

Fiscal Panorama of Latin America and the Caribbean

2020

Fiscal policy amid the crisis
arising from the coronavirus
disease (COVID-19) pandemic



**COVID-19
RESPONSE**



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**COVID-19
RESPONSE**



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Foreword

The launch of *Fiscal Panorama of Latin America and the Caribbean, 2020* comes amid the greatest health, human, economic and social crisis that the region has faced in the past century, as a result of the coronavirus disease (COVID-19) pandemic. The Economic Commission for Latin America and the Caribbean (ECLAC) projects that the crisis will produce an economic contraction of 5.3% in the region in 2020, the deepest recession since the 1930s, with severe repercussions for employment, poverty and inequality.

Against this difficult backdrop, fiscal policy can play a key role in mitigating the human and economic costs of the pandemic. As the first chapter of this edition of the *Fiscal Panorama of Latin America and the Caribbean* shows, the countries of the region are implementing a range of fiscal measures of diverse magnitude and scope to address the short-term challenges posed by this crisis. These measures are intended to protect public health, to ensure the well-being of households, especially the most vulnerable, to preserve production capacity and to create the conditions to revive economic activity. However, they are but a first step towards an inclusive post-pandemic economic recovery. As the health crisis abates, additional rounds of fiscal measures will be needed to boost the economic recovery and respond to growing social demands. This cannot be achieved if the countries of the region do not have appropriate access to sources of funding.

Latin American and Caribbean countries will need additional short- and medium-term solutions, including debt service facilities, and a review of existing concessional lending programmes and graduation policies for middle-income countries. In addition, addressing the persistent inequalities that have plagued the region will be crucial, as will be expediting the transition to welfare States that lay a solid foundation for sustainable growth. A new fiscal covenant is thus of the essence to start designing robust tax frameworks with the instruments required to finance sustainable development through progressive fiscal policy and efficient, effective and equitable public spending that puts the needs of the whole of society first.

As the analysis in chapter II shows, despite adverse macroeconomic conditions in 2019, average total revenue in Latin America held steady at 18.1% of GDP. Total public spending stood at 21.2% of GDP, reflecting a marginal rise of 0.1 percentage point of GDP from 2018. As a result, the central government primary balance deteriorated slightly, running an average deficit of 0.5% of GDP in 2019, compared with 0.4% in 2018. Gross central government debt averaged 45.2% of GDP, 3.3 GDP points more than 2018.

In the Caribbean, average total revenue edged up to 27.5% of GDP in 2019 from 27.3% in 2018. Total expenditure stood at 28.7% of GDP in 2019, down marginally from 28.8% in 2018. The subregion's fiscal balance continued to improve in 2019 with a slightly larger surplus of 1.5% of GDP, as against 1.4% in 2018, while debt continued to track down, narrowing from 71.1% to 68.5% of GDP between the two years.

At the subnational level, while there were modest gains in total subnational government revenues in recent years, subnational government public spending increased at a higher rate. This has affected the fiscal balance and subnational debt, which has been on the rise since 2015 and peaked at 5.8% of GDP in 2018, up from 5.3% in 2017.

This edition of *Fiscal Panorama of Latin America and the Caribbean* also examines some key questions on fiscal policy and how it ties in with the 2030 Agenda for Sustainable Development and the achievement of the Sustainable Development Goals (SDGs).

One of the main challenges in mobilizing domestic resources to finance the implementation of the SDGs in Latin America and the Caribbean is tax evasion. As discussed in chapter III, estimates in relation to tax evasion, aggressive tax planning by multinational corporations and high net worth individuals and illicit financial flows indicate that these practices result in considerable revenue losses in the region. This chapter provides a broad overview of tax evasion, the most advanced techniques that can be used to measure it and the range of actions and innovative steps that countries are taking to address the issue. It also identifies good practices at the regional level and gives general recommendations for the countries of the region.

As discussed in chapter IV, the review of public expenditure policies has a key impact on several dimensions of the SDGs. The availability of up-to-date, detailed and cross-country comparable statistics of the level and composition of public spending by functional classification is particularly important for identifying the intentionality of public policy and assessing whether the use of resources is in line with agreed objectives. This type of analysis is a useful tool to guide countries in making policy decisions to underpin the above-mentioned objectives and channelling tax revenues towards the public spending areas where they will be most effective in achieving sustainable development, eradicating poverty and reducing inequality.

Alicia Bárcena

Executive Secretary
Economic Commission for
Latin America and the Caribbean (ECLAC)



CHAPTER

Fiscal policy and the challenges posed by the coronavirus disease (COVID-19) pandemic

Introduction

- A. The starting point: a weak fiscal position preceding the crisis
- B. Fiscal policy responses to address the crisis arising from the coronavirus disease (COVID-19) pandemic
- C. The complex financing situation for 2020
- D. Conclusion: fiscal policy in the short and medium terms

Bibliography

Introduction

The coronavirus disease (COVID-19) pandemic has caused the worst health, human, economic and social crisis the world has faced in the last century. The exponential infection capacity of the virus heightens the probability of saturation of health systems and increases the risk of mortality. In the absence of a cure or a vaccine for the virus, efforts to control and mitigate its spread have focused on self-isolation, quarantine and physical distancing.

As a result of these measures, global and regional economic activity came to an abrupt halt, leading to sharp falls in aggregate supply and demand. At present, it is difficult to estimate how long the measures to control and mitigate the transmission of the virus will be in effect. Consequently, the prospects for economic performance in the coming months remain highly uncertain.

Preliminary economic data suggest that the world has begun to slip into a deep recession that is likely to be more severe than the global financial crisis, with serious repercussions on the well-being of the population. The Economic Commission for Latin America and the Caribbean (ECLAC) projects that the region's economy will contract by 5.3% in 2020 (ECLAC, 2020a). This could lead to an unemployment rate of around 11.5% for 2020, up 3.4 percentage points from 2019 (8.1%), and would bring the number of unemployed in the region to 37.7 million, an increase of some 11.6 million over the figure of 26.1 million registered in 2019.

Based on these projections, in 2020 poverty in Latin America may rise by at least 4.4 percentage points (28.7 million more people) compared to 2019, bringing the total number of people living in poverty to 214.7 million (34.7% of the region's population). Among the population in poverty, extreme poverty is likely to increase by 2.6 percentage points (15.9 million more people), to a total of 83.4 million or 13.5% of the region's population. ECLAC also estimates that inequality will rise, with increases in the Gini coefficient of between 0.5% and 6.0% across the region (ECLAC, 2020b).

Given the magnitude of the crisis, it is imperative that countries and the international community promote robust responses to mitigate the potentially severe impact on well-being and the economy.

In this regard, fiscal policy becomes a fundamental tool through which countries and the international community can advance clear and timely measures to contain the crisis by providing health care and protecting well-being, and boosting the reactivation capacity of the economy as the health crisis abates.

Contain the pandemic and protect public health by ensuring that the health sector has the requisite resources. In the short term, one of the priorities of fiscal policy must be to guarantee that the health sector has the resources needed to fight the pandemic. This will entail the procurement of additional supplies and investment in medical equipment as well as payment of the wages of current health workers and any supplementary workers that may be required. In addition, conditions must be created to ensure the provision of such supplies. It will therefore be necessary to spend more on health in the coming months, with potentially significant levels of expenditure being incurred against this year's health budgets. The countries of the region are making efforts to cover the additional expenditure that will be needed in the health sector by means of other tools such as budget reorganization. Responding to the health emergency is vital if the crisis is to be overcome and this can only be done if there is an international commitment to recognize that a country's fiscal capacity and access to medical supplies should not stand in the way of strengthening health systems in the short term.

Protect the well-being of households, especially the most vulnerable families. To lessen the impact of the crisis, especially on the most vulnerable groups, household incomes must be protected. This will require the strengthening of social protection systems that cater to vulnerable sectors (including the middle classes), by means of direct transfers, unemployment insurance and benefits for the underemployed and the self-employed. It will also be necessary to maintain access to basic services, food and medicines, especially for those sectors of the population that are most at risk of falling into poverty.

Preserve production capacity and create the conditions to revive economic activity through liquidity mechanisms for companies, particularly small and medium-sized enterprises (SMEs). Once the health crisis has subsided, economic activity will have to be reactivated quickly. It is therefore essential to safeguard production capacity and employment during the isolation phase in order to facilitate a post-pandemic recovery. To that end, mechanisms will be needed to provide liquidity to businesses, in particular microenterprises and SMEs. This support could be made conditional on recipient firms' commitment not to dismiss workers for a specified period. Boosting public investment will also be a key factor in the recovery of the economy and employment after the pandemic.

In accordance with these priorities, the countries of the region have implemented sizeable fiscal packages. These efforts have focused on increasing budgetary contributions to the health sector for the procurement of supplies and the hiring of personnel with a view to preserving its capacity to provide care. In addition, transfer programmes in aid of vulnerable sectors have been enhanced through special grants and by strengthening existing social programmes and pension programmes. Steps have also been taken to protect labour incomes and to provide assistance for the consumption of basic goods, such as food and basic services. Businesses have received support in the form of loans, State guarantees and tax relief.

These fiscal efforts, however, are being undertaken in an unfavourable and highly uncertain macroeconomic environment, as the fiscal position of Latin American and Caribbean countries has been weakened by a number of factors. These include:

- Limited fiscal space, as a result of persistent deficits and rising public debt in the years prior to the crisis;
- Lower fiscal revenues on account of the decline in economic activity and falling commodity prices;
- Substantial short-term public spending requirements aimed at strengthening health systems, protecting the population's well-being and maintaining employment; and
- Tighter financial conditions, which will result in higher financing costs for public expenditure requirements.

Against this complicated backdrop, the countries of the region must find ways to adequately finance the packages of measures needed to address the crisis. The measures announced attest to countries' efforts to use the tools available to them in the immediate term, such as the reorganization of budgetary priorities and recourse to savings funds to channel resources towards urgent spending needs.

However, more funding will be needed to complement these efforts as budget revenues continue to fall and countries will need access to adequate financing mechanisms in order to scale up emergency measures. With the deterioration in financial conditions, an increasing number of countries in the region are turning to multilateral financial organizations for credit.

This chapter presents a detailed analysis of the region's current fiscal situation and the measures that have been announced to contain the COVID-19 pandemic. Section A examines fiscal conditions in Latin America and the Caribbean prior to the outbreak of the pandemic and how trends in fiscal accounts over the past decade have reduced the fiscal space available to respond to the current socioeconomic crisis. Section B focuses on the fiscal effort countries have made to respond to the crisis and provides a detailed overview of the fiscal policy measures —public spending, tax relief and government-backed liquidity support— that have been announced or implemented in the region. Section C explores the complex financing landscape, marked by falling public revenues and adverse financial market conditions, that Latin American and Caribbean countries face in 2020. Lastly, section D offers insights into some of the short- and medium-term challenges for fiscal policy.

A. The starting point: a weak fiscal position preceding the crisis

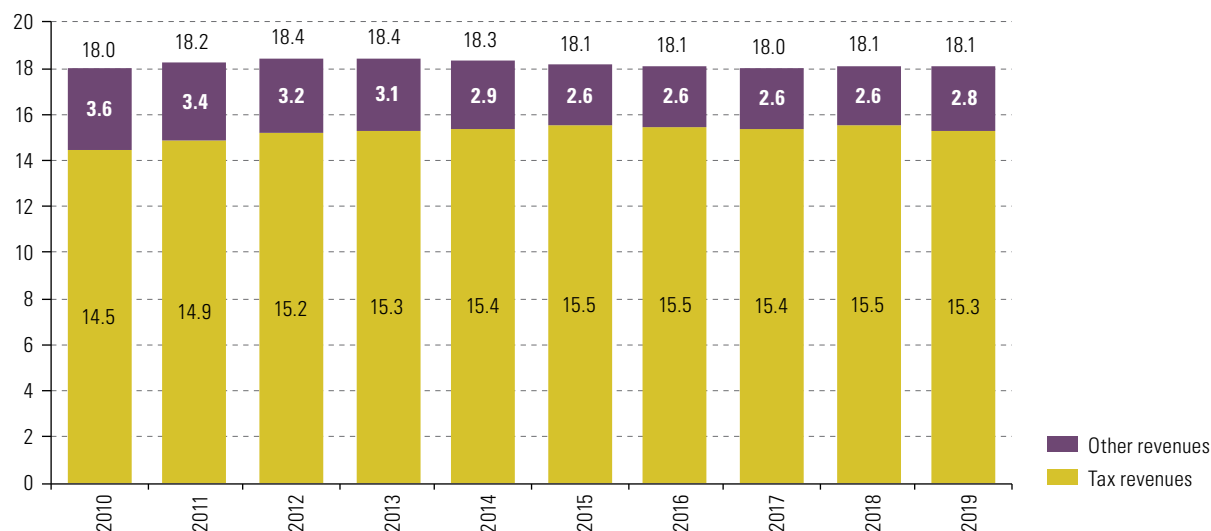
This section presents an analysis of the macroeconomic and fiscal conditions in Latin America and the Caribbean in the period preceding the global outbreak of COVID-19. As noted in the *COVID-19 Special Report No. 2* (ECLAC, 2020a), the region experienced a period of low growth, marked by “twin deficits” —a current account deficit and a fiscal deficit— over the last decade. Broadly speaking, government revenue in the region stagnated and has been insufficient to offset rising public expenditure levels. This imbalance resulted in persistent overall and primary deficits and higher levels of public debt. Trends in fiscal accounts over the last decade have thus left the region in a weak position to face the current crisis. It must nevertheless be borne in mind that each country's situation is different, each with specificities in their respective fiscal space.

The macroeconomic conditions described above have been far from propitious for government revenues, which have stagnated over time. As figure I.1 shows, total revenues in Latin America have been lacklustre over the last decade. Between 2010 and 2019, they accounted for 18.2% of GDP on average, with a coefficient of variation of 0.8%. However, there was a notable change in the composition of total income in that period. In 2010, other revenues —non-tax revenues, capital revenues and external grants— represented 3.6% of GDP in Latin America. This figure fell steadily, reaching 2.6% of GDP in 2018 before edging back up to 2.8% of GDP in 2019. This was equivalent to an overall decline of 0.8 percentage points of GDP between 2010 and 2019.

Conversely, the central government tax ratio increased on the back of a wave of tax reforms and measures (Arenas de Mesa, 2016). Tax revenue climbed from 14.5% of GDP in 2010 to 15.5% in 2018, before slipping to 15.3% of GDP in 2019. Despite this decrease, the overall rise of 0.8 percentage points of GDP between 2010 and 2019 offset the fall in other revenues. During that same period, revenues increased by 2 percentage points of GDP or more in five Latin American countries (Chile, El Salvador, Honduras, Mexico and Uruguay), and by more than 1 GDP point in four others (Colombia, Ecuador, Nicaragua and Paraguay).

Figure I.1

Latin America (16 countries):^a total central government revenues by component, 2010–2019
(Percentages of GDP)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

As figure I.2 shows, changes in total revenue are closely aligned with trends in fiscal revenues from non-renewable natural resources.¹ Total revenues in the region were severely hit by the downtrend in the prices of metals and minerals, which began in 2011, and the plunge in the price of crude oil between 2014 and 2015. Fiscal revenues from mining slumped from 1.0% of GDP in 2011 to 0.2% of GDP in 2016, before rising slightly to around 0.4% of GDP in 2019.

Revenues from hydrocarbon exploration and production plunged from 5.2% of GDP in 2011 to 2.0% in 2017 then rose slightly to 2.5% of GDP in 2019. Despite higher production levels in countries such as Brazil and Colombia, there has been a general decline in crude oil production in the region. In Mexico particularly, long one of the region's largest producers, production plummeted over the past decade.

Although information on tax revenues from the agricultural industry is not widely available, the drop in international prices has led to a decline in the profitability of this sector in producer countries and, in turn, in income tax receipts. It has also reduced export values, affecting receipts from taxes on international trade in some countries, particularly Argentina.

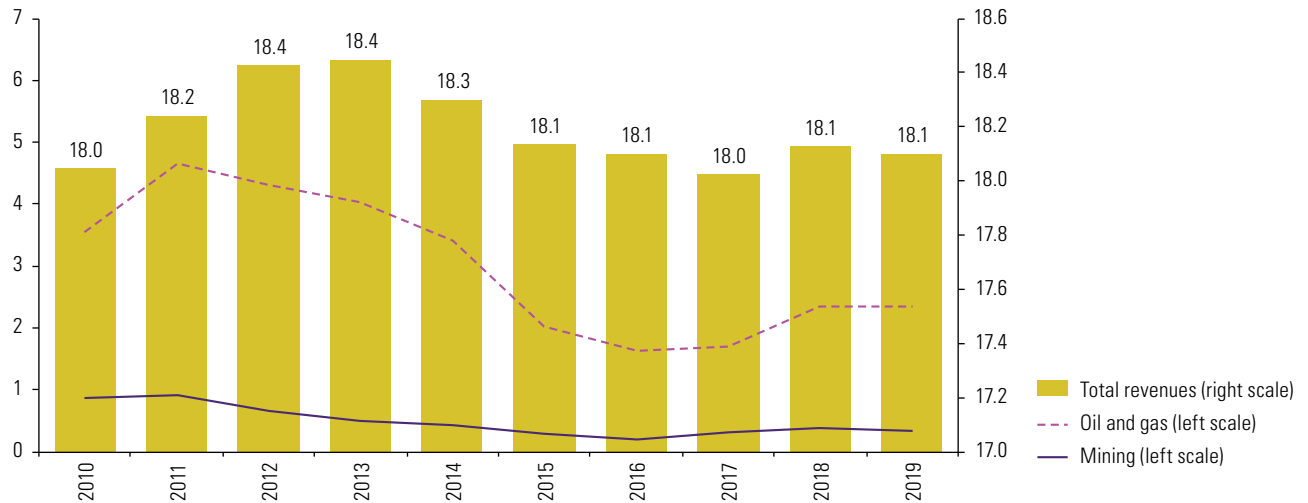
In the Caribbean, total revenues have not been immune to the difficult macroeconomic conditions that affected Latin America. However, the dynamics of public revenues in this subregion were also affected by other factors, such as large-scale natural disasters that result in significant shortfalls in tax receipts, non-recurrent foreign grants and other exceptional revenues. Despite this, total revenues have been on the rise for the past decade (see figure I.3) and represented 25.9% of GDP on average between 2010 and 2019, exceeding 27% of GDP 2018–2019.

¹ Fiscal revenues from non-renewable natural resources comprise tax revenues (for example, payment of corporate income tax) and non-tax and capital revenues (for example, royalties, dividends or profits).

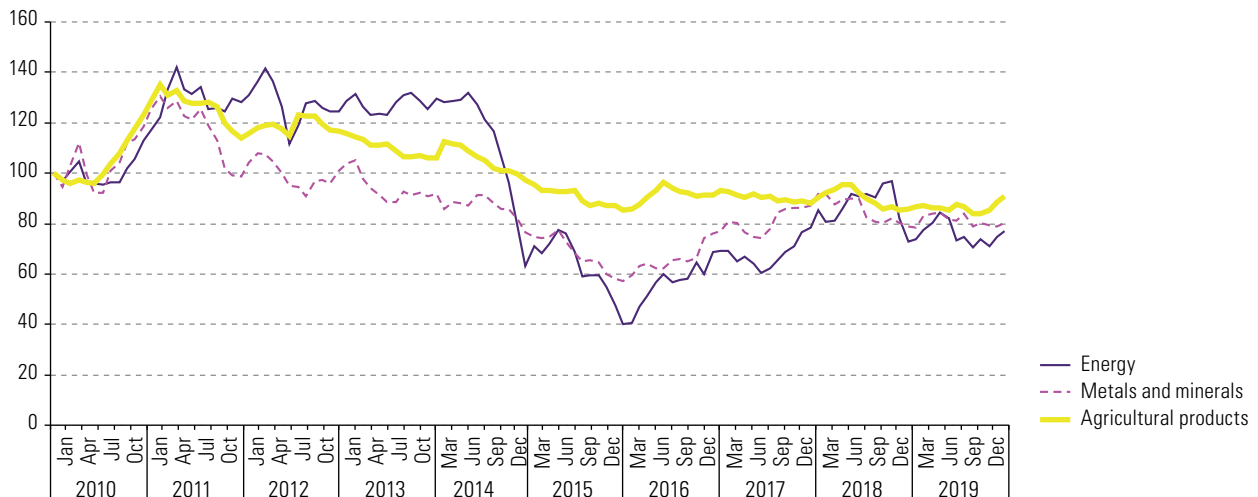
Figure I.2

Latin America (16 countries):^a total central government revenues, fiscal revenues from non-renewable natural resources and international commodity prices, 2010–2019

A. Total revenues and revenues from non-renewable natural resources
(percentages of GDP)^b



B. International commodity prices
(index: 100=average for 2010)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

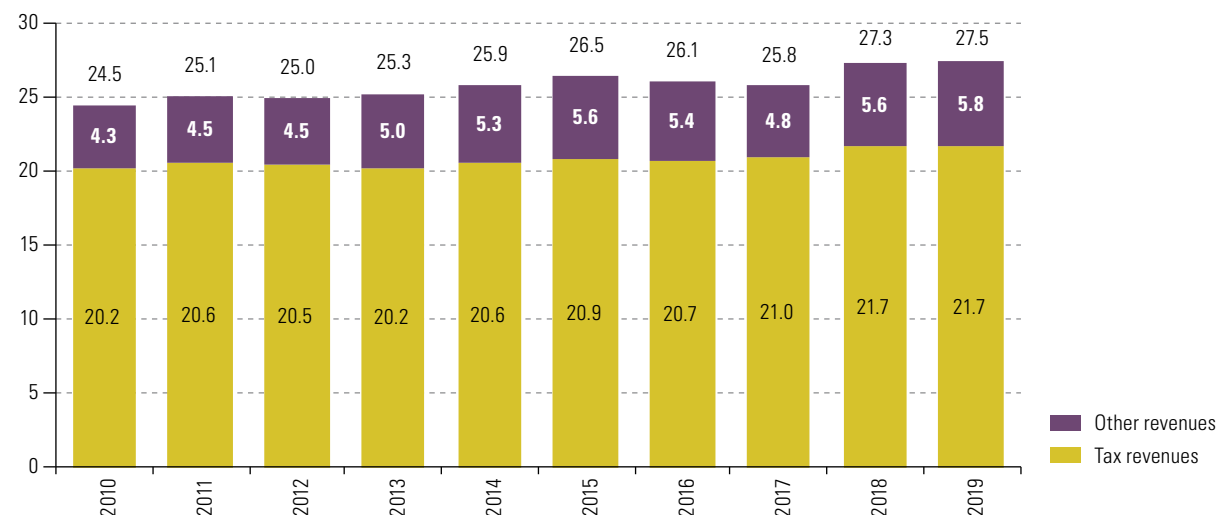
^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

^b The countries in the “mining” sample are Argentina, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Guatemala, Mexico and Peru. The countries in the “exploration and production of hydrocarbons” sample are Argentina, Brazil, Colombia, Ecuador, Guatemala, Mexico, Peru and the Plurinational State of Bolivia.

Be this as it may, the factors mentioned above have made total revenue in the Caribbean 4.5 times more volatile than in Latin America (with a coefficient of variation of 3.8%). As discussed in ECLAC (2019), non-tax revenues—including those in the “other revenues” category in figure I.3—have been particularly volatile in some countries of the Eastern Caribbean Currency Union that collect exceptional revenues from citizen-by-investment programmes. Illustrating the extent of their effects on total revenues, revenues from the programme in Saint Kitts and Nevis accounted for 15.3% of GDP in 2018, up from 5.8% of GDP in 2017, representing a 9.5 percentage point jump in only one year.

Figure I.3

The Caribbean (12 countries):^a total central government revenues by component, 2010–2019
(Percentages of GDP)



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

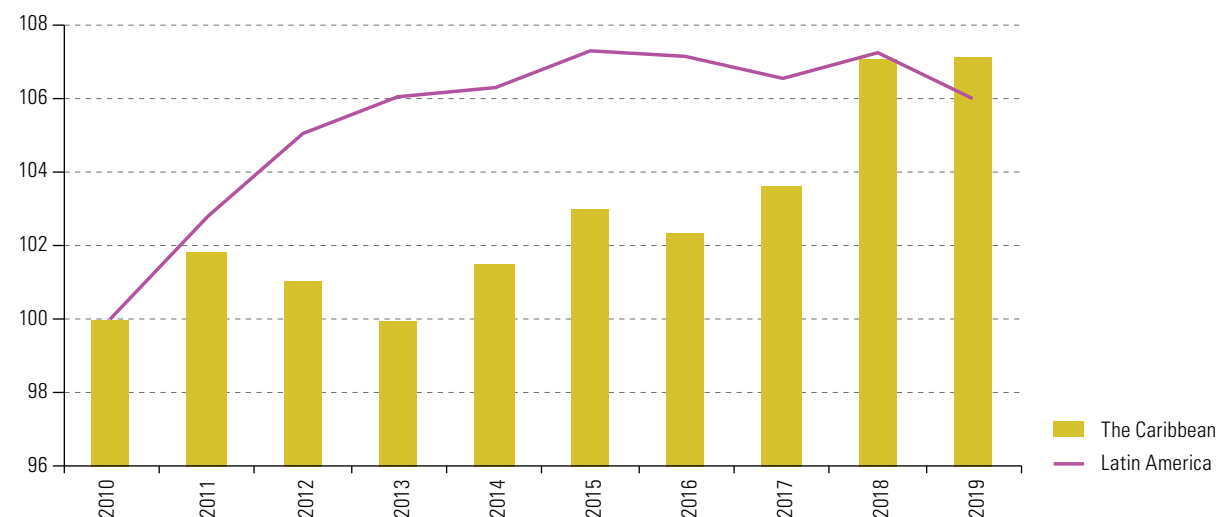
Note: Simple averages. In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

^a Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

Central government tax revenues have held relatively steady in the Caribbean for most of the decade. While some countries engaged in active tax policy measures, this practice was considerably less widespread than in Latin America in the first half of the decade. However, more countries have undertaken tax reforms in recent years, in some cases in an effort to narrow fiscal gaps. As a result, at the end of the decade, the tax ratio was 7% higher than in 2010, a roughly similar increase to that achieved in Latin America in the first half of the decade (see figure I.4). The higher tax ratio in the Caribbean was largely owed to new or amended indirect taxes, notably the adoption of value added tax in some countries and increases in specific tax rates.

Figure I.4

Latin America (16 countries)^a and the Caribbean (12 countries):^b central government tax revenues, 2010–2019
(Index: 100=level in percentages of GDP at 2010 prices)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively. In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

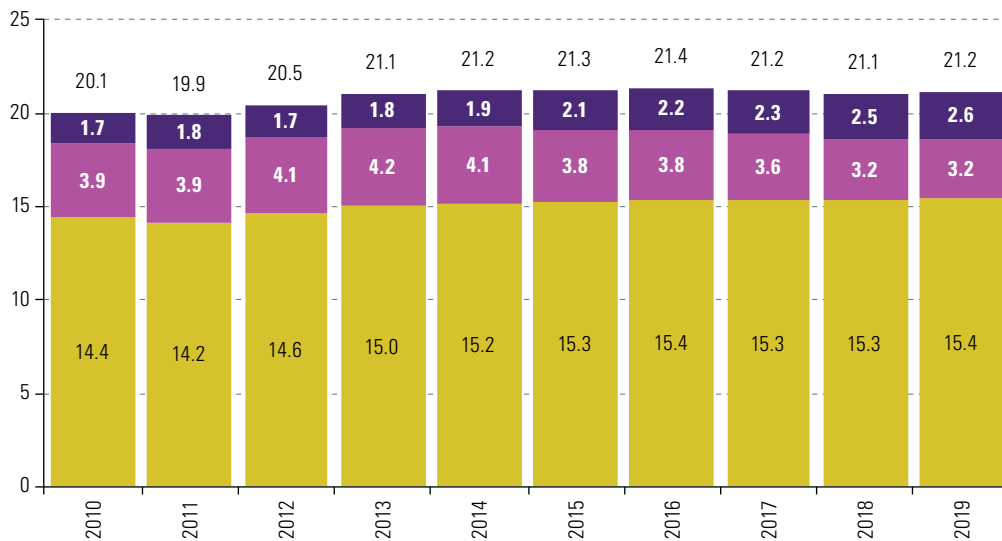
^b Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

Public spending increased in Latin America and the Caribbean over the past decade. Between 2010 and 2019, spending rose from 20.1% of GDP to 21.2% of GDP in Latin America, an increase of 1.1 percentage points (see figure I.5). Over the same period, total expenditure in the Caribbean climbed from 27.5% of GDP to 28.7% of GDP. Although the level of public spending has remained relatively stable since 2013 in both subregions, its composition has changed progressively over time.

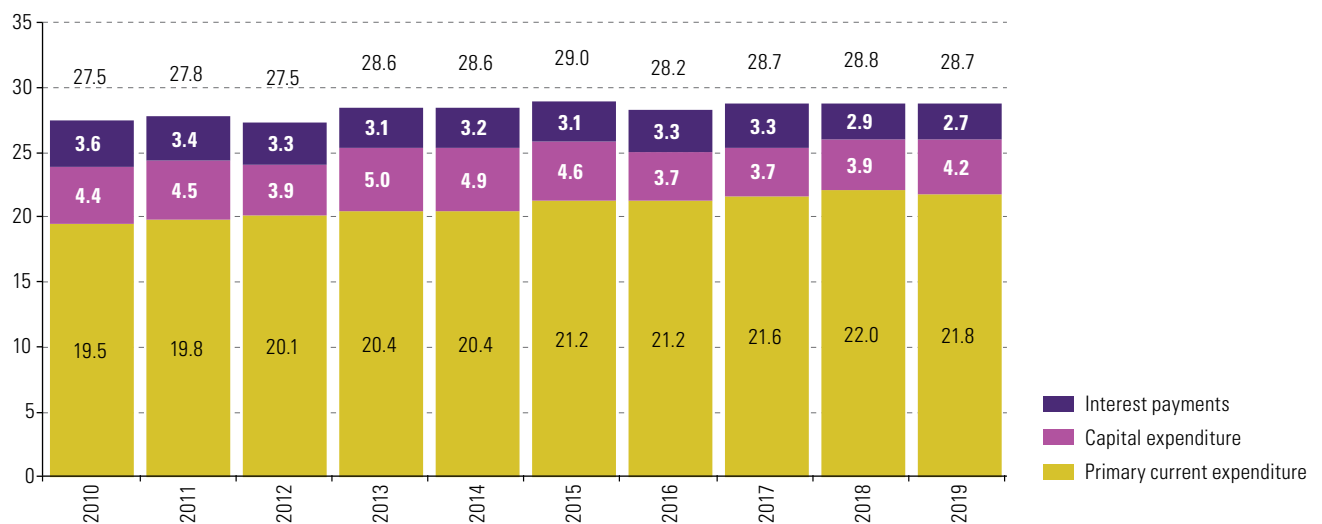
Figure I.5

Latin America (16 countries) and the Caribbean (12 countries): total central government spending by component, 2010–2019
(Percentages of GDP)

A. Latin America^a



B. The Caribbean^b



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively. In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

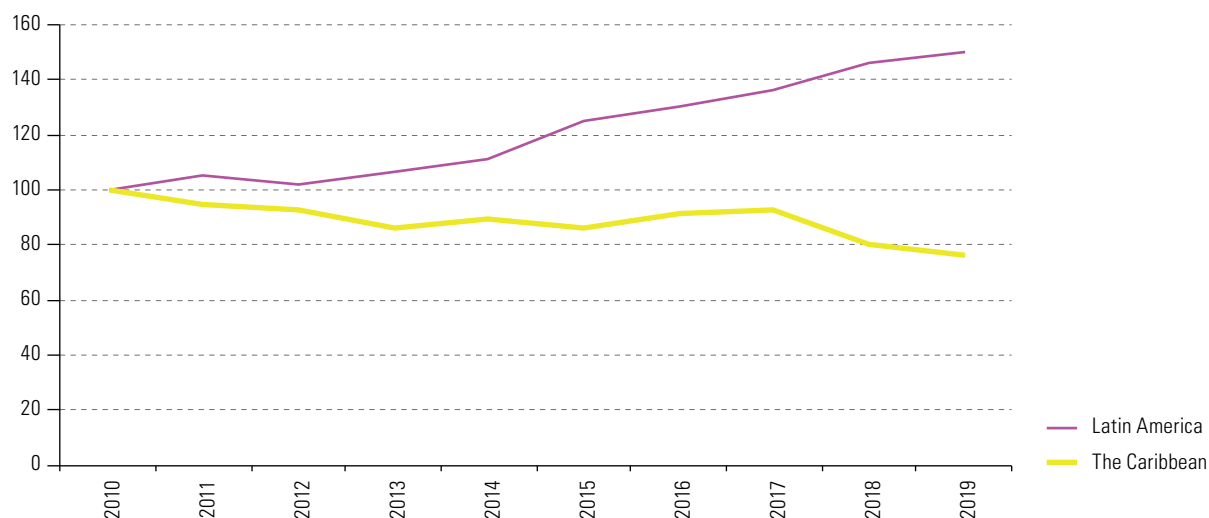
^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

^b Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

The main factor underpinning this change in composition is the level of interest payments. Consistent with rising levels of public debt, spending on interest payments in Latin America rose steadily from 1.7% of GDP in 2010 to 2.6% in 2019 (up 0.9 percentage points). In contrast, interest payments have been on the decline in the Caribbean for the past decade, falling by 0.9 percentage points from 3.6% of GDP in 2010 to 2.7% in 2019. The result is that in 2019, interest payments in Latin America were 50% higher than in 2010, while in the Caribbean, they were 24% lower in 2018 than in 2010 (see figure I.6). Caribbean countries have thus been able to direct increasing resources towards public expenditure in other areas, such as public investment and social spending.

Figure I.6

Latin America (16 countries)^a and the Caribbean (12 countries):^b central government interest payments, 2010–2019
(Index: 100=level in percentages of GDP at 2010 prices)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively. In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

^b Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

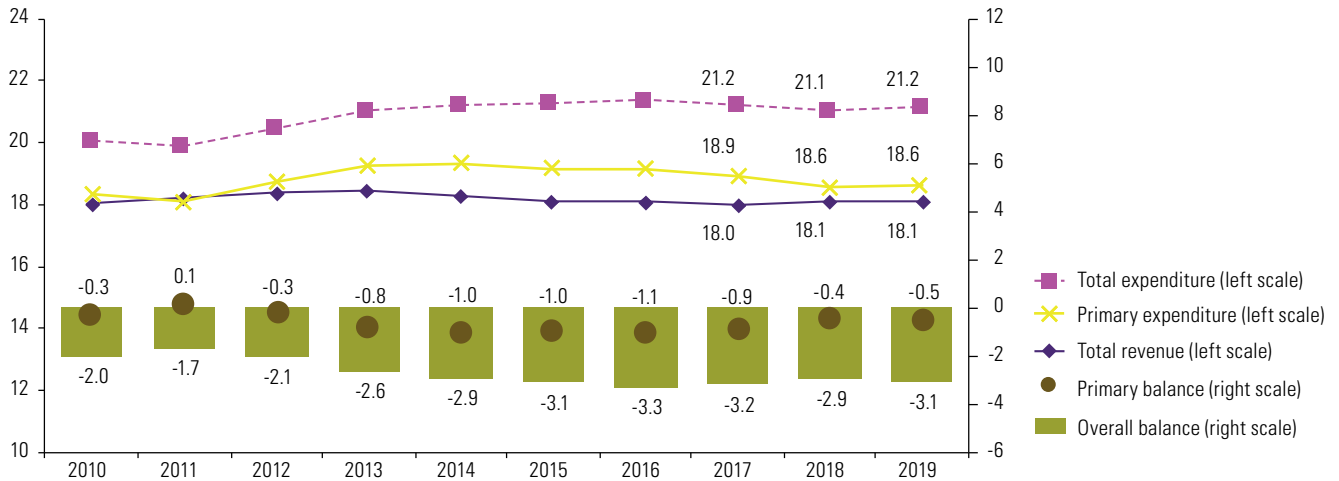
The other components of public spending have behaved somewhat differently. On the one hand, there was a notable increase in primary current expenditure in both subregions, which largely reflects the growth in social expenditure. As discussed in chapter IV, the region saw an upsurge in resources allocated to social policy, particularly since the global economic and financial crisis of 2008–2009. These amounts were not withdrawn following the crisis, as for the most part they addressed a pre-existing need for better provision of public goods and services in the region.

Conversely, capital expenditure declined to offset higher interest payments in Latin America, while it began to pick up in the Caribbean. In Latin America, capital expenditure fell from 3.9% of GDP in 2010 to 3.2% in 2019 (-0.7 percentage points). The downswing is even steeper—a round 1.0 point of GDP—when the 2019 figure is measured against the last peak of 4.2% of GDP in 2013. In the Caribbean, capital spending rose in recent years, up from 3.7% of GDP in 2017 to 4.2% in 2019, after a significant contraction between 2013 and 2016, when it tumbled from 5.0% to 3.7% of GDP.

Stagnant revenues and increased public expenditure resulted in high and persistent fiscal deficits over the last decade in Latin America. The primary balance has been running a deficit since 2012. Between 2012 and 2019, the deficit averaged -0.8% of

GDP, peaking at -1.1% of GDP in 2016, before narrowing to -0.5% of GDP in 2019 (see figure I.7). Despite this improvement, which reflected fiscal consolidation efforts in the region, the primary balance remained too low to curb the growth of public debt. Achieving such a goal will require an ever increasing primary balance as the other underlying determinants of debt dynamics, mainly the differential between interest rates and growth and exchange-rate variations, deteriorate for the region.²

Figure I.7
Latin America (16 countries):^a central government fiscal indicators, 2010–2019
(Percentages of GDP)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

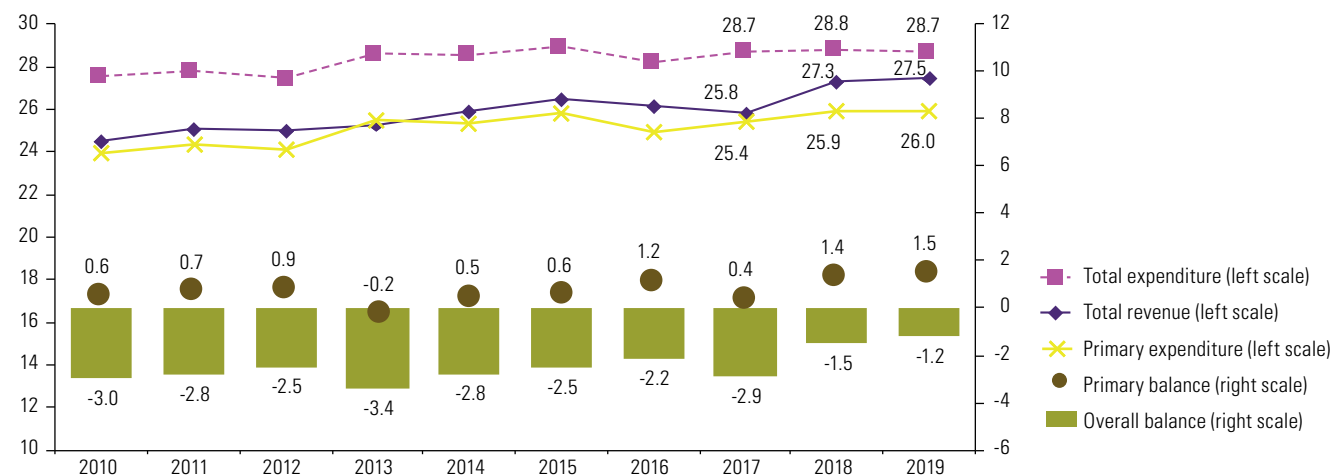
At the same time, the overall fiscal deficit widened significantly, averaging 2.9% of GDP between 2012 and 2019, during which period it varied little, reflecting the challenge of boosting revenues while reducing the level of total public spending amid a steady increase in interest payments. Persistently high overall deficits entail large net financing requirements and this increases countries' vulnerability to financial market conditions, especially in periods of high volatility. In addition, aggregate net financing can also mask substantial gross financing risks, as a year-on-year increase in debt servicing costs could curtail the resources available for financing the overall deficit.

The Caribbean also recorded a deficit in the overall balance over the last decade, although at levels that have varied significantly over the years. Between 2010 and 2019, the deficit averaged -2.5% of GDP, reaching a peak of -3.4% of GDP in 2013 (see figure I.8). The primary balance generally remained in surplus, averaging 0.8% of GDP, as countries implemented fiscal adjustment programmes to tackle high debt levels. Notably, some countries posted significant primary surpluses: Barbados (6.5% of GDP in 2019), Grenada (6.8% of GDP), Jamaica (6.5% of GDP) and Saint Kitts and Nevis (6.0% of GDP).

² If the differential is positive, a primary fiscal surplus is necessary to stabilize or reduce the debt-to-GDP ratio. The higher the initial debt level, the greater the primary surplus required.

Figure I.8The Caribbean (12 countries):^a central government fiscal indicators, 2010–2019

(Percentages of GDP)



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

Note: Simple averages. In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

^a Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

Cumulative fiscal deficits over the past decade resulted in a concomitant increase in public debt levels in Latin America. After narrowing slightly between 2010 and 2011, gross central government public debt in the subregion grew steadily from 29.8% of GDP in 2011 to 45.2% in 2019 (see figure I.9). In the last five years, the debt-to-GDP ratio accelerated pace, as reflected in the annual average growth rate of 2.3 percentage points of GDP between 2015 and 2019, compared with 0.8 GDP points between 2010 and 2014. The average uptrend in debt in the subregion reflects the situation in Argentina, Costa Rica, Ecuador, Brazil, Chile and Honduras, where levels increased by between 16.0 and 50.5 percentage points of GDP between 2011 and 2019.

In the Caribbean, gross central government debt remained relatively stable between 2010 and 2019, edging up from 67.4% of GDP to 68.5% of GDP. This is attributable to the significant efforts that the countries of this subregion have made over the past two years to rein in rising debt, which translated into a 4.3 percentage point contraction in debt between 2017 and 2019. However positive, this should not mask the Caribbean's rather weak fiscal position, as its debt levels are higher than those seen in Latin America. The situation varies greatly from one country to another, however. Between 2010 and 2019, debt levels fell in five countries, with the largest decline (50.9 percentage points of GDP) occurring in Saint Kitts and Nevis. In contrast, the debt-to-GDP ratio rose in eight countries. The largest increase occurred in Suriname, where the ratio jumped by 47.7 percentage points of GDP, followed by Barbados, with an increase of nearly 30 percentage points; in the Bahamas, Trinidad and Tobago and Belize, debt as a proportion grew by approximately 22 GDP points (see figure I.10).

A. Average of gross central government public debt (percentages of GDP)

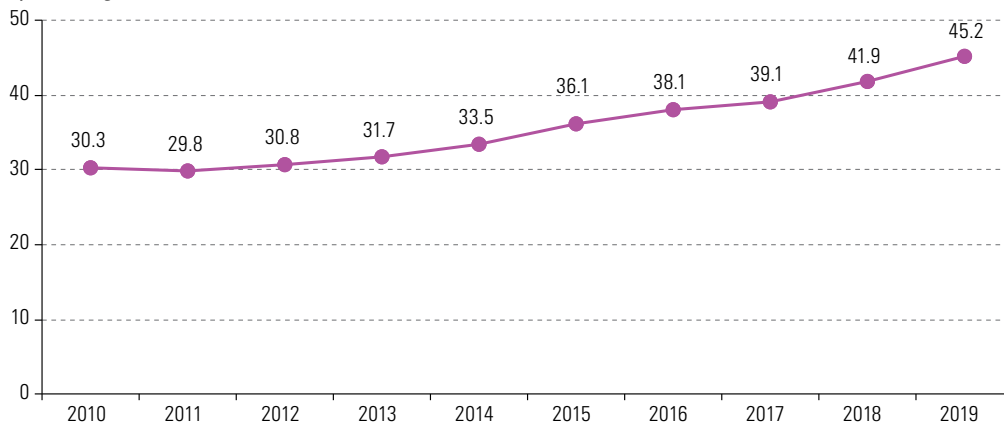
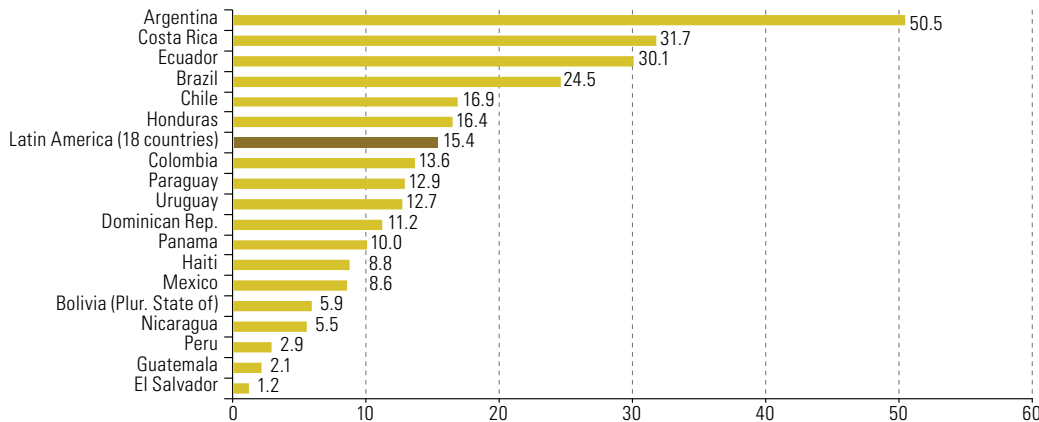


Figure I.9
Latin America (18 countries):^a gross central government public debt, 2010–2019

B. Change in central government gross public debt, 2011–2019 (percentage points of GDP)



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

Note: Figures for Guatemala refer to the third quarter of 2019 and figures for Nicaragua refer to the first quarter of 2019, while those for Haiti refer to the second quarter of 2018.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

A. Average of gross central government public debt (percentages of GDP)

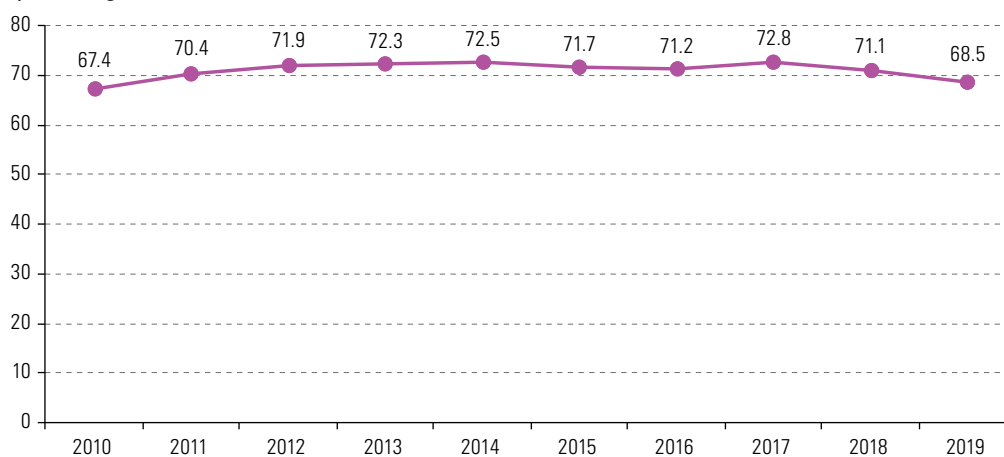
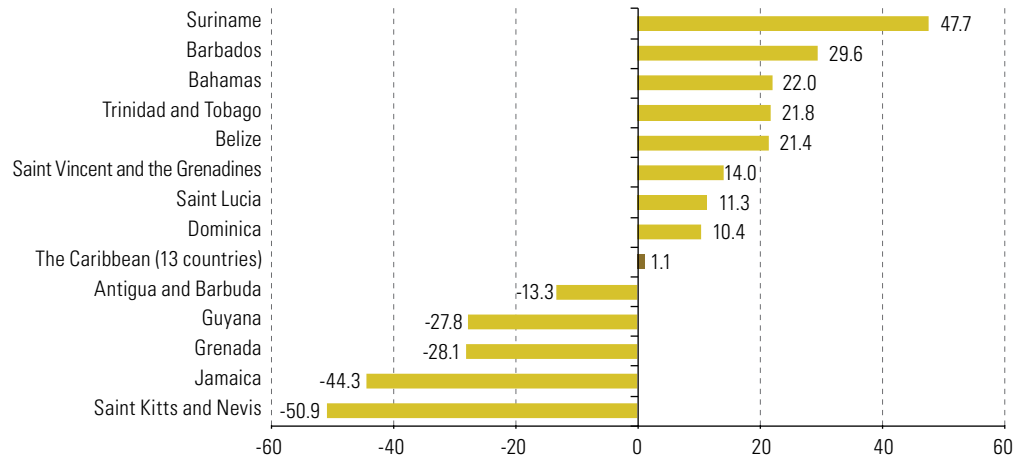


Figure I.10
The Caribbean (13 countries):^a gross central government public debt, 2010–2019

Figure I.10 (concluded)

B. Change in gross central government public debt (percentages of GDP)



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

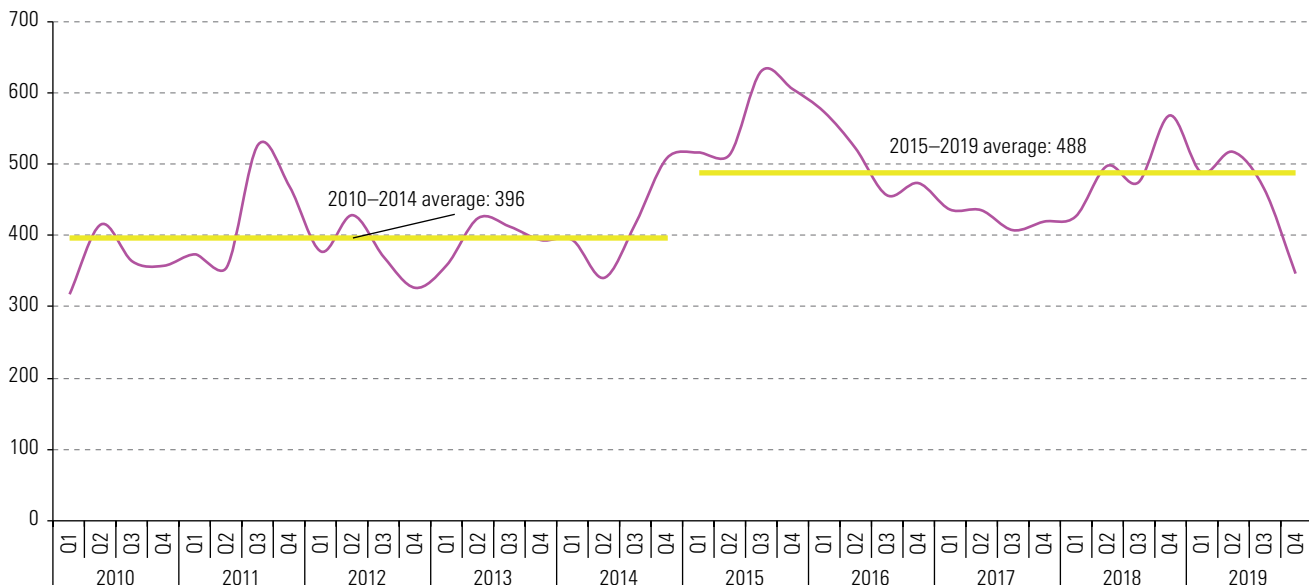
Note: Figures for 2019 period include up to the third quarter.

^a Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

In the light of a general deterioration in the primary and overall balances and an increase in debt levels in Latin America, as well as sharp volatility in international financial markets, risk premiums, measured by the Emerging Markets Bond Index (EMBI Global), fluctuated in the period 2010–2019, with an overall upward trend. In Latin America, the regional average for 2010–2014 was 396 basis points, compared to 488 basis points for 2015–2019 (see figure I.11). These conditions led to an increase in the cost of debt, reflected in interest payments, which rose from 1.7% of GDP in 2010 to 2.6% of GDP in 2019. EMBI Global for Latin America improved in the second half of 2019, with a reduction of 119 basis points compared to the end of the first half of the year. As will be discussed in this report, this improvement allowed certain countries to issue sovereign bonds in international financial markets at attractive rates during this period. However, this window of opportunity was short-lived, as EMBI Global picked up from January 2020.

Figure I.11

Latin America: Emerging Market Bond Index (EMBI Global) yield spread, 2010–2019
(Basis points)



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

B. Fiscal policy responses to address the crisis arising from the coronavirus disease (COVID-19) pandemic

Despite the adverse developments in the fiscal context described above, the countries of the region have announced major fiscal packages to deal with the crisis arising from the coronavirus disease (COVID-19) pandemic. The scale and scope of these measures depend on the specific situation in each country in terms of the progress of the pandemic, the capacities of health systems and social safety nets, the fiscal position and the structure of the economy. Therefore, it is important to examine the fiscal instruments related to public spending, tax revenues and liquidity provision, in addition to the heterogeneous effect these packages of measures will have on public accounts, and especially on the level of total revenue and spending.

The public spending measures included in these packages represent both budgetary reallocations and exceptional budgetary spending financed with new resources (see table I.1). An increase in total public spending can have an impact on the level of public revenue, depending on the source of funding. If increased spending is accompanied by new taxes or changes in current rates, revenues could increase. However, in the case of borrowing, the change in the level of expenditure does not lead to a change in revenues collected in the short term.

Table I.1

Impact of fiscal packages to address the coronavirus disease (COVID-19) pandemic on public revenue and spending

Fiscal policy tool	Modality	Impact on short-term public accounts	
		Revenue	Spending
Public spending	Budget reallocation	No	No
	Exceptional budgetary spending	Yes, if financed by new taxes or fees No, if financed by debt	Yes, increase
Public revenue	Tax relief (lost revenue)	Yes, reduction	No
Government-backed liquidity support ^a	State credit guarantees	No	No
	Government lending to the private sector (policy lending)	No	No
	Capitalization of funds or public financial institutions	No	No

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *Government Finance Statistics Manual 2014*, Washington, D.C., 2014.

^a Public sector financial transactions are usually classified as “below-the-line” and do not correspond to public spending. In this sense, government lending to the private sector—usually defined as policy lending—represents an asset purchase by the public sector (IMF, 2014, pp. 72–73). Capitalization, or capital injection into a public entity, is considered a financial transaction to the extent that the transaction does not represent a subsidy to cover recurrent losses (in this case, the transaction would be classified as a public expense) (IMF, 2014, pp. 132–133). Finally, State credit guarantees generate contingent liabilities, which could be converted to public expenditure in certain situations; in this case, when the beneficiary fails to meet financial obligations (IMF, 2014, p. 76).

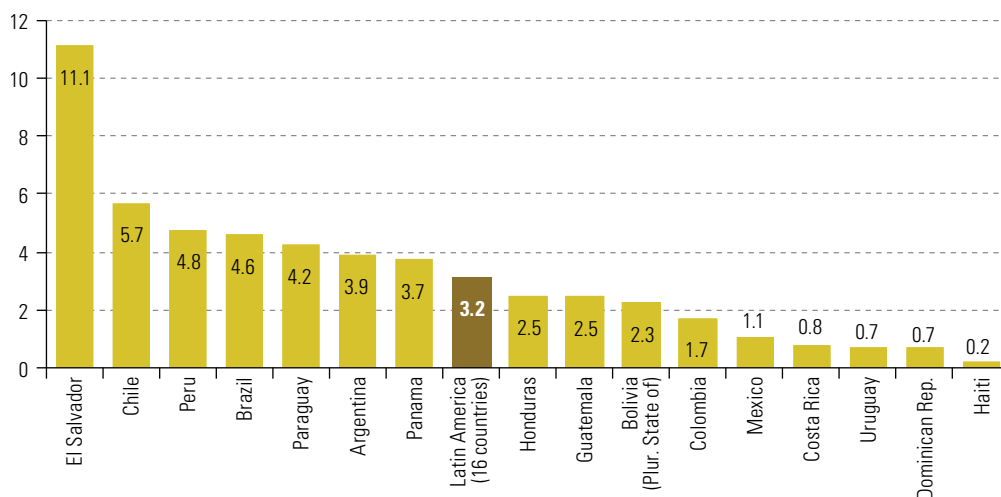
Meanwhile, on the revenue side, the main policy measure announced involves temporary amendments to the tax code to provide tax relief to taxpayers, which represents tax revenue foregone by the treasury and is not budgetary expenditure.³ Finally, government-backed liquidity measures have included the provision of credit guarantees, loans to the private sector and the capitalization of funds and public financial institutions. These measures, which consist of “below-the-line” transactions that change the composition of the public sector’s balance sheet or generate contingent liabilities, do not generally give rise to short-term public expenditure (see table I.1). However,

³ Tax expenditures, such as exemptions, deductions, credits, reduced rates and deferrals, can be considered indirect means of expenditure incurred through the tax system. See chapter IV of ECLAC (2019) for more information.

these measures may create fiscal risks if the future obligations generated become public expenditure in the event that beneficiaries fail to pay their financial liabilities.⁴

It is important to gauge the fiscal effort of the measures included in the packages that governments have announced to address the COVID-19 pandemic and the resulting economic crisis. This effort derives from spending measures—reallocations and exceptional expenses—and from tax relief and liquidity measures (except State guarantees). As figure I.12 illustrates, this fiscal effort represents, on average, 3.2% of the 2019 GDP of the Latin American countries represented in the region as of 20 May 2020. The coverage of these packages ranges widely in the different countries, from 0.2% to over 10% of GDP (see figure I.12).⁵ These figures correspond to announced measures that have been approved or are in the process of being approved; therefore discrepancies could arise with respect to eventual budget execution.

Figure I.12
Latin America
(16 countries): fiscal
effort of measures
announced to address
the coronavirus disease
(COVID-19) pandemic^a
(Percentages of GDP)



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

^a This effort derives from spending measures—reallocations and exceptional expenses—, tax relief and liquidity measures (except State guarantees). Corresponds to announced measures that have been approved or are in the process of being approved; therefore discrepancies could arise with respect to eventual budget execution.

In addition, several countries made government guarantees available to the private sector to support its borrowing capacity. In Chile, the Ministry of Finance announced an expansion of the Small Business Guarantee Fund (FOGAPE) with additional contributions of up to US\$ 3 billion (equivalent to 1.2% of GDP), which will enable the provision of credit guarantees of up to US\$ 24 billion (equivalent to 10% of GDP). In Peru, the central bank injected 60 billion soles (equivalent to 8% of GDP) of capital into private banks to increase credit lines to micro-, small and medium-sized enterprises (MSMEs), and the treasury provided guarantees to the banks for the loans granted. In Colombia, the government created three new lines of credit in the National Guarantee Fund for MSMEs and independent workers representing a total of 16 billion pesos (equivalent to 1.5% of GDP). Paraguay and Uruguay implemented additional capitalization to guarantee funds, bringing their available credit lines to 1.3% of GDP and 4.5% of GDP, respectively. Similarly, the Government of Argentina created a Specific Allocation Fund of 30 billion pesos that the State will transfer to the Argentine Guarantee Fund, increasing its available capital to 91.92 billion pesos (equivalent to 0.4% of GDP).

⁴ For more information, see IMF (2014).

⁵ In the case of El Salvador, the Legislative Assembly approved Decree No. 608 (26 March 2020) and Decree No. 640 (5 May 2020), thereby providing US\$ 3 billion through two trusts to finance the emergency plan prepared by the executive branch in response to the COVID-19 pandemic. In accordance with the above-mentioned decrees, resources will come from external sources of financing, whether from international capital markets or international financial institutions.

In the Caribbean, 11 countries are pursuing significant fiscal measures in response to the COVID-19 pandemic, despite their limited fiscal space. The average for the 11 countries for which information is available is 2.3% of GDP. These include Antigua and Barbuda, Saint Kitts and Nevis and Saint Vincent and the Grenadines, whose fiscal packages account for at least 4 points of GDP (see figure I.13).

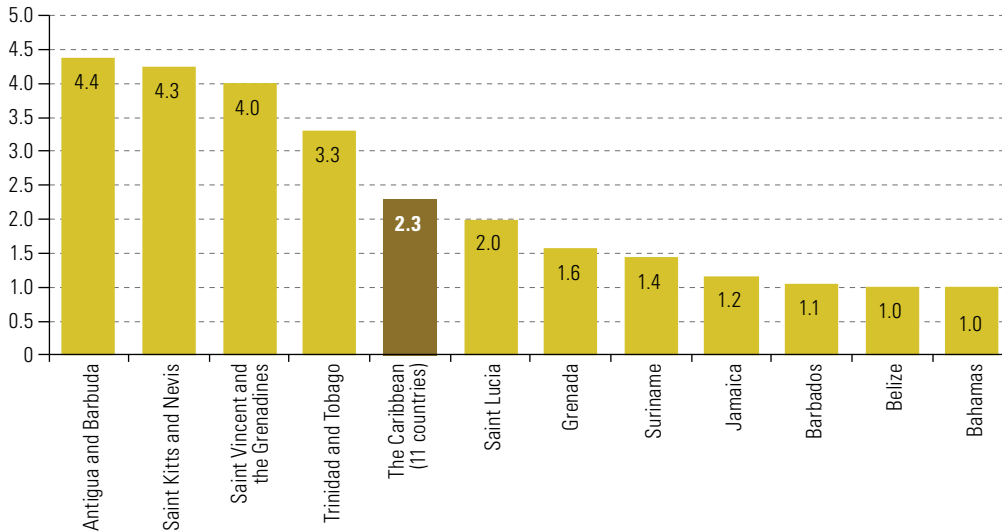


Figure I.13
The Caribbean (11 countries): fiscal effort of measures announced to address the coronavirus disease (COVID-19) pandemic^a
(Percentages of GDP)

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

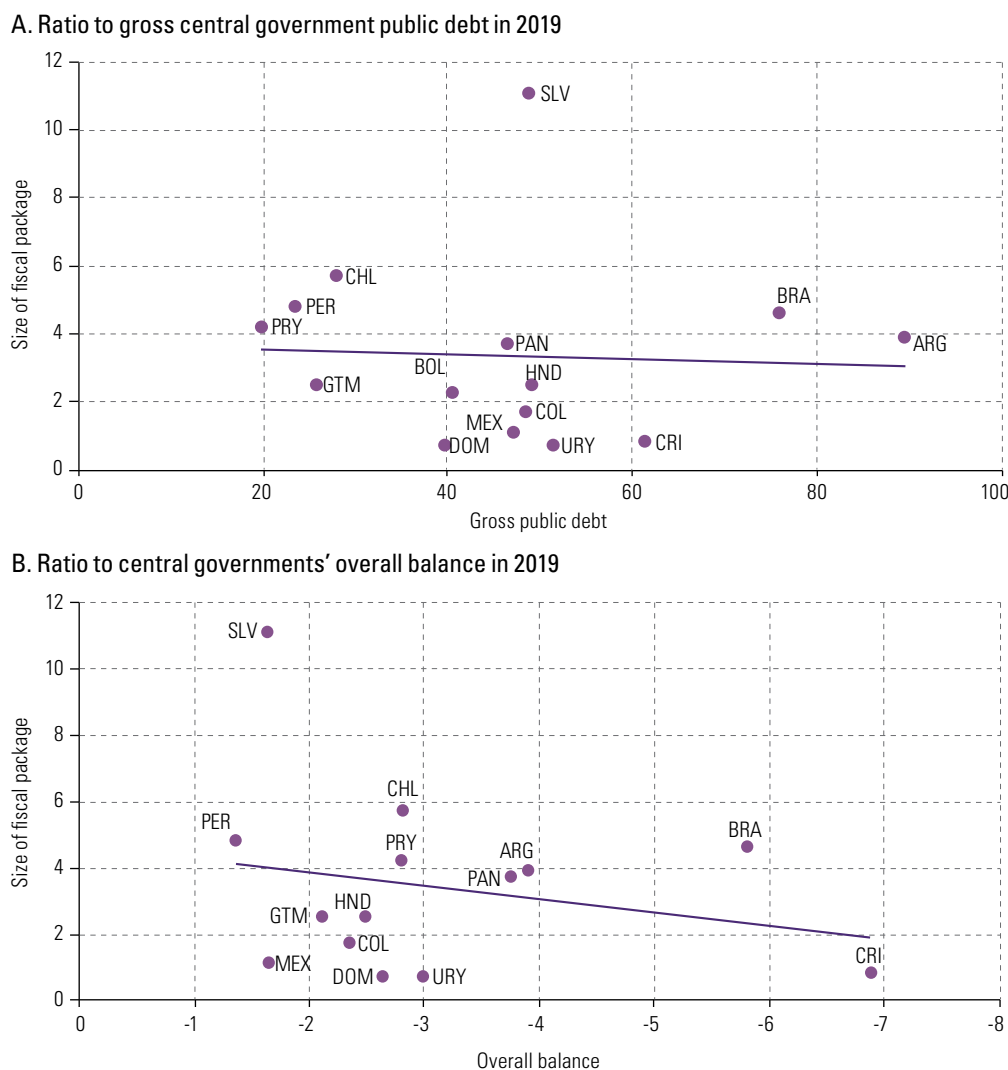
^a This effort derives from spending measures—reallocations and exceptional expenses—, tax relief and liquidity measures (except State guarantees). Corresponds to announced measures that have been approved or are in the process of being approved; therefore discrepancies could arise with respect to eventual budget execution..

As noted earlier, the heterogeneity of fiscal package sizes stems from a multitude of structural and contemporary factors specific to each country. However, one constraint is the fiscal space that each country has to pursue policies to address the crisis. Two important factors affecting fiscal space are the level of public debt and the overall balance of central government operations. As figure I.14 suggests, countries with lower public debt or fiscal deficits have generally been able to make greater fiscal efforts than countries in the opposite situation. However, this is not necessarily the deciding factor. For example, Brazil has adopted a large package of fiscal measures, despite its level of indebtedness and its overall balance, reflecting in part its ability to mobilize resources through the domestic financial market.

The tax packages announced in the region are interesting both in their similarities and in their different formulations. While the main objectives of such measures are aligned across countries—strengthening health systems, supporting vulnerable households and providing liquidity to support businesses—the specific tools employed often vary considerably in terms of scope and magnitude. There follows an analysis of the public spending and tax policy measures the countries in the region have adopted to deal with the COVID-19 pandemic.⁶

⁶ The information presented in this section corresponds to the measures announced or adopted up to 20 May 2020.

Figure I.14
Latin America (selected countries): ratio of fiscal packages announced to address COVID-19 to gross public debt and to central governments' overall balance in 2019^a (Percentages of GDP)



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

^a This effort derives from spending measures—reallocations and exceptional expenses—, tax relief and liquidity measures (except State guarantees). Corresponds to announced measures that have been approved or are in the process of being approved; therefore discrepancies could arise with respect to eventual budget execution.

1. Government-backed public spending and liquidity support policies

As seen in table I.2, 19 Latin American and Caribbean countries have decided to strengthen their health systems by increasing health-sector budget allocations, investing in health infrastructure, purchasing medical inputs and hiring additional staff. Many countries (20) have also implemented credit lines or subsidies for businesses, in order to sustain their cash flow and prevent possible layoffs and bankruptcies, with an emphasis on MSMEs. In addition, eight countries extended or created secured credit lines (see table I.2).

With regard to income protection for the most affected households, 19 countries in the region have announced cash transfers for workers who experience a partial or complete cessation of their activity. Secondly, they have focused on groups considered vulnerable because of their lower income brackets. The instruments targeting these groups, recorded in 17 countries, include unconditional transfers, such as exceptional and temporary grants, or the increase of subsidies from existing social programmes. Thirdly,

there has also been a focus on access to basic goods and services, as 11 countries have adopted specific measures aimed at direct delivery or subsidization of food baskets and other services, such as electricity and water. Finally, large infrastructure projects have been reactivated in Argentina, Barbados, El Salvador, Grenada, Guatemala and Mexico, with the aim of sustaining investment and activity in the medium term. In four of them, measures were also taken to protect access to housing (see table I.2).

Table I.2

Latin America and the Caribbean (28 countries): government-backed spending and liquidity support instruments in response to the coronavirus disease (COVID-19) pandemic

Strengthening the health system	Sustaining business sector liquidity			Protecting household income and well-being					Supporting economic activity	
	Lines of credit		State guarantees	Employment	Pensions	Consumption	Vulnerable groups	Other	Investment in infrastructure	Housing
	Total	Micro-, small- and medium-sized enterprises								
Bahamas	Argentina	Bahamas	Argentina	Argentina	Argentina	Argentina	Argentina	Argentina	Argentina	Antigua and Barbuda
Barbados	Bolivia	Bolivia	Bahamas	Bahamas	Bolivia	Bahamas	Bolivia	Bolivia	Barbados	Argentina
Brazil	Plurinational State of	Plurinational State of	Chile	Barbados	Plurinational State of	Bolivia (Plurinational State of)	Plurinational State of	Plurinational State of	El Salvador	Grenada
Chile	Brazil	Brazil	Colombia	Bolivia (Plurinational State of)	Brazil	Brazil	Brazil		Guatemala	Guatemala
Colombia	Colombia	Chile	Mexico	Plurinational State of	Mexico	Chile	Chile		Mexico	Mexico
Ecuador	Ecuador	Ecuador	Paraguay	Peru		El Salvador	Colombia			
El Salvador	Guatemala	El Salvador	Uruguay	Chile		Guatemala	Costa Rica			
Grenada	Jamaica	Grenada		Colombia		Honduras	Ecuador			
Guatemala	Saint Lucia	Guatemala		Costa Rica		Panama	El Salvador			
Haiti		Honduras		Cuba		Paraguay	Grenada			
Honduras		Jamaica		El Salvador		Dominican Republic	Guatemala			
Mexico		Mexico		Grenada		Uruguay	Haiti			
Panama		Panama		Haiti			Honduras			
Paraguay		Paraguay		Jamaica			Jamaica			
Peru		Peru		Mexico			Mexico			
Saint Kitts and Nevis		Trinidad and Tobago		Paraguay			Panama			
Saint Vincent and the Grenadines		Uruguay		Dominican Republic			Paraguay			
Suriname				Saint Lucia			Uruguay			
Trinidad and Tobago				Trinidad and Tobago						
				Uruguay						

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

(a) Addressing the health crisis

Faced with the rapid progression of the pandemic in some countries, and the resulting pressure on health systems, several countries in the region have decided to increase budgetary contributions to the health sector in order to safeguard its capacity to provide care. Pledged resources have been channelled mainly towards the acquisition of material and human inputs. In Paraguay, the emergency law adopted at the end of March authorized the Ministry of Finance to make the necessary budgetary adjustments to allocate an amount equivalent to 1.3% of 2019 GDP to the Ministry of Public Health and Social Welfare. Similarly, Antigua and Barbuda, the Bahamas, Barbados, Chile, Peru, Saint Kitts and Nevis and Uruguay, among others, proposed a net increase in the health sector budget line. In the case of Uruguay, the additional budgetary contribution included the creation of shelters for homeless persons.

Some countries took advantage of existing financial funds or created new funds to channel resources to the health system. These include the Emergency Prevention and Assistance Fund in Mexico, through which the federal government channelled additional resources of up to 180.733 billion Mexican pesos (about US\$ 7.7 billion, or 0.7% of 2019 GDP). In Colombia, the Emergency Mitigation Fund (FOME) was created with 14.8 billion pesos (1.4% of 2019 GDP) financed with resources from the Savings and Stabilization Fund (FAE) and the National Pension Fund of Territorial Entities (FONPET).

In Brazil, the balance of the fund for compulsory insurance for traffic accidents was allocated to the country's Single Health System. Guatemala reformed its emergency fund to allow the State to tackle the COVID-19 pandemic. This fund was initially created as a response mechanism to address the effects of natural phenomena, to authorize the purchase of emergency goods and services.

Intergovernmental transfers were also implemented in the region to mobilize resources for subnational governments, which are often on the front line of the fight against COVID-19. For example, in Brazil, transfers to states and municipalities equivalent to 1.1% of 2019 GDP were announced, to strengthen the health-care network at the local level. This measure was complemented by the discontinuation of debt payments by subnational governments to the federal government, which was expected to free up 12.6 billion reais (0.2% of 2019 GDP). The federal government of Mexico announced an advance on transfers to subnational governments to provide them with the necessary liquidity to address the social and health emergency, while in Argentina the Provincial Financial Emergency Programme was created to allocate resources totalling 120 billion Argentine pesos (0.6% of 2019 GDP) from the National Treasury Contribution Fund and the Provincial Development Trust Fund.

Governments in the region have also invested in physical health infrastructure to increase the capacity of existing health networks. Mexico launched the Strategic Plan for COVID-19 Care, which defined a network of 70 reference hospitals to care for patients and 20 additional converted hospitals, where care will be concentrated in the critical stage. In El Salvador, the Minister of Public Works and Transport announced the construction of a hospital to care for up to 1,200 patients affected by coronavirus. Financing for this work and the hospital's equipment—equivalent to 0.3% of 2019 GDP—comes from contributions from the Salvadoran Social Security Institute (ISSS), Japanese cooperation and the Civil Protection and Disaster Prevention and Mitigation Fund (FOPROMID).

(b) Protecting household income and well-being

With regard to income protection for those who could be most affected by the pandemic and by confinement measures, a significant number of the region's countries released additional funds to strengthen social safety nets, in order to increase both coverage and the amount of benefits granted. A large number of unconditional transfers were made to sectors identified as vulnerable, either because of income levels or labour informality.

In the same vein, exceptional and temporary grants of between US\$ 40 and US\$ 345 per month were created for the most vulnerable households in Argentina, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Panama, Peru and the Plurinational State of Bolivia, to sustain the income of families in the lowest income brackets. These measures are expected to benefit nearly 940,000 people in Chile, 3 million families in Colombia, nearly 400,000 families in Costa Rica and Ecuador, and 1.5 million families in El Salvador. In Guatemala, the 1,000 quetzal (US\$ 126) grant for the most financially affected families is administered by the recently created Bono Familia fund, whose resources amount to 6 billion quetzals (1% of 2019 GDP). In Argentina and the Plurinational State of Bolivia, the grant is based on the number of children in school, and amounts to US\$ 47 and US\$ 72 per child, respectively.

Other countries, such as Brazil, Colombia, the Dominican Republic, Paraguay and Uruguay, have strengthened existing social programmes. Brazil, for example, approved an extension of the Bolsa Família programme by 3.1 billion reais (US\$ 620 million), while Colombia is seeking to increase the number of beneficiaries of the main conditional cash transfer programme, Familias en Acción. In Paraguay, US\$ 300 million will be

allocated to workers and US\$ 33 million to strengthen the Tekoporā and Maintenance for Older Persons Living in Poverty social programmes. Uruguay allocated additional resources to strengthen the programmes of the National Food Institute (INDA) and to double the amounts of the Uruguay Social Card (TUS). The Quédate en Casa programme was launched in the Dominican Republic, increasing the number of families covered by the existing Comer es Primero programme and creating a special grant of 5,000 Dominican pesos for a period of two months.

Some countries have focused on pension systems for retirees, either by increasing income or payment accommodations, or by advancing the payment of pensions. In the Plurinational State of Bolivia, facilities were put in place for the collection of the Renta Dignidad, allowing the relatives of retirees, for example, to withdraw the payment from the corresponding payment centres. Brazil arranged the advance payment of the second instalment of the thirteenth salary for retirees and pensioners registered with the National Social Security Institute (INSS) for the month of May. Similarly, Mexico will allocate 21 billion Mexican pesos (0.1% of 2019 GDP) to advance pension payments, while Ecuador has announced soft loans for older persons through the Bank of the Ecuadorian Social Security Institute (BIESS). Argentina and Paraguay have decided to increase the income of pensioners, which, in Argentina, takes the form of a supplementary and temporary grant to raise the monthly income to US\$ 296.

As for the impact of the COVID-19 pandemic on workers' incomes, several countries have created programmes to ensure minimum incomes for workers and households. Some countries have implemented exceptional grant programmes for informal workers, own-account workers and employees of MSMEs, which beneficiaries can access directly. The monetary value and duration of the programmes vary from one country to the next. Table I.3 shows four selected cases (Argentina, Brazil, Costa Rica and Paraguay). In Chile, parliament is moving towards approving a monthly benefit for independent workers experiencing a decline in income. According to the bill, independent workers may apply for up to three payments over a period of nine months.

Table I.3
Latin America (4 countries): exceptional benefit programmes, 2020

Country	Name of the programme	Beneficiaries	Amount of benefit
Argentina	Emergency Family Income (IFE)	Workers, those paying into a simplified tax regime for small taxpayers ("monotributistas sociales"), those in taxpayer categories A and B, domestic staff, recipients of the Universal Child Allowance (AUH) or Universal Pregnancy Allowance (AUE), or beneficiaries of the Progresar programme aged 18 to 65 years who do not have income of any kind, whether they are self-employed or recipients of state transfers	10,000 Argentinean pesos (US\$ 157) per month for two months
Brazil	Emergency Aid (Auxílio Emergencial)	Informal workers, unemployed persons and individual micro-entrepreneurs in low-income families	600 reais (US\$ 120) for three months
Costa Rica	The Proteger benefit (Bono Proteger)	Workers who have been furloughed or have reduced working hours, with gross monthly income of less than US\$ 1,300	Between 62,500 and 125,000 colones (US\$ 110 and \$220, respectively) per month for three months, depending on the worker's employment situation
Paraguay	Pytyvõ Programme	Self-employed persons or employees of micro-, small and medium-sized enterprises that do not pay social security contributions or are not retired or pensioners	25% of the prevailing minimum wage, i.e. 548,210 guaraníes (US\$ 84) per month for two months

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

Electronic means—often specially developed websites—have been established for beneficiaries to register for these programmes. This is not only a response to restrictions on movement that form part of public health measures, but also a reflection of the need to reach potential beneficiaries who have limited links with the tax system or are not registered with other social programmes. In Paraguay, the government has launched a smartphone app, providing access to the procedures and services of the Pytyvõ Programme.

For the private sector, countries have implemented various measures to support workers' incomes. Some countries have established benefits and subsidies that companies request on behalf of their employees. The Formal Employment Support Programme (PAEF) in Colombia consists of a monthly benefit per employee equivalent to 40% of the minimum wage (351,000 pesos) for companies that can provide proof of a loss of 20% of their revenue between February and March 2020. In Guatemala, a financial subsidy was established for private sector workers who have been furloughed owing to the pandemic. That benefit, of 75 quetzales per day (US\$ 10), must be requested by firms, which must meet certain requirements established by the programme. In a similar vein, the Dominican Republic launched the Employee Solidarity Assistance Fund (FASE) to provide temporary support to formal workers in the sectors most affected by the crisis. Workers whose employers avail themselves of the programme and who have monthly wages below 5,000 Dominican pesos (US\$ 93) will receive an unconditional cash transfer of 5,000 Dominican pesos. Workers with wages above this threshold will receive a monthly contribution, 70% of which will be covered by the government—up to a maximum of 8,500 Dominican pesos (US\$ 157) per month—and the other 30% by the employer.

Other countries, such as Barbados, Brazil, Cuba, El Salvador, Jamaica and the Plurinational State of Bolivia, have created specific financial mechanisms to maintain businesses' cash flows and ensure a minimum income for people whose employers have been affected by the crisis. In Brazil, for example, a low-interest line of credit equivalent to 0.6% of 2019 GDP was launched for micro- and small enterprises to pay wages and safeguard jobs. Under the initiative, the Government of Brazil will pay up to two minimum wages towards each employee's wages (2,090 reais, equivalent to US\$ 365) for two months. During that period, companies that avail themselves of the financing may not dismiss workers. This type of mechanism was also created in the Plurinational State of Bolivia through a payroll support plan, which provides loans of up to US\$ 615 to each employee.

Countries have also employed programmes that provide direct coverage of companies' payrolls in times of economic crisis. For example, Argentina will expand the Production Recovery Programme (REPRO), under which the State is responsible for supplementing part of the monthly wages of workers in companies whose sales revenue has fallen. In addition, a monthly payment and medical coverage will be provided to all wage workers who can demonstrate unfair dismissal, for the duration of the unemployment situation. In addition to this measure, unemployment benefits have been increased to a minimum of 6,000 pesos and a maximum of 10,000 pesos per month. In Chile, Ecuador, Mexico, Paraguay and Peru, benefits have been extended for workers in the formal sector through transfers from social security institutions.

Lastly, several countries have adopted initiatives explicitly aimed at consumption of basic necessities. For example, in the Plurinational State of Bolivia, a free family shopping basket of goods is being distributed to 1.2 million of the lowest income households, and also in Honduras, where the Honduras Solidaria programme aims to reach 3.2 million people. In Chile, a similar programme has been established to distribute food baskets to 2.5 million vulnerable families. The *Quédate en Casa* programme, which consists of a subsidy of up to US\$ 93 so that informal workers in the Dominican Republic can purchase basic food items through the 6,800 shops belonging to the Social Supply Network (RAS). Similar measures have been announced in Argentina, El Salvador and Guatemala, where governments have proposed delivering food baskets physically or making monetary contributions to them. Some countries have used more indirect measures, announcing a moratorium on price increases for certain basic goods or measures to subsidize access to key services such as water and electricity. In the Plurinational State of Bolivia, the government will finance 50% of drinking water and

electricity consumption up to a monthly bill of 120 bolivianos (US\$ 18) during the months of April, May and June. Similarly, Paraguay will subsidize the consumption of electricity, water and communications, while in Guatemala the National Electrification Institute will subsidize electricity consumption for people who consume up to 125 kWh per month. Lastly, in Chile, legislation was enacted to establish payment facilities and deferred payment of electricity, water and Internet bills for users from the most vulnerable 40% of households.

(c) Supporting companies' liquidity, especially micro-, small and medium-sized enterprises

A third group of actions to address the COVID-19 pandemic is aimed at the corporate sector and, in particular, at MSMEs. To soften the impact of the crisis, countries have adopted government-backed liquidity support programmes. These programmes—which are usually “below-the-line” transactions and thus not necessarily recorded as short-term public spending, as explained above— have enabled countries to respond quickly to the financial needs of businesses, particularly MSMEs, through existing institutions and the formal financial system.

In some cases, this government-backed liquidity support has taken the form of government loans to the private sector or the capitalization of public financial institutions. Several countries have adopted these measures to facilitate access to credit for MSMEs, which often find it more difficult to access the formal financial system. In Brazil, a number of measures were announced, including an additional contribution of US\$ 1 billion by the government to the Employment and Income Generation Programme (PROGER) and a US\$ 21.6 billion expansion of the Federal Economic Fund's credit lines for MSMEs. Chile announced the capitalization of Banco del Estado de Chile (BancoEstado) and the creation of a solidarity fund to ensure access to financing for this groups of enterprises.

Other countries have expanded such efforts to cover a wider range of companies. In Colombia, the national government, together with the country's Foreign Trade Bank (BANCOLDEX), has increased the capital available through the Colombia Responde fund, to increase the number of loans to companies affected by the pandemic. The expanded fund is called Colombia Responde para Todos and is offering concessionary loans to all sectors except agriculture, up a total of 600 billion Colombian pesos (0.06% of 2019 GDP). Guatemala has created the Working Capital Credit Fund (Fondo de Crédito para Capital de Trabajo), for an initial amount of US\$ 378 million (0.5% of 2019 GDP) to grant loans of up to 2,500 quetzales (US\$ 315) per individual or legal entity. Mexico's federal government announced that three million loans of between 10,000 and 25,000 Mexican pesos (between US\$ 425 and US\$ 1,100) would be extended to small businesses registered with the Mexican Social Security Institute (IMSS) that maintained the same level of employment during March and the first half of April 2020. Similarly, Paraguay and Uruguay rolled out flexible credit lines for all businesses, including preferential rates and extended terms for repayment of the principal.

In El Salvador and Panama, special liquidity funds were created to finance soft loans to MSMEs, especially in the agricultural sector. The Panamá Agro Solidario Plan, for example, will initially have a credit line for a total of US\$ 150 million to supply essential inputs to the country's farmers, either directly or indirectly (subsidies). In addition, US\$ 150 million will be used for interest-free loans of up to 100,000 balboas, for rice, bean and corn exporters.

In some cases, these measures have been accompanied by State guarantees, enabling companies to obtain financing through the financial sector. The Reactiva Perú programme provides credit guarantees of up to 60 billion soles (around 8% of

2019 GDP), which can be accessed by companies of all sizes, from microenterprises to large companies. The guarantee extended through the programme depends on the amount of the loan, from 98% for loans of up to 30,000 soles to 80% for loans of between 5 and 10 million soles.

Several of these guarantees have been designed to target MSMEs. In Chile, the US\$ 3 billion contribution to the small businesses credit guarantee fund (FOGAPE) will make secured credit lines of up to a total of US\$ 24 billion available (10% of 2019 GDP). In Peru, the 300 million soles (US\$ 87 million) business support fund (Fondo de Apoyo Empresarial) was created to provide guarantees, especially to SMEs. In addition, legislation was enacted to extent the coverage of Crecer fund loans to 90% of micro- and small enterprises, 70% of medium-sized enterprises and to 60% of export companies.

Colombia has proposed creating three new credit lines, within the National Guarantee Fund, to benefit MSMEs, for a total of 16 trillion Colombian pesos (1.5% of 2019 GDP), while in Argentina a specific allocation fund was created with 30 billion pesos that the State will transfer to the Argentine Guarantee Fund (FOGAR), increasing its available capital to 91.92 billion pesos (0.4% of 2019 GDP). Uruguay increased the credit guarantee fund of the National Development Agency (ANDE) to enable financial institutions to access guarantees of up to US\$ 2.5 billion (4.5% of 2019 GDP). Lastly, Paraguay capitalized the Guarantee Fund for Micro-, Small and Medium-sized Enterprises (FOGAPY) with US\$ 100 million, increasing its potential lending to US\$ 500 million (1.3% of 2019 GDP).

(d) Measures to support economic activity

Argentina, Barbados, El Salvador, Grenada, Guatemala and Mexico announced increases in their investment budgets to reactivate infrastructure projects. In addition, Guatemala created a guarantee fund for social housing with initial capital of 100 million quetzales (US\$ 13 million) and Argentina launched the “Argentina construye” plan with an initial investment of 29 billion pesos (US\$ 450 million) for construction of 5,500 new homes, financing of 42,900 renovations including gas, electricity and sanitation infrastructure work, and microcredit for construction materials, small-scale work, and furnishing of community spaces in working-class neighbourhoods. In Mexico, the Housing Fund of the Social Security and Social Service Institute for State Workers (FOVISSSTE) and the Institute of the National Housing Fund Institute for Workers (INFONAVIT) will allocate 177 billion Mexican pesos (around US\$ 7.4 billion) to provide housing loans over the next nine months to 442,500 workers.

2. Additional tax relief measures

Latin American and Caribbean countries have announced or implemented a number of tax measures to alleviate the impact of the COVID-19 pandemic to date. In general, these measures have sought to address the health crisis directly or to provide liquidity through temporary tax relief for households and businesses. As shown in table I.4, the measures to support efforts to address the pandemic are based mainly on changes to indirect taxation, particularly tariffs. Tax changes to support households’ and businesses’ cash flows have focused on tax deferral. However, there are still few examples of tax incentives to support a recovery in economic activity in the region.

Table I.4

Latin America and the Caribbean: tax measures announced to address the coronavirus disease (COVID-19) crisis

Instrument	Addressing the health crisis	Provision of liquidity to households and businesses							
		Deferral and payment facilities				Accelerated refunds	Preferential treatment		
		Households	Businesses				Households	Businesses	
Total	Specific sector		SMEs	Total	SMEs				
Income tax	Bolivia (Plurinational State of) Guyana	Argentina Belize Brazil Dominican Republic El Salvador Guatemala Guyana Panama Paraguay Peru Saint Lucia Saint Vincent and the Grenadines	Argentina Belize Brazil Bolivia (Plurinational State of) Chile Colombia Costa Rica Dominican Republic El Salvador Grenada Guatemala Guyana Honduras Panama Paraguay Peru Saint Lucia	Colombia Dominican Republic El Salvador Honduras	Chile Panama Peru Paraguay	Belize Chile Peru Trinidad and Tobago	Venezuela (Bolivarian Republic of)	Bolivia (Plurinational State of) Chile Honduras Saint Kitts and Nevis Saint Lucia	Bolivia (Plurinational State of) Honduras Panama
Social or parastatal contributions			Argentina Brazil Barbados Colombia Uruguay	Argentina Colombia	Argentina Uruguay			Argentina Brazil	
Goods and services tax	Argentina Bolivia (Plurinational State of) Brazil Colombia El Salvador Guatemala Guyana Honduras Jamaica Panama Paraguay Peru Saint Kitts and Nevis Saint Vincent and the Grenadines Venezuela (Bolivarian Republic of)		Brazil Chile Colombia Costa Rica Dominican Republic Ecuador Honduras Paraguay Uruguay	Colombia	Chile	Belize Peru Trinidad and Tobago	Dominica Guyana Saint Vincent and the Grenadines	Colombia Costa Rica Dominica	Bolivia (Plurinational State of) Colombia
Other taxes		Chile	Brazil Chile Colombia Grenada Guatemala Guyana	Ecuador ^a Saint Vincent and the Grenadines ^a	Brazil Colombia		Brazil Chile	Brazil Chile Colombia	

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

^a All tax payment is deferred.

(a) Addressing the health crisis

Many countries have taken steps to reduce the cost of imported health inputs, in response to the extent of the crisis caused by the COVID-19 pandemic. Some countries have established tariff exemptions for imports of medical inputs. Argentina, Brazil, Colombia, Panama, Paraguay, Peru and the Plurinational State of Bolivia have reduced import tariffs on medical and hospital products to zero. In addition, Argentina, Costa Rica, El Salvador, Guatemala, Guyana, Jamaica, Saint Kitts and Nevis and Saint Vincent and the Grenadines have exempted medical supplies from import duties.

However, the tax measures aimed at reducing the prices of medical products have not been limited to import duties; some countries have made changes to taxes on goods and services with a similar goal. For example, Colombia, the Bolivarian Republic of Venezuela, El Salvador, Guyana, Honduras, Paraguay and Saint Vincent and the Grenadines all exempted key health products from value added tax (VAT). Furthermore, donations of health supplies to the National Coordinating Committee for Disaster Reduction (CONRED) in Guatemala are VAT-exempt. Paraguay reduced VAT on the sale of health products was to 5%. In Brazil, the federal tax rate on industrialized products has been reduced to zero for health inputs. Jamaica exempted large-volume sales of alcohol from Special Consumption Tax to ensure access to alcohol-based hand sanitizers.

Some countries have established new income tax deductions to encourage cash donations to the health system. In the Plurinational State of Bolivia, to channel resources to the health system, monetary donations (not exceeding 10% of net taxable profit for the 2019 fiscal year) to health centres made up to 31 December 2020 may be deducted from the corporate income tax base. Similarly, in Guyana, companies will be able to deduct from tax any donations they make to health institutions to support the prevention and treatment of COVID-19.

(b) Provision of liquidity through temporary tax relief to households and businesses

The changes made to taxes have focused mainly on the deferral of income tax payments for households and businesses. Several countries in the region have extended the deadline for filing returns or paying income tax for the 2019 fiscal year. In addition, some countries —such as El Salvador— have allowed individuals to settle their tax liabilities in instalments. In the case of companies, several countries (Chile, Costa Rica, the Dominican Republic, Grenada, Guyana, Honduras, Panama, Paraguay and Peru) have suspended advance payments of income tax for the current fiscal year. In most cases, suspension of payments on account has been accompanied by payment facilities, such as the option to pay in instalments without accruing interest or penalties. These benefits have also been extended to the settlement of tax liabilities from previous fiscal periods.

Some countries have implemented measures to extend the deadlines for companies to pay social and parafiscal contributions. For example, in Barbados, employers who retain more than three-quarters of their staff may defer their contributions to the National Insurance Scheme for three months, with the possibility of extending this for a further three months. In Brazil, company payments to the Unemployment Insurance Fund (FGTS) have been suspended and company contributions to the “Sistema S” system, which finances technical and vocational education, have been cut by 50%. In Argentina and Colombia, changes have been made to social contribution payments for the sectors hit by the crisis. In Argentina, a reduction of up to 95% was offered for the employer’s contribution payment for April, and the March and April payments of these contributions were deferred for leisure, transport and tourism businesses. In Colombia, collection of the parafiscal contribution levied on tourism sales has been suspended for six months. In Uruguay, the April and May payments of contributions to the Social Insurance Bank (BPS) by SMEs were deferred.

Indirect taxes have also been modified, to bolster companies’ liquidity. Payment of VAT has been deferred in Chile, Colombia, Costa Rica, Ecuador, Honduras, Paraguay, the Dominican Republic and Uruguay, although these measures have been implemented differently in each country. In Costa Rica, companies must file returns in April, May and June, but will not yet pay; settlement has been deferred to the end of December. In the Dominican Republic, taxpayers can request payment agreements to settle VAT for

February in up to four instalments. In Brazil, payment of the April and May instalments of the Contribution to the Financing of the Social Security System (COFINS) —a tax on gross income— has been deferred to August and October.

In some cases, tax relief measures have focused on companies in certain sectors or on SMEs. For example, in Colombia, the Dominican Republic, Ecuador, El Salvador and Saint Vincent and the Grenadines a number of tax measures have sought to provide relief to sectors that have been hit particularly hard by the crisis, such as tourism and transport. Meanwhile, Argentina, Brazil, Chile, Colombia, Panama, Paraguay and Peru have adopted specific measures to provide relief to micro-, small and medium-sized enterprises. For example, in the case of micro-entrepreneurs, Brazil has deferred payment of social contributions to the National Social Security Institute (INSS) and of the main taxes on the sale of subnational goods and services for six months, namely the sales tax on merchandise and services (state-level) and the tax on services of any nature (municipal-level). Other companies that are part of the Integrated Tax and Contribution Payment System for Micro- and Small Enterprises (SIMPLES) —a simplified tax regime for micro- and small enterprises— can also benefit from these measures, but for a shorter period.

Several countries have used fast-tracked tax refunds to provide rapid liquidity to households and businesses. Chile, Colombia, Peru and Trinidad and Tobago have implemented measures to fast-track income tax refunds, particularly for individuals and MSMEs. Colombia, Peru and Trinidad and Tobago have adopted similar measures for VAT. Belize has fast-tracked all tax refunds.

Countries have also adopted a range of special tax treatments and tax benefits to support families, protect jobs and reduce the cost of borrowing. In Colombia, the administration fast-tracked a planned early VAT refund for 1 million families living in poverty and vulnerability, which will result in a transfer of 75,000 Colombian pesos every two months (US\$ 19). In Dominica, Guyana and Saint Vincent and the Grenadines, no VAT will be levied on electricity consumption.

Honduras, Saint Kitts and Nevis and Saint Lucia approved tax benefits for companies, linked to their employment levels. In Honduras, companies that do not dismiss or suspend their employees between March and December 2020 will qualify for a special tax credit, equivalent to 10% of their payroll. Similarly, Saint Lucia will provide a special tax credit to companies, the amount of which is determined by the percentage of employees retained (with a minimum of 30%). Dominica and St. Kitts and Nevis have reduced the corporate income tax rate for companies that retain a certain percentage of their employees (in the case of Saint Kitts and Nevis, from 33% to 25% from April to June for companies that retain at least 75% of their employees). In Dominica, this measure reduces the rate from 25% to 17% for companies that undertake to continue employing at least 80% of their staff for a period of 12 months from 1 January 2020. Meanwhile, Brazil and Chile have adopted preferential tax treatment measures to reduce the cost of financing for households and businesses. Brazil has exempted credit transactions from payment of the Financial Transactions Tax (IOF) for 90 days. Similarly, Chile has reduced stamp duty on credit transactions to zero, for a period of six months.

(c) Tax incentives to stimulate consumption and economic activity

While the current goal of fiscal policy is to provide temporary relief to taxpayers, the tax system can also serve as a tool to support a revival in economic activity as the current crisis subsides. To date, few countries have enacted measures in this regard. However, Jamaica has announced a number of tax changes to support the country's economy: the VAT rate will be cut from 16.5% to 15% to promote private consumption, and the government will grant a tax credit of 375,000 Jamaican dollars to SMEs that file tax returns.

Box I.1

Fiscal policies and gender equality in the context of the coronavirus disease (COVID-19) crisis

Tax structures, tax collection and budget lines all have an impact on gender inequalities, because they affect the distribution of resources, the provision of public goods and services, and the financing of gender policies.^a The lessons learned from previous crises show that unless a gender perspective is built into the COVID-19 response, policies may not effectively address the discrimination experienced by women and may increase inequality gaps. The disproportionate impact of the crisis on women can be seen in their excessive burden of unpaid work, the potential increase in their poverty and job insecurity, their limited access to public services and the insufficient financing for gender equality policies.

Women in the region are absorbing the impact of measures such as suspending classes in educational institutions and non-essential public services, resulting in an even larger burden of unpaid work and care. In particular, with health systems operating at maximum capacity, the cost of health care is shifting to households, putting more pressure on women's time. The care crisis is also greatly affecting paid domestic work, a sector that employs 11.4% of the region's female workers.^b

Women are overrepresented in poor households in Latin America and the Caribbean. If the repercussions of COVID-19 lead to a contraction of 5.3% in regional GDP and an increase in unemployment of 3.4 percentage points, as projected by the Economic Commission for Latin America and the Caribbean (ECLAC), poverty could increase by 4.4 percentage points. This would mean that about 110 million women in the region would be living in poverty. Before the crisis, women were already overrepresented among the unemployed, and one in two women was in informal work,^c resulting in their currently limited access to social protection. Women are now on the first line of response to the health crisis and are at greater risk of infection, accounting for 72.8% of those employed in the health sector. In addition, women are concentrated in economic sectors that are being hit hard by the crisis, such as services, retail and wholesale, and tourism.

To address the gender dimension of the response to the pandemic, governments in the region are implementing measures in areas such as prevention of violence against women, the promotion of co-responsibility for care, the protection of jobs and income, and access to benefits. In addition, consideration must be given to fiscal measures that have a gender impact and specific distributional effects, given the unequal positions of men and women in the economy as workers, consumers and entrepreneurs and whether or not they are responsible for unpaid and care work. In the framework of the Regional Conference on Women in Latin America and the Caribbean, the governments of the region undertook to strengthen regional cooperation to combat tax evasion and avoidance and illicit financial flows and to increase the progressiveness of tax systems in order to provide the necessary financing for gender equality policies.^d The countries also agreed to implement gender-sensitive countercyclical policies, in order to mitigate the impact of economic crises and recessions on women's lives and to galvanize the economy in key sectors, including the care economy.^e The following actions are being pursued by the governments of the region.

Measures related to employment in sectors with a high proportion of women

Countries such as the Bahamas, Belize and Jamaica have implemented measures to support employment in the tourism sector. Self-employed workers in the Bahamian tourism industry will be entitled to a temporary unemployment benefit, with 10 million Bahamian dollars set aside for this purpose. Women represent almost 60% of workers in accommodation and food activities in Latin America and 61% in the Caribbean. Given the concentration of women in this sector, measures can help compensate for their loss of income. With regard to paid domestic work, information campaigns have been launched in Colombia, Ecuador, Mexico and Peru to guarantee the rights of domestic workers in the face of the COVID-19 pandemic. In Argentina, measures have been adopted such as establishing that workers in private homes should be granted paid leave for the duration of preventive social isolation measures and including them as potential recipients of the Emergency Family Income benefit. In Chile, the Law on Access to the Unemployment Insurance Benefits of Law No. 19,728 under Exceptional Circumstances covers domestic workers who contribute to the pension system, who will be able to access money in their indemnity accounts through a transfer equivalent to 70% of their income (in the first month).

Benefits and transfers

Several governments in the region have increased the coverage or amounts of existing transfer programmes or created new benefits. Women are de facto beneficiaries of these transfers, mainly because they belong to poor households or are financially responsible for their households. Exceptional subsidies have been established

Box I.1 (concluded)

in some countries. In Argentina, this subsidy is automatic, consisting of a single payment to recipients of the Universal Child Allowance and of the Pregnancy Social Protection Allowance, among other beneficiaries. In Brazil, the emergency benefit for informal workers, micro-entrepreneurs, self-employed persons and unemployed persons is 600 reais (US\$ 120) per month and is granted to up to two people from the same family, but provides for a monthly payment of 1,200 reais (US\$ 240) for women from single-parent households. In countries such as Colombia, Costa Rica and Paraguay, the national machinery for the advancement of women works together with the institutions that set the eligibility criteria for subsidies to ensure that women are taken into account in the various social protection instruments.

Public investment in key policies for women's autonomy

Several countries have implemented protocols and special plans for women who are victims of violence and for preventing violence in the emergency situation caused by the pandemic. In some countries, additional public resources have been earmarked to address the increase in reports of gender-based violence. For example, the Colombian Ministry of Health and Social Protection issued a resolution with criteria for allocating resources to improve the quality of rendered services and to increase the places for women in shelters, hostels and refuges. In Mexico, the government has invested 405 million Mexican pesos to support specialized shelters for women who are victims of gender-based violence and external care centres for women in violent situations.

Measures to safeguard consumption of basic necessities

Some countries in the region have pursued policies of suspending payments for basic amenities, applying price controls to basic necessities and providing tax relief. For example, the Government of El Salvador has suspended payments for basic services and for credit for three months. Maximum retail prices have also been set for the essential products in the basic shopping basket. Such measures help poor households, where there is a higher proportion of women and where these costs represent a significant proportion of total spending.

Although the regional and international situation is very adverse, fiscal space must be expanded to move towards an economic reactivation that leaves no one behind, mobilizing public resources in initiatives that address COVID-19 from a gender perspective. It is also crucial to expand coverage of social protection instruments to address the circumstances of informal, domestic or precariously employed female workers, those of women with no income of their own, those of women living in poor households and those of women with dependants. An analysis of previous social programmes shows that it is important to avoid making access to transfers subject to conditions that would impact women's excessive care workload or deepen gender inequalities.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), "The COVID-19 pandemic is exacerbating the care crisis in Latin America and the Caribbean", *COVID-19 Reports*, Santiago, 2020; *Santiago Commitment*, Santiago, 2020; COVID-19 Observatory in Latin America and the Caribbean [online] <https://www.cepal.org/en/topics/covid-19> "Bahamas: follow-up of the evolution of COVID-19, measures and effects", 2020 [online] <https://drive.google.com/file/d/1DF7WdqqzRMlu5wk9WysRVMcaaii-rnD4/view>; "Argentina: follow-up of the evolution of COVID-19, measures and effects", 2020 [online] https://docs.google.com/spreadsheets/d/1YVmtSO2Yuj67-mzQWaw_gVWQeGgf-BjNlgGdFs8Ntmw/edit#gid=1732232661; "Colombia: follow-up of the evolution of COVID-19, measures and effects", 2020 [online] <https://docs.google.com/spreadsheets/d/1eHseTVB7-JKArRsYQ7ZVIFa7XBjukkfgvfJ7qr2GY1E/edit#gid=895376555>; "Mexico: follow-up of the evolution of COVID-19, measures and effects", 2020 [online] https://docs.google.com/spreadsheets/d/1VcntjbcQrKuugB10_fUfVZM3t5DB7ed3G0c1objVs4c/edit#gid=413197414; "El Salvador: follow-up of the evolution of COVID-19, measures and effects", 2020 [online] <https://docs.google.com/spreadsheets/d/1XKx11Psp8HTgmKWphNcnzJ3alxGY68e0JahmiZpPkgg/edit#gid=1171831751>; *Women's autonomy in changing economic scenarios* (LC/CRM.14/3), Santiago, 2019; *Montevideo Strategy for Implementation of the Regional Gender Agenda within the Sustainable Development Framework by 2030* (LC/CRM.13/5), Santiago, 2017; International Labour Organization (ILO), *Women and Men in the Informal Economy: A Statistical Picture*, Geneva, 2018; ILOSTAT, 2020 [online database] <https://ilostat.ilo.org/data/>; Presidency of the Argentine Nation, "Emergencia sanitaria: decreto 310/2020", Boletín Oficial de la República Argentina, Buenos Aires, 2020 [online] <https://www.boletinoficial.gob.ar/detalleAviso/primera/227113/20200324>; "Emergencia sanitaria: decreto 309/2020", Boletín Oficial de la República Argentina, Buenos Aires, 2020a [online] <https://www.boletinoficial.gob.ar/detalleAviso/primera/227114/20200324>; Government of Brazil, "Solicitar Auxílio Emergencial de R\$ 600 - Coronavírus - Covid-19", Brasília, 2020 [online] <https://www.gov.br/pt-br/servicos/solicitar-auxilio-emergencial-de-r-600-covid-19>; Ministry of Health and Social Welfare, "Resolución número 595 de 2020", Bogotá, 2020 [online] https://www.minsalud.gov.co/Normatividad_Nuevo/Resoluci%C3%B3n%20No.595%20de%202020.pdf; National Institute for Social Development, "Lineamientos de operación del Programa de Apoyo para Refugios Especializados para Mujeres Víctimas de Violencia de Género, sus Hijas e Hijos, para el ejercicio fiscal 2020", *Diario Oficial de la Federación*, Mexico City, 2020 [online] http://dof.gob.mx/nota_detalle.php?codigo=5591242&fecha=07/04/2020.

^a See [online] https://repositorio.cepal.org/bitstream/handle/11362/45037/S1900722_en.pdf.

^b See [online] https://repositorio.cepal.org/bitstream/handle/11362/45352/S2000260_en.pdf.

^c See [online] https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_626831.pdf.

^d See [online] https://repositorio.cepal.org/bitstream/handle/11362/41013/1/S1700033_en.pdf.

^e See [online] https://conferenciademujer.cepal.org/14/sites/crm14/files/20-00087_crm.14_santiago_commitment.pdf.

Box I.2

Latin America: the impact of the coronavirus disease (COVID-19) crisis on intergovernmental public finances

The economic crisis resulting from the COVID-19 pandemic is seriously affecting the economic and social outlook of the countries in the region. That is why it is extremely important to discuss not only what measures should be taken, but also which level of government should carry them out and how the financial burden should be shared. Once again, the responses to the questions of “who does what” and “who finances it” are causing tensions.

The impact on intermediate and local governments will be as diverse as their response capacities,^a depending on the different spending pressures arising from the provision of basic public services, health care and support for the local economy. On the revenue side, capacity will depend on the level and structure of taxes, the tax base of those revenues, the amount and composition of intergovernmental transfers, and the possibility, source and purpose of subnational borrowing. These characteristics vary from country to country and mean that the crisis will impact the provision of goods and services, and access to financing by different levels of government to very different degrees.

The pandemic’s characteristics and its consequences are putting pressure on consolidated public sectors and straining the relationships among the different levels of government, regardless of whether they are part of federal or unitary States. In some cases, there are clearly disagreements about the various authorities’ responsibilities, as in Brazil and Colombia, or that allude to states’ autonomy, as in Mexico. In Argentina, conflicts have arisen among provinces and over compensation mechanisms related to the exploitation of natural resources, the possibility of issuing quasi-money or the transfer of price control powers to local authorities. Tensions have also been created in the area of local financing, as is the case in Chile, or by indebtedness and debt restructuring, as in Brazil and Ecuador. Most of these disputes result in incoherent, if not contradictory, public policies within the same country.^b

Each level of government is facing exacting demands. Central governments have been called on to provide decisive, immediate responses to economic and health-care issues, while the pandemic and its consequences have put subnational governments on the front line of the public response: in most cases they have to ensure the continuation of basic services, provide new ones —such as disinfection—, care for the most vulnerable and homeless, and assist older persons during the lockdown. Therefore, the deteriorating distributive situation may require greater coordination among the three levels of government, in order to build on the comparative advantages of each: for example, given their proximity to people, local governments may be best placed to monitor those most affected by the crisis and provide individual assistance, be it in the form of cash, food or care.

While the pandemic does not discriminate between rich and poor, its direct impact and that of the main policies adopted to contain it —such as shutting down all non-essential activities, closing schools and confining people to their homes— is experienced most harshly by the most vulnerable, that is people on lower incomes, with informal jobs or who are unemployed.

Housing conditions are another dimension that reflects the growing inequality stemming from this crisis. Confinement imposes a disproportionate burden on poor families living in overcrowded housing, built using low-quality materials and located in areas that lack basic services. Overcrowding, combined with a lack of access to safe drinking water and sanitation services, increases the risk of exposure to infectious diseases. It may be difficult to comply with the most common and simplest recommendation, that is to stay at home and wash one’s hands frequently, in places without adequate access to basic services, such as clean water, sanitation or food. Housing conditions are at the core of the regional inequalities that need to be addressed, since the poorest areas of Latin American countries tend to have a higher percentage of people living in overcrowded conditions.^c

Crises among levels of government are multiplying: the different government levels do not have the same capacities or access to the resources needed to respond rapidly to a crisis of this nature and the disparities are growing in the face of demands that are unprecedented in both quantity and quality. The disease is spreading exponentially, which poses the threat of increased demand for hospital services that may exceed local capacities, especially in poor regions and territories. A possible response is to improve intergovernmental transfer systems, particularly their equalization components. Several simple, short-term compensatory instruments^c are available, including: (i) those focused on per capita expenditure functions to provide services comparable in quantity and quality in each territory; (ii) those that redistribute income on the basis of territories’ potential tax base, economic activity and real



Box I.2 (concluded)

estate; and (iii) those that take local revenues from extractive activities as a reference to compensate governments of territories that do not have access to those resources.^d These measures take on particular importance given the considerable inequality in the region at the individual and territorial level.

The crisis will not affect all countries to the same extent or through the same channels. The asymmetric nature of the crisis suggests that one-size-fits-all solutions are not appropriate, rather specific actions will be needed, tailored to each particular situation. While most of the measures to tackle the crisis have been taken by central governments, many have needed or will need subnational government resources, whether human or financial, as well as actions coordinated among the different levels of government. This means that greater intergovernmental coordination is needed and further exposes fiscal policy to the effects of the crisis.

In light of the economic crisis and its impact on the social situation of the region's countries, the financing of intermediate and local governments must be guaranteed in order to safeguard public provision of social protection and health services. The interjurisdictional and central government coordination systems play a key role in linking policies together to ensure the equitable provision of public services among different territories of a country. This is particularly important in Latin America and the Caribbean, a region that has high levels of income inequality and regional disparities. Resources must be moved to where they are needed most—especially areas where resources are limited—, taking into account the different administrative and management capacities of stakeholders to facilitate implementation of measures.

Authorities will need to improve on their responses to previous crises and make use of non-conventional instruments. National, intermediate and local governments face challenges on two fronts: to coordinate intergovernmental fiscal connections so that no government is abandoned to its fate; and to provide rapid and effective responses within their territories. This may require a substantial reorganization of aspects of intergovernmental relations, which will certainly be a difficult task, but a serious crisis such as this one can help stakeholders to reach a consensus to solve problems that under normal circumstances seem completely intractable.

Source: Government of the state of São Paulo, “Governo de São Paulo anuncia estado de calamidade pública em território paulista”, São Paulo, 2020 [online] <https://www.saopaulo.sp.gov.br/spnoticias/governo-de-sp-anuncia-novas-medidas-para-intensificar-o-combate-ao-coronavirus/>; *La Silla Vacía*, “Con el coronavirus, Colombia se federalizó”, 2020 [online] <https://lasillavacia.com/coronavirus-colombia-se-federalizo-75890/>; G. Cejudo and D. Gómez, “¿Federalismo en cuarentena?”, *Nexos*, Mexico City, 2020 [online] <https://federalismo.nexos.com.mx/2020/03/federalismo-en-cuarentena/>; P. Romo, “Jalisco podría abandonar el pacto fiscal”, *El Economista*, Mexico City, 2020 [online] <https://www.economista.com.mx/estados/Jalisco-podria-abandonar-el-pacto-fiscal-20200410-0034.html>; G. Origlia, “Provincia blindada: San Luis no deja pasar a productores de otras regiones”, *La Nación*, Buenos Aires, 2020 [online] <https://www.lanacion.com.ar/economia/campo/coronavirus-san-luis-impide-paso-productores-trabajadores-nid2349595/>; S. Spaltro, “Contra el ‘barril criollo’, el instituto de Lapeña propone liberar recursos por hasta US\$ 2500 millones”, *El Cronista*, Buenos Aires, 2020 [online] <https://www.cronista.com/economiapolitica/Contra-el-barril-criollo-el-instituto-de-Lapena-propone-liberar-recursos-por-hasta-us-2500-millones-20200330-0079.html>; E. Burgo, “La economía que viene: el fantasma de las cuasimonedas en las provincias amenaza”, *Clarín*, Buenos Aires, 2020 [online] https://www.clarin.com/economia/fantasma-cuasimonedas-provincias-amenaza_0_fsUo3ZruC.html; *Clarín*, “Comienza el viernes. Publican el decreto que faculta a los intendentes a controlar los precios: todo lo que establece”, Buenos Aires, 2020 [online] https://www.clarin.com/politica/publican-decreto-faculta-intendentes-controlar-precios-establece_0_Db12ubVQc.html; Senate of Chile, “Senado aprueba veto presidencial sobre permiso de circulación”, Santiago, 2020 [online] <https://www.senado.cl/senado-aprueba-veto-presidencial-sobre-permiso-de-circulacion/senado/2020-03-31/191724.html>; R. Rodrigues, “Coronavírus: após decisão do STF, SP vai suspender pagamento de R\$ 7,2 bilhões ao governo federal”, *Globo*, 2020 [online] <https://g1.globo.com/sp/sao-paulo/noticia/2020/03/23/coronavirus-apos-decisao-do-stf-sp-vai-suspender-pagamento-de-r-72-bilhoes-ao-governo-federal.ghtml>; O. Narvaez, “Gerente del BDE ratifica que están atendiendo solicitudes de moratoria de los GAD”, Quito, Development Bank of Ecuador, 2020 [online] <https://bde.fin.ec/los-gad-pueden-reestructurar-sus-deudas-con-el-banco-de-desarrollo-del-ecuador-b-p/>; G. Brosio, J. Jiménez and I. Ruelas, “Federalismo en tensión: las finanzas públicas intergubernamentales frente la crisis del COVID19 en América Latina”, *Foco Económico*, 2020 [online] <https://focoeconomico.org/2020/04/15/federalismo-en-tension-las-finanzas-publicas-intergubernamentales-frente-la-crisis-del-covid19-en-america-latina/>; “Territorial inequality, equalization transfers and asymmetric sharing of non-renewable natural resources in Latin America”, *CEPAL Review*, No. 126 (LC/PUB.2018/26-P), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2018; E. Pineda and A. Radics, “Subnational governments and coronavirus: five critical actions the IDB is supporting”, Washington, D.C., Inter-American Development Bank (IDB), 2020 [online] <https://blogs.iadb.org/gestion-fiscal/en/subnational-governments-and-coronavirus-five-actions-idb-is-supporting/>; Organization for Economic Cooperation and Development (OECD), “The territorial impact of COVID-19: managing the crisis across levels of government”, *OECD Policy Responses to Coronavirus (COVID-19)*, Paris, 2020.

^a See [online] <https://blogs.iadb.org/gestion-fiscal/en/subnational-governments-and-coronavirus-five-actions-idb-is-supporting/>, <http://www.oecd.org/coronavirus/policy-responses/the-territorial-impact-of-covid-19-managing-the-crisis-across-levels-of-government-d3e314e1/> and <https://focoeconomico.org/2020/04/15/federalismo-en-tension-las-finanzas-publicas-intergubernamentales-frente-la-crisis-del-covid19-en-america-latina/>.

^b See [online] <https://federalismo.nexos.com.mx/2020/03/federalismo-en-cuarentena/>.

^c See [online] <https://focoeconomico.org/2020/04/15/federalismo-en-tension-las-finanzas-publicas-intergubernamentales-frente-la-crisis-del-covid19-en-america-latina/>.

^d For more details on equalization systems see [online] https://repositorio.cepal.org/bitstream/handle/11362/44558/1/RV1126_Jimenez.pdf.

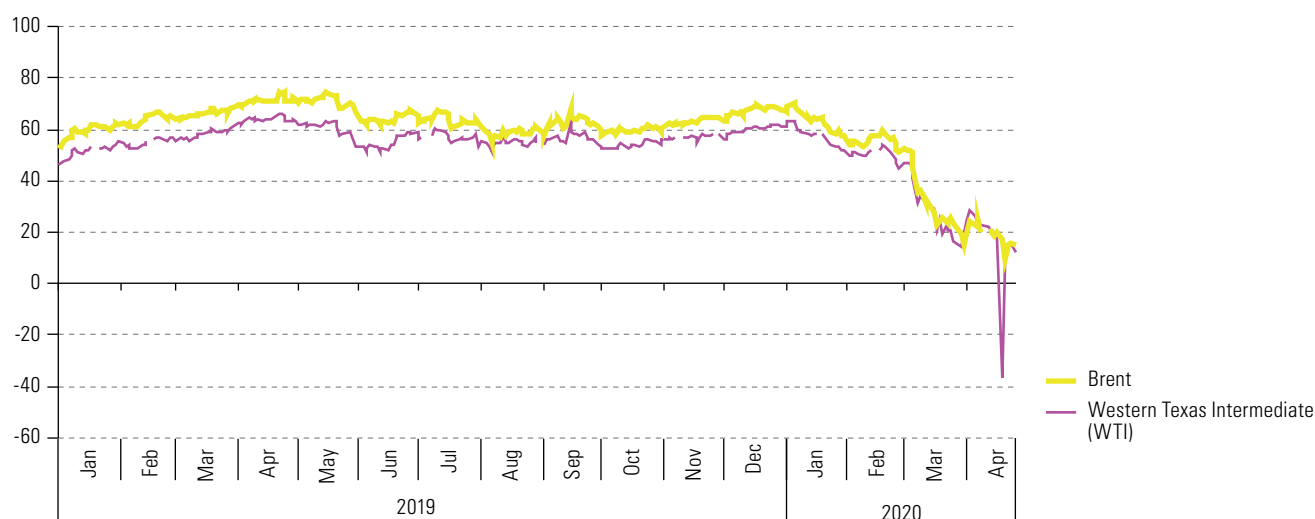
C. The complex financing situation for 2020

Access to traditional sources of financing for the operations of the region's governments—tax revenue collection and public debt issuance—is hampered by the current situation. The sharp contraction in economic activity that began in the first half of 2020, together with the drop in oil and mineral prices, will cut central government revenues significantly in the region. Restrictions on movement and commercial activity are having a negative impact on private consumption, which will directly affect the revenues raised by the main indirect taxes. This is in addition to tax relief measures, such as the postponement of or moratorium on the payment of VAT and income tax. With regard to direct taxes, the likely surge in unemployment and labour informality will affect tax receipts.

At the same time, the current situation is complicating the scenario with respect to tax revenues from non-renewable natural resources. This is evident in the crude oil market, which has seen extreme volatility. The market's main benchmark prices, Brent and Western Texas Intermediate (WTI), fell sharply as Saudi Arabia and the Russian Federation stepped up production in order to retain their share of the global market (see figure I.15). This downward price trend has been exacerbated by the COVID-19 outbreak, which has led to a collapse in demand for oil around the world. As the economic consequences of the pandemic have evolved, these prices have continued to fall. In the case of WTI, prices turned negative at the end of April, as buyers and sellers sought to close their positions, given that they would have to take possession of oil that they would not be able to store.

Figure I.15

Daily spot prices for crude oil, Western Texas Intermediate and Brent, January 2019–April 2020
(Dollars per barrel)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Energy Information Administration (EIA) figures.

Debt securities markets have seen significant volatility since COVID-19 began to spread around the world, as investors' evident aversion to risk led them to put their money in safe assets. This trend is reflected in the yield spread of the Emerging Market Bond Index (EMBI Global), from which country risk premiums are estimated.

As mentioned in section A of this chapter, EMBI Global improved at the end of 2019, shedding 119 basis points compared to the end of the first half of 2019. However, this improvement was short-lived as it rebounded from January 2020, peaking at 827 basis points on 23 March 2020, before gradually subsiding to 585 basis points on 25 May.

Despite this volatile backdrop, Mexico issued securities at the end of April 2020, worth US\$ 6 billion with an average rate of 4.7125%. Before that, in March 2020, Panama issued bonds for US\$ 2.5 billion with a coupon of 4.5%, while Peru issued US\$ 3 billion of bonds with an average rate of 2.585%. Lastly, Guatemala issued bonds worth US\$ 1.2 billion with an average rate of 5.8125% and, on 5 April 2020, Chile raised US\$ 1.458 billion from the sale of bonds denominated in dollars with an interest rate of 2.454%, in addition to US\$ 542 million from euro-denominated bonds at a rate of 1.165%. This is evidence of the major disparities among the countries of the region with respect to access to international financial markets, while competition in these markets is increasing, owing to the high number of countries (both emerging and advanced) that need to raise money at the same time. In this context, the countries most likely to benefit are those with low risk ratings and thus a greater capacity to take on debt. For this reason, a growing number of countries are taking extraordinary measures to meet their financing needs.

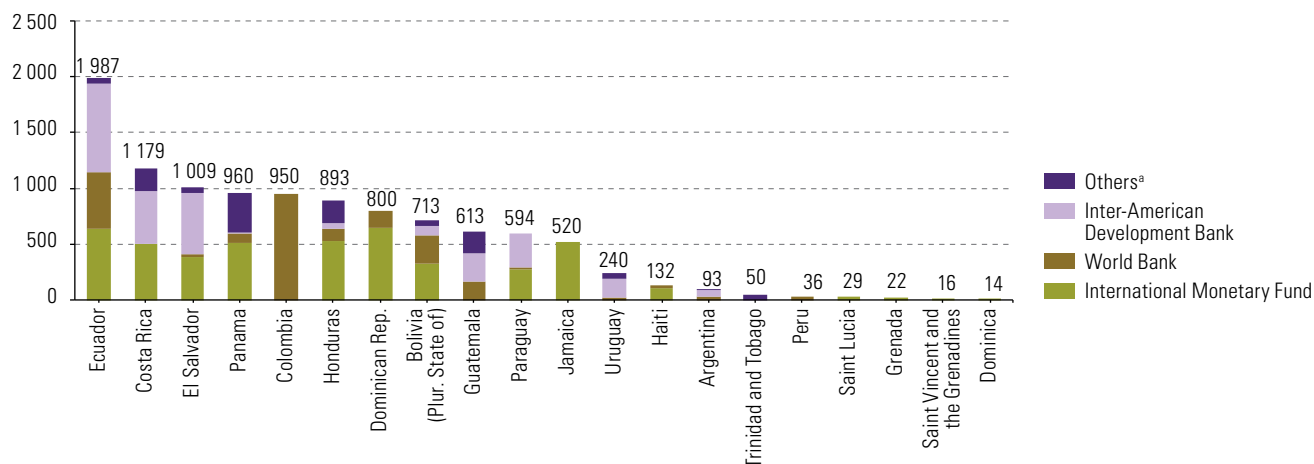
In Brazil, for example, the central bank has said that it will resume its dollar-denominated sovereign bond buyback operations for an estimated 50 billion reais (0.7% of 2019 GDP). Meanwhile, the interim Government of the Plurinational State of Bolivia has received an emergency health-care loan from the central bank for a total of 7 billion bolivianos (2.5% of 2019 GDP). In Guatemala, it was agreed that the three funds created to manage the resources for containing the COVID-19 pandemic would be financed with contributions from the central bank. The total amount stands at 11 billion quetzals (1.9% of 2019 GDP) at a 0% interest rate and with a repayment date duly agreed between the government and the monetary authority. A similar measure has been announced in the Dominican Republic for 12 billion Dominican pesos (US\$ 223 million). In the same vein, the Health Care Emergency Act was passed in April 2020 in Paraguay, authorizing the central bank to provide the resources needed to combat the pandemic in the form of an interest-free loan. In the Caribbean subregion, the Government of Belize announced that the fiscal package will be mainly financed by central bank loans, while the Monetary Council of the Eastern Caribbean Central Bank approved grants to member governments totalling US\$ 1.5 million.

Multilateral financing is another avenue that has been explored by the countries of the region to finance their pandemic containment and economic recovery plans. As figure I.16 shows, 20 Latin American and Caribbean countries had received emergency credit lines from multilateral institutions as at 20 May 2020. In particular, Ecuador received loans totalling US\$ 1.987 billion, followed by Costa Rica (US\$ 1.179 billion), El Salvador (US\$ 1.010 billion), Panama (US\$ 960 million) and Colombia (US\$ 950 million) (see figure I.16A). As a percentage of 2019 GDP, the support provided by multilateral institutions is more significant for the countries of Central America and the Caribbean, equivalent to 3.7% of 2019 GDP in El Salvador and Honduras, 3.4% in Saint Lucia, 3.3% in Jamaica and 2.4% of 2019 GDP in Dominica. In South America, the top recipients were Costa Rica and Ecuador, with 1.9% and 1.8% of 2019 GDP, respectively, followed by the Plurinational State of Bolivia, Panama and Paraguay, with financing equivalent to between 1.4% and 1.7% of 2019 GDP (see figure I.16B).

Figure I.16

Latin America and the Caribbean (20 countries): multilateral financing to address the coronavirus disease (COVID-19) pandemic

A. Multilateral financing by institution
(millions of dollars)



B. Multilateral financing as a percentage of 2019 GDP
(percentages of 2019 GDP)



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

^a The category "other" includes the Development Bank of Latin America (CAF), the Central American Bank for Economic Integration (CABEL) and the French Development Agency (AFD).

Several countries in the region have taken advantage of IMF emergency financing or are negotiating measures with the Fund. By the end of May 2020, IMF had approved requests from the Plurinational State of Bolivia (US\$ 327 million, equivalent to 0.8% of 2019 GDP), Costa Rica (US\$ 504 million, equivalent to 0.8% of 2019 GDP), the Dominican Republic (US\$ 650 million, equivalent to 0.7% of 2019 GDP), Ecuador (US\$ 643 million, equivalent to 0.6% of 2019 GDP), El Salvador (US\$ 389 million, equivalent to 1.4% of 2019 GDP), Honduras (US\$ 530 million, equivalent to 2.2% of 2019 GDP), Jamaica (US\$ 520 million, equivalent to 3.3% of 2019 GDP), Panama (US\$ 515 million, equivalent to 0.8% of 2019 GDP) and Paraguay (US\$ 274 million, equivalent to 0.7% of 2019 GDP) under the Rapid Financing Instrument. The financing granted through this instrument will free up resources to address the pandemic and, at the same time, safeguard the balance of payments. In addition, Haiti received debt relief within the strengthened framework of the Catastrophe Containment and Relief Trust (CCRT) and the Rapid Credit Facility (RCF) for about \$ 112 million (equivalent to 1.3% of 2019 GDP). In the Caribbean,

IMF authorized US\$ 65.6 million in disbursements to Dominica, Grenada, Saint Lucia and Saint Vincent and the Grenadines through the SCR. Moreover, the flexible credit line arrangements were renewed for Colombia and Mexico for US\$ 10.8 billion and US\$ 61.4 billion, respectively. At the beginning of May, Chile and Peru also requested flexible credit lines for amounts totalling US\$ 23.8 billion and US\$ 11 billion, respectively.

At the same time, the World Bank has approved loans requested by some countries to strengthen their health systems under the COVID-19 Fast-Track Facility. These include Argentina (US\$ 35 million), the Dominican Republic (US\$ 150 million), Ecuador (US\$ 500 million), El Salvador (US\$ 20 million), the Plurinational State of Bolivia (US\$ 254 million), Colombia (US\$ 950 million), Honduras (US\$ 113 million) and Paraguay (US\$ 20 million). In addition, Haiti received a US\$ 20 million grant for the same purpose. As for the Inter-American Development Bank (IDB), it has made US\$ 2 billion in resources available to support the countries of the region in containing the effects of the pandemic. By the end of May 2020, a total of 10 Latin American countries had benefited from this financial support; these include Argentina (US\$ 58 million to support the province of Buenos Aires), Costa Rica (US\$ 475 million), Ecuador (US\$ 794 million), El Salvador (US\$ 550 million), Guatemala (US\$ 250 million), Paraguay (US\$ 300 million) and Uruguay (US\$ 170 million). Lastly, the resources offered by the Latin American Development Bank (CAF) include regional emergency credit lines, totalling US\$ 2.5 billion, and US\$ 400,000 grants for individual countries. Loans were extended to Costa Rica, El Salvador, Ecuador, Jamaica, Panama and Trinidad and Tobago for US\$ 50 million in the context of the health emergency caused by the pandemic.

D. Conclusion: fiscal policy in the short and medium terms

The COVID-19 pandemic and the resulting human, economic and social crises are taking a heavy toll on the region. Despite the public health measures taken to date —such as physical isolation and restrictions on commercial activity—increasing numbers are falling victim to the virus and the number of lives lost continues to rise. Meanwhile, economic activity has come to a halt in many countries and, according to ECLAC projections, will suffer its worst contraction in recent history in 2020.

In this context, the fiscal packages already announced and under way represent a first step in what could be a long road to recovery for the region. Some countries are already announcing new fiscal packages to backstop those early measures. In the coming months, countries will have to formulate and implement major fiscal stimulus measures to help revive economic activity, investment and high-quality job creation.

A major challenge to efforts to put these fiscal measures into action is mobilizing the resources needed to finance them. As stated in this chapter, government revenues have stagnated over the last decade and the current crisis is likely to cause them to drop even further. Therefore, measures must be taken to strengthen domestic resource mobilization, particularly through tax collection. One area that deserves special attention is direct taxation, which is exceptionally weak in the region. Low income tax and property tax receipts not only restrict revenue-generation efforts, but also the redistributive power of the tax system as a whole.

One of the main barriers to greater domestic resource mobilization in the region is the high level of tax evasion. It is important to measure the impact of this phenomenon on tax revenues. According to the latest ECLAC estimates, tax non-compliance stood at US\$ 325 billion in 2018, equivalent to 6.1% of GDP (see chapter II). As detailed in chapter III, countries have made tangible progress in reducing levels of tax evasion.

However, these measures must be strengthened in order to generate domestic financing to address the medium-term challenges posed by the pandemic.

Nonetheless, financing the current sets of measures and those likely to be needed in the medium-term will require greater access to sources of funding on appropriate terms. As discussed in this chapter, current financial market conditions are unfavourable for most of the countries of the region. Although some continue to issue a significant number of bonds, more and more countries are turning to international financial institutions for emergency financing. These institutions have taken important steps to provide rapid access to financing, but the countries of the region will need additional short- and medium-term solutions, including debt service facilities, and a review of existing concessional lending programmes and graduation policies for middle-income countries. Debt relief is one mechanism that could increase the fiscal space of many countries in the region in the short term. For some highly indebted countries, a suspension of payment obligations for one year would free up considerable resources.

International cooperation and governance are therefore essential to reach solutions to common problems for the region. With regard to debt, national governments, international financial institutions and private investors could all benefit from the development of innovative mechanisms and programmes to address high levels of debt. In terms of tax issues, international cooperation and governance also play a fundamental role in creating mechanisms that promote the exchange of tax and financial information in order to reduce the scope for tax evasion and avoidance and illicit financial flows, as well as to control and make rational use of tax expenditures, avoiding harmful competition in tax matters.

It is undeniable that the region of Latin America and the Caribbean is facing one of the most serious human, economic and social crises of recent times, which is exacerbated by its structural socioeconomic weaknesses. The COVID-19 pandemic has exposed deficiencies in social protection systems, both the labour market and social security systems, and in the limited provision of crucial, high-quality public goods and services. At the same time, the asymmetric impact of the crisis on society reflects the deep rifts—in terms of income and wealth, gender, ethnicity and age, among other factors—that mark the region.

The public policies pursued at this time and during the post-pandemic recovery process will have a decisive impact on the development path that Latin America and the Caribbean will follow. It is thus of the essence to seize the opportunity to address the persistent inequalities that have prevailed in the region. In this regard, the countries of the region must accelerate their transition to social welfare States that guarantee the well-being of their societies and provide a solid foundation for economic growth. Reducing inequality, strengthening social protection systems—including moving towards a universal basic income—and providing high quality education and health services, and a decent pension system must be the cornerstones of the sustainable development model to be devised as the region emerges from this crisis.

In this context, fiscal policy, and the State in general, will play an increasingly important role in the years to come. New fiscal covenants are required to underpin work on designing robust fiscal frameworks with the instruments necessary to finance the welfare States and, in turn, respond to the needs of the economic cycle. Fiscal policy must contribute to the attainment of this goal through a progressive tax policy and efficient, effective and equitable public spending that puts the needs of the region's societies first.



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CHAPTER



Evolution of public finances in Latin America and the Caribbean in 2019

- A. The deterioration in macroeconomic conditions took its toll on public finances in the region
- B. The collection of exceptional revenues helped to stabilize total income in Latin America
- C. Public spending was relatively stable in Latin America and the Caribbean in 2019
- D. Larger fiscal deficits in Latin America signalled a reversal of the trend towards narrowing deficits seen in the past two years
- E. Debt has kept increasing in Latin America, but has continued to fall in the Caribbean
- F. The policy space for subnational public finances has narrowed in recent years as fiscal deficits remain high and public debt increases

Bibliography

A. The deterioration in macroeconomic conditions took its toll on public finances in the region

As noted in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2019* (ECLAC, 2019a), changes in the main global macroeconomic indicators created an adverse context for fiscal policy in the countries of Latin America and the Caribbean in 2019. Global economic activity slowed to 2.5% year-on-year in 2019—its lowest level since the 2008–2009 financial and economic crisis—after registering 3.1% in 2018 and 3.2% in 2017. International trade, as reflected by global trade volumes, contracted in 2019 against the backdrop of the economic slowdown and rising trade tensions between the United States and some of its trading partners, in particular China. In 2019, China's growth slumped to its lowest levels in 30 years, down to 6.1% compared with 6.6% the previous year. The developed economies were not immune to this trend, with significant slowdowns seen in the eurozone and Japan. Only the United States registered robust growth, which was largely owed to a substantial fiscal stimulus measure.

International commodity prices fell in 2019, dragged down by the weak global economy. International prices for industrial minerals and metals shrank (-1.3% year-on-year for a basket of goods) as growth slowed in China, the leading global consumer of these goods. Crude oil prices also posted negative growth (-11.5%) after falling sharply in late 2018. Prices of food, tropical beverages and oilseeds, which are important commodities in Central America, Argentina, Brazil, Colombia, Paraguay and Uruguay, continued their downward trend in 2019 (-4.4%). These price trends affected fiscal revenues in the region in 2019.

Against this backdrop, economic activity in Latin America and the Caribbean slowed sharply in 2019. ECLAC (2019a) projected 0.1% growth for the economies of Latin America and the Caribbean in 2019, reflecting a widespread and synchronized slowdown in the economies of 18 of the 20 countries in Latin America and 23 of the 33 countries in the wider region. Domestic demand, the main driver of economic growth in recent years, weakened in 2019. Private consumption was particularly lacklustre and made a negative contribution to growth in the first half of the year, which had secondary effects on tax revenue in the region.

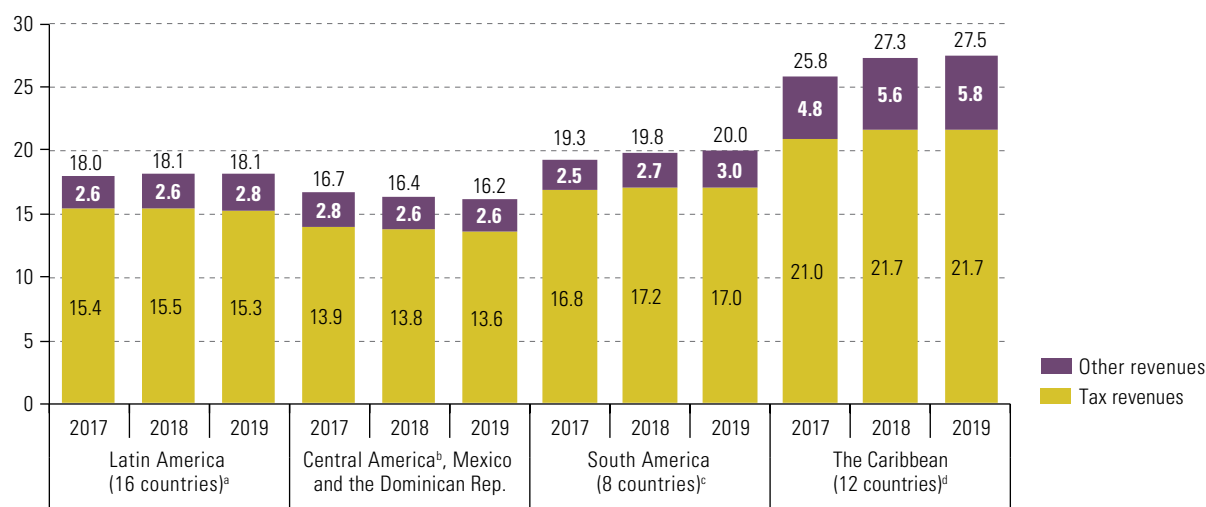
Added to this is increasing pressure on public spending to meet social demands and reduce inequality, which complicated the conduct of fiscal policy. This context calls for fiscal policy to contribute to boosting economic activity, meeting social demands and reducing inequality. However, the fiscal space has been limited by the deterioration in macroeconomic conditions and structural challenges in public finances, such as the low tax burden and poor redistributive capacity of fiscal policy, and shortcomings in the provision of public goods and services. In this regard, the analysis of trends in public finances is important to understand how much space is available for fiscal action and thus inform the rethinking of fiscal policy to help find solutions for the region's economic and social problems.

B. The collection of exceptional revenues helped to stabilize total income in Latin America

Notwithstanding the macroeconomic conditions described above, in 2019 the average of total income in Latin America held steady at 18.1% of GDP, similar to the previous year (see figure II.1). However, this average stability was achieved by the collection of exceptional revenues which, in some cases, helped to make up otherwise weak tax revenues and, in others, drove up other revenues (non-tax revenues, capital revenues, grants). In addition, some countries registered lower total income as a result of fluctuations in international prices of non-renewable natural resources (see box II.1).

Tax revenues in Latin America shrank in 2019 owing to the weakening of economic activity, especially the slowdown in private consumption, and lower international commodity prices. Central government tax revenues accounted for 15.3% of GDP in 2019, compared with 15.5% in 2018, with falls of 0.2 percentage points seen in the group comprising Central America, the Dominican Republic and Mexico and in South America. These figures speak to the importance of strengthening tax collection, particularly measures for controlling tax evasion (see box II.2).

Figure II.1
Latin America and the Caribbean: composition of public revenues, by subcomponent, 2017–2019
(Percentages of GDP)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru the figures are for the national public administration, the federal public sector and the general government, respectively; in the case of Saint Kitts and Nevis, they are for the federal government and in the case of Barbados, the non-financial public sector.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

^b Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

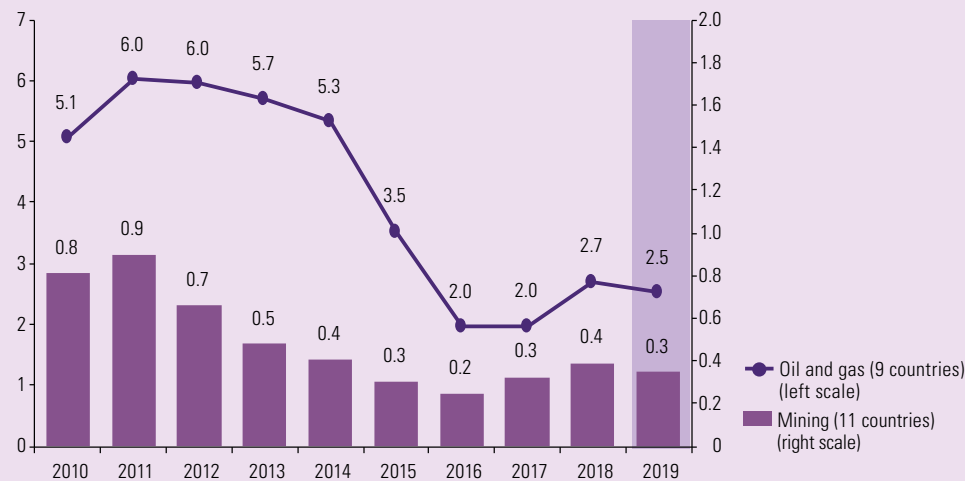
^c Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay.

^d Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

Preliminary figures for 2019 would suggest that fiscal revenues from non-renewable natural resources fell in the region, in line with trends in international commodity prices (see figure 1). Projections for revenues from hydrocarbon exploration and production for 2019 were 2.5% of GDP, down from 2.7% of GDP in 2018. Declines can be expected in many of the countries in the sample, especially those that depend primarily on non-tax revenues that are tied to price trends (royalties and other percentages of the commercial value of production). However, oil revenues may have increased in Colombia and Trinidad and Tobago, as income tax payments on 2018 earnings appear to have offset the decline in non-tax revenues.

Figure 1

Latin America and the Caribbean: observed and estimated tax revenues from hydrocarbon exploration and production and mining, 2010–2019
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

Note: The countries in the “mining” sample are Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Jamaica, Mexico, Peru and the Plurinational State of Bolivia. The countries in the “exploration and production of hydrocarbons” sample are Argentina, Brazil, Colombia, Ecuador, Guatemala, Mexico, Peru, the Plurinational State of Bolivia and Trinidad and Tobago. Figures for 2019 are based on official government estimates from 2020 budget documents or preliminary annual figures. Where figures for 2019 were not available, they were calculated using monthly data (generally for the first nine months of the year). Where monthly data were not available, revenues were estimated by taking the year-on-year change in the price of the most representative product (or basket of products in the case of mining) for the country in 2018, expressed in local currency.

Projections for mining revenues show that they contracted on average, down from 0.4% of GDP in 2018 to 0.3% in 2019. However, this decline is unlikely to have occurred as uniformly across all countries as in the case of hydrocarbon income. Mining revenues have largely mirrored the patterns of prices and production related to each country’s export basket. Even so, the lower prices likely affected both tax and non-tax revenues during the year.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CEPALSTAT [online database] <http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english>.

Box II.1

Fiscal revenues from the exploitation of non-renewable natural resources

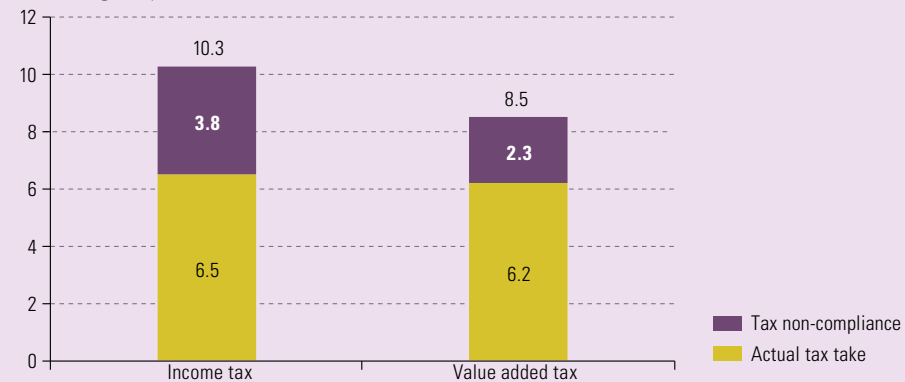
Box II.2

Estimating income tax non-compliance in Latin America

According to the latest ECLAC estimates, tax non-compliance in Latin America stood at US\$ 325 billion in 2018, equivalent to 6.1% of GDP. The level of corporate and personal income-tax evasion remains high, at 3.8% of GDP (see figure 1). The high incidence of evasion and avoidance weakens not only the collection of income tax, but also its redistributive power and its role as an automatic stabilizer. Non-compliance for value added tax (VAT) amounted to 2.3% of GDP. Tax revenue losses seriously challenge the capacity of fiscal policy to respond to macroeconomic shocks and to mobilize national resources for financing sustainable development.

Figure 1

Latin America: income tax and value added tax (VAT) non-compliance, 2018
(Percentages of GDP)



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

Note: Estimates are based on national studies on income tax and value added tax non-compliance. The figures are a weighted average based on GDP in dollars at current prices. For income tax, the countries included are Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Panama, Peru and Uruguay. For VAT, the countries included are Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, the Plurinational State of Bolivia and Uruguay.

ECLAC estimates that the region overall lost US\$ 85 billion—or 1.6% of regional GDP—in illicit financial flows as a result of trade misinvoicing in 2016 (see figure 2). This estimate is based on the discrepancies resulting from the underdeclaration or overdeclaration of imported and exported goods. Misinvoicing occurs when the registered value of a transaction differs between the exporting country and the importing country.

Figure 2

Latin America and the Caribbean (33 countries): estimated value of goods trade misinvoicing, 2000–2016
(Billions of dollars)



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

These distortions may arise in trade transactions both between related firms forming part of a single multinational (through transfer prices) and between independent firms (where there is collusion between the exporter and the importer). ECLAC estimates for the region seem to indicate, however, that most of these price discrepancies are linked to transactions within global value chains, often between related firms (ECLAC, 2016). It is clear, then, that tax and customs administrations in the region must be strengthened in order to address this challenge.

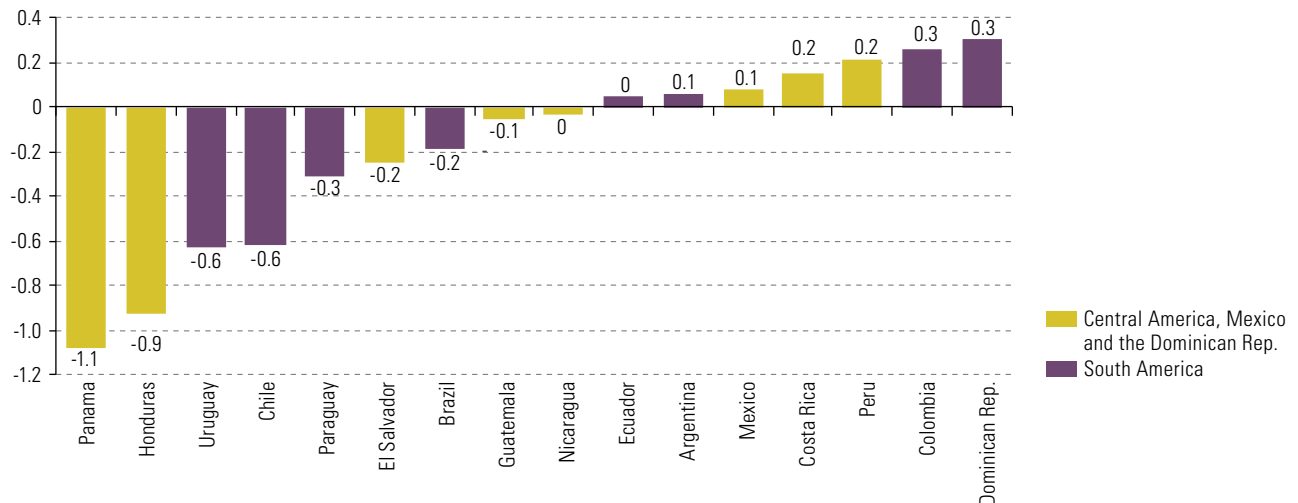
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of ECLAC, *Economic Survey of Latin America and the Caribbean, 2016* (LC/G.2684-P), Santiago, 2016.



At country level, significant declines in tax revenues were posted in Chile, Honduras, Panama and Uruguay (see figure II.2). This outcome was driven in part by lower income tax revenues in Chile, the elimination of the 1.5% advance tax payment in Honduras and lower prices of soybeans in Uruguay. The collection of VAT, in particular of external VAT, declined as imports weakened. In Chile, lower VAT receipts can be attributed to the implementation of a set of measures to support small and medium-sized enterprises (SMEs), under which they were allowed to defer payment of VAT for the months of November and December 2019 and January 2020 until February 2020, without fines or interest. Importantly, in 2019 some countries carried out tax regularization programmes (producing one-off revenues), which helped to offset, in part, the decline in tax revenues (see box II.3).

Other income (non-tax revenues, capital revenues, grants) accounted for 2.8% of GDP in 2019, up 0.2% from the previous year. This is primarily because in South America these revenues amounted to 3.0% of GDP in 2019, compared with 2.7% in 2018, driven in part by the receipt of exceptional revenues. As figure II.3 shows, exceptional revenues rose significantly during the year in Argentina (1.0% of GDP), Brazil (1.1% of GDP) and Colombia (0.8% of GDP). The main factor in the case of Argentina was the transfer of central bank profits to the central government. In Brazil, the increase in other revenues reflects payments for oilfield exploration and production rights in the country from the last round of bidding in November 2019. In addition, the central government received higher dividends from public financial institutions (National Bank for Economic and Social Development (BNDES), Caixa Econômica Federal and Banco do Brazil). In Colombia, the increase stems mainly from higher capital revenues, specifically from an upturn in dividends that the central government received from Ecopetrol and the inclusion of transfers of central bank profits to the central government within total revenues.

Figure II.2
Latin America: changes in central government tax revenues, by subregion, 2018–2019
(Percentage points of GDP)



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

Note: In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

Box II.3

Tax regularization programmes implemented in 2019

In recent years, the countries of the region have turned to tax regularization programmes to encourage contributors to enter the tax system and boost receipts. As table 1 shows, most of the programmes implemented in 2019 were general tax amnesties which allowed taxpayers to settle their tax liabilities on favourable terms, in many cases with a total or partial waiver of interest payments, surcharges or fines.

Table 1
Latin America: recent examples of tax regularization programmes

Country	Benefit	Effective dates	Collection
Colombia	Unreported assets or non-existent liabilities are taxed at a reduced rate of 13%. If the taxpayer invests these assets in Colombia, the tax rate is reduced to 6.5%.	1 January 2019–25 September 2019	1.1 trillion Colombian pesos (0.1% of GDP). Assets and liabilities abroad worth 13.4 trillion Colombian pesos (about 1.3% of GDP) were disclosed, and 4 trillion Colombian pesos (about 0.4% of GDP) of that amount were repatriated.
Costa Rica	Interest on tax debts are waived and a percentage reduction is applied to penalties.	4 December 2018–4 March 2019	207.31 billion colones (0.6% of GDP); 88% of which corresponds to income tax. Corporate entities accounted for 99% of these taxpayers (Ministry of Finance of Costa Rica, 2019).
Honduras	Interest, surcharges and penalties are waived.	25 April–23 July 2019	...
Panama	Interest, surcharges and penalties are waived.	11 October 2019–29 February 2020	77.2 million balboas (0.1% of GDP) (Ministry of Economy and Finance of Panama, 2020).
Trinidad and Tobago	Waiver of penalties and interest.	15 June–15 September 2019	2.382 billion Trinidad and Tobago dollars (1.5% of GDP).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Ministry of Finance of Costa Rica, "Recaudación por amnistía tributaria superó la expectativa de 0,5% del PIB", San José, 5 March 2019 [online] <https://www.hacienda.go.cr/noticias/15009-recaudacion-por-amnistia-tributaria-supero-la-expectativa-de-05-del-pib>; Ministry of Economy and Finance of Panama, "Amnistía tributaria", Panama City, 30 January 2020 [online] <https://www.mef.gob.pa/2020/01/amnistia-tributaria/>; national legislation and official figures.

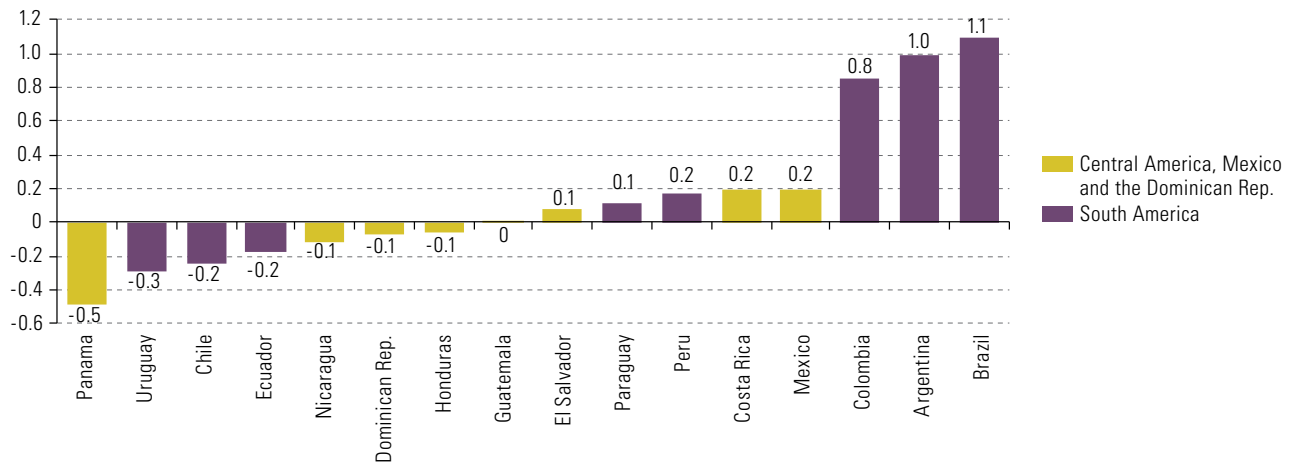
The most striking example of such programmes was implemented in Trinidad and Tobago, which raised about 1.5% of GDP over a three-month period in 2019. A similar amnesty in Costa Rica collected 0.6% of GDP. Payments from corporate entities accounted for 99% of that figure, with 88% related to income tax debts. As at 30 January 2020, Panama's tax amnesty had resulted in the collection of taxes amounting to 0.1% of GDP. Unlike the other countries where corporate income tax accounted for the lion's share of collection, in the case of Panama, the highest tax take was from property taxes (18.1% of the total).

Colombia implemented a programme for the regularization of unreported assets and non-existent liabilities. Taxpayers wishing to benefit from the amnesty had the option to pay this normalization tax at a rate of 13%. If the taxpayer opted to repatriate foreign assets and invest them in Colombia for the period defined under the programme, this rate was reduced to 6.5%. At the close of the programme at end-September, the declared assets and liabilities represented close to 1.3% of GDP, which produced tax income of around 0.1% of GDP. Of the assets disclosed, those repatriated came to some 0.4% of GDP.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Ministry of Finance of Costa Rica, "Recaudación por amnistía tributaria superó la expectativa de 0,5% del PIB", San José, 5 March 2019 [online] <https://www.hacienda.go.cr/noticias/15009-recaudacion-por-amnistia-tributaria-supero-la-expectativa-de-05-del-pib>; Ministry of Economy and Finance of Panama, "Amnistía tributaria", Panama City, 30 January 2020 [online] <https://www.mef.gob.pa/2020/01/amnistia-tributaria/>; national legislation and official figures.

Figure II.3

Latin America: changes in other central government revenues, by subregion, 2018–2019
(Percentage points of GDP)



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

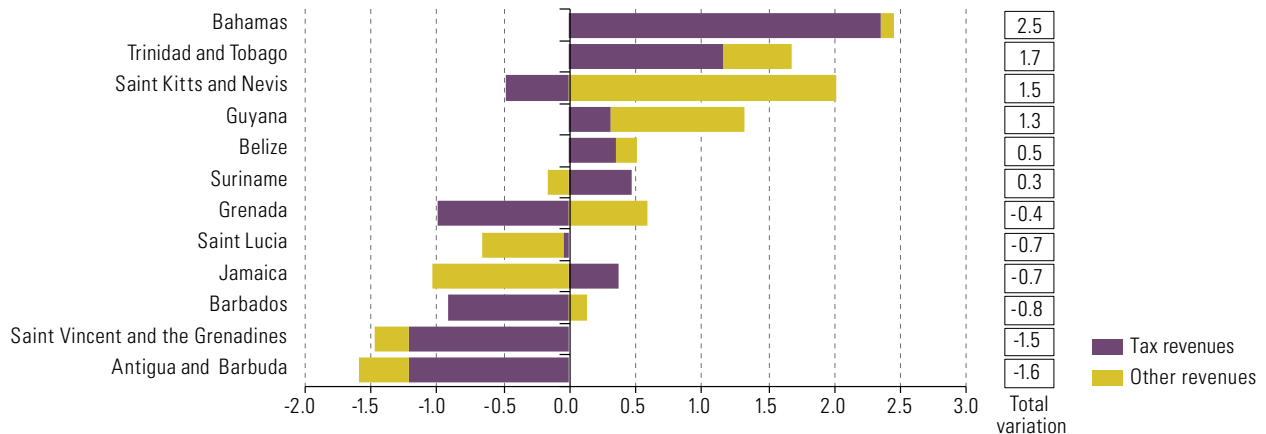
Note: In the cases of Mexico and Peru, the figures are for the federal public sector and the general government, respectively.

In the Caribbean, public revenue trends have also been marked by the collection of non-recurring income. The average of total income in the subregion rose slightly, reaching 27.5% of GDP in 2019 compared with 27.3% in 2018. An analysis by component of revenue shows that tax receipts remained stable at 21.7% of GDP, after a strong performance in 2018 owing to the implementation of tax measures in some countries. However, despite this average stability, the performance of tax receipts was uneven at country level. In the Bahamas, higher tax revenues were driven by an increase in the VAT tax rate (7.5% to 12%), and it also increased in Trinidad and Tobago as a result of the tax regularization programme. In contrast, in Antigua and Barbuda, Barbados and Saint Vincent and the Grenadines, tax revenues shrank, primarily on account of lower receipts from taxes on consumption of goods and services and on international trade.

Other revenues—comprising non-tax revenues, capital revenues and grants—accounted for 5.8% of GDP in 2019, up from 5.6% of GDP in 2018. There were notable increases in Saint Kitts and Nevis, as a result of the citizenship by investment programme, and in Guyana owing to the transfer of funds relating to oil exploration rights from the ExxonMobil signature bonus account that was held at the Bank of Guyana (Ministry of Finance of Guyana, 2019).

Figure II.4

The Caribbean: changes in total central government revenues, 2018–2019
(Percentage points of GDP)



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

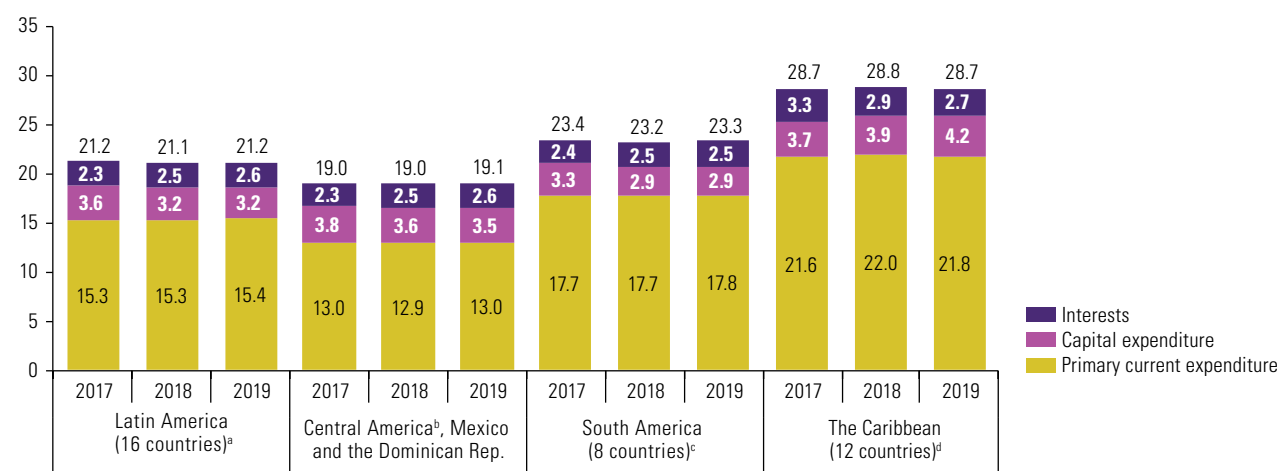
Note: In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

C. Public spending was relatively stable in Latin America and the Caribbean in 2019

In Latin America, total public spending stood at 21.2% of GDP, reflecting a marginal rise of 0.1 percentage point of GDP from 2018 (see figure II.5). This increase was also observed in the group of countries comprising Central America, Mexico and the Dominican Republic and in South America. Among the main components of spending, there was a slight increase of 0.1 percentage points of GDP in primary current expenditure and interest payments. Meanwhile, capital expenditure remained stable at 3.2% of GDP during the year, stemming a downward trend that had begun in 2014.

Figure II.5

Latin America and the Caribbean: composition of public expenditure by subcomponent, 2017–2019
(Percentages of GDP)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively; in the case of Saint Kitts and Nevis, they are for the federal government and in the case of Barbados, the non-financial public sector.

^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

^b Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

^c Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay.

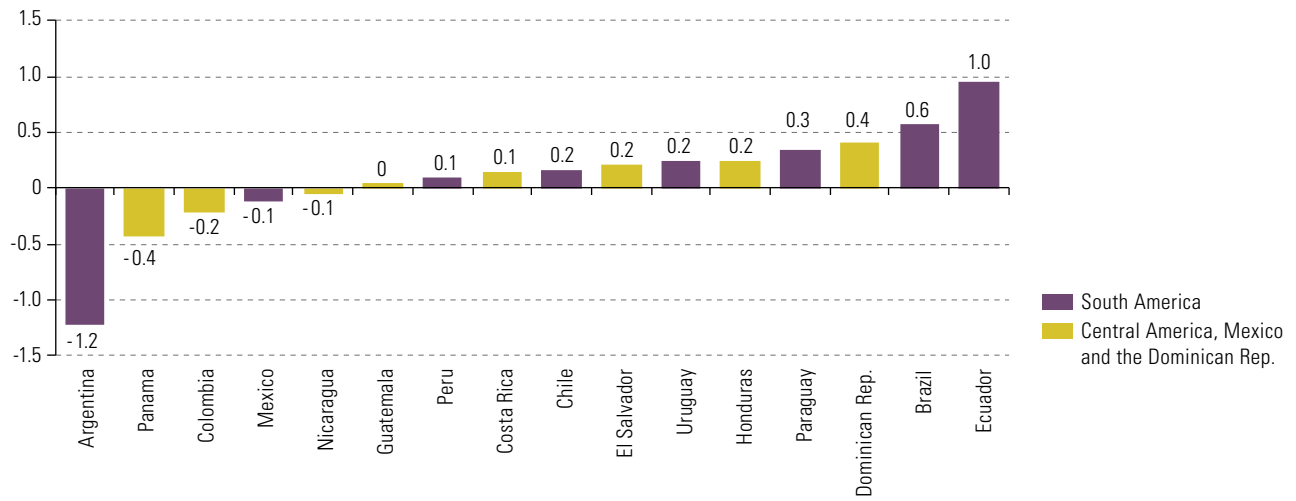
^d Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

In Latin America, primary current expenditure edged up to 15.4% of GDP in 2019 from 15.3% in 2018. Similar changes were seen in the averages for Central America, Mexico and the Dominican Republic and for South America. However, the results varied at country level. Figure II.6 shows increases in Brazil (0.6 percentage points of GDP), resulting from the transfer of funds from tenders for oil and gas exploration and production concessions in November, and in Ecuador (1 percentage point of GDP), resulting from transfers to the Ecuadorian Social Security Institute (IESS), pursuant to an order by the Constitutional Court of Ecuador.¹ The Dominican Republic also registered an increase (0.4 percentage points of GDP), owing to higher subsidies and transfers to the public sector, including the electricity sector. In contrast, Argentina and Panama saw significant contractions in primary current expenditure amid fiscal consolidation.

¹ Under the Labour Justice and Recognition of Work in the Home Act of 2015, the central government's contribution of 40% of pensions was abrogated and replaced by a guarantee. In March 2018, the Constitutional Court of Ecuador ruled this change unconstitutional and ordered the central government to resume the transfer of funds to IESS beginning in 2019.

Figure II.6

Latin America: year-on-year change in central government primary current expenditure, 2018–2019
(Percentage points of GDP)



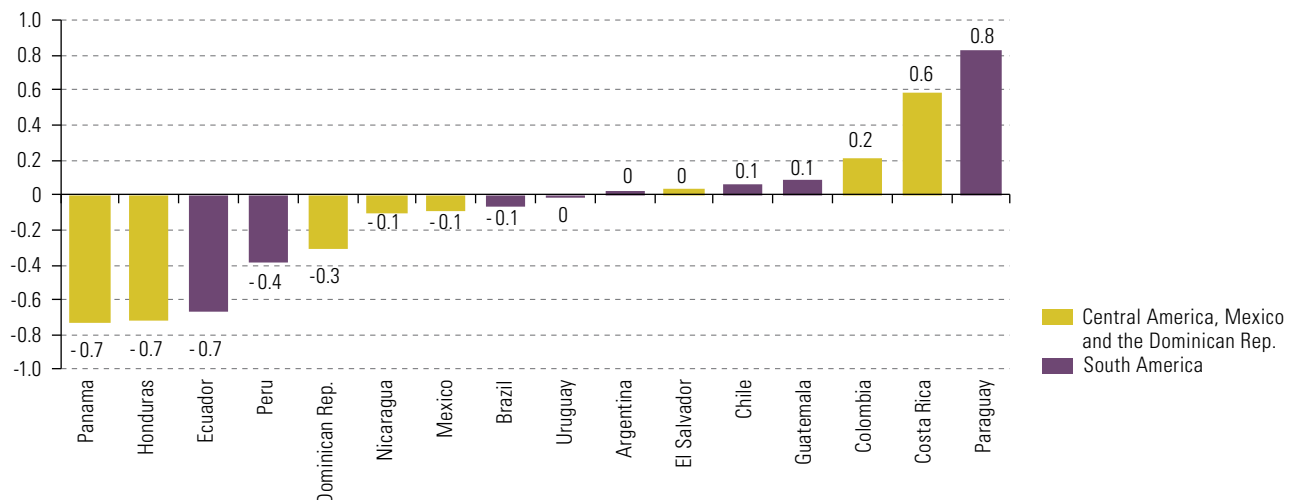
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

The downtrend in capital expenditure seen in recent years in Latin America has slowed, as spending held steady at 3.2% of GDP in 2019, as in 2018. At the subregional level, capital expenditure in Central America, Mexico and the Dominican Republic fell to 3.5% of GDP in 2019, from 3.6% in 2018, while in South America it remained stable at 2.9% of GDP. The patterns in capital expenditure varied considerably from country to country (see figure II.7). Spending picked up in Costa Rica, following a transfer of funds from the Inter-American Development Bank (IDB) towards investment in infrastructure projects, and in Paraguay, where road projects continued to be carried out (Ministry of Finance of Paraguay, 2019 and 2020; IDB, 2019). In contrast, capital expenditure decreased significantly in Ecuador, the Dominican Republic, Honduras, Panama and Peru, reflecting the impact of fiscal consolidation measures and, in some countries, lower revenues from non-renewable natural resources.

Figure II.7

Latin America: year-on-year change in central government capital expenditure, 2018–2019
(Percentage points of GDP)

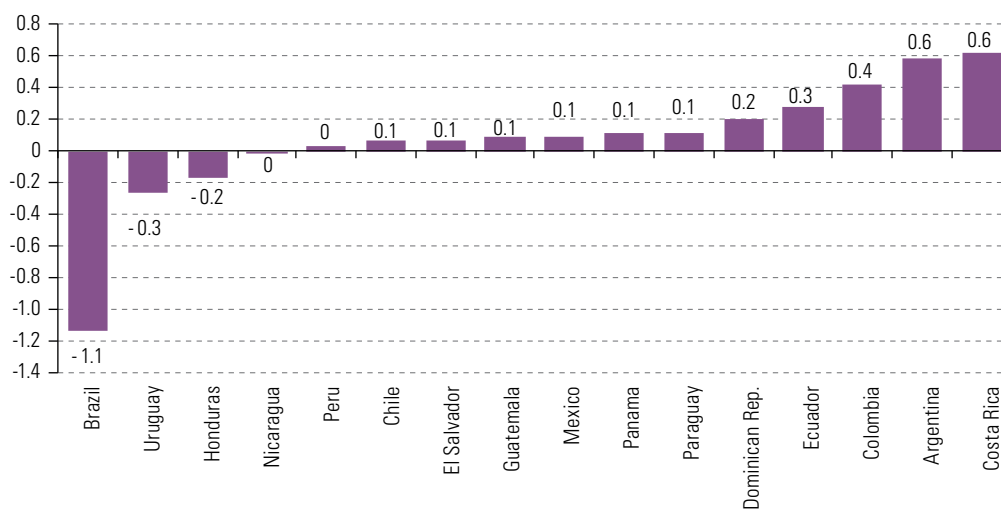


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

Interest payments accounted for 2.6% of GDP in 2019, edging up by 0.1 percentage point of GDP relative to 2018. A subregional breakdown shows an increase in this spending item—in line with the regional average—in the countries of Central America, Mexico and the Dominican Republic, while in South America it held steady at 2.5% of GDP. Four countries recorded increases in interest payments above the regional average: Argentina (0.6% of GDP), Colombia (0.4% of GDP), Costa Rica (0.6% of GDP) and Ecuador (0.3% of GDP). Meanwhile, these payments declined in Brazil (1.1% of GDP), Uruguay (0.3% of GDP) and Honduras (0.2% of GDP). Notwithstanding these trends, Argentina, Brazil and Costa Rica remain the three Latin American countries with the highest interest payments in GDP terms, with levels exceeding 4% (see figure II.8).

Figure II.8
Latin America: year-on-year change in central government interest payments, 2018–2019
(Percentage points of GDP)



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

Note: In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

The Caribbean has seen some change in the breakdown of total expenditure, which stood at 28.7% of GDP in 2019, down marginally from 28.8% in 2018. Notably, capital expenditure increased to 4.2% of GDP in 2019, compared with 3.9% in 2018. At the same time, interest payments were down slightly, in line with the downward trend in public debt levels.

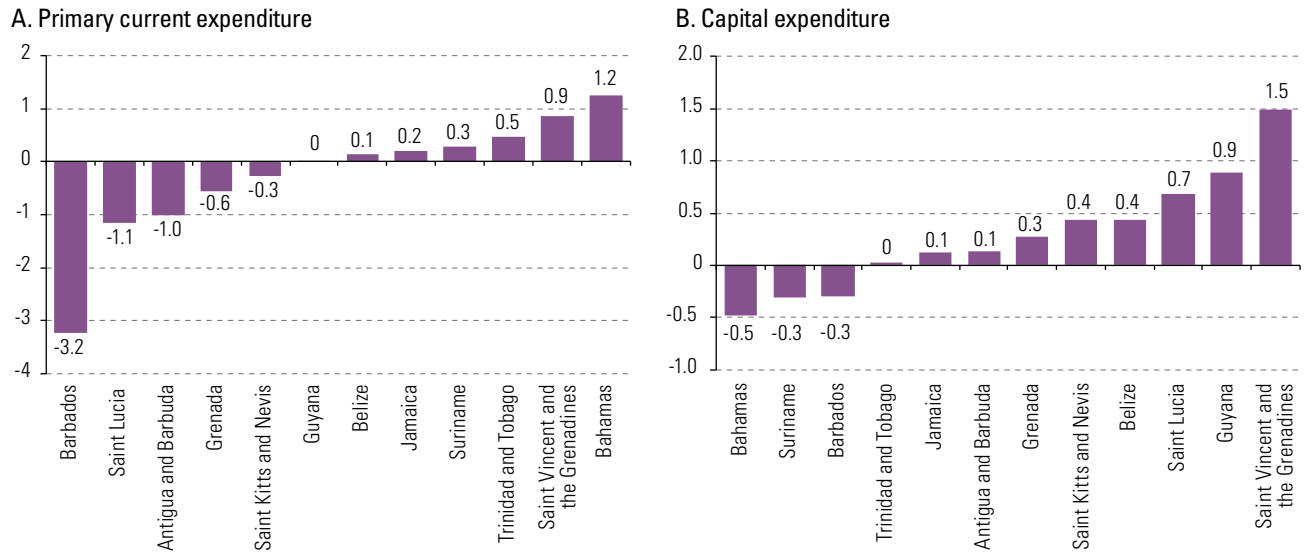
Primary current expenditure contracted slightly in 2019, but this average reflected sharp declines in a few countries, as was the case in Barbados (3.2% of GDP), Saint Lucia (1.1% of GDP) and Antigua and Barbuda (1.0% of GDP) (see figure II.9). Inversely, primary current expenditure as a share of GDP rose in six Caribbean countries, and by over 0.5 percentage points in the Bahamas, Saint Vincent and the Grenadines and Trinidad and Tobago. In the Bahamas, the spending jump 1.2% of GDP was owed to higher payments for goods and services, mainly related to the settlement of arrears owed to suppliers (Central Bank of the Bahamas, 2019). In Saint Vincent and the Grenadines, the upward trend in primary current expenditure reflected the rise in transfers and a higher wage bill following salary increases for teachers. The increase in primary current expenditure in Trinidad and Tobago was driven by a number of factors. These included greater subsidies to households for fuel and non-contributory pension payments, as well as a transfer of funds to the Petroleum Company of Trinidad and Tobago (Petrotrin) for costs associated with the closure of the refinery (Government of the Republic of Trinidad and Tobago, 2019).

Capital expenditure continued its upward trend in the Caribbean countries in 2019, with an increase in the subregion as a whole. Several infrastructure projects were implemented in Saint Vincent and the Grenadines (a geothermal energy plant and a disaster rehabilitation and mitigation project financed by the World Bank, among others), resulting in capital expenditure rising by 1.5% of GDP. In Guyana, the implementation of

an ambitious public investment programme, driven by investment in public works and electricity generation, saw capital expenditure edge up by 0.9% of GDP (Ministry of Finance of Guyana, 2019). Saint Lucia also executed various infrastructure investment projects, including the redevelopment of the Hewanorra International Airport.

Figure II.9

The Caribbean: year-on-year change in central government primary current and capital expenditure, 2018–2019
(Percentage points of GDP)



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

Note: In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

Consistent with shrinking public debt in the Caribbean, interest payments were also on the decline, down to 2.7% of GDP in 2019 from 2.9% in 2018. Only Belize, Jamaica and Saint Vincent and the Grenadines saw their debt interest rise relative to GDP, with increases of 0.4%, 0.2% and 0.1% of GDP, respectively (see figure II.10). Meanwhile, the largest declines were in Barbados (1.4% of GDP) and Suriname (0.5% of GDP). Among the Caribbean countries, Jamaica continued to pay the most interest in relation to GDP (6.5%) in 2019, followed by Suriname (3.3% of GDP), Saint Lucia (3.1% of GDP) and Trinidad and Tobago (3.1% of GDP).



Figure II.10

The Caribbean: year-on-year change in central government interest payments, 2018–2019
(Percentage points of GDP)

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

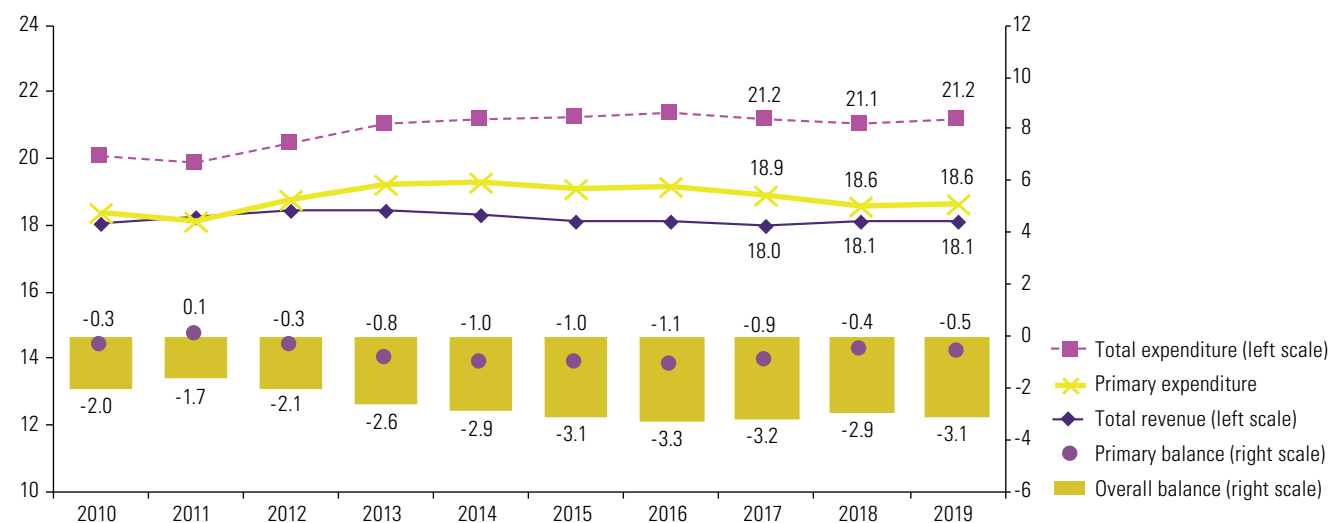
Note: In the case of Saint Kitts and Nevis, figures are for the federal government; in the case of Barbados, for the non-financial public sector.

D. Larger fiscal deficits in Latin America signalled a reversal of the trend towards narrowing deficits seen in the past two years

In Latin America, the central government primary balance, an indicator of fiscal efforts to place public debt on a sustainable path, deteriorated slightly, running an average deficit of 0.5% of GDP in 2019, compared with 0.4% of GDP in 2018 (see figure II.11), owing to the marginal growth in primary spending. Meanwhile, the overall balance improved, up to 3.1% of GDP in 2019 compared to 2.9% of GDP in 2018. Importantly, both deficits would have widened further had it not been for non-recurring income receipts in a number of countries.

Figure II.11

Latin America (16 countries)^a: central government fiscal indicators, 2010–2019
(Percentages of GDP)



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

Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

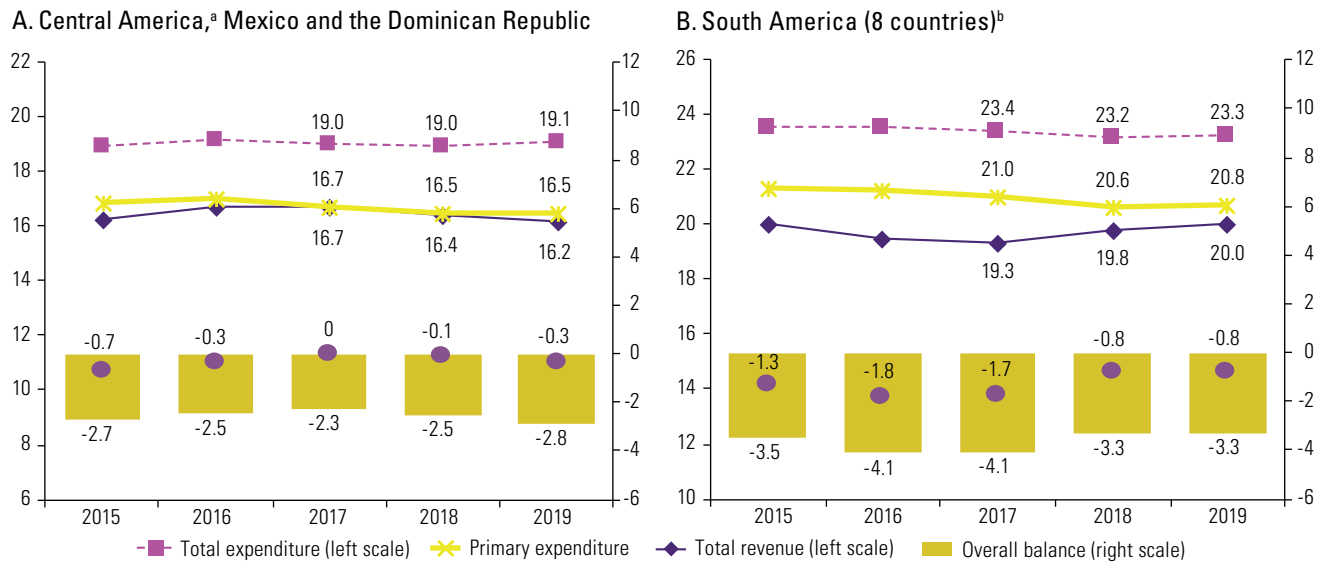
^a Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

Deficit patterns were different across subregions. The group of countries comprising Central America, Mexico and the Dominican Republic recorded a primary deficit of 0.3% of GDP in 2019, reflecting a year-on-year deterioration of 0.2 percentage points of GDP. Meanwhile, the overall balance showed a deficit of 2.8% of GDP in 2019, widening by 0.3 percentage points of GDP compared to 2018. In the countries of South America, the deficits in the primary and overall balances held steady at 0.8% of GDP and 3.3% of GDP respectively (see figure II.12). As mentioned above, both indicators remained stable principally because of the receipt of extraordinary income in some of these countries.

At the country level, the situation varied widely. Among the 16 Latin American countries included in figure II.13, 10 registered a primary deficit in 2019, 6 of them in excess of 1% of GDP (Brazil, Chile, Costa Rica, Ecuador, Panama and Paraguay). In contrast, there was a primary surplus in six countries in 2019 (Argentina, Colombia, the Dominican Republic, El Salvador, Honduras and Mexico).

Figure II.12

Latin America: central government fiscal indicators, by subregion, 2015–2019
(Percentages of GDP)



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

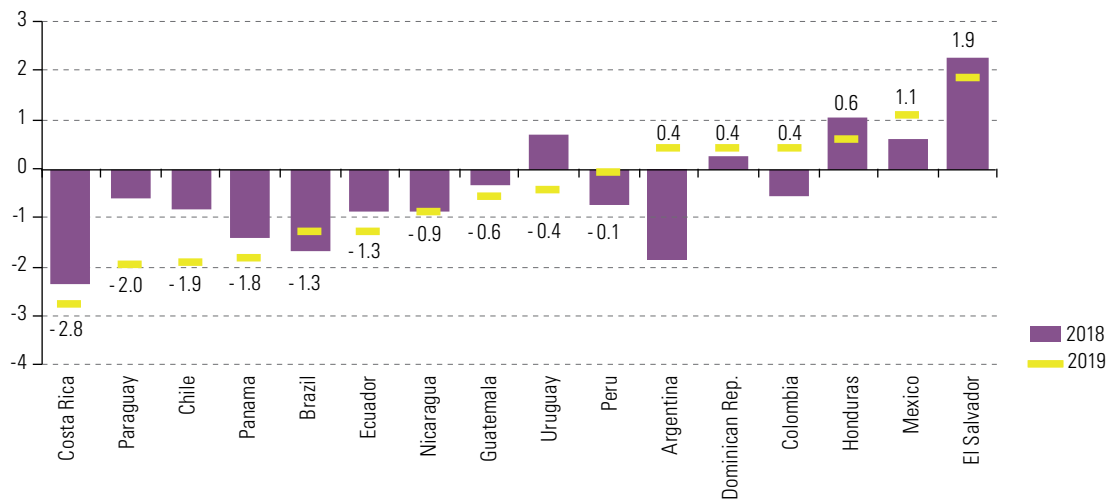
Note: Simple averages. In the cases of Argentina, Mexico and Peru, the figures are for the national public administration, the federal public sector and the general government, respectively.

^a Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

^b Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay.

Figure II.13

Latin America: central government primary balance, 2018–2019
(Percentage points of GDP)



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

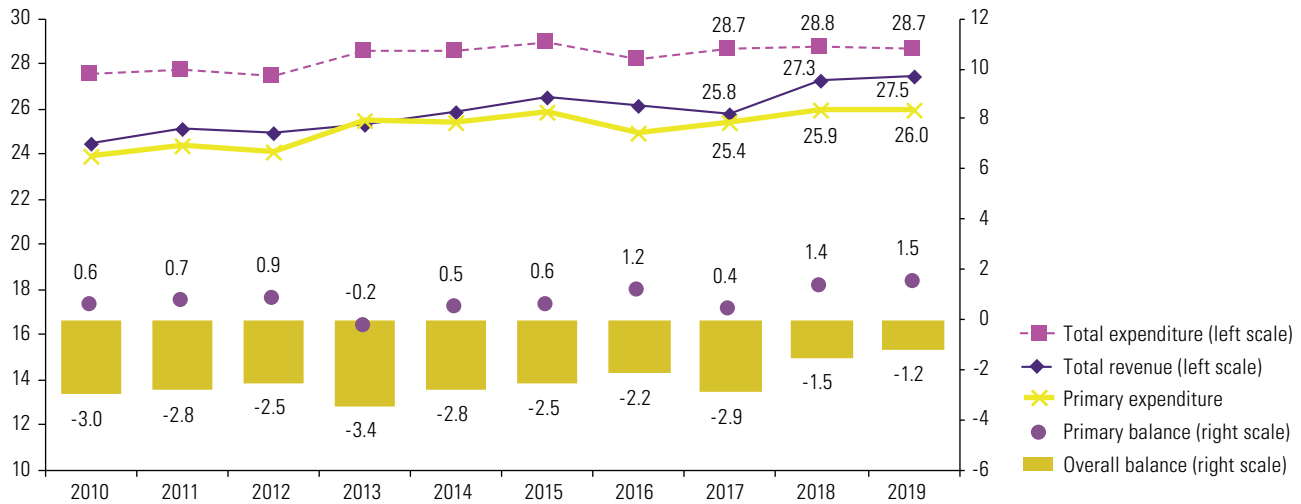
Note: Simple averages. In the cases of Argentina, Mexico and Peru the figures are for the national public administration, the federal public sector and the general government, respectively.

Besides the extent of the primary deficits, large fluctuations were observed in each country's fiscal position in 2019. Argentina attained a primary surplus of 0.4% of GDP, compared to a deficit of 1.9% in 2018, on the back of adjustment measures implemented under its agreement with the International Monetary Fund (IMF). Colombia also saw its primary balance improve from a deficit to a surplus. However, as mentioned above, this was partly due to extraordinary income receipts in 2019. Conversely, negative year-on-year changes of more than 1 percentage point of GDP were recorded in Chile (1.1% of GDP), Paraguay (1.4% of GDP) and Uruguay (1.2% of GDP).

The Caribbean's fiscal balance continued to improve in 2019. Trends in income and expenditure (especially interest payments) eased the deficit in the overall balance, which narrowed to 1.2% of GDP in 2019 from 1.5% in 2018 (see figure II.14). The primary balance remained in surplus, at 1.5% of GDP, which was a slight improvement on the 1.4% registered in 2018. However, like elsewhere in the region, the marginal increase in total revenue was attributable in part to the rise in extraordinary income.

Figure II.14

The Caribbean (12 countries)^a: central government fiscal indicators, 2010–2019
(Percentages of GDP)



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

Note: Simple averages. In the case of Saint Kitts and Nevis, figures are for the federal government and in the case of Barbados, the non-financial public sector.

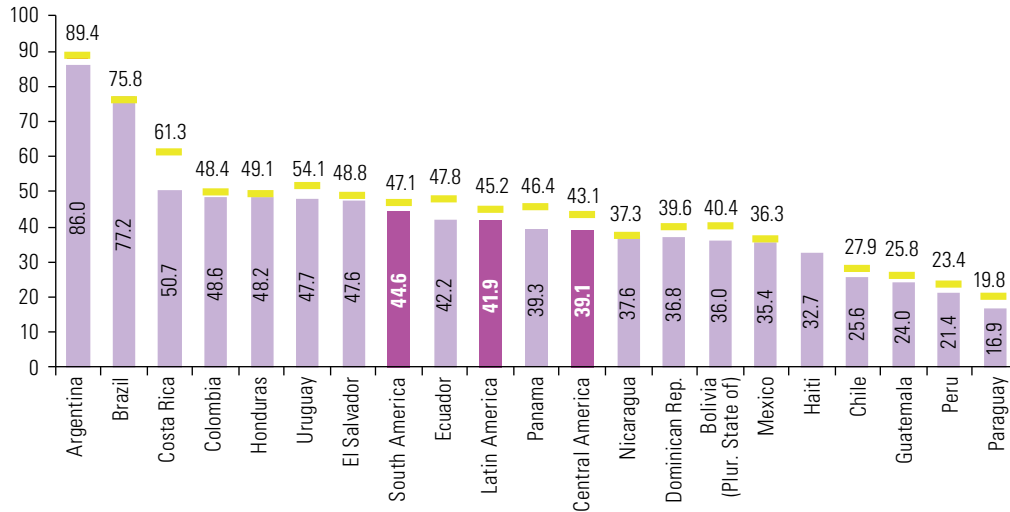
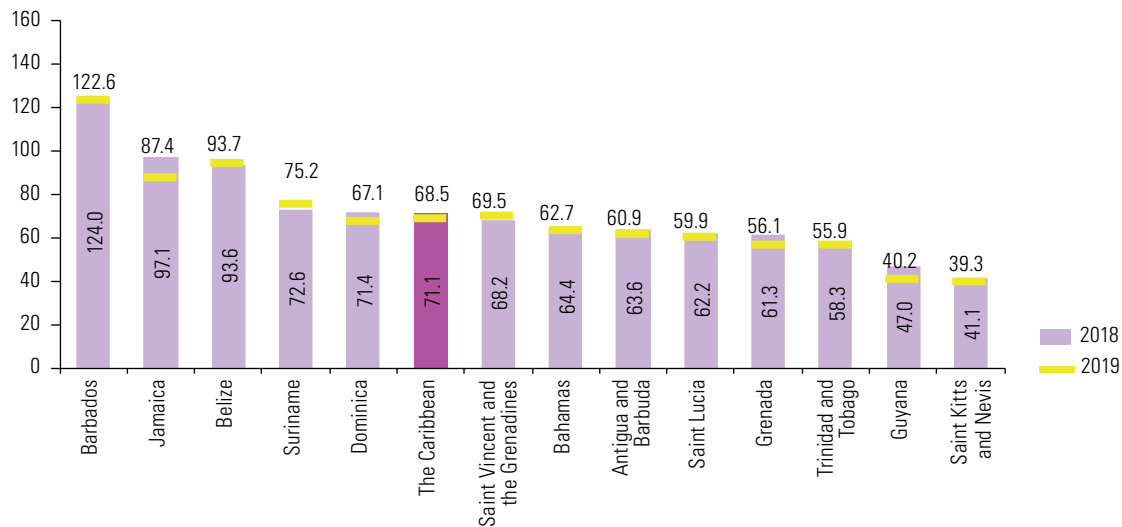
^a Antigua and Barbuda, Bahamas, Barbados, Belize, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

E. Debt has kept increasing in Latin America, but has continued to fall in the Caribbean

In 2019, the gross public debt of the central governments of Latin America averaged 45.2% of GDP, 3.3 GDP points more than 2018. This increase reflects the change in gross central government debt in the countries of Central America, Mexico and the Dominican Republic, which jumped 3.9 percentage points of GDP over the same period. The average for South America rose by 2.5 percentage points of GDP to 47.1% by end-2019. Argentina, Brazil and Costa Rica remain the three countries in the region with the highest levels of debt as a share of GDP, while Guatemala, Paraguay and Peru continue to have the lowest percentages in the region (see figure II.15). The trend in the Caribbean is towards a contraction of debt, which narrowed from 71.1% to 68.5% of GDP between 2018 and 2019.

Figure II.15

Latin America and the Caribbean: central government gross public debt, 2018–2019
(Percentages of GDP)

A. Latin America (18 countries)^{a,b}**B. The Caribbean (13 countries)^c**

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

Note: Figures for Guatemala, Honduras and all the countries of the Caribbean refer to the third quarter of 2019, while those for Nicaragua refer to the first quarter.

^a The figures are for the general government in Brazil and for the National Treasury in the Plurinational State of Bolivia.

^b The figure for Central America includes Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua and Panama.

^c Public sector figures for Belize, Guyana and Jamaica.

Box II.4

Trends and challenges in non-financial public sector gross public debt in Latin America

According to the *Government Finance Statistics Manual, 2014* (IMF, 2014), statistics for the non-financial public sector (NFPS) should be compiled from central government, local governments, state agencies, social security funds and non-financial public companies so as to present a comprehensive picture of overall government.

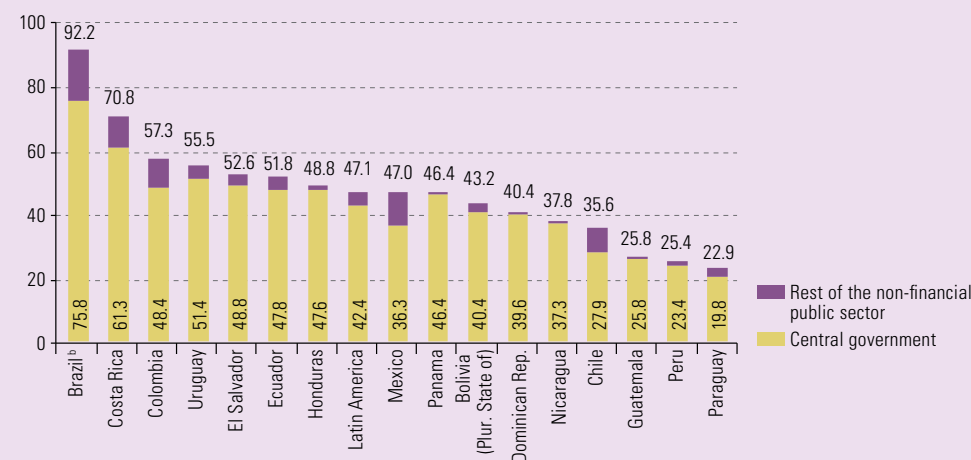
While most Latin American countries follow these accounting standards in presenting their gross debt balances, some countries do not include public enterprises in their official classification (Brazil and Paraguay), or exclude certain companies (Panama). In other countries, the public banking sector is excluded from the public financial sector, but free market operations carried out by the central bank (Brazil) or development bank liabilities (Argentina, Ecuador, Mexico) are included. In Mexico, public debt data are broken down into three categories: (i) federal government debt; (ii) public sector debt; and (iii) the historical balance of public sector financial requirements. Federal government debt includes not only liabilities contracted by the government (loans, bonds and other instruments) but also the accounts related to social security and pension bonds for Petróleos Mexicanos (PEMEX) and the Federal Electricity Commission (CFE). The federal public sector as a whole encompasses data from the federal government, State-owned production companies (PEMEX and CFE) and public development banks.

The historical balance of public sector financial requirements is a broader concept of public debt, as it includes all public policy instruments that may involve public sector borrowing, including off-budget public sector liabilities. Since the amendment of the Federal Budget and Treasury Responsibility Act in 2014, this balance includes: the budgetary public sector, the Bank Savings Protection Institute (IPAB), liabilities related to the support programme for bank debtors, the National Infrastructure Fund (FONADIN) (roads), development banks, development funds (net of assets or recovery value) and productive infrastructure investment projects that allow for deferred recording in CFE public expenditure.

NFPS gross public debt in Latin America averaged 47.1% of GDP in 2019. The countries in which this represented the highest share of GDP were Brazil (92.2%), Costa Rica (70.8%) and Colombia (57.3%) (see figure 1). In those three countries, as well as Mexico, the debt for the rest of the non-financial sector accounted for more than 8% of GDP. In contrast, this subsector's debt did not exceed 1 GDP point in the Dominican Republic, Guatemala, Nicaragua and Panama.

Figure

Latin America (16 countries):^a gross non-financial public sector public debt, by subsector, 2019
(Percentages of GDP)



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

^a Does not include Argentina, Bolivarian Republic of Venezuela or Haiti, owing to a lack of data.

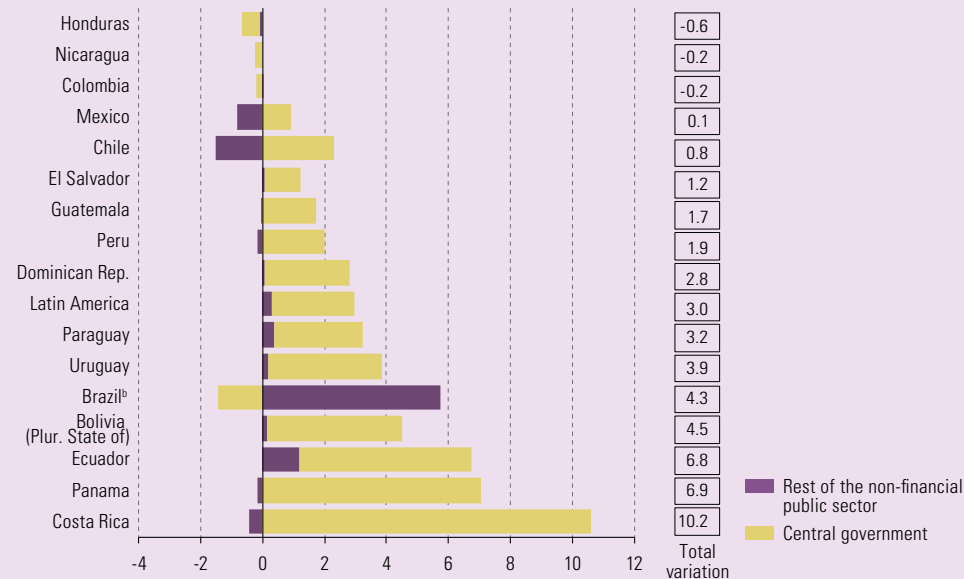
^b Data for the non-financial public sector correspond to IMF projections from July 2019.

Box II.4 (concluded)

Gross NFPS debt in Latin America rose by 3 percentage points, from 44.1% of GDP in 2018 to 47.1% of GDP on average. This gradual increase is mainly attributable to the central government balance, since changes in the rest of the NFPS generally did not exceed 1 GDP point. In Chile, Costa Rica, Mexico, Panama and Peru, the rest of the public sector contributed negatively to the variation in NFPS debt. Brazil is the only country where the debt expanded more for the rest of the non-financial sector than for the NFPS, (by 5.7 and 4.3 percentage points of GDP, respectively) (see figure 2).

Figure 2

Latin America (16 countries)^a: changes in gross non-financial public sector debt, by subsector, 2018–2019
(Percentages of GDP)



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

^a Does not include Argentina, Bolivarian Republic of Venezuela or Haiti, owing to a lack of data.

^b Data for the non-financial public sector correspond to IMF projections from July 2019.

Latin American countries have made progress in harmonizing NFPS accounting standards. However, there are specificities pertaining to each country's institutional framework. Moving towards harmonized and disaggregated accounting for the NFPS would strengthen fiscal transparency on the financial position of the total public sector, and in particular of the social security funds, public enterprises, local governments and semi-autonomous State agencies therein. Consolidating this information in a comprehensive, structured and relevant manner would facilitate the identification of potential financial risks and thus the formulation of appropriate prevention and mitigation measures with a view to preserving macroeconomic stability.

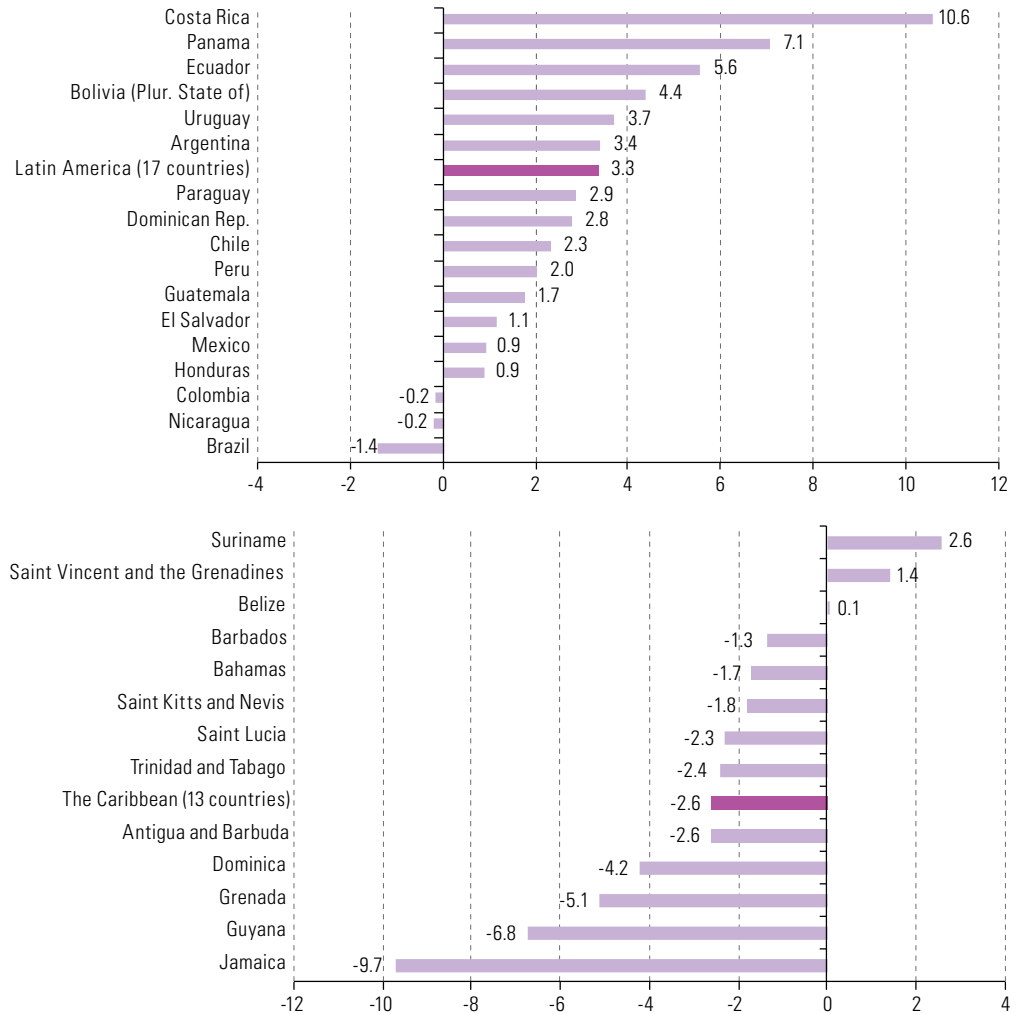
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *Government Finance Statistics Manual, 2014*, Washington, D.C., 2014; and official figures.

The uptrend in debt in Latin America (3.3 percentage points of GDP) was driven mainly by Costa Rica, Panama and Ecuador, which saw their gross debt increase by 10.6, 7.1 and 5.6 percentage points of GDP, respectively (see figure II.16). The situation is different in the Caribbean, where most of the countries have registered a decline in debt as a share of GDP. Jamaica's gross debt narrowed the most —by 9.7 percentage points of GDP— between 2018 and 2019, followed by Guyana (6.8 percentage points), Grenada (5.1 percentage points) and Dominica (4.2 percentage points). Meanwhile,

Suriname, Saint Vincent and the Grenadines, and Belize increased their debt-to-GDP ratios by 2.6, 1.4, and 0.1 percentage points of GDP, respectively.

Central government gross public debt in Latin America hit its lowest level in 20 years in 2011, at 29.8% of GDP. Since then, the region's debt balance has risen by 15.4 percentage points of GDP, reaching 45.2% in 2019. A breakdown of the data shows that among the 18 countries for which information is available, debt growth outpaced the regional average in 6: by 50.1 percentage points of GDP in Argentina; by 31.7 percentage points in Costa Rica; by 30.1 percentage points in Ecuador; by 24.5 percentage points in Brazil; by 16.9 percentage points in Chile; and by 16.4 percentage points in Honduras (see figure II.17).

Figure II.16
Latin America and the Caribbean: change in central government gross public debt, 2018–2019^a
(Percentage points of GDP)



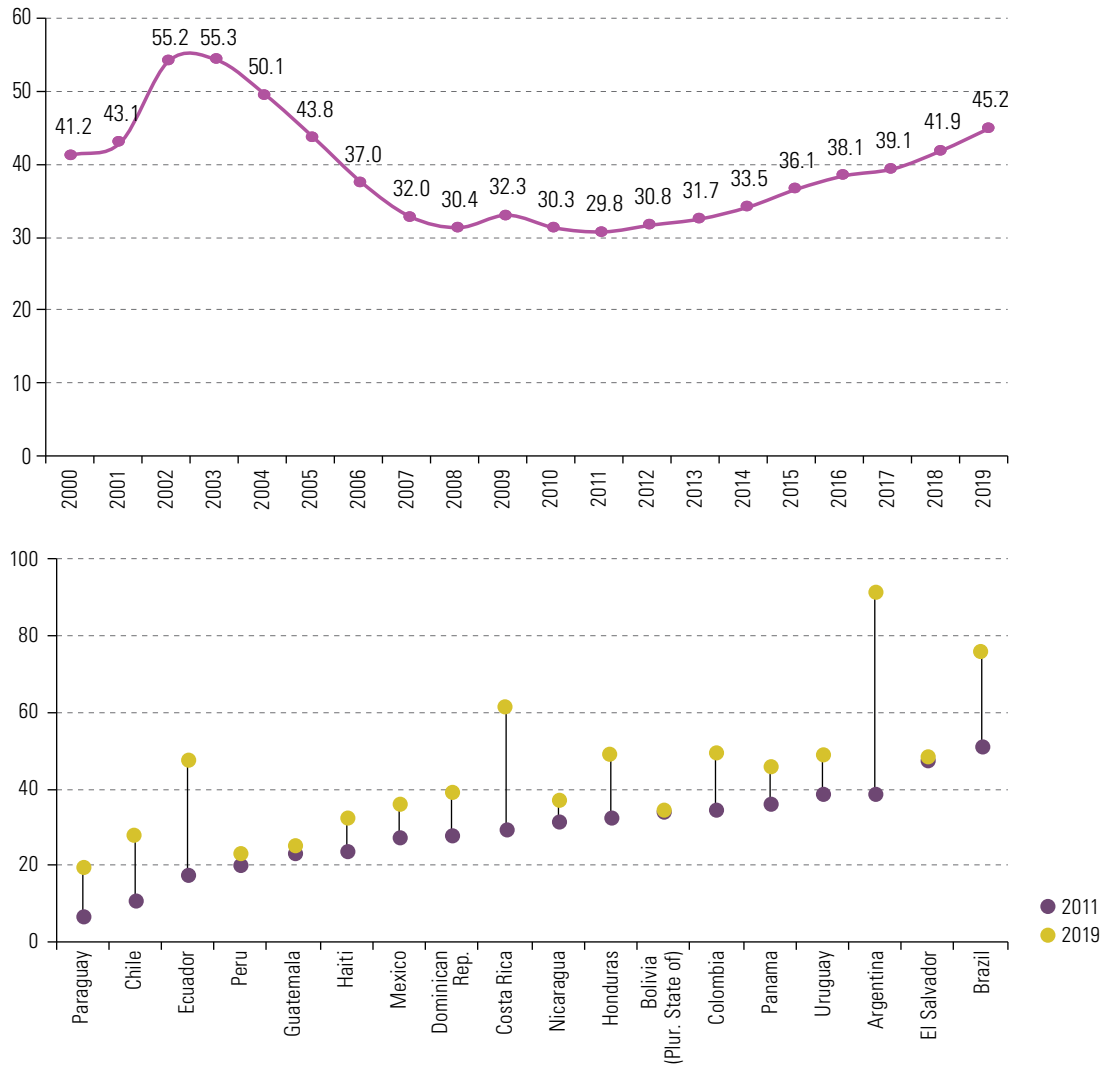
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: The figures are for the general government in Brazil and for the National Treasury in the Plurinational State of Bolivia.

^a Figures for Guatemala, Honduras and all the countries of the Caribbean refer to the third quarter of 2019, while those for Nicaragua refer to the first quarter.

Figure II.17

Latin America (18 countries): change in central government gross public debt, 2011–2019^a
(Percentages of GDP)



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

Note: The figures are for the general government in Brazil and for the National Treasury in the Plurinational State of Bolivia.

^a Figures for Guatemala, Honduras and all the countries of the Caribbean refer to the third quarter of 2019, while those for Nicaragua refer to the first quarter. In the case of Haiti, the second quarter of 2018 is the last year for which data are available.

Box II.5

Debt issues on international financial markets, 2019

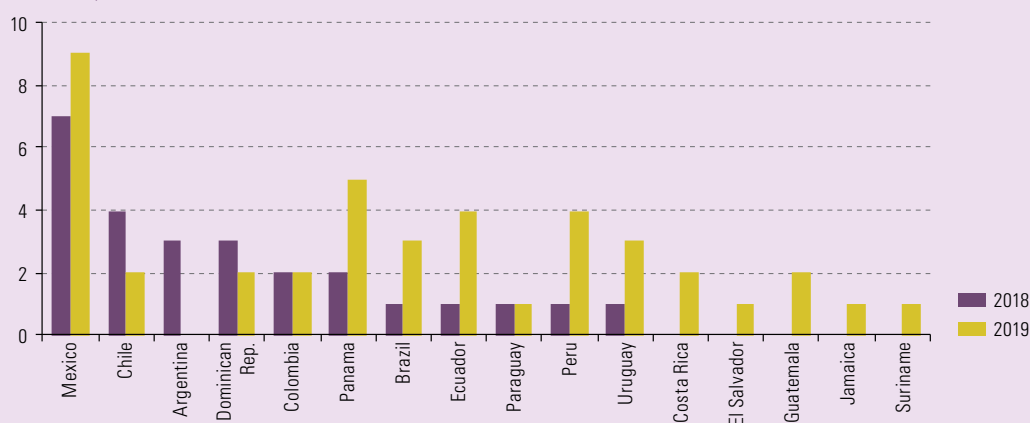
In 2019, the countries of the region placed US\$ 42.354 billion in bonds in international capital markets, an increase of 15.7% over 2018. This rise reflected more favourable access conditions, despite a deterioration in credit ratings. A recent publication of the Economic Commission for Latin America and the Caribbean (ECLAC) shows that, between January and October 2019, there were 18 downgrades and only 11 improvements in credit ratings in the region (ECLAC, 2019b). At the same time, margins shrank as capital markets became less volatile in the wake of the conclusion of the first phase of the trade agreement between the United States and the Republic of China, as well as the commitment by central banks to keep monetary policies loose.

Against this backdrop, there was an increase in the number of sovereign bonds issued by the region's countries (from 26 in 2018 to 42 in 2019) and in the number of countries issuing them (11 countries in 2018 compared with 15 in 2019). Some countries returned to sovereign bond markets after an absence, such as Costa Rica and Suriname, which had not issued bonds since 2015 and 2016, respectively. In November 2019, Costa Rica placed US\$ 1.5 billion in the market in two bond transactions: the first was issued for US\$ 1.2 billion, maturing in 10 years with a 6.13% yield and the other for US\$ 300 million, maturing in 25 years with a 7.16% yield. Roughly 80% of the issuance was bought by long-term bond holders, which include pension funds, portfolio managers and insurance companies, while the rest was placed in banks and hedge funds. Suriname issued US\$ 125 million in medium-term bonds (three-year maturity) with a yield of 9.88%.

Mexico remains the region's largest issuer, with seven transactions in 2018 and nine in 2019. There were also significant year-on-year increases in the number of transactions in Ecuador, Panama and Peru compared with 2018 (see figure 1). In contrast, Argentina —the country with the most bond issues in 2018 (US\$ 9 billion)— did not seek finance for its fiscal deficit on the international capital in 2019.

Figure 1

Latin America and the Caribbean (16 countries): issuance of public debt securities in international markets, 2018–2019
(Number of transactions)



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

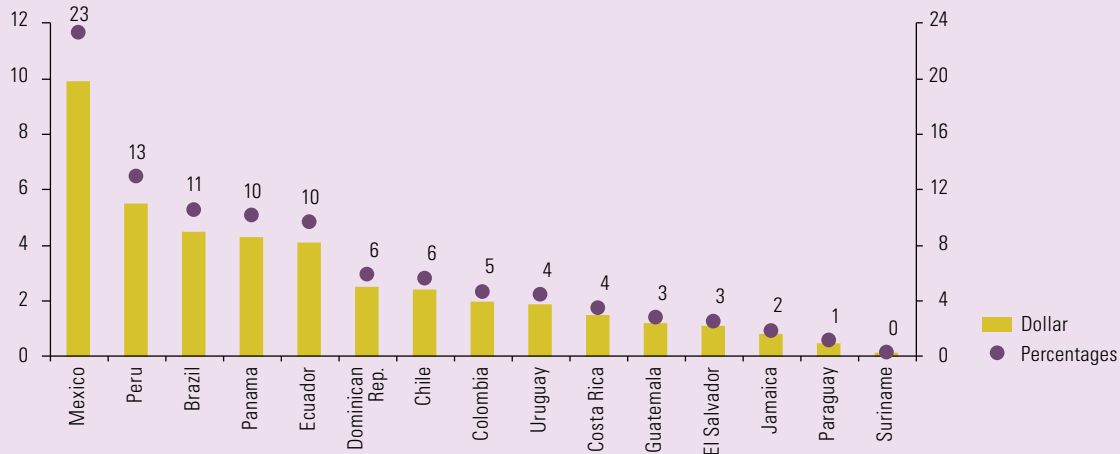
Mexico ranks first in the region in terms of sovereign bond placement, issuing US\$ 9.897 billion in 2019, which accounted for 23% of the total for Latin America and the Caribbean. It is followed by Peru, which issued US\$ 5.491 billion (13%); Brazil (US\$ 4.5 billion and 11% of the total); Panama (US\$ 4.3 billion and 10% of the total); and Ecuador (US\$ 4.125 billion and 10% of the total) (see figure 2). These four countries had the largest increases in the amounts placed in international financial markets, with issues up by 79%, 200%, 146% and 37%, respectively, over 2018. Only three countries decreased the amounts issued in 2019: Chile, down by 48%; the Dominican Republic, by 20%; and Paraguay, by 6%.

In terms of quasi-sovereign entities, which include public enterprises or joint ventures whose bonds are guaranteed by government, Mexico also topped the rankings with US\$ 8.115 billion issued in 2019 by PEMEX (US\$ 7.5 billion) and the Federal Electricity Commission (US\$ 615 million). Chile ranked second, with quasi-sovereign issuers selling US\$ 3.832 billion in bonds, of which the lion's share (US\$ 3.3 billion) was issued by the Corporación Nacional del Cobre de Chile (CODELCO); while Brazilian entity Petrobras issued US\$ 3 billion. In total, the quasi-sovereign corporate sector accounted for US\$ 19.712 billion in issuances in 2019, a 3.3% jump from 2018. This reflects the lower operating margins of the region's public enterprises, particularly those in the oil sector. A case in point is PEMEX, which recorded losses of around US\$ 35 billion (2.7% of GDP) in 2019, in sharp contrast to the comprehensive income of US\$ 2.184 billion recorded in 2018.

These trends in the corporate public sector highlight the need for greater transparency and planning in the internal management of these companies, which raises the familiar question of how to strengthen corporate governance. It is also important to bear in mind the weak tax governance characteristic of these entities: first, they have relatively soft budget restrictions (in terms of how State-owned enterprises take in resources from governments) and, second, governments use these companies' resources in quasi-fiscal operations that usually have a negative impact on their balance sheets.



Box II.5 (concluded)

Figure 2Latin America and the Caribbean (15 countries): issuance of public debt securities in international markets, 2019
(Billions of dollars and shares of total)

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

Debt issuance (including the sovereign and quasi-sovereign sectors) in international markets totalled US\$ 62.067 billion, equivalent to 1.2% of projected GDP in 2019. The sovereign sector (central governments) constituted the larger share, representing 0.8% of GDP compared to 0.4 % of GDP for the quasi-sovereign sector (see figure 3). Panama, with transactions worth US\$ 4.8 billion, issued the most debt as a share of GDP (7.0%), followed by Jamaica (5.2 %), El Salvador (4.1%) and Ecuador (3.8%). In Mexico, which led the region in number and amounts of transactions, total issues represented 1.4% of GDP, with the sovereign sector accounting for 55% of that figure.

Figure 3Latin America and the Caribbean (17 countries): issuance of public debt securities, by institutional sector, 2019
(Percentages of GDP)

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

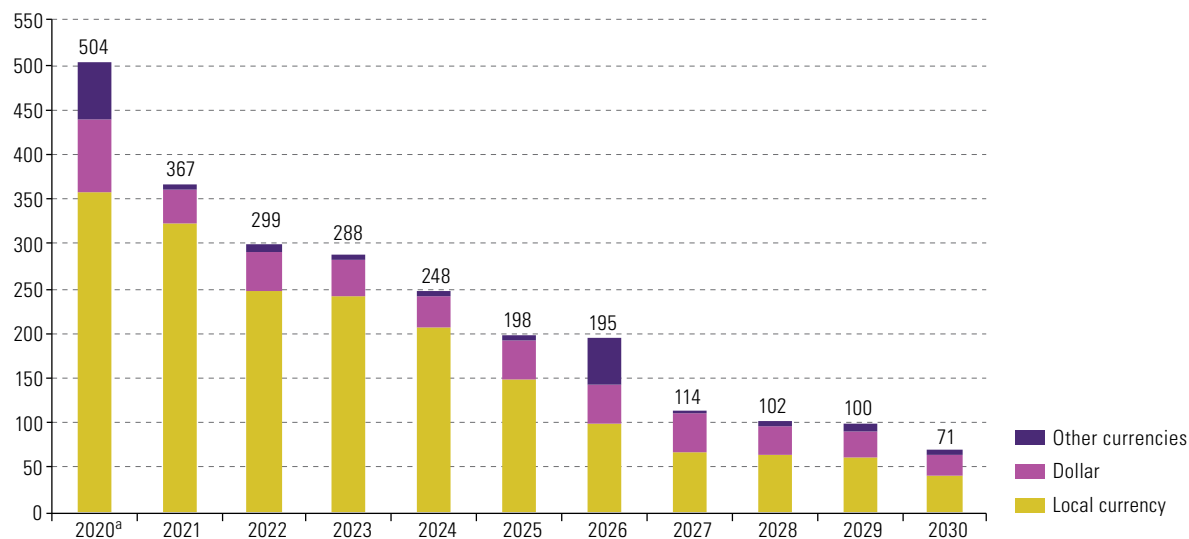
In January 2020, four countries in the region carried out major financial market operations to improve the cost and maturity composition of their debt, among other objectives. It should be noted that these transactions took place under very favourable conditions in international capital markets, which had not yet suffered the shocks caused by the COVID-19 pandemic. Chile issued approximately US\$ 3 billion in green bonds, with yields ranging between 0.695% and 3.275% and maturities between 10 and 30 years, to finance infrastructure projects (extension of certain lines of the Santiago subway system) and liability management (repurchase) transactions. Mexico issued a total of approximately US\$ 4 billion in four transactions, with coupon rates of between 1.1% and 4.5%. Colombia, the Dominican Republic and Peru also capitalized on falling rates exclusively to finance the repurchase of bonds maturing within the next two years, replacing them with bonds with lower coupons.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Dealogic and LatinFinance figures; ECLAC, *Capital Flows to Latin America and the Caribbean* (LC/WAS/TS.2019/6), Washington, D.C., 2019.

Against a backdrop of global financial uncertainty, it is important to analyse future pressure on public debt service. According to Bloomberg figures for February 2020 on sovereign debt instruments traded on the secondary market, Latin American countries will face estimated debt service obligations (principal and interest) of US\$ 2.485 billion between 2020 and 2030 (see figure II.18). Of this amount, 77% (US\$ 1.904 billion) will be payable in the period 2020–2025, with a significant share of US\$ 504 billion (20% of the total) falling due in 2020. The maturity profile of public debt service should change in the coming months in light of the pressures that the COVID-19 pandemic is exerting on central government financing needs.

Figure II.18

Latin America (17 countries): maturity profile of public debt service, by currency, 2020–2030 (Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg [online database] <https://www.bloomberg.com/>.

Note: The figures refer to instruments traded on a secondary market, and thus may not correspond to official data. The sample includes Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

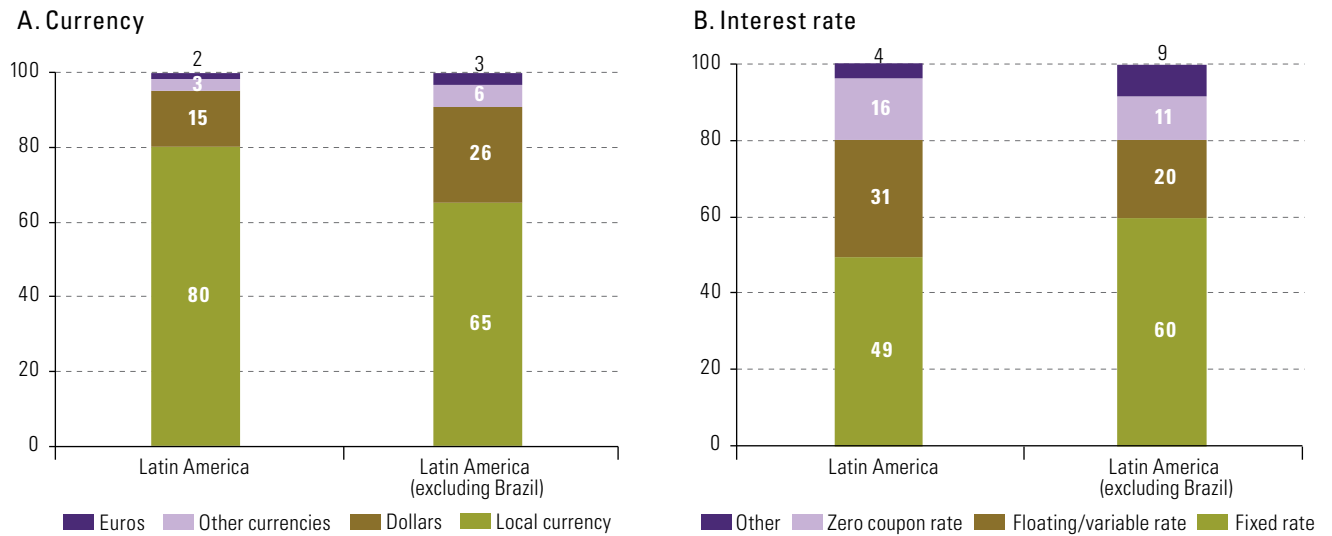
^a Includes cumulative defaults for Argentina and Ecuador.

Analysis of the composition of service on debt stocks for the period 2020–2025, by currency, shows that 80% of debt was in local currency, while 15% was dollar-denominated. However, this breakdown is strongly influenced by Brazil, which issued about 97% of its securities in local currency. If Brazil is excluded from the regional figures, local-currency debt accounts for 65% of the public debt service in Latin America, while dollar-denominated debt accounts for 26% (see figure II.19). The breakdown of interest rates is as follows: about 49% are fixed rates, 31% are floating rates, 16% are zero coupon rates² and 4% other types. When Brazil is excluded, the breakdown shows 60% fixed rate, 20% floating rate, 11% zero coupon and 9% other types, since floating rates account for 33% of the total in that country. The large share of floating rates implies that interest payments are somewhat sensitive to changes in reference rates such as the London Inter-Bank Offered Rate (LIBOR), the United States Federal Reserve interest rate or the central bank rate in the case of Brazil.

² Instrument that pays no interest. It is issued at a discount to its face value and, on the date that it matures, it is redeemed for its face value, since the interest rate paid by the issuer is implicit in the discount. These instruments are usually issued by government treasuries.

Figure II.19

Latin America (17 countries): public debt service burden for the next five years, by currency and interest rate (Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg [online database] <https://www.bloomberg.com/>.

Note: The figures refer to instruments traded on a secondary market, and thus may not correspond to official data. The sample includes Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

The disaggregation of data by country indicates that the composition of debt service is far from uniform. With relatively high shares of foreign-currency debt and floating rates, Costa Rica, Guatemala and Nicaragua, in particular, are doubly exposed to changes in exchange rates and external interest rates. In a second group of countries —El Salvador, Panama and Paraguay— a significant proportion of the debt service is denominated in foreign currency, but most of it is at a fixed rate. Inversely, while Brazil, Ecuador and Mexico have issued primarily local-currency debt, floating rates account for between 19% and 33% of the total. Lastly, Chile, Colombia, the Dominican Republic, Honduras, Peru, the Plurinational State of Bolivia and Uruguay are the least susceptible to external shocks because of their low foreign-currency holdings and the predominance of floating rates (see table II.1).

Table II.1

Latin America (17 countries): breakdown of public debt service, 2020–2025 (Billions of dollars and percentages)

	Debt service (billions of dollars)			Currency (percentages)			Rate type (percentages)			
	Total	Principal	Interest	National currency	Dollars	Other	Fixed	Floating	Zero coupon	Other
Argentina	248	152	95	25	44	32	42	6	17	35
Bolivia (Plurinational State of)	8	1	7	80	19	1	100	0	0	0
Brazil	889	771	118	97	3	0	52	33	15	0
Chile	40	28	12	86	9	5	93	0	7	0
Colombia	80	50	30	70	16	14	91	8	2	0
Costa Rica	37	23	14	62	38	-	86	14	0	0
Dominican Republic	43	25	18	72	28	-	97	3	0	0
Ecuador	22	12	10	0	94	6	80	19	0	1
El Salvador	4	2	3	0	100	-	91	9	0	0
Guatemala	3	2	2	28	72	0	78	22	0	0
Honduras	13	10	3	88	11	1	89	7	4	0
Mexico	437	327	110	89	8	3	66	26	8	0
Nicaragua	0	0	0	0	21	79	0	90	0	10
Panama	15	9	6	0	97	3	91	7	2	0
Paraguay	4	2	1	41	59	0	84	8	9	0
Peru	45	12	32	83	16	1	97	1	0	2
Uruguay	18	12	6	63	35	2	87	3	10	0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg [online database] <https://www.bloomberg.com/>.

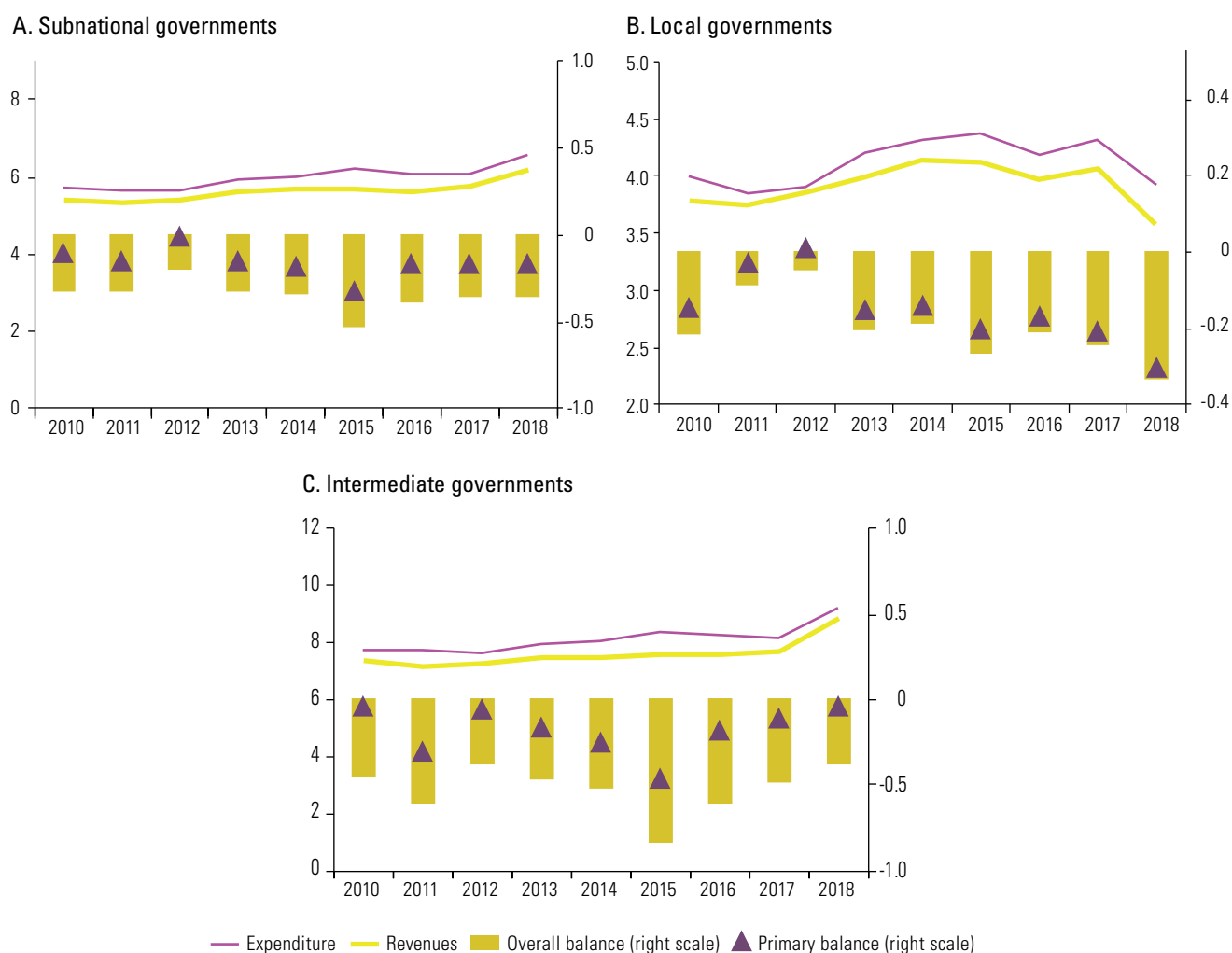
Note: The figures refer to instruments traded on a secondary market, and thus may not correspond to official data.

F. The policy space for subnational public finances has narrowed in recent years as fiscal deficits remain high and public debt increases

Although subnational government revenues have risen marginally in recent years, expenditures have increased at a higher rate, eroding the fiscal space available.³ This has affected fiscal performance and subnational borrowing, in the form of public debt, which has been on the rise since 2015 and peaked in 2018. On average, the countries of the region are running both primary and overall deficits (see figure II.20). The aggregate trend in subnational finances can be broken down into two groups: intermediate governments (provinces, states, departments) and local governments (municipalities).

Figure II.20

Latin America (9 countries): fiscal performance of subnational, intermediate and local governments, 2010–2018^a
(Percentages of GDP)



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

Note: The sample of local governments comprises Argentina, Brazil, Chile, Costa Rica, Mexico and Peru. The sample of intermediate governments comprises Argentina, Brazil, Colombia, Ecuador and Uruguay. No information is included for Colombia or for local governments in Argentina for 2018.

^a Simple averages.

³ The sample of subnational governments refers to both local and intermediate levels and comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Peru and Uruguay.

On average, subnational government revenues have been trending upward in recent years, driven by the revenues of intermediate governments (see table II.2). In Brazil, intermediate government resources saw an increase of 0.6% of GDP, up from 11.2% of GDP in 2016 to 11.8% in 2018. Similarly, intermediate government revenues in Ecuador rose from 5.1% of GDP to 5.4% over the same period.

Table II.2

Latin America (10 countries): fiscal performance of subnational governments, by type of institutional sector, 2016–2018 (Percentages of GDP)

Country	Governments	2016				2017				2018			
		Revenues	Spending	Primary balance	Overall balance	Revenues	Spending	Primary balance	Overall balance	Revenues	Spending	Primary balance	Overall balance
Argentina	Intermediate	15.0	15.6	-0.3	-0.7	15.6	16.1	-0.1	-0.5	15.2	15.2	0.7	0.1
	Local	3.3	3.3	0.1	0.1	3.4	3.4	0.0	0.0	...	...	...	...
Bolivia (Plurinational State of)	Intermediate	11.2	11.1	-1.4	-1.5	11.5	...	...	...	11.8	...	...	...
Brazil	Intermediate	11.2	13.3	-0.8	-2.0	11.5	12.9	-0.6	-1.4	11.8	13.2	-0.4	-1.3
	Local	7.9	8.6	-0.5	-0.7	7.7	8.5	-0.7	-0.8	8.1	8.9	-0.6	-0.7
Chile	Local	3.8	3.7	0.1	0.1	3.8	3.7	0.1	0.1	3.9	3.8	0.2	0.2
Colombia	Intermediate	2.5	3.4	-0.9	-0.9	2.5	3.0	-0.4	-0.4	...	...	...	...
	Local	7.3	7.3	0.2	0.1	7.6	7.7	0.0	-0.1	...	...	...	...
Costa Rica	Local	1.1	1.3	-0.1	-0.1	1.1	1.3	-0.2	-0.2	1.2	1.4	-0.3	-0.3
Ecuador	Intermediate	5.1	4.1	1.0	1.0	5.1	4.0	1.1	1.1	5.4	4.4	1.0	1.0
Mexico	Intermediate	8.7	9.9	-0.4	-1.2	8.4	10.0	-0.8	-1.6	8.4	10.0	-1.6	-1.6
	Local	1.5	1.5	0.1	0.0	1.9	1.9	0.1	0.0	1.7	1.7	0.1	0.0
Peru	Local	2.7	3.6	-0.9	-0.9	2.8	3.7	-0.8	-0.8	2.9	3.8	-0.8	-0.8
Uruguay	Intermediate	3.2	3.1	0.2	0.1	3.2	3.2	0.1	0.0	3.3	3.3	0.0	0.0

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

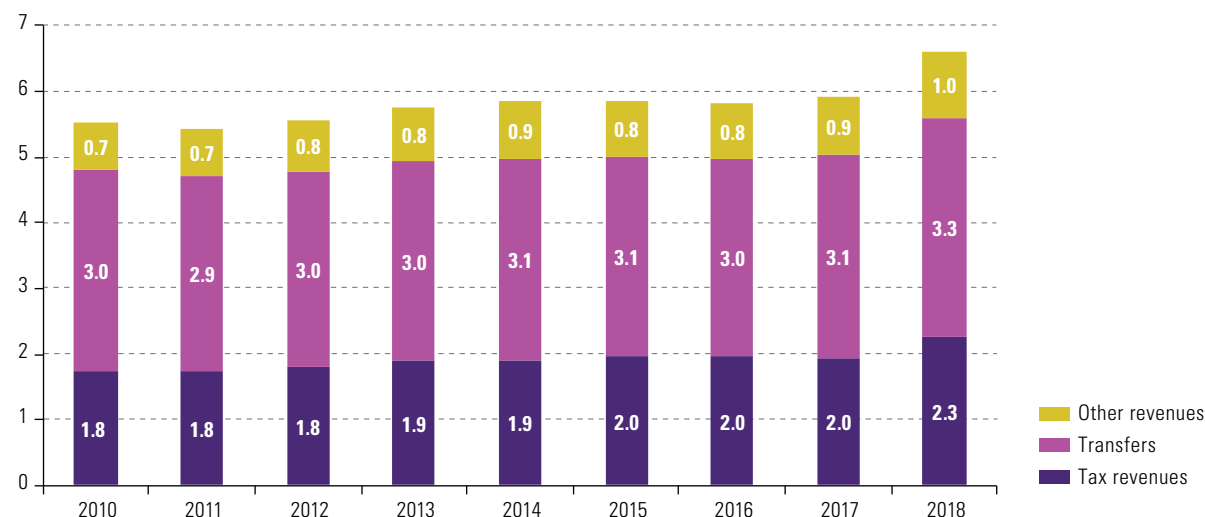
Among countries where the opposite occurred, Argentina stands out, with intermediate levels (provinces) registering a decline in both revenues and expenditures between 2017 and 2018, although expenditures fell more sharply. This was reflected in the primary and overall balance, which posted surpluses of 0.7% of GDP and 0.1% of GDP respectively—having fallen by about 1%—in 2018. This improvement in the fiscal situation is a result of the steep inflation in Argentina, which is passed through more rapidly to revenues than to expenditures. This generates savings, albeit temporarily, as provincial spending (of which more than 65% goes towards wages and pensions) responds more slowly to inflation.

Local government revenues contracted in 2018. Spending also declined, although not as sharply, as evidenced by the widening of the overall and primary deficits. Local government revenues accounted for 3.6% of GDP, while spending stood at 3.9% of GDP in 2018.

As the breakdown of revenues in figure II.21 shows, most comes from transfers from the central government, followed by tax revenues. On average, transfers to local governments fell by 0.2 percentage points of GDP in 2018, while transfers to intermediate governments increased by 0.5 percentage points. In Mexico, transfers represented 75.1% of total local government revenue and 94.1% of intermediate government revenue in 2018, while in Argentina, they accounted for 56.4% of total intermediate government revenue. On the whole, the share of transfers in subnational government revenues remained constant from 2010 to 2018. The exceptions were Ecuador and Peru, where transfers contracted by 12.7 and 5.0 percentage points, respectively, in that period.

Figure II.21

Latin America (9 countries): composition of subnational government public revenues, 2010–2018
(Percentages of GDP)



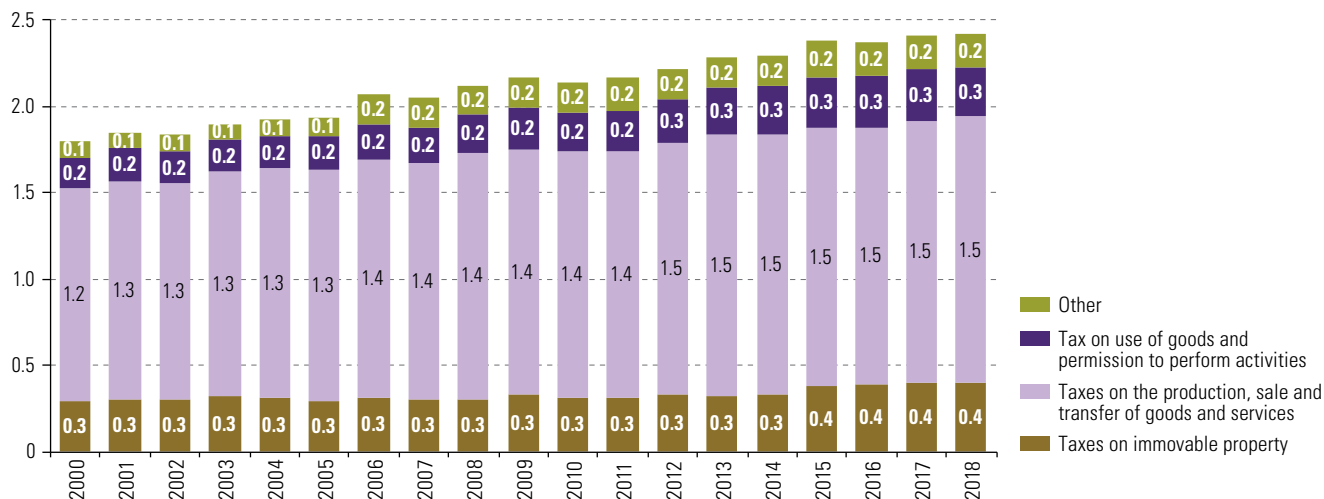
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: No information is included for Colombia or for local governments in Argentina for 2018.

From 2000 to 2018, subnational government tax revenues jumped from 1.4% of GDP to 2.3% of GDP, accounting for a larger share of total revenue (see figure II.22).⁴ In 2018, tax revenues represented 36.4% of total subnational government revenues, while in 2000 they accounted for 32%. On average, there were modest gains in all tax categories, with the biggest increases in taxes on production, sales and transfers.

Figure II.22

Latin America (9 countries): subnational government tax revenues by type of tax, selected countries, 2010–2018
(Percentages of GDP)



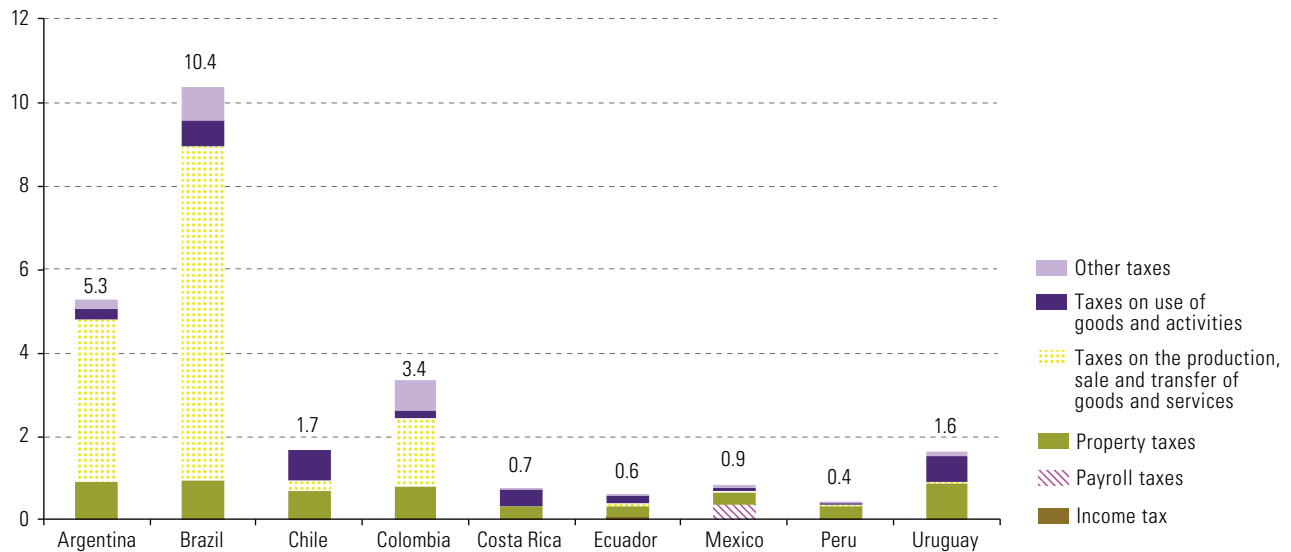
Source: Organization for Economic Cooperation and Development (OECD) and others, *Revenue Statistics in Latin America and the Caribbean 1990-2017*, Paris, 2019, on the basis of official figures.

⁴ The countries included in the average are Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Peru and Uruguay.

The country that collects the most taxes as a share of GDP at the subnational level is Brazil, where this figure represented 10.4% in 2018. It is followed by Argentina, where subnational tax collection stood at 5.3% of GDP. In contrast, in four of the countries in the sample, tax collection did not exceed 1% of GDP (see figure II.23). As stated in the *Fiscal Panorama of Latin America and the Caribbean, 2019*, it is clear that subnational governments find it difficult to use their tax powers to generate income (ECLAC, 2019c).

Figure II.23

Latin America (9 countries): composition of tax revenues at subnational level, by country, 2018 (Percentages of GDP)



Source: Organization for Economic Cooperation and Development (OECD) and others, *Revenue Statistics in Latin America and the Caribbean 1990-2017*, Paris, 2019, on the basis of official figures.

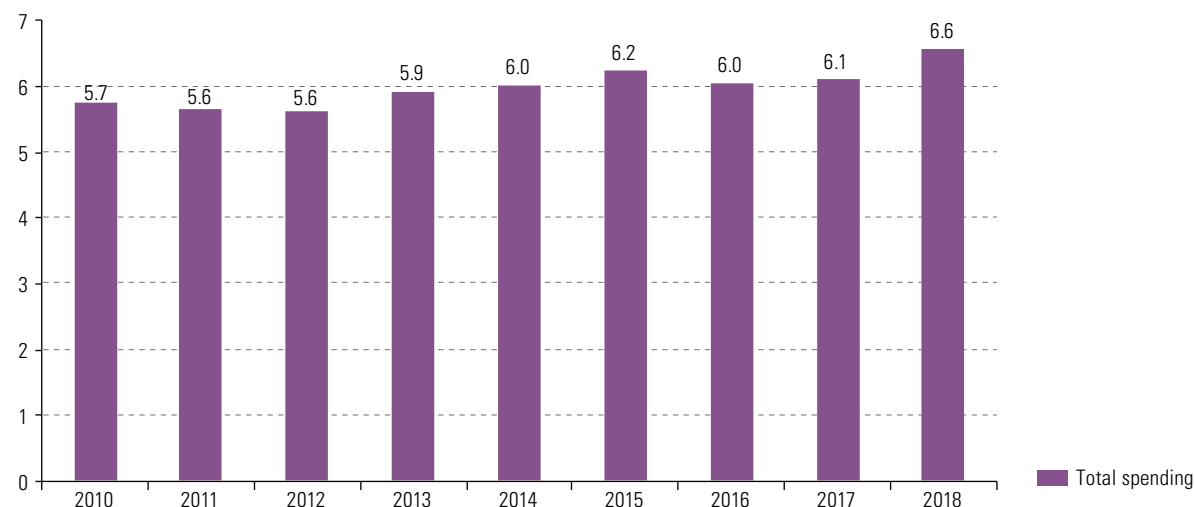
Note: For Brazil, Colombia and Mexico data are aggregated for intermediate and local levels.

Total subnational government spending has been on the rise, up from 5.7% of GDP in 2010 to 6.6% in 2018 (see figure II.24). This growth was driven by current expenditures, as spending picked up in almost all the countries in the sample, both at the intermediate and local levels. Intermediate governments in Argentina registered the largest increase in current expenditure, from 11.2% of GDP in 2010 to 13% in 2018. Second were local governments in Brazil, which increased spending from 7.2% of GDP to 8.4% in the same period. Capital expenditure, however, has remained low and relatively constant at around 1.4% to 1.5% of GDP on average in the period under review.

In line with this trend, subnational debt levels have been rising since 2015 (5.2% of GDP), reaching 5.8% of GDP in 2018 (see figure II.25). This increase reflects primarily the situation in Argentina and Brazil. In Argentina's case, debt had begun to fall after 2009, bottoming out at 4.3% of GDP in 2014, but rose to 7.5% in 2018. In Brazil, while debt levels began to fall from 10.8% of GDP in 2011, they climbed to 12.8% in 2018.

Figure II.24

Latin America (9 countries): subnational government public spending, 2010–2018
(Percentages of GDP)

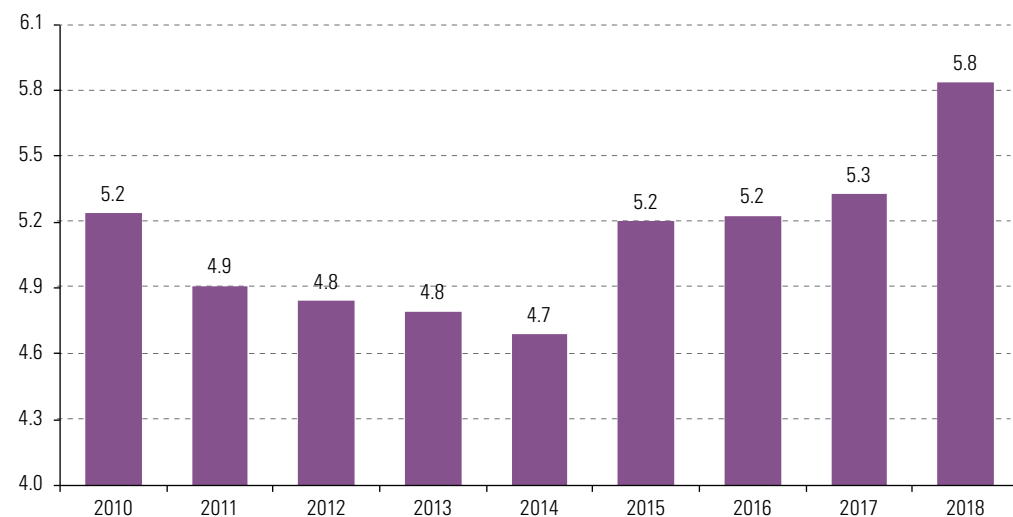


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: No information is included for Colombia or for local governments in Argentina for 2018.

Figure II.25

Latin America (4 countries): subnational government public debt, 2010–2018
(Percentages of GDP)



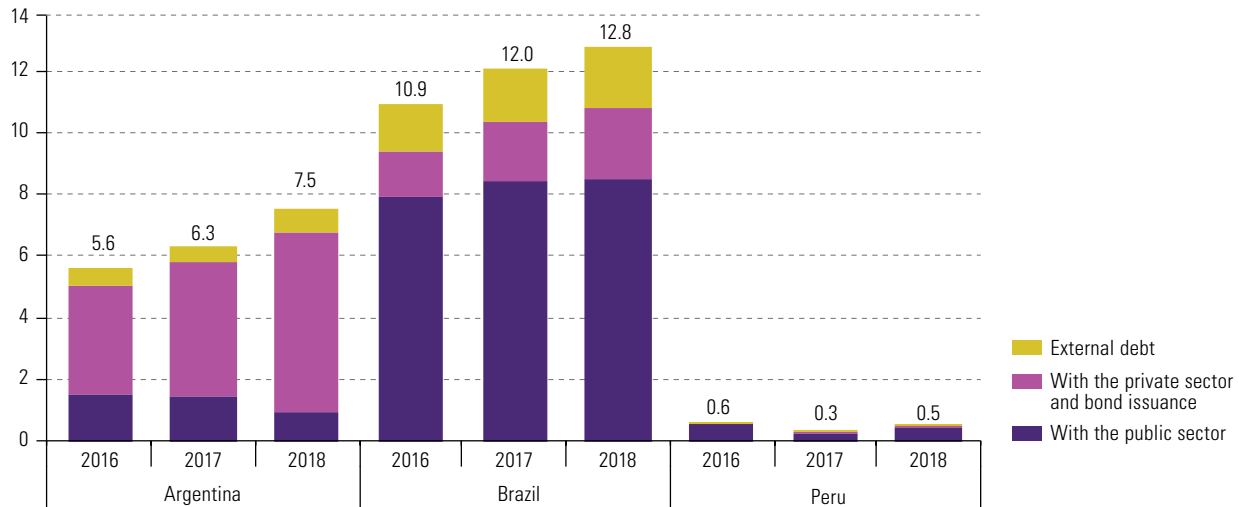
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Note: Countries included are Argentina, Brazil, Mexico and Peru. Aggregated data for intermediate and local levels.

In Peru, debt contracted to 0.3% of GDP in 2017, from 0.6% in 2016, then widened to 0.5% of GDP in 2018 (see figure II.26). This volatility stems from the adoption by local and regional governments of new regimes that allowed for the restructuring of pension system liabilities. This created the enabling conditions that reduced the total debt balance (Ministry of Economic Affairs and Finance, 2018). In Argentina, there was an increase in debt owed to the private sector and in debt issues, and a decrease in obligations to the rest of the public sector. In Brazil, however, most of the debt is owed to the public sector. This involves obligations to the federal government and the National Bank for Economic and Social Development (BNDES), which were renegotiated in 2018 to extend the repayment period.

Figure II.26

Latin America (3 countries): breakdown of subnational government public debt, 2018
(Percentages of GDP)



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

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CHAPTER



Tax evasion levels and the key measures to tackle it in the countries of Latin America and the Caribbean

Introduction

- A. Measuring tax evasion: identifying good practices for the countries of the region
- B. Levels of tax evasion in the region: general and specific features
- C. Actions countries are taking to address this challenge
- D. A road map to tackle tax evasion and foster national resource mobilization in the region

Bibliography

Annex III.A1

Introduction

For some years now the Economic Commission for Latin America and the Caribbean (ECLAC) has been increasingly drawing attention to the urgent need to mobilize a greater flow of domestic resources throughout Latin America and the Caribbean, in order to achieve the priority goals of the 2030 Agenda for Sustainable Development. For the countries of the region, this requires a series of targeted efforts to increase the tax base through specific reforms of their main tax collection instruments (such as value added tax and income tax). Additional innovations or modifications could likewise be applied to other taxes. It is also fundamental that countries ensure the effective collection of fiscal resources that should already be generated by their respective tax systems.

However, for decades it has been pointed out that the amount collected through the main taxes applied across the region and at different levels of government is much lower than what would be obtained if all taxpayers complied fully with their tax obligations, as established in law. Owing to the loss of valuable fiscal resources that it represents for the State, tax evasion has been and remains one of the main obstacles for public finances and, therefore, for the development processes in the countries of Latin America and the Caribbean (ECLAC, 2019a).

As tax evasion has multiple causes and manifests itself differently throughout the region, from the outset, analysis has focused on the main taxes applied at the national level. More recently, the increasing globalization of the operations of large multinational companies has forced countries to take a broader view that goes beyond their geographical borders. Although the available evidence about the magnitude of both aspects of the problem is scarce, it is conclusive in terms of the high levels of non-payment that are estimated in most cases, which translates into significant losses of tax revenue.

It is encouraging that, in recent years, the countries of the region have made tangible progress in reducing or containing levels of tax evasion and avoidance. At the national level, emphasis has been placed on greater investment in human and financial resources and information technology, with a view to strengthening the operational capacity of tax agencies and facilitating voluntary compliance. At the international level, countries have made headway with reforms of their tax legislation to include mechanisms to prevent base erosion and profit shifting to other jurisdictions. Simultaneously, the countries of the region are increasingly participating in the main global initiatives for transparency and exchange of tax information.

However, to design reforms and administrative measures to counter evasion there must first be a proper analysis of the current situation, as well as of past developments. This would provide insight into areas such as: (i) the magnitude of the problem with regard to the different taxes in force; (ii) the channels through which it occurs; and (iii) the segments of taxpayers that are significant in terms of non-payment of tax. Unfortunately, it has always proven difficult to make quantification of levels of evasion a common practice within the respective institutional frameworks of the countries of Latin America and the Caribbean. Moreover, there has been recurrent resistance to disseminating the results of such analysis. As a result, this remains a pending task in the countries of the region.

Given the numerous considerations and perspectives regarding the problem of tax evasion, it is difficult to find systematic evidence about its magnitude. There is also insufficient information on the main trends in terms of the reforms and administrative measures that countries are taking to address this shared challenge at the regional

level. Given the importance of such information for the proper coordination of related actions and initiatives, this chapter provides a broad overview of this problem, the most advanced techniques that can be used to measure tax evasion, the actions and innovations that the countries are implementing to meet this challenge, the identification of good practices at the regional level and suggestions for guidelines on the subject for the countries of the region.

A. Measuring tax evasion: identifying good practices for the countries of the region

Measuring tax evasion is essential not only to improve tax administration by formulating measures to reduce its magnitude, but also to obtain more accurate estimates of the potential impact of reforms of existing taxes or of the actual effect of other tax changes. As in any quantification procedure, methodological aspects are crucial when dealing with this type of research. However, in this specific case, the difficulties are greater, since the aim is to identify, infer and estimate a wide range of actions or characteristics of taxpayers themselves that are not visible to the institutions responsible for tax administration and inspection.

All studies aimed at quantifying levels of tax evasion start by defining the measurement goal, with greater or lesser precision. In the broadest sense, the aim is to determine the difference between the theoretical amount that would be collected if all taxpayers complied in time and form with their tax obligations and the amount actually collected, in a specific period of time and for a given jurisdiction or region. However, owing to the multiple causes of the problem, such estimates must be further refined in the analysis.¹

Firstly, the tax gap is generally made up of a number of elements that are closely related to the determinants of tax evasion. A portion of the gap may be linked to unintentional errors or omissions by taxpayers. The more complex the tax system, and the less precise or clear the tax legislation, the greater this effect tends to be. Another portion may be a result of taxpayer insolvency, reflecting, for example, the volatility of economic cycles or taxes that do not apply the principle of contributory capacity. The remaining portion of the gap between theoretical collection and effective collection—which is also the largest portion—is generally a result of deliberate actions by taxpayers to make their tax burden smaller than that they would be liable for under applicable legislation. Here, a distinction is usually made between tax evasion, which is considered illegal in all its forms, and tax avoidance. Although avoidance does not contravene the letter of the law, it does go against the spirit of the principles and rules that govern a tax system (especially the concept of equity) and often takes the form of intentional transfers of profits to countries with little or no taxation or the manipulation of transfer prices between related companies.

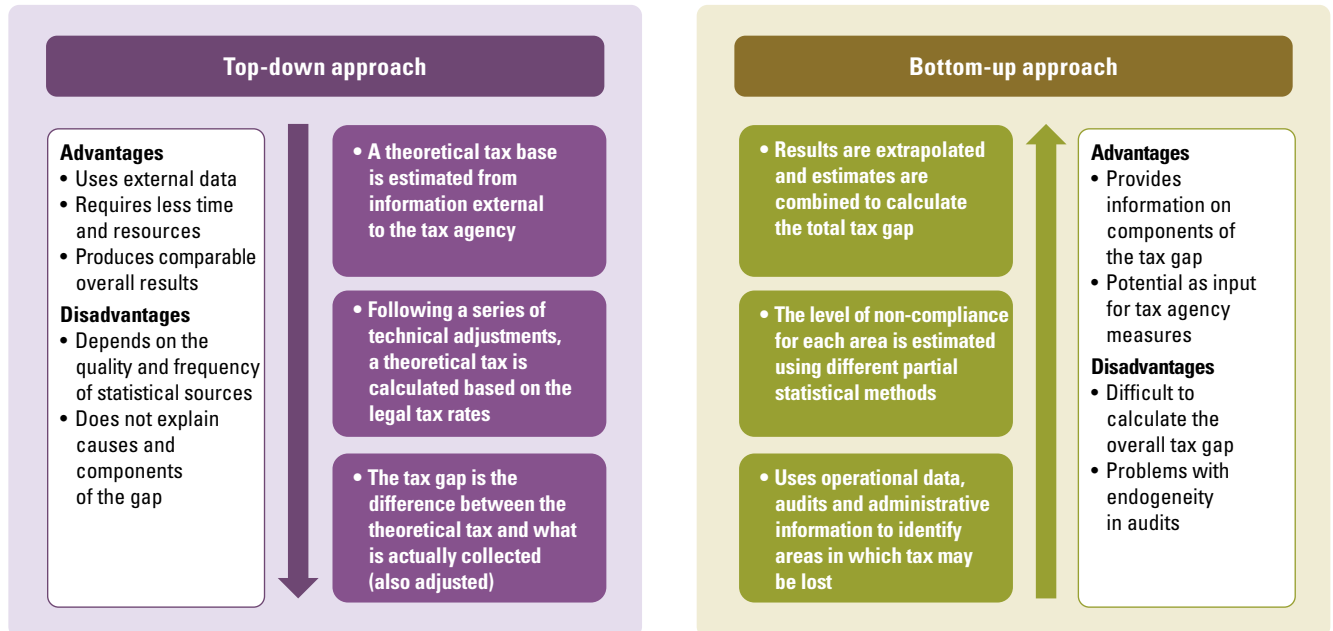
Given the diverse components of the tax gap, careful analysis is needed when selecting and applying an appropriate methodology to estimate its magnitude. In this regard, there is currently consensus on the two main methodological approaches available for achieving

¹ There is extensive body of literature on the determinants of tax evasion. Based on the pioneering theoretical model of Allingham and Sandmo (1972), it has been determined that multiple factors affect the magnitude and intensity of tax evasion. The factors have an impact at both the individual level (such as age, education, income and source of income) and in general (such as the characteristics of the tax system, the size of the informal economy and the social condemnation of tax evasion, or tax morale) (Slemrod, 2007; Richardson, 2006). Moreover, as Bergman (2009) states, in Latin American and Caribbean countries, many of these determinants are reinforced by a number of cultural and institutional factors.

this goal:² (i) the top-down, global or indirect approach; and (ii) the bottom-up, partial or direct approach (IMF, 2015; Jorratt and Podestá, 2010; Hutton, 2017). Although they are often presented as dichotomous alternatives, they are generally complementary owing to the differences in the inputs required, the scope of the estimates, the type of results produced and the conclusions they allow to be drawn (see diagram III.1).

Diagram III.1

Alternative methodological approaches to quantify the tax gap (non-compliance)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of N. Warren, “Estimating tax gap is everything to an informed response to the digital era”, *eJournal of Tax Research*, vol. 16, No. 3, Sidney, University of New South Wales (UNSW), 2019; E. Hutton, “The Revenue Administration—Gap Analysis Program: model and methodology for value-added tax gap estimation”, *Technical Notes and Manuals*, No. 17/04, Washington, D.C., International Monetary Fund (IMF), 2017.

Top-down methodologies use macro models that are based on economic aggregates, with national accounts information. Household surveys and figures related to the use of physical inputs in the production of goods and services can also be used. The aim is to provide a single estimate based on data that are unconnected to the tax administration. This can be an advantage, especially if there is not enough information in operational records, or the available information is inaccurate. In general, top-down methodologies require less time and fewer resources, in relative terms. Moreover, the results can be considered complete and comparable over time, allowing time trends to be tracked. However, these methodologies also have limitations, as they depend on the quality of macroeconomic statistics and are subject to the typical lags in such information. The main weakness of these methodologies is that they do not help to explain the causes and components of the tax gap, which reduces their usefulness in designing specific measures for managing tax compliance (Warren, 2019).

In contrast, bottom-up methodologies use one or more data sources that cover only some components of the tax base. The components of the tax gap are therefore estimated separately for different groups of taxpayers and types of non-compliance. Individual case data is used, collected by the tax administration through audits, surveys

² In fact, other approaches could be added to those already mentioned. For example, the approach that applies different econometric techniques and models with panel data, time series analysis and stochastic frontier analysis. Or the approach based on perception surveys and controlled experiments, which can also be very useful for understanding the various factors that explain taxpayer behaviour, even though the results of these estimates usually depend on very specific assumptions and criteria (Hutton, 2017).

and consultation programmes. The total tax gap is then estimated by extrapolating data related to the entire population corresponding to the relevant component of the tax base. This means relying on data from audits selected statistically rather than according to risk of non-compliance, in order to avoid bias in the estimation process. As the components of the tax gap are determined and estimated separately, there is no guarantee that all elements of the tax gap have been included and therefore that the estimates can be considered comprehensive. However, such an estimate, derived from individual taxpayer data, may provide more detailed information about the areas in which non-compliance is found and the patterns it follows, which tax agencies should seek to address.

Owing to the aforementioned factors, the estimates may be very different from one country to another and from one period to another. These differences are generally linked to the diversity of tax systems, the different economic cycles and the different methodologies used. Even in cases where the same methodology is applied, there are differences between the components, inputs, technical capacities and resources used to obtain these estimates. Consequently, the results of the studies should be taken with caution when comparing the magnitude of the compliance gaps. Instead of the specific point estimates and direct comparisons, the focus should be on the identification and analysis of trends arising from those estimated values.³

Furthermore, although tax evasion rates are recognized as important tax analysis and management tools, their usefulness as summary indicators of the performance of tax agencies is diminished by the degree of implicit uncertainty and the aforementioned methodological provisos. This common interpretation, which in some cases has proved counterproductive to the production and dissemination of studies' results, should no longer be a problem. In fact, in recent years great progress has been made in developing various reference frameworks to enable the comprehensive assessment of tax agencies' operational capacities at the international level (see box III.1).

Box III.1

Alternatives for evaluating the performance of tax administrations

Experiences with tax reforms in Latin America and the Caribbean over the past 20 years show that tax policy changes can only produce the desired results when sufficient attention has also been paid to implementing an efficient tax administration. This has led to a growing interest in evaluating how well collection agencies perform their various functions. Over the past decade, tangible progress has been made in developing frames of reference for this assessment. With time and experience, it has become more widely understood that a systemic approach must be adopted to identify the most advanced practices and trends and that a set of quantitative and qualitative indicators must be used, related to the ability to achieve a high level of compliance at a low operational cost (Gómez Sabaini and Jiménez, 2011).

Specific initiatives in this regard include two tools for monitoring tax management and strengthening tax administrations' capacities. The Tax Administration Diagnostic Assessment Tool (TADAT) developed by the International Monetary Fund (IMF) provides a standardized performance assessment of a country's tax administration. The tool focuses on nine key performance outcome areas (POAs) and has 32 diagnostic indicators. The International Survey on Revenue Administration (ISORA) is a partnership between the Asian Development Bank (ADB), the International Monetary Fund (IMF), the Inter-American Center of Tax Administration (CIAT), the Intra-European Organisation of Tax Administrations (IOTA) and the Organization for Economic Cooperation and Development (OECD). The survey collects data on collection, institutional structure, budget and human resources, segmentation and registration of taxpayers, returns filing and payment, taxpayer assistance and tax education, enforced collection of debts, inspection, audit and investigation of tax fraud, and dispute resolution mechanisms. Through these periodic surveys (159 countries participated in the 2018 round), a series of comparative documents has been produced, describing modern trends in tax administration (OECD, 2019; Díaz de Sarralde, 2019).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. C. Gómez Sabaini and J. P. Jiménez, "Tax structure and tax evasion in Latin America", *Macroeconomics of Development series*, No. 118 (LC/L.3455), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2011; Organization for Economic Cooperation and Development (OECD), *Tax Administration 2019: Comparative Information on OECD and Other Advanced and Emerging Economies*, Paris, OECD Publishing, 2019; S. Díaz de Sarralde, *Overview of Tax Administrations: structure, income, resources and personnel; operation and digitalization. ISORA (International Survey on Revenue Administration)*, Panama City, Inter-American Center of Tax Administrations (CIAT), 2019.

³ While the margin of error of the information used as inputs (such as national accounts statistics in top-down methodologies) is not predictable, it can be assumed that the biases caused by such errors are systemic. This would mean that there is a uniform tendency to overestimate or underestimate the data over time if the methodological criteria are maintained, which would give greater relative reliability to the observed trends in the estimated tax gap in relation to the point estimates of each specific period.

A broader definition of the tax gap can also include the loss of revenue caused by particular tax policy choices embedded in the legal framework of each country or jurisdiction. Such policy decisions introduce deviations from general taxation rules, in the form of exemptions, deductions and reduced rates in specific cases, and their fiscal impact is encompassed in the concept of tax expenditure. Under this approach, which is currently used by IMF, the tax gap is composed of two component gaps:⁴

- The **policy gap** is defined as the difference between total potential tax revenues under the general rules of tax legislation (meaning without taking into account concessions, special treatments and deviations from the general rules)⁵ and the theoretical amount of resources if all taxpayers complied fully with their tax obligations, with the differential treatments allowed under current legislation. To this end, a theoretical tax base is estimated, from which the theoretical collection is obtained by applying the current rates.
- The **compliance gap**, which is comparable to the conventional definitions of the tax gap of other organizations (OECD, ECLAC), is the difference between theoretical tax revenues if there were 100% compliance (according to the existing regulatory framework and including all differential treatment) and actual tax collection. There are different means of calculating this value and several possible adjustments (Hutton, 2017).

Total tax gap = Policy gap + Compliance gap

Where:

Policy gap = Potential tax revenue - Theoretical tax revenue

Compliance gap = Theoretical tax revenue - Actual tax revenue

resulting in:

Total tax gap = Potential tax revenue - Actual tax revenue

When estimating policy gaps, the ideal frame of reference and general tax rules for each country (tax base, tax rate, taxpayers covered) must be determined based on assumptions, which must be identified and described clearly. In practice, this can be a challenging exercise because of the complex rules of multiple taxes, with various exemptions and derogations to the general rule. Once again, determining the assumptions used (on which there is not always consensus at the regional and international level) is key to ensuring a correct interpretation of the results, since it will also affect their comparability among the different countries considered.

This link between concepts and gaps in the functioning of the tax system opens up possibilities for the countries of the region in terms of quantifying tax evasion. Moreover, it builds their capacity to design multiple measures to reduce evasion and, therefore, increase available fiscal resources and improve the overall efficiency of the instruments applied. Even though they are different procedures, it would be advisable to apply a comprehensive approach. Thus, any progress that could be made in improving the statistics and inputs needed for estimates of non-compliance levels for the main taxes applied (whatever the methodology used) would also help to improve other fundamental measures, such as expenditure budgets and tax incentives. More importantly and less frequently, this would enable better quantitative assessments of the fiscal cost and effective economic impacts of such measures (ECLAC, 2019b).

⁴ Based on the top-down method, the methodology of “The Revenue Administration – Gap Analysis Program” can be applied to VAT, corporate income tax and even selective taxes. It provides details of the tax gap according to the sectors of economic activity and basic administrative functions.

⁵ For example, in the case of VAT, it is usual to use the total collection that would be obtained in a scenario of full compliance if all the final consumption of a specific country or jurisdiction were taxed at the general tax rate.

Given the multiple methodological variants for quantifying tax evasion, it is important to consider, based on the experiences of the countries of the region and of developed countries with more consolidated studies, what the most accepted practices are in relation to the various taxes analysed. In general, the available studies on the countries of Latin America and the Caribbean tend to focus on quantifying the amount of potential uncollected resources, without elaborating on the causes, circumstances and repercussions of tax evasion. In most cases, the results are very sensitive to the methodology applied. As previously indicated, this affects and diminishes the international comparability of the estimated values. However, there are certain regularities according to the type of tax analysed.

The available studies on the countries of the region (most of which were conducted and disseminated by tax agencies) use different variants of the top-down method. Using this approach, a theoretical collection for a given tax is estimated and then compared with actual collection. For example, in the case of VAT, a theoretical tax base for a country's entire economy is usually constructed from statistics on economic aggregates, to which the prevailing general rate is then applied (in addition to special rates, if applicable). The result is compared with actual net collection. The methodologies applied in studies of the region show some basic consensus on the items considered and the calculation process to be followed. However, the substantial differences in statistical information on national accounts and other conventional inputs (such as the input-output matrix) have repeatedly prevented a standard methodology from being adopted and consequently also impeded regional comparative studies.

There is a similar pattern in estimates of income tax evasion, which are produced less frequently. In the case of companies, the most commonly used methodology estimates theoretical tax collection from the national accounts operating surplus. This is the macroeconomic aggregate that comes closest to the concept of taxable profit and, after a series of technical adjustments, provides a theoretical tax base to which to apply the general legal tax rate (and reduced rates, if applicable). For natural persons, the conventional methodology usually uses information from household surveys. As personal income tax is progressive, the universe of taxpayers can be segmented by income levels and the different corresponding legal rates can then be applied (Jorratt and Podestá, 2010). Only a few countries have attempted to produce such estimates, but the criteria applied are more heterogeneous than in the studies on VAT.

For most taxes currently in force, countries also use other more direct methods to estimate different components of the tax gap, such as "fixed-point" sampling methods or random field audits. However, such estimates are usually reserved for internal use and tax administrations rarely disclose their results. This is largely because of the complexity of extrapolating them to the rest of the population to obtain a summary evasion rate, in addition to the implicit bias that usually occurs when such analyses focus on taxpayers who are more likely to evade their tax obligations. In that regard, bottom-up methodologies are still an unexplored field for the countries of the region.

At the international level, quantification of evasion has become more prominent in public discourse in recent years, given its impact on public finances and the legitimacy of taxes as instruments to finance the State. Evasion results in inequities among taxpayers within a jurisdiction and beyond its geographical boundaries. In response, there has been an increase in the number of countries producing and, to a lesser extent, publishing estimates of the level of non-compliance with the main taxes applied. A comparative study by OECD (2019) was recently released, surveying a total of 58 countries.⁶ According to the study, 30 of the countries produce these types of calculations for VAT, 20 produce them for personal income tax, 17 for corporate income tax and 16 for

⁶ These include Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru.

other taxes (mainly social security contributions and selective taxes). Although these figures are higher than in previous years, a low percentage of these specific studies, produced regularly by the tax administrations, are published and disseminated (around 50% of the total).

The European Commission has made important contributions to disseminating European countries' practices in this area. Two recent comparative studies of VAT (European Commission, 2016) and corporate income tax (European Commission, 2018) found substantial methodological differences from one country to another and in several dimensions, such as:

- The tax analysed (the most frequent studies are those applied to VAT)
- The origin of the calculation (most are performed by the tax administration, but some countries, such as Germany, commission external researchers to prepare these studies)⁷
- The dissemination of the results (in several countries they are reserved for internal use only)
- The technical and human resources used in these tasks (allocated to specific areas)
- The methodological approach (bottom-up, top-down or a combination of the two)
- Coverage of the components of the estimated tax gap (in some cases, different tax avoidance and aggressive tax planning schemes are included).

Although the above suggests that the methodological approach used is determined by the possibilities and particularities of each country, this does not prevent consensus being sought, to improve existing estimates. In this respect, despite clear heterogeneity among the different countries, the European Commission has funded a number of external studies that seek to measure VAT evasion on the basis of a standard methodology for all European Union member States. The first estimate for the period 2000–2006 was published in 2009 (Reckon, 2009). That study has served as the basis for a gradual improvement in the methodology and has been repeated on an annual basis from 2013 to the present. Its most recent edition contains estimates of the VAT tax gap in 28 member States for the period 2013–2017. It also includes an econometric analysis of VAT gap determinants and policy gap analysis to quantify the contribution of reduced rates and exemptions to VAT losses in relation to the estimated potential value in each case (Poniatowski and others, 2019).

This evidence can be added to other prominent international cases.⁸ Together, the various studies provide valuable reference points for improving methodologies to estimate tax non-compliance levels in Latin American and Caribbean countries. These studies will foreseeably require ongoing consolidation, based on accumulated experience and progress in access to statistical data. Given the complexity of this type of research, information sharing among the various countries could contribute to substantially improving its quality and depth. This would result in gains in terms of the tax administrations and the general functioning of the tax system in each country.

⁷ In Latin America and the Caribbean, the case of Mexico is noteworthy. For a number of years, the Tax Administration Service (SAT) of Mexico has been legally obliged to publish studies on tax evasion annually, in which at least two national academic institutions must participate. The reports prepared to date have analysed different dimensions of evasion in Mexico, in specific areas (VAT or income tax) and overall, in relation to a set of prevailing taxes.

⁸ In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) department publishes annual estimates of the main taxes in force using a comprehensive methodology that combines different partial procedures (bottom-up, top-down and experimental) for each of the instruments analysed, for different groups of taxpayers and for different evasion and avoidance behaviour (HMRC, 2019).

B. Levels of tax evasion in the region: general and specific features

Although tax evasion has been a long-standing problem in the countries of Latin America and the Caribbean, its magnitude has never been properly measured (with a few exceptions) by tax agencies or institutions. In fact, since the beginning of the century, a number of quantitative estimates have been disseminated, highlighting the seriousness of the situation and helping to raise awareness of this problem among governments and citizens. Below is a review of the most up-to-date figures on tax evasion at the regional level, focusing on the main components of the region's tax systems.⁹

1. VAT evasion and its trends in recent years

Since its large-scale introduction into the region's tax systems, value added tax (VAT) has been one of the focuses of the successive tax reforms implemented in the different countries. The tendency towards gradually increasing the general rate and broadening the tax base has made VAT the main instrument for collecting revenue throughout Latin America and the Caribbean. According to OECD and others (2019), for a group of 25 countries in 2017, VAT amounted to 6.0% of gross domestic product (GDP). It represented 26.3% of the total tax burden, up from 15.6% in 1990 (2.3% of GDP). However, available evidence has shown that VAT collection could be much higher, were it not for the high level of non-compliance associated with the tax.

Firstly, since the early 2000s, the production and dissemination of a number of official studies to quantify VAT evasion gave insight into a certain tendency towards lower estimated figures and a narrowing of the gaps among the countries of the region, at least until 2007, before the effects of the global financial crisis of 2008 took hold (Gómez Sabaini and Morán, 2016). Although there may have been multiple reasons for this result (undoubtedly including the favourable macroeconomic conditions of sustained growth), one that stands out is the progress that several countries made in VAT administration during that period. Unfortunately, not all countries have been consistent in disseminating these types of statistics over the past two decades. Nevertheless, this type of quantitative research has been consolidated in countries such as Chile, Mexico, Peru and Uruguay (in terms of both production and dissemination). Some encouraging progress has also been seen recently in countries such as the Dominican Republic, El Salvador, Guatemala, Panama and the Plurinational State of Bolivia.¹⁰

An overall analysis of the available studies shows that the trend at the regional level in VAT non-compliance is no longer uniform in recent years (see figure III.1). In fact, taking 2009 figures as a benchmark (relatively high after the financial crisis), estimated VAT evasion rates followed very different trends in the cases for which data are available. Thus, for example, following a slight convergence between 2009 and 2012 across the board, the most recent figures show a notable increase of over 30% in cases, such as Guatemala and Peru, and even over 40% in the Dominican Republic and Panama. This is in stark contrast to the declines of around or under 20% in Chile,

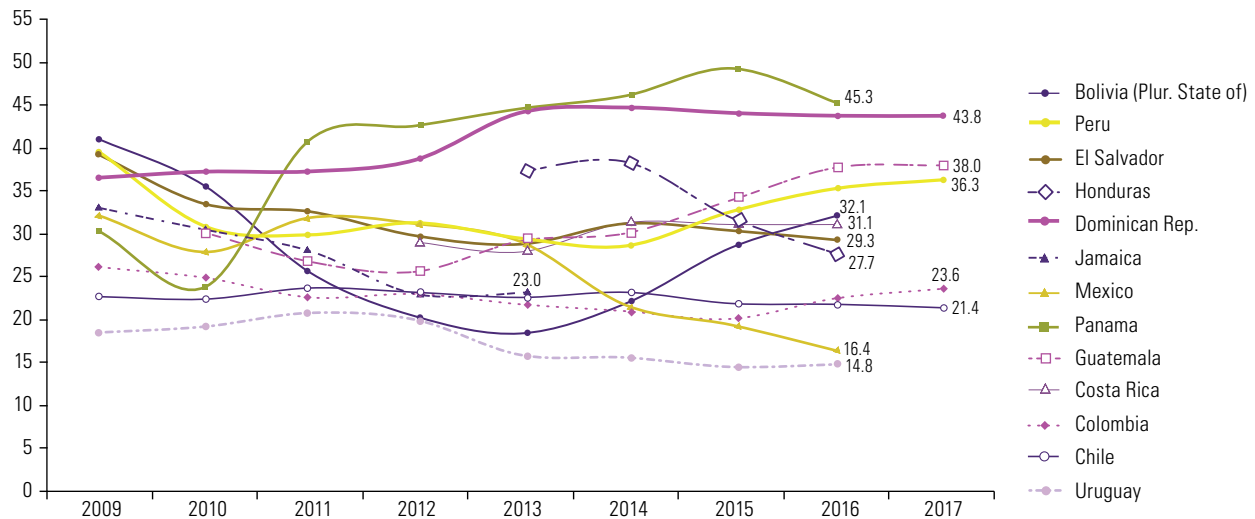
⁹ Despite its prevalence in some countries, there is almost no official evidence of the level of non-compliance in other components of the tax system. Mexico is an exception, where evasion has been calculated for the main selective taxes (San Martín and others, 2017).

¹⁰ For the purposes of this chapter's review of evidence, calculations based on the 1990 base year GDP series are used for El Salvador, even though the Salvadoran Central Bank recently presented new national accounts (base year 2005) that would affect the values obtained, although not the trend seen in previous years.

Mexico and Uruguay.¹¹ Although there is even less evidence available for the most recent years, it is still possible to see a clear gap between two groups of countries within the region. Caution should therefore be exercised when drawing general conclusions and, above all, when developing wide-ranging strategies to reduce current levels of VAT evasion.

Figure III.1

Latin America and the Caribbean (13 countries): estimated VAT evasion rates, 2009–2017
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official studies by the countries (see annex III.A1).

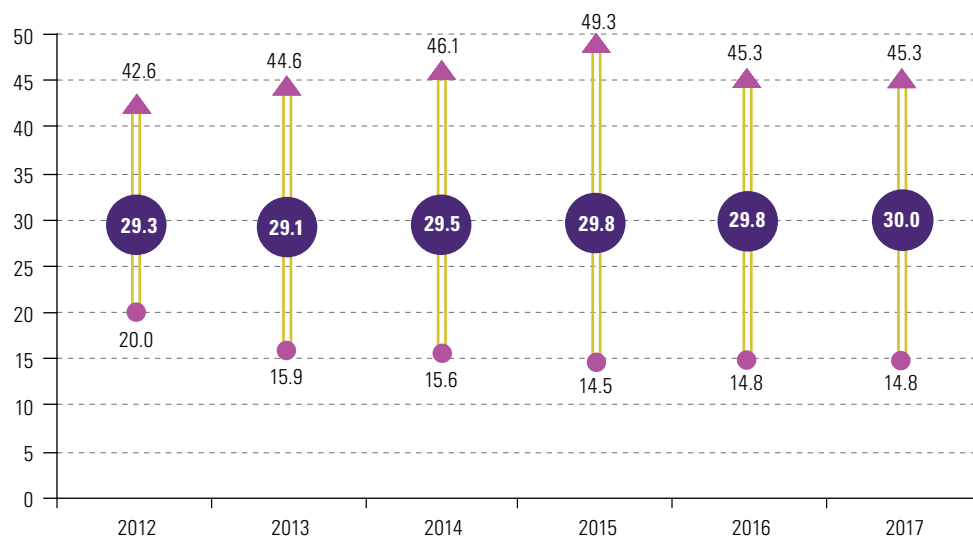
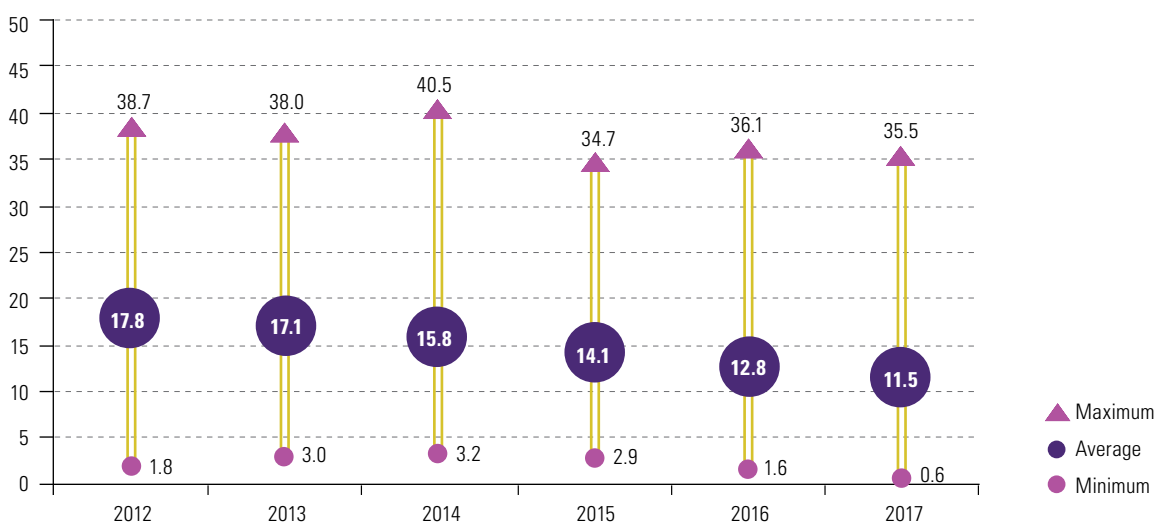
Note: Figure III.1 highlights the latest available figures for the selected countries. Cases have only been included where an annual data series is available, produced under the same estimation methodology, and where up-to-date data are available.

In addition to the different trends in the countries of the region, an examination of available estimates for recent years (see figure III.2A) shows that average levels of VAT non-compliance for a selected group of 12 Latin American and Caribbean countries have remained at around 30%. There is a large gap between the minimum and maximum values for this indicator, which ranges from 14.8% in Uruguay to 45.3% in Panama (both figures are from 2016 and are assumed to be unchanged in 2017). By contrast, when the same method is used to calculate the average VAT evasion rate for the 28 European Union member States (whose rates are also based on a standard methodology), it reveals a slow but steady decline over the past five years (see figure III.2B). The rate fell from 17.8% in 2012 to 11.5% in 2017, although with greater dispersion of country values (from a minimum of 0.6% in Cyprus to a maximum of 35.5% in Romania) (Poniatowski and others, 2019).

¹¹ The latest available update for Chile (Internal Revenue Service (SII), 2019) contains a provisional estimate for 2018 of 21.3% (see references in annex III.A1). The countries that have already presented provisional figures for 2018 also include Guatemala (Office of the Superintendent of Tax Administration, SAT) and Peru (National Tax and Customs Administration, SUNAT), where VAT evasion rates were estimated at 37.9% and 32.9%, respectively (see references in annex III.A1).

Figure III.2

Latin America and the Caribbean (12 countries)^a and the European Union (28 countries): simple average of VAT evasion rates, 2012–2017 (Percentages)

A. Latin America and the Caribbean (12 countries)**B. European Union (28 countries)**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of G. Poniatowski and others, *Study and Reports on the VAT Gap in the EU-28 Member States: 2019 Final Report* (TAXUD/2015/CC/131), Warsaw, 2019; and official studies.

Note: For Latin America and the Caribbean, cases are presented where a series of annual data are available, produced under the same estimation methodology, and where up-to-date data are available for the period 2012–2017.

^a Chile, Colombia, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Panama, Peru, the Plurinational State of Bolivia and Uruguay.

A look at the latest available VAT figures reveals two stylized facts (see figure III.3). Firstly, that tax evasion rates in Latin American and Caribbean countries are generally higher than those estimated for the vast majority of European countries (horizontal scale). Even with striking cases such as Italy (23.8%) and Greece (33.6%), VAT non-compliance was below 15.0% in most of the European Union countries in 2017. Secondly, VAT collection is nonetheless considerable in several countries of the region and is at a similar level to that of the 28 countries of

the European Union (vertical scale). In fact, in countries such as Argentina,¹² Brazil, Chile, El Salvador, the Plurinational State of Bolivia and Uruguay, VAT revenues stood at around 8% GDP in 2017, in line with the majority of the most developed European countries. However, there is a group of countries with more limited VAT collection, which, with the exception of Mexico, also have higher levels of tax non-compliance. For both subgroups, and without seeking to establish a direct relationship between the two variables (given that, among other factors, the fiscal weight of tax expenditures associated with the tax should be considered), it is clear that the potential of the region's countries for obtaining fiscal resources would increase if they reduced tax evasion.¹³

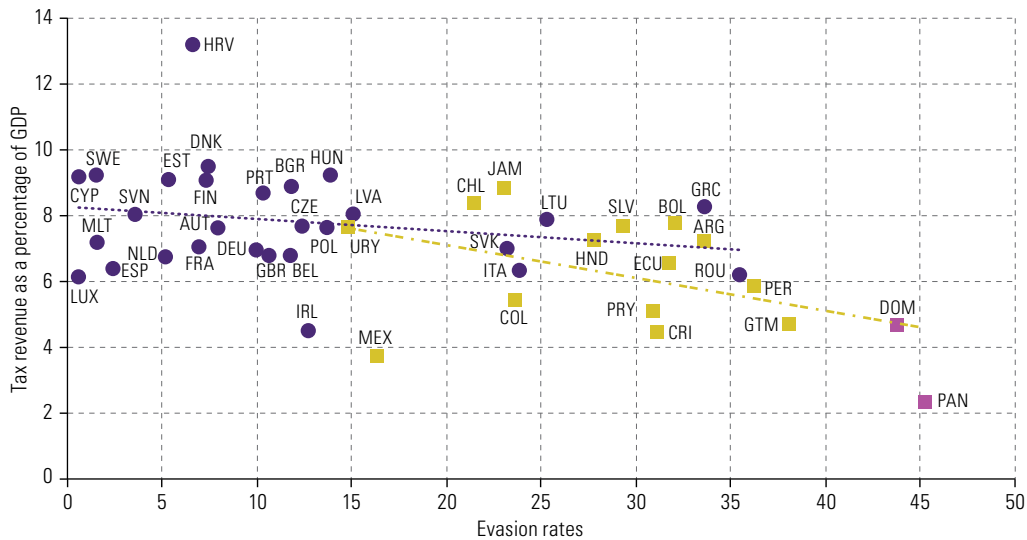


Figure III.3
Latin America and the Caribbean (16 countries) and the European Union (28 countries): estimated evasion rates and actual tax revenues for VAT, 2017 (Percentages)

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), *Revenue Statistics in Latin America and the Caribbean, 1990–2017*, Paris, 2019; G. Poniatowski and others, *Study and Reports on the VAT Gap in the EU-28 Member States: 2019 Final Report (TAXUD/2015/CC/131)*, Warsaw, 2019; and official studies.

Note: The latest available figures for each of the selected Latin American and Caribbean countries have been used to determine VAT evasion rates. The figures are for 2017 for all the European Union countries.

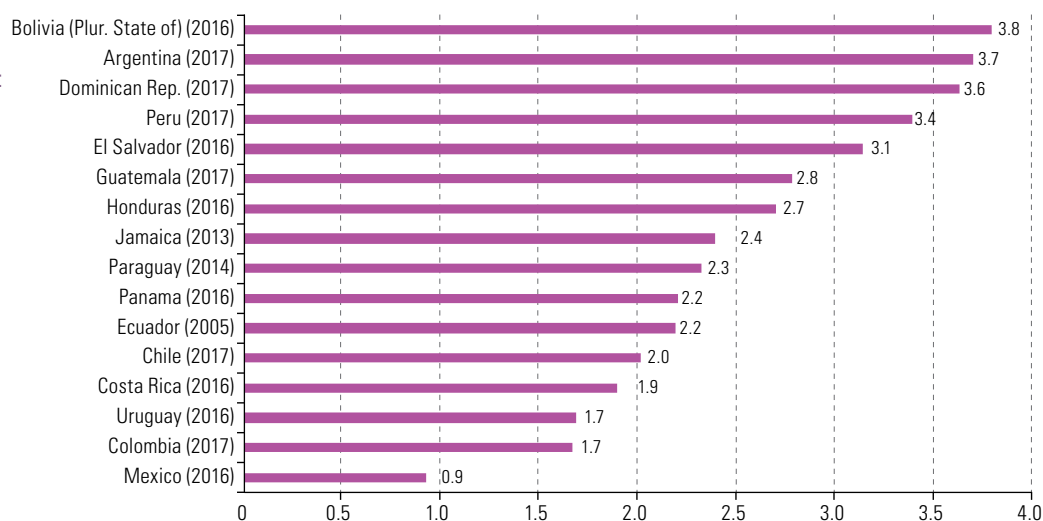
Despite this heterogeneity, the countries of the region are currently not receiving a large volume of tax resources, which could theoretically be used to increase public financing. It is generally acknowledged that in all countries (even developed ones) it is very difficult to reduce tax evasion below a minimum level, as the problem is complex and deep-rooted. Nevertheless, by weighting the most recent VAT evasion rates against current collection in the countries of the region, some preliminary indications can be obtained, showing that the amounts of lost tax are significantly greater than those estimated for developed countries. Figure III.4 shows the official estimates of the VAT gap (corresponding in each case to the most recent estimated year), which highlights the seriousness of the problem in terms of lost tax revenue and reaffirms the need to implement a strategy to reduce its magnitude.¹⁴

¹² Although the latest available official data is for the 2007 fiscal year (AFIP, 2008), recent IMF estimates, which have been validated by the Government of Argentina, point to an evasion rate of around 33.6% for 2017, equivalent to a tax gap of 3.7% of GDP for VAT (IMF, 2019).

¹³ In comparisons among the different countries, it should be borne in mind that estimated evasion rates depend crucially on the components for calculating the tax gap. Estimates may be higher with a higher theoretical collection level (owing to the magnitude and breadth of the tax base and tax rates), or with a lower effective collection of the tax.

¹⁴ Strictly speaking, calculating the implicit amount of lost VAT in a particular year, based on the estimated evasion rates in each country, would require a series of specific adjustments to effective collection that go beyond the scope of this chapter. Even so, given the methodological differences between the official studies, the figures they provide should be taken with caution, which highlights the importance of formulating and applying standard methodologies.

Figure III.4
Latin America and the Caribbean (16 countries): estimated tax revenue losses due to VAT non-compliance, 2017 or latest available year (Percentages of GDP)



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

Note: The year of estimation for each of the selected Latin American and Caribbean countries is indicated in brackets.

2. Income tax: unacceptable non-compliance levels in a very unequal region

Improvements to the design and effectiveness of VAT have made it the main collection instrument in most Latin American and Caribbean countries. A more recent wave of reforms (starting in mid-2000) has consolidated income tax as the second pillar of tax systems in the region. In 2017, the share of income tax in the average tax structure for the region was equivalent to around 6.1% of GDP (25 countries), representing 27.1% of the total tax revenue, whereas in 1990 it was equivalent to 3.3% of GDP and accounted for 20.1% of total revenue (OECD and others, 2019).

However, overall income tax collection could also be considerably higher according to the scarce but specific evidence available, which shows very high levels of non-compliance with this tax in most countries of the region. As noted above, this problem is the result of a number of factors that go beyond administration of the tax and include technical, socioeconomic and even cultural elements. Yet, the gravity of the situation becomes more apparent in light of the fact that income tax (especially personal income tax) is still the instrument with the greatest (actual and potential) progressive redistributive power in Latin American tax systems, and that it coexists with a set of indirect taxes that account for the largest share of total tax revenue and are generally regressive in terms of redistribution.

There is a strong link between the notable lack of quantitative studies at the regional level that determine clearly levels of non-compliance with income tax (and other direct taxes such as those on wealth (see box III.2)) and the more complex calculations that must be performed, which are based on a smaller volume of basic data that is less precise. It is therefore also much more difficult to reach consensus on a standard methodology at the regional and international levels. A study published by ECLAC (Gómez Sabaini, Jiménez and Podestá, 2010) remains a point of reference for the region in this field. The study established certain fundamental guidelines and provided fairly homogeneous evidence for a limited set of countries of the region (Argentina, Chile, Ecuador, El Salvador, Guatemala, Mexico and Peru). Very high levels of income tax non-compliance were found in all cases, above the evasion rates calculated for VAT.

The region of Latin America has vast experience, both theoretical and political, of implementing the different variants of property tax. However, the need for higher tax revenues, a more equitable tax structure and action on territorial disparities, as core elements of the 2030 Agenda for Sustainable Development, mean that the effectiveness of property tax needs to be reviewed, with a view to overcoming key economic, political and administrative constraints. Currently, intermediate and local governments in the region are financed primarily through transfers from central governments, which can discourage fiscal efforts and weaken the accountability and financial autonomy of subnational governments. In the industrialized countries of the Organization for Economic Cooperation and Development (OECD), on average an equivalent of more than 1% of GDP is collected in property tax (it exceeds 4% of GDP in France and 3% in the United Kingdom). Meanwhile, in Latin American countries, the average is less than half that value: only a few countries such as Colombia and Uruguay have higher figures, with annual collection of between 0.8% and 0.9% of GDP.

However, property taxes have significant —largely untapped— revenue potential throughout the region, especially in countries with a large primary sector. According to recent estimates, based on World Bank data on estimated land and property values, most Latin American countries would likely exceed the revenue target of around 1% of GDP, and would be close to 2% if land and rural buildings were effectively included in the tax base. In addition to issues related to the size of the tax base, the current gap between the potential and actual collection of property tax at the regional level is explained by the low tax effort, estimates of which refer to issues such as the rates applied, the number and levels of exemptions granted and the capacity of tax administration. Within this capacity there is an implicit level of tax evasion of varying magnitudes.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of E. Ahmad, G. Brosio and J. P. Jiménez, "Options for retooling property taxation in Latin America", *Macroeconomics of Development series*, No. 202, Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2019.

Box III.2

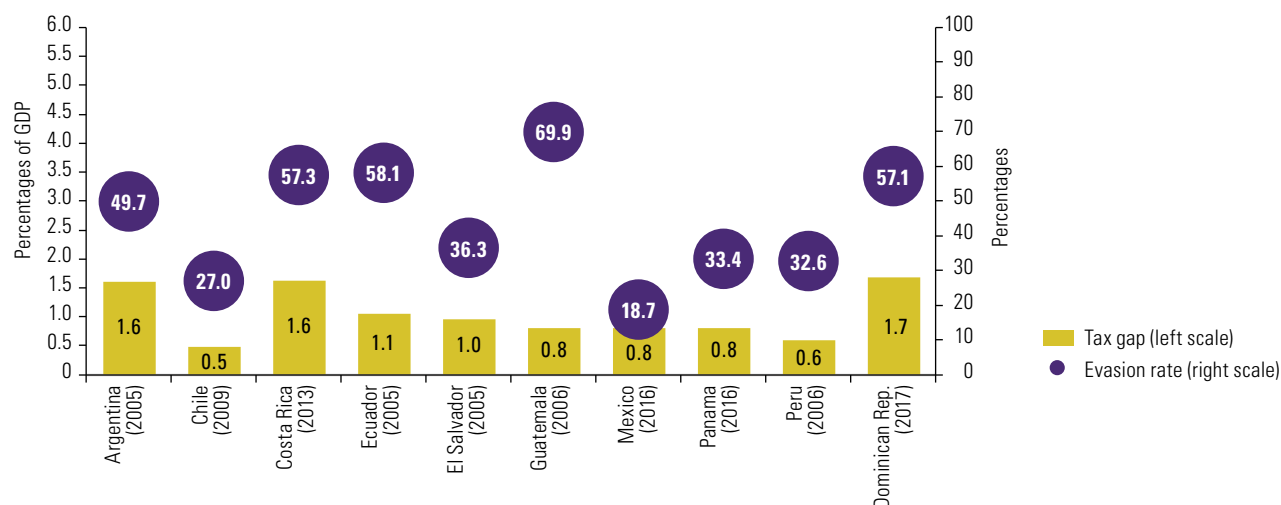
Property taxes
in Latin America:
potential collection

With regard to personal income tax, uncollected tax resources are estimated to be considerable in all countries.¹⁵ This is particularly true in view of modest actual collection of this tax (see figure III.5). Based on the limited number of studies conducted over the past decade, non-compliance rates range from 18.7% in Mexico to 69.9% in Guatemala. The tax revenues generated through personal income tax currently range from 0.4% of GDP in Guatemala to 3.5% of GDP in Mexico. Producing accurate estimates of the amount of revenue currently lost to non-compliance is not a straightforward process, as estimated evasion rates are from different years in most of the available studies. However, the small number of recent examples suggest tax gaps from personal income tax non-compliance that range from 0.8% of GDP in Mexico and Panama (2016) to 1.7% of GDP in the Dominican Republic (2017).

Moreover, on the basis of the few countries with relatively recent official estimates, there is evidence of a regular pattern that has been repeated in several countries of the region. Evasion levels are much higher among self-employed workers who engage in business activities (when they are subject to the tax and do not fall under a simplified taxation regime). At the other extreme are wage earners in a dependent employment relationship and who are usually subject to withholding taxes, limiting their possibilities for tax non-compliance. For example, in Costa Rica the estimated rate of personal income tax evasion was 57.3% in 2013. This percentage can be broken down into a rate of 17.5% for wage earners and pensioners and 91.3% for those engaged in gainful activities (Villalobos and Muñoz, 2015). In Mexico, the personal income tax evasion rate for 2016 (18.7%) is obtained after weighting three very different levels of non-compliance: the tax gap with respect to theoretical collection is 11.5% for wage earners, 56.0% for individuals with business activities and 73.5% for individuals with rental income (San Martín and others, 2017).

¹⁵ In addition to some degree of statistical uncertainty, the lost tax revenue drawn from these studies is not always fully recoverable by the tax administrations owing to various operational restrictions (tax inspection, control and collection) and the fact that the vast majority of these methodologies are static and fail to capture adequately behavioural responses by taxpayers to changes in the extent of compliance enforcement (Gemmell and Hasseldine, 2012).

Figure III.5
Latin America and the Caribbean (selected countries): evasion rates and estimated tax gap
(year of estimation) in personal income tax
(Percentages of GDP and percentages)



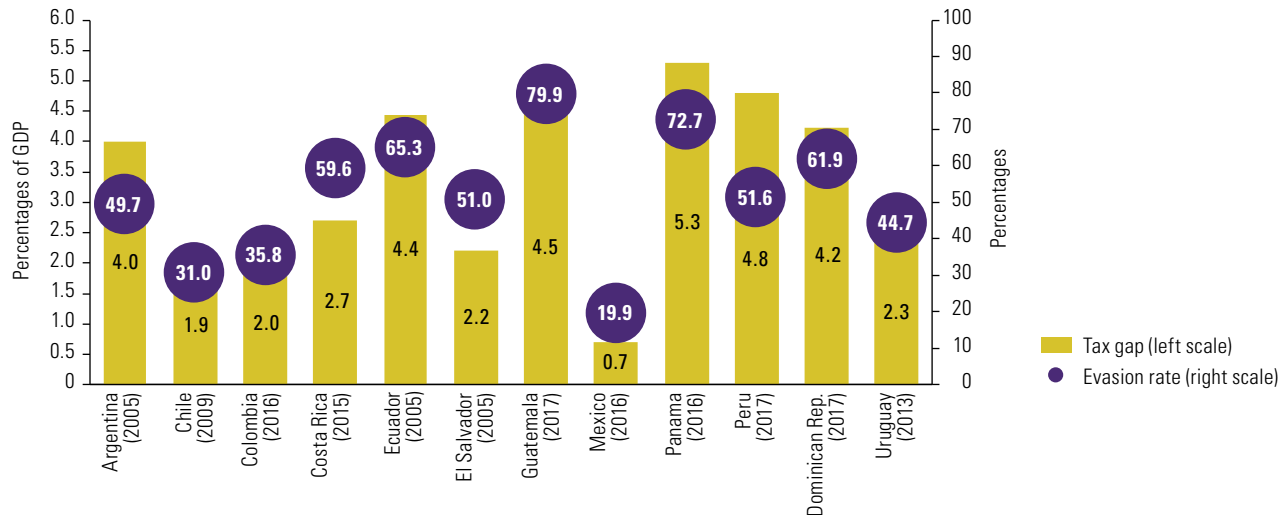
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), OECD Statistics [online database] <https://stats.oecd.org/>; J. C. Gómez Sabaini, J. P. Jiménez and A. Podestá, "Evasión y equidad en América Latina", *Project Documents*, No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2010; and official reports from the respective countries.

Meanwhile, in the case of corporate income tax, a number of quantitative studies have been carried out in recent years in response to the seriousness of the problem. According to these studies, evasion rates for corporate income tax range from 19.9% in Mexico to almost 80% in Guatemala. Given that corporate income tax accounts for the majority of income tax revenues and estimated evasion rates are generally higher than those calculated for individuals, the implicit amounts of lost tax (and potential additional revenues) are estimated to be considerably higher in most countries, especially in Central America and the Andean region. For example, as is shown in figure III.6, the most recent official studies estimate tax gaps equivalent to 0.7% of GDP in Mexico (2016), 2.0% in Colombia (2016), 2.3% in Uruguay (2013), 2.7% in Costa Rica (2015), 4.2% in the Dominican Republic (2017), 4.5% in Guatemala (2017), 4.8% in Peru (2017) and 5.3% in Panama (2016).

The levels of income tax non-compliance are worrying when considering progressive tax reforms in the context of the countries of the region. The contrast is even greater when comparing these figures with those for developed countries. For example, in the United Kingdom, one of the main items analysed in official annual estimates is the component that encompasses income tax, social security contributions (see box III.3) and capital gains tax. In the 2017/18 fiscal year, minimum evasion was estimated at 3.9%, with a higher rate for self-employed taxpayers (17.0%) than for wage earners, among whom non-compliance was almost non-existent, at 1.0%. In the case of the corporate income tax, estimated evasion during the same tax period was 8.1% and the breakdown by taxpayer size confirms a regular pattern seen in other countries: non-compliance is higher among smaller businesses, which are more numerous and which tax authorities find more difficult to control and monitor (HMRC, 2019).

Figure III.6

Latin America and the Caribbean (selected countries): evasion rates and estimated tax gap (year of estimation) for corporate income tax
(Percentages of GDP and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), OECD Statistics [online database] <https://stats.oecd.org/>; J. C. Gómez Sabaini, J. P. Jiménez and A. Podestá, "Evasión y equidad en América Latina", *Project Documents*, No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2010; and official reports from the respective countries.

Box III.3

Evasion within contributory social security systems in Latin American countries

Although conventional estimates tend to focus on the main taxes such as VAT and, to a lesser extent, income tax, quantifying the level of non-compliance in contributory social security systems related to health services and pensions is of great importance for the countries of Latin America and the Caribbean for two key reasons. Firstly, in several cases, the fiscal resources that the countries are able to mobilize today represent a significant portion of their total tax revenue and, therefore, of their public financing. Secondly, since paying these contributions gives contributors rights to a benefit, tax evasion reduces the quality of social protection, promotes exclusion and labour informality, and diminishes the financial sustainability of the whole system.

Available evidence is limited in the region. However, some empirical studies provide a rough idea of the level of non-compliance in contributory social security schemes. Based on information from household surveys, Arenas and others (2012) found that evasion related to pensions in Chile affected 19.0% of all wage earners in 2011. In Uruguay, the General Advisory Office on Social Security of the Social Insurance Bank (BPS, 2019) has estimated evasion through the non-reporting of contributions to BPS and has noted a sustained reduction, from 37.2% in 2004 to 16.1% in 2018. Gómez Sabaini, Cetrángolo and Morán (2014) use a standard methodology for tax gaps to study three cases in the region, covering the pension and health care systems. They found overall evasion rates of 21.5% in Argentina (1.5% of GDP in 2007), 30.0% in Colombia (3.0% of GDP in 2010) and 45.8% in Peru (2.8% of GDP in 2007).

In Colombia, there is the notable example of the Pension and Parafiscal Management Unit (UGPP), which has been monitoring and controlling the settlement and payment of mandatory contributions to the social protection and security system since 2010. UGPP has been quantifying non-compliance in the subsystems for health, pensions, occupational risks and other parafiscal items since 2012, based on the identification of signs of evasion (omission or inaccuracy) in the settlement of contributions by comparing information from different records and official sources. This process has enabled UGPP to improve enforcement and substantially increase voluntary compliance, resulting in a significant reduction in the rate of tax evasion, from 28% in 2012 to 9% in 2017.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of A. Arenas and others, "Análisis de la evasión y elusión en el pago de las cotizaciones previsionales y medidas de política pública para superar sus causas", *Documento de Trabajo*, No. 2, Santiago, Directorate of Pension Studies, Ministry of Labour and Social Security, 2012; Social Insurance Bank (BPS), "Evasión en puestos de trabajo: año 2018. Actualización", *Comentarios de Seguridad Social*, No. 64, Montevideo, 2019; J. C. Gómez Sabaini, O. Cetrángolo and D. Morán, "La evasión contributiva en la protección social de salud y pensiones: un análisis para la Argentina, Colombia y el Perú", *Social Policy series*, No. 208 (LC/L.3882), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2014.

3. International tax evasion and avoidance and the difficulties in determining their magnitude globally

In the countries of Latin America and the Caribbean, the challenge of tax evasion has been included in the fiscal agendas of governments for several decades. However, since the early 2000s, and especially after the global financial crisis of 2008, a new dimension of evasion has had to be incorporated into analysis. From that time onward, international tax evasion and avoidance began to appear more frequently in the media. This helped to raise awareness of the problem and, above all, led to the development of studies and international cooperation projects to better understand the reasons behind it and its magnitude, as well as the design of policies and regulations to prevent or mitigate its negative economic impact.

As multinational companies can expand internationally to broaden their markets, to maximize profits they often take steps to reduce their global tax burden beyond the borders of the countries and regions in which they operate and where their profits are generated. In this regard, emphasis has been placed on the importance of practices relating the transfer of profits and costs between the subsidiaries of a company. Such transfers are often made from countries with high tax rates or significant administrative restrictions on capital flows to jurisdictions that have weak tax systems with relatively low or no taxation (tax havens), taking the form of transfer pricing manipulation.

However, there are multiple aggressive tax planning strategies and they are increasingly sophisticated. According to Loretz and others (2017), these may be implemented through commercial channels, by manipulating the prices of goods and services between related companies, or through financial channels, related to corporate financing transactions via interest or royalty payments between subsidiaries. The ultimate aim of such operations is to reduce taxable income in the country with the largest tax burden. All these practices therefore result in an inexorable erosion of domestic tax bases. They limit countries' capacity to retain tax revenues that could be used to finance development processes or in wealth-sharing instruments to improve social equity and to end poverty. Moreover, these practices undermine the distributive equity and legitimacy of tax systems, as they often result in lower effective rates of income tax for large multinational companies, which bypass their tax obligations in the countries where their profits are generated. This relative advantage for multinationals can also affect domestic economic frameworks by amplifying market concentration and monopolization.

Owing to the nature of these practices, it is very difficult to determine with certainty their magnitude and the resulting loss of tax at the national, regional and global levels. Over recent years, tax administrations in the region have been improving the mechanisms for controlling and requesting accounting information from multinational companies operating in their jurisdictions. While this should enable tax administrations to carry out more accurate audits and quantify resources lost at the level of individual taxpayers or even at the sector level, not all agencies have the financial, human and physical resources and capabilities required to perform these tasks effectively. As a comprehensive approach is not applied, and the focus is on a few major taxpayers, direct comparisons between different countries or at the international level are not possible.

Simultaneously, over the last 15 years a number of empirical studies have approached the problem from a global perspective, using different methodologies to measure the deviations that this behaviour causes in the normal operations of multinational companies.

Also, much more importantly, attempts have been made to measure the implicit loss of tax resources owing to such behaviour. For example, ECLAC has estimated the total illicit financial flows resulting from trade price manipulations (underinvoicing of exports and overinvoicing of imports).¹⁶ It was found that such flows have increased over the past two decades. They were estimated to amount to around US\$ 93 billion or 1.5% of regional GDP in 2015. An earlier estimate (for 2013), puts the associated lost tax at around 30% of that amount, meaning some US\$ 28 billion or 0.5% of GDP (Podestá, Hanni and Martner, 2017).

More recently, several worldwide studies have been published. For example, the United Nations Conference on Trade and Development (UNCTAD, 2015) estimates that uncollected tax resources were around US\$ 200 billion in 2012 (US\$ 90 billion in developing countries alone). An OECD estimate (2015) suggests that global corporate income tax revenue losses amounted to between US\$ 100 billion and US\$ 240 billion in 2014. The latest evidence available from global studies comes from the work of Crivelli, de Mooij and Keen (2015) and Cobham and Janský (2018). These authors estimate that the annual global corporate income tax revenue lost is between US\$ 500 billion and US\$ 600 billion, through both legal and illegal channels. Of that figure, some US\$ 200 billion is accounted for by low-income countries, representing a disproportionately larger share of their actual tax revenues. In addition, Cobham and Janský (2018) estimate that the loss of tax revenue (taking 2013 as a reference year) is very significant in some countries of the region, such as Argentina (4.4% of GDP), Peru, the Central American countries (around 2.3% of GDP in each) and some Caribbean countries, most notably Guyana where losses amount to nearly 7.0% of GDP.

The current global financial architecture, with almost unrestricted mobility of capital among countries and a multiplicity of channels to artificially reduce tax burdens in jurisdictions of origin, has also benefited people with higher incomes and greater financial wealth. For years, in addition to internal factors in each country, the existence of numerous tax havens has encouraged outflows of capital from taxpayers' countries of residence. In addition to little or no taxation, tax havens are characterized by poor regulation and control of the nature and sources of income and wealth inflows, which may include illegal activities. As is the case at the company level, there are a series of complex international mechanisms, the sole purpose of which is to use legal loopholes to conceal the ultimate beneficial owners of such resources.

Some progress has also been made in quantifying the phenomenon globally. Recent studies have used a top-down approach to estimate the amount of extraterritorial wealth worldwide based on macroeconomic data. They have explored discrepancies between current account balances and net flows of foreign investments. The estimated amount is then broken down by country of ownership of offshore deposits and, lastly, the tax revenues lost to this kind of evasion are estimated. For this purpose, a non-compliance rate is assumed for the main taxes affected: (i) income tax; (ii) wealth taxes; and (iii) taxes on wealth transfers (inheritance and gifts). In this respect, a recent study by Vellutini and others (2019) estimates that total offshore wealth was US\$ 7.8 trillion worldwide in 2016, equivalent to just over 10% of global GDP. These values are consistent with other recent estimates such as those of Pellegrini, Sanelli and Tosti (2016), who estimate unreported offshore capital was between US\$ 6 trillion and US\$ 7 trillion at

¹⁶ The concept of illicit financial flows (IFFs) can range from profits from illegal activities to income from legitimate sources, which are transferred between jurisdictions to take advantage of favourable tax conditions. Most available studies focus on one of these elements and provide a partial picture of their magnitude.

end-2013, or Zucman (2017), who estimates that it was around US\$ 8.3 trillion in 2016. The associated lost revenues from income and personal wealth taxes are estimated at around US\$ 160 billion per year.

In short, despite their statistical limitations, the available studies that seek to quantify international evasion in multiple dimensions have the merit of providing indications and evidence about the extent of this phenomenon globally and regionally, based on methodologies that must be perfected over the coming years. In this regard, tax administrations can draw important lessons and knowledge from regular audits and exchanges of tax information. This could contribute to a better understanding of the rationale behind aggressive tax planning strategies and, indirectly, of the magnitude of uncollected tax resources.

C. Actions countries are taking to address this challenge

Irrespective of the accuracy and volume of the available evidence on the magnitude of tax evasion, there is a general consensus on the importance of effectively reducing evasion in the countries of the region. The aim is to ensure not only financing of the State, but also the distributive equity on which any modern tax system is based. The socioeconomic roots of evasion mean that tax agencies must develop mechanisms to improve the oversight and inspection of taxpayers. In addition, they must take a leading role in raising public awareness of the social responsibility to pay the taxes established by the State.

This section provides an update on the latest regional trends to combat tax evasion and avoidance. Before moving forward, however, it is necessary to consider some conceptual issues that serve as a framework of analysis for the rest of the chapter. Responsibility for combating and reducing the magnitude of evasion often lies with tax collection agencies. For this reason, the general approach places great emphasis on tax administration measures to achieve this goal (which will be discussed in the sections below), which are not always sufficient as a comprehensive strategy. In fact, as a study of the situation in Uruguay (General Taxation Directorate, 2019) states, evasion rates can vary over time, in general, because of three key factors: (i) the pattern in economic activity (with countercyclical behaviour by taxpayers); (ii) progress in tax management (linked to the effectiveness of oversight and inspection by the tax administration); and (iii) regulatory changes owing to tax reforms (changes in tax rates and tax bases can create greater incentives for taxpayers to evade obligations).

The last of these factors means that, when formulating strategies to combat tax evasion, it is crucial to consider the importance of the tax system's general coherence in terms of design and reforms. The most common structural problems of taxation in the countries of Latin America and the Caribbean (including insufficient resources, a tax structure biased towards indirect taxes on consumption, substantial tax expenditures in key taxes, weak collection and redistribution of personal income tax) affect taxpayers' incentives, their perception of the tax system and, consequently, overall evasion levels. Consequently —although this topic goes beyond the scope of this chapter— any general strategy to address and reduce tax evasion and avoidance, especially in the countries of the region, should always be accompanied by a necessary reform of tax legislation. Such reforms should promote the principles of efficiency, equity and simplicity in the design of taxes and contribute to alignment of agents' incentives with effective compliance with tax obligations.

1. Measures to promote compliance at the national level

Historically, the countries of Latin America and the Caribbean have had serious problems controlling the recording of all economic transactions that take place in their domestic markets. With a relatively large informal sector in most cases, tax administrations' technical and operational capacities are often overwhelmed by this task. However, the dizzying pace at which technology develops and is incorporated into different areas of the economy has provided growing opportunities for tax agencies to capture and systematize large flows of information using new tax management tools. The main goal of these technological innovations is to simplify and encourage compliance with tax obligations.

One example is the growing diffusion and implementation of e-invoices in the countries of the region. They provide improved insight into the national transactions of each taxpayer and automatically place them under the oversight of national tax authorities. In addition to reducing paper use, these digital documents allow errors in tax returns and accounting records to be found quickly or signs of tax evasion to be detected. In this way, the regulatory body can monitor each link in economic activity, improve the effectiveness of inspections of each taxpayer and, lastly, increase actual tax collection (Barreix and Zambrano, 2018).

Chile was, in 2003, the first country to introduce e-invoicing, although initially it did so only on a voluntary basis. It was made mandatory for large companies in October 2014, and it was gradually extended to all companies by 2018.¹⁷ In 2007, Argentina was the first country to introduce mandatory e-invoicing for a limited group of taxpayers. The requirement was progressively extended to all taxpayers in a long process which ended in mid-2019. Over the years, the rest of the countries of the region have followed the same trend, notably Brazil.¹⁸ Mexico's mass implementation was successful, and progress has recently been seen in Costa Rica, Ecuador, Peru and Uruguay, where mandatory use has been extended to almost all registered taxpayers. Diagram III.2 shows the regional implementation of this tool over the past 15 years. A distinction is made between the years when the basic conditions needed for implementation were established (top) and the different periods that have been necessary for mandatory adoption (below; in some cases, the process has not yet been completed).

Over the last two years, other countries of the region have joined this trend in an effort to increase tax compliance, including Colombia, the Dominican Republic, El Salvador, Honduras, Panama, Paraguay and the Plurinational State of Bolivia.¹⁹ Drawing on the experiences accumulated at regional level, these countries have already completed the initial phases of implementing mandatory e-invoicing. Satisfactory progress has been made so far, with pilot plans for a limited group of

¹⁷ Other specific types of digital documents that are similar in nature to an invoice (export documents and waybills) became mandatory in mid-January 2020.

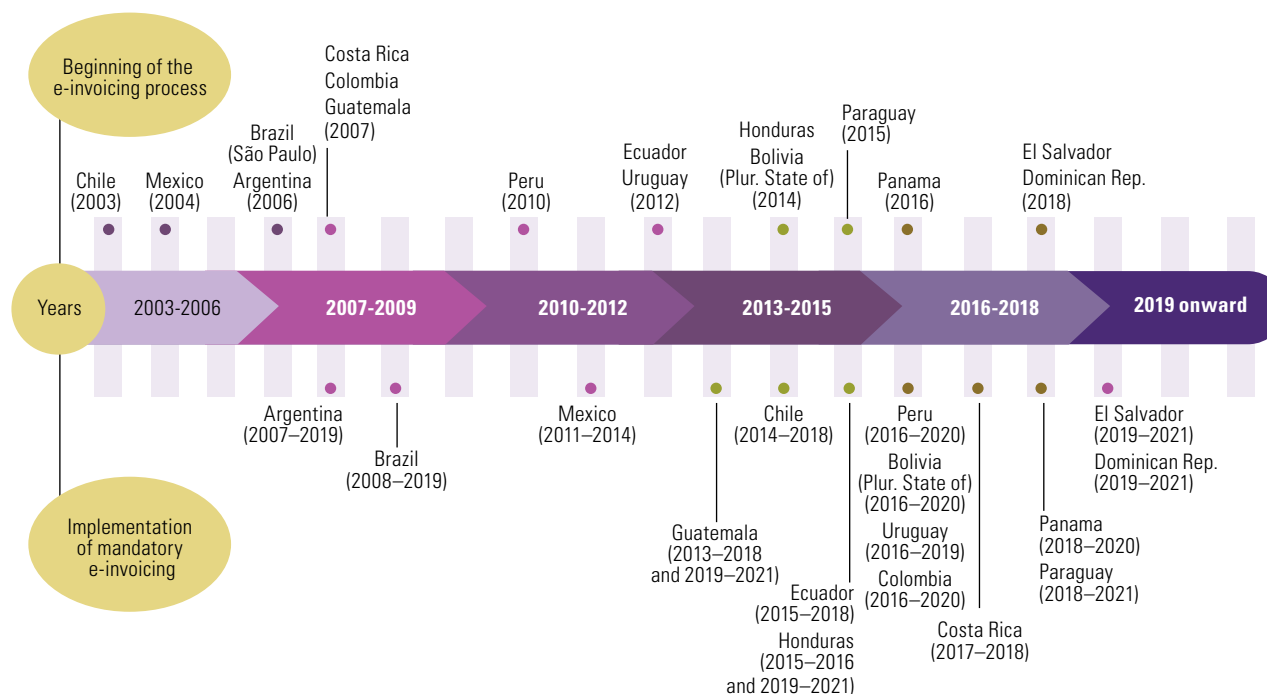
¹⁸ In Brazil, there are also different types of e-invoices for state (NF-e and NFC-e formats for the sale of goods, and the CT-e format for transport) and municipal taxes (NFC-e format for the sale of services).

¹⁹ According to official estimates from the Ministry of Finance and Public Credit, mass implementation of e-invoicing in Colombia would have a significant impact on total revenue, in the order of 0.2% of GDP in 2020 and 0.4% in 2021. It is expected to reach 1.3% of GDP by 2023. This would be a direct result of lower VAT evasion and greater formalization of payment and filing of returns for other key taxes.

large companies, and gradual mass implementation is planned for the next few years. A striking feature of the most recent cases is the speed with which tangible results have been achieved. This highlights the importance of synergies, shared experiences and regional cooperation among the different tax administrations, which has enabled the different countries to learn faster (by reducing errors and obstacles) with regard to technical issues and specific practices linked to e-invoicing.

Diagram III.2

Latin America and the Caribbean (selected countries): process of introducing and implementing e-invoicing



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

Regarding its potential impact, a comparative study by Hernández and Robalino (2018) of five Latin American countries (Argentina, Brazil, Ecuador, Mexico and Uruguay) showed that the implementation of e-invoicing has helped to increase declared sales and profits, and tax collection. The effects described vary according to the period analysed; substantial increases in collection are seen in the short term and, as time goes by, the effects decline, with significant differences among sectors. The positive impact is greater in sectors that are more exposed to administrative controls (construction, commerce, transportation and professional services). More recently, a study by Bellon and others (2019) found positive effects in the case of Peru, where e-invoicing increased reported firm sales, purchases and value-added by over 5% in the first year after adoption. This impact is concentrated among smaller firms and sectors with higher rates of non-compliance, suggesting that e-invoicing lowers compliance costs and strengthens deterrence through inspection and control mechanisms, making it an important complement to the tax treatment of smaller taxpayers in the region's countries (see box III.4).



Box III.4 Simplified tax regimes as formalization mechanisms

The recent dissemination of e-invoicing is an administrative response to combat tax evasion and facilitate voluntary compliance at the national level. However, there are certain tax policy measures or adaptations that are also crucial to achieving these goals, especially in Latin American and Caribbean countries, where a considerable proportion of the population tends to operate in the informal economy. Simplified tax regimes for small taxpayers, which have multiplied and expanded over the past two decades throughout the region, are one example of such a measure.

Current practice shows that most of the simplified regimes in force apply primarily to natural persons engaged in economic activities, although in countries such as Brazil, Chile, Costa Rica, Mexico, Paraguay, Peru and Uruguay they extend to or focus on small businesses. In general, these simplified regimes are based on voluntary registration and self-categorization, and are aimed primarily at the commerce, services, agricultural production and passenger transport sectors. Taxpayer gross income is the most commonly used variable for determining the tax base. With regard to formal aspects, in most countries there are two obligations: (i) the regular filing of tax returns; and (ii) following invoicing processes, in some cases with a requirement to do so electronically. While most of the existing regimes cover VAT and income tax payments, some of them also include social security contributions (Argentina, Brazil and Uruguay). These regimes also provide certain benefits, such as access to retirement pensions or health insurance, helping to expand social protection coverage. Despite the limited statistical information available, low levels of collection are noted in all cases. Sometimes, the government revenue obtained from the regimes is much lower than the costs involved in administering them. In turn, these differential treatments mean that certain negative aspects of tax simplification must be addressed, including "fiscal dwarfism", limited adoption of new technologies and possible distortions in categorization procedures.

Notwithstanding this, positive effects have been seen in terms of formalization of natural persons and small businesses in Argentina, Brazil and Uruguay. In addition, other countries have recently adopted reforms in this area which, despite not yet being close to the single-tax format that includes a social protection component, demonstrate the importance of these simplified regimes as tools to expand the body of taxpayers that can be overseen by tax administrations. For example, Colombia created the Simple Taxation Regime for small businesses, which sought to unify payment of income tax, VAT and other taxes from 2019 onward, following an unsuccessful attempt to introduce a single-tax scheme in 2016. In 2014, Mexico launched the Fiscal Inclusion Regime (RIF), to replace the previous Small Taxpayers Regime (REPECOS), producing good results in terms of formalization of taxpayers.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of O. Cetrángolo and others, "Regímenes tributarios simplificados", *Políticas de formalización en América Latina: avances y desafíos*, J. M. Salazar-Xirinachs and J. Chacaltana (eds.), Lima, International Labour Organization (ILO), 2018.

Furthermore, the improvement of the technologies needed for such systems to function correctly has contributed to a much more efficient and rapid implementation of e-invoicing, and more importantly its uptake by the different taxpayer segments. In a context of growing technological development and optimized information management, this digital tool is a key component of a modern approach taken by tax administrations. In addition to this, other measures include cross-checking and analysing data from government entities and third parties such as financial system entities, implementing a unified tax register, introducing satellite systems for tracing goods to prevent tax fraud, and consolidating systems for automatic withholding-at-source regimes.

According to the latest data from the International Survey on Revenue Administration (ISORA) on operating characteristics and progress with digitization, most of the 159 tax administrations surveyed are taking an increasingly proactive

management approach. A recent OECD report (2019) highlights progress in three categories: (i) support for positive compliance attitudes of taxpayers, through education and taxpayer services to promote voluntary compliance; (ii) compliance risk management, through the increased use of analysis and data sources, taxpayer segmentation and cooperative arrangements; and (iii) the design of multiple strategies, incorporating specific tools to identify and address non-compliance by different types of taxpayers. Examples of these trends include:

- **Mobile platforms and applications:** in Chile, the e-Renta (electronic income tax) application facilitates and encourages the voluntary filing of tax returns. Taxpayers can use the application to view and approve their income tax return. It is based on third-party data and includes tax refund information. In Mexico, the Tax Administration Service (SAT) has developed a mobile application for registering and updating e-invoices issued, viewing financial indicators, scheduling appointments with the tax administration and viewing the status of tax obligations. Similar progress can be seen in the rest of the countries of the region, such as in Argentina, Brazil, Colombia and Peru.
- **Risk management systems:** in Argentina, the Risk Profile System (SIPER), launched by the Federal Public Revenue Administration (AFIP) in 2019, evaluates compliance by taxpayers with their formal and substantive obligations on a monthly basis. Taxpayers are assigned a category that later influences the granting or limiting of benefits linked to the collection, refunding or transfer of taxes and social security resources. This system draws on the information provided by taxpayers in returns and also on complementary systems for monitoring financial transactions and transactions involving registrable assets. This type of system has recently been implemented in Chile and is being studied in other countries in the region.
- **Registration, declaration and payment channels:** to increase tax compliance, some agencies have stepped up the automation of taxpayer registration, declaration and payment processes. In recent years, there has been a notable increase in the use of paper-free channels and applications. In the countries of the region, more than 60% of the total amount of payments received is made through electronic channels. This percentage is as high as 80% in countries such as Argentina, Chile and Ecuador.
- **Pre-filled returns:** this is one of the most recent developments in tax administration, made possible by information and communication technology (ICTs) and e-invoicing, and aims to facilitate voluntary compliance. The basic idea is to provide a form pre-populated with recorded or assumed items based on information obtained from taxpayers via various channels. Chile, Ecuador, Mexico and Peru have made progress with the first phases of implementation (Díaz de Sarralde, 2019).

2. Tax responses to the growth of the digital economy

In recent years, the digitization of the economy has led to changes in companies' business models and production lines, both locally and internationally. This phenomenon, with aspects, intensities and rhythms that are difficult for each State to accommodate, has posed a series of challenges for national tax systems.

Firstly, multinational companies have the capacity to carry out different economic activities and earn income in several countries simultaneously without having to maintain a significant physical presence in some of them. This situation conflicts

with the traditional criteria used to determine tax liabilities, such as the concept of “permanent establishment” and ascertaining the tax residences of the parties involved in electronic economic transactions. Furthermore, it is difficult to collect taxes if suppliers of goods or services are not registered for consumption tax purposes in the country concerned. Secondly, digital businesses interact with their users through social networks and the input obtained from them often contributes to the design of the businesses’ goods and services. The problem lies in how to determine and evaluate the contribution of end-users to the creation of value when this takes place in certain jurisdictions where a company has no physical presence. Even where a company does have a permanent establishment, there is the difficulty of how to allocate profits among the different jurisdictions involved.

These challenges are serious obstacles to the effective collection of key taxes. Digitization ultimately has an impact on the fiscal resources of each country. This is because multinational companies, owing to their high level of flexibility and international mobility, can choose their country of residence and their operations centres according to the tax burden they would face. They then transfer their taxable profits to low- or no-tax jurisdictions, which in turn exacerbates the problem of tax evasion and avoidance on an international scale.

In response to this problem, various tax policy initiatives have emerged at the international level in recent years related to the inclusion of digital services in the VAT tax base.²⁰ In the region, the pioneering countries in this area are Argentina, Colombia and Uruguay, which implemented this measure over the course of 2018 and have already begun to see some positive impact on their tax collection.²¹ In the case of Argentina, progress has also been made in applying additional indirect taxes on digital services: (i) some of the main provinces have begun to apply a tax on gross income, with rates ranging from 2% to 5%; and (ii) under the tax reform approved in late 2019, a selective tax was applied nationwide, the so-called “Tax for a Solidary and Inclusive Argentina” (PAIS), with a rate of 8% on the net price of taxed digital services, which will be used mainly (70%) to finance social security programmes.

Over the past year, Ecuador, Mexico and Paraguay have joined this trend and amended legislation to apply VAT on a wide range of services provided through the main digital entertainment and transport platforms. Following the recent adoption of its tax modernization law, Chile will also apply VAT to these digital services from mid-2020 onward. In the Caribbean, the Bahamas (2019) and Barbados (2020) are also in the process of undertaking this type of reform, the main features of which are summarized in table III.1.

The Plurinational State of Bolivia, Peru and the Dominican Republic are also moving towards levying VAT on digital services provided by foreign suppliers. The Plurinational State of Bolivia is considering applying a 13% tax to digital platforms. In Peru, the National Tax and Customs Administration (SUNAT) has proposed that banks serve as withholding agents for the payment of the 18% general sales tax. Lastly, the Dominican Republic will begin applying the tax on the transfer of industrial goods and services or the selective consumption tax on digital services in 2020. Although the tax rate is still being discussed, it has been decided that service payment intermediaries will serve as withholding agents.

²⁰ According to a survey by KPMG (2020), as of February 2020 there were 77 countries applying indirect taxes on transactions linked to the digital economy, and another 8 where a project of this kind was under public consultation. The number of countries fall to 19 and 6, respectively, for direct taxes (with another 10 having made a public announcement or expressed some clear intention to implement them).

²¹ In Argentina, the tax brought in around US\$ 22 million in the first quarter of 2019. In Uruguay, some US\$ 18.4 million was raised during the first five months of the same year.

Table III.1
Latin America and the Caribbean: examples of taxation on the digital economy through VAT

Country	Year of application	Scope of tax	Rate	Administration
Argentina	2018	Following the tax reform, the taxable base for VAT was expanded to cover digital services—including all Internet transactions—that are automated and require minimal human intervention.	21%	Banking institutions are responsible for collection. If the buyer uses a credit card, the tax is collected when the balance is paid.
Bahamas	2019	As of July 2019, VAT is applicable to all online providers of services relating to hotels and vacation rental properties.	12%	Service providers are required to register and to collect VAT from customers.
Barbados	2019	From 1 December 2019, VAT is applied on goods and services for consumption in Barbados, which are purchased online by local or foreign customers from a vendor abroad or from local vendors when the transaction is processed outside Barbados.	17.5%	Foreign suppliers must register and file digital VAT returns quarterly, and must issue invoices to the purchaser of the digital goods and services.
Chile	2020	As of mid-2020, VAT will be applied to digital services consumed in the national market and provided by foreign entities not domiciled in the country (except in the case of transport companies, which are exempt).	19%	The Internal Revenue Service (SII) will set up a platform that foreign companies can use to file returns and pay VAT electronically.
Colombia	2018	VAT has been levied on digital services provided by foreign suppliers since 2018. Virtual education services for the development of digital content are exempt.	19%	Service providers must register with the Unique Taxpayer Registry (RUT) to file returns and pay the tax, or they can opt for the withholding mechanism operated through commercial banks.
Costa Rica	2020	Pursuant to Decree No. 41779, VAT will be levied on cross-border digital services and will become applicable one month after the tax authority establish the list of services to be taxed.	13%	Two options for collection are set out in the Decree: directly by service providers; or through international credit or debit cards.
Ecuador	2020	The new tax reform was adopted at the end of 2019 and extends VAT to digital services, which include all purchases of goods and services through digital platforms.	12%	The tax will be collected through the credit cards used by consumers to make their respective purchases.
Mexico	2020	Starting on 1 June 2020, the tax will be applicable to services including multimedia downloads, online clubs, and dating, gambling and distance learning websites.	16%	The tax will be collected through the financial entity (credit card company) used by digital service consumers or users, resident in the country.
Paraguay	2020	The recent tax reform (Law No. 6380) established that digital services provided by foreign suppliers will be subject to VAT.	10%	The tax will be collected through withholding mechanisms implemented by the operators of the credit or debit cards used to pay for the service.
Uruguay	2018	Pursuant to Law No. 19,535, the taxable base for VAT was broadened to include services for the transmission of audiovisual content and intermediary services on foreign multi-sided platforms. In the event that one of the parties (provider or requester) is abroad, 50% of the intermediary service is subject to VAT.	22%	Uruguay has opted to collect the tax directly from non-resident suppliers, without establishing withholding mechanisms for credit or debit cards.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Economic Commission for Latin America and the Caribbean (ECLAC), *Fiscal Panorama of Latin America and the Caribbean, 2019* (LC/PUB.2019/8-P), Santiago, 2019; tax legislation of the respective countries.

Two characteristics should be highlighted with respect to the application of VAT on digital services in the countries of the region, both in those where the tax is already being applied and in those which are still in the planning phase. First, there is a tendency to use VAT to tax the provision of digital services by companies located abroad and with no physical presence in the respective economies, instead of introducing a specific tax on these operations. Second, most countries have chosen to channel the collection of taxes on digital services through withholding mechanisms applied to users' credit card payments. Some countries however, such as Chile and Uruguay, require providers to register with the tax registry in the country of consumption (even if they have no physical presence) in order to file returns and pay the tax remotely from the country of origin of the digital services provided.

With regard to income tax, there is currently no general consensus on taxing digital service providers, as there is an ongoing debate on a potential global solution to this issue (as will be outlined in the next section). However, some countries of the region have taken unilateral initiatives to address the tax challenges arising from

the digitization of the economy. These measures seek to protect and expand the tax base of countries where users and consumers are located. Among other things, they include the alternative application of permanent establishment thresholds, withholding of existing taxes through clients, application of turnover taxes or specific regimes targeting large multinational companies. So far, there are only a few instances of direct taxation in the region.

As outlined in ECLAC (2019b), in 2003 Peru expanded the definition of income considered to be of Peruvian origin to include income remitted abroad as payment for digital services. As a result, such payments are subject to a withholding tax of 30%. However, this rule poses some difficulties as it taxes services, but not digital goods. Moreover, it does not address the problem of a significant economic presence without a physical presence in the country. It simply applies a tax on gross income, regardless of the level of presence. In Uruguay, from 2017 onward, it was established that income derived from the transmission of audiovisual content shall be considered to be 100% of Uruguayan origin, resulting in gross remittances abroad for this purpose being taxed at a rate of 12%. With regard to digital platforms, income from the administration of two-sided platforms shall be considered to be 100% of Uruguayan origin when both the supplier and the client are resident in Uruguay, and will be considered to be 50% of Uruguayan origin when one of the two parties is a non-resident. In the first case, the income will be taxed at a rate of 12%, while in the second, a rate of 6% is applied.

More recently, in September 2019, Paraguay promulgated Law No. 6380 to modernize and simplify the national tax system, which states that income from digital platforms will be subject to the non-resident income tax of 15%. This measure applies to digital services used within the country, including entertainment or gambling services, regardless of the provider or whether the service is linked to the receipt of income subject to corporate or personal income tax.

In Mexico, a proposal was made in 2018 to tax digital services through a specific 3% levy on the gross income of service providers. Now, the recently adopted Federal Revenue Law for Fiscal 2020 establishes a tax regime that requires natural persons who engage in business activities and receive income through digital platforms to pay income tax. The tax must be paid from June 2020 onward (the Tax Administration Service must publish the relevant rules) through a withholding regime applied by these platforms. The established rates vary according to the activity and declared monthly income. The rate ranges from 2% to 8% for transport services; 2% to 10% for accommodation services; and 0.4% to 5.4% for the electronic sale of goods and provision of services.

3. The strategies adopted by countries in the new global tax context

As already mentioned, tax evasion transcends countries' geographical borders and leads to a gradual erosion of the tax base as a result of the abusive transfer of profits between jurisdictions. A set of aggressive tax planning strategies is used for this purpose, mainly by large multinational companies and wealthy individuals. In response, the countries of the region have been implementing various measures to improve tax compliance and address the problem of evasion in an international context.

As a first step and in the apparent absence of regional coordination, governments have been forced to take a series of unilateral measures to adapt to these phenomena, mainly by updating and reforming the legal frameworks pertaining to international taxation. These include, for example, introducing and expanding methods to determine transfer prices between related companies. This trend began to emerge in the mid-1990s in some of the countries of the region. Today, regulations to determine transfer

prices have been introduced into the tax legislation of all countries across the region. The only exception is Paraguay, where the matter is addressed in the recent law to modernize and simplify the national tax system, scheduled to enter into force in 2021. In recent years, several countries have modified or fine-tuned their implementation of transfer pricing regulations, including Chile, Colombia, Costa Rica, Ecuador, Mexico, Nicaragua and Uruguay.

Another measure incorporated into some recent reforms is the establishment of guidelines to determine whether a jurisdiction is considered low-tax or a tax haven (Brazil, Ecuador, Mexico). In some cases, changes were made to the definition of bank secrecy and the concept and identification of low or no tax jurisdictions (tax havens), for example in Ecuador, El Salvador and Uruguay. The 2017 tax reform in Argentina introduced a series of anti-abuse rules that include the definitions of low-tax or no tax jurisdictions, rules for loans between related companies and other similar operations for multinational companies. Other countries, such as Colombia, modified the requirements for the treatment of income from entities controlled from abroad. A general anti-abuse rule for fiscal 2020 was also established in Mexico recently, pursuant to which the national tax agency has the authority to reclassify legal acts that lack a business reason or equivalent economic benefit but generate a tax benefit to the taxpayer (through deductions or exemptions, for instance). Moreover, in line with other countries of the region, the legal definition of permanent establishment was updated, and changes were introduced to limit deductions for interest and other payments abroad, among other measures.

In recent years, several countries of the region have implemented programmes to regularize undeclared assets in order to identify assets and income that were not being taxed properly and therefore to increase their tax resources. The first to do so were Argentina and Brazil, with quantitative results that far exceeded expectations (representing 1.8% and 0.8% of GDP, respectively). They were followed by Chile in 2016 (0.6% of GDP) and, more recently, Mexico and Peru, albeit with less revenue, equivalent to 0.1% and 0.2% of GDP, respectively (ECLAC, 2019b). In Colombia, a similar programme imposed a normalization tax to regularize undeclared assets and non-existent liabilities at a rate of 10% in 2015, 11.5% in 2016 and 13% in 2017. This levy was reactivated as a complement to income and wealth taxes, at a rate of 13% in 2019 and 15% of the tax value of the regularized amount for 2020 under the recent tax reform (Law No. 2010 of 2019). Also, at the end of 2019, Ecuador followed the regional trend with plans for a tax reform including a single, temporary tax to regularize assets abroad, although this was not ultimately included in the Tax Simplification and Progressivity Act. In some of these cases, incentives are offered for the effective repatriation of resources and their investment in the recipient country for a specific period of time.²²

In addition to these specific measures at the individual level, over the last decade the governments of the region have come to understand that the respective tax authorities do not have sufficient technical and operational capacities to control and investigate international tax evasion, and, therefore, that an approach is required that goes beyond the geographical boundaries of each jurisdiction. Regional consensus has emerged on the need for international cooperation in tax matters, with special emphasis on the development of a set of control instruments and, above all, on the exchange of financial and tax information among the different countries.

²² Examples of these incentives include reductions in the tax base (for instance in Colombia) or differential rates for taxes on declared assets. A very recent example is Argentina, where the central government's main wealth tax (personal assets tax) has been modified to increase the levy on assets located abroad, with higher rates than those applied to declared assets located in the country. The adopted tax includes an incentive (application of the tax rates for assets located in the country) in the event that a minimum of 5% of declared foreign assets are effectively repatriated during the relevant fiscal year.

As is generally known, the Base Erosion and Profit Shifting (BEPS) project was launched in 2013 and culminated in October 2015 with agreement on international standards and measures by the Group of 20 (G20) countries to address this problem. This OECD and G20 initiative recognizes the importance of ensuring that profits are taxed where substantial economic activities take place and value is created. Since the end of 2015, this initiative has served as an important guide for the necessary reforms of the fiscal legal frameworks of the countries of the region. However, as inferred from a survey conducted by the Inter-American Center of Tax Administrations (CIAT), the implementation of measures to counter the harmful effects of base erosion and profit shifting varies depending on the country and progress remains limited and disparate in most cases (see table III.2).

Table III.2

Latin America and the Caribbean: progress made in the implementation of measures related to the Base Erosion and Profit Shifting (BEPS) Project

Actions to counter base erosion and profit shifting (BEPS) between jurisdictions	Actions implemented to counter base erosion and profit shifting	
	Partially	In full
Action 1: address the tax challenges of the digital economy	Argentina, Colombia, Costa Rica, Mexico	
Action 2: neutralize the effects of hybrid mismatch arrangements	Chile, Costa Rica, Mexico	
Action 3: strengthen the rules on controlled foreign companies	Mexico	Argentina, Chile, Colombia
Action 4: limit base erosion via interest deductions and other financial payments	Colombia, Ecuador, Peru	Argentina, Costa Rica
Action 5: counter harmful tax practices more effectively, taking into account transparency and substance	Argentina, Bermuda, Brazil, Colombia, Ecuador, Jamaica, Peru, Trinidad and Tobago	Chile, Costa Rica, Mexico, Panama, Uruguay
Action 6: prevent abusive use of tax treaties	Barbados, Belize, Brazil, Chile, Costa Rica, Ecuador, El Salvador, Jamaica, Panama, Uruguay	Argentina, Colombia, Mexico, Paraguay
Action 7: prevent the artificial avoidance of permanent establishment status	Chile, Colombia, Costa Rica, El Salvador, Jamaica, Uruguay	Argentina, Brazil, Mexico
Action 8: align transfer pricing outcomes with value creation (intangibles)	Mexico	Ecuador
Action 9: align transfer pricing outcomes with value creation (risks and capital)		Ecuador, Mexico
Action 10: align transfer pricing outcomes with value creation (other high-risk transactions)	Dominican Republic, Mexico, Peru	Colombia, Ecuador
Action 11: measuring and monitoring BEPS	Argentina, Chile, Costa Rica, Mexico, Uruguay	
Action 12: require taxpayers to disclose their aggressive tax planning arrangements	Chile, Ecuador, Mexico	Brazil
Action 13: re-examine transfer pricing documentation	Bermuda, Chile, Panama, Uruguay	Argentina, Brazil, Colombia, Costa Rica, Mexico, Peru
Action 14: make dispute resolution mechanisms more effective	Argentina, Barbados, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama, Paraguay, Uruguay	
Action 15: develop a multilateral instrument	Argentina, Barbados, Belize, Chile, Colombia, Costa Rica, Jamaica, Mexico, Panama, Peru, Uruguay	Curaçao

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Inter-American Center of Tax Administrations (CIAT), BEPS Monitoring Database [online] <https://www.ciat.org/beps-monitoring-database/?lang=en>.

As a complement to countries' individual actions and with a view to ensuring the coordination of measures to be implemented, various participatory forums have been created to coordinate efforts among countries to combat international tax avoidance and evasion. Many of the countries of Latin America and the Caribbean have been participating in these initiatives. In June 2016, OECD established the Inclusive Framework on BEPS as a means of ensuring that member countries participate on an equal footing in developing standards on BEPS-related issues and reviewing and monitoring

implementation of the BEPS project, and of accessing capacity-building support. At the end of December 2019, the Inclusive Framework on BEPS had 137 members. These included 12 Latin American countries: Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Honduras, Mexico, Panama, Paraguay, Peru and Uruguay. Most of the Caribbean countries have also joined the initiative, for example the Bahamas, Barbados, Guyana, Jamaica and Trinidad and Tobago (see table III.3).

Table III.3

Latin America and the Caribbean (selected countries): participation in international cooperation initiatives in tax matters, as of December 2019

Country	Inclusive Framework on BEPS	Global Forum on Transparency and Exchange of Information for Tax Purposes			Convention on Mutual Administrative Assistance in Tax Matters	Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information	Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports
		Member	Standard of exchange of information on request	Date of first automatic exchange			
Argentina	Yes	Yes	Largely compliant	Sept. 2017	Yes	Yes	Yes
Bahamas	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	Yes
Barbados	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	No
Bolivia (Plurinational State of)	No	No	-	-	No	No	No
Brazil	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	Yes
Chile	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	Yes
Colombia	Yes	Yes	Compliant	Sept. 2017	Yes	Yes	Yes
Costa Rica	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	Yes
Dominican Republic	Yes	Yes	Largely compliant	-	Yes	No	No
Ecuador	No	Yes	Pending	Sept. 2020	Yes	Yes	No
El Salvador	No	Yes	Largely compliant	-	Yes	No	No
Guatemala	No	Yes	Non-compliant	-	Yes	No	No
Guyana	Yes	Yes	Pending	-	No	No	No
Honduras	Yes	Yes	Pending	-	No	No	No
Jamaica	Yes	Yes	Largely compliant	-	Yes	No	No
Mexico	Yes	Yes	Compliant	Sept. 2017	Yes	Yes	Yes
Nicaragua	No	No	-	-	No	No	No
Panama	Yes	Yes	Partially compliant	Sept. 2018	Yes	Yes	Yes
Paraguay	Yes	Yes	Pending	-	Yes	No	No
Peru	Yes	Yes	Compliant (only phase 1)	Sept. 2020	Yes	No	Yes
Trinidad and Tobago	Yes	Yes	Non-compliant	-	No	No	No
Uruguay	Yes	Yes	Largely compliant	Sept. 2018	Yes	Yes	Yes
Venezuela (Bolivarian Republic of)	No	No	-	-	No	No	No
Latin American countries	12	15	15	10	14	10	10
Total jurisdictions	137	158	158	109	135	107	83

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD), "Inclusive Framework on Base Erosion and Profit Shifting (BEPS)" [online] <https://www.oecd.org/tax/beps/>.

Moreover, a series of initiatives, some of them within the framework of the BEPS project and led by OECD, have helped to strengthen multilateral cooperation in the areas of information exchange. The first example is the Global Forum on Transparency and Exchange of Information for Tax Purposes. Through a peer-review process, the Forum monitors the implementation of the standards of exchange of information on request and the automatic exchange of information in tax matters. It currently covers more than 155 jurisdictions, including 15 Latin American countries and 22 Caribbean countries and territories, although the level of implementation of the different dimensions varies depending on the country.

With regard to the standard of exchange of information on request, Colombia and Mexico are the only countries in the region to have been rated as “compliant” in both phases. Meanwhile, Argentina, the Bahamas, Barbados, Brazil, Chile, Costa Rica, the Dominican Republic, El Salvador, Jamaica and Uruguay are “largely compliant” and as of the end of 2019, Panama was “partially compliant” (see table III.3). With regard to the implementation of the automatic exchange of financial account information, some countries of the region began to share this information in September 2017 (Argentina, Colombia and Mexico) and others in 2018 (Brazil, Chile, Costa Rica, Panama and Uruguay, in addition to the Bahamas and Barbados in the Caribbean). Through this framework, the participating Latin American countries have sent and will be able to receive tax information from more than 50 jurisdictions simultaneously. Ecuador and Peru plan to send information for the first time by September 2020.

Three other instruments complete the framework developed by OECD to consolidate and make the exchange of information in tax matters between jurisdictions feasible, and are actively used by several countries of the region. The first is the Convention on Mutual Administrative Assistance in Tax Matters, which facilitates international administrative cooperation in the assessment and collection of taxes, with a view to combating tax avoidance and evasion. To date, the Convention has been signed by all Latin American countries that are members of the Global Forum on Transparency and Exchange of Information for Tax Purposes, except Honduras, which became a member of the Forum only recently. The Convention is already in force in most of these countries (the Dominican Republic, Ecuador and El Salvador joined the list in 2019), as well as in Caribbean countries such as the Bahamas, Barbados and Jamaica.

The following were established within the framework of the Convention: (i) the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (which specifies the bank information to be exchanged automatically for tax purposes through the Standard for Automatic Exchange of Financial Account Information in Tax Matters); and (ii) the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (focused on the global operations of multinational companies). At the regional level, all countries participating in the standard for automatic exchange of information have signed both agreements, except Peru (which has not signed the Agreement on Automatic Exchange of Financial Account Information) and Ecuador (which has not signed the Agreement on the Exchange of Country-by-Country Reports). However, it is hoped that both countries will ratify the pending instruments before September 2020, when they are expected to begin sending tax information to other jurisdictions.

Although the United States participates in the Global Forum on Transparency and Exchange of Information for Tax Purposes and has signed the Convention on Mutual Administrative Assistance in Tax Matters, it does not follow the standard for automatic exchange of information, instead it uses its own bilateral agreements pursuant to the Foreign Account Tax Compliance Act (FATCA), passed in March 2010. This is relevant to the countries of the region, as they can only exchange information with the Internal Revenue Service (IRS) if they have signed and ratified a bilateral agreement with the United States. This mechanism is coercive as it imposes penalties on those foreign financial institutions that have commercial links with the United States and fail to cooperate. Some countries of the region have concluded intergovernmental agreements with IRS, for example, Brazil, Chile, Colombia, Honduras, Mexico and Panama. Costa Rica and the Dominican Republic have also done so in the last year. Meanwhile, Nicaragua, Paraguay and Peru only have an agreement in principle. This is also the case for most Caribbean countries, including the Bahamas, Barbados and Jamaica.

Even with the progress made in international cooperation and despite its undeniable importance in the fight against cross-border tax evasion, the limitations of the BEPS project have become evident in recent years in terms of developing coordinated measures to address the challenges of the digital economy. For example, the digital economy is characterized by

its cross-cutting nature and by the fact that it is impossible to adopt an effective approach to protect countries' tax sovereignty in light of multinational companies' new business models. The failure to redefine the foundations of the international tax system with regard to the allocation of taxing powers among the different jurisdictions means that the progress made in multilateral coordination appears insufficient. This has paved the way for the unilateral adoption of various measures that could endanger the entire system. Against the backdrop of sluggish global economic growth, the financial emergencies of various countries and their desire to attract foreign investment flows trigger a race to the bottom in legal tax rates and the emergence of legal gaps between national tax systems. Ultimately, these shortcomings bolster the incentives and mechanisms that allow international tax evasion to spread and worsen, with the aforementioned harmful consequences.

In this context, the Inclusive Framework on BEPS has played a key role in developing a consensus-based, global and structural solution. Within the framework of the reformulation of the BEPS Project, in February 2019, OECD published a series of public consultation documents setting out proposals to address the tax challenges of the digitalization of the economy. At the end of May, consensus was reached on the road map to follow in order to define coordinated global measures to address this challenge. The final report on proposed solutions and the next steps to be taken (approved by 99 countries) focuses on two pillars that consolidate and further the measures already developed in this context and that have the potential to transform the fundamental principles of the international tax system.

The first pillar includes new criteria to determine when a company is considered to be subject to tax in a particular country in which it operates even though it is not physically established there, in other words, even though it does not meet the strict parameters that until now have determined the existence of a permanent establishment (nexus rules). An alternative would be to establish a minimum threshold of some observable variable that would prove a significant economic presence in a specific jurisdiction.

This first pillar also sets out new rules for the allocation of profits and losses among the different jurisdictions where a company has a presence (not necessarily a physical one) through new alternative methods (profit allocation rules). This means that the structural elements of the current tax system (double taxation agreements, the arm's length principle and the permanent establishment concept) could be modified significantly. For example, one of the proposed methods (the modified residual profit split method) involves differentiating between routine and non-routine profit in order to define the allocation of non-routine profit to the jurisdictions in which the companies operate. Under the fractional apportionment method, a multinational enterprise is considered as a whole and allocates the enterprise's profits and losses based on a pre-established formula. To this end, different apportionment factors must be defined, such as the number of employees, asset value, sales volumes and number of users.

The second pillar sets out an income inclusion rule that would allow the country of residence to tax income that is not subject to a minimum rate of corporate income tax in the source jurisdiction. It also includes an undertaxed payments rule designed to tackle domestic tax base erosion in source countries by denying a deduction or a proportionate amount of any deduction for certain payments made to parties located abroad (or by subjecting a payment to a withholding tax in the source country) when those payments are not subject to a minimum effective rate of income tax in the destination country. This approach envisages a global fixed percentage of corporate income tax, unlike the traditional approach, under which the percentage is defined by each country.

The initial estimates of the potential quantitative impact of these proposals and their variants would have globally in terms of the tax resources that could be mobilized to finance States were published recently (OECD, 2020). The preliminary results suggest that the combined effect of the two-pillar approach, currently under discussion, would be global net revenue gains of up to 4% of global corporate income tax revenues (roughly US\$ 100 billion annually). The fact that the G20 has requested the Inclusive Framework

on BEPS to reach agreement on a consensus-based solution by the end of 2020 means that initiatives on this matter must be adopted as a matter of urgency by the countries of Latin America and the Caribbean. Given the potential significance of this paradigm shift for the international tax system, the countries of the region must ask themselves whether these changes are desirable and whether they will be able to adapt to them correctly.

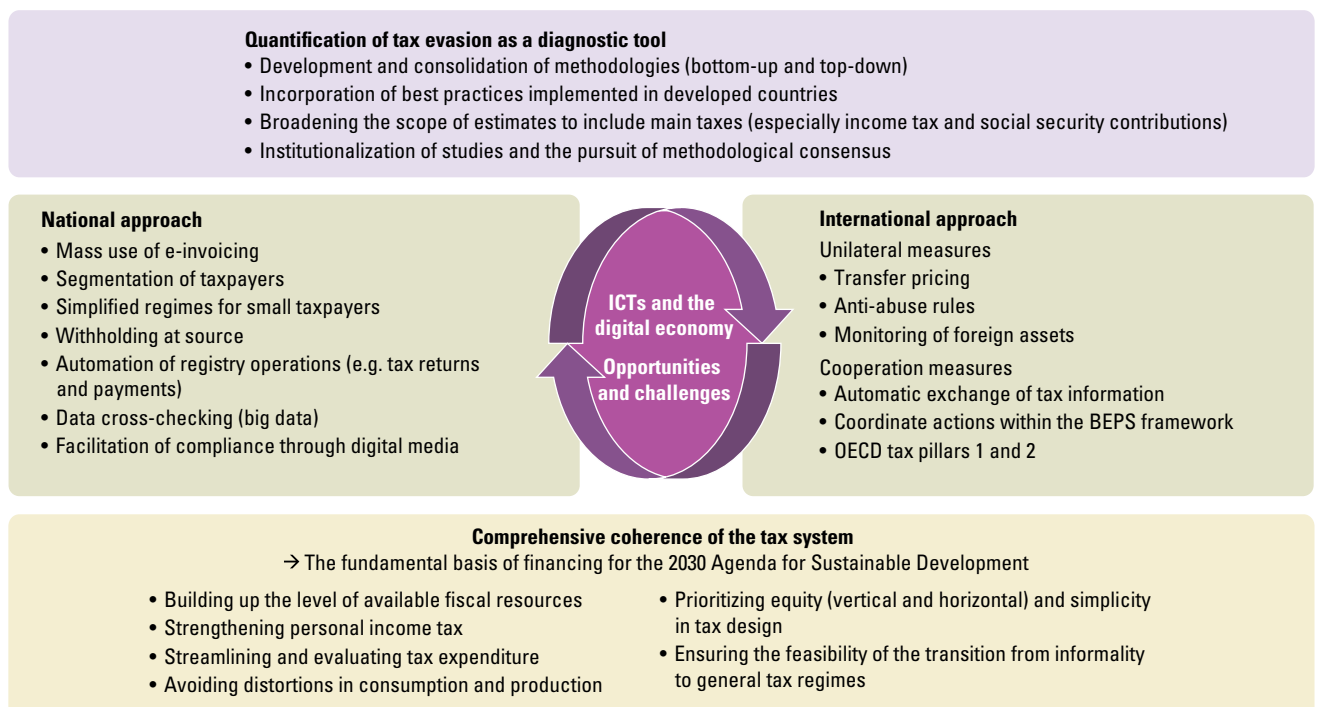
D. A road map to tackle tax evasion and foster national resource mobilization in the region

The 2030 Agenda for Sustainable Development has created opportunities to identify areas of common ground and for regional cooperation, and has become an important guide for the countries of Latin America and the Caribbean. Achieving its Goals and specific targets requires major efforts from all the main actors of each country. Given the current levels of available government revenue, national resources must be mobilized to ensure sufficient funding for the public policies that are to be implemented. To that end, along with possible tax reforms, steps must be taken to ensure that the tax revenue that is currently being lost because of evasion and other structural weaknesses in tax systems throughout the region is collected.

Tax evasion is not just a problem of available public resources. This phenomenon affects the very legitimacy of the tax system, as it undermines its efficiency and the equity that should prevail among taxpayers. The current strategy for tackling tax evasion is particularly relevant to the countries of the region and involves both tax policy measures and administrative reforms. Diagram III.3 summarizes the main elements of this strategy, which are clearly interrelated and also linked to the possible consequences of the recent trends in information and communications technologies (ICTs), the new business models and the growing digitization of the economy.

Diagram III.3

Latin America and the Caribbean: current strategy to tackle tax evasion



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

1. Measuring evasion is a starting point to improve tax management

In order to prepare a proper assessment of the situation and recent trends, the importance of quantifying tax non-compliance cannot be overstated. Understanding the magnitude, as well as the causes and determinants, is crucial when designing tax policy and anticipating its possible effects on different groups of taxpayers. It is not advisable to use the evasion estimates to evaluate the short-term performance of the tax administration. The emphasis should be on evaluating identifiable trends over time, beyond the point estimates seen in specific years. Regular estimates of the tax gap are useful to society as they allow taxpayers to assess the tax authority's efforts to foster voluntary compliance. Institutionalizing procedures to quantify evasion and disseminating them as desirable practices strengthens tax governance at the national and regional levels.

From a methodological perspective, producing evasion estimates is complex and there is no *one-size-fits-all* solution. When evaluating the suitability of a methodology, tax authorities must consider: (i) the structure of the tax system; (ii) potential areas of compliance risk; (iii) existing data; and (iv) the resources available for generating estimates. Ideally, multiple approaches should be used to obtain broader perspectives and to ensure the quality and usefulness of the estimates. At the regional level, there appears to be some methodological consensus on the estimates of VAT non-compliance, and somewhat less with respect to corporate income tax. However, there is still ample room to improve the quality and depth of the processed information.

- With regard to VAT, the estimated figures tend to refer to the total for each economy and the tax gap is not broken down by different economic sectors. On the basis of a recent study on Costa Rica (Ueda and Pecho, 2018), the sectoral analysis of the tax gap could be used to explore the composition and demographics of each sector. This would provide indications to better guide the collection agencies' control and oversight strategies. Similarly, given the differences among countries, the analysis of non-compliance could distinguish between revenue (effective and theoretical) from the national market and that obtained from customs from imports given that they differ in terms of the rationale and margins of evasion and of the tax management mechanisms applied in each case.
- With respect to corporate income tax, it would be advisable to further the analysis by economic sector and by type of taxpayer, and to include estimates of the loss of income associated with tax base erosion owing to profit shifting to other jurisdictions. The automatic exchange of tax information, while very difficult, would be useful in that respect.
- There are considerable statistical limitations with regard to both personal income tax and social security contributions. This underscores the need for the countries of the region to adopt a common agenda: to work in a coordinated manner to prepare, process and refine data inputs from different sources. If several public entities work on evasion estimates together, they could produce studies with an increasingly robust methodology, as reflected in a recent paper on the Dominican Republic (General Directorate of Internal Revenue and others, 2018).
- There is considerable scope for making progress in the sharing of experiences and knowledge in order to identify common strengths and weaknesses. The document published by ECLAC (Gómez Sabaini, Jiménez and Podestá, 2010) remains an example of the feasibility of creating new forums for cooperation

among countries to establish regional reference frameworks. The recent contributions of the European Union, which have been analysed in this chapter, reinforce this idea. They also shed light on another practice that the countries of the region could explore: the possibility of receiving technical assistance from institutions outside the tax administration. Steps have also been taken in that regard in Mexico (with the random participation of national universities) and in Costa Rica and Jamaica (with the adoption of the methodology of the IMF Revenue Administration—Gap Analysis Program).

2. Measures to address tax evasion at the national level

With regard to the concrete measures adopted by the countries to reduce the high levels of evasion relating to the main taxes, there is a need for simultaneous progress on two fronts. A domestic approach must be applied, adapted to the realities of each country and, at the same time, aligned with current international trends in tax reform and administrative measures. For the economies of the region, the widespread implementation of mandatory e-invoicing represents considerable progress in the control and oversight of all types of taxpayer. This tool's potential goes beyond combating evasion and reducing informal trade. The detailed information that can be accumulated in the next few years will create opportunities to improve tax management, focus resources on the most critical areas, allow the cross-checking of information with administrative records to detect irregularities in filed returns and facilitate the incorporation of advanced instruments, such as pre-filled returns.

The facilitation of voluntary compliance also includes a series of instruments such as different e-payment methods and the development of applications and multiple channels of contact with taxpayers, with the aim of reducing the time and costs associated with compliance. Taxpayer segmentation is increasingly necessary to improve the management of available resources and focus audits on the most problematic segments, for example, the ever-growing number of self-employed workers. For this reason, automated control systems are being introduced to reduce the risk of non-compliance in specific activities or sectors (electronic systems to track operations).

Automatic withholding regimes for financial operations have proven to be essential to ensuring tax compliance. The cross-checking of information from different sources enhances control and inspection capacities, by including advanced big data and tax analysis techniques. This is complemented by the consolidation of a large number of simplified tax regimes, specifically targeting small taxpayers. These types of regime are now considered powerful tools for economic formalization. Despite their deficiencies and limitations, reforms can be introduced to expand the coverage of protection schemes (single-tax schemes) and, at the same time, encourage informal agents to transition to general tax regimes.

3. The challenges posed by the digitization of the economy for tax systems

The development of ICTs and their penetration in different areas of activity have simultaneously created a wide range of opportunities and threats. On one hand, there are more technical possibilities to facilitate compliance with tax obligations and the formalization of taxpayers' habitual transactions at the national level. On the other hand, the gradual digitization of the economy has also allowed most multinational companies

to participate actively in specific sectors in different countries without the need for a permanent establishment, which has made it difficult to effectively tax income earned in the countries of origin.

Given the advancement of the digital economy worldwide, in the last two years several Latin American countries have joined others in protecting VAT revenue by incorporating digital services into the tax base. Their experiences to date have produced satisfactory results in terms of collection and appear to be a model for the region, as long as no better solutions emerge at the international level. A few countries have also introduced an income tax for companies that provide digital services, even if they do not have a physical presence in the respective territories. Although there are various alternatives, this area is highly complex given that domestic legislation must be specifically adapted to facilitate the effective application of the tax and companies' inclusion in the national tax registry. It is hoped that a consensus solution will emerge by the end of 2020, within the deadlines set by the OECD Inclusive Framework on BEPS.

4. An international approach to expanding tax controls beyond geographical borders

There are two aspects to the international strategy. First, there is a series of unilateral measures focused on updating and strengthening legal frameworks with respect to transfer pricing, undercapitalization rules and payments between related companies, the redefinition of the permanent establishment concept and anti-abuse rules for bilateral agreements, among other things. The countries of the region must maintain a proactive stance in this regard to address the challenges posed by the endless capacity of multinational companies to shift profits between jurisdictions to reduce their global tax burden. The coordinated adoption of this type of measure should also be encouraged, as sharing restrictions and risks would avoid potential legal disagreements between countries.

While unilateral measures have focused on the operations of multinational companies, tax authorities have begun to place greater emphasis on audits of high income and high net worth individuals, who are particularly important in terms of tax policy. As they are potentially the main contributors to personal income tax and wealth tax revenue, the concentration of evasion in this taxpayer segment could be costly in terms of available resources and tax equity. With regard to the recent implementation of tax regularization and asset repatriation programmes in several countries of the region, most of the returns were submitted by natural persons (ECLAC, 2019b). Although these programmes may have a positive short-term impact on revenue, they should not become regular practice given their harmful effects on tax morale and the equity of the overall tax system. However, the valuable information generated should be used both to improve oversight of these individuals and to design possible direct taxation reforms.

In addition, the countries of region should focus on leveraging the synergies from international cooperation in tax matters. To that end, they should participate actively in various international initiatives that require the automatic exchange of information with other jurisdictions, in light of the persistent difficulties that have arisen in recent years under bilateral agreements calling for the exchange of information upon request. These instruments are useful for strengthening the capacities of tax authorities and for reaching a lasting consensus on combating tax avoidance and evasion at the global level.

The reformulation of the BEPS project based on two fundamental pillars calls for consideration of the potential implications for the countries of the region of a global agreement on the treatment of corporate income and the distribution of tax powers between the jurisdictions in which multinational companies operate, even without a

physical presence. The risks associated with the main proposals regarding the nexus rules and the redefinition of the permanent establishment concept must be analysed and evaluated quickly. There should also be an evaluation of the risks linked to profit attribution methods and, perhaps more importantly, to the global minimum effective rate to be applied in cases where authorities detect evidence of the artificial shifting of profits to low- or no-tax jurisdictions. As outlined by the Independent Commission for the Reform of International Corporate Taxation in some recent publications, not only are resources at stake, but there is also an opportunity to rebuild the foundations of the international tax system. In practice, the current system gives multinational companies too much discretion to allocate profits to the jurisdiction of their choosing (ICRICT, 2019).

5. The coherence of the tax system and coordination of actions within the framework of the 2030 Agenda for Sustainable Development

Ultimately, the strategy to combat tax evasion and avoidance at the national and international levels requires a multidimensional, cooperative and proactive approach that is constantly adapting to technological change. There is room for regional cooperation in the search for comprehensive and coherent solutions in each sphere examined. However, it must also be understood that tax authorities play a crucial role in shaping an effective tax system, which does not always coincide with the legal or formal system established according to tax policy. These two sides of the same coin tend to shape the authorities' different functions in pursuit of distinct objectives, hence the need for coordination in order to achieve multiple goals at the same time.

Improvements in the administration of the main taxes applied will give weight to the implementation of reforms that encourage the region's countries to converge towards a tax structure that is more efficient, fairer, better managed and more credible (in other words, more socially acceptable) and that increases the region's tax revenues. Meanwhile, reforms that seek to maintain coherence and gradually remove the structural obstacles that have characterized taxation in Latin American and Caribbean countries in recent decades will be a decisive contribution to creating better conditions for increasing taxpayers' voluntary compliance and ensuring that the respective tax administration agencies work more efficiently. This coherence is important not just at the national level, but also for the region as a whole. It will help to avoid tax competition between different countries and reaffirm the importance of establishing channels for regional dialogue and coordination in these strategies.

Therefore, the combined actions within the framework of these guidelines should lead to a gradual—but sustained—reduction in levels of non-compliance (which must be quantified periodically to ensure suitable follow-up) and to a subsequent expansion of the tax base. This would translate into a large influx of additional (or recovered) income that could give the countries of the region a considerable boost in their pursuit of the social and economic goals enshrined in the 2030 Agenda for Sustainable Development.

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Annex III.A1 Latin America: recent studies on tax evasion in different countries

Country	Taxes	Period	Source
Argentina	VAT	2001–2007	Federal Public Revenue Administration (2008), “Estimación del Incumplimiento en el IVA, año 2007”, Buenos Aires, June.
	Personal income tax – corporate income tax	2005	IMF (International Monetary Fund) (2019), “Argentina: third review under the Stand-by Arrangement, request for waivers of applicability of performance criteria, financing assurances review, and request for modification of performance criteria”, <i>IMF Country Report</i> , No. 19/99, Washington, D.C., April.
Bolivia (Plurinational State of)	VAT	2005–2015	Gómez Sabaini, J. C., J. P. Jiménez and A. Podestá (2010), “Evasión y equidad en América Latina”, <i>Project Documents</i> , No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).
	VAT	2003–2018	Ministry of Economy and Public Finance (2018), <i>Boletín Económico</i> , year 4, No. 8, La Paz.
Chile	VAT	2003–2018	SII (Internal Revenue Service) (2019), “Serie de evasión de IVA empalmada 2003-2018: base compilación de referencia 2013”, Santiago.
	Personal income tax	2009	Pantoja, E. (2012), “Evasión en el impuesto a la renta en Chile”, document prepared for the workshop entitled Evasion and Income Tax in Latin America, Montevideo, Economic Commission for Latin America and the Caribbean (ECLAC), 22–23 November.
	Corporate income tax	2003–2009	SII (Internal Revenue Service) (2012), “Estimación de la evasión en el impuesto a la renta de las empresas. Serie 2003–2009”, Santiago, February.
Colombia	VAT – Corporate income tax	2000–2012	Ávila, J. and A. Cruz (2015), “Colombia: estimación de la evasión del impuesto de renta de personas jurídicas 2007–2012”, <i>Documento Web</i> , No. 57, Bogotá, Directorate of National Taxes and Customs.
	VAT	2017	Directorate of National Taxes and Customs (2019), “Informe de Gestión y Resultados. DIAN 2018”, Bogotá, April.
	Corporate income tax	2016	Directorate of National Taxes and Customs (2019), “Informe de Gestión y Resultados. DIAN 2018”, Bogotá, April.
Costa Rica	General sales tax – corporate income tax	2012–2016	Jeda, J. and M. Pecho (2018), “Costa Rica. Revenue Administration Gap Analysis Program: Tax Gap Analysis for General Sales Tax and Corporate Income Tax”, <i>IMF Country Report</i> , No. 18/124, Washington, D.C., International Monetary Fund (IMF), May.
	Personal income tax	2010–2013	Villalobos, O. and J. Muñoz (2015), “Incumplimiento tributario en impuestos sobre la renta y ventas 2010–2013”, San José, Ministry of Finance, December. (Evasion of general sales tax and corporate income tax is also estimated)
Dominican Republic	Industrialized goods and services transfer tax – Corporate income tax – Personal income tax	2007–2017	General Directorate of Internal Revenue and others (2018), “Estimación del incumplimiento tributario en la República Dominicana”, Santo Domingo, October.
	VAT – Corporate income tax	2003–2005	Andino, M. and J. Parra (2007), “Estimación de la brecha de recaudación del IVA e impuesto a la renta de las sociedades por industria”, <i>Fiscalidad</i> , No. 1, Quito, Internal Revenue Service.
Ecuador	Personal income tax	2005	Gómez Sabaini, J. C., J. P. Jiménez and A. Podestá (2010), “Evasión y equidad en América Latina”, <i>Project Documents</i> , No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).

Annex III.A1 (concluded)

Country	Taxes	Period	Source
El Salvador	VAT	2005–2016	Ministry of Finance (2018), <i>Marco fiscal de mediano y largo plazo 2018–2028</i> , San Salvador.
	Personal income tax – corporate income tax	2005	Gómez Sabaini, J. C., J. P. Jiménez and A. Podestá (2010), “Evasión y equidad en América Latina”, <i>Project Documents</i> , No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).
Guatemala	VAT	2010–2018	SAT (Office of the Superintendent of Tax Administration) (2019), “Estimación de la productividad, eficiencia e incumplimiento de pago del IVA en Guatemala”, Guatemala City.
	Corporate income tax	2013–2017	SAT (Office of the Superintendent of Tax Administration) (2019), “Estimación del incumplimiento de pago del impuesto sobre la renta (actividades lucrativas) en Guatemala”, Guatemala City.
	Personal income tax	2006	Gómez Sabaini, J. C., J. P. Jiménez and A. Podestá (2010), “Evasión y equidad en América Latina”, <i>Project Documents</i> , No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).
Honduras	General sales tax	2013–2016	Pineda, D. and P. Zúñiga (2019), “Estimación de la evasión en el impuesto sobre ventas (ISV) en Honduras 2013-2016”, Tegucigalpa, Revenue Management Service, January.
Jamaica	VAT	2008–2013	Ueda, J. and M. Thackray (2015), “Jamaica. Revenue Administration Gap Analysis Program: the general consumption tax gap”, Washington, D.C., International Monetary Fund (IMF), April.
Mexico	VAT – Income tax – Special tax on production and services – General import and export tax	2008–2016	San Martín, J. and others (2017), <i>Evasión Global 2017</i> , San Andrés Cholula, University of the Americas, Puebla.
Panama	Movable goods and services transfer tax – Corporate income tax – Personal income tax	2007–2016	Directorate General of Revenue (2018), <i>Boletín Estadístico Tributario 2017</i> , Panama City.
Paraguay	VAT	2005–2014	IMF (International Monetary Fund) (2016), “El proceso de modernización de la SET (2013-2016)”, Washington, D.C., August.
Peru	General sales tax	2003–2017	SUNAT (National Tax and Customs Administration) (2018) “Informe N° 39-2018-SUNAT/1V3000”, Lima.
	Corporate income tax	2007–2017	SUNAT (National Tax and Customs Administration) (2018) “Informe N° 38-2018-SUNAT/1V3000”, Lima.
	Personal income tax	2006	Gómez Sabaini, J. C., J. P. Jiménez and A. Podestá (2010), “Evasión y equidad en América Latina”, <i>Project Documents</i> , No. 309 (LC/W.309), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC).
Uruguay	VAT	2000–2016	General Taxation Directorate (2019), “Estimación de la evasión en el impuesto al valor agregado mediante el método del consumo 2000-2016”, Montevideo.
	Corporate income tax	2013	Olmos, L., E. Reig and F. Peláez (2016), “Estimaciones de incumplimiento tributario”, document prepared for Jornadas Tributarias, Buenos Aires, General Taxation Directorate/University of the Republic, November.

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



CHAPTER

IV

Public spending as a driving force for inclusive economic development and the achievement of the Sustainable Development Goals

Introduction

- A. Public spending as a tool for the achievement of the Sustainable Development Goals
- B. Overview of public expenditure, disaggregated by function, in Latin America and the Caribbean
- C. Conclusions and closing remarks

Bibliography

Introduction

In addition to the fiscal policy challenges that the countries of Latin America and the Caribbean will have to surmount in order to achieve the Sustainable Development Goals (SDGs) set out in the 2030 Agenda for Sustainable Development, the region must now devise and implement proactive policies for coping with the coronavirus (COVID-19) pandemic. The pandemic is not having an impact only on the countries' health-care systems, public expenditure and tax revenues; it has very real implications in all spheres of life, including economic activity as a whole, employment and household incomes.

These challenges are all the more formidable in a region with a high degree of inequality and significant structural, social and economic gaps that are reflected in low productivity, deficient infrastructure, lags in the quality of health services and education, persistent gender gaps, geographically based inequalities and disproportionate climate-related impacts on the poorest sectors of society.¹

In this global context of profound uncertainty, flagging or negative economic growth and climbing levels of unemployment and extreme poverty, attaining the 17 SDGs poses both a great challenge and an opportunity for the countries of the region, which must hold on to the ground gained during the past decade while finding their way on to a path of sustainable, inclusive development. And at this juncture, given the impending impacts of the pandemic in so many different spheres of economic and social affairs, the action taken by the State through fiscal policy measures, in general, and via public spending, in particular, is more important than ever.

The countries of the region have been aligning their plans and strategies with the 2030 Agenda, and most of them have set up institutional mechanisms for tracking and assessing progress towards its fulfilment. A large part of the statistical information needed to gauge progress towards the SDGs is still lacking, however, since, in order to construct the necessary indicators, new types of data have to be compiled, and those data then have to be tabulated at a greater level of disaggregation so that the corresponding analysis can be focused on the most vulnerable groups in society.²

Against this backdrop, a review of public expenditure policies in the region takes on crucial importance for many different dimensions of the SDGs. Having up-to-date, detailed and comparable statistics on the levels and composition of public spending within the framework of a functional classification is particularly important in order to identify the intentionality of public policy decisions and to ensure that the uses being made of public resources are in line with agreed objectives. This type of analysis provides the countries with a useful tool for ensuring that policy decisions will contribute to the achievement of their stated objectives and for targeting public expenditure in the most efficient ways and at the areas where it will be most effective in achieving sustainable development, eradicating poverty and reducing inequality.

Under the unprecedented circumstances created by the COVID-19 pandemic—which will be reflected in slumping tax revenues, tighter credit and greater pressures on government spending—it is essential to identify the main uses to which fiscal resources are being put and to have statistics that can be compared across countries as a basis for taking sound decisions for dealing with the resulting growth and employment shocks.

¹ For further information, see ECLAC (2019e).

² For an analysis of the advances made and the constraints encountered by the countries of the region in the implementation of the 2030 Agenda, see ECLAC (2019a).

This chapter uses a functional classification of expenditures as the basis for a detailed analysis of the policy objectives of government outlays in the countries of Latin America and the Caribbean. This analysis aims to help to provide a solid foundation for a regional conversation around the role of the State within the framework of the 2030 Agenda.

To this end, the first section after this introduction looks at the role of public spending as a tool for achieving the SDGs and at the conceptual framework used for measuring government outlays. The second section offers an overview of public expenditures in the countries of the region according to their corresponding policy objectives. Trends in their composition are examined in order to identify similarities and differences that can serve as a basis for determining how well they are aligned with efforts to achieve the Goals. The section closes with an exploration of the functional relationship between public investment and public spending aimed at identifying sectors where capital expenditure has fallen in recent years and discerning any regional or subregional patterns that may exist in this respect. A number of conclusions and final remarks are presented in the third and final section.

A. Public spending as a tool for the achievement of the Sustainable Development Goals

1. The traditional role of fiscal policy

Traditionally, fiscal policy has served three interconnected purposes: resource allocation, income distribution and economic stabilization.³ The first of these functions involves the efficient provision of public goods and services in such a way as to improve the allocation of resources in the presence of market failures. The second entails altering the way in which goods are distributed among the members of society in such a way as to adjust the apportionment of income and wealth among people, geographic areas, production sectors and factors of production in order to bring it into line with what society regards as being a fairer or more egalitarian distribution. The third has to do with smoothing out business cycles, moderating the volatility of macroeconomic variables and contributing to economic growth, employment and price stability.

The most useful fiscal policy tools for performing these functions, which have a crucial bearing on the fulfilment of the 2030 Agenda and the attainment of the Goals, are public spending and taxation. This chapter will focus on the use of the first of these tools, with special emphasis on the importance of public investment and public spending for achieving various policy objectives.

While these three traditional functions of fiscal policy are interrelated, the analysis to be undertaken in this section will focus on how fiscal policy ties in with investment and economic growth.

There are many different—and some conflicting—theoretical models that attempt to explain how fiscal policy influences economic growth. These models range from ones, such as the Keynesian and neo-Keynesian models, that hold that fiscal stimuli drive up aggregate consumption and demand and, hence, GDP, to others, such as the neoclassical models, that posit that such stimuli have a null or even negative impact. The growth effects of fiscal policy predicted by these different theoretical models depend on the time horizon they use (short, medium or long term), the assumptions

³ For further information, see Musgrave and Musgrave (1991), Buchanan and Musgrave (1999) and Stiglitz (2000).

they make about the behaviour of private agents and the credibility of the strategies employed, among other factors. It would therefore appear that the impact that a given change in public spending may have on economic growth can be determined on the basis of the available empirical data.⁴

A recent study by the International Monetary fund (IMF)⁵ points to an emerging consensus that the size of the government spending multiplier depends on the following factors: (i) the phase of the business cycle, with multipliers being larger in recessions than in expansions (Auerbach and Gorodnichenko, 2012 and 2013; Riera-Crichton, Végh and Vuletin, 2015); (ii) the exchange-rate regime, with multipliers being larger when exchange rates are fixed (Ilzetzki, Mendoza and Végh, 2013); (iii) the level of indebtedness, with multipliers being larger when debt levels are low (Ilzetzki, Mendoza and Végh, 2013; Huidrom and others, 2019); (iv) how accommodating monetary policy is, with multipliers being larger with looser monetary policy or interest rates closer to zero (Christiano, Eichenbaum and Rebelo, 2011; Coenen, Straub and Trabandt, 2013); and (v) how open the economy is, with multipliers being smaller in economies that are more open to international trade (Ilzetzki, Mendoza and Végh, 2013; González-García, Lemus and Mrkaic, 2013).

In the particular case of public investment policies and other fiscal policies designed to promote investment, their effectiveness as a driver of economic growth depends on a number of different factors, such as the investment climate (which is a function of the quality of the institutional structure, organizational constraints, the extent of legal and regulatory certainty, and a number of other conditions), the degree of macroeconomic volatility and the level of financial development.⁶

Another consideration with regard to the relationship between fiscal policy and investment is the extent of complementarity or competition between public and private investment. If they are complementary, then government investment in public services and infrastructure will make private investment more profitable, since it will lower private production costs and can boost demand and the use of installed capacity. The complementarity of public and private investment will be the greatest when the former is channelled into infrastructure and education. On the other hand, public investment may enter into competition with private investment if it is directed towards obtaining financing and productive inputs. In developing countries, competition between the two in financial markets may be greater because the supply of credit is smaller. In addition, if public funds are being invested when the government is running a fiscal deficit, greater government indebtedness may push up interest rates and crowd out private investment.⁷ The empirical data available for the countries of Latin America and the Caribbean appear to indicate a certain degree of complementarity and thus a positive relationship between public and private investment, with public investment generating positive externalities that increase the business sector's overall productivity and contribute to its growth.⁸

This kind of complementarity is also reflected in the fact that estimates of the multiplier effect of government spending on GDP in both developed and developing countries are greater for public investment than they are for primary current expenditure. This strengthens the argument that public investment increases the marginal product of private capital and labour and that it has a positive effect on the economy's production capacity and on private investment and consumption.

⁴ See Martner, Podestá and González (2013).

⁵ See Izquierdo and others (2019).

⁶ See Fanelli (2013) and James (2013).

⁷ See Jiménez and Podestá (2009).

⁸ See Martner and Tromben (2005). These findings are in line with other studies on developing countries, such as that of Furceri and Li (2017), which looks at 79 emerging and developing economies, including a number of Latin American and Caribbean ones.

For example, for 16 Latin American countries, Riera-Crichton, Vegh and Vuletin (2015) estimate the cumulative multiplier of capital expenditure after five years at 2.7, versus 1.6 for current expenditure.⁹ Along the same lines, an empirical analysis of a sample of European countries, states of the United States and Argentine provinces conducted by Izquierdo and others (2019) indicates that, in all three cases, the multiplier for public investment far exceeds the multiplier for primary expenditure. Their findings also show that, in the countries, states and provinces whose initial stock of public capital was low (as a percentage of GDP), the multipliers for public investment were significantly higher than they were in those that had a larger stock of public capital at the outset. In the particular case of the Argentine provinces, the multiplier for the provinces' primary expenditure was below 1 (0.56), whereas the multiplier for public investment was substantially larger (1.60). However, where the initial public capital stock was high, the multiplier for public investment was close to zero (0.23), which means that public investment had almost no effect on GDP; by contrast, the multiplier amounted to 2.03 in those provinces whose initial stock of public capital was small.

The available empirical data also indicate that the multipliers for public investment and spending are greater when efficiency is high (Furceri and Li, 2017; IMF, 2014a; Izquierdo and others, 2019). An inefficient increase in public investment or spending may therefore fail to have a positive effect on growth, whereas an increase in the efficiency of these variables may boost economic activity.

Given public investment's critical role in driving economic growth, the Economic Commission for Latin America and the Caribbean (ECLAC) has drawn attention to the importance of designing fiscal rules that incorporate efficient countercyclical mechanisms for protecting public capital expenditure and that dampen the region's macroeconomic volatility. Mechanisms that reinforce countercyclical policies by providing protection and incentives for public investment during the downside of the business cycle can be much more effective than fiscal rules that are based solely on spending or deficit targets. If public capital expenditure tends to spur growth, then it will generate future tax receipts, contribute to fiscal consolidation and may help to create a virtuous circle of sustainable growth.¹⁰

Thus, the countries of Latin America and the Caribbean should make it a priority to increase the quantity and quality of investment if they are to follow the road map set out in the 2030 Agenda, close the various types of gaps that exist in the region and steer public policies in the direction of economic, social and environmental sustainability. As a point of departure, this chapter will provide a detailed examination of the Latin American and Caribbean countries' public spending priorities, in general, and their capital expenditure priorities, in particular, during recent years.

2. A brief review of the conceptual framework for functionally based measurements of public expenditure

The 1993 System of National Accounts (SNA) uses four purpose-based classifications of expenditure, one of which is the Classification of the Functions of Government (COFOG).¹¹ This system provides a way of looking at public expenditure based on the functions,

⁹ See ECLAC (2018).

¹⁰ See ECLAC (2015 y 2018).

¹¹ The other three classification systems are the Classification of Individual Consumption by Purpose (COICOP), the Classification of the Purpose of Non-Profit Institutions Serving Households (COPNI) and the Classification of the Outlays of Producers by Purpose (COPP).

or purposes, of the different items of expenditure and seeing how governments go about performing various economic and social functions. It also makes it possible to conduct cross-country comparisons over time.¹²

According to the *Government Finance Statistics Manual 2014* (IMF, 2014b), COFOG is a “detailed classification of the functions, or socioeconomic objectives, that general government units aim to achieve through various kinds of expenditure”. The functions are classified into 10 divisions that are then subdivided into groups and classes. The divisions relate to the broad objectives of government, while the groups and classes detail the means by which these broad objectives are achieved.

The COFOG divisions are as follows:

- (i) General public services. Expenditures related to the administration, management and support of executive and legislative organs, financial and fiscal affairs, external affairs, the administration of foreign economic aid, general services (administration and operation of general personal services, overall planning and statistical services), public debt transactions (interest payments and the expenses involved in the issuance of debt securities) and transfers of a general nature between different levels of government.
- (ii) Defence. Outlays for military defence, civil defence and foreign military aid.
- (iii) Public order and safety. Police services, fire protection services, courts of law and prison administration.
- (iv) Economic affairs. General economic, commercial and labour affairs (including the administration, formulation and implementation of economic, commercial and labour policies, their regulation and promotion, the supervision of working conditions and general employment programmes, among others); the administration of agricultural affairs and services and of various programmes in the areas of agriculture, forestry, fishing and hunting; programmes in the fuel sector (coal, petroleum, natural gas, nuclear fuels and others) and the electricity and non-electrical energy sectors; mining, manufacturing and construction affairs, services and programmes; the administration of affairs and services concerning the operation, use, construction and maintenance of road transport systems and facilities, inland, coastal and ocean transport systems, and railway and air transport systems and facilities, along with pipeline and other transport systems; communications systems (postal, telephone, telegraph, wireless and satellite systems); and distributive trades, storage, warehousing, hotels, restaurants, tourism and multipurpose development projects.
- (v) Environmental protection. Solid waste management (collection, treatment and disposal); wastewater management (management of sewerage systems and wastewater treatment); pollution abatement (ambient air and climate protection, soil and groundwater protection, noise and vibration abatement, and protection against radiation); and protection of biodiversity and the landscape (protection of fauna, flora and habitats).
- (vi) Housing and community amenities. Affairs and services related to housing development, slum clearance, housing construction, community development and planning, water supply systems and street lighting.
- (vii) Health. Health services provided to individual persons and services provided on a collective basis; medical products, appliances and equipment (medicaments, prostheses, medical appliances and equipment, and other health-related

¹² See United Nations (2002).

- products for use outside a health facility or institution); outpatient services supplied directly by medical, dental and paramedical practitioners; services provided by general and specialist hospitals, medical centres, maternity centres, nursing and convalescent homes and services in rehabilitation centres providing in-patient care; and public health services (blood-bank operations, disease diagnosis and prevention, epidemiological data collection and family planning and other services).
- (viii) Recreation, culture and religion. Recreational, sporting and cultural services, the management of facilities used for such activities (playing fields, tennis and squash courts, stadiums, parks, beaches, camping grounds, libraries, museums, art galleries, theatres, monuments and other such facilities); the administration, supervision and regulation of broadcasting and publication services; and administration of religious and other community affairs.
 - (ix) Education. Services provided to individual pupils and students and services provided on a collective basis, including the formulation and administration of government policy in the field of education and the establishment and implementation of standards; the regulation, authorization and supervision of educational centres; and applied research. Expenditures in this category are subdivided into the following groups: pre-primary and primary education, secondary education, post-secondary non-tertiary education, tertiary education, education not definable by level and subsidiary services.
 - (x) Social protection. Services and transfers provided to individual persons and households and expenditure on services provided on a collective basis, including services related to the formulation and administration of social policy, the formulation and enforcement of legislation and other standards concerning the provision of social protection services and applied research in social protection affairs. This division is subdivided into the following groups: sickness and disability (cash or in-kind benefits in the event of a temporary inability to work due to sickness or injury, sick leave payments, disability pensions, caregiving services for persons with disabilities, assistance with daily tasks for persons who are ill, lodging for persons with disabilities and others); old age (cash and in-kind benefits to cover risks linked to old age, such as old-age pensions, home help, lodging and meals); survivors (cash and in-kind benefits for survivors, such as pensions and allowances to cover funeral expenses); family and children (cash and in-kind benefits to households with dependent children, such as maternity allowances, child support allowances, birth grants, parental leave benefits, shelter and board for preschool children, childcare services, expenses related to care in orphanages or foster families, among others); unemployment (unemployment benefits, early retirement benefits for unemployed older workers, vocational training programmes and accommodation, food or clothing for unemployed persons and their families); housing (in-kind benefits to help households meet the cost of housing, rental payments and the provision of low-cost or social housing); and other benefits to persons at risk of social exclusion (cash and in-kind benefits for persons who are destitute, immigrants, indigenous persons, refugees, alcohol and substance abusers, victims of criminal violence, etc.).

Support for research and development is also included in each of the 10 divisions described above.

The institutional coverage of the different levels of government is defined in the *Government Finance Statistics Manual 2014* (IMF, 2014b) as follows:

- **Central government:** The central government's political authority encompasses the whole of the country's territory; it is generally composed of a budgetary central government, extrabudgetary units and social security funds (unless a separate subsector is used for such funds).
- **General government:** This institutional level includes the central government, subnational levels of government (state, provincial or regional governments and local governments) and social security funds.
- **Non-financial public sector:** This sector includes the general government sector and public non-financial corporations, i.e. public corporations whose main activity consists of the production of market goods and/or non-financial services.
- **Public sector:** This sector includes the non-financial public sector and public financial corporations (e.g. the central bank and public commercial banks).

This functionally based analysis of trends in public expenditure will primarily focus on the central government of each country because that is the level of government for which most data are available. This focus will also help to maintain comparability with other ECLAC studies on such topics as public social expenditure. However, in some countries, such as those that have a federal system or are highly decentralized, spending by intermediate and local levels of government is a significant factor; therefore, where such information is available, the institutional coverage of the analysis will also be extended to include these other levels of government in order to provide a picture that more accurately reflects the situation on the ground (see box IV.1).

B. Overview of public expenditure, disaggregated by function, in Latin America and the Caribbean

1. Trends in the composition of public expenditure, disaggregated by function, in the region

This analysis of the main trends in central government public expenditure in 16 Latin American countries based on the Classification of the Functions of Government covers the period from 2000 to 2018.¹³ In those cases where the necessary information is available, box IV.1 supplements this analysis with an overview having a broader institutional scope based on the same criteria as those employed in recent editions of *Social Panorama of Latin America*. It also includes an exploration of trends in the composition of expenditure, disaggregated by function, in five English-speaking Caribbean countries for which the corresponding data are available for 2008–2018: the Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

¹³ Owing to the absence of up-to-date functionally disaggregated data on government spending for the entire series, information is not provided for the Bolivarian Republic of Venezuela, Cuba, Haiti or the Plurinational State of Bolivia.

Box IV.1

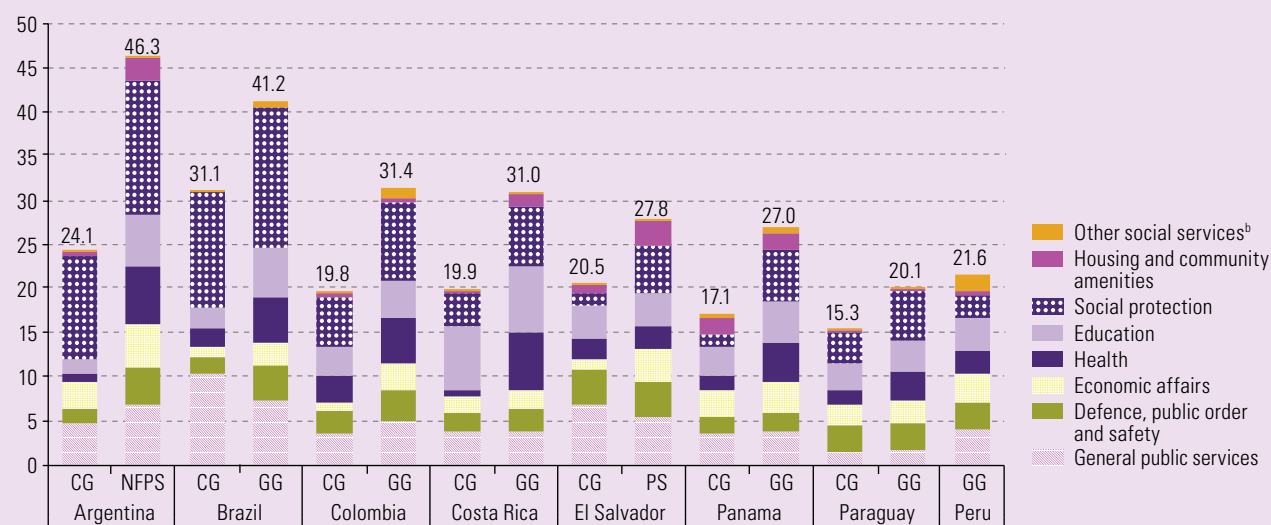
A broader functionally based institutional overview of public expenditure

Throughout the rest of this chapter, as in other ECLAC publications, a comprehensive analysis is provided of expenditure at the central government level, since this is the only institutional level for which information is available for all the countries of the region (see the 2019 edition of *Social Panorama of Latin America*). Here, this analysis is supplemented with findings for a broader range of institutions in eight countries for which statistics are available that permit the different items of expenditure to be disaggregated according to their purpose: Argentina, Brazil, Colombia, Costa Rica, El Salvador, Panama, Paraguay and Peru.^a

The figures for central government expenditure as a percentage of GDP differ considerably from the expenditure levels for a broader institutional category that also includes state/provincial/regional governments, local governments and other public entities, although the size of this differential varies across countries. The bulk of this differential is attributable to differences in the countries' political and institutional structures and to the inclusion or not of social security funds in the central government figures.

The largest difference between these two measurements of expenditure is found in Argentina, but the differentials are also substantial in the cases of Brazil, Colombia, Costa Rica, El Salvador and Panama. In the federal countries (Argentina and Brazil), total public expenditure exceeds 40% of GDP, whereas, in the other countries, it is nearer to 30% (Colombia, Costa Rica, El Salvador and Panama) or 20% of GDP (Paraguay and Peru).

Latin America (8 countries): expenditure, by function and by institutional coverage, around 2018^a
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

Note: CG: central government, GG: general government, NFPS: non-financial public sector, PS: public sector.

^a The data for Argentina, Panama and Paraguay are for 2017; the data for Costa Rica are for 2016.

^b Includes the following government functions: environmental protection, housing and community amenities, and recreation, culture and religion.

When the analysis is extended to take in this broader range of institutions, the expenditure figures for almost all government functions rise, but the distribution of priorities varies depending on the range of coverage and the country concerned.

In the functional category of public order and safety, when the institutional coverage of the analysis is broadened to include subnational levels of government, the largest increases are seen in Argentina and Brazil, where public spending in this category amounts to nearly 4% of GDP or more. For example, in Argentina, the provinces account for more than 60% of the total amount spent on such services.

In the case of El Salvador, while central government spending on economic affairs amounted to scarcely more than 1% of GDP, the corresponding figure for the public sector as a whole (including not only subnational levels of government but also State-owned corporations) approaches 4% of GDP. The fuel and energy sector is the one in which spending levels increase the most when institutional coverage is broadened, partly because of the expenditure levels of the Rio Lempa Hydroelectric Board. In Colombia, too, when spending by subnational governments is included in the data a significant increase (over 2 percentage points of GDP) is seen in outlays on economic development, raising this variable up to 3.2% of GDP.

Box IV.1 (concluded)

Social spending figures are higher for all the countries when the institutional coverage of the analysis is extended to include subnational levels of government, either because those levels of government play an important role in the delivery of social services or because of the inclusion of social security funds in countries that classify these as a subsector outside the scope of the central government. In most of the countries covered in this study, public social spending accounts for nearly 65% of total expenditure or more (Argentina, Brazil, Colombia, Costa Rica, Panama and Paraguay); in El Salvador and Peru, the corresponding figure is 52%. In terms of GDP, social spending represents the largest share in Argentina and Brazil (30.4% and 27.5%, respectively), stands at an intermediate level of around 20% of GDP in Colombia, Costa Rica and Panama (19.9%, 22.5% and 17.5%, respectively), and is the lowest, at under 15%, in El Salvador, Paraguay and Peru (14.6%, 12.8% and 11.2%, respectively).

Levels of expenditure for purposes included in the definition of social spending used by ECLAC vary across countries. When statistical coverage is expanded from the central government to include other levels of government, the figures for spending on health rise the most in Argentina, where provincial governments play an important role in providing health services and benefits and where social works are more decentralized, and in Costa Rica, where social security benefits are subsumed under general government. Substantial increases are also found in the cases of Brazil, Colombia and Panama.

The figures for spending on education by subnational governments are notable in the cases of Argentina and Brazil, where this sector is more decentralized. Thus, when coverage is broadened to include other levels apart from the central government, the levels of expenditure in this sector climb from 1.6% to 5.8% of GDP for Argentina and from 2.4% to 5.4% of GDP for Brazil.

Social protection expenditure levels are considerably higher in all the countries when outlays by other government units and agencies are included, with the increases ranging between 2% and 4.5% of GDP. The largest increases are seen in Panama (from 1.3% to 5.9% of GDP) and El Salvador (from 1.4% to 5.4% of GDP), where social security pensions and other benefits are paid out by subnational levels of government. The differences are somewhat smaller in the cases of Colombia, Costa Rica and Paraguay but are also mainly attributable to the fact that social security benefits are included under the heading of general government.

Finally, the levels of expenditure on housing and community amenities rise most sharply in the cases of Argentina, Costa Rica and El Salvador, while the increases in the figures for spending on other social services (which include expenditures for environmental protection and for recreation, culture and religion) are smaller.

It follows from this analysis that countries in the region that do not disaggregate their statistics on expenditures according to their purpose at the general government level or, failing that, at some other broader institutional level should make an effort to do so and to publish those figures on a regular basis.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a In the case of Peru, the same data series is used here as in other sections of this chapter because the only data available for that country are for general government. The expenditures of Peru's national social security health system (EsSalud) are not included under the heading of general government, however, although social security pensions and benefits are.

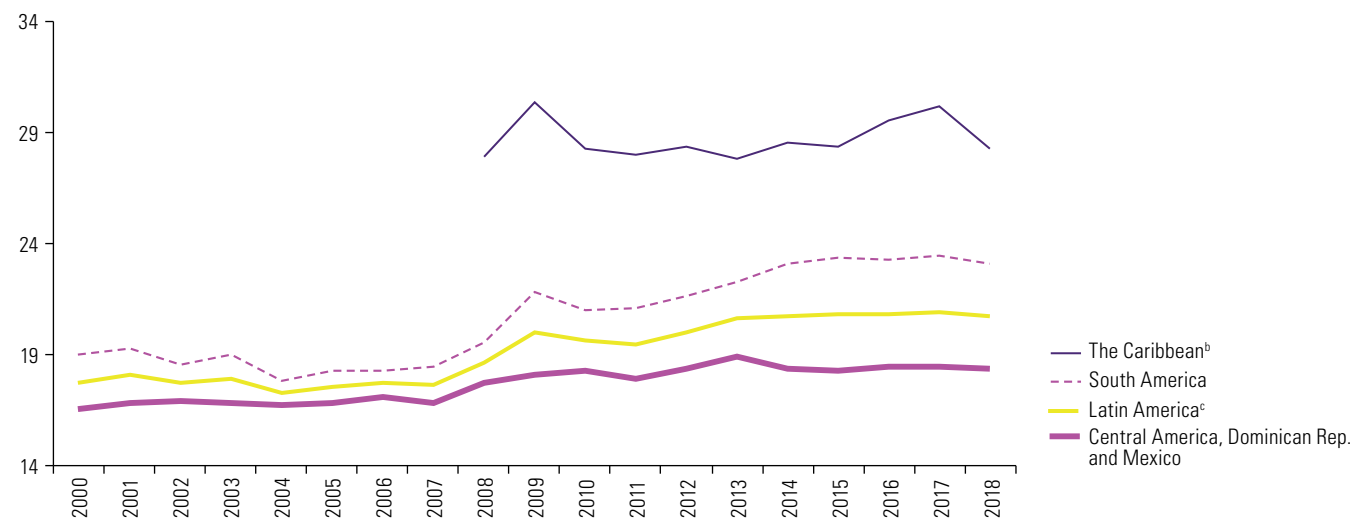
Average public expenditure levels for the 16 Latin American countries at the central government level followed an upward trend during the study period, climbing from 17.8% of GDP in 2000 to 20.7% of GDP by 2018, although this latter figure was lower than the figure for 2017 as a result of the ongoing fiscal consolidation process being pursued by these countries (see figure IV.1).¹⁴

In response to the global economic crisis of 2008–2009, many of the region's countries introduced expansionary fiscal policies to shore up aggregate demand. The additional expenditure on subsidies, transfers and some social programmes helped to lessen the impact of the crisis on the most vulnerable sectors, but in some cases it also resulted in a long-lasting increase in expenditure. Mounting interest payments over the last seven years have also driven up expenditure levels.

¹⁴ The levels of public expenditure registered on the basis of the functional classification do not necessarily match up with the figures derived from the economic classification of expenditure given in chapter I for a number of methodological reasons. The two main ones are that, for some of the countries, the institutional coverage of the two classifications is not entirely the same and the averages are not based on the same number of countries.

Figure IV.1

Latin America and the Caribbean (16 countries): central government expenditure, by subregion, 2000–2018^a
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a The levels of public expenditure that are shown here on the basis of the functional classification do not necessarily match up with the figures derived from the economic classification of expenditure given in chapter I.

^b Simple average for five Caribbean countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

^c Simple average for 16 countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay. The figures for Peru are those reported under the general government heading.

While upward trends in central government expenditure are seen both for the South American subregion and for the group comprising the six Central American countries, the Dominican Republic and Mexico, the upswing in the South American countries started from a higher initial level and has been steeper. The swifter growth in expenditure in these countries is partly due to the boom in raw material prices in the 2000s, which sharply expanded fiscal revenues in the economies that are major commodity exporters and increased the share of public expenditure in GDP.

Average expenditure for the eight South American countries included in this analysis amounted to 23.1% of GDP in 2018, while the average for Central America, the Dominican Republic and Mexico was 18.3% of GDP. Thus, central government expenditure in the first group of countries averaged nearly 5 points of GDP more than in the second group, whereas this differential was just 2.5 points at the start of the century. It should be noted, however, that the central government data in most of the countries in the second group and in some of those in the first group do not include social security expenditures, as these funds are classified as a separate subsector.

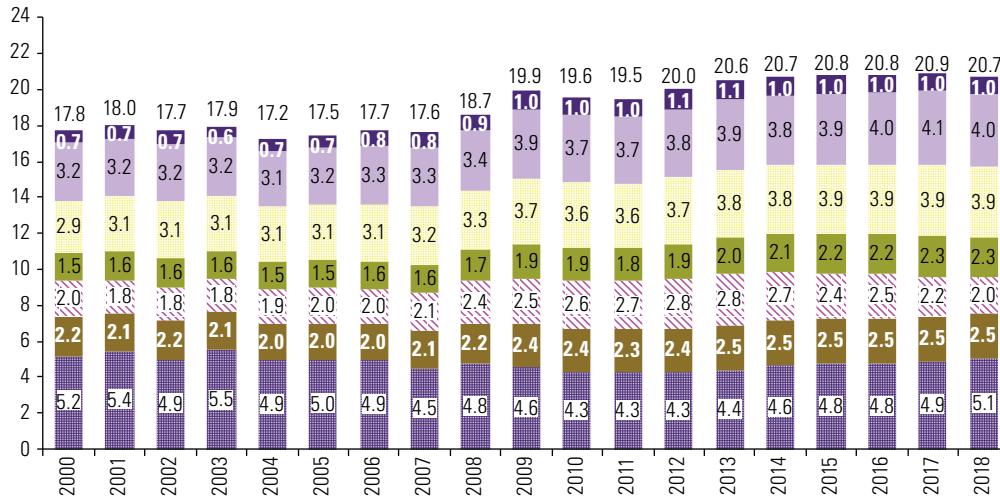
For the sample of five English-speaking Caribbean countries, average central government expenditure remained steady, for the most part, at around 28% of GDP between 2008 and 2018, although spending levels did peak twice, rising to 30% of GDP during the deep recession of 2009 and again in 2017. In 2018, however, public spending subsided, slipping to 28.2% of GDP, as a result of fiscal consolidation policies. These levels are still above the averages for the other two subregions analysed here, however.

An examination of the composition of public expenditure based on the Classification of the Functions of Government provides a means of determining which types of policy objectives have received the most government funding and in which areas public spending has increased the most. This, in turn, will shed light on government priorities as reflected in the supply of public goods and services and how they have changed over time (see figures IV.2 and IV.3).

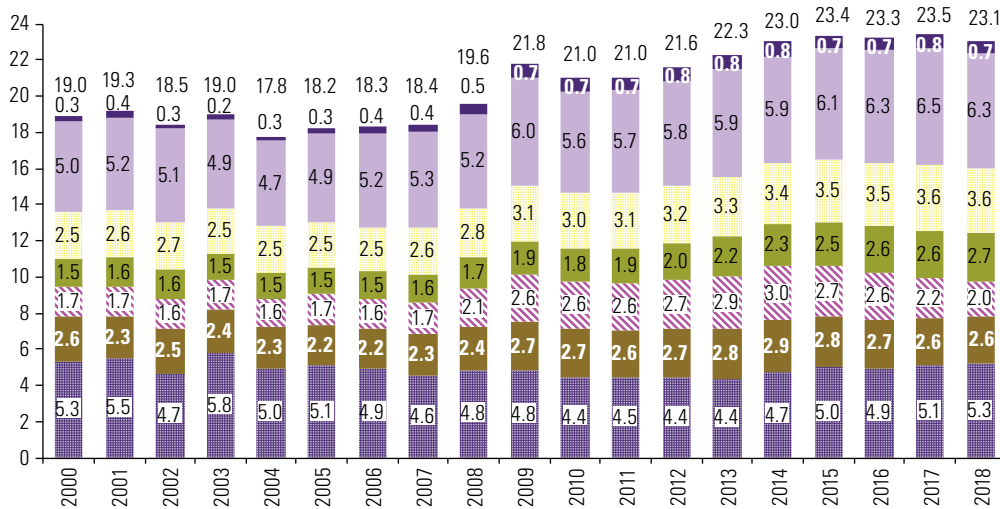
Figure IV.2

Latin America and the Caribbean (16 countries): a central government expenditure, by function, 2000–2018^b
(Percentages of GDP)

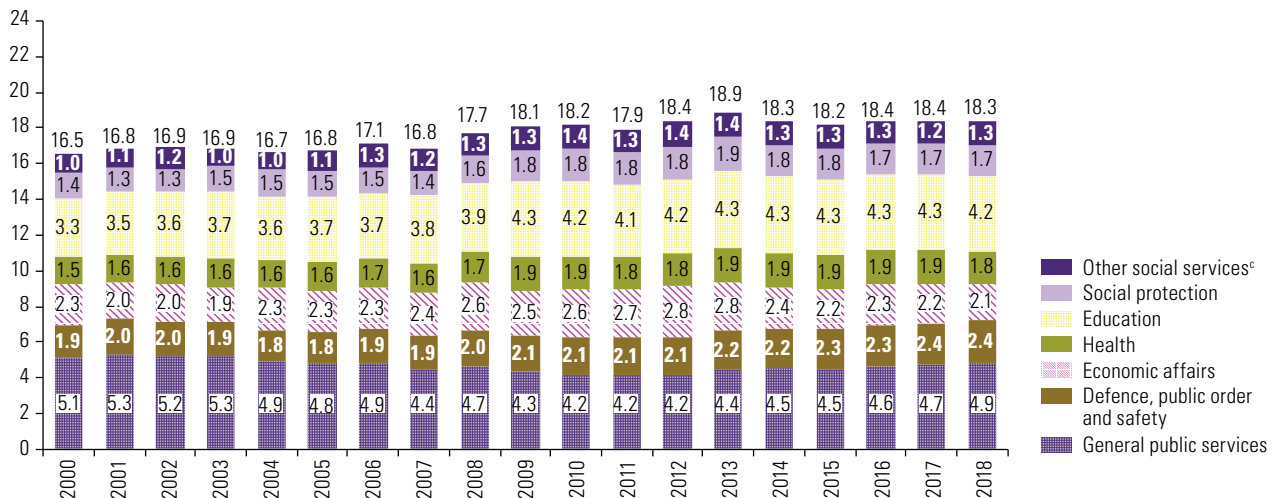
A. Latin America (16 countries)



B. South America (8 countries)



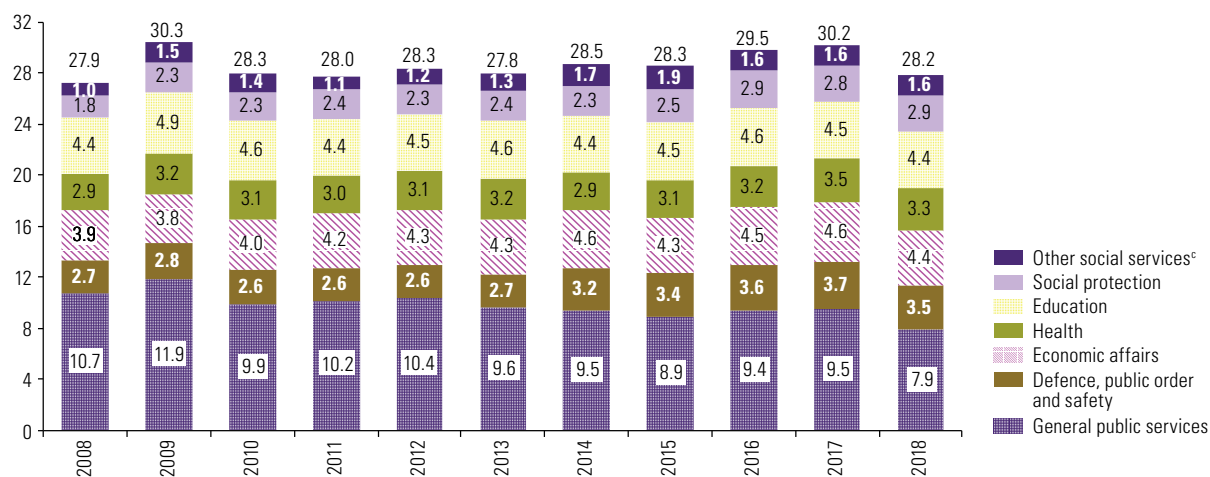
C. Central America, Dominican Republic and Mexico (8 countries)



- Other social services^c
- Social protection
- Education
- Health
- Economic affairs
- Defence, public order and safety
- General public services

Figure IV.2 (concluded)

D. The Caribbean (5 countries)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Latin America (figure A): simple average for 16 countries. These countries are divided into two groups in figures B and C: eight South American countries (Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay) and another group of eight comprising Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama), the Dominican Republic and Mexico. The sample for the Caribbean (figure D) is composed of five countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

^b The levels of public expenditure that are shown here on the basis of the functional classification do not necessarily match up with the figures derived from the economic classification of expenditure given in chapter I.

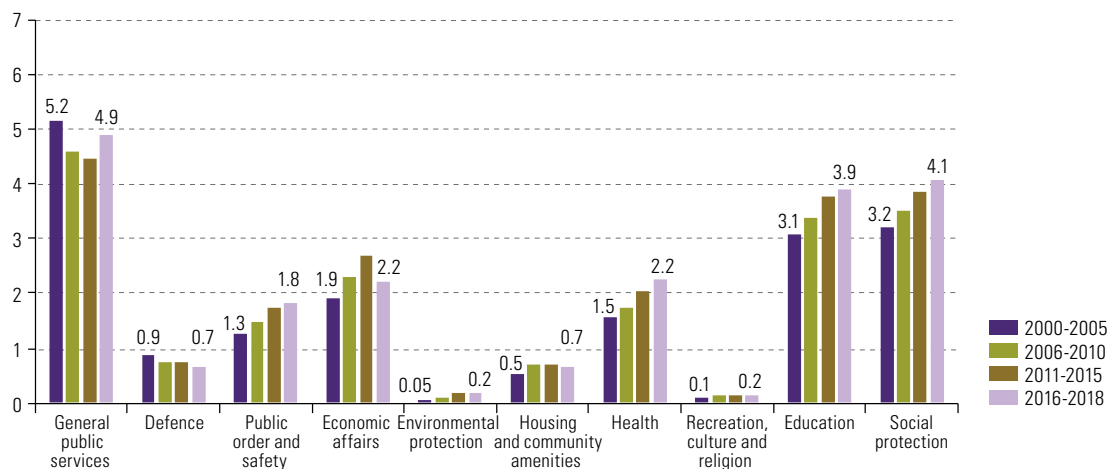
^c Includes the following government functions: environmental protection, housing and community amenities, and recreation, culture and religion.

The increase in central government expenditure recorded for the sample of 16 Latin American countries is accounted for by upturns in spending on social policies, particularly in the areas of health (see box IV.2), education and social protection.¹⁵ Average spending by the Latin American countries in these three functional categories rose from 1.5%, 2.9% and 3.2% of GDP in 2000 to 2.3%, 3.9% and 4.0% of GDP in 2018, respectively (see figure IV.2A). The category of social protection includes pensions and conditional cash transfer programmes, for which funding has been on the rise in the past few decades. Increased spending in these three areas reflects an expansion of the coverage of the countries' school systems (especially at the secondary level, as coverage at the primary level was already fairly high before the year 2000) and of their health and social security systems; increases in contributory and non-contributory pensions have been particularly notable (see figure IV.3A).

Figure IV.3

Latin America and the Caribbean (16 countries)^a: central government spending, by function and by subperiod, 2000–2018 (Percentages of GDP)

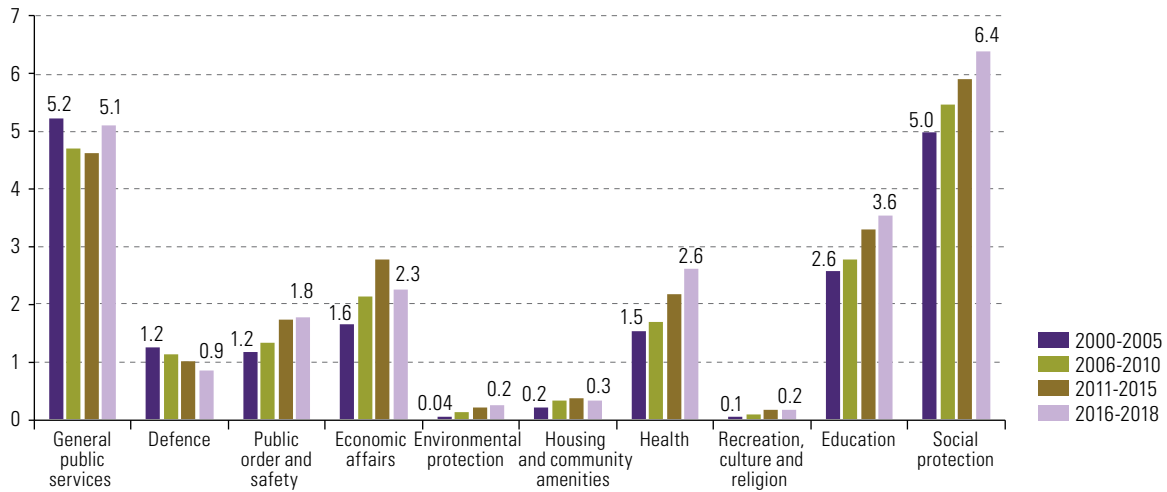
A. Latin America (16 countries)



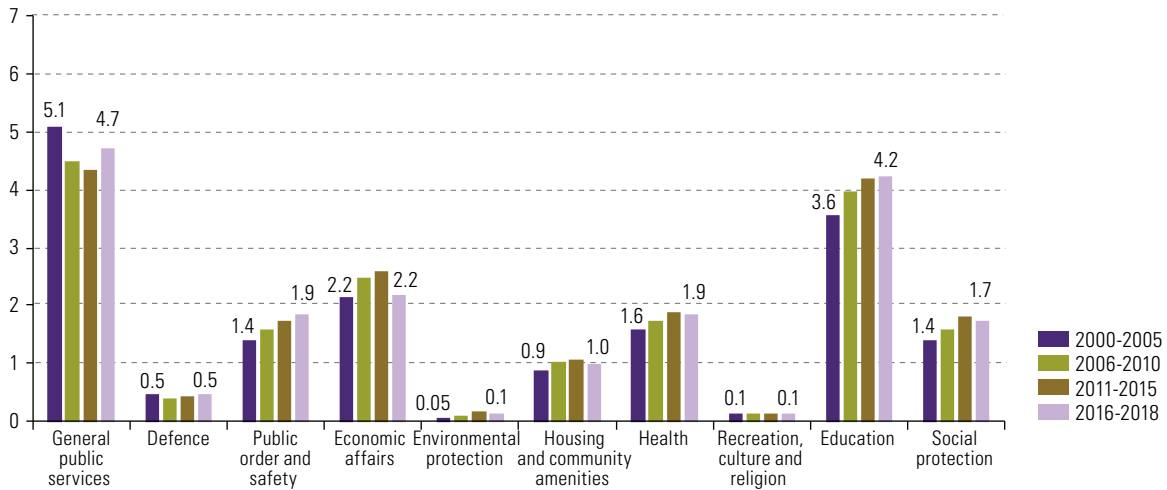
¹⁵ For a detailed analysis of social spending in the countries of the region, see ECLAC (2019b).

Figure IV.3 (concluded)

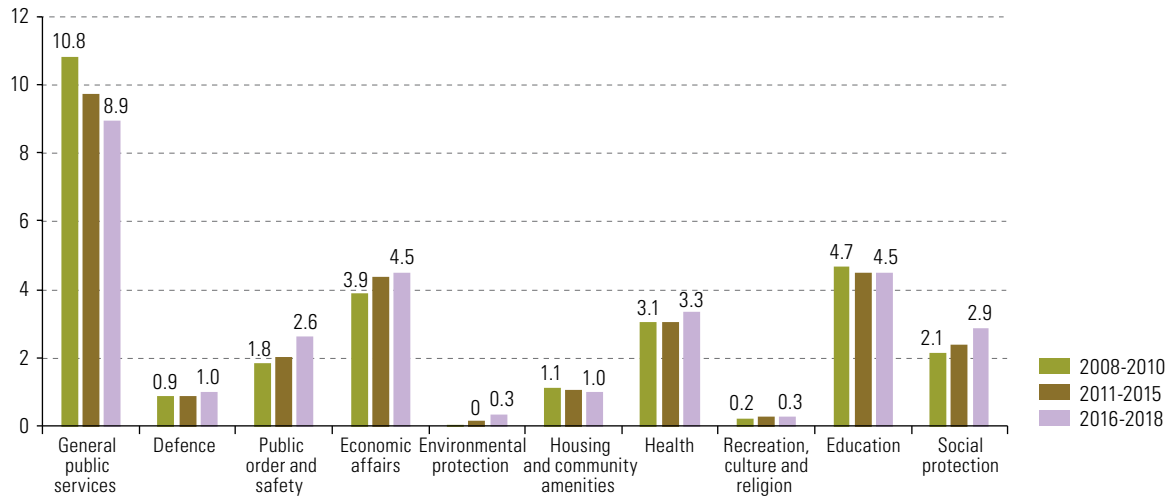
B. South America (8 countries)



C. Central America, Dominican Republic and Mexico (8 countries)



D. The Caribbean (5 countries)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Latin America (figure A): simple average for 16 countries. These countries are divided into two groups in figures B and C: eight South American countries (Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay) and another group of eight comprising Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama), the Dominican Republic and Mexico. The sample for the Caribbean (figure D) is composed of five countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

Box IV.2

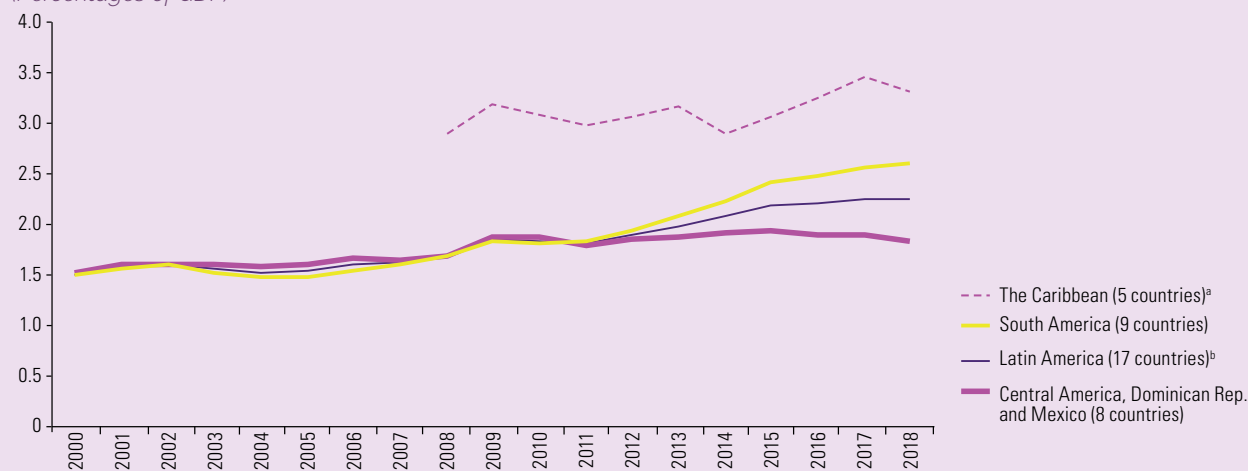
Spending on health in Latin America and the Caribbean

The coronavirus (COVID-19) pandemic has led to differing situations in the countries of the region in terms of public spending on health policies and health care. Some of the countries are still far from attaining the target set out by the Pan American Health Organization (PAHO) in the Sustainable Health Agenda for the Americas 2018–2030 of achieving a level of public expenditure in health of at least 6% of GDP by 2030 in order to ensure adequate and sustainable health financing as a means of advancing towards universal access and coverage (PAHO, 2017).

Over the last two decades, the governments of Latin America and the Caribbean have been increasing their spending on health, as is illustrated in the figure below. For the Latin American countries as a group, central government expenditure on health amounted to 2.3% of GDP in 2018, as compared to just 1.5% in 2000. While central government spending on health is trending upward in all the subregions, the increase has been steeper in South America than in Central America, the Dominican Republic and Mexico. Central government health expenditure averaged 1.5% of GDP in both these subregions in 2000, but in 2018 it amounted to 2.6% of GDP for South America but totalled just 1.8% of GDP in the latter subregion. The average amount spent by central governments on health in a sample of five English-speaking Caribbean countries for which information is available rose from 2.9% to 3.3% of GDP between 2008 and 2018.

Latin America and the Caribbean: central government spending on health, by subregion, 2000–2018

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information from the countries.

^a Simple average for five Caribbean countries for which information is available: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

^b Simple average for 17 Latin American countries for which information is available: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay. The value for Peru corresponds to general government spending.

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

Spending on general public services, which includes interest payments on the public debt, had declined between 2004 and 2012, but then started to rise as the region's debt levels climbed, reaching about the same point (5% of GDP) as at the beginning of the 2000s (see figure IV.2A). The flipside of this pattern is the trend in expenditure on economic affairs, which covers most categories of public investment and moved in the opposite direction, increasing between 2003 and 2013 and then falling thereafter. As a result, expenditure on economic affairs dropped from nearly 3% of GDP in 2013 to 2% of GDP in 2018, the latest year for which functionally based data are available. A similar pattern is seen in expenditures in the category of housing and community amenities, which also includes numerous items of public investment (see figure IV.3A).

Opposing trends are observed in defence spending and expenditure on public order and safety, with the former decreasing during the study period while the latter climbed from 1.3% of GDP in 2000 to 1.8% of GDP in 2018 (see figure IV.3A).

Overall regional trends in expenditure are chiefly a reflection of trends in the South American countries, where, on average, a strong increase has been seen in all social policy areas (health, education, social protection and other social services), with social spending up by almost 4 points of GDP during the study period (see figure IV.2B). While spending in all areas of social policy is also higher for the group comprising the countries of Central America plus the Dominican Republic and Mexico, the increases are smaller. The main changes in terms of policy priorities are reflected in higher expenditure levels for education and for public order and safety (see figure IV.2C).

The same diverging trends in spending on general public services and on economic affairs that were described earlier in relation to Latin America as a whole are seen in both of these subregions as well. However, the starting point for spending on economic affairs in the South American countries was lower in terms of GDP than it was for the Central American countries, the Dominican Republic and Mexico (1.7% for the former group versus 2.3% of GDP for the latter group in 2000) (see figures IV.2B and IV.2C), whereas, by 2018, this ratio was almost the same for these two groups: 2.0% and 2.1% of GDP, respectively. Thus, following the adjustment in public investment and other expenditures on economic affairs made in recent years, the figures for the South American countries are still higher than they were at the start of the 2000s, whereas the values for the second group of countries are slightly lower than they were then.

Subregional trends in defence spending have also diverged. On average, the South American countries reduced their spending under this heading from 1.4% to 0.8% of GDP during the period under analysis, whereas the Central American countries, the Dominican Republic and Mexico, again on average, maintained their defence spending levels at around 0.5% of GDP (see figures IV.3B and IV.3C). By contrast, outlays for public order and safety are at similar levels and trending upward in both groups.

Trends in the five English-speaking Caribbean countries included in the sample have differed from those observed in Latin America, as public spending rose during the 2009 recession, then held steady and then rose again in 2016 and 2017. As may be seen from figure IV.2D, the functional category of expenditure to see the steepest increase in 2009 was general public services, owing to the upswing in interest payments on these countries' debts. However, this higher level of interest payments primarily reflected a sharp increase in debt service that year in Jamaica, whose payment commitments were then greatly reduced under the debt restructuring programme launched in 2010.

This group's level of social spending on education, health, housing and social protection also expanded as a percentage of GDP during the global crisis and, for the most part, these increases then remained in place. As a result, social spending jumped from 10.1% of GDP in 2008 to 12% of GDP in 2009 and was still at around that same level in 2018, which is the most recent year for which information is available.

The expansion witnessed in the Caribbean countries in 2016 and 2017 was chiefly a reflection of higher outlays on economic affairs as part of the upswing in public investment. In 2018, however, capital and current expenditures on economic services contracted as part of the policy effort to curb the growth of public spending but were

still at one of the highest levels registered in the last 10 years (4.4% of GDP). In 2018 expenditure on general public services was also down as a result of fiscal consolidation efforts and the lower interest payments associated with the downward trend in this group of countries' public debt. One of the main reasons for this contraction was the decision taken by Barbados to suspend the principal and interest payments on its external debt while it negotiated a restructuring agreement with its creditors, which it succeeded in doing in 2019. The government of that country also signed a four-year Extended Fund Facility agreement with the International Monetary Fund in 2018 that includes a significant fiscal consolidation component.¹⁶

The trends in defence spending and in outlays under the heading of public order and safety were similar to those seen in Central America, with the former holding fairly steady while the latter were on the rise (see figure IV.3D).

The most recent information on expenditure that is disaggregated by function indicates that, on average, more than half of all government expenditure in the Latin American countries in 2018 came under the headings of social protection (19%), education (19%), health (11%) and other social services (which include environmental protection, housing and community amenities, and recreation, culture and religion). Another functional heading that accounts for a large share of total public spending is general public services (24%), owing to the amount of funds absorbed by interest payments on the public debt in most of the countries. The next-largest categories are economic affairs (10%) and public order and safety (9%), while the remaining functional headings represent much smaller shares, such as defence spending, which accounts for 3% of the total (see figure IV.4).

These data also make it clear that priority items of central government expenditure differ from one subregion to the next. In the South American countries, social functions of government accounted for an average of 58% of total expenditure in 2018, whereas social spending accounted for 49% of total outlays in the countries of Central America, the Dominican Republic and Mexico that year. In South America, a large share of the total (27%) corresponded to social protection, which includes old-age, survivors' and disability pensions, conditional cash transfer programmes, unemployment benefits and other social programmes. The South American countries also spent more on health services than the Central America countries, the Dominican Republic and Mexico did, while this latter group of countries spent a larger share of total expenditure on education (23%).

A major shortcoming of these data should be borne in mind, however, since, as noted earlier, they reflect the portion of total expenditure corresponding to the central government but do not cover the outlays of subnational levels of government, which, in federal and highly decentralized countries, manage a large portion of total expenditure on education and health services. In addition, social security funds are classified as a separate subsector of the central government in some countries, which means that even the data on social protection expenditures are not entirely comparable.¹⁷

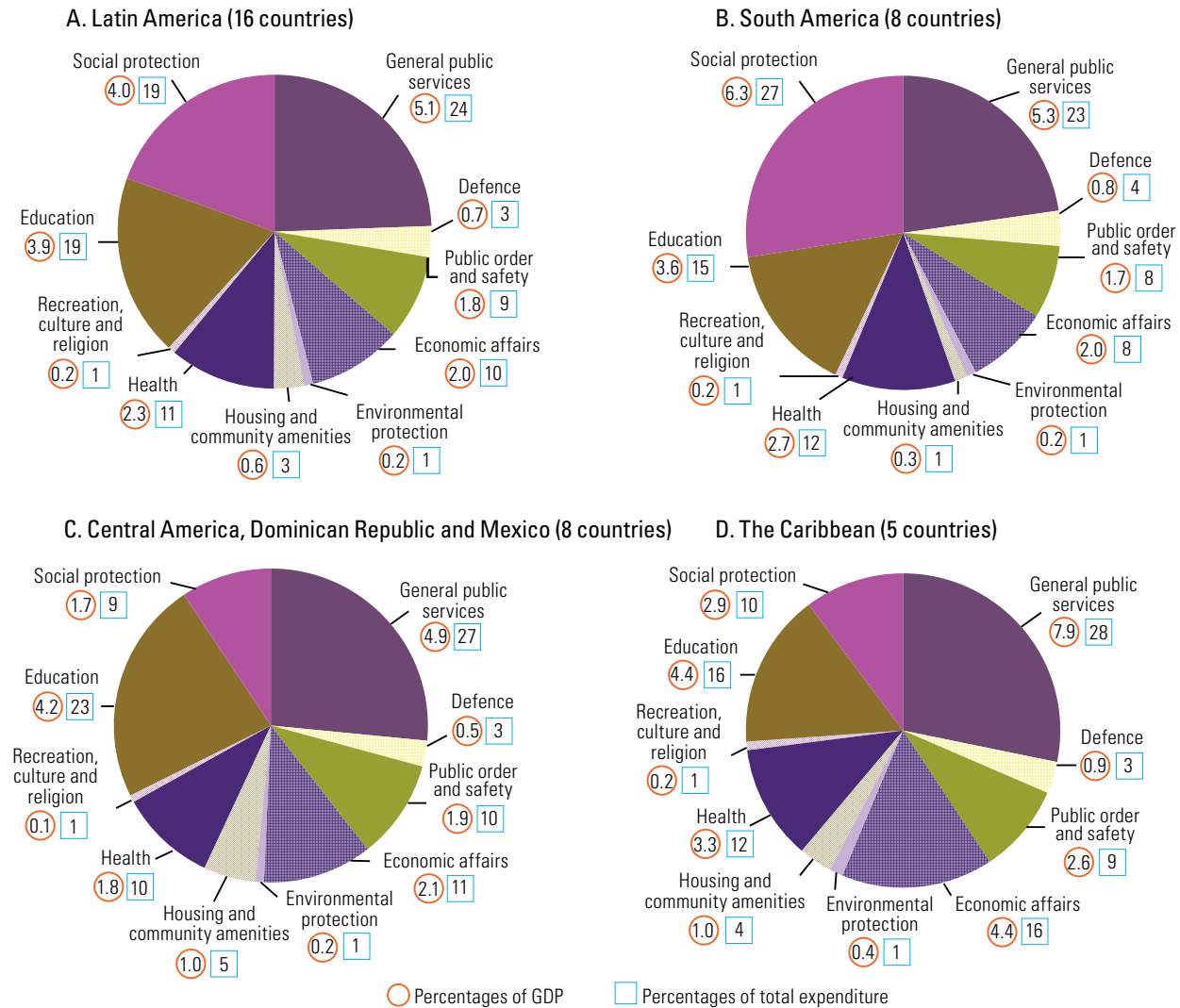
¹⁶ See ECLAC (2019c and 2019d).

¹⁷ See box IV.1, which provides an analysis of expenditure on a broader institutional scale for those countries for which this type of information is available.

Figure IV.4

Latin America and the Caribbean (16 countries)^a: shares of central government expenditure corresponding to each functional heading, 2018

(Percentages of GDP and of total expenditure)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Latin America (figure A): simple average for 16 countries. These countries are divided into two groups in figures B and C: eight South American countries (Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay) and another group of eight comprising Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama), the Dominican Republic and Mexico. The sample for the Caribbean (figure D) is composed of five countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

As a group, the Central American countries, the Dominican Republic and Mexico allocate a larger portion of their total resources to general public services and spending on public order and safety (27% and 10%, respectively) than the South American countries do. The former group of countries also assign a higher priority to expenditure on housing and community amenities, since they spend more than their South American neighbours do on these items regardless of whether spending in this category is measured in terms of GDP or as a percentage of total expenditure.

There is less of a difference in the priority assigned to defence and to economic affairs by these two subregions. The countries of Central America, the Dominican Republic and Mexico devote, on average, 3% of their total outlays to defence and 11% to economic affairs, which is fairly close to what the South American countries allocate for these items (4% and 8% of the total, respectively).

For the sample of English-speaking Caribbean countries, the most important government functions as measured by shares of public expenditure are general public services (28%), economic affairs and education (16% each). These countries have been paring down their public debts in recent years, but the percentage of total expenditure taken up by interest payments is still quite high, and this is reflected in the large share of the total that comes under the heading of general public services. The category of economic affairs, as mentioned earlier, includes a large portion of public investment, which rose more in this subregion than in the Latin American countries during the last three years of the study period.

The English-speaking Caribbean countries allocated 43% of total outlays to social benefits and thus spent less on social sectors than their Latin American counterparts. This is chiefly a result of the smaller share of funds channelled into social protection (10% of the total), since these countries' social security systems are administered by private organizations and social security benefits are funded through mandatory social contributions. The central governments of the English-speaking Caribbean countries devoted much the same proportion of their total outlays to health services as the average for the 16 Latin American countries (12%).

As in the other subregions, the other functions of government represented smaller proportions of total central government expenditure in the English-speaking Caribbean: 9% for public order and safety, 4% for housing and community amenities, 3% for defence, 1% for environmental protection and 1% for recreation, culture and religion.

This overview of general trends should be viewed in the light of the more granular analysis of the situation in the individual countries making up these subregions which is provided in the following section.

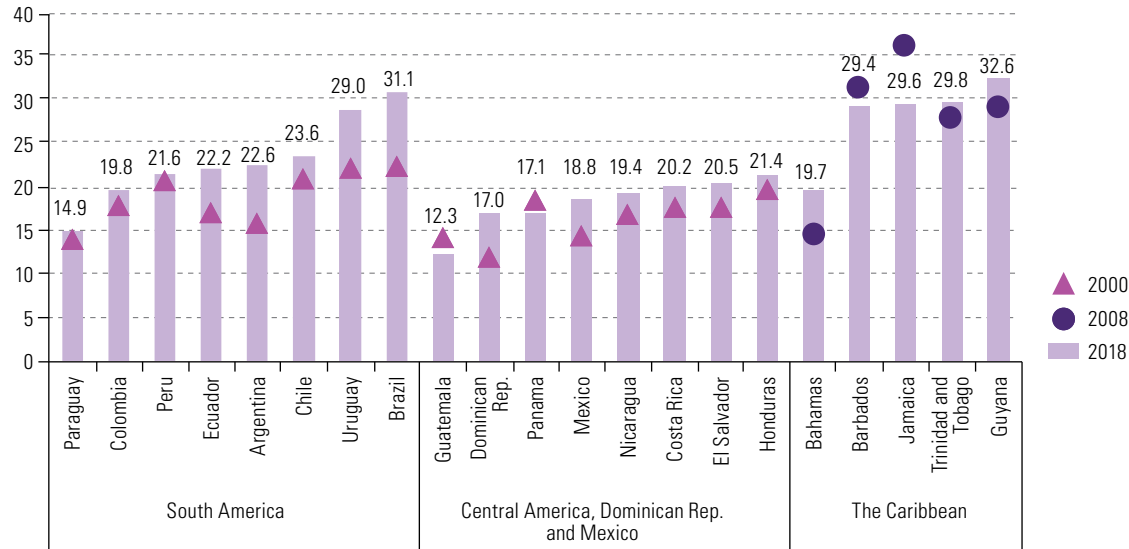
2. Trends in the allocation of public expenditure, disaggregated by function, in each country

In the eight South American countries analysed, increases in public expenditure outpaced GDP growth in 2000–2018, although by differing amounts. The central governments of Argentina, Brazil, Uruguay and Ecuador had the steepest increases. In the first three, government spending climbed by around 7 points of GDP between 2000 and 2018, while in Ecuador it rose by 5 points of GDP. As a result, the central governments of these countries and of Chile expended amounts equivalent to between 22% and 31% of GDP, thereby outspending all the other Latin American countries (see figure IV.5). In the federal countries, such as Argentina and Brazil, expenditure exceeded 40% of GDP when the outlays of subnational levels of government are taken into account, as discussed in box IV.1. The situation was similar in Colombia, where general government expenditure topped 30% of GDP.

Guatemala and Panama were the only two countries in the group comprising the six Central American countries, the Dominican Republic and Mexico in which public spending was lower in 2018 than in 2000 in terms of GDP. If general government expenditure in Panama (which includes the social security system) is analysed, however, it is seen that public spending was actually on the rise, since outlays on social protection and health services trended upward during the study period.

Figure IV.5

Latin America and the Caribbean (21 countries): central government expenditure, by country and subregion, 2000 or 2008 and 2018^a
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a The data for Guyana and Panama are from 2017. The figures for Peru are for general government expenditure.

Central government spending was up by over 4 points of GDP in El Salvador, the Dominican Republic and Mexico and by approximately 2 points in Costa Rica, Honduras and Nicaragua. The countries in this group with the highest central government spending levels in terms of GDP—over 20%—were Honduras, El Salvador and Costa Rica. In this last country, however, this indicator was actually nearing 30% of GDP when spending by subnational governments and social security are included.

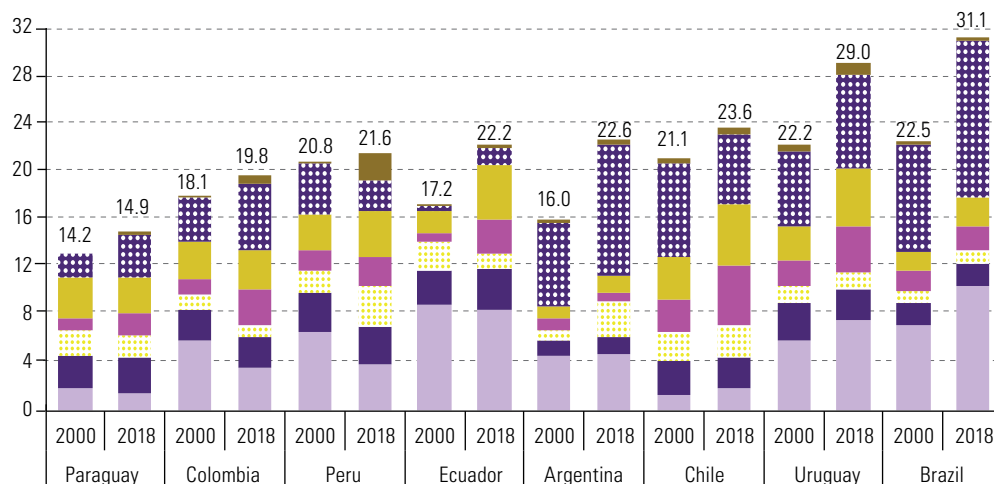
The lowest levels of central government expenditure as a proportion of GDP in Latin America are found in Guatemala (12.3%), Paraguay (14.9%), the Dominican Republic (17%) and Panama (17.1%).

In four of the five English-speaking Caribbean countries covered in this analysis (Barbados, Jamaica, Trinidad and Tobago, and Guyana), central government expenditure was close to or over 30% of GDP, while in the Bahamas it was below 20% of GDP. Expenditure in GDP terms was lower in 2018 than in 2008 only in Barbados and Jamaica, owing to the adjustment policies implemented by the authorities of those countries.

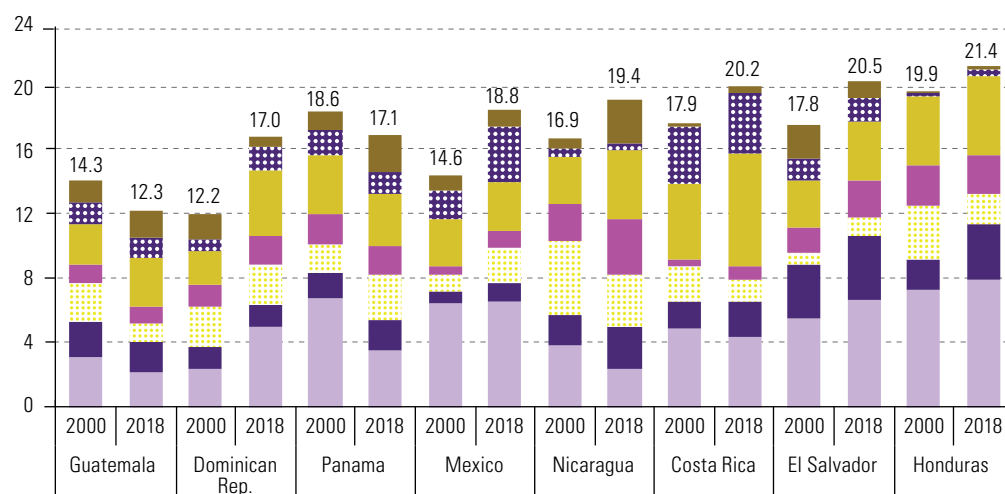
As for the shifts in relative priorities that may be discerned from changes in the allocation of public resources, all eight of the South American countries that were analysed spent more in social policy areas than they had before, with the upswings in central government social spending ranging from 2% of GDP in countries such as Chile, Paraguay and Peru to nearly 6% in Ecuador during the study period (see figure IV.6A).

Figure IV.6
Latin America and the Caribbean (21 countries): central government expenditure, by country and function, 2000 or 2008 and 2018^a
(Percentages of GDP)

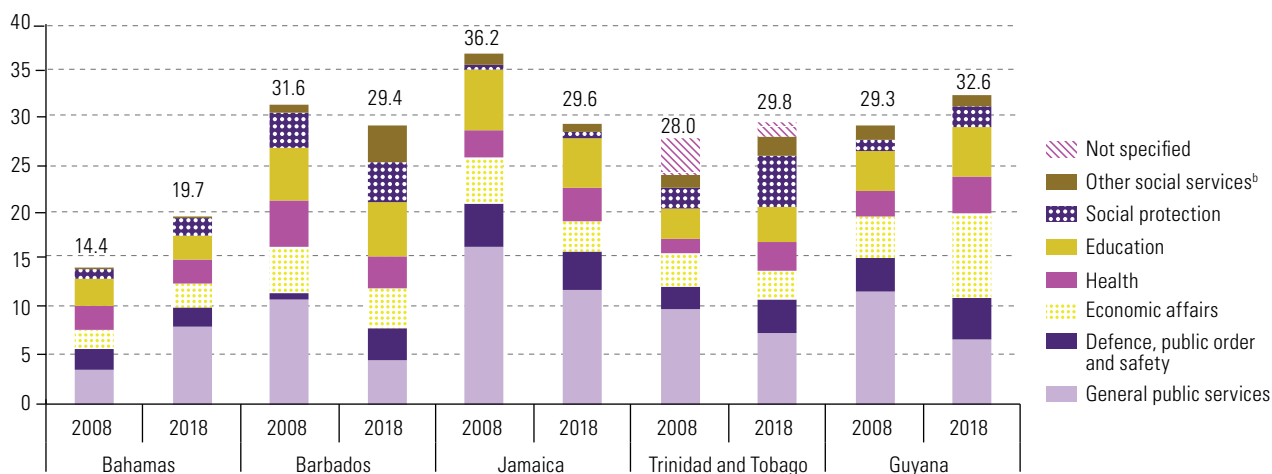
A. South America (8 countries)



B. Central America, Dominican Republic and Mexico (8 countries)



C. The Caribbean (5 countries)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a The data for Guyana and Panama are from 2017. The figures for Peru are for general government expenditure.

^b Includes the following government functions: environmental protection, housing and community amenities, and recreation, culture and religion.

In some of the countries, such as Argentina and Peru, spending on economic affairs was also higher. This was particularly the case in the transport, fuel and energy industries in Argentina and in the transport sector in Peru. The expansion of expenditure in these areas in Argentina was the result of the corporate subsidization policy that was implemented until 2016 in an effort to mitigate the price and rate adjustments introduced by public utilities, after which those subsidies were rolled back. This is why that increase mainly took the form of an upturn in current transfers rather than in public investment. In Peru, on the other hand, most of the increase in spending in the transport sector corresponded to public investments in improvements in roads and urban transport systems (e.g. the expansion of the country's road network and the construction of a second line for Lima's Metro light rail system that will link it up with Callao).

In other countries, such as Brazil and Uruguay, the growth seen in expenditures under the heading of general public services reflected higher interest payments on their public debts, which surged by 2.1% of GDP in Brazil and edged up by 0.8% of GDP in Uruguay between 2000 and 2018. In contrast, Colombia and Peru managed to cut their interest payments by the equivalent of around 1 percentage point of GDP, and expenditure under this heading was therefore lower.

Allocations for defence and for public order and safety did not change significantly relative to GDP in any of the South American countries.

In the sample made up of the six Central American countries, the Dominican Republic and Mexico, central government expenditure shrank relative to GDP only in Guatemala and Panama (see figure IV.6B). Spending on general public services was down in both of those countries, but the decrease was steeper in Panama, thanks to the reduction in its public debt interest payments, which fell by 2.1% of GDP between 2000 and 2018. In Guatemala, the contraction of capital expenditure was reflected in smaller outlays under the heading of economic affairs. In Panama, on the other hand, an expansion of public investment translated into higher levels of expenditure on housing and economic affairs, with a surge in public spending in the transport sector being particularly notable under the latter heading. Public investment projects included the expansion of the Panama Canal, the construction of the Panama Metro rapid transit system in Panama City, road improvement projects, the construction of a large-scale hospital complex and the construction of the Corredor Colon highway.¹⁸

In the six countries in this group where total expenditure rose (Costa Rica, Dominican Republic, El Salvador, Honduras, Mexico and Nicaragua), priority was given to social spending and especially to education, although spending was also up by over 1 point of GDP on social protection policies in Mexico, on health services in El Salvador and on health services and housing in Nicaragua.

Mexico doubled the amount it spent on economic affairs during the study period (from 1% of GDP in 2000 to 2.2% of GDP in 2018). This upsurge in expenditure on economic development policies was spread over the fuel and energy sector, the transport sector and other industries.

In other countries in this group, such as the Dominican Republic and El Salvador, an increase on the order of 2% of GDP in interest payments on the public debt, which translated into higher levels of expenditure under the heading of general public services, was the most notable development; in some cases (El Salvador, Honduras and Nicaragua), spending levels on public order and safety were also higher.

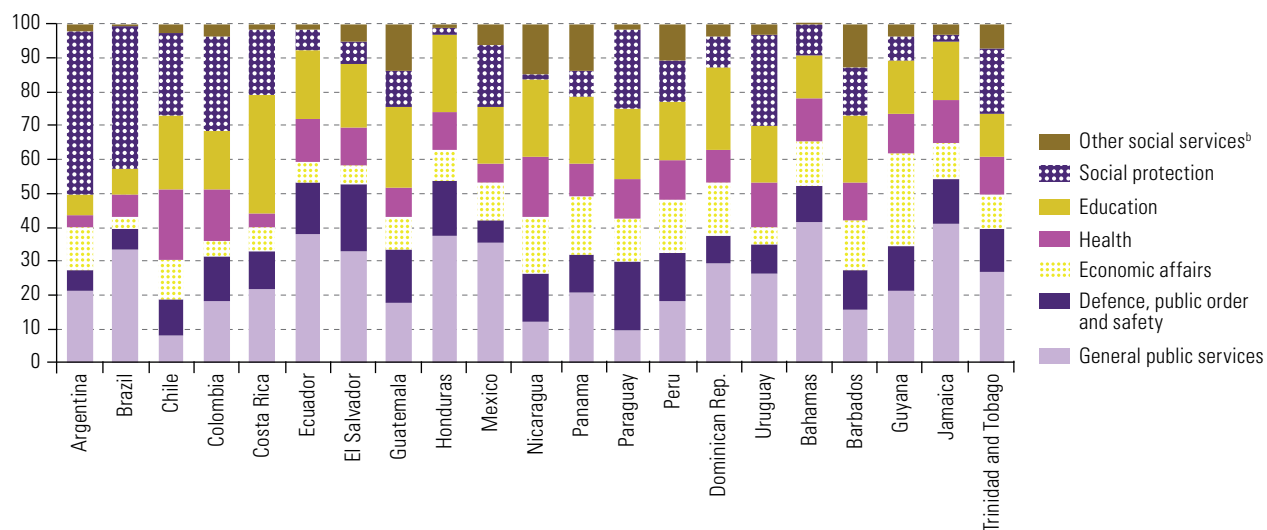
¹⁸ See ECLAC (2015).

As noted earlier, central government spending declined in two of the English-speaking Caribbean countries (Barbados and Jamaica) between 2008 and 2018 (see figure IV.6C). In both countries, expenditure on general public services was sharply lower thanks to their fiscal consolidation policies and public debt restructurings, which translated into large cuts in their interest obligations. These countries also made downward adjustments in public spending on economic affairs. The reduction was much steeper in Jamaica, where the cuts were felt especially keenly in such sectors as agriculture, manufacturing and commerce. In Barbados, priority was placed on public order and safety and on social sectors, but in Jamaica these areas, and especially education, were hit by reductions.

In the three Caribbean countries in which central government expenditure rose in GDP terms in 2008–2018 (Bahamas, Guyana, and Trinidad and Tobago), spending levels were higher for social sectors and particularly for social protection programmes but also for health policies. In the Bahamas, the main drivers of higher public expenditure were interest payments on the debt and other items of expenditure under the heading of general public services. Conversely, in Guyana and in Trinidad and Tobago, spending was sharply down under this heading but spending on public order and safety was up. Expenditure on economic affairs, particularly on agricultural and transport-related sectors, was also substantially higher in Guyana.

Government priorities as reflected in allocations for the various functional categories differed from country to country. In some Latin American nations, such as Argentina, Brazil, Chile, Colombia, Costa Rica and Uruguay, nearly 60% or even more of total expenditure went to social sectors (see figure IV.7).¹⁹ Among the different functions of government classified as social expenditure, these countries devoted the largest share of funds to social protection, with the exception of Costa Rica, which allocated more to education. In Chile, where a large part of expenditure on pensions corresponds to the private sector, spending on social protection still accounted for the largest portion of the total (24%), but its share was quite similar to the shares of health services (21%) and education (22%).

Figure IV.7
Latin America and the Caribbean (21 countries): distribution of central government expenditure by function, 2018^a
(Percentages of total expenditure)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a The data for Guyana and Panama are from 2017. The figures for Peru are for general government expenditure.

^b Includes the following government functions: environmental protection, housing and community amenities, and recreation, culture and religion.

¹⁹ For further information on social spending in Latin America and the Caribbean, see ECLAC (2019b).

Other Latin American and Caribbean countries that spent 20% or more of their total public funds on education include Guatemala, the Dominican Republic, Barbados and Nicaragua. This last country also spent more than any country in the region in relative terms on health services. Other social functions received a smaller portion of total funding, but in Guatemala, Nicaragua, Panama and Barbados, their share was somewhat larger (between 13% and 15% of total expenditure). These countries devoted a larger share of funding to housing and community amenities, although, in Barbados, the share allocated to environmental protection was similar to that of housing.

At the other end of the spectrum, the countries that allocated a smaller share of the total to social benefits and services were Ecuador, Honduras, Bahamas, Guyana and Jamaica, where social spending accounted from between 35% and 40% of total central government expenditure. Education is the social policy-related government function that carries the highest priority in these countries (with a share of between 13% and 23% of total expenditure).

Guyana leads the way when it comes to spending on economic affairs, with this function accounting for 27% of total expenditure and almost 9% of GDP, according to the most recent data available, and a hefty share of this funding took the form of capital outlays. The main recipient sectors under the heading of economic affairs in Guyana were agriculture and transport. Other countries in which a sizeable proportion of total funding (between 15% and 18% of the budget) went to economic affairs were Nicaragua, Panama, Peru, the Dominican Republic and Barbados, with the main recipient sectors being agriculture (Peru), fuel and energy (the Dominican Republic) and transport (all of the above countries except Barbados, which does not publish disaggregated information on this subject).

Generally speaking, outlays for defence, public order and safety were larger in relative terms in the Central American countries, as El Salvador, Guatemala, Honduras and Nicaragua all allocated between 14% and 20% of their total budgets for these purposes, as did Ecuador and Paraguay.

Finally, general public services accounted for over 30% of total expenditure by the central governments of Ecuador, El Salvador, Honduras, the Dominican Republic, Mexico, the Bahamas and Jamaica. A large share of the expenditure under this heading was accounted for by interest payments on the public debt in all of these countries except Mexico, where general transfers to subnational governments were a significant factor. In Ecuador, spending by the executive branch was also substantial.

3. The relationship between public investment and public expenditure, disaggregated by function

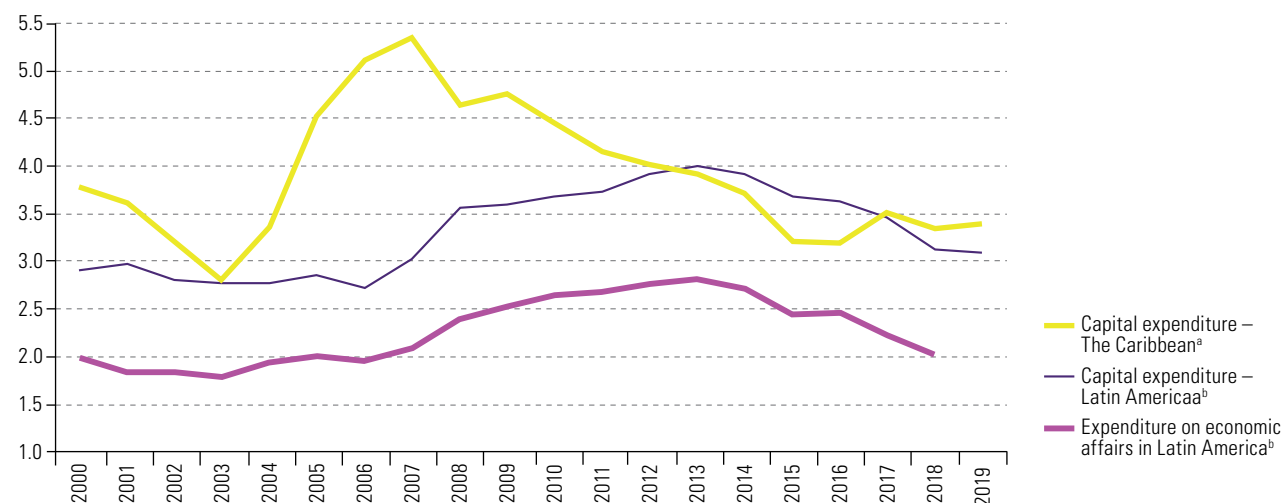
As discussed in section A.1 and as shown by the empirical data on fiscal multipliers presented there, public investment is a key driver of economic growth and is therefore of crucial importance in efforts to achieve the SDGs set out in the 2030 Agenda. Hence the importance of undertaking a detailed analysis in order to determine what areas have been marked out as priorities for capital expenditure and what trends can be observed in that respect. This can be accomplished by looking at the functions and sectors in which governments have been investing and those in which they have been cutting back on capital expenditures in recent years.²⁰

²⁰ Capital expenditure will be used in this section as a proxy for public investment. This category of expenditure includes the acquisition of fixed capital assets, capital transfers and other capital outlays.

In the 16 Latin American countries for which the relevant information for 2000–2018 is available, trends in central government capital expenditure are fairly closely in step with expenditure on economic affairs, since a large share of public investment is for that purpose (see figure IV.8). Public investment began to rebound in 2007 and picked up further in 2008–2009 as the governments of the region used the available fiscal space to employ capital expenditure as a countercyclical tool to help stave off the effects of the global financial crisis and buoy economic activity. This continued until capital expenditure peaked in 2013, boosting the simple average of public capital expenditure for the 16 Latin American countries by 1.1 percentage points of GDP. Thus, that simple average climbed from 2.9% to 4% of GDP between 2000 and 2013, while average spending on economic affairs rose from 2% of GDP to 2.8% during that period. Then, starting in 2014, as the pace of activity in the region’s economies slowed, commodity prices began to sag, tax revenues shrank and fiscal accounts took a turn for the worse, public capital expenditure gradually began to decline as well, slipping to an average of 3.1% of GDP in 2018–2019 for the Latin American countries included in the sample. The downturn in capital expenditure also translated into cutbacks in allocations for economic affairs, which fell to an average of 2% of GDP in 2018 for the Latin American countries.

Figure IV.8

Latin America and the Caribbean (16 countries): central government capital expenditure and expenditure on economic affairs, 2000–2019
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Simple average for five Caribbean countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

^b Simple average for 16 countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay. The figures for Peru are those reported under the heading of general government.

The contraction of capital expenditure was quite widespread across the region between 2013 and 2019. A comparison of the situation in 2019 and in 2013 shows that capital expenditures were adjusted downward in 12 of the 16 Latin American countries covered in this study: Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama and Peru. In Uruguay, the levels of capital expenditure in 2019 and 2013 were quite similar, while there were only three countries in which capital spending levels in 2019 were higher than they had been six years earlier: Costa Rica, Nicaragua and Paraguay.

In the sample of five English-speaking Caribbean countries, public investment grew the most between 2003 and 2007. The simple average for public capital expenditure in these countries jumped from 2.8% to 5.3% of GDP during those years, but this was

chiefly attributable to the surge in public investment seen in Guyana, Jamaica, and Trinidad and Tobago at a time when oil and mineral prices were booming. Between 2008 and 2016, average capital expenditure for these five Caribbean countries trended downward, but an uptick that began to be seen in 2017 had brought it back up to a mean of 3.4% of GDP by 2019.

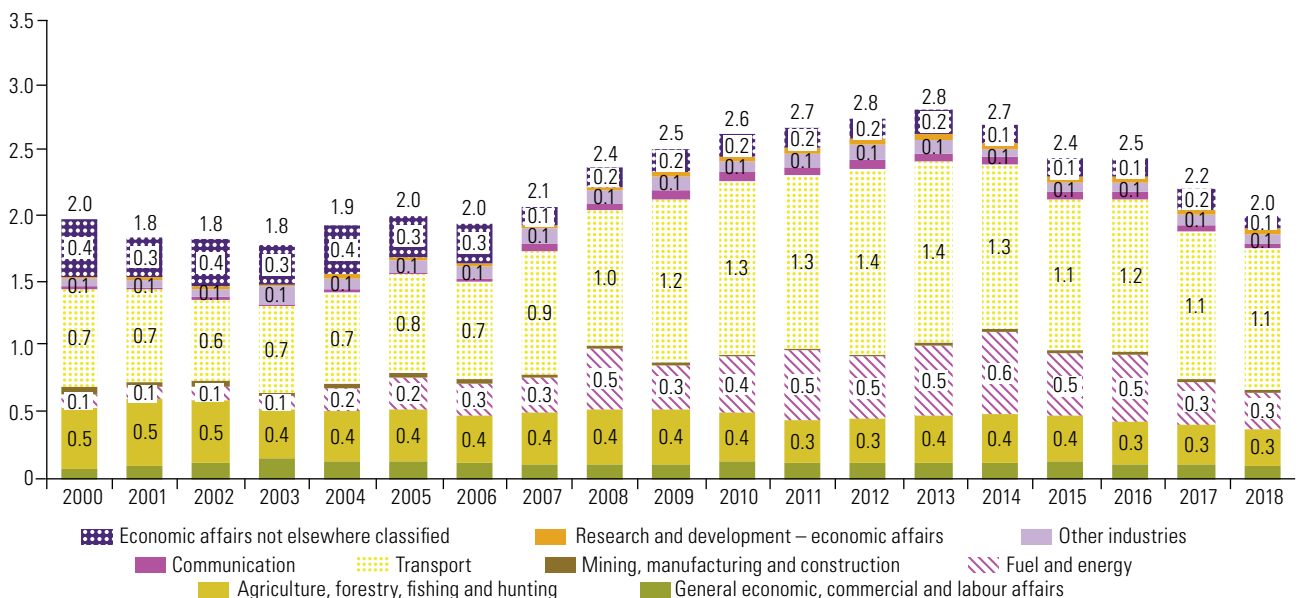
In view of the close correlation between public investment and government spending on economic affairs, trends in the composition of this latter variable in each subregion will be examined in the following discussion. As in the case of total spending patterns in Latin America, trends in expenditure on economic affairs are largely a reflection of trends in the South American countries (see figure IV.9). An upswing in spending on economic affairs began in 2007 and then steepened in response to the 2008–2009 crisis, but spending levels then began to weaken in 2014. This trend was in evidence both in the sample of eight South American countries and in the group comprising the six Central American countries plus the Dominican Republic and Mexico but was much stronger in the case of the former subregion.

In both South America and the subregion composed of the Central American countries, the Dominican Republic and Mexico, growth was strongest in transport, and that was also the group within the category of economic affairs that received the largest share of public expenditure. In terms of GDP, spending on transport more than doubled over this 10-year period, climbing from 0.6% of GDP in 2002 to a peak of 1.4% in 2012, on average, for the 16 Latin American countries before slipping back to 1.1% of GDP in 2018 (the last year for which disaggregated information is available). In South America, the fuel and energy sector was another one in which spending levels rose between 2008 and 2014 before then losing some ground, although this result was mainly a reflection of the subsidies for this sector provided in Argentina and Ecuador. In both subregions, when measured in terms of GDP, central government expenditure in the sector of agriculture, forestry, fishing and hunting plunged to half of its former level between 2000 and 2018.

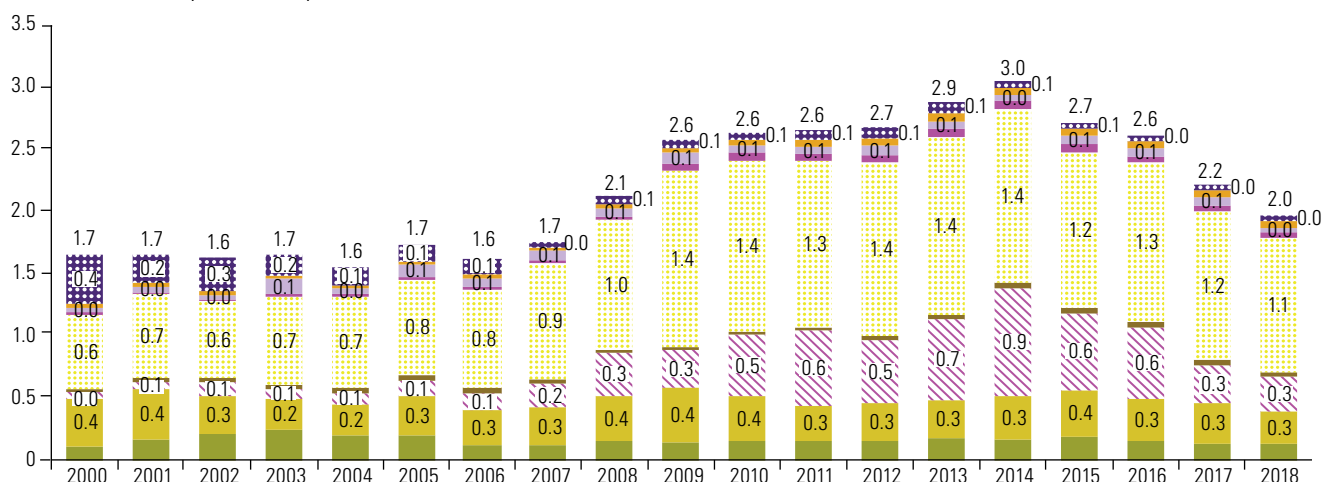
Figure IV.9

Latin America and the Caribbean (16 countries): central government expenditure on economic affairs, by group, 2000–2018^a
(Percentages of GDP)

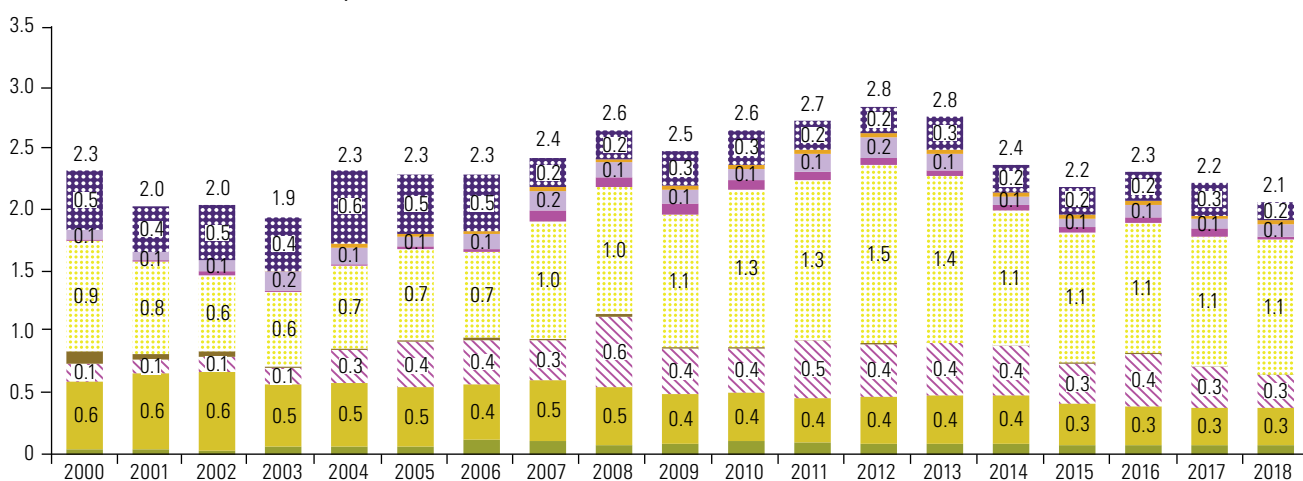
A. Latin America (16 countries)



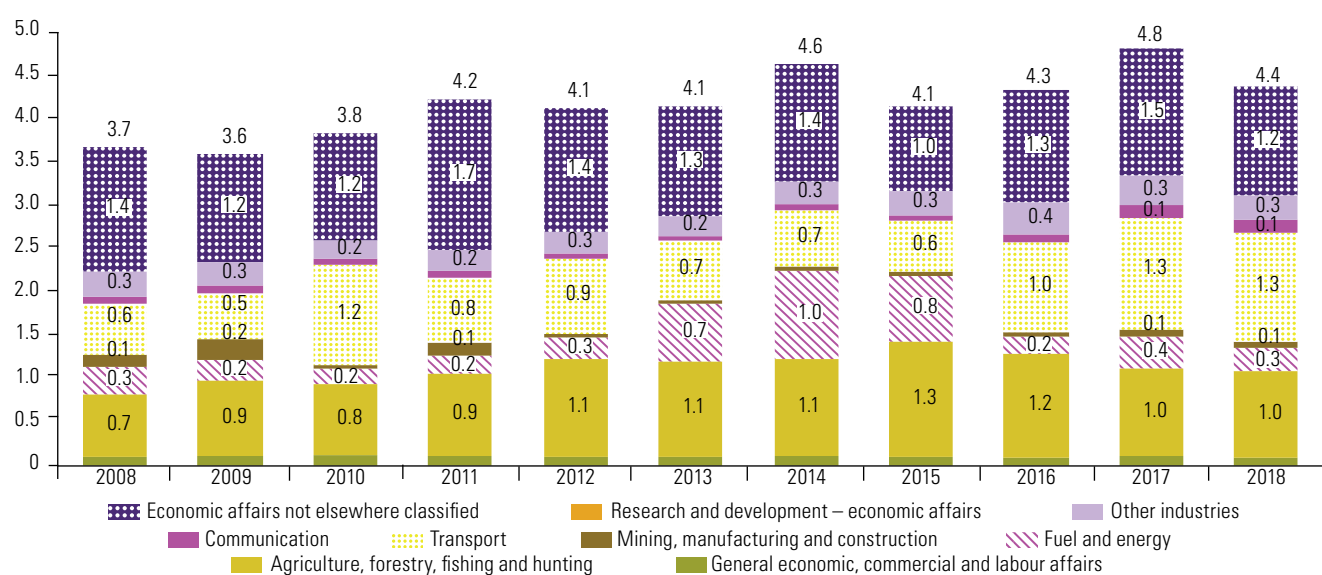
B. South America (8 countries)



C. Central America, Dominican Republic and Mexico (8 countries)



D. The Caribbean (4 countries)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Latin America (figure A): simple average for 16 countries. These countries are divided into two groups in figures B and C: eight South American countries (Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay) and another group of eight comprising Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama), the Dominican Republic and Mexico. The sample for the Caribbean (figure D) is composed of five countries: Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago.

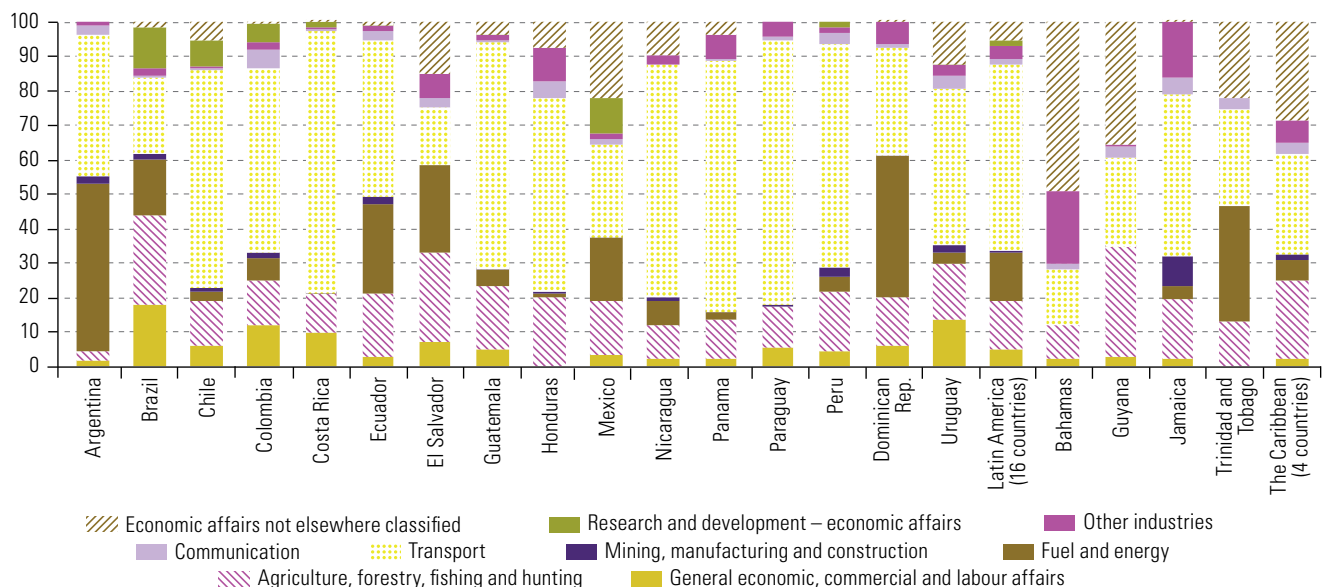
Information on expenditure in 2008–2018 that is disaggregated by functional category is available for only four of the English-speaking Caribbean countries included in the sample. The averages for these countries point to an upward trend in spending on economic affairs until 2018, when levels receded somewhat as fiscal consolidation policies took hold. Even with that drop, however, the Caribbean countries are still spending more than twice as much as the Latin American countries on economic affairs (4.4% and 2% of GDP, respectively).

The upswing in spending on economic items in the Caribbean over the past decade is mainly accounted for by increases in public expenditure in the area of transport and under the heading of agriculture, forestry, fishing and hunting. As in the case of the Latin American countries, spending on transport rose the most, with public funding in that sector more than doubling (from 0.6% to 1.3% of GDP) between 2008 and 2018. Unlike in the Latin American countries, however, where outlays on agriculture declined, the four English-speaking Caribbean countries' expenditures on agriculture climbed, on average, from 0.7% to 1% of GDP; growth in this category of expenditure was particularly strong in Guyana.

Central government expenditure on economic affairs averaged 2% of GDP in 2018 for the 16 Latin American countries covered by the study, with national spending levels ranging from around 3% in Argentina, Chile, Nicaragua, Panama and Peru to 1% of GDP or less in Brazil, Colombia, El Salvador and Guatemala. Within this category, public spending on transport amounted to 1.1% of GDP, or about half the total for this entire functional category. The subcategories of agriculture, forestry, fishing and hunting and of fuel and energy each accounted for expenditures equivalent to 0.3% of GDP (13% of the total for the functional category of economic affairs), while spending in the other subcategories represented less than 5% (see figure IV.10).

Figure IV.10

Latin America and the Caribbean (20 countries): distribution of central government expenditure on economic affairs, by country and by group, 2018^a
(Percentages of expenditure on economic affairs)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a The data for Guyana and Panama are from 2017. The figures for Peru are for general government expenditure.

Although the average level of expenditure on economic affairs for the sample of English-speaking Caribbean countries was 4.4% of GDP in 2018, the differences across countries were quite sharp. For example, as mentioned in the preceding section, Guyana outspent its neighbors in this category, with expenditures equivalent to nearly 9% of GDP, while the other countries allocated between 2.5% and 3.2% of GDP for economic development programmes. Within this category, the largest share of funding went to transport (1.3% of GDP), but the subcategory of agriculture, forestry, fishing and hunting was not far behind (1% of GDP); this means that, taken together, these two subcategories accounted for over 50% of total expenditure under the heading of economic affairs.

There are thus some similarities and some differences across the countries of the region in respect to the composition of expenditures on economic affairs. While, for almost all the countries, the largest subcategory of expenditure was transport, which includes outlays on roads, railways, air transport, shipping and so on., some countries spent more in other economic areas. For example, the level of expenditure on programmes in the fuel and energy sector was higher than in the transport sector in Argentina, the Dominican Republic, Trinidad and Tobago, and El Salvador; in this last country and in Brazil and Guyana, programmes in the agricultural, forestry, fishing and hunting sector also received more funding than transport-related programmes did.

A comparative analysis of public expenditure using both the economic and functional systems for its classification yields a fuller and more accurate picture of public investment, since governments invest in other areas, such as housing, education, health and others, as well as in economic development. Moreover, the functional category of economic affairs includes not only capital expenditure but also current outlays for the purchase of goods and services, wages and current transfers. Not all the countries publish the type of information needed for such an analysis, however, so the following discussion will focus on a sample of 10 countries in the region with available detailed data for the period from 2011 to 2018. The objective here is to determine which sectors have been hit the hardest by the cuts made in public investment in recent years.

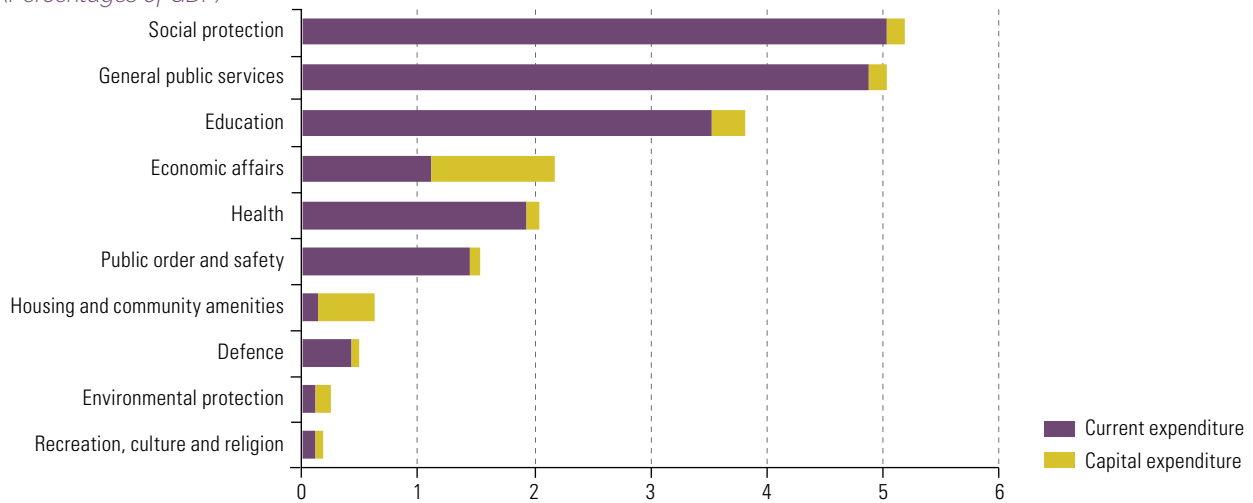
Figure IV.11 shows the average composition of expenditure for a sample of 10 Latin American countries in terms of both the functional and economic classifications of expenditure. As may be seen from the figure, nearly 90% (or in some cases more) of the expenditures on general public services, defence, public order and safety, social protection, health and education are current outlays, while the share of capital expenditure is greater in the functional categories of economic affairs (40%) and housing and community amenities (20%). Capital expenditure makes up 10% of the total for education and between 5% and 7% of total spending on general public services, social protection, environmental protection and health, with the remainder being spread across defence, public order and safety, and recreation, culture and religion.

As noted earlier, capital expenditure has trended downward since 2014 against a backdrop of fiscal consolidation, the flagging growth of economic activity and heightened uncertainty in the global economy. The averages for the 10 Latin American countries for which the information required for a comparative analysis is available indicate that central government capital expenditure has been rolled back in all the functional categories except social protection, which accounts for very little public investment, since a full 97% of the outlays in that category are current expenditures.

Given the large share of spending on economic affairs that takes the form of public investment, this function of government accounts for over half of the drop seen in capital expenditure in recent years. Housing and education also felt the impact of cuts in public investment (see figure IV.12).

Figure IV.11

Latin America and the Caribbean (10 countries):^a functional and economic classifications of central government expenditure, 2018
(Percentages of GDP)

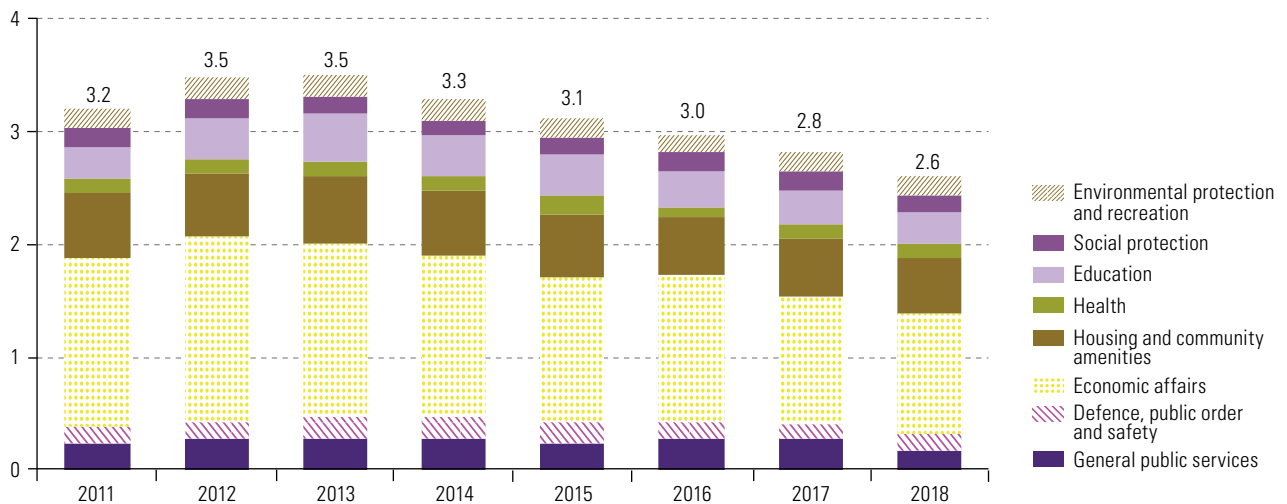


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Simple averages for the following 10 Latin American countries: Argentina, Brazil, Chile, Costa Rica, Dominican Republic, Guatemala, Mexico, Panama, Peru and Uruguay. The figures for Peru are those reported under the “general government” heading.

Figure IV.12

Latin America and the Caribbean (10 countries):^a central government capital expenditure, by functional category, 2011–2018
(Percentages of GDP)



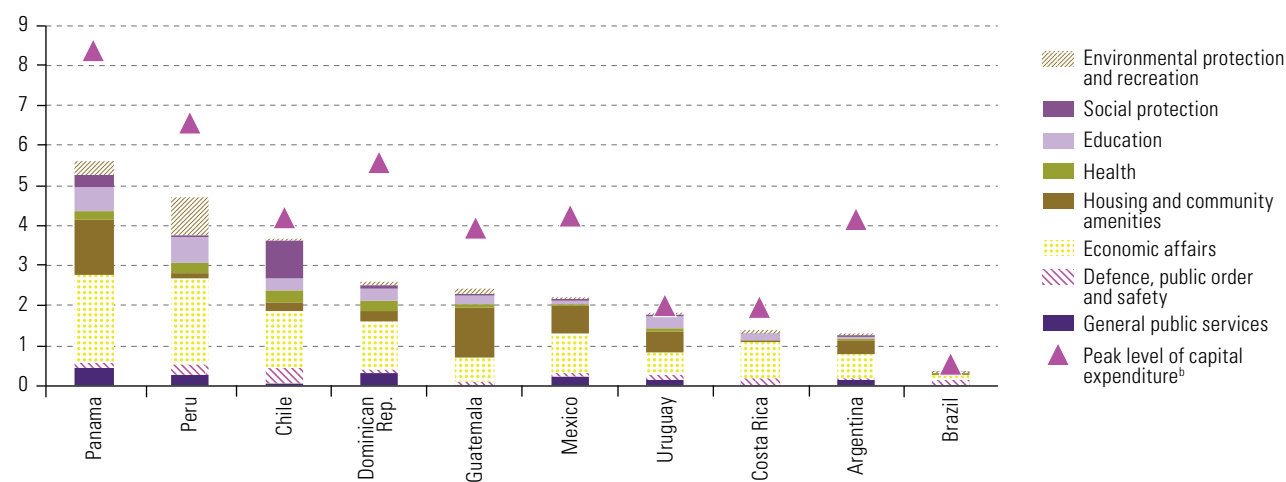
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Simple averages for the following 10 Latin American countries: Argentina, Brazil, Chile, Costa Rica, Dominican Republic, Guatemala, Mexico, Panama, Peru and Uruguay. The figures for Peru are those reported under the “general government” heading.

At the country level, however, differences are found in the level of capital expenditure, the extent of the downward adjustment and the areas in which public investment has been cut the most (see figure IV.13). In Panama and Peru, for example, central government capital expenditure was above the regional average, at 5.6% and 4.7% of GDP in 2018, respectively. In both countries, nearly 40% or more of total capital expenditure went to economic affairs, but public investment was also sizeable in the education sector. Public investment was considerable in housing and community amenities in Panama and in environmental protection in Peru. Public investment was also above the regional average in Chile, where central government capital expenditure totalled 3.7% of GDP. In that country, in addition to the priority placed on public investment in economic affairs, a substantial portion of public funds was also used to finance investment in defence and social protection.

Figure IV.13

Latin America (10 countries): composition of capital expenditure, by central government function, and peak expenditure levels, by country, 2011–2018^a
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Data on the composition of capital expenditure are for 2018; those for peak spending levels are for 2011–2017.

^b Capital expenditure levels peaked in 2014 in Argentina and Brazil, in 2015 in Chile, in 2017 in Costa Rica, in 2012 in the Dominican Republic, in 2011 in Guatemala, in 2016 in Mexico, in 2013 in Panama and Peru, and in 2011 in Uruguay.

At the other end of the spectrum, the levels of central government capital expenditure were lowest in Brazil, Argentina and Costa Rica, although investments by state governments in Brazil and by provincial governments in Argentina, which are not included in the available figures, were substantial.

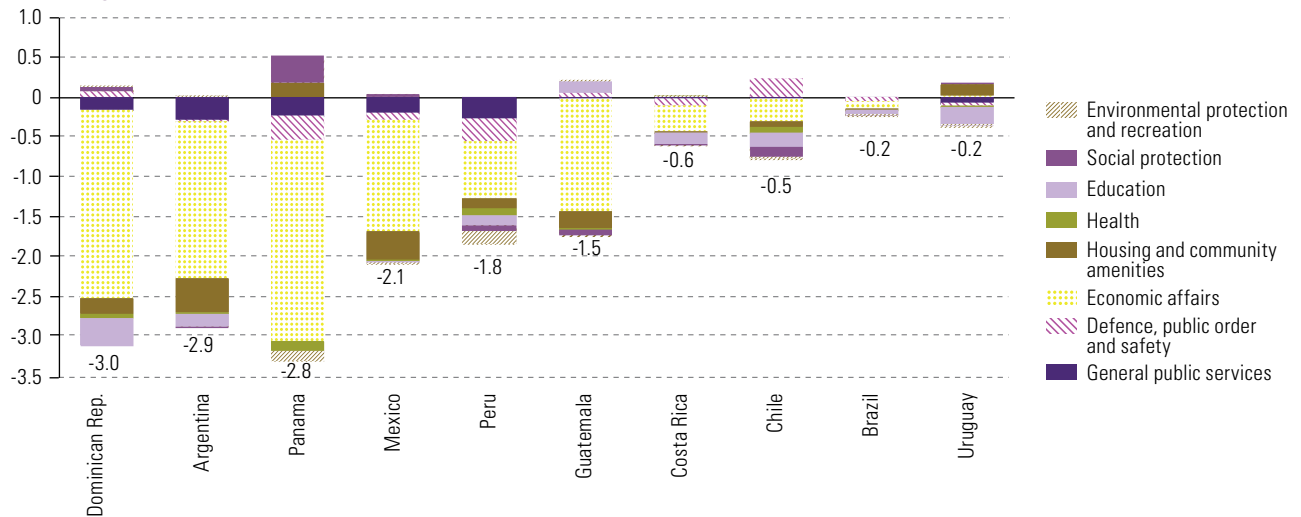
Economic affairs was the functional category with the largest share of total central government capital expenditure in all the countries except Guatemala, where public investment in housing and community amenities accounted for the largest proportion (1.3% of GDP and 53% of total capital expenditure in 2018).

The extent of the contraction in central government capital expenditures in recent years also differs across countries (see figure IV.14). In some, such as Argentina, the Dominican Republic and Panama, the drop amounted to around 3 percentage points of GDP, although it is important to bear in mind that the starting point for this

comparison was quite high (see figure IV.13). In other countries such as Mexico, Peru and Guatemala, the adjustment in capital expenditure amounted to between 1.5 and 2.1 percentage points of GDP, while in the others (Costa Rica, Chile, Brazil and Uruguay), the cuts were much smaller.

Figure IV.14

Latin America (10 countries): variations in capital expenditure, by central government function and country, 2011–2018^a
(Percentage points of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

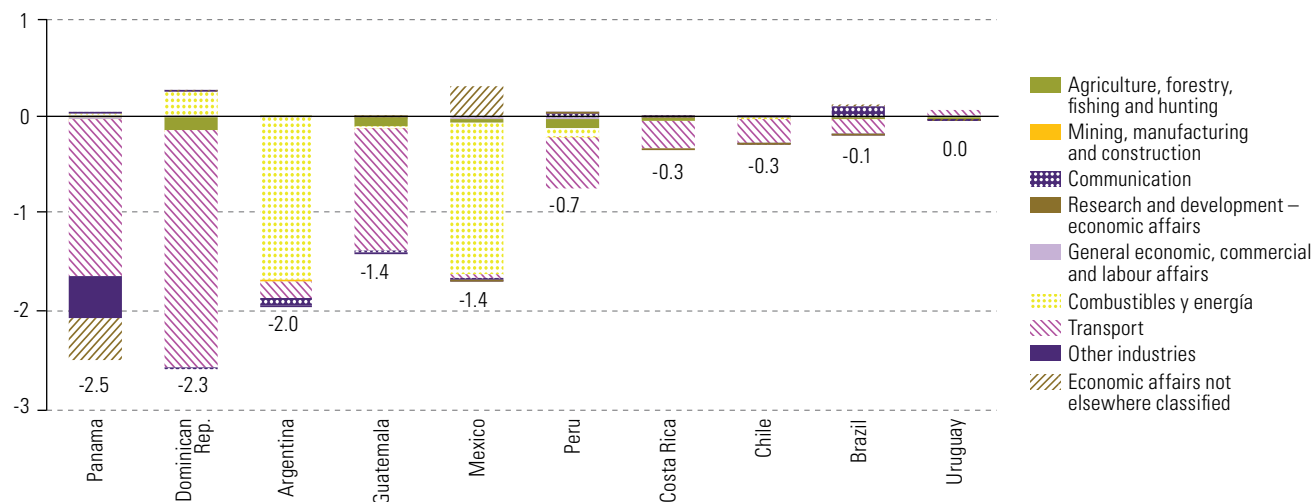
^a Variations in capital expenditure are measured by comparing the level for 2018 with the peak level for each country in 2011–2017. Capital expenditure levels peaked in 2014 in Argentina and Brazil, in 2015 in Chile, in 2017 in Costa Rica, in 2012 in the Dominican Republic, in 2011 in Guatemala, in 2016 in Mexico, in 2013 in Panama and Peru, and in 2011 in Uruguay.

Clearly, economic development programmes are the ones that have been hit the hardest by cuts in public investment in recent years, since the reduction in capital expenditure on such programmes has accounted for nearly two thirds, on average, of the total contraction in central government capital expenditure in the countries included in the sample. The steepest drops have been in Panama, the Dominican Republic, Argentina, Guatemala and Mexico. Reductions in public investment have also been seen in the housing sector, especially in the last three of those countries. In some cases, such as in the Dominican Republic, Chile and Uruguay, the cuts have also had ramifications for the education system while, in others, such as Panama and Peru, less priority has been given to public investment in defence, public order and safety.

Finally, the data can also be used to identify the sectors in which public investment has been reduced the most; this may be of particular interest in the case of the countries where the drop in capital expenditure on economic affairs has been the steepest (see figure IV.15). In most cases, the biggest cuts in capital expenditure have occurred in the transport sector, but the sharpest reductions in Argentina and Mexico have been in fuel and energy. Some governments, such as those of the Dominican Republic, Guatemala and Peru, have also lowered their level of capital expenditure on programmes for agriculture, forestry, fishing and hunting, although less so than in the area of transport.

Figure IV.15

Latin America (10 countries): variation in central government capital expenditure on economic affairs, by group and by country, 2011–2018^a
(Percentage points of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official data from the countries.

^a Variations in capital expenditure are measured by comparing the level for 2018 with the peak level for each country in 2011–2017. Capital expenditure levels peaked in 2014 in Argentina and Brazil, in 2015 in Chile, in 2017 in Costa Rica, in 2012 in the Dominican Republic, in 2011 in Guatemala, in 2016 in Mexico, in 2013 in Panama and Peru, and in 2011 in Uruguay.

C. Conclusions and closing remarks

The changed landscape emerging from the COVID-19 pandemic has compounded the already difficult situation that the countries of Latin America and the Caribbean have been facing for a number of years now —a situation marked by growing uncertainty, an economic slowdown, rising unemployment, setbacks in the drive to lower extreme poverty levels and slumping raw material prices, especially in the case of oil, which has dealt an especially hard blow to the region's commodity producers. This combination of factors depresses tax revenues and thus reduces governments' ability to boost public spending and to implement the kinds of policies needed in order to cope with this new and complex panorama.

What is more, given the sluggish pace of growth in recent years, the loss of fiscal space and the reduced availability of financing, the countries of the region have fewer tools at their command to help them deal with this situation than they did when they were confronted with the global crisis of 2008–2009.

Thus, in addition to the fiscal policy challenges that the countries of Latin America and the Caribbean will have to surmount in order to achieve the SDGs set out in the 2030 Agenda for Sustainable Development, they must now put in place proactive policies for coping with the pandemic and mitigating its economic and social effects. It is therefore of crucial importance for the State to make use of fiscal policy tools, in general, and public spending programmes, in particular, to allocate more funding for health care, increase the efficiency of government expenditure, safeguard sources of employment and household income and, above all else, protect the most vulnerable segments of the population.

The countries of the region are already taking steps to contain the pandemic, and their actions will surely have an impact on public spending and fiscal balances, which were already under pressure. Contributing to fiscal transparency by offering internationally comparable data on the main areas of public expenditure therefore provides critical inputs for government decision-making about how to reallocate funds or whether to increase allocations for certain types of programmes.

This is the objective of this detailed analysis of public expenditure and of the spending priorities of the countries of the region in recent years.

As discussed in section B, even though average central government expenditure in the Latin American countries declined in 2018 as a result of the fiscal consolidation processes under way, spending levels were still higher than at the start of the 2000s thanks to the fact that, in the intervening years, the Latin American countries had placed priority on social spending and had increased the percentage of total expenditure devoted to public order and safety while reducing the allocations for general public services, defence and economic affairs in relative terms. Social spending amounted to nearly 60%, on average, of total expenditure in the South American countries and to almost 50% in the group of countries composed of Central America, the Dominican Republic and Mexico in 2018.

In the sample of five English-speaking Caribbean countries, average central government spending was, overall, more stable, although it fell in 2018 in response to the fiscal adjustment policies being introduced. These countries also directed more funds, both in GDP terms and as a percentage of total expenditure (43%), towards social sectors. In addition, as a result of the sharp drop in outlays under the heading of general public services —thanks to the debt restructuring agreements concluded by some countries, the ensuing reduction of interest payments and other adjustments— the relative share of expenditure on economic affairs and on public order and safety also expanded.

The fact remains, however, that these regional and subregional trends and averages mask notable differences from country to country.

Since public investment plays such a pivotal role in driving economic growth and in paving the way for the achievement of the Sustainable Development Goals, it is important to establish which functional areas and sectors have been singled out as investment priorities and which have been subject to the largest downward adjustments in recent years.

Given the close correlation between public investment and expenditure on economic affairs, trends in the composition of the latter have been examined here. In the Latin American countries, transport has been the economic services sector which has been the most buoyant and has received the largest share of public expenditure. Spending on transport, as a percentage of GDP, more than doubled between 2002 and 2012, after which it declined year by year. In contrast, spending on agriculture, forestry, fishing and hunting trended downward over the entire study period, falling to just half of its initial level. Meanwhile, in South America, trends in allocations to the fuel and energy industry were in step with trends in the transport sector, although the former's share of total expenditure was much smaller.

The upward trend in spending on economic affairs in the English-speaking Caribbean countries lost ground in 2018 owing to the fiscal consolidation policies in effect, but even with this slippage, the Caribbean countries still paid out more than twice as much as the Latin American countries did under this heading (4.4% versus 2% of GDP, respectively). This increase in expenditure on economic affairs in the Caribbean

in 2008–2018 was mainly a reflection of higher public spending levels on transport and on agriculture, forestry, fishing and hunting, which together accounted for over 50% of total expenditure under this heading.

To sum up, given the sluggish pace of growth in the region, the slowdown in the global economy and the uncertainty prevailing throughout the world, all of which are now being compounded by the ramifications of the COVID-19 pandemic, the sagging levels of public investment in most of the countries of the region are a worrisome development that does nothing to help put the region back on a suitable growth path or to enable it to safeguard sources of employment or protect the most vulnerable segments of the population. As discussed in this chapter and as the empirical data demonstrate, this is because the multipliers for capital expenditure are greater than the multipliers for current outlays and because of the complementarity of public and private investment.

Under the current circumstances, the countries are focusing on the priority areas of reinforcing their health-care systems and surmounting the social and economic challenges posed by this pandemic, which are putting added pressure on public expenditure. Nonetheless, in order to continue to follow the road map set out in the 2030 Agenda for achieving the Sustainable Development Goals over the medium term, governments should focus on spurring public investment as well as maintaining their social spending priorities.

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The coronavirus disease (COVID-19) pandemic has generated a health, human and economic crisis without precedent in the past century. The region has responded rapidly, adopting packages of fiscal measures of diverse magnitude and scope. In this context, fiscal policy must play a key role in mitigating the human and economic impact in the short term, while also continuing to provide the impulse for achieving sustainable and inclusive growth in a post-COVID-19 world.

As well as analysing the fiscal policy challenges of the current crisis, the *Fiscal Panorama of Latin America and the Caribbean, 2020* provides a broad overview of the problems of tax evasion in the region. It looks at the challenges of measuring tax evasion and the measures the countries are taking to tackle it. It also compares the functional allocation of public expenditure in the countries of the region, as a factor that has implications for the achievement of the Sustainable Development Goals.



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