do not have a currency of their own. While expenditure is very high in some countries, such as Australia, Canada and Japan (10.1%, 9.1% and 6.8% of GDP, respectively), in others, such as Italy and Spain, the amounts spent are relatively small (1.2% and 2.7% of GDP, respectively). The countries that are spending less are precisely those that made the big mistake of creating the euro and thus lost their monetary policy autonomy. This was clearly seen during the euro crisis of 2010–2015 and is apparently now being repeated in the COVID-19 crisis. Germany, whose expenditures amount to 6% of GDP, is an exception in this study; but it is well known that the fiscal accounts in that country are managed extremely rigorously with the aim of obtaining huge current account surpluses and keeping its industry competitive. The competency of its Chancellor, Angela Merkel, is also well known.

In the current case, in addition to increasing liquidity, bond purchases should not be aimed at reducing public debt, as was the case with quantitative easing, but instead at financing COVID-19-related expenditures without increasing the debt. According to projections made by the International Monetary Fund (IMF, 2020c), by the end of this year the public debt of the rich world will have increased from 106% to 122% of GDP. In Brazil, the public debt is expected to rise from 78% to 95% of GDP. The enormous public expenditures needed to compensate for the reduction in government revenues are bound to generate large fiscal deficits, and, if monetary financing is rejected, a considerable increase in public debt, in addition to a long period of time to pay off this debt once the crisis is over.

The fact that monetary financing of public expenditure does not cause inflation unless there is an excess of demand over supply does not mean that governments can spend at will. This limit is not always clear and there is no reason to take unnecessary risks. Only in special circumstances, such as the COVID-19 pandemic, is it reasonable to use this form of financing. None of the three countries analysed here is taking advantage of this possibility, however: France because it does not have its own currency; and Brazil and Argentina because they are afraid of inflation, which in this situation is not justified.

<sup>5</sup> See Rangel (1963).

<sup>6</sup> See Moore (1979).

<sup>7</sup> That is why, in their basic article on this theory, Bresser-Pereira and Nakano (1984) described the money supply as a sanctioning factor of inflation.

## VII. Economic outcomes

Lastly, the results of this huge fiscal effort in the three countries are shown in table 1, which reports the three most important measures: the rise in unemployment, the increase in poverty and the contraction in GDP. The steepest rise in unemployment occurred in Brazil: the unemployment rate rose by 2.3 percentage points of the labour force, compared to an increase of 1.5 points in Argentina. In France, the data is surprising, since unemployment actually fell by 0.7 percentage points in the second quarter of the year. When this was announced, the National Institute of Statistics and Economic Studies (INSEE), which is responsible for the country's statistics, claimed that the result was misleading, because many unemployed people were not counted during the months of lockdown because they were not actively looking for work (INSEE, 2020). Nonetheless, INSEE ignores the fact that in France there were incentives for firms not to dismiss workers, while Brazil and Argentina failed in that respect. Although emergency aid in Brazil was extensive and significant, there was no public policy to protect employment. This poor employment performance was not unique to these two Latin American countries. According to a study by the Economic Commission for Latin America and the Caribbean published on 2 July (ECLAC, 2020), more than 2.7 million businesses can be expected to close in the next six months, and over 8.5 million formal jobs will be lost in the region because of the COVID-19 pandemic. The report assesses the impact and challenges faced by businesses during the pandemic; and it reports that more than one-third of formal employment and one quarter of the region's GDP are generated in sectors that are heavily affected by the current crisis. It also predicts that 2.6 million of the businesses that will have to close due to the crisis are microenterprises; 1.4 million of these belong to the commerce sector and 290,000 are in tourism, segments that have been disproportionately affected by the restrictions imposed by governments to prevent the spread of the new coronavirus.

Brazil performed best in relation to poverty, which decreased by 0.9% compared to no change in France and an increase of 11.5% in Argentina. The decrease in poverty in Brazil is directly related to the emergency aid, which was generous and provided on a very large scale. While the benefit in question was R\$ 600, the *Bolsa Família* conditional transfer program can pay up to R\$ 205 when there are five beneficiaries in the family. Moreover, although 50 million beneficiaries were expected, 66.9 million people actually benefited, whereas *Bolsa Família* serves 14.2 million.

Lastly, although there was a sharp drop in income in all three countries, the worst case was France, where the reduction in GDP for this year is estimated at 12.5%, as opposed to reductions of 9.1% in Brazil and 9.9% in Argentina. Although this greater reduction in France is understandable, because it was the country that spent the least to neutralize the negative effects of the pandemic, the figure contradicts the fact that the second quarter of the year did not see a rise in unemployment, but instead a slight fall. In Brazil, the 9.1% reduction in GDP forecast for 2020 is consistent with the sharp rise in unemployment.

## VIII. Concluding remarks

In short, although Brazil spent more than France and Argentina relative to GDP, the outcome, in terms of mortality from COVID-19, was much worse than that of the other two countries. The fact that France underperformed Argentina stems from the Government's initial delay in taking action, whereas in Brazil's case was because, instead of a policy to combat the virus, the Federal Government implemented an anti-policy, which was only partially compensated for by decisions taken by the National Congress and the governors, and by the existence (since the transition to democracy) of a universal health system.

Nonetheless, Brazil was the country that spent the most in relation to COVID-19, mainly due to the extensive and generous emergency aid adopted by the National Congress. This was what made it possible to outperform Argentina on poverty and even reduce it slightly. Nonetheless, the fall in GDP in Brazil was only slightly less than in the other two countries analysed.

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# The COVID-19 crisis and the structural problems of Latin America and the Caribbean: responding to the emergency with a long-term perspective

Martín Abeles, Esteban Pérez Caldentey and Gabriel Porcile<sup>1</sup>

## Abstract

The economies of Latin America and the Caribbean have been slipping behind in the global economy, weighed down by structural problems that hinder their capacity to grow and absorb technology. The coronavirus disease (COVID-19) pandemic has not only brought these structural problems into sharper relief, but has also exacerbated them, by reinforcing adverse trends in growth, employment and income distribution. This article analyses these trends and argues that the crisis requires a response that is both immediate but also aims to overcome long-term constraints. Very robust fiscal policies are needed to sustain aggregate demand; and such policies need a substantial investment component aimed at building technological capacities, increasing diversification and strengthening linkages in the production matrix.

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## Keywords

COVID-19, virus, epidemics, economic aspects, economic crisis, economic growth, employment, income distribution, investments, monetary policy, fiscal policy, Latin America and the Caribbean

## JEL classification

O33, O40, O41

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<sup>1</sup> The opinions expressed herein are the authors' own and may not coincide with those of ECLAC.

## I. Introduction

The coronavirus disease (COVID-19) crisis hit Latin America and the Caribbean with exceptional virulence. Not only will the region experience the largest contraction of all developing economies in 2020, but it is also expected to stage the weakest recovery. The pandemic has devastated the region during one of the slowest growth periods in its history.

The commodities trade boom —which lasted practically throughout 2004–2013, aside from a jolt in 2009— fuelled growth in the regional economy and enabled the share of formal employment to expand (which, in conjunction with redistributive policies, helped to improve the income distribution, which was extremely unequal by global standards). Since 2014, however, growth in the Latin American economy has faltered, and progress in the fight against poverty and inequality has been interrupted.<sup>2</sup> A key factor in this stagnation has been the persistence of a pattern of production and export specialization that is concentrated in lower-technology goods and services. This is juxtaposed by an international technology frontier that is moving ever faster, thus accentuating the technology gap in the region.

Backdropped by these structural problems, the COVID-19 crisis is devastating the region and requires urgent action by governments and public policy. The question that arises is to how to transform this emergency and the new role of policies into an instrument that responds to the pandemic but also facilitates an economic transformation based on overcoming these structural problems. This article argues that, in order to sustain effective demand and employment —which have been ravaged by the pandemic— the response needs to be more than immediate and large-scale; it should also reflect a long-term perspective and promote changes in the production structure and build technological capacities. This perspective calls into question the effectiveness of both monetary and fiscal policy transmission mechanisms, in fulfilling that task. The long-term analysis emphasizes the links between fiscal policy, structural change, and overcoming external constraints on growth. The response must involve building a new style of development, rather than restoring a pattern that was showing clear signs of exhaustion before the pandemic broke out.

Section II of this article explains that the Latin America and the Caribbean region will experience both the sharpest contraction in the developing world and the least dynamic recovery. Based on this evidence, it argues that the impact of COVID-19 on Latin America and the Caribbean is explained through the region's structural constraints.

Section III argues that these conditioning factors, in conjunction with others such as the region's considerable financial openness, diminish the response capacity of countercyclical macroeconomic policy —both fiscal, but especially monetary. In fact, in a context of financial openness, with highly concentrated income and wealth, and a production base that is limited and, in some cases, reprimarized, monetary policy transmission mechanisms can work in the opposite direction to that postulated by conventional economic theory. These same factors reduce the effectiveness of fiscal policy transmitted through the multiplier, and they alter the dynamics of public debt and its sustainability over time. This section argues that the sine qua non condition for stabilizing the debt is to underpin economic growth.

In the longer term, to boost growth on a sustainable basis, investment needs to be targeted on building capacities that alleviate the external constraint. This reinforces the message conveyed in the different sections of this article, namely the need to base the recovery on interactions between fiscal policy, investment policy, the revival of effective demand and employment, and structural change. Drawing on the foregoing analysis, sections IV and V analyse the links between investment, fiscal policy and growth, constrained by the specialization pattern in an economy that does not issue the international

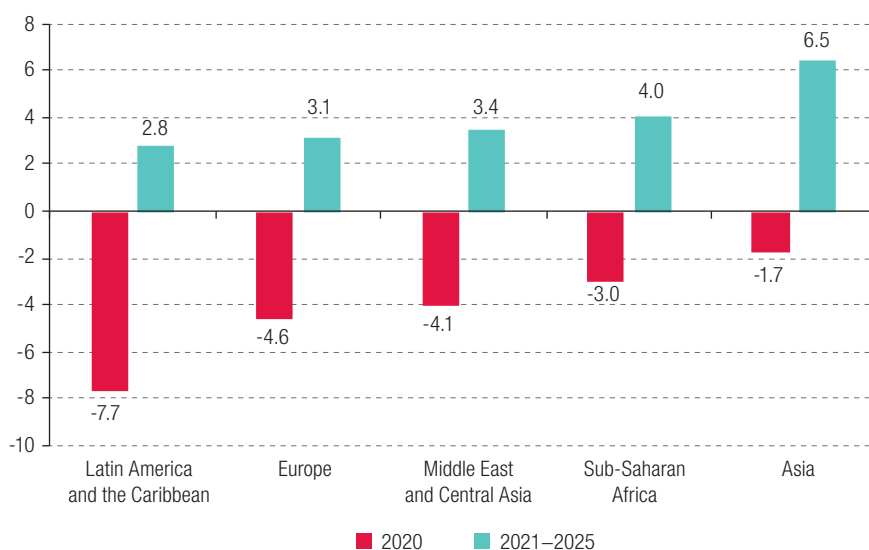
<sup>2</sup> Another very important structural issue is the global environmental crisis and its manifestations and effects in Latin America and the Caribbean —the analysis of which goes beyond the scope of this article. On this subject, see ECLAC (2020a).

reserve currency and relies excessively on short-term financing, as is the case in Latin America and the Caribbean. This situation can fuel increased borrowing on international credit markets to finance the external transactions demanded by the region's growth. It can therefore be concluded that the sustainability of the public debt — that is, economic growth — is ultimately inextricably linked to overcoming the external constraint. Lastly, section VI sets forth the main conclusions.

## II. Why has the COVID-19 crisis had such a heavy impact on Latin America and the Caribbean?

The pandemic has hit the region with particular virulence. The available evidence shows that Latin America and the Caribbean will be the developing region with the sharpest contraction in 2020. As figure 1 shows, the regional economy is expected to shrink by 9.1% — much more than the contractions projected for Europe, the Middle East and Central Asia, Sub-Saharan Africa and Asia, of 4.6%, 4.1%, 3.0% and 1.7%, respectively.

**Figure 1**  
Selected developing regions: gross domestic product (GDP) growth rates, 2019–2025  
(Percentages)



**Source:** International Monetary Fund (IMF), *World Economic Outlook*, Washington, D.C., October 2020; Economic Commission for Latin America and the Caribbean (ECLAC), *Preliminary Overview of the Economies of Latin America and the Caribbean, 2020b* (LC/PUB.2020/17-P), Santiago, 2020.

**Note:** The growth estimate for 2020 has been obtained from ECLAC. Estimates for the period 2021–2025 are from the International Monetary Fund (IMF).

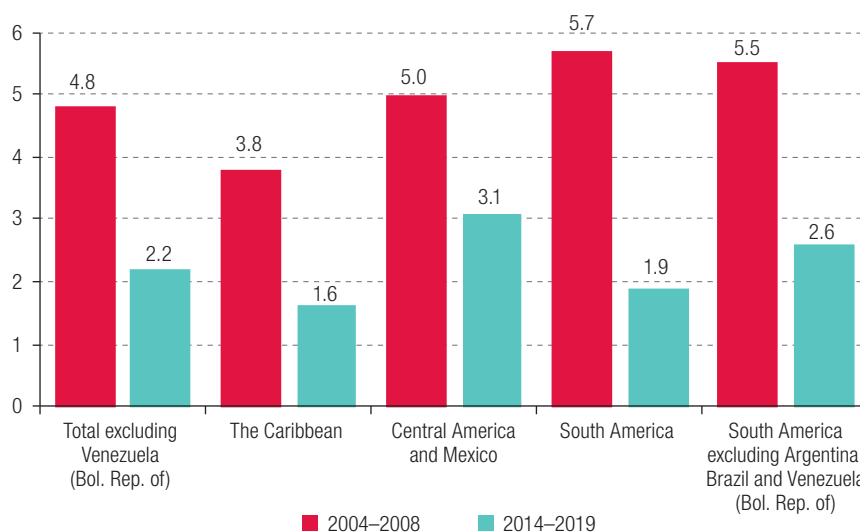
This suggests that the impact of the pandemic crisis could be as regressive and as long-lasting as the debt crisis of the early 1980s, owing to three interrelated phenomena: the region's anaemic growth in earlier years, the heterogeneity of its production structure and the unequal distribution of its income and wealth.

## 1. The pre-COVID-19 situation: sluggish growth and investment

Before the health crisis, economic growth in the region was already meagre. Data for 1991–2019 show that, following a V-shaped recovery from the global financial crisis in 2010 and, especially, since the collapse of international commodity prices, both regional and subregional growth rates have been declining. In 2011–2019, Latin America and the Caribbean recorded its lowest growth rate since the 1950s (ECLAC, 2020a). The subregional data available for South and Central America and Mexico in 1991–2019 display a similar trend. In South America, GDP growth averaged 2.8% in 1991–2002, 4.4% in 2002–2008 and 0.9% in 2011–2019; and the equivalent rates in Central America and Mexico were 3.3%, 2.5% and 3.0%, respectively. The comparison between the years of surging international commodity prices (2004–2008) and the period since their collapse (2014–2019) reflects this trend eloquently, especially in the South American countries.

This growth slowdown was not confined to the countries of South America. In 2014–2019, nine of the 12 Caribbean countries grew more slowly than in the previous period (2004–2008); and, in three of these (Dominica, Suriname and Trinidad and Tobago), GDP actually shrank. In both Central America and Mexico, as well as in South America, all economies grew more slowly in 2014–2019 than in the earlier 2004–2008 period. In South America, three major economies — Argentina, the Bolivarian Republic of Venezuela and Brazil— saw their activity levels decline in the five-year period prior to COVID-19. However, as shown in figure 2, even when these countries are excluded, South America's growth between 2014–2019, at 2.6% was less than half of the 5.5% recorded in 2004–2008.

**Figure 2**  
Latin America and the Caribbean: GDP growth by subregion, 2004–2008 and 2014–2019  
(Simple average, percentages)



**Source:** Prepared by the authors, on the basis of data from the Economic Commission for Latin America and the Caribbean (ECLAC).

**Note:** Central America and Mexico includes Costa Rica, Cuba, the Dominican Republic, El Salvador, Honduras, Mexico, Nicaragua and Panama. South America includes Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay and the Plurinational State of Bolivia. Caribbean countries include Barbados, Bahamas, Belize, Jamaica, Saint Lucia and Trinidad and Tobago.

In the pre-pandemic period, the region's growth was also sluggish compared to that of other developing regions. For example, the developing countries in Asia grew by 4.5% in 2014–2019, outpacing all subregions of Latin America and the Caribbean. Of the 30 developing economies in Asia, 26 expanded by more than Latin America and the Caribbean. The region's growth was also lower than



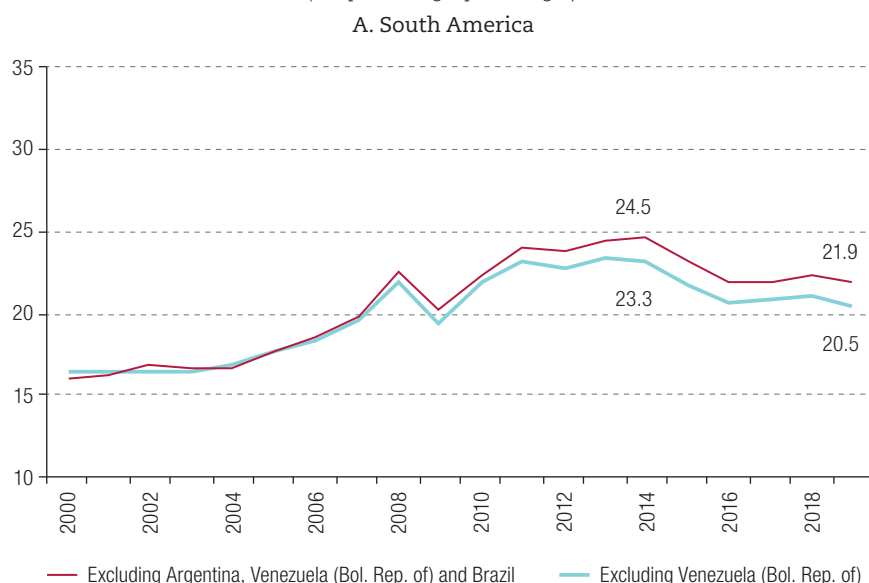
that of the developing countries of Europe, where activity levels grew by 2.8% per year on average between 2014 and 2019, with 13 of the 16 countries in question expanding by more than the 2.3% average for Latin America and the Caribbean in that period.

The region's lacklustre growth had a negative impact on the investment rate. This is not surprising, because it reflects the importance of the accelerator effect on investment decisions, as discussed in greater detail below. An analysis by the Economic Commission for Latin America and the Caribbean (ECLAC) of the determinants of investment in 1995–2017 in six of the region's countries (Argentina, Brazil, Chile, Colombia, Mexico and Peru) shows that the index of economic activity is the key determinant of investment.<sup>3</sup>

This slowdown in the expansion of the capital stock made it difficult to overcome the structural problems that are at the root of the 2014–2019 slowdown: without investment, it is impossible to transform specialization patterns and thus alleviate the external constraint (see section IV). In South America (excluding the Bolivian Republic of Venezuela), the investment rate fell from 23.4% of GDP in 2013 to 20.5% in 2019. If Argentina and Brazil (the countries with the worst relative performance at that time) are also excluded, the investment rate is still down by more than 2 percentage points (from 24.4% to 21.9% in the same period). In the case of Central America and Mexico and the Caribbean, the average investment rate also slipped from over 26% of GDP to just over 22% (see figure 3).

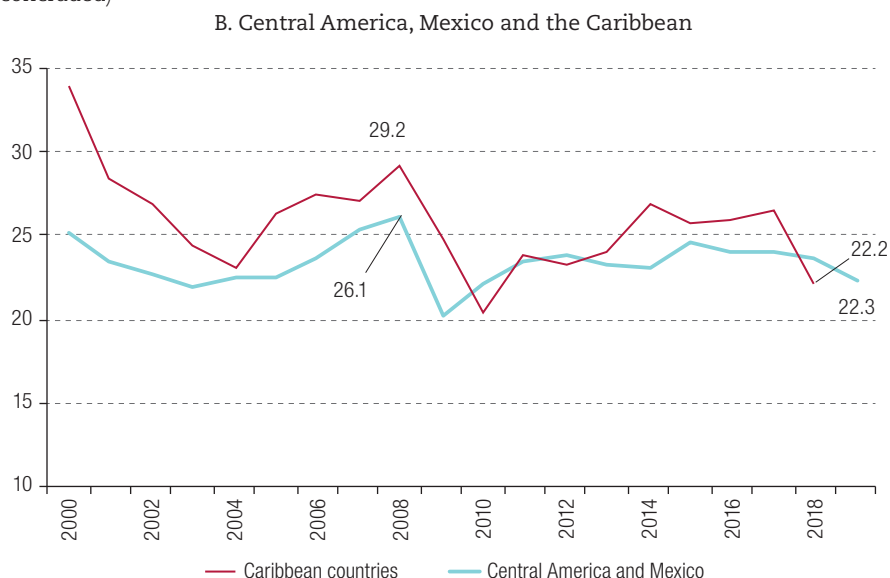
The region's anaemic economic growth explains why the rate of growth of investment declined for four consecutive years (-2.1% in 2014, -4.5% in 2015, -5.2% in 2016 and -0.2% in 2017). This, in turn, undermined job creation, especially in South America, where the average unemployment rate rose from 5.8% in 2013 to 7.6% in 2019 (see figure 4). Joblessness increased during the same period in eight of the nine South American countries for which data is available and in three cases (Argentina, Brazil and Uruguay) the unemployment rate rose by more than two percentage points. In Central America and Mexico and the Caribbean, the unemployment rate behaved unevenly: rising in four of the 15 economies for which data are available.

**Figure 3**  
Latin America and the Caribbean: investment rate, by subregion, 2004–2019  
(Simple average, percentages)



<sup>3</sup> The other variables considered include the domestic monetary-policy rate, the external interest rate, commodity prices, the real exchange rate, and a risk indicator (the Emerging Market Bond Index (EMBI)). See ECLAC (2018).

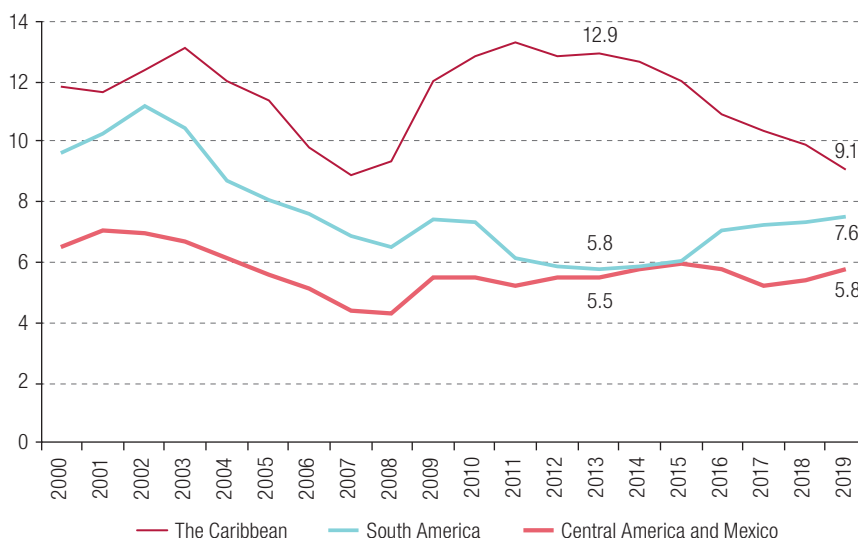
Figure 3 (concluded)



**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

**Note:** Central America and Mexico includes Costa Rica, Cuba, El Salvador, Honduras, Mexico, Nicaragua, Panama and Dominican Republic. South America includes Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay and the Plurinational State of Bolivia. Caribbean countries include Barbados, Bahamas, Belize, Jamaica, Saint Lucia and Trinidad and Tobago.

**Figure 4**  
Latin America and the Caribbean (21 countries): unemployment rate, by subregion, 2000–2019  
(Simple average, percentages)



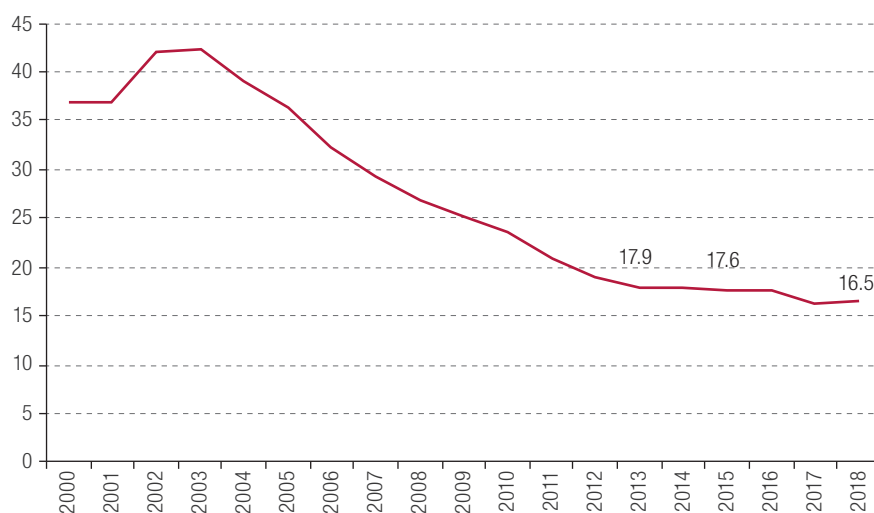
**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

**Note:** Central America and Mexico includes Costa Rica, Cuba, El Salvador, Honduras, Mexico, Nicaragua, Panama and Dominican Republic. South America includes Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay and the Plurinational State of Bolivia. Caribbean countries include Barbados, Bahamas, Belize, Jamaica, Saint Lucia and Trinidad and Tobago.

In South America, the deterioration of conditions on the labour market, combined with a slight increase in inequality, interrupted (and in some cases partially reversed) the declining trend of poverty that had been under way since the early years of the 2000 decade. In 2014–2019, after several years

of uninterrupted reduction, the average poverty rate in South America (excluding the Bolivarian Republic of Venezuela) plateaued between 16% and 17%. By contrast, in Central America and Mexico, despite the growth slowdown, the decreasing trend in the poverty rate did not reverse until the outbreak of the pandemic (see figure 5). The relative deterioration of incomes among the poorest households, which directly detracts from the buoyancy of private consumption, generated negative feedback with the other factors that were undermining aggregate demand (the drop in export earnings and the fall in investment expenditure). This negative relationship between income distribution, poverty and aggregate demand also played a key role in the pandemic crisis.

**Figure 5**  
South America: poverty rate, 2000–2019  
(Simple average, percentages)



**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

**Note:** The series correspond to poverty rates estimated according to ECLAC methodology, and may differ from the estimates published by each country's national statistical institute. The indicator does not include the Bolivarian Republic of Venezuela.

## 2. Structural deficiencies underlying weak economic growth

The economic slowdown in the years prior to the pandemic was associated with a number of, practically endemic, structural weaknesses that rendered the region more vulnerable to an adverse international economic context, despite liquidity abundance.

First, the heavy weight of primary products in the region's export basket, especially in South America, but also in several Caribbean countries, meant that the fall in international commodity prices since 2014 worsened the terms of trade. This reduced momentum on the demand side and also diminished external room for manoeuvre as the region's foreign-exchange earnings declined. Between 2013 (the year before the collapse of international commodity prices) and 2019, average international metal prices fell by 12%, while agricultural prices shed 17% and oil prices plummeted by 35%.

Second, specialization in primary sector production, together with weak intraregional production and trade linkages, meant that the slower growth in world trade and the advance of extraregional trading relations had a significant impact on Latin America and the Caribbean. In fact, the region's export growth, measured in constant prices, slowed more sharply than world trade as a whole. This shows that the export slowdown was due not only to slackening world trade, but also to reductions in the income elasticity of the region's exports, which fell in most cases.

Between 2000–2008 and 2010–2018, the income elasticity of exports fell in six of the eight South American countries for which it had been estimated. In the case of Central America and Mexico, it fell in three of the five countries analysed (see table 1). This dynamic was not matched by a similar change in the income elasticity of imports, which also declined in several of these countries, but less steeply. As noted in section IV, the pre-pandemic growth slowdown in 2015–2019 is explained partly by a fall in the ratio between import and export elasticities which, in conjunction with the rate of global growth, determines the growth rate that is compatible with long-term external balance.

**Table 1**  
Latin America and the Caribbean (13 countries): foreign trade elasticities, 2000–2018

		Income elasticity of exports		Income elasticity of imports		Difference between elasticities		Ratio of elasticities	
		2000–2008	2010–2018	2000–2008	2010–2018	Exports	Imports	2000–2008	2010–2018
South America	Argentina	1.5	0	2.5	2.6	-1.5	0	0.6	0
	Bolivia (Plurinational State of)	2.1	2.3	1.8	1.2	0.2	-0.6	1.2	1.9
	Brazil	2.4	0.4	1.3	2.8	-1.9	1.4	1.8	0.2
	Chile	0.9	0.1	2.2	0.6	-0.8	-1.6	0.4	0.2
	Colombia	1.6	0.9	2.1	1.4	-0.8	-0.7	0.8	0.6
	Ecuador	1.9	1.3	1.8	0.8	-0.6	-1.0	1.1	1.6
	Paraguay	1.6	2.6	2.2	0.8	1.0	-1.4	0.7	3.1
	Peru	2.6	0.9	1.7	0.8	-1.6	-0.9	1.6	1.2
Central America and Mexico	Costa Rica	2.2	2.2	1.2	1.3	0	0.1	1.8	1.7
	Guatemala	1.0	0.6	0.6	1.2	-0.4	0.5	1.7	0.5
	Honduras	2.1	1.6	1.5	0.9	-0.5	-0.6	1.4	1.8
	Mexico	1.7	2.3	2.0	1.8	0.7	-0.2	0.8	1.3
	Nicaragua	3.4	2.7	1.8	1.1	-0.7	-0.7	1.9	2.5

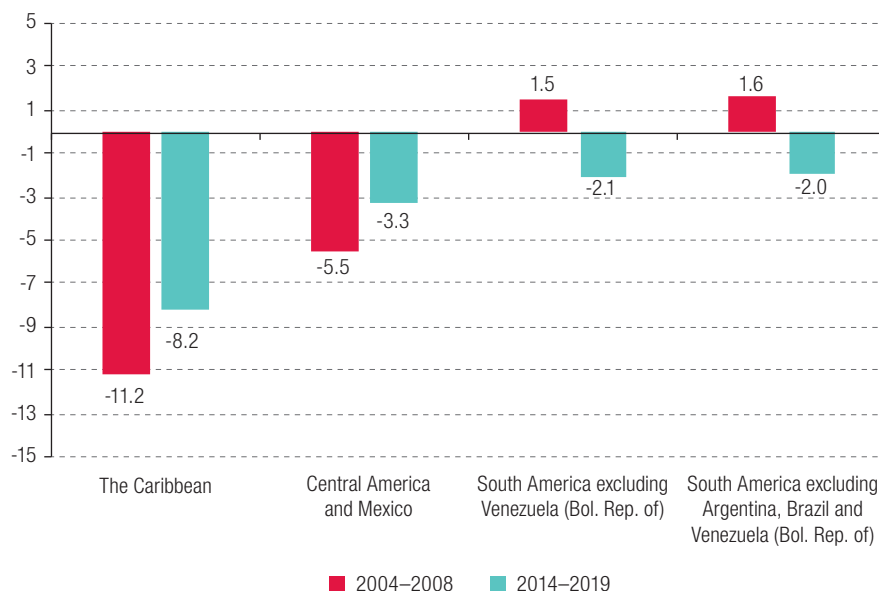
**Source:** Prepared by the authors on the basis of data from the World Bank, International Monetary Fund (IMF) and Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

**Note:** The income elasticity of exports was estimated by the authors using the weighted GDP of trading partners and a relative price indicator calculated as the ratio between the implicit price deflators of exports and GDP, respectively. The income elasticity of imports was estimated considering each country's GDP and a relative price indicator calculated as the ratio between the implicit price deflators of imports and GDP, respectively. The estimates were made by ordinary least squares with logarithmic variables.

Declining terms of trade and weaker export growth (in volume terms) eroded the external accounts and generated a widening current account deficit. In South America, the current account surplus of 1.5% of GDP recorded in 2004–2008 became a deficit of 2.1% in 2014–2019, despite the slower pace of overall expansion (see figure 6). In South America, all countries saw their current account balances deteriorate. In the Caribbean and in Central America and Mexico, by contrast, the current account deficit narrowed as a result of rapid growth in the United States, the subregion's main trading partner. The only countries in these subregions in which the current account deficit deteriorated were the Bahamas, Guyana, Mexico, Panama, Suriname, and Trinidad and Tobago.

The regional growth slowdown would have been even greater, were it not for the fact that most of the region's countries had ample, low-cost access to international financial markets. In South America, private sector external debt, expressed as a percentage of current account inflows (which reflects external repayment capacity) grew from 95% in 2013 to 124% in 2019, while the equivalent figure for public external debt rose from 52% to 91% in the same period. In particular, private external debt increased sharply in Brazil, Chile and Colombia, and public external debt grew in Argentina, Colombia and the Plurinational State of Bolivia. In Central America and Mexico, during the same period, private sector external debt increased from 82% to 90% of current account inflows, while the public sector external debt grew from 52% to 62% (see figure 7).

**Figure 6**  
Latin America and the Caribbean (21 countries): current account balance, 2000–2018  
(Simple average, percentage of GDP)



**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

**Note:** Central America includes Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama and Dominican Republic. Caribbean countries include Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Saint Lucia, Suriname, and Trinidad and Tobago.

**Figure 7**  
Latin America (15 countries): external debt, 2005–2019  
(Simple average, percentage of current account inflows)

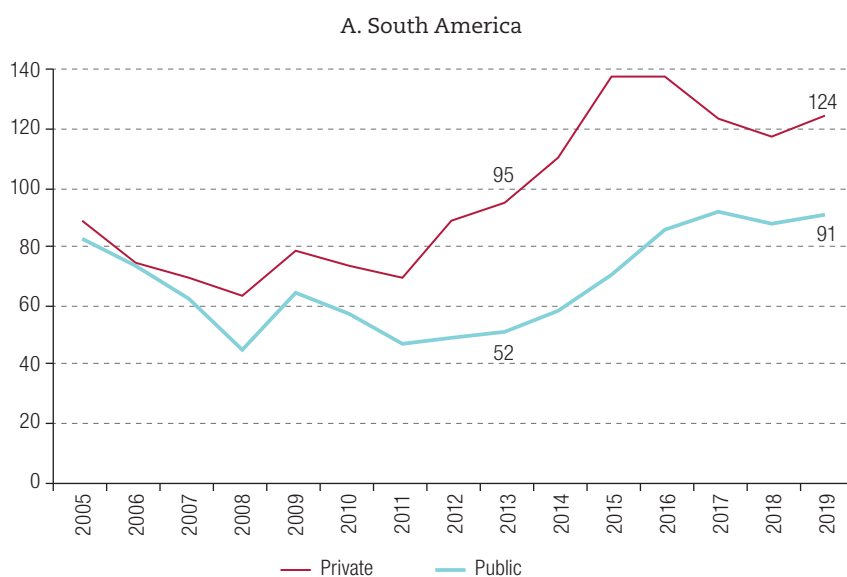
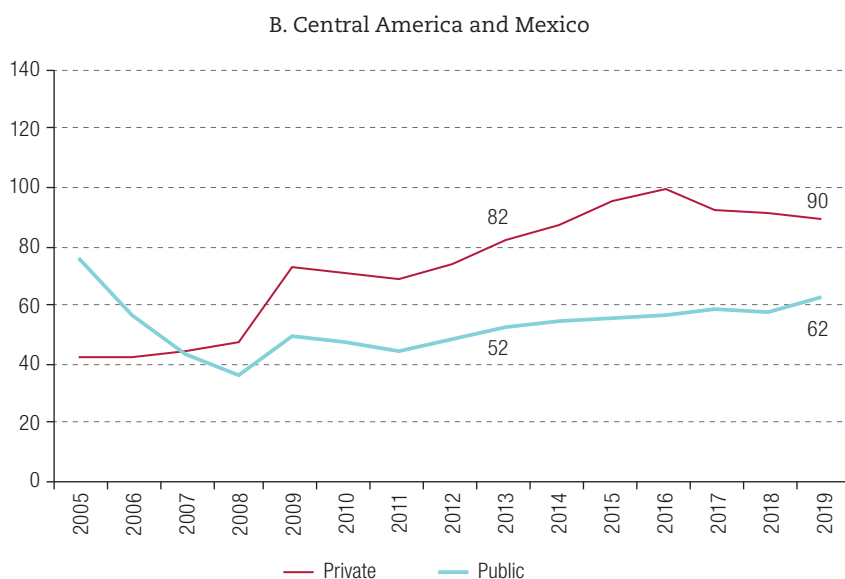


Figure 7 (concluded)

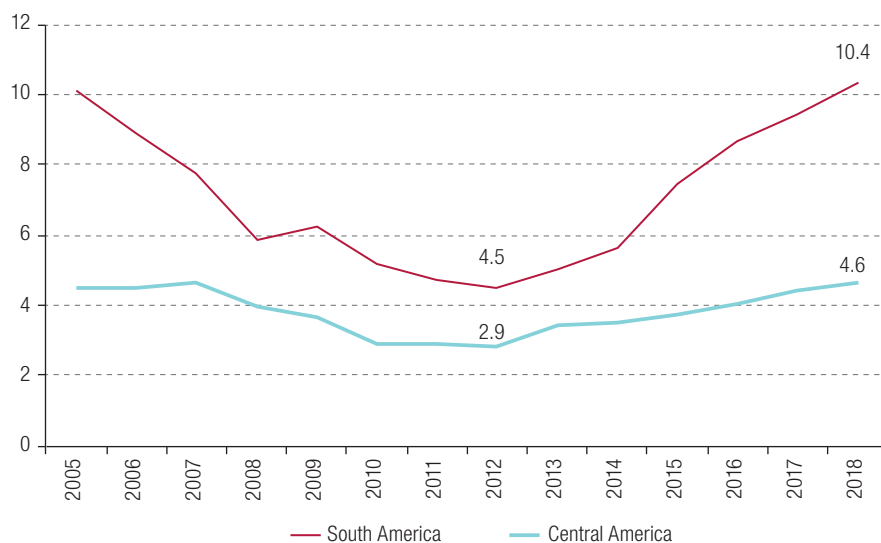


**Source:** Prepared by the authors, on the basis of data from the International Monetary Fund (IMF).

**Note:** South America includes Argentina, Brazil, Chile, Colombia, Ecuador, the Plurinational State of Bolivia and Uruguay. Central America includes: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama and Dominican Republic.

The increase in external debt entailed higher interest charges, which aggravated the scarcity of foreign exchange owing to the structural constraints mentioned above (reprimarization). In South America, this type of expenditure grew from 4.5% of current account inflows in 2012 to 10.4% in 2018; and, in the case of Central America, it went from 2.9% to 4.6% in the same period (see figure 8).

**Figure 8**  
Latin America (12 countries): interest payments on foreign debt, 2005–2018  
(Simple average, percentage of current account inflows)



**Source:** Prepared by the authors, on the basis of data from the International Monetary Fund (IMF).

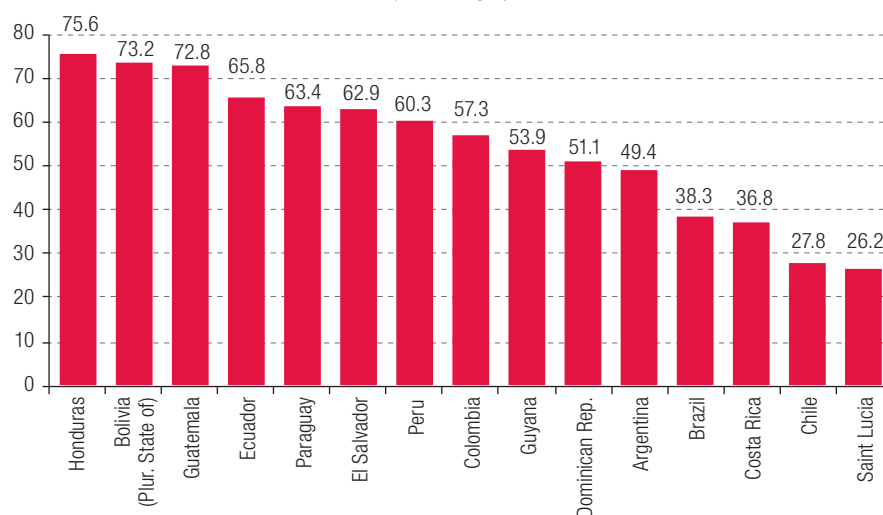
**Note:** South America includes Argentina, Brazil, Chile, Colombia, Ecuador, the Plurinational State of Bolivia and Uruguay. Central America includes Costa Rica, El Salvador, Guatemala, Honduras and Dominican Republic.

The region's weak performance in the years prior to the pandemic was the result of a set of structural deficiencies that generated negative feedback through a variety of channels. First, weak exports reduced the capacity to sustain faster growth, which in turn undermined the process of capital formation and, given the reduced availability of foreign currency, forced the region's economies to resort increasingly to external financing. The lack of linkage between external borrowing processes and the transformation of local production structures (due, among other things, to the weakness of industrial policies in the region) tended to accentuate external vulnerability in the medium term. In several cases, this reduced the scope for accessing additional external financing during the initial stages of the pandemic, as Latin America and the Caribbean (like most developing countries) faced significant capital outflows.

In the later stages of the pandemic this trend has reversed, as the expansionary monetary policies of the major central banks of developed countries, and in particular of the Federal Reserve of the United States, fostered a search for yield by private investors in emerging market economies, including in those of Latin America and the Caribbean. The counterpart of this trend is an unprecedented build-up of debt. As things stand, Latin America and the Caribbean is the most indebted region of the developing world with 80% of general government debt relative to GDP (IMF, 2020b). This not only limits the scope for countercyclical fiscal policy, but could also lead to financial fragility and instability. Also, in the case of some countries of the region (in particular the smaller ones) the rates of interest on debt exceed the historical and projected rates of growth, raising sustainability concerns. Overall, it seems that increased access to international capital markets can reinforce, rather than ease, the external constraint.

The high degree of structural heterogeneity, which in recent years has been exacerbated by the growing share of the primary sector and restricts long-term growth capacity, has amplified the internal shock and in the case of some economies (the smaller ones) the external shock of the pandemic domestically. Such heterogeneity can be discerned in many sectors of low productivity and high levels of labour informality. These are associated with the provision of services in urban areas, which, as the virus spread, left much of the population without income. In most of the region's countries, more than half of all non-farm workers are informal; and in some cases three quarters of all persons employed work informally (see figure 9).

**Figure 9**  
Latin America and the Caribbean (15 countries): labour informality  
in the non-agricultural sector, 2015–2019  
(Percentages)



**Source:** Prepared by the authors, on the basis of data from the International Labour Organization (ILO).

**Note:** The figures shown represent the latest available data. Those for Argentina, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Paraguay, Peru, the Plurinational State of Bolivia and Saint Lucia refer to 2019; data from Brazil correspond to 2015; data from Guatemala and Honduras are for 2017; and data from Guyana and El Salvador refer to 2018.



### III. Challenges in managing countercyclical policy

A contraction as sharp as that experienced by the Latin American economy in 2020 (-7.7%) (ECLAC, 2020b), caused by the impact of COVID-19 on the region's economic and social fabric and compounded by social distancing policies, requires a monetary and fiscal countercyclical response.<sup>4</sup>

However, the implementation of countercyclical policy, whether monetary or fiscal, to boost aggregate demand, cannot be assumed, nor can its effectiveness. In the peripheral economies, which includes those of Latin America and the Caribbean, transmission mechanisms (the process through which economic policy decisions are transmitted through changes in nominal or financial and real variables) do not function smoothly; and they may well produce results that are the opposite of those expected.

The region's economies are characterized by a high degree of openness and financial integration, but also external dependency. This is reflected in their exposure to the liquidity cycle of the central countries and to fluctuations in international commodity prices. These specific features make the financial channel of the exchange rate a key monetary policy transmission mechanism, since it can counteract the effects of the monetary policy channels envisaged in monetary theory.<sup>5</sup>

Monetary policy is rendered even less effective by some of the region's structural features, which also affect peripheral economies in general. These include imperfect substitution between local currencies and international reserve currencies; and the high concentration of income and, more importantly, wealth, which hinders the key objective of countercyclical policy in the downswing phase of the business cycle, namely to boost aggregate demand.

As analysed below, the region's structural characteristics also weaken the multiplier, which is the main transmission mechanism in the case of fiscal policy. It should also be noted that the adjustment policies implemented in the 1980s and 1990s under the Washington Consensus, have led to reduced public sector investment. These policies were inspired by an orthodox view that doubts the effectiveness of fiscal policy, which has prevailed ever since.<sup>6</sup> Moreover, as a "secondary effect", these policies have diminished the implementation capacity of the region's governments, thereby further reducing the power of the multiplier.

#### 1. Interest rate, exchange-rate and balance sheet effects

As a result of COVID-19, nearly all countries of Latin America and the Caribbean, irrespective of their exchange-rate regime, decided to lower interest rates as a monetary policy (see table 2). In some cases (Brazil, Chile, Costa Rica, El Salvador, Mexico and Paraguay), this stance accentuated the downward trend in base rates that had started before 2020.

<sup>4</sup> The need for a countercyclical policy in a recession or contraction of economic activity is currently one of the economic-policy issues on which economists of diverse tendencies generally agree. This has not always been the case in Latin America and the Caribbean, as evidenced by the economic policies deployed in response to the various crises faced by the region, such as the debt crisis (1980-1983), the "tequila" crisis (1995) or the Asian crisis (1996-1997).

<sup>5</sup> For information on the channel that prioritizes prices and rates of return, see Taylor (1995) and Mishkin (1996); and for further information on the credit channel, see Bernanke and Gertler (1995) and Bernanke, Gertler, and Gilchrist (1999). Trautwein (2000) compares these two views of the monetary policy transmission mechanism.

<sup>6</sup> The mainstream economic consensus holds that fiscal policy is a useful countercyclical tool, when expansionary monetary policy is of limited applicability, to expand aggregate demand, including when the monetary policy interest rate nears the zero-bound.

**Table 2**  
Latin America and the Caribbean (27 countries): base interest rates by country  
and by exchange-rate and monetary regime, January, March and August 2020

Exchange-rate regime	Monetary regime		
	Exchange-rate anchor (United States dollars)	Monetary aggregate target	Inflation targets
Dollarization	Ecuador (...) El Salvador (2.18; 4.80; 2.32)		
Currency board	Eastern Caribbean Currency Union (6.5; 6.5; 2.0)		
Conventional parity	Bahamas (4.0; 4.0; 4.0) Barbados (7.0; 7.0; 2.0) Belize (11.0; 11.0; 11.0)		
Stabilization arrangement	Guyana (5.0; 5.0; 5.0) Trinidad and Tobago (5.0; 3.5; 3.5)	Bolivia (Plurinational State of) (2.75; 2.75; 2.75)	Guatemala (2.75; 2.25; 1.75)
Crawling peg regimes	Honduras (5.5; 4.5; 3.75) Nicaragua (...)		Costa Rica (2.25; 1.25; 0.75) Dominican Republic (4.5; 3.5; 3.5)
Floating			Brazil (4.5; 3.75; 2.0) Chile (1.75; 1.00; 0.5) Colombia (4.25; 3.75; 2.5) Jamaica (0.5; 0.5; 0.5) Mexico (7.25; 6.5; 4.5) Paraguay (4.0; 3.25; 0.75) Peru (2.25; 1.25; 0.25) Uruguay (...)

**Source:** Prepared by the authors, on the basis of International Monetary Fund (IMF), *Annual Report on Exchange Arrangements and Exchange Restrictions 2019*, Washington, D.C., 2020, and official data.

**Note:** Figures in parentheses represent base interest rates for January, March and the last available month of 2020. (...) indicates that data is not available. The Eastern Caribbean Currency Union includes Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Saint Vincent and the Grenadines, and Saint Lucia.

The monetary policy transmission mechanism depends on the specific combination of exchange-rate and monetary regimes prevailing in each economy. With the exception of the Caribbean economies (Eastern Caribbean Currency Union, Bahamas, Barbados, Belize, Guyana, Trinidad and Tobago), countries with inflation targets (or monetary aggregate targets) and some degree of exchange-rate flexibility (either floating or crawling peg exchange-rate regimes) make up the bulk of the cases considered in table 2 (71% of all Latin American countries). Taking these countries as an analytical group — particularly those with inflation targets and floating exchange rates — the monetary policy transmission mechanism for an open economy operates through its effect on the local-currency yield curve. A reduction in the domestic monetary policy interest rate makes the slope of this curve steeper, with a consequent depreciation of the exchange rate.<sup>7</sup>

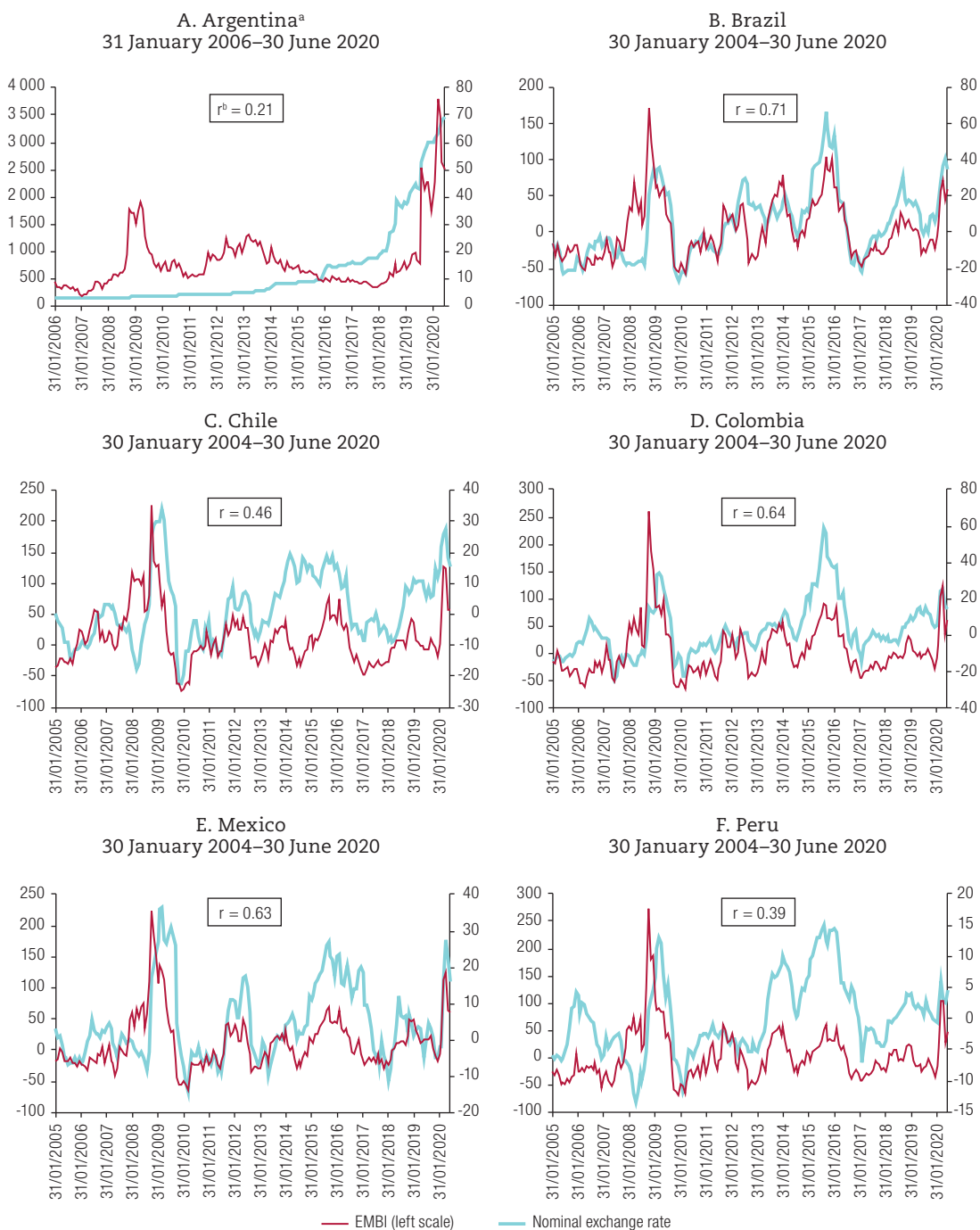
This, in turn, impairs the financial positions of foreign investors in the region whose securities are denominated in local currency.<sup>8</sup> In the case of sovereign debt, the data reveal an inverse correlation between the trend of sovereign risk as measured by the Emerging Markets Bond Index (EMBI)<sup>9</sup> and nominal currency depreciation or appreciation. A depreciation (expected or effective) of the local currency is associated with a higher risk perception and can easily cause capital flight (Borio, 2019). Empirical data collected for Latin America display positive and statistically significant correlations between the rates of variation of the EMBI and those of the nominal exchange rate — for example, Argentina 0.21, Brazil 0.71, Chile 0.46, Colombia 0.64, Mexico 0.63 and Peru 0.39 (see figure 10).

<sup>7</sup> See Shin (2014).

<sup>8</sup> This assumes that foreign investors' financial positions are unhedged.

<sup>9</sup> The emerging market bond index is the key emerging economy risk indicator. It is calculated as the spread between the interest rate that countries pay on dollar-denominated bonds issued by those economies and United States Treasury bonds, which are considered risk-free. The index is based on the behaviour of external debt issued by each country. The less certainty there is that a country will meet its obligations, the higher its EMBI, and vice versa. The minimum rate that an investor would require to invest in a certain country would be equal to the rate on United States Treasury bonds (risk-free) plus the EMBI. See ECLAC (2016). The reasoning here assumes that changes in EMBI are endogenous to changes in the nominal exchange rate. See Borio (2019).

**Figure 10**  
Latin America (6 countries): EMBI and nominal exchange rate changes, 2000–2020



**Source:** Prepared by the authors, on the basis of J.P. Morgan, “EMBI Spreads”, 2020; and Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2020* (LC/PUB/2020/12-P), Santiago, 2020.

<sup>a</sup> In the case of Argentina, the variables are expressed in terms of levels. The right scale measures basis points.

<sup>b</sup>  $r$  = simple correlation coefficient.

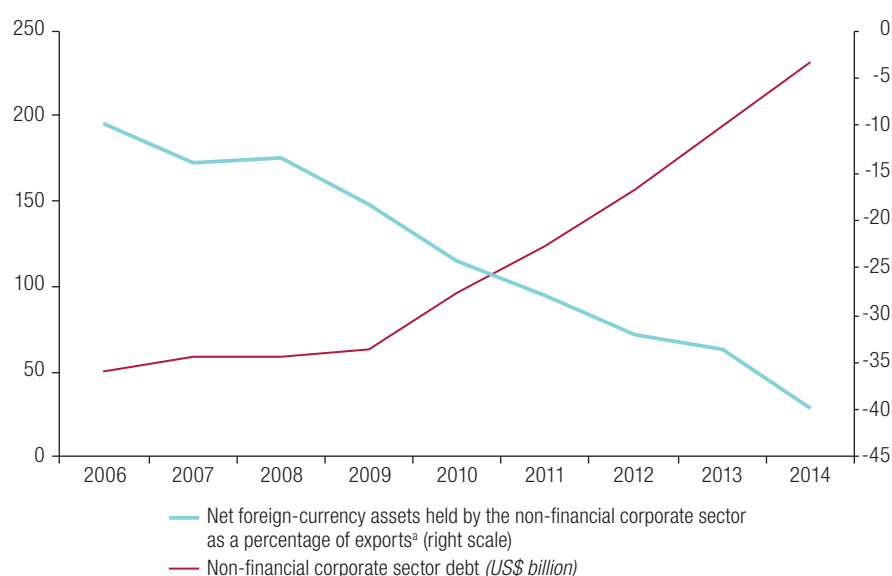
Local-currency depreciation also increases the burden of debt service for agents whose liabilities are denominated in foreign currency. In the case of Latin America and the Caribbean, the foreign currency share of the total debt varies by country and sector. Data for 2019 show foreign currency debt-to-GDP

ratios of 82.1% in the case of Argentina, 23.9% in Brazil, 49.2% in Chile, 28.6% in Colombia and 26.8% in Mexico.<sup>10</sup> Depreciation also increases liabilities by augmenting the local-currency value of the debt stock. Moreover, if the collateral for the debt is also denominated in local currency, then depreciation also reduces asset values.

In short, an interest rate cut not only dampens external financial flows and thus restricts the availability of external liquidity through the mechanisms described here; but it can also generate greater financial fragility.<sup>11</sup>

The intensity of these effects will depend, firstly, on the degree to which the asset and liability currencies are mismatched and, secondly, on the existing debt level. The data indicate that, in developing countries, the corporate sector tends to operate in a mismatch situation,<sup>12</sup> and that this mismatch has trended higher since 2007. At the same time, the level of external debt in the region has increased in all institutional sectors (government, financial and non-financial corporate sectors, and households). The evidence collected on Latin America between 2006 and 2014 shows an increase in the debt of the non-financial corporate sector and, at the same time, a decrease in foreign-currency coverage (as measured by the ratio of net foreign-currency assets to exports, see figure 11), thus signalling an increase in financial fragility in the region.<sup>13</sup>

**Figure 11**  
Latin America: non-financial corporate sector borrowing and corporate sector  
currency mismatches, 2006–2014  
(Billions of dollars and percentages)



**Source:** Prepared by the authors on the basis of Bank for International Settlements (BIS), “Debt Statistics”, Basle, 2020; and Chui, M., E. Kuruc and Ph. Turner, “Leverage and currency mismatches: Non-financial companies in the emerging markets”, *The World Economy*, vol. 41, No. 12 (*Special Issue: Global Trade Policy 2018*), 2018 [online] <http://wileyonlinelibrary.com/journal/TWEC>.

<sup>a</sup> Average of the variable for Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Mexico and Peru.

<sup>10</sup> In the case of Brazil, this figure underestimates the total debt, since part (equivalent to at least 15% of GDP) is held by Brazilian nationals living abroad. See ECLAC (2018).

<sup>11</sup> A policy of reserve accumulation through intervention in foreign exchange markets (which in fact has been the countercyclical monetary policy, par excellence, in the case of some of the economies of the region) can have similar effects.

<sup>12</sup> Imperfect substitution between currencies worsens arbitrage conditions and consequently makes operations in financial markets with hedged currency positions more difficult. As Shleifer (2000, p.13) notes, arbitrage requires the availability of close substitutes for financial assets. Tropeano (2016) argues that hedging operations depend on the fulfilment of arbitrage conditions.

<sup>13</sup> Non-financial corporate-sector debt has continued to grow in Latin America; and, in the second quarter of 2020, it stood at US\$ 343 billion. See Federal Reserve Bank of St. Louis (2020).

## 2. Interest rates and their impact on aggregate demand

In the context of Latin America and the Caribbean, not only can traditional countercyclical monetary policy generate greater financial instability — through the transmission mechanisms described above — but it does not necessarily have expansionary effects. Traditional monetary theory states that a cut in the policy interest rate leads to a reduction in the cost of capital. This should elicit an increase in investment and in the demand for consumer durable goods, which, in turn, should boost aggregate demand and, thus, economic growth. However, in the Latin American and Caribbean economies, a large proportion of capital and consumer durable goods are imported, so exchange-rate depreciation raises the cost of capital and consumer durables and thus discourages demand for them.

According to ECLAC (2016), variations in the real exchange rate and in gross fixed capital formation are negatively related (the correlation coefficient is -0.41), which indicates that real exchange rate variations affect imports more than exports.<sup>14</sup> In other words, an appreciation of the real exchange rate is associated with an increase in gross fixed capital formation. Moreover, a depreciation of the nominal and real exchange rate, stemming from a cut in interest rates, is unlikely to affect export performance, owing to the deep productivity gaps that exist, causing competitiveness problems that are not remedied by devaluation. Also, the available data reveal that international goods and services transactions are invoiced in foreign currency, so a change in the nominal exchange rate will not affect their amount in the short term (Borio, 2019).

In the medium and long terms, the exchange-rate impact will depend on both the size of the economies in question and their production structure. For the smaller economies, there is strong empirical evidence that income effects outweigh substitution effects (relative price effects that lead to nominal and real exchange-rate depreciation).<sup>15</sup> The export performance of these economies depends, fundamentally, on the trend of external demand weighted by the ratio of the income elasticities of exports and imports.<sup>16</sup>

These monetary policy constraints partly explain why peripheral countries, including those that operate inflation targeting monetary regimes, intervene on the foreign-exchange markets,<sup>17</sup> either through transactions in the spot markets or else through other types of instrument (foreign currency swaps, repos and derivatives).<sup>18</sup> However, it is important to keep in mind that foreign-exchange interventions require an adequate stock of international reserves; they are also costly and are not always effective.

Lastly, a context of high inequality impedes the central objective of countercyclical monetary policy. An interest rate cut implies an increase in the present value (demand price) of both real assets (whether investment or real estate) and financial assets.<sup>19</sup> The upward valuation of existing real estate assets in a context of highly unequal income and, especially, wealth, means that the beneficiaries of revaluation are the wealthier groups of society, which are also those with a lower marginal propensity to consume.

A similar argument weakens the strength of the credit approach in the transmission of monetary policy, since it is based on the possibility of obtaining a larger credit flow. This approach alters the cost-of-capital transmission channel by recognizing the existence of information asymmetries between the borrower (for example, a firm) and the lender (such as a bank). In an information asymmetry context,

<sup>14</sup> The countries included in the sample are Argentina, Brazil, Colombia, Mexico and Peru. This relationship also holds at the national level. Two country-level studies conducted by ECLAC on the determinants of investment in Argentina, Colombia and Peru, find a negative relationship between variations in the real exchange rate and variations in gross fixed capital formation. The nominal exchange rate is the main determinant of the real exchange rate.

<sup>15</sup> On this point, see Bernat (2015) and Dvoskin and Feldman (2015).

<sup>16</sup> See McCombie and Thirlwall (1994).

<sup>17</sup> What the literature calls the “fear of floating” (see Calvo and Reinhart, 2002).

<sup>18</sup> See Borio (2019). Mexico and Peru have used repos; Brazil and Mexico have intervened in the future exchange rate; and Colombia and Mexico have intervened in options mechanisms.

<sup>19</sup> In the case of financial assets, the relationship is more direct the longer the maturity of the asset in question.

the least costly way to minimize the risk of default on the lender's claims is to stipulate the transfer or payment of collateral in the event of borrower default. This means that the value of a loan cannot exceed the equity value, that is the sum of the net liquid assets (cash flow minus debt service and principal) and the present value of the collateral. Under this approach, an interest rate cut raises the value of net liquid assets (by reducing debt service) and, also, the present value of the collateral. This in turn reduces information asymmetry by increasing credit and investment.<sup>20</sup> However, as in the case of the traditional cost channel of monetary policy, this approach fails to take into account existing inequality of income, and prioritizes spending by the high-income groups, which have lower propensity to consume than lower income groups. It is also a supply-driven monetary policy mechanism that fails to take into account aggregate demand. Reducing the information asymmetry between the lender and the borrower does not solve the problem of insufficient aggregate demand.

## IV. Fiscal policy transmission mechanisms

### 1. Fiscal policy and the multiplier

The constraints faced by monetary policy in sustaining economic growth make fiscal policy the natural candidate for responding to the effects of the pandemic and securing the recovery. The Government is the only actor with the mandate and capacity to respond to its immediate and urgent effects.

The main argument for countercyclical fiscal policy is the potential role of the multiplier in boosting aggregate demand and counteracting the slump in growth. Multiplier theory basically holds that, logically, investment spending precedes and, through its impact on income, generates a volume of savings sufficient to “finance” the initial investment spending. These results of the operation of the multiplier do not occur instantaneously, however. On the contrary, they are the outcome of a dynamic process of sequential spending and are only achieved at the end of that process.<sup>21</sup>

The size of the multiplier basically depends on three factors: the degree to which the economy is dependent on the rest of the world, which is reflected in the propensity to import; the distribution of income, which partly determines the propensity to consume; and the tax burden. To express this more rigorously, the multiplier can be formally expressed as

$$m = \frac{1}{s_p + \xi + \tau} \quad (5) \quad ^{22}$$

<sup>20</sup> See Trautwein (2000, pp. 162-163).

<sup>21</sup> The multiplier can be explained as follows for a closed economy with no government. The increase in income ( $\Delta Y$ ) represents a series of investment increments ( $\Delta I$ ) adjusted for the corresponding propensities to consume ( $c, c^2, c^3, \dots, c^n$ ). That is to say, (1)  $\Delta Y = \Delta I + c\Delta I + c^2\Delta I + c^3\Delta I + c^4\Delta I \dots c^n\Delta I$ . Factoring out  $\Delta I$  gives (2)  $\Delta Y = \Delta I(1 + c + c^2 + c^3 + c^4 \dots c^n)$ . The expression in parentheses in equation (2) is a geometric series like (3)  $\Delta Y = \frac{\Delta I - \Delta I c^n}{1 - c} = \frac{\Delta I(1 - c^n)}{1 - c}$ . Taking the limit of (2) when  $n \rightarrow \infty$ , gives (4)  $\lim_{n \rightarrow \infty} \Delta Y = \frac{\Delta I}{1 - c}$ . In the case of an open economy with government, the multiplier is equal to  $\frac{1}{(1 - c) + m + t'}$  where  $m$  is the propensity to import and  $\tau$  is the share of taxes in GDP. The multiplier formulation adopted in equation (5) follows that of Kalecki. See Kalecki (1954 and 1971) and Laski (2019).

<sup>22</sup> Richard Kahn (1931) first introduced the multiplier. Kahn defined the multiplier as the ratio of the increment of total employment associated with a given increment of primary employment in the investment industries (Kahn, 1931; Keynes, 1964, p.115): let  $N$  and  $N_2$  be the total and primary employment in the investment goods industry. Kahn's multiplier is equal to  $k' = \Delta N / \Delta N_2$ . On the basis of Kahn's analysis, Keynes developed the investment multiplier ( $m = k = \frac{\Delta Y}{\Delta I}$ ), which “tells us that, when there is an increment of aggregate investment, income will increase by an amount which is  $k$  times the increment of investment” (Keynes, 1964, p.115). Keynes assumed equality between the employment and investment multiplier although these need not be equal (“there is no reason in general to suppose that  $k = k'$ ”). Keynes made this assumption: ( $k = k' \Leftrightarrow \frac{\Delta Y}{\Delta I} = \frac{\Delta N}{\Delta N_2}$ ). This has influenced most analysis of the multiplier. In the case of Latin America and the Caribbean, there is a clear need to distinguish between the investment and the employment multipliers. Taking into account this distinction in the analysis is outside the scope of this paper but is part of the research activities of the authors.

In this equation,  $s_p = (1 - \alpha) + s_w \alpha$  where  $s_p$  = the average propensity to save;  $\alpha$  = the share of wages in GDP;  $s_w$  = the propensity to save from earned income;  $\xi$  = the average propensity to import; and  $\tau$  = the average tax burden. Capitalists are assumed to spend all of their income.<sup>23</sup>

For a given level of tax burden ( $\bar{\tau}$ ), the more dependent an economy is on the rest of the world (the greater  $\xi$ ) and the lower share of wages in GDP ( $\alpha$ ) the lower the value of the multiplier will be and the less impact an expansionary fiscal policy will have. Available data for Latin America, for the period following the global financial crisis (2010–2019), show an average tax burden of 15% of GDP, a wage share of 37% and an average propensity to import of 20%. With these average values, the multiplier is close to 1 (see table 3).<sup>24</sup>

**Table 3**  
Latin America: a first approach to estimate the multiplier

Multiplier parameters and value	Estimation of the multiplier
$s_w$	0
$\alpha$	0.37
$\xi$	0.21
$\tau$	0.15
$m$	1.02
$m_{as}$	1.1
$m_{ac}$	0.84

**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>, and official data for 2020 provided by ECLAC and the World Bank.

**Note:** All the multiplier parameters, with the exception of  $\alpha$ , are calculated from the average values for 2010–2019.  $\alpha$  was computed for the period 2010–2016. In the case of South America, the parameters used are  $\alpha = 0.40$ ,  $\xi = 0.16$  and  $\tau = 0.15$ . In the case of Central America and Mexico, the parameters used are  $\alpha = 0.29$ ;  $\xi = 0.35$  and  $\tau = 0.15$ .

This has significant implications for fiscal policy. First, if the value of the multiplier is close to 1, the impact of fiscal policy on aggregate demand depends essentially on an increase in government spending and, in particular, on the increase in public investment, both relative to GDP. This in turn depends on the rate of growth of public investment, the share of public investment in total investment and the share of total investment in GDP.<sup>25</sup>

Figure 12 reports the results of an exercise to gauge the impact of increased public investment on GDP by combining two hypotheses. The first is the share of public investment in gross fixed capital formation, with values of 10%, 20%, 30% and 50%. The second hypothesis refers to the growth rate of public investment, for which it assumes a range of values between 5% and 30%.

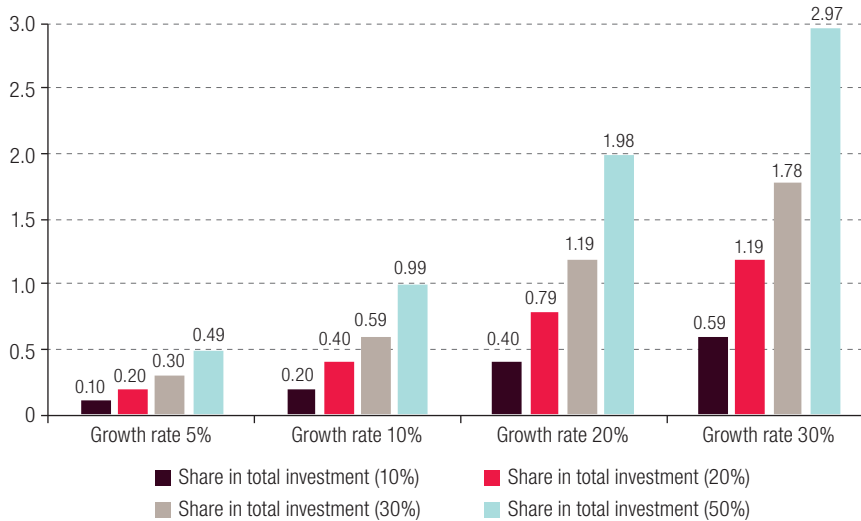
<sup>23</sup> The multiplier was initially formulated in terms of marginal propensities (i.e. marginal propensity to consume. See Keynes (1964). The marginal propensity of the consumption or the export functions is determined by the slope of that function. The average propensity of the consumption or the export functions is determined by both the slope and the level or position of that function.

<sup>24</sup> The tax burden corresponds to the ratio of the tax revenue of the central government to GDP.

<sup>25</sup> It is assumed that the share of total gross capital formation in GDP for the period 2010–2019 averages around 20%.



**Figure 12**  
Latin America and the Caribbean: contribution of increased public investment to GDP growth  
(Rate of growth of GDP)<sup>a</sup>



**Source:** Prepared by the authors on the basis of World Bank, World Development Indicators, Washington, D.C., 2020 [online database] <http://data.worldbank.org/data-catalog/world-development-indicators>.

<sup>a</sup> With different public investment shares in the total and investment growth rates.

The results of this calibration exercise reveal how difficult it is to achieve the conditions needed for the increase in public investment to generate GDP growth of more than 1 percentage point. This can occur in the following cases: (i) an initial situation in which the public sector accounts for 20% of total investment, and public investment growth is on the order of 30%; (ii) an initial situation in which the public sector accounts for 30% of total investment, and public investment growth is on the order of 20%; (iii) an initial situation in which the public sector accounts for 30% of total investment, and public investment growth is on the order of 30%; or (iv) an initial situation in which the public sector accounts for 50% of total investment, and public investment growth is on the order of 10%; (see figure 12). This means that an expansionary fiscal policy will only have a truly significant impact in countries where the public sector accounts for at least 20% of the economy's total gross fixed capital formation, and which can decisively increase their investment expenditure by at least 20% in the short term.

## 2. Debt dynamics

The foregoing analysis also has an impact, in conjunction with other factors, on the dynamics of the debt and its sustainability. This problem can be exemplified with a simple four-equation model. The first equation shows the central government's budget constraint for an open economy in terms of the ratio of public debt to GDP ( $d$ ). Equation 2 defines the interest rate for the entire debt as a sum of domestic and foreign debt payments weighted by the share of the two components in the total debt ( $\delta_d$  and  $\delta_f$ , respectively). Foreign debt service is assumed to include a surcharge ( $pr$ ), whose value depends on foreign investors' risk perception.

The third equation defines the multiplier ( $m$ ), which is the ratio between the GDP growth rate ( $\dot{y}$ ) and the increase in autonomous aggregate demand relative to GDP  $\left(\frac{\Delta D_A}{GDP}\right)$ . The fourth equation establishes a relationship between the GDP growth rate ( $\dot{y}$ ) and the increase in taxes ( $\Delta T$ ). The fifth equation endogenizes the external debt surcharge as a function of the primary deficit and the variation in the debt/GDP ratio.

$$\dot{d} = (r - \dot{y})d + \frac{(G - T)}{Y} \quad (6)$$

$$r = \left\{ r_i \left[ \delta_d + (1 + pr)e\delta_f \right] \right\} \quad (7)$$

Where  $d$  = ratio of public debt to GDP;  $r$  = real interest rate;  $r_i$  = real domestic interest rate on national-currency debt;  $pr$  = surcharge on the domestic interest rate on foreign-currency debt;  $\delta_d, \delta_f$  = shares of domestic and foreign currency debt;  $e$  = nominal exchange rate;  $\dot{y}$  = growth rate of real GDP;  $G$  = total government expenditure;  $T$  = tax revenue;  $Y$  = level of output.

$$\dot{y} = m \cdot \frac{\Delta D_A}{GDP} \quad (8)$$

$m$  = multiplier;  $1 < m < \infty$ .

$$\dot{t} = \alpha \dot{y} \quad (9)$$

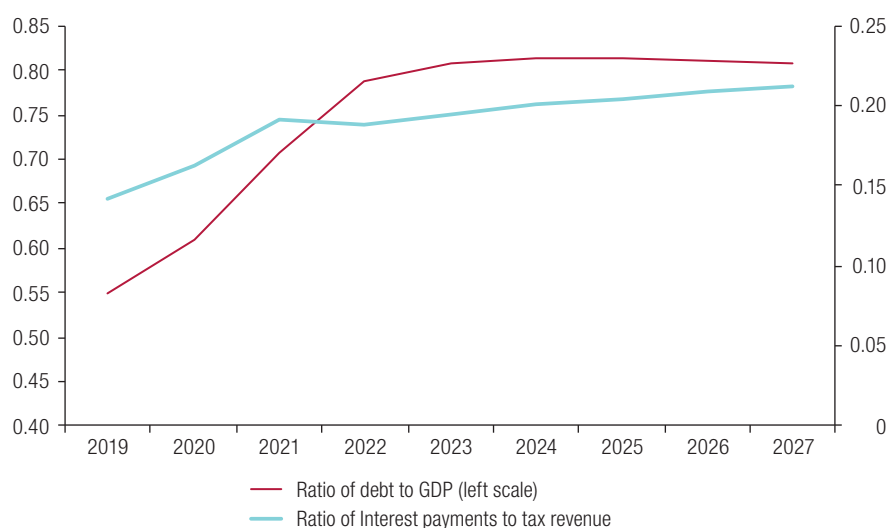
$\alpha$  = elasticity of tax revenue with respect to changes in the GDP growth rate;  $\dot{t}$  = rate of growth of tax revenue;  $\alpha > 0$ .

$$pr = \beta \Delta \left( \frac{G - T}{Y} \right) + \gamma \Delta d \quad \beta + \gamma = 1 \quad (10)$$

Current data for Latin America and parameter values that are within the ranges reported in the literature on the subject, can be used to calibrate the potential evolution of public debt in Latin America, as well as other variables of importance for fiscal performance, such as the interest burden of the public debt. On the basis of a simplified version of the above model<sup>26</sup> figure 13 calibrates the trend of public debt relative to GDP and the burden of debt interest as a proportion of tax revenues for the period 2019-2027.

**Figure 13**

Latin America and the Caribbean: calibration exercise for central government debt relative to GDP and interest payments relative to central government revenue, 2019–2027



**Source:** Prepared by the authors on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2020* (LC/PUB/2020/12-P), Santiago, 2020; ECLAC, *Preliminary Overview of The Economies Latin America and the Caribbean, 2020* (LC/PUB.2020/17-P), Santiago, 2020, and World Bank, *World Development Indicators*, Washington, D.C., 2020 [online database] <http://data.worldbank.org/data-catalog/world-development-indicators>.

<sup>26</sup> We assume for analytical purposes that  $p_f=0$  and we do not distinguish between domestic and foreign debt.

The calibration assumes that the ratios of total central government income and expenditure relative to GDP for Latin America for 2020 are 13.1% and 18.1%, respectively (ECLAC, 2020b);<sup>27</sup> a value of the multiplier of 1 is used for 2019–2022 and 1.5 thereafter, an elasticity of tax collection with respect to GDP of 0.6 and a real interest rate of 4%. It also assumes a contraction in real GDP of 7.7% in 2020 and rate of growth of 3.7% for 2021 (ECLAC 2020b).<sup>28</sup> The rest of the model's values are generated by the workings of the model.

As would be expected, the model's calibration initially reports an increase in debt relative to GDP and an increase in interest payments relative to government revenue.

The debt to GDP ratio begins to stabilize once GDP returns to its pre-COVID-19 level. Within the context of the model's assumption this occurs in 2023, which coincides with the increase in the multiplier from 1 to 1.5. However, debt stabilization is not tantamount to stabilizing the ratio of interest payments to government income. In fact, the model shows that the debt service ratio could continue to increase even after the debt to GDP ratio has stabilized. Policies to stabilize the debt ratio may be necessary to stabilize the debt service ratio, but insufficient on their own.<sup>29</sup>

The results of the model mean that what an economy most needs to do to stabilize its debt position is to boost economic growth. The conclusion drawn from this calibration exercise can also be established, conceptually, from equation (11), which shows that a stable debt/GDP ratio,  $\dot{d} = 0$ , implies that the debt-to-GDP ratio ( $d$ ) is equal to the ratio between the primary deficit  $((G - T)/Y)$  and the difference between the interest rate ( $r$ ) and growth rate ( $\dot{y}$ ). Formally,

$$d = \frac{(G - T)/Y}{\{r_i[\delta_d + (1 + pr)e\delta_f] - \dot{y}\}} \quad (11)$$

Since both  $r_i$  and  $\dot{y}$  have small values, any change in either of them will have a much larger effect than a variation in the primary deficit  $((G - T)/Y)$  (Taylor and others, 2012). The countries of the region do not control the term  $r_i[\delta_d + (1 + pr)e\delta_f]$ . This is essentially due to the existence of a risk premium ( $pr$ ), so the only way to significantly reduce the steady-state value of the debt/GDP ratio is to increase the growth rate.

However, this increase will only be sustainable in the long term if capacity building (true competitiveness) makes it possible to alter the income elasticities of exports and imports, and thus raise the growth rate while maintaining external balance. The variable  $G$  and its effect on  $\dot{y}$  are therefore the main factors determining the fiscal sustainability of the policy response to the pandemic. However, as suggested in the following section, the impact of  $G$  on  $\varepsilon/\pi$  is what ultimately links short-term recovery with long-term reconstruction and establishes the conditions that allow for an expansionary fiscal policy that is sustained over time. Consequently, the ultimate determinant of fiscal sustainability, external sustainability and the growth path of a peripheral economy depends on these variables and on the trend of the debt-to-GDP ratio, rather than on deficit reduction per se.

Stabilizing the debt service ratios may require, in addition to policies to boost growth, a set of consistent exchange rate and monetary policies.<sup>30</sup> However, the leverage to stabilize debt service ratios also depends on external factors outside the control (whether partial or total) of domestic authorities, such as for example changes in the risk premium ( $pr$ ) and also in international rates of interest.

<sup>27</sup> This refers to the period January–September 2020.

<sup>28</sup> The increase in autonomous demand is adjusted, so it translates into 3.7% GDP growth for 2021.

<sup>29</sup> This has obvious implications for economic development. Financial stability does not guarantee the required policy space to pursue fiscal policies for economic development, as some of the fiscal resources will be earmarked for debt service.

<sup>30</sup> A reduction in domestic interest rates may also reduce domestic currency denominated debt service payments and increase foreign currency denominated debt service payments, owing to nominal exchange rate depreciation.

## V. Fiscal policy and investment in structural change in the face of the pandemic

The previous section suggests that the region's institutional and structural characteristics impose considerable constraints on the functioning and effectiveness of countercyclical policy. The conclusion that emerges from the analysis is that a structural change is required to make such a policy more effective.

This idea is exemplified by a model that shows how increasing returns to technological learning and fiscal policy combine with the external constraint to generate different scenarios in a peripheral economy hit by pandemic shocks. Two growth rates are defined: the growth rate that represents the economy's long-term equilibrium and is compatible with the external constraint; and the effective growth rate, which is the actual rate and is not necessarily the same as the long-term equilibrium rate. While the most correct way to assess the external constraint involves considering the basic balance of payments (current account and long-term capital movements), it will be assumed that external balance is achieved when the trade balance is equal to zero. The exclusion of long-term financial flows does not change the analysis substantially. In general, the pandemic has had a greater effect on the current account than on long-term flows.

The effective growth rate of the peripheral economy  $y_p$  has several components that will be divided into two groups: the growth rate of the centre  $y_c$  multiplied by a factor that depends on the income elasticity of exports  $\varepsilon$ , the income elasticity of imports  $\pi$  and the relative weight of imports and exports in GDP; and the rate of increase of autonomous spending in GDP, multiplied by a factor that depends on the shares of autonomous expenditure and imports in GDP, and the income elasticity of imports. As argued in the previous section, the effectiveness of autonomous expenditure also depends on the functional distribution of income. For reasons of analytical simplicity, the model in this section excludes this component.

In figure 14, the TEC curve represents the effective growth rate; and the intercept of this curve changes *ceteris paribus* with variations in the autonomous expenditure of the periphery. The higher the income elasticity of imports and the larger the import share of GDP, the lower the value of the multiplier of incremental autonomous spending (including fiscal expenditure). Thus, production structures that are not very diversified and have less dynamic international demand tend to have a lower-value multiplier, as discussed above.<sup>31</sup>

The (long-term) growth rate with external balance of the periphery  $y_p^E$  is a function exclusively of the relationship between the income elasticity of exports and imports  $\left(\frac{\varepsilon}{\pi}\right)$ , multiplied by the growth rate of the centre  $y_c$ .<sup>32</sup> Formally, this is called Thirlwall's Law, where

$$y_p^E = \frac{\varepsilon}{\pi} y_c \quad (12)$$

The rate at which the periphery can grow by keeping the net long-term trade balance at zero, for each growth rate in the centre, is represented by the CC line. This equation assumes that the real exchange rate is stable.

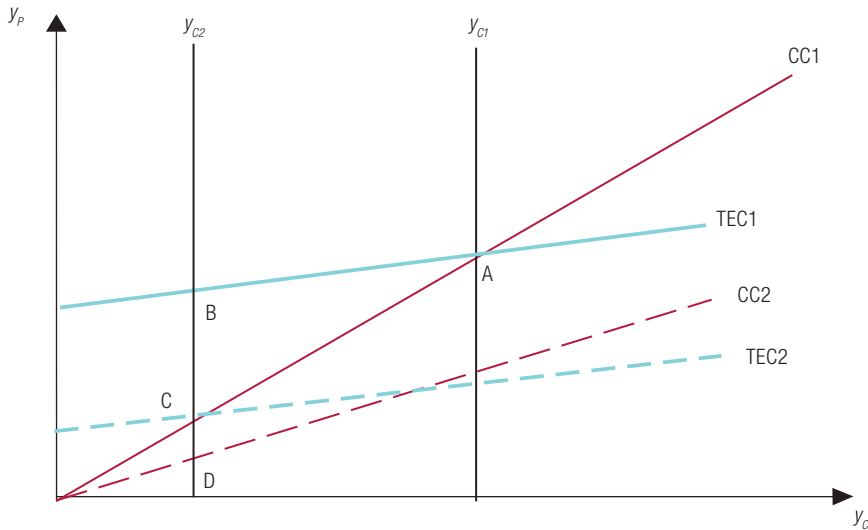
Figure 14 shows the different growth rates, the effective peripheral growth rate (TEC) and the long-term external equilibrium rate (CC). The growth rate of the centre is shown as a vertical line, because it is determined exogenously to the model. The elasticities depend on the production structure

<sup>31</sup> The quotient  $\frac{\alpha}{1 - \beta_2 \pi}$  is the multiplier of the increase in autonomous expenditure (the components of which include public investment and that derived from "animal spirits"). For a study of the multiplier in a model with an external constraint on growth, see McCombie and Thirlwall (1994, chapter 9).

<sup>32</sup> For a review of these models, see Blecker and Setterfield (2019, chapter 12); see also ECLAC (2012).

of the periphery, which, by nature, cannot change very much in the short term. The less technology-intensive and less diversified this structure is, the smaller the ratio  $\left(\frac{\epsilon}{\pi}\right)$  and the flatter the CC line. To make this curve steeper, it is necessary to create “authentic competitiveness” (as opposed to “spurious competitiveness”, in the words of Fernando Fajnzylber); in other words, a competitiveness that is based on technological capacities and on narrowing of the technology gap between the centre and the periphery. At point A, the TEC and CC curves intersect, so the effective and long-term equilibrium rates coincide.

**Figure 14**  
Conservative fiscal policy: investment collapse and loss of capacities



**Source:** Prepared by the authors.

**Note:** CC is the growth rate with current account balance, CC:  $y_p^F = \frac{\epsilon}{\pi} y_c$ . TEC is the effective growth rate  $y_p = \frac{\alpha a + \beta_1 (\epsilon y_c)}{1 - \beta_2 \pi}$ ,

where  $\alpha \equiv A/Y$ ,  $\beta_1 \equiv X/Y$  and  $\beta_2 \equiv QM/Y$ . A is autonomous expenditure; X, exports; M, imports, and Y, GDP, all in real terms.

It is assumed that the pandemic causes a disruption in the world economy, which shifts the centre's effective growth rate to the left. Consequently, the effective rate of growth of the economy moves from point A to point B in figure 14. However, at the same time, domestic demand contracts as a result of reduced aggregate demand, particularly in investment and consumption spending, and the job losses associated with lockdown. The contraction in investment and consumption more than offsets the positive effect of the reduction in the average propensity to import  $\left(\frac{M}{Y}\right)$ . This reasoning is consistent with the stylized facts that have been observed in the region's countries: contraction of investment, consumption and imports of goods and services (ECLAC, 2020a).

The TEC1 curve thus shifts down as a result of the contraction of both domestic and external demand. Depending on the speed with which exports decline (owing to the contraction in global GDP) relative to imports (owing to the fall in national GDP), the economy's external position with respect to the rest of the world could either improve or deteriorate. Available data on the region show that, in the smaller economies, including those of the Central American isthmus and the Caribbean, the contractionary effect on external demand through exports generally outweighs the reduction in imports that results from falling domestic demand. According to the International Monetary Fund, between 2019 and 2020 the current account deficit of the countries of the Central American isthmus is likely to increase on average from 1.7% to 3.3% of GDP, while in the Caribbean it would go from 8% to 18% of GDP (IMF, 2020b). For the rest of the economies in the region, evidence points to an improvement in the current accounts of Brazil, Chile, Colombia, Mexico, Peru and the Plurinational State of Bolivia.

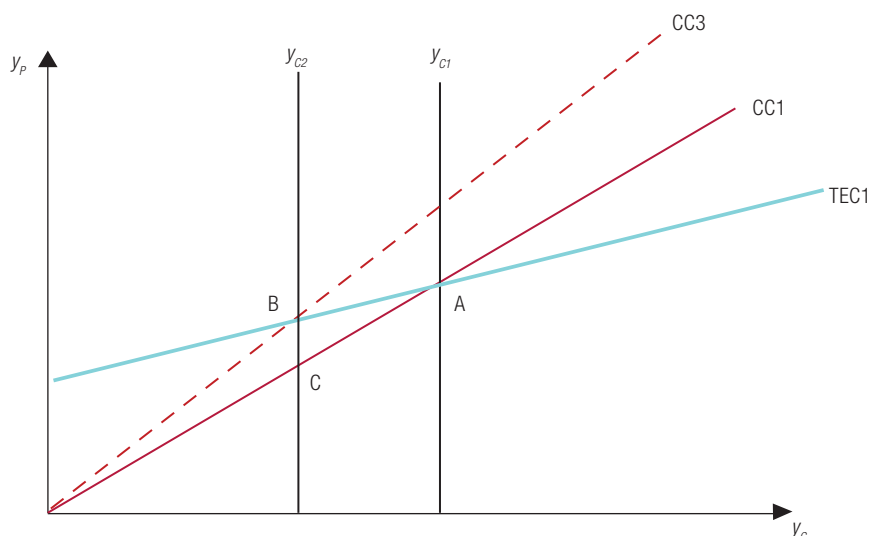
In the long term, the new equilibrium point will be C. Autonomous expenditure would have to move from TEC1 to TEC2 (the dashed blue line) so that the effective exchange rate and external equilibrium coincide in the new situation created by the pandemic, and equilibrium in the trade balance is thus restored. The path of return to external balance (the movement from TEC1 to TEC2) requires autonomous expenditure to be reduced. This movement is explained by factors associated with domestic and external demand. As noted above, in a crisis situation, with significant supply constraints in some key sectors, a general increase in idle capacity and very high uncertainty —such as that generated by the pandemic crisis— capitalists’ “animal spirits” collapse, and consumer spending contracts. The increase in idle capacity dampens expectations for the profitability of new investments. In this context, the effects of aggregate supply and demand are mutually reinforcing and create a negative interaction between the multiplier and the accelerator: while the contraction of autonomous aggregate demand reduces both output and income owing to the multiplier effect, the expectation of lower future consumption reduces investments owing to the accelerator effect.

In general, this contraction in demand is not offset by increased public spending —as was evident during the first year of the pandemic. Public expenditure has been mainly targeted on repair measures and on responding to the urgency of the pandemic, rather than on actions aimed at stimulating the economies (although, of course, compensatory measures helped to cushion the fall in autonomous spending). Naturally, the contraction will be deeper, or the recovery slower, if governments adopt procyclical policies and view the growing fiscal deficit with alarm, or seek premature “consolidation” of the fiscal outcome. In addition, the slide in investment will be aggravated if governments use monetary policy more intensively. As explained above, not only is monetary policy less effective than fiscal policy, but, in a context of close international financial integration, it can become counterproductive. Capital outflows resulting from an expansionary monetary policy can heighten exchange rate volatility and increase the cost of borrowing in international credit markets. Ultimately, it reinforces uncertainty and the fall in aggregate demand and, with it, the decline in the local economy’s expected profit rate.

The story does not end here, however. The retreat of investment implies the loss of technological and productive capacities, which in turn entails a loss of structural competitiveness and, therefore, a fall in the ratio between the income elasticities of exports and imports. The CC curve becomes flatter when the  $\left(\frac{\varepsilon}{\pi}\right)$  ratio falls. The curve representing the external balance is no longer CC1 but CC2 (the dashed red line). In this framework, unless measures are adopted to mitigate the decline in technological and productive capacities, the new point of external balance will be D, and not C, in figure 14. This means that the peripheral economy may find it hard to reduce its trade deficit, even after cutting autonomous expenditure and reaching point C. In such a case, a new adjustment will be needed to establish equilibrium (in other words, a further downward shift in the TEC curve, not drawn). This tends to form a negative spiral of declining growth and loss of capacities (both TEC and CC shift downwards, one curve chasing the other, in a vicious circle). Even if the process is not explosive, the final equilibrium outcome (point D) implies levels of aggregate demand, income distribution and productive capacities that are even less favourable than those resulting from the initial impact of the pandemic.

What happens if the government adopts a countercyclical policy to support aggregate demand? This means that the TEC curve does not shift downwards (or at least not as drastically), as shown in figure 15. To simplify the interpretation of the graph, one can imagine that the government’s fiscal policy (now strongly expansionary) manages to keep the TEC curve in place (TEC1). To achieve this, autonomous public expenditure would have to make up for the deterioration of business “animal spirits” and the retraction of private consumption. Furthermore, based on the analysis in the previous section, this countercyclical policy could —or rather, should— include an income redistribution component in order to raise the marginal propensity to consume and thus strengthen the multiplier.

**Figure 15**  
Fiscal policy combined with industrial policy: capacity building, closing gaps  
and sustaining aggregate demand



**Source:** Prepared by the authors.

**Note:** CC is the growth rate with current account balance, CC:  $y_p^F = \frac{\epsilon}{\pi} y_c$ . TEC is the effective growth rate  $y_p = \frac{\alpha a + \beta_1 (\epsilon y_c)}{1 - \beta_2 \pi}$ , where  $\alpha \equiv A/Y$ ,  $\beta_1 \equiv X/Y$  and  $\beta_2 \equiv QM/Y$ . A is autonomous expenditure; X, exports; M, imports, and Y, GDP, all in real terms.

However, the TEC curve is not sustainable in the long term if the position of the CC curve is not changed to restore the trade balance. Public spending should therefore combine emergency measures to combat poverty and unemployment and redistribute income with an increase in the levels of investment in technology and skills, which aim both to raise  $\epsilon$  and to reduce  $\pi$ —and thus make the CC curve steeper. A reduction in  $\pi$  would also help to make room for the intensity of countercyclical policy by increasing the value of the multiplier (see previous section).

In this case, external balance is achieved by shifting the CC curve from CC1 to CC3 (the dashed red line in figure 15), not by lowering the TEC curve. For simplicity, it has been assumed that the new CC3 curve cuts the TEC1 curve at point B; but the equilibrium is most likely reached at a slightly lower point, between B and C. It would be very difficult for public investment (and fiscal policy in general) to fully compensate for the full impact of the pandemic. Point B is lower than starting point A, but higher than point D, which represented the final balance without fiscal policies to sustain investment and capacities.

While such a strategy implies a determination to support sustained technology expenditure and the structural transformation of the economy, it also means accepting a current account deficit for a certain period of time. In this connection, the international cooperation and more concessional financing of deficits that could emerge in peripheral economies are particularly important in helping peripheral economies recover rapidly from the pandemic. International support is especially necessary if there is already a complicated external situation owing to previous indebtedness and a large deficit on the income account. Moreover, the recovery can benefit the central economies themselves, since it stimulates the recovery of global aggregate demand.

This support does not depend exclusively on greater access to external financing, which may be amply available on international credit markets, especially in the context of the expansionary monetary policies implemented in the central economies. It should also incorporate, a greater acceptance by the central countries of peripheral countries introducing measures to help target this financing towards



their long-term objectives —in particular, structural change aimed at accelerating growth in a manner consistent with long-term external balance. As discussed below, this means not only a greater acceptance of industrial and technological policies in peripheral countries —or at least a “halt” to retaliation— but also regulation of the intensity and use of international capital flows which, in small and open economies such as those of Latin America and the Caribbean, can have both disruptive and constructive effects, as Carlos Díaz Alejandro (1984) predicted.

The foregoing analysis illustrates the importance of the intensity and targeting of fiscal measures during a pandemic. Recovery efforts need to go hand-in-hand with an industrial policy that redefines competitiveness and capacities at the periphery, promotes export diversification (preferably), and substitutes for imports (if appropriate) in a crisis context. As noted below, the conditions that enable such a strategy, including the implementation of an expansionary fiscal policy over a longer period of time than usual, relate to the way the economies in question access international financial markets.

## VI. Conclusions

The pandemic is affecting economies that already had a weak structural platform for growth. The Latin American and Caribbean region has lagged behind the developed economies and, especially, other developing economies that have introduced profound changes in their specialization patterns and international engagement in recent decades. The combination of industrial and macroeconomic policies adopted in several Asian countries, which fostered the development of local production and technological capacities and reduced their exposure to global liquidity cycles, was not adopted by Latin American countries. This is an unresolved issue in our region.

Monetary policies have proven inefficient in both developed and developing countries alike: and there is a consensus on the need to make greater use of fiscal policies. In the Latin American economies, fiscal policies are hampered by the low value of fiscal expenditure multipliers and, depending on the circumstances, by the external constraint on growth. This reflects the heterogeneity of production structures, the existence of a wide spectrum of activities with significant productivity gaps, and generally weak backward and forward linkages. As a consequence of this structural situation, a significant fraction of aggregate demand “leaks” out of domestic circulation, without global demand generating compensatory effects of the same magnitude in the domestic economy.

What response should be made to a scenario as complex as that generated by the pandemic? The lessons drawn from the foregoing analysis are as follows: first, to have a significant impact on aggregate demand, the expansionary fiscal policies adopted in the region must be on a large scale; second, investment must have a very large share in the total fiscal effort; and lastly, investment must be targeted towards the creation of capacities or “true competitiveness”, based on technology and diversification, to avoid external imbalances detracting from the momentum of growth and forcing a retreat towards a policy of austerity. Regional integration policies can support industrial policy in the search for a new production pattern. Progressive tax policies are important to ensure that the public debt/GDP ratio follows a sustainable path that is compatible with the goals of reducing inequality.

To avoid compromising macroeconomic stability and, thus impairing the positive effects of industrial policy on productivity and competitiveness, it is essential to have a stable real exchange rate, which avoids volatile trajectories that move with the swings of global liquidity and the pernicious cycles of external debt —exchange-rate appreciation— contractionary devaluation. In an increasingly volatile world, in which very short-term capital movements predominate (along with their effects on the level of uncertainty), keeping the capital account open is an invitation for the vagaries of financial markets and international commodity prices, currency speculation and liquidity cycles to compromise the

diversification of the production base, the change in the elasticities of trade and the multipliers. There is a seemingly paradoxical situation: long-term policies aimed at changing the production base and creating linkages are the key to making short-term macroeconomic policies more effective. Structural change and macroeconomic stability interact virtuously in the long run.

Despite these difficulties, the crisis also provides an opportunity to overcome the constraints imposed on political action, especially the ideological barriers that prevented giving greater weight to fiscal (expansionary) policy in the toolkit for responding to recessions such as those caused by the pandemic. What this article attempts to convey is that the response to the short-term emergency must involve investments that overcome long-term obstacles, basically the external constraint.

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# Unbridled liberalism and a pandemic: at a crossroads between techno authoritarianism and a new social order

Giovanni Dosi

## Abstract

This paper analyses some of the trends in global capitalism prior to the pandemic and some specificities of the latter that are likely to place the global economy at a crossroads between maintaining the prevailing trend of techno authoritarianism in the governance of countries and a change in the social order. It describes the arrival of the pandemic amid increasing technologization and a fragile socioeconomic architecture, which has been deteriorating since the emergence of neoliberalism in the 1980s and, especially, since the 2008–2009 financial crisis. The major trends analysed are: globalization and the rise of China, wage stagnation and the gap between productivity and wages, along with the explosion in the rate of profit, in addition to (financial and non-financial) corporate profits and the convergence of artificial intelligence and automation. It also outlines a number of lessons to be learned from the pandemic.

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## Keywords

COVID-19, virus, epidemics, economic aspects, social aspects, social structure, economic conditions, liberalism, health, health policy, employment, employment policy, working hours, economic policy, social policy

## JEL classification

D33, F60, O33, P11

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## I. Introduction

This paper will begin by setting out some observations — both general and specific— about the recent COVID-19 pandemic and the official responses to it.<sup>1</sup>

First, the COVID-19 novel coronavirus disease emerged in a Western society characterized by the fragility of its social architecture and its economic and technological structure. At the same time, China has become “the factory of the world” and is gaining increasing weight within global technological and political leadership.

Second, the socioeconomic structure that sustained the “glorious years” of post-war capitalism had already deteriorated for endogenous reasons by the 1970s and was devastated by the conjunction between the rise of fanatic liberalism (Reagan and Thatcher) and the fall of the Soviet Union (which, for all the citizens of the world outside its orbit, represented a miraculous shield against the rapacity of the capitalists).

Third, the 2008 crisis, which immediately turned from a financial crash into a recession in the real economy, was responded to at best (as in the United States) by an attempt to return to a situation of “normality” through Keynesian fiscal policies and (anti-)redistributive policies aimed at socializing financial losses. In the worst case (Europe), the masochistic austerity policies adopted led only to anaemic growth in the stronger countries and persistent stagnation in the others.

And then came the COVID-19 pandemic, which was at first widely underestimated before exploding amidst collective panic. This formed a short-circuit with the incompetence of most political classes which, especially in the presence of disastrous health systems, resorted to the simplest and crudest response, extremely painful in social terms and not very effective from a long-term epidemiological point of view: lockdowns and army patrols on the streets instead of mass testing and early treatment.

Before delving deeper into those issues, however, the pre-existing economic and social trends should be examined.

## II. Ongoing trends<sup>2</sup>

### 1. Globalization and the rise of China as the “factory of the world”

After 40 years of international political pressure towards “free trade”, the liberalization of capital movements has been one of the main causes of the economic instability of the last 20 years (Stiglitz, 2002).

At the same time, far-reaching and rapid changes in the international division of labour with the emergence of China as the world’s industrial hub have significantly reduced the strength of the working classes in the developed West and, in particular, their bargaining power.

### 2. Wage stagnation and a widening gap between productivity growth and wage growth

Differences from one country to the next notwithstanding, from the 1980s onwards average wages (especially in the lower brackets) began to grow more slowly than productivity in almost all countries. As a result, the share of wages in gross domestic product (GDP) also fell.

<sup>1</sup> Most of these issues are discussed in more detail in Dosi (1984) and Freeman and Soete (1994) and, more recently, in Dosi and Virgillito (2019, 2020a and 2020b), Dosi and others (2020) and Bellomo and others (2020).

<sup>2</sup> For more details, see Dosi and Virgillito (2019), on which this section is largely based.

### 3. The explosion of profits, especially financial earnings

This is the obvious corollary to the previous point. The statistical data even underestimate the phenomenon because the remunerations of top management are traditionally included among “wages and salaries” when, clearly, the dynamics of what senior executives are paid in no way correlate to the wages earned by their production-line workers. In addition, the share of financial earnings has increased disproportionately.

### 4. The explosion of financial and non-financial income

The “financialization” of economies certainly includes financial income in the strictest sense: names such as Goldman Sachs, J.P. Morgan and Morgan Stanley are known to all. Less well known are the hundreds of private equity funds that, as a famous prime minister would have it, speculate like locusts on acquisitions and divestitures of companies in the real economy, regardless of the damage to the economy in the long term.

But these rents go far beyond that.

Think of the income derived from patents — primarily, pharmaceutical patents (see below) — and then, more generally, income derived from the expansion of market-based organizational models into spheres that were previously, in Europe at least, almost exclusively public: education, research and health are the obvious examples.

Finally, mention should also be made of the “information-based” revenues of such giant oligopolies as Google, Facebook, Amazon and others.

### 5. Technological convergence between artificial intelligence and automation (the latest trend)

It is only just beginning, but this process promises to radically change working conditions in “factories” and “offices”, significantly increase the role of what are known as platforms, heighten the polarization of working conditions and wages among workers and drastically reduce their bargaining power.

## III. The sudden arrival of COVID-19

It was against the backdrop of those longer-term trends that the pandemic hit. Here too, some background information is necessary. Certainly, COVID-19 is not at all an ordinary flu, but neither is it the Black Death of the fourteenth century. Although the world is facing an unprecedented health crisis, the COVID-19 pandemic is not, in terms of absolute or relative mortality, among the worst ever, especially thanks to the availability of better medical care than in the past. The Spanish flu of 1919 resulted in a mortality rate of 2.73%, but the Black Death of the fourteenth century, which was by far the worst, wiped out more than 40% of the European population.

Unlike the latter, the direct economic impact of the current pandemic has been more limited.

The medieval plague had a great economic impact and was essentially egalitarian: the reduction of almost a third in the labour supply fuelled a surge in wages, while the death of direct heirs led to a massive drop in the price of land.

Today, the main impact of this pandemic is on account of the containment and suppression measures adopted and their interactions with pre-existing economic and social inequalities. The former tend to amplify the latter.

Thus, in many countries —including those with universal public health systems, albeit impoverished by decades of ferocious cuts, such as Italy, France and the United Kingdom— even the location of the patient's home often influences access to hospital care.

The deepest tragedy, however, is to be seen in countries where health care is predominantly a private concern, such as the United States, where income and skin colour are excellent predictors of the likelihood of surviving the virus or succumbing to it.

And then come the effects of lockdowns on present and future earnings, on the probability of dismissals, on the possibility of working remotely...

All this is even more pronounced for workers in the informal economy —which, it should be noted, accounts for as much as 50% of jobs in southern Italy and surely more in developing countries— and for irregular immigrants.

Staying at home appears to be an exclusive privilege of those who work in companies or public agencies that are prepared for teleworking (more the exception than the rule) and for those who have some accumulated savings and therefore can afford not to work. But what about all the others? At best, compulsory vacations and parental leave paid at 50%; in the worst case, significant reductions in job earnings and, in many cases, part-time and precarious work.

One of the many bitter lessons that the pandemic is teaching us is how the difference in labour rights between public employees, private-sector employees, the self-employed and own-account workers becomes unmanageable and even less tolerable during a health emergency. The manufacturing sector strikes of recent months in Italy were clearly motivated by the incomprehensible lack of safety protection measures: for example, reduced shift sizes to ensure distance between workers. Working less but everyone working (spread over several shifts with fewer people) for the same wages could be, and still is, a solution that would ensure output, earnings and employment, but no initiative has been taken in that direction. Orders to avoid crowds have proliferated, but no one says anything about the responsibility of companies to ensure safe conditions with protective equipment.

Then, the economic inequalities are compounded by social and territorial inequalities.

Can online education make up for school closures? Unfortunately, virtual schools cannot be set up in ten days, large sectors of the population lack Internet connections and the necessary devices, and the programmes are far from structured. In any event, it will never compare to face-to-face education, unless the aim is to train a society of subjects with very different and polarized skills, which would also imply polarized “opportunities”. Distance learning is also a source of wide gaps in learning between students of different socioeconomic origins and increases the risk of isolation of students who belong to marginalized groups.

Obviously there is no shortage of anecdotes about (almost) successful experiments —perhaps at schools and colleges in the wealthiest neighbourhoods— but we should also be concerned and ask ourselves whether distance education works for students in poorer and more marginalized neighbourhoods, which tend to have very low school attendance rates.

In classrooms already affected by widespread poverty and social gaps, school —as an institution as well as a building— represents the last chance not only for social exchanges, but also for the promotion of substantial equality. This does not necessarily manifest itself in practice, and we know very well that the income and cultural conditions of families are the variable that most influences actual school achievements and academic paths. Online education, however, opens up a new technology and infrastructure gap that is rooted in social, territorial and economic divides.

Compensatory and support measures have been introduced in all countries, including Italy, for: (i) income (transfers, unemployment benefits, special payments), (ii) companies (transfers again, tax relief, guaranteed loans, possible equity participation), (iii) rent, mainly by means of odious transfers, with people's rents basically paid for by the State for a period, as well as bank credits, also guaranteed by the State.



In the end, almost a year after the outbreak of COVID-19, countries are implementing packages of measures that are not always coherent, designed and assembled by a plethora of bureaucrats representing conflicting interests (with the bankers, of course, much better represented than the unemployed or street vendors).

The social outcome varies from very limited or no protection for informal sector workers and the unemployed poor (with an even worse situation for immigrants), limited protection for permanent workers and small businesses, greater protection for large non-financial companies (just think of the multi-million euro guarantees requested by large European companies), up to an almost complete parachute for financial and real estate income.

## IV. And what about civil liberties?

Efforts to contain and suppress contagion inevitably involve suggestions or coercive measures. According to the Constitution, freedom and health are two fundamental rights and, of course, restrictions of the former must be strictly proportionate to very urgent needs affecting the latter.

On the contrary, it seems there has been a dangerous convergence between total organizational incompetence (where are the masks produced? who sells us the reagents? and the respirators? and how can we expand the intensive care units?) and a kind of common feeling amplified by collective panic that could be called “medical-ethical authoritarianism”.

With all this, the authorities —notoriously incompetent in matters of epidemiology but supported by purported “experts” who, while they did not appear out of nowhere, clearly did not descend from the Olympus of science— regulate our daily lives.

This is a strange and inexplicable ideological coalition between an economic establishment historically indifferent to personal freedoms (“you can only leave the house to go to work”) and a kind of ethical pseudo-left (“we are acting in your interests, so shut up and obey”). And so the paradox is that the standard-bearers of demands for State interference to be constrained have become far-right groups, people who are anti-science and conspiracy theorists.

This gives rise to a very serious problem. The models for curbing the pandemic based on social control, which new surveillance technologies make very easy (and against which liberal democracies have very few antibodies, because they have been weakened by the silent, omnipresent intrusion of major digital platforms), are becoming natural and socially acceptable.

## V. Policies and a possible historical crossroads

The experience of the pandemic teaches some obvious lessons about the policies that should be adopted.<sup>3</sup>

The first very obvious learning is the need to revitalize and strengthen universal public health systems, which have ruined by the “diet” to which the public sector in general —and health in particular— have been subjected in the name of a devastating liberalism taken so far that it has undermined such universal rights as health, education and the generation of knowledge. The fight against the pandemic has been called a “war”. Indeed: wars have always been too serious a matter to leave to the market.

Second, an important corollary to this point is that the State must regain the ability to plan the production of essential goods and services. A couple of months after the attack on Pearl Harbor, the United States was able to produce one battle tank about every hour. Two months into the pandemic, the

<sup>3</sup> For a more detailed analysis, see Pianta (2020).

public administration in most countries within and outside the Organization for Economic Cooperation and Development (OECD) was still not able to produce masks, and did not even know exactly who could make them.

Third, the pandemic has highlighted the dramatic inefficiency of a system of medical and pharmaceutical knowledge generation in which most of the cost is borne by the public sector while the private sector is rewarded with overseeing the exploitation of that knowledge and the revenues it earns. As argued in Cimoli and others (2014), there is an urgent need for the public sector to develop autonomous competence over medicines and vaccines up to the human testing stage and, as a result, for a drastic reduction in the ability of pharmaceutical companies to appropriate the huge revenues guaranteed by “intellectual property rights”.

However, there are policies and programmes whose urgency has only been accentuated by the pandemic, but which still obey the long-term trends described above.

A year ago (Dosi and Virgillito, 2019), attention was dramatically focused on two archetypes in the crossroads that all societies are facing or about to face: the choice between a form of socioeconomic organization that, following Freeman (1992), could be called the “economy of hope” and another that, in honour of the eponymous film, was dubbed the “Blade Runner society”.

Within the political debate, there is finally a growing recognition that something needs to be done in the face of sharply rising inequality, potential mass unemployment, deteriorating working conditions and the erosion of the welfare state. However, the discussions tend to be one-sided (focused on tackling one problem at a time) and too often they are rooted in the interpretative paradigm of economic orthodoxy —based on the idea that policies, if really necessary, should be justified by “market frictions”, rigidities or, at worst, “market failures”— on the assumption that, left to their own devices, markets can generally take care of themselves quite efficiently and, consequently, take care of us all. Thus, for example, by definition, long-term technological unemployment cannot exist.

Of course, societies must assess the effectiveness and possible trade-offs involved in different sets of policies —for redistribution, taxation in a globalized and digitized world, education, training, employment, innovation and industry, for example— but they must be considered together.

More importantly, the debate must be placed in the broader context of the new relationships between people and work and between people and institutions. Different policies will lead to different configurations of the State and its intermediate institutions, with different structures ranging from “minimalist States” to “nanny States” and based on various combinations between individual and collective forms of action and between the provision of collective services by the public sector or by the market.

The different combinations have clearly different consequences: not only in terms of income growth, but also, and at least as importantly, as regards social inclusion and the distribution of work, of income and, ultimately, of power.

First of all, for the first time since the beginning of the twentieth century, a under-proletariat (a lumpenproletariat, as Marx would say) is re-emerging in the industrialized countries of today’s West, made up of people who cannot work, precarious and often clandestine workers, many “platform” workers, in many ways “non-citizens”: think back to the difficulties Italy’s homeless encountered and still face in receiving subsidies or access to the social protection system. Until recently, to read Balzac or Dickens was to read historical novels; today they have to be reread as current events.

And this is a growing part of society that we have to deal with; otherwise, we will be in danger of arriving at the Blade Runner society referred to earlier.

As for “real” workers, so to speak, in the minimalist sense of “those who exist”, those with social security coverage and perhaps “indefinite” employment contracts (with the tragic irony inherent in that adjective after the reforms, in Italy and elsewhere, to make labour markets more flexible): what can we do?

Certainly, alternative programmes for labour market institutions include mechanisms for joint decision-making, through which workers exercise some control over company strategies and, as regards earnings, a universal basic income and a minimum wage are urgently called for. Each alternative has, of course, very different distributive and social consequences. For example, micro-institutional engineering measures involving worker co-ownership, profit-sharing or even German-style joint decision-making put the burden of redistribution on the employer or the individual company. While they are likely to be quite effective “locally”, the major risk they entail is that of creating a gap between an elite group of workers and the rest. While they have the advantage of increasing the share of wages in the income generated and redistributing productivity gains within the company, they have the disadvantage of exacerbating disparities between groups of workers and are relatively ineffective in addressing overall unemployment.

Instead, the lower end of the income distribution must be addressed through more universal programmes, such as the various forms of basic income. These, however, are not without their limitations. While they provide a safety net for all citizens, their implementation tends to be —at best— neutral in terms of general income redistribution. Indeed, basic income is often accompanied by a vast reduction in the welfare state, which entails the transformation of public goods, such as health and education, into (private) income transfers. It should be recalled that Milton Friedman was one of the first proponents of a universal negative income tax. Moreover, basic income programmes can be subject to political distortions, as the right to their access can be made dependent on citizenship, which raises fundamental questions of discriminatory treatment towards “non-citizens” as a whole. Increasing the minimum income level could also help to establish a minimum threshold for labour participation, which is in free fall. However, one should be careful not to weaken the bargaining power of trade unions and threaten the collective organization of workers. It cannot be the only redistributive measure.

In this regard, taxes must once again be given a leading role. Both innovative and proven forms of progressive taxation should be applied. Particular attention should be paid to understanding both the dynamics of the tax base and the ways in which different types of income, whether profits or wages, and rent (financial and non-financial) should be taxed. The pro-market fury of recent decades has combined with a collective anti-tax ideology that has greatly reduced the redistributive impact of fiscal policies and universal services provision. This trend must be reversed and new combinations of tax rates found, so that rent and wealth in general are taxed more heavily than profits and profits more heavily than wages. It is true that it is becoming increasingly difficult to impose levies on rent and profits, not only because there is no political will to do so, but also because of their characteristics and apparent lack of geographical domicile. The technical means exist, however, as profits and financial flows in general can be monitored from their country of origin to their destination country, usually a tax haven.

At the same time, the targets of taxation can also change. New forms of taxation should at least be discussed, including the “robot tax”, the “bit tax” and the “web tax”. Some scholars suggest that whoever owns the robots rules the world (Freeman, 2015).

The Republic of Korea has recently introduced a tax on robots, and the possibility is also being discussed in the European Parliament. However, while a tax on robots would likely delay the adoption of technologies that replace human labour, it is not yet clear whether it should apply to robot ownership or to their use. Indeed, it seems much more reasonable to tax the owners (and thereby, ultimately, the profits generated by the robots). In other times, the choice would have been between taxing locomotives or taxing railroad tycoons, to which the answer is obvious. In addition, robots can be used in different ways, many of which are not intended to replace human activities but to integrate them into a wide range of sectors, from agriculture to industry and the service sector (examples include medical and bio-robot applications).

Another proposal, the “bit tax”, has been part of the political discourse since the early 1990s (Soete and Kamp, 1996). As transactions and the revenues they produce become increasingly “intangible”, the tax base should shift from physical to digital units (i.e. bits of transmitted information). The web tax,

which is levied on digital transactions, can be considered a form of bit tax. The taxation of platforms is another open question of great importance. Platforms are increasingly using individual resources (such as apartments in the case of Airbnb) to make business profits. These assets, which are widely distributed, generate profits that, in contrast, are highly centralized.

In addition to income policies, attention must also be paid to employment policies. Some are indirect and influence, first of all, the characteristics of the job supply. Policies for education and training fall into this category, as do what are known as “active” labour market policies, which provide training programmes for the unemployed and continuing training for workers, so that they can also overcome the possible obsolescence of their skills. While they are certainly essential, these policies alone are completely insufficient and must be accompanied by more direct policies (Dosi and others, 2019). Companies cannot expect the employees they hire to be trained on an ad hoc basis; instead, they should be encouraged to invest in improving employee learning, particularly through on-the-job training programmes. To cope with rapid technological advances, workers should first and foremost possess a wide range of non-specific skills. In particular, higher levels of reasoning and abstract skills should be taught and developed: in other words, the opposite of what many companies require of new hires.

According to an approach dating back at least to Roosevelt’s New Deal, the State is the employer of last resort. Contrary to any notion of a “minimalist State”, this vision implies the creation of massive work programmes during times of recession, which offers the double advantage that publicly useful jobs are performed and that people receive an income (Minsky, 1986).

Last but not least, employment policies include the reduction of working hours. This has also been an ongoing trend in industrialized countries since the mid-nineteenth century, in parallel with the symmetrical ongoing trend towards the mechanization and automation of production. Those policies have recently been tried out in some advanced economies with the dual objective of creating new job opportunities and redistributing productivity gains. Certainly, such measures must be accompanied by strong regulatory limits on involuntary part-time work, non-standard forms of work and “mini-jobs”.

The State has always been a creator of investment opportunities, a sponsor of risky programmes and long-term research, and a generator of innovations with a concrete mission (Mazzucato, 2013). While this has historically been the case —particularly in military and space programmes— it has also played a crucial role in the development of electronics, computing, telecommunications and, before that, synthetic chemistry and pharmaceuticals.

That historic role should be readopted at the present time. One basic objective should be the introduction of ambitious policies that promote the creation and development of new technological paradigms with the sole imperatives of environmental and social sustainability and a fairer redistribution of labour, income and, ultimately, power.

In this way, the public sector must recover its capacity not only to regulate, but also to shape the very strategies of private agents.

Dosi and Virgillito (2019) highlight the way in which information-intensive activities lead to dramatic “increasing returns” —as economists say— to information itself. This, in turn, tends to lead to a (quasi) monopolistic supply structure: the cases of Google, Amazon, Facebook, Airbnb and Uber are archetypical. How should we deal with the socioeconomic consequences of these trends? Competition policies are one obvious measure, and the European Union has recently started to implement them. Will they be enough? Probably not. History teaches us that when “natural” monopolies emerge, the State must regulate them stringently and comprehensively and give due consideration to their nationalization. In the past, that occurred with telecommunications and other public services. We should not try to avoid such policies today, as we face the strongest drive towards monopolization seen since the dawn of capitalism.

Today we stand at a historical crossroads, in terms of both technological trajectories and models of socioeconomic organization. We can move towards a form of techno-feudalism with a deeply divided society or towards a society that collectively shares the benefits of technological advances, as Keynes (1931) advocated almost a century ago.

The path we follow will depend largely on the type of policy we design and implement.

At the end of the day, the pandemic is ultimately nothing more than an acceleration factor and, in the author's opinion, not for the better. Emergencies and fear almost always favour authoritarian solutions and the current situation is no exception. More importantly, there seems to be —at least in early October 2020, as this short essay is being written— no perception of the seriousness of the interaction between a profoundly unfair distribution of income and living conditions and measures that restrict social and individual freedoms, which in the long run are incommensurable and exacerbate the very inequalities of living conditions.

To illustrate this in a dramatic fashion, I conclude with a question: if in Germany in 1933, after a series of restrictive policies that brought the unemployment rate to about 20%, Brüning had also introduced lockdown measures, raising unemployment by another 10%, even if it were motivated by the arrival of the Black Death, how many votes does the reader think Hitler would have obtained? The answer is easy: maybe 80%.

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# The health economy in Mexico

Leonardo Lomelí Vanegas

## Abstract

The global health crisis caused by the coronavirus disease (COVID-19) pandemic has highlighted the important connection between the economy and health. This relationship exists at the microeconomic, macroeconomic and institutional levels, as health markets tend to suffer from market failures; health expenditure tends to increase as a percentage of gross domestic product (GDP), and its financing has long-term implications for public finances. In the case of Mexico, the creation of a public health system that is segmented — as a result of the social protection scheme applied since 1943, which has been reformed several times in recent years— has contributed to making access to health a major factor in inequality, playing a part in the multidimensional poverty of a significant segment of the population.

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## Keywords

Health, health economics, public health, public expenditures, health services, right to health, population, social welfare, health policy, Mexico

## JEL classification

H41, H44, I10, I13, I14, I18, I38

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## I. Introduction<sup>1</sup>

The coronavirus disease (COVID-19) pandemic caused by the SARS-CoV-2 virus has revealed the extent of the strengths and weaknesses of countries' health systems. The pandemic has also highlighted the oligopolistic or monopolistic nature of the main health-related markets, States' insufficient regulatory capacity at the domestic level, and a lack of global governance that is able to organize effective cooperation in situations such as this. For all these reasons, it is no exaggeration to say that the health economy has become a strategic area not only for economic analysis, but also for public welfare and global security.

The health economy emerged as a branch of the welfare economy. This explains why much of the available literature addresses this area of study from a microeconomic perspective and focuses on analysing markets for providing health services and for producing inputs and treatment technology and, more recently, on proposing resource allocation criteria for different medical procedures (Martínez, 2014). From a microeconomic perspective, a fundamental concern regarding the health economy is to correct market failures in the production of such goods and services. This entails different forms of State intervention in these markets; this can range from direct provision to regulation, or direct or indirect subsidization of production or consumption.

The health economy also has a macroeconomic dimension: health expenditure as a percentage of gross domestic product (GDP), or gross national product (GNP) depending on the country under analysis, tends to increase over time, and the financing of health services is a major concern for governments today. In addition, health is a variable that influences economic growth through human capital. Access to health services and their quality are fundamental variables in the population's well-being, affecting both the distribution of income and levels of multidimensional poverty. Therefore, the relationship between health, economic performance and social welfare is strategic, and one of the most promising areas of analysis for modern development theory. The experience of recent decades supports Angus Deaton's proposition that access to health, in addition to being a very important variable in explaining development, is a key factor in reducing or increasing inequality (Deaton, 2015).

## II. The macroeconomics of health

The health economy has an increasingly significant macroeconomic dimension. In all countries, health expenditure is trending upwards in the long term, as a result of two transitions that are closely related to each other and to levels of development: the demographic transition and the epidemiological transition. The combined result is that the population is living longer and a larger proportion is suffering from chronic-degenerative diseases, causing a sustained rise in care costs, which in turn leads to increased health expenditure in the long term.

The demographic transition is characterized by a gradual ageing of the population, owing to increased life expectancy and changes in reproductive patterns, which lead to a transformation of age structures reflected in population pyramids. The increase in life expectancy is the result of the dissemination of hygiene measures that reduce the spread of certain diseases and the universalization of treatments that cure them. The changes in reproductive patterns arise from the increasing proportion of women in the labour market and from family planning; today, families choose to have fewer children, to have them later, or to have no children at all. Increases in school enrolment have reinforced this trend, as women have more information with which to plan their academic, professional and family

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<sup>1</sup> Many thanks to Ismael Valverde Ambriz for his help and valuable comments.

lives (Welti, 2012). The epidemiological transition is also the result of successful prevention policies and access to treatments for infectious diseases, which are curable thanks to the progress in medical knowledge and pharmacology. In 1950, infectious diseases (gastroenteritis, influenza and early childhood diseases) accounted for most of the main causes of death in Mexico, but by 2013 chronic-degenerative diseases predominated, such as diabetes mellitus, ischemic heart diseases and malignant tumours (Soto-Estrada, Moreno-Altamirano and Pahua, 2016).

Public health systems were first created in the late nineteenth century in Mexico, but the process gathered pace after the Mexican Revolution. In 1917, the Department of Public Health was created, which in 1943 was merged with the Secretariat of Public Welfare to form the Secretariat of Health and Welfare (SSA). In that same year, President Manuel Ávila Camacho created the Mexican Social Security Institute (IMSS). These two institutions drove sustained development of the Mexican public health system, based on two pillars: formal workers in the private sector, assigned to the Mexican Social Security Institute, and those not entitled to contributory social security, assigned to the Secretariat of Health and Welfare (Martínez, 2013). In 1960, with the founding of the Social Security and Social Service Institute for State Workers (ISSSTE), a third pillar was created to serve government employees.

For decades, the Mexican State's strategy was to provide access to health services increasingly through social security agencies whose coverage was limited to workers in the formal sector of the economy, in particular, the Mexican Social Security Institute and the Social Security and Social Service Institute for State Workers. In line with this approach, the system to serve those not entitled to contributory social security was conceived as a transitional scheme. However, population dynamics prevented this goal from being achieved and, from the debt crisis and structural change in the 1980s onward, slow economic growth led to a shift away from this objective because of limited growth in formal employment. Consequently, at the beginning of the twenty-first century, Mexico's health expenditure was equivalent to a small percentage of GDP, which had implications both for demographic well-being and for key health and infrastructure indicators.

As shown in table 1, Mexico stands out among Organization for Economic Cooperation and Development (OECD) countries because it has one of the lowest levels of public spending on health as a percentage of total expenditure on health: the proportion of public spending is, together with Turkey's, one of the lowest among the countries in the sample, and below average for OECD countries and even lower than in other Latin American countries such as Argentina, Brazil, Colombia and Peru (PAHO, 2019). Household spending accounts for 41% of health expenditure, including the cost of medication —which represents a significant portion of health spending— and catastrophic medical expenses in health emergencies. In OECD countries, public spending on health care averages 71% of total health spending. Sweden and Japan finance 84% of health expenditure with public resources, while France, Germany, Turkey and the United Kingdom cover more than 75% with public expenditure. In contrast, the United States (50%) spends a similar percentage to Mexico (51%), but the amount of public spending and the proportion with respect to the size of the economy are both significantly higher in the United States.

Mexico also stands out as the country with the least investment in the health sector of the countries analysed: only 1.3% of total expenditure in 2018 was in health, equivalent to 0.1% of GDP. This amount contrasts with Mexico's shortfall in health infrastructure, as shown in table 2. In one crucial indicator —number of hospital beds per 10,000 inhabitants— Mexico is not only behind developed countries such as Germany and the United States, but also behind Latin American countries such as Brazil and Chile. It is also surpassed by other middle-income countries, such as Turkey. This lag is a result of limited investment in health infrastructure in recent decades, owing to insufficient investment in the health sector as a whole from the 1980s to the early twenty-first century.

**Table 1**  
Mexico and selected countries of the Organization for Economic Cooperation  
and Development (OECD): health expenditure indicators, 2008–2018  
(Percentages)

Countries	Annual percentage change in per capita health expenditure (2008–2018)	Financing system as a percentage of the total					Percentage of total public expenditure on health, 2018	Health expenditure from public sources as percentage of total health spending, 2018	Investment in health, 2018	
		Other	Household spending	Voluntary health insurance	Compulsory health insurance	Government systems			As a percentage of total health spending	As a percentage of GDP
Canada	2	2	15	13	1	68	19	73	5.6	0.6
Chile	5	...	34	6	58	2	17	50	2.7	0.2
France	1	1	9	7	78	5	15	77	5.1	0.6
Germany	2	2	13	1	78	6	20	78	9.6	1.1
Italy	1	1	23	2	...	74	13	74	4.1	0.4
Japan	2	1	13	2	75	9	23	84	10.4	1.1
Mexico	1	2	41	6	28	24	11	51	1.3	0.1
OECD	2	2	21	4	37	36	15	71	5.6	0.5
Spain	2	0	24	5	4	66	15	71	8.6	0.8
Sweden	2	1	15	1	0	84	19	84	5.1	0.6
Turkey	3	5	17	...	56	22	10	78	7.4	0.3
United Kingdom	1	2	16	3	0	79	19	79	3.2	0.3
United States	3	4	11	...	58	26	23	50	3.5	0.6

**Source:** Organization for Economic Cooperation and Development (OECD), OECD Health Statistics 2020 [online database] <http://www.oecd.org/els/health-systems/health-data.htm>.

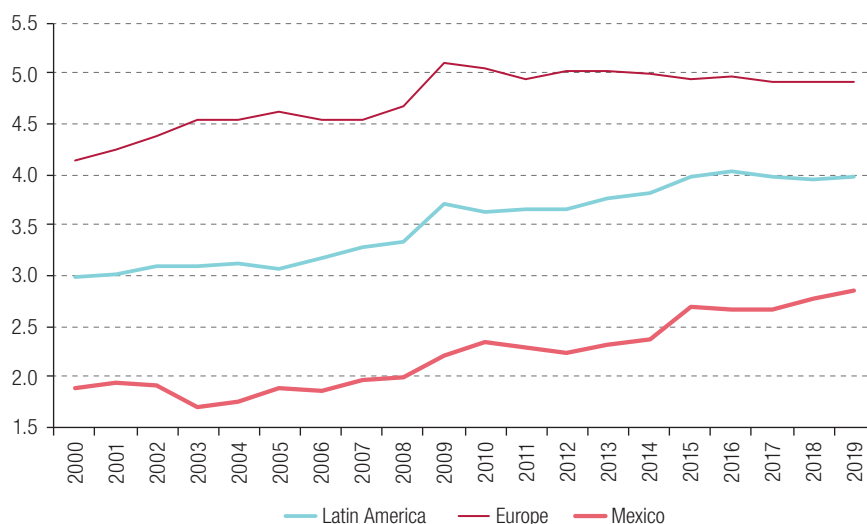
**Table 2**  
Mexico and selected countries of the Organization for Economic Cooperation  
and Development (OECD): hospital beds per 10,000 inhabitants, 2019  
(Number)

	Brazil	Chile	Germany	Mexico	Turkey	United States
2008	24	21	82.13	16	23.39	32
2009	24	21	82.42	16	23.98	31
2010	24	20	82.50	17	25.20	30
2011	23	21	82.24	15	25.34	30
2012	23	22	81.64	15	26.61	29
2013	23	22	82.78	16	26.56	29
2014	22	22	82.78	15	26.66	29
2015	22	22	83.00	15.2	27.00	29
2016						
2017						
2018						
2019	22	22	83.7	15	27	29

**Source:** World Health Organization (WHO), Global Health Expenditure Database (GHED), 2020 [online] <https://apps.who.int/nha/database>.

These deficiencies exist because public spending on health in Mexico has remained below average for OECD countries, and even below the average for Latin America. Over the last 20 years, there have been two clear trends in public spending on health (before and after the crisis of 2008 and 2009): while in Europe and Latin America the trend was upward before the crisis, from 2009 onward it stalled in Europe and slowed in Latin America (see figure 1).

**Figure 1**  
Latin America, Europe and Mexico: public expenditure on health, 2000–2019  
(Percentages of GDP)



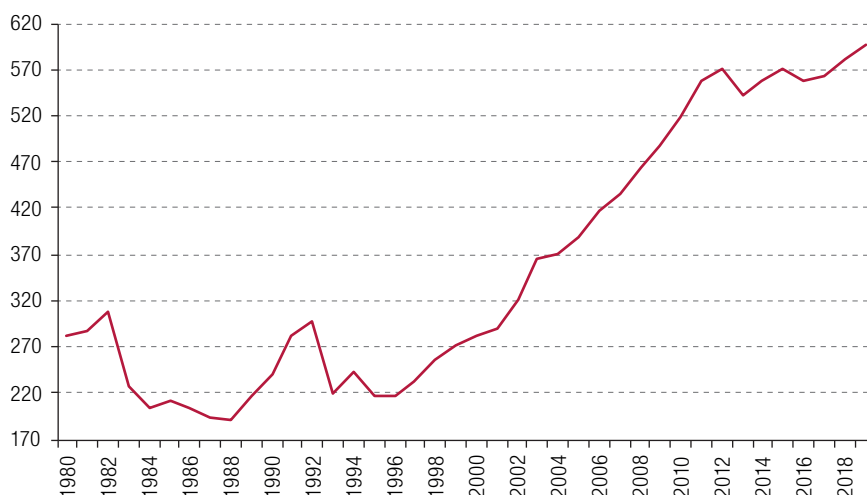
**Source:** World Health Organization (WHO), Global Health Expenditure Database (GHED), 2020 [online] <https://apps.who.int/nha/database>.

In contrast, in the first two decades of this century, public spending on health rose in Mexico, albeit with some fluctuations, an increase that was all the more significant considering that it occurred during a slow-growth period in the Mexican economy. For a little more than a decade, the increase in public spending on health was sustained in real terms. However, despite this effort, Mexico has not managed to reach the Latin American average for public spending on health as a percentage of GDP, let alone the European average. What is more, even the Latin American average does not meet recommended international standards. According to the Economic Commission for Latin America and the Caribbean (ECLAC), most countries in the region have underinvested in health:

Central government spending on the sector, which in 2018 stood at 2.2% of regional GDP [...] is far from the 6% of GDP recommended by the Pan American Health Organization (PAHO) to reduce inequities and increase financial protection within the framework of universal access to health and universal health coverage. Additional resources would help to strengthen the first level of care, with an emphasis on disease prevention (ECLAC, 2020a, p. 9).

Throughout recent history, public spending on health has fluctuated, reflecting the procyclical macroeconomic policy that has predominated in Mexico since 1982 (Ros, 2013), whereby social spending and investment have been reduced to lower overall public spending in times of crisis. As shown in figure 2, real public spending on health declined during crises and economic slowdowns, such as the debt crisis that began in 1982, which was exacerbated in 1986 by a fall in oil prices. After a period of recovery in the late 1980s and early 1990s, there was a further decline from 1993 onward, exacerbated by another crisis in 1995. In 1996, a recovery began that continued through to 2009, when cuts were made to the areas of social spending (mainly education and health) and investment (infrastructure and energy). It was at this time that the Government of Mexico made its greatest effort to provide services to those not entitled to contributory social security, which rather than shrinking was expanding owing to a downturn in formal employment. However, from 2012 onward, there was a clear slowdown in growth.

**Figure 2**  
Mexico: public expenditure on health, 1980–2019  
(Billions of Mexican pesos at 2018 prices)



**Source:** National Institute of Statistics and Geography (INEGI), “Salud”, 2020 [online database] <https://www.inegi.org.mx/temas/saludsat/>.

There is no doubt that Mexico needs to allocate more public resources to health. The high percentage of spending that is borne by households reflects the continuing importance of access to these benefits for the well-being of the population and their impact on poverty and inequality. A lack of access to public health services exposes the population that receives insufficient and unstable income to poverty in the event of potentially catastrophic illness. Furthermore, the segmentation of the systems, with different ranges of services and care quality gaps, adds to the economic and social inequality that characterizes Mexico.

A public health system with universal coverage and a comprehensive range of services would do much to lower the risk of poverty, reduce inequality and strengthen social cohesion. For a system to be viable, it needs to be financed with general taxes, which is only sustainable in the long term with an exhaustive redistributive tax reform. The irony is that if no progress is made towards building this system, which may seem an ambitious goal, segmentation may prove more expensive in the long term, both economically, and because of larger gaps between those not entitled to contributory social security and those who are entitled to benefits from special social security agencies.

### III. The microeconomics of health

According to 2018 records for Mexico’s Health Sector Satellite Account, the health sector provided the equivalent of 5.7% of Mexico’s GDP; 4.1% corresponded to the GDP of economic activities in the sector and 1.6% to the value of unpaid work relating to health care. For the GDP of economic activities in the sector, 71.9% was generated by the economic units that make up the sector and 28.1% corresponded to the monetary value of the unpaid work carried out by households to care for the sick. Of the goods required by the health sector, 80.2% were of domestic origin, 10.4% were imported and the remaining 9.4% corresponded to commerce and distribution margins. The goods and services account of the sector was in surplus, with net exports of 11.799 billion Mexican pesos, including significant exports of dressings and wound care supplies and other health-care goods. In the same year, the health sector created 2,204,897 new paid jobs, representing 5.1% of total national employment (INEGI, 2019).

While the health sector has surpluses in both the trade and service accounts, the related sector of drug manufacturing does not. The Mexican pharmaceutical industry has suffered ups and downs since the crisis of 2009, and its share of manufacturing GDP declined from 5.2% in 2003 to 3.2% in 2014. One of the reasons for this downturn is exchange-rate fluctuations —as around half of its inputs are imported— which has pushed up import costs. Imports of medicines and pharmaceutical inputs amounted to 70.607 billion Mexican pesos in 2018, while exports amounted to 22.143 billion Mexican pesos. The balance of trade in the same year amounted to 48.464 billion Mexican pesos. In terms of health sector imports, key items include health care equipment, dressings and wound care materials and glasses (INEGI, 2019).

In view of the weaknesses revealed by the current health crisis, industrial policy should prioritize the pharmaceutical industry and the sector that produces safety equipment and technology for health care. As the Executive Secretary of the Economic Commission for Latin America and the Caribbean (ECLAC), Alicia Bárcena, highlighted in a briefing for the member countries of the Conference on Science, Innovation and Information and Communications Technologies (a subsidiary body of ECLAC): “we have to bring science, technology and innovation closer to productive sectors [...] such as in the case of manufacturing medical supplies, diverse products for health protection, tests to detect the virus, and critical medical equipment such as mechanical ventilators, among other items” (ECLAC, 2020c). In times of crisis such as 2020, reducing national dependence on medication and devices that are crucial for health care becomes a strategic area, and also opens up possibilities for industrial development, technological innovation and import substitution for the countries of the region.

## IV. The challenges Mexico faces in guaranteeing the right to health

Despite the progress made by Mexico in terms of life expectancy, health care in the country is unsatisfactory, given that the public health-care system shows significant deficiencies in three core indicators: equality, quality and financial coverage, as shown in table 3.

**Table 3**  
Mexico and Organization for Economic Cooperation and Development (OECD): indicators of equality, quality and financial coverage, 2019

Indicator	Mexico	OECD
Equality		
Health service coverage ( <i>percentages</i> )	89.3	98.4
Financial protection ( <i>percentages</i> )	51.3	71.0
Quality		
Effectiveness of basic services	85	225
Effectiveness of secondary services	27.5	6.9
Financial coverage		
Health expenditure per capita ( <i>dollars</i> )	1 138	3 994
Health spending ( <i>percentage of GDP</i> )	5.5	8.8

**Source:** Organization for Economic Cooperation and Development (OECD), *Health at a Glance 2019: OECD Indicators*, Paris, 2019.

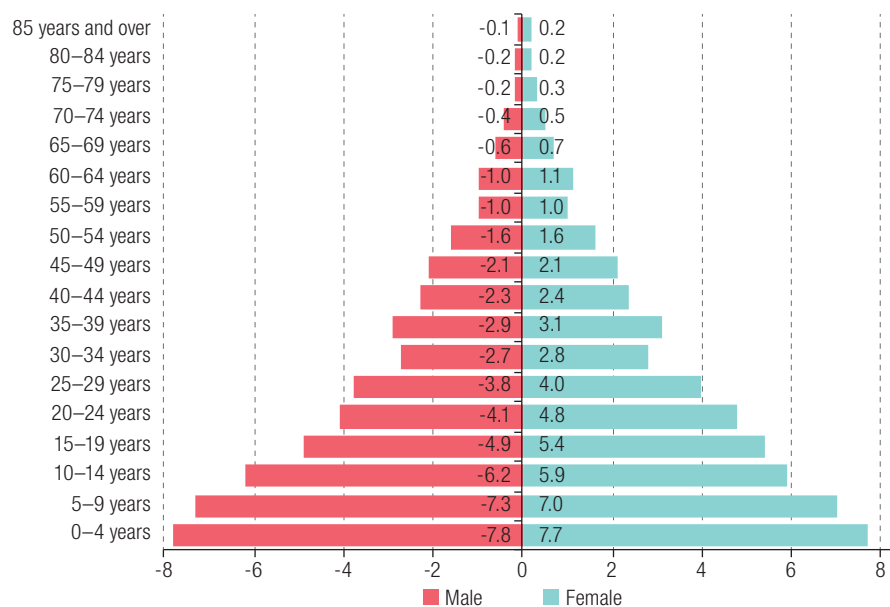
**Note:** Health service coverage is calculated as the percentage of the population eligible for basic services; financial protection is the percentage of the population aged over 15 years whose health expenditure is covered by public sources; The effectiveness of basic services can be discerned from the number of hospital admissions for asthma and chronic obstructive pulmonary disease (COPD) per 100,000 inhabitants, and the effectiveness of secondary services can be inferred from the 30-day mortality rate for myocardial infarction per 100,000 inhabitants.

These gaps are not only apparent in international comparisons, they are also worsening within the country. Inequalities and contrasts remain key characteristics of Mexico and occur in access to health and health infrastructure, both among individuals and social groups and among regions. It can be argued that, as a country's income level determines its health sector conditions, Mexico will be able to aspire to better health levels as its economic performance improves. However, several studies show that health levels also directly affect economic growth. As recently stated by ECLAC and the Pan American Health Organization (PAHO), "sustainable economic growth is a central component of people's health and overall well-being. At the same time, the protection and promotion of the population's health should be the basis for a strategic initiative aimed at long-term growth and development" (ECLAC/PAHO, 2020, p.16).

In the case of Mexico, research by David Mayer-Foulkes (Mayer-Foulkes, 2001) —on the relationship between life expectancy and mortality rates (among different age groups) and economic growth— maintains that advances in health contributed around one third of the (potential) growth recorded in Mexico in the period 1970–1995. Population growth and a rising life expectancy throughout the twentieth century allowed the country to grow from 13 million inhabitants in 1900 to over 100 million in 2000. In addition, over the course of two decades, from 1940 to 1960, Mexico was transformed from an overwhelmingly rural country to a predominantly urban one (Welti, 2012). There is no doubt that this major transformation would not have been achieved without the investments in health made by the government in the post-revolution period, even if they were insufficient.

The system was developed during the rapid industrialization and urbanization of the decades following the Mexican Revolution. This also made it easier to disseminate general hygiene measures and treatments, at a low cost, for the most common infectious diseases. These improvements increased life expectancy at birth. As a result, by 1950, significant progress was being made in reducing child and maternal mortality, which had an impact on population growth. The only discontinuity in an almost perfect population pyramid was, according to the census for 1950, in the group of those born during the critical years of the Mexican Revolution (1913–1916) and the Spanish Flu (1918–1919) pandemic (see figure 3).

**Figure 3**  
Mexico: population pyramid, 1950  
(Percentages)



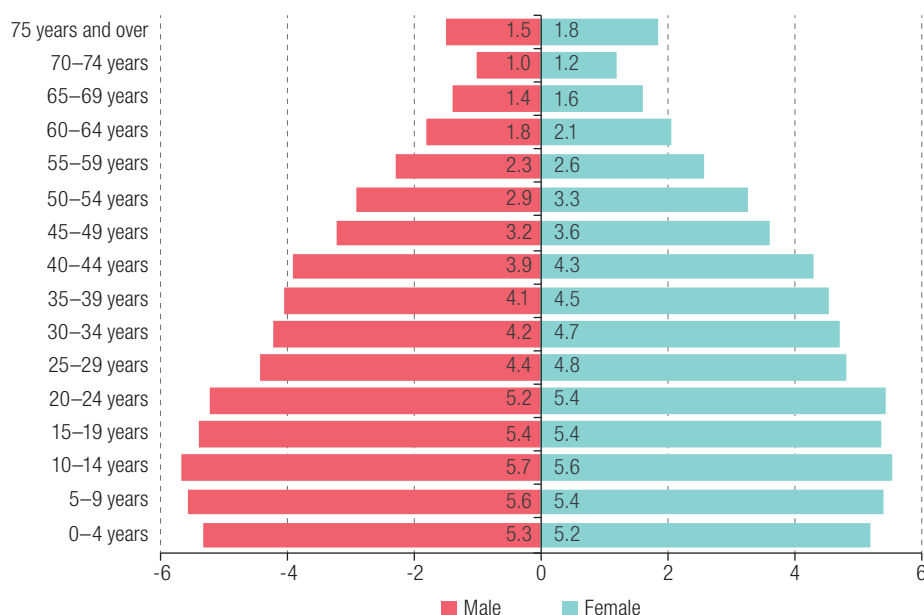
**Source:** National Institute of Statistics and Geography (INEGI), Séptimo Censo General de Población, Aguascalientes, 1950.



The social policy adopted by the State in the post-revolution period, based on including the population in health protection systems through registration of beneficiaries and their families with social security agencies, entered a crisis in the 1980s. It had already become clear that these agencies struggled to absorb a portion of the informal economy, but at this time the economy began to fluctuate, affecting formal employment and bringing the previous growth in coverage to a halt. In addition, quality deteriorated, as a combined result of policies of lower spending in the 1980s and higher costs of health care. This occurred amid a demographic transition, when there was a larger population of working age and the dependent population under 15 years of age was shrinking, resulting in a demographic dividend that was squandered owing to slow growth in the Mexican economy. As the country was unable to generate enough jobs in the formal sector, the main escape valves were emigration and informality (Lomelí and Vázquez, 2016).

Mexico's population structure, in which children and youths predominated in 1950, was substantially different by 2015, as a result of the success of the population policy launched through the 1974 General Act on Population, the creation of the National Population Council (CONAPO) and the systematic roll-out of family planning campaigns. These policies reduced population growth, as reflected in a narrowing base of the population pyramid, resulting in expansion of the working-age population and the consequent reduction in the dependency ratio. These changes are clear in the 2015 population pyramid, despite an upturn in the birth rate in the 2000s (see figure 4).

**Figure 4**  
Mexico: population pyramid, 2015  
(Percentages)



**Source:** National Institute of Statistics and Geography (INEGI), Encuesta Intercensal 2015 [online database] <https://www.inegi.org.mx/programas/intercensal/2015/default.html>.

Despite the reforms, and an average real annual increase of 4.4% in per capita health expenditure between 1997 and 2007 (above the average of 4.1% recorded in OECD countries), in Mexico there are asymmetries between the care provided by the health system and the needs of the population. Because of the crisis in the 1980s and its aftermath in the 1990s, despite the progress made in the twentieth century, some deficiencies remain, with new challenges arising from the demographic and epidemiological transitions. Together, these impediments maintained and exacerbated the problems

caused by the fragmentation of the health system (institutions and programmes), insufficient and unequal coverage, inefficient resource allocation, poor utilization of medical units and financial imbalances. Added to these problems is the unequal distribution of health infrastructure in Mexican territory, which reproduces regional inequalities and coincides with the geographical distribution of poverty (Lomelí, Flores and Granados, 2012).

In 2016, public spending accounted for 52% of total health expenditure, and financed two key types of institutions: those that provide services to people who are eligible because of their employment status (Mexican Social Security Institute, Social Security and Social Service Institute for State Workers, and the health services of *Petróleos Mexicanos* (PEMEX), the Secretariat of Defence (SEDENA) and the Secretariat of Maritime Affairs) and programmes for the population without social security. Private spending in the same year amounted to 48% of the total; more than 80% of private expenditure was out-of-pocket and the rest was covered by private insurance systems. Leaving aside international comparisons and the lack of universal parameters for optimal investment in health in relation to the size of an economy, it is important to ask whether Mexico is investing appropriately (considering total expenditure, financing sources and distribution). The pandemic has made it clear that investment in health is not only lower than needed in Mexico, based on the country's level of development and needs, but also that the distribution of investment does not contribute to reducing disparities in health indicators.

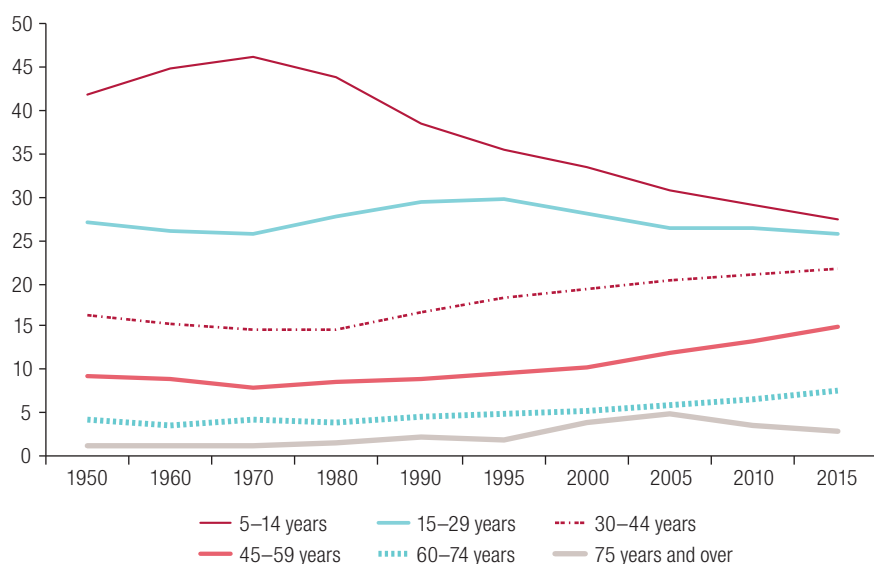
The increase in real terms in federal resources for the population without social security has not resolved the imbalance between public spending on the insured and the uninsured. In 2004, the government launched the *Seguro Popular* insurance scheme, which was theoretically financed from three sources: federal resources allocated by the Secretariat of Health, State resources and family instalments, from which families from the poorest 40% of households were exempt. In 2009, the resources available for *Seguro Popular* accounted for 48.6% of total expenditure in section 12 (health) of the Federal Budget, at 41.368 billion Mexican pesos, 5.7% more than in 2008. In 2019, *Seguro Popular* received 80.144 billion Mexican pesos, representing 64.5% of the resources allocated to section 12 of the budget. This significant increase in resources meant that in 2017 public spending on health was equal to 52% of total health spending. However, total per capita expenditure for people without social security was 3,954.9 Mexican pesos compared to 5,644.7 Mexican pesos for those with social security, once again reflecting the inequality problems caused by segmentation of the public systems (CONEVAL, 2020).

In November 2019 the federal government announced that the *Seguro Popular* scheme was to be dissolved and merged into the Institute of Health for Welfare (INSABI). As explained on its official website (Institute of Health for Welfare, 2020), the purpose of the Institute is to provide “free, quality health services to all people in the country who do not have social security”, in accordance with “criteria of universality, equality and inclusion”. In addition, “beneficiaries of the Institute of Health for Welfare shall receive unrestricted medical services because there shall be universal care for all conditions, including those that entail catastrophic costs”. It also aims to “guarantee and improve care in public health services”, ensure “the supply of medicines and sufficient equipment for the care of beneficiaries at all levels of health care”, as well as “rehabilitating and expanding the medical infrastructure”.

It is undeniable that health services must be extended further and that public programmes must be effectively integrated and interlinked. However, it is not clear whether dissolving the *Seguro Popular* scheme and the creating the Institute of Health for Welfare is the best means of extending coverage. Moreover, the question arises whether the creation of a new programme is not fuelling segmentation of public services, heterogeneity of benefits and operational inefficiency of the national health system. Without a doubt, the budgetary priority given to this new organization, and proper organizational and institutional design, are crucial to it fulfilling its intended purpose.

Coverage is no trifling issue in a country facing a progressively ageing population. It is not yet a problem, but will be in three decades' time. If current demographic trends continue, by the mid-twenty-first century the percentage of adults aged over 60 years without social security in need of health services will have increased significantly. As shown in figure 5, since the 1960s, the under-15 population group has shrunk swiftly, while the over-30 group has been growing rapidly since the 1980s. This trend suggests a progressive population ageing that will necessitate allocation of more resources to both health and social security by the middle of the twenty-first century.

**Figure 5**  
Mexico: population distribution by age group, 1950–2015  
(Percentages of the total)



**Source:** National Institute of Statistics and Geography (INEGI), Encuesta Intercensal 2015 [online database] <https://www.inegi.org.mx/programas/intercensal/2015/default.html>.

Demographic trends indicate population ageing and the ongoing epidemiological transition points to higher health-care costs in the future. The emergence of new diseases, in particular resulting from the rapid spread or mutation of viruses such as SARS-CoV-2, will necessitate increased investment in health research and the development of new prevention and care mechanisms, as well as stronger capacities of curative care services. This is why the challenges of increasing coverage, reorganizing system priorities and improving care quality are interrelated.

In addition to these considerations, access to health services remains a factor in the poverty and inequality for much of the Mexican population. According to the National Council for the Evaluation of Social Development Policy (CONEVAL, 2020), based on data from the 2018 National Household Income and Expenditure Survey, in Mexico in that year 20.2 million people had no access to health services and 71.7 million had no access to social security. These data are of interest because the population not affiliated with social security organizations was covered by the Seguro Popular scheme and was protected for fewer medical services —294 according to its latest catalogue, dated September 2019 (CNPSS, 2019)— than affiliates of the Mexican Social Security Institute or the Social Security and Social Service Institute for State Workers.

But even these data do not reveal the full extent of the health-care problem in Mexico. According to the National Institute of Statistics and Geography, in 2020, 82.2% of those who are currently not entitled to contributory social security will be affiliated with social security organizations or public health

services, while 23.1% will use private medical services (INEGI, 2019). The second percentage includes those whose socioeconomic status enable them to afford private health care and those who resort to it in emergencies because, despite being entitled to State health care, they are unwilling or unable to wait their turn to be treated by public institutions. Indeed, owing to a lack of resources, waiting times have become the main means of rationing used by public health services to manage excess demand, given their insufficient supply. The challenge for the Institute of Health for Welfare is not only to increase coverage, but also to increase the number of medical services covered and the capacity to provide care, reducing waiting times.

As the health emergency of 2020 has shown, another important aspect to consider is the strategic nature of substituting imports of medicines and medical devices. According to ECLAC, “the disruption of several global value chains has shown the risks of heavy regional dependence on imported manufactures. This is particularly evident in the severe limitations on the supply of essential products for combating COVID-19, following restrictions imposed by most of the region’s major suppliers” (ECLAC, 2020b, p. 19).

## V. Conclusions

The main challenge in guaranteeing the right to health is to achieve universal coverage without causing new asymmetries in quality and supply of public health system services, which is a result of their segmentation. For the Institute of Health for Welfare to fulfil its purpose, it will need sufficient material, financial and human resources, and it must be an organization that is able to operate in the short term for the benefit of those not entitled to contributory social security, but is also flexible enough in the long term to integrate and interlink with the other public institutions in the sector, to build a genuinely national health system.

Human development does not and cannot occur without a universal and comprehensive health system. The State cannot renounce its responsibility to ensure access to health for all citizens. A fiscal effort must therefore be made to finance such a national health system. The market would only mirror the asymmetries in income distribution in access to health services. It is therefore clear that market forces or trade negotiations do not determine the health level of the population, and cannot be allowed to do so. The State has the inescapable task of formulating policies to protect the health of Mexicans. In fact, it is a duty enshrined in the country’s Constitution, article 4 of which recognizes the right to health. It is the responsibility of everyone, and in particular of legislators, to design appropriate mechanisms to guarantee this right.

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# A “new normal” as a “new essential”? COVID-19, digital transformations and employment structures<sup>1</sup>

Maria Savona

## Abstract

This paper explores the new policy challenges that have emerged as a result of the coronavirus disease (COVID-19) pandemic. The “new normal” should acknowledge the “new essential” in terms of jobs and sectors. First, the paper examines the trade-off between health policies and anti-recessionary policies. It studies the economic impact of lockdown on households and firms and, relatedly, the slowdown in global value chain-related trade. It then examines lessons that can be learned from this crisis in areas that were topical before the outbreak and are likely to be even more so after it. These include the need to steer digital transformation so as to minimize negative impacts on jobs and sectors while reflecting critically on their “essentiality” and the need for concerted policy action to ensure good governance of health data.

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## Keywords

COVID-19, essential services, viruses, epidemics, economic aspects, employment, international trade, global value chains, labour market, digital technology, capacity-building, working conditions, data governance

## JEL classification

O140, O330, O380, J31

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<sup>1</sup> The author is deeply indebted to Tommaso Ciarli for his detailed comments on a previous draft of this note. She is also very grateful to Gabriel Porcile and Miguel Torres for their encouraging remarks. This note is partly based on Savona (2020); it also reports our recommendations to the European Commission on how to address the impact of digital transformation on labour markets (European Commission, 2019) and sets out ideas for a joint United Kingdom Research Institute (UKRI) research proposal discussed with Tommaso Ciarli and Ariel Wirkierman, both of whom are an endless source of research creativity and rigour.



## I. Introduction

In 2018, Bill Gates predicted that “given the continual emergence of new pathogens, the increasing risk of a bioterror attack, and the ever-increasing connectedness of our world, there is a significant probability that a large and lethal modern-day pandemic will occur in our lifetime”. He believed that “the world needs to prepare for pandemics in the same serious way it prepares for war. This preparation includes staging simulations, war games and preparedness exercises so that we can better understand how diseases will spread and how to deal with responses such as quarantine and communications to minimize panic” (Gates, 2018).

Gates’s argument should not be accepted uncritically, as, arguably, policy priorities ought to be preventing pandemics (and, incidentally, wars) from occurring in the first place and then investing in public health to better deal with them if they do. Two years later, though, the coronavirus disease (COVID-19) pandemic is causing a significant number of excess deaths and still seems far from having been contained, as the world awaits the distribution of the vaccine. And, debatable though the use of war metaphors for government interventions may be,<sup>2</sup> simultaneous global actions of the magnitude of a post-war reconstruction might indeed be needed. Some of the fiscal interventions of governments around the world, for instance in Europe, have indeed been substantial (for a brief summary, see Castellarin, 2020), and a wealth tax has been proposed to fund the response to the pandemic (Landais, Saez and Zucman, 2020).

However, some have argued that properly tackling the current crisis might require more than throwing money at it. We need to “build back better”, as ECLAC has courageously argued in its policy recommendations (ECLAC, 2020), or, as others have argued, “build forward” (Agarwala and others, 2020).

Since the outbreak of the COVID-19 pandemic, there has been an unprecedented output of (grey) literature in the fields of the natural (biomedical, epidemiological) and social sciences; often simply opinion pieces rather than academic studies. Remarkably, some of these contributions were being published even before the virus had fully spread across the Atlantic and really affected economies (Gans, 2020; Baldwin and Weder di Mauro, 2020).

Within this augmented space for discussion, the intended contribution of this brief paper is to selectively unpack the impact of COVID-19 on the economy, with a particular focus on digital transformation and the sectoral and occupational dimensions. It argues that the so-called “new normal” is the result of a structural transformation of modes of production and consumption, aided by digital technologies, that has been imposed by governments to contain the outbreak. From a normative perspective, these structural transformations are forcing us to consider what the “new essential” might be, in terms not only of jobs but of policy priorities, and arguably how it might be possible to “build back better”.

The paper is structured in four sections and attempts to draw lessons not only for policy, but also for research agendas, while unpacking a selection of ingredients that can contribute to the aim of building back better. Following this introduction, section II examines the supposed policy trade-off between containing the pandemic and trying to avoid a global economic recession, reflecting on the employment impact of national lockdowns and shutdowns of firms and sectors and the associated slowdown of global value chain (GVC)-related trade. Section III then looks at opportunities to learn from this crisis in areas that were topical before the outbreak and are likely to become even more so in the aftermath of the pandemic, including the need to steer digital transformation so as to minimize the negative employment and underemployment impacts on particular jobs and sectors, alongside a critical reflection on their “essentiality”, and, in a global context and at a time in history when data-intensive sectors are gaining momentum, the need for concerted policy action to ensure good governance of health data. Section IV concludes.

<sup>2</sup> See [online] <https://www.theguardian.com/commentisfree/2020/mar/21/donald-trump-boris-johnson-coronavirus>.

## II. Coping with the emergency: there should not be a policy trade-off between public health and economic recovery

### 1. Minimizing exposure to contagion and the shutdown of economic activities

At the outset of the pandemic, most governments across the globe intervened with lockdown restrictions on households and shutdowns of economic activities as an emergency response to the pandemic, in an attempt to contain the outbreak. Making public health the priority, these policies had a negative effect on both supply and demand.

A plethora of studies have been produced since to assess the economic, employment and inequality impact of government restrictions brought in to contain the pandemic. This evidence would ideally be used to fine-grain policy interventions in response to subsequent waves of the pandemic and avoid any need for trade-offs between public health and economic recession in any national context or, as discussed in the following section, internationally.

At the macroeconomic level, Guerrieri and others (2020) argue that the COVID-19 pandemic fits the theory of Keynesian supply shocks. This posits that supply shocks linked to shutdowns, layoffs and firm exit trigger aggregate demand shocks larger than the initial supply shocks. Keynesian supply shocks happen in multisectoral economies subjected to lockdown interventions in a context of incomplete markets and consumer liquidity constraints. In this context, aggregate demand shocks amplify the supply shocks in a cascade of direct and indirect effects.

#### (a) What empirical evidence is needed to protect vulnerable jobs and mitigate the recessionary effects of lockdowns?

A macroeconomic analysis must be complemented with an appreciation of sectoral input-output relationships to make sense of how the supply shock is propagated across sectors, depending on the country-specific economic structure and the exposure to risk linked to specializations that are more likely to suffer from shutdowns (i.e., critical intermediate sectors, or sectors that depend on critical intermediate suppliers in other countries).

Several studies have looked at the sectoral and firm-specific impact of supply and demand shocks in different countries. Del Rio-Chanona and others (2020) provide an estimate of the first-order effects of the COVID-19 pandemic on employment in the United States. They examine individual occupations and sectors and classify them as “essential” and “non-essential” by the feasibility of their being conducted remotely and the likelihood of their suffering from supply and demand shocks (see also Dingel and Neiman, 2020). With the analysis limited to first-order effects, the authors find that a full lockdown of households and a total shutdown of firms would bring about a reduction of income associated with the greater of the demand or supply shock, as most of the immediate effect is due to the inability of people to work rather than consume. The findings show that high-wage occupations suffer substantially less than low-wage occupations, very much in line with what is found by Adams-Prassl and others (2020) on the basis of real-time surveys for the United Kingdom, the United States and Germany.

Estimating second-order effects means developing an input-output framework that reflects the health and economic criticality of different jobs and sectors, as has been done for France, the United States, Germany and Japan (Barrot, Grassi and Sauvagnat, 2020; Barrot and Sauvagnat, 2016)

and internationally by taking into account the presence of GVCs in some sectors (see next section). These contributions seem to show that second-order effects contribute up to 50% of the total negative economic impact of supply shocks.

## (b) Is there a way to fine-tune interventions by lifting restrictions at different points in the pandemic to mitigate the trade-off between public health and the economy?

Further empirical evidence is needed for policymakers to alleviate the trade-off between containing the pandemic and avoiding a harsh recession in the medium and long term along the lines proposed in Pichler and others (2020). The authors take into account the essentiality of inputs, the input-output structure of the (United Kingdom) economy and inventory dynamics and analyse different scenarios for the reopening of selected sectors of the economy, including public services such as schools and social care, on the basis of occupation-specific data and information on epidemiological spreading (Pichler and others, 2020). When considering the increase in  $R_0$  and GDP, they find that a reasonable trade-off is achieved when “all non-consumer facing industries reopen, schools are open only for workers who need childcare, and everyone who can work from home continues to work from home” (Pichler and others, 2020, p.1).

Here we make two important pleas for future research that can yield useful evidence for decisions impacting both public health and the severity of economic recession, which policymakers should be aware of.

First, Pichler and others (2020) recognize that standard models for production functions are not adequate to account for the short-term effects of lockdown. Nor, it might be added, are they adequate to account for the medium- and long-term effects, for which input-output models are needed.

Second, as recently suggested by Haldane and Turrell (2018), agent-based models (ABMs) are crucial to devise simulation scenarios for different lockdown and shutdown interventions. ABMs have been extensively used to examine how economic agents interact and react to micro and macro signals, in order to model the evolution of the economic structure (Ciarli and Valente, 2007; Ciarli and others, 2019) or the environment (Ciarli and Savona, 2019). When used for policy, ABMs can simulate scenarios based on fine-grained policy variables that affect individuals, firms and sectors as complex systems and, ultimately, macroeconomic trends.

ABMs in an input-output framework would provide a better understanding of what the macro-level outcomes of a complex combination of effects are. Depending on the firms and sectors shut down, it is important to ascertain which downstream sectors are likely to be affected and what effects are transmitted on to income and consumption patterns, going by the distinction between essential and non-essential workers (see below). For instance, in an extreme scenario, shutting down all essential services would probably result in full containment of the outbreak, as there would be no workers exposed. This would be achieved at the cost of a complete shutdown of the economy, with essential goods and services not available. In the opposite scenario, prioritizing a full economic recovery would most likely increase the spread of the disease and have deleterious long-term effects on public health, resulting in subsequent recessions. ABMs would make it possible to simulate different scenarios on the basis of intersectoral linkages and different degrees of “essentiality” for jobs and sectors, in terms both of their position along the value chain and of risk exposure. In sum, this is what is needed to fine-tune public policy across sectors and jobs and over time.

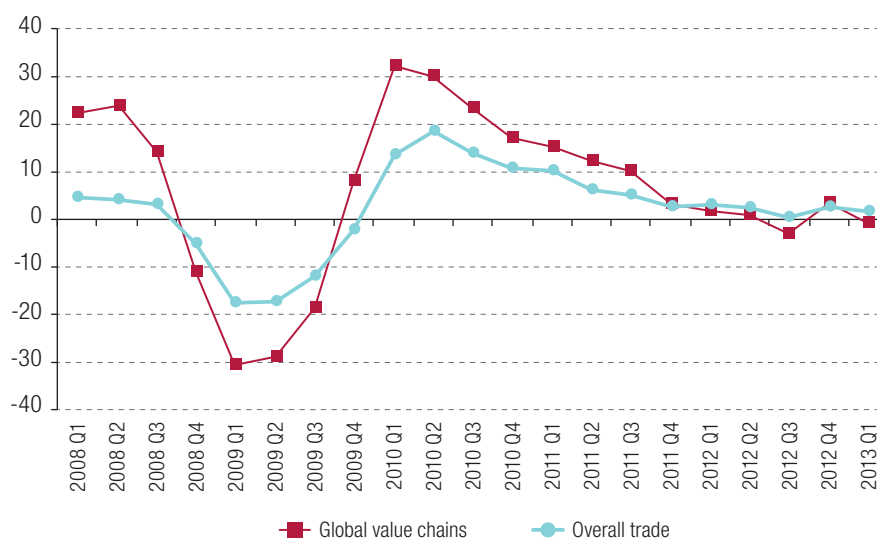
## 2. Are we heading towards a crisis of global value chains?

It is now well documented that, over the last few decades, global trade has undergone a structural transformation involving an increase in trade in intermediates relative to trade in final products; an increase in countries' interconnectedness, as these intermediates are produced in different countries; and an increase in global trade elasticities relative to global income, most likely because of this international fragmentation of production (Escaith, Lindenberg and Miroudot, 2010; Ferrantino and Taglioni, 2014; Baldwin and López González, 2015).

There is still a heated debate about the extent to which countries should actively seek to be engaged in GVCs and the conditions under which this should happen, in both manufacturing and business services activities (Savona, 2016; Sturgeon and Memedovic, 2011; López González, Meliciani and Savona, 2019), and what the consequences are in terms of employment growth and structure (Bontadini and others, 2020). For emerging countries, the conditions for beneficially joining GVCs in order to upgrade domestic economies have not yet been identified unanimously (López González, Meliciani and Savona, 2019), as countries might join under costly conditions, get stuck in low-technology specialization traps and find themselves unable to benefit from opportunities for technological upgrading. This explains current world trade flows and a global landscape heavily polarized between “headquarters” and “factory” economies (Baldwin, 2011; Baldwin and López González, 2015; Taglioni and Winkler, 2016).

In this context, a global downturn in demand, such as the 2008 financial crisis, can affect GVC trade in multiple ways, owing to the higher elasticity of trade to global income and the dual channels (the final and intermediate products traded) through which the crisis spreads across GVCs (Ferrantino and Taglioni, 2014). Needless to say, crises increase uncertainty and the risk of being affected by a slowdown, depending on which macro regions of the world a country is most tightly linked to in terms of trade flows. The global trade slowdown that followed the financial crisis saw a particular trend unfolding (see figure 1). The deep slump in global trade in 2009 was amplified in GVC trade, though the recovery in GVC trade was also more rapid and consistent. Interestingly, this was followed by a steady decline in both overall trade and GVC trade which is still ongoing.

**Figure 1**  
Real year-on-year growth in total trade and trade in global value chains,  
first quarter of 2008–first quarter of 2013  
(Percentages)



**Source:** World Bank, Datastream, cited in M. Ferrantino and D. Taglioni, “Global value chains in the current trade slowdown”, CEPR Policy Portal, 2014 [online] <https://voxeu.org/article/global-value-chains-current-trade-slowdown>.

Some scholars have in fact detected additional forces at work in this decline. For instance, Seric and Winkler (2020) argue that there were rumblings of a GVC crisis long before the COVID-19 pandemic. GVC trade was curtailed as a way of mitigating supply chain risks resulting from demand shocks, high import tariffs and some export restrictions. These early symptoms of a GVC slowdown included some firms reshoring parts of their production processes, or replacing some of their (low-segment) suppliers with automated, in-house or local sources of supply, and shortening the length of GVCs overall (Dachs and Seric, 2019; Seric and Winkler, 2020). The effect of robotization and automation on GVC participation seems to be negative, especially in emerging and low-income countries, and they are likely to contribute further to GVC-related income polarization (Seric and Winkler, 2020).

In sum, global trade and GVC trade trends were already unfavourable when the COVID-19 pandemic struck.

### (a) How has COVID-19 affected trade, and GVC trade in particular?

In a context of weakened GVCs, the impact of the COVID-19 pandemic on overall and GVC trade is expected to be very different from the after-effects of the 2008 financial crisis, and is likely to have very different long-term consequences.

Baldwin and Freeman (2020) and, from a more general perspective, Baldwin and Weder di Mauro (2020) effectively summarize what they call the effects of “COVID-19 concussion” on manufacturing GVCs since the outset of the pandemic.

First, countries shut down trade with different time lags, the first to do so being the Asian and Chinese world “factories”. This affected the supply of intermediates to the United States and Germany, which shut down trade later, when the virus reached Europe and crossed the Atlantic, spreading the trade slowdown to other importing countries. The result is that the shock has had an exponential effect on trade (Baldwin and Everett, 2020).

Second, in addition to the non-synchronicity of the effect, which is a feature of COVID-19 as compared to previous epidemics, the shock has simultaneously affected both the supply side (as described above) and the demand side of trade. People forced into lockdown have put on hold not only their working patterns but their consumption patterns too as a result of recession, risk aversion, investment delays and wait-and-see strategies (Baldwin and Freeman, 2020). This has for the first time affected service GVCs in addition to manufacturing ones, extending the recessionary effects to the reduction of service imports and exports between trading partners (see López González, Meliciani and Savona, 2019, for the underlying rationale).

Third, a sort of reverse supply chain contagion has occurred: even as China got back to work in March-April 2020, the rest of the globe shut down. This resulted in a pendulum propagation, including direct and indirect effects that depended on the density, composition and country source and destination of the intermediates imported and exported. This sort of pendulum mechanism is likely to reappear if and when subsequent waves of the pandemic hit economies.

### (b) How should the GVC crisis be tackled?

Baldwin and Freeman (2020) and Baldwin and Everett (2020)<sup>3</sup> provide a compelling series of suggestions for avoiding a GVC crisis arising from “contagion and reinfection” dynamics that might perhaps also be exacerbated by the automation and reshoring trends which preceded the spread of the

<sup>3</sup> See also OECD (2020) for a focus on GVC interconnectedness around specific COVID-19-related goods.

pandemic (Seric and Winkler, 2020). Baldwin and Freeman (2020) argue that “international coordination on containment exceptions could help. All nations make exceptions to lockdown policies for essential goods. Realizing the extent to which trade partners are dependent upon key inputs should broaden the definition of ‘essential’. This would be a matter of enlightened self-interest. The United States may need China and India to keep their ‘active pharmaceutical ingredient’ plants open, while China and India may need the United States to keep its semiconductor plants open.”

The concept of what is “essential” will be returned to in the next section. For now we shall just touch on the question of how, in this context, countries should pursue their own “enlightened self-interest” when it comes to GVC trade. There is no bullet-proof answer to this. Lessons from earlier crises in history might be drawn on here. An intermediate scenario is likely to be the most plausible: it might be premature to talk about a radical GVC reversal involving a strong push for reshoring and nearshoring in an attempt to limit risks, i.e., to turn “inwards” at this stage of the crisis. Resilience to shocks might therefore rely on a fine balance between improving the quality of GVC participation and ensuring a virtuous presence of regional and global value chains. In the long term, this might mean a more beneficial kind of participation in GVCs.

### **III. Learning from the emergency: rethinking policy for “essential” jobs and sectors**

#### **1. Steering digital transformation towards inclusive labour markets**

##### **(a) How essential are the “essential services”? Is there still a productivity burden of essentiality?**

As mentioned in section II.1, opportunities for remote working have large occupational and sectoral specificities (Dingel and Neiman, 2020; Del Rio-Chanona and others, 2020). Some anecdotal evidence seems to suggest that remote working is either for privileged, highly skilled and well-paid workers or for precarious, self-employed gig workers. The global lockdowns have accelerated the pace of remote working and exacerbated these differences (Adams-Prassl and others, 2020; Haldane, 2020).

Stuck in the middle are all the “essential services” that are unsuited to remote working. Wholesale and retail services, including delivery services, transport and services auxiliary to transport, personal care, social services and health care are the essential services that have played a crucial role during the first lockdown and are likely to do the same in the next ones. Essential service occupations cannot be carried out from home “by design”, and yet are indispensable for the economy to retain a minimum of functioning when most economic activities are shut down.

While some 50% of information and communication service workers, 45% of professional and scientific service workers and 40% of finance and real estate service workers could turn to home working during the pandemic in the United Kingdom, for instance (Haldane, 2020; ONS, 2020; Pichler and others, 2020), essential services are structurally unsuited to remote working.

For a scholar who has dealt with the economics of services for some years, it is poignant to see sectors that have traditionally been labelled as low-technology, low-productivity and low-skilled and (ironically) as spreaders of cost disease (Baumol, 1967; see Grassano and Savona, 2020, for a review) suddenly upgraded to “essential”.



It is hard to reconcile the oxymoron of essentiality: in pandemics, the very notion of essentiality comes back to that of basic needs; in normal times, these are the very activities that are seen as the main drag on productivity growth and the main source of cost disease. Either productivity performance should not be a consideration where essential services are concerned, or decades of productivity mismeasurement in services have misconstrued or ignored the feature of essentiality. This is not just an academic issue: it has consequences for the mechanisms and structure of remuneration in these activities. If we had to rethink the mechanisms of wage formation for essential jobs, we could perhaps start by ignoring the link with productivity and making wages for essential services commensurate with the well-being they provide.<sup>4</sup>

More generally, there are two further important aspects of the impact the COVID-19 pandemic has been having on remote working and on the challenges of managing the effects of digital transformations on working conditions.

The first aspect are the long-term consequences of the global shift towards smart (remote) working, from which, as argued here, essential services are most likely to be excluded. The second aspect is the extent to which digital home working, in both its traditional and emerging forms, can be made more inclusive.

Haldane (2020) suggests two interesting potential long-term negative effects of home working. First, the lack of face-to-face interactions might lead to the loss of a fertile environment for the creative and novel ideas that are at the very core of innovation. Second, the loss of social networks and the opportunity to exchange ideas informally might lead to a loss of social capital as existing social capital is eroded and new social capital does not get formed. “Whether it is creative sparks being dampened, existing social capital being depleted or new social capital being lost, these are real costs and costs which would be expected to grow, silently but steadily, over time. They weigh on the other side of the ledger when it comes to assessing the case for home working. They cast doubt on whether it will lead to the promised land of improved productivity and greater happiness” (Haldane, 2020).

This is all very plausible, and applies to non-essential but highly valued services. Services which are very essential but on which a low value is set will most likely be immune from the risks of creative sparks being dampened or social capital lost, simply because they did not enjoy these things in the first place. Acknowledging the costs of home working is undoubtedly forward-looking, but recognizing that the value of essential services is not reflected in their wages would be revolutionary.

## (b) How can digital transformation be managed to ensure employment inclusion?

Remote working and digital jobs are only a symptom of a much deeper and longer-standing transformation of occupations and working models, long predating (but accelerated by) the current pandemic and the restrictions imposed by governments on some occupations. Digital transformations have in fact profoundly modified the structure of jobs and skills (see, among others, Goos and Manning, 2007; Mokyr, Vickers and Ziebarth, 2015).

In the recent High Level Group Report on the Impact of Digital Transformations on EU Labour Markets (European Commission, 2019), we unpacked the effects of digitalization trends on several occupations. While the literature dealing with the effects of digitalization on occupations and tasks has produced robust findings, what is missing is a systematic effort to devise policies that tackle potential side effects. The policy recommendations offered in the report will now be summarized, as they have proved to be somewhat prophetic in the context of the current crisis.

<sup>4</sup> There is no space here to develop this argument further, but we hope to initiate a debate and a fruitful research agenda around this topic, which the current crisis has allowed us to consider in depth.



### (c) A skilled workforce

The abrupt shift to home working and the need to shield at-risk categories, including those with hidden disabilities, have shown that one of the most important requirements for survival in current labour markets is for workers to acquire digital literacy and update digital skills. Workers might not be aware of the need or have the opportunities and access to invest in their digital skills. If so, policymakers can organize digital skills personal learning accounts that belong to workers and are portable from job to job. Details such as contributions, the number of hours per year, top-ups, eligible expenses and taxation schemes are important, and not much is known yet about their effectiveness.

### (d) New labour relations and a new social contract

The combination of the abrupt shift mentioned above and the effects of lockdown have put a dramatic strain on workers' mental health. The European Commission (2019) recommendations emphasized the need to avert occupational safety and health risks like mental health and stress-related issues resulting from digitalization and increased volatility in today's world of work. What is needed is to increase the focus on prevention in employee assistance programmes and improve uptake by increasing social acceptance of mental health issues through informed discourse. The crisis is an unprecedented opportunity to increase public expenditure in the health sector, and governments should plan a substantial expansion of mental health programmes.

Remote working has accelerated the pace of growth in platform working and alternative work arrangements, a trend which started before the crisis (Ciarli and others, 2019; Bell and Blanchflower, 2018). One of the most inclusive steps that governments could and should take in the wake of the crisis, as we proposed in the report, is to equalize the (administrative) treatment of standard and non-standard work arrangements, e.g., by providing equal access to government services and credit lines and limited benefits mobility regardless of employment status.

Along the same lines, it is important to ensure neutral social protection against unemployment, sickness and other life circumstances independently of employment status. The increasing number of workers with non-standard employment should have access to social protection, e.g., through portable benefits attached to the worker rather than the job, or the establishment of an "underemployment insurance" to smooth out fluctuating incomes in the gig economy.

These structural, forward-looking actions could well be spillovers from government spending on furlough schemes to tackle the COVID-19 crisis. What we are advocating is a combination of context-specific and structural interventions that not only cover the emergency but ensure long-term inclusivity in labour markets.

## 2. The use of digital technologies at times of crisis: learning from the succession of COVID-19 contact tracing applications

Digital transformations affect society at large, beyond the labour market effects discussed above. One of the characteristics of digital technologies is that they are ubiquitous in their applications, to the extent that they have been described as a new generation of general purpose technologies (Breshnan and Trajtenberg, 1995; Trajtenberg, 2018).

The COVID-19 pandemic has given rise to a very interesting instance of the implementation of digital technologies, namely COVID-19 contact tracing applications, bringing forward the need to regulate (or at least openly debate) some of the technical, legal and ethical issues arising from their use and spread.

In any disease outbreak, provided that people rely on their tested or diagnosed rather than self-reported status, a digital contact tracing application is supposed to be more effective than a manual contact tracing procedure, as it immediately identifies and informs all the contacted and potentially infected people in real time, and has the potential to reduce the R number. In addition, a digital application is meant to alert all those contacts who are unknown to the potential spreader, rather than relying on their memory of encounters, voluntary contact and self-reporting. The automation of the contact tracing procedure and the digitalization of information should do what technical change is ideally meant to: provide solutions to pressing societal challenges.

However, this pandemic has been forcing us to engage in much-needed reflection on the appropriateness of (digital) technology for devising tools to help contain the outbreak. In a recent note (Savona, 2020), we considered the case —or, perhaps more appropriately, the saga— of the development and use of contact tracing mobile applications, which we report here.<sup>5</sup>

At exceptional times of public health emergency such as the current one, Taiwan Province of China, the Republic of Korea and Singapore, among other East Asian countries, have managed to limit the spread of the first wave of contagion better than other countries. Besides immediate and strict lockdowns, they have had recourse to the digital tracking of individuals with symptoms, identifying and isolating their contacts, and managed a very effective combination of high rates of testing, contact tracing and immediate isolation or treatment. Most likely because of their experience of earlier outbreaks, these countries have done better than others that have reacted sluggishly and been largely unprepared, such as the United States and the United Kingdom.

For instance, Lanier and Weyl (2020) have examined the Taiwanese strategy and described the proto-model of the Taiwanese contact tracing application. This consisted of a platform developed in cooperation between the digital minister, a group of local entrepreneurs and the g0v<sup>6</sup> movement and used voluntarily by citizens to share their symptoms and locations, which were promptly verified by local health centres and collated in a centralized repository of individual health records.<sup>7</sup> The Taiwanese population has shown a shared sense of public purpose and a substantial degree of trust in the government, and most particularly in Audrey Tang, the country's young and industrious digital minister. This was on 20 March, in what may be considered the pre-history of the debate, given the unprecedented pace at which the pandemic has forced governments to mobilize in response to the geography of contagion.

Now, the use of digital technology as a tracing tool is likely to raise as many challenges as it overcomes, chiefly with regard to personal data collection and storage, user consent, and surveillance, particularly in the context of health data. These are matters of concern in a democracy, which should ideally be a safe space for public scrutiny and monitoring of government accountability. There are some historical precedents for exceptional public interventions in emergencies, with reduced space for public debate and a pervasive sense of menace that prevents actions from receiving proper scrutiny and favours emotional responses.

<sup>5</sup> There is not yet a proper academic literature on this specific subject, but there have been a number of contributions in the grey literature, blogs and public debates that have informed some reflections on the use of technology at times of crisis.

<sup>6</sup> See [online] <https://www.nytimes.com/2019/10/15/opinion/taiwan-digital-democracy.html>.

<sup>7</sup> In a nutshell, a contact tracing application based on a decentralized protocol allows individual data to be left on devices, whilst a centralized solution requires data to be collected in a central repository such as a public health authority. A decentralized protocol is more likely to adhere to the European Union General Data Protection Regulation principles of data minimization; purpose limitation; storage limitation; integrity and confidentiality; lawfulness, fairness and transparency; accountability; and accuracy (see Savona, 2020, for more details).

## (a) What can we learn from the saga of contact tracing applications for data governance? Towards good governance of health data

The rapid unfolding of the contact tracing saga since mid-March 2020 has provided material for a first-hand reflection on the wider issue of data governance for social scientists interested in the economic and social impact of digital technology. In addition, this debate has clearly shown that getting the narrative right needs multidisciplinary expertise.

For instance, Google and Apple are going to support a decentralized solution for contact tracing applications developed using the DP3T protocol (Troncoso and others, 2020). They will be technically unable to access any personal data, as these data will remain on adopters' devices. The partnership of Google and Apple will allow health-related applications to be adopted on a global scale, as virtually all smartphones run on either the Android or the iOS system. Google and Apple's involvement has gone unquestioned, and yet has been welcomed as a small step in support of privacy and public health (Waters, 2020).

Some preliminary surveys across the European Union and the United States have shown concerning evidence that, if further corroborated, shows a clear tendency for citizens to trust Google and Apple more than governments when it comes to data collection and use. This should lead us to reflect on the state of public awareness of what is, at least in principle, a public value as against a private interest. We should devote research efforts towards predicting with a reasonable degree of accuracy the consequences of the public conferring their trust on large technology firms more than on their own governments, when the degrees to which they are respectively accountable to society are compared. All this despite the recent history of private surveillance and the massive concentration of power and equity value, which has been well documented by several studies in the academic and grey literature, and which was discussed briefly in Savona (2019).

Transparency and accountability are the watchwords here, for trust is a key ingredient in the whole saga and will be desperately needed in the post-COVID-19 reconstruction. The development of digital tools for tackling emergencies should be a clear and transparent process. More specifically, the main points to consider, as summarized in Savona (2020), are technical, legal and ethical in nature.

Technically, the public should be in a position to understand the features, effectiveness and (hopefully limited) purpose of any digital tool they (hopefully voluntarily) adopt. Understanding "privacy by design" and the side effects of a centralized protocol or a back-end central data repository is crucial. Similarly, it is up to data scientists, privacy engineers and Internet law experts to explain the importance of interoperability, not only in the context of contact tracing applications, but within the system of digital platforms. Technical literacy is a fundamental ingredient to ensure that people make informed choices and ultimately that the minimum take-up rate required to make the tool effective in containing the outbreak is achieved.

Legally, as is now being discussed within the European Union institutions, safeguards governing the deployment of digital tools should be based on human rights rather than privacy rights alone. This requires an informed public debate in parliament, primary legislation and independent oversight bodies. Clarity and transparency in regulating "compatible purposes for secondary use" of personal health data are crucial ingredients in building public trust.

From an ethical perspective, it is important to first predict and then regulate for the potential side effects of digital exclusion and potential discrimination in the use of digital tools for tracking, tracing and certifying immunity. Vulnerable low-income citizens might not be in a position to access information and familiarize themselves with and develop agency over their personal health (and location) data. None of the digital solutions considered here should lead to discrimination or further polarize inequalities, whether in labour markets or in society at large.

Taiwan Province of China might be a first mover in the direction of health data governance based on a complex institutional architecture to regulate and manage an effective government response, though trust in public institutions seems to be a necessary (albeit probably insufficient) condition for this to be successful. A European Union-style, certainly fundamental, institutional safeguard of privacy seems not to be fully paralleled by the actual level of trust that citizens have in their governments. We should be asking why this is the case. This crisis seems to be an unprecedented opportunity to learn more in this area as well.

## IV. Conclusion

In a recent and, as it proved, far-sighted contribution, Jedwab, Johnson and Koyama (2019) considered the incidence of the Black Death on deaths in European cities between 1347 and 1352. The Black Death killed 40% of the European population. Although urban areas were worst hit, in the long run they recovered better as they were able to attract more labour migrants than rural areas, at a time when trade was developing. Both the effects and the recovery were heterogeneous.

The COVID-19 pandemic has hit some sectors and workers particularly hard, exacerbated the existing polarization of labour markets and accelerated the reversal of GVC trade. It has forced governments to face the policy conundrum of having to contain a deadly pandemic while trying not to plunge the world into the worst depression ever. It has forced civil society to debate more openly the consequences of digitalization, which promises solutions to public health emergencies but creates the threat of greater surveillance.

In modern times, pandemics can and should be tackled more effectively and hopefully more inclusively.

This brief paper has selectively considered a variety of areas which are of policy relevance to the COVID-19 emergency and in which lessons can be learned from this. They will hopefully provide some of the ingredients for the Building Back Better strategy, which is intended to identify areas that are of structural relevance. This paper has raised questions and provided some evidence on possible ways to:

- (i) cope with the need to contain the outbreak while attempting to mitigate a global recession due to lockdown and shutdown restrictions;
- (ii) mitigate the GVC trade crisis that the COVID-19 pandemic has accelerated;
- (iii) learn from the fast-forward digitalization of the labour market that the pandemic has brought about, in terms of the long-term effects of home working and the polarization of online workers;
- (iv) learn a lesson of inclusion by considering the gap between the value of “essential” services and the wages paid to them;
- (v) learn what the ingredients of health data governance are when the use of digital technologies has to be managed at times of emergency, as in the case of the deployment of digital COVID-19 contact tracing applications.

There is tremendous scope for making this crisis an opportunity to build back better in terms of inclusive employment and transparent and trustworthy use of digital technologies, while debunking myths about irresolvable trade-offs between public health and economic recovery. All that is needed is high-quality research and an open space for reflection and action, such as that provided by this special issue. We hope that the above considerations will spark some debate and further research in these areas.

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# Women's economic autonomy during the COVID-19 pandemic

Nicole Bidegain, Lucía Scuro and Iliana Vaca Trigo

## Abstract

This article is a contribution to the debate on the impacts of the COVID-19 crisis on gender inequalities in Latin America and the Caribbean, with a focus on women's economic autonomy. Through a review of the contributions of feminist economics and an analysis of the empirical evidence, it identifies a deterioration in the indicators associated with women's incomes and their participation in the labour market. The sexual division of labour is deepening in the region, endangering the scant progress made regarding women's economic autonomy in the pre-crisis years. It warns about gender biases in crisis mitigation policies and reflects on the importance of redistributing time, resources and power to move towards a new style of development based on gender equality and sustainability.

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## Keywords

Viruses, epidemics, economic aspects, feminism, women, income, labour market, women's employment, time, gender equality, Latin America and the Caribbean

## JEL classification

B54, O54, D31, I38, J22

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## I. Introduction

The COVID-19 pandemic in Latin America and the Caribbean has triggered multiple crises, and these have impacted men and women differently. The situation has showcased the structural nature of gender inequalities in the region and the greater exposure of women to the effects of crises. This pandemic arose in a context marked by asymmetries at the global level, low growth in the region's economies, deteriorating job quality and rising inequalities in countries with fragmented health systems, segmented labour markets and under-resourced gender equality policies. As in previous crises, women seem to be cushioning the impact by providing increased unpaid domestic and care work (ECLAC, 2020d and 2020f).

The recent literature agrees on the impact of the crisis for women, in both the developed world and developing countries and regions (United Nations, 2020). There are different approaches to the extent of the impact, to the factors that explain this phenomenon and to the dimensions of gender inequality being analysed, their intersection with other factors such as income, age and race and ethnicity, and their links with productive structures.

This article aims to contribute to the debate on the impact of the COVID-19 crisis on gender inequalities in Latin America and the Caribbean, with a focus on women's economic autonomy, and to identify some of the main underlying structural factors at play that must be attacked in order to avoid deepening gender inequalities in the medium and long terms. Section I reviews the literature on the main contributions of feminist economics to understanding the links between economic dynamics and gender inequalities, particularly at times of crisis. The following section analyses various indicators of women's economic autonomy based on the empirical evidence available from official sources and forecasts by the Economic Commission for Latin America and the Caribbean (ECLAC). Section III presents some thoughts on the approach to be adopted by mitigation and recovery measures in order to move towards a new style of development based on gender equality and sustainability.

## II. Crisis, feminist theory and COVID-19 in Latin America and the Caribbean

Feminist economics, as a current of heterodox thought, has developed conceptual and methodological tools to understand how gender relations permeate the economic system and its dynamics, and these tools are useful in examining the externalities of the current crisis on women's lives and in proposing profound changes in the prevailing development model. In contrast to gender economics, feminist economics represents a transformative form of thinking, proposing a new paradigm that situates care work as a determining factor in social reproduction and in the population's living conditions (Picchio, 2005).

On the one hand, it offers an epistemological and methodological criticism of neoclassical theory on account of the androcentric bias implicit in the "representative agent", which attributes to the economic man (*Homo economicus*) characteristics that it considers universal but that, in reality, belong to a white, healthy, adult male human being of average income (Picchio, 2005; Rodríguez, 2015). The COVID-19 crisis highlights the fact that considerations such as gender, age, race and ethnicity place people in unequal positions of power for dealing with the pandemic and its related crises. The asymmetries of power that actors experience have repercussions on their probabilities of exposure to the virus, of securing access to quality health services, of enjoying a safe and violence-free domestic space, of having savings, of being able to engage in teleworking or distance education and so on. Therefore, the assumptions behind economic theories and policies should transcend homogenizing views of those actors in order to equip them with suitable instruments for responding to the multiple crises inherent in the pandemic through an approach that aims to close gaps.

On the other hand, through conceptual tools and studies on gender, development and macroeconomics, it is possible to identify the implications of globalization processes and financial and fiscal policies for gender inequalities, particularly in crisis contexts. This area of knowledge production has also promoted frameworks of analysis to showcase the links between the macro, meso and micro levels of the economy (Elson, 1994), considering that men and women occupy asymmetrical positions of power as economic agents. Different studies analysing the policies implemented in developing countries and regions during the 1980s and 1990s have revealed that to a greater extent, women absorbed the costs of debt crises, structural adjustment programmes and public spending cuts, through an increase in care work and the greater precarity of their living conditions (Grown and Sen, 1987; Elson and Cagatay, 2000; Benería, Berik and Floro, 2015). Subsequent analyses examined the impacts of the 2007–2008 financial crisis and austerity policies (Elson, 2010; Montaña and Milosavljevic, 2012; Esquivel and Rodríguez, 2014; Fukuda-Parr, Heintz and Seguino, 2015; Bohoslavsky, 2018).

Elson (2010) proposes a framework for analysing the gender dimensions of the financial crisis in developing countries by examining economies as structures based on gender relations in the spheres of finance, production and social reproduction. It presents channels of transmission from the global North, the immediate impacts and the responses of governments, businesses and individuals in those three spheres. By analysing Argentina, Ecuador and Mexico, Esquivel and Rodríguez (2014) examine the impacts of the global economic crisis through the contraction of trade and the reduction of foreign direct investment and remittances and identify the repercussions on the activity, employment and incomes of men and women. Their analysis of the policy responses concludes that neither the design nor the impact assessments of the countercyclical policies adopted include considerations for addressing gender inequalities. The support provided for productive sectors and public investment was geared towards bolstering sectors where men are predominant, such as construction and infrastructure, and it did not explicitly include the creation of job opportunities for women as an objective. These analyses have been key in identifying the gender biases contained in the macroeconomic policy responses to different crises, and they are of relevance in the current context, when countries are launching fiscal stimulus packages.

Critical feminist economics has challenged orthodox and heterodox approaches to economics for their narrow definitions of the discipline that reduce it to the market economy. “The various economic approaches —whether more Keynesian or more neoliberal and despite the differences between them— focus exclusively on production, consumption and the distribution of goods and services, without considering labour and the many activities that fall outside the scope of the market. As a result, those analyses are not only partial but could also be erroneous. If only one part of the reality is taken into account and analysed but under the assumption that it forms the totality, there can be no assurance that the results —whether statistics or policies to be implemented— will be proper” (ECLAC, 2015, p. 13). The COVID-19 pandemic has served to showcase one of the main contributions of feminist economics: that the care work mainly performed by women within households is critical to the reproduction of the labour force and the functioning of economies (Picchio, 2001, 2005 and 2009).<sup>1</sup> In that context, production relationships within households are made visible, where goods and services are produced to meet people’s needs through unpaid work. Similarly, lockdown measures, physical distancing, the closure of schools and workplaces have increased this workload for women and deepened the care crisis (ECLAC, 2020d; ECLAC/UN-Women, 2020). In addition, the demands of education, the health care needs of sick people and the pressure to increase hygiene standards to prevent infection have been concentrated within households. In societies shaped by patriarchal and discriminatory cultural patterns, gender inequalities appear to be deepening.

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<sup>1</sup> As a reference, it should be noted that Picchio (2001, p. 1) defines the content of unpaid social reproduction work as “care of the maintenance of domestic spaces and goods, as well as care of bodies, education, training, maintenance of social relations and psychological support for family members”.

As a result of the COVID-19 crisis and the containment measures imposed worldwide, the boundaries between the public and private spheres have become blurred, further underscoring the interdependence between unpaid work and work for the market. Fully understanding this unprecedented phenomenon requires returning to the different contributions of feminist economics that have enabled the identification of distributive conflicts and gender power asymmetries within households and different types of families. Questions have been asked about the limitations of treating households as units of observation and the assumption that the household is a harmonious, conflict-free organization in which resources are equitably distributed among the members and where interests and “preferences” are reconciled to maximize benefits.<sup>2</sup>

Time-use measurements reveal the sexual division of labour and, in particular, the work overload faced by women, the differences between the types of tasks that men and women perform, the care arrangements that are established and the tensions between household members in reconciling paid and unpaid work. These elements are fundamental in analysing possibilities for labour market insertion, for teleworking and for accessing resources and own incomes. Attention should also be paid to household structures, family arrangements and the prevailing patriarchal cultural patterns.

The COVID-19 pandemic is revealing the importance of care work and calling into question one of the major androcentric biases of labour markets: the “ideal worker” model. That model assumes the “individual” as a person (man) who has no domestic and care responsibilities and who has the goods and services required for his well-being produced invisibly (Marçal, 2016; Picchio, 2001). He is a subject with plentiful time available for work in the market. This illusion has been shattered in the current context, which has evidenced the close interdependence between living conditions, health and care demands and availability for paid work.

One of the most important contributions to understanding the current crisis is the fact that feminist economics aims to expand the frontiers of the discipline of economics by placing the sustainability of life at the centre of the analysis. The central object of the economy should therefore be the provision of well-being, orienting its dynamics to sustain and reproduce human life in conditions of dignity (Carrasco, 2006 and 2009). The interdependence between people and their eco-dependence with nature and ecosystems highlighted by various authors (Carrasco and Tello, 2013; Pérez Orozco, 2014) is increasingly evident when analysing the causes and effects of the pandemic and the numerous crises associated with it. Those principles are key to reorienting economies’ goals towards sustainability. From this more radical perspective within feminist economics, it can be seen that there are axes of domination that cannot be reduced to the conflict between capital and (paid) labour. There is a structural conflict between the process of capital accumulation and the sustainability of life, which obey opposing logics. Given the pre-eminence of accumulation, aspects of life and whole lives are treated as superfluous (Pérez Orozco, 2014). At this juncture, the conflict between capital and life manifests itself in different contexts and frames the policy decisions made by States in responding to the COVID-19 crisis. Therefore, the distributive question is central for feminist economics, but it must consider not only capital, but also resources, time and women in their diversity.

Within that framework, the concept of “the care economy” has been developed. This is understood to comprise all unpaid work carried out within households, as well as paid care work performed in the labour market. This concept covers care for the reproduction of the labour force in households, together with the dynamics of care in markets and employment, in the provision of public services and infrastructure and in the formulation of public policy. By relating the way societies organize the care of their members to the economic system, the concept of care can be linked to the economic value it generates (Montaño and Calderón, 2010).

<sup>2</sup> See article on the contribution of Amartya Sen’s conceptualization of cooperative conflicts to the conceptualization of negotiation models in the domestic unit (Benería, 2008).

Although the impact of the COVID-19 crisis on women's economic autonomy is an ongoing phenomenon, the elements presented here provide background for research and conceptual tools for understanding the dynamics of the current crisis.

### III. Labour market, time and income: women's economic autonomy

In Latin America and the Caribbean, gender inequalities are a structural element and they imply an unequal distribution of power, resources, wealth and time. The structural challenges of gender inequality are at the root of the unsustainability of the prevailing development model and they relate to socioeconomic inequality and the persistence of poverty, discriminatory and violent patriarchal cultural patterns and the predominance of the culture of privilege, the rigid sexual division of labour, the unjust social organization of care and the concentration of power. These challenges exacerbate each other and curtail the full enjoyment of women's rights and their progress towards substantive equality.

The reduction in income inequality attained over the last decade —through a combination of economic growth and progressive policies— did not produce a more balanced distribution between capital and (paid) labour. This asymmetry is exacerbated for women, who have less access to capital and are predominantly found in more precarious forms of paid work. Despite poverty reduction initiatives, there has been no decrease in the feminization of poverty, owing to the structural nature of gender inequality in the region (ECLAC, 2017).

The structural heterogeneity of the region's countries is reinforced by the current sexual division of labour, and therefore the interdependence between employment and unpaid work performed in the home must not be overlooked. This produces labour markets where employment is segregated by gender and where women have lower rates of participation in employment and are concentrated in economic sectors and occupations with weaker productivity, lower levels of income and limited access to social protection. The phenomena of vertical and horizontal gender segregation in the workplace and wage gaps are still common in current production structures that are not very diversified, make intensive use of natural resources, have low technological content and have major vulnerabilities associated with international asymmetries and external constraints. Barriers also persist in women's access to productive resources, such as credit, land, water, training, technologies and time (ECLAC, 2019).

Women are currently being affected by falling labour participation and heightened care demands. These impacts represent a reversal in the (albeit limited) progress made with the inclusion of women into the workforce. In recent decades, Latin America and the Caribbean recorded the world's largest percentage reduction in the labour participation gender gap, most of which occurred between 1997 and 2007 (7 percentage points). That trend was driven by a steady decline in the male participation rate combined with an increase in the proportion of women entering the workforce. Between 1997 and 2007, the female participation rate increased by 5.3 percentage points (Vaca Trigo, 2019). It has since continued to increase, albeit slowly, to an average of 51.3% in 2019, 22.7 percentage points below that of men (ECLAC/ILO, 2020).

From a sectoral perspective, women are concentrated in activities such as commerce, tourism, manufacturing and the care economy (domestic service, health and education). The tourism, trade and manufacturing sectors are exposed to the external transmission channels of the crisis, such as the total or partial closure of borders, falling demand for tourism and the disruption of global value chains. In the context of the COVID-19 crisis, along with domestic service, those are exactly the sectors that faced the greatest losses in terms of output and employment. In Latin America, 56.9% of female employment and 40.6% of male employment is concentrated in sectors facing high economic risks and the danger

of job losses (ECLAC, 2020g). At the same time, while their jobs were not threatened, women employed in the health and education sectors had to provide the front-line response to the crisis by providing care work and preventing the spread of the virus while simultaneously increasing their working hours, exposing themselves to contagion or having to respond to the new demands of remote education.

In terms of labour market participation, the COVID-19 crisis differs from previous economic crises: in particular, significant numbers of both men and women withdrew from the region's workforce (see table 1). In previous crises, the economic contraction affected men and women differently, with an increase in women's labour participation while men were discouraged from working<sup>3</sup> (ECLAC, 2014; Espino, 2012; Antonopoulos, 2009; Arroyo and others, 2010; Montaña and Milosavljevic, 2012). In the case of women, therefore, the "secondary worker" effect operates: those who enter the job market at times of crisis to increase the possibilities of securing an income for their families when male unemployment is running high (Esquivel and Rodríguez, 2014).

**Table 1**  
Latin America and the Caribbean (14 countries): cumulative change in GDP during previous economic crises and during the COVID-19 pandemic, and variation in main labour market indicators by gender (Percentages)

		Change in GDP growth	Change in the labour participation rate		Change in the unemployment rate		Change in the employment rate	
			Women	Men	Women	Men	Women	Men
Previous crises	Brazil (1989–1990)	-4.4	1.0	-1.1	3.7	20.2	0.8	-1.1
	Argentina (2000–2002)	-14.8	2.5	-1.8	9.7	30.4	0.5	-6.5
	Uruguay (2000–2002)	-14.0	0.2	-1.9	24.9	24.4	-4.4	-4.4
	Paraguay (2008–2009)	-4.0	2.5	-0.2	7.6	26.8	1.9	-1.5
	Venezuela (Bolivarian Republic of) (2008–2009)	-3.2	1.8	-0.3	6.0	6.3	0.8	-1.1
		2020 GDP growth forecast	Change in the labour participation rate <sup>a</sup>		Change in the unemployment rate <sup>a</sup>		Change in the employment rate <sup>a</sup>	
			Women	Men	Women	Men	Women	Men
COVID-19 crisis	Argentina	-9.1	-8.7	-12.2	2.3	2.6	-8.7	-12.4
	Bolivia (Plurinational State of)	-5.2	-7.3	-6.9	3.0	4.4	-8.6	-9.6
	Brazil	-9.2	-7.1	-6.2	0.8	1.7	-6.5	-6.7
	Chile	-7.9	-9.0	-7.2	11.7	9.4	-12.9	-12.8
	Colombia	-5.6	-11.4	-10.1	3.9	5.7	-12.2	-13.0
	Costa Rica	-5.5	-6.2	-4.6	15.4	10.1	-12.1	-11.3
	Dominican Republic	-5.3	-8.8	-7.9	-5.2	-1.8	-5.7	-6.3
	Jamaica	-5.3	-4.3	-3.5	3.8	5.7	-5.9	-7.1
	Mexico	-9.0	-9.6	-16.1	-0.9	1.7	-8.9	-16.6
	Nicaragua	-8.3	-4.6	-3.3	-0.5	0.4	-4.1	-3.4
	Paraguay	-2.3	-6.3	-2.5	1.0	-0.5	-6.4	-2.0
	Peru	-13.0	-28.4	-24.9	3.5	6.4	-	-
	Uruguay	-5.0	-3.6	-3.8	0.6	1.2	-3.6	-4.3

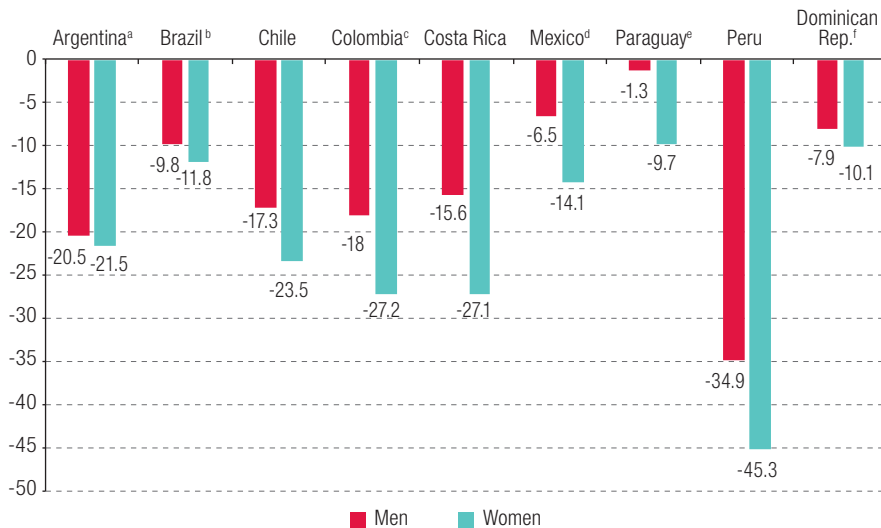
**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), "Addressing the growing impact of COVID-19 with a view to reactivation with equality: new projections", *COVID-19 Special Report*, No. 5, Santiago, 2020; *Social Panorama of Latin America, 2014* (LC/G.2635-P), Santiago, 2014; Center for Distributive, Labor and Social Studies (CEDLAS); household surveys and official data from the respective countries.

<sup>a</sup> The variation in the main labour market indicators during past crises corresponds to the cumulative change for the periods indicated in ECLAC (2014). The figures for the COVID-19 crisis correspond to the year-on-year variation in the indicators between the second quarters of 2019 and 2020; the exceptions to this are Jamaica, where the data correspond to the year-on-year change between July 2019 and July 2020, and Mexico and Uruguay, which use the year-on-year change between May 2019 and May 2020.

<sup>3</sup> Discouraged workers are those who are outside the workforce and who are not seeking employment for reasons linked to the labour market: e.g. previous failure to find a suitable job, lack of experience or qualifications, absence of jobs suited to the person's job skills, shortage of job vacancies in the area or the person is considered too young or too old by potential employers.

It can be seen that during the second quarter of 2020, a higher proportion of women withdrew from the labour market than men. According to official figures from the region's countries for changes in employment levels between the second quarter (April to June) of 2020 and the corresponding period the previous year, women's employment recorded a greater contraction, reaching a figure of 45% in the case of Peru. In Chile, Colombia and Costa Rica, one in four women abandoned the job market compared to the corresponding quarter in 2019 (see figure 1).

**Figure 1**  
Latin America (9 countries): change in the employed population, by sex,  
second quarter (April–June) 2020/2019  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of National Institute of Statistics and Censuses (INDEC), Permanent Household Survey, Buenos Aires, 2020; Brazilian Institute of Geography and Statistics (IBGE), Continuous National Household Sample Survey – Continuous PNAD, Brasília, 2020; National Institute of Statistics, *Boletín estadístico: empleo trimestral*, No. 261, Santiago, 2020; National Administrative Department of Statistics (DANE), “Boletín técnico: Gran Encuesta Integrada de Hogares (GEIH) junio 2020”, Bogotá, 2020; National Institute of Statistics and Censuses, “Encuesta Continua de Empleo al segundo trimestre de 2020: resultados generales”, San José, 2020; National Institute of Statistics and Geography (INEGI), National Survey of Occupation and Employment (ENOE) 2019, Aguascalientes, 2019; National Survey of Occupation and Employment (New Edition) (ENOEN) 2020, Aguascalientes, 2020; Department of Statistics, Surveys and Censuses, “Boletín trimestral de empleo: EPHC 2do trimestre 2020”, Asunción, 2020; National Institute of Statistics and Informatics, “Comportamiento de los indicadores de mercado laboral a nivel nacional”, *Informe Técnico*, No. 3, Lima, 2020; Central Bank of the Dominican Republic, Continuous National Survey of the Workforce, Santo Domingo, 2020

<sup>a</sup> Second quarter of 2020. Figures for 31 large conurbations.

<sup>b</sup> Second quarter of 2020, persons aged 14 and above employed in the reference week, by sex.

<sup>c</sup> National total does not include the population of the Departments of Amazonas, Arauca, Casanare, Guainía, Guaviare, Putumayo, Vaupés, Vichada and San Andrés.

<sup>d</sup> Data for Mexico refer to July 2019 and July 2020.

<sup>e</sup> Does not include the Departments of Boquerón and Alto Paraguay.

<sup>f</sup> Quarterly data for April–June 2020. 2020 figures are preliminary data.

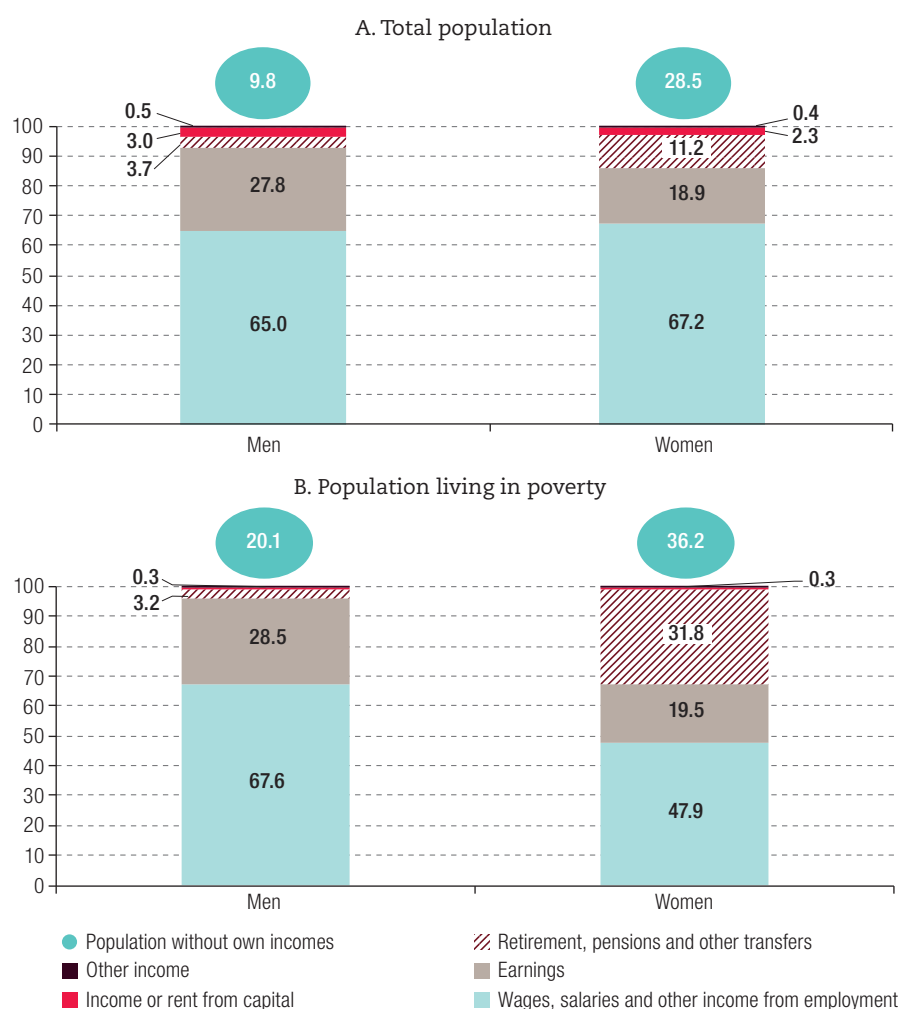
In recent years, the increased labour participation of women, together with a slower pace of job creation, has resulted in increased female unemployment, which remains higher than among men. In contrast to what usually happens during economic crises, the unemployment rate increased more for men than for women. This does not necessarily mean that men have been more affected by the crisis than women; instead, it underlines the need to complement labour market analyses based on the unemployment rate with the examination of other indicators relating to workforce participation and the distribution of unpaid work (ECLAC/ILO, 2020). In the current situation, there has also been a decline in women's economic participation rate: this was because many women, faced with loss of employment,



the circumstances of the crisis and the high demand for care, did not to embark on the search for a new job. According to the latest estimates by ECLAC, women's labour market participation will contract by at least 6 percentage points regionwide (ECLAC, 2020h).

At the same time, the main source of income for both men and women (65% and 67.2%, respectively) is the remuneration of work through wages and salaries (see figure 2). This highlights the importance of wages in the composition of incomes in the region and, hence, the leading role of the labour market in economic autonomy and in cushioning the effects of crises. In addition to their predominance in income composition, wages and salaries also provide entitlement to various social benefits and rights if earned through formal employment.

**Figure 2**  
Latin America (weighted average of 16 countries): income composition of people aged between 20 and 59, by sex and by income source and poverty, around 2019  
(Percentages)



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys conducted in the respective countries.

**Note:** People can receive incomes from a variety of sources: from insertion into the labour market in the form of wages and salaries or as earnings from self-employment, from income derived from the ownership of physical or financial assets and from transfers related to personal work histories or to any condition for which an individual receives money in a personal capacity. Transfers may come from the State, where they may be contributory (e.g. pensions) or non-contributory (e.g. disability pensions or special poverty alleviation programmes), or they may derive from a link with a family member or former family member in the form of remittances or obligations linked to marital dissolution. The data refer to 2019 para Argentina, Brazil, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Panama, Paraguay, Peru and Uruguay; to 2018 for Colombia, Mexico and the Plurinational State of Bolivia; to 2017 for Chile; and to 2014 for Guatemala.



Among men, the next third of their income comes from earnings, while for women that component accounts for 18.9% (see figure 2). In Latin America this type of income is associated not only with business undertakings and the management of financial assets — areas in which women have a lower presence— but also with the earnings from self-employment or own-account work: phenomena that are very widespread in the region, in both the formal and informal sectors, and in which women have a very strong presence. In this case, women's earnings can be more unstable and less protected, as they are strongly associated with informal work (ECLAC, 2016).

The Gender Equality Observatory for Latin America and the Caribbean (OIG) uses data on persons without their own incomes as a central element in examining women's autonomy and as an alternative for analysing individual resources without considering the household as a unit of analysis or assuming an equitable distribution of resources among all household members (ECLAC, 2020e). Among women aged between 20 and 59 in poor households, 36% have no incomes of their own: hence, one in every three, which contrasts with the ratio of one in five found among the corresponding segment of the male population (see figure 2b).

Among men and women who do have their own incomes, there are marked differences in their composition. The most extreme case is transfers from the State. Identifying this difference in the sources of income is essential because of its strong link to the formulation of public policies to mitigate the current crisis. Transfers represent 11.2% of women's total incomes, compared to only 3.7% of men's (see figure 2).

An analysis of gender inequalities in poor households reveals that among women living in such conditions, transfers account for an average of 31.8% of their incomes, compared to only 3.2% of the incomes of men in a similar situation (see figure 2).

It should be noted that although more women than men receive transfers from programmes intended to fight poverty or mitigate the effects of economic crises, they cannot freely dispose of those funds: instead, they generally play the role of “managers” of resources assigned to the household under conditional transfer programmes. Women do not receive these resources as individuals in their own right but rather as operational beneficiaries, which reinforces their roles as “women-mothers” and as the main caregivers. The impact of conditional transfer programmes on women depends on such factors as the amount of the transfer, its coverage and the associated conditionalities. Recommendations have been made, however, to review the approach of these programmes, given that they reinforce the social maternalism of the policies, and even to assess eliminating conditionalities and promoting the principle of co-responsibility (ECLAC, 2016).

The general adoption of these social policy instruments, without adequate planning and scenarios for sustainable reconstruction and equality, poses the risk of distancing women from quality employment and universal social security policies (Montaño and Milosavljevic, 2012). In the current situation, when several of the region's countries have strengthened their transfer programmes, this notion is gaining importance as a way to avoid reproducing gender bias in public policy. Moreover, the criteria for ending this type of programme generally obey macroeconomic goals and indicators that do not necessarily take into consideration the difficulties women face in securing new sources of income of their own after the programmes end.

The health and economic crisis caused by the COVID-19 pandemic promotes the logic of targeted allocations of monetary resources without questioning those programmes' potential to perpetuate gender inequality if they are not examined in light of their gender-differentiated impacts. Although they are essential measures in the short term to cushion the fall in household incomes and mitigate increases in poverty, their design must incorporate additional measures for the medium and long terms since, if they are adopted as the only solution, mechanisms that may result in the worsening of gender gaps will be perpetuated.

## IV. Reflections for a transformative recovery

The COVID-19 crisis has served to showcase the close interdependence between market-oriented economic processes and those of social reproduction. Given the absence of policies for the social redistribution of care and the persistence of patriarchal cultural patterns that translate into gender-differentiated expectations, women are absorbing the care overload and, consequently, are facing heightened barriers to their labour market participation.

This crisis is affecting women's levels of activity, employment and income and is increasing the precarity of their living conditions. A deterioration in the indicators associated with women's links to the labour market has been identified, most particularly a fall in their labour participation and their concentration in sectors exposed to loss of employment and incomes. As a result, the sexual division of labour is deepening and endangering the scant progress with women's economic autonomy made in the years prior to the crisis.

The region's governments have launched various initiatives to address the gender dimensions of the pandemic and its socioeconomic impact (ECLAC, 2020b). These measures have focused mainly on dealing with gender-based violence against women, protecting employment and incomes, providing access to benefits and transfers (with expanded coverage and amounts) and addressing various aspects of the care economy. So far, the actions seem to focus on measures to contain the short-term effects without the ability to transform inequality in the medium and long terms. To a lesser extent, the gender perspective has been incorporated into fiscal stimulus packages aimed at medium- and long-term reactivation, which would create more stable sources of income for women and boost their attainment of economic autonomy.

On occasions, the underlying approach of these policies reproduces gender biases by considering men as the households' main providers and women as workers with secondary incomes or primarily as caregivers. Measures are being adopted to protect the purchasing power of households without examining intra-household dynamics and under the assumption that resources are equitably distributed among family members.

At the same time, specific measures that consider women as a vulnerable population or a homogeneous group are part of a vision that perpetuates gender asymmetries and fails to address the structural causes of inequality. A rights-based approach is crucial for recognizing women's capacities to take their own decisions and States as the guarantors of their rights. In addition, such factors as age, income and race or ethnicity must be taken into account in determining women's exposure to the different socioeconomic impacts of the crisis and their ability to respond to them. It is therefore necessary to promote the design of short-, medium- and long-term policies with an intersectional approach that recognize the diversity of women and make real progress towards substantive equality.

The COVID-19 crisis should be an opportunity to trace out a new path in the region's development model that will help to overcome the structural challenges of gender inequality and advance towards full autonomy for women.

With this in mind, incorporating a gender perspective into macroeconomic, productive and social policies for the reactivation period is essential in transforming the economies. This requires not only the full incorporation of women into the recovery's strategic and driving sectors,<sup>4</sup> but also profound changes in policy approaches, the distribution of power and time, resource allocation and economic incentives, basing the policy response on the principles of gender justice, sustainability and equality. This implies rethinking production, consumption and sustainable distribution patterns and reorienting finance towards the real economy. It also means advancing towards productive diversification in sectors strategic for

<sup>4</sup> ECLAC (2020a) identifies the digital economy, health-sector manufacturing, sustainable tourism and others.

the sustainability of life that will contribute to creating quality jobs, overcoming gender-based labour segregation and improving the social redistribution of care in line with the principle of co-responsibility.

What is needed is macroeconomic environment conducive to recovery with equality. The policy space of States to determine their policies must be respected so they can deploy tools to address the impact of the crisis in a way that guarantees women's rights and works to close structural gaps. Although the countries' fiscal space is limited, it can be expanded by increasing the progressiveness of tax systems, through direct taxes on income and wealth and by combating tax evasion, tax avoidance and illicit financial flows (ECLAC, 2019 and 2020a). The mobilization of additional public resources is necessary to strengthen the financing of gender equality policies in areas that are of strategic importance for women, such as care services, sexual and reproductive health and attending to gender-based violence. Proposals for fiscal austerity and procyclical policies under the assumption that the market is the most efficient allocator of resources will not help close inequality gaps. The recommendation is therefore the adoption of countercyclical fiscal policies that incorporate the gender perspective into their design in order to reverse the effects of the crisis on women's autonomy and promote a sustainable and transformative recovery that will allow substantive equality to be attained.

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# Hyper-fortunes and the super-rich: why a wealth tax makes sense<sup>1</sup>

Ramon E. López and Gino Sturla

*As Covid-19 strikes the world, millionaires like us have a critical role to play in healing our world. [...]*

*Unlike tens of millions of people around the world, we do not have to worry about losing our jobs, our homes, or our ability to support our families. [...]*

*So please. Tax us. Tax us. Tax us. It is the right choice. It is the only choice. Humanity is more important than our money.*

Arthur and others (2020)

## Abstract

This article proposes a model to estimate the wealth of the richest groups in society and to design an efficient wealth tax system. For design and implementation issues, it reviews comparative international experience and provides an analytical discussion of the effects of a wealth tax, reviewing the main criticisms that orthodox economists have levelled against it. The methodology used to calculate wealth involves first-order approximations and Pareto criteria to compensate for data shortcomings. This article also presents a tax system which corrects the problems that have arisen when implementing this type of tax in other countries. The model is applied to the reality of Chile, which, like other countries in the region, suffers from structural inequality in both income and wealth, which has been amplified by the effects of the COVID-19 pandemic.

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## Keywords:

Wealth, measurement, taxation, income tax, property tax, tax collection, fiscal policy, income distribution, equality, economic development, case studies, Chile

## JEL classification

D31, H24, E62

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<sup>1</sup> The authors are deeply grateful for valuable comments and observations made by Miguel Torres and Nicole Favreau, both of the Economic Commission for Latin America and the Caribbean (ECLAC).

## I. Introduction

The COVID-19 pandemic has caused what has been described as the worst health and economic crisis of recent decades. This study starts by formulating three key questions.

Who has been impacted by this crisis? The vast majority of the population has endured enormous physical suffering, major economic losses and even death. Low-income sectors and the middle classes have taken an unprecedented socioeconomic hit that has set their well-being back by many years. Poverty has spread rapidly, with some segments of the population going hungry and having to rely on food banks. Workers, shanty-town dwellers and small-scale traders have been particularly hard hit by this crisis, which has generated very high unemployment rates, significant reductions in real wages and the collapse of countless small and medium-sized enterprises (SMEs).

Who has financed the enormous economic costs of this crisis? First and foremost, it has been workers and the middle classes, who have had to draw on their meagre savings just to survive. This has entailed a significant reduction in funds accumulated for old age pensions and the near exhaustion of unemployment funds. In addition, government measures have generated burgeoning fiscal deficits—in many countries on a scale not seen for many decades— together with increased fiscal borrowing and a reduction in sovereign wealth funds. Unless major tax reforms are introduced in the medium term, workers and SMEs will bear the brunt of the fiscal deficits and higher debt, as has happened in countless previous crises.

Who has not been impacted by this crisis or contributed to financing its costs? Far from suffering the effects of the pandemic, individuals in the higher income and wealth brackets have seen their wealth increase significantly. An Oxfam study (Ruiz, 2020) reports that the fortunes of Latin American billionaires had grown by more than US\$ 48 billion by late 2020, a time of grave crisis and suffering for the rest of the population.

This is the main reason why, in many of the region's countries, proposals have been made to levy a tax on the wealth of large fortunes, and thus be able to alleviate the heavy burden of financing the economic effects of this crisis on the rest of the population. The super-rich have benefited enormously from the prevailing neoliberal economic model, and they have borne a tax burden that is disproportionately small relative to their huge incomes and fortunes. So, if they fail to contribute to financing this major crisis, the widespread perception of injustice will continue to fester in the region's countries. This could fuel social and political instability, which, in turn, could generate yet more suffering for the population and a further deepening of the economic crisis in the medium term.<sup>2</sup>

As a result of the health crisis, the wealth tax debate has gained ground in nearly all the region's countries, including Argentina, Brazil, Chile, Ecuador, Paraguay and Peru. The COVID-19 pandemic has regressive effects, hitting hard those who have the least, in terms of both their health status and their economic situation. This results in deepening inequality, unless the government reverses the situation, or at least compensates for it. The fulfilment of government functions is based on two pillars: the way taxes are collected and how expenditure is executed (Strada and others, 2020).

Wealth taxes have a long history in nearly every country in the world. Traditional wealth taxes, which include levies on physical property (houses, land, and so forth), inheritances, and other assets, exist in almost all countries; and, as shown in this article, in some of them they generate a large proportion of tax revenues. There is another category, which here are referred to as non-traditional wealth taxes, which are levied on financial and other forms of wealth, including stock market assets

<sup>2</sup> Oxfam has argued that governments in the region are undertaxing both personal wealth and corporate profits, and that this undermines their efforts to combat COVID-19, poverty and inequality. It has also recommended the application of a wealth tax throughout the region, targeted on net fortunes in excess of US\$ 1 million, with progressive rates ranging from 2% to 3.5% (Ruiz, 2020).



and other stores of value. Non-traditional wealth taxes are far less common, and are currently applied in just a few countries. They have been criticized by both orthodox economists and some policymakers. Total wealth taxes combine both the traditional and non-traditional type.

This article makes an in-depth analysis of wealth taxes, focusing particularly on the non-traditional ones. It also proposes a methodology for estimating potential revenue and for targeting the tax on very-high-net-worth population groups. The article discusses design and implementation issues, with a view to mitigating the main problems these taxes have faced when implemented in other countries, and thus make them less vulnerable to the main criticisms levelled against them. Non-traditional wealth taxes are framed in the context of total wealth taxes, with the overall revenue being separated into traditional and non-traditional in countries where both types of wealth tax coexist.

## II. The case of Chile

The topic of wealth taxes is particularly relevant in Chile for several reasons.

First, unlike other countries, in Chile the health crisis erupted shortly after the social upheaval that occurred in October 2019. This conflict persists as an undercurrent, basically for two reasons: because the social demands that triggered it have in no way been met; and because the health crisis has merely exacerbated the enormous social deficits and vulnerability that afflict certain sectors of society. Given the intensity of the current crisis, if urgent measures are not adopted to support the sectors most affected by huge income losses, poverty in Chile could engulf 50% of the population and fuel a spiral of violence with consequences that are hard to predict.

Second, as discussed below, levels of inequality and, particularly, the concentration of wealth in Chile are egregious —perhaps among the highest in the world. This makes the issue of wealth taxes all the more relevant, because they have the potential to tackle this inequality at its deepest roots.

Third, despite such profound inequality, Chile's tax burden is one of the lightest among member countries of the Organization for Economic Cooperation and Development (OECD). The tax system has also given special privileges to income obtained from capital, practically eschewing the charging of royalties on economic rents, and making capital gains virtually tax-exempt.

Fourth, since the onset of the COVID-19 health crisis, the country has been confronted with two dominant views: that of the government, which tends to impose too many conditions on eligibility for social assistance; and that of certain progressive sectors, which have advocated for more liberal social support, financed by fiscal borrowing or by drawing on sovereign funds. Although the second alternative would have generated less dramatic economic and social consequences, it perpetuates the logic that the costs of the crises will be borne by the middle- and lower-income sectors, over the short and medium terms. This is a perception that is widely held among the population, and it has been amplified by the social conditions prevailing since October 2019.

Fifth, the relative lack of government support for vulnerable sectors has forced workers to make large withdrawals from their unemployment funds and draw down their pension funds. This latter measure attracted a good deal of support among citizens, and was embraced by all opposition forces and even by a section of the ruling party. Notwithstanding the short-term benefits for the population, in this case the resources are obtained from the workers themselves; in no way are they obtained from population segments that have the largest fortunes.

Sixth, in conjunction with a group of orthodox economists, the government drew up an economic recovery plan, the Social Protection and Job Recovery Agreement, which was approved by the opposition, despite initial resistance.<sup>3</sup> This agreement includes a fiscal package that, *grosso modo*, provides for some

<sup>3</sup> See Infrastructure Policy Council (2020).



US\$ 12 billion to be spent over a 24-month period. In keeping with the logic discussed in the previous point, this plan also does not involve tax reforms that would avoid the aforementioned perception that “we all pay for crises”.

Seventh, in June 2020 a draft constitutional reform that would levy a one-time tax on the super-rich was submitted to the National Chamber of Deputies.<sup>4</sup> The project enjoys a high level of citizen support (CELAG, 2020), and it has been well received by opposition parliamentarians, garnering historic votes. Nonetheless, a number of orthodox economists, who claim to represent progressive forces, are strongly opposed for the reasons discussed below.

In view of these seven points, it is clear that the country will face the future with an external financial debt and, more importantly, with a social debt to all the workers and SMEs that have already borne the costs of the crisis with their savings, and will continue to do so with their taxes.

The fiscal cost of the social support could amount to US\$ 15 billion (almost 6% of GDP). The fundamental issue —and consistent with the foregoing— is that much of this financing ought to be contributed by the wealthiest segments of the population, among which billionaires (individuals with a net worth of over US\$ 1 billion) have seen their fortunes grow by 27% during the COVID-19 crisis (Ruiz, 2020).

A large share of the necessary social support must come from the largest fortunes. This article proposes a mechanism for this contribution that involves a very simple non-traditional wealth tax levied on a small group of the rich and super-rich (representing 0.07% of the adult population).<sup>5</sup>

### III. Review of comparative experience

#### 1. Wealth taxes in other countries

At the present time, eight countries, spanning the Organization for Economic Cooperation and Development (OECD) and Latin America, levy non-traditional wealth taxes of varying scale. Table 1 reports the key features of systems that tax financial wealth: the type of wealth taxed; exemption thresholds; tax rates; revenue, both total and relative to GDP; and whether or not the tax impinges on the middle- and upper-middle income groups.

**Table 1**  
Comparative experience of the application of non-traditional wealth tax

Country	Wealth taxed	Exemption threshold	Rates (percentage)	Revenue (percentage of GDP)	Revenue (percentage of total revenue)	Impinges on middle and upper-middle income groups?
Spain	Total wealth (natural persons)	US\$ 760 000 US\$ 325 000 permanent residence	0.15 to 3.75	0.18	0.50	No
Norway	Total wealth (natural and legal persons)	US\$ 146 000	0.85	0.45	1.10	Yes
Switzerland	Total wealth (natural and legal persons)	Between US\$ 50 000 and US\$ 250 000, depending on household size	0.30 to 1.00	1.09	3.90	Yes
Luxembourg	Total wealth (legal entities)	Certain assets: qualifying shareholdings (10%) and intellectual property rights	0.05 to 0.5	2.90	9.35	No

<sup>4</sup> See [online] <https://www.camara.cl/verDoc.aspx?prmID=13876&prmTIPO=INICIATIVA>.

<sup>5</sup> In the United States, 0.1% of the adult population owns 20% of total private wealth (Saez and Zucman, 2019a). In Chile, as estimated in this article, 0.07% of the population holds 34% of total private wealth (the percentage of the Chilean adult population is obtained from INE (2020)).

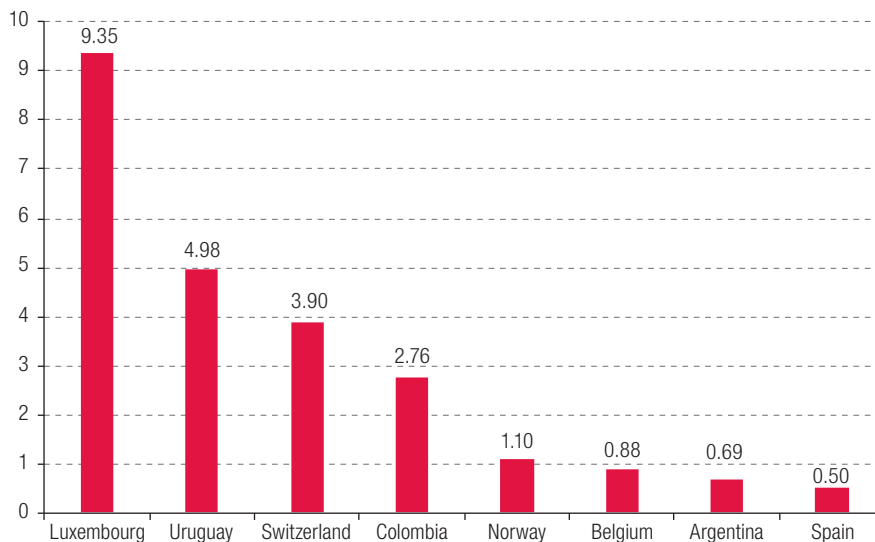
Table 1 (concluded)

Country	Wealth taxed	Exemption threshold	Rates (percentage)	Revenue (percentage of GDP)	Revenue (percentage of total revenue)	Impinges on middle and upper-middle income groups?
Belgium	Financial wealth (natural persons)	US\$ 550 000	0.15	0.21	0.88	No
Colombia	Total wealth (natural and legal persons)	US\$ 140 500, permanent home	1.00	0.40	2.76	No
Uruguay	Total wealth (natural and legal persons)	Agricultural and rural assets, assets held abroad and public debt securities. No limit.	0.40 0.70 1.50	1.00	4.98	Yes
Argentina	Gross wealth (natural and legal persons)	US\$ 300 000 first home and other assets (fixed-term deposits, government debt securities and intangible assets, such as trademarks and patents)	0.25 to 2.25	0.20	0.61	No

**Source:** Prepared by the authors, on the basis of Organization for Economic Cooperation and Development (OECD), "Revenue Statistics - OECD countries: comparative tables: comparative tables - OECD countries", 2019 [online] <https://stats.oecd.org/Index.aspx?QueryId=21699>; Organization for Economic Cooperation and Development (OECD), The Role and Design of Net Wealth Taxes in the OECD, OECD Tax Policy Studies, No. 26, Paris, 2018; Economic Commission for Latin America and the Caribbean (ECLAC), Fiscal Panorama of Latin America and the Caribbean, 2017 (LC/PUB.2017/6-P), Santiago, 2017; Argentine Investment and Trade Promotion Agency, "El sistema tributario en la Argentina", 2019 [online] [https://www.inversionycomercio.org.ar/docs/pdf/El\\_Sistema\\_Tributario\\_en\\_la\\_Argentina.pdf](https://www.inversionycomercio.org.ar/docs/pdf/El_Sistema_Tributario_en_la_Argentina.pdf); KPMG International, Tax Facts 2020: a Survey of the Norwegian Tax System, 2020 [online] [https://assets.kpmg/content/dam/kpmg/no/pdf/2020/03/Tax-facts-2020\\_WEB.PDF](https://assets.kpmg/content/dam/kpmg/no/pdf/2020/03/Tax-facts-2020_WEB.PDF); Harrison Brook, "Wealth tax in Spain 2020 for expats", 3 June, 2019 [online] <https://www.harrisonbrook.co.uk/wealth-tax-spain-2018/>; The Norwegian Tax Administration, "Wealth tax", 2020 [online] <https://www.skatteetaten.no/en/rates/wealth-tax/?year=2020#rateShowYear>; E. Asen, "Wealth taxes in Europe", Tax Foundation, 20 November, 2019 [online] <https://taxfoundation.org/wealth-tax-europe/>, and C. Barria, "Los 3 países de América Latina que cobran impuesto a la riqueza (y qué resultados han tenido)", BBC News, 17 January, 2020 [online] <https://www.bbc.com/mundo/noticias-51099710>.

Figure 1 displays the revenue obtained from total wealth taxes relative to tax revenue in each country. In some cases, these taxes have made a significant contribution, averaging over 3% of total tax revenue intake.

**Figure 1**  
Selected OECD countries and Latin American countries: revenue from total wealth taxes as a share of tax revenue, 2017–2018  
(Percentages)



**Source:** Prepared by the authors, on the basis of Organization for Economic Cooperation and Development (OECD), "Revenue Statistics - OECD countries: comparative tables: comparative tables - OECD countries", 2019 [online] <https://stats.oecd.org/Index.aspx?QueryId=21699>, and Economic Commission for Latin America and the Caribbean (ECLAC), Fiscal Panorama of Latin America and the Caribbean, 2017 (LC/PUB.2017/6-P), Santiago, 2017.

**Note:** While for Colombia and Uruguay the amounts correspond to 2017, for the rest of the countries they correspond to 2018.

Figure 2 compares total wealth taxes, both in the countries analysed and in others that have traditional wealth taxes that are quite similar to the non-traditional ones, under other names or modalities, and also in Chile.<sup>6</sup> The list of countries considered includes not only those with high levels of development, but also several with similar or even lower income levels than Chile. As the figure shows, Chile taxes total wealth the most lightly; that is, besides not having a non-traditional wealth tax, its total wealth taxes are lighter than in all other countries considered.

**Figure 2**  
Selected OECD countries and Latin American countries: total wealth tax revenue relative to GDP, average 2008–2017  
(Percentage points)



**Source:** Prepared by the authors, on the basis of Organization for Economic Cooperation and Development (OECD), "Revenue Statistics - OECD countries: comparative tables: comparative tables – OECD countries", 2019 [online] <https://stats.oecd.org/Index.aspx?QueryId=21699>.

## 2. Other cases of interest

In France, only real estate wealth has been taxed since the non-traditional wealth tax was abolished in 2017; the revenue collected represented 0.2% of GDP in that year and 0.1% in 2018 (OECD, 2019a). Although OECD still includes it as a wealth tax in its reports (OECD, 2019a), it has not been considered a non-traditional wealth tax for the purposes of this study, especially since France's total wealth tax is the highest of all OECD countries (4.4% of GDP in 2018).

Denmark and Sweden recorded very low rates of avoidance and evasion of (non-traditional) wealth tax during the period in which it was in force. In Sweden, the wealth tax was suspended in 2007; and, in Denmark, the personal wealth tax was the highest of its kind until it was discontinued in 2003. The marginal rate of wealth tax was 2.2% (Seim, 2017; Jakobsen and others, 2019).

Two important econometric studies have shown that a 1% increase in the wealth tax reduces the amount of wealth declared by less than 1% (Seim, 2017; Jakobsen and others, 2019), which indicates a high revenue potential. Moreover, neither of the two studies detects significant effects on saving and investment from these taxes.

<sup>6</sup> According to OECD (2020), "tax on property is defined as recurrent and non-recurrent taxes on the use, ownership or transfer of property. These include taxes on immovable property or net wealth, taxes on the change of ownership of property through inheritance or gift and taxes on financial and capital transactions".

## IV. Analytical discussion of wealth taxes

### 1. Criticism of non-traditional wealth taxes

This section considers the three main criticisms that orthodox economists have levelled against non-traditional wealth taxes (see, for example, Kopckuk in Schrager (2020), one of the most prominent critics).

#### (a) Non-traditional wealth taxes are likely to discourage saving and investment

An overwhelming proportion of large fortunes is held either in assets of personal use, such as mansions, land, yachts, aeroplanes or helicopters, or else in tax havens. This represents conspicuous consumption or savings that are largely unproductive for the rest of society. Wealth taxes would therefore discourage overconsumption or savings in tax havens, rather than savings that could generate benefits for most of the society. The authors of this article are unaware of any empirical studies showing that these taxes have actually affected savings. In fact, three recent highly sophisticated empirical studies have shown that wealth taxes have no such effect (Seim, 2017; Jakobsen and others, 2019; Londoño-Vélez and Ávila-Mahecha, 2018).

Apart from solid empirical evidence, there are robust conceptual reasons to believe that wealth taxes affecting a very small fraction of the population have no impact on investment. As these taxes do not target business profitability, but only personal fortunes, it is very unlikely that they will have a negative effect on investment. In the case of Chile and many other countries, the ownership of large firms is highly concentrated among “controlling interests”. Often, 80% or 90% of the shares are held by a handful of controlling shareholders who are in the super-rich bracket.<sup>7</sup>

Provided investing in these firms remains profitable, investment in them need not be affected. For, while the individuals subject to the non-traditional wealth tax would have less incentive to invest, potential investors not affected by the tax (the tax will only impinge on a very small fraction of the population) would still have incentives to invest in profitable projects. A non-traditional wealth tax could therefore expand the range of investors in large firms, rather than reduce investment in profitable projects. This, in turn, could increase the dispersion of ownership of large firms, thus reducing its concentration, which could be considered a positive development. If the super-rich decide not to invest in highly profitable projects, they will create space for investment by other less wealthy investors who are not affected by the non-traditional wealth tax.

#### (b) There are better taxation alternatives, especially taxes on economic rents that would reduce incentives for rent-seeking

While taxes on economic rents are forward-looking, an important function of the non-traditional wealth tax is to reclaim for society the economic rents that were appropriated by a small group of super-rich individuals over many years when such rents were not taxed. A large proportion of the large fortunes has been accumulated on the basis of rents of all kinds, including monopolies, oligopolies, the use of privileged information and rents from natural resources that were handed over at no cost.<sup>8</sup> This

<sup>7</sup> For further details, see Echeverría, Valdivia and Acuña (2020) and Santiago Exchange (2020).

<sup>8</sup> In the case of Chile, a study on economic rent in the large-scale private mining sector (Sturla and others, 2018) reports rents appropriated over a 10-year period on the order of US\$ 120 billion, equivalent to 50% of the country's total annual GDP. Studies have also been made of economic rents in the health market (Accorsi and Sturla, 2019).

rent appropriation represents a forced transfer of wealth to the super-rich from the rest of society. It has occurred at the expense of consumers who have had to pay monopoly prices; the suppliers of large firms who have received monopsony prices; and small and medium-scale investors who have been exploited by a small number of speculators using privileged information. It also has been extracted from citizens at large, the true owners of natural resources and the environment, who have been deprived of fair payment for the use and abuse of these resources by the super-rich.

This means that, in the past, it would have been better to have a system that taxed flows of economic rent, which would have made the need for non-traditional wealth taxes less obvious. However, in most countries this has not happened, and, in Chile, the rents in question have certainly not been taxed for many decades. Accordingly, starting to tax economic rents today would be a major step forward, but it would not erase the huge misappropriations of these rents that have occurred in the past. Non-traditional wealth taxes are not substitutes for taxes on new economic rent flows, but are complementary to them; some of them tax rents accumulated in the past, while others tax new rent flows.

If a decision were made to start taxing economic rent from now on, it would be necessary to impose non-traditional wealth taxes, until the rents that were expropriated from many citizens in the past were recovered. This requires the present value of the annual flow of revenue from non-traditional wealth taxes to be equal to the fraction of the wealth of the super-rich that consists of the economic rents accumulated by them.

Lastly, one of the great benefits of taxes on economic rents is that they reduce incentives for rent-seeking, and thus promote greater economic efficiency by ensuring that fewer resources are squandered on such activities.<sup>9</sup> However, wealth taxes have this discouragement effect too, since they also reduce the cumulative benefits of rent-seeking. Both types of tax are desirable and help reduce unproductive rent-seeking activities, thereby improving economic efficiency.

Wealth taxation is justified not only as a way to generate resources needed by the State, by reducing economic inequality at its deepest roots and compensating for the misappropriation of rents that has occurred over many decades, but also as a tool to enhance economic efficiency.<sup>10</sup>

### (c) Implementation and collection difficulties

Non-traditional wealth taxes have been criticized chiefly on the grounds that they have not raised the revenue expected of them, owing to the difficulty in valuing certain assets, which facilitates evasion. The three empirical studies applied to the cases of Denmark, Sweden and Colombia mentioned above (Seim, 2017; Jakobsen and others, 2019; Londoño-Vélez and Ávila-Mahecha, 2018) have shown that, in practice, revenue has been closely in line with what was expected, according to the objective designed for these taxes.

In some countries, however, these taxes have raised less revenue than expected; and in others they have largely failed for this reason. What are the main factors that have conspired against the effectiveness of non-traditional wealth taxes in the countries where they have been trialled? A review of their use in various countries reveals the following:

- They have targeted a large number of people and often included the middle class. In many cases, exemption thresholds have been very low.

<sup>9</sup> A famous and highly orthodox article by Murphy, Shleifer and Vishny (1993) shows the great problems and costs of rent-seeking for economic growth, emphasizing the negative effects on production and, above all, innovation — two key elements for sustaining long-term growth.

<sup>10</sup> Several studies have confirmed the existence of relations between income, inequality and economic growth. Piketty (2005 and 2015) provides a long-term, evidence-based view of these links.

- Their design has been highly complex, with multiple tax rates and a variety of deductions.
- The rates applied have been heterogeneous: some assets are subject to very low rates, while others receive much less favourable treatment.
- Certain taxes have targeted only part of the wealth; some have even been levied on only wealth held inside the country, rather than on global wealth.

The first of these factors has generated major resistance among the population and has made these taxes very unpopular, in several cases resulting in their suspension. The other three factors listed facilitated large-scale evasion, which led to low collection rates and persuaded many governments to eliminate the tax.

What follows is a discussion of how these difficulties can be overcome by a more appropriate system than that used in countries where they either have raised little revenue or have failed.

## 2. Implementation and advantages of the proposed system compared to other experiences

The system proposed here for Chile aims to address most of the implementation problems that critics have detected in some of the experiences of other countries, as follows:

- A much higher exemption threshold is proposed than in other countries (US\$ 5 million), which makes it unnecessary to distinguish between asset types for tax purposes. The low exemption thresholds in some countries have brought the middle class into the tax base, which makes it very difficult to apply and control. None of these countries has exemption thresholds of more than US\$ 1 million. In Colombia, although wealth tax is paid on amounts over US\$ 1.5 million, the exemption threshold is no more than US\$ 140,500 (Londoño-Vélez and Ávila-Mahecha, 2018), which has caused cut-off problems. The design proposed here corrects for this issue.
- The various types of asset owned by individuals with fortunes in excess of US\$ 5 million are all taxed at the same rate, which reduces the scope for evasion through transfers between assets.
- The tax being proposed here should be applied to the total of global fortunes, whether held in Chile or abroad, using the same rate.
- Unlike all countries that have introduced wealth taxes in the past, the proposed system targets a very small group of people (just 0.07% of the population). This makes it possible to exempt the vast majority of the population (which, in turn, avoids social rejection) and it also makes it possible to target the tax efficiently. In two thirds of the countries examined, these taxes affect the middle classes. Nonetheless, they remain in force and, in Switzerland and Uruguay (the two key countries in this regard), they raise substantial amounts, accounting for 3.90% and almost 5% of total tax revenue, respectively (OECD, 2019a).
- Countries that have just a single tax rate have other very high corporate and personal taxes (Norway), or else a high exemption threshold (Belgium). The vast majority of countries apply two or more tax rates. Here we propose a system with two tax rates or, alternatively, a flat rate, which makes inspection of the tax very simple.
- Many countries, Colombia being an exception, have a much less unequal distribution of wealth and income than Chile. In contrast, Chile has low rates of income tax, charges virtually no royalties, and leaves most capital gains totally untaxed. In general, Chilean law treats

capital income much more favourably than most countries that have wealth taxes. So taxing financial wealth is much more necessary in Chile than in countries that have higher income taxes and treat capital gains less favourably.

- When these taxes have been well designed, avoidance and evasion have been greatly reduced. While they were in force in Sweden and Denmark, countries where bank secrecy is limited, realized revenue levels were above 98% of their theoretical or potential levels (see Seim, 2017; and Jakobsen and others, 2019). Even in Colombia, where implementation has been more problematic, levels of evasion and avoidance have been relatively low (Londoño-Vélez and Ávila-Mahecha, 2018).

To ensure adequate inspection, a special department of the Internal Revenue Service (SII) should be tasked with the control and supervision of this tax. A formal sworn statement of all assets should be required, with very harsh penalties for evaders. In terms of valuing the different assets, the recommendation is to use the asset valuation formula used by Switzerland, which has been recognized as successful and highly accurate. Financial institutions should be asked to provide SII with annual information on time deposits, bonds, current accounts, shares at market value, mutual funds and others. In addition, following the example of Switzerland, SII should develop a systematic mechanism for obtaining data on asset valuations. Official municipal property registers can be used to value physical assets, including land and forests, and easily accessible records exist for motor vehicles, aeroplanes, helicopters and yachts.

Saez and Zucman (2019a) note that the composition of wealth among the very rich is different from that of the average citizen: 80% of the wealth of the top 0.1% is held in stocks, bonds and real estate, which are quite easy to measure and value.

### 3. Additional compliance measures

#### (a) Tax transparency and international data exchange

A major concern when applying these taxes is the possibility of concealing assets in other countries, particularly in tax havens. Nonetheless, there is an extensive international network of journalists dedicated to tracking down accounts in tax havens and exposing the names and volume of assets concealed in them. There is also a global trend towards placing restrictions on these tax havens and making the accounts that exist in them transparent.

OECD has created a tax transparency system for the exchange of international financial data. This greatly facilitates the control of tax evasion by making it possible to identify the original sources of large fortunes that are hidden under different subterfuges (OECD, 2019b). Concealing assets by using highly complex corporate networks is extremely difficult, if countries use the capacities of this data system. Chile should use this system much more intensively than it has done thus far, to drastically reduce evasion of the various income taxes and any future wealth tax. The system allows for both unilateral information requests and bilateral or multilateral cooperation.

According to the Financial Transparency Coalition (FTC, n/d), country-by-country reporting would require multinationals to share this information for each country in which they operate. The information would greatly enhance the capacity of governments to detect irregular activities that require further investigation, including cases of corruption and bribery. Multinational companies should be required to publish their reporting data on a country-by-country basis, because this global problem has proved too large for national governments to handle alone. Journalists, civil society organizations and academics have raised public awareness of the scale of tax evasion and avoidance; they are also crucial for analysing not only the problem, but also possible solutions.



Lastly, it is worth mentioning the reciprocal agreement on financial information that exists between banks and other institutions in the United States and several Latin American countries, including Chile (the Foreign Accounts Tax Compliance Act).<sup>11</sup>

## (b) Sworn statement of wealth

It is crucial to have a statement of wealth for control purposes, for which certain considerations need to be taken into account (Benítez and Velayos, 2018):

- The design of the statement of wealth should be stable over time, since changes, especially if very radical, make intertemporal comparisons difficult.
- The statement needs to be divided into sections that identify different wealth categories, and also debts because these can distort the control.
- The design of the statement of wealth should be coordinated with the income tax return. For example, private pension saving, on which cumulative earnings are usually income tax exempt, could be declared in a separate section in the statement of wealth. This would ensure that data relating to this part do not prejudice cross-referencing with the income tax returns.
- Coverage of the general universe of declarants, encompassing all assets (with very few exceptions) and the capacity to update their valuation using efficient criteria, all need to be maintained.

## (c) Bank and tax secrecy

The success of revenue collection, both from this tax and also from income taxes, depends partly on having significant limitations on banking secrecy.

In Switzerland, for example, bank secrecy means there is no third-party reporting of financial wealth, which has led to its being under-reported by between 23% and 34% (Brühlhart and others, 2016).

According to OECD (2019c), “ten years since the G20 (Group of 20) declared the end of banking secrecy, the international community has achieved unprecedented success in using new transparency standards to fight offshore tax evasion”. Automatic data exchange between countries involves the systematic and regular transmission of tax data to the country of residence, in relation to various categories of income, such as dividends, interest, gross income, royalties, wages and pensions. The Standard for Automatic Exchange of Information on Financial Accounts was established in 2014 with the aim of ending bank secrecy. Today, more than 90 jurisdictions exchange financial account information automatically, and more than 95 billion euros have been recovered through this system to date. As a result, information on 84 million accounts has thus far been exchanged abroad, representing a total value of about 10 trillion euros (OECD, 2019d).

Since 2009, Chile has had a law allowing the tax authority to access banking information subject to secrecy or reserve.<sup>12</sup> Although this law makes banking secrecy more flexible, it is still extremely difficult to access bank account data. The Internal Revenue Service (SII) can only invoke this law if it can show that this is essential for confirming the veracity and integrity of tax returns, or the lack thereof (Brokering Abogados, 2020).

<sup>11</sup> See Saez and Zucman (2019a) for an exhaustive analysis of the case of the United States performed by two renowned economists, from the University of California at Berkeley. The study focuses particularly on the mechanisms that should be put in place for a correct implementation of a wealth tax.

<sup>12</sup> See Library of the National Congress of Chile (BNC), “Ley 20406: establece normas que permiten el acceso a la información bancaria por parte de la autoridad tributaria”, 2009 [online] <https://www.bcn.cl/leychile/navegar?idNorma=1008772>.

To deal more effectively with assets located inside the country and offshore, and thus make the law considerably more effective, Chile should adhere to the OECD global standard and abolish banking secrecy, a measure that has been successful in the countries that have adopted it.<sup>13</sup>

## 4. Positive externalities of non-traditional wealth taxes

Regardless of the amount of revenue collected, wealth taxes generate very important economic and tax incentives, of which two of the main ones are described below.

### (a) Productivity, competition and innovation

Articles by Guvenen and others (2019) and Shakow and Shuldiner (2000) show that a wealth tax can foster greater innovation. These authors argue that, under non-traditional wealth taxes, entrepreneurs who have similar wealth levels pay similar taxes, regardless of their productivity. This would shift the tax burden towards unproductive wealth and thus encourage its owners to deploy their assets productively in pursuit of higher returns.<sup>14</sup>

Saez and Zucman (2019b) show that a wealth tax with a threshold of US\$ 50 million in the United States would only impinge on about 1% of total household wealth. The authors note that increased saving by the rest of the population (as a result of declining inequality) and by the government could offset any reduction in the capital stock. In terms of effects on innovation, they indicate that most innovation is produced by young persons who are not yet wealthy (the rich tend to be much older than average), who would not be covered by a wealth tax that has a high exemption threshold. They also argue that established firms spend resources to protect their dominant market positions, which reduces innovation. As a result, a wealth tax that only collects from owners of established firms could foster increased competition and thus innovation.

### (b) Synergy with income tax

Wealth taxes are levied on the wealth stock on an accrual basis, while income taxes are charged on the income that flows from the wealth stock. A low rate of wealth tax is equivalent to a high-rate income tax. The interaction between wealth taxes and existing income taxes must be considered when analysing a wealth tax plan.<sup>15</sup>

A mixed system makes it possible to improve income tax revenue collection, especially with respect to individuals that have capital gains. Both the sworn statement of assets and their inspection must be consistent with the earnings obtained as dividends and declared for income tax. This would significantly reduce losses from tax avoidance or evasion in the wealthier income brackets.

<sup>13</sup> In their book *Empresarios zombies: la mayor elusión tributaria de la elite chilena*, Guzmán and Rojas (2017) make a thorough journalistic study of tax evasion perpetrated by large business groups in Chile. As one of the authors notes, these groups not only avoided taxes, but also concentrated wealth. The research revealed large-scale tax avoidance through multiple tax strategies, and it goes even further by establishing a clear-cut connection between avoidance strategies and Chile's profound economic inequality. One highly relevant issue was tax secrecy. As the authors note, an investigation like this would not have been possible without many sources considering that tax secrecy should be set aside, to publish a story that had essentially remained concealed for nearly a decade (Guzmán and Rojas, 2017, p. 10).

<sup>14</sup> For a more in-depth discussion, see the article by economist Garret Watson (Watson, 2019).

<sup>15</sup> For further details, see Li (2019).

## V. The model

This section proposes a methodology for estimating the wealth of the highest income groups, which are those normally targeted by non-traditional wealth taxes. It considers the most important sources of wealth data available for a large group of countries, particularly those provided by The Boston Consulting Group (BCG) (Beardsley and others, 2015; Zakrzewski and others, 2018) and Credit Suisse Research Institute (2019), which can often be supplemented with local sources. The most accurate data available concern the distribution of financial assets among various population groups in each country. The total wealth of the richest groups must be estimated indirectly. Accordingly, the methodology described below starts from the financial wealth data that are the most precise, after which a methodology is suggested for estimating the total wealth of the richest groups. Lastly, a methodology is proposed for estimating revenue from non-traditional wealth taxes.

### 1. Financial assets and total equity<sup>16</sup>

Following the Boston Consulting Group methodology (Zakrzewski and others, 2018), financial wealth is defined as the assets owned by individuals, excluding their majority shareholdings in firms and all real estate assets.

The following variables are defined:

- $X_{ij}^t$  A group that contains a number of people who have financial wealth of between  $i$  and  $j$  monetary units, in year  $t$ . With  $i=0, 1, \dots, l$  and  $j=1, \dots, \infty$ .
- $f(X_{ij}^t)$  Financial assets associated with the group  $X_{ij}^t$ .
- $c(X_{ij}^t)$  Financial assets associated with the group  $X_{ij}^t$  as a fraction of total assets, with  $c \in (0, 1)$ .
- $p(X_{ij}^t)$  Total wealth associated with the group  $X_{ij}^t$ .

The total wealth of the group of individuals  $X_{ij}^t$  can be written as:

$$p(X_{ij}^t) = \frac{f(X_{ij}^t)}{c(X_{ij}^t)} \quad (1)$$

In principle, the variables  $X_{ij}^t$  and  $f(X_{ij}^t)$  are assumed known for period  $t$ ; otherwise, they can be estimated on the basis of information from an earlier period.<sup>17</sup>

If  $X_{ij}^t$  is not known for period  $t$ , but  $X_{s,j}^t$  is, with  $s < i$ , and if  $X_{ij}^{t-h}$  and  $X_{s,j}^{t-h}$  are both known for period  $t-h$ , the estimator of this variable ( $\hat{X}_{ij}^t$ ) will be:

$$\hat{X}_{ij}^t = X_{s,j}^t \frac{X_{ij}^{t-h}}{X_{s,j}^{t-h}} \quad (2)$$

If the same is true of  $f(X_{ij}^t)$  the estimator will be:

$$f(\hat{X}_{ij}^t) = f(X_{s,j}^t) \frac{f(X_{ij}^{t-h})}{f(X_{s,j}^{t-h})} \quad (3)$$

<sup>16</sup> Throughout this article, the term “wealth”, whether financial or total, refers to net wealth, that is assets minus liabilities.

<sup>17</sup> If information from earlier periods is not available or is unsuitable,  $\hat{X}_{ij}^t$  and  $f(\hat{X}_{ij}^t)$  can be calculated on the basis of the Pareto distribution, following a methodology similar to that described in section V.2.

Considering total wealth (not just financial wealth), people who were in an  $i - j$  bracket according to their financial wealth move into a higher (total wealth) bracket,  $k - l$ . This methodology assumes that it is possible to calculate the lower ( $k$ ) and upper ( $l$ ) bounds of the new wealth bracket based on the factor  $c(X_{i,j}^t)$ . In other words, individuals who are in the  $i - j$  financial wealth bracket will be in a higher total wealth bracket.

$k(i)$  Amount in monetary units of the lower bound of the total wealth bracket, with  $i$  the lower bound of the financial wealth bracket, where  $k > i$ .

$l(j)$  Amount in monetary units of the upper bound of the total wealth bracket, with  $i$  the upper bound of the financial wealth bracket, where  $l > j$ .

Where

$$k(i) = \frac{i}{c(X_{i,j}^t)} \quad (4)$$

$$l(j) = \frac{j}{c(X_{i,j}^t)} \quad (5)$$

## 2. Redefining groups by total wealth

The following variables are defined to classify individuals by their total wealth.

$Y_{i,j}^t$  Group (No.) of people who have total wealth of between  $i$  and  $j$  monetary units, in year  $t$ . With  $i=0, 1, \dots, l$  and  $j=1, \dots, \infty$ .

$Y_{i,k}^t$  Group (No.) of persons with total wealth of between  $i$  and  $k$  monetary units, in year  $t$ . With  $k$  of equation (4) and  $k > i$ .

$Y_{j,l}^t$  Group (No.) of people who have total wealth of between  $j$  and  $l$  monetary units, in year  $t$ . With  $l$  of equation (5) and  $l > j$ .

Thus,  $Y_{i,j}^t$  will correspond to persons with financial wealth of between  $i$  and  $j$ ,  $X_{i,j}^t$  plus those that enter  $Y_{i,k}^t$  minus those who exit  $Y_{j,l}^t$  (some people may leave the group to join a higher one). Thus:

$$Y_{i,j}^t = X_{i,j}^t + Y_{i,k}^t - Y_{j,l}^t \quad (6)$$

The total wealth associated with the group  $Y_{i,j}^t$  will correspond to  $p(Y_{i,j}^t)$  expressed as:

$$p(Y_{i,j}^t) = p(X_{i,j}^t) + p(Y_{i,k}^t) - p(Y_{j,l}^t) \quad (7)$$

For any total wealth bracket, the number of persons, the amount of wealth and its distribution among individuals is not necessarily known, owing to data shortcomings. The following methodology is used to deal with this constraint.

It is assumed that the distribution of total wealth within the different brackets can be represented by the Pareto distribution, which behaves well in the upper segments of the income and wealth distribution (López, Figueroa and Gutiérrez, 2016; Atkinson, 2007). This distribution (adapted to total wealth) is written as follows:

$$N = A \left( \frac{z_m}{z} \right)^\alpha = A \cdot z_m^\alpha \cdot z^{-\alpha} \quad (8)$$

Where:

- $N$  Number of individuals who have total wealth greater than  $z$
- $A$  Total number of individuals
- $z$  Total personal wealth in monetary units
- $z_m$  Lowest amount of wealth associated with an individual in this group
- $\alpha$  Parameter representing the degree of wealth inequality

This makes it possible to estimate the number of people with total wealth of between  $i$  and  $k$ , and also those with wealth of between  $j$  and  $l$ .

$$Y_{i,k}^t = A \cdot z_m^\alpha \cdot (k^{-\alpha} - i^{-\alpha}) \quad (9)$$

$$Y_{j,l}^t = A \cdot z_m^\alpha \cdot (l^{-\alpha} - j^{-\alpha}) \quad (10)$$

The total wealth of individuals with wealth greater than  $w > z_m$  but less than  $M > w$ ,  $P_{w,M}(N)$  is estimated using the Pareto distribution density function, as follows (based on equation (9)):

$$P_{w,M}(N) = \int_w^M \frac{dN}{dz} \cdot z \cdot dz = A \cdot z_m^\alpha \int_w^M z^{-\alpha} \cdot dz \quad (11)$$

The values of  $Y_{i,j}^t$  and  $p(Y_{i,j}^t)$  are obtained from equations (6), (7), (9), (10) and (11). This redefines the groups of interest correctly.

$$Y_{i,j}^t = X_{i,j}^t + A \cdot z_m^\alpha \cdot (k^{-\alpha} - i^{-\alpha} - l^{-\alpha} + j^{-\alpha}) \quad (12)$$

The total wealth associated with  $Y_{i,j}^t$  will correspond to  $p(Y_{i,j}^t)$  expressed as:

$$p(Y_{i,j}^t) = p(X_{i,j}^t) + A \frac{\alpha}{1-\alpha} z_m^\alpha \cdot \alpha (k^{1-\alpha} - i^{1-\alpha} - j^{1-\alpha} + l^{1-\alpha}) \quad (13)$$

### 3. Updated total wealth

A fraction of the total wealth of each group consists of stock market wealth, the value of which varies. These variations will occur during period  $t+1$  for the group with total wealth associated with the period  $t$  ( $Y_{i,j}^t$ ). The following variables are defined:

$b(Y_{i,j}^t)$  Fraction of the stock market wealth associated with  $Y_{i,j}^t$  with  $b(Y_{i,j}^t) \in (0,1)$ .

$\Delta_{t+1}(Y_{i,j}^t)$  Percentage change in stock market wealth associated with  $Y_{i,j}^t$ , during period  $t+1$ .

Thus, the updated total wealth of each group in period  $t+1$ , taking account of stock market fluctuations, can be written as:

$$R_{t+1}(Y_{i,j}^t) = p(Y_{i,j}^t) \cdot [1 - b(Y_{i,j}^t) \cdot \Delta_{t+1}(Y_{i,j}^t)] \quad (14)$$

## 4. Wealth tax

The amount  $R_{t+1}(Y_{ij}^t)$  represents the tax base for levying the wealth tax on group  $Y_{ij}^t$  for the period  $t+1$ . The following variables are defined:

- $\tau_{ij}$  Tax rate for the  $i-j$  wealth bracket with  $\tau_{ij} \in (0,1)$ .
- $u_*$  Tax exempt amount in monetary units.
- $\varepsilon(Y_{ij}^t)$  Evasion losses associated with collection of the wealth tax on the updated total wealth of group  $Y_{ij}^t$ , with  $\varepsilon(Y_{ij}^t) \in (0,1)$ .
- $W_{t+1}(Y_{ij}^t)$  Actual revenue collection associated with the group  $Y_{ij}^t$ . The first step in the process is to set up the system during period  $t+1$ .
- $T_{t+1}$  Total effective collection for period  $t+1$ .

It is assumed that there are two groups (classified by total wealth bracket) and a single tax rate  $\tau$ , such that:

$$\tau_{u*,m} = \tau_{m,\infty} = \tau \quad (15)$$

In this case, the revenue collected on the wealth of each of these two groups is obtained by substituting (18) in (15) and (16). Total revenue collection is the sum of the two.

$$W_{t+1}(Y_{u*,m}^t) = [R_{t+1}(Y_{u*,m}^t) - Y_{u*,m}^t \cdot u_*] \cdot \tau \cdot [1 - \varepsilon(Y_{u*,m}^t)] \quad (16)$$

$$W_{t+1}(Y_{m,\infty}^t) = [R_{t+1}(Y_{m,\infty}^t) - Y_{m,\infty}^t \cdot u_*] \cdot \tau \cdot [1 - \varepsilon(Y_{m,\infty}^t)] \quad (17)$$

## VI. Application to the case of Chile

This section applies the methodology developed above to the case of Chile. The exercise is important as a guide for wealth tax policies in Chile and serves as an illustration that could be useful for applying these taxes in other countries.

The model is used to estimate the updated total wealth of two groups that have been defined —rich (between US\$ 5 million and US\$ 100 million) and super-rich (over US\$ 100 million)— and to determine the potential revenue that could be raised from a wealth tax.

The procedure is as follows:<sup>18</sup>

- Equations (1), (2) and (3) make it possible to estimate financial wealth as of 2018 based on information from The Boston Consulting Group (Beardsley and others, 2015; Zakrzewski and others, 2018), and on data reported by the Credit Suisse Research Institute (2019).
- Equations (4) to (13) are used to estimate the total wealth of the rich and super-rich groups, as classified in this study. For the coefficients used in the estimation under the Pareto distribution, two cases have been defined, for which the coefficient has been calibrated on the basis of

<sup>18</sup> For details of the stepwise application of the model to the case of Chile, see López and Sturla (2020).

existing data. These two cases are separated on the basis of the major asymmetry existing in the highest wealth groups, which is why the highest possible wealth bracket must be considered when estimating the distribution within a group. The higher the wealth bracket, the higher the Pareto coefficient (Atkinson, 2007; López, Figueroa and Gutiérrez, 2016). In addition, when no data are available to calibrate the coefficient, data are obtained from the literature, with values above 1.5 and rising to 3.0 for very high wealth brackets (Atkinson, 2007; Clementi and Gallegati, 2005). The two cases thus correspond to the following:

- Individuals with total wealth of over US\$ 1 million, for which the calibrated Pareto coefficient is 0.89.<sup>19</sup>
- Individuals with total wealth of over US\$ 5 million, for which the calibrated Pareto coefficient is 1.25.
- Equation (14) makes it possible to estimate total wealth, updated as of late 2019, taking account of stock market fluctuations since late 2018 which affected part of the wealth of the group of interest. The share of stock market wealth associated with the two groups has been estimated on the basis of Echeverría, Valdivia and Acuña (2020). The variation in stock market wealth is estimated according to the Santiago Stock Exchange index, encompassing firms included in its selective share price index (IPSA), during 2019 (Santiago Exchange, 2020).

Table 2 reports updated total wealth for the rich and super-rich groups.

**Table 2**  
Updated total wealth, 2019

Group	Wealth bracket (US\$ million)	Number of individuals	Updated total wealth (US\$ million)	Per capita (US\$ million)
Rich	5-100	8 900	113 716	12.8
Super-rich	100-∞	263	150 444	572.0
Total	-	9 163	264 160	-

**Source:** Prepared by the authors, on the basis of B. Beardsley and others, *Global Wealth 2015: Winning the Growth Game*, Boston, The Boston Consulting Group (BCG), 2015; A. Zakrzewski and others, *Global Wealth 2018: Seizing the Analytics Advantage*, Boston, The Boston Consulting Group (BCG), 2018; Credit Suisse Research Institute, *Global Wealth Databook 2019*, Zurich, 2019; Santiago Exchange, *Memoria anual 2019, 2020* [online] <https://servicioscms.bolsadesantiago.com/Noticiascibe/Avisos%20Generales/Memoria%20Bolsa%20de%20Santiago%202019.pdf>, and C. Echeverría, C. Valdivia and G. Acuña, "Ranking de grupos económicos RGE 2018", Santiago, University for Development, 2020 [online] <https://ceen.udd.cl/files/2020/02/RGE-18-12vf-2.pdf>.

## 1. Tax system and collection

In a study of Colombia, Londoño-Vélez and Ávila-Mahecha (2018) found that wealth was underreported by an estimated 3% for every percentage point of the wealth tax. So, assuming a flat tax rate of 2.5%, the predicted total rate of underreporting would be 7.5%. The declared amount of total wealth would then be US\$ 244.348 billion.

With a total tax-exempt wealth of US\$ 45.815 billion (9,163 individuals with an exemption threshold of US\$ 5 million each) subtracted from this amount, total taxable wealth would be US\$ 198.533 billion. Applying the 2.5% tax rate generates revenue of US\$ 4.963 billion.

Equivalently, using equations (15), (16) and (17) of the model, and assuming an evasion loss of 7.5%, gives the results shown in table 3.

<sup>19</sup> For this case, a truncated Pareto distribution was considered.



**Table 3**  
Effective collection, with a flat tax rate of 2.5%

Group	Number of people	Revenue collected (US\$ million)
Rich	8 900	1 491
Super-rich	263	3 472
Total	9 163	4 963

**Source:** Prepared by the authors.

## VII. Conclusions

This article has developed a model to estimate the wealth of a country's richest population groups. The methodology used makes it possible to obtain results despite data shortcomings in most cases. An exhaustive analysis has also been made of existing wealth taxes, which shows that the criticisms that have typically been levelled against them have little validity when these taxes are well designed. It has also been shown that wealth taxes contribute to reducing the very foundations of the inequality that has been exacerbated by COVID-19. Moreover, in countries where economic rents are not taxed, wealth taxes are a valuable instrument for recovering part of the rents that have been appropriated by the super-rich and which often forms the basis of their accumulated fortunes. An elementary principle of economic justice calls for the restitution of rents captured by a very small group in society as a result of many decades of privileges, which have been allowed —and even promoted— by governments committed to the interests of the individuals in question. It is also clear that, by reducing incentives for rent-seeking, wealth taxes become a tool to reduce economic inefficiencies.

A comparative analysis of the wealth taxes in force in other countries shows that a tax of this type would be totally viable in Chile. While it is true that other countries have, or have had, lower rates, the vast majority of them have other direct taxes that are higher than those applied in Chile, as well as fiscal expenditure in excess of 30% of GDP (compared to 21% in the case of Chile).

A wealth tax is under discussion in the United Kingdom —a country known for its generous treatment of large fortunes and where the health crisis threatens to accentuate inequalities. A YouGov poll released in mid-May reports that 61% of British citizens would be in favour of a wealth tax levied on fortunes of more than £750,000 (US\$ 950,000) (Vera, 2020). This amount is one fifth of the threshold proposed in this article, which means that the tax system being proposed here is much less risky in this respect. Not only would this facilitate its application, but it would also attract greater citizen support.

A survey conducted by the Latin American Strategic Center for Geopolitics (2020) revealed, in May, that 72.8% of the Chilean population supports a tax on large fortunes.

In April 2020, the International Monetary Fund (IMF) urged governments around the world to impose new taxes on wealth to obtain liquidity, and its proposal also included lowering payroll taxes and providing cash transfers to the hardest hit individuals (IMF, 2020). In January, IMF had stated that inequality should be tackled by raising social spending, financed by taxes at the top of the income distribution. At that time, this international institution claimed that such a policy would not affect economic growth (Georgieva, 2020). Similarly, in a historic editorial published on 3 April, the *Financial Times* (2020) recently argued that income and wealth taxes should both be in the mix in the redistributive agenda.

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# Central America and the pandemic: macroeconomic policy challenges<sup>1</sup>

Juan Carlos Moreno Brid and Rodrigo Alfonso Morales López

## Abstract

This article has a twofold purpose: to describe the social and economic situation in the countries of the Central American subregion prior to the coronavirus disease (COVID-19) pandemic and to provide a comparative analysis of the macroeconomic policies introduced by the governments of these countries in response to this health crisis. As a central part of that analysis, it looks at the main structural policy challenges for the enhancement of social protection and reactivation of production activity and employment to be met by these countries during and after the pandemic. The need for a national compact around a new development agenda is explored, with special emphasis on external elements that should be coupled with national policies, such as regional coordination, international cooperation and finance, and a restructuring of financial and lending institutions.

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## Keywords

COVID-19, virus, epidemics, economic aspects, macroeconomics, fiscal policy, monetary policy, gross domestic product, exports, tourism, remittances, poverty, regional cooperation, economic development, Central America

## JEL classification

E52, E60, E62, H60

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<sup>1</sup> The authors wish to thank Abraham Pazos Rodríguez, Research Assistant, for his valuable contributions.

## I. Introduction

The coronavirus disease (COVID-19) pandemic has led to a double tragedy: death and sickness, on the one hand, and the collapse of production activity and employment and the resulting deterioration in people's living conditions, on the other. Its impact has plunged the Latin American economies into the deepest depression to overtake them in nearly 100 years. For Central America, the impact has been devastating. The lockdowns — which may be required numerous times, although no one knows for sure — have dealt a brutal blow given the high poverty rate, glaring inequality and prevalence of poorly paid informal working arrangements that do not provide adequate medical insurance or reserves to offset a loss of income. In addition, since these are small, very open, weakly industrialized economies, their performance hinges on their currently paralysed external sector. This balance-of-payments constraint is heightened by the pressure on macroeconomic policy being exerted by capital volatility and the unrelenting conditions imposed by rating agencies, which alter these economies' access to international finance from one day to the next.

The governments of the Central American countries were quick to grasp the seriousness of the pandemic and its repercussions. All of them except Nicaragua declared a state of emergency or its equivalent. Drawing on theoretical and practical macroeconomic lessons learned from pre-pandemic experiences, they first moved to adopt measures to reinforce the health sector, distributed health information and issued lockdown orders, mandated social distancing requirements and put other safeguards in place. Once those steps had been taken, their next move was to introduce countercyclical fiscal and monetary policies.

This article will review the status of macroeconomic policy in the countries of Central America as they grapple with the pandemic. The second section will look at the main features of the economic situation in Central America just before the outbreak of this health emergency and the international crisis to which it has given rise. It will also trace the channels through which the COVID-19 crisis has impacted the subregion. The third section will analyse the main macroeconomic responses which, to varying degrees and with varying scope, have been mounted by the Central American governments. The article closes with a series of observations about the lessons to be learned by the subregion from the pandemic and the resulting economic crisis. Without getting ahead of the analysis to be presented here, it can nonetheless be affirmed that the subregion has been put on notice that it must alter the development path that it, like the rest of the world, has been following. In order to heed this warning, it must take steps, as a matter of urgency, to enter into a regional compact to support a steady, sustainable and inclusive form of growth based on a new development agenda.

## II. Central America: the background of this twofold crisis and its vectors of transmission

When the pandemic hit Latin America in early 2020, its economy was stalled. As an average for the region, real gross domestic product (GDP) for 2019 had shown no growth over the preceding 12 months. Central America's economy, on the other hand, had exhibited moderate growth, with its real GDP expanding, on average, by 2.5% albeit with considerable differences across the countries of that subregion. Guatemala's and Panama's economies were growing by slightly more than 3.0% and those of Costa Rica, El Salvador and Honduras by slightly less (between 2.0% and 3.0%), while Nicaragua, which has been immersed in a deep economic and political crisis since 2018, saw its GDP plummet by 4% for the year (ECLAC, 2020a).

The balance of payments exerts a strong influence on the economies of this subregion. Since these economies are small and very open, their performance is largely determined by the nature of their positions in today's globalized markets. If world trade is sluggish, the subregion's economies will languish. Another factor underlying their slow pace of growth during this period is the lack of a sustained upswing in gross fixed capital formation. According to the data available in CEPALSTAT (ECLAC, 2020i), real investment contracted by an average of 1.7% in 2019 in response to the prevailing uncertainty fueled by tense trade relations between the United States and China, Brexit, oil price volatility and mounting protectionism in the developed world. The situation was further exacerbated by the political crisis in Nicaragua, some measure of institutional instability in Honduras and political tensions in Costa Rica.

On the public finance front, according to data from the Economic Commission for Latin America and the Caribbean (ECLAC, 2020b), Latin America's public deficit in 2019 averaged 3.1% of GDP, with only Costa Rica and Panama registering higher levels (6.9% and 3.7%, respectively). The fiscal space available to the subregion, which was to some extent reflected in the public debt as a percentage of GDP, varied from country to country but averaged 47.5%. At the national level, this quotient was 26.1% in Guatemala, 37.5% in Nicaragua, 46.4% in Panama and 49.1% in Honduras. El Salvador (67.4%) and Costa Rica (58.5%) had somewhat less manoeuvring room in this connection than their neighbours, which influences, but does not determine, their ability to implement countercyclical policies. Inflation has been under control for some time now.

On the social front, data stored in CEPALSTAT (ECLAC, 2020i) and recorded by ECLAC (2020a) indicate that poverty levels trended downward between 2012 and 2019 (except in Nicaragua) but nonetheless remained high at 33.7% in El Salvador, 48.6% in Guatemala, 54.8% in Honduras and 47.1% in Nicaragua. Costa Rica (16.5%) and Panama (14.6%) were the only countries in this subregion to report poverty rates below 20%. The extent of inequality is similar in all the countries of this subregion. The Gini coefficient for 2018 was 0.40 for El Salvador, 0.48 for Honduras, 0.49 for Costa Rica and 0.50 for Panama, while the latest statistics available (2014) for Guatemala and Nicaragua put their Gini coefficients at 0.54 and 0.50, respectively.

In sum, the subregion's pace of growth was moderate when the pandemic broke out and it was not troubled by inflationary pressures. Public finances, although complex, were not a cause of concern even though the countries' fiscal space was limited. Nonetheless, the subregion had high levels of poverty, inequality and undernutrition, and its health system was not robust. The challenges posed by the pandemic far outweigh those associated with the global financial crisis of 2008–2009 (World Bank, 2020).

The pandemic that began in China and then spread to neighbouring countries and the industrialized world has become an even more serious problem in developing economies such as those of Central America. One factor has been that the already alarming levels of poverty and inequality in these countries rose even further with the introduction of lockdowns and the subsequent deep reductions in employment and remunerations. In many countries, years' worth of the progress made in combating poverty and expanding educational coverage, as well as in other areas, are being wiped out. The reason why the pandemic has had such a stronger impact on some countries than others lies in such factors as these countries' chronic problems with their social security systems, their high morbidity rates, the lack of automatic stabilizers, the huge size of their informal labour markets and the scale of the precarious informal sectors of their economies, which have very low banking penetration rates.

The subregion also labours under the effects of having a low tax ratio and regressive tax structure, with tax receipts in some of the countries tending to hinge on export earnings from commodities whose prices are volatile on international markets. Their position in the global economy, which is founded on commodity exports or maquilas, amplifies the constraint on the Central American economies' growth generated by the balance of payments. This reliance on external demand and the terms of trade makes these countries' economies incapable of achieving the high, sustained growth rates needed to absorb their expanding workforce and reduce the prevalence of informal employment conditions.



The pandemic has dealt a tremendous blow to aggregate supply and demand. It has also dampened inter-institutional flows of funds, weighed heavily on corporate balance sheets and household budgets, clouded the business climate, curbed domestic and foreign investment and added further to the power wielded by credit rating agencies. The first impact in the subregion was seen with the introduction of lockdowns, social distancing and restrictions on mobility. The suspension of works, the closure of businesses and wage cuts slashed expenditure and depressed production activity even further. All this has undermined the well-being of the entire population (although the impact has been far from evenly distributed), including the middle class, many of whose members have lost their formal-sector jobs and benefits. The upshot has been higher poverty levels and deepening inequality.

External constraints on the subregion's economic growth have tightened with the advent of the pandemic. Its impact has been transmitted through the various components of both the current and capital accounts on the balance of payments. Lockdowns and recessions in the developed world —and particularly the United States— have stifled exports, disrupted global supply chains, smothered tourism and caused remittances to plummet, thereby undercutting Central America's main sources of foreign exchange. The situation has been exacerbated by the decrease in foreign investment inflows to developing economies, in particular. And all this is compounded by capital flight and limited access to international financing. While imports have also fallen as a result of the slowing of economic activity, the balance of payments continues to constrain the outlook for an economic recovery. This puts the dollarized economies of El Salvador and Panama at an even greater risk because they are unable to adjust their nominal exchange rates in order to blunt the effect of external shocks.

Central America is particularly vulnerable to the impacts of the pandemic in a number of ways. Its exports account for a larger percentage of GDP (between 22.2% of GDP in Guatemala and 51.2% of GDP in Panama), on average, than is the case for the rest of Latin America (see table 1). According to the trade statistics compiled by the Secretariat for Central American Economic Integration (SIECA, 2020), 34% of the subregion's total exports of goods went to the United States in 2019. Intraregional exports are also significant, accounting for another 31% of those exports.<sup>2</sup>

**Table 1**  
Central America: contribution of exports, tourism and remittances to GDP, 2019  
(Percentages of GDP)

Country	Exports	Tourism	Remittances
Latin America	20.4	8.1	1.7 <sup>a</sup>
Costa Rica	37.5	12.0	0.8
El Salvador	29.7	11.0	20.9
Guatemala	22.2	6.2	13.7
Honduras	45.7	11.7	21.6
Nicaragua	49.0	10.1	13.2
Panama	51.2	13.6	0.7

**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT, 2020 [online database] <http://interwp.cepal.org/cepalstat/portada.html?idioma=english>; ECLAC, *Estudio económico de América Central y la República Dominicana en 2019 y perspectivas para 2020* (LC/MEX/TS.2020/29), Mexico City, 2020, and World Travel and Tourism Council (WTTC), "Economic Impact Reports" [online] <https://wtcc.org/Research/Economic-Impact>.

<sup>a</sup> Corresponds to 2018.

The weakening of external demand is also putting downward pressure on the prices of a wide range of commodities and other products sold by the subregion. The figures for January–May 2020 show year-on-year increases in the prices commanded by some key export products, however. For example,

<sup>2</sup> The figures published by SIECA do not include free-zone or maquila exports.



Costa Rica registered an upswing in the prices of its exports of medical devices, while Guatemala, Honduras and Nicaragua have reported rising prices for some agricultural or mineral exports, such as bananas and gold.

Exports of farm goods have been hurt somewhat less than other products because of the low income elasticity of external demand for foodstuffs (ECLAC, 2020c). It is still too soon to know if the higher prices for some types of export products will last or not, however. On the other side of the coin, the decline in energy prices has considerably reduced Central America's import costs. In monitoring price trends for agricultural and mineral products and for petroleum, it will be important to keep an eye on changes in the subregion's terms of trade as well.

The biggest impact that the pandemic has had on service exports has been in the tourism sector owing to mobility restrictions and the added risk of contagion associated with travelling. No prospect of a robust recovery appears to be on the horizon in the short run. As tourism gradually reactivates, people are expected to show a preference for short trips, which could give a boost to domestic and regional travel. The countries for which tourism is the most important in terms of its share of GDP are Panama (13.6%), Costa Rica (12.0%) and Honduras (11.7%). The tourism sector's contribution to employment and service exports is equally significant. In 2014–2018, tourism accounted for 22.4% of Panama's service exports and 12.2% of employment in Costa Rica (Mooney and Zegarra, 2020).

The reduction in family remittances that can be expected as part of the fallout from the deteriorating situation in the United States labour market is another blow for Central America, although its severity differs across the countries of the subregion. In El Salvador, Guatemala, Honduras and Nicaragua, 2019 remittances amounted to between 13.2% (Nicaragua) and 21.6% (Honduras) of GDP, whereas, in Costa Rica and Panama, they were less than 1%. In net terms, these latter two countries tend to be sources, rather than destinations, for these kinds of remittances, at least during times of economic growth. After having fallen sharply, the level of remittances to El Salvador, Guatemala and Honduras has been moving back up since June 2020 (ECLAC, 2020a). Trends for the second part of the year will be determined by factors that are difficult to predict. The health, economic and even political situations in the United States are a source of risk, as is the prevailing uncertainty about the continuation of special support measures for workers, which are a pillar of countercyclical policy. In addition, exchange-rate variations will also influence purchasing power in destination countries.

Disruptions of global value chains caused by the pandemic are also reducing Central America's access to intermediate inputs needed for the production of both domestic consumer goods and exports. El Salvador, Honduras and Nicaragua are the countries in the subregion that rely most heavily on imported inputs, while Panama will see a considerable drop in its revenues from the operations of the Panama Canal and the Colón Free Zone (Castellani and others, 2020).

In addition to the effects described above, the pandemic has triggered greater volatility and risk perception in financial markets. The Emerging Markets Bond Index (EMBI) — which measures the spread between the interest rates paid on bonds issued by developing countries and the rates paid on United States Treasury bonds — reflects a deterioration in both the subregion and the developing world as a whole. Data from the Central Bank of the Dominican Republic (2020) for February–September 2020 indicate that country risk as measured by the EMBI rose by 31.8% in Latin America as a whole (31.7% in Guatemala, 52% in Honduras, 52.9% in Panama, 54.7% in Costa Rica and 111.7% in El Salvador). El Salvador's country risk is thus the highest in the subregion (841 basis points) — no data are available for Nicaragua — followed by Costa Rica (667), Honduras (398), Guatemala (323) and Panama (203), compared to a regional aggregate of 441 for Latin America. For the rest of the year, the difficulty in gaining access to external financing will no doubt only increase further, and there is no way that the low interest rates being paid in international markets will offset the impact that increased country risk will have on the cost of financing for the subregion.

This is dampening flows of foreign direct investment (FDI) to Central America and may eventually trigger massive capital flight. In the first quarter of 2020 —when the full force of the pandemic was not yet being felt— official figures pointed to falling levels of FDI in all the Central American countries. CEPALSTAT data (ECLAC, 2020i) show that the year-on-year drop in FDI for that period amounted to 90.9% in El Salvador, 11.6% in Guatemala, 9.1% in Costa Rica, 5.1% in Panama and 1.5% in Honduras, and the decline is quite likely to have continued throughout the rest of the year.

This situation has repercussions on public finances. While expenditure levels have been raised to cover the increased needs associated with the pandemic, revenues have dwindled as the pace of domestic economic activity and foreign trade slows. The hardening of lending terms and conditions darkens the horizon, and currency depreciations are elevating the debt-to-GDP ratio, which tends to reduce governments' fiscal space. In this type of situation, governments need to ensure that public investment does not act as the adjustment variable. On the contrary, they should try to strengthen investment in order to mitigate the drop in present demand and help change their countries' production patterns in the medium and long terms so that they can set out on a rapid, sustainable and inclusive growth path.

The investment climate is being hurt by the overwhelming impact of slumping sales, business closures and uncertainty about the outcome of the pandemic and future trends in key variables of the national and world economies. By the same token, private-sector consumption is declining as people's incomes fall and so many lose their jobs, as well as because they are becoming more cautious.

These negative impacts are distributed unevenly over different economic sectors and population groups. Tourism, the culture industry, retail trade, hotels and restaurants, transport and the textiles sector are being hit the hardest (ECLAC, 2020e). One of the most vulnerable groups in the population is made up of women whose situation is made more difficult by the absence of a care economy and by domestic violence, which tends to become more prevalent when people are forced to live in close quarters and when their incomes are reduced. Lower-middle-income groups run the risk of falling below the poverty line, which would wipe out the progress that it has taken the middle class years to achieve. Informal-sector workers —including those in domestic service— begin to have new and different kinds of needs and to experience new health risks when support programmes do not respond to their needs and risks properly. Children's and adolescents' access to a quality education is reduced or lost altogether, to say nothing of the support for the full personal development of the individual that they need at these stages in life. Many of them may drop out of school so that they can work to help out their families as household incomes shrink. The list of groups experiencing serious shortcomings is long and includes older adults, rural residents, indigenous peoples and persons of African descent, persons with disabilities, migrants, homeless persons and others (ECLAC, 2020f).

The ultimate scale of these various impacts on the Central American economies will depend on the path taken by the pandemic, the measures adopted by the countries and their success in designing appropriate economic policies for implementation over the medium and long terms. The following section will explore the economic policy responses, especially in the fiscal and monetary realms, that the governments of the subregion have set into motion in order to deal with this emergency.

### **III. Macroeconomic policy responses to the pandemic**

The governments of the subregion have begun to adopt extraordinary measures to deal with this grave situation. They have mobilized resources for health care, imposed restrictions on people's movements and on production and commercial activities, and have put a stop to community and social life as we

used to know it. In line with Keynes' teachings, they have introduced countercyclical policies. This section will focus on the most significant types of macroeconomic policies under these conditions: fiscal and monetary/financial policies.<sup>3</sup> Table 2 provides a classification of these policy responses.

**Table 2**  
Central America: policies adopted to address the COVID-19 crisis

Type of policy	Measure	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
Fiscal policy	Temporary changes in tax collections	X	X	X	X		X
	Public transfers	X	X	X	X	X	X
	Deferral of service fees	X	X	X	X	X	X
	Pay raises in the public sector		X				
	Physical investment	X	X	X	X		X
	Public bond issues	X	X	X	X		X
Monetary and credit policy	Lowering of monetary policy rate	X		X	X	X	
	Alteration of bank reserve requirement	X	X	X		X	
	Other liquidity-boosting measures	X		X	X		
	Loan moratorium and restructuring	X	X	X	X		X
	Freeze on credit ratings and streamlining	X	X		X		
	Creation of new lines of credit	X	X	X	X		X
	Exchange rate interventions			X			
Other	Price controls	X	X	X	X		X
	Direct intervention in the labour market	X	X	X	X		X

**Source:** Prepared by the authors, on the basis of A. Matarrita and R. Romero, "Políticas económicas implementadas en la región CAPARD para contrarrestar el impacto del COVID-19", *Notas Económicas Regionales*, No. 114, San José, Executive Secretariat of the Central American Monetary Council, June, 2020; Economic Commission for Latin America and the Caribbean (ECLAC), "COVID-19 Observatory in Latin America and the Caribbean: economic and social impact", 2020 [online] <https://www.cepal.org/en/topics/covid-19>; International Monetary Fund (IMF), "Policy Responses to COVID-19", 2020 [online] <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>; Central Bank of Honduras, "El Banco Central de Honduras revisa el programa monetario 2020–2021 y aprueba una nueva reducción en su tasa de política", *Boletín de Prensa*, No. 42/2020, Tegucigalpa, 31 July 2020; Bank of Guatemala, "La Junta Monetaria por unanimidad reduce en 25 puntos básicos la tasa de interés líder de política monetaria", *Boletín de Prensa*, Guatemala City, 25 June 2020; Ministry of Finance of El Salvador, *Estimación de los costos económicos, sociales, fiscales y medidas adoptadas en el marco de la pandemia COVID-19*, San Salvador, April 2020, and Ministry of Employment and Labour Development of Panamá, "Reglamentan la suspensión de los contratos de trabajo", 20 March 2020 [online] <https://www.mitradel.gob.pa/reglamentan-la-suspension-de-los-contratos-de-trabajo-2/>.

Costa Rica, Guatemala and Honduras have made use of a wide array of fiscal, monetary and credit policies. Nicaragua's response has been weak and clearly insufficient. Since Panama and El Salvador have dollarized economies, their main responses have taken the form of fiscal and credit supports. On the fiscal front, as may be seen from table 3, the authorities' countercyclical stance in 2020 can be expected to result in lower-than-budgeted tax revenues. By the same token, increases in public expenditure and the fiscal deficit are projected for all the countries of the subregion. The combination of a contraction in production activity and the implementation of countercyclical policies entailing both higher spending levels and lower tax receipts in some categories — owing, up to a point, to endogenous factors — will result in a considerable increase in the ratio of public debt to GDP in 2020. The change in this ratio will be larger in the non-dollarized economies if sizeable exchange rate depreciations occur throughout the year.

<sup>3</sup> A detailed list and description of the wide range of economic and social policy responses mounted by each country of the region in response to the pandemic is available from the ECLAC COVID-19 Observatory in Latin America and the Caribbean at: [online] <https://www.cepal.org/en/topics/covid-19>. Information for the countries of the world is available at the following websites: <https://www.imf.org/external/spanish/index.htm> (International Monetary Fund (IMF) and <https://www.bancomundial.org/> (World Bank).

**Table 3**  
Central America: variations in the main fiscal indicators, 2020  
(Percentages of GDP)

Indicator	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
Tax revenues						
Budgeted	13.3	18.2	10.4	16.8	17.2	7.7
Closing estimate	12.6	17.1	9.8	15.8	17.0	7.0
Expected loss ( <i>percentage points</i> )	0.7	1.1	0.5	1.0	0.2	0.7
Total expenditure						
Budgeted	22.1	22.1	13.8	18.4	18.9	15.5
Closing estimate	22.6	28.6	16.3	21.6	19.4	22.0
Expected increase ( <i>percentage points</i> )	0.5	6.5	2.5	3.2	0.5	6.4
Fiscal deficit						
Budgeted	-7.9	-1.9	-2.6	-2.0	0.0	-3.1
Closing estimate	-8.3	-11.9	-5.8	-6.4	-0.8	-6.2
Expected increase ( <i>percentage points</i> )	-0.4	-10.0	-3.3	-4.4	-0.9	-3.1
Public debt						
Budgeted	62.8	71.1	27.3	51.2	35.9	46.8
Closing estimate	67.2	92.1	31.7	56.7	38.0	56.2
Expected increase ( <i>percentage points</i> )	4.5	21.0	4.4	5.6	2.0	9.3

**Source:** Central American Institute for Fiscal Studies (ICEFI), "Estimación de la situación fiscal de Centroamérica al final de 2020", *Notas de Coyuntura*, No. 05-2020, Guatemala, July 2020.

Projections computed by the Central American Institute for Fiscal Studies (ICEFI, 2020b) indicate that central government debt will climb to 57% of GDP, on average, which is 8 percentage points of GDP higher than the budgeted figures. The steepest upswing, of 21 percentage points, will be seen in El Salvador, whose debt is expected to top 90% of GDP. In the other countries, the increase will be in the single digits, with the sharpest being in Panama (9 percentage points), followed by Honduras (6 percentage points), taking these two countries' debt levels to the equivalent of 56% of their respective GDP totals. For Guatemala and Costa Rica, the ratio is expected to climb by around 4.5 percentage points to 32% and 67%, respectively. Nicaragua's debt will hold almost steady relative to GDP, with an increase of just 2 percentage points bringing its ratio to 38%.

This unusually large upswing in the public debt reflects the expansion of the fiscal deficit. In all the countries, this shortfall will outstrip the approved deficit levels set in their national budgets, ranging from less than 1 percentage point in the cases of Costa Rica (-0.4%) and Nicaragua (-0.9%) and under 4 percentage points or around that figure in Panama (-3.1%), Guatemala (-3.3%) and Honduras (-4.4%) to 10% in El Salvador. In all the countries except Costa Rica, the growth of the fiscal deficit will be more an effect of higher spending than of lower tax receipts, as the reduction in the latter is expected to be quite small in 2020 (between 0.2% and 1.1% of the corresponding country's GDP) (ICEFI, 2020b). These contractions are not just the result of slackening activity; countercyclical tax incentives are also a factor. The overages in spending (relative to initial projections) are fairly similar across the countries of the subregion. ICEFI (2020b) estimates put this "excess" expenditure at half a percentage point of GDP for Costa Rica and Nicaragua, which is in step with the fairly limited increase in their fiscal deficits. For Guatemala and Honduras, the project increases are 2.5 and 3.2 percentage points of GDP, respectively, while the steepest rise (6.5 percentage points) is expected in El Salvador.

Some of the main countercyclical fiscal measures adopted by the Central American countries on varying scales and at different points in time will be examined in greater detail in the following discussion, including temporary modifications in tax collections involving tax credits, waivers, amnesties, exemptions, reductions and deferrals.

Fiscal support measures have been introduced to assist individuals, families and businesses that are vulnerable or have already been impacted by these extraordinary circumstances.<sup>4</sup> In Costa Rica, transfers have been made to persons living in poverty and food and biosafety packages have been distributed to persons with disabilities, people living in extreme poverty, older adults and the unemployed. In El Salvador, US\$ 300 per family has been distributed to 1.5 million households, and 1 million food packages have been delivered. In Guatemala, targeted transfers of US\$ 130/month have been granted for a period of three months and assistance allowances have been made available to persons in the informal sector, pensioners and health workers. Packages of food, medicines and other inputs have been delivered to vulnerable persons. In Honduras, transfer payments have been made to transport workers, and packages containing food and personal hygiene items have been distributed. In Panama, vouchers for the purchase of food, medicines and petrol have been provided in urban areas and packages of these items have been distributed in rural areas. In Nicaragua, the only official reports of assistance deal with the distribution of food packages in various areas of the country. As an additional measure, some countries have subsidized basic services. Measures have also been introduced in the labour market. In El Salvador, for example, a US\$ 150 wage hike for civil servants directly involved in combating the pandemic has been approved. Increased fiscal assistance measures for households have, for the most part, taken the form of monetary or in-kind transfers.

In addition to the measures adopted to buoy household consumption, various kinds of steps have also been taken to help businesses maintain employment levels and to shore up their production capacity. In Costa Rica, temporary public transfer payments have been made to microenterprises and to small and medium-sized enterprises (MSMEs) in the fishery, tourism and farm sectors. The taxes paid by airlines on the fares that they sell have been suspended for four months and the annual tax fees levied on businesses in the fishery sector have been suspended for three months. In Guatemala, a three-month moratorium on corporate tax payments has been declared, and the contributions to be paid by employers to the Private Enterprise Workers' Recreation Institute (IRTRA), the Technical Training and Productivity Institute (INTECAP) and the Social Security Institute of Guatemala (IGSS) have all been suspended for three months as well. In Honduras, tax payment deferrals have been granted to businesses classified as small or medium-sized enterprises. In Panama, all tax payments have been deferred for 120 days. Subsidies have been granted in El Salvador to firms employing 100 or fewer employees to cover 50% of their wage bill for up to two months, and the special tax levied on tourism companies has been deferred. In addition to all these fiscal measures, companies have received different kinds of financial assistance, as will be discussed in greater detail below. The only country in the subregion that has not introduced fiscal support measures for businesses is Nicaragua.

Other fiscal measures have benefited households and companies alike. For example, Costa Rica has declared a moratorium on income taxes and value added taxes and has lowered the tax floor for social security payments by 75% for employers, independent workers and public-sector employees. In El Salvador, income tax payments have been deferred for both individuals and institutions. Honduras has deferred all tax payments for small and medium-sized taxpayers until June 2020 and income tax payments until August, in addition to instituting an 8.5% income tax cut for this category of taxpayer, while Panama has deferred tax payments for 120 days.

The governments of the subregion have needed additional financing to fund special programmes and other responses to the twofold emergency. Major external sources have included the International Monetary Fund (IMF), World Bank, Inter-American Development Bank (IDB) and Central American Bank for Economic Integration (CABEI). For the subregion as a whole, the biggest disbursements have been made by IMF (US\$ 2.145 billion) and the World Bank (US\$ 2.025 billion). CABEI has also

<sup>4</sup> Information on fiscal measures has been obtained from the following sources: Matarrita and Romero (2020), ECLAC (2020f), IMF (2020) and the Ministry of Finance of El Salvador (2020).

provided large sums of financing (US\$ 1.453 billion). According to ECLAC data (2020a), the countries that have issued the most debt paper are Costa Rica (US\$ 1.679 billion), Honduras (US\$ 1.169 billion) and Panama (US\$ 1.065 billion).

One limitation of the initial strategy for coping with the emergency has been that — as is to be expected — the countries have focused their fiscal stimulus packages on steps that needed to be taken in the short run, while putting off the design of a post-emergency strategy to ensure the sustainability of the countries' debt profiles in line with a new sustainable, inclusive long-term development agenda.

The public budgets being drawn up for 2021 should include plans for backstopping a sustained and sustainable economic recovery in the medium and long terms. As of September 2020, only Costa Rica, Guatemala, Honduras and Panama had unveiled their draft budgets for 2021.<sup>5</sup> The draft budgets of Guatemala and Honduras include multi-annual guidelines up to 2023, but the amounts set out for the fiscal effort to deal with the consequences of the crisis over the medium term may fall short of what is needed.<sup>6</sup> What is more, both countries plan to resort to fiscal consolidation measures in order to counterbalance the impact on public finances. Costa Rica has proposed strong fiscal consolidation measures for 2021 and, as of September, was negotiating an agreement with IMF that would call for major public spending cuts and asset sales in the medium term. The subregion thus runs the risk of making a far too premature return to austerity policies that would lengthen and deepen the recession, further worsen conditions in the labour market and, as a result, raise their societies' levels of poverty and inequality.

In the area of monetary and credit policy, the Central American countries' main responses have taken the form of reductions in interest rates and bank reserve requirements and measures designed to ease access to credit.<sup>7</sup> Inflation rates are low enough to provide room for the conventional types of expansionary monetary policies. According to data compiled by the Executive Secretariat of the Central American Monetary Council (SECMCA, 2020), between February and September 2020, Costa Rica cut its rate by 450 basis points (from 5.25% to 0.75%), Guatemala by 100 basis points (from 2.75% to 1.75%) and Honduras by 150 basis points (from 5.25% to 3.75%). Nicaragua set its monetary policy rate at 6% in April and then lowered it by 175 basis points in August 2020.

Some of the countries have modified their bank reserve requirements to buoy liquidity and encourage the domestic banking system to buy public debt securities. In Guatemala, the way in which the reserve requirement is to be calculated was changed to make it more flexible for a period of 180 days. Nicaragua lowered its legal reserve requirement by 10.5% for the whole of 2020 and, according to data from SECMCA (2020), El Salvador reduced its effective bank reserve requirement from 22.8% in February to 16.6% in July 2020. Other steps taken to boost liquidity include the purchase of 250 billion colones worth of government bonds on the secondary market by the Central Bank of Costa Rica. Guatemala is the only country to intervene in the currency market; it stepped in, with purchases of US\$ 400 million, in March 2020 to maintain the stability of its exchange rate.

As inflation has remained low, interest rate cuts and injections of liquidity have taken effect in real terms. Nevertheless, the fact remains that the effectiveness of conventional expansionary monetary policy tools is extremely limited during times of crisis because of investors' very subdued expectations of future profits and because of the highly concentrated and shallow nature of the subregion's financial markets.

<sup>5</sup> See Ministry of Finance of Costa Rica (2020), Ministry of Finance of Honduras (2020a and 2020b), Ministry of Public Finance of Guatemala (2020) and Ministry of Economic Affairs and Finance of Panamá (2020).

<sup>6</sup> Guatemala's draft general government budget for 2021 puts the cost of the special measures envisaged for mitigating the damage caused by the crisis at 2.9% of the total amount allocated for the entire year (Ministry of Public Finance of Guatemala, 2020).

<sup>7</sup> Information on monetary and credit measures is drawn from Matarrita and Romero (2020), ECLAC (2020f), IMF (2020), Bank of Guatemala (2020) and Central Bank of Honduras (2020).



Most of the countries have coupled expansionary monetary policies with measures to make credit more readily available and with offers of more attractive terms for households and businesses. In Costa Rica, a special line of credit for financial intermediaries of 700 billion colones has been opened up along with another line for MSMEs to provide them with seed capital and to enable them to buy intermediate inputs or cover their payrolls. El Salvador has created a US\$ 600 million trust fund to support MSMEs and the informal sector. Honduras has also created a trust fund to facilitate credit access for MSMEs. Guatemala has established a credit line of 100 million quetzales for MSMEs, and Panama has set up a special fund for strengthening credit access that will supply US\$ 500 million for use in stabilizing the financial system and another US\$ 500 million for a credit line for the sectors that have been hit the hardest by the pandemic. Several countries have called moratoriums, have restructured personal and business loans and have frozen and/or regularized credit ratings. For example, Costa Rica has temporarily suspended the collection of interest on mortgages from the National Institute for Housing and Urban Affairs (INVU), and El Salvador has declared a moratorium on payments on bank loans in order to provide financial support for the farm sector.

In addition to these macroeconomic measures, other tools have been used to control the prices of key goods or to institute new regulations in the labour market, for example. All the countries except Nicaragua have put price controls on staples in place. Some have also introduced price controls for personal hygiene and biosafety products. Direct interventions in the labour market have included Costa Rica's creation of a temporary subsidy for workers impacted by the health emergency and El Salvador's passage of an employment protection law<sup>8</sup> that provides for temporary safeguards to maintain job stability in the private sector.

It takes a considerable fiscal effort to implement economic policies that will counteract the negative impact of this crisis on the Central American economies.<sup>9</sup> The magnitude of the measures announced by the countries to make that effort ranges from 0.8% of GDP in Costa Rica to 11.1% of GDP in El Salvador, with those of the other countries coming in at 4.3% of GDP in Honduras, 2.5% in Guatemala and 3.7% in Panama (ECLAC, 2020d). No data are available for Nicaragua because it has not announced any fiscal stimulus programme.

The scale of this effort is not necessarily related to the amount of fiscal space that theoretically exists. Costa Rica and El Salvador are having greater difficulties with their public finances, since their public debts, when measured as a percentage of GDP, amounted to over 70% in 2019 (ICEFI, 2020a), and the size of their fiscal packages, again in terms of GDP, marks a sharp contrast. The success of countercyclical measures is not determined solely by the total amount that is spent on them, however, since their composition and timing are also influential factors. Proper planning based on reliable, relevant statistical records is also important, as is transparency in these measures' implementation and a clear accounting of how public monies are being used.

In the midst of a crisis, fiscal and monetary policies need to be closely coordinated. Fiscal policy should take a leading role in spurring production activity, while monetary policy should ensure the availability of financing at the lowest cost possible as the fiscal deficit inevitably expands (Panico, 2020). El Salvador and Panama both have dollarized economies, which makes it impossible to coordinate these policies. Costa Rica, Guatemala and Honduras, on the other hand, have —albeit to differing degrees— coordinated their implementation of expansionary fiscal and monetary policies in order to cope with the effects of the crisis.

<sup>8</sup> See [online] <https://www.diariooficial.gob.sv/diarios/do-2020/05-mayo/05-05-2020.pdf>.

<sup>9</sup> The final budget figures may differ because of restrictions on access to external finance. In addition, public debt issues are subject to congressional approval.



It is important for fiscal policy to take the lead, not only in the short run to deal with immediate problems, but also in the medium and long terms to contribute to a robust, inclusive economic recovery. Consideration should therefore be given to the implementation of progressive, redistributive fiscal reforms and the minimization of tax avoidance and evasion in order to cope with the deterioration in public finances across the board. The design and execution of measures for overcoming external growth constraints are equally important, with examples of such measures including the regulation of capital flows and a policy for changing production patterns in ways that will increase the value-added content of exports.

Countercyclical policies cannot entirely absorb the immense force of the blow dealt by this twofold crisis, however, and estimates of economic activity, inequality and poverty levels for 2020 are not promising. The Monthly Index of Economic Activity (IMAE) for the Central American countries is already reflecting a steep downturn. Information from SECMCA (2020) indicates that the slump witnessed up to mid-2020 (according to the most recent figures available for each country as of September) has amounted to year-on-year declines of 9.5% for Nicaragua as of April, 40.9% for Panama as of May, 12.2% for El Salvador as of June, 13.4% for Honduras as of June, 8.1% for Costa Rica as of July and 4.8% for Guatemala as of July. As lockdowns and other restrictions are relaxed, the countries should gradually regain their former rates of economic activity. If there is a second wave of contagion, however, the impact will be devastating.

ECLAC projections (2020a) point to a steep drop in real GDP in all the countries of the subregion (see table 4), although the average estimated contraction for Central America of 5.9% is much lower than the projected 9.1% downswing for Latin America and the Caribbean as a whole. The steepest decreases in the subregion are expected to be in El Salvador (-8.6%) and Nicaragua (-8.3%); the projection for Nicaragua is a cause of concern because such a sharp decline would only deepen a crisis that has already lasted for two years. An alternative indicator of the pandemic's effect on these economies' growth profiles which may be even more informative is the differential between their growth rates for 2019 and 2020. This measurement of the pandemic's impact would appear to indicate that the extent of the slowdowns in Central America and in Latin America and the Caribbean will, on average, be quite similar (8.4 percentage points for the former versus 9.1 points for the latter). Nevertheless, the rates of economic activity will fall sharply in all of them: El Salvador (-11.0 percentage points), Panama (-9.5), Honduras (-8.8), Guatemala (-7.9) and Costa Rica (-7.6). Nicaragua is expected to have the smallest decrease, but starting from the low point set by a significant recession in 2019. Clearly, however, the impact of the pandemic on economic activity would have been much greater if it had not been for the countercyclical policies that have been put in place.

**Table 4**  
Central America: real GDP growth rates, 2019 and 2020  
(Percentages)

Country	2019	2020 <sup>a</sup>	Differential 2019–2020 <sup>a</sup> (Percentage points)
Central America	2.5	-5.9	8.4
Costa Rica	2.1	-5.5	7.6
El Salvador	2.4	-8.6	11.0
Guatemala	3.8	-4.1	7.9
Honduras	2.7	-6.1	8.8
Nicaragua	-3.9	-8.3	4.4
Panama	3.0	-6.5	9.5
Latin America and the Caribbean	0.0	-9.1	9.1

**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), CEPALSTAT, 2020 [online database] <http://interwp.cepal.org/cepalstat/portada.html?idioma=english>; *Estudio económico de Centroamérica y la República Dominicana en 2019 y perspectivas para 2020* (LC/MEX/TS.2020/29), Mexico City, 2020, and "Addressing the growing impact of COVID-19 with a view to reactivation with equality: new projections", *COVID-19 Special Report*, No. 5, Santiago, 15 July, 2020.

<sup>a</sup> ECLAC projections.

ECLAC (2020a) projects that real per capita GDP will fall by 7.1% in 2020 for the subregion as a whole, with the largest decreases being in El Salvador (-9.4%) and Nicaragua (-9.2%). This contraction will thus be so drastic that it will take Central America years to regain its pre-pandemic levels. The Economist Intelligence Unit projects that El Salvador and Guatemala will not reclaim their 2019 levels of GDP until 2023 (*The Economist*, 2020a and 2020b) and that Nicaragua will not even have returned to its 2017 level of GDP (reached prior to the country's 2018 sociopolitical crisis) by 2024 (*The Economist*, 2020c).

Table 5 shows projected poverty levels for 2020, which indicate that poverty and extreme poverty will rise in all the countries of the subregion. In Guatemala, El Salvador, Honduras and Nicaragua, these increases will outstrip the projected rises in Latin America as a whole.

**Table 5**  
Central America: poverty and extreme poverty levels, 2019 and 2020  
(Percentages)

Indicator	Country	2019	2020 <sup>a</sup>	Differential 2020–2019 (Percentage points)
Poverty	Latin America	30.2	37.3	7.1
	Costa Rica	16.5	20.5	4.0
	El Salvador	33.7	40.2	6.5
	Guatemala	48.6	51.6	3.0
	Honduras	54.8	59.0	4.2
	Nicaragua	47.1	52.7	5.6
	Panama	14.6	17.5	2.9
Extreme poverty	Latin America	11.0	15.5	4.5
	Costa Rica	3.4	5.1	1.7
	El Salvador	7.4	11.9	4.5
	Guatemala	19.8	22.7	2.9
	Honduras	18.7	22.2	3.5
	Nicaragua	18.0	22.8	4.8
	Panama	6.5	8.5	2.0

**Source:** Prepared by the authors, on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), "Addressing the growing impact of COVID-19 with a view to reactivation with equality: new projections", *COVID-19 Special Report*, No. 5, Santiago, 15 July 2020.

<sup>a</sup> ECLAC projections.

El Salvador and Nicaragua are also the countries in which poverty and extreme poverty are expected to increase the most. This reversal will be a serious one and will wipe out the ground gained over years in the fight against poverty. The projected regression will mean that in 2020 the incidence of poverty will be similar to what it was in 2007 in Costa Rica, in 2015 in El Salvador, in 2014 in Guatemala, in 2013 in Honduras, in 2009 in Nicaragua and in 2015 in Panama (ECLAC, 2020d). Inequality is also expected to increase in all the countries, with the Gini coefficient projected to climb by between 5.0% and 5.9% in El Salvador, 3.0% and 3.9% in Costa Rica and Panama, 2.0% and 2.9% in Honduras and Nicaragua, and 1.0% and 1.9% in Guatemala (ECLAC, 2020d). Overall, Nicaragua and El Salvador are the countries that will be hurt the most by the crisis in terms of waning economic growth and rising poverty.

These projections of economic growth, poverty and inequality raise some question as to the efficacy of countercyclical policies. While the measures that have been implemented have, in general, been effective, a much greater effort will be needed going forward. So far this effort, measured as a percentage of GDP, has been insufficient in Costa Rica and negligible in Nicaragua. Given the magnitude of the crisis and the outlook for the future, the possibility that the countries might revert to austerity policies too soon is a cause of concern. It would be best if countercyclical fiscal policies are institutionalized through the creation of automatic stabilizers. These measures should also be framed within a vision of the future and directed towards protecting jobs, shielding vulnerable groups in the population and promoting changes in production patterns that will contribute to environmental sustainability and social inclusion. This point will be explored in greater depth in the following section.

## IV. Concluding remarks

The governments of the subregion moved quickly to counter the brutal blow dealt by the pandemic. Initially, in addition to imposing lockdowns and social distancing measures, they provided support for the health care system and the material well-being of households and businesses. Once the restrictions were relaxed, their finance ministries, in coordination with their central banks and economic and social agencies, embraced Keynes' maxim: "The boom, not the slump, is the right time for austerity at the Treasury."<sup>10</sup> Accordingly, all of the countries except Nicaragua set up programmes —of differing scales in terms of scope and funding— that called for the expansion of public expenditure and the relaxation of monetary and financial conditions. The range of measures applied to date is quite broad, but they will not be enough to drive a robust recovery. GDP projections for 2020 and 2021 have repeatedly been revised downward, apparently foreshadowing a deep recession and slow reactivation. These revisions will continue to be subject to the uncertain outcome of the pandemic and the continuation or discontinuation of countercyclical measures.

While a good measure of uncertainty does surround public revenue and expenditure projections, there is no doubt about the fact that the primary and global fiscal balances will deteriorate and that the debt will swell, in part because of the contraction of GDP, the fact that tax revenues will lag behind emergency spending and the effect of exchange-rate depreciations. It is also inarguable that the fiscal space available to each of the countries in the subregion in 2021 will be much smaller than it was in 2020, and this greater limitation of fiscal manoeuvring room will coincide with much greater needs on the part of the population: as 2020 draws to a close, average per capita GDP in the subregion will have slipped back in real terms to the levels seen 10 or more years ago, millions of people will have lost their formal-sector jobs, and many will have seen their incomes dwindle and will fall below the poverty line. What is more, there are no signs of an economic recovery in 2021, other than perhaps in China and some other Asian countries, where an upswing in activity may be strong enough to make up for the present contraction.

Given these conditions, the subregion is confronted with formidable challenges in relation to its short-term macroeconomic and social policies and its long-term development path. The first such challenge will be to refrain from prematurely withdrawing the countercyclical fiscal, monetary and financial stimulus measures targeting vulnerable groups in the population and those designed to buoy investment and production activity and to protect jobs.<sup>11</sup> There is no shortage of examples in which an overly hasty return to austerity measures before an economic recovery has taken firm hold has prolonged a recession and deepened poverty and inequality. A central premise of macroeconomic policy should be that sustainable fiscal consolidation can only occur against the backdrop of a robust recovery of economic activity. Attempting to achieve such a consolidation, as has been done in the past, by prioritizing austerity measures and curbing or cutting public spending is counterproductive and extremely costly in social and economic terms. The longer and deeper a recession is, the more the debt-to-GDP ratio will tend to rise, rather than fall.<sup>12</sup> The governments of the subregion should take this into account, especially since, even before the first wave of COVID-19 has been fully brought under control, a second wave appears to be in the making in a number of countries.

<sup>10</sup> "Fiscal austerity and corporate cost-cutting would do nothing but worsen the globe's pre-existing conditions" (Kozul-Wright, quoted in UNCTAD, 2020b).

<sup>11</sup> The United Nations Conference on Trade and Development (UNCTAD, 2020a) has warned that a return to austerity policies in 2021 would dampen the growth of production activity, increase unemployment and the labour gap, and reduce the share of labour income.

<sup>12</sup> For a reasoned analysis of the type of expansionary austerity proposed by Alesina, Favero and Giavazzi (2019) that is particularly relevant for Central America and other developing economies, see Skidelsky and Fraccaroli (2017) and Skidelsky (2019).

Meeting this first challenge will require a fiscal commitment to, at the least, maintain existing public spending stimuli during this phase of the recession and to make them more effective and efficient. This will entail taking steps —or at least making a commitment— to augment tax and non-tax revenues and to give consideration to a support programme backed up by international financing. It is imperative for countercyclical spending initiatives to have high income and employment multipliers without putting excessive pressure on the balance of payments. Government revenues in the subregion are hurt by its low tax rates and the fact that its taxation systems are doing very little to bring about a more progressive redistribution of income. The governments should therefore consider increasing their borrowing levels, at least over an intermediate time horizon, to ensure that the subregion does not veer away from a path of sustainability. Dealing with this challenge will influence the degree to which the countries of the subregion will be able to maintain their countercyclical policy effort and the chances of setting the scene for a robust economic upswing. Because of the structural weakness of fiscal income sources, public investment has been the adjustment variable in the countries' efforts to cope with the pressure for fiscal consolidation, to the detriment of infrastructure, private investment growth and, in sum, the Central American economies' potential growth rate. Monetary authorities need to coordinate their actions in order to support this effort, and the Central American governments need to think about the possibility of having the central banking system play a more active role in financing development and, more specifically, public investment, as well as, in some cases, considering the possibility of entering into joint ventures with the private sector. As noted by Barbosa and others (2020), this way of financing the public debt may entail some risks in terms of macroeconomic stabilization in the medium term, but those risks are overshadowed by the threat that would otherwise be posed to the population's subsistence and to social peace.

The second challenge, which is not unrelated to the first, is a major political economy issue. A consensus needs to be reached by political, social and economic stakeholders —first in each nation and then in the subregion as a whole— to rewrite the development agenda. Just as this unprecedented emergency has demanded unprecedented economic and social policy responses, now unprecedented political agreements and economic strategies are called for in order to pull through the pandemic and the associated economic crisis and to place production activity and employment in Central America on a rapid and steady growth path. There is no returning to the pre-crisis status quo. Reverting to the same accumulation, production and distribution patterns as before is unthinkable and would be both negligent and irresponsible in the face of the inequality, exclusion and environmental issues that the subregion faces. These approaches have proven to be incapable of doing away with the balance-of-payments constraint on the subregion's economic growth; on the contrary, they have accentuated it. The subregion's reactivation must be environmentally sustainable and socially inclusive. If it is not, the subregion will be doomed to a future marked by intermittent outbreaks of health, financial and fiscal crises that may eventually lead to political and social instability.

As stated by Mukhisa Kituyi, Secretary-General of the United Nations Conference on Trade and Development (UNCTAD): “Building a better world requires smart actions now. The lives of future generations, indeed of the planet itself, will depend on the choices we all take over the coming months” (Kituyi, quoted in UNCTAD, 2020b). The work involved in building this future has to start now, in the midst of the battle against the pandemic. The short term and the long term are different, but they both start right now, today. One way in which countercyclical policies can make a contribution is for support measures for businesses to be made subject to certain environmental and social performance standards (see UNCTAD, 2020a). By the same token, countercyclical investment projects undertaken or promoted by the public sector should help to lay the foundations for the long-term changes in production patterns that are needed in the subregion. One aspect of pivotal importance is for the implementation of these policies to be linked to an effort to build a consensus around a thorough-going fiscal reform package —to be put into effect during the recovery— to expand the countries' fiscal space and ensure that

the State is capable of meeting its key responsibilities in the areas of social protection and economic development. From a broader perspective, the pandemic and its impacts, which have been magnified by the inequalities and shortcomings inherent in Central America's patterns of accumulation and integration into the global economy, should be seized as an opportunity to launch a national compact for a sustainable, egalitarian development process based on a culture of rights.

Looking beyond national borders, the new development agenda for Central America necessarily entails a revitalization and intensification of regional cooperation and integration initiatives. How else could such an agenda be realized by a cluster of small economies that are wide open to trade and to world capital markets but have very small domestic markets and whose production sectors and innovation systems are far removed from the leading edge of global value chains? Central American integration has been a very active process for some time now, despite some obstacles and setbacks, as is demonstrated by the fact that nearly a third of its trade is intraregional. Leveraging this process will be a vital step forward on the path to a sustainable, inclusive form of development. And the subregion can already start moving in this direction by implementing countercyclical policies and focusing investments and incentives on strategic activities or areas in order to shift the production matrix towards greater environmental sustainability and equality. The transition to what is commonly referred to as the "green economy" opens up vast opportunities for regionally coordinated cooperation and investment in the private and public sectors that can set up and maintain a new cycle of change in production patterns and economic growth. The list of possibilities is almost endless. To name just a few of the steps that could be taken, agreements could be reached on taxation, the selective attraction of foreign direct investment, the circulation of short-term capital, migration and the strategic production of certain types of products. Over a longer time horizon, agreements could be arrived at in such areas as the modernization of the health system's infrastructure, clean energy, public transport, science, technology and innovation, and fiscal coordination.

Yet even if the integration process is reactivated soon, the subregion cannot see this process through to fruition on its own without a change in the stance taken by the international economic and financial community. Public-sector revenues and expenditures are very limited and cannot possibly cover all the social protection and development promotion needs of the subregion. Central America can only free itself from the inequality, environmental degradation and stagnation trap in which it finds itself if it can draw on strong support from the international community, especially in connection with the recovery of the economy and world trade, on the one hand, and the flow of resources from international financial institutions, on the other. In order to drive such a recovery, developed-country macroeconomic policies must remain firmly on the side of fiscal and monetary variables until consumption and particularly private investment strengthen once again. The relevant international agencies must also have the political conviction and funds to provide Central America with the necessary financial support. As noted recently by UNCTAD (2020a y 2020b), the developing world is looking at a deficit of between US\$ 2 trillion and US\$ 3 trillion over the next 18 months as a consequence of the pandemic.

More specific recommendations regarding the international financial architecture required to find a path out of the pandemic and embark on a new sustainable, inclusive development agenda for Central America can be based on four recent proposals put forward by UNCTAD: (i) significantly increase the use of special drawing rights (SDRs) to support developing countries' national strategies; (ii) launch a Marshall Plan for global health recovery to be financed on a tripartite basis with development cooperation resources and multilateral agency funding combined with a renewed effort under the Base Erosion and Profit Shifting (BEPS) initiative of the Organization for Economic Cooperation and Development (OECD) to reduce tax avoidance and evasion; (iii) set up a multinational credit rating agency under government control to take the place of the extremely powerful rating agencies now operating in the market and open up access to much more objective records that reflect the interests of developing countries as well as those of financial corporations; and (iv) establish a global debt authority

to set up a broad, transparent international legal and institutional mechanism for instituting automatic temporary suspensions of sovereign debt repayments in times of crisis and managing restructurings fairly, efficiently and transparently.<sup>13</sup>

In closing, we would like to highlight two fundamental lessons to be learned from this pandemic. The first is that the State needs to be restored to its rightful place as a key, irreplaceable actor in the definition of the development agenda, the identification of crucial obstacles or constraints and the mobilization of resources for surmounting those hurdles. The second is the importance of reassessing how we view the public sector in relation to the private sector. During these past few months, when the cities and peoples of the subregion and the entire world have been living through such dramatic events, we are reminded that the health of all depends on the health of the most vulnerable among us. The pandemic has made the absence of anything that could be likened to a social welfare system glaringly clear.<sup>14</sup> It has laid bare agonizing inequalities in something so basic as access to drinking water and adequate food, not to mention access to a quality education, a high standard of health care and decent employment. These inequalities are social wounds whose causes are rooted in long-standing inequities in the distribution of the fruits of growth. These wounds are reopened each and every day with the complicit silence and indifference of those who have the largest share of those fruits, and the pandemic has suddenly made this clear in a very dramatic way. This situation makes it imperative to enter into a national —and regional— compact of the kind described above. Without such a compact, the future of Central America will be nullified for vast contingents of its poor, marginalized and vulnerable people and, if that comes to pass, for all those who wish to live in a civilized society.

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<sup>13</sup> For a detailed description of these initiatives, see UNCTAD (2020a).

<sup>14</sup> For an analysis of the features that a social welfare system should have that makes specific reference to Central America and Mexico, see ECLAC (2020a and 2020h).



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# COVID-19 and social protection of poor and vulnerable groups in Latin America: a conceptual framework

Nora Lustig and Mariano Tommasi

## Abstract

The growing crisis caused by the coronavirus disease pandemic has dire implications for Latin American societies. As is often the case, the most vulnerable sectors of society —especially those living in extreme poverty— are being hit the hardest. This article identifies strategies and specific responses designed to achieve three goals: (i) reduce epidemiological risks to save lives; (ii) protect livelihoods; and (iii) ensure human capital accumulation. Epidemiological externalities, as well as humanitarian concerns, demand universal social inclusion. In order to protect the lives, health, livelihoods and human capital of the poor and vulnerable, it will be essential to: implement targeted and decisive interventions at the local level that go beyond transferring cash; allocate adequate resources to fund income support and other key interventions; and involve on local actors and grass-roots organizations for the interventions to be effective.

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## Keywords

COVID-19, viruses, epidemics, social aspects, social security, poverty, socially disadvantaged persons, income, health, education, social conditions, social policy, Latin America

## JEL classification

C63, D31, I32, I38

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## I. Introduction<sup>1</sup>

The global coronavirus disease (COVID-19) pandemic, along with foreign and domestic responses to it, have taken a huge toll on society as a whole in terms of lives and economic losses. Even if Latin America had been miraculously spared by the pandemic, the adverse external shocks (falling demand for exports and tourism, declining commodity prices and unprecedented capital outflows) would have hurt the region's countries significantly. The pandemic and the measures designed to contain it compound the negative impact on living standards in ways that are still being assessed, given the uncertainty surrounding the dynamics of the pandemic.

Although every level of society has been affected, the intensity of impact has varied widely across social groups. The pandemic is further impoverishing the poor and exacerbating inequality. Informal workers are severely affected by the lockdown measures. Low-skilled workers are not able to work from home. The poor and the vulnerable<sup>2</sup> are being hit the hardest because their living conditions and future opportunities are threatened by economic dislocations and other negative effects of the pandemic. As the virus spread from more affluent districts where it first arrived, it began to take hold among populations that live in poorer sanitary conditions and suffer from multiple disadvantages that are magnified due to lockdown.

The current situation calls for urgent actions on multiple connected fronts: (i) the epidemiological, health care and sanitation front; (ii) the economic front; (iii) the labour market front; and (iv) the social protection front. This paper focuses on one important component of the social protection front, which is to identify strategies capable of achieving three goals for those living in poverty and vulnerable situations: (i) reduce epidemiological risks to save lives; (ii) protect livelihoods; and (iii) protect and secure human capital accumulation. The aim of the paper is to provide a conceptual framework to guide policy design.

The complex vector of shocks induced by the pandemic decreases the income of most people. Among other things, for given poverty lines it will increase the number of people living in poverty in official statistics. A recent report by the Economic Commission for Latin America and the Caribbean (ECLAC) estimates this number of “new poor” to be in the order of 45 million people (ECLAC, 2020b). Current macroeconomic and other measures are (should be) attempting to soften the downward pressure on the income curve. A number of measures are (should be) devoted to soften the employment and income blow on many affected individuals, and particularly those at risk of falling into poverty. However, those who were already living in poverty are at risk of suffering great income losses, in some cases pushing a number of them below the extreme-poverty line. According to ECLAC, nearly 29 million people could join the ranks of those living in extreme poverty in 2020 as a result of the pandemic (ECLAC, 2020b). People living in poverty should definitely be given priority when it comes to income support, but that will not be enough to effectively protect their lives, livelihoods and human capital. These individuals, the chronic poor, do not only experience income poverty. They also tend to: live in overcrowded homes, lack basic social services, receive poor health care and education and face various forms of discrimination. This group includes residents of urban slums and other areas of concentrated poverty, undocumented migrants and indigenous communities. Within these groups, children, women, older adults, the differently-abled and those belonging to groups such as lesbian, gay, bisexual, transgender, queer and intersex (LGBTQI) face even greater challenges.

<sup>1</sup> This paper is based on a longer version (see Lustig and Tommasi (2020)), which includes the complete set of background material and references. Among other things, this paper includes updates to reflect the rapid changes the region experienced as a result of the coronavirus disease (COVID-19). We would like to thank Mart Trasberg for his help with this task.

<sup>2</sup> In some economics literature, the word “vulnerable” is used to refer to people whose income is above the poverty line but are at risk of falling into poverty if faced with an adverse shock. Here, we are not using the term in that way, but in the standard dictionary sense of a person in need of special care, support or protection because of age, disability or risk of abuse/neglect.

Paying special attention to those living in poverty and vulnerable situations in the policy response is crucial for three main reasons. First, because this group is already suffering from multiple disadvantages, there is an ethical imperative to prioritize their needs —as they are the ones who can least afford to be hit by the multiple negative shocks detonated by the pandemic. Second, the negative effects on this group are likely to have a long-lasting impact. Modern development literature emphasizes the permanent effects that temporary shocks can have on the lives of infants, children, teenagers and women. Circumstances such as child malnutrition, school dropout and traumatic experiences at some point in life often have irreversible effects.

In a pandemic, there is a crucial third reason to prioritize those living in poverty and vulnerable situations. As the virus spreads rapidly, those with more precarious day-to-day realities not only face a greater risk of infection but are also a plausible source of transmission. If these groups are not at least partially compensated for their income loss during lockdowns, it will be very difficult for them to comply with the restrictions. If tests or the eventual vaccine are not made widely available and at no (or very low) cost, the poor and vulnerable are likely to choose not to be tested or vaccinated. This externality is one of the main arguments in favour of prioritizing these groups within the context of a pandemic. During the pandemic, “forgetting” to protect certain sectors of society (such as slum-dwellers, the homeless, undocumented migrants or the transsexual population, to name but a few) can severely hinder the ability to contain the spread of the virus. During a pandemic, universal social protection becomes a precondition to successfully combating the spread of the disease.

## II. COVID-19 exacerbates pre-existing inequalities and vulnerabilities

### 1. Groups at risk of infection, illness and death

While the initial number of infections and deaths in the region was relatively low, Latin America has now emerged as one of the hotspots of COVID-19. At the time of writing, Argentina, Brazil, Colombia, Mexico and Peru are among the top 10 countries in terms of infections; and Brazil, Colombia, Mexico and Peru are among the top 10 in terms of deaths per 100,000 inhabitants (CRC, 2020).<sup>3</sup> Older adults and individuals with pre-existing health conditions are the two main groups at risk of contracting and succumbing to COVID-19. As for age, the share of older adults in the population of Latin America is not large (less than 9%) (CEDLAS/World Bank, 2020). Regarding pre-existing conditions, however, the situation is worrisome. Excess weight and obesity are very prevalent in Latin America (nearly 60% of the population), and 10% of the population suffers from diabetes (PAHO, 2020). Also, the very poor sanitary conditions in the slums and other poor neighbourhoods of Latin America make them a particular focus of concern.

### 2. Multiple deprivations

Using the international poverty indicator of US\$ 5.50 per day (expressed in terms of purchasing power parity), the poverty rate in Latin America before COVID-19 was 23%. Nearly 4% of Latin Americans lived in extreme poverty (namely, those at or below the US\$ 1.90/day poverty line), and did not earn enough to purchase the minimum amount of food to have adequate nutrition. In Latin America, 10% of the population (delineated by the US\$ 3.20/day poverty line) were at risk of falling into extreme poverty.

<sup>3</sup> Also, projections by the Institute for Health Metrics and Evaluation (IHME) released on 25 June 2020 estimated that, by October 1, total deaths due to COVID-19 in Latin America and the Caribbean would reach almost 440,000 (IHME, 2020).

This percentage was notably higher in some Latin American countries such as the Plurinational State of Bolivia, Guatemala and Ecuador (CEDLAS/World Bank, 2020; ECLAC, 2020a).

Income poverty is only the tip of the iceberg in terms of the lives of the chronic poor, however. For most of the population in question, poverty is a living condition that implies disadvantages in multiple dimensions. Over 80% of those included in the poorest quintile of income distribution work in the informal sector and therefore have no access to unemployment insurance, contributory pensions or other benefits. In Latin America, 22% of people lack access to safe drinking water; 34% do not have an Internet connection, which is so essential in these circumstances; and 45% do not have a bank account. While the severity of poverty is higher in rural areas, about two thirds of the poor live in urban areas. This seems to be the sector where the pandemic is hitting the hardest. Over 20% of urban residents live in slums, where conditions in terms of overcrowding and poor habitat are extreme (CEDLAS/World Bank, 2020; ECLAC, 2020a).

### 3. The COVID-19 shock interacts with existing inequalities and vulnerabilities

All of the above-mentioned disadvantages that give rise to multidimensional poverty interact with the conditions generated by the pandemic to create a potentially vicious cycle. Many of these vulnerabilities make people more likely to get infected by the coronavirus, and many of the effects of the pandemic exacerbate the suffering produced by deprivation.

For example, living in slums makes people more susceptible to infection and serious illness because of overcrowded spaces and lack of access to water and sanitation. Labour market informality is a key aspect of poor and vulnerable people's lives, and it amplifies the effects of the sharp income decline produced by the pandemic —particularly for people who own few or no assets. In most of the region's countries, informal workers have no social protection whatsoever. The poor are not only unlikely to have a job that can be performed remotely, but it would also be difficult for them to do so given the conditions of their homes and the lack of infrastructure (including an Internet connection).<sup>4</sup> This feeds into whether it is possible to “stay home.” If the poor lack the means to satisfy their basic needs in the short term, they cannot follow the rules of social isolation. They cannot stay at home if that prevents them from procuring their daily sustenance.

Staying at home means enduring a number of hardships caused by overcrowding, lack of basic services and the suboptimum environments in which homes are located. In addition, education and trustworthy sources of information are less likely to reach these families, as they lack the tools necessary for connectivity. Staying at home could breed other health issues, especially given the current health sector scenario in which issues unrelated to coronavirus are not receiving proper attention. The confinement, boredom, uncertainty and fear associated with lockdown measures could aggravate family dysfunction that, in extreme cases, exacerbates violence in the home and child abuse.

Some of the main vicious-cycle dynamics arising from the combined effect of containment policies and economic fallout include those affecting the human capital of children. In particular, undernutrition in utero and in the early stages of life is likely to increase as a result of lower incomes. Second, school closures are likely to deeply affect the children of poor households that may find it extremely difficult (if not impossible) to continue their education at home due to lack of adequate equipment, connectivity and —above all— coaching. Children are quite likely to end up with lower achievements and many might drop out of school altogether. This year may end up featuring the largest loss of human capital in modern history. That loss will be distributed very unfairly, with the most vulnerable bearing the brunt of this cost.

<sup>4</sup> The same applies to schooling. The educational disadvantages experienced by poor children are worsening, as they are isolated in their unconnected homes with their uneducated parents.

### III. A brief profile of the vulnerable groups

As we said in the introduction, our goal is to provide a conceptual framework for an effective policy response to protect the health and lives, livelihoods and human capital of the poor and vulnerable. Defining the income poor is straightforward: anybody whose income is below the country's poverty line is classified as poor. Helping families living in poverty cope with income losses during the pandemic is also straightforward: governments should expand existing cash transfer programmes (or add new ones). At least 15 States introduced new social assistance programmes in the first few months of lockdown, and most have also expanded existing schemes.

However, we argue that other forms of deprivation —beyond lack of sufficient income— require equal attention. Violence at the hands of a domestic partner or discrimination in the health system because of skin colour, sexual orientation or migratory status are disadvantages that have been exacerbated during the pandemic. These dysfunctional behaviours cannot be combated simply through cash transfers. Similarly, the difficulties of poor children in slums continuing their education during shutdowns cannot be solved with cash transfers. Cash transfers will not produce the type of coaching children need for effective home schooling. The design of an effective policy response therefore must involve an identification of the vulnerable groups and their particular circumstances. Below, we provide an overview of some of the main vulnerable groups.

- **Urban poor.** The urban poor, especially those living in slums, are facing a high-stake situation in terms of epidemiological risk, their livelihoods, their human capital and life conditions. They overlap with various other categories of deprivation.<sup>5</sup> They are largely informal workers with no assets or social security. They live in overcrowded homes without water or sanitation. A large proportion of them have no access to the Internet. They face pre-existing health issues. Most of them do not have access to the banking system. Various family dysfunctions are commonplace, and under lockdown these can get magnified to the point of domestic violence and child abuse. For this group, staying at home is extremely difficult.
- **Women.** Most women are involved in the service sector, which has been especially hard hit by physical distancing measures. Women are the heads of many single-parent households, which are at greater risk —making women more vulnerable to financial instability. Women throughout the region are responsible for the bulk of domestic chores, which in many cases have increased due to quarantine. Women are the main victims of violence in the home, and abuse has worsened as quarantine has forced families to lock down together —thereby raising tensions amongst household members. Additional frictions arise as families struggle to make ends meet. Even before the advent of COVID-19, 15% of Latin American women had reported suffering from domestic violence (UN-Women, 2020).
- **Children.** There are more than 150 million children in Latin America. Nearly half of them are living in poverty. Even without reference to extreme cases such as children who live on the streets, many of these children are extremely vulnerable in normal times, and even more so at the moment. There are children who can end up alone due to the illness or death of a sole caregiver. Many children see their living conditions worsen due to their parents' income problems. High numbers of children are facing difficulties in receiving care in the current circumstances. Poor children's schooling is interrupted because of school closures. Many young people face several of these risks and disadvantages at the same time. Especially for young children, any of these temporary situations might have permanent effects.

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<sup>5</sup> Many of the conditions we describe here apply also to rural poverty.

- **Older persons.** Besides having the highest chance of dying of COVID-19, older persons also stand out as a vulnerable group from a social perspective. They are highly dependent on others, as they are not experienced in handling technology or communication tools. Some of them live alone and have difficulties accessing food, medical care and medicines because of the lockdowns.
- **Indigenous people.** Latin America has almost 50 million inhabitants who belong to indigenous communities (from over 500 different ethnicities). These communities account for 8% of the total population of the region, 14% of the population living in poverty and 17% of those living in extreme poverty (Albertos, 2018). In terms of their relationship with the labour market, indigenous people tend to work in precarious, low-skilled jobs. Indigenous communities also have restricted access to education and have first-hand experience of the negative impacts of climate change. Moreover, they lack access to medical centres and basic sanitation, and they have very poor health conditions compared to non-indigenous people with similar characteristics.
- **Migrants.** Migrants, especially undocumented ones, often suffer marginalization and discrimination. They tend to work in the service sector — especially in the hospitality industry— which has been hit particularly hard. Unless they are long-term permanent residents, migrants are not entitled to receive benefits from cash transfer and other programmes. Complying with lockdowns therefore becomes an impossible task, since there is no safety net for these groups. This is problematic because these very groups become natural carriers of the disease and can trigger new outbreaks. The problem is compounded because, in some countries, undocumented migrants have no access to the health-care system.
- **Other vulnerable groups.** The “forgotten” and excluded population also includes other groups: for instance, the homeless, prison population, sex workers and transgender individuals. In designing policies to contain the spread of the virus and mitigate the impact of the ensuing economic crisis, policymakers must be as inclusive as possible. The overriding guiding principle should be as stated in the introduction: universal social protection (in a multidimensional sense) as a precondition to successfully combatting the spread of the disease.

## IV. Impact of lockdown measures on those living in poverty and vulnerable situations

### 1. Income

While there are no official data yet on the effect of COVID-19 on poverty and inequality, microsimulations provide a glimpse of the potential impacts. Lustig and others (2020) estimate the impact of COVID- induced lockdown policies in Argentina, Brazil, Colombia and Mexico. Lockdown measures have a large impact on income poverty: the rise in the number of people living in poverty in these four countries (without factoring in social assistance) varies between 23.3 million and 30.4 million depending on the scenario. The authors do not assume that the income losses are proportionally equal across the income distribution, which makes the simulated effect larger than some previous estimations. Contrary to prior expectations, Lustig and others find that the worst effects are not on the poorest but those (roughly) in the middle of the income distribution. This is because the social assistance policies implemented by most Latin American countries over the past 25 years mitigate effects on falls in the incomes of the poorest. The analysis also shows that the substantial expansion

of existing social assistance or entirely new programmes (Argentina and Brazil) is potentially offsetting a significant share of the poverty caused by the crisis.<sup>6</sup>

## 2. Multidimensional deprivation

To prevent the virus from spreading unchecked and —in the absence of robust testing, tracing and isolating capacity— all Latin American countries have implemented full or targeted lockdowns (quarantines). A survey carried out in poor urban neighbourhoods in Argentina and brief reports from United Nations Development Programme (UNDP) country offices on another 12 countries offered early evidence on the effects of lockdown measures on the poor and vulnerable (Kessler, 2020).

First, 8 of the 13 countries named health-related issues among the main concerns. Usual services have been restricted and there are major obstacles when it comes to accessing much-needed medication and prescriptions. Second, in 5 of the 13 countries, increasing domestic violence —both on the streets and inside households— was identified among the main concerns. This is made worse by the high levels of alcohol and drug consumption.

Third, access to food emerged as a major issue. Neighbourhood grocery stores frequented by the poor population lack adequate supplies, and this combines with sharp price increases and falling incomes. It is difficult for non-governmental organizations (NGOs), churches and other local social actors to keep their usual operations running under current circumstances. Other issues identified included discrimination and exclusion of minorities, migrants and members of the LGBTQI community; overcrowding; and unequal access to online learning.

Virtual classes are not available to everyone, as connectivity services are unevenly distributed in these neighbourhoods. Since young people have not been able to begin the academic year properly, their situation has deteriorated. Dropping out of school is a frequent phenomenon, and such temporary circumstances might have permanent effects for children and adolescents on the edge of society.

There is some evidence about the impact of COVID-19 on other, non-income dimensions such as nutrition, health, school enrolment and learning outcomes. The World Food Programme (WFP, 2020) estimates that the total number of people in severe food insecurity could increase from 3.4 million in 2019 to about 16 million in 2020 due to COVID-19 in the region. School feeding programmes are a crucial component of policies to ensure the right to food, and an estimated 65 million schoolchildren have had their usual form of food delivery affected because of school closures (FAO/ECLAC, 2020). While children were expected to complete 7.7 years of schooling prior to the pandemic in Latin America and Caribbean, the simulations conducted by Azevedo and others (2020) suggest that lockdowns could lower schooling to 7.4 years in the optimistic scenario (schools are closed for 3 months of a 10-month school year) and to 6.8 years in the pessimistic scenario (schools are closed for 7 months). Under the Programme for International Student Assessment (PISA), the average score in the region is expected to decrease from 402 to 396 in the optimistic scenario and to 376 in the pessimistic scenario.

## V. Designing and implementing an effective response

This section outlines institutional recommendations to design and implement an effective policy response. It also puts forward specific policy recommendations, many of which are already being tested throughout the region.

<sup>6</sup> These countries do not fare so well when the long term human capital effects of school closings are taken into consideration, as shown in Lustig, Neidhöfer and Tommasi (2020).



## 1. Institutional recommendations

As discussed above, many Latin American communities and groups are facing several simultaneous disadvantages. In other words, they suffer from multidimensional poverty. These pre-existing situations are worsened by the COVID-19 pandemic, which threatens not only their lives and livelihoods, but also their human capital. Modern human development theory recognizes that people's lifetimes include critical events that might affect them forever —such as a house fire, death of a family member, inadequate health care during pregnancy, child malnutrition, traumatic experiences, teen pregnancy, violence in the home, drug use and school dropout. Given the existence of multiple reinforcing dimensions of deprivation, and considering the risks of such disruptive life events, it is incredibly important that —in normal times and even more so during the current emergency— public interventions are able to focus on supporting these vulnerable population groups. For the most vulnerable people, general top-down policies are not enough. They must be accompanied by coordinated efforts that focus on the specific risks faced by each community, each family and each individual. Expressed in public policy jargon, coordination across government sectors and focus on individual and local circumstances are essential.

The question is how best to achieve such coordination and focus from an organizational point of view. There are two essential institutional functions that need to be carried out for the effective design and implementation of policies targeting the most vulnerable. First, there must be a physical and social proximity with vulnerable communities to ensure their trust, and to mediate between the specific needs of the community (and families and people) and the wide and disorganized range of public programmes. Second, there must be sufficient coordinating or persuasive capacity with regards to central agencies, ministries and programmes in order to attend to the particular needs of a given community.

Different governmental structures might fulfil such institutional functions. Various Latin American countries have governmental units that are in line with this rationale to some extent. Generally speaking, however, two steps are necessary: first, identify which existing government structures best fulfil these functions; and second, endow them with the adequate resources and political backing at the highest level (the Office of the President in most Latin American countries).

In the longer version of this article, we detail actors, roles and recommendations at various layers from senior government to field level. For brevity, we will mention the functions corresponding to three crucial layers: (i) the agency responsible for assisting the most vulnerable populations; (ii) the relevant territorial units in each poor neighbourhood and community; and (iii) the local networks and organizations involved in grass-roots implementation.

- (i) Ideally, the coordination of all State efforts aimed at providing social support to poor neighbourhoods and communities should be coordinated by an agency responsible for this task. This agency should adjust all general policies (dissemination of information, epidemic control, income transfers, food, health, security and education) to the particular needs of these communities. It should demand that the relevant ministries implement any additional measures required. One example would be the education provision for populations with limited Internet access. Such an agency should also coordinate the territorial units in each neighbourhood. By means of territorial units, the entity should gather information on the general and specific needs of these populations.
- (ii) The main tasks of the territorial units within each poor neighbourhood are as follows:
  - Coordinating the local implementation of all interventions from the national and local levels.
  - Involving neighbourhood networks and local organizations (NGOs, churches and social movements) in identifying specific urgencies and priorities.
  - Enhancing the networks of local social actors.

- (iii) The engagement of local grass-roots actors is crucial for ensuring that interventions are effective and appropriately targeted. Monetary and non-monetary interventions are crucial for those living in poverty and vulnerable situations. These include food, clothing, medical and educational assistance and emotional support, to name but a few. State agencies must rely on local actors that are aware of the specific needs of each individual child, adolescent mother, at-risk youth and survivor of violence in the home, as well as knowing when such essential help is needed.

We add a fourth recommendation related to the allocation of resources.

- (iv) Every action suggested has major budgetary implications. The extremely dire current situation requires a courageous reallocation of resources. Our main claim in that regard is that we need to allocate more resources to protect the lives, livelihoods and human capital of the poorest. With regard to the institutional recommendations in this section, this implies:

- allocating more resources to governmental units that focus on the most vulnerable; and
- channelling part of the distribution of support and services through NGOs and grass-roots social organizations, and allocating the necessary budget.

We hasten to add that, even though budgetary resources are needed, part of these objectives can be fulfilled with political decisions and institutional focus.<sup>7</sup>

## 2. Specific recommendations

In addition to the above-mentioned broad recommendations, this section includes a set of specific recommendations for various stages of the pandemic's cycle. We classify them into two main categories: reducing exposure to epidemiological risk; and protecting livelihoods, human capital and the provision of basic services.

### (a) Reducing exposure to the epidemiological risk of illness and death

During the state of emergency:

- Design suitable communication strategies. Information campaigns should be as transparent as possible and match the realities of the target audience.
- Plan strategies that involve marginalized groups in urban areas and indigenous communities. Authorities should prevent the virus from spreading, while avoiding any sort of discrimination along the way.
- Guarantee access to clean water, soap and other essential products —such as masks— that are needed for prevention.
- Guarantee access to income, food and basic necessities. This is crucial for making the stay-at-home restrictions viable.
- Ensure connectivity in marginalized areas. This is essential to enable people to communicate with support networks in real time, report violence or crime, provide alternative activities for children and youth and, in some cases, to facilitate some income-generating activities. This might include providing some equipment to key representatives within the community.

<sup>7</sup> Successful implementation is less expensive than it may appear. It requires energetic and determined political action to change some bureaucratic incentives. This applies to several policies other than cash transfers, such as protecting women from domestic violence or targeting interventions to avoid child malnutrition.

- Use spaces other than hospitals, such as schools or hotels, to successfully isolate COVID-19 patients or those exhibiting similar symptoms.
- Design strategies to safely move patients in need of special medical care from one medical facility to another. This means that additional funds should be invested in transport such as ambulances —particularly in rural areas.

After the state of emergency:

- Give free access to COVID-19 tests to the poorest and most vulnerable groups in society.
- Continue to open new isolation centres to allow people who may be infected to be isolated.
- Guarantee access to safe drinking water.
- Make sure that marginalized groups own technology devices that allow them to be tracked. This will help avoid a new COVID-19 upsurge, as well as improving all-round communication through connectivity.
- Financial inclusion based on information and communications technologies (ICTs). Granting access to bank services and debit cards will not only make transfers more efficient but will also give authorities an inside view of the economic impact of the virus outbreak.

## (b) Protecting livelihoods, human capital and the provision of basic services

### **Access to income, food and services**

- Transfers. We recommend providing monetary transfers that allow those living in poverty to reach a minimum consumption level, especially for those people not covered by previous programmes. One additional alternative is the use of food coupons (more recently, debit cards, to be used for purchasing food).
- Temporary employment programmes. We recommend hiring the currently unemployed workforce to do tasks requiring similar skills in the sectors that have high demand today, such as sanitizing transport vehicles or public spaces, guarding and providing various services to hospitals and doctors or working on food distribution.
- Direct food distribution. Attention should be given to optimizing the protocols and materials to minimize human contact. This should be done by supporting existing grass-roots organizations.
- Tax cuts or deferrals. For instance, taxes on international transfers or remittances (below a certain amount) should be temporarily eliminated.
- Prevent vulnerable households from having basic services like water, electricity and Wi-Fi disconnected.

**Mitigation of violence in the home.** Additional policies to deal with violence in the home should be rapidly designed and executed. Standard procedures should be implemented to identify and prevent violent episodes. For instance, victims must be guaranteed access to confidential spaces to alert authorities. Here again, grass-roots organizations and local networks should be key players, and local government officials should be made accountable for implementing quick solutions.

**Continued education.** Education must be continued through TV or radio while connectivity is not an option for some families. Communication companies should begin to offer special packages as part of their services in order to allow free or subsidized wireless Internet services for educational use. Vulnerable children at the edge of society should be the focus of strategies to ease restrictions.

**Ensured access to health and medication beyond COVID-19.** Adequate protocols are essential to isolate patients with potential COVID symptoms. However, regular vital health-care services should continue to be provided (including vaccinations, treatment of infectious diseases, care of sexual and reproductive issues including contraception, medicines for chronic and mental illness, emergency surgery and care for victims of violence and accidents). The services offered by existing neighbourhood primary health-care units should be enhanced, including the extension of operating hours.

**Consideration for particularly vulnerable groups.** The impact of crises such as this is twice as devastating for groups that, in addition to living in poverty, suffer from specific problems or risks. These include children, at-risk youth, undocumented migrants or people who are transgender, homeless or in prison. Throughout Latin America, some non-profit organizations play a key role in easing and addressing their difficulties. Those efforts should be supported and promoted.

## VI. Concluding remarks

Given the interconnections between the various dynamics of the pandemic, it is crucial to integrate epidemiological, economic and social strategies under a consistent overarching umbrella. The well-being of the poorest and most vulnerable people in society should be prioritized, with the three goals of preserving lives, livelihoods and human capital. This is imperative not only for humanitarian reasons, but also to minimize the impact of epidemiological and economic externalities —as well as social and political risks. The poorest and most vulnerable groups require special attention not only in terms of income support but also in terms of the whole array of actions directed to their overall well-being. It is vital to complement general policies (health, education, security and connectivity) with special actions targeting vulnerable groups. This requires urgent action in the short term, as well as strategic investments in the medium term. In the short term, it is crucial to maintain access to incomes, food and health care, as well as implementing decisive actions to prevent the negative consequences of the pandemic (such as the rise in violence —especially violence in the home—). In the medium term, it is fundamental to invest in connectivity services and identify actions to ensure that poor children are able to make up for lost schooling and do not drop out.

When designing interventions, it is vital to take into account the specificities and levels of heterogeneity across and within vulnerable groups. To do that, it is important to build on local social networks and to make use of non-governmental actors that work in close proximity to these groups.

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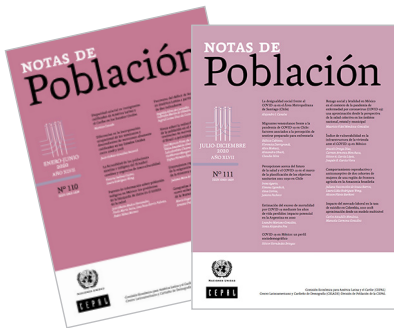
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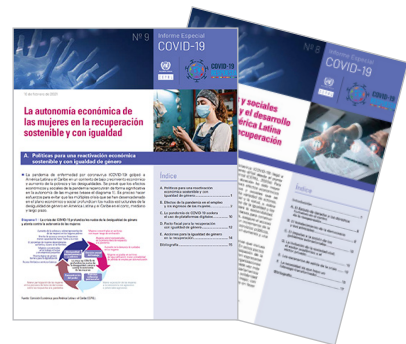
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United Nations Publication • S.20-00628 • December 2020 • ISSN 0251-2920  
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LC/PUB.2021/4-P