



UNDP LAC C19 PDS N°. 2

Suggestions for the Emergency

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Abstract

Latin America and the Caribbean's health and economic emergency demands an immediate shift in economic policy to minimize the human costs of the pandemic, mitigate the social costs, and preserve macroeconomic stability. Mitigation measures should be focused on workers, with available instruments like conditional cash transfer programs, and tax and other registries. Sustaining formal employment is a priority; layoffs and firm closings need to be avoided subsidizing firms' labor costs and giving them preferential access to credit guarantees conditional upon not firing workers. Mitigation measures need a mix of expenditure switching and augmenting, based on individual country circumstances. Fiscal revenues will fall, and a worsening of fiscal balances is inevitable. To resume growth after the health crisis, it is indispensable to avoid a financial crisis and maintain access to external credit. Debt sustainability will require tax increases once the crisis is over, which in some cases should be preannounced. If the recession is very deep and extends beyond the sanitary emergency, mitigation measures need to be extended. This needs to be preannounced to reduce uncertainty to banks and firms and facilitate the flow of credit. Overcoming the crisis requires a transition in the strategy to contain the virus, from generalized to localized confinements, accompanied by more tests and other measures that allow renewal of contacts between people.



Policy Documents Series

UNDP LAC C19 PDS N°. 1

A Conceptual Framework for Analyzing the Economic Impact of COVID-19 and its Policy Implications

By Constantino Hevia and Andy Neumeyer

UNDP LAC C19 PDS N°. 2

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*A Conceptual Framework for Analyzing the Economic Impact of COVID-19 and its Policy Implications
March 2020*

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Introduction to the series:

Evidence, Experience, and Pertinence in Search for Effective Policy Alternatives

The Covid-19 pandemic is one of the most serious challenges the world has faced in recent times. The total cost in terms of human lives is yet to unfold. Alongside the cost of lives and deep health crisis, the world is witnessing an economic downfold that will severely impact the wellbeing of large parts of the population in the years to come. Some of the measures that are currently being used to counteract the pandemic may impact our future lives in non-trivial ways. Understanding the association between different elements of the problem to broaden the policy space, with full awareness of the economic and social effects that they may bring, is the purpose of this series.

Thus far, the impossibility of targeted isolation of infected individuals and groups has led to policies of social distancing that impose a disproportionately high economic and social cost around the world. The combination of policies such as social distancing, lockdowns, and quarantines, imply a slowdown or even a complete stop in production and consumption activities for an uncertain period of time, crashing markets and potentially leading to the closure of businesses, sending millions of workers home. Labor, a key factor of production, has been quarantined in most sectors in the economy, borders have been closed and global value chains have been disrupted. Most estimates show a contraction of the level of output globally. For the Latin America and Caribbean region, the consensus forecasts are at -3 to -4%, and it is not until 2022 that the region is expected to go back to its pre-crisis output levels in scenarios that foresee a U-shaped crisis pattern. According to ECLAC, more than 30 million people could fall into poverty in the absence of active policies to protect or substitute income flows to vulnerable groups.

We face a crisis that requires unconventional responses. We are concerned about the level-effect: the impact of the crisis on the size of the economies and their capacity to recover growth after the shock. But we are equally concerned about the distributional impact of the shock. The crisis interacts with pre-existing heterogeneity in asset holdings, income-generation capacity, labor conditions, access to public services, and many

other aspects that make some individuals and households particularly vulnerable to an economic freeze of this kind. People in the informal markets, small and micro entrepreneurs, women in precarious employment conditions, historically excluded groups, such as indigenous and afro-descendants, must be at the center of the policy response.

UNDP, as the development agency of the United Nations, has a long tradition of accompanying policymaking in its design, implementation, monitoring and evaluation. It has a mandate to respond to changing circumstances, deploying its assets to support our member states in their pursuit of integrated solutions to complex problems. This series aims at drawing from UNDPs own experience and knowledge globally and from the expertise and capacity of our partner think tanks and academic institutions in Latin America and the Caribbean. It is an attempt to promote a collective reflection on the response to the Covid-19 health crisis and its economic and social effects on our societies. Timeliness is a must. Solutions that rely on evidence, experience, and reasoned policy intuition –coming from our rich history of policy engagement– are essential to guide this effort. This series also contributes to the integrated approach established by the UN reform and aspires to become an important input into the coherent response of the United Nations development system at the global, regional, and national levels.

Ben Bernanke, former Governor of the US Federal Reserve, reminds us in his book *The Courage to Act* that during crises, people are distinguished by those who act and those who fear to act. We hope this policy documents series will contribute to the public debate by providing timely and technically solid proposals to support the many who are taking decisive actions to protect the most vulnerable in our region.

Luis F. Lopez-Calva
United Nations Development Programme
Regional Director, Latin America and the Caribbean
New York, March 2020



1. Introduction¹

Over the last few weeks the global economic context changed drastically and for the worse. Every country in the world is suffering the repercussion of coronavirus. There will be a global recession, deeper than the one experienced in 2008-2009. Latin America and the Caribbean (hereon, LAC) will not be able to isolate itself from this situation. With variations from country to country, the region will suffer a severe recession of uncertain length.

This document offers some proposals to tackle this situation. These are general ideas that must be tailored to each country's particular conditions, and then quantified. The timeframes and parameters used here are only illustrative and must be adjusted based on experience. A lot depends on the orders of magnitude. It is urgent to make estimates, even if imperfect, and to act very quickly. It is equally urgent to update our understandings of what is and is not feasible. Measures that a few weeks ago would have been considered "unthinkable," or "politically impossible," will probably prove insufficient in a couple of weeks. Unprecedented times require unprecedented responses.

II. This crisis is different

It is useful to compare this crisis to the 2008-2009 one. Both are external crises that impact LAC through the market for goods: fall in commodity prices, lower exports, a decrease in tourism and potentially also remittances; and through financial markets: capital outflows from the "flight to quality", and currency depreciations.

But there are three additional elements in this case:

- the external demand shock will be reinforced by internal effects, as the pandemic's progress across countries demands closure of offices, restaurants, hotels, theaters and, in general, of economic activity where people congregate. This will make the shock a very strong one, affecting practically everyone (with the possible exception of economic activity in rural areas);
- in some countries, primarily those with manufacturing activity integrated in the world market, the shock will be more complex due to interruptions in value chains. Supply contractions will compound the demand fall, with factories closing due to lack of intermediate inputs; and,
- in other countries, less integrated to manufacturing chains and more dependent on final goods imports, the reductions in global production and lower trade flows may cause substantial supply problems.

Conceptually it is useful to separate the crisis in two stages. The first, while the pandemic lasts, characterized by social distancing; the second, once the virus is under control, with gradual recommencing of social interactions. At the beginning of the first stage, which started a few days ago, economic activity drops because individuals cannot go out shopping, not because of lack of income, and because workers are impeded to go to their workplaces, not because firms lack sales. Nonetheless, this situation will soon evolve: as lack of economic activity reduces firms' sales, layoffs will start and workers' incomes will drop; the income of the self-employed

¹ Document prepared for the UNDP. I thank Marcela Meléndez and Luis Felipe López-Calva for very useful comments. The views expressed here are the author's and not necessarily reflect those of UNDP.



will also drop, even if they keep on carrying out their regular activities (assuming sanitary restrictions allow). Towards the end of the first stage, what started as a crisis due to the need to isolate individuals, will evolve into a “traditional” economic crisis, in the sense that economic activity will be depressed because of lack of demand and income, not because people cannot be together.

Not enough is known about Covid-19. Particularly, little is known about how long the factors behind the pandemic will persist, including the possibility of mutations or reappearances.² This implies that no one knows when the first stage will end, that is, when workers will be able to slowly return to their jobs, and people go out of their homes and shop. That said, one can imagine that the first stage will last two or three months (although evidently this judgement must be evaluated in the face of experience). It is equally hard to predict how long the second stage will last, because a lot will depend on the measures taken during the first. If these are adequate, the second stage may be short, say five or six months; if not, it can last much longer. That said, it will also depend on global measures, in particular on how quickly the United States and Europe recover, and growth resumes in China.

This division of the crisis in two stages suggests that towards the end of the second stage, say November, we will return to normality. Hopefully. But what happens in the next few months will redefine normality. It is natural to think that by year’s end we will be where we were at the beginning. But the world will be different in many dimensions: tourism flows, production chains, conditions in financial markets, etc. What started as a transitory shock may in some dimensions become permanent. For example, if there are long-lasting changes in the activities of tourism cruises, the Caribbean and similar destinations will be affected; if multinational businesses decide to shift their production chains, the manufacturing sectors in some countries will be affected. These aspects are not discussed in this document, and normality near the end of 2020 is assumed to be not too different from what it was at the start.

III. Immediate adjustments to economic policy are required

In the context of a more severe and complex crisis than the 2008-2009 one, it is essential to have clarity about the objectives that economic policy should pursue, and the instruments that can be deployed to reach them. The proposal here is that economic policy be immediately restructured around three objectives:

- **Objective 1:** minimize the human cost of the pandemic;
- **Objective 2:** minimize the regressive effects of the crisis, with measures to protect workers’ incomes, especially low-income ones; and,
- **Objective 3:** preserve macroeconomic stability and the capacity to resume growth once the economic crisis resulting from the pandemic concludes.

It is always difficult for governments to rapidly readjust their plans, especially when this implies a radical shift. Every government has legitimate objectives associated with infrastructure projects, education, rural and regional development programs, and the like. I do not propose to abandon those objectives, but to postpone

² Events in Hubei province and the City of Wuhan in China in the next few weeks, as economic activity resumes, will be important to judge if one quarantine proves enough to control the virus, or if reappearance force a second quarantine or a change in the containment strategy.



them, explicitly recognizing that, due to the drastic change in global context, this is the best way –in some countries the only way- to reach them further down the line. The quicker this is recognized and, in parallel, credibly communicated to the markets, the lesser the economic costs will be resulting from the perception of confusion and lack of understanding of the gravity of the situation. (Part of the extreme volatility experienced by financial markets in the United States over the last few days derives from the perception that the US government does not have -or at least did not have until very recently- a clear understanding of the size and nature of the challenge it faced, and had not articulated a coherent response.)

IV. Objective 1: minimize the loss of life from the pandemic

This objective is conceptually the simplest, but operationally the most complex one, at least during the first stage of the crisis. To reach it, public health systems must have all the budgetary resources necessary to face the pandemic. The constraint here must be operational capacity. It is impossible to make quantitative estimates given the uncertainty of the virus' evolution, but all the required budgetary allocations and administrative facilities must be made to allow resources to flow exceptionally quickly.

Health systems are already taking emergency actions, as this is as it should be. Nonetheless, it is necessary to in parallel revise the containment strategy, given the immense cost of indiscriminately suspending economic activity for a long period of time. Many countries are innovating to design more targeted isolation strategies, based on the early identification of contagion points, increased testing to detect who is a carrier and who is not, and on novel mechanisms to identify who should and should not be isolated.

A prolonged generalized isolation, of over two months, would lead to a very deep recession, or practically to an economic collapse, which would in turn reduce the resources at the disposal of health systems. In other words, while initially no expenses should be spared to tackle the pandemic with the generalized isolation strategy already laid out, new more effective and less costly modalities to respond to the virus should be designed parallel. The experience of South Korea and Singapore are very valuable in this context.

V. Objective 2: Protect workers' incomes

The fall in internal demand in the next few months will be unprecedentedly strong, at least in some countries. In that context, the first priority must be to help those directly affected, which in this case are workers. Measures must focus on those between 25 and 65 years of age, who were in the labor market before the crisis, and who are at risk of losing their income.³

At times, counter cyclical expansions of public expenditures are confused with the measures used to mitigate the social costs of a recession. They are undoubtedly related, but conceptually they must be separated. Where possible, and considering each country's macroeconomic context, mitigating measures must be financed through a counter cyclical expansion of expenditure, which should also help dampen the recessive effects of the crisis. However, there may be cases where a country's context makes it impossible to increase expenditures;

³ All workers risk infection, but not all risk losing their income; in particular, public workers, and to a lesser extent, rural workers.



in those cases, expenditures must instead be redirected.⁴ The point is that one way or another, public expenditures must be channeled to mitigate social costs. Section VI discusses this issue in more detail.

Mitigating measure must consider the specifics of this crisis. What is needed in this case is to aid workers at risk of losing their incomes, because they will soon be laid-off from the companies they work for; because they will not be able to attend their jobs; or because if they are self-employed or manage a micro-firm, they will not be able to carry out their regular activities, because sanitary restrictions do not allow it, or because they have very few clients (as these cannot leave their homes). The epicenter of the crisis is the labor market, and that is where efforts must be centered.

Expanding many of the existing social programs may not be the adequate response to this crisis. Some may be adapted, as proposed below for conditional cash transfers programs (hereon, CCT). However, others, while they should be maintained, must not be expanded as part of the response to the crisis. For example, many countries in LAC have non-contributory pension programs. These pensions must be maintained in real terms, but not expanded. Those in retirement will not be directly affected by the crisis; they are already outside of the labor market and will not lose income as a result of the recession.

For similar reasons, educational scholarships for children and youth training programs, and employment programs should not be expanded either. The labor market will deteriorate rapidly and severely in the coming weeks. Under those conditions it will be very hard to place new workers into the labor market; one must first help those that are already in it, because they are the ones at risk of losing a substantial part of their incomes. Similarly, microcredits are not an adequate tool to face this crisis either. Micro and small firms will face a demand problem of uncertain duration; many of them will not be able to pay off their debts, at least during the first stage of the crisis, because they will have fewer clients. It does not make a lot of sense to indebt them. In fact, one does not want to help those firms, but their workers-owners; and what they need is rapid income.

The targeting criteria of social programs typically revolve around the concept of vulnerable households or vulnerable families, based on indicators like number of children, number of elderly, years of schooling of adults, access to clean water and electricity, and the like. In general, this works when designing programs and measures to help households overcome structural deficiencies. But the situation faced now is different. Without denying the importance of these deficiencies, this crisis' novelty lays in the vulnerability derived from a sanitary enclosure that impedes those who a few days ago were working to continue doing so. What is urgent is to attend to this new vulnerability. This does not mean that the prior targeting criteria be abandoned; these must be maintained for the purpose of programs in place before the crisis. But it does mean that, for the purpose of the mitigating measure to the social costs of this crisis, new ones must be adapted.

In that context, it is useful to classify workers in four groups. First, those that are members of a family that benefits from an existing CCT (like Familias en Acción in Colombia, Bono de Desarrollo Humano in Ecuador, Bolsa Familia in Brazil or Prospera in Mexico). Second, those employed by a firm that affiliates them to contributive social security. Third, those registered with fiscal authorities for tax purposes, but that are not registered by a firm to contributive social security. And fourth, those that do not belong to families benefitting from a CCT, are

⁴ In extreme cases where there is not possibility of external financing and redirecting expenditures isn't enough, a tax increase will be required. In these cases, it is essential that this be as progressive as possible. Although clearly a tax increase is highly undesirable at this juncture, that option must be weighed against the option of inflationary financing, which would de facto be a tax on all households. Moreover, in countries without their own currency, inflationary financing is not an available option.



not in a firm that registers them with social security, and are not registered with fiscal authorities. Henceforth, I refer to the first group as poor workers on a CCT; the second, formal workers; the third, registered workers; and the fourth non-registered workers.⁵

It must be noted that these groups are not mutually exclusive; there can be an overlap between them, although probably small. It must also be noted that this classification can vary between countries, as well as the proportion of workers in each case. Its purpose is to determine how to help each group. We want to answer two questions: First, ¿what public policy tools, already operating in the country, can be used to transfer income to workers during the first stage of the crisis? Second ¿how many workers would be excluded, and what options exist to help them that can be implemented in the very short term?

V.1 Poor workers in a CCT

Typically, the registries of CCT beneficiaries have information on all household members.⁶ This allows identifying households with members between 20 and 65 years of age (which is taken here as working age, although this range must be adjusted for each country). We propose an income transfer to households with members in that age range, of an amount that must be further calibrated, but that should be around the median of the wage distribution of all informal workers, which is probably close to the labor income that poor workers currently receive. In principle, these transfers would compensate for the loss of income in the extreme case that they all become unemployed. The transfers must clearly be announced as transitory, not be conditioned to any behavior by the beneficiary and must be eliminated once the economic emergency is over, near the end of the second stage.

It is worth highlighting that the transfers should not be conditioned on the number of kids, as is usually the case with these programs, or on assistance to school or health clinics.⁷ They should also not be conditioned on working; in fact, at least in the first stage, they are partly for not being able to work. That said, calculations can be sharpened. The prior proposal supposes participation rates of 100% in the labor market, which clearly was not the case before the crisis.

The effectiveness of this measure depends on the CCT's coverage and the quality of its registry. In countries where the CCT has wide coverage, as could be Brazil and Mexico, the measure helps protect a large portion of poor workers from the effects of recession. In countries where it does not, as could be Peru for example, it will not be very effective, although that does not mean it should not be implemented; simply that more must be done with other tools.

The quality of the registry also matters. Inclusion errors in this case can be a virtue, as they help to make

⁵The classification of workers as formal or informal varies between countries depending on their laws and their enforcement (in some countries self-employed workers are obligated to enroll in contributory social security and in others they are not; and in some countries there are self-employed workers that do meet this obligation). As a result, in the third group there may be self-employed workers that do contribute to social security and that would be usually classified as formal. Nonetheless, as detailed further below, what matters here is that they are not associated with a formal firm, even if they themselves are formal.

⁶Other poverty programs can also be applied. What remains important is: (i) being able to identify people of a working age, and (ii) having an operational monetary transfer system (or being able to create this system quickly). Above I make reference to poor workers who are part of a CCT, but it should be understood as poor workers on any program that fits the mentioned criteria.

⁷The "normal" CCT, per say, would continue to exist. What is suggested is using its registry and system to reach workers in their homes.



transfers to informal workers who are not poor. Exclusion errors instead are worrying. It is necessary to better understand each country's case, in order to see if these are more significant in urban or rural areas and determine what can be done to correct them very quickly.

V.2 Formal Workers

The objective must be no layoffs and, the other side of the coin, no firm closures. This is a difficult objective to achieve, but the closer countries can get to it, the lower the social cost of the crisis will end up being, and the higher the possibility of resuming growth once it ends.

Experience from prior crisis in LAC indicates that the cost from the destruction of formal jobs is higher than that of lost salaries. The available data indicates that these are the most productive jobs, as well as the ones that offer workers the best prospects in terms on learning, training and professional growth. When a worker leaves formality, the investment that the firm made in her training is lost; part of the investment that the country made in her education is also lost, as are the taxes paid by the firm that employed her. And, of course, her family loses the right to medical attention and other social security benefits, precisely what must be avoided in the context of a medical emergency.

Moreover, it must be clear that, once the sanitary emergency is over, the country's productivity, and its capacity to quickly recover from the crisis, will greatly depend on preserving pre-established relations between formal workers and their firms. During the first stage of the crisis many laid off formal workers will accept almost any job so as to have some income. Later on, once the crisis is over, if they the firm that laid them off survives, it will have to hire and train other workers. On the other hand, firm bankruptcies translate into losses of tangible and intangible assets that the country requires to grow. This rotation and waste of assets end up being very costly for the country and must be avoided as much as possible. Without a doubt, protecting formal employment must be a priority objective.

¿How can it be achieved? The general idea is to temporarily reduce firms' labor costs without reducing employment and minimizing the reduction of salaries. Two conditions are required: first, that the government subsidize part of labor costs; second, that the subsidy be conditioned on certain behavior by the firm, in particular, to not fire any workers.

There are many ways of subsidizing labor costs. One of them is to subsidize non-salary costs. We explore this option first, in the understanding that section VII proposes that under certain circumstances salaries should also be subsidized.

There is large variation between countries in the region in the composition and magnitude non-salary costs. Nonetheless, we can divide them in three categories: first, contributions to social security which give a present benefit to workers (certain or contingent) like health and daycare services, child allowances, or disability, life, work accidents and unemployment insurance. Second, contributions to social security for a future benefit, mainly pension funds, and in some countries like Jamaica or Mexico, savings for housing. And third, contributions ear-marked to ends that do not represent a proportional benefit to the worker, present or future, as are training or education programs for the general population, or others.



With that division in mind, during the first stage the proposal is to maintain contributions for the first category, but to fully finance them from the national budget; and to suspend contributions to the second category and most, or ideally all, of the contributions for the third, in all cases conditioned upon the firm not laying off any worker.

The reasoning behind suspending contributions for retirement pensions (and, in certain cases, housing), is very clear: there is little sense forcing workers to save for their future consumption, or for an asset like housing, when their present consumption is being strongly threatened.⁸ The reasoning behind suspending contributions to training programs and the like is similar: in the context of an acute crisis, these programs are of secondary importance relative to the central priority of maintaining formal employment; aside from that fact that many of the contributors do not benefit from them. This is not the time to make cross-subsidies from formal workers to other ends.⁹

Now, the registries of social security institutes allow identifying the number of firms and the number of workers that each firm had on February 29th, 2020.¹⁰ With that information, a program (“No Layoffs in My Firm” to use a name that appeals to future reputation) can quickly be put in place that offers participating firms:

- i. during the first stage of the crisis, substituting firms’ and workers’ contributions to programs in the first category with resources from the national budget; and,
- ii. the possibility of subsidizing, during the second stage of the crisis stage, a share of workers’ salaries.

The reduction in labor costs associated with these measures varies from country to country. In some it can be substantial; in others it can be less relevant, because contributions as a share of salaries are low. However, in all cases, workers’ access to health, disability, life, or work accidents insurance, among others, is preserved.¹¹ Sadly, maintaining life insurance can prove very important in this crisis; in its absence, the families of some workers could be left in a tough spot.

The efficacy of this measure depends on two factors: the magnitude of reduction in labor costs and the share of formal employment in total employment. Here there is also wide variation among LAC countries. Clearly, for those where formal employment is low, as are Honduras, Guatemala, or Bolivia, the measure has low efficacy. Nonetheless, even in those countries it still relevant, as it helps the more productive firms stay in business, positioning the country better for when the worst part of the crisis has been overcome.

In the context of this crisis we must highlight that the objective is to maintain workers’ income, not necessarily that they attend the workplace. In fact, during the first stage of the crisis, for sanitary reasons it may be desirable

⁸ The region’s retirement systems are either defined contribution in individual accounts or pay-as-you-go. The first case is simpler: less resources would be accumulated in the retirement account, reducing the size of the pension in the future. The second is more complicated in the sense that contributions from active workers are directly financing pensioners. In that case reserves can be used, or the financing may need to continue, but from government resources.

⁹ In some countries, important programs are financed through these contributions, amongst them, for early child development. Those programs must undoubtedly continue, but at least during the first stage of the crisis must be financed directly by the government. Other programs may have lower priority and can be suspended or slowed down.

¹⁰ This date is taken as the pre-crisis level of employment, but it could also be the 15th of march. It is likely many firms already started, or will start in the coming days, to reduce their workforce.

¹¹ The suspension of contributions for retirement pensions would not impact the accumulation of required weeks to qualify for a pension, as workers would keep contributing to the other programs (with government resources). This is relevant to countries that require minimum periods of contribution in order to qualify for a pension.



that many do not attend. However, this should not be an impediment for them to collect their wage. Because of this, during the first stage it will also be necessary to: (i) manage the timing and payment of vacations flexibly, and (ii) establish criteria for transitory disability payments associated with the pandemic, financed by from disability insurance. (This highlights again the importance of maintaining formal employment.)

Firms' response to this measure depends on many factors: they sector they are on, the size of the shock that they face, their access to credit, their expectations about the crisis' length, etc. For some the reduction in labor costs may be sufficient to maintain the same level of employment. For others it may not. In the second group there may be some that wish to retain their employees (they know them, they have trained them, etc.), and can finance keeping them on the payroll for a short period with the same wages. But there will be others that cannot. In those cases, voluntary agreements between firms and employees must be encouraged, with temporary salary reductions that allow firms to survive while no one loses their job. Generally, these agreements should be facilitated by countries Ministries of Labor.

It may be that that in some cases firms attempt to take advantage of the crisis and reduce salaries even if this is not necessary for the business to survive. To minimize this possibility, it could be stated that salary reductions are only permitted to firms that participate in the "No Layoffs in My Firm" program, and maybe only from the third month on, for example. Another variant would be to allow firms to postpone payment of a part of the wage from the critical months of 2020 to 2021; that is, the same wages are registered, under the agreement a part will be payed once the crisis is over, or at least once the sharpest stage is behind (de facto, workers would give credit to their firm with no interest, to avoid losing their jobs and the totality of their wages). Clearly, there are many other variants. It is hard to find a balance here, as the crisis will affect different firms differently. The point is to recognize that an acute situation requires innovative options to reach what must be the main objective: workers do not lose their job, and they still receive all or most of their salaries, while still maintaining access to social security.¹²

Nevertheless, there will be some firms that regardless of the measure proposed, will reduce employment, perhaps because they believe the shock will persist for many months, or perhaps because they have no access to credit. It is hard to predict how many will find themselves in this situation, but these cases will be reduced to the extent that if firms know that if the recovery does not begin by the end of the first stage, there will be additional aid as long as there are no layoffs; I return to this point in section VII.

Many firms will soon begin to have liquidity problems. Because of this, in addition to the reduction in labor costs, access to credit must be facilitated, taking advantage, when possible, of development banks. Once again, the wide variance between LAC countries makes a general discussion difficult. That said, an option which could be relevant are guarantee programs from development banks to facilitate credit from commercial banks. In that context, an idea worth exploring is that these programs be more generous for firms which do not layoff their workers. In this case, aid is doubled: lower labor costs and preferential access to credit.¹³ This combination could raise the number of firms that do not layoff.

¹² The suggestion to postpone paying part of the salary can be relevant in countries where the minimum wage is high, and there are legal barriers to reduce it.

¹³ The government would not determine which firms have preferential access; firms would self-select. The ones that do not layoff get it. Those that do would still have access to credit, but without preferential conditions.



Three more observations. First, this is the most direct measure governments have at their disposal to maintain formal employment. Second, the measure facilitates negotiations between firms and workers. And third, the measure only costs public resources if firms do not layoff workers; firms that lay off do not receive any subsidies. The government spends funds subsidizing firms only as long as they keep all their workers on the payroll.

These observations imply that the proposed measure is budgetarily more efficient than generalized subsidies to all formal firms, or generalized reductions to corporate taxes, or other alternatives that have been suggested (e.g., lowering the cost of electricity). From the point of view of maintaining employment and formal workers' incomes, these last options are problematic because they do not approach the objective directly; they deal with it indirectly. Because of this, in principle, they must be discarded; their efficiency in terms of "formal jobs saved per dollar spent" is lower (and in addition they distort other margins of behavior).

Finally, it is clear there are many variants of the proposed measure. For example, limiting it to only firms employing x number of works (focusing on small and medium sized); limiting it only to workers earning up to x level of wages (excluding firm managers and staff with very high wages); limiting it to only activities most affected by the pandemic (e.g., restaurants and factories, but excluding those that can function without the agglomeration of people); limit it by region (ex: touristic zones), etc. The benefits of doing so depend on the intensity and the nature of the shock in each country; on administrative capacities; on budgetary cost considerations; and on the balance between these and the other proposed measures. For reasons of space these variants are not explored further here, but it must be noted that to the extent that the shock is a generalized one, the easiest and most convenient is a broad-based measure.¹⁴

V.3 Workers registered with fiscal authorities

Tax authorities have registries of individual taxpayers and micro firms subject to special tax regimes. Occasionally, in this last case, contributors are not legally constituted firms (that is, firms registered with limited liability or similar legal figures), but individuals. It is worth noting here that in many countries in the region the dividing line between an individual worker and a micro-firm is vague.

Again, there are many variations between countries, and it is difficult to undertake a case by case discussion. That said, the general objective is to identify and, critically, to have a medium to transfer income to a subset of workers in the next few months, that are neither in a CCT nor work for a formal firm. These last workers, even if they are included taxpayer registries, would not be beneficiaries of this measure. Here we are attempting to reach those that cannot be helped via the formal firm. This group is mainly conformed by informal workers, but also includes self-employed workers that may be affiliated to social security. Ideally, taxpayer registries have reasonable coverage of these workers, at least of those in urban zones, which are the ones that will be the most affected during the first stage of the crisis. If they do not, one can consider complementing them with the registries from sub-national entities, when states, provinces, or municipalities charge fees for economic activity.

¹⁴ That said, it's evident that for public sector workers this measure is not necessary, as they do not run the risk of being fired (in the understanding that workers who are government contractors are included in this category). Similar reasoning applies to other workers like employees in embassies, religious organizations or private universities. The key is to help workers in private firms who are at risk of losing their job and income because their firms is either going to lay them off or go bankrupt.



The proposal is to use these registries to make a temporary income transfer of the same duration as that proposed for poor workers in a CCT. The amount can be set in different ways: equally for all; in proportion to the taxes paid in 2019; in proportion, but with a maximum amount equivalent, say, to the median of the tax distribution, etc. Transfers do not have to be identical, but they must have some progressivity. Much depends on magnitudes and administrative capabilities. Without underestimating its importance, I do not discuss this aspect further here. What is key is that these workers have a secure income during the first stage of the crisis, independently of whether they are able to attend their job or not because of sanitary restrictions.

Undoubtedly, there remains a universe of workers that do not belong to any of the three previously mentioned groups, informal unregistered workers. This universe will vary from country to country according to the coverage of its CCT, of its taxpayer registry, and its labor informality. Besides quantifying it, it must be characterized in terms of its urban-rural composition, income level, and any other available information.

The size and composition of this universe is critical. If it is a small, it may be that the transfers made to the three previously identified groups are enough to protect the majority of those affected by the crisis, understanding that it will never be possible to protect all. However, if it is large, and if it is also primarily urban, it is necessary to find other ways to identify them and quickly reach them with a transfer. In this context one can note that some countries have non-contributory health programs for informal workers (in some cases for all of them, as in Peru, Mexico or Jamaica, and in some cases only for lower income ones, as in Colombia). The information from these programs must be evaluated to determine if working-age individuals can be identified; afterwards, it will be necessary to think of a mechanism to quickly reach them with an income transfer.

All that said, it is useful to note that in some labor markets in LAC are characterized by the high mobility of workers between the formal and informal sectors, and by the absence of unemployment insurance. This means that layoffs of formal worker layoffs will in part translate into an increase of informal workers (and another part in open unemployment). The influx of laid off formal workers to informality would depress the income of those already in that condition before the shock. In addition, to the extent that the income of formal workers does not fall, their demand for products produced by informal workers would not fall either (as long as sanitary restrictions allow). This is another argument that highlights the strategic importance of preserving formal employment; informal workers are also helped by ensuring formal employment does not fall.

On the other hand, it must sadly be recognized that during this crisis some workers that do not have life insurance from social security could lose their lives. Because of this, a proposal is made for the government to make special compensations to families who lose a worker because of coronavirus. This could take the shape of an annuity similar to a survivorship pension, with benefits equivalent to the ones that the family would have received in the case the worker had been formally employed when the pandemic started. The objective is simple: to avoid leaving families helpless after the crisis is over. Ideally no one would have to benefit from this measure, but its introduction will help in contexts where the social fabric is being strongly strained.¹⁵

Finally, this crisis is not the moment to introduce a universal minimum income (even if considered desirable under normal circumstances). This measure is less effective as it would disperse resources between people who,

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throughout these critical months, are not directly impacted (individuals who despite being of working age were not in the labor market, senior citizens, students, or workers who will not be affected like those in the public sector). As discussed below, the crisis will strongly depress tax revenues and deteriorate fiscal balances. In that context, it is indispensable to assure that available public resources are channeled towards those who will, or are already experiencing, a strong drop in their income.

Moreover, a minimum income does little to maintain formal employment and avoid firm closures, a critical issue since the recovery from the crisis will depend on there being firms that can offer workers productive jobs. The instruments applied to mitigate the social impacts of the crisis must also consider the need to resume growth once it has been overcome.¹⁶

VI. Objective 3: preserving macroeconomic stability

Objectives 1 and 2 generate four paths to mitigate the social impacts of the crisis, and require public spending for: (i) the health system to attend the pandemic; (ii) workers from poor families in a CCT (iii) subsidies to labor costs for formal firms and, (iv) income transfers to the rest of the workers.¹⁷ Evidently, numerical calculations and many operational details are still missing. But what is most important at this juncture is to direct government action to where it has the highest social impact, avoiding the dispersion of efforts into numerous measures that could have little efficacy in terms of the objectives being sought.

The recession will reduce tax revenues. This phenomenon will intensify in countries where revenues depend on the prices of primary commodities (as with oil in the case of Ecuador and Colombia, or copper in the case of Peru or Chile). In other countries, the fall in commodity prices may actually be beneficial (e.g., oil importers like the Dominican Republic). On balance, however, tax revenues will fall, in some cases quite dramatically. Even without any additional public expenditures to mitigate the crisis' social impact, fiscal balances will deteriorate rapidly, and debt to GDP ratios will increase.

Unfortunately, this crisis finds most LAC countries with less solid public finances than in 2008-2009. Generally, debt to GDP ratios are higher, reducing in most cases the capacity for counter cyclical responses, or exposing countries to a negative reaction from financial markets in the case that a counter cyclical expansion of spending gives the impression they have lost control of their public finances. In the extreme, one could face an unexpected and abrupt interruption ("sudden stop") of capital flows, which would limit the capacity to issue debt of countries that still have it, and strongly affect the debt placements and refinancing of their main private firms.

The immense challenge being faced is how to finance the expenditure required for objectives 1 and 2 without undermining macroeconomic stability, and the possibility of resuming growth once the pandemic ends. Ideally, governments could in the first instance obtain resources from the IADB, WB and CAF. However, these institutions' balance sheet do not allow for large increases in lending. For smaller countries it may be possible that new loans from these banks, jointly with the redirection of undisbursed balances from existing ones, could

¹⁶ That said, in countries where formal employment is almost nonexistent, as are registries, fiscal or other, and where administrative capabilities are very weak, a flat transfer without targeting (or with quick-and-dirty methods to try to exclude, say, workers in the last quintile of the income distribution), could be the only short term option. Considerations here would be budgetary ones, to the extent that the larger the universe of beneficiaries the lower the size of the transfer.

¹⁷ I ignore here the contingent cost of credit guarantee programs and survivorship pensions for workers without social security



contribute to finance a relevant part of required expenditure. But for the rest this is not feasible, as the amounts involved are clearly.

In the face of this reality, as a second instance governments could place debt in private markets. Nonetheless, the context for doing this is very bad because: (i) the high volatility in financial markets associated with the recessions in the United States and Europe, (ii) the fact that many OECD countries, including the United States, will be issuing debt in the coming weeks, in unprecedented volumes, which could saturate markets. Now, it is true that OECD central banks are injecting unheard of amounts of liquidity; that interest rates are at historic lows; and that many investors are searching for higher yielding assets. But it is also true that sovereign risks for most countries in the region have increased, and that the combination of depressed commodity prices, recession, deterioration of fiscal positions together with large increases in expenditures may make credit very expensive and short term, or inexistent.

The balance of these observations varies from country to country, and it is impossible to make a general judgement. Nonetheless, it is a mistake to believe that the fact that Germany, the United States, France, and other OECD countries, are increasing their debt without giving large considerations to its sustainability, means LAC countries can do the same. With few exceptions, like Chile or Peru to mention two notable cases, the reality is that our countries face larger restrictions to access financing in the markets. Consequently, our challenge in this crisis is larger than that faced by OECD countries, because we must not only consider the mechanisms to spend quickly and protect workers (and, where possible, maintain aggregated demand); we must also consider the short-term financial implications. We must not, in the anguish that we all experience given the problem we presently face, adopt an “let us increase expenditure now and we will see the rest later” attitude. Currently there is no financial crisis in the region; it is important to keep it so.

From the point of view of sustaining aggregate demand, it is desirable that mitigating measures be financed by external debt, and not by redirecting expenditure or by higher taxes. Here is a suggestion that could help facilitate this option. This consist in legislating an immediate increase in public expenditure and, in parallel, an increase in taxes to be put into effect once the crisis is surpassed, say, early or mid-2021. This tax increase would be legislated as temporary and its sole objective would be to finance, ex-post, the additional 2020 expenditures. Collections would be placed in a separate account to the National Treasury, and the tax increase would remain in place until it is assured that debt to GDP ratios are on a sustainable trajectory.¹⁸ The key points here are to: (i) avoid deepening the recession with a tax increase today; (ii) strengthen the credibility of the country’s commitment to the sustainability of its debt, (iii) signal to financial markets that the government is acting prudently, and (iv) simultaneously indicate to society that extraordinary expenditure measure will require paying off once the economic emergency is over.

Ideally, the tax increase must be progressive. That said, some taxes can be progressive, but collect very little, or be new taxes where potential revenues are very uncertain. Clearly, there is a difficult trade-off between distributive and revenue objectives here, a trade-off that is sharpened in a context where what is required is to show fiscal solidity so as to access financing and carry out cyclical expenditures without risking a financial crisis. It is difficult to have a general discussion given the heterogeneity of the region, and careful analysis of each case is indispensable.

¹⁸ This does not imply that this ratio should return to its March 2020 level. In face of the shock’s magnitude, it may be that higher debt levels are justified for several more years. This may not matter too much, as long as the debt is sustainable.



The credibility of the future tax increase is crucial. That is why reference was made to a legislative act. If this is not feasible, a strong substitute mechanism is required. Here the options vary widely, depending on country's institutional and political context. At the end of the day, one has to recognize that there is a problem of inter temporal consistency, that requires novel mechanisms to address it. The more successful countries are in this task, the more space they will have for a more generous social mitigation response, that implies a counter cyclical expansion of expenditures consistent with preserving stability.

The crisis will be less intense to the extent that there's more confidence in country's fiscal solidity. Governments and large firms will have better access to international financial markets; and medium and small firms to national ones. Put differently, government interventions must not consist solely of measures to mitigate the crisis' social cost. They must also focus on reducing uncertainty and building confidence, because this will reduce the crisis' intensity and duration; these are, in a sense, part of the counter cyclical response, intangible but equally important.

VII. Uncertainty, credit and the possibility of further aid in the crisis' second stage

It was mentioned previously that one of this crisis' characteristics is that, originating from an insufficiently known virus, it is very hard to determine its duration. Formal firms, commercial banks, and economic agents in general face unprecedented uncertainty. Undoubtedly, facilitating credit either from commercial or development banks must play a fundamental role to help firms get through the crisis' first stage. However, in some cases the problem can be credit demand, rather than supply. If firms consider that the demand contraction will last a long time, they may not ask for credit even if it is available. The cost of losing their assets in the face of a credit that they consider will not be able to serve can be higher than that of ending operations.

To deal with this issue, we suggest measures to lengthen the period in which firms can survive, avoiding bankruptcies and losses of formal employment. In particular, it is suggested that if in three or four months economic indicators point towards a very long second stage, support measures to workers be prolonged for three or four more months, with a variation for formal ones: besides the suspension of contributions to pension and, in some cases, housing funds, and the subsidy for the remaining contributions to social security, that the government also subsidize a certain percentage of workers' salaries (based on labor registries and wages as of the 29th of February of 2020), as long as, as in the first stage, the firm does not lay off workers.

It is important that this measure be announced from the start, including the percentage of support provided (for which the necessary calculations are required). The objective is to facilitate planning to formal firms and increase their incentives to access credit lines and keep operating instead of closing. Firms and banks must know that, if in a few months there is no sign of recovery, the government will intensify its support, and they must also know through which measures. More precisely, they need to know that support to firms will increase as long as they do not lay off workers. The point is this: firms will be more willing to ask for credit if they know they will receive more support in the case of a longer crisis. On their part, banks will be more willing to offer credit if they know that firms will be further supported. Of course, support for the second stage must have preannounced indicators that everyone is aware of, and that cannot be manipulated to be triggered.

On the other hand, it is clear that in the coming months many unexpected situations will arise that will require a flexible response. We are experiencing unprecedented times. In this context it is impossible to plan every-



thing, and governments must have margins to respond. The second stage may involve additional measures, in response to situations that no one can predict now. Nonetheless, the point is that, through the mechanism proposed to maintain formal employment, the government will reduce uncertainty for firms and banks, and that this reduction of uncertainty will, in turn, help to reduce the intensity of the crisis.

Of course, measures for this second stage must be framed within the government's financing possibilities. That is why it is vital to preserve stability during the first stage. Ideally, by the time we reach the second stage the pandemic is either controlled, or else that isolation measures are more localized and shorter. As a result, workers can return to their jobs, people can agglomerate and, more generally, economic activity can be undertaken minimizing the risk of contagion. Without a doubt, aggregated demand will be depressed in three or four months. But if one managed to maintain stability, there will be better chances of creating space for additional expenditure actions to help workers, as the ones here mentioned, which simultaneously reduce social costs and accelerate the recovery.

VIII. Interconnection between sanitary and economic measures

While this crisis originated outside LAC, sanitary measures have already transformed it into an internal crisis in every country. Undoubtedly, at this point the economic costs from the interruption of economic activity associated with the generalized isolation, are larger than those due to the fall in commodity prices and export, or to higher risk premiums or currency depreciations.

Therefore, and contrary to prior economic crises, the solution to this one depends on the solution to the sanitary emergency, not in the sense of "eliminating" the pandemic (which could not happen absolutely until a vaccine is discovered, or high levels of herd immunity are reached); but in the sense of transitioning to containment strategies that do not depend on the generalized isolation of individuals. If containment strategies do not evolve, the economic crisis will reach levels of magnitude which are hard to imagine, and a lot of what is mentioned in this document will prove insufficient or no longer pertinent.

Two conditions are required for this recession to have a "V" shape, that is, a drastic fall in production and income for two or three months, and then an orderly and swift recovery: (i) that the indispensable measures to mitigate its social costs do not create in turn a financial crisis, accompanied by the closure and bankruptcy of firms; and, (ii) that sanitary strategies evolve. This document can help fulfill the first condition. But a lot rests on advances in the health front. In other words, even a very well-designed package of economic measures can prove insufficient to overcome the crisis and resume growth. The evolution of the sanitary strategy, from generalized isolation measures towards more focused strategies, is an essential part of the economic crisis containment program, and later on, of recovery.

Practically every country in the region has decreed generalized isolation. But few have suggested how these will be abandoned. Credible announcements from governments in this area are part of the response to the economic crisis.



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